

Q1/2015

CESEE Research Update

Foreign Research Division

www.oenb.at/cesee-research-update

Content

EBRD Transition Report 2014.....	2
Conference on The Western Balkans: 15 Years of Economic Transition	4
Focus on European Economic Integration Q1/15	5
OeNB Euro Survey	6
Olga Radzyner Award 2015	8
Visiting Research Program 2015	8
Call for Papers: "Toward a Genuine Economic and Monetary Union"	9
OeNB Courses at the JVI.....	10

<http://www.oenb.at>

<http://cesee.oenb.at>

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

- **Presentation: EBRD Transition Report 2014** (see p. 2)
- **Save the Date: East Jour Fixe, May 29, 2015** on "Russia: Economic turmoil and policy options" (see p. 3)
- **Conference on The Western Balkans: 15 Years of Economic Transition** (see p. 4)
- **Studies in: Focus on European Economic Integration Q1/15** (see p. 5)
- **OeNB Euro Survey** (see p. 6)
- **Olga Radzyner Award 2015** (see p. 8)
- **Visiting Research Program 2015** (see p. 8)
- **Call for Papers: "Toward a Genuine Economic and Monetary Union"** (see p. 9)

EBRD Transition Report 2014: Innovation in Transition

On January 29, 2015, the Austrian Ministry of Finance (BMF) hosted the presentation of the 2014 Transition Report of the European Bank for Reconstruction and Development (EBRD), which included January 2015 GDP growth forecast updates for the EBRD region. The event was opened by *Harald Waiglein*, Head of the BMF's Directorate General for Economic Policy and Financial Markets.



Harald Waiglein (BMF) with Piroska Nagy (EBRD) and Doris Ritzberger-Grünwald (OeNB). Copyright: BMF/Grondahl.

After Waiglein's introductory remarks, *Piroska Nagy* the EBRD's Director for Country Strategy and Policy, outlined the key messages of the EBRD Transition Report 2014 and summarized the latest growth forecasts for the countries in the EBRD region.

Part I: Innovation: Adopt, Adapt, Advance

Nagy explained that economic transition and convergence have slowed down in CESEE in recent years. And in the light of current policies, convergence will continue to slow unless reform efforts can be revived. One important element would be to strengthen innovation in CESEE, namely that individual firms improve their productivity by adopting and adapting novel technologies and advancing toward technological frontiers. The firm-level survey based on face-to-face interviews with managers that the EBRD carries out in partnership with the World Bank shows that exports have become more innovation intensive in the EBRD region, in particular in Central Europe and the Baltics. Furthermore, there is a high payoff for all types of innovation (i.e. product, process, marketing and organizational) in all sectors. The type of firm ownership affects innovation, too, with foreign-owned firms and exporters innovating more. Nagy

raised the question whether banks could help firms in their drive to innovate. Here, the arguments are inconclusive, however: On the one hand, intangible and firm-specific assets cannot be used as collateral and firms are hesitant to reveal sensitive information about innovation projects. On the other hand, banks may specialize in establishing lending relationships with their clients, and bank loans might be the only source of external financing in some countries. The survey showed that access to bank credit helps firms to innovate. What, then, can policymakers do to foster innovation? They should tailor policies to account for the individual country's capacity to access, absorb and create new technologies given that innovation policies are surprisingly similar across the region. In a nutshell, to achieve good results, firms must be willing to innovate and governments to support firms in acquiring or creating the know-how they need.



From left to right: Johannes Seiringer (EBRD), Harald Waiglein (BMF), Piroska Nagy (EBRD), Doris Ritzberger-Grünwald (OeNB), Michael Landesmann (wiiw). Copyright: BMF/Grondahl.

Part II: New Regional Forecast of the EBRD

Overall, the EBRD expects GDP to contract by an average 0.3% in the transition region in 2015, compared with growth of 1.6% in 2014. The forecast is marked by strong differences across the subregions: Central Europe and the Baltic states will grow, on average, by 2.6% in 2015 (2014: 2.8%). Growth in Southeastern Europe will increase to 2.2% in 2015, compared with 1.7% in 2014, while Turkey will see almost unchanged growth (of around 3%). In Russia, growth is expected to decline strongly to -4.8% in 2015, after 0.4% in 2014.

The outlook for 2015 is shaped by the collapse of the oil price. Here, Nagy distinguished between commodity producers and commodity importers. In Russia for example, which is a commodity producer, the oil price drop has worsened the negative impact of structural problems. Furthermore, the country suffers from waning investor confidence and the negative effects of sanctions related to the conflict with Ukraine. Countries with close ties to Russia are hit by negative spillover effects. In contrast, commodity importers which are not closely linked to Russia will be net gainers. Nagy explained that the divergent performance in advanced markets – namely in the U.S.A. (tighter global liquidity due to U.S. interest rate hikes) and in the euro area (still weak performance of main trading partners) – poses some challenges to CESEE. As a result, growth in CESEE is mostly driven by domestic demand rather than exports. Moreover, credit growth is expected to remain subdued or negative in many countries and is also constrained by high nonperforming loans.

Panel Discussion

The presentation by Piroska Nagy was followed by a panel discussion with Michael Landesmann (wiiw), Doris Ritzberger-Grünwald (OeNB) and Harald Waiglein (BMF). Waiglein stressed that most innovation in CESEE takes place within firms. He added

that, while many firms in CESEE need a loan, only about half of them are able to get one. Efficient financial markets are crucial for diversifying risk and supporting economic growth. Michael Landesmann pointed out that the EBRD survey for the first time contained a module on innovation and that the comparative group has been widened. He also emphasized the need for more research on the distribution of innovation. Ritzberger-Grünwald showed that R&D drives innovation and that, in this context, Austria performs well. However, if one takes account of global value chains, it gets more tricky as the underlying mechanisms are not straightforward. Furthermore, she explained that the crisis has changed the economic environment in CESEE: During the boom years, capital inflows had fueled domestic demand and caused GDP to grow strongly. The crisis, by contrast, has led to a substantial reduction in capital inflows, a broad-based deleveraging of the private and public sectors as well as a greater importance of domestic demand. All these factors attest to the need for more domestic funding and a further deepening of domestic capital markets in CESEE.

[EBRD Transition Report 2014](#)

[EBRD Forecast](#)

Save the Date

77th East Jour Fixe on “Russia: Economic turmoil and policy options,” which will take place at the OeNB in Vienna on May 29, 2015

By invitation only.

The **77th East Jour Fixe** will focus on Russia’s economic policy challenges and options against the background of the country’s current and likely longer lasting economic turmoil, which has laid bare the vulnerabilities of the Russian economy. In session 1, we will therefore discuss structural reform needs and how to use FDI more efficiently. In session 2, we will then explore ways to safeguard banking sector stability and buttress monetary policy. Finally, session 3 will deal with Russia’s recent recalibration of its external economic policy orientation and the options ahead.

Conference on The Western Balkans: 15 Years of Economic Transition

The International Monetary Fund (IMF) and the Oesterreichische Nationalbank (OeNB), in cooperation with the Joint Vienna Institute (JVI), hosted a conference in Vienna on March 10, 2015, marking 15 years of economic transition in the Western Balkan countries. Following on the heels of the IMF's presentation of its recently published Regional Economic Issues Special Report on the Western Balkans, the conference delivered a platform for ministers and central bank governors of the region to exchange their views on economic policy issues.

After having spent much of the 1990s mired in conflict, the Western Balkan countries have, over the past 15 years, experienced a notable transformation toward a market-based system. The pace of structural reform has been disappointing, however, owing to a combination of reform fatigue, resistance from vested interests, legacy problems, and a delayed EU membership perspective. Moreover, part of the catching-up before the financial crisis was driven by unsustainable capital inflows. As a result, the Western Balkan countries still lag well behind the CESEE EU Member States in terms of economic transformation, per capita income levels and labor market participation.



At the conference, Ivanna Vladkova Hollar from the IMF and Gallina Vincelette from the World Bank presented recent research results on drivers of economic growth, the pace of convergence, and progress in inclusiveness. Isabella Moder (OeNB) discussed to what extent the business cycles of the Western Balkan economies are synchronized both within the region and with the euro area. Zuzana Murgasova (IMF) discussed the key macroeconomic challenges, while Peter Sanfey (EBRD) elaborated on the inherited structural challenges of the Western Balkan



countries at the start of the transition process and how they have progressed in the structural transformation since 2000. Maksym

Ivanyina (JVI) analyzed how Western Balkan countries compare to CESEE EU Member States in terms of implementing structural reforms and proposed reform priorities both at the regional and country level.

Nadeem Ilahi (IMF) and Johanna Jaeger (World Bank) presented their research on financial sector development and financial inclusion. They highlighted threats to financial stability, stressed the necessity to tackle the large stock of nonperforming loans and proposed policies to enhance small and medium-sized enterprises' access to finance. Elisabeth Beckmann (OeNB) discussed the relative importance of demand and supply factors in explaining the high incidence of foreign currency borrowing by Western Balkan households.

The conference concluded with a high-level panel discussion chaired by Poul Thomsen (IMF), and with Božidar Đelić (Managing Director of Lazard), Ewald Nowotny (Governor of the OeNB), Jeffrey D. Sachs (Director of The Earth Institute at Columbia University), Zoran Stavreski (Minister of Finance of FYR Macedonia), and Boris Vujčić (Governor of the Croatian National Bank) as panelists.

Among other things, the panelists made it clear that it is the incomplete nature of the institutional and structural reforms undertaken that is holding the region back. To attract the scale of investment flows needed to unleash faster and, at the same time, sustained growth and thus to raise per capita income from currently less than one-third of EU levels, the Western Balkan countries will have to push ahead courageously with comprehensive reforms.

Focus on European Economic Integration Q1/15



Studies

Sectoral Deleveraging in Europe and Its Economic Implications, Gächter, M., Geiger, M., Glözl, F., Schuberth, H., p. 8-23

We examine net lending/net borrowing and the underlying debt dynamics at the sectoral level in the European Union. Saving and investment patterns indicate that there have been considerable deleveraging efforts since the start of the global financial crisis, particularly in the nonfinancial corporate and household sectors. In many EU countries, however, this decline in credit transactions has not yet led to a significant reduction of sectoral debt-to-GDP ratios. Subdued output growth and low or even negative inflation rates have undermined the deleveraging process and increased real debt burdens in a number of European economies. Since these are often the countries that had experienced

strong credit booms prior to the crisis, rebalancing needs are likely to persist and may be a significant drag on the recovery in the near future. Furthermore, most of the ongoing rebalancing – both in terms of debt levels and current account deficits – is based on a sharp decline in investment rather than an increase in saving, which might lead to lower potential growth in the future. Recent developments may even jeopardize the catching-up process of peripheral euro area countries and non-euro area EU Member States in Central, Eastern and Southeastern Europe.

[Focus on European Economic Integration Q1/15](#)

A Local or a Foreign Currency Loan? Evidence on the Role of Loan Characteristics, Preferences of Households and the Effect of Foreign Banks, Beckmann, E., Roitner, A., Stix, H., p. 24-48

Using data from the OeNB Euro Survey in CESEE, which covers both EU Member States and (potential) candidate countries, we analyze how the currency of existing loans to households relates to (1) loan characteristics (loan maturity and purpose), (2) households' preferences regarding the loan currency and (3) bank ownership (domestic or foreign). Our findings support the existing literature's view that both demand- and supply-side factors have an influence on foreign currency lending. In the period under investigation, foreign currency loans were sought after by households in particular for long-term borrowing. Likewise, banks were more likely to grant large and long-term loans in foreign currency. On a descriptive level, we find that in Croatia and Hungary, foreign-owned banks had a

higher share of foreign currency loans than local currency loans – in the remaining seven countries, however, the share of foreign currency loans is similar to or lower than that of local currency loans. In regression models we account for the possibility that foreign-owned and domestically-owned banks may differ in that they have issued loans with different characteristics and in that they have customers with different credit ratings and different preferences. Holding these factors constant reveals that, on average, foreign-owned banks did not issue more foreign currency loans – neither consumption loans nor mortgages – than domestically-owned banks.

[Focus on European Economic Integration Q1/15](#)

Price and Wage Rigidities in the Republic of Macedonia: Survey Evidence from Micro- Level Data, Huber, F., Petrovska, M., p. 49-64

This paper exploits the information collected from an ad hoc survey conducted on a sample of Macedonian firms to study the extent of nominal price and wage rigidities in the Republic of Macedonia. The research was motivated by the observation that sticky prices influence the responsiveness of inflation to changes in a central bank's policy rate. Against this background, the paper investigates the relative importance of most determinants of the frequency of price and wage changes identified in the literature. This paper

presents a Bayesian analysis of ordinal data. Posterior inference is carried out using Markov Chain Monte Carlo (MCMC) techniques. Infusing the model with prior information allows us to shrink the parameter space, resulting in more precise and reliable parameter estimates. Our results suggest that higher price flexibility is associated with a higher degree of product market competition. Specifically, we find that firms facing high levels of domestic and international competition tend to adjust prices faster.

[Focus on European Economic Integration Q1/15](#)

CESEE-Related Abstracts from Other OeNB Publications

Austrian Subsidiaries' Profitability in the Czech Republic and Slovakia – CESEE Margins with an Austrian Risk Profile, Kavan, S., Widhalm D.

Published in [Financial Stability Report 28](#)

The Euroization of Bank Deposits in Eastern Europe, Brown, M., Stix, H.

Published as [OeNB Working Paper 197](#)

Spillovers from Euro Area and U.S. Credit and Demand Shocks: Comparing Emerging Europe on the Basis of a GVAR Model, Fadejeva, L., Feldkircher, M., Reininger, T.

Published as [OeNB Working Paper 198](#)

Foreign currency loans and bank ownership – Evidence from the OeNB Euro Survey

In many – although not in all – Central, Eastern and Southeastern European (CESEE) countries, a significant percentage of loans are denominated in foreign currencies. The recent appreciation of the Swiss franc, again, highlighted the risks associated with foreign currency lending. A large and growing literature seeks to identify the drivers and consequences of foreign currency borrowing. Macro data-based studies argue that the high market share of foreign-owned bank plays an important role for foreign currency lending (Basso et al., 2011) and that banks seek currency-matched portfolios; hence, it is argued that credit euroization is closely linked to deposit euroization (Luca and Petrova, 2008).

However it is difficult to separate demand from supply effects on the basis of macro data.

Thus, empirical research began to use micro data to explore these issues further. Employing bank survey data from 2005, Brown and De Haas (2012) conclude that foreign banks' easier access to foreign wholesale funding is not a driver of foreign currency lending. Studying firms, also on the basis of survey data, Brown et al. (2011) show that firms' foreign currency revenues are more important than interest rate differentials and conclude that foreign currency loans are taken out by customers who are hedged or are equipped to bear the exchange rate risk.

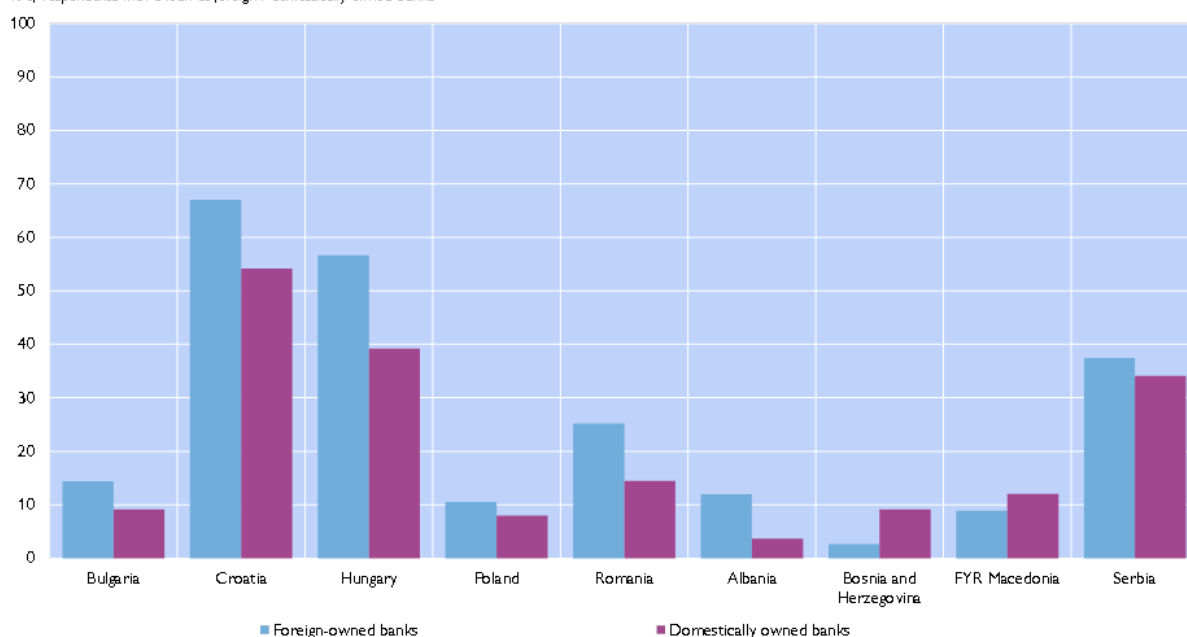
At the same time, Brown et al. (2014) demonstrate that foreign currency lending may partially be driven by banks. Analyzing a dataset of firm loans between 2003 and 2007 from one Bulgarian bank which includes information on both requested and granted loan currency, they find that this bank sought to match the currency structure of their assets with that of their liabilities. However, results for firms are not necessarily transferable to households.

Employing recent evidence from the OeNB Euro Survey, Beckmann, Roitner and Stix (2015) analyze *inter alia* how the currency of loans to households relates to bank ownership (domestically or foreign owned banks). Based on this analysis, Chart 1 shows that foreign-owned banks had a higher share of foreign currency loans than local currency loans in Croatia and Hungary – for the remaining seven countries, however, the share is similar or lower.

Chart 1

Foreign Currency Loans and Bank Ownership

% of respondents with a loan at foreign / domestically owned banks



Source: OeNB Euro Survey, 2012-2013.

However, accounting for the possibility that foreign-owned and domestically-owned banks may differ in that they issued loans with different characteristics and in that they have customers with different credit ratings and different preferences in regression

models, Beckmann, Roitner and Stix (2015) find that, on average foreign-owned banks did not issue more foreign currency loans, neither consumption loans nor mortgages.

References:

- Basso, H. S., Calvo-Gonzales, O., Jurgilas, M., 2011. Financial dollarization and the role of foreign-owned banks and interest rates. *Journal of Banking and Finance* 35, 794-806.
- Beckmann, E., Roitner, A., Stix, H. 2015. A local or a foreign currency loan? Evidence on the role of loan characteristics, preferences of households and the effect of foreign banks, *Focus on European Economic Integration*, q1/2015.
- Brown, M., De Haas, R., 2012. Foreign banks and foreign currency lending in emerging Europe. *Economic Policy* 69, 57-98.
- Brown, M., Ongena, S., Yesin, P., 2011. Foreign currency borrowing by small firms. *Journal of Financial Intermediation* 20, 285-302.
- Brown, M., Kirschenmann, K., Ongena, S., 2014. Bank funding, securitization and loan terms: Evidence from foreign currency lending. *Journal of Money, Credit, and Banking*, 46(7), 1501-1534.
- Luca, A., Petrova, I., 2008. What drives credit dollarization in transition economies? *Journal of Banking and Finance* 32, 858-869.

Olga Radzyner Award 2015 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 2014, 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 shall send their submissions by postal mail – with the envelope marked “Olga Radzyner Award” – to the Oesterreichische Nationalbank, Foreign Research Division, Otto-Wagner-Platz 3, PO Box 61, 1011 Vienna, Austria. Entries for the 2015 award should arrive at the OeNB by September 4, 2015, at the latest.

For more information, please contact [Eva Gehringer-Wasserbauer](mailto:eva.gehringer-wasserbauer@oenb.at) in the OeNB's Foreign Research Division.

See also: [Olga Radzyner Award](#)

Call for Applications: Visiting Research Program



The OeNB invites applications from external researchers 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 pursue 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 for 2015 should be e-mailed to eva.gehringer-wasserbauer@oenb.at by May 1, 2015.

Applicants will be notified of the jury's decision by mid-June 2015. The following round of applications will close on November 1, 2015.

See also: [Visiting Research Program 2015](#)

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.

Call for Papers:

“Toward a Genuine Economic and Monetary Union”

Workshop in Vienna on September 10 and 11, 2015

This workshop's **purpose** is to inspire reflection on the long-term future of Economic and Monetary Union (EMU). Starting from current crisis-related challenges, the workshop focuses on four areas in which reforms might increase the resilience of EMU architecture and the prosperity of the euro area. The workshop intends to give an overview of the current state of economic research and the policy debate, with an emphasis on creative proposals aimed at overcoming existing deadlocks.

The specific areas covered are in line with the “Four Presidents’ Report – Towards a Genuine Economic

and Monetary Union” of June 2012:

- Banking Union and Capital Market Union
- Fiscal Union and Area-Wide Taxation Issues
- Economic Union and the Social Dimension of EMU
- Political Union and Legitimacy of EMU

More information: <http://www.oenb.at/en/Monetary-Policy/Research/workshops.html>

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.

May 29, 2015	77 th East Jour Fixe on “Russia: Economic turmoil and policy options” By invitation only!
September 11-12, 2015	Workshop: “Toward a Genuine Economic and Monetary Union” at the OeNB. By invitation only!
October 15-16, 2015	Conference on European Economic Integration in cooperation with the Narodowy Bank Polski in Warsaw. By invitation only!

OeNB Courses at the Joint Vienna Institute (JVI)

For further details see: www.jvi.org and [Program JVI 2015](#)

January 19-22, 2015	Advanced Course on Financial Stability Stress Testing for Banking Systems
May 18-22, 2015	Institutional Challenges for Candidate and Potential Candidate Countries on the Road to the EU and EMU
September 14-18, 2015	Macro-Financial Stability in Central, Eastern and Southeastern Europe
October 12-14, 2015	Cash Circulation and Payment Systems in Austria
October 19-23, 2015	Integration in Europe: European Union and Eurasian Union
November 16-18, 2015	Financial Education
November 30—December 3, 2015	Building New Skills in Financial Translation

Imprint/inquiries/copyright 2015:

Oesterreichische Nationalbank, Foreign Research Division

Postal address: P.O. Box 61, A 1011 Vienna, Austria

To subscribe or unsubscribe to our newsletter, please visit our website <http://cesee.oenb.at>