

Q1/2013

CESEE Research Update

Foreign Research Division

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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

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Highlights of This Issue

- **The 72nd East Jour Fixe** hosted by the OeNB on February 18, 2013, dealt with macroeconomic imbalances in CESEE before and after the 2008–2009 crisis touching on a great number of aspects related to both trade and financial flows as well as to external debt (see p. 2).
- **The recent results of the OeNB Euro Survey** indicate that trust in the euro is recovering in all ten CESEE countries included in the survey, notably the first improvement in more than a year (see p. 2).
- The latest issue of the OeNB's quarterly publication "**Focus on European Economic Integration**" has just been released (see p. 5).
- The OeNB invites applications from external researchers for participation in a **Visiting Research Program** established by the OeNB's Economic Analysis and Research Department (see p. 8).
- The OeNB invites entries from young economists from CESEE countries for the **Olga Radzyner Award** for excellent research on topics of European economic integration (see p. 8).

72nd East Jour Fixe¹

External Imbalances and Adjustment to the Crisis in CESEE

The 72nd East Jour Fixe, which took place at the OeNB on February 18, 2013, approached the topic of macroeconomic imbalances in CESEE before and after the 2008–09 crisis from different viewpoints, touching on a great number of aspects related to both trade and financial flows as well as external debt. In his keynote address, Boštjan Jazbec from the University of Ljubljana pointed out that in many CESEE countries pre-crisis capital flows had often been wasteful rather than useful, as banks mostly invested in collateralizable sectors given weak institutions in the recipient countries. Despite past and current institutional weaknesses, Jazbec identified clear progress in investor protection and contract enforcement in the region.

The three speakers in the first session analyzed determinants of crisis severity and agreed that pre-crisis growth in domestic credit had amplified the real downturn. Martin Feldkircher, OeNB, furthermore stressed the simultaneous risk of overheating in the credit market and dependence on foreign funding, while Irina Bunda, JVI, referred to still elevated levels of external debt in the region. Ettore Dorrucci, ECB, stressed the need for structural reforms especially with respect to improvements of the judicial system and further cutting of red tape. Two country experiences, namely those of Latvia and Slovakia were discussed in the second session. Uldis Rutkaste, Latvijas Banka, gave a comprehensive presentation on Latvia's road to recovery. As a reaction to the strong impact of the crisis, Latvia implemented a large and frontloaded fiscal

consolidation package, which was underpinned by structural reforms. Rutkaste stated that Latvia aimed to adopt the euro in 2014. Ján Tóth, Národná banka Slovenska, pointed out that Slovakia underwent the biggest structural reforms during the 2003–2006 period, which helped Slovakia attract considerable volumes of FDI. The overall impact of the reforms on the economy helped dampen the effects of the crisis in Slovakia, which had reached the country mainly through a trade shock. In the concluding session, Gillian Edgeworth, UniCredit Research, argued that the crisis has improved policymakers' understanding of fiscal and external risks and expressed concerns about the changing composition of capital flows to CESEE. She called for a more ambitious approach to integrating the newer EU states into the European banking union that is currently being set up. In the final presentation, João Nogueira Martins from the European Commission provided insights into the EU's Macroeconomic Imbalances Procedure (MIP), a new component in the toolbox of European economic governance. He stressed that the scoreboard is not designed to be applied mechanically and that the Commission recognizes the need to take a holistic look when assessing indicators that exceed threshold values.

¹The presentations and the workshop program are available at <http://ceec.oenb.at> (Events).

[Focus on European Economic Integration Q1/13](#)

Summary EBRD Transition Report 2013

On January 30, 2012, the Oesterreichische Nationalbank (OeNB) and the Austrian Ministry of Finance (BMF) for the first time jointly organized the presentation of the EBRD¹ Transition Report showcasing findings of the 2012 Transition Report and the January 2013 update of the EBRD's growth forecasts for Central, Eastern and Southeastern Europe (CESEE). The event took place at the premises of the BMF and was opened by Harald Waiglein, Head of the BMF's Directorate General

Economic Policy and Financial Markets, and OeNB Governor Ewald Nowotny. In their opening remarks, both Waiglein and Nowotny underlined the importance of the EBRD Transition Report as a flagship publication for the analysis of the CESEE countries. In addition, both speakers stressed the strong CESEE commitment of both Austria and the EBRD within the framework of the Vienna initiative and its follow-up, the Vienna 2.0 initiative,

At the press conference, Jeromin Zettelmeyer, the EBRD's Deputy Chief Economist and Director of Research, summarized the EBRD's new growth forecasts for the countries in which it operates² and outlined the most important findings of the EBRD Transition Report 2012 "Integration across borders."

Part I: Economic Prospects in the EBRD Region – The Impact of the Euro Area Crisis on the Transition Region

The EBRD expects that GDP growth in the transition countries (including the SEMED countries) will rise moderately from about 2.6% in 2012 to 3.1% in 2013, though growth will remain slower than in the recovery year 2011. The general deceleration of the economic expansion in 2012, especially in many of the most exposed CESEE countries, can be attributed largely to the continued external pressures from the euro area countries. However, signs of bottoming out could be observed, as exports have started to recover and as net capital flows have slowly returned to some CESEE countries, most notably the Baltic countries. In addition, on the back of progress in key policy areas in the euro area, such as the establishment of a banking union and of medium-term fiscal frameworks, the pressure on the region's parent banks has eased.

Part II: The Eurasian Customs Union: An Early Empirical Assessment

In the second part of his presentation, Zettelmeyer elaborated on the benefits and challenges of the Eurasian customs union (among Russia, Kazakhstan and Belarus) effective since January 2011. The customs union could potentially have multiple benefits: (1) it might help Russia to diversify its export structure; (2) it could benefit producers within a regional integration grouping through increased market size; and (3) it could serve as a first step toward the expansion of exports from a regional area to a worldwide base. On the downside, however,

given the dominance of the Russian economy, asymmetries on account of the size of the economies in the customs union could become an obstacle to reaping benefits. So far, the tariff-related impact on trade has been assessed to be small, with only Russia experiencing trade creation effects, and Belarus and Kazakhstan mainly facing trade diversion effects because they have higher trade barriers to China and the EU. Zettelmeyer also outlined that the customs union creates the potential for improvement through the strong demonstration effect of supranational institutions with good governance.

Part III: A Banking Union for the Euro Area and Beyond: Implications for Emerging Europe

In the third part of his presentation, Zettelmeyer turned his attention to possible solutions of cross-border supervision problems within the framework of the euro area banking union and outlined a practical approach to the integration in the banking union of both non-euro area EU member countries and non-EU emerging European countries. In particular, the report recommends to create a loss-sharing rule to mitigate moral hazard. Its purpose is to ensure that the European Stability Mechanism is primarily about catastrophic loss insurance. However challenges remain; they consist in finding approaches to incorporate the financially integrated non-EU countries. Possible solutions could be to define a regime in which the host country authorities and the ECB would share responsibility for subsidiaries and parent banks operating in the host countries.

¹European Bank for Reconstruction and Development.

²The EBRD recently expanded its coverage to include 30 countries ("the EBRD region") ranging from Central and Eastern Europe to Central Asia, which includes Turkey. Recently, the EBRD expanded the scope of its operations to include Egypt, Morocco and Tunisia, i.e. the southern and eastern Mediterranean countries (SEMED). Effective from 2008, the Czech Republic was the first country to graduate from the EBRD.

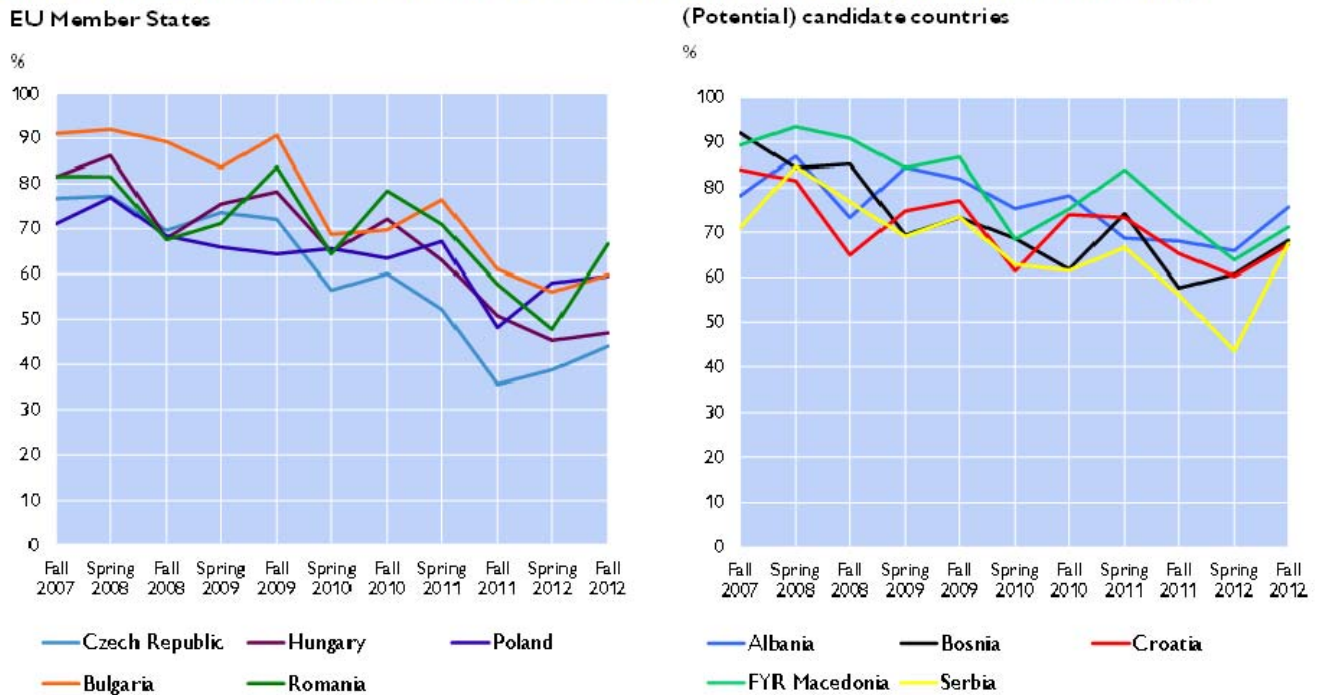
[Focus on European Economic Integration Q1/13](#)

OeNB Euro Survey: Trust in the Euro Is Recovering

Recent results of the OeNB Euro Survey show that trust in the euro is recovering in all of the ten CESEE countries that are included in the survey. Respondents were asked whether they agreed or disagreed with the statement "Over the next five years, the euro will be very stable and trustworthy." Chart 1 shows that trust in the euro had

dropped to an unprecedented low between fall 2011 and spring 2012, when less than 50% of respondents trusted the euro in the Czech Republic, Hungary, Romania and Serbia. In fall 2012, however, trust improved in each of the ten countries. In seven of them, this was the first improvement in more than a year.

Consent to the Statement: Over the Next 5 Years, the Euro Will Be Very Stable and Trustworthy



Source: OeNB Euro Survey.

Note: Respondents were asked whether they agreed or disagreed on a scale from 1 (fully agree) to 6 (fully disagree) to the statement above. Values represent the percentage share of respondents who agree (1 to 3) and exclude respondents answering "Don't Know" or "No Answer".

The question is rather broad in its design and measures a range of factors influencing households' trust in currencies. Beckmann and Scheiber (2012b) show that, among other factors, this trust is strongly correlated with trust in the EU. A look at the Economic Sentiment Indicator of the European Commission reveals that this improvement in economic sentiment in CESEE regarding the euro and by extension the EU is in line with a notable improvement in sentiments for six of the seven largest Member States in fall 2012 (European Commission, November 2012).

For CESEE and especially for Southeastern Europe, however, trust in the euro is of particular significance, as the euro has been the predominant safe haven currency in these countries. The observed decline in trust in the euro vis-à-vis the local currencies had raised the question

whether the euro would be displaced as a safe haven currency (Beckmann and Scheiber, 2012a). The recent marked improvement in trust in the euro renders this increasingly unlikely.

The OeNB Euro Survey has been conducted since fall 2007 on a semi-annual basis in 10 Central, Eastern and Southeastern European countries. It gathers information on the use of the euro among households with regard to cash holdings, savings and loans and provides a picture of how households evaluate the current and future economic situation of their country as well as of the household itself. For further information on the survey and related publications please visit ceec.oenb.at.

References:

Beckmann, E. and T. Scheiber. 2012a. Not so Trustworthy Anymore? The Euro as a Safe Haven Asset in Central, Eastern and Southeastern Europe. Focus on European Economic Integration. Q2/12. 65–71.

Beckmann, E. and T. Scheiber. 2012b. The Impact of Memories of High Inflation on Households' Trust in Currencies. Focus on European Economic Integration. Q4/12. 80–93.

European Commission. 2012. Business and Consumer Survey Results. November 2012.

OeNB Publications

Focus on European Economic Integration Q1/13



Studies

How Important Is Total Factor Productivity for Growth in Central, Eastern and Southeastern European Countries?

Konstantins Benkovskis, Ludmila Fadejeva, Robert Stehrer, Julia Wörz

Nonperforming Loans in Western Europe –
A Selective Comparison of Countries and National Definitions

Stephan Barisitz

Understanding Central Banks' Role in Enlargement – Governance Issues

Isabella Lindner, Gabriela Mihailovici

The Dynamics of Deposit Euroization in European Post-Transition Countries: Evidence from Threshold VAR

Marina Tkalec, Olga Radzyner Award winner 2011

Event Wrap-Ups

Conference on European Economic Integration 2012:

Achieving Balanced Growth in the CESEE Countries

Compiled by Susanne Steinacher and Katharina Steiner

EBRD Transition Report 2012: Integration across Borders

Compiled by Mariya Hake

72nd East Jour Fixe: External Imbalances and Adjustment to the Crisis in CESEE

Compiled by Mathias Lahnsteiner and Julia Wörz

Benkovskis, K., Fadejeva, L., Stehrer, R., Wörz, J., “How Important Is Total Factor Productivity for Growth in Central, Eastern and Southeastern European Countries?” p.8-27.

The evolution of total factor productivity (TFP) is a key determinant of long-run economic growth of a country. In this paper we analyze the contributions from technological change at the industry level to an economy's aggregate growth performance. Our derivation of economywide TFP growth entails three major improvements over the traditional Solow residual approach: First, we allow for non-constant returns to scale as well as changes in the utilization of input factors in our estimation of industry TFP growth. Second, we use a novel approach to aggregate TFP from the industry level to the macro level, which incorporates both direct and indirect effects through intermediate linkages within an economy. Third, we take account of open economy

characteristics by assigning an explicit role to terms of trade shocks. Our calculations for the sample of ten Central, Eastern and Southeastern European EU member countries over the time period 1995–2009 are based on the newly available World Input- Output Database (WIOD).

Keywords: Total factor productivity, terms of trade, utilization, input-output table, Central, Eastern and Southeastern Europe

JEL classification: C23, D24, E23, O47

[Focus on European Economic Integration Q1/13](#)

Barisitz, S. “Nonperforming Loans in Western Europe –A Selective Comparison of Countries and National Definitions“, p. 28-47.

As a follow-up study to the author's previous paper on “Nonperforming Loans in CESEE – What Do They Comprise?”, the present contribution focuses on the definitions of nonperforming loans (NPLs) in a number of Western European nations – Austria, Finland, France, Germany, Ireland, Italy, Portugal, Spain and the United Kingdom. Supervisors or at least general practice in the majority of Western European countries seem to endorse the rule that for a loan to be nonperforming, at least one of two (primary) elements has to be present: (1) principal or interest 90 days or more overdue, and (2) existence of underlying well-defined weaknesses of loan

or borrower. However, there are also other (secondary) elements that have an impact on NPL measurement and the comparability of definitions: the question whether a restructured loan is classified as NPL or not, whether the presence of a collateral or guarantee influences loan

classification or not, whether the full outstanding value or only part of a loan is reported as nonperforming, and whether a bank is required to downgrade all loans to a given debtor if any of these loans are classified as impaired or not. While these elements may introduce upward or downward biases into some nations' NPL definitions and ratios, and these would need to be further investigated, the above-outlined NPL rule appears to constitute a feasible yardstick for most of the countries mentioned above. Moreover, this definition is also in line with a draft EU ruling for a Capital Requirements Regulation (CRR).

Keywords: Bank lending, EU, credit quality, credit risk, financial soundness indicators, nonperforming loans

JEL classification: G12, G21, G32, G33

[Focus on European Economic Integration Q1/13](#)

Lindner, I., Mihailovici, G. “Understanding Central Banks' Role in Enlargement – Governance Issues“, p. 48-65.

The EU's enlargement policy is enshrined in the Treaty on European Union, which lays down the requirements for the accession of any European state. It is against this background that Southeastern European (SEE) national central banks (NCBs) strive to prepare for the challenges of enlargement. This paper relies on the practical experience with three EU accession support projects of the European System of Central Banks (ESCB) to draw a general EU accession road map for applicant countries on which the accession framework for an NCB should be based. During preaccession, an NCB would be well advised to develop governance to improve its decisionmaking capacity. In this paper, we have defined three forms of governance: First, good governance to ensure the fulfillment of economic, legal and institutional requirements; second, external governance for an NCB to participate in accession coordination at the national and EU level; and third, internal governance comprising operational and institutional changes inside an NCB.

If NCBs do not pursue a consistent path toward good governance, they might – in the medium to long run – be affected by risks of a strategic, economic, operational and institutional nature. Thus, successful acceding NCBs make EU accession a top priority of their strategy. An NCB's policy of coordination should be the key policy for effective central bank governance. We therefore recommend that an NCB establish an EU coordination mechanism, an EU coordinator, coordination guidelines and an EU Scenario Process to continuously implement the changes necessary for successful ESCB/EU membership. This process will be more effective if NCBs cooperate in technical projects and draw on the experience of other NCBs.

Keywords: Central bank, enlargement, governance, policy of coordination

JEL classification: E58, K0, Z18

[Focus on European Economic Integration Q1/13](#)

Tkalec, M. “The Dynamics of Deposit Euroization in European Post-Transition Countries: Evidence from Threshold VAR“, p. 66-83.

This paper investigates the determinants and dynamics of deposit euroization (DE) in 12 European post-transition economies based on threshold models. The results suggest that exchange rates and interest rate differentials are important for explaining DE. The results for the two countries with the highest macroeconomic and institutional credibility and flexible exchange rate regimes, the Czech Republic and Poland, suggest no evidence of threshold effects, while for other countries threshold behavior was found. The threshold VAR results indicate that depreciations have a stronger effect on DE than

appreciations, while interest rate spreads widen more after home currency depreciations than after appreciations. Moreover, we found evidence that DE changes more strongly after interest rate differentials increase than after they decrease.

Keywords: Deposit euroization, exchange rate, transition, threshold

JEL classification: C32, E44, E58, F31, F41

[Focus on European Economic Integration Q1/13](#)

Other CESEE-Related Publications

Gächter, M., Riedl, A., Ritzberger-Grünwald, D. (2013): “Business Cycle Convergence or Decoupling? Economic Adjustment in CESEE During the Crisis”, BOFIT Discussion Papers, No. 3

We analyze business cycle convergence in the EU by focusing on the decoupling vs. convergence hypothesis for central, eastern and south eastern Europe (CESEE). In a nutshell, we find that business cycles in CESEE have decoupled considerably from the euro area (EA) during the financial crisis in terms of both cyclical dispersion (i.e. the deviation of output gaps) and cyclical correlation. The results are mainly driven by smaller countries, which can be explained by the fact that small economies seem to have larger cyclical swings as they are more dependent on external demand, which causes a decoupling in terms of higher output gap deviations from the EA cycle in times of economic crises. At the same time, this does not necessarily affect business cycle synchronization as measured by cyclical correlations, where the strength of the

linear relationship of two cycles is measured. However, despite the recent declines in the co-movement, we generally observe high correlation levels of CESEE countries with the EA after their EU accession in 2004. Finally, we find a significant decoupling of trend growth rates between EA and CESEE until the onset of the financial crises. Since the beginning of the crisis, trend growth rates have declined both in CESEE and the EA with the trend growth differential decreasing significantly from about three to below two percentage points in 2011.

Keywords: Business cycles, EMU, CESEE, optimum currency areas

JEL Classification: G21, D14, C25.

[BOFIT Discussion Paper](#)

Research Update Q1 2013:

Economic Analysis and Research Department of the OeNB

To find out more about OeNB economic research and analysis topics as well as past and forthcoming OeNB events ranging beyond CESEE-related research, see the next issue of the OeNB's Research Update, which is due to be released in March 2013.

http://www.oenb.at/en/presse_pub/period_pub/volkswirtschaft/newsletter/einleitung.jsp

Call for Applications: Visiting Research Program



The Oesterreichische Nationalbank (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 post-doc) 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 3 and 6 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 2013 should be e-mailed to eva.gehringer-wasserbauer@oenb.at by May 1, 2013. Applicants will be notified of the jury's decision by mid-June. The following round of applications will close on November 1, 2013.

See also: [Visiting Research Program 2013](#)

Call for Entries: Olga Radzyner Award 2013 for Scientific Work on European Economic Integration

The Oesterreichische Nationalbank (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 2013, 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 2013 award should arrive at the OeNB by September 20, 2013, at the latest.

For more information, please see www.oenb.at or contact Ms. Eva Gehringer-Wasserbauer in the OeNB's Foreign Research Division either by e-mail eva.gehringer-wasserbauer@oenb.at or by phone (+43-1-40420-5205).

See also: [Olga Radzyner Award 2013](#)

Upcoming and Recent 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.

Upcoming

| | |
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| June, 2013 (tbc) | 73rd East Jour Fixe "Croatia's EU Accession and Future Perspectives for the Region" |
| November 18 - 19, 2013 | Conference on European Economic Integration 2013 in Vienna |

Recent

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|-------------------|---|
| February 18, 2013 | 72 nd East Jour Fixe „External Imbalances and Adjustment in CESEE to the Crisis” |
| January 30, 2013 | EBRD Transition Report 2012 |

OeNB Courses at the Joint Vienna Institute (JVI)

For further details see: http://www.jvi.org/fileadmin/jvi_files/JVI_Program_2013.pdf

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| 11.-15.3.2013 | Institutional Challenges for EU candidate and potential candidate countries on the Road to the EU and EMU (Oesterreichische Nationalbank in cooperation with the Federal Ministry of Finance) |
| 16.-18.9.2013 | Cash Circulation and Payment Systems in Austria |
| 14.-18.10.2013 | Macro-financial Stability in Central, Eastern and Southeastern Europe |
| 21.-25.10.2013 | Economic and Monetary Integration in Europe (Oesterreichische Nationalbank in cooperation with the Federal Ministry of Finance) |
| 18.-22.11.2013 | Monetary and Financial Statistics Collected and Compiled by the ESCB |
| 2.-5.12.2013 | Building New Skills in Financial Translation |

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