17th ESCB Emerging Markets Workshop

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On December 9 and 10, 2019, the OeNB hosted the 17th ESCB workshop on emerging markets. Since its inception in 2003, this workshop series has been a platform for researchers in the ESCB – with the central banks of Finland, Spain and Austria taking the lead – to present and discuss their analytical work on macroeconomic and financial issues related to emerging economies.

Having received many high-quality submissions from a broad range of central banks from inside and outside the EU, the organizing committee, in addition to two keynotes, selected thirteen papers for the one-and-a-half-day event. The topics covered aspects of monetary and macroprudential policy, financial stability and international macroeconomics.

In his opening remarks, *Robert Holzmann*, Governor of the OeNB, emphasized the increasing relevance of emerging markets for the global economy in general and for Austria in particular. He then moved on to ponder the heterogeneity of, and reasons for, lower economic growth inside and outside the euro area and stressed that developing capital markets may provide a welcome stimulus to economic and productivity growth in many countries.

Session 1 and 2: Monetary and macroprudential policy issues

André Geis (ECB) presented a paper on potential implications of euro area monetary policy normalization for CESEE countries. Using shock-specific conditional forecasts, Geis and his ECB coauthors *Isabella Moder* and *Tobias Schuler* find that changing policy rates in the euro area trigger potentially sizeable spillovers to CESEE. However, the effect is not homogeneous across the region and depends to a large extent on the economic environment in which the monetary policy stance is altered. Having studied the question to what extent macroprudential policies have been able to stabilize capital flows in CESEE, *Markus Eller* (OeNB) presented a novel regime-switching factor-augmented vector autoregressive model, which allows for potential structural breaks in the policy regime and controls for the impact of global factors. According to Eller and his coauthors *Niko Hauzenberger*, *Florian Huber*, *Helene Schuberth* and *Lukas Vashold*, tighter macroprudential policies generally do not shield CESEE countries from capital flow volatility. Yet, they could be effective in containing private sector credit growth and the volumes of gross capital inflows.

Complementing in some ways André Geis's contribution, *Martin Feldkircher* (OeNB) presented his and *Pierre L. Siklos's* work on international effects of conventional monetary policy (actual interest rate changes) and forward guidance (defined as expected interest rate changes) in the euro area. While the effects vary over the sample period, the two researchers find that both actual and expected interest rate hikes in the euro area imply significant spillovers to a broad range of countries. However, Feldkircher pointed out that, compared with actual interest rate increases, the forward guidance shock has a more persistent impact on euro area and international interest rates. *Irina Kozlovtceva* (Bank of Russia) concluded session 2 by presenting empirical evidence for the procyclicality of monetary policy in a group of inflation-targeting, commodity-exporting emerging market economies. Her coauthors *Alexey Ponomarenko*, *Andrey Sinyakov*, *Stas Tatarintsev* and she found that monetary policy eases in response to a price increase of an exported commodity, while real credit grows. In addition, in a theoretical DSGE framework calibrated to the Russian economy, their research shows that, when commodity price volatility is relatively high, leaning-against-the-wind strategies outperform pure inflation targeting.

Keynote lecture by Adam Geršl

Subsequently, *Adam Geršl*, senior economist at the Joint Vienna Institute, reviewed in the first keynote address a specific macroprudential tool, namely the countercyclical capital buffer (CCyB). The Basel Committee on Banking Supervision proposed that national policymakers set the CCyB rate as a function of the credit-to-GDP gap, which is based on standard HP filtering with a high smoothing parameter reflecting the typically longer duration of financial cycles. Geršl mentioned that there is a surprising lack of correlation between credit-to-GDP gaps and the CCyB rate in many countries and that national authorities take into account a much larger set of indicators to calibrate the CCyB rate. Based on his research, Adam Geršl discussed whether augmenting the HP filtering with forecasts improves the signaling properties of the credit-to-GDP gap and presented possible ways to assess whether existing private sector debt levels are sustainable or not – another important input into the decision on the CCyB. Geršl also reminded participants that the CCyB is designed to increase resilience against shocks, and not necessarily to tame the financial cycle. Nevertheless, as shown by preliminary results of his current research with coauthors from the IMF, capital-based tools such as the CCyB decrease the risk of a credit boom turning into a credit bust.

Session 3 and 4: International macroeconomic and finance issues

Oleksandr Faryna (National Bank of Ukraine) presented a paper, coauthored with *Heli Simola* (Suomen Pankki – Finlands Bank), on the transmission of international output and oil price shocks to CIS economies, in which they employed standard GVAR estimations. The authors find that CIS countries are highly sensitive to global and regional shocks, with that sensitivity increasing after the global financial crisis. Moreover, CIS countries react most strongly to output shocks originating in the U.S.A., Russia and within the region itself, while shocks originating from China still have a relatively moderate impact. *Fabrizio Venditti* (ECB) followed up by presenting work, coauthored with *Maurizio Habib* (ECB), on how shocks to global financial risk are transmitted to capital flows. Venditti argued that not all the risk shocks driving the global financial cycle have the same effect on capital flows. Changes in global risk caused by purely financial shocks have the largest impact on the global configuration of capital flows. As regards the transmission of risk to capital flows, the authors corroborate that countries that are more financially open and have adopted a strict peg are more sensitive to global risk shocks.

Irma Alonso (Banco de España) presented work carried out with *Luis Molina* on a tool to detect the accumulation of vulnerabilities in emerging market economies based on a synthetic index of vulnerability for different types of crises. The so-called SHERLOC (i.e. Signaling Heightened Emerging Risks that Lead to the Occurrence of Crises) tool outperforms all individual indicators in predicting the probability of being vulnerable to different types of crises. The first day of the workshop was rounded out by *Utku Bora Geyikçi* (Central Bank of the Republic of Turkey), who presented a paper, coauthored with *Süheyla Özyildirim*, that examines deviations from covered interest parity (CIP) in six emerging market economies (EMEs) after the global financial crisis. According to Geyikçi, the sustained deviations from CIP after 2010 can be explained to a large extent by local factors, while global factors play no prominent role in predicting CIP deviations.

In her dinner remarks, *Doris Ritzberger-Grünwald*, Director of the OeNB's Economic Analysis and Research Department, reviewed the history of the emerging markets workshop series. She pointed out that this event is a showcase of the ESCB's division of labor, with various central banks having developed a significant comparative advantage with respect to different emerging market regions.

Keynote lecture by Enrique Alberola

Discussions on day two of the workshop were kicked off by a keynote speech delivered by *Enrique Alberola*, advisor in the monetary and economic department of the Bank for International Settlements, who emphasized that EMEs are more vulnerable to external shocks than advanced economies. It follows that monetary policy frameworks differ quite significantly. Inflation targeting may be only one policy goal, next to exchange rate stabilization and financial stability considerations. Moreover, trade and financial channels of exchange rate changes work in different directions, which adds to the policy dilemmas faced by EME-based central banks. Other instruments such as foreign reserves and macroprudential policies are likewise needed and implemented. Alberola also warned that, while useful, macroprudential policies are not a panacea.

Session 5: International macroeconomic and finance issues continued

Jacopo Timini (Banco de España) analyzed the effects of trade agreements signed by Latin American countries on international trade, using a structural gravity model and exploiting treaty-level information. Overall, trade agreements spur international trade even though the effects of such agreements vary greatly. Running various simulations on the effects of five different scenarios of enhanced integration, Timini and his coauthor *Ayman El Dahrawy Sánchez-Albornoz* showed that both trade gains and welfare gains may be substantial. In the subsequent presentation, *Claudia Maurini* (Banca d'Italia) argued that IMF assistance programs have a stigmatizing effect on EMEs in terms of increased borrowing costs. Addressing the selection bias through the propensity score matching methodology, she found that traditional IMF programs have indeed a stigmatizing effect on emerging markets by increasing sovereign spreads, while precautionary programs have the opposite effect by decreasing the sovereign spreads. Maurini's paper is particularly policy relevant as financial stigma may induce EMEs to delay or even avoid IMF assistance.

Session 6: The financial sector and the real economy

The last session featured papers on linkages between the real and the financial economy. *Ivan Huljak* (Croatian National Bank), using a standard stochastic frontier model, argued that standard profitability measures for banks in the CESEE region may disguise underlying inefficiencies of their cost structure. According to this paper coauthored with *Reiner Martin* (Joint Vienna Institute) and *Diego Moccero* (ECB), CESEE banks would produce the same output at only 80% of current costs if they operated at the efficiency frontier. *Tania Karamisheva* (Bulgarian National Bank) studied the interactions between financial and real cycles in Bulgaria. She and her coauthors *Gergana Markova*, *Svilen Pachedzhiev* and *Boyan Zahariev* found that the Bulgarian economy is currently entering a phase of cyclical risk accumulation and sees a high synchronization between both cycles. Finally, *Karlo Kauko* (BOFIT) cast doubt on nonperforming loan (NPL) data as reported by banks in China and attempted to estimate more realistic NPL figures. Employing stochastic frontier analysis, he found in his study that overall (including hidden) NPLs are likely to be higher than the reported NPLs. Interestingly, banks with strong capital adequacy have higher hidden NPLs, whereas high profitability (return on equity) does not play any role in the trends of hidden NPLs. According to Kauko's findings, dependence on interbank funding seems to boost the amount of nondisclosed NPLs.

Next ESCB Emerging Markets Workshop

The Banco de España will host the *18th ESCB Emerging Markets Workshop* in the second half of 2020 in Madrid.