

# Euro Survey of Spring 2010: Sovereign Debt Crisis Left Traces in CESEE Households' Sentiment, Foreign Currency Portfolios Broadly Unchanged

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*The OeNB Euro Survey's spring wave was conducted in May and June 2010 at a time of highly exceptional circumstances in the EU and in the euro area, which appear to have had a significant effect on CESEE households' trust in the euro. However, it can be assumed that the reported low trust levels were extraordinary and of only temporary nature. Nevertheless, confidence in the euro was still "ahead" of that in the respective local currencies. By contrast, trust in the EU as an institution remained rather high in almost all countries surveyed and continued to be substantially higher than trust in domestic governments. Despite worsened results from some sentiment-related questions, people did not adjust their foreign currency portfolios. The deposit substitution index (DSI) as well as the projected amount of euro cash holdings per capita remained broadly unchanged throughout the region.*

*JEL classification: D14, E41, E50, G01*

*Keywords: Euroization, global financial crisis, portfolio decision, survey data, Central, Eastern and Southeastern Europe*

## 1 Introduction

The OeNB Euro Survey's spring wave was conducted in May and June 2010, at a time when the overall situation in the EU in general, and in the euro area in particular, was highly exceptional. The adoption of the support package for Greece in March 2010, the creation of the European Stabilization Mechanism in May 2010 and a strong commitment to accelerated fiscal consolidation contributed to restoring confidence both in the euro area and the EU in the following months. However, it can be expected that broad media coverage of these events in the CESEE region fed into changes in people's sentiment. The survey results provide a unique snapshot on CESEE households' perceptions, including possible changes in their sentiment vis-à-vis the euro as well as changes in their behavior as regards the use of the euro in their countries.

This article is structured as follows. Section 2 presents survey evidence on CESEE households' sentiment as of spring 2010, in particular on their trust in the euro and in their respective local currencies, on their trust in the EU as compared to their domestic governments as well as on their expectations regarding euro adoption. Section 3 analyzes whether the reported changes in households' sentiment entailed any changes in their actual behavior: We will examine whether people rearranged their portfolios, i.e. whether they exchanged their foreign currency holdings (both cash holdings as well as saving deposits) into local currencies or into other foreign currencies (U.S. dollar, Swiss franc). Section 4 concludes.

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## 2 Exceptional Circumstances in the EU Left Traces in CESEE Households' Sentiment

Since its launch in fall 2007, the OeNB Euro Survey has contained questions about the perceived stability and trustworthiness of the euro as well as of the respective local currencies. Previous results from the OeNB Euro Survey showed a generally very high level of confidence in the euro in all countries surveyed, especially as compared to trust in the respective local currencies (see Dvorsky, Scheiber and Stix, 2009). While the arrival of the financial crisis in the fall of 2008 had marked a temporary decline of trust in the euro and the respective local currencies in some CESEE countries, trust levels recovered in the months afterward and partly reached pre-crisis levels again.

### 2.1 Trust in the Euro Affected by Developments in the Euro Area

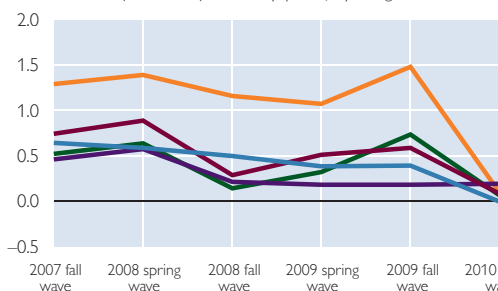
The new results obtained from the 2010 spring wave, however, reveal a significant decline of trust in the euro. This decline can be observed in nine out of ten countries surveyed and it is substantial in some countries (see chart 1). Moreover, the survey contains a forward-looking question on respondents' expectations regarding the euro's stability and trustworthiness over the next five years. Results from this question render a very similar picture as presented in chart 1, reflecting the increased uncertainty surrounding the euro area at the time the survey interviews were conducted.

Chart 1

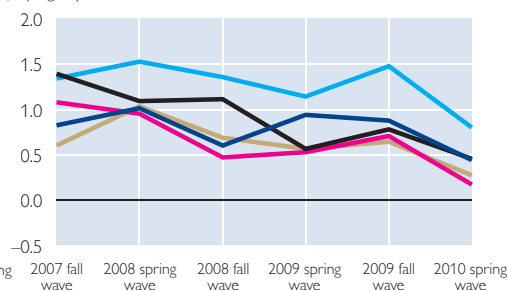
#### Consent to the Statement: Currently, the Euro Is Very Stable and Trustworthy

##### EU Member States

Normalized sample means per country (-2.5 fully disagree, 0 neutral, +2.5 fully agree)



##### (Potential) Candidate Countries



Source: OeNB Euro Survey.

Note: Respondents were asked whether they agreed or disagreed on a scale from 1 (fully agree) to 6 (fully disagree) to the statement above.

This observed decline in trust might have been aggravated by the marked depreciation of the euro vis-à-vis the U.S. dollar in the period from mid-May to mid-June 2010.

Given the particular timing<sup>2</sup> of the spring wave, it can be assumed that the reported trust levels were exceptionally low and only of a temporary nature. Most

<sup>2</sup> In four countries, interviews started on May 6, in the remaining countries on May 10, 2010. This means the survey was conducted virtually at the same time the European Stabilization Mechanism was adopted (May 9, 2010) and Greece received the first instalment of the EU-IMF support package (May 18, 2010).

likely, a recovery of trust already took place over the summer months. More recent survey results that might confirm this hypothesis will only be available at the end of 2010, however.

## 2.2 Trust in the Euro Still “Ahead” of Trust in Local CESEE Currencies

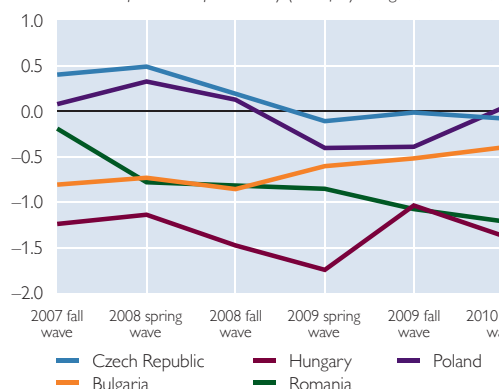
Interestingly, decreased trust in the euro does not translate into short-term gains of trust in the local currencies (see chart 2). Compared over a longer time period e.g. with pre-crisis levels and neglecting smaller changes in trends and ups and downs during the recent crisis period, the loss in trust regarding the Romanian and the Serbian currencies is particularly pronounced, while trust in the Hungarian forint continued to be exceptionally low. However, according to results obtained from the forward-looking question regarding the expected stability of the local currencies over the next five years, Hungarian respondents seem to have more favorable expectations, while Romanian and Serbian respondents are very skeptical even regarding the future.

Chart 2

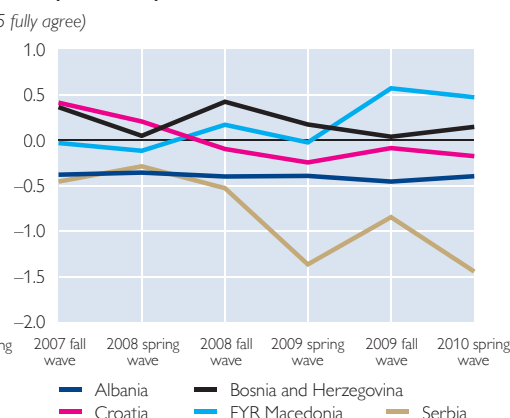
### Consent to the Statement: Currently, the Local Currency Is Very Stable and Trustworthy

#### EU Member States

Normalized sample means per country (-2.5 fully disagree, 0 neutral, +2.5 fully agree)



#### (Potential) Candidate Countries



Source: OeNB Euro Survey.

Note: Respondents were asked whether they agreed or disagreed on a scale from 1 (fully agree) to 6 (fully disagree) to the statement above.

When relating the perceived stability of the local currency to actual exchange rate developments (vis-à-vis the euro), one can separate three groups of countries.

The first group consists of countries whose exchange rate has markedly depreciated against the euro since the beginning of the crisis in fall 2008: Albania, Serbia and Romania. In line with actual exchange rate movements, people’s assessment of the stability of their local currency declined or remained low (in the case of Albania).

The second group of countries experienced depreciation during the crisis months but their currencies rebounded afterward: Hungary, Poland and the Czech Republic. For these countries, again, respondents’ sentiment toward the local currency seems to be correlated with actual exchange rate movements.

The third group consists of countries whose exchange rate was kept stable or relatively stable during the crisis (the two currency board countries Bulgaria and

Bosnia-Herzegovina as well as FYR Macedonia and Croatia). In these countries, the assessment of the stability of the local currency remained high or even increased since the beginning of the crisis – with the notable exception of Croatia, where sentiment toward the kuna deteriorated.

To sum up, while exchange rate developments may have played a role for people's confidence in their local currencies, the assessment of a country's overall economic situation may also have contributed to this picture: A comparison of the perceived stability of the euro with that of the local currencies reveals that the euro is still "ahead" of the respective local currencies in all countries surveyed. However, in the Czech Republic and Poland – the two countries which had shown the best economic performance throughout the region over the previous six months – the difference melted away and is now very small compared to previous waves. By contrast, in Hungary, Romania and Serbia the lead of the euro is still considerable.

### 2.3 Trust in the EU Remains Very High throughout the CESEE Region

While the instabilities of the euro area during spring 2010 seem to have contributed to a significant decline in trust in the euro in nine out of ten countries surveyed, the general level of trust in the EU as an institution appears to have hardly been affected. Furthermore, in all the countries concerned, the level of trust in the EU is above the level of trust in the respective domestic government (for trust in domestic governments, see annex, chart 9). Thus, it can be argued that the package of measures the EU adopted in spring 2010 to preserve financial stability in Europe was perceived as credible by CESEE households and that the EU as an institution successfully proved its ability to manage a crisis situation.

Chart 3

#### Trust in the European Union



Source: OeNB Euro Survey.

Note: Respondents were asked whether they trusted the respective institution on a scale from 1 (I trust completely) and 5 (I do not trust at all). Results are based on the share of respondents answering "rather trust" (2) or "trust completely" (1). The answers "Don't know" and "No answer" are not included. \*\*\* indicate a statistically significant change in normalized sample means (at the 1% level) between the 2009 fall and the 2010 spring waves.

Chart 3 depicts the results on respondents' trust in the EU, which generally speaking remained broadly unchanged over the past one and a half years in many countries – with the exception of Bulgaria, Romania and FYR Macedonia, where it significantly decreased as compared to the 2009 fall wave, but still remained at a comparatively high level. For Romania, this substantial loss of confidence in the EU might be related to the perception of the austerity measures under the EU-IMF balance-of-payments support program. However, in all three countries trust in the EU was still higher than trust in the respective national government.

As regards reported levels of trust in the EU, Croatia and Serbia are exceptions throughout the CESEE region. In Croatia, despite substantial progress in the country's EU accession negotiations during the six months preceding the spring wave (following the successful resolution of the border dispute with Slovenia), only below 20% of respondents said they had trust in the European Union. For Serbia, levels of trust are also reported to be still very low, albeit showing a significant increase as compared to the previous survey wave.

#### **2.4 Dampened Expectations on Future Euro Adoption in EU Member States**

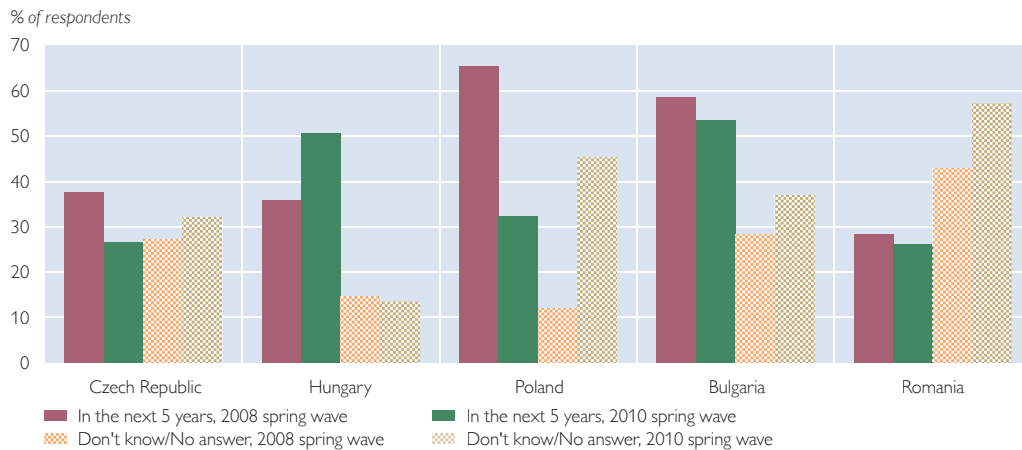
During the 2010 spring wave, people were also asked when they expected the euro to be introduced in their respective countries. When comparing results for the EU Member States surveyed to those obtained from the 2008 spring wave (see Dvorsky, Scheiber and Stix, 2008), it is quite striking that the share of respondents who expect the euro to be introduced in their countries within the next five years has decreased in four of the five Member States (see chart 4). The largest drop was recorded in Poland, where the share of respondents expecting euro introduction within the next five years more than halved against 2008 results. At the same time, the share of replies in the “I don't know/no answer” category increased substantially and reached close to 50% in Poland and even 60% in Romania, possibly reflecting the increased perception of uncertainty surrounding euro adoption in an environment of economic and financial crisis.<sup>3</sup> The only exception in this context seems to be Hungary, where the share of people expecting euro introduction within the next five years even increased to around 50%, with only around 10% answering they did not know. Interestingly, these results seem to be largely unrelated to the respective countries' official announcements on euro adoption plans.<sup>4</sup>

<sup>3</sup> *Contrary to previous OeNB Euro Survey results, the current results do not seem to be in line with the European Commission's most recent Eurobarometer, which draws a markedly more optimistic picture for all EU Member States covered (see European Commission, 2010a). The results are, however, not fully comparable, as the dominant mode of the Eurobarometer are telephone interviews (as opposed to the face-to-face interviews mainly used in the OeNB Euro Survey). Furthermore, the Eurobarometer questionnaire deals exclusively with euro-related questions, whereas the euro-related questions in the OeNB Euro Survey are part of a larger set of questions on a wide range of topics.*

<sup>4</sup> *While Bulgaria maintains its official target of introducing the euro “as soon as possible,” Romania quotes “2015” as the official target date for euro adoption. Poland seems to pursue a more cautious policy stance, announcing ERM II entry “as soon as conditions are met.” The Czech Republic and Hungary currently do not announce any official target date (see European Commission, 2010b).*

Chart 4

### Trust in the European Union



Source: OeNB Euro Survey.

Note: The categories "5 years and later" and "Never", which are not shown in the chart, represent the remaining percentage share.

From people's answers to the question of when they expected the euro to be introduced in their respective countries, median years of euro adoption were calculated. A comparison of these median years derived from the 2010 and 2008 spring waves reveals that in four of the five EU Member States analyzed, people expect euro adoption later than previously (see table 1).

Table 1

### Expected Date for the Adoption of the Euro in EU Member States

	Median <sup>1</sup> 2008	Median <sup>1</sup> 2010
Czech Republic	2013	2016
Hungary	2015	2015
Poland	2012	2015
Bulgaria	2011	2013
Romania	2013	2015

Source: OeNB Euro Survey.

<sup>1</sup> Calculated median years are based on the question: "When, in which year, do you think the euro will be introduced in your country?"

This generally worsened sentiment on the possible date of euro adoption in four out of five EU Member States surveyed probably reflects people's awareness that the consequences of the financial and economic crisis, both for the euro area and for the respective countries, might pose additional challenges to further euro area enlargement. Moreover, people may have taken note of the growing fatigue of euro area decision makers with regard to taking in new members.

### 3 Foreign Currency Holdings of CESEE Households Broadly Unaffected by Worsened Sentiment: Role of the Euro Remains Predominant

Given CESEE households' perceptions on the decreased trustworthiness of the euro as well as their dampened expectations regarding the future adoption of the euro by their respective countries, it might be assumed that people adjusted their behavior with respect to their foreign currency portfolios and, in particular, their euro holdings. Therefore, section 3.1 examines households' behavior with respect to savings deposits and section 3.2 takes a closer look at their foreign currency cash holdings. Evidence is available from a question on the perceived attractiveness of savings deposits and cash holdings (in both cases, foreign versus local currency). These survey results will be analyzed against the background of aggregate statistics on households' savings deposits (section 3.1) and projections on euro cash holdings per capita (section 3.2).

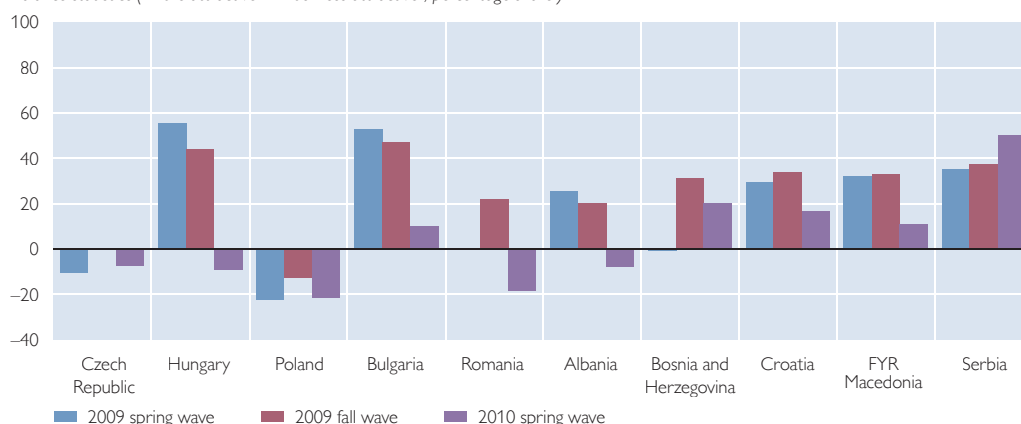
#### 3.1 Foreign Currency Deposits: Virtually No Change

Chart 5 shows that in spring 2010 the perceived attractiveness of foreign currency deposits decreased substantially in all countries surveyed, with the only exception of Serbia. By contrast, in 2009, a majority of respondents in six countries had assessed foreign currency deposits as safer than those in local currency (see Dvorsky, Scheiber and Stix, 2009). Given the sharp decline in trust in the euro observed in the same survey wave, this U-turn, however, does not come as a surprise.

Chart 5

#### Attractiveness of Deposits in Foreign Currency versus Deposits in Local Currency

Balance statistics ("more attractive" minus "less attractive", percentage share)



Source: OeNB Euro Survey.

Note: Recorded answers are based on the question "How has the economic and financial crisis changed your attitude towards the following types of savings... Have they become a lot safer in terms of preserving the value of your savings?" The sample is restricted to respondents holding deposits or transaction accounts.

Did this substantial change in CESEE households' sentiment on foreign currency deposits lead to an actual change in their behavior, i.e. to a reshuffling of savings deposits from foreign currencies into the respective local currency? Chart 6 depicts the deposit substitution index (DSI) for the ten CESEE countries under observation. It shows quite clearly that the share of foreign currency-denominated

deposits in total deposits remained virtually unchanged in nine of the ten countries surveyed between October/November 2009 and May/June 2010 – only in FYR Macedonia, the DSI decreased by 4 percentage points since February 2010.

The absence of any large changes in savings behavior implies that the extent of financial euroization continues to follow the usual pattern across the CESEE region: A comparatively low level of deposit substitution prevails in the Czech Republic, Hungary and Poland, while the other countries display medium substitution levels, and the “extreme cases” of Croatia, Serbia and FYR Macedonia are at the high end of the spectrum.

Why did people not convert their foreign currency, i.e. euro, savings deposits into local currency, although at the same time they report to be increasingly skeptical as regards the preservation of the value of their savings? First, the reputation of the euro as a stable and trustworthy currency, despite its recent downturn, is still considerably higher than that of the respective local currencies in those countries where euro deposits play a significant role. Second, trust in the EU as an institution remained at a comparatively high level in all countries, and recent EU crisis management measures were obviously perceived as credible. Third, evidence from the fall of 2009 shows that higher interest rates offered for deposits in local currency did not change respondents' perception that euro deposits were more attractive than those in local currency (Stix, 2010). Finally, practical considerations, such as banking fees, agreed maturity periods or lack of time may have reduced people's readiness to convert their savings deposits.

Chart 6

### Deposit Substitution Index



Source: National central banks.

Note: Deposit substitution index (DSI) = Foreign currency deposits divided by total deposits of the household sector; averages of May/June and October/November, respectively. Data on foreign currency deposits for Croatia do not include deposits indexed in foreign currency. Entries for Bosnia and Herzegovina comprise savings deposits of households and the corporate sector.



An alternative option for CESEE households would have been to convert (parts of) their euro-denominated deposits into alternative foreign currencies, such as the U.S. dollar or the Swiss franc. In particular, this might have been expected for countries where anecdotal evidence suggests a certain “tradition” or “culture” of using e.g. the U.S. dollar, such as Albania or Romania. Evidence from aggregate statistics on household deposits, however, does not point into this direction. In general, the currency composition within foreign currency-denominated savings deposits remained broadly unchanged, and if any adjustments were found, they were only small.<sup>5</sup>

### 3.2 Euro Cash Holdings Broadly Unchanged

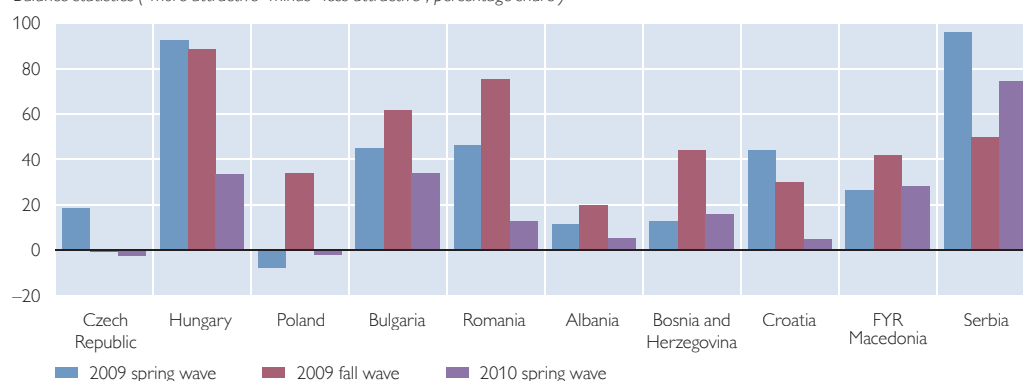
Foreign currency cash holdings – and in particular euro cash holdings – play an economically significant role throughout the CESEE region (see e.g. Scheiber and Stix, 2009). Particularly high amounts of cash holdings are typically reported from four non-EU members covered by the survey, namely Albania, Croatia, FYR Macedonia and Serbia. Reasons for this behavior can be mainly found in the past. First, people still remember past periods of instability in their countries and therefore hold foreign currency cash as a means of precaution, i.e. they “save” in foreign currency cash. Second, these countries have a certain “history” of using legacy currency cash for transactions (Deutsche mark and Austrian schilling) before the euro cash changeover. Third, network effects creating a necessity for economic agents to keep euro cash holdings contribute to the continuous use of euro cash in the countries surveyed.

Survey evidence from a direct question on the attractiveness of cash holdings might shed some light on the question whether the recent crisis situation in the EU influenced people’s attitude. Chart 7 clearly shows that the special circumstances

Chart 7

#### Attractiveness of Foreign Currency Cash versus Local Currency Cash

Balance statistics (“more attractive” minus “less attractive”, percentage share)



Source: OeNB Euro Survey.

Note: Recorded answers are based on the question “How has the economic and financial crisis changed your attitude towards the following types of savings... Have they become a lot safer in terms of preserving the value of your savings?” The sample is restricted to respondents holding deposits or transaction accounts.

<sup>5</sup> Monthly statistics on the foreign currency composition of household deposits were available for the Czech Republic, Bosnia and Herzegovina, Bulgaria and Romania. We found a significant decline of euro denominated deposits versus other foreign currency deposits in May and June 2010 (from 91.3% in April to 88.8% in August) only in Romania.

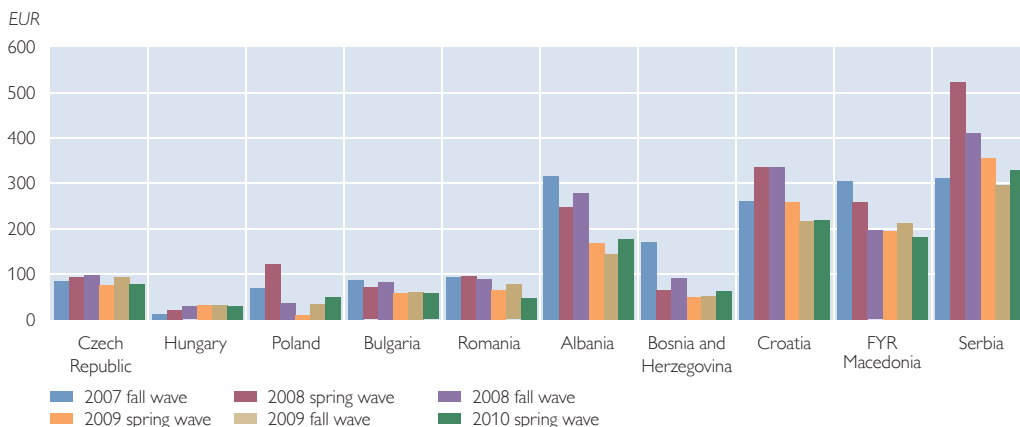
prevailing in the EU at the time of the 2010 spring wave had an impact on CESEE households' assessment of the attractiveness of euro cash holdings. In all countries surveyed, with the only exception of Serbia, respondents on average assessed foreign cash holdings to be substantially less safe than six months earlier.

Given this worsened assessment as well as the general decline in trust in the euro across the entire CESEE region at the time of the 2010 spring wave, one might have presumed that households reduced their euro cash holdings and at least partly converted them into the respective local currency.

Chart 8 reveals that this did not happen. Based on the current survey results, the projected amount of euro cash holdings per capita remained virtually unchanged in comparison to six months earlier. The only exception is Romania, where a substantial drop of euro cash holdings per capita was recorded. The country's very difficult economic situation, which is also reflected in a generally more pessimistic sentiment reported from Romania in spring 2010 as compared to the other CESEE countries, suggests that Romanian households used their cash reserves for consumption purposes.<sup>6</sup>

Chart 8

### Projected Amount of Euro Cash Holdings per Capita



Source: OeNB Euro Survey.

Note: Projections per capita refer to the population older than 14 years.

What are the possible explanations for respondents' behavior with respect to their euro cash holdings? Why do the extraordinary circumstances prevailing in the euro area in spring 2010 not seem to have had a substantial impact on respondents' behavior? First, for some countries this may be explained by network effects, which prompt economic agents to keep euro cash holdings because other agents do so as well. Second, the euro's relatively high reputation as compared to some local currencies might have played a role. This is in line with survey evidence on deposits (section 3.1). Finally, the generally high level of trust in the EU as an institution might have contributed to this behavior.

<sup>6</sup> In a similar vein, direct evidence from ad hoc questions of the 2009 fall wave of the OeNB Euro Survey confirmed that households that had withdrawn money from savings deposits during the financial crisis had to use at least parts of it for consumption purposes and did not bring it back to the banking system (see Dvorsky, Scheiber and Stix, 2010). Furthermore, monetary statistics on Romania show that the annual growth rate of total savings deposits decelerated considerably during the course of 2010.

#### 4 Conclusions

When the recent OeNB Euro Survey was carried out in spring 2010, circumstances prevailing in the EU and the euro area were highly unusual.

Therefore, it comes as no surprise that CESEE households' sentiment on the reputation of the euro was markedly affected. However, it can be assumed that the reported low trust levels were exceptional and of only temporary nature. Nevertheless, confidence in the euro was still "ahead" of that in the respective local currencies. By contrast, trust in the EU as an institution remained rather high in almost all countries surveyed and continued to be substantially higher than trust in domestic governments. In four out of five EU Member States surveyed, we observe that respondents expect euro adoption later than they did in 2008. This probably reflects people's awareness that the consequences of the financial and economic crisis, both for the euro area itself as well as for the other EU Member States, might pose additional challenges to further euro area enlargement.

While this generally deteriorated picture of CESEE households' sentiment would have suggested that people changed their behavior with respect to their foreign currency holdings, such a change did not take place. The deposit substitution index (DSI) as well as the projected amount of euro cash holdings per capita remained broadly unchanged throughout the region.

To sum up, despite worsened results from some sentiment questions, the results of the OeNB's Euro Survey 2010 spring wave show that the generally high level of trust in the EU as an institution remained unchanged and that people did not adjust their foreign currency portfolios in line with sentiment changes.

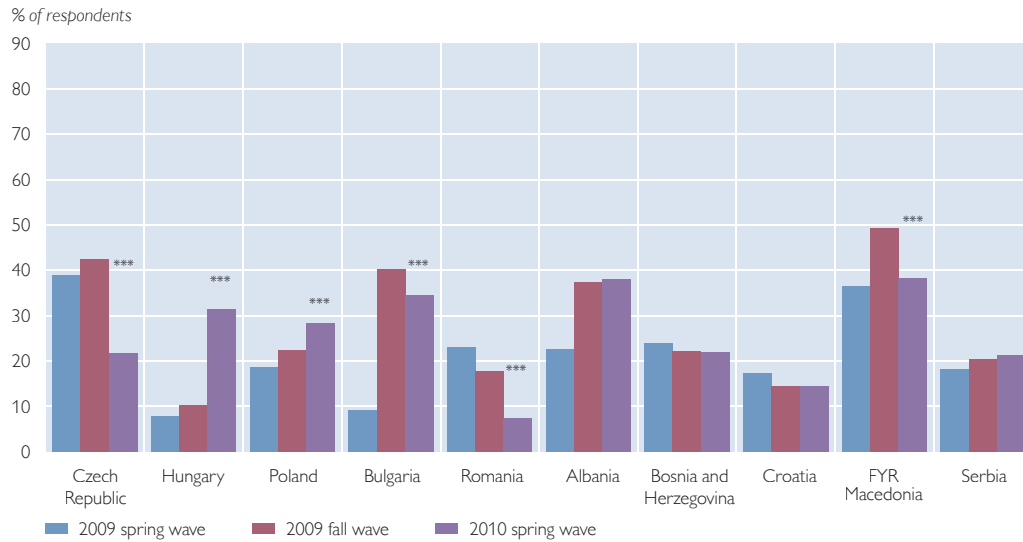
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## Annex

Chart 9

### Trust in Government/Cabinet of Ministers



Source: OeNB Euro Survey.

Note: Respondents were asked whether they trusted the respective institution on a scale from 1 (I trust completely) and 5 (I do not trust at all). Results are based on the share of respondents answering "rather trust" (2) or "trust completely" (1). The answers "Don't know" and "No answer" are not included. \*\*\* indicate a statistically significant change in normalized sample means (at the 1% level) between the 2009 fall and the 2010 spring waves.