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Euro, financial crisis and fiscal policy SR

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Financial crisis and economic recession = optimal timing for euro introduction

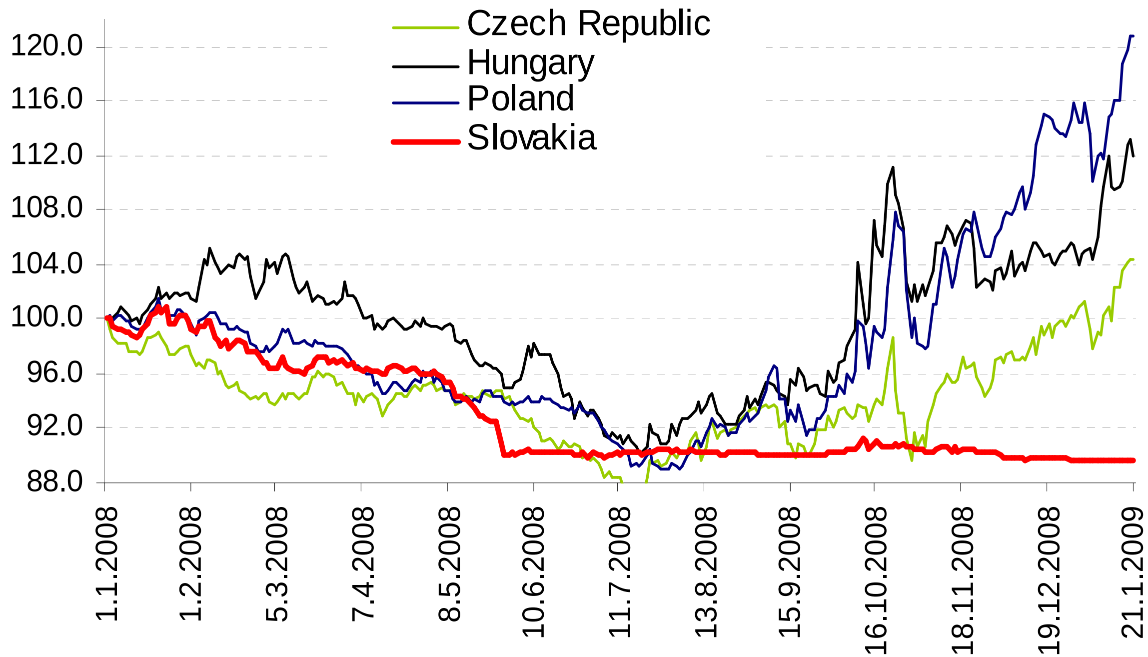
1) Exchange rate volatility

2) Nominal interest rates

3) Fiscal (economic policy) discipline

Exchange rate volatility

Exchange rate development vs. EURO (1.1.2008 = 100)

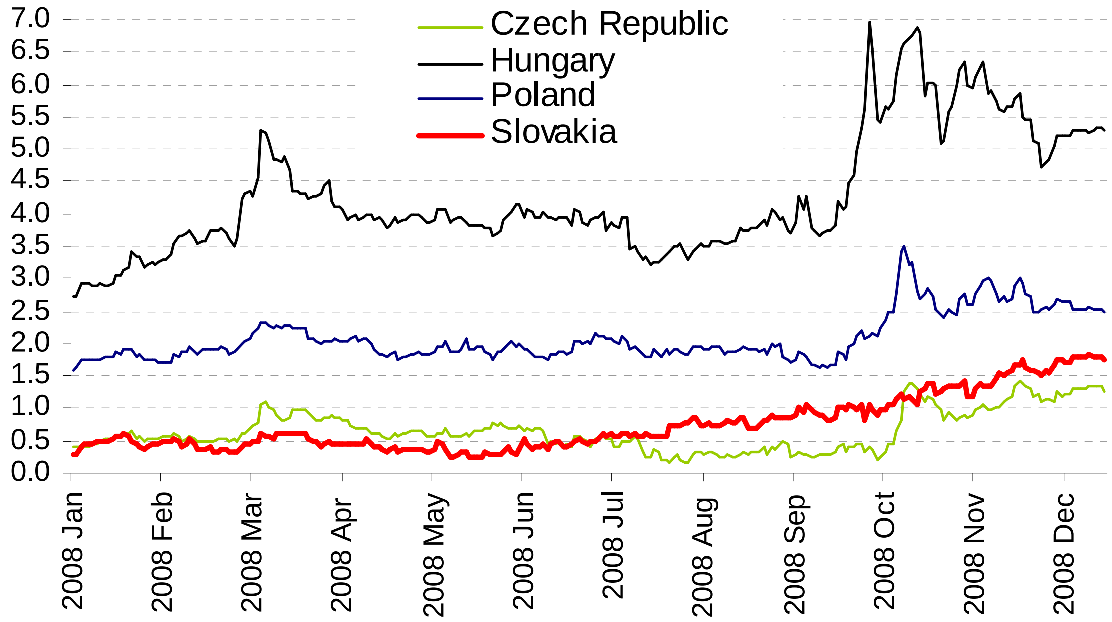


Source: MF SR, Reuters

- Stable exchange rate of slovak koruna
- High volatility of the exchange rates of the other V4 countries after the beginning of the financial crisis (the growing risk aversion of the investors)

Nominal interest rates

Spreads between 10Y government bonds of V4 countries and 10Y Germany Bunds

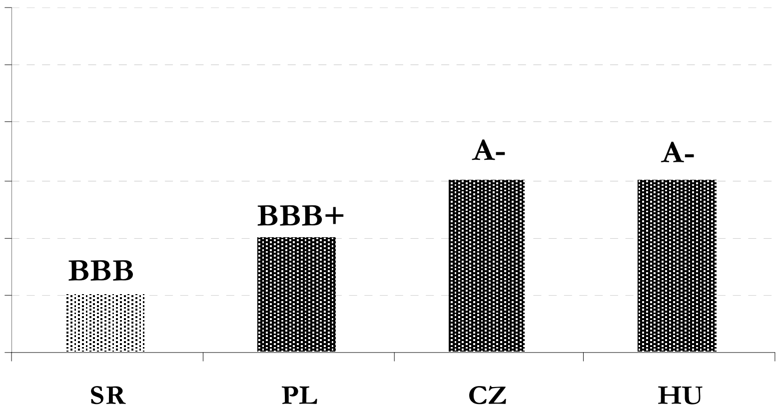


Source: MF SR, Eurostat

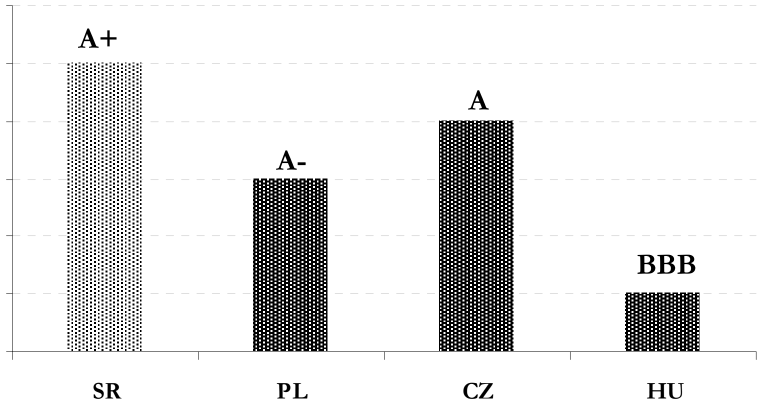
- Increase in risk premium in all V4 countries
- The spreads of the slovak government bonds are less volatile than the spreads of the bonds of other V4 countries

Rating development in V4 countries (S&P)

2003



2008



Sourse: S&P

- In 2003, the Slovak government set up the date for the euro adoption
- In 2008, Slovakia successfully met all the Maastrichtt criteria and its membership in euro area was approved from 1.1.2009

Fiscal discipline

Euro introduction

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Maastricht criteria

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Need for fiscal consolidation

Fiscal targets

2003 – Strategy for Euro Adoption in SR
(political decision)

2004 – 1st Convergence programme (two fiscal targets):

- 2007 – fiscal deficit under 3% of GDP
- 2010 – fiscal deficit under 1% of GDP (MTO)

Starting position in 2002:

- General government deficit at 8.2% of GDP
- General government debt at 43.4% of GDP

Fiscal strategy

- Fiscal strategy to achieve fiscal targets in 2007 and 2010
- Public finance management reform
  - Comprehensive general government budgeting
  - Accrual budgeting
  - Medium-term budgeting

- Fiscal performance:

in % of GDP	2002	2007	2008E
GG BALANCE	-8.2	-1.9	-2.3
GG DEBT	43.4	29.4	29.0

Two political lessons

1. Euro introduction makes fiscal consolidation politically more feasible

2. Healthy public finances provide room for manoeuvre in bad times