

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 National Bank (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

- The latest issue of the OeNB's quarterly publication "**Focus on European Economic Integration**" has just been released (see p. 7).
- The **70th East Jour Fixe**, hosted by the OeNB on February 23, 2012, dealt with macroeconomic forecasting for CESEE economies against the backdrop of high uncertainty in the international environment. (see p. 2).
- The **OeNB February 2012 CESEE interim projections update** for the CEE-7 countries expects GDP growth in the region to expand by only 1.5% year-on-year in 2012 after having shown surprisingly strong GDP growth in 2011 (see p. 3).
- **Recent results from the OeNB Euro Survey** confirm households' trust in the euro to have been affected by the sovereign debt crisis (see p. 4).
- 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. 6).
- 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. 5).

70th East Jour Fixe Forecasting CESEE Growth in Turbulent Times

The 70th East Jour Fixe, which was hosted by the OeNB on February 23, 2012, dealt with macroeconomic forecasting for CESEE economies against the backdrop of high uncertainty in the international environment. The distinct behavior of professional forecasters in the recent times of heightened uncertainty has illustrated the need to thoroughly rethink existing forecasting techniques and address the specific challenges that exist with respect to forecasting CESEE growth based on short time series that are often plagued by low data quality. Moreover, the CESEE region's strong economic ties with the euro area deserve particular attention, as they constitute a growth pillar in good times but give cause for severe vulnerability during bad times.

The first keynote address stressed the importance the trade channel plays in this respect as it trumped the financial channel in amplifying the stress that emanated during the 2008/09 crisis. Looking ahead, debt overhang and the possible repatriation of capital from foreign-owned banks with the aim of meeting domestic capital requirements will pose the key risks for the CESEE region.

The first session gave an overview of different approaches to forecasting CESEE growth. Strongly model-based approaches grounded in theory as well

as time series analysis and strongly expert-based approaches were discussed and evaluated with respect to their forecasting performance. The decomposition of the česká národní banka forecasting error during the recent crisis illustrated the importance of expert judgment as an input to model-based forecasting.

The second keynote introduced a judgment-free nowcasting tool, which proves very flexible in dealing with a wide array of data sources and which was recently applied to nowcasting economic activity in Poland.

The ensuing second session centered on alternative approaches to forecasting. Individual contributions included a presentation of the Business Tendency Survey in Ukraine, a discussion of the merits of using confidence indicators in forecasting Czech GDP and a presentation of two particular timely available indicators used by the OeNB, namely truck mileage as an indicator for export forecasts and electricity consumption as an indicator for nowcasting industrial production in Austria.

The presentations and workshop program are available at [ceec.oenb.at \(Events\)](http://ceec.oenb.at/Events)

EBRD Transition Report 2011: The Crisis from the Household Perspective

On January 31, 2012, the Oesterreichische Nationalbank (OeNB) hosted the presentation of the 2011 EBRD Transition Report and the January 2012 update of the EBRD's growth forecasts for Central, Eastern and Southeastern Europe (CESEE). At the press conference (which was chaired by Doris Ritzberger-Grünwald, Head of the OeNB's Foreign Research Division), 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 operates the EBRD region¹ and

outlined the most important findings of the EBRD Transition Report 2011 "Crisis and Transition: The People's Perspective."² The main contribution of the 2011 Transition Report lies in delivering a better understanding of both the financial crisis (2008–2010) and its longer-term implications from the household perspective, based on the findings of the second round of the Life in Transition Survey (LiTS II), a household survey that was conducted jointly by the EBRD and the World Bank.³

¹ Covering 29 countries, the EBRD region stretches from Central and Eastern Europe to Central Asia, including Turkey. Effective from 2008, the Czech Republic was the first country to graduate from the EBRD.

² See www.ebrd.com/pages/research/publications/flagships/transition.shtml for the full report.

³ In addition to the countries of the EBRD region, the second round of the LiTS household survey comprises also five Western European countries, i.e. Germany, France, Italy, Sweden and the United Kingdom.

Part I: Economic Prospects in the EBRD Region – Emerging Europe under Threat from the Euro Area Sovereign Debt Crisis

The EBRD expects that GDP growth in the transition countries will slow substantially from about 4.8% in 2011 to 3.1% in 2012. This can largely be attributed to significantly reduced growth in CESEE, where a few countries (Hungary and Slovenia) are expected to fall back into recession in 2012. Next to contractive fiscal consolidation measures in this region, the financial transmission of the sovereign debt crisis experienced in some euro area partner countries is seen as the main reason for the projected economic slowdown. However, the EBRD's economic outlook also cites encouraging prospects. Compared to 2008, economic fundamentals have largely strengthened. The EBRD region is also less dependent on external financing, and bank balance sheets are generally stronger as a result of recapitalization and deleveraging. In addition, Russia and other CIS countries which are not very integrated with Western Europe will most likely continue to post respectable GDP growth rates, assuming that commodity prices remain high.

Part II: Understanding the Impact of the Crisis from the Household Perspective

In the second part of his presentation, Zettelmeyer elaborated on the impact of the financial and economic crisis on household consumption in the EBRD region as compared to a benchmark group of Western European countries. Based on an index comprising a variety of crisis events (e.g. job losses, reduction of wages or working hours, reduction of remittances), the EBRD analysis showed that households in the transition countries suffered more crisis-related "shocks" and reduced their consumption (in particular for essentials such as staple foods and health care) much more strongly

than their Western European counterparts. The decline in consumption can partly be attributed to the fact that most of the transition countries have by far less effective formal safety nets (e.g. safety benefits, access to finance) in place than the countries in the Western European benchmark group. Furthermore, the Transition Report revealed that the role of formal borrowing in shaping a transition region's response to the crisis was ambiguous. On the one hand, those respondents who were successful in obtaining a loan during the crisis were able to cushion the impact of the crisis. On the other hand, pre-crisis borrowing exacerbated the decline in household consumption during the crisis. Moreover, households that were affected more strongly by the crisis were more likely to be in arrears on their mortgage.

The discussion that ensued after the presentation reiterated that the repayment of debt in foreign currency is apparently still manageable at the micro-level, but is associated with negative consequences at the macro-level given that household consumption has been cut back in order to continue servicing foreign currency loans. In addition, Zettelmeyer pointed out that mortgage holders in the five Western European comparator countries fared better than their counterparts in Eastern Europe, who were presumably subject to stronger over-borrowing before the crisis and a stronger decline of asset (in particular housing) prices during the crisis.

A more detailed summary of the presentation of the EBRD Transition Report 2011 has been published in the [Focus on Economic European Integration Q1/2012](#)

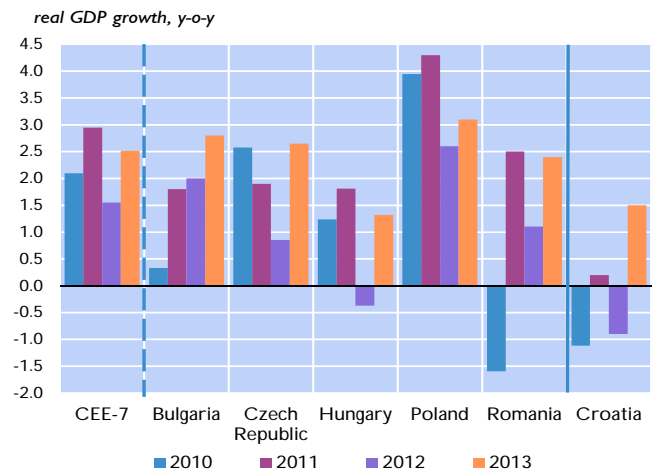
OeNB February 2012 CESEE Interim Projections Update: External and Domestic Uncertainties Impair Growth in 2012

The worsening external environment led to a downward revision of our growth expectations for 2012. The CEE-7 region - that is Bulgaria, the Czech Republic, Hungary, Latvia, Lithuania, Poland and Romania – will expand by only 1.5% year- on-year in 2012 after having shown surprisingly strong GDP growth in 2011 of 2.9%. This upward revision in

2011 is mainly due to the good performance of Poland and good harvests in Hungary and Romania. With dim prospects for euro area growth in 2012, the fading demand for exports will compound domestic weaknesses such as fragile labor markets, high consolidation needs and tight credit conditions in the current year. Country specific factors

(uncertain business environment in Hungary and the VAT hike in Croatia) will cause a slight GDP contraction in those two countries. Net exports will continue to contribute positively to the overall weak growth performance, while the contribution from domestic demand remains negative. The risks to these projections remain on the downside and arise from both, external (prolonged problems inside the euro area) and domestic factors (tighter financing conditions in the private and the public sector, additional consolidation needs).

OeNB CESEE GDP Projections 2011-2013
Interim Update February 2012



Source: Eurostat, OeNB.

The Sovereign Debt Crisis Dampens CESEE Households' Trust in the Euro

The OeNB Euro Survey finds that households' trust in the euro has been affected by the sovereign debt crisis. Consent to the statement that "the euro will be a very stable and trustworthy currency over the next five years" further declined in all countries in October and November 2011 (Chart 1). The rebound in sentiments, which was found for some

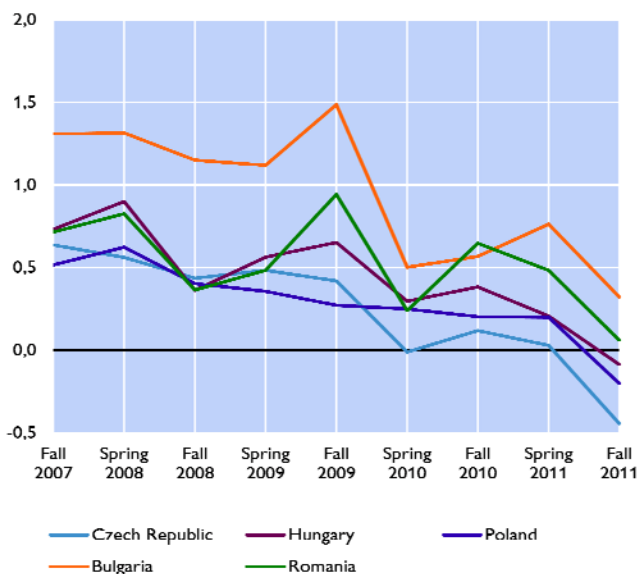
SEE countries in spring 2011, has been reversed substantially. In the Czech Republic, Poland and Hungary the assessment of the future stability and trustworthiness of the euro even fell into the negative territory for the first time ever. In the remaining seven countries, however, assessments are still in the positive range.

Chart 1

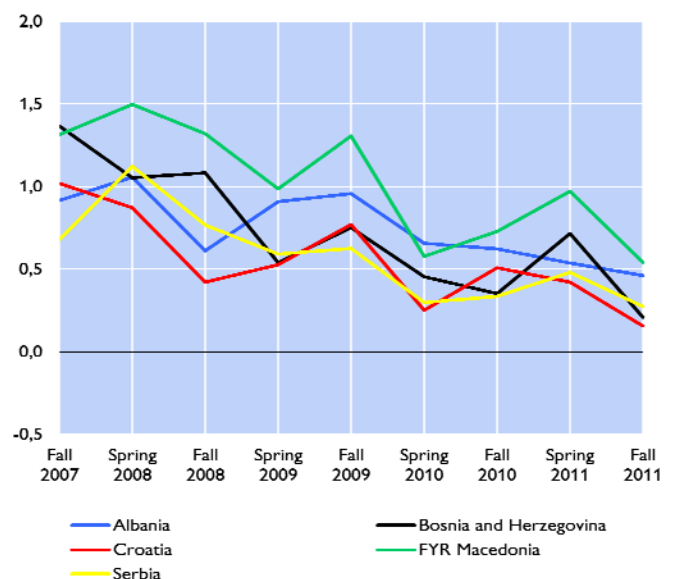
Consent to the Statement: Over the Next Five Years, the Euro Will be a Very Stable and Trustworthy Currency.

EU Member States

Normalized sample means per country (-2.5 fully disagree, 0 neutral, +2.5 fully agree)



(Potential) Candidate Countries



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.

Although the sovereign debt crisis triggered a hitherto unprecedented deterioration of trust in the euro, it did not lead to an overall change in the relative assessment of the local CESEE currencies vis-à-vis the euro. In eight of ten countries trust in the euro still exceeds trust in the local currencies. The exceptions are Poland, where the trust levels are on a par, and the Czech Republic, where the koruna continues to enjoy more trust than the euro. However, the difference in trust between the local currencies and the euro has shrunken substantially in almost all SEE countries. Interpretation: Research on Euroization concludes that the portfolio decisions of CESEE households are inter alia sensitive with

respect to the credibility of local currency vis-à-vis safe haven currencies, which in the case of the CESEE region is predominantly the euro. Given households' reduced confidence in and growing uncertainty about the euro since the conclusion of the first support program for Greece in May 2010 and the temporary escalation of the crisis in December 2011, one might expect some households to adjust their portfolios and to shift their savings, e.g. from euro-denominated deposits to local currency deposits or to other foreign currencies. These hypotheses however, remain to be confirmed by monetary statistics. More sentiment indicators can be found on ceec.oenb.at

Research Stay of Ursula Vogel (Frankfurt School of Finance & Management) at the OeNB's Foreign Research Division

Ursula Vogel, PhD student and research assistant at the Centre for Development Finance of the Frankfurt School of Finance & Management visited the Foreign Research Division of the OeNB as a guest researcher in November 2011. Together with Mathias Lahnsteiner (Foreign Research Division) and Markus Hameter (Credit Division), she worked on a research project on cross-border credit to CESEE extended by Austrian banks, specifically on analyzing a dataset compiled by the Austrian Central Credit Register on the basis of which lending to affiliated entities (parent-subsidary relationship) may be separated from

lending to nonaffiliated entities, both in the bank and nonbank sectors. The results show that intra-group cross-border credit from Austrian banks vis-à-vis borrowers was more stable than lending to nonaffiliated borrowers during the 2008/2009 financial crisis period. The outcome of this joint research project will be published in the OeNB's Financial Stability Report in June 2012. Ursula Vogel also took the opportunity to present previous work on macroprudential policies and housing prices in CESEE to staff experts of the Economic Analysis and Research Department.

Call for Applications: Visiting Research Program



The Oesterreichische Nationalbank (OeNB) invites applications from external researchers for 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 are provided with accommodation on demand and have, as a rule, access to the department's computer resources. Their research output can 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 stay, and
- information on previous scientific work.

Applications for 2012/13 should be e-mailed to Eva.Gehring-Wasserbauer@oenb.at by May 1, 2012.

Applicants will be notified of the jury's decision by mid-June.

The following round of applications will close on November 1, 2012.

Call for Entries: Olga Radzyner Award 2012 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 2012, 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 2012 award should arrive at the OeNB by September 17, 2012, at the latest.

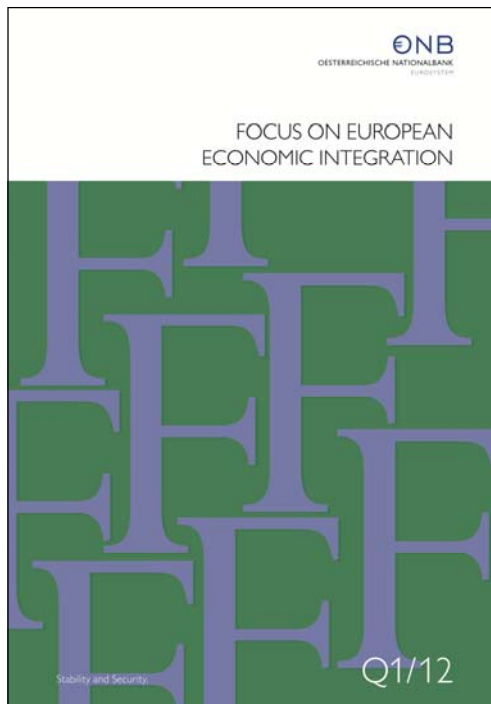
For more information, please see www.oenb.at or contact Ms. Eva Gehring-Wasserbauer in the OeNB's Foreign Research Division either by e-mail (Eva.Gehring-Wasserbauer@oenb.at) or by phone (+43-1-40420-5205).

OeNB Publications

Focus on European Economic Integration Q1/12

The latest issue of the Oesterreichische Nationalbank's quarterly publication "Focus on European Economic Integration" has just been released. As a channel for communicating the OeNB's ongoing research on Central, Eastern and Southeastern Euro-

pean (CESEE) countries, this publication includes peer-reviewed studies on macrofinancial and monetary integration as well as economic country analyses, cross-regional comparisons and summaries of CESEE-related events hosted by the OeNB.



Call for Entries: Olga Radzyner Award 2012 for Scientific Work on European Economic Integration

Call for Applications: Visiting Research Program

Studies

Residential Property Markets in CESEE EU Member States *by Antje Hildebrandt, Reiner Martin, Katharina Steiner and Karin Wagner*

Spillovers of the Greek Crisis to Southeastern Europe: Manageable or a Cause for Concern? *by Peter Backé, Sándor Gardó*

Event Wrap-Ups

EBRD Transition Report 2011: The Crisis from the Household Perspective *Compiled by Markus Eller and Mariya Hake*

[Focus on European Economic Integration Q1/12](#)

Hildebrandt, A., Martin, R., Steiner, K., and Wagner, K.: "Residential Property Markets in CESEE EU Member States", pp. 8 - 30

This paper provides an overview of residential property market developments in ten Central, Eastern and Southeastern European (CESEE) EU Member States over the last 10 to 15 years, featuring price developments, housing conditions, affordability, housing financing and policy measures targeting residential property markets. The descriptive cross-country approach particularly focuses on the period of the economic and financial crisis by capturing the recent boom and bust of residential property prices across the whole region. We observe that high levels of home ownership and low costs of external housing financing were related to rising residential property prices. Besides the small

size of the rental market, rising demand for affordable good-quality housing suggests that price developments during the forthcoming catching-up of residential property markets are likely to be dynamic. In this respect, policy action in different areas should increasingly attempt to keep a lid on housing market developments in CESEE.

JEL classification: E3, F36, P2, P5, R21, R31

Keywords: Residential property market, housing finance, regulation of housing markets, CESEE countries

Backé, P., Gardó, S.: "Spillovers of the Greek Crisis to Southeastern Europe: Manageable or a Cause for Concern? ", pp. 31 - 48

During the boom years in the run-up to the global financial and economic crisis, Greece established close economic ties with the Southeastern European (SEE) region. As a consequence, the current Greek sovereign debt crisis could potentially have adverse economic implications for SEE. Both real and financial transmission channels might have a bearing, though

in most countries real economic linkages do not seem as strong as the degree of interconnectedness in the realms of banking and finance, where risks might materialize both directly and indirectly (i.e. via changes in expectations and risk perceptions). So far, the Greek crisis has only had a relatively limited impact on SEE. Available buffers and policy tools

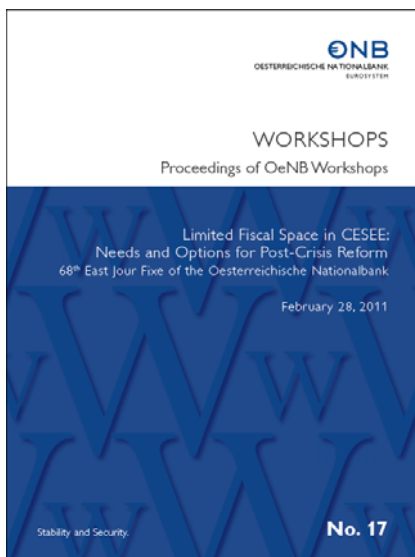
have helped SEE to cope with the related risks and also provide some more room for the region to address vulnerabilities caused by the Greek crisis that may materialize in the future. Possible challenges appear to be largest in the realm of banking, even though banking sector adjustment during the crisis has been fairly orderly so far. However, the recent intensification of the sovereign debt crisis in euro area countries may put the macrofinancial resilience of SEE countries to a much stiffer test, given its

ramifications on external demand, potential negative feedback loops affecting European banks and a further rise in global risk aversion.

JEL classification: F36, G2, O52, P2

Keywords: Financial stability, banking sector, sovereign debt crisis

A new issue of „Workshops – Proceedings of OeNB Workshops“ (No. 17) has just been released: “Limited Fiscal Space in CESEE: Needs and Options for Post-Crisis Reform”.



This conference volume collects the papers presented at the 68th OeNB East Jour Fixe, which took place on February 28, 2011. The included papers focus on the limited room for budgetary maneuver and on the limited resilience of public finance systems, which were revealed in the CESEE economies during the 2008–2009 financial and economic crisis. Answers to three main questions are provided:

1. What were the underlying economic conditions for limited fiscal space?
2. What are the related implications and what kind of reforms are necessary to provide more fiscal space in the future?
3. Can an improved access to and a more effective use of international funds be considered as a possibility to create more fiscal space in CESEE?

http://www.oenb.at/en/presse_pub/period_pub/volkswirtschaft/workshops/workshop_no_17.jsp

The conclusions should be valuable in understanding the impact of the Great Recession on fiscal positions in CESEE and in deriving lessons for today's fiscal adjustment and institutional reforms in the region.

CESEE-Related Abstracts from Other Publications

Barisitz, S. (2012), “The Kazakhstani banking system: Highly leveraged boom, painful bust, costly recovery” in „Modern Kazakhstan – Images and Realities“, Heinrich, H.G., Lobova, L., (Ed.)

Pushed by expanding income (on the back of rising oil prices) and by rapid external debt accumulation, the Kazakhstani banking sector featured one of the most dynamic credit booms in CESEE until 2007. Following the US subprime crisis, banks' access to external funding plummeted and credit expansion

ground to zero. The global economic crisis that broke out in late 2008 forced credit institutions to drive down their external indebtedness. Moreover, the (temporary) collapse of the oil price and the devaluation of the tenge cut domestic demand, liquidity and solvency. The share of nonperforming

loans (NPLs) skyrocketed from 5% at end-2008 to 21% a year later, and further to 26% in mid-2011. Large losses stemming from real estate exposure (burst of housing bubble), related-party lending, and fraud, likely played a role. Loan-loss provisions were sharply ramped up, profitability was all but wiped out in 2008 and hefty losses incurred in 2009 (ROA end-2009: -24%), when sector capital even turned negative. The authorities' crisis-response measures included the nationalization of two of the four largest banks and the recapitalization (via the acquisition of minority stakes) of the two others in early 2009 (all four banks together accounting for 2/3 of sector assets). The two nationalized banks then defaulted on their high foreign liabilities and initiated debt-

restructuring negotiations that produced steep haircuts (53% resp. 76%) for creditors in 2010. The sector's debt burden was thus substantially eased, capital turned positive again and banks witnessed a fragile return to profitability in 2010-2011. However, stubbornly high and even rising credit risk and declining coverage ratios coupled with a weak institutional environment suggest the need for a new government program to clean up NPLs. Important shock-absorbing factors include: the strong (oil-driven) recovery of the real economy, depositor confidence (underpinned by state-owned firms' deposits), record-level official currency assets, and a modest public debt.

Denisova, I., Eller, M., Frye, T., Zhuravskaya, E. (2012) "Everyone Hates Privatization, but Why? Survey Evidence from 28 Post-Communist Countries", Journal of Comparative Economics, 40, pp. 44–61.

Studies of mass support for economic reform reveal a simple conclusion: Everyone hates privatization. Yet whether respondents hold this view due to a preference for state property or concerns about the legitimacy of privatization is unclear. We test these arguments using a 2006 survey of 28,000 individuals in 28 post-communist countries and find that a lack of human capital affects support for revising privatization primarily via a preference for state property over private property; whereas transition-

related hardships influence support for revising privatization due to both a preference for state property and concerns about the legitimacy of privatization. These results suggest the value of analyses that not only link respondent traits with support for policy, but that also probe the motivations that underpin this support. They also indicate that opposition to privatization should not be equated with support for renationalization.

OeNB Courses at the Joint Vienna Institute (JVI)

For further details see: http://www.jvi.org/fileadmin/jvi_files/JVI_Program2012.pdf

March 5 - 9, 2012	Institutional Challenges for Candidate and Potential Candidate Countries on the Road to the EU and EMU
September 17-18, 2012	Cash Circulation and Payment Systems in Austria
October 1-5, 2012	Economic and Monetary Integration in Europe: CIS –Related Aspects
Nov 19-23, 2012	Macro-Financial Stability in Central, Eastern and Southeastern Europe
January 30 – February 2, 2012	Financial Stability Stress Testing for Banking Systems: An Introduction (STB)

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

June 18, 2012	SUERF/OeNB Workshop: „The Interaction of Political, Fiscal and Financial Stability: Lessons from the Crisis“
July 9, 2012	OeNB's 71 st East Jour Fixe: "Slovenia: The first five years in monetary union"
Oct. 4-5, 2012	10th Emerging Markets Workshop
November 26 - 27, 2012	Conference on European Economic Integration (CEEI) 2012 "Achieving balanced growth in the CESEE countries" Jointly organized by Suomen Pankki and the Oesterreichische Nationalbank (OeNB) subject to change

Recent

February 23, 2012	OeNB's 70 th East Jour Fixe: "Forecasting CESEE Growth after the Crisis"
January 31, 2012	Jeromin Zettelmeyer (EBRD): Presentation of the EBRD Transition Report 2011

Research Update Q1 2012:

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 2012.

http://www.oenb.at/en/geldp_volksw/vowi_pub/newsletter/einleitung.jsp#tcm:16-171525

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