Economic Alignment and Euro Adoption in the Czech Republic: What Is New?

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• Successful inflation targeting since 1998
• Exchange rate serves as a moderator of shocks
• No serious macro imbalances
• No financial imbalances
• Public demand for euro adoption remains low
Basic Facts

- Euro adoption is a political decision, but it should be based on economic analysis.

- Good performance of Czech monetary policy has led to low and stable inflation, low interest rates, appreciating koruna exchange rate, and consequently to low public desire for euro adoption.

- Major issues are in the level of economic convergence achieved, labor market flexibility and long term ability of the fiscal policy to serve as macro stabilizer (after we lose flexible exchange rate and our own monetary policy).

- Problems in the euro area as a new factor to consider.
Questions

Does the Czech Republic fulfill the Maastricht criteria?

Is the fulfilment of the Maastricht criteria enough to adopt euro?

Has the recent macroeconomic development altered the alignment with the Euro Area?
MAASTRICHT CRITERIA FULFILLMENT
Evaluation of Maastricht Criteria

- Fulfilment of the Maastricht Convergence Criteria evaluated each year since 2005 (MoF and CNB material)

- Except periods of administrative price increases, the Czech Republic is compliant with the price stability criteria
  - Inflation forecast for this year at the edge of the criteria value (inflation close to the CNB’s target)

- Improvement in government financial position starting 2014, safely compliant nowadays

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Source: Assessment of the Fulfilment of the Maastricht Convergence Criteria and the Degree of Economic Alignment of the Czech Republic with the Euro Area
### Evaluation of Maastricht Criteria

- **Long term interest rate** convergence safely compliant
- **Exchange rate criteria** cannot be evaluated unless ERM II adopted
- **New evaluation will be released in December 2017**

CNB cannot decide about the euro adoption. It is within the competence of the government.

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ALIGNMENT WITH THE EURO AREA
• Convergence until 2008, GDP per capita in PPP declined relative to EU15 during the world financial crisis
• Real convergence renewed starting in 2013 but price converge still falling behind

Real and nominal convergence still unfinished

Source: Eurostat
Structural Alignment

- Structural similarities reduce risks of asymmetric effects of economic shocks

- Higher share of industry in the Czech economy, lower share of services – both relatively stable in time

- Strong trade and ownership links with the euro area increase the benefits of eliminating potential exchange rate fluctuations

**Trade and ownership structure are the main arguments for the euro**
• The cyclical alignment => single monetary policy well configured for the Czech economy
• Optimum currency area => the loss of independent monetary policy is less costly for a country with a more correlated business cycle

Analyses indicate a high degree of cyclical alignment

Real GDP growth in the Czech Republic and the euro area (% YoY)

Growth rate of industrial production index in the Czech Republic and the euro area (% YoY)

Source: Eurostat and CNB’s calculations
Fiscal policy Ideally countercyclical

- Lower structural deficits and lower debt => more space to cope with downturns and recessions
- Improvement of the structural balance since 2014 – structural surplus in 2016
- Government debt is low but coping mainly with population ageing (pension and health expenditures)

Sufficient fiscal space nowadays

Fiscal policy might be able to fulfill its role in the future

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Source: European Commission
Business environment is still more burdened by administrative and regulatory barriers than those in the other countries under comparison.

Space to improve and catch up with advanced countries

Source: World Economic Forum
EURO ADOPTION – OBLIGATIONS
Is the fulfilment of Maastricht criteria sufficient to adopt the euro?

Definitely not.

- In response to the **debt crisis**, surveillance and prudential mechanisms strengthened in the EU => **new institutions, frameworks and funds**
- Adopting the euro implies participation and obligations to these entities including payments
Payments (Direct Costs)

- Rest in the share in subscribed capital of the ECB
  - CZK bn 4.4
- Single Resolution Mechanism – banking union has to be joined not later than euro adoption
  - Up to CZK bn 25.6
- Single Supervisory Mechanism – payments of annual fees paid by Czech commercial banks to the ECB for the conduct of supervision
  - CZK mil 57.4
- European Stability Mechanism
  - Capital repayments up to CZK bn 49.6 within four years

Additional payments related to the euro adoption estimated up to about CZK 80 bn
ESM is an intergovernmental organization to safeguard and provide instant access to financial assistance programs in financial difficulty
- For member states of the Eurozone
- Capacity EUR bn 500

Our membership is not linked to the adoption of the euro but might be required

The Czech Republic should seek to mitigate the impact of potential losses resulting from ESM loans granted before the accession whose provision could not affect
- Example: Greece program repaid in 2034—2058
Thank you for your attention

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