Decoupling of Cycles in Slovenia?

Boštjan Jazbec

Oesterreichische Nationalbank, Vienna

November 18, 2013

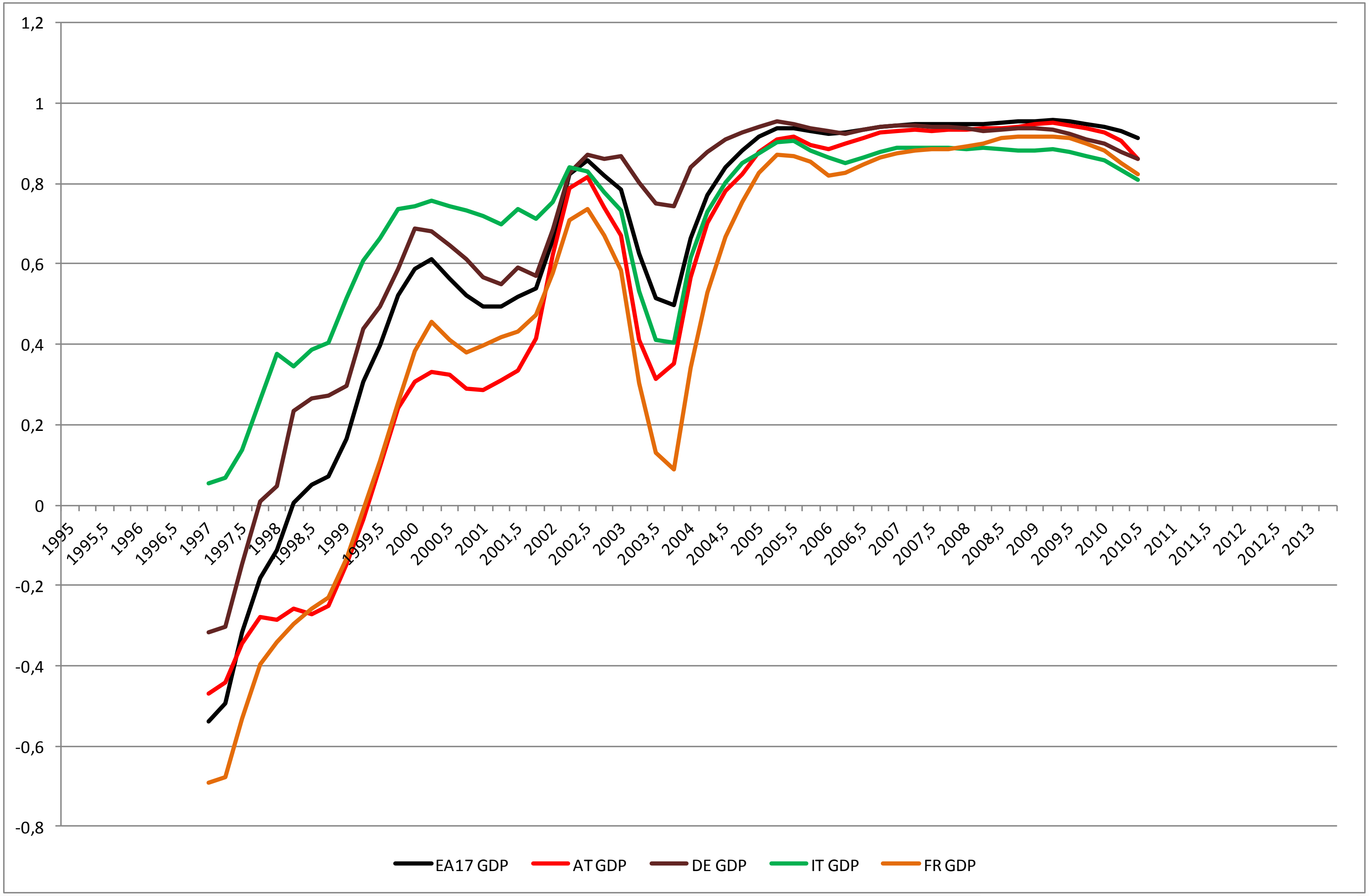
Contents

- **Synchronization of business cycles and the key driving forces**
  - Increasing synchronization
  - Driven by trade
- **Likely reasons for the recent – although slight – decoupling of the business cycle in Slovenia**
- **Tentative conclusions**

General observations

- Are real and financial cycles synchronized?
- Should they be synchronized?
- Does EUR monetary policy help to synchronize the cycles in EA?

Correlations of cyclical components of Slovenian GDP with GDP of EA-17 and the main trading partners have been increasing

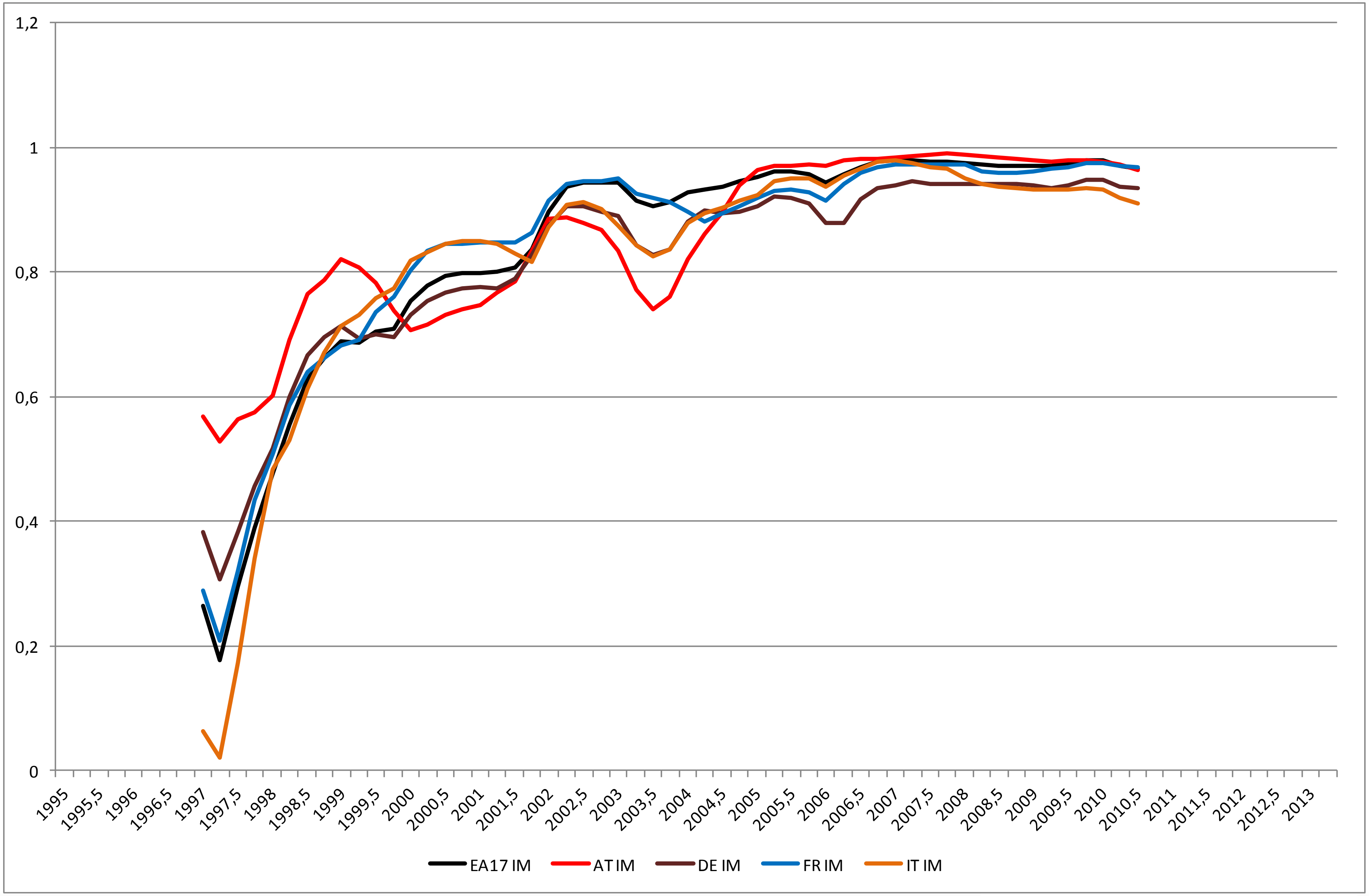


High synchronization of Slovenia's business cycle with that of the main trading partners and the euro area

- ***Correlation*** of cyclical components of GDP has been ***increasing over time***
- Synchronization has been ***at its highest after the entry into the EU and the Euro adoption***
- There was ***no decrease*** in correlations of cyclical components of GDP ***during the crisis*** compared to the pre-crisis period
- There has been a ***small decrease*** in correlations of cyclical components of GDP ***during post-crisis period*** (especially with AT and DE)

Correlations of GDP	***1995-2013***	***Pre-2009***	***Post-2009***	***Post-2011***
CORR(SI, EA17)	0,6095	0,5008	0,9737	0,9624
CORR(SI, AT)	0,5613	0,4480	0,9472	0,8239
CORR(SI, DE)	0,6286	0,5422	0,9489	0,8835
CORR(SI, FR)	0,4364	0,2704	0,9548	0,9263
CORR(SI, IT)	0,6412	0,5596	0,9530	0,9595

The synchronization of the business cycle is mainly driven by the increase in correlation of Slovenian exports with imports of the main trading partners



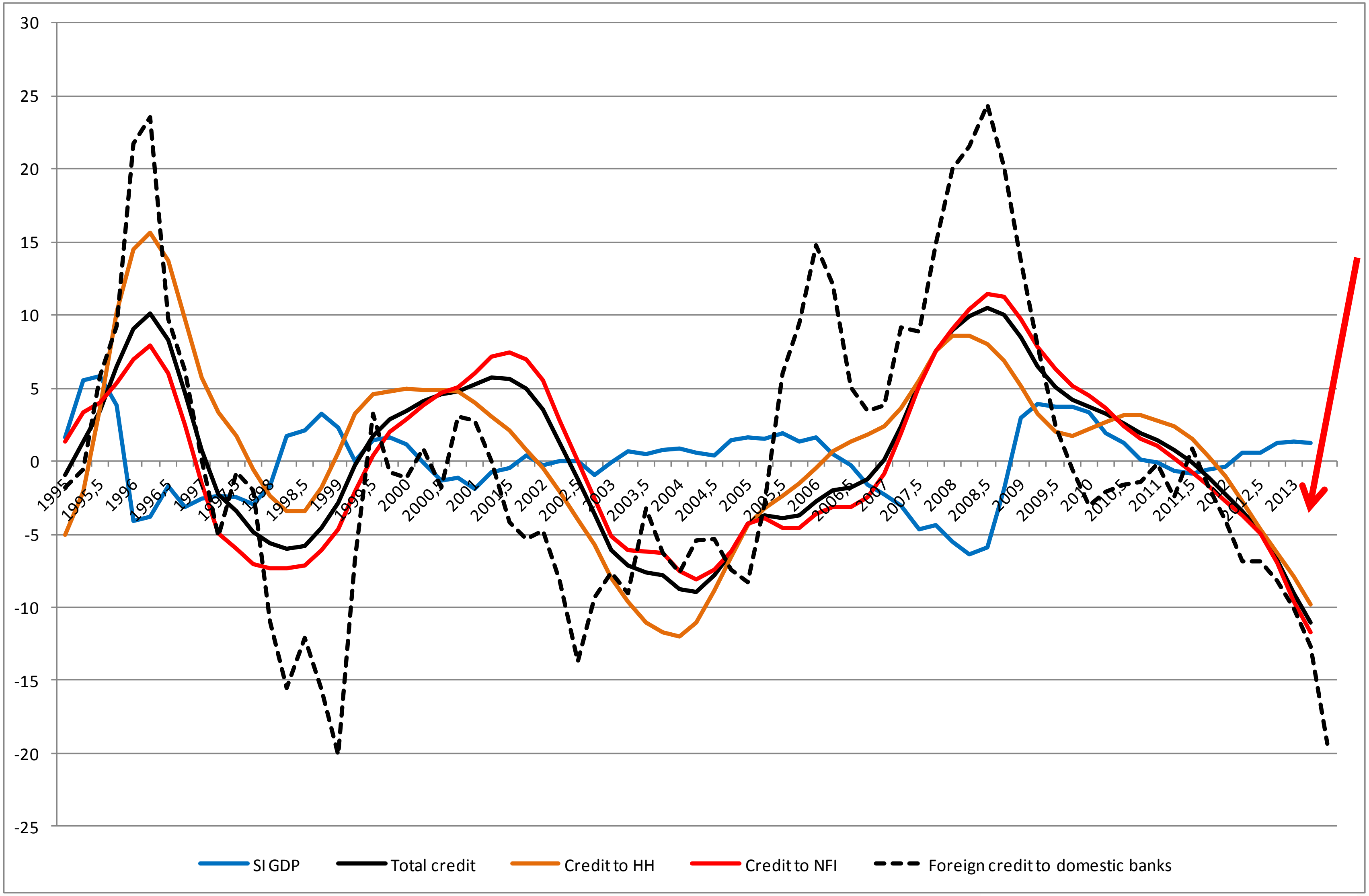
Main drivers of the business cycle synchronization

- Synchronization of the business cycle seems to be **mainly driven by trade variables:**
  - Trade correlations are ***positive throughout the period***
  - Trade correlations are ***higher and less heterogeneous*** than correlations of GDP cycle
  - There is ***no decrease in trade correlations at the end of the sample***

- **De-synchronization** of the business cycle with the main trading partners in the post-crisis period **is not due to trade**

  => the result of domestic developments

Cyclical components of GDP and credit to households, nonfinancial institutions, and foreign credit to domestic banks



Problems in the financial sector are one of the reasons for reduced synchronization of the Slovenian business cycle in the recent period

- There has been a strong cyclical reduction in financing of both households and companies
- There has been a withdrawal of foreign funding for banks
- Empirical evidence: An increase in supply of foreign funds stimulates bank lending to domestic corporations and real activity. Shocks to loan supply induce positive co-movement between loans and real activity.

- **Implication:** Fluctuations in foreign funds supply can cause large fluctuations in credit and output at home.
- **A teaser:** Are financial developments the main (only) culprit for decoupling of the Slovenian business cycle in the most recent period?

Conclusions

- Synchronization of Slovenian business cycle with the EA and the main trading partners was increasing and was at its peak around the entry in the EU and the Euro adoption
- The increase was driven by trade integration
- Recent de-synchronization of the business cycle is not due to trade
- Domestic financial factors are the most likely reasons for reduction in business cycle synchronization
- EUR monetary policy?