BUSINESSEUROPE

ECONOMIC OUTLOOK
AUTUMN 2013

RECOVERY EMERGING BUT POLICY SUPPORT ESSENTIAL

ECONOMIC SITUATION

- BUSINESSEUROPE **expects GDP growth in 2013 of 0.0% in the EU and -0.5% in the Euro Area,** in line with our spring forecast. Growth is expected to pick up through **2014, when GDP is expected to grow by +1.4% in the EU and 1.1% in the Euro Area.**
- **Domestic demand is expected to become a positive contributor to growth in 2014.** Having contracted in 2013, private consumption is expected to grow by 0.9% in the EU in 2014. While overall investment will rise by 2.9%.
- **Private investment may also be at a turning point;** It is expected to grow by 3.3% in 2014, having contracted by 2.1% in 2013. Stronger external demand will be a key factor supporting new investment, as well as slightly recovering profitability. **But in a number of Euro Area countries, bank lending conditions hinder new investment.**
- The **EU's current account balance is set to further improve** through 2014, with the surplus growing to 1.9% of GDP in the EU and 3.0% of GDP in the Euro Area, as adjustments in wage imbalances continue to take effect.
- **The employment situation remains an acute concern,** with unemployment expected to be almost unchanged in the Euro Area in 2014, but falling to 10.6% in the EU (from 11.2% in 2013). In spite of the mounting recovery, only 0.5 million jobs are expected to be created in the EU next year. Half of these jobs are foreseen to come from Germany alone.
- **Downside risks to growth remain significant,** with businesses pointing to the potential for tax increases and continuing difficult banking lending conditions as particular concerns.

POLICY CONSIDERATIONS

- **While European businesses see the potential for a pick-up in investment, this is dependent on the delivery of policy commitments** which can enhance confidence in Europe's long-term growth prospects.

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- **Member States must continue to press ahead with structural reforms**, in both labour and product markets, and undertake growth enhancing fiscal consolidation focussed particularly on expenditure reduction.

- **A well functioning banking union is needed to enhance access to finance**, particularly for European SMEs. As an essential prerequisite to the single supervisory mechanism, the ECB/EBA's **planned asset quality review** stress-tests of banks must be carried out ensuring a level playing field **in a** thorough, robust and transparent **manner which contributes to restoring confidence in financial institutions.**

- The recent increase in capital of the European Investment Bank (EUR 10 billion) needs to be accompanied by an **examination of further innovative ways through which finance for long-term investment can be mobilised at both EU and Member State level.**

- **Development of the single market,** particularly areas of digital economy, telecoms and energy **is essential to enhance Europe's global competitiveness and support reindustrialisation.**

1. OVERVIEW

The European Economy is turning the corner...

Recent economic developments have been generally positive. Since the spring we have seen a moderate return to GDP growth in the majority of EU economies, and as predicted in our Spring Economic Outlook 2013, tentative signs of rising business confidence.

Business confidence has benefitted from a further stabilisation in financial markets, in terms helped by the clear commitment by the ECB to safeguard the Euro, further steps towards a banking union and progress on structural reforms in a number of Member States.

While still below its growth potential, the European economy is expected to continue to move forward. Our forecasts for 2013 and 2014 growth remain broadly unchanged from last spring. After GDP growth of 0.0% in the EU and a fall of 0.5% in the euro area in 2013, the growth of 1.4% in the EU and 1.1% in the Euro Area is expected in 2014.

Table 1: BUSINESSEUROPE main forecasts

	EU27		Euro Area	
Main Variables	**2013**	**2014**	**2013**	**2014**
Real GDP (annual % growth)	0,0	1,4	-0,5	1,1
Inflation (%)	1,7	1,8	1,5	1,6
Unemployment (%)	11,2	10,6	11,6	11,5
government net lending (% of GDP)	-3,3	-3,1	-2,7	-2,4
gross public debt (% of GDP)	88,8	89,7	96,3	95,7

	EU27		Euro Area	
GDP components	**2013**	**2014**	**2013**	**2014**
Private consumption (%)	-0,2	0,9	-0,8	0,4
Public consumption (%)	0,2	-0,1	-0,4	-0,1
Gross fixed capital formation	-2,8	2,9	-3,4	2,1
Exports (%)	1,8	4,5	2,0	4,6
Imports (%)	0,0	3,8	-0,1	3,7

Source: BUSINESSEUROPE's forecasts

... but country differences remain

As table 2 illustrates, economic performance in 2014 will continue to widely differ from one country to another.

Amongst the largest economies, 3 main groups of countries can be identified according to their growth forecasts. Firstly, countries outside the euro area such as the United Kingdom (+2.3%), Poland (+2.6%), or Sweden (+2.1%) are expected to grow relatively strongly. Secondly, in the euro zone, Germany (+1.8%) will continue to lead the recovery, while in third group of countries such as France (+0.6%), Italy (+0.7%), Spain (+0.8%) and the Netherlands (+0.5%) the rebound is not yet expected to be particularly strong.

Table 2: Main forecasts for all the economies surveyed

	Real GDP growth		Inflation		Unemployment	
% Change	2013	2014	2013	2014	2013	2014
Austria	0,5	1,8	2,1	1,9	4,9	4,9
Belgium	0,1	1,1	1,3	1,6	8,6	8,9
Cyprus	-8,7	-3,9	1,0	1,2	17,0	19,5
Finland	-0,4	1,6	1,7	1,7	8,2	8,2
France	0,1	0,6	1,0	1,5	10,5	10,8
Germany	0,4	1,8	1,6	1,9	5,3	5,3
Greece	-4,0	0,6	-0,8	-0,4	27,5	28
Italy	-1,6	0,7	1,5	1,7	12,1	12,3
Luxembourg	1,0	2,3	1,8	1,8	6,6	6,8
Malta	0,8	1,8	1,1	1,8	6,4	6,3
Netherlands	-1,3	0,5	2,8	2,0	7,0	7,5
Portugal	-1,8	0,8	0,6	1,0	17,4	17,7
Slovenia	-2,6	-0,8	2,2	1,7	10,7	11
Spain	-1,2	0,8	1,6	1,5	26,4	25,8
Bulgaria	1,0	1,8	-0,5	2,0	10,8	10,5
Czech Republic	-1,2	1,2	1,6	1,7	7,2	7,2
Denmark	0,3	1,5	0,5	1,4	6,9	6,3
Estonia	3,0	3,0	3,6	3,0	9,4	8,8
Hungary	0,3	1,3	1,9	2,5	10,8	10,8
Lithuania	3,1	3,6	2,1	2,7	11,8	10,5
Poland	1,4	2,6	1,1	2,2	10,5	10,0
Sweden	0,9	2,1	0,3	1,9	8,5	8,4
United Kingdom	1,2	2,3	2,7	2,4	7,8	7,6
Norway	2,0	2,0	N/A	N/A	3,8	4,0
Turkey	3,6	4,0	6,8	5,3	9,5	9,4
Iceland	1,9	2,7	4,2	3,4	4,9	4,6

Source: BUSINESSEUROPE's forecasts

2. DOMESTIC DEMAND AND INVESTMENT

Growth will be driven by stronger domestic demand

In recent years, we have seen a picture of net exports increasing and overall consumption and investment contracting.

In 2013, we expect net exports (+1.8%) to continue to be the only GDP component positively contributing to economic growth. As result of the protracted uncertainty and tough fiscal adjustment the EU economy had experienced during 2012 and the first months of 2013, private consumption (-0.2%) and overall investment (-2.8%) will make a negative contribute to this year's output growth.

But looking at 2014, this trend is expected to begin to change. BUSINESSEUROPE's members see the recovery starting to broaden to the domestic economy, with private consumption picking up by 0.9%, and overall investment by 2.9%.

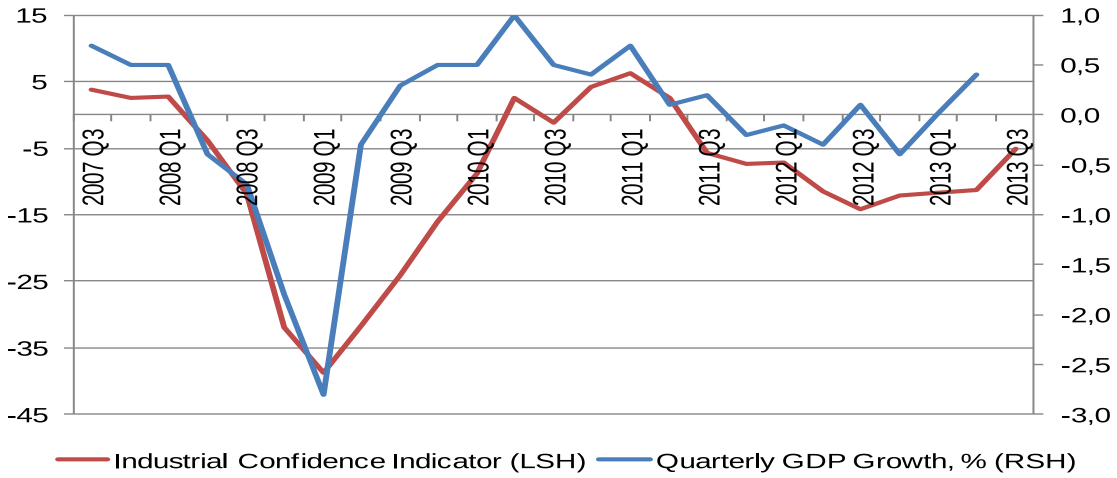
This shift will be driven by a gradual improvement in consumer optimism, as we started seeing in the last months. For example, the European Commission Consumer Confidence Indicator, after having reached its 4 years lowest level, - 24.0, in December 2012, moved up to -14.5 in October. But further inroads will need to be made into unemployment (see section 4) before the consumer confidence returns more strongly.

Restoring confidence is a pre-condition for a strengthened recovery

As we forecast in the spring, business confidence indicators have also improved throughout the year. Figure 1 illustrates that the Industrial Confidence Indicator has increased steadily since last spring, as GDP growth resumed.

Whilst indicating that more growth can be expected in the coming months, this shows that confidence has much further to go before we will see a firm upturn.

Figure 1: Economic sentiment indicator and GDP growth



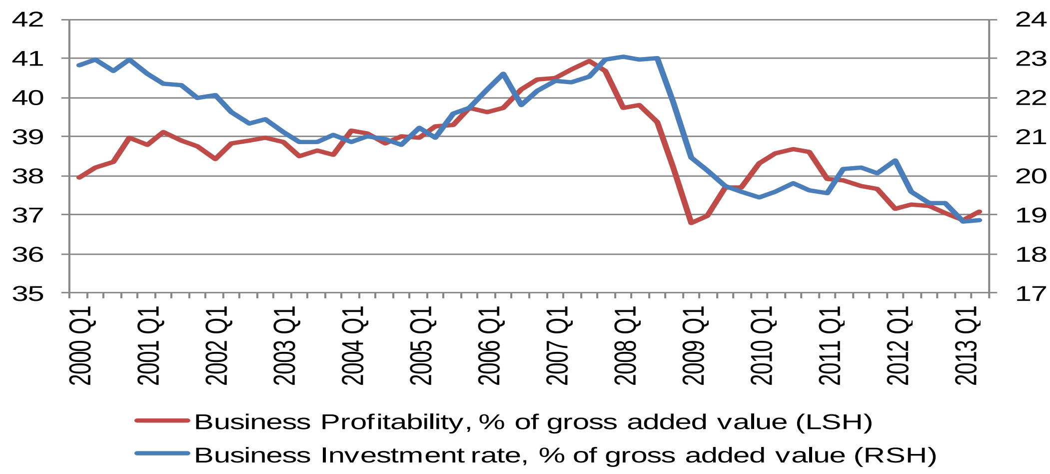
Source: Eurostat

Business investment may be at a turning point...

In the last 12 months, Euro Area business investment fell by € 16.5 billion (or by 6.8%), dropping to its lowest level for at least a decade in the EU in Q1 2013.

But as figure 2 illustrates, a turning point in the investment cycle seems to have been reached in the second quarter of 2013, when corporate investment slightly increased. A stronger upturn in capital spending is foreseen in 2014, when EU private (non-residential) investment is forecast to grow by 3.3%.

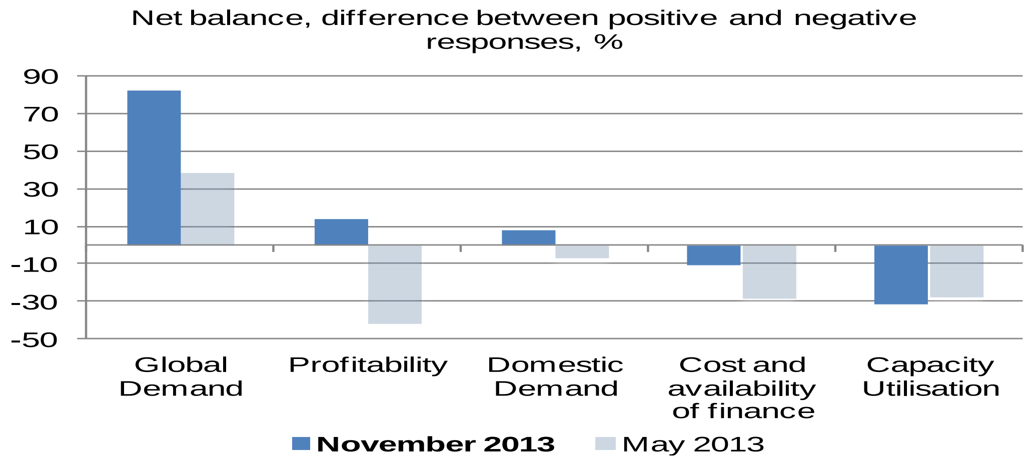
Figure 2: EU business investment and profitability



Source: European Central Bank and Eurostat

BUSINESSEUROPE's members see increased global demand as the key factor supporting capital investment, with profitability and domestic demand becoming gradually more supportive. But low capacity utilisation alongside cost and availability of finance is still restraining factor holding down business investment, as figure 3 illustrates.

Figure 3: Factors supporting investment decisions



Source: BUSINESSEUROPE's survey of Member Federations

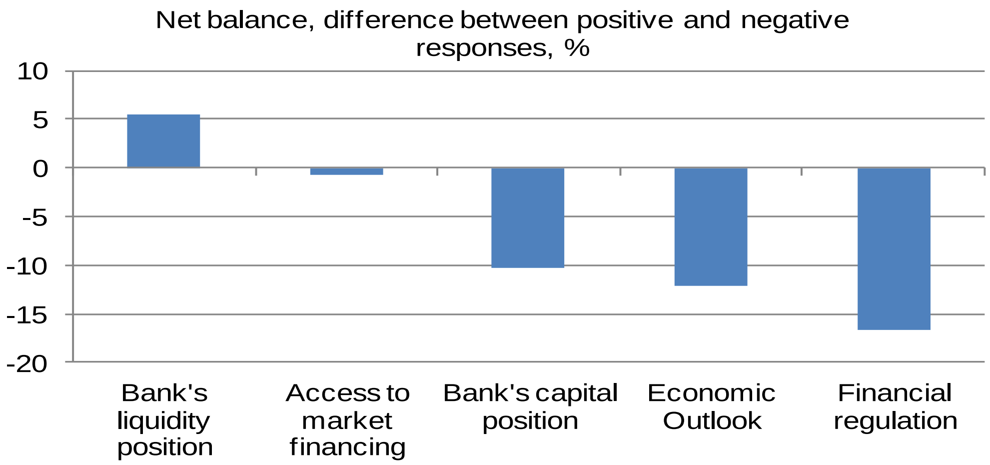
In terms of investment needs, our survey shows that innovation remains a key driver, with 91% of respondents pointing to this being a primary need, compared to 77% in May.

A number of factors hinder access to finance...

Access to finance on reasonable terms is a pre-condition to allow businesses to make the investments necessary to drive growth and maintain competitiveness.

But access to finance continues to be a concern for businesses. Figure 4 assess BUSINESSEUROPE's views on the main factors hampering the supply of financing. While the uncertain economic outlook (12% of net responses) associated with the impact of the changes in financial regulation (16% of net responses) play a strong role in maintaining credit supply mute, weak banks' capital position is also exerting downward pressure on bank lending supply (10% of net responses). This clearly hampers a recovery in investment, with only companies with strong equity and low leverage positions best able to finance further investments at reasonable rates.

Figure 4: Factors contributing to the supply of banking lending



Source: BUSINESSEUROPE's survey of Member Federations

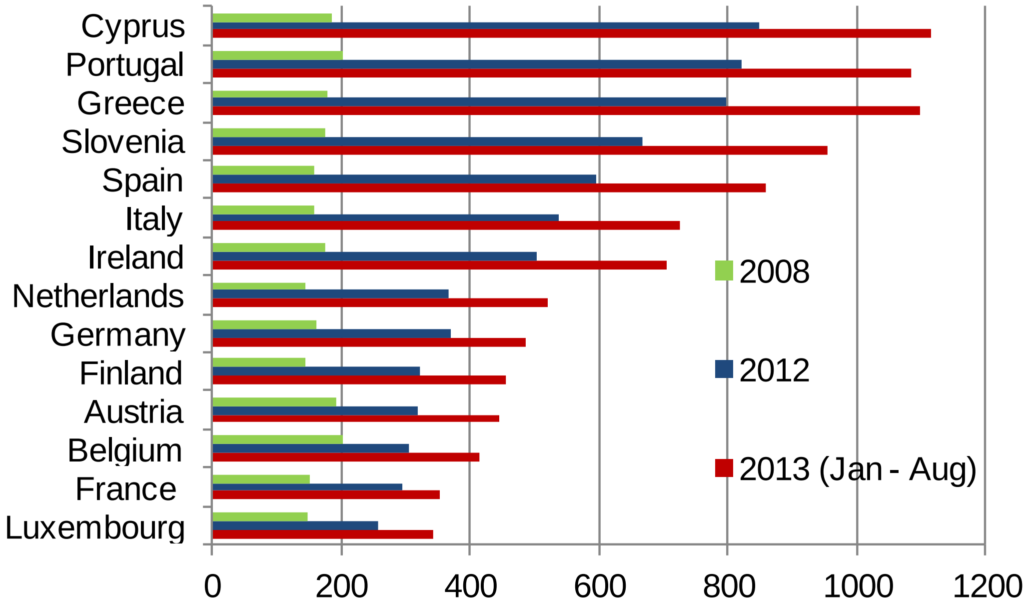
As result of these factors, in the last two years bank lending to businesses fell by € 300 billion in the Euro Area.

Lending to the real economy is unlikely to pick up substantially until access to finance and financial fragmentation is addressed by strong steps towards a functioning banking union.

As figure 5 shows, the increase in borrowing costs that a number of European firms have been facing in the last few years has been stronger for businesses located in the peripheral economies of the euro area. For those firms, resuming investment continues to be a growing challenge.

As the European Central Bank has also underlined, such a fragmentation shows that the transmission of the monetary policy is partially broken and the impact of any refinancing rate decision is likely to be limited, especially in the countries in which businesses would aspire most to benefit from it.

Figure 5: Company short-term borrowing cost – Spread between interest rates paid for bank loans by non-financial corporations and ECB marginal lending facility rate, %



Source: BUSINESSEUROPE's calculation based on European Central Bank data

3. EXPORTS AND COMPETITIVENESS IMBALANCES

Trade performance will remain solid

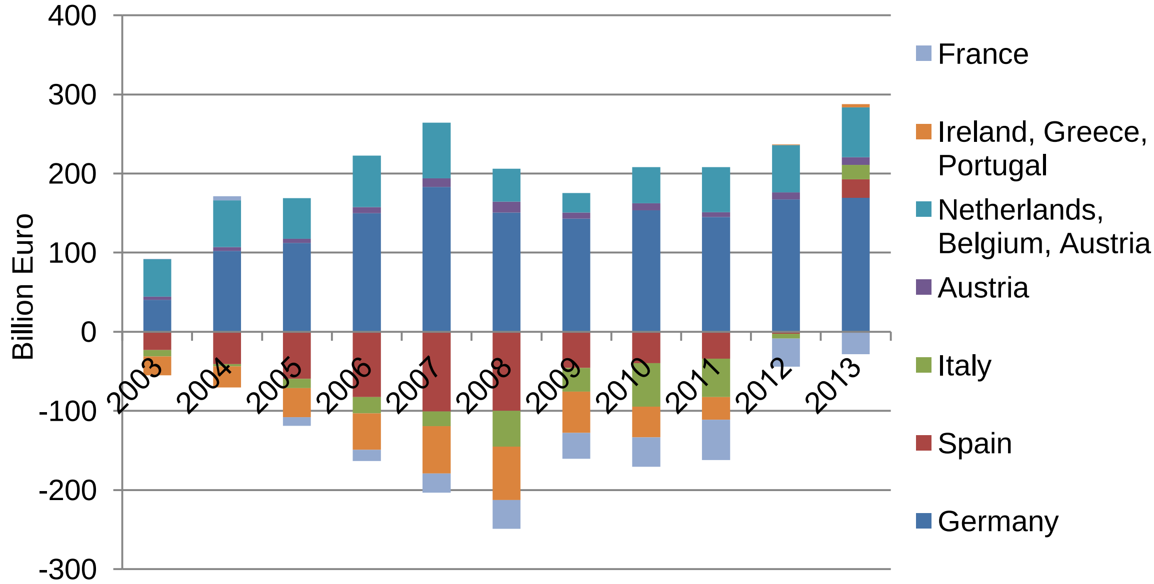
External demand is expected to further support EU exports in the coming years, but less than earlier expected. The IMF expects world trade to grow by 4.9% in 2014, instead of the 5.4% predicted 6 month ago. This mainly results from reduced growth prospects for some key emerging markets.

Our forecast for the EU's current account sees a continuation of the pattern for larger trade surpluses. Reflecting the positive export performance, the EU's current account balance is expected to reach 1.7% of GDP in the EU and 2.8% of GDP in the Euro Area for 2013, with the surplus set to further increase in 2014 to 1.9% of GDP in the EU and 3.0% of GDP in the Euro Area.

As structural reforms are reducing competitiveness imbalances

As figure 6 shows, the countries most affected by the financial crisis started in 2010 are contributing most strongly to such developments. In particular, between 2008 and 2013 Spain turned a € 100 billion deficit to an expected surplus of € 23 billion in 2013. In the same period, Ireland, Greece and Portugal are together foreseen to move from a € 60 billion euros trade deficit to a € 4 billion surplus in 2013.

Figure 6: Current Account balance for selected Euro Area countries

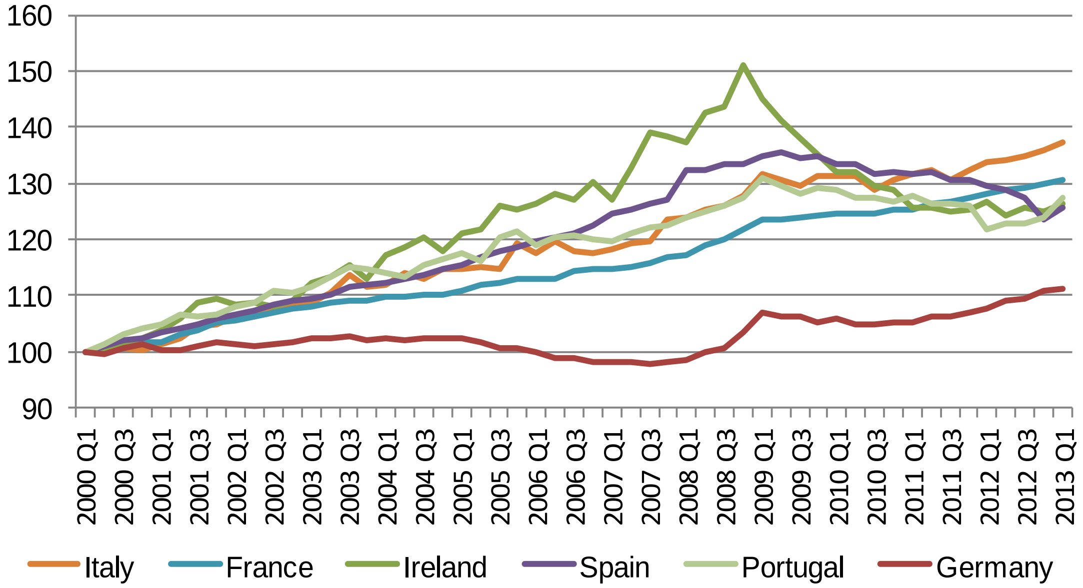


Source: BUSINESSEUROPE's calculation based on ameco data

Such developments were partially driven by progress in structural reforms aimed at increasing export competitiveness and reducing the labour cost imbalances accumulated within the euro area since the creation of the single currency.

Evidence from nominal unit labour cost developments, illustrated in figure 7, show significant progress. In particular, unit labour costs have continued to shrink between the first quarter of 2012 and the first quarter of 2013 in countries including Spain (-3.0%) and Ireland (-0.4%).

Figure 7: Nominal Unit Labour Cost in selected Euro Area countries (100 = Q1 2000)



Source: Eurostat

In countries like Greece and Ireland such developments have been in part led by a negative growth in nominal compensation per employee, which fell by respectively 6.6% and 4.2% between 2008 and 2012. At the contrary, in Portugal and Spain average salary increased by 2.0% and 6.2% respectively, suggesting that the adjustment in these two countries took place to a larger extent through employment losses.

4. LABOUR MARKETS

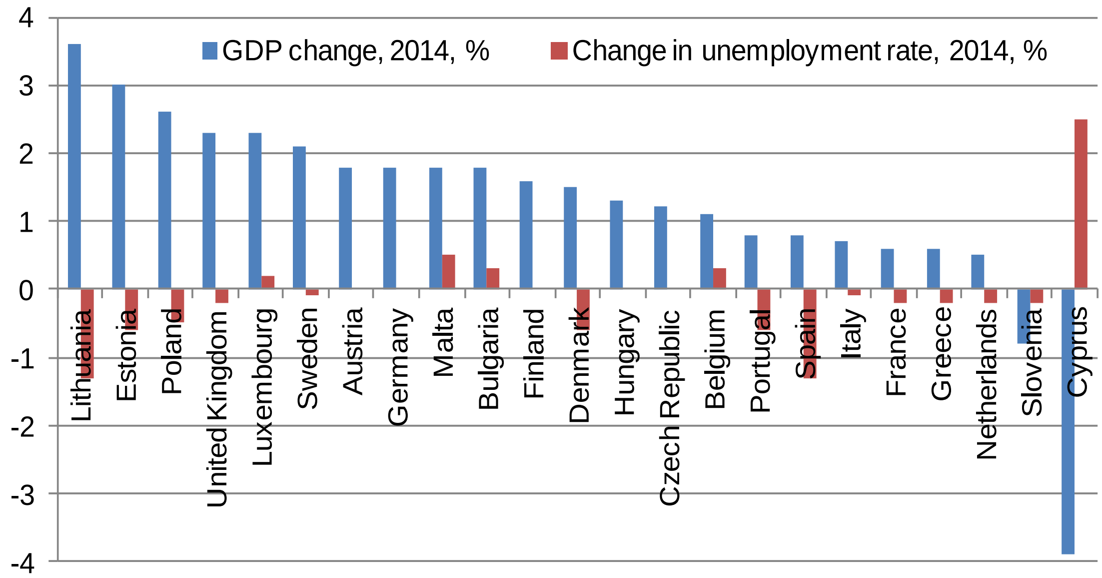
Stronger growth rates and reforms are needed for a job-rich recovery

Labour market conditions will remain uneven. The unemployment rate in Spain, for instance, is around 26% although expected to slightly decrease next year, and joblessness in Austria and in Germany is around 5%.

In spite of the mounting recovery, only 0.5 million jobs are expected to be created in the EU next year. Half of these jobs are foreseen to come from Germany alone.

Reflecting this, as figure 8 illustrates, BUSINESSEUROPE members do not foresee significant falls in unemployment rates in 2014, even in those countries which are expected to see stronger growth.

Figure 8: Change in GDP and unemployment, 2014



Source: BUSINESSEUROPE's forecasts

Looking at the last recession, a picture of employment growth coming slightly later than output in the recovery is what we would normally expect. For example, in 2010 when the EU economy was beginning to bounce back from the initial financial crisis GDP growth was 2%, but unemployment nevertheless increased from 9.0% to 9.7%.

This can be expected because there will have been some labour hoarding during the current recession. Some firms that have been able to keep workers employed during the downturn will be able to draw on that excess capacity. Others may extend the hours of existing workers.

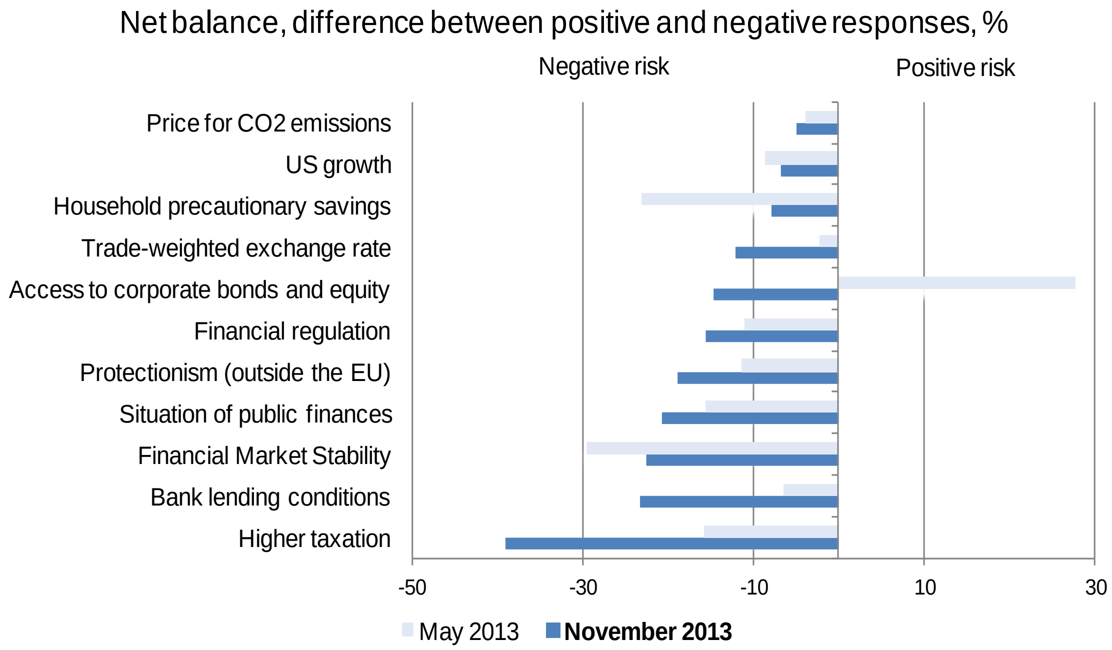
This is why much stronger growth is needed to really bring down unemployment, supported by labour reforms that make it more attractive for firms to take on workers.

5. RISKS TO GROWTH

Risks to growth require appropriate growth-enhancing policies

While BUSINESSEUROPE's members see an improvement in economic activity, substantial downside risks to our outlook remain. In order of importance, BUSINESSEUROPE members identified these in (1) tax increases, (2) bank lending conditions, (3) financial market stability, (4) situation of public finances, and (5) protectionism outside the EU. Addressing such concerns is key to ensure that European businesses will be able to drive a sustained recovery.

Figure 9: Main risks to the BSINESSEUROPE growth baseline scenario



Source: BUSINESSEUROPE's survey of Member Federations

WHO ARE WE?

BUSINESSEUROPE is the leading advocate for growth and competitiveness at European level, standing up for companies across the continent and actively campaigning on the issues that most influence their performance.

We speak for all-sized enterprises in 35 countries whose national business federations are our direct members.

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 autumn's questionnaire were received in late October.

BUSINESSEUROPE

Austria	Belgium	Bulgaria	Croatia	Cyprus	Czech Republic
Denmark	Denmark	Estonia	Finland	France	Germany
Germany	Greece	Hungary	Iceland	Iceland	Ireland
Italy	Latvia	Lithuania	Luxembourg	Malta	Montenegro
Norway	Poland	Portugal	Portugal	Rep. of San Marino	Romania
Serbia	Slovak Republic	Slovenia	Spain	Sweden	Switzerland
Switzerland	The Netherlands	Turkey	Turkey	United Kingdom	

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