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COMMUNICATION FROM THE COMMISSION TO THE COUNCIL, THE EUROPEAN PARLIAMENT, THE EUROPEAN ECONOMIC AND SOCIAL COMMITTEE, THE COMMITTEE OF THE REGIONS AND THE EUROPEAN CENTRAL BANK

The introduction of the euro in Cyprus and Malta

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1. INTRODUCTION

The Council decided on 10 July 2007 to abrogate Cyprus' and Malta's derogation for the adoption of the single currency with effect from 1 January 2008.

The successful changeover of both countries confirmed that, if meticulously prepared, a four-week dual circulation period can be sufficient, even for countries with a very high amount of cash in circulation[1]. A large majority of Cypriots (95%) and Maltese (90%) perceived the changeover in their countries as smooth or rather smooth and efficient.

This Communication covers the most important aspects of the changeover process, in particular the cash changeover, the conversion of the administrative and financial systems, the real and perceived impact of the euro's introduction on prices, and the citizens' opinion on the information and communication campaigns; additionally, some conclusions are drawn which may be of value for future changeovers.

2. THE CASH CHANGEOVER

The cash changeover constitutes the most visible element of the changeover process since virtually all financial institutions, businesses and citizens are involved. The success of this operation depends on timely supply of the euro cash to all parties involved and thorough preparation for the recovery of legacy currencies.

2.1. Frontloading and sub-frontloading operations before €-day

A) Cyprus

The Central Bank of Cyprus (CBC) started the frontloading of commercial banks on 22 October 2007 for euro coins and on 19 November 2007 for euro banknotes. Some 80% of the value of euro banknotes (worth €950 million) and 64% of the value of euro coins (worth €64 million) were supplied to the banking sector before €-day. All the bank branches in Cyprus (approximately 900) were involved in the frontloading operations.

Sub-frontloading of the euro cash to retailers was initiated at the same time. Although the CBC was active in explaining the need for sub-frontloading to enterprises dealing with cash, the euro-cash orders were well below expectations. Many small entrepreneurs claimed that it was difficult and costly to fulfil all sub-frontloading requirements. To overcome this problem, banks, in agreement with the CBC, allowed enterprises to be sub-frontloaded on 31 December using a simplified procedure. Almost 58% of enterprises out of a total of 1 377 which were

[1] Cyprus' and Malta's changeover plan specified that the so-called "big bang" scenario and a dual circulation period of one month should be applicable. The first wave euro-area countries introduced the euro in accordance with the "Madrid" scenario, which involved a transitional period of three years (one year for Greece). Slovenia was the first country to use the "big bang" scenario, whereby euro banknotes and coins were introduced on the same day as the euro became legal tender (1 January 2007).

sub-frontloaded used this simplified procedure and were supplied with a total of €3.3 million (compared with €11.1 million under the standard procedure).

In addition, some banks started to exchange Cyprus pounds for euro banknotes for their customers at the conversion rate and without charges as of 1 November, allowing the businesses which could not take on the burden of sub-frontloading to buy euro cash in advance.

Some 40 000 pre-packed coin kits (starter kits), worth €172 each, were also available for businesses, but only 22 000 were sold. Since these starter kits contained rolled coins, the remaining kits could easily be used by the banks after €-day.

Another 250 000 mini-kits, worth CYP 10 (€17.09) each, were available for the general public as from 3 December 2007. Some 189 000 mini-kits were sold. According to the Eurobarometer survey[2], more than 70% of the citizens who had bought a mini-kit opened it and used the coins after the changeover while some 20% kept it untouched.

As from the changeover, the unsold mini-kits have been exported to satisfy the demand of coin collectors abroad. Cypriot euro coins worth €3.5 million were exported in the first three weeks of January.

B) Malta

The frontloading of euro cash to commercial banks started on 15 September 2007. Some 107 bank branches received euro banknotes worth €540 million and euro coins worth €27.81 million before €-day.

During the sub-frontloading phase (which started on 1 December 2007), 134 businesses were supplied with euro notes worth €3.9 million and coins worth €1.9 million. The very limited number of businesses participating in the sub-frontloading operation is probably due to the rather strict conditions imposed.

Considering the particularly high amount of cash in circulation, the Central Bank of Malta encouraged the public to deposit excess cash at the banks as from 1 December. Simultaneously, the banks undertook to exchange Maltese lira banknotes and coins into euro free of charge to enable small businesses to acquire euro cash ahead of the changeover.

Many businesses preferred to buy starter kits to supply themselves with sufficient volume of euro coins. All 33 000 starter kits for businesses (worth €131 each) were sold. The banks registered some demand for starter kits containing both coins and notes and some demand for coin starter kits of different composition than the standard ones offered.

Malta has also recorded big orders for Maltese coins from collectors abroad. Some 1 200 000 pieces of each denomination had been exported by private banks between €-day and 25 January. By the same time, the Central Bank of Malta had sold abroad some 32 000 euro presentation sets and had exchanged some 10 000 pieces of each coin denomination with other euro-area Central Banks.

The fact that businesses showed little interest in sub-frontloading confirms the negative impact of the strict security and information requirements, particularly for small companies. The ECB is therefore currently investigating the possibility of simplifying its guidelines on sub-frontloading for future changeovers, having regard in particular to the simplified procedure used at the end of December in Cyprus.

[2] Flash Eurobarometer 223 (February 2008)

The mismatch between the demand for and supply of coin kits highlights the importance of careful planning of the volume to be produced. Producing one coin kit per household seems to be a reasonable benchmark.

The relatively high volumes of exported coins suggest that collector market demand should be taken into consideration, especially for small countries. Orders from collectors may significantly alter the volume of coins available during the changeover.

2.2. The period of dual circulation

Cyprus and Malta opted for a dual circulation period of one month. The smooth changeover in these two countries confirmed that four weeks are sufficient for introducing the new currency and for recovering a substantial volume of legacy currencies. [3]

2.2.1. Distribution of euro notes and coins after €-day

Automated teller machines (ATMs) and bank counters were the chief ways of acquiring euro cash used by the public and businesses in the first days after the changeover. But in both countries people were also using retail outlets massively to dispose of their legacy currencies and obtain euro.

A) Cyprus

To facilitate the exchange of Cyprus pounds into euro, a number of bank branches were open on 1 January 2008, which is normally a bank holiday.

Cypriots paid around 336 000 visits to their banks during the first 10 days of this year and withdrew or exchanged more than €578 million (averaging €1 177 per operation).

All 550 ATMs were converted to dispensing only euro banknotes by 0.30h on 1 January. During the first weeks after the changeover, ATMs were only dispensing small-denomination banknotes, with a view to reducing the amount of change which retailers had to give in cash transactions. Cypriots withdrew more than €32 million in some 251 000 operations during the first ten days after the changeover. On average, €127 was withdrawn per operation.

As in Slovenia and in some countries which adopted the euro in 2002 (e.g. Germany and Spain), a great many citizens went to bank counters rather than to ATMs in the days following the changeover to acquire new currency. Comparing the figures for the whole dual circulation period (January 2008) to those of January 2007, there was a 55% rise in the value of withdrawals and exchanges with a corresponding 61% increase in the volume of transactions made over-the-counter, while the volume of ATM transactions rose by only 23%[4].

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[3] The dual circulation period is the period starting on €-day during which both euro and legacy currency (i.e. old national currency) are legal tender. It may last six months at most, while Member States may shorten this period. Under the first-wave changeover, most countries opted for a dual circulation period of two months. Slovenia chose only a 14-day dual circulation period.

[4] The value of ATM transactions increased by only 15%, mainly because low-denomination banknotes exclusively were dispensed by ATMs in January 2008.

The relatively high average value of exchanges or withdrawals per bank operation in Cyprus (€1 177) suggests that people were keeping high amounts of hoarded cash, causing queues in banks in the first days after the changeover despite the bank counters being open exceptionally on 1 January. The situation in banks did, however, quickly return to normal.

B) Malta

Almost 230 000 over-the-counter exchanges took place between 1 and 10 January, for a total amount of around €165 million. The average exchange was worth some €720. In Malta there were more withdrawal operations from ATMs than over bank counters, but the total value of euro acquired at bank counters was more than four times higher.

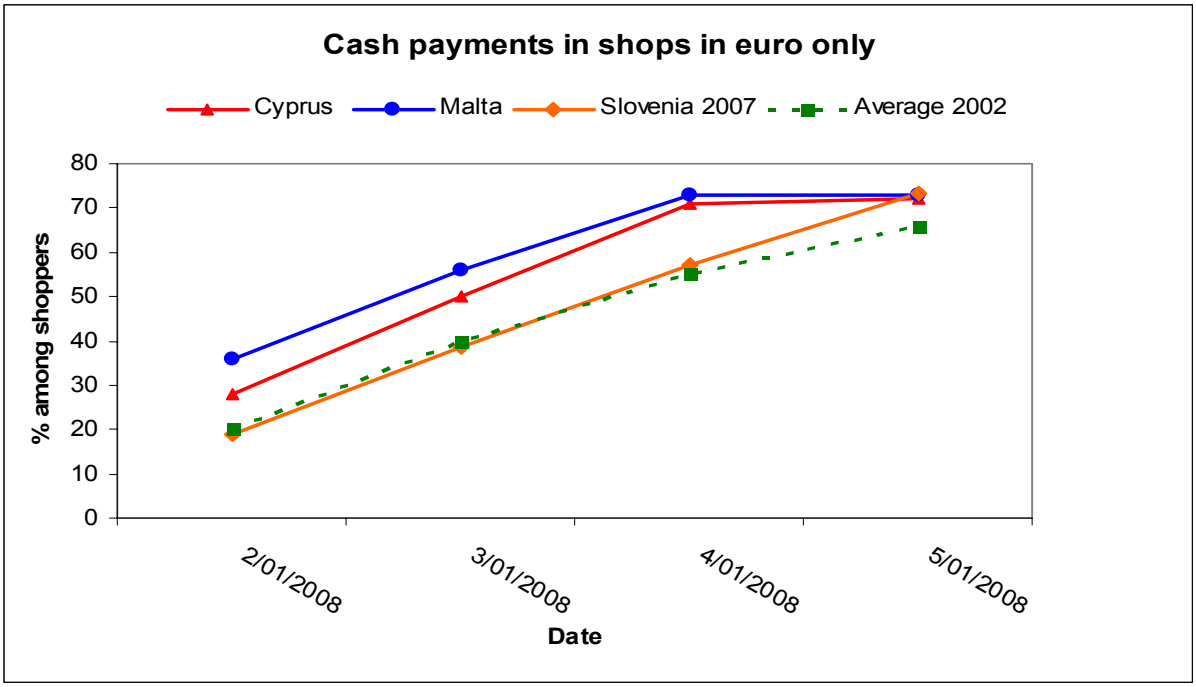
Around 90% of all ATMs (154 in total) in Malta were issuing only euro banknotes by midnight on 1 January; the rest were adapted in the following hours. Some 316 000 withdrawals for a total amount of around €40 million were made up to and including January 10. Like in Cyprus, about €126 were withdrawn per operation.

As people appeared to be eager to exchange their national cash holdings into euro and to withdraw euro cash, sizeable queues occurred at some bank branches. Several banks had opened special counters for businesses to reduce waiting times. However, the long queues observed even a week after the changeover demonstrated that the measures taken were not always sufficient. The banks were not fully prepared to handle such a large extra workload, despite the deployment of 600 cashiers.

2.2.2. Development of cash payments

The figures on cash payments in euro show that the euro has quickly become Malta's and Cyprus' currency. Its use in the first three days progressed much quicker than in the first wave (see Graph 1). In both countries the share of euro cash payments in shops reached 70% of all cash payments on 4 January, whereas in the 2002 changeover the share of cash payments in euro did not go over 70% until 6 January. More than 90% of retailers were giving change exclusively in euro as from 2 January 2008.

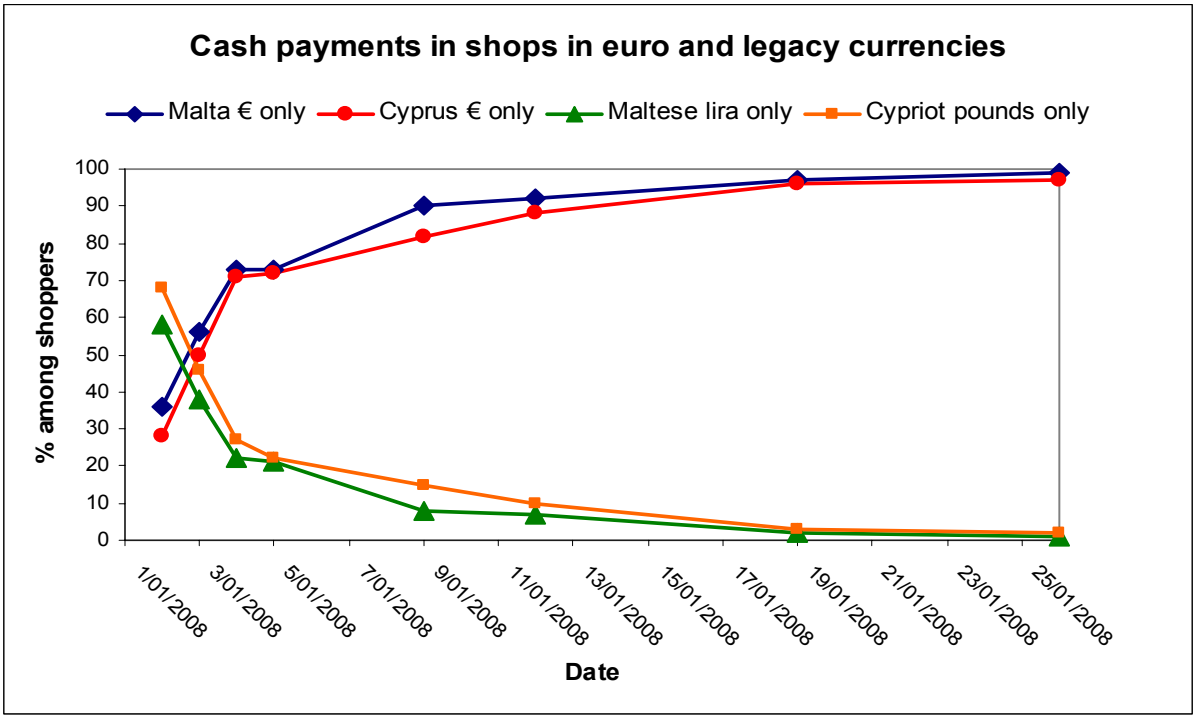
Graph 1



Source: Commission services

As a consequence, payments in the legacy currencies dropped swiftly from 100% on 29 December 2007 to only 7-10% of all cash payments on 12 January 2008. On 20 January 2008 (i.e. ten days before the end of the dual circulation period) only 3% of payments in shops were being made in the legacy currencies (see Graph 2).

Graph 2



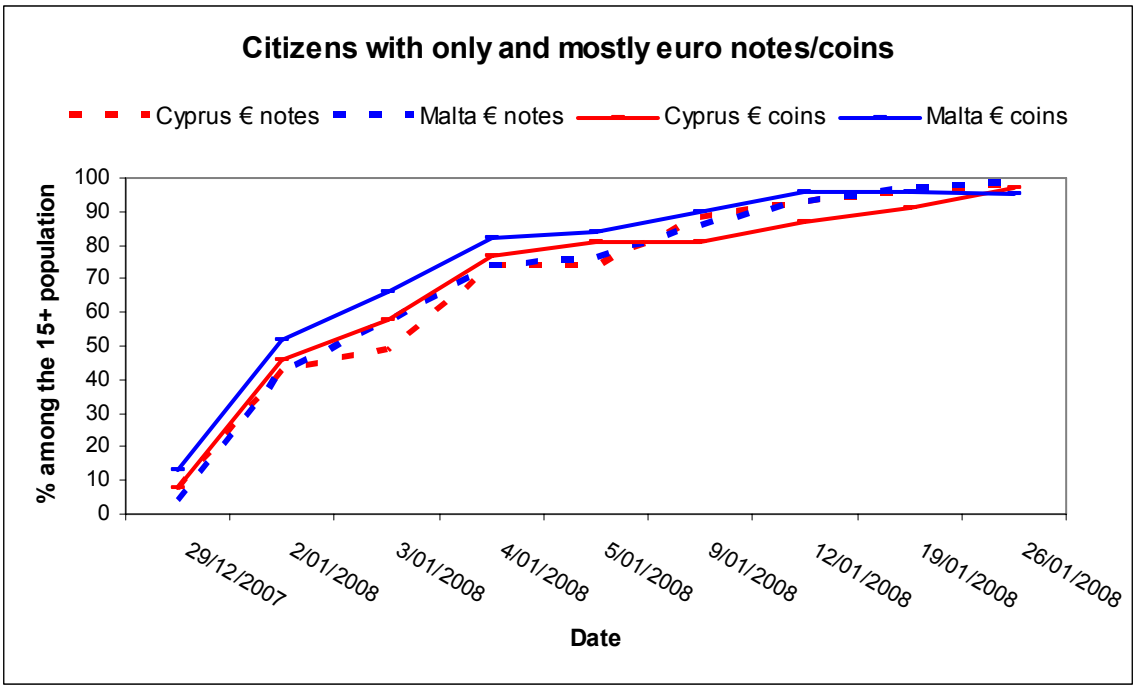
Source: Commission services

Some retailers experienced cash shortages during the first few days as many citizens, discouraged by the long queues in the banks, used the shops to get rid of the legacy currencies. As a result, cashiers needed more high-denomination euro coins and low-denomination euro notes than originally planned.

Some retailers and service providers in Malta (e.g. bus drivers) ran out of 1 and 2 euro cents, which were needed to give exact change. As the rounding up of prices was prohibited by law, unexpected amounts of some denominations were required and additional orders had to be placed by the Central Bank of Malta.

The results of the Commission survey depicted in Graph 3 show that already 12 days after the changeover, more than 90% of both Maltese and Cypriots had *only or mostly* euro coins and banknotes in their wallets. The changeover was surprisingly fast considering that, compared to Slovenia, fewer people had acquired some euro cash before €-day. On 29 December 2007, 7% of Cypriots had mostly euro notes while 8% had mostly euro coins. The respective figures for Malta are 4% and 12%. In Slovenia, the proportion reached 20% for euro notes and 27% for euro coins in the comparable period.

Graph 3



Source: Commission services

Citizens very quickly became familiar with their new currency. By the beginning of February 2008, almost 90% of Maltese and 95% of Cypriots found it very easy or quite easy to distinguish the euro banknotes. More than half of Maltese citizens (53%) calculated prices most often in euro when doing day-to-day shopping and some 40% did so even when making exceptional purchases. Cypriots were still counting most often in pounds when purchasing goods of greater value, but they were thinking mostly in euro when doing their day-to-day shopping. [5]

2.2.3. Recovery of legacy currencies

The legacy currencies started to return during the last months of 2007. On 1 January 2008, some 40% of the value of notes in circulation had already been recovered in Malta and some 10% in Cyprus. The process accelerated in the first days of January, with a daily withdrawal of 5-6% of the volume of outstanding legacy banknotes in Cyprus and around 3% in Malta.

Some 50% of the value of Cypriot pound banknotes and Maltese lira remaining in circulation on 1 January was recovered by 15 January and 17 January respectively[6]. In both countries the pace of the recovery was faster than in 2002, where the 50% mark was not exceeded until 21 January. Some 25% of the Cypriot and 35% of the Maltese legacy cash was still in circulation by the end of January, a result quite similar to the one observed in 2002. [7]

Overall, no problems were reported by cash-transport companies or by banks regarding the collection and storage of the legacy currency.

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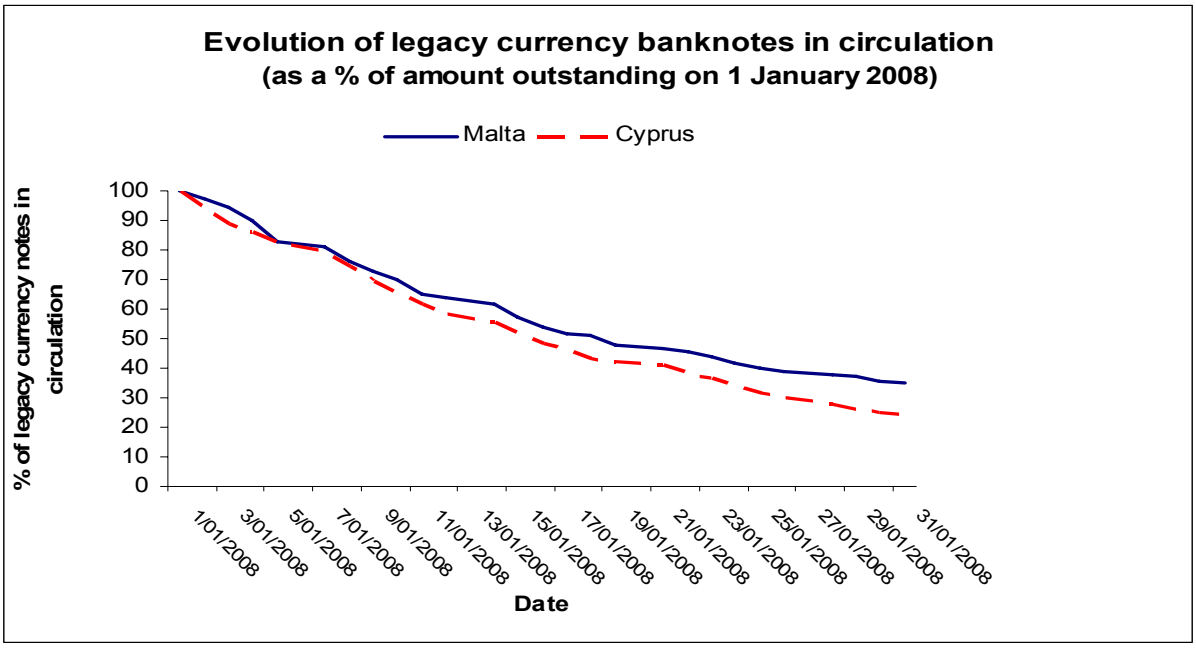
5 Flash Eurobarometer 222 for Cyprus and Flash Eurobarometer 223 for Malta, both February 2008

6 The total value of Cypriot pound banknotes and coins in circulation on 1 January 2008 amounted to €994 million and €66 million respectively. The corresponding figures for Maltese lira were €635 million and €44 million.

7 The Central Bank of Cyprus will continue to exchange legacy banknotes until ten years after €-day, and coins until two years after this date, free of charge. The Central Bank of Malta will continue to exchange Maltese lira coins and notes until 2 February 2010 and 1 February 2018 respectively.

Graph 4



Source: ECB

The cash changeover in Cyprus and Malta confirms that a short dual circulation period is technically feasible, even for countries with a very high amount of cash in circulation.

Although the banks took specific measures to cope with the large extra workload, it was not always sufficient to avoid queues during the first weeks after the changeover. The return of hoarded legacy currencies prior to €-day, extensive sub-frontloading and the use of non-cash means of payment should also be heavily promoted before each changeover to alleviate the transition.

3. THE CONVERSION OF FINANCIAL AND ADMINISTRATIVE SYSTEMS

In line with the big-bang changeover scenario chosen by both Cyprus and Malta, all administrative and financial systems were running exclusively in their respective national currencies up to 31 December 2007 and switched over to the euro on 1 January 2008.

According to all available data, the Cypriot and Maltese public administrations and enterprises managed to prepare themselves adequately and in good time. Experts from both Member States participated in information and training actions organised by the Commission/OLAF, ECB and Europol with a view to making them familiar with the procedures and methods designed to protect euro against counterfeiting.

Nearly all the enterprises surveyed in both countries in September 2007[8] had been informed about the changeover and had begun preparations.

[8] Flash Eurobarometer 218 (September 2007) for Cyprus, NECC Business Survey (September 2007) for Malta

No major technical problems were reported by the banks or retailers during the changeover. The changeover of ATMs, card payment systems and bank accounts went equally smoothly.

4. PRICE DEVELOPMENTS

4.1. Price monitoring during the changeover

The results of the Eurobarometer survey on public perception of the euro conducted in September 2007 showed that more than three quarters of citizens in both Cyprus and Malta were afraid of abuses and cheating on prices during the changeover. To address these fears, both countries put in place a comprehensive set of measures.

In Cyprus, the correct dual display of prices[9] was closely monitored by five Euro Observatories and the prices of frequently purchased goods were monitored by the Ministry of Finance and consumer associations. The Fair Pricing Code, subscribed by 7 579 businesses, was apparently successful in limiting price increases as most cases of abusive practices were detected among the businesses which had not signed it. The Euro Observatories contacted the retailers and service providers whose prices had increased abnormally (mainly barber shops, hairdressers, kebab shops, private car parks, doctors, cafes and cinemas) to investigate the reasons, and published on the internet the names of those who had abused the changeover.

In Malta, the price situation is monitored by the National Euro Changeover Committee (NECC)[10], which has also concluded a FAIR initiative with more than 7 900 businesses.

Malta is the first country where smoothing up of prices upon conversion to the euro has been prohibited by law[11]. Each report of rounding of prices lodged on the euro line or sent by email from citizens is immediately investigated. During the first seven weeks of the year, some 107 shop owners and other operators (including many doctors and some car park owners) revised prices downwards following a NECC warning that they had unfairly hiked up fees or prices because of the euro. Fines for unjustified price increases were imposed on three businesses while some 96 complaints proved to be unjustified.

4.2. Price trends

Inflationary developments in Cyprus and Malta in 2007 were largely influenced by global factors. Relatively low inflation in the first part of the year was to a large extent due to favourable base effects from energy prices, which have been reversed as of August-September 2007. Thus, in the second part of 2007, unfavourable base effects from energy prices coupled with rising commodities prices have contributed to the upward trend in inflation.

Annual inflation in Cyprus averaged 2.2% in 2007, with values being low in the first half of the year and high in the second half. The ascendant trend of HICP inflation in 2007 continued

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9 The dual display of prices in Cyprus pounds and in euro became mandatory on 1 September 2007 and will continue to be mandatory until 30 September 2008. In Malta the dual display of prices in Maltese lira and in euro became mandatory on 11 July 2007 and is obligatory until 30 June 2008.

10 The price monitoring will continue until June 2008

11 According to the Maltese Euro Adoption Act (CAP.485), the smoothing of monetary amounts is only permitted when it results in a monetary amount in euro which is less than the equivalent monetary amount in Maltese lira prior to conversion. In the case of monetary amounts forming part of a continuum for the purpose of establishing threshold values, the conversion of such amounts into euro may, provided this is necessary, be smoothened to ensure continuity in the threshold values of neighbouring brackets to distinctly delimit the bracket in a threshold. Where exceptional circumstances motivated by technical constraints so dictate, and after an application is made to the Euro Observatory, a concession may be granted by the Euro Observatory allowing smoothing to take place in other manner, under such terms and conditions as the Euro Observatory may determine.

in the first month of 2008. Thus, annual inflation stood at 4.7% in February 2008, up from 4.1% in January 2008. Annual inflation in Malta averaged 0.7% in 2007, while inflation was very volatile: a deceleration in the first part of the year was followed by an acceleration of inflation in the second half of the year. In February, the year-on-year figure stood at 4.0 %, up from 3.8% in January 2008.

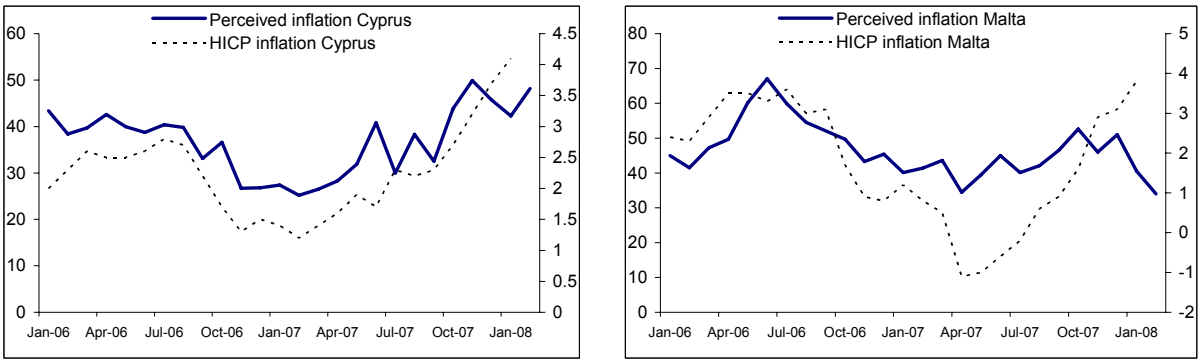
Eurostat's provisional assessment (Euro Changeover and Inflation in Cyprus and Malta, April 2008) is that in both Cyprus and Malta the total (one-off) impact of the changeover on headline inflation, during and immediately after the changeover, was probably between 0.2 and 0.3 percentage points. These estimates for Cyprus and Malta are in line with the experience of the first-wave changeover in 2002 and of Slovenia in 2007. Eurostat considers therefore that the euro changeover effects in both Cyprus and Malta seem to have been noticeable but were not of a magnitude that could drive headline inflation in either country. Eurostat will update its conclusions concerning the impact of the changeover in Cyprus and Malta if necessary when further information becomes available.

4.3. Price perceptions

Data from the Commission Services show that perceived inflation has generally followed the trend in HICP inflation in Cyprus and Malta in the last few years. In Cyprus, perceived inflation has followed closely the path of headline inflation, as both have had an upward trend since early 2007. In Malta, inflation perceptions have also tracked HICP inflation though less closely, as the sharp fall in HICP inflation in April was not matched by a corresponding fall in perceived inflation.

Data available since the euro changeover show that inflation perceptions have not been initially affected. Notwithstanding increasing HICP inflation, perceived inflation in Cyprus decreased to 42.3 pp in January 2008, from 45.7 pp in December last year, and perceived inflation in Malta stood at 40.5 pp in January 2008, down from 51.0 pp in the previous month. It thus seems that neither the acceleration in HICP inflation nor the possible impact of the euro's introduction on prices have affected consumers' perceptions about inflation. Other factors, such as the information campaigns, might have helped to reduce inflation perceptions in the two newest euro-area Member States. For Malta, it is also very likely that this is linked to the prohibition on smoothing up of prices and rigorous enforcement thereof.

Graph 5



Source: Commission services

However, the picture has changed partially in February 2008. While in Malta inflation perceptions have continued to decrease and are down to 34.0 pp from 40.5 pp in January 2008, in Cyprus perceived inflation has gone up to 48.2 pp from 42.3 pp in January 2008. It would, however, be premature to draw conclusions on further developments in inflation perceptions in Cyprus or Malta.

Cyprus and Malta have been experiencing inflationary pressures since mid-2007, mainly on account of global inflation acceleration in the subcategories of energy and food. At the same time, inflation perceptions have generally followed the trend in HICP inflation. In the first month after the euro changeover, inflation perceptions were kept in check although measured inflation accelerated. In February, perceived inflation in Cyprus picked up while in Malta it went down further.

5. COMMUNICATION CAMPAIGN ON THE CHANGEOVER AND PUBLIC PERCEPTION

The **Cypriot** euro campaign and the national euro website (www.euro.cy) were officially launched on 31 May 2006. The mass media campaign did not start until spring 2007, partly owing to the tendering problems for the selection of a public relations agency. The campaign focused on SMEs, rural areas and vulnerable groups. The main messages dealt with the timeline for the changeover, the benefits of the euro, the exchange rate and fears of unjustified price increases. The main channels used were radio (10 225 spots), television (3 260 spots) and printed advertising (206 magazine and 241 newspaper adverts). 'Eurobusses' travelled around the island to inform people in remote areas. Mindful of the continuing low support for the euro, the Cypriot authorities increased their communication efforts in the last months, mainly targeting the vulnerable groups. The European Commission supported a number of activities including the display of the newly developed euro exhibition, a model conference and a seminar for journalists, a national school competition and the production of promotional material.

The information campaign appears to have yielded very good results. According to the February 2008 Eurobarometer, 9 out of 10 Cypriots felt very well or quite well informed about the changeover. The media were the principal information source for most citizens (61%), followed by commercial banks (16%) and the Central Bank of Cyprus (10%). People were also very satisfied (49%) or quite satisfied (44%) with the information provided by the national authorities regarding the euro. Eight out of ten Cypriots received a euro calculator and found it very useful. In February 2008 some 80% of the people surveyed by the Eurobarometer still wished to have more information on fair rounding and correct pricing, on the social, economic and political implications of the euro and on the security features of the euro.

The initially low support for the euro in **Malta** was reversed by a comprehensive multiphase campaign, first focusing on awareness and on the benefits of the euro, then on the practical aspects of the changeover. It provided a mix of mass media activities (4 750 TV spots, 20 125 radio spots and 1 465 newspaper and magazine adverts) and person-to-person communication activities (a euro telephone line, contacts with the press, NGOs, local councils and parishes, consumer and business organisations, schools and vulnerable groups). People's fear of unfair practices was regularly tackled during the information campaign. A dedicated website (www.euro.gov.mt) supported all actions and methodically listed all euro-related information.

The European Commission supported, under the umbrella of a Partnership Agreement, two euro exhibitions and a euro conference, a general public and a dual circulation survey, and a national school competition.

The long and intensive information campaign appears to have yielded very good results. According to the February 2008 Eurobarometer, 9 out of 10 Maltese felt very well or quite well informed about the changeover. Media were the prime source of information for the

majority of people (68%), with television being regarded as the most efficient source. The TV spots were seen by 87%, of which more than 90% found them quite or very useful. In February 2008 56% of the people surveyed by the Eurobarometer still wished to have more information on fair rounding and correct pricing, and on the security features of the euro.

The changeover and related information campaign were perceived in both countries as smooth and efficient. This shows that a well-managed and comprehensive communication campaign can boost public support for the euro. Furthermore, the Maltese campaign has shown that fears as regards changeover-related price increases can be successfully addressed through well-targeted and intense information activities.