Adjustment and labour markets in EMU

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The early EMU debate

- Nominal convergence: needed for a stable currency

- Stabilisation to asymmetric shocks: OCA debate

  - **Likelihood of asymmetric shocks**
    - Synchronisation, co-movement (real convergence and integration)

  - **Adjustment to asymmetric shocks**
    - Fiscal transfers
    - Adjustment on the "quantity side" (migration, financial risk sharing)
    - Price adjustment: "automatic adjustment mechanism". Competitiveness channel versus real interest rate channel ("Walters' critique")
Competitiveness channel: working as expected before the crisis in response to EMU start up shock...

...and associated with current growing account divergences...
Note: countries grouped according to their external position.
EA center: BE DE LU NL AT FI EA; EA periphery: EE IE EL ES FR IT CY LV LT MT PT SI SK.
Unemployment response to GDP and uncertainty shocks: euro area 1996Q1-2011Q4 (Arpaia and Turrini, 2013)
Three waves of convergence? (Buti and Turrini, 2015)

Nominal and real convergence pre-crisis, followed by divergence
Structural convergence post-crisis

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Restored convergence in unemployment rates since 2014
Asymmetric rebalancing
Two notions of adjustment: tensions?
  - Asymmetric shocks (internal adjustment)
  - External adjustment

External adjustment in an evolving rebalancing context
  - Flows vs. stocks
  - Structural change
  - Low-inflation environment

Internal adjustment
  - Supra-national fiscal stabilisation capacity

Preventing and dealing with current account crises
  - Completing EMU: Banking union, capital markets union

Stable framework
Current account: cyclically-adjusted balances and balances required to stabilise or reduce external liabilities