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Country Size and Business Cycle Correlation in the Euro Area

Recently, the differential of GDP growth in the European Monetary Union (EMU) renewed the interest about the heterogeneity of the member states business cycles. In fact, whether the deepening of economic and monetary integration in the euro area has resulted in an increased synchronization, this is, if the "endogeneity of Optimum Currency Areas (OCA) hypothesis" has been confirmed, still an open question. In addition, due to globalization it has been an intensification of international trade. This phenomenon tends to amplify the spillover effects among the world economies.

We analyze the correlation between aggregate euro area and 28 OECD countries business cycles, using quarterly data from 1980 to 2010. We mainly focus on the first 12 countries that adopted the euro, emphasizing the comparison between smaller and larger countries. Moreover, we also use a control group of 16 OECD's countries. The role of the control group is to assess whether there's evidence of the endogeneity of the OCA properties in the EMU and whether there's evidence of a "world business cycle".

Also, we investigate the role of within-EMU trade as a determinant on business cycle synchronization, accessing if the trade effect is influenced by the country size. The preliminary results suggest that the adoption of the euro has set in motion a process that is capable of inducing greater similarity and synchronicity in the business cycles experienced by member states adhering to the euro.