Where do current accounts stand in the euro area?

Usefulness of the article: In the sequels of the 2008-2009 crisis, the euro area countries with the highest current account deficits and the worst international investment positions (e.g. Spain, Portugal and Greece) faced the highest increase in their public funding costs (sovereign returns), owing to the concerns of foreign investors in a context of growing public deficits. This publication aims at taking stock of euro area current accounts as well as the risks weighing on the sustainability of net international investment positions.

Summary:

- Compared to their pre 2008-2009 crisis levels, the current account deficits in Euro area countries have dramatically decreased: while in 2007, the sum of the country current account deficits amounted to 2.2 % of the Euro area GDP, it only reaches 0.5% of this GDP over the period ranging from July 2021 to June 2022;
- Yet Euro area countries are confronted with two shocks that are negatively impacting their current accounts: the gradual way out of the covid-19 pandemic and its effects on trade and tourism as well as the rise in oil and gas prices stemming from the war in Ukraine. Even though all Euro area countries are exposed to these two shocks, the extent of this exposure varies by country; the length and intensity of the shocks will probably play an important role in the assessment of the vulnerability of current accounts;
- Cyprus is notably in a concerning situation, the country facing a structurally high current account deficit (5.6% of the GDP in 2019) ; in Greece, the current account deficit is significant as well, but is to a greater extent accounted for by the two ongoing shocks ; in Malta, Slovakia and Latvia, the current account might be far away from equilibrium for some time, depending on the shocks, but should converge towards the equilibrium if the situation comes back to normal.

Current account imbalances[1] can constitute a major driver of economic crises notably, but not exclusively, in developing countries. This is why they are closely monitored by the International monetary fund (IMF). For instance, accumulating large current account deficits leads to a quick deterioration of the net international investment position (NIIP) – *i.e.* the difference between assets and liabilities toward non-residents. When the NIIP seems to deteriorate too fast to be sustainable, foreign investors can doubt the ability of the recipient country to refund them and therefore withdraw part of their financing offer.

Southern euro area countries facing large current account deficits in 2008 worried foreign investors who reduced their financing offer in 2010-2012, thereby contributing to the increase in the sovereign funding costs of these countries. This publication deals with euro area countries, whose current account disequilibrium cannot be dealt with via a change in the exchange rate, that of the euro being determined at the level of the whole euro area.

While a significant rebalancing of current accounts occurred after the euro area crisis (2010-2012), the sanitary crisis and the war in Ukraine negatively contribute to the euro area current accounts. The sanitary crisis acts through three channels : i) the slowdown of international trade (linked to bottlenecks in the countries taking the most restrictive steps, such as China), ii) the reduction in transport flows and iii) the decrease in tourism. Southern euro area countries, who register the largest net exports of tourism services, are those who were hit the hardest by the sanitary crisis[2]. The war in Ukraine has, at this stage, mainly impacted current accounts through the channel of commodity prices (oil and gas notably).

Where do current account balances stand in the euro area?

1) In northern euro area, current accounts remain robust

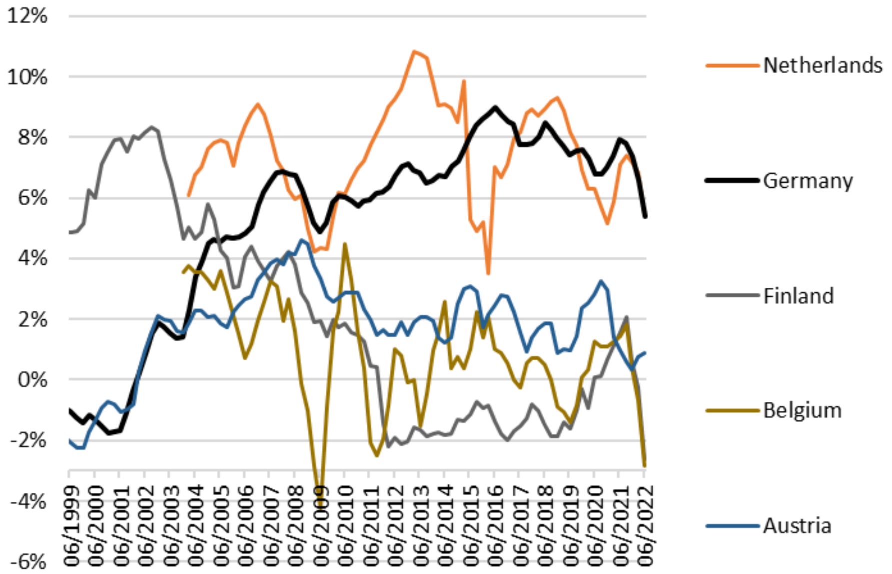
In **northern** Euro area countries, the current account should remain solid, only two of them registering current account deficits owing to the rise in oil and gas prices.

Germany and the Netherlands still run current account surpluses larger than 5% of their GDP notably due to their balance of goods. Over the period ranging from July 2021 to June 2022, the current account of Austria is close to equilibrium while that of Belgium and Finland is slightly in deficit. Luxembourg and Ireland have large current account surpluses which are subject to major variations in the short run, due to their balance of services or their balance of income: given their high amount of assets and liabilities with respect to the rest of the world, a small change in the return on their international assets or liabilities can have a significant impact on their balance of income.

[1] As a reminder, the current account encompasses all current flows (goods, services, income) between resident and non-resident agents. The inward payments (for instance those stemming from export receipts) are registered with a positive sign.

[2] For instance, Malta's travel balance is currently 3.7 GDP points lower than in 2019.

Graph : current account (% of the GDP) in five northern Euro area countries



Source : Eurostat

Despite their sound current accounts, northern euro area countries were hit, to various extents, by the war in Ukraine. Between 2021 and the period ranging from mid-2021 to mid-2022, the balance of goods deteriorated by 1.4 GDP point in Germany and by 3.2 GDP points in Belgium, mainly because of the increase in the value of their hydrocarbon imports. The price of gas and oil remaining high, it should contribute even more negatively to their balance of goods over the whole year 2022. Nevertheless, this effect should remain essentially provisional.

2) Thanks to the reduction in current account deficits, only two Southern Europe countries are in a concerning situation

A group of **southern Euro area countries** had current accounts close to the equilibrium in

2019, but since experienced a deterioration due to the impact of covid-19 on tourism and transport and the rise in oil and gas prices since the end of 2021.

The extent to which Italy, Spain and Portugal improved their balance of goods since 2007 is noteworthy. Conversely, the French balance of goods deficit kept on slowly growing. In Spain, Italy and France, the long-term equilibrium of the current account should not be jeopardized by the rise in oil and gas prices, this shock being mostly temporary. In France, the current account (-0.5 GDP point) remains backed by a surplus in the balance of services and the balance of income which almost offset the balance of goods deficit (-4 GDP points). The extent of the current account deficit in Portugal in 2022 shall depend on how long the rise in oil and gas prices will last and the potential recovery in non-resident tourism receipts.

In Malta, Greece and Cyprus the balance of goods and current account are still deep in negative territory, despite a significant improvement since 2007 in the last two countries.

Current account and international investment position (GDP %)							
	Current account		Balance of goods		Balance of services		Net IIP end of
	Jul21-Jun22	in 2007	Jul21-Jun22	2007	Jul21-Jun22	2019	June 2022
Italy	**0,9%**	-1,4%	0,8%	0,1%	-0,5%	0,0%	5,7%
Spain	**0,8%**	-9,4%	-3,5%	-8,7%	4,8%	5,1%	-64,9%
France	**-0,5%**	-0,1%	-4,0%	-1,7%	2,1%	1,1%	-26,7%
Portugal	**-2,1%**	-9,6%	-9,7%	-11,4%	6,9%	8,4%	-90,6%
Greece	**-8,2%**	-15,2%	-17,3%	-18,4%	**8,5%**	**11,5%**	**-155,7%**
Malta	**-4,1%**	-3,0%	-16,4%	-15,9%	**21,2%**	**25,8%**	47,0%
Cyprus	**-8,7%**	**-10,3%**	**-20,9%**	**-25,9%**	21,4%	21,0%	**-108,9%**

Source : Eurostat

Greece, Cyprus and Malta register a current account deficit of more than 4% of their GDP, but are structurally in differing situations. In Malta, the deficit is limited to 4.1 GDP points, an amount that almost corresponds to the deterioration (-3.7 GDP points) of the travel balance compared to its pre-covid-19 level. In Greece, the current account deficit amounts to 8.2 GDP points, but is mostly accounted for by the deterioration of the travel balance since 2019 (-2 GDP points) and of the balance of goods since 2021 (-2.7 GDP points) owing to the rise in the price of hydrocarbon imports. In Cyprus, the current account deficit (-8.7 GDP points) however appears more structural, being attributable to the deterioration of the travel balance since 2019 for only 1 GDP point and to the deterioration of the balance of goods since 2021 for 2.9 GDP points. We can notice that the travel balance of these countries rebounded in the second quarter (Q2) of 2022 compared to 2021 Q2, which suggests a possible continuation of this recovery in 2022 Q3.

3) The current account deficit reduction is also noteworthy in Eastern Europe, but the war in Ukraine deteriorated the situation in a number of them

Lithuania, Latvia and Estonia very significantly improved their current account since 2007 due to a major reduction in their balance of goods deficit. Slovenia did the same, but to a lesser extent and one third of which owing to its balance of mineral products (including hydrocarbons).

In the last observable period (July 2021-June 2022), Slovenia and Estonia's current accounts are close to equilibrium, while Slovakia and Latvia's are in noticeable deficit (over 4 % of the GDP), that of Lithuania being more moderate (-2.9 GDP points).

In Slovakia, Latvia and Lithuania, the current account deficit should keep on increasing in 2022 due to the increase in the value of their imports of mineral products, which already significantly deteriorated their balance of goods compared to 2021. However, given their growth potential, these countries should be structurally able to maintain their current account at a level that does not deteriorate their net international investment position in GDP terms.

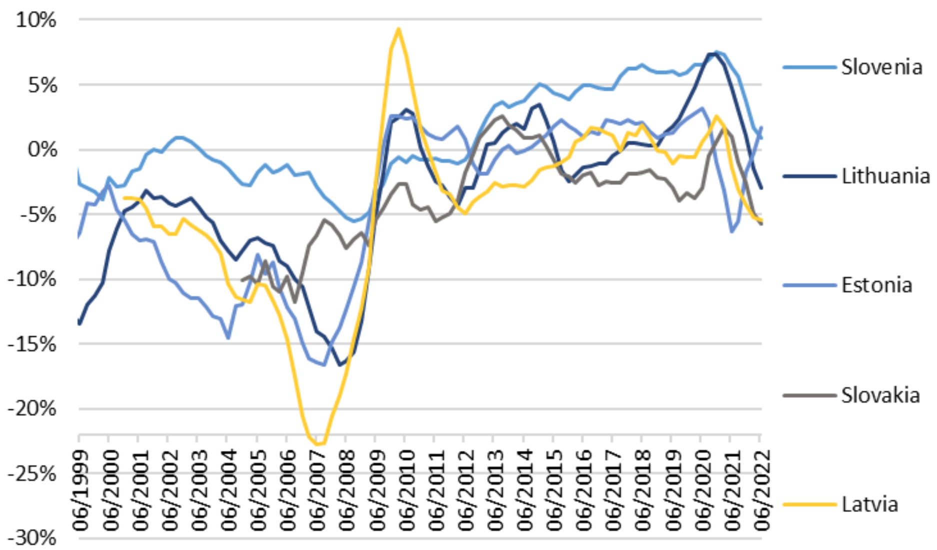
However, in Slovenia, which registers a current account surplus of 0.9 GDP point, the deterioration of 3.9 GDP points of the balance of goods between 2021 and the period ranging from mid-2021 to mid-2022 is attributable not to a rise in hydrocarbon imports but to other goods including vehicles.

Current account and international investment position (GDP %)

	Current account		Balance of goods			Net IIP end
	Jul21-Jun22	in 2007	**Jul21-Jun22**	**2021**	2007	of June
Slovenia	**0,9%**	-4,1%	-2,2%	1,7%	-4,0%	-4,0%
Lithuania	**-2,9%**	-15,3%	-8,3%	-5,2%	-15,4%	-6,2%
Estonia	**1,6%**	-14,9%	-5,4%	-4,1%	-15,6%	-21,0%
Slovakia	**-5,8%**	-5,9%	-3,7%	-0,5%	-1,8%	-66,1%
Latvia	**-5,5%**	-20,6%	-9,8%	-8,2%	-23,3%	-28,3%

Source: Eurostat

Graph: current account (% of GDP)



Source: Eurostat

Conclusion

The extent of the reduction of current account deficits since 2007 is striking in both Southern Europe and Eastern Europe. Nevertheless, the covid-19 pandemic and the war in Ukraine made current account deficits reappear in ten Euro area countries, among which three in Eastern Europe and five in Southern Europe. The situation is concerning in Greece and especially in Cyprus, where the current account deficit is little related to the two recent shocks.

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