Estonia: three years with the euro

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SEB Estonia
Households in Estonia are the most positive about the euro

- The euro changeover in January 2011, in the middle of the government debt crises
- In Estonia, 80 per cent of the population favours the euro which is the highest in Europe
- In Latvia, the support for the euro increased significantly after the changeover, from 53% in autumn 2013 to 68% in spring 2014

Support for EU with one single currency (%)

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<tbody>
<tr>
<td>Estonia</td>
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<tr>
<td>Latvia</td>
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<td>Lithuania</td>
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<td>EU28</td>
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<td>51</td>
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</table>

Euro is a good thing for the country (%)

<table>
<thead>
<tr>
<th>Country</th>
<th>Autumn 2011</th>
<th>Autumn 2012</th>
<th>Autumn 2013</th>
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<tbody>
<tr>
<td>Estonia</td>
<td>59</td>
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<tr>
<td>Slovakia</td>
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<td>56</td>
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<tr>
<td>Slovenia</td>
<td>67</td>
<td>59</td>
<td>55</td>
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<tr>
<td>Euro area</td>
<td>67</td>
<td>55</td>
<td>57</td>
</tr>
</tbody>
</table>

Source: Eurobarometer
The main concern was about the price increase

The euro will increase inflation (results shortly after the changeover, %)

- The inflation expectations started to increase half a year before the euro changeover, in June 2010
- In Estonia, the fear about inflation was higher than in Slovakia or in Slovenia
The fear about higher inflation due to the euro changeover has not been justified

- There were other reasons behind the price increase in Estonia than the euro changeover
- At the end of 2010, the prices increased in all Baltic countries
- Ca 1/10 of the price increases can be related to the euro changeover (up to 0.5 per cent from total price increase of over 5 per cent)
- The euro increased the prices in small stores rather than in supermarkets. The price increases were more obvious for relatively cheaper goods (incl. food)
Most of the euro prices are not converted to the local currency any more

Big purchases - calculate in old currency (%)

Day-to-day purchases - calculate in old currency (%)

- Households in Estonia have given up to calculate the euro prices to kroon relatively fast, the share of households converting the prices to the local currency is on the Euro area average
- Big purchases are calculated more often to kroon than day-to-day purchases

Source: Eurobarometer
Has the euro affected the travelling behaviour of Estonians?

Total number of visits to abroad in Estonia (thous.)

Total number of visits to the euro area countries in Estonia (thous.)

- The incentives to travel abroad has not been affected by the euro. The travel intensity in 2014 is still below the level of 2008, it has not recovered from the recession
- The preference to travel to the eurozone countries has increased. The number of visits to the eurozone countries is higher in 2014 than it was in 2008

Source: Bank of Estonia
Euro did not affect the real estate market

- There was an expectation that households might increase their attention towards real estate purchases before the euro adoption.
- In 2010 Q4, the volume of real estate purchases increased by 4 per cent compared to 2010 Q3 (usually there is a decline in Q4). However, even higher increase was observed in 2009 Q4 (12 per cent) induced by the recovery from the recession.

Source: LandBoard
There is no direct effect of the euro on the borrowing

New household loans in Estonia (mEUR)

New household loans in Latvia (mEUR)

- In Estonia, the volume of issued loans increased significantly in 2010 Q4, by 12 per cent compared to 2010 Q3 (usually a decline is observed). But the reason for the increase is related to the increased consumer confidence and the realisation of postponed borrowing.
- In Latvia, the new borrowing increased in the second half of 2013 but there is no growth in the first half of 2014.
Latvia: fresh memories of euro
Introduction

Edmunds Rudzītis
SEB Latvia
Inflation perceptions and actual inflation

Price changes after euro adoption (% of all respondents)

- Increased significantly: 39.0
- Increased slightly: 48.0
- Declined significantly: 0.3
- Declined slightly: 1.0
- Not changed: 8.0
- NA: 4.0

Source: SKDS (March 2014)

Changes in consumer prices in August 2014, y-o-y

87 per cent noticed price increase due to the euro changeover.

Source: National Statistics
Euro adoption brings money into banking sector

Monthly changes in the outstanding volume of household deposits (in millions of euro)

Dynamics of household deposits a year before and after euro adoption

Source: Bank of Latvia

Over the last 2 months of 2013 household deposits grew by 387 million euros or by 8 per cent.
Non-cash transactions more popular

Number of card transactions (in millions)
- Number of ATM cash withdrawals
- Number of purchases with payment cards

Value of card transactions (in millions of euros)
- Value of ATM cash withdrawals
- Value of purchases with payment cards

Source: Association of commercial banks of Latvia
From lats to euros

6 one size notes; 8 circulation coins + 23 commemorative 1 Ls coins

7 different size notes; 8 x 18 = 144 circulation coins plus ≈ 100 commemorative 2 € coins
Large portion of cash remains unexchanged

- Since the last year less than 40 per cent of coins have been exchanged.
- According to Bank of Latvia at the end of August 347.7 million coins or approx. 799 tonnes of cash was unchanged.
Is Lithuania going to use the privilege of being the last one – to learn the lessons of others?

- Actual and perceived changes in prices
- **Cash** changeover challenges
- Period necessary to **re-learn** the prices
- Euro adoption effect on borrowing and savings **terms**
- Euro introduction effect on **behaviour** of household related to borrowings and savings
- **Lessons** to be transferred to new candidate states
Increase in prices related to the euro introduction should be small

Price changes prior to the euro introduction (y-o-y, %)

- Service prices in Lithuania started to increase long before the euro adoption date
- Relatively smaller effects are expected later
- Prices of goods that were cheaper compared to other countries increase more rapidly
- Perceived inflation will also be higher than the announced official inflation rate
Cash changeover challenges

Household deposit dynamics (y-o-y, %)

- Estonia (2010)
- Latvia (2013)
- Lithuania (2014)

Source: National central banks

Household cash-to-deposit ratio (%)

- 3 months before euro adoption
- 3 months after euro adoption
- 3 years after euro adoption

Source: ECB

- Value of cash (in the litas) kept by households is similar to the cash (in the lat) value in Latvia
- Compared to other countries, residents of Lithuania started to bring cash to financial institutions earlier
- Value on unexchanged coins and banknotes will reach several hundred million litas
Re-learning prices will take longer than 12 months

### Planning big purchases (%)

- **Ireland (2002)**: Convert to old currency 7, Do not convert to old currency 89
- **Belgium (2002)**: Convert to old currency 55, Do not convert to old currency 37
- **Portugal (2002)**: Convert to old currency 47, Do not convert to old currency 46
- **Estonia (2002)**: Convert to old currency 43, Do not convert to old currency 44

### Day-to-day shopping (%)

- **Ireland (2002)**: Convert to old currency 4, Do not convert to old currency 92
- **Belgium (2002)**: Convert to old currency 24, Do not convert to old currency 66
- **Portugal (2002)**: Convert to old currency 31, Do not convert to old currency 62
- **Estonia (2002)**: Convert to old currency 19, Do not convert to old currency 69

- People more rapidly become accustomed to the new prices of frequently purchased items
- Complicated calculation shortens the time

\[
1 \text{ EUR} = 0.787564 \text{ IEP}; 1 \text{ EUR} = 40.3399 \text{ BEF}; 1 \text{ EUR} = 200.482 \text{ PTE}; 1 \text{ EUR} = 15.6466 \text{ EEK}
\]

*Source: Eurobarometer*
Less uncertainty for borrowers

Loan composition by currency the year prior euro adoption (%)

<table>
<thead>
<tr>
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<th>Foreign currency</th>
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<tbody>
<tr>
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<td>14</td>
<td>86</td>
</tr>
<tr>
<td>Latvia (2013)</td>
<td>13</td>
<td>87</td>
</tr>
<tr>
<td>Lithuania (2q2014)</td>
<td>31</td>
<td>69</td>
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Inter-bank borrowing interest rate (6 months)

Source: National central banks

- Lithuanians more willingly than their neighbours obtained loans in the national currency, therefore currency risk seemed more acute for them.
- Euro introduction will give an opportunity to enjoy lower interest rates and currency risk will be eliminated.
Doubts prevail whether the euro adoption may stimulate borrowings

SEB Housing Price Expectations' Indicator

Mortgage loans' interest rate (Eur, initial rate fixation up to 1 year, weighted average, %)

- Expectations of increase in the dwelling prices are shrinking
- Interest rates on the euro loans are dropping, irrespective of the fact whether the euro is introduced or not

Source: SEB

Source: National central banks
Euro adoption decreases depositors’ profit

Deposit composition by currency the year prior euro adoption (%)

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Household term deposit interest rate (weighted average, %)

Source: National central banks

- Less opportunities for depositors to earn higher interest
- Wider range of the savings instruments to be offered
Lessons for the new member states

• Businessmen start rounding prices long before the euro introduction date
• Residents take early measures related to savings in the national currency
• Euro adoption decreases the cash volume in the economy
• Irrespective of changes in savings and borrowing terms, the euro adoption does not make a significant effect of behaviour of households