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Commission recommends 11 Member States for EMU

The European Commission has today recommended that the following eleven countries meet the necessary conditions to adopt the single currency, the euro, on 1 January 1999: Belgium, Germany, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Austria, Portugal and Finland. To qualify for the final stage of EMU, Member States must attain a high degree of sustainable economic convergence. Progress is measured against criteria covering inflation, government deficit and debt, exchange rate stability and long-term interest rates. Countries must also meet certain other conditions, in particular central bank independence. The Commission's analysis of Member States' performance is presented in its convergence report which is published today together with the Spring economic forecasts. In addition, the Commission has recommended that 9 countries no longer have excessive deficits. These countries therefore join the 5 which already meet the criterion for EMU in terms of public finances. European Union heads of state and government will confirm the list of EMU participating countries on 2 May, on the basis of the Commission's recommendation and convergence report together with the convergence report from the European Monetary Institute (also published today). The final decision will be taken on a recommendation from the Ecofin Council (Finance Ministers) after consulting the European Parliament.

A favourable economic climate for the start of the euro

The Commission adopted these recommendations and the convergence report on the initiative of President Jacques SANTER and Yves-Thibault de SILGUY, Commissioner responsible for economic, monetary and financial affairs. These historic decisions are presented against the background of a sound economic recovery in Europe. The Commission's spring economic forecasts published today indicate that growth will be 2.8% in 1998 and 3.0% in 1999, following 2.7% in 1997. These figures are marginally lower than the Commission's Autumn forecasts, largely because growth is returning to the German economy more slowly than expected. Recent events in Asian financial markets have also had limited negative effects on the European economy (in particular in terms of weaker export demand), but these have been largely offset by positive factors, in particular lower interest rates.

Overall however, the economic fundamentals in Europe are very positive. Low inflation, favourable monetary conditions, high profitability of investment and sustained external demand should ensure that the present recovery continues to strengthen leading to the creation of 3.4 million jobs over the period 1997-1999. These positive results illustrate the benefits of low inflation and improved public finances in terms of investment, growth and job creation. Member States' impressive efforts to prepare their economies for the euro are bearing fruit.

Record low inflation

The latest available inflation data (up to January 1998) shows 14 countries with average inflation over the last year of less than the reference value of 2.7%[1]. These are Belgium, Denmark, Germany, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Austria, Portugal, Finland, Sweden and the United Kingdom. Member States have made substantial progress with reducing inflation over recent years, and this trend was continued in 1997. In particular, Spain, Italy and Portugal have achieved rapid reductions over the last 18 months, bringing these countries into line within the Treaty reference value since mid-1997. In view of developments in unit labour costs and other price indices, as well progress with central bank independence, the Commission concludes that there are strong reasons to believe that the current inflation performance in these 14 Member States is sustainable.

Sustainable public finances

Fourteen member states had government deficits of 3% of GDP or less in 1997: Belgium, Denmark, Germany, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Austria, Portugal, Finland, Sweden and the United Kingdom. Member States have achieved significant reductions in the level of government borrowing, in particular in 1997. This remarkable outcome is the result of national governments' determined efforts to tackle excessive deficits combined with the effects of lower interest rates and stronger growth in the European economy. The Commission's report critically examines the one-off measures which have contributed to some Member States' 1997 figures. In particular it analyses Budget measures for 1998 and other factors to asses whether the budgetary situation is sustainable. The report concludes that the major part of the deficit reductions are structural.

In 1997 government debt was below the Treaty reference value of 60% of GDP in 4 Member States - France, Luxembourg, Finland and the United Kingdom. According to the Treaty, countries may exceed this value as long as the debt ratio is "sufficiently diminishing and approaching the reference value at a satisfactory pace". This was the case in almost all Member States with debt ratios above 60% in 1997. Only in Germany, where the ratio is just above 60% of GDP and the exceptional costs of unification continue to bear heavily, was there a small rise in 1997. In 1998, all countries above 60% are expected to see reductions in their debt levels. The Commission concludes that the conditions are in place for the continuation of a sustained decline in debt ratios in future years.

In view of these positive results, the Commission has today recommended to the Council that the following nine countries no longer have excessive deficits (as defined in Article 104c): Belgium, Germany, Spain, France, Italy, Austria, Portugal, Sweden, and the United Kingdom. Five further countries - Denmark, Ireland, Luxembourg, the Netherlands and Finland - already do not have excessive deficits. If the Council follows the Commission's recommendations, there will therefore be 14 countries which meet the public finances criterion in the Treaty.

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[1] The reference value is calculated by adding 1.5 percentage points to the simple arithmetic average of the rates of the three member states with the lowest levels of inflation (France, Ireland and Austria). This calculation uses Eurostat's Harmonised Index for Consumer Prices which was introduced in 1997.

No surprises for the financial markets

The arrival of the euro on the basis recommended by the Commission is already largely anticipated by the markets. The eleven countries on the Commission's list have enjoyed a long period of exchange rate stability within the Exchange Rate Mechanism of the European Monetary System, with most currencies trading very close to their central rates for the last two years. Only the Irish Pound has deviated from the reference range of ±2,25% significantly during the review period, but remained above its central rate. The Italian Lira and the Finnish Markka have participated in the ERM since November 1996 and October 1996 respectively, but they have displayed sufficient stability throughout the two-year reference period. The Greek Drachma entered the ERM on 16 March at the same time as a 3% revaluation of the central rate of Irish Pound. The Swedish Krona has never participated in the ERM and, over the last two years, has been volatile in relation to currencies in the ERM. The Pound Sterling has not been in the ERM during the reference period[2].

Fourteen countries had average interest rates over the last year below the reference rate of 7.8% calculated according to the Treaty rules[3]. These are Belgium, Denmark, Germany, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Austria, Portugal, Finland, Sweden and the United Kingdom. Long-term interest rates are a good measure of the durability of convergence because they are forward-looking indicators of the markets' assessment of underlying economic conditions, in particular in terms of inflation and public finances.

Independent Central Banks - legal convergence

The Commission's convergence report also examines whether the statutes of National Central Banks are compatible with the Treaty requirements, in particular regarding independence and the primary objective of price stability for monetary policy. Eight countries - Belgium, Germany, Greece, Ireland, Italy, the Netherlands, Portugal and Finland - already have legislation which is compatible with the Treaty. A further four countries - France, Spain, Luxembourg and Austria - have announced legislation which, if implemented in its present form, would ensure compatibility. In Sweden, planned legislative changes will not be adopted before late 1998 for constitutional reasons, and some incompatibilities remain between the present text and the Treaty.

The convergence report covers a number of other issues required by the Treaty including the development of the ECU, progress with integration of national markets, the balance of payments situation and the development of unit labour costs and other price indices.

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[2] Exchange rate stability of Sterling is not assessed in the convergence report on account of the UK opt-out (see conclusion).

[3] The reference value is calculated by adding 2 percentage points to the numerical average of the long-term interest rates (10-year benchmark bonds) of the three countries with the best performance in terms of price stability (France, Ireland, and Austria).

Conclusion

The Commission concludes that 11 countries have achieved a high degree of sustainable economic convergence: Belgium, Germany, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Austria, Portugal and Finland. It therefore recommends that these countries should be the founder members of EMU from 1 January 1999, thus creating a euro-zone with nearly 300 million inhabitants accounting for 19.4% of world GDP and 18.6% of world trade. This compares with 19.6% of world GDP and 16.6% of world trade for the United States and 7.7% of world GDP and 8.2% of world trade for Japan.

In two countries - Greece and Sweden - the Commission does not consider that the necessary conditions for EMU are met. Denmark and the United Kingdom have exercised their right under the Treaty not to participate in EMU with other Member States from 1 January 1999. Although the convergence report contains an analysis of the economic performance of these two countries, they are not considered for the purposes of the Commission’s recommendation.

The attached summary table illustrates Member States’ performance against the convergence criteria.

Current performance of the Member States in relation to convergence

	Inflation	Government budgetary position						Exchange rates	Long-term interest rates
	HICP (a)	Existence of an excessive deficit (b)	Deficit (% of GDP) (c)	Debt (% of GDP)				ERM participation	(d)
	January 1998		1997	1997	Change from previous year			March 1998	January 1998
					1997	1996	1995		
Reference value	2.7 (e)		3	60					7.8 (f)
B	1.4	yes (g)	2.1	122.2	-4.7	-4.3	-2.2	yes	5.7
DK	1.9	no	-0.7	65.1	-5.5	-2.7	-4.9	yes	6.2
D	1.4	yes (g)	2.7	61.3	0.8	2.4	7.8	yes	5.6
EL	5.2	yes	4.0	108.7	-2.9	1.5	0.7	yes (h)	9.8 (i)
E	1.8	yes (g)	2.6	68.8	-1.3	4.6	2.9	yes	6.3
F	1.2	yes (g)	3.0	58.0	2.4	2.9	4.2	yes	5.5
IRL	1.2	no	-0.9	66.3	-6.4	-9.6	-6.8	yes	6.2
I	1.8	yes (g)	2.7	121.6	-2.4	-0.2	-0.7	yes (j)	6.7
L	1.4	no	-1.7	6.7	0.1	0.7	0.2	yes	5.6
NL	1.8	no	1.4	72.1	-5.0	-1.9	1.2	yes	5.5
A	1.1	yes (g)	2.5	66.1	-3.4	0.3	3.8	yes	5.6
P	1.8	yes (g)	2.5	62.0	-3.0	-0.9	2.1	yes	6.2
FIN	1.3	no	0.9	55.8	-1.8	-0.4	-1.5	yes (k)	5.9
S	1.9	yes (g)	0.8	76.6	-0.1	-0.9	-1.4	no	6.5
UK	1.8	yes (g)	1.9	53.4	-1.3	0.8	3.5	no	7.0
EUR	1.6		2.4	72.1	-0.9	2.0	3.0		6.1

(a) Percentage change in arithmetic average of the latest 12 monthly harmonized indices of consumer prices (HICP) relative to the arithmetic average of the 12 HICP of the previous period.
(b) Council decisions of 26.09.94, 10.07.95 , 27.06.96 and 30.06.97
(c) A negative sign for the government deficit indicates a surplus.
(d) Average maturity 10 years ; average of the last 12 months.
(e) Definition adopted in this report: simple arithmetic average of the inflation rates of the three best performing Member States in terms of price stability plus 1.5 percentage points.
(f) Definition adopted in this report: simple arithmetic average of the 12-month average of interest rates of the three best performing Member States in terms of price stability plus 2 percentage points.
(g) Commission is recommending abrogation.
(h) Since March 1998.
(i) Average of available data during the past 12 months.
(j) Since November 1996.
(k) Since October 1996.

Source: Commission services.