

## Jean-Claude Trichet: The entry of Slovakia into the euro area

Speech by Mr Jean-Claude Trichet, President of the European Central Bank, at the “Slovakia Euro Changeover Conference”, Bratislava, 22 September 2008.

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Ladies and gentlemen,

It is a great pleasure to be with you here, in Bratislava, at this conference taking place a few weeks before Slovakia joins the euro area in January 2009. Let me first congratulate all the parties who have been involved in the preparation and implementation of the euro adoption strategy since 2004. Today, we are looking forward to the launch of the single currency in Slovakia next January. This country will become the 16th member of the euro area.

### 1. Slovakia’s economic achievements on its way to the euro

I would like to stress that the transition to the euro of any national economy is a challenge that needs to be prepared for carefully. Slovakia, after some early difficulties, has proved to be a real success story in recent years, enjoying strong economic growth and a marked increase in employment. Average annual real GDP growth reached a remarkable 8.5% between 2005 and 2007, and average annual employment growth was close to 3% in that period.

Slovakia has made notable progress in both nominal and real convergence. In respect of nominal convergence, inflation was rather volatile in the first half of this decade. But recently, the economy has seen a gradual decline in HICP inflation, reaching 1.9% in 2007, although in the first half of 2008 it rose to 3.7%. As the ECB has always stressed, low-inflation environment attained in the recent past will need to be confirmed and sustained over the years to come. The convergence of long-term interest rates has been even more dynamic, as they are now at around 5%, more than a third less than they were earlier this decade. It’s a change that reflects the confidence of financial markets participants in the policies pursued by the authorities.

Some progress has also been achieved with regard to the consolidation of public finances. However, the ECOFIN Council brought the excessive deficit procedure for Slovakia to an end as recently as June this year. Looking ahead, an ambitious additional consolidation effort appears necessary if Slovakia is to reach its medium-term objective for the structural deficit of 0.8% of GDP in 2010.

The vitality of the country’s economy can be seen by comparing its real GDP growth with that of the euro area. Between 2000 and 2007 average economic growth in Slovakia was 5.6%, significantly above the average economic growth in the euro area. This resulted in real economic convergence as the GDP per inhabitant in purchasing power parity terms as a percentage of the GDP per inhabitant of the “euro area” increased from below 44% in 2000 to above 62% in 2007. The good times for the Slovak economy are exemplified by rising real incomes. Importantly, the gains in prosperity have also spread beyond the country’s economic heart in Bratislava, even though considerable disparities between regions still exist.

Slovakia has experienced only limited external economic imbalances in recent years. The current account deficit remained relatively contained in the past few years and, due to increasing export capacities, it has in fact been shrinking lately. Unit labour costs have until recently favoured the competitiveness of Slovak producers.

The koruna has participated in the exchange rate mechanism II since November 2005. The underlying strong macroeconomic performance has led to a gradual appreciation of the

nominal exchange rate against the euro, without impairing the competitiveness of Slovak exporters. Reflecting strong macroeconomic fundamentals, the central parity of the Slovak koruna against the euro was revalued by 8.5% and 17.65% in March 2007 and May 2008, respectively.

Economic progress in Slovakia has been based on a series of structural reforms. The substantial reforms of taxes and social benefits together with a greater flexibility in product and labour markets have brought Slovakia to the attention of foreign investors. The ensuing inflow of foreign direct investment has boosted the economy and promoted rapid real GDP growth.

And these days, more than ever, the pace of reforms from earlier years has to be maintained in order to reap all the benefits of euro adoption.

## **2. Sustainable convergence is key**

Euro adoption by Slovakia implies that the benefits of the Single Market will be further enhanced by the single currency. The euro offers a credible framework for price stability as it removes exchange rate uncertainty within the euro area. Slovakia will benefit from the stability-oriented policy of the ECB, which will help to anchor inflation expectations. Furthermore, euro adoption may help to shield Slovakia, a small and highly open economy, against the effects of international financial turbulence, which often has disproportionate effects on smaller economies.

However, for the euro to remain a success story in Slovakia, the national authorities will need to be very alert and pursue ambitious economic policies on all fronts. Our main concern is that Slovakia, being a catching-up economy, is likely to face inflationary pressures that could derail the economy from a sustainable convergence path after euro adoption. Top priority must therefore be given to the sustainable economic convergence of the Slovak economy towards the more mature countries of the euro area. This certainly cannot be seen as an automatic outcome of joining the euro area – indeed, it will require major efforts in the years to come from all parties concerned.

We appreciate the fact that the Slovak authorities have firmly committed themselves to pursuing appropriate supportive policies – ones which aim in particular to maintain sustainable convergence, underpin external competitiveness and strengthen economic resilience. Fulfilling these commitments is vital for the Slovak economy to function smoothly within the euro area.

Let me stress three areas that we consider crucial for preserving sustainable convergence in Slovakia.

Firstly, after euro adoption, when monetary policy is no longer autonomous, a rigorous and credible implementation of fiscal policy in line with the Stability and Growth Pact commitments is essential to contain inflationary pressures in the economy. To this purpose, the fiscal adjustment in structural terms must be at least 0.5% of GDP per year until the medium-term objective is reached in 2010.

Secondly, the functioning of Slovakia's labour market must be further improved and the high structural unemployment reduced. While the reform of the educational system might help to reduce unemployment in the medium term, making labour legislation more flexible as well as eliminating existing wage rigidities would help to alleviate pressures in the labour market more rapidly. Any temptation to introduce wage indexation schemes should be resisted; social partners should focus on labour productivity growth and competitiveness as the main factors in any wage adjustments. Refraining from any kind of mechanical wage indexation is particularly important today to avoid any spillovers from the recent more elevated levels of inflation to wages and salaries.

Thirdly, the authorities must also focus on further improving the business environment in Slovakia in order to enhance productivity growth and continue to attract foreign capital. The strengthening of the competitive environment should be seen as a prerequisite for any further initiatives.

Commitment by all policy actors is key. Only a decisive approach by the government and social partners in these areas would, in our view, help to keep Slovakia's inflation on a sustainable track in the future.

The Slovak authorities must be ambitious in pursuing sound economic policies that, jointly with the stability-oriented policy of the ECB, will bring sustainable economic growth, job creation and social cohesion for the people of Slovakia.

### **3. Preparations for the changeover**

The ECB values the fruitful cooperation that has developed with Národná banka Slovenska over the last couple of years. The Governor of the National Bank of Slovakia has been a member of the General Council of the ECB since May 2004 and an observer at the meetings of the Governing Council of the ECB since mid-July 2008.

On 1 January 2009 the euro will become legal tender in Slovakia. Great efforts have already been made, and even greater ones will be made, to ensure that the people of Slovakia are well-informed about euro coins and euro banknotes, and in particular their security features. The European Central Bank and the Eurosystem have helped in the preparations for the introduction of the euro in Slovakia.

188 million euro banknotes will initially be needed, and these will be taken from the Eurosystem stocks. The Oesterreichische Nationalbank, as the closest euro area neighbour, will be arranging the delivery of the cash, on behalf of the Eurosystem.

While euro cash is already being used to some extent in Slovakia due to its proximity to the euro area, the pre-launch distribution of euro cash to banks – the “frontloading” – and its subsequent “sub-frontloading” to retailers and other businesses remains important in order to make banknotes and coins widely available as quickly as possible. The frontloading has just begun. In addition, 1.2 million coin mini kits will be sold to the public as from 1 December.

The Eurosystem will continue to support the campaign informing people about their new currency and its introduction. As part of this joint campaign, many seminars and training sessions have been held, and over seven million copies of various publications – that's more than the country's population – have been produced by the ECB. Over two million leaflets and four million conversion cards, which show the most important security features of the €20 banknote, will shortly be sent to all households in the country by the National Bank of Slovakia. The bank wants to be certain that everyone is well prepared for the changeover.

One symbol of the excellent partnership between Národná banka Slovenska and the ECB is the Euro Exhibition, which I had the honour to open yesterday. It will give the public a chance to learn more about their new currency. It's one of many joint efforts that will lead to the successful launch of the euro in Slovakia. I'm confident of this.

Ladies and gentlemen, let me again congratulate you all on your achievements during the run-up to the euro in Slovakia. I'd also like to take this opportunity to urge the Slovak authorities to continue with their prudent economic policies. In other words, to remain on the path of fiscal consolidation so as to improve the sustainability of public finances and also to keep working on structural reforms. These policies should address the real challenges that lie ahead.

Even though it is a little while until the euro becomes a reality in people's wallets, I am looking forward to welcoming Národná banka Slovenska to the Eurosystem, and Slovakia to the euro area. Vitaj Slovensko! Welcome, Slovakia!