



EUROPEAN CENTRAL BANK

# **ECB Convergence Report 2004**

## **Press Briefing**

### **Background Information**

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Frankfurt am Main, 20 October 2004

## 2. Common framework for analysis

- Treaty provisions (the convergence criteria) as regards price, fiscal, exchange rate, long-term interest rate developments and other factors
- A range of backward and forward-looking economic indicators considered useful for examining sustainability
- Applied on a country-by-country basis

### 3. Reference values I

- **The criterion on price stability:**

taking the average inflation rate of Finland, Denmark and Sweden (0.9%) + 1.5 percentage points = **2.4%**

Price developments in Lithuania have been judged to be an outlier

- **The criterion on the government budgetary position:**

- The ratio of the government deficit to GDP should not exceed **3%**

- The ratio of government debt to GDP should not exceed **60%**

## 4. Reference values II

- **The exchange rate criterion:**

ECB examines whether a Member State has participated in ERM II for at least two years prior to the examination without severe tensions, in particular, without devaluing its currency against the euro. Focus is put on the exchange rate being close to the central rate.

- **The long-term interest rate criterion:**

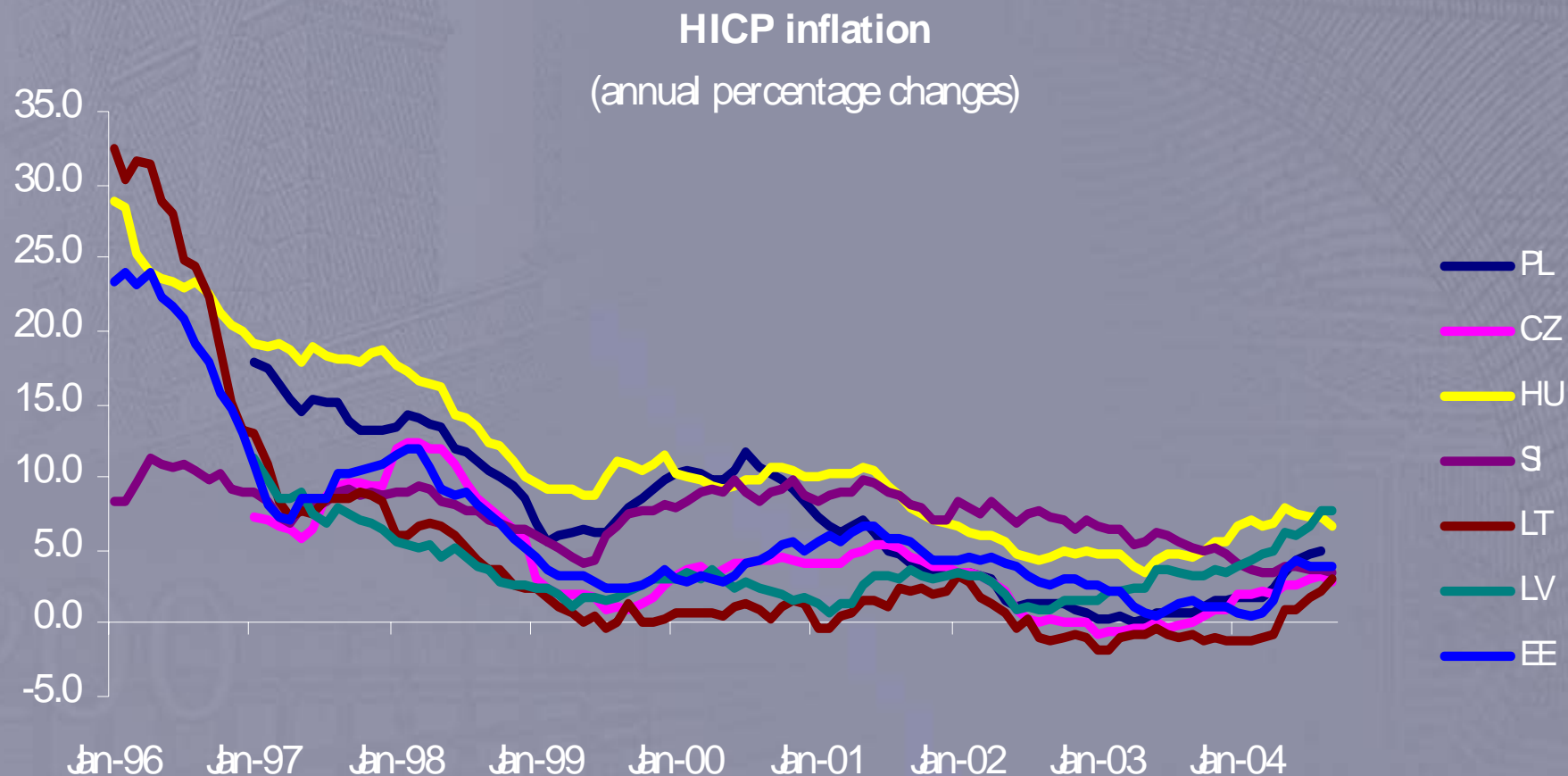
taking the average of long-term interest rates in Finland, Denmark and Sweden (4.4%) + 2 percentage points = **6.4%**

## 5. Statistical issues

- Data used in the application of the convergence criteria were provided by the European Commission, in co-operation with the ECB in the case of long-term interest rates.
- The assessment of the convergence process is dependent on the quality and integrity of data, which should be treated as a priority matter.

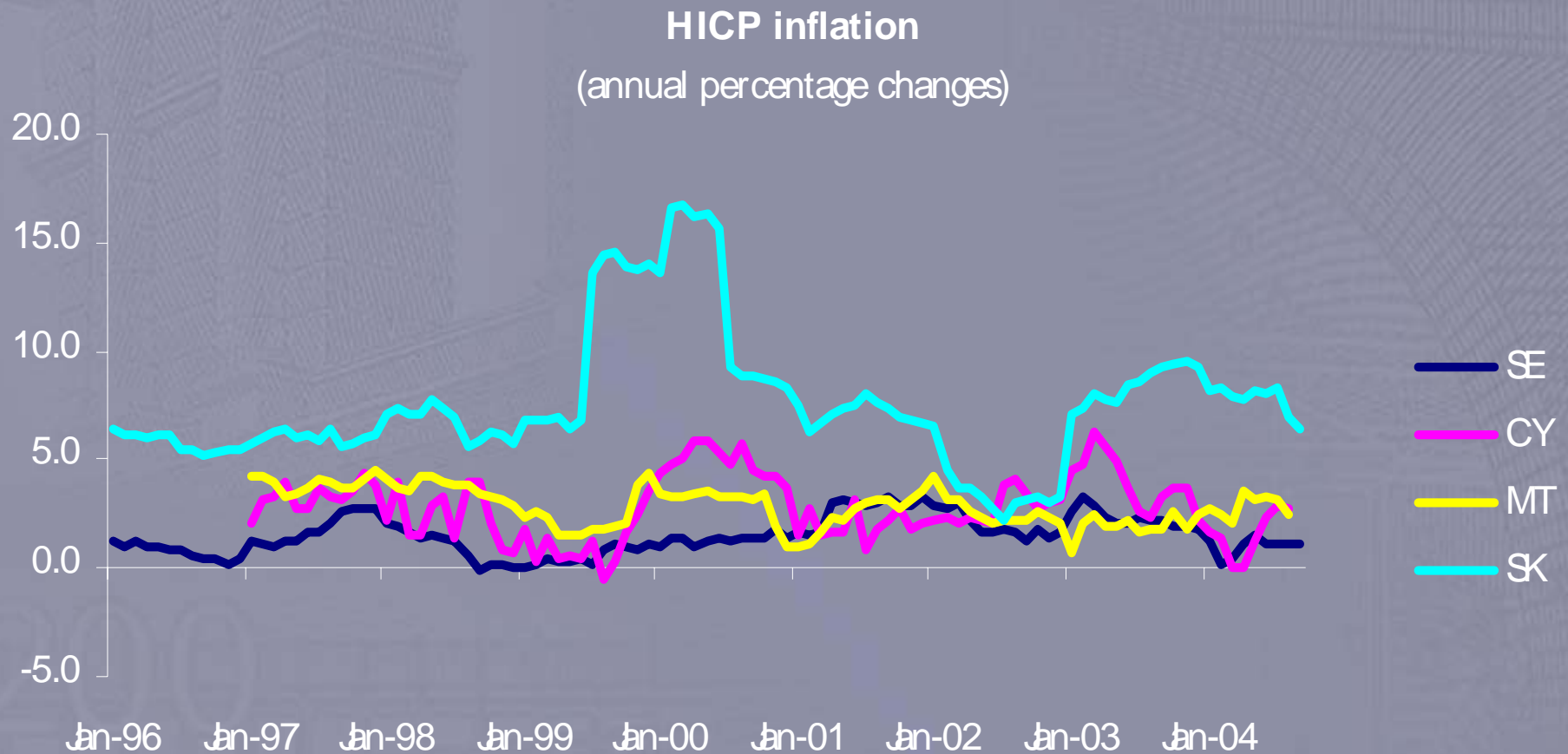
# 6. Progress with convergence – price stability

Clear downward trend in HICP inflation but recent pick-up in most new Member States



# 7. Progress with convergence – price stability

CY, MT, SK and SE

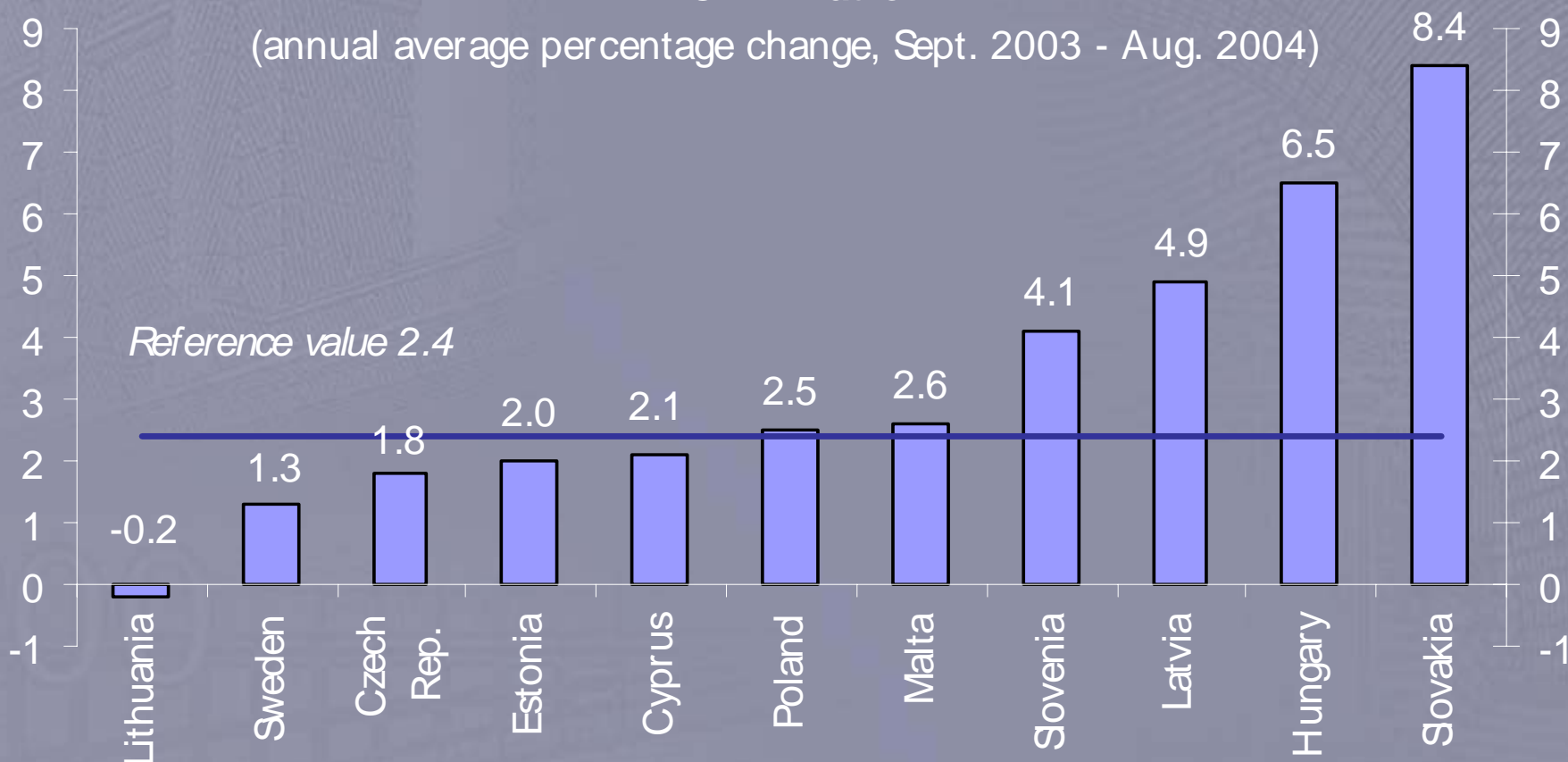


# 8. State of convergence – price stability

Five countries comply with the reference value

## HICP inflation

(annual average percentage change, Sept. 2003 - Aug. 2004)



Source: Eurostat



## 9. Challenges to price stability

- Risk of second-round effects on wages stemming from the present rapid price increases
- Still high unit labour cost growth in most countries – partly reflecting rapid growth in domestic demand and capacity utilisation
- Fiscal policy still not providing sufficient support for price stability in a number of countries
- Need to complete disinflation process in a few countries

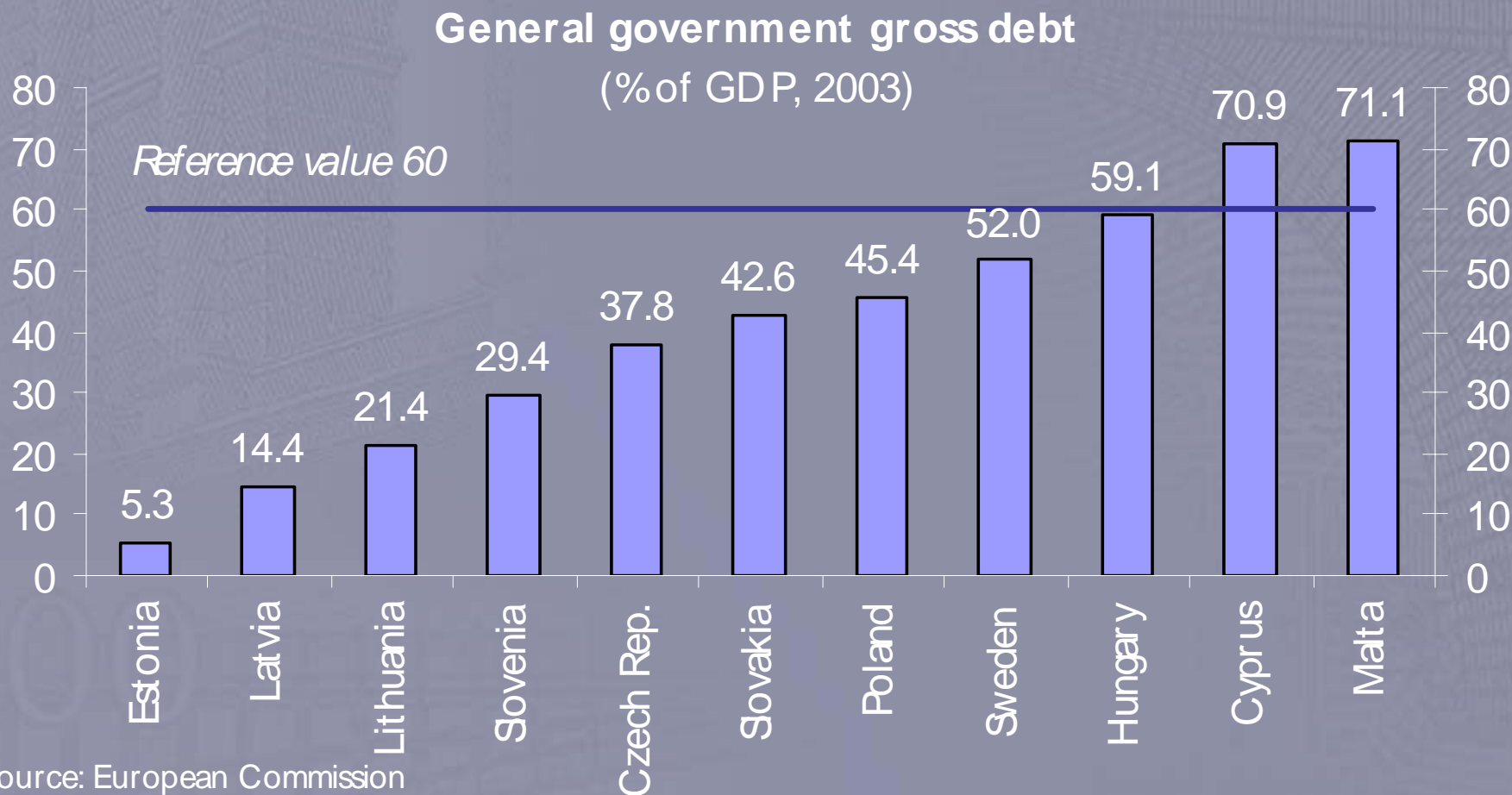
# 10. State of convergence – deficit ratio

Five countries comply with the reference value



# 11. State of convergence – debt ratio

Nine countries comply with the reference value



# 12. Fiscal challenges

- Need for consolidation in countries with deficits
- Rise in debt ratios raises concerns over sustainability
- Expenditure ratios are already high - need to achieve fiscal consolidation through expenditure restraint
- Risk of additional fiscal liabilities arising from population ageing and unreformed pay-as-you-go pension systems in a number of countries

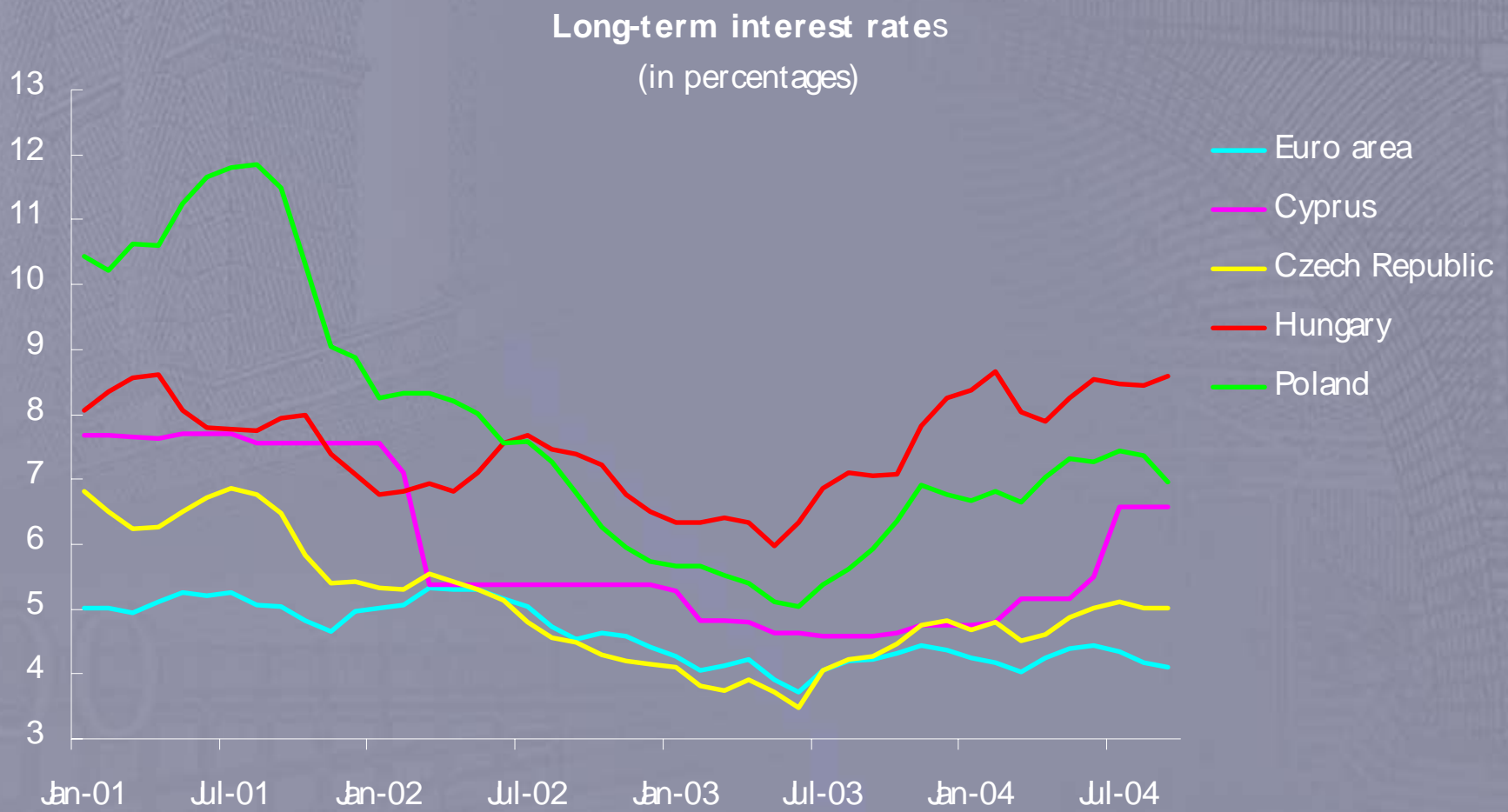
# 13. State of convergence - exchange rates

- **No country participated in ERM II for the full two-year reference period**
- **Three countries joined ERM II in June 2004, eight countries kept their currencies outside ERM II**

	Participation in ERM II	with effect from
Czech Republic	No	
Estonia	Yes	28 June 2004
Cyprus	No	
Latvia	No	
Lithuania	Yes	28 June 2004
Hungary	No	
Malta	No	
Poland	No	
Slovenia	Yes	28 June 2004
Slovakia	No	
Sweden	No	

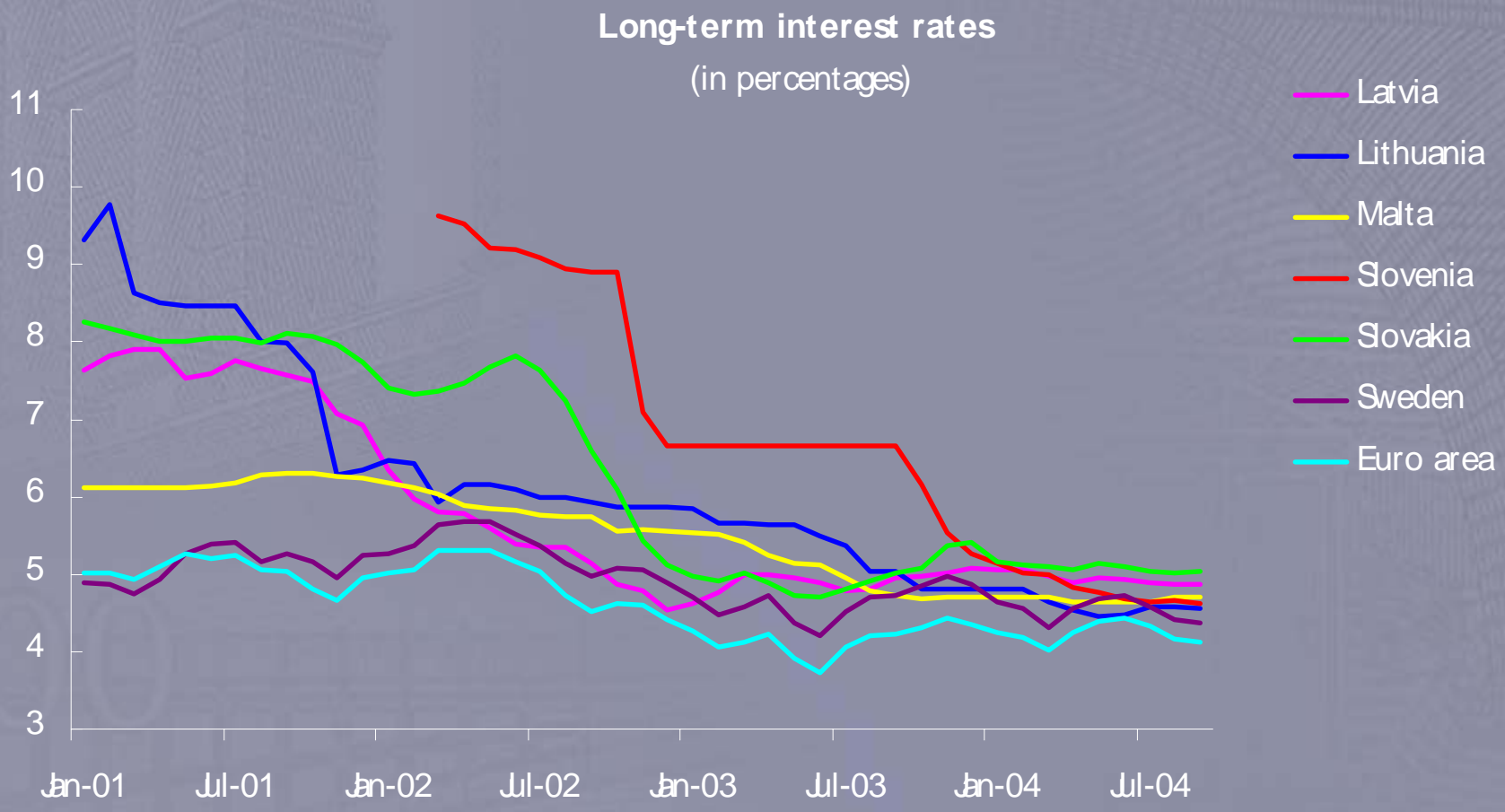
# 14. Progress with convergence - interest rates

## Recent pattern of divergence in CY, CZ, HU and PL



# 15. Progress with convergence - interest rates

Continuing pattern of convergence in LV, LT, MT, SI, SK and SE

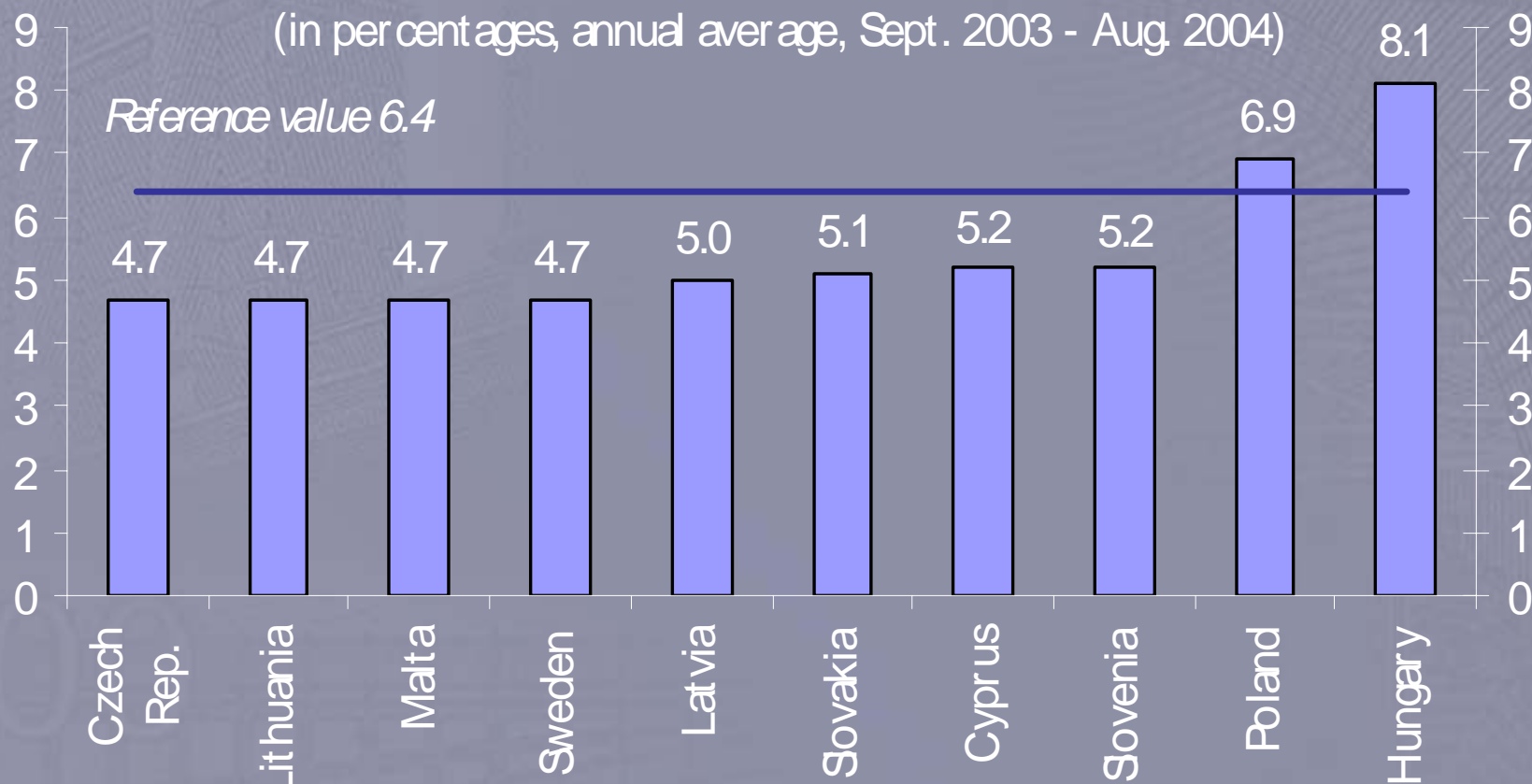


# 16. State of convergence – interest rates

Eight countries comply with the reference value

## Long-term interest rates

(in percentages, annual average, Sept. 2003 - Aug. 2004)



Source: European Commission and ECB



# 17. Challenges to interest rate convergence

- Fiscal policy not providing sufficient support for convergence of long-term interest rates in a number of countries
- Widening of inflation differentials with the euro area a matter of concern as regards convergence of long-term interest rates in several countries

# 18. Chapter II – legal convergence

- Chapter II examines legal convergence in the examined Member States. In particular, to the extent to which the national legislation, including the statutes of their NCBs, is compatible with Articles 108 and 109 of the Treaty and the Statute of the ESCB.
- Article 108 establishes the principle of independence of national central banks and the members of their decision-making bodies.
- Article 109 requires each Member State to ensure, at the latest at the date of the establishment of the ESCB or upon accession to the EU, that its national legislation including the statutes of its national central bank is compatible with the Treaty and the Statute of the ESCB.

# 19. Structure of the legal chapter

- Chapter II has the same structure as that of earlier EMI and ECB Convergence Reports:
  1. An introduction to the basic principles of legal convergence
  2. Individual country assessments
- In substance, the assessment of legal convergence in each country focuses on two areas: central bank independence and legal obstacles to integration into the Eurosystem

# 20. Central bank independence

Assessed by reference to four types of independence:

## Functional:

- Price stability must be legally recognised as the primary objective of the NCB's monetary policy.

## Institutional:

- National laws must prohibit:
- members of the NCB decision-making bodies from seeking or taking instructions from any government, parliament or other third parties;
- ex ante consulting on draft NCB decisions;
- voting rights for third parties in NCB decision-making bodies.

# 21. Independence cont.

## Personal:

- Grounds for dismissal and minimum term of office of a Governor and other members of the NCB board must follow the ESCB Statute.
- Right of other members of the NCB board to go to a court to review their dismissal.
- Safeguard against conflict of interests.

## Financial:

- NCB must be able to take independent decisions on its finances.
- NCB must have sufficient resources at its disposal to fulfil its mandate as ESCB member.
- No financial liability for third parties.

# 22. Legal obstacles to Eurosystem integration

Chapter II also highlights:

- national legal provisions that would impede the integration of the NCB into the Eurosystem if not amended before introduction of the euro;
- Especially, national rules that would impede the execution by the NCB of Eurosystem-related tasks or its compliance with ECB decisions in key areas.

## 23. Conclusions on the legal assessment

- All of the examined countries are well advanced in adapting their NCB statutes and other legislation to bring them in line with the Treaty and the ESCB statute;
- Most, while fulfilling the basic requirements for NCB independence, still have legal provisions requiring further adaptation to safeguard effective independence of their NCBs.
- As yet, none fulfil all of the legislative requirements for integration into the Eurosystem.