BUSINESSEUROPE

UNCERTAINTY WEIGHING HEAVILY ON THE ECONOMY

ECONOMIC SITUATION

- The increase in political and financial uncertainty associated with the euro and, in particular, the banking system has damaged business confidence. BUSINESSEUROPE expects GDP growth to be 0.1% this year and 1.4% in 2013 in the EU 27.
- Net exports will be the only main demand component contributing positively to GDP growth this year as businesses take advantage of growth in the global economy.
- Unemployment is expected to reach its highest level in almost 20 years. While both labour market and overall economic performance differ widely among Member States, average EU unemployment levels will reach 10.5% this year, and 10.8% in 2013.
- Investment is being constrained by both weak demand and access to finance. BUSINESSEUROPE expect the cost and difficulty of access to finance to increase even more over the next 6 months, placing further pressure on business survival and expansion.

Table 1: Main forecasts

	EU27		Euro Area	
Main Variables	2012	2013	2012	2013
Real GDP (annual % growth)	0,1	1,4	-0,3	1,1
Inflation (%)	2,4	2,1	2,1	1,9
Unemployment (%)	10,5	10,8	11,1	11,6
Employment (%)	-0,4	0,1	-0,7	-0,1
Hourly wage growth (%)	1,2	1,3	1,1	1,2
Hourly productivity growth (%)	0,3	0,6	0,2	0,5
government net lending (% of GDP)	-3,6	-3,3	-3,0	-2,7
gross public debt (% of GDP)	85,8	88,9	90,9	95,0
	EU27		**Euro Area**	
GDP components	**2012**	**2013**	**2012**	**2013**
Private consumption (%)	-0,2	0,7	-0,5	0,3
Public consumption (%)	-0,9	-0,7	-1,3	-0,9
Gross fixed capital formation	-0,6	2,9	-1,6	2,8
Private non-residential investment	0,0	1,9	-0,2	1,9
Exports (%)	1,8	4,4	1,5	3,8
Imports (%)	0,2	3,3	-0,5	2,7

Source: BUSINESSEUROPE June 2012 Economic Outlook

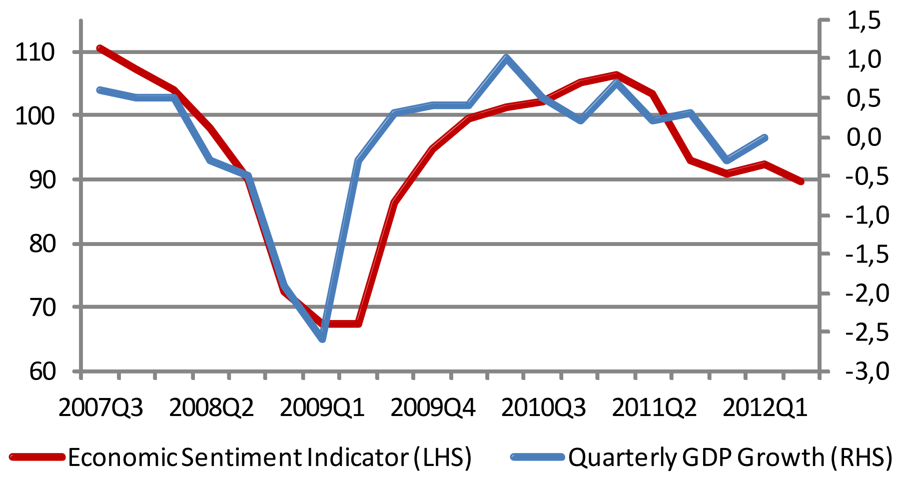
1. CONFIDENCE AT THE LOWEST LEVEL SINCE 2009

After the sudden slowdown in economic sentiment towards the end of 2011, some signs of stabilization emerged during the first quarter of 2012. However, during the last weeks, a re-emergence of the negative feedback loop between a weak banking sector and tensions in sovereign debt markets has resulted in a generalized lack of confidence and exceptional levels of uncertainty.

The downward risks identified in our November 2011 Economic Outlook have materialized, leading to a downward revision of our growth forecasts for this year. BUSINESSEUROPE now expects GDP growth to be 0.1% this year and 1.4% in 2013 in the EU 27. The Euro area, however, will experience a contraction this year, and is expected to grow very moderately in 2013.

The latest data confirms a marked fall in confidence and activity: the Economic Sentiment Indicator reached in April its lowest level since early 2009, whereas GDP growth stagnated in 2012Q1 (figure 1).

Figure 1: A return of confidence is a precondition for a return to growth



Source: Eurostat

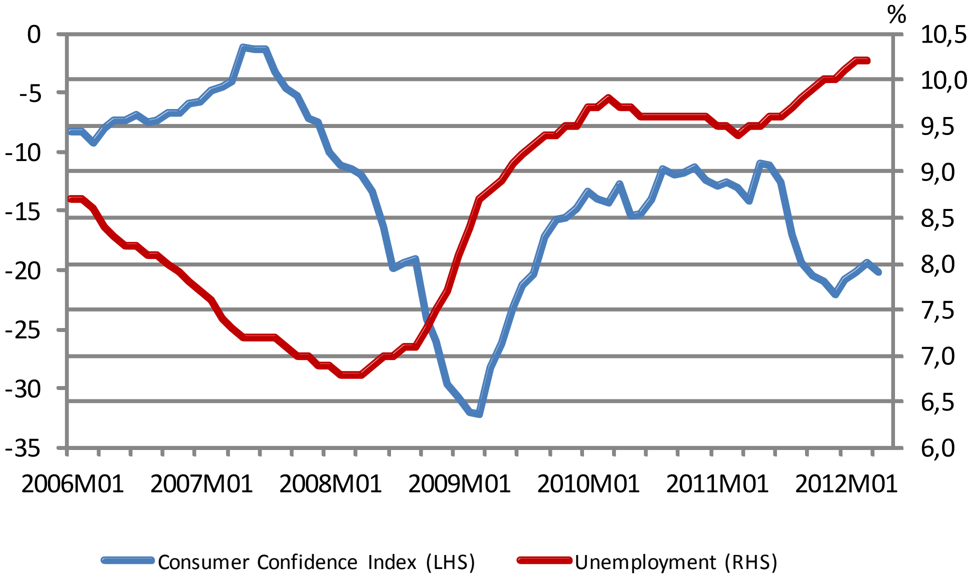
It is crucial to restore confidence for the dynamics of the recovery to unfold. If confidence returns, the export led rebound forecasted for 2013 is expected to gradually filter through the domestic economy, by stimulating investments and industrial production, and in turn driving up consumer sentiment and private consumption.

a. Labour markets continue to deteriorate impacting consumer confidence

In autumn 2011, we predicted that EU businesses would create almost a quarter of a million jobs this year. But in light of the fall in confidence and economy activity outlined above, we now expect employment to contract by 0.4% this year, equivalent to a loss of almost one million jobs. However, if there is a gradual return of confidence throughout 2013, EU private businesses could still create about 225,000 new jobs next year, helped by an incipient recovery and the positive effects of labour market reforms. This would imply that in the coming two years, there would be a loss of about 775,000 jobs.

Unemployment is expected to reach its highest level in almost 20 years, increasing to 10.5% this year, and 10.8% in 2013 (11.1% and 11.6% for 2012 and 2013 respectively in the euro area). Reflecting weakening labour markets, consumer confidence continues to decrease, further depressing private consumption, which is expected to shrink this year (by -0.2%), only to grow moderately again in 2013 (by 0.7%) (Figure 2).

Figure 2: Unemployment is expected to reach its highest level in almost 20 years



Source: Eurostat

b. Country differences: reform efforts do deliver results

Labour market performance continues to differ widely among Member States, mirroring differences in overall economic performance (figure 3). But countries that maintained a sustainable competitive and fiscal position before the crisis have fared much better throughout the crisis and the recovery:

- While unemployment in Germany and Austria is expected to further decline in the coming year, in Spain unemployment is expected to increase to above 25% in 2013.
- Youth unemployment has reached pandemic levels of 52.7% in Greece and 51.5% in Spain, and in April 2012 there were 5.5 million people under 25 unemployed in the EU.

Recent efforts to implement structural reforms in order to improve cost competitiveness in a number of Member States are also starting to translate into reduced current account imbalances.

- Since 2008-2009, Ireland has reduced unit labour costs by around 20% compared to the euro area as whole. As a consequence, exports increased by over 4% in 2011 alone, and the current account deficit is expects to decrease by 2/3rds from its peak, by the end of the year.

This emphasises the importance for both confidence and long-term growth of member states implementing clear and credible plans to undertake growth-enhancing structural reforms and fiscal consolidation. Nevertheless, we expect that heterogeneity will persist for some time, given both the time required for the current round of reforms to work through and the need for further reforms to increase convergence.

Figure 3: A rebalancing is underway, but country divergences persist

Change in %	Real GDP Growth		Unemployment		Investments		Exports		Government Budget Deficit	
	2012	2013	2012	2013	2012	2013	2012	2013	2012	2013
EU 27	**0,1**	**1,4**	**10,5**	**10,8**	**-0,6**	**2,9**	**1,8**	**4,4**	**-3,6**	**-3,3**
Euro area	**-0,3**	**1,1**	**11,1**	**11,6**	**-1,6**	**2,8**	**1,5**	**3,8**	**-3.0**	**-2,7**
Germany	1,0	2,0	5,8	5,6	3,3	7,9	3,1	5,1	-0,6	-0,2
France	0,6	1,4	9,8	9,8	2,0	2,7	2,7	6,0	-4,5	-3,8
United Kingdom	0,6	2,0	8,6	8,8	1,8	4,3	1,5	5,9	-8,2	-6,3
Italy	-1,6	0,6	10,0	10,5	-4,5	2,3	0,2	3,6	-1,5	-0,1
Spain	-1,6	-0,6	24,2	25,4	-7,9	-3,5	3,4	5,7	-6,0	-4,0
Netherlands	-0,8	1,3	5,5	6,0	-3,3	3,8	-1,8	3,8	-4,6	-3,0
Poland	3,1	2,9	9,9	9,7	5,0	4,0	6,0	8,0	-3,0	-3,0
Belgium	-0,1	1,2(*)	7,7	7,9(*)	0,7	1,6(*)	0,5	4,2(*)	-3,0	-3,3(*)
Sweden	0,2	1,7	7,9	7,9	2,0	1,0	-1,5	3,5	-0,3	0,3
Austria	0,8	1,7	4,5	4,4	-1,0	2,1	3,3	5,7	-3,0	-1,9

(*) Data for Belgium in 2013 refers to the European Commission Spring Forecast 2012

Source: BUSINESSEUROPE June 2012 Economic Outlook

c. Exports will be the only driver of growth in 2012

Since our latest forecast, global growth has gained some momentum, especially in the US (driven by private consumption and milder fiscal consolidation), and in Japan (due to investments in the aftermath of the disaster in 2011).

- Growth in emerging and developing economies is expected to remain robust, with the IMF forecast 5.7% growth for 2012 and 6.0% for 2013.
- Global trade is expected to grow by 4.1%, this year, and to accelerate to 6.5% in 2013.

Against this background, and helped by a 7.2% depreciation of the (trade-weighted) euro real effective exchange rate since May 2011, exports are expected to accelerate in the second half of 2012 and 2013, whereas imports will remain contained due to weak domestic demand.

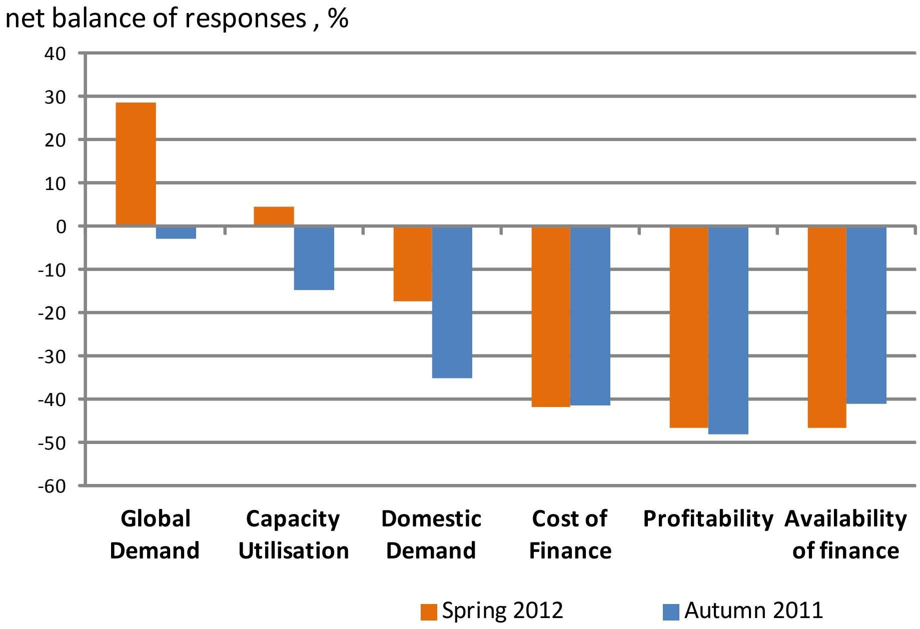
Net exports will be the only main demand component providing a positive contributor to GDP growth this year and, if confidence improves at a European level, can contribute to an export-led rebound, filtering through to the domestic economy, and stimulating industrial production and investment.

Such forecast supports our confidence that many EU businesses remain competitive in world markets despite the negative policy environment. However, in order to benefit from a more dynamic global environment, all Member States can do more to support business competitiveness and job creation through domestic policy reforms.

2. TENSIONS IN THE BANKING SECTOR ARE RESTRICTING ACCESS TO FINANCE

Compared to six months ago, investments are being held back by increasingly difficult access to finance, decreased profitability and domestic demand as well as decreased capacity utilization. Only global demand is a positive factor supporting investment decisions (Figure 5).

Figure 5: Factors affecting investment decisions

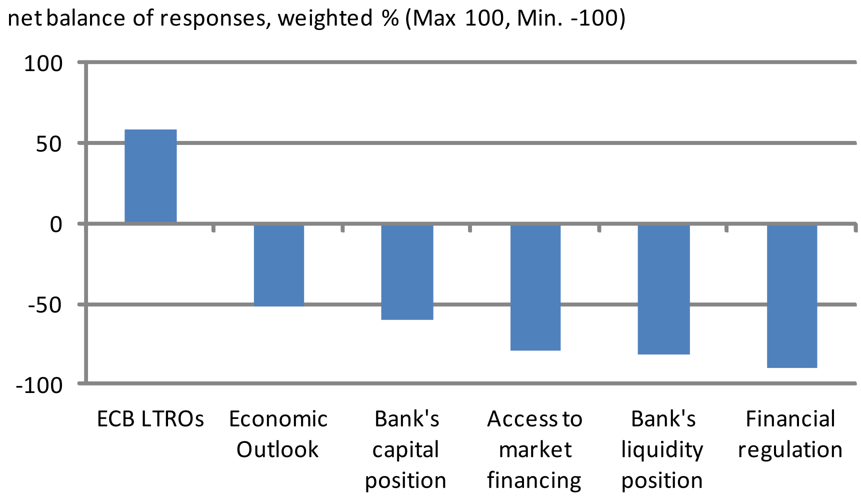


Source: BUSINESSEUROPE June 2012 Economic Outlook

BUSINESSEUROPE members expect the cost and difficulty of access to finance to increase slightly over the next 6 months. This is viewed by businesses as one of the major factors restraining investment decisions. These results are in line with the results of the ECB's Euro Area Bank Lending Survey from April 2012, which reports that 9 % of the banks expected a net tightening of credit standards. This figure is much smaller than in the previous quarter (35%), but it indicates that overall access to finance remains severely restrained.

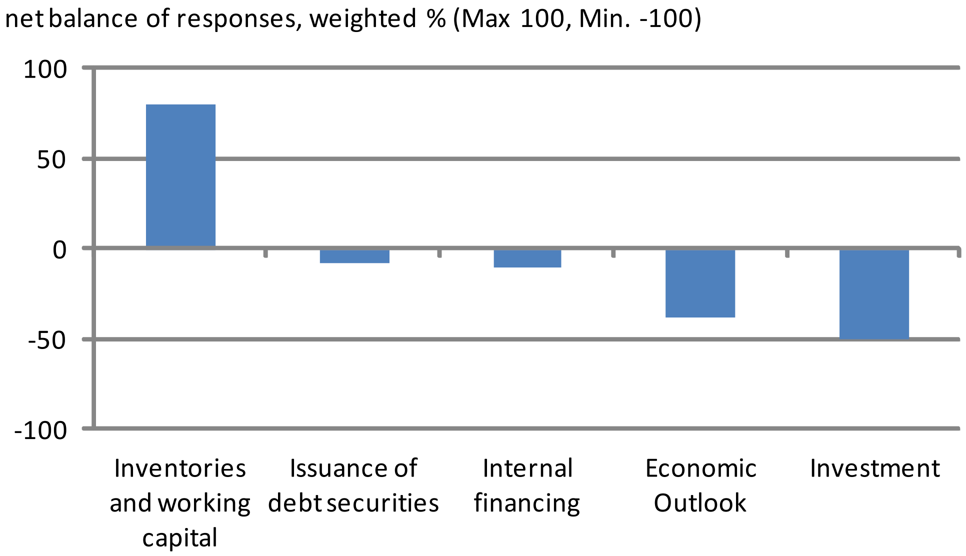
BUSINESSEUROPE Members identify action by the ECB to provide 3-year liquidity (LTRO) as the only factor having a positive effect on the supply of bank lending. However, all other factors, (from the economic outlook to banks' capital and liquidity position, access to market financing, or financial regulation), are seen as having a detrimental effect on bank lending (Figure 6).

Figure 6: Factors affecting the supply of bank lending



Weak investment prospects and the negative economic outlook are the major factors restraining the demand for credit (Figure 7). Besides, deleveraging by both lenders and borrowers is further restraining demand for credit by both companies and households. This deleveraging is part of the correction of the imbalances that accumulated before the crisis, and it appears to be more of a structural than cyclical nature in the deficit countries.

Figure 7: Factors affecting the demand of bank lending



Source: BUSINESSEUROPE June 2012 Economic Outlook

Therefore, removing the financial constraints on the private sector ability to invest is crucial to set up the basis of the recovery. In this context, the priority should be to strengthening bank's balance sheet in order to allow the banking sector to support the recovery of the real economy, and to break the negative feedback loop between a weak banking sector and tensions in the sovereign debt market.

A challenging financial environment places significant constraints on company investment, and in turn, risks having an impact on long-term growth. Therefore, there is the **risk that the current downturn translates into a permanent reduction of the growth potential** of the EU economy.

WHO ARE WE?

BUSINESSEUROPE IS THE CONFEDERATION OF EUROPEAN BUSINESS, WHICH REPRESENTS MORE THAN 120 MILLION SMALL, MEDIUM AND LARGE COMPANIES EMPLOYING SOME 120 MILLION PEOPLE. OUR MEMBERS ARE 40 LEADING BUSINESS FEDERATIONS FROM 34 COUNTRIES WORKING TOGETHER TO ACHIEVE GROWTH AND COMPETITIVENESS IN EUROPE.

WHAT IS THE ECONOMIC OUTLOOK?

THE ECONOMIC OUTLOOK TWICE A YEAR PROVIDES A BUSINESS INSIGHT INTO RECENT AND PROJECTED ECONOMIC DEVELOPMENTS IN EUROPE, BASED ON A SURVEY OF BUSINESSEUROPE MEMBER FEDERATIONS.

ANSWERS TO THIS SPRING'S QUESTIONNAIRE WERE RECEIVED BY EARLY MAY.

MORE DETAILED RESULTS AND INDIVIDUAL MEMBER STATE FORECASTS ARE PUBLISHED ON OUR WEBSITE [WWW.BUSINESSEUROPE.EU](http://www.businesseurope.eu)