

Preparations for the Euro Introduction



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Preparations for the euro introduction progressed in 2006 both from the economic-political perspective and on the technical and organizational side. These preparations will allow Slovakia to adopt the euro as of 1 January 2009, and favourable economic developments are increasing the chances of meeting this deadline. The Národná banka Slovenska continued to perform its tasks under the National Euro Changeover Plan and its internal euro adoption plan, and thereby contributed to the accomplishment of the euro adoption strategy.

9.1 National Euro Changeover Plan and organizational preparations

Preparations for introducing the euro and the completion of tasks under the National Euro Changeover Plan for the Slovak Republic proceeded on schedule, and the euro is on track to be introduced on 1 January 2009. The National Plan tasks with a deadline in 2006 were for the most part fulfilled. The tasks were not, however, brought to completion at an even pace across different areas. Nevertheless, important tasks were fulfilled at the beginning of 2007, and the completion of following activities was not put at risk. An important milestone for the continuation in the preparations was the approval of the Government

Programme Declaration, in which the new Slovak Government confirmed the commitment to adopt the euro in 2009. The tasks for 2006 that were not performed included mainly the nomination of a new national coordinator for the euro changeover and the update of the National Euro Changeover Plan. The coordinator was appointed in January 2007 and the National Plan was updated in March 2007.²¹

The regular semi-annual report on the completion of tasks under the National Plan as at the end of 2006 confirmed that the state of preparations for the euro changeover in Slovakia was good. However, some working committees did not work intensively enough and time reserves have been largely spent.

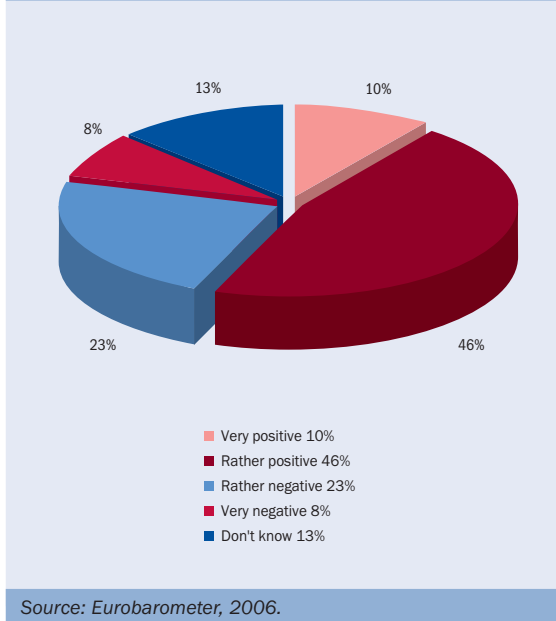
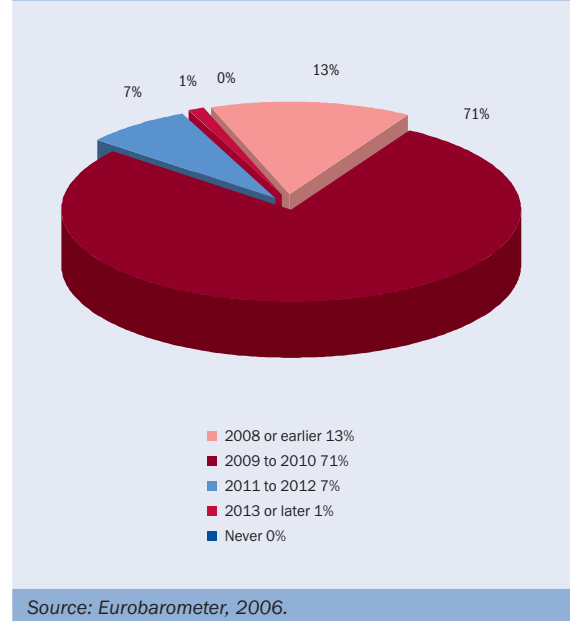
Most of the tasks for 2006 that the Národná banka Slovenska was assigned under the National Plan were completed. The NBS internal euro adoption plan was supplemented and updated, and a majority of the tasks stipulated for 2006 were met. Where tasks were not completed on schedule, the cause lay either with third parties or excessively ambitious deadlines. Extending these deadlines will not prevent the euro from being introduced on the planned date.

The NBS conducted a review of the legal regulations either issued by the NBS or concerning the NBS which will need to be amended in connection with the euro changeover. A plan to modify the domestic payment

Table 42 **Procedures before and after euro adoption**

Fulfilment of the Maastricht Criteria	2007 to March 2008
EC and ECB convergence reports	April/May 2008
EC proposal to the Council of the EU for abrogation of the derogation	May 2008
Consultations with the European Parliament	May/June 2008
Council of the EU abrogates the derogation and sets the conversion rate	June/July 2008
Start of mandatory dual pricing	July 2008
Euro area entry – “€ Day”	1 January 2009
Dual circulation of koruna and euro banknotes and coins	1–16 January 2009
End of mandatory dual pricing	31 December 2009
Recommended end of voluntary dual pricing	30 June 2010

²¹ The document is published at www.nbs.sk/Euro/Documents.

**Chart 86 Expectations of Slovak citizens for the effect of the euro changeover in Slovakia****Chart 87 Expectations of Slovak citizens for the date of the euro changeover in Slovakia**

system was drawn up and preparations were made for connecting to the European payment system. Preparatory analyses were carried out in regard to producing a concept for linking the NBS to the ECB's information systems. There were also several detailed analyses of the effect of euro changeover on enterprises, banking and financial institutions, and households made in 2006. In addition, a large number of information and communication activities were carried out (exhibitions, lectures, seminars, presentations in the media).

Slovakia's preparations for introducing the euro have been positively assessed abroad. The European Commission's regular reports on practical preparations for the euro make clear that Slovakia is making sufficient progress in its preparations for introducing the currency. The schedule for euro adoption remains largely unchanged. The experience of Slovenia indicates that the dates set for certain key decisions by European institutions may be put back slightly from the dates originally expected, but this will not prevent the euro from being introduced, as planned, on 1 January 2009.

Confidence that Slovakia will introduce the euro from 2009 is rising not only in professional circles, but also among the public. According to an opinion poll on the euro changeover which the European Commission conducted in the new EU Member States in September 2006, 71% of Slovak citizens expect Slovakia to introduce the euro in 2009 or 2010. The same survey shows that 56% of Slovak citizens expect the introduction of the euro in Slovakia to have a positive effect, compared to 31% who forecast a negative effect.

9.2 Economic policies and the Maastricht Criteria for euro adoption

Meeting the Maastricht Criteria is a key precondition to introducing the euro. The significance of economic policies to their fulfilment was confirmed by the negative development recorded by Slovakia in the summer months soon after the parliamentary elections. The regional effects and uncertainty in regard to the direction of economic policy was reflected in the weakening exchange rate of the Slovak koruna.

Sound economic policies are required not only for the euro changeover itself, but also to ensure that the Slovak economy is able to function successfully within the euro area and to make maximum use of the potential benefits offered by the single European currency.

The Národná banka Slovenska is co-responsible for, in particular, the criteria of inflation and exchange rate stability. The priority is to meet the Maastricht inflation target.

The year-end inflation target for 2006 was set at 2.5% and it was not met. The main cause of the faster inflation growth and overshooting of the inflation target was the higher than expected dynamics of prices of energy and foodstuffs. In regard to such effects, exemptions from the fulfilment of the inflation target were precisely defined in the NBS Monetary Programme until 2008, since they are out of influence of NBS monetary policy.

The average rate of inflation for 2006 stood at 4.3%, which was substantially higher than the reference value of the inflation criterion. The most critical year for euro adoption will be 2007, for which the NBS has set an HICP inflation target of up to 2%. The forecast for inflation development indicates that the target, and therefore the inflation criterion, will be met at the end of 2007.

The second target for which the NBS is co-responsible is exchange rate stability within ERM II. The stability of the exchange rate is at present a joint responsibility of the Government and the NBS. The central bank is responsible for preventing short-term fluctuations of the exchange rate, and, together with the Government, should seek to keep the medium-term development of the exchange rate close to the equilibrium level and prevent creation of imbalances that could affect exchange rate developments.

The Slovak koruna exchange rate followed a stable course in 2006, but since the condition of two-year membership in ERM II was not met, the fulfilment of the exchange rate criterion cannot be assessed as yet.

The koruna joined ERM II on 28 November 2005. At the same time as the decision on entry was made, the central parity was set at SKK 38.4550 per euro. Within ERM II, the koruna observes the standard fluctuation band of $\pm 15\%$ around a central parity. The lower compulsory intervention rate was set at SKK/EUR 32.6868 and the upper rate at SKK/EUR 44.2233. Should either of these rates be reached, the currency must be defended by the central banks of all euro area countries and of countries participating in ERM II, including the NBS. Of course, the NBS may intervene to stabilize the exchange rate at any time, not only at the compulsory intervention rates, and in 2006 it exercised this option on more than one occasion. In the period after the parliamentary election, in June and July 2006, the NBS intervened on the foreign exchange market since its exchange rate was not corresponding to the economy's development and had weakened excessively. In this period, the koruna remained for several days on the depreciation side of the fluctuation band. The rate then appreciated steadily and reached historical peaks. By the end of the year, the koruna's exchange rate was not in line with the equilibrium value, and, therefore, the NBS intervened again. For most of its time in ERM II, the koruna has been stronger than the central parity and at the end of 2006 it was fluctuating at around 10% above the parity.

Since entry into ERM II, the Slovak economy has gone through significant structural changes. The differential in productivity growth in comparison with the euro area led to substantial strengthening of the real equilibrium exchange rate, and, in an environment

Chart 88 The koruna's exchange rate following entry into ERM II



of relatively low inflation, these developments were reflected in the level of the nominal exchange rate. As a consequence, the central parity ceased to be in line with the current state of the economy. At the request of Slovakia, and with the agreement of members of the ERM II Committee, the koruna's central parity in ERM II was revalued with effect from 19 March 2007, to SKK 35.4424 per euro. The lower compulsory intervention rate was reduced to SKK/EUR 30.1260 and the upper compulsory intervention rate to SKK/EUR 40.7588.

While the Slovak koruna has been in ERM II, its exchange rate against the euro has been sufficiently stable. Despite several interventions, the exchange rate's stability was maintained naturally, and exchange rate stabilization did not have to be sought at the expense of the stability of the rest of the economy.

The fiscal criterion was not met in 2006. The general government deficit excluding the effect of introducing the second pension pillar declined year-on-year to 2.3% of GDP. However since April 2007 costs of pension reform have to be included in the deficit, which raises the deficit to 3.4% of GDP, i.e. above the limit of 3% GDP. It will be important in 2007 to reduce the deficit to the required level.

A lower general government deficit will enable to ensure the long-term sustainability of government debt, which represents the second part of the fiscal criterion. The level of government debt is substantially lower than the reference value limit. The fulfilment of this part of the fiscal criterion has not as yet been in danger. Reducing the deficit and meeting the fiscal

Table 43 **Fulfilment of the Maastricht Criteria in 2006**

Criterion	Figure for 2006	Reference value
Inflation (average HICP, in %)	4.3	2.8
Long-term interest rates (%)	4.4	6.2
Government debt (% of GDP)	30.7	60.0
General government deficit (% of GDP)	3.4	3.0
Exchange rate stability	ERM II since November 2005	

Source: Eurostat, NBS, MF of the SR.

criterion helps to curb demand-side pressures and is therefore essential to fulfilling the inflation criterion. A responsible and credible fiscal policy also supports stabilization of the exchange rate.

Fiscal consolidation is essential not only for meeting the Maastricht Criteria, but also for ensuring that the government has the discretion, during economic downturns, to raise public spending in order to stabilize the economy without fear of breaking the rules of the Stability and Growth Pact.

The fulfilment of the last Maastricht criterion – the level of long-term interest rates – is closely related to meeting the other criteria. Given the decline in inflation and the high credibility of economic policies,

Slovak long-term interest rates are substantially lower than the reference value. If all the other Maastricht Criteria are met, the fulfilment of the interest rate criterion should not be at risk.

Meeting the Maastricht Criteria and introducing the euro in Slovakia represent short-term objectives that support the fulfilment of the more significant and longer-term objectives of real convergence. These objectives include mainly achieving economic growth and higher living standards through increasing the economy's flexibility. On the other hand, nominal convergence – the fulfilment of the Maastricht Criteria – is already taking place with the robust support of real convergence. An example of this is the record economic growth which Slovakia reported in 2006.