

Q2/2015

CESEE Research Update

Foreign Research Division

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The CESEE Research Update is released quarterly by the Foreign Research Division of the Oesterreichische Nationalbank (OeNB). The aim of this newsletter is to inform readers about OeNB research and analysis output on Central, Eastern and Southeastern Europe (CESEE) as well as past and forthcoming CESEE-related events.

Foreign Research Division

OeNB

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77th East Jour Fixe: Russia – economic turmoil and policy options

The 77th East Jour Fixe of the Oesterreichische Nationalbank (OeNB) was dedicated to the recession and financial instability that struck Russia due to the impact of Western sanctions and the plunge in the oil price, and what Russia is doing in response.



The welcome address and introductory statement was given by Doris Ritzberger-Gruenwald, Director of the OeNB's Economic Analysis and Research Department.

Professor Jacques Sapir, Directeur d'Études at the École des Hautes Études en Sciences Sociales (EHESS), Paris, delivered the keynote address entitled "Russia in troubled times."

Session 1, chaired by Helene Schuberth, Head of the Foreign Research Division of the OeNB, focused on the issue of where Russia stands with respect to structural reforms and attracting investment. The panelists were Yaroslav Lissovlik, Chief Economist and Member of the Managing Board of Deutsche Bank, Moscow, and Birgit Niessner, Head of Country Analysis of Raiffeisen Bank International AG, Vienna. Mr. Lissovlik spoke of Russia's reform needs toward a new industrial policy, and Ms. Niessner presented her assessment of the investment climate and policy in Russia and how conducive it is to growth.



Securing monetary policy and banking sector stability was the topic of session 2, chaired by Peter Backé, Deputy Head of the OeNB's Foreign Research Division. Riikka Nuutilainen, Research Economist at the Bank of Finland Institute for Economies in Transition (BOFIT), Helsinki, spoke about Russia's move toward a flexible exchange rate policy and other monetary

policy options. The banking sector and its vulnerabilities and challenges were the focus of Lubomir Mitov's presentation. Mr. Mitov is Chief CEE Economist and Managing Director at UniCredit, London.

The final session was devoted to Russia's efforts to recalibrate its external economic orientation. Thomas Gruber, Head of Unit of CESEE Analysis at the OeNB, chaired the session. The two panelists were Andreas Wörgötter, Head of Division at the Economics Department of the Organisation for Economic Co-operation and Development (OECD), Paris, and Peter Havlik, Research Economist at the Vienna Institute for International Economic Studies (wiiw). Mr. Wörgötter assessed to what degree import substitution policy can be a viable strategy or palliative for Russia. Mr. Havlik dealt with Russia's policy options for economic diversification away from the EU.

Among the key findings of the event are the following: While Russia has boasted impressive macroeconomic achievements in recent years (e.g. current account and budget surpluses, low external debt, high international reserves, a positive net international investor position), the country at the same time has continued to feature a chronically weak investment climate, a sprawling bureaucracy, and pervasive corruption. In this ambiguous situation, the Russian economy experienced a double shock in 2014: the impact of geopolitical tensions and Western sanctions and, more importantly, a plunge in the oil price. These two shocks pushed the country into recession in early 2015. However, the downturn has so far been milder than expected, i.e. due to the slight recovery of the oil price in recent months and to the authorities' relatively prudent policy reaction (including the introduction of exchange rate flexibility, the tightening of monetary policy, bank recapitalization measures, and limited fiscal loosening).



Still, clear downside risks prevail relating to possible new oil price declines and to a possible aggravation of the Ukrainian crisis.

There was agreement among the speakers at the East Jour Fixe that against the backdrop of the current unstable conditions, Russian monetary policy has de facto switched from inflation targeting (which is still the official guideline) to a greater orientation toward the real exchange rate and to combating recession. This contributes to explaining the central bank's recent interest rate cuts and forex market interventions to curb upward pressures on the ruble. Thus, one could argue that the monetary authority has taken a crisis-induced break in its medium-term policy strategy.

Russia's banking sector is facing increased vulnerabilities and challenges. Against the backdrop of banks' traditional dependence on foreign financing, the sanctions and capital outflows have triggered widespread liquidity shortages, which pushed up banks' dependence on central bank refinancing. Overall, a systemic crisis is not expected to materialize in the near future, even if lack of access to foreign funding will subdue investment finance.

Russia's growth malaise clearly pre-dates the Ukrainian crisis. Russia has been "stuck in transition" for a couple of years already. The country's old growth model, founded on steadily rising oil prices and thus improving terms of trade, appears to have definitely reached its limits. Moscow therefore urgently needs a new growth model. For the time being, the authorities appear to have embraced a combination of a weak ruble, an import substitution strategy, and a top-down industrial policy (even if the latter does not yet seem to be clearly spelt out) as planks of their new model. In any case, some dynamic and promising regions (like the Kaluga Oblast) might serve as bottom-up examples of "good" growth that may spill over to the federal level.

Triggered by the sharp devaluation of the ruble, there has been an emergence of elements of incipient import substitution over the last year in some selected economic sectors. This is particularly true

for the food industry, which appears to have got back onto its feet also thanks to Russia's counter-sanctions. Electrical and optical equipment, metallurgy and the production of finished metal products as well as the chemical and petrochemical industry have also been witnessing robust growth rates in recent quarters. However, in order to be sustainable, import substitution i.a. requires the elimination of entry barriers (which often support oligarchic interests) – which invites a big question mark over its political feasibility.

The Russian economy's partial reorientation to the east also started years before the outbreak of the Ukrainian crisis. The Belarus-Kazakhstan-Russia cus-



tom union was established as early as in 2010 and transformed and enlarged to the Eurasian Economic Union (EEU) in 2015. The BRICS

group of nations (comprising Brazil, Russia, India, China and South Africa) emerged in 2011; BRICS aims at the emancipation of emerging markets from the international dominance of the IMF, the World Bank and the U.S. dollar. In 2014 and the first quarter of 2015, Russia's trade with China remained steady (despite Russia's slide into recession), while that with the EU declined sharply. China's share in pledged FDI in Russia is higher than any other country's. Russia appears to fit well into Beijing's "Silk Road Economic Belt" strategy running from China via Central Asia to Europe. Investment projects provide for a major expected increase of energy flows from Russia to Asia in the coming years.

Overall, the OeNB's East Jour Fixe on Russia aroused much interest and was very well attended. Given the breadth of relevant topics, views were sharpened for opportunities, risks and challenges; Russia is currently in difficult and conflict-prone waters and possibly at a crossroads in its (economic) history.

OeNB-BOFIT outlook for selected CESEE countries¹: steady growth in CESEE-6², deep recession in Russia

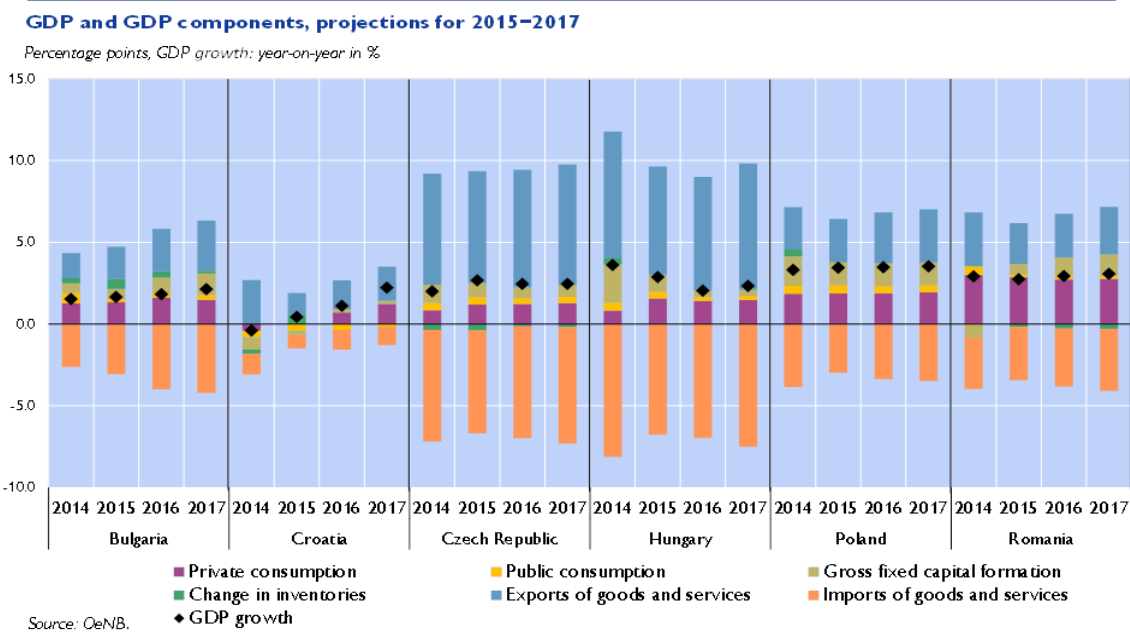
Annual economic growth in the CESEE-6 region will settle at about 3% from 2015 to 2017, thus continuing the moderate expansion observed in 2014. This corresponds to an annual improvement of less than ½ percentage point over the October 2014 projections and is in line with the improved external environment outlook. Improving external conditions imply strong export growth, but import growth will also be robust, pushing the contribution of net exports close to or slightly below zero. Domestic demand will thus continue to be the main growth driver. In 2015, all countries in the region are expected to post positive GDP growth, with Poland remaining the growth engine and Croatia being at the bottom of the league. The economic expansion will, however, remain too weak to speed up the convergence process. Given steady growth in 2016 and 2017, the region's growth advantage over the euro area average will even decline from 1.4 percentage points in 2015 to about 1 percentage point in 2016 and 2017. The risks to these projections are downward biased. The two major downward risks are linked to the recovery in the euro area (which constitutes a significant element of our baseline projection) and to the

Russia-Ukraine conflict.

Following almost flat growth in 2014, the Russian economy is contracting in 2015 on account of the oil price slump. We forecast Russian GDP to decrease by over 4% in 2015. Private investment will remain plagued by uncertainty, which is reinforced by ongoing geopolitical conflict and Western sanctions related to the crisis in Ukraine. Private consumption will be curbed by high inflation. Imports will continue to decline sharply – by an estimated 20% – due to shrinking domestic demand, the weak Russian ruble and falling export proceeds. In 2016 and 2017, a moderate recovery in oil prices will help revive export revenues and cause the contraction of the economy to fade. One major external risk factor is a lower or higher oil price than assumed in our baseline scenario as any unexpected price changes would have immediate substantial effects on the Russian ruble, export income, state revenues and import spending. As an internal risk factor, either domestic policies might cause business sentiment to deteriorate beyond expectations or in particular fiscal policy could turn out to be more supportive in the short run than envisaged in our baseline scenario.

¹ Cut-off date for data underlying this outlook: April 2, 2015.

² CESEE-6: Bulgaria, Croatia, the Czech Republic, Hungary, Poland and Romania.



For the full version of this outlook, see

<http://www.oenb.at/en/Monetary-Policy/Central-Eastern-and-Southeastern-Europe--CESEE-/CESEE-Outlook.html>

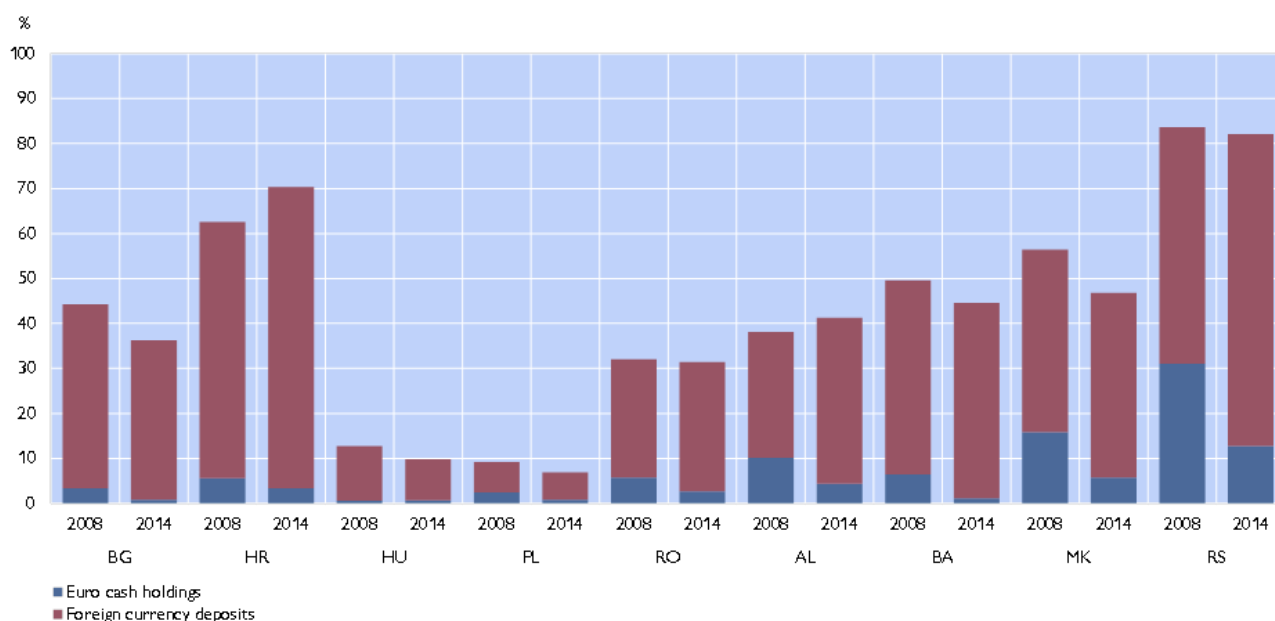
O e N B E u r o s u r v e y n e w s :

Overall euroization of household assets has only gradually declined since 2008

The chart below compares the degree of euroization with reference to both households' euro cash holdings and foreign currency deposits between 2008 and 2014 (asset substitution). While the euro cash component declined in all CESEE countries under observation over this period, the importance of foreign

currency deposits remained rather stable or even increased – in particular in Albania, Croatia and Serbia. Some progress in reducing overall euroization has been achieved in Bulgaria, Bosnia and Herzegovina and FYR Macedonia.

Euroization index: extent of asset substitution in CESEE



Source: National central banks, OeNB Euro Survey.

Note: Euroization index = (euro cash + foreign currency deposits) / (total cash + total deposits). All entries are per capita figures referring to the population aged 14 years or more. Entries for both domestic and foreign currency deposits are averages of selected monthly figures for the household sector including nonprofit institutions serving households provided by national central banks' monetary statistics. Domestic currency cash per capita is derived from MD circulating outside MFIs. Euro cash holdings per capita have been projected on the basis of OeNB Euro Survey data, for details see Scheiber and Stix (2009).

OeNB Euro Survey data reveal that CESEE households already have access to a broad range of savings products in local currency. Nevertheless, many households seem to prefer foreign currency savings. The usage of euro cash and households' preference for foreign currency deposits are partly driven by their distrust in the stability of the respective domestic currency, which in turn is related to their assessment of current policies and institutions (Stix, 2013; Brown and Stix, 2015). Furthermore, Brown and Stix (2015) conclude that a stable monetary policy fos-

ters de-euroization but may not be sufficient in dealing with the hysteresis of deposit euroization across the CESEE region since the holding of foreign currency deposits (1) has become a "habit" in CESEE and (2) is still strongly influenced by households' experiences during the 1990s financial crises.

For more detailed results on various euroization indicators, see <http://www.oenb.at/en/Monetary-Policy/Surveys/OeNB-Euro-Survey.html>

References:

Brown, M. and H. Stix. 2015. The Euroization of bank deposits in Eastern Europe. In: Economic Policy 30 (81). 95–139.
 Scheiber, T. and H. Stix. 2009. Euroization in Central, Eastern and Southeastern Europe – New Evidence on Its Extent and Some Evidence on Its Causes. OeNB Working Paper 159. Vienna.
 Stix, H. 2013. Why Do People Save in Cash? Distrust, Memories of Banking Crises, Weak Institutions and Dollarization. Journal of Banking and Finance 37 (11). 4087–4106.

Focus on European Economic Integration Q2/15



Studies

Bridging the information gap: small-scale nowcasting models of GDP growth for selected CESEE countries, Feldkircher, M. , Huber, F., Schreiner, J. , Tirpák M. , Tóth, P. , Wörz, J. p. 56-75

In this article, we describe short-term forecasting models of economic activity for seven countries in Central, Eastern and Southeastern Europe (CESEE) and compare their forecasting performance since the outbreak of the Great Recession. To build these models, we use four variants of bridge equations and a dynamic factor model for each country. Given the differences in availability of monthly indicators across countries and the rather short time period over which these indicators are available, we favor small-scale forecasting models. We selected monthly

indicators on the basis of expert judgment, correlation analysis and Bayesian model averaging techniques. While our models generally outperform a purely time series-based forecast for all CESEE countries, there is no single technique that consistently produces the best out-of-sample forecast. To maximize forecasting accuracy, we therefore recommend selecting a country-specific modeling approach for every CESEE economy on the basis of out-of-sample forecasting performance.

[Focus on European Economic Integration Q2/15](#)

What can we learn from Eurosystem Household Finance and Consumption Survey data? – An application to household debt in Slovakia, Fessler, P., Jäger-Gyovai, K., Messner, T., p. 76-87

This study delivers a stock-taking exercise of household debt in Slovakia. About 27% of all Slovak households hold at least some debt. The rate of homeownership in Slovakia is close to 90% and the highest in the euro area, while the share of indebted households is lowest. The reason for this peculiarity lies in the country's history. Less than 10% of households are mortgage debt holders, and about 20% hold nonmortgage debt. About 15% of total debt holdings are covered by liquid financial assets and about 50% by households' total assets excluding the main residence. When accounting only for the

debt of vulnerable households, the share of total debt not covered by households' total assets excluding the main residence lies between about 4% and 15% – depending on the definition used for debt burden measures. In Slovakia, mostly households with relatively young household heads are indebted. Regression analyses show that while self-employed persons and persons with higher education are more likely to hold debt, especially the self-employed are less likely to be vulnerable.

[Focus on European Economic Integration Q2/15](#)

Recent economic developments and outlook

Developments in selected CESEE countries: Gradual recovery in CESEE EU Member States continues, moderate growth in Turkey, stagnation in Russia, p. 8-43

Compiled by Josef Schreiner

[Focus on European Economic Integration Q2/15](#)

CESEE-Related Abstracts from Other OeNB Publications

Ukraine: struggling banking sector amid substantial uncertainty, Barisitz, S., Fungacova, Z.

To be published in [Financial Stability Report 29](#) available on July 8, 2015

Spillovers from euro area and U.S. credit and demand shocks: comparing emerging Europe on the basis of a GVAR model, Fadejeva, L., Feldkircher, M., Reininger, T.

Published as [OeNB Working Paper 198](#)

Event Wrap-Ups and Miscellaneous

Conference: "The Western Balkans: 15 Years of Economic Transition"

Compiled by Antje Hildebrandt and Thomas Scheiber

[Focus on European Economic Integration Q2/15](#)

Call for Papers I (for ESCB economists only)

13th ESCB Emerging Markets Workshop

Dear Colleagues,

For the past twelve years different members of the European System of Central Banks (ESCB) have organised annual workshops devoted to macroeconomic and financial issues in emerging market countries. This year the Oesterreichische Nationalbank (OeNB) will again host the workshop.

The 13th Emerging Markets Workshop will take place on November 5-6, 2015, in Vienna at the premises of the OeNB.

We welcome paper proposals from all ESCB members and other central banks. Papers should deal with a topic relevant to macroeconomic or financial issues in emerging market countries, their economic policies and/or integration with the global economy. We plan to have several open sessions covering the whole range of emerging market topics, as indicated before.

In addition, we will have one or more special sessions devoted to the issue of "economic growth in emerging market economies". Thus, submissions dealing with issues in this particular area would be especially welcome.

Our deadline for extended abstracts or complete papers of the paper proposals is August 31, 2015. Proposals should be sent to peter.backe@oenb.at. Peter is also available to answer any inquiries related to the 13th Emerging Markets Workshop.

Doris Ritzberger-Grünwald

Call for Papers II

“Financial development and economic growth in South-East Europe A historical and comparative perspective”, 10th Conference of the South-East European Monetary History Network (SEEMHN) in Vienna on October 1, 2015

The purpose of the conference is to gather scholars working on financial development (e.g. banks, central banks, and financial markets) and economic development (e.g. growth and structural change) in Southeastern Europe to get new, challenging, and exciting insights into the interrelationships between the financial sector and the real economy. Quantitative and qualitative research as well as national case studies and cross-country comparative

work can be presented at this conference.

The conference is organized by the *Oesterreichische Nationalbank* and the *University of Vienna, Institute for Economic and Social History*. The conference will be followed by a workshop on “The central bank balance sheet in the (very) long run” on October 2 (see separate call for papers).

More information: <http://www.oenb.at/en/Monetary-Policy/Research/conferences.html>

Call for Papers III

“The central bank balance sheet in the (very) long run – How to construct it, how to read it, what to learn from it”, Workshop in Vienna on October 2, 2015

The aim of the workshop on central bank balance sheets is to gather scholars who have worked with historic central bank balance sheets to put these current debates into a longer-term perspective. Contributions that highlight the challenges posed when analyzing balance sheets both in a cross section and over time, notably by possible different meanings of balance sheet categories and changes in the underlying operations, are particularly welcome.

The workshop is organized by the *Oesterreichische Nationalbank* and the *University of Vienna, Institute for Economic and Social History*. Participants at the workshop are invited to attend the conference of the SEEMHN on October 1, 2015 as well.

More information: <http://www.oenb.at/en/Monetary-Policy/Research/workshops/call-for-papers-02102015.html>

Save the Date: October 15-16, 2015 in Warsaw

Conference on European Economic Integration (CEEI) and

Conference on The Future of the European Economy (CFEE)

BOOSTING EU COMPETITIVENESS – The Role of the CESEE Countries

The CEEI and CFEE 2015 focus on long-term European growth prospects and competitiveness – a major objective of the Lisbon and Europe 2020 Strategies. In the wake of the recent crisis and given the urgency of anti-crisis measures and assistance programmes, economic analysis and policymaking have paid less attention to the issues these long-term strategies intended to address: how to increase productivity and resist the competitive pressures of a globalised economy. Moreover, the crisis showed that decreasing competitiveness poses a challenge for

both the European Union as a whole and individual Member States at different stages of integration. In particular for Central, Eastern and Southeastern Europe (CESEE), competitiveness is a key ingredient in the convergence process. The joint conference will adopt a comprehensive view and discuss various dimensions of competitiveness: price and cost developments, innovation, labour market issues, the role and design of structural and industrial policies, and the effects of global supply chains.

Olga Radzyner Award 2015 for Scientific Work on European Economic Integration

The OeNB has established an award to commemorate Olga Radzyner, former Head of the OeNB's Foreign Research Division, who died in a tragic accident in August 1999. The award is bestowed on young economists for excellent research on topics of European economic integration and is conferred annually. In 2015, four applicants are eligible to receive a single payment of EUR 3,000 each from an annual total of EUR 12,000.

Submitted papers should cover European economic integration issues and be in English or German. They should not exceed 30 pages and should preferably be in the form of a working paper or scientific article. Authors shall submit their work before their 35th birthday and shall be citizens of any of the following countries: Albania, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, FYR Macedonia, Hungary, Kosovo, Latvia, Lithuania, Moldova, Montenegro, Poland, Romania, Russia,

Serbia, Slovakia, Slovenia and Ukraine. Previous winners of the Olga Radzyner Award, ESCB central bank employees as well as current and former OeNB staff are not eligible. In case of co-authored work, each of the co-authors has to fulfill all the entry criteria.

Authors shall send their submissions by postal mail – with the envelope marked “Olga Radzyner Award” – to the Oesterreichische Nationalbank, Foreign Research Division, Otto-Wagner-Platz 3, PO Box 61, 1011 Vienna, Austria. Entries for the 2015 award should arrive at the OeNB by September 4, 2015, at the latest.

For more information, please contact [Eva Gehringer-Wasserbauer](mailto:eva.gehringer-wasserbauer@oenb.at) in the OeNB's Foreign Research Division.

See also: [Olga Radzyner Award](#)

Call for Applications: Visiting Research Program



The OeNB invites applications from external researchers for participation in a Visiting Research Program established by the OeNB's Economic Analysis and Research Department. The purpose of this program is to enhance cooperation with members of academic and research institutions (preferably postdoc) who work in the fields of macroeconomics, international economics or financial economics and/or pursue a regional focus on Central, Eastern and Southeastern Europe.

The OeNB offers a stimulating and professional research environment in close proximity to the policymaking process. Visiting researchers are expected to collaborate with the OeNB's research staff on a prespecified topic and to participate actively in the department's internal seminars and other research activities. They will be provided with accommodation on demand and will, as a rule, have access to the department's computer resources. Their research output may be published in one of the department's publication outlets or as an OeNB Working Paper.

Research visits should ideally last between three and six months, but timing is flexible.

Applications for 2015 should be e-mailed to eva.gehringer-wasserbauer@oenb.at by November 1, 2015.

Applicants will be notified of the jury's decision by mid-December 2015. The following round of applications will close on May 1, 2016.

See also: [Visiting Research Program 2015](#)

Applications (in English) should include

- a curriculum vitae,
- a research proposal that motivates and clearly describes the envisaged research project,
- an indication of the period envisaged for the research visit, and
- information on previous scientific work.

Upcoming Events

The following events are organized by the OeNB and cover CESEE relevant topics. Please note that attendance is by invitation only. If you are interested in participating in one or more of the events, please send an e-mail to ceec@oenb.at.

September 10-11, 2015	Workshop: "Toward a Genuine Economic and Monetary Union" at the OeNB. By invitation only!
October 1, 2015 in Vienna	10 th Conference of the South-East European Monetary History Network (SEEMHN)
October 2, 2015 in Vienna	"The central bank balance sheet in the (very) long run – How to construct it, how to read it, what to learn from it" Workshop
October 15-16, 2015 in Warsaw	"BOOSTING EU COMPETITIVENESS – The Role of the CESEE Countries" Conference on European Economic Integration and Conference on The Future of the European Economy jointly organized by the Oesterreichische Nationalbank and Narodowy Bank Polski. By invitation only!
November 5-6, 2015	13 th Emerging Markets Workshop at the OeNB. By invitation only!

OeNB Courses at the Joint Vienna Institute (JVI)

For further details see: www.jvi.org and [Program JVI 2015](#)

January 19-22, 2015	Advanced Course on Financial Stability Stress Testing for Banking Systems
May 18-22, 2015	Institutional Challenges for Candidate and Potential Candidate Countries on the Road to the EU and EMU
September 14-18, 2015	Macro-Financial Stability in Central, Eastern and Southeastern Europe
October 12-14, 2015	Cash Circulation and Payment Systems in Austria
October 19-23, 2015	Integration in Europe: European Union and Eurasian Union
November 16-18, 2015	Financial Education
November 30—December 3, 2015	Building New Skills in Financial Translation

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