UNICE ECONOMIC OUTLOOK
AUTUMN 2004

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UNICE
WHO ARE WE?

UNICE represents more than 20 million small, medium, and large companies. Active in European affairs since 1958, UNICE's members are 36 central industrial and employers federations from 30 countries, working together to achieve growth and competitiveness in Europe.

The UNICE Economic Outlook provides a business insight into recent economic developments, based on a survey of UNICE member federations in the 25 Member States of the EU. Qualitative data and forecasts were established in September 2004. Aggregate values are GDP (at PPS) weighted, unless otherwise indicated.

Due to the unique nature of the incorporation of 10 new countries in our outlook, we will often pay particular attention to the new Member States which are designated as EU10.

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UNICE FORECASTS

	2004			2005		
	EU10	EU15	EU25	EU10	EU15	EU25
GDP (annual % change)	4.9	2.3	2.6	5.1	2.3	2.6
Inflation (%)	3.9	2.0	2.1	3.4	1.9	2.0
Unemployment (%)	14.5	8.1	9.1	13.6	7.9	8.8
Employee compensation (annual % change)	5.3	2.8	3.0	5.7	2.7	2.9

EXECUTIVE SUMMARY

- THE EU IN THE STARTING BLOCKS …
- RECOVERY CONFIRMED …
- RECOVERY AT RISK … RELEASE GROWTH POTENTIAL!
- DO NOT GIVE UP IN THE LISBON RACE … PLAY TO WIN!

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THE EU IN THE STARTING BLOCKS ...

The European Union is facing serious difficulties in modernising our economy. National governments and the EU institutions do not have the time to be too patient. We are in a situation that requires urgent action. Policy-makers need to tackle the internal barriers that stand in the way of competitiveness. As stated in our "Business Vision for Europe 2004-2009", we urge them to lead the whole of European society to more competitiveness, and thus to more growth, jobs and prosperity!

RECOVERY CONFIRMED ...

Recovery has consolidated but lacks momentum. Compared with our Spring Economic Outlook, growth forecasts have been revised upwards. European economy is expected to grow by 2.6% in both 2004 and 2005. However, the growth gap with our major competitors is not expected to narrow significantly.

Our outlook points to the not yet self-sustaining nature of the current recovery. European growth is recovering thanks to the export stimulus induced by world economic growth. The robust export contribution to GDP variation results from increasing external demand, rather than a significant gain of shares in international markets. Although there is a gradual improvement in consumer confidence expectations, private consumption remains weak in Europe. More fundamentally, recovery has not yet translated into significant renewal investments. Expectations are improving but we are still bearing the costs of weak investment accumulated in previous years. Low production capacities are constraining the growth potential of the EU economy.

There are marked differences between the Member States. Growth is higher in EU10 than in EU15. Recovery appears more broad-based in countries such as France and Spain than in countries such as Germany and the Netherlands.

RECOVERY AT RISK ... RELEASE GROWTH POTENTIAL!

Sustainable recovery is not given. Energy price developments constitute the most immediate risk to our outlook. Although the current situation is different from the 1970s crises, a permanent $10-a-barrel rise could cost the European economy between 0.3% and 0.5% of GDP in 2005.

Our survey indicates that growth recovery, albeit modest, is not yet reflected in significant employment gains, particularly in industry that has been more exposed to international competition. After recording 9.1% in 2004, unemployment is only expected to decrease slightly in 2005. More optimistic developments cannot be expected unless major labour market rigidities are removed. In addition to reforms aimed at ensuring the sustainability of health and retirement systems, better growth prospects are also likely to reduce consumers' reluctance to spend.

DO NOT GIVE UP IN THE LISBON RACE ... PLAY TO WIN!

Nearly half way through our timeframe, the Lisbon strategy is more urgent than ever in order to deliver growth, new jobs and prosperity for EU citizens. The expected cyclical upturn will not solve structural problems in Europe and enable us to preserve our economic and social models. Our message to the EU institutions, to national policy-makers and to European society as a whole is clear: play to win! Implement the Lisbon Strategy!

MAIN FORECASTS

With expected growth of 2.6% in 2004 and 2005, recovery is consolidated thanks to the growth pull exerted by the global economy. New Member States have also provided a fresh stimulus to the European Union and its growth prospects. However, recovery remains weak and fragile.

The growth gap between the EU and its major competitors remains large. Growth in Europe does not come from a broad base but is mainly export-driven. Although private consumption is expected to improve in some European countries, investment would have to increase significantly to transform the recovery momentum into self-sustaining growth. Despite the welcome cyclical upswing, growth potential remains weak and constrains the growth gains that could be expected at such a turning point in the economic cycle.

All the downside risks identified warn us that recovery will not strengthen in Europe unless its resilience to external shocks and its competitive advantages are improved. Europe will not expand its growth potential unless we react adequately by tackling the internal obstacles that stand in the way of competitiveness.

→ GROWTH

→ INFLATION

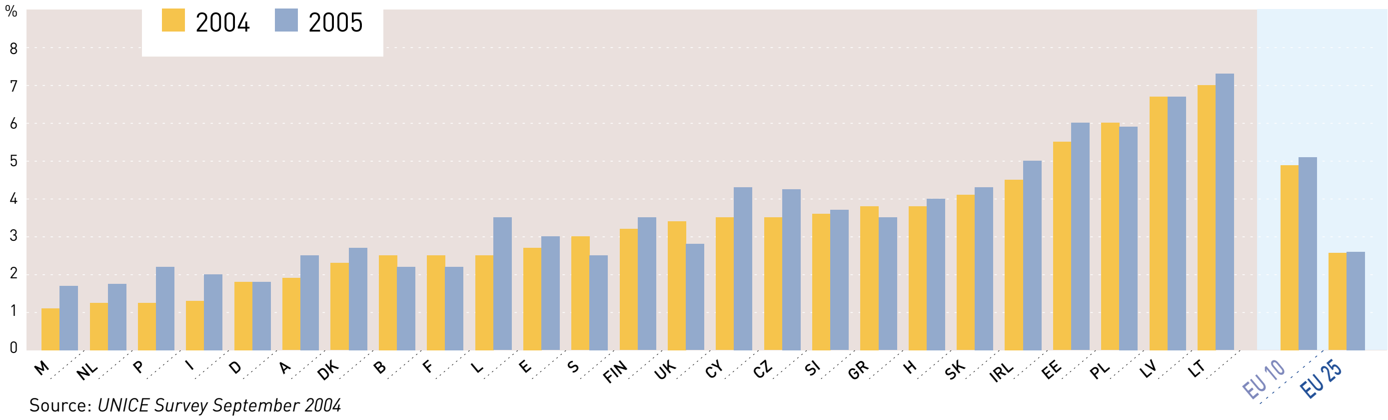
→ UNEMPLOYMENT

GROWTH

With the exception of the year 2000, the EU has never achieved growth of 3% over the last decade while the US and Canada have respectively produced average rates of 3.3% and 3.7%. According to our survey, the EU is expected to grow by 2.6% in 2004, far below the rates forecast in the US (4.2%) or even in Japan (3.4%).

The September Eurostat estimates confirm the recovery momentum identified in our Spring Economic Outlook. However, private consumption improvements have slowed down in the second quarter of 2004 and this component of GDP has remained relatively weak. Although enterprises are reported in some countries to be losing shares on international markets, exports have continuously accelerated thanks to strong external demand resulting from the global recovery. Despite some slight improvements in our federations' expectations, investment remains weak. Hence, the current recovery is not likely to reflect more than a cyclical improvement unless we create more favourable conditions, notably for investment.

Chart 1 **Growth forecasts for 2004 and 2005**



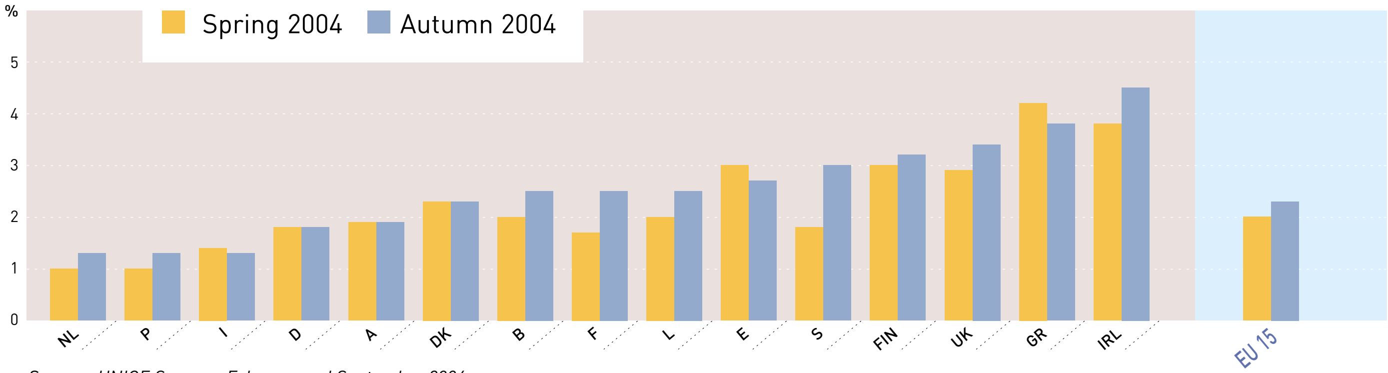
Source: *UNICE Survey September 2004*

Compared with our Spring Economic Outlook and with the exception of Mediterranean countries (GR, E, I), all panellists from EU15 have revised their forecasts upwards or at least maintained them (D, A) for the year 2004. The 2.3% growth figure for 2004 in EU15 remains moderate compared with the robustness of the world economy.

In addition to the Mediterranean exceptions, the reason for modest recovery in 2004 remains the weakness of the German economy (1.8%) which still suffers from sluggish domestic demand. Lack of consumer confidence is worrying and linked to uncertainty regarding new burdens, oil prices and employment prospects. France (2.5%) and to some extent Spain (2.7%) and Italy (1.3%) present a different pattern with weak export prospects but with improved signs of private consumption. Italy (1.3%), the Netherlands (1.3%), Portugal (1.3%) and Austria (1.9%) remain far below the 2% growth rate.

At the good end of the spectrum, we find Ireland (4.5%), Greece (3.8%), UK (3.4%), Finland (3.2%), and Sweden (3.0%) that confirm their status as growth engines in EU15. Comparison is a very difficult task in an enlarged and heterogeneous EU. Nevertheless, the best performing countries are to be found in the members that joined the EU in May 2004, with an average growth rate of 4.9% in 2004. The Baltic countries (Estonia, Latvia, Lithuania) and Poland are expected to grow well above 5%. Provided they continue to implement growth-enhancing reforms, these countries are clearly engaged on a path of robust convergence with an expected growth gap higher than 2% compared with the EU15 average. Apart from Malta (1.1%), other newcomers are growing at a moderate rate of more than 3% a year, expecting to reap increasing benefits from the Single Market and from new investment opportunities.

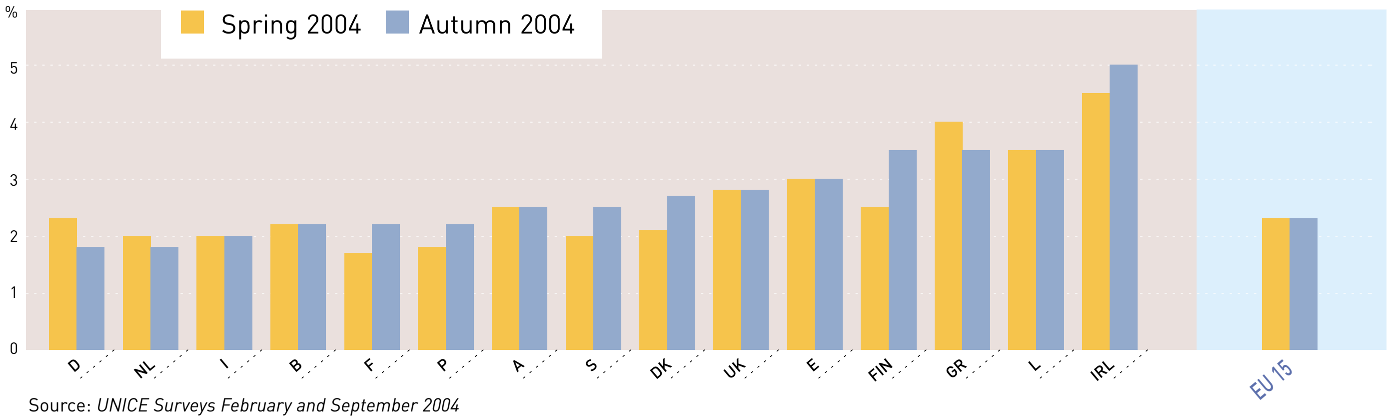
Chart 2 **Growth forecasts revision for 2004**



Source: *UNICE Surveys February and September 2004*

Compared with our Spring Economic Outlook, the EU15 growth rate is expected to stabilise at 2.3% in 2005, reflecting the fact that the stimulus coming from the US, China or even Japan could not last for ever. Despite the good performances expected in EU10, the limited growth potential of the European economy is also holding back its medium-term outlook.

Chart 3 **Growth forecasts for 2005**

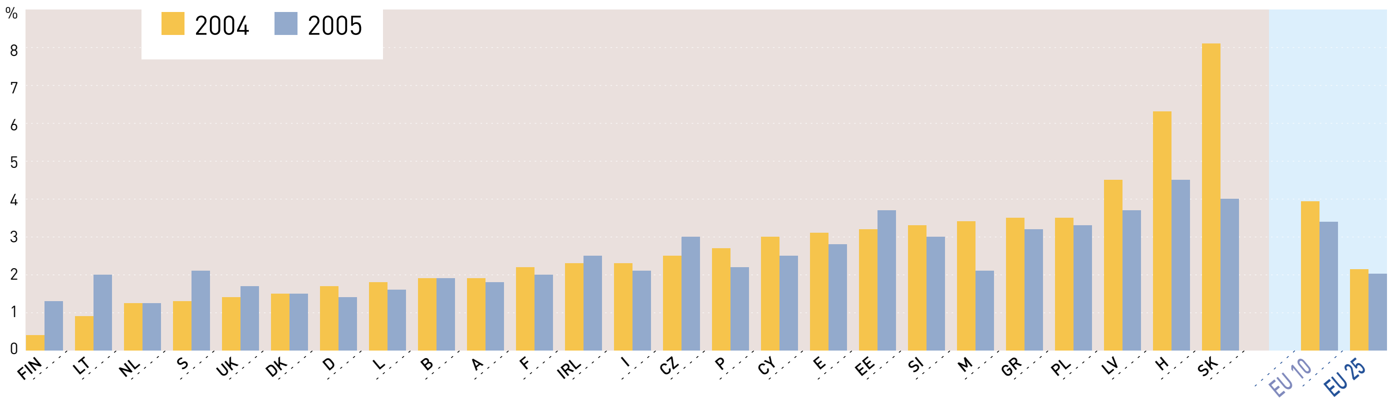


Source: *UNICE Surveys February and September 2004*

INFLATION

Inflation in the Eurozone is expected to slightly exceed the 2% target fixed by the ECB. Although somewhat more resilient to commodity (especially oil) price increases than expected, inflationary pressures are a source of concern. Expected inflation has indeed been revised upwards from 1.9 to 2.1% on average. More worrying, high inflation differentials mainly pushed up by price developments in Southern Member States further complicate the task of the ECB in pursuing an appropriate monetary policy.

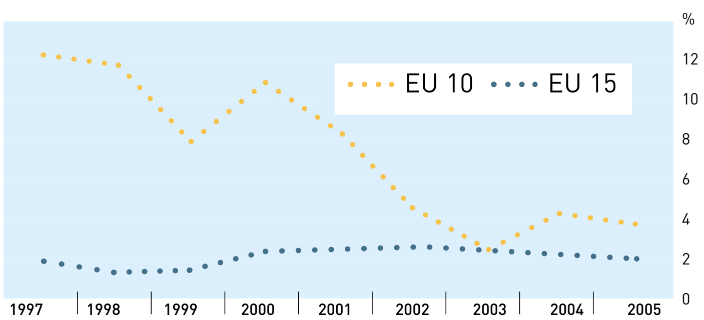
Chart 4 **Forecasts inflation rates in 2004 and 2005**



Source: *UNICE Survey September 2004*

The EU inflation level is slightly higher than the Eurozone price index, mainly due to the inclusion of some more inflationary countries after enlargement. The average inflation rate in EU10 (3.9%) is expected to be higher than the rate of inflation of EU15 (2.0%) in 2004. Although Eurostat data show a clear convergent trend in price indexes between EU15 and EU10 since 1997, our survey indicates that close attention should be paid a renewal of inflationary pressures in EU10.

Chart 5 **Weighted inflation rates 1997-2005**



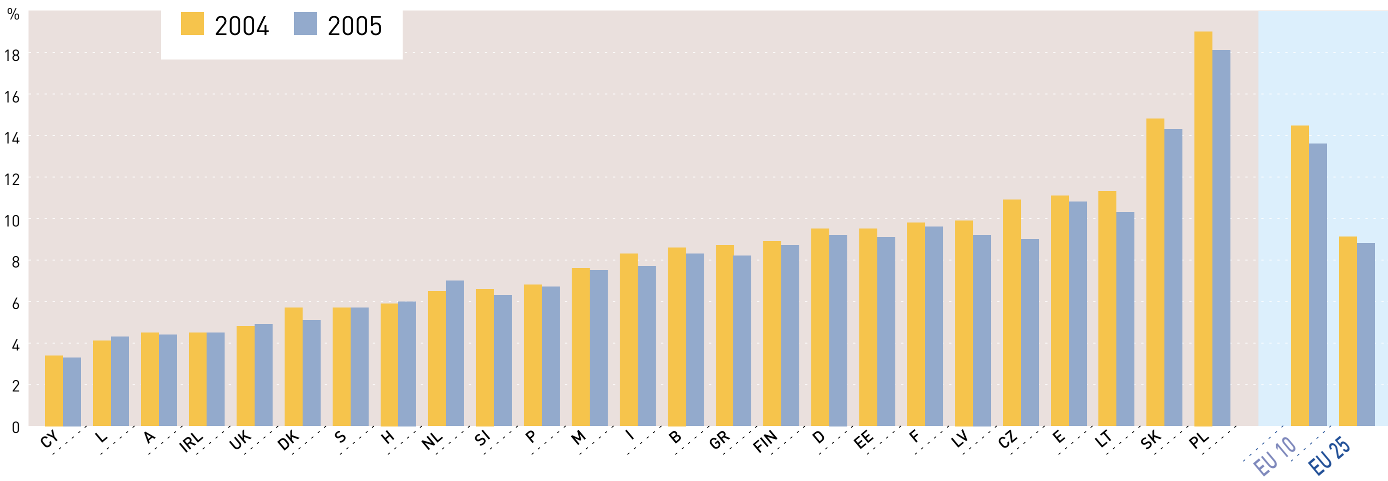
Source: *Eurostat 1997-2002 and UNICE Survey September 2004*

UNEMPLOYMENT

Growth recovery has not yet been translated into significant employment gains, at least in EU15. Labour markets remain stagnant, although some significant signs of improvement are to be expected in Greece and Italy. Still more worrying is the fact that between 2003 and 2005 unemployment rates are expected to increase by 1.9% in the Netherlands, by 0.8% in Sweden and by 0.5% in Luxembourg.

Unemployment is particularly worrisome in the new Member States with an average rate of 14.5% in 2004. This extreme level is highly influenced by the levels reached in Poland (19%), Slovakia (14.8%), and Lithuania (11.3%). With the exception of Hungary, improvements are however foreseen over the next year.

Chart 6 **Forecasts unemployment rates 2004 and 2005**

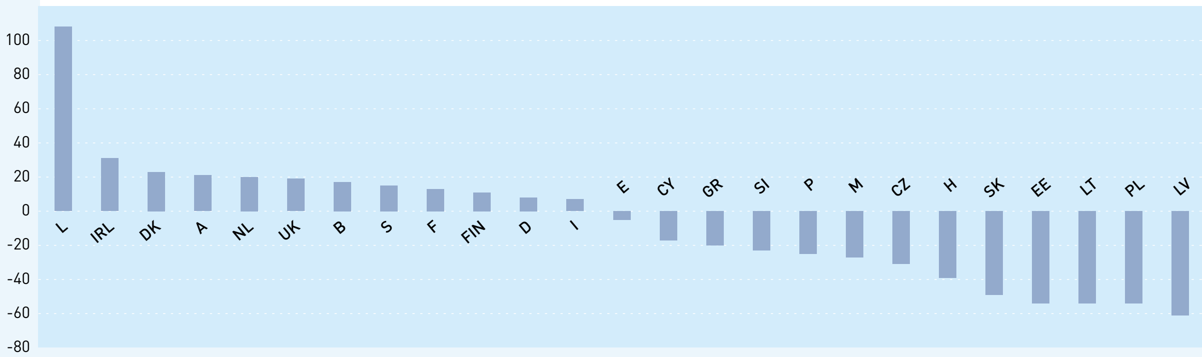


Source: *UNICE Survey September 2004*

THE CHALLENGE OF CONVERGENCE WITHIN THE EU

New Member States still have a long way to go to close the prosperity gap with EU15. The newcomers have an average per capita GDP below 60% of the EU average. The biggest challenge now is to advance real convergence without jeopardising macroeconomic and financial stability. Speeding up convergence will help to ease the excessive fears its consequences by making increasingly obvious the benefits of this historic enlargement.

Chart 7 **Per capita GDP in PPS, EU25 = 0**



Source: *Eurostat August 2004*

Human resources are certainly a key factor for convergence. Although the new Member States have a relatively good endowment of human capital, further investment in education could speed the process. Labour mobility should be enhanced to foster factor price equalisation. Greater mobility of production factors will also increase resilience towards external shocks, which characterises transition economies and remains one of the weaknesses of the whole EU economy. Improvements are also needed in the field of financial regulation and public finance sustainability to ensure greater stability for (foreign) investors. Investment is an important channel for innovation and technological transfers. Fostering the internal market through directive transposition and improved cross-border infrastructure will also enhance GDP convergence between Member States.

MAIN RISKS TO THE ECONOMIC OUTLOOK

→ ENERGY PRICES

→ BUT ALSO OUR OWN RESPONSIBILITY...

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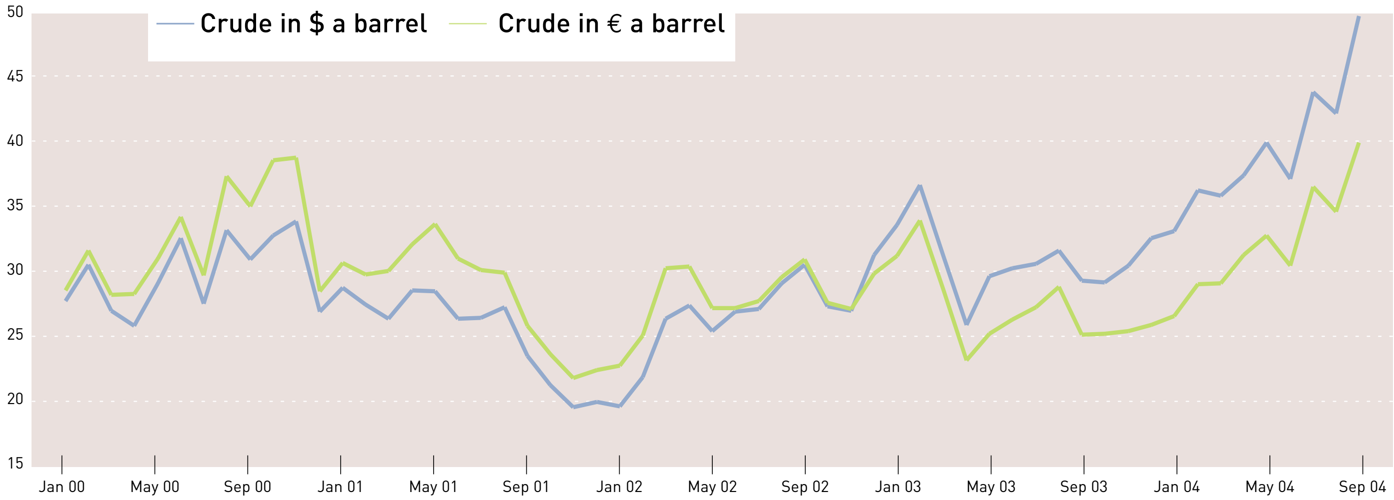
ENERGY PRICES

Upward pressure on energy and raw material prices, as well as availability, is a constant threat to the world recovery. Despite the relief provided by the OPEC decision on 3 June 2004 to increase production quotas, oil prices have been on an increasing trend since the end of July. On 1 October 2004, crude oil crossed the psychological level of $50 a barrel on the New York Mercantile Exchange.
Oil price peaks have reflected the risk premium resulting from the Yukos affair in Russia and political instability in oil producer countries (Venezuela, Nigeria, etc.). The volatility of oil prices in the face of extra-economic factors is a current source of instability and does not help firms to make long-term investment decisions. However, the current upward trend is mainly explained by booming demand from fast-growing countries such as China and India, and from countries such as Japan that is recovering from a long period of economic recession.

Chart 8 **Oil price fluctuations** (Jan 00-Sep 04)



Source: *Bloomberg (monthly data, last day of the month, WTI crude oil)*

Nevertheless, the situation remains different from the 1970s crises. The increasing weight of services and a much more energy-efficient industry make our economy less vulnerable to oil price movements than 30 years ago. Although price developments should be kept under scrutiny, inflation so far remains under control. The increase in oil prices in 1974 and 1979 occurred at a time when inflation was rising.

Beyond these historical considerations, the oil price increase is reported as an immediate risk for the recovery. The increase from $28 (1 Oct 2003) to $50.12 (1 Oct 2004) in one year's time is likely to hamper the current cyclical upturn. Most panellists expect an oil crude level of between $35 and $40 a barrel by February 2005. This range is nevertheless close to the threshold of $46 (weighted average) around which the European economy would be significantly hurt. According to most panellists, a sustained $10-a-barrel rise would cost the European economy between 0.3% and 0.5% of GDP in 2005, which is consistent with most international organisations' simulations. However, it should be noted that the effect of an oil shock is quite variable, as it depends on many country-specific factors such as oil intensity and dependence, wage elasticity, the Central Bank's reaction function or the exchange rate, which for the Eurozone is currently limiting the harmful effect of oil peaks.

The transmission mechanisms through which oil prices have an impact on the real economy include demand-side channels (e.g. consumption, investment), supply-side channels (e.g. production costs, profit margins) and indirect effects (e.g. exchange rate and inflation). The second-round effect on wages and inflation has so far been limited. Needless to say, not all sectors are equally affected by this external shock. Businesses such as transport, chemicals and automotive are particularly vulnerable to oil price fluctuations.

BUT ALSO OUR OWN RESPONSIBILITY...

Internally, the slow pace of reform implementation is threatening in a context of ageing population and global competition. Actions need to be taken to release the growth potential in Europe and better employment prospects. But consumer confidence will not improve without providing citizens with the guarantees that health and retirement systems are sustainable. Employment will not increase in a significant manner without greater labour flexibility, mobility and productivity.

POLICY MIX AND BUSINESS REGULATION

→ EXCHANGE RATE

→ MONETARY POLICY

→ FISCAL POLICY

→ BUSINESS REGULATION

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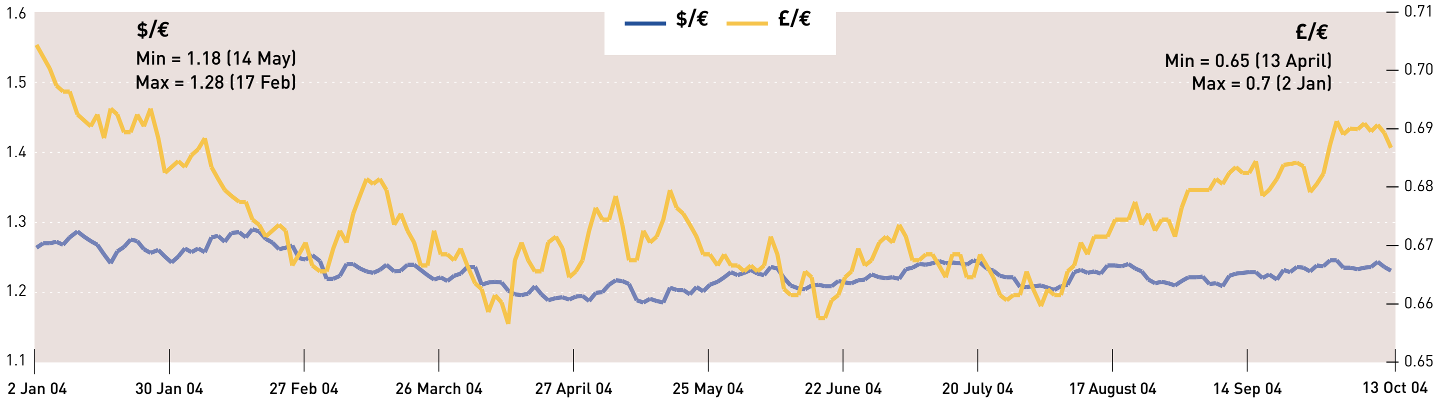
EXCHANGE RATE

The rapid appreciation of the euro was considered the most immediate source of concern during the previous exercise of the UNICE Economic Outlook (Spring 2004). Today, it would also be misleading to neglect this parameter as the current level remains very high. The level is not so far from the threshold around 1.28 dollars per euro identified by UNICE federations above which the European economy will be significantly hurt. Any euro appreciation and its volatility would harm European enterprises doing business in international markets, thus cutting away the sole leg on which the recovery is based. The current peg of the Chinese renminbi to the US dollar is exacerbating the potential harmful effect resulting from a lower US exchange rate.

Chart 9 **Exchange rate of the euro** (2 Jan 04 - 13 Oct 04)



Source: *ECB*

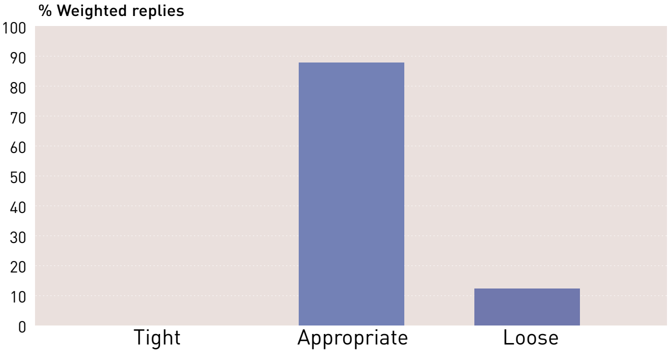
However, the risk is slightly less pressing. On the one hand, between mid-February and mid-May 2004, the dollar bilateral exchange rate decreased significantly to achieve relative stability within a range of 1.20 -1.24 $/€ since end-May 2004. With a rate of 1.227 $/€ on 13 October 2004, it remains historically high but more stable over time. This reflects market anticipation of the Federal Reserve's and European Central Bank's monetary stance. On the other hand, the relatively high exchange rate is limiting the detrimental effect of oil price increases (expressed in dollars), considered the most threatening risk at the time of our survey.

MONETARY POLICY

An overwhelming majority of our federations consider appropriate the monetary policy conducted by the European Central Bank for EU12 and by their central banks for non-EMU members.

In EU12, the ability of the ECB to keep core inflation under control has been positively assessed by the majority of our panellists. Many federations consider it necessary to keep interest rates low given the fragile state of the Eurozone economy and as long as the mandate of the ECB is met. Only in Spain where inflation rates are particularly high is ECB monetary policy considered to be too loose, setting the conditions for negative real interest rates.

Chart 10 **Appropriateness of monetary policy, EU12**



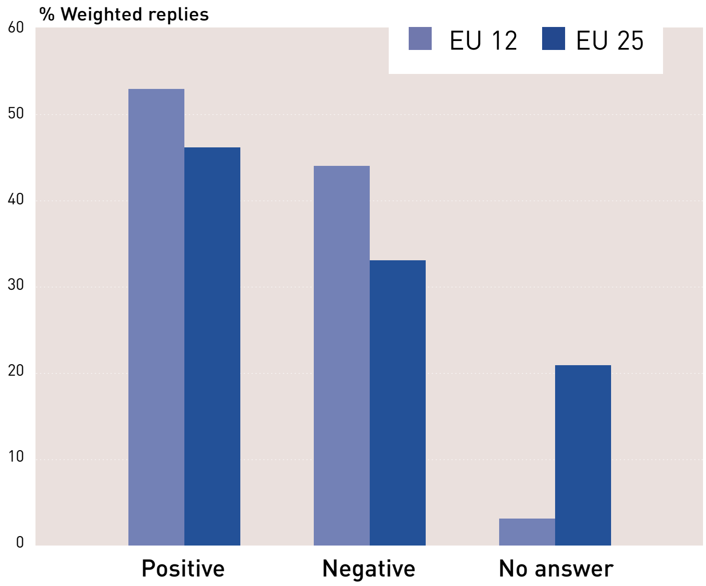
Source: *UNICE Survey September 2004*

In particular in the UK, recent interest rate increases were considered justified to move from an expansionary policy stance towards a more neutral level. UK interest rates are probably now at or near their peak for this cycle. On the contrary, the Hungarian employers' federation has raised concerns about the policy stance of the National Bank of Hungary. The negative effects of a strong forint and high real interest rates are viewed as unduly constraining business investment and economic growth. On 27 June 2004, the Estonian kroon, the Lithuanian litas and the Slovenian tolar joined the Exchange Rate Mechanism II (ERM II). Though little reported, this decision constitutes the first step towards euro area enlargement. Provided the three candidates respect the Maastricht criteria and keep their currency fluctuating only within a predefined range against the euro (+/-15%), they might convert to the euro by the end of 2006 or early 2007. Cyprus has also expressed its commitment to enter ERM II as soon as possible.

FISCAL POLICY

Most panellists have formulated a positive assessment of their country's multiannual stability programme. Excessive budgetary deficits are detrimental to growth recovery in the Eurozone. Countries in excessive deficit include Germany, Greece, France and the Netherlands (in 2003) while important budget imbalances characterise Italy. According to our survey, budget consolidation remains insufficient in Germany and Greece. In the Netherlands, the outlook seems rather more optimistic. While the Dutch deficit exceeded the 3% limit in 2003, it is expected to stay below the limit this year and resume its medium-term orientation. In France, the budget deficit will come back to a level compatible with the 3% criterion. However, our survey also indicates that the budget outlook in Belgium, France and Italy is likely to be improved thanks to one-off measures with only temporary effects.

Chart 11 **Assessment of stability / convergence programme implementation**



Source: *UNICE Survey September 2004*

Tax burden on business in EU15 has remained unchanged in the last six months. Portugal is the only exception with a corporate tax rate decreasing from 30% to 25% this year. Corporate tax cuts are nevertheless expected in Austria, Finland, France, Germany, Italy and the Netherlands in the near future. In EU10, the scenario is likely to be reversed. No improvement is expected in the coming six months in all countries but one: Slovenia (abolition of wage taxes for lower salaries). But this follows significant corporate tax cuts in the Czech Republic, Hungary, Latvia, Poland and Slovakia over the past six months. Efforts in the enlarged EU have been overshadowed by the tax increases in Estonia, France, Ireland, Malta and Spain over the past or the next six months.

BUSINESS REGULATION

At the national level, some positive developments are expected on the regulation front in eight countries (CZ, CY, E, EE, GR, I, LV, NL). Although many reforms are still needed in services and public sectors, Italy is an illustrative case where several measures have been implemented to foster competition, especially in energy and telecommunications markets. Three federations are expecting regulation that could harm competitiveness (IRL, M, S). The Swedish business sector is facing an increased regulatory burden with regard to compulsory payments for employees on sick leave, while Irish business continues to suffer from new environmental regulation.

The stress placed on the ambivalent nature of EU regulation in the previous UNICE Economic Outlook has never been as relevant as with 25 Member States. The EU can be a facilitator when, for instance, it helps to reduce the resulting additional burden for cross-border businesses. EU legislation is also certainly needed to tackle any barriers to the deepening of the EU Internal Market. Nevertheless, many UNICE federations underline the heavy burden resulting from some forms of regulation (e.g. exaggerated environmental regulation, new administrative requirements). Chemicals regulation (REACH) has notably been reported as an important threat to EU competitiveness.

A NEW INTERPRETATION OF THE STABILITY AND GROWTH PACT: DOING MORE HARM THAN GOOD?

On 3 September 2004, the European Commission adopted a Communication on EU economic governance and, more specifically, on the revision of the Stability and Growth Pact (SGP). The proposals would allow a country with a "protracted period of sluggish growth" to break the Pact; a longer adjustment time could be conceded according to country-specific economic conditions (cyclical development, debt level, etc.); and the medium-term objective could take further into account debt sustainability. Contributing to the debate, UNICE has not been in favour of changing the rules of the SGP.

The proposal to provide an exception to slow-growing countries would be a bad signal for European competitiveness. Relaxing the rules for countries with a "protracted period of sluggish growth" will give the wrong incentives for bad performers to slow down the necessary reform process. This will also penalise the good performers that have successfully implemented the Lisbon reforms, as they will suffer from higher inflation and interest rates resulting from budget deficits allowed in other countries.

As for as corrective path is concerned, differentiated treatment should not be based on political discretion but on country-specific conditions (e.g. indebtness, growth potential, ageing population, etc.).

Focusing on debt sustainability makes economic sense but debt accountancy should not be vulnerable to divergent interpretation. Taking greater account of debt level and dynamics will at least require greater budget harmonisation to avoid unduly subjective interpretation of the Pact.

The Commission regards peer pressure and early warnings as the channels through which the Stability and Growth Pact will be strengthened in economic good times. This proposal would be more promising if peer pressure had not proved to be weak in bad times.

ECONOMIC SENTIMENT

→ BUSINESS CLIMATE
→ PROFITABILITY
→ INVESTMENT
→ SME FINANCING
→ CONSUMER CONFIDENCE

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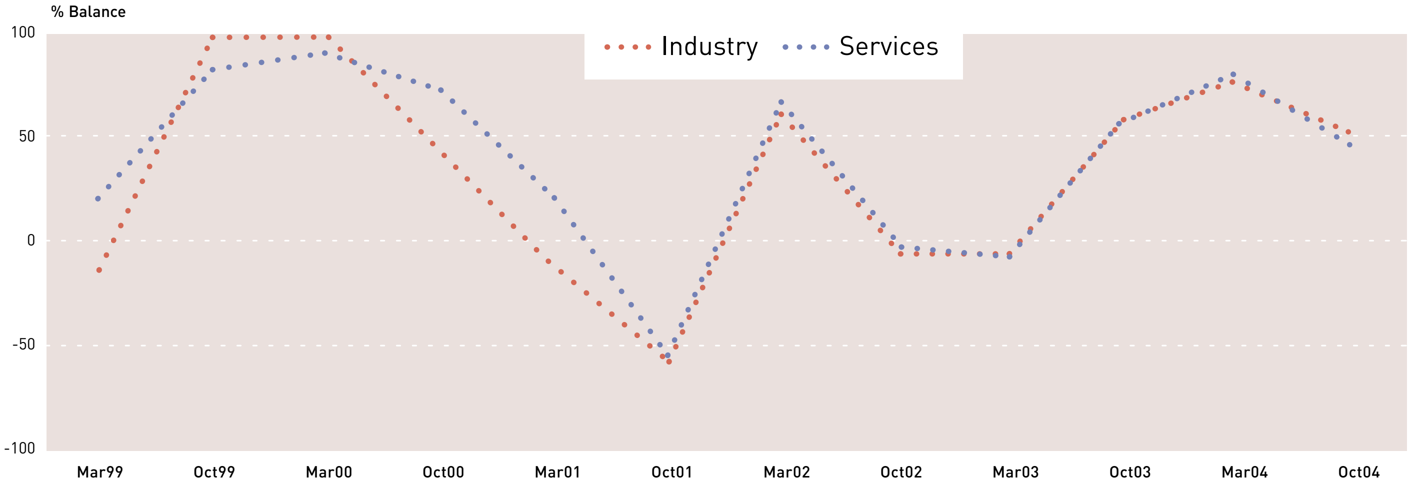
BUSINESS CLIMATE

Business climate over the next six months remains positive. However, there is a significant deterioration compared with our Spring Outlook. The main reasons are German employers' uncertainty regarding the strength of the recovery and the negative outlook for Spanish services, especially in tourism and transport activities. No change is expected in Denmark, France, Lithuania and Slovakia. All other federations expect an improvement in general in both sectors or at least in one of them.

Chart 12 **Trend in Business Climate**



Source: *UNICE Surveys 1999-2004*

Sectoral distinctions provide a very heterogeneous picture. But it broadly confirms the growth stimulus provided by the world recovery and the sluggish private consumption in some countries. Industries benefiting from a strong foreign demand, particularly those producing investment goods, are generally improving their prospects (esp. in D, I, S, E, UK). On the contrary, low-value-added manufacturing industries (e.g. leather, furniture, textiles) face difficulties with fierce cost competition from low-wage countries (esp. in E, F, I). In the new Member States, sectors such as agriculture, textile, forestry or steel industries are generally suffering from the necessary restructuring process. On the service side, the most promising services are generally business-related (esp. IT-related services) that indirectly benefit from the positive external environment (esp. in A, D, NL). Financial and banking services are also following a positive trend (esp. in D, I, L, LV). Although improvements in private consumption have been observed in countries such as France, Italy and Spain, retail trade, hotels and restaurants have not yet taken off in the whole EU (esp. in D, NL). Mixed prospects are also reported in tourism, being either positive in Austria, Cyprus, Estonia, Greece and Slovenia, or negative in Hungary, Ireland, Malta and Spain.

CHART 12 COMMENTS

This chart shows the difference between weighted shares of respondents expecting positive developments over the next six months and those expecting negative developments. Those respondents expecting unchanged developments are not included in this chart (same for Charts 13, 14 and 16). Data include 25 Member States from October 2004 and 15 earlier. This discontinuity does not radically bias our assessment over time as the 10 newcomers only account for about 5% of EU GDP. The exclusion of these data would only push down the trends by 3.1% and 2.7%.

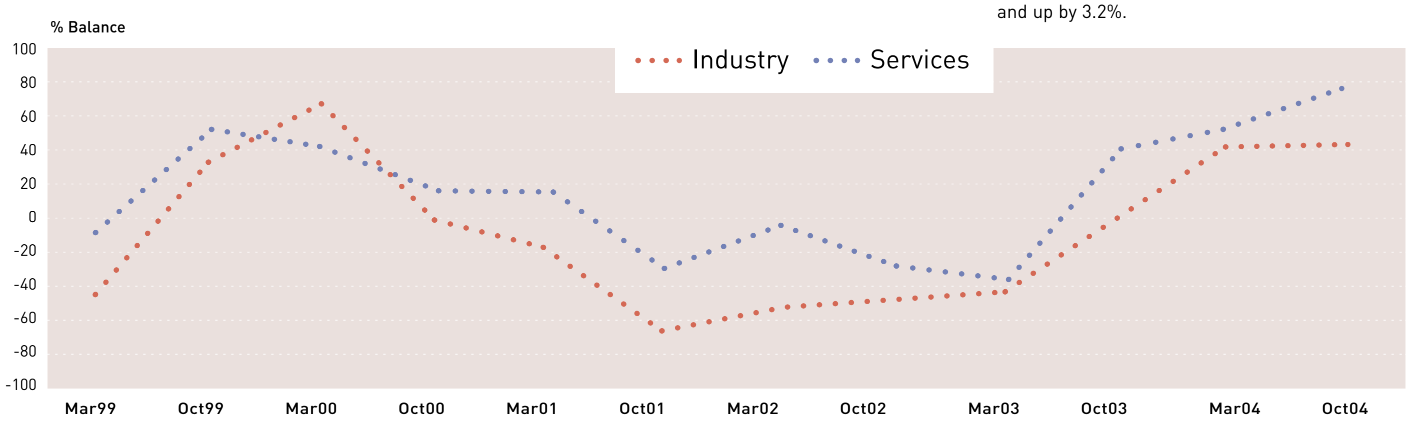
PROFITABILITY

Profitability expectations continue to stand at relatively high levels. None of our EU15 federations is expecting deterioration either in industry or in services. In EU10, only services in Malta and Hungary are expected to deliver decreasing profits. Despite the generally positive trend in the EU, oil and raw material prices are squeezing expected profit margins. In services, profitability expectations remain higher than six months ago but are following a slower pace than they might usually do at this point of the cycle. In industry, the energy-related cost burden has slightly depressed profitability expectations over the next six months.

CHART 13 COMMENTS

Data include 25 Member States from October 2004 and 15 earlier. The exclusion of the EU10 expectations would only push the trends down by 3.9% and up by 3.2%.

Chart 13 **Trend in profitability expectations**



Source: *UNICE Surveys 1999-2004*

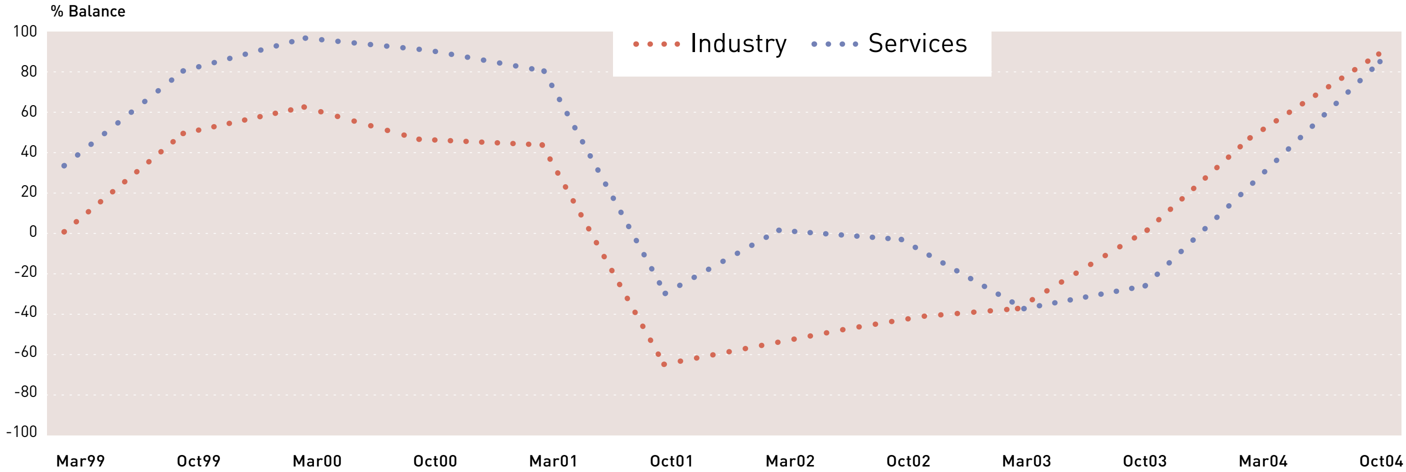
INVESTMENT

Except in Cyprus, none of our panellists is expecting a negative trend in investment over the next six months. Investment expectations are even reaching a level close to the peak recorded in March 2000.

CHART 14 COMMENTS

Data include 25 Member States from October 2004 and 15 earlier. The exclusion of the EU10 expectations would only push down the trends by 0.9% and 1.1%.

Chart 14 **Trend in investment outlook**



Source: *UNICE Surveys 1999-2004*

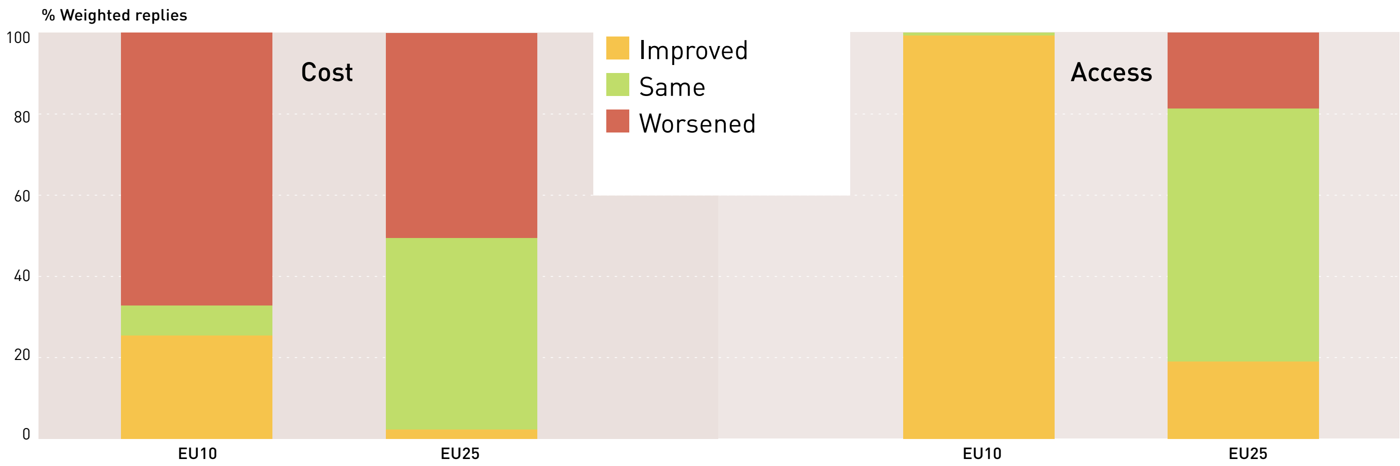
Investment is expected to benefit from the improvement in profitability registered in 2003. Higher capacity utilisation will support industrial investment. In services, investment projects are expected to be undertaken mainly in business-related activities. At least in the UK, the pick-up is nevertheless unlikely to match the bounce-backs experienced in the wake of previous recoveries, principally because of weakness in profits.

Investment outlook is likely to improve in the EU but from a very low base resulting from a declining trend over the last three years. Despite some optimistic signs, it remains disappointing compared with other major economies. According to September Eurostat data, less than one fifth of average quarterly GDP variation is explained by gross fixed capital formation from the third quarter of 2003 to the second of 2004 in the EU, compared with almost one half of the strong GDP variation in the US. It is still very hard to invest in Europe due to the lack of a competitive labour force, high taxation, non-wage costs, red tape, etc., so that lack of capital accumulation is constraining growth potential in Europe.

SME FINANCING

No significant change is expected in access to finance, suggesting that banks remain cautious in their lending policy in many countries. The situation in the UK is even worsening, particularly amongst medium-sized firms. Nevertheless, more optimistic prospects are foreseen in Belgium and in the new Member States. In EU10, the role of structural funds and increasing competition on financial markets are often regarded as positive factors. More competitive capital markets are also exerting downward pressure on the cost of financing in five of these new Member States (EE, CY, LT, H, and SI). However, the cost of financing is expected to increase across the EU. Higher interest rates are exacerbating the cost of financing in Czech Republic, Latvia, the Netherlands, Poland, Spain and the UK.

Chart 15 **Trends in SME cost and access to finance**

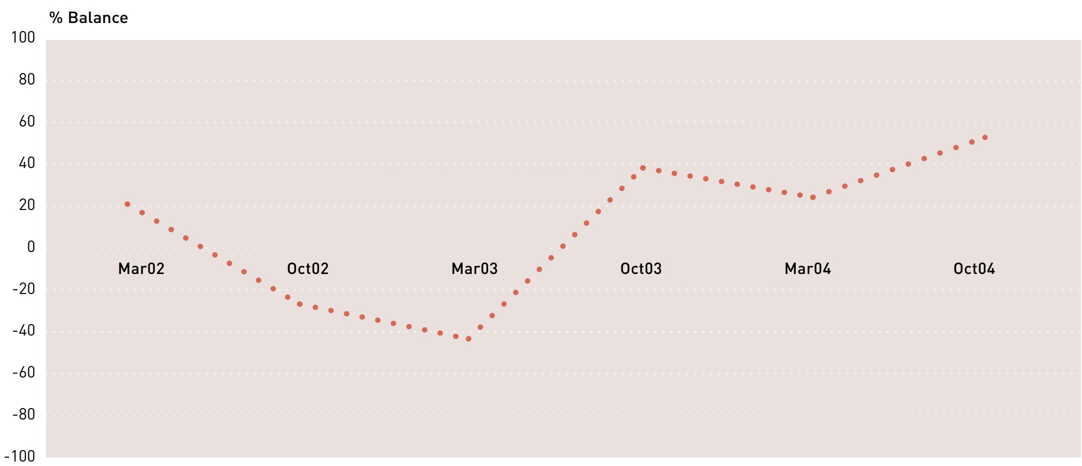


Source: *UNICE Survey September 2004*

CONSUMER CONFIDENCE

Gradual improvement of consumer confidence is expected in the next six months. However, most panellists remain cautious about the direction of consumer confidence. Positive expectations are likely to be tempered by consumer uncertainty, notably regarding the sclerotic labour market and resulting high unemployment, or the financial sustainability of pension and health care systems. In the UK, the possibility of further interest rate rises and falling house prices constitute downside risks for consumer spending.

Chart 16 **Trend in consumer confidence**



Source: *UNICE Surveys 2002-2004*

CHART 16 COMMENTS

Data include 25 Member States from October 2004 and 15 earlier. The exclusion of the EU10 expectations would only push down the trend by 3.1%.

LABOUR MARKET
AND WAGE INDICATORS

→ EMPLOYMENT

→ PRODUCTIVITY AND LABOUR COST

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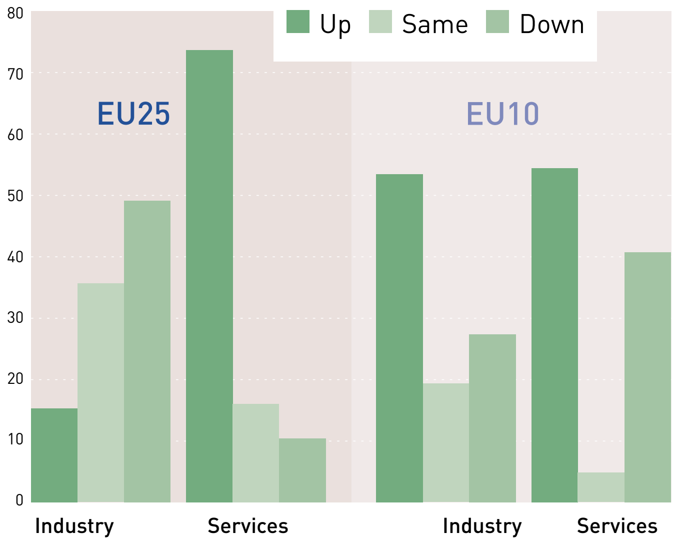
EMPLOYMENT

UNICE forecasts indicate that unemployment is stabilising at 9.1% in 2004, i.e. the highest level recorded since 1999 (9.2%). A slight improvement is only expected in 2005 with a rate of 8.8%. As the recovery gradually gathers pace, employment should improve with a certain lag. However, this lag might be longer than expected due to labour market rigidities.

The contrast between industry and services identified in the previous Economic Outlook is exacerbated. In industry, employment has generally continued to decrease in the last six months and, at lower speed, is expected to go on doing so. Only 15% of weighted replies expect industrial employment to improve in the next six months. In services, the situation is radically different with more than 70% of weighted replies expecting an improvement on the labour markets. Seeing the aggregated data, positive developments in services are likely to compensate for large losses in industrial employment. Regarding EU10, such a contrast does not exist. The very heterogeneous figures could simply reflect the different phase at which these economies stand in the transition process.

Concerning labour market tightness, no major change is expected. Labour markets in the EU remain remarkably unbalanced. Unemployment rates are stuck at high levels while, by contrast, risks of skills shortages are reported in Ireland and the UK. Some easing is expected only in Lithuania, the Netherlands, Slovakia, and Spain.

Chart 17 **Expected trend in employment in the next six months**



Source: *UNICE Survey September 2004*

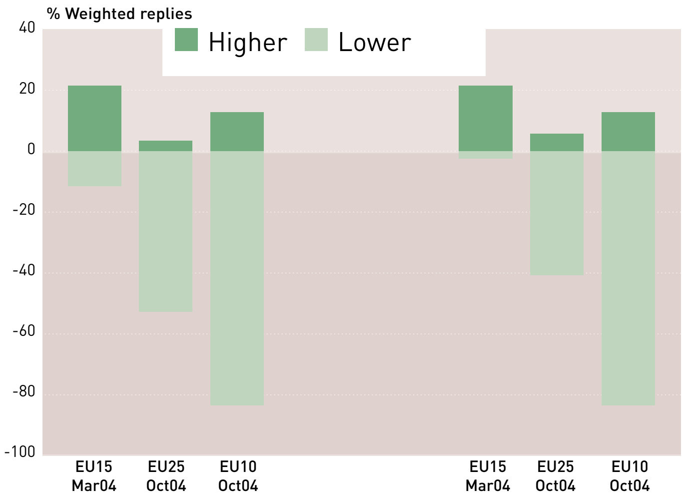
PRODUCTIVITY AND LABOUR COSTS

Nominal employee compensation is expected to increase by 3% in 2004 and 2.9% in 2005. However, expectations indicate that labour costs (non-wage included) in real terms are unlikely to increase faster than productivity growth. Only Luxembourg, Denmark (for services), Estonia, Cyprus, Greece, Latvia and Slovakia expect the reverse scenario.

However, our panellists also stress modest productivity growth per hour compared with what could be expected from the phase of the cycle. Low labour utilisation (working hours per person) in the EU has been recently highlighted by notably the ECB, the IMF and the OECD, and stronger productivity gains per head will be needed to face the challenge of an ageing population for the sustainability of our social protection systems.

In a context of high oil price, close attention should also be paid to wage developments, particularly in EU10. Inflationary pressures are particularly high in these countries, where higher productivity in tradable goods sectors could generate wage pressure in non-tradable goods sectors (so-called Balassa-Samuelson effect).

Chart 18 **Real labour-cost increase compared with productivity increase**



Source: *UNICE Surveys February and September 2004*

CHART 18 COMMENTS

Comparison between EU15 and EU25 remains relevant as the marginal difference of the inclusion of ten new Member States accounts for less than 5 %

FINANCIAL PERSPECTIVES 2007-2013

The debate on the financial perspectives 2007-2013 has really started following a Commission Communication of 10 February 2004. The Commission proposal indicates a significant re-orientation of resources towards the Lisbon Strategy. On 14 July 2004, the European Commission formulated further proposals relating to the revenue side of the EU budget.

UNICE cannot support compromise at the end of the negotiations being achieved at the expense of the competitiveness priority. The EU budget should act as a lever to achieve the Lisbon goals. A sufficient allocation of resources to competitiveness should be the prior objective independent of other decisions about the overall ceiling and/or the cost of common policies.

The EU budget should also make possible the absorption of 12 or more members and speed up their catching-up process. Furthermore, budget spending must be strongly justified. Efficient management of EU funds remains the key channel to ensure "good value for money".

Concerning the financing system, any EU tax-based own resource must not increase the overall tax burden on companies and citizens, which is already very high in the EU. UNICE cannot support any proposal that requires a minimum tax rate, as it would negate the interdependence between the different types of tax that Member States levy on an independent basis.

ANNEX
COUNTRY RESULTS

COUNTRIES

B	Belgium
CZ	Czech Republic
DK	Denmark
D	Germany
EE	Estonia
GR	Greece
E	Spain
F	France
IRL	Ireland
I	Italy
CY	Cyprus
LV	Latvia
LT	Lithuania
L	Luxembourg
H	Hungary
M	Malta
NL	Netherlands
A	Austria
PL	Poland
P	Portugal
SI	Slovenia
SK	Slovakia
FIN	Finland
S	Sweden
UK	United Kingdom

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UNICE ECONOMIC OUTLOOK AUTUMN 2004

	B	D	GR	E	F	IRL	I	L	NL	A	P	FIN
FORECASTS 2004												
Real GDP (annual % growth)	2.5	1.8	3.8	2.7	2.5	4.5	1.3	2.5	1.3	1.9	1.3	3.2
Inflation (%)	1.9	1.7	3.5	3.1	2.2	2.3	2.3	1.8	1.3	1.9	2.7	0.4
Unemployment (%)	8.6	9.5	8.7	11.1	9.8	4.5	8.3	4.1	6.5	4.5	6.8	8.9
Nom. compensation of employees (annual % growth)								na				
FORECASTS 2005												
Real GDP (annual % growth)	2.2	1.8	3.5	3.0	2.2	5.0	2.0	3.5	1.8	2.5	2.2	3.5
Inflation (%)	1.9	1.4	3.2	2.8	2.0	2.5	2.1	1.6	1.3	1.8	2.2	1.3
Unemployment (%)	8.3	9.2	8.2	10.8	9.6	4.5	7.7	4.3	7.0	4.4	6.7	8.7
Nom. compensation of employees (annual % growth)								na				
Question 1	**Trend in business climate over the next six months**											
Positive	Ser		Ind Ser			Ind Ser	Ind Ser	Ind Ser	Ind Ser	Ind Ser	Ind Ser	Ind Ser
Negative				Ser								
Neither pos nor neg	Ind	Ind Ser		Ind	Ind Ser							
Question 2	**Trend in profitability over the next six months**											
Positive	Ind Ser	Ser		Ind Ser	Ind Ser	Ser	Ind Ser	Ind Ser	Ind Ser	Ind Ser		Ind Ser
Negative												
Unchanged		Ind	Ind Ser			Ind					Ind Ser	
Question 3	**Trend in investment over the next six months**											
Positive		Ind Ser	Ser	Ind Ser	Ind Ser	Ind	Ind Ser	Ind		Ind Ser		Ind
Negative												
Unchanged	Ind Ser		Ind			Ser		Ser	Ind Ser		Ind Ser	Ser
Question 4	**Level of exchange rate with**											
USD	High	High	High	Appr	High	High	High	High	High	Appr	High	High
GBP	High	Appr	Appr	Low	Appr	Appr	High	Appr	Appr	Appr	Appr	Appr
JPY	Appr	High	na	Low	Appr	Appr	Appr	Appr	Appr	High	Appr	Low
Euro	na	na	na	na	na	na	na	na	na	na	na	na
Others: RNB/CHF	High	na	na	na	na	na	na	na	na	High	na	na
Question 5	**Stance of monetary policy**											
Tight												
Appropriate	yes	yes	yes		yes	yes	yes	yes	yes	yes	yes	yes
Loose				yes								
Question 6	**What is your opinion of the ECB (conduct of monetary policy favourable to business. transparency)**											
Positive	yes	yes	yes	yes		yes	yes	yes	yes	yes	yes	
Negative												
No answer					yes							yes
Question 7	**Compared to six months ago. SME's cost/access to capital for business development is**											
Higher / more difficult				C	C				C			
Same	C	C A	C A	A		C A	C A	C A		C A	C A	C A
Lower / less difficult	A								A			
Question 8	**Trend in government bond yields and stock market prices over the next six months**											
Stock mkt prices	same	same	same	up	same	same	same	up	same	same	up	up
Govt bond yields	same	up	same	up	up	up	up	same	up	up	same	up
Question 9	**Trend of total tax burden on business in the past six months**											
Increase				yes	yes							
Decrease											yes	
No change	yes	yes	yes			yes	yes	yes	yes	yes		yes
Question 10	**Trend in total tax burden on business in the next six months**											
Increase						yes						
Decrease		yes			yes		yes			yes		yes
No change	yes		yes	yes				yes	yes		yes	
Question 11	**What is your assessment of the budgetary policy ?**											
Positive	yes								yes	yes		
Negative		yes										
No answer			yes	yes	yes	yes	yes	yes			yes	yes
Question 12	**What is your assessment of your country's multiannual stability programme/pace of convergence?**											
Positive				yes	na	yes	yes	yes	yes	yes		yes
Negative	yes	yes	yes									
No answer											yes	
Question 13	**National regulations that harm competitiveness will increase. decrease or not change?**											
Increase		both				yes				na		
No change	yes				yes			yes		na	yes	yes
Decrease		both	yes	yes			yes		yes	na		
Question 14	**Overall trend in employment**											
Ind: past 6 months	Down	Down	Same	Down	Same	Down	Same	Same	Down	Down	Same	Down
Ind: next 6 months	Same	Down	Down	Up	Same	Down	Same	Up	Down	Same	Same	Down
Ser: past 6 months	Same	Same	Up	Up	Same	Up	Same	Up	Down	Same	Same	Up
Ser: next 6 months	Up	Up	Up	Up	Same	Up	Up	Up	Down	Up	Up	Up
Question 15	**Expectations of labour markets over the next six months**											
More tight	yes	yes										
Unchanged			yes		yes	yes	yes	yes		yes	yes	yes
Less tight				yes					yes			
Question 16	**Evaluation of labour productivity**											
High		Ind								Ind Ser		
Average	Ind Ser		Ind Ser		Ind Ser	Ind Ser	Ind Ser	Ind Ser	Ind Ser		Ind Ser	Ser
Low		Ser		Ind Ser								Ind
Question 17	**Real labour cost increase compared to growth in labour productivity**											
Higher			Ind Ser		na			Ind Ser				
Same	Ser	Ind Ser				Ind Ser				Ser	Ind Ser	Ind Ser
Lower	Ind			Ind Ser	Ind		Ind Ser		Ind Ser	Ind		
ONE-OFF QUESTIONS												
A	**Above which level of dollar/euro exchange rate will European economy be significantly hurt ?**											
Dollar per euro	1.20	1.30	1.20	1.30	1.10	1.35	1.35-1.4	1.35	1.30	1.30	na	1.30
B	**According to you where will the dollar/euro rate stand in February?**											
Dollar per euro	1.25	1.30	1.25-1.30	1.20	na	1.22	1.20	1.15	na	1.20	1.20	1.25
C	**Above which level of US crude oil will European economy be significantly hurt?**											
US dollar a barrel	35	45	na	45	38	60	50	40	37.5	40	na	60
D	**According to you where will the US crude oil price stand in February?**											
US dollar a barrel	33	35-40	na	30	na	40	39	na	na	33	42	35
E	**How will consumer confidence develop over the next six months?**											
Positively	pos	pos				pos	pos		pos	pos	pos	
Negatively												
Unchanged			unch.	unch.	unch.			unch.				unch.

EU-12	DK	S	UK	EU-15	CZ	EE	CY	LV	LT	H	M	PL	SI	SK	EU
2.1 2.1 9.0 2.4	2.3 1.5 5.7	3.0 1.3 5.7 na	3.4 1.4 4.8	2.3 2.0 8.1 2.8	3.0-4.0 2.0-3.0 10.9	5.5 3.2 9.5	3.5 3.0 3.4 na	6.7 4.5 9.9	7.0 0.9 11.3	3.8 6.3 5.9	1.1 3.4 7.6	6.0 3.5 19.0	3.6 3.3 6.6	4.1 8.1 14.8 na	2.6 2.1 9.1 3.0
2.2 1.9 8.7 2.3	2.7 1.5 5.1	2.5 2.1 5.7 na	2.8 1.7 4.9	2.3 1.9 7.9 2.7	4.0-4.5 3.0 9.0	6.0 3.7 9.1	4.3 2.5 3.3 na	6.7 3.7 9.2	7.3 2.0 10.3	4.0 4.5 6.0	1.7 2.1 7.5	5.9 3.3 18.1	3.7 3.0 6.3	4.3 4.0 14.4 na	2.6 2.0 8.8 2.9
Ind/Ser 34 38 0 12 66 50	 Ind Ser	 Ind Ser	 Ind Ser	**Ind/Ser** 47 50 0 10 53 41	 Ind Ser	 Ind Ser	 Ser Ind	 Ind Ser	 Ind Ser	 Ind Ser	 Ind Ser	 Ind Ser	 Ind Ser	 Ind Ser	**Ind/Ser** 50 52 0 9 49 40
Ind/Ser 65 95 0 0 35 5	 Ind Ser	 Ind Ser	 Ind Ser	**Ind/Ser** 51 74 17 0 31 26	 Ind Ser	 Ind Ser	 Ind Ser	 Ind Ser	 Ind Ser	 Ser Ind	 Ind Ser	 Ind Ser	 Ind Ser	 na na	**Ind/Ser** 54 73 16 1 31 26
Ind/Ser 85 84 0 0 15 16	 Ind Ser	 Ind Ser	 Ind Ser	**Ind/Ser** 87 83 0 0 13 17	 Ind Ser	 Ind Ser	 Ind Ser	 Ind Ser	 Ind Ser	 Ind Ser	 Ind Ser	 Ind Ser	 Ind Ser	 na na	**Ind/Ser** 88 85 0 0 12 15
H/A/L 88/12/0 23/65/12 29/57/14	 Appr Appr Appr Appr na	 Low Low Appr Low na	 High na Appr Appr na	**H/A/L** 86/11/3 67/33/0 22/66/11	 High Appr Appr Appr na	 High High na Appr na	 Appr Appr Appr Appr na	 Appr Appr Appr Appr na	 Appr High Appr High na	 High High High High na	 Low Appr Appr High na	 High High High Appr na	 Appr Appr Appr Appr na	 na na na na na	**H/A/L** 86/11/2 27/60/13 26/64/10
0 88 12	 yes	 yes	 yes	0 90 10	 yes	 yes	yes	yes	 yes	yes	 yes	 yes	 yes	na	2 90 9
76 0 24	yes	yes	 yes	64 0 36	 yes	 yes	 yes	yes	 yes	 yes	 yes	 yes	na	na	59 1 40
C A 40 0 60 87 0 13	 C A	 C A	 C A	**C A** 49 21 51 70 0 9	 C A	 C A	 C A	 C A	 C A	 C A	 C A	 C A	 C A	 C A	**C A** 50 19 47 62 2 19
U/S/D 17/83/0 91/9/0	 same up	 same up	 up same	**U/S/D** 30/70/0 75/25/0	 up down	 up na	 same same	 same same	 up same	 up down	 up same	 up same	 same same	 down down	**U/S/D** 35/64/1 69/27/4
34 2 64	 yes	 yes	 yes	27 2 71	 yes	yes	 yes	 yes	 yes	 yes	yes	 yes	 yes	 yes	24 10 66
2 71 28	 yes	 yes	 yes	1 56 43	 yes	 yes	 yes	 yes	 yes	 yes	yes	 yes	 yes	 yes	1 51 48
10 28 62	yes	 yes	yes	27 22 51	 yes	yes	 yes	yes	 yes	yes	 yes	both both	 yes	yes	29 24 48
53 44 3	yes	yes	 yes	44 33 23	both both	 yes	yes	yes	yes	yes	 yes	both both	yes	na	46 33 21
16 30 54	 yes	yes	 yes	15 43 43	 yes	 yes	 yes	 yes	 yes	 yes	yes	 yes	na	 yes	13 41 45
U/S/D 0/47/53 13/47/40 19/75/6 72/22/6	 Up Up Up Up	 Down Down Down Down	 Down Down Up Up	**U/S/D** 2/37/62 11/37/51 34/59/7 76/17/7	 Down Down Down Down	 Up Up Up Same	 Down Down Up Up	 Up Up Same Same	 Down Down Down Down	 Same Same Same Down	 Down Same Down Same	 Up Up Up Up	 Same Same Up Up	 Up Up Same Up	**U/S/D** 6/35/59 15/36/49 35/56/9 74/16/10
32 50 18	 yes	 yes	 yes	25 43 32	 yes	yes	 yes	yes	 yes	 yes	 yes	 yes	 yes	 yes	23 47 30
Ind/Ser 28 0 58 60 14 40	 Ind Ser	 Ind Ser	 Ind Ser	**Ind/Ser** 24 3 65 66 11 31	 Ind Ser	 Ser Ind	 Ind Ser	 Ind Ser	 Ser Ind	 Ind Ser	 Ind Ser	 Ind Ser	 Ind Ser	 Ind Ser	**Ind/Ser** 26 5 64 66 10 29
Ind/Ser 3 4 34 48 63 48	 Ser Ind	 Ind Ser	 Ind Ser	**Ind/Ser** 2 5 48 60 50 36	 Ind Ser	 Ind Ser	 Ind Ser	 Ind Ser	 na na	 Ind Ser	 Ind Ser	 Ind Ser		 Ind Ser	**Ind/Ser** 3 6 44 54 53 41
not relevant	na	1.30	1.35	not relevant	1.40	1.40	1.30	1.40	1.40	1.10	na	na	na	na	1.28
not relevant	same	1.25	1.20	not relevant	1.30	1.25	1.26	1.23-1.25	1.25	1.25	na	1.22-1.25	na	na	
not relevant	na	50	50	not relevant	50	60	50	45	60	51	na	na	na	na	46
not relevant	40	40	37	not relevant	45	40	41	40	35-40	37	na	na	43	na	
61 0 39	 unch.	 unch.	 unch.	48 0 52	pos	pos	 unch.	pos	pos	pos	 unch.	pos	 unch.	na	52 0 48

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