

### Box 13

#### **IS THE DOWNWARD IMPACT OF GLOBALISATION ON IMPORT PRICES WANING?**

After having declined significantly between 2001 and 2004, prices of euro area manufacturing imports, expressed in euro terms, are again on an upward trend. An earlier analysis, described in Box 6 of the August 2006 issue of the Monthly Bulletin, showed that the rise in trade integration with emerging markets and developing economies had contributed significantly to

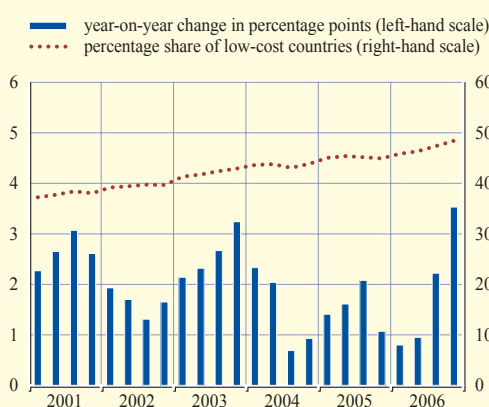
import price moderation in the euro area. The recent price increases have triggered a debate on whether the downward impact of low-cost countries<sup>1</sup> on euro area import prices is fading, especially since these increases were recorded in a period marked by an appreciation of the euro, which is likely, a priori, to have had an offsetting effect. Against this background, this box briefly reviews the effect of globalisation on import prices by reconsidering the two main dimensions of the impact of rising imports from low-cost countries.

First, with price levels of imports from low-cost countries remaining substantially lower than those of imports from high-cost countries, the size and persistence of the downward effect on euro area import prices depends predominantly on the so-called “share effect”, i.e. the extent to which the share of imports from low-cost countries into the euro area will keep increasing. Between 2001 and 2006, the import penetration in the euro area of goods originating in low-cost countries rose from 37% to almost 50%. The share of imports from these countries even saw a renewed surge in the fourth quarter of 2006, with an increase by 3.5 percentage points, the highest year-on-year change of this indicator since 2001 (see Chart A). There is, therefore, no substantive evidence to suggest that the import substitution away from high-cost partners towards low-cost exporters has recently come to a halt.

Second, the downward impact on euro area import price inflation also depends on import price inflation differentials between high-cost and low-cost countries (the “price effect”). In contrast to the significant decline recorded over the period from 2001 to 2004, import price inflation from China and the ASEAN countries picked up in late 2005. Import price inflation from Member States that have joined the EU since 2004, already started to increase in 2004. However, while the rising import prices from low-cost countries could be a sign, in principle, that the downward impact of globalisation is waning, this does not seem to be the case. Price dynamics of imports from the remaining euro area suppliers, high-cost and low-cost countries alike, have followed the same upward trend (see Chart B). The broad basis of the observed increases in euro area import prices indicates that they are likely to be associated with cost-driving factors that are common to all euro area trading partners. The generally high and positive correlation between changes in global energy prices and changes in the prices of exports by most euro area suppliers, which ranges from 0.5 to 0.8, suggests that higher input costs, in the form of higher energy and raw material prices, have

**Chart A Share of euro area imports from low-cost countries**

(values in euro; quarterly data)



Sources: Eurostat and ECB calculations.  
Notes: The last observation refers to the fourth quarter of 2006. The country decomposition is explained in footnote 1.

<sup>1</sup> The country decomposition considers 29 countries (and regions) of origin that cover the main trading partners of the euro area. These were divided into two groups (“high-cost countries” and “low-cost countries”) on the basis of their GDP per capita. The group of “high-cost countries” includes Canada, Denmark, Hong Kong, Israel, Japan, the Republic of Korea, Norway, the OPEC countries, Singapore, Sweden, Switzerland, Taiwan, the United Kingdom and the United States. The group of “low-cost countries” is made up of 15 countries and regions: Algeria, Argentina, the ASEAN, Brazil, Chile, Central America and the Caribbean, the CIS, China, India, eastern European countries that have joined the EU since 1 May 2004, rest of North Africa, rest of Africa, rest of Asia, rest of South America, and Turkey.

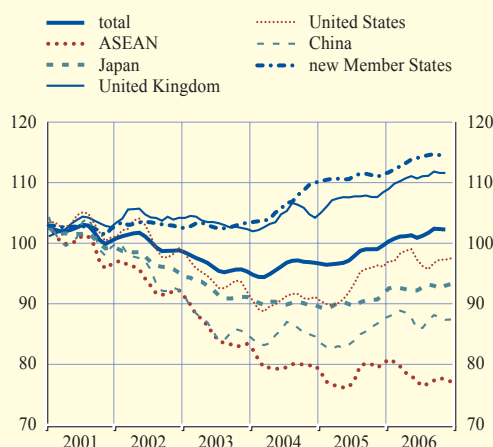
been an important factor behind the recent increase in manufacturing prices.

It should also be noted that, in the second half of 2006, the prices of manufacturing imports from ASEAN countries reverted to a falling trend, while price changes for imports from China moderated as well. With price inflation of manufacturing imports from China and the ASEAN countries remaining persistently lower than the average import price inflation from all other euro area trade partners, the “price effect” continued to make a negative contribution.

Looking forward, the downward impact of globalisation on euro area import prices depends primarily on the ability of low-cost suppliers to continue to export large quantities of goods at prices well below the international average. Economic development, wage increases and a deterioration of the terms of trade in many low-cost countries may ultimately cause their export prices to converge to higher levels. However, the substantial differences between the price levels of imports from low-cost countries and those from high-cost countries, associated with the unbroken trend of gains in export market shares by the former, and the strong specialisation of these countries in producing and exporting products and varieties characterised by lower prices, seem to indicate that the downward pressures of globalisation on euro area import prices are not yet petering out.

**Chart B Prices of euro area manufacturing imports from selected countries and regions**

(unit value indices in euro; 2001 Q1=100)



Sources: Eurostat and ECB calculations.  
 Notes: The latest observation refers to December 2006, except in the case of the euro area and the United Kingdom (November) and the new EU Member States (October). The chart shows the total import prices for the new Member States, due to the non-availability of manufacturing import prices. The new Member States refer to the eastern European countries that joined the EU on 1 May 2004.