Economic Outlook
Autumn 2008

BUSINESSEUROPE

Restoring Confidence in Turbulent Times

Knock-on impact of financial turmoil and global economic slowdown significantly affects European outlook in 2009

- BUSINESSEUROPE **forecasts growth** in 2009 to reach 0.4% for the EU and 0.2% for the euro area.
- **Both investment spending** and **employment** levels are expected to contract significantly in 2009, for the first time since 1993.
- Lower commodity prices, weak economic activity and rising unemployment will contribute to a decline in euro-area **inflation** from 3.4% this year to 2.4% next year.

Most urgent actions

1. European governments must prove their firm attachment to a coordinated European but also global approach to stabilise the international financial system and take appropriate measures to **ensure a continued flow of credit to the economy.**
2. The business community expects the ECB to consider in coming months all available options, including further **interest rate cuts**, in order to attenuate the economic impact of the crisis while maintaining price stability.
3. Rapid implementation of agreed **structural reforms** remains the most pertinent reaction to boost the EU's resilience and to allow companies as well as workers to seize opportunities that will arise once the peak of the turmoil has passed.
4. Governments must improve the quality of their expenditure and tax structures in order to ensure a sustained supply-side recovery while keeping a tight lid on deficits, in full respect of the letter and spirit of the **Stability and Growth Pact**.

For further information: **Economics Department**
Marc Stocker, Director and Erik Sonntag, Adviser
Tel +32 (0) 2 237 65 23 - **Fax** +32 (0) 2 231 14 45 - **E-mail** p.troisi@businesseurope.eu

BUSINESSEUROPE Av. DE CORTENBERGH 168 / BE - 1000 BRUSSELS
TEL +32 (0) 2 237 65 11 / E-MAIL MAIN@BUSINESSEUROPE.EU / WWW.BUSINESSEUROPE.EU

Table 1: BUSINESSEUROPE forecasts

	Euro area		EU 27	
	2008	**2009**	**2008**	**2009**
Real GDP (annual % growth)	1.2	0.2	1.4	0.4
Inflation (%)	3.4	2.4	3.6	2.5
Unemployment (%)	7.5	8.2	7.0	7.8
Employment (%)	1.0	-0.3	1.0	-0.5
GDP components				
Private consumption (%)	0.7	0.4	1.2	0.5
Public consumption (%)	1.9	1.7	1.8	1.8
Gross fixed capital formation (%)	1.2	-1.2	1.2	-1.7
Exports (%)	3.9	2.8	3.9	2.8
Imports (%)	3.0	2.4	3.2	2.0

Source: BUSINESSEUROPE Economic Outlook, autumn 2008

The Economic Outlook is based on a survey of BUSINESSEUROPE member federations. Answers to this autumn's questionaire were received by end-October.

More detailed results and individual member state forecasts are published on our website www. businesseurope.eu.

BUSINESSEUROPE's ASSESSMENT OF THE ECONOMY

Rapid deterioration in investment and employment outlook

Financial crisis dampening economic prospects

Until mid-2008, faith in a gradual recovery of the European economy was supported by expectations of stabilising commodity prices, dynamic exports to emerging markets, resilient labour markets and the absence of EU-wide housing market imbalances.

However, the financial market crisis has exacerbated global economic headwinds dramatically since mid-2008, leading to a further deterioration in confidence levels (see Chart 1) and expectations of a more broadly based downturn continuing into 2009. BUSINESSEUROPE forecasts annual **real GDP growth** to reach 1.4% this year and 0.4% in 2009 for EU27, and 1.2% and 0.2% respectively for the euro area.

Investment intentions falling markedly

Following a gradual erosion of corporate profitability, the combination of weakening growth and extreme financial market turbulence (see Chart 2) is significantly affecting investment prospects. The business community's assessment for the expansion of production capacities in coming months and throughout 2009 is particularly dim (see Chart 3). Overall, BUSINESSEUROPE forecasts that EU27 **fixed investment** spending will contract in 2009 by 1.7%.

EU employment level expected to decline by 1.1 million in 2009

Under present circumstances, improvements on **European labour markets** will also grind to a halt and are expected to shift into reverse gear next year (see Chart 4). Our survey indicates that companies' employment intentions over the coming six months have fallen sharply, in particular in the manufacturing sector. Member federations expect EU27 employment to decline by 1.1 million in 2009 from a net job creation of more than 2 million this year.

More severe fallout from the financial market crisis cannot be ruled out

Fully-fledged credit crunch biggest risk to growth scenario

The most fundamental preoccupation of the business community is obviously the way in which the impact of the financial market turmoil will play out (see Chart 5). Even though a fully-fledged **credit crunch** has not yet appeared in Europe, uncertainty about the impact for companies and consumer markets has increased tremendously. Companies are also concerned about the political consequences of this crisis for future policy orientations, and in particular the **risk of a regulatory over-reaction** and a return of protectionist reflexes.

Wage development must be monitored

Beyond the financial market crisis, BUSINESSEUROPE's member federations identify current **wage pressures** as a downward risk to employment and growth prospects, although the present deterioration in economic activity will reduce the risk of wage-price spirals in coming months.

Emerging economies facing growing challenges

Finally, whereas economic growth remains **dynamic in emerging Asian and oil-producing economies**, a more significant effect of the global slowdown and financial turbulence on these markets cannot be ruled out. This represents another downside risk to our growth scenario for 2009.

BUSINESSEUROPE's KEY RECOMMENDATIONS

The size and scope of present headwinds generates a tremendous degree of uncertainty, emphasising the need for the rapid implementation of adequate policy responses at national, European and global level to restore confidence. Measures must be taken first to stabilise financial markets, and second to facilitate the economic recovery.

Responding to financial market turmoil

Business strongly supports EU action plan to stabilise financial markets

Euro-area and EU governments have agreed on **joint actions** to be undertaken in order to alleviate the impact of the financial market turmoil. In particular as regards euro-area countries, the comprehensive response to the crisis agreed upon in close collaboration with the ECB and the Commission represents a significant step forward for the economic governance of European monetary union.

National implementation must ensure a level playing field

Governments and supervisors must now show their commitment to translate this European approach into national measures, ensuring sufficient coordination and **a level playing field on the internal market**. Achieving more transparency, better coordination and convergence of market supervision is vital to resolve the crisis effectively and without generating harmful market distortions.

While the present financial turbulence will undoubtedly accelerate a review of certain regulatory arrangements, the European business community insists that **excessive regulation and protectionism** will delay the return of confidence and hold back the recovery process.

BUSINESSEUROPE also strongly emphasises the following points:

1 In the face of global turmoil, **international initiatives** must be reinforced to increase the resilience of the international financial system and its institutions. EU policy makers should engage their partners in order to foster an in depth debate on cross-border supervision, rating agencies, risk managment and accounting standards.

2 The pro-cyclical nature of **fair value measurement** of financial assets appears to have worsened the impact of the crisis on financial and non-financial corporations. It is vital that accounting standard-setters take up the issue and seriously consider amending fair value accounting rules for assets in markets where liquidity suddenly disappears.

4 The EU's overall resilience to the present turmoil will depend on its capacity to maintain and facilitate **access to finance**, in particular for SMEs. Targeted measures and state guarantees could be considered at national level, while at EU level, the instruments of the European Investment Bank could provide significant support if sufficiently funded and effectively used.

5 Commercial banks must do their utmost to restore confidence by cleaning up their balance sheets, communicating their precise financial situation in a transparent way, and ensuring a **continued flow of credit** to the economy.

Preparing and facilitating the next upturn

While finding solutions to the financial crisis, policy-makers should agree on measures that will allow a swift recovery once the present turmoil starts to abate.

1 Concerted interest rate cuts by major central banks on 8 October have shown that the ECB and its counterparts across the world were ready to take collective responsibility and will do what is necessary to contain the ongoing crisis. The ECB's steps to ease liquidity constraints and lower market interest rates were timely, and should help to support confidence during the difficult months to come. BUSINESSEUROPE expects the ECB to consider all future options, including further **interest rate cuts**, in order to attenuate the economic impact of the crisis while maintaining price stability (see Chart 6).

2 Governments should make real efforts to improve the quality of public expenditures and tax systems in order to encourage a sustained supply-side recovery, while keeping a tight lid on budget deficits. The **Stability and Growth Pact** allows for certain flexibility in case of exceptional circumstances but we consider that the 3% of GDP limit should remain binding in all countries where annual average growth is not expected to be in negative territory in 2008 or 2009. In any case, a clear commitment to corrective measures beyond the present downturn will be needed to ensure a credible path towards balanced budgets in coming years.

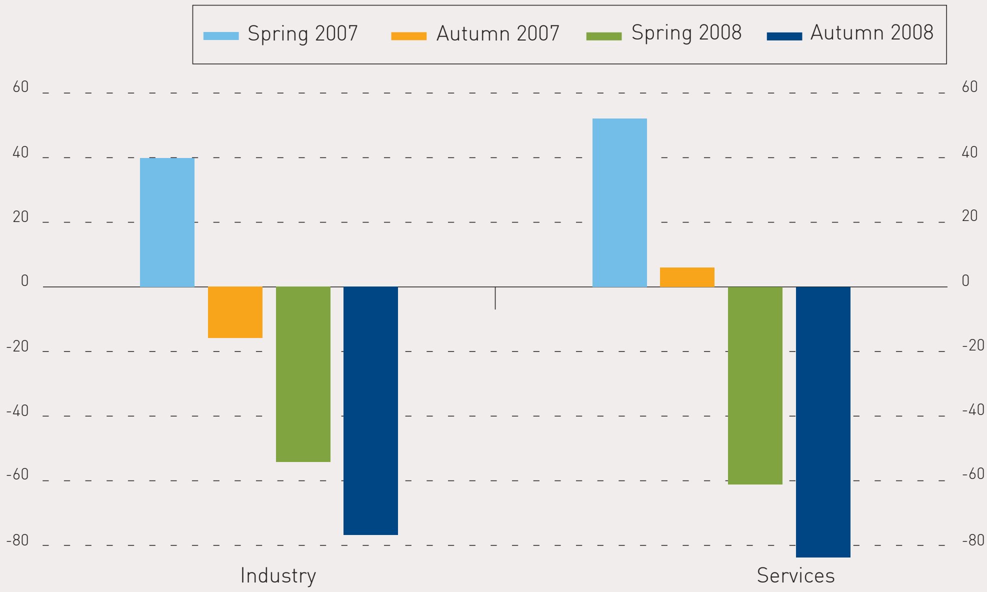
3 Responses that balance legitimate concerns about purchasing power and the need to reinforce companies' competitiveness need to be found (see Chart 7). The answer will not come from rising wage demands, which will only lead to persistently high inflation and less employment, but from measures that could effectively boost productivity and increase the adaptability of companies and workers. This calls for the rapid implementation of the agreed recommendations under the **Lisbon strategy** for growth and jobs, which remains the pertinent framework to respond to current challenges.

4 Boosting Europe's disappointing productivity gains must be an absolute priority for the future. Indeed, current problems emphasise the negative effects of lacklustre productivity growth especially on inflation and Europe's overall resilience to external shocks. **Productivity and enhancing reforms** are particularly urgent in countries having seen their competitiveness and current account positions deteriorate in recent years. Furthermore, with demographic trends will start affecting labour markets negatively around 2010, growth and prosperity will more than ever rely on a substantial productivity push (see Chart 8).

5 European policy-makers must make rapid progress in implementing the principles of the **Small Business Act**. Unlocking the huge growth, innovation and productivity potential of SMEs is essential in order to sustain growth in Europe.

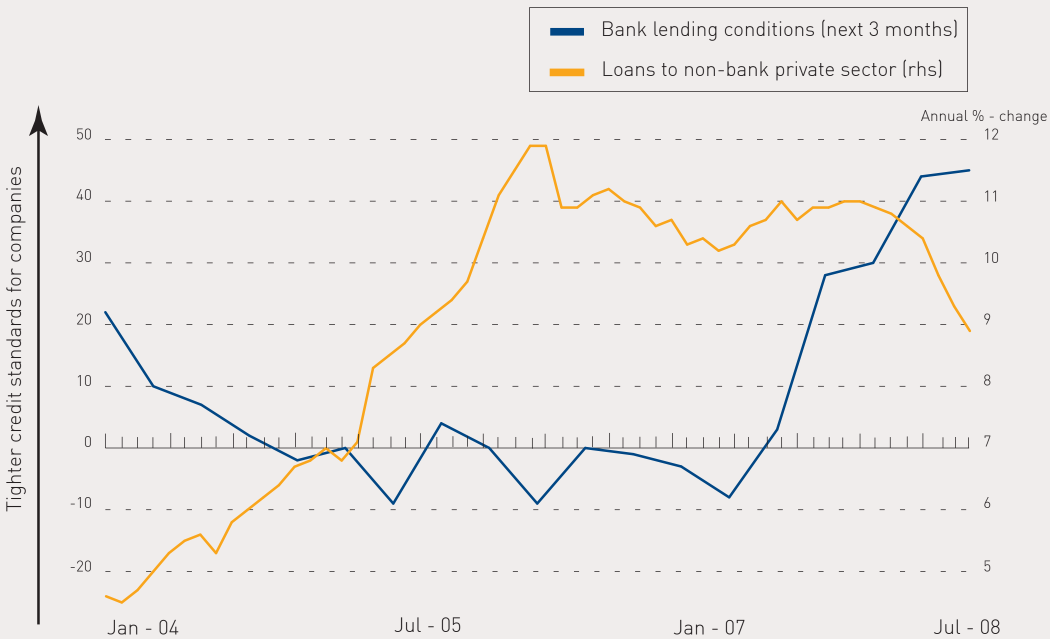
Business confidence in industry and the services sector continues to erode

Chart 1
EU27 business confidence over the next six months
Source: BUSINESSEUROPE Economic Outlook (Autumn 2008)



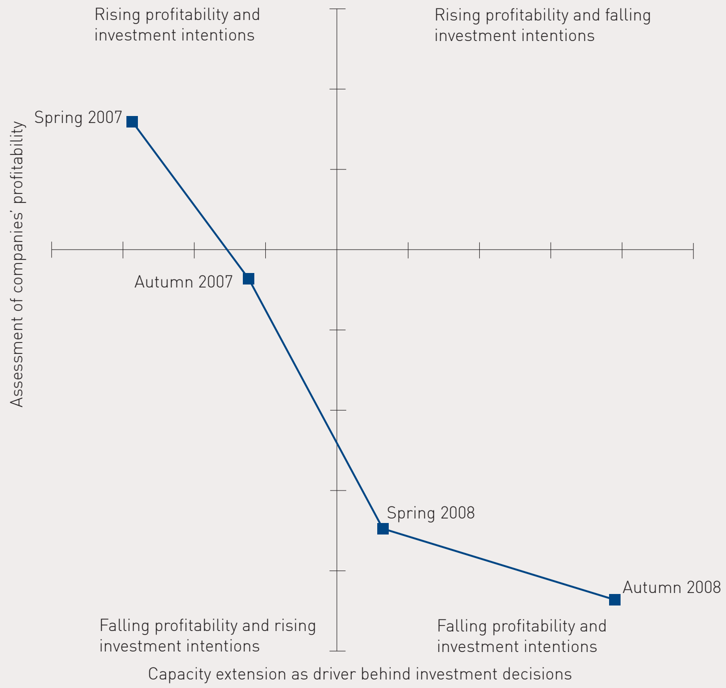
Banks' tighter credit standards will contribute to a further slowdown of credit growth to the private non-financial sector. However, a full-blown credit crunch is not yet observed

Chart 2
Tightening bank lending conditions and slowing credit growth in the euro area
Source: BUSINESSEUROPE, ECB



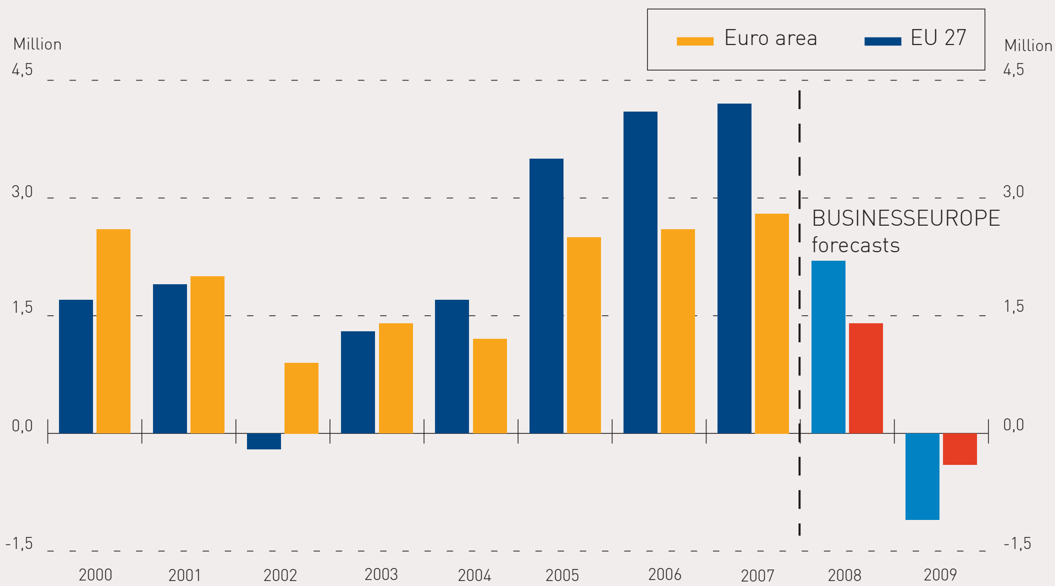
Following the rapid erosion of companies' profitability since spring 2007, investment intentions for capacity extension have fallen substantially

Chart 3
Assessment of companies' profitability and investment intentions for extension purposes
Source: BUSINESSEUROPE Economic Outlook (Autumn 2008)



While companies will still create more than 2 million jobs this year, employment will contract in 2009

Chart 4
EU27 and euro-area annual change in employment level
Source: BUSINESSEUROPE Economic Outlook, Eurostat



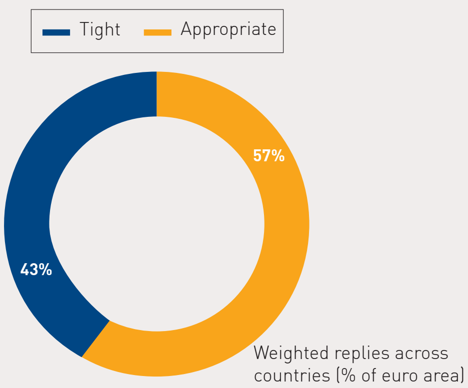
Member federations are particularly concerned about a more significant fallout from the financial market crisis in terms of their access to finance

Chart 5
Major downside risks to BUSINESSEUROPE's baseline growth scenario
Source: BUSINESSEUROPE Economic Outlook (Autumn 2008)

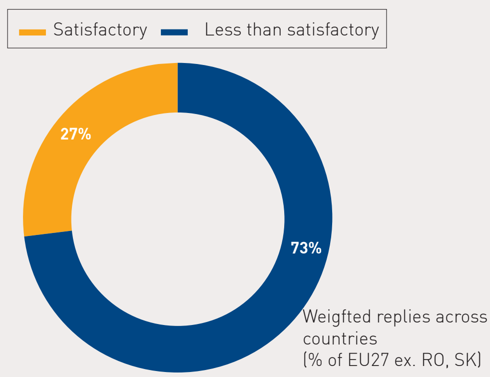
Business federations from euro-area member states consider the ECB's current monetary policy stance as being appropriate.

At the same time, a majority of our members esteem that their governments have not done enough in order to improve their national budget positions.

Chart 6
Assessment of the ECB's monetary policy
Source: BUSINESSEUROPE Economic Outlook (Autumn 2008)

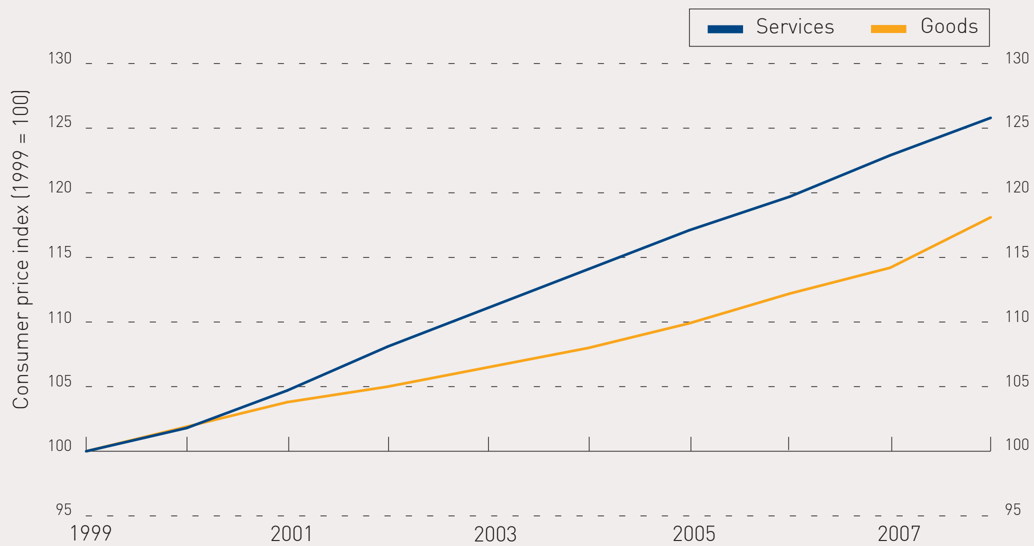


Assessment of member states progress towards medium-term budget objectives
Source: BUSINESSEUROPE Economic Outlook (Autumn 2008)



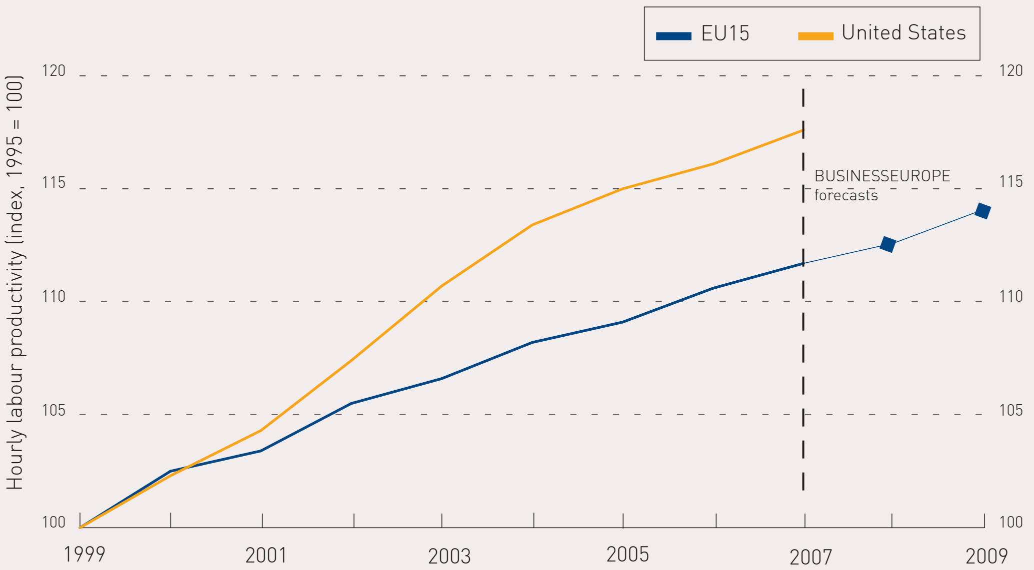
Increased competition in the services sector would help to bring down overall inflation rates, and bring direct gains to consumers' purchasing power

Chart 7
Euro-area inflation highest in services sector
Source: BUSINESSEUROPE, Eurostat



A substantial boost in labour productivity will be needed in coming years to lift EU growth, increase purchasing power and the resilience of our domestic markets to external shocks

Chart 8
Europe's hourly labour productivity falling further behind US
Source: BUSINESSEUROPE, The Conference Board and Groningen Growth and Development Centre (Total Economy Database, September 2008)



MEMBERS ARE 40 LEADING
NATIONAL BUSINESS FEDERATIONS
IN 34 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
Slovak Republic	Slovenia	Spain	Sweden	Switzerland	Switzerland
The Netherlands	Turkey	Turkey	United Kingdom		

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