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EUROPEAN PARLIAMENT, THE EUROPEAN ECONOMIC AND SOCIAL
COMMITTEE, THE COMMITTEE OF THE REGIONS AND THE EUROPEAN
CENTRAL BANK**

Sixth report on the practical preparations for the future enlargement of the euro area

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1. INTRODUCTION

Following the Council decisions of 10 July 2007 that Cyprus and Malta fulfil the necessary conditions for the adoption of the euro on 1 January 2008,¹ the practical preparations for the introduction of the euro are currently being completed in both countries. This report addresses these final preparations, in particular the introduction of euro cash into the economy, the state of the private sector's preparations as well as the state of public opinion on the euro in Cyprus in Malta.

The attached Commission staff working paper provides for more technical details on the preparations in both countries and in the other Member States concerned.

The report follows five reports on the state of practical preparations for the future enlargement of the euro area, which were issued between November 2004 and July 2007.²

2. STATE OF PREPARATIONS

2.1. Cyprus

2.1.1. *How will euro cash be introduced into the Cypriot economy and how will Cyprus pound cash be withdrawn?*

The introduction of the euro in Cyprus implies that a population of about 775 000 will take part in the changeover from the Cyprus pound to the euro, be it as individuals or within the enterprise or public body in which they work. The responsibility for the introduction of the euro in physical form and for the withdrawal of the Cyprus pound from circulation lies with the Central Bank of Cyprus (CBC).

Euro notes and coins needed

In order to replace the currency in circulation in Cyprus pound with euro cash, 60.7 million euro banknotes (worth € 1 190 million) and 395 million euro coins (worth € 100.26 million) are necessary, according to the estimates of the CBC.

In line with the European Central Bank's decision that new euro-area entrants can borrow the necessary volumes of euro banknotes from the Eurosystem and pay them back after the changeover with euro banknotes produced by their own supply arrangements, the CBC received the euro banknotes from the Bank of Greece in the course of October.

The Cypriot euro coins were produced by the Mint of Finland, following a public call for tenders. Mass production started once the Council had decided, on 10 July 2007, that Cyprus can adopt the euro on 1 January 2008. About 60% of the coins arrived by mid-October via container shipments, while the remaining 40% are expected to be delivered by the end of November.

Frontloading and sub-frontloading

With a view to preparing a smooth cash changeover, the CBC implements a frontloading operation under which it supplies commercial banks with euro banknotes and coins before €-

¹ Council Decision of 10 July 2007 in accordance with Article 122(2) of the Treaty on the adoption by Cyprus of the single currency on 1 January 2008, OJ L 186, 18.7.2007, p. 29; Council Decision of 10 July 2007 in accordance with Article 122(2) of the Treaty on the adoption by Malta of the single currency on 1 January 2008, OJ L 186, 18.7.2007, p. 32.

² COM(2004) 748 of 10 November 2004; COM(2005) 545 of 4 November 2005; COM(2006) 322 of 22 June 2006; COM(2006) 671 of 10 November 2006; COM(2007)434 of 16 July 2007.

day.³ Frontloading started on 22 October for euro coins, and on 19 November for euro banknotes. The CBC estimates that approximately 80% of the value of the euro banknotes which will be introduced into the Cypriot economy (i.e. 48.4 million banknotes, worth approximately € 950 million) will be supplied to the banking sector before €-day, as well as 64% of the value of euro coins (i.e. 251.2 million coins, worth approximately € 64 million). The frontloading operation involves all approximately 900 bank branches in Cyprus (each serving about 860 inhabitants on average).

In a next step, commercial banks have to ensure that enterprises involved in cash-related operations, and retailers in particular, receive euro cash before €-day (sub-frontloading) and are able to give change in euro only as from the changeover date. This contributes to reducing to a minimum the period during which euro cash and national cash are used in parallel. The details of the sub-frontloading are laid down in agreements between the banks and their clients, defining the timing of deliveries, the debiting date, the necessary insurance cover and collateral requirements. Although the CBC and commercial banks are active in explaining the need for sub-frontloading to all enterprises dealing with cash, the first euro-cash orders by businesses were significantly below expectations. Additional measures to encourage enterprises are being taken, already showing positive results. On 31 December, which is to be declared a special bank holiday, banks will sub-frontload SMEs with small amounts of euro cash. The efforts to ensure an appropriate level of sub-frontloading should be continued.

As part of the sub-frontloading operation, 40 000 pre-packed euro coin kits (starter-kits) for businesses (worth € 172 each) as well as 250 000 mini-kits for the general public (worth € 17.09 each) will be on offer as from 3 December 2007. Simple packaging of the kits has been chosen to ensure that the coins will be used for payments and not retained as collector items.

In addition, since 1 November, some banks exchange Cyprus pounds into euro banknotes for their customers at the conversion rate and without exchange charges, so that the public can prepare for payments in euro as from €-day.

Introduction of cash into the economy as from 1 January 2008

Most of the euro banknotes will be channelled into circulation through ATMs. Approximately 550 ATMs are operated by credit institutions in Cyprus, virtually all within the banks' premises which allows for their immediate refilling. Some large banks have announced that they implement the conversion of their ATMs in the evening of 31 December. At least 70 % of the ATMs will be converted to dispensing exclusively euro banknotes at the latest by 1.00 a.m. on €-day, while the remaining 30% will be converted by noon on the same day. Under normal circumstances, all ATMs together serve for approximately 170 000 withdrawals with a total value of around € 22 million per week (on average, data from 2006).

During the first weeks after €-day, ATMs will dispense € 10 and 20 banknotes only, with a view to reducing the amount of change which retailers have to give in cash transactions.⁴ For the same reason, banks have committed to distribute only low denomination banknotes at their counters in a first period after €-day (primarily € 5, 10 and 20, maximum € 50 banknotes).

³ €-day is the day on which euro banknotes and coins are put into circulation (1 January 2008 for Cyprus and Malta).

⁴ The cash needs of retailers in the first days and weeks after the changeover will be significantly higher than under normal circumstances, since national cash received from customers can no longer be used for giving change and since customers will use national cash for payment purposes more than usual to get rid of it without having to exchange it in banks. If customers who pay in euro already use small denomination euro banknotes or pay the exact amount, retailers will need less euro change.

The retail sector will be the main channel for introducing euro coins into the economy, given that coin withdrawals at bank counters are not common. In order to avoid any 'recycling' of national cash, the retail sector is expected to give change in euro only as from €-day.

Return of national cash

As regards the return of national cash, the CBC intensified its campaign encouraging citizens to use hoarded national cash or to deposit it with banks in October 2007. The CBC estimates that by the end of this year 80.9 million national banknotes and 472.7 million national coins will be in circulation. It is expected that most of these banknotes and about half of the coins will sooner or later be returned to the CBC.

On 1 January 2008, which is a bank holiday, a number of centrally located bank branches will be open in every district to facilitate the exchange of Cyprus pounds into euro.

Banks will exchange Cyprus pound banknotes and coins into euro free of charge until 30 June 2008, for amounts up to CYP 1 000 per customer and per transaction in the case of banknotes, and up to CYP 50 in the case of coins. The CBC continues to exchanges national banknotes until ten years after €-day, and coins until two years after this date, free of charge.

Cheques; POS terminals

About 25 million cheques are being used per year in Cyprus. Since cheques denominated in Cyprus pound and dated after 31 December 2007 will not be valid, banks have started supplying their customers with cheque books in euro, which are being used already now.

The approximately 19 000 point-of-sale terminals (POS) operated in Cyprus pound will be switched to the euro on 1 January 2008. Those POS which are, for example, working at restaurants and hotels and should keep accepting card payments through New Year's eve, will change over immediately at 00:01 a.m. on €-day.

Protection of the euro against counterfeiting

The necessary framework for the protection of the euro against counterfeiting has been established.⁵ Cypriot experts have also participated in relevant training actions and working groups of the Commission, the European Central Bank and Europol.

2.1.2. How well are enterprises prepared for the changeover?

In September 2007, a Eurobarometer survey among enterprises was conducted in Cyprus on behalf of the European Commission in cooperation with the Cypriot authorities, following a similar survey carried out in January 2007.⁶ The results indicate that the Cypriot enterprises are well prepared for the changeover and that they did not experience any significant problems in the course of their preparations. By mid-September 2007, virtually all enterprises (97%) had started preparing for the changeover; most of them had done so as from April 2007 (88%).

More than 88% of all enterprises dealing with cash in their customer relations indicated that they expect to be supplied with euro banknotes before €-day by their banks. Four out of five enterprises (80%) expect their IT systems (e.g. accounting, invoicing, payroll systems) to be ready for switching to the euro immediately on 1 January 2008.

⁵ See Fourth report, page 8

(http://ec.europa.eu/economy_finance/euro/transition/transition_main_en.htm).

⁶ See Flash Eurobarometers 200 and 218. All Eurobarometer surveys are available at http://ec.europa.eu/public_opinion/euro_en.htm.

More than 9 out of 10 enterprises are aware that prices have to be displayed both in euro and in Cyprus pound since September 2007, and the large majority of enterprises do not experience any particular difficulties in fulfilling this obligation. Concerning enterprises' pricing policy, the results of the September survey indicate a positive trend. When adjusting prices to the euro, e.g. psychological prices such as CYP 5.99 which due to the application of the conversion rules would result in un-rounded amounts in euro, 17% of the businesses mentioned that they will adjust their prices mostly downwards (3% in January), while only 3% will mostly adjust upwards (16% in January). Moreover, the percentage of those who will exactly apply the conversion rules without further adjustments increased from 28% in January to 51% in September.

2.1.3. What measures are being taken to avoid the perception of price increases around the changeover?

According to the latest Eurobarometer on public opinion on the euro, still 74% of respondents in Cyprus fear prices increases on the occasion of the changeover to the euro.⁷ This constitutes only a slight change compared to the situation in April 2007, when 78% shared this concern.⁸

Over the last months, the Cypriot authorities have further strengthened their measures with a view to contributing to price stability and enhancing consumer confidence around the changeover. The dual display of prices in Cyprus pound and euro became mandatory for enterprises on 1 September 2007. Its implementation is carefully monitored by five Euro Observatories established throughout the country which send more than 100 inspectors to each retail outlet on a regular basis. The Euro Observatories consist of ten members, including the district commissioner, representatives of government, consumer associations, trade unions and the business sector. As from the start, about 80% of all retailers correctly applied dual displays according to the legal requirements established by national law, while the remaining enterprises were given assistance for correct dual displays. The general feedback on the mandatory dual display is positive, and it is seen as contributing to greater price transparency by establishing the habit of displaying prices more widely.

About 7 130 enterprises, including in particular larger retailers and banks, subscribed to the Fair Pricing Code launched by the government in July 2007. They are allowed to display the logo of the Code in their shops and branches, provided they comply with the Code under which they committed to carry out the changeover fairly and not to seek advantage from it. The Ministry of Finance publishes the list of participating businesses on Cyprus' euro website and in the official journal. The Code is valid until 10 July 2008.

The Ministries of Finance and of Commerce and Industry, in cooperation with the Statistical Services and the Pan-Cyprian Consumers Association, carry out systematic price monitoring since September 2007. The Statistical Services notably monitor price developments related to a basket of certain products which, according to past experience in other countries, may be subject to unjustified price increases. With a view to informing consumers, lists of retail outlets offering the least expensive products are being published once a month.

In addition, the Cyprus' Consumer Association carries out and publishes market surveys, analysing the price developments of about 80 000 items in 11 000 retail outlets. First results from the period of July to September 2007 indicate that the prices of about 80% of the products remained stable or decreased, while price increases of different degrees were

⁷ Flash Eurobarometer 214, September 2007.

⁸ Flash Eurobarometer 207.

observed for the remaining 20% of items. The Association intends to publish cases of significant price increases in the media, along with the reasons for the price increase given by the retailer concerned.

2.1.4. How well are citizens prepared for the changeover?

Cyprus has significantly increased its communication efforts on the euro in the last months. The Ministry of Finance and the CBC are coordinating closely with business and consumers organisations as well as the European Commission and the European Central Bank.

The general public has been addressed via mass media campaigns, partly funded by the European Commission. The key messages concern the fixing of the conversion rate, the Fair Pricing Code, the dual display of prices, de-hoarding of national cash and enhanced consumer awareness. The campaigns were conducted in all media, notably TV (approximately 2 500 inserts), radio (approximately 6 500 inserts) and print (approximately 200 inserts).

Promotional material concerning the Fair Pricing Code and the dual display of prices (posters, leaflets, etc.) was distributed to all businesses, presentations were given in schools and to social workers and a school competition was launched. The national euro website is regularly updated and the press is informed on a constant basis by the authorities. Specific target groups (SMEs, the vulnerable, women, youth) are reached via posters and leaflets and a 'talking card' for the blind, and with the help of the Euro Observatories and four 'euro-busses' touring around the island. The free telephone line receives approximately 500 calls per week.

In August, the Cypriot authorities modified the communication strategy and asked the communication agency to change the content of the mass media campaigns so as to respond more adequately to the needs of target groups who remain sceptical about the benefits of the euro.

The latest Eurobarometer survey confirms that the support for the euro is increasing in Cyprus albeit from a low level: some 44% of the respondents stated that they are personally very or rather happy that the euro will replace their currency (up from 40% in April 2007 and 32% in September 2006).

It appears fair to assume that the ongoing communication campaign in Cyprus is instrumental to increase the support for the euro. Other factors confirm this: 67% of the respondents felt quite or very well informed which is a huge leap forward from previously 47% (April 2007) and 39% (September 2006). Similarly, the familiarity with some key features of the euro and EMU has further improved.

2.1.5. Conclusion

In the last few months Cyprus has achieved considerable progress on the practical changeover preparations and seems generally well prepared for the introduction of the euro. With a view to enabling businesses, in particular retailers, to give change exclusively in euro as from €-day, the Central Bank and banks should continue their efforts to convince businesses of the need for being sub-frontloaded. The communication activities on the euro should be further strengthened with a view to increasing the support for the euro.

2.2. Malta

2.2.1. How will euro cash be introduced into the Maltese economy and how will Maltese lira cash be withdrawn?

In Malta, a population of about 400 000 will change over from the Maltese lira to the euro. According to estimates of the Central Bank of Malta (CBM), 41.51 million euro banknotes

(worth € 799 million) and 140 million euro coins (worth € 39.29 million) are necessary to replace the currency in circulation in Maltese lira.

The CBM borrowed the necessary volumes of euro banknotes from the Banca d'Italia. The Maltese euro coins were produced by the Monnaie de Paris and arrived in Malta between mid-September and end of October 2007.

Frontloading of euro cash to commercial banks started on 15 September. In total, about 92.5% of the banknotes which will be introduced into the Maltese economy (38.43 million banknotes, worth € 749 million) and about 71% of the euro coins (99.12 million coins, worth € 27.81 million) will be supplied to the 107 bank branches throughout the country before €-day.

According to estimates of the CBM, 4.5% of the banknotes to be introduced and 19.5% of the coins will be supplied to businesses before €-day by their banks under sub-frontloading agreements as from 1 December 2007. These estimates include 33 000 starter-kits for businesses (worth € 131 each) and 330 000 mini kits for citizens (worth € 11.65) which will be available at banks as from 1 and 10 December 2007, respectively.

Around 60% of all ATMs (154 in total) will dispense low denomination (mainly € 10 and 20) euro banknotes as from 1 January 2008 at 0:00. By noon on the same day between 85 and 90% of ATMs will issue euro banknotes, while the remaining ATMs will be converted by 16:00. On average, all ATMs serve for 306 000 withdrawals per week, with an average total value of € 26.55 million.

Considering that Malta has a particularly high amount of cash in circulation, the CBM launched a TV and press advertising campaign in September 2007, encouraging the public to deposit excess cash with banks, with a view to reducing the volume of national cash to be exchanged after €-day. The national cash in circulation to be returned to the CBM as from 1 January 2008 is estimated to amount to approximately 37 million banknotes and 128 million coins.

As from 1 December, banks are committed to exchange Maltese lira banknotes and coins into euro free of charge at the conversion rate, subject to availability of the euro banknotes. This is mainly intended to enable small businesses to acquire some euro banknotes ahead of the changeover. The general public will be reminded that the euro will only become legal tender on 1 January 2008. From that date until 31 March 2008, commercial banks will exchange national cash into euro free of charge at the conversion rate for their clients and up to MTL 250 (€ 582.34) for non-customers. The CBM will continue to exchange Maltese lira coins and notes until 1 February 2010 and 1 February 2018, respectively.

Banks will be open on 31 December and closed on 1 January as usual. On 2 and 3 January, they will only handle over-the-counter business with the public for cash deposits, foreign currency exchange and exchanges into euro. On 4 and 5 January the normal banking hours will be extended until 16:00. During the extended hours only cash deposits, foreign currency exchange and exchanges into euro will be handled.

About 12 million cheques are being used in Malta per year. Cheques issued in Maltese lira dated before 1 January 2008 will be accepted for payment for the normal validity period of six months from the date of issue, unless a shorter period is indicated. Cheques drawn on MTL denominated accounts and issued in euro before 1 January 2008 will be honoured by commercial banks if presented after that date.

The necessary framework for the protection of the euro against counterfeiting has been established.⁹ Maltese experts have also participated in relevant training actions and working groups of the Commission, the European Central Bank and Europol.

2.2.2. *How well are enterprises prepared for the changeover?*

In the second half of August and early September, the National Euro Changeover Committee (NECC) conducted, in cooperation with the National Statistics Office, a survey on the state of euro preparations in the Maltese business sector.¹⁰ Virtually all of the 908 enterprises (representing a population of 16 500) participating in the survey (98%) knew that the euro will be introduced on 1 January 2008, and a majority of 56% was aware that the dual circulation period during which they may still accept payments in Maltese lira is one month. Nine out of ten enterprises were aware that change should be given exclusively in euro as from €-day.

The majority of enterprises (55%) expected to receive euro cash from their banks before 1 January 2008. Among the 33% which did not plan to be sub-frontloaded, more than one third (37%) either has euro cash already or will obtain it from ATMs or at banks in January, while one fourth (26%) does not transact in cash.

Concerning the IT systems which need to be modified with a view to the changeover, enterprises mentioned most often systems in the logistics area, followed by sales and marketing applications, accounting and human resources systems. About one third of the enterprises (31%) had by that time upgraded their accounting systems with a view to the euro. This figure appears rather low, while it needs to be considered that a considerable share of Maltese enterprises are small businesses (72% of all businesses are self-employed persons with no employees, where, generally, IT accounting systems are not used).

The NECC embarked upon an intensive business training programme, whereby 70 euro assistants are directly training the SME sector, whilst the NECC adopted a 'train the trainer' approach enabling larger businesses to cascade euro changeover training within their organisations.

2.2.3. *What measures are being taken to avoid the perception of price increases around the changeover?*

Still about two-thirds of the Maltese population (65%) fear price increases on the occasion of the changeover to the euro, and 76% even expect price abuses. In order to address these fears, the NECC continues to implement a comprehensive set of measures.¹¹ The dual display of prices in Maltese lira and in euro became mandatory on 11 July 2007, and will continue to be mandatory until 30 June 2008. The FAIR initiative, under which more than 6 500 businesses (representing about 80% of the retail outlets) have committed not to increase the prices of goods and services "for the reason that a monetary changeover is taking place", was complemented by Price Stability Agreements which the NECC concluded with a number of importers, distributors and manufacturers in August and September 2007. Under these agreements the businesses promised to keep the prices for a wide range of products and services stable during a certain time before and after the changeover. The price monitoring currently implemented by the Maltese authorities remains crucial to assess price developments and to inform consumers, and should continue throughout 2008 when the FAIR initiative and the dual display of prices will come to an end.

⁹ See Fourth report, page 11.

¹⁰ See <http://www.euro.gov.mt/page.aspx?ID=590>.

¹¹ See Fifth report, page 7 (http://ec.europa.eu/economy_finance/euro/transition/transition_main_en.htm).

2.2.4. How well are citizens prepared for the changeover?

The NECC, responsible for implementing the communication strategy towards the changeover in Malta, launched, after a brief pause during August 2007, an intensive and comprehensive last phase campaign on the 'immediacy' of the euro introduction (e.g. when to deposit Maltese lira, how to use the euro converter). Part of this campaign is being funded by the European Commission.

The mass media campaign, running in newspapers, magazines, radio, TV, on bus shelters and billboards is supported by specific actions towards selected target groups: in parishes a 'eurocentre' was set up to answer questions of the village people, a kit was developed for trainers of vulnerable groups and for the business sector and a school competition on the euro has been launched for secondary schools. Extra actions include three large countdown clocks placed in strategic places in Malta and a 1.5 minute "euro-related news" in the daily evening news bulletin on the leading TV stations in Malta. In October, Malta organised, in cooperation with the European Commission and the European Central Bank, a conference on EMU and the euro.

The latest Eurobarometer survey of September 2007 shows very encouraging results for Malta confirming the success of the intensive and comprehensive communication campaign by the authorities. The trend remains positive and the support for the euro has reached a good level. 56% (compared to 54% in April 2007 and 48% in September 2006) stated that they are personally very or rather happy that the euro will replace their currency which is the second highest value in the countries concerned. However, the level of support remains substantially lower than in Slovenia at the same juncture.

The impact of the ongoing communication campaign in Malta is visible also in other areas. The good level of self-perceived information measured in April this year has improved further, although only slightly: 74% of the respondents felt quite or very well informed compared to previously 71%. 99% of the respondents know that the euro will be introduced in 2008. The familiarity with some key features of the euro and EMU has slightly improved.

2.2.5. Conclusion

In the last few months, Malta has further refined and completed its practical changeover preparations and seems well prepared for the introduction of the euro. With a view to enabling businesses to give change exclusively in euro as from €-day, particular attention should be paid to ensuring an appropriate level of sub-frontloading. The comprehensive communication activities on the euro should be continued so as to further increase the support for the euro.

2.3. Other Member States

The Commission staff working paper attached to this report provides an overview of the practical preparations in the other Member States which yet have to adopt the euro.