



# **Euro adoption - a macroeconomic view**

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# **A premature project**

- **Common currency for fair weather only**
- **Euro zone is not an optimal currency area**
- **Weak nominal (Maastricht) criteria**
- **Later, divergence instead of convergence**





# **The first decade – hidden risks**

- **Nominal convergence (Maastricht criteria) did not imply real convergence**
- **SGP breach by D and F in 2003-4 and negligent penalization provided for a wrong signal to some other countries and to financial markets**
- **Continued loss of competitiveness**





## **The first decade – hidden risks**

- **Single (low) basic discount rates, followed by low money market rates**
- **Political solidarity turned up to be a myth, that was blindly believed by financial markets**





# The crisis

- **Convergence of interest rates: cheap credits to peripheral Europe, risk of state bankruptcy was not on the radar screen**
- **Banks and insurance companies incentivized to purchase peripheral government bonds, this exacerbated by capital flows from North to South due to North fiscal discipline**
  - **Inflationary boom at the periphery**
  - **Too much momentum, leading to the bubble burst after US financial crisis swept over Europe and immediate crisis**
  - **Larger inflation and appreciation in the periphery**



# **The crisis**

**The southern countries plus Ireland lost the competitiveness just by becoming too expensive**

**Consequence: divergence in deficits, debts and in balance in current account between North and South**

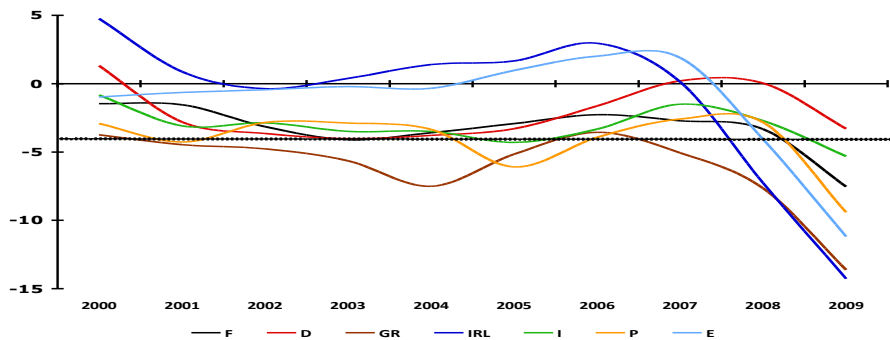
**Periphery left at the mercy of the North**



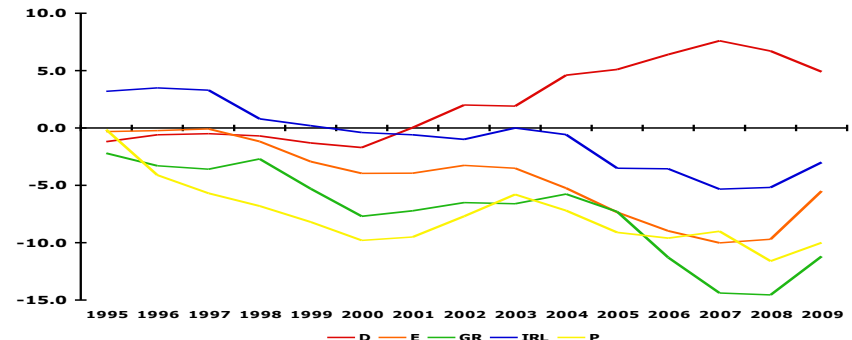


# Divergence instead convergence

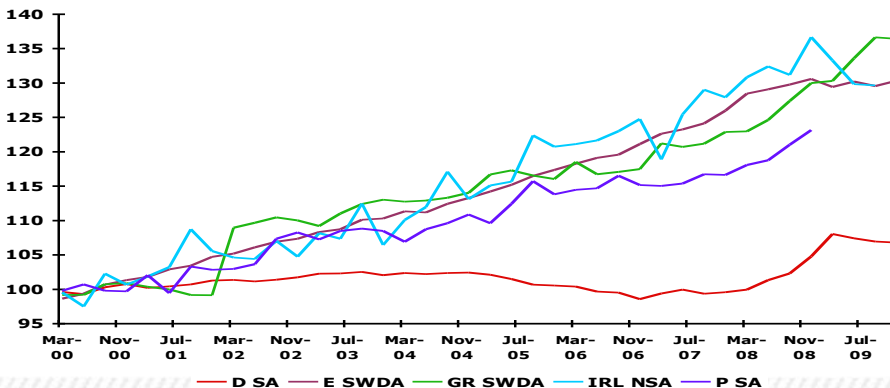
**Public finance deficit, % GDP**



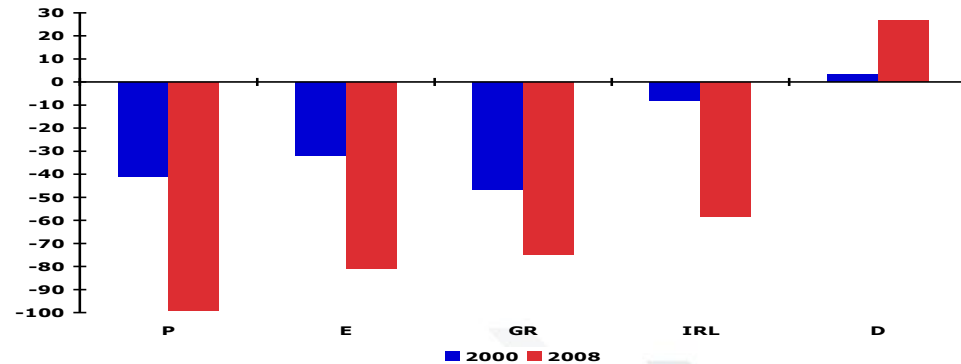
**Current account deficits, % GDP**



**Unit labor costs**

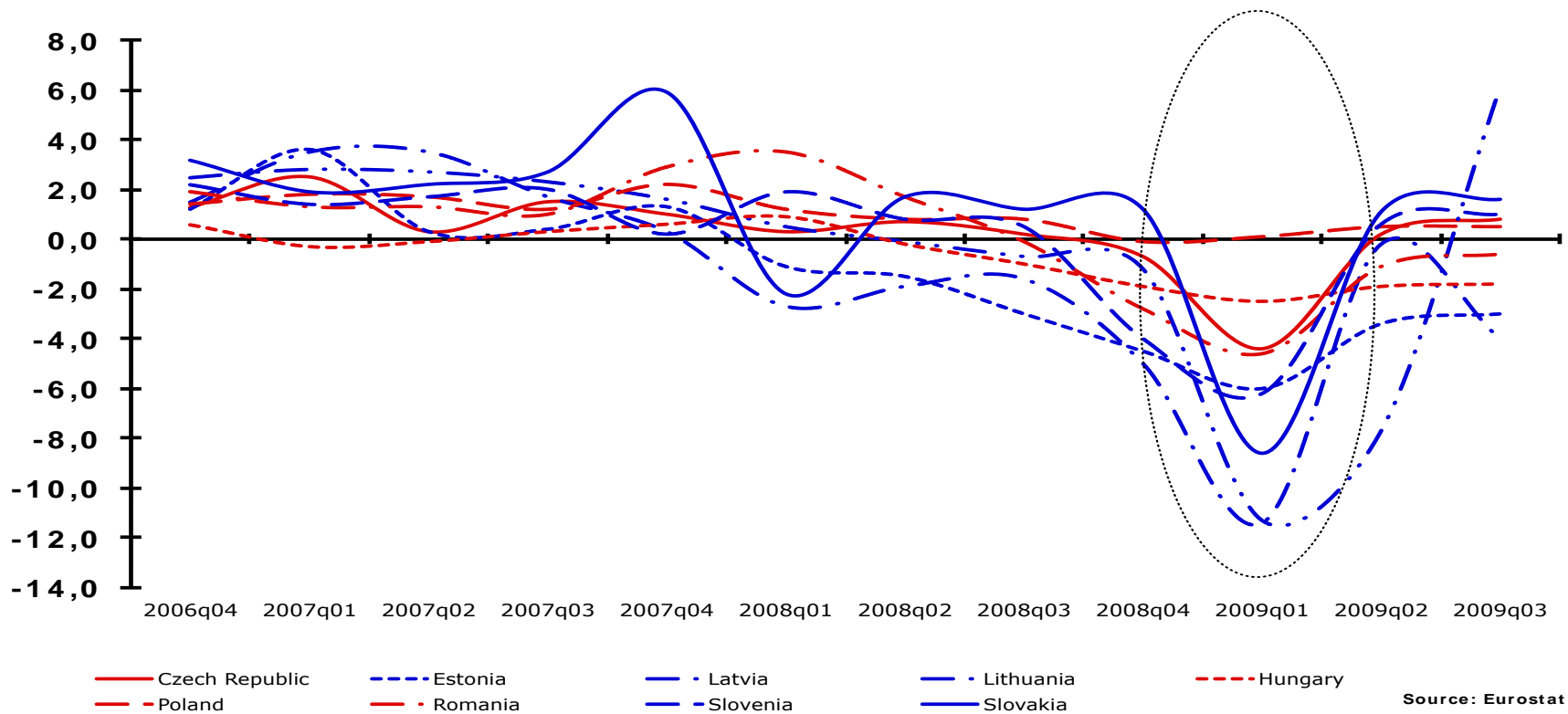


**Net investment position, % GDP**





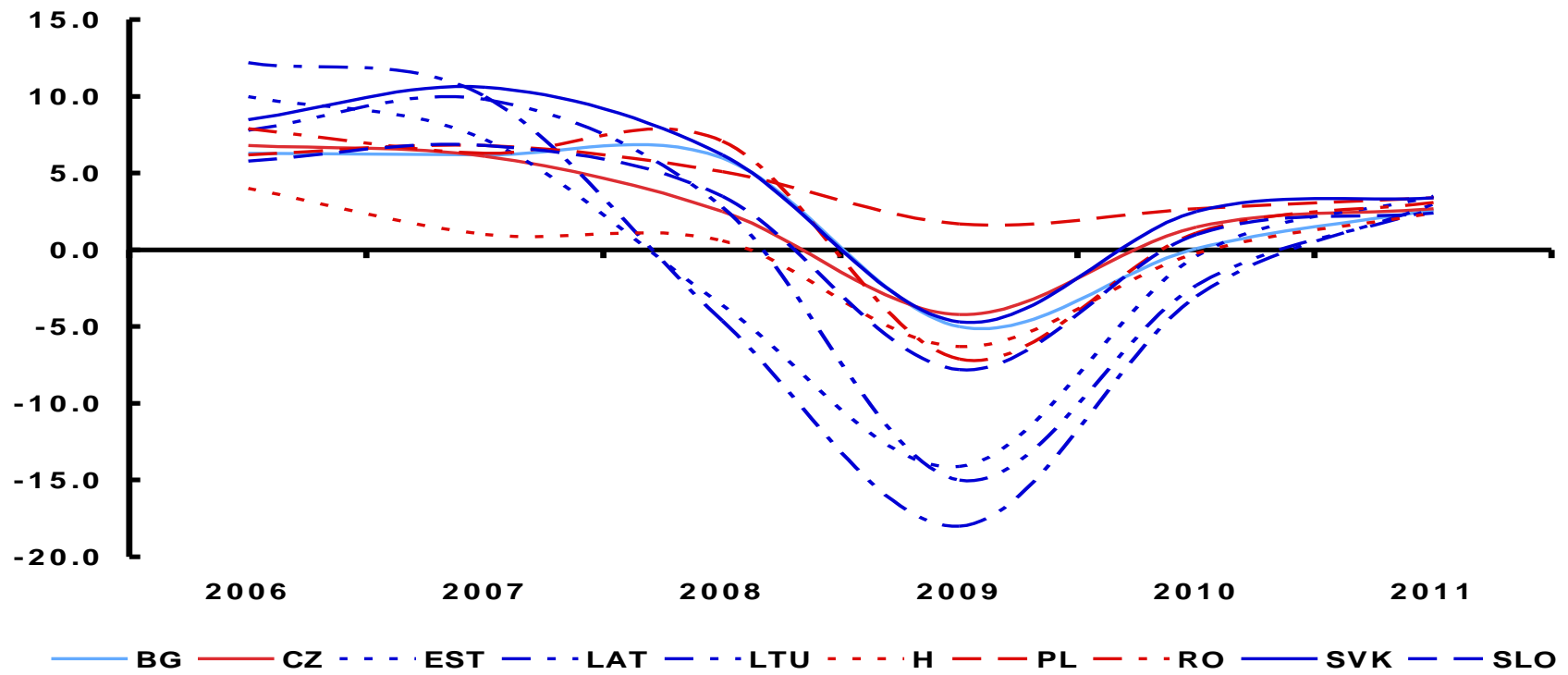
# CEE: GDP growth, %qoq







# CEE: GDP growth, %yoy





# **Little appetite for Euro now**

## **Few reasons for that**

- **Internal**
  - **Lingering Euro scepticism**
  - **Unwilling to give up control over currency and monetary policy**
- **External**
  - **Not ready before Eurozone solves its problems and reduces the risk of having to bail out member**
  - **Risk of joining a monetary union that may look very different in few years from now**





# **Economic benefits of joining differ**

- **Czech Republic appears most fitting to join, given high correlation of the economic cycles with Germany and other core Euro area countries**
- **Hungary could probably benefit to similar extent**
- **Poland, with large domestic economy would have more to loose from loosing a floating exchange rate**





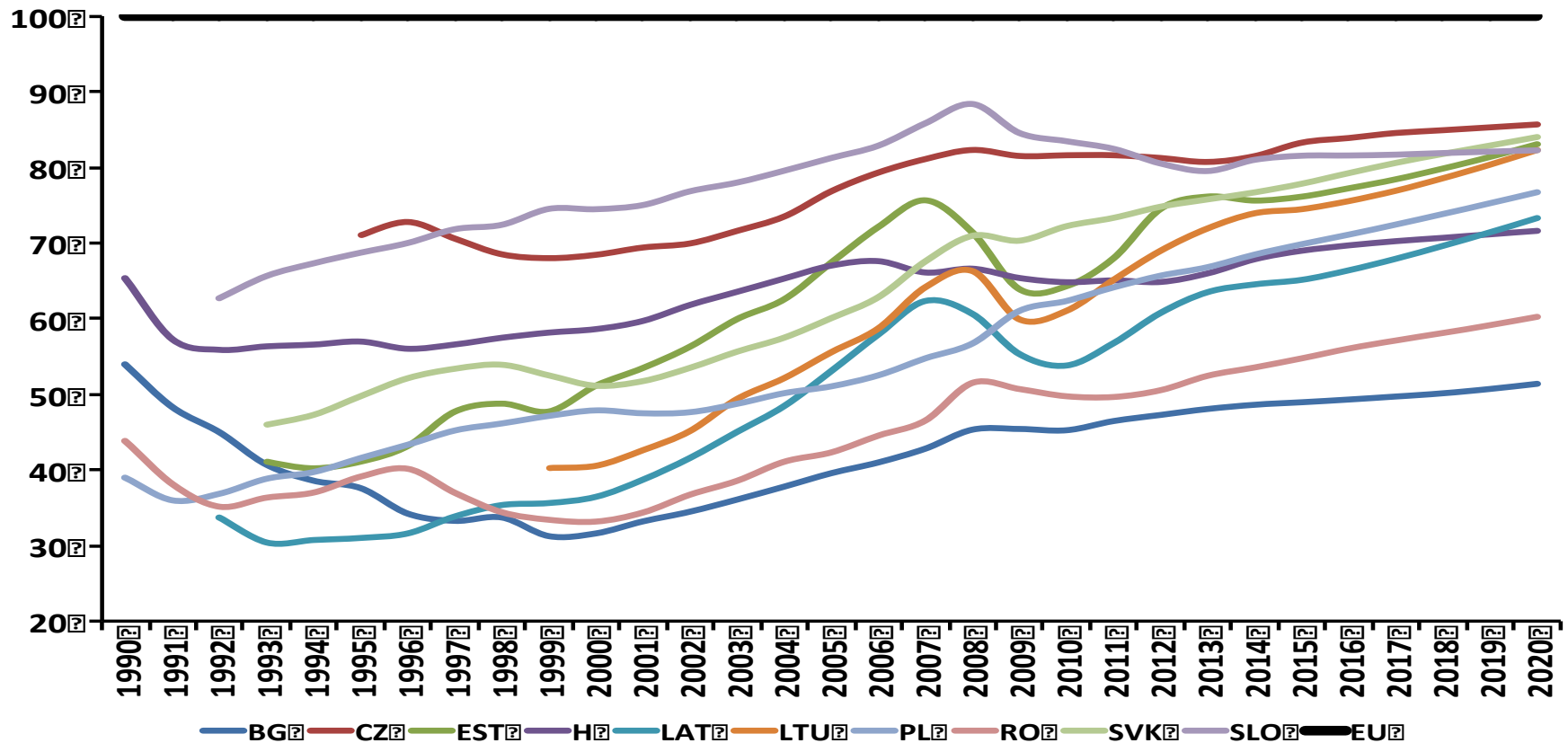
# **Effects of joining – is conventional wisdom still valid?**

## **Growth and employment**

- **Long term growth and convergence - potential Euro membership just marginally important**
- **Structural problems and reforms much more significant**
- **Long term growth factors decisive**



# Closing the gap: GDP pc, PPP, EU=100





## **Effects of joining – is conventional wisdom still valid?**

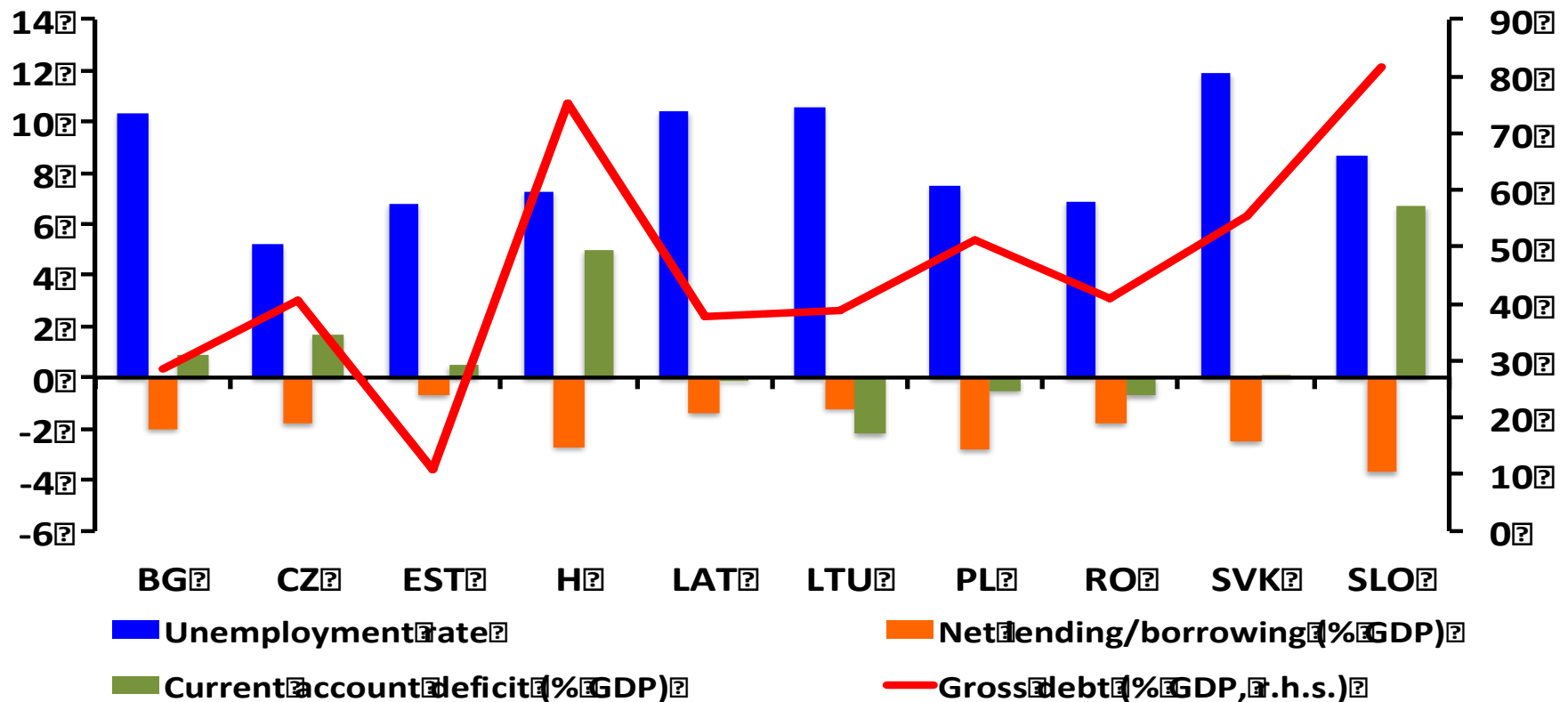
**Euro - abandoning FX volatility and unpredictability as a way of boosting trade and cross-border investments**

- **World of sophisticated derivatives and hedging instruments**
- **if used WISELY, can reduce cost of FX changes, FX volatility matters less, especially for larger companies**
- **Still, has impact on the smaller firms**
- **Cross border investment depends to large degree on costs, availability of skilled workforce, regulation, tax environment, etc., – less on whether the country has the same currency**
  - **Maybe Slovakia has different experience**





# CEE: macroeconomic stability, 2014





# Life is elsewhere

- **Maastricht criteria relevance?**
- **European cohesion?**
- **Efficiency – OCA (optimal currency area), real convergence, solidarity**
- **There is no European “Demos”**





# **Thank you for your attention**

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