

Part I (missing bricks) : From Investment to Capital Financing

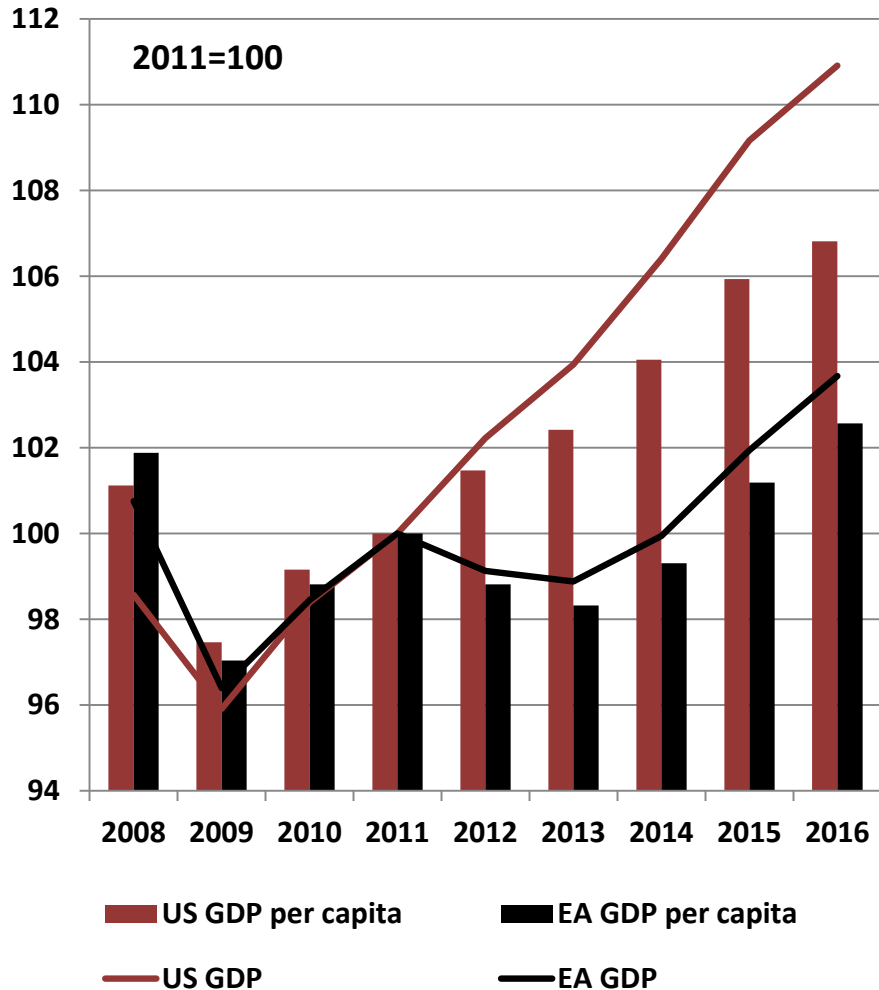
- 1. Context & deficit in (productive) investment**
- 2. 'Debt addiction' vs 'lack of equity' (high risk premium)**
- 3. Financing Union for Investment & Innovation**

Marc-Olivier Strauss-Kahn, Director General, Banque de France *

*** This document does not reflect the position of the Banque de France or the Eurosystem**

1. Growth context & deficit in (productive) investment

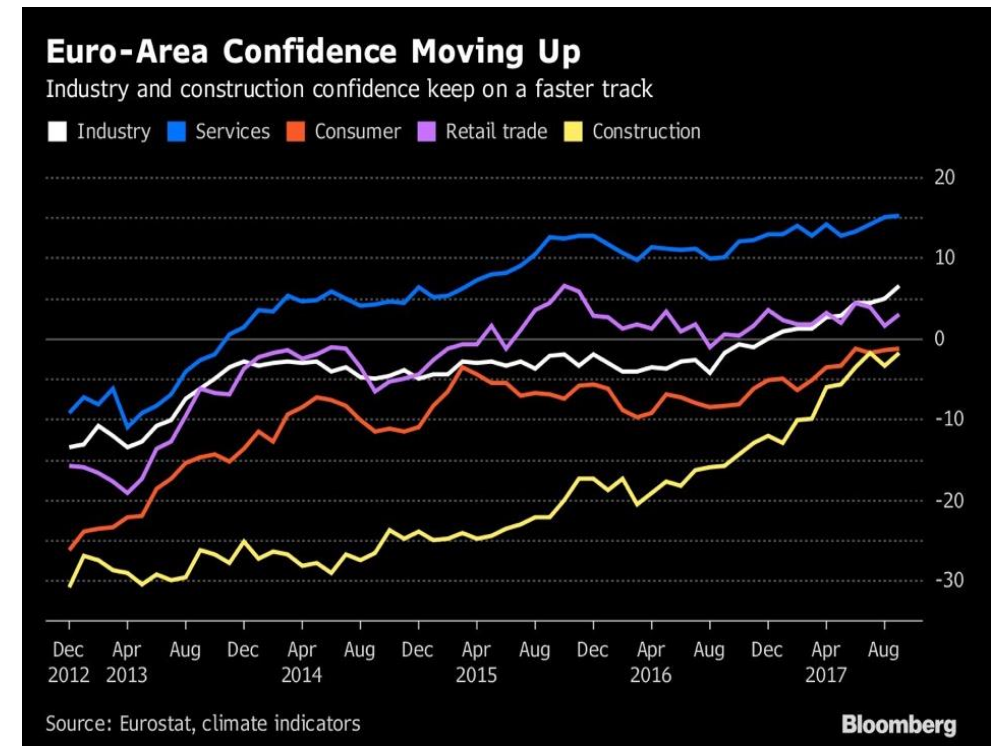
After a 'lost decade', better EA prospects (both in economics & politics?)



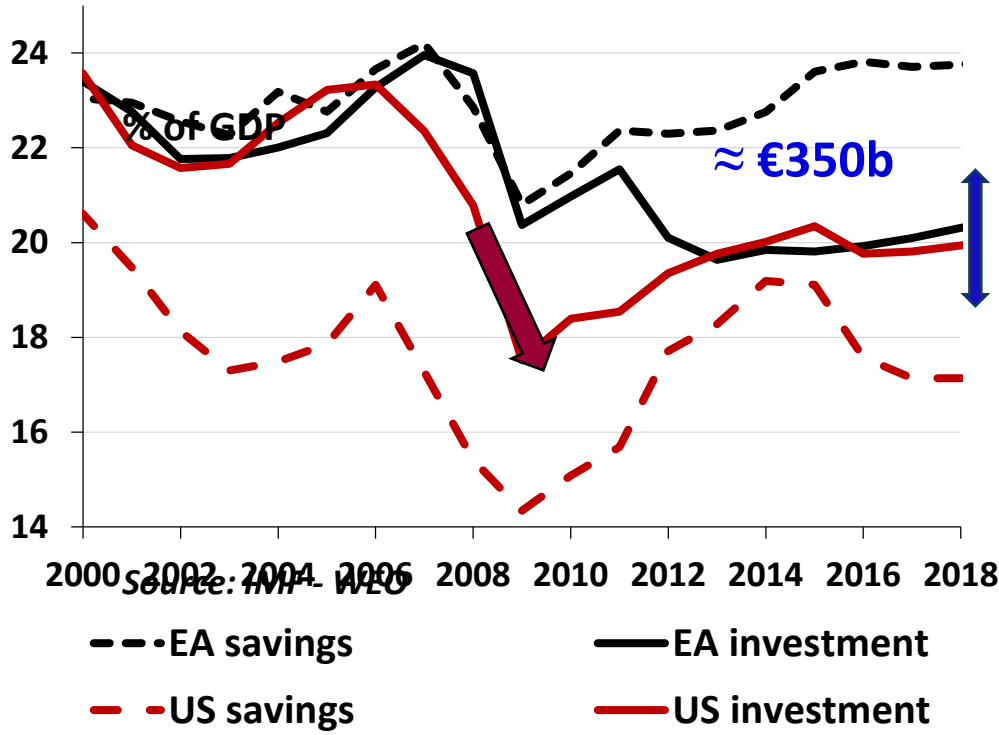
EA ≈ US forecasts
despite slower
demographics

	WEO	USA		EA
2016		1.5	<	1.8
2017		2.2	≈	2.1
2018		2.3	>	1.9

EA confidence
at its highest



1... Yet persistent EA deficit in (productive) investment

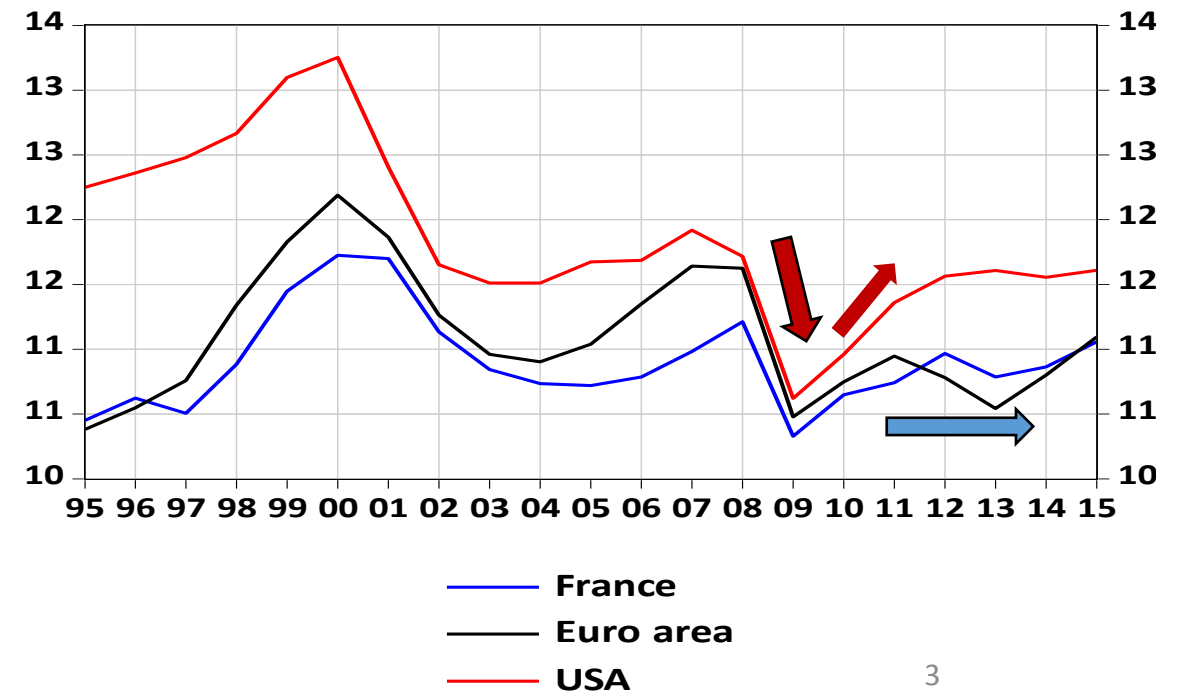


Productive inv. (= inv. excl. construction) has not recovered enough in the EA or FR, unlike in the US (as % of GDP)

Both **US & EA** investment/GDP ratios remain below pre-crisis levels.

EA: the savings surplus could be put to better use within the area.

Ratio of productive investment to value added, Total economy (% values)

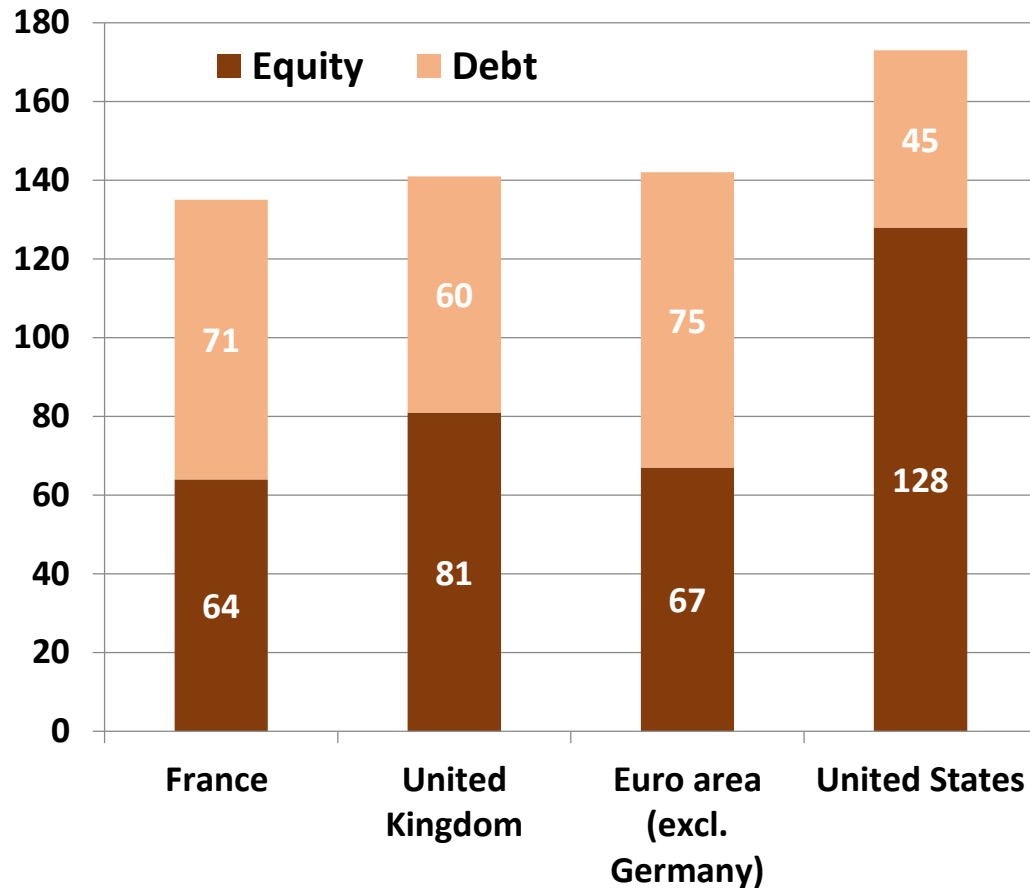


Sources: Eurostat, BEA, Board of the Federal Reserve System

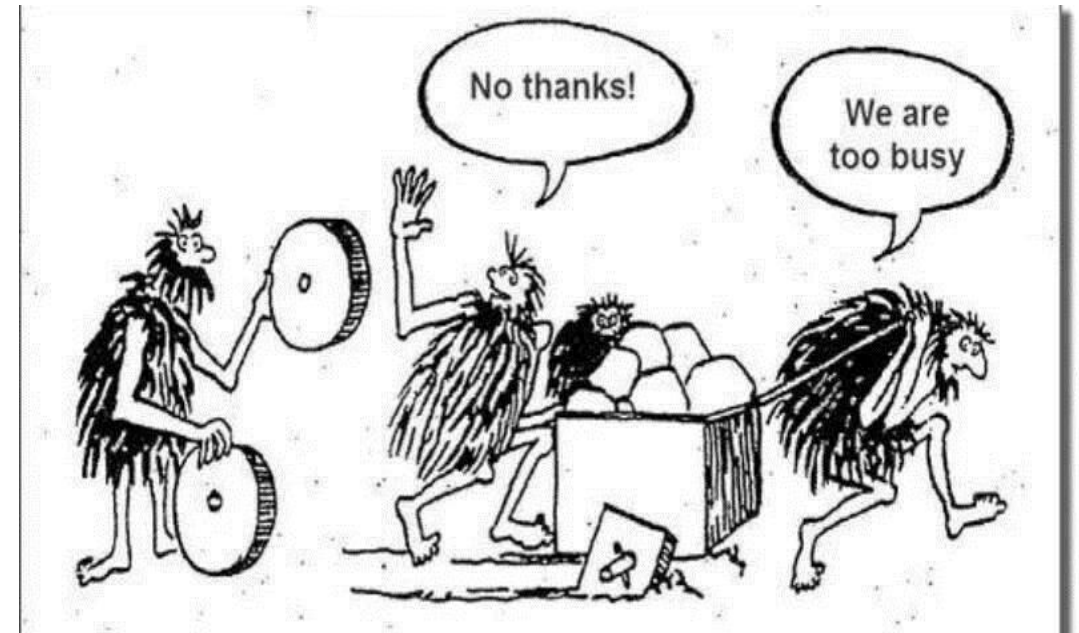
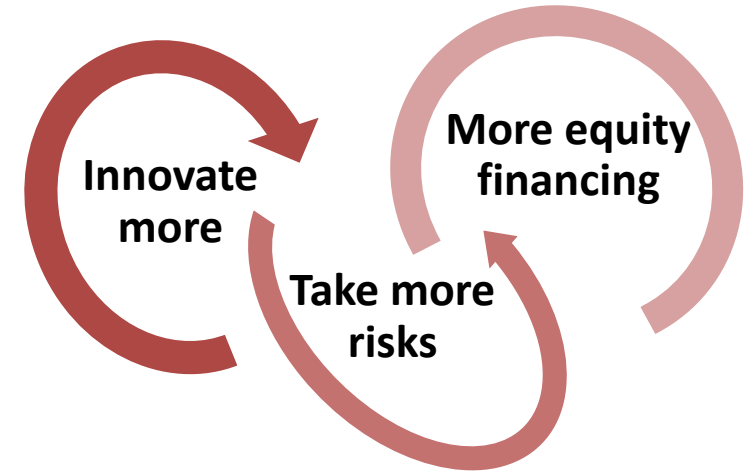
2. Risk-taking versus insufficient EA equity capital

Higher risk and longer-term return on innovative projects imply that **equity financing is more suitable than debt**

NFC liabilities: net equity capital & financial debt, % of GDP

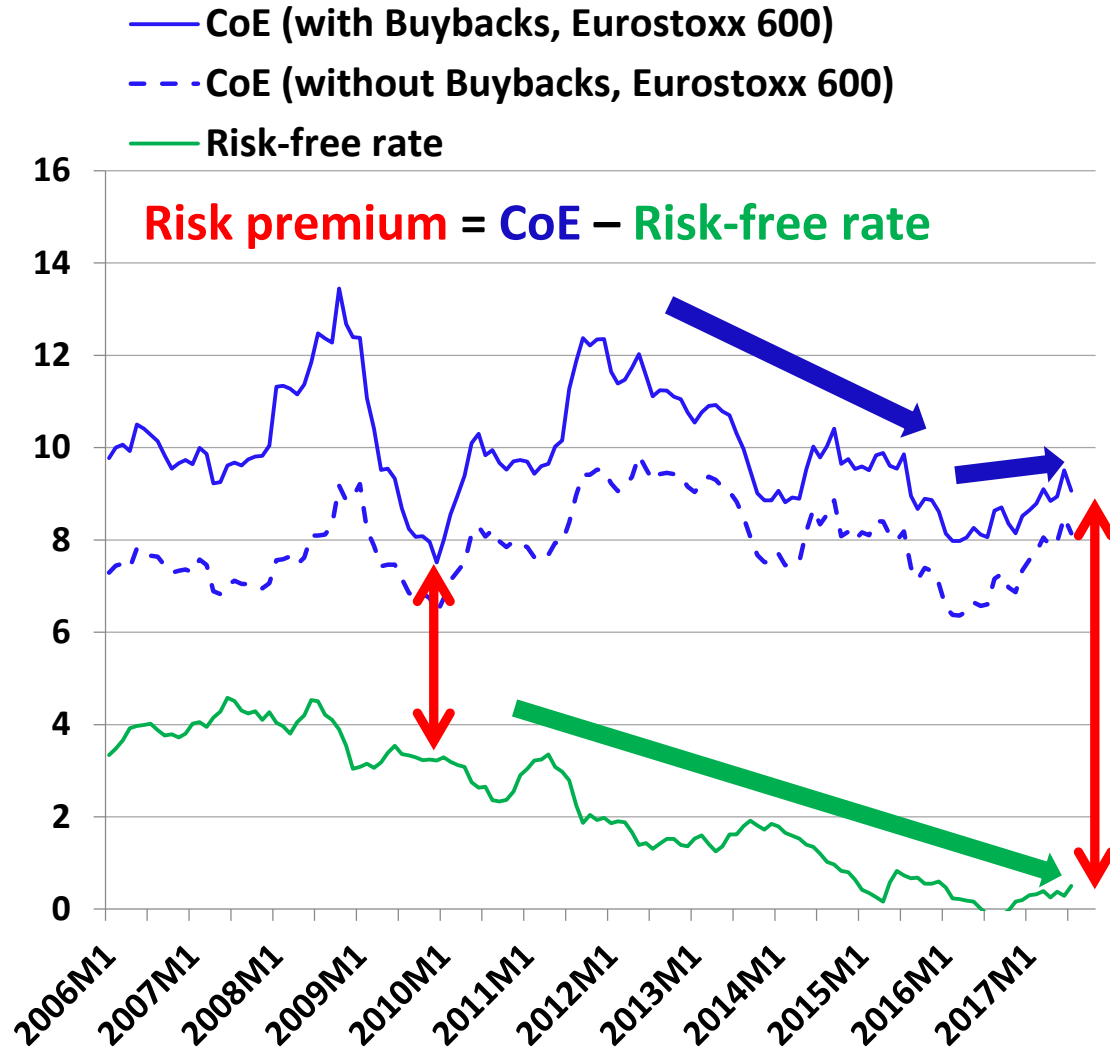


BDF: Q4 2016 data



2... Persistently high Cost of Equity & risk premium

Change in the CoE of EA large Non Financial Corporates (2006-2017) *



The risk-free rate has fallen by ≈ 400 bp relative to pre-crisis levels

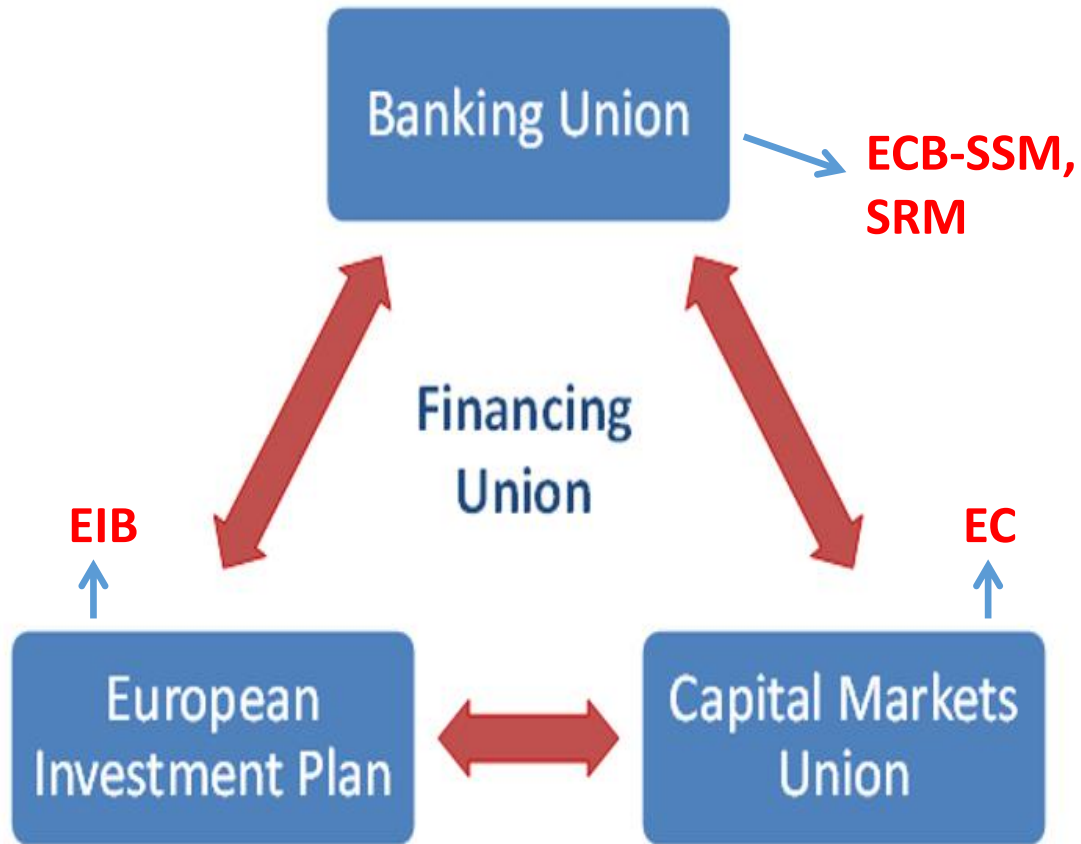
CoE (return demanded by investors to compensate for risk) has fallen to a much smaller extent (≈ 100 bp)

The difference is the risk premium which has risen by 600-900 bp, and is dragging on investment

Sources: Bloomberg, ECB and BdF calculations

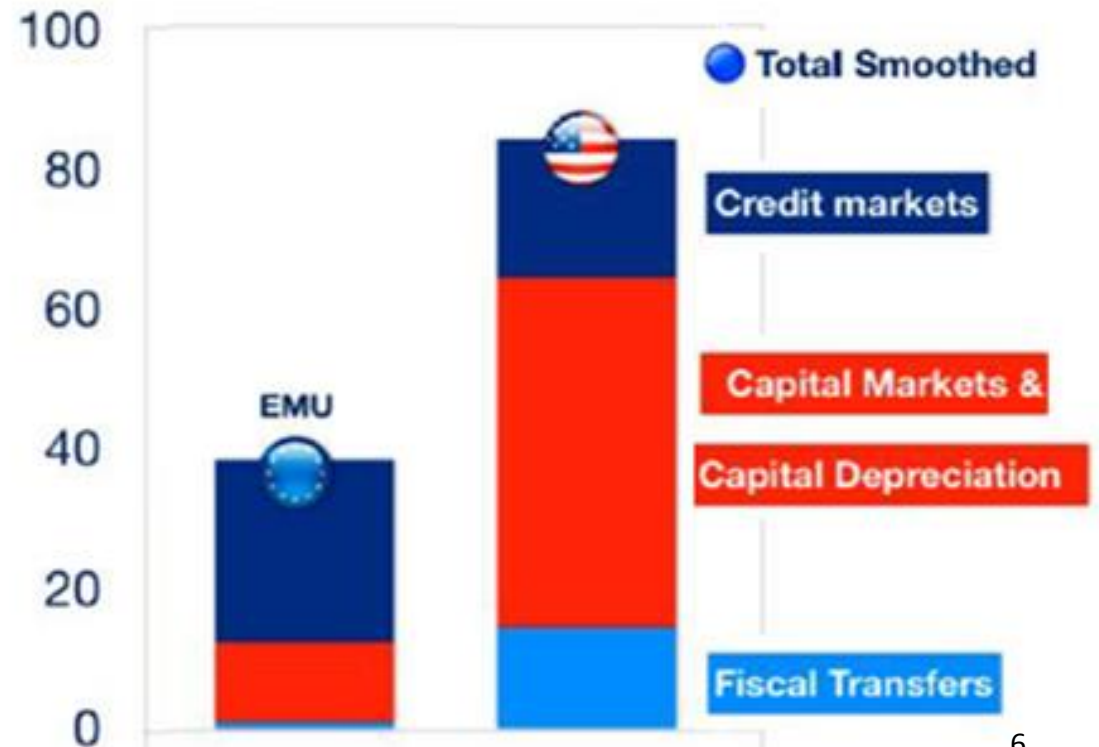
* "The cost of equity for large non-financial companies ..." (Mazet-Sonilhac & Mésonnier, 2016), Bulletin, BDF; see also BLOG BDF 10.5.17

3. Need of Financing Union for Investment & Innovation



Foster consistency & synergies between existing initiatives, **different** institutions and various sources of funding

% of a state income shock (GDP) smoothed by other states through various channels

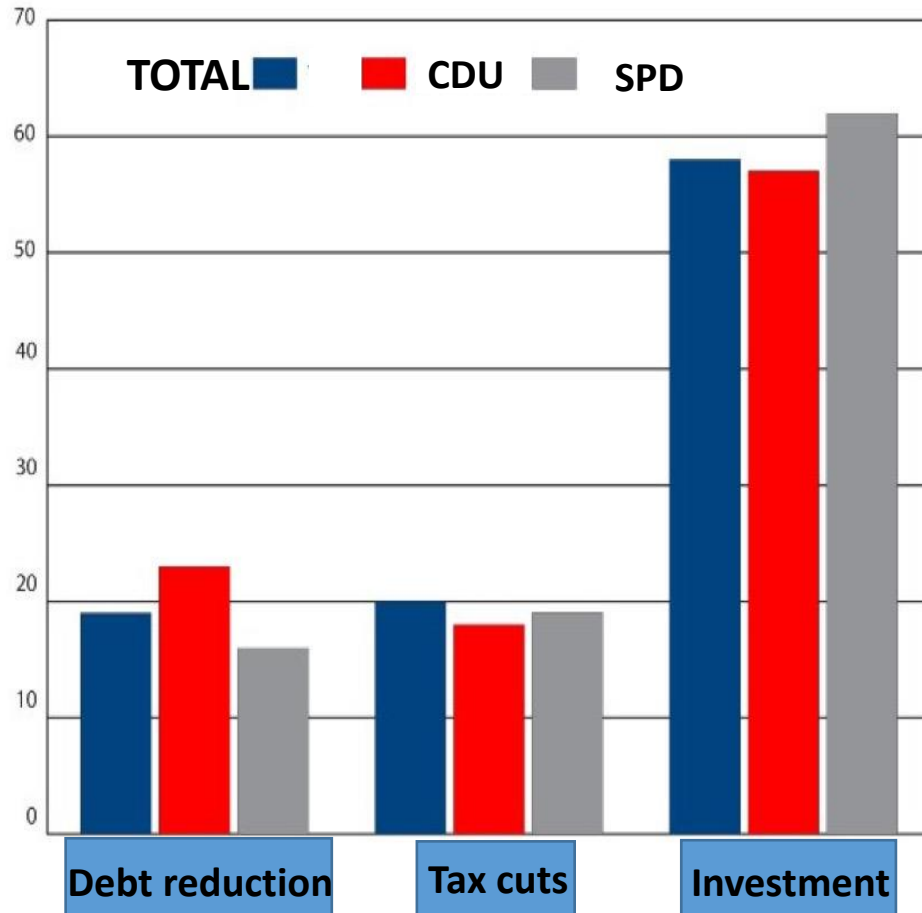


Europe needs a Financing Union for Investment & Innovation by E. Vidon et M. Després, BLOG: *Eco notepad of the BdF*

SOURCES: Sorensen and Yosha (1998) for the United States;

Afonso and Furceri (2008) for the Economic Monetary Union

How to spend the German federal budget?



Source: Infratest Dimap, July 2017.

Part II (Time factor): Breaking with muddle through

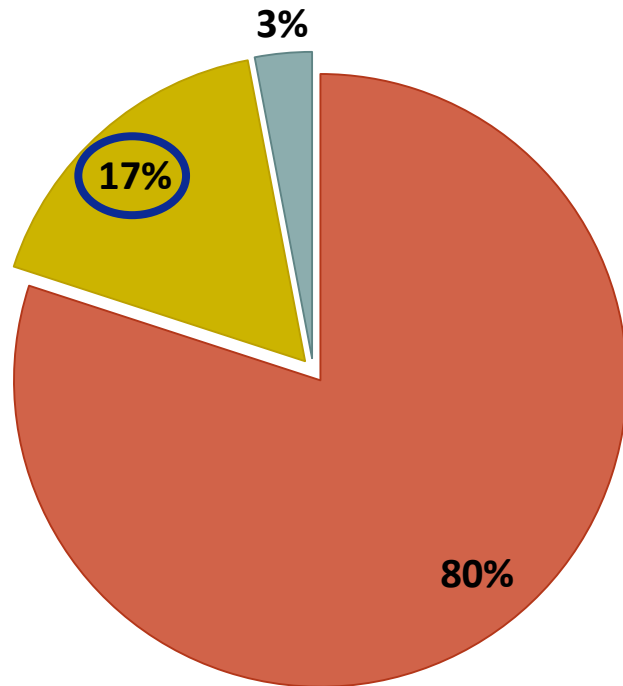
1. Uncertainty & regulation hamper investment
2. Towards a triangle for growth

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1. Investment OBSTACLES: slack, uncertainty, regulation

Determinants of Short-Term investment: advanced economies

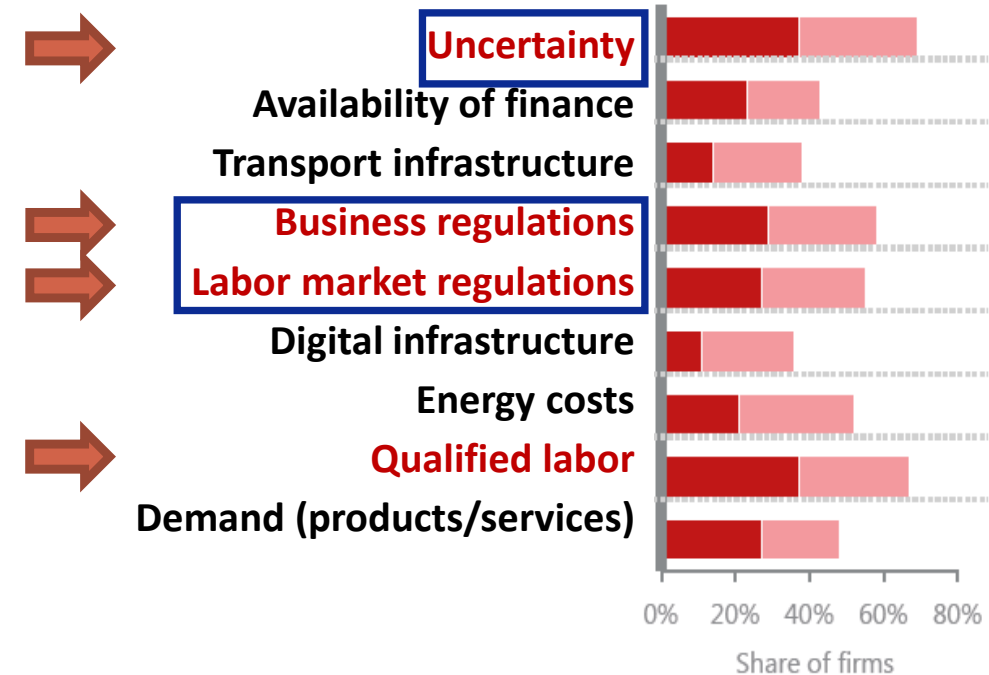


■ expected demand ■ **uncertainty** ■ other

Contrib. to slowdown in business investment, panel of 22 advanced economies, 1996-2014

M. Bussière, L. Ferrara, J. Milovich, "Explaining the recent slump in investment: the role of expected demand and uncertainty", Banque de France WP No 571, September 2015

Barriers to Long-Term investment: Europe



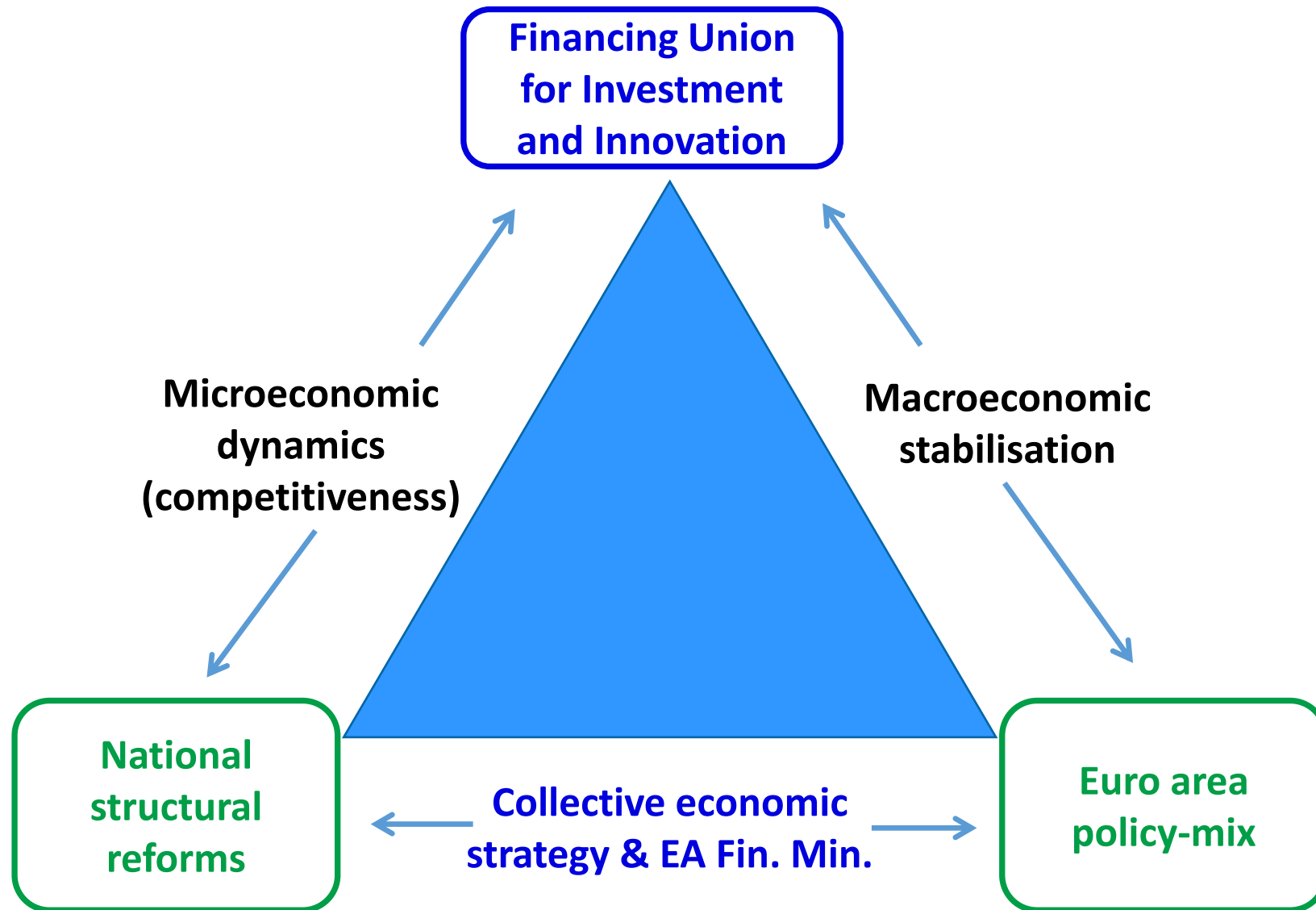
■ A major obstacle ■ A minor obstacle

Base: EU average of all firms (data not shown for those who said not an obstacle at all/don't know/refused)

Q. Thinking about your investment activities in #country#, to what extent is each of the following an obstacle? Is a major obstacle, a minor obstacle or not an obstacle at all?

EIB survey: investment & investment finance, 2016

2. TOWARD A TRIANGLE FOR GROWTH



The EA Finance Minister & its means

EA FM

Define & supervise:
EA collective strategy

Manage:
EA convergence fund, then budget

Implement:
Centralized crisis management

Institution

Legitimacy:
Appointment process & international role

Capacity:
Treasury administration & advisory councils

Accountability:
Stronger democratic control over EA affairs

SUMMARY RECAP

A “Financing Union for Investment & Innovation”

Better channel EA savings (CA surplus \approx € 350 bn / year) towards productive investment across borders

F.U.I.I. = Capital Markets Union + Juncker Plan + Banking Union



A collective economic strategy

Combine more structural reforms (France, Italy) and more fiscal support (Germany)

An institution fostering confidence: the EA Finance Minister



In the longer term, a European fiscal capacity

A EA stabilization tool: unemployment insurance scheme

A means to finance certain « European public goods »

The ability to issue common debt and even raise taxes

Annex: CHRONOLOGY OF THE EA CRISIS AND INSTITUTIONAL RESPONSE

