

Box 7

RECENT DEVELOPMENTS IN EURO AREA INVESTMENT

In the first half of 2006 investment in the euro area increased by 2.2% relative to the second half of the previous year, following a semi-annual increase of 2.0% in the second half of 2005. This is the highest semi-annual investment growth rate recorded since the second half of 2000, when investment rose by 3.0%. Investment was thus one of the main driving forces behind the favourable overall developments in economic activity in the euro area in the first half of 2006. This box reviews in further detail developments in investment in the euro area up to the second quarter of this year.

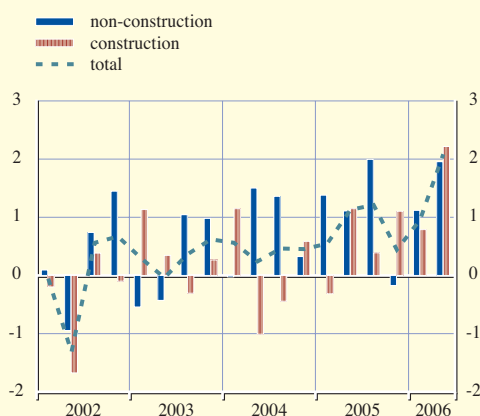
The increase in investment growth in the first half of 2006 was broadly based. It reflected strong growth rates for both construction and non-construction investment, each of which accounts for roughly half of total investment (see Chart A). The semi-annual growth rates in these sectors stood at 2.5% and 2.0% respectively. For the construction sector this represented a 1.0 percentage point increase in the semi-annual growth rate as compared with the second half of 2005, whereas for the non-construction sector this represented a decline of 0.5 percentage point. The strong investment performance in the first half of 2006 was also broadly based across countries.

Non-construction investment

The moderate fall in non-construction investment growth in the first half of this year largely reflects the decrease, by 1.2 percentage points to 1.7% , in the semi-annual growth of investment in metal products and machinery (accounting for 60% of non-construction investment) and in the semi-annual growth of investment in “other products” (representing a further 20% of total non-construction investment), by 1.3 percentage points to 0.8%. On the other hand, investment in transport equipment (which also accounts for 20% of non-construction investment) rose by

Chart A Total construction and non-construction investment

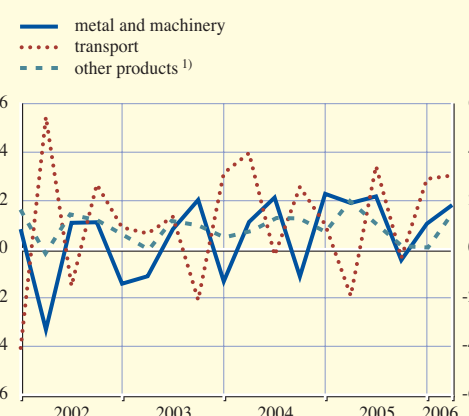
(quarter-on-quarter changes; seasonally adjusted)



Source: Eurostat.

Chart B Breakdown of non-construction investment

(quarter-on-quarter changes; seasonally adjusted)



Source: Eurostat.
1) Includes agriculture.

a substantial 4.3%, which is 2.1 percentage points higher than in the second half of 2005. All three components of non-construction investment were strongly affected by positive developments in Germany, where a negative trend in the period up to 2004 was reversed.

Investment in construction

The increase in euro area construction investment growth to 2.5% in the first half of 2006 represents the highest growth rate for around five years. The developments in the first half of 2006 as a whole were broadly similar for both housing and non-housing construction investment (each representing half of total construction investment), which grew by 2.1% and 2.9% respectively. The two countries contributing most to construction investment growth in the first half of 2006 were Spain, at around 0.6 percentage point, and France, at around 0.4 percentage point. Developments in Germany are also worth mentioning, where construction investment decreased by 2.9% in the first quarter of 2006, but increased by 4.6% in the second quarter, leading to a relatively small positive contribution to the semi-annual construction investment growth of 0.1 percentage point.

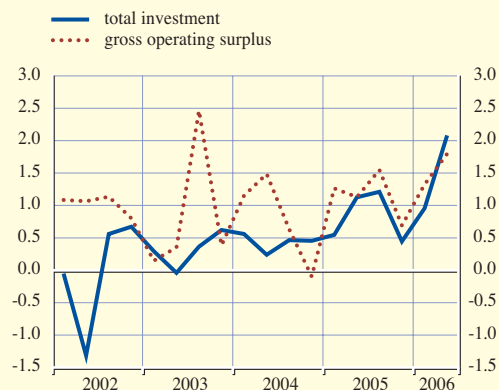
In the case of housing investment, the ongoing growth is in line with the generally dynamic conditions in several euro area housing markets, including house price increases. In addition, both construction and non-construction investment have benefited from buoyant corporate profits, favourable financing conditions and high expectations of future economic growth and demand. Gross operating surplus, an indicator of corporate profit growth in the euro area and an important source of internal funding for corporate investment, increased by 1.3% and 1.8% respectively on a quarter-on-quarter basis in the first and second quarters of 2006 (see Chart C). These are the two highest consecutive quarterly growth rates in this indicator since the second half of 2001. Profit growth, which moved closely in line with real investment in 2005 and the first half of 2006, is supported by moderate wage developments and the continued pick-up in demand. Notwithstanding strong external price and cost pressures, this combination of factors, together with very favourable financing conditions, has enabled euro area firms to invest. Looking ahead, such factors are expected to continue to support overall euro area investment.

For the third quarter of 2006, as shown by the bank lending survey, banks report a strong positive net demand for loans by enterprises, behind which fixed investment was one of the main driving forces. This demand for loans may provide a further positive signal for investment growth in the second half of 2006.¹ In addition, the EC industrial sector surveys on the current level of capacity utilisation and the assessment of current production capacity, which have a high degree of correlation with year-on-year investment growth, point to a further strengthening of investment growth in the third quarter of 2006.

¹ See Box 2 in this issue of the ECB's Monthly Bulletin for a detailed analysis of the results of the bank lending survey for the euro area.

Chart C Total investment and gross operating surplus

(quarter-on-quarter changes; seasonally adjusted)



Source: Eurostat.
Note: Gross operating surplus is defined as GDP less compensation of employees less taxes (minus subsidies) on production.