NÁRODNÁ BANKA SLOVENSKA

Euro Adoption in Slovakia

Lessons Learned & Challenges Ahead

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Presentation Outline

- Consistent Plans
- In-depth Impact Analysis
- Maastricht Criteria Sustainability
- Main Challenges

Consistent Plans

- Euro adoption strategy in 2003 – set target for euro area entry in 2008 or 2009
- Specification of euro adoption strategy in 2004 – € target set in 2009
- National euro changeover plan approved in 2005
- In-depth impact analyses elaborated in 2006
- New government in 2006 confirmed plans to adopt euro in 2009
- Updated Changeover plan in 2007

Euro adoption has broad political support in Slovakia

In-depth Impact Analyses

- Confirm that Euro will be beneficial for Slovakia – benefits will exceed costs
  - The Effects of Euro Adoption on the Slovak Economy, NBS 2006
  - The Assessment of Potential Effects of Euro Adoption on Slovak Population, NBS 2006
  - The Assessment of Potential Effects of Euro Adoption on Business Sector in Slovakia, NBS 2006

Benefits of Euro Adoption

Direct (immediate) benefits

- elimination of exchange rate risk against euro
- lower costs of capital
- elimination of some transaction costs
- better resistance to (currency) crises
- lower exchange rate risk against USD
- higher price transparency

Indirect (long-term) benefits

- trade growth
- increase of FDI
- faster growth/increase of living standards/progress in real convergence

Broadly in line with analyses prepared in current euro area countries

Costs of Euro Adoption

- Technical costs of currency changeover: one-off costs of 0,3% GDP
- Banking sector losses
- Loss of independent monetary policy – loss of an instrument for stabilization of economy
- Likelihood of moderately higher inflation

Time Table of Euro Adoption*

Maastricht criteria fulfillment	year 2007 to March 2008
Convergence reports of ECB and EK	May 2008
European Commission recommendation to the Council on abrogation of derogation	May 2008
Consultation with European Parliament	June 2008
Council abrogates derogation and sets conversion rate	July 2008
Eurozone entry	**1.1.2009**

*Based on previous euro area entry examples

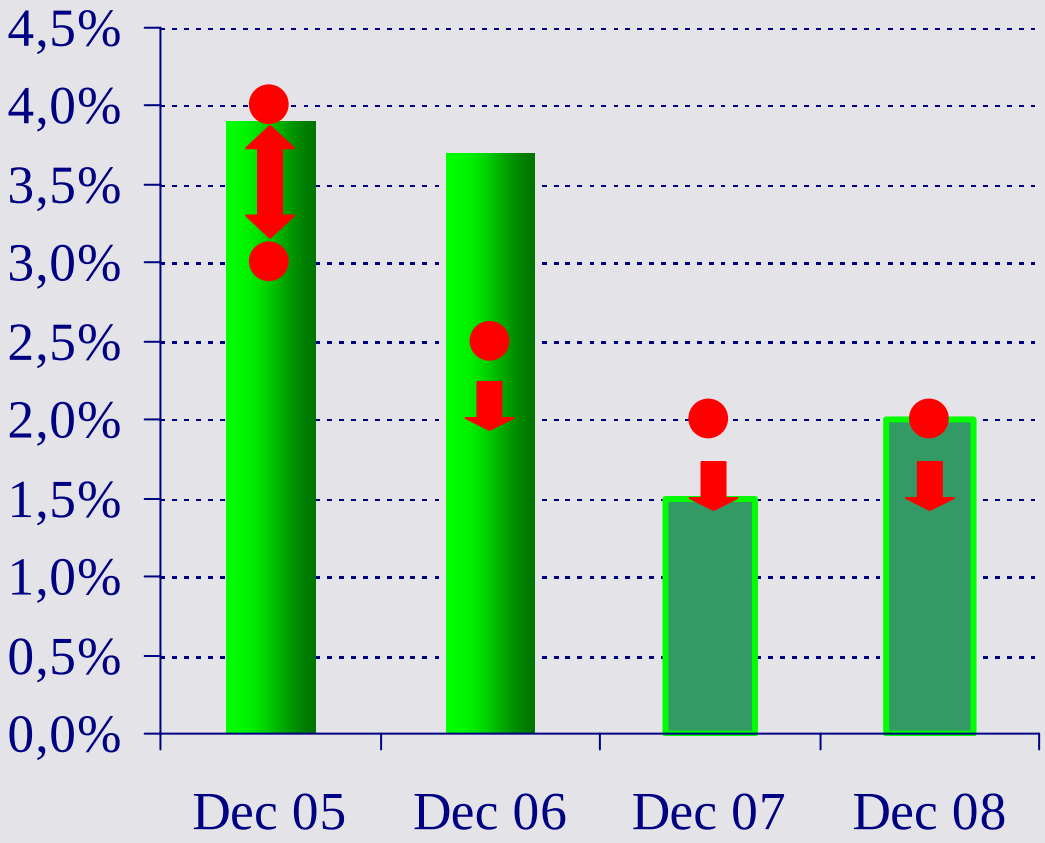
Maastricht Criteria Outlook

Criterion	Sept. 2007	Ref. value	Spring 2008	Ref. value in 2008
Inflation (average, %)	2.1	2.6	1.7	2.5 (est.)
Interest rates (%)	4.4	6,3	4.4	6.4 (est.)
Public debt (% GDP)	30.4	60.0	31.8	60.0
Public deficit (% GDP)	3.7*	3.0	2.9	3.0
ER stability	ERM II since Nov. 05		expected	

*Without the impact of pension reform, total deficit was 2.6% of GDP in 2006.

Source: Eurostat, European Commission, MF SR, NBS

Inflation Outlook



In 2007 and 2008 NBS expects to meet its inflation targets

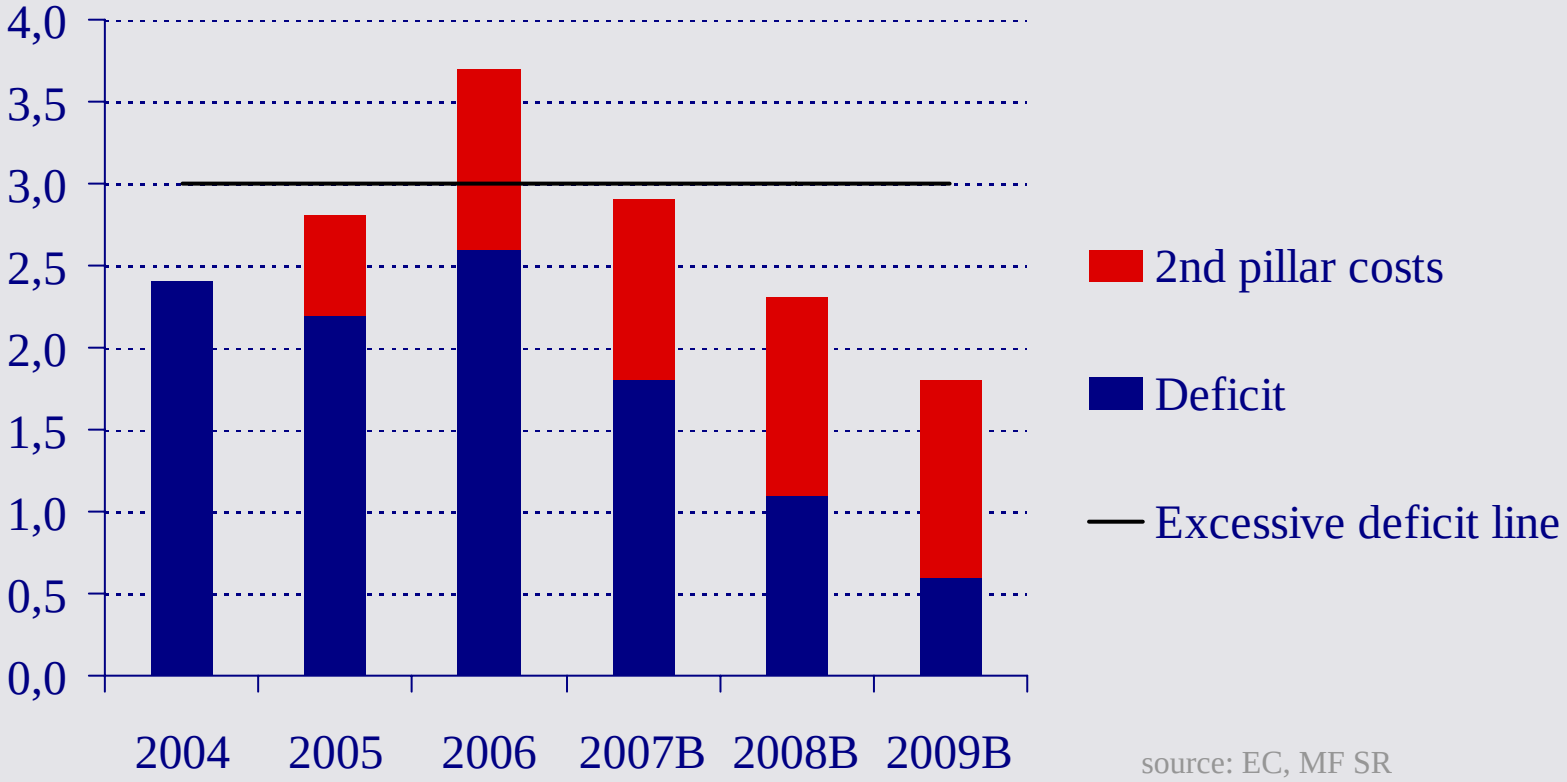
• inflation will be well below reference value for at least 2 years after convergence assessment

(2009 inflation is forecasted at 2.5%)

Source: NBS

Red points = targets, green bars = outcomes/estimates

Public Deficit



source: EC, MF SR

The budgeted deficit will be lower than the reference value even including full costs of the 2nd pillar.

Inflation Sustainability

- Inflation expected to stay below the reference value for at least next 2 years
- No artificial measures
  - no decrease in indirect taxes
  - no regulated prices freezes or any other one-off measures
- All regulated prices are at cost recovery levels
- Energy prices are at or above EU average

Public Finances Sustainability

- No evidence of „cheating“
  - no use of Public Private Partnerships
  - no new doubtful government guarantees
  - no temporary increase in taxes
  - no intentional postponement of expenditures
- Permanent methodology discussion with Eurostat (ex-ante discussion of planned operations)
- Very good track record – in the last few years the deficit was always lower than budgeted

Public Finances Sustainability (2)

- Currently public debt at 30% GDP – well below the 60% reference value
- Long-term sustainability of public finances. Evaluation by the EC:

  Slovenia – high risk

  Cyprus – high risk

  Malta – medium risk

  Slovakia – medium risk

Exchange Rate Sustainability

- Nominal appreciation due to fundamentals – high productivity differential vis-à-vis the euro area and low inflation differential
- Profitability of Slovak companies increases, exports grow at very high pace and current account deficit decreases

Conclusion on Maastricht Criteria

Based on strong fundamentals and equal treatment, it is very likely that Slovakia will meet the Maastricht criteria.

- Slovakia is the first country adopting Euro from freely floating exchange regime => the evaluation will become precedent for future assessments and the suitability of the ER regime will be verified

Main Euro Adoption Challenges

Impossible Trinity: Country with open capital account cannot control both exchange rate and inflation.

=> As short as possible participation in ERM II

„Shooting moving target“: Inflation criterion is not known in advance. It often depends on development in countries out of euro area.

Balassa-Samuelson Effect: Higher price increases in non-tradable sector lead to higher overall inflation. Estimations differ significantly. Due to several softening factors, we expect only 0.7 pp contribution to overall inflation in medium term.

2€

1€

Thank You for Your Attention

50, 20, 10 c

5, 2, 1 c