Adoption by Malta of the single currency on 1 January 2008

2007/0092(CNS) - 16/05/2007 - Document attached to the procedure

Article 122(2) of the Treaty requires the Commission and the ECB to report to the Council, at least once every two years, or at the request of a Member State with a derogation, on the progress made by the Member States in fulfilling their obligations regarding the achievement of economic and monetary union. This report has been prepared in response to the request submitted by Malta on 27 February 2007. A detailed assessment follows:

Inflation: the average inflation rate in Malta during the 12 months to March 2007 was 2.2%, below the reference value of 3%. It is likely to continue below the reference value in the coming months. Moderate core inflation indicates that underlying inflationary pressures have remained limited. Progress towards price stability has been supported by wage discipline and increasing competition in some product markets, also related to integration in the EU single market and effects of globalisation. The improvement in price stability is based on sound foundations, suggesting that the moderate levels of inflation will be maintained after euro adoption. Nevertheless, Malta will need to stay vigilant and stem inflationary risks as cyclical conditions improve. A prudent fiscal stance aimed at avoiding the build-up of excessive demand pressures and wage developments in line with productivity gains would be well advised. Continued structural reforms to improve the functioning of product markets, in particular utilities), are also warranted.

Budgetary situation: the Commission also concluded that Malta had corrected its budget deficit and recommended that the ECOFIN Council abrogates the excessive deficit procedure started upon accession to the EU, in 2004.The deficit-to-GDP ratio decreased from 10% in 2003 to 2.6% in 2006 and, according to the Commission's spring forecast, would amount to 2.1% in 2007. The government debt increased significantly in the first half of the decade, but has followed a downward path since 2004 to reach 66.5% of GDP in 2006. In view of this, the Commission considers that Malta has corrected its deficit in a credible and sustainable way and its debt is diminishing at a satisfactory pace towards the Treaty reference value of 60% of GDP. Malta, therefore, meets the budgetary criterion. It should, nevertheless, continue efforts to reduce the debt-to-GDP ratio and to make further progress in the design and implementation of the healthcare reform in order to improve the long-term sustainability of its public finances.

Exchange rate: the Maltese lira has participated in the Exchange Rate Mechanism ERM II since 2 May 2005, i.e. for 24 months at the time of the adoption of this report. During these two years, the lira has remained stable vis-à-vis the central rate and has not experienced severe tensions.

Long-term interest rates: the average long-term interest rate in Malta in the year to March 2007 was 4.3%, below the reference value of 6.4%. Average long-term interest rates in Malta have been below the reference value since EU accession. Long-term yield spreads vis-à-vis the euro area have also fluctuated at relatively moderate levels and decreased further since 2005, which testifies to the low residual country risk priced in by markets.

Legal convergence: all outstanding incompatibilities have been addressed in a Law amending the Central Bank of Malta Act adopted by Parliament on 28 February 2007. Legislation in Malta, in particular the Central Bank of Malta Act, is now compatible with the requirements of the EC Treaty and the ESCB Statute.

To conclude, in the light of its assessment on the fulfilment of the convergence criteria and assuming that the Council will follow the Commission's recommendation for the abrogation of the excessive deficit, the Commission considers that Malta has achieved a high degree of sustainable convergence.