

Box 7

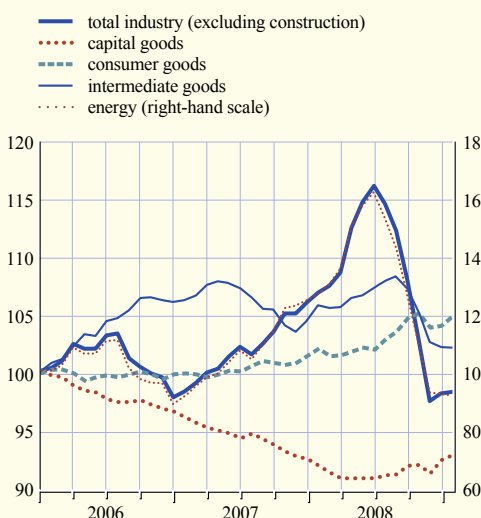
RECENT DEVELOPMENTS IN EXTRA-EURO AREA TRADE PRICES AND PRICE COMPETITIVENESS

From July to December 2008, extra-euro area import prices fell by 16.0% (Chart A) and extra-euro area export prices by 3.5% (Chart B), both in euro terms. Since then, trade prices have shown some signs of stabilisation. This box looks at the different factors behind these developments and implications for euro area price competitiveness.

The abrupt fall in import and export prices in the second half of 2008 was driven by common factors, most prominently repercussions from the sharp decline in commodity prices – particularly energy prices – in the wake of the ongoing financial crisis. With energy import prices falling by 42.6% and energy export prices by 50.4% between July and December 2008, lower energy prices mechanically accounted for a significant share of the decline in overall trade prices. As commodity

Chart A Extra-euro area industrial import prices

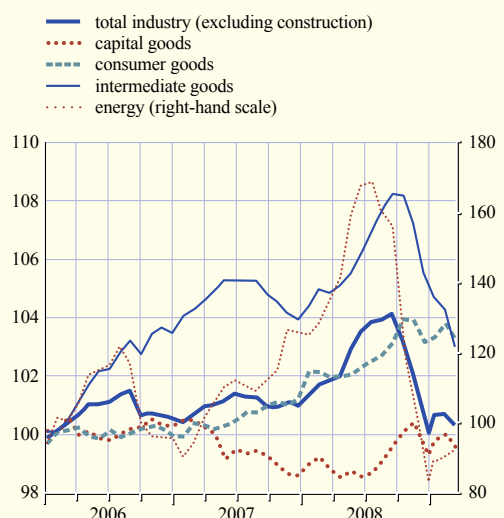
(index: January 2006 = 100; monthly data)



Source: Eurostat.
Note: The latest observations refer to February 2009.

Chart B Extra-euro area industrial producer export prices¹⁾

(index: January 2006 = 100; monthly data)



Source: Eurostat.
Note: The latest observations refer to March 2009.
1) Industrial producer export prices refer to direct transactions between domestic producers and non-domestic customers. They do not cover exports from wholesalers or re-exports and therefore are only a proxy for an export price index for industrial goods.

prices rebounded in early 2009, trade prices stabilised somewhat. By gradually feeding into input costs, lower commodity prices have also indirectly put downward pressure on trade prices in other categories. Extra-euro area export prices of consumer goods, for instance, responded with a lag, declining by 0.7% in December.

Increasing competitive pressures in international markets may have prompted euro area and foreign exporters to cut prices beyond the margin for manoeuvre opened up by falling input prices in order to protect their market shares. Furthermore, in the light of the sharp slowdown in global demand, the pass-through of the euro's depreciation in nominal effective terms in the second half of 2008 (Chart C) seems to have been asymmetric: euro area

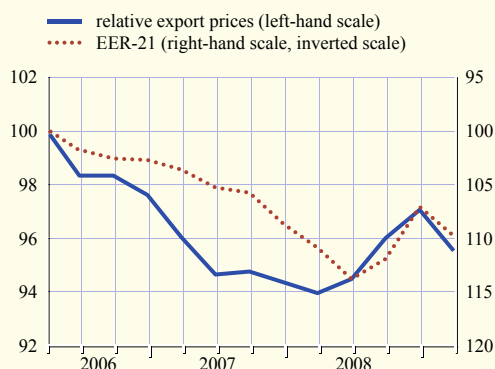
producers passed on the depreciation to lower export prices in foreign currency – possibly more so than in a global upswing – and exporters to the euro area may have been less inclined to raise prices in euro terms, squeezing profit margins instead. These competition effects are expected to gain importance in the near term compared with the impact of commodity prices, which have stabilised of late. Moreover, the recent slowdown in import price growth has to be seen against the backdrop of the downward pressure on manufacturing import prices resulting from the rising share of euro area imports of manufactured goods from low-cost countries, such as China and the new EU Member States.¹

Since the start of the global downturn, competitors' export prices – when measured in national currencies – have been highly synchronised with those of the euro area. That said, trade-weighted relative export prices in euro terms indicate that the euro area gained in price competitiveness in the second half of 2008, mostly as a result of the depreciation of the euro (Chart C). These gains were somewhat mitigated, however, as the euro appreciated again in early 2009. Looking ahead, future developments in price competitiveness will therefore depend crucially on exchange rate movements as well as the behaviour of competitors' export prices, given the possible intensification of competition in an environment of subdued global trade.

¹ ECB staff calculations show that rising import penetration from low-cost countries may have dampened euro area import prices of manufactured goods by about 2 percentage points per annum in the period 1995-2004 (see the article entitled "Globalisation, trade and the euro area macroeconomy" in the January 2008 issue of the Monthly Bulletin). This is mostly due to the "share effect" of China and the new EU Member States, which captures the downward impact on import prices of the rising import share of low-cost countries combined with the relatively lower price level of low-cost import suppliers.

Chart C Euro area relative export prices and nominal effective exchange rate (EER-21)

(index: 2006 Q1 = 100; quarterly data)



Sources: ECB staff calculations and Eurostat.

Note: The latest observations refer to the first quarter of 2009. An increase in relative export prices amounts to an improvement in the euro area's price competitiveness.