

Box 6

THE INTRODUCTION OF THE EURO IN CYPRUS AND MALTA ON 1 JANUARY 2008

Following requests by the national authorities of Cyprus and Malta for a review of progress with respect to their fulfilling the provisions of the Maastricht Treaty (Article 122(2)) for the adoption of the euro, the ECB and the European Commission both prepared the required Convergence Reports. These reports, examining the achievement of a high degree of sustainable convergence, were published on 16 May 2007. On the basis of the results of the underlying examination, Cyprus and Malta were both found to have fulfilled the necessary conditions for the adoption of the single currency. On 10 July 2007 the EU Council therefore adopted a decision allowing Cyprus and Malta to adopt the euro as their currency as from 1 January 2008.

The EU Council also adopted a regulation fixing the irrevocable conversion rates for the Cyprus pound and the Maltese lira to the euro. The respective conversion rates were set at CYP 0.585274 and MTL 0.429300 to the euro. Both conversion rates correspond to the respective central rates agreed on 2 May 2005 when the Cypriot and Maltese currencies entered the exchange rate mechanism II (ERM II). Within ERM II, Cyprus and Malta have not changed their currencies' central rates against the euro and the respective exchange rates have stayed close to or at the central rates. The ECB supported the choice of the current central rates as the conversion rates upon adoption of the euro. Following the fixing of the conversion rates, the ECB, together with the national central banks of Cyprus and Malta, will monitor developments in the market exchange rates of the two currencies against the euro in the context of the ERM II agreement until the end of 2007.

With the introduction of the euro by Cyprus and Malta on 1 January 2008, the euro area will comprise 15 EU Member States. Cyprus and Malta will be able to share the benefits of the single currency, which eliminates exchange rate uncertainty within Economic and Monetary Union and offers a credible monetary policy framework for maintaining price stability in an environment of low long-term interest rates, full price and cost transparency, reduced transaction and information costs and a greater resilience to economic and financial shocks. In order to ensure that the benefits of adopting the euro are reaped in full, the EU Council has encouraged Cyprus and Malta to continue with appropriate policies with regard to, in particular, budgetary rigour, structural reform and maintaining the competitiveness of their respective economies.

More specifically, for Cyprus it will be important to continue on a sustainable and credible path of fiscal consolidation based on structural measures and to improve its fiscal performance by tangibly reducing its high debt ratio. It will also be important, particularly in the public sector, to maintain moderate wage developments that take into account labour productivity growth, labour market conditions and developments in competitor countries. Moreover, it will be essential to proceed with structural reforms of the product and labour markets. For example, the indexation mechanism for salaries and some social benefits (cost-of-living allowances) should be overhauled in order to reduce risks associated with inflation inertia. Such structural reforms will not only make the economy more resilient to shocks but also create the best conditions for sustainable economic expansion and growth in employment. Finally, a possible reunification of Cyprus could entail additional structural and fiscal challenges depending on the specific economic and fiscal arrangements.

For Malta, it will be important to continue on a sustainable and credible path of fiscal consolidation and to improve its fiscal performance by tangibly reducing its high debt ratio. It will also be important, in both the public and the private sector, to maintain moderate wage developments that take into account labour productivity growth, labour market conditions and developments in competitor countries. Attention must also focus on overcoming the structural constraints on economic growth and job creation, notably by fostering labour participation. The strengthening of competition in product markets and improvements in the functioning of the labour market are key elements in this regard. Such measures will also help to make these markets more flexible, thereby facilitating adjustment in the face of possible country or industry-specific shocks. The ability to absorb such shocks is particularly important in view of the economy's relatively high degree of specialisation. These measures will help to achieve an environment conducive to price stability, as well as to promote competitiveness and employment growth.