CITIZENS' SUMMARY

Convergence Report 2013 on Latvia

All EU Member States, except the UK and Denmark, are committed by the Treaty to adopt the euro once they fulfil the necessary conditions. Seventeen countries already share the single currency. This leaves eight EU members which still remain outside the euro area.[1]

The Convergence Reports[2] form the basis for the final decision on whether a Member State fulfils the conditions for joining the euro area. The decision is taken by the Ecofin (Economic and Financial Affairs) Council – made up of the economics and finance ministers of all the EU Member States – on the Commission's proposal, after consulting the European Parliament, a recommendation from the euro area Finance Ministers and a discussion at the European Council (EU summit).

This year's report was prepared upon the request of Latvia to assess its progress in preparing for euro adoption.[3] The assessment of convergence is also aligned with the broader "European semester" approach which takes an integrated and upstream look at the economic policy challenges facing the EMU in ensuring fiscal sustainability, competitiveness, financial market stability and economic growth. The 2013 Convergence Report on Latvia concludes that Latvia fulfils the conditions for adopting the euro. On the basis of this report, the Commission has proposed to the Council that Latvia adopts the euro on 1 January 2014.

The convergence assessment

In order to be prepared to integrate smoothly into the euro area, Member States adopting the euro are required to have achieved a high level of sustainable economic convergence. This means that the progress made with convergence must be grounded on structural elements that guarantee its durability, rather than on temporary factors. The assessment, which involves both quantitative and qualitative elements, is based on the Maastricht convergence criteria, which consist of four stability-oriented economic conditions, and takes into account additional factors. Moreover, a country's national legislation on monetary affairs must be brought into line with the EU Treaty.

The Maastricht criteria set requirements relating to:

- price stability, requiring a sustainable price performance and average **inflation** in the period of one year before the assessment that does not exceed by more than 1.5% of that of, at most, the three best performing Member States in terms of price stability The inflation reference value for the purpose of this report was 2.7% in April 2013,

[1] These countries are formally known as 'Member States with a derogation'.
[2] The European Commission issues convergence reports every two years, or in case a Member State intending to join the euro requests it. The European Central Bank (ECB) also publishes a convergence report at the same time.
[3] The progress in other Member States which are required to adopt the euro will be assessed in the next regular convergence reports in spring 2014.

- sound and sustainable **public finances** (absence of an ‘excessive deficit’)

- **exchange rate** stability (participation in ERM II – the exchange rate mechanism – without severe tensions and devaluation for a period of two years before the assessment). The period of required participation in ERM II was set for the purpose of this report at 17 May 2011-16 May 2013.

and

- durability of convergence (average nominal long-term **interest rates** over the preceding year must not exceed that of, at most, the three best EU performers in terms of price stability by more than 2%). The reference value for this criterion was 5.5% in April 2013

In addition, the Treaty requires **legal convergence,** i.e. Member States to bring their national legislation on monetary matters in line with the Treaty and the Statute of the ECB and European System of Central Banks, most notably ensuring the independence of their national central banks.

The Treaty also calls for an examination of **other factors** relevant to economic integration and convergence. These additional factors include the integration of markets and the development of the balance of payments. The assessment of additional factors is an important indication of whether the integration of a Member State into the euro area would proceed smoothly.

The report finds that Latvia has achieved a high degree of sustainable convergence and therefore it is considered ready to adopt the euro in 2014.

On the price stability criterion, average inflation in Latvia was 1.3% in the relevant period, well below the reference value. The analysis of underlying fundamentals and the fact that the reference value has been met by a wide margin support a positive assessment on the fulfilment of the price stability criterion.

On the public finance criterion, Latvia’s general government deficit and debt are well within the acceptable limits for the convergence assessment: the deficit was 1.2% of GDP in 2012 and is forecast to amount to 1.2% of GDP in 2013. Its general government debt stood at 40.7% of GDP at end-2012.

Regarding the interest rate criterion, Latvia’s average long-term interest rate over the year to April 2013 was 3.8%, below the reference value.

As for the exchange rate, the Latvian lats has participated in ERM II since 2 May 2005, which is considerably more than the minimum two years. Upon ERM II entry, the Latvian authorities committed to keep the lats within a ±1% fluctuation margin around the central rate. During the two years preceding this assessment, the lats exchange rate did not deviate from its central rate by more than ±1% and it did not experience tensions.

Regarding the additional factors relevant for convergence, Latvia's external balance adjusted significantly during the crisis. Latvia has improved its external competitiveness and has continued to gain export market shares. Latvia's economy is well integrated within the EU economy through trade and attracts sizeable foreign direct investments. The labour market has

demonstrated a high degree of mobility within the EU market and substantial flexibility although structural unemployment is high. On the basis of selected business environment indicators, Latvia performs broadly in line with the average of euro area Member States. The integration of the domestic financial sector into the EU financial system is substantial, mainly due to a high level of foreign ownership of the banking system. The national supervising authority has implemented several measures to reduce risks related to non-resident banking activity.

Finally, Latvia’s legislation in the monetary domain is fully compatible with the EU legislation.

Based on Latvia's fulfilment of the necessary conditions, introducing the euro is set to bring a range of benefits to Latvian citizens, including a highly credible monetary policy framework geared at price stability, a reduction in exchange rate risk, lower transaction costs, favourable financing conditions and enhanced price transparency. Latvia's trade with the euro area economy will continue to increase, creating new economic opportunities, strengthening growth and creating jobs.

Latvia's euro readiness is supported by its long-standing experience of operating in a fixed exchange rate framework. At the same time, continuing to pursue sound policies after the adoption of the single currency will prove essential in order to reap the full benefits of the Monetary Union. In the near term, provided that the Council decides that Latvia will join the euro area on 1 January 2014, thorough technical preparation should ensure a successful and smooth practical changeover.