

# Research Update

Economic Analysis and Research Department

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## Upcoming Highlights

Mai 31 - June 1 2010

OeNB Economics Conference: Central Banking after the Crisis; responsibilities, strategies, instruments



## Editorial

by Peter Mooslechner  
 Director of the Economic Analysis and Research Department

The World Has Come In out of the Cold – But Spring Has Yet to Get Underway in Europe

It's time to put away our skis after a wonderful skiing season and to prepare for spring with its warmer temperatures and its more relaxed atmosphere. By the same token, recent economic forecasts look a little bit better than those a few months ago. But at least from a European perspective, the year 2010 seems to be better characterized as "the third year of the crisis" than as "the first year after the crisis." Unusually high risks still prevail, and in many respects, the situation is still exceptional and extremely fragile:

- First of all, financial markets have not stabilized to the extent that we can be assured that they will function appropriately in the near future. Obviously, one of the highest risks the world economy faces is any kind of additional financial shock.
- Second, domestic demand in almost all European countries still can't benefit from sufficient endogenous dynamics. In particular, private investment hasn't picked up enough to power a sustainable upswing. As private consumption will suffer from weak household income growth and high unemployment until 2011, and as the consolidation of public finances will put a brake on growth, foreign demand is the only GDP component that will be able to provide a positive impulse.
- Last but not least, it seems rather puzzling that Europe is lagging behind the worldwide upturn once again. Europe does have specific problems, such as imbalances and failures of policy coordination, but are they really worse than those that triggered the financial crisis or that exist elsewhere in the world?

Economic science and economic policy as its instrument are still under pressure to formulate and implement appropriate policies to meet these challenges. As we would all be interested in having a quieter summer this year, it would be very helpful if we would at least be able to avoid additional negative shocks over the forthcoming months by pursuing good policies.

## EBRD Growth Forecast and the Role of Financial Integration in Crisis Transmission in CESEE

– Presentation by Jeromin Zettelmeyer, EBRD Director for Policy Studies, at the OeNB on January 27, 2010

On January 27, 2010, Jeromin Zettelmeyer, Director for Policy Studies at the European Bank for Reconstruction and Development, presented at the OeNB the latest growth forecasts of the EBRD as well as background research conducted for the EBRD Transition Report 2009 with a special focus on the role of financial integration in the transmission of the crisis to the CESEE countries.

The first part of the presentation investigated the role of financial integration in crisis transmission. Notwithstanding the robust evidence that financial integration had economically tangible growth benefits in the transition region from 1994 until 2008, it had a mixed direct role in the crisis. On the one hand, it provided a conduit for financial shocks (obvious, in financial autarky there would not be contagion) and some aspects of financial integration even aggravated the crisis, such as pre-crisis credit booms, private external debt and FX exposures. On the other hand, a higher degree of financial integration was also a mitigating factor in the output decline as foreign banks buffered the financing shock because of commitments to subsidiaries. There is evidence that financial integration – either via the presence of foreign banks or cross-border debt flows – contributed to a mismatch in FX positions over and above standard causes.

Appropriate policy reactions would lie in the development of local currency bond markets, higher creditworthiness standards for FX borrowers, or limits on open FX positions of firms and households.

In the second part of the presentation, Mr. Zettelmeyer presented the latest growth forecasts for the transition region (30 countries from central Europe to central Asia, including Turkey), reflecting a slightly faster economic recovery than anticipated in October 2009, but with stark variation across the region. The recovery is expected to strengthen moderately in 2011. Following a contraction of real GDP of about 6% in 2009, the EBRD now expects average growth for the region of 3.3% in 2010 (compared to 2.5% predicted in October) and of 3.8% in 2011. The upward revision is primarily driven by stronger than expected performance in four large economies in the region: Poland, Turkey, Russia, and Kazakhstan, on the back of stronger commodity prices, and a resumption of capital flows to large emerging market countries. In contrast, for most of the smaller countries that do not export commodities, the recovery will continue to be slow and in some cases (the Baltic countries and Hungary) the EBRD expects to see continued negative growth in 2010.

For more details see <http://www.ebrd.com/pubs/econo/tr09.htm>

## Contagion and Spillovers – New Insights from the Crisis

On February 12, 2010, the Oesterreichische Nationalbank (OeNB) hosted a SUERF Conference and Special OeNB East Jour Fixe on “Contagion and Spillover: New Insights from the Crisis.” More than 100 participants took part in the event, which was jointly organized by SUERF – The European Money and Finance Forum, the OeNB and the Austrian Society for Bank Research. The conference focused on three

aspects of contagion and spillovers: real economy channels of crisis transmission, financial sector contagion and spillovers to emerging markets.

The President of SUERF, Cathérine Lubochinsky (University of Paris 2), and OeNB Governor Ewald Nowotny held introductory statements. The ensuing keynote session was chaired by Philipp Hartmann (Vice President of SUERF, ECB). The first keynote speech, “Contagion and Spillovers –

Recent European Experience and the Way Forward," was delivered by Jürgen Kröger (European Commission). He highlighted divergent developments within the euro area and then presented the results of an empirical study on transmission channels. In the second keynote speech Javier Santiso (OECD), discussed how politics and elections shape financial and capital market sentiment.

Session 1, chaired by Ernest Gnan (Secretary General of SUERF, OeNB), dealt with real economy channels of crisis transmission. Filippo di Mauro (ECB) gave an overview of the real economic impacts of the global crisis by elaborating, inter alia, on the long-standing stylized fact that the U.S. business cycle leads the world economy. Julia Wörz (OeNB) presented a paper on the role international trade played in transmitting the crisis and thereby pointed to several reasons for the particularly strong response of trade to the recent recession. In the last presentation of this session, Simon Evenett (University of St. Gallen), identified key developments in global protectionism during the recent economic crisis.

Session 2 was chaired by Peter Mooslechner (OeNB) and dealt with aspects related to financial sector contagion. Már Guðmundsson (Governor of the Central Bank of Iceland) held a keynote speech on lessons learned from the crisis

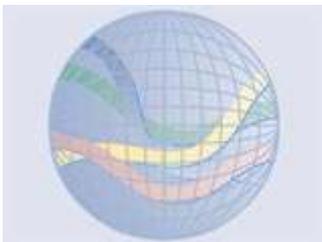
with regard to cross-border banking, with a special focus on the case of the Icelandic banking sector. Ove Sten Jensen (Danmarks Nationalbank) went on to explore the nature of the crisis, its impacts and consequences for financial markets from the perspective of a public debt manager. In his view, the crisis brought about new tasks for debt managers in addition to the primary task of managing the central government's financing needs.

Session 3, chaired by Peter Backé (OeNB), focused on the spillovers of the crisis to specific emerging market regions and on two country cases. José María Serena (Banco de España) and Reiner Martin (ECB and OeNB), presented a paper on "The Impact of the Global Economic and Financial Crisis on the CESEE Region and on Latin America." This paper analyzed the vulnerability patterns present in the two regions before the onset of the crisis and provided an overview of the impact of the crisis on the two regions. Finally, Lars Tranberg Rasmussen (Danske Bank) delivered a case study on Latvia and Dimitry Sologoub (Raiffeisen Bank Aval) presented a case study on Ukraine. Both speakers referred to various factors that added to the weaknesses and vulnerabilities of the Latvian and Ukrainian economies before the crisis and discussed their economic prospects.

See also Focus on European Economic Integration Q2/10.

## FRANZ WENINGER AWARD;

*Award for master's and doctoral theses in the field of monetary theory and monetary policy*



The Franz Weninger Award is granted at the annual Conference on European Economic Integration (CEEI) of the Oesterreichische Nationalbank (OeNB). The OeNB confers this award every year for outstanding master's and doctoral theses in the field of monetary theory and monetary policy in commemoration of the late head of the Economic Analysis Division of the OeNB. The Governing Board of the OeNB bestows the Franz Weninger Award on recommendation of a panel of experts.

Three one-time prizes of EUR 3,000 each may be conferred for such theses every year. The theses shall be approved by an Austrian university. Approval shall be from the academic year (October 1 – September 30) immediately preceding the submission date. The master's or doctoral thesis submitted shall be postmarked October 4, 2010, at the latest, must bear the reference "Franz-Weninger-Stipendium/Franz Weninger Award" and sent to Oesterreichischen Nationalbank, Otto-Wagner-Platz 3, A-1090 Vienna, Austria. For further details please go to [Conditions for Participation](#) on the OeNB webpage (you can also the order these conditions via telephone or e-mail).

## Austria's Economy Growing Robustly in Early 2010 March 2010 Update of the OeNB's Short-Term Indicator

The current outlook for the Austrian economy indicates robust growth for the first half of 2010. The OeNB's latest short-term indicator predicts real GDP to increase by 0.5% in both the first and second quarters of 2010 (seasonally and working day-adjusted, on a quarterly basis). The majority of leading indicators used for the short-term indicator are clearly pointing upward. If this positive trend continues in the second half of 2010, the OeNB expects real GDP to rise by 1½% in 2010. This forecast is subject to considerable downside risks, as the temporary growth factors could fade, which would dampen growth significantly.

Growth is mainly driven by the global recovery, which drives Austrian exports. The OeNB expects these positive developments to fuel growth also in the months ahead, based on truck mileage and order books data. Capacity utilization is still at very low levels, so investment will continue to be weak. Private consumption – albeit growing at a moderate pace only – has helped to stabilize GDP growth in the recent past. However, consumption growth is expected to slow down in light of rising unemployment and modest wage settlements for 2010.

### Olga Radzyner Award 2010 for Scientific Work on European Economic Integration

The Oesterreichische Nationalbank has established an award to commemorate Olga Radzyner, former Head of the Foreign Research Division, who died in a tragic accident in August 1999. The award is bestowed on young economists for excellent research focused on topics of European economic integration and is conferred annually. In 2010, four applicants are eligible to receive a single payment of EUR 3,000 each from an annual total of EUR 12,000.

The submitted work shall be in English or in German, should not exceed approximately 30 pages and shall preferably be in the form of a working paper or a scientific article. The topic of the submitted work should be on European economic integration issues. Authors shall submit the 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 coauthored work, each of the coauthors has to fulfill all the criteria.

The Oesterreichische Nationalbank shall receive the work submitted for this award, by October 4, 2010, and the work shall be sent by electronic mail to [eva.gehringer-wasserbauer@oenb.at](mailto:eva.gehringer-wasserbauer@oenb.at) or in hard copy to the Oesterreichische Nationalbank, Foreign Research Division, Otto Wagner-Platz 3, POB 61, A-1011 Vienna, Austria. To identify their work as a submission, applicants shall mark the envelope with the reference "Olga Radzyner Award". Apart from the copy of the applicant's birth or citizenship certificate, the author shall provide a brief CV.

For detailed information, please visit our Internet website at <http://ceec.oenb.at> or contact Eva Gehringer-Wasserbauer in the Foreign Research Division of the Oesterreichische Nationalbank either by e-mail ([eva.gehringer-wasserbauer@oenb.at](mailto:eva.gehringer-wasserbauer@oenb.at)) or by phone (+43-1-40420-5205).

## Economic Analysis of the Proposal to Impose a Bank Tax in Austria

Both in public and in the academic literature, the introduction of a bank tax is currently being discussed from three perspectives:

First, a bank tax is considered to be a contribution by banks and/or the financial system to covering crisis costs (fiscal objective).

Second, as a liability fee for the free-of-charge implicit state guarantee in case of crisis (“too big to fail,” correction of systemic externalities), a bank tax is intended to help correct adverse incentives (financial stability objective), given that banks take excessive risks because they expect government bail-outs. A bank tax may be considered an important macroprudential tool to mitigate systemic risk.

Third, depending on the design and definition of the tax base, a bank tax is expected to have steering effects, as it treats macroeconomically desirable financial instruments preferentially. Indirectly, the bank tax would thus also promote the stability of the financial system.

Theoretically, a bank tax combined with other regulatory measures (capital regulation) may, *ceteris paribus* (and depending on its specific design), have positive implications for the stability of the financial system. In particular, it will reduce systemic risk.

The study examines various taxation scenarios for Austria, discusses the pros and cons of the tax design of various scenarios from the perspective of financial stability as well as the interaction between a bank tax and a financial transaction tax. It concludes that both taxes are complementary.

Particular emphasis is given on the macroeconomic effects of a bank tax. A number of possible economic effects need to be taken into consideration; these are analyzed in greater depth in the present study. First of all, we must determine whether the envisaged bank tax is to be analyzed *per se* or as a substitute of some other type of tax. Treating the bank tax as a

separate measure, we analyze two extreme scenarios: The first scenario assumes that the bank tax is passed on entirely to bank customers. Simulations calculated with the OeNB’s macroeconomic model showed that within three years of collecting a bank tax of EUR 500 million per year, annual GDP growth would be between 0.01% and 0.1% lower than in a scenario without a bank tax. These effects, however, must be offset against the (probably stronger) effects of alternative forms of budget financing.

The second scenario assumed that the tax incidence entirely falls upon bank customers. In this case, the bank tax must be analyzed in connection with the reforms of regulatory capital requirements and the competitive position of the Austrian banking system. It is not possible to quantify the effects observed in this scenario. In a period when banks have to raise capital ratios to meet regulatory requirements, lending might be limited (if capital ratios are raised by deleveraging); credit costs may also rise. This might have unintended repercussions on the real economy. *Ceteris paribus*, a bank tax may impede equity capital formation out of corporate profits (which will be reduced by the tax). Whether such a hypothetical scenario materializes, however, depends on how banks react strategically. Theoretically, if capital ratios were increased by raising new capital, the bank tax would not immediately influence capital formation; but if, while raising their capital ratios, banks increasingly drew on the capital market at the same time, financing costs could deteriorate, which in turn could cause lending rates to go up. To understand the interaction between a bank tax and regulatory capital requirements, it is essential, however, to bear in mind that the intended increase in the capital ratio can be achieved by various measures (external equity financing, allocation from profits, reduction of risk-weighted assets). It is realistic to assume that in practice, a mix of measures will be chosen.

## OeNB Periodical Publications

[http://www.oenb.at/de/geldp\\_volksw/vowi\\_pub/volkswirtschaftliche\\_publicationen.jsp](http://www.oenb.at/de/geldp_volksw/vowi_pub/volkswirtschaftliche_publicationen.jsp)



### Financial Stability Report 19

Stress Testing Austrian Households (Albacete, Fessler)

Auswirkungen des Zahlungsdienstegesetzes auf den österreichischen Finanzmarkt (Freitag, Schimka)

Die Relevanz österreichischer KAGs und Investmentfonds für die Finanzmarktstabilität (Kavan, Sedlacek, Seliger, Ubl)

Banking sector Kazakhstan (Barisitz)



### Monetary Policy & The Economy, Q1/10

D Shocks, the Crisis and Inflation Expectations Uncertainty: Some Theory and Evidence for the Euro Area (Ernest Gnan, Johannes Langthaler, Maria Valderrama)

The Relationship between Competition and Inflation (Philipp Schmidt-Dengler, Jürgen Janger)

Determinants for Sectoral Price Comparison and Switching Rates in Austria (Jürgen Janger)

Bank Recapitalization and Restructuring: An Economic Analysis of Various Options (Helmut Elsinger, Martin Summer)



### Focus on European Economic Integration Q2/10

Privat Sector Credit in CESEE: Long-Run Relationships and Short-Run Dynamics (Eller, Frömmel, Szentric)

OeNB Euro Survey (Dvorsky, Scheiber, Stix)

Contagion and Spillovers - New Insights from the Crisis (Backé, Feldkircher, Gnan, Lahnsteiner) (report on SUERF conference / Special OeNB East Jour Fixe on February 12, 2010)

The OeNB now offers users new RSS feeds (in German) on its economics publications, including Focus on European Economic Integration. For more information and to subscribe to feeds, go to: [www.oenb.at/de/service\\_veranst/rss/rss\\_der\\_oenb.jsp](http://www.oenb.at/de/service_veranst/rss/rss_der_oenb.jsp)

## OeNB Working Papers

### Working Paper 160

“Spatial Filtering, Model Uncertainty and the Speed of Income Convergence in Europe” (January 11, 2010) by Jesús Crespo Cuaresma and Martin Feldkircher

In this paper we put forward a Bayesian Model Averaging method dealing with model uncertainty in the presence of potential spatial autocorrelation. The method uses spatial filtering in order to account for different types of spatial links. We contribute to existing methods that handle spatial dependence among observations by explicitly

taking care of uncertainty stemming from the choice of a particular spatial structure. Our method is applied to estimate the conditional speed of income convergence across 255 NUTS-2 European regions for the period from 1995 to 2005. We show that the choice of a spatial weight matrix - and in particular the choice of a class thereof - can have an important effect on the estimates of the parameters attached to the model covariates. We also show that estimates of the speed of income convergence across European regions depend strongly on the form of the spatial patterns which are assumed to underlie the dataset. When we take into account this dimension of model uncertainty, the posterior distribution of the speed of convergence parameter has a large probability mass around a rate of convergence of 1%, approximately half of the value which is usually reported in the literature.

[http://www.oenb.at/en/presse\\_pub/research/020\\_workingpapers/working\\_papers\\_2010.jsp](http://www.oenb.at/en/presse_pub/research/020_workingpapers/working_papers_2010.jsp)

## External Publications by Staff Members

“How Automatic Adjustment Factors Affect the Internal Rate of Return of PAYG Pension Systems”, Output Volatility and Economic Growth”

Markus Knell

Journal of Pension Economics and Finance 9(1), January 2010, 1-23

In this paper we analyze automatic adjustment factors that can be used to keep the budget of a PAYG pension system balanced when cohort sizes fluctuate. The adjustment factors are defined in a way that is similar to their real-world counterparts and they differ in the relative weight they put on changes in the contribution rate and in the pension level. We show how the internal rate of return of the PAYG system depends on the fluctuations in cohort size and on the choice of the adjustment regime. We find that fluctuations in the cohort size have the smallest impact on the internal rate of return if the relative weight of the adjustment

parameters directly corresponds to the length of the retirement period relative to the length of the working period. For reasonable numerical values, this weight is close to the actual choice in the German system.

“Does adding up of economic capital for market- and credit risk amount to conservative risk assessment?”

Thomas Breuer, Martin Jandačka, Klaus Rheinberger, Martin Summer

Journal of Banking and Finance, 34, 4, April 2010 703-712

There is a tradition in the banking industry of dividing risk into market risk and credit risk. Both categories are treated independently in the calculation of risk capital. But many financial positions depend simultaneously on both market risk and credit risk factors. In this case, an approximation of the portfolio value function separating value changes into a pure market risk plus pure credit risk component can result not only in an overestimation, but also in an underestimation of risk. We discuss this compounding effect in the context of foreign currency loans and argue that a separate calculation

of economic capital for market risk and for credit risk may significantly underestimate true risk.

**“Choosing and using payment instruments: evidence from German microdata”**

Ulf von Kalckreuth, Tobias Schmidt und Helmut Stix

ECB Working Paper No. 1144 und Deutsche Bundesbank Working Paper No. 36/2009

Germans are still very fond of using cash. Of all direct payment transactions, cash accounts for an astounding 82% in terms of number, and for 58% in terms of value. With a new and unique dataset that combines transaction information with survey data on payment behaviour of German consumers, we shed light on how individuals choose payment instruments and why cash remains so important.

We propose a two-stage empirical framework which jointly explains credit card ownership and the use of cash. Our results indicate that the pattern of cash usage is compatible with systematic economic decision making. Consumers decide upon the adoption of payment cards and then use available payment media according to their transaction and personal characteristics, the relative costs of cash and card usage, and their assessment of payment instruments’ characteristics. Whereas older consumers use significantly more cash, the comparison with younger consumers shows that the difference in payment behaviour is not explained by age as such but to a large extent by differences in the characteristics of these two groups. It is interesting that the possession of a credit card, especially alongside a debit card, does not significantly affect the use of cash in Germany.

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

[http://www.oenb.at/de/img/publications\\_2010\\_1\\_fin\\_tcm14-189588.pdf](http://www.oenb.at/de/img/publications_2010_1_fin_tcm14-189588.pdf)

## 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](mailto:OeNB.ResearchUpdate@oenb.at)

April 09, 2010	Friday Seminar: TBA, held by Herbert Gintis (Santa Fe Institute; Central European University, Budapest; University of Siena)
April 23, 2010	Friday Seminar: Endogenous Systemic Liquidity Risk, held by Gerhard Illing (LMU München)
April 30, 2010	OeNB East Jour Fixe: Kazakhstan: From Star Performance to Crises and back again?
May 17, 2010	Presentation of IMF Regional Economic Outlook for Europe
May 21, 2010	Friday Seminar: TBA, held by David Lando (Copenhagen Business School)
May 31 - June 1 2010	OeNB Economics Conference: Central Banking after the Crisis; responsibilities, strategies, instruments
June 14, 2010	Press conference: Gesamtwirtschaftliche Prognose der OeNB für Österreich 2010 bis 2012 vom Juni 2010
June 21, 2010	CESEE Workshop: Macro-Financial Stability in CESEE: Have we learned all the lessons?
June 25, 2010	Press conference: Financial Stability Report 19
June 25, 2010	Friday Seminar: TBA, held by Christian Ewerhart (University of Zurich)
August 3 – September 30, 2010	OeNB Summer School: Micro Econometrics
November 15–16 2010	OeNB Conference on Eastern European Integration: Catching-Up Strategies after the Crisis

Recent Events: January 13, 2010	Research seminar: Inflation Targeting: A Framework for Communication, held by Maria Demertzis (DNB)
January 27, 2010	Presentation of the EBRD Transition Report
January 29, 2010	Friday Seminar: Dynamic Factor Price Equalization and international convergence, held by Clint Shiells (JVI)
February 12, 2010	SUERF Conference and Special OeNB East Jour Fixe: Contagion and Spillovers – New Insights from the Crisis
March 12, 2010	Friday Seminar: Asset Prices and Monetary Policy: A New View of the Cost Channel, held by Tiziana Assenz (Catholic University of Milan)
March 26, 2010	Friday Seminar: Forgiving vs. Financing a Debt Overhang, held by Alex Stomper (MIT and IHS)

TBA: to be announced.

## OeNB Courses at the Joint Vienna Institute (JVI)

March 8 - 11, 2010	Financial Stability Stress Testing for Banking Systems: An Introduction
April 26 - 29, 2010	Institutional Challenges for SEE Countries on the Road to the EU and EMU
October 4 - 8, 2010	Monetary and Financial Statistics Collected and Compiled by the ESCB
October 11 - 14, 2010	Economic and Monetary Integration in Europe: CIS Related Aspects

For further details see: [http://www.jvi.org/fileadmin/jvi\\_files/JVI\\_Program2010.pdf](http://www.jvi.org/fileadmin/jvi_files/JVI_Program2010.pdf)

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