

" RESEARCH NEWSLETTER "

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I. FRIDAY SEMINARS

Research papers presented in "Friday Seminar Series" during January-June 2014 addressed various issues, such as the effect of inflation targeting in a dollarized economy, factors determining foreign currency lending in the case of Albania, house prices and their equilibrium. A detailed description of the papers follows in the next sections.

INFLATION TARGETING IN A DOLLARIZED ECONOMY, BY EDA DOKLE, WINNER OF THE GOVERNOR'S AWARD FOR THE BEST DIPLOMA THESIS 2013, MASTERS IN ECONOMICS AND FINANCE, CHARLES UNIVERSITY (PRAGUE).

The study presents an overview of general characteristics of the targeted inflation regime starting with its origin and preconditions and compares it with other alternative regimes. Based on the empirical analysis of 29 countries from Central and Eastern Europe and the Commonwealth of Independent States, characterized by a certain level

of dollarization, it was concluded that the level of average inflation decreased under the inflation targeting regime. Also, output growth was not affected by the targeted inflation and dollarization of deposits did not deteriorate the positive impact of inflation targeting on inflation.

FOREIGN CURRENCY LENDING IN ALBANIA, BY GERTI SHIJAKU, RESEARCH DEPARTMENT

The paper assesses the determinant factors of lending in foreign currency in Albania, in 2000-2012. The investigation of lending behaviour is very important given that 65% of private sector credit is denominated in foreign currency. Results show that foreign currency lending is more preferred due to the lower interest rates in foreign currency, inflation stability and the exchange rate.

GDP, CONSUMPTION COMPONENTS AND DEFLATORS: EXTRAPOLATION AND QUARTERLY INTERPOLATION, BY ILIR VIKA AND ENIAN ÇELA, RESEARCH DEPARTMENT

This paper presents the methodology applied in quarterly interpolation of nominal and real GDP in the interval 1996-2011. At the same time, it explains the steps in extrapolating the expenditure side components in the years 2009-2011 in nominal and real terms. The material explains the method of transformation of the series from real terms with previous year prices to real terms based on 2005 prices and also the quarterly distribution of deflators for overall GDP and expenditure components.

EXTERNAL INTERVENTION IN ETHNIC CONFLICTS, BY ADA HUIBREGTSE, PH.D, PROFESSOR AT NEW YORK UNIVERSITY OF TIRANA

This study explores how ethnic composition of states and the power of ethnic kinship affect external state interventions in ethnic conflicts. The research question of the study is whether ethnic composition in the state, ethnic kinship with groups in other states, and ethnic settlements of the ethnic group in conflict make some states more prone to others to intervene in ethnic conflicts. The study raises two assumptions: (i) in the states with well-defined ethnic groups, political decision-making is aligned with the ethnic divisions; (ii) ethnic conflicts, due to their nature, perform differently compared to the other types of civil wars. Results show that states with a definite

ethnic dominance have higher impact on the ethnic conflicts.

HOUSE PRICES IN ALBANIA: DEVIATIONS FROM AN EQUILIBRIUM, BY ENDRIT YZEIRAJ, RESEARCH DEPARTMENT

The paper presents a “fundamental” price index for housing, based on key macroeconomic indicators, such as, economic growth rates, interest rates, and demographic developments. This index is used as a benchmark for the actual house prices in Albania in order to measure the possible deviations from equilibrium. The research finds that house prices starting have appreciated since the post-2006 period. However, from 2012 and onwards the findings suggest a price correction process. Nonetheless, the long term relationship between actual and fundamental house prices remains weak.

II. RECENTLY CONCLUDED RESEARCH PAPERS

CONFIDENCE AND MACROECONOMIC EXPECTATIONS: THEIR EFFECTS ON THE ALBANIAN ECONOMY, BY ENDRIT YZEIRAJ, RESEARCH DEPARTMENT

Periods of worsening economic conditions are often associated with deteriorating expectations from economic agents. Various studies conducted for countries affected by the crisis indicate that changes in expectations affect other important economic indicators such as economic growth and inflation. This paper aims to measure these effects for the case of the Albanian economy. Unlike other advanced economies, where researchers can obtain various indicators from financial markets, in the case of Albania, only results from business and consumer surveys undertaken by the Bank of Albania in collaboration with INSTAT are used. The results of these surveys are aggregated into a single indicator through a statistical technique called Principal Component Analysis. The research results suggest that confidence indicators have a relatively small effect on main macroeconomic indicators and are not always statistically significant compared with the results obtained from the experience of other countries.

ON EXTERNAL CREDIT ASSESSMENT INSTITUTIONS RECOGNITION, BY LINDITA VRIONI, RESEARCH DEPARTMENT

The External Credit Assessment Institutions (ECAIs) assume a more important role under the Basel II framework, in particular for banks using the Standardized

Approach. In order for the process of ECAIs recognition to be completed as the regulation dictates, some additional important technical criteria are needed. For the practical implementation of the credit assessment under the Standardized Approach, intensive data are necessary (borrower data, guarantor data, asset-specific data, default data, data on recoveries, data on rating and migration, industry data, macro data, correlation data). This approach delivers risk sensitivity only if all corporates are rated and if their ratings properly reflect their risk profiles.

THE COMPETITIVENESS OF ALBANIAN PRODUCTS AND THE SECTORAL J – CURVE, BY ALBAN PLLAHA, RESEARCH DEPARTMENT.

The purpose of this paper is to identify the domestic economy sectors, whose trade is affected by the depreciation of the domestic currency. It also aims at determining which sectors of Albanian economy show competitive advantages. This paper employs the Vector Error Correction Methodology and indexes of comparative advantage in order to carry out data analysis. It further analyses the impact of exchange rate on Albania's foreign trade balance for the nine main categories of goods. The assessment uses quarterly data for the period 2005-2013. Findings suggest that, in the long run, a real depreciation of the domestic currency positively impacts the improvement of trade balance for the major part of sectors of trade, in the long run. Meanwhile, a real lek depreciation has a lesser impact on the trade balance of commodities.

III. RESEARCH PAPERS IN PROGRESS**FISCAL POLICY, OUTPUT AND FINANCIAL STRESS IN THE CASE OF DEVELOPING AND EMERGING EUROPEAN ECONOMIES: A THRESHOLD VAR APPROACH (2014), BY GERTI SHIJAKU, RESEARCH DEPARTMENT**

The aim of this paper is to investigate the relationship between fiscal policy, output and financial stress during episodes of economic growth slowdowns and stress in financial markets. The author analyses such relationship for 10 developing and emerging market economies of Central Eastern and Southeastern Europe, during 2000- 2013, employing the Threshold-Vector Autoregressive approach. The financial stress index is constructed by considering a wide range of market patterns, including banking related stress, money market related stress, exchange markets stress and real estate markets related stress, upon which the threshold market condition is build.

CONDITIONAL DENSITY ESTIMATES, A GENERALIZATION OF CONDITIONALITY. APPLICATION ON ECONOMIC DATA, BY ALTIN TANKU AND KLITI CECA, RESEARCH DEPARTMENT

This paper aims to provide a natural generalization of the conditionality concept on the density estimates for multi-dimensional densities. This way of modelling of random vectors enables users of such methodology to realize shocks to these densities under one and multi-dimensional condition.

RATIONAL MAP OF ECONOMIC TRANSITION IMPACT ON ENTERPRISES IN SOUTH AND EASTERN EUROPE: ANALYSIS OF RELATED WORDS, BY MARGERITA TOPALLI, RESEARCH DEPARTMENT

This paper summarises the systemic literature related to the impact of economic transition on enterprises in the Central and Eastern European countries. Based on quantitative method and "analysis of related words", from 2053 scientific articles collected for the period 1989-2013, taken from different data bases, this paper analyses how such topic has evolved and has been addressed in the last 25 years. Thanks to this methodology, the author has managed to identify 39 various research fields for the entire period, and to assess other areas and phenomena, which are not explored yet.

NATURAL RATE OF UNEMPLOYMENT – REDUCED FORM APPROACH, BY LORENA SKUFI AND ENIAN ÇELA, RESEARCH DEPARTMENT

The aim of this paper is to estimate a series of natural rate of unemployment (NAIRU) according to the reduced form approach. The reduced form is an intermediate approach that brings together structural and statistical approaches and creates a model, which features characteristics of both approaches. The model is based on Phillips Curve equation and an equation defining the behaviour of natural rate of unemployment over time. The latter is estimated using Kalman Filter technique and its output comprises the NAIRU series and the coefficients of the Phillips Curve, as

well. Finally, the natural rate is compared with the actual rate of unemployment.

THE EFFECT OF THE CRISIS ON POTENTIAL GDP: THE CASE OF ALBANIA, BY ENDRIT YZEIRAJ, RESEARCH DEPARTMENT

This project aims to measure the potential effect that the prolonged economic crisis might have on the potential GDP in Albania. The global economic crisis has led to a constant decrease of the economic growth rate in many countries, including Albania. More specifically, the paper aims to assess whether the decline in the growth rate is temporary and the economy is able to reach its previous trend of growth. The alternative hypothesis suggests that the crisis would have had a permanent effect and would reduce the trend of growth. This may be due to different scenarios, such as possible hysteresis in the labour market, and permanent loss of previously planned investments. An accurate assessment of the long-term effects of the crisis on potential GDP is also important to determine a proper response from policy-makers. The methodology that is used is that of state-space models and the Kalman filter.

PARAMETERIZATIONS IN THE MODELS BASED IN THE ESTIMATED DENSITIES – A GENERAL APPROACH, BY ALTIN TANKU AND KLITI CECA, RESEARCH DEPARTMENT

The aim of this paper is to provide various ways of parameterization in models built using the concept of estimated densities. In this framework, this paper aims to build general functional forms in order to establish relationships between the derivative of conditional expectations

curves and conditional distributions of the estimated densities. Authors are also working on constructing general matrices in linear forms.

A NEW FISCAL MODEL: THE ESTIMATION OF MAIN LINE ITEMS OF REVENUES AND EXPENDITURES, FISCAL BALANCE AND DEBT, BY LORENA SKUFI AND ENIAN ÇELA, RESEARCH DEPARTMENT

The model aims to estimate the fiscal line items related to the dynamics of economy's sectors. This material focuses on estimating the impact of cross-sectorial linkages that exist between the fiscal sector and the rest of the economy. General fiscal statistics are disaggregated up to the third level of fiscal line items. The equations are estimated using Vector Error Correction Methodology for the period 1996-2012, while the model is solved by Gauss – Siedel algorithm.

INTEREST RATE PASS-THROUGH IN ALBANIA FROM POLICY RATE TO INTERBANK, PRIMARY AND RETAIL MARKET INTEREST RATES, BY ESIDA ABAZAJ, RESEARCH DEPARTMENT

This paper aims to estimate the velocity and the magnitude of the interest rate pass-through from policy rate to other interest rates (of interbank, primary and retail market), over the period 2002M01:2014M03. The methodology employed is the Vector Error Correction Mechanism (VECM), which allows estimating the short- and long-run pass-through of the policy rate. The empirical analysis is based on a “rolling windows” approach, in order to estimate the stability of parameters over time, and to check whether the pass-through has changed during the time period considered in the study.

OVERVIEW ON THE MONETARY POLICY TRANSMISSION, BY ALTIN TANKU, ILIR VIKA, ELONA DUSHKU AND ENDRIT YZEIRAJ. RESEARCH DEPARTMENT

This paper analyses the monetary policy transmission mechanism in the case of Albania, mainly after the global financial crisis period, by assessing the transmission and response elasticities to shocks given to the policy rate. The material presents and analyses the existence of the same phenomenon in the global economy. It also analyses other countries' experiences, with the focus on policies and instruments available to the policy-makers of these countries in order to address the monetary issues. This analysis attempts to judge from the general equilibrium viewpoint, while considering other important aspects of macro-financial equilibrium. Lastly, the paper focuses on the probability of success and potential risk which might associate the proposed policies in the Albanian economy.

LOAN LOSS PROVISIONS AND PROCYCLICALITY; EVIDENCE FOR BANKS IN ALBANIA, BY ELONA DUSHKU (RESEARCH DEPARTMENT) AND ARGITA FRASHËRI (FINANCIAL STABILITY AND STATISTIC DEPARTMENT).

The global financial crisis showed the need for enriching the traditional financial supervision and establishing a coherent and compressive macro-prudential framework, according to which rules of loan loss provision are crucial in assessing the stability of financial system. This material aims to estimate the behaviour of loan loss provision for banks in Albania, during the period 2004-2013m while taking into consideration the discretionary and non-discretionary components of loan loss provision, and economic growth.

IV. ARTICLES

This section presents an overview of several articles and papers published by the Bank of Albania and other central banks and/or institutions, to give a better view on scientific research published during January – June 2014.

GDP, EXPENDITURE COMPONENTS AND DEFLATORS: QUARTERLY INTERPOLATION, 1996-2012, BY ENIAN ÇELA, RESEARCH DEPARTMENT

The material reports the methodology applied in the quarterly interpolation of GDP from the production side in the years 1996-2012 taking into account the newly published statistics by INSTAT for the years 2008-2012. All expenditure components with the exception of Private Population Consumption and Private Investment were also interpolated. The methodology also deals with eliminating the structural break featured in the new statistics and the production of a consistent series both in nominal and real terms.

ALTERNATIVE INDICES OF EXTERNAL DEMAND FOR ALBANIAN EXPORTS, BY ENIAN ÇELA, RESEARCH DEPARTMENT

The material explains the calculation of alternative indices constituting foreign demand for Albanian goods' exports, based on industrial and output figures. One index engulfs the entire export of goods. It is based on three main export categories and covering the period 1996-2013. The other two are related to "construction materials" and "service exports. Due to data unavailability, they include a shorter period

of time.

LONG-TERM DAMAGE FROM THE GREAT RECESSION IN OECD COUNTRIES, BY LAURENCE M. BALL, NATIONAL BUREAU OF ECONOMIC RESEARCH

This paper estimates the long-term effects of the global recession of 2008-2009 on output in 23 countries. I measure these effects by comparing current estimates of potential output from the OECD and IMF to the path that potential was following in 2007, according to estimates at the time. The losses in potential output range from almost nothing in Australia and Switzerland to more than 30% in Greece, Hungary, and Ireland; the average loss, weighted by economy size, is 8.4%. Most countries have experienced strong hysteresis effects: shortfalls of actual output from pre-recession trends have reduced potential output almost one-for-one. In the hardest-hit economies, the current growth rate of potential is depressed, implying that the level of lost potential is growing over time.

<http://www.nber.org/papers/w20185>

REDISTRIBUTION, INEQUALITY AND GROWTH, BY JONATHAN D. OSTRY, ANDREW BERG AND CHARALAMBOS G. TSANGARIDE, INTERNATIONAL MONETARY FUND

Economists are increasingly focusing on the links between rising inequality and the fragility of growth. Narratives include the relationship between inequality, leverage and the financial cycle, which sowed the seeds for crisis; and the role of political-economy factors (especially the influence

of the rich) in allowing financial excess to balloon ahead of the crisis. In earlier work, we documented a multi-decade cross-country relationship between inequality and the fragility of economic growth. Our work built on the tentative consensus in the literature that inequality can undermine progress in health and education, cause investment-reducing political and economic instability, and undercut the social consensus required to adjust in the face of shocks, and thus that it tends to reduce the pace and durability of growth.

Main findings of the paper are:

First, more unequal societies tend to redistribute more. It is thus important in understanding the growth-inequality relationship to distinguish between market and net inequality.

Second, lower net inequality is robustly correlated with faster and more durable growth, for a given level of redistribution.

And third, redistribution appears generally benign in terms of its impact on growth; only in extreme cases are there some evidence that it may have direct negative effects on growth.

<http://www.imf.org/external/pubs/ft/sdn/2014/sdn1402.pdf>

INTERNATIONAL BANKING AND LIQUIDITY RISK TRANSMISSION: LESSONS FROM ACROSS COUNTRIES, BY CLAUDIA M. BUCH, LINDA S. GOLDBERG

Activities of international banks have been at the core of discussions on the causes and effects of the international

financial crisis. Yet we know little about the actual magnitudes and mechanisms for transmission of liquidity shocks through international banks, including the reasons for heterogeneity in transmission across banks. This paper summarizes the common methodology and results of empirical studies conducted in eleven countries to explore liquidity risk transmission. Among the main results is, first, that explanatory power of the empirical model is higher for domestic lending than for international lending. Second, how liquidity risk affects bank lending depends on whether the banks are drawing on official-sector liquidity facilities. Third, liquidity management across global banks can be important for liquidity risk transmission into lending. Fourth, there is substantial heterogeneity in the balance sheet characteristics that affect banks' responses to liquidity risk.

http://www.newyorkfed.org/research/staff_reports/sr675.html

MONETARY POLICY AND REAL BORROWING COSTS AT THE ZERO LOWER BOUND, BY SIMON GILCHRIST, DAVID LOPEZ-SALIDO, EGON ZAKRAJSEK

This paper compares the effects of conventional monetary policy on real borrowing costs with those of the unconventional measures employed after the target federal funds rate hit the zero lower bound (ZLB). For the ZLB period, we identify two policy surprises: changes in the 2-year Treasury yield around policy announcements and changes in the 10-year Treasury yield that are orthogonal to those in the 2-year yield. The efficacy of unconventional policy in lowering real borrowing costs is comparable to that

of conventional policy, in that it implies a complete pass-through of policy-induced movements in Treasury yields to comparable maturity private yields.

<http://www.federalreserve.gov/pubs/feds/2014/201439/201439abs.html>

V. OTHER ACTIVITIES

TECHNICAL SEMINARS

In the framework of the Medium-Term Development Strategy of Research in the Bank of Albania, the Research Department organizes a series of technical seminars and/or informative seminars on various issues, events, or phenomena of high interest. The following provides a summary of the seminars organised during January – June 2014.

NEW NATIONAL ACCOUNT STATISTICS, 2008-2012, BY ENIAN ÇELA, RESEARCH DEPARTMENT

This seminar presented new national account statistics from the production and expenditure side, which were published by INSTAT in May 2014. Also, it featured a short analysis on data changes compared to the previous statistics. The seminar also highlighted the presence of a structural break in year 2008 due to the new methodology of calculation both for gross data and deflators. In the end, certain new features were reported regarding the report of Population Consumption and Investment and possible statistical overlapping with other sources.

MEASURING FINANCIAL STRESS FOR CENTRAL, EASTERN AND SOUTHEASTERN EUROPEAN COUNTRIES, BY GERTI SHIJAKU, RESEARCH DEPARTMENT

The aim of the seminar was to present some preliminary results related to the material on “Fiscal policy, output, and financial stress in the case of developing and emerging European economies: A threshold approach”, particularly regarding the construction of the financial stress index for 10 countries in Central, Eastern and Southeastern European countries during 2000-2013. The index aims to capture the stress in the financial system based in four main markets: banking market, money market, foreign exchange market and real estate market. The obtained index is used to determine the threshold level of financial stress of these countries.

SEMINAR ON: ANCHORING ECONOMIC POLICIES IN SOUTH EAST EUROPE: THE ROLE OF EUROPEAN AND INTERNATIONAL INSTITUTIONS

In the framework of the co-operation agreement between the Bank of Albania and the University of Oxford, a seminar was organized on 9 May 2014, in Oxford, on “Anchoring economic policies in South East Europe: The role of European and

International Institutions". Representatives of the International Monetary Fund, European Bank for Reconstruction and Development, other central banks in the region attended the workshop.

In his address to the workshop, Mr. Ardian Fullani, Governor of the Bank of Albania, focused on the evolution of theoretical and practical concepts of decision-making in the field of economic policies, as well as the role and importance of structural reforms indispensable particularly for developing economies.

WORKSHOP ON: "KNOWING AND USING MEAM MACROMODEL"

On 27-28 March, the Research Department organized the workshop on "Knowing and using MEAM macromodel", at the Research Centre of the Bank of Albania in Berat. The aim of this workshop was the introduction and usage of the MEAM macro model, for conducting various scenarios analysis, which is useful in Bank of Albania's decision-making.

TRAINING SEMINAR: BANK OF ALBANIA AND SWISS STATE SECRETARIAT FOR ECONOMIC AFFAIRS

In the framework of the co-operation agreement between the Bank of Albania and the Swiss State Secretariat for Economic Affairs, three trainings seminars were organised by experts from the Graduate Institute Geneva. The activity was held in the Research Centre of the Bank of Albania in Berat. Following is a brief summary on each of the training seminars:

Seminar I: Doing publishable empirical research in macroeconomics, by Prof. Fabio Canova, Tirana, 6-10 January, 2014

The aim of this seminar was to introduce and analyse the most applicable autoregressive vectors such as SVAR, BAVAR, FAVAR and panel data models. The seminar focused on the use of autoregressive vectors models, given the lack of long time series and their adoption in the analysis related to regional economies.

Seminar II: Course in econometrics-intermediate level, by Prof Erich Battistin, Berat, 14-18 April 2014

This seminar dealt with the core mathematical concepts and application of methods for the analysis of qualitative data at unit level (individual, business, family). More specifically, the seminar addressed the role of instrumental indicators, the analysis of regressions used in experiments, the two-stage least square and the panel data method.

Seminar III: Designing DSGE models, by Prof. Celine Poilly, Berat, 2 - 6 June 2014

The seminar addressed core economical and mathematical concepts in designing and structuring the stochastic models of the general equilibrium. More specifically, it dealt with DSGE models of Optimal Monetary Policy, interaction of monetary policy with fiscal policy, and the calibration of DSGE models. The seminar also comprised practical exercises using Dynare software.

LINKS:

Banca d'Italia
(<http://www.bancaditalia.it/studiricerche>)

Banco de Espana
(<http://www.bde.es/informes/be/docs/docse.htm>)

Bank of England
(<http://www.bankofengland.co.uk/publications/workingpapers/index.htm>)

Bank of Finland
(http://www.bof.fi/en/julkaisut/bofit_julkaisut/index.htm)

Bank of Greece
(<http://eng.bankofgreece.gr/en/publications/research.asp>)

Czech National Bank
(<http://www.cnb.cz/en/research/>)

Deutsche Bundesbank
(http://www.bundesbank.de/vfz/vfz_diskussionspapiere_2009.en.php)

European Central Bank
(<http://www.ecb.int/home/html/researcher.en.html>)

Oesterreichische Nationalbank
(http://www.oenb.at/en/presse_pub/research/research.jsp)

Federal Reserve
(<http://www.federalreserve.gov/econresdata/default.htm>)

BIS Central Bank Research Hub
(<http://www.bis.org/cbhub/index.htm>)

International Journal of Central Banking
(<http://www.ijcb.org/>)

National Bureau of Economic Research
(<http://www.nber.org/>)

International Monetary Fund
(<http://www.imf.org/external/pubind.htm>)

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