



Seðlabanki Íslands

A tale of two countries

With or without the euro: Italy and Iceland tackling their financial crises

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Thórarinn G. Pétursson

Chief Economist of the Central Bank of Iceland

Views expressed are my own and do not have to reflect those of the Central Bank of Iceland

Background

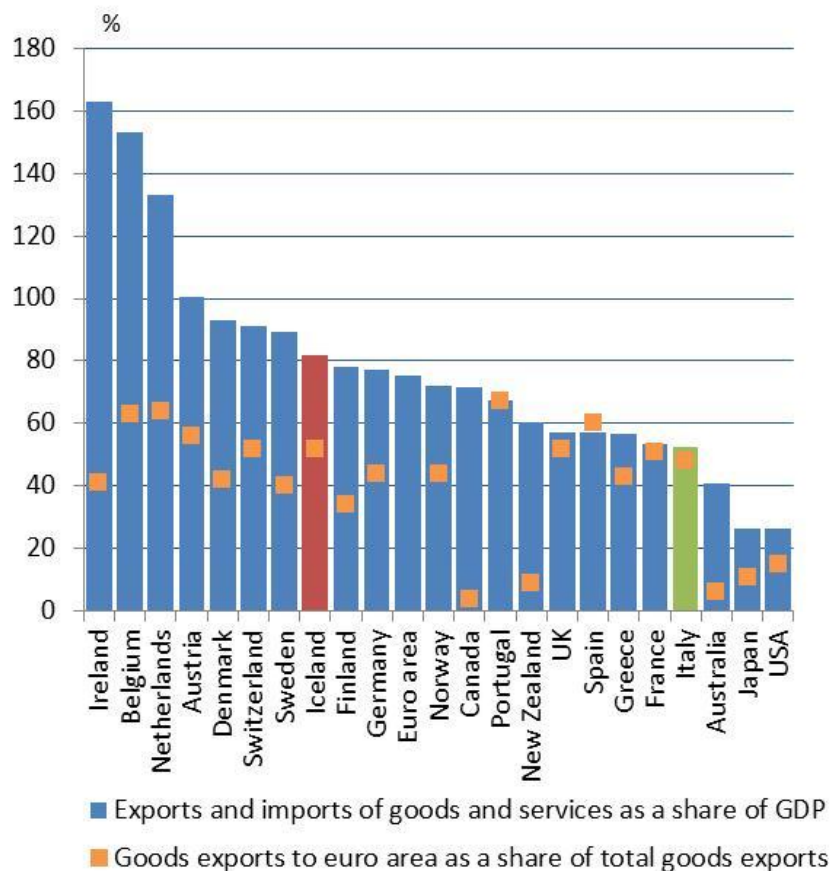
Comparison of economic structure in
Iceland and Italy

Economic structure

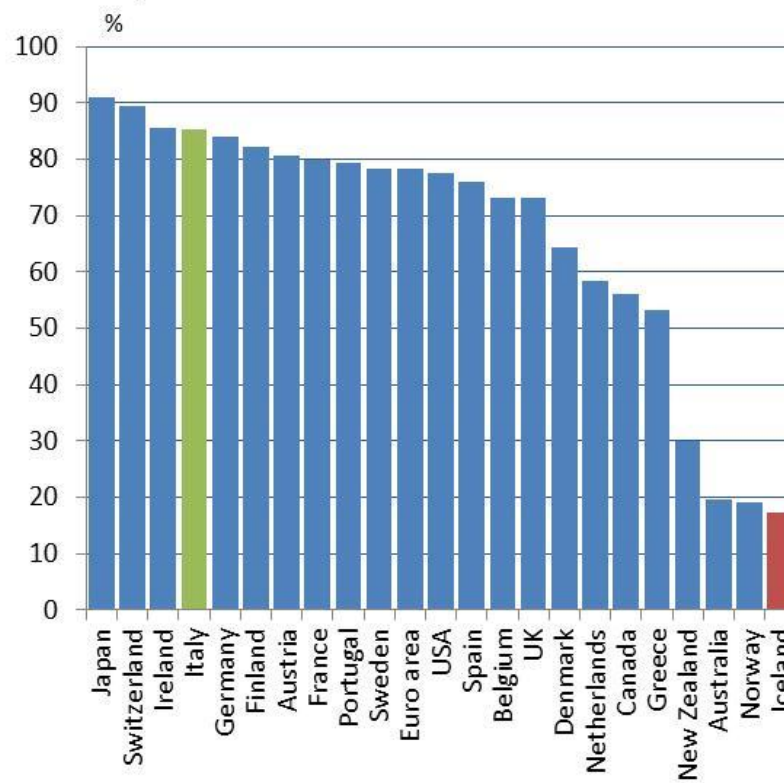
Similar export markets but different composition ...



Trade openness and share of exports to euro area 2000-2010



Share of manufacturing exports in goods exports 2000-2010

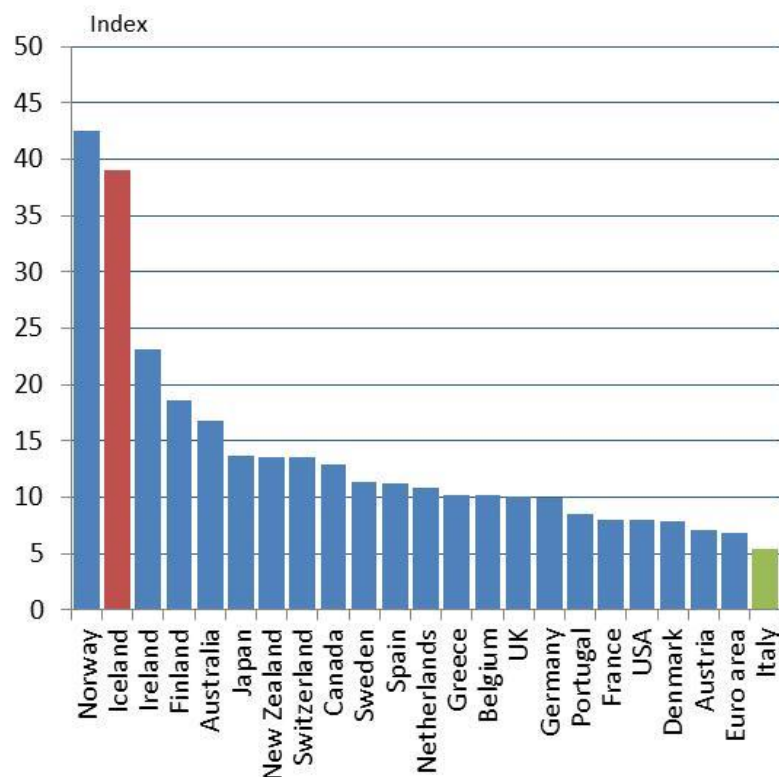


Economic structure

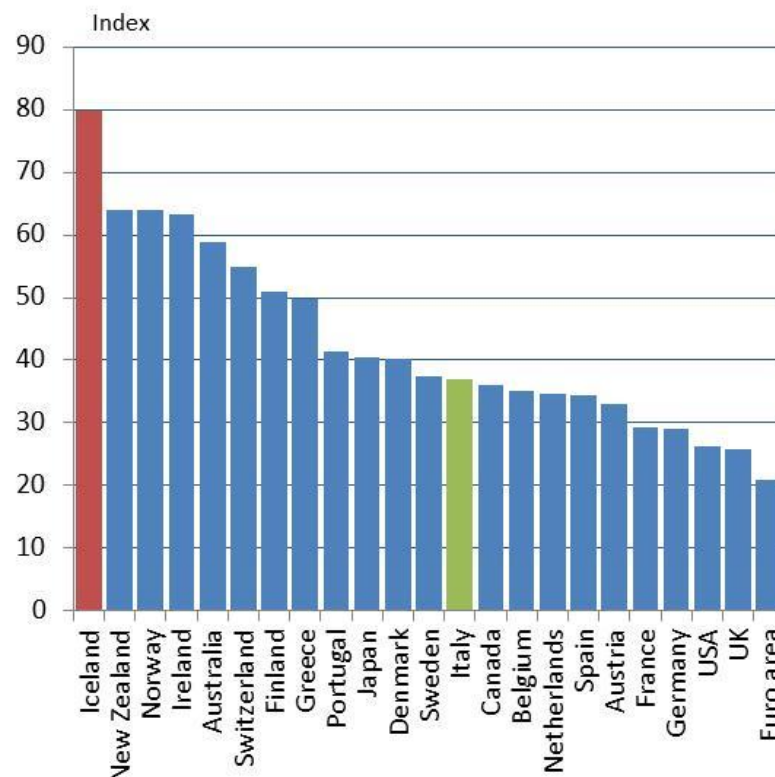
... leads to different export structures ...



Trade concentration 2000-2010¹



Trade diversification 2000-2010¹



1. Herfindahl-Hirschmann index of export concentration. Index between 0 and 100 with higher values indicating greater trade concentration.

Source: United Nations database (UNCTAD).

1. Finger-Kreinen index of export diversification. Index between 0 and 100 with higher values indicating greater difference from export basket of the average country.

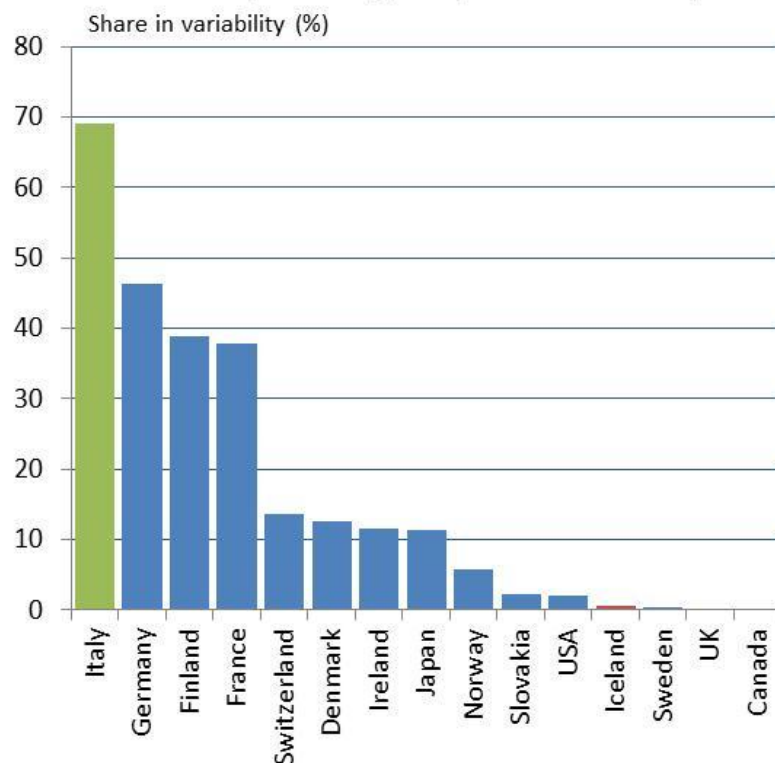
Source: United Nations database (UNCTAD).

Economic structure

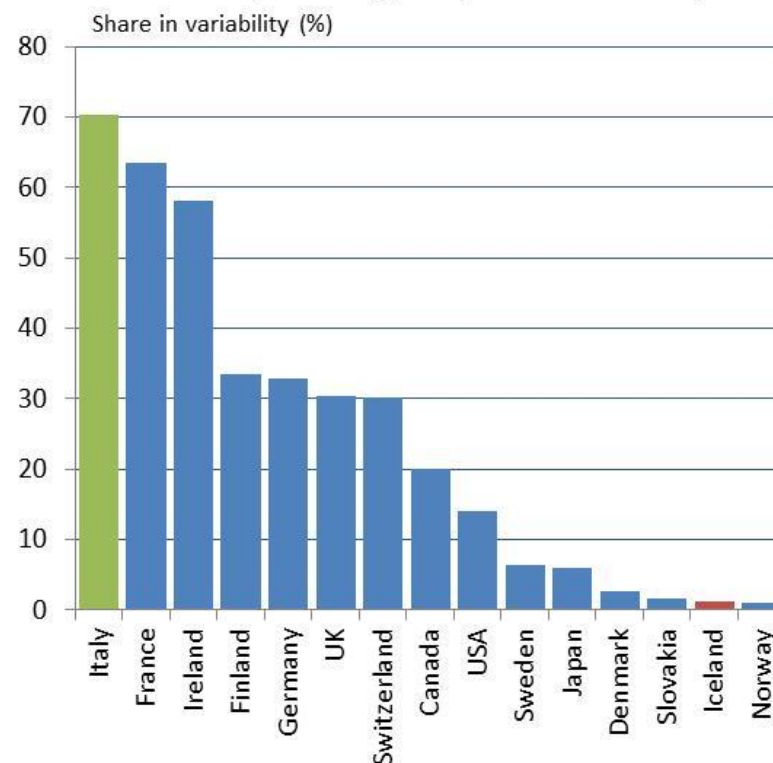
... and less symmetric business cycle with the euro area



Share of common euro area supply shocks explaining output variability¹



Share of common euro area demand shocks explaining output variability¹



1. Common euro area supply shocks from a principle component analysis of supply shocks for individual countries estimated from a structural VAR analysis.

Source: Central Bank of Iceland (2012). Iceland's currency and exchange rate policy options. *Special Reports* no. 7.

1. Common euro area demand shocks from a principle component analysis of demand shocks for individual countries estimated from a structural VAR analysis.

Source: Central Bank of Iceland (2012). Iceland's currency and exchange rate policy options. *Special Reports* no. 7.

The financial crisis

Comparison of pre- and post-crisis developments

Two crises

Two stories ... both Dickensian tragedies



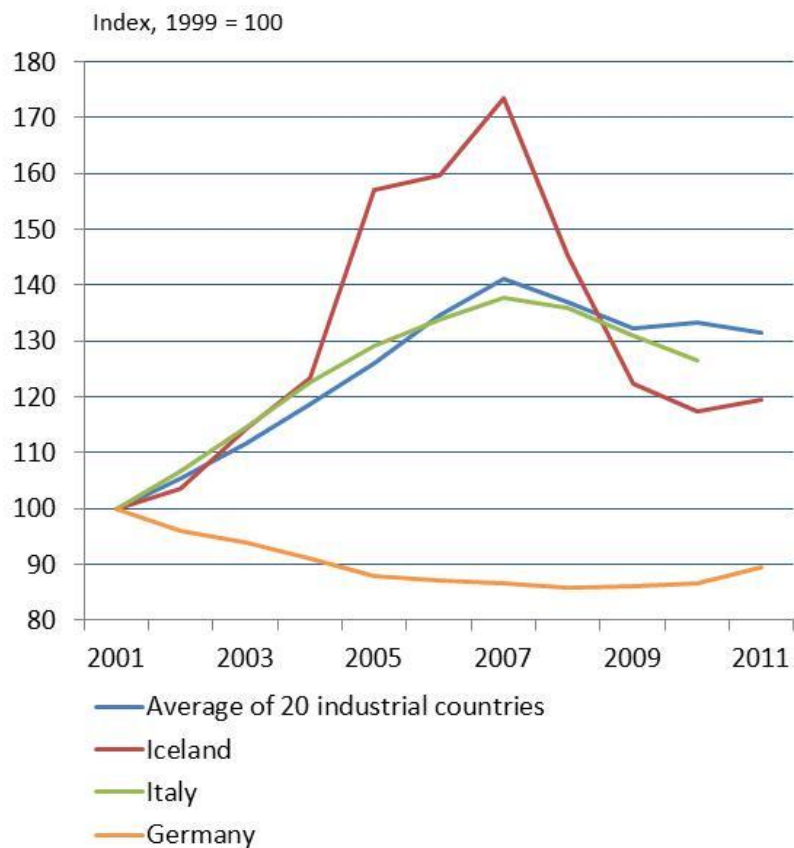
	Financial crisis of 2007-2008				Sovereign debt crisis of 2010-		
	Local crisis		Spillover effects from global crisis			Spillover effects	
	Systemic banking crisis	Currency crisis	Trade channel	Financial channel	Epicentre of crisis	Trade channel	Financial channel
Iceland	Yes	Yes	Limited	Yes	No	Some	Limited
Italy	No	No	Yes	Limited	Yes/No	Yes	Yes

Build-up and unwinding of imbalances

Asset prices and debt levels

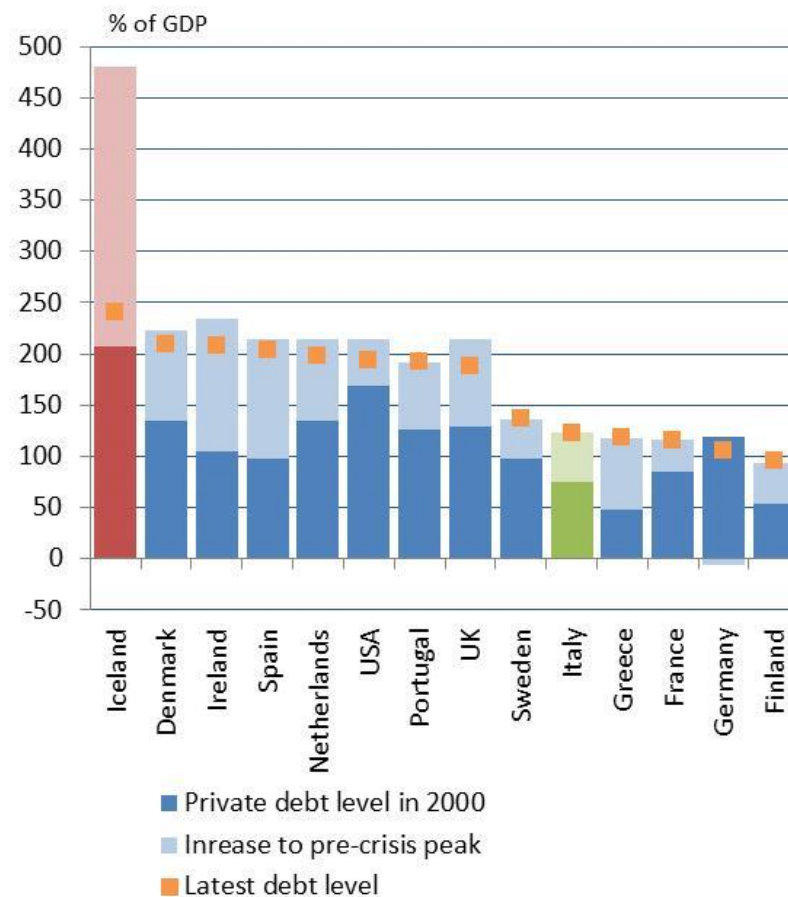


Real house prices 2001-2011



Source: OECD.

Domestic private sector debt



Sources: Macrobond and Central Bank of Iceland.

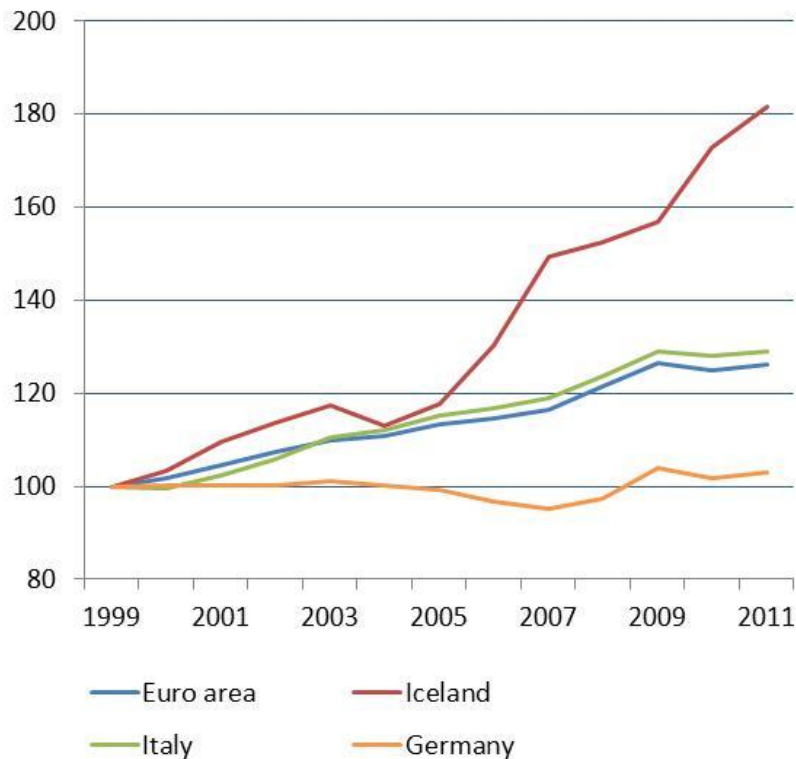
Build-up and unwinding of imbalances

Domestic costs and competitiveness



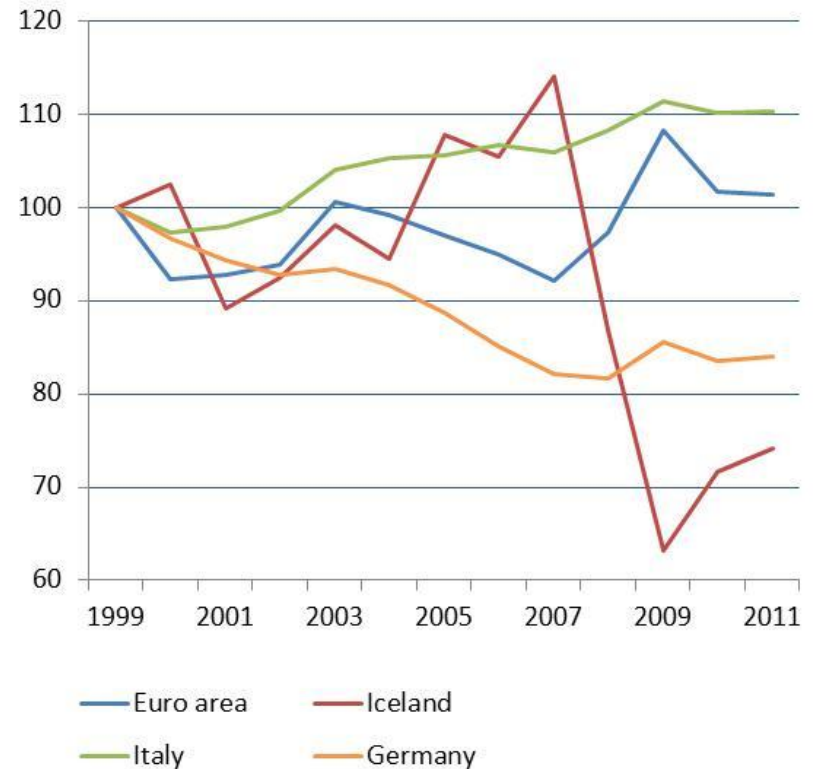
Total economy unit labour costs 1999-2011

Index, 1999 = 100



Real exchange rate (relative unit labour costs) 1999-2011

Index, 1999 = 100

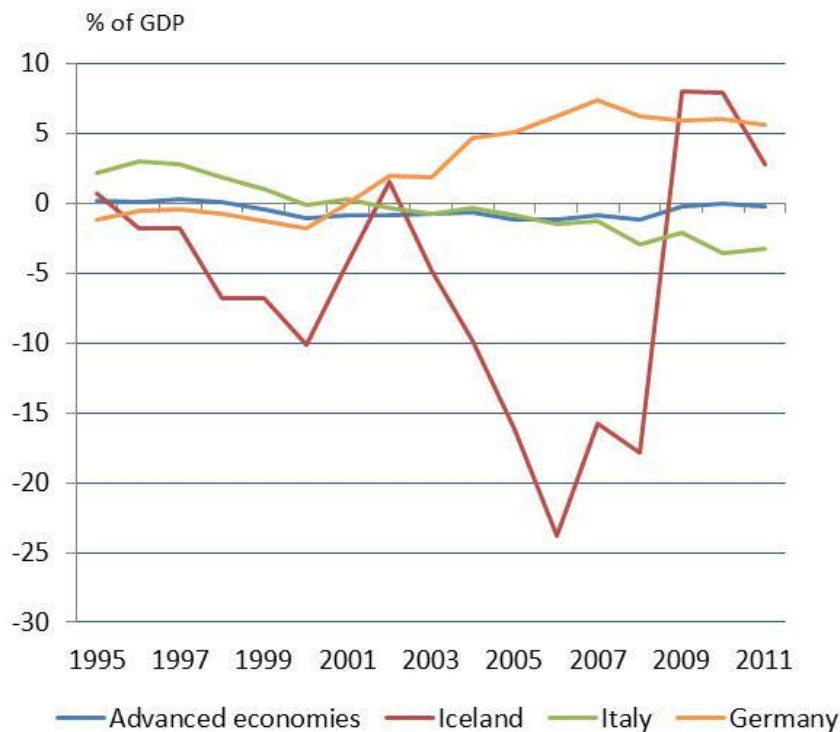


Build-up and unwinding of imbalances

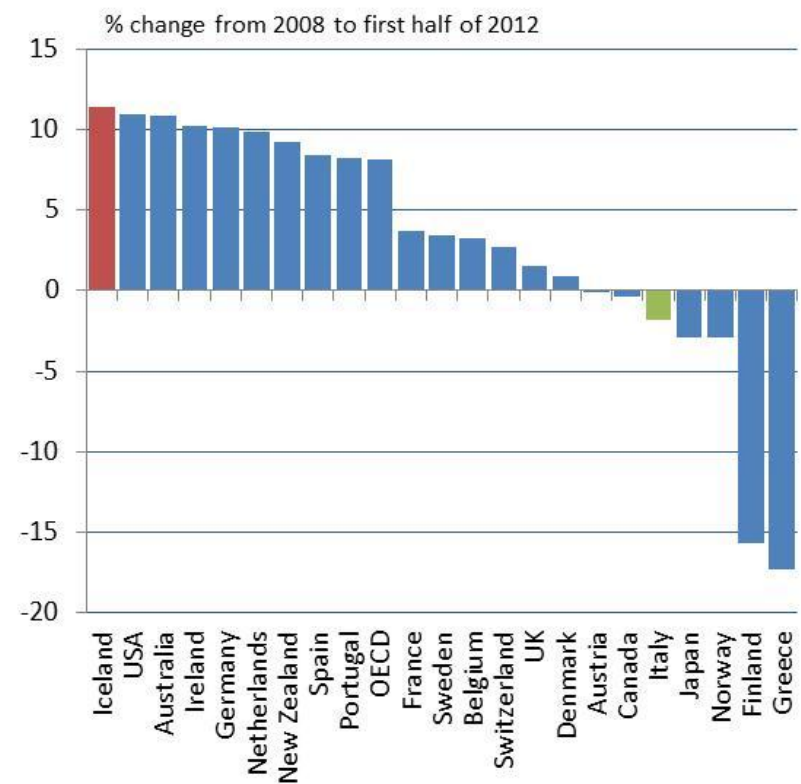
External balances and exports



Current account balance 1995-2011¹



Post-crisis export developments



1. Figures for Iceland exclude deposit money banks in winding-up proceedings (but including flows based on the estimated outcome of the proceedings) and the international pharmaceutical company, Actavis.

Sources: International Monetary Fund and Central Bank of Iceland.

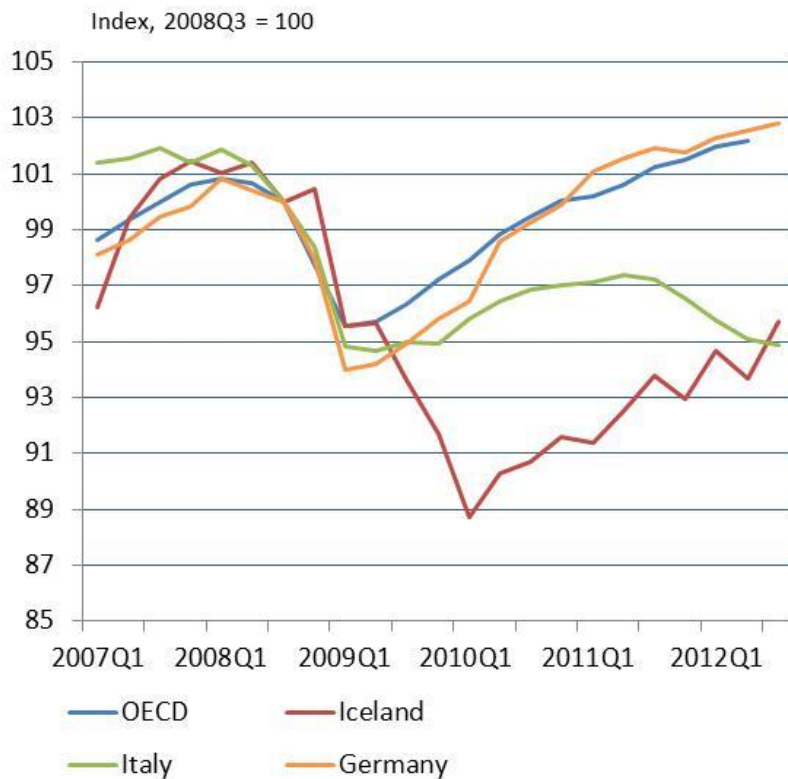
Sources: Eurostat and OECD.

Build-up and unwinding of imbalances

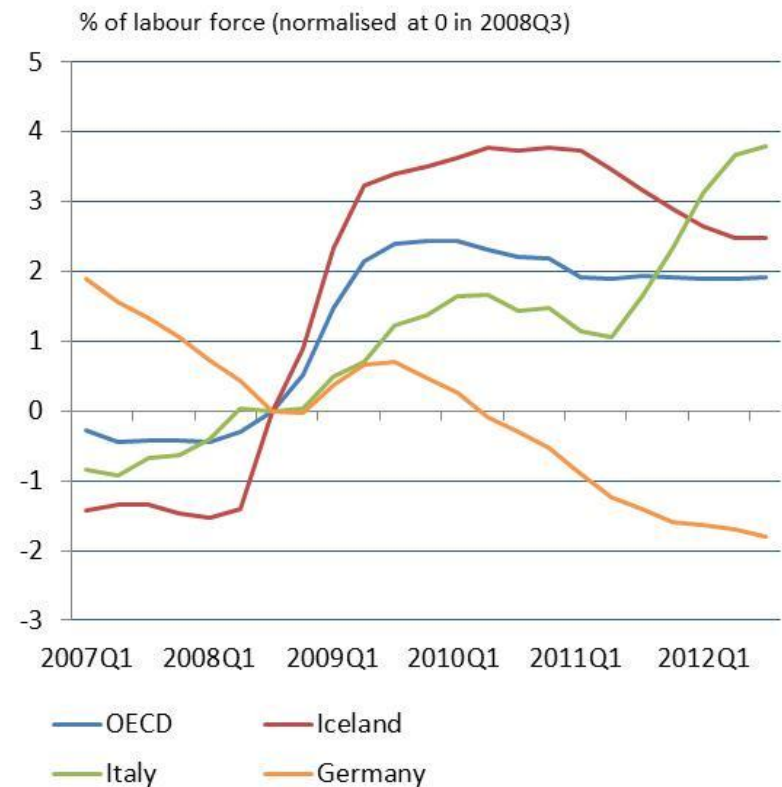
Post-crisis real-economy developments



GDP level in the financial crisis¹



Unemployment rate in the financial crisis¹



1. Seasonally adjusted GDP data for Iceland from the Central Bank of Iceland.

Sources: OECD and Central Bank of Iceland.

1. Seasonally adjusted harmonised unemployment rate.

Source: OECD.

Build-up and unwinding of imbalances

Comparison of insiders and outsiders



		All 46 countries	EMU ins	EMU outs
Output	Peak-to-trough difference	6.8	7.2	6.5
	Peak-to-2011Q4 difference	1.0	4.1	-0.7 [†]
	Duration of contraction (quarters)	5.3	6.3	4.7 [‡]
Consumption	Peak-to-trough difference	6.2	5.5	6.5
	Peak-to-2011Q4 difference	1.1	3.6	-0.2
	Duration of contraction (quarters)	5.7	6.7	5.2 [‡]
Unemployment	Trough-to-peak	4.5	4.8	4.3
	Peak-to-2011Q4 difference	3.2	3.5	3.0
	Duration of increases (quarters)	6.5	7.2	6.2

Comparison of 46 medium and high income countries. * (†) [‡] indicates that the difference between the groups is statistically significant at the 1% (5%) [10%] critical level based on a Satterthwaite-Welch *t*-test. *Source*: Central Bank of Iceland (2012). Iceland's currency and exchange rate policy options. *Special Reports* no. 7.