



Euro adoption by Slovakia: the challenges ahead

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"The Impact of the Euro Changeover on Inflation and
Interest Rates in the Slovak Republic"

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Outline

1. Policy challenges in the euro area
2. Policy needs for Slovakia

1. Policy challenges in the euro area

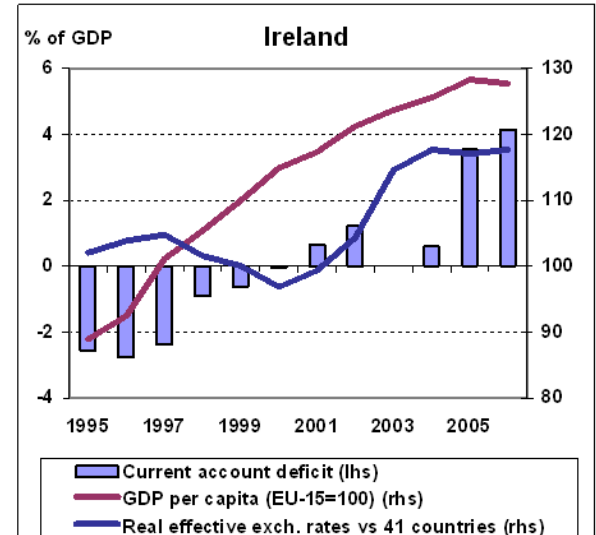
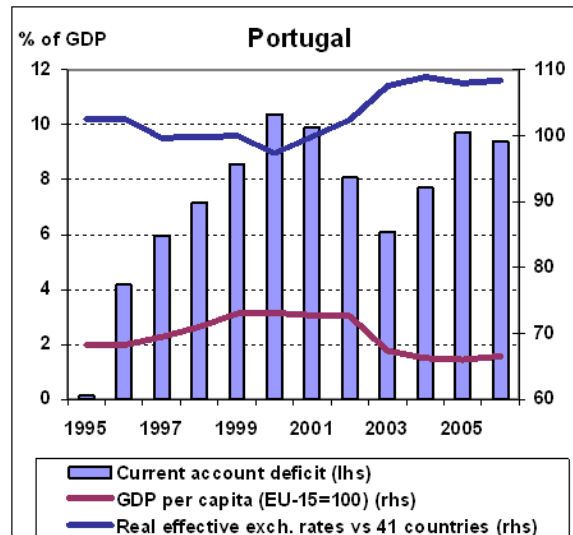
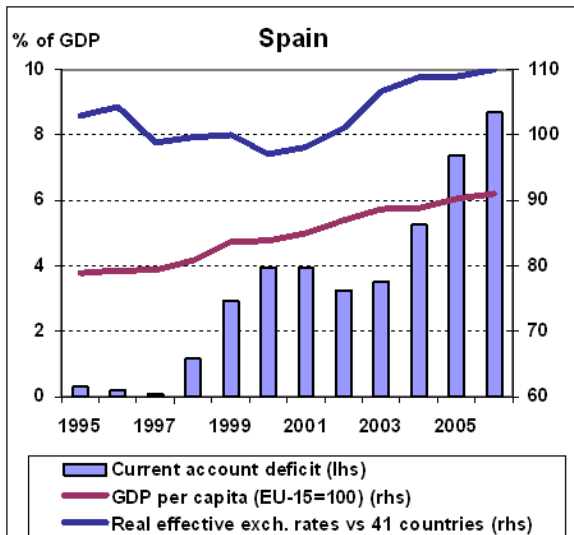
- EMU - need for stronger domestic adjustment mechanism
- Catching-up countries – more demanding still due to need to ensure rapid real convergence and macroeconomic stability
- SK - atypical path to the euro (sustained XR appreciation). Larger regime change than for previous cases. Uncertain impact on domestic agents

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1. Policy challenges in the euro area

Lessons from first 10 years of the euro :

- Catching-up MS (IE, ES, PT) – Euro-related credit booms; Policies important (growth-enhancing use of capital inflows; supportive role of fiscal policy in containing demand pressures; efficient resource allocation on labour and product markets)
- Risk of drawn out overheating – overcooling cycles
- Reform fatigue after euro adoption



2. Policy needs for Slovakia

Overriding policy objective: assuring continuing rapid real convergence while safeguarding macro-economic stability .

Policy needs:

- **Fiscal policy**
- **Structural reforms**
- **Credit growth**

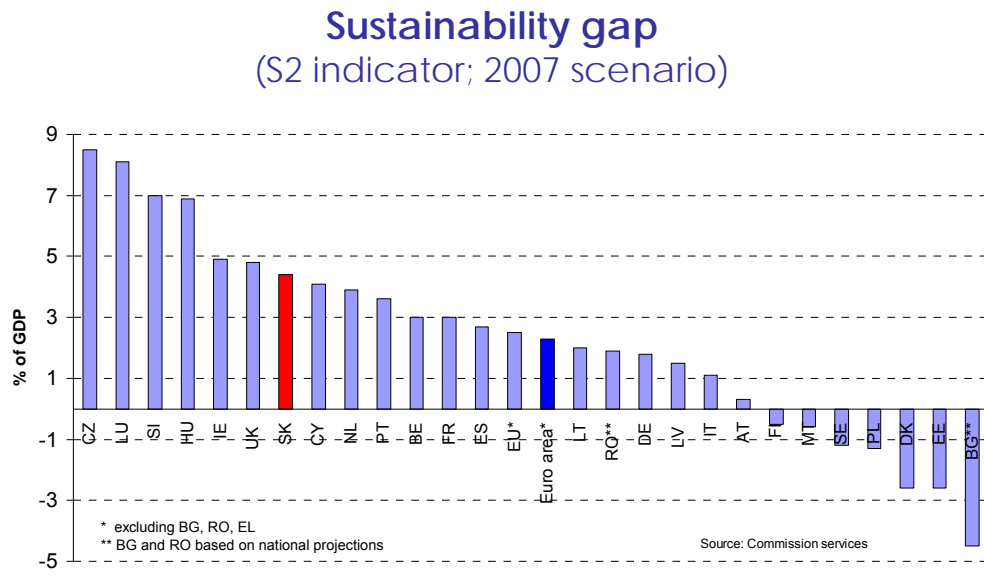
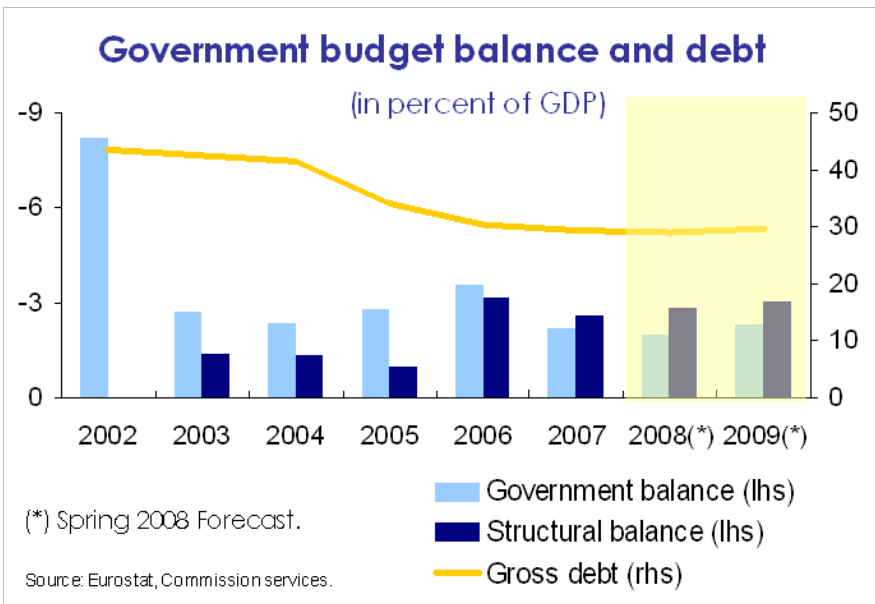


2. Policy needs for Slovakia

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a) Fiscal policy

- Deficit was **2.2%** in 2007, forecast to be 2.0% in 2008 and 2.3% in 2009. Debt was **29.4% of GDP** in 2007 and is forecast to stabilise.
- Little structural effort so far - More ambitious fiscal policy needed to prevent inflationary pressures and overheating
- Quality of public finances
- Long-term sustainability of public finances

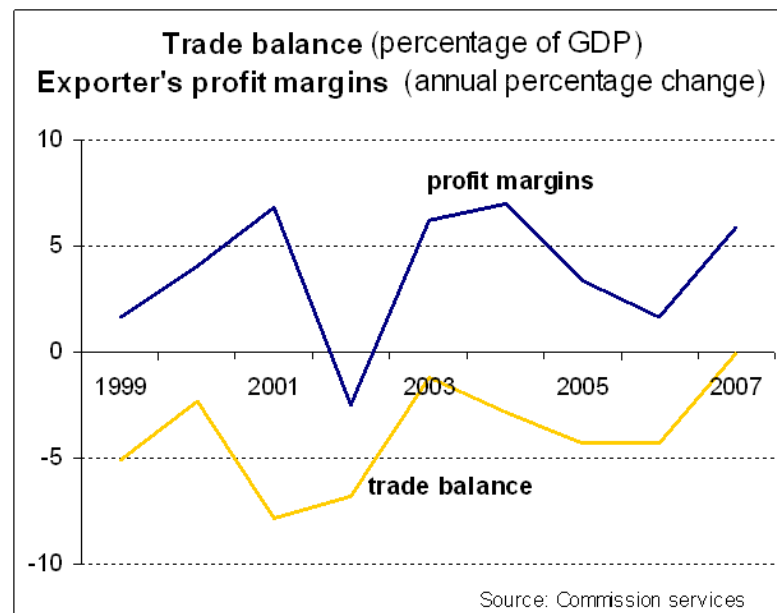
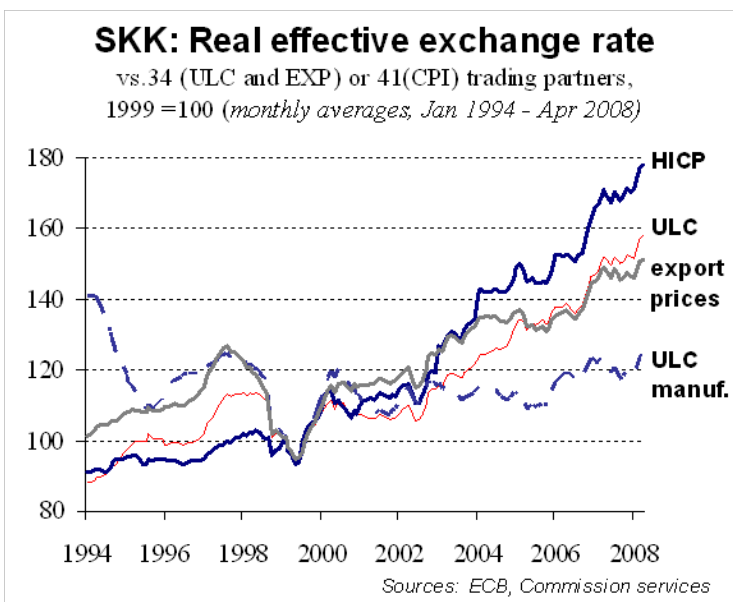


2. Policy needs for Slovakia

b) Structural reform

need for strong adjustment capacity in EMU; preserve competitiveness

- Strong real appreciation has not been detrimental to external cost competitiveness so far (improving trade balance, profit margins)
- BUT, risk of rise in ULC/ loss of competitiveness after the FDI-induced productivity surge has subsided



2. Policy needs for Slovakia

Key areas for reform

- Labour markets: tackle high structural unemployment, regional disparities and emerging skill mismatches
- Product markets: strengthen competitive environment (e.g. utilities)
- Education and R&D: enhance the institutional framework
- Business environment: less red-tape

2. Policy needs for Slovakia

c) Credit growth

- Good starting position
- Vigilance to excessive credit boom after euro adoption
- Cross-border dimension

Last but not least, careful management of the changeover is key

Concluding remarks

- Slovakia has made impressive progress with both real and nominal convergence
- Euro area is open to all MS fulfilling the criteria
- The Maastricht-based assessment is over but the euro is a permanent commitment. Strong policies needed after euro adoption