



## EU GROWTH TO REMAIN ABOVE TREND

### ECONOMIC SITUATION

- While the EU economy slightly slowed in the first half of 2018, growth is still expected to proceed above its long-term rate.
- For 2018, we expect **GDP growth** of 2.2% in the EU and 2.1% in the Euro area, a slight downward revision of -0.2 percentage points from spring. For 2019, we expect growth to slightly slow down to 2.0% in the EU (-0.1pp from spring) and 1.9% in the Euro area (-0.2pp).
- We have seen a further improvement in **labour markets**, with EU unemployment back to pre-crisis levels (6.8% in August 2018). Euro area unemployment also improved but remains above its pre-crisis rate. While unemployment is expected to further come down to 6.5% in 2019, rates remain uneven across EU member states and well above those forecasted for the US (3.5% acc. to IMF for 2019).
- **Skills shortages** are an acute concern for employers and limit growth, even in Member States with still relatively high unemployment as the rapid digitalisation increases the demand for skilled technical workers.
- A key risk to growth continues to be the **danger of an escalating trade war**, with the IMF estimating that such an escalation would reduce global GDP by almost one percent in 2020. In addition, significant uncertainty remains regarding the **future EU-UK relationship**.

### POLICY CONSIDERATIONS

- Further **reforms at both national and EU level**, particularly to reduce rigidities in product and labour markets, are required to raise long-term growth.
- Member states must respect the **Stability and Growth Pact (SGP)**, drawing on in-built flexibility to support structural reforms and growth-enhancing investment. Proper enforcement of the Stability and Growth Pact is essential to help member states put their public finances on a stronger footing.
- Vigorous action needs to be taken to **up-skill and re-skill** people to address skills shortages and ensure the EU is best placed to take full advantage of new opportunities in the global economy, including through digitalisation.
- It is essential that decisive steps are taken forward in the Euro summit in December on deepening **EMU**, after a disappointing lack of progress in the June Council. Priority issues include completing the banking union and the establishment of a stabilisation function. We support, in particular, the Commission's proposal for an Investment Protection scheme, and hope the EU will agree to build up the capacity of this in future years.
- A number of uncertainties loom over the international trading system. The ongoing **trade** spat between China and the US has repercussions for other trading partners including Europe. The EU and the US are holding bilateral discussions but the possibility of additional tariffs on certain EU exports is not off the table. The WTO dispute settlement mechanism risks being ineffective in the coming months in a moment where we have a rise in trade disputes.



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## 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 in October 2018.

## FOR FURTHER INFORMATION:

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### 1. OVERVIEW

Following strong economic growth of 2.4% in 2017, the EU economy has returned to rates closer to its long-term potential. EU quarterly growth reached 0.4% in each of the first two quarters of 2018, after very strong rates of 0.6 to 0.7% throughout 2017. Against the background of continuing global trade tensions, weaker extra-EU exports were a key factor behind the recent slowdown. Amidst greater policy uncertainty and a more moderate pace of economic growth, business confidence dropped slightly, although from record high levels.

While the recent moderation has led business federations to slightly revise down their EU growth projections, the expansion is projected to continue at a pace slightly above trend growth. This reminds us that growth has been boosted by monetary policy support, while we still need to address structural weaknesses regarding long-term unemployment and our potential to innovate. Consumer spending is expected to continue to drive economic growth, even though retail sales have been a bit sluggish in recent months. Responding to increasingly tight production capacity, businesses are expected to proceed investing strongly in 2018 and at a slightly lesser rate in 2019. Finally, exports are expected to be somewhat dampened by less dynamic global trade, so that net exports will not make a positive contribution to growth (table 1).

Against this background, we expect GDP growth of 2.2% in the EU and 2.1% in the Euro area for 2018, a slight downward revision of -0.2 percentage points from spring. For 2019, we expect growth to slightly slow down to 2.0% in the EU (-0.1 pp from spring) and 1.9% in the Euro area (-0.2 pp).

Skills shortages, partly related to insufficient digital and STEM skills, continue to be a real concern for employers and limit growth, even in member states with still relatively high unemployment. These partly reflect the rapid digitalisation of the EU economies. Vigorous action needs to be taken to up-skill and re-skill people to fill new jobs linked to digitalisation. In the longer-term, it is clear that the EU's underlying growth potential is too low, with the Commission estimating that EU trend growth is 1.7% and thus well below current cyclical growth, highlighting the importance of speeding up the implementation of labour and product market reforms as well as institutional reforms.

**Table 1 Economic growth expected to slow slightly after strong 2017**

*BusinessEurope main forecast*

Main Variables	EU28		Euro Area	
	2018	2019	2018	2019
Real GDP (annual % growth)	2.2 (-0.2)	2.0 (-0.1)	2.1 (-0.2)	1.9 (-0.2)
Inflation (%)	1.9	1.9	1.7	1.8
Unemployment (%)	6.8	6.5	7.8	7.3
Government net lending (% of GDP)	-0.7	-0.7	-0.7	-0.6
Gross public debt (% of GDP)	81.3	79.6	88.4	86.4
GDP components	EU28		Euro Area	
	2018	2019	2018	2019
Private consumption (%)	1.9	1.7	1.6	1.6
Public consumption (%)	1.7	1.3	1.6	1.3
Gross fixed capital formation (%)	4.6	3.4	4.7	3.5
Exports (%)	3.3	3.7	3.2	3.5
Imports (%)	3.5	3.7	3.3	3.8

*Source: BusinessEurope's forecast based on survey of member federations*



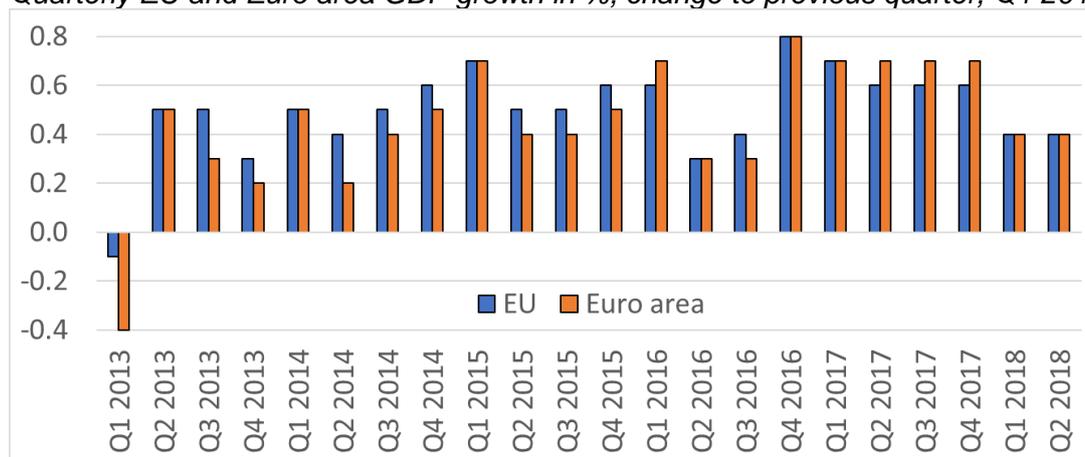
### 2. OUTLOOK FOR GDP GROWTH

#### After a strong 2017, growth returns to rates closer to its long-term sustainable level

After a strong 2017, EU growth has slightly slowed to rates closer to its long-term potential in the first half of 2018. GDP growth reached 0.4% in the first and second quarter of 2018 in both the EU and Euro area; a moderation compared to the very strong rates of 0.6 to 0.7% throughout 2017 (figure 1).

**Figure 1 Moderation of growth in the first half of 2018 after a strong 2017**

Quarterly EU and Euro area GDP growth in %, change to previous quarter, Q1 2013 – Q2 2018



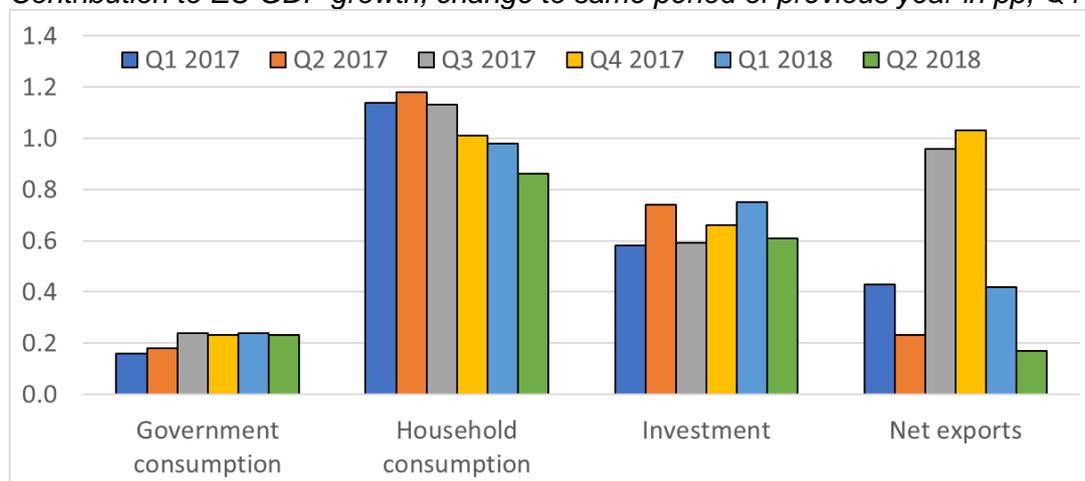
Source: Eurostat

#### ... as a result of lower exports and slightly weaker consumer spending

Looking at the composition of EU growth, the recent moderation is the result of weaker exports and slightly less dynamic consumer spending. As shown in figure 2, net exports contributed on average only 0.3 percentage points to EU GDP growth, compared to an exceptionally strong turnout in the second half of 2017 where net exports contributed on average 1 pp to growth. In addition, we can observe a slight, gradual fall in the contribution of consumer spending, whereas the contribution of public spending and investment remains unchanged since the beginning of 2017.

**Figure 2 Net export contribute less to growth at the beginning of 2018**

Contribution to EU GDP growth, change to same period of previous year in pp, Q1 2017 – Q2 2018



Source: Eurostat



### Small drop in confidence across industry and services from high levels...

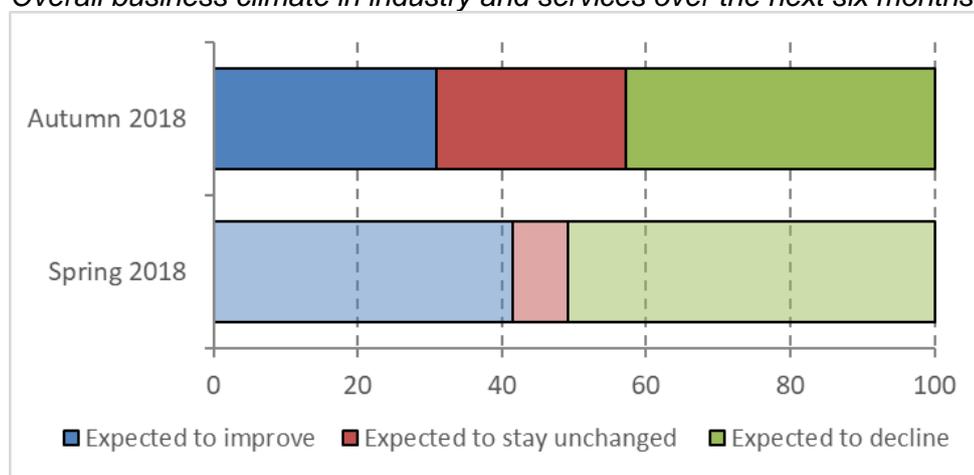
In line with the slower momentum in economic growth, business confidence has slightly dropped from record high levels in January. For industry (i.e. total manufacturing), confidence fell from 9.2 points in January to 4.5 points in September, according to the Commission's business survey, and for services confidence declined from 14.6 to 13.1 points in the same period.

### ...with an increasing number of members expecting that the business climate will remain unchanged over the coming six months

While there are varying opinions about the future direction of the business climate among our members, an increasing number of federations believe that the business climate will remain unchanged in the coming 6 months as shown in figure 3 (in this autumn survey a weighted average of 26% of members expect no change in the business climate, compared to 8% in spring).

**Figure 3 High uncertainty about the future development of the business climate**

Overall business climate in industry and services over the next six months



Source: BusinessEurope's forecast based on survey of member federations

\*weighted average of members' responses

Against the background of more moderate growth in the first half of 2018 and a slight drop in forward-looking confidence indicators, we have slightly revised down our growth forecast compared to spring. For 2018, we forecast growth of 2.2% in the EU and of 2.1% in the Euro area (both down by -0.2 pp). For 2019, we expect growth of 2.0% in the EU (-0.1 pp) and 1.9% in the Euro Area.



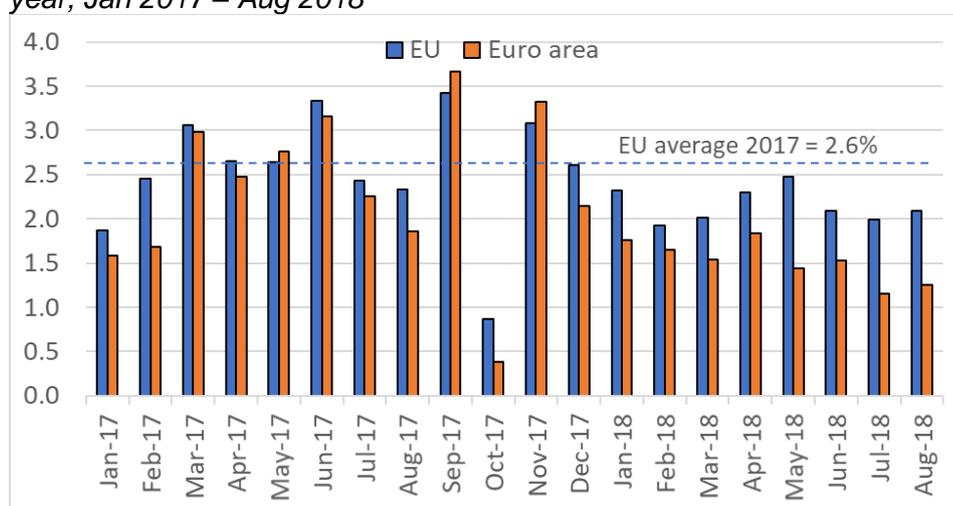
### 3. KEY DRIVERS OF GROWTH

#### Consumer spending continues to drive growth despite losing a little impetus

Looking at the drivers of growth, consumer spending, the largest component of demand, continues to constitute the key driving force behind economic growth, but does so at a slightly lower rate compared to 2017. As shown in figure 4, EU retail trade grew somewhat less vigorously since January 2018 (average of 2.1% between January and August 2018, compared to an average of 2.6% in 2017). In the Euro area, retail trade growth was even a bit more sluggish (average of 1.5%).

**Figure 4 Retail trade grew at slightly lower rates since January**

Real turnover of retail trade, percentage change compared to the same month of the previous year, Jan 2017 – Aug 2018



Source: Eurostat

#### Overall, we expect consumer spending to grow at rates of slightly less than 2%

Thanks to the ongoing improvements in EU labour markets, consumer spending is expected to remain overall robust with growth of 1.9% in 2018. For 2019, we expect consumer spending growth to slow slightly to 1.7% due to somewhat slower employment growth. This, together with the recent increase in energy prices, is expected to slightly reduce consumers' disposable income and thus spending.

#### EU business investment growth increased slightly at the start of 2018

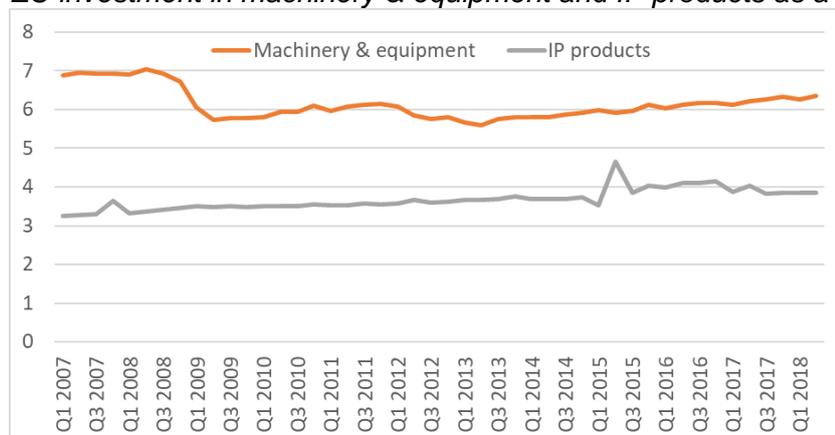
EU business investment growth saw a slight increase in the first half of this year, growing at 3.4% following average growth of 3.2% in 2017.

In figure 5, we look more in detail into the longer-term development of two key components of EU business investment, namely that in machinery and equipment and intellectual property (IP) products. Firstly, investment in machinery and equipment saw a significant decline in its share of GDP during the financial crisis (by over 1 pp) and it has not recovered yet by Q2 2018. Secondly, investment in IP products did not see such a decline during the crisis and it saw a gradual increase in its share of GDP (up by 0.5 pp between Q1 2007 and Q2 2018), emphasising the growing importance of digitalisation and the broader knowledge based economy within the EU, with the additional possibility that some of its impact is underreported in current GDP statistics.



**Figure 5 Investment in machinery and equipment yet to recover to its pre-crisis share, while the share of IP investment saw a gradual increase since the crisis**

EU investment in machinery & equipment and IP products as a share of GDP, Q1 2007 – Q2 2018



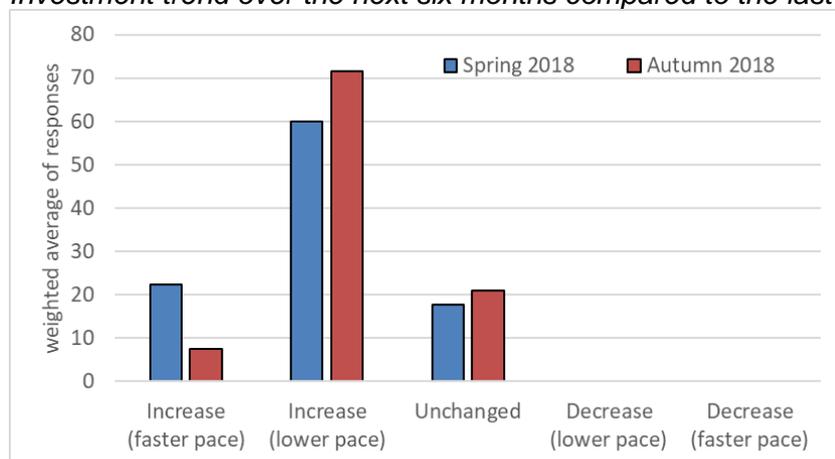
Source: Eurostat

### We expect business investment growth to see a further increase in the coming months...

Our survey points out that the majority of respondents expect EU business investment to see a further increase over the coming six months compared to the last six (figure 6). Compared to our survey from last spring, there are now however fewer respondents that expect investment growth to see a significant boost (weighted average of 8% compared to 22% in spring).

**Figure 6 Investment expected to increase at a moderate pace over the coming six months**

Investment trend over the next six months compared to the last six



Source: BusinessEurope's forecast based on survey of member federations

\*weighted average of members' responses

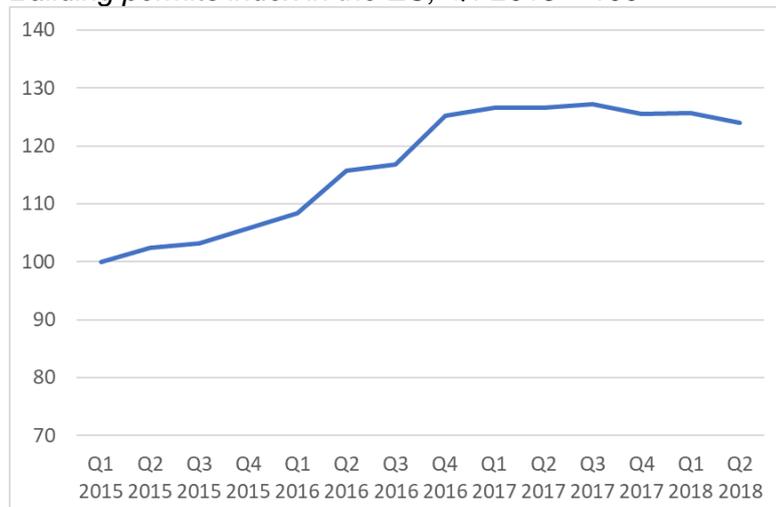
In line with increasingly tight production capacity, with Eurostat estimating that EU capacity utilisation is currently at its highest level since the pre-crisis period (84% in Q3 2018), we expect total investment to grow at a strong 4.6% in 2018. For 2019, we expect EU investment growth to moderate slightly to 3.4%.

The forecast slowdown of overall investment in 2019 partly relates to an expected decline in residential investment. Residential investment appears to have peaked in 2018 and is expected to slightly decrease in 2019 given increasingly binding capacity constraints in the construction sector and adverse demographic trends in several countries. This is also reflected in a slight recent decline in the number of building permits as illustrated in figure 7.



**Figure 7 A recent slowdown in the issuance of building permits likely suggests less vibrant residential construction activity in the period ahead**

*Building permits index in the EU, Q1 2015 = 100*



Source: Eurostat

### Companies' investment plans are supported by improved cost and access to finance

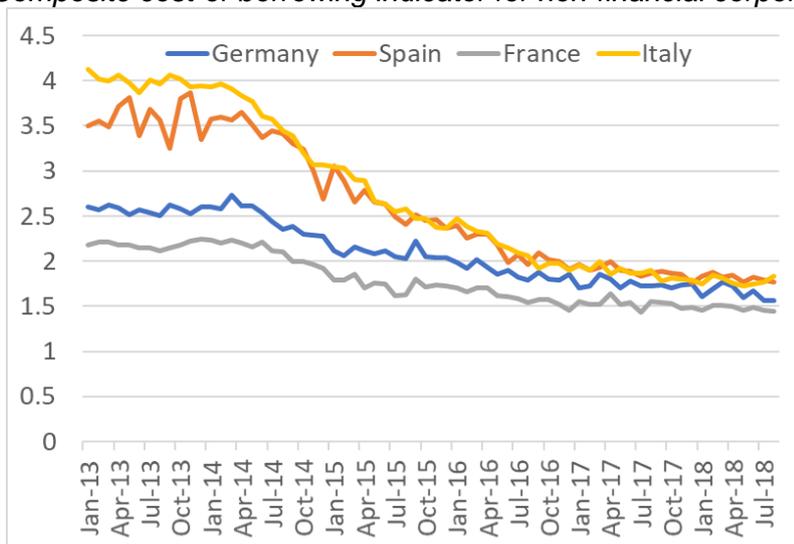
Companies' investment plans are also subject to the availability and cost of finance which have both improved over the recent years and are expected to remain supportive in the near future in almost all member states.

First, regarding access to finance, the October 2018 bank lending survey from the ECB indicates that credit standards for loans to enterprises eased further in the third quarter of 2018 (-6%), after easing in the first and second quarter (-8% and -3%, respectively). Similarly, the ECB survey on the access to finance of enterprises (SAFE) points to an improving availability of finance to SMEs since 2014, with some exceptions.

Second, regarding costs, the ECB's composite cost-of-borrowing indicator (figure 8) shows that interest rates across countries remain considerably below the rates during the European debt crisis, with a significant convergence of rates between countries, a development which was in part underpinned by ECB monetary policy support. However, since this time series only extends until August 2018, it may not fully capture the recent increase in government bond yields in Italy which could impact on companies' financing costs.



**Figure 8** *Headline borrowing rates for European companies came down since Euro crisis*  
Composite cost-of-borrowing indicator for non-financial corporations, Jan 2013 – Aug 2018, %



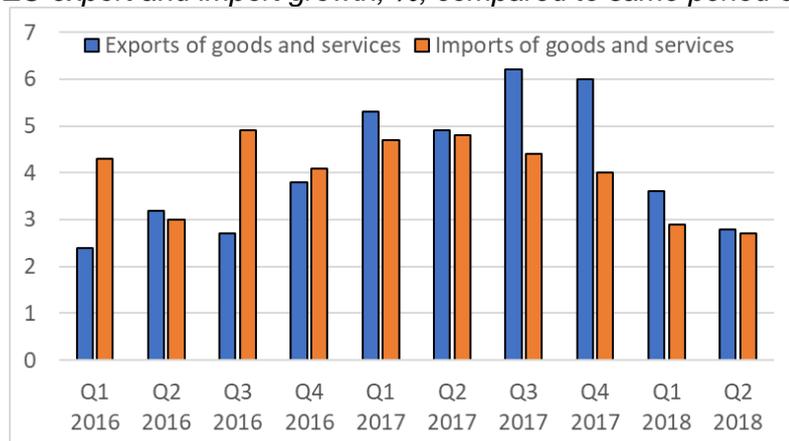
Source: ECB

### Export growth slowed at the beginning of 2018, compared to a very strong performance during 2017

The relatively weak contribution of net exports to EU GDP growth at the beginning of 2018 can be explained by a steeper slowdown of export growth, compared to import growth. As shown in figure 9, export growth only marginally exceeded import growth in the first two quarters of 2018, compared to a very strong export performance especially in the last two quarter of 2017.

**Figure 9** *Exports slowed more than imports in the first half of 2018, leading to a lower contribution of net exports*

EU export and import growth, %, compared to same period of previous year, Q1 2016 – Q2 2018



Source: Eurostat

### Weaker EU exports came on the back of less dynamic global trade growth

The weaker performance of EU exports comes against the background of a decline in world trade growth. As shown in figure 10, previously quite strong world trade growth slowed at the start of 2018 and has not gained significant traction towards the middle of the year.

It is conceivable that the discussion about a possible escalation of global trade conflicts has to an extent adversely affected the trade outlook, with the IMF noting in its October World Economic

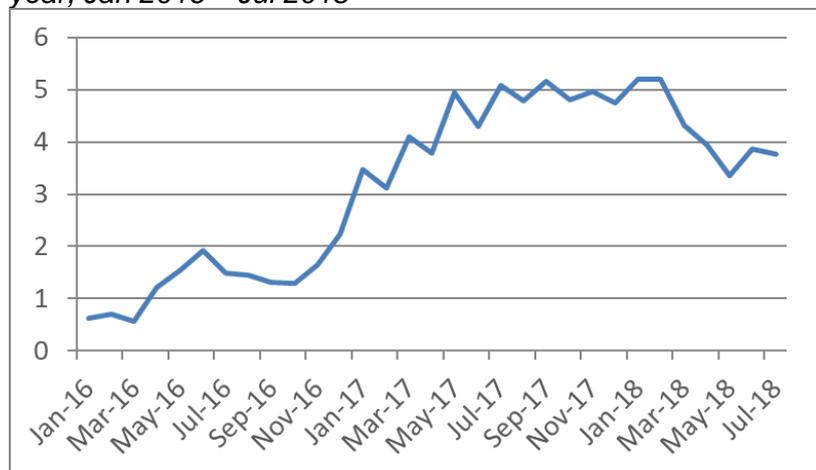


Outlook that the trade slowdown could reflect some payback from the very strong trade growth in late 2017 as well as weaker capital spending in a more uncertain global environment. Recent IMF analysis looks at the global economic impact of the tariffs which have been recently imposed between the US and several of its trading partners. It also includes some trade measures which have been announced or considered, but not yet implemented (e.g. a 25% tariff on all imported cars and car parts, and further bilateral measures between the US and China). The IMF concludes that all these measures together would inflict “significant costs” on the global economy, with its estimates showing that global GDP would fall by more than 0.8% in 2020 and remain about 0.4% lower in the long term.

In addition to weaker global trade, Euro area exports may have been negatively impacted by the lagged effect of the past appreciation of the Euro’s effective exchange rate, which increased by around 5% between January and August 2017, and stayed around that level since then.

**Figure 10 Global trade growth slows down at beginning of 2018**

Global trade, average % change over last 3 months compared to the same period of the previous year, Jan 2016 – Jul 2018



Source: CPB, BusinessEurope staff calculations

Against the background of a less dynamic global trade outlook,<sup>1</sup> we expect EU export growth of 3.3% in 2018 and 3.7% in 2019. Imports are expected to grow at a similar pace (3.5% and 3.7%, respectively), so that the contribution of net exports to EU growth is expected to be flat.

<sup>1</sup> The IMF expects world trade growth to slow from 5.2% in 2017 to 4.2% in 2018 and 4.0% in 2019.



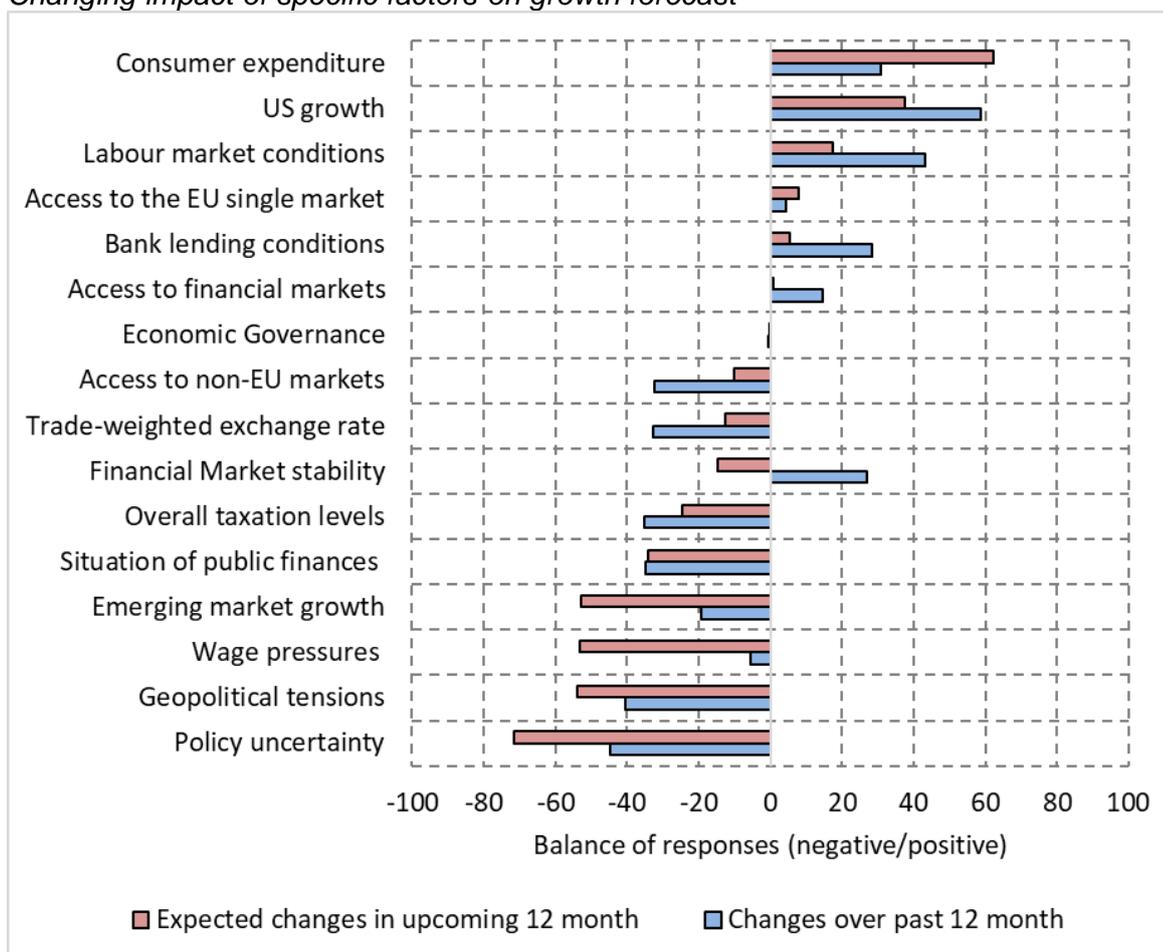
### 4. KEY GROWTH DRIVERS – MEMBER SURVEY:

Our specific survey of what member federations see as growth drivers for the upcoming 12 months (figure 11) shows that the overall picture of growth is driven by consumer spending, US growth (benefiting from pro-cyclical US policies) and improving labour market conditions. We can however see that the positive impact of US growth and labour market conditions is expected to be less pronounced than it was over the past 12 months.

Our survey also emphasises a number of factors which are expected to weigh on economic growth over the coming 12 months. In particular, our members are concerned about increasing policy uncertainty, geopolitical tension, and a weaker outlook for some emerging market economies. Our members also observe wage pressures gradually building up in some countries against the background of increasing shortages of qualified workers. In addition to still enduring trade tensions, uncertainty remains regarding the future relationship of the EU and UK. It is absolutely essential that the withdrawal agreement, including a status-quo like transition period, is agreed in time to allow for ratification in the EU and the UK. Regarding the future framework, BusinessEurope wants to keep the economic relationship as close as possible while preserving the integrity of the single market.

**Figure 11 Uncertainty increasingly comes from politics**

*Changing impact of specific factors on growth forecast*



Source: BusinessEurope's forecast based on survey of member federations

\*weighted average of members' responses



### 5. UNEMPLOYMENT, INFLATION AND PUBLIC FINANCES

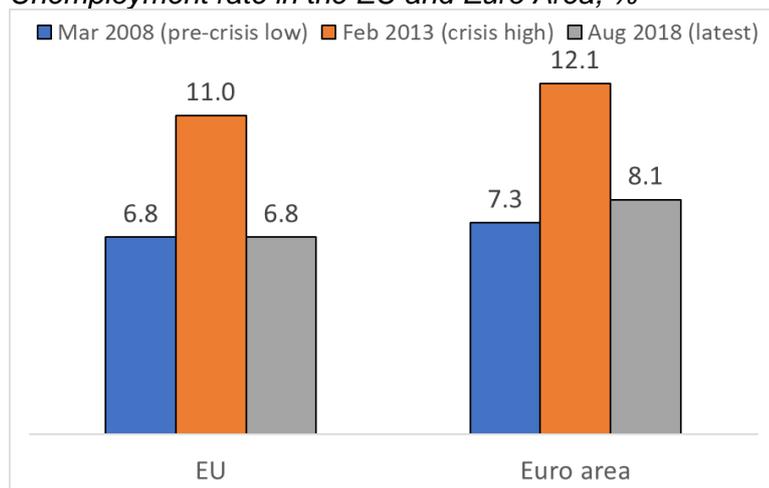
#### Unemployment rates are back to pre-crisis level in the EU, but remain above that in the Euro area

The strengthening of economic growth has led to a further improvement in labour markets. Eurostat's unemployment figures from 1 October show that EU unemployment was at 6.8% in August 2018 back to pre-crisis levels, and well below the 11% seen in March 2013 at the peak of the Eurozone crisis. While unemployment rates have also improved strongly in the Euro area (from 12.1% in February 2013 to 8.1% in August 2018), rates remain about one percentage point above pre-crisis levels (see figure 12).

Despite these improvements, it is worth noting that unemployment rates remain uneven across EU countries, with Greece and Spain facing rates above 10%, whilst rates are 4% and below in the Czech Republic, Germany, Poland, Hungary, Malta, the Netherlands and the UK. While overall EU unemployment is expected to further come down to 6.5% in 2019, rates remain well above those forecasted for the US (3.5% acc. to IMF for 2019).

**Figure 12 EU unemployment back to pre-crisis level**

*Unemployment rate in the EU and Euro Area, %*



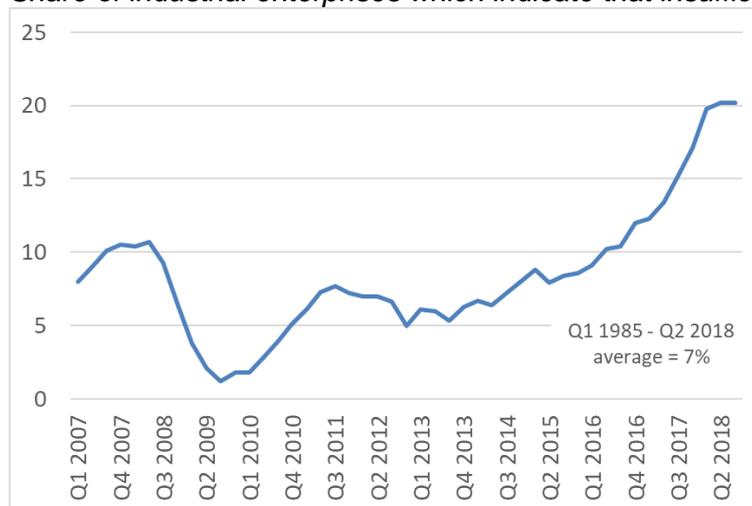
Source: Eurostat

Of particular concern is that even at this early stage of the recovery, there are already signs of the emergence of a structural mismatch, where business across the EU increasingly report difficulties in hiring workers. The share of industrial enterprises which indicate that insufficient labour limits their production is already at twice the pre-crisis level and the highest on record since 1985 (figure 13).

Against this background, we need to see urgent policy action to avoid labour market mismatches increasingly acting as a break on economic growth over the coming years. Next to a strong impetus to improve work-orientated learning for all age groups as well as equipping the workforce with key skills needed in the digital era (see box 1), broader efforts are needed to ensure that regulation, collective-bargaining structures and the tax system all support employment creation.



**Figure 13 Companies are increasingly concerned that a lack of labour hampers production**  
Share of industrial enterprises which indicate that insufficient labour/demand limits production, %



Source: European Commission

### Box: Impact of digitalisation on the European economy and labour market

New technology is fundamentally changing our economies and the way we work, with the potential to hugely increase our prosperity. But recent technological breakthroughs<sup>2</sup> have also triggered concerns about job losses.<sup>3</sup>

Such concerns relate to the speed and magnitude of the digital transformation, which McKinsey Global Institute<sup>4</sup> estimates to be happening 10 times faster and at 300 times the scale of the first industrial revolution.

However, recent studies suggest that, contrary to what is often argued, new technologies such as job robotisation and artificial intelligence are likely to increase, rather than reduce overall labour demand. For example, a recent survey of the World Economic Forum (WEF)<sup>5</sup> finds that globally 75 million jobs may be displaced by new technology by 2022, while 133 million additional *new* roles may emerge concurrently.

In this box, we look more closely at how the digital transformation may impact on labour markets and the economy at large, and conclude that whilst concerns about massive aggregate job losses appear misplaced, it is essential that policy supports those workers whose jobs are displaced by technology in developing the skills necessary to find new jobs.

#### **Estimating the scope for automation of particular occupations**

Concern that technology will put human jobs at risk is understandable and has been a recurring issue in the past. For example, the Luddites movement, a radical group of English textile workers at the onset of the Industrial Revolution, destroyed weaving machinery because they feared that unskilled machine operators were stealing their livelihood. Similarly, when computers began to appear in offices in the 1960s, US President John F. Kennedy declared that the key domestic challenge “is to maintain full employment at a time when automation [...] is replacing men”.

Fears about a jobless future centre on the fact that companies, in order to increase productivity, may replace workers with machines carrying out tasks that were previously done out by workers (replacement effect).

<sup>2</sup> Such as those in digitalisation, robotics, artificial intelligence, machine learning, big data analytics and cloud technology.

<sup>3</sup> For example, a recent column in the New York Post noted “Hollywood got it wrong. The highly intelligent machines [...] won’t be coming for our lives. They’ll be coming for our jobs.” See: Tucker, R., (2017). “Why no job is safe from the rise of the robots”, Opinion piece in the New York Post.

<sup>4</sup> Dobbs, R., Manyika, J., and Woetzel, J., (2015), “The four global forces breaking all the trends”. McKinsey Global Institute.

<sup>5</sup> World Economic Forum (2018), “The Future Jobs Report”, Centre for the New Economy and Society.



The extent of this happening depends on both the scope for automation (the extent to which capital can technically replace labour), and the relative prices of capital goods to labour.<sup>6</sup>

A frequently cited study from 2013<sup>7</sup>, looking at the potential to automate, estimated that 47% of American workers are in jobs at 'high risk' of automation within the next 10 to 20 years. In Europe, it has been estimated<sup>8</sup> that the share of jobs susceptible to automation ranges from the mid-40% range (similar to the US) to well over 60%, with workers in Southern Europe facing the highest exposure to a potential automation. However, the risk of job loss due to automation varies a lot among regions and local communities, depending on local circumstances regarding occupational structures, the current extent of digitalisation, education and skills levels, and the size of the tradable sector. Another study<sup>9</sup> concludes that jobs at risk of automation may range from close to 40% in some regions (e.g. West Slovakia) to merely 4% in others (e.g. the region Oslo in Norway).

A report of the OECD<sup>10</sup> nevertheless suggests that the share of jobs at risk of automation may have been significantly overestimated by some studies. This is because it is very unlikely that entire occupations will be automated. In reality, even 'high risk' occupations contain a wider range of tasks, of which a significant share is likely to be difficult to automate. Studies which take a task- rather than occupation-based approach show that only 9% of jobs face a high risk of being automated (i.e. where at least 70% of the tasks could be automated) - while for another 25% of jobs 50%-70% of the tasks could change significantly because of automation.

As the OECD also notes, the adoption of technology is likely to be delayed for an array of economic, legal and societal hurdles. Thus, even if new technology is already out there this does not mean it is immediately adopted by companies.

### **Jobs will continue to be created as our needs change**

The idea that an increasing use of technology can lead to long-term unemployment, stems in many cases from a model of a relatively limited range of human needs and demands, constraining future employment paths.

Keynes' vision of the grandchildren of adults living in the 1930s only working a small number of hours and enjoying simple lives of leisure has not generally come to fruition.<sup>11</sup> This is due the fact that technological change does not just destroy jobs, but also generates new ones. The OECD notes for each high-tech job created in industries such as Computing Equipment or Electrical Machinery, it has been estimated some 4.9 additional jobs are created for lawyers, taxi drivers, and waiters in the local economy.

Looking at the historical evidence, it also seems clear that technological advancement is not likely to lead to long-term unemployment:

- For instance, the first Industrial Revolution led to a strong decline of jobs in agriculture (the male labour force working in agriculture fell from 61% in 1700 to 29% in 1840 in Britain), while there was strong corresponding increase in the proportion of the labour force employed in industry (19% in 1700 to 47% in 1840).<sup>12</sup>
- The IMF<sup>13</sup> notes, in the past "technology has boosted productivity, which, in turn, has driven strong per-capita GDP growth and has been associated with expanding employment."

<sup>6</sup> IMF, (2018), "Technology and the Future of work". Background note prepared by staff.

<sup>7</sup> Frey, C.B., and M. Osborne (2013), "The future of employment: How susceptible are jobs to computerisation?", Oxford Martin Programme on Technology and Innovation Working Paper.

<sup>8</sup> Bowles, J., (2014), "Chart of the Week: 54% of EU jobs at risk of computerisation", Blog Post, Bruegel, 24 July. The authors apply the methodology used by Frey's and Osborne's and arrive at an EU average of 54%.

<sup>9</sup> OECD (2018). "Job Creation and Local Economic Development 2018".

<sup>10</sup> OECD, (2017), "Future of work and skills". Paper presented at the 2nd Meeting of the G20 Employment WG.

<sup>11</sup> Keynes, J. M., (1930), "Economic Possibilities for our Grandchildren," in Essays in Persuasion (New York: Harcourt Brace, 1932), 358-373

<sup>12</sup> Craft, N., (1987). "The Industrial Revolution: Economic Growth in Britain, 1700-1860". Recent Findings of Research in Economic & Social History. In the rest of Europe, where the industrial revolution started later, the male labour force in agriculture fell from 72% in 1700 to 55% in 1840, while the share in industry increased from 13 to 25% during the same period.

<sup>13</sup> IMF, (2018), "Technology and the Future of work". Background note prepared by staff.



Even within a specific industry or occupations, automation does not necessarily lead to falling employment. This is probably the case if the falling relative price of the final product leads to increased demand. Prominent examples include:

- During the Industrial Revolution mechanical weaving machines allowed more and more tasks to be automated so that workers could focus on other tasks such as operating the machine. As a result, labour required per yard of cloth fell drastically. Prices fell, which increased demand for cloth and ultimately led to more jobs, with the number of weavers quadrupling between 1830 and 1900.
- More recently, the introduction of ATMs reduced the average number of 'bank tellers' (from 20 per branch in 1988 to 13 in 2004), but led to banks opening more branches (+43%) due to the reduced cost of running a branch and higher customer demand. This in turn led to an increase in the total number of 'bank employees' who focused more on sales and customer service rather than routine tasks.

### ***Change in the landscape of work: How to facilitate the digital transformation?***

While technical progress is a key driver of economic growth, and improvements in living standards in the long-term, and can potentially increase demand for labour, as noted above, the potential for significant job losses in specific sectors or occupations means there is an important role for governments in helping facilitate workers in moving to new jobs.

According to a survey by the WEF<sup>14</sup>, the global landscape of work is expected to change considerably by 2022. 75 million jobs are expected to become redundant through a shifting division of labour between machines and human workers, while 133 million *new* roles may emerge. Whilst routine-based, middle-skilled roles, such as for example Data Entry Clerks, are expected to become redundant, jobs are likely to emerge in fields based on enhanced use of technology (e.g. Big Data Analysts and Machine learning/AI specialists, Social Media Specialists), and roles that leverage 'human' skills (e.g. Sales and Marketing Professionals, Customer Service Workers).

- In line with this, the vast majority of employers surveyed by the WEF expect that the skills set required to perform a job will change significantly by 2022. Similarly, Cedefop's European skills and jobs (ESJ) survey<sup>15</sup> finds that already today 10% of EU adult workers are at high risk of technological skills obsolescence, with 21% of employees considering it very likely that their skills will be outdated in the next 5 years.
- The ESJ survey further shows that simply improving digital literacy is not enough. Jobs in the future will increasingly combine digital with technical, soft and behavioural skills. Those jobs expected to grow the strongest in the future are particularly likely to require high cognitive (literacy, numeracy, foreign languages, problem-solving, learning to learn) and non-cognitive (communication, planning, customer service) skills.

It is a key policy priority to ensure that education systems adapt in line with ongoing changes in both the economy and society at large. The balance between future skills' demand and supply determines to a significant extent labour market performance<sup>16</sup>, not only regarding skills mismatches and wage developments, but also with respect to equipping workers with the skills necessary to successfully transition on the labour market.

### **Digitalisation raises potential issues for economic convergence between countries**

New technology may also raise questions about regional inequality and, in the case of the EU, about convergence between member states. Clearly, digitalisation will affect countries and regions differently

<sup>14</sup> World Economic Forum (2018), "The Future Jobs Report", Centre for the New Economy and Society. For its study, the WEF surveyed chief human resources officers and senior talent executives of employers representing 15 of the world's largest economies, accounting for 65% of the global workforce.

<sup>15</sup> Cedefop, (2017), "People, machines, robots and skills". Briefing note.

<sup>16</sup> Daron Acemoglu (2002). Technical Change, Inequality, and the Labor Market. Journal of Economic Literature, Vol. 40, No. 1 (Mar., 2002), pp. 7-72.



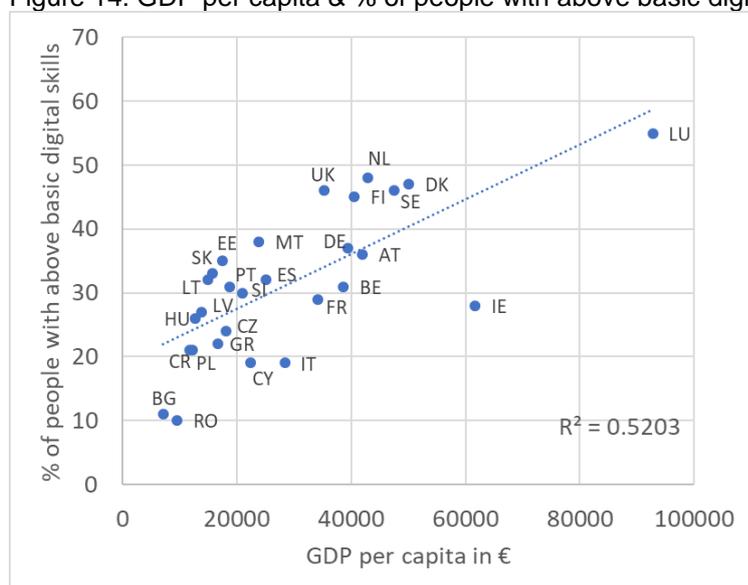
depending on factors such as the current use of digital technology, availability of infrastructure, the skills and education level and composition of the workforce, as well as the conditions in general on the labour market, potentially raising important questions about economic convergence.

“Technological innovation such as automation can drive productivity growth, generate new jobs and contribute to better living standards. But we must guard against any increase in regional divides in job quality and employment,” said OECD Secretary-General Angel Gurría commenting on a recent report.<sup>17</sup> The report notes that regions where a lower share of jobs is at risk of automation tend to have a highly educated workforce and a strong tradeable services sector.

On EU member state level, a key issue for cross-country convergence may thus be that those countries with relatively low per-capita income tend to have a workforce which is less skilled in using digital technology, as shown in figure 14. This reflects that broad measures of institutional quality contribute to cross-country differences both in income and the delivery of key policies that are important to secure growth in the digital age<sup>18</sup>.

### People from countries with low per capita income tend to have lower digital skills, raising important questions for cross-country convergence

Figure 14: GDP per capita & % of people with above basic digital skills in EU countries, 2017



Source: Eurostat

### Policy recommendations

In conclusion, technological progress is a key driver of aggregate economic growth and improving living standards. While concerns about a loss of overall demand for jobs are misplaced, future skills needs are likely to change with possible implications for job churn. Policy action is needed to ensure that workers are equipped with the adequate skills to navigate successfully through a changing, technology-rich work environment.

- *Rapidly changing skills needs increase the risk of skills mismatches and shortages, with significant economic costs.*
  - *For the EU to remain globally competitive, policymakers must ensure that adequate frameworks for re-skilling are in place.*
  - *Modern systems of lifelong learning are essential to allow workers to update their skills throughout their career which will help to harness the benefits of technological change for*

<sup>17</sup> OECD (2018). “Job Creation and Local Economic Development 2018”.

<sup>18</sup> The World Economic Forum (2018). The Global Competitiveness Report 2018.



*a broad group of the population. In particular, soft skills (communication, problem solving, team work, and leadership) and digital skills will be key in the future.*

- *Technology-enabled solutions that improve matching, access and bridge skills gaps should be embraced. Solutions by social partners must also be supported, for example, regarding re-skilling and training, work organisation, or job mobility, to make sure that both employers and workers reap the benefits of digitalisation at the workplace. This must be done at the appropriate level, in respect of national industrial relations systems and practices.*
- *Social protection and welfare systems should be designed to accompany people in an effective and efficient way in their transitions on the labour market, focusing on getting people back into work. Activation systems need to be strengthened to provide displaced workers with the necessary means to find a new job.*
- *Given the vast benefits of new technology, governments must create an environment that supports their development, adaptation and diffusion. Policy measures are needed to ensure the EU is at the global forefront of research and innovation, the provision of key infrastructure (e.g. fast broadband connections), and the development of high-growth start-ups. This can ensure that the EU is the leading global destination in which to found, develop, and scale-up technology-based businesses. Europeans are creating many start-ups, but they face obstacles when trying to scale them up and therefore often move then to the US to reach a critical mass.*
- *Intra-EU as well as international cooperation will be essential to address the cross-border aspects of new technologies, and share and learn from national experiences.*
- *It is important that new technologies are used to make the public sector more efficient, and thereby support endeavours to reduce distortionary taxes that hamper growth.*
- *Finally, institutions must also converge to a common high standard in order to ensure that the necessary policy preconditions are in place to share the benefits of digitalisation among all member states.*

### Inflation prospects are gradually picking up

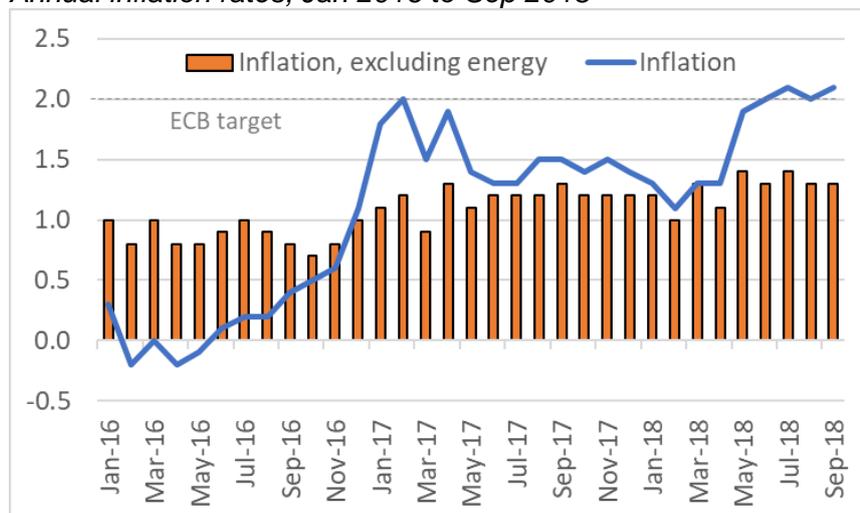
Euro area inflation has recently increased significantly to rates of slightly above 2% due to increases in energy prices, reflected in significantly higher oil prices since 2017 (up by about 50% in October 2018). However, core inflation (excl. energy) has only very slightly picked up since the start of 2017 and remains well below rates of 1.5% (see figure 15).

In the coming period two effects are expected to affect inflation in opposite directions. While the positive effect of higher energy prices on inflation is likely to fade over the course of 2019, supply constraints are expected to become increasingly binding, putting upward pressure on prices. We expect the net effect to be slightly positive and headline inflation to increase from 1.5% in 2017 to 1.7% in 2018 and 1.8% in 2019.



**Figure 15 Euro area inflation increased to rates of around 2% since May 2018, driven by higher energy prices**

Annual inflation rates, Jan 2016 to Sep 2018



Source: Eurostat

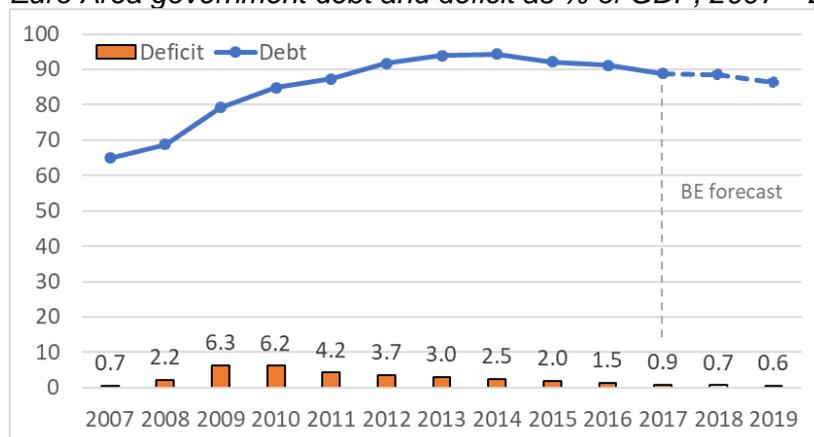
### While we have seen a gradual reduction in public deficits, debt levels remain high

The outlook for public finances in the Euro area has improved, with public sector deficits falling for the eighth consecutive time in 2017. At the same time, the progress in reducing the public debt burden has been slow. After peaking at 94% in 2014, the Euro Area public debt-to-GDP ratio reached 89% in 2017 and we expect the figure to fall marginally to 86% in 2019 (figure 16).

It is now important to use the current upswing to place a greater focus on bringing down government deficit and debt levels, while drawing on the flexibility within the Stability and Growth Pact to support member states who are undertaking significant public investment and growth enhancing structural reforms.

**Figure 16 While Euro area public deficits gradually decreased since the financial crisis, the debt ratios come down only very slowly**

Euro Area government debt and deficit as % of GDP, 2007 – 2019



Source: Eurostat

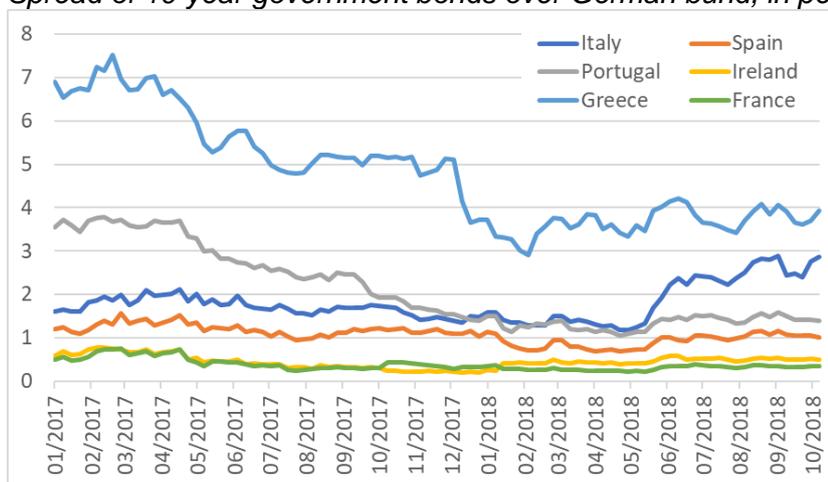
The importance of member states putting their public finances on a sustainable footing in order to strengthen investors' trust in the Euro-area is underlined by recent developments in public bond markets. As shown in figure 17, Italy's sovereign spreads have widened since May, initially on account of difficulties of forming a new government and, more recently, as a result of concern regarding the draft 2019 budget. At the same time, spreads in other Euro area members states have



not increased, which may indicate that investors have a stronger confidence in the Economic and Monetary Union as a whole, compared to the time during Euro crisis, where spreads strongly increased in some Euro area countries. While still incomplete, this underlines important progress on EMU after the crisis, in particular in relation to crisis prevention (improved policy monitoring and guidance, and the establishment of a Single Supervisory Mechanism), crisis containment (e.g. the establishment of the European Stability Mechanism) and crisis resolution (e.g. the Bank Recovery and Resolution Directive, and Single Resolution Mechanism).

Given the Italian outlook is characterized by low and slower growth, very high public debt and rising interest rates, it is necessary to take action, in the next Budget Law, by adopting economic policy measures able to improve growth and to sustain investment. Italy needs to accelerate the reduction of public debt, through measures that significantly affect the dynamics of GDP and employment.

**Figure 17 Italian yield spread widens in spring, with no signs of wider Euro Area contagion**  
 Spread of 10-year government bonds over German bund, in percentage points



Source: Investing.com, BusinessEurope staff calculations



### 6. COUNTRY DIFFERENCES

#### All countries expected to grow, but important differences remain

As in 2017, we again expect to see positive growth across all EU member states. However, the speed of expansion is expected to slow in many countries. In particular, larger economies such as Germany (2.2% in 2017, 2.0% in 2018, and 1.8% in 2019), France (2.2% in 2017, and 1.6% in both 2018 and 2019), and Italy (1.6% in 2017, 1.1% in 2018 and 0.9% in 2019) are expected to see some loss of growth momentum. The recovery in Greece continues but remains moderate. Ireland is expected to remain the strongest growing economy, with a still strong growth outlook also for most Eastern European countries (table 2).

Higher economic growth is also expected to help further reduce countries' unemployment rates. Yet again strong country differences remain, with unemployment rates ranging from an expected 2.4% in the Czech Republic to 16.7% in Greece in 2019. Finally, inflation is expected to exceed 2% in half of the EU countries in 2019, with the remaining 14 EU member states expected to see price increases in the range of 1.1% and 1.9%.

**Table 2: Growth rates expected to slightly slow or stagnate in all but two economies in 2019**

Main forecasts for all the economies surveyed.<sup>19</sup>

% Change	Real GDP growth		Inflation		Unemployment	
	2018	2019	2018	2019	2018	2019
Austria	2.9	1.7	2.1	2.1	5.0	5.0
Belgium	1.8	1.8	2.0	1.9	6.0	5.8
Cyprus	4.0	3.8	1.0	1.2	8.5	7.0
Estonia	3.6	3.0	3.3	2.8	5.7	6.0
Finland	2.8	2.2	1.1	1.4	7.7	7.4
France	1.6	1.6	2.1	1.9	9.0	8.8
Germany	2.0	1.8	1.8	2.0	3.2	3.0
Greece	2.1	2.5	0.6	1.2	18.3	16.7
Ireland	5.7	4.3	0.6	1.1	5.5	4.7
Italy	1.1	0.9	1.4	1.3	10.9	10.6
Latvia	3.3	3.3	2.7	2.6	8.2	7.6
Lithuania	3.4	2.8	2.7	2.5	6.3	5.9
Luxembourg	3.8	4.0	1.3	1.6	5.6	5.4
Malta	5.4	5.0	1.8	1.9	4.3	4.3
Netherlands	2.8	2.6	1.6	2.5	3.9	3.5
Portugal	2.3	1.9	1.4	1.5	7.2	6.2
Slovak Republic	4.0	4.2	2.4	2.1	7.1	6.3
Slovenia	4.4	3.7	1.8	2.1	5.5	4.9
Spain	2.7	2.3	1.7	1.3	15.3	13.5
Bulgaria	3.8	3.7	1.8	1.8	5.5	5.3
Croatia	2.8	2.7	1.7	1.6	9.5	8.5
Czech Republic	3.4	3.0	2.5	2.5	2.4	2.4
Denmark	1.3	1.8	1.0	1.6	4.9	4.6
Hungary	4.2	3.2	3.0	3.5	3.7	3.6
Poland	4.3	3.7	1.3	2.5	4.1	3.9
Romania	4.5	3.9	4.2	3.4	4.5	4.4
Sweden	2.5	1.9	1.9	2.6	6.2	6.2
United Kingdom	1.4	1.3	2.5	2.2	4.2	4.3

Source: BusinessEurope's survey of member federations

<sup>19</sup> Note that for blank surveys we used figures from the spring 2018 forecast of the European Commission. This is the case for Latvia, Slovakia, Bulgaria, Poland, and Romania.

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