Box 8

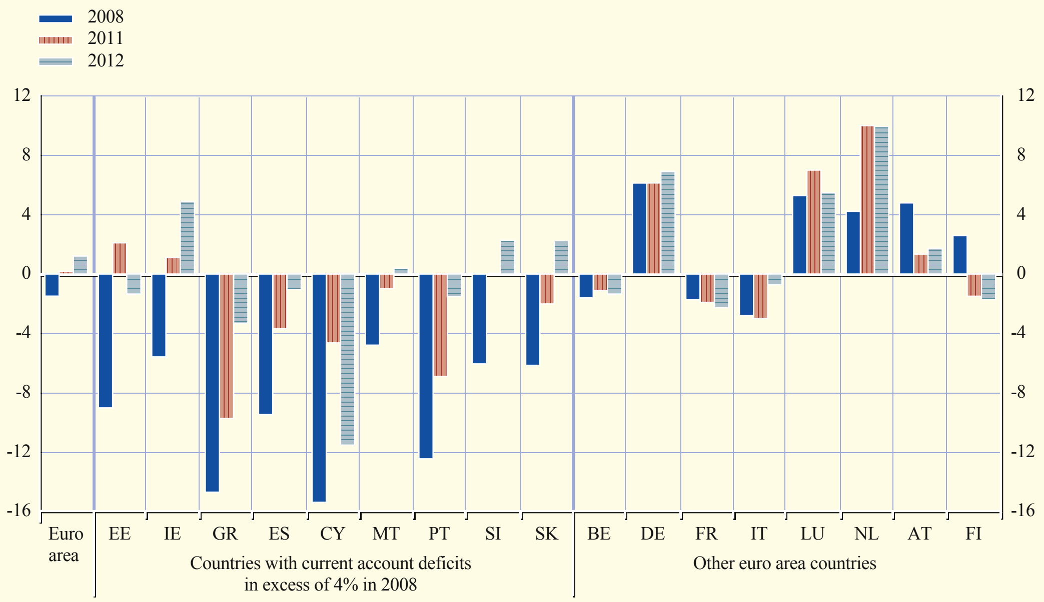
PROGRESS IN THE CURRENT ACCOUNT ADJUSTMENT IN THE EURO AREA IN 2012

This box discusses the current account developments in the euro area in 2012.[1] In the euro area as a whole, the gradual improvement in the current account balance continued in 2012, resulting in a moderate surplus of 1.2% of GDP (see Chart A). This development partly reflected the ongoing external adjustment in those euro area countries that had recorded pronounced current account deficits prior to the financial crisis.

1 For a comprehensive assessment of the ongoing adjustment process in the euro area, see the article entitled "Country adjustment in the euro area: Where do we stand?", *Monthly Bulletin*, ECB, Frankfurt am Main, May 2013.

Chart A Current account balance

(as a percentage of GDP)



Sources: Eurostat and ECB.

In fact, most of the countries with pronounced pre-crisis current account deficits saw further current account improvements in 2012. The largest correction was recorded in Greece, where the deficit narrowed to 3.4% of GDP. At 6.5 percentage points, the correction registered in Greece between 2011 and 2012 was larger than that seen over the entire period between 2008 and 2011. Meanwhile, the current account deficits in Spain and Portugal narrowed to 1.1% and 1.5% respectively in 2012, from the sizeable levels seen in 2008. Ireland, Malta, Slovenia and Slovakia, which had also registered pronounced pre-crisis current account deficits, recorded surpluses in 2012. Most notably, the current account surplus in Ireland (as a percentage of GDP) was the fourth largest in the euro area, following a rapid adjustment facilitated by flexible labour and product markets. Estonia, which had also witnessed a frontloaded current account correction in the aftermath of the financial crisis, moved from a surplus back to a small deficit in 2012. Among the countries with pronounced pre-crisis current account deficits, Cyprus stood out, with the current account deficit widening to 11.7% in 2012, largely due to a deterioration in the income account. This deterioration, in turn, partly reflected exposure to the Greek economy, including the so-called Private Sector Involvement (PSI) that took place in 2012. However, despite the improvements in the current account deficits, between 2008 and 2012, in most euro area countries with pronounced pre-crisis current account deficits, net foreign liabilities generally remained at elevated levels.[2]

Turning to the other euro area countries, the deterioration in external positions continued in France and Finland in 2012. The current account deficits in these countries, although still of moderate size, are now among the largest in the euro area. At the same time, relatively small changes were observed in countries with pronounced pre-crisis current account surpluses. The surplus in Germany increased from 6.2% in 2011 to 7.0% in 2012, while the surplus in the Netherlands remained virtually unchanged at 10.1%. In Luxembourg, the current account surplus narrowed somewhat.

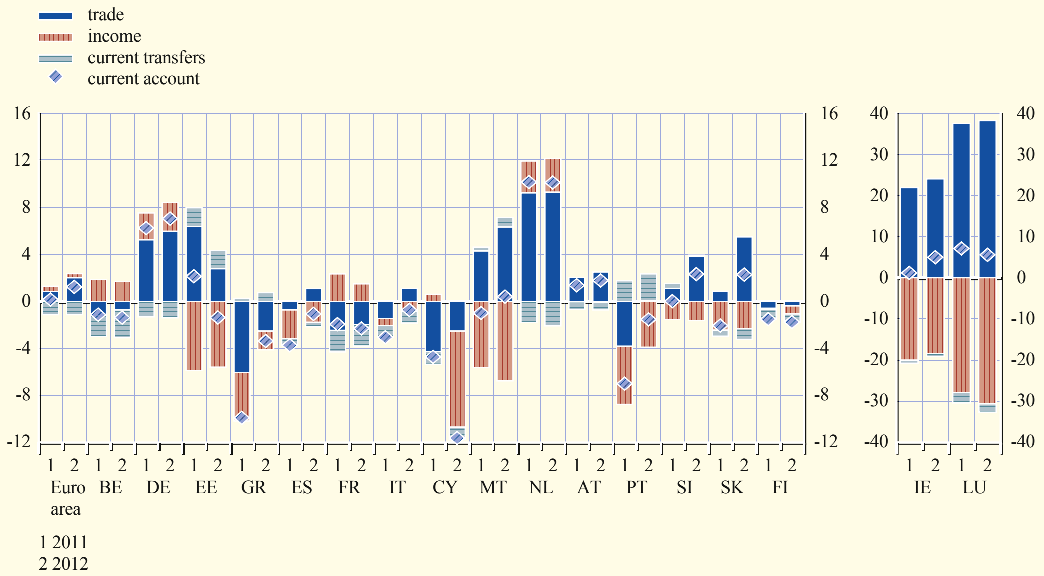
The current account improvements seen in 2012 in countries with pronounced pre-crisis deficits were mainly driven by the trade balance (see Chart B). In most of these countries, trade with the rest of the world is now close to balance or in surplus. In the IMF/EU programme countries, improvements in the income balance on the back of lower interest payments on foreign liabilities also contributed significantly to the current account correction in 2012. The largest improvement in the income balance was seen in Greece – partly due to the PSI.

Taking a closer look at the developments in the trade balance, import compression continued to be an important driver of the current account adjustment in countries with pronounced pre-crisis deficits, particularly in Greece and Portugal (see Chart C). However, solid export growth also contributed to the current account correction in several countries with pronounced pre-crisis deficits, particularly in Slovakia and Ireland. Compared with 2011, overall trade dynamics were, nonetheless, rather subdued in all euro area countries against the backdrop of weak demand at home and abroad. According to national accounts data, euro area exports and imports of goods and services grew, in nominal terms, by 4.5% and 1.6% in 2012 respectively, compared to an expansion of around 10% in 2011.

2 See the box entitled "Net foreign liabilities in selected euro area countries", *Monthly Bulletin*, ECB, Frankfurt am Main, April 2013.

Chart B Main components of the current account balance

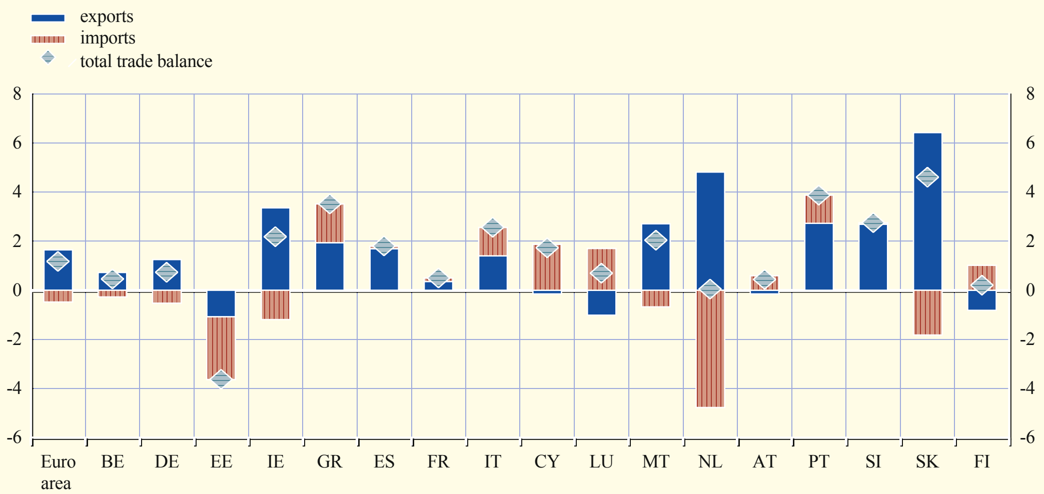
(as a percentage of GDP)



Sources: Eurostat and ECB.

Chart C Contribution of exports, imports and trade balance to the change in the current account balance in 2012 compared with 2011

(in percentage points of GDP)



Sources: Eurostat and ECB.

In summary, external adjustment in countries with pronounced pre-crisis deficits progressed further in 2012. More recent data suggest that the current account correction continued in the first quarter of 2013. Notwithstanding this, considerable adjustment requirements remain in these countries, given the need to reduce net external liabilities to more sustainable levels.