BUSINESSEUROPE

ECONOMIC OUTLOOK
SPRING 2011

SAILING UPWIND: EU BUSINESSES TO CREATE 1 MILLION NEW JOBS IN 2011

ECONOMIC SITUATION

- The recovery has so far been stronger than anticipated and should continue in coming months. BUSINESSEUROPE predicts real GDP growth in 2011 to reach 1.8% in the EU 27 and 1.7% in the euro area.
- Almost one million new jobs will be created this year in EU 27, the vast majority of these in the countries which have a stronger competitive position and sounder public finances. Employment growth will be strongest in Poland, Luxembourg, Lithuania, Finland, Netherlands, Germany, and Belgium.
- The recovery in Europe remains uneven, reflecting the unwinding of pre-crisis imbalances. This implies particularly acute policy challenges for Member States which accumulated large current account deficits before the crisis.
- In countries with stronger current account positions, the export-led recovery has now broadened to domestic demand, with rising investment and employment being the main sources for propagation of the momentum throughout the EU's internal market.
- The events in Japan and North Africa are expected to have only a limited impact on EU growth this year, although lasting disruptions to supply chains, commodity and financial markets are at present very difficult to estimate.
- Main downside risks to our forecasts are in order of importance: oil prices, the situation of public finances, wage pressures, financial market instability, and the risk of a tax-driven budgetary consolidation.

POLICY CONSIDERATIONS

- Modernising wage bargaining and wage-setting mechanisms is key to improve competitive adjustment channels. This must complement labour market reforms geared towards flexicurity principles to improve mobility and skills matching.
- Member States' commitment to improve competitiveness and pursue growth-enhancing reforms should translate into concrete and ambitious National Reform Programmes to be submitted to the European Commission this April.
- Fiscal consolidation in most Member States should be geared more clearly towards enhanced public sector efficiency and cuts in wasteful expenditures, while supporting growth-enhancing investments and tax reforms.
- Credible stress tests for banks must be accompanied by clear commitments to provide financial backstops and recapitalisation plans for vulnerable institutions.
- The business community is fully confident in the ECB's ability to firmly anchor price expectations while preserving a dynamic recovery.
- Fiscal responsibility must lie with the Member States and the independence of the ECB must be strongly defended.

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Table 1: BUSINESSEUROPE forecasts

Main Variables	EU27		Euro area	
	2010	2011	2010	2011
Real GDP (annual % growth)	1,8	1,8	1,8	1,7
Inflation (%)	1,8	2,6	1,6	2,2
Unemployment (%)	9,6	9,6	10	10
Employment (%)	-0,6	0,4	-0,5	0,3
Hourly productivity growth (%)	1,6	1,0	1,6	0,9
government net lending (% of GDP)	-6,9	-5,0	-6,0	-4,2
gross public debt (% of GDP)	79,1	81,6	84,1	86,1

GDP components (annual % growth)	EU27		Euro area	
	2010	2011	2010	2011
Private consumption	1,0	1,0	0,8	0,9
Public consumption	0,8	-0,2	0,5	-0,1
Gross fixed capital formation	0,9	2,4	0,6	1,7
Private non-residential investment	2,1	4,2	2,1	3,5
Exports	9,9	7,0	10,8	6,6
Imports	8,6	5,9	8,4	5,4

Table 2: Forecast largest EU Member States

Change in %	Real GDP Growth		Unemployment		Investment		Exports		Government Budget Deficit	
	2010	2011	2010	2011	2010	2011	2010	2011	2010	2011
Germany	3,6	2,5	6,8	6,4	6,0	5,5	14,1	8,0	-3,3	-2,5
France	1,5	1,9	9,3	9,0	-1,7	2,2	9,9	6,1	-7,6	-5,9
United Kingdom	1,5	1,8	7,9	8,4	2,9	4,5	5,3	6,6	-10,2	-8,3
Italy	1,3	*(c)*	8,5	*(c)*	2,5	*(c)*	9,1	*(c)*	-4,6	*(c)*
Spain	-0,1	0,7	20,1	20,6	-7,5	-3,6	10,3	8,1	-9,2	-6,5
Netherlands	1,7	1,8	4,5	4,3	N/A	N/A	12,7	7,3	N/A	N/A
Poland	3,8	4,2	9,7	8,9	-2,0	6,0	10,2	16,0	-7,9	-5,0
Belgium	2,1	1.8	8,4	8,6	-1,8	2,1	10,2	4,8	-4,1	-4,7
Sweden	5,5	3,9	8,4	7,8	6,3	7,0	10,7	6,6	-0,3	-0,2
Austria	2,0	2,3	4,5	4,4	0,3	2,0	10,8	6,3	-4,5	-3,2

(c) Forecasts for Italy are confidential

1. RECOVERY CONFIRMED DESPITE RENEWED UNCERTAINTY

Until the onset of the events in North Africa and Japan, the recovery had been stronger than previously anticipated. Based on the evidence gathered so far, our assessment for 2011 remains one of moderate optimism. BUSINESSEUROPE forecasts GDP growth in 2011 to reach 1.8% in EU 27 and 1.7% in the euro area.

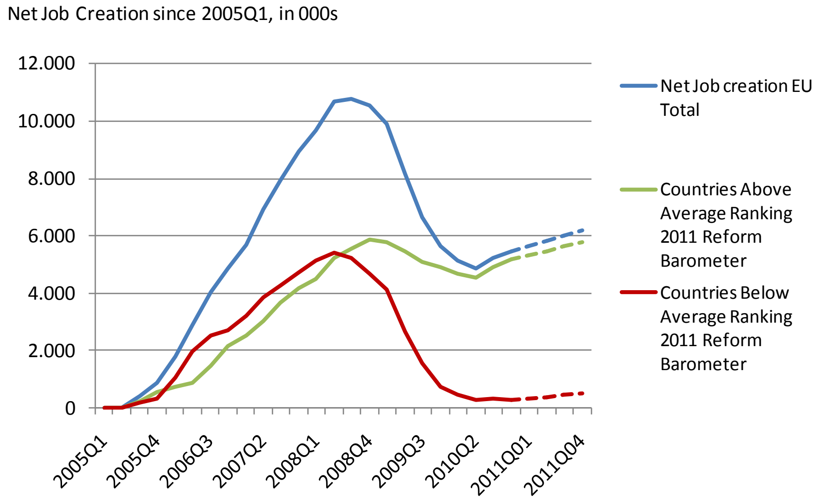
Employment is expected to grow this year by 0.4% in the EU and 0.3% in the euro area, which means that a million new jobs will be created. Unemployment is expected to remain stable at 9.6% of the labour force in the EU and 10% the euro area.

However, the situation differs widely from one country to another. Countries such as Sweden, Germany, Finland or Poland are expected to grow strongly while real GDP in Greece and Portugal are set to contract this year. The same goes for labour markets: while the unemployment rate in Spain, for instance, is above 20% and still expected to increase this year, joblessness in Austria and in the Netherlands is below 5% and decreasing.

As illustrated throughout this report, countries with higher external competitiveness, more robust public finances and a sounder macroeconomic environment are generally holding out better and contributing most to growth and labour market improvements in the EU.

As illustrated in Figure 1, countries scoring above average in our 2011 Reform Barometer will create more than 80% of all new jobs in the EU in 2011 and should see employment back to pre-crisis levels before the end of the year. A much less benign picture of labour market trends is presented in Figure 1 for countries scoring below average in our Reform Barometer.

Figure 1: Employment tightly linked to competitiveness and stability



<u>EU Countries above Average Ranking:</u>
Austria, Bulgaria, Czech Republic, Denmark, Estonia, Finland, Germany, Luxembourg, Netherlands, Poland, Slovenia, Sweden

<u>EU Countries below Average Ranking:</u>
Belgium, Cyprus, France, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Malta, Portugal, Romania, Slovakia, Spain, UK

BUSINESSEUROPE 2011 Reform Barometer Score is based on 34 indicators covering:

- Productivity and Investment
- Trade and Competitiveness
- Employment and labour participation
- Fiscal Sustainability
- Financial Stability

Source: BUSINESSEUROPE 2011 Reform Barometer, Eurostat

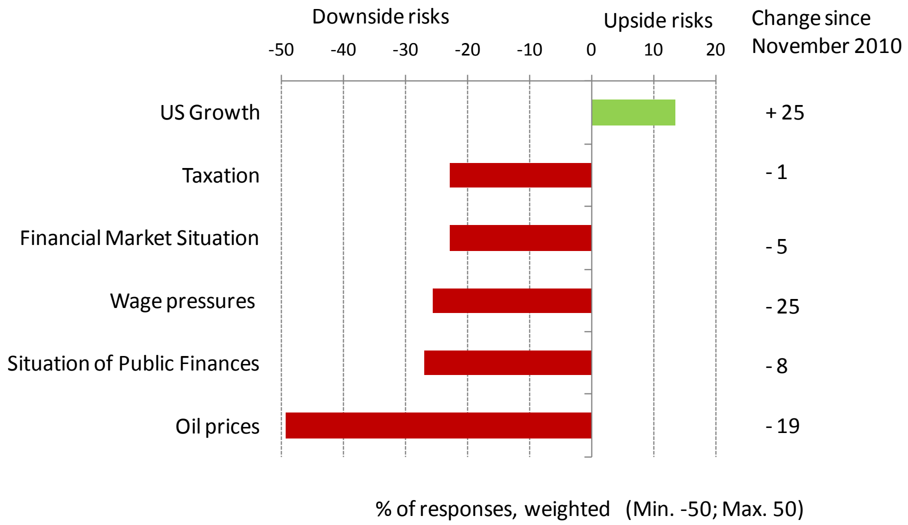
The export-led recovery has now broadened to domestic demand, with rising investment and employment being the main sources for propagation of the momentum throughout the EU's internal market. Strong industrial confidence has led to a turnaround in capital spending, with investments becoming a key contributor to GDP growth.

More stable or gradually improving labour market conditions are supporting consumer confidence and stimulating private consumption, which is expected to make an increasingly positive contribution to GDP growth in the coming quarters.

However, recent events in Japan and North Africa combined with renewed tensions on financial and commodity markets have led to renewed uncertainty on the strength of the European and global recovery looking ahead.

The risk assessment by our members identifies oil prices and the ongoing sovereign debt crisis as the main downside risks to growth. Other downside risks are the possibility of second-round inflationary impacts on wage formation, financial market instability, and the risk of a tax-driven fiscal consolidation. On the other hand, growth in the US has proved more resilient than anticipated providing an upside risk to our baseline forecast (see Figure 2).

Figure 2: Assessment of main risks by BUSINESSEUROPE members



Source: BUSINESSEUROPE April 2011 Economic Outlook

Concerns remain about the sustainability of public finances and a genuine drive to undertake necessary reforms. We are now at a critical moment after the EU Spring Summit when commitments must translate into concrete action at the national and EU level.

BUSINESSEUROPE 2011 Reform Barometer published on 22 March indicates that governments are not yet sufficiently committed to stepping up their reform efforts. Policy challenges are particularly acute in certain member states but all European countries have their "homework" to do.

Our 40 member federations have identified seven urgent priorities for further action:

- capping public expenditures and increasing public sector efficiency,
- improving framework conditions for research, development and innovation,
- supporting active labour market policies,
- removing regulatory barriers to entrepreneurship,
- developing effective public investments,
- reforming pension systems,
- improving wage bargaining and wage setting systems, in the framework of the necessary labour market reforms based on the flexicurity approach.

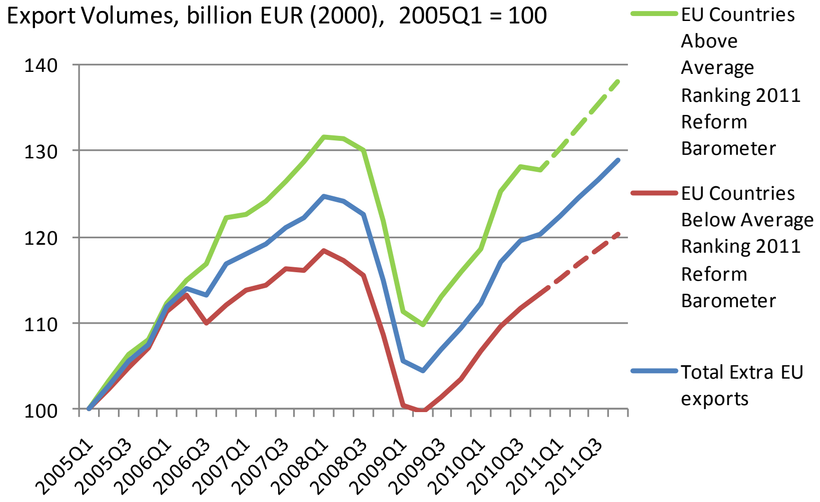
2. GLOBAL DEVELOPMENTS: RISKS AND OPPORTUNITIES

a. Exports as an engine of growth

As world trade continues to expand, exports remain a key engine of the recovery in Europe, driving industrial production and stimulating overall economic activity along the value chain. Industrial production continues to grow healthily, but remains significantly below pre-crisis levels, whereas industrial confidence has recovered to near-record highs.

The dynamism of exports can be attributed to strong demand from emerging markets, and exports to Brazil or China grew by more than 40% during 2010. Exports continue to be the most dynamic demand component in the EU economy, and are expected to grow by 7% in 2011 – after a 10% increase during 2010.

Figure 3: export performance is a key factor of success



<u>EU Countries above average ranking:</u>
Austria, Bulgaria, Czech Republic, Denmark, Estonia, Finland, Germany, Luxembourg, Netherlands, Poland, Slovenia, Sweden

<u>EU Countries below average ranking:</u>
Belgium, Cyprus, France, Greece, Hungary, Ireland, Italy, Latvia, Lithuania, Malta, Portugal, Romania, Slovakia, Spain, UK

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- Financial Stability

Source: BUSINESSEUROPE 2011 Reform Barometer, Eurostat

Exchange-rate volatility is a source of concern, but the exchange rate of the EUR is still below the pain threshold. The value of some emerging country currencies does not respond to market fundamentals, and more exchange rate flexibility is important to correct global macroeconomic imbalances.

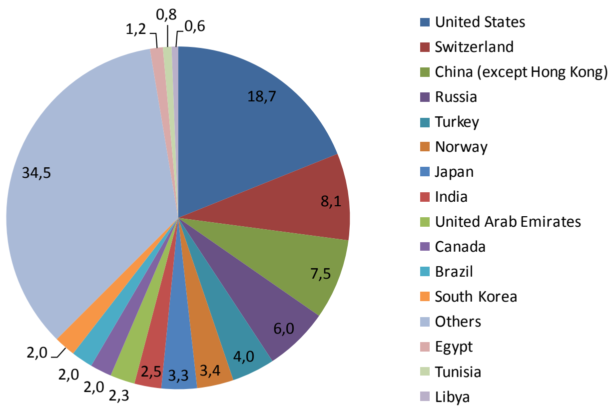
Using the results from our 2011 Reform Barometer (Figure 3), it can be seen that countries that obtained an above-average score across the range of 34 structural indicators have generally seen stronger export growth in the past - which ultimately reflects competitiveness vis-à-vis other countries (see Figure 3).

b. Risks inherent to the global environment

As stated previously, events since the beginning of 2011 have brought additional uncertainty to the economic situation, and despite the baseline scenario being reasonably positive, the risks are clearly on the downside.

None of the countries that are at present subject to turmoil (North Africa, Middle East and Japan) hold a large share of extra EU exports. Among these countries, Japan is the EU's main trading partner, and accounts for 3.3% of export markets, whereas North African countries account for a combined share of less than 5% (see Figure 4). Therefore, the impact from direct trade links with Japan and North Africa could be limited.

Figure 4: Share of extra-EU exports: EU's main trading partners (%)

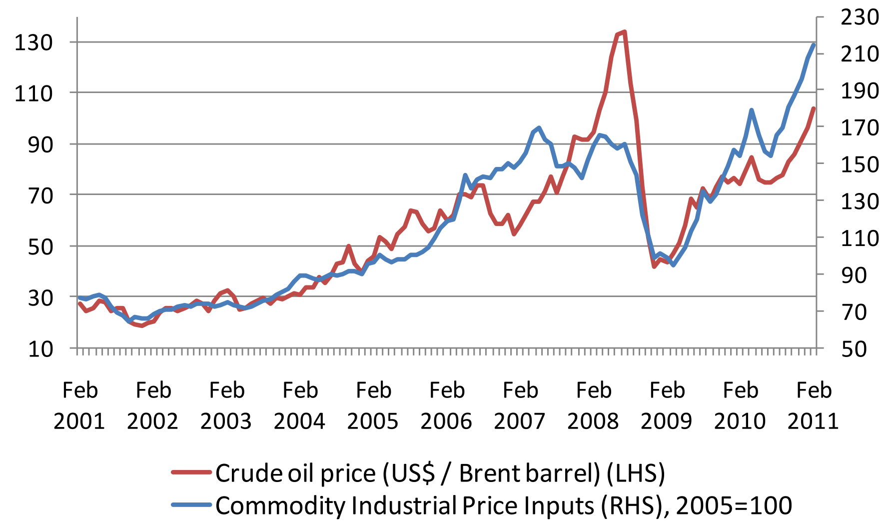


Source: Eurostat

However, and more importantly, the situation in Japan may also affect the EU economy through disruption of global supply chains, especially in sectors such as electronics, where Japan accounts for more than half of the global production for some products. Although it is too early to assess the gravity of the situation, there are already reports of companies in Asia, the US and Europe being affected by the rupture of the supply-chain by their Japanese suppliers. Evidence nevertheless suggests that the channel of transmission through global supply chains will also be limited, as Japanese suppliers start to resume production, and manufacturers start to shift towards alternative sources of supply.

Commodity and oil prices have returned to near-record levels not seen since the end of 2007 and beginning of 2008 (see Figure 5), due to political instability in North Africa and the Middle East, combined with increased demand from emerging economies and robust global growth.

Figure 5: Oil and commodity prices are reaching pre-crisis record levels



Source: IndexMundi based on IMF data. Commodity industrial price inputs price includes agricultural raw materials and metals price index

While the first factor may prove to be transitory, the second could be of a more permanent nature. The impact of the current geopolitical tensions is estimated to account for less than 25% of the recent increase in oil prices. Under these assumptions, the surge in oil prices seems more of a lasting nature. The effect of the Japanese natural disaster on oil prices is, at this stage, unclear.

This situation has renewed the concern over commodity price inflation, and the risk of second-round inflation effects materialising into increased domestic prices and labour costs. This will not only have a direct effect on economic activity, but could also put upward pressure on interest rates, hence complicating the exit from the economic, financial, and sovereign debt crisis.

Finally, the last, and perhaps most important channel of transmission, is through financial market contagion, and the current uncertainty adds to existing tensions related to the sovereign debt crisis and banking sector restructuring.

Besides, capital markets can also suffer from volatility as large capital stocks are repatriated to Japan to finance reconstruction, having an additional impact on exchange rates and capital availability.

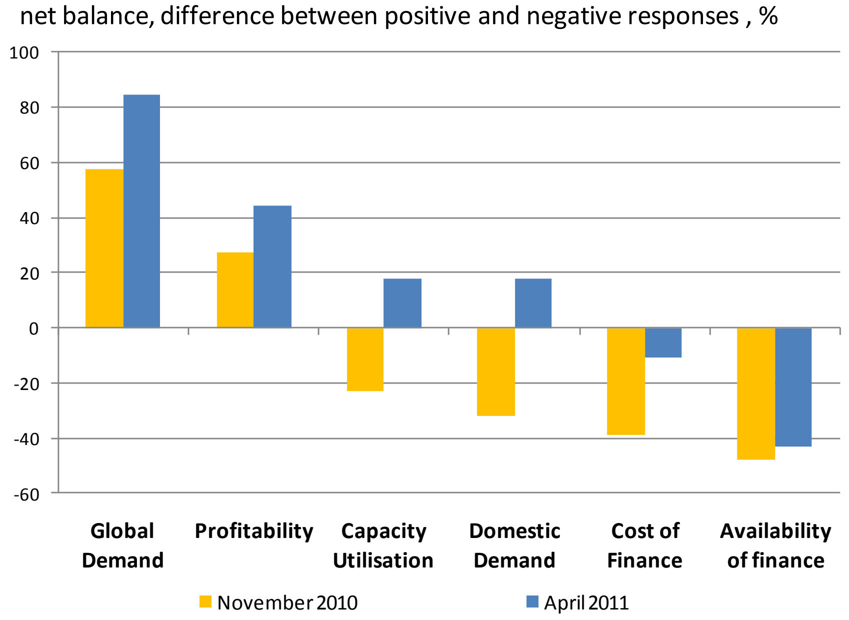
3. DOMESTIC FACTORS OF RESILIENCE

a. Investment is picking up as the recovery broadens to the domestic sector

The outlook for investment has improved substantially since the last publication of our Economic Outlook. Capital expenditure has been stronger than expected during the second half of 2010, being the main contributor to GDP growth. Private non-residential investment is forecast to grow at a healthy 4% during 2011, making a positive contribution to growth of almost 0.5 percentage points. Nevertheless, investment is still below its pre-crisis levels.

Increased global demand and profitability are the positive factors supporting capital investments, whereas availability of finance and, to a lesser extent, cost of finance, are still a restraining factor holding down capital spending (see Figure 6).

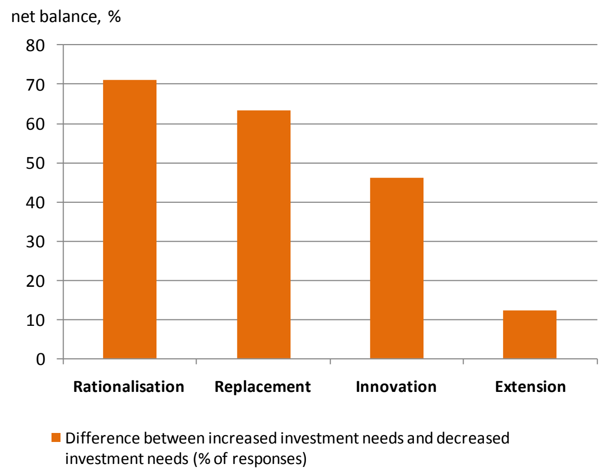
Figure 6: Factors supporting investment decisions



Source: April 2011 Economic Outlook

Investment decisions are mainly focused around rationalisation and replacement. Innovation, and to a lesser extent, extension have increased their importance as a factor supporting investment decision, highlighting a more positive general outlook for the EU economy (Figure 7).

Figure 7: Main investment needs



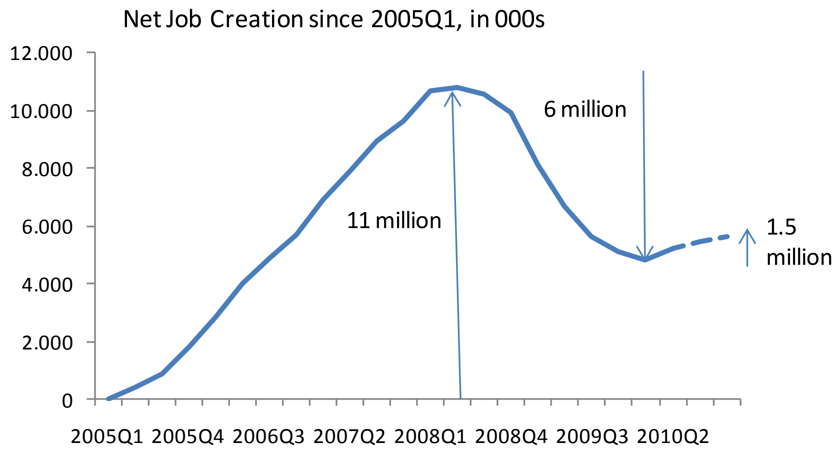
Source: April 2011 Economic Outlook

However, access to finance continues to be a hindering factor. Current capital spending appears at present to be largely financed through internal financing. Looking ahead, external financing constraints, linked to persistent dysfunctions in capital markets and rising public indebtedness, will exert downward pressure on the investment recovery, as only companies with strong equity and low leverage positions may be able to finance further investments at reasonable rates.

b. As labour markets stabilise, consumer confidence is recovering

The labour market has been the main factor of resilience during this crisis, supporting private consumption, although large country divergences persist. As employment has started to recover, consumer confidence has improved and is currently above its long-term average.

Figure 8: Job creation has resumed after the crisis – one million jobs will be created in 2011



Source: Eurostat, BUSINESSEUROPE Spring 2011 Economic Outlook

Private consumption has become the largest contributor to GDP growth in the second half of 2010, and is expected to add more than 1 percentage points to GDP growth in 2011.

From 2005 to 2008, more than 11 million jobs were created in the EU, however, the crisis wiped out about half of these (Figure 8). The majority of the job destruction during the crisis took place in the countries which had accumulated the largest macroeconomic and competiveness imbalances before the crisis.

This year, one million new jobs will be created in EU 27, the vast majority of these in the countries which had a stronger competitive position before the crisis, where labour markets have shown a much greater level of resilience. This is shown in Figure 1, on page 3.

Labour market reforms geared towards flexicurity principles would improve geographical and occupational mobility, as well as a better matching of skills and jobs. These are key preconditions to enhance adjustment dynamics, employment, and productivity levels.

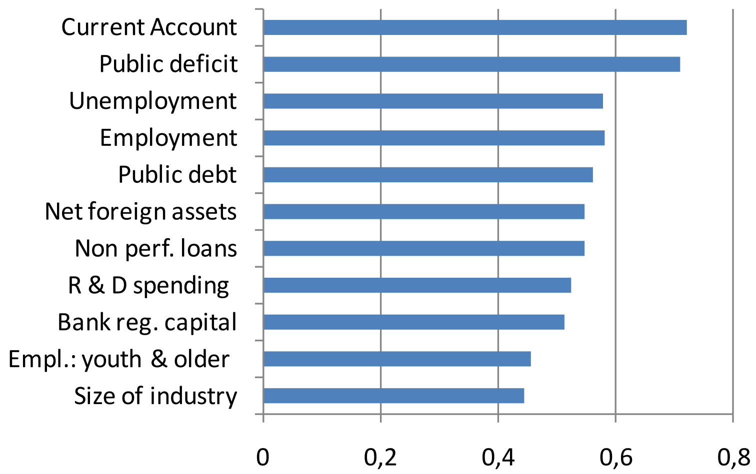
Modernising wage bargaining and wage-setting mechanisms is also key to improve competitive adjustment channels, so that companies can produce in each country with unit labour costs that are globally competitive. Removing price-indexation schemes, restricting indirect labour costs, and reforming social benefit systems are important priorities in this respect.

c. Main factors of success for a strong, resilient economy

Using the results from our BUSINESSEUROPE 2011 Reform Barometer, the overall score of the different countries is compared with their performance in individual indicators, to assess what are the most common features of successful economies at present.

Figure 9 shows that countries performing best in the current circumstances are likely to have strong current account positions, lower public deficits, high employment rates, lower external debt, a strong capital base in their banking sector and a large manufacturing sector.

Figure 9: Correlation coefficient between overall score in BUSINESSEUROPE 2011 Reform Barometer and individual indicators



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Source: BUSINESSEUROPE 2011 Reform Barometer, Eurostat

The above relationship illustrates the interaction between external competitiveness, macroeconomic stability, and employment. It tends to vindicate the importance of these dimensions on the current debate on economic governance.

In this context, BUSINESSEUROPE supports the decisions taken by the European Council on 24 and 25 March to enhance crisis management instruments, improve policy coordination and competitiveness in the "Euro Plus Pact".

Member States' commitment to improve competitiveness and better adapt their policy frameworks to the reality of a monetary union, should translate into concrete action in the National Reform Programmes to be submitted in April.

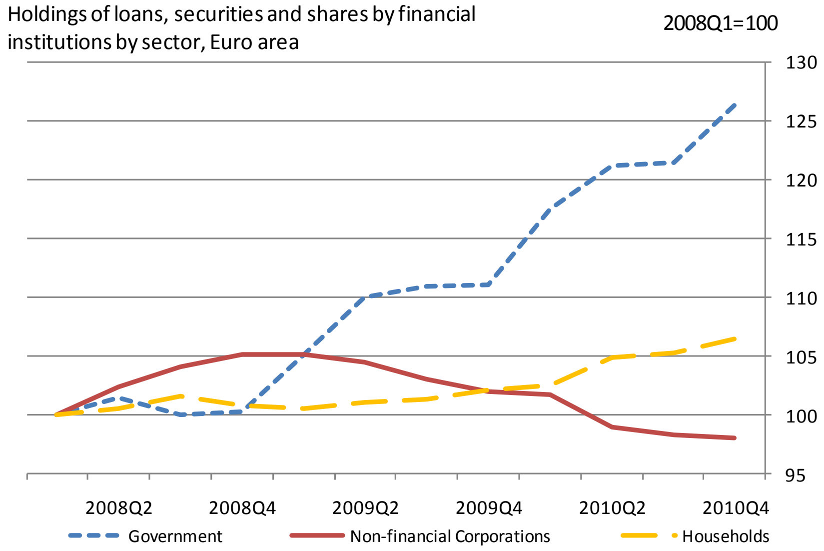
The ambitious legislative package to reinforce economic governance with automatic enforcement rules and a central role for the Commission will also need to be agreed between the European Parliament and the European Council before the end of June.

4. FISCAL SUSTAINABILITY AND FINANCIAL STABILITY

The state of the public finances and the lack of confidence in the banking sector are interacting in complex ways which, ultimately, are creating instability in financial markets, and constraining access to finance for companies.

- Large public debt financing needs are reducing capital availability for companies, and sending waves of instability to financial systems with recurring episodes of sovereign debt crisis (see Figure 10).
- Lack of confidence in the banking sector, balance-sheet restructuring, and new prudential rules are limiting the amount of interbank lending, reducing risk appetite by banks, and, resulting in reduced capital availability, and increased systemic risk of the financial sector.
- Upward pressure on interest rates stemming from rising inflationary pressures will affect the conditions for exit from the sovereign and banking crisis.

Figure 10: Large financing needs by governments are reducing capital availability for companies



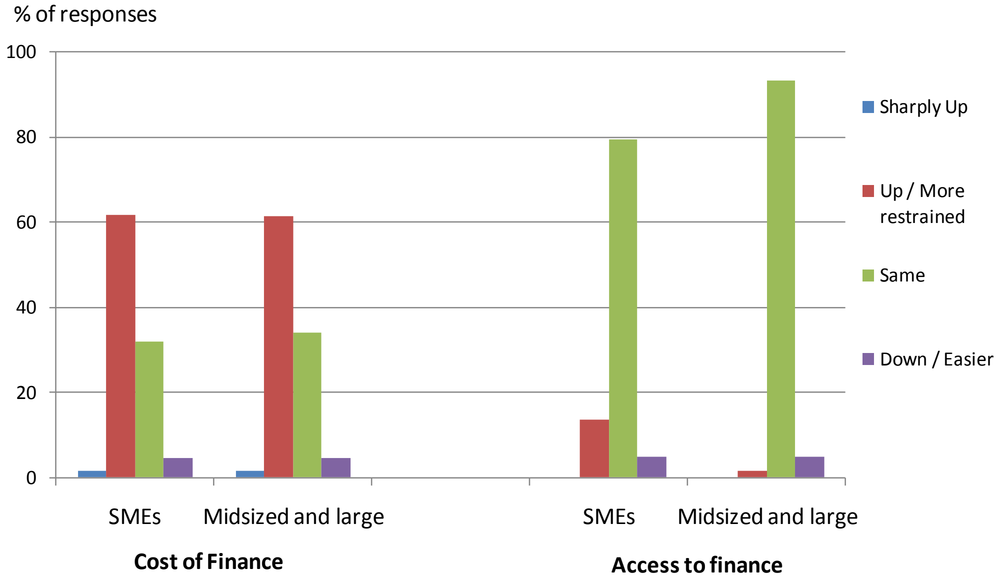
Source: ECB Statistical Data Warehouse

The interplay of these effects affects financial market stability, and consequently, access to finance. As the recovery strengthens, credit constraints may hold down investments and growth over the medium term. This ultimately translates into less investments and growth, as higher cost of capital makes less investment projects viable, thus reducing potential output.

Our members expect cost of finance to increase over the next 6 months (Figure 11). Access to finance for SMEs could also become slightly more restrictive, whereas members expect that it could marginally improve for large companies.

Therefore, it is now even more urgent to take firm policy action, and put the recovery on a firmer footing. This will largely depend on governments' ability to restore confidence in public finances and push forward ambitious competitiveness and growth-enhancing reforms.

Figure 11: BUSINESSEUROPE's Members assessment on cost and access to finance over the next six months

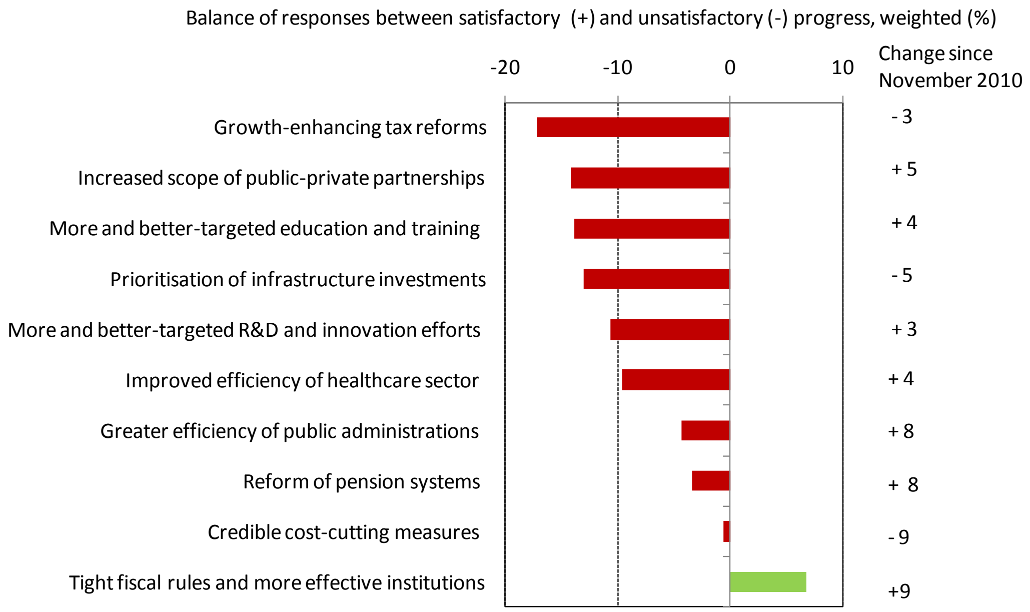


Source: BUSINESSEUROPE April 2011 Economic Outlook

a. Smart consolidation of public finances and structural reforms

BUSINESSEUROPE members have identified the areas where governments are showing insufficient commitment to budgetary consolidation (Figure 12).

Figure 12: Assessment of budgetary consolidation efforts by BUSINESSEUROPE's members



Source: BUSINESSEUROPE April 2011 Economic Outlook

While members assess that some progress has been made to consolidate public finances, especially in terms of more tight fiscal rules, reform of pension systems, and greater efficiency of public administration, the focus on a smart consolidation of public finances is missing. Expenditure cuts have on occasion been more forceful through market discipline than motivated by a credible commitment to undertake structural reforms.

A reform agenda for a smart consolidation of public finances should focus on expenditure cuts while preserving productive public investments in education, innovation and infrastructure, and undertaking growth-enhancing tax reforms. The fear of a tax-driven budgetary consolidation underlines the necessity to combine fiscal sustainability and growth, and this can only be achieved through far-reaching structural reforms.

b. Restoring financial stability is key to ensure access to finance

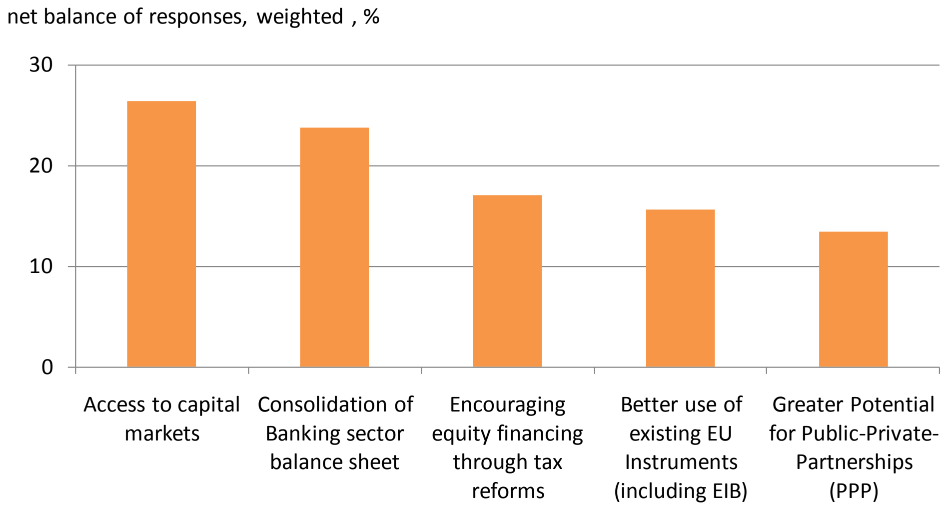
As mentioned before, access to finance is still restrained due to the interplay of the large financing needs by the public sector, the health of the banking sector, and reduced risk appetite in financial markets.

This feedback loop is especially intense in Europe, where companies depend highly on bank intermediation. As demand for capital intensifies, companies will find it increasingly difficult to obtain credit, especially if securitisation markets remain dysfunctional, hindering banks' ability to free up capital for new lending.

BUSINESSEUROPE members' assessment confirms that improving access to capital markets and consolidating the banking sector are critical to restore access to finance by companies (Figure 13).

Financial market reform should aim at achieving well-functioning, resilient and stable financial markets, facilitating the access to both debt and equity finance for companies and pursuing a balanced agenda on financial sector reform which is more attentive to its impact on growth and job creation. Stress tests for banks have been undertaken, and in this context, it is important that governments have financial backstops to recapitalise banks if necessary.

Figure 13: Priorities to improve SMEs' access to finance



Source: BUSINESSEUROPE April 2011 Economic Outlook

Building counter-cyclical buffers in the financial sector, developing credible bank resolution frameworks and orderly restructuring conditions in a crisis situation are all fundamental elements to mitigate risk and protect taxpayers' money in the future.

c. Monetary policy of the ECB

Regarding monetary policy, the majority of BUSINESSEUROPE members believe that the current monetary policy stance of the ECB is appropriate.

The business community views price stability as a key condition for sustainable growth and has full confidence in the ECB's ability to steer the right course of action, firmly anchoring expectations while preserving a dynamic recovery.

We consider appropriate that the ECB does not pre-commit to a series of interest rate hikes after its decision in April to increase its main refinancing rate to 1.25%.

An orderly exit from the sovereign debt and banking crisis remains of utmost priority and requires growth in the euro area as a whole to remain firmly on track.

This said, country divergences is a matter for national governments to sort out, not the ECB. Fiscal responsibility must lie with the Member States and the independence of the ECB must be strongly defended.

Emergency liquidity measures and purchase of government debt by the ECB have been effectively used as crisis management tools, but are of temporary nature and should gradually give way to more structural solutions.

WHO ARE WE?

BUSINESSEUROPE IS THE CONFEDERATION OF EUROPEAN BUSINESS, REPRESENTING SMALL, MEDIUM AND LARGE COMPANIES. 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 APRIL.

MORE DETAILED RESULTS AND INDIVIDUAL MEMBER STATE FORECASTS ARE PUBLISHED ON OUR WEBSITE WWW.BUSINESSEUROPE.EU

BUSINESSEUROPE

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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