Flash Economics

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Are competitiveness gaps within the euro zone being corrected?

One would expect that a country with a competitiveness gap relative to the other members of a monetary union will benefit from a depreciation of its real exchange rate, that is, prices and wages in that country will rise more slowly than elsewhere in the union. Over time, that country should therefore restore its cost competitiveness and revive its tradable output (manufactured goods and services exposed to international competition). We examine whether this mechanism has been at work since 2016 (the year taken to mark the end of the euro zone crisis) in the four largest euro zone economies (Germany, Spain, France and Italy). In 2016, cost competitiveness in France and Italy had deteriorated relative to that in Germany and Spain.

Between 2016 and 2026, nominal compensation per employee rose by 42.5% in Germany, 37.9% in Spain, 23.0% in France and 22.2% in Italy. Consumer prices rose by 38.5% in Germany, 35.8% in Spain, 30.5% in France and 29.7% in Italy. The GDP deflator increased by 36.8% in Germany, 30.3% in Spain, 21.1% in France and 22.3% in Italy.

These developments are consistent with the hypothesis that an initial weakness in competitiveness is subsequently corrected through a real depreciation, that is, through a more moderate increase in prices and wages.

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The state of cost competitiveness in 2016

A country's cost competitiveness can be gauged by looking at its trade balance in goods and services (Charts 1A and 1B), at the change in its export volumes relative to world trade (Charts 2A and 2B) and finally at the change in its manufacturing output (Chart 3).

Chart 1A
Trade balance in goods and services
(EUR bn, quarterly data)

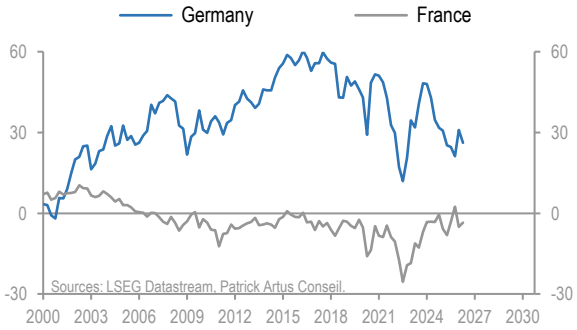


Chart 1B
Trade balance in goods and services
(EUR bn, quarterly data)

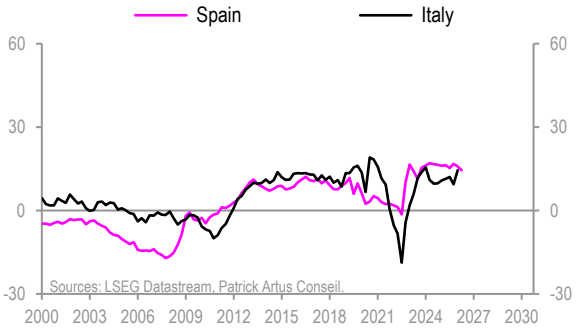


Chart 2A
Exports of goods and services (volume, 2002 = 100)

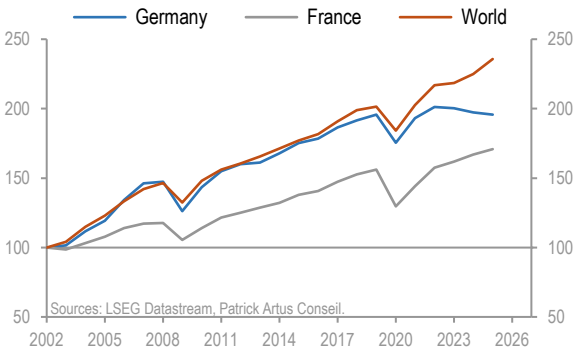


Chart 2B
Exports of goods and services (volume, 2002 = 100)

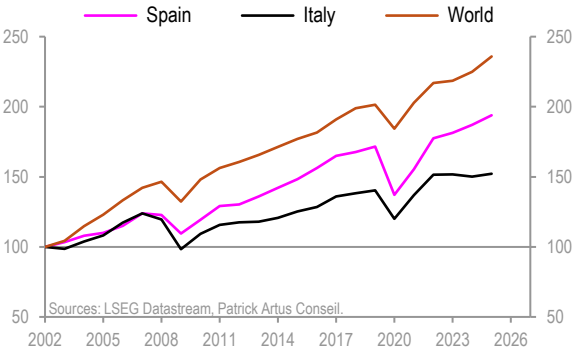
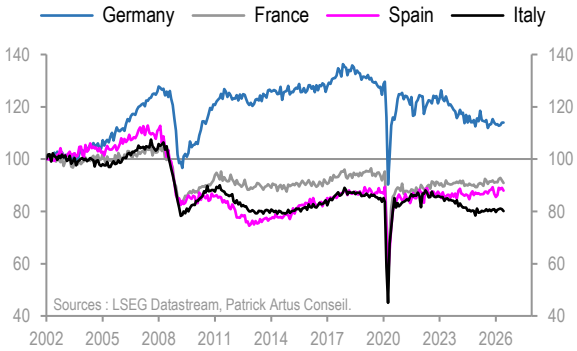


Chart 3
Manufacturing production (January 2002 = 100)



These indicators show that in 2016:

- Germany's cost competitiveness was very strong;
- that of Spain was fairly strong;
- those of France and Italy had deteriorated (exports growing more slowly than world trade in France and Italy, a trade deficit in France and a marked decline in manufacturing output in Italy).

Have the countries whose competitiveness had deteriorated in 2016 restored it since then?

We examine the changes in compensation per employee, consumer prices and the GDP deflator since 2016 (Charts 4, 5 and 6).

Chart 4
Nominal compensation per employee
(2016 Q1 = 100)

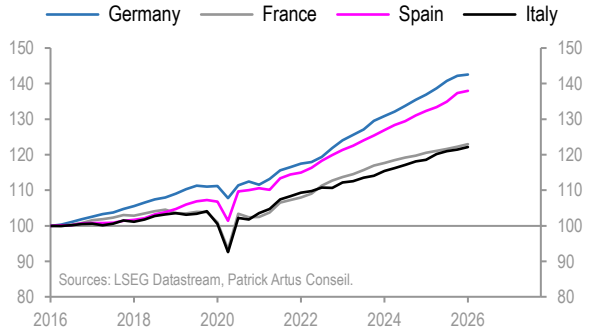


Chart 5
Harmonised index of consumer prices
(January 2016 = 100)

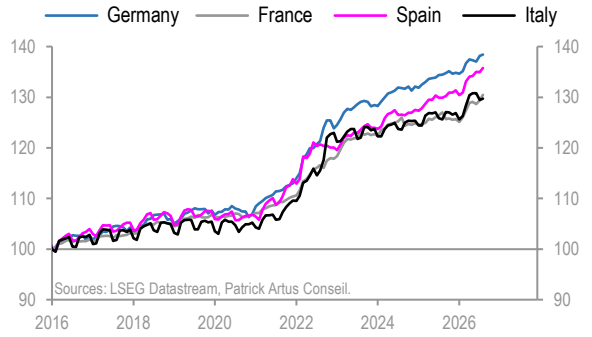
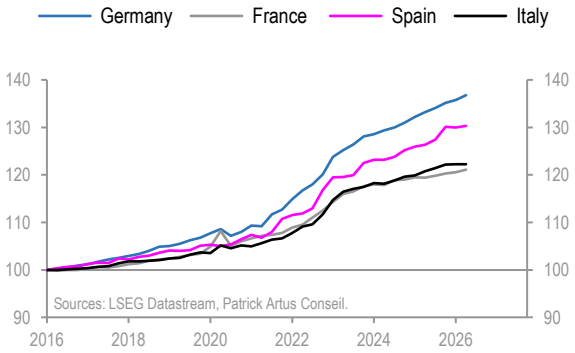


Chart 6
GDP deflator (2016 Q1 = 100)



From 2016 to 2026, the increase in compensation and prices has been markedly faster in Germany and Spain than in France and Italy.

Summary: developments in competitiveness across euro zone countries are in line with intuition

In 2016, cost competitiveness and price competitiveness within the euro zone had deteriorated in France and Italy, while they remained strong in Germany and Spain. From 2016 to 2026, compensation and prices rose more slowly in France and Italy than in Germany and Spain. The correction mechanism is therefore clearly at work, with competitiveness recovering in the countries where it had initially deteriorated most.

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