



Activity Report

Professorship of Monetary Economics

September 1, 2009 – August 31, 2010

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1 Preface



The professorship of monetary economics was established in September 2007. During the first 16 months of its existence it was a reduced professorship since Professor Dr. Ralf Fendel additionally held a position at another private business school. On January 1, 2009 the professorship is transformed into a full appointment and with Professor Fendel only holding the WHU professorship. Parallel to its integration into the WHU teaching program in economics, the main focus of the professorship is on research activities. The areas of research are monetary theory and policy as well as international monetary economics and applied macroeconomics.

2 Teaching



2.1 Courses, Fall Term 2009

Bachelor of Science

Grundlagen der Marktwirtschaft (Principles of the Market Economy)
Professor Ralf Fendel and Professor Michael Frenkel

The course introduced participants to principles of economics and demonstrated the basic functioning of a market economy. The material covered both microeconomic and macroeconomic topics.

2 SWS – 3.0 ECTS

Macroeconomics II
Professor Ralf Fendel

The course built on the course “Macroeconomics I” and provided participants with a broader view on economic issues. Through the in-depth analysis and discussions, participants gained a better understanding of contemporary macroeconomic events. They also learn how to present economic concepts through reasoning, through graphical expositions and through formal analyses.

2 SWS – 3.0 ECTS

2.2 Courses, Spring Term 2010

Bachelor of Science

Macroeconomics II
Professor Ralf Fendel

The course built on the course “Macroeconomics I” and provided participants with a broader view on economic issues. Through the in-depth analysis and discussions, participants gained a better understanding of contemporary macro-

economic events. They also learn how to present economic concepts through reasoning, through graphical expositions and through formal analyses.

2 SWS – 3.0 ECTS

Introduction to International Economics Professor Ralf Fendel

The course explained the basic concepts of monetary and trade linkages between economies. It began with a part on trade theory and trade policy, within which the main theories of international trade as well as the effects of protectionism were discussed. The second part was devoted to the balance of payments and its dependence on exchange rate movements. In the final part the reasons for the exchange rate movements themselves were analyzed.

2 SWS – 3.0 ECTS

Management Abroad “Chile” Professor Ralf Fendel

The course consisted of a 2 week excursion to Santiago de Chile and combines the advantages of a traditional seminar on international business with those of site visits and exposure to the relevant national and cultural context. The preparation started in Vallendar with a lecture held on the Chilean economy and the main aspects of international management.

3 SWS – 3.0 ECTS

Master of Science

Macroeconomics of Financial Markets Professor Ralf Fendel

The course deepened students' understanding of financial markets and its paramount role within market economies. It, therefore, explicitly related the financial market to the macroeconomic environment. It first reviewed the key economic issues of financial markets, its institutions and its links to the real economy. It then examined the behavior of central banks and the design of monetary policy. Furthermore, the issue of financial stability and how it can be safeguarded to avoid financial crises both on a national and an international level was discussed.

2 SWS – 3.0 ECTS

2.3 Defense of the Dissertation

2.3.1 “Economic Aspects of European Union Foreign Trade Policy” by Marco Semmelmann (Prof. Fendel acts as second reader)

With a share of 17.0% in world trade of goods and 28.5% in services, the EU-27 has the biggest share in world trade, ahead of the United States (14.5% in goods, 18.2% in services; 2007 figures). It is therefore the largest trade destination and origin in the world. Consequently, an analysis of the trade policy of the European Union is particularly insightful. The aim of the dissertation is to analyze the economic impacts of the European Union’s trade policy.

In the first part of the dissertation, the impact of recent preferential trade agreements that have been agreed upon between the European Union and its respective contractual partners will be analyzed by using a gravity model and applying econometric techniques. This will be done both on an aggregate EU level and on a country level, in order to explain whether individual EU countries have benefited more than other countries. In addition to that, it will be tested whether individual extra-EU trade partner countries profited from the agreements.

The second part will deal with EU trade defense instruments, in particular anti-dumping investigations. An empirical analysis of anti-dumping measures will be conducted, while controlling for trade diversion and changes in trade patterns in the aftermath of the application of anti-dumping measures.

The third part intends to shed light on the correlation between trade policy and its significance for development economics. It focuses on the role of foreign trade policy in the development cooperation between the European Union and the respective developing countries. This subject is particularly important, as the European Union is a major player in the complex system of one-way trade preferences to developing countries and because the European Union is the most important trading partner for the majority of these countries.

2.4 Dissertation Project Presentations

2.4.1 “Monetary Policy Rules: Empirical Applications based on Survey Data” by Dirk Bleich (Prof. Fendel acts as second reader)

The objective of the dissertation is to provide empirical applications of monetary policy rules. Therefore a unique data set with expectations for macroeconomic variables for 75 different countries from 1989 to 2009 is used.

First, the question whether inflation targeting (IT) makes a difference as a monetary policy framework is addressed. Novel evidence on inflation stabilisation in IT countries is provided and it is shown that the introduction of inflation targeting significantly shifts the central bank's reaction function towards inflation stabilizing

for the majority of countries. It is also shown that the long-term inflation rate significantly decreases in the inflation targeting period compared to the period before. Moreover, there is evidence for a time-varying effect. These results can be interpreted as strong evidence that the introduction of inflation targeting makes the difference for monetary policy strategies.

Second, the influence of oil price expectations on monetary policy is analyzed. Estimates for the Bank of Canada, Bank of England, Federal Reserve and the European Central Bank show that a one percent increase in oil price expectations leads to an interest rate increase of on average about eleven basis points. Moreover, there is provided evidence for asymmetries in the central banks behaviour. Finally it is shown that those central banks do not respond to the realized oil price.

Third, the link between monetary policy and the Spanish real estate bubble is investigated. It is demonstrated that a central bank only responsible for the Spanish economy and following the same monetary policy rule as the Banco de España in the time period from 1995 to 1998, would have set the interest rate up to 3.0% above the ECB's interest rate between 1999 and 2007. Thus, an inadequate monetary policy seems to be an important issue for the explanation of the emergence of the Spanish real estate bubble. This result provides a show case of possible negative consequences of a central bank that has to conduct a "one-size-fits-all" monetary policy in a monetary union with economic heterogeneity among its members.

2.4.2 "New Impulses Affecting Fiscal Policy" by Eliza Lis (Prof. Fendel acts as second reader)

First, we use the ECB's Survey of Professional Forecaster to show that euro area expectations are consistent with standard macroeconomic building blocks such as the Phillips curve, Okun's law, and the Taylor rule. Moreover, the paper finds that the financial and economic crisis of 2007-2009 did not change the expectation formation process as professional forecasters still adopt macroeconomic building blocks for their forecast. The scepticism that has recently been raised concerning macroeconomic building blocks has apparently not yet affected professional forecasts. On the contrary, we conclude that professional forecasters still have faith in macroeconomic building blocks.

Secondly, we empirically analyze whether budget balance expectations are anchored. To this end, we use budget balance forecasts for 12 industrialized and emerging economies. We examine whether budget balance rules improve the anchoring of budget balance expectations and find mixed results. Our results have far reaching policy implications as they indicate that only countries implementing budget balance rules with strong enforcement mechanisms are successful.

Thirdly, we explore the linkages between fiscal responses and credit crunches and hereby the effectiveness of fiscal policy during credit crunches for 63 advanced and developing countries during 1970 – 2008. In a first step we determine the financial cycles of private credit and therefore are able to determine the beginning

and duration of crises episodes. We identify 228 credit contractions and consider the top 25% as credit crunch episodes (57 episodes) based on the cumulative losses, which serve as an indicator for the severity of a crisis. By estimating a simultaneous equations model with three equations we are able to identify whether financial crises trigger a fiscal response and how effective fiscal policy is in responding to financial crises.

2.4.3 “Trade Determinants and Current Account Forecasts” by Lilli Zimmermann (Prof. Fendel acts as second reader)

The dissertation follows a multiple-paper approach and comprises research papers on empirical issues in international economics.

The first part of the dissertation focuses on the determinants of merchandise trade, adding to international trade literature. More precisely, several theoretical hypotheses are reviewed aiming to explain the performance of trade and factors are examined explaining the dynamics of merchandise exports. As Germany has traditionally been one of the most successful export countries in the world, one of the papers analyzes which factors explain Germany’s export performance. Based on the estimation of several specifications of a conditional single equation error correction model for export demand, numerous determinants are systematically examined for their ability to explain German exports during the period 1992-2008. The estimation results indicate that besides the traditional determinants (world demand and price competitiveness) other determinants, such as energy prices and the increasing fragmentation of production processes are also crucial. An assessment of the relative importance of the determinants reveals that price competitiveness, despite prolonged effort in containing costs through wage moderation, played a comparatively smaller role in explaining German exports. The increased fragmentation of production processes, by contrast, significantly contributed to its upsurge, indicating that German firms have been able to optimize their value chain of production in such a way as to make use of the comparative advantages of individual firms and locations.

The second part of the dissertation focuses on the properties of current account expectations and contributes, therefore, to the forecasting literature. As global external imbalances have received considerable attention in the last decade and expectations about the current account movements provide valuable insights for policymakers, it is inevitably important to study how current account forecasters form their expectations. Using data from the Consensus Economics Forecast Poll

one of the papers shows that private sector forecasts for the euro area and G7 countries do not satisfy the traditional unbiasedness and orthogonality criteria for forecast rationality. A further empirical investigation indicates that this outcome relates to an anti-herding behaviour of forecasters. As the cross-sectional heterogeneity of forecasters with regard to anti-herding translates into cross-sectional heterogeneity with regard to forecast accuracy, there is some evidence that forecasters who tend to herd provide more accurate forecasts than their colleagues who follow an anti-herding strategy. These results provide valuable information for policymakers, especially when it comes to the assessment of future external developments.

2.5 Bachelor Thesis

2.5.1 “Trade and Development – Virtuous or Vicious Linkages” by Frank-Alexander Raabe

This thesis dealt with the complex relation between international trade and economic development. Economic development in this respect besides economic growth also includes aspects of health and education. The thesis contains theoretical as well as empirical work. The empirical part consists of a panel data analysis which produced new evidence on the topic that has not been presented in the literature do far.

2.5.2 “A Comparative Study of Historical Financial Crises and the Recent Subprime Crisis” by Jan-Peter Schmütsch

The thesis presents a historical perspective on past financial crises and discusses the recent subprime crisis in this context. The main focus is put on the aspect of banking crises and the Diamond-Dybvig model as a theoretical basis for the discussion. The thesis connects theoretical with empirical aspects.

2.6 Research Seminar in Economics (FORSEM)



In close cooperation with all members of the Economics Group at the WHU a research seminar with the following presentations was organized.

2.6.1 Fall Semester 2009

- **Dr. Markus A. Schmidt** (Deutsche Bundesbank)
“The Dealer’s Oracle: How Useful is Order Flow Data for Out-Of-Sample Forecasting in FX Markets”
- **Pia Pinger** (ZEW and University Mannheim)
“Intergenerational Transmission of Inequality: Maternal Skills, Prenatal Risk Behavior and Birth Outcomes”

- **Professor Gerhard Satzger** (University Karlsruhe)
“Service Innovation: Capturing Value from Networks”
- **Marcelo Sanchez** (European Central Bank)
“Relative Prices and Sectoral Productivity: Is There Evidence of Structural Change in the Euro Area?”
- **Frank Gotthardt** (CompuGROUP)
“Das deutsche Gesundheitssystem – Auslaufmodell oder Chance für erfolgreiches unternehmerisches Engagement?”
- **Professor Carsten Eckel** (Otto-Friedrich-University Bamberg)
“International Trade and Retailing”
- **Dr. Vanessa von Schlippenbach** (DIW)
“Quality Distortions in Vertical Relations”
- **Christina Günther** (Max Planck Institute of Economics)
“Firm Survival in Dynamic Industries – Innovation in the German Machine Tool Sector”

2.6.2 Spring Semester 2010

- **Professor Gerd Mühlheusser** (University Bielefeld)
“Sequential Location Games”
- **Professor Daniel Rubinfeld** (UC Berkeley)
“Can Federalism in South Africa Survive Democracy?”
- **Professor Christian von Hirschhausen** (TU Berlin)
“Desertec: Economics – Engineering – Institutional Analysis”
- **Paul de Bijl** (CPB Netherlands Bureau for Economic Policy Analysis)
“Competition, Innovation and IRPs in Software Markets”
- **Anja Schmiele** (ZEW Mannheim)
“The Influence of International Dispersed vs. Home-based R&D on Corporate Growth”
- **Dr. Martin Weiss** (University Erlangen-Nürnberg)
“Die Diversifikation von Unternehmen und deren Erfolg – Empirische Erkenntnisse und weitere Forschungsfelder”
- **Professor Matti Liski** (Helsinki School of Economics)
“Energy Saving Investments: Simple Analytics and an Application to Electricity”

2.7 Executive Teaching

Metro Business Program Advanced China and the World Economy Professor Ralf Fendel

The course provided an overview over China`s recent and future macroeconomic developments. Comparing China to the U.S. and Germany, the course analysed the causes and consequences of China`s rapid growth over the past decades. Some stylized facts highlighted the main quantitative aspects of the current situation (e.g. the trade structure and the patterns of growth). The course also introduced participants into the problems challenging the Chinese economy in the near future. Among those problems are the demographic development, income disparities, the financial sector weakness and slow consumption growth. The discussion focused on China`s future growth prospects given the current worldwide economic downturn.

Metro Business Program Developments in International Trade Professor Ralf Fendel

The course provided an overview over recent developments in international trade. Some stylized facts highlighted the main quantitative aspects of the current situation. The module introduced participants also into basics of the rationale of trade policies. Since regional integration has also played an important role in the context of international trade policies, the module also covered economic and political aspects of regional integration. Furthermore, the discussion focused on the World Trade Organization (WTO) as the main body for the promotion of international trade liberalization.

Melbourne Business Program European Integration Professor Ralf Fendel

The course introduced participants to business relevant stylized facts of European countries, the role of European countries in the global economy, and the background of European integration. Furthermore, the course focused on the consequences of the Single European Market and the process of European monetary integration. The implications for international business were assessed and the relationship between trade and monetary integration were examined. Finally, the course examined the functioning of the European Monetary Union and the current developments in the euro area. It combined official views from the European Central Bank with an assessment from the banking industry.

3 Research Activities: Publications, Cooperation and Presentations



In its research activities the professorship analyzes theoretical and empirical aspects of monetary economics, macroeconomics and international economics with relevance to economic policy. During the period covered by this report, the research activities resulted in 8 working papers that are currently in the referee process. The following papers have been published or have been accepted in the academic year under consideration in this report.

3.1 Publications in Refereed Journals

Fendel, R., Frenkel, M. and Rülke, J.-C. 2010. Real-Time Data Does Not Make a Difference! Evidence from the Expectation Forming Process, *Empirical Economic Letters* 9 (7), pp. 723-729.

Fendel, R., Lis, E. and Rülke, J.-C. 2009. Expectations on the NAIRU – Evidence from the G7 Countries. *Empirical Economic Letters* 8 (6), pp. 544-553.

Fendel, R., Lis, E. and Ruelke, J.-C., “Do Professional Forecasters Believe in the Phillips Curve? – Evidence from the G7 Countries”, forthcoming, *Journal of Forecasting*.

3.2 Other Publications

Fendel, R. and Bleich, D. 2009. Der Learning Ansatz II: eine geldpolitische Anwendung [The learning approach in monetary theory]. *Das Wirtschaftsstudium (wisu)*, vol. 38, pp. 1496-1502.

Gnos, C. and Rochon, L.-P. (Hrsg.) 2010. Monetary Policy and Financial Stability – A Post-Keynsian Agenda, *Journal of Economics and Statistics*, vol. 230, p. 131 (book review by Ralf Fendel).

3.3 Referee Activities

Throughout the academic year Professor Ralf Fendel served as a referee for the journals

- Journal of International Money and Finance
- Journal of Economics and Statistics
- Economic Modelling
- Empirica

3.4 Presentations in Research Seminars

Banco de Chile (Santiago/Chile), Research Seminar: „Monetary Policy Regimes and Credibility”

3.5 Other Presentations

European Youth Parliament: „The Euro and the Financial Crisis“

Annual Workshop of the “Verein für entwicklungsökonomische Forschungsförderung”: “The Financial Crisis and its Implications for Development Policy - An Overview”

4 Contributions to the Leadership of the WHU



Throughout the academic year covered by this report Professor Ralf Fendel served in different functions contributing to the leadership of the WHU – Otto Beisheim School of Management. He

- was member of the WHU senate;
- acted as WHU liaison professor for the „Friedrich Naumann Stiftung für Freiheit“;
- was evaluator for the Studienstiftung des deutschen Volkes for students at the WHU;
- participated in the bachelor students selection process;
- contributed to the WHU strategy project in the sub-group on “duties and responsibilities of the WHU faculty“;
- contributed to the organization of the 25 years celebration of the WHU.

5 Connections to the Business Community and to Institutions



During the period covered by this report, several activities with cooperations and institutions were continued. Seven activities were of particular importance:

- **World Economic Forum (WEF), Geneva, Switzerland**

The cooperation between Professor Ralf Fendel and the WEF began in 2002 and has focused on supporting the WEF in its work on the annually published World Competitiveness Report. This report currently ranks about 140 countries with respect to their current and their growth competitiveness. It is based on officially published data and the results of a survey among business leaders. The chair provides input into collecting data and conducting the survey among German businesses. This cooperation has also led to several publications on the methodology of the World Competitiveness Report, on the performance of Germany compared to other industrial countries, and on the changes in competitiveness of individual European countries.



- **Verein für entwicklungsökonomische Forschungsförderung**

Professor Ralf Fendel took over the chairman position of the “Verein für entwicklungsökonomische Forschungsförderung” which regularly brings together researchers and practitioners from the field of development economics. In doing so, Professor Fendel continued his close cooperation with the Kreditanstalt für Wiederaufbau (KfW), the German development bank. In 2010 Professor Fendel also organized the annual seminar in Erfurt on “The Financial Crisis and its Implications for Development Policy”.



- **Summer Academy, Studienstiftung des deutschen Volkes in La Villa (Italy)**

In August 2010 Professor Ralf Fendel organized 2-week seminar within the 2010 summer academy of the “Studienstiftung des deutschen Volkes” in La Villa (Italy). The seminar titled “Financial Crises: A Macroeconomic Perspective” was jointly taught with Dr. PD Martin Mandler from the University of Giessen.

