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Center for Transatlantic Relations

CENTER FOR TRANSATLANTIC RELATIONS

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The Transatlantic Economy 2014
Fall 2014 Update

Uneven overall -- but significant German activity;
U.S. firms in Europe earn 3 times more than U.S. firms in Asia

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Economically Out of Sync

The transatlantic economy remains the cornerstone of the global economy, with the combined U.S.-EU share of the world economy totaling 46.1% in 2013 (in nominal U.S. dollars). With many developing nations slipping into recession in 2014 (Russia, Brazil) or experiencing weaker-than-expected growth (China, South Africa), the transatlantic economy's contribution to aggregate global demand has increased this year.

However, transatlantic growth has been significantly uneven over the past year. Out front: the United States. Lagging behind: the European Union. While Germany, France and Italy moved towards recession in 2014, economic growth in the United States accelerated to an annualized rate of 3-4 %in the second half of the year.

In the second quarter of 2014, real demand in the eurozone was 5% less than it was in the first quarter of 2008 -- meaning that some six years after the financial crisis erupted (September 2008), real demand in the eurozone is still less than its pre-crisis level.[1]

Divergent monetary policies help, in part, to explain the growth differential between the United States and Europe. While the U.S. Federal Reserve has been abundantly generous with credit creation in the post-crisis environment (per unconventional quantitative easing policies), the European Central Bank has been slower and more passive in pursuing easy monetary policies. Indeed, monetary conditions in Europe became tighter over the balance of 2014, helping to push Europe towards a triple-dip recession.

Reflecting divergent growth paths, the United States posted a merchandise trade deficit of $91.2 billion with the European Union in the first eight months of this year, a 12% rise from the same period a year ago.

[1] Martin Wolf, "Reform alone is no solution for the Eurozone," *The Financial Times*, October 23, 2014.

America's trade deficit in goods with Germany widened by nearly 14% in the first eight months of this year, to roughly $48 billion. Germany accounted for more than half of America's trade deficit with the EU in the January-August period.

Transatlantic M&A Activity: The Animal Spirits Return

Transatlantic corporate mergers have increased noticeably in 2014, with European acquirers of U.S. firms leading the way. The attraction of the United States lies with its lower energy costs, expanding economy, entrepreneurial culture and first-mover advantage in a number of key technologies.

In the year-to-date through September 2014, European firms were active acquirers in some 735 deals in the United States, with the volume of the deals amounting to $174 billion. Both the dollar volume of deals and the number of deals were up significantly from the levels of 2013.

German firms have been notably active in the United States this year. According to *The Economis*t, "of all the American companies receiving foreign bids this year, a fifth were from German buyers, measured in value. And of all the cross-border takeovers worldwide led by German firms, 60% were for American firms."

U.S. M&A activity remains relatively robust in Europe: some 919 deals were concluded in the first nine months of the year, totaling some $196 billion in value.

European Foreign Direct Investment in the United States

In the first half of 2014, U.S. capital inflows from Europe totaled $88 billion, with the bulk of the decline reflecting one transaction: Vodafone of the UK selling its 45% stake in Verizon Wireless back to Verizon. This deal (or disinvestment) was completed in the first quarter of 2014 for $130 billion. As a consequence, U.S. inflows from the UK were -$122 billion in the first quarter of 2014, skewing the overall figure.

U.S. FDI inflows from Luxembourg were -$12.4 billion in the first half of 2014, a negative number that most likely reflects a similar transaction noted above with the United Kingdom.

When the figures from the United Kingdom and Luxembourg are removed from the total in the first quarter, U.S. FDI inflows from Europe in the first half of 2014 were a positive $55 billion.

Reflecting strong M&A activity by German firms, U.S. FDI inflows from Germany totaled nearly $2 billion in the first half of 2014, up 40% from the depressed levels of a year ago.

As the largest investor in the United States in the first half of 2014, inflows from the Netherlands totaled $12.7 billion in the first six months of the year, up 3% from a year ago.

European Foreign Affiliate Income Earned in the United States

European foreign affiliate income fell modestly—to $54.5 billion—in the first half of 2014, a drop of nearly 6% from a year earlier. However, second-quarter affiliate income of $28.1 billion was 6.1% higher than income in the first quarter ($26.4 billion).
Of the big players, affiliate income of British, Dutch and German affiliates in the United States fell 10.7%, 12.7%, and 15.1%, respectively, in the first half of 2014.

U.S. Foreign Direct Investment in Europe

U.S. FDI outflows to Europe totaled $55.5 billion in the first half of 2014, a decline of 42% from the same period a year ago. However, the aggregate numbers were skewed by a -$19 billion figure for the Netherlands in the first quarter of this year.

We believe the large recorded outflow reflects the fact that many U.S. firms, rather than repatriating retained earnings to the United States for tax reasons, have instead raised funds in Europe and then transferred the proceeds to the United States. This represents a negative intra-company loan, which in turn depresses aggregate U.S. FDI outflows (keep in mind that intra-company loans is a key component of FDI, along with retained earnings and equity from the parent firm).

U.S. Foreign Affiliate Income Earned in Europe

Despite some pockets of weakness, U.S. foreign affiliate income in Europe (excluding Luxembourg) surged by over 23% in the first half of 2014 versus a year earlier. In 2013, foreign affiliate income was flat for the year.

In the first half of this year U.S. firms in Europe earned nearly three times more than what U.S. firms earned in Asia. ($97.2 billion in Europe, ex. Luxembourg, vs. $36 billion in Asia).

U.S. affiliate income earned in the United Kingdom dropped 13.5% in the first half of 2014; income was flat in the Netherlands (0.4%) but rose 7.8% in Ireland.

After declining sharply in 2013 (by 30%), U.S. foreign affiliate income in Germany recovered in the first half of 2014, posting a rise of 191% in the first six months of the year versus the same period a year earlier. Income is on track to exceed $4 billion this year, better than the levels of 2012 ($3.2 billion) and 2013 ($2.2 billion), but off from the peak of 2010 ($5.9 billion).

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