



Brussels, 20 June 2007

BACKGROUND¹

COUNCIL IN THE COMPOSITION OF HEADS OF STATE/ GOVERNMENT

Thursday 21 June in Brussels

*The Council² will meet at 17.30 on Thursday, in the margins of the European Council, to examine proposals aimed at allowing **Cyprus and Malta** to **adopt the euro as their currency** as from 1 January 2008.*

If the proposals meet with the Council's approval, they will be referred to the Economic and Financial Affairs Council for a decision, probably at its meeting on 10 July. This would allow Cyprus and Malta six months to prepare for the changeover.

The president of the Council will report on the outcome of the discussion at the presidency press conference on Friday following the meeting of the European Council.

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¹ This note has been drawn up under the responsibility of the press office.

² The subject matter on the agenda (relating to article 122(2) of the treaty) requires the Council to meet in the composition of heads of state/government.

Enlargement of the euro area

- **Convergence reports on Cyprus and Malta**
- **Proposals on adoption of the euro by Cyprus and Malta on 1 January 2008**

The Council, meeting at the level of heads of state/government, will:

- take note of reports by the European Central Bank and the Commission on progress made by Cyprus and Malta in fulfilling convergence criteria and their obligations regarding economic and monetary union.
- discuss proposals from the Commission for Council decisions allowing Cyprus and Malta to adopt the euro as their currency, by abrogating what is considered as a derogation, as from 1 January 2008.

The convergence reports examine the compatibility of the member state's legislation with treaty provisions and with the statute of the European system of central banks (ESCB). They also examine progress on fulfilment of the convergence criteria -- namely price stability, the government's budgetary position, exchange rate stability and long-term interest rates -- and several other factors.

After discussion by heads of state/government, and after consulting the European Parliament, the Economic and Financial Affairs (Ecofin) Council will decide on introduction of the euro by Cyprus and Malta, probably at its meeting on 10 July.

The Ecofin Council held an initial discussion at its meeting in Luxembourg on 5 June. It shared the Commission's assessment that Cyprus and Malta have achieved a high degree of sustainable convergence, and that they therefore fulfil the necessary conditions for adoption of the euro. It welcomed the Commission's proposals regarding the two countries' accession to the euro area with effect from 1 January 2008.

The president of the Ecofin Council has presented the outcome of that discussion in a letter sent to heads of state and government. His analysis is as follows.

As regards Cyprus:

- Following a strong fiscal adjustment in 2004 and 2005, the general government deficit was reduced from 6.3% in 2003 to 1.5% of gross domestic product (GDP) in 2006; the general government debt to GDP ratio is above the EU's 60% debt-to-GDP reference value but has been on a declining path since 2005 and is expected to decline further in 2007 to reach 61.5% of GDP. Cyprus is not subject to an excessive deficit procedure, which is a precondition for joining the euro.
- The average HICP³ inflation rate in Cyprus in the year ending March 2007 stood at 2.0%, which is below the reference value for the price stability criterion⁴. The 12-month average inflation rate in Cyprus has been below the reference value since August 2005; Cyprus' price performance is assessed to be sustainable. Cyprus has participated in ERM⁵ II since May 2005. In the two-year period ending on 26 April 2007 the Cyprus pound (CYP) has not been subject to severe tensions and, since it joined the ERM II, Cyprus has not devalued on its own initiative the CYP bilateral central rate against the euro.

³ Harmonised index of consumer prices.

⁴ Calculated as the average in the three best-performing member states plus 1.5 percentage points.

⁵ Exchange rate mechanism. The aim is to reduce exchange rate variability and achieve monetary stability in preparation for introduction of the euro.

- In the year ending March 2007, the long-term interest rate in Cyprus was 4.2% on average, which is below the reference value⁶.
- Other relevant factors to which the treaty refers, such as the integration of markets or the situation and development of the current account, confirm that Cyprus has achieved a high degree of sustainable convergence. National legislation, including the statutes of its national central bank, are compatible with the treaty and the ESCB statute requirements for stage three of economic and monetary union.

Concerning Malta:

- The Council abrogated on 5 June its 2004 decision on the existence of an excessive deficit in Malta. After peaking at around 10% of gross domestic product (GDP) in 2003, the budget deficit decreased significantly under Malta's fiscal consolidation programme, reaching 2.6% in 2006. The general government debt-to-GDP ratio is above the EU's 60% reference value but has been on a declining path since 2005 and is expected to continue to decline further in 2007 to around 66% of GDP.
- The average HICP inflation rate in Malta in the year ending March 2007 stood at 2.2%, which is below the reference value for the price stability criterion. The 12-month average inflation rate has been at or below the reference value since July 2005, except for the period from May to October 2006; Malta's price performance is assessed to be sustainable. Malta has participated in ERM II since May 2005. In the two-year period ending on 26 April 2007, the Maltese lira (MTL) has not been subject to severe tensions and, since it joined the ERM II, Malta has not devalued on its own initiative the MTL bilateral central rate against the euro. In the year ending March 2007, the long-term interest rate in Malta was, on average, 4.3%, which is below the reference value.
- Other relevant factors to which the treaty refers, such as the integration of markets or the situation and development of the current account, confirm that Malta has achieved a high degree of sustainable convergence. National legislation, including the statutes of its national central bank, are compatible with the treaty and the ESCB statute requirements for stage three of economic and monetary union.

The current situation as regards economic and monetary union is as follows:

- ❖ Belgium, Germany, Spain, France, Ireland, Italy, Luxembourg, the Netherlands, Portugal, Austria and Finland adopted the euro on 1 January 1999. Greece joined them on 1 January 2001. Euro notes and coins were introduced in all twelve countries on 1 January 2002;
- ❖ Slovenia adopted the euro and introduced euro notes and coins on 1 January 2007;
- ❖ Denmark and the United Kingdom have opt-out clauses and have not been assessed by the Council;
- ❖ The Czech Republic, Estonia, Cyprus, Latvia, Lithuania, Hungary, Malta, Poland, Slovakia and Sweden are considered as member states with derogations.

⁶ Calculated as the average interest rate in the three best-performing member states in terms of price stability plus 2 percentage points.