

Analysis of the impact of the introduction of the euro in Slovak economy

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Abstract: By signing the Accession Treaty to the European Union (16 April 2003 in Athens), the Slovak Republic committed itself to join the EMU and to introduce the common currency – the euro. Euro is the official currency in 16 of 27 EU countries and in six countries outside the EU. Slovakia introduced the euro on 1 January 2009. When introducing the new currency, it was the same as in other countries; to put smooth changeover and to avoid unjustified price increases. This was reflected in the General Act, in several other laws, as well as in the Code for the euro. Presented issues can be regarded as highly actual, and therefore *the aim of this paper is the analysis of the impact of the euro in Slovak economy.*

Keywords: euro, introduction of the euro in Slovakia, financial impact of the euro in Slovakia, EU, the world economic crisis

INTRODUCTION

The euro is the currency and monetary unit of the Euro zone, as well as third countries involved. It is the second most important currency in the international monetary system after the U.S. dollar. It is managed by the European Central Bank in Frankfurt. It is the official currency in 16 of 27 EU countries and in six countries outside the EU. It is fixed exchange rate to the euro in other five countries and two currency areas (www.euromena.sk). Slovakia introduced euro as the 16th country on 1st January 2009. When introducing a new currency, it was the same as in other countries; to get the smooth changeover and to avoid unjustified price increases. This was reflected in the General Act, in several other laws, as well as in the Code for the euro. Mandatory dual display of prices had been introduced nearly five months before introduction of the euro and continued for one year after its introduction; as well as regular decade monitoring of the selected types of goods by the Statistical Office of Slovakia done from August 2008. However, the prices of some goods and services can be increased by the conversion for the new currency (not just because of rounding prices). This so-called changeover effect was observed in each country introducing the euro. *The aim of this paper is the analysis of the impact of the euro in Slovak economy.*

MATERIAL AND METHODS

Introduction of the euro caused several fears in population in Slovakia.

- ✚ The Slovak public thought that the euro would be followed *by increasing of prices*. Population rated the jump of prices as the biggest fear connected to the euro. In Slovakia, as in other EU countries, the principle of free pricing is applied. Development (growth) of prices of goods and services depends on the competition in various segments of the consumer basket, so *it didn't lead to any unjustified prices rises.*

- ✚ Another public fear was that the introduction of the euro causes **a reduction of the savings value of population**. However, savings in the crowns were converted to the euro by the same conversion rate as prices. An instantaneous value of savings (incurred expenditure in Slovakia) in relation to domestic prices was not changed.
- ✚ The third concern was the fear of **progressive deterioration of savings due to low real interest rate after joining the Euro zone**. The real degradation of savings in Slovakia has already been occurred in the past. It was caused by the negative real interest rates on deposits due to the fact that the inflation rate was higher than the interest rates on deposits offered by banks in Slovakia. Otherwise, Slovakia entered the low inflation environment by the joining the Euro zone, but it is necessary to reflect that the inflation rate in Slovakia is slightly higher than in euro area.
- ✚ The fear of **reduction of value of pensions** is essentially very similar to the fear of **the reduction of savings value of population**. If the introduction of the euro led to an increase of the price level or to an increase of inflation, and income remained unchanged (what did not happened), their real value would be reduced.
- ✚ The situation is very clear by pensions that are granted after the introduction of the euro. **Real value of new pensions** is based on the average real wage in the national economy. Introduction of the euro accelerated the growth of real wages; therefore the new pensions granted after the entry of Slovakia into the euro area are higher.

RESULTS AND DISCUSSION

Table 1 shows the essentials positive effects (benefits) of the euro introduction in Slovakia and the estimated impact. By processing of the analysis of the impact of the euro on Slovak economics, we should be aware that the introduction brings many advantages, which presents the benefit for the future development of our country, but also losses as additional costs.

Tab. 1 Positive effects of the euro introduction in Slovakia

S.n.	POSSITIVE EFFETS	IMPACT
1.	Reduction of financial transaction costs	Savings of 0.30 % of GDP
2.	Reduction of administrative transaction costs	Savings of 0.06 % of GDP
3.	Elimination of exchange rate risk against the euro	Savings by eliminating the risk of 0.02 % of GDP (range 0.01% to 0.08 % of GDP)
4.	Reducing the volatility of exchange rates against currencies of the other trading partners	Reducing the overall effective volatility to 0.35 % (from 0.63 % - years: 2001 – 2005) After the entering of the all V4 countries to the Euro zone to 0.17%
5.	Reducing of the cost of capital	Decline of the real interest rates for companies from around 2 % to about 1 to 1.5 %
6.	The increase of foreign trade	The increase of foreign trade by 50 %
7.	Increasing the level of GDP per capita (an increase of foreign trade and foreign direct investment)	The increase of GDP per capita between 70-20% in the long term The increase of GDP in annual growth of 0.7 % (range 0.4 to 1% per year)
8.	Increase of the foreign direct investment	
9.	Increase of the price transparency and competitiveness	Increasing pressure on prices and prevent their growth

Table 2 presents the strongest negatives (in the form of additional costs) of the euro introduction in Slovakia and their estimated impact.

Tab. 2 Additional costs for the introduction of euro in Slovakia

S.n.	ADDITIONAL COSTS	IMPACT
1.	Technical and organizational costs for conversion of the currency	One-off costs amounting to 0.3 % of GDP
2.	Specific costs of banking sector	Costs associated with the task of ensuring free conversion of local currency to the euro and a decrease of activities and income of banks
3.	The loss of independent monetary policy (the renunciation of the instrument to reduction of asymmetric shocks)	The value of the loss of independent monetary policy is evaluated scored around 0,4 % of GDP
4.	The possible higher inflation in the long term	Additional contribution to inflation compared to the euro zone average amounting to 1.5 p. b. per annum

Slovakia was hit by the global crisis just before entering the Euro zone. Those few months between the announcement and actual introduction of the euro has been proved extremely advantageous, as compared to neighboring states that still pay their own money, as well as to those that already have the euro. Thus, while Slovakia is not immune against the global problems, the impact of the crisis has not caused such great shocks for Slovak economy, as in other countries, whether in Euro zone or in the V4 countries. This is a consequence of the fact that the Slovak currency acted as if it had been the euro in the last weeks and months prior to the euro introduction. The upcoming acceptance of the euro has protected us against the turbulences at financial markets. This is confirmed by the development of the exchange rate against other currencies in the region and also the development of long-term interest rates. According to the estimates of analysts, in the event that Slovakia did not have fixed exchange rate, the euro would be sold by six crowns more expensively than in that time. Such a fall of currency during the global crisis would multiply its effects and consequences. ***From the presented results that Slovakia, among the neighboring countries, best resists the global economic and financial crisis.***

It is undeniable that ***the economic crisis temporarily reduces the benefits of the euro in Slovakia.*** But analysts predict that the benefits of the new currency will more reflect when the economic situation in other countries revives again. Global economic crisis delayed the expected positive effects of introduction of the new European currency in Slovakia. Analysts agree that the euro is clearly positive during the declining foreign demand. Although the volume of foreign trade is declining and the foreign companies are cautious in investments; in the short term, the financial crisis may slow some of the beneficial effects of the euro. On the other hand, the economic environment in Slovakia is more stable and predictable due to the entering the Euro zone, in comparison with neighboring countries. Advantages of the new currency for companies would be reflected again more markedly in the payment system, when the economic situation revives. Slovakia became a member of the Euro zone, when the financial crisis had fully hit the real economy of many countries. The main negative consequence of the crisis is a decrease of foreign demand for Slovak products, which will affect the overall level of production in Slovak economy this year, too. The introduction of euro in Slovakia eliminated foreign exchange costs, transaction costs, as well as various administrative costs. From the presented eliminations it is possible to expect the better connection between Slovak market and the other European Union markets. Thanks to the Euro, Slovakia has a mainly advantage in eliminating of the exchange rate risk in comparison with the surrounding countries that use their own national currencies. The high volatility of currencies in neighboring countries may be a particular symbol of instability and a negative in eyes of investors when deciding to entry into the specific country. Significant fluctuations in exchange rates, which the central neighboring European markets are faced, increase the price of ensuring the exchange of export revenues and remind potential investors, but also the

multinational companies, the vulnerability in times of global market turbulence. Not so much domestic but external negative factors are the reason of the main weakening of the neighboring currencies.

CONCLUSION

In conclusion, we must not forget that the export-oriented Slovak economy is mainly focused on the markets of the European Union. Up to 86% of Slovak exports aim at Member States and more than 50% directly to countries paying the unified currency euro. Euro is therefore expressly good news for Slovak exports and it provides the Slovak Republic also the stability of the euro zone domestic market from 1st January 2009. For multinational concerns from Germany or France, the investment in Slovakia is not the foreign investment in the strict sense - although it is a cross-border investment, but in the home market area. Although the year 2010 will be a loading test also for Slovakia, Slovakia is prepared a little better in comparison with its neighbors; thanks to the acceptance of the euro.

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Streszczenie: *Analiza wpływu wprowadzenia euro na ekonomię słowacką.* Poprzez podpisanie traktatu o akcesji do unii europejskiej (16 kwietnia 2003 w Atenach), Słowacja zobowiązała się do przystąpienia do unii monetarnej i wprowadzenia wspólnej waluty- euro. Euro jest oficjalną walutą w 16 z 27 krajów członkowskich. Słowacja wprowadziła euro 1 stycznia 2009, w podobny sposób jak w innych krajach, w sposób łagodny zapobiegając nieuzasadnionemu wzrostowi cen. Celem artykułu jest analiza wpływu wprowadzenia euro na ekonomię Słowacji.

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