Box 4

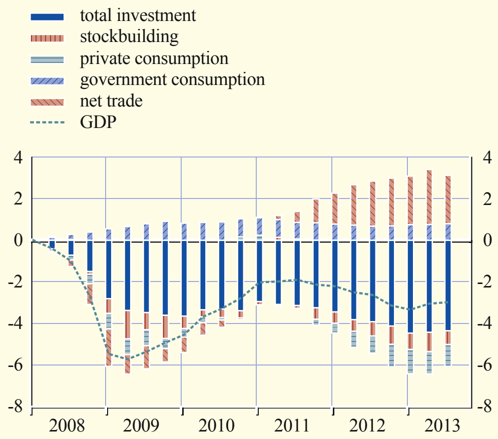
BUSINESS INVESTMENT – SIGNS OF A MODEST RECOVERY AHEAD

This box presents developments in investment, particularly business investment, since 2008, and gives an indication of the outlook for 2014. Total investment in the euro area has shrunk steadily and substantially during the financial crisis. Thus far total investment has contracted by more than 15% since the simultaneous peak in GDP and investment in 2008. This fall explains most of the sharp decline in euro area GDP that has been registered since 2008. This is because, in accounting terms, total investment (including housing) has subtracted more than 4 percentage points from real GDP in cumulative terms over this period (see Chart A). While total investment is usually among the most volatile components in GDP over the business cycle, the contraction over the past six years has been deeper and more extensive than during any recession in the past 30 years in the euro area. A weak recovery has been observed recently, with total investment growing by 0.2% in the second quarter of 2013 and by 0.4% in the third quarter of 2013 respectively. However, its level remains far below that of 2008.

Total investment refers to activities by businesses, households and the public sector. The fall in business investment (non-financial corporations) accounts for about half of the decline in total investment since 2008 (see Chart B). The household sector has contributed almost as much to this reduction, largely reflecting the drop in housing investment.[1] Public sector investment has

Chart A Euro area real GDP and contributions to cumulative change in real GDP since the first quarter of 2008

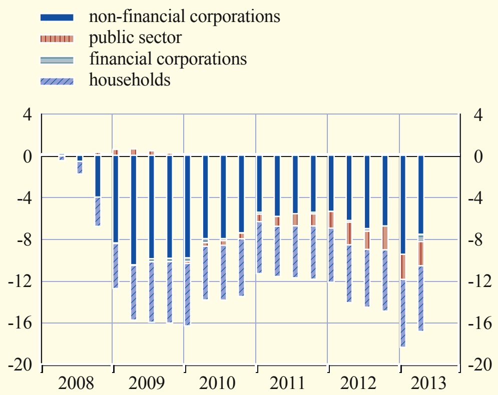
(percentage points)



Source: Eurostat.
Notes: The last observation is for the third quarter of 2013. For Spain, inventories are reported within investment.

Chart B Euro area sectoral contributions to cumulative change in nominal investment since the first quarter of 2008

(percentage points)



Source: Eurostat.
Note: The last observation is for the second quarter of 2013.

1 See the box entitled "Uncovering the dynamics of residential investment", *Monthly Bulletin*, ECB, Frankfurt am Main, May 2013.

also contracted sharply. However, given the relatively small share of public sector investment in total investment, its contribution is much more limited.

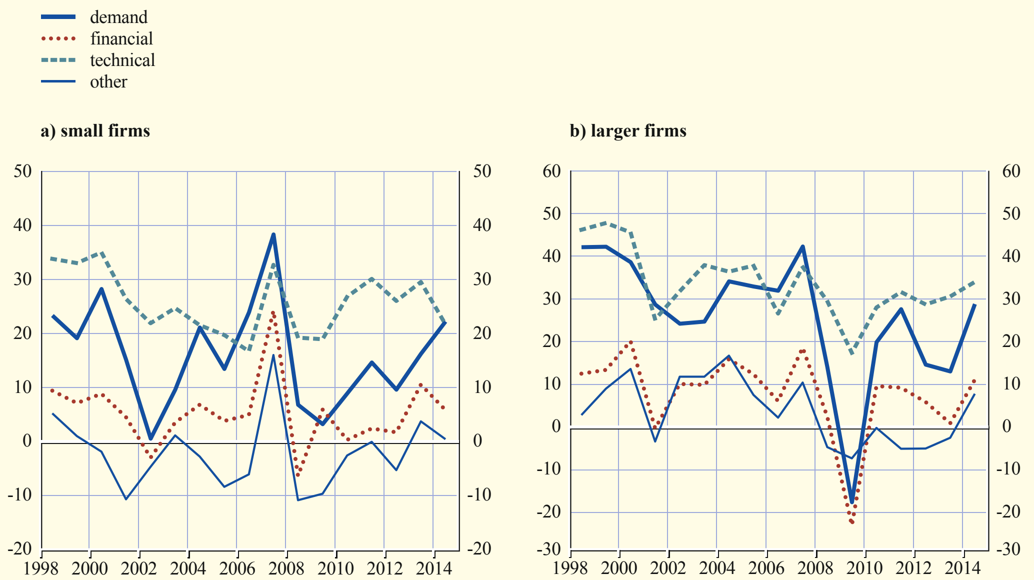
Looking closer at business investment, fundamental factors, such as weak demand and profits[2], as well as abundant spare capacity, help to explain the contracting dynamics over recent years. Particularly during the financial crisis, high levels of uncertainty[3], tight financing conditions and deleveraging needs among firms and banks also contributed to dampening firms' investment activity.

According to the European Commission's November 2013 investment survey, real euro area investment in the manufacturing industry is estimated to have decreased by a further 3% in 2013 and is expected to increase by 3% in 2014.

The survey also shows that, on balance, demand factors are expected to be more supportive of investment growth in the euro area in 2014 than they were a year earlier. Currently demand factors are broadly as supportive of investment growth as they have been on average since the start of EMU. The Commission survey distinguishes between small firms with less than 50

Chart C European Commission investment survey – factors influencing industrial investment in the euro area

(balances)



Sources: European Commission investment survey and Eurostat.
Notes: Larger firms have more than 250 employees; small firms have less than 50 employees. Plotted are the levels of the balances of responses: the higher the balance, the more supportive the factor is perceived to be (and the lower the balance, the more restrictive). "Demand factors" cover the capacity utilisation rate and sales prospects; "financial factors" include the availability of resources for investment and their cost together with the return on investment and the lack of opportunities for the company to use its resources more profitably than by investment (notably by purely financial operations); "technical factors" comprise technological developments, the availability of labour and workers' attitudes towards the new technologies, and the technical conditions set by the public authorities before they grant the investment permit; "other factors" may include the policy of the public authorities, notably with regard to taxation, and whether or not production can be transferred abroad.

2 See the box entitled "Sectoral contributions to rebalancing within the euro area", *Monthly Bulletin*, ECB, Frankfurt am Main, December 2013.

3 See the box entitled "How has macroeconomic uncertainty in the euro area evolved recently?", *Monthly Bulletin*, ECB, Frankfurt am Main, October 2013.

employees and larger firms with more than 250 employees. An encouraging result is that in 2014 smaller firms expect demand factors to be more supportive than they have been on average since 2009 (see Chart C). Unlike for larger firms, overall, the demand factors have provided limited support for investment since 2009 for small firms. The survey also shows that financing considerations remain heavily dependent on firm size: while larger companies expect financial factors in 2014 to become substantially more supportive of investment decisions compared with a year ago, small companies expect some deterioration.

All in all, following the weak recovery in recent quarters, moderate growth in business investment is expected to continue, as demand gradually picks up, confidence and financing conditions improve and uncertainty diminishes. The euro area bank lending survey also shows that lending for investment purposes is expected to become less subdued. However, the recovery is expected to take place at a modest pace, from low levels, as it remains dampened by *inter alia* the continued deleveraging by both banks and firms and to some extent by difficulties encountered by firms with bank-financing constraints to find alternative financing via market securities issuance, foreign direct investment flows or trade credits.