THE UNITED STATES AND EUROPE: SHORT-TERM DIVERGENCE BUT SHARED CHALLENGES

Discussion of Jason Furman’s Talk by Natacha Valla
EIB and Paris School of Economics

Bruegel Lunchtime Event – 33 rue de la Charité, Brussels - 11 May 2016
EU challenges – short term

• Recovery, but very moderate
• Heterogeneity across EU countries
• Banking sector restructuring
• Limited room for fiscal stimulus
• Concerns over monetary policy effectiveness
• Political risks – Brexit, Greece, Netherlands, Austria, France...Migrations
EU challenges – long term

• Competitiveness
  – productivity slowdown
  – demography

• Completing the EU (EA) – make or break?
  – single market
  – Banking Union
  – CMU
  – Euro area “+”
Bird’s eye view on US/EU challenges

Real GDP growth, annual %

Source: IMF WEO 2016
Potential output: a ST or LT challenge?

Evolution of potential output growth over time
(EU28 vs. US)

Decomposition of potential output growth
Contribution of capital, labour and TFP (EU28 vs. US)

Next: looking at potential with more granularity...
(all usual caveats apply)
Potential in the United States: mostly a capital stock / investment issue (labour helps)

Potential growth - dynamics
percentage change, yr/yr

Potential growth - composition
percentage change, yr/yr

Source: own estimates, EC, OECD, IMF.

Source: own estimates.
...While the euro area cumulates handicaps (investment, labour, TFP)...

**Potential growth - dynamics**
percentage change, yr/yr

**Potential growth - composition**
percentage change, yr/yr

Source: own estimates, EC.

Source: own estimates.
...yet, individual countries tell different stories: France (pretty much US like, but at a tiny scale)

Potential growth - dynamics
percentage change, yr/yr

Source: own estimates, EC, OECD, IMF.

Potential growth - composition
percentage change, yr/yr

Source: own estimates.
...yet, individual countries tell different stories: Germany (where is labour?)

Potential growth - dynamics
percentage change, yr/yr

Potential growth - composition
percentage change, yr/yr

Source: own estimates, EC, OECD, IMF.
Source: own estimates.
...yet, individual countries tell different stories:
Italy (pending impact on enacted reforms?)

Source: own estimates, EC, OECD, IMF.
Monetary policy challenges Fed/ECB: is timing the sole difference?

ECB policy rates (in percent)

ECB’s QE: Monthly purchases

Now including investment grade corporate bonds
Amount estimates: € 5-10 billion

33% overall envelope increase from € 60 billion to € 80 billion

11% increase of EU institutions envelope from € 7.2 billion to € 8.0 billion*

Source: ECB.

* Limit per EU issuer increased from 33% to 50% of outstanding.
Fiscal balances: will the “exorbitant privilege” do the trick for the US?

General government balance (% of GDP)

Source: OECD.
Investment: an EU-specific challenge?

Total fixed assets (% GDP)

→ about 2pp below pre-crisis average

Source: Eurostat.
## Annual investment needs

<table>
<thead>
<tr>
<th>Investment need/objective</th>
<th>Annual investment (EUR billions)</th>
<th>Required</th>
<th>Current</th>
<th>Gap</th>
</tr>
</thead>
<tbody>
<tr>
<td>Education</td>
<td>960</td>
<td>860</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>Energy</td>
<td>230</td>
<td>130</td>
<td>100</td>
<td></td>
</tr>
<tr>
<td>ICT</td>
<td>160</td>
<td>95</td>
<td>65</td>
<td></td>
</tr>
<tr>
<td>Industry</td>
<td>320</td>
<td>230</td>
<td>90</td>
<td></td>
</tr>
<tr>
<td>R&amp;D</td>
<td>170</td>
<td>85</td>
<td>130</td>
<td></td>
</tr>
<tr>
<td>Transport and Logistics</td>
<td>160</td>
<td>80</td>
<td>80</td>
<td></td>
</tr>
<tr>
<td>Water and Waste</td>
<td>138</td>
<td>48</td>
<td>90</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>2,138</strong></td>
<td><strong>1,528</strong></td>
<td>EUR <strong>655bn</strong></td>
<td></td>
</tr>
</tbody>
</table>

Source: EIB (2016) Restoring EU Competitiveness

Note: For details on calculations, please see report Restoring EU Competitiveness
...suggests that investment is needed in both “traditional” and “innovative” sectors

<table>
<thead>
<tr>
<th>Investment need/objective</th>
<th>Required</th>
<th>Current</th>
<th>Gap</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Education</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Capital expenditure on education infrastructure, including IT equipment</td>
<td>960</td>
<td>860</td>
<td>100</td>
</tr>
<tr>
<td>Operating expenditure (mostly teaching staff)</td>
<td>880</td>
<td>790</td>
<td>90</td>
</tr>
<tr>
<td><strong>Energy</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Energy efficiency savings in buildings and industry</td>
<td>230</td>
<td>130</td>
<td>100</td>
</tr>
<tr>
<td>Power generation, including renewables</td>
<td>112</td>
<td>42</td>
<td>70</td>
</tr>
<tr>
<td>Upgrading energy networks (gas and electricity)</td>
<td>53</td>
<td>41</td>
<td>12</td>
</tr>
<tr>
<td>Matching US data centre capacity</td>
<td>65</td>
<td>47</td>
<td>18</td>
</tr>
<tr>
<td><strong>ICT</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Matching US investments in cyber-security</td>
<td>160</td>
<td>95</td>
<td>65</td>
</tr>
<tr>
<td>Reaching global benchmark for broadband services</td>
<td>75</td>
<td>45</td>
<td>30</td>
</tr>
<tr>
<td><strong>Industry</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adoption of latest generation technology in advanced manufacturing sector</td>
<td>320</td>
<td>230</td>
<td>90</td>
</tr>
<tr>
<td><strong>R&amp;D</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Life sciences/pharmaceuticals</td>
<td>170</td>
<td>85</td>
<td>130</td>
</tr>
<tr>
<td>Machinery and equipment, including ICT and electronics</td>
<td>40</td>
<td>15</td>
<td>25</td>
</tr>
<tr>
<td>Other sectors</td>
<td>75</td>
<td>40</td>
<td>35</td>
</tr>
<tr>
<td>Renewable energy and eco-innovation</td>
<td>55</td>
<td>30</td>
<td>25</td>
</tr>
<tr>
<td><strong>Transport and Logistics</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ensuring sufficient capacity in interurban traffic</td>
<td>160</td>
<td>80</td>
<td>80</td>
</tr>
<tr>
<td>Modernising urban transport to meet global benchmarks</td>
<td>80</td>
<td>40</td>
<td>40</td>
</tr>
<tr>
<td><strong>Water and Waste</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Additional needs for resilient and efficient urban infrastructure</td>
<td>138</td>
<td>48</td>
<td>90</td>
</tr>
<tr>
<td>Compliance and rehabilitation of Europe’s water infrastructure</td>
<td>40</td>
<td>13</td>
<td>27</td>
</tr>
<tr>
<td>Enhancing waste management/materials recovery</td>
<td>75</td>
<td>30</td>
<td>45</td>
</tr>
<tr>
<td>Water security, including flood risk management</td>
<td>8</td>
<td>3</td>
<td>5</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>2,138</td>
<td>1,528</td>
<td>EUR 655bn</td>
</tr>
</tbody>
</table>

Source: EIB (2016) Restoring EU Competitiveness
Note: For details on methodology and calculations, please see report Restoring EU Competitiveness
A reminiscent challenge in Europe: bank balance sheets – assets...

Balance sheets MFI euro area

Source: ECB.
...and liabilities

Source: IMF.
Bottom line

• Currency (will) make(s) the difference
  – International role
  – Fiscal space
• Monetary policy ahead: complex everywhere
• Potential growth: labour markets and mobility
• Will politics dominate anyway?