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Current account development between the euro area and China and possible determinants

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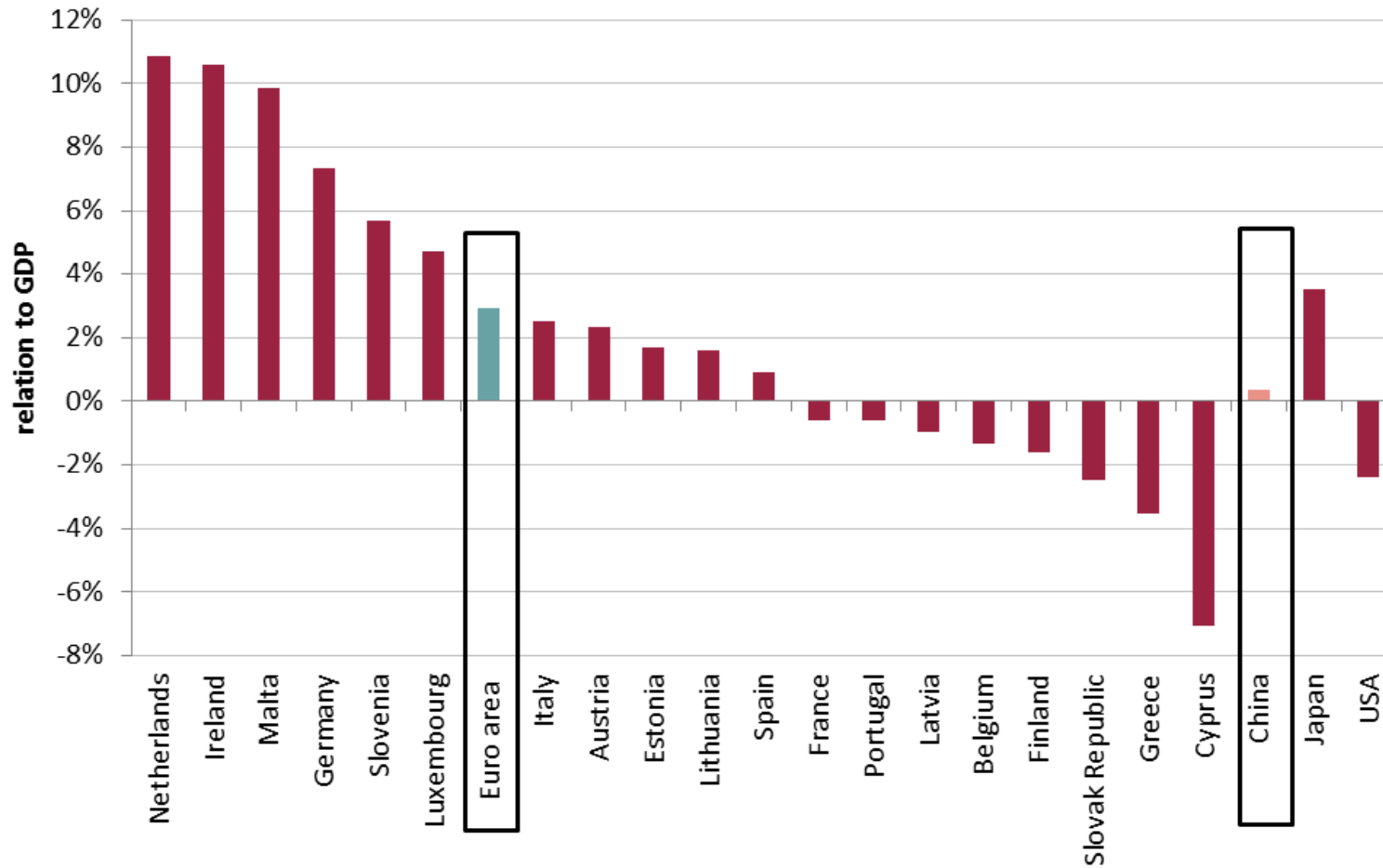
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Motivation

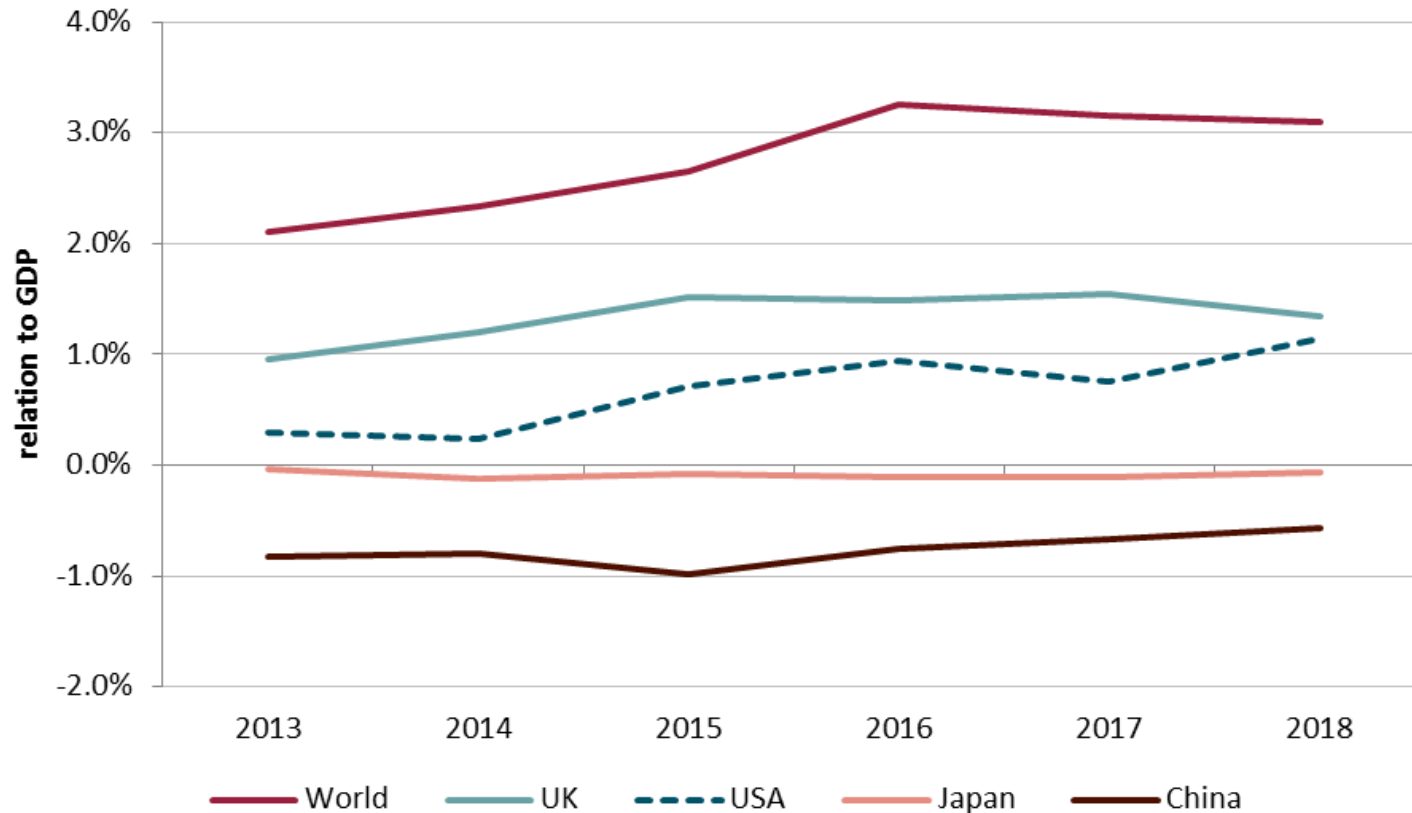
- Trade dispute between USA and China due to large bilateral trade imbalance
- Rise of China's importance in world trade
- Is this also an issue between the euro area and China?
- Heterogeneity within the euro area between member states
- What determines the trade balance?
- Is there need for policy action on the European side?

Development of the current account and trade balances of selected countries and regions

Current account balances of selected countries 2018

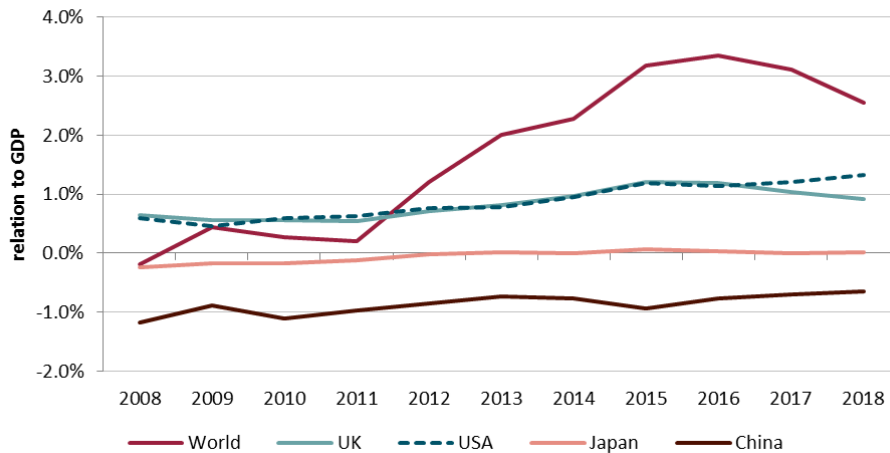


Current account balance of the euro area

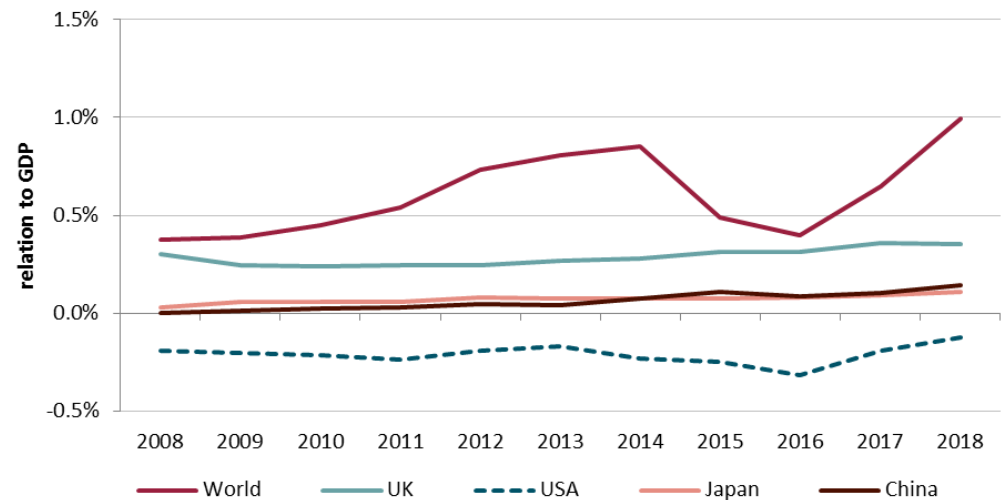


Trade balance of the euro area

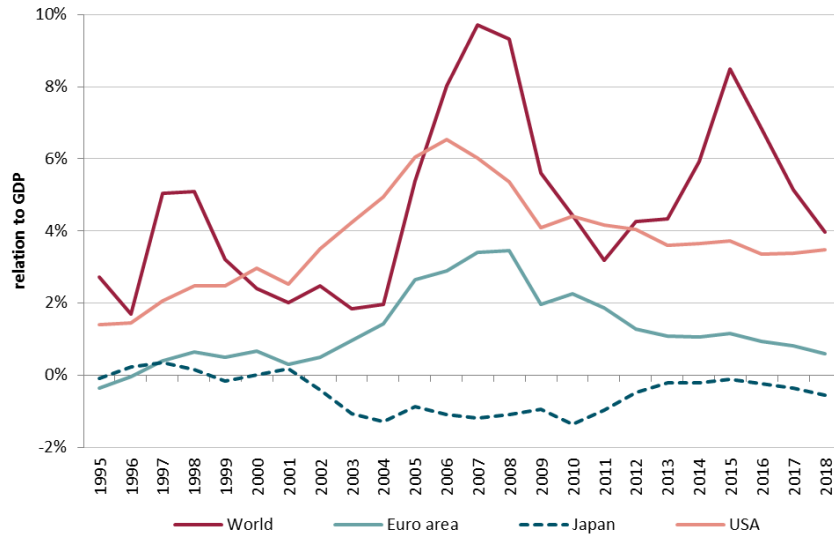
Trade in goods



Trade in services

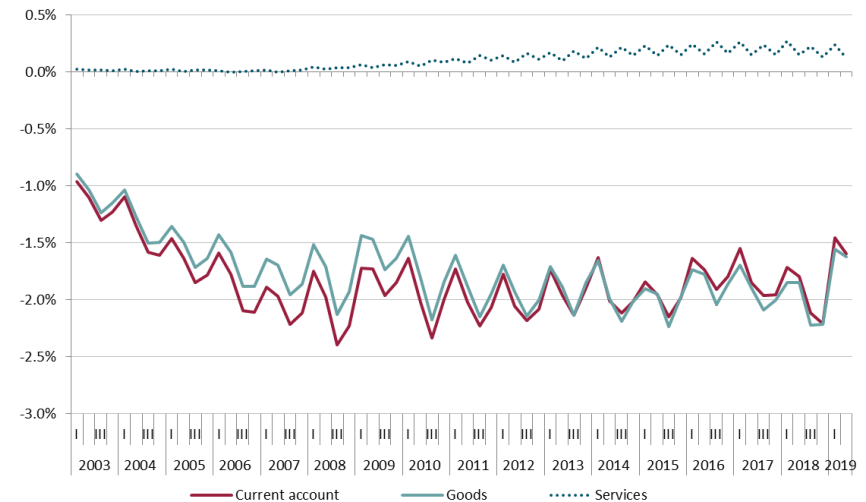


Trade balance of China

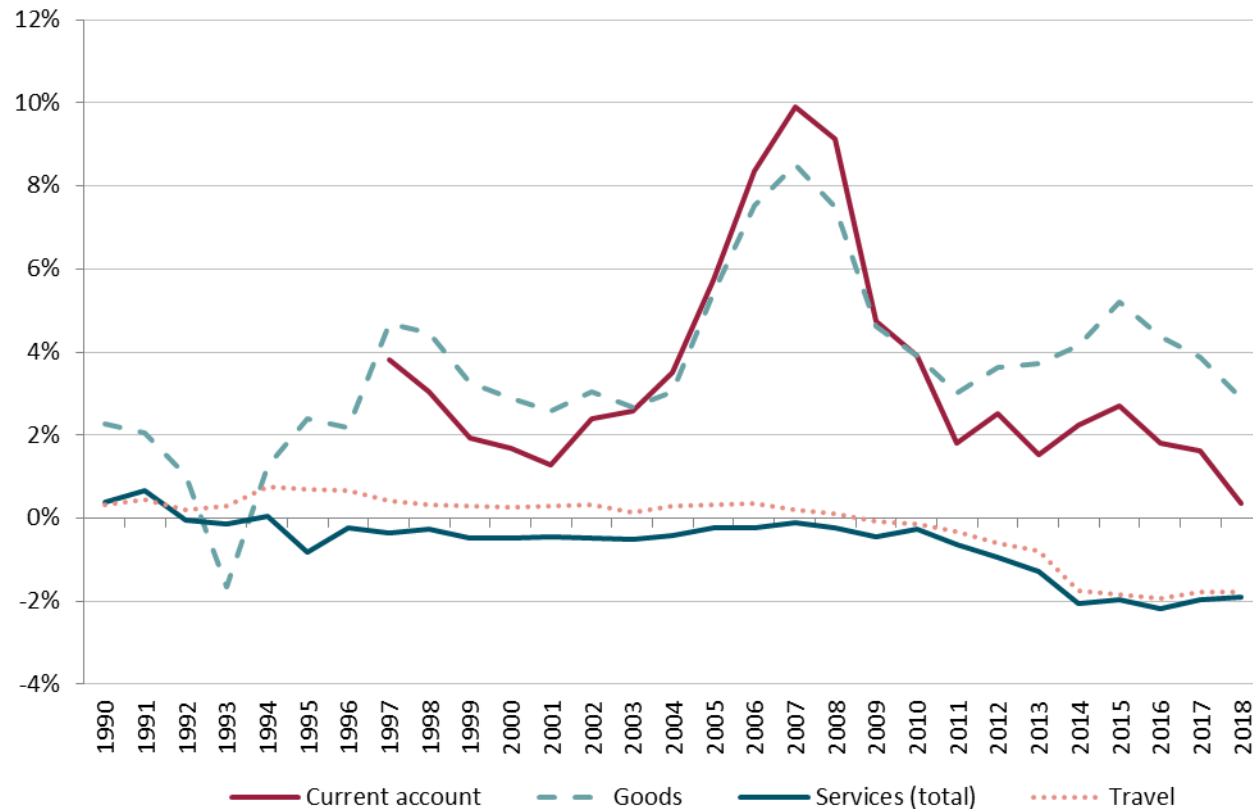


Trade balance (goods) vis-à-vis
selected countries and regions

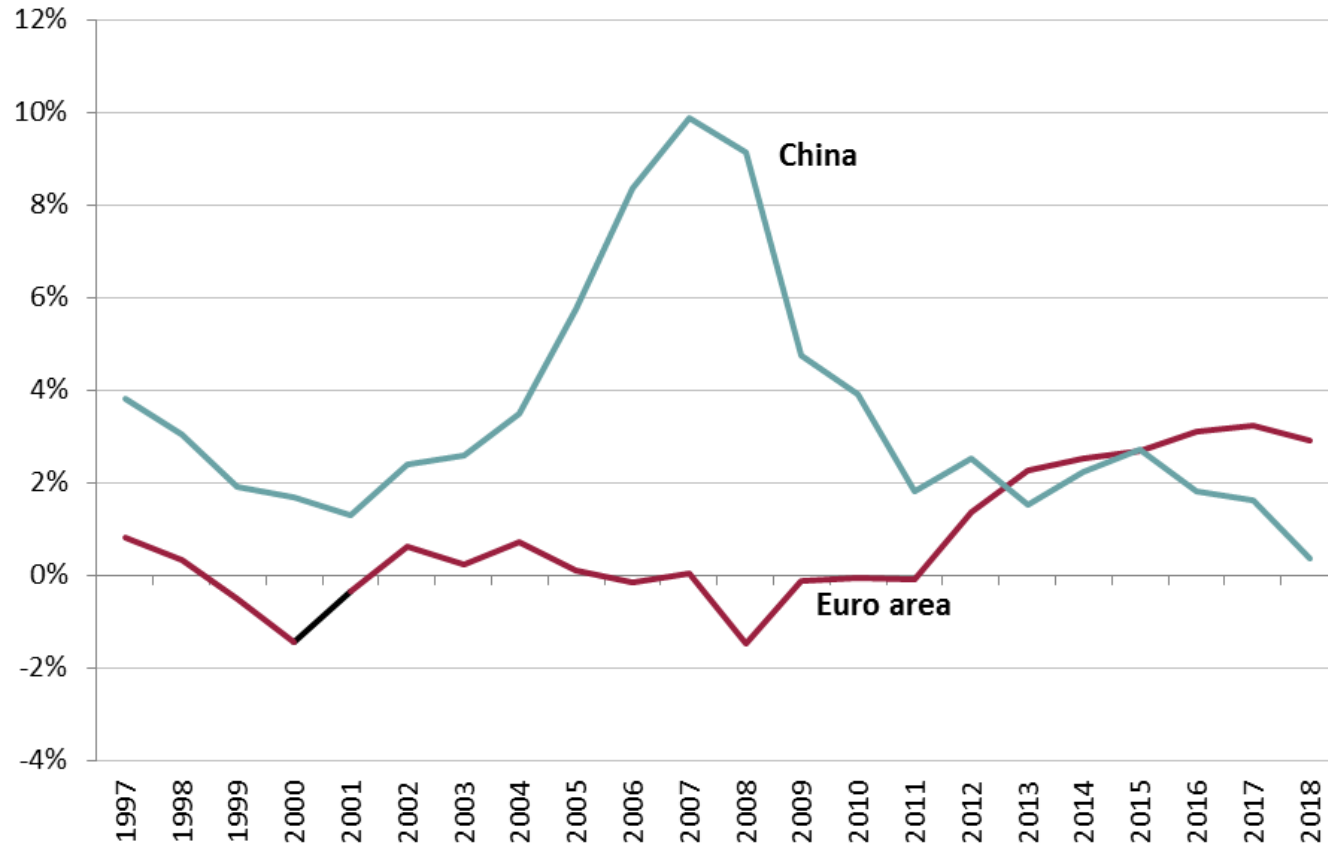
Current account balance
of the US vis-à-vis China



Current account balance of China



Current account balances of the euro area and China

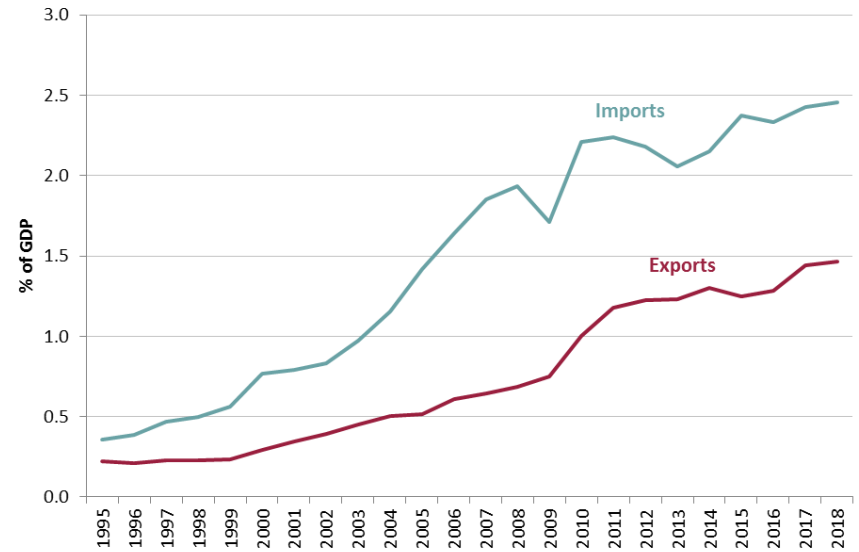
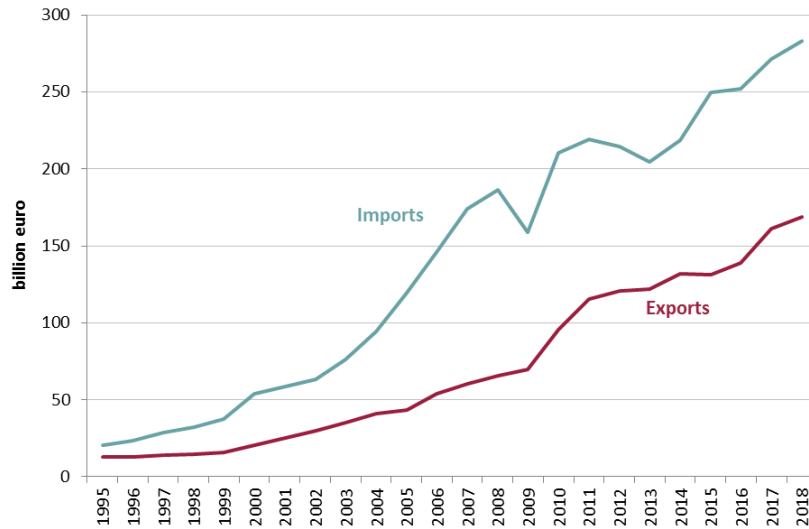




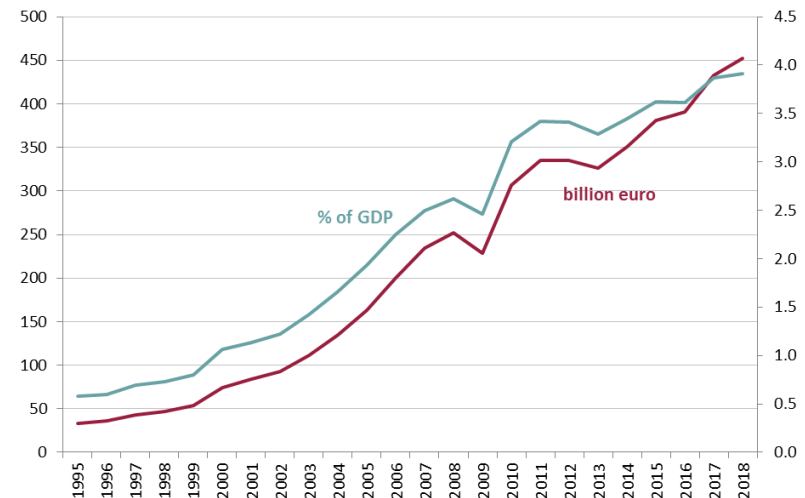
Trade between the euro area and China



Trade (goods) between the euro area and China

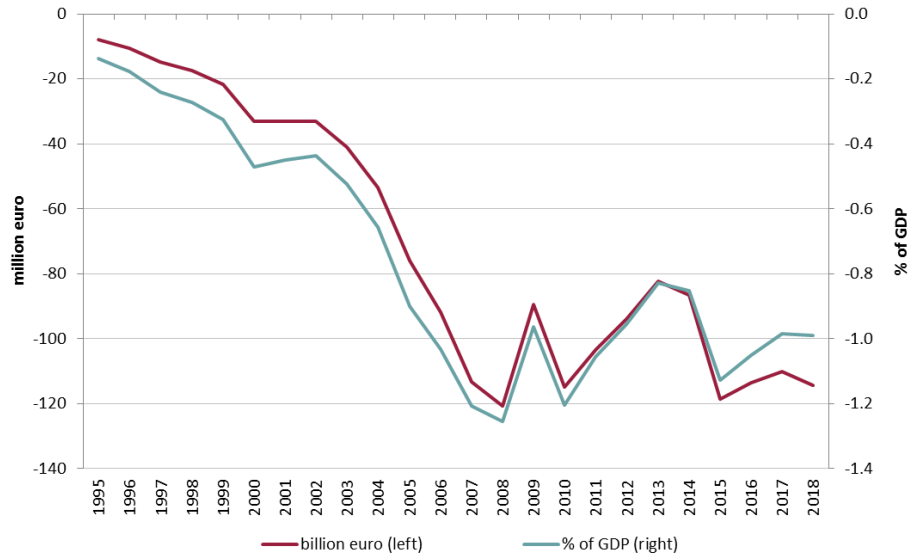


Total trade (exports + imports)

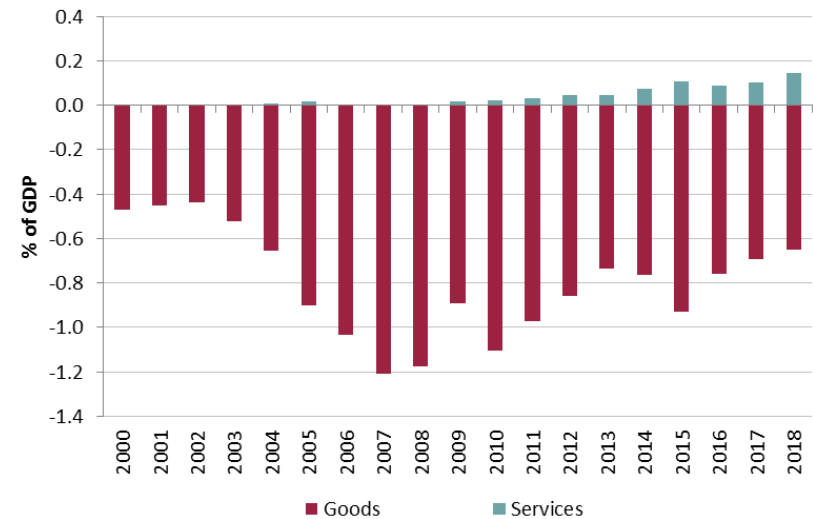


Trade balance euro area / China

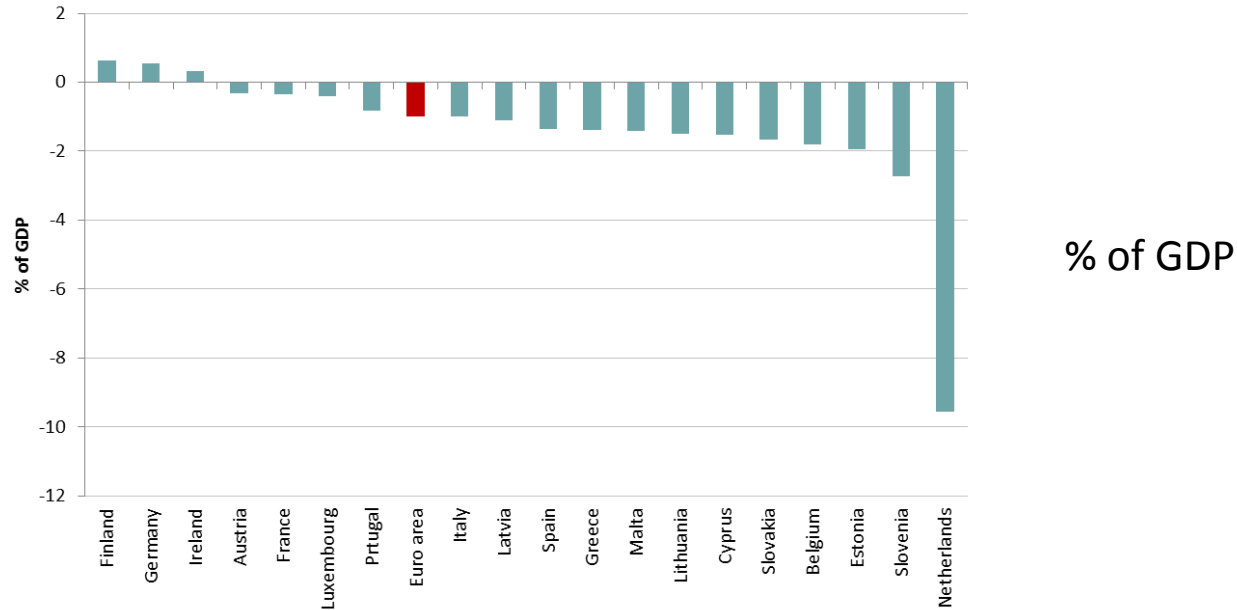
Goods



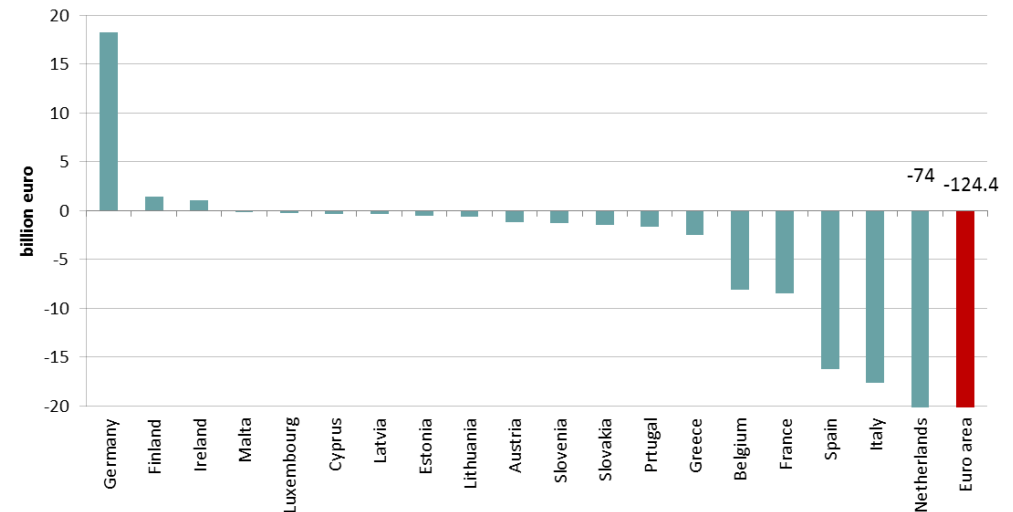
Goods and services



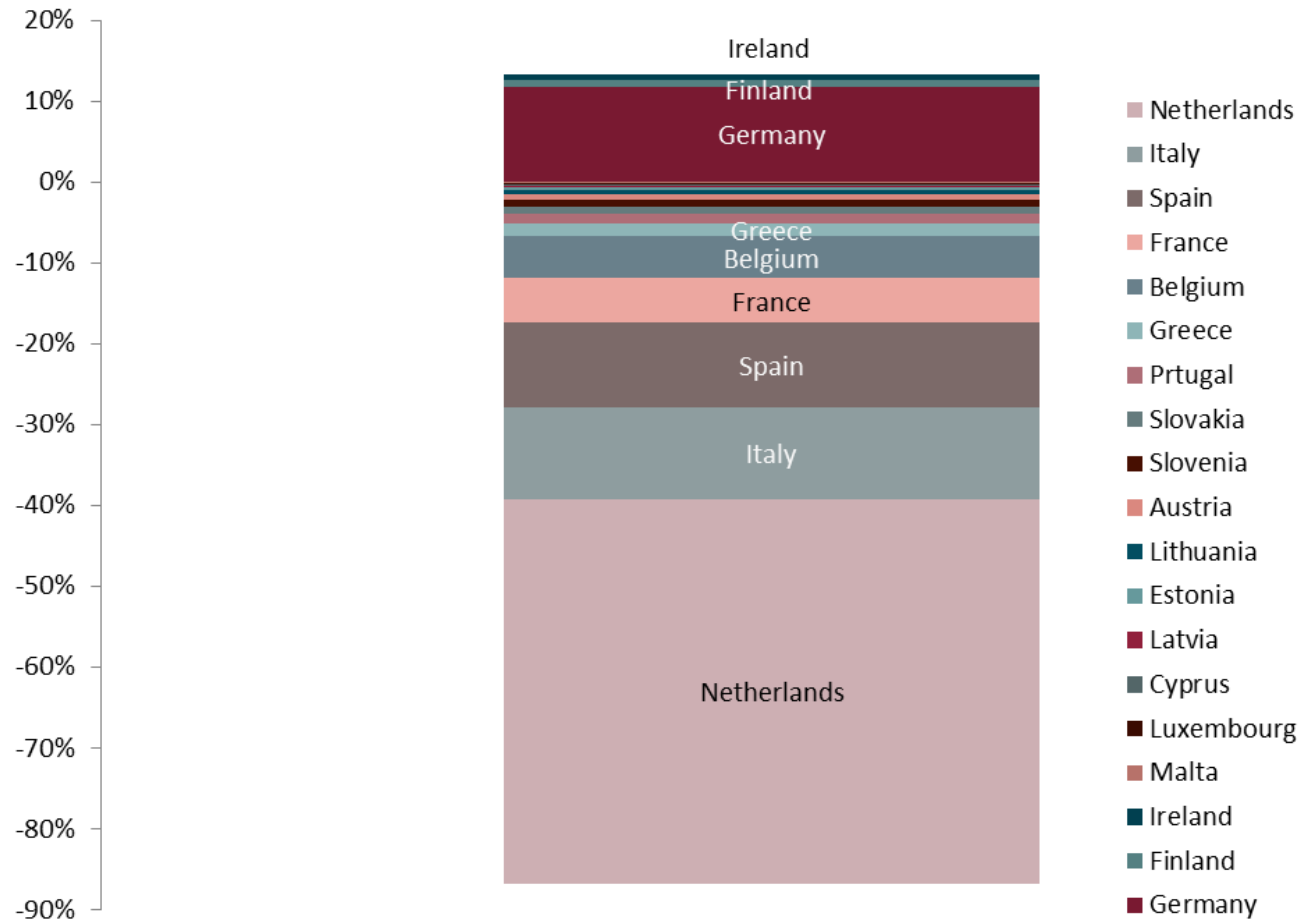
Trade balance (goods) of euro area countries / China 2018



billion euro



Trade balance euro area countries / China 2018



Possible determinants of the bilateral trade balance

Possible determinants of bilateral trade balance

Improvement of euro area trade balance	Deterioration of euro area trade balance
Domestic demand in China	Domestic demand in the euro area
Real effective appreciation of the renminbi	Real effective appreciation of the euro
Depreciation of the euro vs. the renminbi	Appreciation of the euro vs. the renminbi
Fiscal consolidation in the euro area (increase of cyclically adjusted primary budget balance)	Fiscal consolidation in China (increase of cyclically adjusted primary budget balance)
Higher output gap in China	Higher output gap in the euro area
Decrease of Chinese tariffs	Decrease of euro area tariffs
Revealed comparative advantage of euro area	Revealed comparative advantage of China

Econometric analysis – variables

Variables included	Data sources
Domestic demand (DEMAND) in the euro area and in China	AMECO, OECD
Real effective exchange rate (REER), euro area and China	Eurostat, OECD
Nominal exchange rate euro / renminbi (RENMINBI)	Eurostat (from 1999), US Fed
Cyclically adjusted primary budget balance (CAPB), euro area and China	AMECO, OECD
Output gap (GAP); percentage deviation of real GDP from potential GDP (euro area) and trend GDP (China)	AMECO, OECD
Average tariff rate (TARIFF) of China and the euro area	World Bank (World Development Indicators)
Revealed comparative advantage (RCA) of China and of the euro area (for capital goods, intermediate goods, capital goods)	World Bank, World Integrated Trade Solutions Database; for euro area calculated as weighted average of single country data

Econometric analysis – results

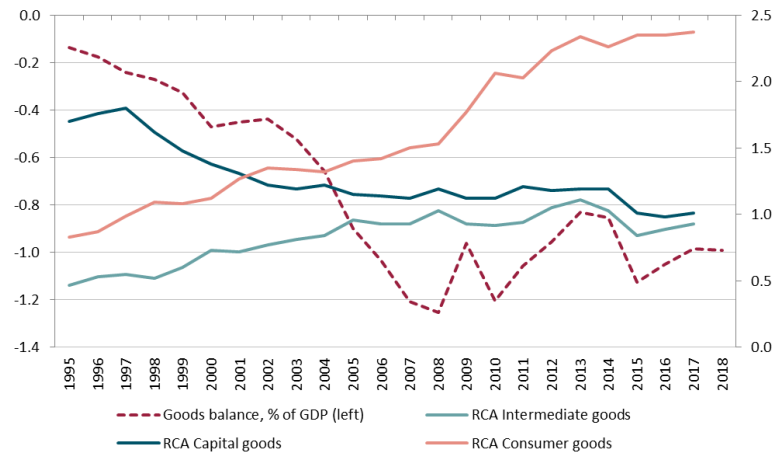
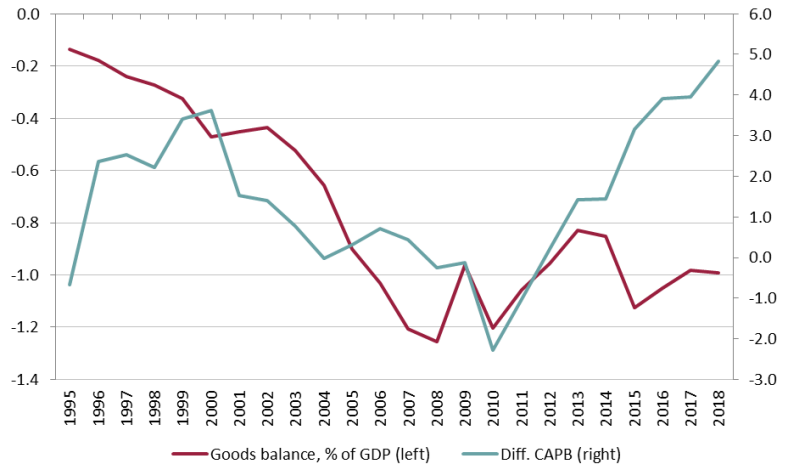
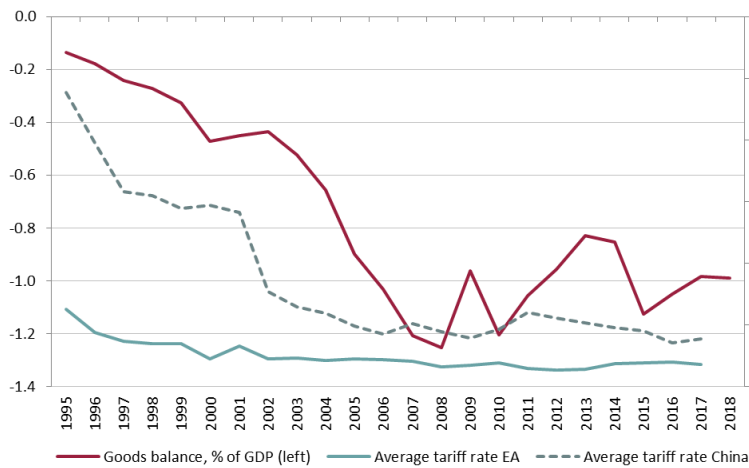
Variable	Model 1	Model 2	Model 3	Model 4
Constant	49.295 ***	49.644 ***	37.870 ***	36.900 ***
log (DEMAND euro area)	-5.442 ***	-5.467 ***	-4.148 ***	-4.011 ***
CAPB China	-0.045 (*)	-0.054 **	-0.031	-0.025
RENMINBI	-0.050 **	-0.062 ***	-0.044 *	-0.057 ***
TARIFF China	-0.020 (*)	-0.021 **		
RCA China (intermediate goods)			-1.080 (*)	-1.367 ***
DUMMY 2010				-0.278 ***
DUMMY 2015		-0.276 ***		-0.248 ***
Adjusted R ²	0.921	0.943	0.921	0.965
Period	1995 – 2017			

*, **, *** significant at the 10, 5, 1 percent level. (*) significance slightly below 10 percent

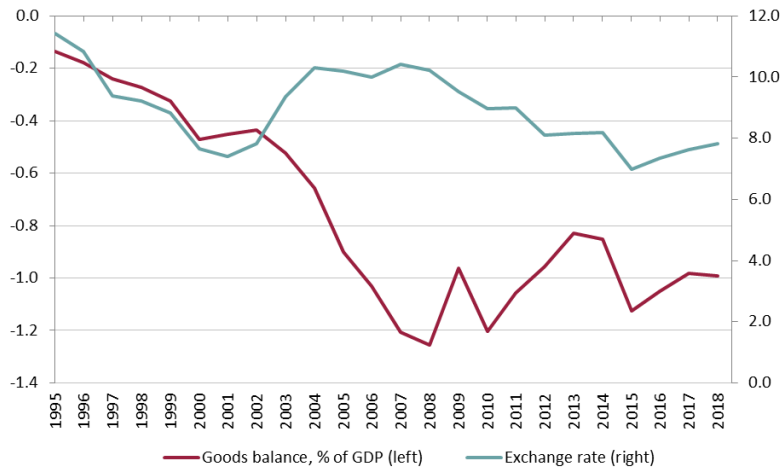
Summary of results

- Domestic demand is an important determinant of bilateral trade balance
- Tariffs and revealed comparative advantage are only found weakly significant with the correct sign in one specification
- Output gap never significant (correlated with domestic demand, but also when included instead of demand)
- Fiscal stance is relevant – fiscal contraction decreases demand and thus improves the trade balance
- Exchange rate: only nominal exchange rate euro / renminbi found significant and with the correct sign; real effective exchange rate in most specifications insignificant

Development of some determinants

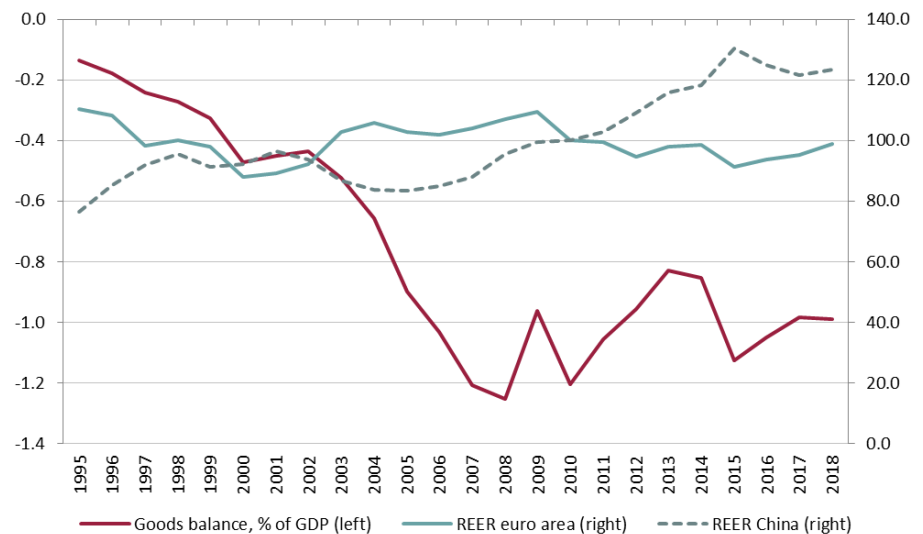


Development of exchange rates



Nominal exchange rate euro / renminbi

Real effective exchange rates





Summary and conclusions

Summary – current account development

- Meanwhile, euro area has a larger current account surplus than China
- Current account as well as trade between euro area and China more or less balanced
- Euro area has a surplus in trade in services
- Heterogeneity within the euro area: Germany, Finland and Ireland have surpluses in the trade with China
- Germany +18.2 billion euro (0.5 % of GDP), Netherlands -74 billion euro (1% of GDP); euro area: -114.4 billion euro (1% of GDP)

Summary – determinants

- Domestic demand is relevant for the bilateral trade balance
- Tariffs and revealed comparative advantage are only weakly significant
- Fiscal stance is relevant – fiscal contraction decreases demand and thus improves the trade balance
- Only nominal exchange rate euro / renminbi, but not real effective exchange rates were found significant for the bilateral trade balance

Policy conclusions

- Development and size of trade (im)balance between euro area and China does not justify policy actions
- Literature and empirical evidence (US/China) shows that tariffs and other trade barriers are not adequate to address trade imbalances
- Tariffs are harmful for overall welfare
- However, distributional impacts of openness do matter
- Other aspects like international technology transfer, protection of certain domestic industries, “European Champions” might be discussed, but outside the context of trade (im)balances



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Thank you for your attention

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