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Highlights: 5th Workshop on Macro Dynamics

On December 20 the Economic Research Department hosted for the first time the annual “Workshop on Macroeconomic Dynamics: Theory and Applications”. The workshop was launched five years ago by a group of representatives of the main Italian universities, to bring together Italian-based researchers and their Italian colleagues working abroad. The purpose is to offer participants, in particular junior economists, an opportunity to present and discuss research on modern dynamic macroeconomics and to encourage the creation of networks of economists

working in closely related fields and topics, ideally for future joint research projects and collaborations. The list of participants included several talented economists from the most prestigious international and Italian universities. This year’s edition recorded an increased presence of representatives of international institutions, including the European Central Bank, the Bank of England, the Federal Reserve Bank of New York and the Bank of Canada, bearing witness to the growing importance of the interactions between academia and policymakers.

The workshop was opened with a welcome address by Mario Draghi, Governor of the Bank of Italy. Each of the twelve papers presented during the day illustrated, in different ways, the evolution of knowledge in economics. A wide range of topics was covered - from the application of dynamic general equilibrium methods to policy problems, to the attempt to model a new equilibrium notion based on the idea of limited commitment by the policymaker, to the quest for a new theory to account for the trends economic and demographic development. All the papers made use of rigorous theory and careful empirical analysis, which is the best service the economics profession can offer to those who have ultimately to make policy decisions. The workshop programme and papers are available at the [Bank of Italy’s website](#).

March 31, 2007 is the deadline for the submission of papers to the 3rd Bank of Italy-CEPR conference on Money, Banking and Finance, devoted to “Monetary policy design and Communication” (see the [call for papers](#)).

Abstracts of the latest working papers

No. 604: The Political Economy of Investor Protection

Pietro Tommasino

Why do some countries suffer from backward financial institutions and weak corporate governance rules? We show that, even if, overall, the economy would benefit from corporate governance reforms, not all the agents would stand to gain from the improvement. In particular, entrepreneurs and firms that are already well-established fear better rules, which would allow the financing of new firms and enhance competition. As a consequence, industry incumbents will try to influence the political process to block the reforms. If national political institutions are weak, these efforts are likely to be successful.

[\(full pdf text\)](#)

No. 605: Search in Thick Markets: Evidence from Italy

Sabrina Di Addario

I analyze empirically the effects of both urban and industrial agglomeration on men's and women's labor search behavior and on the efficiency of matching. The analysis is based on a unique panel data set from the Italian Labor Force Survey micro-data, which covers 520 randomly drawn Local Labor Market Areas (66 per cent of the total) over the four quarters of 2002. I compute transition probabilities from non-employment to employment by jointly estimating the probability of searching and the probability of finding a job conditional on having searched, and I test whether these are affected by

urbanization and/or industry localization. The main results indicate that both urbanization and industry localization raise job seekers' chances of finding employment (conditional on having searched), but neither of them affects non-employed individuals' search behavior.

[\(full pdf text\)](#)

No. 606: The Transmission of Monetary Policy Shocks from the US to the Euro Area

Andrea Nobili and Stefano Neri

This paper studies the transmission of monetary policy shocks from the US to the euro-area using a two-country structural VAR with no exogeneity assumption. The analysis reveals the following results. First, in response to an unexpected increase in the Federal funds rate, the euro immediately depreciates with respect to the dollar and then appreciates in line with the prediction of the uncovered interest parity condition. Second, there is evidence of a temporary positive spillover to euro-area output in the short run, while a negative effect emerges in the medium run. Third, the contribution of the trade balance channel to the transmission of monetary shocks is negligible. Finally, the degree of pass-through of the exchange rate changes onto euro-area consumer prices is incomplete and small in the short run, while it is close to zero in the medium run

[\(full pdf text\)](#)

No. 607: What does a Technology Shock do? A VAR Analysis with Model-Based Sign Restrictions

Luca Dedola and Stefano Neri

This paper estimates the effects of technology shocks in VAR models of the U.S., identified by imposing restrictions on the sign of impulse responses. These

restrictions are consistent with the implications of a popular class of DSGE models, with both real and nominal frictions, and with sufficiently wide ranges for their parameters. This identification strategy thus substitutes theoretically-motivated restrictions for the atheoretical assumptions on the time-series properties of the data that are key to long-run restrictions. Stochastic technology improvements persistently increase real wages, consumption, investment and output in the data; hours worked are very likely to increase, displaying a hump-shaped pattern. Contrary to most of the related VAR evidence, results are not sensitive to a number of specification assumptions, including those on the stationarity properties of variables.
(full pdf text)

No. 608: Merge and Compete. Strategic Incentives for Vertical Integration

Filippo Vergara Caffarelli

Vertical integration followed by quantity competition is studied. In the first stage of the game downstream firms simultaneously decide whether to integrate with one of the upstream suppliers. If firms are not able to observe whether their vertically integrated competitor enters the intermediate-good market then they are indifferent about vertical integration. If the entry choice of the integrated firm is observable then the unique equilibrium involves vertical integration and in-house production of the intermediate good. The importance of entry observability sheds light on the strategic importance of information exchange institutions such as the internet and business fairs.
(full pdf text)

No. 609: Real-Time Determinants of Fiscal Policies in the Euro Area: Fiscal Rules, Cyclical Conditions and Elections

Roberto Golinelli and Sandro Momigliano

We examine the impact of four factors on the fiscal policies of the euro-area countries over the last two decades: the state of public finances, the European fiscal rules, cyclical conditions and general elections. We rely on information actually available to policy-makers at the time of budgeting in constructing our explanatory variables. Our estimates indicate that policies have reacted to the state of public finances in a stabilizing manner. The European rules have significantly affected the behaviour of countries with excessive deficits. Apart from these cases, the rules appear to have reaffirmed existing preferences. We find a relatively large symmetrical counter-cyclical reaction of fiscal policy and strong evidence of a political budget cycle. The electoral manipulation of fiscal policy, however, occurs only if the macroeconomic context is favourable.
(full pdf text)

No. 610: The Under-Reporting of Financial Wealth in the Survey on Household Income and Wealth

Leandro D'Aurizio, Ivan Faiella, Stefano Iezzi and Andrea Neri

The sample estimates are uniformly below those of the Financial Accounts, even after harmonising all the definitions and the evaluation criteria. Such a problem can stem from the interviewee's unwillingness to disclose the actual value of the asset (under-reporting). The paper presents a method to correct this potential source of bias in order to improve Survey of Household Income and Wealth financial

assets. We use a sample survey of customers of the Unicredit group, coupled with administrative data on the assets actually owned, as external sources of information. The adjustment procedure enables to account for a large share of the gap between the figures derived from the sample and from the Financial accounts, significantly increasing the average value of the financial assets (inflating the unadjusted figure of 22.000 euros to 59.000 euros, amounting to about 85 percent of the Financial account estimates). The adjustment produces a larger correction for private bonds and mutual funds. The intensity of the correction is higher for one-person households, when the head of household is less educated or not employed, and it raises with his/her age. [\(full pdf text\)](#)

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No. 611: Spatial Polarization of Per Capita Income: The Analysis of the Italian Case Based on Province-Level Data

Stefano Iezzi

Economic convergence at the sub-national level could have spatially explicit manifestations reflecting convergence clubs and other forms of geographical clustering that are not captured by an overall inequality measure. By decomposing the Theil index of per capita income inequality into between and within groups of neighbouring locations, the degree of spatial polarization is measured as the share of inequality accounted for by the between group component. The choice of the partition can fundamentally change any inequality measure decomposition, both qualitatively and quantitatively. In order to overcome this issue I propose a kernel approach to the spatial polarization measure based on the Theil index computed on the spatial moving averages.

This allows to detect a polarization curve measuring the degree of geographic concentration as a function of a spatial scale parameter, denoting the geographic dimension of the groups. The analysis of per capita income data of Italian provinces in XX century shows the existence of a multiple polarization, that is per capita income is polarized at different spatial scales. The forces sustaining the polarization are stronger at medium and high spatial scales. The analysis also shows the presence of a long-run geographic club convergence with converging clubs and a strengthening of the polarization, mainly referable to regional differences; the reinforcement of North – South dualism is more limited. [\(full pdf text\)](#)

Abstracts of the latest Occasional Papers

No. 3: The effects of Basel 2 on Italian Banks: Evidence From the Fifth Quantitative Impact Study

Francesco Cannata

In 2007 the new framework for capital adequacy of banks (Basel 2), defined in 2004 by the Basel Committee for Banking Supervision, will replace the 1988 Accord (Basel 1) in all major countries. In the last years the Committee has carried out several impact studies in order to simulate the possible quantitative effects of the new discipline. This paper describes the main results of the last survey (Fifth Quantitative Impact Study, QIS5) for the Italian banks included in the sample. The evidence suggests that the new rules should not produce significant effects – on average – on the level of capitalisation of the Italian

banking system. For large internationally active intermediaries the capital requirements, calculated with the advanced methodologies, decrease with respect to the current regime; for medium-sized banks the capital requirements slightly increase when calculated with the standardised approach. These results are broadly in line with the evidence for the banks from other European and G10 countries participating in the same exercise.

(full pdf text; available only in Italian)

No. 4: The Effectiveness of Investment Subsidies: Evidence From Survey Data

Luigi Cannari, Leandro D'Aurizio, Guido de Blasio

This paper investigates the effects of subsidies on the investment decisions of a sample of Italian manufacturing firms. We use survey information on firms' subjective evaluations of the investment they would have undertaken without financing, finding that subsidies have limited effectiveness as a stimulus. Without subsidies, three-quarters of the firms financed would have made the same amount of investment at the same date; most of the remaining firms would have made the same amount of investment at a future date.

(full pdf text)

Forthcoming working papers

Claudia Biancotti, Leandro D'Aurizio and Raffaele Tartaglia Polcini, *A Neural Network Architecture for Data Editing in the Bank of Italy's Business Surveys.*

Stefano Federico and Gaetano Alfredo Minerva, *Outward FDI and Local Employment Growth in Italy.*

Fabiano Schivardi and Eliana Viviano, *Entry Barriers in Italian Retail Trade.*

Mario Quagliariello, *Macroeconomic Uncertainty and Banks' Lending Decisions: The Case of Italy.*

Recently published working papers

No. 603 Claudia Biancotti, *A Dual-Regime Utility Model for Poverty Analysis.* (September 2006).

No. 602 Roberta Fiori and Simonetta Iannotti, *Scenario Based Principal Component Value-at-Risk: An Application to Italian Banks' Interest Rate Risk Exposure.* (September 2006).

No. 601 Ugo Albertazzi and Leonardo Gambacorta, *Bank Profitability and the Business Cycle.* (September 2006).

No. 600 Federico Cingano and Alfonso Rosolia, *People I Know: Workplace Networks and Job Search Outcomes.* (September 2006).

No. 599 Mario Quagliariello, *Banks' Riskiness Over the Business Cycle: A Panel Analysis on Italian Intermediaries.* (September 2006).

No. 598 Elisabetta Iossa and Giuliana Palumbo, *Overoptimism and Lender Liability in the Consumer Credit Market.* (September 2006).

No. 597 Raffaello Bronzini and Paolo Piselli, *Determinants of Long-Run Regional Productivity: The Role of R&D, Human Capital and Public Infrastructure.* (September 2006).

No. 596 Piero Cipollone and Alfonso Rosolia, *Social Interactions in High School: Lessons from an Earthquake*. (September 2006).

Selection of forthcoming or recent articles by Bank of Italy's staff

(full list since 1990)

Bonaccorsi di Patti E. and G. Gobbi, *Winners or losers? The effects of banking consolidation on corporate borrowers*. Forthcoming, *Journal of Finance*. (WP No. 479)

Cipollone P. and A. Rosolia, *Social Interactions in High School: Lessons from an Earthquake*. Forthcoming, *American Economic Review*. (WP No. 596)

Dedola L. and S. Neri, *What does a technology shock do? A VAR analysis with model-based sign restrictions*. Forthcoming, *Journal of Monetary Economics* (WP No. 607).

Marchetti D. J. and F. Nucci, *Pricing Behavior and the Response of Hours to Productivity Shocks*, Forthcoming, *Journal of Money, Credit and Banking* (WP No. 524).

Paiella, M., *The Foregone Gains of Incomplete Portfolios*, Forthcoming, *Review of Financial Studies*.

Álvarez, L. J., E. Dhyne, M. Hoeberichts, C. Kwapil, H. Le Bihan, P. Lünemann, F. Martins, **R. Sabbatini**, H. Stahl, P. Vermeulen, J. Vilmunen (2006), *Sticky prices in the euro area: a summary of new micro evidence*,

Journal of the European Economic Association, 4, 575-584

Bianco M. and G. Nicodano (2006), *Pyramidal Groups and Debt*, *European Economic Review*, 50, 937-961.

Busetti, F. (2006), *Tests of seasonal integration and cointegration in multivariate unobserved component models*, *Journal of Applied Econometrics*, 21, 419-438.

Dhyne, E., E. Vilmunen, L.J. Álvarez, H. Le Bihan, **G. Veronese**, D. Dias, J. Hoffmann, N. Jonker, P. Lannemann, F. Rumler (2006), *Price Changes in the Euro Area and the United States: Some Facts from Individual Consumer Price Data*, *Journal of Economic Perspectives*, 20, 171 – 192.

Fabiani, S., Druant, M., I. Hernando, C. Kwapil, B. Landau, C. Loupias, F. Martins, T. Mathä, **R. Sabbatini**, H. Stahl, A. Stokman (2006), *What firms' surveys tell US about price-setting behaviour in the euro area*, *International Journal of Central Banking*, 2, 3-47.

Gaiotti E. and A. Secchi (2006), *Is there a cost channel of monetary transmission? An investigation into the pricing behaviour of 2000 firms*. *Journal of Money, Credit, and Banking*, 2006, 38, 8, 2013-2038 (WP No. 525).

Lippi F. and S. Neri (2006), *Information variables for monetary policy in a small structural model of the euro area*. Forthcoming, *Journal of Monetary Economics* (WP No. 511).

Brandolini A., P. Cipollone and E. Viviano (2006), *“Does the ILO Definition Capture All Unemployment?”*, *Journal of the European Economic Association*, 4, 153-179. (WP No. 529)

Lippi F. and W. Fuchs (2006), *Monetary union with voluntary participation*.

Review of Economic Studies, 73, 437-457 (WP No. 512).

Buseti F. and R. Taylor (2005), *Stationarity tests for irregularly spaced observations and the effects of sampling frequency on power*. *Econometric Theory*, 21, 757-794.

Cristadoro R., M. Forni, L. Reichlin and **G. Veronese** (2005), *A core inflation indicator for the euro area*. *Journal of Money, Credit, and Banking*, 37, 539-560. (WP No. 435)

Dedola L. and **F. Lippi** (2005), *The monetary transmission mechanism: Evidence from the industries of five OECD countries*. *European Economic Review*, 49, 1543-69 (WP No. 389).

Guiso L., L. Pistaferri and **F. Schivardi** (2005), *Insurance within the firm*. *Journal of Political Economy*, 113, 1054-1087, (WP No. 414).

Adalid R., G. Coenen, P. McAdam and **S. Siviero** (2005), *The performance and robustness of interest-rate rules in models of the euro area*. *International Journal of Central Banking*, 1, 95-132.

Gambacorta L. (2005), *Inside the bank lending channel*. *European Economic Review*, 49, 1737-1759.

Marchetti D.J. and Nucci F. (2005), *Price stickiness and the contractionary effects of technology shocks*. *European Economic Review*, 49, 1137-1164 (WP No. 392).

Angeloni I., A.K. Kashyap, B. Mojon, and **D. Terlizzese** (2004), *The output composition puzzle: A difference in the monetary transmission mechanism in the euro area and the United States*. *Journal of Money, Credit, and Banking*, 35, 1265-1306.

Buseti F. and R. Taylor (2004) *Tests of stationarity against a change in persistence*, *Journal of Econometrics*, 123, 33-66.

Cingano F. and **F. Schivardi** (2004), *Identifying the sources of local productivity growth*. *Journal of the European Economic Association*, 2, 720-742 (WP No. 474).

Useful links

Working papers of the other euro-area central banks:

Banque Nationale de Belgique
Deutsche Bundesbank
Bank of Greece
Banco de España
Banque de France
Central Bank of Ireland
Banque Centrale du Luxembourg
De Nederlandsche Bank
Oesterreichische Nationalbank
Banco de Portugal
Bank of Slovenia
Bank of Finland
European Central Bank

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