



Arbeitskreis  
Europäische  
Integration  
e.V.

SWP



## Eurozone under stretch

**Is divergence stabilizing or destabilizing?**

**Véronique Riches-Flores**

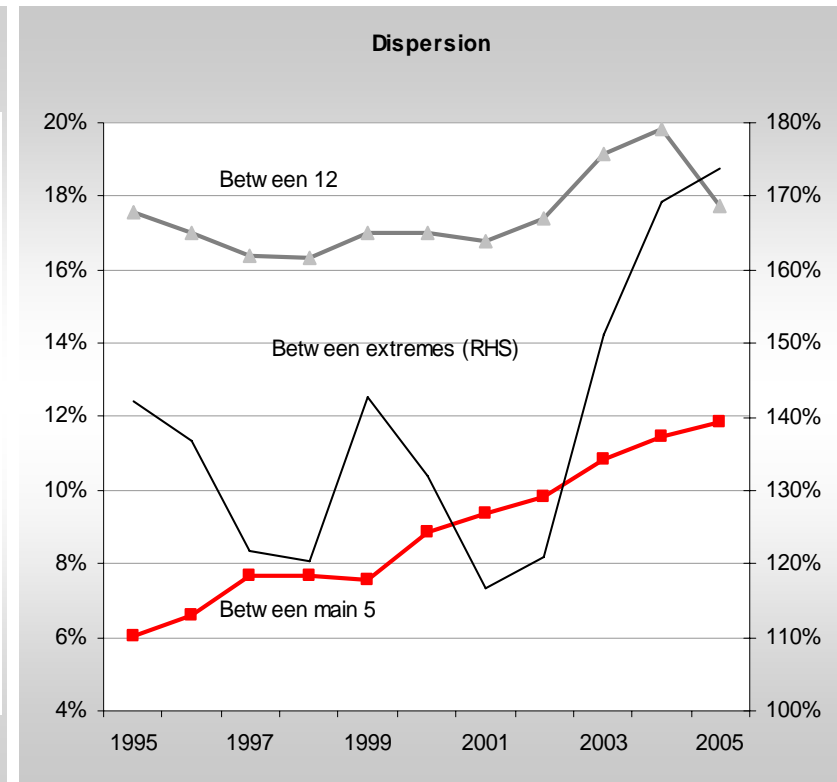
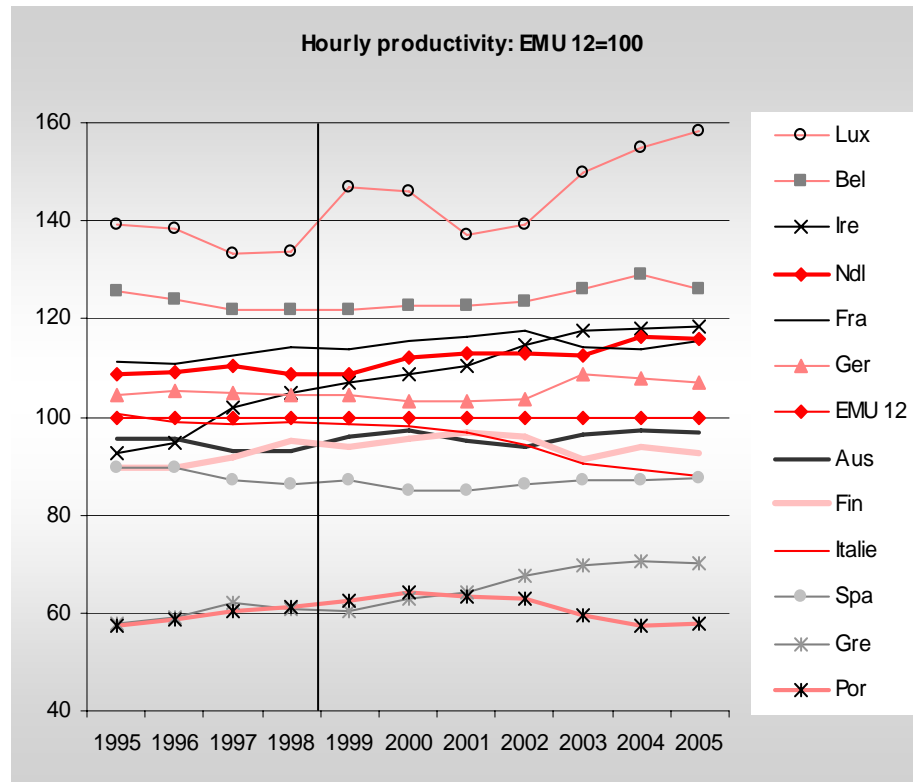
**Chief Economist**

**Société Générale - Corporate & Investment Banking**



« Convergence in productivity will be key to achieve German monetary unification », T. Waigel 1990

## What's about EMU?





## Major differences between EMU countries: 1- GDP breakdown



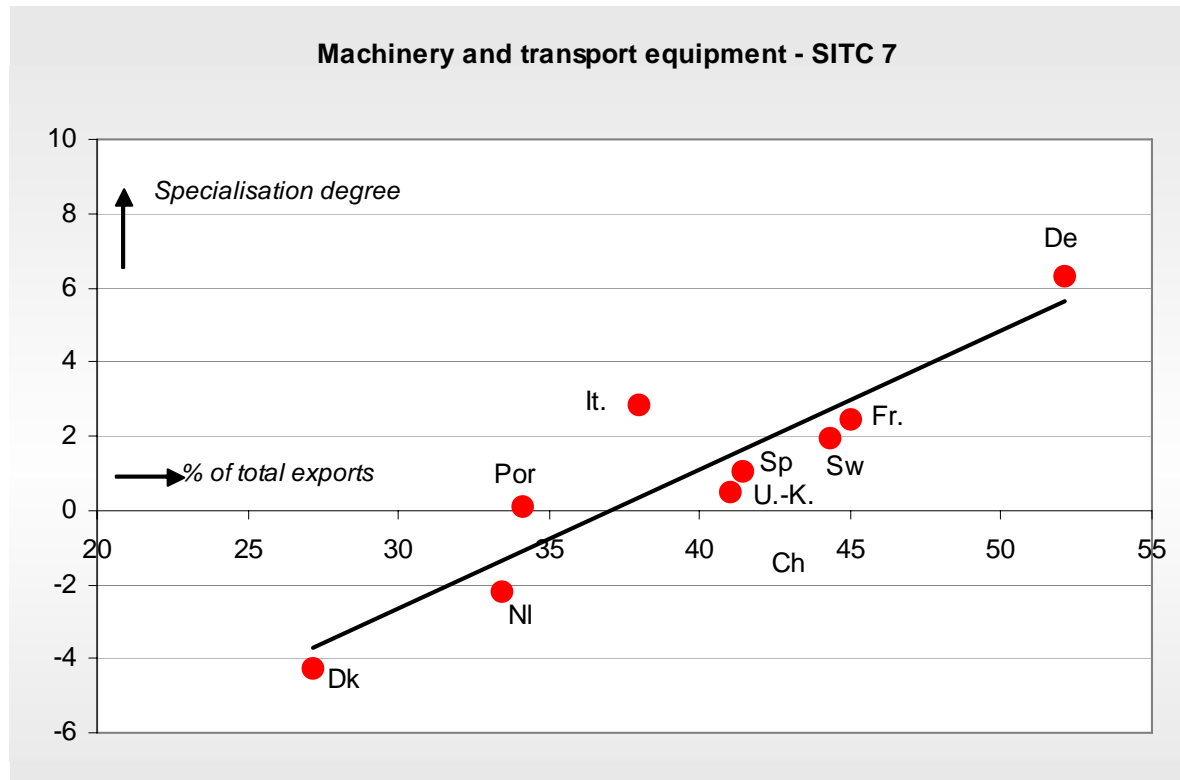
	Industry	construction	services
<b>Finlande</b>	45.5%	8.3%	46.1%
<b>Ireland</b>	45.1%	6.8%	48.1%
<b>Germany</b>	44.2%	5.4%	50.4%
<b>Italy</b>	40.6%	9.3%	50.0%
<b>Belgium</b>	37.6%	7.1%	55.3%
<b>Austria</b>	36.8%	9.5%	53.7%
<b>Portugal</b>	35.8%	11.0%	53.2%
<b>France</b>	33.0%	8.4%	58.7%
<b>Spain</b>	29.1%	16.3%	54.5%
<b>Ndlld</b>	28.5%	9.5%	62.1%



## Major differences between EMU countries: 2- Industry specialisation



Specialisation In Machinery in Equipment industry – 2004



Based on Lafay index: the comparative advantage of a country in the production of a certain sector is measured by the deviation of the specified product normalised trade balance from the overall normalised trade balance. Positive value of the index indicates the existence of a comparative advantage; the larger the value, the higher the degree of specialisation



## Major differences between EMU countries: 3- Trade exposure



**Potential foreign demand to export countries, annual growth in %**

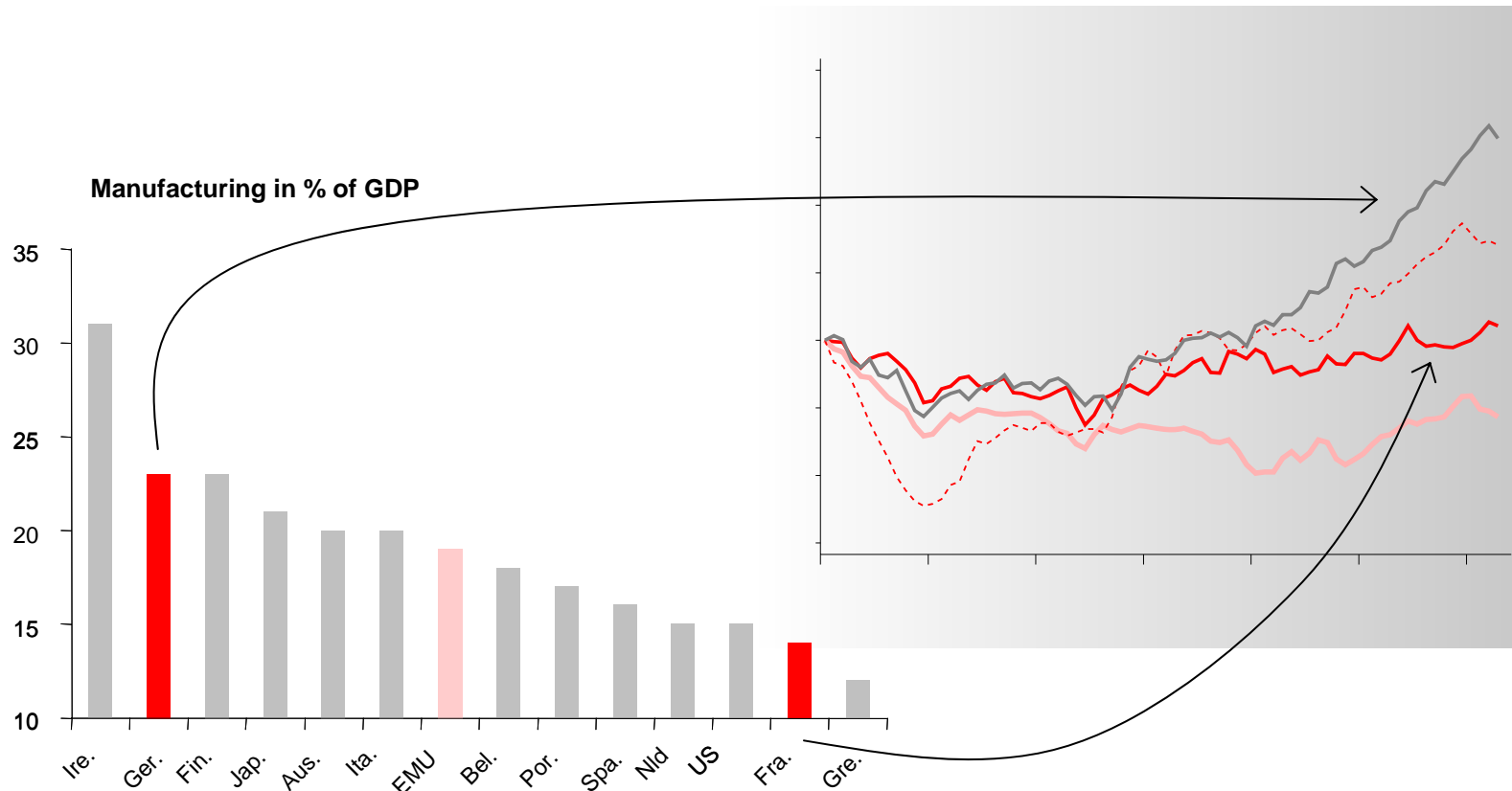
	2000	2001	2002	2003	2004	2005	2006	Weight 2006
Germany	12.3	1.9	3.1	5.2	10.1	6.8	8.3	
<i>Intra-EMU</i>	5.2	0.9	0.4	1.2	2.8	2.3	2.9	45.1
<i>"Dynamic countries"</i>	4.7	0.3	2.2	3.2	5.1	2.6	3.4	30.3
France	10.6	1.6	2.3	4.8	9.0	6.5	8.1	
<i>Intra-EMU</i>	5.2	0.9	0.1	2.1	3.5	2.7	3.9	54.2
<i>"Dynamic countries"</i>	3.1	-0.2	1.4	1.9	3.1	1.7	2.0	19.3
Italy	12.4	1.8	2.9	5.7	10.1	7.3	9.0	
<i>Intra-EMU</i>	5.9	1.0	0.3	1.9	3.5	2.8	4.0	48.5
<i>"Dynamic countries"</i>	4.4	0.1	2.2	2.9	4.4	2.5	3.0	27.3
Spain	11.2	1.4	1.6	3.4	8.1	6.1	8.0	
<i>Intra-EMU</i>	6.9	0.8	0.1	1.3	3.7	3.0	4.6	63.9
<i>"Dynamic countries"</i>	2.3	-0.1	1.0	1.4	2.1	1.2	1.3	12.4

\* USA, Asia ex-Japan, EEC

Sources : IMF, SG economic research



## Major differences between EMU countries: 4- Inequal sensitivity to external environment



Impact of world demand and EUR eff. exchange rate on extra-EMU export growth

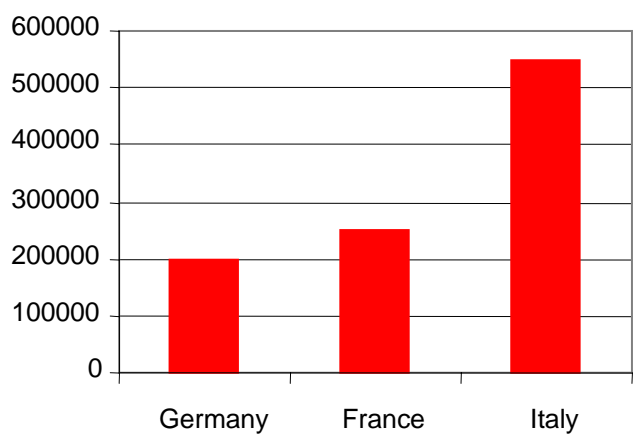
	France		Germany	
	94-99	99-05	94-99	99-05
OECD index (1)	1.4	0.8	1.4	1.1
EUR eff. exchange rate (2)	-0.7	-0.9	-0.7	-0.6
Ratio (1/2)	-2.1	-1.0	-2.1	-1.9
R2 on equation	0.8	0.7	0.8	0.7



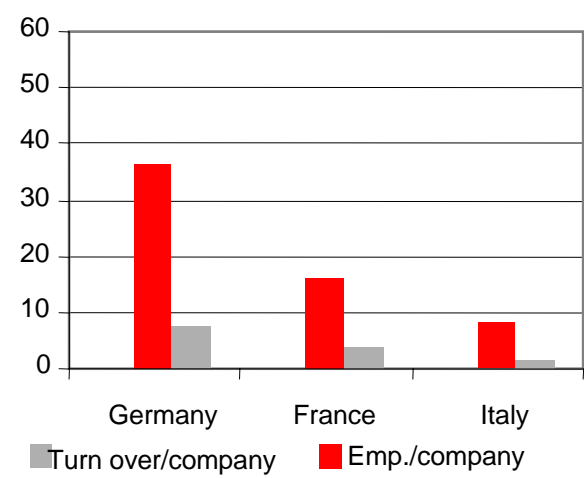
# Major differences between EMU countries: 5- Company size

Productivity adjustments easier in big and high value added industry than in small and low value added industry

Number of companies - manufacturing



Performance and size of companies

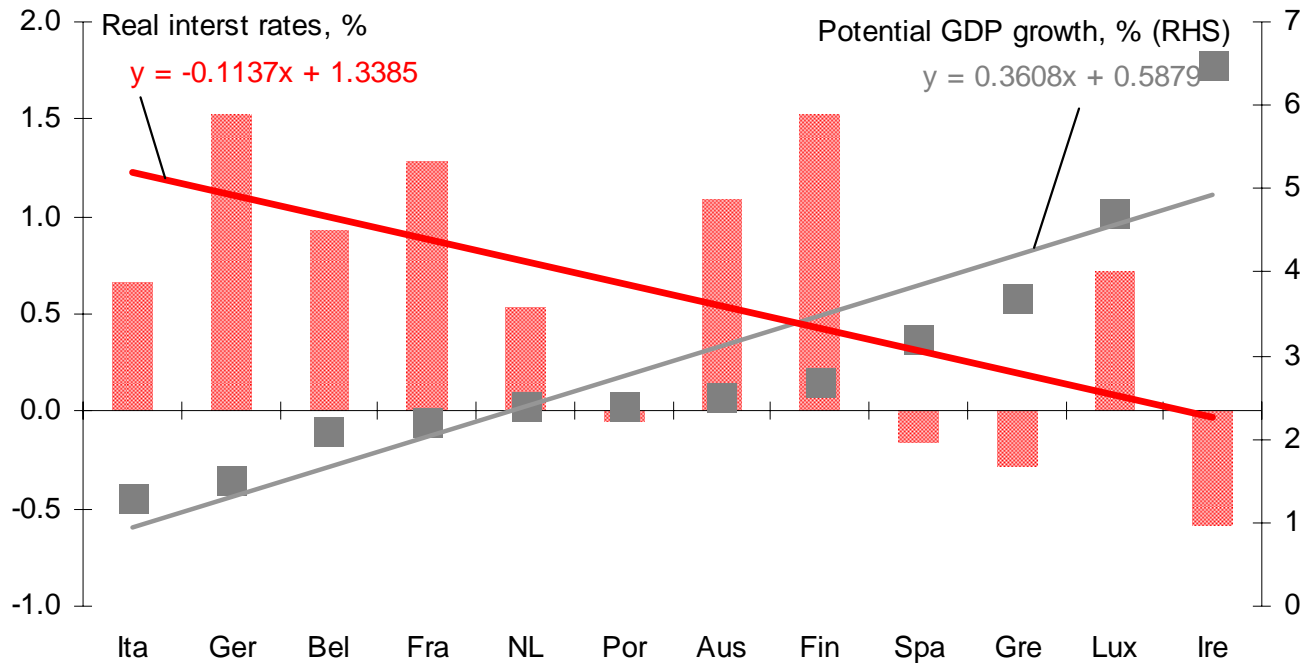




# Structural divergences in monetary union: a case for pro-cyclical policies...



Potential growth and real short-term interest rates  
1999-2005 average

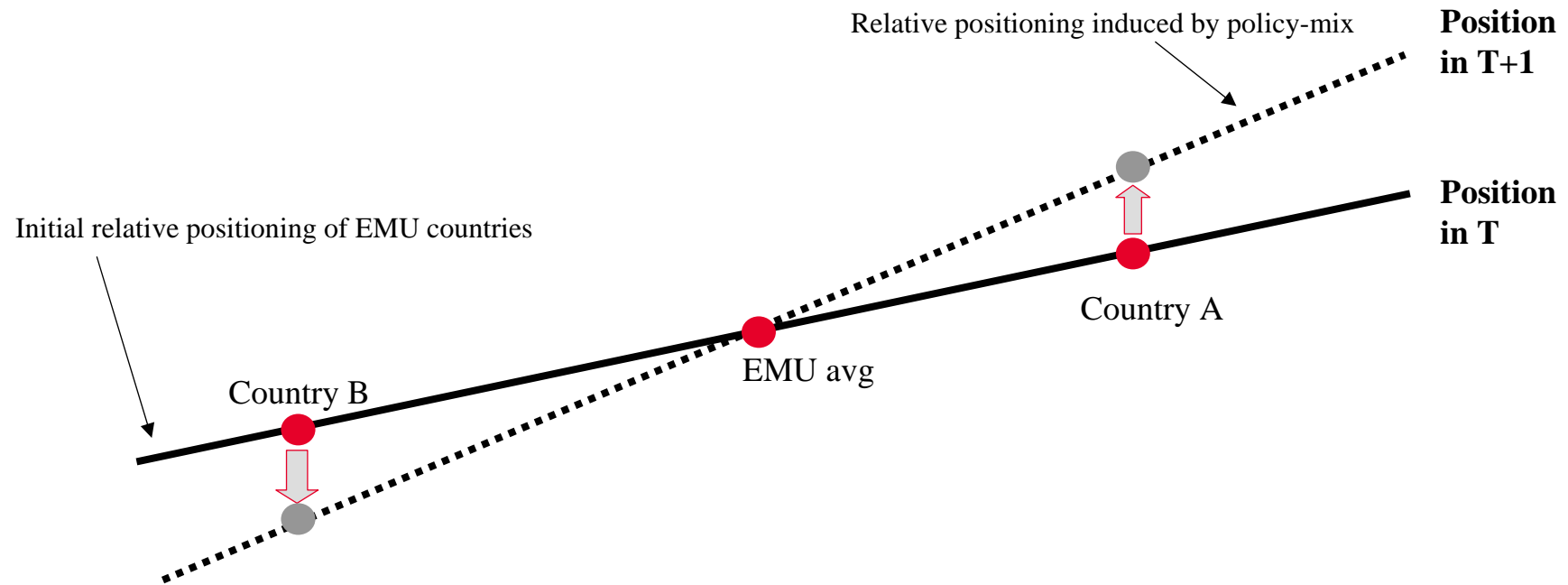




# ...and deeper divergences

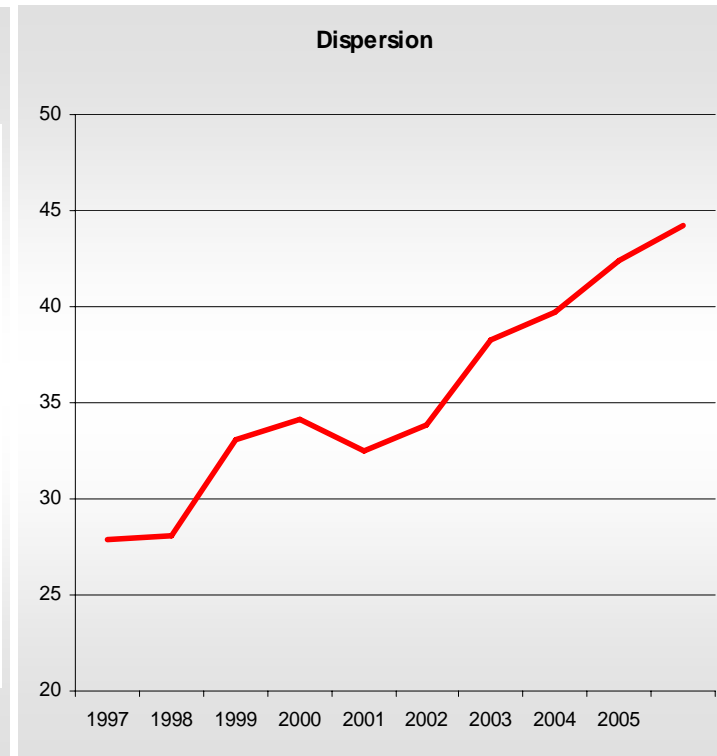
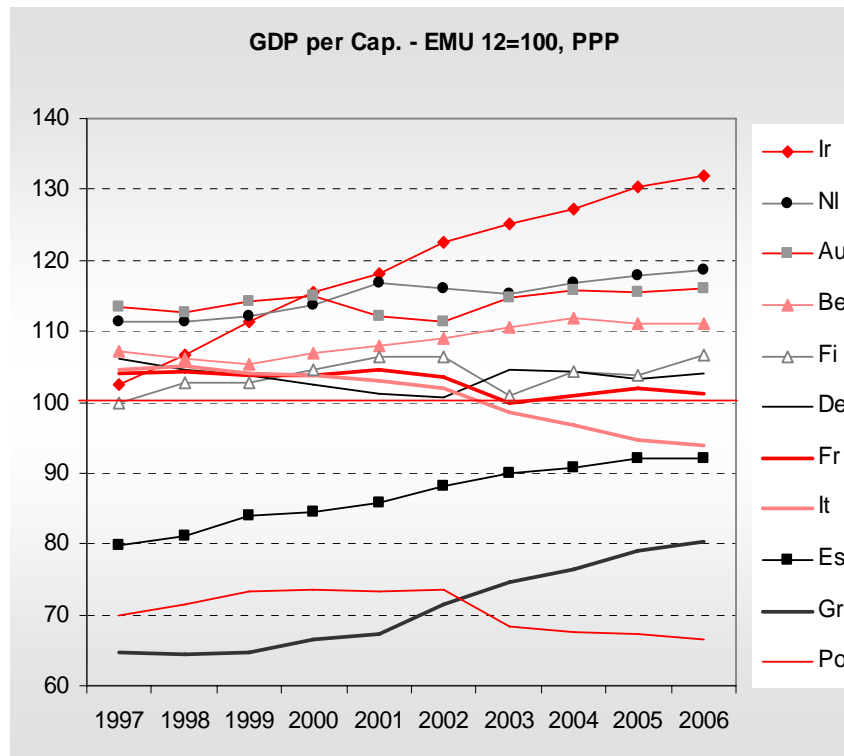


## Economic growth hierarchy



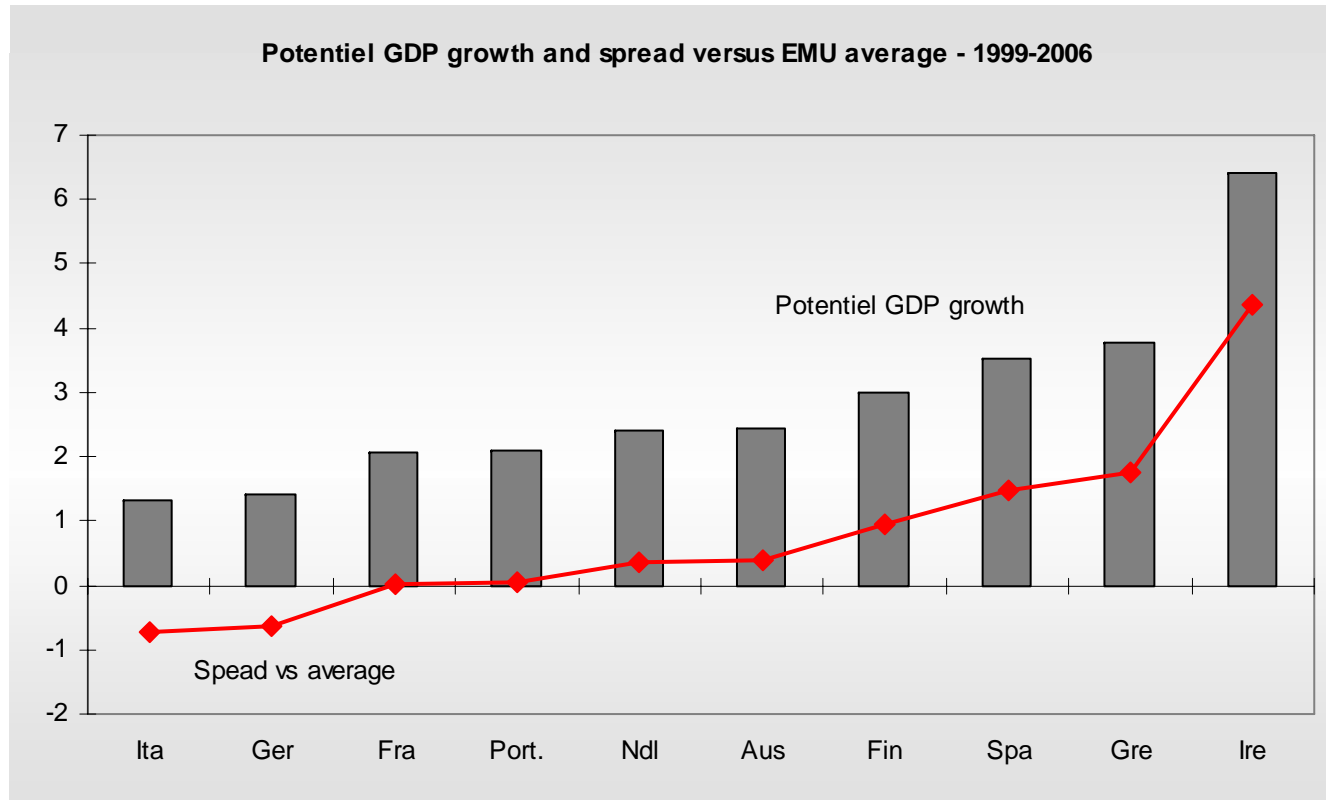


# Lasting divergences and instability



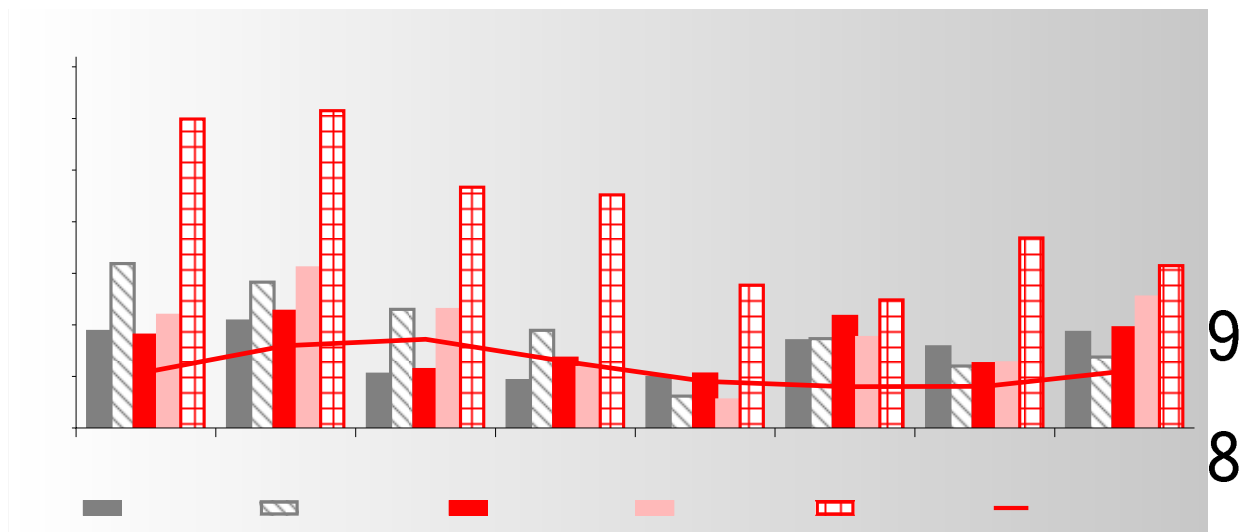
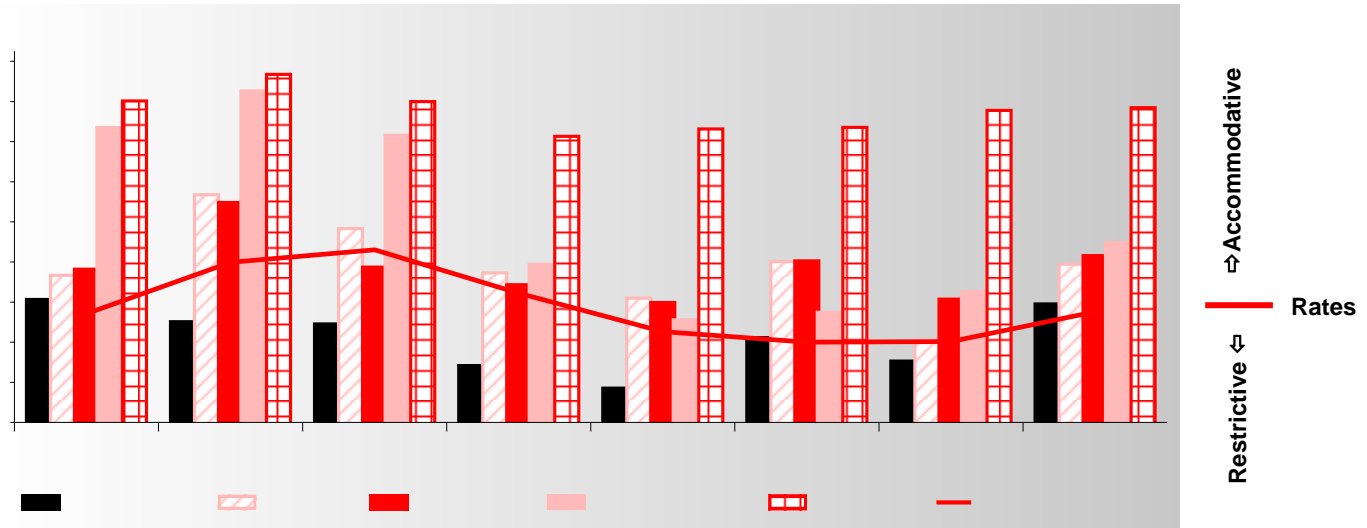


# Major short and long term distortions



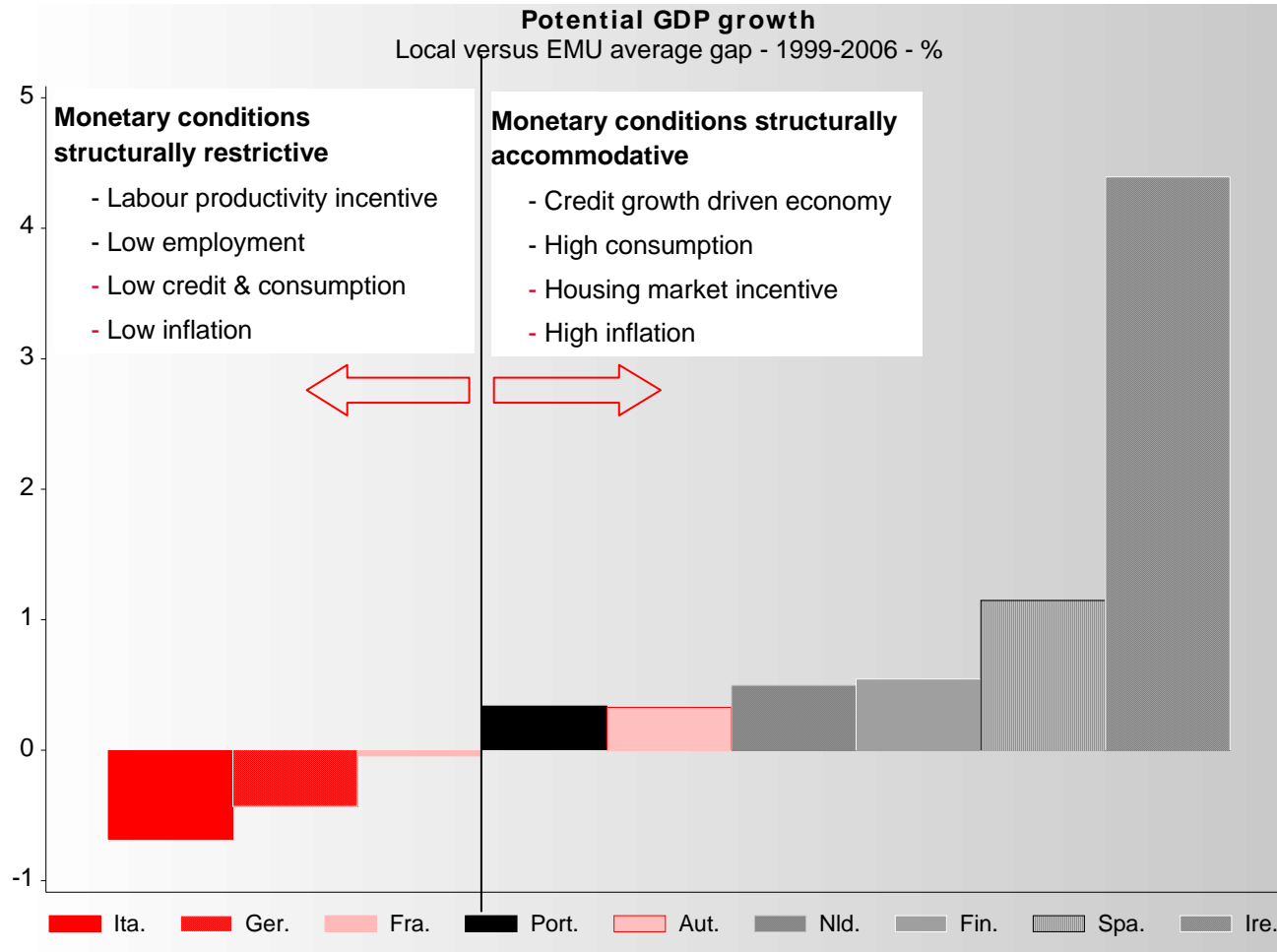


# Nominal GDP growth versus interest rates



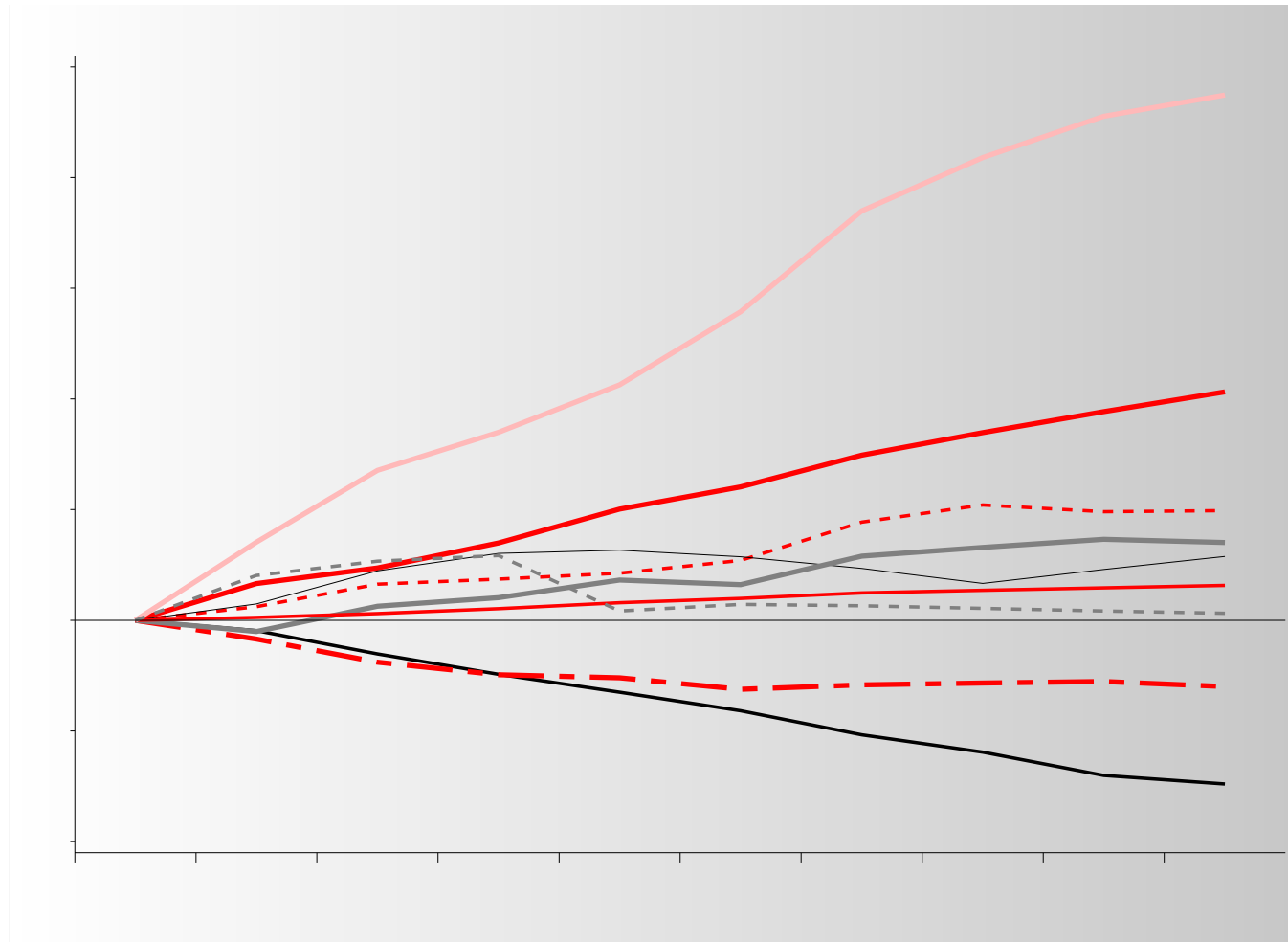


# Potential growth hierarchy and structural growth conditions within monetary union



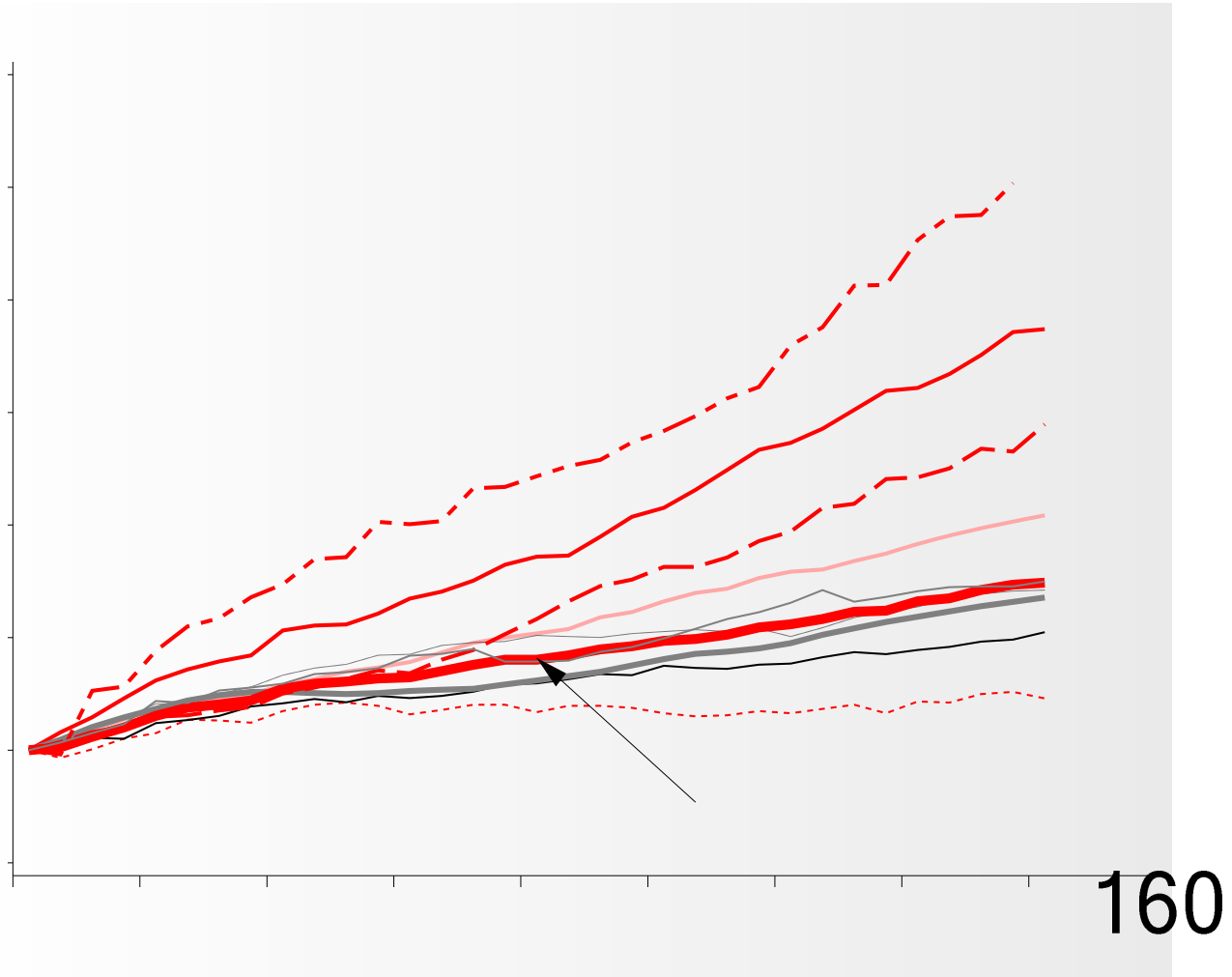


# Wages and Unit labor costs



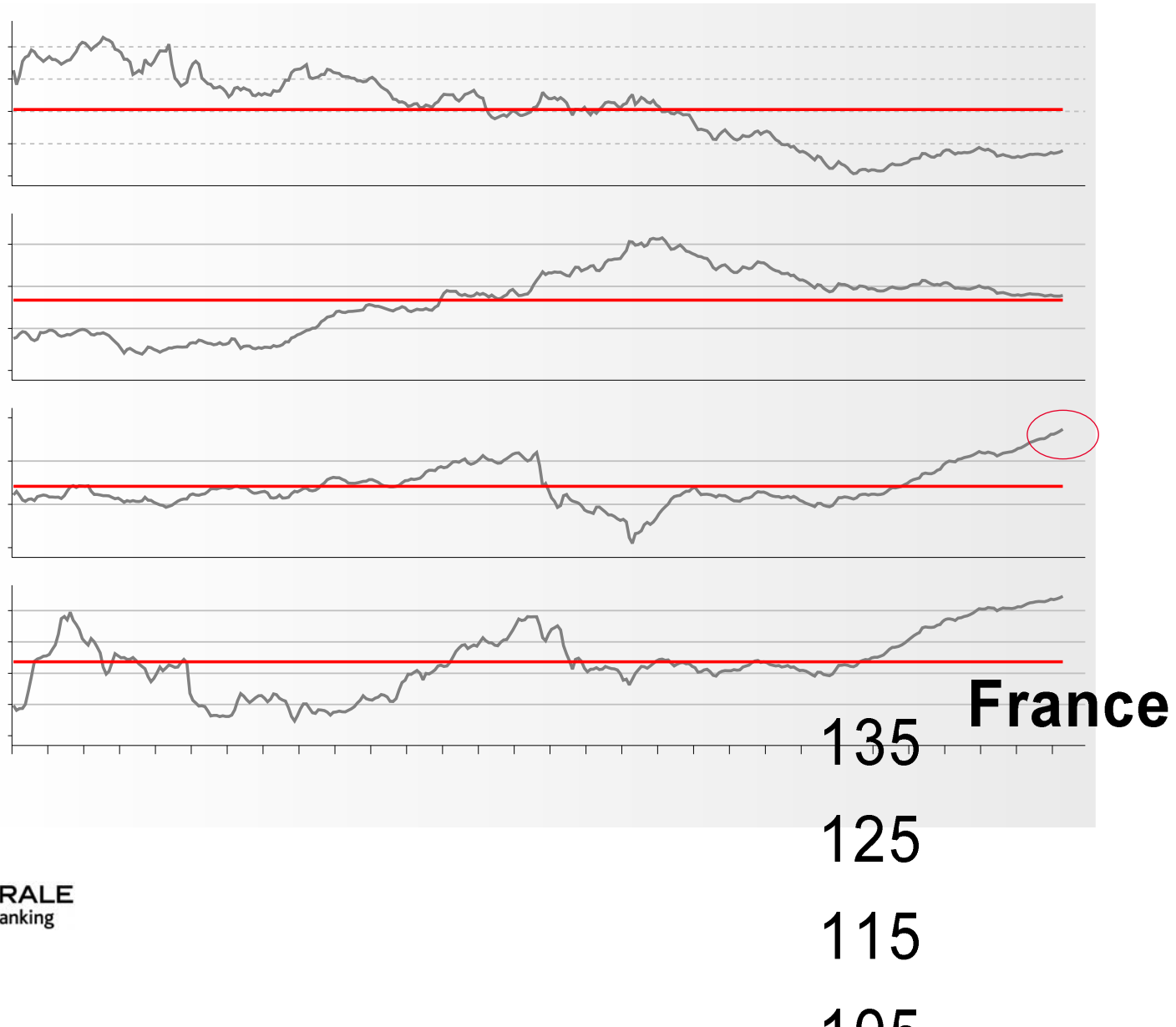


# Consumption within Eurozone countries



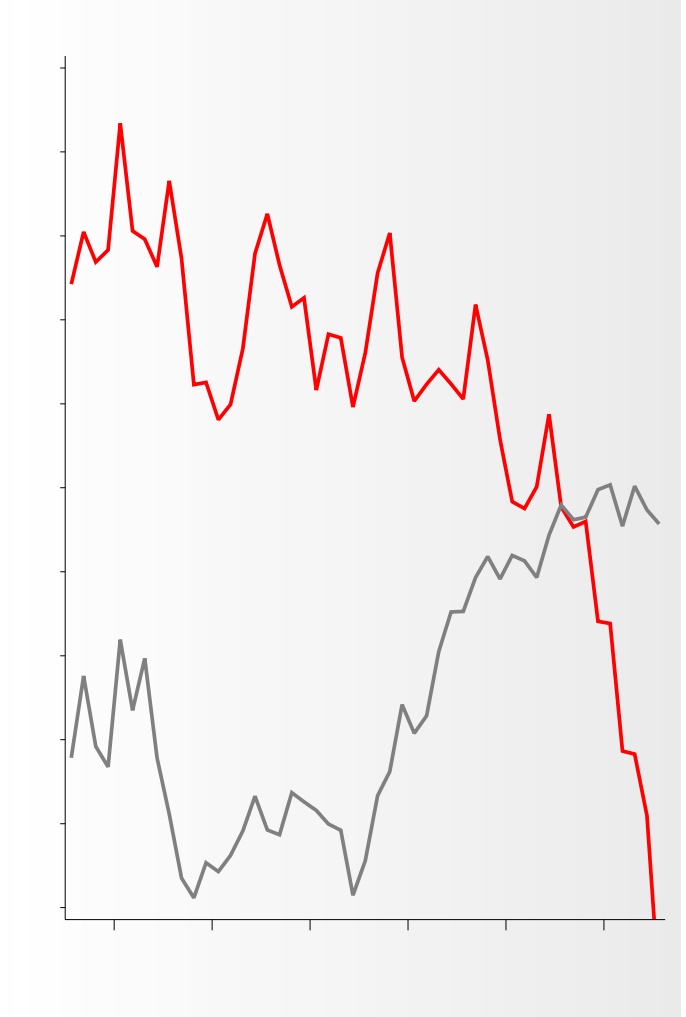
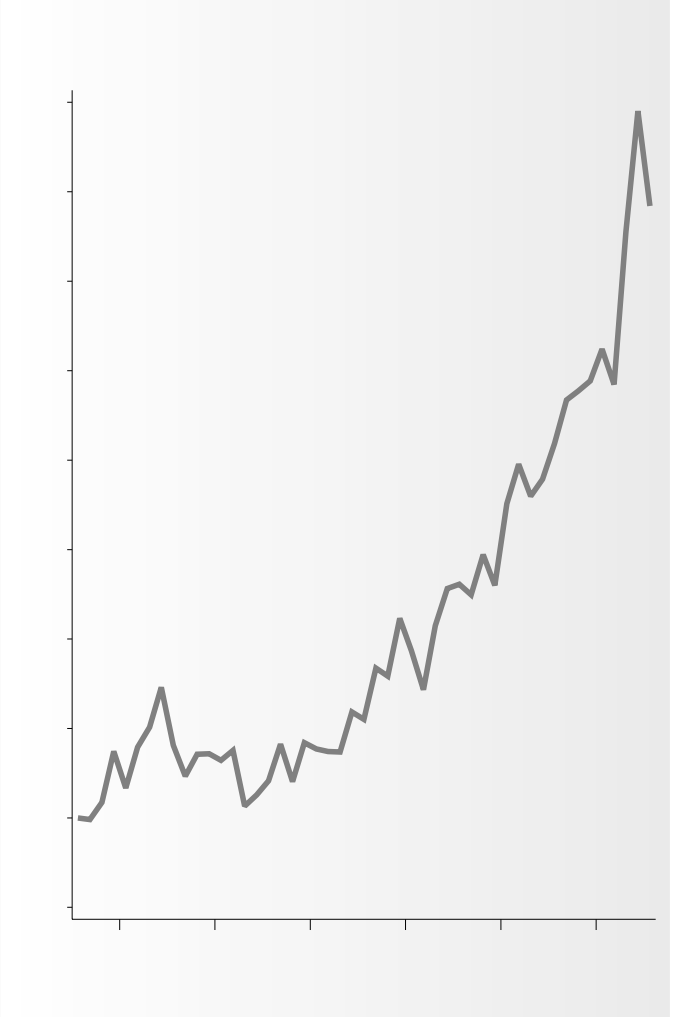


# Real exchange rates instability





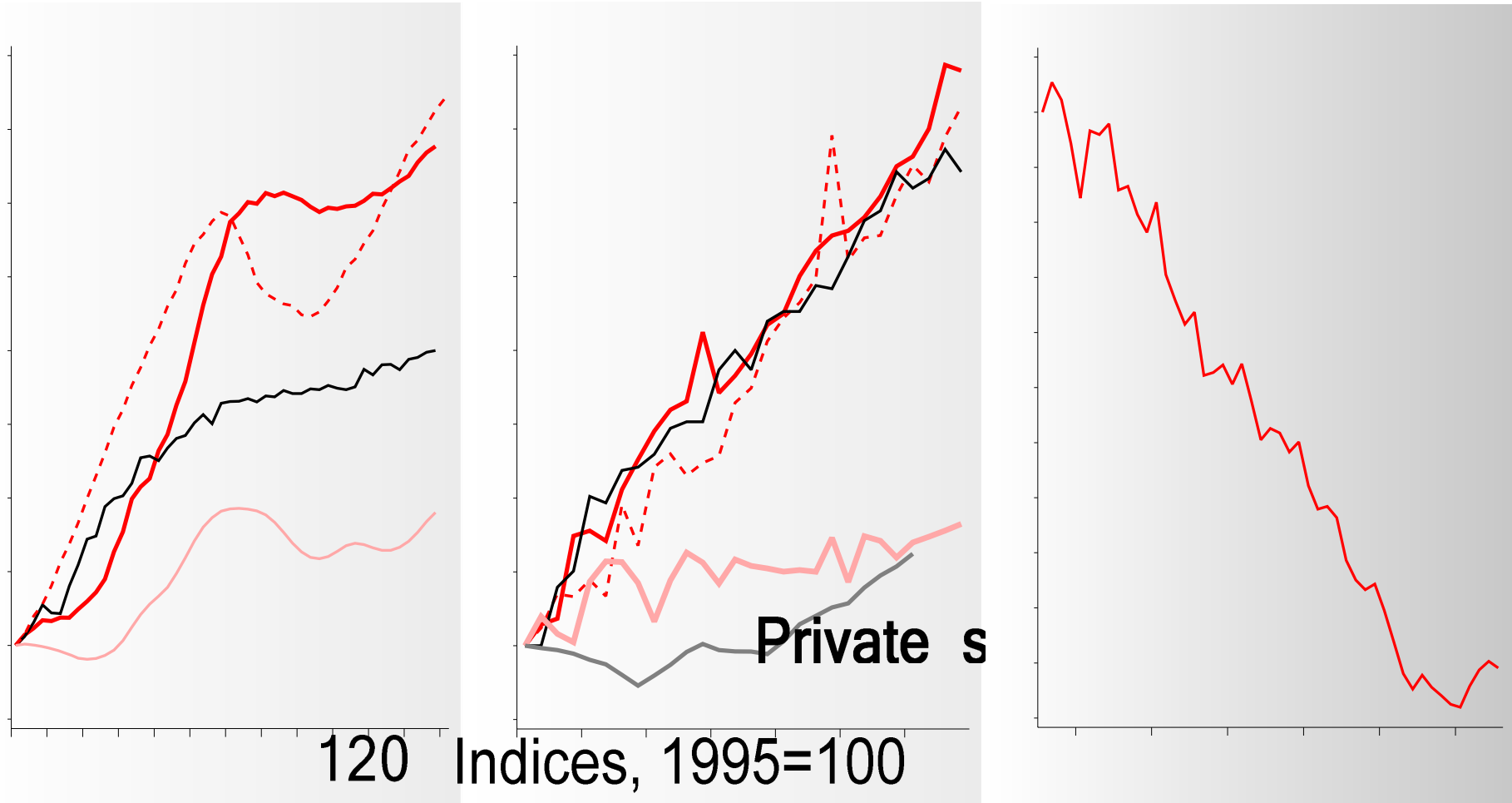
# From one model to another – Germany and France



Rel



# The cost of the adjustment





# Policy mix and economic trends- the construction and real estate sector



Policy mix trends for the European countries 2000-2005

	Ger	Den	Net	Swe	Por	Fra	Aus	Bel	Ita	Spa	Ire	Fin	UK	Nor
Monetary stimulus <sup>1</sup>	-1.22	0.38	1.40	0.86	0.70	0.09	0.18	0.34	0.68	4.52	5.63	0.37	0.44	0.74
Expressed as points of GDP <sup>2</sup>	-0.61	0.19	0.70	0.43	0.35	0.04	0.09	0.17	0.34	2.26	2.81	0.19	0.22	0.37
Fiscal stimulus <sup>3</sup>	-0.92	-1.57	-1.33	-	-0.76	0.62	0.70	0.79*	1.60	0.11	0.44	3.23	3.50	3.59
Overall Policy mix	-1.54	-1.38	-0.63	1.03*	-0.41	0.66	0.79	0.96	1.94	2.37	3.26	3.42	3.72	3.96

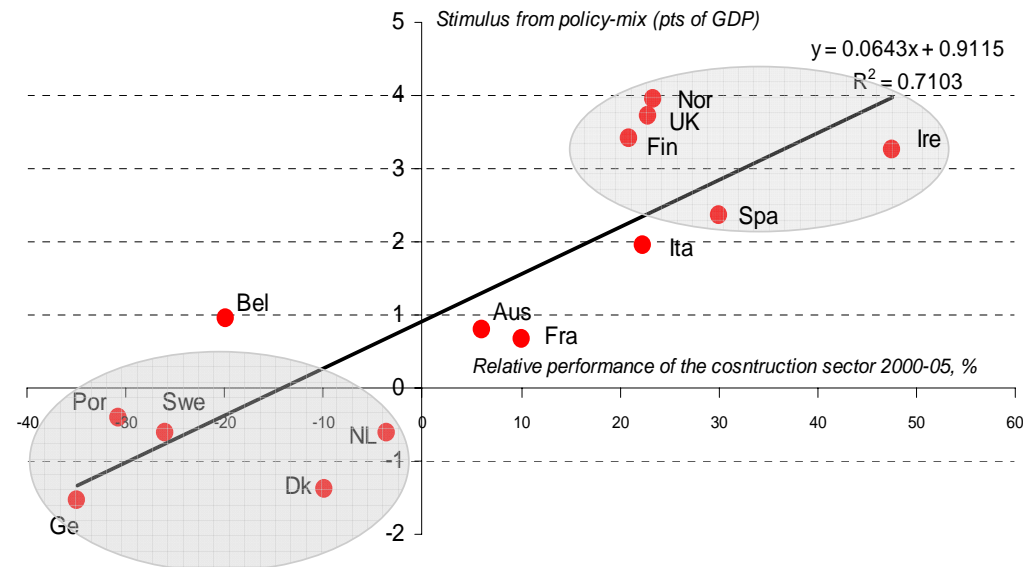
Source: SG Economic Research

<sup>1</sup> Average spread between nominal annual GDP growth and the average key interest rate

<sup>2</sup> For the sensitivity of growth to the level of key interest rates, we have assumed 0.5% of growth for every 100 bp change in key interest rates

<sup>3</sup> Expressed as a % of GDP structural change between 2001 and 2005, except for Sweden and Belgium\*, for which results are calculated over the period 2002 to 2005 due to major changes in economic policy that occurred between 2001 and 2002.

Policy mix stimulus and construction sector performance 2000-2005

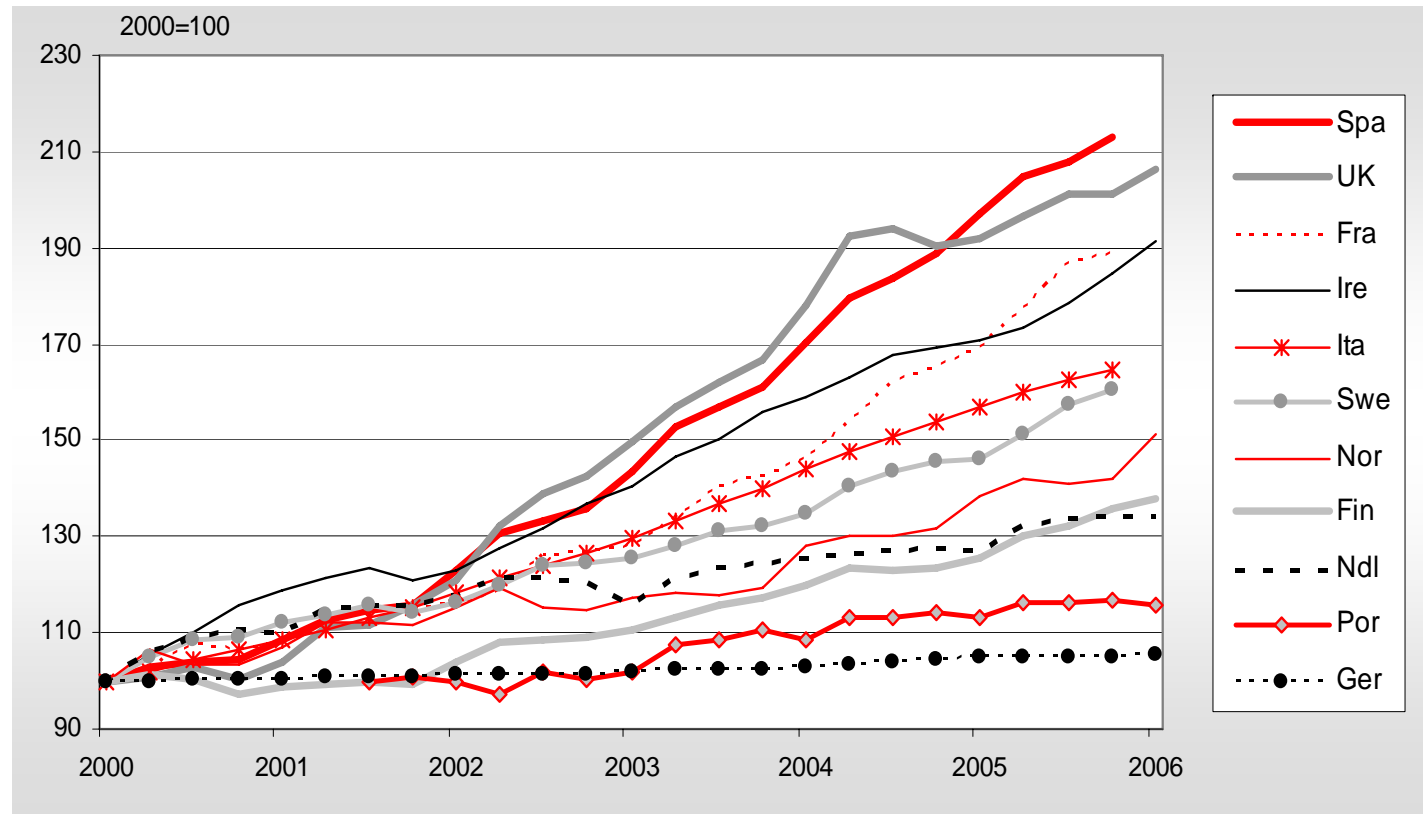




# Housing market performance



House price trends European countries





# Consumer debt



## Three-year trend in household debt\*, end-2002 to end-2005

%	Italy	Greece	Belgium	France	Austria	Finland	EMU	Germany	Spain	Portugal	Ireland	Netherlands	US
Total lending <sup>1</sup>	39.1	109.0	35.5	30.4	67.6	47.6	26.0	1.3	74.3	19.6	98.8	29.2	33.2
- Consumer credit	56.0	112.0	-2.3	16.9	21.8	40.3	6.4	-24.1	41.4	8.5	20.0	32.3	11.1
- Home loans	64.9	104.0	48.9	42.2	49.4	56.5	33.3	4.3	89.6	22.3	115.0	31.1	40.2

Source: ECB loan statistics, SG Economic Research

\* Including individual enterprises

<sup>1</sup> Including "Other loans"

<sup>2</sup> Home loans and consumer credit only

## Degree of risk associated with the rise in debt in Eurozone economies

	Germany	EMU	Austria	Belgium	Netherlands	France	Italy	Portugal	Finland	Greece	Spain	Ireland
Increase in debt, 2002-05	+	+	+++	++	+	++	++	+	++	+++	+++	+++
Level of debt, 2005	+++	++	++	++	+++	++	+	+++	++	+	+++	+++
Trend in debt	(-)	0	+	+	+++	+	++	+++	+++	++	+	+
Accommodative nature of monetary policy	(-)	+	++	+	(-)	+	+	+	++	+++	+++	+++
Past increases in asset prices	(-)	++	(-)	++	++	+++	+++	+	++	++	+++	+++
Proportion of variable-rate loans	+	++	++	++	++	+	+++	+++	+++	+++	+++	+++
<b>Overall risk level</b>	<b>2</b>	<b>8</b>	<b>9</b>	<b>10</b>	<b>10</b>	<b>10</b>	<b>12</b>	<b>12</b>	<b>14</b>	<b>14</b>	<b>16</b>	<b>16</b>

Source: SG Economic Research

Each of the applied criteria assessed on a risk-degree scale ranging from (-) through zero to +++

Increase in debt between end-2002 and end-2005 – under 10% pa on average: +; between 10% and 20% pa: ++; above 20% pa: +++

Debt level as a % of GDP in 2005 – 0% to 40%: +; 40% to 60%: ++; over 60%: +++

Trend in debt, as measured by the discrepancy between growth in debt and in GDP in 2005 – over 1%: +; over 2%: ++; over 3%: +++; negative discrepancy: (-)

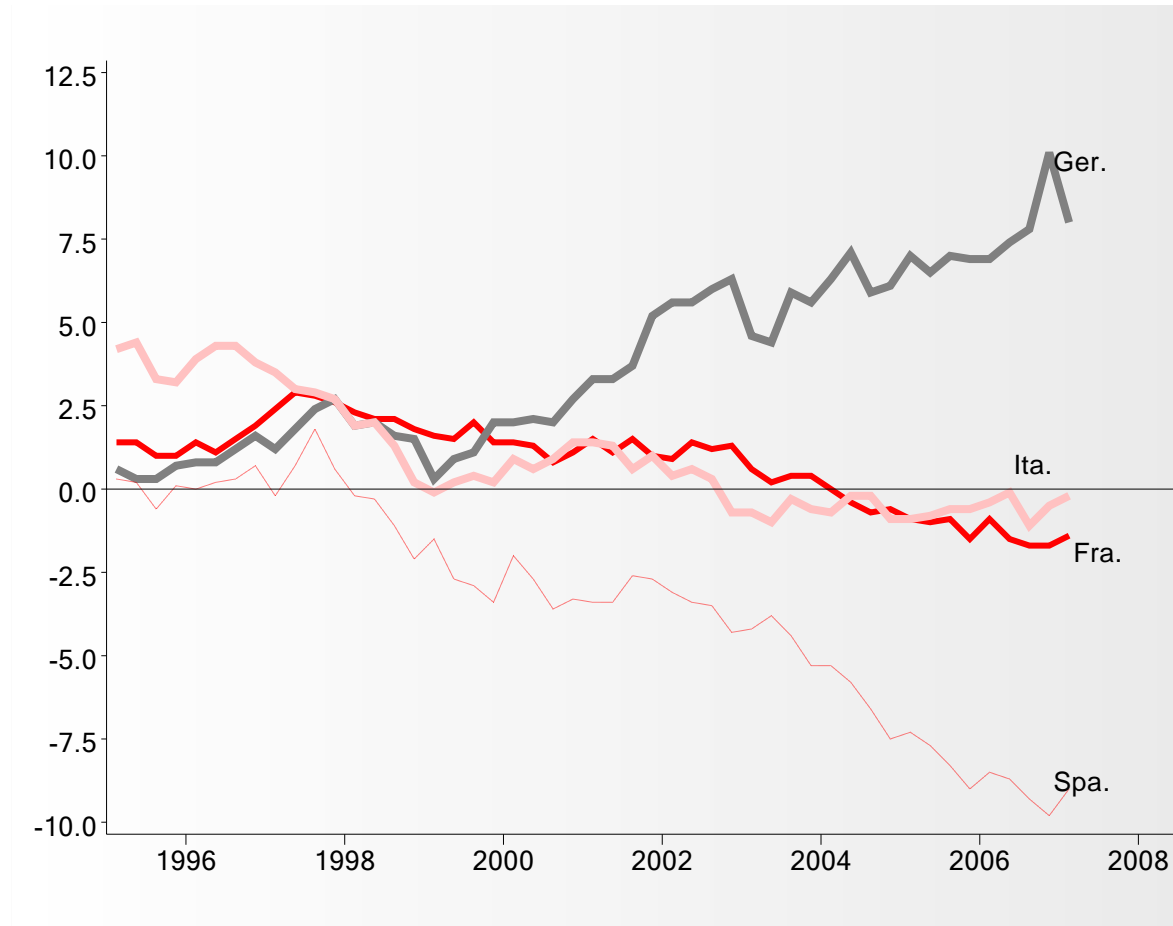
Supportiveness of monetary policy, as measured by the discrepancy between key rates and growth in nominal GDP – over 1%: +; over 2%: ++; over 3%: +++; negative discrepancy: (-)

Average annual increase in asset prices between 2000 and 2004 – under 5%: +; between 5% and 10%: ++; over 10%: +++ (N.B. The declines observed in Germany and Austria, averaging under 1% pa, have been ranked (-))

Proportion of variable-rate loans in new home lending between January 2003 and March 2005 – under 30%: +; between 30% and 60%: ++; over 60%: +++

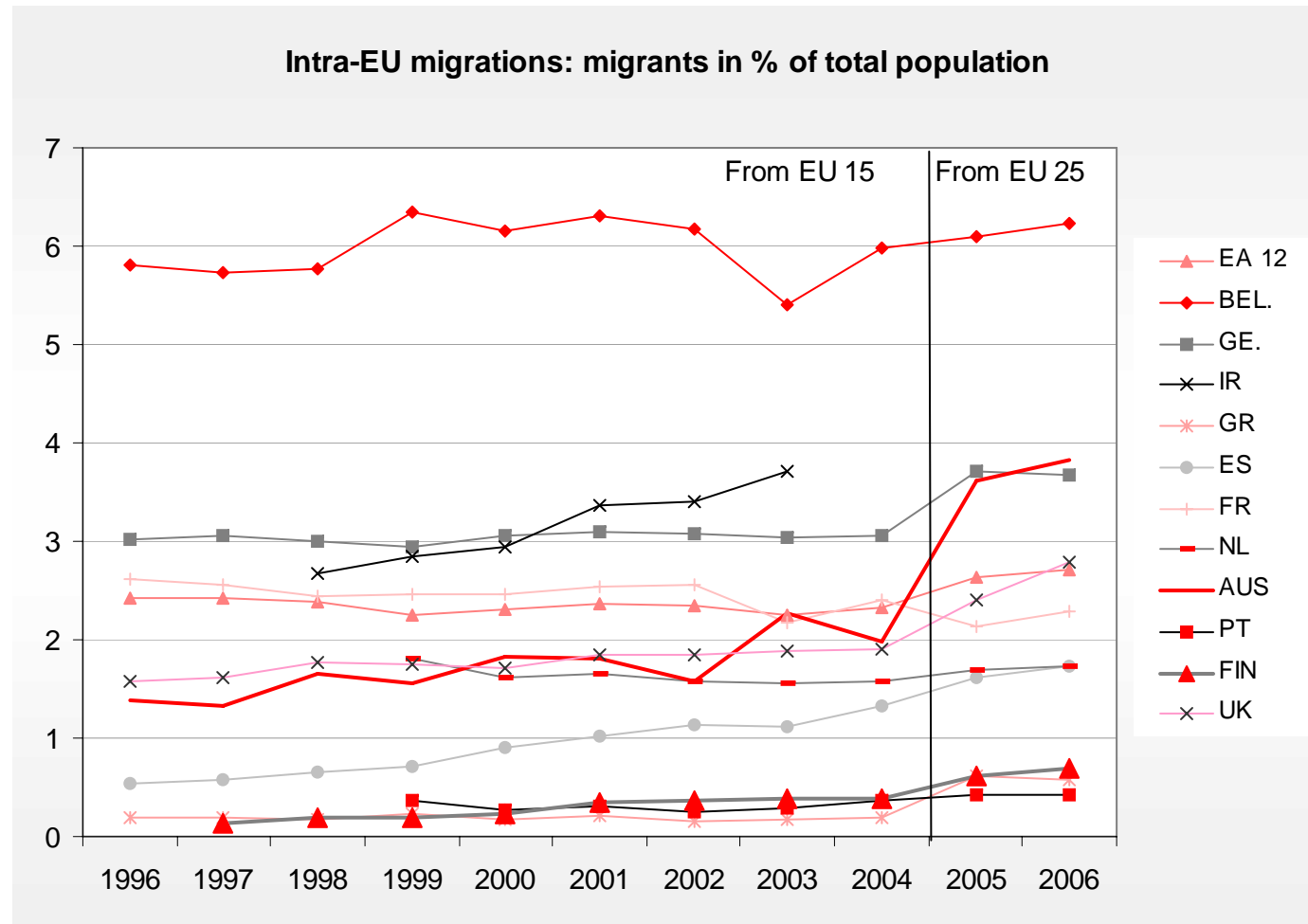


# Current balance imbalances





# Will mobility improve in the future?



# EURO CAPITAL MARKETS DERIVATIVES STRUCTURED FINANCE

Widen your horizons

