

Q2/2014

# 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

- **OeNB-BOFIT Projections** for Selected CESEE Countries: Moderate but Firming Growth (see p.2)
- Summary **75th East Jour Fixe**: Ten Years After the 2004 EU Enlargement: Achievements and Next Steps (see p. 2/3)
- Studies in: **Focus on European Economic Integration Q2/14** (see p.4)
- **OeNB Euro Survey** How Do CESEE Households Perceive Their Ability to Borrow? First Evidence on the Role of Formal vs. Informal Borrowing (see p.5)
- **Event Wrap-Ups** (see p. 2-4)
- Call for Applications: **Visiting Research Program** (see p. 7)
- Call for Entries: **Olga Radzyner Award 2014** (see p. 7)
- Save the Date:

November 24 – 25, 2014: Conference on European Economic Integration (CEEI) 2014

# OeNB-BOFIT Projections for Selected CESEE Countries<sup>1</sup>: Moderate but Firming Growth

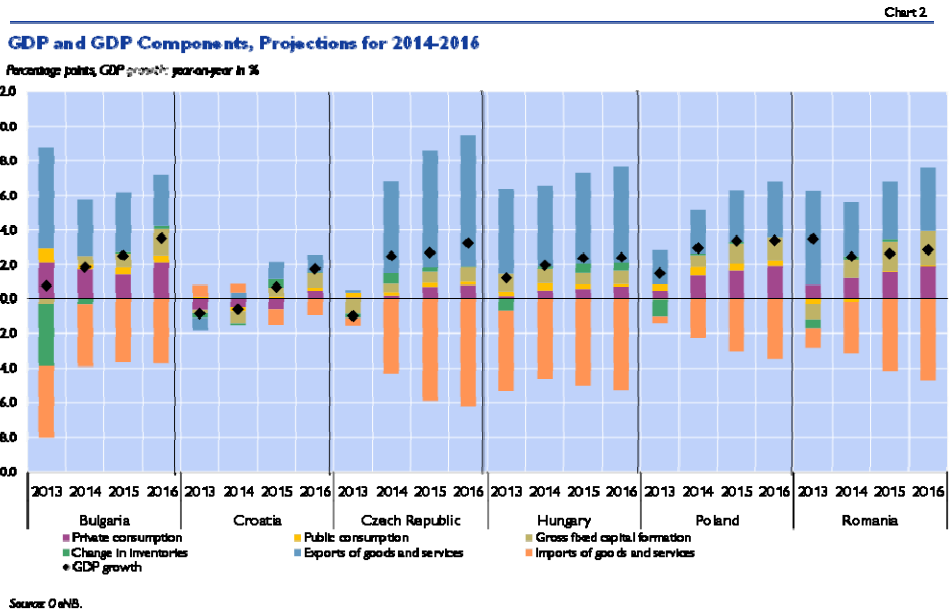
In the CESEE-7<sup>2</sup> region, economic growth will accelerate to 2.5% in 2014. Growth dynamics will strengthen further over the projection horizon on the back of recovering domestic demand and against the background of a gradually firming external environment. Overall, growth will be driven predominantly by exports and private consumption, with gross fixed capital formation following suit. The robust expansion of exports will not be sufficient to prevent the growth contribution of net exports from receding in all countries (but the Czech Republic) given strong import growth. Apart from Croatia, all countries in the region will post positive growth rates in 2014. Despite a general improvement of economic performance, individual developments will remain differentiated. Two

years later, in 2016, Bulgaria, the Czech Republic, Poland and Romania will grow at or above 3%, while the growth rate recorded by Hungary and Croatia will stay closer to 2%. Political uncertainties arising from the current tensions between Russia and Ukraine imply a sharp increase in the downside risks to our projections. A negative outcome from the ECB's Asset Quality Review also implies downside risks and vice versa, a positive outcome would pose an upside risk to our projections.

In Russia, business activity will slow further to 0.5% in 2014 despite a pickup in global economic growth and world trade, as investments are being postponed because of the Crimean crisis. GDP growth of 1.3% in 2013 undershot forecasts by a

margin stemming from a tangible slowdown in domestic demand. Amid a continuation of the global economic recovery, growth in Russia will probably pick up again slightly, but remain at low levels (2015: 1%; 2016: 2%). Risks to the Russia forecast are also strongly tilted to the downside as tensions between Russia and Ukraine could intensify and trigger even more capital flight and sanctions. Already, domestic uncertainty surrounding private and public capital formation poses significant risks to the forecast. [\(full article\)](#)

1. Cut-off date: April 4, 2014.
2. Central, Eastern and Southeastern Europe: Bulgaria, Croatia, the Czech Republic, Hungary, Lithuania, Poland and Romania.



## Event Wrap-Ups

### 75th East Jour Fixe:

### Ten Years After the 2004 EU Enlargement: Achievements and Next Steps

Summarized by Maria Silgoner

The 75th East Jour Fixe was part of a two-day conference designed to assess the 25th anniversary of the fall of the iron curtain and the 10th anniversary of the 2004 EU enlargement round. In 2004, the EU added ten new members, eight of which were CESEE countries. The conference was organized jointly by the OeNB, the Austrian Federal Ministry for Europe, Integration and Foreign Affairs, the Austrian Federation of Industries, the Institute for Human Sciences (IWM) and The Vienna Institute for International Economic Studies (wiiw). All contributing institutions



have a longstanding dedication to the CESEE region. In view of the institutions' different responsibilities, interests and approach-

have a longstanding dedication to the CESEE region. In view of the institutions' different responsibilities, interests and approach-

es, the conference covered a broad range of topics that investigated past achievements and lessons learned not only from an economic, but also from a historical and political science perspective. The conference webpages contain more information on the program as well as a video documentation of the conference. An extended summary of the conference will be released in the OeNB's forthcoming publication Focus on European Economic Integration Q2/14. ([Full article](#))



In his opening remarks, OeNB Governor Ewald Nowotny emphasized that the single biggest enlargement round of EU in history was a win-win success story not just for the ten acceding countries and for the EU, but especially for Austria, which has strong trade and investment links to the region. At the same time, he cautioned that the past decades have also shown that as the catching-up process

is neither automatic nor irreversible, countries must be well prepared for entry to ensure that membership benefits are sustainable.

The first conference day, which was organized by the wiiw, started with a very topical panel discussion on the frictions in Eastern Europe. The highly controversial contributions diverged especially in the assessment of the appropriate EU approach to the Ukraine-Russia conflict. A clear EU entry perspective would support Ukrainian independence but could be seen as a menace by Russia, potentially exacerbating the conflict. The second session focused on the Western Balkans, where the goal of reaching stability in the region has only been half met. EU membership offers market access, but not an automatic guarantee of security or of a stable democracy. The third session discussed intellectual failures before and during the crisis. The policy response was described as late and weak, with the effect that the EU was more divided after the crisis than before, both politically and economically. What the EU would need now is a new grand bargain that opens the way for two-speed integration, using enhanced cooperation to cope with unavoidable heterogeneity. The first conference day concluded with a high-level panel discussion opened by Austrian Foreign Minister Sebastian Kurz, who stressed the need to develop the European project further and who pointed to Austria's vital role as a partner for the Western Balkans. The panelists agreed that the loss of enlargement euphoria was to a large extent the result of unrealistic promises ahead of EU accession.

The morning of the second conference day was organized by the OeNB as the 75th East Jour Fixe, which was itself an anniversary. Chief economists, heads of research and other high-

level central bank representatives of ten CESEE countries discussed economic, monetary and financial strategies and challenges in two panel rounds. These were followed by a working meeting on further avenues of research for the CESEE region. In her introductory statement, Doris Ritzberger-Grünwald, Director of the OeNB's Economic Analysis and Research Department, described the evolution of the OeNB's longstanding technical cooperation activities from informal seminars into a broad-scale training program provided by the Joint Vienna Institute (JVI). While the OeNB's interest in the CESEE region originated from historical ties, it is now linked to Austrian banks' CESEE activities. Panelists of countries with fixed exchange rate strategies or euro membership highlighted the stabilizing and sheltering effects of the euro but also emphasized the importance of supportive domestic policies. Macroprudential policies, which have become the third leg of policy next to monetary and fiscal policy, play a crucial role in supporting foreign investors' confidence. But effective macroprudential policies also require good coordination across countries and a proper understanding of the linkages between business and credit cycles.

The 75th East Jour Fixe finished with a statement by Gertrude Tumpel-Gugerell, former Member of the Executive Board of the ECB and former Vice Governor of the OeNB. She recalled the expectations a decade ago that European integration would bring stability, growth and employment in the CESEE region. These hopes were not fully met, given a lack of proper institutions and regulations. Tumpel-Gugerell wound up by presenting the vision that at the next ten-year anniversary, the distinction between 'old' and 'new' EU Member States would have ceased to exist.



Foto: BMEIA/Mahmoud-Ashraf

The last half-day of the conference was organized by the IWM and investigated the revival of nationalism, the failure to develop a European identity and the longer historical perspective of overlapping periods of integration and disintegration, given that in 2014 we also remember the start of World War I 100 years ago. The peculiar aspect about European integration is that the EU is neither a nation state nor an empire; nonetheless, its very structure makes small nation states economically viable.

In addition to official debates, the two conference days provided a welcome opportunity for informal discussions and networking among central bankers, government officials, business and financial sector managers, researchers and journalists. Both media coverage and the positive feedback from participants confirmed the success of the approach to investigate the decade since EU enlargement from various angles.

## IMF Spring 2014 “Regional Economic Issues” Report for CESEE: Safeguarding the Recovery as the Global Liquidity Tide Recedes

Summarized by Christina Lerner

The recent recovery of the euro area economies has also fueled growth in most Central, Eastern and Southeastern European countries. As outlined in the IMF's Spring 2014 Regional Economic Issues<sup>1</sup> report for CESEE<sup>2</sup>, the region is projected to grow by 2.3% in 2014 (compared with 1.2% in 2013). Growth in the CESEE countries will, however, be weaker than previously expected and is threatened by an unusual constellation of risks:

Downside risks comprise increasing geopolitical tensions, protracted weak growth in the euro area and global financial market volatility. However, at the moment, volatile funding structures represent the biggest threat to CESEE economies as they are highly reliant on external funding and hence strongly susceptible to external funding shocks. In addition, a significant degree of financial euroization in the region further increases the risks stemming from large foreign currency exposures. Moreover, the outlook is clouded by increased foreign investor participation in

local bond markets and the extended role of foreign institutional investors in these markets.

As regards the policies to be pursued, the REI report states that many countries in the region lack policy space: fixed exchange rate regimes, elevated fiscal deficits and above-target inflation impede policy flexibility. The report recommends that most countries should diversify funding sources, strengthen fiscal positions and boost growth through structural reforms. ([full article](#))

1. Regional Economic Issues (REI) reports, published biannually by the IMF, cover analytical issues of interest to policymakers, academics and the broader public in the relevant region. The CESEE REI Spring 2014 has a special focus on funding structures and risks.
2. CESEE refers to Albania, Belarus, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Kosovo, Latvia, Lithuania, FYR Macedonia, Moldova, Montenegro, Poland, Romania, Russia, Serbia, the Slovak Republic, Slovenia, Turkey, and Ukraine.

## Focus on European Economic Integration Q2/14

### “Finance, Potential Output and the Business Cycle: Empirical Evidence from Selected Advanced and CESEE Economies”,

Bernhofer D., Fernández-Amador O., Gächter M. and Sindermann F., pp. 52-75



In this paper we compare the determinants of loan dollarization in two emerging market regions, namely Central, Eastern and Southeastern Europe (CESEE) and Latin America, through a meta-analysis of 32 studies that provide around 1,200 estimated coefficients for six drivers of foreign currency lending. As a common pattern, we find macroeconomic instability (as expressed by inflation volatility) and banks' funding in foreign currency to play a significant role in explaining loan dollarization

in both regions. In contrast, the interest rate differential appears to be a key determinant only in Latin America, while the positive impact of exchange rate volatility on dollarization implies a more prominent role for supply factors in the CESEE region. While the robustness of the results has been verified, our meta-analysis shows that estimates reported in the literature tend to be influenced by study characteristics such as the methodology applied and the data used. ([full article](#))

### “How Did CESEE Households Weather the Crisis? Evidence from the OeNB Euro Survey”

Corti M. and Scheiber T., pp. 76-87

For Central, Eastern and Southeastern European (CESEE) countries, the euro area is the most important export destination. Nevertheless, geographical export patterns differ among individual CESEE countries, and economic growth within the euro area has diverged in the run-up to and since the economic and financial crisis. We therefore examine the effects such heterogeneous developments have had on trade – and thus economic growth – in CESEE. Given the importance of such spillovers for macroeconomic projections, we evaluate the OeNB's macroeconomic forecasting model (FORCEE) for Bulgaria, Croatia, the Czech Republic, Hungary, Poland and

Romania. The FORCEE model captures trade spillovers via aggregate demand from the euro area. We challenge this simplification by introducing a more differentiated representation of the regional structure of trading partners. Our results show that such a modification improves the forecasting performance of our structural macro model in particular for the three Southeastern European countries in our sample. However, our tests do not yet account for the additional uncertainty introduced into the model by broadening the set of external assumptions, when we cover external demand from a wider range of partner countries. ([full article](#))

## OeNB Euro Survey

### How Do CESEE Households Perceive Their Ability to Borrow?

#### First Evidence on the Role of Formal vs. Informal Borrowing

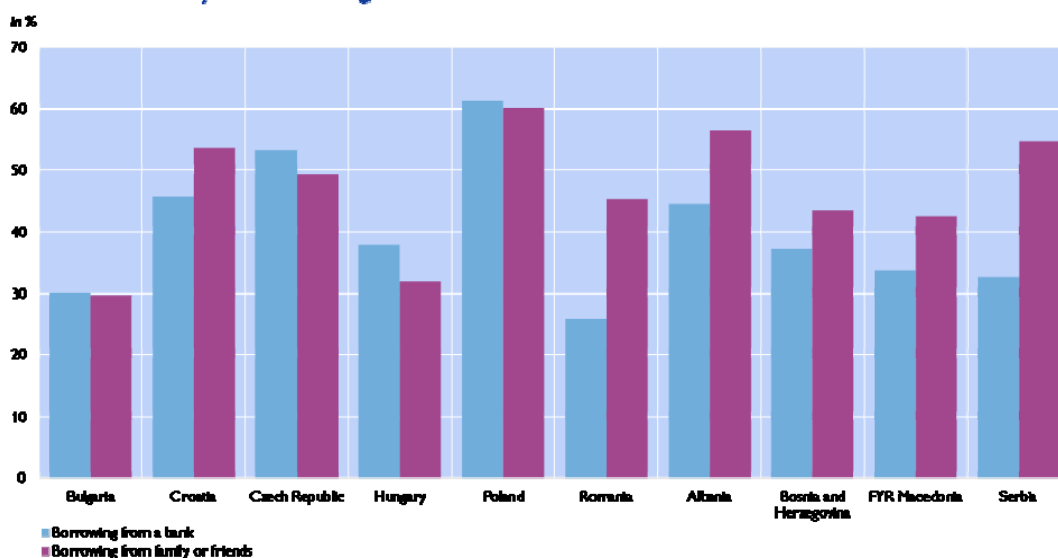
Not all CESEE households were able to borrow the amount of money they intended to in the past, according to survey results presented by Corti and Scheiber (2014). Looking ahead, one might ask whether every household that needs credit will actually get it. The answer to this question is likely to depend on households' access to bank services in general and whether there are any geo-

also reflect that currently some households expect their loan applications to be rejected by banks.

So, what do we know about alternative funding sources, such as informal borrowing? The importance of informal borrowing for CESEE households has been confirmed in the most recent Euro Survey, in line with findings from the Life in Transition Survey II (EBRD, 2011). Households in Central and Eastern Europe thought they had a lower likelihood of obtaining money from family or friends than from banks in fall 2013, while households in Southeastern Europe (in particular in Romania and Serbia) found the opposite was the case. Bulgarians and Hungarians rated their perceived ability to borrow either formally or informally lowest of all respondents.

Chart

Perceived Possibility to Borrow a Significant Amount From Banks vs. Informal Sources



Source: OeNB Euro Survey (fall 2013).

Note: Respondents who answered "Don't know" or indicated "No answer" have been excluded. Values show percentage of respondents who responded "yes, almost certainly" or "yes, probably" to the question "Generally speaking, would you have the possibility to borrow a significant amount of money from a bank / from family or friends?"

graphical or institutional obstacles. The ongoing banking sector deleveraging in the region might possibly restrict households' access to bank loans. Hence the question arises whether households will be able to resort to informal borrowing.

During the OeNB Euro Survey fall 2013 wave, respondents were asked whether they had the possibility of borrowing a significant amount of money from a bank or from family and friends (see chart). More than half of the respondents in the Czech Republic and around 60% of those in Poland expected that a bank would grant them a loan. These rather optimistic views reflect improving financing conditions in the Czech Republic and continued favorable financing conditions in Poland as well as a rather dense network of bank branches.

By contrast, pessimistic views on the same question prevailed in particular in Bulgaria, Romania, FYR Macedonia and Serbia, where merely one-third of the households questioned assumed that they would "probably" or "almost certainly" be able to obtain a bank loan. These results coincide with smaller branch networks and might

#### References:

Corti, M. and T. Scheiber. 2014. How Did CESEE Households Weather the Crisis? Evidence from the OeNB Euro Survey. In: Focus on European Economic Integration Q2/14. 76–87.

EBRD. 2011. Transition Report 2011: Crisis and Transition – The People's Perspective. London.

The OeNB Euro Survey has been conducted since fall 2007 on a semi-annual basis in ten 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, related publications, and main results, please visit [cesee.oenb.at](http://cesee.oenb.at).

## CESEE-Related Abstracts from Other OeNB Publications

### “Capital Market Development in CESEE Countries and the Need for Further Reform”,

Jäger-Gyovai K., *Financial Stability Report 27*, forthcoming

Capital markets in CESEE continue to be less developed than capital markets in more advanced economies. Unhedged foreign currency borrowing and dependence on external funding have been among the key vulnerabilities in CESEE during the global economic crisis. Therefore, there is a need for better developed local capital markets in the region, additional local sources of domestic funding, and a reduction in foreign exchange exposure in domestic financial markets. International

initiatives, such as the “Vienna Initiative” or the EBRD Local Currency and Capital Markets Development Initiative, support local capital market development in the region. Well-developed capital markets are not only a crucial component for generating economic output, but also foster more stable growth through the ability of diversified financial sources to offset a slowdown of economic activity caused by the credit crunch.

### “Macrofinancial Developments in Ukraine, Russia and Turkey from an Austrian Financial Stability Perspective”,

Wittenberger T., Widhalm D., Lahnsteiner M. and Barisitz S., *Financial Stability Report 27*, forthcoming

Recent bouts of international financial market volatility and adverse geopolitical developments have put the spotlight on Ukraine, Russia and Turkey. While Austrian banks benefited from a benign macrofinancial environment in Russia and Turkey, in particular with regard to the swift

recovery from the 2008–2009 crisis, they are burdened by legacy issues of the last credit boom in Ukraine. By discussing macrofinancial developments in Ukraine, Russia and Turkey, this study sets the scene for a more in-depth analysis of Austrian banks’ activities in these countries.

### One Money, One Cycle? The EMU Experience, Gächter M. and Riedl A., *OeNB Working Paper 186*

The authors examine whether the introduction of the euro had a significantly positive impact on the synchronization of business cycles among members of Economic and Monetary Union (EMU) which might arise due to the lack of country-specific monetary policy shocks in the euro area. Empirical evidence on this relationship is rare so far and suffers from methodical weaknesses, such as the absence of time variability, which is crucial for addressing this issue. Using a synchronization index that is constructed on a year-by-year basis (1993-2011), the authors uncover a strong and robust empirical ending:

the adoption of the euro has significantly increased the correlation of member countries’ business cycles above and beyond the effect of higher trade integration. Thus, our results substantially strengthen the conclusion by Frankel & Rose (1998), i.e. a country is more likely to satisfy the criteria for entry into a currency union ex post rather than ex ante. Remarkably, however, this reasoning is even verified when controlling for the effect of increased trade linkages implied by entering a currency union.

[\(full article\)](#)

## Euro Survey

### “Foreign Currency Borrowing and Knowledge about Exchange Rate Risk”,

Beckmann E. and Stix H., *OeNB Working Paper 188*

Foreign currency borrowing is widespread in many regions of the world. This raises the question whether unhedged borrowers do not understand the exchange rate risk emanating from such loans. Employing household level micro-data from eight Central and Eastern European countries we study how agents’ knowledge about exchange rate risk affects the currency denomination of loans. Results show, first, that a majority of respondents is aware that depreciations increase loan installments.

Second, we find that knowledge about the exchange rate risk lowers the demand for foreign currency borrowing. To assess the causal effect of literacy on loan demand we utilize information on agents’ exchange rate expectations. Overall, results suggest that financial literacy exerts a strong impact on the choice of the loan currency. However, from an aggregate perspective, a misunderstanding of the underlying risks is not the main cause of foreign currency borrowing.

[\(full article\)](#)



## 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 (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 2015 should be e-mailed to [eva.gehringer-wasserbauer@oenb.at](mailto:eva.gehringer-wasserbauer@oenb.at) by November 1, 2014.

Applicants will be notified of the jury's decision by mid-December 2014. The following round of applications will close on May 1, 2015.

See also: [Visiting Research Program 2014](#)

## Call for Entries: Olga Radzyner Award 2014 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 35<sup>th</sup> 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 2014 award should arrive at the OeNB by September 19, 2014, at the latest.

For more information, please see [www.oenb.at](http://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](mailto:eva.gehringer-wasserbauer@oenb.at) or by phone (+43-1-40420-5205).

See also: [Olga Radzyner Award](#)

## Upcoming Events

September 12, 2014	76 <sup>th</sup> East Jour Fixe OeNB Euro Survey: Using Survey Data For Economic Policy Research
November 24 – 25, 2014	Conference on European Economic Integration (CEEI)

### November 24 – 25, 2014: Conference on European Economic Integration (CEEI)

Topic: The Rebalancing Challenge in Europe – Perspectives for CESEE

#### CONFERENCE ASPECTS

The CEEI 2014 will examine the multiple challenges and potentially conflicting objectives of sectoral rebalancing in Europe, with a special focus on Central, Eastern and Southeastern Europe (CESEE). While significant progress has been made with the repair of banks' balance sheets, issues like private sector deleveraging, the considerable costs involved, slow economic growth as well as the difficulty of rebalancing simultaneously across countries and sectors still remain unsolved. Against this background, economic policy requires careful decisions on the type and sequencing of rebalancing exercises and prudent coordination across a wide range of stakeholders. The CEEI 2014 will analyze internal and external adjustments in Europe, discuss historical examples and thereby attempt to clarify the role of macro-economic policy in largescale rebalancing episodes.

## OeNB Courses at the Joint Vienna Institute (JVI)

May 12-16, 2014	Institutional Challenges for EU Candidate and Potential Candidate Countries on the Road to the EU and EMU
September 15-17, 2014	Cash Circulation and Payment Systems in Austria
October 13-17, 2014	Macro-Financial Stability in Central, Eastern and Southeastern Europe
October 20-24, 2014	Economic and Monetary Integration in Europe
November 17-21, 2014	Monetary and Financial Statistics Collected and Compiled by the ESCB
December 1-2, 2014	Financial Education in Central Banks: Initiatives and Activities

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

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