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## Coming up

Seminar BDF/TSE, Laura Veldkamp (New York University), 3rd September, 2013

Conference BDF/BCE/BoE, "What has OTC derivatives reform achieved so far?" 11-12 September, 2013

Seminar BDF/TSE, Marija Vukotic (Warwick University), "Sovereign debt crisis and private credit," 17 September, 2013

Seminar BDF/TSE, François Gourio (Boston University), 24 September, 2013

Conference ACP, "Risk taking in financial institutions, regulations and the real economy," 14-15 October, 2013

Conference BDF/BCE « Retail payments at a crossroads: Economics, strategies, and future policies », 21-22 October, 2013

Conference DEMS: Firm's Behavior in the Crisis: What do Micro Data tell us? 28-29 November

Seminar BDF/TSE, Olivier Coibion (UT Austin), 3 December 2013-06-12

Conference SEMSI, "Global banking," 13 December 2013

Conference SAMIC/AMSE, "Labor market," 16-17 December 2013

## Four questions to... Thorsten Beck



Professor of economics, Tilburg University and CEPR

*There is a general consensus on the need for a banking union and on its key features. Such a union would help the euro area to break the vicious circle between sovereign debt and banks. What obstacles do you see in the way of further banking integration?*

I see two barriers for the banking union. One is that we have to separate the treatment of the legacy assets from the forward-looking problem, to deal with the immediate crisis before introducing long-term reforms. The other is about the political economy. It seems that governments are not quite ready yet to cut their direct links to the banking system. The calls for German savings and cooperative banks to stay out of the banking union or the continuous search for national champions are indications that there is still too much political interest in the banking system.

Economists often think that they know the solution but they tend to forget the political economy aspect of it. It's an illustration of the Coase theorem: there is a tension between efficiency and distribution — the optimal solution cannot be reached because somebody has to pay. So we have these summits that come with great promises at war time and give a lot of relief to markets, and then a couple of months later we go back as the pressure abates ...

*In the current debate, bank supervision powers are seen as either left in the hands of national authorities or coupled with the ECB's lender of last resort function. Why weren't they rather allocated to the deposit insurance system or to the various funds that ultimately bear the costs of excessive forbearance or suboptimal loan decisions?*

There are two answers to that. The first is euro area-specific and boils down to the fact that the ECB is really the only institution that has the credibility to take on this task in the short and long run. The European Banking Authority may not be strong enough to do it right now. The other is that there is a general trend for reintegrating bank supervision into the central bank, as we have seen with the Bank of England or the Federal Reserve. And I think that's because the financial vortex cannot be separated any more from the macro prudential part. There could possibly be an issue over these "chinese walls" between monetary policy and the supervisory function, but I am not sure whether they are required at this stage. In the long term it is true that institutional safeguards are warranted, but right now such a separation is not going to be a primary concern.

*From the vantage point of your recent VoxEU ebook, would you rather favour a unified-regulator framework under the auspices of the ECB, or a multi-regulator one with the lender of last resort and closure/restructuring functions kept under the responsibility of separate institutions?*

I would rather see the resolution authority kept outside the ECB, with a possible resolution-cum-deposit insurance function. Otherwise we have another conflict of interest. Those who supervise on a daily basis may not want to recognise their mistakes so they could call for more forbearance. Whereas those in the resolution authority just want to protect and intervene early to prevent bank losses. Of course the question might be that both would be looking at the same banks. On site, there could be some costly duplication, because you can't force people to share their soft information and the resolution authority may want to intervene separately. But off site information sharing is not a problem. Examinations can be based on the same data requirements, even if they are processed differently.

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## Past events

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### Conferences and symposiums

Seminar “Green growth: from theory to implementation” • Paris, March 21, 2013

Conference “Globalization and labor market outcomes: recent advances” • Paris, 16/17 May 2013

4<sup>th</sup> Banque de France – Deutsche Bundesbank Macroeconomics and Finance Conference • Paris, May 23-24, 2013

Conference “Global Spillovers and Economic Cycles” • Paris, 30-31 May 2013

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*At which stage of the banking union do you think it will become possible for the European Stability Mechanism to relieve weaker states of the burden of rescuing banks?*

The ESM has the resources to take over the legacy assets directly, and it should do it right now because in a banking union we need to break the links between banks and governments anyway. I understand the logic behind the banking union being a prerequisite for resolving banks, but the risk is that by kicking the can down the road, the problem is going to get worse: growth is not picking up, bank supervision won't be enough. So, the legacy problems have to be addressed now in order to gain time to undertake the necessary institution building for the banking union.

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## Current events

## Towards the Banking Union

The year 2012 was marked by the launch of the Banking Union, an ambitious and decisive initiative aimed at breaking the vicious circle between bank and sovereign risks and addressing the threat of a fragmentation of euro area banking markets. From the outset, the Banque de France and the *Autorité de contrôle prudentiel* (ACP – the Prudential Supervisory Authority) played a particularly active role in supporting and developing this new institutional framework.

Following on from the conclusions of the Van Rompuy Report, the European Summit meeting of 28-29 June 2012 recommended the creation of a single integrated financial framework for the euro area, a Banking Union, based on three complementary pillars:

- A single supervisory mechanism (SSM) for all banks in the euro area and in non-euro area EU Member States wishing to join. The effective establishment of this first pillar is a prerequisite for the European Stability Mechanism to be able to lend directly to troubled banks without involving Member States;
- A bank resolution mechanism (crisis management) and a single resolution fund;
- A single deposit guarantee scheme.

The main calendar and rules for the creation of the SSM were agreed at the ECOFIN meeting of 12 December 2012, and welcomed by the European Council meeting of 13-14 December 2012:

- The SSM, comprising the ECB and national bank supervisors, will have legal authority over all banks in the euro area and those in non-euro area Member States which have joined the mechanism. The extent of the ECB's operational involvement will depend on the size of the credit institution concerned. Three criteria will be used in this respect, namely i) the value of the institution's assets (above 30 billion euro), ii) the size of the institution's assets as a proportion of national GDP (20%, with a minimum of 5 billion euro), and iii) a presence in at least three countries. Banks meeting at least one of these three criteria will come under the direct operational supervision of the ECB. All others will be supervised at national level. However, in the latter case, a number of safeguards will be put in place: aside from the fact that the ECB will be able to ask to directly supervise any institution it chooses, the respective roles to be carried out by the “central” authority and national authorities will also be stipulated in an ECB regulation. National authorities will thus be required to follow specific procedures in carrying out their supervisory activities and will have to report their findings to the ECB on a regular basis:

- To avoid non-euro area Member States systematically finding themselves in a minority, notably in any mediation proceedings, a double majority of countries both in and outside the euro area will be required for European Banking Authority decisions;

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<sup>1</sup> “Towards a Genuine Economic and Monetary Union”, presented to the European Heads of State and Government on 26 June 2012.

<sup>2</sup> Even if most of the day-to-day supervision will continue to be carried out by the ACP, in accordance with the decentralisation principle already used for the Eurosystem's monetary policy.

## Publications in the 2<sup>nd</sup> half of 2012

“Sticky wages: Evidence from quarterly microeconomic data”, H. Le Bihan, J. Montornès, T. Heckel, *American Economic Journal: Macroeconomics*, July

“The Money Demand Function for the Euro Area: Some Empirical Evidence”, S. Avouyi-Dovi, F. Drumetz, J-G Sahuc, *Bulletin of Economic Research*, July

“Testing Catching-Up between the Developing Countries: ‘Growth Resistance’ and Sometimes ‘Growth Tragedy’”, G. Dufrenot, V. Mignon, T. Naccache, *Bulletin of Economic Research*, October

“Monthly GDP forecasting using bridge models: Application for the French Economy”, K. Barhoumi, O. Darné, L. Ferrara, B. Pluyaud, *Bulletin of Economic Research*, December

“Bilateral Exposures and Systemic Solvency Risk”, C. Gourieroux, J-C. Héam, A. Monfort, *Canadian Journal of Economics*, November

“Estimation of consistent multi-country FEERs”, K. Herve, B. Carton, *Economic Modelling*, July

“Macro-financial linkages and business cycles: A factor-probit approach”, L. Ferrara, C. Bellégo, *Economic Modelling*, September

“The changing role of house price dynamics over the business cycle”, G. Dufrenot, S. Malik, *Economic Modelling*, September

“Nowcasting the French Index of Industrial Production: A Comparison from Bridge and Factor Models”, V. Brunhes-Lesage, O. Darne, *Economic Modelling*, November

“Convergence of firm-level productivity, globalisation and information technology: Evidence from France”, R. Lecat, P-A. Chevalier, N. Oulton, *Economics Letters*, August

“Financial Reforms and Income Inequality”, L. Agnello, S. Mallick, R. Sousa, *Economics Letters*, September

“On the Severity of Economic Downturns: Lessons from Cross-Country Evidence”, L. Agnello, C. Nerlich, *Economics Letters*, October

“Perceived inflation”, D. Irac, J. Accardo, C. Célerier, N. Herpin, *Économie et Statistique*, July

“Effects of minimum-wage rises on average wages”, G. Verdugo, G. Cette, V. Chouard, *Économie et Statistique*, October

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- There will be specific rules for the participation of non-euro area Member States represented on the SSM Supervisory Board but not on the ECB Governing Council;
- The operational implementation of the SSM will begin one year after the legislation has come into force.

Following the trialogue discussions, which concluded on 19 March 2013, some aspects of the two proposed regulations were adjusted, without affecting their overall balance. Germany will not be able to adopt the proposals in the Council until it has consulted its parliament. The European Parliament, meanwhile, should adopt the proposals in the coming weeks or possibly months (a postponement of the adoption until the autumn cannot be ruled out).

While the SSM is a major step forward, it is also important to make headway on the other two pillars of Banking Union, a common bank resolution mechanism including the creation of a single recapitalization fund for troubled banks, and a single deposit guarantee system. The European Council meeting of 14-15 March 2013 requested that an agreement be reached before June 2013 on i) the bank recovery and resolution Directive which will provide EU Member States with a common set of tools for preventing and resolving bank defaults, and on ii) the deposit guarantee scheme Directive, ensuring greater harmonisation and a fair balance between home and host countries. Once these directives have been finalised, the European Commission plans to put forward a draft regulation to create a single resolution system specifically for countries taking part in the SSM.

At the Banque de France and the Autorité de contrôle prudentiel, the Banking Union project has prompted reflection on a number of issues, drawing both on existing studies and providing the basis for new research. Some of the particular areas of focus, for example, are the early detection and analysis of systemic risks, the calibration and implementation of macro-prudential instruments and the interaction and coordination between the authorities in charge of macro-prudential policies at both European and national level. In this context, it should be noted that the draft French banking law gives the Bank an explicit mandate to maintain financial stability, in conjunction with the future *Conseil de Stabilité Financière* (Council for Financial Stability). The issue of resolution is also a major concern, and the banking law gives the ACP new rights in this field and changes its name to the *Autorité de contrôle prudentiel et de résolution* (ACPR – Prudential Supervision and Resolution Authority). The harmonisation of macro and micro-prudential supervision methods should also prompt new, more in-depth research and analysis, notably in the field of risk management. Moreover, the preparation required for meetings of the SSM Board should also lead to more systematic comparative analyses with banking systems in other SSM-member countries.

### Taryk Bennani, Henri Fraise

Taryk Bennani is head of the Macro-Finance Division at the Financial Stability Directorate of the DG Operations. He was previously the Banque de France’s representative in New York. He has been trained as an engineer before being a graduate of the ESSEC then of Stanford University.



Henri Fraise is head of the Actuarial Research and Simulation Division at the Research Directorate of the Autorité de contrôle prudentiel (Prudential Supervisory Authority). He was previously deputy head of the Microeconomic Studies Division at the Microeconomic and Structural Analysis Directorate of the DG Economics and International Relations. He is a graduate of the ENSAE and holds a PhD in economics (Cornell University).



1 “Towards a Genuine Economic and Monetary Union”, presented to the European Heads of State and Government on 26 June 2012.  
2 Even if most of the day-to-day supervision will continue to be carried out by the ACP, in accordance with the decentralisation principle already used for the Eurosystem’s monetary policy.

“Global Excess Liquidity and Asset Prices in Emerging Countries: A PVAR Approach”, S. Brana, M-L. Djigbenou, S. Prat, *Emerging Markets Review*, September

“Produce or speculate? Asset bubbles, occupational choice & efficiency”, E. Challe, P. Cahuc, *International Economic Review*, November

“Voluntary Cooperation in Terms of International Financial Supervision”, P. Diev, *International Review of Finance*, September

“Job Durations With Worker-and Firm-Specific Effects: MCMC Estimation With Longitudinal Employer”, G. Horny, R. Mendes, G. Van Den Berg, *Journal of Business and Economic Statistics*, July

“Macroeconomic Fluctuations and Corporate Financial Fragility”, C. Bruneau, O. de Bandt, Widad El Amri, *Journal of Financial Stability*, December

“Two-way interplays between capital buffers and credit growth: Evidence from French banks”, V. Coudert, J. Coffinet, A. Pop, C. Pouvelle, *Journal of International Financial Markets, Institutions and Money*, December

“Convergence of Euro Area Inflation Rates”, C. Lopez, D. Papell, *Journal of International Money & Finance*, October

“How Does Fiscal Policy React to Wealth Composition and Asset Prices?”, L. Agnello, V. Castro, R. Sousa, *Journal of Macroeconomics*, September

“Identifying news Shocks from SVARs”, P. Fève, A. Jidoud, *Journal of Macroeconomics*, December

“Price Stickiness and Sectoral Inflation Persistence: Additional evidence”, J. Matheron, H. Le Bihan, *Journal of Money, Credit and Banking*, October

“Price setting in the euro area: some stylised facts from individual producer price data”, P. Vermeulen, D. Dias, M. Dossche, E. Gautier, I. Hernando, R. Sabbatini, H. Stahl, *Journal of Money, Credit and Banking*, December

“Nowcasting German GDP: A comparison of bridge and factor models”, P. Antipa, K. Barhoumi, V. Brunhes-Lesage, O. Darné, *Journal of Policy Modeling*, November

“Credit constraints and the cyclical of R&D investment: Evidence from France”, P. Aghion, N. Berman, L. Eymard, P. Askenazy, G. Cette, *Journal of the European Economic Association*, October

“Wage and Productivity Differentials in Japan: The Role of Labor Market Mechanisms”, Y. Kalantzis, R. Kambayashi, S. Lechevalier, *Labour*, December

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## 4th Banque de France–Deutsche Bundesbank Conference on Macroeconomics and Finance

23-24 May 2013

The 4th Banque de France–Deutsche Bundesbank Conference focused on the causes and consequences of the crisis and of monetary policy in these exceptional times. In the first session on nonconventional monetary policy, Annette Vissing-Jorgensen and Arvind Krishnamurthy (Northwestern University) examined the relationship between the supply of private-sector short term debt and the supply of government bonds. Simon Gilchrist (Boston University) and Egon Zakrajsek (Federal Reserve Board) measured the effect of the announcement of the Federal Reserve’s large-scale asset purchase programmes on private sector risk premiums. Lastly, Francesco Bianchi and Leonard Melosi (Duke University) developed a theoretical framework to account for the deferred impact of fiscal policy on inflation.

The second session was devoted to finance. Patrick Bolton, Tano Santos (Columbia University) and Jose Scheinkman (Princeton University) proposed a model for explaining some of the features that characterised the years leading up to the crisis, such as the rise in leverage among financial intermediaries. Thomas Philippon (French Ministry of Finance) questioned the efficiency of financial intermediation in the United States over the past 130 years.

Maurice Obstfeld (UC Berkeley) gave a keynote address, looking back over the weaknesses of the euro area (such as the unforeseen risk of contagion between the banking/financial system and sovereigns). His recommendations on the development of banking supervision, a bank resolution mechanism and a deposit guarantee scheme are largely consistent with the path of current European policies, as emphasised by Christian Noyer in his speech.

The third session related to fiscal policy in a monetary union. Giancarlo Corsetti and Luca Dedola (ECB) showed that monetary sovereignty and the issuance of sovereign debt in national currency are not a sufficient condition to eliminate self-fulfilling debt crises. Emmanuel Farhi (Harvard) and Ivan Werning (MIT) studied the benefits of a system of fiscal transfers in a currency union. Olivier Jeanne and Hou Wang (Johns Hopkins University) looked at the interaction between monetary policy and the dynamics of government debt in a model where the government may default.

In his policy lecture, “Who calls the shots? The problem of fiscal dominance”, Jens Weidmann (President of the Deutsche Bundesbank) looked at the relationship between fiscal and monetary policy, showing how an excessively large deficit can lead to “fiscal dominance”. He argued that although fiscal consolidation can have a negative impact on short-term growth, there is no question that its effects on long-term growth are beneficial.

The final session was on the assessment of levels of debt and risk. Andrew Atkeson, Andrea Eisfeldt and Pierre-Olivier Weill (UCLA) presented a new indicator for measuring financial soundness. Atif Mian (Princeton University), Kamelesh Rao (MasterCard Advisors) and Amir Sufi (Chicago Booth) analysed the impact of the bursting of the housing bubble on the geographical distribution of private consumption in the United States. Lastly, Juliane Begenau, Martin Schneider and Monika Piazzesi (Stanford University) showed that the major US banks used interest-rate derivatives not to hedge their interest rate risk but rather to increase their exposure.

“Market access in global and regional trade”, S. Zignago, T. Mayer, J. De Sousa, *Regional Science and Urban Economics*, November

“Global Sourcing under Imperfect Capital Markets”, J. Carluccio, T. Fally, *Review of Economics and Statistics*, August

« *La production bancaire dans les comptes nationaux : aspects méthodologiques et évaluation pour la France (1980-2011)* », M. Beaujour, *Revue d'Économie Financière*, July

« *Investissement à long terme : enjeux pour la croissance, la stabilité monétaire et financière* », P. Jaillet, *Revue d'Économie Financière*, December

« *L'épargnant au bord de la crise* », L. Arrondel, V. Borgy, F. Savignac, *Revue d'Économie Financière*, December

“Is gold a safe haven or a hedge during recessions and bear markets?”, V. Coudert, H. Raymond, *Revue Économique*, September

“Évolution des inégalités salariales en France : Le rôle des effets de composition”, G. Verdugo, H. Fraisse, G. Horny, *Revue Économique*, November

## Nominal wage rigidity: the role of labour market institutions

*Wages do not react instantly to economic shocks. Sanvi Avouyi-Dovi, Denis Fougère and Erwan Gautier propose to look at how, in France, the existence of several levels of wage negotiation and a national minimum wage affect the way wages are adjusted.*

New-Keynesian macroeconomic models, regularly used in monetary policy analysis, assume that economic agents adopt optimising behaviours at the microeconomic level. A crucial hypothesis in these models is that wages can remain fixed – for a certain period – in spite of economic shocks. Unlike the United States, France's wage adjustments are framed by a multi-level bargaining system (industry- and firm-levels) and by the existence of a relatively high national minimum wage. However, few empirical studies, particularly in Europe, have focused on the links between microeconomic wage rigidity and collective bargaining systems.

Based on individual data on wage agreements concluded at industry- and firm-level, Sanvi Avouyi-Dovi, Denis Fougère and Erwan Gautier study the impact of these agreements on wage rigidity.

The average duration of negotiated wages is roughly 10 months and about 20% of wage durations are exactly equal to one year. A significant proportion of French wage agreements contain several implementation dates, which suggests a certain degree of wage predetermination. Wage agreements are quite staggered over the year whereas the implementation dates of these agreements are concentrated on certain months of the year, especially in January and July. Negotiated wage increases depend on the macroeconomic context and particularly on past inflation and on the unemployment rate. Lastly, the existence of a national minimum wage coupled with the interactions between firm- and industry-level agreements play a significant role in the way wages are adjusted in France.

**S. Avouyi-Dovi, D. Fougère and E. Gautier, “Wage Rigidity, Collective Bargaining and the Minimum Wage: Evidence from French Agreement Data”, *Review of Economics and Statistics* (forthcoming)**

Erwan Gautier is a consultant at the Microeconomic Analysis Department of the Banque de France and Professor at the University of Western Brittany. He is a graduate of the ENSAE and holds a PhD in Economics from the EHESS-Ecole d'Économie de Paris. His work focuses on price and wage rigidity and on the use of individual data for monetary policy. His articles have been published in journals such as *Empirical Economics*, the *Journal of Economic Dynamics and Control*, the *Journal of Money, Credit and Banking* and the *Review of Economics and Statistics*.

## Forward-looking behaviour and interest rate pass through in the euro area

*Theoretical and empirical models of interest rate pass through have traditionally ignored information concerning expectations of the future behaviour of the economy. Anindya Banerjee proposes a more realistic and relevant framework to study interest-rate setting behaviour by financial institutions in the euro area.*

In studying interest-rate setting behaviour by financial institutions, a large number of both theoretical and empirical studies of the equilibrium relationship and pass through between market rates and retail interest rates have assumed a contemporaneous relationship between these interest rates. In this paper, Anindya Banerjee, Paul Mizen and Victor Bystrov argue instead that this assumption has led to forecasts of rates that might be undertaken by banks when setting interest rates, being largely ignored. Therefore, since the inclusion of future rates would be expected to alter the equilibrium relationship and the dynamics of the models used to evaluate the degree of interest rate pass through, models that rely only on contemporary market rates to explain retail rates downplay the importance of expected market rates that could help a bank to deal with uncertainty surrounding the future market rate.

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## Banque de France Working Papers – 2<sup>e</sup> semestre 2012

415 “The impact of a ‘soda tax’ on prices. Evidence from French micro data”, Nicoletta Berardi, Patrick Sevestre, Marine Tepaut and Alexandre Vigneron

414 “Bilateral Exposures and Systemic Solvency Risk”, Christian Gourieroux, Jean-Cyprien Heam and Alain Monfort

413 “Optimal Monetary and Prudential Policies”, Fabrice Collard, Harris Dellas, Behzad Diba and Olivier Loisel

412 “Monetary Policy and Herd Behavior: Leaning Against Bubbles”, Olivier Loisel, Aude Pommeret and Franck Portier

411 “Bank Ownership and Credit Cycle: the lower sensitivity of public bank lending to the business cycle”, Thibaut Duprey

410 “Foreign Entry and Spillovers with Technological Incompatibilities in the Supply Chain”, Juan Carluccio and Thibault Fally

409 “Short-term forecasts of French GDP: a dynamic factor model with targeted predictors”, Marie Bessec

408 “Export dynamics and sales at home”, Nicolas Berman, Antoine Berthou and Jérôme Héricourt

407 “Tails of Inflation Forecasts and Tales of Monetary Policy”, Philippe Andrade, Eric Ghysels and Julien Idier

406 “Capital Controls with International Reserve Accumulation: Can this Be Optimal?”, Philippe Bacchetta, Kenza Benhima, and Yannick Kalantzis

405 “Did the crisis induce credit rationing for French SMEs?”, Elizabeth Kremp and Patrick Sevestre

404 “Households Debt Restructuring: Evidence from the French Experience”, Henri Fraisse and Philippe Frouté

403 “Generalizing the Taylor Principle: New Comment”, Jean Barthélemy and Magali Marx

402 “Good Luck or Good Policy? An Expectational Theory of Macro-Volatility Switches”, Gaetano Galballo

401 “Nowcasting German GDP: A comparison of bridge and factor models”, Pamfili Antipa, Karim Barhoumi, Véronique Brunhes-Lesage and Olivier Darné

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A simple theoretical framework is offered to examine forward-looking behaviour by institutions, and forecasts based upon both Nelson-Siegel and principal components methods are introduced into the empirical dynamic models of interest rate setting for the four major euro-area economies. A significant role for forecasts of future money market rates is found in the results, consistent with the practice of using money market funding to re-finance lending of much longer maturities. The results using aggregated data are corroborated using a unique anonymised dataset for individual banks in France.

On-going research by the authors is looking at whether information obtained from a wide range of non-financial data, summarized for example by factors, could be used to consider the impact of monetary and macroeconomic variables as well as yield curve information on expected future short term changes to money market rates. The role of bank-specific characteristics, such as bank size, liquidity, profitability, capitalization and efficiency in interest-rate setting behaviour is also being explored.

**A. Banerjee, P. Mizen and V. Bystrov, “How do anticipated changes to short-term market rates influence banks’ retail interest rates? Evidence from the four major euro area economies”, *Journal of Money, Credit and Banking*, forthcoming.**

Anindya Banerjee is a scientific expert at the Macro-Analysis and Forecasting Division of the Business Conditions and Macroeconomic Forecasting Directorate. He is Professor of Econometrics at the University of Birmingham in the United Kingdom. In addition to models of interest rate pass through, his current research focuses on large dataset methods including structural factor error correction models and methods of dealing with cross-section dependence and structural breaks in panels of integrated data. He has published in journals such as the *Review of Economics and Statistics*, the *Journal of Applied Econometrics* and the *International Journal of Forecasting* and has been Editor of the *Oxford Bulletin of Economics and Statistics* since 1989.

## Near-Cointegrated VAR(p) Term Structure Models

*The extraction of reliable measures of the expectation and term premium components of long-term bond yields is highly dependent on the persistence of short-term interest rates. Caroline Jardet, Alain Monfort and Fulvio Pegoraro show how best to address this problem using an averaging estimator approach.*

Recent macro-financial literature has focused on the extraction of reliable measures of the expectation component (i.e. the expected path of the short-term rate) and the term premium component (i.e. compensation for bearing interest rate risk) in long-term bond yields, given their significant implications for monetary policy. Unfortunately, we observe relatively little consensus on the empirical properties of these two elements.

In a study co-written with Caroline Jardet and Alain Monfort, we propose an averaging estimator approach to this problem. More precisely, in a VAR setting, we extract a reliable measure of the term premium by means of averaging estimator techniques aimed at optimally solving prediction problems given that highly persistent interest rates processes are present. We call this model the Near-Cointegrated VAR(p) approach.

We find that the NCVAR-based expectation part drives the variability of long-term yields and decreases (increases) when we enter (exit) a recessionary period. This is coherent with empirically observed sustained monetary policy actions transmitted through the expected short-rate channel. The associated term premium measure is rather stable and counter-cyclical, as suggested by interest rates survey-based estimations of yield curve models and by its risk compensation role.

When the persistence of interest rates is not properly accounted for at the estimation stage, we obtain an opposite and contradictory result: the term premium appears to drive the variability of interest rates, whereas the expectation term is almost flat. This strongly suggests that the future sequence of short-term interest rates is not a reliable transmission channel for monetary policy and that risk compensation systematically declined between the 1990s and the beginning of 2007.

**C. Jardet, A. Monfort and F. Pegoraro, “No-arbitrage near-cointegrated VAR(p) term structure models, term premia and GDP growth”, *Journal of Banking and Finance*, 37 (2013), 389-402.**

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400 “Inventory Investment Dynamics and Recoveries: A Comparison of Manufacturing and Retail Trade Sectors”, Frédérique Bec and Marie Bessec

399 “Wage and Productivity differentials in Japan. The Role of Labor Market Mechanisms”, Yannick Kalantzis, Ryo Kambayashi and Sébastien Lechevalier

398 “Too-connected versus too-big-to-fail: banks’ network centrality and overnight interest rates”, Silvia Gabrieli

397 “Asset Pricing with Second-Order Esscher Transforms”, Alain Monfort and Fulvio Pegoraro

396 “Credit Ratings and Debt Crises”, Matthieu Bussière and Annukka Ristinieni

395 “A model of the euro-area yield curve with discrete policy rates”, Jean-Paul Renne

394 “Bank leverage shocks and the macroeconomy: a new look in a data-rich environment”, Jean-Stéphane Mésonnier and Dalibor Stevanovic

393 “European Export Performance”, Angela Cheptea, Lionel Fontagné and Soledad Zignago

392 “Funding for green growth”, Daniel Fuentes Castro

391 “Equilibrium Risk Shifting and Interest Rate in an Opaque Financial System”, Edouard Challe, Benoit Mojon and Xavier Ragot

390 “Macro-Prudential Policy and the Conduct of Monetary Policy”, Denis Beau, Laurent Clerc and Benoit Mojon

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386 “Why have governments succeeded in reducing French public debt historically and can these successes inspired us for the future? An historical perspective since 1890”, Gilles Dufrénot and Karim Triki

385 “Public debt ratio and its determinants in France since 1890 Does econometrics support the historical evidence?”, Gilles Dufrénot and Karim Triki

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## Bilateral Exposures and Systemic Solvency Risk

*Based on detailed examination of the exposures between financial institutions, interbank network analysis is an alternative to the systemic risk measures based on market data. This explicit measure of contagion effects represents a new tool for the supervisory assessment of systemic risk.*

In a publication co-authored with Christian Gouriéroux, Jean-Cyprien Héam and Alain Monfort propose a structural model of interconnections between banks. For any exogenous shock and any given degree of interconnection, the propagation of the shock through the network can be computed. The model can therefore easily be used as an operational tool. Moreover, from a theoretical viewpoint, the model clearly reveals the complex effects of different levels of interconnectedness on network shock propagation. For instance, a high level of interconnection can diminish average losses, but increase their variances. Lastly, in order to measure the consequences of interconnectedness, the authors propose a method to decompose the effects of a shock into two components. The first component reflects the direct effects of a shock whereas the second component stands for indirect effects, i.e. the part of interconnectedness in the shock diffusion. Using a concrete example, the authors use the decomposition to quantify the effects of interconnections on the probability of default of each bank in the network.

**C. Gouriéroux, J.-C. Héam and A. Monfort, “Bilateral exposures and systemic solvency risk,” *Canadian Journal of Economics*, 2012, 45(4).**

Jean-Cyprien Héam is an economist at the Research Directorate of the Autorité de Contrôle Prudentiel (France’s Prudential Supervisory Authority) and a PhD student at CREST (Centre de Recherche en Économie et Statistique). His research topics are focused on the analysis of systemic risk using network modeling. He is a graduate of the ENSAE and the Ecole Centrale Lyon.

## A Pitfall with Estimated DSGE-Based Government Spending Multipliers

*An accurate estimate of fiscal multipliers is crucial when devising consolidation plans. Julien Matheron and Jean-Guillaume Sahuc show that omitting the endogenous component of government policy would lead an econometrician to underestimate them.*

Standard practice in the estimation of DSGE models is to assume that government consumption expenditures are described by an exogenous process and are separable in the utility function. This standard practice has been adopted in the most recent analyses of fiscal policy.

In this paper, Patrick Fève, Julien Matheron, and Jean-Guillaume Sahuc argue that both short-run and long-run government spending multipliers obtained in this literature may be downward biased. This is so because the standard approach does not typically allow for the possibility that private consumption and government spending are Edgeworth complements in the utility function (i.e. the marginal utility of private consumption increases with government spending) and that government spending has an endogenous countercyclical component (automatic stabiliser).

A countercyclical component in the government spending rule and Edgeworth complementarity work in opposite directions in terms of generating correlation between output and government expenditures. Edgeworth complementarity tends to increase the correlation between output and government spending since, under such a configuration, an increase in government expenditures would induce people to consume more; at the same time, a countercyclical

component in the policy rule reduces this correlation, by construction. This yields a trade-off: given an observed pattern of correlation between output and government spending that an analyst seeks to match, a highly countercyclical endogenous component of policy must be offset by a high degree of Edgeworth complementarity. Since the multiplier increases with the degree of Edgeworth complementarity, this will mechanically translate into a large multiplier. Conversely, omitting the endogenous component of policy will imply a small degree of complementarity, thus yielding a smaller multiplier.

**Fève, P., Matheron, J. and Sahuc J.-G. (2012), "A Pitfall with Estimated DSGE-Based Government Spending Multipliers", *American Economic Journal: Macroeconomics* (forthcoming).**

*Julien Matheron is head of the Monetary Policy Research Division. His research on quantitative macroeconomics has been published in journals such as the American Economic Journal: Macroeconomics, The Economic Journal, the Journal of Money, Credit and Banking, the Review of Economic Dynamics, and the International Journal of Central Banking.*

*Jean-Guillaume Sahuc is deputy head of the Monetary Policy Research Division. His research on quantitative macroeconomics and macroeconometrics has been published in journals such as the American Economic Journal: Macroeconomics, The Economic Journal, the Journal of Money, Credit and Banking, the Journal of Macroeconomics, and the International Journal of Central Banking.*

## Market access in global and regional trade

*Using a theory-based measure on a large set of countries, industries, and years, Soledad Zignago shows that market access difficulties have fallen noticeably since 1980, particularly for developing countries' exporters in accessing developed markets.*

How impeded are goods by national borders? Do trade costs still matter in the modern era, which seems characterised by a fall in all types of transaction costs? Complaints regarding restrictions in the access to foreign markets quite naturally become louder in times of economic crisis, when countries claim to be very open and accuse their trading partners of restricting their imports in an unfair manner. In the current context of seemingly stalled WTO negotiations, and rising protectionist pressures, a rigorous measure of the difficulties to access markets encountered by exporters can contribute to the policy debate.

This paper develops a method to measure difficulties in market access over a large set of industries and countries (both developing and developed), during the period 1980–2006. We use a micro-founded heterogeneous-consumers model to estimate the impact of national borders on global and regional trade flows. Difficulties in market access are measured as a (negative) deviation from a theoretical benchmark, which is given by the border effects method comparing imports from foreign countries to « imports » from domestic producers, (facing the best possible market access).

Results show that difficulties faced by developing countries' exporters in accessing developed markets are 50% higher than those faced by Northern exporters. These difficulties have however fallen noticeably since 1980 in all industries. It is 23 times easier to enter Northern and Southern markets for a Southern country exporter in 2006 than in 1980. Expressed in tariff-equivalent, the level of protection implied when crossing a border fell from 180% to 89% for this same sample. While tariffs still have an influence on trade patterns, they do not seem to explain a substantial part of the border effect. Lastly, our measure offers a renewal of the assessment of the impact of regional trading arrangements. The EU, NAFTA, ASEAN and MERCOSUR agreements all tend to reduce the estimated degree of market fragmentation within those zones, with the expected ranking between their respective trade impact.

**José de Sousa, Thierry Mayer, Soledad Zignago, "Market access in global and regional trade," *Regional Science and Urban Economics*, 42(6), 2012**

Soledad Zignago is deputy head at the Competitiveness and International Trade Analysis Division of the Microeconomic and Structural Analysis Directorate. Beside market access, her works focus on competitiveness, specialisation and prices in the international trade. Her articles have been published in journals such as *Economic Policy*, *Canadian Journal of Economics*, *Papers in Regional Science* and *Asia Pacific Business Review*.



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## The coordination of DSGE modelling in the DGEI

DSGE models are used for analysis in several DGEI departments. They are used to clarify projections, analyse different monetary and fiscal policy scenarios, describe the international environment and capture global imbalances. They also provide material for debates on structural reform, and are the focus of more targeted individual or group research destined for publication.

Given the rapid increase in this strand of literature and the difficulty of the quantitative techniques used, it soon became apparent that some form of coordination was needed for DSGE work within the DGEI. This coordination had, for a number of years, taken the form of regular meetings by a DSGE working group, which got together to present and discuss ongoing work and share experiences.

Since September 2012, we have modified our method of operation. Work in progress is presented at a broader seminar, the brown bag seminar, which meets monthly to look at all ongoing projects, regardless of methodology, and is chaired by A. Banerjee, F. Ferroni, C. Lopez, M. Juillard and J. Suda.

For more regular DSGE modelling work in the departments, more restricted coordination meetings are held on a regular basis, in conjunction with the economists actually involved in the project. These meetings help to share information on the work being carried out by each department. They are also useful for identifying the skills needed for solving particular problems, and for developing joint projects with other departments.



Michel Juillard is coordinator of the DSGE network at the Banque de France

### Research Newsletter

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