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BUSINESSEUROPE SUMMER ECONOMIC OUTLOOK 7 July 2022

EUROPEAN BUSINESSES FACE A DIFFICULT PERIOD AS COSTS RISE AND GROWTH FALLS

ECONOMIC SITUATION

- **The EU economy**, in common with much of the global economy, **is facing a very difficult period**. Whilst some services sectors, are continuing to benefit from further reopening following Covid, many industrial sectors have seen either output hit by **continuing global supply chain issues** exacerbated by shutdowns in China or are suffering due to **rising energy and raw material prices**.

- Our forecast is for the EU economy to **grow by 2.6% between 2021 and 2022** (a downward revision of 1.3% from our Autumn forecast). But **'within year' growth in 2022 is expected to be just 0.6%**, raising the prospect that individual Member States may experience at least 'technical recessions' during 2022. We anticipate **Euro Area inflation of 6.5% in 2022, falling to 2.6% in 2023**. But this will depend upon a fall in energy prices and moderate wage increases amidst a very tight labour market.

POLICY RECOMMENDATION

- **Macroeconomic policymakers need to find a proper balance between controlling inflation and the need to support the recovery while avoiding recessive effects**. The application of the flexibility of the Stability and Growth Pact rules in 2023 as a consequence of increased short-term government spending requirements related to the Ukraine war must not delay the long-term **strengthening of public finances**. It remains essential to make the best use of the **EU's Recovery and Resilience facility** to drive productive investment and reform.

- With inflationary pressures continuing to rise, the ECB has set out further steps towards the **normalisation of monetary policy**. But all players need to be vigilant to the growth of inflationary expectations. Social partners need to engage responsibly in collective bargaining on wages and help ensure that temporary price rises **do not give rise to a damaging wage-price spiral**.

- To avoid a worsening of the current **energy crisis** and make the green transition economically and socially workable, the EU needs a coordinated plan to **decrease Europe's energy dependency**, bring down barriers to an integrated European energy market, and facilitate investment in all zero- and low-carbon energy sources and solutions.

- The EU must pursue an ambitious trade policy that can respond to successive shock by building coalitions with like-minded partners and diversify sources of supply. This means the acceleration of ratification of negotiated **bilateral trade agreements** such as with Mercosur, Mexico, and Chile and the deepening of trade relations with **key international partners such as the US and the UK**.

ABOUT THE ECONOMIC OUTLOOK

BusinessEurope publishes a biannual Economic Outlook that provides business insight into recent and projected economic developments in Europe.

In producing our economic projections and assessing current challenges and developments in the international and regional economy, BusinessEurope works closely with its member federations and draws on their specialist expertise and detailed knowledge of their national economies and ongoing interactions with business.

In particular, our EU27 and Euro Area forecasts are a reflection of the GDP-size weighted economic forecasts from each member state from the economic research departments of our national member federations. Our economic projections are therefore informed by leading country experts with in-depth knowledge and day-to-day monitoring of the economic situation in every EU member state.

This outlook has benefitted from the work of Grégoire Magne, during his internship at BusinessEurope.

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INTRODUCTION

The EU economy, in common with much of the global economy, is facing a very difficult period. Whilst some services sectors, notably travel and tourism are continuing to benefit from further reopening following Covid, many industrial sectors have seen either output hit by continuing global supply chain issues, particularly related to recent COVID restrictions in China, or are suffering due to rising energy and raw material prices. Across the EU economy, firms are also facing tight labour markets, with record levels of vacancies and skill shortages.

With Euro Area inflation now running at 8.6%, and core inflation at 3.7%, we expect domestic demand to be reduced in the coming month, both from hit to real incomes that high energy and food prices, in particular, are having on household incomes, and from impact of expected interest rate rises by the ECB in the coming months on both household disposable income and business investment; already subdued due to increased uncertainty.

Table 1: BusinessEurope economic forecast, growth slows and inflationary pressures mount
Forecast based on economic analysis from each EU28 member state, aggregated based on GDP relative to total EU / Euro Area GDP

	EU		Euro Area	
Main variables	**2022**	**2023**	**2022**	**2023**
Real GDP (annual % growth)	2.6	2.1	2.5	1.9
Inflation (%)	7.1	3.2	6.5	2.6
Unemployment (%)	6.3	6.1	6.6	6.4
Government net lending (% of GDP)	-1.5	-1.2	-0.8	-0.6

Source: Own calculations based on member federations' forecasts

Our forecast is for the EU economy to grow by 2.6% between 2021 and 2022 although 2 percentage points of this growth reflects the strong growth that took place within 2021 the so-called 'carry-over'. Within year growth in 2022 is expected to be just 0.6%, raising the prospect, as we explore in the country differences section, that individual Member States may experience at least 'technical recessions' during 2022, with two or more periods of negative growth. This represents a downward revision of 1.3% from our Autumn forecast, with members suggesting this can largely be accounted for by the shock to both output and confidence resulting from the Russian invasion of Ukraine (an issue we explored in more detail in our 2022 Reform Barometer[1]).

We anticipate Euro Area inflation of 7.1% in 2022, falling to 3.2% in 2023. But this will depend upon a fall in energy prices and moderate wage increases amidst a very tight labour market.

[1] https://www.businesseurope.eu/sites/buseur/files/media/reports_and_studies/reform_barometer_2022/2022-03-23_reform_barometer_2022_final.pdf

1. HIGHER PRICES FOR IMPORTED ENERGY ARE CREATING A DRAG ON GROWTH

Table 2, below, shows in more detail the changes in the main components of growth. Overall, we still see a picture of the EU economy continuing to bounce back from the severest Covid related restrictions on activity experienced in 2020, with private consumption growth still expected to be above 3% in 2022. However, compared to 2021, growth is clearly being given less of a boost by public expenditure, given we the strong growth we saw in public expenditure at the start of the pandemic.

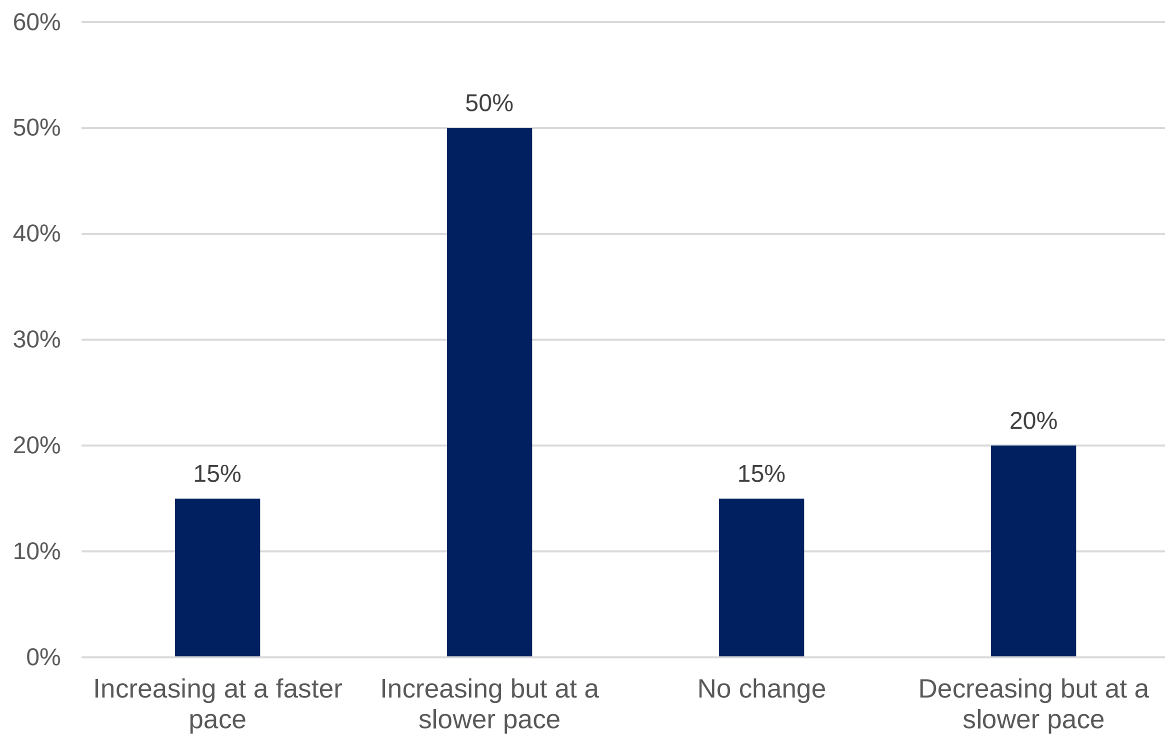
Table 2: Private consumption remains main growth driver
Percent growth expected by European business in 2022 and 2023

	2021		2022		2023	
	Euro area	EU 27	Euro area	EU 27	Euro area	EU 27
GDP	5,5	5.5	2.5	2.6	1.9	2.1
Private consumption	3,5	4.0	3.0	3.1	2.3	2.5
Public consumption	3,8	3.6	1.2	1.3	0.5	0.7
Investment *(Gross Fixed Capital Formation)*	6.1	5.5	3.4	3.3	3.0	3.2
Exports	11,2	11.1	4.9	4.9	4.3	4.3
Imports	10,1	10.6	5.1	5.1	4.5	4.5
Net trade	*1.1*	*0.5*	*-0.2*	*-0.2*	*-0.2*	*-0.2*

Source: Own calculations based on member federations' forecasts

Whilst **investment** across the economy continues to provide a positive boost to growth, there are clear signs that businesses investment intentions are starting to soften, given the more uncertain global outlook, with our survey of member federations suggesting that most companies will continue to increase their investment, but at a slower pace than previously (graph 1).

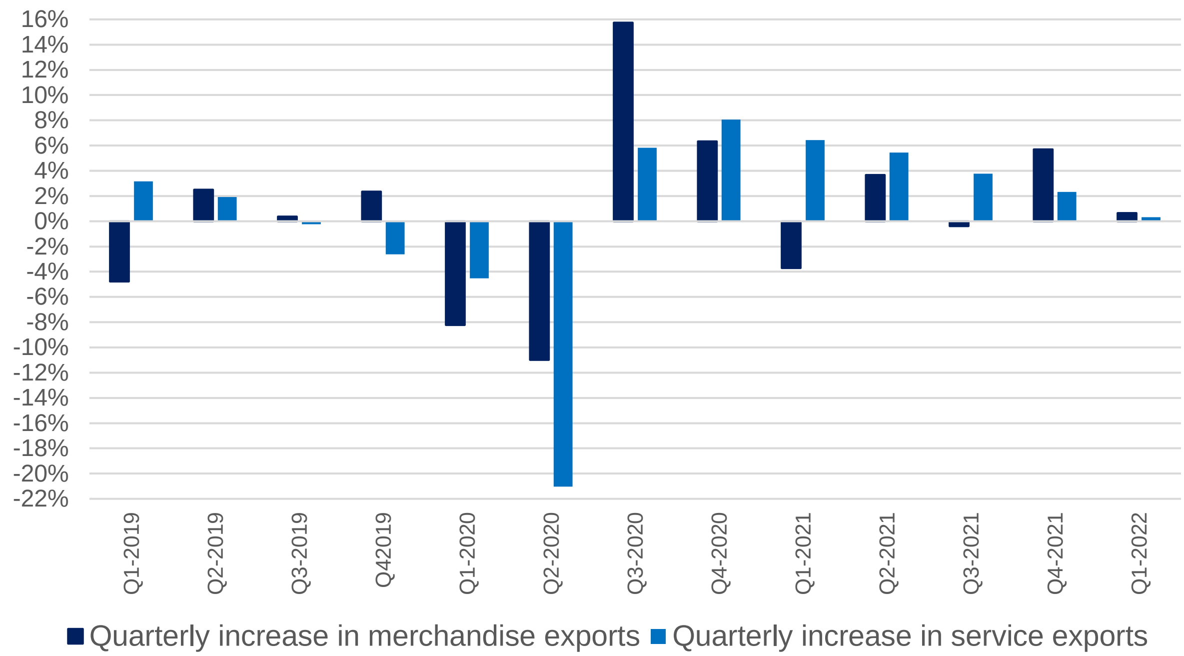
Graph 1: European businesses expect a slowdown in investment
Member federations' view on the most likely investment trend (Industry/Services) over the next 6 months



Source: member federations

EU external trade is also expected to continue to bounce back after falling significantly at the height of Covid disruptions in 2020. Our forecast is for EU trade growth of over 4% in both 2022 and 2023, slightly higher than the most recent global trade data from UNCTAD (graph 2). But given the EU is a net importer of energy, global prices rise in this area are contributing to growing imports, with the result that net trade is actually expected to be a negative factor for EU growth in the coming years.

Graph 2: International trade growth slowed in Q1 2022
Quarterly increase in merchandise and service exports in the world

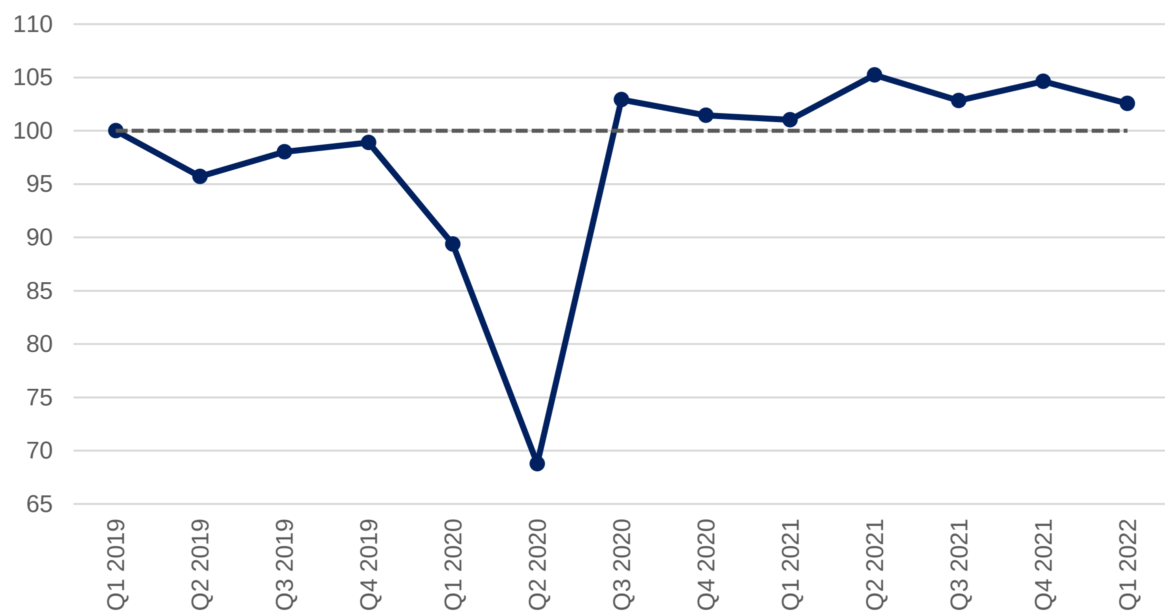


Source: United Nations Conference on Trade and Development (UNCTAD), Global Trade Update 2022 and UNCTADStat

2. ACCESS TO FINANCE AND BANKRUPTCIES

The strong support to businesses and workers, as has been well documented, meant that bankruptcies actually feel significantly during 2020. Whilst bankruptcies bounced back above pre-crisis levels in 2020, there has been no dramatic increases in company closures, suggesting that governments have acted carefully in gradually withdrawing covid related support.

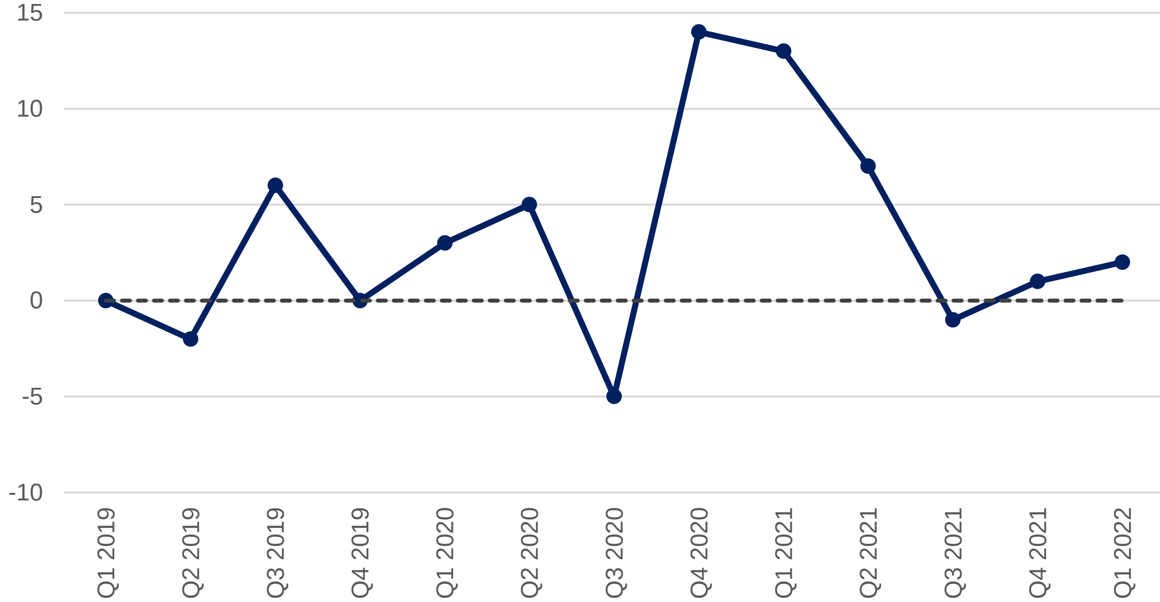
Graph 3: Bankruptcy levels remain relatively modest
Bankruptcy index – quarterly data (Q1 2019=100)



Source: NACE Rev.2 (Eurostat)

As well as government support, the low level of bankruptcies has been supported by liquidity support for businesses, funneled through the banking system (for example via the ECB's TLTRO). Whilst credit conditions generally tightened during the latter part of 2020, recent data from the ECB's lending survey (graph 4) doesn't point to a dramatic tightening of lending conditions. Nevertheless, we will be increasingly vigilant regarding access to finance in the coming months as the ECB seeks to normalize monetary policy. Moreover, implementation of the final Basel III requirements within the EU, also presents a risk in the terms of reducing access to finance for companies, particularly in relation to our overseas competitors.

Graph 4: We have seen a slight tightened of credit standards for bank lending
net balance in % in credit standards for loans to NFCs

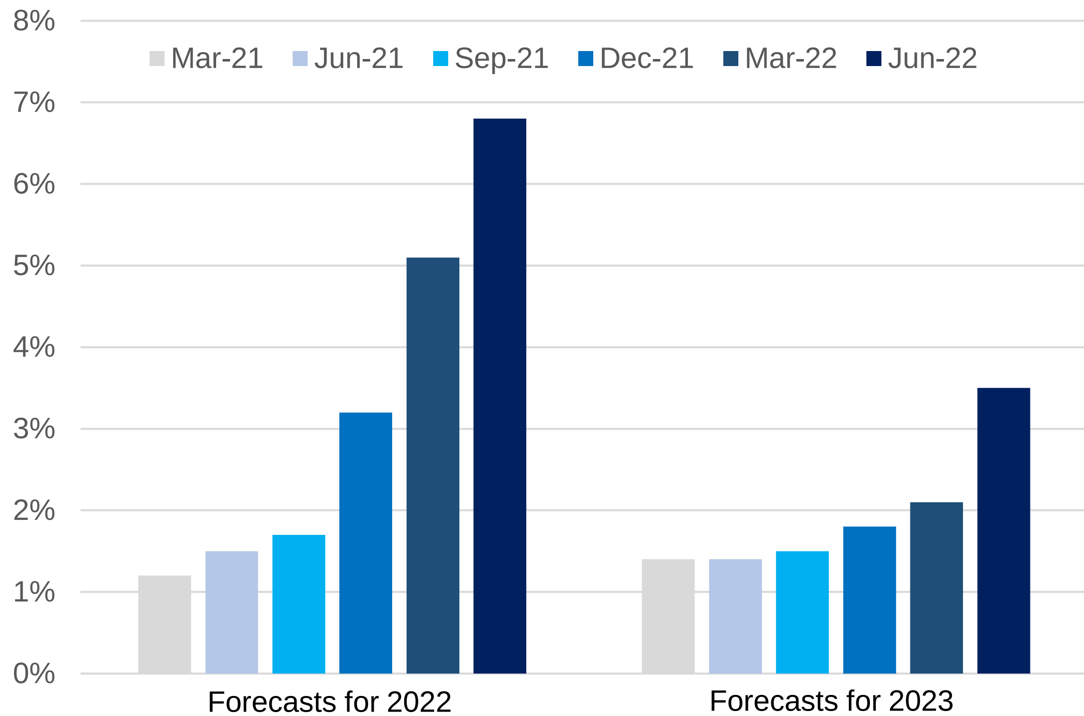


Source: European Central Bank

3. INFLATION

Since our Autumn forecast, we have seen a significant increase in inflationary pressures. The ECB, having expected in its September 2021 forecast, Euro Area inflation to be around 1.5% in 2022, had by June 2022, increased this forecast to 6.8% (Graph 5). Whilst revisions to the 2023 forecast have been more limited, the ECB's 3.5% forecast for 2023 is, it should be noted, based on a sharp decline in energy inflation, as well as compensation per employee not rising above 3.6% in 2022, with the forecast clear particularly uncertain given the war in Ukraine.

Graph 5: The ECB has had to remove up its inflation forecasts over the past year
Euro area – HICP forecast



Source: European Central Bank – Macroeconomic projections

As widely noted, the rise in inflation has been primarily driven by rises in energy and broader commodity prices, with graph 6, in particular showing the huge rise in gas prices, since last Spring (noting much of the increase in the gas price took place prior to the Ukraine war.)

Such huge energy and food prices are reflected in the fact that whilst overall HICP inflation was 8.6% in the 12 months to June 2022, 'core' inflation, excluding energy, food, alcohol, and tobacco was a more modest 3.7%.

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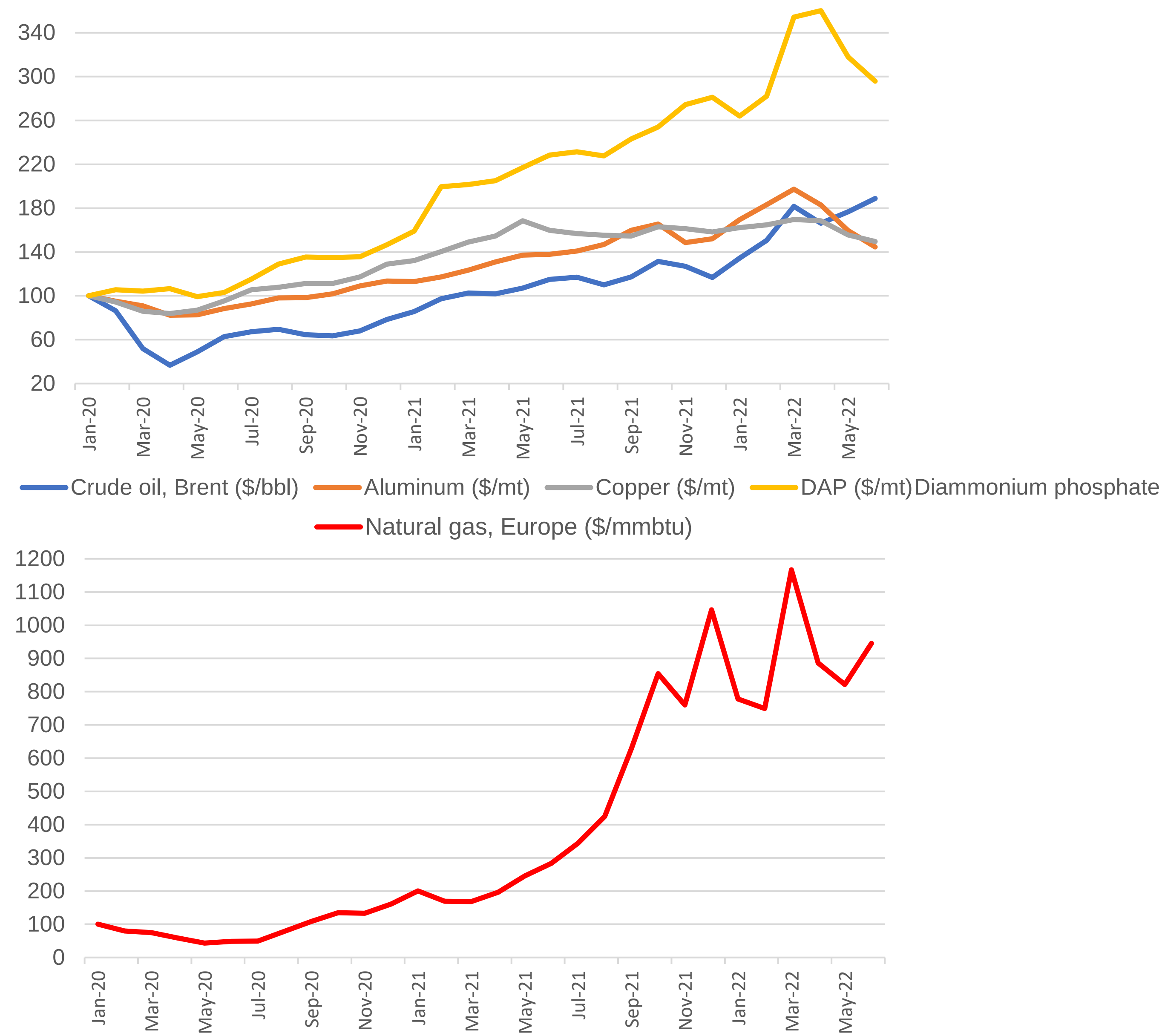
Graph 6: Commodity prices have risen enormously, but there are signs that prices may be peaking
January 2020=100



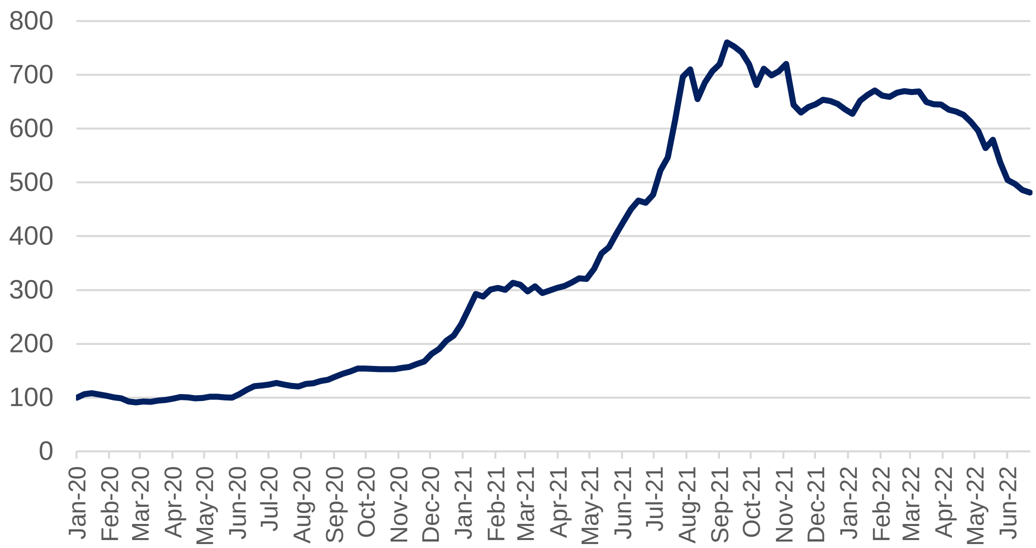
Source: World Bank

Alongside this, the bottlenecks in global supply chains that developed as the global economy reopened following Covid have also increased inflationary pressures. Although, as the IMF note, such supply bottlenecks are generally anticipated to ease through 2022, including as production responds to higher prices, factors such as recent covid related lockdowns in China, as well as the Ukraine war are likely prolonged disruptions in some sectors into 2023. For instance, Russia and Ukraine together account for 30% of worldwide wheat exports, 20% of gas or corn and 11% of oil.

On a positive note, there has been some drop off in the global cost of container transport (graph 7), although average prices remain on average over 5 times higher than pre-covid levels.

Such price rises are clearly putting competitive pressures on many EU companies, particularly energy-intensive industries who are competing in global markets against firms who may have seen less dramatic rises in inputs. Many companies will have little choice but to pass some of the increased input costs onto consumers, or as the ECB notes, ‘about one percentage point in the current inflation rate for non-energy industrial goods can be attributed to the indirect impact of elevated energy costs and the contribution of bottlenecks’ suggesting that with ‘the process the absorption of higher energy costs across all sectors of the economy… may still have some distance to run[2].

Graph 7: Global shipping prices have stabilized, albeit at very high levels
Weekly prices - January 2020 = 100

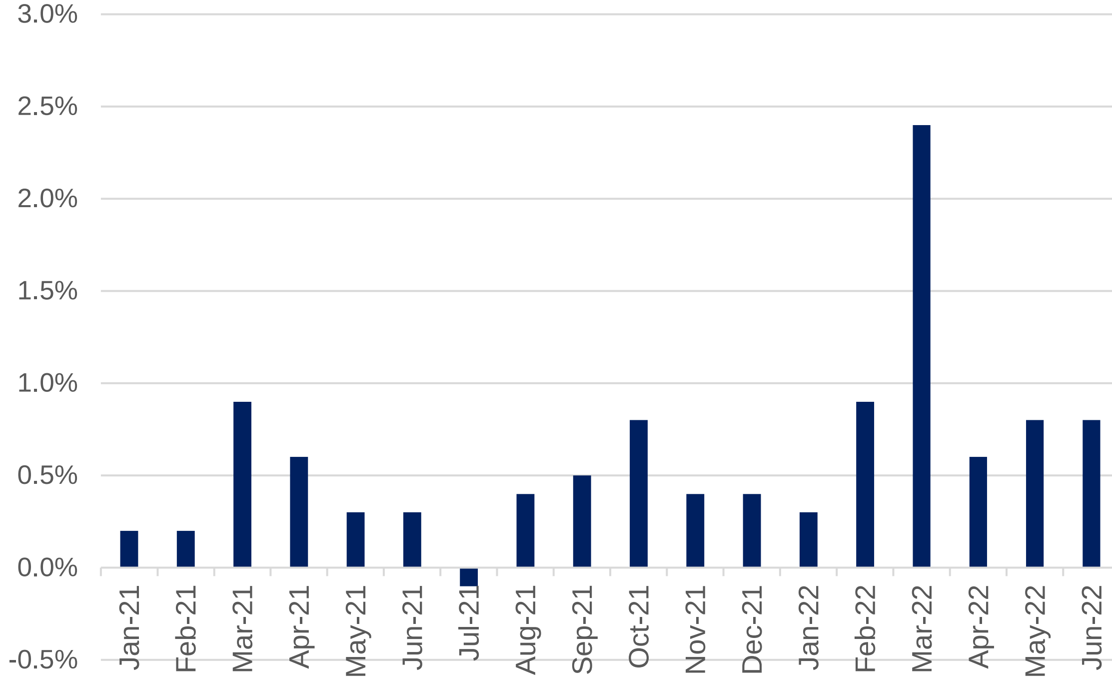


Source: Freightos

Looking in more detail at prospects for inflation in the coming months, a good starting point, is to consider monthly price prices, given these will have an immediate impact on inflation as they drop out of the index once 12 months passes (so-called base effects). Graph 8 shows that we saw a particularly strongly monthly increase in (energy drive) inflation in March and April 2021, which would normally have provided some dampening to inflation when the monthly rises dropped out of the index in March and April 2022, but with monthly rises so high in March 2022, inflation also increased. The chart shows that we won’t be until September and, particular October, that we can once again expected a strong dampening from such base effects.

[2] Speech by Philip Lane, at Bruegel, 5th May
https://www.ecb.europa.eu/press/key/date/2022/html/ecb.sp220505~dcbd30ecb6.en.html

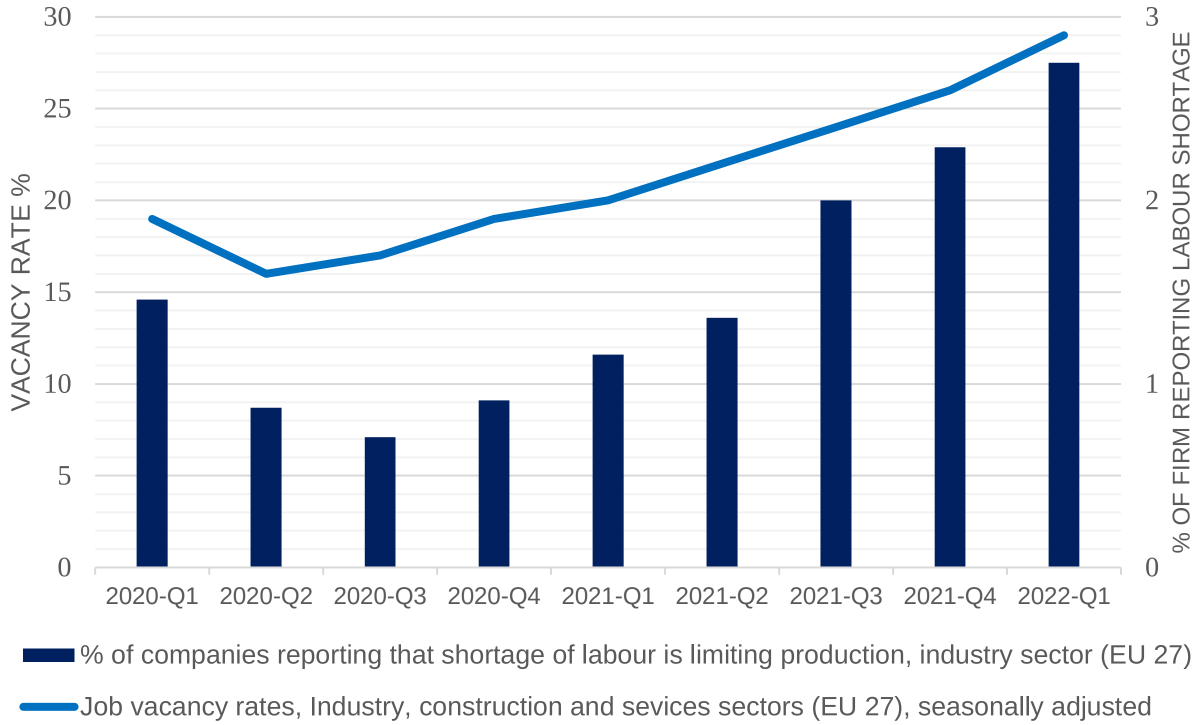
Graph 8: Monthly Harmonized index of Consumer Prices (HICP) rate in the Euro Area
Monthly rate of change in %



Source: Eurostat

A key factor going forwards will clearly be the development of wages, given these are for most companies, the most significant cost. Whilst some labour market measures, notably hours worked, might suggest there is some slack in the labour market, when compared to the pre-covid trends, the experiences of many businesses is that the labour market is already tight at the present. Graph 9 shows that both job vacancies and the number of companies reporting that a shortage of labour is a constraint on production are at unusually high levels. In this context, wage agreements of the magnitude of around 3% for 2022 and 2.5% for 2023, which the ECB's experimental wage tracker suggests has been the average since the start of the year, would suggest there remains an expectation, at least at present, that high inflation is likely to be temporary.

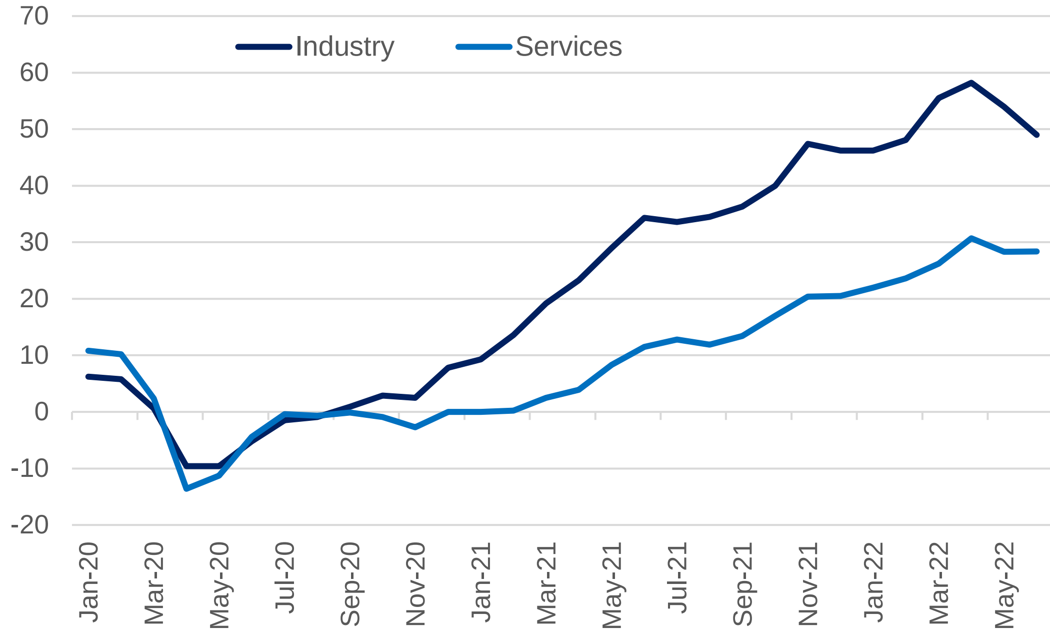
Graph 9: Components contributing to a very tight labour market
Share of companies in the industry sector reporting that shortage of labour is limiting production and job vacancy rates - EU 27 - seasonally adjusted



Source: Directorate General for Economic and Financial Affairs and Eurostat

But a more detailed look at inflationary expectations does present some warning signs. Graph 10 shows that there has been an increased number of firms expecting price rises since the end of 2020, led initially by industry, but later joined by service companies, although in both sectors, the number of firms expecting price rises fell in May 2022. Perhaps of more concern is the ECB's new consumer expectations survey, which saw an increase in average consumer inflation expectations from 4% to 5% in March 2022, with, in particular, more consumers now expecting inflation this year of above 4%.

Graph 10: Firms expect prices to rise further in the coming months
Net Balance of Firms Expecting Price Rises in the next 3 months - Seasonally adjusted Data for European Industry and Services



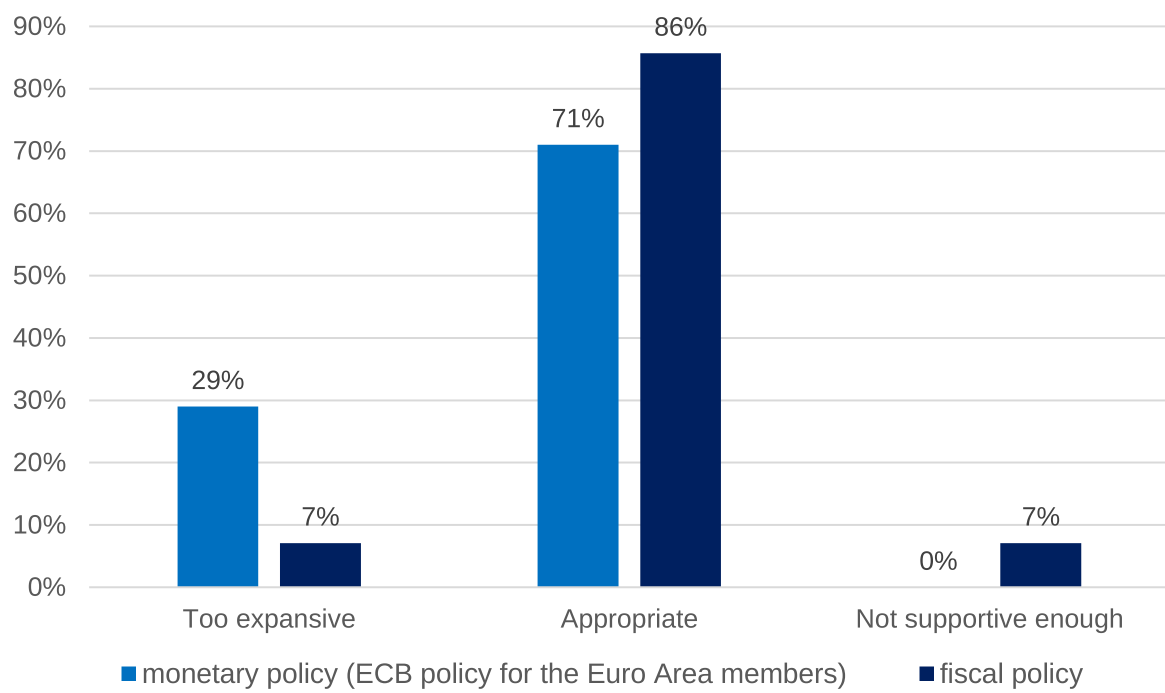
Source: EU Commission – Business survey

4. MACROECONOMIC POLICY MAKERS FACE A DIFFICULT BALANCING ACT

With the EU economy still not fully recovered from the Covid shock and now facing additional negative pressures from global energy, commodity and supply chain shortagse, all of which have been exacerbated by the war in Ukraine and are contributing to rising inflation pressures, macroeconomic policy making at present is clearly particularly challenging.

The survey of our Euro Area based Member Federations (Graph 11) suggests that macroeconomic policy makers for the Euro Area have essentially made the right choices, with for example, over 80% of Federations considering the fiscal stance to be appropriate. In the case of monetary policy, 70% of members consider the ECB's overall stance (including its forward guidance), as set out when the survey was undertaken prior to the governing council's June meeting to be appropriate, although there were a significant minority of members (36%), who *viewed the ECB's policy at the time as too loose.*

Graph 11: European Businesses find fiscal policy appropriate for the Member States but are more divided on monetary policies, almost a third finding it too expansive
Percentage of BusinessEurope member federations from the Euro Area suggesting that, given national circumstances, monetary and member states' fiscal policies are too expansive/appropriate/not expansive enough



Source: Member federations

On the fiscal side, the Commission has now proposed that the rules of the Stability and Growth Pact be suspended once again in 2023 given the impact of the Ukraine war on output and public finances. But the suspension of the SGP in 2023 must not delay the long-term strengthening of public finances. In particular, It remains essential to make the best use of the EU's Recovery and Resilience facility to drive productive investment and reform.

On the monetary side, the Ukraine war is clearly having a negative impact on business and consumer confidence– so it was understandable that the ECB acted with caution following the initial outbreak of the war, before setting out important further steps towards the normalisation of monetary policy at its June meeting. In addition, following the ECB's announcement after its ad hoc meeting on 15th June that it will 'accelerate the completion of the design of a new anti-fragmentation instrument', July 21st's ECB governing Council meeting will be followed with increased interest by financial markets.

But we all need to be vigilant to the growth of inflationary expectations. In particular, as a net importer of energy, we cannot escape the fact that higher global energy prices will tend to lower real incomes in the EU. Over 65% of our federations have reported being very concerned about a wage-price spiral, with a further 11% of federations suggesting that such a spiral is already the case in the member states where they are located. In the coming months, social partners need to engage responsibly in collective bargaining on wages and help ensure that temporary price rises do not give rise to a damaging wage-price spiral, which would force a more aggressive monetary policy response than otherwise necessary, and weaken medium-term growth and employment prospects.

5. COUNTRY DIFFERENCES

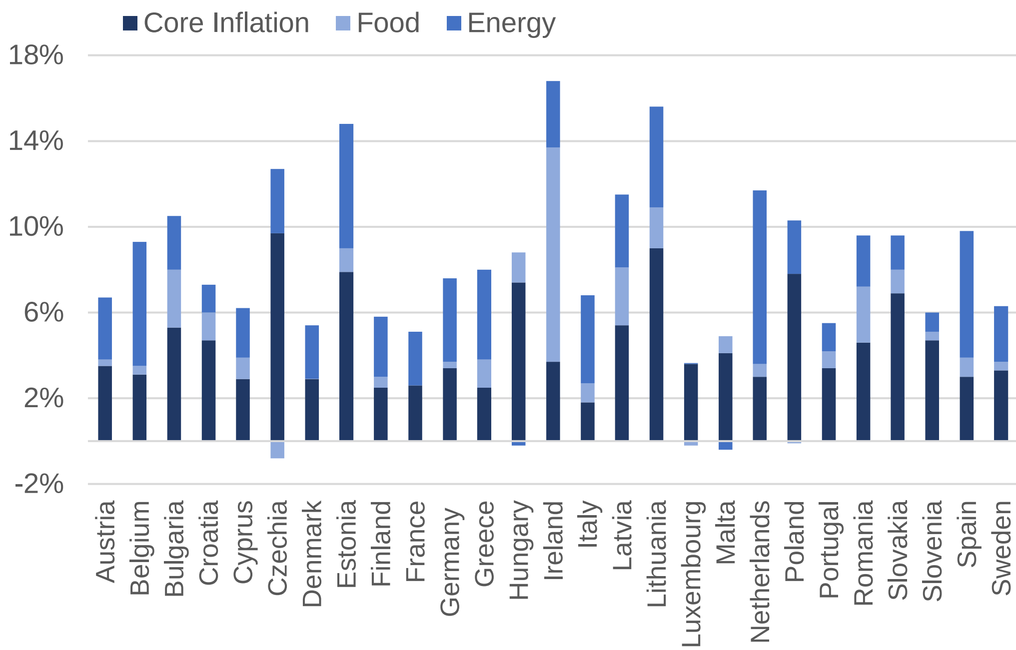
Table 3: GDP and Unemployment for each EU Member State according to Member Federations

	Real GDP growth		Unemployment	
Country	**2022** (Difference from autumn forecast)	**2023**	**2022**	**2023**
Austria	3,2% (-1,3)	0,0%	5,0%	4,8%
Belgium	2,4% (-1,4)	1,8%	6,0%	5,6%
Bulgaria	2,1% (-2,5)	3,1%	5,4%	5,3
Czechia	1,2% (-2,8)	3,5%	2,6%	2,4%
Estonia	1,0% (-2,5)	2,4%	6,8%	6,9%
France	2,5% (-1,2)	0,3%	7,0%	7,1%
Germany	1,5% (-3,0)	2,4%	2,8%	2,7%
Greece	3,5% (-1,0)	3,1%	13,7%	13,1%
Hungary	3,8% (-1,2)	3,0%	4,0%	3,8%
Luxembourg	2,2% (-1,6)	2,7%	5,2%	5,1%
Malta	6,0% (+0,2)	5,3%	3,5%	3,6%
Netherlands	3,6% (+0,1)	1,7%	4,0%	4,3%
Slovenia	4,2% (-0,5)	3,0%	4,3%	4,1%
Spain	4,2% (-1,8)	3,2%	13,7%	12,9%
Sweden	2,5% (-1,1)	1,5%	7,5%	7,0%
Italy	1,9% (-2,3)	1,6%	9,1%	8,8%
Croatia	3,2% (-2,7)	3,5%	6,3%	5,8%
Ireland	4,3% (-0,8)	3,7%	5,0%	4,5%
Denmark	2,9% (+0,3)	1,5%	4,4%	4,4%
Finland	2,0% (-0,9)	1,0%	6,8%	6,7%
Portugal	4,8% (-0,3)	2,8%	6,4%	6,1%
Poland	3,7% (-1,5)	3,0%	4,1%	3,9%
Cyprus	2,7% (-1,1)	3,8%	7,1%	6,4%
Latvia	1,8% (-4,2)	3,2%	7,1%	6,0%
Lithuania	1,7% (-2,2)	2,7%	7,2%	7,2%
Romania	2,6% (-2,3)	3,6%	5,5%	5,3%
Slovakia	2,3% (-3,0)	3,6%	6,7%	6,3%
EU 27	**2,6% (-1,7)**	**2,1%**	**6,3%**	**6,1%**
Euro Area	**2,5% (-1,8)**	**1,9%**	**6,6%**	**6,4%**

Source: BusinessEurope and member federations

Table 3 shows the forecast for each Member State. While macroeconomic forecasts show a slowdown in economic growth, substantial differences within the EU member countries remain. Countries which have experienced the greatest deterioration in their growth forecasts in 2022 since the autumn economic outlook are, as would be expected, the countries of Central and Eastern Europe and which are most linked to Russian energy or broader supply chains.

Graph 12: Annual Inflation Rate – Euro Area - March 2022 (HICP + Energy)



Source: Eurostat

Graph 12 also shows the strong disparities that exist in inflation amongst Member States. Whilst differences in headline inflation can to a certain extent be explained difference in energy price inflation in Member States (itself dependent on the energy mix), they are by no means the determining factor. For example, the relatively low inflation seen in France is in part a result of lower energy inflation, as well as relatively low core inflation. Further underlining the difference in inflationary pressures in Member States, we see most of the inflation in Ireland presently accounted for by food prices rises, whilst food is exerting downward pressure on prices in Czechia, further illustrating the difficult challenges facing the ECB.

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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 35 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	Romania	Serbia
Slovak Republic	Slovenia	Spain	Sweden	Switzerland	Switzerland
The Netherlands	Turkey	Turkey	United Kingdom		

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