Pros & Cons of EUR Adoption

Bucharest
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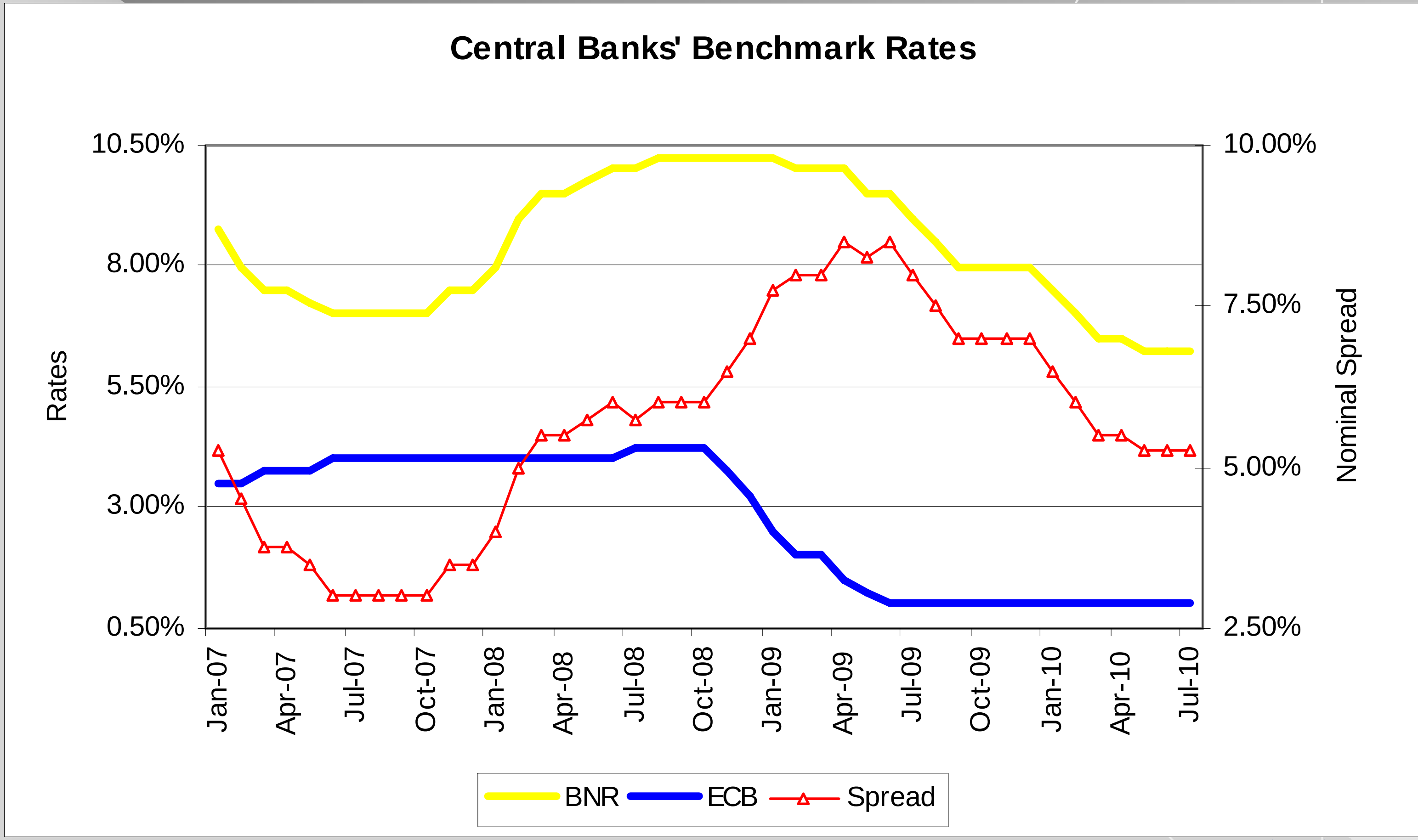
Maastricht Convergence Criteria



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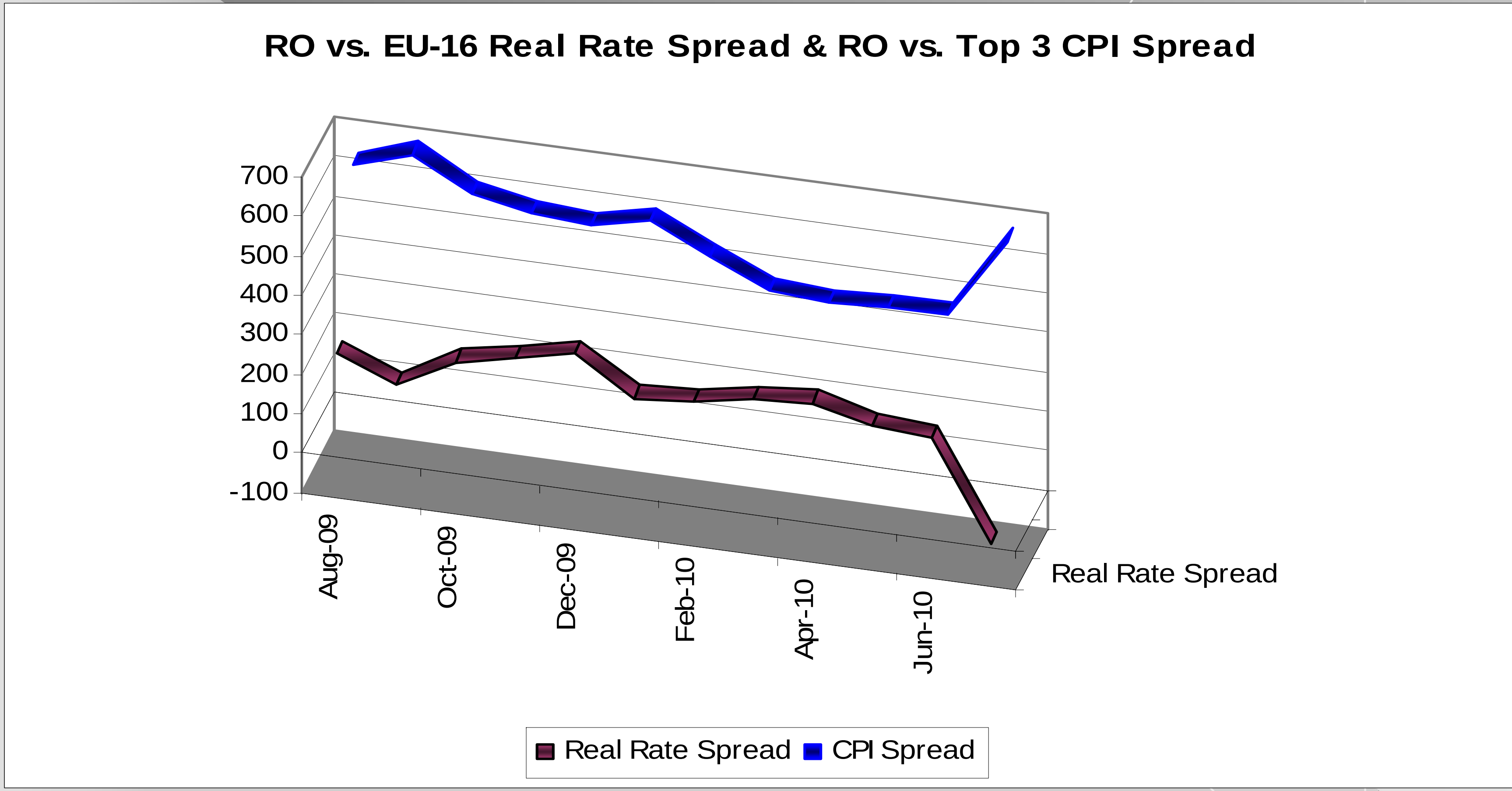

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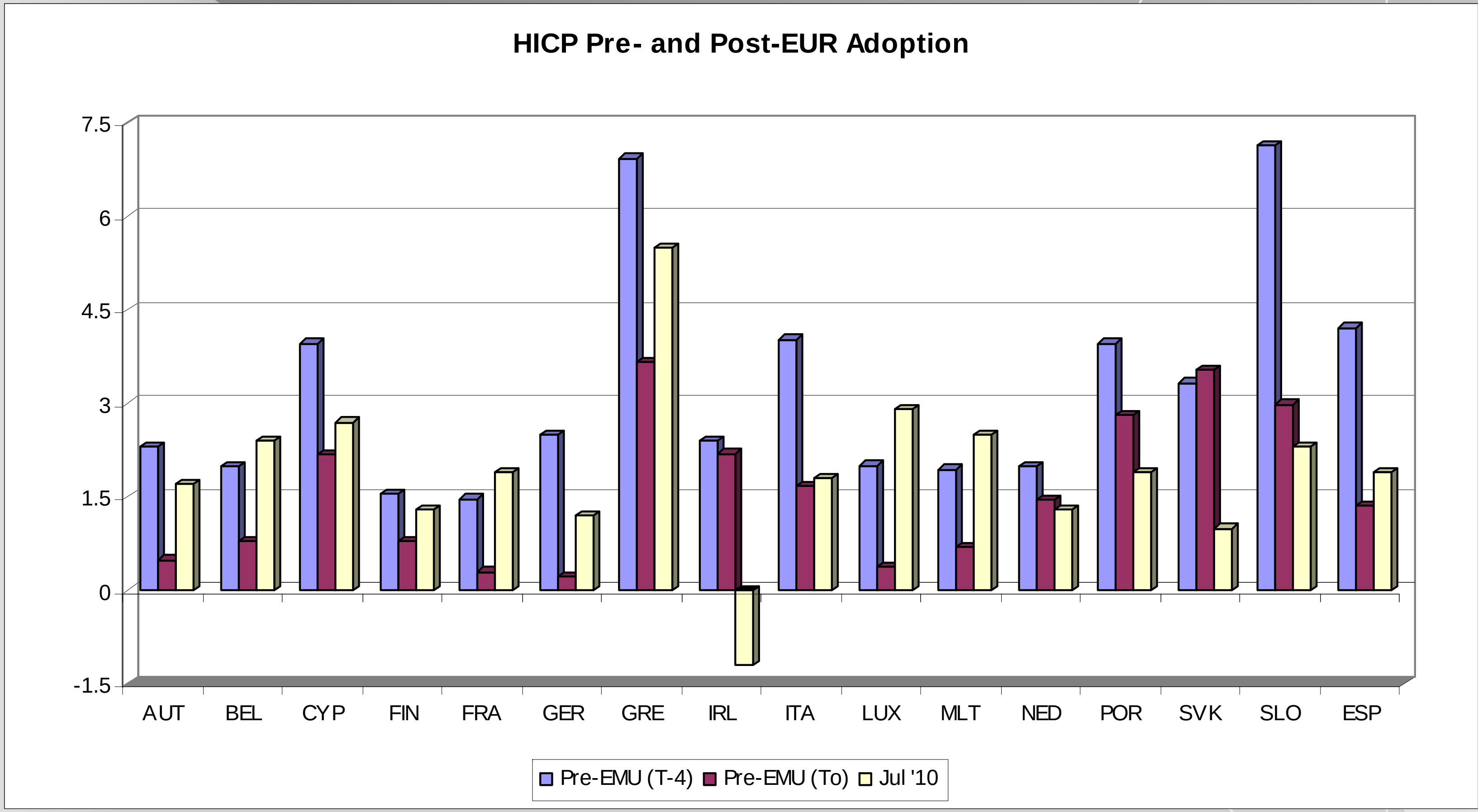

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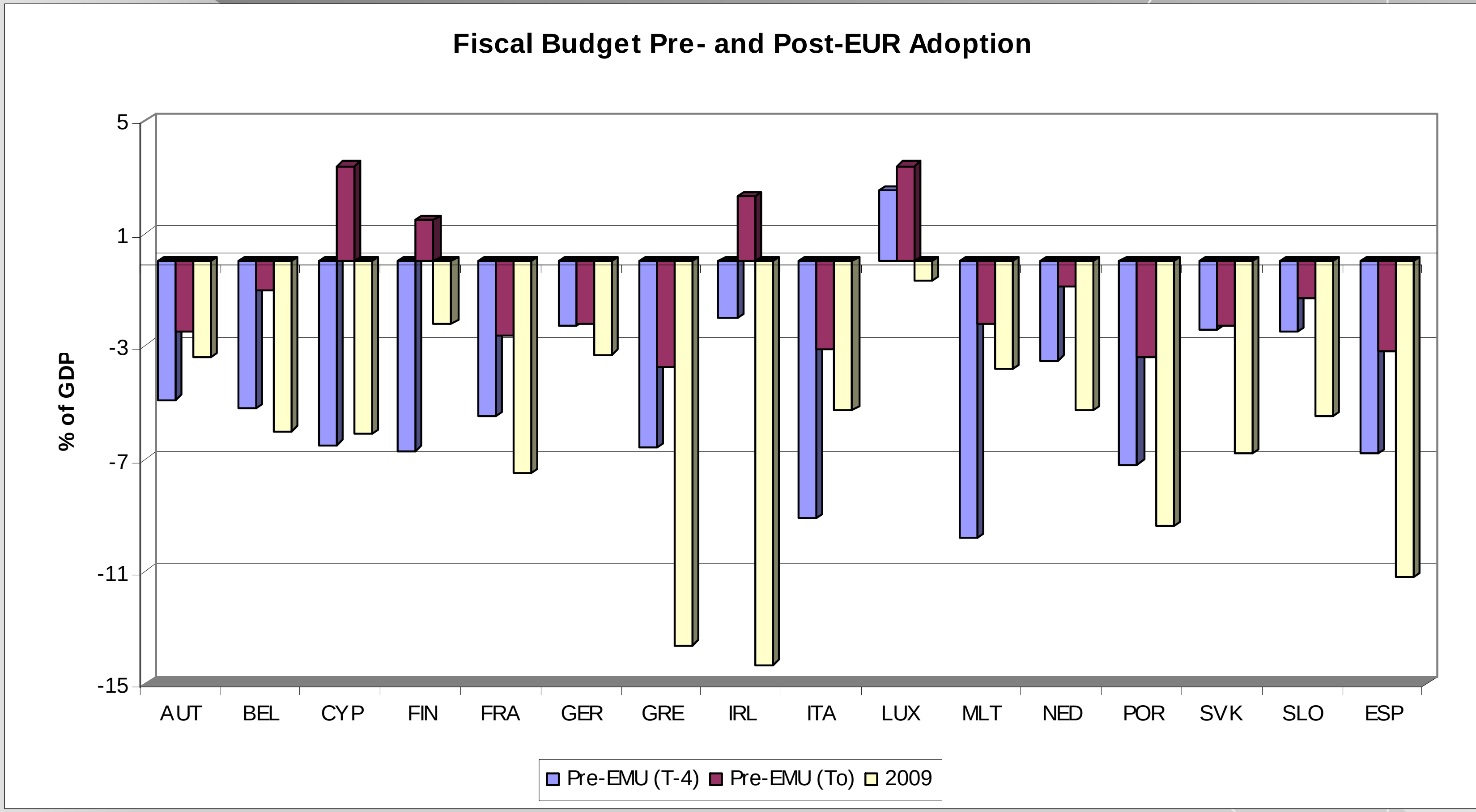


Cost-Benefit Analysis

- Do the marginal benefits outweigh the marginal costs?
  - (+) eliminating FX risk/volatility/hedging
  - (+) MM rates will converge toward EU average rate (table #1)
  - (+) long-term increased trading volume (table #2)
  - (+) increased capital inflow – VC & FDI (table #2)
  - (+) long-term strong income growth
  - (+) fiscal policy discipline
  - (+) no more NBR interventions on the FX markets
  - (+) opening the doors for accessing the capital markets, including the credit markets (private and public entities)
  - (+) the budget ALM will have to be addressed and ultimately fixed
  - (+) a substantial increase in market competitiveness (Ottaviano, Taglioni and Di Mauro, 2009)

Cost-Benefit Analysis

Table #1: Spreads MM Rates ESP/POR/GRE vs. EU

[bps]	Pre-EMU (T-3)	Pre-EMU (T-2)	Pre-EMU (T-1)	EMU (T1)
Spain	**273**	**124**	**51**	**-25**
Portugal	**246**	**153**	**51**	**-26**
Greece	**647**	**533**	**181**	**11**

Source: Industrial and Financial Systems (IFS)

Table #2: FDI/Exports Annual Growth Rates

	FDI Growth Rate		Exports Growth Rate	
[%]	Pre-EMU (T-t)	EMU (t)	Pre-EMU (T-t)	EMU (t)
Spain (t=3)	**3.2**	**19.5**	**3.1**	**3.7**
Portugal (t=3)	**8.6**	**16**	**7.8**	**4.6**
Greece (t=2)	**6.1**	**5.5**	**0.1**	**-0.8**

Source: Industrial and Financial Systems (IFS), National Central Banks

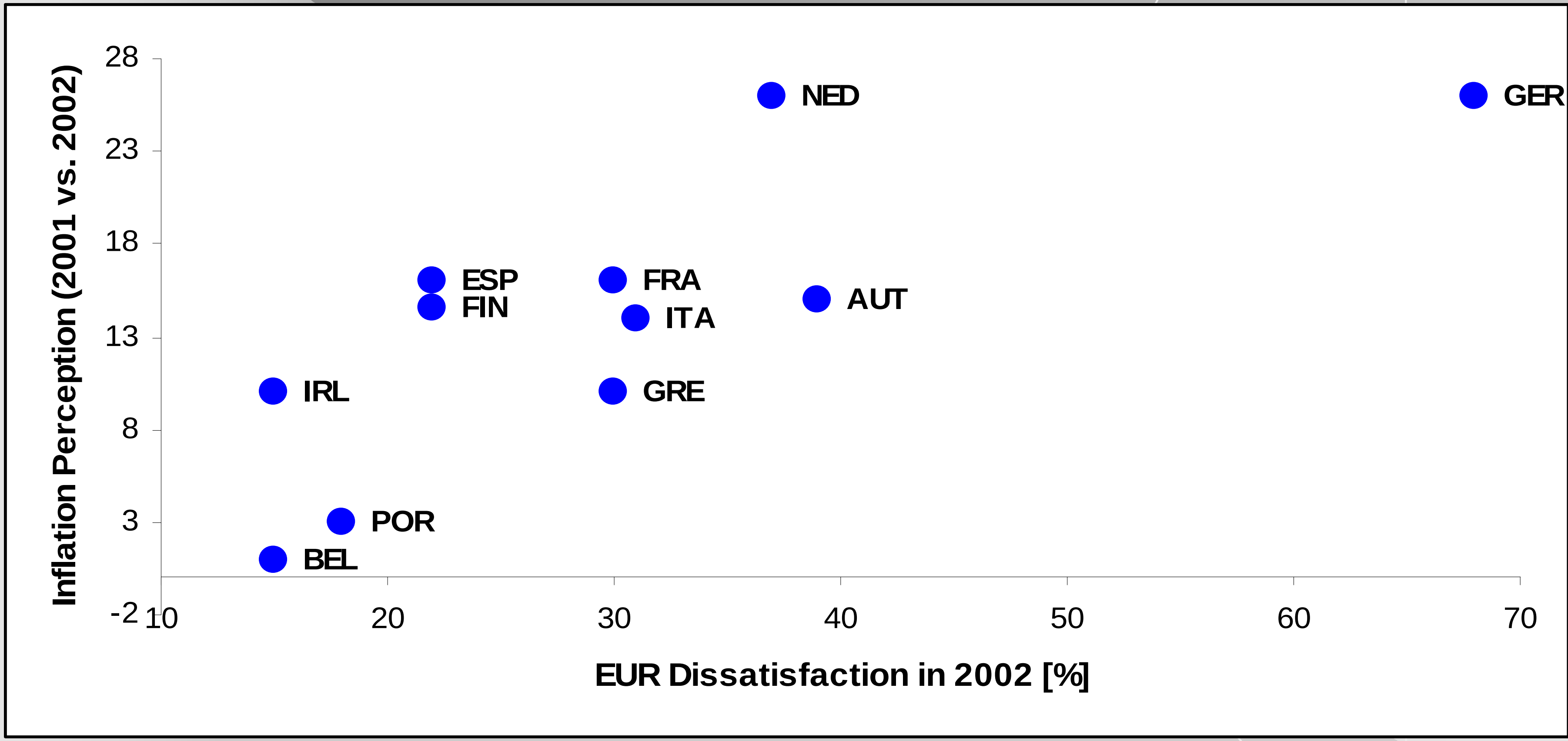
Cost-Benefit Analysis

- Do the marginal benefits outweigh the marginal costs?
  - (-) relinquishing own monetary policy will leave little maneuvering power in case of an economic downturn
  - (-) susceptibility to asymmetric shocks or asynchronized cycles
  - (-) the contagion effect that could lead to massive capital outflows and hence to a Capital Account vulnerability
  - (-) a short-term credit boom could resurge and a property bubble could follow
  - (-) short-term post adoption inflation will hurt consumer spending
  - (-) no guaranteed immediate positive effect on funding the fiscal deficit and on servicing the running debt
  - (-) if fiscal policies are deficient, the capital outflow could accelerate

Macroeconomic Analysis

- When monetary policy is not appropriate, the impact of interest rates on GDP and CPI will run under the EMU average (S/T) and due to the strengthening of the domestic financial markets, the IR sensitivity on GDP and CPI will converge toward EMU norm (L/T)
- Initially, the number of the domestic financial institutions will drop, as both Net Interest Income (IR spread) and Net Non-Interest Income (Fees & Commissions) will be under pressure
- Initially, the inflation expectation gap will remain high, but a couple of years into EMU, the effect will prove to be a temporary bump (see chart)
- Price transparency across EMU banking sector will shift the bargaining power more toward banks' clients (retail and corporate)
- Banks will increase their Market Securities activities, they will diversify the lending offerings and M&A activity

Macroeconomic Analysis



Credit Market Analysis