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Europe faces either weak long-term growth or a public debt crisis

The euro zone currently runs a current account surplus and has a low investment rate. Even if the euro zone's public debt ratio rises continuously, the euro zone has sufficient savings to finance the public deficit and public debt, thereby avoiding a debt crisis.

However, even if European countries were to invest more – both in terms of corporate investment and public investment – they would shift to a position of external deficit, with higher public deficits and rapidly rising public debt, and would then face the risk of a public debt crisis, as they would need other countries' savings to cover their public deficits.

In reality, it is the weakness of investment, and hence of the euro zone's potential growth, that allows it to avoid a public debt crisis.

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Low investment rate and weak long-term growth in the euro zone

Both the corporate investment rate and the public investment rate are low in the euro zone (**Charts 1A/B**), although the public investment rate has been recovering since 2019.

Chart 1A
Euro zone: Investment of corporations (in value terms, as % of nominal GDP)

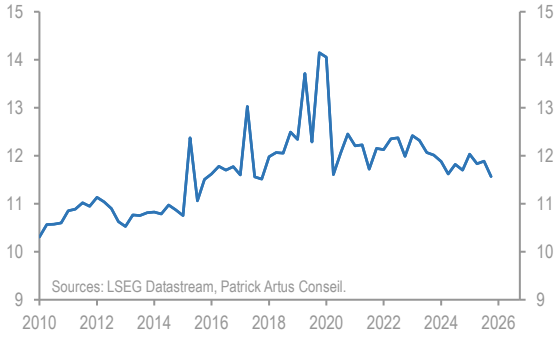
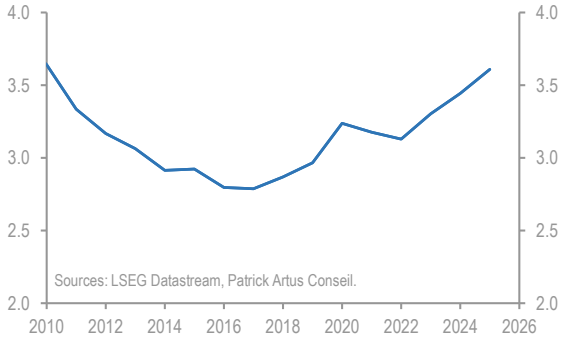


Chart 1B
Euro zone: Public Investment (as % of nominal GDP)



One component of corporate investment is **research and development investment**, **which is also low** in the euro zone (**Chart 2**). **This weakness in investment naturally leads to low long-term growth**; real GDP has grown at an average of 1.4% per year since 2010 (**Chart 3**).

Chart 2
Corporate R&D spending (as % of nominal GDP)

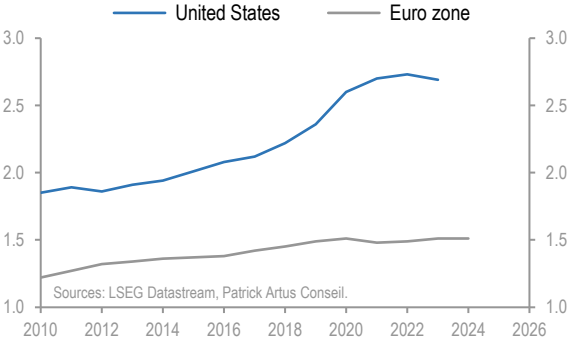
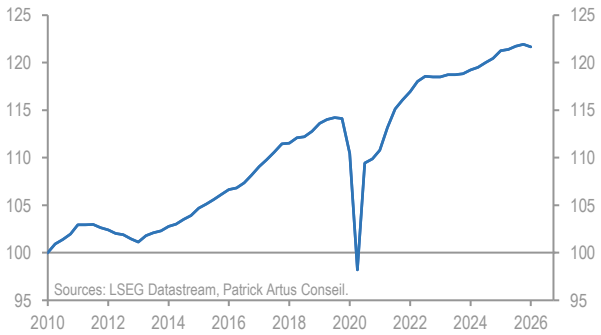


Chart 3
Euro zone: Real GDP (100 = 2010.Q1)



Current account surplus facilitating the financing of the public deficit

Owing to the low investment rate, **the euro zone has a structural current account surplus** (**Chart 4**). This shows that **the euro zone has sufficient savings to finance its public deficit** (**Chart 5**).

Chart 4
Euro zone: Current account balance
(as % of nominal GDP)

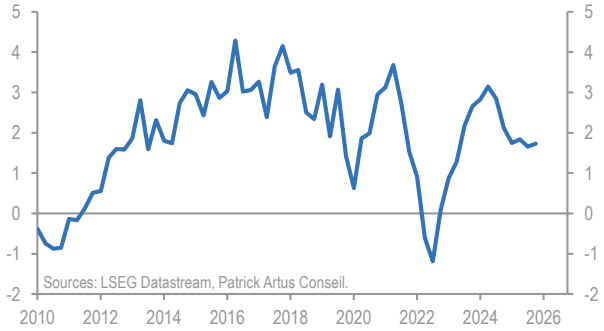
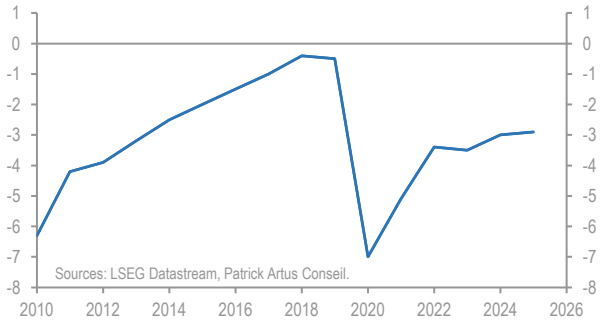


Chart 5
Euro zone: Fiscal deficit
(as % of nominal GDP)



Viewed in terms of stocks rather than flows, the euro zone, by accumulating **net external assets** (**Chart 6**), holds a **sufficient stock of savings to finance its public debt** (**Chart 7**).

Chart 6
Euro zone: Net foreign assets or liabilities
(as % of nominal GDP)



Chart 7
Euro zone: Public debt
(as % of nominal GDP)



The weakness of investment (primarily private) in the euro zone therefore means that financing the euro zone's public deficit is straightforward, owing to the excess of savings.

However the euro zone should be investing far more

It is well known, particularly since the Draghi report, that the **investment deficit in the euro zone is considerable** (at least 4.5 percentage points of GDP per year). European countries are underinvesting in the energy transition, in digital technology, and in groundbreaking innovation. **Corporate investment and public investment would therefore need to be significantly higher for Europe to close its gap, particularly in technology**.

Even if the corporate investment rate were higher by 2.25 percentage points of GDP (assuming that the investment effort should be shared equally between firms and governments) and if the public investment rate were also higher by 2.25 percentage points of GDP, the result would be:

- **A shift to a very large current account deficit** (of almost 3 percentage points of GDP);
- **A very large increase in the euro zone's public deficit** (which would rise from 2.9% of GDP, its 2025 level, to 5.1% of GDP).

The **public debt ratio** would therefore rise, with the primary budget deficit increasing from 1.2% of GDP to 3.5% of GDP. This would result in **a situation in which financing the public deficit and public debt would become considerably more difficult**, as it would require continuously rising external borrowing, with a savings deficit replacing the current savings surplus.

Summary: boosting long-term growth in the euro zone would give rise to the risk of a public debt crisis

The long-term growth of the euro zone is currently weak, owing to low corporate investment ratios and low public investment ratios. To support long-term growth, euro zone countries would need to invest significantly more in equipment for the energy transition, in digital technologies, and in research and development. However, this additional investment would give rise to both an external deficit (on the current account) and a sharply increased public deficit. The euro zone would then depend on the rest of the world to finance its public deficit, which would substantially increase the risk of a public debt crisis.

In reality, if the savings rate remains unchanged, the euro zone faces a choice between maintaining weak long-term growth with a low investment ratio, and accepting the risk of a public debt crisis if it invests more — unless an increase in savings and a compression of consumption are factored in.

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