

February 2017

CESEE Research Update

Foreign Research Division

www.oenb.at/cesee-research-update

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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

Highlights of this Issue

- **79th OeNB East Jour Fixe:** “Capital Flows to CESEE – Impact on Macro-Financial Stability and Policy Responses” (see p. 2)
- **World Bank’s flagship report** „Risks and Returns: Managing Financial Trade-Offs for Inclusive Growth in Europe and Central Asia“ (see p. 4)
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- **Focus on European Economic Integration Q4/16** (see p. 9)
- **Olga Radzyner Award 2017** (see p. 9)
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79th OeNB East Jour Fixe: “Capital Flows to CESEE – Impact on Macro-Financial Stability and Policy Responses”, November 4, 2016

The 79th East Jour Fixe hosted by the OeNB on November 4, 2016, focused on recent developments and driving factors of capital flows in Central, Eastern and Southeastern European (CESEE) countries, the impact of capital flows on macro-financial stability and the effectiveness of policy responses so far.

In his **keynote address**, Professor Joshua Aizenman (University of Southern California) gave an overview of gains and costs arising from financial liberalization. He stressed that gains tend to be front-loaded while related costs are often hidden and rise with the buildup of balance sheet vulnerabilities. In the discussion he denied that capital flows to CESEE are an exception to this rule. Although no major commercial bank in the region failed following the global financial crisis, there were bail-outs via taxpayers. Focusing on prudential regulation, he expressed sympathy for regulations prohibiting or limiting FX mortgage funding, taxes on external borrowing in hard currency and considerably higher required capital ratios for banks. With respect to FDI, Aizenman emphasized that equity-related (greenfield) FDI flows are most beneficial as they strengthen international technology transfers.



Session 1 was devoted to current risks related to external funding and drivers of capital flows to the CESEE region. Emil Stavrev (IMF), illustrated the region’s strong reliance on external funding, with FDI representing an important source and the private sector accounting for

most of external debt. Further both, the private and the public sectors are subject to foreign exchange risk. Stavrev also highlighted signs of stabilization in Western banks’ exposure to CESEE after a long period of deleveraging. Markus Eller (OeNB) analyzed the factors driving gross capital flows to CESEE and identified the global financial cycle as the most important driving force, followed by the global real business cycle. The growing role of idiosyncratic factors in CESEE in the pre-2008 boom period may be related to the strategic positioning of Western banks in the region during that time.



Session 2 focused on macroprudential policies (MPPs) and other capital flow management measures (CFMs) to cope with large and volatile capital inflows. The speakers of the session provided novel evidence on the effectiveness of such measures. According to John Beirne (ECB) the structure of the domestic financial system plays an important role in this respect. In particular, better regulatory quality and a higher credit-to-deposit ratio increase MPP effectiveness. Deniz Igan (IMF) presented evidence from firm-level data to show that other investment inflows are related to more rapid credit growth for firms with increasing equity and collateral values but also in the case of financially constrained domestic banks. Turning to CESEE economies, she concluded that MPPs that target capital adequacy and/or non-standard liquidity have apparently been parti-

cularly effective. Kiril Koshev (OECD) pointed out that currency-based capital flow management measures (e.g. limits on FX lending) have been effective in reducing cross-border bank flows. But he also stressed that growth could be hampered if restrictions to capital flows resulted in limited access to finance for credit-constrained domestic enterprises. Moreover, Koshev emphasized that potentially negative externalities affecting other economic partner countries call for the international coordination of CFM implementation.



In the concluding **panel discussion** Professor Evžen Kočenda (Charles University Prague) underlined that efforts to tame the capital flow cycle in CESEE are warranted in order to reduce external vulnerability and excessive credit growth. Besides domestic responses, also internationally coordinated policies need to be considered given the importance of global factors and spillovers from decisions made by the most important central banks. Russia's experience with capital flows was discussed by Yaroslav Lissovolik (Eurasian Development Bank). With hindsight, Russia's pace of capital account liberalization was probably too high, and the introduction of exchange rate flexibility probably happened a bit too late. Lissovolik also emphasized the substantial reduction of capital outflows from Russia as a result of the strong consolidation of the Russian banking system in recent years. Thomas Richardson (Joint Vienna Ins-

titute) argued that growth differentials between advanced and emerging economies have been the main determinant of shifts in capital flows. Among various possibilities to cope with volatile capital flows, he strongly favored better international coordination of domestic policies. A second-best alternative for CESEE countries – saddled with growth costs – would be to pursue extremely prudent macroeconomic policies in order to reduce their vulnerabilities with respect to international capital flow swings.



In his **event wrap-up** the event, Dubravko Mihaljek (BIS), advocated rethinking CESEE's growth model, discussing in greater depth the banking sector's role in the economy and thinking about ways to attract beneficial types of capital flows rather than discussing solely restrictions on capital flows.

The presentations and the workshop program are available at:

<https://www.oenb.at/en/Calendar/terminarchiv-2016/2016/79th-OeNB-East-Jour-Fixe.html>.

For a full version:

https://www.oenb.at/dam/jcr:20ad3ab4-e6c5-4a10-a626-396177cbe610/feei_2016_q4_event%20wrap-ups%20and%20miscellaneous.pdf

World Bank's flagship report „Risks and Returns: Managing Financial Trade-Offs for Inclusive Growth in Europe and Central Asia“



On January 16, 2017, the OeNB hosted a presentation of the World Bank's flagship report „Risks and Returns: Managing Financial Trade-Offs for Inclusive Growth in Europe and Central Asia“. The report was presented by the two Lead Economists David Gould and Martin Melecky of the

World Bank and OeNB economist Elisabeth Beckmann, who had contributed to the report during a research stay at the World Bank in Washington, D.C.

According to this report, striking the right balance across all dimensions of financial development (stability, efficiency, inclusion, and overall depth) is crucial for achieving and sustaining inclusive growth. The Emerging Europe and Central Asia region, perhaps now more than ever, faces an urgent need for financial sector reforms: not only to make the region more resilient to financial shocks but also to support efforts to strengthen income growth, especially with regard to middle- and lower-income earners. For the majority of lower- and middle-income households in Emerging Europe and Central Asia, real income levels have declined, or not increased appreciably, since they hit their peak in 2007.

Although improving financial sector development alone cannot solve these problems, it may help build a consensus for complementary policies that support inclusive sustainable growth, rather than a reflexive inward tug toward isolationism and away from the liberalization and integration policies that began during the early 1990s. This report argues that financial development must go beyond improving the access to and pricing of credit. It should help build a broad-based and balanced financial system of both bank and nonbank markets, one that enables responsible financial inclusion of firms and individuals and enhances financial efficiency and stability.

The OeNB contribution to the report examines the drivers of household saving behavior in Central Europe and the Western Balkans and is based on household

survey data from the OeNB Euro Survey, which covers ten Central, Eastern and Southeastern European (CESEE) countries. Some key findings are: Household savings are comparatively low in this group of countries, with the global financial crisis having reduced them further. Diversification of saving instruments is limited, informal saving (saving in cash) is widespread, and foreign currency holdings are high. Income, remittances, receipt of income in euro, real estate ownership and trust are important determinants of saving. First-hand experience of banking crises during transition has contributed to widespread mistrust in financial institutions, which affects the choice of saving instruments. Physical access to banks, in turn, does not have a strong influence on formal savings. The composition of savings is related to internet access, but only in the case of the financially literate.

Finding the right balance in financial development also involves trade-offs that are often overlooked, much to the peril of policy makers. Too much credit and overly generous support for financial inclusion (even if well-meaning) have led to financial bubbles and crises. Likewise, too much financial sector repression to achieve stability has generated financial exclusion and inefficiencies with negative consequences for economic opportunities and growth.

To shed light on the policy implications of the report's findings the second part of the event featured a high-level central bankers' panel that discussed specific country cases in the Western Balkans. Chaired by the World Bank Chief Economist for Europe and Central Asia, Hans Timmer, this panel consisted of Governor Gent Sejko (Albania), Governor Dimitar Bogov (former Yugoslav Republic of Macedonia), Vice Governor Fehmi Mehmeti (Kosovo), Vice Governor Nikola Fabris (Montenegro) and Director General Ana Ivković (Serbia). As to financial inclusion, it was noted that savings have increased in the region, but more needs to be done to strengthen financial trust and thus further broaden and diversify savings. Widening access to credit, e.g. by microfinance institutions or by special state agencies, was seen as equally important, while supervisory challenges and problematic business practices of the shadow banking

sectors (e.g. short-term lending at prohibitive interest rates) were cited as trouble spots. Two general key challenges that were mentioned relate to the need to proceed with de-euroization (in those countries which are not de iure euroized) and to speed up the resolution of nonperforming loans (NPLs). In addition, the panelists called for greater cross-border cooperation in the supervisory area. In conclusion, Hans Timmer stressed the importance of advancing financial sector reforms, espe-

cially with a view to building trust. In doing so, the financial sector should always be seen as part of the economy as a whole (including its bearing on macro developments, income distribution, and participation), with a focus on the trade-offs involved.

[World Bank Report Risks and Returns: Managing Financial Trade-Offs for Inclusive Growth in Europe and Central Asia](#)

EBRD Transition Report 2016-17 – Transition for all: Equal opportunities in an unequal world

On January 19, 2017, Ralph de Haas, EBRD Director of Research, presented the main findings of the Transition Report 2016-17 of the European Bank for Reconstruction and Development (EBRD) at an event hosted by the Austrian Ministry of Finance (BMF). Harald Waiglein, Head of the BMF's Directorate General for Economic Policy and Financial Markets, opened the event

The presentation of Ralph de Haas was followed by a panel discussion moderated by Leander Treppel (BMF). Doris Ritzberger-Grünwald (OeNB), Harald Waiglein (BMF), Gallina Vincelette (World Bank) as well as Mario Holzner (wiiw) acted as panelists.



After the introductory remarks of Harald Waiglein, Ralph de Haas outlined the key messages of the report entitled “Transition for all: Equal opportunities in an unequal world.” It is the first Transition Report that brings into focus key aspects of inequality and economic inclusion in the EBRD region by looking beyond average economic growth.

De Haas started off by looking at **convergence and inequality**. In post-communist countries, 23 percent of the population is worse off today than in 1989, for 33 percent income has grown below the G7-average. Thus only 44% of the people have seen their income to converge in the long run. He also showed that mainly the higher income recipients have benefited from income convergence. He emphasized that different problems – wealth concentration, inequality and poverty – required specific responses. Wealth concentration, for instance, could be tackled by the taxation of wealth and/or inheritances whereas in the case of inequality some form of redistributive taxes would be more appropriate.

The report also shows that **satisfaction with life has been increasing in the transition countries**. The happiness gap with their counterparts living in non-transition countries has finally disappeared. Turning to the most striking results of the report, de Haas showed that people born around the beginning of the transition process are on average around one centimeter shorter than their older or younger peers. This proves, among other things, that transition was a traumatic experience with tremendous stress for many people in the region.

According to de Haas, **inequality of opportunity** in the EBRD region is more pronounced than in Western European countries. Gender, race, place of birth and/or parental background have a strong impact on opportunities. He went on to explain that this situation leads to inefficient outcomes because people are prevented from making the best use of their skills. De Haas also argued that inequality of opportunity has a

direct or an indirect impact on people's support for the market economy as well as for democracy.

Turning to another dimension of inequality, namely **financial inclusion**, de Haas pointed out that there are significant differences in terms of access to bank accounts in the EBRD region. In the presentation, it also became clear that access to financial products, i.e. debit cards,

credit cards and bank accounts, is improving with growing income. Also education, gender and age influence access to financial products. By looking more closely at foreign-owned banks, there is evidence that they improved access to finance on average, but the gains are unevenly distributed because foreign banks focus on people who are less economically vulnerable.

EBRD 2016-2017 Transition Report features OeNB Euro Survey based analysis of household loan application strategies and access to bank credit

Parts of this chapter are based on OeNB Euro Survey data. Apart from preparing the data set, OeNB economists Elisabeth Beckmann and Helmut Stix also designed the relevant survey questions for the report. The analysis moreover benefited from discussions with EBRD economists on working visits to the OeNB.

The quantitative analysis showed significant differences in approaching banks and asking for loans depending on education, employment status and income level. Moreover, blue-collar workers, self-employed and students are less likely to approach banks for loans than white-collar workers. Among those households who have applied for a loan, the analysis shows a higher level of education increases the number of banks that households approach when seeking a loan, while having a higher level of income reduces the number of banks approached. Among different types of workers, blue-collar workers approach more banks.

Furthermore, less educated and lower income households are less often successful in their loan applications. Finally, foreign banks seem to be relevant mostly for employed people. Even when faced with the same banking environment, unemployed respondents are less likely to approach foreign banks. Employed loan applicants receive offers from a higher percentage of the foreign banks to which they submit applications than unemployed applicants. Employment status, however, only has a significant impact on the success ratio of loan applications to foreign banks

Panel Discussion

Doris Ritzberger-Grünwald, Director of the Economic Analysis and Research Department of the OeNB, opened the discussion by pointing out that globalization is often blamed for people's unhappiness in transition countries. However, the outcome of transition is often a legacy of the privatization strategy a country has chosen at the beginning of transition. This knowledge should be used to learn more about the best approaches to privatization. She also linked the large share of people in transition countries who are worse off today than in communist times to motives for migration outflows from the region and emphasized the huge brain drain implied.



Focusing on the OeNB Euro Survey data based part of the report, she raised the question whether financial inclusion has gone too far given high NPL levels in many countries of the EBRD region. At the same time, she recalled the substantial unmet loan demand reflected in the high percentage of surveyed households who applied for a loan and were rejected by all banks they contacted. Ritzberger-Grünwald argued for the need to discuss how these – most vulnerable – borrowers can be protected from turning to unregulated, and often “predatory” lenders for satisfying their loan demand.

Gallina Vincelette, Senior Economist in the World Bank’s Europe and Central Asia desk, emphasized that the EBRD Transition Report 2016–17 is a timely report



in light of a period marked by displaced persons, violent extremism and a general questioning of the benefits of globalization. It is also complementary to the work of the World Bank. Vincelette pointed out that the quality of institutions can be regarded to lie at the root of economic growth and inequality. She argued that there should be a clear commitment to support the people in need. Transfers play an important role for the region but fiscal space is often limited. Therefore a better targeting of social assistance and pensions is needed.

Mario Holzner, Deputy Director of the wiiw, started off by noting a lack of research on inequality. This should focus more on macroeconomics by linking inequality and macroeconomic imbalances. Given a negative link between inequality and the level of income, new approaches in industrial policy are needed. Holzner called for a revival of social partnerships employers’ and employees’ representatives to address the issue of inequality. He also raised the question how policies targeting inequality can be implemented given the fact that oligarchs are generally well connected to politics.

EBRD Transition Report 2016-2017: <http://www.ebrd.com/transition-report>

The chapter on financial inclusion of the latest EBRD Transition Report is partly

Save the Date

80th East Jour Fixe of the Oesterreichische Nationalbank

Bulgaria and Romania – 10 years after EU accession

On the occasion of the 10th anniversary of Bulgaria and Romania joining the EU this workshop will review post-accession economic and political developments in Bulgaria and Romania and the influence of EU policy instruments on these countries. Representatives of the central banks of Bulgaria and Romania will deliver presentations on macroeconomic developments since EU accession with a special focus on the financial sector and monetary policy. Further, academics and representatives from international institutions will shed light on some EU-related aspects that are of particular relevance for the catching-up process, such as EU fund absorption, progress in the framework of the cooperation and verification mechanism, the role of FDI in the catching-up process and migration trends.

March, 31st, 2017

Oesterreichische Nationalbank, Vienna
Veranstaltungssaal, ground floor

More information: https://www.oenb.at/en/Calendar/2017/20170331_80_east_jour_fixe.html

Announcement

The OeNB's Conference Volume “Boosting European Competitiveness“

Edited by Marek Belka, President, Narodowy Bank Polski, Poland, Ewald Nowotny, Governor, Oesterreichische Nationalbank, Austria, Pawel Samecki, Management Board Member, Narodowy Bank Polski, Poland and Doris Ritzberger-Grünwald, Director, Oesterreichische Nationalbank, Austria

In the global financial crisis, competitiveness gaps between euro area countries caused additional strain. This book discusses the various dimensions of competitiveness, with a special focus on emerging Central, Eastern and Southeastern European countries. For Europe to proceed with convergence and to resist global competitive pressures, it argues that policies to boost productivity and innovation are vital. With products becoming ever more technically sophisticated and global interconnectedness on a relentless rise, it also demonstrates that quality, customer orientation and participation in global production networks and global value chains are at least as important as relative costs and prices.

This book delves into the literature and dissects the complexity of competitiveness, aiming to offer tangible policy advice focused on how well the European economy is performing and how it could improve. The key findings of the book, from a mix of academics and policymakers, constitute a state-of-the-art assessment of competitiveness that may challenge traditional perceptions of how economies can return to a path of sustainable growth.

Comprehensive and forward-looking, this enlightening book will appeal to academics, researchers and policymakers with a particular interest in European economies and economic integration.

https://www.e-elgar.com/shop/books/?_sort=_score&_query=%27Boosting+European+Competitiveness%27+



Focus on European Economic Integration Q4/16 [\(full version\)](#)



Recent economic developments and outlook

Developments in selected CESEE countries: Temporarily sluggish investment dampens CESEE growth whereas domestic demand continues to thrive, compiled by Josef Schreiner, p. 6-40.

[\(link\)](#)

Outlook for selected CESEE countries: Steady growth in CESEE-6 after temporary dip in early 2016 – trough reached in Russia, compiled by Antje Hildebrandt, p. 41-51.

[\(link\)](#)

Studies

On the optimal number of indicators – nowcasting GDP growth in CESEE, Havrlant, D., Tóth, P., Wörz, J., p. 54-72.

[\(study\)](#)

Currency substitution in CESEE: why do households prefer euro payments?, Scheiber, T., Stern, C., p. 73-98. [\(study\)](#)

Event wrap-ups and miscellaneous

The OeNB's 79th East Jour Fixe: Capital Flows to CESEE – Impact on Macro-Financial Stability and Policy Responses, compiled by Stephan Barisitz, Markus Eller and Mathias Lahnsteiner, p. 102-106. [\(link\)](#)

Olga Radzyner Award 2017 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 2017, 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 are requested to send their submissions by electronic mail to eva.gehringer-wasserbauer@oenb.at. Entries for the 2017 award must arrive by September 15, 2017, at the latest. Together with their submissions, applicants must provide copies of their birth or citizenship certificates and a brief CV.

For more information, please contact [Eva Gehringer-Wasserbauer](#) in the OeNB's Foreign Research Division.

See also: [Olga Radzyner Award](#)

Call for Applications: Visiting Research Program

The Oesterreichische 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.



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 (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.

Applications for 2017 should be e-mailed to Eva.Gehringer-Wasserbauer@oenb.at by May 1, 2017.

Applicants will be notified of the jury's decision by mid-June 2017. The following round of applications will close on November 1, 2017.

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

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.

March 3, 2017	Conferece on "Investment and investment finance: the Austrian story", jointly organized with the European Investment Bank
March 31, 2017	80 th East Jour Fixe: "Bulgaria and Romania – 10 years after EU accession" of the Oesterreichische Nationalbank By invitation only!
May 29 to 30, 2017	JVI 25 th Anniversary at the Oesterreichische Nationalbank By invitation only!
September 18, 2017	81 st East Jour Fixe: "Non-Performing Loans" (working title) By invitation only!
November 20 and 21, 2017	Conference on European Economic Integration By invitation only!

OeNB Courses at the Joint Vienna Institute (JVI)

For further details see: www.jvi.org

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 DBB)
March 2 – 3, 2017	International Cooperation in Central Banks
March 13 – 17, 2017	Monetary Policy Implementation (in cooperation with JVI and DBB)
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	Implementing Early Warning Frameworks for Macro-Financial Stability Assessments in Central, Eastern and Southeastern Europe
November 22 – 24, 2017	Financial Translation and Editing: New Skills for New Challenges
November 27 – 29, 2017	Cash Circulation and Payment Systems in Austria