



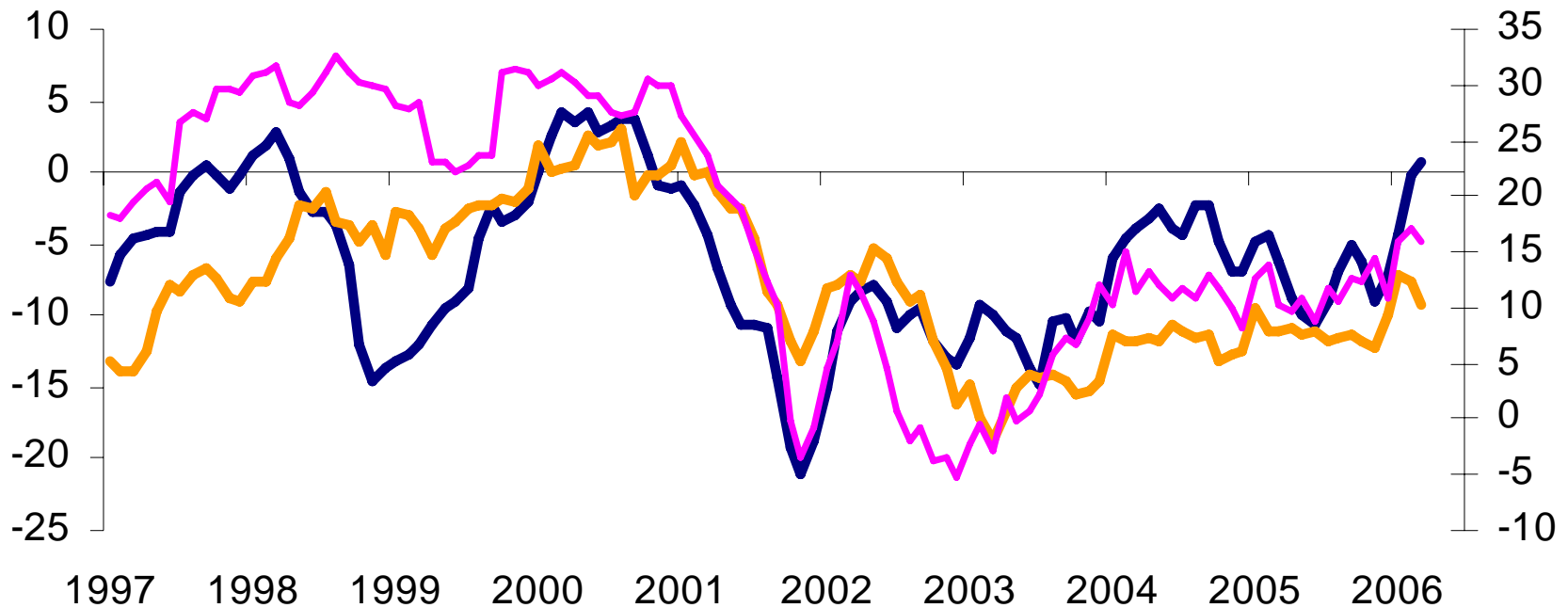
Economic outlook and policy challenges in Europe

Marc Stocker
Senior Economic Adviser

The business climate is warming up...

EU confidence indicators

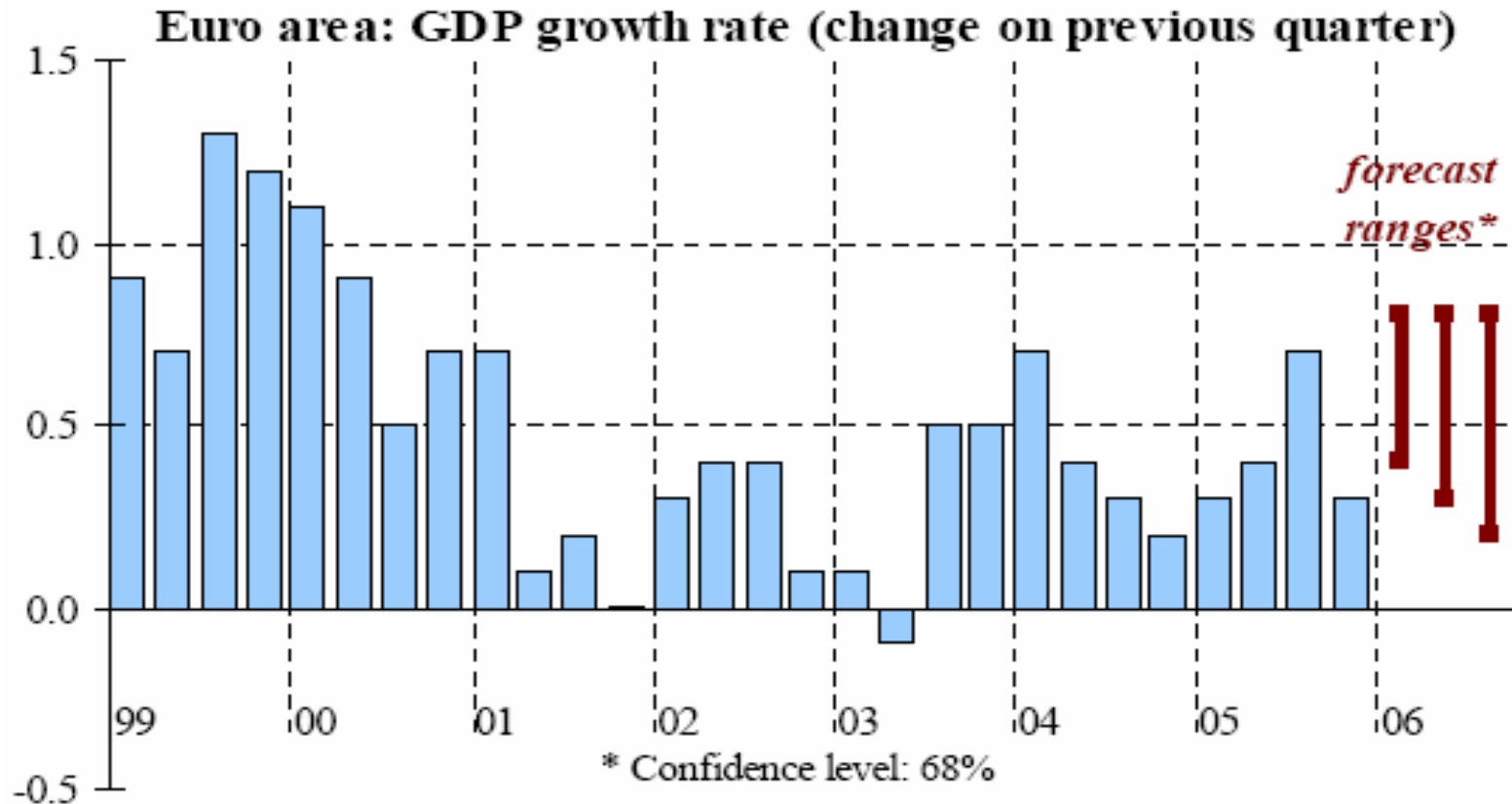
— Industry — Consumers — Services



Sources: European Commission



But leading indicators are already sending mixed signals for 2006H2...



Sources: European Commission



Main factors supporting an economic upturn this year...

- The renewed strength of global growth / trade will underpin European exports
- Business investment is recovering, supported in particular by low financing costs and sound corporate balance sheets
- Gradual improvement in labour market conditions



The outlook for private consumption is uncertain...

+

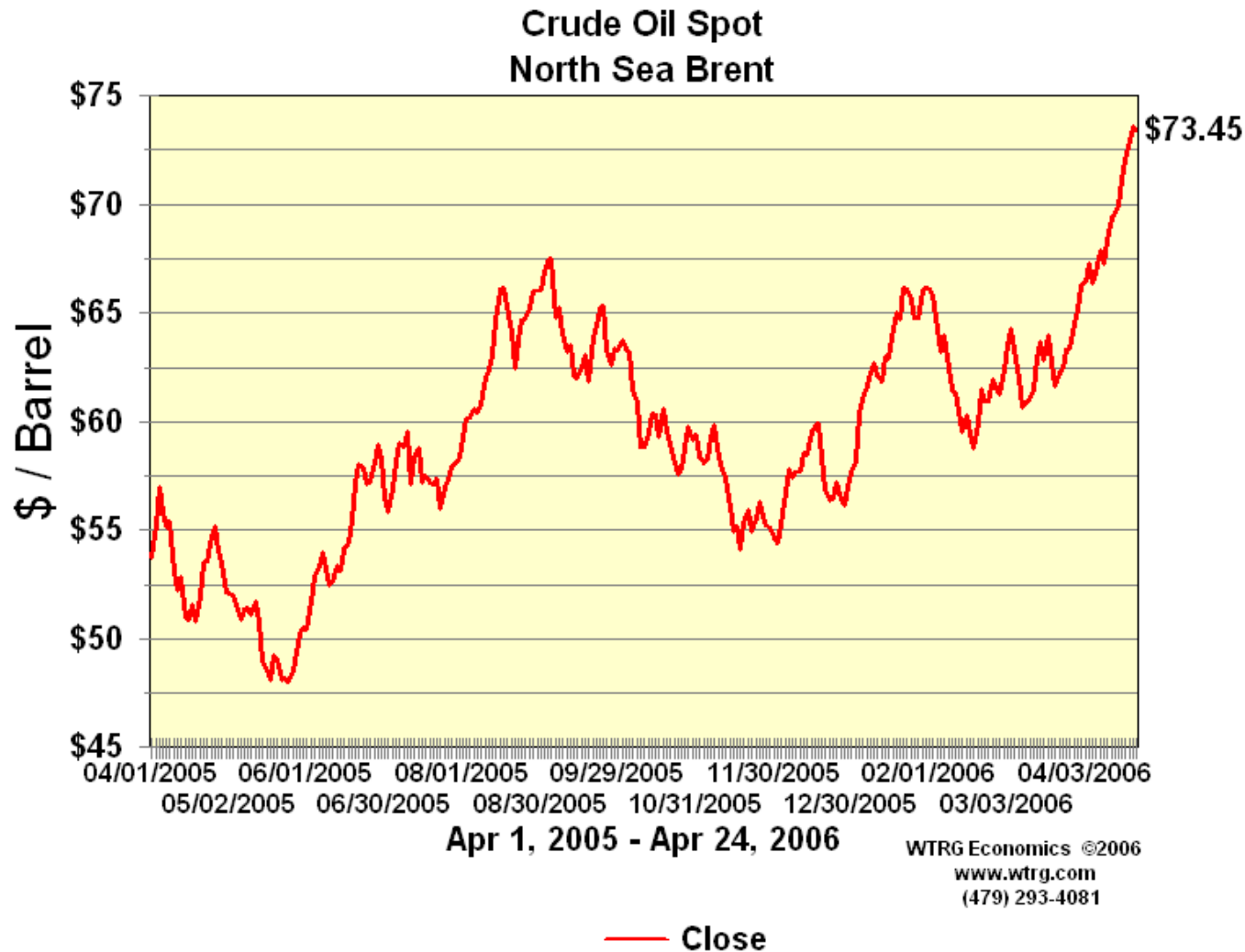
- A modest decline in the unemployment rate
- Low interest rate
- Housing and financial wealth gains

-

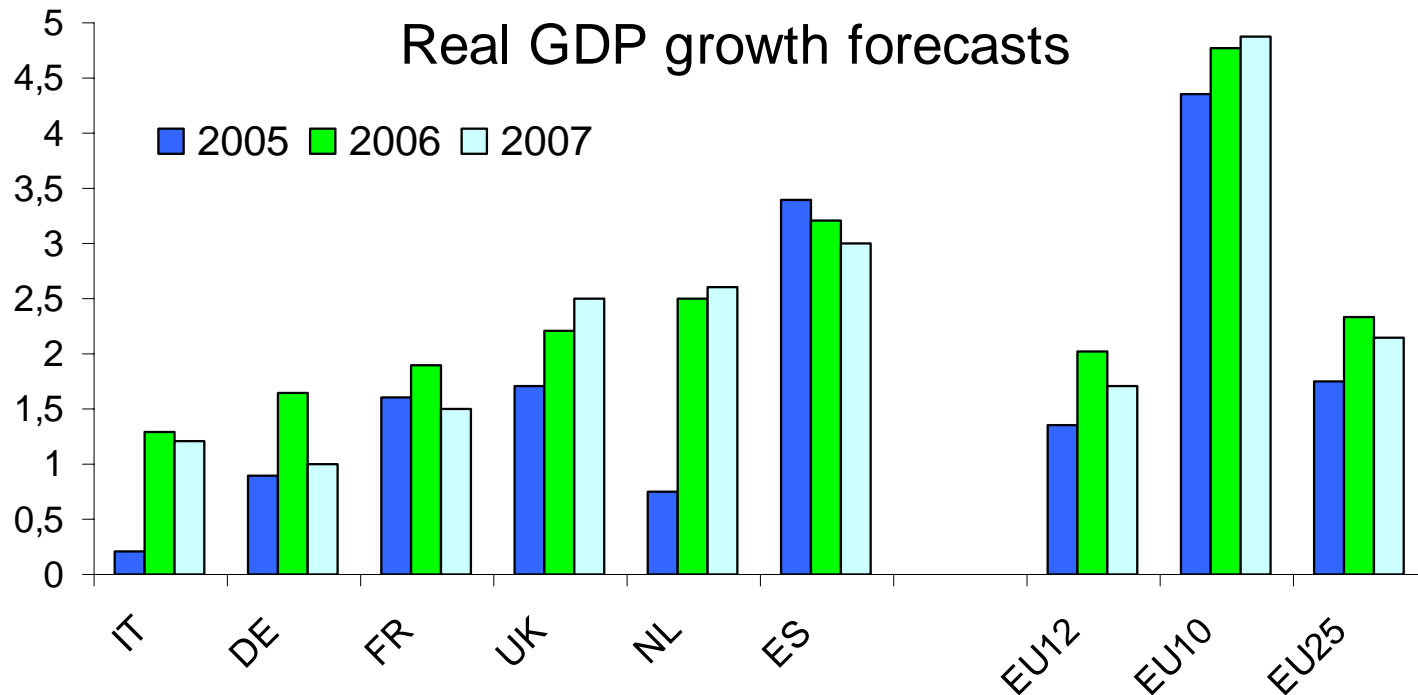
- Low productivity growth constraining income developments
- Uncertain future of pension and health care systems
- Perception of the globalisation threat
- 2007 VAT hike in Germany



New record high oil prices will not help...

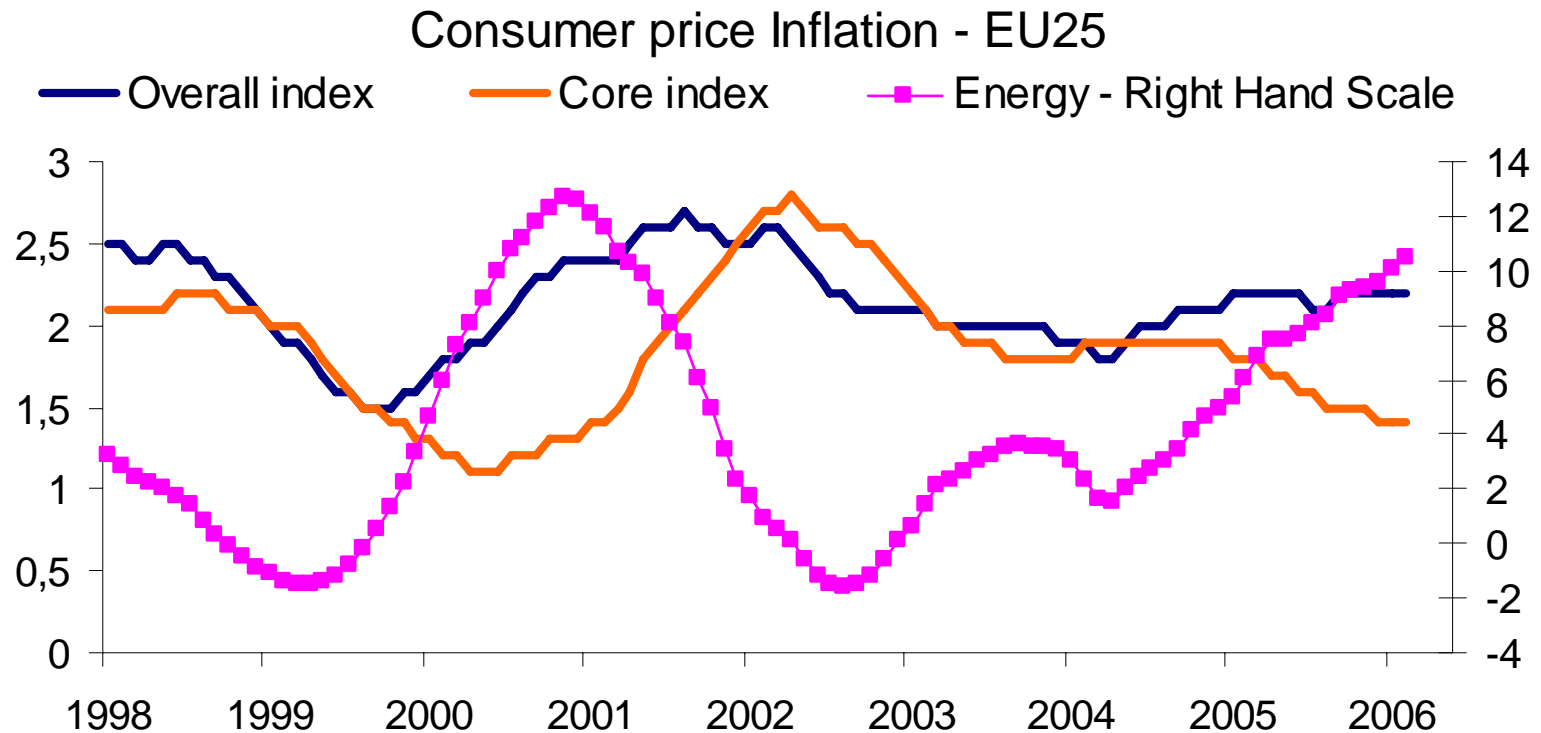


After a pick-up in 2006, growth expected to slow down in 2007...



Source: UNICE Spring 2006 Economic Outlook
(www.unice.org)

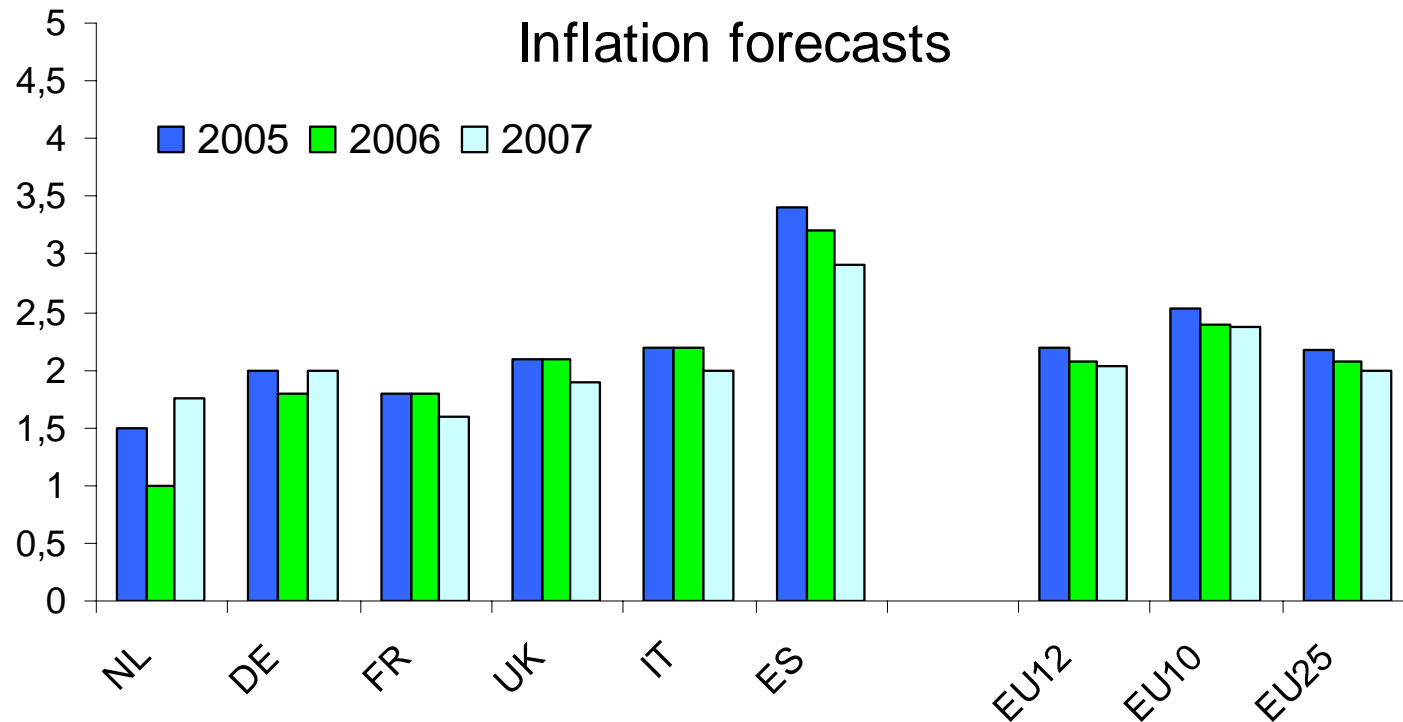
High energy prices will push up core inflation in 2006/07, but only modestly...



Sources: Eurostat



A benign inflation outlook should persist over the next two years...



Source: UNICE Spring 2006 Economic Outlook
(www.unice.org)



Appropriate macro policy response...

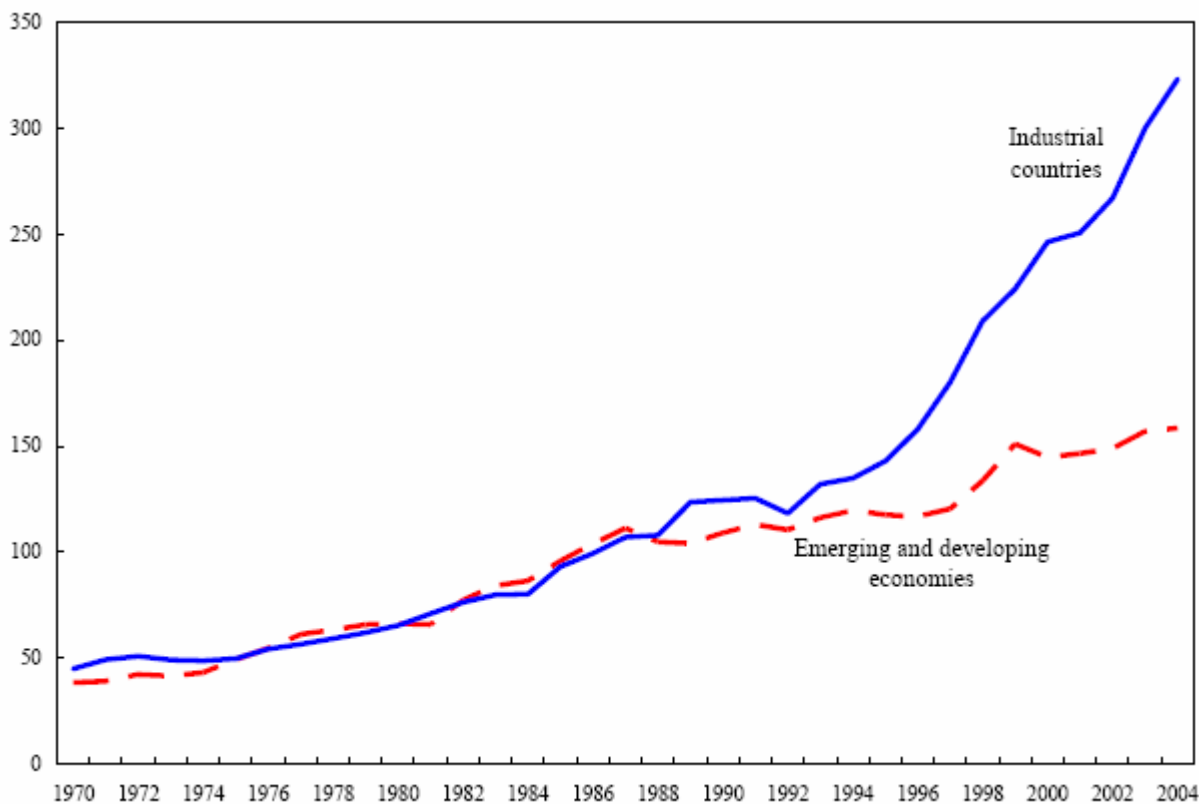
- Downside risks to growth and no sign of underlying inflationary pressures: ECB should not rush to increase interest rates in the short term
- Governments need to be more serious about fiscal consolidation



Europe's main policy challenge....

1) Benefit more from globalisation

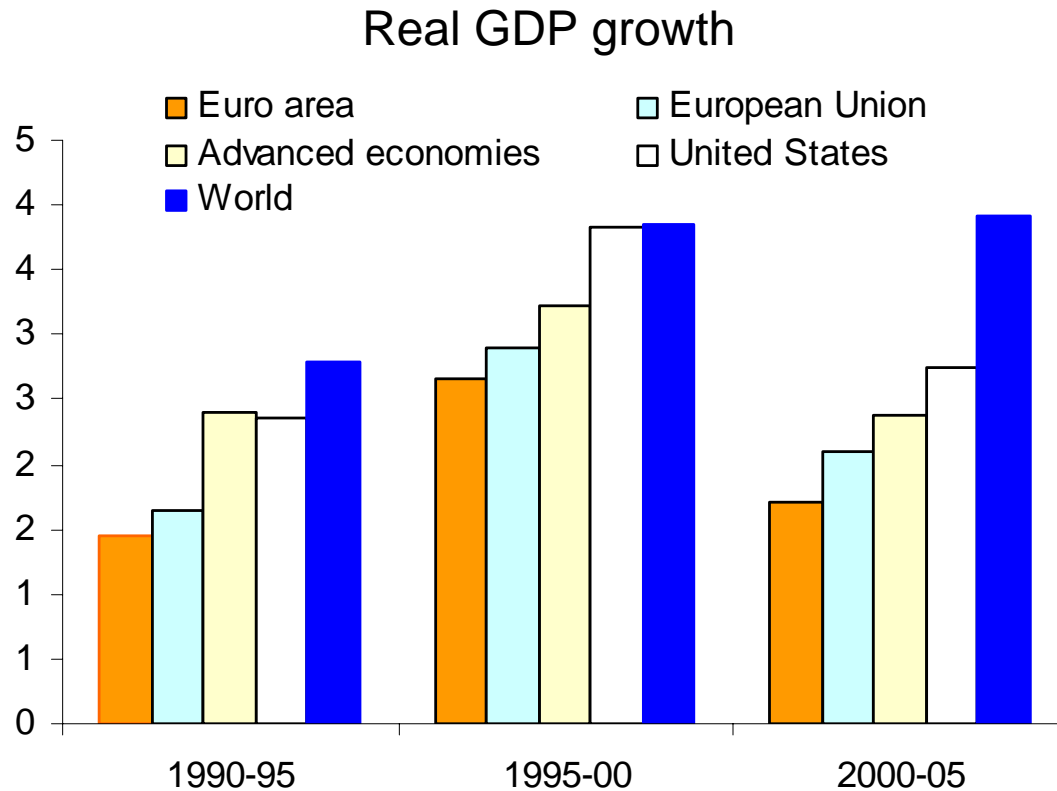
Stock of foreign assets
and liabilities as percent of GDP



Sources: IMF (2006)



This has not yet happened: Europe is falling behind...

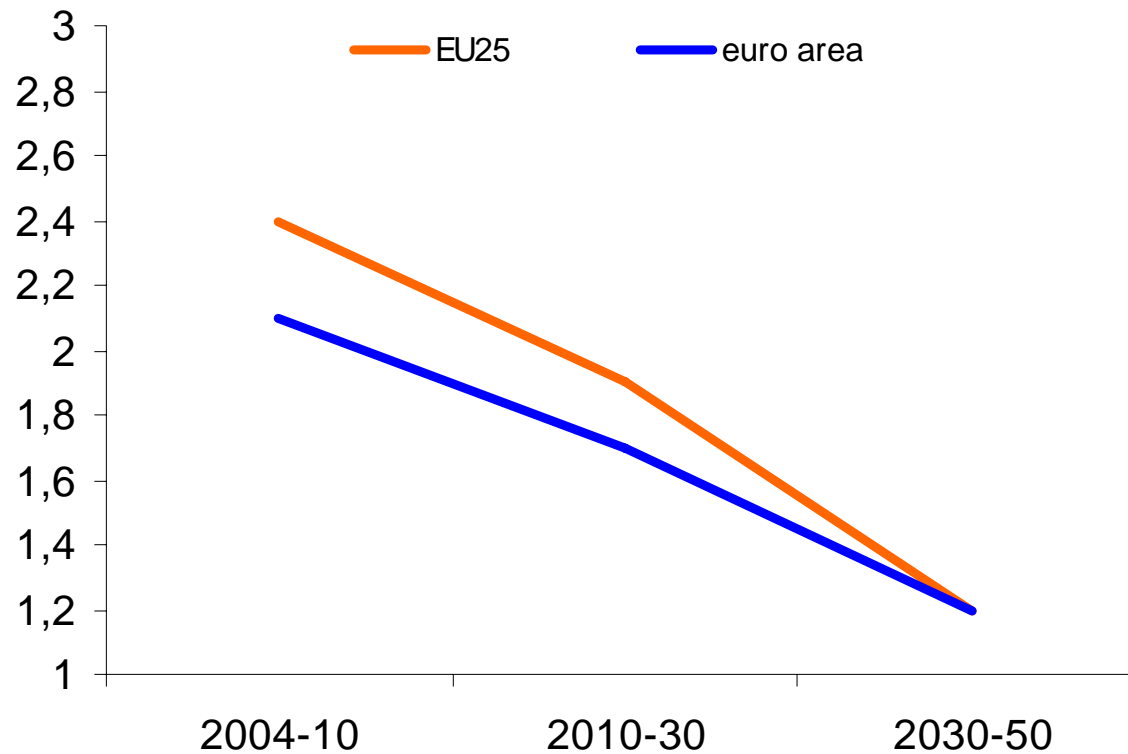


Sources: IMF WEO April 2006



2) face the consequences of an ageing and shrinking workforce...

Impact of ageing on real GDP growth



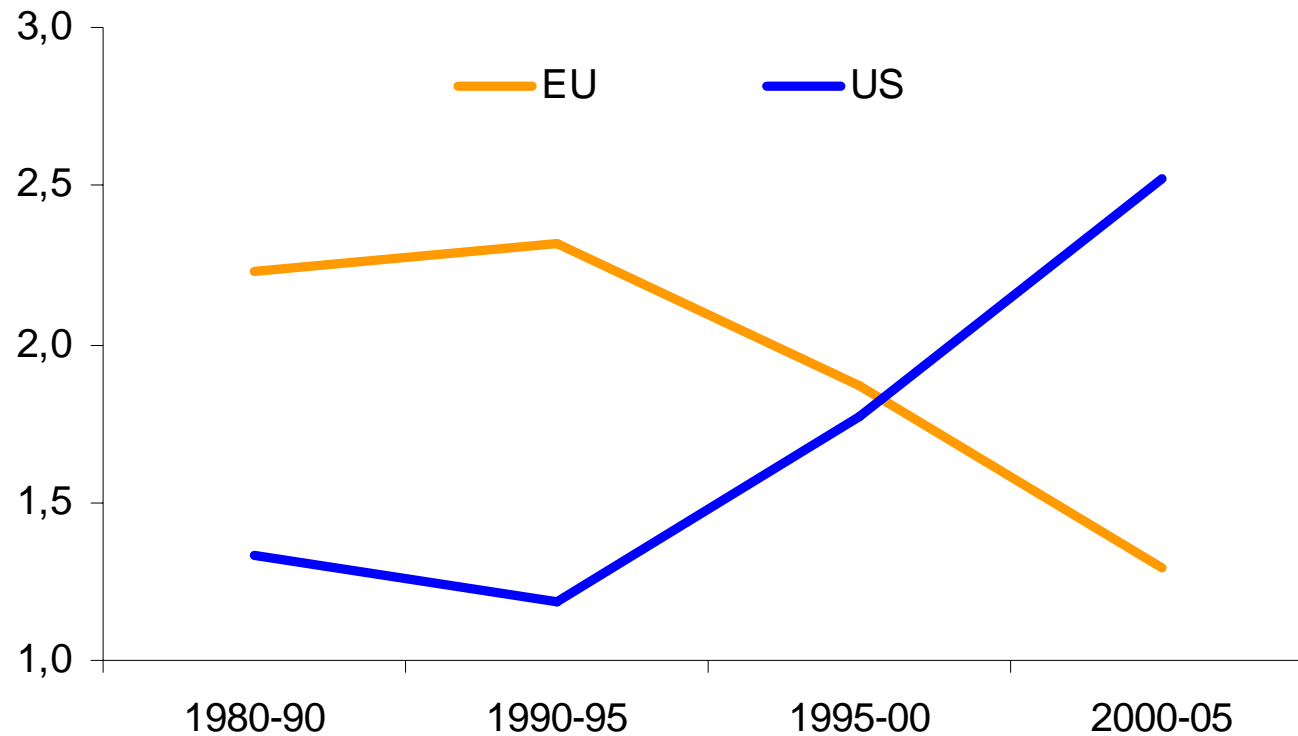
Sources: EPC and European Commission (2006)



Policy response:

1) Improve the business environment...

Hourly labour productivity growth

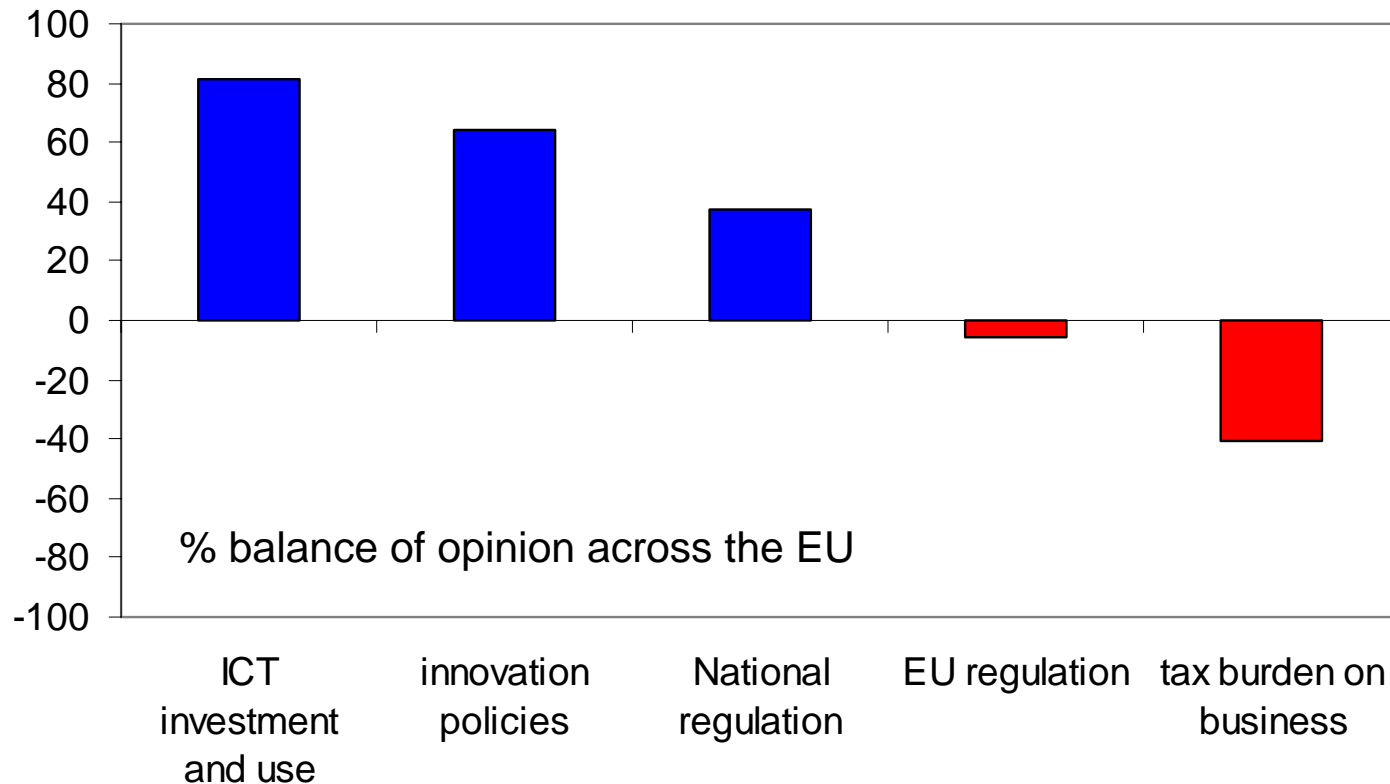


Sources: Groningen Growth and Development Centre (2006)



What UNICE expects in coming years...

Expected trends in key policy areas to restore productivity growth



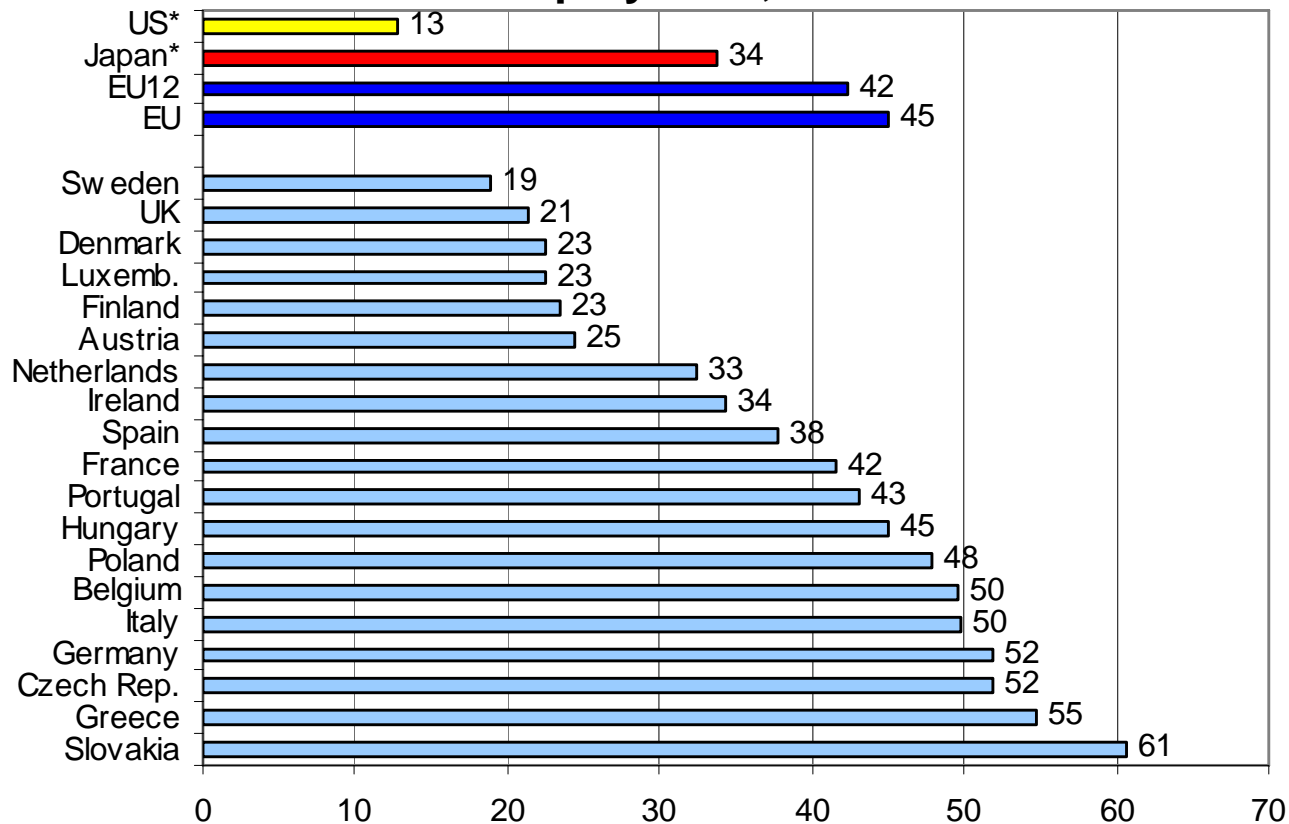
Source: UNICE Spring 2006 Economic Outlook
(www.unice.org)



Policy priorities:

2) Create more fluid labour markets...

Long-term unemployment as a % of total unemployment, 2004

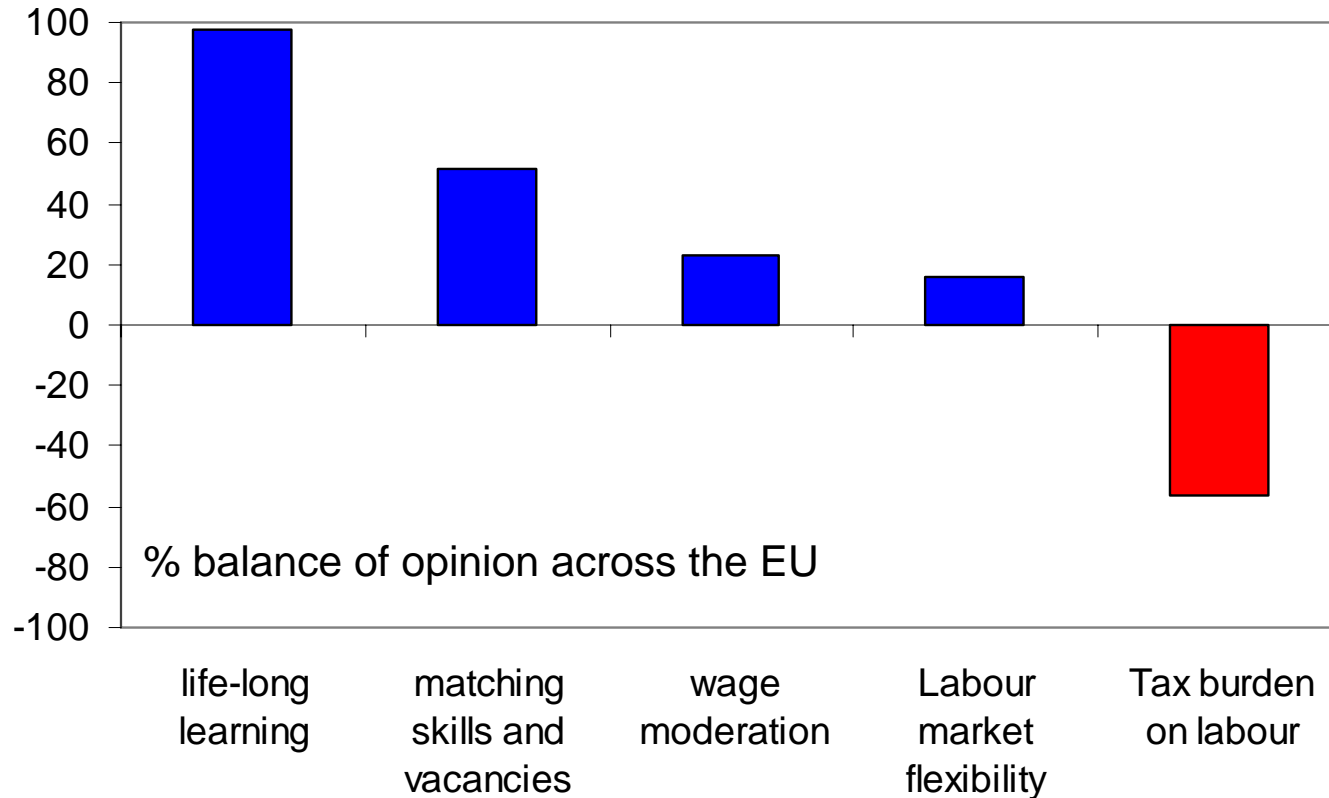


Sources: Eurostat



What UNICE expects in coming years...

Expected trends in key policy areas to improve labour market conditions



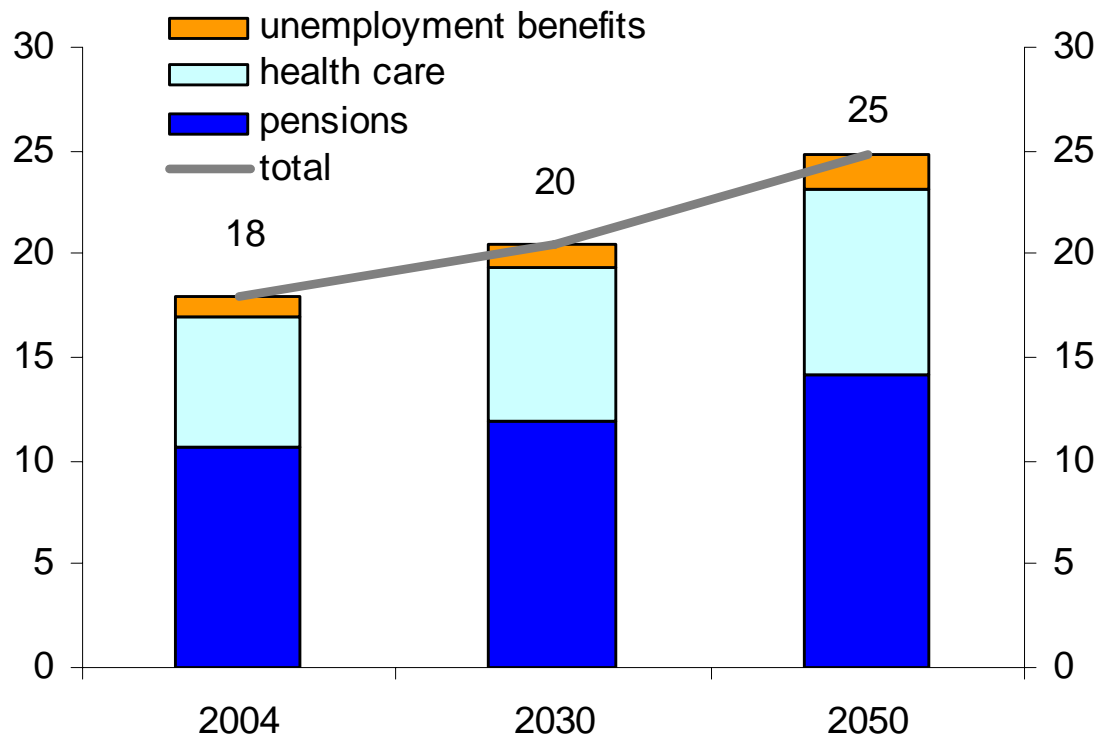
Source: UNICE Spring 2006 Economic Outlook
(www.unice.org)



Policy priorities:

3) Ensure sustainable public finances...

Impact of ageing on certain public expenditures - % of GDP

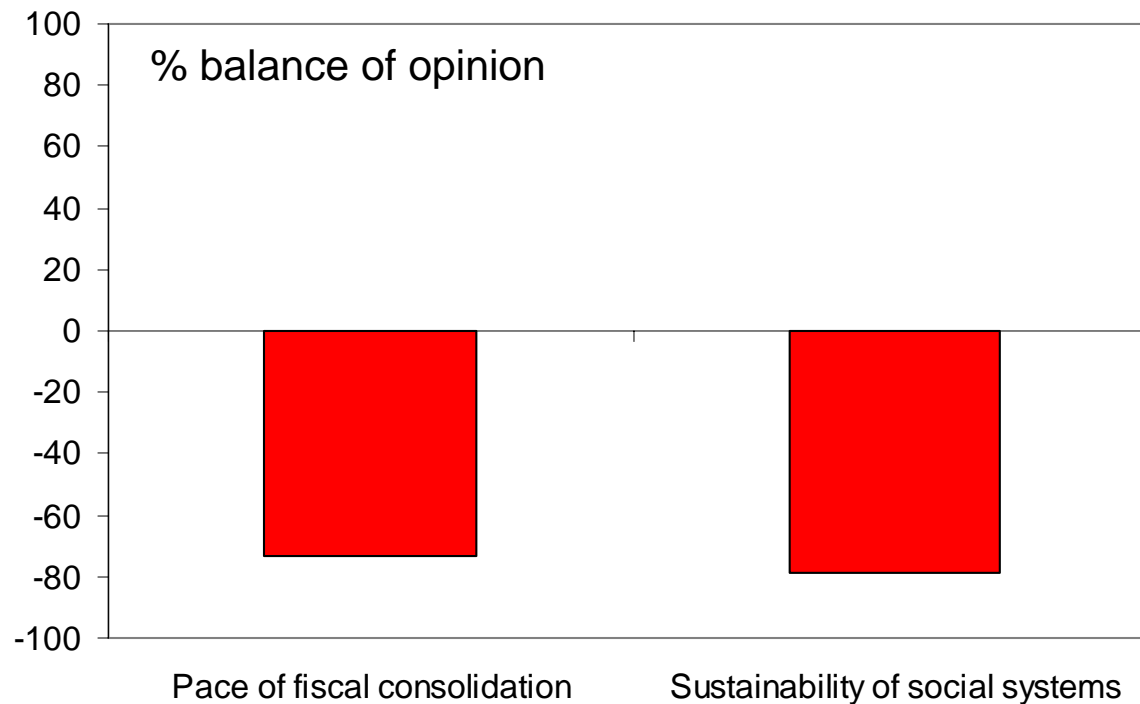


Sources: EPC and European Commission (2006)



UNICE's assessment ...

Sustainability of public finances and social systems



Source: UNICE Spring 2006 Economic Outlook
(www.unice.org)



Conclusion

- A modest recovery is underway but around a weak growth potential...
- Stronger reform momentum will be needed to...
 - Restore more sustainable growth and job creation in today's global environment...
 - Ensure the survival of Europe's Social Model in an ageing society...

