

Welcome to the NBB Conference 2024

Deglobalisation, decarbonisation and digitalisation

How the three Ds affect firm pricing,
markups and productivity

Pierre Wunsch, Governor

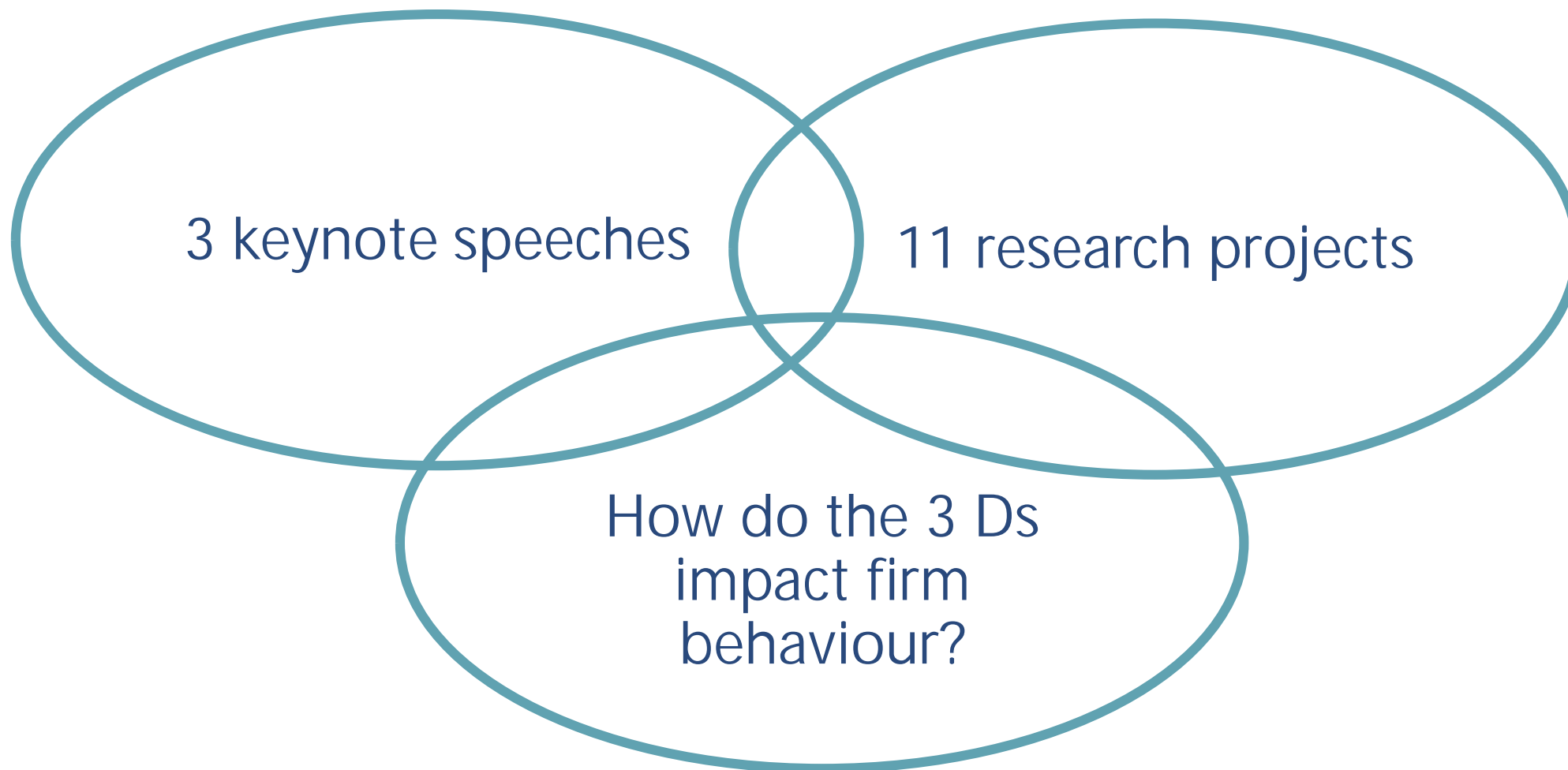
3 October 2024



The coming days we discuss 3 structural supply side forces



During the conference we combine high-level keynotes with in-depth research



Keynote Insights: unpacking the 3Ds

Deglobalisation, Decarbonisation, and Digitalisation



- Challenges and successes of renewable integration
- Political economy of the phase-out of fossil fuels
- Relevance: a more efficient (i.e. cheaper) energy system is key for European competitiveness



- Reflection on past, present and future productivity growth
- Factors behind recent productivity growth slowdown and potential of new sources of innovation
- Relevance: Europe cannot afford to miss out (again) on the next wave (AI)



- New perspectives on global value chains
- Empirical and theoretical challenges of multi-country corporate production and sourcing decisions
- Relevance: need to understand firms' response to policy interventions and other shocks

11 contributions covering a wide range of topics



Economic situation and structural challenges in the EU and Belgium

Waiting for the recovery or Eurosclerosis 2.0 ?

Pierre Wunsch, Governor

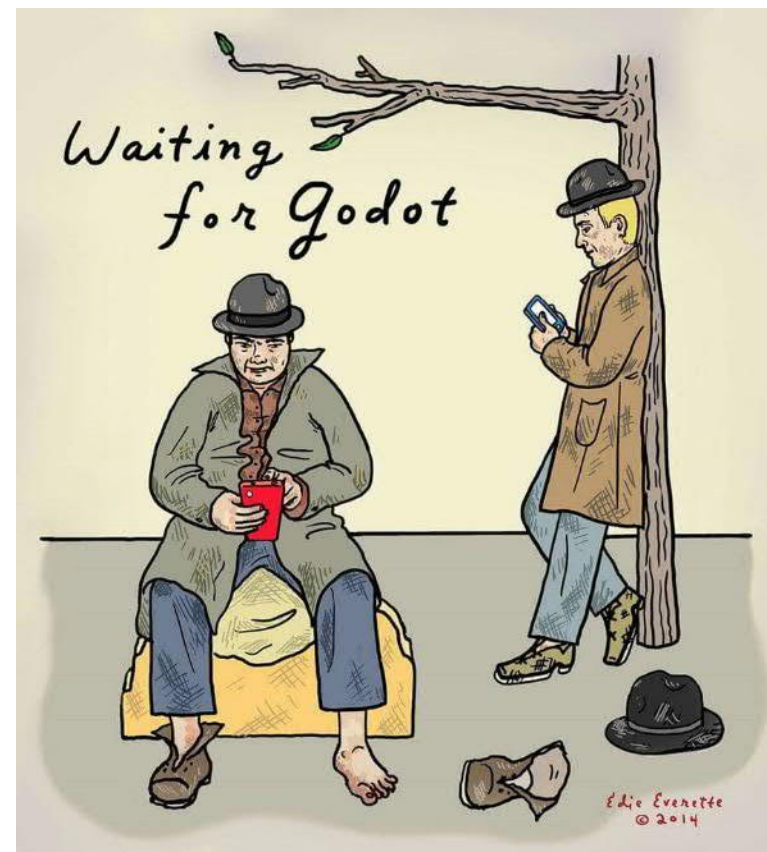
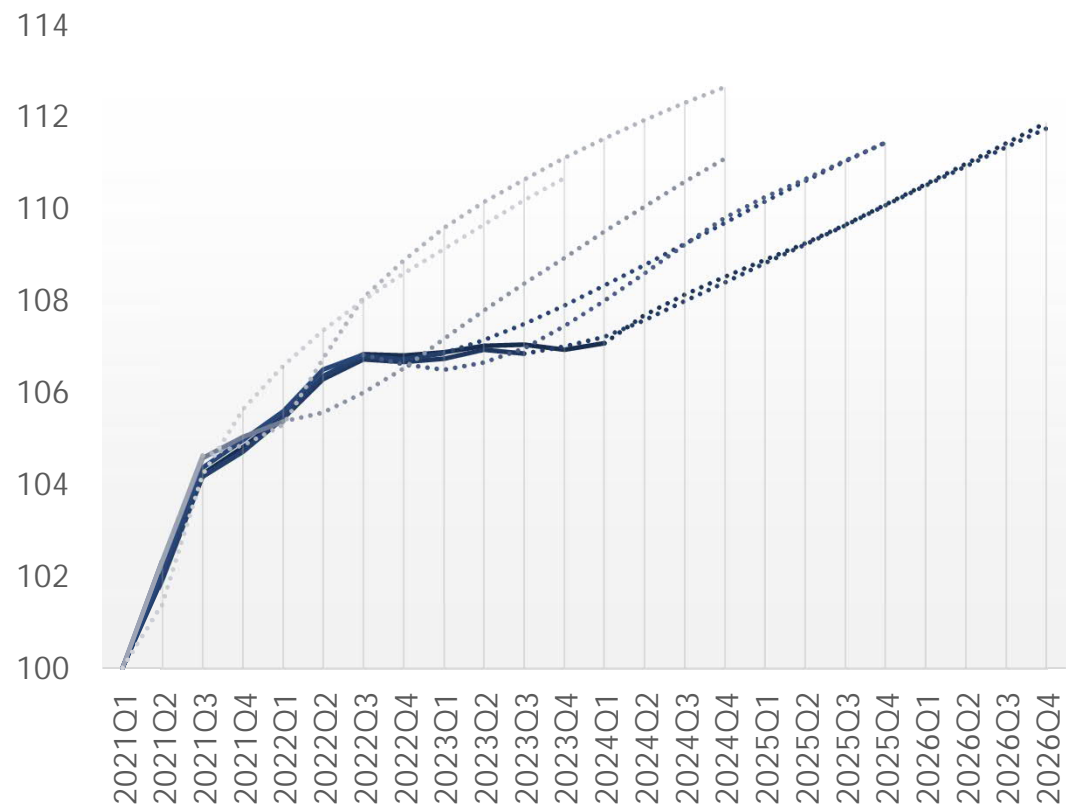
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The euro area recovery was announced but was delayed several times ...

Forecast vintages for EA real GDP

(volume index, 2021Q1 = 100: Eurosystem and ECB projections)



How much of the slump is cyclical and how much is structural?

We have our strengths, champions and unicorns ...

LVMH

BIONTECH



ASML



accenture



odoo

... but, overall, European companies are gradually losing ground

We do not like disruptive growth!

The EU is traditionally good at incremental technological progress in specific industries

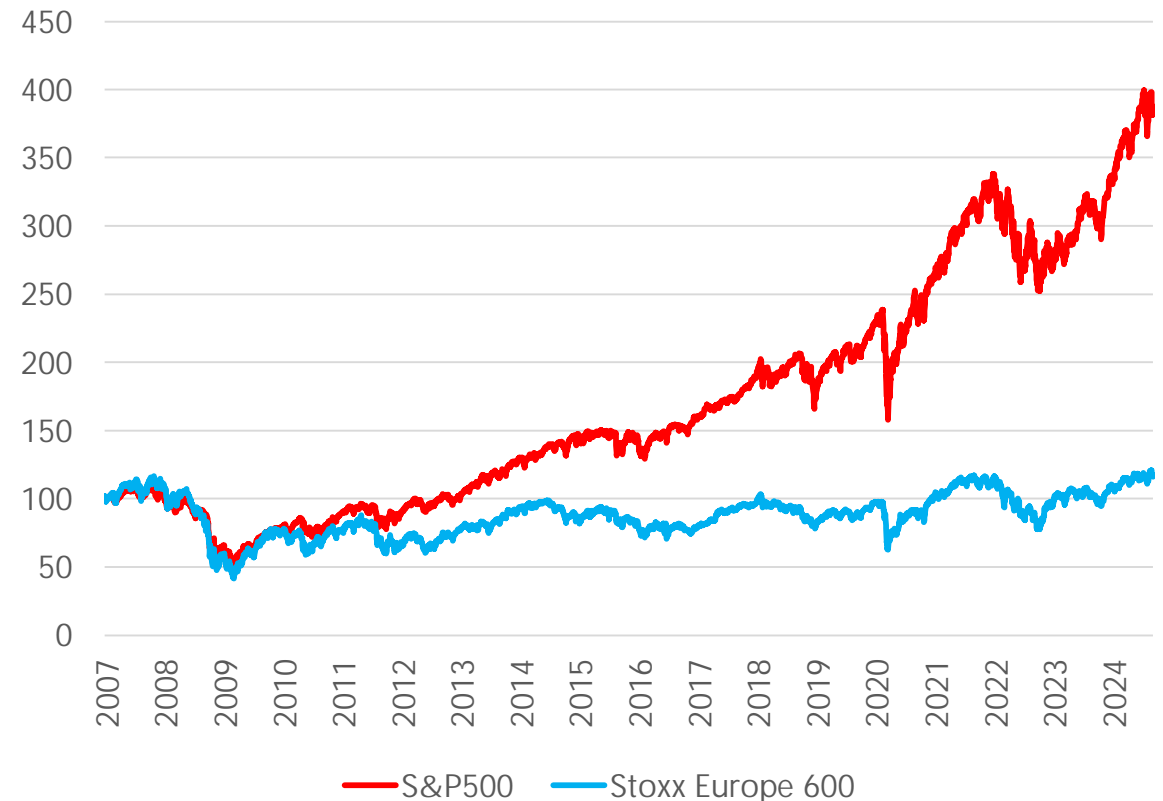
- Combustion engine cars, robotics, optics, pharmaceuticals, airplanes...
- Our culture and institutions (labour market/ capital markets...) play against speed and disruption
- Jobs & Musk and the like are not part of our star system

Our first inclination is to control and regulate

- GDPR, AI, ...
- INEOS

Stoxx Europe 600 vs S&P500 market capitalisation

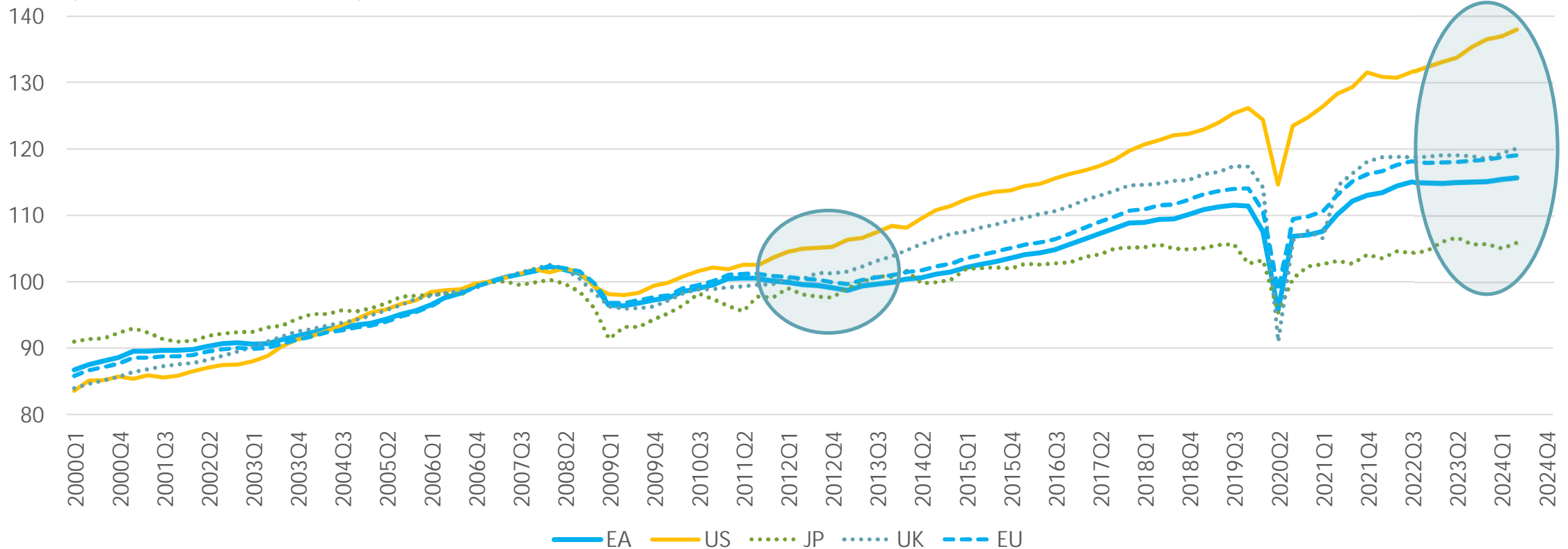
(index, 01/01/2007 = 100, in \$)



...and the gap with the US is widening.

Real GDP growth: international comparison

(volume index, 2007Q1 = 100)

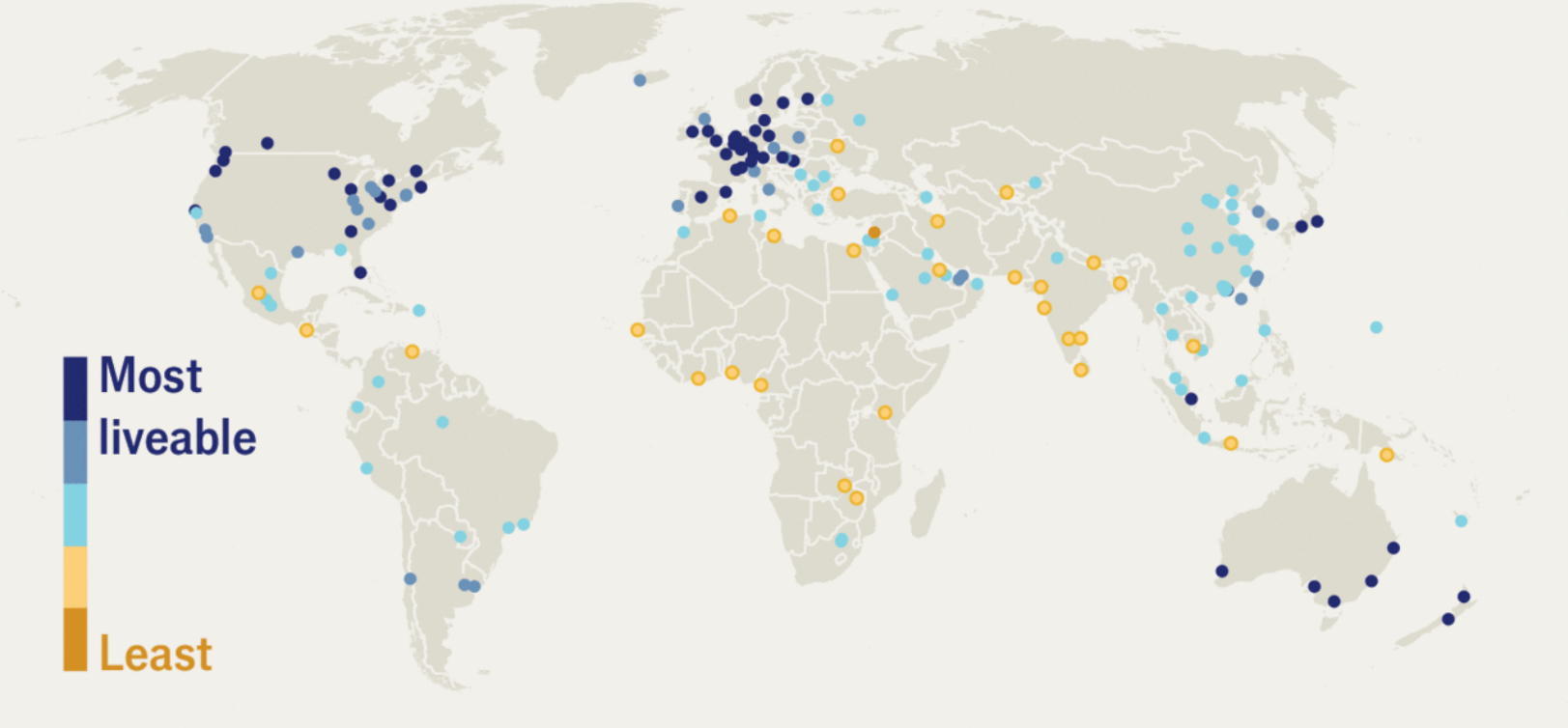


Still, Europe remains an attractive place to live

Top ten positions

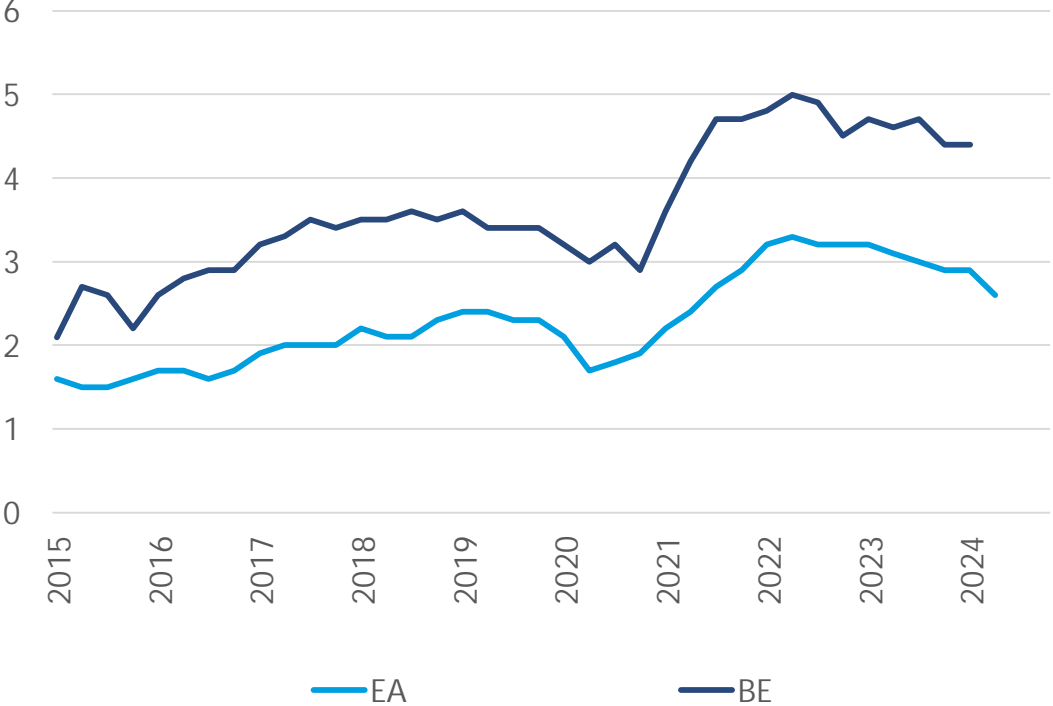
City	Location	Rank
Vienna	 Austria	1
Copenhagen	 Denmark	2
Zurich	 Switzerland	3
Melbourne	 Australia	4
Calgary	 Canada	5
Geneva	 Switzerland	5
Sydney	 Australia	7
Vancouver	 Canada	7
Osaka	 Japan	9
Auckland	 New Zealand	9

City liveability index, 2024



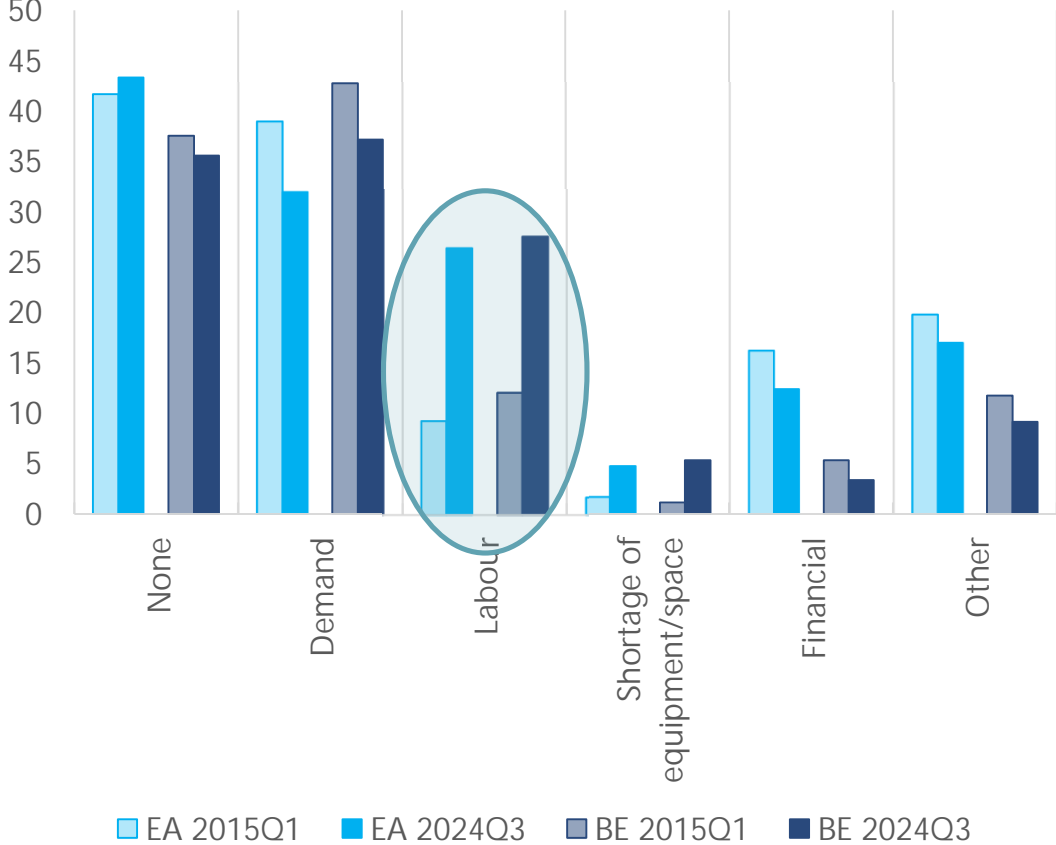
Europe's/Belgium's problems increasingly come from the supply side

Job vacancy rate



Factors limiting the business in services

(in % of respondents, multiple replies possible)



So, is there a cause for concern? Yes!

Familiar foes

- High tax burden + structurally higher social expenditures
- Less dynamic employment growth
- Regulation hampering the development and growth of new industries ...
- ... and effective competition
- Slow(er) decision-making

“Euro sclerosis 2.0”

Additional pressure

- Demographics: working age population under pressure (tighter labour market)
- New budget challenges (e.g. defence)
- (More) Intense global competition (China, US)
- But also (risk of) fragmentation of the global economy
- Climate policy induced supply shock

Regulation as the European niche?

EU seems stuck between:

- US with digital champions and cheap energy and;
- China with strong manufacturing base and very competitive (subsidised) green industries such as solar, EVs, wind, ...

Prevailing narrative: “The US innovates, China replicates, Europe regulates”



Draghi Report: the problem is clearly acknowledged ...



Analysis: the post-Cold War framework has shifted and global challenges and risks are mounting

- “Existential challenge”
- “We’re going to be a society that basically shrinks”
- “We are killing our companies”

The EU needs to:

- Deregulate – raise productivity growth through innovation and less red tape
- Derisk – increase security and reduce dependencies
- Decarbonize – shift away from fossil fuels while maintaining competitiveness

... and the proposed solution is multi-pronged

- Reform governance:
 - improve the decision-making process (faster, simpler)
 - reduce policy fragmentation (between countries, between levels of governance)
 - reduce regulatory burden
- Strengthen and deepen the single market
- €800bIn (5% of EU GDP!!!) annual investment boost from a combination of private and public sources. Draghi called for the reform of existing EU budgets and for the issuance of new common debt to finance the public side of the boost. But ...
 - what about EU fiscal rules?
 - what about rising interest rates?



And will the investment boost work? Will this time be different?

We have seen this before:

- Lisbon Strategy (2000)
- EU2020 Strategy (2010)
- European Commission's Investment Plan for Europe ("Juncker plan") (2015)
- Next Generation EU (NGEU)
 - underutilisation of resources, (in)efficient central planning ? (the jury still out)
 - precedent that does not bode well for the feasibility of Draghi's ambitions

And again: if the problems are on the supply side, throwing money at the demand side will mostly result in ... inflation

What we need more is a paradigm shift in terms of EU governance

How did the US do it?



- Demand stimulation as part of “Bidenomics” partly backfired in the presence of structural supply constraints, causing inflation and huge fiscal deficits ...
- ... but other elements may turn out to have been more “future-proof” by addressing the supply side:
 - CHIPS and Science act
 - Inflation Reduction Act

Minimal red tape, stimulate business investment by offering (temporary) financial incentives such as tax breaks and backing loans
- Further supply-side relief came from the strengthening of admissions of immigrants, which are reducing labour market tightness and now make up 18.6% of the US labour market

Climate transition is also akin to a supply shock

“The transition is a great opportunity...”

Or rather a negative supply shock ?.

While no free lunch, full decarbonisation appears manageable from a macro perspective ...

- for Belgium: cost of about 2-3.5% of current GDP
(can be interpreted as a loss of about 0,1pp growth rate per year)
- comparable to an oil shock but spread over 25 years
- it is not so much a problem of “finding hundreds of billions of EUR” (we still are in a savings glut) but more a problem of the distribution of the cost: who will pay?

... AND we have decided to be more ambitious / faster than other constituencies (US, China, etc.) – raising an important competitiveness issue

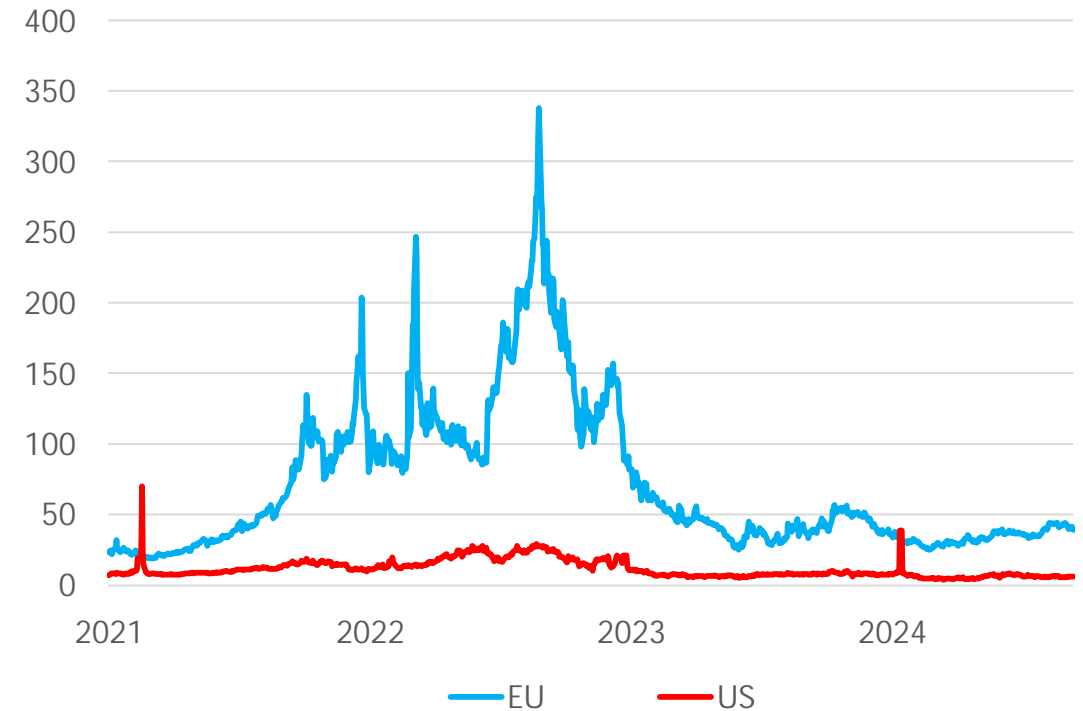
Market-based EU carbon pricing (EU ETS) vs. US subsidies (IRA)

The jury is still out on what will be more effective in guiding the climate transition but wholesale prices for energy are significantly higher in the EU than in the US

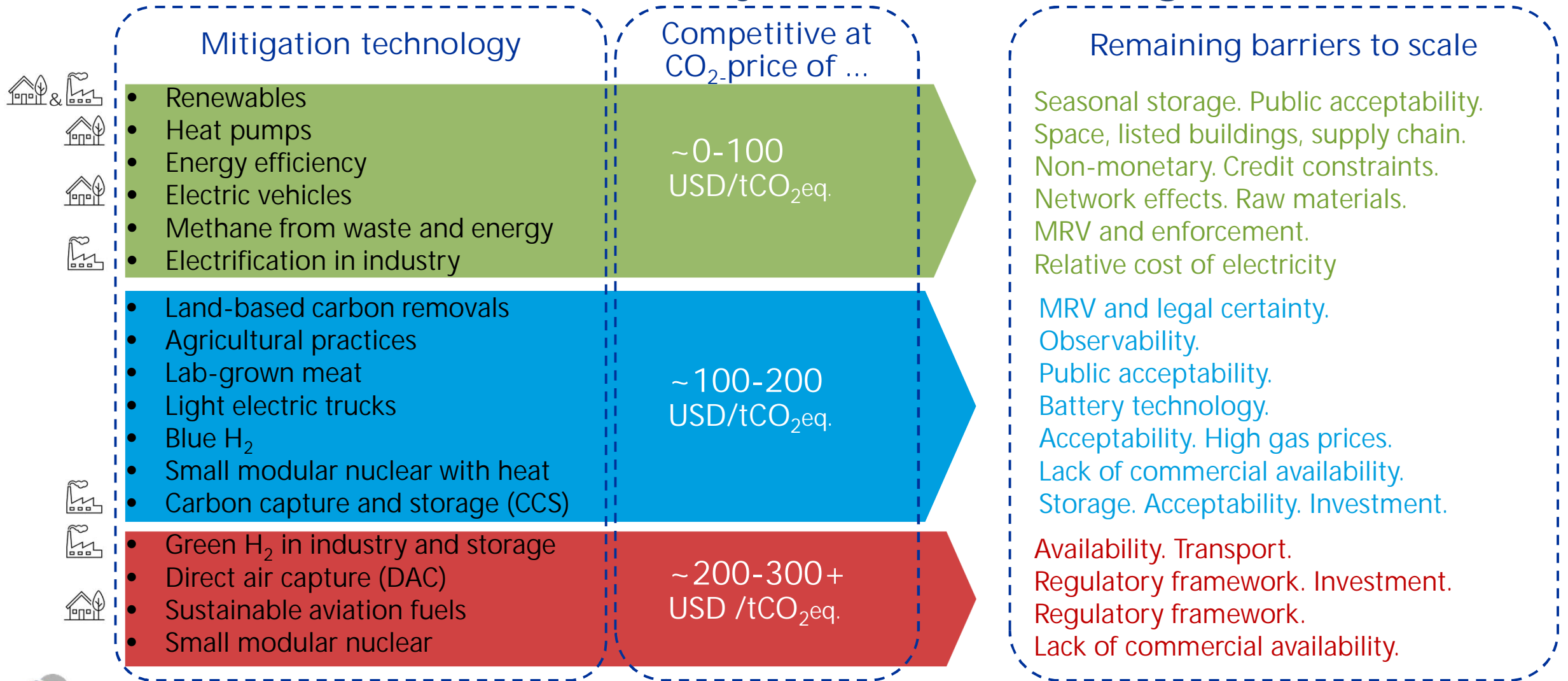
The difference in climate policy measures amplifies the already large divergence in base energy costs between EU and US

- Prices for natural gas (before distribution costs etc!) are currently 6 to 7 times higher in Europe than in the US
- Similarly, renewable electricity is currently 5-10 times more expensive, with decarbonized fuels (gas with CCS, green H2, SAF) at an additional premium
- On that note: the US will definitely *not* decarbonize its economy with a gas price at 10\$/MWh

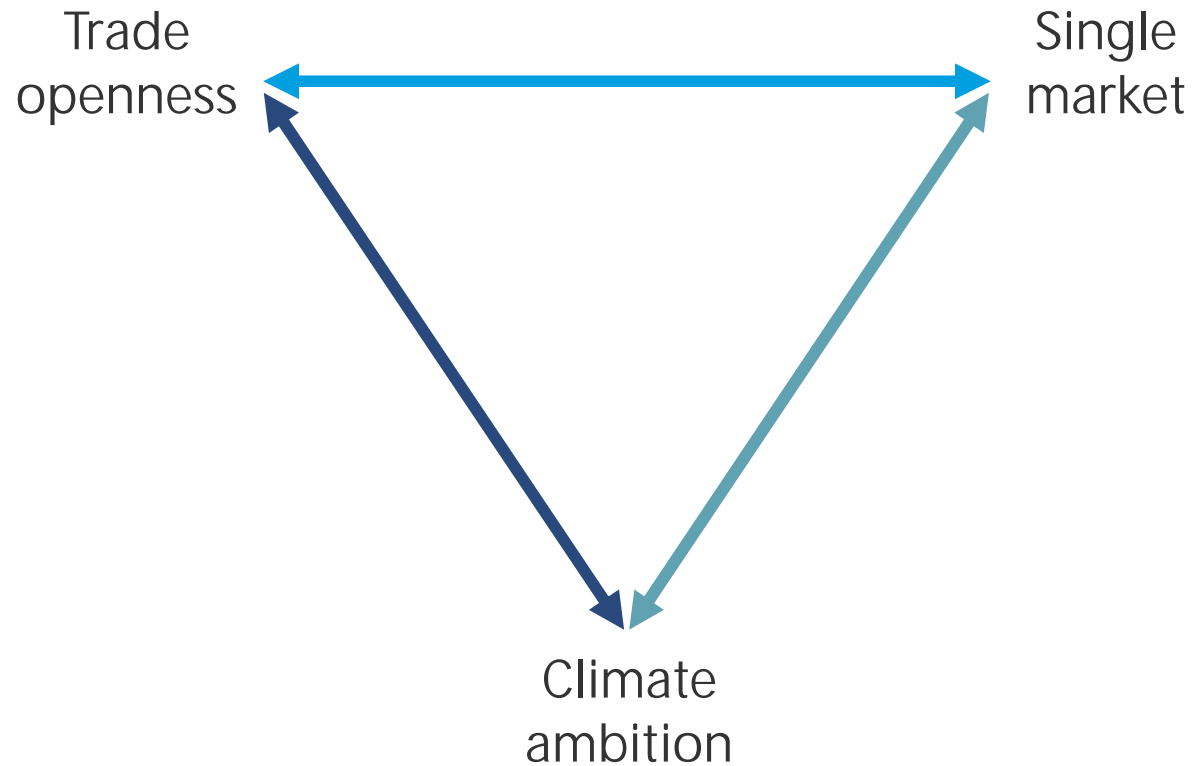
Prices for natural gas in Europe vs the US
(in \$ per MWh, TTF for EU, Henry Hub for US)



The current state of technological progress seems to favour households more than industry for the time being



The climate trilemma



Signs of tension

- Calls for a pause... or more (e.g. housing renovation in Belgium, low emissions zone in Brussels, etc.)
- CBAM and tariffs on Chinese EVs
- (European!) subsidy war with little direction from the European Commission

There is a EU social climate fund to support households and microenterprises for the climate transition

- Quid manufacturing industry? Also use ETS proceeds to finance a (second-best) industrial policy?

To conclude: it is often about (geo)politics ...

Global competition has intensified while geopolitical risks have increased

Europe has relatively few mineral resources and is heavily dependent on imports, which poses security risks and brings challenges for European manufacturing activities in particular.

Moreover, the EU is not a country:

- no centralized decision-taking & a relatively small EU-budget
- progress in the EU single market has stagnated
- populist, anti-EU parties with national(ist) agenda's flourishing across the EU:
 - more fragile, less effective governments. E.g. Belgium: how long will the coalition talks last? Cf. 541 days of caretaker government in 2010
 - European Commission monopoly on trade and competition under pressure
 - new fiscal rules at risk
- Footloose multinationals : firms vote with their feet

... in the end, it is mainly about us

We decide the rules. Rules are important and serve to organise a functioning society
... but the scale of regulation also reflects societal risk-aversion

Europeans often have higher expectations of the (welfare) state than Americans

- control: planning and regulating as modus operandi... but is it efficient?
 - *"the USA did not 'plan' to outgrow Europe"* (cfr. Janan Ganesh in the FT on 18/09/2024)
 - there is no attractive political platform in the EU for a return of Reagan and Thatcher (or a European Milei?)
 - protection: the immediate social cost of low growth is limited with low unemployment (that's the nice part of supply-side constraints) and generous welfare states (but someone has to foot the bill eventually)
- *"We know what needs to be done but not how to get re-elected afterwards"*

Thank you for your attention

Pierre Wunsch, Governor

3 October 2024