Economic divergences within the Euro area: lessons for EMU enlargement

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1. Microeconomic impact of the euro

• Limited aggregate impact:
  ➢ The euro would have raised intra-zone trade by 6% (Micco et al. 2003)
  ➢ No impact on consumption prices

• Microeconomic gains:
  ➢ More competition (export prices)
  ➢ More varieties
Evolution of French exports

Composition of growth in value of French manufacturing exports between 1998 and 2003 according to destination, in %

Impact of the euro (econometric analysis)

Impact of the euro on French export prices

Gap between export prices to specific areas and average export prices

Source: Méjean & Martin (2009).

Lower prices towards the Eurozone
Impact of the euro on French export prices

Intensive and extensive margins

EMU

Rest of the OECD

Mean price deviation (in %) with respect to the OECD average, computed on intensive and extensive flows.

Source: Méjean & Martin (2009).
Intensive margins: (firm, product) couples that are present during the whole time sample.

The extensive margins has made the difference
Impact of the euro on French export prices

Before 1999, average price dispersion is lower by 5% in the Eurozone compared to other OECD markets; after the introduction of the euro, the gap is close to 7%.
Still, little price convergence within the Eurozone

Coefficient of variation of consumption prices, including indirect taxes, in %

Source: Eurostat, structural indicators.
Tax divergence?

Standard deviation of standard VAT rates in the Eurozone12

Source: Author’s calculations based on European Commission.
Reform fatigue?

Regulatory conditions in retail distribution

2. Macroeconomic gains & costs

Credibility gains

Graph 2 – Eurozone inflation rates

Table 1 – Average inflation rates – 1999 – 2008, in %

<table>
<thead>
<tr>
<th>Country</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Greece</td>
<td>3.3</td>
</tr>
<tr>
<td>Spain</td>
<td>3.2</td>
</tr>
<tr>
<td>Ireland</td>
<td>3.0</td>
</tr>
<tr>
<td>Portugal</td>
<td>2.9</td>
</tr>
<tr>
<td>Luxembourg</td>
<td>2.8</td>
</tr>
<tr>
<td>Italy</td>
<td>2.4</td>
</tr>
<tr>
<td>Netherlands</td>
<td>2.4</td>
</tr>
<tr>
<td>Belgium</td>
<td>2.2</td>
</tr>
<tr>
<td><strong>Euro zone</strong></td>
<td><strong>2.2</strong></td>
</tr>
<tr>
<td>France</td>
<td>1.9</td>
</tr>
<tr>
<td>Austria</td>
<td>1.9</td>
</tr>
<tr>
<td>Germany</td>
<td>1.7</td>
</tr>
</tbody>
</table>

* Year-on-year variation in the consumer price index.

*Source*: Eurostat.
One size does not fit all
Real interest rates (3 months)

Source: OECD.
Internal divergences 1

Loans to Euro area households
(% change per annum)

Source: ECB.

Spain

Euro area
Internal divergences 2

Bilateral competitiveness

Source: OECD.
3. Inadequate policy surveillance

Excess focus on public savings

Fiscal balance and current account (% of GDP)

Source: OECD.
Apparent virtue

General government balance


Inflated tax receipts

Graph IV.2.3: Property taxes in 1999 and 2007 (% of GDP)

Notes: Includes taxes on property values and transactions.
Source: OECD and Commission services.
« Sudden stops »

Current account balance (% of GDP)

Source: European Commission, Spring 2009 forecasts.
4. Challenges for EMU enlargement

Price convergence implies higher inflation in some countries!

Inflation rates 2006-2036, Euro27

Risks

Higher inflation → Lower real interest rate → Leverage → Bubbles

Solutions

Fiscal policy → Structural reforms
Financial regulation → Taxation
Markets are alive!

10-year sovereign debt yields (%)

Source: Datastream.