



LIETUVOS BANKAS

Euro adoption in Lithuania: benefits and costs

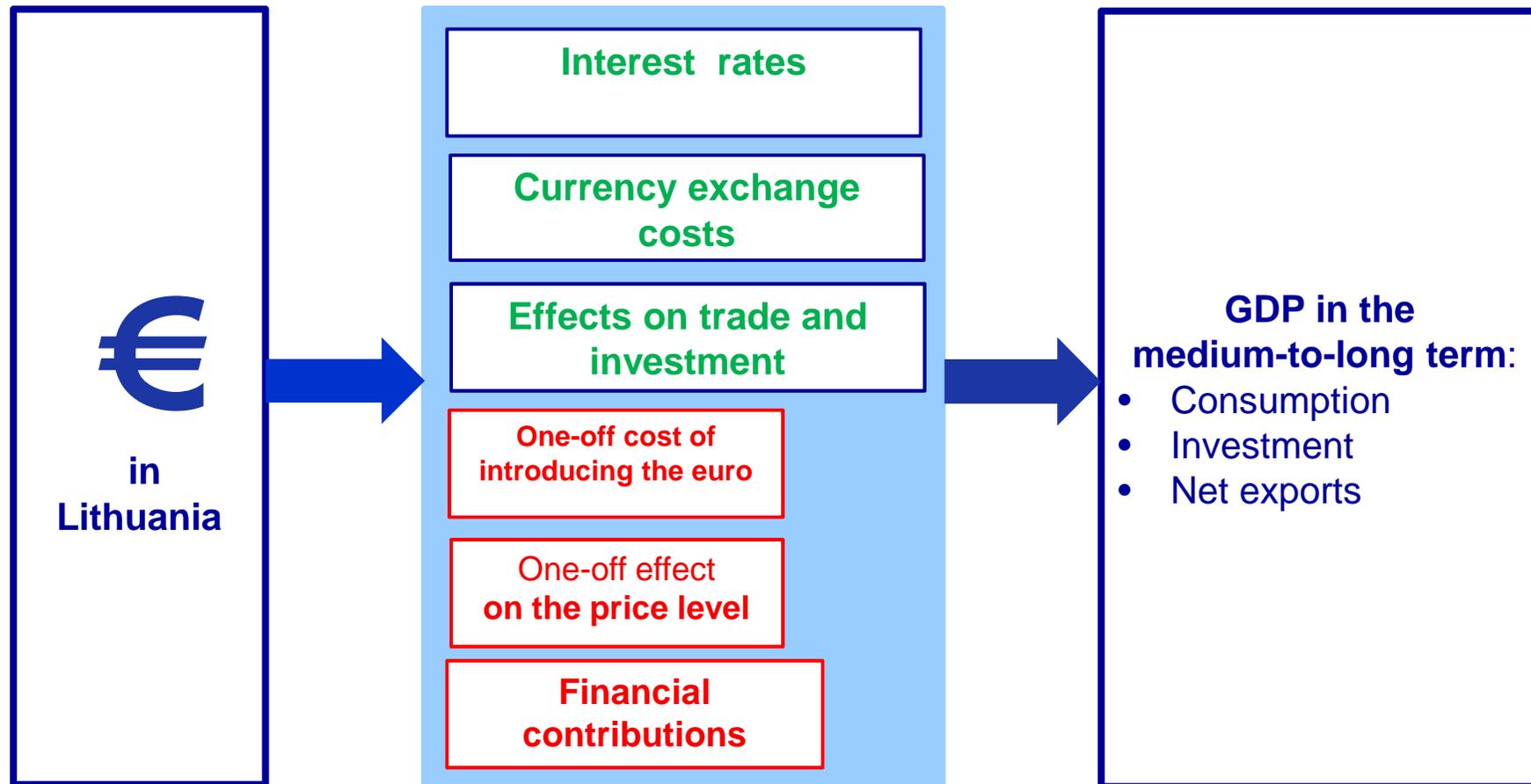
Quantitative assessment

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Impact of the euro: key trends





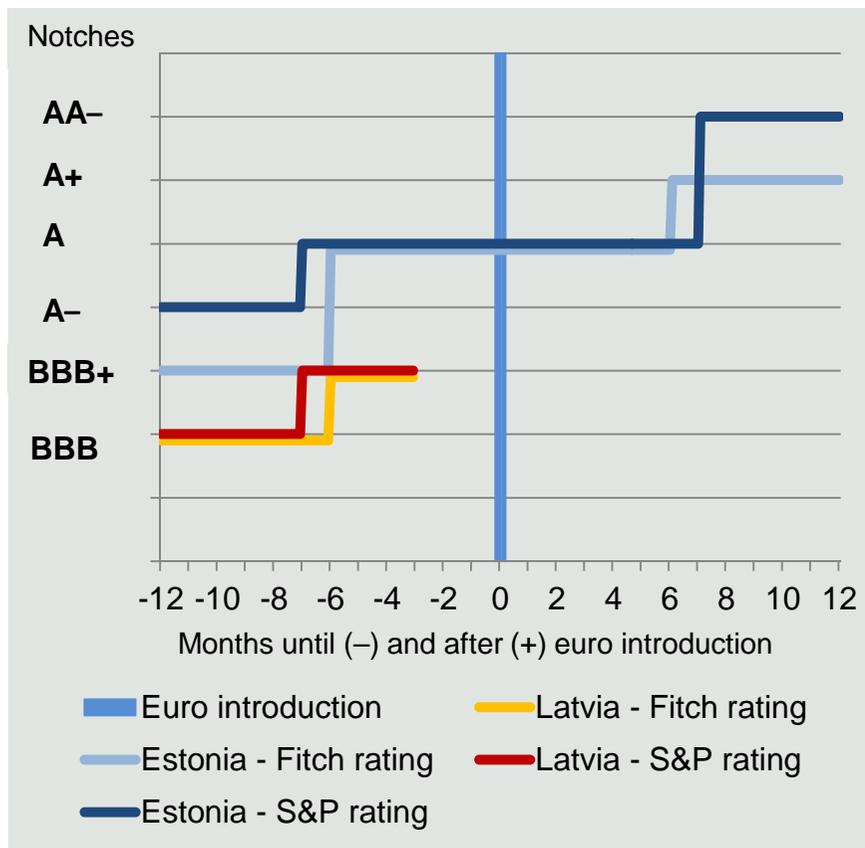
Impact of the euro — Scenarios

Scenario 1 (main)	Scenario 2 (conservative)
<ul style="list-style-type: none">➤ Declining exchange rate risk;➤ Decreasing the country's credit risk;➤ Lithuania's ratings are improving	<ul style="list-style-type: none">➤ Only the exchange rate risk decreases;➤ Credit risk does not change;➤ Lithuania's ratings are not changing;
<ul style="list-style-type: none">➤ Interest rates are decreasing:<ul style="list-style-type: none">✓ interest rates in litas are replaced by interest rates in euro,✓ interest rates in euro are decreasing in Lithuania.	<ul style="list-style-type: none">➤ Effect on interest — less:<ul style="list-style-type: none">✓ interest rates in litas are replaced by interest rates in euro,✓ interest rates in euro are not decreasing in Lithuania.

Available data suggests that the reality would be close to Scenario 1



Increase in ratings — highly probable

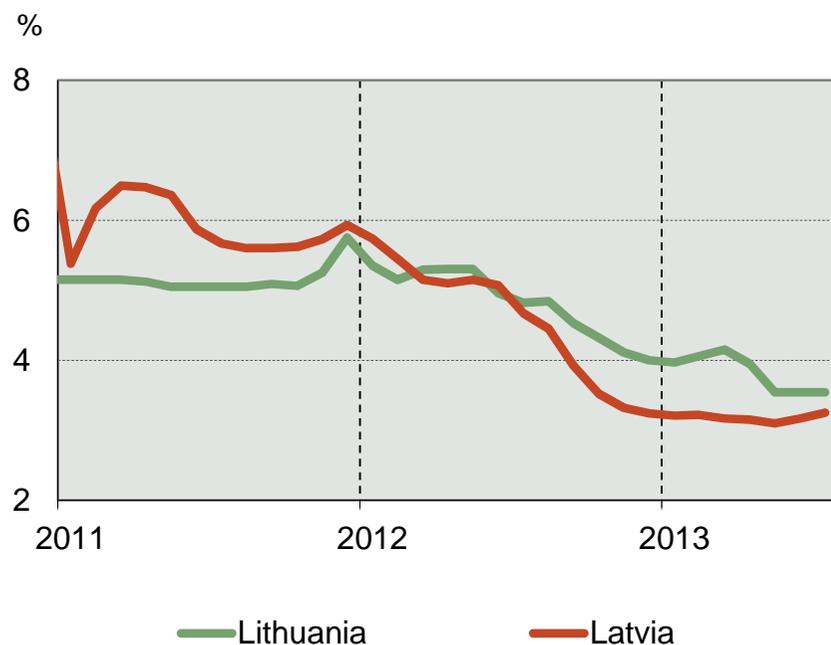


- 6–7 months **until the euro** introduction, **Latvia's** and **Estonia's** ratings — **increased**;
- Rating agencies: the introduction of the euro in Lithuania mitigates credit risk:
 - ✓ state access to the financial market and bank liquidity management capabilities will improve;
 - ✓ reduced state and economic agent risks related to the currency structure of assets, income and liabilities.



Euro effect: Latvia borrows cheaper

Long-term (10 y.) government security interest rates



Latvia's long-term interest rates in the national currency are lower than Lithuania's from July 2012.



Impact of the euro on interest rates

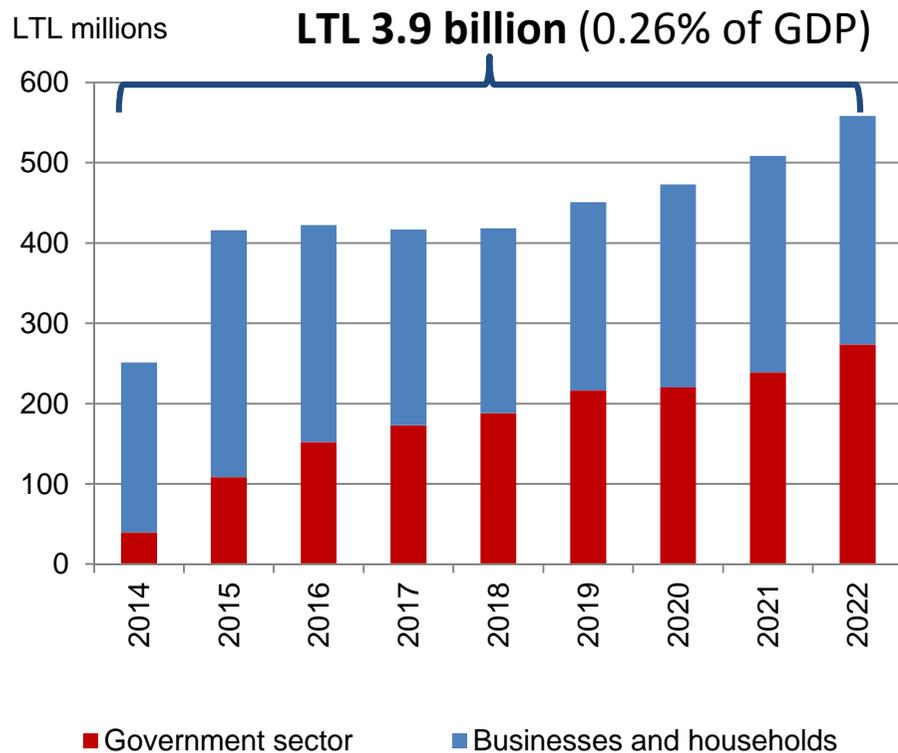
Borrowers (credit form)	Change in interest rate (p.p.) 2015	
	Scenario 1	Scenario 2
Government (Republic of Lithuania debt securities)	-0.80	-0.18
Households (loans)	-0.56	-0.34
Non-Financial Enterprises (loans)	-0.49	-0.26
Weighted average interest rate	-0.56	-0.29



How much would the interest burden decrease? (1)

Savings due to reduced interest in 2014–2022.

Main scenario



Saved interest amount

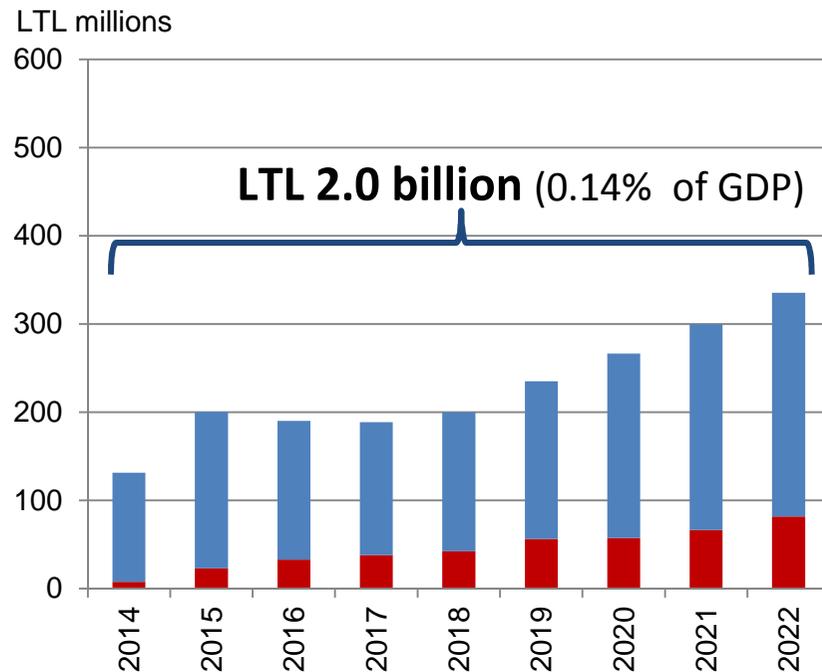
Government	LTL 1.6 billion
Households	LTL 1.2 billion
Enterprises	LTL 1.1 billion
Total	LTL 3.9 billion



How much would the interest burden decrease? (2)

Savings due to reduced interest in 2014–2022.

Conservative scenario



Saved interest amount

Government	LTL 0.4 billion
Households	LTL 0.9 billion
Enterprises	LTL 0.7 billion
Total	LTL 2 billion



Impact of the euro on currency exchange costs

- **With the introduction of the euro, the following disappear:**
 - ✓ the changeover costs
 - ✓ insurance against litas and euro exchange rate change costs
- The changeover and insurance against litas exchange rate fluctuations in the annual cost of non-banking sector, accounts for about **0.14% of GDP** (2010–2012 — an average of LTL ~140 million/y.)
- In 2015–2022 the non-banking sector **would save at least LTL 1.9 billion.**
- The adoption of the euro in the short-term would decrease the earning of banks operating in Lithuania.

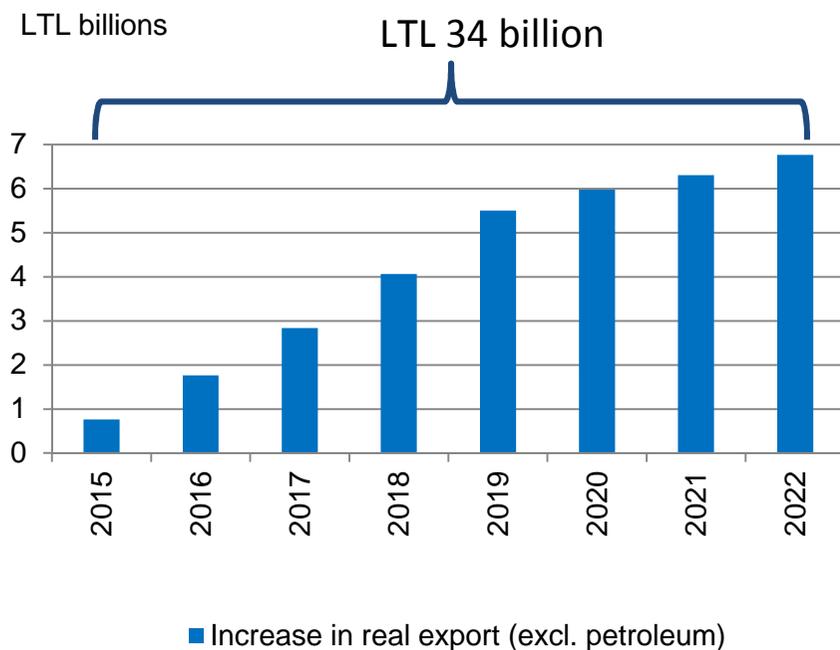


Impact of the euro on export (1)

- Lower trade and market entry costs
- Increased foreign investment
- Greater transparency in the market and competition
- With the introduction of the euro, foreign trade grew by 5–10 per cent



Impact of the euro on export (2)



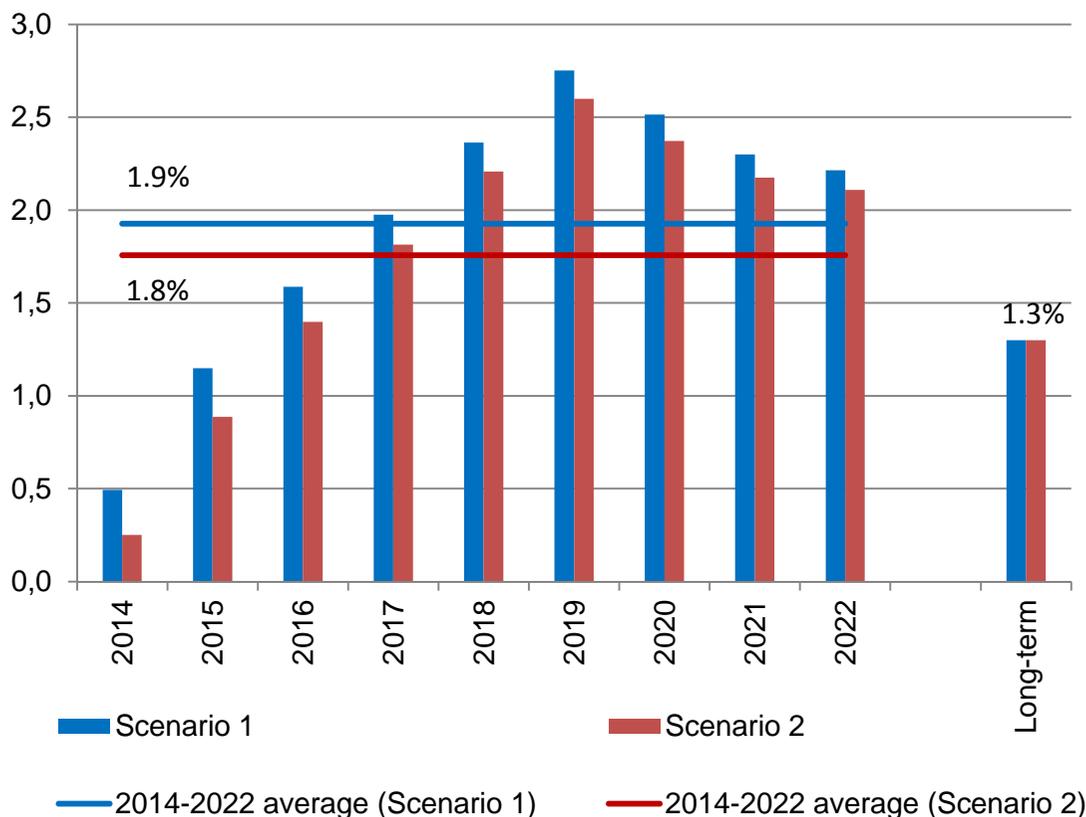
Estimated impact of the euro on Lithuanian exports in 2015–2022

- The gradual increase in export — **5%**
- Total export value growth — **LTL 34 billion**



Euro effect on the economy

Impact of the euro on the GDP level



The adoption of the euro in Lithuania would, on average, increase the GDP level by:

2014–2022

Scenario 1 **+ 1.9%**

Scenario 2 **+ 1.8 %**



Euro effect on prices

Possible reasons for rising prices

- ✓ Price rounding
- ✓ Introduction of euro introduction costs for consumers
- ✓ "Rational inattentiveness" of consumers
- ✓ Synchronisation of price changing

The first months of the introduction of the euro can have a one-off impact on the increase in inflation of 0.2-0.3 p. p.

Necessary amortising measures

- Mandatory dual display of prices
- Active monitoring of prices and response
- Strict control of price conversion for goods and services
- Public involvement in price control, free phone line
- Rapid investigation of potential violations and application of sanctions
- Publically announcing offenders
- Implementation of the Code of Good Business Practice



Euro changeover costs

Common one-off euro introduction costs:

- issuing and exchanging cash;
 - adaptation of information and payment systems;
 - reorganising accounting systems
-

One-off expenses in Lithuania could amount to 0.5–0.7% of GDP (LTL 660–920 million)

Net euro introduction costs will be much lower:

- part of the order will be given to Lithuanian companies;
- part of the work will be financed by EU funds;
- part of the preparation for the euro introduction work will coincide with the usual information and other system upgrade work.



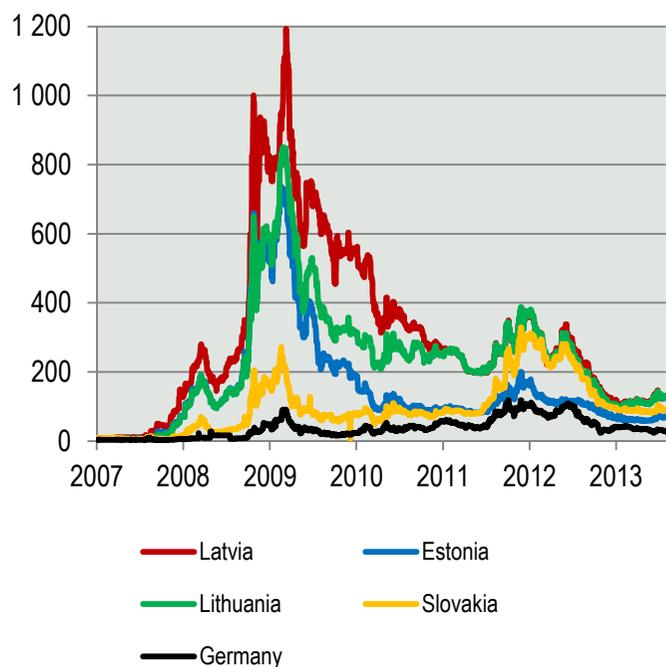
Euro changeover and financial contributions

European stability mechanism	<p>Contribution — EUR ~300 million (about LTL 1 billion) over 5 y. (20% every year) Maximum liabilities <u>if necessary</u> — EUR 2.5 billion (LTL 8.5 billion).</p> <p>Return:</p> <ul style="list-style-type: none">➤ Support guarantee;➤ Investment into financial intermediary undertaking capital;➤ EU economic stability.
European Central Bank	<p>Contribution to the ECB capital — EUR ~ 43 million(LTL 148 million).</p> <p>Return:</p> <ul style="list-style-type: none">➤ For the country's banks — direct access to the Eurosystem's liquidity➤ For the Bank of Lithuania — part of the Eurosystem's profits, proportionate to contribution.



How much would we have saved if the euro had been introduced in 2007?

Interest rates (5 y. credit default swap (CDS)):



Savings in 2007–2014	LTL billions
Households and companies	2.1–2.9
Government sector	4.1–4.9
Total	6.2–7.8



Balance of benefits and costs

Benefits/costs	Value, LTL billions
2014–2022	
Public debt management cost reduction	~0.4–1.6
Business and household interest expenditure savings	~1.6–2.3
Currency exchange cost savings	~1.9
Gradual increase in exports (incl. mineral products)	~34
2014–2019	
One-off cost of introducing the euro	~0.9
Lithuania's contributions and obligations to the ESM	1
The Bank of Lithuania's contributions to the capital of the ECB	0.148



Thank you for your attention