

Dealing with Structural External Imbalances

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This talk will cover the issue of persistent external imbalances which are a feature of a range of lower and middle income economies (LMIEs) in Europe, both within the European Union as well as of countries strongly integrated with the EU. The lecture will show the differentiation amongst the LMIEs in this respect, analyse pre- and post-crisis patterns in current account developments, and discuss the problematic nature of a singular focus on the real exchange rate as the principal adjustment mechanism in the face of external imbalances. In this discussion, we shall point to a number of factors which entrench 'structural' external imbalances in LMIEs: financial markets integration and capital flows which build up distortions in sectoral developments and lead to cumulative processes of real exchange rate over-valuations; strong agglomeration tendencies of tradables in Europe's economy; the cumulative nature of upgrading or falling behind in non-price factors of international competitiveness; the specific role of significant remittance flows, etc. Policy conclusions follow from the above analysis of the causes of persistent external imbalances of LMIEs.

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