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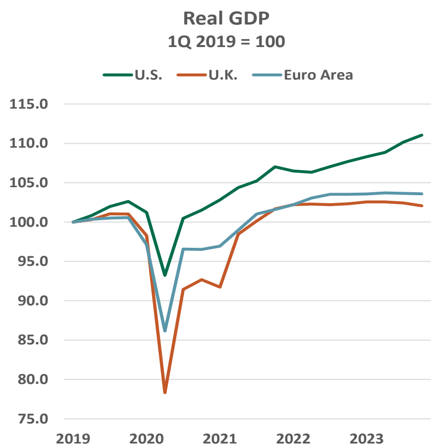
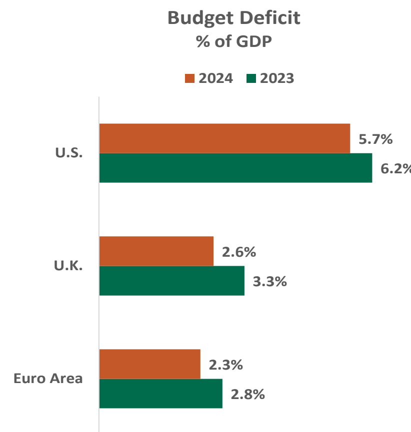
We Americans often think that we are the best at everything. But I can say categorically that is not true. Two weeks of work in Europe reinforced the conclusion that our breads and pastries are no match for the bakery offerings in the Old World. Breakfast is just better over there.

The coffee is pretty good in Europe, too, and it fueled a great series of conversations centered on what's ahead for the global economy. Following are a handful of key reflections from a very productive fortnight.

- "How do you do it?" I was often asked. Thinking the question referred to the sometimes hectic pace of my travel, I highlighted the importance of organization and fitness.

  But the curiosity was not about my personal endurance, but rather that of the American economy. The difference in performance on either side of the Atlantic over the past few years has been substantial.





Sources: Oxford Economics, Haver Analytics

  A central reason for this has been fiscal policy: whereas the United States has been spending money with seeming impunity, European countries have been constrained.

  Government spending in Europe moderated after COVID-19, but the U.S. kept on going. Congress passed the CHIPS Act, the Infrastructure Bill, and the Inflation Reduction Act (which had more to do with energy transition than the price level). Together, these initiatives will cost more than $2 trillion, spread over several years. The issuance of new Treasury securities has been immense.

  By contrast, annual deficits in both the United Kingdom and the euro area are capped by formal guidelines and investor appetite for sovereign debt. With rising interest rates

increasing the costs of debt service, room in national budgets for expansive investments has diminished.

- Europe could probably use a fiscal boost. Britain's economy is growing only marginally, and several euro area economies (including Ireland and Germany, which have traditionally been leaders) are contracting. Monetary policy across Europe remains restrictive. But officials in the region have been reluctant to propose stimulus.

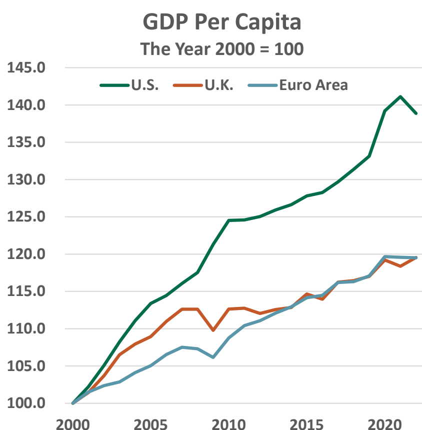
  An interim budget released by the Chancellor of the Exchequer (equivalent to the U.S. Treasury Secretary) offered little in the way of growth initiatives. In late 2022, an ambitious budget proposal roiled Britain's government bond market; policymakers fear a similar reaction if too much fiscal expansion is suggested in the run-up to the U.K. election later this year.

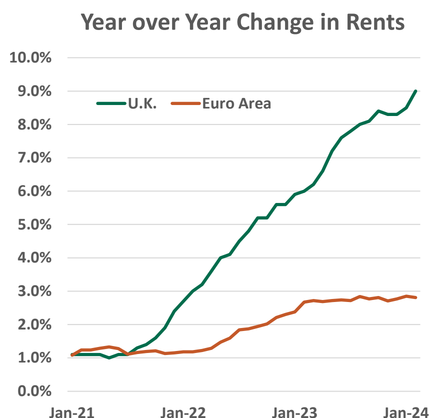
  Europe is being similarly cautious, having just adopted updated debt and deficit rules last year. The continent is struggling to find space for additional spending on security, energy transition and digital transformation.

The apparent ability of the U.S. to spend without limit is the subject of some envy in Europe.

- Clients I met with expressed wonderment over how the U.S. Treasury can continue to issue so much debt without apparent consequence. Europeans also struggle to understand how America can be almost halfway through its fiscal year without a complete budget, and why markets haven't punished the periodic threats of government shutdowns or technical defaults. I had to admit that I shared their concerns, and pointed them to the article decrying the sad state of U.S. finance we wrote last fall.

  For now, the lack of fiscal discipline in the United States is paying economic dividends. But Europe's experience suggests that those who fail to be sufficiently austere will have austerity thrust upon them. Washington would do well to heed that lesson.





Sources: OECD, Oxford Economics, Haver Analytics

- Europe has also lagged the U.S. in productivity growth. Gross domestic product (GDP) per capita has expanded more rapidly in America for more than two decades, and the gap has widened since the pandemic.

  Some have posited that America's headlong rush into artificial intelligence is at play. The top U.S. stocks, known as the "Magnificent Seven," are dominated by drivers of the new technology. (By contrast, Europe's top stocks are known as the "GRANOLAs," a composite of first letters that is dominated by pharma companies producing path-breaking weight loss drugs.)

But the impact of AI is largely ahead of us. Structural factors that foster more innovation have favored the U.S., providing hope for inflation, market performance, and debt sustainability.

- Housing shortages are chronic across Europe. Construction has not kept up with the flow of newcomers, keeping substantial upward pressure on rents and property prices. Europe does not include the costs of shelter in its inflation measures to the same degree that the U.S. does; if American conventions were used, European inflation would be worse than is currently stated.
- At several stops, we met with investors who are focused on emerging markets. The developing world avoided the buildup of inflation seen in larger economies. But many of their central banks nonetheless had to raise interest rates to protect the values of their currencies. Cuts from the Federal Reserve, the Bank of England, and the European Central Bank (ECB) would give smaller countries further room to relax monetary policy and provide relief to their economies.
- I was asked repeatedly about the U.S. election. Our European clients follow American politics very closely; I was constantly impressed by their detailed knowledge of the leading candidates. I encouraged them to focus on the policies, and not the personalities. (Admittedly, that was not an easy thing to do.) We discussed the major economic issues that surround the November voting: trade, immigration, and fiscal policy chief among them. While politics are certain to be turbulent over the next eight months, markets often behave more steadily during these intervals.

To escape a future of slow growth, Europe will need to invest in itself more aggressively.

I am writing this essay while walking on a treadmill, part of an effort to atone for visiting too many *boulangers* and *bäckereien*. But if croissants are wrong…I don't want to be right.

Low Battery

Students of science and history will recognize December 17, 1903 as the date the Wright Brothers proved that a self-powered, heavier-than-air machine could take flight. But the discovery did not happen overnight, nor did the modern aircraft industry emerge in a day. The Wrights logged three years of failed experiments at Kitty Hawk before they flew. They needed another five years before taking a passenger in the air and getting interest in the machine from the U.S. War Department.

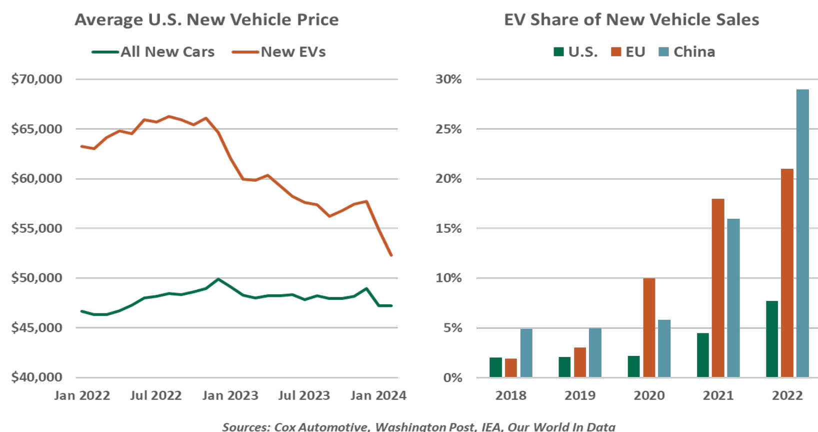
Human flight is ubiquitous today, making it easy to overlook the years required for the technology to become mainstream. Electric vehicles (EVs) are the latest example of a transportation technology which may take a long time to gain traction.

EV owners rave about their vehicles' performance and lack of direct emissions. Their satisfaction increases in tandem with gasoline prices. But EVs have not yet won over a broader segment of consumers. Buyers' skepticism is reflected in this week's pared-back U.S. emission targets. How can automakers and policymakers reduce emissions by encouraging more EV purchases?

Range anxiety is a major reason for hesitation to commit to an EV; most models can't exceed 300 miles on a full charge. This was an issue in the early days of motoring, as well, when distilled petroleum was sold in cans at hardware stores. That worry was resolved by the mass construction of service stations. Compared to the ready availability of motor fuel, EV charging networks are nascent and sparse. Public chargers have varying costs, speeds, connections and states of repair.

The need for chargers is not solely to put long-distance travelers at ease. Most car trips start and end close to home, where charging requires dedicated, off-street parking that is not available to everyone. While the U.S. is making progress building EV chargers, the most rapid growth has been at hotels and auto dealerships, not locations where most people live and work.

Building infrastructure is a natural role for industrial policy to fill. The Infrastructure Investment and Jobs Act (IIJA) of 2022 allocated $7.5 billion for a nationwide charging network. Only 2% of those funds have been used. As of last December, 27 states had not even begun soliciting bids. The long runway of unspent funding promises years of network enhancements ahead, but also gives potential buyers more reason to wait to make their purchase.



A better network of chargers will help overcome some EV skepticism.

Even if charging were more convenient, EV buyers have had to overcome sticker shock. Batteries represent 40% of the cost of a typical EV. EV prices are falling as battery technology continues to improve; the U.S. Department of Energy estimates the cost of batteries fell 90% from 2008 to 2022. Longer ranges and lower prices may await those who defer their EV purchases.

The federal government has long offered tax credits to offset EVs' higher prices, but the Inflation Reduction Act of 2022 narrowed the eligibility for those credits. The full $7,500 credit is only available to vehicles assembled in the U.S., using critical minerals sourced domestically. The list of vehicles eligible for even partial rebates is short. Manufacturers are retooling to produce EVs in the U.S., and tax rebate eligibility will grow. But this is yet another reason for buyers to be patient.

The slow launch of the U.S. EV industry has left a gap for competitors to fill. China has seized on EVs as their next productive frontier, a category that can help break the nation out of its looming malaise. China's new EV sales increased by 82% in 2022, with domestic demand supported by a massive buildout of charging stations. Tariffs may keep China's EVs away from U.S. ports, but its automakers are investing in factories in Mexico to build for the North American market.

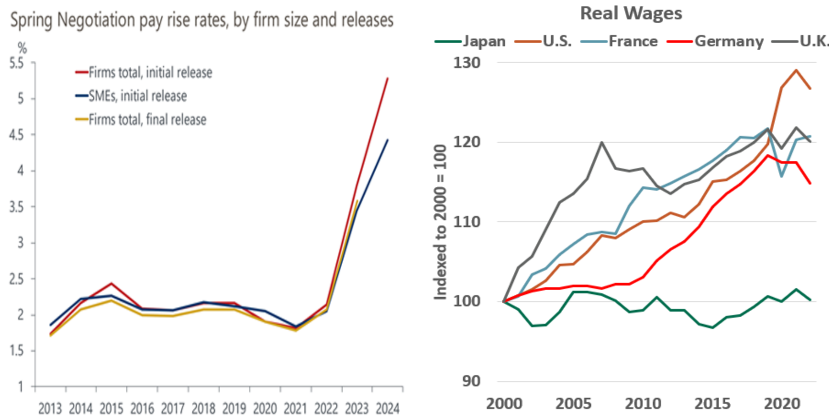
Future generations may look back on internal combustion engines the way we think of slide rules or steam locomotives: the best technology of its time that gave way to better-performing alternatives. The takeoff has not been smooth, but the EV market is still poised to take flight.

Easy Exit

Eight years after turning to negative interest rates and 17 years after its last rate hike, the Bank of Japan (BoJ) raised rates into positive territory this week. The move ended the most aggressive monetary stimulus program in recent times, and marks the end of the era of negative interest rates.

The small rate adjustment was part of a comprehensive change to monetary policy. The meeting also saw the end of yield curve controls on Japanese government bonds (JGBs). The central bank ended purchases of exchange-traded funds and domestic real estate investment trusts.

Inflation brought about the end of the negative rate regime, and its drivers were varied. The pandemic, the Ukraine war and weaker domestic currency values all helped Japan exit from entrenched deflationary pressures. The annual Shunto spring wage negotiations delivered the biggest pay increase in more than three decades, gave the BoJ further conviction about the sustainability of inflation.



Sources: Oxford Economics, Rengo, OECD

Disruptions from COVID and the Ukraine war delivered what decades of monetary and fiscal policy couldn't.

The strong wage settlement amid labor shortages will boost real wages and underpin underlying price pressures, supporting the case for further hikes. But Japan's room for aggressive tightening is limited. The economy lacks clear drivers of growth, and inflation expectations are not anchored at the 2% target. Actual inflation is likely to drop back below 2% by the end of next year. This was the reason the BoJ stressed that monetary policy will continue to remain easy for the time being, and that the bank will continue to purchase JGBs.

Higher interest rates would make it harder for the government to finance the country's massive debt, which is twice the size of its economy and the largest among developed nations. Businesses could also be shocked by higher borrowing costs. Narrowing interest rate differentials will lead to a stronger yen, which will counteract inflation and lower export earnings.

Japan has exited a prolonged period of deflation and its workers secured strong pay increases, but the virtuous cycle between wages and prices won't become permanent until the economy addresses its long-term structural challenges. The era of negative interest rates in Japan has ended, but the march towards a neutral policy stance is ongoing.

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