Gertrude Tumpel-Gugerell: A case for rapid euro adoption

Introduction for panel discussion by Ms Gertrude Tumpel-Gugerell, Member of the Executive Board of the European Central Bank, at the Austrian National Bank Conference on European Economic Integration on "The Euro's Contribution to Economic Stability in CESEE", Vienna, 16 November 2009.

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Ladies and gentlemen,[1]

It is a pleasure to be at this conference among such distinguished panellists to speak about the European economic integration and the adoption of the euro. For us at the ECB, the topic of the optimal timing of euro adoption for the EU countries in Central and Eastern Europe (CEE) that have not yet done so is very important. According to the Maastricht Treaty, all EU countries are called upon adopting the euro at some stage. So it's not a question of if, but rather on when to join.

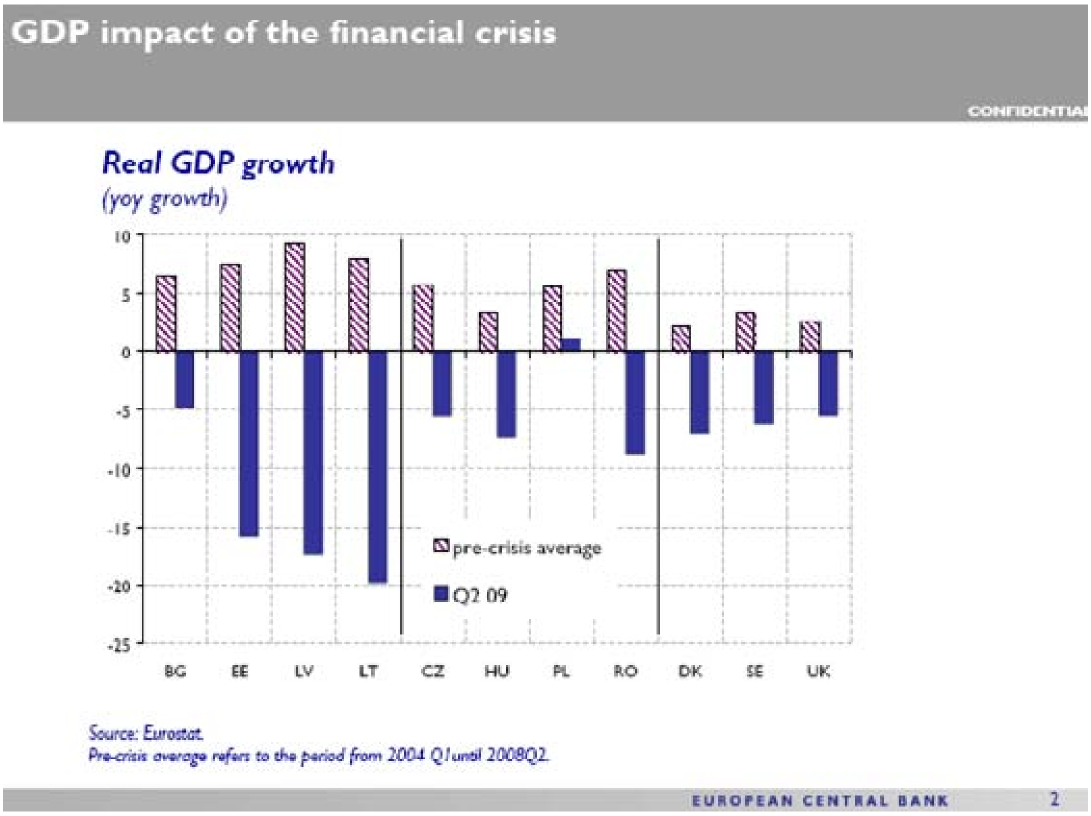
However, to ensure that the monetary union is working smoothly, it is essential – and the Maastricht Treaty has foreseen this – that the countries joining the euro area have achieved a sufficient degree of sustainable convergence. This is first of all in the interest of the country concerned. Moreover, sustainable convergence is a cornerstone of the European Monetary Union on which the success story of the euro is built. Since its introduction back in 1999, the euro has become one of the major currencies of the world. The low inflation environment in the euro area can be largely attributed to the well anchored inflation expectations and the high credibility of the ECB's monetary policy strategy to ensure price stability over the medium-term. During the global financial crisis, it became apparent that the euro has been an important shelter for the euro area countries to protect them against what otherwise may have resulted in an exchange rate and balance of payments crisis. This led to the widespread perception that the euro area is a safe haven.

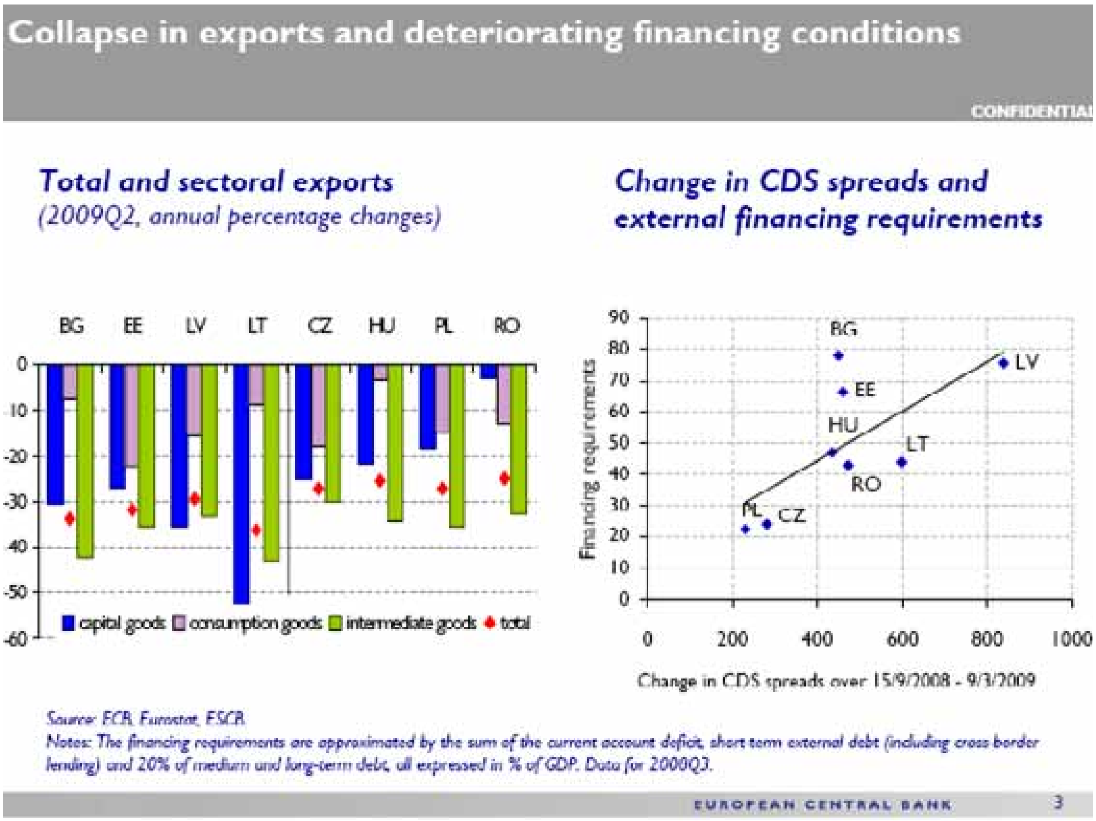
Let me in the following speak about the economic situation in the CEE countries and their prospect on joining the euro.

The CEE countries have been strongly hit by the financial crisis

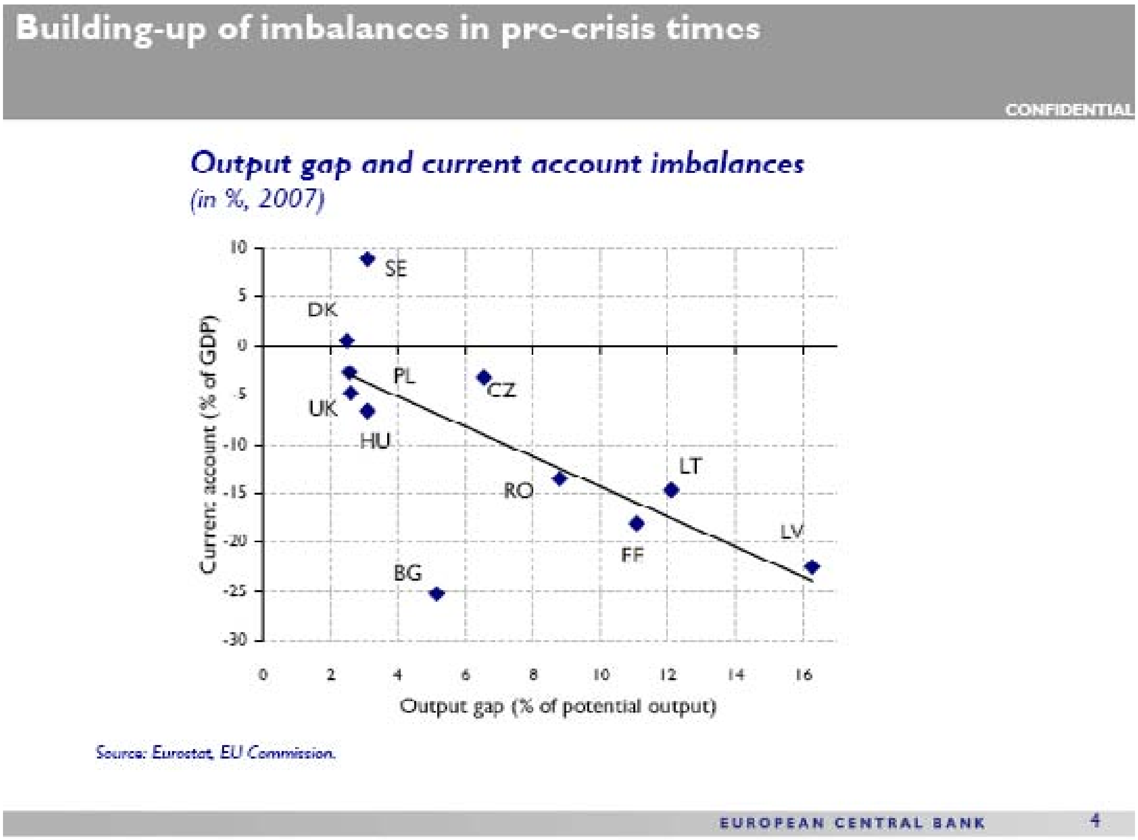
Following the bankruptcy of Lehman Brothers, the CEE countries have been strongly hit by the global financial crisis, although at varying degrees across countries. Due to the slump in global activity, heightened risk aversion by international investors and a de-leveraging by financial institutions, most CEE countries have seen a significant weakening of export demand and a substantial worsening of their external financing conditions. It seems that financing difficulties have been particularly severe in those countries that had accumulated large imbalances during pre-crisis times and whose debt structure was characterised by significant currency and maturity mismatches. In some countries balance sheet effects associated with large exchange rate depreciations posed a risk to financial stability.

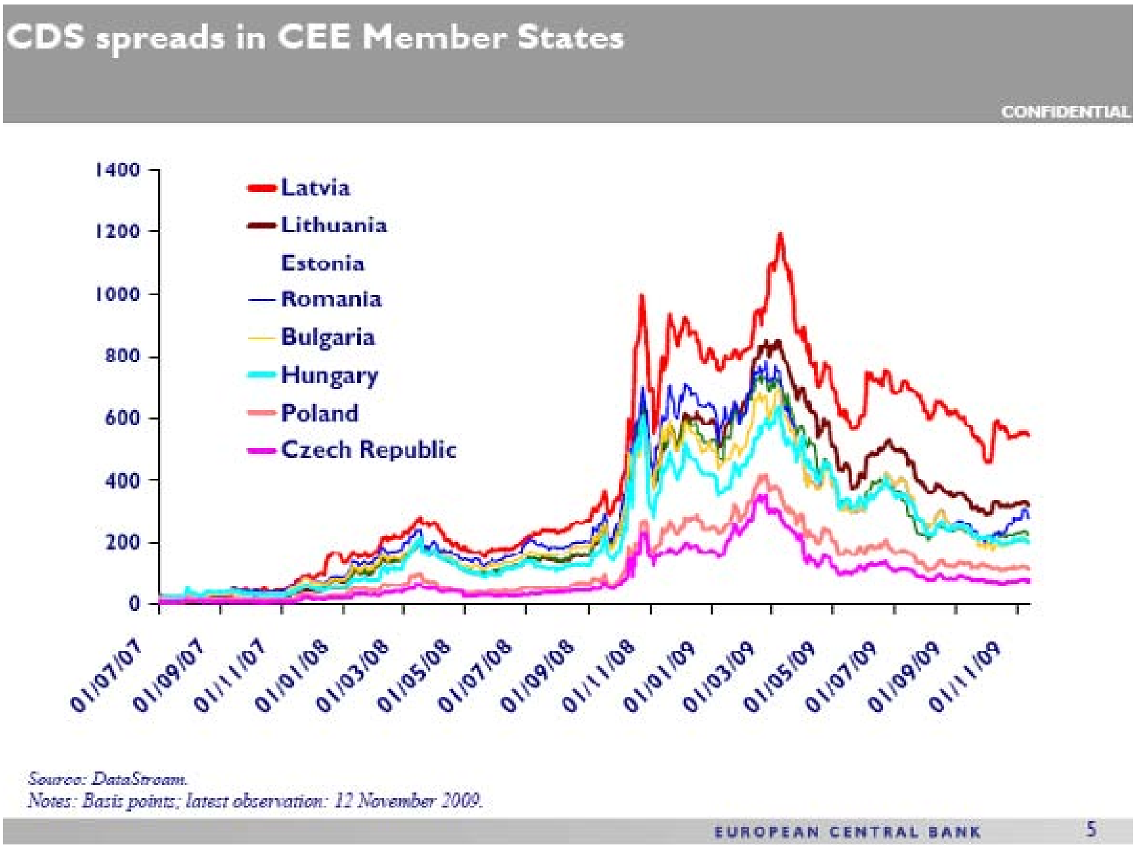
[1] I would like to thank Carolin Nerlich and Eva Katalin Polgar for their valuable input to the preparation of this intervention.





The financial crisis reversed some of the impressive progress that the CEE countries had already made in terms of convergence. In the years preceding the crisis most CEE countries were growing rapidly. However, excessive credit growth, substantial wage increases and house price bubbles, contributed to the overheating of some of the economies. This in turn led to a widening of the positive output gap and a non-sustainable deterioration of the current account position. Moreover, the overheating pressures in some countries translated into rising inflation and led to a real appreciation of their currencies, which in turn aggravated the external imbalances further.





To dampen the impact of the crisis, national authorities have adopted a number of policy measures, which however differed significantly across countries, depending on the room for manoeuvre to adopt supportive monetary and fiscal policies in the various countries.

Substantial EU and ECB support to weather the crisis

Also the international and European community provided substantial financial support to some countries in the region. The EU supported some CEE countries via the medium-term financial assistance (MTFA) facility, in conjunction with the IMF programmes. This MTFA facility was substantially increased during the crisis and also the EU structural funds have helped to cushion the impact of the crisis.

Let me also emphasize the support from the ECB, contributing to the stabilisation of financial markets in the region. Many banks in the CEE countries are owned by euro area banks. Therefore, the CEE countries benefited strongly from the ECB's enhanced credit support policy and the unlimited provision of liquidity to euro area banks. On top of this, the ECB has offered some of the national central banks repo lines to meet euro liquidity needs.

Overall, we can say that European authorities and institutions have supported the CEE countries to weather the crisis.

Need to return to a sustainable convergence process

The financial crisis has clearly shown how important it is generally for *any country* in the EU to embark on policies aimed at sustainable growth paths. This includes sound economic policies, enhanced economic flexibility and the building-up of fiscal buffers in normal times. Also the regulatory framework for financial markets has to be adjusted at the national and supranational level such as to ensure economic and financial stability.

The need for such policies and the need for pursuing a regulatory reform agenda, certainly applies to all EU countries, not just the CEE countries. That said, there have been some proposals that a rapid euro adoption could help the CEE countries to overcome the impact of the crisis more quickly. On this, let me stress that policies to overcome the financial crisis and the adoption of the euro are two distinct issues that need to be clearly separated.

On the one hand, policies to overcome the crisis – such as large fiscal measures – were clearly needed and have been put in place in all EU countries. Now that the worst of the financial crisis seems to be over, we have to return to sustainable policies and must advance with the regulatory reform agenda as spelled out by the G20.

On the other hand, the financial crisis has not changed anything with respect to the procedure governing the euro adoption process. Before joining the euro area, countries need to ensure that the right accompanying policies are implemented and that the structure of their economies ensures a high shock absorption capacity. In particular, the economies need to be sufficiently flexible to cope with the more limited range of economic policy instruments once they enter the euro area. While the CEE countries have already made good progress in this respect before the crisis, further efforts are needed. The financial crisis has hit the CEE countries in a severe way and, therefore, required a forceful policy response. Once the crisis is over, a return to sustainable policies is absolutely essential for the further convergence process. A sufficient degree of sustainable convergence is crucial for the CEE countries, to be able to reap the full benefits of euro area membership. Otherwise, the single monetary policy of the euro area might not be suitable, thereby bearing the risk of boom-bust cycles and high inflation volatility in the country concerned.

All this underlines the importance of a credible euro adoption strategy. I should emphasize that entering the euro area prematurely – that is before reaching a sufficient degree of convergence and economic flexibility – would not be a panacea for the CEE countries to overcome the crisis impact. On the contrary, a premature entry into the euro area would deprive the countries from important adjustment tools and would therefore not be in the interest of the country joining.

A credible euro adoption strategy is important

A credible euro adoption strategy helps stabilising the economies, as it provides an important anchor for policymakers. As already mentioned before, a credible strategy requires in particular responsible macroeconomic policies and advancements in structural reforms.

One essential element of the countries' euro adoption strategies relates to the credibility of timetables. At the time of EU accession most countries had announced to join the euro area as soon as possible. We all know that this was based on assumptions at the time of the accession. The recent financial crisis has impacted the convergence progress and has moved the euro adoption further into the future. Therefore, individual countries' timetables have to be carefully looked at and adjustments may be necessary.

Let me emphasise that an overly ambitious timetable for adopting the euro can be rather costly for the country concerned. This may encourage market participants to pursue strategies which may prove to be risky if the timetable turns out not to be achievable. We observed this in some CEE countries, which for example allowed the emergence of unsustainable credit growth and a large share of loans denominated in euro.

A look beyond the EU borders

The financial crisis also took its toll outside EU borders. Many non-EU emerging European economies, including EU candidate and potential candidate countries, recorded a strong fall in external and domestic demand, amid mounting concerns over financial stability and increased uncertainty about the availability of external financing.

While policymakers in these countries currently focus rather on the entry into the EU and not on euro adoption, the need for sustainable convergence is still high on their agenda. Overall, non-EU emerging European economies are in the early stages of catching-up in income levels with those of the EU. Ensuring a smooth process of real and nominal convergence is therefore a key priority in the region. Moreover, the risks of boom-bust cycles in credit or asset prices have been amply illustrated by the recent developments, whereby countries with sounder fundamentals were generally less affected by the crisis. Rapid and determined international policy actions, including support from European institutions via Macro-Financial Assistance (MFA) and Instrument for Pre-Accession Assistance (IPA) funds have contributed to bringing confidence back.

Moreover, I have to mention an issue of relevance for some economies in the region, namely the official, unilateral use of the euro. As you all know, unilateral euroisation is not in line with the provisions of the Treaty. And as the recent intensive financial pressures experienced by the unilaterally euroised economies (in particular Montenegro) have also illustrated, the unilateral adoption of the euro is not the magic tool that automatically provides protection against the impact of external shocks.

Concluding remarks

Let me conclude my remarks. The CEE countries have already made significant progress with respect to their catching-up with the euro area. However, some of the countries have been severely hit by the financial crisis. This clearly has an impact on the state of the convergence process of the CEE countries and has potentially moved euro adoption further into the future. The timetables of the euro adoption have to be carefully assessed, given particularly the large uncertainties that are associated with the current economic and financial situation.

One thing, however, needs to be very clear. The financial crisis has not changed our policy for adopting the euro. Therefore, to prematurely adopt the euro, in particular if not accompanied by a sufficient degree of sustainable convergence, is certainly not a solution to overcome the impact of the crisis. Only a credible euro adoption strategy helps stabilising the economies, also with respect to the crisis impact. Achieving sustainable convergence can be seen as an important anchor and an opportunity for the CEE countries to adopt economic policies that will eventually lead to the successful adoption of the euro, hopefully not in the too distant future.