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PREPARATION OF THE CZECH REPUBLIC'S ENTRY INTO THE EURO AREA

Czech Republic's accession to the European Union undertook the adoption of the common currency, the euro, and took the steps that would lead to the inclusion in the European Monetary Union (EMU). The question for the Czech Republic is not, therefore, whether to adopt the euro, but when do this step.

The introduction of the euro is a process with many aspects. On the one hand it brings a number of advantages, such as easier travel or greater macroeconomic stability. There are here, but also disadvantages and risks of adopting the euro. With the demise of our Crown disappears the power of the Czech National Bank to carry out monetary policy. This role will take over the European Central Bank. This will have in terms of perspective of the Eurozone as a whole, not according to the actual needs of our Czech economy.

Introduction of the euro will touch all of the inhabitants of the Czech Republic. To facilitate better orientation to the Czech economy's transition to the euro has been drawn up the national plan for the introduction of the euro in the Czech Republic, which addresses the technical, organizational and legal requirements of this transition. The national plan specifies that the transition to the euro must respect several important principles, and legal certainty, the protection of consumers and minimizing the costs associated with the introduction of the euro.

The Maastricht criteria

The Czech Republic Membership in the euro zone, as well any other Member State of the European Union not- using euro, requires the fulfilment of the convergence criteria, also known as the Maastricht criteria.

These convergence criteria can be divided into budgetary and monetary policy. The budget provides the maximum amount of the deficit criteria of public budgets and public debt in relation to GDP. Monetary criteria relate to the rate of inflation, the level of long-term interest rates and exchange rate stability. A necessary condition for the fulfilment of these criteria is their sustainability, rather than their mere one-off filling at the time of entry into the euro area.

Specifically, the Maastricht criteria include:

- the criterion on price stability
- the criterion of public finances
- the criterion on participation in the exchange-rate mechanism
- the criterion of convergence of interest rates.

The Czech Republic is committed to take steps to ensure that the accession to the euro area as soon as possible. The determination of the date of entry into force depends on the extent of our preparedness. This can be assessed both in terms of economic complementarity and the structural similarity of the Czech economy and the euro area economy, in terms of the ability of the economy to cushion asymmetric shocks and flexibly adapt to them, for example, through effective fiscal policy, flexible labor market and a healthy financial sector.

Changes in the economic-political order of the Monetary Union and changes in the operation of the rescue mechanisms for acceding countries may derive new and previously unforeseen liabilities.

Final fixing date will depend on the Government, but it should depend on the recommendation of the Czech National Bank (CNB), which annually evaluates the economic consistency.

The current implementation of the individual criteria

The Czech Republic fulfills currently the criterion on price stability, and in spite of the increase of both VAT rates at the beginning of 2013. Outlook for price developments for the years 2014-2016 continues to be characterized by only moderate inflation, which should ensure compliance with the criteria of price stability. The CNB's inflation target from the beginning of the 2010 (for the national index of consumer prices) was set at 2%. The CNB shall endeavor to not deviate from the true value of inflation target by more than one percentage point. This objective creates in relation to the ECB'S definition of price stability and inflation objectives for EU countries outside the euro area in a good position for the future implementation of the criteria of price stability.

The reference value for price stability is obtained as the 12-month average inflation in the three member countries of the European Union, which in the reference period achieved the lowest rate of inflation, increased by 1, 5 percentage points. Inflation shall be measured by the so-called harmonized index of consumer prices (HICP).

Table 1

Harmonized index of consumer prices

	2010	2011	2012	8/2013	2013	2014	2015	2016
The average of 3 EU countries with the lowest inflation	0,9	1,6	1,6	0,8	0,8	1,1	1,4	1,4
Value of criteria	2,4	3,1	3,1	2,3	2,3	2,6	2,9	2,9
The Czech Republic (convergence program)	1,2	2,1	3,5	2,0	2,1	1,7	1,9	1,1
The Czech Republic (prediction 10/2013)					1,4	0,7	1,9	0,9

Source: [4]

The criterion of public finances provides the conditions for the total deficit and debt of the General Government sector institutions. This criterion he Czech Republic currently does not meet, since 2009 there is an excessive deficit procedure (EDP). The next criteria are expected again in 2014 on the basis of the anticipated decline in the share of the government deficit below 3% of GDP in 2013 and by keeping below the reference value in subsequent years, which should lead to the end of the EDP. The Deficit of the General Government sector is foreseen for 2013 amounting to 2.9% of GDP, which is the value that meets the Maastricht criteria.

The current intention of the fiscal policy is when the expected macroeconomic development is to meet the Maastricht criterion in the future. Specifically, the Government's fiscal strategy is directed towards the values of 2, 9% of GDP deficit in

2014 and 2015, and 2.8% in 2016. The main risk for this development represents the persistent debt crisis in the euro area and its possible macroeconomic and fiscal impact on the economic development of the Czech Republic.

Table 2

The balance of the General Government sector

	2010	2011	2012	2013	2014	2015	2016
Value of criteria	-3,0	-3,0	-3,0	-3,0	-3,0	-3,0	-3,0
The Czech Republic	-4,7	- 3,2	- 4,4	-2,9	-2,9	-2,9	-2,8

Source: [4]

The ratio of government debt to GDP in the Czech Republic in the long term is below the 60% of GDP. Due to the relatively low level of government debt at the time of entry into the EU had so far, the fulfilment of the Czech Republic´s indication does not have a problem, although the debt in 2009-2012 has increased significantly. For 2013 the amount of debt is expected about 46.1% of GDP, i.e. about 0.1 percentage points lower than in 2012.

In the medium term should the level of government debt because of the expected annual deficits of the Government sector to grow further, and it's up to the level of 49.9% of GDP in 2016. The annual increase in the relative debt, however, should slow down. The long-term risk for the future development is primarily expected negative impacts of an ageing population.

Unless structural changes of the pension and health system will be in the long term, otherwise the same circumstances must reckon with another increase in the debt to GDP ratio.

Table 3.

The balance of the General Government sector

	2010	2011	2012	2013	2014	2015	2016
Value of criteria	60,0	60,0	60,0	60,0	60,0	60,0	60,0
The Czech Republic	38,4	41,4	46,2	46,1	47,9	49,0	49,9

Source: [4]

Evaluation of the implementation of the **criteria for participation** in **the mechanism of the Exchange rate** will be possible only after the Czech Republic enters the ERM II and the central parity of the Crown to the euro is set. The Czech currency has so far signed up to the system, and therefore also does not have a fixed central rate against the euro, which would monitor the fluctuation of the exchange rate and therefore the implementation of this criterion. Mode of use of the course as an additional tool loose monetary policy cannot be seen as setting the central parity for the adoption of the euro. The course of the Crown against the euro in the post-crisis period is reinforcing the long-term trend.

Since 2008, however, this trend was stopped. Since then, the exchange rate fluctuations reflect the different stages of economic and debt crisis, mostly with the stabilizing effect on domestic economic activity. Further weakening of the exchange rate has occurred in connection with the CNB, pointing the interventions release of monetary conditions. Using the exchange rate as an instrument of monetary policy ends at the moment when it will result in very significant inflationary pressures to achieve the inflation target needed to significantly tighten monetary policy, which will be achieved by the end of the intervention and subsequent increase in interest rates over zero (technically).

You can assume then that the course will continue on the previous strengthening, but at a more moderate pace.

Also, it is possible to observe that the displacements of the course in turbulent times may approach or even exceed the range of fluctuations. For the successful implementation of the criteria for the stability of the exchange rate in the future, the appropriate timing of entry into the exchange rate mechanism of ERM II is the main key.

This entry should take place in the conditions of a stable situation in the domestic economy, the stability of the world financial markets and convenient investment sentiment towards the Czech Republic and the whole central region.

Graph 1: Nominal exchange rate of CZK/EUR

Source: [5]

The criterion of convergence of interest

The Czech Republic currently performs it without problems and despite certain risks (a new escalation of the debt crisis in the euro zone) and there are no significant pressures, which would prevent the implementation of the convergence criteria in the following years. However, it is important to maintain the confidence of the financial markets in the medium-term consolidation and long-term sustainability of the public finances.

Table 4.

Long-term interest rates for convergence purposes

	2010	2011	2012	8/2013	2013	2014	2015	2016
The average of 3 EU countries with the lowest inflation	4,0	3,3	3,1	2,2	2,9	3,5	3,1	3,3
Value of criteria	6,0	5,3	5,1	4,2	4,9	5,5	5,1	5,3
The Czech Republic	4,2	3,7	2,8	2,2	2,2	2,3	2,7	3,1

Source: [4]

Compliance with fiscal consolidation is reflected in the long-term stable and quality rating assessment of the Czech Republic and the smooth Czech Government bond underwriting, which contributes to the stability of their revenues.

Due to the still existing and not solved debt problems in the euro area there is the prediction for the 2014-2016 loaded with certain risks. On the basis of the current development, however, we can believe that the Czech Republic would not have problems with the fulfilment of the convergence criteria in the following period. However, it is an essential condition for maintaining the confidence of the financial markets in the medium-term consolidation and long-term sustainability of the public finances.

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