



EUROPEAN CENTRAL BANK

EUROSYSTEM

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European Central Bank
Euro Area External Sector and Euro
Adoption

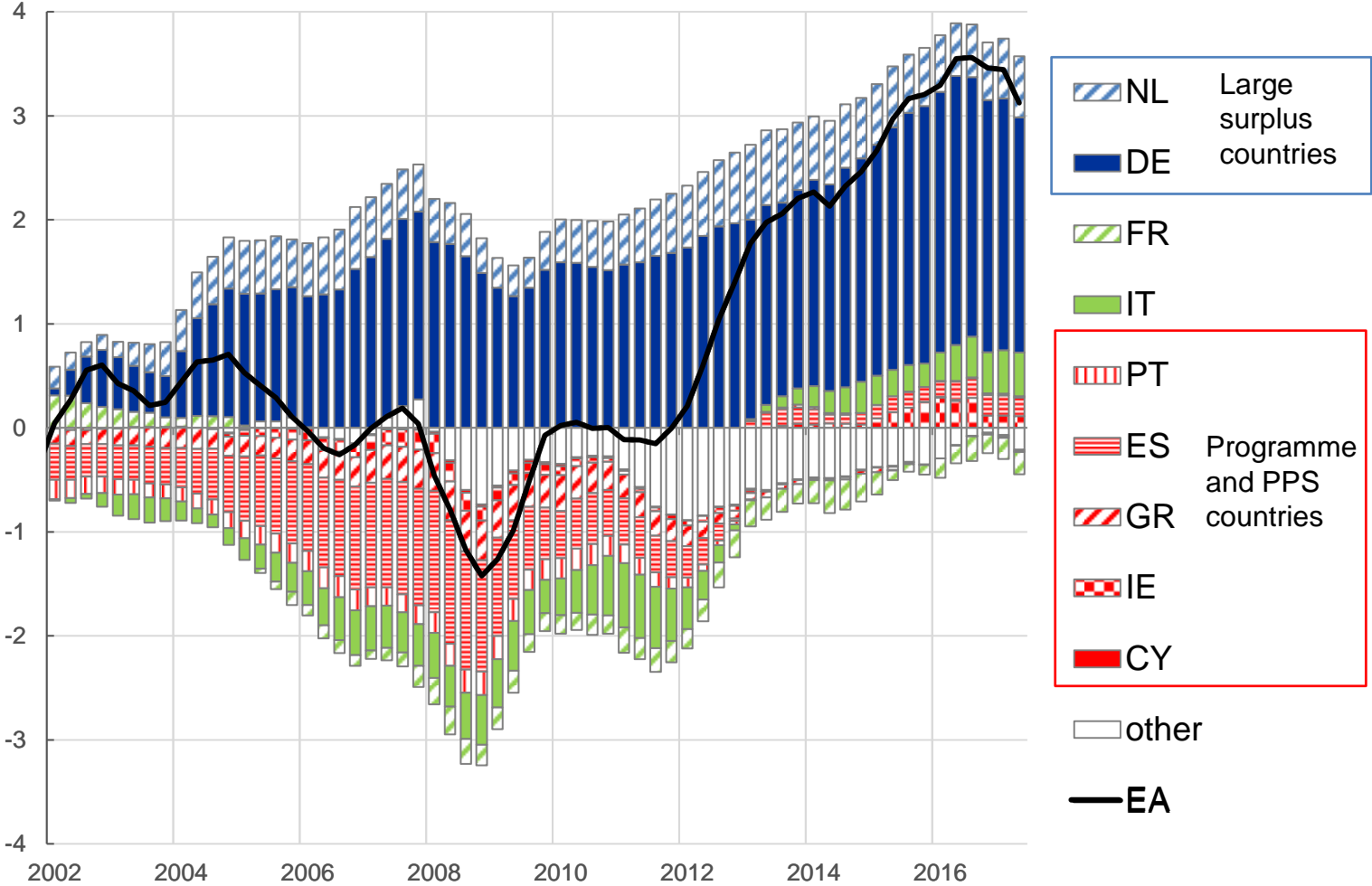
with support from F. Ansbacher and L. Pinnell

Is extra and intra CA rebalancing needed in the euro area?

Presentation to AIECE Meeting
Brussels 16-17 November 2017

Euro area current account balance

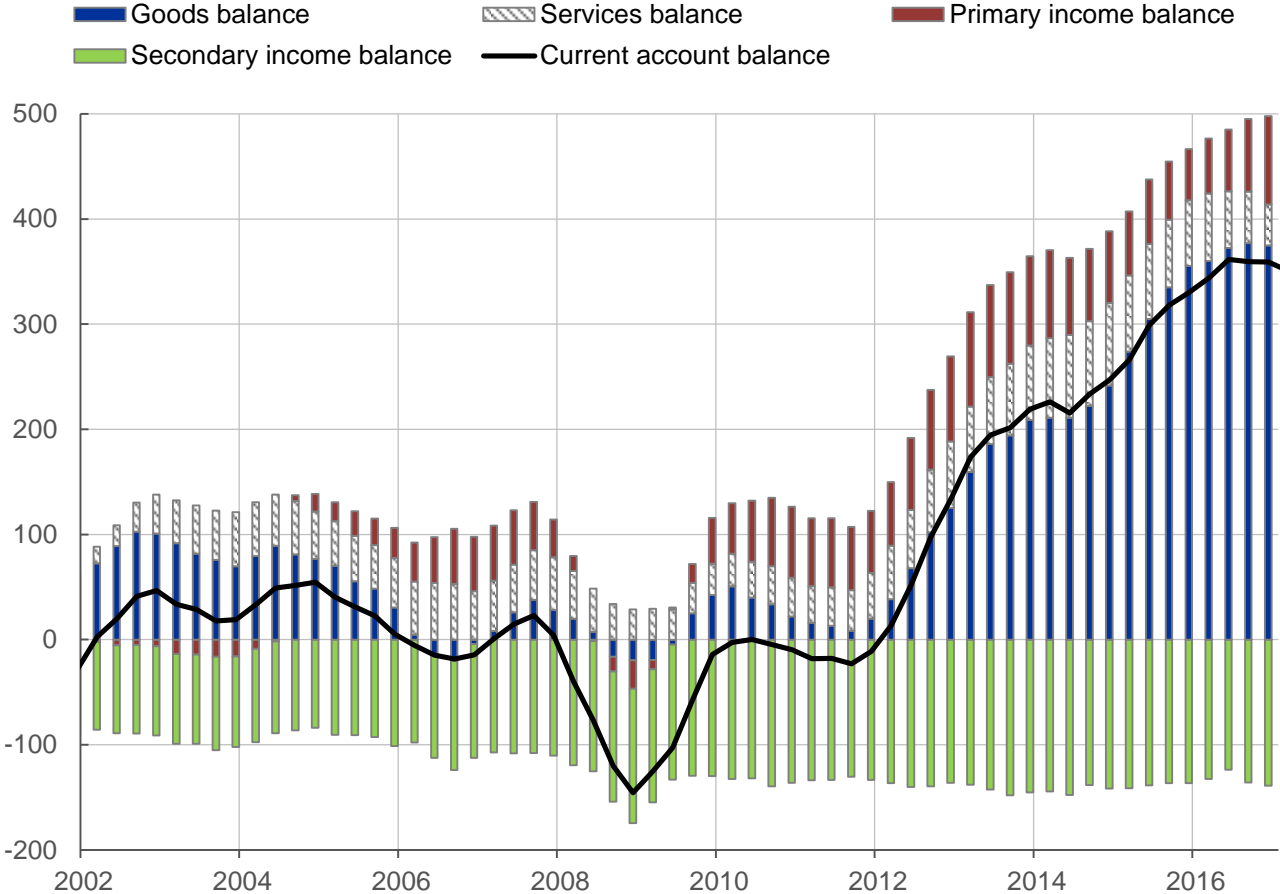
(% of euro area GDP)



Sources: ECB and Eurostat
 Latest Observation refers to 2017Q2.

Euro area current account balance by component

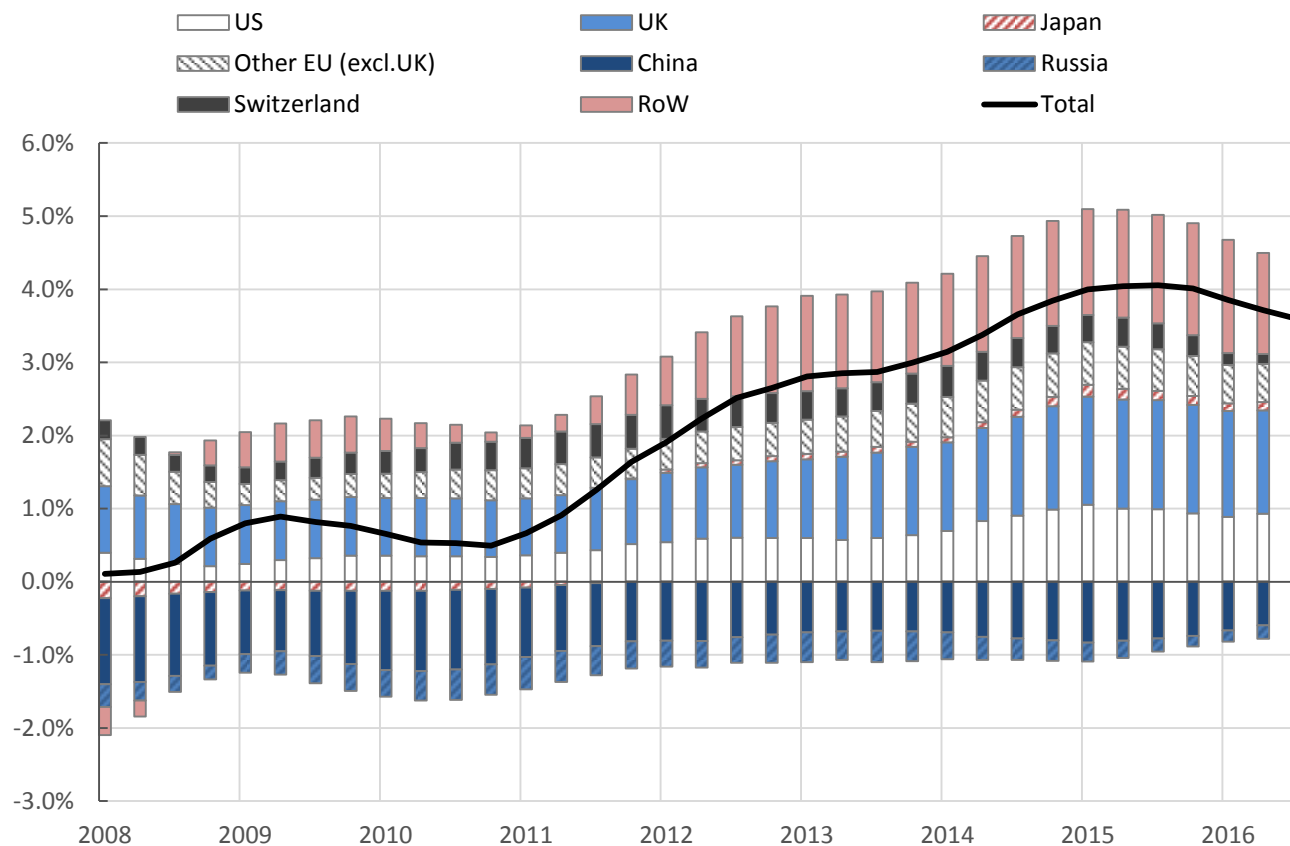
(Billions of Euros)



Sources: ECB and Eurostat
 Latest Observation refers to 2017Q2.

Euro area trade balance

(% of euro area GDP, 4-quarter average)



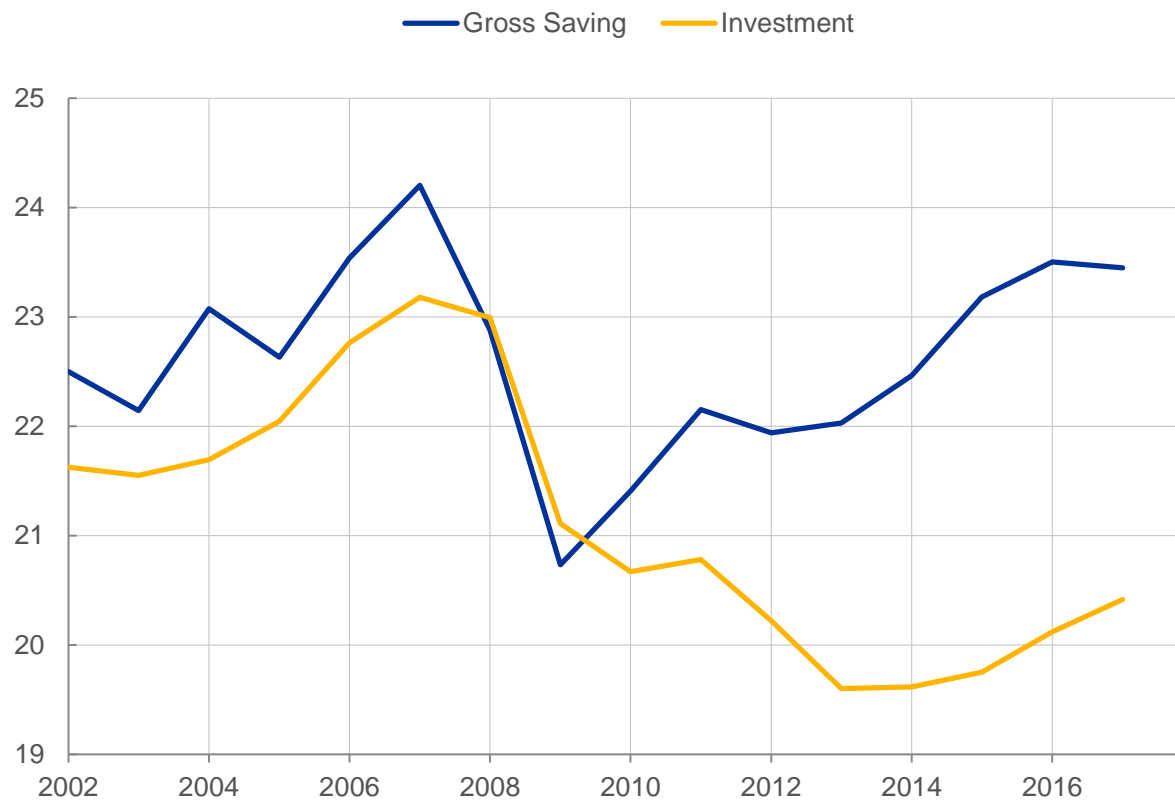
Sources: ECB and Eurostat.

Note: Data unavailable before 2008. Breakdown not available for the total current account balance.

Latest observation refers to 2017Q2.

Euro area saving and investment

(% of GDP)



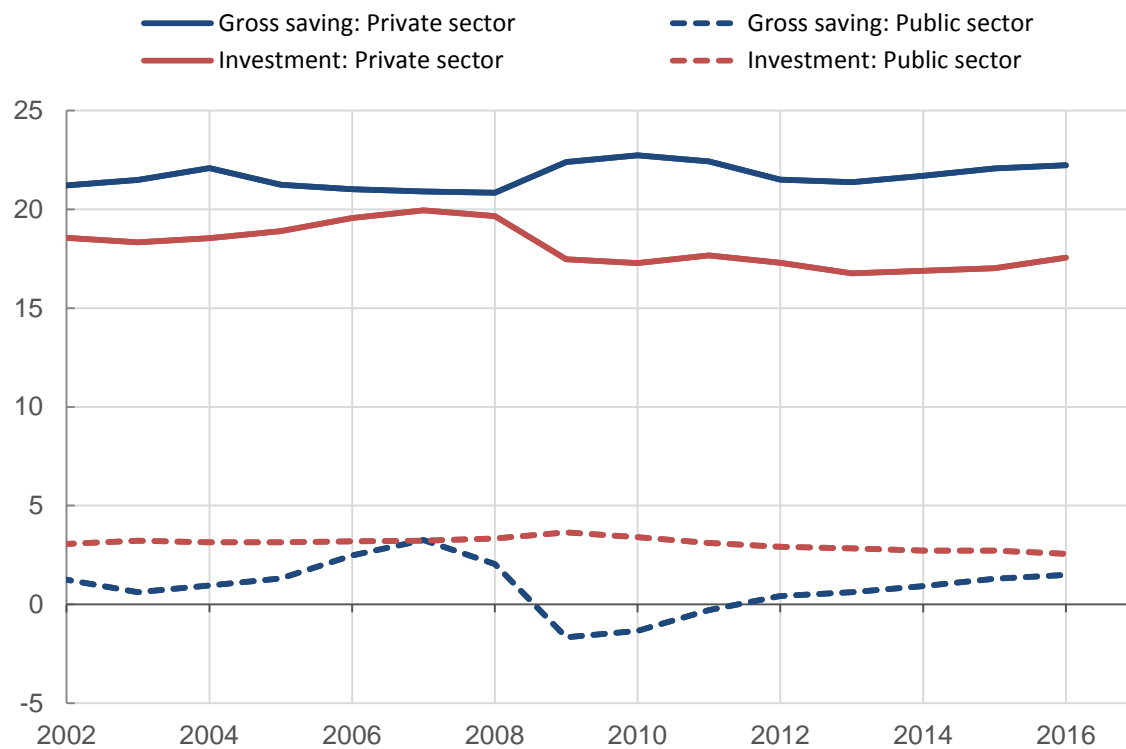
Source: European Commission.

Note: In practice, the gap between gross saving and investment may deviate from the current account balance.

Latest observation refers to 2017 (AMECO forecast).

Euro area saving and investment by institutional sector

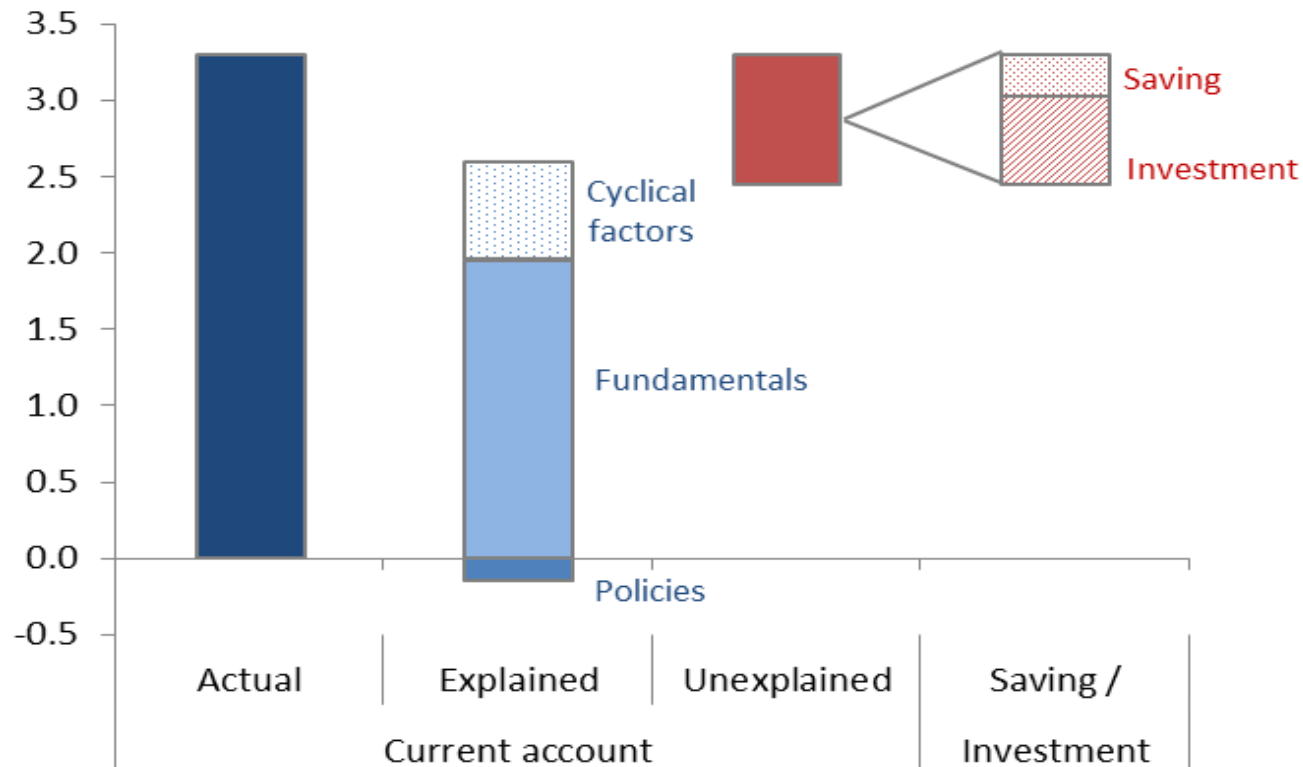
(% of GDP)



Source: European Commission.

Latest available observation refers to 2017 (AMECO forecast).

Model-based assessment of the euro area current account balance



Source: ECB staff.

Note: The estimates are based on DG-E's Current Account Benchmark (CAB) model.

Latest observation refers to 2016.

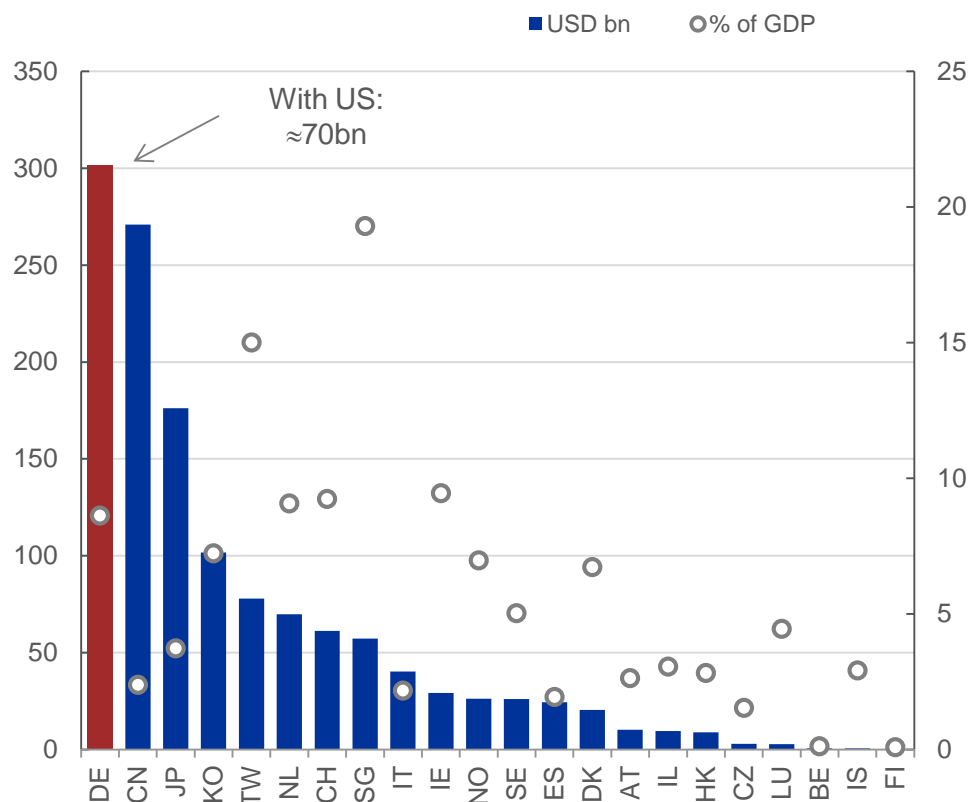
1 **Is Germany's current account surplus excessive?**

2 Is Germany's real exchange rate undervalued?

3 Why does this matter for Germany?

Germany's current account surplus is the largest in the world...

(current account balance, lhs: USD bn, rhs: % of GDP)

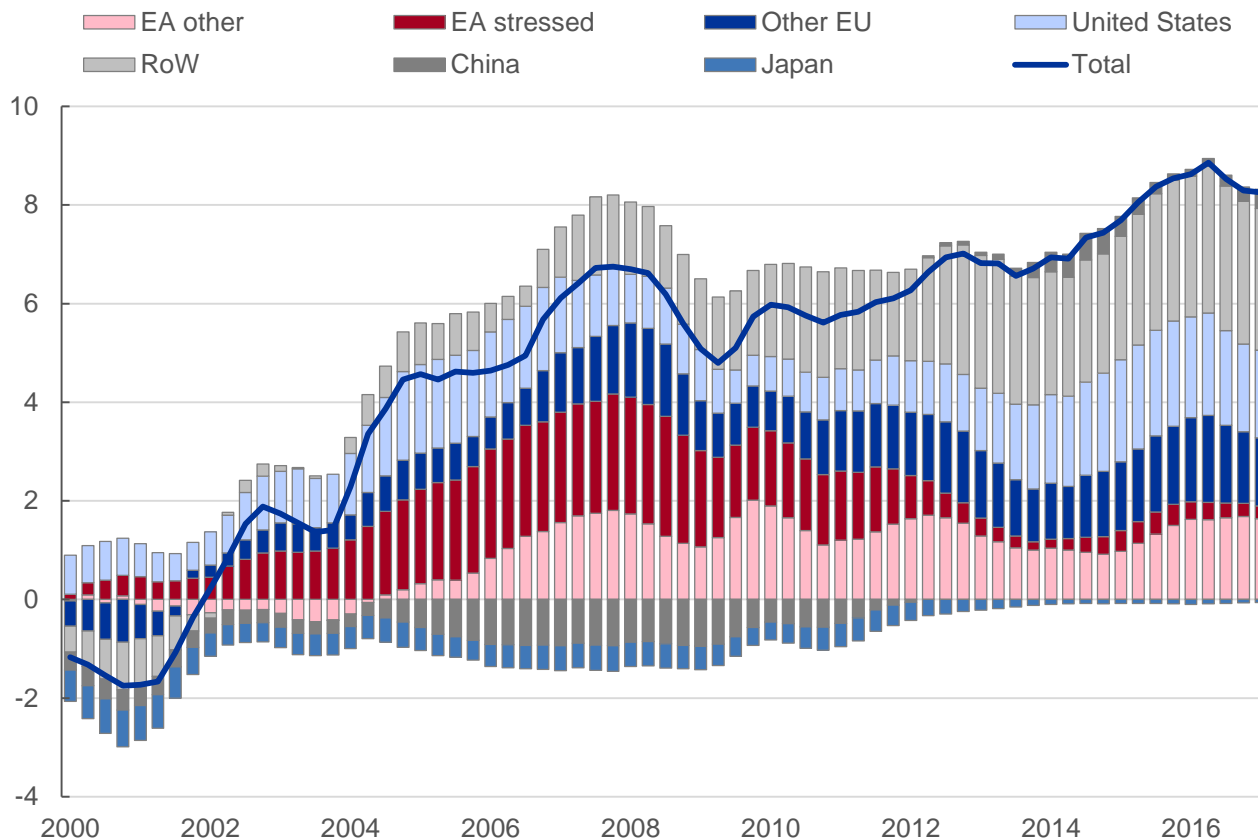


Source: IMF.

Notes: The chart covers all advanced surplus economies plus China.

Latest observation: 2016.

...and mainly stems from transactions with economies outside the euro area (Germany's current account balance, % of GDP)

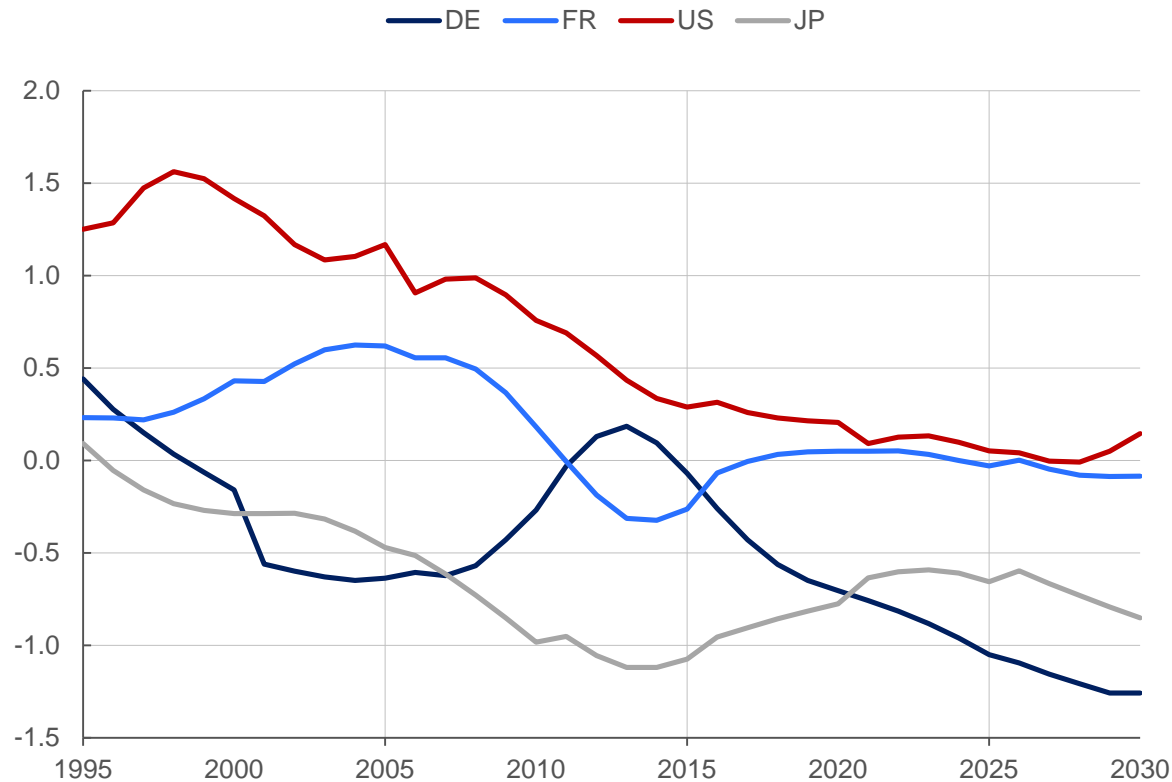


Sources: Deutsche Bundesbank and Eurostat.
Latest observation: 2017Q2.

- Before moving to our model-based analysis of DE's CA surplus, I will try to provide you with the economic **intuition** behind some of the key **driving factors**.
- Let me highlight just 3 of them.
 1. Demographic challenges
 2. Fiscal consolidation
 3. Oil price decline

The surplus partly reflects demographic challenges, ...

(working age population growth, %)

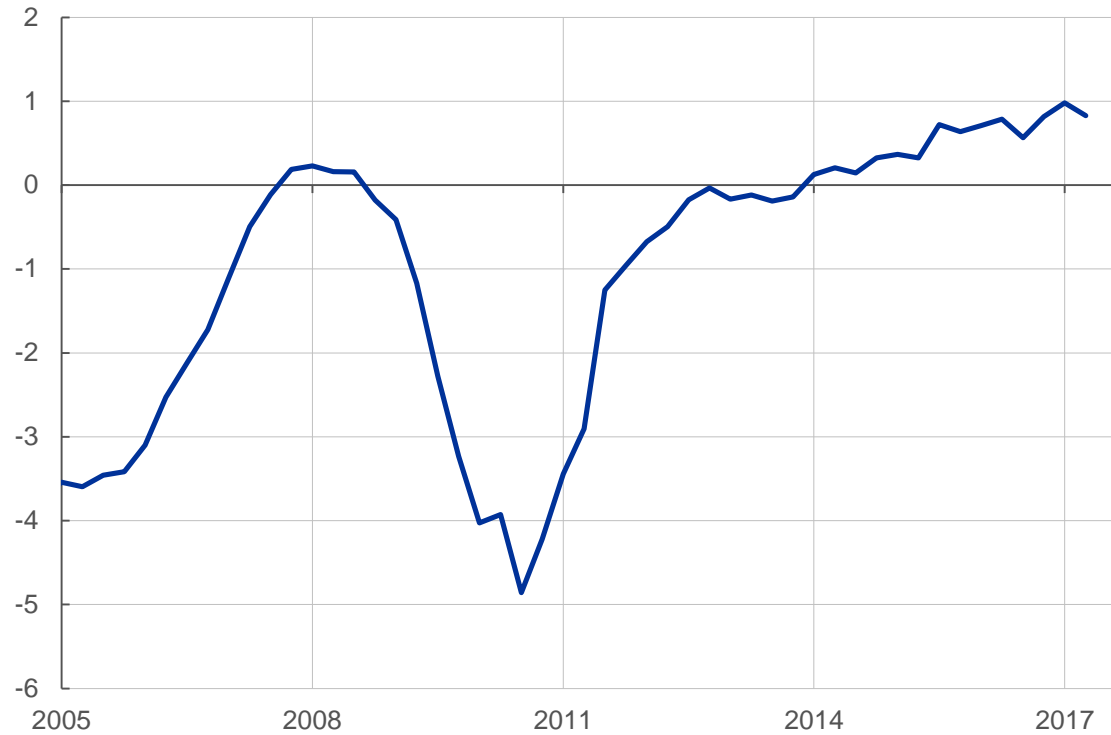


Source: United Nations.

Notes: Impacts of the recent increase in immigration to Germany only partly taken into account.

Latest observation: 2030 (forecast).

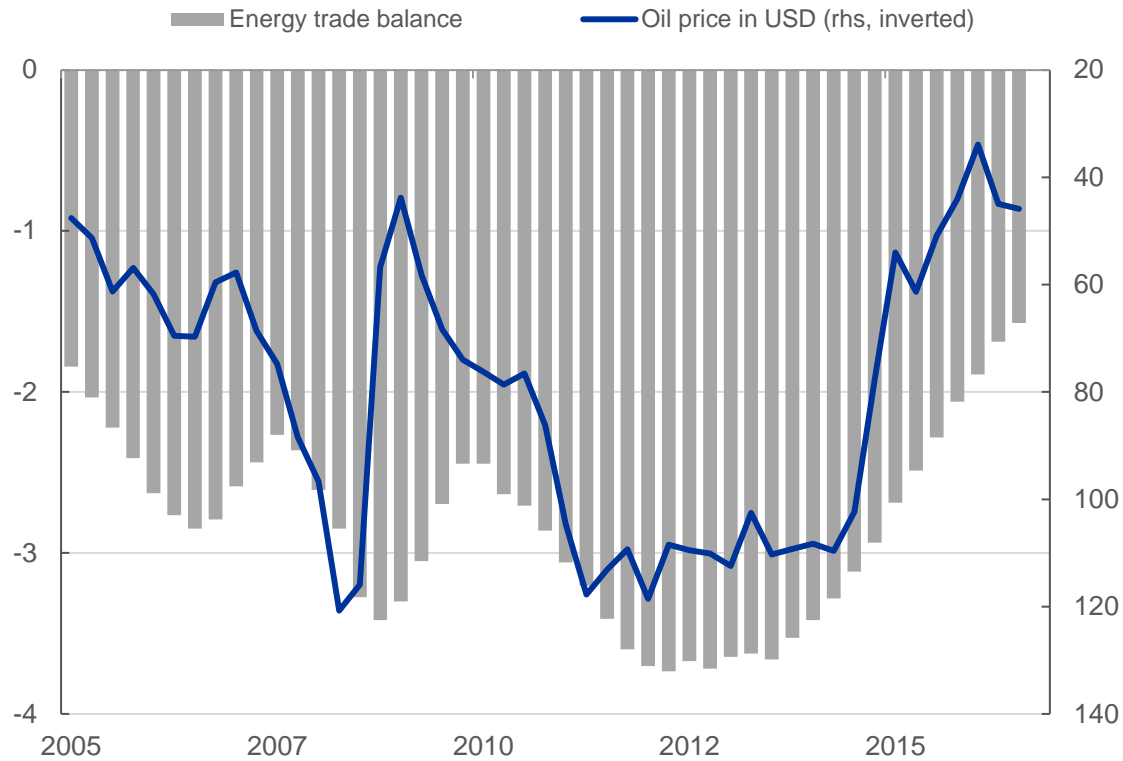
...fiscal consolidation ("twin surpluses")... (budget balance, % of GDP)



Source: ECB.
Latest observation: 2017Q2.

...and the recent oil price decline

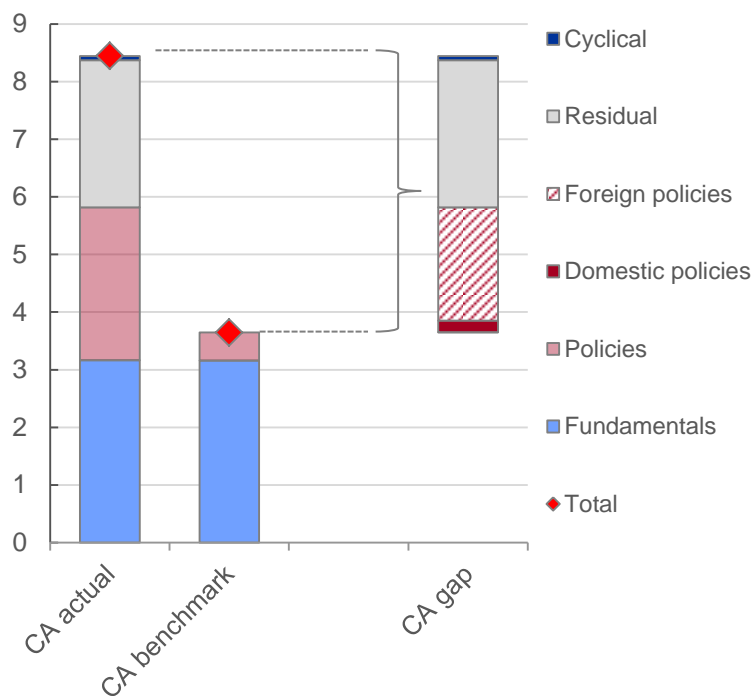
(lhs: % of GDP, rhs: USD per barrel)



Sources: Deutsche Bundesbank and Haver.
Latest observation: 2017Q2.

However, the **question** is if such economic fundamentals really justify a surplus of 9% of GDP...

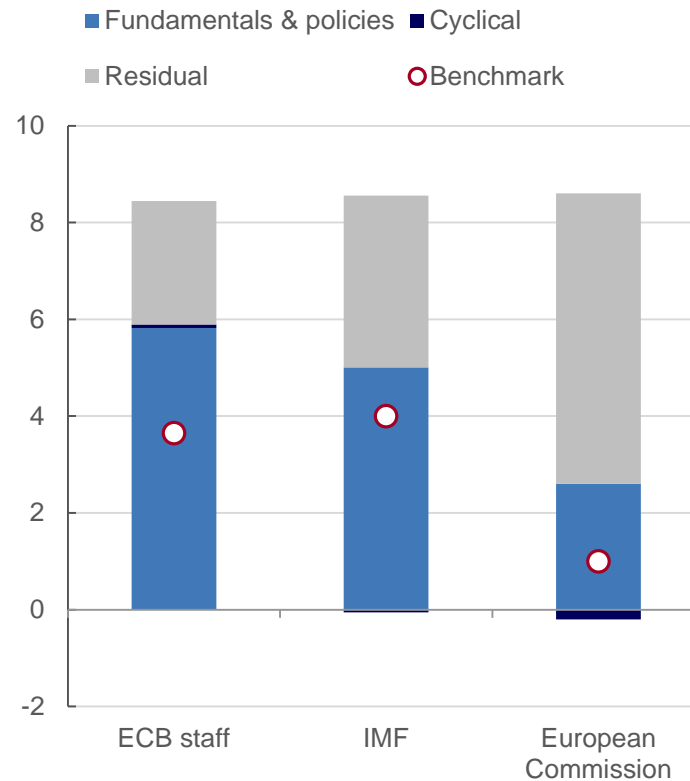
Yet, Germany's current account surplus still appears excessive... (% of GDP)



Source: ECB staff.

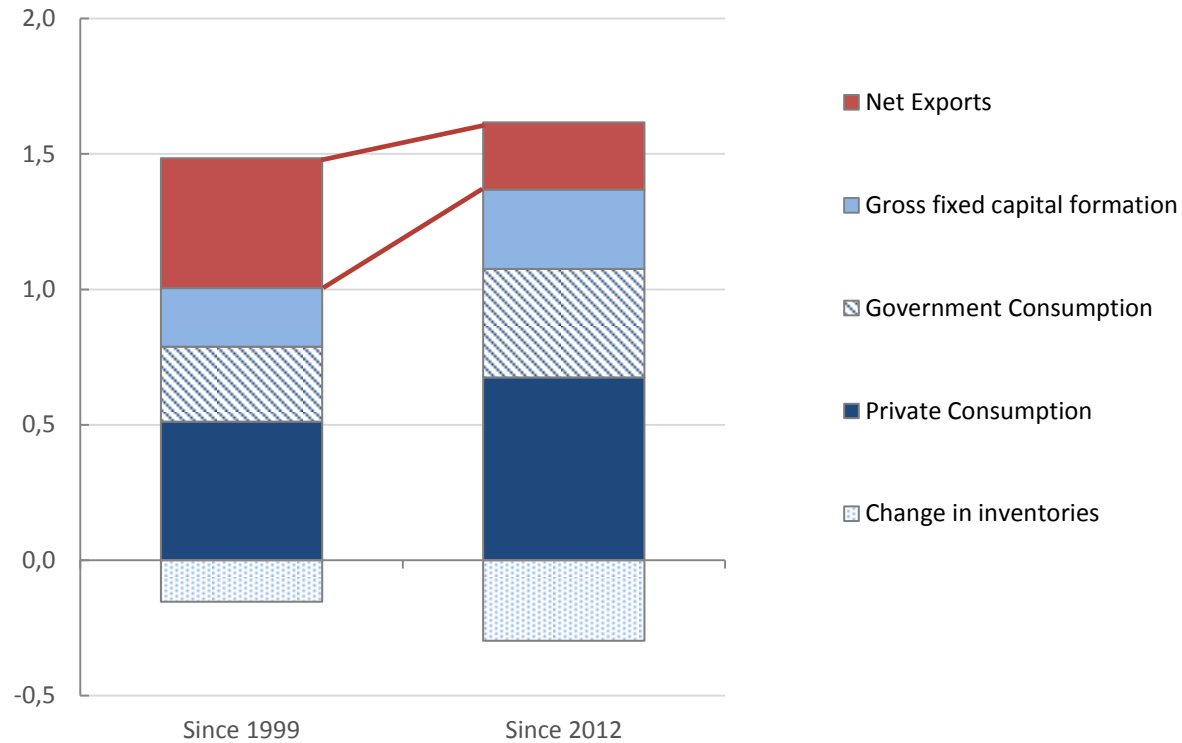
Note: The chart is based on the Current Account Benchmark (CAB) model. The results refer to the year 2016.

...broadly consistent with estimates of other institutions (current account, % of GDP)



Sources: European Commission (Country Report 2016), IMF (EBA 2016) and ECB staff.

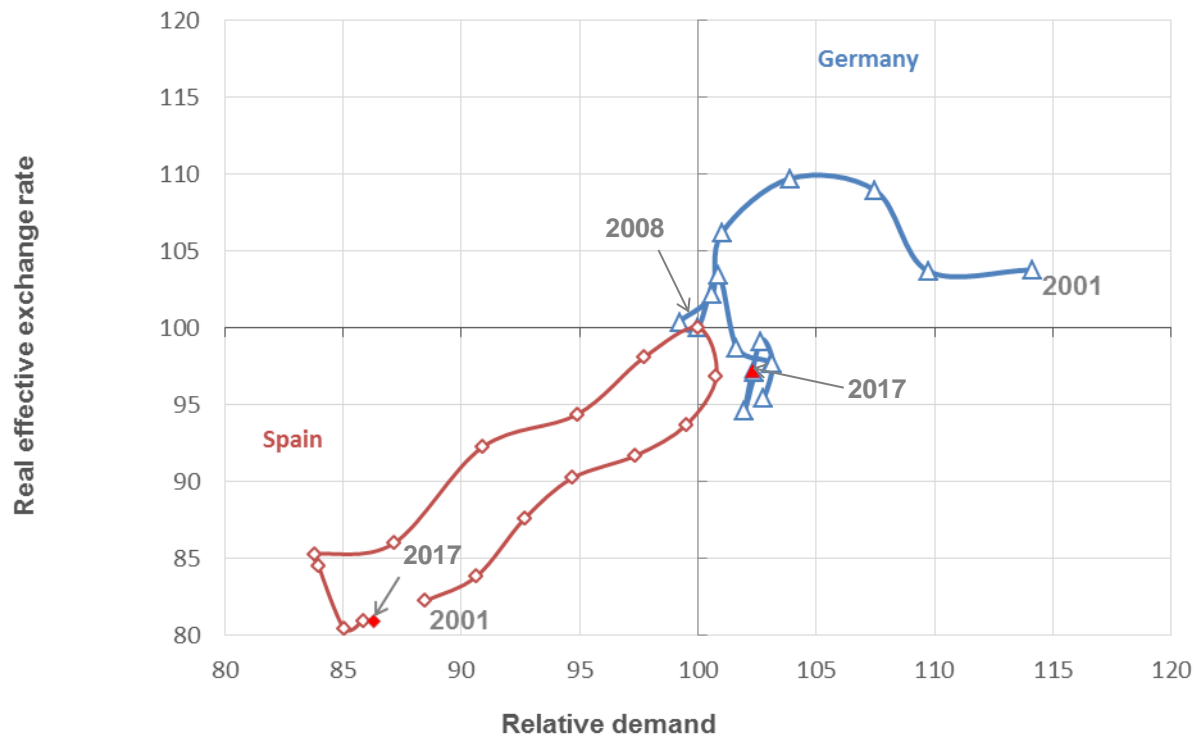
Despite reduced reliance on net exports as a growth engine... (average contributions to GDP growth)



Source: Statistisches Bundesamt.
Notes: Annualised geometric mean of quarterly growth rates.
Latest observation: 2017Q2.

...external rebalancing has progressed slowly in Germany...asymmetric rebalancing

(index, 2008=100)



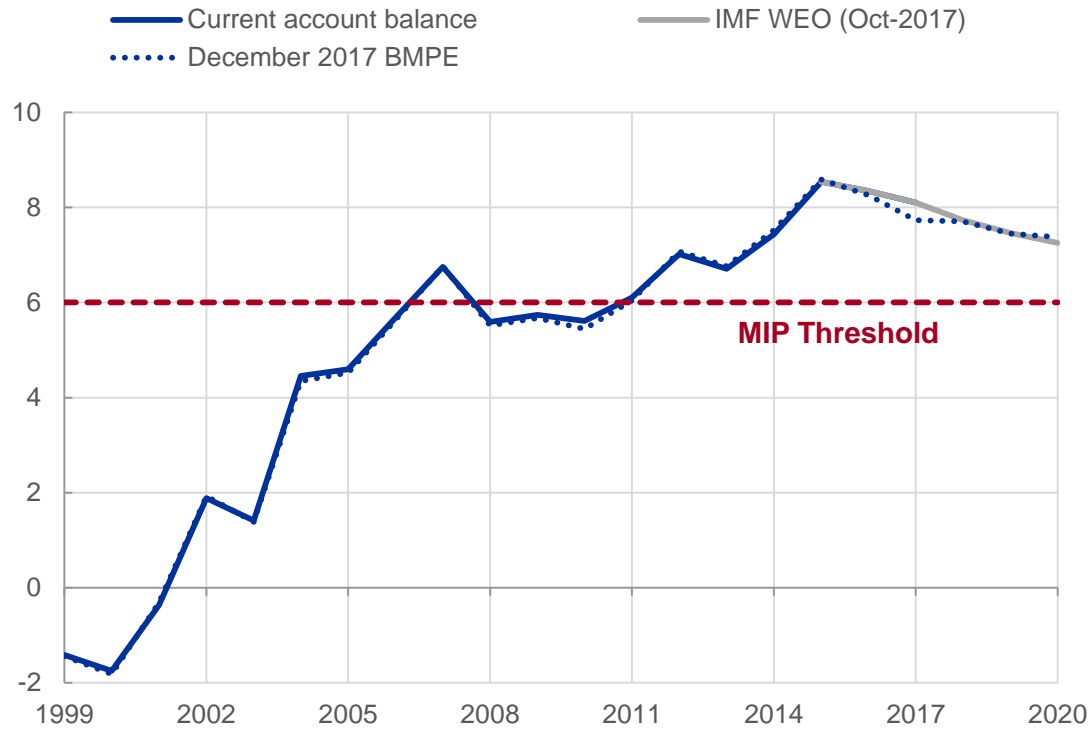
Sources: ECB and European Commission.

Notes: "Relative demand" is domestic demand divided by an export-weighted measure of trading partners' domestic demand. "Real effective exchange rate" is the ULCT-deflated HCl.

Latest observation: 2017 (partly forecasted).

...and the surplus is projected to unwind only gradually

(current account balance, % of GDP)



Sources: ECB and IMF.
Latest observation: 2020 (forecast).

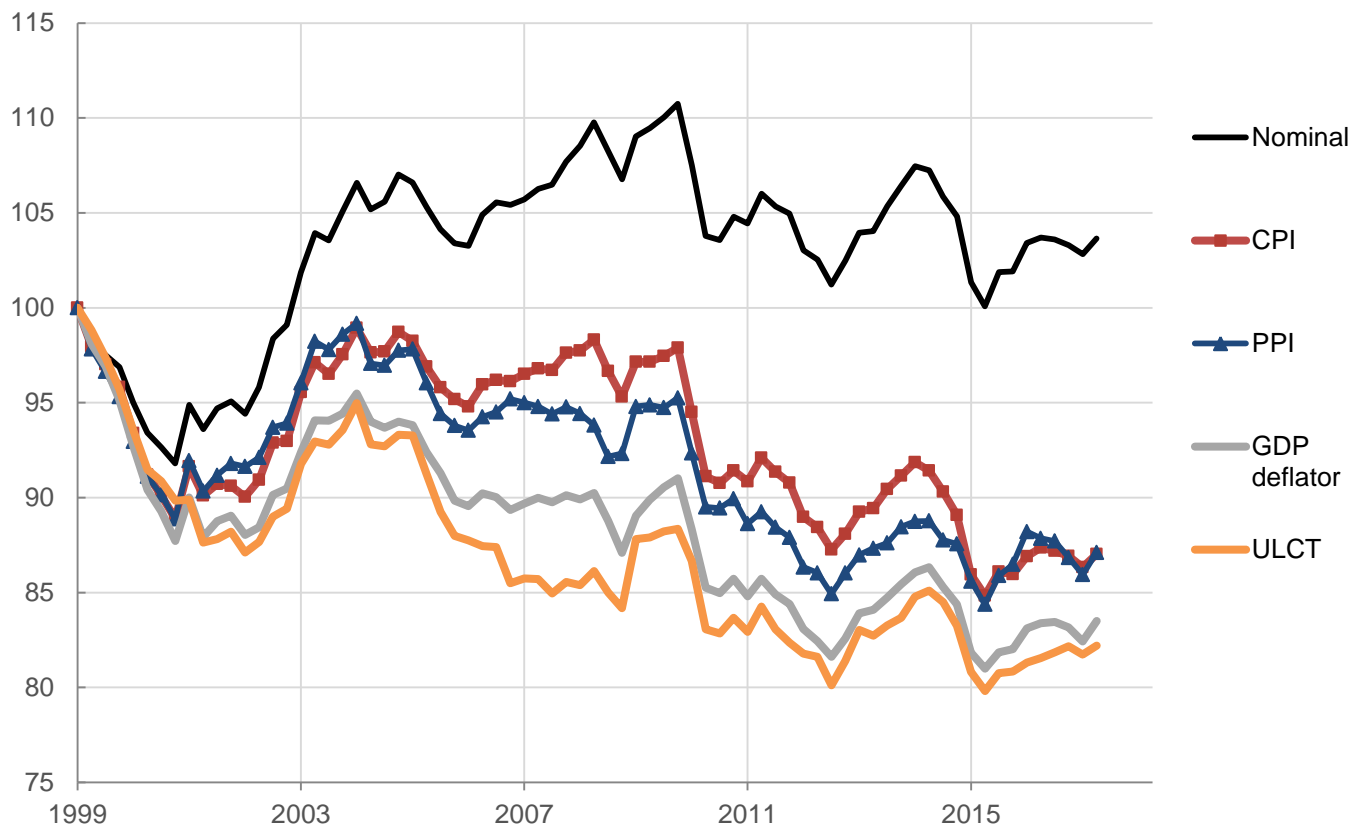
1 Is Germany's current account surplus excessive?

2 Is Germany's real exchange rate undervalued?

3 Why does this matter for Germany?

Gains in price competitiveness are not due to the nominal euro exchange rate...

(Germany's effective exchange rates, 1999Q1 = 100)



Source: ECB and ECB staff calculations.

Notes: A decline (increase) indicates an improvement (worsening) in price/cost competitiveness. CPI-deflated and nominal effective indicators are calculated vis-à-vis the other euro area Member States and 38 trading partners, while all other indicators are calculated vis-à-vis the other euro area Member States and 19 trading partners. Last observation 2017Q2.

● Germany 1993-2016

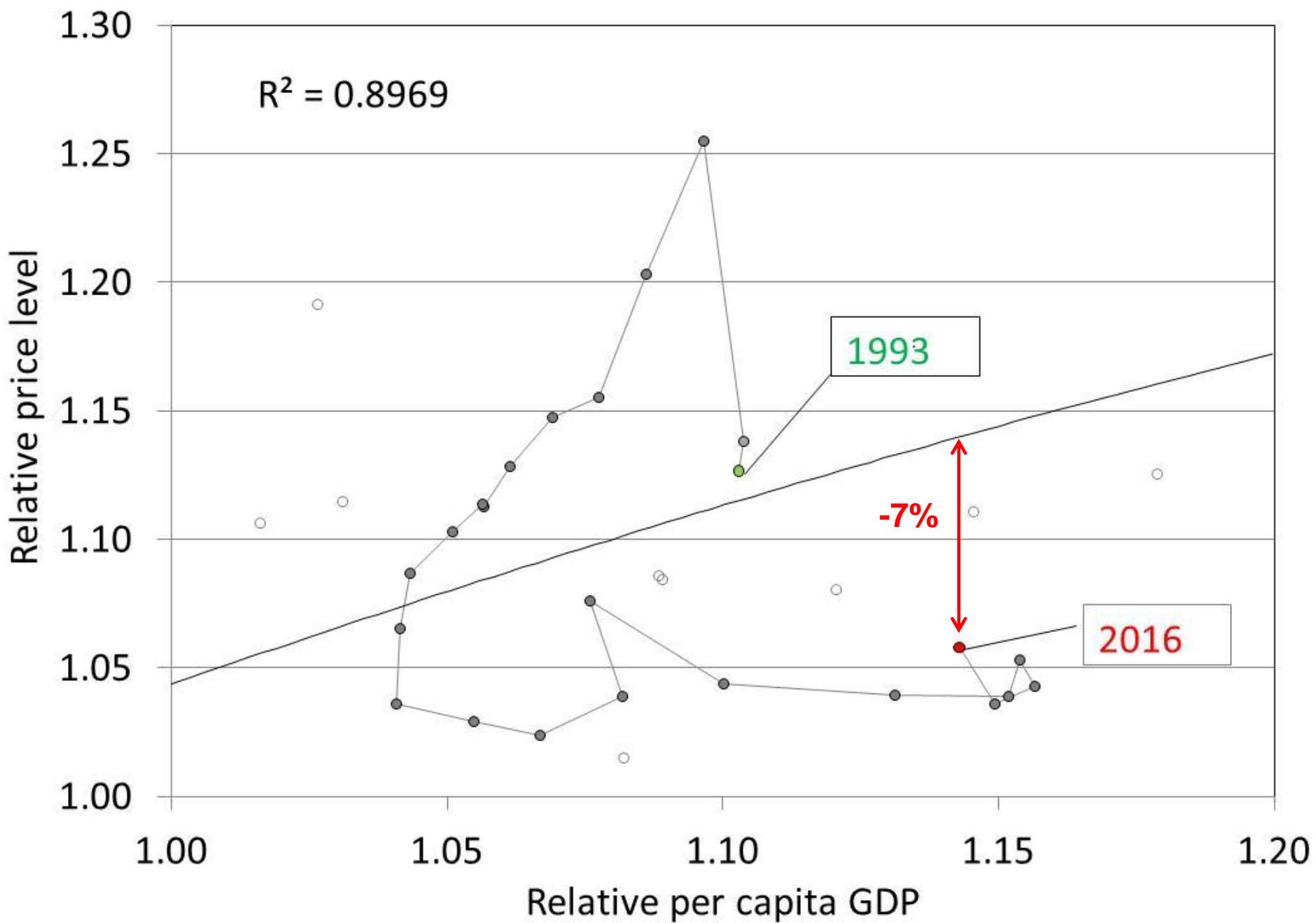


Table 1: ECB staff Behavioural Equilibrium Exchange Rate Model confirms the finding of significant undervaluation

(Estimated real exchange rate misalignment, in percent)

Real Exchange Rate Measure:		Effective vis-à-vis 57 trading partners	
Proxy for Balassa-Samuelson effect		GDP	Labour Productivity
Deflator:			
	CPI	-6.8	-5.2
	PPP	-6.1	-5.5
	PPI	-4.6	-2.4
	GDP	-6.6	-5.7
	ULCT	-5.3	-6.9

Source: ECB and ECB staff calculations.

Note: A negative figure indicates an undervaluation.

Table 2: Required inflation differential consistent with 1.9% euro area inflation to eliminate the lower-bound estimate of undervaluation over 3 years
(in percent)

	Inflation rate differential of Germany vis-à-vis the euro area	Inflation rate of Germany	Inflation rate of the rest of the Euro area
Deflator:			
CPI	1.2	3.1	1.4
GDP	0.8	2.7	1.6
ULCT	2.5	4.4	0.8

Source: ECB and ECB staff calculations.

1 Is Germany's current account surplus excessive?

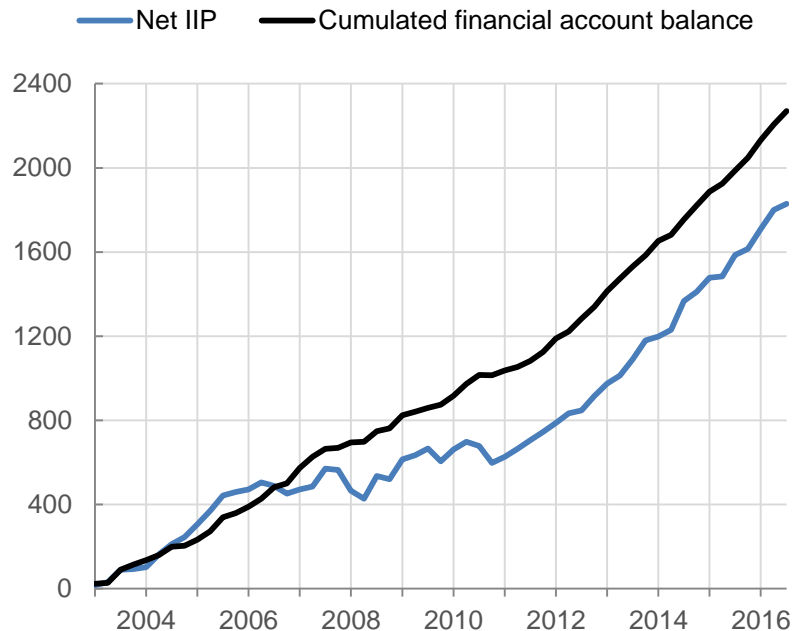
2 Is Germany's real exchange rate undervalued?

3 Why does this matter for Germany?

Why does this matter for Germany?

Net foreign asset position falling short of cumulated current account surpluses...

(cumulated financial account balance and net international investment position EUR bn)



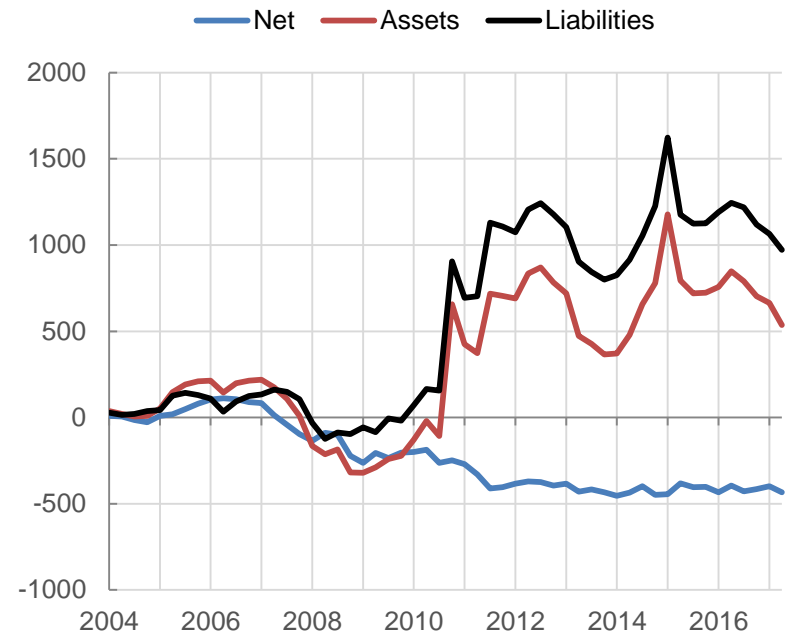
Sources: Bundesbank and ECB staff calculations.

Note: The difference between the net IIP and the cumulated financial account balances (= current account + capital account) reflects valuation effects (and possibly other effects, such as measurement error).

Latest observation: 2017Q2.

...reflecting poor investment decisions or effective international risk sharing?

(valuation effects on international investments since 2004, EUR bn)



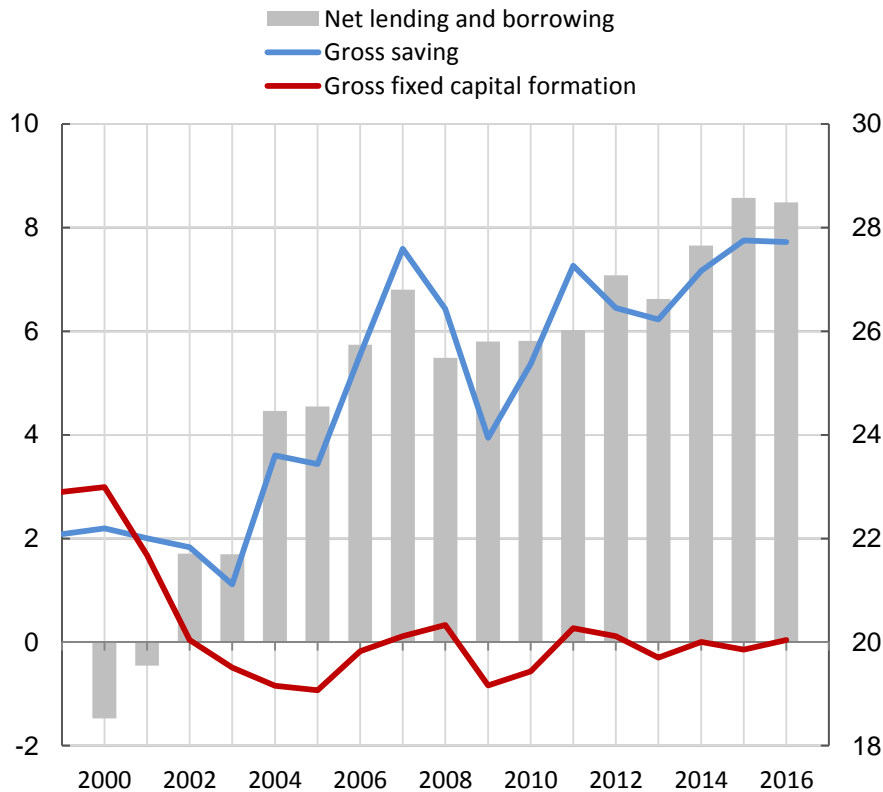
Sources: Bundesbank and ECB staff calculations.

Latest observation: 2017Q2.

Why does this matter for Germany?

High savings amid a persistent weakness of investment...

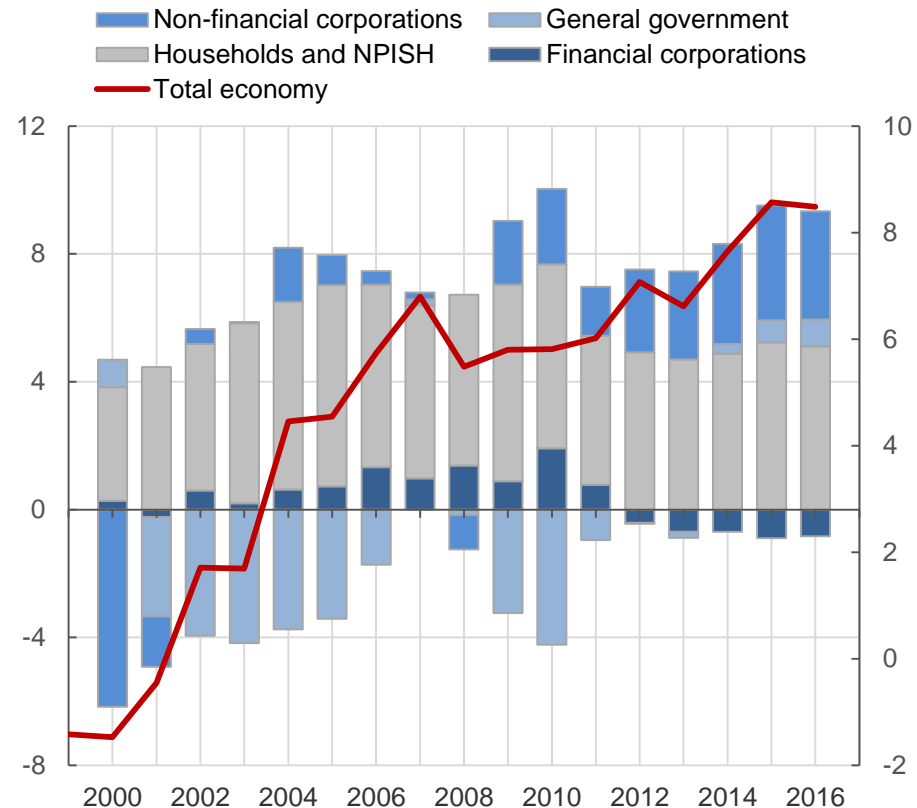
(breakdown of Germany's net lending/borrowing, % of GDP)



Source: European Commission.
Latest observation: 2016.

...in particular driven by NFC net lending...

(Germany's net lending/borrowing by sector, % of GDP)



Source: European Commission.
Latest observation: 2016.

Why does this matter for Germany?

...despite completed deleveraging...
(Germany's NFC debt relative to financial assets, %)

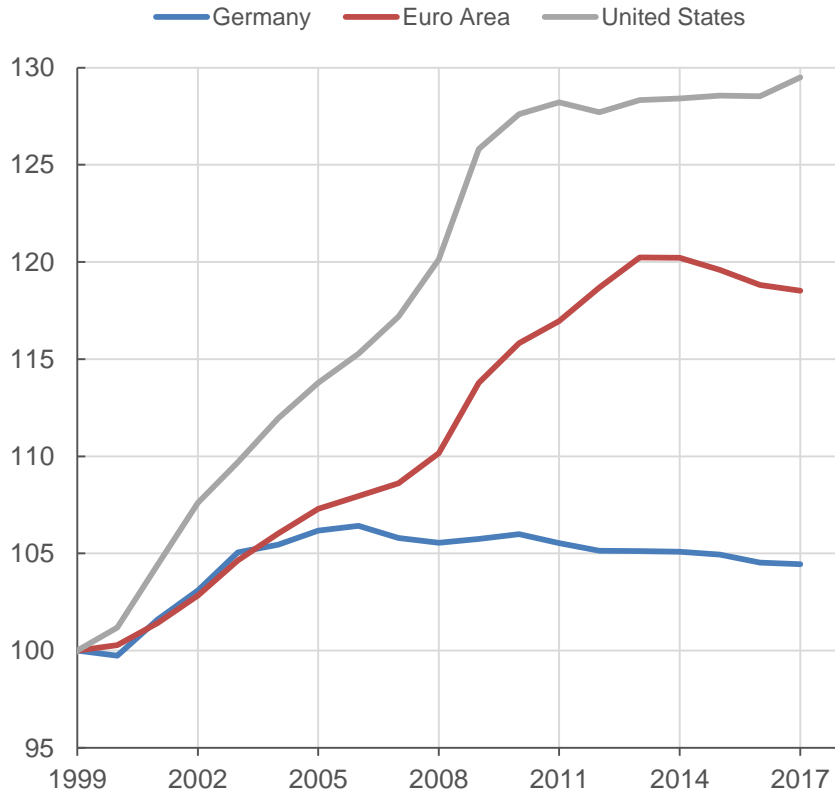


Source: European Commission.
Latest observation: 2017Q1.

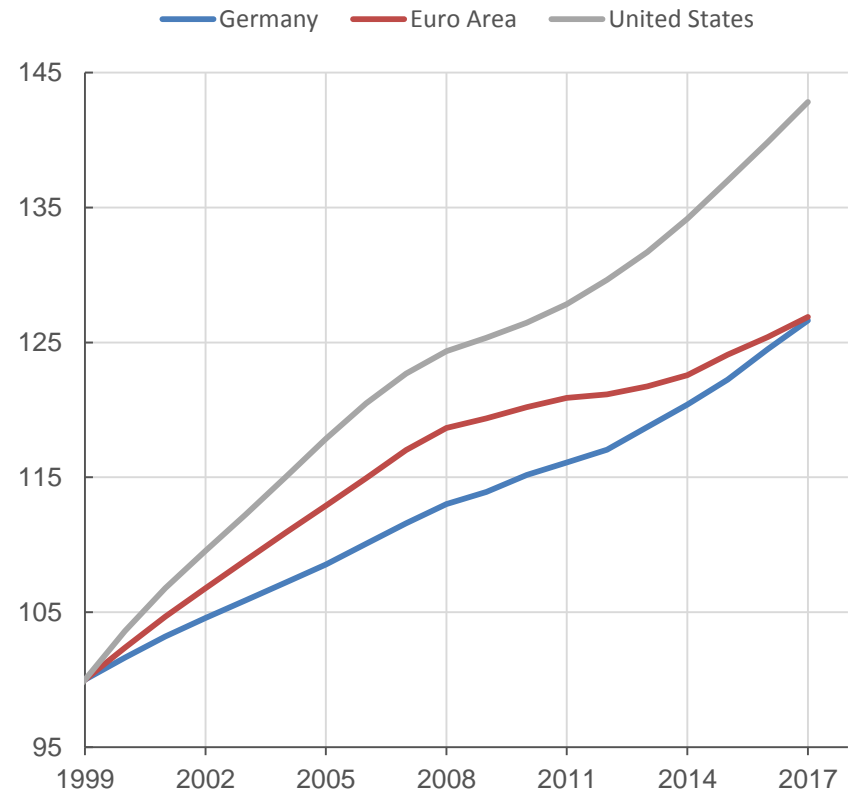
Why does this matter for Germany?

...keeps a mark on Germany's capital stock and longer-term growth...

(net capital stock per person employed, index, 1999=100)



(potential output, index, 1999=100)



Source: European Commission.
Latest observation: 2017 (partly forecast).

