# Preparation for the Euro Introduction

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Since acceding to the European Union, Slovakia has been a member of the Economic and Monetary Union (EMU) with a derogation from the obligation to introduce the single European currency – the euro. Under the EU Accession Treaty, Slovakia undertook to take the steps that will enable it to adopt the euro. What is more important, according to the analysis made by the National Bank of Slovakia and the Slovak government, adoption of the euro will be beneficial for the Slovak economy. The main potential benefit of the euro introduction will be an acceleration of economic growth by an estimated 0.7 % (±0.3 %) per year over the decades following entry to the euro area. Other significant advantages of the euro will include elimination of the costs of converting korunas into euros, the removal of the exchange rate risk vis-à-vis the euro, greater price transparency in foreign trade, and a decline in the costs of capital. These benefits outweigh the disadvantages and risks (changeover costs, loss of an independent monetary policy, possible asymmetric shocks, risk of slightly higher inflation). The Government and NBS have therefore decided, under the euro adoption strategy, that Slovakia will adopt the euro as soon as possible after fulfilling the Maastricht Criteria.

In 2005 the National Bank of Slovakia continued to fulfil the Strategy for Adopting the Euro, approved by the Government and the NBS. Preparations for the euro changeover progressed both from the economic policy aspect and on the technical and organizational side. All these efforts are aimed at making Slovakia ready to introduce the euro from 1 January 2009.

Box 1 **Decisions of the Slovak Government and NBS**

16 July 2003
**Strategy for Adopting the Euro in the Slovak Republic:** it is beneficial to adopt the euro as soon as possible after fulfilling the Maastricht Criteria. The euro changeover is expected to take place in 2008 or 2009.

8 September 2004
**Specification of the Strategy for Adopting the Euro:** the target date for the euro changeover is set as 1 January 2009 with the Maastricht Criteria to be fulfilled in 2007.

6 July 2005
**National Euro Changeover Plan for the Slovak Republic:** a plan of the practical steps required for a smooth transition to the euro.

## 8.1 National Euro Changeover Plan and organizational preparations

In the first half of 2005 the National Euro Changeover Plan for the Slovak Republic was drawn up by the NBS together with the Ministry of Finance of the Slovak Republic (MF SR) and other institutions. Besides the NBS and MF SR the preparation has involved the Ministry of Economy of the SR, Ministry of Justice of the SR, the Ministry of Labour, Social Affairs and Family of the SR, the Ministry of Interior of the SR, the Office of the Government of the SR, the Association of Banks, the Association of Towns and Municipalities of Slovakia, the Antimonopoly Office of the SR, the Statistical Office of the SR, the Financial Market Authority, the Slovak Chamber of Commerce and Industry, Slovak Radio, Slovak Television, the Slovak Trade Inspectorate, the Social Insurance Agency, and other invited organizations.

The euro changeover is a complex process affecting every entity in the Slovak economy and the society as a whole. The Changeover Plan defines the most important organizational and technical tasks that have to be met prior to the euro changeover and it designates the institutions responsible for meeting them. During the euro changeover process, all entities in Slovakia will be able to rely on this document. The euro will be introduced simultaneously into cash and non-cash circulation in Slovakia; without a transition period.

The aim of the Changeover Plan is to introduce the euro quickly and smoothly, to the satisfaction of the whole society. The leading organizational role is performed by the National Coordination Committee for the Euro Changeover in the Slovak Republic (the Committee), under the leadership of the Minister of Finance of the SR and with the NBS Governor as his deputy. Six working committees have been set up to address specialized tasks, and two of them – the Working Committee for Banks and the Financial Sector and the Working Committee for Communication – are led by the National Bank of Slovakia. At the end of 2005 a government commissioner for the euro changeover was appointed in order to coordinate day-to-day activities of the working committees and to present euro changeover issues to the general public.

The tasks set out in the Changeover Plan are divided according to the main areas of economic activity, in other words according to the fields of the individual working groups, as follows: the financial sector, general government, corporate sector and consumers, legislative tasks, communication, and adjustment of information and statistical systems. The Changeover Plan lays down the time requirements for individual tasks, as well as their control dates and fulfilment deadlines. Also stated in the Changeover Plan are the core principles of the euro changeover including: Big Bang (simultaneous introduction of the euro into cash and non-cash circulation), the principle of continuity of contracts, the principle of not harming the citizen, avoidance of unjustified price increases, and the minimizing of euro changeover costs.

During 2005 the National Bank of Slovakia fulfilled all the tasks assigned to it for that year under the Changeover Plan. These included drafting an internal plan for the transition to the euro, adopting core deci-

Box 2 **National sides of Slovak euro coins**

**1 euro and 2 euros – Double cross on three hills**
(designed by sculptor Ivan Řehák)
The double cross on three hills represents the coat of arms of the Slovak Republic, one of the symbols of the state. It is set in a circular area against a relief of stylised rocks that symbolize the permanence and strength of the state.

**10, 20 and 50 cents – Bratislava Castle**
(designed by Ján Černaj and Pavel Károly)
Bratislava Castle is the dominant sight in the capital city of Slovakia. It is a national cultural monument that is among the best-known symbols of Bratislava. Set within the castle motif is the coat of arms of the Slovak Republic, one of the symbols of the state.

**1 cent, 2 cents and 5 cents – Kriváň**
(design by Drahomír Zobek)
Kriváň, a peak in the Tatra Mountains, has associations with key events of the Slovak nation. As the destination for tours undertaken by patriots associated with Ľudovít Štúr, it played an important role in the struggle for national awakening. During the Slovak National Uprising, the fight for freedom took place in its vicinity. Consequently, it has come to symbolize the defence of the sovereignty and historical territory of the Slovak nation.

**Designs of the national sides of Slovak euro coins**

2 euros

1 euro


50 cents


20 cents

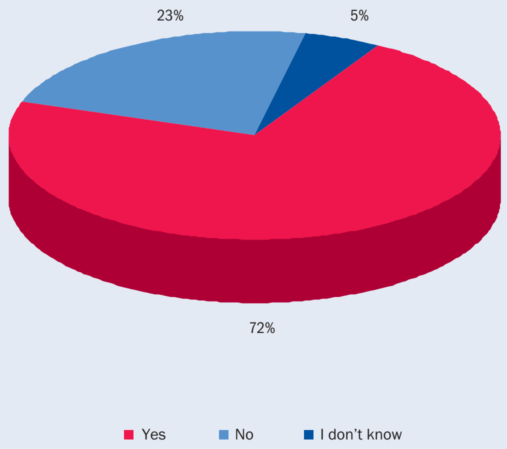

10 cents

1 cent, 2 cents and 5 cents

sions on the future payment system in Slovakia, and conducting a large number of various communication activities (exhibitions, lectures, seminars, media presentations). The NBS was also involved in preparation of the legislative schedule for the euro changeover.

A special mention should be made about the selection of the national sides of Slovak euro coins, which was carried out with public participation. In July 2004 the National Bank of Slovakia announced a competition for the anonymous submission of designs for the national sides of the euro coins. Altogether 658 designs were entered, and the ten best were selected over two rounds by expert committees and the NBS Bank Board. The NBS then presented the ten designs for a public opinion poll conducted between 12 and 20 November 2005. People could present their preferences via the Internet, SMS or fixed-line telephone. More than 140,000 votes were received. In selecting the designs for Slovak euro coins the NBS Bank Board respected the public opinion and chose the three designs that have received the most votes.

Chart 61 **Public support in Slovakia for the euro introduction** (%)




*Source: Eurobarometer 2005.*

Box 3 **Maastricht Criteria**

Before entering the euro area, Slovakia, like any other non-euro area state, must fulfil the four convergence criteria – the Maastricht Criteria under the Maastricht Treaty:

1. **Public finances:** The general government deficit for the last year before assessment, based on ESA 95 methodology, may not exceed 3% of GDP. A slightly higher deficit is allowed in countries introducing a capitalized pension pillar and in other strictly defined circumstances. At the same time, total government debt may not exceed 60% of GDP.
2. **Inflation:** Average inflation for the previous 12 months, as measured by the Harmonized Index of Consumer Prices (HICP), may not exceed by more than 1.5 percentage points the average of the three EU countries with the best performance in terms of price stability.
3. **Stability of long-term interest rates:** Average market interest rates on long-term government or similar bonds may not exceed by more than 2 percentage points the average of the three EU countries with the best performance in terms of price stability.
4. **Exchange rate stability:** The Slovak koruna must participate in the exchange rate mechanism (ERM II) for two years prior to assessment. During this period the Slovak koruna may not be unilaterally devalued, nor may it deviate from the agreed fluctuation band; it must remain close to the central parity and there must be no serious severe tensions in the development of its exchange rate.

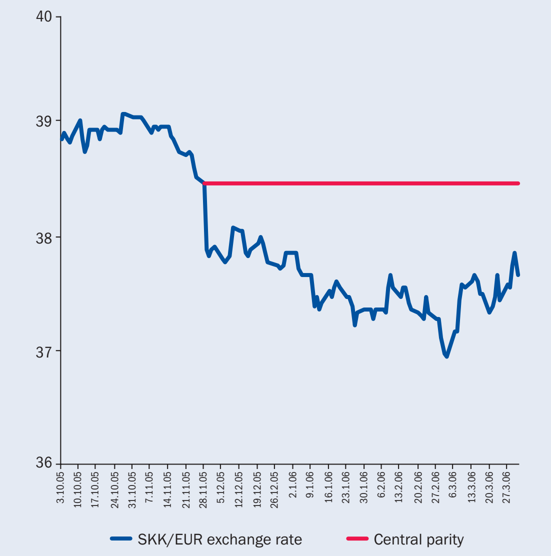
Table 39 **Process towards the euro changeover**

| | |
|---|---|
| Fulfilment of Maastricht Criteria | 2007 to March 2008 |
| Convergence reports by the ECB and European Commission | April 2008 |
| EC proposal to the EU Council for abrogation of derogation | May 2008 |
| Consultation with the European Parliament | May 2008 |
| EU Council to abrogate the derogation and set the conversion rate | June 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 |

As for Changeover Plan tasks for which the NBS is not responsible, most of those with a fulfilment deadline in 2005 were completed on time. The majority of unfulfilled tasks were completed at the beginning of 2006 and did not pose any risk to the fulfilment of related activities. Overall, preparations for the euro changeover in Slovakia are progressing satisfactorily, a fact confirmed at the beginning of 2006 by the regular semi-annual report on the fulfilment of tasks under Changeover Plan.

Preparations for the euro changeover in Slovakia have also received positive response from abroad. The European Commission's second report on practical preparations for the future enlargement of the euro area, published in November 2005, described the situation in Slovakia as the best among all the new EU Member States. The Commission commended the Changeover Plan for its comprehensiveness and for providing all sectors and affected persons with the information necessary to make their own preparations.

Chart 62 **Exchange rate of the koruna since ERM II entry**




*Source: NBS.*

## 8.2 Entry into ERM II

Before a country adopts the euro, its currency must spend at least two years in the European Exchange Rate Mechanism, ERM II. During this period, the country must show that its currency is sufficiently stable against the euro and therefore the exchange rate may be irrevocably fixed upon the euro changeover. The country must also demonstrate during this period that it can maintain exchange rate stability without having to resort to measures at the expense of the stability of the rest of the economy.

The Slovak koruna joined ERM II on 28 November 2005. This agreement was reached on 25 November at a meeting of finance ministers from euro area countries, the ECB president, and finance ministers and central bank governors from Cyprus, Denmark, Estonia, Lithuania, Latvia, Malta, Slovenia and Slovakia. Due in part to very good cooperation between the Ministry of Finance and the NBS, the discussions on ERM II entry were concluded in an exceptionally short time.

Together with the decision on entry, the central parity was set at SKK 38.4550 per euro. At the proposal of Slovakia, the central parity was fixed at the market exchange rate. The Slovak representatives made this proposal on the grounds that the current market rate at that time fully corresponded to the medium-term equilibrium exchange rate.

The koruna observes the standard fluctuation band of ±15% around the central parity in ERM II. The lower compulsory intervention rate is set at 32.6868 SKK/EUR and the upper rate at 44.2233 SKK/EUR. 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. Naturally, the NBS may intervene to stabilize the exchange rate at any time, not only at the compulsory intervention rates. Since ERM II entry, however, the NBS has not exercised this option in 2005. Unlike the majority of countries that joined ERM II in 2004 or at the beginning of 2005, Slovakia has not made any unilateral commitment to maintain the exchange rate within a band narrower than ±15% around the central parity.

Upon joining ERM II Slovakia pledged to continue pursuing a responsible economic policy that supports the the exchange rate stability within ERM II. The main emphasis is on sound fiscal policy and on keeping wage growth in line with productivity growth, though it is also important to continue with structural reforms. These steps are fully in accordance with the Convergence Programme of the Slovak Republic and the NBS monetary programme. While the fulfilment of these commitments is primarily in the interest of Slovakia, it also respects the common interest of all ERM II and euro area members in strengthening exchange rate stability.

The foreign exchange markets reacted very positively to the koruna joining ERM II, and the currency immediately appreciated by around 1.5%. Investors saw entry into ERM II as confirmation of Slovakia's course towards the euro area and a key step on the way to adopting the euro in 2009 as planned. In 2005 the koruna has traded on the stronger side of the fluctuation band in ERM II, between 1% and 4% above the central parity.

Membership in the ERM II and the fixed central parity should contribute to the stable development of the koruna exchange rate. Maintaining exchange rate stability is now a joint responsibility of the Slovak Government and the National Bank of Slovakia. The Government has declared its determination to support the stability of the koruna exchange rate in ERM II with the fiscal policy and structural policies.

## 8.3 Economic policies for the euro introduction

Prior to the euro introduction in Slovakia, there need to be appropriate economic policies to ensure that
1) Slovakia fulfils the Maastricht Criteria on time and is able to adopt the euro on 1 January 2009;
2) 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.

With regard to the euro adoption, the most important objective of economic policies for the next two years is to make progress in nominal convergence so that Slovakia fulfils the Maastricht Criteria in 2007. The National Bank of Slovakia shares the responsibility for meeting these criteria. This objective was one of the reasons for the change in monetary policy framework to inflation targeting. Given the need not only to meet an inflation target but also to meet the exchange rate stability criterion, the NBS has introduced a slightly modified system of inflation targeting, called inflation targeting in the conditions of ERM II.

The primary objective of this new method of conducting monetary policy is to fulfil the Maastricht inflation target in 2007 or at the beginning of 2008. Inflation targeting by the NBS had a successful introduction in 2005. The interim target for end-year inflation was set at below 4%, and this was met despite the increase in oil and energy prices and the rise in regulated prices.

The average rate of inflation for 2005 stood at 2.8%, which was slightly higher than the reference value of the inflation criterion, though at the same time it was the closest to the target in Slovak history. As regards the euro adoption, the most important year will be 2007, for which the NBS has set an HICP inflation target of up to 2%. The target was set low in order to provide sufficient margin in the event of an unexpectedly low the inflation criterion reference value. Besides setting a clear target for inflation, the inflation-targeting regime is able to exert a positive effect on inflation expectations, and thus contribute to the reduction of inflation.

The second objective, for which the NBS is co-responsible, is exchange rate stability in ERM II. The koruna exchange rate followed a stable course in 2005, but the koruna only joined ERM II in November, and the fulfilment of the exchange rate criterion cannot be assessed until the condition of two year membership in ERM II is met. Exchange rate stability is at present a joint responsibility of the Slovak Government and the NBS; the central bank should respond to short-term fluctuations of the exchange rate, and, together with the Government, should both maintain the medium-term development of the exchange rate close to the equilibrium level and prevent creation of imbalances that could affect exchange rate development.

In 2005, the fiscal criterion was fulfilled for the first time. The general government finances were unexpectedly successful, with the eventual deficit of 2.9% of GDP substantially lower than budgeted. This indicator does not, however, include the loss in revenues due to the introduction of the second pension pillar. After taking into account the costs of pension reform, the deficit in 2006 will exceed the limit of 3% of GDP. What will be important, however, is to decrease the deficit to the required level in 2007. This is necessary not only to fulfil the Maastricht Criterion on public finances, but also for other reasons. Fiscal consolidation helps to curb demand pressures and is therefore essential to meeting the inflation criterion. Having a responsible and above all a credible fiscal policy also supports exchange rate stability. Deficit reduction is further required to create room for using discretionary policy tools in worse economic conditions for econo-

Table 40 **Fulfilment of the Maastricht Criteria in 2005**

| Criterion | Value for 2005 | Reference value |
|---|---|---|
| Inflation (average HICP, in %) | 2.8 | 2.5 |
| Long-term interest rates (%) | 3.5 | 5.4 |
| Government debt (% of GDP) | 35.2 | 60.0 |
| General government deficit (% of GDP)[1)] | 2.9 | 3.0 |
| Exchange rate stability | ERM II since November 2005 | |

*Sources: Eurostat, NBS, Ministry of Finance of the SR.*
*1) Excluding the effect of pension reform.*

mic stabilization without fear of breaking the rules of the Stability and Growth Pact. Finally, a low general government deficit is required to ensure the long-term sustainability of government debt.

Long-term interest rates represent the final Maastricht Criterion. Given the decline in inflation and the high credibility of economic policies, Slovak long-term interest rates are substantially below the reference value. Should all the other Maastricht Criteria be met, the fulfilment of the interest rate criterion will not be at risk.

Slovak progress in nominal convergence – in meeting the Maastricht Criteria – also supports gradual real convergence, above all strong economic growth and a rising standard of living. But there is also an opposite relationship – progress in real convergence makes it easier to fulfil the Maastricht Criteria. The ultimate aim of the euro adoption is to further accelerate real convergence. The benefits of joining the euro area can be fully exploited only with a highly flexible economy. That is why the NBS supports structural reforms, especially labour market reforms that make the Slovak economy more flexible and increase its resistance to possible shocks.