Flash Economics

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It is crucial for Europe to keep its savings, but this would be very unfavourable for the United States

International capital flows from the eurozone to the United States. This includes share purchases, direct investments and purchases of US Treasury securities.

However, since Mario Draghi's report, we know that Europe needs considerable additional investment, €800 billion a year (combining public and private investment), €450 billion for investment in the energy transition, €150 billion for investment in digital technologies, €50 billion for the defence industry and €150 billion for disruptive innovation. If Europe makes this investment effort, and if the attraction of long-term investors for the United States does not change, there will be a very significant shortfall in savings available for investment in Europe, resulting in a sharp rise in long-term interest rates.

It is therefore crucial for Europe to be able to retain its savings so that it can make the necessary additional investments (which represent 4.7% of the European Union's GDP). And if Europe manages to hold on to its savings, there will be a savings deficit in the United States, which will lead to a rise in long-term interest rates in the United States: we therefore have the prospect of a war for savings between the United States and the European Union.

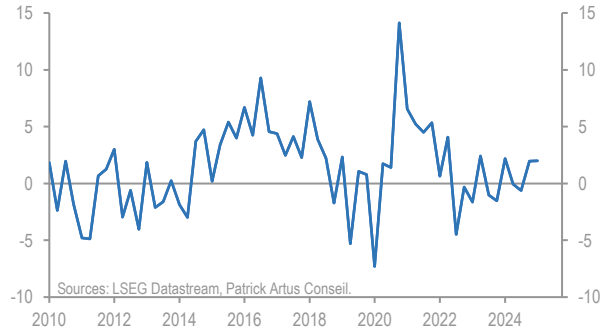
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1- The flight of European savings to the United States

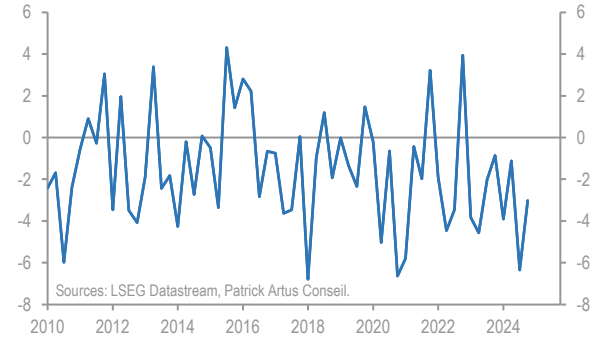
A comparison of long-term capital flows in the balance of payments of the eurozone and the United States shows that long-term savings are leaving the eurozone and returning to the United States (Charts 1A/B).

Chart 1A
Euro zone: Net direct and portfolio investments*
(as % of nominal GDP)



(*) The direct and portfolio investment balance represents the change in the net international investment position. An increase in the net international investment position has a positive sign

Chart 1B
United States: Net direct and portfolio investments*
(as % of nominal GDP)

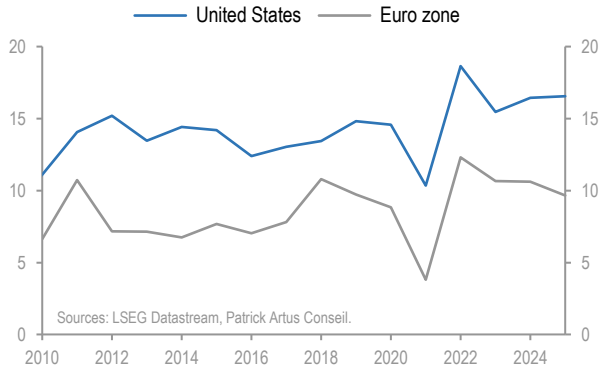


(*) The direct and portfolio investment balance represents the change in the net international investment position. An increase in the net international investment position has a positive sign

This flight of savings from Europe to the United States can be explained by:

- Higher returns on US companies (Chart 2);

Chart 2
RoE



- Stronger growth in the United States (Chart 3), with investment in new technologies (Chart 4A) and corporate research and development (R&D) (Chart 4B) significantly higher in the United States than in Europe;

Chart 3
Real GDP (2010.Q1 = 100)

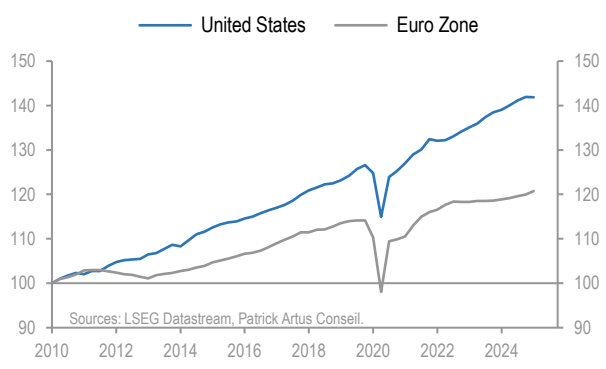


Chart 4A
ICT investment including software
(in value terms, as % of nominal GDP)

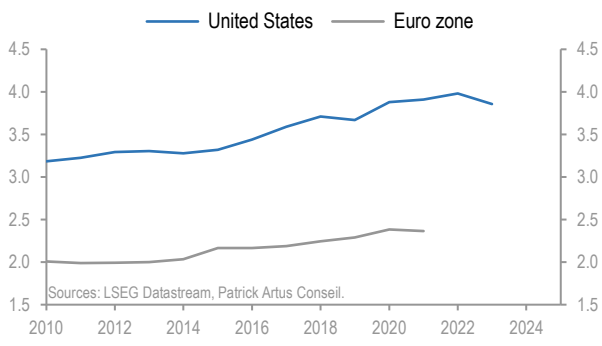
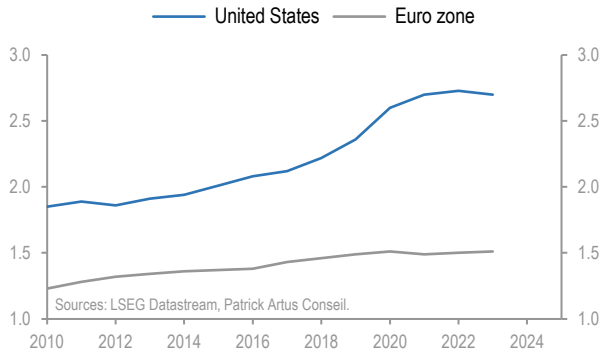
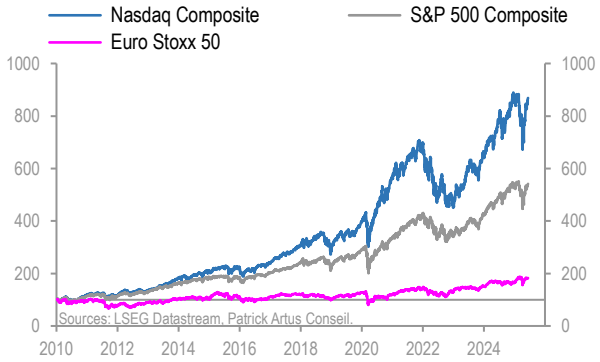


Chart 4B
Corporate R&D spending (as % of nominal GDP)



- The much faster rise in stock market indices in the USA, particularly those for technology companies (Chart5);

Chart 5
Stock market indices (01.01.2010 = 100)



- The availability of substantial financing for start-ups and risky companies in the United States. Venture capital fundraising in the US reached $250 billion in 2023, compared with €21 billion in the European Union.

2- Consequences if the attractiveness of the US for financial and business investment continues

We know that Europe will have to make a considerable investment effort (€800 billion a year, or 4.7% of GDP) to achieve the energy transition, and to finance disruptive innovations, defence industries and digital innovations.

If Europeans' savings continue to be attracted to the United States as much as they are today, there will be insufficient savings available to finance investment in Europe, and the result will be a sharp rise in the eurozone's real long-term interest rates (Chart 6).

Chart 6
Euro zone: Real interest rate on 10-year government bonds (deflated by 10-year inflation swap, as %)



The consequences of this rise in long-term real interest rates would be very unfavourable:

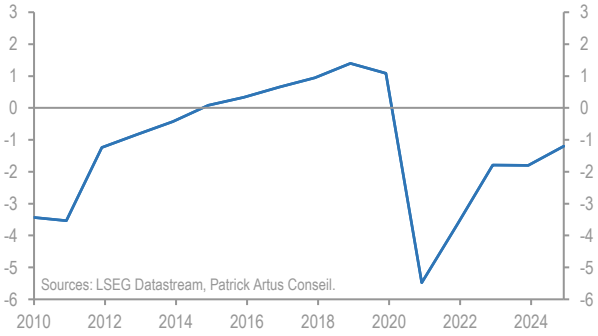
- Lower investment (Chart 7);

Chart 7
Euro zone: Investment of corporations (in value terms, as % of nominal GDP)



- Greater difficulty in stabilising the public debt ratio, since a return to a primary budget surplus would be necessary (Chart 8).

Chart 8
Euro zone: Primary fiscal surplus or deficit (as % of nominal GDP)

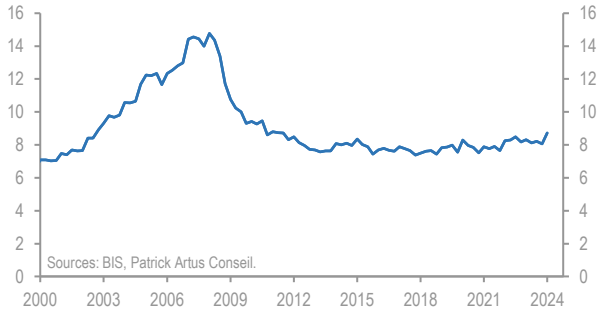


3- How can Europeans keep their savings in Europe?

The savings of Europeans will remain in Europe to a greater extent if the attractiveness of European financial markets and companies is increased, and if the return on European financial or corporate investments improves.

The need to achieve capital market union in Europe is often put forward (a single regulator for financial markets, unified bankruptcy law and taxation of savings, a single clearing and settlement authority, the possibility for banks to freely transfer liquidity to their subsidiaries in other European countries). These developments are desirable, given the weakening of cross-border financing in Europe (which the BIS is trying to stimulate by interconnecting domestic payment systems), Chart 9.

Chart 9
Euro zone: banks' foreign claims
(ratio to Tier 1 capital)



But unifying capital markets in the European Union will not be enough if the aim is to keep Europeans' savings in Europe.

We need to:

- Increase the profitability of investments in Europe, with an additional effort in R&D and technological investment ;
- Develop European venture capital, to prevent start-ups and growth companies from relocating to the United States;
- Modify the prudential ratios of insurers, to allow them to invest more in risky assets (this could be done by increasing the stress-test horizon on the value of assets held, which is currently 1 year);
- Decompartmentalising bank financing;
- Have a unified public debt in Europe, issued by the European Union and financing modernisation investments.

4- If Europe were to keep its savings, this would be very bad news for the United States

We saw above that if the eurozone kept all its long-term savings, it would have 3 GDP points of additional savings available for investment. If these savings were taken entirely from European savings invested in the United States, the result would be a significant fall in capital inflows to the United States, and difficulty in financing the external deficit (Chart 10), which would force a fall in investment and a rise in real long-term interest rates in the United States (Chart 11).

Chart 10
United States: Current account balance
(as % of nominal GDP)

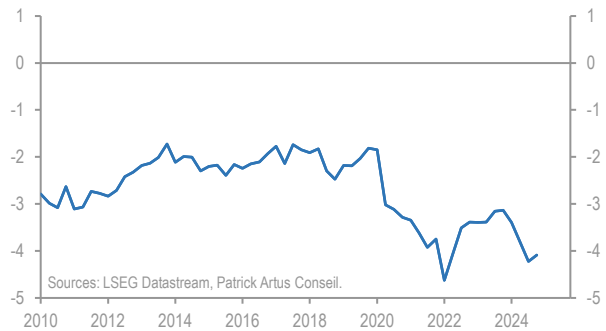
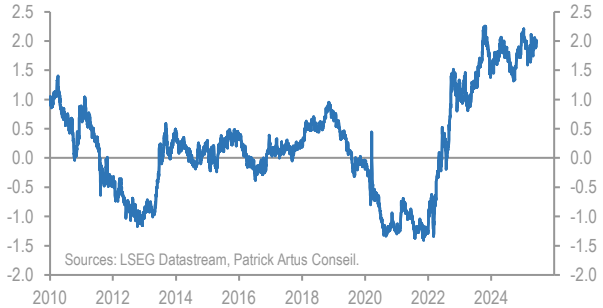


Chart 11
United States: Real interest rate on 10-year Treasuries
(deflated by 10-year inflation-swap, as %)



This rise in real long-term interest rates would have a particularly negative effect on stock market indices and on commercial and residential property in the United States.

Summary: Towards a war to attract savings?

If we look at the current account balances of the major countries (Charts 12A/B/C), we see a current account surplus in the eurozone, Japan, China, the OPEC countries and South Korea.

Chart 12A
Current account balance (as % of nominal GDP)

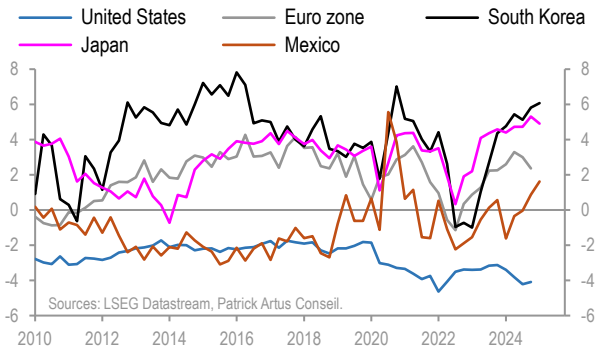


Chart 12B
Current account balance (as % of nominal GDP)

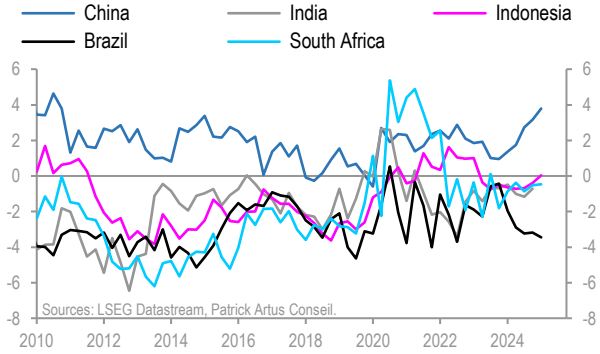
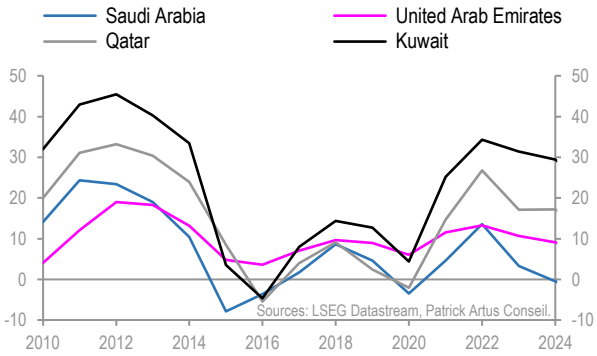


Chart 12C
Current account balance (as % of nominal GDP)

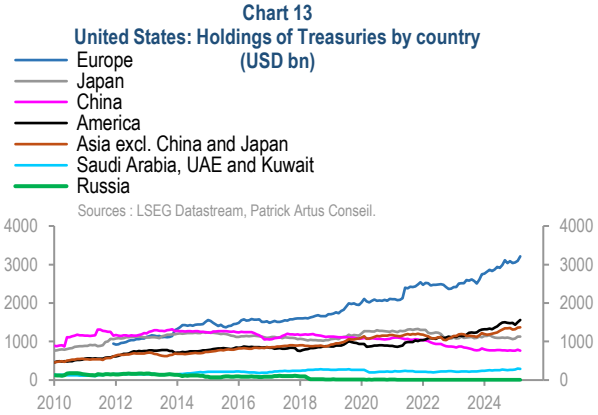


The other countries (Asia excluding China, Japan and South Korea; the United States, South Africa and Latin America) are competing for the savings surpluses of countries with a current account surplus.

As we have seen, it is crucial for Europe to retain its savings in order to finance the necessary increase in investment. However, OPEC countries will increasingly need to retain their savings to finance the diversification of their economies away from oil and natural gas.

And China, which is fighting against the hegemony of the dollar, has reduced its dollar-denominated foreign exchange reserves (Chart 13).

Chart 13
United States: Holdings of Treasuries by country
(USD bn)



We are therefore seeing the emergence of a 'war for global savings', essentially between the United States and Europe, with the United States needing to finance its chronic external deficit and Europe needing to retain its savings.

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