



# Future of Europe

A region in recovery

May 2017





# Foreword

For so long the eurozone has been a weak pillar of the global economy. Now, in 2017, we're getting used to a new narrative. The economy has been expanding steadily since 2013, outpacing the United States in 2016, and it is on course for its third consecutive year of above-trend growth.

Grant Thornton's International Business Report (IBR), a quarterly survey of 2,500 businesses in 36 economies worldwide, shows that this economic strength is reflected in positive business sentiment. Optimism among business leaders in eurozone countries is at almost a two-year high of net 43%.

Germany remains the dominant force, but it has been joined by other engines of growth, including a newly competitive Spain and a rebounding Ireland. In the year ahead, prospects are expected to further improve for 14 eurozone economies, including France, Ireland and Spain.

Our research shows that European business leaders are brushing off the unknowns of Brexit. They no longer believe it poses an existential threat to the Union; indeed, the majority tell us they would like to see further economic integration. Their confidence doesn't seem to have been hit by a string of general elections in key eurozone states either.

However, the outlook will remain vulnerable to any fallout from Brexit. A large number of businesses predict it will result in a two-tier EU membership model, which would clearly require deep change. And companies haven't avoided the risk of increased protectionism altogether. Despite the defeat of far-right candidates in Austria, the Netherlands and France, our data reveals the rise of populist politics is of growing concern to the European business community. Elections in the UK and Germany are still to come. At the same time, the EU's southern flank remains unsettled.



So, what is the future of Europe? This year we asked this of business leaders and their answers reveal both an enduring belief in the spirit of Europe and uncertainty about its future.

## **Francesca Lagerberg**

Global leader – tax services and regional responsibility for Europe, Grant Thornton

# Business confidence has reached nearly a two-year high

Almost a decade on from the financial crisis, economic growth is boosting business confidence.

Over the past few years, less austerity and demand-stimulating measures from the European Central Bank have helped spur a post-crisis recovery. Now cheap credit, low-cost oil and a weaker euro are resulting in widespread growth. These conditions have seen a healthy increase in investment and consumer spending, along with steadily falling unemployment.

Export expectations in the eurozone grew from 24% to 26% in the first three months of 2017 to the second highest level in any region of the world after Africa. Germany (35%), the Netherlands (30%) and Ireland (28%) saw the most improvement during this timeframe. The eurozone's composite Purchasing Managers' Index (PMI) – an indicator of the economic health of the manufacturing sector – also hit a six-year high in April.

In Spain, structural reforms in labour and product markets have contributed to improving industrial productivity, increasing exports and a sustainable rise in living standards. GDP growth has averaged 2.5% over the past three years, with the economy expanding by 0.8 per cent in the latest quarter.

**But the gains of a eurozone bounce-back are not evenly spread.**

The Greek economy is beginning to show early signs of recovery and the agreed IMF bailout will offer businesses in the region some reassurance for the future. According to our data on expectations for the year ahead, in Q1 2017 48% of Greek firms were anticipating a boost to employment, compared with 14% in Q4 2016. Improvements in profitability at 50% and revenue at 58% were also expected, up from 24% and 34%, respectively, in the previous quarter.

**Optimism\* across the Eurozone is at its highest level in almost two years**



**43%**

Net optimism in Q1 2017



**37%**

Net optimism in Q4 2016

Source: Grant Thornton IBR 2017

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

However, recovery in Greece remains extremely fragile, and it could be some time before debt sustainability, competitiveness and growth make a return.

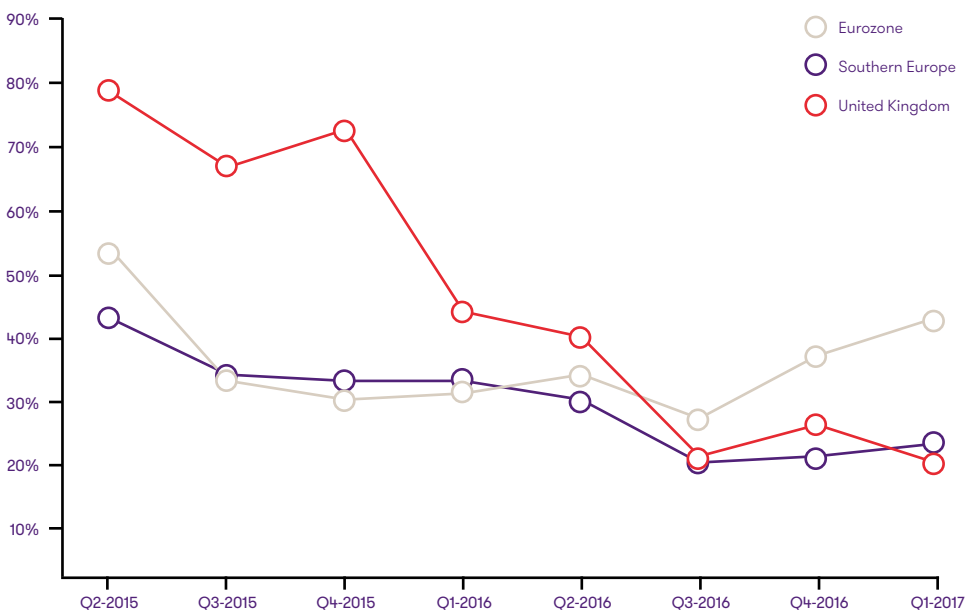
At the same time, continuing problems in Italy could drag on the eurozone’s economic growth this year. Italy is saddled with high levels of public debt – at €2.7 trillion or 133 percent<sup>1</sup> of the total economy. The country suffers from low productivity, excessive regulation and a lack of research and development spending. And because the economy is dominated by small to medium sized businesses, its capital markets are poorly developed. It cannot reduce its debt pile without an expanding economy. Although growth has been sluggish, last year Italian GDP expanded by 0.9% – its fastest pace since 2010 – giving early hope of recovery.

Outside the eurozone, ongoing geopolitical threats – conflict in Iraq and Syria, the migrant crisis, Brexit, and EU policy towards Russia – will continue to affect the continent’s economic trajectory in years to come. Although China’s debt concerns are easing, a possible slump in the Chinese economy cannot be ruled out. This too would have a damaging effect on the developed world.

“The eurozone economy is exceeding expectations, with a good performance restoring business optimism in the past six months. However, threats remain within and outside the eurozone economy that could undermine confidence in the year to come.”

**Mark Bugeja**  
Managing Partner, Malta

**Figure 1: Net optimism – European groupings**



Source: Grant Thornton IBR 2017

<sup>1</sup>Source: Oxford Economics

# The rise and fall of business concerns

The rise in populism is the fastest growing concern among business leaders.



In the context of a solid-looking economic upturn, eurozone businesses are less worried about threats to economic stability this year compared with last.

The longstanding macroeconomic challenge of low growth rates remains the top concern, cited by 20.5% of businesses. However, this has fallen significantly from 24.8% in 2016. Similarly, migration into the EU, deflation, high unemployment and migration within the EU are now seen to pose less of a threat.

On the other hand, high levels of national debt and the rise of populist parties have become significantly more troubling. Ireland (44%), Germany (32%), Finland (28%) and the Netherlands (26%) are particularly worried about the lurch towards nationalism.

**“A fall in economic uncertainty and higher growth are bolstering business expectations. But business leaders are wary of over-confidence.”**

**Joachim Riese**

CEO, Warth & Klein Grant Thornton AG

So far, the rise of far-right parties in mainstream European politics has not dented business optimism, which stands at its highest level in nearly two years (43%). Electoral results in Austria, the Netherlands and France will have undoubtedly strengthened this confidence. However, business leaders recognise that there is still much political risk on the horizon.

**Figure 2: What is the single biggest threat to the economic stability of the EU?**

	Low growth rates	Rise of nationalist political parties	National debt	High unemployment	Deflation	Migration into the EU	Other	Migration within the EU
2017	20.5%	20.3%	17.2%	16.9%	8.5%	4.3%	4.1%	1.8%
2016	24.8%	11.6%	13.5%	19.2%	13.3%	10.4%	1.8%	3.6%

Source: Grant Thornton IBR 2017

### The rise and rise of populism

Populism is unlikely to disappear as a political option given the depth of economic and social challenges facing advanced democracies. The recent defeat of France’s Marine Le Pen may be the third blow to the European far-right in six months, but the populist movement remains stronger than ever and it will continue to have a constraining influence on governing powers.

The German elections in September will be the next big event. The most recent DeutschlandTrend<sup>2</sup> survey released on 22 April gave German Chancellor, Angela Merkel, a 6-point lead over her main challenger, Martin Schulz. Support for Frauke Petry, the leader of the anti-immigrant Alternative for Germany (AfD), has dwindled. But although the forces of populism appear to be receding, recent history has taught us to expect the unexpected: the political landscape could yet change significantly.

In the meantime, many feel the Conservative Party in the UK is poised to win a comfortable majority in the June election by adopting a “hard Brexit” agenda, whereby the UK exits the single market.

“Looking at the wider geopolitical landscape, the far-right may not yet have taken power in Europe, but political populism has certainly taken root. Many businesses recognise the continuing threat of a wave of protectionism that could undermine trade, capital flows and migration. Countries still facing potential political overhaul, or those that could be hurt the most if the Brexit negotiations go badly, are particularly worried.”

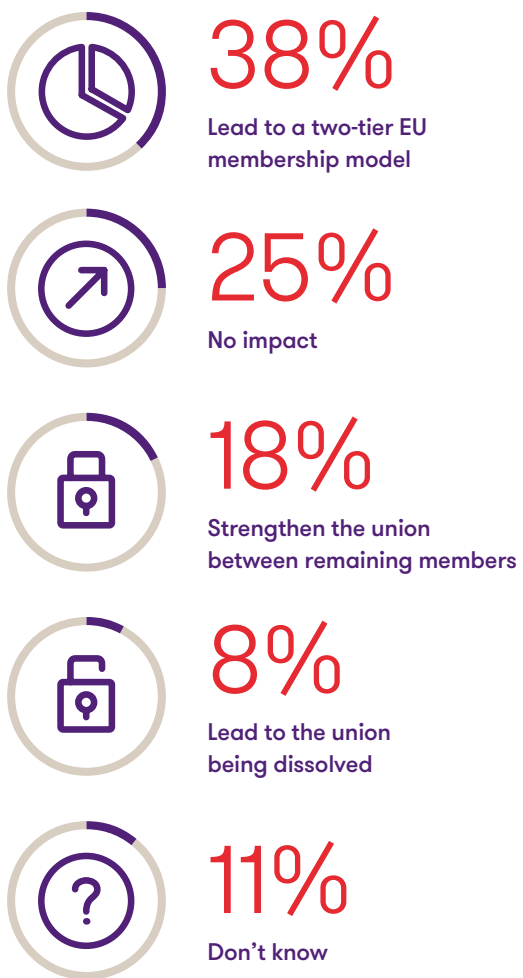
**Alejandro Martinez Borrel**

President, Grant Thornton Spain

<sup>2</sup> <https://www.infratest-dimap.de/en/>

Business leaders do not see Brexit as an existential threat to the Union, and are in favour of further economic – but not political – integration.

## What impact do you think Brexit will have on the EU?



Only 1 in 12 business leaders believe Brexit will lead to the dissolution of the EU. A combined 43% are either neutral or positive, with 25% expecting to see no change to the EU and 18% anticipating that Brexit will strengthen the region. Brexit, they clearly believe, does not pose an existential threat to the Union.

The largest number (38%) predict that Brexit will lead to a two-tier EU membership model. This implies confidence in a deal that will accommodate the UK and not require it to fall back on World Trade Organisation (WTO) agreements. But it also signals doubt in the ability of the EU to carry on as normal; something – and possibly quite a lot – will have to give.

**Trade agreements:** Britons have less confidence in the outcome of trade negotiations than Germans. 45% of business leaders in Germany believe the British Government and the EU will reach a trade agreement that is mutually beneficial to both parties, compared with 39% in the UK. On the whole, European leaders are ambivalent about the negotiations, with 31% feeling unconfident and 37% feeling confident. More than a quarter (26%) feel neither one way or the other, and 6% do not know.

Source: Grant Thornton IBR 2017



The Union is clearly at a crossroads and there is no majority view on what will happen next. (When it comes to the outcome of trade negotiations, the Germans are more confident than the “Brits”.) But, although businesses may be worried about the medium term-impacts, there is continued support for the European project itself. A resounding 92.1% would like to stay inside the eurozone, with just 4.2% wanting to leave.

Countries are less unanimous on the subject of further integration among EU member states. A majority (63%) would like further economic integration, in contrast to a majority (56%) that does not want further political integration. This demonstrates the need for in-depth reform to the EU, a mandate President Macron feels he has been given. However, when it comes to political cooperation, France may discover strong points of difference with the region’s other most stalwart member, Germany (see Figure 3).

**Figure 3: In which of the following ways would you like to see further integration of EU member states?**

	Political	Economic	No further integration
Eurozone	44%	63%	14%
Italy	76%	62%	10%
Germany	55%	67%	13%
Lithuania	46%	68%	6%
Ireland	26%	78%	16%
Malta	22%	71%	12%
Spain	28%	62%	6%
Estonia	28%	62%	24%
Netherlands	26%	62%	22%
Greece	40%	46%	26%
France	24%	60%	15%
Finland	20%	50%	30%

Source: Grant Thornton IBR 2017

**Corporation tax:** The majority of European businesses (53%) would support the setting of EU-wide corporate tax rates, offering perhaps a taste of where further economic integration is wanted. An even playing field is particularly desired by business leaders in Italy (70%), Spain (66%), France (64%) and Greece (62%). However, a handful of countries feel strongly that each country should determine its own rate, including Ireland (94%), Estonia (78%) and the Netherlands (66%). Unsurprisingly, given the government’s plan to lower corporation tax to keep Britain competitive after Brexit, 78% of British businesses would like the UK to set its own rate.

“The French presidential election, the prospect of reconstituting the Franco-German engine and Brexit must be considered as opportunities to consolidate European growth.”

**Daniel Kurkdjian**

Managing Partner, Grant Thornton France

# Recommendations for business

The UK's vote to leave the EU has not proved the shock many feared and Greece is no longer an existential threat to the single currency. Economic data underlines the strength of the eurozone, and our research highlights a rise in business optimism, which is a positive sign for markets.

Therefore, given the current economic and political environment, Grant Thornton recommends that businesses:



## Evaluate finance options to invest for growth

The uncertainty over the future of global trade policies may cause business leaders to act defensively and put investment decisions on hold. Instead, they should monitor developments closely and have contingency plans in place but act to consolidate and extend recent successes by using available finance to invest for the future.

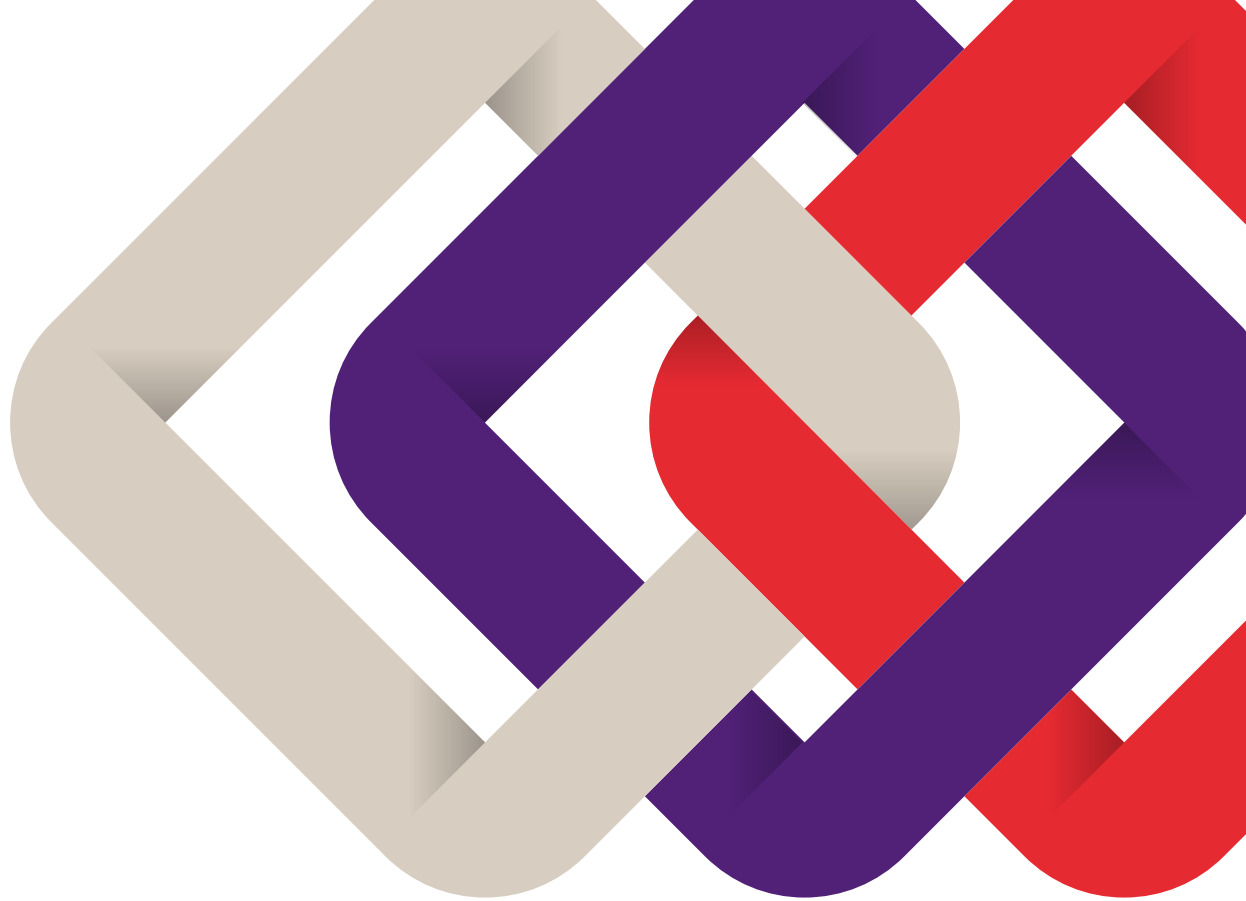


## Assess export strategy for a sustained recovery

Recent economic data demonstrates that business confidence is triggering key investment cycles that are critical to the sustainability of the recovery. Assess your export strategy's suitability to take advantage of where these investments are most likely to strengthen. Growth in US infrastructure and industry investment expectations, for example, represent clear opportunities for trade, particularly in high value capital goods.

Grant Thornton can help you realise your strategic ambitions, drawing on the expertise of over 13,000 people in 250 offices across Europe. Speak to us today about how we can help you grow your business in Europe and beyond.

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### **IBR 2017 methodology**

The Grant Thornton International Business Report (IBR) is the world's leading mid-market business survey, interviewing approximately 2,500 senior executives every quarter in listed and privately-held companies all over the world. Launched in 1992 in nine European countries, the report now surveys more than 10,000 businesses leaders in 36 economies on an annual basis, providing insights on the economic and commercial issues affecting the growth prospects of companies globally. The data in this report are drawn from 922 interviews conducted between January and March 2017 with chief executive officers, managing directors, chairmen and other senior decision-makers from all industry sectors in mid-market businesses in 15 European economies. The definition of mid-market varies across the world: in mainland China, we interview businesses with 100-1,000 employees; in the United States, those with US\$20million to US\$2billion in annual revenues; in Europe, those with 50-499 employees. For the purposes of this research senior management is defined as those holding C-suite jobs, such as chief executive officer (CEO), chief operating officer (COO) or chief finance officer (CFO), managing directors or partners.

### **More information:**

**Publications:** [grantthornton.global](http://grantthornton.global)

**Methodology:** [grantthornton.global](http://grantthornton.global)

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