

# CESEE Research Update

Foreign Research Division

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## Content

Recent results of the OeNB Euro Survey .....	2
Focus on European Economic Integration Q3/11 .....	3
OeNB Publications .....	3
69 <sup>th</sup> East Jour Fixe "Credit to the Private Sector: Threat to or Opportunity for Growth in CESEE?" .....	5
CESEE-Related Abstracts from Other OeNB Publications.....	6
Olga Radzyner Award 2011 .....	7
Visiting Research Program .....	8
Upcoming and Recent Events .....	8
OeNB Courses at the Joint Vienna Institute (JVI).....	9
Conference on European Economic Integration (CEEI) 2011: "European Integration in a Global Economic Setting – CESEE, China and Russia" .....	9

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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. 3ff).
- The recent results of the **OeNB Euro Survey** find deteriorating consent, in all countries surveyed, to the statement that the euro will be a very stable and trustworthy currency over the next five years; by contrast, the majority of households in the Czech Republic, in FYR Macedonia and in Bosnia and Herzegovina expect the respective local currency to be stable and trustworthy over the next five years (see p. 2).
- The **69<sup>th</sup> East Jour Fixe**, hosted by the OeNB on June 20, 2011, dealt with the development of credit to the private sector in CESEE from a macroeconomic perspective (see p. 5).
- The OeNB invites entries from young economists from CESEE for the **Olga Radzyner Award** for excellent research on topics of European economic integration (see p. 7).
- 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 Sovereign Debt Crisis Impacts CESEE Households' Trust in the Euro. Evidence from the OeNB Euro Survey

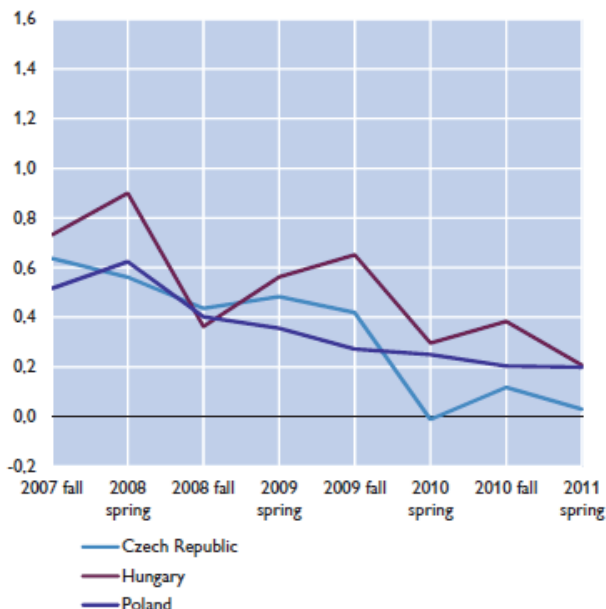
Research on euroization concludes that the portfolio decisions of CESEE households are sensitive to (i) the safety of deposits and (ii) the credibility of local currencies vis-à-vis safe haven currencies. For the CESEE region, the euro is the predominant safe currency. Hence, deteriorating trust in banks or the local currency might lead to substantial portfolio shifts. In Southeastern European (SEE) countries, in particular, savings deposits

denominated in euro and holdings of euro cash are a widespread phenomenon. With respect to the credibility of local currencies vis-à-vis the euro, the question arises whether the sovereign debt crisis may have changed the way the euro's stability and trustworthiness is assessed in the CESEE region, and if it has, whether people still have more confidence in the euro than in their local currencies.

Chart 1

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

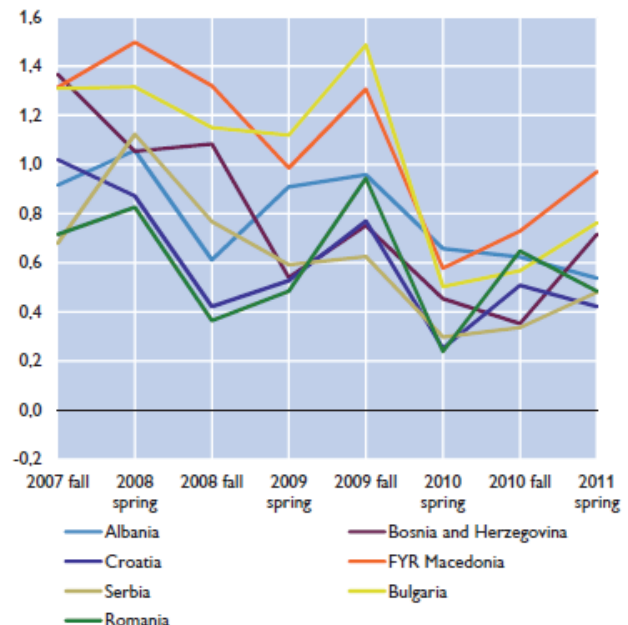
#### CEE countries



Source: OeNB Euro Survey.

Note: Respondents were asked whether they agreed or disagreed on a scale from 1 (fully agree) to 6 (fully disagree) with the statement above. Values are normalized sample means per country (-2.5 fully disagree, 0 neutral, +2.5 fully agree)

#### SEE countries



The OeNB Euro Survey finds that consent to the statement that the euro will be a very stable and trustworthy currency over the next five years deteriorated in all countries surveyed in May/June 2010 but remained in positive territory. The drop was especially pronounced in some SEE countries. Since then, trust in the euro has rebounded in the SEE countries except Albania, but current levels (May/June 2011) of trust are still below pre-crisis levels. For the Central and Eastern European (CEE) countries, no such rebound can be reported. It seems that in the Czech Republic, Hungary and

Poland – countries which have a more concrete perspective of joining Economic and Monetary Union and might therefore follow the public debate on the future of the euro area more closely – people are more sceptical.

A majority of households in the Czech Republic, in FYR Macedonia and Bosnia and Herzegovina expect the local currency to be stable and trustworthy over the next five years, whereas respondents in particular in Hungary, Bulgaria, Romania and Serbia rather distrust their local currency.

This probably reflects the difficult (current and past)

economic situation in these countries. What is the impact of the sovereign debt crisis on respondents' relative trust in the currencies relevant for them?

Chart 2 shows that trust in the future stability of the euro still exceeds trust in the respective local currency in all CESEE countries except the Czech Republic. This finding corresponds well to the appreciation of the Czech koruna vis-à-vis the euro.

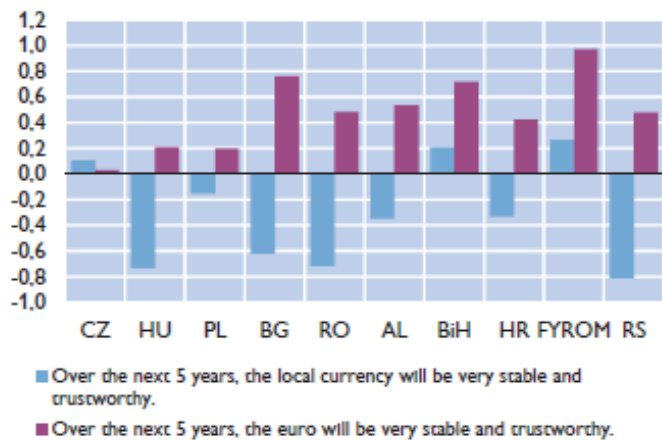
Nevertheless, the sovereign debt crisis did not lead to a significant change in the relative assessment of local CESEE currencies vis-à-vis the euro. Therefore, no major portfolio shift is to be expected – a hypothesis which has so far been supported by monetary statistics.

[The OeNB's Euro survey](#)

Chart 2

### Trust in the Future Stability of the Local Currency vs. Trust in the Euro

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



Source: OeNB Euro Survey.

Note: Respondents were asked whether they agreed or disagreed on a scale from 1 (fully agree) to 6 (fully disagree) with the statement above.

## OeNB Publications

### Focus on European Economic Integration Q3/11

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 European (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.



The Transmission of Euro Area Monetary Shocks to the Czech Republic, Poland and Hungary: Evidence from a FAVAR Model (Benkovskis, Bessonovs, Feldkircher, and Wörz)

Shifts in International Trade and Value Added from 1995 to 2007: Insights into the Drivers of Growth (Francois and Wörz)

A Markov Switch to Inflation Targeting in Emerging Market Peggery with a Focus on the Czech Republic, Poland and Hungary (Petreski)

CESEE-Related Abstracts from Other OeNB Publications

69<sup>th</sup> East Jour Fixe – Credit to the Private Sector: Threat to or Opportunity for Growth in CESEE?

Olga Radzyner Award 2011 for Scientific Work on European Economic Integration – Call for Entries

Visiting Research Program – Call for Applications

[http://www.oenb.at/integration/focus\\_on\\_european\\_economic\\_integration\\_q3](http://www.oenb.at/integration/focus_on_european_economic_integration_q3)

## The Transmission of Euro Area Monetary Shocks in the Czech Republic, Poland and Hungary: Evidence from a FAVAR Model,

Benkovskis, K., Bessonovs, A., Feldkircher, M. and Wörz, J., Focus on European Economic Integration Q3/11, pp. 8–36 ([online version](#)).

We analyze the effects of euro area monetary policy on three Central and Eastern European non-euro area EU countries: the Czech Republic, Poland and Hungary. We employ an open economy version of the factor-augmented vector autoregression model (FAVAR) to estimate the cross-border effects of a contractionary monetary policy of the ECB. We find significant and sizeable effects of euro area monetary policy in these small and highly open economies,

with economic activity variables being primarily affected through the impact of increased interest rates and reduced foreign demand – thus leading to a contraction of GDP – and exchange rate effects being important for price reactions.

JEL classification: C32, E31, E32, E40, F42

Keywords: FAVAR, monetary policy shocks, international transmission, euro area, Central and Eastern Europe

## Shifts in International Trade and Value Added from 1995 to 2007: Insights into the Drivers of Growth,

Francois, J., and Wörz, J., Focus on European Economic Integration Q3/11, pp. 37–56 ([online version](#)).

We decompose global export growth into a structural and a pure growth component in order to highlight the importance of structural change at the regional and industry level for the impressive growth performance of international trade. For this, we combine data on exports, output and sector-specific prices for a sample of roughly 150 countries and 22 manufacturing industries over the period from 1995 to 2007. While structural change played only a minor role for Western Europe, NAFTA and also Southeast Asia over this period, the CESEE region shows an outstanding amount of restructuring at the industry level. Especially the new EU Member States were rapidly restructuring toward globally important industries despite their initial harmful specialization pattern. Furthermore, this region shows by far the

highest elasticity of exports to output and demand changes at the industry level. While we do not observe an excessive reaction of exports to output expansion at the level of individual industries, exports react highly elastically to changes in global demand. However, elasticity differs greatly among individual regions and among industries. This corroborates the view that rapid growth in world trade arises from changes in the regional and sectoral composition of global production and trade, with faster-growing economies moving rapidly into more trade-intensive activities.

JEL classification: F14, F15, O52

Keywords: Trade growth, industrial export structure, trade elasticities, Central, Eastern and Southeastern Europe

## A Markov Switch to Inflation Targeting in Emerging Market Peggers with a Focus on the Czech Republic, Poland and Hungary,

Petreski, M., Focus on European Economic Integration Q3/11, pp. 57–75 ([online version](#))

The objective of this paper is to empirically examine if monetary policy conduct has significantly changed in nine emerging economies, including the Czech Republic, Poland and Hungary, after the

switch from exchange rate targeting to inflation targeting. An augmented Taylor rule is estimated with a Markov switching method for each of the nine countries on the basis of monthly data over

the period from the early 1990s to end-2009. In general, the results suggest that inflation targeting represented a real switch in eight emerging economies. We identified the following differences for the period of inflation targeting compared to the preceding period of exchange rate targeting: (1) The economic environment became more stable; (2) the central bank's reaction to inflation deviations from the target moderated (as it was probably possible to share the burden of inflationary pressures between interest rate increases and currency depreciations); (3) the central bank's response to the output gap also moderated although it was statistically significant in only half of the countries; this

is an indication of strict inflation targeting whereby meeting the inflation target is the primary objective. For the Czech Republic and Poland, an intermediate regime is identified, which is associated with the economic developments in these two countries prior to establishing a full-fledged inflation targeting regime. For Hungary, we identified only one regime, which is likely to reflect the combined strategy of targeting both the exchange rate and inflation that the country followed nearly over the entire period under review.

JEL classification: E42, E52, E58

Keywords: monetary regime switch, inflation targeting, CESEE-3, Markov switching

## 69<sup>th</sup> East Jour Fixe: “Credit to the Private Sector: Threat to or Opportunity for Growth in CESEE?”

The 69<sup>th</sup> East Jour Fixe, hosted by the OeNB on June 20, 2011, dealt with the development of credit to the private sector in Central, Eastern and South-eastern European (CESEE) countries from a macroeconomic perspective. While credit dynamics in the CESEE region have been explored in depth from a financial stability perspective, the interlinkages between credit and macroeconomic variables like GDP growth or private consumption have received comparatively little attention as yet. To fill this void, the 69<sup>th</sup> East Jour Fixe provided a platform for stocktaking and for assessing the implications of future credit growth in the CESEE region. The workshop brought together distinguished experts from academia, central banks and international institutions. *Martin Brown* from University of St. Gallen, *Märten Ross* from Eesti Pank, *Aleksandra Zdzienicka* from the CEPII, *Mariya Hake* from the OeNB, *Naotaka Sugawara* from the World Bank, *Fabrizio Coricelli* from Université Paris 1 Panthéon-Sorbonne, *Abdul de Guia Abiad* from the IMF and *Martin Bijsterbosch* from the ECB discussed the following two main topics: (1) Credit developments in CESEE: Where do we stand and what do we know?, (2) The way forward: Creditless recoveries, a revival of credit growth or subdued economic performance due to insufficient credit supply?

With a view to the first topic, speakers concluded that credit drives economic growth (rather than the

other way round), but episodes of excessive credit growth have a detrimental impact on output growth in the medium to longer run (*Zdzienicka*). Moreover, in the corporate sector, there are certain risks of a debt overhang in some countries which might weigh on prospective economic performance whereas household debt, in particular mortgage debt, appears to be less of a problem at the current juncture (*Brown*). Finally in this session, attention turned to the widespread phenomenon of foreign currency lending in CESEE. A recent meta-analysis on the CESEE region shows that macroeconomic factors (in particular, exchange and inflation rate volatility) were crucial determinants for the development of foreign currency lending in CESEE (*Hake*). Additionally, results from a household stress test performed by the World Bank indicate that, on average, the share of households vulnerable in case of a shock (defined as the largest depreciation of the local currency and the largest increase in interest rates measured in the period from January 2007 to December 2009) more than doubled from 7% to 16% during the crisis – an increase that was, however, rather marginal from the perspective of the economy as a whole. (*Sugawara*).

Looking ahead, the speakers underlined that the crisis has revealed the importance of having prudent policies and safeguards in place in both home and host countries. The broadening of the EU superviso-

ry framework is a positive development in this respect, subject to the caveat that while more players become involved in the decision-making process, some important issues still remain unresolved (e.g. burden sharing) (Ross). The “unconditional income convergence miracle” of EU integration was based on rapid trade and financial integration facilitated through dominant foreign ownership of banks and large cross-border capital flows. As long as the banking system in the core countries remains weak and endangered by the sovereign debt crisis, less capital will flow to the CESEE countries (Coricelli). The predicted probability of a creditless recovery during the coming years is relatively high in the Baltic countries, where credit growth has been subdued due to a combination of supply and demand factors (Bijsterbosch). Furthermore, as supply-driven

creditless recoveries reflect impaired financial intermediation, ensuring the functioning of the financial sector is key to avoiding credit supply bottlenecks. Finally, in the short term, subdued lending may not only dampen output growth but also hold back structural change, which needs to be financed as well. In the medium term, capital flows will return if adequate policies are pursued – and with these capital flows, the risks of a renewed lending boom and of a re-emergence of macroeconomic imbalances will return as well (Abiad).

The presentations and the workshop program are available at <http://ceec.oenb.at> (Events). A more detailed summary of the 69<sup>th</sup> East Jour Fixe Workshop has been published in Focus on Economic European Integration Q3/11.

## CESEE-Related Abstracts from Other OeNB Publications

**Oesterreichische Nationalbank. 2011.**

**Limited Fiscal Space in CESEE: Needs and Options for Post-Crisis Reform.**

**Workshop – Proceedings of OeNB Workshops 17.**

**68<sup>th</sup> East Jour Fixe of the Oesterreichische Nationalbank, Forthcoming.**

Vol. 17 of the OeNB's Workshops series brings together the papers presented at the 68th East Jour Fixe of the OeNB on February 28, 2011. This workshop focused 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 2008–09 financial and economic crisis. The workshop aimed to provide an-

swers to three main questions: (1) What were the reasons that 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 improved access to and more effective use of international funds be considered as a possibility to create more fiscal space in CESEE?

## Other Publications by OeNB Staff

**Fillat Castejón and Wörz. 2011.**

**Good or Bad? The Influence of FDI on Output Growth: An Industry-Level Analysis.**

**Journal of International Trade and Economic Development, Vol. 20, Issue 3, pp. 293–328.**

This paper attempts to reconcile the often inconclusive evidence on the role of FDI in the process of economic development by taking into account the heterogeneity both among industries and among countries. Using a comparable database at the industry level for 35 countries in the OECD, Asia and Eastern Europe from 1987 to 2002, we test for the influence of both stage of development and sectoral FDI patterns in the relationship between FDI and

productivity growth. In certain industries and for the catching-up countries, a significant and positive relationship emerges when FDI coincides with high investment or export orientation.

JEL Classifications: C33; F14; F21; L60

Keywords: FDI, labour productivity, heterogeneity, manufacturing sector, panel data analysis, openness

Eller, Markus. 2011.

**Essays on Fiscal Policy and the Support for Economic Reform in Emerging Europe.  
Doctoral thesis, WU Vienna University of Economics and Business, June 2011.**

In a sequence of five essays this doctoral thesis addresses the question how fiscal policy and economic output are interrelated in emerging Europe and how this relationship is shaped by the respective political and economic environment and the individual-level support for economic reforms. Following main findings can be highlighted: (1) Countries in Central, Eastern and Southeastern Europe (CESEE) respond to a fiscal expansion in the euro area with fiscal easing at home, while the GDP response is mixed across countries. (2) Automatic fiscal stabilizers are comparatively small and discretionary fiscal policy

has been largely pro-cyclical in CESEE. (3) The public spending and revenue structure is more "growth-friendly" in CESEE than in the EU-15. (4) In transition economies with more democratic institutions and a better quality of governance, individuals with high market-relevant skills show a significantly larger support of the privatization status quo than individuals with low market skills. (5) The society in Russia – owing to a lack of social capital – chooses to demand more state regulation and tolerate corruption to reduce negative externalities imposed by private business.

## **Olga Radzyner Award 2011 for Scientific Work on European Economic Integration Call for Entries**

The Oesterreichische Nationalbank has established an award to commemorate Olga Radzyner, former Head of the Foreign Research Division, who died in a tragic accident in August 1999. The award is bestowed on young economists for excellent research focused on topics of European economic integration and is conferred annually. In 2011, 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 or 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 2011 award should arrive at the OeNB by October 10, 2011, 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).

## Visiting Research Program Call for Applications



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), and with
- central bank researchers<sup>1</sup>

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 policy-making process. Visiting researchers are expected to collaborate with the OeNB's research staff on a pre-specified 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 data and computer resources and to re-

search assistance. Their research output will 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 the year 2012 should be e-mailed to [Eva.Gehring-Wasserbauer@oenb.at](mailto:Eva.Gehring-Wasserbauer@oenb.at) by November 1, 2011.

Applicants will be notified in the first week of December of the jury's decision. The next round of applications will close on May 1, 2012.

<sup>1</sup> Other than those eligible for the External Work Experience program established within the ESCB.

## 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](mailto:ceec@oenb.at).

Upcoming	
October 24, 2011	<b>Global Economy Lecture</b> , Richard Baldwin, Graduate Institute, Geneva, and CEPR, London: "Filling the Gap Between 21st Century Regionalism and 20th Century Trade Rules"
November 21–22, 2011	<b>Conference on European Economic Integration (CEEI) 2011: European Integration in a Global Economic Setting – CESEE, China and Russia</b> , jointly organized by the OeNB and Suomen Pankki – Finlands Bank
Recent	
June 20, 2011	69 <sup>th</sup> OeNB East Jour Fixe: "Credit to the Private Sector: Threat to or Opportunity for Growth in CESEE?"
June 28, 2011	Revival in the Visegrad countries' mutual trade after their EU accession: a search for explanation"; Neil Foster, Gábor Hunya, Olga Pindyuk and Sándor Richter (wiiw) presented the results of the OeNB's Jubiläumsfonds project no. 13367.



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

For further details see: [http://www.jvi.org/fileadmin/jvi\\_files/JVI\\_Program2011.pdf](http://www.jvi.org/fileadmin/jvi_files/JVI_Program2011.pdf)

September 26–30, 2011	Macro-Financial Stability and Road to the Euro
October 3–7, 2011	Economic and Monetary Integration in Europe: CIS-Related Aspects
November 7 – 10, 2011	Cash Circulation and Payment Systems in Austria
November 21–25, 2011	Monetary and Financial Statistics Collected and Compiled by the ESCB
December 12–14, 2011	Translation in a Central Bank Setting

## Conference on European Economic Integration (CEEI) 2011 “European Integration in a Global Economic Setting – CESEE, China and Russia”

Jointly organized by the Oesterreichische Nationalbank (OeNB) and Suomen Pankki – Finlands Bank

November 21 and 22, 2011, Vienna Marriott Hotel

By invitation only



### CONFERENCE ASPECTS

The CEEI 2011 will discuss various aspects of European economic integration from a global perspective, investigating the impact of China and Russia as emerging global economic players on the catching-up process in CESEE. Speakers and panelists from central banks, international organizations, businesses, financial institutions and academia will focus on the sustainability of current growth strategies, competitiveness and challenges for monetary policy and banking in the light of the global economic and financial crisis.

The keynote lectures will be held by Professor Andrew K. Rose (University of California, Berkeley), Deputy Managing Director Min Zhu (IMF), Deputy Minister Andrey N. Klepach (Ministry for Economic Development of the Russian Federation) and First Deputy Chairman Alexey V. Ulyukaev (The Central Bank of the Russian Federation). This year's CEEI is organized in cooperation with Suomen Pankki (Bank of Finland), and will be opened by Governor Erkki Liikanen and Governor Ewald Nowotny.

### Research Update Q3 2011: 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 at the beginning of October.

[http://www.oenb.at/en/geldp\\_volksw/vowi\\_pub/newsletter/einleitung.jsp#tcm:16-171525](http://www.oenb.at/en/geldp_volksw/vowi_pub/newsletter/einleitung.jsp#tcm:16-171525)

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