BUSINESSEUROPE SPRING ECONOMIC OUTLOOK

5 June 2024

EU ECONOMY TO SLOWLY RETURN TO GROWTH - BUT LONG-TERM CHALLENGES REMAIN

ECONOMIC SITUATION

- **The EU economy is expected to grow by 1.2% in 2024,** increasing **to 1.8% in 2025**. This is a 0.4 pp downward revision for 2024 in comparison to our Autumn Economic Outlook as EU industrial producers face continuing challenges resulting in the lowest level of capacity utilisation (excluding Covid) for 11 years.

- **Headline inflation is to continue its** steady **decline, averaging 2.9% and 2.6% respectively in the EU and** Euro Area **in 2024**, before approaching the ECB's 2.0% target in 2025.

- **Increased private consumption and investment are set to be the main drivers of growth in 2024** with EU investment growth reaching 3.4% in 2025 on the back of lower interest rates.

POLICY RECOMMENDATIONS

- Policymakers must urgently address the structural challenges facing European industry vis-à-vis global competitors, such as high energy prices and an excessive regulatory burden. It's crucial that the EU's industrial base is maintained for our economic security and prosperity.

- The ECB must continue to carefully calibrate monetary policy to ensure a timely return to the 2% inflation target. Fiscal policy should continue to be supportive of monetary policy, and it will be particularly important that the Commission ensures that the new economic governance framework effectively supports Member States in putting their public finances on a more sustainable footing.

- EU leaders must use the recommendations of the Letta, and forthcoming Draghi report, to develop a long-term European growth strategy, including strengthening the single market, deepening capital markets, and supporting structural reforms in Member States, to put competitiveness at the heart of the next political cycle.

ABOUT THE ECONOMIC OUTLOOK

BusinessEurope publishes a biannual Economic Outlook that provides business insight into recent and projected economic developments in Europe.

In producing our economic projections and assessing current challenges and developments in the international and regional economy, BusinessEurope works closely with its member federations and draws on their specialist expertise and detailed knowledge of their national economies and ongoing interactions with business.

In particular, our EU27 and Euro Area forecasts are a reflection of the GDP-size weighted economic forecasts from each member state from the economic research departments of our national member federations. Our economic projections are therefore informed by leading country experts with in-depth knowledge and day-to-day monitoring of the economic situation in every EU member state.

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OVERALL FORECAST

Table 1: BusinessEurope Economic Forecast

	EU		Euro Area	
Main Variables	**2024**	**2025**	**2024**	**2025**
Real GDP (annual % growth)	1.2	1.8	0.9	1.4
Inflation (%)	2.9	2.3	2.6	2.0
Unemployment (%)	5.9	5.7	6.3	6.2
Government net lending (% of GDP)	-2.0	-1.8	-1.7	-1.4

Source: BusinessEurope staff calculations based on Member Federations

After a disappointing year for the European economy in 2023, with growth of only 0.5%, compared to 2.5% in the US, there are signs that the economy may now be bottoming out. Both EU and Euro Area GDP grew by 0.3% in the first quarter of 2024, following 2 quarters of stagnation

Based on input from member federations, we expect:

- **The EU economy to grow by 1.2% in 2024, with EU growth** increasing **to 1.8% in 2025**. This is a 0.4 pp downward revision for 2024 in comparison to our Autumn Economic Outlook, owing to a weaker-than-expected recovery in investment and export activity.

- **Headline inflation is to continue its steady decline, averaging 2.9% and 2.6% respectively in the EU and Euro Area in 2024**, before approaching the ECB's 2.0% target in 2025.

- **Unemploymen**t, which is currently at record-low levels in the EU will fall slightly from its April 2024 level of 6.0%, **reaching 5.9% in the EU in 2024 and 5.7% in 2025** and declining from 6.3% in 2024 to 6.2% in 2025 in the Eurozone.

- **Private and public consumption are set to be the main drivers of growth in 2024**, though the latter is set to decline in 2025 as the new European fiscal rules set in and government support measures are rolled back as headline inflation approaches the 2% target.

- **Investment and trade are expected to strongly rebound in 2025** with EU investment growth reaching 3.4% in 2025 on the back of lower interest rates. Robust growth of global trade will lead to export growth of 1.4% in 2024 before accelerating to 3.2% in 2025.

Business borrowing, and consequently investment, continues to be negatively impacted by elevated interest rates which also continue to dampen consumer demand.

Both headline and, most importantly, core inflation (excluding energy, food, and tobacco) have steadily come down since the publication of our Autumn Economic Outlook, with Euro Area headline inflation reaching 2.6% and core inflation at 2.9% in May 2024. Whilst risks remain to the inflation outlook, notably increasing pressures on many global commodity prices, and persistent services inflation, following above inflation wage increases, market expectations remain that businesses will benefit from more favourable lending rates in the second half of the year, as the ECB gradually lowers its key interest rates in the coming months.

Recent increases in disposable incomes, rising along real wages and the prospect of lower interest rates in the second half of the year are therefore reasons for cautious optimism that domestic demand will increase in the second half of 2024. However, increases in consumer confidence and similar indicators such as PMI surveys should not be overinterpreted, as they're recovering from very low levels, and often remain in negative territory despite recent increases.

Moreover, the picture continues to vary significantly across sectors. EU manufacturing output has steadily declined after peaking in February 2023, with output in January of this year only 0.3% higher than 2019 levels and export volumes of manufactured goods almost 10% lower compared to 2019 levels. A number of downside risks may slow down the expected economic recovery in 2024. The geopolitical situation globally remains volatile, with risks of new supply chain disruptions that may lead to renewed price pressures. A stronger-than-expected transmission of the current restrictive monetary policy stance may slow down the expected economic recovery as businesses delay their investment decisions. Policy decisions made in other major economies may also have consequences for the EU's growth outlook.

Growth is set to pick up despite sectoral divergences in performance

After two quarters of stagnation in the EU in the second half of 2023, the EU economy grew by 0.3% in the first quarter of 2024. Similarly, the Euro Area moved out of technical recession with 0.3% growth in Q1-2024 after a contraction of 0.1% in both of the preceding quarters. The weak performance was broad-based across the different GDP components.

Whilst overall, there is some very cautious optimism for 2024, this is not universal across all sectors. In particular, businesses in the manufacturing sector continue to face challenging times as energy prices remain high compared to major competitors and losses in competitiveness reduced the export potential for European businesses. Exports are set to increase as global trade picks up later in the year, though structural disadvantages make it unlikely for European businesses to fully recover their market share.

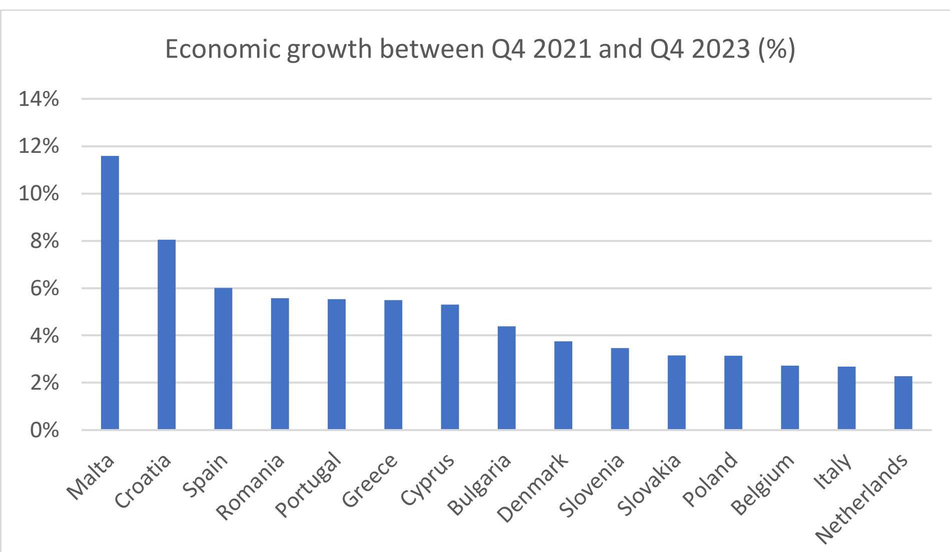
Table 2: Private consumption and investment are expected to increase significantly as interest rates fall

	EU		Euro Area	
Main Variables	**2024**	**2025**	**2024**	**2025**
Private consumption (%)	1.5	1.8	1.2	1.5
Public consumption (%)	1.6	1.1	1.2	0.8
Investment (%)	0.6	3.4	0.2	3.1
Exports (%)	1.4	3.2	1.0	3.0
Imports (%)	1.1	3.2	0.5	2.9

Source: BusinessEurope staff calculations based on Member Federations

From Q4 2021 to Q4 2023, the EU economy grew by just 2%. This growth was broad-based, as 16 countries underperformed compared to the EU average, with four Member States seeing their output fall during this period. Southern European economies grew notably faster than the EU average in recent quarters, owing to strong private and public consumption growth, partially supported by NextGenEU funding. Chart 1 shows the growth rates for the countries that outperformed the EU average growth rate of 2.0% in the last two years.

Chart 1: Southern European economies performed strongly despite the energy crisis



Source: Eurostat [namq_10_gdp] and BusinessEurope Staff calculations

As real wages rise and unemployment is set to remain low, we forecast private consumption to increase by 1.5% in the EU in 2024 and 1.8% in 2025. Recent wage increases are reflected in increasing consumer spending, with retail trade volumes in the EU in February 2024 reaching a level not seen since November 2022. Consumer confidence has similarly been on the rise since September 2023, increasing by 3.4 points but remaining in decisively negative territory at -13.7 in April 2024.

The EU's weak growth performance in 2023 is not evenly spread across the EU as a consequence of the different composition of national economies as services outperformed industry. The EU's services industry was 12% larger in Q4-2023 compared to the 2019 average, continuing its persistent growth pattern since the record low of Q2-2022. Strong growth in the tourism sector provided an extra boost to tourism-oriented economies as the accommodation industry grew past pre-pandemic levels to a new record high.

The EU's manufacturing sector continues to perform poorly as a consequence of subdued demand and high non-consumer energy prices, as both industrial electricity and gas prices remained more than double their pre-covid levels in the second half of 2023 despite recent declines[1]. The EU's manufacturing output has steadily declined after peaking in February 2023, with output in January of this year only 0.3% higher than 2019 levels, 6% lower than in February 2023 and export volumes of manufactured goods almost 10% lower compared to 2019 levels. The manufacturing of computer, electronic, and optical products (-28%) and the pharmaceutical industry (-16%) have seen the strongest decline in output over the last year.

EU ETS carbon prices have increased by about 26% between the start of March and the start of May 2024, and are expected to almost double in the medium term as free allowances are phased out[2]. This increase creates another challenge for energy-intensive industries, which have already seen their cost competitiveness decrease as a consequence of the energy crisis and carbon pricing policies[3].

Industrial confidence in the EU has been negative since August 2022, with no sign of recovery following a new decline in April this year. Most worryingly, as chart 2 shows, manufacturing capacity utilisation fell to less than 80% in April 2024, which excluding the Covid period, is the lowest level since 2013, illustrating the significant pressures facing the sector[4].

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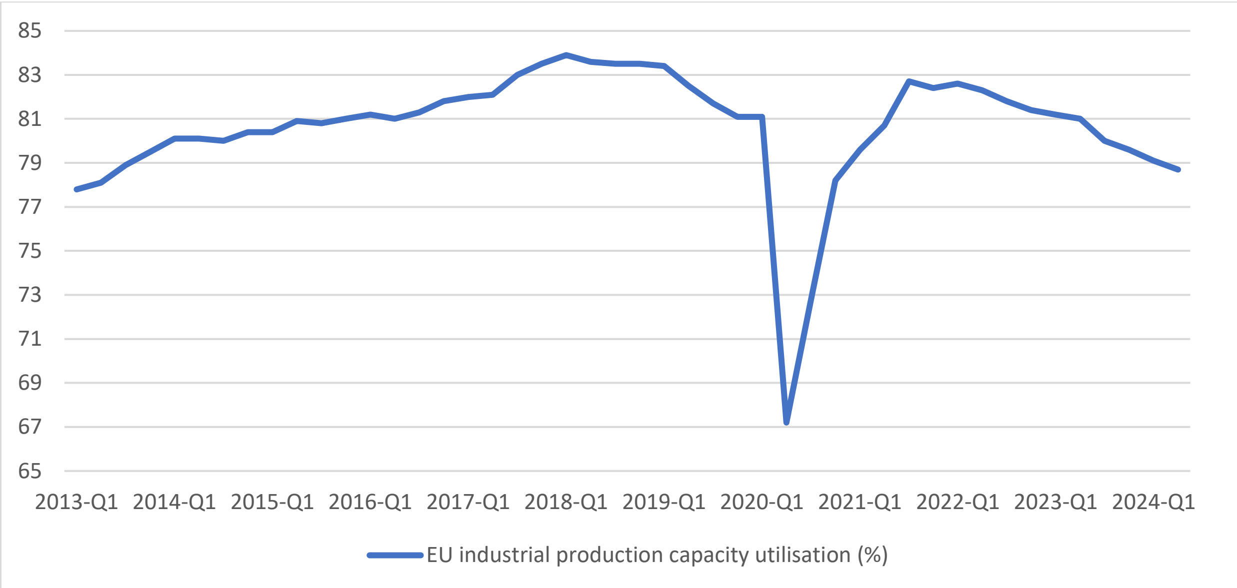
[1] Eurostat [nrg_pc_203] and [nrg_pc_205]
[2] Ruiz, P. (2023). The End of Free EU ETS Rights: the Carbon Bill Reshaping European Industry. Rabobank Research
[3] ERT & BCG. (2024). Competitiveness of European Energy-Intensive Industries
[4] European Commission Business and Consumer Survey; April 2024

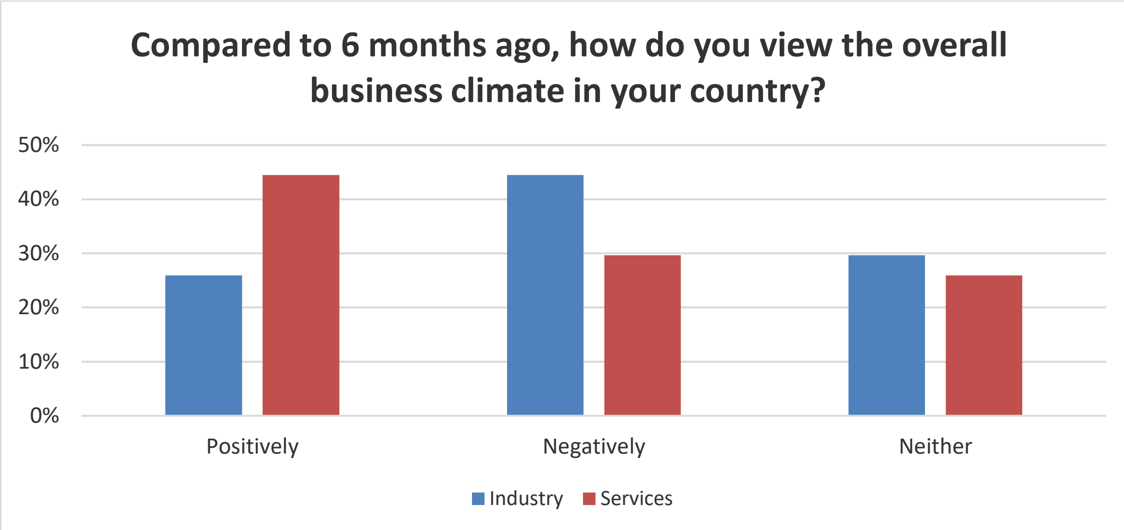
Chart 2: Industrial capacity utilisation is at its lowest level since 2013



Source: European Commission

Despite the expected pick-up in overall growth, Chart 3 shows that almost three-quarters of BusinessEurope Member Federations believe that the business climate for industrial producers has either worsened or shown no improvement compared to 6 months ago. This is a strong contrast with the almost half (44%) of BusinessEurope Member Federations that view the business climate for services more positively than half a year ago.

Chart 3: BusinessEurope Member Federations remain pessimistic about European industry while outperformed by the services industry



Source: BusinessEurope Member Federations

Investment remains subdued by high borrowing costs and tough credit standards

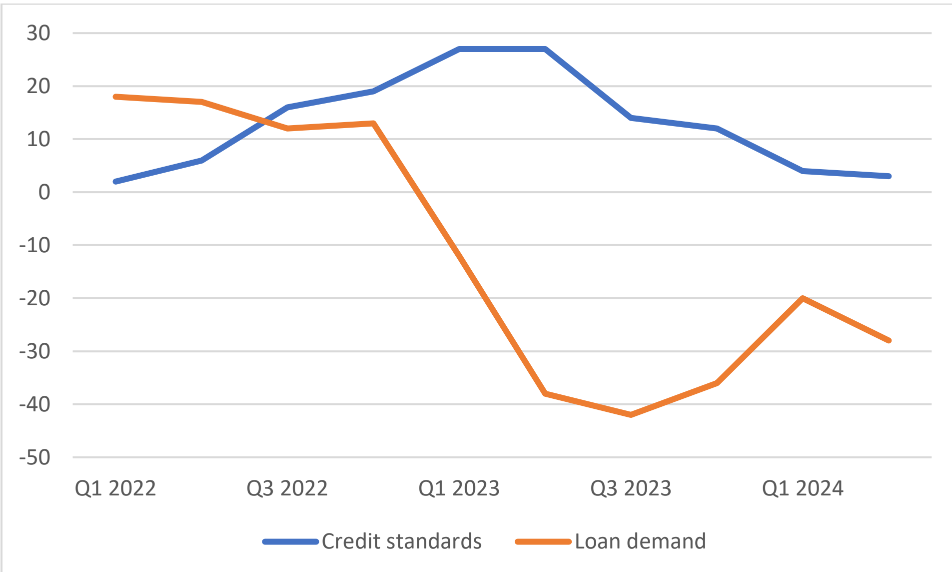
European businesses continue to face high borrowing costs, despite facing massive investment needs to stay competitive on the global stage, and for managing the green and digital transitions. Previous key interest rate increases are still being transmitted through the economy, dampening demand.

Eurostat estimates show that gross fixed capital formation growth declined from 2.7% in the EU in 2022 to 1.5% in 2023. We forecast gross capital formation in the EU to grow by just 0.6% in 2024 before rebounding to 3.4% growth in 2025 as a consequence of a less restrictive monetary policy in 2025.

As the restrictive monetary policy stance of the ECB continues its transmission through the economy, businesses' borrowing remains understandably subdued. The ECB's composite cost of borrowing indicator reached its highest point since late 2008 in October 2023, but has marginally declined from 5.27 in October to 5.18 in March 2024. Borrowing costs are highest for the smallest size of loans surveyed (up to EUR 250.000), creating particular challenges for SMEs.

As a consequence, net loan demand by firms declined by a further 28% in the first quarter of this year, according to the ECB's Bank Lending Survey. Credit standards for businesses continue to tighten at a slower pace, but corporate loan demand continues to decline as seen in chart 4. This decline was not only larger than expected, but also halted the recovery path set in after the all-time low in net loan demand of Q2-2023. At the same time, bankruptcies appear to have stabilised at a level slightly higher than observed prior to the COVID-19 pandemic.

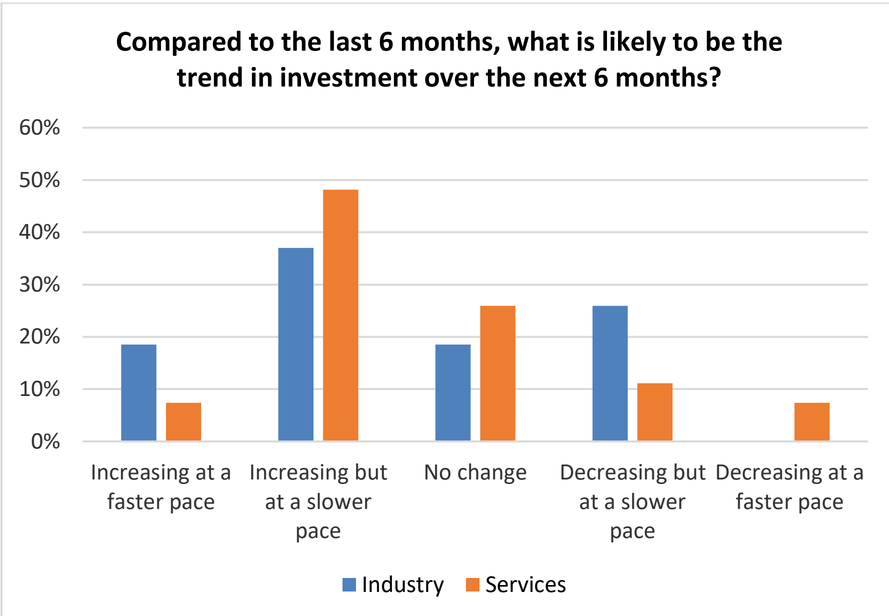
Chart 4: Credit standards tightening slows but loan demand remains negative



Source: ECB Bank Lending Survey

56% of BusinessEurope Member Federations expect investment in industry to pick up, whereas 26% expect a decline in industrial investment as indicated in chart 5. 55% expect services investment to pick up, and 18% of Member Federations expect a fall in services investment, indicating that optimism about the EU's economic recovery is far from universal.

Chart 5: The majority of BusinessEurope Member Federations expect investment to increase in the next six months



Source: BusinessEurope Member Federations

A return to price stability and fiscal consolidation requires carefully calibrated policy choices

Monetary Policy

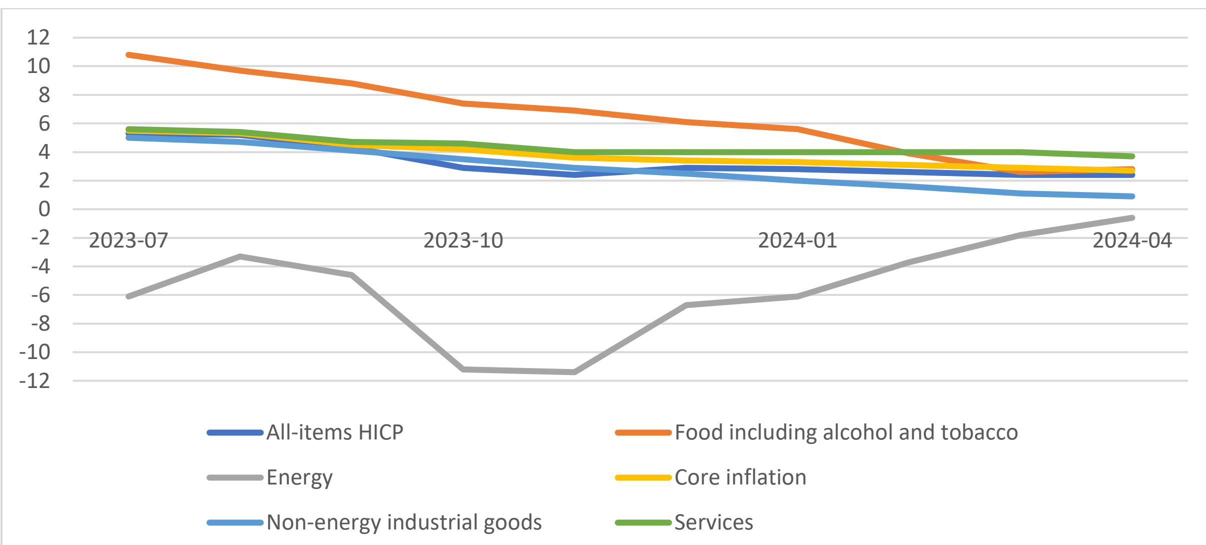
Headline and core inflation have steadily come down since the publication of our Autumn Economic Outlook, with Euro Area headline inflation reaching 2.6% and core inflation at 2.9% in May 2024. Businesses may benefit from more favourable lending rates in the second half of the year if the ECB decides to lower its key interest rates in the coming months.

As the disinflation process has continued over the previous months, the ECB Governing Council is expected to consider lowering its key interest rates at its June meeting. Following the April Governing Council meeting ECB president Lagarde indicated that the Governing Council will await the release of more data prior to the June Governing Council meeting before making a final decision.

Chart 6 shows the gradual convergence of headline and core inflation toward the 2% target. High wage growth and the corresponding stickiness of services inflation remain an obstacle however, as services inflation remained at 4% for five months prior to declining by 0.3 pp according to the latest Eurostat estimate for April 2024. The ECB has previously indicated that the interplay between wage increases and profits will be of key importance to rate-setting decisions. As noted, elsewhere, there are signs of wage agreements increasing, with collectively agreed wages (including one-off bonuses) rising by 6.2% in Germany in the first 3 months of 2024 (compared to 3.6% observed in the previous quarter). Recent wage increases appear to have been absorbed by businesses, as businesses' gross profit margin continuously declined from its peak at 42.4% in Q3-2022 to 41% in Q4-2023, just marginally above the long-term average since 1999 of 40.7%.

The relatively weak economic performance of recent quarters along with moderating wage rises and anchored inflation expectations may offer room for a slight loosening of monetary policy in June. Nevertheless, it is key that the ECB remains focused on returning headline inflation to the 2% target while making sure that the monetary policy stance remains appropriate and does not lead to an overtightening which may delay the Euro Area's economic recovery. A few Central Banks outside the Eurosystem, in Sweden, Hungary and Czechia, have already started reducing interest rates following sustained increases in headline inflation.

Chart 6: Inflation has steadily declined over the past months, though services inflation remains sticky



Source: Eurostat

Fiscal policy

The recent subdued economic performance in recent quarters has been somewhat moderated by public spending, though this is set to change in 2024. High interest rates will further elevate borrowing costs for Member States. The European Commission forecasts interest expenditures to reach 2% of GDP by 2025. Though interest expenditures are set to increase for almost all member states, 8 member states will spend more than 2% of GDP on debt servicing costs annually, limiting much-needed space for investments and regaining a fiscal buffer.

In February 2024, the Council of the EU and the European Parliament reached an agreement on a revision of the EU's economic governance rules. The entry into force of this agreement will likely require a majority of member states to tighten their fiscal policy. The new rules will allow for a longer adjustment trajectory and contain a number of safeguards to allow for key investments while making progress toward further fiscal consolidation. After years of suspension, the fiscal rules will be enforced again in 2024, with member states expected to deliver their spending plans to the Commission by 22 September 2024 and a new report on opening the Excessive Deficit Procedure (EDP) against member states currently not complying with the numerical benchmarks expected as part of the Spring Package in June 2024. Initial estimates by Bruegel indicate that a number of Member States will have to make significant fiscal adjustments in the coming years as Italy, Greece, Spain, Portugal and Hungary are projected to require adjustments of the structural primary balance amounting to at least 2% of GDP [5]. As member states have yet to present their national medium-term fiscal plans, projections of the effects of the new economic governance framework on fiscal stances in the coming years are unavailable as the European Commission forecasts assume a continuation of existing budgetary policies[6]. At least some of the expected reduction in government spending may be mitigated by an acceleration in growth and government revenues, as well as further absorption of RRF funds in the coming years[7].

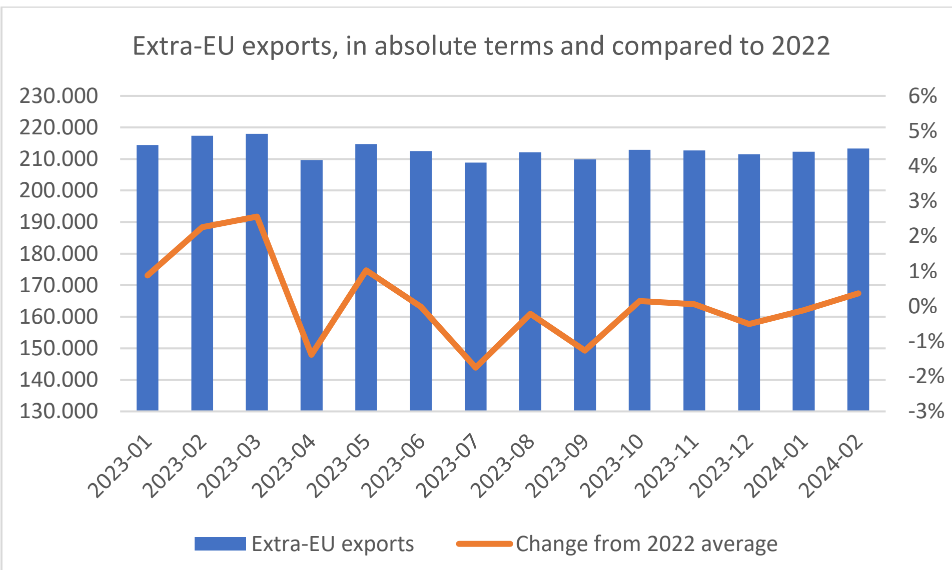
[5] Darvas, Z., L. Welslau and J. Zettelmeyer (2024) 'Incorporating the impact of social investments and reforms in the EU's new fiscal framework', Working Paper 07/2024, Bruegel
[6] European Commission 2024 Spring Economic Forecast
[7] European Commission 2024 Spring Economic Forecast

Global trade is set to rebound as growth recovers

Global trade declined by 3% last year due to a downturn in demand in developed economies according to UNCTAD[8]. Trade in goods dropped by 4% while services trade grew by 8%, showing a similar divergence in growth trends as EU output. The latest IMF projections estimate that world trade volume will increase by 3% in 2024 and 3.3% in 2025, with emerging markets outperforming advanced economies.

Our forecast is for exports to grow by 1.4% in 2024 and 3.2 in 2025, and for EU imports to grow by 1.1% in 2024 and 3.2% in 2025. The EU's net trade balance is therefore set to decline from 0.3% in 2024 to -0.08% in 2025.

Chart 7: Following competitiveness losses and weak growth, extra-EU exports stagnated in 2023



Source: BusinessEurope Staff calculations based on Eurostat [ext_st_eu27_2020sitc]

Recent falls in the external competitiveness of the EU's manufacturing sector and a decline in global trade last year have contributed to a weak export performance as seen in chart 7. The stronger-than-expected growth performance in the US, the EU's most important trade partner, likely helped prevent a stronger decline in key parts of the EU's manufacturing sector, as the most important export products were machinery & vehicles (41%) and chemicals (27%).

[8] UNCTAD Global Trade update (March 2024)

Despite concerns over disruptions of major trade routes such as the Panama Canal as a consequence of droughts and the Red Sea following attacks on ships, the Global Supply Chain Pressure Index has remained in negative territory since November 2023, indicating a loosening of supply chain pressures. Nevertheless, shipping prices on the key route from China to Europe have increased as a consequence of the volatile situation in the Red Sea.

Downside risks to trade growth include further disruption in supply chains as a consequence of the geopolitical situation in the Middle East or droughts affecting the capacity of key trading corridors. Geo-economic fragmentation remains a risk to the global economy and the EU's open economy as trade restrictions and industrial policy measures increasingly undermine the rules-based trade order. Trade fragmentation can already be observed between blocs according to the IMF[9], with total goods trade and trade in strategic sectors declining by almost 5% between geopolitical blocs.

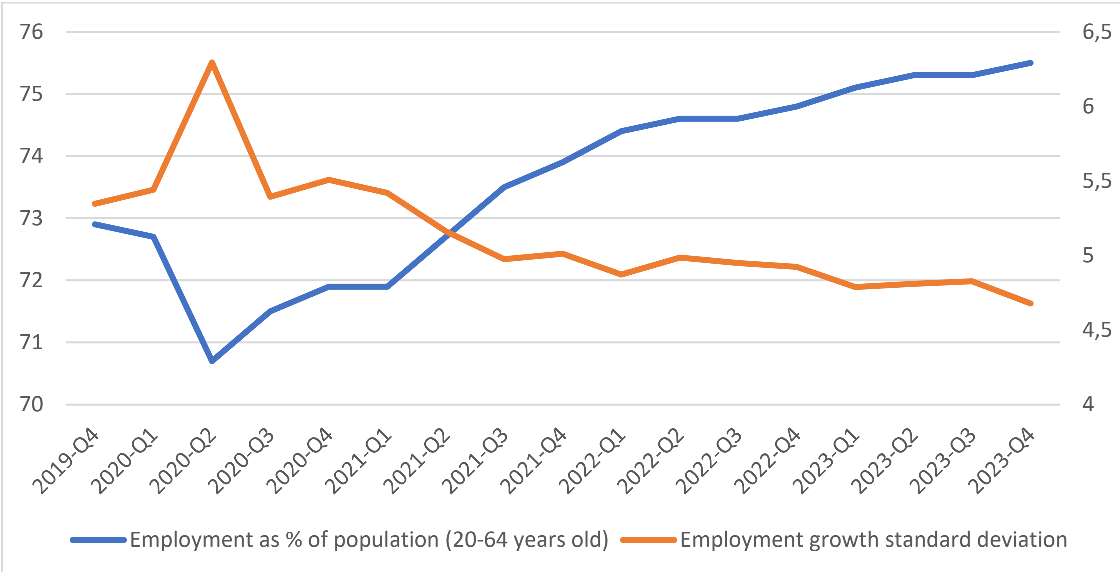
A robust labour market despite weak economic growth

The EU's labour market remains robust, with unemployment close to record-low levels. Unemployment in the EU remained at a low level of 6% in April 2024, as Euro Area unemployment similarly remains low at 6.4%. We forecast unemployment to decline further, to 5.9% in the EU in 2024 and 5.7% in 2025, and 6.3% and 6.2% in the Euro Area respectively.

The labour market does not appear to tighten further, though there are few signs of a loosening so far and employment continued to grow in line with its post-pandemic trend as seen in chart 8. The job vacancy rate has declined from its peak of 3.1% in Q3-2022 to 2.6% in the final quarter of 2023 according to the latest Eurostat data and labour hoarding marginally declining[10], while the share of managers indicating that staff shortages are a factor limiting production remained at 22.5%, which is stable at elevated levels[11].

[9] IMF World Economic Outlook April 2024
[10] European Commission Labour Hoarding Indicator
[11] European Commission Business and Consumer Survey; April 2024

Chart 8: Employment growth in the EU has been significant and broad-based since the initial pandemic shock



Source: BusinessEurope Staff Calculations and Eurostat [lfsi_emp_q]

Recent stagnation in labour productivity presents a challenge to European businesses which compete on global markets and the growth potential of the EU. Labour productivity declined by 0.8% in 2023 according to the ECB. Though productivity growth has been structurally low in recent decades, cyclical factors such as labour hoarding have further depressed productivity growth since the pandemic, leading to record-low unemployment during a period of sluggish economic growth.

Labour productivity is forecast to increase somewhat over the next years, as wage growth moderates and labour hoarding becomes less attractive following increases in real wages. Recent increases in minimum wages in member states, the tight labour market, and the desire to compensate losses of real wages are leading to strong growth in negotiated wages. Compensation per employee is expected to increase by 4.5% in 2024 and 3.6% in 2025 according to the ECB, significantly over the projected levels of headline inflation.

Country differences

The overall projected growth rates continue to vary significantly across Europe. The economies of Malta (4.4%), Croatia (3.5%), Romania (3.4%), Cyprus (2.9%), Ireland and Denmark (2.6%) are forecast to grow robustly this year. A number of economies such as Estonia (-0.6%), Finland (0.0%), Sweden (0.2%), Germany (0.3%), and France (0.4%) are however facing a more complicated economic situation.

	Real GDP Growth		Unemployment	
Country	2024	2025	2024	2025
Austria	0.5	1.5	5.3	5.2
Belgium	1.1	1.3	5.5	5.5
Croatia	3.5	3.1	6.0	5.6
Cyprus	2.9	3.1	5.8	5.5
Estonia	-0.6	3.2	7.6	7.2
Finland	0.0	1.4	7.4	6.9
France	0.4	1.8	7.8	7.9
Germany	0.3	1.0	3.2	3.0
Greece	2.2	2.3	10.3	9.7
Ireland**	2.6	2.9	4.6	4.5
Italy	0.9	1.1	7.5	7.1
Latvia	1.4	2.9	6.4	6.0
Lithuania	1.6	3.1	7.0	6.8
Luxembourg*	1.4	2.3	5.8	5.7
Malta	4.4	3.6	2.6	2.7
Netherlands	1.1	1.6	3.7	3.9
Portugal	1.6	1.9	6.4	6.3
Slovakia	2.3	2.6	5.7	5.7
Slovenia	2.4	2.5	3.8	3.8
Spain	2.2	1.8	11.4	10.9
Euro Area	**0.9**	**1.4**	**6.3**	**6.2**
Bulgaria	2.3	3.1	4.5	4.0
Czechia	1.6	2.8	2.8	2.7
Denmark	2.6	1.9	5.2	5.3
Hungary	2.0	3.5	4.0	4.0
Poland	2.3	3.8	2.9	3.0
Romania	3.4	4.0	2.7	2.5
Sweden	0.2	2.0	8.4	8.2
EU27	**1.2**	**1.8**	**5.9**	**5.7**
Norway	0.9	1.1	3.9	4.0
Switzerland	1.1	1.5	4.3	4.3

Source: BusinessEurope Member federations, BusinessEurope Staff calculations.

*European Commission data.

** Data for Ireland refers to GNI rather than GDP

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BusinessEurope is the leading advocate for growth and competitiveness at the European level, standing up for companies across the continent and campaigning on the issues that most influence their performance. A recognised social partner, we speak for all sized enterprises in 36 European countries whose national business federations are our direct members.

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Germany	Greece	Hungary	Iceland	Iceland	Ireland
Italy	Latvia	Lithuania	Luxembourg	Malta	Montenegro
Norway	Poland	Portugal	Rep. of San Marino	Romania	Serbia
Slovak Republic	Slovenia	Spain	Sweden	Switzerland	Switzerland
The Netherlands	Turkey	Turkey	Ukraine	Ukraine	United Kingdom

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