

NBP

**POLAND
AND
THE EURO AREA**

National Bank of Poland

**Presentation prepared for the international conference
"EURO in New Member Countries of European Union"
Prague, 28 March 2009**

Plan of the presentation:

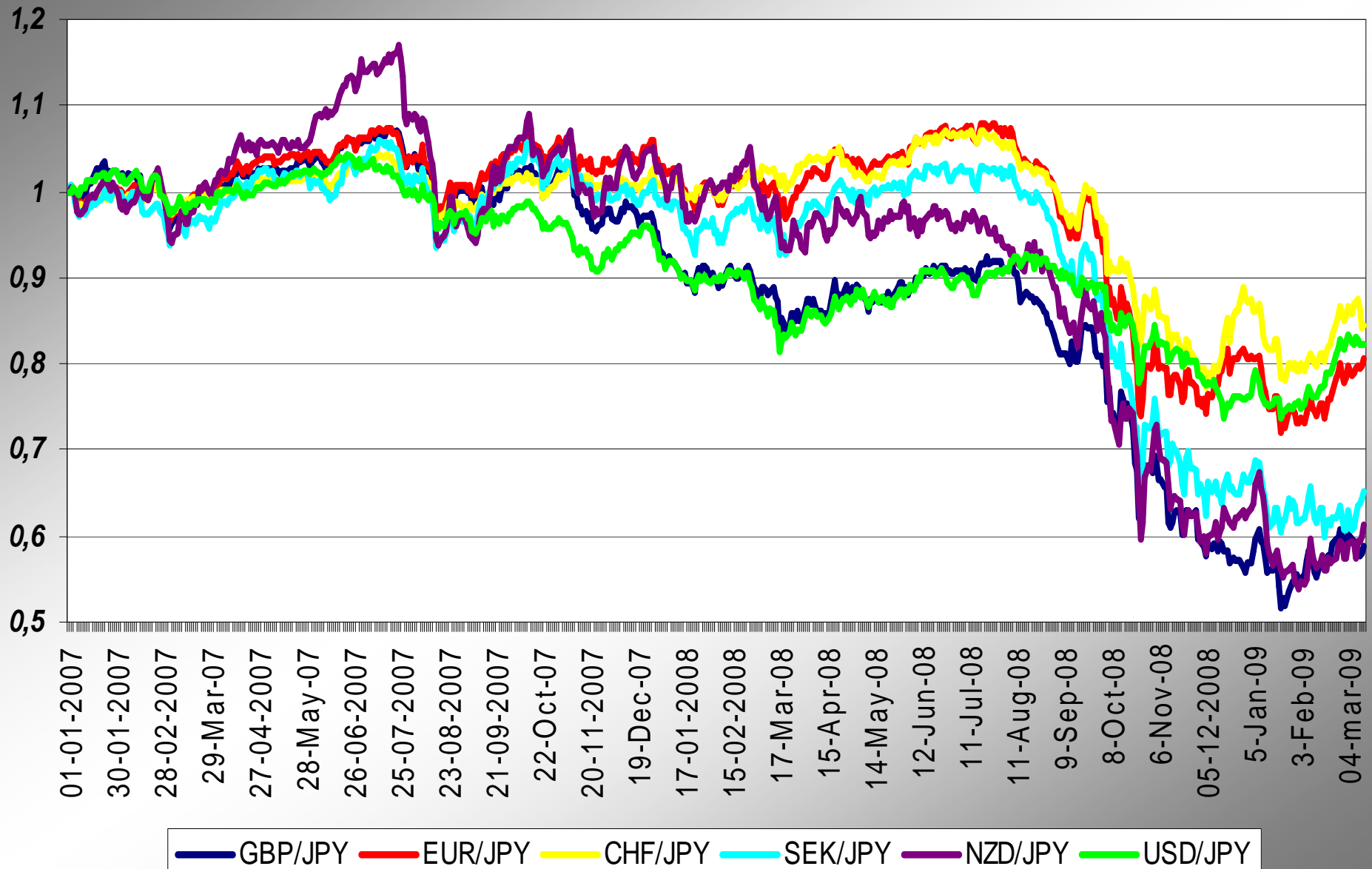
- The review of the latest tendencies in the international monetary system.**
- The impact of the recent turmoil on the integration process in Europe.**
- Lessons stemming from the first decade of the existence of the euro area and their importance for the aspiring members.**
- Poland's ability to join the euro area.**
- Conclusions.**

- **Turbulences in the international monetary system affected almost the entire globe.**
- **Europe was no exception.**
- **The magnitude of the crisis in Europe depended on several factors.**

- **Iceland was the worst to be hit by the crisis.**
- **Staying out of the EU and the euro area proved to be a costly solution.**
- **However, neither membership in the EU nor in the euro area ensured sufficient immunity to the current turmoil.**

Countries outside the euro area were exposed to a sharp depreciation of their currencies (and in some cases it had to be accompanied by interest rates hikes).

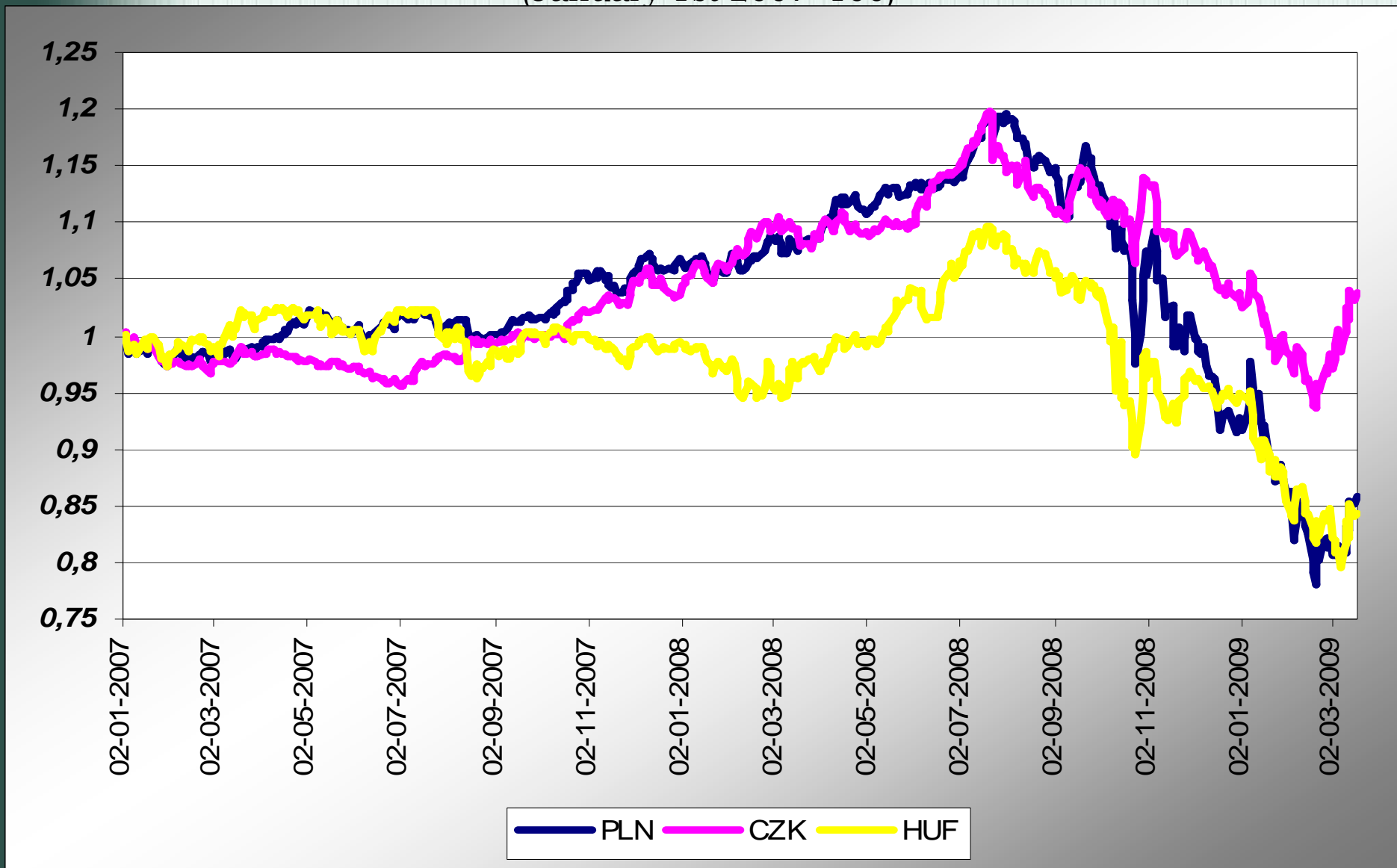
The carry trade and the performance of the key European currencies (January 1st 2007=100)



- **However, the scale of depreciation proved to be far greater in the NMS.**
- **Most probably, the CEE currencies were bolstered by the carry trade.**
- **As a result of the adjustment, some currencies lost up to the one third of their value.**

The CE 3 currencies against the euro

(January 1st 2007=100)

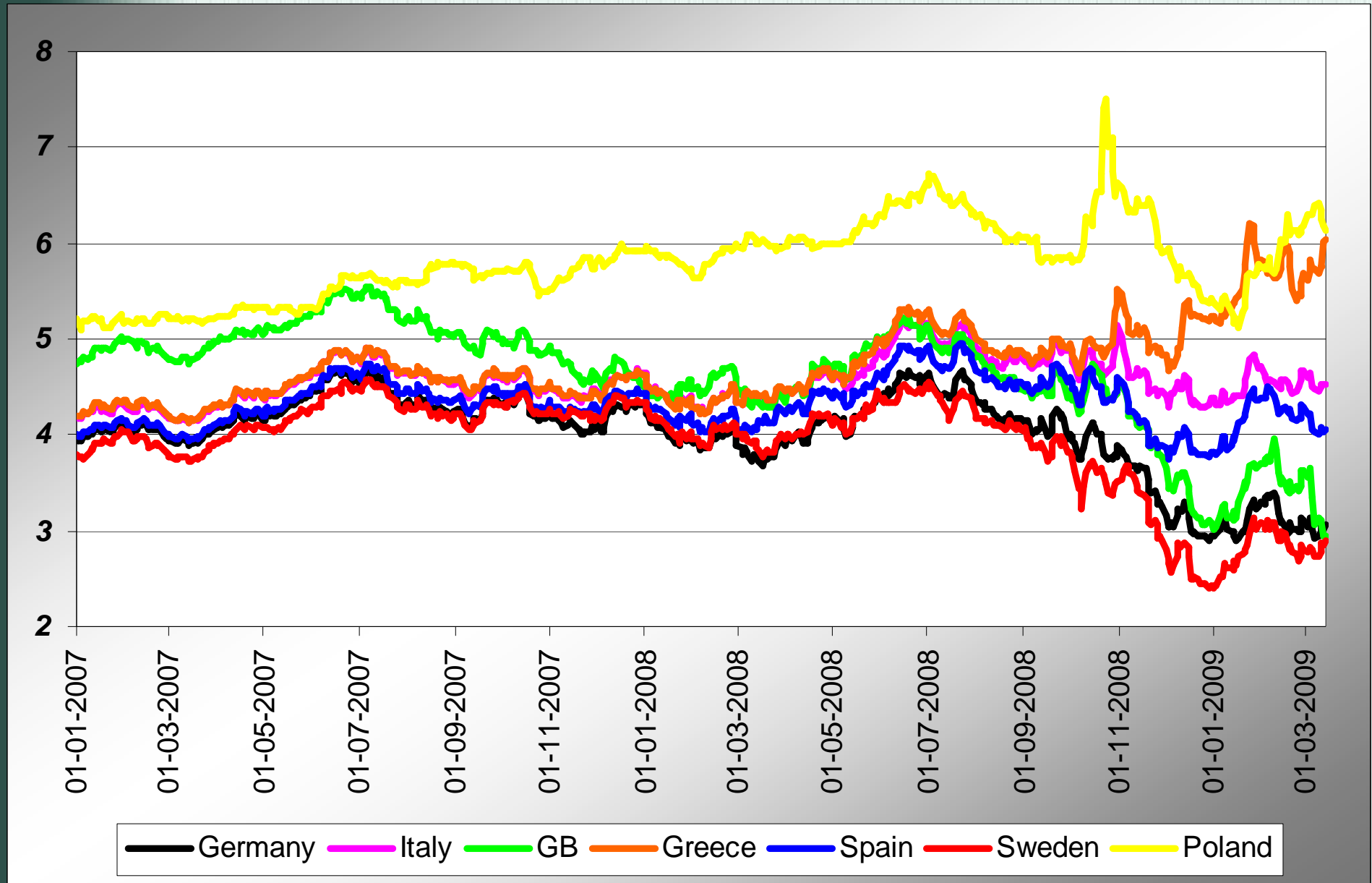


- **Furthermore, the repatriation rally along with flee towards safety paved way toward quick evaporation of liquidity in many NMS.**
- **Sharp drop in liquidity led to a drastic increase in volatility.**
- **However, the possibility of resorting to the ECB credit lines proved to be of significant importance.**

- **Nevertheless, membership in the euro area did not help to prevent all bitter consequences stemming from the current turmoil.**
- **Significant increase in the yields of 10 year bonds.**
- **Downgrading of Spain, Greece and Portugal.**

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10 year yields in selected economies (Bloomberg)



Poland and the euro area membership

- **As an EMU member with derogation Poland is obliged to join the euro area.**
- **The questions are not “whether” but “when” and “how”.**
- **Close scrutiny of the most recent events does not give unanimous verdict as far as monetary future of European economies is concerned.**

Benefits and chances

- **Direct effects**
 - **Elimination of the costs related to zloty/euro exchange rate transactions**
 - **Elimination of exchange rate risk and subsequent decline in interest rates**
- **Long-term benefits**
 - **Investment growth**
 - **Trade expansion**
 - **Decrease in the country's macroeconomic risk**
 - **Financial markets integration**
 - **Increased competition**
 - **More stable environment**
 - **Maastricht criteria should impose a clear framework for macroeconomic discipline**

Costs and threats of the euro adoption

Monetary union membership involves major macroeconomic costs:

- **Giving up an independent interest rate policy and a floating exchange rate,**
- **The risk of ECB monetary policy being inappropriate for the Polish economy**
- **Potential short-term cost of meeting the inflation criterion**
- **Changeover costs**

Nominal and real convergence in the euro area countries

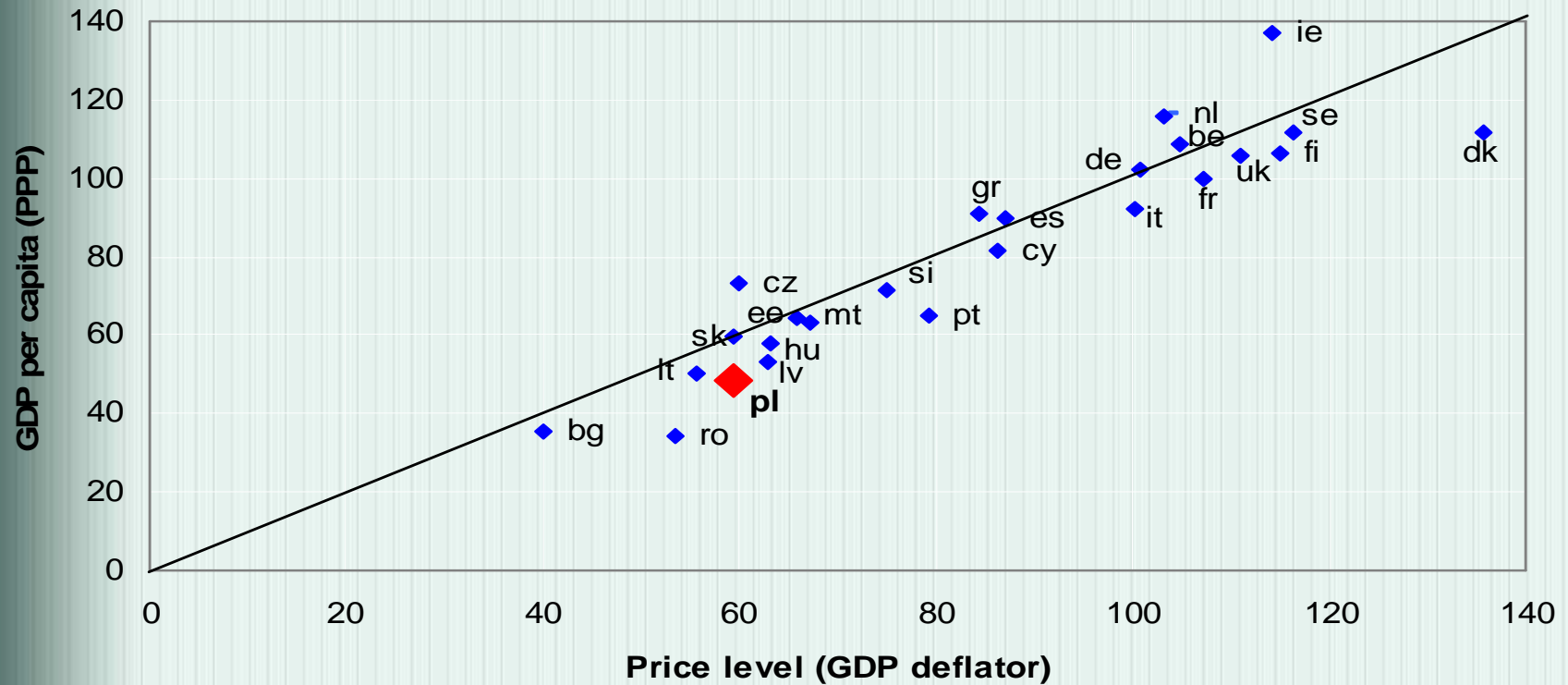
- Nominal convergence criteria constitute a mechanism of supervision over the quality of economic policy.
- The endeavour of meeting the criteria provided a historical challenge, which helped to reduce fiscal imbalances and increase the stability of the economic policy.
- Peripheral countries achieved a significant level of nominal convergence with the so-called 'core' euro area countries. However, the sustainability of this convergence remains the issue of concern.

Nominal and real convergence in the euro area countries

- The balance of costs and benefits of membership in the monetary union may depend on the degree to which **nominal and real convergence criteria have been achieved in a sustainable way.**
- The overall effects of the euro adoption that member states have experienced so far are generally positive, **though they have varied among individual countries.**
- **Structural convergence** and **flexibility of economies** are the underlying causes of why some benefits have not always materialized, whereas some costs and risks turned out to have been underestimated.

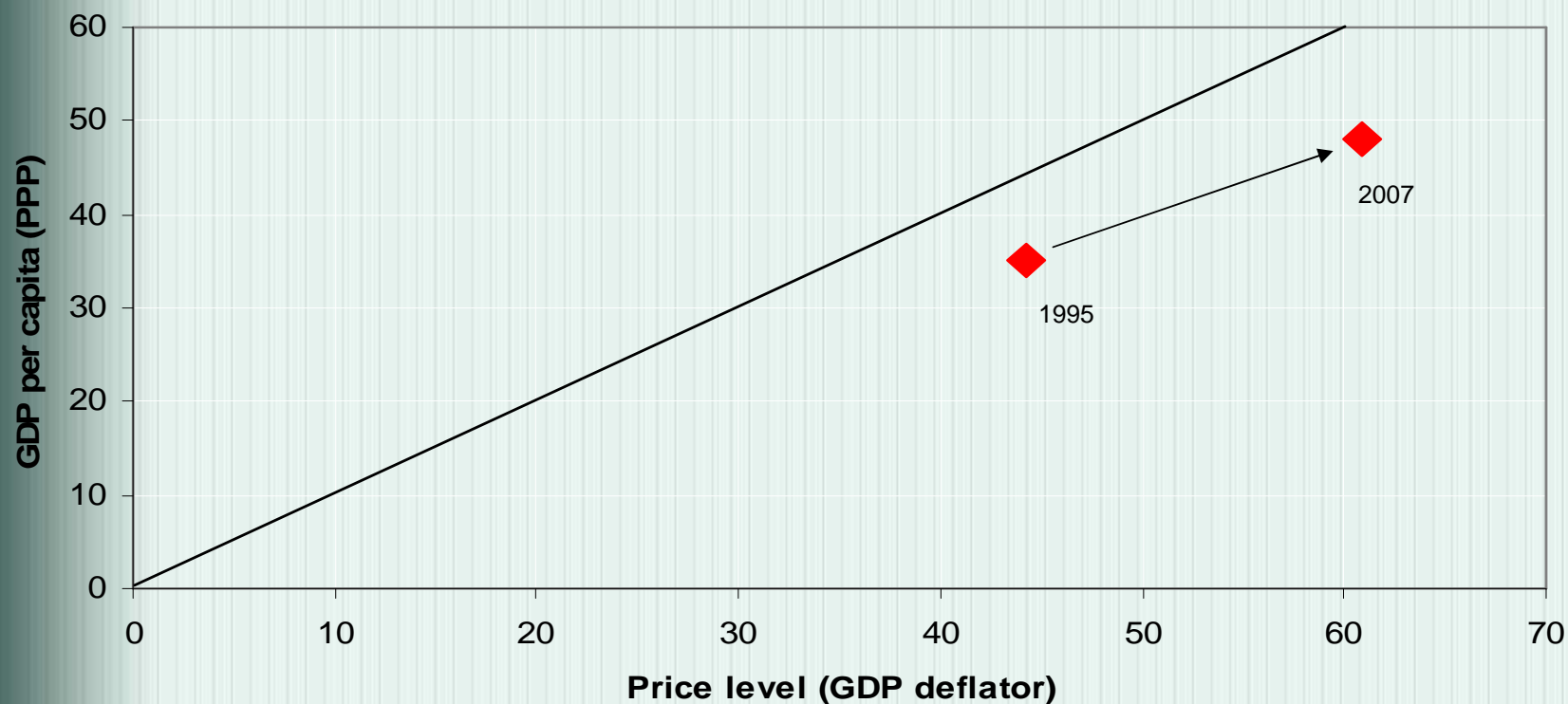
GDP per head in Poland, as well as price level are relatively low in Poland compared to the euro area countries

Per capita GDP (PPP, EA12 = 100) and price level (EA12 = 100) in EU countries, 2007



Data from Eurostat and Total Economy Database

Poland is undergoing the process of income convergence, accompanied by price convergence



Data from Eurostat and Total Economy Database

Structural convergence

- **Poland's economic structures are fairly divergent, compared to the euro area...**
- **...but the similarity increases over time**
- **Persistent differences partly result from lower GDP per capita**
- **The share of euro area countries in Polish trade is significant (over 55%)**
- **The structure of Polish exports differs considerably from the euro area's...**
- **...but at the same time it is highly diversified**
- **Intra-industry trade in Poland has gained in significance in the last years (up from 48% to 65% between 2001 and 2006), even though its share is still lower than in most of the euro area countries (75% on average)**

Cyclical convergence

- **Results concerning the degree of synchronisation are not unambiguous (numerous methods and analyses).**
- **However...**
 - **Poland's business cycle usually turns out to be relatively well synchronised with the euro area (compared to other CEECs)**
 - **Shocks affecting the economies of Poland and euro area tend to be asymmetrical...**
 - **...but reactions to those shocks are similar**

Weaknesses of Polish economy that motivate gradual integration

- **Structural (sectoral and supply) convergence in output composition is far from complete (Arratibel and others 2007).**
- **In spite of the dominant role of foreign investors Poland's financial system is underdeveloped (IMF 2007).**
- **Labour market structures are more flexible than those of the euro area countries but labour utilization is poor (EC 2006).**
- **Low level of competitiveness of Polish economy due to weak institutional environment and overregulation.**

How to cope with potential asymmetric shocks?

Effectiveness of alternative mechanisms for absorbing asymmetric shocks:

- **labour and product market flexibility are not yet efficient enough mechanisms for mitigating negative effects of asymmetric shocks in Poland**
- **fiscal policy - high and persistent structural deficit hampers the stabilizing function of fiscal policy and constitutes a barrier to meeting the fiscal criterion**

Conclusions

- **Current crisis has brought about sharp adjustment processes within the international monetary system.**
- **Analysis of the events in Europe points towards immense caution.**
- **Conclusions from analyses show that in the long run adopting euro should bring more benefits than costs. The positive balance is however not certain in every point in time.**
- **In short run direct benefits (reduction of FX risk and transaction costs) will be accompanied by the risk of suboptimal monetary policy of the ECB.**
- **Indirect benefits (chances) will not materialize before medium run and will largely depend on the macroeconomic policy carried out in the pre-accession period as well as after joining euro area.**

References

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- EC (2006), Growth and Competitiveness in the Polish economy: the Road to Real Convergence
- IMF (2007), Euro Area Policies: Selected Issues
- Arratibel and others (2007), Determinants of Growth in the Central and Eastern European UE Member States -a Production Function Approach