



EUROPEAN CENTRAL BANK

# **Inflation and competitiveness divergences in the euro area countries: causes, consequences and policy responses**

*Lucas Papademos*

**Vice-President of the European Central Bank**

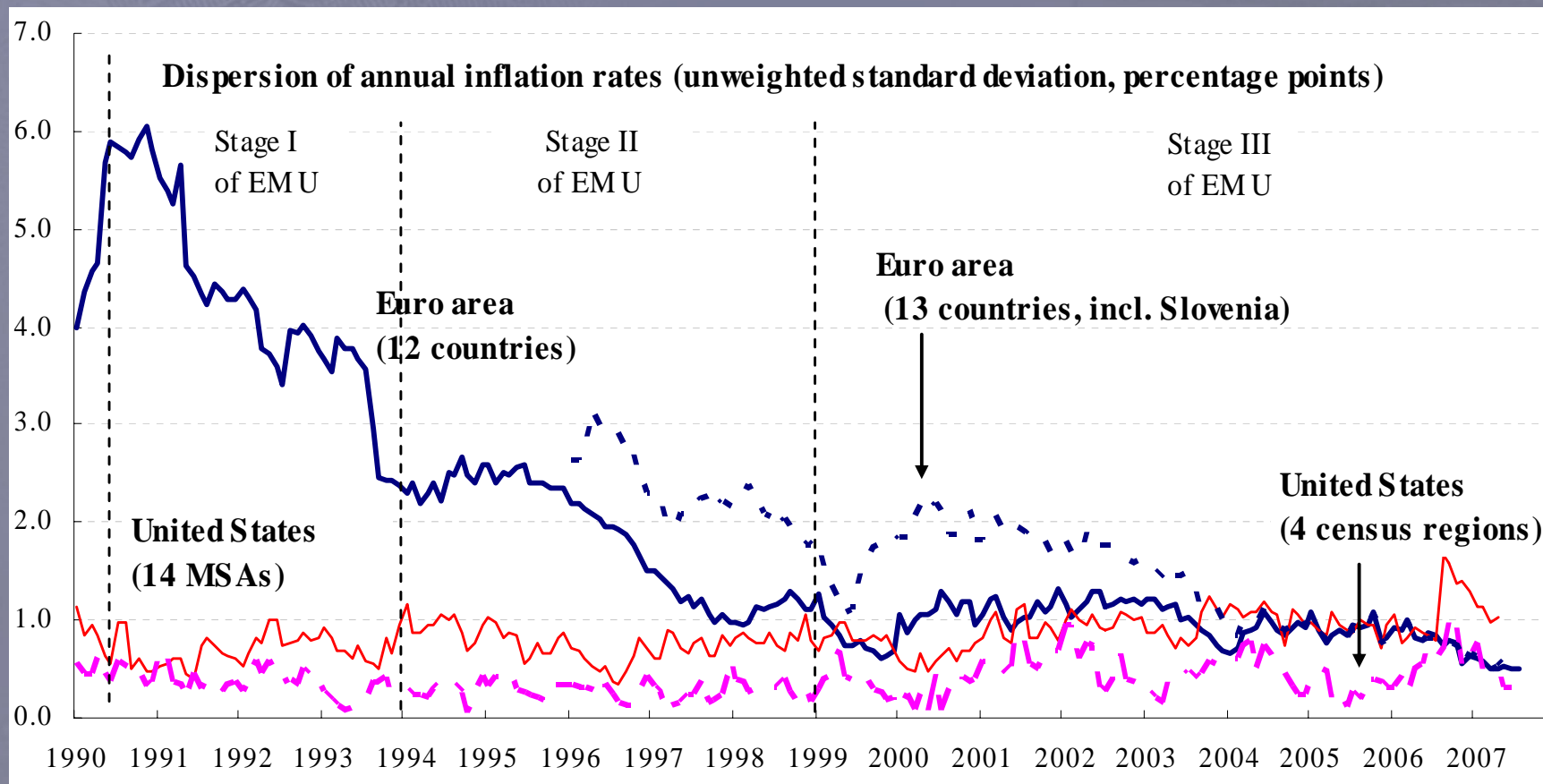
**The ECB and its Watchers IX**

**Frankfurt, 7 September 2007**

# Outline

- **Introduction**
- **Some stylised facts**
- **Causes of unit labour cost (ULC) growth differentials and consequences for economic performance**
- **Policy responses**

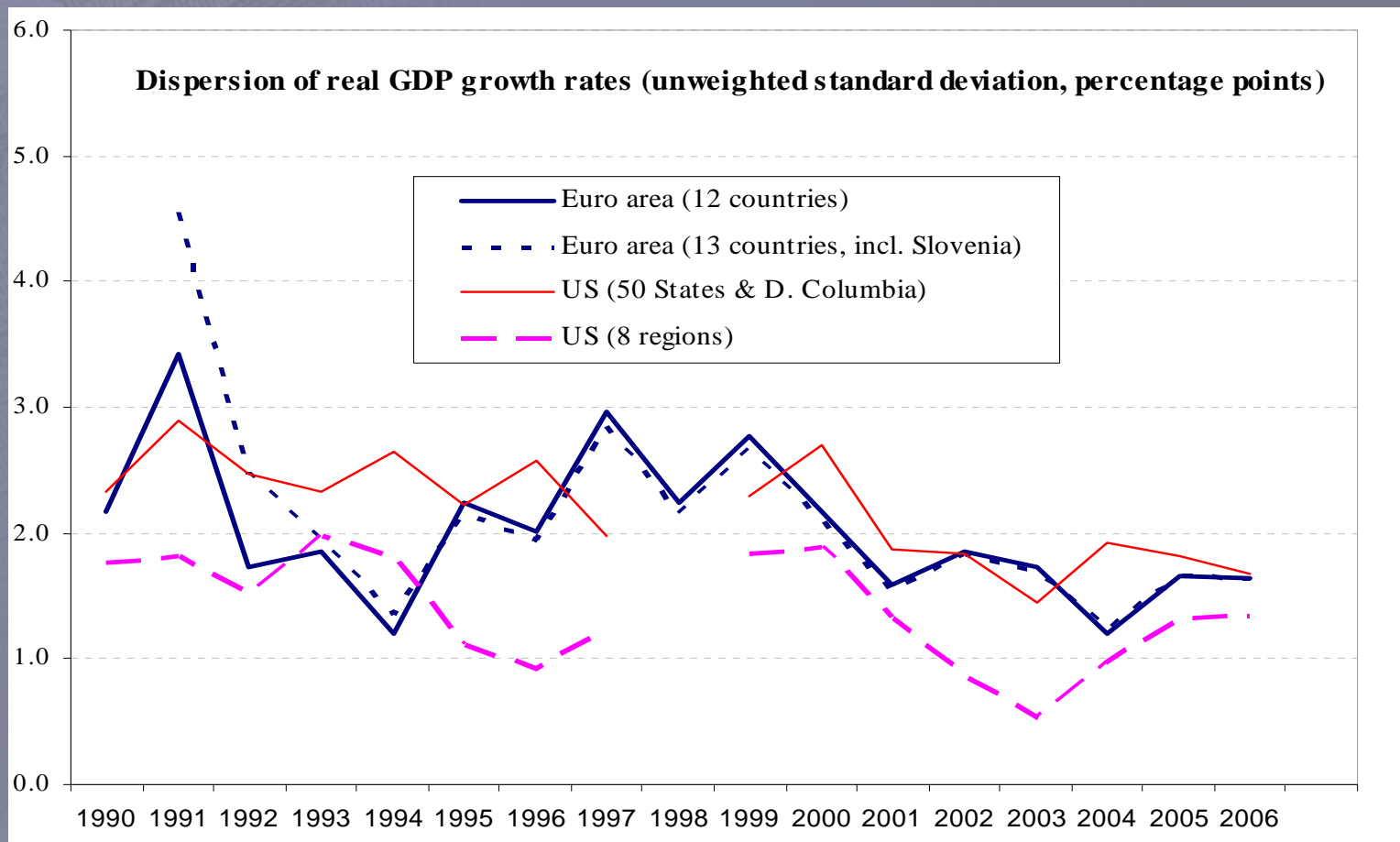
# Inflation dispersion in the euro area and in the United States



Sources: Eurostat and US Bureau of Labor Statistics.

Note: Euro area data up to July 2007. US 4 census regions up to June 2007 and US 14 MSAs up to April 2007.

# Real GDP growth dispersion in the euro area and in the United States

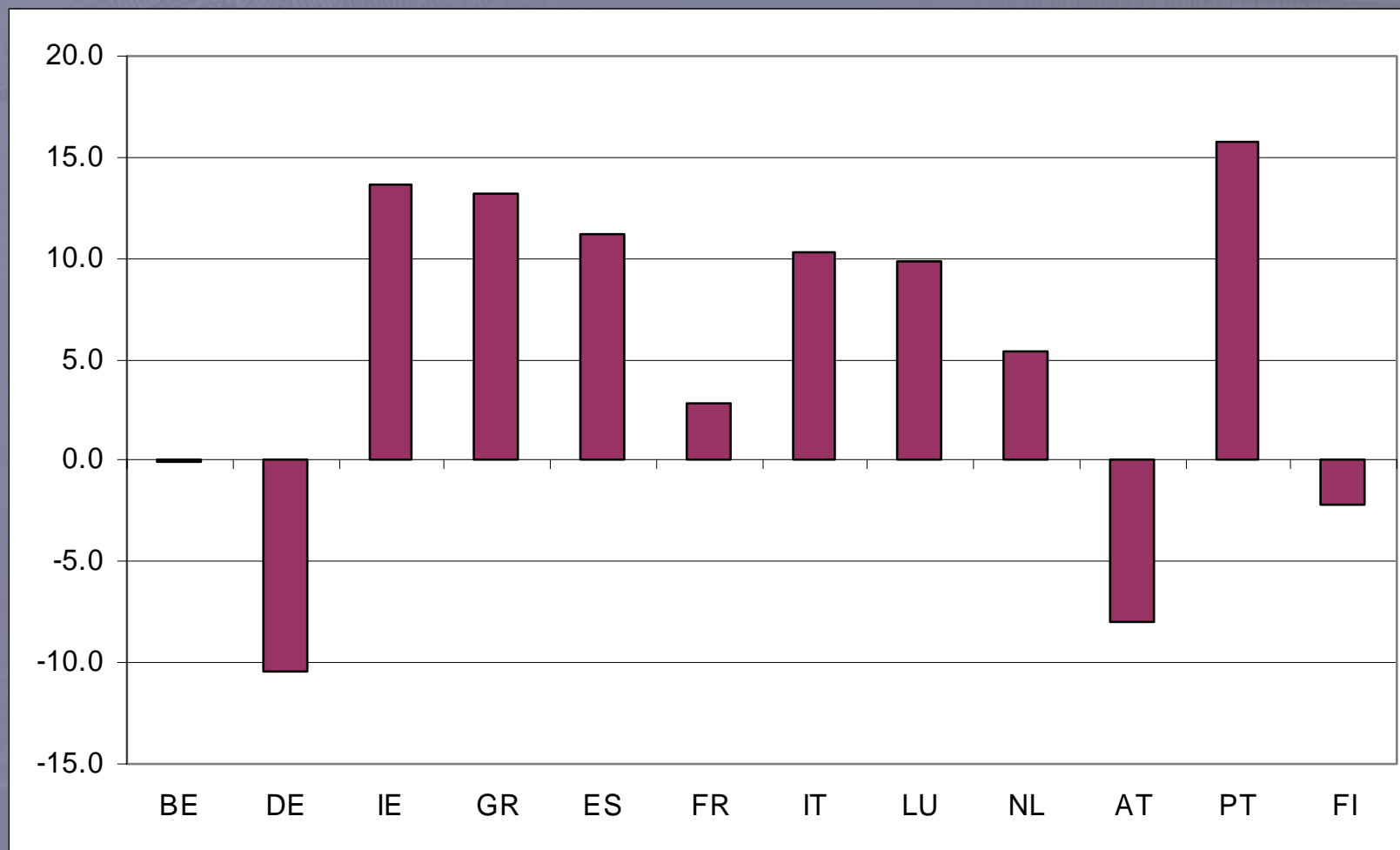


Sources: European Commission (Ameco database) and US Bureau of Economic Analysis (BEA).

Note: There is a statistical break in the US regional data in 1998. In the US states and regions, the data refer to Gross State Product (GSP). The 8 regions are defined by BEA covering the whole country. Data for Slovenia start in 1991.

# Total ULC growth between 1999-2006 in euro area countries relative to euro area average

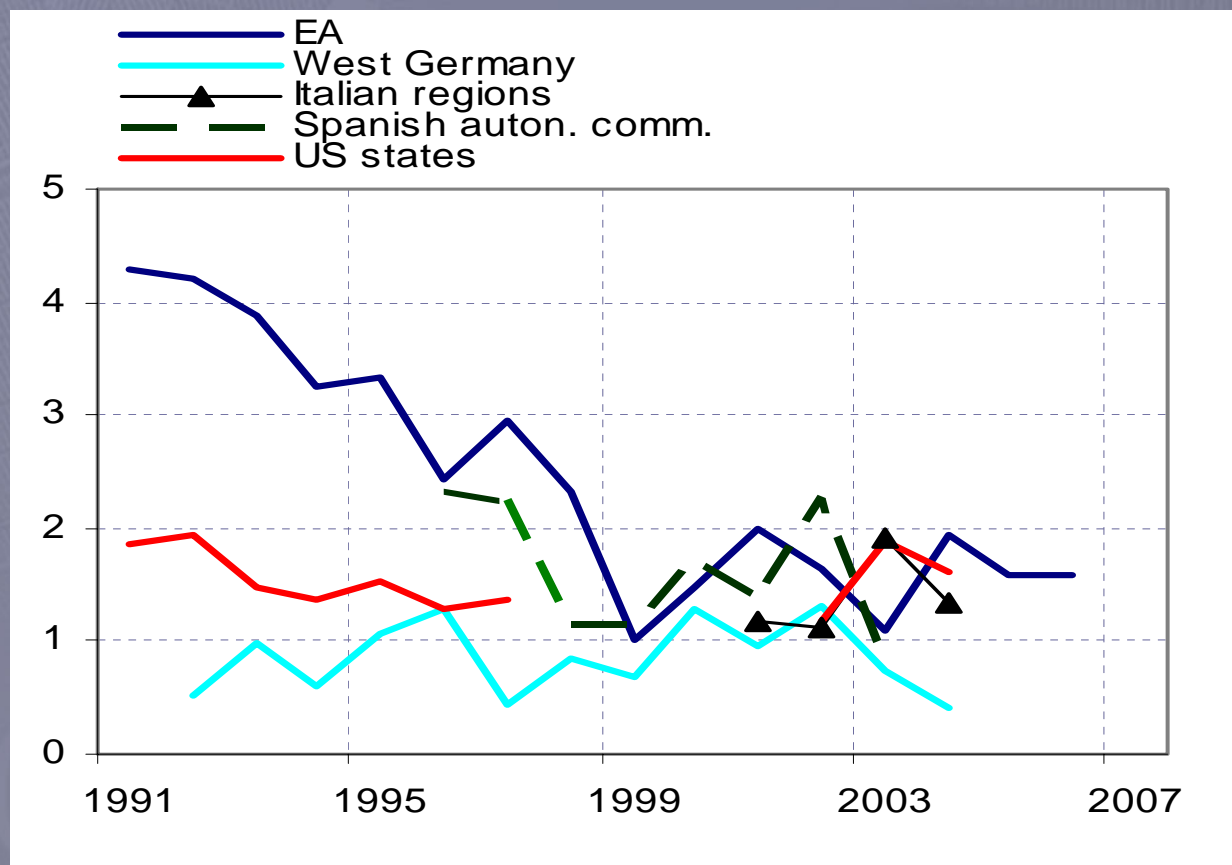
*(in percentage points)*



Source: European Commission

# Euro area ULC growth dispersion in line with benchmark areas since 1999

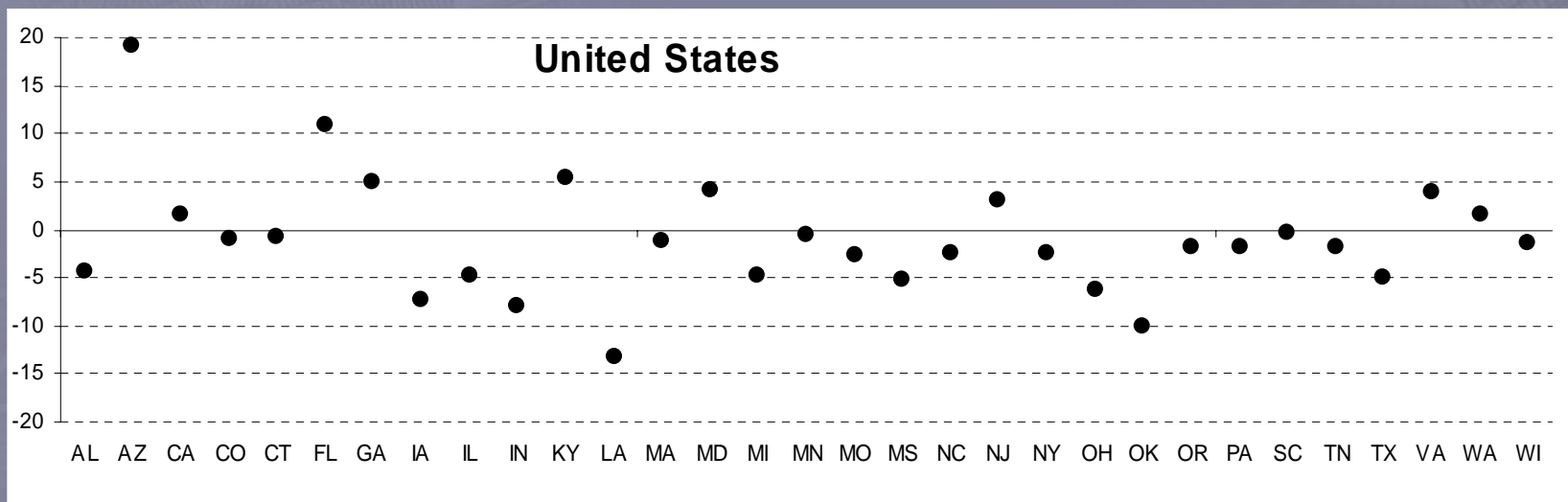
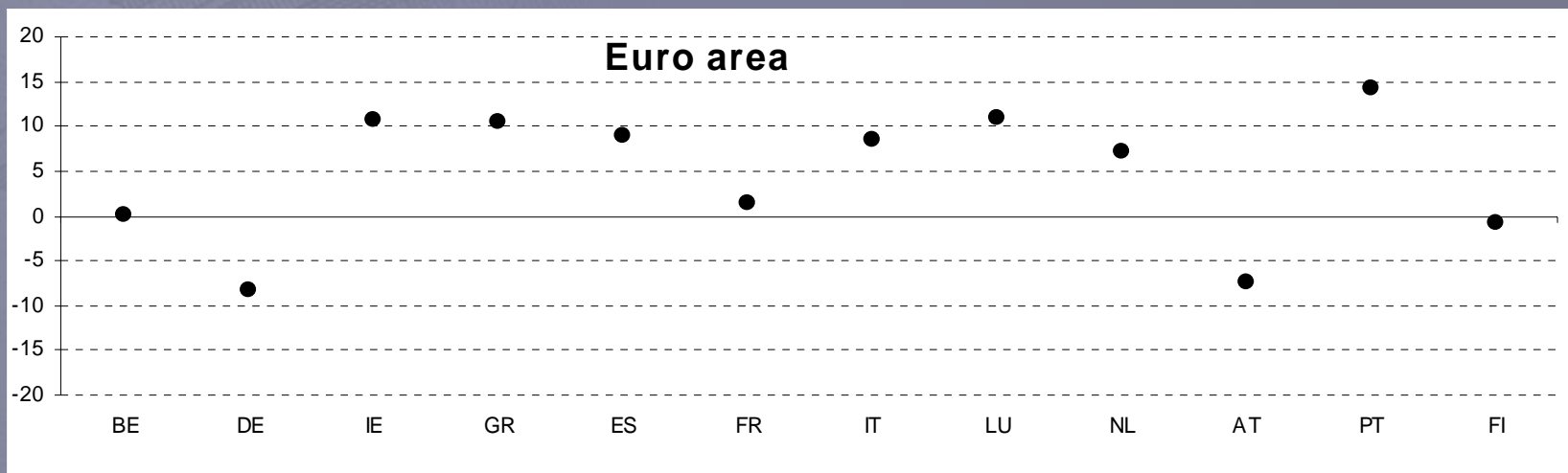
ULC growth dispersion in the euro area compared with states in the US and with regions of large euro area countries (in percent)



Sources: Eurostat and national statistical offices.

Note: there is a statistical break in the US regional data in 1998.

# Cumulative ULC growth between 1999-2005 across countries/states relative to the average change, respectively, in the euro area/the United States (%)

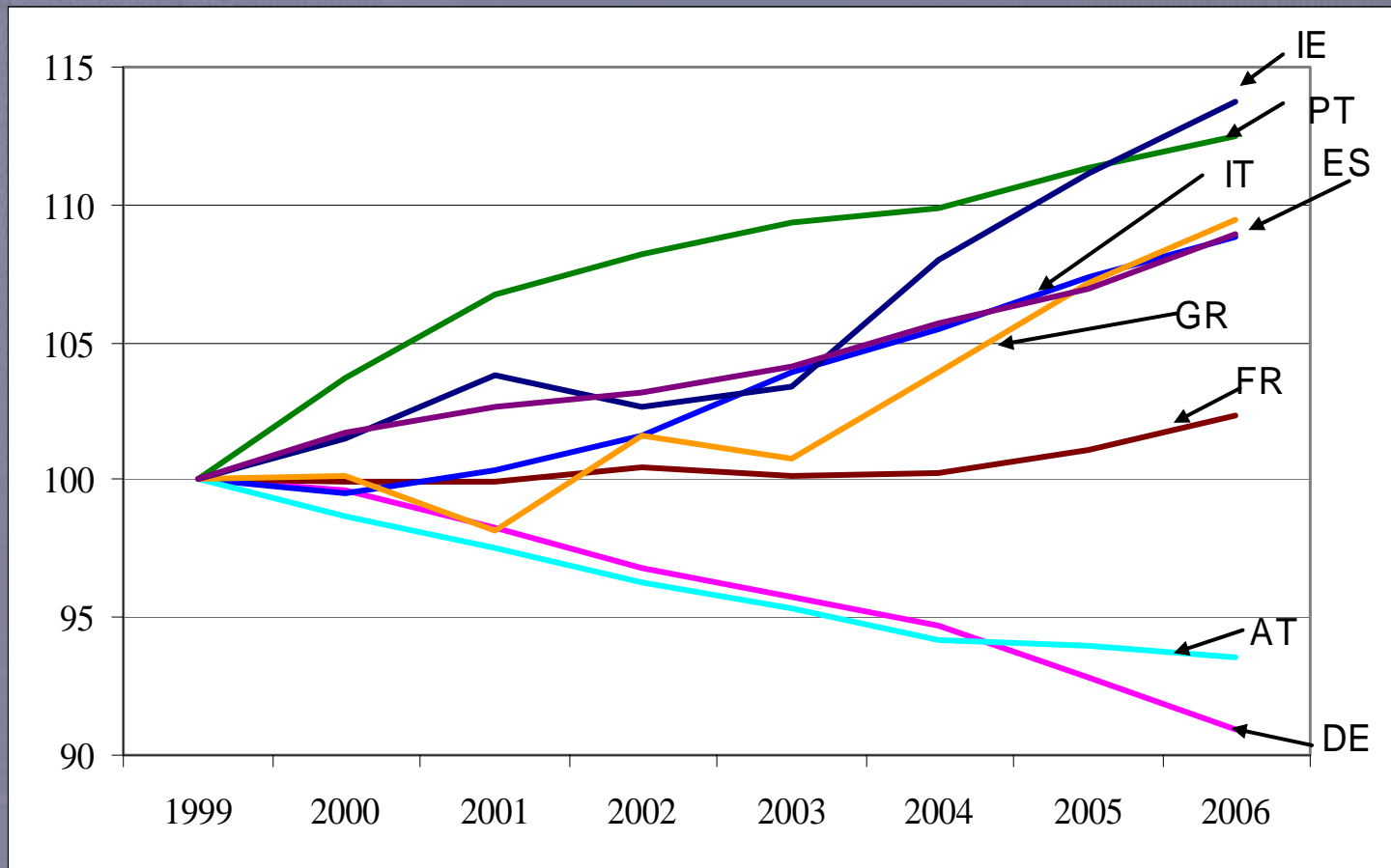


Sources: European Commission/U.S. Census Bureau



# Persistent ULC developments in the euro area

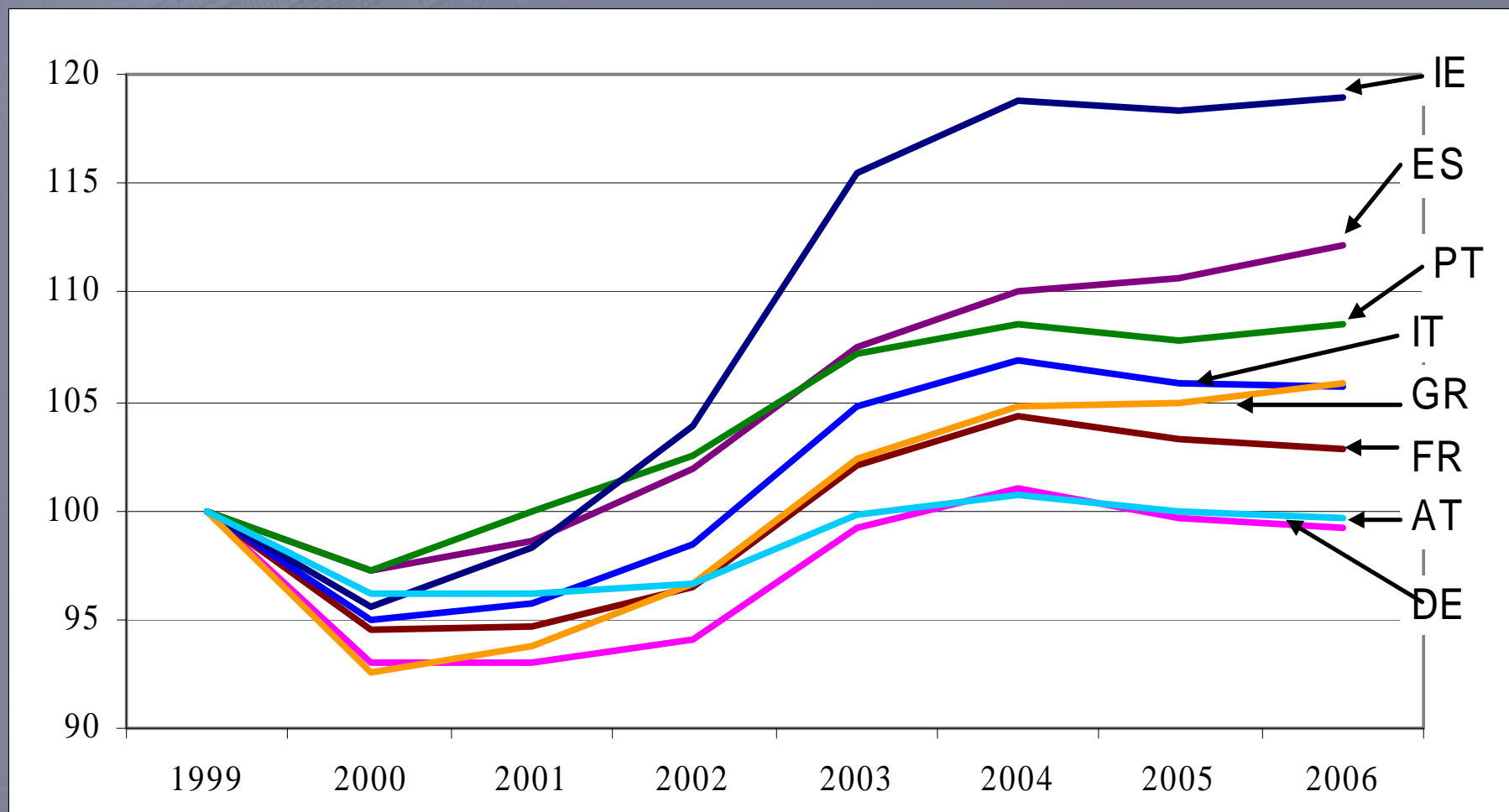
ULC developments across euro area countries relative to the euro area average (Index 1999=100)



Sources: European Commission (Ameco database)



# Evolution of Harmonised Competitiveness Indicators across euro area countries (Index 1999=100)



Source: ECB

# Strong ULC growth mostly stems from compensation growth exceeding productivity growth

## Cumulated increases in ULC, compensation per employee and labour productivity (1999-2006)

*(percentage changes)*

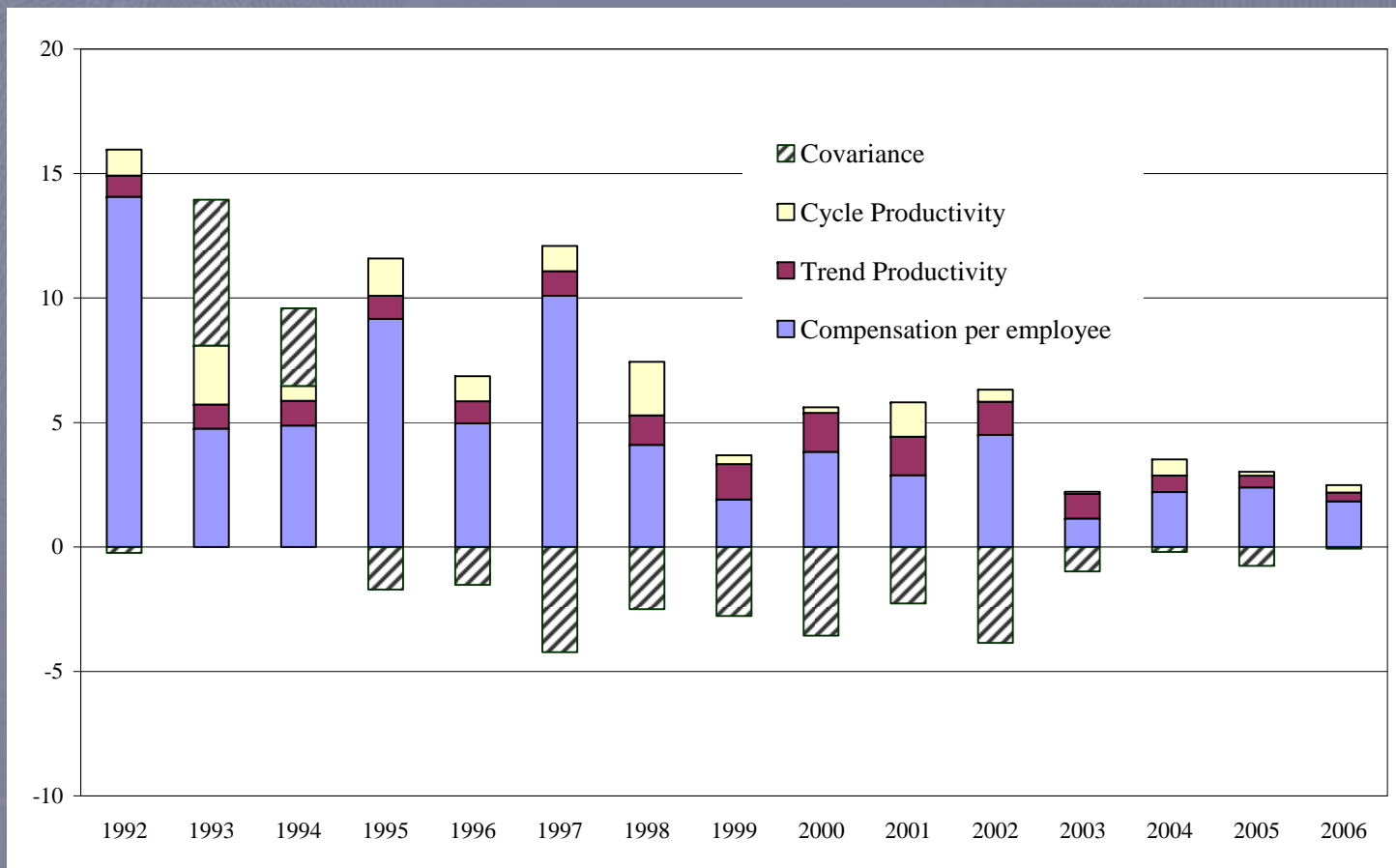
|             | ULC  | Compensation per employee | Labour productivity |
|-------------|------|---------------------------|---------------------|
| Belgium     | 11.9 | 23.7                      | 10.5                |
| Germany     | 1.5  | 15.7                      | 14.0                |
| Ireland     | 25.6 | 57.9                      | 25.7                |
| Greece      | 25.2 | 63.8                      | 30.8 <sup>a)</sup>  |
| Spain       | 23.2 | 27.3                      | 3.3                 |
| France      | 14.8 | 23.9                      | 8.0                 |
| Italy       | 22.3 | 25.9                      | 3.0                 |
| Luxembourg  | 21.8 | 32.1                      | 8.4                 |
| Netherlands | 17.4 | 34.2                      | 14.3                |
| Austria     | 4.0  | 16.5                      | 12.0                |
| Portugal    | 27.7 | 36.3                      | 6.7                 |
| Finland     | 9.8  | 29.1                      | 17.6                |
| Euro area   | 12.0 | 22.6                      | 8.9                 |

Source: European Commission (Ameco database)

a) Development in labour productivity in Greece has been strongly affected by the structural decline in the number of self-employed persons in the agricultural sector. Looking at dependent employment, the cumulated unit labour cost growth between 1999 and 2006 amounted to 32.8 % (Source: Bank of Greece)

# Compensation per employee growth most important factor behind ULC differences

## Decomposition of ULC growth variance across euro area countries



Source: ECB calculations

## Similar compensation per employee growth across sectors but lower productivity growth in services

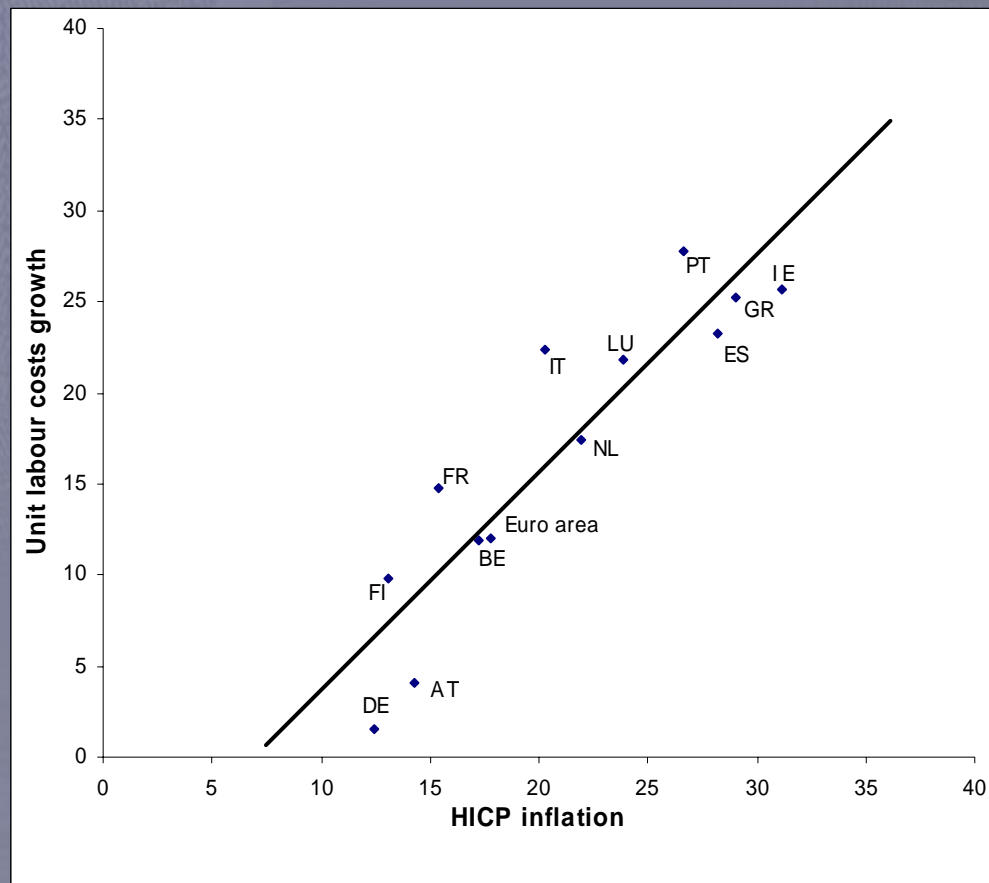
**Cumulative unit labour cost growth and components 1999-2005 in the industry and services sectors (percent)**

| Country         | Industry |                           |                     | Services incl. construction |                           |                     |
|-----------------|----------|---------------------------|---------------------|-----------------------------|---------------------------|---------------------|
|                 | ULC      | Compensation per employee | Labour productivity | ULC                         | Compensation per employee | Labour productivity |
| Belgium         | 3.0      | 20.6                      | 17.1                | 14.4                        | 21.8                      | 6.5                 |
| Germany         | -7.3     | 14.9                      | 23.9                | 4.2                         | 6.7                       | 2.4                 |
| Spain           | 14.9     | 21.0                      | 5.3                 | 27.6                        | 23.6                      | -3.2                |
| France          | -5.0     | 18.4                      | 24.6                | 18.0                        | 22.3                      | 3.7                 |
| Italy           | 20.4     | 19.1                      | -1.0                | 20.9                        | 19.0                      | -1.6                |
| Luxembourg      | 8.1      | 33.4                      | 23.5                | 26.5                        | 28.6                      | 1.6                 |
| the Netherlands | 2.1      | 28.5                      | 25.8                | 20.3                        | 28.6                      | 6.8                 |
| Austria         | -9.6     | 14.1                      | 26.2                | 8.9                         | 11.8                      | 2.7                 |
| Finland         | -14.9    | 28.2                      | 50.7                | 23.3                        | 24.6                      | 1.0                 |
| Euro area 9     | 0.0      | 16.9                      | 16.9                | 15.6                        | 16.6                      | 0.9                 |

Source: European Commission (Ameco database)

# ULC developments have contributed to shaping the inflation dynamics in the euro area

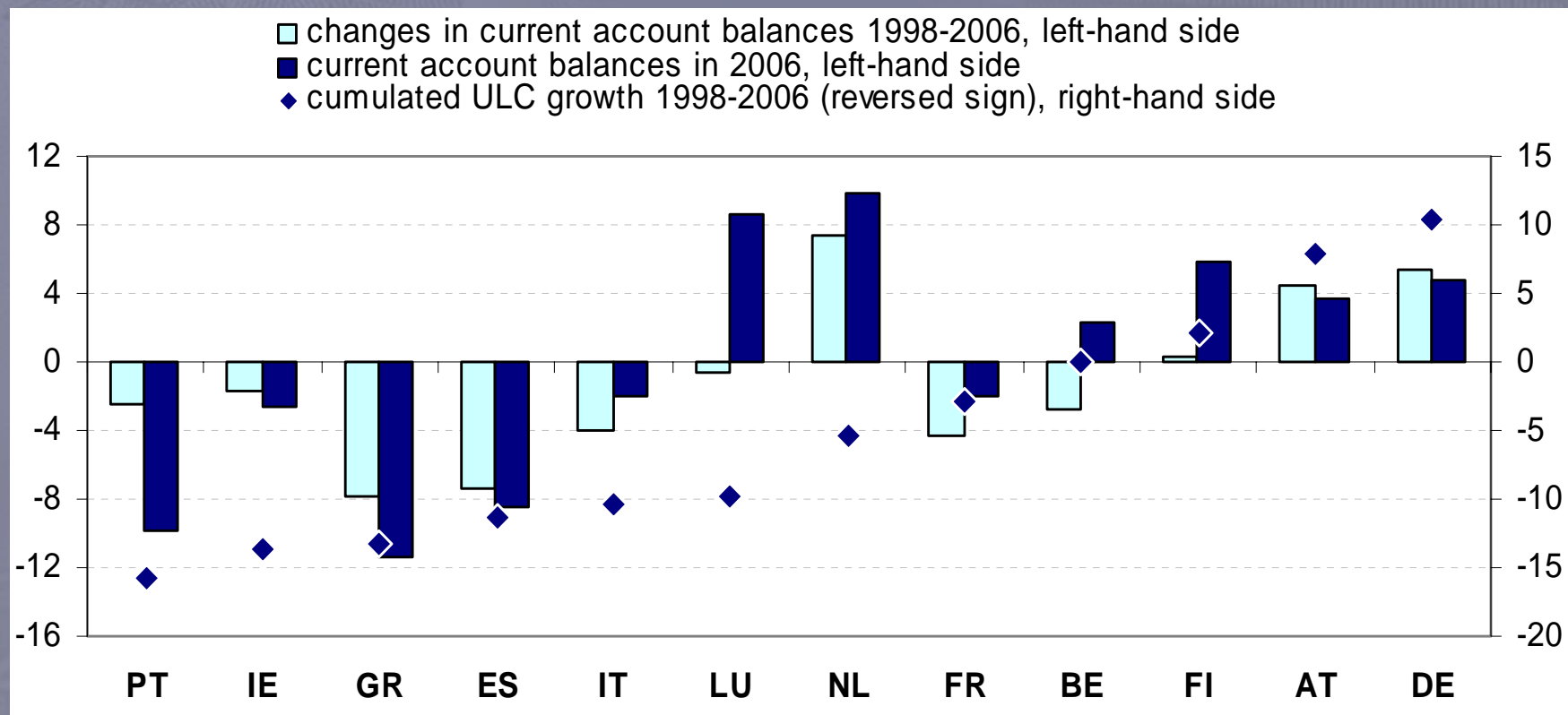
Unit labour cost growth and HICP inflation in euro area countries  
(cumulative rate of change 1999-2006, in %)



Sources: European Commission and Eurostat

# Some correlation between ULC developments and current account balances across euro area countries

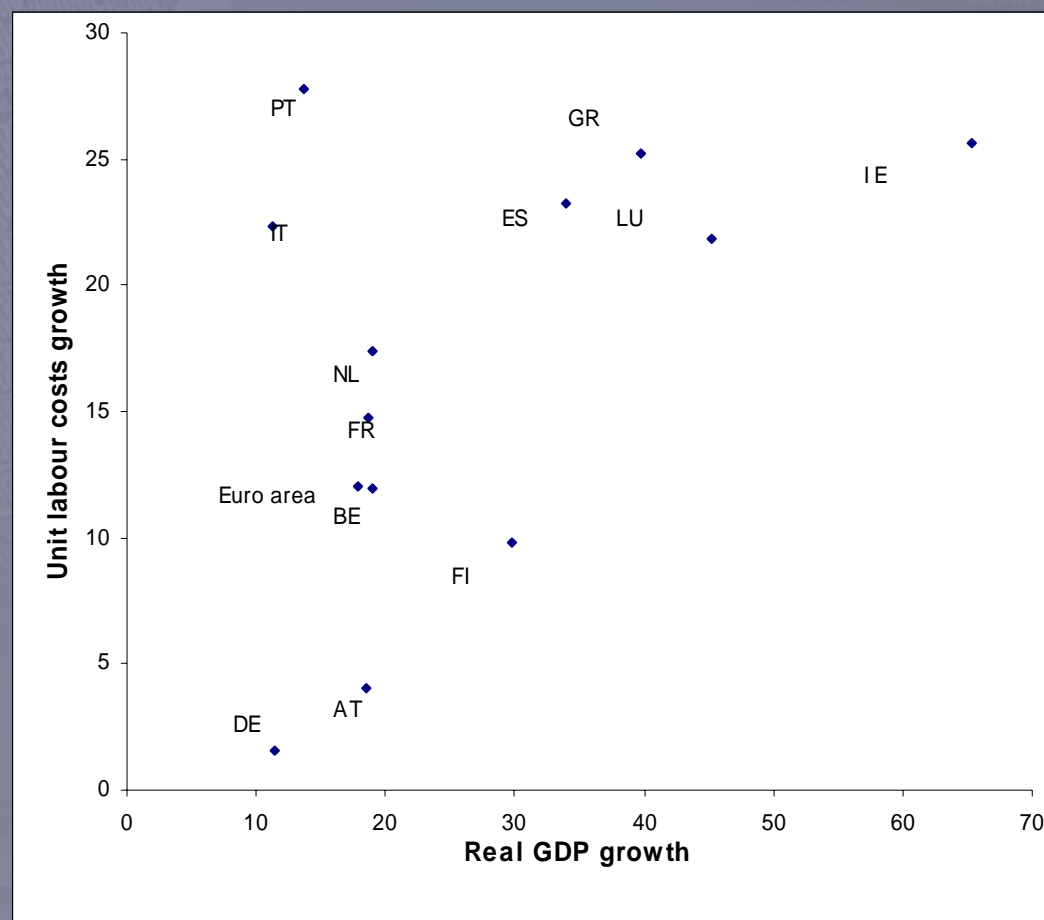
## ULC growth and current account balances across euro area countries (cumulative changes)



Source: ECB computations based on European Commission data.

# No clear link between ULC and real GDP developments in the euro area

ULC growth and real GDP growth in euro area countries  
(cumulative rate of change 1999-2006, in %)



Source: ECB computations based on European Commission data.