

Czech and EA Convergence

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EEAG Report on European Economy 2019 presented today by Prof. Clemens Fuest focuses on key convergence and structural issues faced by EA (such as under-performance of Italy and long-term challenges posed by China)

CNB each year publishes:

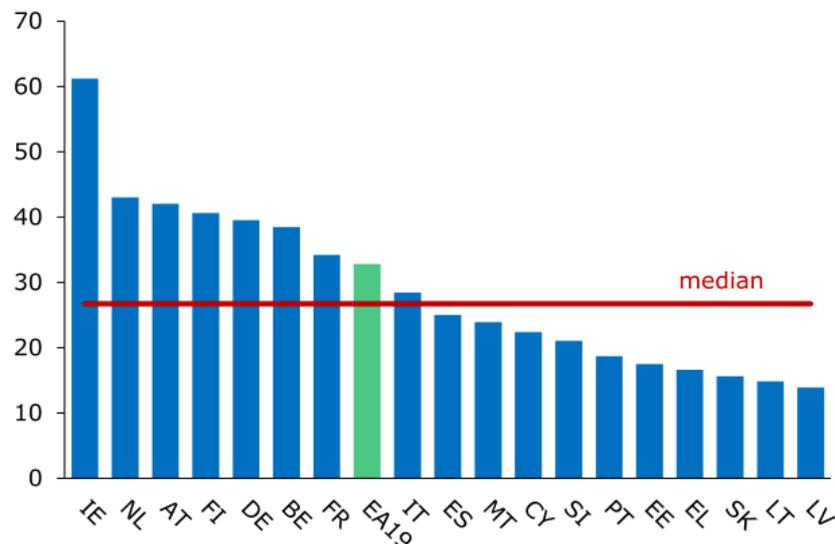
- *Analyses of Czech Republic's current economic alignment with euro area* – most recent: December 2018
- *Assessment of fulfilment of Maastricht convergence criteria and degree of economic alignment of Czech Republic with euro area* – published jointly with Ministry of Finance of Czech Republic

Note: Restriction on communication prior to CNB Board meeting (held on 28 March 2019) prevents me from commenting on Chapter 1 of EEAG Report or other current issues.

1. Euro area convergence
2. Czech economic convergence
3. Some takeaways

EURO AREA CONVERGENCE

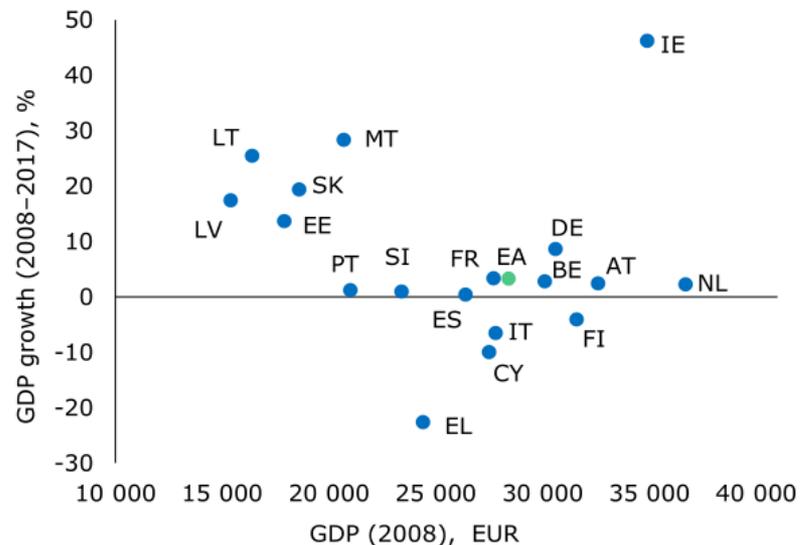
GDP per capita in euro area countries
(2017, GDP at current prices in EUR thousands)



Note: Luxembourg is not included in either of the charts due to the many specificities of its economy, which result in exceptionally high GDP per capita.

Source: Eurostat.

Beta-convergence of real GDP in euro area countries

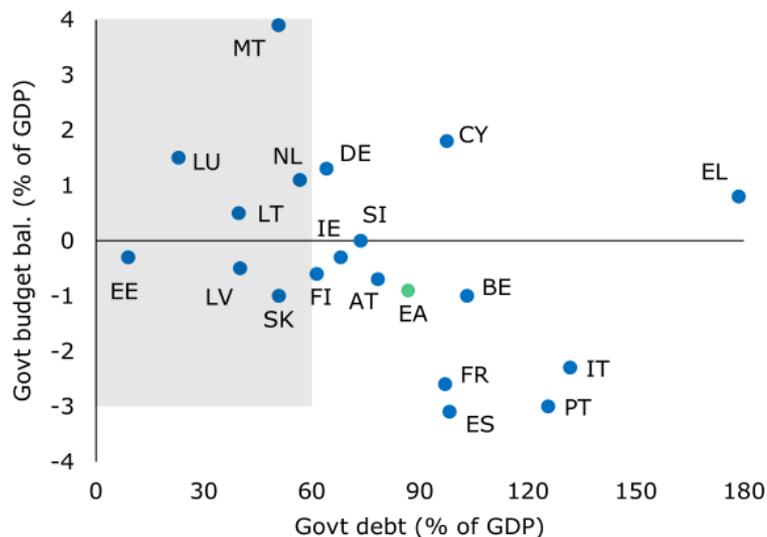


Note: The chart depicts the relation between GDP growth per capita in each country and its initial level (beta-convergence).

Source: Eurostat.

- Economic strength remains very heterogeneous across euro area economies.
- Real convergence is taking place in new member states (LT, LV, SK), while no convergence is being observed in countries hit by financial or debt crises (CY, EL, IT).

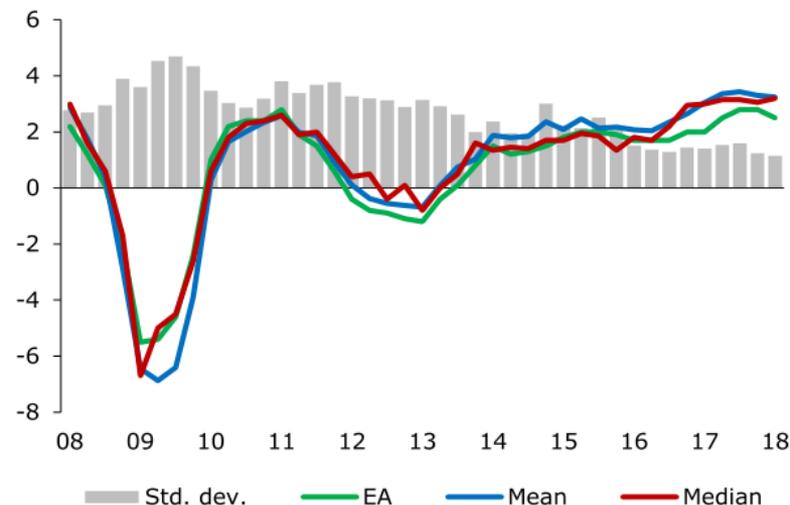
Fiscal positions of euro area countries (2017)



Note: 2017 data. Countries compliant with the Stability and Growth Pact lie in the grey area.

Source: Eurostat.

Real GDP growth in euro area countries (y-o-y, %)

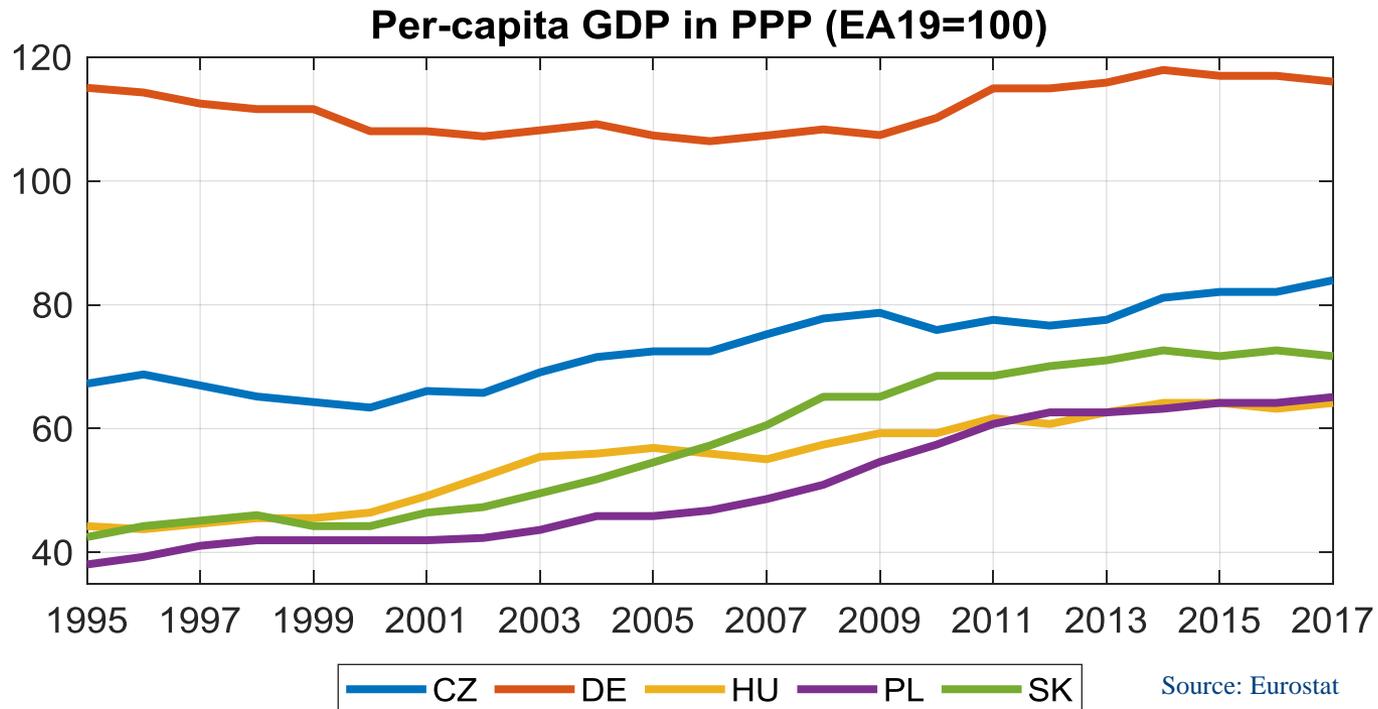


Note: The mean series depicts the unweighted arithmetic mean of GDP growth in the given quarter across euro area countries. Data for Ireland were not included due to exceptionally high growth in 2015. The source series are seasonally adjusted.

Source: Eurostat, CNB calculations.

- Fiscal indiscipline is long-standing problem in euro area, as most countries are not compliant with debt and deficit criteria (southern euro area countries in particular).
- However, alignment of business cycles has risen in recent years.

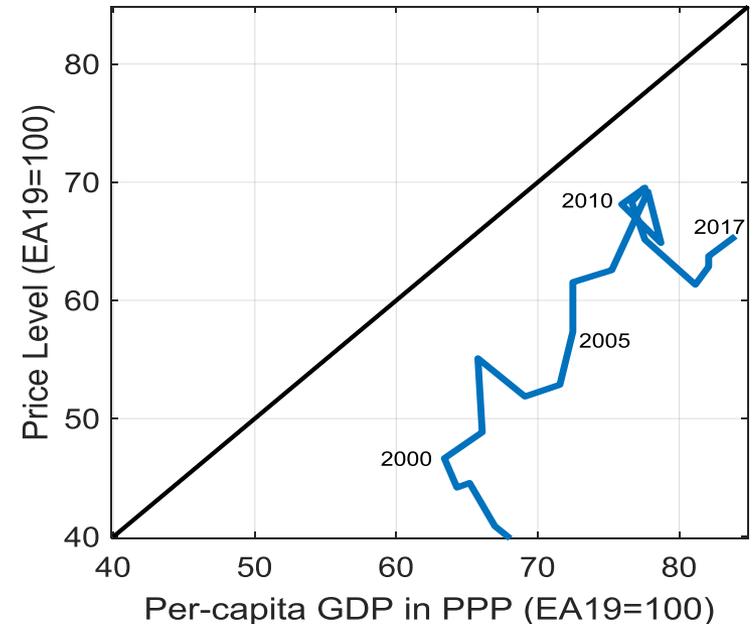
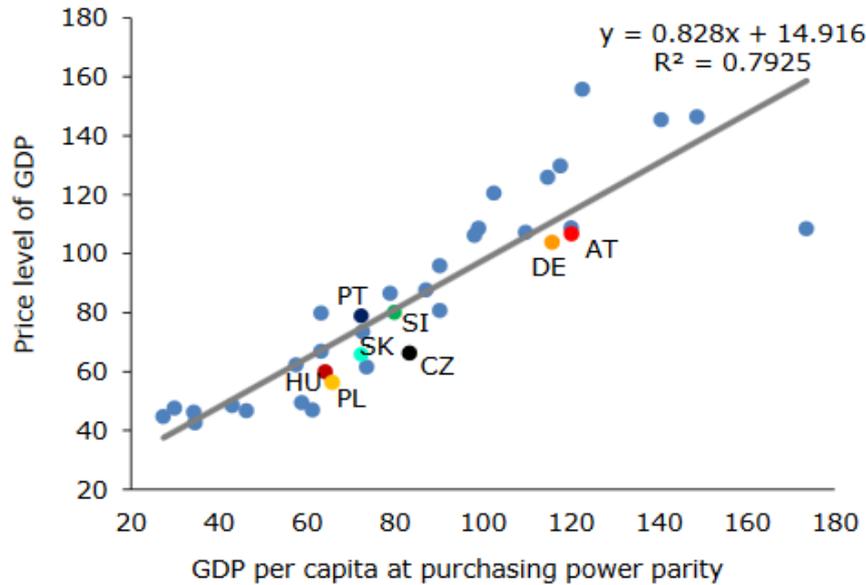
CZECH ECONOMIC CONVERGENCE



- Czech real per-capita GDP in PPP reached 83% of EA19 in 2017, resuming its convergence after slowdown of 2010–2013.
- There were originally higher expectations after joining EU and successful initial transformation to market-based economy.
 - Per-capita GDP increased by 15 p.p. in 1995–2017, i.e. by about 0.7 p.p. per year.
 - Is there risk of “middle-income trap”?

GDP per capita at purchasing power parity versus the price level

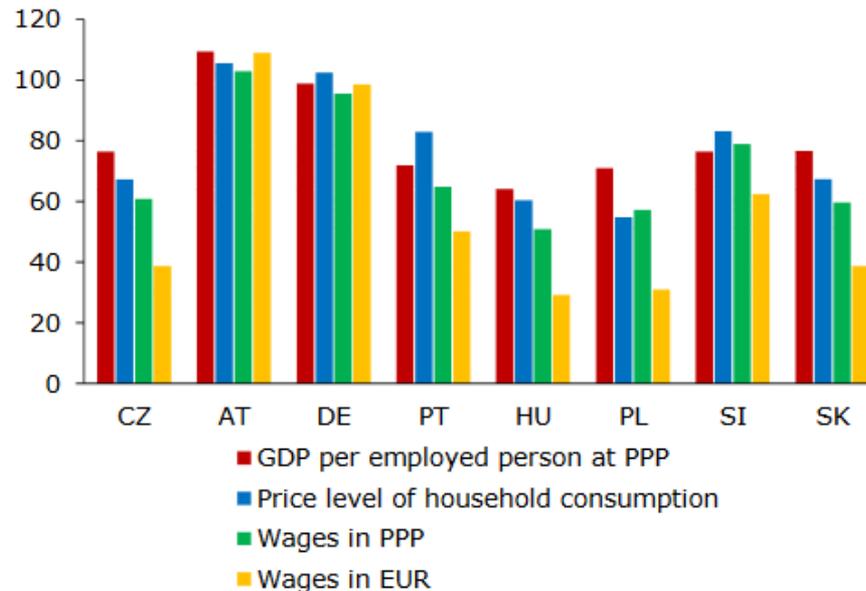
(2017, EA = 100)



Source: Eurostat, CNB calculations.

- Czech price level is below level corresponding to GDP per capita by international comparison \Rightarrow ample space for real exchange rate appreciation.
- However, situation is similar in other Central European countries and initial price gap has not closed since 2000 (i.e. may reflect some persistent factors).

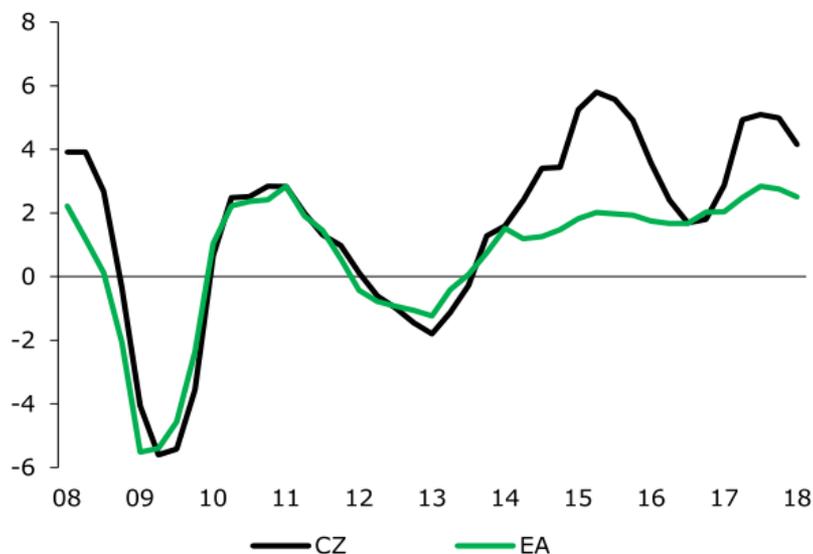
Other indicators of long-term convergence (2017, EA = 100)



Source: Eurostat, European Commission, CNB calculations.

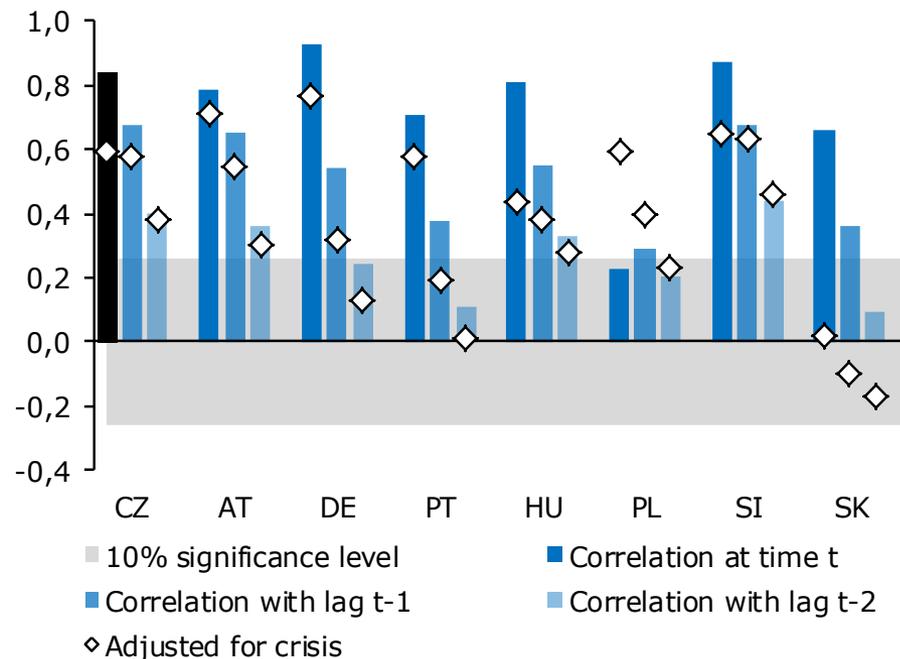
- Lower wage level compared to euro area average \Rightarrow incomplete convergence.
 - Czech wages at purchasing power parity are roughly 60% of euro area average and only around 40% in euro terms.
 - Situation is similar in Slovakia, which has similar level of GDP per employee.

Year-on-year changes in real GDP (%)



Source: Eurostat, CNB calculations.

Correlation coefficients of GDP with the euro area



- Cyclical alignment with EA was particularly strong during economic crisis and has declined during recovery on back of independent monetary policy (including unconventional measures such as CNB's FX commitment).
- Alignment remains relatively high, though, owing to strong trade links.

SOME TAKEAWAYS

- Euro area
 - Real convergence has been experienced mainly by newcomers who are not struggling with fiscal indiscipline and high public debt.
 - Cyclical alignment is rising.
- Czech Republic
 - Convergence has resumed after pause in 2010–2013.
 - However, convergence is slower than originally expected.
 - There is incomplete convergence in prices and wages.
 - Cyclical alignment with EA is relatively high.

Economic convergence seems to be spread over decades, significantly hindered by crises and structural issues.

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