Ministry of Finance

Government Plenipotentiary for the Introduction of the Euro in Poland

Prerequisites for Implementation of the Next Stages of the Road Map for Euro Adoption in Poland

EXECUTIVE SUMMARY

Warsaw, April 2009

Adopting the euro and benefiting from full membership of the Economic and Monetary Union is among top priorities of the Polish government's economic policy. The government aims at achieving this goal as soon as possible and in a way that would maximize benefits and opportunities, as well as minimize any potential costs and risks related to monetary integration.

Introduction of the common currency has to be preceded by completing four successive stages, as outlined in the the *Road Map for Euro Adoption in Poland*[1] (hereinafter referred to as the *Road Map*). Entering the ERM II is a key element of the second stage of this strategy. Prior to the change in the exchange rate regime, however, a number of conditions have to be met. These have been outlined in the *Prerequisites for Implementation of the Next Stages of the Road Map for Euro Adoption in Poland*, a document approved by the Polish government on 27 April 2009.

The document emphasizes that entry to the ERM II should convey Poland's readiness to adopt the common currency. As a part of the credible monetary integration strategy it should support exchange rate stability with the central parity acting as a nominal anchor for the FX market. In order to achieve stability conditions within the ERM II framework, however, a number of requirements have to be met:

Firstly, the level of the central parity should reflect macroeconomic fundamentals, i.e. be consistent with the equilibrium exchange rate;

Secondly, the declared duration of ERM II membership should be as short as possible;

Thirdly, the fulfilment of all the formal requirements at the time of assessing Poland's readiness for euro adoption should be ensured;

Fourthly, a political consensus over the necessary formal adjustments to adopt the common currency is indispensable. The political commitments made in this respect need to be regarded as sustainable.

Whereas the fulfilment of the above-listed conditions was highly probable at the moment of preparing the *Road Map*, since then a number of factors have changed significantly. In particular, the deepening financial turbulence and sharp deterioration in the global economic activity impede the fulfilment of the euro adoption timetable, announced in October 2008. External factors beyond

[1] Approved by the government on 28th October 2008.

the influence of the domestic policy have destabilized the zloty exchange rate and negatively affected the prospects of economic growth in Poland. Should the economic slowdown turn out deep and protracted, bringing back the general government deficit to the level not exceeding 3% of GDP would be an additional challenge. Nevertheless, the government is determined to adopt all the necessary measures so that the fiscal criterion does not pose an obstacle to Poland's membership in the euro area.

Since November 2008, the exchange rate volatilities[2] have increased significantly both in old and new EU member states and, so far, stability in the FX markets has not been restored. Entering the ERM II, however, does not require that volatility of the zloty exchange rate decline to the level observed before the financial market turbulence. This is due to the stabilizing effect ERM II membership should have under a credible monetary integration path. Nevertheless, although current exchange rate behaviour is not a proper benchmark for the zloty movements within the ERM II framework, it constitues a serious obstacle to setting the central parity at the level that would be perceived as a credible nominal anchor consistent with macroeconomic fundamentals. Therefore, the moment of ERM II entry should be preceded by at least a few-month period of exchange rate volatility not exceeding significantly the level observed for other currencies before their entry to the new mechanism.

A failure to meet the above-outlined conditions would delay the moment of entry to the ERM II beyond 2009Q2. Nevertheless, it would not exclude the possibility of adopting the euro in 2012, provided that the Polish zloty has stabilized before July 2009 and that assessment of the exchange rate criterion is based on the 24-month period beginning just before ERM II membership, as was already the case in other countries. With other prerequisities fulfilled, entering the ERM II in the second half of 2009 would then allow Poland to adopt the common currency in line with the *Road Map* timetable. Should that condition not be met either, euro area membership would have to be postponed beyond 2012.

Irrespective of the moment of ERM II entry, all other preparations for euro adoption in Poland will be continued, in line with the *Road Map* schedule. In order to make this process smooth and efficient, and drawing on the experience of other Member States, the government will establish an organizational structure that will comprise:

[2] As measured by moving standard deviations, *ERV* (exchange rate volatility measure applied in the ECB Convergence Reports) and option pricing.

- Government Plenipotentiary for the Introduction of the Euro in Poland,
- National Coordination Committee for Euro Changeover,
- Coordinating Council,
- Working Committees,
- Task Groups.

Within this new organizational setup a detailed strategy of euro adoption will be prepared. The document presenting the national strategy and defining activities that should be undertaken in the process of monetary integration, including the timetable of their completion, will be ready in July 2009. The details of this document will be subsequently fleshed out in the form of the National Changeover Plan.

All these measures are to ensure that Poland's strategy to adopt the euro as soon as possible will be continued.