

3 BANKNOTES AND COINS

3.1 THE CIRCULATION OF BANKNOTES AND COINS

DEMAND FOR EURO BANKNOTES AND COINS

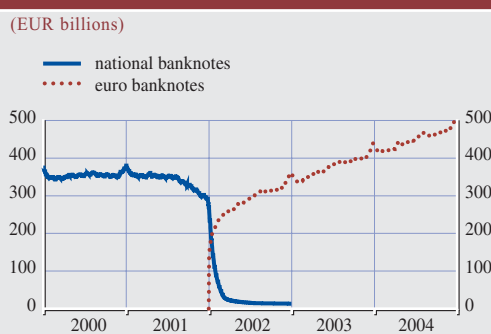
Following an annual growth rate of 22% in 2003, the value of euro banknotes in circulation increased by 15.0% in 2004, from €436.1 to €501.3 billion. The number of euro banknotes in circulation increased by 6.8% (compared with 10.1% in 2003), from 9.0 to 9.7 billion. Chart 37 shows the development of national banknotes and euro banknotes in circulation in terms of value between 2000 and 2004. Chart 38 illustrates the development of the number of euro banknotes in circulation since their introduction.

The value of banknotes in circulation has risen more steeply than the number ever since the cash changeover, which reflects the particularly strong increase in the number of high-denomination banknotes in circulation. Chart 39 shows the development of euro banknotes in circulation by denomination between 2002 and 2004. The strongest increase in demand in 2004 was for the €500 banknote, at 28.4%. Demand was also very strong for the €50 and €100 banknotes, which saw circulation growth rates of 12.4% and 13.5% respectively.

Overall growth in the number of €5, €10, €20 and €200 banknotes in circulation has been very moderate since the introduction of the banknotes in 2002, although developments may vary between countries. Only during seasonal peaks has a strong rise in demand been witnessed for the €10 and €20 banknotes, i.e. those denominations which are mainly used for daily cash transactions. In the case of the €50 banknote, both fairly high growth and seasonal fluctuations have been recorded. By contrast, the circulation of the €5 and €100 banknotes has shown only moderate seasonal variation, while that of the €200 and €500 banknotes has followed no seasonal pattern at all. It is clear that demand for transaction purposes within the euro area alone does not explain the lasting upward trend in demand for these denominations, but that other factors must also play a role. One such factor seems to be the growing international demand for euro banknotes. Recent analyses suggest that around 10% to 15% of the banknotes in circulation are held outside the euro area. Another factor is hoarding by the public, partially influenced by the low level of interest rates.

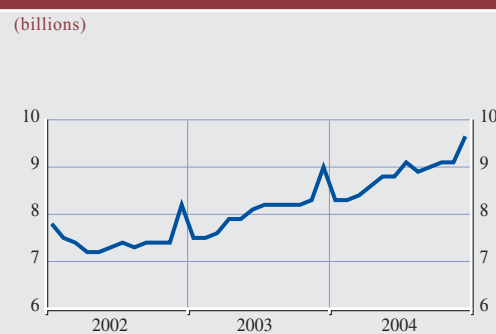
During 2004 the value of euro coins in circulation (i.e. the net circulation excluding stocks held by NCBs) increased by 9.1%, from €14.1 billion to €15.3 billion. The total number

Chart 37 Total value of banknotes in circulation between 2000 and 2004



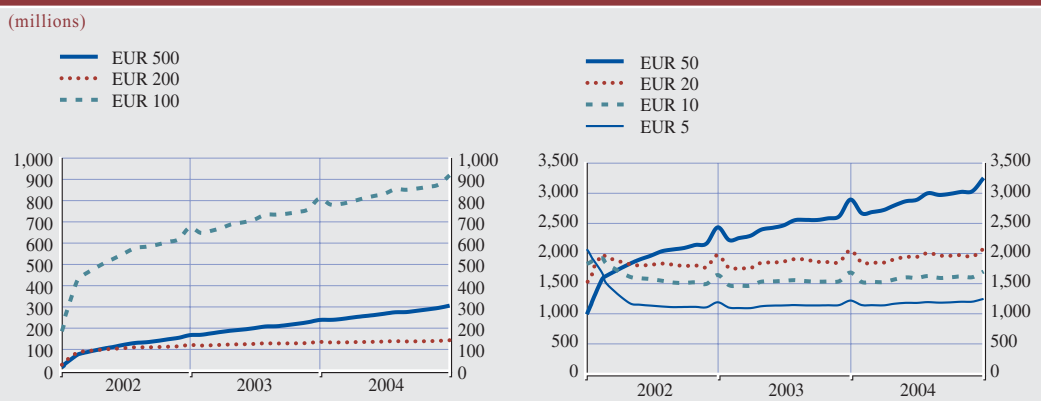
Source: ECB.

Chart 38 Total number of euro banknotes in circulation between 2002 and 2004



Source: ECB.

Chart 39 Number of euro banknotes in circulation between 2002 and 2004



Source: ECB.

of euro coins in circulation grew by 14.8% to stand at 56.2 billion. There has been a steady growth in the number of euro coins in circulation since the beginning of 2003, when the volume returned to the initial level of 40.4 billion coins issued at the time of the changeover.

BANKNOTE HANDLING BY THE EUROSISTEM

Deposits and withdrawals of euro banknotes have been quite stable for all euro area NCBs since the second quarter of 2002. Fluctuations in the monthly deposits and withdrawals mainly reflect the usual seasonal variations in banknote demand.

A total of 29.4 billion euro banknotes were processed by euro area NCBs in 2004, which was similar to the figure for 2003. Between January and December 2004 a total of 30.4 billion banknotes were issued and 29.7 billion were returned to the NCBs. The return frequency of banknotes, measured as the ratio of banknotes deposited at NCBs to the number of banknotes in circulation, has remained relatively stable since 2002 and in 2004 stood at around 3.4 times a year. 3.8 billion unfit banknotes were destroyed in 2004.

3.2 BANKNOTE COUNTERFEITING AND COUNTERFEIT DETERRENCE

COUNTERFEIT EURO BANKNOTES

Having risen steadily in 2002 and much of 2003, the rate of euro banknote counterfeiting is now relatively stable. From the last quarter of 2003 to the end of 2004, an average of around 50,000 counterfeits were recovered from circulation each month, with seasonal fluctuations coinciding with those of genuine banknotes, for example during holiday periods. The total number of counterfeits received by National Analysis Centres (NACs)⁴ in 2004 was 594,000. This represents an increase of 7.8% compared with 2003, which is substantially lower than the growth rate observed one year earlier. Chart 40 shows the trend in counterfeits recovered from

Table 14 Distribution of counterfeits by denomination

	€5	€10	€20	€50
Percentage	1	5	24	48
	€100	€200	€500	Total
Percentage	17	4	1	100

Source: Eurosystem.

⁴ Centres established in each EU Member State for the initial analysis of counterfeit euro banknotes at the national level.

circulation, with figures taken at half-yearly intervals since the banknotes were launched.

Table 14 shows that the €50 banknote remains the counterfeiters' biggest target, although some evidence emerged during the year that organised crime is increasingly targeting the €100, €200 and €500 banknotes. A small quantity of better than average counterfeits have been produced in these denominations.

Overall, it is evident that the number of counterfeits (594,000 in 2004) is a tiny fraction of the average number of genuine banknotes in circulation (8.9 billion in 2004). The public can continue to have confidence in the security of the euro: it remains a well protected currency, in terms of both the sophistication of its security features and the effectiveness of European and national law enforcement authorities. However, the public should continue to be watchful. The "feel-look-tilt" test remains sufficient to detect counterfeits in almost all cases.

COUNTERFEIT DETERRENCE

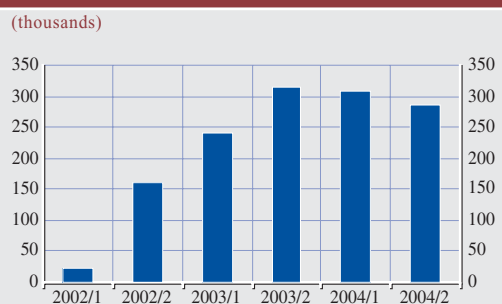
In addition to cooperating with the NCBs, Europol and the European Commission (in particular the European Anti-Fraud Office, OLAF), the ECB concluded an agreement with Interpol in 2004 on the protection of the euro and the fight against counterfeiting. Further cooperation agreements were established with the central banks of two of the EU's



neighbouring countries (Ukraine and Bulgaria), and similar agreements with other countries are envisaged for the future. The Eurosystem was active in training cash-handling professionals, both in the EU and beyond, in recognising and handling counterfeit banknotes. The Counterfeit Analysis Centre at the ECB and the NACs collaborated with the police in the fight against counterfeiting, and technicians from the NACs provided, upon request, legal authorities with expert advice and technical reports.

The International Counterfeit Deterrence Centre, hosted by the ECB, continued to evaluate new reproduction equipment and counterfeit deterrence systems and to support the Central Bank Counterfeit Deterrence Group, a joint initiative of 27 central banks worldwide.

Chart 40 Number of counterfeit euro banknotes recovered from circulation between 2002 and 2004



Source: ECB.

3.3 BANKNOTE ISSUANCE AND PRODUCTION

THE EUROSISTEM'S ROLE IN THE CASH CYCLE

In December 2004 the Governing Council agreed on common principles and objectives in respect of the Eurosystem's role and responsibilities in the cash cycle. The

definition of its role and responsibilities will contribute to the establishment of the Single Euro Payments Area (see Section 3 of Chapter 3). It also provides a reliable framework for the Eurosystem's partners in the cash cycle (i.e. the banking industry and cash-in-transit companies). In line with the principle of decentralisation, the Governing Council did not establish a fully harmonised system for euro area cash services. While some harmonisation and standardisation under the guidance of the ECB is necessary, the NCBs are responsible for the implementation at the national level, taking into account the respective national economic environment and banking structures, the existing NCB branch network and the relative share of cash payments and/or long-term agreements.

ECB FRAMEWORK FOR THE DETECTION OF COUNTERFEITS AND FITNESS SORTING

Following consultations with the banking and cash-in-transit industries, in December 2004 the ECB adopted a framework for the detection of counterfeits and the sorting of banknotes by quality (known as "fitness sorting") by credit institutions and other professional cash-handlers. The principal objectives of this framework are to implement a common policy for banknote handling and processing by credit institutions and other professional cash-handlers as well as to provide them with assistance in fulfilling their obligations according to Article 6 of Council Regulation (EC) No 1338/2001 regarding the detection and withdrawal of counterfeit euro banknotes. NCBs will implement this framework within their jurisdiction by the end of 2006 at the latest. There will be a two-year transition period, ending no later than the end of 2007, for the adaptation of procedures and existing machines in operation by credit institutions and other professional cash-handlers.

PRODUCTION ARRANGEMENTS

A total of 1.6 billion banknotes were produced in 2004, compared with 3.1 billion in 2003. This significant reduction in the 2004 production requirement was primarily due to a

Table 15 Allocation of euro banknote production in 2004

Denomination	Quantity (millions of banknotes)	NCB commissioning production
€5	-	-
€10	378	DE, FR, GR, IE, AT
€20	290	FR, PT
€50	683	BE, DE, ES, IT, NL
€100	124	IT, FI
€200	-	-
€500	124	DE, LU
Total	1,599	

Source: ECB.

lower actual replacement need than expected in 2003.

Since 2002 the production of euro banknotes has been allocated to the NCBs in accordance with a decentralised production scenario with pooling. Under this arrangement, each euro area NCB is responsible for the procurement of an allocated share of the total requirement for certain denominations. Table 15 summarises the 2004 production allocation.

The arrangements for future banknote procurement are laid down in Guideline ECB/2004/18, adopted by the Governing Council in September 2004. The Guideline establishes a single Eurosystem tender procedure for the production of euro banknotes, which will be implemented by 1 January 2012 at the latest. The implementation of this procedure will be preceded by a transitional period, thus allowing NCBs and the printing works ample time to prepare for the new procedure. This transitional period will start no earlier than 1 January 2008, but the precise starting date – which will be decided by the Governing Council – is dependent on the achievement of a critical mass in terms of both the number of NCBs agreeing to participate in the single Eurosystem tender procedure and the total volume of banknotes to be tendered.

The Guideline has been developed in accordance with the principle of an open market economy with free competition, favouring an efficient allocation of resources,

and in line with EU competition law. In particular, the objectives of the procedure are to ensure equal treatment of all printing works wishing to participate in the single Eurosystem tender procedure, as well as to guarantee transparency and the continued secure production of euro banknotes. The tender rules laid down in the Guideline will apply to the Eurosystem's entire banknote requirement. Those NCBs with in-house printing works or those using public printing works may decide not to participate in the single Eurosystem tender procedure and will then continue to produce the euro banknotes allocated to them in those printing works.

VERY LOW-DENOMINATION BANKNOTES

In response to suggestions from various sources, the Eurosystem examined the potential positive and negative aspects of introducing very low-denomination banknotes, i.e. €1 and/or €2. After careful consideration, the Governing Council decided in November 2004 not to revise the decision it had taken in 1998 on the denominations of euro banknotes and, consequently, not to issue €1 or €2 banknotes. Having assessed all the arguments put forward in the debate, the Governing Council concluded that, on balance, the negative aspects of introducing very low-denomination banknotes outweighed the positive aspects. The insufficient demand for very low-denomination banknotes by the majority of euro area citizens, the increased inefficiency which their introduction would imply for most of the affected third parties – for instance, the retail sector and the vending machine industry – and the high costs of printing and processing contributed in particular to this decision.