

Macroeconomic Performance in a Globalising Economy

The process of globalisation has been ongoing for centuries, but few would doubt that it has accelerated and intensified in recent decades. This acceleration is evidenced as much by the strong synchronicity in the rapid transmission of financial crises starting in late 2007, as it is by the decade of almost unprecedented growth in international trade and financial market liberalisation that preceded it. This book shows how the international economy has become more connected via increased production, trade, capital flows and financial linkages. Using a variety of methodologies, including both panel econometrics and DSGE modelling, a team of experts from academia, central banks, the OECD and the IMF examine how this increased globalisation has affected competitiveness, productivity, inflation and the labour market.

This timely contribution to the globalisation literature provides a longer-term perspective while also evaluating some of the potential implications for policy makers, particularly from a European perspective.

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xiv Notes on contributors

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Foreword

Globalisation has been one of the most pervasive and important economic trends shaping the world economy over the last two and a half decades or so, leading to greater international economic interdependence across the globe on both the real and financial sides. This has affected a wide range of economic variables as well as providing significant challenges for policy makers. There is no doubt that globalisation has long-run benefits for both advanced and emerging economies through a more efficient resource allocation, along with welfare gains from deepening specialisation, increased competition, lower prices, greater product choice and ultimately higher living standards. Nevertheless, more recently, the increased interconnectedness of economies across the globe has also been associated with global financial turmoil and a highly synchronised global economic downturn.

This book is therefore a timely, as well as highly comprehensive, contribution to the globalisation literature, providing mostly a longer-term perspective while also touching on some of the elements and events associated with the financial crisis that began in mid 2007. The inspiration for this book was the ECB 2007 conference on Globalisation and the Macroeconomy. Hence this volume consists of papers presented at that conference as well as other research papers on this topic. Overall, the book tells us how the international economy has become more connected via increased production, trade, capital flows and financial linkages and how this has possibly affected competitiveness, productivity, inflation and labour markets, while also evaluating some of the potential implications for policy makers. In order to address these issues the papers in the book exploit a variety of methodologies, including both panel econometrics and DSGE modelling. The analysis covers globalisation's impacts in the service sector as well as the more traditional traded goods and manufacturing sectors. It therefore provides a detailed analysis of the major influences of globalisation on the euro

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area and other major economies. Some key questions investigated by the book are:

- (1) How has the emergence of China as a global player in world export markets affected the competitiveness of the euro area?
- (2) How might globalisation be affecting the labour market?
- (3) Has globalisation changed the exchange-rate pass-through to import prices; and to what extent has globalisation influenced world commodity prices and inflation in advanced industrialised countries?
- (4) How might developments in the exchange rate and other asset prices be considered as key variables for policy makers?
- (5) How is monetary policy affected by an increasingly globalised economic environment?

The increased linkages due to globalisation seemed to be a major reason behind the strength of the global upturn of the 2000s, with exceptional growth in Asia – particularly China – helping to boost activity in the rest of the world. In particular, world trade grew strongly, partly because of the rapid growth in ‘vertical specialisation’ which created widespread global production chains. Meanwhile, international capital flows grew enormously, reflecting greater access to finance across the globe. By the same token, it seems that the increased international interconnectedness of financial and product markets contributed to the financial turmoil that began in mid 2007 as well as the mechanisms behind the subsequent highly synchronised downturn in global trade and activity.

In addition to documenting many of the above inter-linkages, a number of the associated policy implications are also addressed. In terms of monetary policy, there has been much debate about the possible increased role of global factors in the determination of inflation, and whether globalisation may have weakened the ability of central banks to control their domestic rate of inflation. Overall, the conclusion seems to be that globalisation has had effects on inflation in the shorter term, largely arising from relative price impacts and increased competition. Accordingly, it is necessary to actively monitor possible ongoing changes in the inflationary process resulting from globalisation. However, the bottom line continues to be that monetary policy ultimately determines the inflation rate over longer horizons. At the same time, the recent financial turmoil has also shown that globalisation has increased the degree of international financial interconnectedness, which has important implications for cross-border propagation of systemic risk, and thereby gives rise to an urgent need for greater

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international cooperation in the supervision and regulation of financial markets. In particular, macro-prudential financial supervision needs to be strengthened considerably to monitor and help prevent the propagation of systemic risk.

Another key policy message of this book relates to the continued need for structural reforms in the economies of the euro area countries. Flexible product and labour markets are increasingly necessary in order to cope with the challenges arising from globalisation and to speed up the adjustment process, thereby enhancing the ability of euro area firms to adjust efficiently to shocks and allow resources to move flexibly towards expanding sectors, as well as helping to improve competitiveness. At the same time, an efficient adjustment in response to the forces of globalisation will also be facilitated by focusing on price stability and continuing to anchor inflation expectations in the face of relative price shocks. Finally, against the background of the recent global downturn, protectionist pressures are rising in certain regions of the world. Given the large welfare loss that a rise in protectionism would cause, this calls for additional vigilance in resisting such pressures worldwide.

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Acknowledgements

This volume takes much of its inspiration from a conference entitled ‘Globalisation and the Macroeconomy’ held at the European Central Bank in Frankfurt in the course of July 2007. The aim of the conference was to bring together researchers from central banks, the academic community and international organisations in a two-day meeting to present papers and discuss globalisation and its impacts on economic activity and inflation. The discussions were aimed at improving our understanding of the pace and changing characteristics of globalisation and at identifying the various channels through which it affects the macroeconomy as well as the associated implications for macroeconomic policy. Many of the insights gleaned from these exchanges are reflected in the various contributions to this volume. We would therefore like to thank the presenters of papers at the conference as well as their discussants and co-authors. We also offer a special thanks to our colleagues on the conference organising committee and other ECB colleagues who provided strong support for the project, in particular Luca Dedola, Filippo di Mauro, Katrin Foster, Paul Hiebert, Hans-Joachim Klöckers, Lucas Papademos, Gabor Pula, Jürgen Stark and Daria Taglioni. The conference also benefited greatly from outstanding administrative support from Joanna Steele and Anja Tonn, while Britta Bertram, Stephanie Brown and Claudia Sullivan-Sepúlveda have been very supportive in helping to put this volume together.