BUSINESSEUROPE

ECONOMIC OUTLOOK
SPRING 2013

POLICY PERSEVERANCE CAN RESTORE GROWTH

ECONOMIC SITUATION

- BUSINESSEUROPE **expects GDP growth in 2013 of 0.0% in the EU and -0.4% in the Euro Area.**
- But output is expected to expand moderately in **2014, by +1.4% in the EU and 1.1% in the Euro Area**, assuming business confidence picks up through the second half of 2013.
- The **employment** situation remains an acute concern, with unemployment **in the Euro Area expected to remain around 12% in 2013**. EU unemployment is expected to fall by around 0.5% in 2014, although our Euro Area forecast is for employment to remain stuck at around 12.0%.
- The **EU's current account balance is set to improve** thorough 2013 with the surplus growing to 0.9% of GDP in the EU and 1.9% of GDP in the Euro Area.
- **Fiscal consolidation also continues to progress.** The public deficit in 2013 will fall to 3.3% of GDP in the EU and 2.8% of GDP in the Euro Area. However, public debt remains on an upward path, and will reach 89.3% of GDP in the EU, and 95.0% in the Euro Area in 2013.
- Private investment and private consumption may also start to contribute to growth in 2014, they are forecast to rise by 2.3% and 0.8% respectively in the EU in 2014.
- Bank **lending conditions remain extremely divergent** within the euro area. In a number of European countries, a credit crunch is hampering investment and economic recovery.

POLICY CONSIDERATIONS

- Although the EU has the prospect of returning to limited to growth in 2014, the recovery is at a critical point. Delay in policy actions has created lack of confidence. **Resolute policy actions are required to rebuild business confidence, improve competitiveness, and restore private investment**.

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- **Member States must continue to press ahead with structural reforms**, particularly in priority areas such as increasing labour market flexibility, enhancing product market competition, including through completion of the EU single market, and increasing competitiveness by reducing the regulatory burden on businesses.
- **Efforts to improve the sustainability of public finances must continue**. While Member States may use the room for manoeuvre in the EU fiscal framework regarding the exact speed of consolidation, the overall trajectory of public finance consolidation must be maintained and fully address structural weakness. Consolidation efforts should focus on public expenditure reductions rather than tax increases, with improvements in the efficiency of public services and the elimination of any traces of corruption allowing greater prioritisation of long-term investment.
- The European Commission has an important role to play in supporting reform by providing ambitious Country Specific Recommendations, with the European Council helping to ensure their implementation.
- **Supporting industrial competitiveness, in particular, is key to long-term growth**. The Commission must take immediate action to maintain the EU as a leading location for business activities and investment. Increasing manufacturing's share of production to 20% by 2020, as envisaged by the European Commission, would mean the sector would create at least 400,000 new jobs a year, with further jobs in related services.
- These reforms must go hand in hand with **a more stable and integrated EU financial sector which supports adequate lending, particular to SMEs**. The EU must urgently finalise and implement the new Single Supervisory Mechanism and progress towards a deeper European banking union.

1. OVERVIEW

1.1 Growth expectations for 2013 revised downwards

The first half of 2013 saw further stabilization in financial markets, as result of the clear commitment by the ECB to safeguard the Euro, steps towards a banking union and progress on structural reforms in a number of Member States.

However, it is now clear that the protracted uncertainty the EU economy had experienced during 2012 had a longer lasting and deeper impact on business confidence, private investment and consumption than was expected at the time, while the fragmentation of the Single Market for financial services also persists.

Compared with our Autumn 2012 Economic Outlook, we have slightly revised down our growth expectations for 2013. Growth rate is now foreseen at 0.0% in the EU and -0.4% in the Euro Area this year (table 1). Net exports will continue to positively contribute to GDP growth, with export growth exceeded import growth by +2.2%. But the protracted contraction of private investment (-1.0%) given weakened business confidence, and weak private and public consumption (-0.3%) will continue to provide a drag on growth in 2013.

Table 1: BUSINESSEUROPE main forecasts

	EU27		Euro Area	
Main Variables	**2013**	**2014**	**2013**	**2014**
Real GDP (annual % growth)	**0,0**	**1,4**	**-0,4**	**1,1**
Inflation (%)	**1,9**	**1,8**	**1,6**	**1,6**
Unemployment (%)	**11,1**	**10,6**	**12,1**	**12,0**
Employment growth (%)	**-0,5**	**0,2**	**-0,7**	**0,1**
Government net lending (% of GDP)	**-3,5**	**-3,3**	**-2,8**	**-2,6**
Gross public debt (% of GDP)	**89,3**	**90,1**	**95,0**	**95,7**
	EU27		**Euro Area**	
GDP components	**2013**	**2014**	**2013**	**2014**
Private consumption (%)	**-0,3**	**0,8**	**-0,8**	**0,4**
Public consumption (%)	**-0,3**	**-0,2**	**-0,4**	**-0,1**
Gross fixed capital formation	**-1,0**	**2,3**	**-2,0**	**1,8**
Exports (%)	**2,4**	**3,6**	**2,5**	**2,9**
Imports (%)	**0,2**	**2,5**	**-0,5**	**1,8**

Source: BUSINESSEUROPE's forecasts

Fiscal consolidation is expected to continue to progress. Public deficit in 2013 will fall to 3.5% of GDP in the EU, and to 2.8% of GDP in the Euro Area. However, public debt remains on an upward path, and will reach 89.3% of GDP in 2013, and 95.0% in the Euro Area.

1.2 Signs of a moderate recovery in 2014 are emerging...

BUSINESSEUROPE's members expect the overall business climate, for both industry and services, to start picking-up in the coming six months, pointing to a gradual recovery in the second part of 2013. BUSINESSEUROPE's business climate index for industry rose from 23.5 to 71.8, moving from below to above the 50 level that marks the line between an expected improvement and an expected worsening of industrial activity in the future 6 months.

Reflecting this, a more optimist economic outlook has been formulated for the year 2014, with a growth rate of 1.4% in EU and 1.1% in the Euro Area, provided the expected signals of improvement in private investment and consumption materialise throughout the current year.

1.3...but the employment situations remain an acute concern

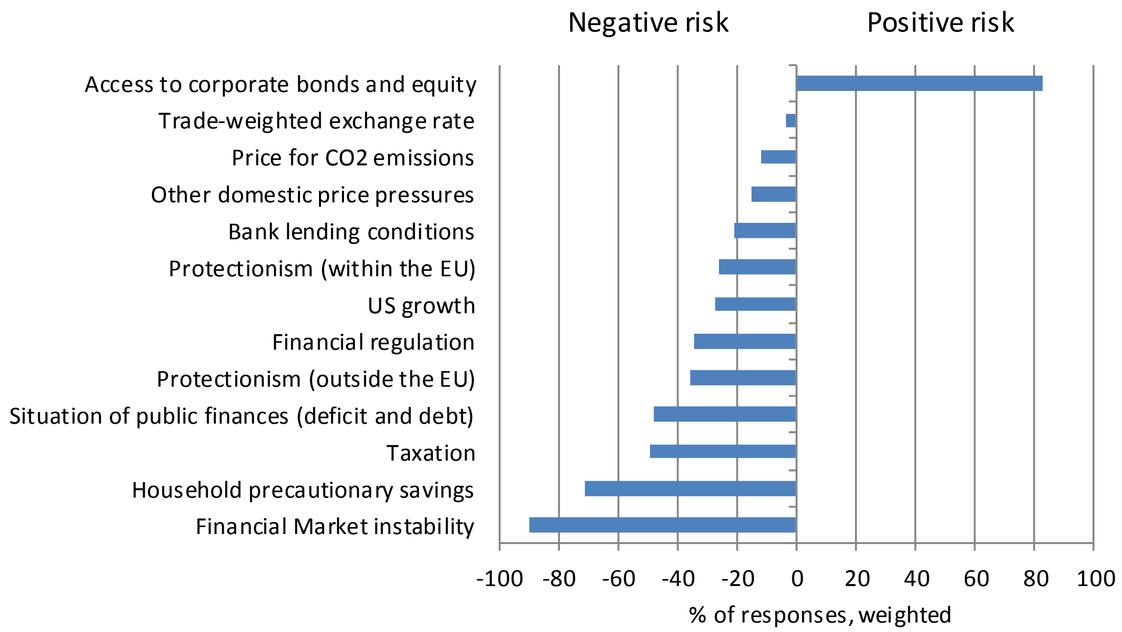
Unemployment in the Euro Area is expected to remain around 12% in 2013. While total EU unemployment is expected to fall by around 0.5% in 2014, our Euro Area forecast is for employment to remain stuck at around 12.0% in 2014. In line with this, up to 1 million jobs remain at risk in the EU in 2013, although 400,000 jobs may be created as the economy picks up in 2014

1.4 Downside risks point to the importance of strong policy decisions

Recent developments relating to the bail-in in Cyprus and the persistence of political uncertainty in some EU countries about the implementation of necessary structural reforms, remind us of the precariousness of the present situation. This reinforces the need to quickly restore growth across the EU, under a sustainable path, and to put in place adequate tools to address weaknesses in its banking sector.

Reflecting this, our outlook remains subject to significant downside risks that our members identify in financial stability, household precautionary savings, higher taxation and overall situation of public finances (figure 1). Addressing such issues by appropriate policy measures will be the key to put Europe back to economic growth and maintain it as an attractive place where to invest.

Figure 1: Main risks to the BUSINESSEUROPE baseline scenario



Source: BUSINESSEUROPE's survey of Member Federations

2. COUNTRY DIVERGENCES

Not surprisingly, although growth in all the largest EU economies remains below potential, the differences in economic performance among European economies remain important (table 2). Amongst the largest economies, Germany (+0.8%), United Kingdom (+1.0%) will continue to show more resilience this year, while in France (-0.2%), Italy (-1.1%) and Spain (-1.5%) GDP is set to contract.

Amongst the countries most affected by the financial crisis started in 2010 we expect to see significant signs of improvement during the forecast period. In Ireland, the pace of recovery is expected to pick up, from 1.8% in 2013, to 2.5% in 2014. While Portugal and Greece are expected to experience another year of GDP contraction in 2013 (-2.3% and -4.6% respectively), Portugal is expected to return to growth in 2014 (1.1%) and Greece to stabilise (0.0%). However, in the case of Cyprus, the cost of the adjustments following its banking crisis will be dramatic, with output now expected to contract by 10.0% this year.

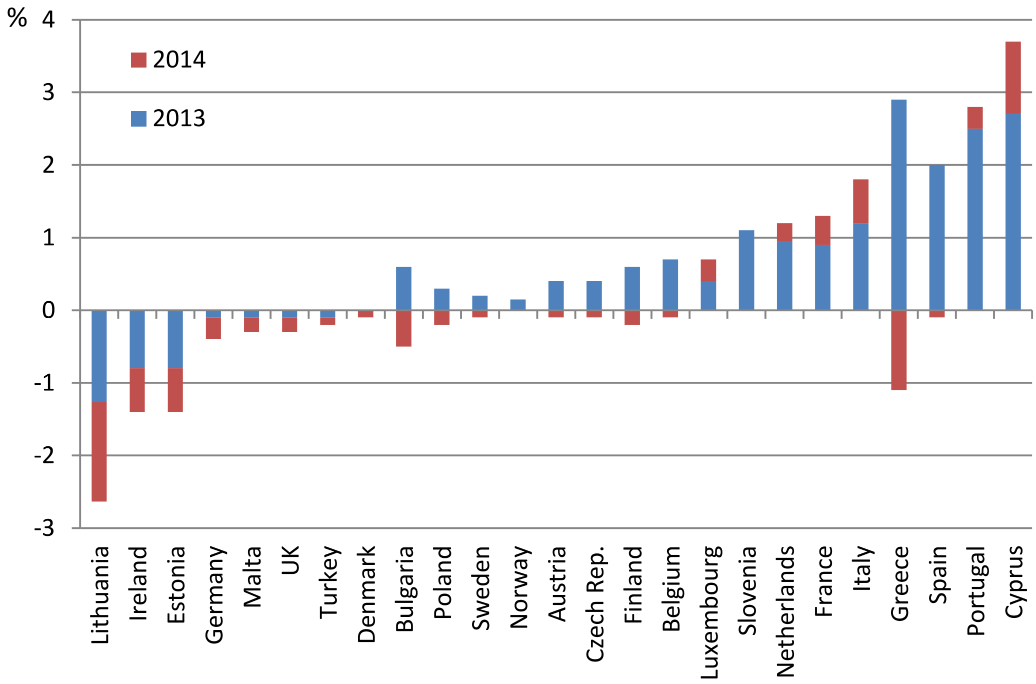
Table 2: Forecast selected EU Member States

%	Real GDP Growth 2013	Change from December Economic Outlook	Real GDP Growth 2014	Unemployment 2013	Unemployment 2014 Percentage point change from 2013
EU 27	**0,0**	*(-0,5)*	**1,4**	**11,1**	**-0,5**
Euro area	**-0,4**	*(-0,5)*	**1,1**	**12,1**	**-0,1**
Germany	0,8	*(-0,2)*	1,9	5,4	-0,3
France	-0,2	*(-0,4)*	0,7	10,8	0,4
United Kingdom	1,0	*(-0,4)*	2,0	7,8	-0,2
Italy	-1,1	*(-0,6)*	0,6	11,8	0,6
Spain	-1,5	*(-0,1)*	0,8	27,0	-0,1
Greece	*-4,6*	*(-0,1)*	*0,0*	*27,6*	*-1,1*
Portugal	*-2,3*	*(-1,3)*	*1,1*	*18,2*	*0,3*
Ireland	*1,8*	*0,0*	*2,5*	*13,9*	*-0,6*
Cyprus	*-10,0*	*(-8,3)*	*-8,0*	*15,0*	*1,0*

Source: BUSINESSEUROPE's forecast

Nevertheless, reduced economic activity continues to contribute to weak labour markets in a number of countries. Our members expect unemployment rates in 2013 to reach record levels of 27.6% in Greece, 27.0% in Spain, 18.2% in Portugal and 11.8% in Italy. More positively, in Germany and United Kingdom, labour markets are expected to remain resilient all over 2013 and 2014, with figure 2 illustrating the varying employment picture across EU member states.

Figure 2: Change in Unemployment in 2013 and 2014



Source : BUSINESSEUROPE's forecast

3. DETAILED ANALYSIS

3.1 A positive external environment is supporting EU export growth

Growth prospects for the main EU international partners show that the external environment remains resilient. However, this also highlight that, compared to its main competitors, the EU economy is losing further ground. The IMF expects that the engines of world growth this year will remain in non-EU countries, notably the US (+1.9%), Japan (+1.6%) and China (8.0%).

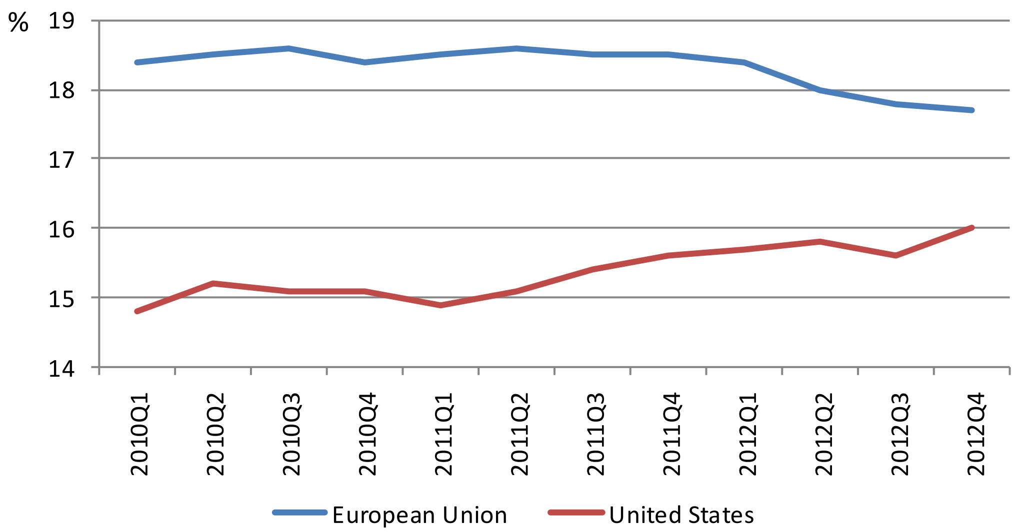
World trade has been growing by 1.7% over the last year, and is expected to remain supportive of EU exports. EU net exports are expected to expand by 2.2% in 2013. Such a positive balance is set to shrink to 1.1% in 2014, due to an expected pickup in imports.

As our **box on macro-economic imbalance procedures** describes more in detail, improvements in labour cost competitiveness in a number of Euro Area countries are contributing to improvement in current accounts in a number of countries that were contributing to overall imbalances within the monetary union. Boosted by global growth, the EU's overall current account balance is also set to improve, the surplus growing thorough 2013 to 0.9% of GDP in the EU and 1.9% of GDP in the Euro Area.

3.2 Private investment currently stagnating

Concern that the EU is losing ground on international competitors is illustrated strongly by investment data. EU investment as a share of GDP continues to drop. The presently rate of 17.5% is well below the 21% observed in the pre-crisis years (before 2008) and continues to decline. In contrast, in the US this rate has started recovering since the last part of 2012 (figure 3).

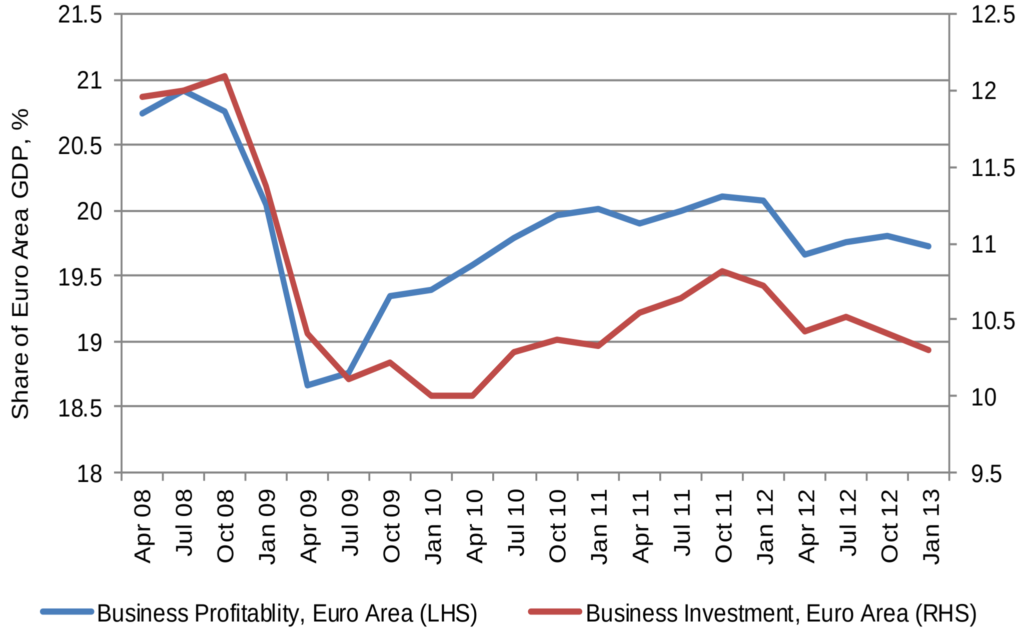
Figure 3: Gross fixed capital formation as share of GDP



Source : Eurostat

Weak investment in Europe is mainly due to a protracted stagnation of private investment, especially within the Euro Area. As figure 4 illustrates, the investment rate of non-financial corporations continues to fall.

Figure 4: Euro Area Business Investment and business profitability as share of GDP



Source : Eurostat

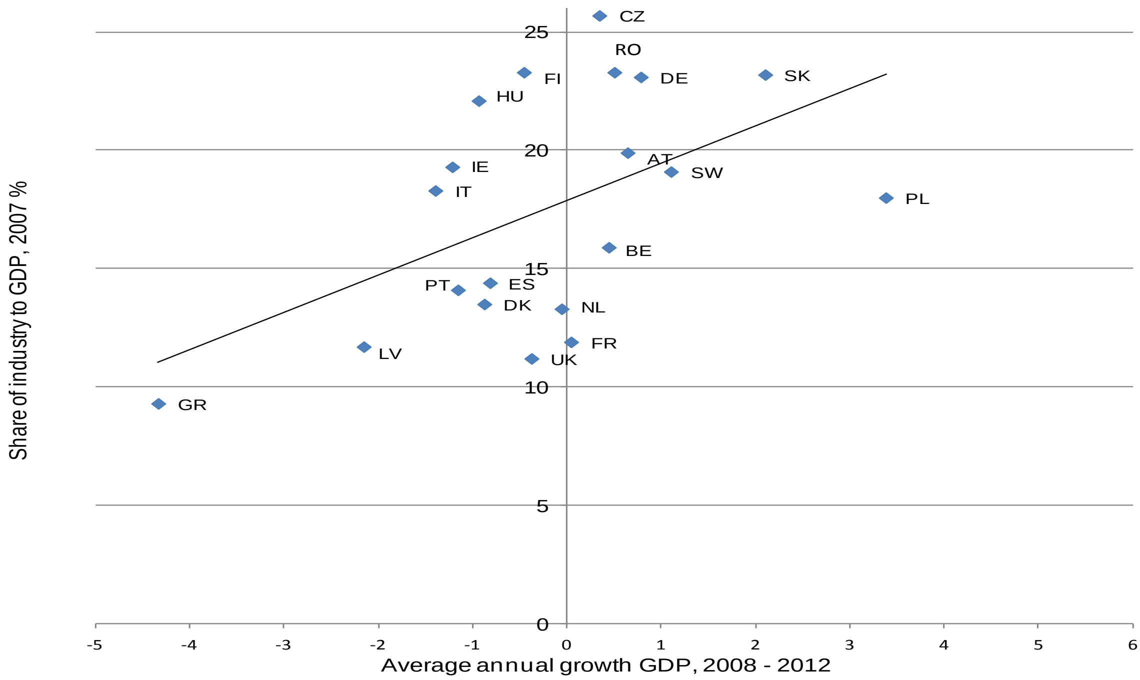
3.3...and industrial activity remains weak

Industrial activity remains weak, and in last March was 1.7% lower than the same period last year, (despite an increase of 0.4% between February and March). This follows a negative trend observed during the last years, which, in a number of EU countries, coincided with very weak output growth and significant job losses.

The importance of industrial growth is illustrated by figure 5, which shows that those countries that had a stronger industrial base before the crisis, generally experienced better economic performance in recent years.

In this context the blueprint set out by the European Commission to raise industry's contribution to EU GDP to 20 % by 2020 is a necessary step forward. The EU needs to reverse its process of de-industrialisation decline in order to underpin a sustainable recovery of economic growth. **Increasing manufacturing's share of production to 20%** by 2020, would mean the sector would create at least 400 thousand new jobs a year, reversing the losses of recent years.

Figure 5: Industry and Output Growth



Source : BUSINESSEUROPE on Eurostat data

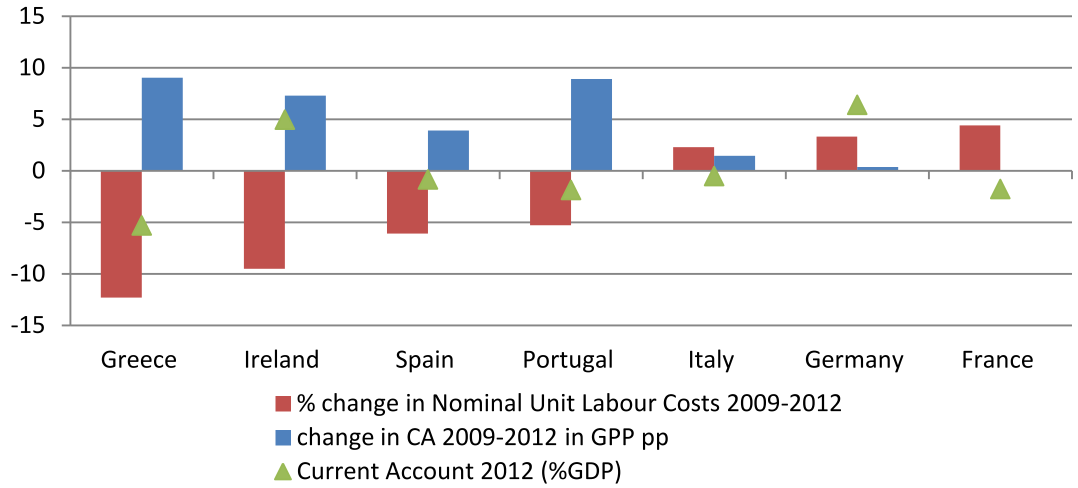
FOCUS: Increasing long term competitiveness and stability: the role of the EU's Macroeconomic Imbalances Procedures

The financial crisis, and subsequent sovereign debt crisis, was preceded in many EU Member States by a sustained deterioration in competitiveness, as wage increases not underpinned by reform-driven productivity growth led to growing current account deficits and to the building-up of unsustainable current account and budget deficits. The sharp withdrawal of capital flows resulted in economic contraction, rising unemployment and a deterioration of public finances.

In order to avoid the build-up of such imbalances across the EU, the EU has introduced a new macroeconomic imbalances procedure which complements the stability and growth pact's emphasis on fiscal discipline, to help prevent the build-up of broader imbalances. The new framework is aimed at identifying macroeconomic imbalances at an early stage and at preventing and correcting them through recommendations to member states for specific economic measures, which can be enforced with the help of financial sanctions where severe macroeconomic imbalances weigh high recessive and spill-over risks.

The Commission's 2nd alert mechanism report published in November 2012 highlights that adjustment is on-going in the countries that accumulated the largest competitiveness imbalances in the years prior to the crisis. The decline in unit labour cost, in some cases as Member States have made progress in tackling structural reforms aimed at reducing labour market rigidities and better linking wages to productivity has contributed to improvements in their current account deficits. For example, as figure 1 shows, unit labour costs have declined by 6.1% in Spain and 12.3 % in Greece, helping reduce their current account deficits as a share of GDP respectively by 3.9 and 9.0 percentage points between 2009 and 2012.

Figure 6: Trends in unit labour cost improved current account positions



Source: Ameco, Eurostat

However, governments must remain resolute in pursuing efforts to strengthen competitiveness, not least given part of the decline in unit labour costs is due to the shedding of workers and a divergence in living standards within the EU, while current account positions have been helped by weak domestic demand reducing imports, as well as improved exports in the countries with more favourable business environments.

The Commission's November report indicated that aside from countries undertaking EU/IMF led restructuring programmes, 13 EU Member States continue to demonstrate significant imbalances. In particular, companies' access to finance and their ability to make the necessary investments to drive growth and competitiveness remain strongly hampered in those countries where the banking and financial system is exposed to high private debt levels and sovereign risks, in particular where strong housing market corrections occur. The Commission's analysis demonstrates that coupling consolidation efforts with resolute implementation of competitiveness-enhancing structural reforms will be key for them to reduce macroeconomic imbalances and restore sustainable growth.

For example, the Commission notes:

- Although Spain has responded with efforts to consolidate public finances and reforms, the nature of the policy challenges require a comprehensive and ambitious policy response. Thus, further steps to strengthen competition in product and service markets, improve business environment, support growth and internationalisation of firms, widen the sources of financing and review tax system would contribute to a greater adjustment capacity of the Spanish economy. External and private debts levels which, at 92% and 227 % GDP respectively, continue to pose serious risk for growth and financial stability. The very high unemployment level, which should peak at 27% this year, also calls for efforts to improve the employability of younger workers, link wages to economic performances and encourage flexible forms of employment.
- In **Slovenia**, where firms' competitiveness and financial situation have deteriorated, the Commission considers that risks to the stability of the financial sector stemming from corporate indebtedness and deleveraging are substantial, including through inter-linkages with public finances. Measures must ensure flexible wage setting supports cost competitiveness adjustments and must additionally improve banks' and firms' governance structures, in particular by reducing state involvement in the economy.
- In **France,** further policy action will be needed to restore firms' profitability and increase their capacity to invest and innovate. Measures to address labour market rigidities alleviate the tax burden and support firm's export and innovation capacity are necessary to reverse the on-going deterioration of cost and non-price competitiveness that resulted in a decrease in global export market share of 11.2% between 2006 and 2011.

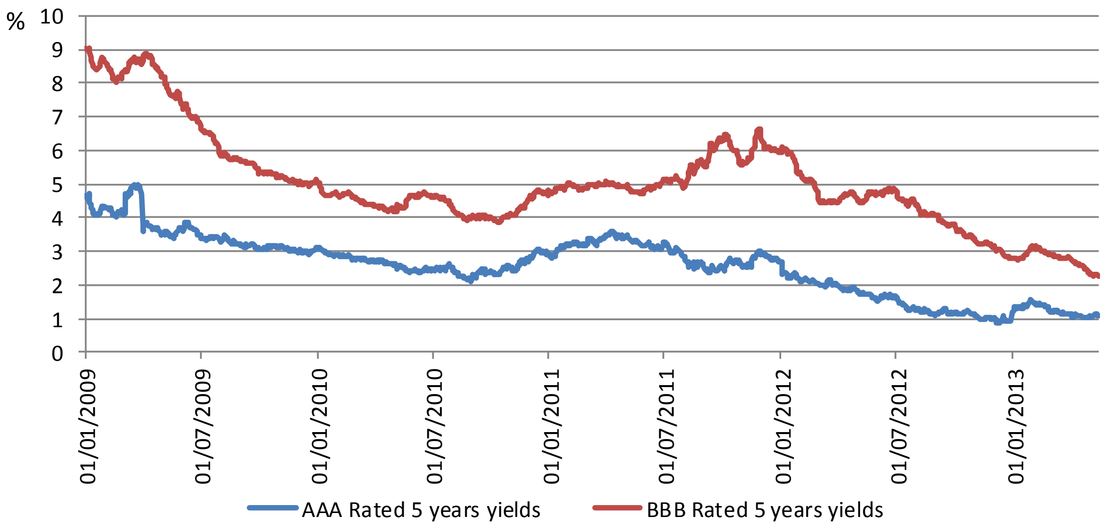
In conclusion, the macroeconomic imbalances procedure has the potential to play an important role in increasing both economic stability in the EU and in turn long-term competitiveness.

3.4 Access to Finance a continuing concern

The last six months saw a further reduction of financial market uncertainty, with sovereign borrowing interest rates considerably reducing in the countries that were mostly affected by recent financial turmoil. For example, 10 years bond yields are presently around 4.2% in Spain, compared to 5.2% in December 2012, and 3.9% in Italy, compared to 4.4% in December 2012. These are the lowest interest rates observed over the last 2 years and show increasing investors' confidence about fiscal sustainability in these countries.

Many large firms have continued to benefit from falling interest rates. As figure 7 illustrates, improvements in corporate bond markets have continued all over the last months.

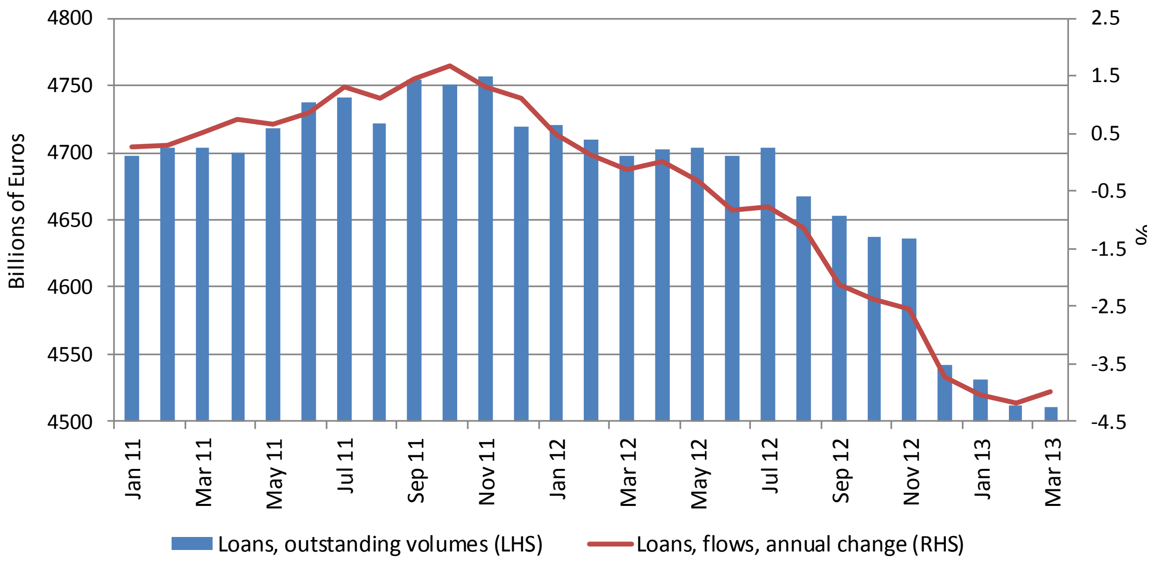
Figure 7: Corporate bonds yields in the Euro Area



Source : Macrobond

But for a large number of European businesses recent progress was not yet reflected by improved access to finance. At the contrary, as illustrated in figure 8, lending to non-financial corporations continues to fall dramatically (-4.0% between March 2012 and March 2013 in the euro area).

Figure 8: Loans to non-financial corporations in the Euro Area, volumes

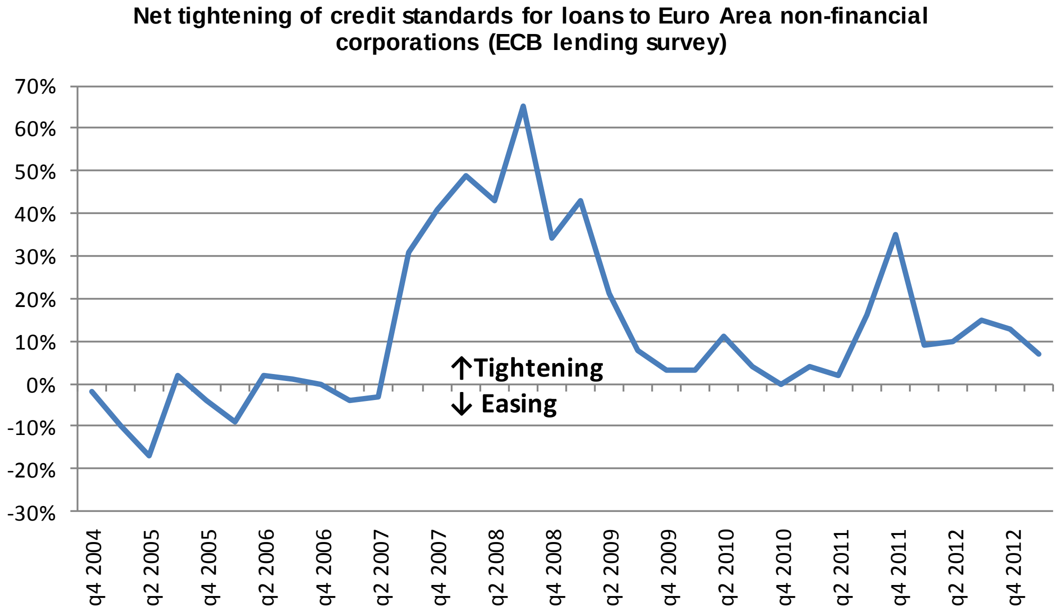


Source : European Central Bank

This continues to be partially due to weak demand. But at same time, small and medium businesses remain considerable constrained on the credit supply side, a credit crunch being largely hampering their investment activities in a number of Euro Area economies.

As the ECB lending survey shows (figure 9), businesses located in the Euro Area continue to suffer from an overall tighten in credit conditions applied by banks to the approval of loans to enterprises.

Figure 9: ECB lending survey on credit standards for bank loans to enterprises



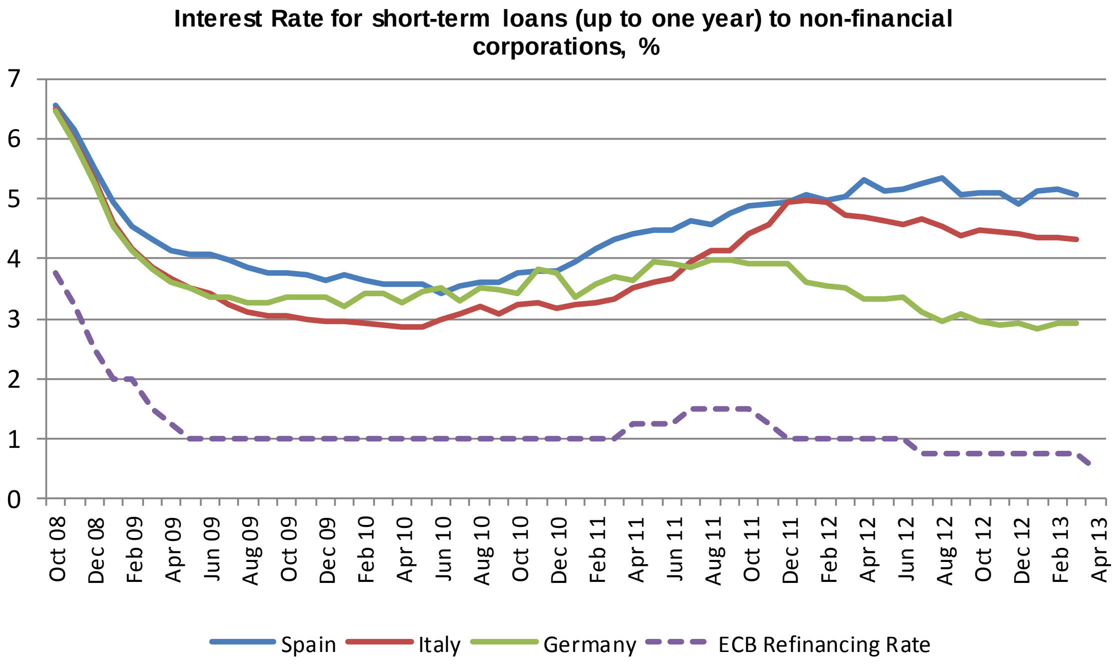
Source : European Central Bank

At the country-by-country level, the worrying trend towards falling integration of EU lending markets that was underlined in BUSINESSEUROPE's Autumn Economic Outlook remains a source of concern. As figure 10 illustrates, interest rates charged for bank loans to businesses within the Euro Area continue to diverge, depending on and the country where the business applied for bank loans.

For example, the bank lending interest rate for short-term loans (maturity below one year) to businesses in March 2013 was at around 5% in Spain and 4.3% in Italy, against an average of 2.9% in Germany. Likewise, this rate is at around 7.3% in Cyprus and 6.5% in Portugal, against a 2.0% in Belgium and 2.2% in Austria.

As a result of the continuing fragmentation of Single Market for financial services, a number of European businesses, mostly SMEs, remain excluded from bank funds regardless the quality of their business projects.

Figure 10: Bank lending interest rates in selected Euro Area economies



Source : European Central Bank

The recent ECB cut of its refinancing rate, from 0.75% to 0.5%, can provide some easing of credit conditions to businesses. However, as the ECB has also underlined, the limited relationship between the ECB policy rate and bank lending interest rates to businesses in a number of Euro Area countries shows that the transmission of the monetary policy is partially broken and the impact of the cut is likely to be limited, especially in the countries in which businesses would aspire most to benefit from it.

Annex 1: Main forecasts for all the economies surveyed

	Real GDP growth		Inflation		Unemployment	
% Change	2013	2014	2013	2014	2013	2014
Austria	0,8	1,8	2,1	1,9	4,7	4,6
Belgium	0,0	1,2	1,6	1,6	8,1	8,0
Cyprus	-10,0	-8,0	2,3	2,1	15,0	16,0
Finland	0,3	1,8	2,4	1,9	8,3	8,1
France	-0,2	0,7	1,0	1,6	10,8	11,2
Germany	0,8	1,9	1,7	2,0	5,4	5,1
Greece	-4,6	0,0	-0,1	-0,4	27,6	26,5
Ireland	1,8	2,5	1,3	1,9	13,9	13,3
Italy	-1,1	0,6	1,8	1,6	11,8	12,4
Luxembourg	0,8	1,6	1,9	1,7	5,5	5,8
Malta	1,4	1,8	1,9	1,9	6,3	6,1
Netherlands	-0,5	1,0	2,8	2,0	6,3	6,5
Portugal	-2,3	1,1	0,7	1,0	18,2	18,5
Slovenia	-2,0	0,2	2,3	1,4	10,0	10,0
Spain	-1,5	0,8	2,0	1,2	27,0	26,9
Bulgaria	0,5	1,0	4,0	4,5	12,0	11,5
Czech Republic	0,1	1,2	1,8	2,0	7,4	7,3
Denmark	0,5	1,6	0,8	1,7	7,5	7,4
Estonia	3,0	3,0	3,6	3,0	9,4	8,8
Hungary	0,5	1,9	2,9	3,0	10,8	10,7
Lithuania	2,9	3,6	2,3	2,9	12,0	10,6
Poland	1,2	2,1	1,2	2,0	10,7	10,5
Sweden	1,0	2,2	1,2	1,7	8,2	8,1
United Kingdom	1,0	2,0	2,6	2,2	7,8	7,6
Norway	0,5	2,3	1,4	1,3	3,3	3,3
Turkey	4,0	5,0	7,0	4,9	8,9	8,8
Iceland	1,9	2,7	4,2	3,4	4,9	4,6

WHO ARE WE?

THROUGH ITS 41 MEMBER FEDERATIONS, BUSINESSEUROPE REPRESENTS MORE THAN 20 MILLION COMPANIES FROM 35 COUNTRIES. ITS MAIN TASK IS TO ENSURE THAT COMPANIES' INTERESTS ARE REPRESENTED AND DEFENDED VIS-À-VIS THE EUROPEAN INSTITUTIONS WITH THE PRINCIPAL AIM OF PRESERVING AND STRENGTHENING CORPORATE COMPETITIVENESS.

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 2013.

BUSINESSEUROPE

Members are 41 leading national business federations in 35 european countries

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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