

Box 8

INVESTMENT OUTLOOK IN THE EURO AREA: AN ASSESSMENT BASED ON SURVEY AND CAPACITY UTILISATION DATA

After declining for eight consecutive quarters from the second quarter of 2008, falling by a total of 11.3% in 2009, gross fixed capital formation in the euro area fell less sharply in 2010. Despite the general improvement in economic activity in the euro area, low levels of overall capacity utilisation, which were still below their long-term average up to the first quarter of 2011, contributed to a slowing of the recovery in investment by reducing firms' incentives to renew

their fixed capital. However, with capacity utilisation rates progressively growing and picking up quickly in certain countries, industrial groupings, companies and factories, such obstacles could now be disappearing.¹

In addition to its regular monthly and quarterly business surveys, the European Commission conducts, in the spring and autumn of each year, a detailed investment survey among companies in the manufacturing industry. This box presents an assessment of the investment outlook for 2011 based on the latest survey and capacity utilisation results.²

In the past, the results of investment surveys have consistently and correctly indicated the direction of change of gross fixed capital formation – particularly signalling the strong downturns in non-construction investment in 1993, 2002 and 2009 – even if they did not always give accurate point forecasts on total investments for the following year, as recorded in the national accounts data. However, when also considering the balance of expectations on the main factors influencing investment (especially demand) and the whole picture provided by the structure of investment (especially the share of extension investment), companies' forecasts manage to track developments in investment at the euro area level quite well.

According to the companies surveyed, investment plans for 2011 show a year-on-year growth in volume in the euro area of 2.4%. This reflects both continued improvements in countries which were already recording relatively good results in 2010 and robust rebounds in most of the other countries. Overall, only companies in a few countries foresee average negative investment plans growth for 2011. This can be attributed, in particular, to uncertainty regarding financing conditions and, in some cases, to the unwinding of temporary factors which had supported gross fixed capital formation in 2010. Reflecting these developments, cross-country heterogeneity in investment expectations, measured by variance in plans, has remained at the relatively high levels seen in the autumn 2009 survey.

Data at the sectoral level are available in values: the projected total outcome for the euro area in 2011 of 3.9% was driven by the positive expectations of producers of investment goods (+4.5%), while producers of consumption goods foresee a 1.9% increase, and capital formation is expected to remain broadly stable for producers of intermediate goods (+0.2%). The positive result in the consumption sector masks a weakening in investment plans by producers of durable consumption goods (-7.4%), which is more than offset by a robust rise in the non-durables sector (+4.7%). Overall, such forecasts broadly mirror the latest data on capacity utilisation, available at the sectoral level only up to the first half of last year (see Chart A).³ In the second quarter of 2010 the capacity utilisation rate was still notably below its long-term average both in the investment and intermediate goods sectors. However, both sectors (and particularly the investment goods sector) recorded the fastest recovery rates. An assumption that such dynamics continued in the second half of 2010 helps to reconcile the data presented in Chart A.

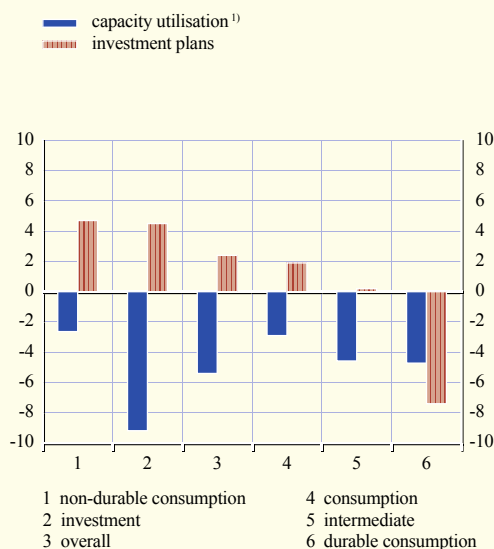
1 See the box entitled "The recovery of production capacity utilisation in the euro area", *Monthly Bulletin*, ECB, October 2010.

2 The European Commission investment survey is described in Box 5 of the March 2007 issue and in Box 8 of the March 2008 issue of the *Monthly Bulletin*. The latest euro area results were published on 29 November 2010. This survey was the first to implement the new classification of economic activities NACE Rev. 2 (previous data refer to the former NACE Rev. 1.1 classification). This change in classification might have introduced a structural break in the survey data. However, it should be noted that, as the differences between the former and the new classification are relatively small at the aggregate level, the potential size of the break is contained.

3 According to the European Commission, the migration to NACE Rev. 2 is still ongoing. Provisional sectoral data are expected to become available at the end of February 2011, while fully validated series will become available in autumn 2011.

Chart A Capacity utilisation and growth in investment plans for 2011 by main industrial grouping

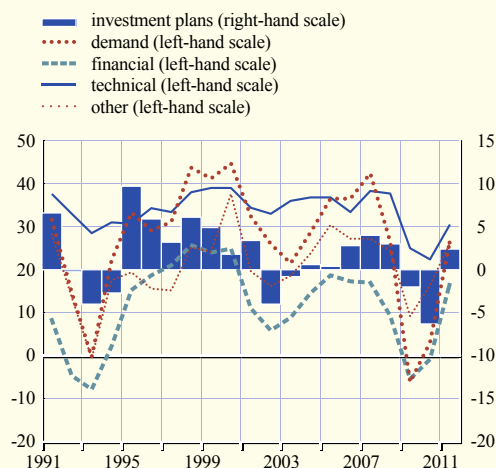
(percentages; annual percentage changes)



Sources: European Commission investment survey and business survey in manufacturing.
Notes: Sector capacity utilisation data up to the second quarter of 2010. Sectors ordered by expected growth of investment in value.
1) Difference from the long-run average.

Chart B Factors influencing investment

(percentages; annual percentage changes)



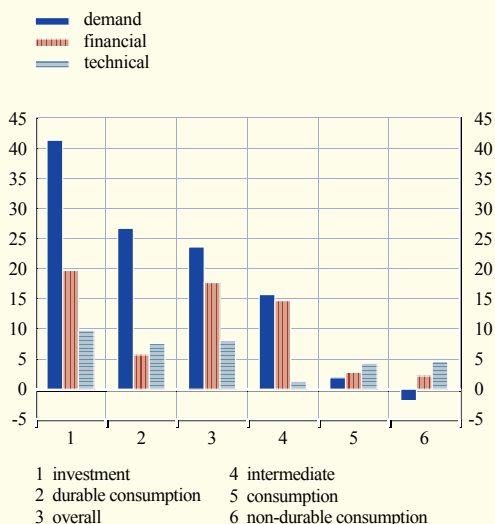
Source: European Commission investment survey.
Note: The survey questions on factors are of qualitative nature, data are expressed as percentage balances; investment plans in volume.

Among the factors influencing investment decisions, the largest positive balance (31%) is recorded by technical factors, which, in the past, have also been considered a main driver for investment (see Chart B). However, demand factors show the strongest upswing, with the balance rising from 3% in the judgements on 2010 formulated in the autumn 2009 survey to 27% in the judgements on 2011 surveyed in autumn 2010. The availability of financial resources also registers a strong improvement, rising to 17% from a negative balance the year before. The increase in expected demand as a reason for new investment is particularly strong among producers of investment goods, with an upswing of 41 percentage points, more than double the increase recorded by producers of intermediate goods (16 percentage points), while the expectations of producers of consumer goods show minor overall improvements, despite the strong increase in the durables sector. The financial conditions and expected profits are seen to be recovering especially robustly by producers of investment and intermediate goods (see Chart C).

Regarding the structure of planned investments for 2011, in terms of shares adding up to 100%, the largest component is expected to be devoted to replacement (30%, a share inferior to that reported in the autumn 2009 survey), 28% of the new fixed capital is to be associated with the extension of production capacity, sharply up from the previous year, 24% is for the rationalisation of production, with the remaining 18% of planned investments set to be motivated by other reasons (see Chart D).

Chart C Change in the judgements on factors affecting investment plans

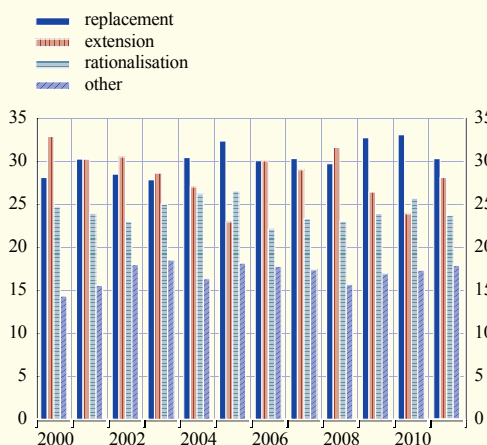
(percentages; 2011 compared with 2010)



Source: European Commission investment survey.
Note: Sectors ordered by change in demand.

Chart D Investment structure

(percentages)



Sources: European Commission investment survey and ECB calculations.
Note: Sum of shares is made equal to 100.

Overall, the sizeable positive growth of investment plans, the robust upswing in demand as a factor for capital accumulation, the growth in the share of extension investment with respect to the previous survey and the continued recovery in capacity utilisation suggest a continued revival of total investment in the euro area in 2011. This would be in line with the December 2010 Eurosystem staff macroeconomic projections for the euro area, which indicate a range of growth for gross fixed capital formation between -0.5% and 3.1% in 2011, and with the European Commission autumn forecast, which foresees a 2.2% rise.⁴

4 For details about the Eurosystem staff macroeconomic projections, see the December 2010 issue of the Monthly Bulletin.