

Monetary aggregates, exchange rates, the Bank of Slovenia's interest rates					
Monetary aggregates <sup>1</sup> , end-of-month stock*, % growth	2003		2004		
	Dec 03/ Dec 02	Φ Oct 03-Dec 03/ Φ Oct 02-Dec 02	May 04/ April 04	May 04/ May 03	Φ Mar 04-May 04/ Φ Mar 03-May 03
M1	10.6	10.8	4.4	18.5	15.4
M2	5.2	8.5	-0.1	3.6	4.5
M3	4.9	7.2	0.0	5.6	6.0
End-of-month exchange rate, % rise	Dec 03/ Dec 02	Φ Jan 03-Dec 03/ Φ Jan 02-Dec 02	June 04/ May 04	June 04/ June 03	Φ Aug 03-June 04/ Φ Aug 02-June 03
EUR	2.8	3.3	0.2	2.3	2.7
USD	-15.0	-14.0	0.5	-4.0	-9.7
Nominal interest rates, %	Dec 03	Jan-Dec 03	April 04	May 04	June 04
Overnight deposit	3.00	3.6	2.50	2.25	2.25
TBZ <sup>2</sup> 60-d	6.00	6.9	4.75	4.50	4.00
TBZ <sup>2</sup> 270-d	6.75	8.0	5.00	4.75	4.25
Temp. purchase of FX	3.00	3.7	2.25	2.00	1.00
BS' refinancing rate	5.00	5.9	4.25	4.00	3.00

Source of data: the BS. Notes: \*end-of-month stock (the average of daily stock levels published earlier), revised BS' data from October 2003; <sup>1</sup>national definition, <sup>2</sup>tolar bills (60- and 270-days).

Slovenia entered the **Exchange Rate Mechanism (ERM) II** at the end of June. After being in the EU for less than two months, Slovenia (together with Estonia and Lithuania) recorded a level of nominal convergence that allows it to participate in the ERM II and enter the fast-track procedure for adopting the euro.

Two years of successful participation in the ERM II, along with meeting the Maastricht criteria, are preconditions for adopting the euro and, therefore, enjoying the advantages of membership in the monetary union. Entry into the ERM II implies a **change in conducting monetary policy and exchange rate policy** because the (managed) floating exchange rate of the tolar will be replaced by a stable exchange rate around the central parity. The Bank of Slovenia, in co-operation with EU institutions, adopted the position that the market exchange rate of the euro before entry into the ERM II was an equilibrium exchange rate so the central parity was set at SIT 239.64 for EUR 1. In accordance with the current rules, any fluctuation in the actual exchange rate around the central parity should be limited to 15% in either direction during participation in the ERM II. Since the actual rate of depreciation has been significantly lower in the last few years (3.3% in 2003 on average), the BS is expected to pursue fluctuations within a much narrower band. In addition to exchange rate stability, Slovenia will have to maintain stability in the fiscal area, where it already satisfies both Maastricht criteria, and keep an appropriate level of long-term interest rates (see SEM 5/2004:19). The main task in the forthcoming period will be to reduce inflation, which exceeded the Maastricht criterion by 2.1 percentage points in May, by adopting an appropriate mix of macroeconomic reforms and by implementing further structural reforms.

Participation in the ERM II also reduces the **Bank of Slovenia's autonomy** in conducting monetary and exchange rate policies. The conduct of these policies now depends more on the ECB's guidelines and is also subject to the common interest of member-states. This reduces the manoeuvring space for the BS to take measures in the case of asymmetrical shocks and increases the relative role played by other macroeconomic policies in responding to changes in the macroeconomic environment.

**Prior to entry into the ERM II, the BS' policy** was mainly focused on preparations for entry. Hence, the BS continued to lower interest rates in May and June, which dropped by an average of 1.0 percentage point from the end of April to the end of June, and reduced the tolar's depreciation, which was still 2.3% in May and June in annual terms, but the BS had already signalled a faster slowdown in its depreciation.

Graph: **Meeting the Maastricht criteria**

