

## Box 1

**THE INTRODUCTION OF THE EURO IN LITHUANIA ON 1 JANUARY 2015**

On 23 July 2014 the Council of the European Union adopted a decision allowing Lithuania to adopt the euro as its currency on 1 January 2015. Lithuania will be the nineteenth EU Member State to join the euro area. Euro area countries participate automatically in the Single Supervisory Mechanism (SSM) and Lithuania will therefore also join the SSM on the same date that it adopts the euro. Lithuania will be the first country to join both the euro area and the SSM in this way.

Both the ECB and the European Commission published their respective Convergence Reports on 4 June 2014, in line with the requirement laid down in Article 140 of the Treaty on the Functioning of the European Union to report to the EU Council at least once every two years, or at the request of an EU Member State with a derogation “on the progress made by the Member States with a derogation in fulfilling their obligations regarding the achievement of economic and monetary union”. Based on the findings of the Convergence Reports, the Commission concluded that Lithuania fulfilled all of the necessary conditions for adopting the euro.

At the same time, the EU Council also adopted a regulation on the conversion rate to the euro for Lithuania. The irrevocable conversion rate is set at 3.45280 Lithuanian litas to one euro, which corresponds to the current central rate of the litas in the Exchange Rate Mechanism II (ERM II). This rate is unchanged from that agreed at the time the litas entered ERM II in 2004. The ECB and Lietuvos bankas will monitor developments in the market exchange rate of the litas against the euro in the context of the ERM II agreement until the end of 2014. It is to be recalled that Lithuania joined ERM II on 28 June 2004 with its existing currency board arrangement in

place as a unilateral commitment, thus placing no additional obligations on the ECB. Over the reference period the litas continued to be stable and did not exhibit any deviation from its central rate within ERM II.

Lithuania's entry in the euro area is a significant achievement for economic policy in the country, providing an important source of confidence. Membership of the euro area may facilitate further economic integration, an improved investment environment and the continuation of sustainable economic convergence. The Lithuanian economy is already deeply integrated in the Single Market and while the benefits of joining the monetary union are clear, it also implies the national authorities' commitment to ensuring that the catching-up process is sustainable and not associated with new boom/bust episodes. Developments during the boom period of 2005-07 in particular highlighted the difficulties in controlling domestic price pressures and avoiding renewed economic overheating. Based on this experience, the ECB expressed concerns in its Convergence Report with regard to the sustainability of inflation convergence in Lithuania. That said, the ECB also noted that the Lithuanian economy had demonstrated high adjustment capacity in labour and product markets after the onset of the crisis, while fiscal discipline and reforms in the public sector also facilitated the adjustment process. The country's macroeconomic imbalances were corrected in the subsequent years without the help of an IMF programme, and the European Commission did not select Lithuania for an in-depth review in its Alert Mechanism Report 2014.

In order to lock in the competitiveness gains of recent years and ensure stability, the Lithuanian authorities must address the structural issues that the economy continues to face. These include continued high structural unemployment, labour supply bottlenecks, high energy dependence and low energy efficiency, as well as the burden stemming from a large shadow economy. The Lithuanian authorities have published a letter of self-commitment on their policy priorities and some of these undertakings are to be achieved prior to the adoption of the euro on 1 January 2015. By way of example, the draft Constitutional Law on the implementation of the fiscal compact is to be adopted shortly. Also, the process of broadening Lietuvos bankas' mandate to include macro-prudential policy is scheduled to be completed soon, so that all of the instruments for conducting counter-cyclical macroeconomic policy are in place in time. Furthermore, a ceiling on cash transactions is also expected to be introduced rapidly as a step towards reducing the shadow economy.

As for all of the countries which joined the euro area after 2004 including, most recently Latvia, much work has been done by the NCB – Lietuvos bankas – and the ECB to prepare for Lithuania's integration in the euro area and the cash changeover, as well as to carry out the necessary statistics and economic analyses.

It is important that each new euro area Member State continues to demonstrate its commitment to and sense of ownership of the euro project after it has joined. The experience of recent years has confirmed that participation in the currency union does not only come with rights, but also with obligations. Indeed, the success of the euro depends on all euro area countries seriously engaging with the responsibilities that go hand in hand with the benefits that euro area membership offers. The ECB welcomes the Lithuanian authorities' demonstrated commitment to addressing the economy's structural issues and ensuring Lithuania's successful participation in the single currency.