Presentation at the OeNB by Éva Katalin Polgár (ECB): Are Policy Measures Effective in Controlling Credit Growth in Emerging Europe?

Compiled by
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Strong credit growth in the run-up to the financial crisis has partly been seen as a convergence phenomenon of financial deepening in Central, Eastern and South-eastern Europe (CESEE), but it has also posed substantial risks to financial stability. While a number of countries have implemented micro- and macroprudential measures to control the growth of credit or its composition, others have been rather reluctant to use regulatory tools, pointing to their long-term ineffectiveness.

To shed some light on the issue of regulation, the OeNB invited Éva Katalin Polgár, economist at the ECB's EU Neighbouring Regions Division, to present a pertinent paper on March 17, 2011. The work, entitled "The effectiveness of policy measures to control credit growth in emerging Europe," was co-authored with Aleksandra Zdzienicka, economist at the French research center CEPII. In her presentation, Polgár pointed to the fact that only very few papers deal with the effectiveness of policy measures, which is partly due to the many caveats pertaining to their empirical analysis, e.g. difficulties regarding the construction of indices or modeling the combined impact of measures. The authors dealt with these constraints in a transparent and cautious manner. Their work on this highly policy-relevant issue is a welcome addition to the field, as reflected by the high number of economists attending the presentation.

The empirical exercise by Polgár and Zdzienicka is based on an unbalanced dynamic panel of twelve CESEE EU Member States and EU candidate and potential candidate countries over the period 1998 to 2009. It analyzes the dynamic impact of the policy interest rate, regulatory and prudential tools that affect (mainly) the supply side (e.g. changes in risk weights and quantitative restrictions on lending) and measures that are supposed to deal with credit demand (e.g. the introduction of credit guidelines).

The main findings show an insignificant effect of supply-side tools and demand-side measures but a significant negative correlation of prudential measures with credit growth with a lag of about one year. Standard monetary policy also turns out to be effective in influencing credit developments, which is rather surprising, given that it is rather constrained in many CESEE countries due to the exchange rate regimes in place and/or the high degree of currency substitution in a number of countries. Polgár concluded that besides standard monetary policy, more explicit prudential measures – despite the distortions they may create – should help to curb excessive credit growth in boom times.

The subsequent discussion centered on policy implications and methodological issues, such as modeling the combined impact of various policy measures. While the presentation focused above all on the impact of these policy measures on the growth of real credit to the private sector, the discussion also centered on more preliminary results concerning the impact on foreign currency and cross-border lending. For those specifically interested in the topic, the forthcoming publication of the study will allow in-depth insights into the methods applied and the final results.