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).

\[ y = 0.7323x - 0.4388 \]

\[ R^2 = 0.868 \]
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

$y = -1.1913x + 3.0467$

$R^2 = 0.5945$
REER and cyclically adjusted Trade Balance in the euro zone excl. Greece correlation tighter

\[ y = -1.2626x + 4.0121 \]

\[ R^2 = 0.7599 \]
REER and the cyclically adjusted Trade Balance across the EU

![Graph showing the relationship between REER and cyclically adjusted Trade Balance across the EU. The graph includes data points for various EU countries and a linear regression line with the equation: \( y = -1.3048x + 1.6159 \). The coefficient of determination, \( R^2 = 0.4483 \), indicates the proportion of variance in the cyclically adjusted Trade Balance explained by the change in REER.](image)
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.