

# CONTENTS

Convergence Report 2008	1
Convergence Report 2008 - Technical annex	37
1. Introduction	39
1.1. ROLE OF THE REPORT	39
1.2. APPLICATION OF THE CRITERIA	40
1.2.1. Compatibility of legislation	41
1.2.2. Price stability	41
1.2.3. Government budgetary position	44
1.2.4. Exchange rate stability	46
1.2.5. Long-term interest rates	47
1.2.6. Additional factors	47
2. Bulgaria	49
2.1. LEGAL COMPATIBILITY	49
2.1.1. Introduction	49
2.1.2. Objectives	49
2.1.3. Independence	49
2.1.4. Integration in the ESCB	49
2.1.5. Prohibition of monetary financing	50
2.1.6. Assessment of compatibility	50
2.2. PRICE STABILITY	50
2.2.1. Respect of the reference value	50
2.2.2. Recent inflation developments	50
2.2.3. Underlying factors and sustainability of inflation	51
2.3. GOVERNMENT BUDGETARY POSITION	54
2.3.1. Developments until 2007	54
2.3.2. Medium-term prospects	55
2.4. EXCHANGE RATE STABILITY	56
2.5. LONG-TERM INTEREST RATES	57
2.6. ADDITIONAL FACTORS	57
2.6.1. Development of the balance of payments	57
2.6.2. Product market integration	59
2.6.3. Financial market integration	61

3.	Czech Republic	63
3.1.	LEGAL COMPATIBILITY	63
3.1.1.	Introduction	63
3.1.2.	Objectives	63
3.1.3.	Independence	63
3.1.4.	Integration in the ESCB	63
3.1.5.	Prohibition of monetary financing	64
3.1.6.	Assessment of compatibility	64
3.2.	PRICE STABILITY	64
3.2.1.	Respect of the reference value	64
3.2.2.	Recent inflation developments	64
3.2.3.	Underlying factors and sustainability of inflation	65
3.3.	GOVERNMENT BUDGETARY POSITION	68
3.3.1.	The excessive deficit procedure for the Czech Republic	68
3.3.2.	Developments until 2007	68
3.3.3.	Medium-term prospects	69
3.4.	EXCHANGE RATE STABILITY	70
3.5.	LONG-TERM INTEREST RATES	71
3.6.	ADDITIONAL FACTORS	72
3.6.1.	Development of the balance of payments	72
3.6.2.	Product market integration	73
3.6.3.	Financial market integration	74
4.	Estonia	77
4.1.	LEGAL COMPATIBILITY	77
4.1.1.	Introduction	77
4.1.2.	Objectives	77
4.1.3.	Independence	77
4.1.4.	Integration in the ESCB	77
4.1.5.	Prohibition of monetary financing	77
4.1.6.	Assessment of compatibility	77
4.2.	PRICE STABILITY	78
4.2.1.	Respect of the reference value	78
4.2.2.	Recent inflation developments	78
4.2.3.	Underlying factors and sustainability of inflation	79
4.3.	GOVERNMENT BUDGETARY POSITION	81
4.3.1.	Developments until 2007	81
4.3.2.	Medium-term prospects	82
4.4.	EXCHANGE RATE STABILITY	83
4.5.	LONG-TERM INTEREST RATES	84
4.6.	ADDITIONAL FACTORS	85
4.6.1.	Development of the balance of payments	85
4.6.2.	Product market integration	87
4.6.3.	Financial market integration	88

5.	Latvia	91
5.1.	LEGAL COMPATIBILITY	91
5.1.1.	Introduction	91
5.1.2.	Objectives	91
5.1.3.	Independence	91
5.1.4.	Integration in the ESCB	91
5.1.5.	Prohibition of monetary financing	92
5.1.6.	Assessment of compatibility	92
5.2.	PRICE STABILITY	92
5.2.1.	Respect of the reference value	92
5.2.2.	Recent inflation developments	92
5.2.3.	Underlying factors and sustainability of price performance	93
5.3.	GOVERNMENT BUDGETARY POSITION	96
5.3.1.	Developments until 2007	96
5.3.2.	Medium-term prospects	97
5.4.	EXCHANGE RATE STABILITY	98
5.5.	LONG-TERM INTEREST RATES	100
5.6.	ADDITIONAL FACTORS	101
5.6.1.	Development of the balance of payments	101
5.6.2.	Product market integration	103
5.6.3.	Financial market integration	104
6.	Lithuania	107
6.1.	LEGAL COMPATIBILITY	107
6.1.1.	Introduction	107
6.1.2.	Objectives	107
6.1.3.	Independence	107
6.1.4.	Integration in the ESCB	107
6.1.5.	Prohibition on monetary financing	107
6.1.6.	Assessment of compatibility	107
6.2.	PRICE STABILITY	107
6.2.1.	Respect of the reference value	107
6.2.2.	Recent inflation developments	107
6.2.3.	Underlying factors and sustainability of inflation	108
6.3.	GOVERNMENT BUDGETARY POSITION	111
6.3.1.	Developments until 2007	111
6.3.2.	Medium-term prospects	113
6.4.	EXCHANGE RATE STABILITY	114
6.5.	LONG-TERM INTEREST RATES	115
6.6.	ADDITIONAL FACTORS	116
6.6.1.	Development of the balance of payments	116
6.6.2.	Product market integration	117
6.6.3.	Financial market integration	119

7.	Hungary	123
7.1.	LEGAL COMPATIBILITY	123
7.1.1.	Introduction	123
7.1.2.	Objectives	123
7.1.3.	Independence	123
7.1.4.	Integration in the ESCB	123
7.1.5.	Prohibition of monetary financing	124
7.1.6.	Assessment of compatibility	124
7.2.	PRICE STABILITY	124
7.2.1.	Respect of the reference value	124
7.2.2.	Recent inflation developments	125
7.2.3.	Underlying factors and sustainability of inflation	126
7.3.	GOVERNMENT BUDGETARY POSITION	128
7.3.1.	The excessive deficit procedure for Hungary	128
7.3.2.	Developments until 2007	129
7.3.3.	Medium-term prospects	130
7.4.	EXCHANGE RATE STABILITY	131
7.5.	LONG TERM INTEREST RATES	132
7.6.	ADDITIONAL FACTORS	133
7.6.1.	Development of the balance of payments	133
7.6.2.	Product market integration	135
7.6.3.	Financial market integration	136
8.	Poland	139
8.1.	LEGAL COMPATIBILITY	139
8.1.1.	Introduction	139
8.1.2.	Objectives	139
8.1.3.	Independence	139
8.1.4.	Integration in the ESCB	140
8.1.5.	Prohibition of monetary financing	140
8.1.6.	Assessment of compatibility	141
8.2.	PRICE STABILITY	141
8.2.1.	Respect of the reference value	141
8.2.2.	Recent inflation developments	141
8.3.	GOVERNMENT BUDGETARY POSITION	145
8.3.1.	The excessive deficit procedure for Poland	145
8.3.2.	Developments until 2007	146
8.3.3.	Medium-term prospects	147
8.4.	EXCHANGE RATE STABILITY	148
8.5.	LONG-TERM INTEREST RATES	148
8.6.	ADDITIONAL FACTORS	149
8.6.1.	Development of the balance of payments	149
8.6.2.	Product market integration	151
8.6.3.	Financial market integration	151

9.	Romania	155
9.1.	LEGAL COMPATIBILITY	155
9.1.1.	Introduction	155
9.1.2.	Objectives	155
9.1.3.	Independence	155
9.1.4.	Integration in the ESCB	155
9.1.5.	Prohibition of monetary financing	156
9.1.6.	Assessment of compatibility	156
9.2.	PRICE STABILITY	157
9.2.1.	Respect of the reference value	157
9.2.2.	Recent inflation developments	157
9.2.3.	Underlying factors and sustainability of price performance	158
9.3.	GOVERNMENT BUDGETARY POSITION	161
9.3.1.	Developments until 2007	161
9.3.2.	Medium-term prospects	161
9.4.	EXCHANGE RATE STABILITY	163
9.5.	LONG-TERM INTEREST RATES	164
9.6.	ADDITIONAL FACTORS	165
9.6.1.	Development of the balance of payments	165
9.6.2.	Product market integration	167
9.6.3.	Financial market integration	169
10.	Slovakia	171
10.1.	LEGAL COMPATIBILITY	171
10.1.1.	Introduction	171
10.1.2.	Objectives	171
10.1.3.	Independence	171
10.1.4.	Integration into the ESCB	171
10.1.5.	Prohibition of monetary financing	172
10.1.6.	Assessment of compatibility	172
10.2.	PRICE STABILITY	172
10.2.1.	Respect of the reference value	172
10.2.2.	Recent inflation developments	172
10.2.3.	Underlying factors and sustainability of price performance	173
10.3.	GOVERNMENT BUDGETARY POSITION	176
10.3.1.	The excessive deficit procedure for Slovakia	176
10.3.2.	Developments until 2007	177
10.3.3.	Medium-term prospects	178
10.4.	EXCHANGE RATE STABILITY	179
10.5.	LONG-TERM INTEREST RATES	180
10.6.	ADDITIONAL FACTORS	181
10.6.1.	Development of the balance of payments	181
10.6.2.	Product market integration	183
10.6.3.	Financial market integration	184

11. Sweden	187
11.1. LEGAL SITUATION	187
11.1.1. Introduction	187
11.1.2. Objectives	187
11.1.3. Independence	187
11.1.4. Integration in the ESCB	187
11.1.5. Prohibition of monetary financing	188
11.1.6. Assessment of compatibility	188
11.2. PRICE STABILITY	188
11.2.1. Respect of the reference value	188
11.2.2. Recent inflation developments	189
11.2.3. Underlying factors and sustainability of price performance	190
11.3. GOVERNMENT BUDGETARY POSITION	192
11.3.1. Developments until 2007	192
11.3.2. Medium-term prospects	192
11.4. EXCHANGE RATE STABILITY	194
11.5. LONG-TERM INTEREST RATES	195
11.6. ADDITIONAL FACTORS	195
11.6.1. Development of the balance of payments	195
11.6.2. Product market integration	197
11.6.3. Financial market integration	198

## LIST OF TABLES

2.1. Bulgaria - Components of inflation	51
2.2. Bulgaria - Other inflation and cost indicators	52
2.3. Bulgaria - Budgetary developments and projections	55
2.4. Bulgaria - Balance of payments	58
2.5. Bulgaria - Product market integration	60
3.1. Czech Republic - Components of inflation	65
3.2. Czech Republic - Other inflation and cost indicators	66
3.3. Czech Republic - Budgetary developments and projections	69
3.4. Czech Republic - Balance of payments	72
3.5. Czech Republic - Product market integration	74
4.1. Estonia - Components of inflation	78
4.2. Estonia - Other inflation and cost indicators	80
4.3. Estonia - Budgetary developments and projections	82
4.4. Estonia - Balance of payments	86
4.5. Estonia - Product market integration	87
5.1. Latvia - Components of inflation	93
5.2. Latvia - Other inflation and cost indicators	94
5.3. Latvia - Budgetary developments and projections	97
5.4. Latvia - Balance of payments	101

5.5.	Latvia - Product market integration	103
6.1.	Lithuania - Components of inflation	108
6.2.	Lithuania - Other inflation and cost indicators	110
6.3.	Lithuania - Budgetary developments and projections	112
6.4.	Lithuania - Balance of payments	116
6.5.	Lithuania - Product market integration	118
7.1.	Hungary - Components of inflation	125
7.2.	Hungary - Other inflation and cost indicators	127
7.3.	Hungary - Budgetary developments and projections	129
7.4.	Hungary - Balance of payments	134
7.5.	Hungary - Product market integration	136
8.1.	Poland - Components of inflation	142
8.2.	Poland - Other inflation and cost indicators	143
8.3.	Poland - Budgetary developments and projections	146
8.4.	Poland - Balance of payments	150
8.5.	Poland - Product market integration	152
9.1.	Romania - Components of inflation	158
9.2.	Romania - Other inflation and cost indicators	159
9.3.	Romania - Budgetary developments and projections	162
9.4.	Romania - Balance of payments	166
9.5.	Romania - Product market integration	168
10.1.	Slovakia - Components of inflation	173
10.2.	Slovakia - Other inflation and cost indicators	174
10.3.	Slovakia - Budgetary developments and projections	177
10.4.	Slovakia - Balance of payments	182
10.5.	Slovakia - Product market integration	183
11.1.	Sweden - Components of inflation	189
11.2.	Sweden - Other inflation and cost indicators	190
11.3.	Sweden - Budgetary developments and projections	193
11.4.	Sweden - Balance of payments	196
11.5.	Sweden - Product market integration	197

## LIST OF GRAPHS

1a.	Bulgaria – Inflation criterion since 2004	8
1b.	Bulgaria – Government budget balance and debt	9
2a.	Czech Republic – Inflation criterion since 2004	10
2b.	Czech Republic – Government budget balance and debt	12
3a.	Estonia – Inflation criterion since 2004	14
3b.	Estonia – Government budget balance and debt	14
4a.	Latvia – Inflation criterion since 2004	16
4b.	Latvia – Government budget balance and debt	17
5a.	Lithuania – Inflation criterion since 2004	19

5b.	Lithuania – Government budget balance and debt	19
6a.	Hungary – Inflation criterion since 2004	21
6b.	Hungary – Government budget balance and debt	22
7a.	Poland – Inflation criterion since 2004	24
7b.	Poland – Government budget balance and debt	25
8a.	Romania – Inflation criterion since 2004	27
8b.	Romania – Government budget balance and debt	28
9a.	Slovakia – Inflation criterion since 2004	30
9b.	Slovakia – Government budget balance and debt	31
10a.	Sweden – Inflation criterion since 2004	33
10b.	Sweden – Government budget balance and debt	34
2.1.	Bulgaria - Inflation criterion since 2004	50
2.2.	Bulgaria - HICP inflation	51
2.3.	Bulgaria - Inflation, productivity and wage trends	52
2.4.	Exchange rates - BGN/EUR	56
2.5.	Bulgaria - 3-M Sofibor spread to 3-M Euribor	57
2.6.	Bulgaria - Long-term interest rate criterion	57
2.7.	Bulgaria - Long-term interest rates	57
2.8.	Bulgaria - Effective exchange rates	58
2.9.	Bulgaria - Saving and investment	59
2.10.	Bulgaria - Recent development of the financial system relatively to the euro area	61
2.11.	Bulgaria - Foreign ownership and concentration in the banking sector	61
2.12.	Bulgaria - Domestic credit expansion	62
2.13.	Bulgaria - Share of foreign currency loans	62
2.14.	Bulgaria - Recent developments in bank credit to households and corporations relatively to the euro area	62
3.1.	Czech Republic - Inflation criterion since 2004	64
3.2.	Czech Republic - HICP inflation	65
3.3.	Czech Republic - Inflation, productivity and wage trends	66
3.4.	Exchange rates - CZK/EUR	71
3.6.	Czech Republic - Long-term interest rate criterion	71
3.7.	Czech Republic - Long-term interest rates	71
3.8.	Czech Republic - Effective exchange rates	73
3.9.	Czech Republic - Saving and investment	73
3.10.	Czech Republic - Recent development of the financial system relatively to the euro area	75
3.11.	Czech Republic - Foreign ownership and concentration in the banking sector	75
3.12.	Czech Republic - Domestic credit expansion	75
3.13.	Czech Republic - Share of foreign currency loans	75
3.14.	Czech Republic - Recent developments in bank credit to households and corporations relatively to the euro area	76
4.1.	Estonia - Inflation criterion since 2004	78
4.2.	Estonia - HICP inflation	78
4.3.	Estonia - Inflation, productivity and wage trends	79
4.4.	EEK - Spread vs central rate	84

4.5.	Exchange rates - EEK/EUR	84
4.6.	Estonia - 3-M Talibor spread to 3-M Euribor	84
4.7.	Estonia - Interest rate indicator	85
4.8.	Estonia - Interest rate indicator	85
4.9.	Estonia - Effective exchange rates	86
4.10.	Estonia - Saving and investment	87
4.11.	Estonia - Recent development of the financial system relatively to the euro area	88
4.12.	Estonia - Foreign ownership and concentration in the banking sector	88
4.13.	Estonia - Domestic credit expansion	89
4.14.	Estonia - Share of foreign currency loans	89
4.15.	Estonia - Recent developments in bank credit to households and corporations relatively to the euro area	90
5.1.	Latvia - Inflation criterion since 2004	92
5.2.	Latvia - HICP inflation	93
5.3.	Latvia - Inflation, productivity and wage trends	95
5.4.	LVL - Spread vs central rate	99
5.5.	Exchange rates - LVL/EUR	99
5.6.	Latvia - 3-M Rigibor spread to 3-M Euribor	99
5.7.	Latvia - Long-term interest rate criterion	100
5.8.	Latvia - Long-term interest rates	100
5.9.	Latvia - Effective exchange rates	102
5.10.	Latvia - Saving and investment	102
5.11.	Latvia - Recent development of the financial system relatively to the euro area	104
5.12.	Latvia - Foreign ownership and concentration in the banking sector	105
5.13.	Latvia - Domestic credit expansion	105
5.14.	Latvia - Share of foreign currency loans	105
5.15.	Latvia - Recent developments in bank credit to households and corporations relatively to the euro area	105
6.1.	Lithuania - Inflation criterion since 2004	107
6.2.	Lithuania - HICP inflation	108
6.3.	Lithuania - Inflation, productivity and wage trends	109
6.4.	LTL - Spread vs central rate	114
6.5.	Exchange rates - LTL/EUR	114
6.6.	Lithuania - 3-M Vilibor spread to 3-M Euribor	114
6.7.	Lithuania - Long-term interest rate criterion	115
6.8.	Lithuania - Long-term interest rates	115
6.9.	Lithuania - Saving and investment	116
6.10.	Lithuania - Effective exchange rates	117
6.11.	Lithuania - Recent development of the financial system relatively to the euro area	119
6.12.	Lithuania - Foreign ownership and concentration in the banking sector	119
6.13.	Lithuania - Domestic credit expansion	120
6.14.	Lithuania - Share of foreign currency loans	120
6.15.	Lithuania - Recent developments in bank credit to households and corporations relatively to the euro area	120

7.1.	Hungary - Inflation criterion since 2004	125
7.2.	Hungary - HICP inflation	125
7.3.	Hungary - Inflation, productivity and wage trends	126
7.4.	Exchange rates - HUF/EUR	132
7.5.	Hungary - 3-M Bubor spread to 3-M Euribor	132
7.6.	Hungary - Long-term interest rate criterion	133
7.7.	Hungary - Long-term interest rates	133
7.8.	Hungary - Saving and investment	134
7.9.	Hungary - Effective exchange rates	135
7.10.	Hungary - Recent development of the financial system relatively to the euro area	137
7.11.	Hungary - Foreign ownership and concentration in the banking sector	137
7.12.	Hungary - Domestic credit expansion	137
7.13.	Hungary - Share of foreign currency loans	138
7.14.	Hungary - Recent developments in bank credit to households and corporations relatively to the euro area	138
8.1.	Poland - Inflation criterion since 2004	141
8.2.	Poland - HICP inflation	141
8.3.	Poland - Inflation, productivity and wage trends	143
8.4.	Exchange rates - PLN/EUR	148
8.5.	Poland - 3-M Wibor spread to 3-M Euribor	148
8.6.	Poland - Long-term interest rate criterion	148
8.7.	Poland - Long-term interest rates	149
8.8.	Poland - Effective exchange rates	150
8.9.	Poland - Saving and investment	150
8.10.	Poland - Recent development of the financial system relatively to the euro area	152
8.11.	Poland - Foreign ownership and concentration in the banking sector	152
8.12.	Poland - Domestic credit expansion	153
8.13.	Poland - Share of foreign currency loans	153
8.14.	Poland - Recent developments in bank credit to households and corporations relatively to the euro area	153
9.1.	Romania - Inflation criterion since 2004	157
9.2.	Romania - HICP inflation	157
9.3.	Romania - Inflation, productivity and wage trends	159
9.4.	Exchange rates - RON/EUR	163
9.5.	Romania - 3-M Robor spread to 3-M Euribor	164
9.6.	Romania - Long-term interest rate criterion	164
9.7.	Romania - Long-term interest rates	165
9.8.	Romania - Effective exchange rates	166
9.9.	Romania - Saving and investment	167
9.10.	Romania - Recent development of the financial system relatively to the euro area	169
9.11.	Romania - Foreign ownership and concentration in the banking sector	169
9.12.	Romania - Domestic credit expansion	169
9.13.	Romania - Share of foreign currency loans	169

9.14. Romania - Recent developments in bank credit to households and corporations relatively to the euro area	170
10.1. Slovakia - Inflation criterion since 2004	172
10.2. Slovakia - HICP inflation	173
10.3. Slovakia - Inflation, productivity and wage trends	174
10.4. SKK - Spread vs central rate	179
10.5. Exchange rates - SKK/EUR	179
10.6. Slovakia - 3-M Bribor spread to 3-M Euribor	180
10.7. Slovakia - Long-term interest rate criterion	180
10.8. Slovakia - Long-term interest rates	181
10.9. Slovakia - Effective exchange rates	181
10.10. Slovakia - Saving and investment	182
10.11. Slovakia - Recent development of the financial system relatively to the euro area	184
10.12. Slovakia - Foreign ownership and concentration in the banking sector	184
10.13. Slovakia - Domestic credit expansion	185
10.14. Slovakia - Share of foreign currency loans	185
10.15. Slovakia - Recent developments in bank credit to households and corporations relatively to the euro area	185
11.1. Sweden - Inflation criterion since 2004	189
11.2. Sweden - HICP inflation	189
11.3. Sweden - Inflation, productivity and wage trends	191
11.4. Exchange rates - SEK/EUR	194
11.5. Sweden - 3-M Stibor spread to 3-M Euribor	194
11.6. Sweden - Long-term interest rate criterion	195
11.7. Sweden - Long-term interest rates	195
11.8. Sweden - Saving and investment	196
11.9. Sweden - Effective exchange rates	196
11.10. Sweden - Recent development of the financial system relatively to the euro area	198
11.11. Sweden - Foreign ownership and concentration in the banking sector	198
11.12. Sweden - Domestic credit expansion	198
11.13. Sweden - Share of foreign currency loans	199
11.14. Sweden - Recent developments in bank credit to households and corporations relatively to the euro area	199

## LIST OF BOXES

1.1. Article 122(2) of the Treaty	40
1.2. Article 121(1) of the Treaty	41
1.3. Assessment of price stability and the reference value	43
1.4. Excessive deficit procedure	45