

Editorial

Euro banknotes and coins were introduced as legal tender in Austria on January 1, 2002. Following the introduction of the euro in Slovenia on January 1, 2007, some 317 million Europeans in 13 euro area countries now have the euro as their currency. At the turn of the year 2006 to 2007, five years after the “physical” introduction of the euro, numerous Austrian media took stock of the history of euro cash and its performance so far. Their assessment covers a broad range of views from “the euro’s performance is exemplary” and “the euro – a success story” to “the euro – unloved birthday boy” and “the euro continues to boost prices.”¹

People Consider Stable Money Very Important

These contradictory headlines have one thing in common: the euro is still an emotional topic. The contrasting captions, for one thing, signal people’s fundamental interest in money and its stability. Indeed, opinion poll results² show that 94% of Austrian respondents attach great importance to monetary stability. People’s interest appears to be reinforced by the fact that the euro is still a fairly new currency. After all, five years³ is not a long time for the life of a currency by historical standards. For another thing, the ambivalent and emotional reactions to the euro demonstrate that the need for communication is still there. Against this background, the Oesterreichische Nationalbank (OeNB) has taken the euro’s 5th anniversary as an occasion to examine the euro experience from various angles in this special issue of “Monetary Policy & the Economy.”

People Find the Euro Increasingly Easy to Use – The Euro Enjoys a High Degree of Acceptance

A currency must be accepted by the general public to fulfill its functions as a means of payment, unit of account and store of value. The first analysis in this special issue (*Fluch, Gnan and Schlögl*) approaches this theme by analyzing Austrian public opinion on the euro using the results of regular surveys conducted by the OeNB and the European Commission. The authors find that in 2006, 62% of the Austrians were convinced of the benefits of the euro and euro cash. Austrians acknowledge the economic and practical benefits of the euro, in particular as it has made traveling easier and prices more transparent, and as it has had positive effects on the European economy. However, relatively few people realize that the euro has made cross-border payments within the euro area cheaper. The difficulties people encountered in day-to-day use of the euro – when paying for purchases and trying to tell the various denominations apart – declined sharply during the five years from 2002 to 2006. After initial problems, people have found the euro increasingly easy to use, especially since 2004. In 2006, 93% of all Austrians considered themselves adept at handling

¹ Headlines on December 27, 2006 (taken from Austrian dailies, e.g. *Die Presse, Kurier* and *Der Standard*; German originals: *Musterschüler Euro*; *der Euro als Erfolgsstory*; *Euro – der ungeliebte Jubilar*; *Euro bleibt Teuro*).

² Source: OeNB Barometer, Report on the 4th quarter of 2006, November/December 2006.

³ Five years since the introduction of euro cash; eight years since the introduction of the euro for noncash payments.

the new banknotes (68% found it very easy or easy to handle euro coins). Austrians have become accustomed to using the euro as a unit of value for daily purchases. Only 12% still had major difficulties using the euro value scale in 2006. According to the OeNB Barometer survey of December 2006, 56% of all Austrians found it easy to gauge the value of euro prices. Through a broad range of information activities, the OeNB and its partner institutions were able to contribute substantially to making people familiar with the euro.

Perceived Inflation Declines as People Become More Used to the Euro

As *Fluch and Stix* argue, dispelling the mistaken impression that the euro has led to price increases remains a challenge. Given the dynamics of the psychology of perception and the high visibility of above-average price increases in some categories of items bought on a day-to-day basis, people perceived rises in inflation after the cash changeover but hardly registered the sharp decline in the price of other items in the basket of consumer goods. Economic psychologists are aware of the phenomenon of the biased perception of price increases. People's deep-seated expectation that the introduction of the euro would make prices rise, the slow pace of familiarization with euro pricing and the inclination to keep thinking in schilling terms, especially for large, exceptional purchases, reinforced the impression of euro-induced inflation. However, the discrepancy between perceived and actual inflation, which was especially prevalent during the first years following the changeover, had become perceptibly smaller by the end of 2006. Moreover, Austrians have developed a feel for the new currency over time and have become accustomed to using the euro as a unit of value. These developments give rise to the hope that people have largely overcome their impression of a "euro price shock" and that actual and perceived inflation will converge again.

Price Increases and Price Cuts Roughly Balanced Each Other Out during the Cash Changeover

The analysis of individual price data in the Austrian consumer price index (*Glatzer and Rumler*) reveals that price-setting habits and the structure of Austrian consumer prices have not changed significantly since the cash changeover. The authors find that at the time of the changeover itself, the observed price changes were more frequent but smaller than usual. Moreover, as upward and downward price adjustments were also fairly balanced, the cash changeover had no significant overall inflationary effects. The enforcement of the dual pricing law caused the share of attractive prices (i.e. prices ending in 9 or 90, and even prices) to plummet temporarily in the first few months following the introduction of euro cash. In the course of the next four years, however, this share again approached the 60% level observed before the changeover.

Price Level Convergence in the Euro Area Remains Smaller than Expected

Theoretical arguments would suggest a convergence of prices in the euro area as a result of both product market integration in the EU's Single Market and more transparent prices across borders following the introduction of the common currency. *Crespo Cuaresma, Égert and Silgoner* empirically assess this hypothesis for 27 European countries on the basis of the development of 160 goods and service prices. The authors' conclusions confirm that prices had converged already at the beginning of the 1990s following the establishment of the EU's Single Market. Overall, the introduction of the single currency did not lead to a further significant narrowing of price differentials in the euro area since 1999, except in the case of some tradable goods – e.g. cars – and, perhaps surprisingly, some services. This could be explained by product market integration having been substantially promoted by exchange rate stability within the Exchange Rate Mechanism of the European Monetary System in the run-up to Economic and Monetary Union (EMU). The fact that price convergence did not continue since 1999 may be due partly to the different pace of liberalization across the euro area, which even caused price differentials across countries to widen temporarily. Still existing regulatory obstacles may be another reason why price differentials did not narrow further. These obstacles should be eliminated in the course of the completion of the Single Market.

Widespread Use of the Euro across Central, Eastern and Southeastern Europe

As *Backé, Ritzberger-Grünwald and Stix* demonstrate, many Central, Eastern and Southeastern European EU Member States have euro-denominated cash holdings, savings and loans. The euro also plays an increasingly important role on Eastern European capital markets. At the end of 2006, 30% of all Czechs and Slovaks, 25% of Croatians and 7% of Hungarians held euro cash. Cash holdings are contingent on geographical proximity along with close economic ties, foreign ownership of banks, risk considerations and traditions. The volume of domestic payments in euro, however, tends to be insignificant. The strong presence of the euro influences the transmission of monetary policy impulses in Central, Eastern and Southeastern European EU Member States and may have an impact on financial stability and economic activity. "Euroization" does not influence the time at which these countries enter the euro area; much rather, entry is contingent on progress with convergence, as prescribed by the Maastricht Treaty.

Euro Cash Moves through the Euro Area at a Fast Pace

Schneeberger and Süß show that the pace of banknote migration through the euro area is very fast. An Austrian wallet will typically hold coins and banknotes from all euro area countries. The national origin of euro coins is readily discernible, as all coins have a distinct national face, and the letter contained in the banknote's number indicates the country of origin. The share of foreign banknotes and coins in Austria has been edging up. Migration of banknotes took place at a much faster rate than migration of euro coins. Austria is largely

an “importer” especially of EUR 50, EUR 20 and EUR 5 banknotes. Banknote migration in Austria commenced at a very rapid pace and on a large scale, evidently above all because of the country’s geographical location, tourism and commuter movements and, particularly, owing to the strong presence of Austrian banks in Eastern Europe. With the advent of the common currency, cash is no longer national. It is European.

Euro Cash is Secure

In Austria, cash is used for 86% of all payment transactions, making it the most prevalent means of payment by far, as *Schautzer* reports. To ensure that Austria’s business community and the general public have an ample supply of cash, the OeNB and its subsidiaries (Oesterreichische Banknoten- und Sicherheitsdruck GmbH, Münze Österreich AG, GELDSERVICE AUSTRIA Logistik für Wertgestionierung und Transportkoordination G.m.b.H.) have in place efficient distribution logistics. A banknote is returned an average of three to four times to the OeNB, where it is counted and checked with high-performance banknote processing machines and, if necessary, withdrawn from circulation. In 2006, 1.2 billion banknotes and 1.7 billion coins were examined to establish whether they were fit for reuse and prepared for recirculation. The total of counterfeit notes withdrawn from circulation in Austria more than halved from roughly 13,000 in 2004 to less than 6,000 in 2006. To secure trust in the currency, the authorities will continue to invest in the integrity of euro cash. Preparations for the next generation of euro banknotes are already well under way.

The Euro Influences NCB Balance Sheets and Monetary Income

Banknotes in circulation have always been the most important liability in central banks’ balance sheets. The euro has changed the presentation and development of this item, which had been a purely national liability item prior to the introduction of the euro. As *Handig and Holzfeind* show, banknote migration between euro area countries has a strong impact on this liability item in every national central bank’s (NCBs) balance sheet. To ensure an unbiased balance sheet presentation of banknotes in circulation, national circulation is not determined on the basis of banknotes physically issued and withdrawn by individual NCBs. Much rather, of the total value of euro banknotes placed in circulation by the Eurosystem, the European Central Bank (ECB) is allocated a share of 8%, while the remainder is allocated to NCBs according to their weightings in the capital key of the ECB (the OeNB’s share has stood at 2.9002% since January 1, 2007). The monetary income of the Eurosystem – income that accrues to the NCBs in the performance of the Eurosystem’s monetary policy function – is also distributed to the NCBs in line with their respective shares in the capital of the ECB. Five years of experience with euro cash have shown that the stipulations on banknotes in circulation and monetary income provide for an equitable distribution of seigniorage income within the Eurosystem.

The Euro Strengthens Economic Performance in the Euro Area and in Austria

At the end of December 2006, the value of euro cash in circulation totaled some EUR 646 billion – which is actually above the value of circulating U.S. dollars – and consisted of 11 billion banknotes and 70 billion coins.

The euro has boosted the euro area's economic performance. The steady low rate of inflation anchors inflation expectations and keeps real interest rates at low levels. Between 1999 and 2006, euro area inflation averaged 2.1% a year. Despite the surge in oil prices and other unfavorable shocks, inflation has also been comparatively low at an average of 2.2% since the cash changeover. These stable framework conditions foster investment, economic growth and employment.

Along with Finland and Germany, Austria figures among the three euro area countries with the lowest inflation rates. Inflation in Austria as measured by the Harmonized Index of Consumer Prices (HICP) came to 1.7% a year on average for the period from 1999 to 2006 – the lowest eight-year average since 1945 – and likewise averaged only 1.7% in the five years since the euro cash changeover, notwithstanding the sharp rise in oil prices in that period.

Transparency and Information Promote Confidence

According to an OeNB survey, at the end of 2006, three-quarters of all Austrians considered the euro a stable currency. Roughly the same percentage expects the euro to remain stable in the short run (one year), and close to 70% expect the euro to remain stable in the next five years. Moreover, Austrians ascribe the Eurosystem and the OeNB high competence in securing the stability of the euro. The Eurosystem and the OeNB will do their utmost to keep living up to the high expectations the public has placed in them by pursuing a stability-oriented monetary policy and by providing comprehensive information to the public. Confidence requires transparency and information – which is why we are publishing these studies in “Monetary Policy & the Economy.”

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