

Jean-Claude Trichet: Slovenia's adaption of the euro

Keynote address by Mr Jean-Claude Trichet, President of the European Central Bank, at the "€conference Slovenia", organised by the Bank of Slovenia and the European Central Bank, Ljubljana, 15 January 2007.

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Ladies and Gentlemen,

It is a great pleasure to talk to you here, in Ljubljana at a conference celebrating the adoption of the euro on the very first day, when the euro is the single currency in circulation in Slovenia. Let me first and foremost congratulate to all parties involved in the successful cash changeover two weeks ago, that went very smooth and without any problems. Not only did Slovenia perform exceptionally well in its convergence process to the euro area, but the last bit, the cash changeover was also exemplary so far.

It is amazing to recall that Slovenia had three currencies over a period of just 15 years (Dinar, tolar and euro) - even disregarding the coupons or vouchers that were in circulation for about 1 year prior to the introduction of the tolar. To me this is clearly a sign that economic developments can happen very fast if a country is determined to make rapid progress. After all, who would have thought 10 or 15 years ago that Slovenia would today celebrate the adoption of the euro?

It has been exactly five years since the first – and until two weeks ago the last – euro area enlargement, when Greece joined the original eleven euro area members. Let me say that I am delighted that after half a decade we can today welcome again a new country to the euro area and expand the number of participating countries from 12 to 13. Measured in terms of population and economic activity, the euro area is one of the largest economies in the world. The euro serves as single currency to more than 300 million citizens; today around 317 million people including the Slovene population of two million, and the euro area GDP amounts to just above 8000 billion euros.

Slovenia is the first of the ten countries that joined the EU in 2004 that managed to comply with the criteria to join the single currency, thus allowing it to introduce the euro as the national currency. After all it is only two and a half years after Slovenia joined the EU and today we already have the pleasure to welcome Slovenia also in the euro area.

The adoption of the euro that we are celebrating today is a result of the macroeconomic policies that the authorities of Slovenia have pursued and the macroeconomic performance they have achieved. As a result, Slovenia has made significant progress in nominal and real convergence over recent years, owing to a successful policy-mix, in particular well-managed monetary and exchange rate policies, sound fiscal policy and a range of structural reforms. Inflation came down from 8.9% in 2001 to 2.5% in 2006. Accordingly, both short-term and long-term interest rates fell considerably and are now in line with the euro area average. While the short-term interest rate differential vis-à-vis the euro area persisted until recently, reflecting the monetary policy strategy pursued by Banka Slovenije, long-term interest rates approached levels close to the euro area already in 2004, reflecting market confidence in general economic and fiscal developments in Slovenia and the credibility of the monetary and exchange rate policy.

The process of nominal convergence has been accompanied by robust economic growth. Real GDP growth in Slovenia has been well above the euro area in the recent years. Growth has been underpinned by domestic demand as well as strong exports, which reflects the increased integration of Slovenia with the EU and the euro area. In this respect, foreign direct investment (FDI) has also been an important factor. Nevertheless, we should bear in mind that Slovenia has a good opportunity to catch up further with the euro area average income. Slovenia's GDP per capita (in PPP terms) progressed from 60 % of the euro area average in 1995 to 76 % in 2005: this is a significant improvement, which also still gives room for catching up towards the EU average.

High economic growth and advances in income per capita levels clearly indicate the progress made in real convergence. Indeed, nominal and real convergence are interdependent processes and nominal convergence provides the necessary environment for lasting real convergence. At the same time, real convergence also requires continued efforts to remove rigidities in the labour and goods markets, as well as continued efforts to reform the financial system.

It is remarkable that Slovenia has achieved its progress in nominal and real convergence without experiencing major imbalances; in particular the Slovenian current account balance has remained contained over quite a long period of time. The fiscal balance (the deficit-to-GDP ratio) has been on a broadly improving trend since 2000 (even though further consolidation is required for Slovenia to comply with the medium-term objective quantified in the convergence programme). Looking at the financial side, Slovenia is experiencing a substantial process of financial deepening, which has been reflected in robust credit activity. In this context let me say that the process of financial deepening, which is taking place in almost all countries that joined the EU in 2004 and 2007 will also support economic development as it is expected to promote more efficient investment. However, this process does require careful monitoring and strong prudential supervision, in particular if financial deepening takes place at a very rapid pace.

Another element of Slovenia's successful convergence experience is its participation in the Exchange Rate Mechanism II (ERM II). Slovenia's participation in the Mechanism has been smooth. The parity at which Slovenia entered the ERM II was set at the market rate at the time of ERM II entry and the tolar-euro exchange rate remained very close to the parity for the entire period of ERM II participation. As a consequence, the EU Council decided that the central parity should also become the final conversion rate of the tolar to the euro.

Let me use this opportunity to stress again that participation in ERM II is a very important step on the road to the euro. A smooth participation in ERM II is testimony for the sustainability of the necessary convergence process prior the adoption of the euro. ERM II participation ties the exchange rate and hence acts as a "testing phase" of the irrevocably exchange rate fixation. In this respect, the mechanism provides flexibility with a 15% band around the parity and the possibility of mutually agreed realignments of the parity. Let me also recall that while two years of participation are the minimum period required, there are no limits on the maximum length of the participation. This in turn allows countries which have not yet achieved a sufficient level of sustainable convergence with regard to all criteria to adequately prepare for the single currency while already enjoying the benefits of a stable exchange rate anchor.

Let me at this point also mention that currently there are seven countries participating in the ERM II (Denmark since 1979 [ERM I], Estonia and Lithuania that joined ERM II in 2004, Cyprus, Malta, Latvia and Slovakia that joined in 2005). For these countries, the ERM II experience has been and remains a useful test to check whether their economies can work smoothly under conditions of stable exchange rates or whether further efforts are needed to make the convergence process sustainable.

Finally, let me say that the ECB has established excellent working relations with Banka Slovenije over the last couple of years. Already prior to EU accession, the Banka Slovenije was invited to participate in selected activities of the European System of Central Banks and the ECB at various levels. Since 2004, the colleagues from Banka Slovenije have attended numerous working groups and committees and thus contributed to our work. Governor Mitja Gaspari has been a member of the General Council of the ECB since May 2004. Since August 2006 he attended the meetings of the Governing Council as an Observer, and became official member of this decision-making body for monetary policy in the euro area on 1 January 2007.

Once the EU Council had taken the decision to abrogate the derogation of Slovenia, thus paving the way for the introduction of the euro, the ECB and Banka Slovenije, together with the National Changeover Board, the European Commission and national and international authorities cooperated closely in many ways for preparing the adoption of the euro. As a result today we can celebrate the successful cash changeover. I am sure that the good working relationship between the Banka Slovenije and the ECB will also continue in the future and will even become closer as the Banka Slovenije is now a fully integrated part of the Eurosystem. As you may know, close cooperation between the national central banks of the Eurosystem, the ESCB and the ECB is essential for our work and crucial to ensure the success of the single monetary policy in the euro area.

From now on Slovenia will enjoy the general benefits of participation in the single currency area, such as no exchange rate risks with respect to its most important trade partners and price transparency, which will promote trade. It will also benefit from the stability oriented policy of the ECB, which will help anchor inflation expectations. Furthermore, as Slovenia is a small open economy, adopting the euro provides considerable protection against international financial disturbances, which often have a disproportional effect on smaller economies. All this will translate into strong growth and job creation over time. Nevertheless, in order to reap the benefits of participation in the single currency area to the greatest extent possible, Slovenia (as all countries that are members of the euro area) needs to

ensure appropriate national policies, in particular fiscal and structural policies, as well as appropriate wage developments. This will, in turn, help to maintain price stability in Slovenia and to preserve its competitiveness and growth.

Certainly, in the first period of the changeover there have been concerns arising related to price rises in certain parts of the economy, especially in the services sector. This was dealt with by the Slovene authorities and consumer associations, by means of the long dual pricing period and price monitoring teams, to name a few. Let me stress that the citizens of Slovenia play a very important role here: the consumers in a market economy have a major influence on price formation. Consumers will be a major force in preventing any unjustified price increases.

Ladies and gentlemen, let me again congratulate to all the achievements of the process of euro adoption in Slovenia and give my warm welcome to the new member in the family of the Eurosystem. Bravo, Slovenija!