Flash Economics

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Why is growth so weak in the euro zone?

GDP growth in the euro zone was just 0.5% in 2023 and is forecast to be 0.8% in 2024, whereas in the United States growth was 2.5% in 2023 and is forecast to be around 2.5% in 2024.

The weakness of growth in the euro zone is due primarily to structural causes: an ageing population, a lack of productivity gains, and a loss of industrial competitiveness leading to a decline in export market share and manufacturing output.

But it is also due to cyclical causes: a rising household savings rate, weak business investment, a decline in housing investment, and restrictive budgetary policies.

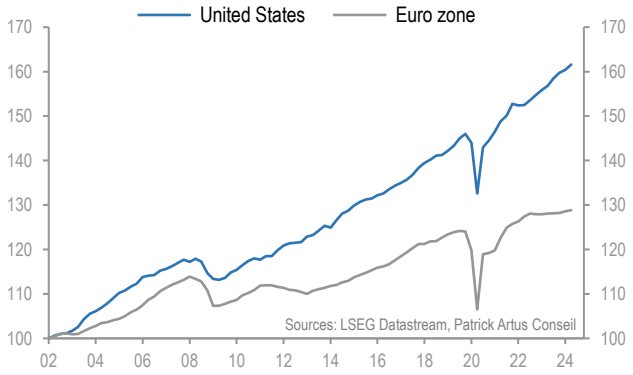
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Weakness of growth in the euro zone

A comparison of GDP growth in the euro zone and the United States (Chart 1) clearly shows the weakness of growth in the euro zone.

Chart 1
Real GDP (2002.Q1 = 100)



The purpose of this paper is to show that the weakness of growth in the euro zone has both structural and cyclical causes.

The structural causes of weak growth in the euro zone

There are three main structural causes of weak growth in the euro zone: an ageing population, a lack of productivity gains, and a loss of competitiveness in industry. Chart 2 shows the growth in the population aged between 15 and 64, which is faster in the United States than in Europe; moreover, the very high level of immigration, some of it illegal, in the United States in the recent period is not included in these figures.

Chart 2
Population aged 15 to 64 (as % per year)

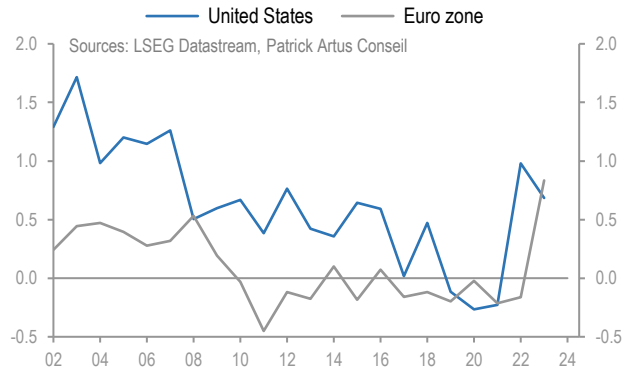
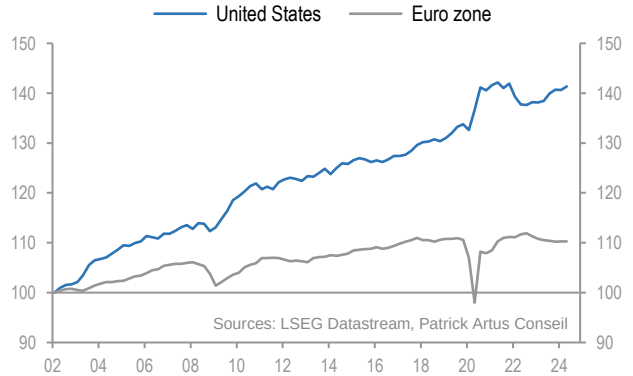


Chart 3 shows the very large gap between productivity gains in the United States and in the euro zone, which is mainly due to the weakness of R&D spending in Europe (R&D spending in 2023 reached 3.5% of GDP in the United States and 2.2% of GDP in the euro zone) and the low level of investment in new technologies (in 2022, 5.8% of GDP in the United States and 2.8% of GDP in the euro zone).

Chart 3
Productivity per capita (100: 2002.Q1)



Finally, the euro zone's loss of competitiveness can be seen on the one hand when we look at its export market share since 2009 (Chart 4), and on the other when we look at the trend in its manufacturing production (Chart 5). This loss of market share can of course be linked to the same causes as the stagnation in productivity: insufficient spending on R&D and investment in new technologies.

Chart 4
Exports of goods and services
(in value terms, 2005 Q1 = 100)

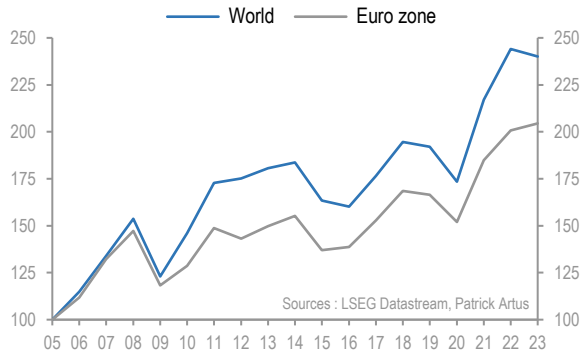
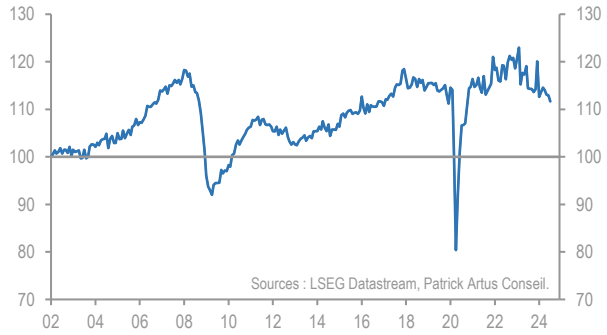


Chart 5
Euro zone: Manufacturing production
(01.01.2002 = 100)

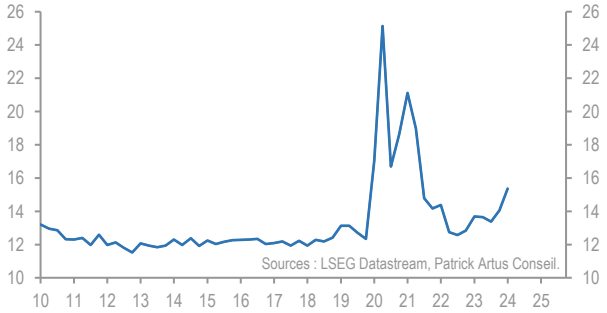


The cyclical causes of weak growth in the euro zone.

One can identify four cyclical causes of weak growth in the euro zone: the rise in the household savings rate, weak business investment, the decline in housing investment, and restrictive fiscal policy.

Chart 6 shows the household savings rate in the euro zone. One can see that it has been rising sharply since mid-2022, implying that the recovery in household purchasing power linked to the fall in inflation has not led to a recovery in consumption.

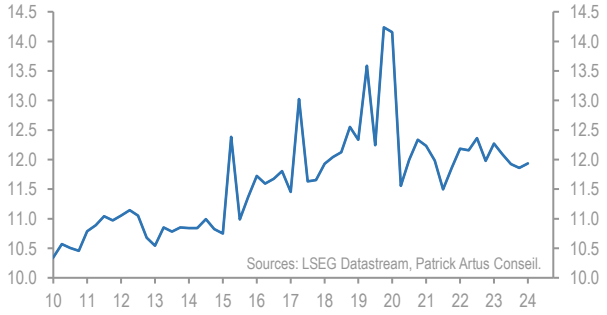
Chart 6
Euro zone: Gross household savings rate
(as % of gross disposable income)



This rise in the gross household savings rate may be linked to Europeans' pessimism about the economic situation or to the expectation that the public deficit will be reduced in the future.

Chart 7 shows the total business investment rate by value.

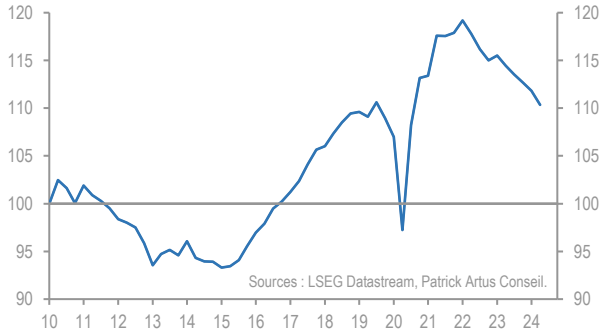
Chart 7
Euro zone:Investment of non-financial corporations
(in value terms, as % of nominal GDP)



Business investment has been weak since 2020.

Chart 8 shows the evolution of household investment in housing in volume terms.

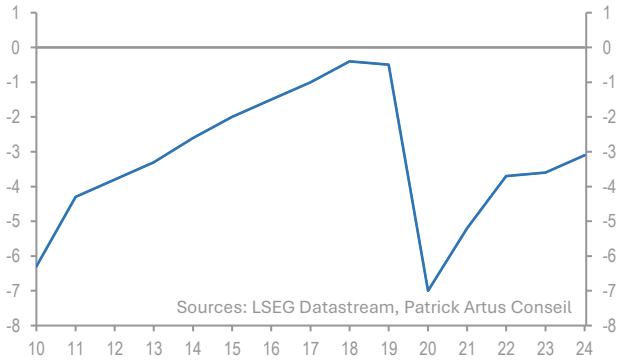
Chart 8
Euro zone: Real housing investment
(2010 Q1 = 100)



There has been a sharp decline since the beginning of 2022.

Chart 9 shows the fiscal deficit in the euro zone; one can see that fiscal policy in the euro zone has been restrictive since 2021, which is linked to the desire to comply with national (Germany with its almost zero fiscal deficit target) or European budgetary rules.

Chart 9
Euro zone : Fiscal deficit (as % of nominal GDP)



Summary: the cyclical causes of weak growth in the euro zone are exacerbating the structural causes.

Weak demand from households, with their rising savings rates, and weak business investment are leading to weak growth, which means that there is less incentive to invest in productivity, and difficulties for public finances, which make it harder for governments to increase R&D spending and help businesses to invest. The cyclical causes of weak growth are reinforcing its structural causes, productivity stagnation and loss of competitiveness.

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