What drives the German current account? And how does it affect the other EU member states?

Discussion

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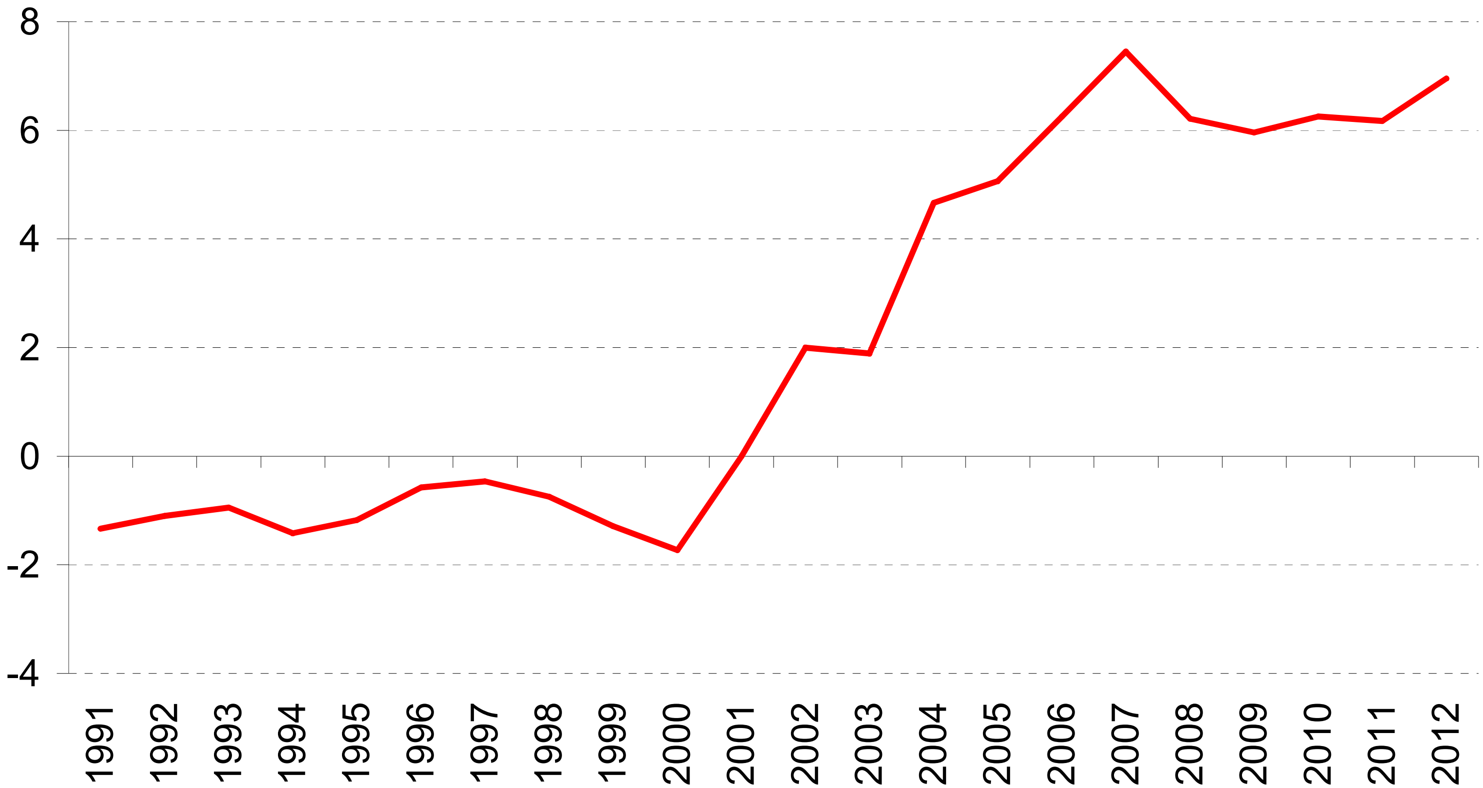
What this paper is about

German current account balance (% of GDP)



Overview of the paper

- Evaluates various hypotheses about the causes of the high German CA surplus
- Using an estimated 3-country DSGE model with a rich structure
- Examines the impact of the CA surplus on the rest of the Euro Area

Main results

- Based on historical shock decomposition, the most important explanations of the surplus are:
  - Financial integration with rest of the Euro Area
  - Labour market reforms and wage restraint
  - Strong RoW demand for German products

- Other, less relevant factors:
  - Households’ rising propensity to save
  - Tighter financing conditions for households and firms
  - Fiscal policy
  - EUR/USD appreciation (works to reduce CA surplus)

- These shocks had a positive overall effect on the rest of the Euro Area

Comments on the methodology

- Results of the historical decomposition are driven by modelling choices
  - The decomposition cannot be used to test the hypotheses
- However, modelling choices can be evaluated formally (e.g. likelihood ratio test, indirect inference)
  - Use the decomposition of the most plausible model
  - Check how robust the decomposition is to model specification

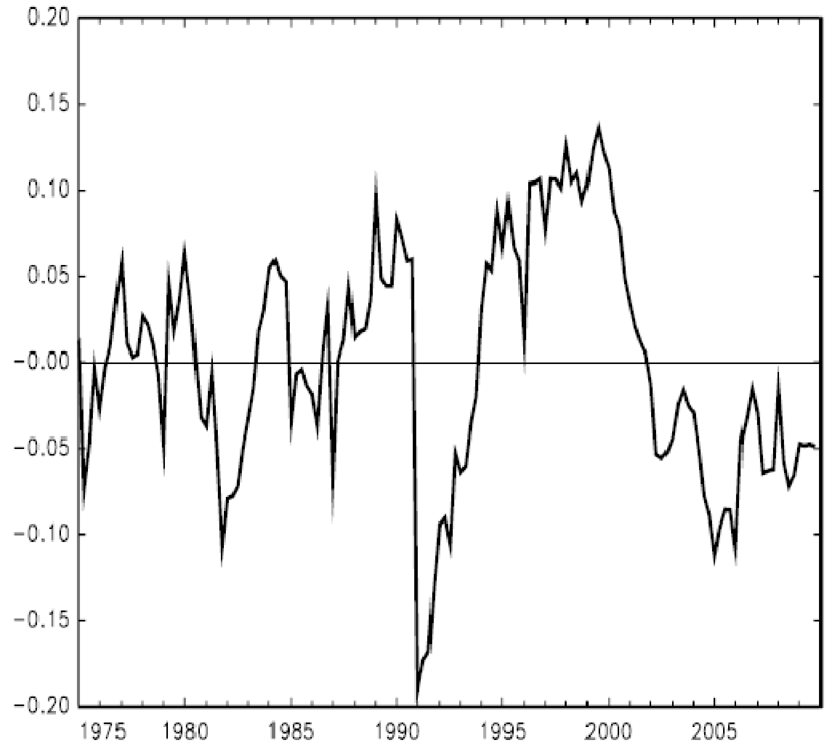
Adjustment of household savings or investments?

- Change of HH S and I between 1991-2000 and 2002-2012 :
  - ΔS = -0.06% of GDP
  - ΔI = -2.20% of GDP

- Housing bust after the boom of the 1990s

- This is in fact modelled, but not discussed in the paper

Deviation of residential investment from its long-run trend*



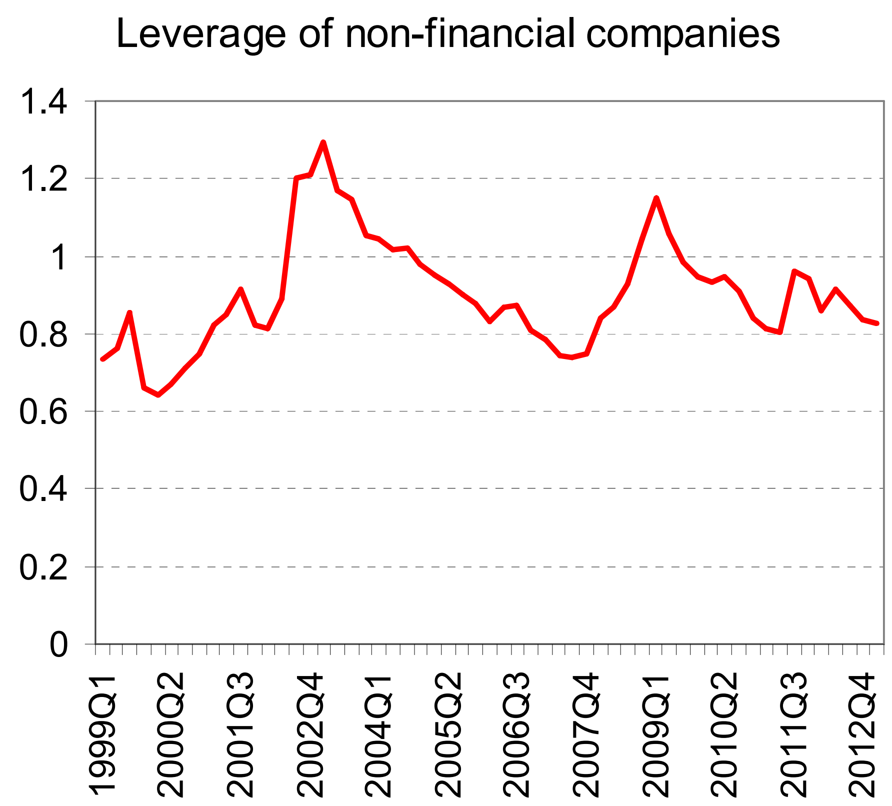
** Trend is driven by population, income and real house prices. Source: Knetsch (2010)*

Corporate balance sheet adjustment

- Firms aggressively reduced leverage after 2002:
  - Burst of the stock market bubble
  - Corporate tax changes favouring internal funding
  - Lower growth expectations
  - Tighter financing conditions

  (see Ruscher-Wolff, 2012)

- Could be made explicit by modelling the corporate balance sheet (e.g. financial accelerator)



The role of FDI

- German firms invest less at home, but they keep investing abroad: average FDI outflow ~2.2% of GDP between 1990-2012

- Might actually reduce the CA surplus!
  - Rising import content of German exports: 19% to 27% between 1995-2009
  - Contributes negatively to trade balance (-2.6% of GDP)
  - Partly offset in the income balance (1.5% improvement due to FDI)

- Might be rewarding to model production location choice

To summarize

- Very relevant topic
- Rich model structure can encompass various hypotheses
- Model selection could be formalized
- Additional hypotheses appear relevant as well