

Research Update

Economic Analysis and Research Department

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Imprint/inquiries/copyright 2017:
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Editorial

by Doris Ritzberger-Grünwald
 Director of the Economic Analysis and Research Department

Financial surprises in Basel: money matters outside the BIS

As a central banker, you travel to Basel rather often. When I extended my stay over the weekend last time I was there, I had several extraordinary experiences, all related to money. By chance, a German amateur theater group was in town, playing "Das Wunder von Wörgl," a play about a regional currency introduced in the town of Wörgl in Tyrol during the economic crisis in the 1930ies. Apart from enjoying a great performance and gaining some insights into why people



were (and still are) fascinated by this kind of parallel money, I found myself watching a female director of the Oesterreichische Nationalbank onstage. Shaking hands with the actress after the performance and introducing myself was an unforgettable experience for both of us.

Strolling across the flea market in Basel on Sunday morning also brought a surprise. Between old coins and medals, I found a bitcoin, made of copper and looking nice and shiny. Actually holding a virtual currency in your hands is a strange feeling. In any case it was a bargain, as I paid CHF 15 instead of EUR 5.000 ☺ But there is still an open question: Does the fact that I bought this bitcoin on a flea market, a place where they trade with goods people actually do not need any more, tell us something about the future of bitcoins?

Doris Ritzberger-Grünwald

OeNB expects Austria's inflation rate to decline from 2.0% in 2017 to 1.7% in 2018

In its most recent inflation forecast of September 2017, the OeNB anticipates an average HICP inflation rate of 2.0% for Austria in 2017 and a drop to 1.7% in 2018. The major drivers of the expected decline are energy prices, which – after a temporary growth in the third quarter of 2017 – are expected to fall year on year in accordance with oil price assumptions for the remainder of the forecast horizon. Food prices will also curb headline inflation in 2018, as the one-off effects caused by price developments in dairy products (shortened supply

following the liberalization of the EU dairy market) and oils and fats (cheap palm oil is increasingly substituted by premium oils) should have faded out by then. Despite the current strong economic growth, no noticeable price pressure will come from the demand side over the forecast horizon, implying that inflation rates of industrial goods excluding energy and of services will remain largely stable until end-2018. The core inflation rate (HICP excluding energy and unprocessed food) will thus decline only marginally to 2.0% in 2018 (and to 2.1% in 2017).

Higher “inflation literacy” and confidence in the central bank improve households’ inflation expectations

Consumers' inflation expectations are an important indicator for central banks, since they not only constitute a leading indicator for future inflation development but also serve as a source of information on the credibility of price stability-oriented monetary policy measures. The current issue of “Inflation aktuell” focuses on this topic and analyzes what influence people's understanding of inflation (“inflation literacy”) and their confidence in the central bank have on their individual inflation expectations. Based on a survey of 2,000 Austrian households, an OeNB study analyzes to what extent knowledge of inflation measuring methods, inflation developments, the reasons behind inflation and its consequences as well as people's confidence in the OeNB influence the levels and accuracy of the reported inflation expectations. Evidently, individuals with a

relatively better knowledge of inflation and higher confidence in the OeNB turn out to have, on average, significantly lower and at the same time more accurate inflation expectations. These findings suggest that the OeNB's extensive and long-standing efforts to enhance the public's economic and financial literacy can contribute to rendering households' inflation expectations more realistic.

“Inflation aktuell” is a quarterly OeNB report on inflation in Austria (issued in German only). It analyzes inflation developments over the past few months, presents the OeNB's inflation forecast and elaborates on current topics of interest.

More information: <https://www.oenb.at/Publikationen/Volkswirtschaft/inflation-aktuell.html>

Presentation of “The Euro and the Battle of Ideas” by Markus Brunnermeier

On August 28, 2017, Markus K. Brunnermeier, Edwards S. Sanford Professor of Economics and Director of the Bendheim Center for Finance at Princeton University, gave a public talk on “The Euro and the Battle of Ideas,” a book he co-authored with Harold James und Jean-Pierre Landau.

The starting point of the book is the fact that a sizeable group of observers believe that the euro will not survive the current crisis. The authors do not share this pessimistic view. They argue that the euro's core problem is that the leading economic ideas in the euro area countries differ considerably, most notably between Germany and

France. These different approaches to interpreting economic phenomena has to be overcome. Since the euro crisis, the euro area countries have increasingly relied on national solutions. While Germany with its federal structure insists on rigid fiscal policy rules, centralist France demands stimulus programs and flexible solutions. From the German point of view, financial distress is mainly attributable to solvency problems, which require structural reforms, whereas from the French

point of view, financial distress means temporary liquidity problems, which can be bridged by state-run interim financing. The authors advocate overcoming these different ideas in favor of a common European economic culture.

After an introduction by OeNB Governor Ewald Nowotny, Markus K. Brunnermeier summarized the book's main points. His presentation was followed by a discussion by the historian Philipp Ther (University of Vienna) and by a lively general discussion.

OeNB panel at the Annual Congress of the German Economic Association (Verein für Socialpolitik)

On September 5, 2017, the OeNB's Economic Studies Division together with the research units of the Deutsche Bundesbank and the Swiss National Bank held a joint policy panel at the Annual Congress of the German Economic Association in Vienna. Martin Summer, Head of OeNB's Economic Studies Division, discussed the topic of "Digital currencies: challenges for central banks?" with Michael Kumhof (Bank of England), Rainer Boehme (University of Innsbruck), Mathias Binswanger (Fachhochschule Nordwestschweiz) and Fabian Eser (European Central Bank).

Michael Kumhof argued that central banks should make use of new technological developments and issue digital central bank money. According to a study conducted by the Bank of England, this would improve both macroeconomic stabilization and the resilience of the payment system. Rainer Böhme pointed out numerous technological security risks that would come with such a switch in payment technology. One of the main

problems is that errors occurring in a decentralized ledger system, even if only through programming errors, can hardly be managed, which entails, in particular, significant systemic risks. Mathias Binswanger saw the digital currency debate as a side issue. In his view, it distracts from the more important debate about the deeper and more fundamental problems of the modern financial system. For him, the long intermediation chains with very short-term, market-dependent funding – which all depend on the banking system in a complex network of money market funds, hedge funds and securitization vehicles – are at the core of the problems of modern finance. In his opinion, such a system cannot be sufficiently controlled neither by regulation nor by the central bank. Fabian Eser finally went through some empirical facts about digital currencies. From the ECB's perspective, these forms of payment are still far from presenting a serious competition for the existing monetary and payment system.

OeNB Summer School 2017: "Measuring economic inequality: Principles, methods and applications" with Philippe van Kerm

The 14th OeNB Summer School was dedicated to the topical issue of economic inequality and its applications in an in-depth policy analysis also from a central bank's perspective. From August 21 to 25, Philippe van Kerm, head of the "Living conditions" department of the Luxembourg Institute for Socio-Economic Research and

Research Associate at ZEW Mannheim, discussed the fundamental principles and methods of economic inequality and its numerous applications with economists from the OeNB, from other ESCB central banks (BE, DE, EE, PL, RO), from the Joint Vienna Institute as well as from several Austrian universities (University of Graz,

University of Linz, University of Salzburg and Vienna University of Economics and Business). In total, 32 economists participated in the OeNB Summer School 2017 held at the premises of the JVI, thus making it the best attended OeNB Summer School in recent years.

Philippe van Kerm is a highly recognized scholar in the areas of applied micro-econometrics and income and wealth distribution dynamics. At present, his major research interests are the econometrics of social mobility as well as inferential methods for survey data. He has published in high-ranked journals such as *Economica*, *The Journal of Economic Inequality*, *Review of Income and Wealth*, and he has programmed an array of codes for distributional analysis using the statistical software STATA. The OeNB course provided useful insights into the trends, drivers and consequences of income and wealth inequality. It also shed light on the fundamental principles of measuring economic inequality and provided an up-to-date overview of empirical methods in the field,

including inference issues with survey data and the estimation of econometric models for distributional analysis. In addition, the course dealt with portfolio decisions of households and asset prices, thus highlighting the relevance of income and wealth distribution from a central bank's perspective. Finally, the theoretical lectures were complemented by practical "hands on" applications based on micro-data on household living conditions from the Luxembourg Income Study Database (LIS) and the Luxembourg Wealth Study Database (LWS).

The participants highly appreciated the intuitive presentation of the complex material and the stimulating discussions with the lecturer, thus giving the best final evaluation of an OeNB Summer School since its establishment. They outlined that the knowledge attained would certainly add value to their professional work in particular applications in the area of social mobility, tax policy as well as the analysis of top income and wealth distribution.



"The new macroeconomic quadrilemma – Mundell's trilemma in the era of financial instability": OeNB public lecture by Joshua Aizenman, September 4, 2017

Joshua Aizenman, Dockson Chair in Economics and International Relations at the University of Southern California, gave a well-received lecture at the OeNB on September 4, 2017. Aizenman outlined how Mundell's (1963) economic trilemma hypothesis has been reinterpreted and challenged in recent years, mainly due to recurrent bouts of financial instability.

Aizenman started out by recalling that the original trilemma hypothesis states that a country may

simultaneously choose any two, but not all of the following three policy goals – monetary independence, exchange rate stability and financial integration. This binary choice was particularly contested in the period of rapid financial globalization during the 1990s and 2000s, as several emerging markets and developing countries experienced "sudden stops" of capital inflows, followed by twin or triplet crises (i.e. exchange rate, banking and sovereign debt crises). Aizenman attested that a growing share of

countries thus converged to “in-between” regimes in the middle ground of the trilemma – limited but viable monetary autonomy, managed exchange rate flexibility and controlled financial integration.



With the 2008/2009 global financial crisis (GFC), a few scholars contended that Mundell's trilemma should be transformed into a dilemma (e.g. Rey, 2015), arguing that whenever capital is freely mobile, the global financial cycle constrains national monetary policies in non-core economies irrespective of the exchange rate regime. Aizenman, on the other hand, pointed to a series of recent papers (Aizenman, Chinn and Ito, 2013, 2016 and 2017) that do not only underpin the continuing importance of exchange rate stability but also add financial stability as a fourth dimension, morphing Mundell's trilemma into a new macroeconomic quadrilemma. Aizenman concluded that the GFC and the sovereign debt crisis in some euro area countries validated that no country is immune from the exposure to financial instability, and from the modern quadrilemma (see Aizenman, 2017).

The discussion following Aizenman's lecture centered on the role of flexible exchange rates, the quality of public institutions and the scope for international policy coordination. Aizenman provided evidence that a managed float mitigates exposure to external shocks. However, he also emphasized that a (managed) flexible exchange rate is not a panacea – the size of the country matters as well as its balance sheet exposure to external hard currency debt. Referring to the example of Poland during the GFC episode, the audience added that – besides the flexible exchange rate – also macroprudential measures implemented already before the outbreak of

the GFC, regional financial agreements or foreign bank ownership helped cushion the impact of this global shock.

As for the quality of public institutions, participants raised the question whether it would be necessary to add a fifth dimension to the modern discussion of macroeconomic tradeoffs and mitigations. Aizenman endorsed this view by referring to the modelling attempts by Dani Rodrik. According to Aizenman, the quality of social contract and the effectiveness of policy implementation are of key importance in this respect, not necessarily the particular degree of democracy.



Finally, with regard to the feasibility of international policy coordination to mitigate negative cross-border spillovers, Aizenman stressed that cost-benefit analyses would clearly point to international coordination of monetary policies as a superior strategy. However, in practice this type of coordination is restricted to fat-tail events (see Aizenman, 2016). Instead of counting on international policy coordination, precautionary strategies are important, Aizenman reiterated, especially in non-core economies. Emerging market economies being in the trilemma middle ground should be able to attain greater monetary autonomy by holding higher levels of foreign exchange reserves. Only countries with more mature institutions and fiscal space may substitute the reliance on costly buffers with macroprudential regulation and/or bilateral swap lines coordinated among their central banks (if feasible).

Presentation slides are available at:

<https://www.oenb.at/Termine/2017/2017-09-04-public-lecture-aizenman.html>

SAVE THE DATE

We have the pleasure to inform you that the Oesterreichische Nationalbank (OeNB) will host its annual **Conference on European Economic Integration (CEEI)** on November 20 and 21, 2017, at the Vienna Marriott Hotel. This year's conference topic will be

"A modern take on structural reforms – past and future challenges for CESEE and Europe at large".

Amid today's formidable challenges, well-designed and effective structural reforms are key to shaping Europe's future and facilitating its return to balanced growth and convergence. The CEEI 2017 will revisit the profound market reforms carried out in Central, Eastern and Southeastern European (CESEE) countries, shedding light on individual privatization strategies as well as gradual versus shock transformation. In line with a modern understanding of structural reforms that goes beyond the liberalization and deregulation doctrine of the past, speakers will also highlight social aspects and distributional effects of such reforms. Given the quickening pace of technological change, the conference will moreover serve to assess the implications of future challenges arising from digitalization, deindustrialization and the emerging protectionist threat to Europe. Taking a forward-looking perspective, experts from academia and politics will discuss which reform steps are necessary to provide for prosperous labor, product and capital markets.

The conference language will be English.

More information: https://www.oenb.at/en/Calendar/2017/20171120_21_ceei.html

OeNB Periodical Publications

List of all Publications since 2001 (by staff of the Economic Analysis and Research Section)



Focus on European Economic Integration Q3/17

Recent economic developments and outlook

Studies

The new silk road, part I: a stocktaking and economic assessment

Stephan Barisitz, Alice Radzyner

**Competitiveness of CESEE EU Member States:
recent trends and prospects**

Doris Ritzberger-Grünwald, Josef Schreiner, Julia Wörz

Fintechs and their emergence in banking services in CESEE

Caroline Stern

**Comparing market power at home and abroad:
evidence from Austrian banks and their subsidiaries in CESEE**

Martin Feldkircher, Michael Sigmund

[Read More](#)

Call for Applications: Visiting Research Program

The Österreichische Nationalbank (OeNB) invites applications from external researchers (EU or Swiss nationals) 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 with a regional focus on Central, Eastern and Southeastern Europe.



See also: [Visiting Research Program 2017/2018](#)

Upcoming and Recent Events

The following events are organized by the OeNB. 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 OeNB.ResearchUpdate@oenb.at or take a look at <http://www.oenb.at/en/Calendar.html>

Upcoming Events

November 10, 2017	Friday Seminar*: Michael Bordo, Rutgers University, Central bank issued digital currencies
November 17, 2017	Friday Seminar*: Hanna Halaburda, Bank of Canada, Central bank digital currencies: a framework for assessing why and how
November 20 and 21, 2017	Conference on European Economic Integration (CEEI): "A modern take on structural reforms – past and future challenges for CESEE and Europe at large" (by invitation only!)
January 12, 2018	Friday Seminar*: Martin Gonzalez Eiras, University of Copenhagen, Treasury Auctions
January 19, 2018	Friday Seminar*: Katharina Bergant, Trinity College Dublin, The Anatomy of the Transmission of Macroprudential Policy

* Friday Seminar: Friday from 11:00-12:30 at the Österreichische Nationalbank

Recent Events

October 11, 2017	Global Economy Lecture jointly organized by the Österreichische Nationalbank and The Vienna Institute for International Economic Studies, at the OeNB. David Dorn, Professor of Economics, University of Zurich, will give a lecture on "The rise of the machines – how computers have changed work". (by invitation only!)
September 18, 2017	81 st East Jour Fixe: "Nonperforming loans in CESEE: macroeconomic dimension and resolution strategies" (by invitation only!)
August 28, 2017	Book presentation by Markus K. Brunnermeier: "The Euro and the Battle of Ideas" ("Euro: Der Kampf der Wirtschaftskulturen") by Markus K. Brunnermeier, Harold James and Jean-Pierre Landau. Markus K. Brunnermeier is Edwards S. Sanford Professor of Economics at Princeton University and Director of Princeton's Bendheim Center of Finance. Please note that the event will be in German. (by invitation only!)
June 23, 2017	Friday Seminar: Evren Damar (Bank of Canada): International Banking and Cross-Border Effects of Regulation: Lessons from Canada
June 29 and 30, 2017	25 th Anniversary of the Joint Vienna Institute: "Globalization, Technology and Lifelong Learning" (by invitation only!)

OeNB Courses at the Joint Vienna Institute (JVI) 2017

For further details see: <https://www.jvi.org/home.html>

January 23 – 26, 2017	Advanced Course on Financial Stability Stress Testing for Banking Systems
January 30 – February 3, 2017	Banking Supervision within the Basel Framework (in cooperation with JVI and Deutsche Bundesbank)
March 2 – 3, 2017	International Cooperation in Central Banks
March 13 – 17, 2017	Monetary Policy Implementation (in cooperation with JVI and Deutsche Bundesbank)
March 20 – 22, 2017	Financial Education
May 8 – 12, 2017	Integration in Europe: European Union and Eurasian Economic Union (in cooperation with the Austrian Federal Ministry of Finance)
September 11 – 15, 2017	Challenges for Candidate and Potential Candidate Countries in the EU and EMU Accession Process (in cooperation with the Austrian Federal Ministry of Finance and the ECB)
October 9 - 13, 2017	Macro-Financial Stability in Central, Eastern and Southeastern Europe (in cooperation with the ECB)
November 22 – 24, 2017	Financial Translation and Editing: New Skills for New Challenges
November 27 – 29, 2017	Cash Circulation and Payment Systems in Austria

OeNB Courses at the Joint Vienna Institute (JVI) 2018

For further details see: [Course Schedule 2018](#)

January 15 – 18, 2018	Advanced Course on Financial Stability Stress Testing for Banking Systems
January 22 – 26, 2018	Banking Supervision within the Basel Framework (in cooperation with JVI and Deutsche Bundesbank)
March 5 -9, 2018	HR Issues and Compliance (in cooperation with Deutsche Bundesbank)
March 12 -16, 2018	Monetary Policy Implementation (in cooperation with JVI and Deutsche Bundesbank)
May 14 – 18, 2018	Integration in Europe: European Union and Eurasian Economic Union (in cooperation with the Austrian Federal Ministry of Finance)
September 10 – 14, 2018	Challenges for Candidate and Potential Candidate Countries in the EU and EMU Accession Process (in cooperation with the Austrian Federal Ministry of Finance and ECB)
October 15 – 19, 2018	Macrofinancial Stability in Central, Eastern and Southeastern Europe
November 5 – 7, 2018	Cash Circulation and Payment Systems in Austria
November 19 -23, 2018	Financial Education
November 26 – 30, 2018	Monetary and Financial Statistics Collected and Compiled by the ESCB