



Exit from the Euro? Provisional first- impact effects for Italy with INTIMO

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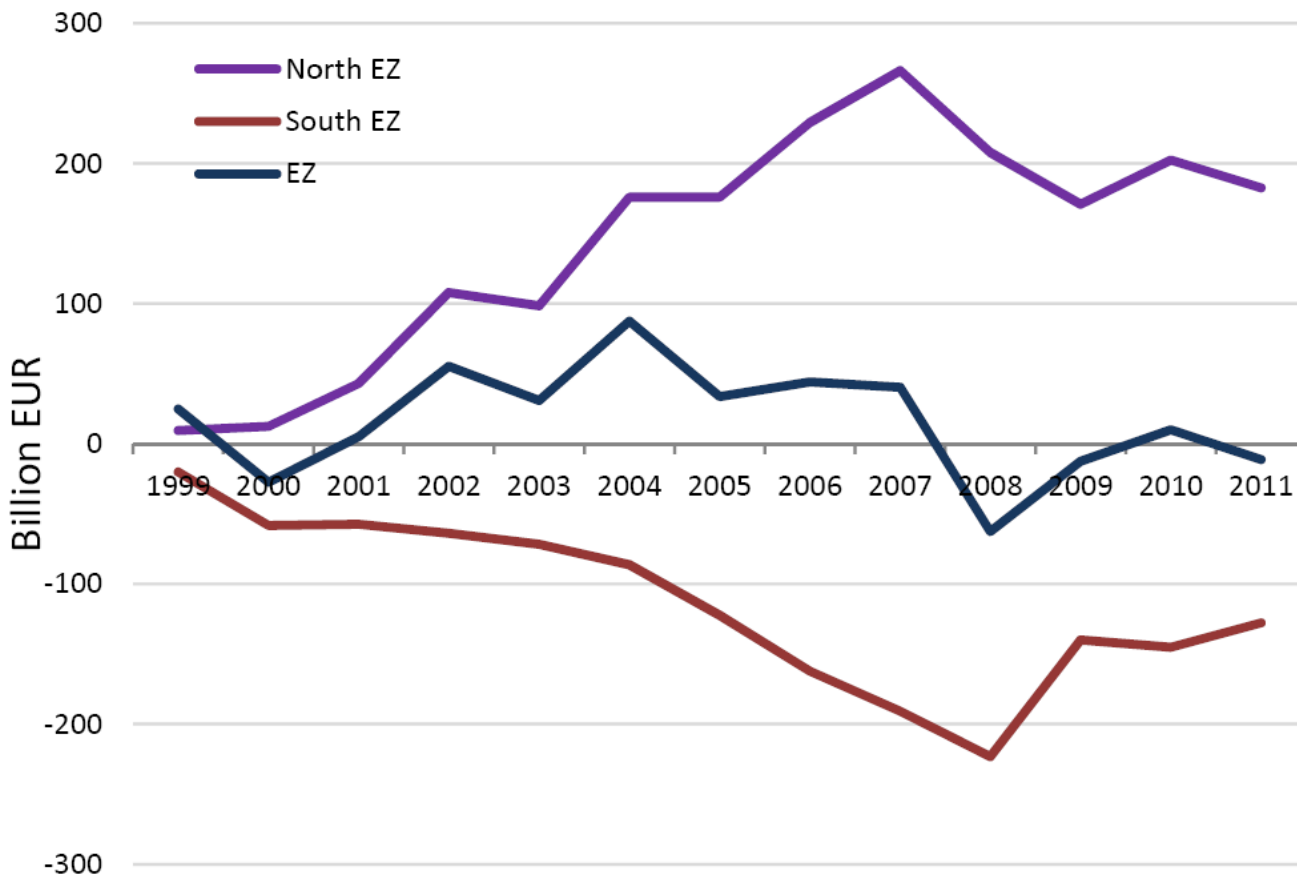
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Outline

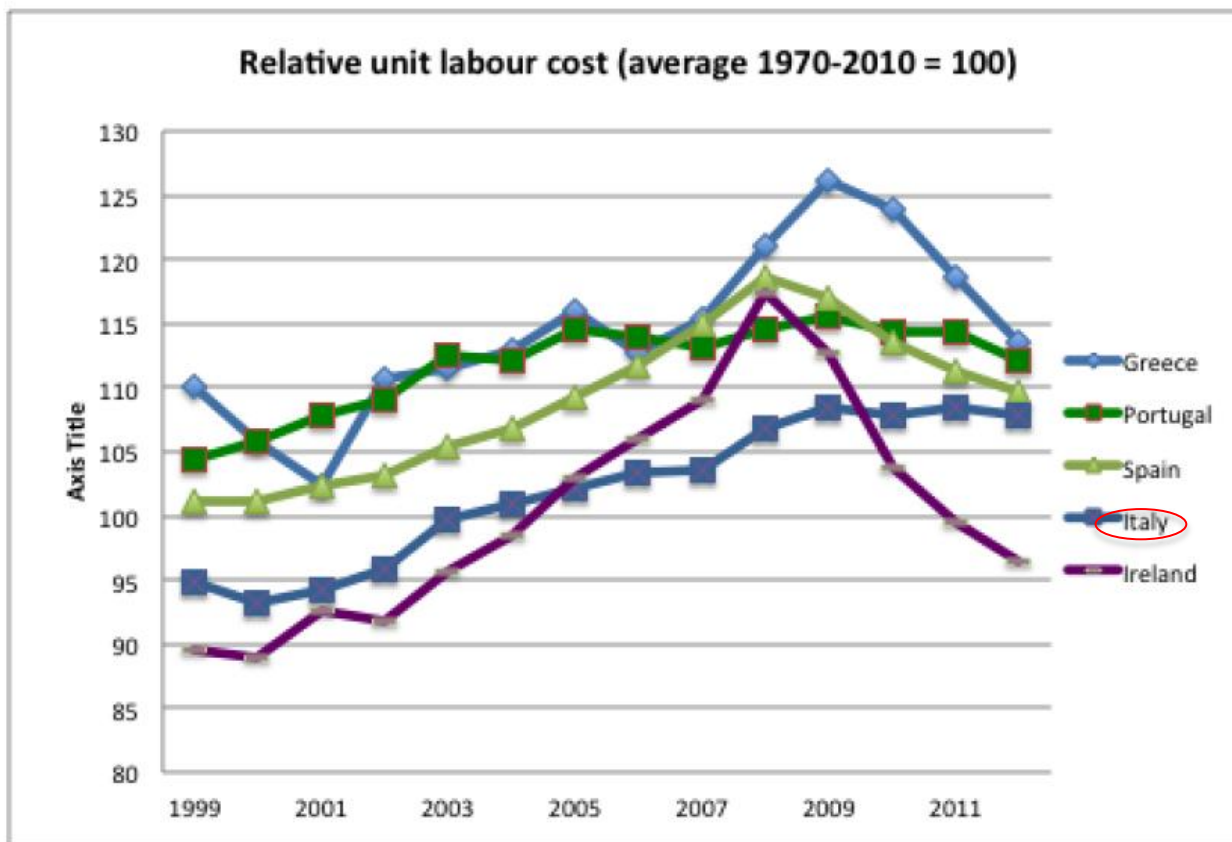
- Competitiveness and macroeconomic imbalances in EU countries
- Some Italian facts
- A possible way out: exit from the euro?
- A simple simulation
- Results and much further work

Macroeconomic Imbalances in the Euro Area: the current account balance



... due to different competitiveness ...

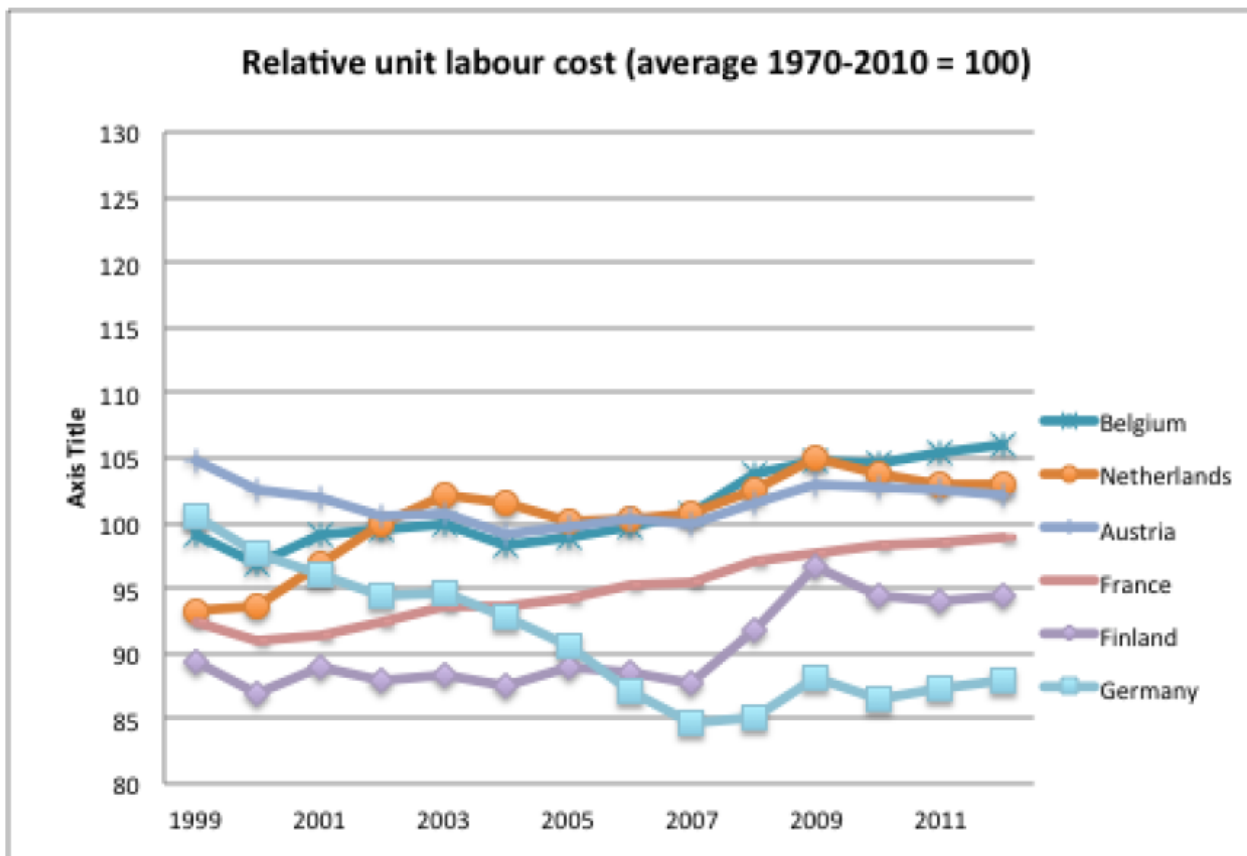
- Southern EU countries



Source: European Commission, Ameco.

... due to different competitiveness ...

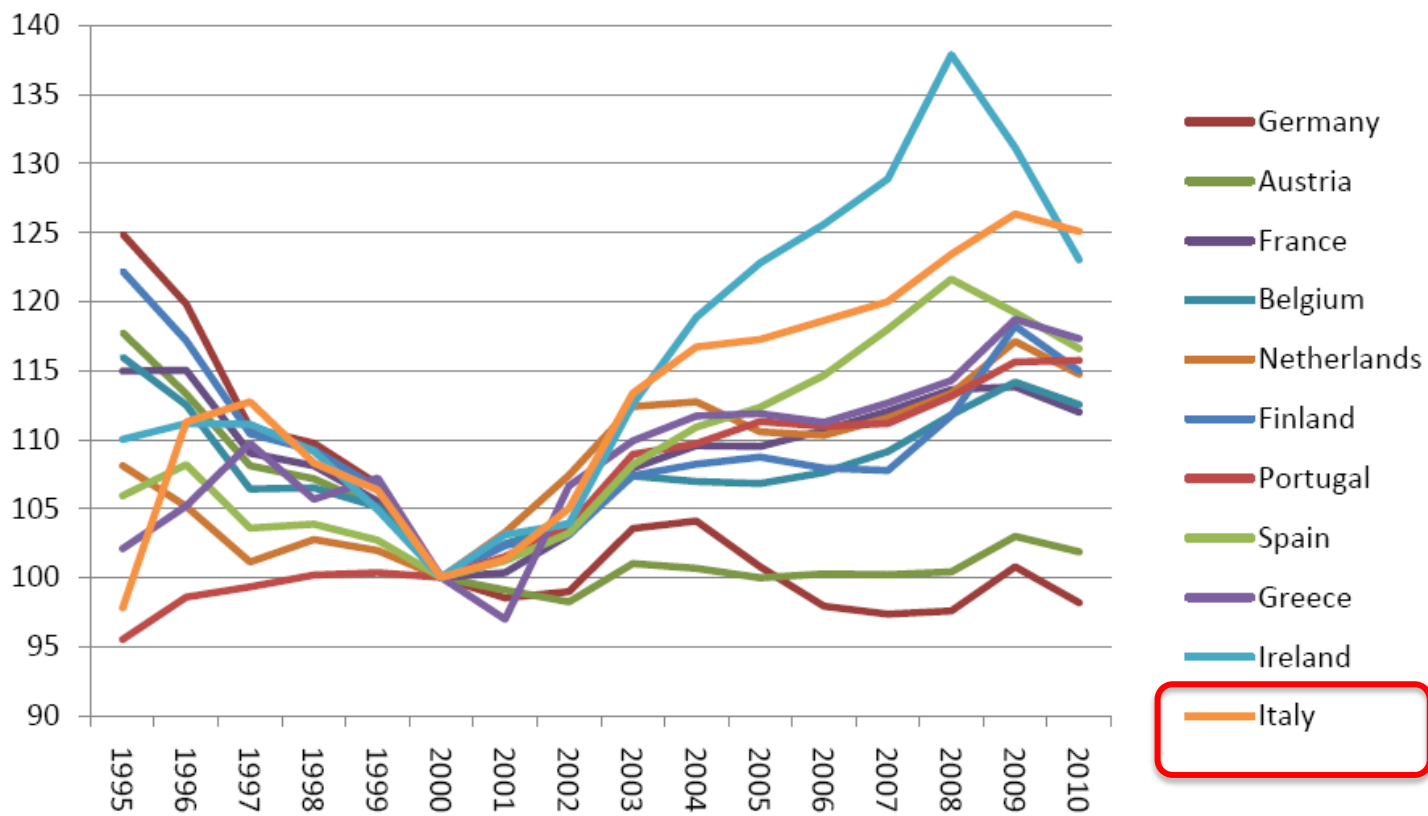
- North-Central EU countries



Source: European Commission, Ameco.

... reflecting in diverging real exchange rates.

Figure 4: Real Effective Exchange Rate (based on unit labor cost), 2000=100



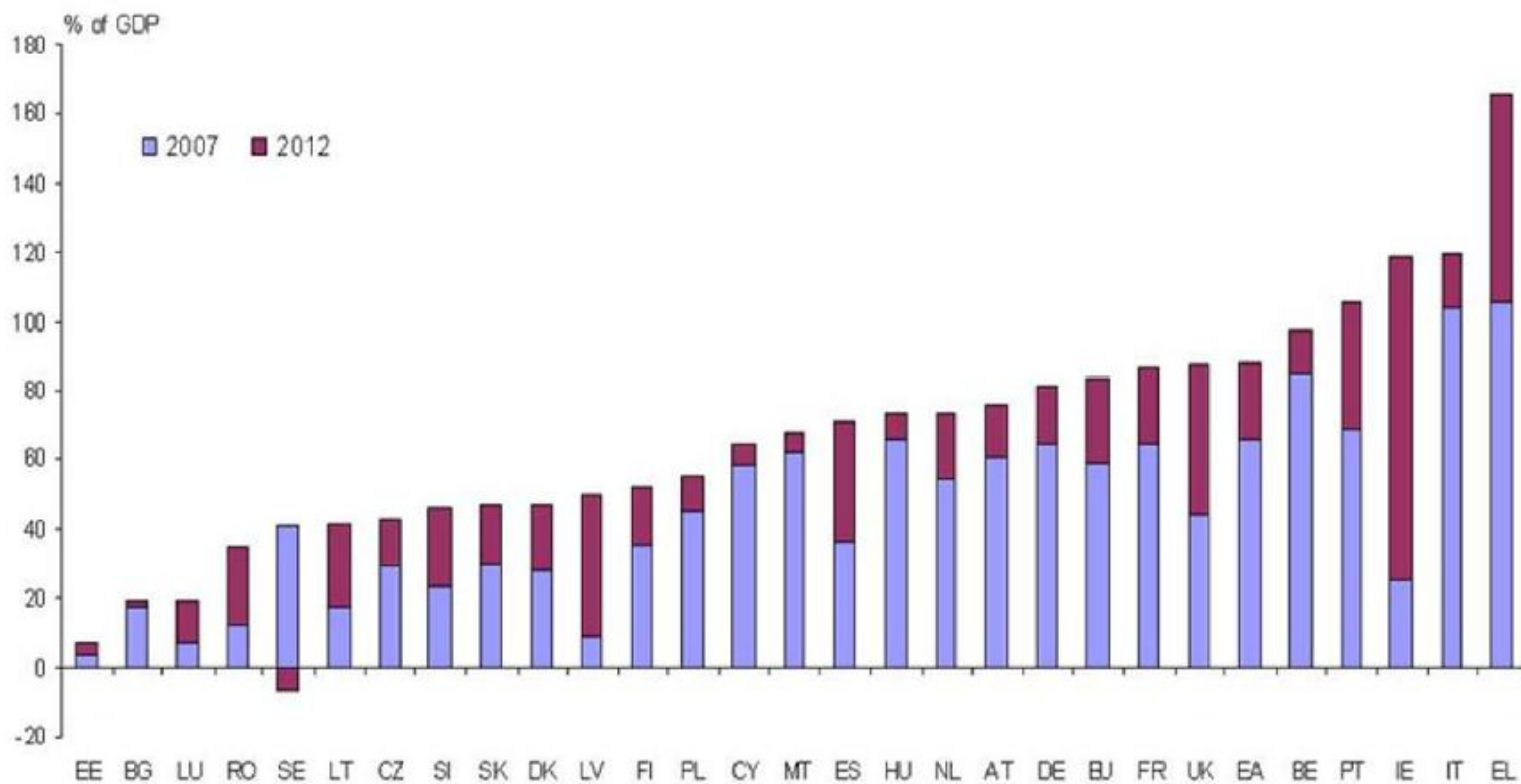


Italy after the crisis

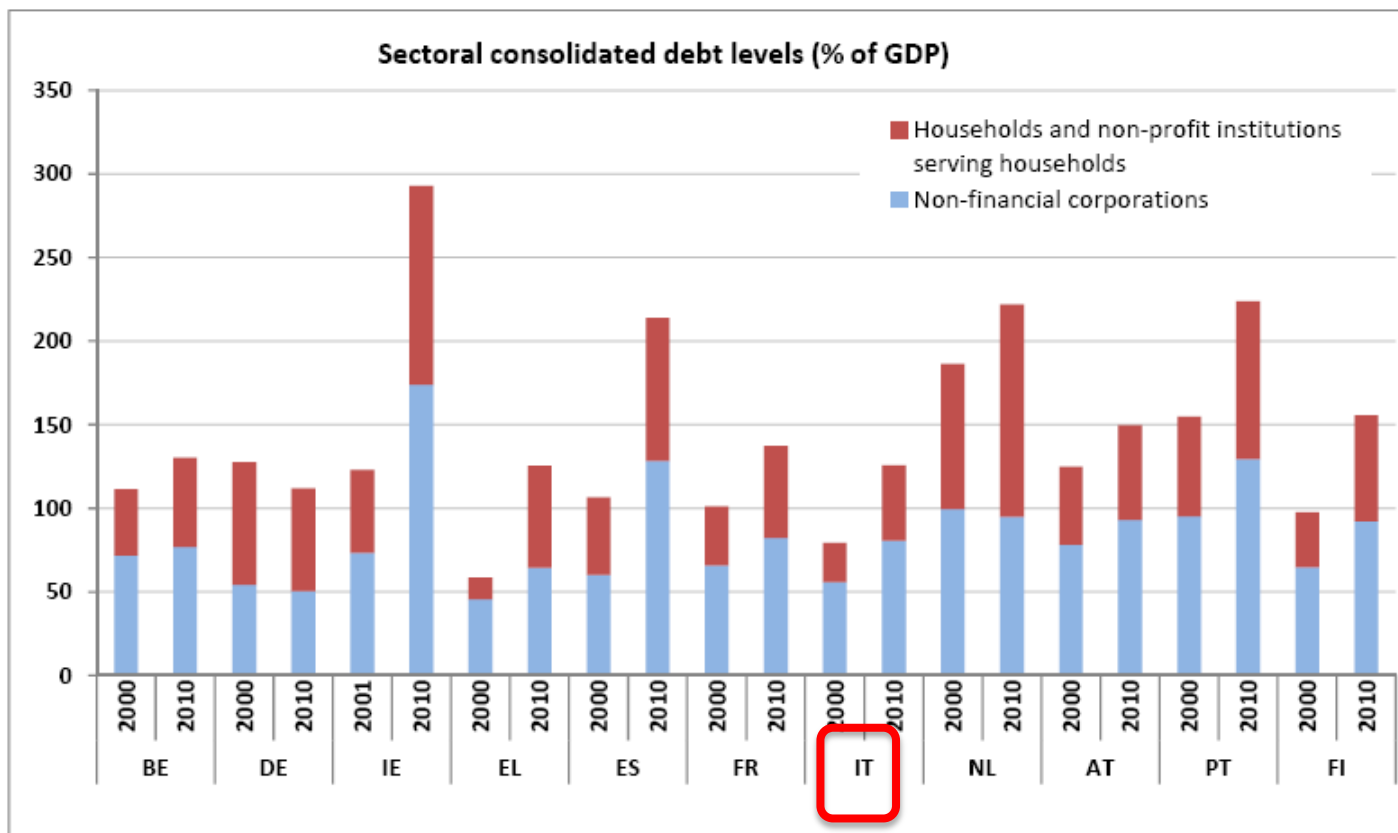


The second-highest public debt in the EU

... but with little increase during the crisis



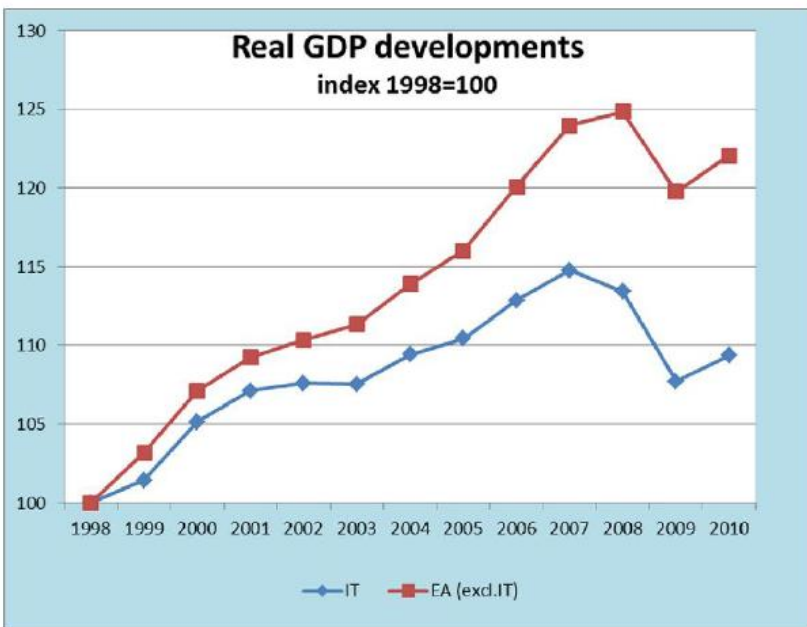
... private sector indebtedness among the lowest in the euro area



Source: Eurostat

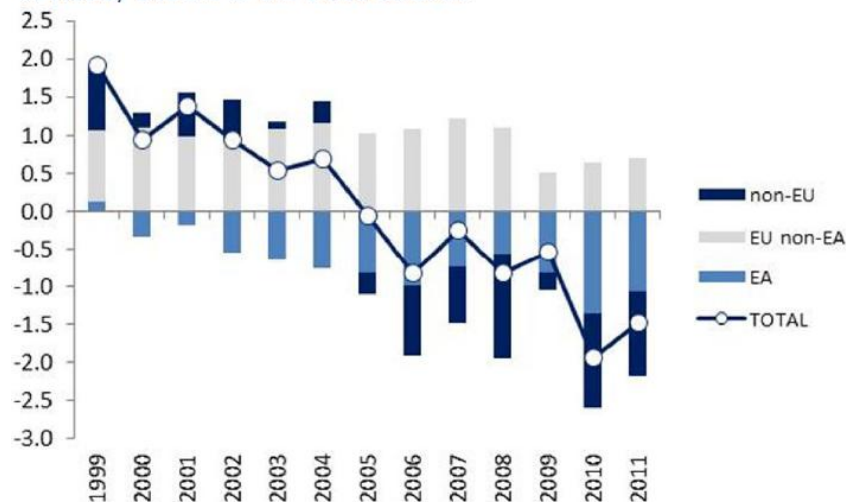
Main problems

Real GDP growth below the euro area average



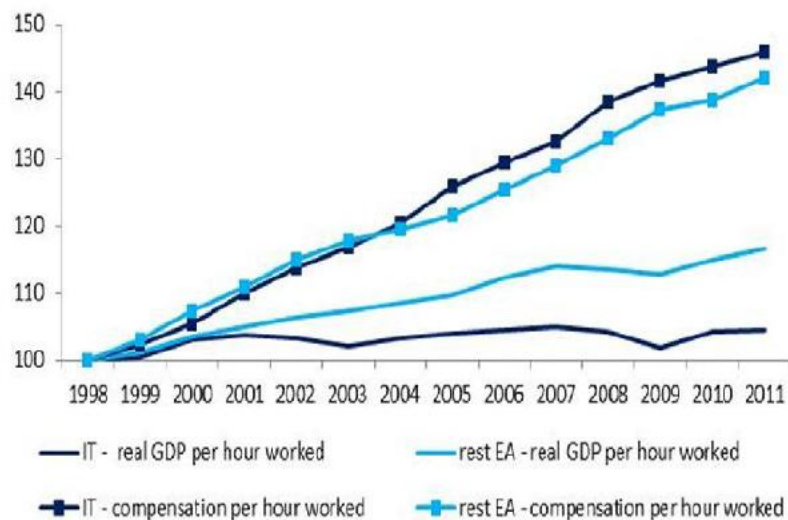
... and the country has been losing competitiveness

A steady decline in the trade balance

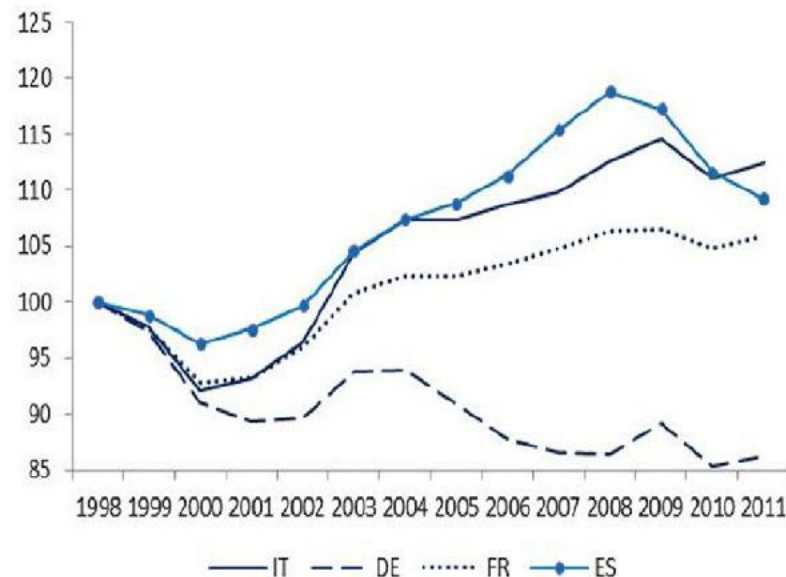


Italy competitiveness losses (1)

Wages and productivity developments in Italy vs EA, 1998=100



Real effective exchange rate based on unit labour costs, 1998=100



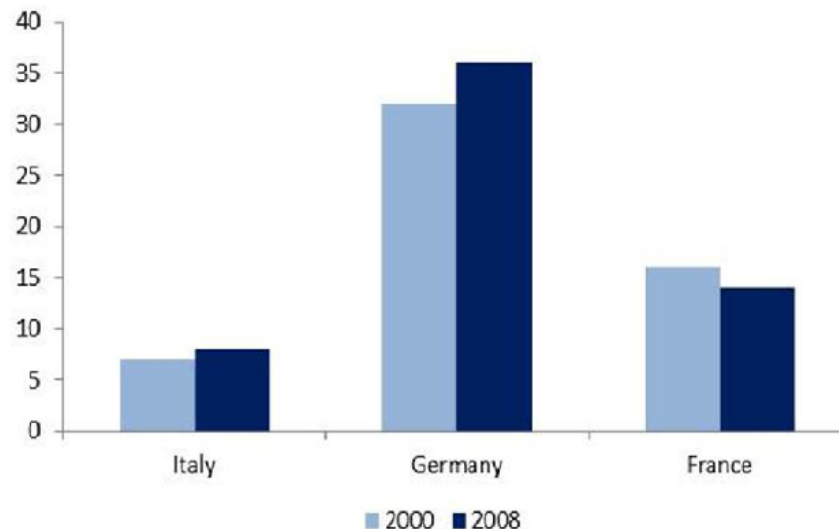
Deteriorating cost competitiveness: wages have grown slightly more than in the euro-area average, while productivity has lagged behind

Italy competitiveness losses (2)

Unfavourable sectoral specialisation
(Pattern of manufacturing exports by
technological content (in %))

		2000	2011
Italy	High technology	11.8	10.4
	Medium-high technology	38.6	39.1
	Medium-low technology	18.7	25
	Low technology	30.9	25.5
Germany	High technology	20.0	18.8
	Medium-high technology	51.3	50.5
	Medium-low technology	14.7	17.4
	Low technology	14.0	13.3
France	High technology	25.7	26.2
	Medium-high technology	39.2	35.8
	Medium-low technology	14.9	18.0
	Low technology	20.2	20.1

Small size of firms: average number of employees per
firm



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Non-cost competitiveness weaknesses: Unfavourable sectoral specialisation, also due to the small size of firms; low R&D, innovation and technology intensity (low educational attainment of labour force)

Table 22: The MIP scoreboard for Italy

	Italy	Thresholds	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
External imbalances and competitiveness	3 year average of Current Account Balance as a percent of GDP	-4/+6%	0.4	-0.1	-0.3	-0.5	-0.7	-0.9	-1.2	-1.9	-2.0	-2.8	-2.9
	Net International Investment Position as % of GDP	-35%	-5.8	-12.4	-13.6	-15.8	-16.8	-22.2	-24.5	-24.1	-25.3	-24.0	-20.6
	% Change (3 years) of Real Effective Exchange Rate (REER) with HICP deflators	±5% & ±11%	-5.7	-2.0	8.8	9.9	6.9	1.1	0.7	3.2	3.9	-0.9	-2.1
	% Change (5 years) in Export Market Shares	-6%	-18.5	-14.2	-13.4	-7.4	-5.2	-12.5	-9.3	-16.3	-17.9	-19.2	-18.4
	% Change (3 years) in Nominal ULC	+9% & +12%	4.8	7.0	10.7	9.8	8.7	6.5	6.1	8.3	10.5	8.1	4.4

Possible policy responses: the EU suggestions

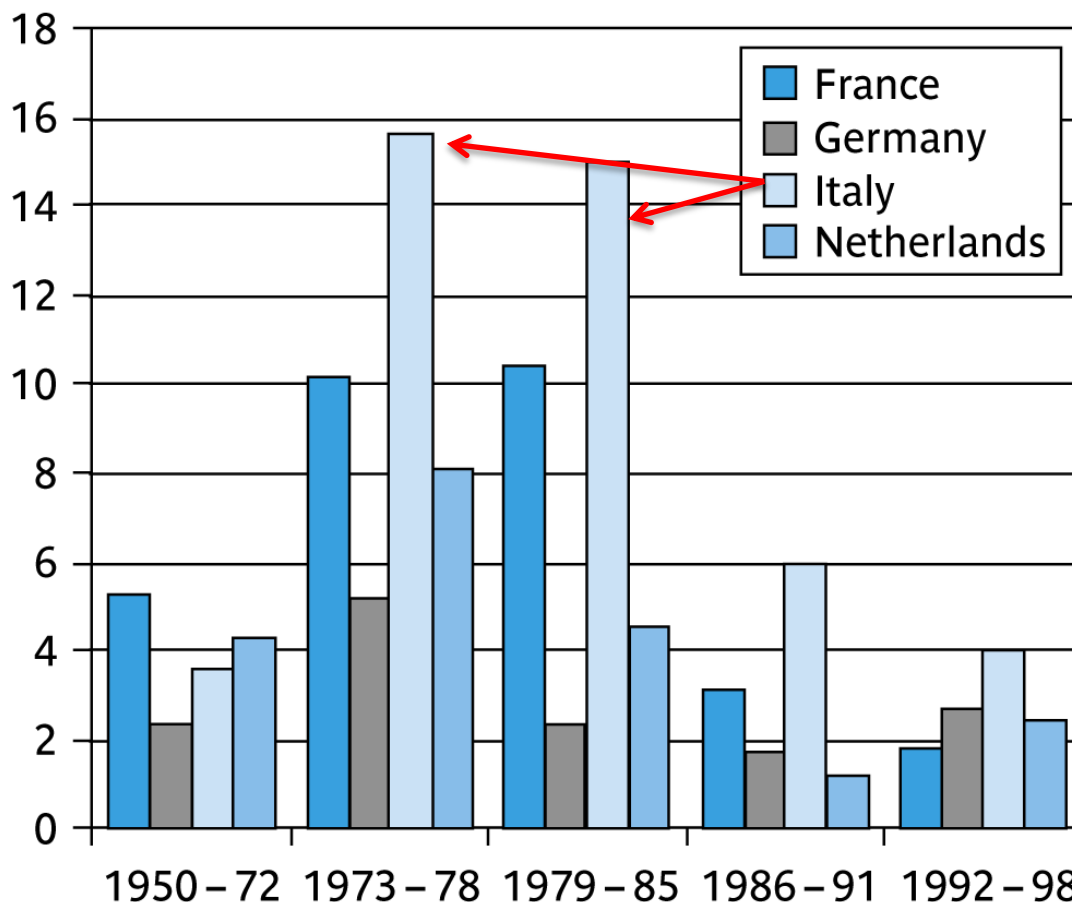
- Fiscal consolidation and structural reforms
- Reducing the costs of doing business (high energy costs, low competition, inefficient public administration, slow civil justice, ...)
- Labour tax wedge reduction
-

But, very tempting...

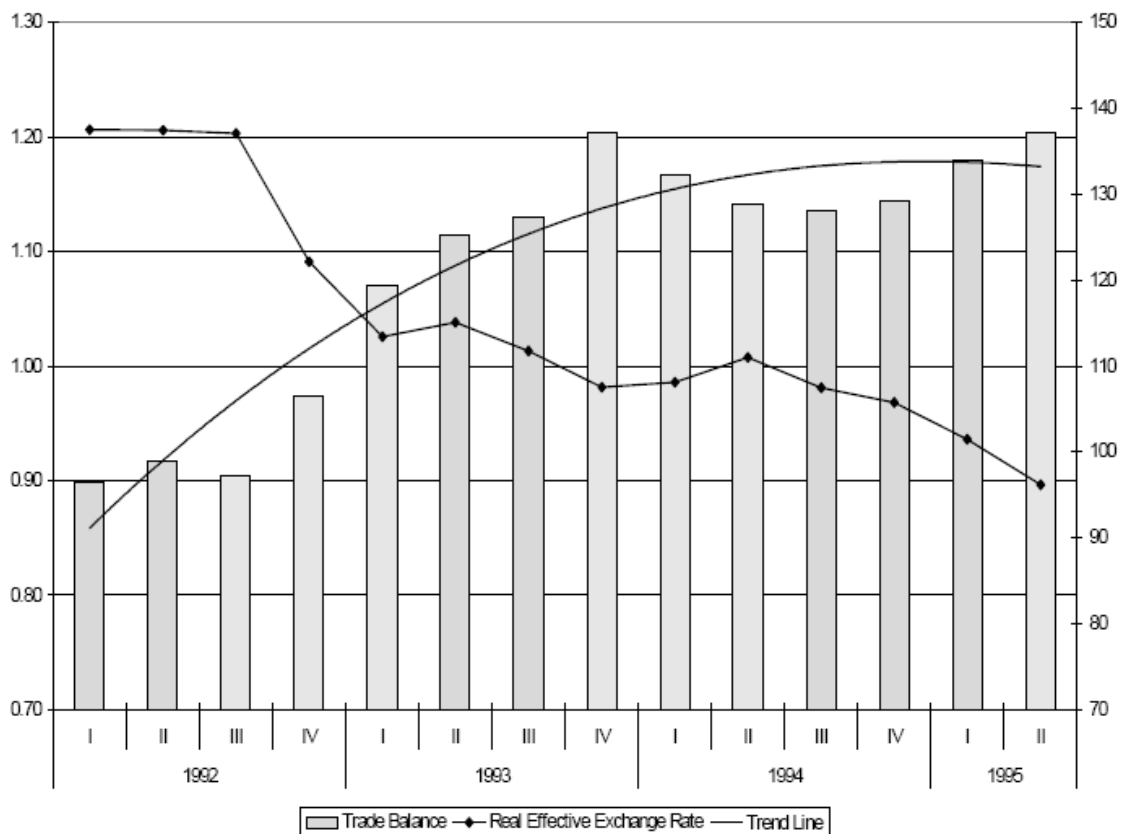
**Exit from the euro = devaluation = export
relaunch and GDP growth?**

Back to the past

In the European Monetary System very frequent realignments during 1979-1987 due to different inflation rates

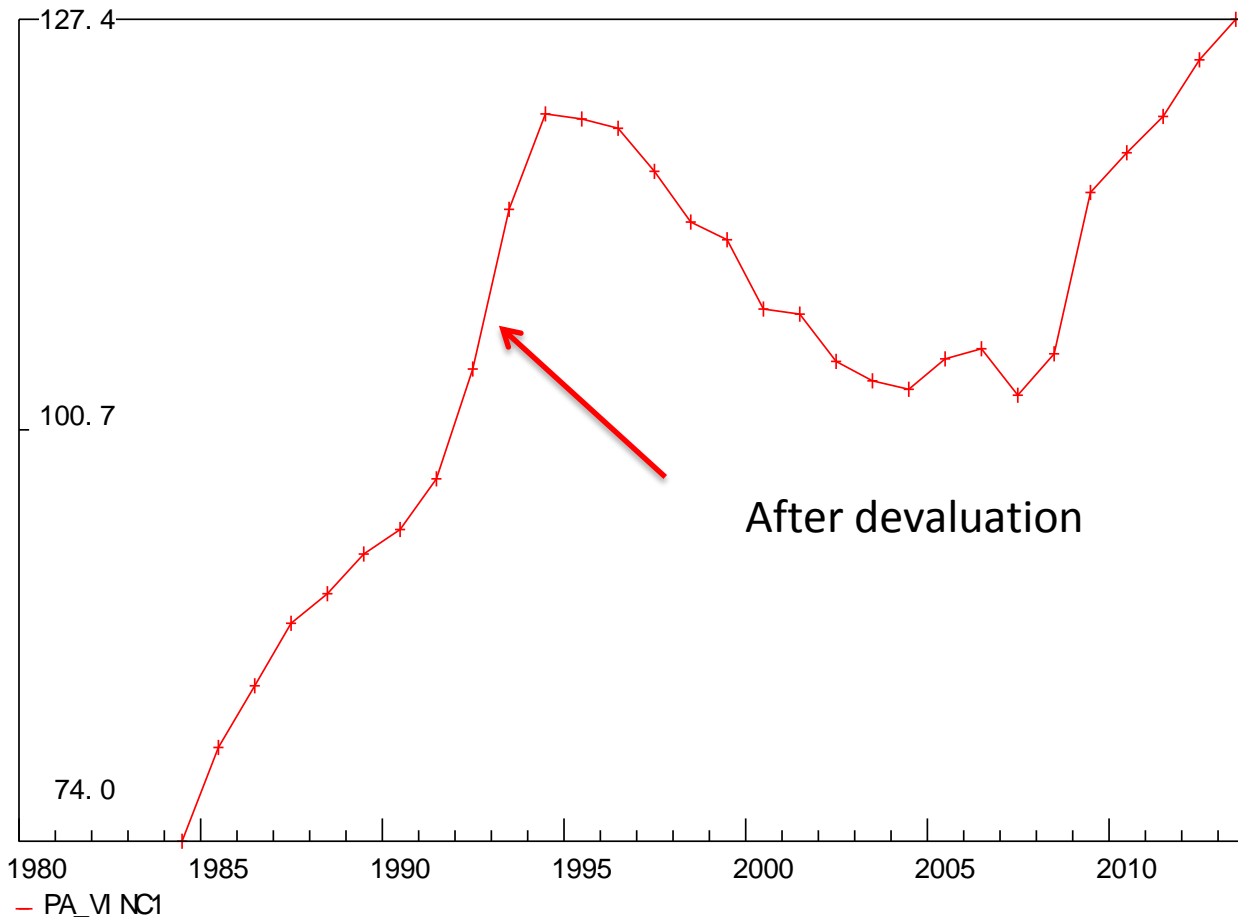


The 1992 devaluation and exit from the ERM: a positive effect on the trade balance ...



... but inflation increased by 5% per year and public debt increased by 20% because of higher interest rates.

Leonardo's yesterday picture



A simple simulation with INTIMO

We decided to implement a first simple simulation with INTIMO to investigate the effects of a 30 per cent currency devaluation (the approximate devaluation during and after the 1992 crisis)

Many caveats

- **The version of the model used is very simple (to be updated): personal consumption expenditure and investments do not react to the price increase**
- **Effects on interest rates are not considered, therefore effects on public debt and deficits are not investigated**
- **Others**

The purpose of this exercise is just to estimate first-round effects on the most important macrovariables and take this as a starting point for further improvements.



Simulation scenarios

- Baseline scenario: the model runs up to 2030 with the assumption of constant rate of growth for exports, import prices and household consumption. Compensation of employees in the public sector is assumed to stagnate as it is in fact, given to a government policy up to 2015.
- Noeuro scenario: an increase in export competitiveness of about 30% is applied with sectoral differences given by the BTM price elasticities on 120 commodities. Import prices are assumed to increase by the same amount.

Results (1)

Line 1: BASELINE SCENARIO - AUGUST 2013								
Line 2: NO EURO SCENARIO - AUGUST 2013 - difference from base								
Alternatives are shown in deviations from base values (growth rates).								
DEFLATORS								
	2013	2014	2015	2016	2017	2018	2019	2020
Household consumption deflator	2.8	2.6	2.6	2.6	2.7	2.9	3.0	3.1
	0.0	6.3	3.7	1.8	0.7	0.5	0.4	0.3
Output deflator	1.2	0.9	0.9	0.9	1.0	1.1	1.3	1.4
	0.0	4.7	3.7	2.3	0.7	0.5	0.3	0.2
Import deflator	2.1	2.3	2.7	2.8	2.8	3.5	3.6	3.4
	0.0	26.2	0.1	0.1	0.0	0.1	0.1	0.0

Results (2)

Line 1: BASELINE SCENARIO - AUGUST 2013								
Line 2: NO EURO SCENARIO - AUGUST 2013 - difference from base								
Alternatives are shown in deviations from base values (growth rates).								
INTERNATIONAL TRADE								
	2013	2014	2015	2016	2017	2018	2019	2020
Imports	2.5	2.0	2.1	2.0	2.1	2.2	2.2	2.2
	0.0	2.1	3.1	2.1	0.0	0.3	0.3	0.3
Exports	4.0	4.0	4.0	4.0	4.0	4.0	4.0	4.0
	0.0	22.3	18.2	0.0	0.0	0.0	0.0	0.0

Results (3)

Line 1: BASELINE SCENARIO - AUGUST 2013								
Line 2: NO EURO SCENARIO - AUGUST 2013 - difference from base								
Alternatives are shown in deviations from base values (growth rates).								
	2013	2014	2015	2016	2017	2018	2019	2020
Output	1.9	2.1	2.0	2.1	2.0	2.1	2.1	2.1
	0.0	7.1	6.6	-0.4	0.3	0.2	0.2	0.2
Gross Domestic Product	1.8	1.9	1.9	1.9	1.9	1.9	2.0	2.0
	0.0	6.0	5.6	-0.3	0.3	0.2	0.2	0.2
Total labour income	3.5	3.1	3.1	3.1	3.1	3.2	3.4	3.6
	0.0	1.9	10.3	6.1	0.7	0.7	0.5	0.4
Employment (total)	0.5	0.5	0.6	0.6	0.6	0.6	0.7	0.7
	0.0	1.4	4.7	3.1	-0.1	0.1	0.1	0.1
Labour income (private sector)	2.8	2.3	2.4	2.3	2.4	2.5	2.7	2.8
	0.0	2.4	12.4	7.6	0.7	0.9	0.6	0.5
Labour income (public sector)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0

Results (4): some possible negative feedbacks (not accounted for in the present version of the model)

Some of the highest growth rates of sectoral imports concern either final consumption goods or delocalized production of Italian firms (leather, textiles) or energy and machinery. Are there possible negative effects on consumption and investments?

IMPORTS GROWTH RATES RANKING (2013-2020)		
13	Leather and leather products	9.0
31	Secondary raw materials	7.4
3	Fish and other fishing products	6.7
30	Furniture; other manufactured goods n.e.c.	5.8
11	Textiles	5.7
19	Rubber and plastic products	5.6
12	Wearing apparel; furs	5.3
28	Motor vehicles, trailers and semi-trailers	4.1
5	Crude petroleum and natural gas	4.1
10	Tobacco products	4.1
4	Coal and lignite; peat	4.1
26	Radio, TV and communication equipment	4.1
9	Food products and beverages	3.3
15	Pulp, paper and paper products	3.1
18	Chemicals and man-made fibres	2.9
1	Agriculture, hunting and related services	2.8
21	Basic metals	2.0
23	Machinery and equipment n.e.c.	1.8
22	Fabricated metal products	1.4
27	Medical, precision and optical instruments	0.5

Some preliminary conclusions and further issues

- The first-round short-run effects of an “exit from euro” are apparently positive: higher GDP growth rate, positive trade balance, increased employment and labour income. Is it a free lunch?
- As imports become more expensive and no import substitution can take place for energy inputs and raw materials, investments can be negatively affected, especially in a situation of credit crunch.
- An increase in labour compensation may have positive effects on household consumption but we should also consider the increase in interest rates and prices in a policy framework of no turnover in the public sector and restricted credit.

