

The Balassa-Samuelson effect and the channels of its absorption in the Central and Eastern European Countries

Karolina Konopczak*, Aleksander Welfe†

Abstract

The aim of the study is to estimate the magnitude of the Balassa-Samuelson effect as well as the effectiveness of the labour and the product market in its absorption in Poland, the Czech Republic, Hungary and Slovakia. The obtained results allowed to determine the magnitude of the systematic component of inflation differentials relative to the euro area, hence to assess the risk of common monetary policy inadequacy with respect to these economies. The obtained estimates suggest that the catching-up driven inflationary pressure is a non-negligible issue in the context of the CEECs integration with the euro area, since the systematic inflation differentials were comparable in size to those experienced by the so-called peripheral member states in the first decade after the introduction of the euro. Moreover, in the case of Poland none of the potential absorption mechanisms of the Balassa-Samuelson effect seemed to mitigate the convergence-induced inflationary pressure over the sample period. The outcomes suggest that ignoring the non-fulfilment of theoretical model assumptions regarding wages and markups, which is common in the literature, distorts estimation results.

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*Institute for Market, Consumption and Business Cycles Research

†Chair of Econometric Models and Forecasts, University of Lodz