Box 3

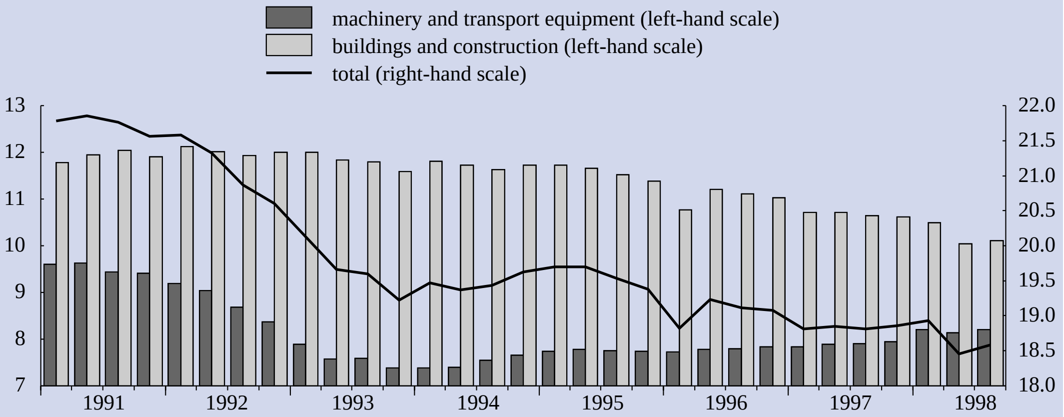
Investment in the euro area

For the euro area as a whole, gross domestic fixed capital formation rose by 4.2% in 1998, compared with an increase of around 2% in the previous year. The contribution of investment to real GDP growth rose to 0.8 percentage point in 1998, compared with 0.4 percentage point in 1997. This was the strongest contribution to growth since 1990 and, in conjunction with robust private consumption, it underpinned the overall acceleration in output growth observed last year. However, viewed from a more medium-term perspective, the rise in investment has been relatively subdued for a number of years and it may be regarded as somewhat surprising that investment growth has not responded more strongly to the upturn in activity that has taken place from mid-1995 onwards. Indeed, it appears that, since peaking at around 22% in the early 1990s, the ratio of investment to GDP has fallen significantly, to around 18.5% during 1998 (see the chart below). The ratio of investment to GDP is calculated on the basis of current prices. However, as the relative price of investment goods has tended to fall, the development of investment has been slightly more positive when measured in terms of constant prices. This relative price decline is at least partly due to the strong downward trend in the prices of many high technology investments, such as personal computers and computer software.

Investment is not only a significant component of total GDP, but also important in the context of increasing the productive potential of the economy, as long as the capital expenditure is allocated efficiently. Thus any secular decline in investment over the longer term could be a cause for concern.

Breakdown of investment

(as a percentage of GDP; quarterly data)



Sources: Eurostat and ECB calculations.

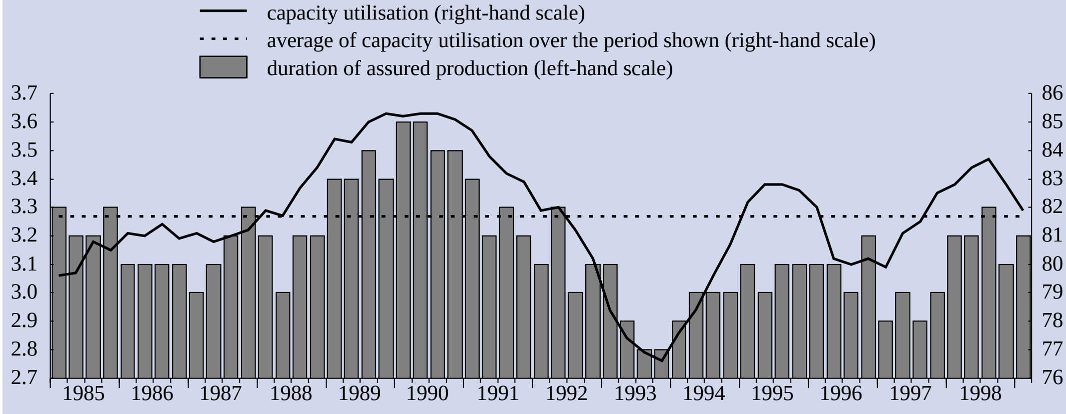
A breakdown of euro area investment into two components – machinery and transport equipment, and buildings and construction – is available from Eurostat for the period from 1991 onwards. The annual growth rate of investment in machinery and transport equipment (which is generally somewhat more volatile than that of investment in buildings and construction and accounts for around 40% of the total) has increased more rapidly since mid-1994, whereas the level of investment in buildings and construction has remained broadly unchanged (and even fell slightly in the last quarter of 1998). In recent quarters investment in machinery and transport has risen at a year-on-year growth rate of around 8%. This rise in machinery and transport equipment follows a relatively sharp decline in the early 1990s. In addition, although the breakdown of private as opposed to public investment is not readily available for the euro area, the ratio of public investment to GDP has fallen somewhat in recent years, to a large extent as a result of the fiscal consolidation efforts being placed on investment expenditure by Member States in the euro area. This, too, has contributed to lower rates of investment.

Investment intentions for 1999 may well have been adversely affected by the emerging markets crisis. According to a survey undertaken on behalf of the European Commission in October and November of last year, some reduction in the rate of growth of investment in both value and volume terms was expected in 1999, compared with the preceding year. The slowdown in world demand, reflected in industrial production figures, together with an expected slowdown in real GDP growth in the euro area in 1999 suggest that the immediate need to increase capacity may have diminished. Estimates of capacity utilisation have fallen and now stand close to their long-term averages (see the chart below). In addition, in some countries there may be some hesitancy to undertake further investment when future tax policy is uncertain and the path of wage developments is either unclear or is threatening to undermine the profitability of investment.

However, there are also some positive factors which may help to support continued investment expenditure. Figures on the duration of production assured by current order books do not yet suggest an unusually low position which might point to a sharp slowdown in investment. Furthermore, the low level of nominal and real interest rates, together with stock market buoyancy, would suggest that financial conditions are also very favourable for investment.

Capacity utilisation and duration of assured production

(percentage and number of months; quarterly data)



Sources: European Commission Business and Consumer Surveys and ECB calculations.