Development of economic alignment among euro area countries

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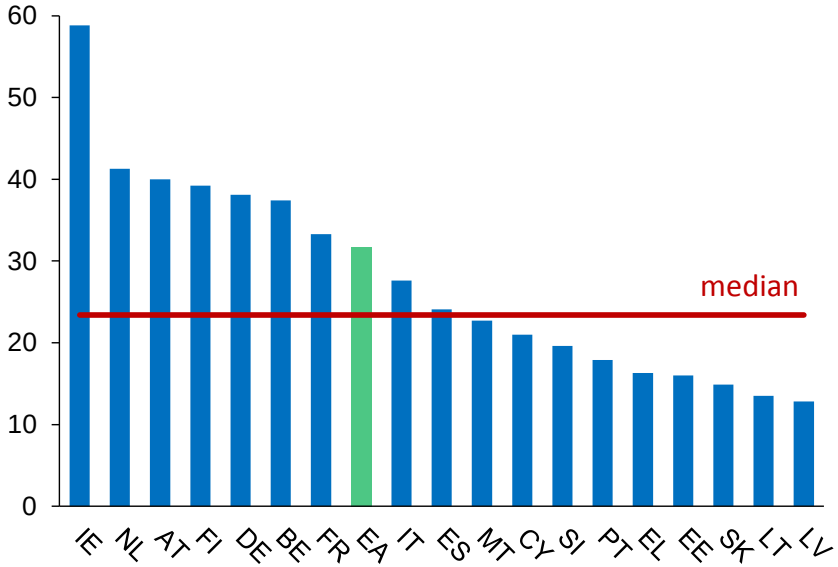
Outline

- I. Real Convergence (GDP and unemployment)
- II. Fiscal position
- III. Inflation, bond yields
- IV. Funding costs and bank loans

I. Real convergence (GDP)

GDP per capita in euro area countries
(2016, EUR thousands)

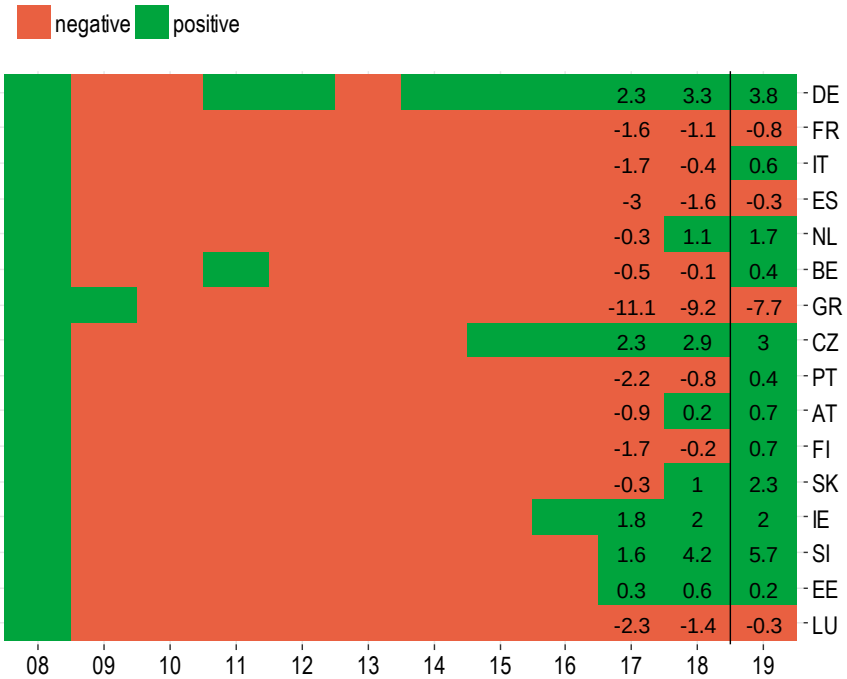


Note: GDP at current prices. The horizontal line shows the median value across euro area countries. Luxembourg is not included in the chart due to the specific structure of its economy (the high number of foreign workers in the country and the large number of high-value-added international corporations based there), which results in exceptionally high GDP per capita in the country.
Source: Eurostat

GDP per capita in EA:

- expresses wealth levels
- is very diverse
- in founding countries (EA-11) exceeds 30000 EUR
- in newcomers is only around 15000 EUR
- median = red line

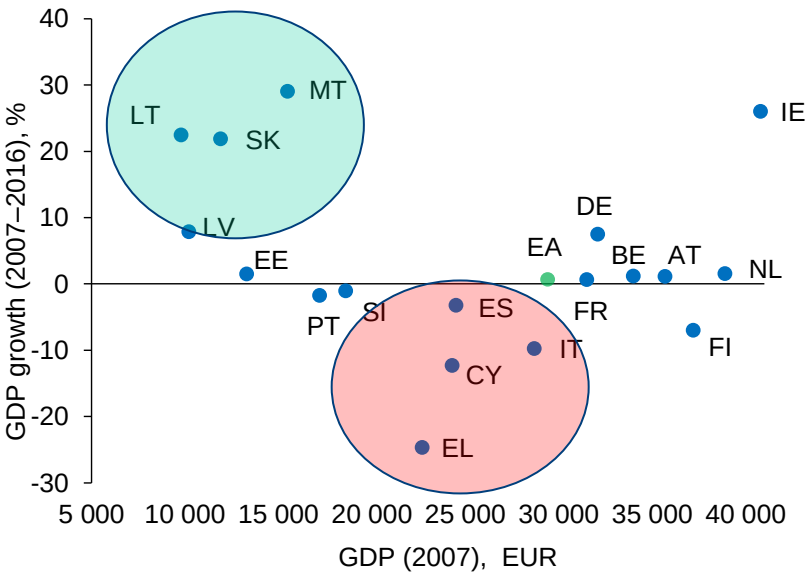
Output gaps in euro area countries and the Czech Republic
(% of GDP)
Note: only OECD member states are shown, countries are sorted by the size of population



Source: OECD

I. Real convergence (GDP)

Beta-convergence of real GDP in EA



Note: The chart depicts the relation between GDP growth per capita in each country and its initial level (beta-convergence). X-axis – the GDP per capita of each country in 2007 at 2010 prices. Y-axis – real GDP growth in 2007–2016.
Source: Eurostat

Beta-convergence:

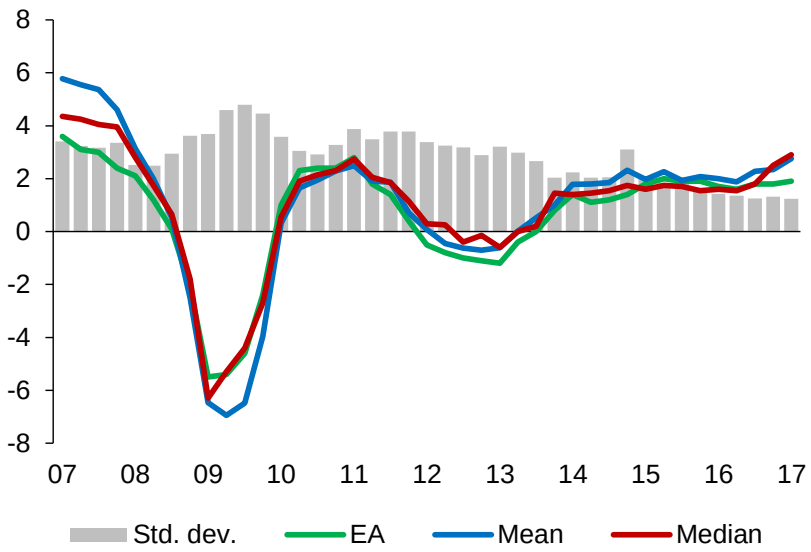
- **theory:** less advanced countries should grow faster than wealthier ones
- **reality**: this is occurring only partially in the euro area
- newcomers (Latvia, Lithuania, Malta and Slovakia recorded the highest growth rates => convergence to the wealthier EA countries)

BUT

- others (Italy, Cyprus, Greece and Spain) showed a decline in output => divergence from the wealthier EA countries

I. Real convergence (GDP, unemployment)

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



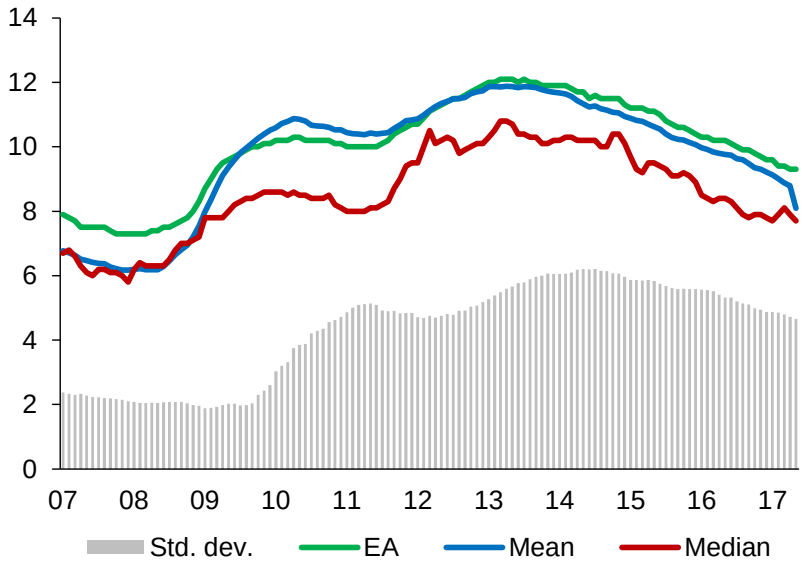
Note: The mean series depicts the unweighted arithmetic mean of GDP growth in the given quarter across euro area countries. Data for Ireland were not included due to exceptionally high growth in 2015, which exceeded 20% owing to the relocation of the headquarters of several international corporations to Ireland. The source series are seasonally adjusted.
Source: Eurostat, CNB calculations.

GDP growth in EA:

- **business cycles** in the euro area has become more aligned, as indicated, for example, by a decrease in the standard deviation of real GDP growth across countries
- **low growth in large economies** (Germany, France and Italy) relative to smaller countries => rate of growth of the euro area as a whole being lower than the average and median rates across all countries in recent quarters.

I. Real convergence (GDP, unemployment)

Unemployment in euro area countries
(y-o-y, %)



Note: The mean series depicts the arithmetic mean of unemployment in the given month across euro area countries. The source series are seasonally adjusted.
Source: Eurostat, CNB calculations.

Unemployment in EA:

- **the upswing in the business cycle** is also apparent in the labour market
- **unemployment rate** is decreasing and the cross-country dispersion of its levels is also going down
- **unemployment in the euro area dropped to the 2011 level** and the differences between countries narrowed further
- **the unemployment rate in Germany** fell to historical lows (below 4%)

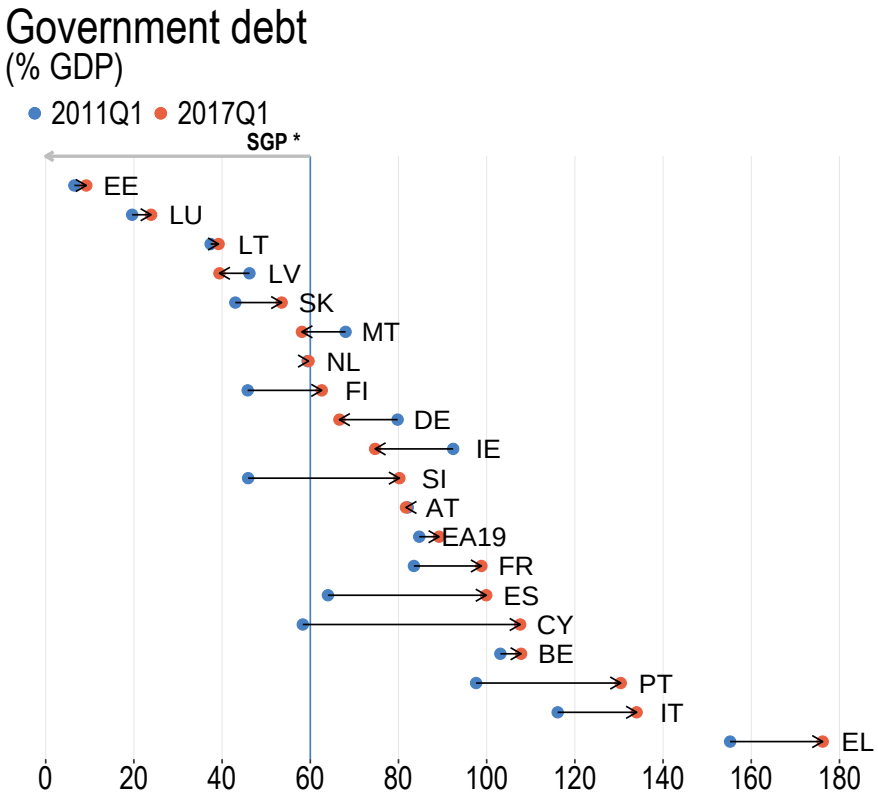
BUT

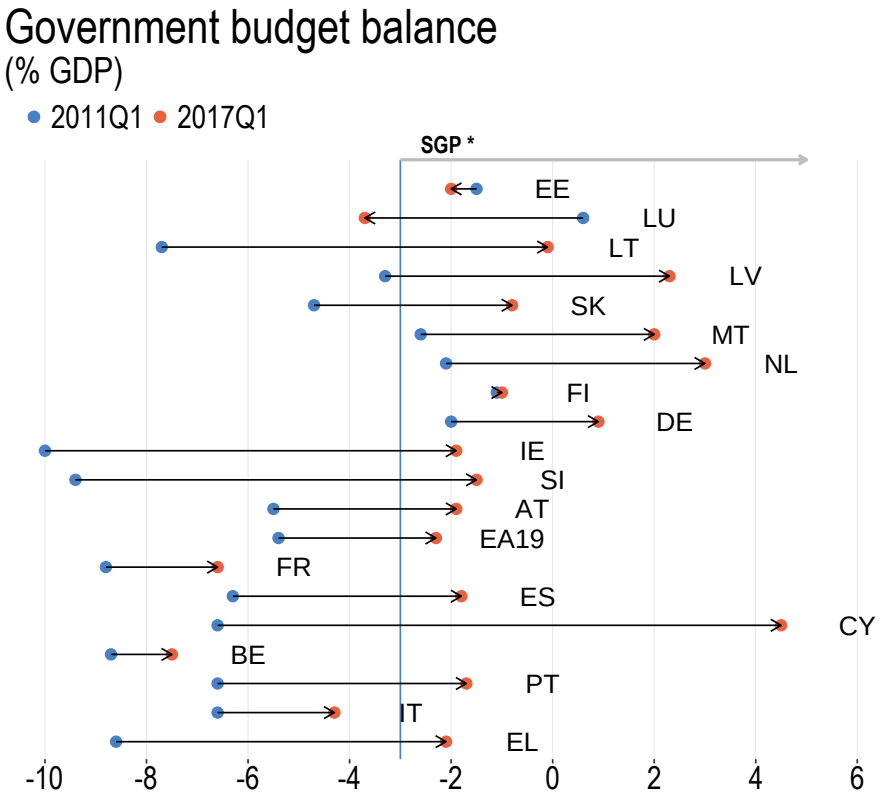
- **high unemployment, especially among people aged 16-24**, remains a key macroeconomic and social problem in some countries (in particular Greece, Italy and Spain)

II. Fiscal positions

- The decline in real GDP in the southern euro area countries was due in part to the **restrictive fiscal policy** that their governments had to pursue despite a cyclical contraction or stagnation of their economies.
- However, fiscal positions of euro area countries shows, even though **government budget balances** shifted more towards balanced budgets or surpluses between early 2011 and 2017, only Germany, Ireland, Latvia and Malta recorded decreases in debt.
- After a country joins the monetary union, it needs to maintain or create **fiscal space for stimulating the national economy** at times of crisis, especially in the absence of major fiscal transfers between countries.
- In this respect, **fiscal indiscipline of individual EMU members is a long-running problem in the euro area** – several countries were not compliant with the Stability and Growth Pact even before the crisis.

Fiscal positions of euro area countries
(y-o-y, %)

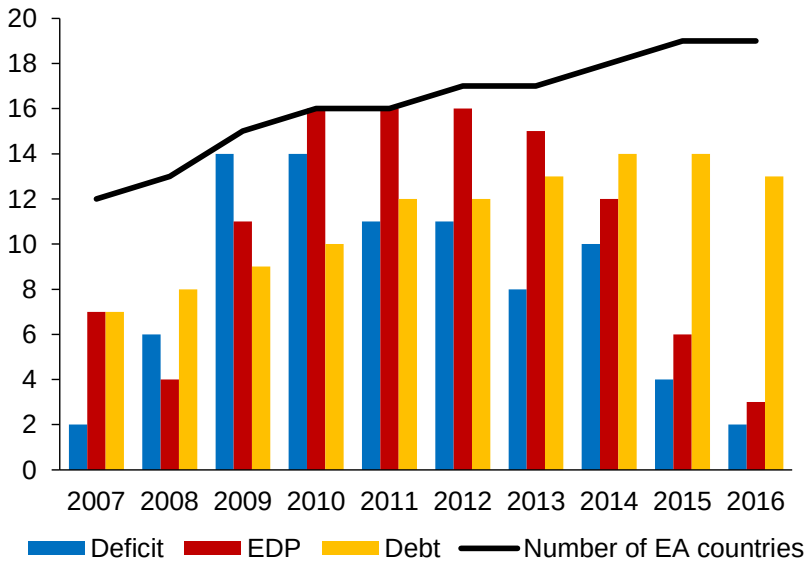




Note: Countries compliant with the Stability and Growth Pact (SGP) lie in the area labelled SGP*. The SGP sets limits on government deficits (3% of GDP) and debt (60% of GDP). The starting point (2011 Q1) was chosen to capture the negative fiscal effects of the financial crisis (such as rescue programmes in banking sectors financed from state budgets).
Source: Eurostat.

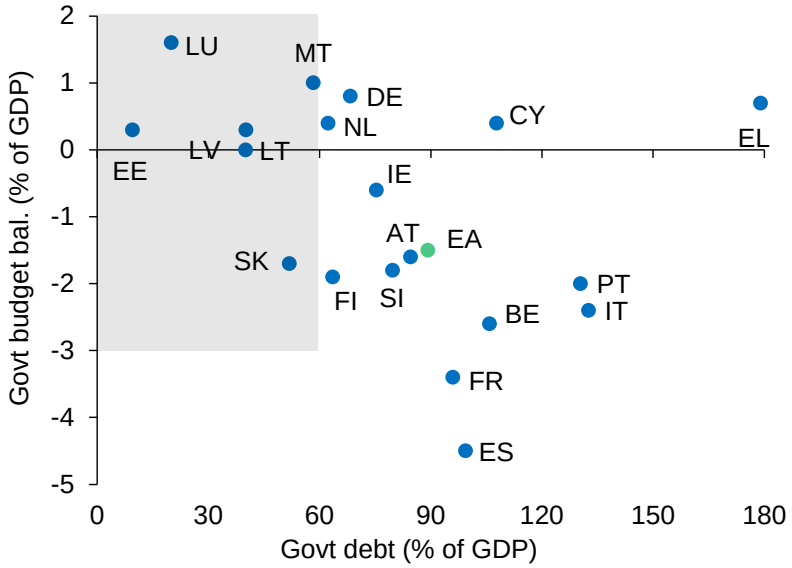
II. Fiscal positions

Non-compliance with the fiscal criteria



The number of countries non-compliant with the Stability and Growth Pact. The EDP series shows the number of countries in an excessive deficit procedure. The number of countries in an EDP can be higher than the number of countries with an excessive deficit, as EDPs usually last several years.
Source: Eurostat, European Commission, CNB calculations.

Fiscal positions of euro area countries

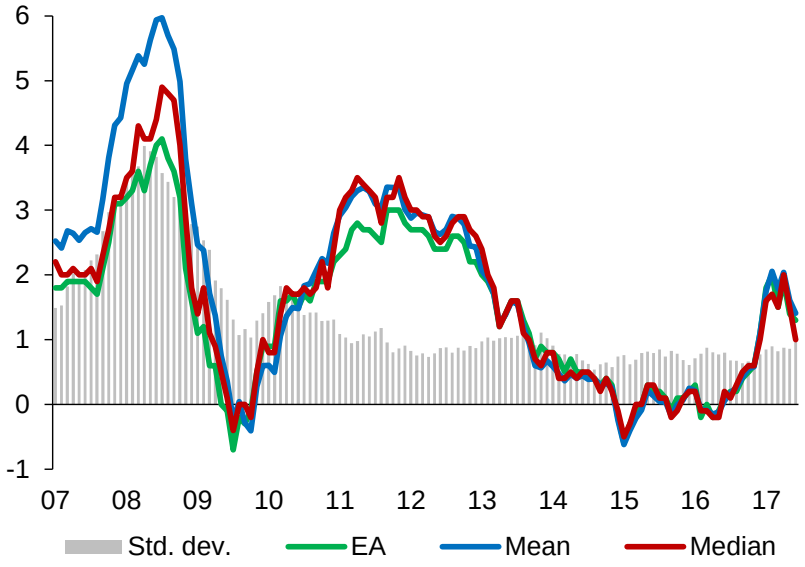


Note: 2016 data. Countries compliant with the Stability and Growth Pact lie in the grey area.
Source: Eurostat

- Only six countries were compliant with the debt and deficit criteria at the same time in 2016.

III. Inflation, bond yields

Inflation in euro area countries in EA (%)



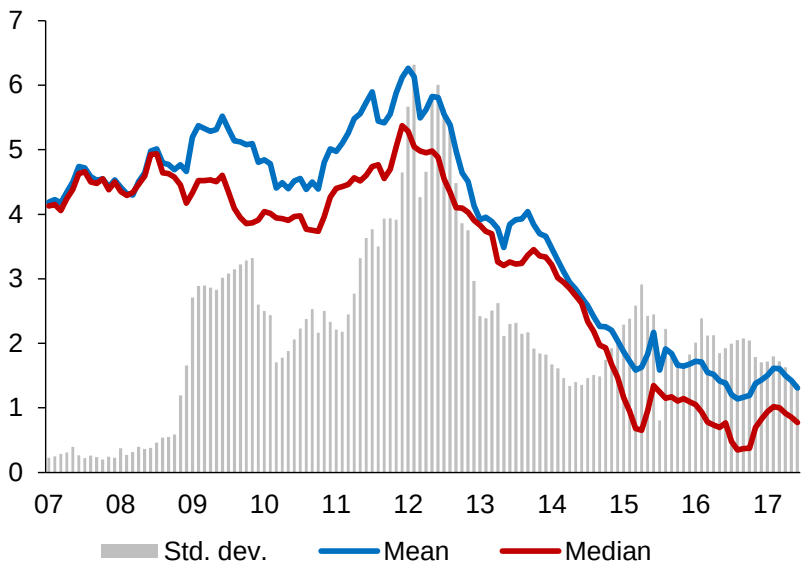
Note: The mean series depicts the unweighted arithmetic mean of inflation in the given year across euro area countries.
Source: Eurostat, CNB calculations.

Inflation in EA:

- **euro area inflation** remains below the ECB's definition of price stability
- although headline inflation rose above 2% at the start of 2017 due to base effects and a rise in energy prices; it has gone down again in recent months.
- **core inflation** remains stable just above 1%, reflecting among other things low wage growth, which persists despite a decline in the unemployment rate across the euro area countries.
- **the cross-country alignment** of the inflation rate, as captured by the standard deviation, showed no major changes

III. Inflation, bond yields

Long-term government bond yields in EA (%)



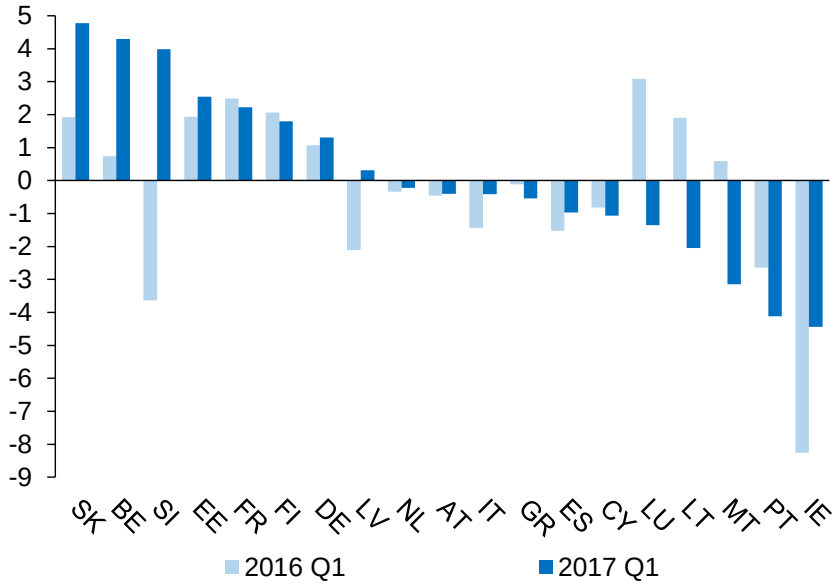
Note: Bond yields for the convergence criteria. The bond maturity is about ten years. Estonia is not included in the chart because the time series is not available.
Source: ECB, CNB calculations.

Long-term government bond yields in EA:

- declined mainly due to the **ECB's very accommodative monetary policy**
- declined sharply further at the end of 2013 on the back of expectations and the subsequent announcement of the PSPP by the ECB
- went up temporarily at the end of 2016 (presidential elections in the USA and the monetary policy tightening by the Fed), but then declined again
- cross-country differences in yields are thus close to the lows recorded after the financial crisis, but the degree of interest rate convergence seen between the onset of the euro area and the crisis has not resumed

IV. Funding costs and bank loans

Growth in bank loans to domestic non-financial corporations (%)



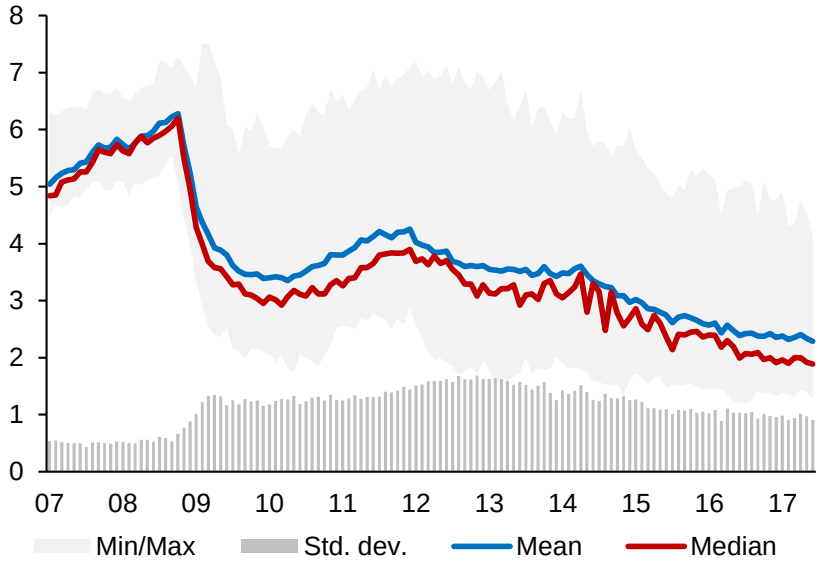
Note: Annual growth in outstanding volumes provided by monetary financial institutions.
Source: ECB (BSI database).

Lending:

- **bank lending rates** have decreased across the euro area countries in recent years, but the trends in the volume of bank loans remain mixed
- **annual growth rates in bank loans to non-financial corporations** are an important factor behind private investment growth
- **monetary policy has fostered a decrease in loan financing costs** => loan volumes are still declining in several countries, including those in the southern part of EA (private sector deleveraging, banking sector problems in some countries, insufficient investment opportunities in an environment of low economic growth)

IV. Funding costs and bank loans

Funding costs of non-financial corporations (%)



Note: The composite indicator comprises a weighted average of short-term and long-term loans to non-financial corporations.
Source: ECB (MIR database), CNB calculations.

Funding costs in EA:

- there was an initial increase and subsequent decline in the misalignment of the funding costs of non-financial corporations
- the decline started at the end of 2012 and accelerated after the ECB started its bond purchases
- along with the decline in misalignment, the average and median costs have decreased, the largest drop having been recorded for countries hit by the debt crisis

The series are calculated on the basis of actual loans provided. It is thus not possible to capture the credit constraints faced by small and medium-sized enterprises in the southern euro area countries, which have eased significantly in recent years.

Thank you for your attention!

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I would like to thank Tomáš Adam, who is co-author of the presented analysis.