

3 BANKNOTES AND COINS

3.1 THE CIRCULATION OF BANKNOTES AND COINS AND THE HANDLING OF CURRENCY

DEMAND FOR EURO BANKNOTES AND COINS

At the end of 2006 the number of euro banknotes in circulation stood at 11.3 billion, with a value of €628.2 billion, which represented an increase of 9.5% in terms of volume and 11.2% in terms of value compared with the levels at the end of 2005 (10.4 billion banknotes with a value of €565.2 billion). The value of banknotes in circulation has continued to rise since the euro cash changeover in 2002, albeit at a diminishing annual growth rate (see Charts 44 and 45). It is estimated that, in value terms, between 10% and 20% of the euro banknotes in circulation are held by non-euro area residents, who continue to generate demand for euro banknotes, mainly as a store of value or as a parallel currency.

The dynamic growth of the number of €50, €100 and €500 banknotes in circulation continued in 2006, with rates of 12.5%, 9.6% and 13.2% respectively. The number of the other denominations in circulation rose at rates of between 2.7% and 8.2% (see Chart 46).

In 2006 the total number of euro coins in circulation (i.e. the net circulation excluding stocks held by NCBs) grew by 10.4% to 69.5 billion, while the value of coins in circulation rose by 7.4% to €17.9 billion. The comparatively strong increase in the number of coins was

mainly due to the continuing strong demand for low-value coins resulting from relatively high loss rates and hoarding.

BANKNOTE HANDLING BY THE EUROSISTEM

Euro banknote issues and withdrawals continued to follow the slight upward trend observed in previous years. In 2006 the euro area NCBs issued 32.5 billion banknotes, while 31.5 billion banknotes were returned to them. The return frequency¹⁶ of banknotes in circulation fell slightly from 3.17 in 2005 to 3.03 in 2006. All euro banknotes returned from circulation to the euro area NCBs are authenticated and checked for circulation fitness using fully automated banknote-processing machines in order to maintain the quality of the banknotes in circulation. In this process, some 5.2 billion banknotes (an increase of 26.2% compared with the previous year) considered to be unfit for circulation were replaced by the NCBs.

3.2 BANKNOTE COUNTERFEITING AND COUNTERFEIT DETERRENCE

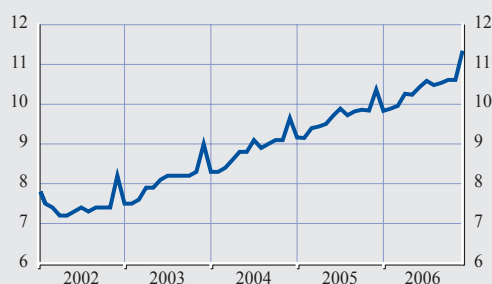
COUNTERFEIT EURO BANKNOTES

Following two years in which the number of counterfeit euro banknotes removed from circulation remained stable, a slight decline

¹⁶ Defined as the total number of banknotes returned to NCBs in a given period divided by the average number of banknotes in circulation during that period.

Chart 44 Total number of euro banknotes in circulation between 2002 and 2006

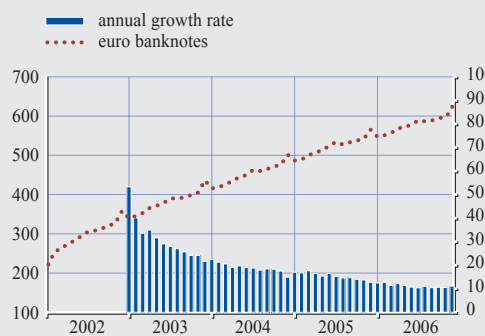
(billions)



Source: ECB.

Chart 45 Total value of euro banknotes in circulation between 2002 and 2006

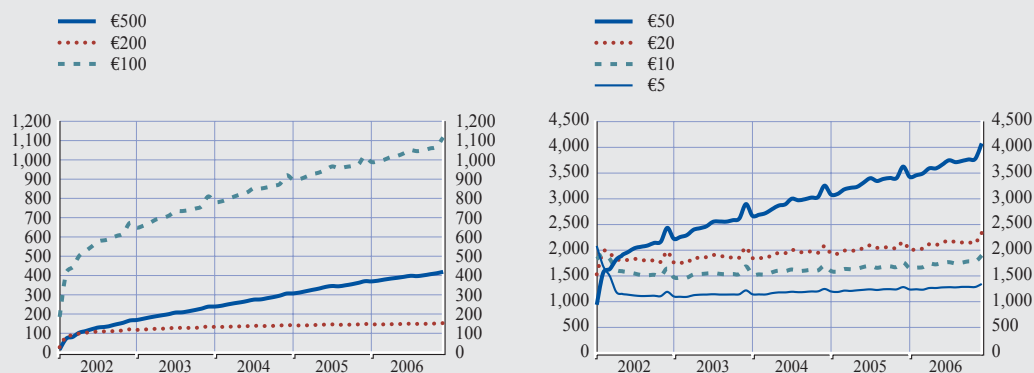
(EUR billions, left-hand scale; percentages, right-hand scale)



Source: ECB.

Chart 46 Number of euro banknotes in circulation between 2002 and 2006 by denomination

(millions)



Source: ECB.

occurred in 2006. Chart 47 shows the trend in counterfeits removed from circulation, with figures taken at half-yearly intervals since the euro banknotes were launched. The total number of counterfeits received by National Analysis Centres¹⁷ in 2006 was around 565,000¹⁸. A significant development in 2006 was the change in the denominational split of counterfeits detected. Before 2006 the €50 banknote was the counterfeiters' biggest target. However, the proportion of counterfeit €50 banknotes detected has fallen sharply, with a corresponding rise in both the number of counterfeit €20 banknotes and, to a much lesser extent, the number of counterfeit €100 banknotes (see Table 13). As a result, the total face value of counterfeits removed from circulation, and therefore the potential financial damage caused by counterfeiting, diminished in 2006.

The public can be confident in the security of the euro: it is a well-protected currency, in

Table 13 Distribution of counterfeits by denomination

	€5	€10	€20	€50
Percentage	1	4	40	34
	€100	€200	€500	Total
Percentage	18	2	1	100

Source: Eurosystem.

terms of both the sophistication of its security features and the effectiveness of European and national law enforcement authorities. However, this confidence should never give rise to complacency, and the ECB's advice to the public is to be alert and to remember the "feel-look-tilt" test.¹⁹

COUNTERFEIT DETERRENCE

The Eurosystem continued in 2006 to work closely with Europol and the European Commission (in particular the European Anti-Fraud Office, OLAF) in the fight against counterfeiting of the euro. The Eurosystem is active, both in the EU and beyond, in training professional cash handlers in the recognition and handling of counterfeit banknotes.

The International Counterfeit Deterrence Centre continues to support the Central Bank Counterfeit Deterrence Group (a group of 27 central banks cooperating under the auspices of the G10) and acts as the technical centre for all members. Its main role is to provide technical support and to operate a centralised communication system serving all parties

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

18 This figure is subject to a very slight correction on account of late reports, particularly from outside the EU.

19 For details, see <http://www.ecb.int/bc/banknotes/security/html/index.en.html>

Chart 47 Number of counterfeit euro banknotes recovered from circulation between 2002 and 2006



Source: Eurosystem.

involved in the field of counterfeit deterrence systems.

3.3 BANKNOTE ISSUANCE AND PRODUCTION

FRAMEWORK FOR THE DETECTION OF COUNTERFEITS AND FITNESS SORTING

The Banknote Recycling Framework (BRF) covers the detection of counterfeits and fitness sorting by credit institutions and other professional cash handlers. It establishes a common policy for the recirculation of euro banknotes within the credit sector and defines uniform rules and minimum standards for banknote processing which are to be followed by credit institutions and other professional cash handlers. Following a decision taken by the Governing Council in December 2004, all except two of the euro area NCBS have now transposed the BRF into national arrangements.

Credit institutions and other professional cash handlers will have a transitional period until the end of 2007 to adapt their banknote handling machines to the new requirements. In view of the significant differences in national cash-handling infrastructures, the Governing Council decided in December 2006 to extend the one-year transitional period in some euro area countries. The transitional period will be

extended by two years for France, where it will expire at the end of 2009, and by three years for Greece, Spain, Ireland, Italy and Portugal, where it will finish at the end of 2010.

A central element of the BRF is the requirement to check banknotes to be dispensed by automated teller machines for authenticity and circulation fitness using staff-operated machines which comply with Eurosystem standards. Customer-operated cash deposit and cash recycling machines must also comply with certain technical standards regarding the verification and subsequent handling of banknotes. Most of the euro area NCBS have provided machine manufacturers with tests for their equipment. In addition, the ECB has established a webpage listing all machines which have passed the Eurosystem's common test procedure and are thus suitable for recycling purposes.

In July 2006 the Governing Council decided on a transitional regime for the future implementation of the BRF in new euro area countries. It requires the NCBS of those Member States adopting the euro before 2010 to implement the BRF at the latest within 12 months of joining the euro area. There will then be a one-year transitional period for credit institutions and other professional cash handlers. The NCBS of Member States entering the euro area from 2010 will have to implement the BRF before joining, but credit institutions and other professional cash handlers will still have a one-year transitional period to adapt their equipment.

By adapting their operations in accordance with the BRF, credit institutions and other professional cash handlers will strengthen their ability to detect potential counterfeit euro banknotes. This will effectively contribute to their compliance with the legal obligation to remove potential counterfeits from circulation immediately and to make them available to law enforcement authorities for further investigation. Furthermore, it will ensure that credit institutions supply customers with banknotes that are in good physical condition, thus helping

them to distinguish between genuine and counterfeit banknotes.

THE ESTABLISHMENT OF AN EXTENDED CUSTODIAL INVENTORY PILOT PROGRAMME

The Governing Council decided in 2006 to launch an Extended Custodial Inventory (ECI) pilot programme in Asia. An ECI is a cash depot maintained by a private bank (ECI bank) that holds currency on a custodial basis. The Eurosystem expects the ECI programme to facilitate the international distribution of euro banknotes and to improve the monitoring of their circulation outside the euro area. Since between 10% and 20% of the total value of euro banknotes in circulation is estimated to be held outside the euro area, the Eurosystem deems it useful to obtain better information on these banknotes. Following an open tender procedure, two large commercial banks active in the wholesale banknote market have been selected to operate one ECI each; one ECI will be established in Hong Kong and the other one in Singapore. The Deutsche Bundesbank will be the logistical and administrative counterpart for the ECI banks. Both ECIs will become operational in the first half of 2007. The ECI pilot programme will be used to assess the functioning of ECIs, their contribution to the information on euro banknotes in circulation outside the euro area, and their impact on the wholesale banknote market. On the basis of this pilot programme, the Governing Council will decide in 2008 whether to continue with the ECI programme.

DIALOGUE WITH THE EUROPEAN PAYMENTS COUNCIL AND OTHER STAKEHOLDERS IN THE CASH CYCLE

Information about the user requirements of different stakeholders – the banking industry being the main counterpart of the NCBs – is important for the smooth functioning of the euro cash cycle and the delivery of appropriate cash services by the Eurosystem. Topical cash issues, such as overall cost reductions, are discussed with European stakeholders in various fora, such as the Euro Cash User Group and the

European Payments Council's Cash Working Group.

The organisation of the cash supply chain differs from one country to another, in view of the different national environments (e.g. the structure of the central bank and commercial banking systems, the legal regime, the payment behaviour of the general public, the cash-in-transit infrastructure and geographical considerations). As a consequence, a "one-size-fits-all" model for cash supply in the euro area is not desirable. However, the Governing Council decided in September 2006 that a timetable and roadmap should be established with the aim of achieving greater convergence in NCB cash services in the medium term.

PRODUCTION ARRANGEMENTS

A total of 7.0 billion euro banknotes were produced in 2006, compared with 3.63 billion in 2005. The lower production volume in 2005 was caused to a considerable extent by the use of the banknote surpluses accumulated since 2002, as the uncertainties surrounding the introduction of the euro warranted high production volumes for the initial supply.

The rise in production growth in 2006 reflected the following factors: i) an increase in circulation, ii) a rise in the number of unfit banknotes, iii) the depletion of the NCBs' stock levels and iv) the decision to produce in 2006 a part of the future banknote requirements.

The allocation of euro banknote production continued to be based on the decentralised production scenario with pooling adopted in 2002. Under this arrangement, each euro area NCB is responsible for the procurement of an allocated share of the total requirement for certain denominations (see Table 14).

Table 14 Allocation of euro banknote production in 2006

Denomination	Quantity (millions of banknotes)	NCB commissioning production
€5	1,080.0	ES, FR, IE, AT, FI
€10	1,780.0	DE, GR, FR, NL
€20	1,940.0	DE, ES, FR, IT, PT
€50	1,920.0	BE, DE, ES, IT, NL
€100	280.0	IT, LU, AT
€200	-	-
€500	-	-
Total	7,000.00	

Source: ECB.

THE SECOND SERIES OF EURO BANKNOTES

Following a preparatory phase in which the requirements for the new series of banknotes were established and an inventory was made of possible technical improvements, the Governing Council in 2006 approved the overall project plan for the development of the new series and the start of the industrial validation phase. This phase involves testing different security features to assess their performance and to identify potential problems in a large-scale production environment. The majority of the industrial validation activities are carried out by paper mills and printing works accredited by the ECB for the production of the current series. On the basis of the results of the industrial validation phase, the general specifications for the new series of banknotes will be defined and work on the design will start.

The design of the new banknotes will be based on the “ages and styles” theme of the first series, and a number of design elements from that series will be used in the new design. A designer has been chosen to redesign the present series.

The first banknote in the new series is expected to be issued in a few years’ time. The exact timing and sequence of issuance will, however, depend on the progress made in the development of new security features and on the counterfeiting situation. The different denominations of the new series will be launched over a period of several years.