

**Euro Adoption in Central Europe:
A Case for Action and Priorities for Preparation**

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Generally slow progress to euro adoption. Why?

- Fear of Maastricht
- Fiscal indiscipline
- Lack of public support

Three questions

- Early estimates of net gains: still right?
- Market response to slow progress?
- Priorities for preparation?

Gains from euro adoption

- ✓ Greater trade
- ✓ Foreign savings at lower risk
- ✓ Less exchange rate-driven volatility
- ✓ Lower transaction costs

Potential costs can be limited

OCA criteria are OK

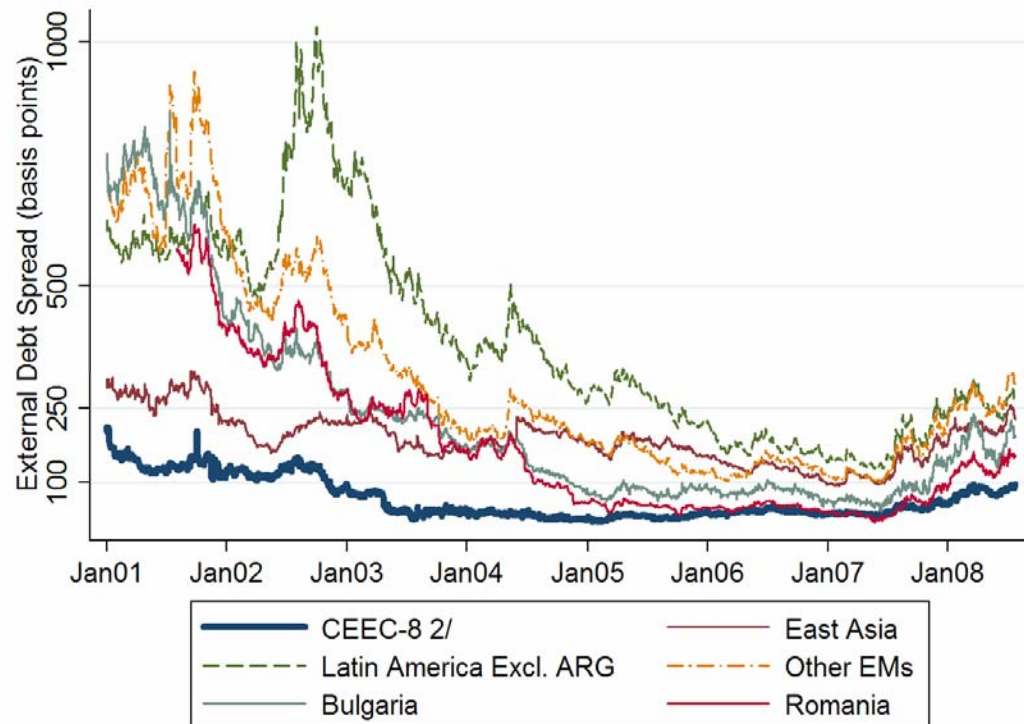
AND

- Cyclical synchronization likely to rise
- Adaptability improving...but more needed
- Limits to own monetary policy...
...even in crises

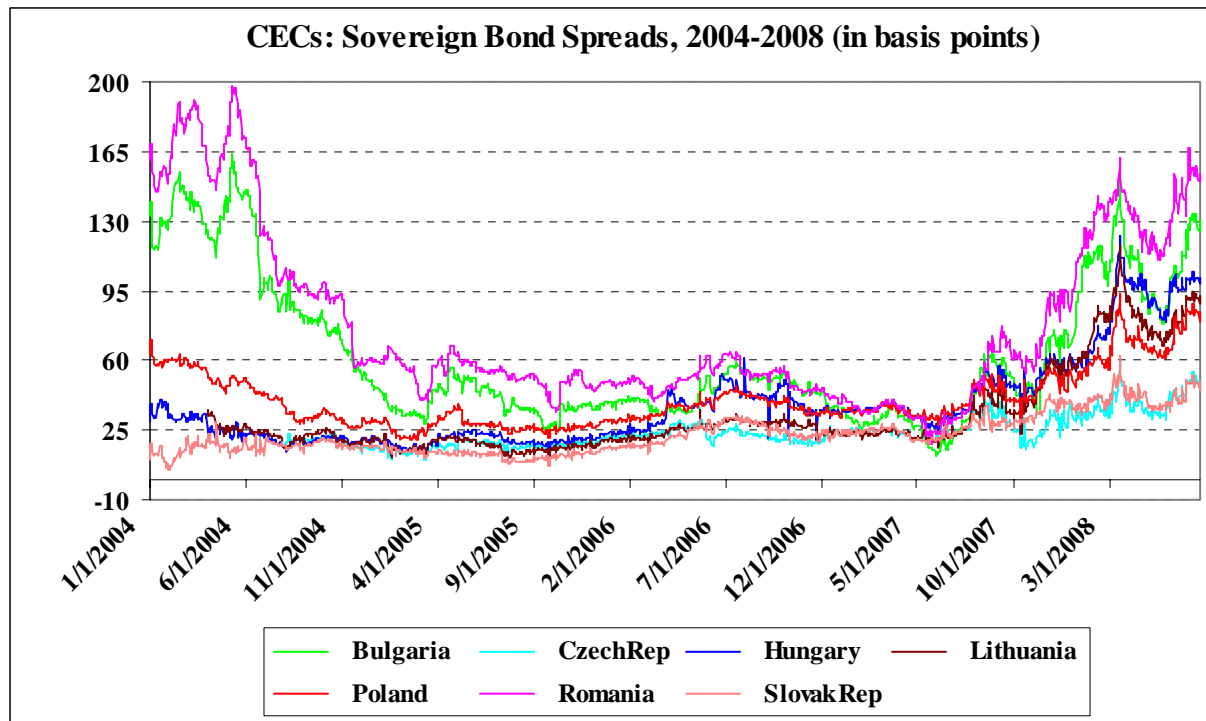
Market views of delayed euro adoption

- So far, so good
- But beware turbulent times

CEC sovereign bond spreads below other EMs, but gaps are narrowing



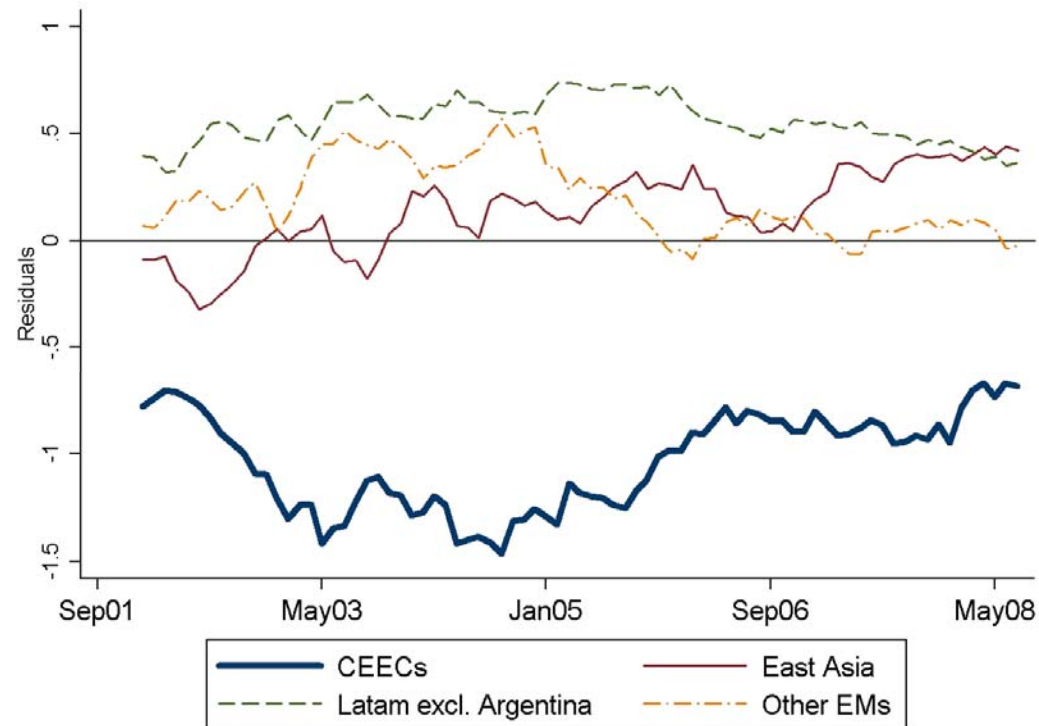
Increased differentiation across CECs since mid-2007



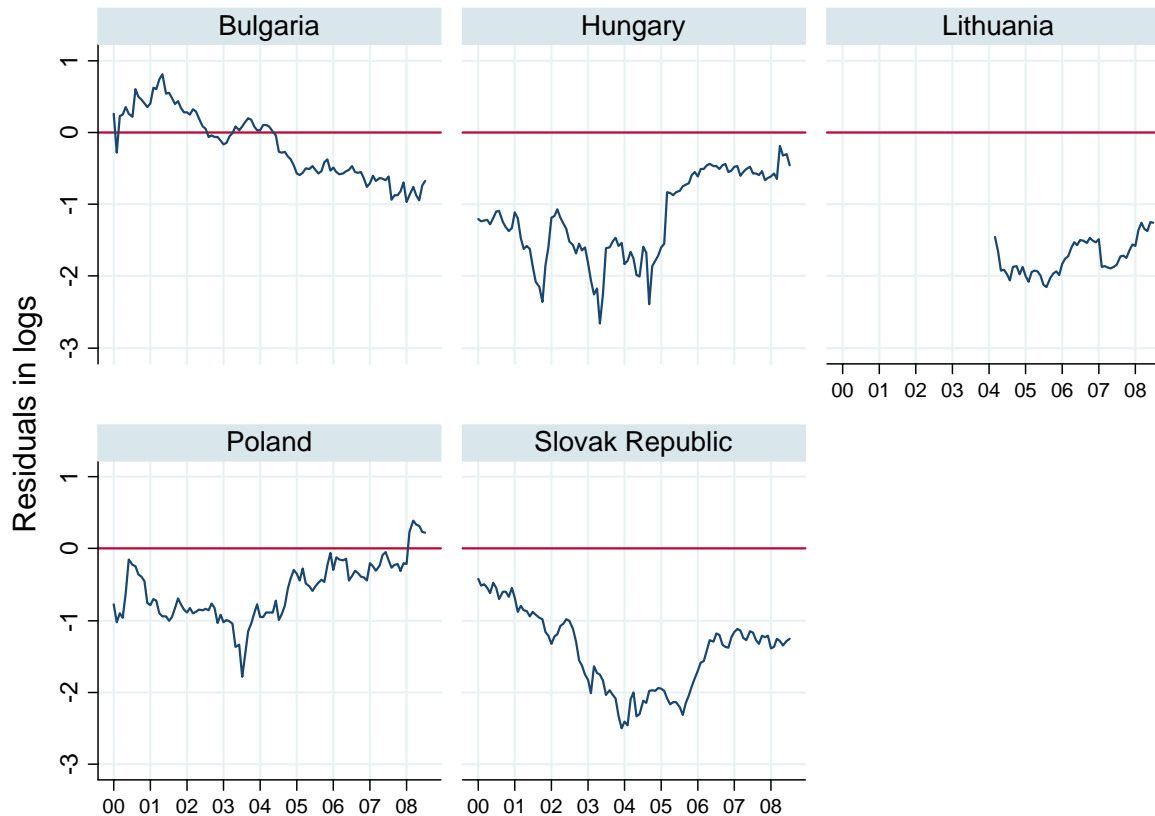
What makes CECs special?

- Policy fundamentals?
- Something else?

What fundamentals cannot explain



The CEC edge may be disappearing



What could cause an EU halo effect?

- Greater policy credibility—SGP
- Belief in implicit EU bail-out
- Comfort from euro adoption commitment

Moving ahead with euro adoption

- Maastricht--necessary, but not sufficient
 - too rigid on inflation/ exchange rate stability,
 - too lenient on fiscal
- Strategies for long-term success in the euro area

3 Priorities for success in euro area

- 1st class labor market institutions/regulations
- Fiscal rule for counter-cyclicality + crowding in private investment
- Ultra-sound bank supervision and regulation

Case for early euro adoption still strong

- Begin now=>gains as global slowdown bites
- Partial protection from rising risk aversion
- Markets may be losing patience

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