COLLEGE OF EUROPE
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# COMPETITIVENESS AND THE CURRENT ACCOUNT
## An Analysis of German Spillovers

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# Abstract

The objective of this thesis is to investigate the relationship between the current account and competitiveness in two ways. Firstly, we see how the current account of a country reacts to changes in competitiveness within that country. Secondly, we wish to see how changes in German competitiveness transmit to other Euro Area countries.

To analyse the first question, this thesis employs the use of bivariate standard and structural vector autoregressions (SVARs). We assume that the real exchange rate is more exogenous than the current account. We find that real exchange rate changes do not influence the current account for countries such as Germany, the Netherlands and Spain. Real exchange rate appreciations are weakly associated with fallings current accounts for Portugal, Greece, Finland, and Ireland.

Our structural vector autoregressions use the identification whereby a monetary shock should not have any permanent effect on the real exchange rate, thus allowing us to distinguish between competitiveness shocks and monetary shock (Lee and Chinn, 2006). We find that competitiveness shocks only affect the current account for Portugal, Greece and Spain, but not for other Euro Area countries such as Germany, Austria and the Netherlands.

To evaluate the impact of changes to German competitiveness on the current accounts of other Euro Area countries, we use a bilateral SVAR. To identify this model, we adapt the Lee and Chinn (2006) identification strategy and combine it with a block-exogeneity assumption whereby competitiveness and monetary shocks to other European countries cannot affect German variables in the long-run. We detect a negative spillover effect for Ireland in the case of German monetary shocks, and for Finland in the case of German productivity shocks. However, positive spillovers to productivity shocks are found for Spain, Italy and the Netherlands, and positive spillovers to temporary shocks are found for Italy.