External rebalancing is it cyclical or structural?

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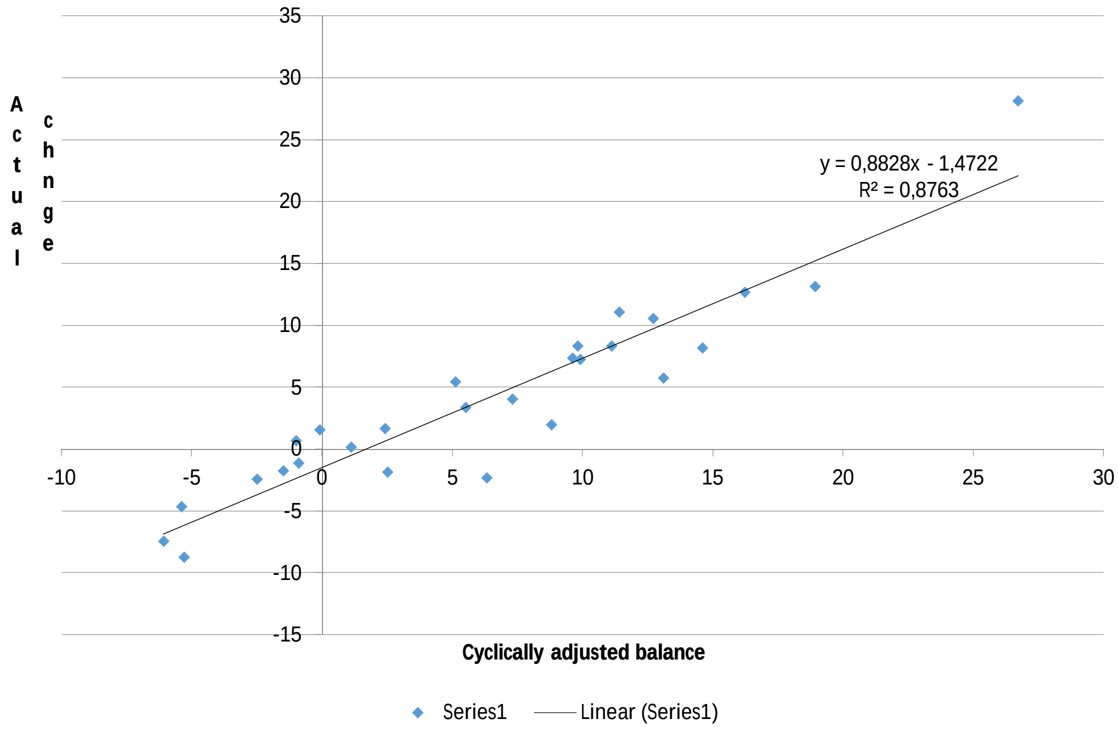
Rebalancing

- Large improvement in current account balances throughout most of EU, particular in CEECs.
- Average for EU 6.3 % of GDP
- CEECs: often double digit!
- But little general correlation between size and sign of initial ‘imbalance’ and subsequent change.
- => Not rebalancing, but general shift.
- Recent study of Commission calculates ‘cyclically adjusted change in current account imbalance’ (by subtracting impact of lower demand on imports).

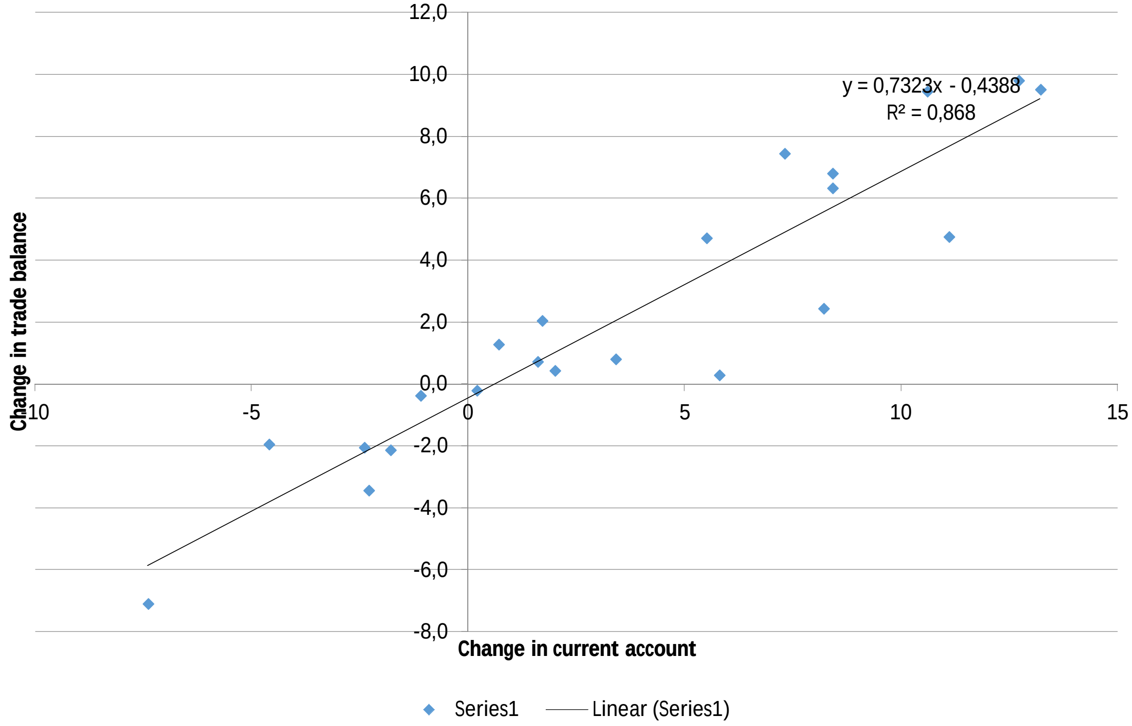
Was it just import compression?

- Actual and cyclically adjusted current account balances similar across countries (chart).
- Current account versus balance on goods and services. Factor payments and EU funds make a substantial difference for most CEECs (savings on factor payments).
- But is non-cyclical = structural?

In general cyclically adjusted change smaller than actual (6.3 versus 4.1).



Current account different from trade balance (which matters for jobs).



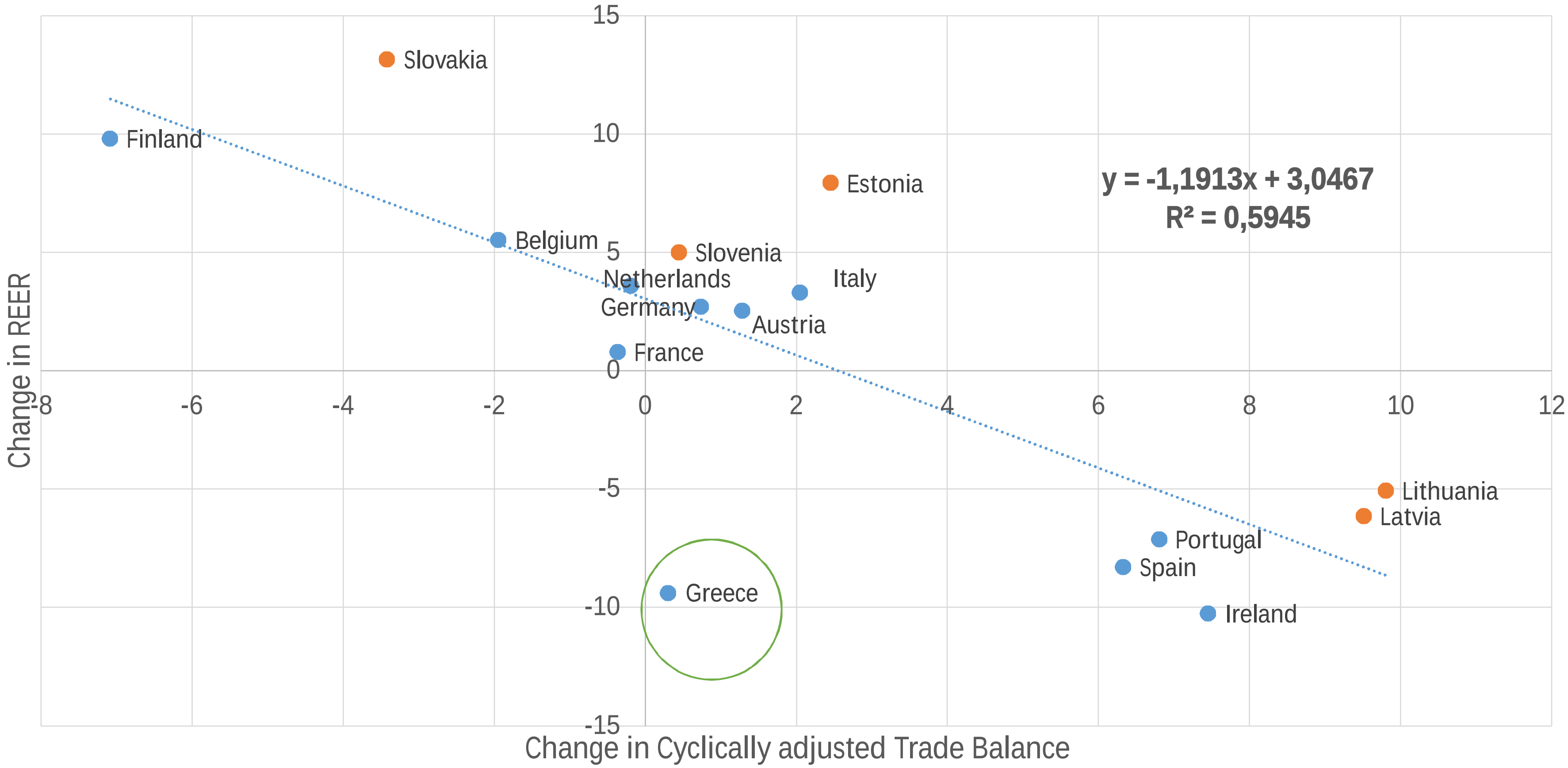
With a little help from lower interest rates

- Current account balance key for external debt sustainability.
- Trade balance key for jobs.
- On average difference small (about 1 % of GDP).
- In CEECs difference between current account and trade balance large, often several times larger (lower factor payments).
- Greece again outlier with 5 % of GDP gain through lower factor payments (result of debt cut plus lower interest rate).

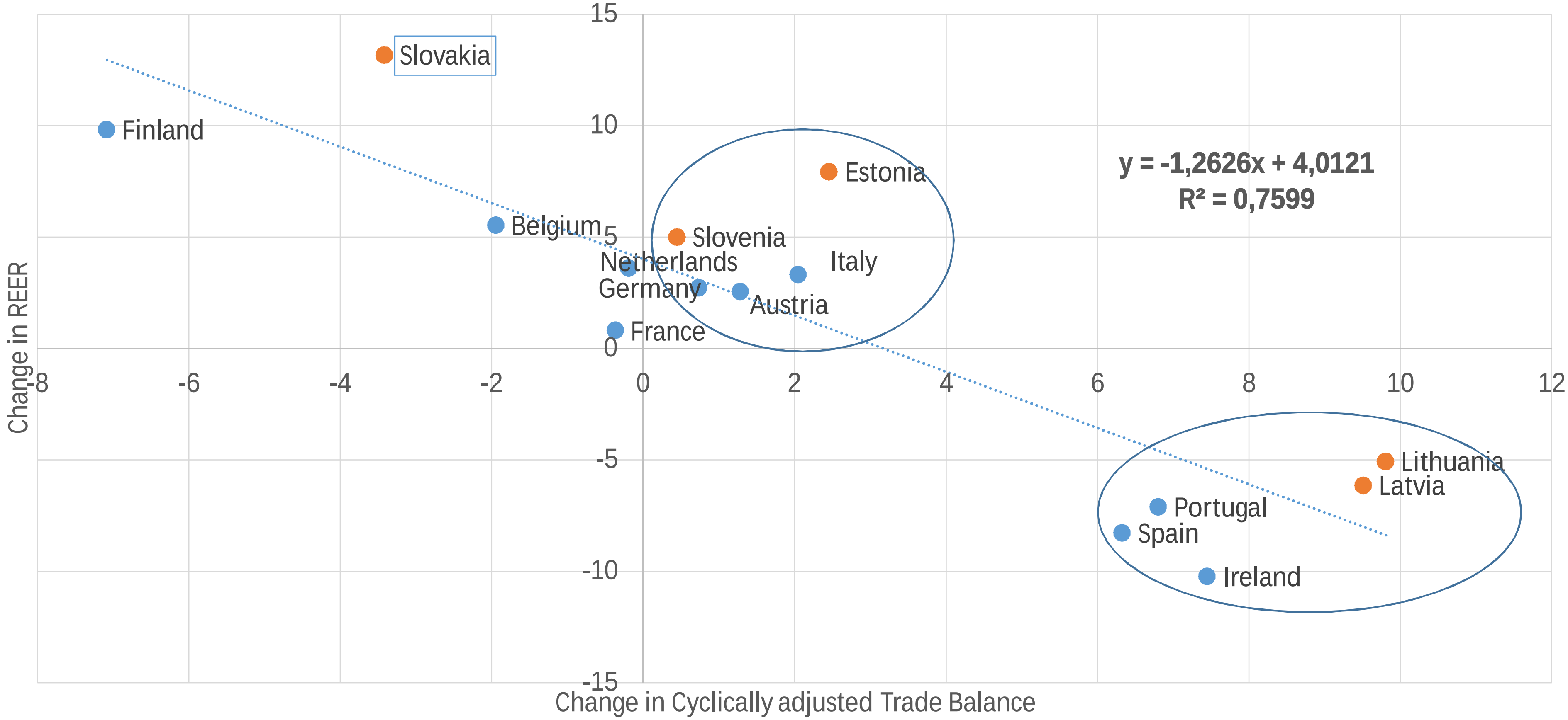
Trade flows did adjust

- Trade balance improvement key for keeping jobs (especially throughout CEECs as domestic demand boom fueled by foreign capital ended in 2008).
- What explains differences across countries in (cyclically adjusted) trade balances (good and services)?
- Real exchange rate?
- Foreign market growth?
- Are the CEECs special?

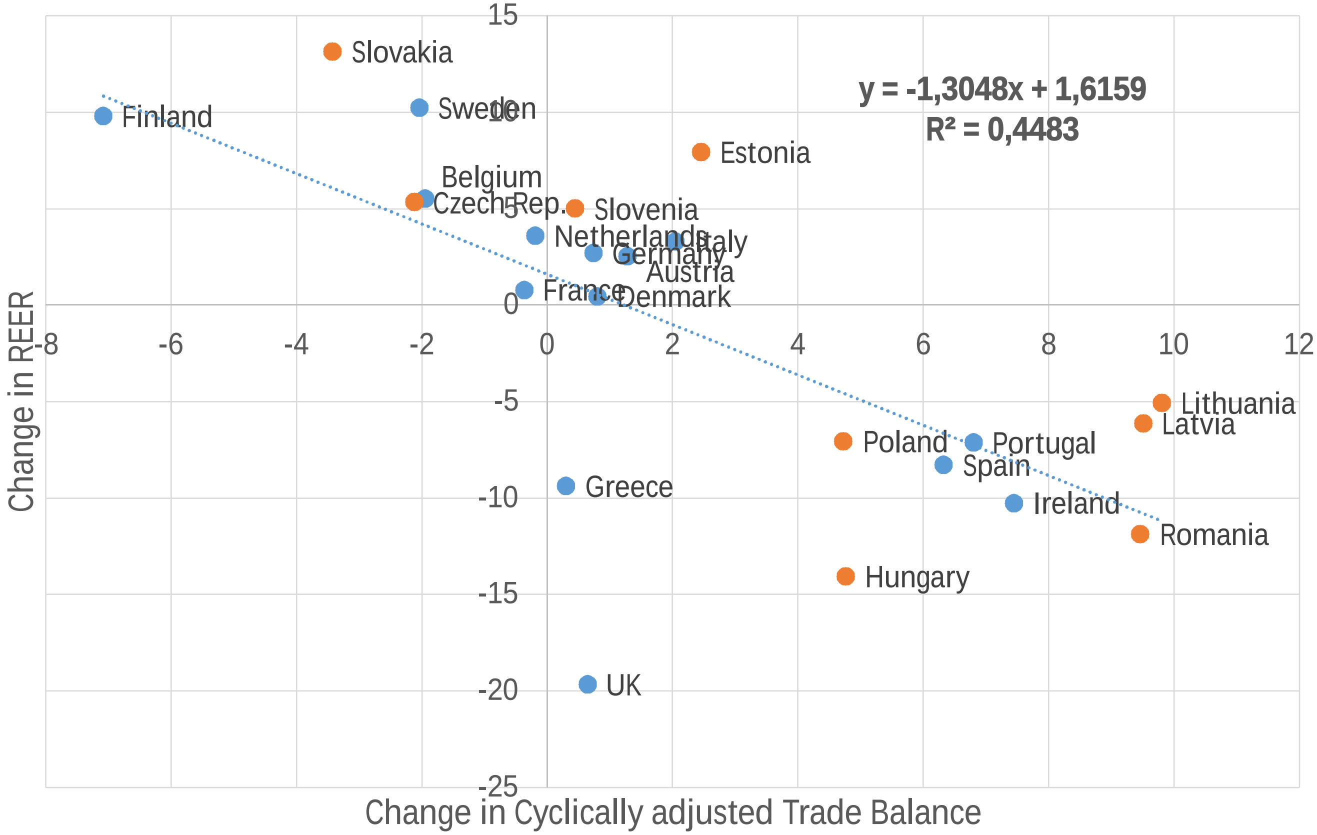
REER and cyclically adjusted Trade Balance in the euro zone



REER and cyclically adjusted Trade Balance in the euro zone excl. Greece correlation tighter



REER and the cyclically adjusted Trade Balance across the EU



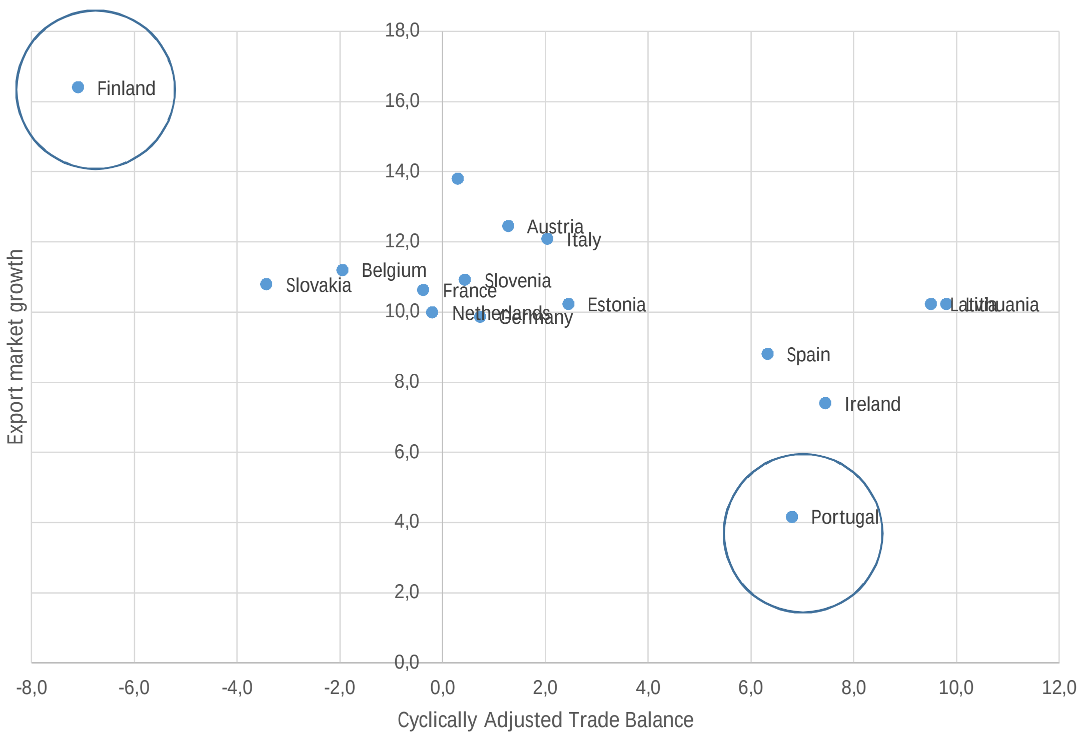
Results for link between REER and the cyclically adjusted Trade Balance

- Strong relationship within euro zone, but not outside!
- Large changes in relative competitiveness across euro area.
- Greece and UK outliers.
- Euro area CEECs special, usually better than predicted
- Non euro CEECs dispersed.

Determinants of cyclically adjusted Trade Balance

- What matters more for cyclically adjusted trade balance: real exchange rate or export market growth?
- Expect positive correlation: stronger export market growth should help rebalancing.
- Until Russia/Ukraine crisis: CEECs sit between sluggish euro area and dynamic Russian market.

Difficult to believe: Export market growth and trade balance but outliers dominate (Fin, PT)



Determinants of cyclically adjusted Trade Balance

- What matters more for cyclically adjusted trade balance: real exchange rate or export market growth?
- Real exchange rate (= competitiveness) seem to matter more.
- No ‘normal’ relationship between export market growth (OECD indicator, not available for all countries) and trade balance (cyclically adjusted).
- Outliers dominate:
- Finland: Nokia decline dominates dynamic Russian market
- Portugal: Switch to Angola (EMEs) dominates collapse of Spain.

Conclusions

- Large improvement in current account imbalances, but little link between original imbalance and subsequent change, i.e. not real re-balancing (movement asymmetric as surplus countries keep surplus).
- Trade balance more important for jobs than current account (difference between the two large for CEECs).
- Actual and cyclical tightly linked: most actual is also ‘non cyclical’.
- Competitiveness most important factor with two outliers: Greece and UK.
- ‘Structural’ = non cyclical, but not due to relative costs: improvement rare.