PRESS POINTS FOR CHAPTER 4: PRIVATE INVESTMENT: WHAT'S THE HOLDUP?
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Key Points

- Private fixed investment in advanced economies contracted sharply during the global financial crisis, with little recovery since. It has generally slowed more gradually in the rest of the world.
- The weakness in business investment (the largest component of private investment) is primarily a symptom of the weak economic environment. With few exceptions, business investment has been as low as might have been expected based on the weakness in economic activity.
- A comprehensive policy effort to expand output would thus contribute to a sustained rise in private investment.

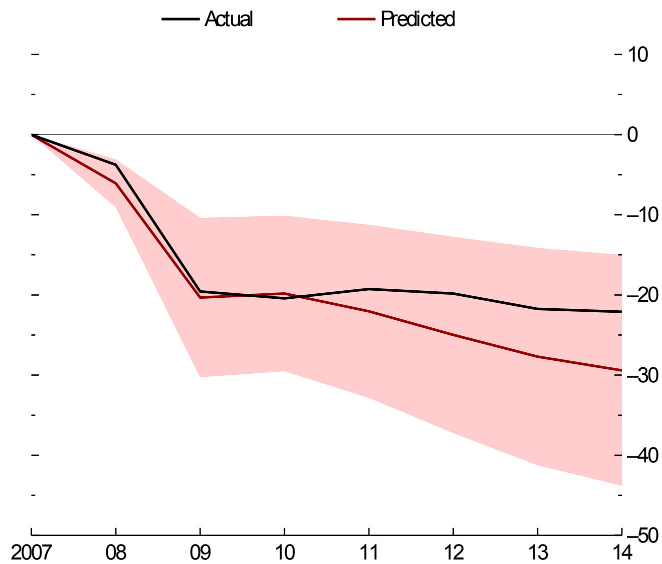
The disappointing performance of private fixed investment has featured prominently in the public policy debate in recent years. In advanced economies, private fixed investment has declined by an average of 25 percent since the global financial crisis compared with precrisis forecasts. The slump has been broad based, encompassing both residential (housing) and nonresidential (business) investment. Private investment in emerging market and developing economies has also slowed in recent years, following a boom in the early- to mid-2000s, but more gradually than in advanced economies.

The weakness in business investment is primarily a symptom of the weak economic environment. Although business investment contracted more severely following the global financial crisis than in historical recessions, the contraction in output was also much more severe, implying a broadly normal comovement of business investment and output. Business investment has deviated little, if at all, from what could be expected, given the weakness in economic activity in recent years (Figure 1). Firms have reacted to weak sales—both current and prospective—by reducing capital spending. Business survey responses provide complementary evidence to the chapter's analysis, with firms often reporting lack of customer demand as the dominant factor limiting their production.

Beyond weak economic activity, financial constraints and policy uncertainty have also held back business investment in some economies, particularly in southern Europe. Confirmation of these additional factors at play comes from the chapter's analysis of investment decisions by different types of firms. Investment by firms in sectors that rely more on external funds, such as pharmaceuticals, has fallen more since the crisis than investment by other firms. And firms whose stock prices typically respond more to measures of aggregate uncertainty have cut back more on investment, even after the role of weak sales is accounted for. This suggests that, given the irreversible and lumpy nature of investment projects, uncertainty has played a role in discouraging business investment.

A comprehensive policy effort to expand output would thus contribute to a sustained rise in private investment. Fiscal and monetary policies can encourage firms to invest, although such policies are unlikely to return investment fully to precrisis trends. Additional public infrastructure investment may also be warranted (in economies with clearly identified infrastructure needs, efficient public investment processes, and economic slack) to spur demand in the short term, raise supply in the medium term, and thus "crowd in" private investment. Structural reforms, such as those to strengthen labor force participation, could also increase the outlook for potential output and thus encourage private investment. Finally, to the extent that financial constraints hold back private investment, there is also a role for policies aimed at relieving crisis-related financial constraints, including through tackling debt overhang and cleaning up bank balance sheets.

Figure 1. Real Business Investment in Advanced Economies: Actual and Predicted Based on Economic Activity
(Percent deviation of investment from spring 2007 forecasts)



Sources: Consensus Economics; Haver Analytics; national authorities; and IMF staff estimates.
Note: Prediction based on historical investment-output relation and postcrisis decline in output relative to precrisis forecasts. Shaded areas denote 90 percent confidence intervals.