

Future of Europe: *Resilience despite the risks*

The European economy, still continuing its economic recovery after the 2008 financial crisis, faces many potential risks. Though varied, they fall into two broad categories. Firstly, a band of social and political pressures which are driving media headlines: a potential 'Brexit', the migrant crisis and the continued rise of nationalist sentiment. Secondly, we have economic issues that have been present for a good few years: high unemployment, low inflation and persistently low economic growth.

52%
OF EU BUSINESS LEADERS
ARE OPTIMISTIC
ABOUT THE FUTURE

Amid this backdrop, how are businesses faring? Grant Thornton's International Business Report (IBR), a quarterly survey of over 2,500 businesses in 36 economies worldwide, put a series of questions to Europe's business leaders to find out.

Our research has found that despite this complex web of pressures, the business community remains resilient in its outlook. There's optimism around the economy's ability to weather the storms. It has held firm in recent months, while support for the European 'project' remains largely robust. However, businesses cite weak economic fundamentals such as low inflation, high unemployment and economic growth as the biggest threats to economic stability. Furthermore, if summer 2016 does bring a UK vote to leave the European Union (EU) and the predicted increase in the flow of migrants materialises, confidence could face its most significant test in recent years.



Francesca Lagerberg
Global leader – tax services and
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Business leaders remain optimistic in face of threats

Our IBR research finds that 34% of business leaders in the EU are more optimistic than pessimistic (net 34%)* in the first quarter (Q1) of 2016.

Despite the risks threatening to destabilise the economy, this has remained remarkably consistent with previous quarters: net 38% in Q4 and Q3 2015. It's higher than the 26% recorded globally in Q1, and compares well with the levels of confidence we saw pre-financial crisis.

Expectations over increased employment among EU business leaders have also remained pretty consistent over the last four quarters (25%, 30%, 26%, 22%).

Underpinning this resilience is a broad based upturn in Gross Domestic Product (GDP) growth. And it's most notable in some economies hardest hit by the financial crisis, who are now

returning to growth. The Economist Intelligence Unit estimates GDP growth in Italy (0.9%), Spain (2.8%) and Greece (1.4%) in 2016.

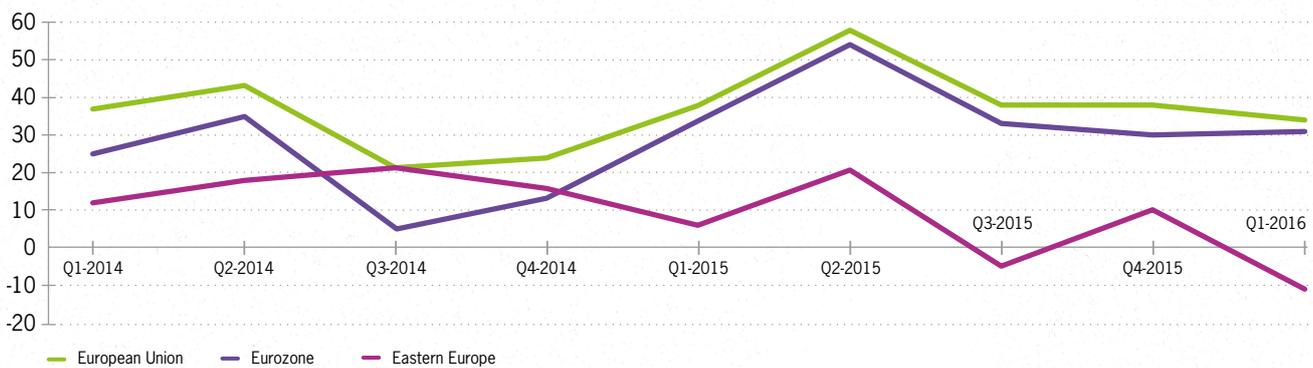
Our IBR data also reveals that seven in ten eurozone business leaders believe the European Central Bank's (ECB's) stimulus measures, including quantitative easing, have had a positive impact.

But confidence is not the same across the region. Net optimism among Eastern European business leaders stands at -11% in Q1 2016, compared to 34% across the EU. Meanwhile in the UK, optimism fell from 73% to just 44% net optimism in Q1, as the referendum on EU membership comes into sharp focus.

The drop in UK business confidence is somewhat ironic, given that the fundamentals of the UK economy are actually quite strong as interest rates, inflation and unemployment remain relatively low, our banks remain well capitalised and corporations maintain high cash balances. However, it is clear that the uncertainty around Brexit and geo-political issues are undermining business confidence.

Robert Hannah, COO, Grant Thornton UK LLP

Net optimism - European country groupings



Source: Grant Thornton IBR Survey

“Despite the Russian economy negatively impacting Eastern Europe and the potential risk associated with high immigration and Brexit, Polish entrepreneurs remain optimistic and confident. My view is that we should proceed positively, yet cautiously.”

Tomasz Wróblewski, CEO, Grant Thornton Poland

*Net optimism is calculated as optimistic business leaders less pessimistic respondents

Businesses are confident economic and political challenges can be met... for now

We asked European business leaders what they saw as the biggest threats to EU economic stability.

Eurozone leaders' top concern, cited by 25% of those surveyed, is the relatively (and historically) low rate of economic growth. This echoes recent concerns by the IMF; while growth has returned to many economies, overall the rate of growth remains stubbornly low. The second biggest concern, cited by 20% of eurozone leaders, is high unemployment.

But they viewed deflation (13%), migration into the EU (10%) and the rise of nationalist parties (12%) as lesser concerns - even with these issues dominating the headlines. They're seen as temporary challenges, the likes of which Europe has seen before. It's the fundamental and longstanding macroeconomic challenges that concern them more so.

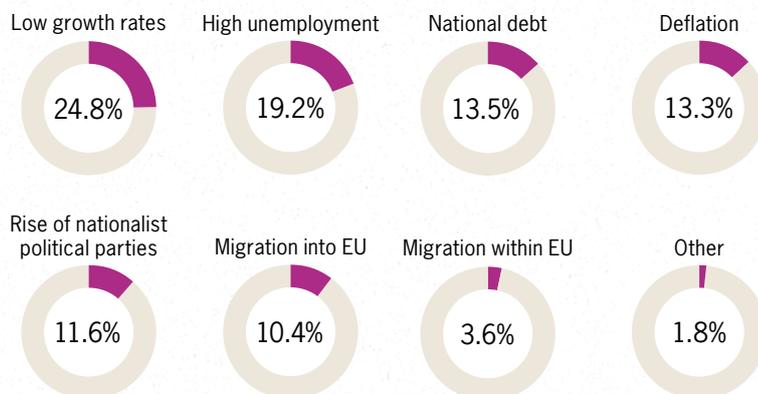
Despite concerns over growth and unemployment, businesses appear confident that policymakers and other authorities can deal with these challenges. For example, our research has found that the reaction to the ECB's quantitative easing programme has been overwhelmingly positive.

As we look ahead to the coming months, what's clear is that we cannot take the current confidence and resilience of the European business community for granted. The warmer summer months could see the flow of migrants into the EU rise - a test for the business outlook if economies start to wobble under the strain. Elsewhere, the referendum on the UK's membership of the EU

looms large. With current polls suggesting the outcome is too close to call, a Brexit is a real possibility. Businesses recognise this would have economic repercussions; nearly eight in ten eurozone business leaders we spoke to recognise that the EU would be negatively impacted if the UK left.

Further afield, US Federal Reserve chair Janet Yellen has hinted that it may slow or delay further increases to the US interest rate, which would mitigate the effectiveness of existing ECB policy to weaken the euro versus other currencies in a bid to jump start economic growth.

Single biggest threat to the economic stability of the EU?



Source: Grant Thornton 2016 IBR Survey

German businesses are slightly optimistic that the ECB's programme will ignite growth and investment in major markets in the EU. Expectations rise that exports and profitability will increase over the year.

Joachim Riese,
CEO,
Warth & Klein
Grant Thornton AG

Recommendations for businesses

Thus far business leaders across Europe don't appear to have let the whirlwind of threats to economic stability affect their outlook and optimism too dramatically.

However, they also recognise that persistently low growth, high unemployment and the shock of a Brexit could all become destabilising factors in the near future if not handled properly. We have seen optimism swing in other regions in the face of economic pressures, for example in the Asia Pacific region last year as concerns about the slowdown in China were high on the agenda.

Persistently low growth, high unemployment and the shock of a Brexit could all become destabilising factors in the near future if not handled properly.

The results of our research show that the factors which businesses feel could destabilise the European economy – low growth, high

unemployment, deflation and national debt levels – are factors largely out of their control. But there are still many actions businesses can take to ensure they are as well insulated as possible in the event of any of these external factors worsening.

This includes reviewing contingency plans and considering whether they reflect the factors businesses are telling us they are most worried about. As part of this review, businesses may consider assessing supply chains to identify any stakeholders or links in the chains that may be particularly vulnerable to worsening economic conditions.

Our findings tell us that business expectations for investment in plant and machinery and new buildings, as well as plans to export goods and services, have remained

TAKE STEPS TO BUILD RESILIENCE TO ENSURE INVESTMENT EXPECTATIONS REMAIN HEALTHY

relatively stable during this period of uncertainty. This is an encouraging sign, but with the potential for economic pressures to grow, reviewing current operations and taking steps to build resilience could ensure those investment expectations remain healthy over the coming months.

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