EURO ADOPTION: VIEWS FROM THE THIRD ROW

(summary)

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Euro adoption: views from the third row

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Abstract

Croatia is already much more euroized then any of the first wave accession countries. The paper demonstrates that Croatia has a strong incentive to adopt euro as soon as it becomes feasible. Costs of doing so are smaller because the degrees of freedom for an independent monetary policymaking are already reduced, while the benefits are higher. A special benefit that a heavily euroized economy derives from formally adopting the euro is removal of relatively high costs of prudential regulation connected to the balance sheet risk and a possible run on the foreign exchange liabilities of the banking system. This would in turn substantially reduce costs of financial intermediation and interest rate spreads. Our analysis suggests that in a highly euroized economy the costs of euro adoption are smaller and the benefits are larger than in a non-euroized economy.

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