

The Use of the Euro in Central, Eastern and Southeastern Europe – Extent, Causes, and the Impact of the Global Financial Crisis

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The views expressed are strictly those of the author and do not necessarily represent the views of the Oesterreichische Nationalbank.

Motivation

- Use of foreign currencies is considered to be a **widespread phenomenon** in many Central, Eastern (CEE) and Southeastern European (SEE) countries
 - This has **implications**
 - **for countries concerned**, i.e. for the conduct of monetary and fiscal policy
 - **for the euro area**, as a considerable amount of euro cash in circulation is estimated to be held abroad
 - **Challenge: monetary aggregates do not provide information on cash holdings, on actual/planned behavior, on motivations of individuals**
- **Provide evidence based on data from the OeNB's Euro Survey** conducted among individuals in 10 CESEE countries
- **Has the euro been a safe haven?**

Motivation

Has the euro been a safe haven for households in CESEE countries?

Before the crisis? **Yes**

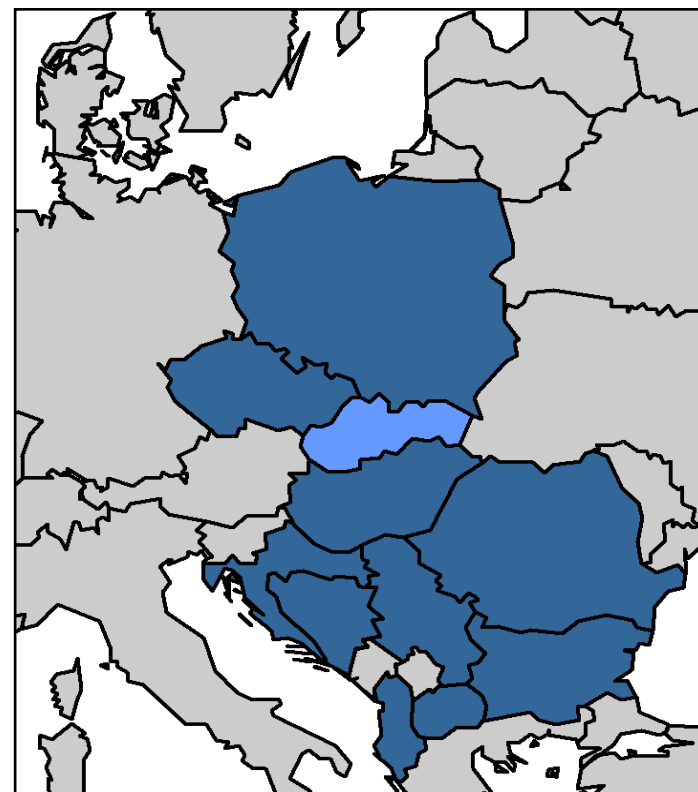
During the crisis? **Yes**

In the near future? **Yes**

- **Some qualifications**
 - Regional differences
 - Cash and deposits
 - Different reasons

Main Features of the OeNB's Euro Survey

- **Geographical scope**
 - 6 EU Member States:
Bulgaria, Czech Republic, Hungary, Poland, Romania, Slovakia
 - 5 (Potential) EU Candidate Countries:
Albania, Bosnia and Herzegovina, Croatia, FYR Macedonia, Serbia
- **Conducted semi-annually since fall 2007, last wave May/June 2009**
- Representative sample of **1000 persons aged 15+** per country (or, in Poland, of the population of the 10 largest cities)
- **Face-to-face** interviews of **individuals**, NOT households



“Value added” by OeNB Euro Survey Results

- Evidence on foreign currency cash holdings
- Actual and planned portfolio structure (cash vs. deposits, currency composition)
- Sentiments, memories and expectations of individuals
 - survey provides **harmonized data** for cross-country comparisons
 - allows deriving **comprehensive measures** on the use of the euro
 - micro-data allow **causal relationships** to be identified
- **Limitations:**
 - Issue of underreporting
 - Top of wealth distribution not covered
 - Survey results useful for obtaining cross-country comparisons and information on behavior of broad public

Before the Crisis: Foreign Currency Cash Holdings

- **Dissemination of foreign currency cash**

- CEE: 8% - 27% of respondents hold euro cash
- SEE: 12% - 43% of respondents hold euro cash
- other currencies of minor importance

→ **euro predominant foreign currency**

- **Motivations for euro cash holdings**

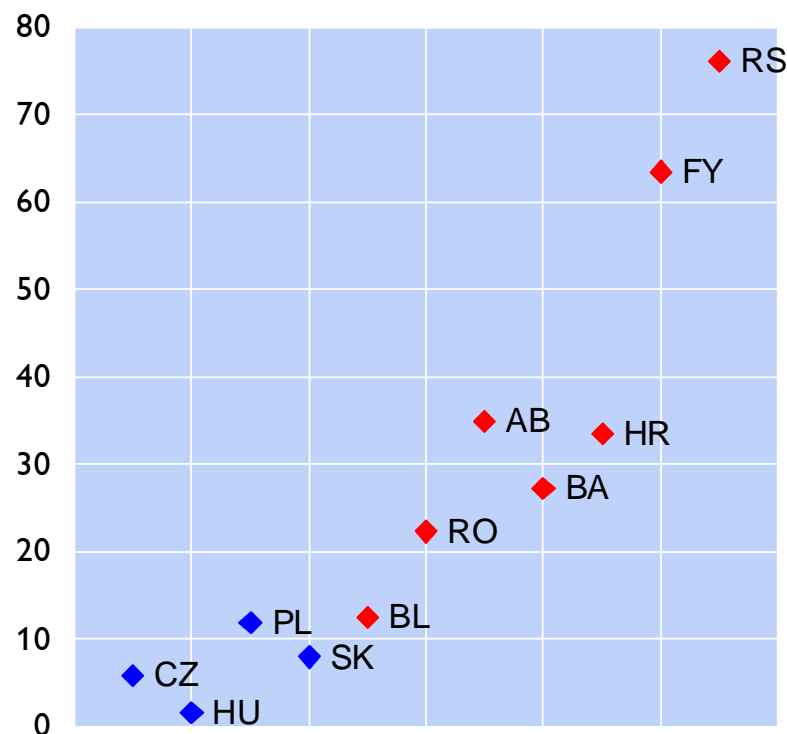
- CEE: mainly for transactions abroad
- SEE: mainly “as a store of value”, also used for payments

→ **in line with different motivations, amounts higher in SEE than in CEE**

Before the Crisis: Currency Substitution

Foreign Currency Share in Total Currency in Circulation

in % of total currency in circulation



→ values derived from survey responses: underestimation

share of >50% → amount of foreign currency cash in circulation **higher** than amount of local currency cash

share of about 33% → amount of foreign currency cash in circulation **half** of amount of local currency cash

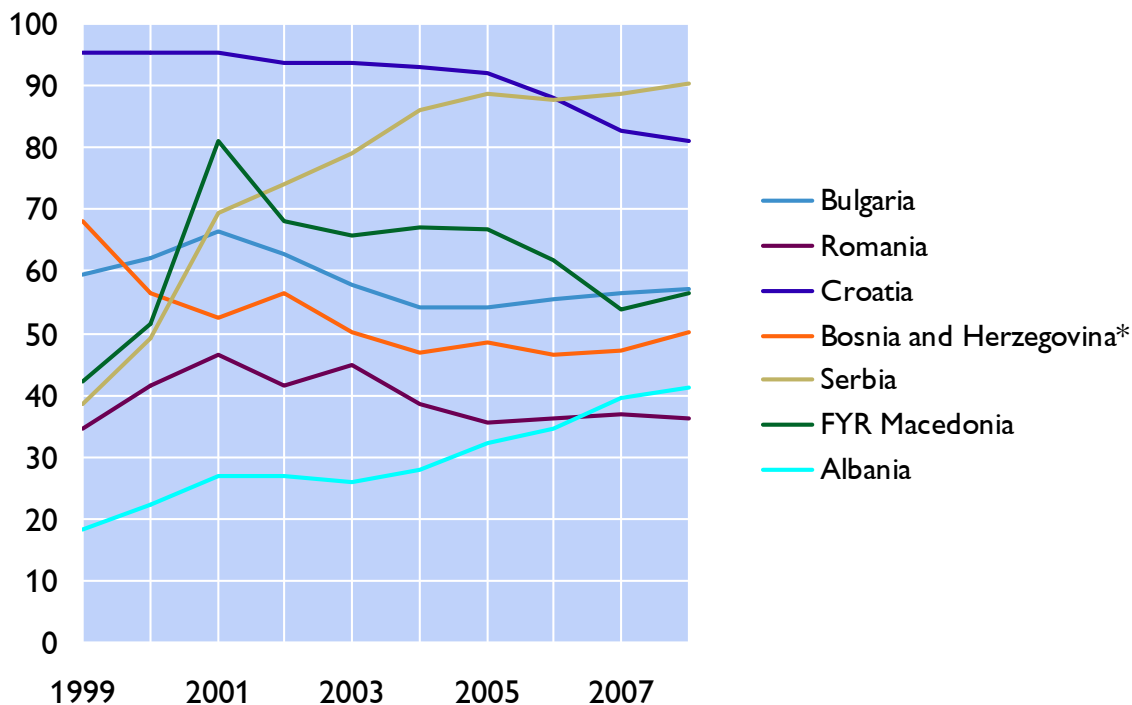
→ **euro cash important in some SEE countries**

Before the Crisis: Deposit Substitution

- CEE: between 4% and 15% of deposits of households are denominated in foreign currency
- SEE: significantly more
- euro predominant foreign currency
- high persistence

Degree of Deposit Substitution in Southeastern Europe 1999-2008

in %, FCD as share of total savings deposits,



Source: National Central Banks.

*) Entries for Bosnia and Herzegovina comprise savings deposits of private households and corporate sector.

Before the Crisis: Findings and Causes

- 1) High importance of euro-denominated assets in SEE
 - 2) Persistence in (deposit) euroization shares
 - 3) Relatively high euro cash holdings in some countries
- **ad 2) Why have deposit substitution shares remained high despite macroeconomic stabilization prior to the crisis?**
 - Research suggests that reasons can mainly be found in **past periods of instabilities**, past economic governance quality
 - **Hysteresis**, network effects
 - Progress in economic stabilization and in restoring trust in institutions leads to **substitution of foreign currency cash holdings for foreign currency deposits**, not necessarily to a change in overall euroization

Before the Crisis: Findings and Causes

- 1) High importance of euro-denominated assets in SEE
 - 2) Persistence in (deposit) euroization shares
 - 3) Relatively high euro cash holdings in some countries
- **ad 3) Reasons for euro cash holdings?**
 - Estimations to determine **reasons for high cash preference**: direct survey evidence (“I prefer to hold cash rather than a savings account”)

results show higher preference for cash for those ...

 - with **memories of past periods of instabilities** (banking problems, restricted access to savings deposits)
 - with **low trust in banks** (perceive savings deposits unsafe)
 - who **expect higher inflation** (implies preference for foreign currency cash)

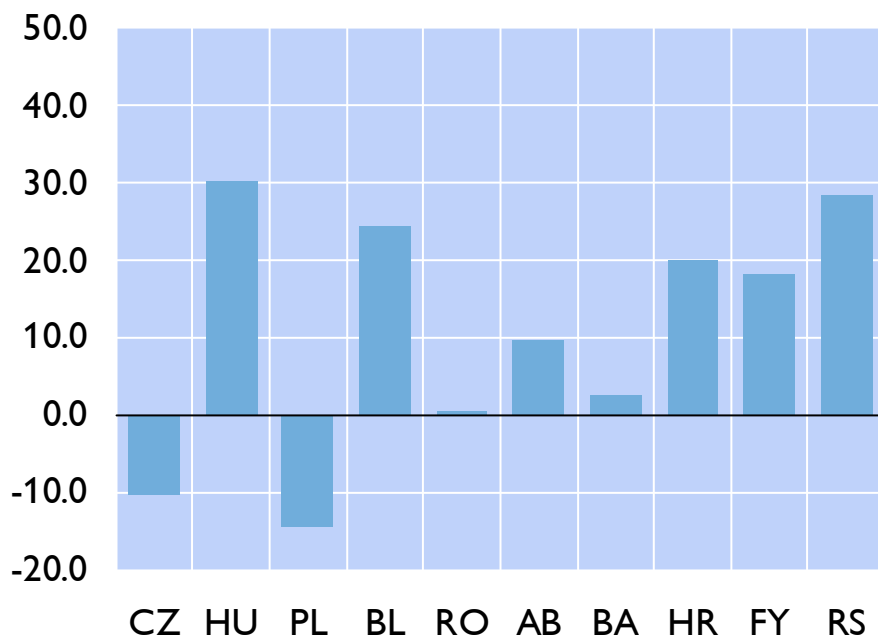
During the Crisis

- **Trust in banks diminished during crisis, but has since stabilized**
 - Decrease in trust in banks not particular of CESEE region
 - But, given history, higher sensitivity of behavior to a loss of trust in banks
- **Deposit withdrawals in SEE during fall 2008** – strength and duration of households' reaction differ considerably across countries
 - Withdrawals of deposits denominated in euro → euro cash holdings as safe haven
 - Given the extent of the shock, reaction of households not “overly strong” → success of pre-crisis and crisis stabilization policies
 - Countries with stronger withdrawals have since seen some reversal
- **Uncertainties regarding exchange rate, depreciations** (in some countries) → changes in deposit substitution

During the Crisis: Has Attractiveness of Deposits in Foreign Currency Changed Because of the Crisis?

Deposits in Foreign Currency vs. Deposits in Local Currency

balance statistics (percentage share of those answering "safer" minus percentage share of those answering "less safe")



Foreign currency deposits considered more safe in terms of preserving the value of savings

Source: Own calculation based on OeNB Euro Survey spring wave 2009.

Note: Recoded answers based on the question "How has the global financial crisis changed your attitude towards the following types of savings...Have they become safer or less safe in terms of preserving the value of your savings?" Sample restricted to those who have savings and those who are older than 18.

In the Near Future

- **Will the euro remain important?**

→ evidence from the survey

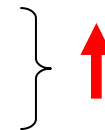
→ analyze **plans of households**

“Do you think that the share of your financial assets which is denominated in foreign currency will change in the future?” (increase/no change/decrease)

→ **Estimation results** show (inter alia):

expectations of exchange rate depreciations

ownership of euro assets



Summary: Has the Euro Been a Safe Haven?

- **Before the crisis: Yes**
 - Mainly in SEE; Cash and deposits
 - Observed high euroization mainly reflects past events

→ Quick and significant **reduction** through sound macroeconomic policy is **difficult**; policymakers are **constrained by past events**
- **During the crisis: Yes**
 - Deposit withdrawals and use of euro cash

Summary: Will the Euro Be a Safe Haven?

- **In the near future:**

- Planned portfolio behavior reflects habit persistence and exchange rate expectations
- **Expectations** regarding depreciations have increased in many countries; might be **difficult to influence in the short run**

→ no large changes in de facto euroization levels (may increase somewhat) in the near future, especially in highly euroized economies

→ Euro will continue to have important role in portfolios of households

Thank you!

**See <http://ceec.oenb.at>
for information on the OeNB's Euro Survey**