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## Croatia entering Eurozone – Farewell to Kuna

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Sometime early February this year, my 9-year-old daughter told me out of the blue after I had picked her up from school, that she couldn't wait for the year 2023 to come. I was shocked to hear that; especially given the fact she rarely plans her life more than 2 business days ahead. She explained to me that she couldn't wait for the euro to be introduced – another shocker, as I wouldn't have thought our conversation to take that direction. In her opinion, it is highly unfair that Croatian kids are the only ones in Europe who need to do conversion math and think in one currency while soon to be doing business in another.

On the other hand, my 11-year-old son is very skeptical about the technicalities of the conversion. He has somewhat reluctantly agreed to give us all his Kuna denominated life savings so that we transfer it to our bank account and thus facilitate the conversion. Still, he plans to do it on midnight of New Year's Eve and not a minute sooner – he can't trust us with that kind of money...

### The long road to the Euro

Yes folks, we really are in a final stage of a huge project that started back in 2012 with a referendum on EU accession. An artificially low turnout of only 44% (back then we had more registered voters than actual people), shamefully put us on the back of CEE countries accession referendum list but was nevertheless marked by a positive answer of a 66% majority. This implied we could start putting our finances in order and begin our journey towards the Eurozone. In 2014 we managed to meet convergence criteria covering inflation, price stability and long-term interest rates, but failed in fiscal criteria covering budget deficit and public debt. We remained in excessive deficit procedure until 2017 after we have reined in our budget deficit and showed our public debt is on a steadily decreasing path.

The Eurozone entry process was officially started in 2018 when the government adopted the "Strategy for the introduction of the euro as the official currency in the Republic of Croatia" and its first milestone was achieved in July 2020 when Croatia successfully applied for and joined ERM II mechanism. Two-year term was expiring this summer and Croatia needed to prove that it was still meeting the so-called Maastricht criteria in order to be allowed to join the Eurozone as soon as January 2023, which was the working date of many officials, and as we have witnessed, also a working date for the school system!

### Inflation as the last hurdle

With the deficit criteria suspended due to pandemic related expenses, the only potential problem lurking behind the corner could have been the inflation. The goal was to stay within the 1,5% margin of the three best performing Member States in terms of price stability. Technically speaking, this wouldn't have been a problem were the inflation a uniformly present phenomenon – which it never is. Some Member States seem to be exhibiting a structurally lower inflation than others thus lowering the reference inflation rate. Also, this wouldn't be a problem if a 1,5% add-on today was relatively comparable to its former self – which, in my opinion, it isn't. It would have been easier to stay below the 1,5% threshold in deflationary Europe two years ago than it was now with supply side shocks and war threats shooting food and energy prices through the roof. Provided I did my math correctly, Croatia did not, technically, check the inflation box.

Luckily, the European Commission allows to label possible best performing Member States in terms of price stability as outliers and to kick them out of the reference rate calculations. Which they did. And we thank them for that. On July 12<sup>th</sup> Croatia was formally accepted as the 20<sup>th</sup> Eurozone member, with the entry date set at January 1<sup>st</sup> 2023, and the central parity exchange rate set at 7.5345.

### A clear "yes" to the Euro

In terms of public opinion, Croats have had their say. Last year's final attempt of a coup organized by some of the right-wing parties failed miserably even though they used several techniques like collecting petition signatures in front of churches after Sunday masses. They played the monetary sovereignty card as if losing it would be detrimental for our society. Monetary sovereignty seems to be a good buzzword for evoking patriotic feelings, and it works especially well when one has no clue of what it really stands for. Fortunately, as one of my

favorite Croatian macro chroniclers puts it, you can't lose something you don't own. Opting for keeping the exchange rate pegged to the euro was one of the smartest things we could have done. No doubt about it. There should be no shame in revoking it if local lifestyle and habits are better off with something else.

## The Croatians' long relationship with the Euro

Monetary sovereignty makes sense in a big, productive, and open economy where people save and take out loans in local currency. We are not big, nor productive (in terms that our exports depend heavily on our imports). Additionally, latest data show that Croatian households hold more than 70% of their term savings in Euro deposits, a trend that is not new or related to Eurozone entry, but a trend that goes uninterrupted since forever. The same goes for home loans; 70% of home loans are euro denominated while less than half of that amount refers to pure Kuna loans. Within our UCITS industry, 62% of assets under management refer to EUR denominated funds. We quote our prices per square meters for housing in euros, as well as monthly home rents and building land. Used cars are also quoted in euros, as are the costs of a wedding, music gigs or new braces. For an average Croat, euro introduction will represent only an institutionalization of a previously assumed long-term relationship.

Croatia entering Eurozone is a done deal. Even the kids know it! With euro adoption crossed off our bucket list we can hopefully turn to other important stuff. For instance, did you know that last year's census showed that Croatian population shrank by more than 9%, main culprits being both the natural decrease as well as emigration flows? I wonder if this ever makes it to someone's top-priority list...

This article is part of our [Euro dossier](#). In the coming months, Erste Asset Management experts from the CEE countries will provide insights on topics related to the euro.

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