

Flash Economics

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The euro zone's current account surplus is shrinking: is it for the right reasons?

The current account surplus of the euro zone and the European Union has been declining since 2018, with major fluctuations linked to the rise in energy prices at the start of the war in Ukraine (2022). It is well known that Europe needs to invest much more (in the energy transition, in digital technologies) and must significantly increase its Research and Development expenditure. A virtuous development would therefore be for the reduction in the EU's current account surplus to stem from this increase in investment. But if the reduction in the EU's current account surplus comes from another cause (a deterioration in foreign trade, a decline in net capital income received from the rest of the world, etc.), the situation would be unfavourable, since the capacity to finance the additional investment required by using Europe's excess savings would be diminished.

Patrick Artus

Senior Economic Advisor

patrick.artus-ext@ossiam.com

 @PatrickArtus

 Patrick Artus

Isabelle Gravet

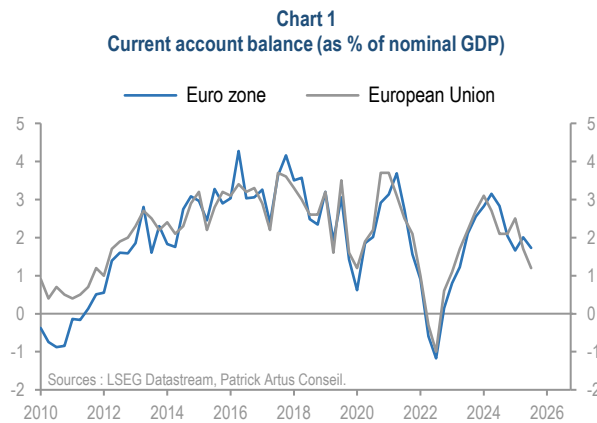
Research Assistant

isabelle.gravet-ext@ossiam.com

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Reduction in the current account surplus of the Euro zone and the European Union since 2018

Chart 1 shows the current account surplus of the Euro zone and the European Union since 2010. This surplus was affected by the rise in energy prices in 2022 following the start of the war in Ukraine. But if one looks at its trend, it can be seen that it has been declining since 2018.



One can envisage a favourable dynamic and an unfavourable dynamic, both of which lead to a reduction in the current account surplus of the EU (or the Euro zone).

- The dynamic that leads to a reduction in the European current account surplus can be favourable if it results from an increase in investment or in research and development expenditure. It is well known that Europe's investment shortfall (public and private) is considerable, which undermines Europe's capacity to invest in the energy transition and in the digital economy. An increase in investment or in R&D expenditure that results in a decline in the current account surplus would therefore be a favourable development. Charts 2a/b show that corporate investment in the Euro zone has been declining since 2019, while public investment has been picking up since 2017.

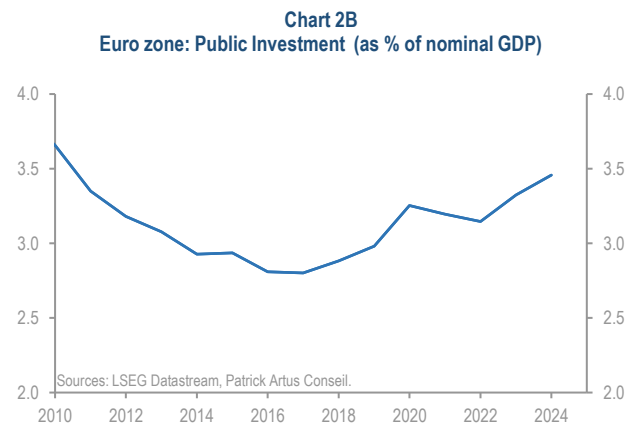
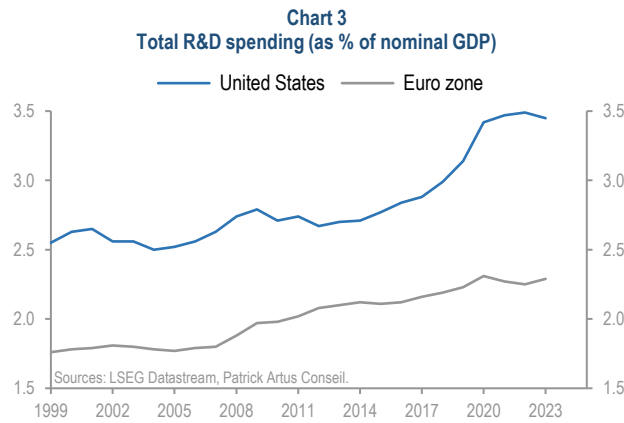
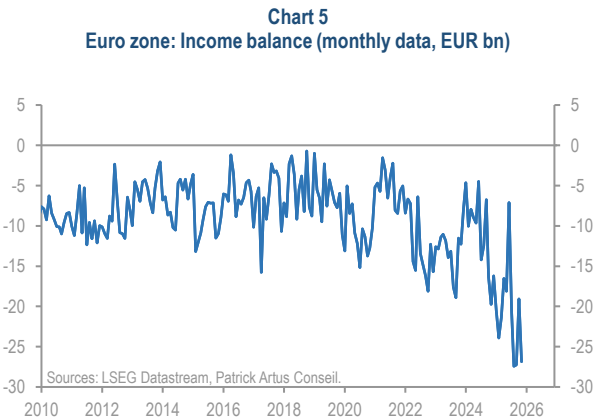
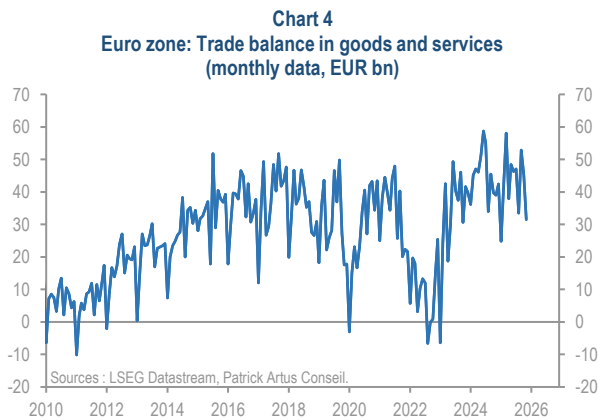


Chart 3 shows that research and development expenditure in the Euro zone has been stagnating since 2019.



- However, the dynamic leading to a reduction in the current account surplus is unfavorable if this reduction results from a deterioration in foreign trade or a decline in net income from abroad.



Charts 4 and 5 show:

- a stable balance of trade in goods and services, except for 2022, the start of the war in Ukraine;
- a sharp deterioration in the income balance since 2019.

If the EU's (or euro zone's) current account deteriorates due to a worsening of foreign trade or income flows, rather than an increase in investment, this deterioration of the current account is unfavourable, as it indicates a reduced capacity to finance the necessary investments using Europe's excess savings.

Summary: Is the deterioration of the euro zone's current account due to a favourable development?

If the reduction in the euro zone's (or EU's) current account surplus since 2018 were explained by an increase in investment—whether by businesses or the public sector—or by higher research and development expenditure, this would be encouraging, as it would indicate that Europe is catching up on its investment lag.

We have observed that:

- While public investment has been recovering, private investment has been declining sharply since 2019;
- The euro zone's trade balance has remained stable, while the income balance has been deteriorating since 2019.

The decline in private investment outweighs the rise in public investment and the deterioration in the income balance. It is therefore underinvestment since 2019 that explains the improvement in the euro zone's current account, which is not a favourable explanation.

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