NOTE

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1. Economic Outlook Spring 2008

BUSINESSEUROPE is convinced that excessive pessimism regarding the European economy, and the euro area in particular, is misplaced.

In particular, a marked improvement in the labour market, sound corporate and households' balance sheets and the absence of excessive vulnerability on the EU housing market as a whole support a cautious optimism and contribute to the more positive growth forecasts as compared with the IMF's Spring World Economic Outlook (see table 1). The IMF predicts significant negative knock-on effects of financial market turmoil, a US recession and the euro overvaluation on the European economy in 2008 and 2009.

Table 1: Comparison of euro-area growth forecasts

	BUSINESSEUROPE			IMF		
	2007	2008	2009	2007	2008	2009
Real GDP (annual % growth)	2.6	1.7	1.8	2.6	1.4	1.2
Inflation (%)	2.1	2.6	2.2	2.1	2.8	1.9
Unemployment (%)	7.4	7.1	7.0	7.4	7.3	7.4
Employment (%)	1.6	0.9	0.7	1.5	1.1	0.5
GDP components						
Private consumption (%)	1.5	1.7	1.9	1.4	1.4	1.2
Public consumption (%)	2.2	1.7	1.5	2.2	1.9	1.9
Gross fixed capital formation (%)	4.3	2.6	1.9	4.4	1.8	1.0
Exports (%)	6.0	4.4	4.4	6.0	4.1	3.7
Imports (%)	5.2	4.6	4.5	5.3	4.2	3.9

Source: BUSINESSEUROPE Economic Outlook (Spring 2008), IMF World Economic Outlook (Spring 2008)

Differences in growth forecasts are discernible mainly for fixed capital formation. According to BUSINESSEUROPE, companies do not yet feel a significant impact from the financial market turmoil on their investment decisions, although external financing conditions have indeed tightened in recent months. This said, the housing market correction in Spain, Ireland and the UK will weigh significantly on gross fixed capital formation is these individual countries.

Differences between BUSINESSEUROPE's and the IMF's forecasts also persist at the member-state level. Among larger euro-area countries, the IMF is significantly more pessimistic for example on Spain or Germany. Whereas the housing market correction in Spain poses additional downside risks to BUSINESSEUROPE's forecast over the coming quarters, the IMF's pessimism regarding the German economy seems exaggerated, in particular when the substantial labour market improvements and restructuring efforts at company level over the past decade are taken into account.

Among new member states, the IMF is less sanguine than BUSINESSEUROPE. We continue to observe strong resilience to the financial market turmoil and discount immediate risks related to large current account deficits and a strong dependence on foreign direct investment.

Table 2: Real GDP growth forecasts

	BUSINESSEUROPE			IMF		
	2007	2008	2009	2007	2008	2009
Austria	3.4	2.1	1.7	3.4	1.9	1.7
Belgium	2.7	1.9	na	2.7	1.4	1.2
Cyprus	4.4	4.1	4.0	4.4	3.4	3.5
Finland	4.4	2.6	2.4	4.4	2.4	2.1
France	1.9	1.7	1.4	1.9	1.4	1.2
Germany	2.5	1.8	1.8	2.5	1.4	1.0
Greece	4.1	3.8	3.8	4.0	3.5	3.0
Ireland	5.3	2.2	3.8	5.3	1.8	3.0
Italy	1.5	0.7	1.2	1.5	0.3	0.3
Luxembourg	5.0	4.0	5.0	5.4	3.1	3.2
Malta	4.0	3.4	4.1	3.8	2.2	2.0
Netherlands	3.5	2.3	1.8	3.5	2.1	1.6
Portugal	1.9	2.0	2.3	1.9	1.3	1.4
Slovenia	5.9	4.5	4.2	6.1	4.1	3.5
Spain	3.8	2.4	1.9	3.8	1.8	1.7
Bulgaria	6.5	6.5	6.0	6.2	5.5	4.8
Czech Republic	6.6	5.9	5.5	6.5	4.2	4.6
Denmark	1.8	1.7	1.6	1.8	1.2	0.5
Estonia	7.1	4.2	5.0	7.1	3.0	3.7
Hungary	1.4	2.6	4.0	1.3	1.8	2.5
Latvia	10.2	6.0	6.5	10.2	3.6	0.5
Lithuania	8.0	6.5	6.0	8.8	6.5	5.5
Poland	6.5	5.3	5.6	6.5	4.9	4.5
Sweden	2.6	1.9	2.6	2.6	2.0	1.7
United Kingdom	3.1	1.8	1.7	3.1	1.6	1.6
Norway	6.0	3.0	1.4	3.5	3.1	2.3

Source: BUSINESSEUROPE Economic Outlook (Spring 2008), IMF World Economic Outlook (Spring 2008)

In the current environment, this relative confidence of the business community must be supported by the right policy decisions:

a) *Inflation and monetary policy*

- In the case of a more severe economic downturn than currently expected, monetary policy must be the first line of defence. Yet, the ECB will continue to be reluctant to act if inflation is not brought under control and if any signs of second-round effects materialise. Trade unions should realise that high wage demands risk locking in euro-area interest rates at the current level for the foreseeable future.

b) *Fiscal policies and reforms*

- Strict enforcement of the Stability and Growth Pact remains vital. Fiscal discipline is a public good, for which member states must feel individually and collectively responsible. Hence, an appropriate response to present economic uncertainties is not to spend more public money but to spend it better. Greater emphasise is needed on the quality of public expenditures with a clearer focus on growth-enhancing areas (research, innovation education) and on tax reforms that will support investment and job creation.
- Governments should also spur more competition in a number of highly regulated markets (retail, transport, energy), which has a great potential to lower price pressures, increase productivity and employment (hence boosting both consumers' income and companies' competitiveness).

c) *Financial market turmoil and exchange rate situation*

- The strong euro should not be blamed for the lack of competitiveness and structural weaknesses of certain national economies. But the rapid rise of the euro and the risk of protracted dollar weakness are having far-reaching consequences. Cooperation with Europe's partners on issues of global economic governance should therefore be stepped up, with a particular focus on:
  - stronger positions taken by the G8 on ways of alleviating US dollar weakness while ensuring appropriate burden-sharing among major global economic players.
  - closer integration of emerging economies in discussions on issues of global economic governance.
- We also need to draw the right lessons from the credit crisis and work rapidly towards an appropriate strategy to limit the risks and consequences for the wider economy. This requires:
  - banks to rapidly reveal their losses and clean their balance sheets
  - central banks to continue ensuring good functioning of money markets
  - market supervisors to better coordinate their actions
  - more transparency in risk evaluation and risk management strategies
  - avoiding knee-jerk reactions on the regulation front which could impair financial market innovation and feed protectionist reflexes.

2. 10 Years of EMU – taking stock

The celebartions for the tenth anniversary of the euro – one of the most important milestones for European integration – have been launched by the publication of the Commission's report on 10 years of EMU. For European business, setting up the single currency for 15 (Slovakia will join in January 2009 as the 16th member) is an indisputable success. BUSINESSERUOPE is proud of the euro, which is the second most important currency in the world and continues to gain ground on the US dollar. Among the numerous advantages, it is worth mentioning the following:

- The euro's international status is a strong asset for European companies in both their trade relations and in their access to the global capital pool. For instance, around 60% of euro-area exports with the rest of the world are billed in euros and close to 50% of international bonds and notes issued across the globe are denominated in euros (against 35% in US dollars).
- Companies can operate in a market of 320 million people facing no exchange risks, fewer cross-border costs and more transparency. In addition, the euro has created a momentum towards financial market integration also across the EU. Although consumers may perceive that the euro has contributed to higher prices and lower purchasing power, the common currency has in fact encouraged competition and helps to contain inflation.
- Companies can rely on a credible central bank to deliver price stability at favourable financing conditions. This credibility is a great advantage as it keeps long-term interest rates at lower levels than would otherwise be the case. This is why business strongly supports the independence and the mandate of the ECB.
- Having a single currency and a single monetary authority has also shown its relevance since the outbreak of financial market turbulences in August 2007, as decisive actions were taken to ensure sufficient levels of liquidity and avoid a deeper impact of the crisis for the real economy.

Despite the indisputable successes, the growing divergences between member states' competitiveness is there to illustrate that not all countries have adjusted well to the new reality. Since 1998, countries like Italy, Spain or France have lost between 15% and 25% of their cost competitiveness vis-à-vis Germany or Austria.

With the disciplining role of financial markets significantly reduced, governments' tendency to delay budget consolidation and structural reforms has been a significant burden on some member states' performance and the euro area as a whole. Indeed, within monetary union difficulties in one country spread to others more easily (through monetary, exchange rate, trade and financial market channels). Although this problem has been recognised for fiscal policies and been addressed by the Stability and Growth Pact, implementation remains unsatisfactory. Interactions in other policy areas have hitherto received too little attention.

3. EMU Governance and enlargement

To improve governance of EMU and to overcome the above-mentioned obstacles, the business community identifies the following priorities:

a) The European Commission must further reflect on ways of "internalising" cross-border spillovers when formulating its recommendations to euro-area member states. It should closely monitor governments' efforts to fulfil policy commitments, and should utilise its right of alert – reinforced by the Lisbon Treaty – when national policies are inconsistent with these commitments.

b) Peer review of budgetary and structural reform policies must be reinforced, inter alia via ex-ante policy discussions in the eurogroup – the informal Council of Finance Ministers of the euro area – rather than ex-post exchanges of information.

c) The eurogroup must advance with a common vision of policy priorities at the international level, and its president must forcefully defend these positions with global partners.

d) Social partners play a crucial role as well in a properly functioning monetary union notably by ensuring that wage policies are flexible and responsive to the triple objective of price stability, full employment and high competitiveness.

e) The future success of the euro also depends on the effective integration of new member states which committed to joining the euro when entering the EU in 2004 and 2007. The so-called convergence criteria are important benchmarks to evaluate readiness to join the euro, but clear guidance must also bee given on more structural measures able to ensure sustainable growth and competitiveness in the euro area.