

Abstract

In this paper we document the growing dispersion of external and internal balances between countries in the North and South of the Euro area over the time period 1992 to 2007. We find a persistent divergence process that seems to have started with the introduction of the common currency and has its roots in the savings and investment behavior of private sectors. We dismiss the common argument in the literature that imbalances are the temporary outcome of an overall European economic convergence process and argue that future research should place greater emphasis on country heterogeneity in behavior to fully understand economic developments in the Euro area and to derive policy implications.