



Cost competitiveness and euro area rebalancing*

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* Preliminary results – please do not cite

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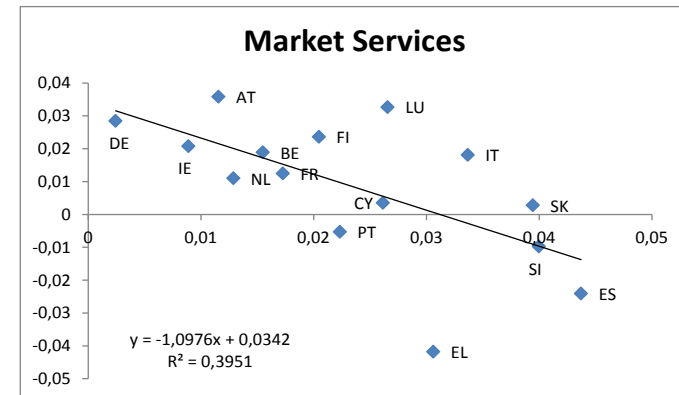
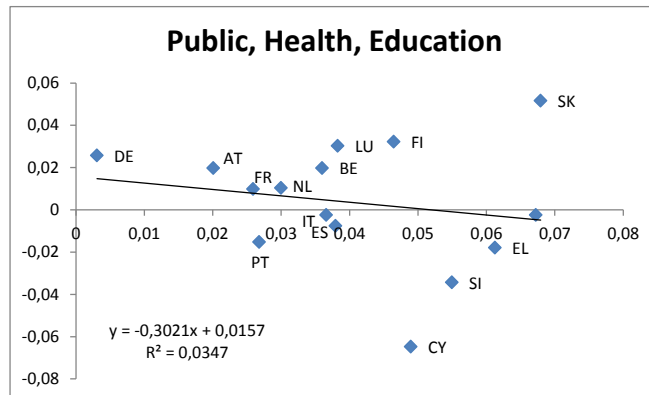
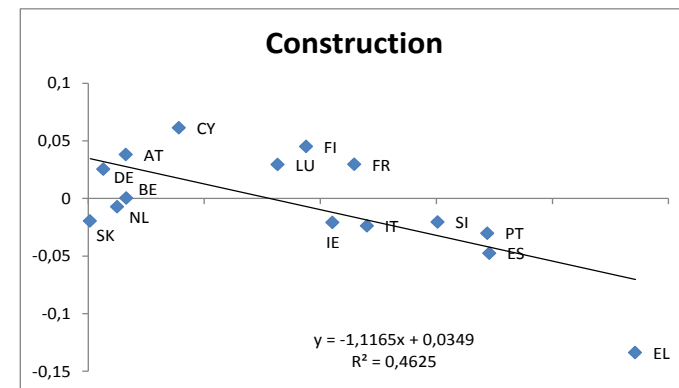
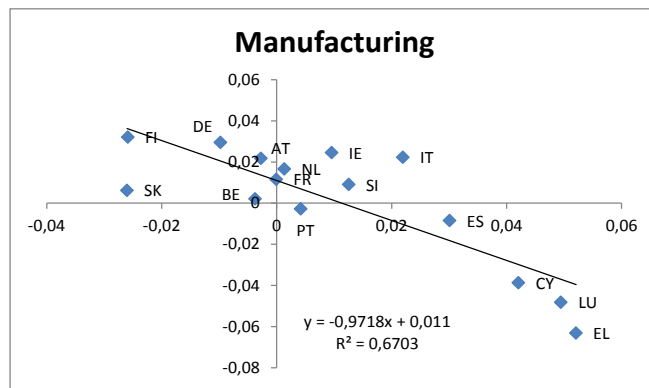
Outline

- *Introduction and motivation*
- *ULC and trade balance adjustment: stylized facts*
- *ULCs and export performance*
- *Econometric results*
- *Conclusions*

Motivation

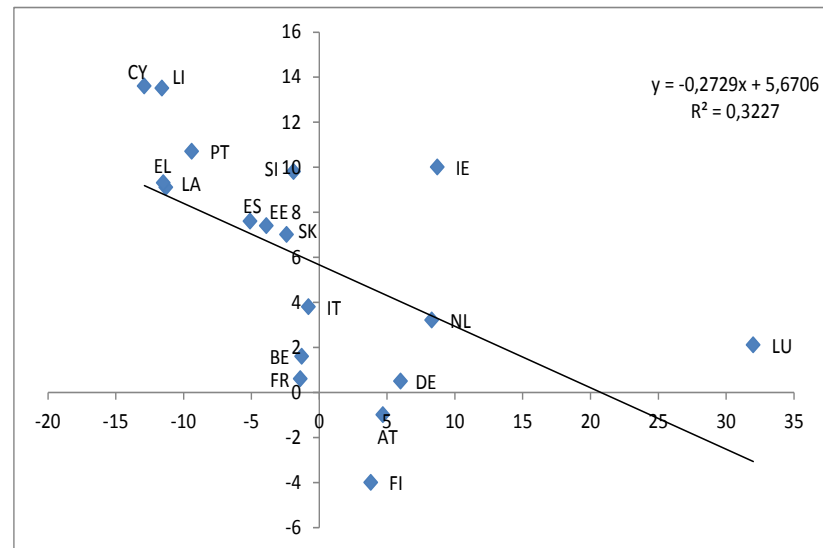
- *The importance of price- and cost-competitiveness*
- *The sectoral dimension of ULCs and the spillovers*
- *A euro area dimension: the peculiarity of the monetary union*
- *"Rebalancing" and export performance*

Adjustment in sectoral ULCs



Note: average annual % growth in ULCs before the crisis (2001-08) on the horizontal axis and during the adjustment period (2012-14) on the vertical axis in EMU countries

Adjustment in Trade Balances



Note: Trade Balance in 2008 on the horizontal axis and change 2008-2014 on the vertical axis. A negative relation implies rebalancing of the Trade Balance.

ULCs and export performance

- *A standard export equation:*

$$\Delta exp_{ijt} = \beta_{0i} + \beta_1 \Delta gdp_{jt} + \beta_2 \Delta rel_ulc_{ijt} + \beta_3 \theta_t + \varepsilon_t$$

- Δexp_{ijt} = *bilateral export growth (%)*
- Δgdp_{jt} = *GDP growth in partner country*
- Δrel_ulc_{ijt} = *relative ULC growth*

Asymmetries and heterogeneities

- *We account for asymmetric effects of cost competitiveness changes...*

- $\Delta rel_ulc_{ijt}^+ = \begin{cases} \Delta rel_ulc_{ijt} & \text{if } \Delta rel_ulc_{ijt} > 0 \\ 0 & \text{otherwise} \end{cases}$; $\Delta rel_ulc_{ijt}^- = \begin{cases} \Delta rel_ulc_{ijt} & \text{if } \Delta rel_ulc_{ijt} \leq 0 \\ 0 & \text{otherwise} \end{cases}$

- *...And correct for cross-country heterogeneities that may stem from export quality*

- *Multiplying ULC by an average export quality ranking based on Vandebussche (2014)*

$$\Delta exp_{ijt} = \gamma_{0i} + \gamma_1 \Delta gdp_{jt} + \gamma_2 \Delta rel_ulc_{ijt}^+ + \gamma_3 \Delta rel_ulc_{ijt}^- + \gamma_4 \theta_t + \varepsilon_t$$

Data

- *Annual data 2001-2014*
- *15 euro area countries (i.e. excl. Malta, Luxembourg, Cyprus and Lithuania)*
- *Bilateral trade in goods, source: COMTRADE*
- *ULCs in Industry: source Eurostat (NACE-R2:B-E)*
- *Quality: based on Vandenbussche (2014). Avg. quality rank of manufacturing exports, (0-1)*

Export equation: asymmetric effects and heterogeneity

	Base model with asymmetric effects			Corrected for export quality		
	(1)	(2)	(3)	(4)	(5)	(6)
Dep. Var.: Δrex_p	Full sample	2001-08	2009-14	Full sample	2001-08	2009-14
$\Delta relulci^+$	-0.580*** (0.125)	-0.943*** (0.276)	-0.487*** (0.160)	-0.445*** (0.127)	-0.733*** (0.279)	-0.401** (0.164)
$\Delta relulci^-$	0.293** (0.126)	-0.057 (0.272)	0.321** (0.162)	0.197* (0.111)	-0.133 (0.227)	0.246** (0.121)
Δgdp_{par}	1.915*** (0.206)	0.897* (0.472)	2.693*** (0.319)	1.923*** (0.207)	0.800* (0.472)	2.725*** (0.321)
Constant	0.017 (0.011)	-0.019 (0.013)	0.010 (0.013)	0.014 (0.011)	-0.021* (0.013)	0.008 (0.013)
Country & Year FE	YES	YES	YES	YES	YES	YES
Obs.	1,882	814	1,068	1,882	814	1,068
R-squared	0.243	0.103	0.295	0.239	0.097	0.292
Asymm. test $\gamma_2 = -\gamma_3$ (p-value)	5.40** (0.02)	11.45*** (0.00)	1.12 (0.29)	4.43** (0.03)	9.76*** (0.00)	1.04 (0.31)

Robust standard errors in parentheses. *** p<0.01, ** p<0.05, * p<0.1

Conclusions

- *Adjustment both in trade balances and unit labour costs is occurring*
- *Cost-competitiveness matters for intra-EA export performance and is relevant for rebalancing*
- *Before the crisis, cost-competitiveness losses, rather than gains explained export performance. Since 2009, changes in both directions contributed, and the effect of changes in relative ULCs seems symmetric.*
- *Looking forward: further investigate such asymmetries and whether structural reforms played a role in reducing them.*
- *Quality is one of the elements defining non-cost competitiveness: while reducing ULCs can help in the short run, increases in quality are important for the long run.*