Brussels, 18 June 2008

BACKGROUND[1]

COUNCIL in the composition of HEADS OF STATE/GOVERNMENT

Thursday 19 June in Brussels

The Council[2] will meet on Thursday at 17.00, prior to the European Council, to examine reports from the Commission and the ECB on convergence towards European economic and monetary union and a proposal for ***Slovakia to adopt the euro as its currency*** *as from 1 January 2009.*

If the proposal meets with the Council's approval, it will be referred to the Ecofin Council for a decision at its next meeting, on 8 July. This would allow Slovakia six months to prepare for the changeover.

The president of the Council will report on the outcome of the discussion at the presidency press conference on Thursday evening, at the end of the first working day of the European Council (around 22.30).

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1 This note has been drawn up under the responsibility of the press office.

2 The subject matter on the agenda, relating to article 122(2) of the treaty, requires the Council to meet in the composition of heads of state/government.

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Enlargement of the euro area

- **Reports on convergence**
- **Proposal on adoption of the euro by Slovakia**

The Council, meeting at the level of heads of state/government, will:

- take note of reports by the Commission and the European Central Bank on progress made by the ten non-euro area member states with a derogation[3] in fulfilling convergence criteria and their obligations regarding economic and monetary union;

- discuss a proposal from the Commission for a Council decision that would allow Slovakia to adopt the euro as its currency, by abrogating what is considered a derogation, as from 1 January 2009.

The convergence reports examine the compatibility of the member state's legislation with treaty provisions and with the statute of the European system of central banks (ESCB). They also examine progress on fulfilment of the convergence criteria – namely price stability, the government's budgetary position, exchange rate stability and long-term interest rates – and several other factors.

As regards introduction of the euro in Slovakia, the discussion by heads of state/government should enable the Economic and Financial Affairs (Ecofin) Council to decide on the proposal at its meeting on 8 July, following adoption by the European Parliament of its opinion on 17 June.

[3] Bulgaria, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, Slovakia and Sweden.

The Ecofin Council held an initial exchange of views on the proposal at its meeting in Luxembourg on 3 June. It shared the Commission's assessment that Slovakia has achieved legal compatibility and a high degree of sustainable convergence, and that it therefore fulfils the conditions for adoption of the euro. It welcomed the Commission's proposal on Slovakia's accession to the euro area with effect from 1 January 2009, and encouraged Slovakia to pursue prudent fiscal policies and implement further structural reforms.

The president of the Ecofin Council has presented the outcome of that discussion in a letter sent to heads of state and government (*doc. 9115/08*). His analysis is as follows:

- Slovakia's general government deficit has seen a credible and sustainable reduction from 8.2% in 2002 to 2.2% of gross domestic product (GDP) in 2007. Likewise, the general government debt-to-GDP ratio has been reduced since 2002, reaching 29.4% of GDP in 2007. The Ecofin Council has adopted a decision closing the excessive deficit procedure for Slovakia[4].

- The average HICP[5] inflation rate in Slovakia in the year ending March 2008 was 2.2%, which is below the reference value for the price stability criterion[6]. The 12-month average inflation rate is expected to remain below the reference value in the months ahead, albeit with a narrowing margin.

4 The Council adopted the decision at its meeting on 3 June.

5 Harmonised index of consumer prices.

6 Calculated as the average of the three best-performing member states plus 1.5 percentage points.

After several years of trend appreciation of the Slovak currency, operating under conditions of irrevocably fixed exchange rates will create new challenges for the Slovak economy. Insisting on the importance of the sustainability of inflation convergence, the Ecofin Council underlined the need for Slovakia to be vigilant and to implement budgetary and structural policies supportive of price stability. In this context, it welcomed measures planned by the Slovak government with the aim of containing inflationary pressures over the medium-term, and the commitment to step up efforts towards achieving this goal should unexpected inflationary pressures arise, which are supported by the recent upward realignment of the Slovak currency's central rate within ERM[7] II.

- Slovakia has participated in ERM II since November 2005. In the two-year period ending 18 April 2008, the Slovak koruna (SKK) has not been subject to severe tensions and Slovakia has not devalued, on its own initiative, the SKK bilateral central rate against the euro.

- In the year ending March 2008, the long-term interest rate in Slovakia was on average 4.5%, which is below the reference value[8].

- Other relevant factors to which the treaty refers, such as the integration of markets or the situation and development of the balance of payments, also point to a high degree of sustainable convergence. National legislation, including the statutes of its national central bank, is compatible with the treaty and the ESCB statute requirements for stage three of economic and monetary union.

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[7] Exchange rate mechanism. The aim of ERM II is to reduce exchange rate variability and achieve monetary stability in preparation for introduction of the euro.

[8] Calculated as the average interest rate of the three best-performing member states, in terms of price stability, plus two percentage points.

The situation as regards economic and monetary union is as follows:

- Belgium, Germany, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Austria and Finland adopted the euro on 1 January 1999. Greece joined them on 1 January 2001. Euro notes and coins were introduced in all twelve countries on 1 January 2002;
- Slovenia adopted the euro and introduced euro notes and coins on 1 January 2007, Cyprus and Malta on 1 January 2008;
- Denmark and the United Kingdom have opt-out clauses and have not been assessed by the Council;
- Bulgaria, the Czech Republic, Estonia, Latvia, Lithuania, Hungary, Poland, Romania, Slovakia and Sweden are considered as member states with derogations;
- On 1 January 2009, if all necessary decisions are adopted, Slovakia will become the 16^{th} member of the euro-zone.