Europe and Global Imbalances:
An Incredibly Shrinking Role?

Comments on
"Macroeconomic Performance and Global Capital Flows:
Is There a Role For Europe to Play"
by Paola Subacchi

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Recapitulation of the Paper

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- Review of Europe’s S (high) and I (low)
  - Demographics reduce private incentive to invest
  - Financial innovation to aid consumer borrowing and spending
- Euro issues
  - Financial usage (see/want increased use, but….)
  - Implications for trade (appreciation hurts, X not ‘replaced’)
- Long-dated government bonds
  - Mop-up domestic savings
  - Finance government investment spending

Is Europe Really Unbalanced?

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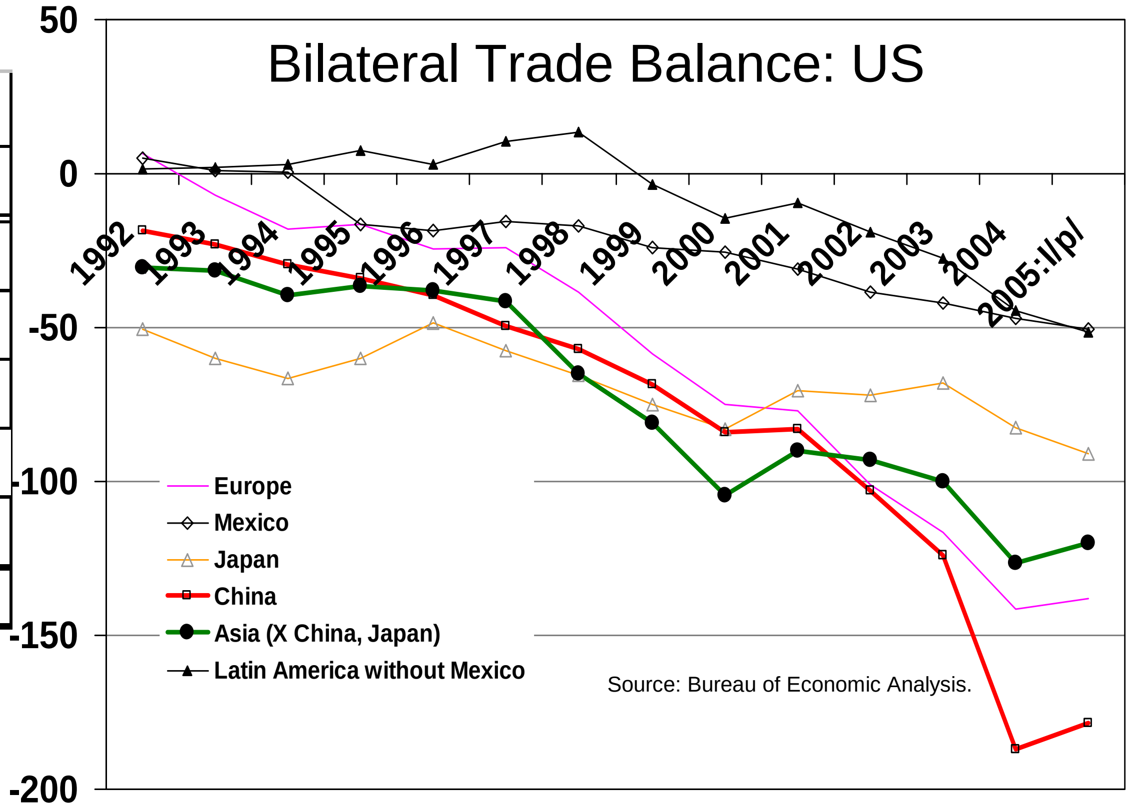
Current Account/GDP					
	1990	1995	1998	2004	2005p
China	3.1	0.2	3.3	4.2	6.1
Japan	1.4	2.1	3	3.7	3.3
Dev.Asia	-1.3	-2.4	2.6	2.9	3.0
WestHemi	-0.1	-2.2	-4.5	0.9	0.9
EU	-0.6	0.4	0.5	0.1	-0.1
IMF,WEO database 9/2005					



EU current account is about in global balance

Europe does depend substantially on net exports to the US

Is Europe Really Unbalanced?

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Table 2.4 Average Annual Growth of GDP per Hour Worked of ICT-producing, ICT-using and non-ICT Industries in EU and US 1979-1995 and 1995-2002

	1979-1995		1995-2002	
	EU-15	US	EU-15	US
Total Economy a)	2.3	1.2	1.8	2.5
ICT Producing Industries	6.8	7.2	8.6	9.3
ICT Producing Manufacturing b)	11.6	15.1	16.2	23.5
ICT Producing Services	4.4	2.4	5.9	2.7
ICT Using Industries c)	2.3	1.6	1.8	4.9
ICT Using Manufacturing	2.7	0.8	2	2.6
ICT Using Services	2	1.9	1.7	5.3
of which				
Whosale Trade	2.4	3.5	1.5	8.1
Retail Trade	1.7	2.4	1.5	7.1
Financial Services	1.9	1.5	2.3	5
ICT-intensive Business Services	0.8	-0.9	0.6	0.7
Non-ICT Industries	1.9	0.4	1.1	0.2
Non-ICT Manufacturing	3.2	2.3	2.1	1.2
Non-ICT Services a)	0.8	-0.3	0.5	0.2
Non-ICT Other	3.4	1.4	2.1	0.4

a) excl. real estate

Substantial domestic imbalance in productivity growth by sector,
Compared to the US, much less productivity acceleration in services.
Suggests substantial domestic investment opportunities,
especially given the demographics--older people need more services.

exact grouping.

Europe and US Trade: How Important?

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Consumer Goods Exports (Share of Total US)	1980	1986	1992	1999	2003
Western Europe	**34**	**30**	**26**	**24**	**27**
Canada	13	15	20	23	23
Asia and Pacific	6	7	8	7	7
Japan	7	12	12	10	8
Mexico	6	5	9	13	12
China, HK and Maca	4	4	3	3	4
Western Hemisphere	13	11	10	11	8

Capital Good Exports (share of US Total)	1980	1986	1992	1999	2003
n	**29**	**32**	**29**	**28**	**26**
n	15	15	16	19	19
d	11	13	13	11	13
p	5	8	8	7	7
x	7	6	8	10	13
a	2	4	4	4	6
H	11	8	8	8	7

Consumer Goods Imports (share of total US)	1980	1986	1992	1999	2003
Western Europe	**22**	**21**	**17**	**18**	**19**
Canada	5	4	4	6	6
Asia and Pacific	13	16	21	17	16
Japan	19	21	12	8	6
Mexico	3	2	6	10	8
China, HK and Maca	12	13	23	26	31
Western Hemisphere	3	4	5	6	5

Capital Goods Imports (share of US Total)	1980	1986	1992	1999	2003
n	**40**	**32**	**28**	**23**	**22**
n	17	11	10	11	10
d	4	7	12	16	16
p	23	33	30	18	13
x	6	6	8	14	15
a	2	2	3	8	16
H	2	2	1	2	2

Europe is a key trading area, but its role is shrinking

Reviving Europe's Demand: How Important for the US Trade Deficit?

- Construct a new disaggregated dataset (1980-2003)
- Disaggregates below total trade and below GDP
  - Components of domestic demand (C and I) by country (31)
  - Components of trade by 4 product groups and 31 countries
- Estimate new elasticities: sources of growth, exchange rates
  - For 4 product groups and various groups of countries
  - TS panel estimation with fixed effects, error correction.

- See: The US Trade Deficit: A Disaggregated Perspective," Catherine L. Mann and Katharina Plück, Institute for International Economics Working Paper, August 2005.

Key Elasticity Estimates

Commodity Group	Matched Expenditure				Matched Relative Price				Variety
	Industrial Country		Developing Country		Industrial Country		Developing Country		
	SR	LR	SR	LR	SR	LR	SR	LR	
Imports									
Capital goods	1.29**	0.77**	-0.40#	3.12	-0.31	-0.71**	-0.20	5.01**	1.42**
Consumer goods	3.55	1.32	4.16**	1.96#	-1.35**	-4.34**	0.86*	14.34**	-0.19
Exports									
Capital goods	0.67	0.70*	0.79**	0.94**	-0.38**	0.12	-0.01	0.01	5.2**
Consumer goods	0.45**	1.09**	0.69**	1.64**	-0.45**	-0.58#	0.01	0.02	-0.12

- Using matched relative price (e.g. real exchange rate) elasticities: significant and plausible values for industrial countries, but not significant for developing countries– esp. strong relative price effects for consumer goods from industrial countries
- Using matched expenditure components: Elasticities differ across product and country groups— esp. high SR for cons. goods; plausible LR; reduce Houthakker-Magee asymmetry; results reject assumption of constant income elasticities for imports

Assumptions for Growth Scenarios:

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Consensus Forecasts (real growth,pp)	2005	2006	Add %-points to achieve→	Average for "boom" in ROW/ "realistic slowdown" for the US (based on 1980-2003 data)
Gross Fixed Capital Formation				
Europe and Japan	3.5	3.7	5.0	8.4
Other Industrial Countries	7.4	7.2	7.0	14.8
Developing Countries	9.2	7.5	1.0	9.9
United States	8.8	7.5	-13.0	-6
Personal Consumption Expenditures				
Europe and Japan	1.3	1.7	7.0	8.3
Other Industrial Countries	3.1	3.1	5.0	8.3
Developing Countries	4.9	4.4	11.0	15.2
United States	3.5	3.1	-3.0	0

Note: These scenarios assume an average boom for foreign countries but only a realistic slowdown for the US; to achieve an 'average' recession for the US, I would fall an additional 13pp and C an additional 3 pp

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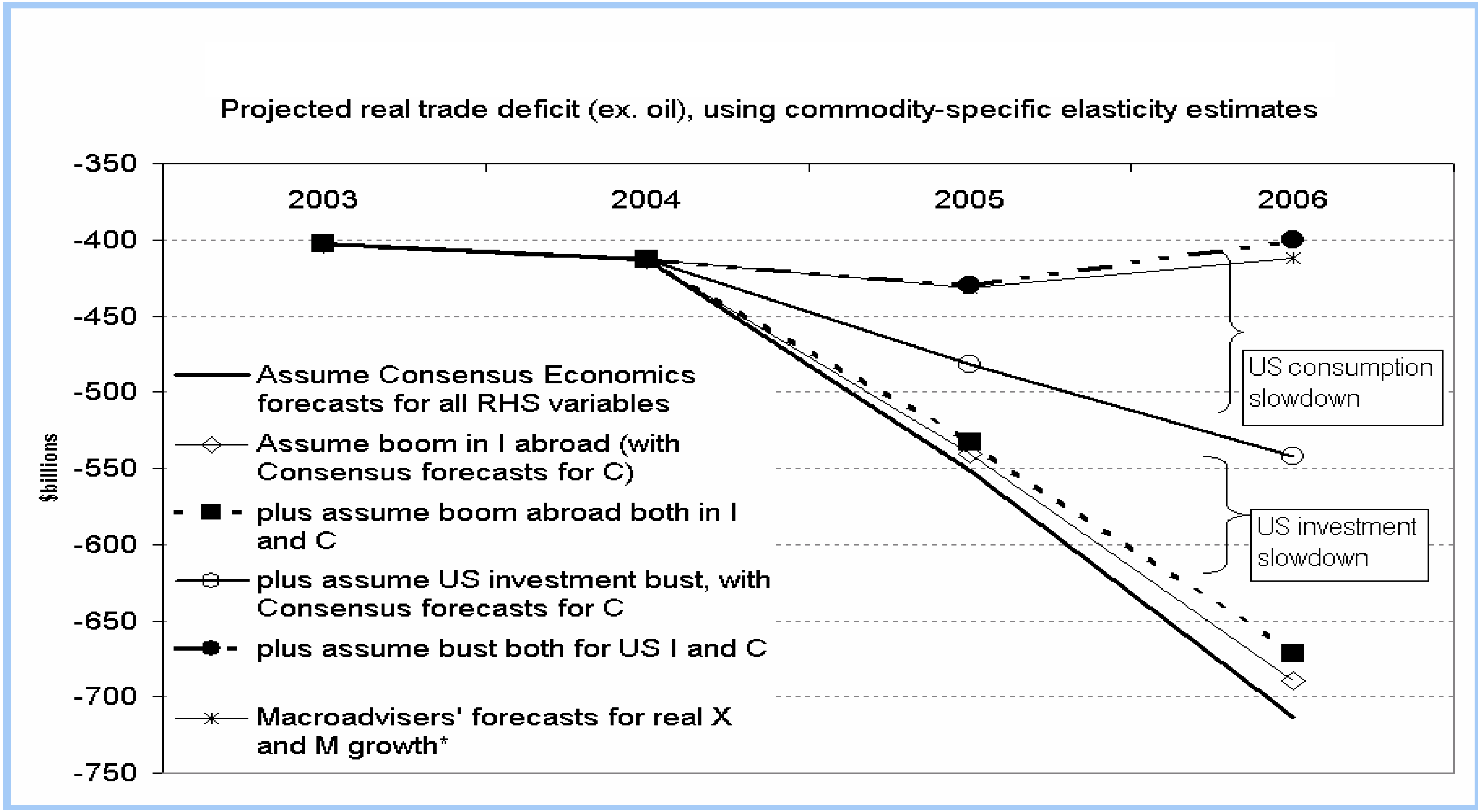
Adjustment Scenarios: Without substantial exchange rate moves, global demand likely slow down



Sources: UN Comtrade; *Consensus Economics* forecasts; *Macroadvisers' Economic Outlook*, June 22, 2005; authors calculations from previously cited paper.

Conclusions

- Europe’s internal imbalance is greater than external imbalance
  - Most apparent in sluggish productivity growth in services
- Stronger investment and consumption in Europe is important for Europe
  - But demand will not close the US trade imbalance.
- Euro/Dollar exchange rate must play a big role.
  - Will long-dated Euro government bonds play a role in exchange rate adjustment? Shift Asian demand from UST?