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REPORT FROM THE COMMISSION TO THE EUROPEAN PARLIAMENT AND THE COUNCIL

CONVERGENCE REPORT 2024

(prepared in accordance with Article 140(1) of the Treaty on the Functioning of the European Union)

{SWD(2024) 270 final}

1. PURPOSE OF THE REPORT

The euro is meant to be the single currency of the European Union as a whole. It is now used every day by around 350 million people in the 20 Member States of the euro area. The practical benefits include more stable prices, lower transaction costs for people and businesses, more transparent and competitive markets and increased intra-EU and international trade. The euro is also the second most used currency worldwide.

Article 140(1) of the Treaty on the Functioning of the European Union (TFEU) requires the Commission and the European Central Bank (ECB) to report to the Council, at least once every 2 years, or at the request of a Member State with a derogation[1], on the progress made by Member States in fulfilling their obligations on the achievement of economic and monetary union. The latest Commission and ECB convergence reports were adopted in June 2022.

The 2024 Convergence Report covers the following six Member States with a derogation: Bulgaria, Czechia, Hungary, Poland, Romania and Sweden[2]. The staff working document accompanying this report provides a more detailed assessment of the state of convergence in these Member States[3].

Article 140(1) TFEU requires the reports to include an examination of the compatibility of national legislation, including the statutes of national central banks, with Articles 130 and 131 TFEU and the Statute of the European System of Central Banks and of the European Central Bank ('the ESCB/ECB Statute'). The reports must also examine whether a high degree of sustainable convergence has been achieved in the Member State concerned by reference to the fulfilment of the four convergence criteria (price stability, public finances, exchange rate stability and long-term interest rates), and by taking account of other factors relevant to economic integration and convergence mentioned in the final subparagraph of Article 140(1) TFEU. The four convergence criteria are developed further in a protocol annexed to the Treaties (Protocol No 13 on the convergence criteria).

The convergence assessment presented in this report has been influenced by several major economic shocks and policy developments over the past 2 years. Russia's full-scale invasion of Ukraine on 24 February 2022 and the subsequent use of energy as a political weapon disrupted the global energy market and supply chains. Energy prices reached record highs in August 2022. The EU economy has shown remarkable resilience in this challenging environment. It has successfully reduced its dependence on Russian fossil fuels and limited the adverse impact on economic activity. Nonetheless, under the pressure of energy, food and other commodity prices, headline inflation in the EU peaked at 11.5% year-on-year in October 2022, while inflation divergences across the EU Member States also reached historic highs. The EU economy lost momentum in 2023, weakened by the erosion of households' purchasing power, a subdued external environment and tighter financing conditions. As energy prices retreated from their peaks and monetary tightening worked its way through the economy, annual HICP inflation fell sharply, reaching 2.7% in May 2024. The surge in energy prices in 2022 also led many Member States to take emergency energy support measures to cushion its economic and social effects. In 2023, the cost for the government deficit of those emergency measures is estimated at almost 1% of GDP for the EU as a whole, but a sizeable reduction in energy-related measures is projected in 2024 (by 0.8 percentage point to 0.2% of GDP).

At the same time, the steady implementation of the Recovery and Resilience Facility (RRF) and the Cohesion Policy programmes is continuing to support major reforms and investments across a wide range of policy areas in the EU and support fiscal sustainability.

Designed as a response to the economic and social fall-out from the COVID-19 pandemic and established in February 2021, the RRF is the centrepiece of NextGenerationEU (NGEU), the EU's recovery instrument. It has also proven to be an agile instrument, helping Member States to deal with the above-mentioned challenges and circumstances. In the context of the REPowerEU plan, Member States benefitted from additional resources through the introduction of REPowerEU chapters in their Recovery and Resilience Plans (RRP), including reforms and investments that diversify the EU's energy

[1] The Member States that have not yet fulfilled the necessary conditions for the adoption of the euro are referred to as 'Member States with a derogation'. Denmark negotiated an opt-out before the adoption of the Maastricht Treaty and does not participate in the third stage of economic and monetary union.

[2] Denmark has not expressed an intention to adopt the euro and is therefore not covered in the assessment.

[3] The cut-off date for the data used in this report is 18 June 2024. The convergence assessment is based on a range of monthly convergence indicators that have been calculated up to May 2024.

supplies, accelerate the green transition and support vulnerable households. By early June 2024, EUR 240.3 billion had been disbursed against the fulfilment of milestones and targets for ambitious reforms and investments. Commission modelling suggests that NGEU has the potential to increase EU real GDP by up to 1.4% in 2026 above a no-NGEU scenario[4].

EU Cohesion Policy funds provide EUR 378 billion to Member States for the 2021-2027 period. Cohesion policy concentrates in fields that are critical for promoting convergence and competitiveness through long-term investment in line with EU priorities. Its interventions aim particularly to improve productivity, foster sustainable growth, boost innovation and develop the skills of the labour force, as well as grant better access to public services and foster the integration in the single market through better infrastructure.

Cohesion Policy has a strong positive impact on the structure of the EU economies. Recent model simulations suggest that the 2014–2020 and 2021–2027 programmes, taken together, could increase EU GDP by close to 1% at the end of their implementation. The impact of the policy is particularly high in the main beneficiaries of the policy, thereby supporting convergence of these countries.

The general escape clause in the Stability and Growth Pact was deactivated at the end of 2023. In April 2024, the European Parliament and the Council adopted the legislation reforming the EU fiscal rules[5]. Over the next months, the Member States will prepare their first medium-term fiscal-structural plans, outlining fiscal, structural and investment policies for the next 4 to 5 years. The reformed framework promotes debt sustainability and economic growth. On 19 June 2024, as part of its European Semester spring 2024 package, the Commission published a report under Article 126(3) TFEU assessing compliance with the deficit criterion of the Stability and Growth Pact in twelve EU Member States, including Czechia, Hungary and Poland[6]. On the basis of the conclusions of its report, the Commission confirmed that in July, and after considering the opinion of the Economic and Financial Committee, it will propose to the Council to adopt decisions establishing the existence of excessive deficit situations for the Member States for which this is warranted. The assessment of the convergence criterion dealing with the government budgetary position presented in this report therefore takes into account the conclusions of the report under Article 126(3) TFEU.

<u>*Convergence criteria*</u>

The examination of the **compatibility of national legislation**, including the statutes of national central banks of Member States with a derogation, together with Article 130 TFEU and the compliance duty under Article 131 TFEU, includes an assessment of observance of the prohibition of monetary financing (Article 123 TFEU) and the prohibition of privileged access to financial institutions (Article 124 TFEU); consistency with the ESCB's objectives (Article 127(1) TFEU) and tasks (Article 127(2) TFEU), and other aspects relating to the integration of national central banks into the ESCB.

The first indent of Article 140(1) TFEU defines the price stability criterion as *'the achievement of a high degree of price stability; this will be apparent from a rate of inflation which is close to that of, at most, the three best performing Member States in terms of price stability'.*

Article 1 of the Protocol on the convergence criteria further provides that *'the criterion on price stability [...] shall mean that a Member State has a price performance that is sustainable and an average rate of inflation, observed over a period of one year before the examination, that does not exceed by more than 1.5 percentage points that of, at most, the three best-performing Member States in terms of price stability. Inflation shall be measured by means of the consumer price index on a comparable basis, taking into account differences in national definitions'*[7].

The sustainability requirement implies that the satisfactory inflation performance must be attributable to the behaviour of input costs and other factors that influence price developments in a structural manner, rather than the influence of temporary factors. The convergence examination therefore

4 QUEST is the global macroeconomic model that the Directorate General for Economic and Financial Affairs (DG ECFIN) uses for macroeconomic policy analysis and research. See https://economy-finance.ec.europa.eu/economic-research-and-databases/economic-research/macroeconomic-models/quest-macroeconomic-model_en and see the Staff Working Document on the RRF mid-term evaluation for further information on QUEST's results regarding the macroeconomic impacts of the RRF.

5 OJ L, 2024/1264, 30.4.2024; OJ L, 2024/1263, 30.4.2024; and OJ L, 2024/1265, 30.4.2024.

6 Romania has been subject to an excessive deficit procedure since the spring of 2020.

7 For the purpose of the price stability criterion, inflation is measured by the Harmonised Index of Consumer Prices (HICP) defined in Regulation (EU) 2016/792 of the European Parliament and of the Council.

includes an assessment of the factors that have an impact on the inflation outlook and is complemented by a reference to the most recent Commission inflation forecast[8]. The report also assesses whether the country is likely to meet the reference value in the months ahead.

The inflation reference value was calculated as 4.1% in May 2024, with the Netherlands, Italy and Latvia being the three 'best-performing Member States'[9].

Denmark, Finland and Belgium have been identified as outliers because their inflation rates deviated by a wide margin from the euro area average and were driven by country-specific factors that limit their scope to serve as meaningful benchmarks for other Member States[10]. This is consistent with past practice, with outliers having also been identified in the Convergence Reports of 2004, 2010, 2013, 2014, 2016 and 2022. Outliers are identified on the basis of two criteria taken in combination: i) an inflation rate substantially below the euro area average and ii) an inflation rate driven by country-specific factors that cannot be seen as representative of the process that is driving inflation in the euro area. In past convergence reports, Member States that had an inflation rate 1.5 percentage points or more below the euro area were generally considered as outliers. In May 2024, the 12-month average inflation rates of Denmark, Finland and Belgium were respectively 2.3, 1.6 and 1.5 percentage points below the euro area average of 3.4%.

In addition, the inflation performances of Denmark, Finland and Belgium were driven by country-specific factors. In the case of Denmark, the country-specific factors that drove the relatively very low average inflation rate included a faster unwinding of the exceptional energy inflation shock than in the euro area that was mainly due to the fact that most electricity contracts in Denmark have variable prices, which are adjusted either monthly or quarterly. This led to a much faster transmission of the drop in wholesale energy prices to retail prices in Denmark than the euro area average. A very low rate of inflation for food and non-energy industrial goods compared with the euro area also contributed to the low inflation rate in Denmark.

In the case of Finland, the relatively very low average inflation rate compared with the average inflation rate of the euro area as a whole reflected lower energy inflation and an adjustment by Statistics Finland to the price index of electricity because the rise in prices had been erroneously taken into account twice in the index[11]. The correction, which was introduced in August 2023, reduced the year-on-year HICP inflation rate by 0.7 percentage point in that month. It will continue to artificially reduce HICP inflation in Finland until July 2024. Furthermore, the 12-month average of HICP inflation excluding energy and food in Finland was significantly below the corresponding inflation rate for the euro area as a whole, reflecting a much weaker cyclical position and weaker wage growth than the euro area as a whole.

In the case of Belgium, the country-specific factors that drove the relatively very low average inflation rate include lower retail energy prices in 2023. After a rapid transmission of exceptionally high wholesale gas and electricity prices into retail prices in 2022, energy inflation fell sharply throughout 2023. A combination of factors weighed on energy inflation. Contract prices for gas and electricity are typically based on formulae that use the future gas and electricity prices. This led to a much faster transmission of the drop in wholesale energy prices to retail prices in Belgium than the euro area average. This effect was reinforced by (i) the HICP inflation being calculated on the basis of the prices of new contracts; and (ii) the new HICP weights for 2023 reflecting a strong increase in the size of the energy component, which amplified the effect of the very sizeable drop in energy prices on HICP inflation in 2023.

The second indent of Article 140(1) TFEU defines the convergence **criterion dealing with public finances** is defined in the as *'the sustainability of the government financial position; this will be*

[8] All forecasts for inflation and other variables in the current report are from the Commission's Spring 2024 Economic Forecast. The forecasts are based on a set of common assumptions for external variables and on a 'no policy change' assumption, but also take into consideration measures that are known in sufficient detail.

[9] The respective 12-month average inflation rates were 2.5%, 2.6% and 2.6%.

[10] In May 2024, the 12-month average inflation rates of Denmark, Finland and Belgium were 1.1%, 1.9% and 1.9% respectively and that of the euro area 3.4%.

[11] Statistics Finland, Adjustment of the price index of electricity in the releases of the Consumer Price Index and the Harmonised Index of Consumer Prices for August 2023, August 2023. See https://stat.fi/en/revisionrelease/clm92f0dg5s810avvk7mlerjj.

apparent from having achieved a government budgetary position without a deficit that is excessive as determined in accordance with Article 126(6)'.

Furthermore, Article 2 of the Protocol on the convergence criteria states that this criterion means that *'at the time of the examination the Member State is not the subject of a Council decision under Article 126(6) of the said Treaty that an excessive deficit exists'*.

The TFEU refers to the **exchange rate criterion** in the third indent of Article 140(1) as *'the observance of the normal fluctuation margins provided for by the exchange-rate mechanism of the European Monetary System, for at least two years, without devaluing against the euro'.*

Article 3 of the Protocol on the convergence criteria provides that: *'The criterion on participation in the exchange rate mechanism of the European Monetary System [...] shall mean that a Member State has respected the normal fluctuation margins provided for by the exchange-rate mechanism of the European Monetary System without severe tensions for at least the last two years before the examination. In particular, the Member State shall not have devalued its currency's bilateral central rate against the euro on its own initiative for the same period'*[12].

The relevant 2-year period for assessing exchange rate stability in this report ran from 19 June 2022 to 18 June 2024. In its assessment of the exchange rate stability criterion, the Commission takes into account developments in auxiliary indicators such as foreign reserve developments and short-term interest rates. It also takes into account the role of policy measures (including foreign exchange interventions) and international financial assistance (wherever relevant) in maintaining exchange rate stability. One of the Member States with a derogation assessed in this report currently participates in the European exchange rate mechanism (ERM II) – Bulgaria. Entry into ERM II is decided upon request by a Member State and by the mutual agreement of all ERM II participants[13]. This report is not related to the ERM II entry process and does not assess any Member State's capacity to join ERM II.

The fourth indent of Article 140(1) TFEU requires *'the durability of convergence achieved by the Member State with a derogation and of its participation in the exchange rate mechanism'* to be *'reflected in the **long-term interest rate levels**'.*

Article 4 of the Protocol on the convergence criteria further states that *'the criterion on the convergence of interest rates [...] shall mean that, observed over a period of one year before the examination, a Member State has had an average nominal long-term interest rate that does not exceed by more than 2 percentage points that of, at most, the three best-performing Member States in terms of price stability. Interest rates shall be measured on the basis of long-term government bonds or comparable securities, taking into account differences in national definitions'.*

The interest rate reference value was calculated as 5.5% in May 2024[14].

Article 140(1) TFEU also requires the reports to take account of **other factors** relevant to economic integration and convergence. These include the integration of markets, the development of the balance of payments on the current account and of unit labour costs and other price indices. The latter are covered within the assessment of price stability. The additional factors to be considered are important indicators of whether a Member State would integrate into the euro area without difficulties. They also broaden the view on the sustainability of convergence.

The assessment of the degree of sustainable convergence for the Member States with a derogation presented in this report draws on the Commission's Spring 2024 Economic Forecast and the policy guidance provided under the European Semester. It is informed in particular by the fiscal surveillance carried out under the Stability and Growth Pact and the Macroeconomic Imbalance Procedure. It also reflects the Commission's assessments of fiscal sustainability risks and of the national fiscal frameworks, as well as the implementation of the recovery and resilience plans.

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12 In assessing compliance with the exchange rate criterion, the Commission examines whether the exchange rate has remained close to the ERM II central rate. Reasons for an appreciation may be taken into account, in accordance with the Common Statement on Acceding Countries and ERM2 by the Informal ECOFIN Council held in Athens on 5 April 2003.

13 The ERM II participants are the euro-area finance ministries, the ECB, non-euro area ERM II finance ministries and central banks.

14 The reference value for May 2024 was calculated as the simple average of the 12-month average of long-term interest rates of the Netherlands (2.8%), Italy (4.1%) and Latvia (3.7%), plus two percentage points.

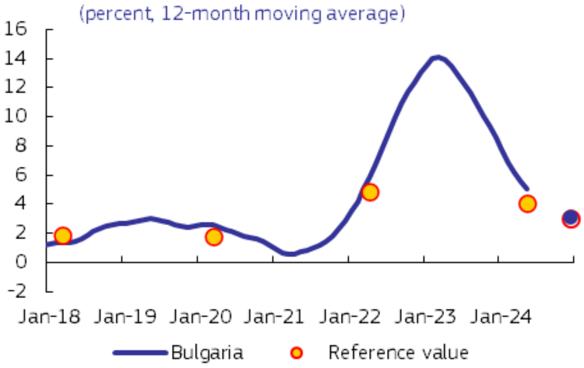
2. BULGARIA

In the light of its assessment on legal compatibility and on the fulfilment of the convergence criteria, and taking into account the additional relevant factors, the Commission considers that Bulgaria does not fulfil the conditions for the adoption of the euro.

Legislation in Bulgaria. Subject to the conditions and interpretations set out in Section 2.1 of the Technical Annex, the Law on the Bulgarska Narodna Banka (BNB) can **be** considered **compatible** with the relevant provisions of EU law regarding central bank independence, the prohibition of monetary financing and privileged access, and central bank integration into the ESCB at the time of euro adoption with regard to the BNB's objectives and the ESCB tasks laid down in Article 127(2) TFEU and Article 3 of the ESCB/ECB Statute.

Bulgaria does not fulfil the criterion on price stability. The average inflation rate in Bulgaria during the 12 months to May 2024 was 5.1%, above the reference value of 4.1%. The Commission forecasts that it will remain slightly above the reference value in the coming months but the gap is projected to close by the end of 2024 or early 2025.

Graph 2a: **Bulgaria - Inflation criterion**
(percent, 12-month moving average)



Note: The dots at the right end of the chart show the projected reference value and 12-month average inflation rate of Bulgaria in December 2024. The reference values for 2018, 2020 and 2022 refer to the reference values calculated in the previous convergence reports.
Source: Eurostat, Commission's Spring 2024 Economic Forecast.

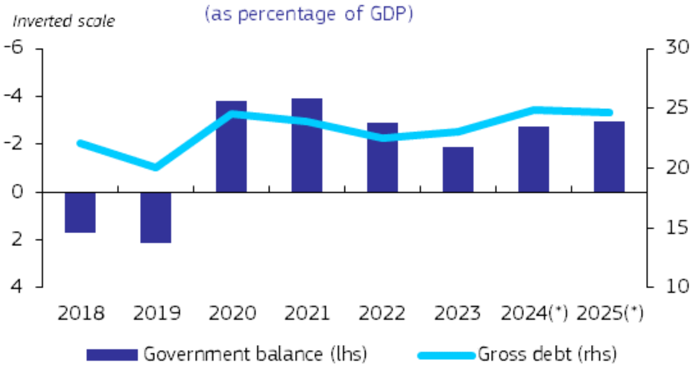
Bulgaria's annual HICP inflation rate averaged 13.0% in 2022 and decreased to 8.6% in 2023. Annual HICP inflation increased from 12.1% in April 2022 to 15.6% in September 2022. Headline inflation then stabilised at 14.3% between November 2022 and January 2023, before slowing to 2.7% in May 2024. The direct contribution of energy prices to headline inflation initially surged in 2022 but gradually diminished after the middle of the year and turned negative as of April 2023. The contributions to inflation from the other HICP components continued to grow throughout 2022. In 2023, the deceleration in inflation became broad-based, with an important contribution from food prices. Services price inflation was more persistent, despite the lower inflation in transport, food and accommodation services. The stronger than usual tourism season in the summer of 2023 also temporarily held back disinflation in tourist services. The annual HICP inflation rates in Bulgaria in 2022 and 2023 were on average higher than those for the euro area as a whole.

The Commission's Spring 2024 Economic Forecast projects that average annual inflation will fall markedly from 8.6% in 2023 to 3.1% in 2024 and gradually ease further to 2.6% in 2025. Headline inflation is expected to come down because import prices are set to exert downward pressure on the energy, food and non-energy industrial goods components. Services price inflation is also projected to slow, driven by second-round effects from lower input prices and a projected moderation in wage growth. The relatively low price level in Bulgaria (about 55% of the euro area average in 2022) suggests potential for price level convergence in the long term.

Bulgaria fulfils the criterion on public finances. Bulgaria is not the subject of a Council Decision on the existence of an excessive deficit. The general government deficit narrowed by 1.1 percentage points to 2.9% of GDP in 2022 and narrowed further to 1.9% of GDP in 2023. In 2022, the government introduced a set of measures to reduce the deficit, including a gradual increase in excise duty on tobacco and toll taxes. It also adopted expenditure-increasing measures with effects to be felt in the next fiscal year, including increases in the minimum wage and changes to the pension policy parameters. Furthermore, some key COVID-19 support measures, the support provided to Ukrainian refugees and measures to mitigate the impact of high energy prices weighed on the government balance in 2022. In 2023, increases in wages and pensions that had been legislated in 2022 began to have a budgetary impact that was mitigated by measures to increase revenue collection and the phasing-out of previous energy-related support measures. The Commission's Spring 2024 Economic Forecast expects the general government balance to deteriorate to -2.8% of GDP in 2024 and to reach -2.9% of GDP in 2025 under a 'no policy change' assumption. The government debt-to-GDP ratio increased from 22.6% in 2022 to 23.1% in 2023, and is expected to increase further to 24.8% in 2024, before falling slightly to 24.6% in 2025. Despite the low projected debt level by 2034 (41% of GDP), Bulgaria's debt sustainability risks appear medium in the medium term. However, the projection is subject to considerable uncertainty. Bulgaria has the key elements of a robust fiscal framework, but some difficulties in implementation remain. Bulgaria has a complex system of national fiscal rules in place and there is scope to improve key dimensions, including the narrow mandate of the Fiscal Council.

Graph 2b: **Bulgaria - Government budget balance and debt**

(as percentage of GDP)



(*) Commission's Spring 2024 Economic Forecast.

Source: Eurostat, Commission's Spring 2024 Economic Forecast.

Bulgaria fulfils the exchange rate criterion. Bulgaria entered ERM II on 10 July 2020 and had been participating in the mechanism for almost 4 years at the time of the adoption of this report. The Bulgarian lev observes a central rate of 1.95583 to the euro with a standard fluctuation band of ±15%. The Bulgarian National Bank pursues its primary objective of price stability through an exchange rate anchor as part of a currency board framework. Bulgaria introduced its currency board in 1997, pegging the Bulgarian lev to the German mark at first and later to the euro. Bulgaria joined ERM II with its existing currency board framework in place, as a unilateral commitment, thereby placing no additional obligations on the ECB. The lev exchange rate remained at the ERM II central rate for the 2 years covered by the assessment without any signs of tensions or devaluation against the euro. Additional indicators, such as developments in foreign exchange reserves and short-term interest rates, suggest that investors' risk perception towards Bulgaria has remained favourable. The (negative) spread of the Bulgarian benchmark short-term interest rate (i.e. the 3-month base interest rate (BIR) to the Euribor) widened throughout 2022. It then narrowed from -30 basis points in December 2022 to 1 basis point in April 2024. A sizeable buffer of official reserves continues to underpin the currency board arrangement's resilience. Upon its ERM II entry, Bulgaria committed to implement a set of policy measures (known as post-entry commitments) to ensure that its participation in the mechanism is sustainable and that Bulgaria achieves a high degree of economic convergence before adopting the euro. The measures cover four policy areas: (i) the non-banking financial sector; (ii) the insolvency framework; (iii) the anti-money laundering framework; and (iv) governance of state-owned enterprises.

Bulgaria fulfils the criterion on the convergence of long-term interest rates. The average long-term interest rate in the 12-months to May 2024 was 4.0%, below the reference value of 5.5%. From a low rate at the beginning of 2022, the Bulgarian long-term interest rate has since been increasing step by step. It increased in the first months of 2022 before remaining within a narrow band of 1.6-1.9%, from April 2022 to January 2023. It then increased again substantially in the following 2 months. However, between March 2023 and December 2023, the interest rate remained in a very narrow band of 4.0-4.2%. The yield spread vis-à-vis the German benchmark bond stayed in the 0.4-0.9% range from the beginning of 2022 to February 2023 before increasing to a range of 1.2-1.9% between March 2023 and May 2024.

The Commission has also examined **additional factors**, including balance of payments developments, the integration of markets and the institutional environment. Bulgaria's external balance (the combined current and capital account) improved to -0.5% of GDP in 2022 and further to 1.3% in 2023. The Bulgarian economy is well-integrated with the euro area through trade and investment linkages. Selected indicators related to the institutional environment show that Bulgaria performs worse than many euro area Member States. In particular, challenges relate to the rule of law, corruption and government effectiveness. However, in the context of its participation in the ERM II and in accordance with its recovery and resilience plan (RRP), Bulgaria is taking measures to improve its institutional framework and the business environment, including in the four areas covered by the post-entry ERM II commitments. The financial sector in Bulgaria is smaller and less developed than in the euro area. It is dominated by the banking sector which is well-integrated into the euro area's financial sector (particularly through a high level of foreign ownership). The underdevelopment of market-based financing is reflected in the very small markets for equity and private sector debt. Continued policy action and a favourable macroeconomic environment have reduced risks and vulnerabilities to the financial sector. In the context of the Macroeconomic Imbalance Procedure, the Commission concluded in its Alert Mechanism Report for 2024 that it was not necessary to carry out an in-depth analysis for Bulgaria.

Bulgaria's recovery and resilience plan (RRP) includes measures to address a series of structural challenges, in synergy with other EU funds, including cohesion policy funds, to boost its competitiveness and stimulate sustainable growth, and reduce the country's territorial and social disparities. The RRF funding provides Bulgaria with EUR 5.7 billion in grants over the 2021-2026 period. Bulgaria has submitted two payment requests resulting in an overall disbursement of EUR 1.37 billion on 16 December 2022. The implementation of the Bulgarian RRP faces significant delays. Bulgaria has yet to implement major reforms and investments for the decarbonisation of the energy sector, as well as key business environment reforms in the areas of rule of law, anti-corruption, governance of state-owned enterprises and public procurement.

In addition, cohesion policy provides Bulgaria with EUR 10.7 billion for the 2021-2027 period. Cohesion policy financing aims particularly to further support Bulgaria's competitiveness, green transition, including energy independence, the just transition and climate change resilience, as well as upward social convergence, including by addressing labour shortages, further developing educational and training systems and making them more inclusive for disadvantaged groups. Bulgaria has made progress in implementing cohesion policy but challenges remain.

3. CZECHIA

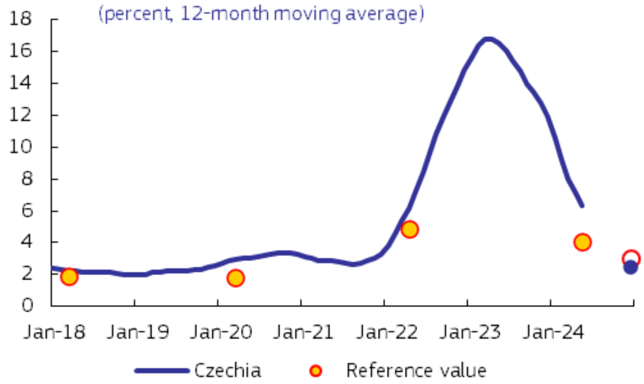
In the light of its assessment on legal compatibility and on the fulfilment of the convergence criteria, and taking into account the additional relevant factors, the Commission considers that Czechia does not fulfil the conditions for the adoption of the euro.

Legislation in Czechia – in particular the Czech National Council Act No. 6/1993 Coll. on the Česká národní banka (the ČNB Law) – **is not fully compatible** with the requirements of Article 131 TFEU. Incompatibilities concern the independence of the central bank and central bank integration into the ESCB at the time of euro adoption with regard to the ČNB's objectives and the ESCB tasks laid down in Article 127(2) TFEU and Article 3 of the ESCB/ECB Statute. In addition, the ČNB Law also contains imperfections relating to the prohibition of monetary financing and the ESCB tasks.

Czechia does not fulfil the criterion on price stability. The average inflation rate in Czechia during the 12 months to May 2024 was 6.3%, well above the reference value of 4.1%. It is projected to be below the reference value in the coming months.

Graph 3a: **Czechia - Inflation criterion**

(percent, 12-month moving average)



Note: The dots at the right end of the chart show the projected reference value and 12-month average inflation rate of Czechia in December 2024. The reference values for 2018, 2020 and 2022 refer to the reference values calculated in the previous convergence reports.

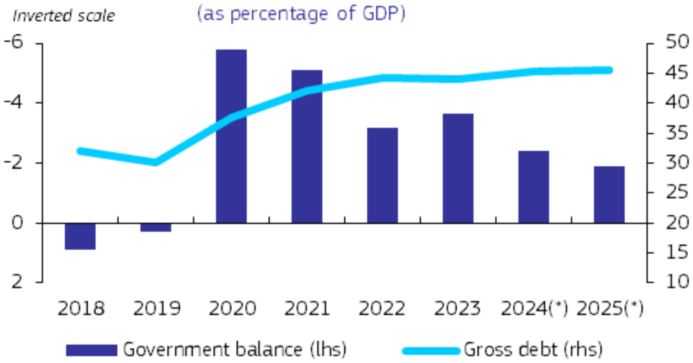
Source: Eurostat, Commission's Spring 2024 Economic Forecast.

Annual HICP inflation in Czechia averaged 12.0% in 2023, down from 14.8% in 2022. The high inflation rates in 2022 and 2023 were primarily the result of the growth in energy and food prices, triggered by Russia's full-scale invasion of Ukraine and supply bottlenecks. Annual HICP inflation peaked at 19.1% in January 2023 and gradually decreased throughout the rest of the year, due to the stabilisation of energy and food prices in the second half of 2023. The high commodity prices also had spill-over effects on other categories of HICP inflation, which also registered high growth rates. Headline inflation decreased to 7.6% in December 2023 and continued to decrease in the first 5 months of 2024, reaching 2.8% in May 2024. Czechia's annual HICP inflation rates in 2022 and 2023 were on average higher than those for the euro area as a whole.

The Commission's Spring 2024 Economic Forecast projects that average annual HICP inflation will decrease to 2.5% in 2024 and to 2.2% in 2025. The significant projected decrease compared with 2022 and 2023 is attributed to declining wholesale prices of energy and food combined with a very modest recovery in internal demand. The relatively low price level in Czechia (about 80% of the euro area average in 2022) suggests that there is still potential for further price level convergence in the long term.

The Commission report under Article 126(3) concludes that Czechia fulfils the deficit criterion of the Stability and Growth Pact. On 19 June 2024, the Commission adopted a report under Article 126(3) of the TFEU. The report assessed the budgetary situation of Czechia, as its government deficit in 2023 exceeded the Treaty reference value of 3% of GDP. The report concluded that the deficit criterion of the Stability and Growth Pact is fulfilled by Czechia, taking into account the relevant factors brought forward by Czechia. While its general government deficit in 2023 exceeded and was not close to the Treaty reference value of 3% of GDP, and the excess over the Treaty reference value is not considered to be exceptional, Czechia took consolidation measures in 2024 that should translate into a year-on-year reduction in the deficit to well below 3% of GDP in 2024. The Commission concluded that it would not propose the opening of the excessive deficit procedure. The general government deficit was 3.2% of GDP in 2022 and 3.7% of GDP in 2023, above the 3% of GDP Treaty reference value. The Commission's Spring 2024 Economic Forecast projects that the general government deficit will decrease to 2.4% of GDP in 2024, mainly reflecting the discontinuation of emergency energy support measures. It also forecasts a decrease to 1.9% of GDP in 2025, under a 'no policy change' assumption. The government debt-to-GDP ratio decreased from around 44.2% in 2022 to 44.0% in 2023, but is forecast to increase to 45.2% in 2024 and 45.5% in 2025. Czechia's debt sustainability risks appear medium over the medium term. Government debt is projected to slightly increase from around 45% of GDP in 2024 to around 48% in 2034.

Graph 3b: **Czechia - Government budget balance and debt**



(*) Commission's Spring 2024 Economic Forecast.

Source: Eurostat, Commission's Spring 2024 Economic Forecast.

Czechia does not fulfil the exchange rate criterion. The Czech koruna does not participate in ERM II. Since the late 1990s, the ČNB has been operating an explicit inflation targeting framework combined with a floating exchange rate regime that allows for foreign exchange market interventions by the central bank. Following a period of relative stability in 2018-2019, the Czech koruna has experienced significant volatility since the COVID-19 pandemic. It depreciated significantly in 2020, due to an economic downturn that was more pronounced than expected. This was then followed by a moderate appreciation trend up to early 2022. Depreciation pressures following Russia's full-scale invasion of Ukraine triggered stabilising interventions by the ČNB on the foreign exchange market between May and October 2022. The koruna then resumed its previous appreciation trend until April 2023, after which it depreciated back to close to pre-pandemic levels, on account of market expectations of a cut in interest rates. In May 2024, the koruna was about 0.3% weaker against the euro than it had been 2 years earlier. Short-term interest rate differentials vis-à-vis the euro area increased significantly throughout 2022, reaching 720 basis points in July 2022, reflecting the ČNB's early monetary policy tightening in response to high inflation levels and the currency depreciation. The short-term spread fell considerably in 2023 and early 2024, and stood at around 140 basis points in May 2024.

Czechia fulfils the criterion on the convergence of long-term interest rates. The average long-term interest rate in the 12 months to May 2024 was 4.2%, below the reference value of 5.5%. The long-term interest rate of Czechia increased in the first half of 2022 and peaked at 5.1% in June 2022. It then decreased gradually to 4% in December 2023 as inflation fell rapidly. The long-term interest rate reached 4.2% in May 2024, with the spread vis-à-vis the German benchmark bond nearing 164 basis points.

The Commission has also examined **additional factors**, including balance of payments developments, the integration of markets and the institutional environment. Czechia's external balance (the combined current and capital account) recorded a surplus of 0.5% of GDP in 2023. The Czech economy is highly integrated with the euro area through trade and investment linkages. Selected indicators related to the institutional environment show that Czechia ranks higher than the average of the five euro area Member States with the lowest scores, in particular in relation to indicators that measure regulatory quality, the rule of law, control of corruption, government effectiveness, and political stability and absence of violence. The financial sector in Czechia is smaller and less developed than in the euro area. Market based financing is less developed, which is reflected in the very small markets for equity and private sector debt. The Czech banking sector is highly integrated into the euro area's financial system, in particular through a high degree of foreign ownership of banks. In the context of the Macroeconomic Imbalance Procedure, the Commission concluded in its Alert Mechanism Report for 2024 that it was not necessary to carry out In-Depth Review analysis for Czechia.

Czechia's recovery and resilience plan (RRP) includes measures to address a series of structural challenges, in synergy with other EU funds, including cohesion policy funds, to boost its competitiveness and stimulate sustainable growth, and reduce the country's territorial and social disparities. The RRF funding provides Czechia with EUR 8.4 billion in grants and EUR 818 million in loans over the 2021-2026 period. Czechia has submitted two payment requests resulting in an overall disbursement of EUR 2.69 billion on 2 April 2024. To deliver on the commitments of the plan by August 2026, it is essential for Czechia to address emerging delays while strengthening absorption capacity. The absorption capacity is constrained by limitations of administrative capacity at some of the implementing bodies and is particularly visible in areas that require more expertise, such as the digital and green transition.

In addition, cohesion policy provides Czechia with EUR 21.1 billion for the 2021-2027 period. Cohesion policy financing aims particularly to further support Czechia's competitiveness, by facilitating the adaptation to the digital era and to the green transition, including energy efficiency, renewable energy and just transition and by helping workers and businesses to adapt to change.

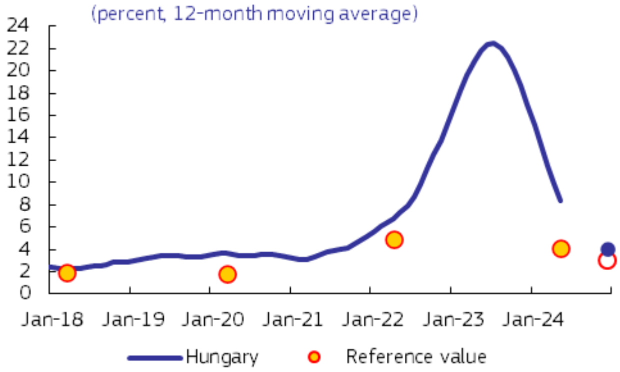
4. HUNGARY

In the light of its assessment on legal compatibility and on the fulfilment of the convergence criteria, and taking into account the additional relevant factors, the Commission considers that Hungary does not fulfil the conditions for the adoption of the euro.

Legislation in Hungary - in particular the Law on the Magyar Nemzeti Bank (the MNB Law) - is not fully compatible with the requirements of Article 131 TFEU. Incompatibilities notably concern the independence of the MNB, the prohibition of monetary financing and central bank integration into the ESCB at the time of euro adoption with regard to the ESCB tasks laid down in Article 127(2) TFEU and Article 3 of the ESCB/ECB Statute. In addition, the MNB Law also contains further imperfections relating to central bank independence and the MNB's integration into the ESCB.

Hungary does not fulfil the criterion on price stability. The average inflation rate in Hungary during the 12 months to May 2024 was 8.4%, well above the reference value of 4.1%. It is projected to remain above the reference value in the coming months.

Graph 4a: **Hungary - Inflation criterion**
(percent, 12-month moving average)



Note: The dots at the right end of the chart show the projected reference value and 12-month average inflation rate of Hungary in December 2024. The reference values for 2018, 2020 and 2022 refer to the reference values calculated in the previous convergence reports.
Source: Eurostat, Interim Spring 2024 Economic Forecast.

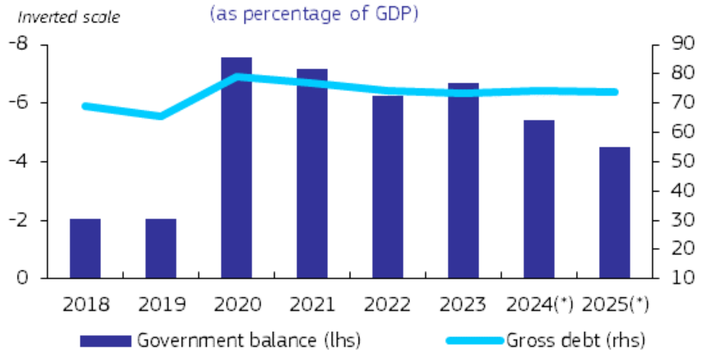
Annual HICP inflation in Hungary surged in 2022 and 2023 to 15.3% and 17.0% respectively. In particular, annual HICP inflation rose from 10.9% in May 2022 to 26.2% in January 2023. It then quickly fell to 3.7% in January 2024. The rise in inflation in 2022 was mostly driven by developments in energy and food commodity prices, a depreciation of the forint and strong demand until mid-2022. Government interventions in consumer prices of energy and certain food items also significantly affected the profile of inflation. Inflation stood at 3.9% in May 2024. Annual HICP inflation rates in Hungary in 2022 and 2023 were on average higher than those for the euro area as a whole.

The Commission's Spring 2024 Economic Forecast expects annual HICP inflation to decrease to 4.1% in 2024 and to slow to 3.7% in 2025, as the transmission of commodity price increases to consumer prices is completed. The relatively low price level in Hungary (about 64% of the euro area average in 2022) suggests that there is potential for further price level convergence in the long term.

The Commission report under Article 126(3) concludes that, after considering the opinion of the Economic and Financial Committee, the Commission intends to propose to open an excessive deficit procedure for Hungary, by proposing to the Council to adopt a Decision under Article 126(6) establishing the existence of an excessive deficit. On 19 June 2024, the Commission adopted a report under Article 126(3) of the TFEU. The report assessed the budgetary situation of Hungary, as its government deficit in 2023 exceeded the Treaty reference value of 3% of GDP. The report concluded that the general government deficit in 2023 exceeded and was not close to the Treaty reference value of 3% of GDP. The excess over the Treaty reference value was not considered to be exceptional and was not expected to be temporary. The general government deficit was 6.2% of GDP in 2022 and 6.7% of GDP in 2023, above the Treaty reference value of 3% of GDP. The Commission's Spring 2024 Economic Forecast projects that the general government deficit will decrease to 5.4% of GDP in 2024, reflecting the robust growth in tax revenue, lower projected subsidies to utility companies and a decrease in public investment. It is forecast to further decrease to 4.5% of GDP in 2025, under a 'no policy change' assumption. The government debt-to-GDP ratio decreased from around 74.1% in 2022 to 73.5% in 2023. It is forecast to increase to 74.3% in 2024 but then fall back to 73.8% in 2025. Hungary's debt sustainability risks appear medium in the medium term. Government debt is projected to slightly increase from around 74% in 2024 to around 78% of GDP in 2034. Hungary's fiscal framework has gradually become more compliant with EU legal requirements, but it has not fostered transparency and a prudent fiscal stance. The country's medium-term budgetary framework could be more binding on the national budgets, and the role of the Fiscal Council of Hungary could be strengthened.

Graph 4b: **Hungary - Government budget balance and debt**

(as percentage of GDP)



(*) Commission's Spring 2024 Economic Forecast.

Source: Eurostat, Commission's Spring 2024 Economic Forecast.

Hungary does not fulfil the exchange rate criterion. The Hungarian forint does not participate in ERM II. Hungary operates a floating exchange rate regime that allows foreign exchange market interventions by the central bank. Overall, the forint depreciated against the euro in 2022 and 2023 in a context of large exchange rate fluctuations. Russia's full-scale invasion of Ukraine triggered a strong depreciation phase, which was followed by a partial recovery after the end of 2022. The forint started depreciating again in the second half of 2023. In May 2024, the forint was about 0.7% weaker against the euro than 2 years earlier. Short-term interest rate differentials vis-à-vis the euro area increased substantially throughout 2022 reaching 1400 basis points as monetary policy reacted to surging inflation levels and currency depreciation much more strongly than in the euro area. The short-term spread fell considerably in 2023 and early 2024 but remained large at 343 basis points in May 2024.

Hungary does not fulfil the criterion on the convergence of long-term interest rates. The average long-term interest rate in the 12 months to May 2024 was 6.8%, above the reference value of 5.5%. The long-term interest rate in Hungary rose steeply in 2022 reflecting rapidly rising inflation, monetary policy tightening and heightened risk aversion due to Russia's full-scale invasion of Ukraine. It peaked at 10.2% in October 2022 but then started declining on the back of falling inflation and monetary easing. The long-term interest rate spread vis-à-vis the German benchmark bond widened substantially in 2022 and peaked at around 800 basis points in October, reflecting markedly higher inflation and central bank policy rates in Hungary as well as higher sovereign risk in a context of emerging macroeconomic imbalances, as evidenced by a widening of credit default swaps spreads. As inflation fell rapidly and began converging with that of the euro area, the long-term interest rate spread decreased substantially on the back of monetary easing in 2023. Hungary's long-term interest rate increased in the first 5 months of 2024, reaching 6.8% in May 2024. The long-term spread vis-à-vis the German benchmark bond was 427 basis points that month, down from 806 basis points in October 2022.

The Commission has also examined **additional factors**, including balance of payments developments, the integration of markets and the institutional environment. The external balance improved substantially from -6.2% of GDP in 2022 to 1.2% in 2023 as domestic demand and energy prices declined. The Hungarian economy is highly integrated with the euro area through trade and investment linkages. Selected indicators relating to the institutional environment, show that Hungary performs worse than many euro area Member States, in particular in relation to indicators that measure voice and accountability, regulatory quality and control of corruption. It also performs lower than the euro area average in terms of government effectiveness and the rule of law. Hungary's financial system is characterised by a large presence of foreign holdings that do not perform any financial intermediation in the domestic economy. Excluding these, Hungary's financial system is less developed than in the euro area. Hungary's banking sector represents a large and relatively stable share of the financial sector and is well-integrated into the euro area's financial system due to a relatively large share of foreign ownership. The equity and debt markets are small and relatively less developed. In the context of the Macroeconomic Imbalance Procedure, the Commission concluded in its Alert Mechanism Report for 2024 that an In-Depth Review was warranted for Hungary. The latter concluded that Hungary is experiencing macroeconomic imbalances. Vulnerabilities relate to strong price and cost pressures, government and external financing needs, and house prices.

Hungary's recovery and resilience plan (RRP) includes measures to address a series of structural challenges, in synergy with other EU funds, including cohesion policy funds, to boost its competitiveness and stimulate sustainable growth, and reduce the country's territorial and social disparities. The RRF funding provides Hungary with EUR 10.4 billion over the 2021-2026 period. The implementation of the Hungarian RRP faces significant delays. Hungary has not submitted any payment requests so far. Structural challenges linked to implementing the necessary measures to ensure the protection of the EU's financial interests call for swift action to ensure that reforms and investments can be completed on time.

In addition, cohesion policy provides Hungary with EUR 21.7 billion for the 2021-2027 period. Cohesion policy financing aims to further support Hungary's competitiveness, including innovation and the uptake of advanced technologies, green transition, and upward social convergence, including by addressing poverty and developing education systems and skills. While Hungary has made progress in implementing cohesion policy, challenges remain and significant social and regional disparities persist.

5. POLAND

In light of its assessment on legal compatibility and on the fulfilment of the convergence criteria, and taking into account the additional relevant factors, the Commission considers that Poland does not fulfil the conditions for the adoption of the euro.

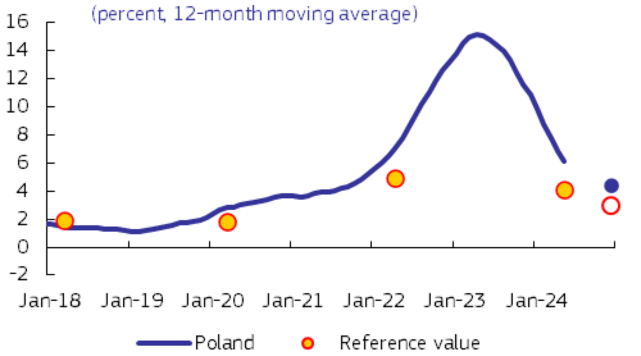
Legislation in Poland - in particular the Act on the Narodowy Bank Polski (the NBP Act) and the Constitution of the Republic of Poland - **is not fully compatible** with the requirements of Article 131 TFEU. Incompatibilities concern the independence of the central bank, the prohibition of monetary financing and central bank integration into the ESCB at the time of euro adoption. In addition, the NBP Act also contains some imperfections relating to central bank independence and the NBP integration into the ESCB at the time of euro adoption with regard to the NBP's objectives and the ESCB tasks laid down in Article 127(2) TFEU and Article 3 of the ESCB/ECB Statute.

Poland does not fulfil the criterion on price stability. The average inflation rate in Poland during the 12 months to May 2024 was 6.1%, well above the reference value of 4.1%. It is projected to remain above the reference value in the coming months.

Poland recorded a significant and broad-based increase in annual HICP inflation in 2022 followed by rapid disinflation in the second half of 2023. Overall, headline inflation averaged 13.2% in 2022 and 10.9% in 2023. In 2022, inflation was driven by rising energy and food prices as well as accelerating HICP inflation excluding energy and food. Consumer energy and food prices increased in spite of sizeable government measures aimed at curbing energy price increases and a reduction of VAT on some food products (both were introduced at the beginning of the year). Annual inflation peaked in February 2023 at 17.2% and gradually fell to 6.2% by the end of 2023 on the back of an easing of energy and food price pressures. It continued to decelerate in the first 3 months of 2024 but expiration of the zero VAT rate on food increased HICP inflation in April. In 2022 and 2023, annual HICP inflation in Poland was persistently higher than in the euro area.

The Commission's Spring 2024 Economic Forecast projects that annual HICP inflation will average 4.3% in 2024 and 4.2% in 2025. Disinflation is projected to continue but inflation will remain high due to a gradual unfreezing of energy prices (it is assumed that global energy prices will weaken further). Monetary policy easing in September and October 2023 is set to affect inflation with a delay and may prop up price growth in 2024-25. The inflation outlook remains uncertain due to downside risks from weaker than projected domestic demand and, on the upside, a tight labour market. The relatively low price level in Poland (about 57% of the euro area average in 2022) suggests potential for price level convergence in the long term.

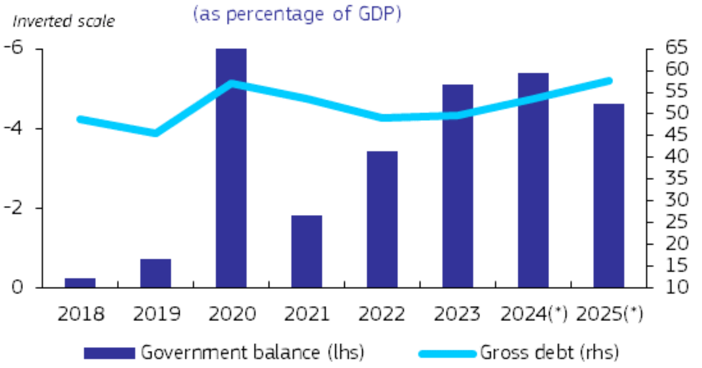
Graph 5a: **Poland - Inflation criterion**



Note: The dots at the right end of the chart show the projected reference value and 12-month average inflation rate of Poland in December 2024. The reference values for 2018, 2020 and 2022 refer to the reference values calculated in the previous convergence reports.
Source: Eurostat, Commission's Spring 2024 Economic Forecast.

The Commission report under Article 126(3) concludes that, after considering the opinion of the Economic and Financial Committee, the Commission intends to propose to open an excessive deficit procedure for Poland, by proposing to the Council to adopt a Decision under Article 126(6) establishing the existence of an excessive deficit. On 19 June 2024, the Commission adopted a report under Article 126(3) of the TFEU. The report assessed the budgetary situation of Poland, as its government deficit in 2023 exceeded the Treaty reference value of 3% of GDP. The report concluded that the general government deficit in 2023 exceeded and was not close the Treaty reference value of 3% of GDP. The excess over the Treaty reference value was not considered to be exceptional and was not expected to be temporary. The general government deficit increased to 3.4% of GDP in 2022 and further to 5.1% in 2023. The Commission's Spring 2024 Economic Forecast projects that the general government deficit will increase to 5.4% of GDP in 2024 (reflecting high spending on defence, salary increases in the public sector and new social benefits) before falling back to 4.6% of GDP in 2025. The government debt-to-GDP ratio increased from 49.2% in 2022 to 49.6% in 2023 and is expected to increase further still to 53.7% in 2024 and 57.7% in 2025. Poland's debt sustainability risks appear medium over the medium run. Government debt is projected to increase steadily from around 54% in 2024 to around 85% of GDP in 2034. The fiscal framework in Poland is strong overall and the numerical fiscal rules are at the centre of the framework.

Graph 5b: **Poland - Government budget balance and debt**
(as percentage of GDP)



(*) Commission's Spring 2024 Economic Forecast.

Source: Eurostat, Commission's Spring 2024 Economic Forecast.

Poland does not fulfil the exchange rate criterion. The Polish zloty does not participate in ERM II. Poland operates a free-floating exchange rate regime that allows foreign exchange market interventions by the central bank. Throughout 2022, the zloty continued to trade against the euro at its weakest levels in almost two decades in the context of heightened risk aversion due to Russia's full-scale of invasion of Ukraine. This was followed by a period of broad appreciation in 2023 that reflected increased investor confidence. In the first 5 months of 2024, the exchange rate stabilised at around 4.30 PLN/EUR, which was similar to its pre-pandemic levels. In May 2024, the zloty was about 8.6% stronger against the euro than 2 years earlier. The short-term interest rate differential with the euro area surged in 2022, due to the NBP's early and strong tightening cycle. It peaked at around 710 basis points in June 2022 before narrowing again as the ECB started its own tightening cycle. In 2023, the euro area 3-month rate continued to rise, while the Polish 3-month rate stabilised, contributing to further spread decreases. After the NBP's policy rate cuts in September and October 2023, the interest rate differential stabilised at around 190 basis points. The spread increased to slightly above 200 basis points in May 2024.

Poland does not fulfil the criterion on the convergence of long-term interest rates. The average long-term interest rate in the 12 months to May 2024 was 5.6%, slightly above the reference value of 5.5%. The long-term interest rate of Poland continued its upward trend in 2022, peaking at 7.8% in October – the highest level since 2002. This reflected monetary policy rate increases, strong inflationary pressures and heightened risk aversion due to Russia's full-scale invasion of Ukraine. Over that period, the long-term interest rate spread vis-à-vis the German benchmark bond repeatedly reached record levels, albeit with strong fluctuations. October 2022 saw a turning point that coincided with the end of NBP's hiking cycle, after which the long-term interest rate entered a period of gradual decrease, reaching 5.7% in May 2024. The spread vis-à-vis the German benchmark bond narrowed from its peak of around 570 basis points in June 2022 to about 315 basis points in May 2024.

The Commission has also examined **additional factors**, including balance of payments developments, the integration of markets and the institutional environment. Poland's external balance (the combined current and capital account) was volatile in 2022-2023, including due to fluctuations in commodity prices. The 2022 deficit (-1.9% of GDP) became a surplus in 2023 (1.8% of GDP). The Polish economy is well-integrated with the euro area through trade and investment linkages. Selected indicators relating to the institutional environment show that Poland performed worse than many euro area Member States, in particular in relation to indicators that measure voice and accountability, as well as government effectiveness. The financial sector in Poland is smaller and less developed than in the euro area. It is highly dominated by banks, which are well integrated into the euro area's financial system through a high level of foreign ownership. Market-based financing is less developed and this is reflected in the very small markets for equity and private sector debt. In the context of the Macroeconomic Imbalance Procedure, the Commission concluded in its Alert Mechanism Report for 2024 that it was not necessary to carry out In-Depth Review analysis for Poland.

The implementation of Poland's recovery and resilience plan is underway, however timely completion requires increased efforts. Poland has submitted one payment request, corresponding to 38 milestones and targets in the plan and resulting in a disbursement of EUR 6.3 billion on 15 April 2024. The

Commission has so far disbursed a total of EUR 11.4 billion to Poland, of which EUR 8.1 billion in loans, including EUR 5.1 billion of pre-financing payments. The implementation of the Polish RRP faces emerging delays. The size and complexity of the plan, and challenges linked to absorption capacity, call for accelerating investments and addressing emerging delays while strengthening administrative capacities to ensure that reforms and investments can be completed on time. While Poland is taking some measures to address the lack of administrative capacity, challenges remain in particular in terms of finishing the largest investments within the lifetime of the RRF.

In addition, cohesion policy provides Poland with EUR 75.5 billion for the 2021-2027 period. Cohesion policy financing aims particularly to further support Poland's competitiveness by boosting R&D investment and high-tech exports, digitalisation, the green and just transition and the development of skills and public services, including access to formal childcare for children under three years of age. Poland has made progress in implementing cohesion policy but challenges remain and regional disparities between eastern regions and the rest of the country have continuously widened.

6. ROMANIA

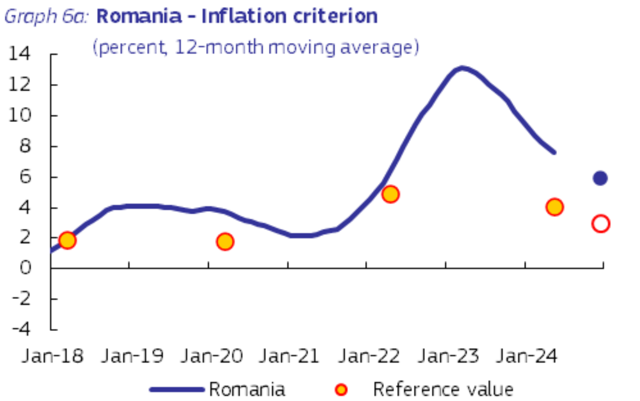
In the light of its assessment on legal compatibility and on the fulfilment of the convergence criteria, and taking into account the additional relevant factors, the Commission considers that Romania does not fulfil the conditions for the adoption of the euro.

Legislation in Romania – in particular Law No. 312 on the Statute of the Bank of Romania of 28 June 2004 (the BNR Law) – **is not fully compatible** with the requirements of Article 131 TFEU. Incompatibilities concern the independence of the central bank, the prohibition of monetary financing and central bank integration into the ESCB at the time of euro adoption. In addition, the BNR Law contains imperfections relating to central bank independence and to central bank integration in the ESCB at the time of euro adoption with regard to the BNR's objectives and the ESCB tasks laid down in Article 127(2) TFEU and Article 3 of the ESCB/ECB Statute.

Romania does not fulfil the criterion on price stability. The average inflation rate in Romania during the 12 months to May 2024 was 7.6%, well above the reference value of 4.1%. It is projected that it will remain well above the reference value in the coming months.

Annual HICP inflation in Romania averaged 9.7% in 2023, down from 12% in 2022. During 2022, annual HICP inflation accelerated, as the sharp rise in oil, gas and food commodity prices in global markets was passed on to the domestic industry and to retail food and energy prices. The annual inflation rate peaked at 14.6% in November 2022. It has since decelerated, reflecting the decline in energy prices and a tighter monetary policy stance and financial conditions. Headline inflation returned to single-digits by mid-2023 and reached 7.0% in December 2023. It continued to decelerate in the first 5 months of 2024, reaching 5.8% in May 2024. Annual HICP inflation rates in Romania in 2022 and 2023 were on average higher than those for the euro area as a whole.

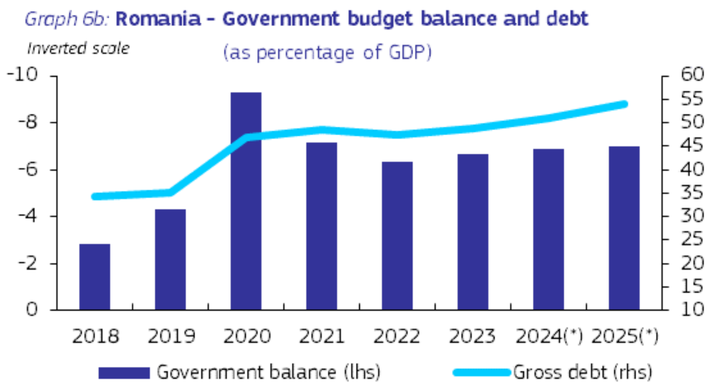
The Commission's Spring 2024 Economic Forecast expects the annual average rate of inflation to decrease to 5.9% in 2024 and to ease further to 4.0% in 2025, supported by relatively low energy prices and moderate import prices. The relatively low price level in Romania (about 56% of the euro area average in 2022) suggests potential for price level convergence in the long term.



Note: The dots at the right end of the chart show the projected reference value and 12-month average inflation rate of Romania in December 2024. The reference values for 2018, 2020 and 2022 refer to the reference values calculated in the previous convergence reports.

Source: Eurostat, Commission's Spring 2024 Economic Forecast.

Romania does not fulfil the criterion on public finances. Romania is subject to an excessive deficit procedure. On 18 June 2021, the Council adopted a recommendation under Article 126(7) of the Treaty (TFEU), with a view to bringing an end to the situation of an excessive government deficit in Romania by 2024 at the latest. On 19 June 2024, the Commission recommended a Council Decision establishing that Romania had not taken effective action in response to the Article 126(7) recommendation. The general government deficit remained high in 2023, reaching 6.6% of GDP. This was mainly due to continued high government spending growth, particularly in goods and services, social transfers and personnel expenditure. A slowdown in government revenue, due to weaker than expected nominal GDP growth, also played a role. The Commission's Spring 2024 Economic Forecast projects that the general government deficit will increase to 6.9% of GDP in 2024. It is forecast to increase slightly further to 7.0% of GDP in 2025 under the 'no policy change' assumption. The government debt-to-GDP ratio increased from 47.5% in 2022 to 48.8% in 2023 and is expected to increase further to 50.9% in 2024 and 53.9% in 2025. Romania's debt sustainability risks appear high in the medium term, particularly because government debt is projected to increase rapidly to around 103% of GDP in 2034. Romania has the appropriate legislative setting, but the implementation of its fiscal framework has generally been weak and has not improved since the last report.



(*) Commission's Spring 2024 Economic Forecast.

Source: Eurostat, Commission's Spring 2024 Economic Forecast.

Romania does not fulfil the exchange rate criterion. The Romanian leu does not participate in ERM II. Romania operates a 'crawl-like' exchange rate arrangement that allows for foreign exchange market interventions by the central bank. Exchange rate stability has been used by the BNR as an important mechanism to ensure financial stability and anchor inflation expectations. The leu depreciated against the euro in 2022 and 2023. In May 2024, the leu was about 0.6% weaker against the euro than 2 years earlier. The short-term interest rate spread vis-à-vis the euro area increased substantially (by around 400 basis points) between January and August 2022, reflecting the increase in the BNR's key policy rate over this period. The short-term spread peaked at around 760 basis points in August 2022. Subsequently, the spread decreased steadily during the last 4 months of 2022 and throughout 2023, reflecting the ECB's monetary tightening during this period and the sizeable liquidity surplus in Romania's money market. It stood around 225 basis points in May 2024.

Romania does not fulfil the criterion on the convergence of long-term interest rates. The average long-term interest rate in the 12 months to May 2024 was 6.4%, above the reference value of 5.5%. The long-term interest rate in Romania increased sharply in the first half of 2022, rising from 5.4% in January 2022 to 9.3% in July 2022, largely reflecting monetary tightening and the rise in inflation, together with increased market risk aversion. The long-term interest rate then decreased significantly in the second half of 2022 and throughout most of 2023, reflecting the outlook for lower inflation. In the first 5 months of 2024, Romania's long-term interest rate was broadly stable, standing at 6.3% in May 2024. The long-term spread versus the German benchmark bond was 377 basis points in that month, down from 818 basis points in July 2022.

The Commission has also examined **additional factors**, including balance of payments developments, the integration of markets and the institutional environment. Romania's external balance (the combined current and capital account) improved from -6.7% of GDP in 2022 to -4.9% in 2023, mainly due to a significant decline in the goods trade deficit that was caused by a lower external energy bill and broadly flat imports driven by a notable deceleration in domestic demand. But the current account deficit remains large, mainly due to high and increasing government deficits and is not forecast to improve this year and next. The Romanian economy is well-integrated with the euro area through trade and investment linkages. Selected indicators relating to the institutional environment show that Romania performs worse than many euro area Member States. The main obstacles to investment and productivity growth include labour and skills shortages and mismatches, volatile tax and regulatory environment, certain aspects regarding the functioning of the judiciary, insufficient competition in procurement, poor quality of education and training and large gaps in transport infrastructure. The financial sector in Romania is smaller and less developed than in the euro area. Romania's banking sector is well-integrated into the euro area's financial system, in particular through a high level of foreign ownership in its banking system. However, market-based financing is less developed, and this is reflected in the very small markets for equity and private sector debt. In the context of the Macroeconomic Imbalance Procedure, the Commission concluded in its Alert Mechanism Report for 2024 that an In-Depth Review was warranted for Romania. The latter concluded that Romania is experiencing excessive macroeconomic imbalances. Vulnerabilities relate to external accounts and are mainly linked to large government deficits, while price and cost pressures have increased, with a potential negative impact on cost competitiveness. At the same time, policy action has been week.

Romania's recovery and resilience plan (RRP) includes measures to address a series of structural challenges, in synergy with other EU funds, including cohesion policy funds, to boost its competitiveness and stimulate sustainable growth and reduce the country's territorial and social disparities. The RRF funding provides Romania with EUR 28.5 billion over the 2021-2026 period. Romania has submitted three payment requests, resulting in an overall disbursement of EUR 9.4 billion on 29 September 2023. The implementation of the Romanian RRP faces significant delays. Structural challenges are linked to limited administrative capacity and lack of specific actions to ensure that reforms and investments can be completed on time.

In addition, cohesion policy provides Romania with EUR 31 billion for the 2021-2027 period. Cohesion policy financing aims to further support Romania's competitiveness and upward social convergence, including innovation and digitalisation, the green and just transition, the modernisation of public employment services, the development of skills and increased quality and inclusiveness of education and training, as well as the reduction of poverty. Romania has made progress in implementing cohesion policy but challenges remain and significant territorial disparities in investment and employment persist between the capital region and the other regions, as well as between urban and non-urban areas.

7. SWEDEN

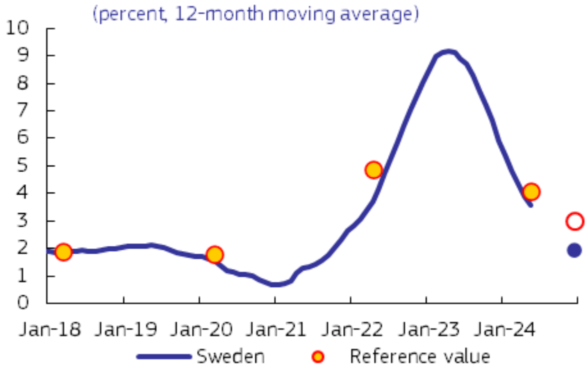
In the light of its assessment on legal compatibility and on the fulfilment of the convergence criteria, and taking into account the additional relevant factors, the

Commission considers that Sweden does not fulfil the conditions for the adoption of the euro.

Legislation in Sweden - particularly the new Riksbank Act, **is not fully compatible** with the requirements of Article 131 TFEU. Incompatibilities and imperfections exist in the fields of independence of the central bank, prohibition of monetary financing and privileged access and central bank integration into the ESCB at the time of euro adoption with regard to the Riksbank's objectives and the ESCB tasks laid down in Article 127(2) TFEU and Article 3 of the ESCB/ECB Statute.

Sweden fulfils the criterion on price stability. The average HICP inflation rate in Sweden during the 12 months to May 2024 was 3.6%, below the reference value of 4.1%. The Commission projects it to be below the reference value in the coming months.

Graph 7a: **Sweden - Inflation criterion**
(percent, 12-month moving average)



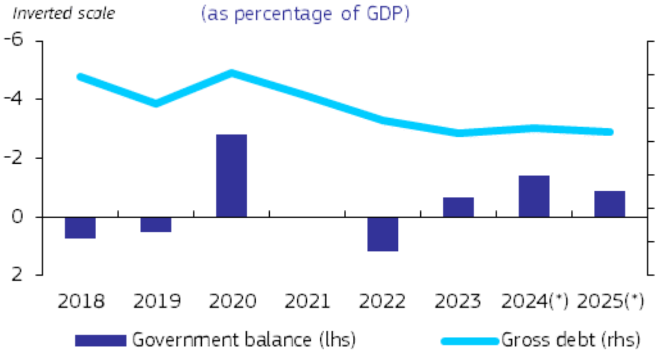
Note: The dots at the right end of the chart show the projected reference value and 12-month average inflation rate of Sweden in December 2024. The reference values for 2018, 2020 and 2022 refer to the reference values calculated in the previous convergence reports.
Source: Eurostat, Commission's Spring 2024 Economic Forecast.

Sweden's annual inflation rate reached 5.9% in 2023, down from 8.1% in 2022. Having picked up in 2021, inflation rose sharply in 2022 due to rising energy and food prices in the context of Russia's full-scale invasion of Ukraine and due to supply bottlenecks. Price increases then broadened in the economy. Furthermore, the weakening of the effective exchange rate of the krona from 2021 to the last quarter of 2023 contributed to price increases for imported goods and services. After peaking at 10.8% in December 2022, inflation decreased to slightly below 2% in December 2023, on the back of lower energy prices and broad base effects. At the beginning of 2024, base effects related to energy prices and services inflation accounted for a slight rebound in headline inflation while food prices eased further. In May 2024, annual HICP inflation stood at 2.5%. Annual HICP inflation rates in Sweden in 2022 and 2023 were on average broadly in line with those for the euro area as a whole.

In the Commission's Spring 2024 Economic Forecast, the Commission projects inflation to decrease to around 1.9% in 2024 before decreasing slightly further to 1.7% in 2025, as the economy normalises, and despite some upside price persistence (especially for services). The price level in Sweden is relatively high (about 116% of the euro area average in 2022).

Sweden fulfils the criterion on public finances. Sweden is not the subject of a Council Decision on the existence of an excessive deficit. The general government balance deteriorated from a surplus of 1.2% of GDP in 2022 to a deficit of 0.6% of GDP in 2023, reflecting the economic slowdown, and increases in government expenditure on items such as defence and higher pension costs due to the increase in inflation. According to the Commission's Spring 2024 Economic Forecast, the general government balance is expected to reach -1.4% of GDP in 2024 and -0.9% in 2025, partly reflecting weakening nominal revenues and increased social transfers to households. The government debt-to-GDP ratio decreased from 33.2% in 2022 to 31.2% in 2023 and is expected to stand at 32.0% of GDP in 2024, and 31.3% of GDP in 2025. Sweden's debt sustainability risks appear low over the medium term, particularly as government debt is projected to decrease to around 22% of GDP in 2034. Sweden has a strong fiscal framework that was reformed in 2019, preserving the key pillars of the previous set-up and reinforcing it with new elements (such as a debt anchor at 35% of GDP).

Graph 7b: **Sweden - Government budget balance and debt**



(*) Commission's Spring 2024 Economic Forecast.

Source: Eurostat, Commission's Spring 2024 Economic Forecast.

Sweden does not fulfil the exchange rate criterion. The Swedish krona is not participating in ERM II. Sweden operates a free-floating exchange rate regime, that allows foreign exchange market interventions by the central bank. The krona resumed its trend depreciation against the euro over 2022 and 2023 amid volatility that also resulted in temporary episodes of appreciation. From November 2021 to September 2023, the krona depreciated by around 15% against the euro and reached a historical low of 12 SEK/EUR in September 2023. It then recouped some of its losses and averaged 11.2 SEK/EUR in December 2023. Since the beginning of 2024, the krona has depreciated again. During this weakening episode, the 3-months STIBOR-Euribor spread increased from around 50 basis points at the end of 2021 to 110 basis points in July 2022, before decreasing to around 15 basis points at the beginning of 2024. It had averaged 66 basis points in 2022 and 27 basis points in 2023. In May 2024, the spread stood at -2 basis points and the exchange rate was 11.6 SEK/EUR, 10% weaker against the euro than 2 years earlier.

Sweden fulfils the criterion on the convergence of long-term interest rates. The average long-term interest rate in Sweden in the 12 months to May 2024 was 2.5%, well below the reference value of 5.5%. Long-term interest rates increased markedly over 2022 and 2023, in line with euro area trends, reflecting the monetary policy tightening and persistent inflationary pressures. Swedish long-term interest rates increased from 0.1% at the end of 2021 to 3.0% in October 2023. They fell back to 2.2% at the beginning of 2024 before rebounding slightly to 2.4% in May 2024. The spread vis-à-vis the German benchmark bond was volatile in 2022 and 2023. It peaked at slightly above 80 basis points in May 2022 and decreased to slightly negative levels at the end of 2022. In May 2024, it stood at -14 basis points.

The Commission has also examined **additional factors**, including balance of payments developments, the integration of markets and the institutional environment. Sweden's external balance (the combined current and capital account) remained in surplus, at 5.5% of GDP in 2022 and 6.8% in 2023. Sweden's economy is well-integrated with the euro area through trade and investment linkages. Selected indicators relating to the institutional environment show that Sweden performs better than most euro area Member States. The financial sector in Sweden is highly developed and well-integrated into the euro area's financial system. Banking dominates the financial sector, but the insurance and pension funds are integral and sizeable parts. Moreover, Sweden has among the most developed credit and equity markets in the EU, and the level of market financing is among the highest among Member States. In the context of the Macroeconomic Imbalance Procedure, the Commission concluded in its Alert Mechanism Report for 2024 that an In-Depth Review was warranted for Sweden. The latter concluded that Sweden is experiencing macroeconomic imbalances, related to its real estate market and high private debt. Vulnerabilities relate to high fixed property prices and high private indebtedness. Furthermore, there are risks of further correction in commercial real estate valuations.

Sweden's recovery and resilience plan (RRP) includes measures to address a series of structural challenges, in synergy with other EU funds, including cohesion policy funds, to boost its competitiveness and stimulate sustainable growth and reduce the country's territorial and social disparities. The RRF funding provides Sweden with EUR 3.4 billion over the 2021-2026 period. Sweden has not submitted any payment requests so far. The implementation of Sweden's RRP is significantly delayed.

In addition, cohesion policy provides Sweden with EUR 1.7 billion for the 2021-2027 period. Cohesion policy financing aims particularly to further improve conditions for research and innovation, create opportunities for entrepreneurship and industrial transformation, and support digitalisation, internationalisation and competitiveness. Sweden has made progress in implementing cohesion policy but challenges remain and disparities persist between the capital region and the rest of the country.