

wiiw Spring Seminar 2015

26 March 2015

Correcting External Imbalances in the European Economy

Michael Landesmann (support from Doris Hanzl-Weiss)

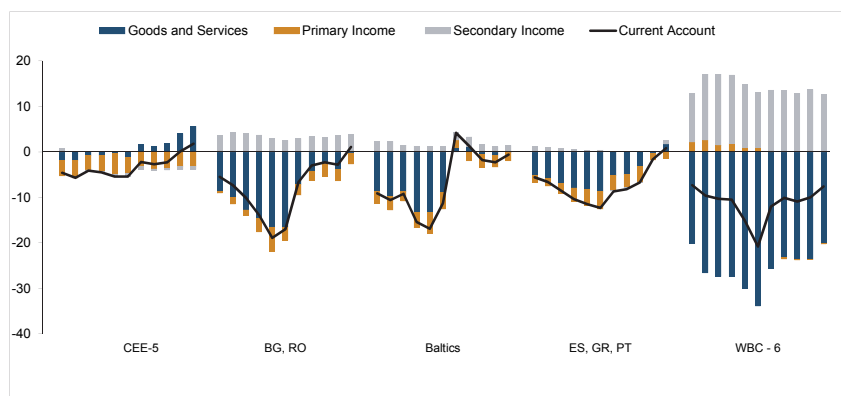
External imbalances in the European economy –
why is it a problem?

- Pre-crisis we did not think it was a problem in the EMU
- Now (after the onset of the crisis) we think it is a problem
- Just like with fiscal deficits, it is a sustainability (stock) problem, not a flow problem; inside and outside the EMU
- Hence the issue is: longer-run weaknesses on the current/financial accounts

External imbalances in the European economy – focus on lower-/medium-income economies

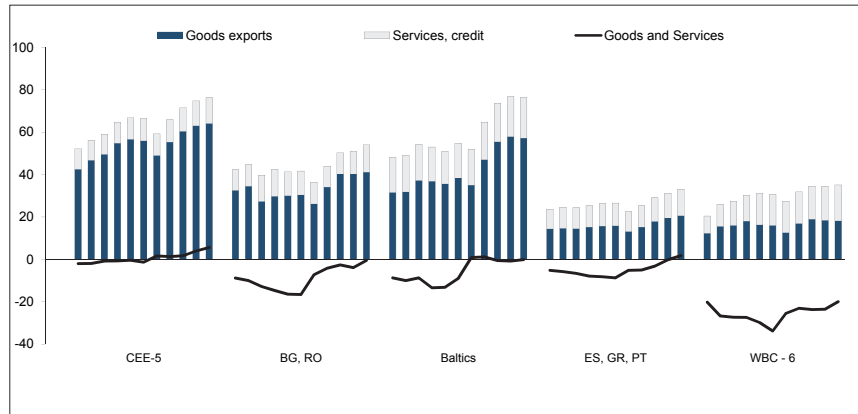
- Specific issues for **catching-up economies** in an **unstable external environment**
- We focus on **differentiation between**:
 - **EU-South** (ES, GR, PT)
 - **CEE-5** (CZ, HU, PL, SK, SL)
 - **Baltics** (EE, LT, LV)
 - **BG, RO** (at times HR)
 - **Western Balkans** (WBC-6; AL, BA, MK, ME, RS, XK)

Composition of the current account of the balance of payments, 2003-2013, in % of GDP - **pre-crisis: run-away deficits in some countries; then?**



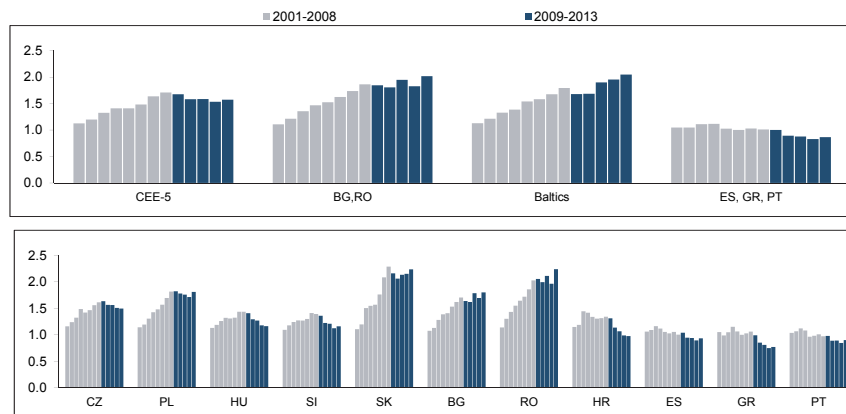
Remark: Components refer to BOP 6th edition as far as available, BOP 5th edition before. Primary income refers to Income Accounts, secondary income to current transfers.
Source: wiiw Annual Database incorporating national and Eurostat statistics.

External trade, 2003-2013, in % of GDP - **Persistent low export capacities in some countries**



Source: wiiw Annual Database incorporating national and Eurostat statistics.

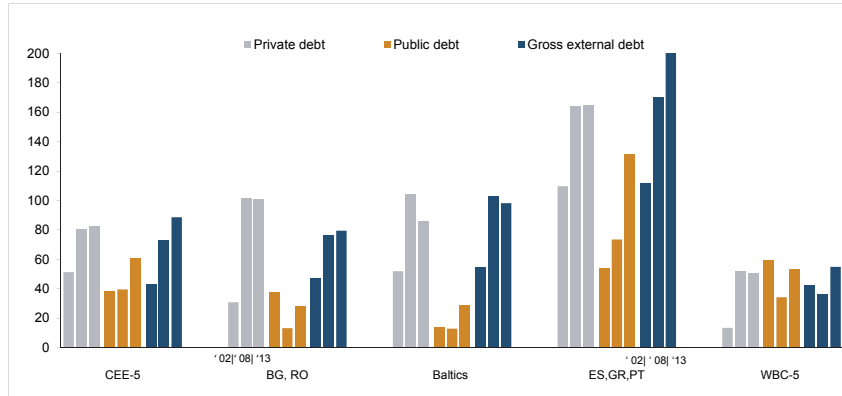
(Global) export market shares – 2000-2013 (2000 = 1.0)
Goods and services % of world total exports – **differentiation again!**



Source: wiiw Annual Database incorporating national and Eurostat statistics.

Debt in % of GDP, 2002, 2008, 2013 – private, public, external

Sequencing in private, public, external debt evolution



Remark: Data 2002: Public debt for ES, GR, PT refers to ES, PT only and to 2003. Gross external debt for ES, GR, PT refers to 2003, BA and ME gross external public debt.
Private debt for Baltics refers to 2004 (without EE), for WBC-5 to 2003 (without BA).
Source: wiiw Annual Database incorporating national and Eurostat statistics.

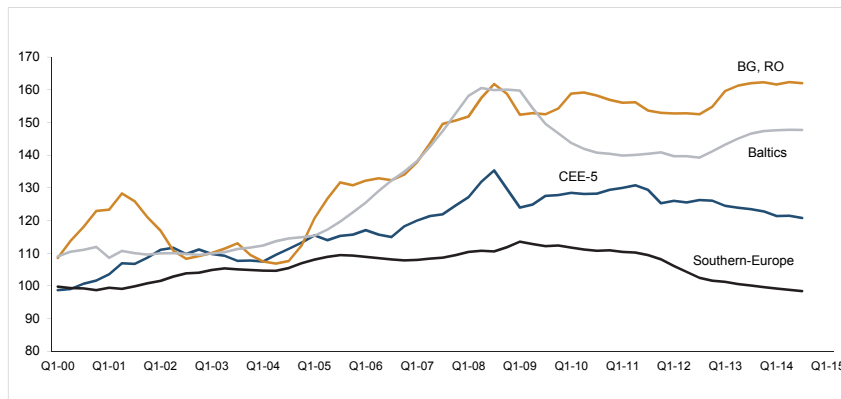
External imbalances and real exchange rates –

Do real exchange rates (REER) drive external imbalances?

Real Effective Exchange Rates vs (rest of) EU-28

(average 1994-2004 = 100) – 2000Q1 – 2015Q1

Nominal unit labour costs, total economy

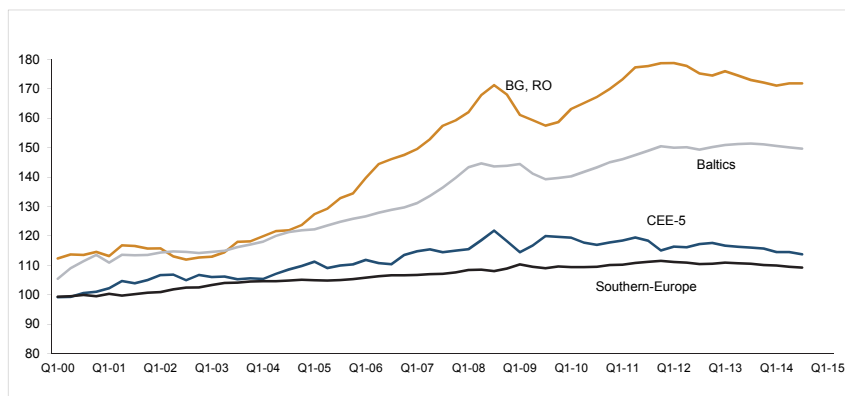


Source: AMECO, own calculations.

Real Effective Exchange Rates vs (rest of) EU-28

(average 1994-2004 = 100) – 2000Q1 – 2015Q1

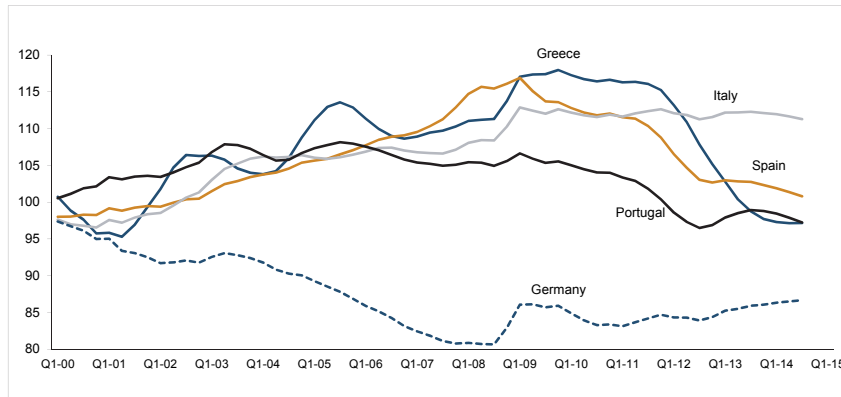
Price deflator, exports of goods and services



Source: AMECO, own calculations.

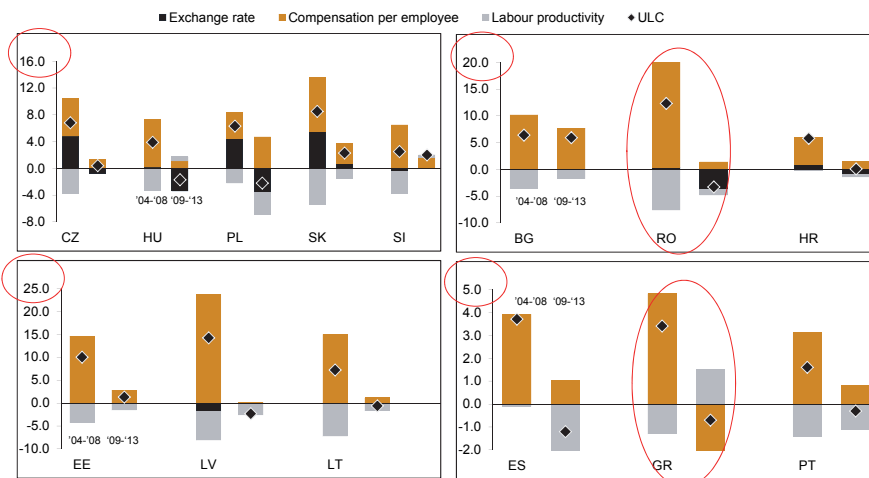
Real Effective Exchange Rates vs (rest of) EU-28 (average 1994-2004 = 100)

Nominal unit labour costs, total economy – **surprise, surprise!**



Source: AMECO, own calculations.

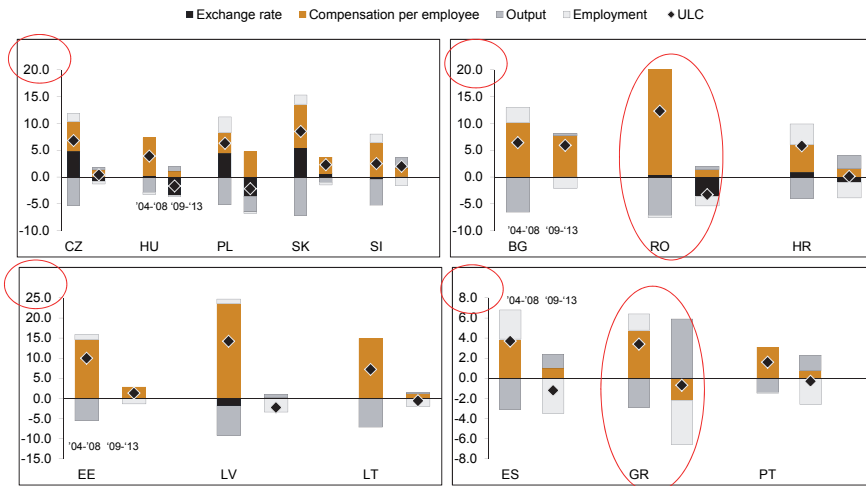
Components of ULCs – Changes: 2004-2008, 2009-2013 Total economy – **What drives the development of ULCs?**



Source: wiiw Annual Database incorporating national and Eurostat statistics.

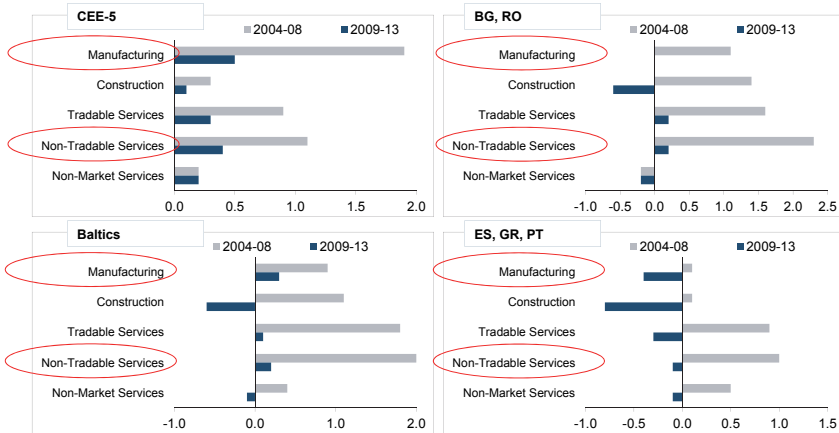
Components of ULCs – Changes: 2004-2008, 2009-2013

Total economy – **What about output and employment?**



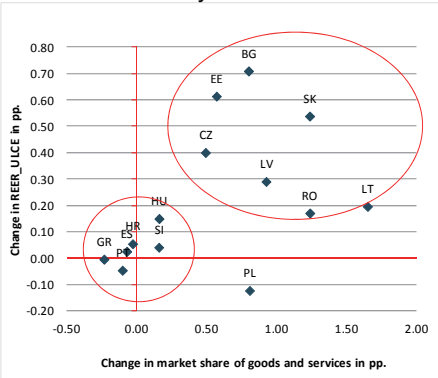
Contributions to GDP growth by sectors, percentage points 2004-2008 and 2009-2013 (from constant prices)

– **Look at manufacturing and NTS!**

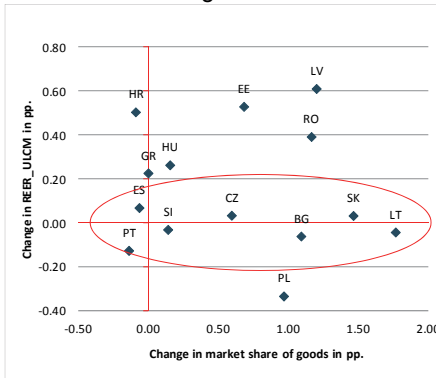


Change in global export market shares and change in REER -
Goods and services pp changes – 2000 to 2014 (2000=0.0) – Any relationship?

Total economy



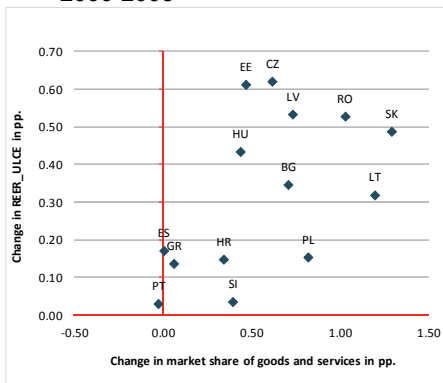
Manufacturing



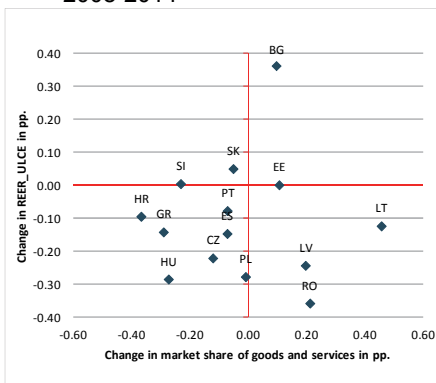
Source: AMECO Database, Eurostat.

Change in global export market shares and change in REER -
Goods and services pp changes – 2000-2008 and 2008-2014 – What about before
and after the crisis?

2000-2008

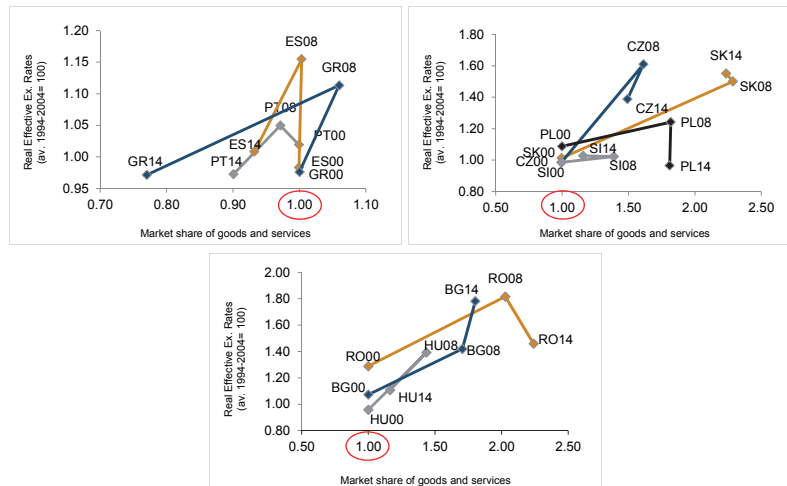


2008-2014



Source: AMECO Database, Eurostat.

Change in global market shares and change in REER, 2000, 08, 14 - See difference between GR, PT, ES and (most) others



Remark: Quarterly Real Effective Exchange Rates vs (rest of) EU-28. Nominal unit labour costs.
Source: AMECO Database, Eurostat.

External imbalances in the European economy – what have we learnt?

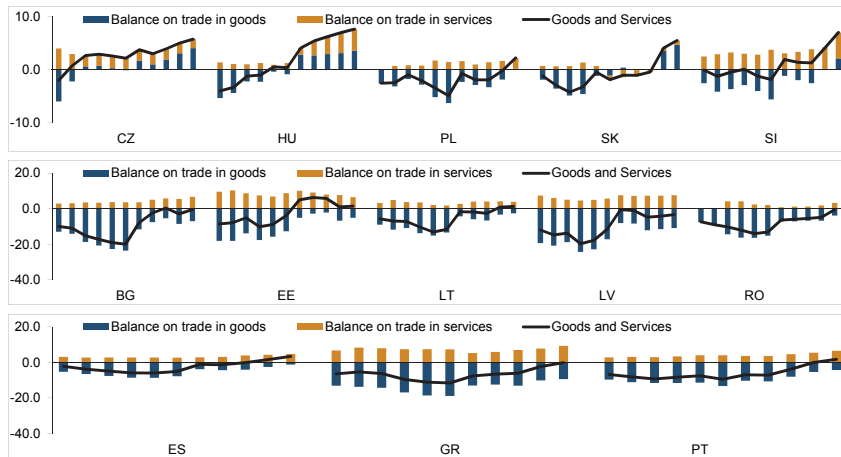
- 'Structural' external imbalances are a problem inside and outside the EMU
- 'Structural' refers to persistent weaknesses of the tradable sector – can lead to long-term constraint on growth, build-up of external debt and vulnerability to external shocks (e.g. 'sudden stops')
- Real exchange rate dynamics and capital inflows:
 - capital inflows can generate overvaluation and longer-term distortions of sectoral structures (tradables/non-tradables);
 - equally, FDI can cause positive cumulative causation – up-grading of export structures, quality improvements, real appreciation; hence nature of capital imports is very important

External imbalances in the European economy –

Policy issues

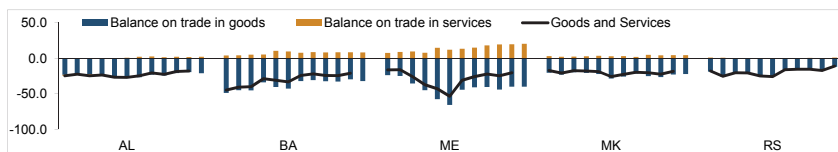
- Simple **adjustment of real exchange rates is weak mechanism** and contraction during crisis might have counter-productive short-term and longer-term hysteretic impact
- In economies with ‘structural’ current account problems, **wider range of instruments needed**:
 - incentive structures to attract FDI to tradable sector;
 - industrial policy instruments to steer export activities towards dynamic comparative advantages and sufficient degree of diversification;
 - keep balance of wage-productivity-skill acquisition dynamics; incomes policy, as well as human capital and productivity-enhancing policies are integral part of real exchange rate policy
- **‘Structural’ current account problems is a long-run policy issue!**

External trade, 2003-2013, in % of GDP



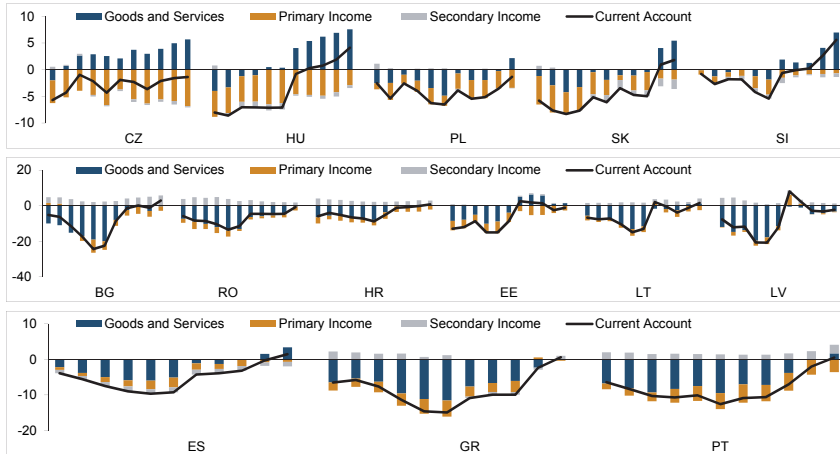
Source: wiiw Annual Database incorporating national and Eurostat statistics.

External trade, 2003-2013, in % of GDP



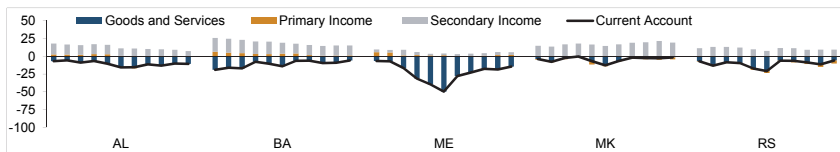
Source: wiiw Annual Database incorporating national and Eurostat statistics.

Composition of the current account of the balance of payments, 2003-2013, in % of GDP



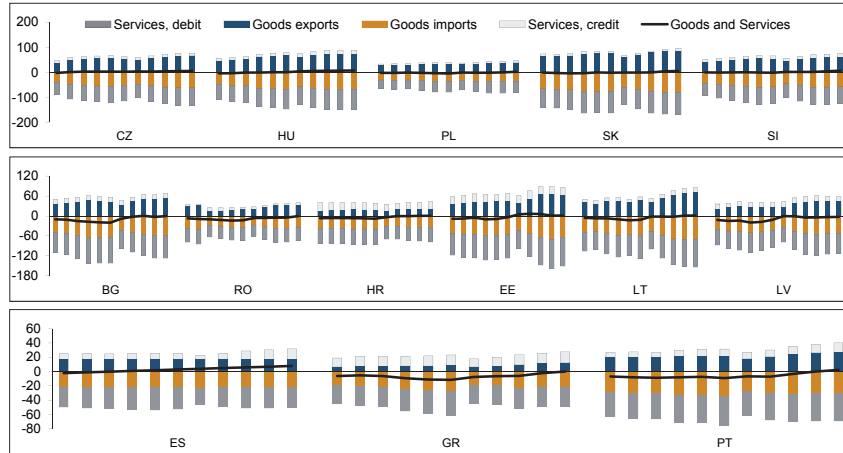
Remark: Components refer to BOP 6th edition as far as available, BOP 5th edition before. Primary income equals Income, secondary equals current transfers.
Source: wiiw Annual Database incorporating national and Eurostat statistics.

Composition of the current account of the balance of payments, 2003-2013, in % of GDP



Remark: Components refer to BOP 6th edition as far as available, BOP 5th edition before. Primary income equals Income, secondary equals current transfers.
Source: wiiw Annual Database incorporating national and Eurostat statistics.

External trade, 2003-2013, in % of GDP



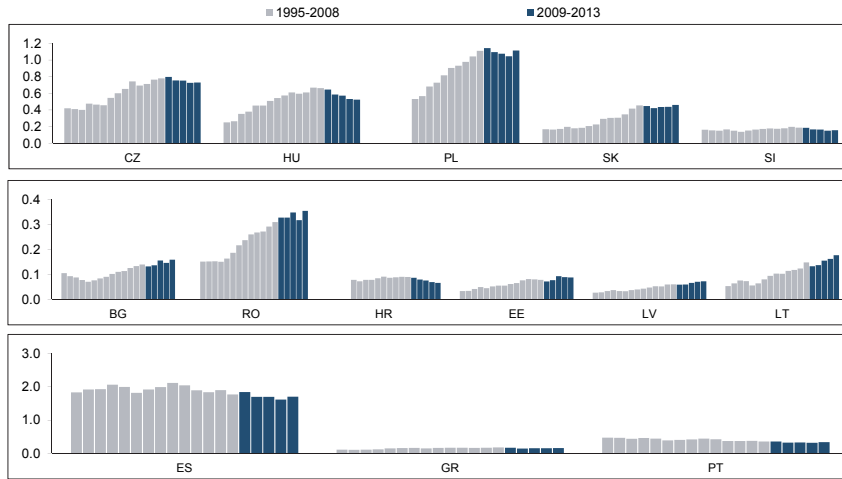
Source: wiiw Annual Database incorporating national and Eurostat statistics.

External trade, 2003-2013, in % of GDP



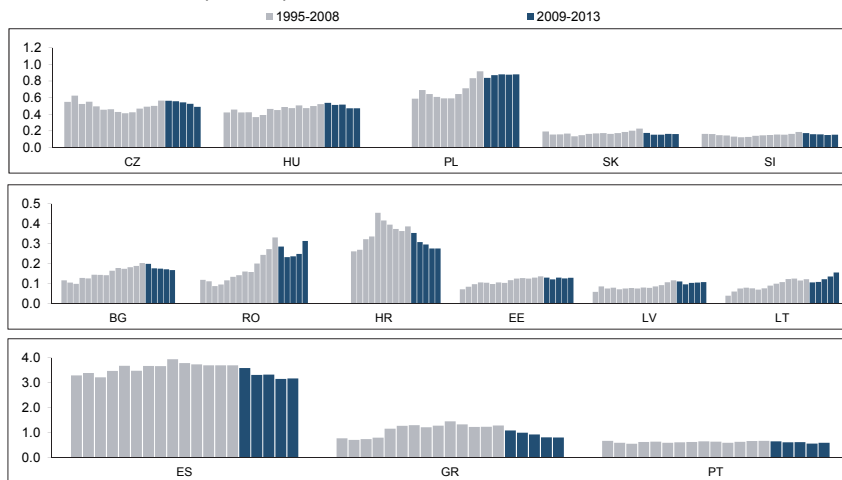
Source: wiiw Annual Database incorporating national and Eurostat statistics.

Export market shares of goods % of world total (BPM5)



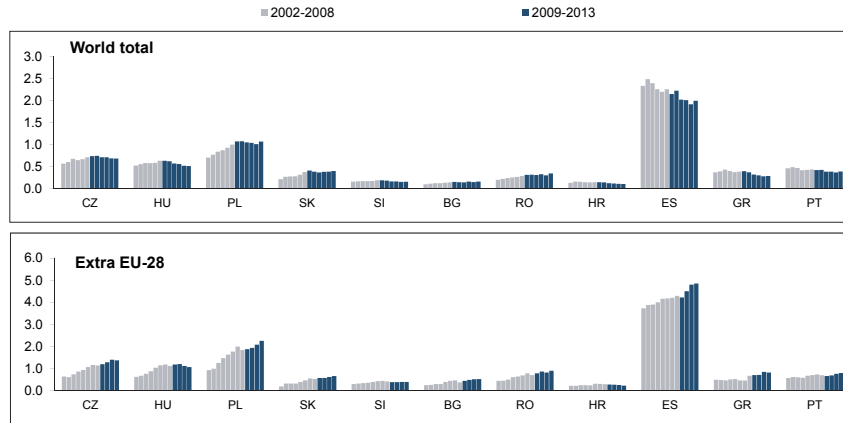
Source: wiiw Annual Database incorporating national and Eurostat statistics.

Export market shares of services % of world total (BPM5)



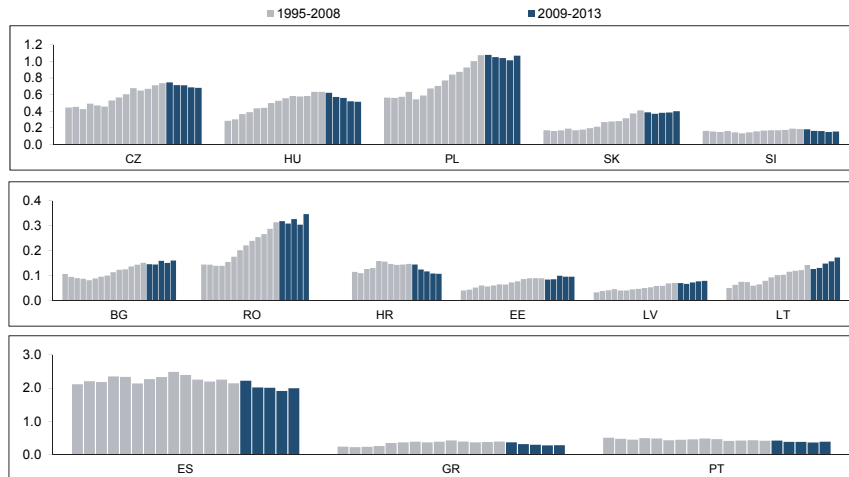
Source: wiiw Annual Database incorporating national and Eurostat statistics.

(Global) export market shares – 2002-2013
goods and services % of extra EU-28



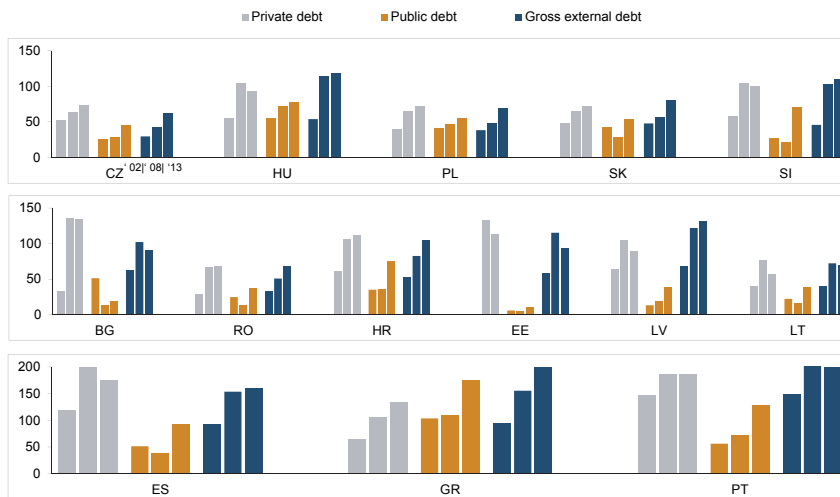
Source: wiiw Annual Database incorporating national and Eurostat statistics.

Export market shares of goods and services
% of world total (BPM5)



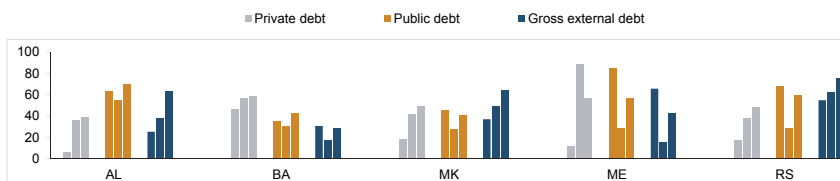
Source: wiiw Annual Database incorporating national and Eurostat statistics.

Debt in % of GDP, 2002, 2008, 2013



Remark: Data 2002: Private debt for LV, LT refers to 2004; public debt for GR refers to 2006; gross external debt for PT refers to 2003.
Source: wiiw Annual Database incorporating national and Eurostat statistics.

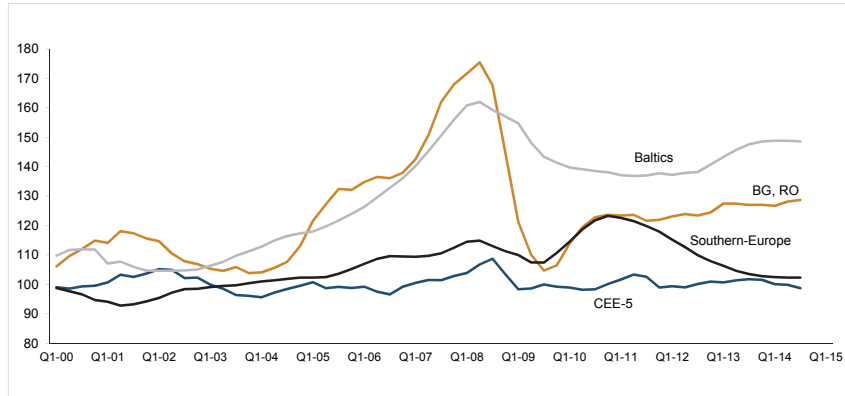
Debt in % of GDP, 2002, 2008, 2013



Remark: Data 2002: Private debt for MK, ME refers to 2003, for BA to 2006. BA and ME gross external public debt.
Source: wiiw Annual Database incorporating national and Eurostat statistics.

Real Effective Exchange Rates vs (rest of) EU-28
(average 1994-2004 = 100) – 2000Q1 – 2015Q1

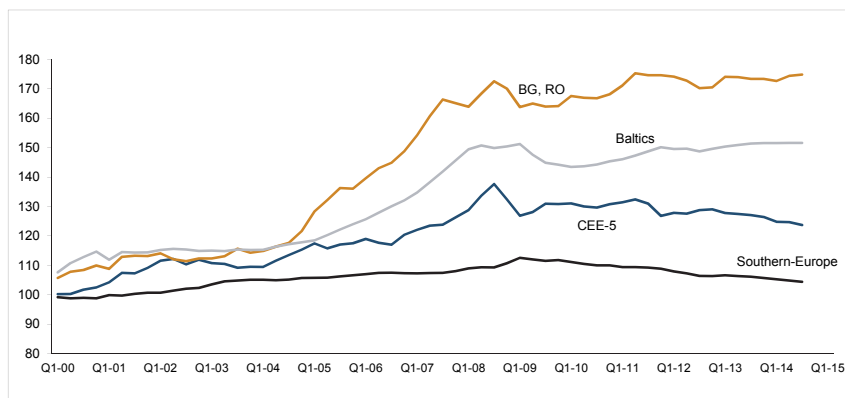
Nominal unit wage costs, manufacturing



Source: AMECO, own calculations.

Quarterly Real Effective Exchange Rates vs (rest of) EU-28 (average 1994-2004 = 100)

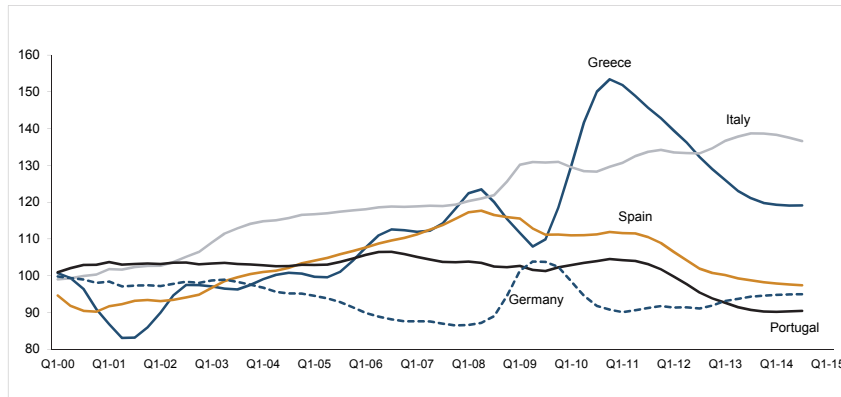
Price deflator GDP, market prices



Source: AMECO, own calculations.

Real Effective Exchange Rates vs (rest of) EU-28 (average 1994-2004 = 100)

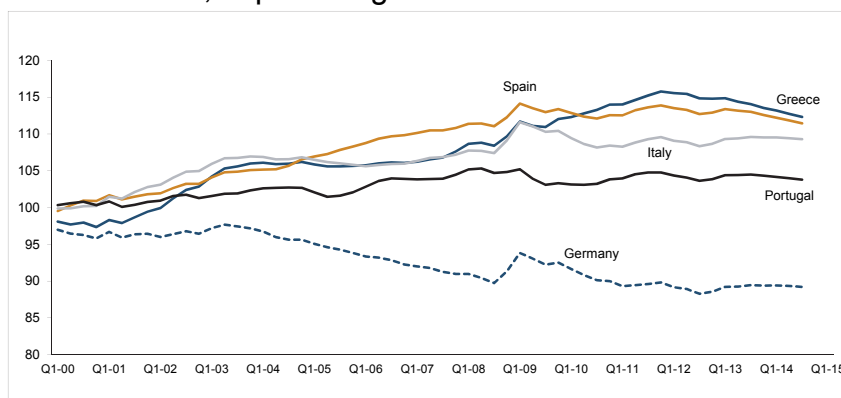
Nominal unit wage costs, manufacturing



Source: AMECO, own calculations.

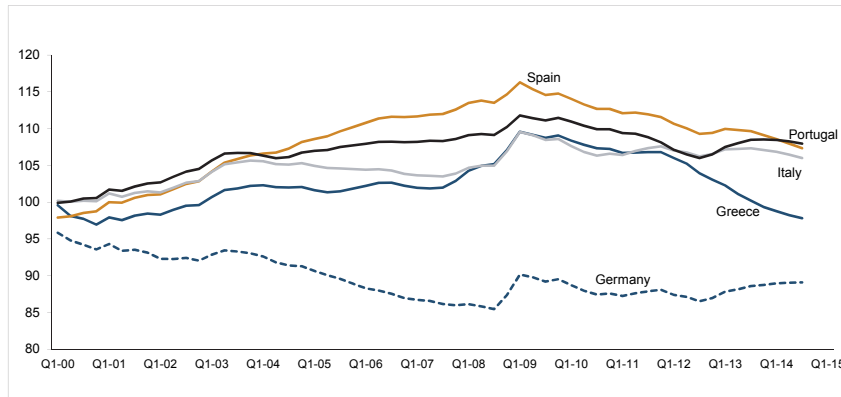
Quarterly Real Effective Exchange Rates vs (rest of) EU-28 (average 1994-2004 = 100)

Price deflator, exports of goods and services



Source: AMECO, own calculations.

Quarterly Real Effective Exchange Rates vs (rest of) EU-28 (average 1994-2004 = 100)
Price deflator GDP, market prices

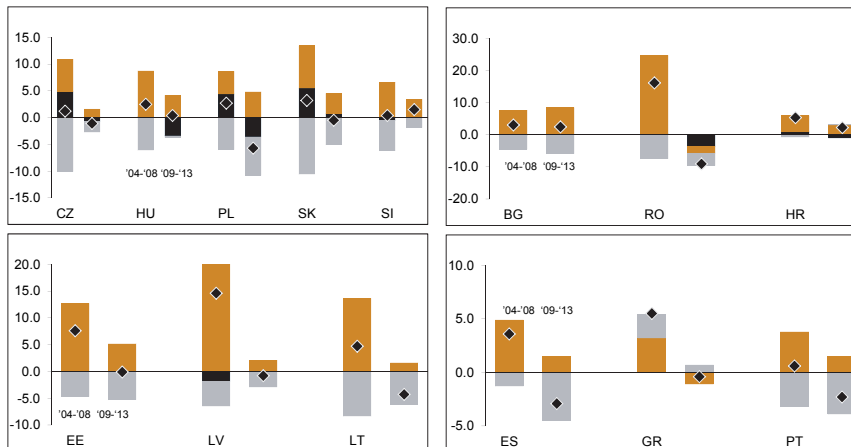


Source: AMECO, own calculations.

Components of ULCs – Changes: 2004-2008, 2009-2013

Manufacturing

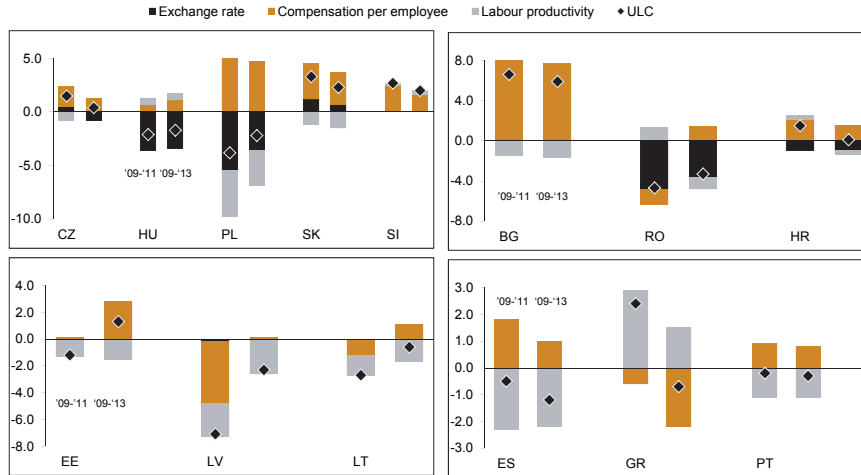
■ Exchange rate ■ Compensation per employee ■ Labour productivity ◆ ULC



Source: wiiw Annual Database incorporating national and Eurostat statistics.

Components of ULCs – Changes: 2009-2011, 2009-2013

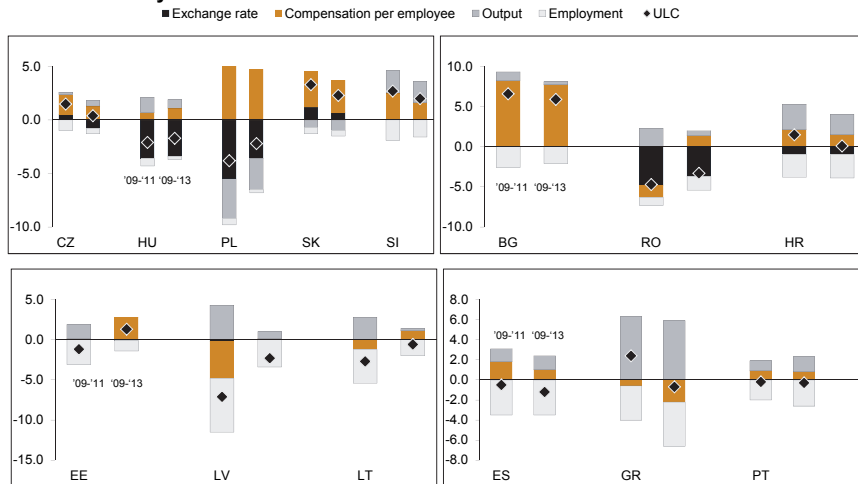
Total economy



Source: wiiw Annual Database incorporating national and Eurostat statistics.

Components of ULCs – Changes: 2009-2011, 2009-2013

Total economy

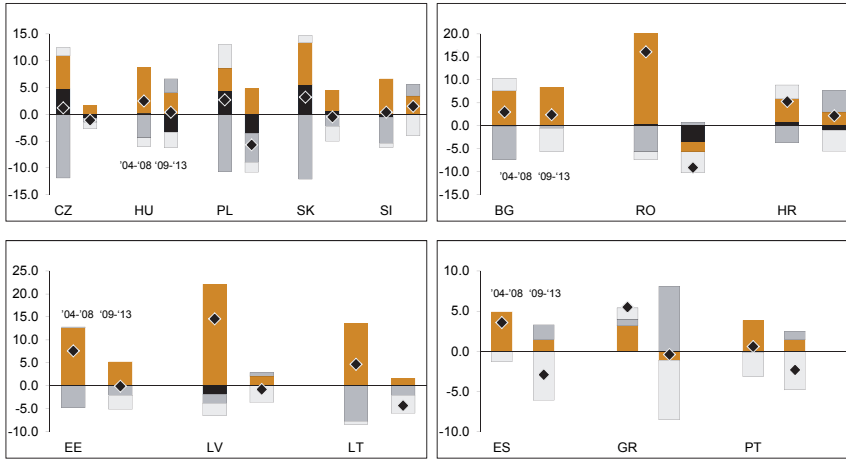


Source: wiiw Annual Database incorporating national and Eurostat statistics.

Components of ULCs – Changes: 2004-2008, 2009-2013

Manufacturing

■ Exchange rate ■ Compensation per employee ■ Output ■ Employment ◆ ULC

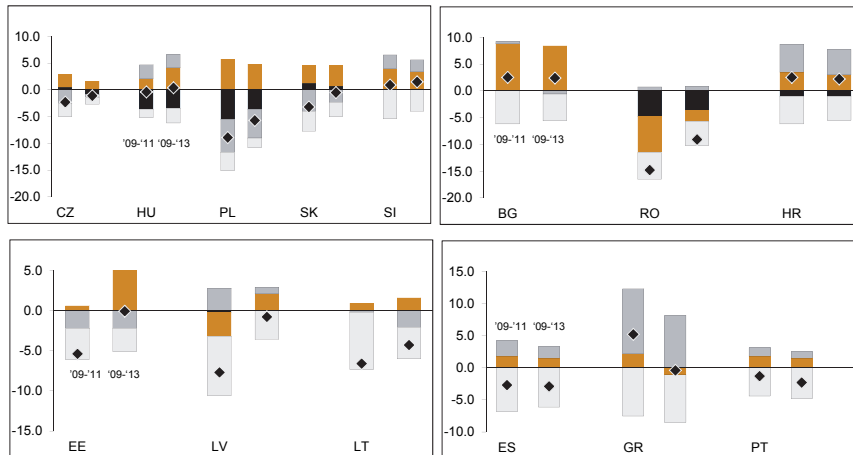


Source: wiiw Annual Database incorporating national and Eurostat statistics.

Components of ULCs – Changes: 2009-2011, 2009-2013

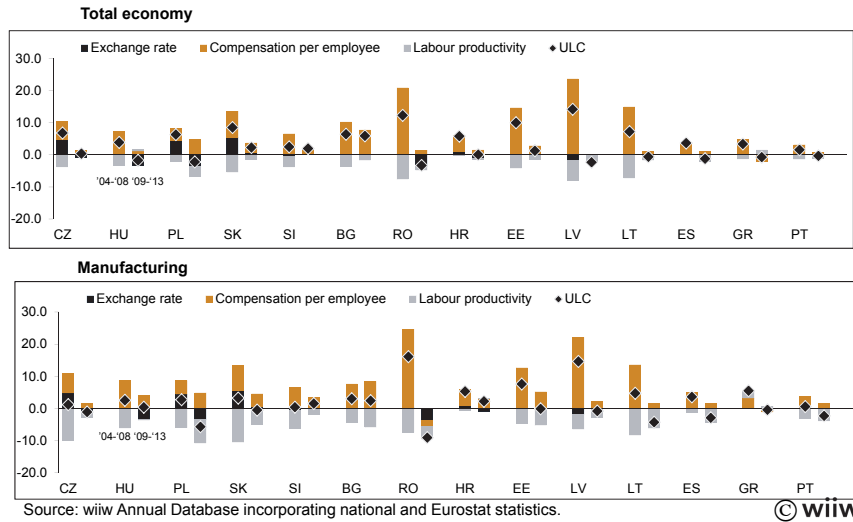
Manufacturing

■ Exchange rate ■ Compensation per employee ■ Output ■ Employment ◆ ULC

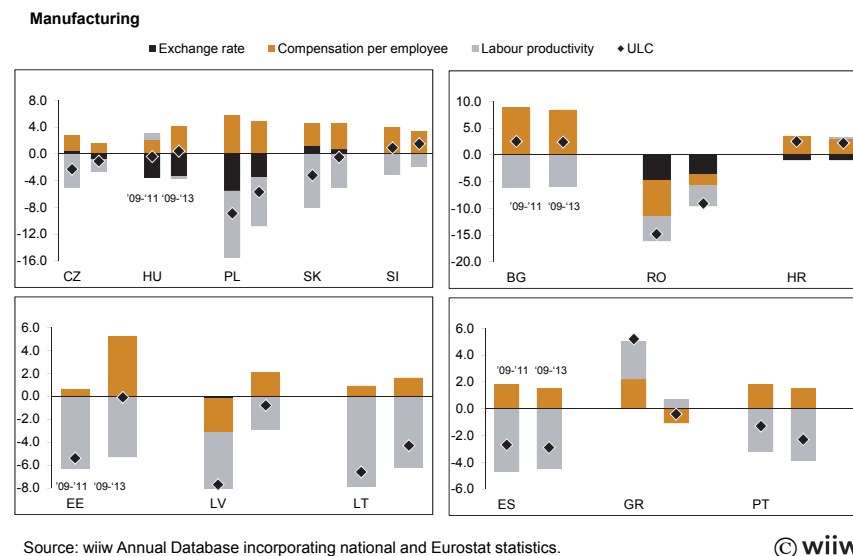


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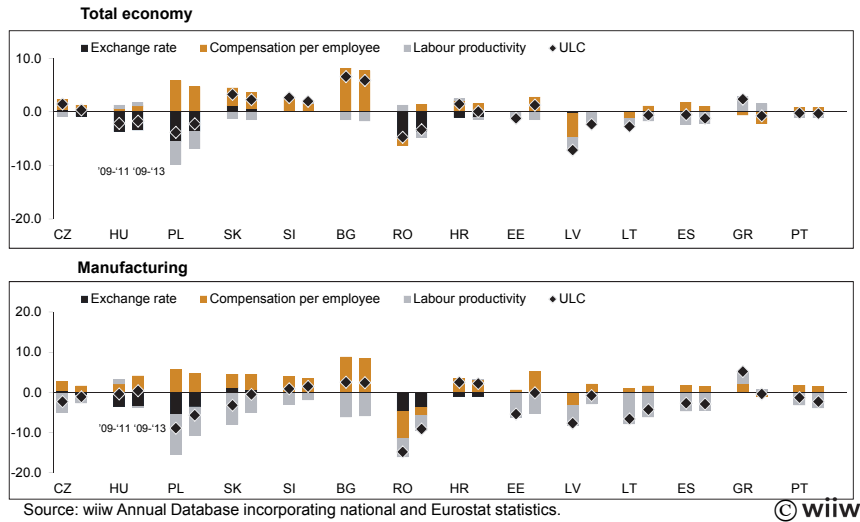
Components of ULCs, 2004-2008, 2009-2013



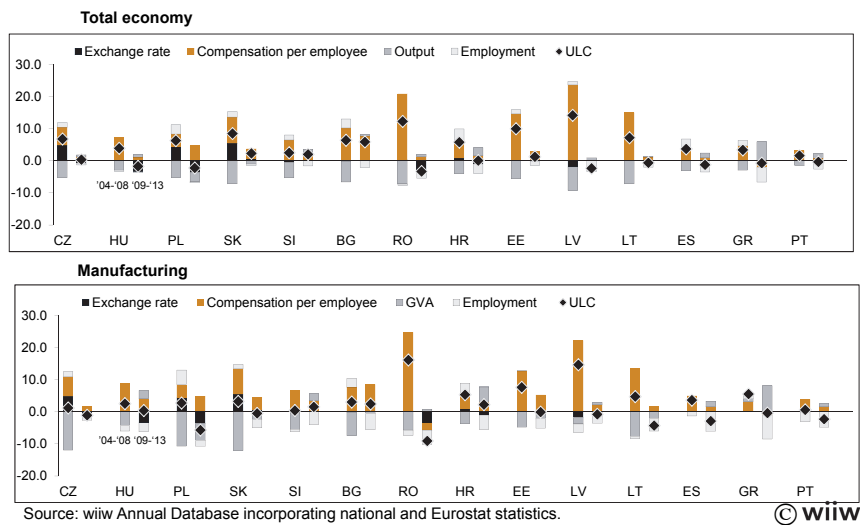
Components of ULCs, 2009-2011, 2009-2013



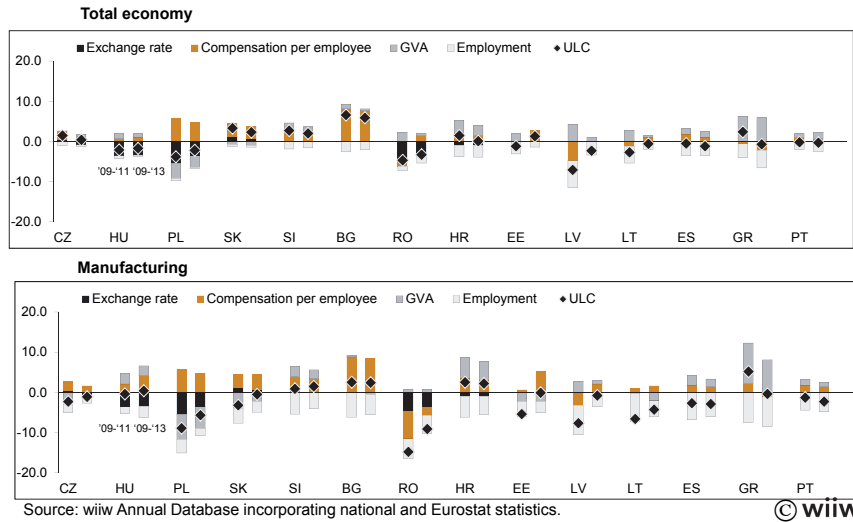
Components of ULCs, 2009-2011, 2009-2013



Components of ULCs, 2004-2008, 2009-2013

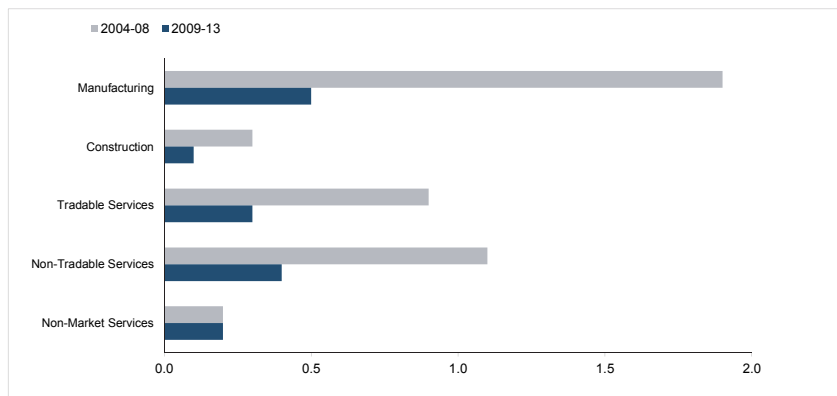


Components of ULCs, 2009-2011, 2009-2013



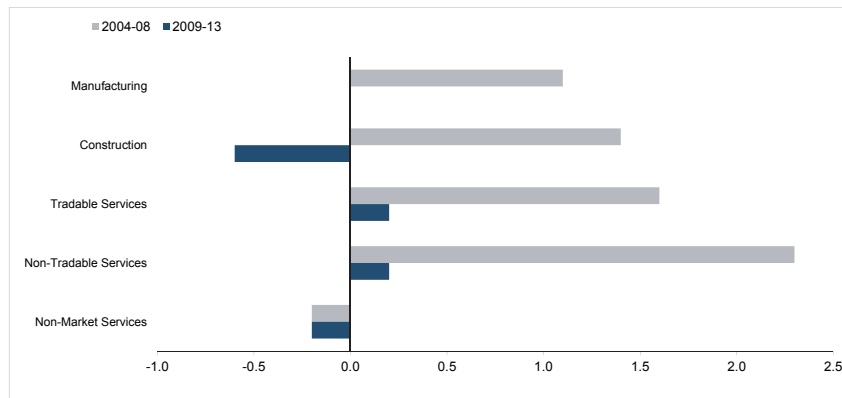
CEE-5

Contributions to GDP by activities growth rates, constant prices, in percentage points



BG, RO

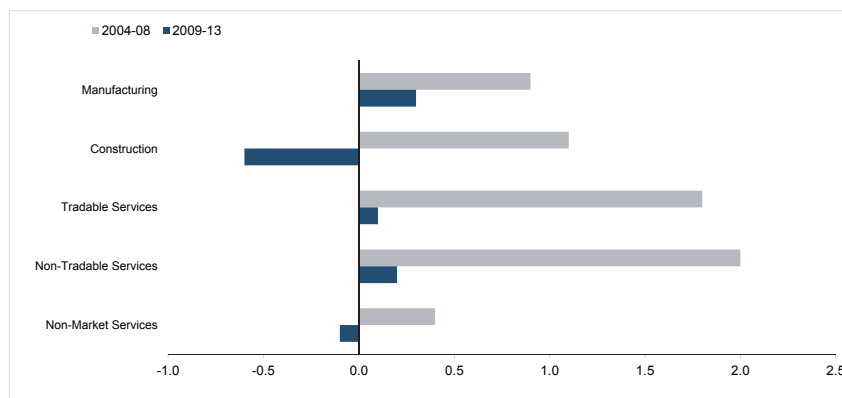
Contributions to GDP by activities growth rates, constant prices, in percentage points



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculations.

Baltics

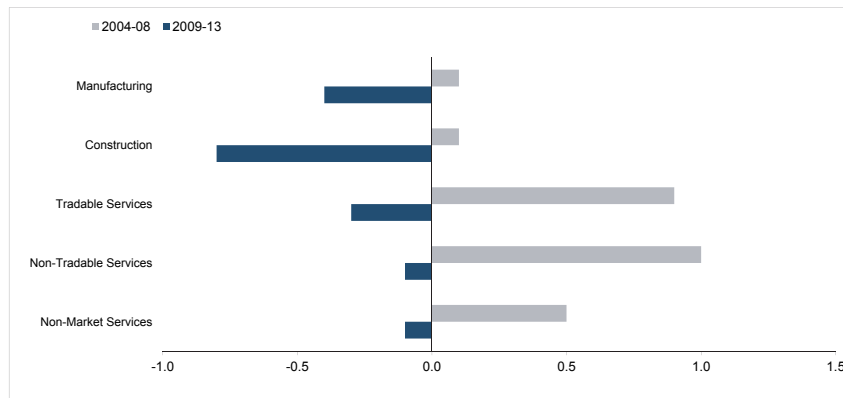
Contributions to GDP by activities growth rates, constant prices, in percentage points



Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculations.

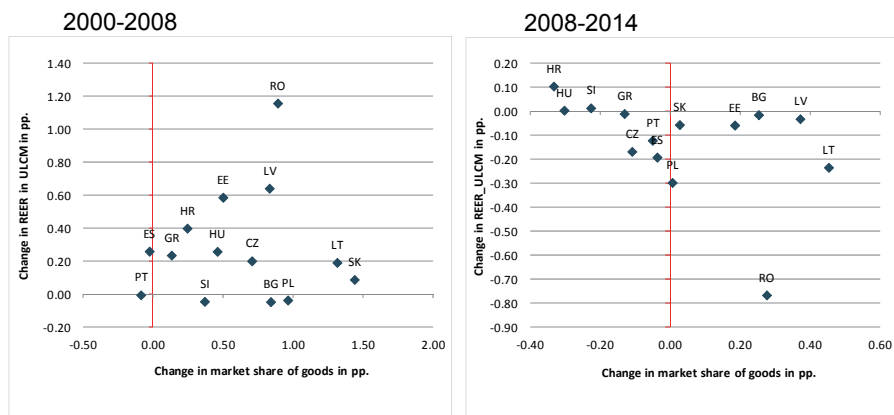
ES, GR, PT

Contributions to GDP by activities growth rates, constant prices, in percentage points



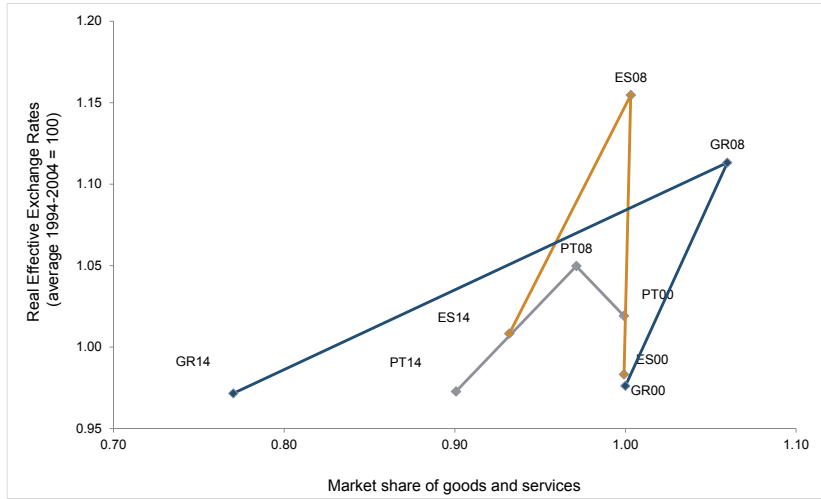
Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculations.

Change in global export market shares and change in REER - Manufacturing, pp changes – 2000–2008 and 2008-2014



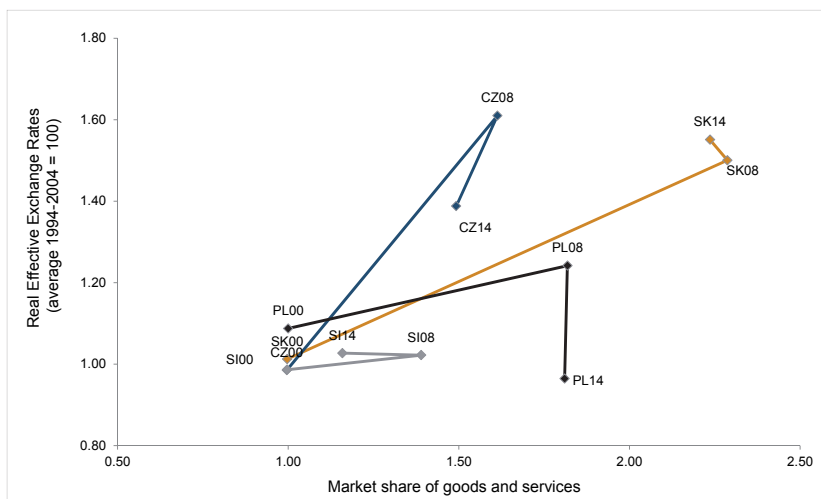
Source: AMECO Database, Eurostat.

Total economy – ES, GR, PT



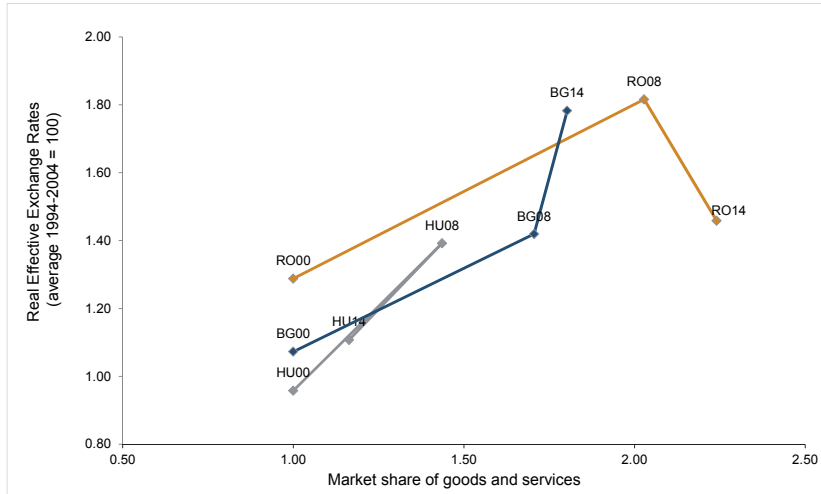
Remark: Quarterly Real Effective Exchange Rates vs (rest of) EU-28. Nominal unit labour costs.
Source: AMECO Database, Eurostat.

Total economy – CZ, PL, SI, SK



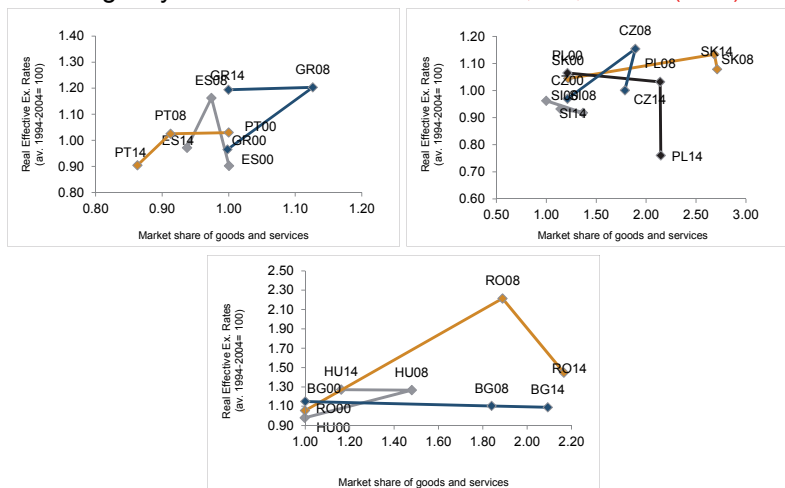
Remark: Quarterly Real Effective Exchange Rates vs (rest of) EU-28. Nominal unit labour costs.
Source: AMECO Database, Eurostat.

Total economy – BG, RO, HU



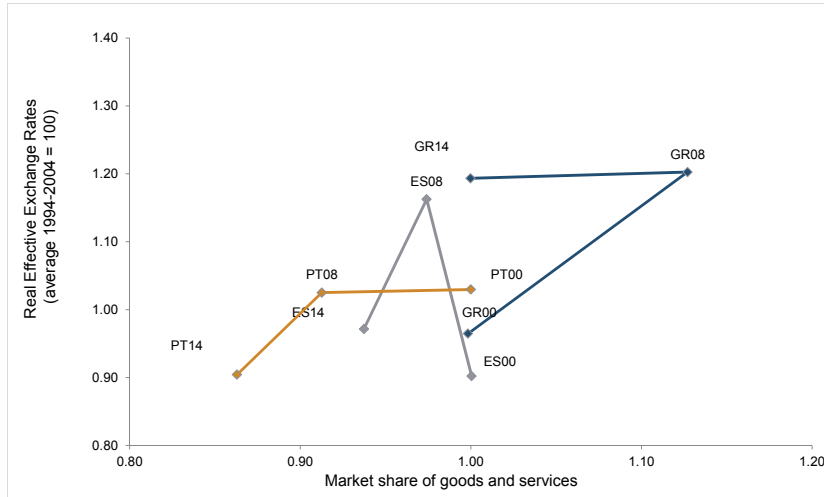
Remark: Quarterly Real Effective Exchange Rates vs (rest of) EU-28. Nominal unit labour costs.
Source: AMECO Database, Eurostat.

Change in global market shares and change in REER: 2000, 08, 14, manufacturing only – Check difference between ES, GR, PT and (most) others



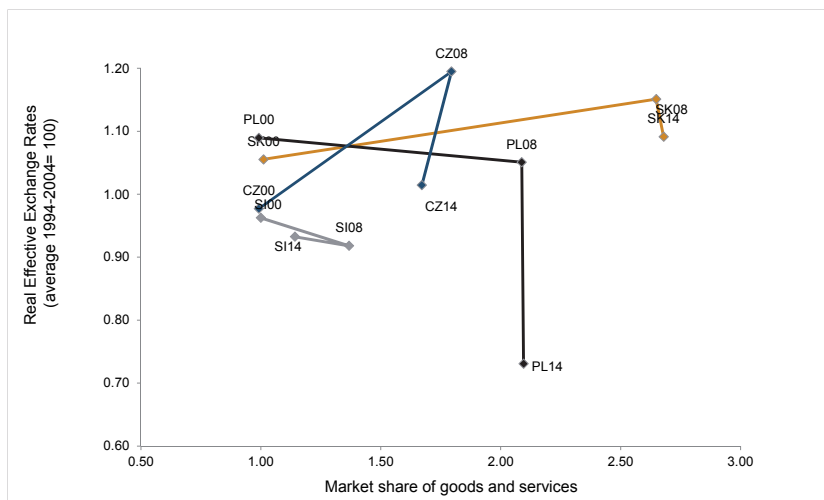
Source: wiiw Annual Database incorporating national and Eurostat statistics, own calculations.

Manufacturing – ES, GR, PT



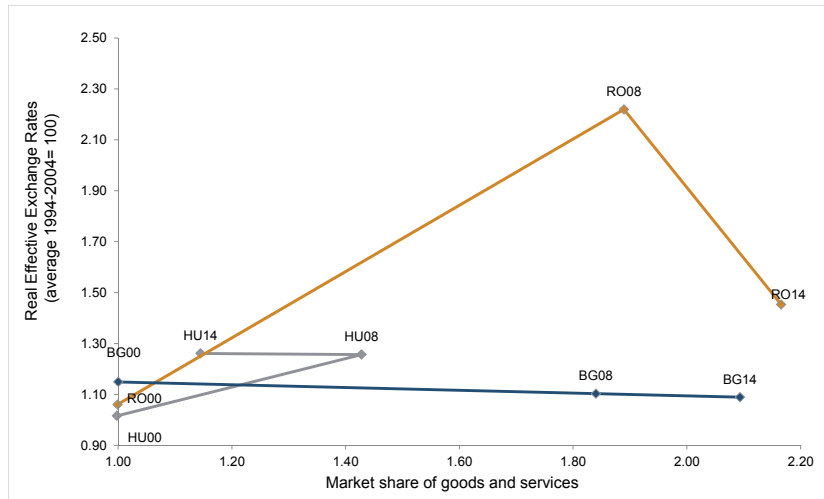
Remark: Quarterly Real Effective Exchange Rates vs (rest of) EU-28. Nominal unit labour costs.
Source: AMECO Database, Eurostat.

Manufacturing – CZ, PL, SK, SI



Remark: Quarterly Real Effective Exchange Rates vs (rest of) EU-28. Nominal unit labour costs.
Source: AMECO Database, Eurostat.

Manufacturing – BG, RO, HU



Remark: Quarterly Real Effective Exchange Rates vs (rest of) EU-28. Nominal unit labour costs.
Source: AMECO Database, Eurostat.

Country codes

AT	Austria	IE	Ireland
BE	Belgium	IT	Italy
BG	Bulgaria	LT	Lithuania
CY	Cyprus	LU	Luxembourg
CZ	Czech Republic	LV	Latvia
DE	Germany	MT	Malta
DK	Denmark	NL	Netherlands
EE	Estonia	PL	Poland
GR	Greece	PT	Portugal
ES	Spain	RO	Romania
FI	Finland	SE	Sweden
FR	France	SI	Slovenia
HR	Croatia	SK	Slovakia
HU	Hungary	UK	United Kingdom
CESEE	Central, East and Southeast Europe		
NMS	New Member States	RoW	Rest of the World