ECONOMIC OUTLOOK SPRING 2017

THE EU's ECONOMIC RECOVERY CONTINUES

ECONOMIC SITUATION

- **The EU economy has maintained its recovery**, with signs that growth is becoming more broad-based across countries and sectors and indications of moderate increases of business confidence.

- We expect **growth** of 1.9% in the EU and 1.7% in the Euro Area in 2017, which is slightly higher (0.3 and 0.2 percentage points, respectively) than we had forecast last autumn. For 2018, we expect growth to continue at a similar pace with 1.8% in the EU and 1.7% in the Euro Area. We see the potential of stronger growth if political and economic developments are supportive.

- **Consumer spending** is expected to remain the key driver of growth, with EU private consumption expected to grow by 1.8% in 2017 and 1.5% in 2018. While total **investment** is picking up with almost 3% this year and next year, at the current pace it would still take up to 2024 to close the existing gap compared to pre-crisis levels. Rising global demand is expected to support **EU exports**, while EU imports are forecast to grow at the same pace.

- We expect **unemployment rates** to come down to 7.7% in the EU and 8.6% in the Euro Area this year and to 7.3% and 8.1%, respectively, in 2018 (from current rates of 8.0% in the EU and 9.5% in the Euro Area). While this is a strong improvement compared to 2013 heights, unemployment will remain above pre-crisis levels. Strong differences in countries' labour markets remain, with some firms seeing increasing difficulties in hiring skilled labour.

POLICY CONSIDERATIONS

- Member States need to continue to implement **structural reforms**, focus government spending on **growth-enhancing investment**, and, where necessary, continue **fiscal consolidation** while drawing on the flexibility within the Stability and Growth Pact. Against this background, we welcome the Commission's country-specific recommendations for reform and encourage the Council to adopt them.

- Given continuing investment weakness, the EU must urgently address existing barriers in order to **increase the attractiveness of Europe as an investment destination**. Further efforts to increase the supply of skilled labour can also play a crucial role in supporting investment.

- It remains key to work towards **reducing remaining barriers to global trade**. Inward-looking policies that threaten global economic integration must be avoided.

- **Completing the EMU** and strengthening trust in the euro is both a priority and matter of urgency for business. In particular, while there are indications that access to finance, and in particular bank lending, has recently improved in most countries, banks still see access to credit as tighter than in the pre-crisis period. This emphasises the need to put in place a full banking union based on the three pillars of supervision, resolution and deposit schemes.

- Improving access to diversified financing routes such as equity and bonds through rapid and comprehensive implementation of the **Capital Markets Union** is also essential.

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 spring's questionnaire were received in April 2017.

FOR FURTHER INFORMATION:

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1. OVERVIEW

The European economy has maintained its recovery in recent months, proving resilient to continuing high levels of political uncertainty. Real GDP rose by 0.6% in the EU in the fourth quarter of last year and is estimated to have reached 0.5% in the first three months of this year, with signs that growth is becoming more broad-based both across countries and sectors.

European business federations expect the recovery of the European economy to continue in the coming months with indications of slightly further increasing business confidence. Consumer spending is likely to remain the key driver of growth, supported by improving labour market conditions, with retail sales growing at rates well above the historical average. The external environment, which posed an important challenge to companies' export during the last year, with falls in extra-EU goods exports to the US, Japan, Russia and Brazil, is also set to slightly brighten up this year. There are also indications that, with many companies starting to run up against capacity constraints, investment may see a pick-up in the coming months, supported by improvements in the cost and availability of finance in a number of Member States.

At the same time, however, our members report that policy uncertainty and geopolitical tensions remain a significant concern. Whilst as noted above, investment is expected to see some improvement, it has yet to show signs of a more robust pick-up. At the currently expected rate of GDP and investment growth, it would take up to 2024 to close the existing gap compared to pre-crisis levels. Finally, even though falling, unemployment rates still remain (well) above 10% in seven Member States. It thus remains essential that policy measures which can increase economic growth, particularly around product and labour market reforms, are pursued with vigour.

Overall, we expect growth of 1.9% in the EU and 1.7% in the Euro Area for 2017, which is slightly higher (0.3 and 0.2 percentage points, respectively) than we had forecast last autumn. For 2018, we expect growth to continue at a similar pace with 1.8% in the EU and 1.7% in the Euro Area. We see the potential of stronger growth if political and economic developments are supportive. Unemployment is forecast to further decrease from 8.5% in the EU in 2016 to 7.7% this year and 7.3% the year after that (EA: from 10% in 2016 to 8.6% in 2017 and 8.1% in 2018). Finally, EU and Euro Area inflation is expected to gradually pick up to rates close to 1.5% over the forecast horizon, mainly due to the previous fall of energy prices now dropping out of the index.

Table 1 Economic growth prospects for the EU and Euro Area strengthen slightly

Main Variables	EU28		Euro Area	
	2017	2018	2017	2018
Real GDP (annual % growth)	1.9 (+0.3)	1.8	1.7 (+0.2)	1.7
Inflation (%)	1.6 (+0.3)	1.6	1.5 (+0.3)	1.4
Unemployment (%)	7.7 (-0.6)	7.3	8.6 (-0.7)	8.1
Government net lending (% of GDP)	-1.7 (+0.2)	-1.6	-1.4 (+0.3)	-1.4
Gross public debt (% of GDP)	84.4 (-1.4)	83.3	91.8 (+0.8)	90.7
GDP components	**EU28**		**Euro Area**	
	2017	**2018**	**2017**	**2018**
Private consumption (%)	1.8	1.5	1.4	1.3
Public consumption (%)	1.4	1.2	1.3	1.1
Gross fixed capital formation (%)	2.7	2.7	3.2	2.7
Exports (%)	3.1	3.4	2.7	3.2
Imports (%)	3.3	3.4	3.0	3.3

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

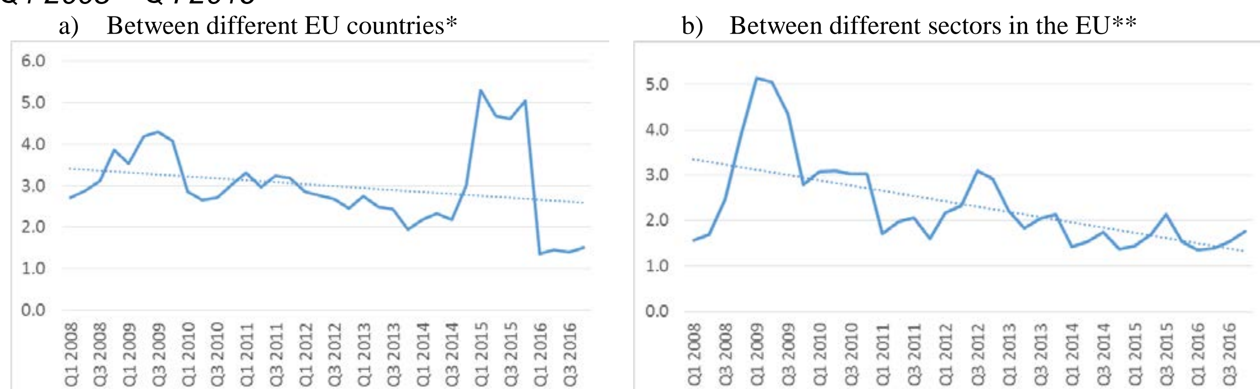
2. RECENT DEVELOPMENTS IN MORE DETAIL

Moderate economic growth continued in recent quarters…

Official data shows that the EU economy continued to grow at a moderate pace. GDP rose by 0.6% in the EU and 0.5% in the Euro Area during the fourth quarter of 2016, with GDP growth overall in 2016 of 1.9% in the EU and 1.8% in the Euro Area. Initial Eurostat estimates for the first quarter of this year put growth at 0.5% in both the EU and the Euro Area.

There are also indications that the recovery has become more broad-based, with growth rates more widely shared both across countries and across sectors and with slightly less variation (Fig 1). Amongst EU Member States, only Greece experienced negative growth in Q4 2016. At a sectoral level, only the agriculture, forestry and fishing sector experienced a slightly negative growth in Q4.

Figure 1 The recovery has become more broad-based, both among countries and sectors
Standard deviation of quarterly GDP, change compared to the same quarter of the previous year, Q1 2008 – Q4 2016

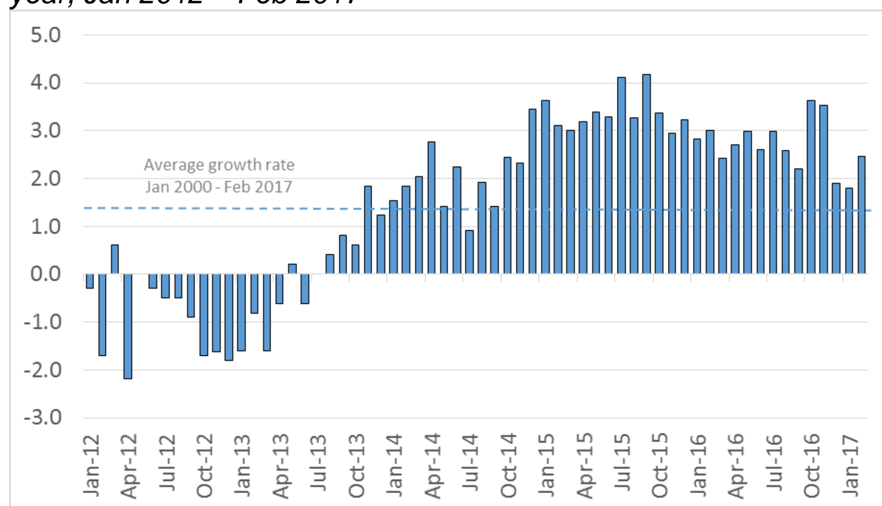


** No data for Slovakia*
*** Sectors according to NACE 2 classification*
Source: Eurostat

… further supported by strong consumer spending

Consumer spending, the largest component of demand, still constitutes the key driving force behind economic growth (0.3 pp contribution to quarterly growth in Q4). Retail trade growth, which turned positive in mid-2013, was close to, or above, 2% in recent months, and thus well above average historical growth rates of 1.4%, albeit slightly below the strong rates seen in 2015 (Fig 2). Consumer spending is supported by further improving labour market conditions, with gradually declining unemployment, and still relatively low energy prices boosting household’s disposable income.

Figure 2 Growth in retail trade is still well above historical average rates
Real turnover of retail trade, percentage change compared to the same month of the previous year, Jan 2012 – Feb 2017



Source: Eurostat

EU investment growth slowed down slightly in 2016 compared to the previous year…

Investment, which started picking up in 2014, nevertheless remains relatively weak by historical standards. Despite substantial policy support and further improving financing conditions (see p. 9f). EU investment growth amounted to only 2.6% in 2016, following growth of 3.6% in the previous year. In particular, investment in equipment slowed down (from 4.5% in 2015 to 3.4% in 2016), while we have seen a slight increase in construction investment (from 1.9% to 2.6%).[1]

An important contributor to the general slowdown of EU investment growth in 2016 was the slowdown in investment in some cohesion countries after the changeover to a new programming period for EU structural funds.[2] In addition, UK investment declined sharply from 3.4% in 2015 to 0.5% in 2016.

It is however of some concern that EU investment growth would have been lower both in 2015 and in 2016 were it not for exceptional Irish data (33% investment growth in 2015 and 45% in 2016)[3]. Excluding Ireland, EU investment growth would have been about 0.5pp lower in 2015 and 1pp lower last year.

…while a more challenging global trading environment negatively impacted on EU exports

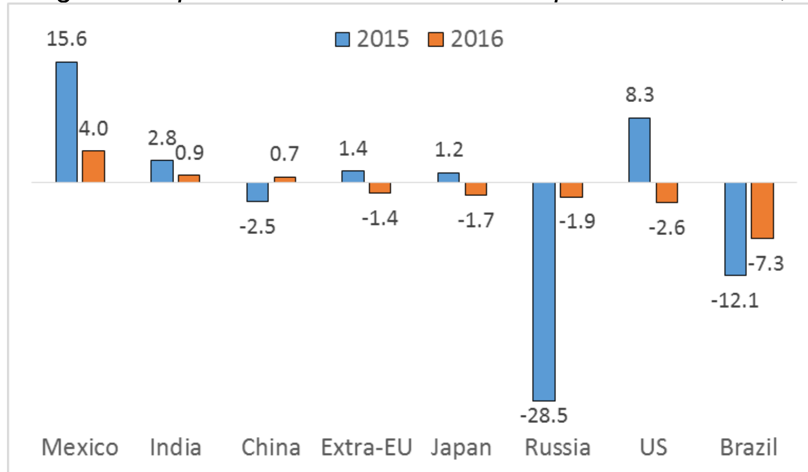
In 2016, we witnessed a slowdown in global demand and trade growth. Global trade grew with 2.2% (in volume terms) at its slowest pace since 2009, well below its historical average of 5.3% since 1980 and below the 2.4% growth rate of world GDP (at market exchange rates).

Weaker global demand negatively impacted on extra-EU exports of goods which decreased by 1.4% in 2016, reversing gains of the previous year (Fig 3). While the EU still recorded positive export growth to Mexico (4%), India (0.9%) and China (0.7%), EU exports to Japan (-1.7%),

[1] Data for EU-15
[2] See: European Investment Bank (2016). "Investment and Investment Finance in Europe. Financing productivity growth", p.30f.
[3] This is in part due to large patent transfers (imports) by some multinational companies to their Irish affiliates.

Russia (-1.9%), the US (-2.6%)[4] and Brazil (-7.3%) fell in 2016. Overall, net exports made with -0.1pp a slightly negative contribution to EU growth last year.

Figure 3 Slowdown in extra-EU exports in 2016 in most markets
EU goods exports in volumes to different partner countries, % change compared to previous year



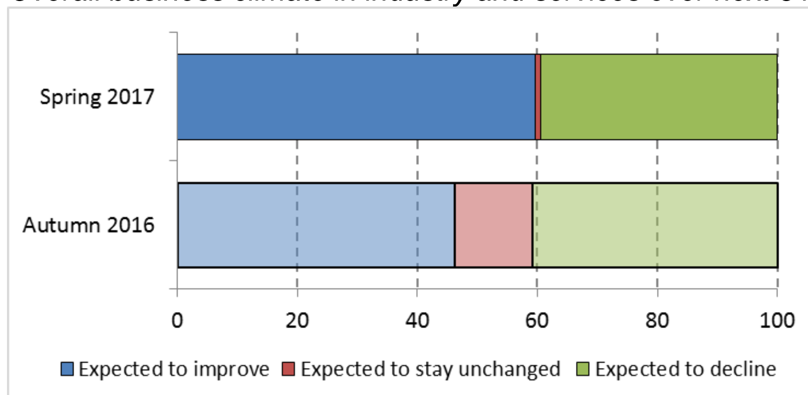
Source: Eurostat

3. Future prospects

Business confidence likely to slightly further improve, indicating moderate economic growth is set to continue

Our survey of member federations indicates that business confidence is expected to slightly further improve from its currently already relatively high levels,[5] with slightly more respondents expecting to see an improvement in the business climate than those expecting a deterioration (Fig 4).

Figure 4 Business confidence likely to increase slightly further over the next months
Overall business climate in industry and services over next 6 months



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

[4] While Brazil (-3.6%) and Russia (-0.2%) recorded negative growth in 2016, US growth slowed substantially from 2.6% in 2015 to 1.6% in 2016. A substantial part of the decline of EU exports to the US can be attributed to a decline in exports in machinery and transport equipment (-2.7%) and chemicals (-3.3%) which taken together make the bulk of EU exports to the US (69%).

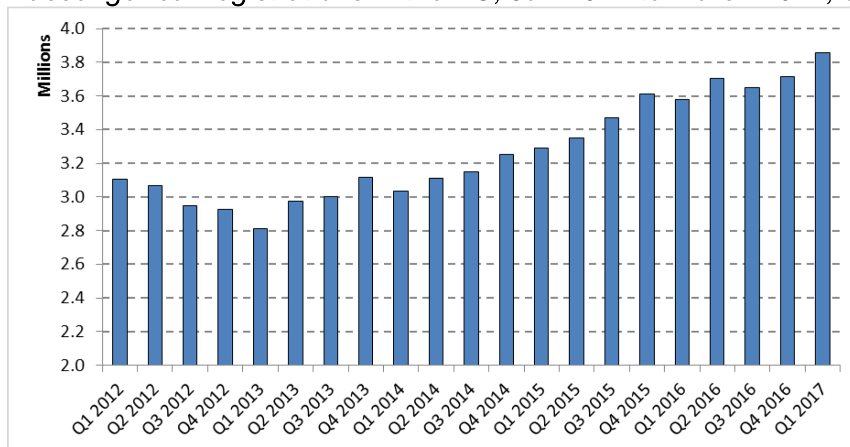
[5] For example, the Commission's Business Climate Indicator was in the first four months of this year with an average of 2.1 points at the highest level since June 2011, with further improvements compared to the end of last year.

Consumer spending likely to remain key growth driver…

Consumer spending is expected to remain the key driver of economic growth. The continuing rise in car registrations we have seen in the EU in recent months (Fig 5) is an important indication of further increasing consumer confidence, with improvements also observed over the last months in the European Commission's EU consumer confidence indicator.

Supported by an improving labour market situation, we expect private consumption growth of 1.8% in 2017 and 1.5% in 2018 in the EU (1.4% and 1.3%, respectively, in the Euro Area).

Figure 5 Rising car registrations point to further improvements in consumer confidence
Passenger car registrations in the EU, Jan 2012 to March 2017, seasonally adjusted



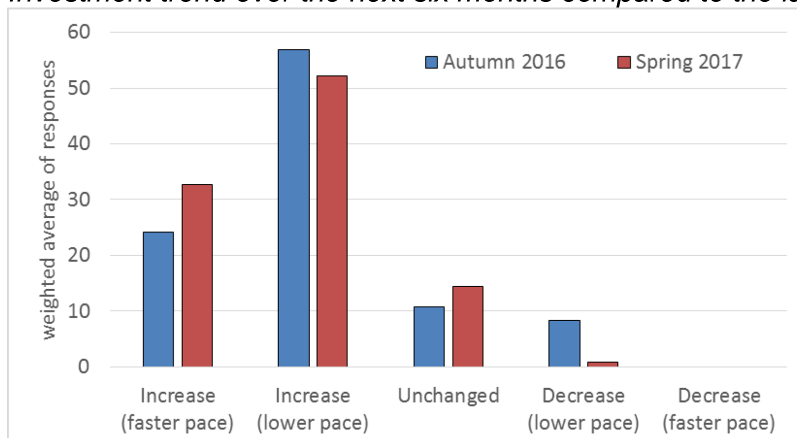
Source: European Automobile Manufacturers Association (ECEA), seasonally adjusted by BusinessEurope

… whereas EU investment growth is likely to remain only moderate

Our survey indicates that the majority of respondents expect EU investment growth to pick up only at a moderate pace over the coming 6 months (Fig 6).

Overall, we expect investment growth of 2.7% both this year and the next, and thus at the same pace as in the last year, with Euro Area investment growth expected to slow to overall EU levels (from 3.7% in 2016 to 3.2% in 2017 and 2.7% in 2018).

Figure 6 Investment expected to pick up only at moderate pace over the coming 6 months
Investment trend over the next six months compared to the last six

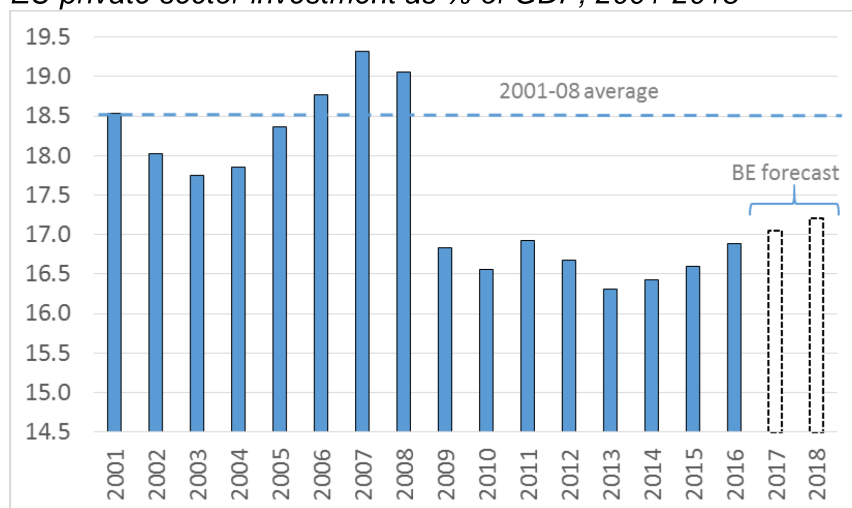


Source: BusinessEurope's forecast based on survey of member federations

Our forecast shows that at the end of 2018, we will still see a sizable investment gap, with EU private investment as a share of GDP remaining more than 1 percentage point below pre-crisis level (Figure 6).[6] At the current pace of GDP and investment growth, it would take until 2024 to close the gap.

Figure 7 EU investment to remain well below historic pre-crisis average

EU private sector investment as % of GDP, 2001-2018



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

Looking at the factors that influence business investment decisions, which makes up the bulk of total investment, Figure 8 illustrates that capacity utilisation has become increasingly important. After years of low investment, and with global activity gradually picking up,[7] companies see an increasing need to expand their production capacities to meet the demand. According to Eurostat data, the rate of capacity utilisation increased to 82.1% in the first quarter of this year, compared to 81.8% in the previous quarter, which is the highest level since Q3 2008 (83%). In addition, an increasing number of projects approved under the Investment Plan for Europe is expected to move to the implementation phase, supporting both public and private investment.[8]

At the same time, there are still a number of factors which hamper a more substantial pick-up of investment. These include notably rigidities in product markets, remaining deleveraging needs in several countries given the still high levels of debt, as well as weaker expectations of potential growth, associated with remaining political uncertainties, and access to finance issues in some countries, notably Greece.[9]

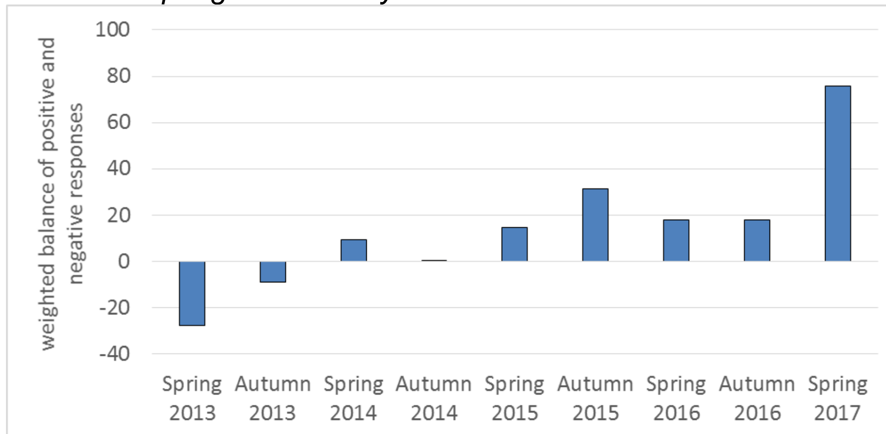
[6] In turn, public investment as a share of GDP was in 2016 with 2.7% 0.4pp below it pre-crisis average. In contrast to private investment, public investment continued falling in recent years from shares of 3% in 2013 and 2.9% in both 2014 and 2015.

[7] In its World Economic Outlook from April, the IMF expects global growth to rise from 3.1% in 2016 to 3.5% in 2017 and 3.6% in 2018.

[8] European Commission, Winter Economic Outlook 2017.

[9] See also European Central Bank, "Staff macroeconomic projections for the euro area", March 2017.

Figure 8 Capacity utilization has become a key factor in driving investment decisions
Influence of capacity utilization on companies' investment decisions, Economic Outlook Spring 2013 until Spring 2017 surveys

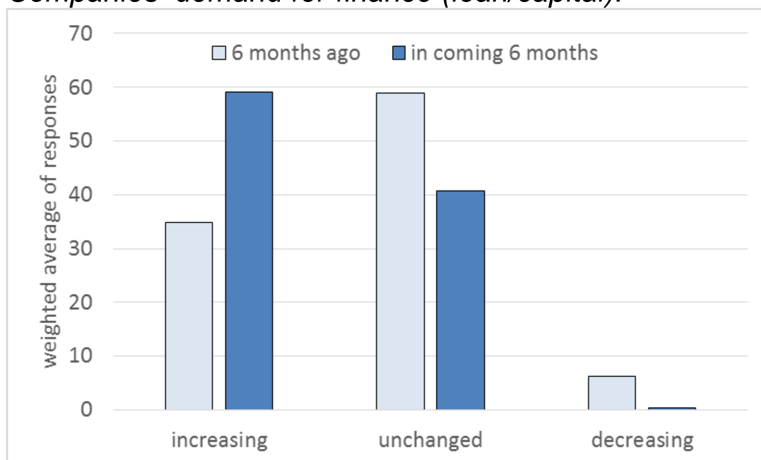


Source: BusinessEurope's forecast based on survey of member federations

Companies' investment plans are supported by improving access to finance

Companies' investment plans are also subject to the availability of finance, with our survey indicating that in many Member States demand for finance has risen compared to 6 months ago (Fig 9), in line with economic activity continuing to pick up. Demand for finance is expected to increase even further over the coming 6 months.

Figure 9 Companies' demand for finance continues to increases with activity picking up
Companies' demand for finance (loan/capital).



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

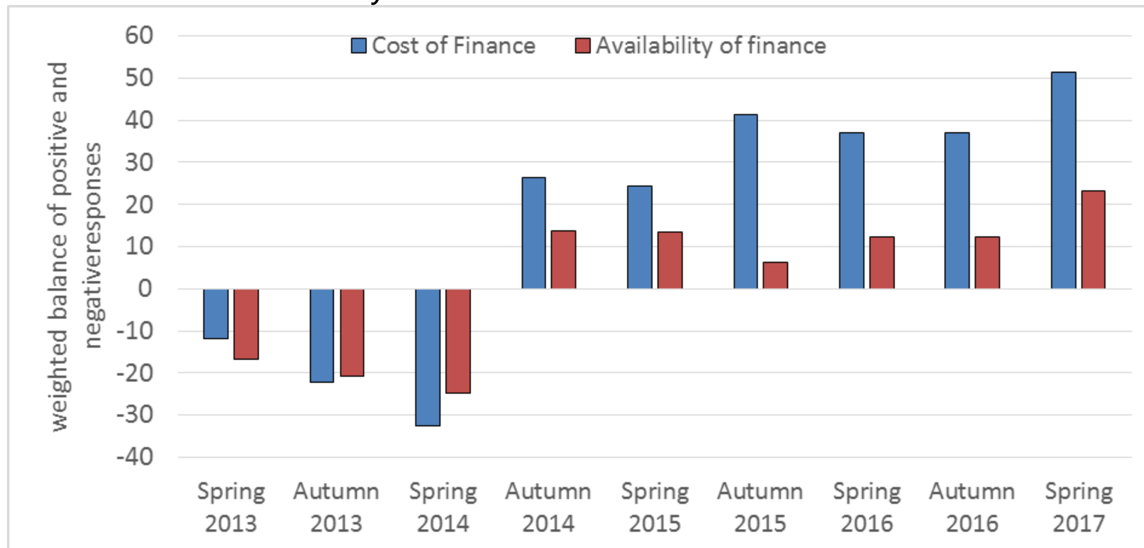
Against the background of increasing demand for finance, our members continue to see improvements in access to finance, with 47%[10] of our survey respondents indicating that access to finance improved over the last 6 months ago, while only 4% suggested access is more restrained.

Our survey also indicates that both (higher) availability and (lower) cost of finance has had a positive influence on companies' investment decisions since mid-2014 (Fig 10). In particular, in the recent 6 months, we can observe some further positive impact.

[10] GDP weighted average

Figure 9 Improvements in the cost and availability of finance have an increasingly positive influence on companies' investment decisions

Influence of the cost and availability of finance on companies' investment decisions, Spring 2013 to Autumn 2017 surveys.



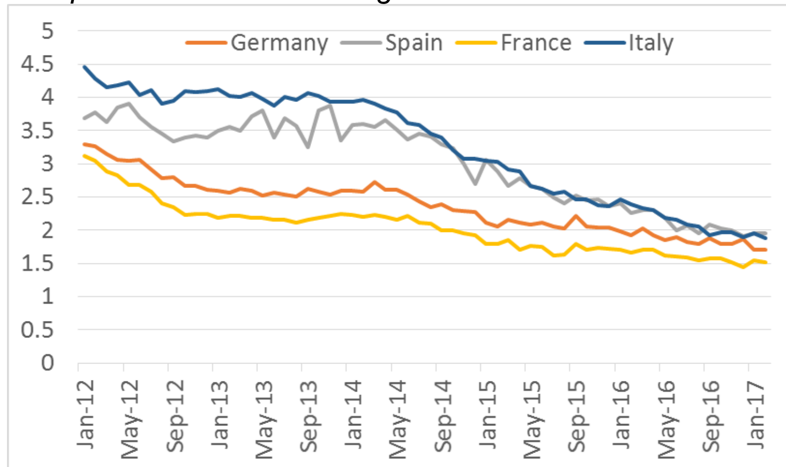
Source: BusinessEurope's forecast based on survey of member federations

Our results are in line with the latest bank lending survey from the European Central Bank which indicates that credit standards for loans to enterprises eased slightly in the first quarter of 2017 (-2% in net terms). This follows a net tightening of 5% in the previous quarter, driven mainly by developments in the Netherlands. Similarly, the ECB survey on the access to finance of enterprises (SAFE) also points to an improvement in the availability of finance to SMEs since 2014, with few exceptions (e.g. Greece).

Finally, regarding costs, the ECB's composite cost-of-borrowing indicator, which is based on bank interest rate statistics and measures borrowing costs for non-financial corporations while enhancing cross-country comparability, shows a further reduction and gradual convergence of interest rates across countries (Fig 11), a development which has been supported by ECB monetary policy action.

Figure 11 Gradual convergence at lower levels of interest

Composite cost-of-borrowing indicator for non-financial corporations, Jan 2012 – Feb 2017, %



Source: European Central Bank

While we thus see a clear improvement in overall access to finance, the recent ECB bank lending survey also points out that even after years of ECB support banks still see access to credit as tighter than in the pre-crisis period.[11] Against the likelihood of demand for finance for investment further picking up in line with an improving economy, there remains a risk that access to finance will become an increasingly biting containt in the future.

Given that in Europe companies remain heavily reliant on bank finance for their investment,[12] it is key to reinforce and implement the Capital Markets Union proposals to ensure that the EU establishes a genuine single market in financial services, and develops complementary sources of finance. There is a clear need to strengthen capital markets in the Euro Area in order to provide new sources of funding for business, help increase options for savers and make the economy more resilient.

In addition, EU Member States should adress the high stock of non-performing loans on balance sheets of many European banks, which, together with high levels of corporate debt, according to the IMF[13], “have constrained investment in capital goods and intangible assets, slowing the pace of capital-embodied technological change.”[14]

Increase global growth to drive EU export growth

With the global recovery now starting to pick up (see box for more details), EU exports growth is expected to slightly increase from 2.8% in 2016 to 3.1% in 2017 and 3.4% in 2018. For the Euro Area, we expect export growth of 2.7% in 2017 (same rate as in 2016) and 3.2% in 2018.

Box: Global growth increasing but uncertainty remains around US policy development

As noted in the main text, improvements in the global economy are likely to provide a boost to EU export growth in the coming year, with the IMF now expecting global growth to increase from 3.1% in 2016 to 3.5% in 2017 and 3.6% in 2018, a slight improvement on its Autumn forecast.

Key to global growth performance, will as ever be the US economy, with both developments in the economy itself, and in broader economic policy, having reverberations for the global economy.

Six months on from the election of Donald Trump as president, there remains some uncertainty regarding the likely policy stance of his administration, in terms of both macro and micro economic policy. As the IMF have noted, “financial markets are buoyant and expect continued fiscal expansion and deregulation in the US”[15]. There has been a clear rise in US equity markets (also reflected in global markets) since the US elections in November (Fig 12).

[11] This is also in line with the findings of the ECB Survey on the Access to Finance of Enterprises.

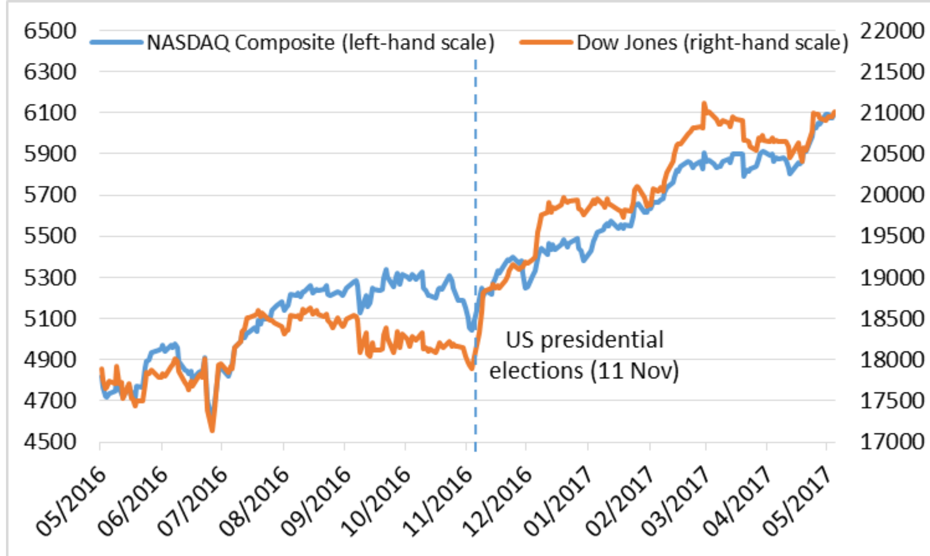
[12] Banking-sector assets make up 316% of GDP in the EU, compared to only 115% of GDP in the US, with equity and debt securities playing a less important role in the EU. Bank loans currently make up 80% of debt financing by non-financial corportations in the EU (see: European Investment Bank (2017). “Beyond the Equity-Efficiency Trade-Off: Practical Ideas for Inclusive Growth and Competitiveness in Europe”.)

[13] IMF World Economic Outlook, April 2017.

[14] An ECB analysis suggests that if the capital tied up to support NPLs could be deployed to support new lending then ‘total credit volume’ in the Euro-area could increase by at least 2.5% overall, and at least 6% in the six Member States with the highest concentration of NPLs.

[15] IMF, World Economic Outlook, April 2017

Figure 12: Clear rise in US equity markets since November elections
NASDAQ Composite Index and Dow Jones, 02 May 2016 – 05 May 2017

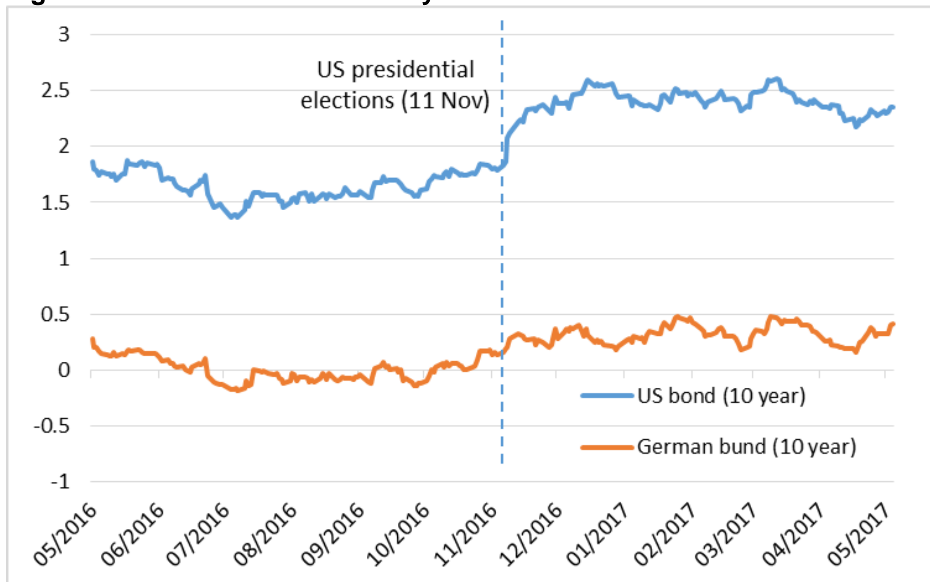


Source: Yahoo Finance

In terms of **macroeconomic policy,** many market participants will have latched onto Trump's pre-election comments regarding on the one hand, tax cuts, and on the other hand, increased investment spending, which taken together would imply a significant fiscal expansion.[16]

Should such an expansion take place, the impact on US domestic demand would be mitigated by the increased likelihood of the US Federal Reserve making further rises in interest rates. Taken together, the prospect of an increasing US government deficit and further interest rates rises has already led to a rise in bond yields for 10 year US treasuries, with knock-on effects for yields on other bonds (both government and corporate), as noted in Figure 13 showing a corresponding increase in German government 10 year yields.

Figure 13: US and German bond yields have risen



Source: Yahoo Finance

[16] Trumps pre-election pledge was for a 1.3$ trillion increase in infrastructure investment over the course of his presidency and for a reduction in Federal revenue (primarily through lower business taxes) which according to analysis in January 2016 by the independent Tax Policy Center, would lead to a 25 percentage point increase in US government debt by 2026.

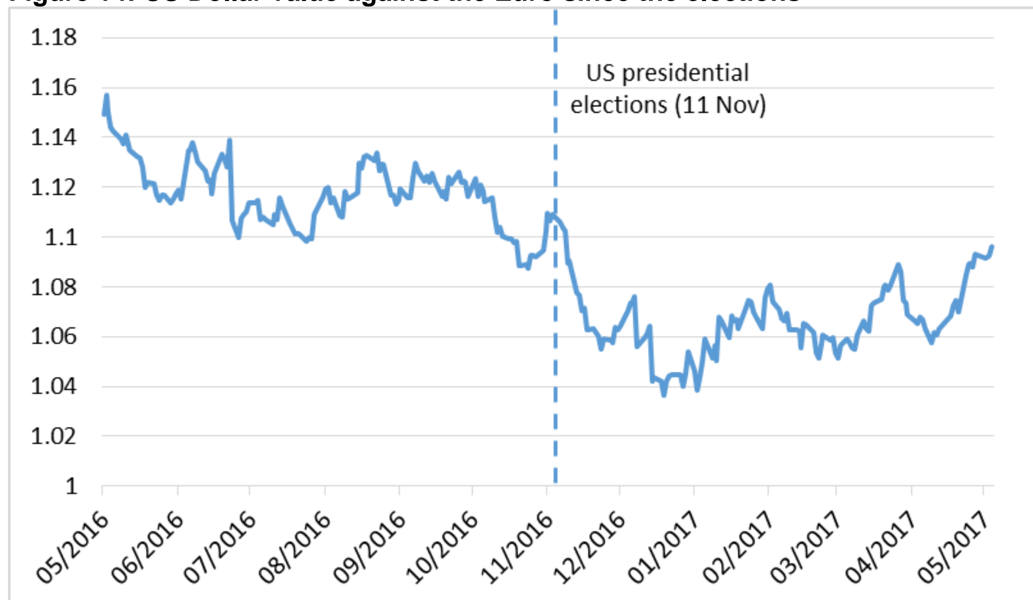
The implications for the global economy are also transmitted though the exchange rate with the prospect of higher US interest rates, plus a fiscal expansion, leading to an immediate appreciation of the dollar on global markets, and in particular a fall in the value of the euro against the dollar.

However, as the European Commission argues in its recent Spring Economic Outlook, the fiscal stimulus now appears likely to be smaller than expected, noting that alongside the level of ambition of tax reform being more limited than initially thought, “the administration’s Budget Blueprint and a lack of political momentum around the infrastructure investment bill would suggest no major increase in federal spending in the near term”.

In line with the scaling down of the extent of fiscal stimulus, we have seen some of the initial financial market exuberance reversed, with a small fall in treasury yields compared to their early 2017 levels, and a near reversal of the dollar’s rise against the euro (Fig 14).

Nevertheless, given ongoing macroeconomic policy uncertainty, there is the clear potential for financial market fluctuations, with the wider implications of further dollar rises for the global economy for example noted by the IMF who discuss the potential for “further US dollar appreciation straining emerging market economies with exchange rate pegs to the dollar”.

Figure 14: US Dollar value against the Euro since the elections



Source: ECB

Trump’s **micro economic policies** could have more profound implications for companies both in the US and overseas. The prospect of **regulatory changes** which may be welcomed by US businesses, and in particularly, the finance, energy and health care sector, was clearly a key factor behind some of the rises in US equity markets following Trumps election. Regulators, both globally and in the EU, will need to monitor any regulatory development, particularly regarding financial services, taking into account impacts both on global financial stability and regional competitiveness.

As noted above, the macroeconomic impact of the planned cut in taxes appears to have been scaled down in the White House’s **tax reform plan** released on April 26th. Most importantly, in terms of the specific measures proposed, there was no reference to a Border Adjustment Tax, such as that proposed by senior Republicans Paul Ryan and Kevin Brady, which would have seen US companies able to offset export revenues against their potential profits, but not any import costs. BusinessEurope’s President, Emma Marcegaglia had previous suggested a border tax would be a declaration of a trade war.

Nevertheless, the tax reform plan, still **foresees radical corporate tax reform**, not only bringing the headline rate down from close to 40% to 15%, but ending the currently territorial systems which makes US companies pay profit on all global income, through a new one time tax on assets held overseas. It will be

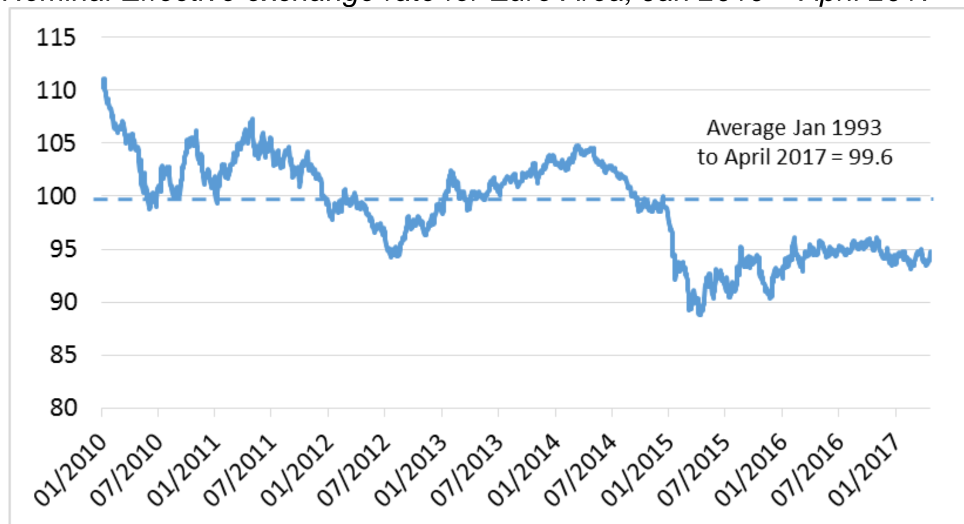
important for EU member states to monitor these developments, given the potential implications for global tax competitiveness.

In **conclusion,** both US economic performance, and particularly US policy development have potential to have important impacts on the EU economy and EU competitiveness. There remains great uncertainty around the course of US policy, in particular around the size of any fiscal expansion and the details of corporate tax reform. As the European Commission has also noted, the principal downside risk facing the US economy is around trade and immigration with a more protectionist stance "implying significant losses for the US and global economy".

Alongside, growing global demand, EU exports are expected to continue to benefit from a relatively low Euro exchange rate (Fig 15).

Figure 15 Euro effective exchange rate remains historically low despite slight increase since spring 2015

Nominal Effective exchange rate for Euro Area, Jan 2010 – April 2017



Source: ECB

However, given that import growth is expected to be in line with, or even slightly outgrow, EU and Euro Area export growth, net exports are not expected to make a contribution to growth this year and the next.

Key growth drivers – member survey:

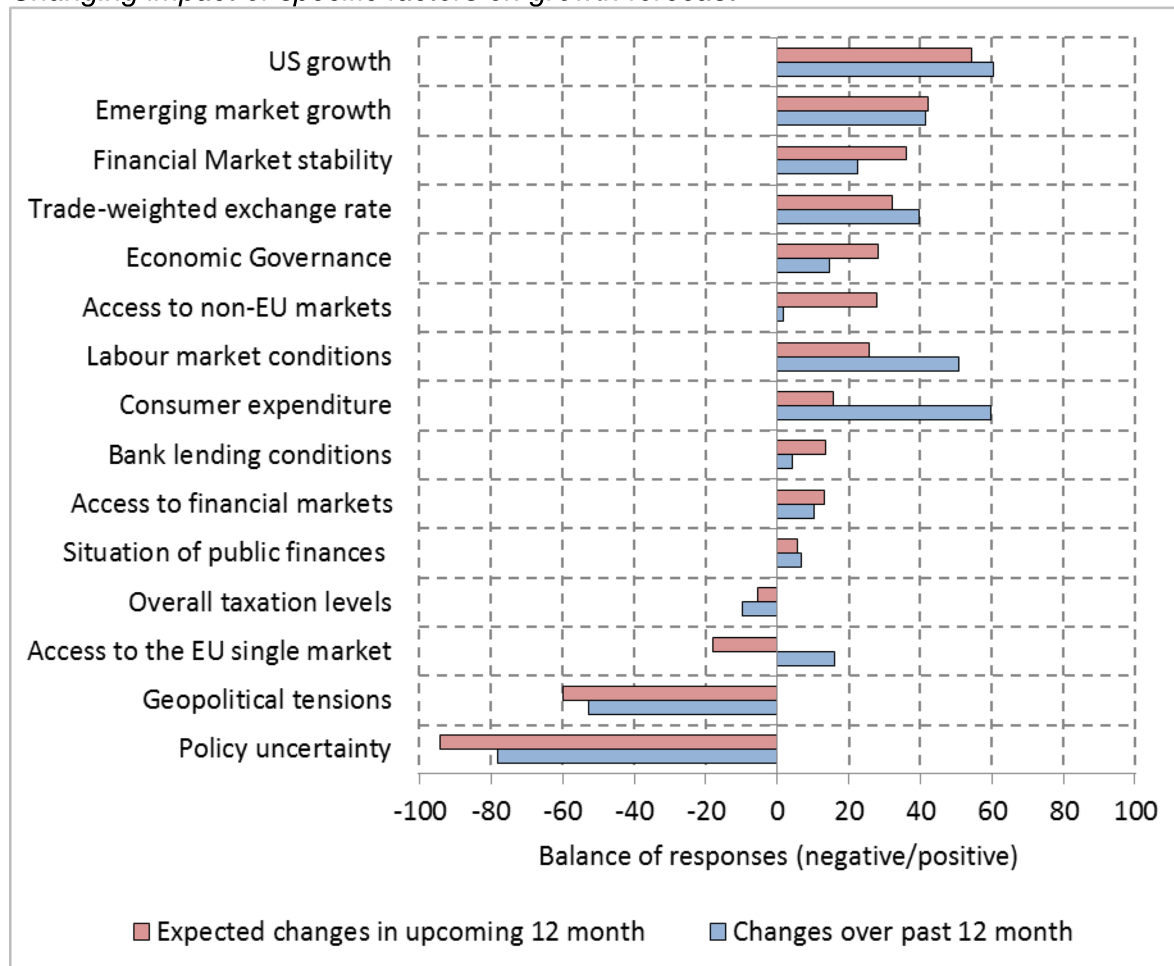
The overall picture of growth driven by consumer spending and supported by a gradual improving external environment, both in the US[17] and in emerging market economies, a still supportive euro trade-weighted exchange rate, and improving labour market conditions is emphasised by our specific survey of what Member Federations see as growth drivers (Fig 16).

In contrast, policy uncertainty and geopolitical tensions remain a significant concern, with an even slightly stronger negative impact expected on growth in the coming 12 months as over the last year.

So far, EU growth has been largely resilient thanks to a number of well-known favourable factors such as the past depreciation of the euro exchange rate, ECB policy support and relatively low oil prices. However, given the temporary nature of these supportive factors as well as low estimates for potential growth in the EU, the weakness in investment and slow implementation of product and labour market reforms in many Member States remain of particular concern.

[17] though Q1 US growth disappointed with 0.2%, after 0.5% in Q4

Figure 16 Policy uncertainty and geopolitical tensions remain key obstacles to growth
Changing impact of specific factors on growth forecast



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

4. UNEMPLOYMENT, INFLATION AND PUBLIC FINANCES

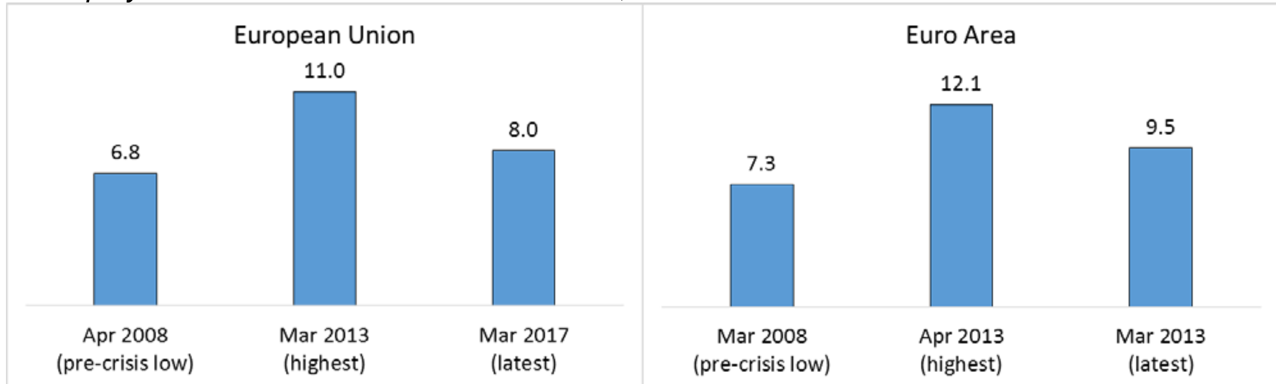
Gradual reduction in unemployment rates but from high levels

Labour market conditions continued to improve in recent months, with unemployment rates falling. Over 3.2 million new jobs were created in the EU over the last year alone.

Over the upcoming two years, we expect unemployment rates to further improve and to come down from current rates of 8.0% in the EU and 9.5% in the Euro Area (March 2017), to 7.7% in the EU and 8.6% in the Euro Area this year and to 7.3% and 8.1%, respectively, in 2018.

While this is a strong improvement compared to 2013 heights, unemployment remains still well above pre-crisis levels (and is not expected to return to pre-crisis levels over our forecast horizon), suggesting that the legacies of the financial crisis and ensuing sovereign debt crisis in the Euro Area have not yet been fully offset (Fig 17). Strong country differences continue to persist and high rates of youth unemployment (17.3% in the EU in Feb), the high percentage of long-term unemployed (46.4% of the unemployed), and unemployment among the low-skilled (16.1% in 2016) remain important concerns. In some firms we start seeing increasing difficulties in recruiting skilled labour.

Figure 17 Unemployment gradually decreasing, but still above pre-crisis level
Unemployment rates in the EU and Euro Area, %



Source: Eurostat

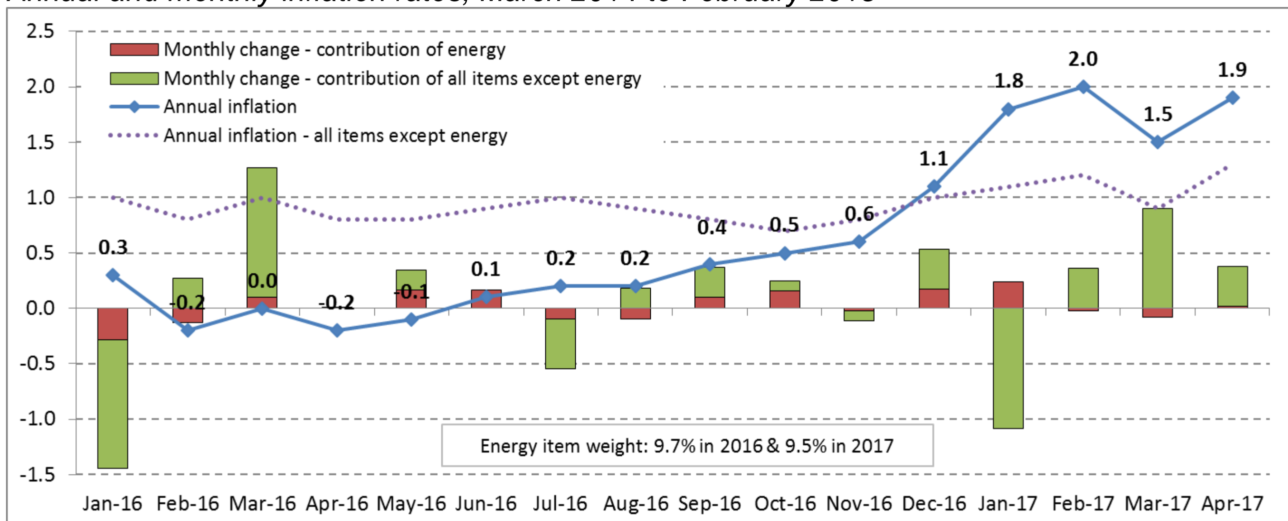
Inflation prospects increase mainly due to energy price effect

Euro area annual headline inflation has picked up since mid-2016, with price increases surpassing 1% as of last December (fig 13). However, core inflation (excluding energy) has hovered consistently at slightly below 1%, indicating that the recent pick-up of headline inflation was primarily an energy story. Only this April core inflation increased more strongly which is likely linked to the late Easter holiday (spending took place in April this year, but in March in the last year).

As Figure 18 shows, the previous fall of energy prices is now dropping out of the index, with energy prices having largely contributed positively to month-on-month inflation over the last year, pulling up headline rates (as measured against the same month of the previous year).

This development is expected to continue until the second half of this year, leading to an expected inflation rate of 1.5% for 2017 for the Euro Area. For 2018 we assume the energy component to have a smaller positive impact and inflation to be 1.4%.

Figure 18 Inflation increased since mid-2016 mainly due to energy price developments
Annual and monthly inflation rates, March 2014 to February 2015



Source: Eurostat

5. COUNTRY DIFFERENCES

Economic prospects strengthen across countries while strong divergences remain

For 2017 and 2018 we expect all countries survey to growth again. We expect the strongest growth rates among some of the Eastern European countries such as Romania, Bulgaria, Slovenia and Poland as well as in Malta and Luxembourg. Italy is the only country where growth is expected to be below 1% this year.

There has recently been particular interest in the developments of France, given the presidential elections, and the UK, following the referendum's vote in favour of leaving the EU.

In France, GDP grew at 1.2% in 2016, slightly below the EU average of 1.9%. On a quarterly basis, latest estimates show a slight slowdown of momentum, perhaps linked to political uncertainty ahead of the French presidential elections, with growth of 0.3% in Q1 2017, compared to 0.5% in Q4 of 2016. This first Q1 2017 GDP estimation confirms nevertheless the dynamic pace of household investment (+0.9% q/q) and corporate investment (+1.3% q/q after +0.9% q/q in Q4 2016) thanks to measures such as the "extra depreciation" which has ended in April and the "CICE" which allowed a rebound in corporates' margins. According to the latest forecast of our French member (MEDEF), conducted before the elections, the French economy is expected to grow by 1.3% in both 2017 and 2018 and thus at a similar rate compared to last year.

After the first round of the French elections on 23 April, we observed a strong market reaction, with for example the Eurostoxx increasing by 4% the following day and the euro increasing by more than 1% against the US Dollar, indicating market participants anticipating stronger economic and business growth. BusinessEurope has congratulated the newly elected President Emmanuel Macron, with President Emma Marcegaglia noting that "this strong and clear vote in one of the EU's largest founding countries opens the door to moving the European project forward. We are sure that France will strengthen its role in creating a strong and competitive Europe."

Regarding the UK, the latest forecast from our member (CBI) dates back to November 2016, with growth expected to be 1.3% in 2017 and 1.1% in 2018. However, the CBI now believes that UK growth over 2017 is likely to be somewhat stronger than previously forecast, mostly due to the resilience of the UK economy after the EU referendum. However, the outlook for growth remains tepid, particularly given that much of the recent strength in the economy has been driven by household spending, which is likely to soften going forward. Reporting on the results of their latest business surveys, their chief economist noted for example that "while firms expect to see steady growth over the next three months, the headwinds countering this are also picking up strength. Rising inflation has taken the edge off real household incomes over the last few months. And with inflation set to rise further still, real earnings are likely to take a greater hit, which will put a larger dent in households' spending power." In addition, uncertainty in relation the negotiations regarding the UK's withdrawal from the EU is expected to deter business investment with forword planning becoming more difficult for companies.

In line with generally higher growth, unemployment rates are expected to fall across countries. Germany and the Czech Republic are the countries with the lowest expected rates, in contrast to Greece, Spain, Croatia, Cyprus and Italy where unemployment is expected to remain above 10% over the forecast horizon.

Finally, inflation prospects gradually increase with rates expected to surpass 2% in Lithuania, Hungary, Estonia, the Czech Republic, Belgium and the United Kingdom.

Table 2: Wide growth divergence in surveyed countries in 2016 and 2017[18]

Main forecasts for all the economies surveyed.

	Real GDP growth		Inflation		Unemployment	
% Change	**2017**	**2018**	**2017**	**2018**	**2017**	**2018**
Austria	1.7	1.5	1.9	1.9	5.9	6.0
Belgium	1.7	1.8	2.2	1.5	7.4	7.0
Cyprus	2.5	2.4	0.8	1.3	11.0	10.0
Estonia	2.3	2.6	2.4	2.5	7.2	7.5
Finland	1.7	1.5	0.8	1.4	8.4	8.1
France	1.3	1.3	1.3	1.1	9.4	9.0
Germany	1.5	1.8	1.8	1.7	3.6	3.3
Greece	2.5	3.0	1.3	1.0	22.0	21.0
Ireland	3.1	2.8	0.7	1.2	6.8	6.2
Italy	0.8	1.0	0.7	1.4	11.0	10.5
Latvia	3.2	3.5	2.2	2.0	9.2	8.7
Lithuania	2.6	2.8	2.8	2.2	7.2	7.1
Luxembourg	4.2	4.0	2.0	2.0	6.2	6.1
Malta	3.7	3.7	1.4	1.6	4.9	4.9
Netherlands	2.1	1.8	1.6	1.4	4.9	4.7
Portugal	1.8	1.7	1.6	1.5	9.9	9.0
Slovak Republic	3.1	3.2	1.0	1.4	8.5	8.0
Slovenia	3.6	3.2	1.8	1.6	7.0	6.4
Spain	2.8	2.3	2.0	1.1	17.5	15.8
Bulgaria	3.7	3.5	0.6	1.2	8.2	8.0
Croatia	3.0	3.2	1.6	///	13.9	///
Czech Republic	2.6	2.8	2.4	2.0	3.3	3.2
Denmark	1.5	1.7	1.3	1.6	6.3	6.3
Hungary	3.2	3.7	2.5	3.0	4.1	4.0
Poland	3.6	3.4	2.0	2.1	4.9	4.8
Romania	4.3	3.7	1.1	3.0	5.4	5.3
Sweden	2.5	2.1	1.4	1.7	6.7	6.5
United Kingdom*	1.3	1.1	2.2	2.4	5.2	5.3
Norway	1.9	1.5	///	///	4.4	4.2

** The UK forecast dates back to November 2016.*

Source: BusinessEurope's survey of member federations

[18] Note that for blank surveys we used figures from the spring 2017 forecast of the European Commission. This is the case for Latvia and Romania.

BusinessEurope is the leading advocate for growth and competitiveness at the European level, standing up for companies across the continent and campaigning on the issues that most influence their performance. A recognised social partner, we speak for all-sized enterprises in 34 European countries whose national business federations are our direct members.

Austria	Belgium	Bulgaria	Croatia	Cyprus	Czech Republic
Denmark	Denmark	Estonia	Finland	France	Germany
Germany	Greece	Hungary	Iceland	Iceland	Ireland
Italy	Latvia	Lithuania	Luxembourg	Malta	Montenegro
Norway	Poland	Portugal	Rep. of San Marino	Serbia	Slovak Republic
Slovenia	Spain	Sweden	Switzerland	The Netherlands	Switzerland
Turkey	Turkey	United Kingdom			

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