NATIXIS

FLASH ECONOMICS
ECONOMIC RESEARCH

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Above all, no pure Keynesian stimulus in the euro zone!

There is a lot of talk about stimulating growth in the euro zone, but really kick-starting growth should be achieved in another way than by simply boosting demand:

- ***the euro zone's key problem is the low level of potential growth and, therefore, the shortfall in supply; if this problem is not solved, increasing fiscal deficits now makes no sense;***

- ***stimulating demand in the euro zone's troubled countries will first and foremost lead to an increase in their imports and their external deficits in view of the supply-side deficiencies in these countries and the productive sector's inability to meet domestic demand.***

In all the countries where industry (the exporting sectors) is small, a pure stimulus of demand would have a few positive effects in the near term (reduction in the fiscal deficit, but hardly any drop in unemployment) but would absolutely not solve the long-term problem, in other words the inability to produce and create jobs in the exporting and sophisticated sectors. By consequence, we can only hope that the euro zone's stimulus programme will focus on investments generating long-term growth and exportable production capacity.

ECONOMIC RESEARCH
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Pressing requests to bolster growth in the euro zone

Growth prospects are very bleak in the euro zone (Charts 1A and **1B),** unemployment is on the rise and the capacity utilisation rate is lower than its average **(Chart 1C)**: all the components of demand are affected **(Chart 1D).**

Chart 1A
Euro zone: Real GDP growth (Y/Y as %)

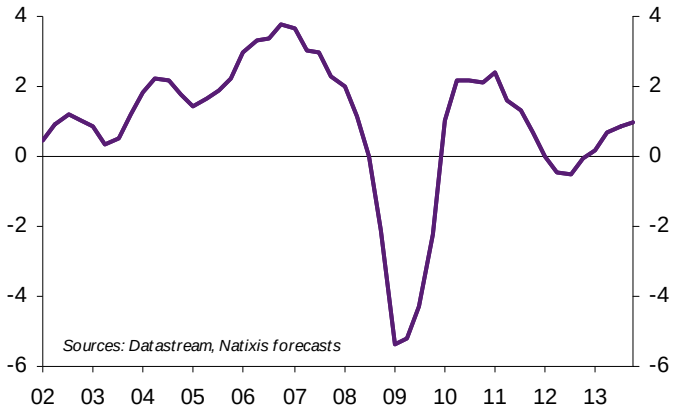


Chart 1B
Euro zone: PMI

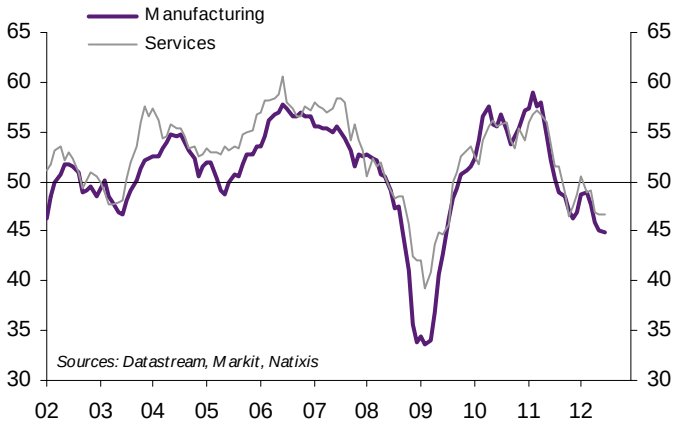


Chart 1C
Euro zone: Unemployment rate and capacity utilisation rate

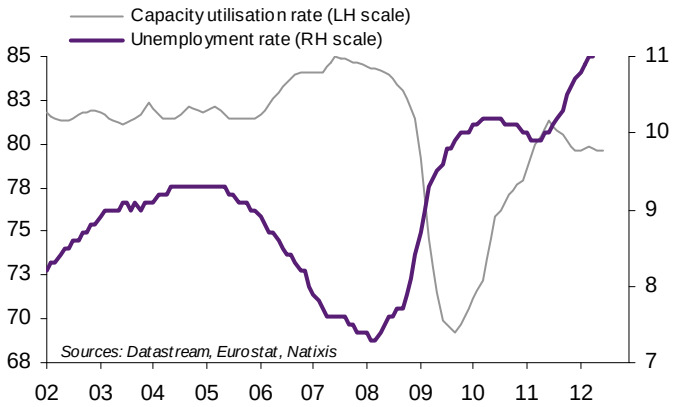
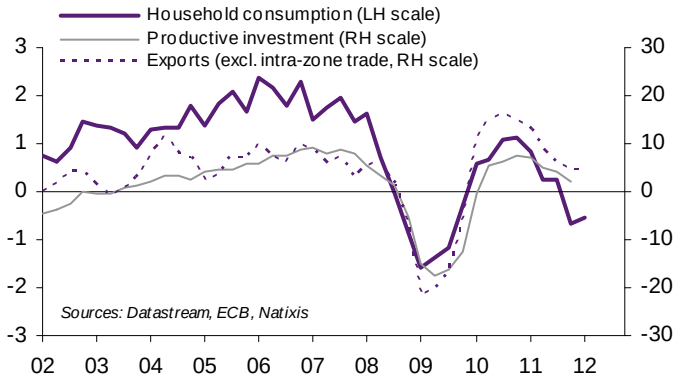


Chart 1D
Euro zone: Household consumption, productive investment and exports (in volume terms, Y/Y as %)



Growth is so sluggish that **fiscal deficits are no longer shrinking (Charts 2A** to **2E).**

Jump-starting growth in the euro zone is therefore now a very "popular" idea; there is talk of slowing down the pace at which fiscal deficits of euro-zone countries are being reduced **(Table 1)**, increasing EIB investments and European structural funds, using project bonds to finance investments, etc., since government investment is declining **(Chart 3).**

Chart 2A
Spain: Cumulative fiscal deficit (in EUR bn)

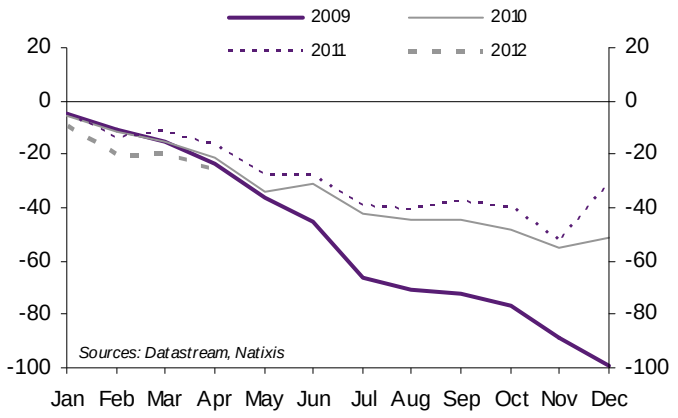


Chart 2B
Italy: Cumulative fiscal deficit (in EUR bn)

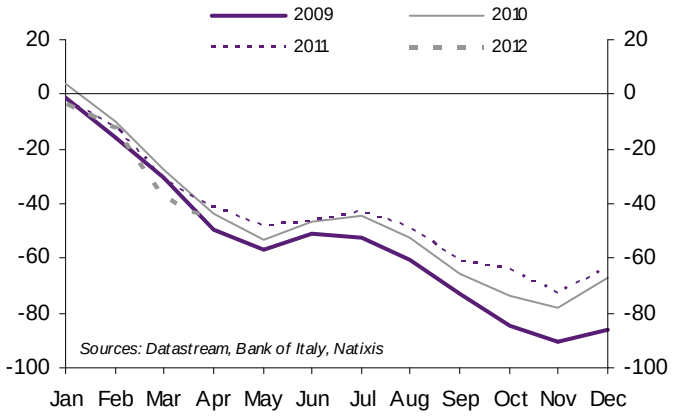


Chart 2C
Greece: Cumulative fiscal deficit (in EUR bn)

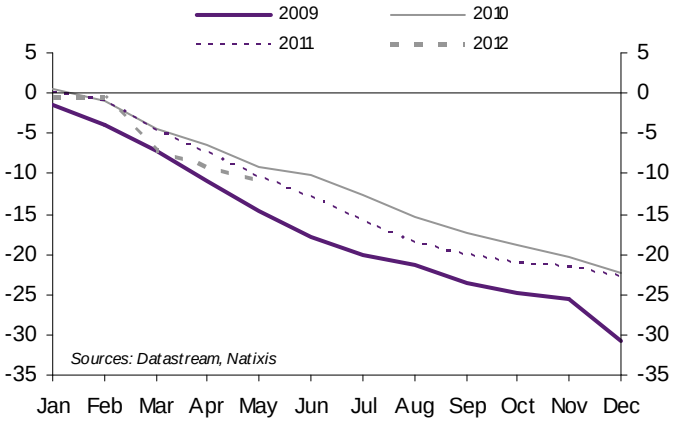


Chart 2D
Portugal: Cumulative fiscal deficit (in EUR bn)

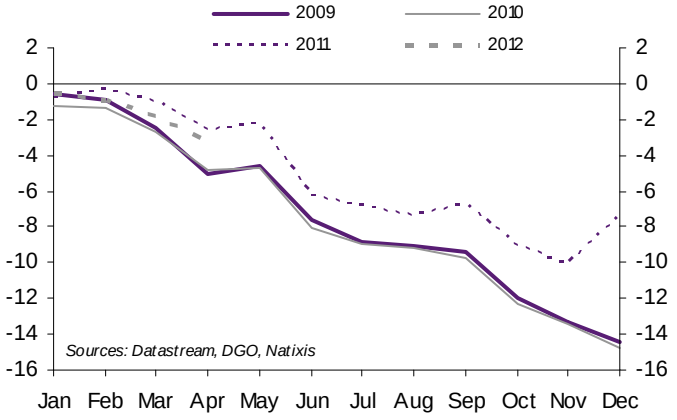


Chart 2E
France: Cumulative fiscal deficit (in EUR bn)

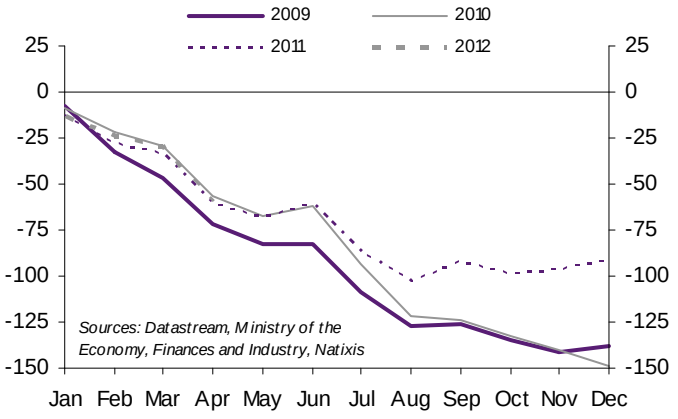


Chart 3
Euro zone: Government investment (as % of real GDP)

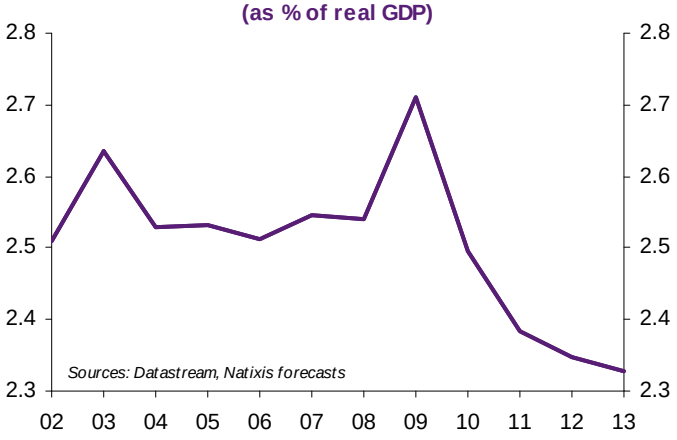


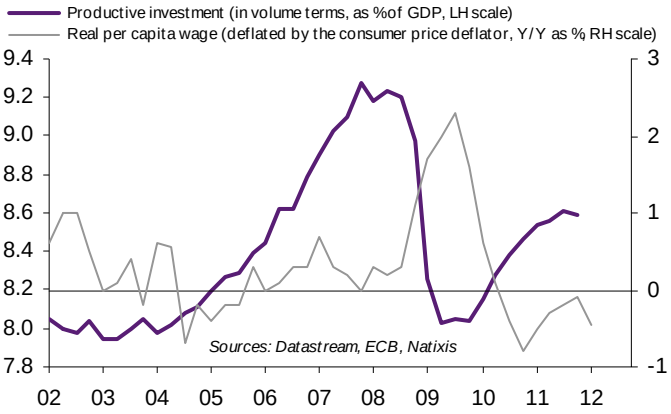
Table 1
Government forecasts of fiscal deficits (as % of GPD)

	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017
Germany	0.1	-3.3	-4.3	-1.0	-0.9	-0.6	-0.4	-0.2	-0.1	-
France	-3.3	-7.5	-7.0	-5.2	-4.5	-3.0	-2.3	-1.6	-0.8	-
Spain	-4.2	-11.2	-9.3	-8.9	-5.3	-3.0	-	-	-	-
Italy	-2.7	-5.2	-5.0	-3.9	-1.7	-0.5	-0.1	-	-	-
Portugal	-3.5	-10.0	-9.1	-4.2	-4.5	-3.0	-1.8	-0.5	-	-
Greece	-7.7	-15.4	-10.6	-8.5	-6.5	-4.9	-2.6	-1.1	-	-
Ireland*	-7.3	-11.7	-11.8	-9.4	-8.3	-7.5	-4.8	-2.8	-	-
Netherlands	0.5	-5.6	-5.1	-5.0	-4.6	-3.0	-	-	-	-
Austria	-0.9	-4.1	-4.5	-2.6	-3.2	-	-	-	-	-
Belgium	-1.3	-5.9	-4.1	-3.6	-2.8	-1.8	-0.8	-	-	-
Luxembourg	3.0	-0.9	-1.7	-1.0	-1.5	-1.2	-0.8	-		-
Finland	4.2	-2.6	-2.8	-0.8	-0.6	-0.7	-0.9	-0.9		-
Slovenia	-1.7	-6.0	-5.5	-5.5	-3.9	-2.9	-2.0	-		-
Cyprus	0.9	-6.0	-7.1	-4.0	-2.6	-2.0	-1.6	-		-
Estonia	-2.8	-1.7	-2.5	-0.4	-2.1	0. 1	0.5	1.0		-
Malta	-4.8	-3.8	-4.3	-2.8	-2.1	-1.6	-1.0	-		-
Euro zone as a whole	-2.0	-6.3	-6.0	-4.1	-3.1	-1.9	-1.2	-0.7	-	-

* Excluding bank recapitalisation
Sources: National sources, Natixis

Obviously, growth has to be boosted in the euro zone. When growth sinks to such a low level that unemployment soars, fiscal deficits can no longer be reduced, the business investment rate declines **(Chart 4)**, something that threatens long-term growth, and real wages drop (**Chart 4**), one has to react.

Chart 4
Euro zone: Productive investment and real per capita wage



However, we would like to defend the following idea in this Flash: **stimulating growth in euro zone must not consist only in stimulating demand.**

Why a simple Keynesian stimulus would be inefficient

Basing the stimulating of growth in the euro zone on merely boosting demand in our opinion would be extremely inefficient:

(1) **The euro zone's key problem is the low level of potential growth and, therefore, of the supply** of goods and services. When we look at the trend in productivity gains and the demographic outlook **(Charts 5A** and **5B),** we can see that the **euro zone's potential growth is anaemic** (*circa* 1% per year), and weaker than in the United States, Sweden and the United Kingdom. This low level of potential growth in the euro zone is accounted for in particular by **the insufficient innovation and higher education drive (Tables 2A, 2B** and **2C),** and a Keynesian stimulus would not solve this problem.

Chart 5A
Per capita productivity (1998:1 = 100)

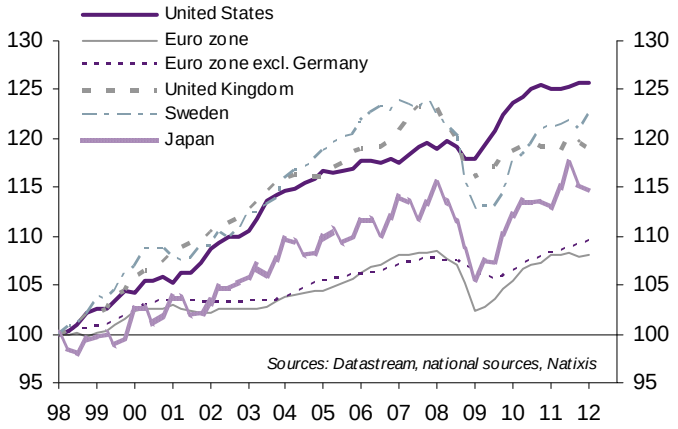


Chart 5B
Growth in population aged 20 to 60
(as % per year)

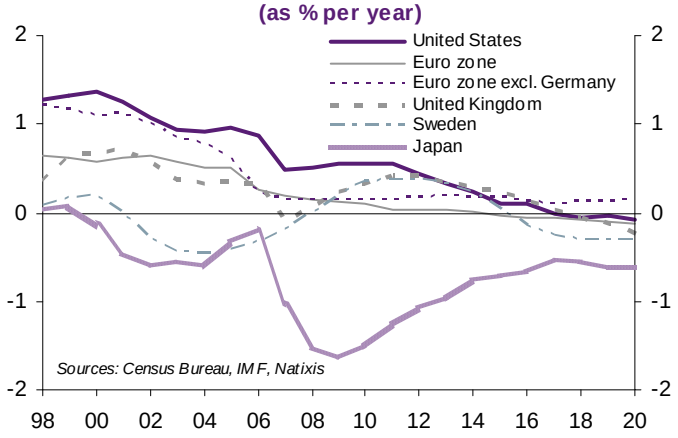


Table 2A
Total R&D expenditure (as % of GDP)

Country	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
United States	2.60	2.64	2.71	2.72	2.62	2.61	2.54	2.57	2.61	2.67	2.79	2.78	-
United Kingdom	1.76	1.82	1.81	1.79	1.79	1.75	1.68	1.73	1.75	1.78	1.79	1.86	1.77
Euro zone	1.71	1.78	1.84	1.86	1.88	1.87	1.85	1.84	1.87	1.88	1.96	2.06	2.06
Euro zone excluding Germany	1.50	1.54	1.61	1.63	1.65	1.62	1.61	1.59	1.62	1.63	1.68	1.77	1.77
Japan	3.00	3.02	3.04	3.12	3.17	3.20	3.17	3.32	3.40	3.44	3.44	3.33	-
Sweden	3.53	3.58	3.86	4.13	3.97	3.80	3.58	3.56	3.68	3.40	3.70	3.61	3.42

Sources: Main Science and Technology Indicators 2011, Eurostat, Natixis

Table 2B
Number of triadic patents (per million inhabitants)

Country	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
United States	54.13	58.36	55.48	54.09	55.69	51.97	51.90	51.77	50.82	48.17	45.83	44.75
United Kingdom	27.83	33.56	27.72	27.46	28.06	27.19	27.45	27.39	27.30	27.41	26.92	26.47
Euro zone	38.12	40.51	39.90	40.60	39.36	37.88	38.89	38.72	40.68	40.25	39.40	38.74
Euro zone excluding Germany	25.26	26.35	26.25	27.31	26.14	25.91	27.47	26.92	28.15	27.68	27.36	26.88
Sweden	102.33	107.86	67.80	66.33	73.93	75.02	77.89	91.96	104.01	104.39	102.55	99.35
Japan	86.75	95.33	116.09	107.51	109.57	104.75	107.63	108.53	107.71	108.74	107.86	104.62

Sources: Main Science and Technology Indicators 2010, OECD, Natixis

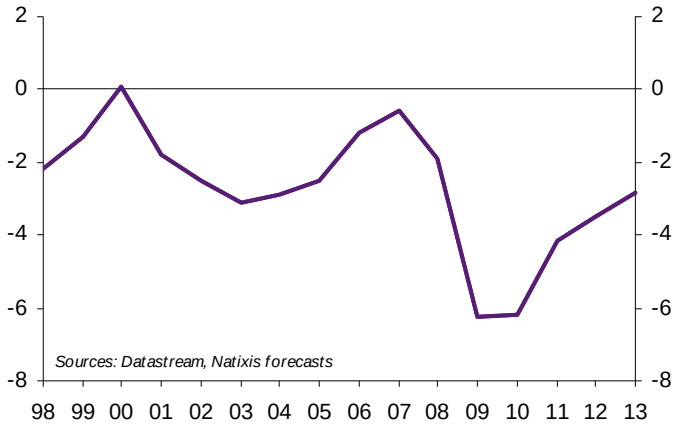
Table 2C
Expenditure on higher education per student (in equivalents of US dollars converted on the basis of PPP)

Country	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
United States	19,220	20,358	22,234	20,545	24,074	22,476	24,370	25,109	27,010	29,910
United Kingdom	9,554	9,657	10,753	11,822	11,866	11,484	13,506	15,447	15,463	15,310
Euro zone	8,524	9,085	9,214	9,657	10,413	10,484	10,799	11,449	12,253	13,509
Euro zone excluding Germany	7,328	7,926	8,388	8,798	9,658	9,352	9,746	10,448	11,250	12,307
Japan	10,278	10,914	11,164	11,716	11,556	12,193	12,326	13,418	14,201	14,890
Sweden	14,222	15,097	15,188	15,715	16,073	16,218	15,946	16,991	18,361	20,014

Sources: OECD, Education at a Glance 2011, Natixis

If the problem of boosting supply is not solved, increasing the fiscal deficit now (or reducing them to a lesser extent, **Chart 5C**) **is meaningless since the fiscal deficit will have to be cut in the future while the supply of goods will not be higher.**

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



(2) In many troubled countries, boosting demand would have very few positive effects

To a large extent, many of the difficulties faced by troubled euro-zone countries (Spain, Portugal, Greece and France) **are due to the small size of their industry (Chart 6A),** and accordingly their inability to have sufficiently large exports and to balance their external trade **(Chart 6B).**

Chart 6A
Value added in the manufacturing sector
(in volume terms, as % of GDP)

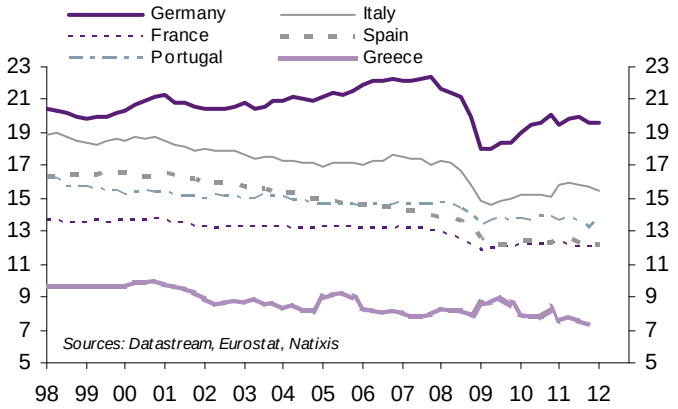
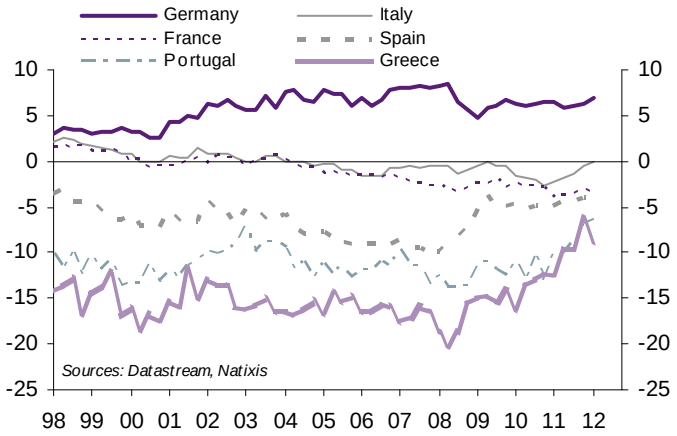


Chart 6B
Trade balance (as % of GDP)



These countries are therefore characterised by **the inability of productive capacity to meet domestic demand (industrial demand primarily, Charts 7A, 7B, 7C, 7D** and **7E),** in Spain, Greece, Portugal until 2008, and France, and even in Italy.

Chart 7A
Spain: Production capacity, value added and domestic demand in the manufacturing sector (1998:1 = 100)

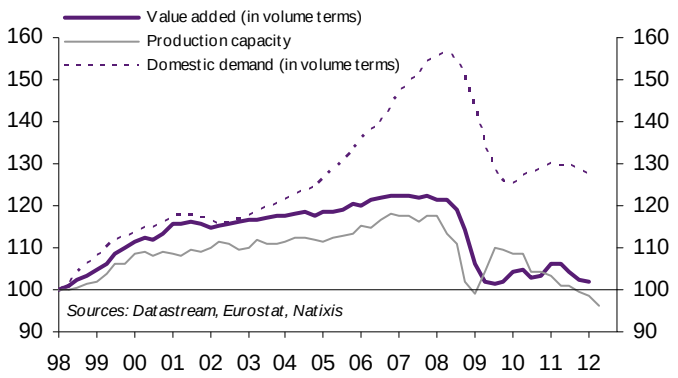


Chart 7B
Greece: Production capacity, value added and domestic demand in the manufacturing sector (1998:1 = 100)

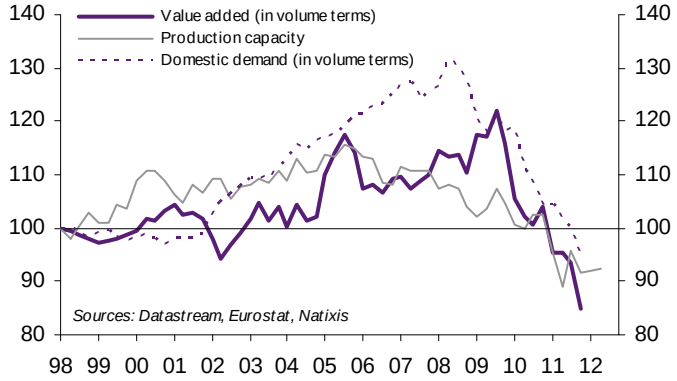


Chart 7C
Portugal: Production capacity, value added and domestic demand in the manufacturing sector (1998:1 = 100)

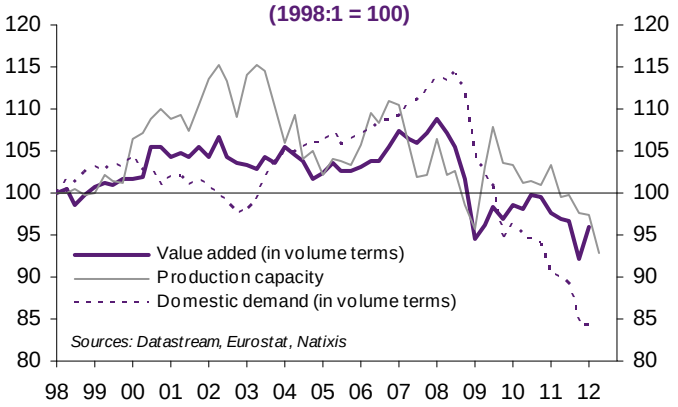


Chart 7D
France: Production capacity, value added and domestic demand in the manufacturing sector (1998:1 = 100)

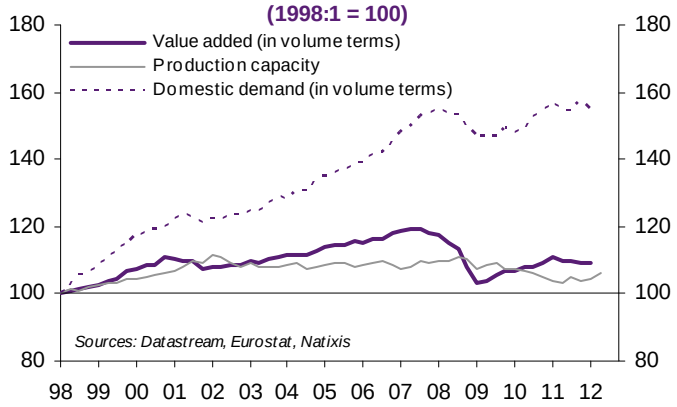
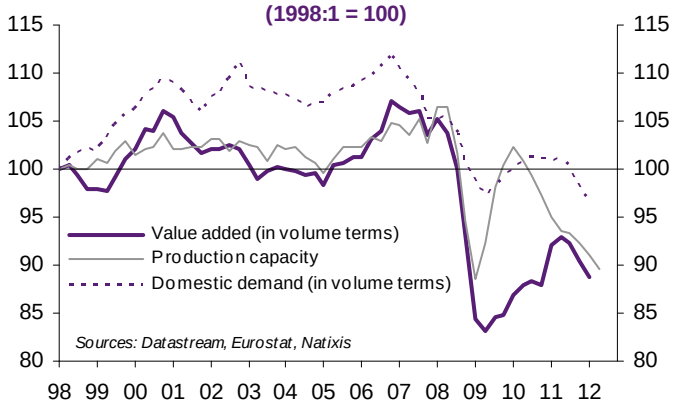


Chart 7E
Italy: Production capacity, value added and domestic demand in the manufacturing sector (1998:1 = 100)



Stimulating demand in these countries would thus lead above all to an increase in imports and a deterioration in external trade (Charts 8A, 8B, 8C, 8D and 8E).

Chart 8A
Spain: Domestic demand, imports and current-account balance

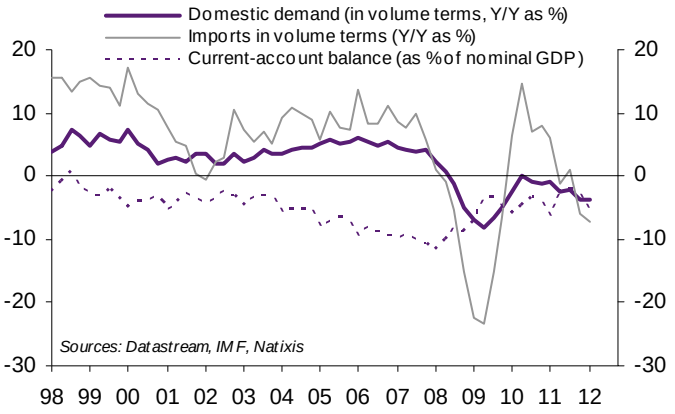


Chart 8B
Greece: Domestic demand, imports and current-account balance

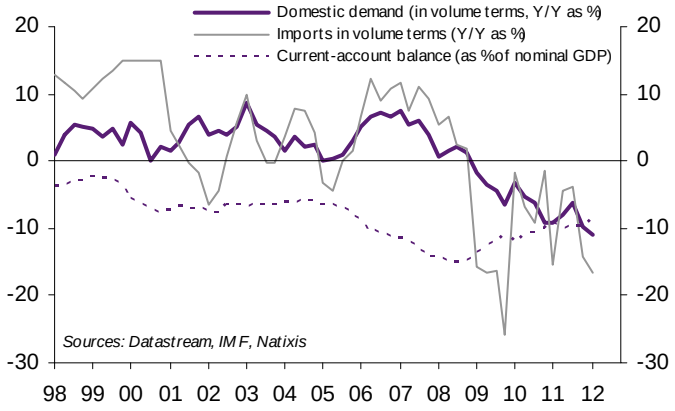


Chart 8C
Portugal: Domestic demand, imports and current-account balance

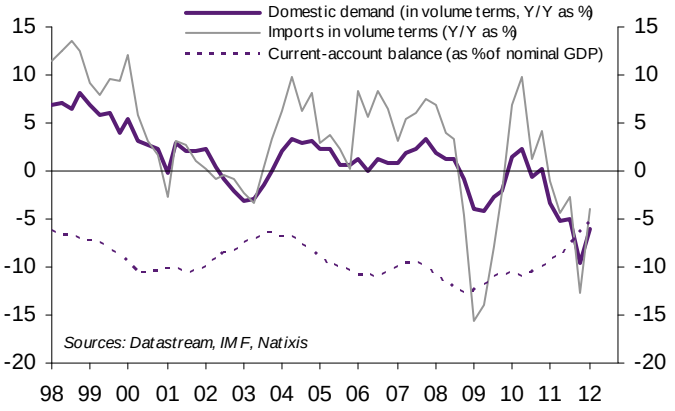


Chart 8D
France: Domestic demand, imports and current-account balance

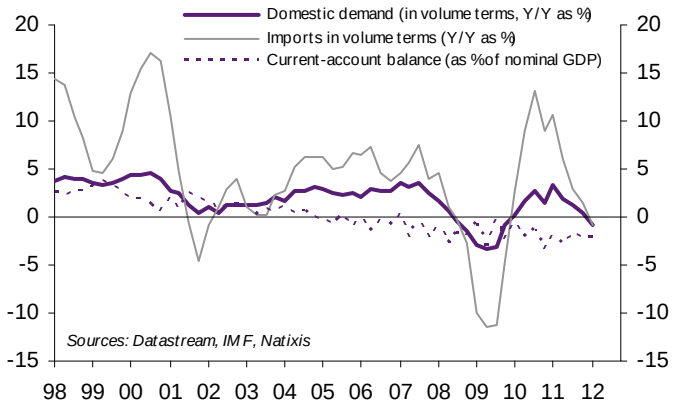
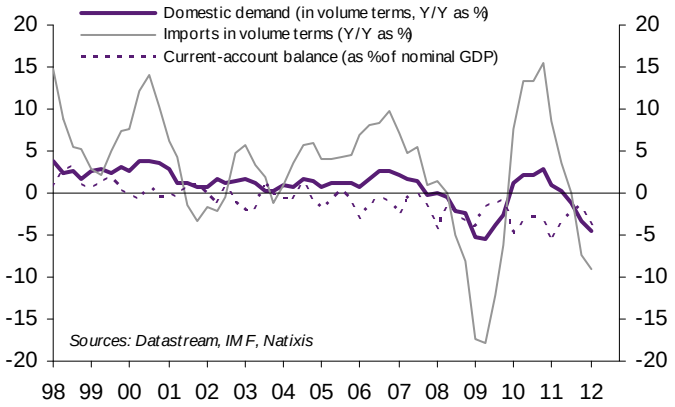


Chart 8E
Italy: Domestic demand, imports and current-account balance



When domestic demand was robust (in 2003-2007 in particular), these countries witnessed a surge in imports; this was still the case in 2010 in Spain, Portugal, France and Italy.

Conclusion: A pure Keynesian stimulus would hardly improve anything in the euro zone

The euro zone's very weak growth results in obvious negative effects on the job market, the capacity to reduce fiscal deficits and future potential growth.

However, we believe that boosting growth in the euro zone through a pure Keynesian stimulus would be very inefficient:

- **the euro zone suffers from a problem of potential growth and, therefore, of supply;**
- **increasing fiscal deficits now would impose reducing them again soon, and this is meaningless if supply has not been increased;**
- **in many euro-zone countries, boosting demand primarily results in additional imports and a deterioration in external trade.**

We must therefore hope that growth will be boosted in the euro zone by policies aimed at bolstering investment that leads to additional long-term growth and building up additional exportable production capacity.

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