BUSINESSEUROPE

ECONOMIC OUTLOOK
Autumn 2007

Taming uncertainties, speeding up reforms
Key for sustained growth in Europe

WHO ARE WE?

BUSINESSEUROPE, the Confederation of European Business, is the voice of more than 20 million small, medium and large companies.

BUSINESSEUROPE's members are 39 central industrial and employers' federations from 33 countries, working together to achieve growth and competitiveness in Europe.

BUSINESSEUROPE actively promotes the role of business in Europe: strong enterprises make a strong Europe. It advocates a favourable and competitive business environment to foster sustainable economic growth and sound economic governance.

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 autumn's questionnaire were received by the end of October 2007.

For further information: **Economics Department**
Marc Stocker, Director and Erik Sonntag, Adviser
Tel +32 (0) 2 237 65 23 - **Fax** +32 (0) 2 237 66 23 - **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
Source: BUSINESSEUROPE members survey autumn 2007

	Euro area		EU27	
Autumn 2007 forecasts	2007	2008	2007	2008
Real GDP (annual % growth)	2.6	2.1	2.9	2.4
Inflation (%)	2.0	2.1	2.1	2.2
Unemployment (%)	7.0	6.8	7.0	6.6
Employment (%)	1.5	1.1	1.6	1.2
Hourly wage growth (%)	2.7	3.1	3.1	3.3
Hourly productivity growth (%)	1.3	1.3	1.4	1.5
GDP components				
Private consumption (%)	1.8	1.9	2.3	2.2
Gross fixed capital formation (%)	4.6	3.5	5.4	3.9
Exports (%)	5.6	5.1	4.2*	5.2*
Imports (%)	5.2	5.4	4.3*	5.6*

* Statistical treatment of VAT fraud creates distortions in UK forecasts

TAMING UNCERTAINTIES, SPEEDING UP REFORMS KEY FOR SUSTAINED GROWTH IN EUROPE

The sub-prime mortgage crisis in the US and the shockwaves it has sent through Europe's financial system since August are having a knock-on effect on economic prospects in the EU. The exact magnitude of the impact or its duration will notably depend on three factors: changes in financing conditions in coming months, exchange-rate developments, and member states' efforts to enhance competitiveness and ensure sustainable public finances. In all these areas, companies are expecting clear signs from policy-makers that will help underpin confidence and encourage them to continue investing and hiring to support self-sustaining growth in Europe.

Confidence is expected to prevail in the absence of further disorderly exchange-rate and financial-market developments

During the first half of 2007, the EU economy was still in a strong cyclical upturn, benefiting from favourable ingredients of a maturing business cycle. In particular, business confidence was high and investment growth dynamic, both supported by strong demand prospects and sound corporate profitability. Labour-market improvements must also be seen as an important factor explaining the recent buoyancy of the EU economy. The estimated 3.6 million new jobs created in the EU in 2007 and the decline in the unemployment rate to below 7% is providing a welcome stimulus to consumer confidence and spending at a time when uncertainty in other parts of the economy is rising.

Against this background, we expect that a robust upturn in 2006 and the vigorous start of 2007 will provide sufficient momentum for real GDP growth to exceed its long-term performance again in 2007, averaging 2.9% in EU27 and 2.6% in the euro area.

However, the outlook beyond the short term has been considerably affected since the summer and growth is expected to soften more rapidly than assumed in our spring forecasts. Our survey reveals a significant erosion of business confidence for the next six months, with exchange-rate and financing conditions ranking high on the list of concerns.

In this more challenging environment, BUSINESSEUROPE's baseline scenario for growth in 2008 remains cautiously optimistic, with forecasts of 2.4% for EU27 and 2.1% for the euro area. In particular, the German economic revival is proving more entrenched than expected at the start of 2007, partly compensating for rising uncertainties and faster deceleration in economic activity in other parts of the EU. Overall, EU employment is still expected to increase by 1.2% in 2008, extending the gains over three years to 9 million new jobs.

Whereas employment trends have witnessed remarkable improvements in recent years, labour productivity growth continues to be disappointing, averaging in our forecasts

1.4% in 2007 and 1.5% in 2008. Serious hurdles to business development continue to place a ceiling on European competitiveness and productivity growth, thereby restraining long-term economic prospects and the EU economy's ability to withstand external shocks.

High risk of more serious headwinds affecting the recovery in Europe

Our forecast considers a relatively benign resolution of current economic and financial uncertainties, but risks to this scenario largely lie on the downside. In order of importance, the five major risks identified by the business community are:

1. The strength of the euro and other European currencies vis-à-vis the US dollar, the Japanese yen and the Chinese yuan already represent a major challenge for European companies. Yet, the large US current account deficit combined with a more uncertain economic outlook in the US suggests a further weakness of the US dollar in the short to medium term. Tentative signs of an improving US trade balance could prove insufficient to alleviate these downward pressures. Without an appropriate burden-sharing of the dollar weakness by countries with large current account surpluses like China, Japan and oil-producing economies, there is a significant risk of excessive appreciation of European currencies with damaging consequences for growth and job prospects.

2. The US economy is currently expected to escape recession but the precise impact of its housing market correction on consumption and investment is difficult to quantify. A more significant slowdown in the US would have important consequences for European companies through trade, exchange-rate and financial-market channels.

3. Past turmoil on credit markets and the deterioration in the balance sheet of European commercial banks could by itself imply a substantial increase in borrowing costs for companies in coming months. Our survey shows that changes in financing conditions are currently a major downside risk to investment and growth prospects in Europe.

4. Several European housing markets face the risk of correction. Given the importance this particular sector has gained in countries like Spain, the UK or Ireland over recent years, negative repercussions on domestic demand could be felt over the medium term in those countries.

5. Oil prices have reached record high levels this autumn, constituting an increasing cost for companies and households. Although the strength of European currencies lessens to some extent the impact of high oil prices, notably for consumers, the net effect on companies' profit margins is negative.

In the face of these rising and wide-ranging risks, the strength of the recovery in Europe will depend more than ever on decisive and confidence-building measures by policy-makers at all levels.

ECB must remain pragmatic in the face of an unusually large degree of uncertainty

BUSINESSEUROPE has fully supported the ECB's handling of the financial-market crisis, which again illustrated the relevance of its independence and clear mandate. Political interference in the ECB's monetary policy will not help to find positive solutions to today's challenges. Looking forward, the business community expects that the ECB will continue to guarantee the orderly functioning of money markets and to remain open and pragmatic as regards its interest-rate policy.

Inflationary pressures appear contained. Increases in oil and other commodity prices could create some tensions in the short term, but with euro-area inflation expected to remain at 2.1% in 2008 and wage developments broadly under control, upside risks to medium-term price stability are largely offset by downside risks to growth. In this context, no further tightening of monetary conditions seems warranted in the near future.

To restore confidence in money markets and limit the risks of tighter credit conditions going forward, it is also essential that commercial banks clarify their exposure to the US sub-prime crisis and communicate the losses incurred.

Regarding the impact of monetary policy on foreign-exchange developments, while independent of each other and facing different economic circumstances, the ECB and the US Federal Reserve should continue to monitor the exchange-rate situation closely and avoid policies that could encourage a fast depreciation of the dollar against the euro.

However, effective measures to prevent disorderly exchange-rate movements must be of a more structural nature and imply an increased level of responsibility by all global players. Reducing global current account imbalances while preserving strong growth in Europe and in the rest of the world calls primarily for measures to contain downward pressures on the dollar and increase US savings, to induce Chinese authorities to revalue their currency significantly and foster stronger internal demand, to let the yen better reflect Japan's large current account surplus, and to step up structural reforms in Europe.

Budgetary consolidation and structural reforms are crucial for the resilience of growth in Europe

Regarding budgetary policy, most governments have been in autopilot mode in 2007, counting on economic growth to reduce deficits. Member states continue to favour pro-cyclical polices, largely ignoring the lessons from the expansionary budgetary policies during the boom of the late 1990s leading to painful adjustments in the subsequent slowdown, and a near collapse of the Stability and Growth Pact. The absence of sufficient budgetary provisions in the upturn would once again lead to swelling public deficits and debts should European growth hit a soft patch. It is crucial that member states engage in active consolidation and that euro-area countries stick to their pledges to balance their budgets by 2010.

With rising uncertainty, advancing with structural reforms is becoming increasingly vital. In a more challenging global environment and with demographic pressures building up, growth in Europe will rely more and more on measures to support competitiveness and foster higher productivity growth.

The areas for action are numerous, but BUSINESSEUROPE considers that a key objective will be to integrate the concept of flexicurity as a main pillar of the Lisbon strategy. In this regard, we call for the joint recommendations of European social partners released in October to be duly considered when common principles for flexicurity are decided at EU level, and subsequently implemented at national level.

A comprehensive review of structural reform priorities across the 27 EU member states will be spelled out in BUSINESSEUROPE's Reform Barometer to be released in December 2007. This report will present the state of reforms in Europe and give recommendations to member states and European institutions to make the Lisbon strategy deliver on its goals for the remaining period 2008-10.

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OUTPUT AND DEMAND

Until the summer, the European economy benefited from a sustained economic recovery. Together with an exceptionally vigorous 2006, recent trends should provide sufficient momentum for growth to exceed potential once again this year with annual GDP growth of 2.9% in EU27 and 2.6% in the euro area.

Our survey confirms that in a majority of EU member states, companies still intend to increase their investment spending in coming months, not only for replacement or rationalisation purposes but also to extend their production capacities. Investment growth is expected to reach 5.4% for 2007 as a whole. Also on a positive note, the rapid improvement in labour market conditions provides good foundations for private consumption growth, which is expected to average 2.3% in 2007.

However, since mid-August, the economic environment has become appreciably less supportive and an increasing number of uncertainties are attached to prospects for next year. Compared with the spring Economic Outlook, business confidence in industry and the services sector has deteriorated markedly. Indicators currently remain at high levels but the peak of the business cycle lies clearly behind us.

In this context, the annual growth rate of EU27 investment spending is expected to shift down a gear, from 5.4% in 2007 to 3.9% in 2008. Although no clear evidence of the financial market turmoil is discernible thus far, the situation needs close monitoring. European companies rely on bank lending for more than 50% of their external financing needs and rising capital costs have been identified as a major risk to economic growth (see also Box I). The impact of a credit squeeze could be aggravated by falling profitability. Even though company balance sheets rest on solid foundations for the time being, the autumn survey results point towards a deterioration in profitability over the coming months.

Export growth remains dynamic, bolstered by strong global demand. However, the rapid appreciation of the euro and other European currencies and a weakening US economy will exert a negative impact in coming quarters. Although the sensitivity to exchange rates differs across countries and sectors,

Chart 1
Business confidence has deteriorated since spring
Source: BUSINESSEUROPE autumn survey

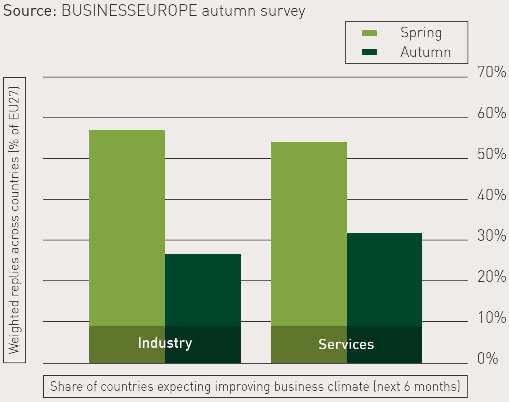
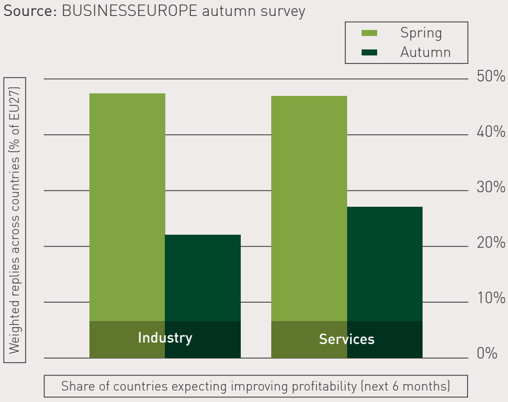


Chart 2
... as has corporate profitability
Source: BUSINESSEUROPE autumn survey



developments on foreign-exchange markets are an increasing source of concern for European business. Against this background, our forecasts for 2008 real GDP growth at 2.4% in EU27 and 2.1% in the euro area should be viewed as cautiously optimistic.

At member-state level, important differences persist. Within the euro area, real GDP growth is expected to be fairly robust in Finland, Ireland, and Slovenia, whereas Spanish growth is forecast to fall below 3% for the first time in five years. The expected housing market corrections in Ireland and Spain as well as in the UK (see Box II) are important reasons for downward revisions of 2008 national growth forecasts. Euro-area member states whose GDP growth was particularly lacklustre in 2007 – Portugal, Italy and France – are expected to witness a modest improvement in 2008, although remaining at the bottom of the growth league.

The case of Germany deserves special attention as its economic revival has been more vigorous than anticipated in early 2007. Robust export and investment growth, rising corporate profitability, the recovery in the ailing construction sector and an appreciable improvement in the labour-market situation are delivering results. German real GDP is forecast to grow by up to 2.8% in 2007 and by 2% in 2008.

Whereas strong external competitiveness and corporate restructuring have propelled the German economy out of the doldrums, private consumption continues to be relatively subdued in the face of important demographic pressures. France on the contrary has experienced the opposite. Dynamic French consumption has fed into high import growth and, with weak exports, the overall growth performance is unsatisfactory. Based on the forecasts for 2007 and 2008, this situation is not expected to change dramatically.

Regarding the United Kingdom, it has outperformed the largest euro-area economies by a significant margin in recent years, driven by strong domestic demand and a buoyant housing market. However, a so far orderly correction of the housing market will affect the economy in 2008 and annual real GDP growth is expected to decrease towards 2.2%, following 3.0% in 2007.

Finally, new member states are expected to continue enjoying rapid catching-up dynamics. Growth forecasts for 2008 are particularly vigorous in the Baltic States and the Slovak Republic. For the biggest new member states, the situation is not so clear-cut. Whereas Poland and the Czech Republic are expected to keep 2008 real GDP growth at 5% annually, Hungary will witness a mere 2.8%.

Chart 3 Real GDP forecasts – weaker growth in almost all member states in 2008
Source: BUSINESSEUROPE autumn survey

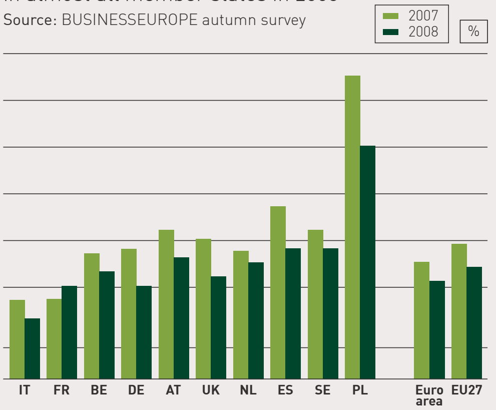
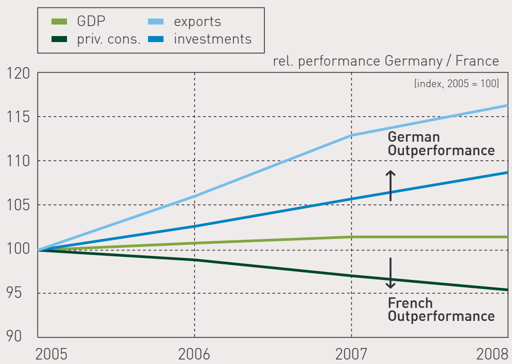


Chart 4 Divergent developments in Germany and France
Source: BUSINESSEUROPE based on Eurostat and autumn survey



BOX I: FINANCIAL MARKET TURMOIL – DOOM AND GLOOM FOR THE EUROPEAN ECONOMY?

Increasing defaults on US sub-prime mortgages have prevented banks from trading complex financial products. Distrust regarding their exposure to these instruments has quickly spread worldwide, causing liquidity levels in the money markets to fall dramatically. The interbank market, the backbone of the financial system, has been under considerable strain as spreads between central bank and money market rates have widened sharply.

To overcome this confidence crisis, the ECB was the first central bank to react and injected massive amounts of liquidity. The ECB shelved its interest-rate hike previously announced for the governing council meeting on 6 September. Other central banks have followed the ECB with liquidity injections and the US Federal Reserve cut rates by 50 basis points on 18 September. Nevertheless, the long-term segment of money markets has remained unsettled since August.

Although the crisis started in the relatively confined US real-estate sector and has thus far been confined to financial markets, risks for the real economy have gradually mounted. European business confidence has been affected and tighter credit conditions could follow. In fact, rising borrowing costs because of liquidity shortages or distrust among banks would come on top of the ECB's 200 basis-point rate hikes since December 2005.

As European companies on average rely on bank credits for more than 50% of their external financing needs, business activity could be affected. Investment spending in particular – one of the most dynamic drivers of EU GDP growth in the current upswing – would be dampened. Even rapidly growing new member states which face sizeable current account deficits could experience restrictions on access to capital.

Our autumn survey exposes European companies' fears as regards their financing conditions and the ECB's latest bank lending survey confirms that these fears appear to be justified. Banks clearly intend to tighten credit standards considerably over the coming months, especially for big companies and M&A activities.

On the positive side, the financial market turmoil has also brought about a necessary re-pricing of risk. The unprecedented period of economic stability and absence of market volatility had caused risk premia to fall to unsustainably low levels. In this respect, the correction from past complacency was needed. Nevertheless, it is essential that commercial banks clarify their exposure to the US sub-prime market and communicate the losses incurred.

This would help restore trust and prevent a sharp decline in economic activity. If the crisis rapidly comes to an end and bank lending standards do not tighten further, the damage to the European economy will be relatively contained. However, at this stage it is still too early to sound the "all clear".

LABOUR MARKET AND PRODUCTIVITY

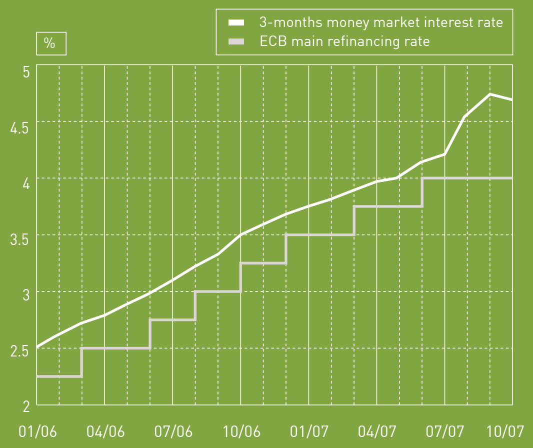
The improving situation on the European labour market continues to be an important factor supporting the recovery. The positive trend is expected to continue with EU27 employment growth attaining 1.6% in 2007 and 1.2% in 2008. However, in the context of weaker GDP growth in 2008 and rising uncertainties about the business environment, the number of job creations will be affected. After the creation of 3.6 million new jobs in 2007, the pace will decelerate to 2.7 million in 2008. Nevertheless, newly created jobs in the EU will add up to more than 9 million over the period 2006 to 2008 – more than previously anticipated and a strong performance by historical standards.

At the national level, employment growth will be particularly vigorous in new member states, with Lithuanian, Polish, Slovakian and Bulgarian growth rates exceeding the EU27 average by more than one percentage point.

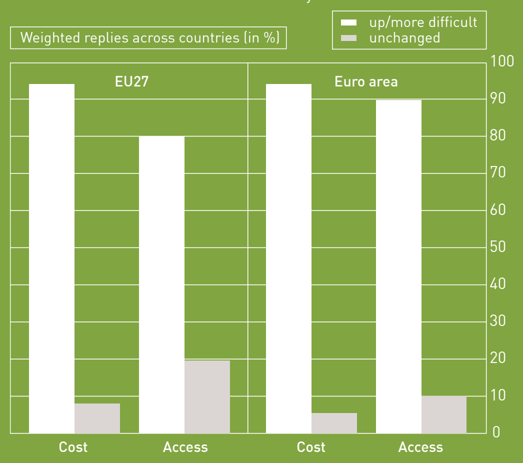
The unemployment rate has already fallen below 7% in the EU, the lowest level in more than two and a half decades, and this positive trend is likely to remain on track in the short term. EU27 and euro-area unemployment rates are expected to average 6.6% and 6.8% in 2008 respectively. The average German unemployment rate will fall to 6.4% in 2008, the lowest level since 1992.

Regarding progress towards the Lisbon objectives, current employment rates are still insufficient to meet the 2010 targets. Participation rates need to increase sharply, especially for workers between 55 and 64 years. At 43.6% in 2006, the aim of a 50% participation rate by 2010 will significantly undershoot for EU27. The situation is particularly problematic in Belgium, Luxembourg, Austria, Hungary, Malta and Poland, where older workers' employment rates barely exceed 30%. Unemployment among younger workers (between 15 and

BOX I - Chart 1
Unsettled money market means tighter monetary conditions
Source: BUSINESSEUROPE based on ECB, EURIBOR



BOX I - Chart 2
European companies face less favourable financing conditions in coming months
Source: BUSINESSEUROPE autumn survey



24 years) remains another area of concern, being more than twice the level of the overall unemployment rate. The situation is worse in France, Italy, Spain, Greece, Belgium, Poland, Slovakia and even Sweden, where youth unemployment rates remain around 20%.

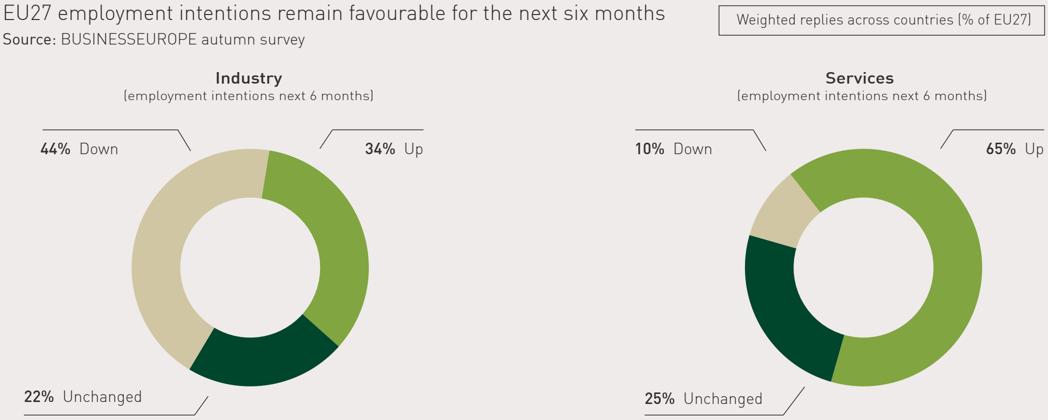
European business considers that flexicurity is the right way forward to face future labour-market challenges. Mutually reinforcing economic and social policies adapted to and based on the specific features of national labour markets are key to boost employment and productivity growth. The ingredients of the flexicurity system are based on the following parameters: flexible labour regulations, more effective active labour-market policies and lifelong learning systems, and modern social protection. Creating more productive jobs is at the heart of a strategy to tackle Europe's most daunting economic challenges.

Unfortunately, the current pace of productivity gains is largely insufficient to meet the requirements of sustainable growth and to support social systems in an ageing society. For 2008, labour productivity is expected to progress at a weak 1.5% annually in EU27. Against the background of a generally disappointing performance, new member states continue to enjoy strong productivity growth at around 3%. However, falling unemployment and shortages of skilled labour leading to significant wage growth could eventually compromise a rapid catching-up process if left unchecked.

Chart 5

EU27 employment intentions remain favourable for the next six months

Source: BUSINESSEUROPE autumn survey



PRICE AND COST DEVELOPMENTS

Inflationary pressures continue to be relatively benign. The euro-area headline inflation rate remained below the ECB's 2% threshold between September 2006 and August 2007 despite the rise in the German VAT rate by 3 percentage points on 1 January. Euro-area inflation is expected to average 2.0% in 2007. Looking ahead, the Autumn Outlook does not identify major risks to price stability over the medium term. At 2.1%, euro-area inflation will exceed the ECB's 2% threshold only marginally. Furthermore, growth declining towards potential in 2008 will keep a lid on underlying inflationary pressures as well. Nevertheless, the business community acknowledges that the impact of recent sharp rises in commodity prices and a very tight oil market need close monitoring.

Wage developments do not currently represent a threat to price stability, but recent rises will add to other cost pressures and squeeze profit margins. Nominal hourly wages in the euro area are expected to grow at an annual rate of 2.7% in 2007 and 3.1% in 2008. This is faster than in the past but based on the projected annual euro-area inflation rate of 2.1%, wage increases are still consistent with productivity developments. This aggregate development also masks important national differences. For example Germany's gain in competitiveness and its economic revival have been facilitated by a reduction in unit labour costs due to wage moderation and company restructuring. This development is not shared by all euro-area member states though, increasing their exposure to exchange-rate fluctuations and lowering the pain threshold for companies in individual countries.

Chart 6
Consumer price inflation forecasts – no imminent dangers
Source: BUSINESSEUROPE based on Eurostat and autumn survey

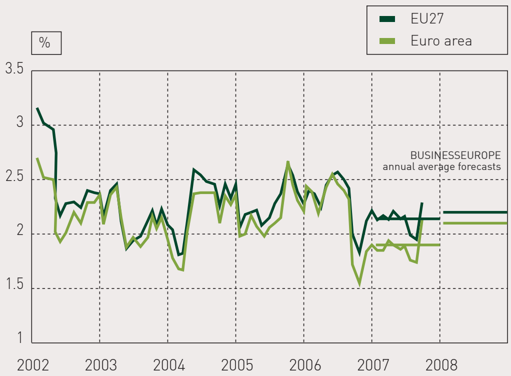
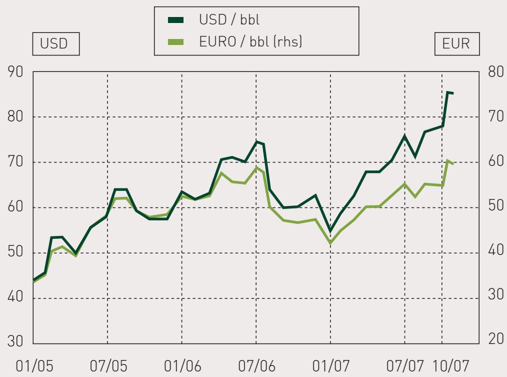


Chart 7
Rising oil prices hardly offset by strong euro
Source: BUSINESSEUROPE based on Handelsblatt.de
Oil price: Brent



MAIN RISKS TO THE OUTLOOK

At present, risks to the outlook clearly lie on the downside and relate to a weakening US economy, disorderly exchange-rate movements, financial-market turmoil and high oil prices. Although a US recession is not the prevailing scenario, it has become evident that the housing market correction has the potential to drag US growth down further than currently envisaged. The negative effect on the economy has been aggravated by subsequent financial-market turmoil. Although the precise implications are still unknown, growth forecasts for the US have been revised downwards substantially. The US Federal Reserve has acknowledged that the risks to growth are mounting and has hence started to cut interest rates.

Uncertainties regarding the US economy's outlook and prospects of further monetary easing have also translated into a weakening dollar. The euro has passed the psychologically sensitive mark of 1.40 USD and a further appreciation is probable, especially in the context of the persistent substantial US current account deficit. According to our autumn survey, European companies identify the euro's exchange rate as the most worrying downside risk to economic growth. Countries that have experienced a loss in competitiveness over the past years are especially exposed to the negative effects of the euro's appreciation. This calls for decisive measures in order to increase labour productivity and to prevent a significant pick-up in wage inflation.

The increasing importance of fast-growing Asian economies as export destinations compensates for the deceleration of the US economy to some extent. In fact, the share of the EU's exports to the US in its total external trade has decreased from 28% in 2000 to 23% in 2006. At the same time, exports to Asia but also to OPEC countries and Russia have increased. However, the euro's excessive strength vis-à-vis the Japanese yen, the Chinese yuan and on a trade-weighted basis prevent European economies from taking more advantage of strong demand from fast-growing markets. The fact that exchange-rate movements do not necessarily reflect economic fundamentals is an increasing source of concern.

Chart 8

Downside risks to growth

Source: BUSINESSEUROPE autumn survey

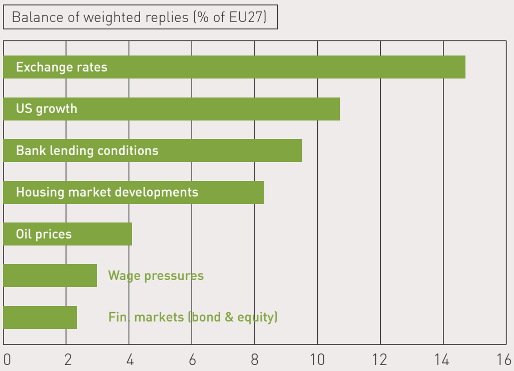
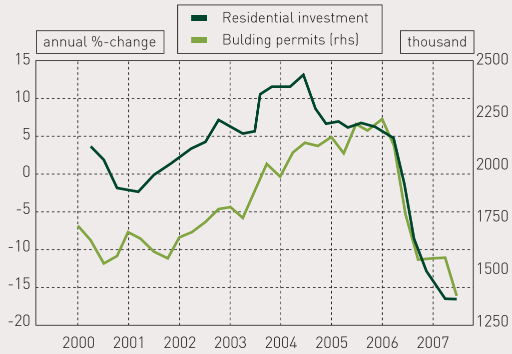


Chart 9

US housing market – correction set to continue

Source: BUSINESSEUROPE based on US Census Bureau, Bureau of Economic Analysis (USDOC)



Tighter financing conditions are also identified as an important downside risk to the economic outlook. Although a direct impact on economic activity cannot be observed thus far, our survey reveals that businesses expect tighter credit standards and rising borrowing costs in the near term. In the case of a substantial deterioration in borrowing costs, businesses would ultimately be obliged to cut back on investment. In addition, record oil prices and a tight energy market add to the environment of rising uncertainties for European companies. As demand from emerging economies remains strong and oil supply faces constraints, prices are unlikely to recede from current levels in the short term.

Financial-market turmoil has increased risks to the growth outlook also in eastern European member states, facing substantial current account deficits. A reversal of foreign capital inflows could hamper their economic growth and catching-up process.

Another important factor of uncertainty is embodied in European housing-market developments. In fact, as real estate bubbles have taken on awkward proportions in several EU countries over the past years, a correction would inevitably weigh on economic growth. First signs of a correction - orderly so far - are already discernible in recent developments (also see Box II).

Chart 10 Extra EU trade – EU27 export destinations
Source: BUSINESSEUROPE based on Eurostat

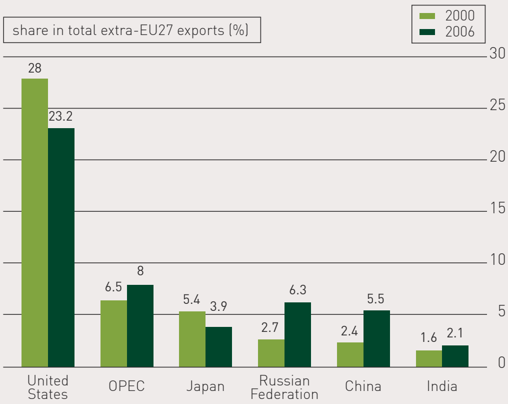
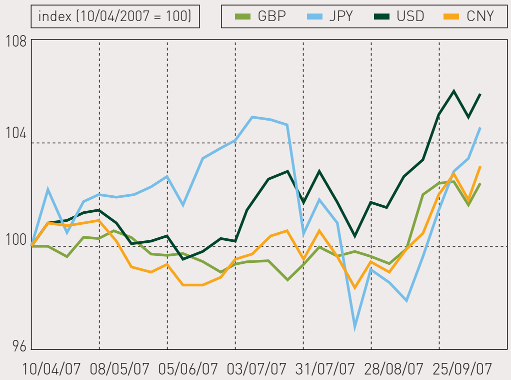


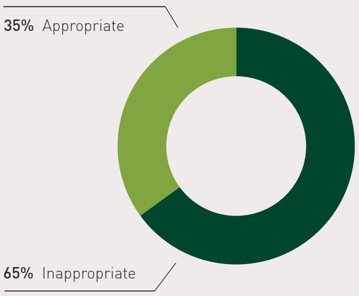
Chart 11 Significant euro appreciation vis-à-vis main trading partners Source: BUSINESSEUROPE based on ECB



MACROECONOMIC POLICIES

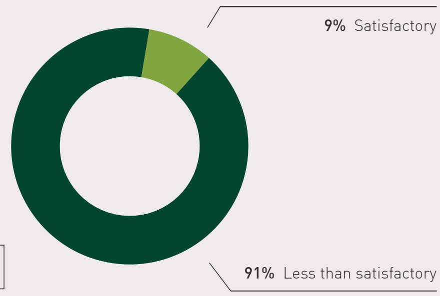
European companies are well aware of the changing economic environment and the accompanying challenges. Although short-term fundamentals remain broadly supportive for the time being, the business community is increasingly searching for confidence fostering signals. In addition to accelerating the implementation of structural reforms as outlined in the Lisbon strategy, fiscal consolidation and sound budget policies are vital for companies' continuing investment spending and job creation. However, budgetary progress is lagging behind, leading the business community to consider the mix between monetary and fiscal policies to be inadequate in a number of countries accounting for almost two thirds of the EU's GDP, including France, Spain, Italy, the UK and Poland.

Chart 12
Mix between fiscal and monetary policy is inadequate
Source: BUSINESSEUROPE autumn survey



Weighted replies across countries (% of EU27)

Chart 13
Insufficient progress towards sound budget position
Source: BUSINESSEUROPE autumn survey



BOX II: EUROPEAN HOUSING MARKETS – MIND THE CORRECTION

The ongoing US housing market correction has put the spotlight on Europe's home-grown real-estate bubbles. The fundamentals of European and American housing markets differ considerably, especially as regards the criteria for granting mortgages – there is virtually no "sub-prime" segment in European housing markets. A correction of the most overvalued housing sectors could already be under way. Spain, Ireland and the UK could feel significant consequences as the property market has made a sizeable contribution to their past growth performances.

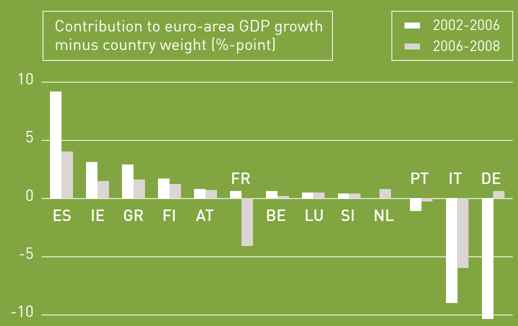
Taking the Spanish case as an illustration, house prices (measured in EUR per m^2) have more than doubled since 2001. Although demographic projections, strong immigration and foreign investment are important fundamental arguments behind developments on the Spanish housing market over the past years, the overvaluation is substantial. For the entire euro area, residential-property prices have risen by slightly more than 40% over the same period.

Comparing member states' contributions to the euro area's GDP growth with their actual economic weights provides an important insight into the importance the housing sector has gained for some national economies. Between 2002 and 2006 Spain's contribution to euro-area growth was in fact almost twice as large as its actual share in the area's total output. The same holds true for Ireland. On the contrary, during the same period, Germany's growth contribution undershot its actual economic weight considerably. Although the housing sector might not be the only reason for respective performances, it has certainly made an important contribution to growth differences across member states.

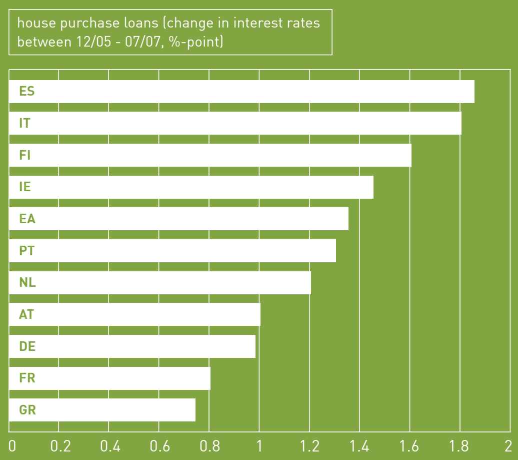
The price tag of a housing market correction is aggravated by other factors. Household debt has risen sharply in countries such as Spain or Ireland and debt pressures are intensified by the underlying credit regimes. Due to the prevalence of variable mortgage rates, interest on Spanish loans for house purchases has increased by more than 180 basis points since December 2005. According to the ECB's recent bank lending survey, the risks surrounding European housing markets are an essential argument for banks to tighten credit standards further over the coming months.

Against this background it cannot be excluded that housing-market developments could worsen the growth forecasts for some European economies. In any event, the likely reduction in the contribution of the real estate sector to growth in Europe over the coming years emphasises even more the need to foster reforms supporting competitiveness, productivity and employment in other sectors of the economy.

BOX II Chart 1
Contribution to euro-area GDP growth compared with country weight
Source: Eurostat, BUSINESSEUROPE



BOX II Chart 2
Change in interest rates for house purchases
Source: ECB, BUSINESSEUROPE



Fiscal policies

Strong cyclical conditions have led to an overall improvement in fiscal positions. However, the improvement in budget balances in a number of member states over the last two years have relied to a large extent on windfall gains from strong growth and related tax receipts. Reductions in government expenditure have been limited compared with the rise in revenues.

National governments do not seem to have learned the costly lessons from the expansionary fiscal policies during the boom of the late nineties. The lack of ambition in consolidation plans will claim its price if growth in Europe hits a soft patch as demographic pressures start to kick in. Overall, the progress towards budget balance is considered to be insufficient in countries representing more than 80% of EU GDP.

Monetary policies

The business community is a strong supporter of the ECB's independence and considers political interference in its conduct of monetary policy to be misplaced. The financial market crisis has once again underlined the importance of this independence as it has allowed rapid and decisive responses.

Regarding interest-rate policy, the ECB will have to remain pragmatic and closely monitor all economic and financial developments. Whereas the business community largely endorses its monetary policy, our autumn survey reveals that some member federations consider that the ECB fails to give sufficient weight to exchange-rate developments and downside risks to growth.

In the face of growing global economic and financial interdependence, it appears crucial that the ECB considers the impact of its decisions in the present international context.

Chart 14
ECB policy broadly endorsed
Source: BUSINESSEUROPE autumn survey

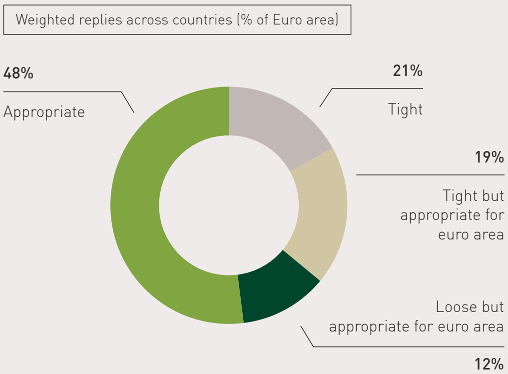
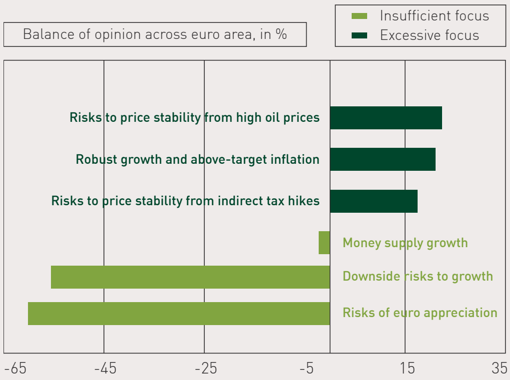


Chart 15 Assessment of factors underlying the ECB's monetary policy stance
Source: BUSINESSEUROPE autumn survey



The monetary policy of the Bank of England (BoE) is also endorsed by the business community. Having kept a bias towards tighter monetary policy until August, the BoE has adapted its monetary policy stance subsequent to the fallout from the sub-prime mortgage crisis in the United States and its particular impact on the confidence of Northern Rock depositors. Although an impact on the real economy has not been detected, yet, the BoE will need to be alert to any market instability or sudden decline in consumer or business confidence. Consequently, UK monetary policy has shifted to "neutral" with a chance of an interest-rate cut.

Lower-than-anticipated inflation rates have contributed to the shift in the BoE's policy stance. As inflation will settle just below target in the second half of 2008, the baseline scenario forecasts stability in interest rates until the second quarter of 2008, when a modest reduction of 25 basis points is expected.

STATISTICAL ANNEX

	Real GDP growth			Inflation		
	2007	2008	2009	2007	2008	2009
Austria	3.2	2.6	na	1.8	1.6	na
Belgium	2.7	2.3	2.1	1.6	1.8	na
Finland	4.4	3.0	2.5	2.4	2.9	1.8
France	1.8	2.0	na	1.6	2.0	na
Germany	2.8*	2.0	na	2.0	1.9	na
Greece	4.0	4.0	4.1	2.8	2.8	2.6
Ireland	4.8	3.4	4.0	2.7	2.5	2.3
Italy	1.7	1.3	1.5	1.7	1.9	1.9
Luxembourg	6.0	5.0	3.5	2.3	2.4	2.3
Netherlands	2.8	2.5	2.4	1.5	2.3	2.6
Portugal	1.8	2.2	3.0	2.3	2.1	2.1
Slovenia	5.7	4.4	4.1	3.2	3.3	2.7
Spain	3.7	2.8	2.4	2.6	2.6	2.5
Bulgaria	6.5	6.5	6.5	8.0	8.0	7.5
Cyprus	4.0	4.0	4.1	2.0	2.3	2.1
Czech Republic	5.8	5.0	4.9	2.3	4.5	4.0
Denmark	1.2	1.8	1.8	1.5	2.0	2.0
Estonia	8.0	6.5	5.0	6.5	7.0	5.0
Hungary	2.2	2.8	4.1	7.5	4.5	3.0
Latvia	9.5	7.5	7.5	9.0	5.0	3.8
Lithuania	8.0	6.5	6.0	4.8	5.0	4.0
Malta	3.0	2.8	3.0	1.1	2.0	2.0
Poland	6.5	5.0	5.0	2.0	2.6	3.0
Romania	na	na	na	na	na	na
Slovak Republic	8.8	7.5	6.9	2.4	1.9	2.2
Sweden	3.2	2.8	2.9	2.1	2.5	2.3
United Kingdom	3.0	2.2	na	2.4	1.9	na
Norway	3.5	3.7	2.2	0.8	2.4	2.0
Turkey	5.5	5.7	5.7	7.5	6.0	4.0

* forecast ceiling for GDP growth in 2007

	Investment			Employment growth		
	2007	2008	2009	2007	2008	2009
Austria	5.9	3.9	na	1.9	1.0	na
Belgium	6.8	3.7	2.7	1.4	1.3	na
Finland	4.6	5.6	2.4	1.8	0.5	0.2
France	3.0	2.1	na	0.9	0.4	na
Germany	6.0	5.0	na	1.7	1.3	na
Greece	8.5	7.9	7.9	1.8	1.8	1.9
Ireland	-0.1	-3.3	3.0	3.1	1.3	1.5
Italy	2.7	1.7	2.4	0.6	0.8	1.0
Luxembourg	na	na	na	3.9	3.6	3.3
Netherlands	5.3	4.8	4.6	2.3	1.0	1.0
Portugal	1.0	4.0	6.8	0.4	0.9	1.5
Slovenia	11.0	4.0	4.9	3.0	1.0	1.0
Spain	6.2	3.8	2.5	3.0	2.0	1.8
Bulgaria	na	na	na	4.3	4.3	3.5
Cyprus	2.7	3.6	3.8	1.2	1.2	1.2
Czech Republic	6.6	9.1	7.0	1.1	1.0	0.9
Denmark	5.3	6.8	4.5	2.6	0.6	0.2
Estonia	14.0	9.0	7.0	1.0	0.0	0.0
Hungary	2.1	3.7	7.0	0.0	0.3	0.7
Latvia	na	na	na	1.5	1.0	0.5
Lithuania	5.8	6.1	6.4	2.1	2.2	2.2
Malta	6.8	0.8	1.3	1.0	1.0	1.0
Poland	18.2	10.1	12.0	4.1	2.9	1.0
Romania	na	na	na	na	na	na
Slovak Republic	7.9	7.4	8.0	3.0	2.3	1.0
Sweden	10.5	6.0	4.0	2.6	1.9	1.8
United Kingdom	5.2	3.0	na	0.5	0.5	na
Norway	8.0	4.0	5.0	3.5	2.0	1.0
Turkey	7.2	6.0	5.7	na	na	na

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

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