

Chapter 2

Disentangling Growth: From Business Cycle Comovement and Higher-Order Linkages in Europe*

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Abstract

Business cycles in Europe are highly synchronized. This comovement is of great macroeconomic interest, as it is typically seen as a necessary condition for the feasibility of a common European monetary and regulatory policy. However, there is still no consensus on the mechanisms behind such a concurrent cyclicity. The more traditional trade literature has focused on bilateral trade linkages between countries, while a more recent strand emphasizes the role of multi-sectoral production networks where idiosyncratic shocks propagate through these networks leading to comovement in the aggregate by higher-order linkages. We jointly employ a structural decomposition analysis with a principal component analysis to contribute to the discussion about first-order and higher-order linkages. Empirical evidence from the World Input-Output Database (WIOD) suggests that macroeconomic volatility in Europe tends to originate in final goods markets and to spread through higher-order rather than bilateral linkages.

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