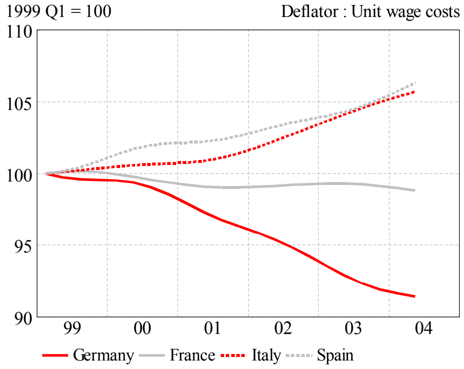
MAJOR CHANGES IN COST COMPETITIVENESS IN THE EUROZONE

- *Recent developments in eurozone countries' foreign trade have favoured Germany, reflecting in particular Germany's increased competitiveness over the last few years due to lower unit wage costs.*
- *Meanwhile, France has seen its cost competitiveness within the eurozone stabilise due to a deterioration in its position in relation to Germany and an improvement as compared to Italy and Spain, two countries where French products are doubtless in less direct competition.*

Eurozone countries exhibit different export profiles despite suffering from a common handicap in recent years, namely the euro's appreciation in nominal terms. Whereas German exports of goods and services have risen substantially since mid-2003 (+7 % yoy in Q3 2004), exports from French (+3.9 %) and Spanish (+3.1 %) have turned in less stunning performances. This can be attributed not only to differences in geographical and sectoral specialisations but also the improvement in Germany's cost competitiveness since 1999. If we assess changes in cost competitiveness among the different eurozone countries using the relative trend in real exchange rates based on unit wage costs, it is noticeable that German competitiveness has improved since the introduction of the euro and even accelerated at the end of the period: the real exchange rate in Q2 2004 was nearly 9 % below its 1999 level, with a depreciation of nearly 8 % compared with the European average. Conversely, Spain and Italy have seen a marked appreciation in their real exchange rate (+6.3 % and +7 % respectively), whereas France's cost competitiveness is virtually unchanged compared with the European average.

REAL EXCHANGE RATE IN THE EUROZONE

1999 Q1 = 100 Deflator : Unit wage costs

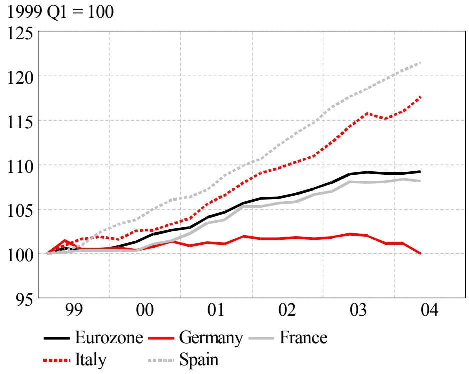


Source : European Commission

In fact, Germany has embarked on a process to control its unit wage costs. While the EMU's unit wage costs have increased by an average 9 % since 1999, they have barely risen in Germany and have even declined since spring 2003.

UNIT WAGE COSTS - WHOLE ECONOMY

1999 Q1 = 100

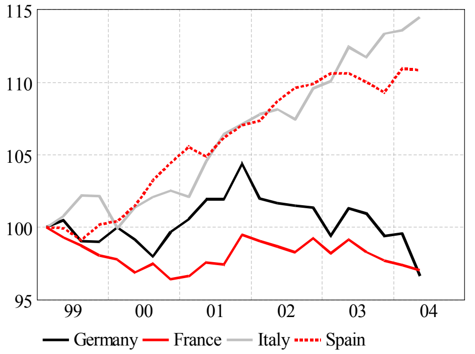


Sources : ECB, Eurostat, SG calculations

Although the growth in France's unit wage costs is marginally lower than the European average and has fallen slightly since the start of 2004, Spanish and Italian unit wage costs have seen an increase well above the European average. The decline in Germany's unit wage costs has been even more marked in industry, particularly since mid-2003. Once again, it is mainly Spain and Italy that have become less competitive in the industrial sector.

UNIT WAGE COSTS FOR INDUSTRY (EXCL. CONSTRUCTION)

1999 Q1 = 100



Sources : ECB, Eurostat, SG calculations

Germany's improved competitiveness compared with the European average has helped correct the particularly unfavourable DM conversion rate when the euro was introduced. This was due essentially to the rapid growth in wage costs following German reunification, which lasted until 1995.

The improved cost competitiveness of German companies compared with their European counterparts, including French companies, can primarily be attributed to very moderate wage increases over the last few years, particularly since the beginning of 2003 (the per capita wage rose 0.2 % yoy in Q2 2004 vs. 2.1 % in the eurozone). There are signs that this trend is increasing as a result of pressure from the relocation of production abroad. In France, wages have risen at a faster pace: with an increase of 2.6 % between spring 2003 and spring 2004, the retail hourly labour cost has risen more rapidly in France than the European average (+2.2 %), whereas it has increased by only 1.3 % in Germany. The wage cost of a French employee is 7.6 % higher than the European average. Although the figure for Germany remains much higher than for France, the gap is narrowing: it is now only around 6 % vs. 11.7 % in 1996.

Hourly labour cost (excl. non-retail services)

FRANCE = 100	***1996***	***2000***	***2001***	***2002***	***2003***	***2004****
Eurozone	91.4	92.1	91.9	92.1	94.1	92.4
Germany	111.7	108.8	107.5	107.3	109.0	106.3
Spain	55.5	58.3	59.3	60.5	60.8	62.0

** Average of the first two quarters - Source: Rexecode calculation, based on the 2000 labour costs survey and the quarterly hourly labour cost indices published by Eurostat*

Employment has also been used to adjust unit wage costs: between 2000 and 2003, France created nearly 530,000 new jobs, whereas Germany destroyed around 440,000. Similarly, French companies were slow to adjust their workforce to the slowdown in 2002-2003 (employment fell 0.2 % in France in 2003 vs. –1 % in Germany). This resulted in a temporary decline in productivity in France compared with substantial productivity gains in Germany.

However, since the start of 2004, France has seen a slight improvement in its cost competitiveness. French companies are currently attempting to restore their financial position and are therefore limiting recruitment and wage increases. This has led to significant productivity gains (per capita productivity was up 2.8 % yoy in Q2 vs. +1.8 % for the eurozone).

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