IN THE NEWS

Investment spending in the Euro-Area has failed to recover

- A major reason that the Euro-Area economic recovery has been lackluster is that businesses are failing to do their part. Investment spending remains well below its pre-crisis peak and has fallen dramatically as a share of growth domestic product (GDP). Gross fixed capital formation is still 15% below its 2008 peak. The U.K. figure by contrast is about 2% below the comparable level, and that for the U.S. is about 1% above it.

- The absence of a rebound represents a stark departure from past cycles and a puzzle for policymakers. Additional stimulus from the European Central Bank in March could at least help at the margin, but a return to healthy levels of investment seems to be a distant prospect.

- Perhaps structural reasons are behind the failure of the investment share to rebound.
  - Businesses don’t seem to think that their productive capacities will have to rise to meet future demand. That could be because they invested too much before the crisis years and are still suffering from overcapacity, which is probably particularly the case in southern Europe, where the inflow of foreign capital fuelled investment spending during the first decade of the monetary union. This recovery has also been unusually fragile.
  - There have already been false dawns, and businesses may lack confidence in future demand or doubt the return on investment will be high enough relative to borrowing costs to be worthwhile. Surveys of business confidence provide some support for the latter explanation — they remain below their pre-crisis peaks.

- So how can the ECB encourage investment spending? It’s likely to face an uphill battle because the monetary authorities can’t do much about overcapacity apart from stoking demand. As that capacity gets put back to use, and productivity and incomes rise, it would reassure firms that the outlook is improving. Still, that’s easier said than done.
  - A further cut to the deposit rate may, at the margin, encourage consumers and businesses to borrow and spend more, though it’s unlikely on its own to make a meaningful difference to the outlook, especially since financial conditions appear to have tightened in recent months.
A further expansion of asset purchases might be needed to lift confidence more broadly and help offset possible risks from abroad. For now, at least, resistance among some Governing Council members means that is far from a done deal. It could be a while yet before investment pulls its weight in the Euro-Area recovery.