



ERM II – the EU's Exchange Rate Mechanism

The Exchange Rate Mechanism (ERM II) was set up on 1 January 1999 as a successor to ERM to ensure that exchange rate fluctuations between the euro and other EU currencies do not disrupt economic stability within the single market.

Within the euro area, there is only one currency – the euro – but there are EU countries outside the euro area with their own currencies. The Exchange Rate Mechanism (ERM II) was set up on 1 January 1999 as a successor to ERM to ensure that exchange rate fluctuations between the euro and other EU currencies do not disrupt economic stability within the single market, and to help non euro-area countries prepare themselves for participation in the euro area. The convergence criterion on exchange rate stability requires the smooth participation of non-euro area countries' currencies in ERM II. ERM II provides the framework to manage the exchange rates between EU currencies, and ensures stability.

Participation in ERM II is voluntary although, as one of the convergence criteria for entry to the euro area, a country must participate in the mechanism without severe tensions and without devaluing its central rate against the euro on its own initiative for at least two years before it can qualify to adopt the euro.

Currently, ERM II includes the currencies of Bulgaria and Denmark. The Bulgarian lev joined ERM II on 10 July 2020 and observes a central rate of 1.95583 to the euro. Bulgaria also committed unilaterally to continue its currency board arrangement within the ERM II. Following the Croatian kuna joining ERM II on 10 July 2020, Croatia adopted the euro on 1 January 2023. The Danish kroner joined ERM II on 1 January 1999, and observes a central rate of 7.46038 to the euro with a narrow fluctuation band of $\pm 2.25\%$.

How does ERM II work?

In ERM II, the exchange rate of a non-euro area Member State is allowed to fluctuate against the euro within set limits. ERM II entry is based on an agreement between the

finance ministers of the euro area Member States, the European Central Bank (ECB) and the ministers and central bank governors of the non-euro area Member States participating in the mechanism. The agreement covers the following:

- A central exchange rate between the euro and the country's currency is agreed. The currency is then allowed to fluctuate by up to 15% above or below this central rate
- When necessary, the currency is supported by intervention (buying or selling) to keep the exchange rate against the euro within the $\pm 15\%$ fluctuation band. Interventions are coordinated by the ECB and the central bank of the non-euro area Member State
- Non-euro area Member States within ERM II can decide to maintain a narrower fluctuation band, but this decision has no impact on the official $\pm 15\%$ fluctuation margin, unless there is agreement on this by ERM II stakeholders
- The General Council of the ECB monitors the operation of ERM II and ensures co-ordination of monetary- and exchange-rate policies. The General Council also administers the intervention mechanisms together with the Member State's central bank

A measure of sustainable economic convergence

When a Member State adopts the euro, its central bank becomes part of the Eurosystem, which is made up of the national central banks of the euro area and the ECB. The ECB conducts monetary policy in the euro area independently from national governments.

The consequence of this is that euro area Member States can no longer have recourse to currency appreciation or depreciation to manage their economies and respond to economic shocks. For example, they can no longer devalue their currency to slow imports and encourage exports. Instead, they must use budgetary and structural policies to manage their economies prudently.

ERM II mimics these conditions thereby helping non-euro area Member States to prepare for them. Successful participation in ERM II for at least two years is considered as confirmation of the sustainability of economic convergence and that the Member State can reap all the benefits of the euro. It also provides an indication of the appropriate conversion rate that should be applied when the Member State qualifies and its currency is irrevocably fixed.

Joining ERM II

Successful participation in ERM II is one of the convergence criteria, and an important milestone towards adopting the euro.

In July 2018 and July 2019, respectively, Bulgaria and Croatia took important steps towards euro adoption by committing to put in place a range of policy measures to prepare themselves for participating in ERM II. The ECB and the Commission were tasked by the ERM II parties to monitor, in their respective areas of competence, the implementation of these so-called prior commitments (prior commitments 1 and 2 for the ECB and prior commitments 3 to 6 for the Commission). In June 2020, the two countries requested an assessment of the implementation of their respective prior-commitments. In July 2020, the Commission and the ECB provided positive assessments of the fulfilment of these prior commitments. At their meeting on 10 July 2020, the ERM II parties agreed to include the Bulgaria lev and the Croatian kuna in the ERM II mechanism.

Commission assessments of the prior commitments 3 to 6 of Bulgaria and Croatia

10 JULY 2020

Commission letter and accompanying Staff Working Document on the implementation of Bulgaria's prior commitments 3 to 6

English (692.54 KB - PDF)

[Download](#) 

10 JULY 2020

Commission letter and accompanying Staff Working Document on the implementation of Croatia's prior commitments

English (661.52 KB - PDF)

[Download](#) 

Further documents

- [Decision of ERM II parties on Bulgaria's participation in ERM II](#)
- [Decision of ERM II parties on Croatia 's participation in ERM II](#)
- Governing Council decision on entry into close cooperation for [Bulgaria](#) and [Croatia](#)
- ECB letter and assessments of the completion of prior commitment 2 on the macro-prudential toolkits by [Bulgaria](#) and [Croatia](#)