Ministry of Finance of the Czech Republic
and the Czech National Bank

Assessment of the Fulfilment of the Maastricht Convergence Criteria and the Degree of Economic Alignment of the Czech Republic with the Euro Area

April 2025

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The Assessment of the Fulfilment of the Maastricht Convergence Criteria and the Degree of Economic Alignment of the Czech Republic with the Euro Area provides the Czech Government with a basis for appropriately timing entry into the exchange rate mechanism and subsequent adoption of the euro by the Czech Republic. It is available on the Ministry of Finance website at:

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informace@mfcr.cz

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Abbreviations

CNB .... Czech National Bank
CZ .... Czech Republic
CZK .... Czech koruna
CZSO .... Czech Statistical Office
EC .... European Commission
ECB .... European Central Bank
ERM II .... Exchange Rate Mechanism II
ESM .... European Stability Mechanism
EU .... European Union (covering all 27 countries)
EUR .... euro
GDP .... gross domestic product
IMF .... International Monetary Fund
MF CR .... Ministry of Finance of the Czech Republic
NERV .... National Economic Council of the Government

Country codes

AT – Austria, BE – Belgium, BG – Bulgaria, CY – Cyprus, CZ – Czech Republic, DE – Germany, DK – Denmark, EE – Estonia, ES – Spain, FI – Finland, FR – France, GR – Greece, HR – Croatia, HU – Hungary, IE – Ireland, IT – Italy, LT – Lithuania, LU – Luxembourg, LV – Latvia, MT – Malta, NL – Netherlands, PL – Poland, PT – Portugal, RO – Romania, SE – Sweden, SI – Slovenia, SK – Slovakia

Symbols used in tables

A dash (–) in place of a number indicates that the phenomenon did not occur.

Cut-off dates for data sources

The document was prepared using the data available as of 28 January 2025.

Note

Sum totals published in tables may be subject to inaccuracy in the last decimal place in some cases due to rounding.

Summary and Recommendations

The Czech Republic undertook to adopt the euro by signing the Act concerning the conditions of accession of the Czech Republic to the European Union. One of the conditions that must be fulfilled by each Member State in the process of joining the euro area is the achievement of a high degree of sustainable convergence, which is assessed according to compliance with the **Maastricht convergence criteria**.

Adopting the euro could have a whole range of benefits for the Czech economy. According to a report by the The government's National Economic Council (2024), the most frequently mentioned benefits are the elimination of exchange rate risk and lower transaction costs, which could give a stimulus to foreign trade, and hence closer integration into the EU's internal market, easier business planning for firms, more affordable and accessible investment financing and simpler management of EU funds for the public sector. On the other hand, there are also economic costs and risks associated with adopting the euro. These stem mainly from the loss of independent monetary policy and the nominal exchange rate channel in an environment where the Czech economy has a different structure to the euro area (asymmetric shocks) and from the loss of autonomous banking supervision and the risk of moral hazard in public finances and financial commitments to the euro area.[1] The individual benefits and risks are very hard to quantify and will differ in size depending on the characteristics of each economy (for example, the elimination of exchange rate risk is of greater benefit to an open economy, whereas the loss of independent monetary policy may pose a greater risk to countries that have little room for countercyclical fiscal policy).

Setting a specific date for joining the euro area is fully within the competence of each Member State, but it should ideally depend on its degree of preparedness. **The preparedness of the economy to join the euro area** must be **assessed mainly from the perspective of its economic alignment** and **structural similarity with the monetary union**, and also from the point of view of its **ability to absorb asymmetric shocks using other mechanisms**, in particular via fiscal policy, the labour market and the banking sector, **after the loss of independent monetary policy**.

More than 20 years have passed since the Czech Republic signed the Treaty of Accession to the EU in 2003. During this period, the euro area and the European Union as a whole experienced the global financial crisis and subsequent economic recession in 2008 and 2009. Some euro area countries went through a debt crisis. In 2020 and 2021, the world was paralysed by the Covid-19 pandemic, and in 2022, the energy crisis and Russia's aggression against Ukraine accelerated growth in the price level. These and other events are affecting other processes of European integration aimed at strengthening economic and fiscal coordination and completing the banking union and the capital markets union. New institutions and rules are thus changing the shape of the euro area and the content of the obligation to adopt the euro. These facts also need to be properly assessed and considered in decisions about the timing of monetary union entry.

In addition to assessing **legal compatibility**, the **assessment of a country's preparedness** for euro adoption and the related rights, obligations, privileges and commitments includes an assessment of compliance with the **convergence criteria**: the achievement of a high degree of price stability, the sustainability of the government financial position, the observance of the normal fluctuation margins of the exchange rate, and the durability of convergence being reflected in the long-term interest-rate levels.

The Czech Republic did not meet the criterion on price stability in 2024. Inflation fluctuated within the tolerance band around the Czech National Bank's inflation target in 2024, due to the fading of adverse supply-side factors and the effects of previous monetary and fiscal tightening. However, uneven price growth across EU countries resulted in a low reference value of the inflation criterion.

The Czech Republic met the interest rate convergence criterion in 2024, aided by renewed convergence between the monetary policy settings of the CNB and the European Central Bank.

After the one-off, deficit-widening measures introduced in 2023 to mitigate the impact of the energy crisis on households and businesses faded out, the government continued on a path of reducing the high deficits accumulated during the pandemic. The consolidation package and a gradual recovery in domestic economic activity fostered a drop in the general government deficit. **The Czech Republic thus probably met the criterion on the government financial position for 2024 in both the deficit and debt components.**

In 2025, the Czech Republic **will probably fulfil the reference values for the criteria on the government financial position, the convergence of interest rates and price stability.**

The Czech Republic is formally non-compliant with **the exchange rate stability criterion**, as it does not participate in the relevant exchange rate mechanism.

[1] See NERV (2024) for more on the benefits and risks of adopting the euro.

As regards the Czech economy's alignment with the euro area and its ability to adjust to possible asymmetric shocks without its own monetary and exchange rate policy, the characteristics of the Czech economy can be divided into three groups.

The first group consists of **economic indicators suggesting a relatively low level of risk associated with potential euro adoption** in the area analysed. This group has long included the Czech economy's close trade and ownership links with the euro area, which increase the benefits of euro adoption and foster alignment between the Czech and euro area business cycles. The latter is currently at very high levels. The close trade links are also contributing to a high share of euro financing of Czech corporations. The substantial growth in this financing seen in previous years halted in 2024 amid a falling interest rate differential between koruna and euro rates. Interest rate spreads between Czech and euro area market rates have returned to near pre-pandemic levels, their decline reflecting the convergence of the monetary policy rates of the Czech National Bank and the European Central Bank. The koruna and the euro remain aligned against the dollar. Inflation persistence in the Czech Republic, which remains broadly in line with levels in the euro area, does not pose an obstacle to euro area entry either. As regards the adjustment mechanisms of the Czech economy, the low long-term unemployment rate, which is still among the lowest in Europe, and the high level of economic activity (which does not apply to all groups of the population, however) are positive factors. The situation in the domestic banking sector also remains favourable. It has seen an improvement in its already solid liquidity position and continues to be characterised by a robust capital position, high profitability and a low ratio of non-performing loans. Its resilience to potential negative shocks thus remains high.

The **category of indicators with a neutral message** includes an assessment of the alignment of the Czech and euro area financial cycles, which increased slightly in 2023, and the alignment of the Czech and euro area financial markets, which returned to pre-pandemic levels. Most indicators of monetary policy transmission similarity between the Czech Republic and the euro area are also neutral. Although the Czech Republic differs from the euro area average in some of them – such as the structure of households' financial assets and the structure of housing loans by fixed-rate period – this cannot be considered a fundamental barrier to euro adoption. Neither can the condition of the Czech financial system: the depth of financial intermediation and the level of private sector debt in the Czech Republic are relatively low, which means that the economy is less sensitive to potential shocks from the financial system. As regards the risks associated with potential euro adoption, the assessment of general government debt is also neutral. In 2023, despite continuing public finance deficits, it did not increase, remaining well below the 60% threshold of the Maastricht convergence criterion.[2] Some labour market indicators can also be considered neutral. These include the share of part-time employment, which remains relatively low despite a slight increase, the geographical mobility of the labour force, and the labour taxation system. According to an indicator published by the International Institute for Management Development, the competitiveness of the Czech economy has declined slightly but remains solid.

The third group consists of **indicators suggesting economic risks associated with euro adoption** in the area analysed. These indicators include the unfinished process of economic convergence of the Czech Republic towards the euro area, especially as regards the price and wage levels, which remain well below the euro area average despite faster convergence of the relative level of Czech prices and wages observed over the last two years. The relatively low structural similarity between the Czech economy and the euro area, consisting mainly in an above-average share of industry in domestic GDP, could also be a risk in the event of euro adoption. As regards adjustment mechanisms, the structural imbalance in Czech public finances is a persisting issue. The general government deficit is expected to fall below the 3% Maastricht criterion in 2024 due to the consolidation package, but it will be desirable to continue reducing the deficit in the years ahead for the Czech Republic to function smoothly in the euro area in the future (according to the Act on Budget Responsibility, the structural deficit should be no more than 1% of GDP in 2028). The room for fiscal policy to have a countercyclical effect is limited by a high ratio of mandatory expenditures to state budget revenue and by the persistent structural government deficits mentioned above. Moreover, long-term public finance sustainability remains unresolved, especially in the context of the fiscal implications of population ageing. As regards labour market flexibility, the relatively low participation of women in some age groups in the labour market has long been a problem.

The design and functioning of the economic and monetary union are evolving over time, so these processes continue to require monitoring and assessment. Apart from benefits, the adoption of the single currency also entails institutional and financial **obligations**, which must be taken into account when deciding on the timing of euro area entry. The currently estimated financial obligations for the Czech economy, which were not known when the Czech Republic joined

[2] While the current general government debt is still relatively low, it should be taken into account that the Czech Republic is assessed as a medium-risk country in terms of financial sustainability in both the medium and long term (European Commission, 2024a). While the main cause is population ageing, the current level of debt is also having a negative effect to a lesser extent.

the European Union, mainly include a capital subscription to the European Stability Mechanism and a transfer of contributions from banks registered in the Czech Republic to the Single Resolution Fund. Although it would only be possible to exactly quantify the financial obligations at the time of the Czech Republic's hypothetical entry into the euro area, these obligations – together with the payment of the rest of the share in the subscribed capital of the ECB and a contribution to the ECB's reserve funds – can be estimated at a minimum of around CZK 118 billion overall (more details and the assumptions for this estimate are given in Appendix B). Based on these financial transfers, the Czech Republic would receive shares in the ESM and the Czech National Bank would increase its share of the capital of the European Central Bank and gain a share of its foreign reserves.

The real economic convergence of the Czech Republic towards the euro area has almost stalled since 2020, with the process of real convergence having resumed only recently. By contrast, the price levels in the Czech Republic and the euro area have converged thanks to higher inflation in the Czech Republic. The wage levels have likewise converged.

The risk associated with long-term public finance sustainability has a crucial weight in the considerations of the Ministry of Finance and the Czech National Bank regarding the risks of euro area membership. Moreover, there are still **large differences in the structure of economies**, which could present challenges under a single monetary policy. **Unresolved domestic structural issues** related to the current economic model and future challenges (population ageing, infrastructure investment, etc.) pose a significant risk. In the light of EU economic policy and the Government Economic Strategy (2024), it will also be necessary to change the economic model of the Czech economy in order to achieve the objective of higher long-term sustainable growth based on competitiveness and high value added.

Besides the need to address the long-term fiscal impacts of population ageing, further discretionary measures will have to be adopted in the years ahead to eliminate the still high structural deficits, which will additionally be **burdened in the coming years by large-scale projects** (construction of high-speed railways and new nuclear units). Addressing these long-term challenges which jeopardise the soundness of public finances is crucial, especially given the future strengthening of the role of fiscal policy as a stabilisation mechanism in the monetary union. While potential entry into the monetary union is not expected to have a significant impact on achieving the above objectives, these factors will affect long-term public finance sustainability. Given their urgency and significance, **ensuring adequate financing should therefore take precedence over discussions on monetary union membership**.

In view of the above, it would thus be desirable to **carefully address changes in the structure of the economy and the ways of financing these changes** before joining the monetary union, while **limiting the risks associated with economic transformation**. This would support the smoother adoption of the single currency without any major macroeconomic shocks. Membership in the euro area alone would not eliminate these risks, as the single currency does not have a significant impact on economic growth, as evidenced by the analysis in NERV (2024).

Addressing the current **challenges of economic transition and long-term public finance sustainability should therefore be prioritised before making a decision on joining the monetary union**.

Moreover, **the euro area** also continues to face challenges, especially as regards the fiscal positions of its member states (only six euro area countries met the reference values for the general government deficit and debt in 2023) and weak economic growth.

In view of all the above facts, **the Ministry of Finance and the Czech National Bank recommend that the Czech government not set a target date for euro area entry for the time being**. Given the complexity of the process of joining the euro area, **it is advisable that any decision be made and any target date be set at the beginning of the electoral cycle and the government's mandate** (as recommended by NERV). This will give enough time to implement the necessary economic and legislative measures, allow for stable communication with the public and the business sector, and provide for effective coordination with European institutions. It will also minimise the political risks and ensure the continuity of the key reforms needed for a smooth transition to the euro.

The recommendation not to set a target date for euro adoption implies that the government should not aim for the Czech Republic to join the exchange rate mechanism either.

Joining the exchange rate mechanism should only be part of a binding government euro adoption plan **to minimise the length of stay in ERM II before joining the euro area**. This is mainly because the Czech Republic has an autonomous monetary policy with a floating exchange rate regime and inflation targeting, while allowing for the free movement of capital. Maintaining a stable exchange rate in an environment of this kind is very complicated. In such cases, a central bank ensuring price stability while also participating in ERM II would be pursuing two objectives (i.e. price stability in the form of meeting the inflation target, and exchange rate stability, with limited scope for deviation from the fixed central rate without the option of devaluation) but would have only one tool to achieve these objectives: interest rates. The **setting of interest rates would also have to be adapted to**

exchange rate policy, effectively **causing the country to lose its own monetary policy** with all its economic consequences. **Therefore, as an isolated step without a clear path to the early adoption of the euro, prolonged participation in ERM II poses risks for the Czech Republic.** NERV (2024) likewise advises the government against entering ERM II without a clear timetable for euro adoption. Moreover, it points to the risk of potential additional conditions for ERM II entry, such as mandatory participation in the banking union as seen in the cases of Bulgaria and Croatia. This would result in a Member State surrendering part of its supervisory powers without being able to participate in the decision-making in the ECB's Governing Council. The central bank would thus effectively lose its supervisory powers over systemically important banks. **From the perspective of the Ministry of Finance and the Czech National Bank, ERM II membership without a comprehensive and credible plan for adopting the euro and a broader political consensus thus entails significantly more costs and risks than benefits.**

The conclusions arising from the analysis of the Ministry of Finance and the Czech National Bank are purely advisory. They are therefore in no way binding for the government's decision regarding entry into the monetary union.

1 Fulfilment of the Maastricht Convergence Criteria

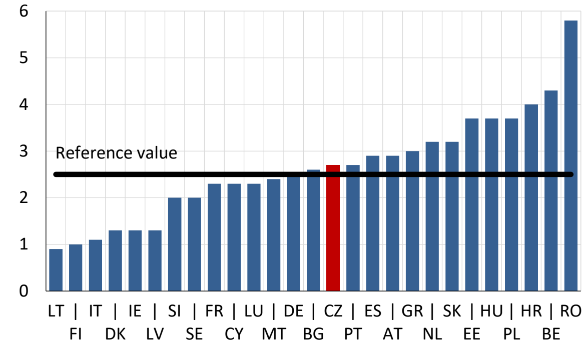
Besides being required to harmonise their legislation with Articles 130 and 131 of the Treaty on the Functioning of the European Union (the Treaty) and the Statute of the European System of Central Banks and the European Central Bank, EU Member States are required to **achieve a high degree of sustainable convergence** in order to join the euro area. This is determined according to the criteria for the achievement of a high degree of price stability, the sustainability of the government financial position, the observance of the normal fluctuation margins of the national currency against the euro and the durability of convergence being reflected in the long-term interest-rate levels (also referred to as the Maastricht criteria). The criteria are enshrined in Article 140 of the Treaty and detailed in Protocol No. 13 on the convergence criteria. This section briefly describes the individual criteria (more precise definitions are given in Appendix A) and analyses their fulfilment. Although the actual assessment of compliance with all the convergence criteria would take place several quarters ahead of the planned changeover date, the Czech Republic did not fulfil the reference value of the price criterion in 2024.

1.1 Criterion on Price Stability

The price stability criterion assesses the rate of consumer inflation, which must not be more than 1.5 percentage points higher than the average of the three best performing EU countries in terms of price stability.

Chart 1.1: Average inflation rate in 2024

harmonised index of consumer prices; in %



Source: Eurostat (2025a).

The Czech Republic did not meet this criterion in 2024, as uneven consumer inflation across EU countries resulted in a low reference value of the price stability criterion (see Chart 1.1). The inflation pressures in the Czech Republic were significantly lower than in the previous two years, but persisting elevated growth in services prices continued to be an inflationary factor. The contribution of administered prices to the average inflation rate remained significant. While the commodity components of electricity and gas prices decreased, this was offset by a sharp increase in the regulated components of overall electricity and gas prices at the start of the year. Indirect taxes were affected by the fiscal consolidation package. Increases in excise duties on alcohol and tobacco products had an inflationary effect in 2024, while the contribution of VAT rate changes, as recorded in the price statistics, was negative. The restrictive effect of monetary policy was amplified by the income effect of the fiscal consolidation package, together helping to moderate domestic demand-driven inflation pressures. A slight decline in the dollar oil price also fostered lower inflation. Conversely, inflationary factors included not only growth in nominal wages, but also a marked depreciation of the koruna against the euro and the dollar.

In 2025, inflation pressures will be affected mostly by market factors. Administered prices will rise slightly due mainly to an increase in the administered component of energy prices. A drop in the commodity components of electricity and gas prices should have the opposite effect. An increase in excise duties on alcohol and tobacco products is expected to result in a slightly positive contribution from changes in indirect taxes. A fall in oil prices is expected to have an anti-inflationary effect this year and, given the length of transmission, monetary policy will continue to moderate inflation pressures through interest rates. The koruna-euro exchange rate will have a broadly neutral effect. Continued wage growth and depreciation of the koruna against the dollar will be inflationary factors. Services inflation will stay elevated this year, with expected higher growth in imputed rents becoming a more significant contributing factor. The market component of inflation will thus increase as the anti-inflationary effect of declining prices of many production inputs fades. In 2025, annual inflation is expected to stay very close to the CNB's inflation target. **The Czech Republic will probably meet the criterion on price stability in 2025** (see Table 1.1).

Table 1.1: Consumer prices

harmonised index of consumer prices; average for last 12 months vs. average for previous 12 months as of end of period; growth in %

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025 Forecast
Average for 3 EU countries with lowest inflation*	-0.8	0.6	0.7	0.4	-1,0	0.7	7.1	2.9	1,0	1.7
Reference value	0.7	2.1	2.2	1.9	0.5	2.2	8.6	4.4	2.5	3.2
Czech Republic	0.6	2.4	2.0	2.6	3.3	3.3	14.8	12.0	2.7	2.4

*Note: * More precisely, the three best performing Member States in terms of price stability (see Appendix A). These are Lithuania, Finland and Italy for 2024 and Sweden, Lithuania and Denmark for 2025.*

Source: Eurostat (2025a). Forecasts for 2025 according to EC (2024b) and MF CR (2025). MF CR calculations.

1.2 Criterion on the Government Financial Position

The criterion on the government financial position requires the position to be sustainable in the long term. Formally, it is fulfilled if an excessive deficit procedure is not ongoing for the country in question. This procedure is usually opened if a country fails to meet one of the components of the fiscal criterion – simply put, if, under normal circumstances, the general government deficit exceeds 3% of GDP and the European Commission's forecasts do not indicate a return, or if the debt exceeds 60% of GDP, unless the debt ratio is decreasing towards this level at a sufficient pace (in line with the net expenditure path).

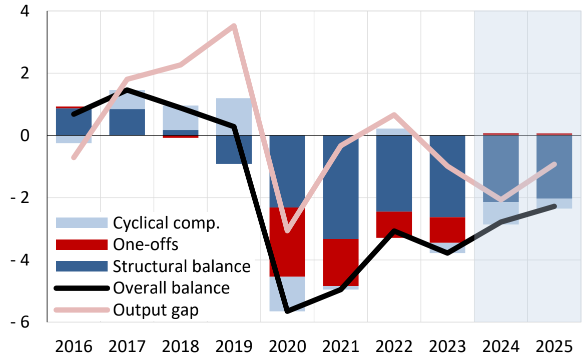
In 2022, the economic recovery and the end of the government's one-off stabilisation, support and redistributive policies in response to the Covid-19 pandemic led to an improvement in the general government balance to **−3.1% of GDP**. However, the incipient fiscal consolidation was disrupted by Russia's invasion of Ukraine, which contributed to a sharp rise in energy prices in 2022 and 2023. The government adopted temporary measures to mitigate the impact of this surge on economic agents. However, these measures caused the deficit to widen. Rising social expenditure and economic stagnation **in 2023** contributed to a deterioration of the deficit to **3.8% of GDP**. The Czech Republic thus exceeded the 3% reference value of the criterion. However, the Commission did not propose the opening of an excessive deficit procedure, as the breach of the reference value was temporary and the fiscal consolidation ensured a credible return below the reference value in 2024. Thus, the Czech Republic remained formally compliant with the criterion on the government financial position.

The Czech Ministry of Finance expects a deficit of **2.8% of GDP** for **2024**. Besides the measures in the government's consolidation package, the improvement in the balance was driven by the winding down of one-off expenditure to cushion the impact of high energy prices. In addition to the consolidation package, an acceleration of economic growth should further improve the balance **in 2025**. The Ministry of Finance therefore estimates the overall general government deficit at **2.3% of GDP**.

From the perspective of fiscal policy and budgetary surveillance, the balance under review is adjusted for the business cycle and one-off and other temporary measures (the "**structural balance**"). Chart 1.2 captures the structural components of the general government balance quantified by the OECD method. Under this methodology, the Czech Ministry of Finance expects a gradual decrease in the structural deficit.

Chart 1.2: General government balance

general government balance in % of GDP; output gap in % of potential output



Source: MF CR (2025).

A reform of the EU fiscal framework came into effect in 2024. Its central monitored indicator – capturing a country's fiscal policy stance – is the binding multi-annual **net expenditure path**, where net expenditure is defined as general government expenditure net of interest expenditure, expenditure on programmes of the EU fully matched by revenue from EU funds, discretionary revenue measures, one-offs and other temporary measures, national expenditure on co-financing of programmes funded by the EU and cyclical elements of unemployment benefit expenditure. The net expenditure path is intended to ensure a sustained and gradual reduction in debt and sustainable and inclusive growth. For Member States fulfilling both the debt and deficit criteria, which include the Czech Republic, the Commission, at the Member State's request, provided guidance on the primary structural balance in 2028 and 2031 necessary to maintain the deficit below the 3% of GDP reference value in the medium and long term.

Public deficits are reflected in **growth in debt**. Given the current fiscal stance, the debt-to-GDP ratio is expected to continue rising despite the economic recovery and decreasing deficit. However, with a projected value of 44.3% of GDP in 2025, the **debt level** should remain below the **reference value of the convergence criterion**.

Table 1.2: General government finances

general government balance and debt; in % of GDP

	2016	2017	2018	2019	2020	2021	2022	2023	2024 Forecast	2025 Forecast
Reference value of government balance	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0	-3.0
Czech Republic	0.7	1.5	0.9	0.3	-5.6	-5.0	-3.1	-3.8	-2.8	-2.3
Reference value of general government debt	60.0	60.0	60.0	60.0	60.0	60.0	60.0	60.0	60.0	60.0
Czech Republic	36.2	33.8	31.7	29.6	36.9	40.7	42.5	42.4	43.4	44.3

Note: A precise definition of this criterion is given in Appendix A.
Source: MF CR (2025).

1.3 Criterion on the Convergence of Interest Rates

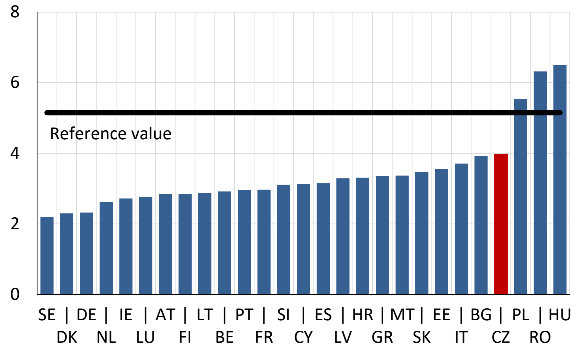
Under the criterion, convergence of interest rates is achieved if yields on government bonds with an average residual maturity of 10 years do not exceed by more than 2 percentage points the average of the yields on government bonds in the three best performing EU countries in terms of price stability.

This criterion **was fulfilled in 2024** (see Chart 1.3, Table 1.3). A decrease in the differential between CNB and ECB interest rates has contributed to a decline in long-term koruna rates below the reference value over the past two years. The Czech Republic's low public debt by international standards and its overall macroeconomic and financial stability is likely to lead to the fulfilment of this criterion in the coming years too. These factors have long been reflected in the country's high credit rating and smooth subscription of government bonds. However, another key factor will be the level at which the equilibrium interest rates of the CNB and ECB stabilise in the long term. Koruna rates are likely to remain relatively high.

Based on the forecasts for the reference countries outlined in their national medium-term fiscal-structural plans (EC, 2024c), which replaced the Convergence Programmes and Stability Programmes in 2024, **long-term interest rates for the Czech Republic can be expected to remain below the reference value of the relevant Maastricht criterion in 2025**.

Chart 1.3: Long-term interest rates in 2024

yields on government bonds with average residual maturity of 10 years; in %



Source: Eurostat (2025b).

Table 1.3: Long-term interest rates on government bonds

yields on government bonds with residual maturity of 10 years; 12-month average; in %

	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025 Forecast
Average for 3 EU countries with lowest inflation*	2.1	1.3	2.1	1.3	0.7	0.6	1.6	2.9	3.2	2.3
Reference value	4.1	3.3	4.1	3.3	2.7	2.6	3.6	4.9	5.2	4.3
Czech Republic	0.4	1.0	2.0	1.5	1.1	1.9	4.3	4.4	4.0	3.7

*Note: * More precisely, the three best performing Member States in terms of price stability (see Appendix A). The reference value of the criterion was calculated from the outlooks for long-term interest rates for Lithuania, Finland and Italy for 2024 and for Sweden and Denmark for 2025. The third reference country for 2025 was Lithuania. However, due to a negotiated exemption, Lithuania is expected to submit its medium-term fiscal-structural plan to the European Commission by spring 2025. For this reason, it was excluded from the calculation of the reference value.*
Source: Eurostat (2025b), EC (2024b, 2024c). MF CR (2025) calculations and forecasts.

1.4 Criterion on Participation in the Exchange Rate Mechanism

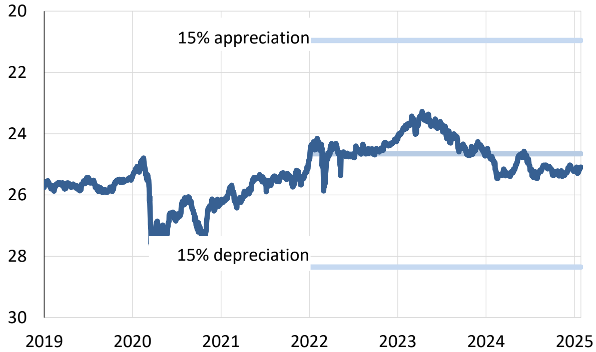
The admission of a country into the euro area is conditional on a successful, at least two-year stay of the national currency in the exchange rate mechanism (ERM II). The exchange rate is expected to move within the fluctuation band of ±15% without devaluation of the central rate and excessive pressures on the exchange rate. Formal fulfilment of the criterion on exchange rate stability will only be possible after the Czech Republic joins ERM II. Until then, the **assessment** can be made **only at a hypothetical level**. It is also important to bear in mind that the European Commission and the ECB may require the exchange rate to stay much closer to the negotiated central rate than indicated by the fluctuation band of ±15% (CNB, 2024) when assessing the fulfilment of the exchange rate criterion.[3]

The central rate of the koruna against the euro, against which exchange rate fluctuations would be monitored, would be set before entry into ERM II. The length of stay in the mechanism is set at a minimum of two years before the assessment of preparedness to adopt the euro. The Czech Republic's Euro-area Accession Strategy (CNB, Czech Government, 2003), its update (MF CR, 2007) and the NERV Analysis on the Adoption of the Single European Currency (NERV, 2024) all conclude that the Czech Republic should stay in ERM II for the minimum required period only.

For the purposes of this document, the hypothetical CZK/EUR central rate is set as the average exchange rate in 2022 Q1, i.e. the quarter preceding hypothetical ERM II entry at the start of 2022 Q2, which would have allowed euro adoption on 1 January 2025. Chart 1.4 shows that the **exchange rate fluctuated around the hypothetical central rate for most of the period under review**. After strengthening to near its strongest ever level in the first half of 2023, the koruna exchange rate gradually returned to the hypothetical central rate and tended to be weaker in 2024. This was mainly due to a faster decline in CNB interest rates compared to rates abroad, an only gradual recovery of the Czech economy and an unstable geopolitical environment. Nevertheless, the koruna exchange rate remained comfortably within the ±15% band over the entire two-year period. However, the CNB prevented excessive fluctuations of the koruna for part of 2022 by intervening in the foreign exchange market.[4]

According to the forecast in MR CR (2025), the koruna will remain broadly stable against the euro in 2025. This will probably be due to a strong effect of geopolitical factors, which thus might ultimately offset the slight appreciation effect of domestic economic fundamentals – a recovery of the European and Czech economy, higher growth compared to the euro area and a favourable interest rate differential amid continued global easing of monetary conditions. Real convergence could continue to exert gradual long-term appreciation pressure on the koruna. However, this should not be inconsistent with fulfilment of the exchange rate criterion. This conclusion is also guided by the fact that the assessment of this criterion has historically been more lenient on the side of appreciation of the domestic currency and shifts of the central rate towards revaluation have been tolerated.

Chart 1.4: Nominal CZK/EUR exchange rate



Note: The hypothetical central rate is simulated by the average exchange rate in 2022 Q1. Data up to 28 January 2025.
Source: CNB (2025). MF CR calculations.

[3] The interpretation of the exchange rate criterion is not entirely straightforward, and any deviation from the central rate towards a weaker koruna would likely be assessed more strictly than the ±15% fluctuation band would indicate. For more details, see Appendix A of this document and the discussion in the thematic chapter *ERM II and the Maastricht criterion on exchange rate stability*: *What lies ahead for inflation-targeting central banks?* in CNB (2024).

[4] In May 2022, the CNB started to make foreign exchange interventions in response to a significant depreciation of the koruna. The CNB has not been active in the foreign exchange market since October 2022. It formally ended the intervention regime in August 2023, when it also resumed its programme of sales of part of the income on international reserves.

2 Assessment of the Degree of Economic Alignment

Future adoption of the single European currency should increase the benefits accruing to the Czech Republic from its intense involvement in international economic relations. Euro adoption will lead to the elimination of exchange rate risk and part of the transaction costs in relation to the euro area. Foreign trade and investment will thus become more efficient. Besides these benefits, however, euro adoption simultaneously entails risks arising from the loss of independent monetary policy and the stabilising role of a flexible exchange rate. The key factors for the Czech Republic to function successfully in the monetary union will therefore be its economic alignment with the euro area and the economy's ability to absorb potential asymmetric shocks using other mechanisms (CNB, 2024).

This section is thus divided into two basic areas. The first part assesses the similarity of the long-term trends, medium-term developments and the structure of the Czech economy compared to that of the euro area, including the similarity of monetary policy transmission. It thus captures the risk of the euro area single monetary policy being inappropriate for the Czech economy. The second part examines the extent to which the Czech economy is capable of absorbing the impacts of asymmetric shocks using its own adjustment mechanisms, namely autonomous fiscal policy, labour market flexibility, the product market and the banking sector. More details on the indicators assessed in this section can be found in the Alignment Analyses (CNB, 2024).

2.1 Cyclical and Structural Alignment

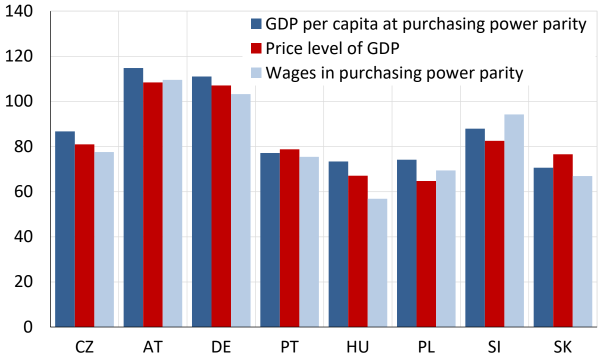
A high degree of alignment of the Czech economy with the euro area economy is a necessary condition for the euro adoption costs arising from the loss of the Czech Republic's own monetary policy to be relatively small.

Price level convergence can take place via two channels: nominal appreciation of the koruna against the euro and/or higher inflation in the Czech Republic than in the euro area. The koruna has not been following a nominal appreciation trend since the start of the CNB's exchange rate commitment in 2013. In 2014–2024, the inflation rate as measured by the harmonised index of consumer prices in the Czech Republic was 1.8 percentage points higher than in the euro area on average. Thus, 87% of the price convergence has taken place via higher inflation than in the euro area. For comparison, in 2003–2013, 89% of the price convergence occurred via appreciation of the koruna and 11% via higher inflation than in the euro area.

The convergence of the real economic level of the Czech Republic (as measured by GDP per capita at purchasing power parity) with the euro area has almost stalled since 2020, while the price and wage levels have converged significantly. The lag behind the euro area average nonetheless remains significant, especially for the price and wage levels. The unfinished process of convergence thus remains a factor arguing against early euro adoption. In the event of further appreciation of the equilibrium real exchange rate and continued convergence of the wage level, euro adoption could lead to an overshooting of the current 2% inflation target.

Chart 2.1: Degree of economic convergence in 2023

euro area = 100

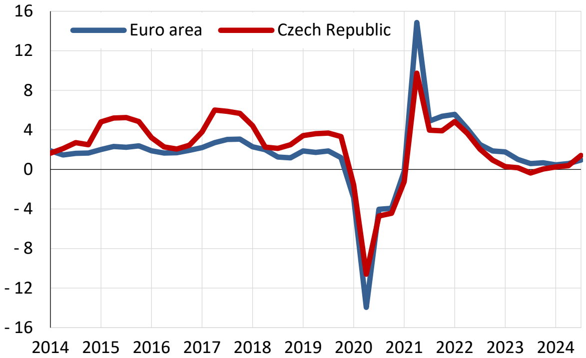


Source: Eurostat (2025c). CNB calculations.

The correlation of economic activity in the Czech Republic and the euro area has long been high, as their business cycles have been largely determined by common external shocks. However, despite the high correlation of the cyclical components of GDP, there have been substantial medium-term differences in their output gaps in the past. In recent years, the economies have become even more cyclically aligned, mainly due to the global pandemic, but also as a result of the energy crisis and the war in Ukraine. This has been reflected in a high correlation of GDP growth in the Czech Republic and the euro area. This increase in cyclical alignment may thus be just a temporary phenomenon. At the same time, the growth of the Czech economy has been lagging slightly behind that of the euro area in recent years.

Chart 2.2: Real GDP growth in the Czech Republic and the euro area

year-on-year; seasonally adjusted; in %

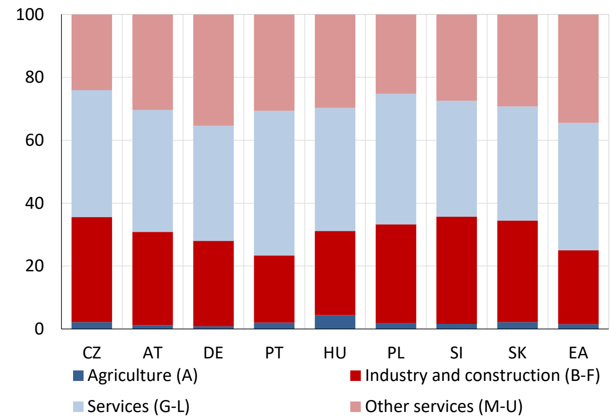


Source: Eurostat (2025c). CNB calculations.

The persisting **differences in the structure of the economies** consist mainly in an above-average share of industry in Czech GDP. As regards euro adoption, the structural differences pose a risk of asymmetric effects of economic shocks, to which the single euro area monetary policy would not be able to respond in full. There have been no major changes in the economies' structural similarity in recent years. For example, the trend towards electromobility remains a challenge for the domestic economy, as the share of the automotive sector in domestic industry is well above the European average.

Chart 2.3: Sectoral structure of the economy in 2023

in % of gross value added

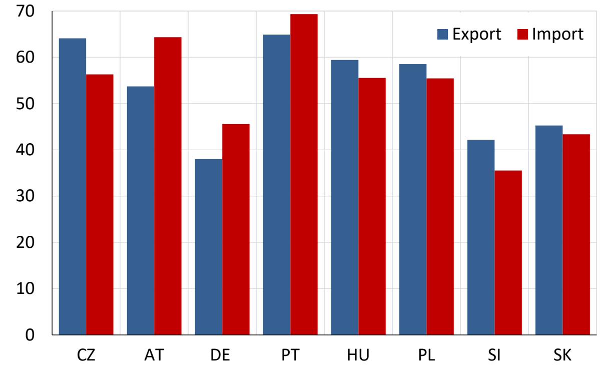


Note: The sectors are broken down by NACE classification.
Source: Eurostat (2025c). CNB calculations.

The Czech Republic's close **trade and ownership links** have long been one of the strongest arguments for it joining the euro area. Despite a slight decline in recent years, these links remain strong. The Czech Republic's transition to the euro would eliminate exchange rate risk and reduce transaction costs for trade with euro area countries. At the same time, the high intensity of international economic relations, including intra-industry trade, leads to greater synchronisation of economic shocks and cyclical alignment and hence to lower costs associated with the loss of independent monetary policy. Alignment is also supported by a high level of ownership links in terms of investment from euro area countries in the Czech Republic.

Chart 2.4: Exports to and imports from the euro area

in % of total exports and imports; annual moving total of the monthly data as of October 2024



Source: Eurostat (2025c). CNB calculations.

According to the CNB's calculations, the **alignment** of the Czech and euro area **financial cycles** rose slightly in 2023.

The **interest rate spread** between Czech and euro area rates has fallen slightly below the pre-pandemic level. Since mid-2022, the main factor behind the decline in the spread between short-term rates has been the tightening of ECB monetary policy. At the end of 2023, the Czech Republic began a cycle of monetary policy rate cuts, while euro rates stayed unchanged for another six months. This further narrowed the short-term interest rate differential (i.e. that between three-month interbank rates) to close to 1 percentage point. The response in long-term interest rates has been less pronounced, especially over the last year, so the spread between Czech and German government bond yields is higher than that between three-month rates at just under 2 percentage points.

The Czech currency reacts to changes in the environment outside the euro area similarly to the euro. The correlation of the koruna-dollar exchange rate with the euro-dollar exchange rate thus remains high. The volatility of the koruna-euro exchange rate has shown no clear trend in the past year. In addition to financial market sentiment, it has reflected changes in the monetary policy settings in the Czech Republic and the euro area. Although the exchange rate volatility of the koruna is low relative to other Central European currencies, it would pose a problem if the Czech Republic joined ERM II under a strict interpretation of the exchange rate criterion (requiring the exchange rate to stay much closer to the agreed central rate than indicated by the fluctuation band of ±15 %, see section 1.4).

The **alignment of financial markets** with the euro area has increased slightly. The alignment of the Czech and German government bond markets has returned to pre-pandemic levels, as has that of the Czech money and foreign exchange markets with the euro area market. The rate of transmission of global news to Czech financial markets has stabilised over the last year. In 2024, it remained elevated in the government bond and foreign exchange markets and was also little changed in the money market.

The **depth of financial intermediation** and the level of private sector debt remain relatively low in the Czech Republic. They are still well below the euro area average. There is considerable heterogeneity among EU countries in this area. Economies with lower depth of financial intermediation and debt ratios are generally less sensitive to shocks acting through the financial system. While this lower sensitivity reduces systemic risk (especially in terms of interest rate and credit risk), it may also weaken the transmission of monetary policy. The banking sector has long played the dominant role in financial intermediation in the Czech Republic, just like in all the other countries under review. The investment fund segment is also gradually gaining in significance. By contrast, the importance of the pension fund and insurance segments has been declining visibly in most of the countries under review (including the Czech Republic) over the last five years. Private sector debt has been falling gradually in all the countries under review except Germany since 2020.

The **similarity of the structure of the financial liabilities** of Czech and euro area companies has returned to relatively high levels after a temporary decline caused by the exceptional energy situation. A decline in the share of trade credits and advances in the total liabilities of Czech corporations long contributed to a decline in the structural mismatch. However, this trend has not continued over the last year. Additionally, a decline in structural mismatch has been fostered by convergence of the share of loans in total liabilities in the Czech Republic with that in the euro area, specifically an increase in this share in the Czech Republic and a simultaneous decrease in the euro area (to 24% in the Czech Republic and 25% in the euro area).

The **similarity of the structure of the financial assets** of Czech households and households in the euro area remains rather low. Czech households continue to prefer to hold investment fund units and shares, along with cash and deposits, while households in the euro area hold a large part of their balance sheets also in insurance and pension schemes. In addition, in the past year, a further increase in the proportion of shares and investment fund units held by Czech households has fostered an increase in the structural mismatch, with this share exceeding that of cash and deposits for the first time in the period under review. Differences in the asset structure of households in the Czech Republic and in the euro area may imply different sensitivities to changes in interest rates and hence different impacts of a single monetary policy.

The **structure of loans to non-financial corporations** by fixed-rate period is similar in the Czech Republic and the euro area. More than 84% of loans to non-financial corporations have floating rates or rates fixed for up to one year in the Czech Republic and in most of the euro area countries under review. Such a high share of loans with short fixed-rate periods implies fast transmission of changes in monetary policy rates and, in turn, interbank market rates to rates on loans provided to non-financial corporations.

Changes in monetary policy rates are most often and most strongly transmitted to client rates on loans to non-financial corporations in the Czech Republic through the three-month interbank market rate. Six-month rates are also relevant. In the Czech Republic, the transmission through short-term interbank rates has been complete in recent years, most of it taking place within one month. However, companies that use interest rate swaps to hedge large loans with variable rates may be less sensitive to changes in market rates. The spread between client rates on loans to non-financial corporations and the three-month interbank rate (the aggregate risk premium) in the Czech Republic fluctuated around its long-term average of 1.5 percentage points in the first half of last year and was slightly higher than in the euro area. This is due mainly to a decline in the spread in the euro area over the last two years to 1.2 percentage points. The spread in the euro area declined in parallel with the tightening of ECB monetary policy. Banks therefore absorbed part of the increase in monetary policy rates.

As regards **housing loans**, the trend towards shorter fixed-rate periods among Czech households continued. In 2024, fixed-rate periods of up to and including 5 years accounted for 86% of the volume of new housing loans in the Czech Republic. Households preferred shorter or flexible fixed-rate periods due to expectations of a fall in interest rates. At the same time, banks limited the supply of longer fixed-rate periods because of the risk of early repayment by clients. The main difference between the fixed-rate structure in the Czech Republic and that in the euro area still consists in the share of fixed-rate periods of over ten years. This is negligible in the Czech Republic, while it is 49% in the euro area. Households with long fixed-rate periods are less sensitive to fluctuations in interest rates.

The **financing of Czech corporations in foreign currency** (mainly in euro) stabilised in 2024 after a previous increase, while the share of foreign currency loans and deposits of Czech households has long remained very low. The share of foreign currency in the financing of Czech companies from domestic banks and from abroad (via foreign parent companies or directly by domestic corporations abroad) has been close to 60% since 2023. Monetary policy thus affects a smaller proportion of corporate debt financing through the interest rate channel of the transmission mechanism than in the past. The share of foreign currency corporate loans from domestic banks stabilised at close to 52% amid a decline in the differential between domestic and foreign interest rates and remains above the long-term trend. As a result of the easing of the CNB's restrictive monetary policy stance, the interest rate differential on corporate loans declined to around 1 percentage point in 2024, as against 6 percentage points in 2022. The decline in the interest rate differential is making euro financing less attractive to corporations and is likely to foster a return of the share of foreign currency loans to close to its trend. This share has long been rising, mainly due to strong trade links with the euro area and corporations' efforts to hedge naturally against exchange rate risk. The gradual euroisation of the Czech economy can be expected to continue in line with this trend. There may be a further increase in euroisation in connection with an amendment to the Accounting Act allowing selected entities to keep accounts in euro as of 1 January 2024 and with a draft amendment to the Labour Code that would allow wages to be paid to certain professions in euro.

According to the CNB's calculations, **inflation persistence**, which expresses the pace of return of inflation to equilibrium, has increased in all the countries under review. In the Czech Republic, it is still one of the lowest. However, the difference compared to euro area countries is not significant, so the single monetary policy would have similar effects on inflation in this respect.

2.2 Adjustment Mechanisms

If set correctly, **fiscal policy** should be a stabilising element for the economy. Otherwise, it becomes a source of shocks and deepening macroeconomic imbalances.

While fiscal policy in the Czech Republic has helped mitigate the adverse economic effects of the 2020–2023 crisis, it has also led to one of the largest increases in public debt relative to GDP in the EU. The ratio of the general government deficit to GDP has exceeded the 3% Maastricht convergence criterion reference value every year since the outbreak of the Covid-19 pandemic in 2020. This has led to a sharp rise in general government debt servicing costs amid soaring interest rates. Virtually all EU Member States have responded actively to the crises of recent years with fiscal policy, but the Czech Republic has stood out with its exceptionally long-lasting fiscal stimulus. Despite this, it remains one of the least indebted EU Member States. As regards the fulfilment of EU fiscal commitments, the Czech Republic avoided the opening of an excessive deficit procedure in 2024 (when the general escape clause of the Stability and Growth Pact had already been deactivated), due mainly to the consolidation package.

The general government deficit should fall below 3% of GDP in 2024. Along with the persisting government structural deficit, the current high share of mandatory and quasi-mandatory expenditures – over 90% of state budget revenues – very significantly limits the flexibility of, and any changes in, economic policy. Some areas of long-term public finance sustainability, which mainly reflects the fiscal impact of population ageing, remain unresolved. However, the pension reform approved at the end of 2024 should bring about positive changes in this area.

The labour market is another important mechanism through which the economy can cope with asymmetric shocks in the absence of independent monetary policy.

Indicators of the real part of the Czech labour market have remained largely unchanged despite the recent headwinds in the economy and the episode of elevated inflation. The key challenge is still persistently low female participation rates in some age cohorts. The long-term unemployment rate, which is among the lowest in the EU and has remained low even in the turbulent economic environment of recent years, remains a positive factor. Moreover, the labour market has absorbed a large number of foreign workers (from Ukraine and elsewhere). On the other hand, labour market rigidities persist in the regional mobility of workers and a low willingness of employees to change jobs, which may hinder a more effective allocation of resources supporting a more dynamic recovery in labour productivity. The rate of economic activity of the population is at a historical high and the labour market participation rate of people of pre-retirement age is high compared to other countries and continues to grow.

However, some long-running issues in the labour market persist. Despite rising steadily, the participation rate of women remains lower than in other countries. However, the proposed "flexible" amendment to the Labour Code currently under discussion could help improve the situation. This amendment includes provisions allowing a combination of parental leave with an agreement to complete a job or an agreement to perform work with the same employer for the same type of work as specified in the employee's employment contract. The share of part-time jobs remains relatively low by international standards.

As regards nominal variables, lower labour taxation than in more advanced EU countries and a still low minimum wage relative to the average wage are contributing to labour market flexibility. Tax changes in 2021 helped reduce overall labour taxation. This was also reflected in a moderation of the "low-wage trap", which reduces the incentive to seek better-paid work. Despite declining, the "unemployment trap", which reduces the incentive to return to employment, remains relatively high. The ratio of the minimum wage to the average wage (40% in 2023) is lower than in the other countries under review, although the indicator may be distorted by guaranteed wages in the Czech Republic. However, under an approved amendment to the Labour Code, it will gradually increase to 47% in 2029.

According to an indicator published by the Institute for Management Development (IMD, 2024), the Czech Republic remains among the better-scoring countries under review as regards overall competitiveness, despite seeing a decline in its competitiveness last year.

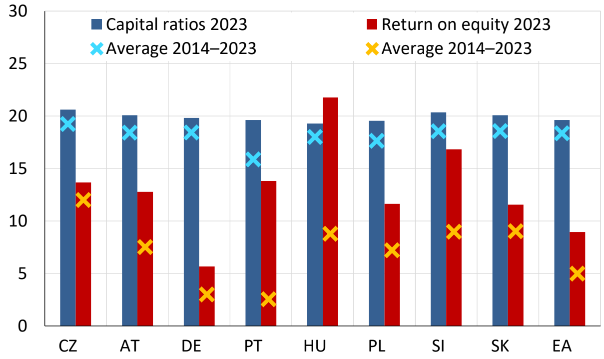
The condition of the **financial sector** plays an important role in the economy's ability to absorb economic shocks.

The Czech **banking sector** fared well in 2023 and maintained its high resilience to potential adverse shocks. Its capital position remained robust thanks in part to prescribed capital buffers and voluntary capital surpluses in excess of the regulatory requirements and was mostly higher than in the other countries under review. Capital buffers, along with a capital surplus, create favourable conditions for smooth lending to the real economy and for absorbing any increased credit losses. The profitability of the Czech banking sector declined slightly year on year but remains above the euro area average. The solid profitability in the Czech Republic and other EU countries was due mainly to low impairment losses and stable interest profit.

The liquidity position of the domestic banking sector improved in 2023 and remains robust due to persistently high shares of liquid assets and stable funding sources. The default rate in the Czech Republic, as in the other countries under review, remains near a historical low despite the persisting environment of relatively high interest rates.

Chart 2.5: Banking sector indicators in 2023

in %



Note: The capital ratio is the ratio of a bank's capital to its risk-weighted assets. It thus expresses the bank's financial strength and measures its ability to cover any future losses with capital.
Source: ECB (2024).

3 Situation and Institutional Developments in the Euro Area

It has been more than 20 years since the Czech Republic signed its commitment to adopt the euro. During that period, the EU has been through a major economic recession which – in some euro area countries – subsequently transformed into a debt crisis, followed by a pandemic crisis and an energy crisis triggered, among other things, by Russia's military aggression against Ukraine. These and other events have shaped and will continue to affect euro area integration aimed at strengthening economic and fiscal coordination and completing the banking union and the capital markets union. Over the years, the euro area has also expanded to include new members – most recently on 1 January 2023, when Croatia became its 20th member. Bulgaria is also seeking to join the monetary union. Its ambition was to become a member at the same time as Croatia. However, it failed to achieve this goal, and the target date for Bulgaria's entry has been repeatedly postponed (it is currently 1 January 2026).

Euro adoption is associated with costs arising from new institutional commitments due to developments in the euro area, including the obligation to join the banking union and the European Stabilisation Mechanism. New institutions and regulations are thus changing the shape of the euro area and hence also the content of the obligation to adopt the euro, which will have to be properly assessed and considered in decisions on the timing of monetary union entry.

3.1 Situation in the Euro Area

Economic alignment of euro area countries is essential to the smooth functioning of the monetary union. However, the series of events faced by the global economy after 2019 exacerbated the macroeconomic imbalances of the euro area countries, amplifying the already fundamental **structural and economic differences**.

The year 2024 was characterised by a fading energy crisis. Supply chains were operating without major issues, but inflation remained high in many countries despite falling gradually, and thus continued to erode households' purchasing power. Economic activity was dampened by restrictive monetary policy, ongoing military conflicts and associated heightened uncertainty limiting international trade and investment activity in particular. However, the European economy proved highly resilient to these negative factors, although the intensity of the impacts differed from country to country. This was most likely due to different economic structures and levels of openness and different trading partner diversification, especially as regards energy commodity suppliers. The hardest-hit countries in the monetary union were Ireland, Estonia and Finland, while the impacts on the economic growth of southern European countries were dampened by a continuing post-pandemic recovery in the services sector. The trends in the relative economic levels of the Member States thus remain very uneven.

Relatively strong demand for labour and firms' efforts to retain highly qualified staff resulted in **labour market** tightness and a drop in the unemployment rate in most euro area countries in 2023. However, significant differences persist across countries. In 2023, the unemployment rate exceeded 11% in Greece and in Spain, while in Italy, Finland, France and Sweden it was above 7%. By contrast, the unemployment rates in Germany and Malta were no higher than 3.5% in the same year. Unemployment showed a downward trend in the euro area as well in 2024. In the autumn, however, this halted and the rate stayed at 6.3% until November. Given the expected modest economic upswing, employment could also continue to rise in 2025.

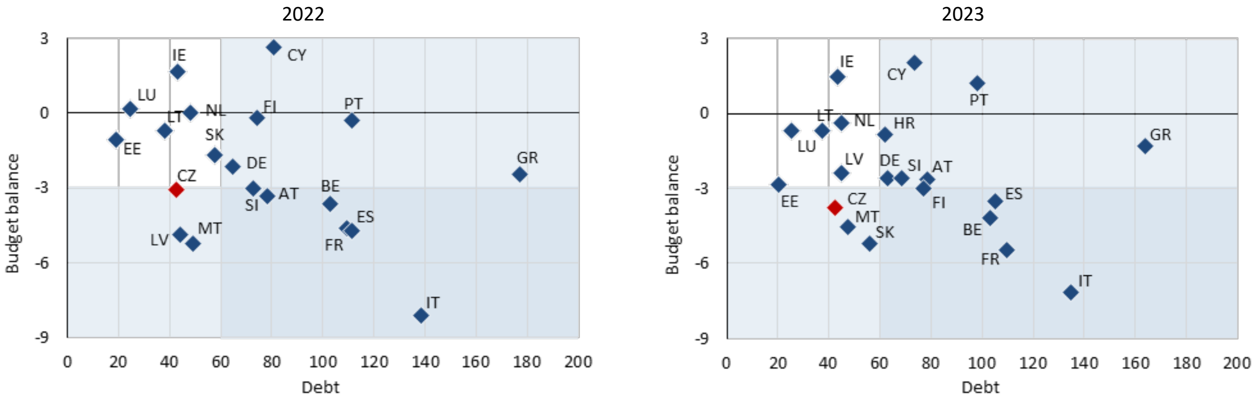
After peaking in double figures in October 2022, **inflation** in the euro area started to slow due to a sharp drop in energy commodity prices. However, the pace of price growth differs across the countries of the monetary union. In December 2024, the highest annual inflation rates (4.0% or more) were in Belgium, Estonia and Croatia. By contrast, the lowest (below 1.5%) were in Italy and Ireland. Fearing that inflation would remain above the 2% target for an extended period, the European Central Bank continued to raise its key interest rate until September 2023, to 4%. It only started lowering the rate in 2024, reducing it to 2.75% in January 2025.

Public finance performance in a number of euro area countries (see Chart 3.1) has improved slightly due to public budget consolidation and a reduction in compensation for high energy prices. However, most countries' debt remains high and well above the limit. Higher defence spending combined with very moderate economic growth led to a slight increase in the euro area general government **deficit** to 3.6% of GDP on average in 2023. The average debt fell to 87.4% of GDP. **General government debt** exceeded 60% of GDP in 12 countries, with debt-to-GDP ratios exceeding 100% in five countries (Belgium, France, Greece, Italy and Spain). In 2023, only six of the 20 euro area countries were compliant with both the deficit and debt benchmarks (Estonia, Ireland, Latvia, Lithuania, Luxembourg and the Netherlands).

The discontinuation of energy measures, the ongoing process of fiscal consolidation and the gradual economic recovery are likely to lead to a further decline in the general government debt-to-GDP ratio in 2024 and 2025.

Household consumption is expected to aid the economic recovery due to falling inflation and rising real wages. Like corporate investment activity, household consumption is also expected to be supported by the ongoing reduction of the ECB's key interest rate. Conversely, foreign trade could dampen growth due to adverse developments in the industrial sector.

Chart 3.1: Fiscal positions in the euro area and the Czech Republic
in % of GDP



Note: The Czech Republic is not a euro area country and is only listed here for comparison. Data as of 22 October 2024.
Source: Notification tables of the various countries, Eurostat (2024).

3.2 Institutional Developments in the EU and Related Obligations

Since the Czech Republic joined the EU, many reforms have been implemented to **enhance the stability and deepen the integration of the union**. Nonetheless, the institutional framework of the EU and the euro area is continuing to evolve. The Czech Republic faces further institutional and financial changes and obligations arising from previously submitted and expected future proposals. These must be taken into account when debating the timing of euro area entry.

A Strategic Agenda for 2024–2029 was adopted at the European Council meeting in June 2024 (Council of the EU, 2024a). This set out priorities for the direction of the EU and, among other things, confirmed the ambition to strengthen the long-term competitiveness of the EU and improve the living standards of its citizens (economically and socially). The strategic agenda outlines the EU's priorities aimed at reinforcing Europe's sovereignty in strategic sectors and making it a technological and industrial powerhouse. These include a deeper single market and, in line with previous efforts to deepen economic and monetary union, achieving a capital markets union and completing the banking union.

As regards the **banking union project**, after relatively rapid progress between 2012 and 2014 – when significant advances were made in establishing a single rulebook and creating the first two pillars of the banking union in the form of the Single Supervisory Mechanism and the Single Resolution Mechanism – further discussions have slowed considerably. This has occurred amid a debate on the possible future shape of the European Deposit Insurance Scheme, on which there is still no agreement among Member States on its form or necessity. Partial progress was achieved in 2019 (i.e. before the pandemic) with the adoption of a banking package to strengthen the resilience and resolvability of EU banks (Council of the EU, 2019). The package enshrined a set of reforms aimed at improving the situation in these areas. It also implements important international standards and aims to contribute to the completion of the implementation of "post-crisis" international regulation. In the context of strengthening bank resilience, it is worth mentioning the publication of another banking package of legislative proposals in 2021 (EC, 2021a) focused on completing the implementation of the rest of the Basel III standards. The Council adopted the package, which amends the Capital Requirements Directive and the Capital Requirements Regulation, at the end of May 2024, with the new rules expected to apply mostly from the start of 2025/2026 (Council of the EU, 2024b). Owing to the delayed implementation of the Basel III rules in the USA, and to prevent the EU banking sector from being put at a competitive disadvantage, it was decided in July 2024 to postpone the application of one part of the Basel III standard – specifically the prudential requirements for market risk – by one year.

In June 2022, the Eurogroup adopted a statement (Council of the EU, 2022) declaring that work on completing the banking union should focus directly on strengthening the crisis management framework for banks and national deposit insurance schemes. In April 2023, the Eurogroup followed up on this statement, after which the Commission presented a proposal for a legislative package on the crisis management and deposit insurance framework (EC, 2023b). In May 2024, the Council adopted a general position on this package (Council of the EU, 2024c). The other three topics previously discussed – the introduction of a European Deposit Insurance Scheme, the strengthening of crossborder integration of banking groups and the regulation of holdings of sovereign exposures (government bonds) by domestic banks – were set aside for the time being.

In the area of reducing the level of non-performing loans, the Council underlined the need to proceed swiftly with legislative proposals on secondary markets for these loans and accelerated extrajudicial collateral enforcement (see Council of the EU, 2021). However, the directive on accelerated extrajudicial collateral enforcement (European Parliament and Council of the EU, 2018) is still awaiting the adoption of the European Parliament's mandate. By contrast, substantial progress has been made in developing the aforementioned secondary market for NPLs, in particular the adoption of Directive (EU) 2021/2167 of the European Parliament and of the Council on credit servicers and credit purchasers (European Parliament and EU Council, 2021a). The directive is being implemented through Act No. 84/2024 Coll., on the market for non-performing loans, and Act No. 85/2024 Coll., amending certain laws in connection with the adoption of the Act on the market for non-performing loans. Both laws were published in the Collection of Laws in April 2024.

In the context of the negotiations on deeper economic and monetary union, meetings were held from the end of 2017 to March 2020 on reforming the **European Stability Mechanism (ESM)**. This reform also concerned the introduction of a new instrument called the common backstop to the **Single Resolution Fund**. The target level of this fund was reached at the end of 2023, when the resources available amounted to EUR 78 billion.

In 2021 Q1, the euro area member states as the shareholders of the European Stability Mechanism (ESM) signed a revised ESM Treaty (ESM, 2021) providing the legal basis for a set of new competences for the European Stability Mechanism. The treaty will enter into force after ratification by the parliaments of the countries concerned. Italy is the last signatory Member State that has yet to ratify the reformed Treaty.

Since 2015, the EU has been developing the concept of a **capital markets union (CMU)**. In line with its medium-term work plan in this area, the Commission in November 2021 presented another package of legislative proposals on the CMU (EC, 2021b) aimed primarily at improving investor access to company and trading data. The legislative process for these proposals was completed in March 2024. The Commission supplemented this package with additional legislative proposals in December 2022 (EC, 2022). The Council and the European Parliament have reached preliminary agreement on some of them. In 2023 and early 2024, the Eurogroup undertook a strategic initiative to reach agreement among the finance ministers of all EU Member States on the top priorities for strengthening and deepening European capital markets in the coming years. The initiative complements ongoing legislative work on the capital markets union. The Eurogroup March 2024 agreement (see Council of the EU, 2024d) includes additional measures that must be pursued as a priority to create a thriving capital markets ecosystem within the EU, commensurate with the EU's position as the world's largest single market. Member States' finance ministers have identified three priority areas where policy action is necessary to improve the functioning of European capital markets: **(1)** developing a competitive and smart regulatory and supervisory system, **(2)** ensuring that EU businesses have better access to private funding, and **(3)** facilitating citizens' access to capital markets. The development of the CMU as one of the key priorities for the 2024–2029 EU institutional cycle is also proposed in the reports published in 2024 by Enrico Letta (Letta, 2024) and Mario Draghi (Draghi, 2024) and in the political guidelines for the new European Commission (EC, 2024d).

The EU's main pillar for implementing EU policies and responding to external shocks is the **Multiannual Financial Framework for 2021–2027**, approved at EUR 1,074 billion (at 2018 prices). New instruments will be created and key programmes strengthened so that investment can be channelled swiftly to where it is needed most. In response to global developments and their impacts on the EU and the new challenges the EU is facing, the Commission made a proposal for a mid-term revision of the framework in June 2023. The proposal focuses on three political priorities: assisting Ukraine, supporting Member States on migration issues and establishing the Strategic Technologies for Europe Platform. The above revision was definitively approved in February 2024. The Multiannual Financial Framework was increased by EUR 21 billion in grants to support these political priorities. It now also covers support for Ukraine in the form of loans of up to EUR 33 billion. The changes apply retroactively from 1 January 2024.

The other pillar is the EUR 750 billion **Recovery plan for Europe** – **"Next Generation EU"** – aimed at temporarily boosting the EU budget with financing raised on the financial markets. The centrepiece of the recovery plan is a **Recovery and Resilience Facility** (European Parliament and EU Council, 2021b). The aim of the facility is to provide large-scale financial support for reforms in the Member States and for public investment projects that will strengthen the cohesion and resilience of the Member States. The approved maximum allocation of EUR 648 billion (at current prices) is a combination of grants (EUR 357 billion) and supplementary voluntary preferential loans (EUR 291 billion). By the cut-off date for this assessment, the Commission had already disbursed EUR 269.5 billion (at current prices), with the Czech Republic having received EUR 2.7 billion in grants from its allocation.

On the revenue side of the EU budget, the Commission presented two packages of proposals for new own resources, which should primarily be used to repay loans under the Recovery Plan for Europe. The first package, put forward in December 2021, proposes a new financing source based on revenues from emission allowances, revenues from the carbon border adjustment mechanism and a source based on the profits of multinational companies. In the second package presented in June 2023, the Commission updated the first two aforementioned resources and complemented them with a proposal for a new temporary statistical own resource based on company profits. The Council, which decides unanimously on own resources, is now discussing the proposals.

Following the **REPowerEU** initiative, which aims to end the EU's dependence on imports of fossil fuels from Russia, the financial envelope of the Recovery and Resilience Facility was increased by EUR 20 billion.

The end of April 2024 saw the completion of the legislative process on the proposals to **reform the EU's fiscal governance framework** (Council of the EU, 2024e). The primary aim of the new framework is to strengthen debt sustainability and promote economic growth in all Member States through reforms and investment. The reform proposes to simplify economic governance, increase Member States' responsibility for defining their commitments and strengthen the focus on the medium term. Specifically, the changes will be reflected in the European Semester in the replacement of National Reform Programmes and Convergence Programmes (or Stability Programmes) with medium-term fiscal-structural plans, which are the cornerstone of the new framework. The plans integrate fiscal and structural aspects and the reform and investment commitments of the Member States. In addition to the fiscal level, the plans should focus on describing the implementation of reforms and investments that respond to the challenges identified in the context of the European Semester and address common priorities of the EU. A key element of the plan is a net expenditure path, i.e. a multi-year spending plan for each Member State spanning at least four years in line with the length of the period covered by the fiscal-structural plan. The Member States were required to submit their first fiscal-structural plans to the Commission by 20 September 2024, unless they had agreed with the Commission to extend that deadline by a reasonable period. By the cut-off date of this report, the Commission had received fiscal-structural plans from 22 Member States (including the Czech Republic). These were endorsed by ECOFIN (the Member States' finance ministers) and in accompanying Council recommendations.

No excessive deficit procedure was proposed against any Member State while the general escape clause was active (from March 2020 to the end of 2023).[5] In summer 2024, the Commission proposed that the Council open this procedure against seven Member States (Belgium, France, Hungary, Italy, Malta, Poland and Slovakia) based on the budget deficit criterion. At the same time, the Commission recommended continuing the excessive deficit procedure opened in 2020 against Romania, as it had not taken sufficient action to correct its excessive deficit. At the end of 2024, following an assessment of the fiscal-structural plans, the Council was called upon to adopt a recommendation requiring the above Member States to take effective action to correct their excessive deficits within the specified deadline. This is important, among other things, for the assessment of the criterion on the government financial position. In the context of the new EU fiscal rules, it has not yet been possible to open an excessive deficit procedure based on the debt criterion, as the Council has not yet set net expenditure paths for the Member States. If the Member States (including the highly indebted ones) follow this path, thereby credibly reducing their debt and approaching the reference value of 60% at a satisfactory pace, they will not be subject to an excessive deficit procedure.

There has been no further enlargement of the monetary union since Croatia's accession on 1 January 2023. Apart from Denmark, which has a permanent opt-out from the euro, only Bulgaria remains in the ERM II system. Bulgaria joined ERM II along with Croatia in July 2020. The **entry of Croatia and Bulgaria into ERM II** in July 2020 as part of the process of adopting the single currency was accompanied for the first time by their **simultaneous entry into the banking union**. Although the entry of the two countries into the banking union was formally a voluntary commitment, it was de facto a condition for joining ERM II. This approach was identified by the ERM II participants as a precedent for other candidates, so it can be assumed that it will be required of all future applicants for ERM II entry. However, EU law does not make accession to the banking union a condition for joining ERM II. **The Czech Republic does not feel legally obliged to adopt Bulgaria's and Croatia's approach** and does not regard participation in the banking union as a necessary condition for ERM II entry.

Given the ongoing discussions in the EU about the future institutional arrangement of the euro area, the obligations that would arise for the Czech Republic on accession to the euro area cannot be fully assessed at present. Selected estimated financial liabilities and costs associated with the Czech Republic's hypothetical entry into the euro area, which arise mainly from participation in the banking union and the ESM and payment of the rest of the share in the subscribed capital of the ECB, are quantified in Appendix B.

[5] In the case of Romania, this procedure continued while the escape clause was active.

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A Appendix – Maastricht Convergence Criteria

Criterion on Price Stability

Treaty provisions

The first indent of Article 140(1) of the Treaty requires: "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 Protocol No. 13 on the Convergence Criteria also stipulates 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".

Application of Treaty provisions in ECB and EC Convergence Reports

With regard to "an average rate of inflation, observed over a period of one year before the examination", the inflation rate is calculated using the increase in the latest available 12-month average of the Harmonised Index of Consumer Prices (HICP) over the previous 12-month average.

The reference value of the price criterion is calculated as 1.5 percentage points plus the simple arithmetic average of the rate of inflation in the three countries with the lowest inflation rates, provided that this rate is compatible with price stability.

Implementation of the price stability criterion – current practice

Both the Treaty and the Protocol in some areas leave scope for interpretation by the institutions that assess the fulfilment of the criteria in their Convergence Reports (the European Commission and ECB). Therefore, when assessing the fulfilment of the criteria one should also take into account the specific way in which these institutions implement the criterion. Previous practice shows that countries with low or negative inflation rates are not automatically excluded as reference countries. Only countries that record significant deviations in inflation from the other EU countries owing to extraordinary or specific factors are excluded.

Criterion on the Government Financial Position

Treaty provisions

The second indent of Article 140(1) of the Treaty requires "the sustainability of the government financial position; this will be apparent from having achieved a government budgetary position without a deficit that is excessive as determined in accordance with Article 126(6) of the Treaty".

Article 2 of Protocol No. 13 on the Convergence Criteria stipulates that this criterion "shall mean that at the time of the examination the Member State is not the subject of a Council decision under Article 126(6) of this Treaty that an excessive deficit exists".

Article 126 of the Treaty sets out the excessive deficit procedure, which is specified in more detail in the Stability and Growth Pact. According to Article 126(3) of the Treaty, the European Commission shall prepare a report assessing whether an excessive deficit exists on the basis of the following two criteria if a Member State does not fulfil the requirements for budgetary discipline.

1. whether the ratio of the planned or actual government deficit to GDP exceeds a reference value (defined in Protocol No. 12 on the excessive deficit procedure as 3% of GDP), unless:
    a. either the ratio has declined substantially and continuously and reached a level that comes close to the reference value;
    b. or, alternatively, the excess over the reference value is only exceptional and temporary and the ratio remains close to the reference value.
2. whether the ratio of government debt to GDP exceeds a reference value (defined in the Protocol on the Excessive Deficit Procedure as 60% of GDP), unless the ratio is sufficiently diminishing and approaching the reference value at a satisfactory pace.

However, several other steps need to be taken between the European Commission's report and the start of the excessive deficit procedure. The excessive deficit procedure is opened by the EU Council, acting on a proposal from the European Commission. The EU Council also closes the procedure, acting on a recommendation from the Commission.

Criterion on the Convergence of Interest Rates

Treaty provisions

The fourth indent of Article 140(1) of the Treaty requires: “the durability of convergence achieved by the Member State…and of its participation in the exchange-rate mechanism being reflected in the long-term interest-rate levels”.

Article 4 of Protocol No. 13 on the Convergence Criteria specifies 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 two 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”.

Implementation of the criterion on the convergence of interest rates

As in the case of the price stability criterion, the Treaty and the Protocol provide scope for a looser interpretation of the specific value of the criterion. It is within the competence of the assessing institutions to decide whether the calculation of the interest rate criterion will include all three countries used for the calculation of the price stability criterion or whether certain countries will be excluded from the calculation of the interest rate criterion.

Interest rates measured on the basis of long-term government bonds or comparable securities are regarded as long-term interest rates. These interest rate statistics are based on monthly average interest rates on long-term government bonds in per cent per annum. Bonds with residual maturities ranging from 8 to 12 years are classified as benchmark bonds (this range is fully in line with the conditions on the Czech government bond market and is based on the Czech government bond issue frequency). A combination of bonds whose average residual maturity is as close to 10 years as possible is then generated from this set.

Criterion on Participation in the Exchange Rate Mechanism

Treaty provisions

The third indent of Article 140(1) of the Treaty requires: “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 Protocol No. 13 on the Convergence Criteria stipulates that: “The criterion on participation in the exchange-rate mechanism of the European Monetary System referred to in the third indent of Article 140(1) of the Treaty 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”.

Application of Treaty provisions in ECB and EC Convergence Reports

The Treaty refers to the criterion of participation in the European exchange-rate mechanism (ERM until December 1998 and ERM II since January 1999).

First, the ECB and the EC assess whether the country has participated in ERM II “for at least the last two years before the examination”, as stated in the Treaty.

Second, as regards the definition of “normal fluctuation margins”, the ECB recalls the formal opinion that was put forward by the European Monetary Institute Council in October 1994 and its statements in the November 1995 report entitled “Progress towards Convergence”.

The European Monetary Institute Council’s opinion of October 1994 stated that “the wider band has helped to achieve a sustainable degree of exchange rate stability in the ERM”, that it “considers it advisable to maintain the present arrangements”, and that “member countries should continue to aim at avoiding significant exchange rate fluctuations by gearing their policies to the achievement of price stability and the reduction of fiscal deficits, thereby contributing to the fulfilment of the requirements set out in Article 140(1) of the Treaty and the relevant protocol”.

In the “Progress towards Convergence” report it was stated that “when the Treaty was conceived, the ‘normal fluctuation margins’ were ±2.25% around bilateral central parities, whereas a ±6% band was a derogation from the rule. In August 1993, the decision was taken to widen the fluctuation margins to ±15% from the agreed central rate. The interpretation of the criterion, particularly the concept of ‘normal fluctuation margins’, became less straightforward.”

It was then also proposed that account would need to be taken of “the particular evolution of exchange rates in the European Monetary System (EMS) since 1993 in forming an ex post judgement”.

Against this background, in the assessment of exchange rate developments the emphasis is placed on exchange rates being close to the ERM II central rates.

Third, the issue of the presence of “severe tensions” or “strong pressures” on the exchange rate is addressed by examining the degree of deviation of exchange rates from the ERM II central rates against the euro. Other indicators, such as short-term interest rate differentials vis-à-vis the euro area and their evolution, are used as well. The role played by foreign exchange interventions is also considered.

In its Convergence Reports, the Commission also regularly refers to the Common Statement of the Finance Ministers, the ECB President and the Commission members on ERM II and the then acceding Member States by the Informal ECOFIN Council, Athens, 5 April 2003. This statement states that the assessment of exchange rate stability will focus on the exchange rate of the national currency against the euro being close to the agreed central rate while also taking into account factors that may have led to an appreciation of the national currency during its stay in ERM II.

B Appendix – Financial Obligations for the Czech Republic of Euro Area Entry

This Appendix lists the estimated direct financial costs in the hypothetical case of the Czech Republic entering the euro area, and the financial obligations closely linked with entry. These are the financial costs and obligations for the Czech Republic (general government) or economic entities established in the Czech Republic. With the exception of the obligation vis-à-vis the ECB, these obligations arose after the Czech Republic's EU entry as a result of the further development of the EU, and therefore were not known at the time the Czech Republic committed to adopt the euro. Besides the current legislation, the calculations are based on a number of assumptions. An exchange rate of CZK 25.2 to the euro, the expected exchange rate in 2024 Q4, was always used to convert the obligations and costs expressed in euro into Czech koruna.

	Estimate[1]
Payment of the rest of the CNB's share in the subscribed capital of the ECB and transfer of part of the CNB's international reserves to the ECB.	
− Following euro area entry, the CNB would have to pay up the outstanding amount of the subscribed capital of the ECB (Article 48 of the Protocol (No. 4) on the Statute of the European System of Central Banks and of the ECB). − Only a minimal percentage (3.75%) of the subscribed capital of the ECB has been paid up to date, as a contribution to the operational costs of the ECB (Decision ECB/2020/2).	EUR 0.2 billion CZK 5.2 billion
− In accordance with Article 48(1) of Protocol No. 4, the CNB will also transfer part of its international reserves to the ECB.	EUR 1 billion CZK 25 billion
Obligations associated with the Czech Republic's participation in the European Stability Mechanism	**Estimate**
− The total obligation is CZK 429.8 billion, of which CZK 380.7 billion is a contingent liability payable in the event of full use of the European Stability Mechanism's lending capacity and in the extreme scenario. − The Czech Republic would thus have to pay up capital totalling around CZK 49.1 billion within four years, for which it would receive shares of the European Stability Mechanism with the same total nominal value. The Czech Republic will also acquire the relevant shareholder rights and obligations. − The Czech Republic may theoretically adopt the euro without becoming a contracting party to the European Stability Mechanism, but euro area members can de facto make their consent to euro adoption in the Czech Republic conditional on European Stability Mechanism entry.	EUR 1.9 billion CZK 49.1 billion
Liabilities to the Single Resolution Fund	**Estimate[2]**
− The Czech Republic is obliged to join the banking union no later than upon euro adoption. − The intergovernmental Agreement on the transfer and mutualisation of contributions to the Single Resolution Fund requires that funds from the national resolution tool – the Resolution Fund in the case of the Czech Republic – be transferred to the Single Resolution Fund.	up to EUR 1.5 billion up to CZK 38.4 billion
− The annual fees that Czech banks would pay for the operation of the Single Resolution Board. − The provisions of the Agreement will start to apply to the Czech Republic upon euro area entry (or banking union entry, should the Czech Republic join the banking union before adopting the euro).	direct: a few hundred thous. EUR; indirect: a few mil. EUR[3]
Costs associated with the Czech Republic's participation in the Single Supervisory Mechanism	**Estimate[3]**
− The annual fees that Czech banks would pay the ECB for supervision.	direct: a few hundred thous. EUR; indirect: several mil. EUR

Note: 1) *Moreover, the adoption of the euro entails a potential obligation for the central bank of the acceding country to contribute to the reserves of the ECB. The details of this transfer are set out in an agreement between the ECB and the acceding country's central bank, as well as in an ECB decision in accordance with the Statute of the ESCB (Article 48(2)) and the balance of the ECB's profit and loss account as at 31 December of the year prior to the abrogation of the derogation. In the case of the Czech Republic, this contribution could amount to several hundred million euros.*
2) *The available funds of the Resolution Fund as of 30 September 2024. However, the amount of funds transferred will depend on the risk profile of Czech banks and on the specific number of Member States that join the banking union. In the case of the Czech Republic, with its generally less risky banking sector, the amount transferred would probably be lower than stated here.*
3) *Direct costs only include fees to be paid directly by small and some medium-sized Czech banks. Moreover, indirect costs also include fees for large and some medium-sized Czech banks, which would, however, be covered by their parent institutions.*

The Appendix does not capture other factors that would have an impact on the Czech Republic's budget or, more broadly, on the conduct of budgetary and fiscal policy in the event of euro area entry. Budgetary impacts would stem from any financial penalties that might be imposed on euro area countries under EU surveillance of members' budgetary policies or surveillance of macroeconomic imbalances. The implementation of budgetary and fiscal policy in the Czech Republic would be affected, among other things, by Regulation (EU) No. 473/2013 of the European Parliament and of the Council, which deepens EU surveillance of euro area members' budgetary policies.

Glossary

An **asymmetric shock** is a macroeconomic shock with an uneven impact on the individual countries of the monetary union.

Convergence means the tendency of less advanced economies to catch up with the more advanced ones. As a rule, the level of gross domestic product per capita at purchasing power parity is compared.

Correlation is the statistical expression of the relationship between two variables. Correlation does not imply that the evolution of one variable is a cause and that of the other a consequence.

The **cyclically adjusted balance** of the general government sector is used to identify the fiscal policy stance, as it does not include revenues and expenditures generated by the position of the economy in the business cycle.

Discretionary measures are direct interventions by executive or legislative authorities in the revenues and expenditures of the general government sector.

The **euro area** comprises the EU Member States that have adopted the euro under the Treaty. As of 1 January 1999, the euro area consisted of eleven countries – Austria, Belgium, Finland, France, Germany, Ireland, Italy, Luxembourg, the Netherlands, Portugal and Spain. Greece joined the euro area in 2001, followed by Slovenia in 2007, Cyprus and Malta in 2008, Slovakia in 2009, Estonia in 2011, Latvia in 2014, Lithuania in 2015 and Croatia in 2023.

The **European Stability Mechanism** is a financial assistance fund for EU Member States that use the euro as their currency. It was established in 2012 by an international treaty outside EU law, so it is an independent international financial institution. However, its operations are closely linked with EU law as well as EU and euro area institutions.

The **general government sector** is defined using internationally harmonised rules at EU level. In the Czech Republic, it consists of three main subsectors under ESA 2010 methodology: central government, local government and social security funds.

The **Harmonised Index of Consumer Prices** is an index measuring the price level. It is constructed on the basis of regular monitoring of prices of selected goods and services, which have certain weights in the consumer basket. Its calculation in EU countries is governed by unified and legally binding procedures, which enables cross-country comparisons. It is therefore used to assess the criterion on price stability.

Inflation is growth in the general price level, i.e. internal depreciation of a currency. The price level is measured using price indices such as the Harmonised Index of Consumer Prices.

Long-term interest rates are measured on the basis of long-term government bonds or comparable securities. These interest rate statistics are based on monthly average interest rates on long-term government bonds in per cent per annum. Bonds with residual maturities ranging from 8 to 12 years are classified as benchmark bonds (this range is fully in line with the conditions on the Czech government bond market and is based on the Czech government bond issue frequency). A combination of bonds whose average residual maturity is as close to 10 years as possible is then generated from this set.

The **net expenditure path** is the single operational indicator for assessing the implementation of the new fiscal framework. It defines general government expenditure net of interest expenditure, expenditure on programmes of the EU fully matched by revenue from EU funds, discretionary revenue measures, one-offs and other temporary measures, national expenditure on co-financing of programmes funded by the EU and cyclical elements of unemployment benefit expenditure.

One-off and other temporary operations are measures on the revenue or expenditure side that have only a temporary effect on the general government balance and often stem from events beyond the direct control of executive or legislative authorities (e.g. expenditure on flood damage repairs).

The **Single Resolution Fund** is a fund financed by contributions from banks, collected by the participating countries. Lending between national compartments will be allowed. To prevent a shortage of funds in the Single Resolution Fund during a transitional period (until the end of 2023), the states of the banking union have agreed on temporary public funding in the form of individual (not mutualised) credit lines. A permanent mechanism of financial backstops should be fully operational by the end of the transitional period.

The **Single Resolution Mechanism** is a mechanism comprising a centralised board, which will prepare proposals for bank resolution procedures, and a fund for bank resolution in the banking union. Its objective is to ensure proper bank resolution with a minimal impact on public budgets, as the bank's shareholders and creditors, as well as a dedicated fund financed by banks themselves, will bear primary responsibility for covering any losses.

The **Single Supervisory Mechanism** is a new system of banking supervision in the EU. It falls within the competence of the ECB and the national competent authorities of the participating countries.

The **Stability and Growth Pact** is a binding framework for the coordination of national fiscal policies in the European Union. If an EU Member State has a general government deficit exceeding 3% of GDP, or does not reduce its debt exceeding 60% of GDP at a sufficient pace, an **excessive deficit procedure** is usually opened against it. This procedure is opened on the basis of a comprehensive assessment of the country's economic and budgetary situation. For example, if the excessive deficit (or debt) is only temporary, caused by adverse (cyclical) economic developments, an excessive deficit procedure may not be launched. The penalties imposed differ according to whether or not the country is a member of the euro area.

The **structural balance** is the difference between the cyclically adjusted balance and one-off and temporary operations (see above).

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