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GRANT THORNTON INTERNATIONAL BUSINESS REPORT 2012

The future of Europe: clouded by uncertainty

In 1951, in the aftermath of the Second World War, Belgium, France, Germany, Italy, Luxembourg and the Netherlands came together to found the European Union. Over the ensuing years, the EU has grown both in membership, and in economic and political influence to become the largest single market in the world. On 1 Jan 1999 the single currency – the euro – was launched and has now been adopted by 17 of the 27 EU member states.

However, cracks started to appear in 'the European project' in 2010, driven by the sovereign debt crisis. In 2011, these cracks have widened, clouding the future of Europe in uncertainty. This report looks at the situation in Europe (and the future of the single currency) from the perspective of businesses within the eurozone, those in the EU but outside of the single currency, and neighbouring countries outside of the EU.

Key findings:

- **more than three in four businesses in eurozone believe the single currency has benefitted their operations**
- **support for the euro project is highest in Finland and lowest in Italy**
- **most businesses want to see the euro survive, but two in five in Germany want to see some countries dropping out**
- **two in three businesses in both Denmark and Poland want to join the euro, compared to just one in ten in UK**
- **nine in ten businesses in Turkey would like to see further integration with the EU.**

2011 was a tough year…

2011 was arguably the toughest year in the history of the European Union (EU). Most economies ground out some growth to avoid a return to regional recession. However, whilst 2009 was a global problem, in 2011, Europe found itself at the eye of the storm as an escalation of financial problems in southern Europe turned into a full-blown crisis.

Following the bailouts of Greece and Ireland in 2010, Portugal became the third member of the eurozone to turn to the EU and IMF for funds. In Italy and Greece, democratically elected governments were replaced by technocratic officials with the principal aim of reigning in huge budget deficits. Spain and Ireland also turned to new leaders who were faced with the unenviable mission of recovering competitiveness whilst implementing austerity.

NET BUSINESS OPTIMISM FOR 2012:

-17%

FIGURE 1: BUSINESS CONFIDENCE PLUMMETS

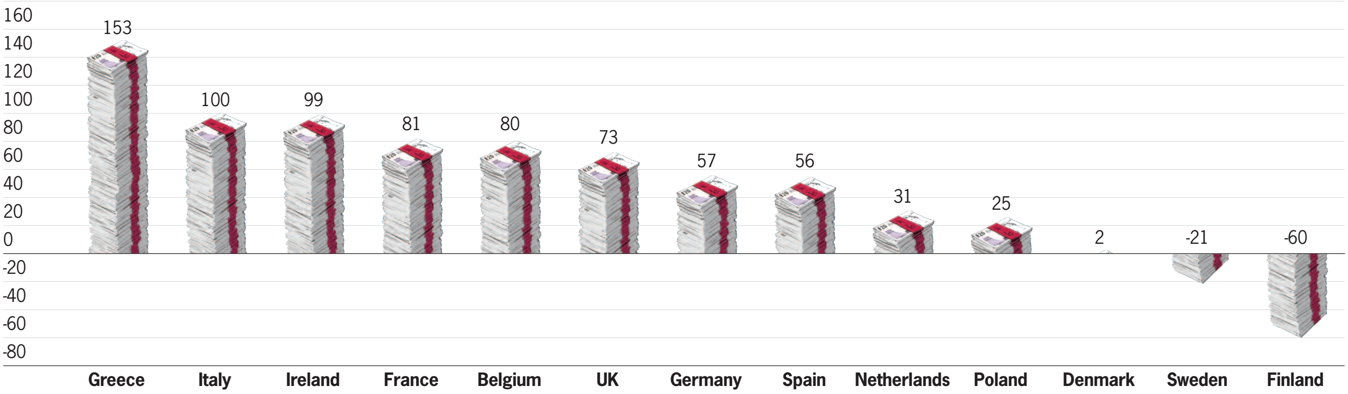
NET PERCENTAGE OF BUSINESSES INDICATING OPTIMISM/AN INCREASE IN NEXT 12 MONTHS LESS THOSE INDICATING PESSIMISM/A DECREASE; EU

SOURCE: GRANT THORNTON IBR 2012

> "Borrowing costs have eased which helps the new government. However, the 2011 budget deficit target was missed and unemployment, especially amongst young people, remains very high."
>
> **GEMMA SOLIGÓ**
> GRANT THORNTON SPAIN

FIGURE 2: INDEBTED EUROPE

NET GOVERNMENT DEBT AS A PERCENTAGE OF TOTAL GDP, EU



SOURCE: IMF 2011

European officials met on numerous occasions throughout the year and introduced a raft of measures including making greater funds available to buy back debt and help recapitalise banks; extending the European Financial Stability Fund's (EFSF) scope of activity and increasing its guarantee commitments from €440 billion to €780 billion; offering €489bn in short-term funds through the European Central Bank (ECB) to banks to support liquidity; increasing the tools available to the ECB to support the system; and by working towards much greater fiscal co-ordination among eurozone members.

However, none of these has offered the definitive solution – or 'big bazooka' – hoped for. Meanwhile the two options that might provide this solution – the guaranteeing of sovereign debt by the ECB and eurobonds remains off the table in the face of severe German opposition. Meanwhile, borrowing rates in troubled economies surged upwards, widening their spread over the much safer German bunds. By the end of 2011, Italy's benchmark borrowing costs had surged to 7%, a level considered unsustainable in terms of sovereign debt servicing.

With consumers and governments in Europe deleveraging following the excesses of the years leading up to the collapse of Lehman Brothers, businesses were supposed to be driving the recovery. However, the uncertainty has had a huge impact on business confidence; expectations for revenues, profits and employment as well as wider economic optimism have all nosedived since Q2-2011. Indeed optimism for the year ahead dropped to net -17% across the EU in Q4-2011.

The impact on economic growth has been stark. Having expanded by 0.8% in Q1-2011, the EU economy grew by just 0.2% and 0.3% over the following two quarters. In Q4, the eurozone – and possibly the wider EU – is estimated to have contracted. Growth for the year is estimated at just 1.6%.

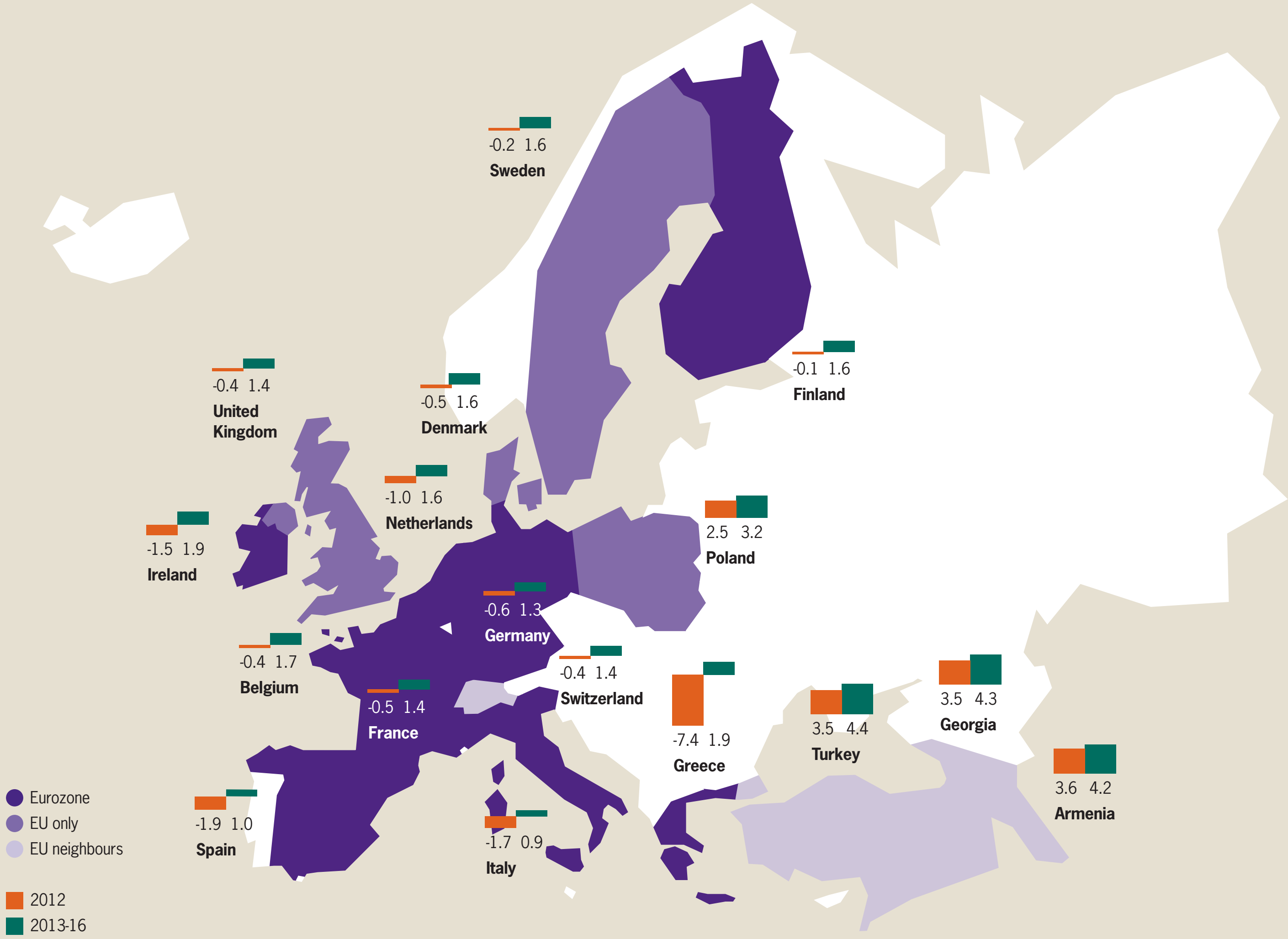
…but 2012 could be even tougher

Unfortunately 2012 has not brought EU leaders any more joy. Negotiations with Greece over the next tranche of bailout money have come to a standstill, which could lead to a default on €14.5bn of bonds that are due for repayment on 20 March. Meanwhile Standard & Poor's, the ratings agency, recently downgraded Austria and France government bonds to AA+. It subsequently stripped the EFSF of its AAA status as well, meaning the fund will have to offer higher rates of interest or operate with less cash at its disposal.[1]

The focus from the northern creditor nations – including Germany, the Netherlands and Finland – is for more fiscal responsibility. However, the plan does not seem to be working. Spain has undertaken severe austerity measures but looks set to overshoot its budget deficit reduction target of 6% by around a third whilst the unemployment rate remains above 25%.

In Greece, despite severe fiscal tightening, the deficit is expected to have come down by less than 1% in 2011 whilst government debt rose from 145% of GDP in 2010 to over 150% in 2011. Unemployment is closing in on 20%, the economy has contracted by around 12.5% since 2008 and businesses are suffering – many have closed and close to 500,000 jobs have been lost following the recession. Writing in the Financial Times the deputy minister of finance of the Greek government, Iannis Mourmouras, says: "Too much austerity is self-defeating: it leads to a vicious cycle of deficits and recession."

FIGURE 3: SLOWDOWN IN EUROPE
FORECAST PERCENTAGE GROWTH IN GDP (IBR PARTICIPANT ECONOMIES)



SOURCE: ECONOMIST INTELLIGENCE UNIT 2012

FIGURE 4: GERMAN BUSINESS CONFIDENCE REMAINS STRONG

NET PERCENTAGE OF BUSINESSES INDICATING OPTIMISM FOR THEIR ECONOMY OVER NEXT 12 MONTHS LESS THOSE INDICATING PESSIMISM

Georgia	**78**
Armenia	**52**
Germany	**46**
Turkey	**20**
Poland	**12**
Denmark	**0**
Switzerland	**-4**
Sweden	**-8**
Ireland	**-12**
EU	**-17**
Italy	**-20**
United Kingdom	**-35**
Greece	**-42**
Netherlands	**-44**
Belgium	**-46**
France	**-46**
Finland	**-48**
Spain	**-62**

SOURCE: GRANT THORNTON IBR 2012

> "The austerity measures imposed by the IMF, EU and ECB are strangling the Greek economy. Businesses are struggling and unemployment is rising. We need a plan for restructuring and growth to kick start the economy."
>
> **GEORGE DELIGIANNIS**
> GRANT THORNTON GREECE

In Italy, Mario Monti, the new Prime Minister and Minster for the Economy, has cut public spending, raised taxes and is now taking on the trade unions with a programme of labour reforms and service liberalisation in an effort to boost an economy which lost competitiveness over the past decade and has now stalled. However, to assuage voter fears both that policy is being driven by Rome rather than Berlin, and that there is an upside to painful austerity measures, he is now calling on Germany to help lower Italy's borrowing costs.

The outlook from businesses is, on the whole, equally gloomy. The IBR indicates that, inside the EU, only businesses in Germany (46%) and Poland (12%) are optimistic about the next 12 months. Some of the other large economies, such as Italy (-20%), the United Kingdom (-35%), France (-46%) and Spain (-62%) are very pessimistic. Interestingly some neighbouring economies, such as Georgia (78%), Armenia (52%) and Turkey (20%) remain optimistic.

Against this backdrop of austerity and falling business confidence, the outlook for Europe in H1 is pretty bleak with stagnation or mild contraction forecast, before picking up slightly in H2. The ECB is forecasting growth of 0.3% in the eurozone in 2012, but the World Bank is expecting a contraction of the same amount.

The break-up of the eurozone represents a severe downside risk to even this gloomy forecast. The situation in Greece is particularly concerning; if the country defaults in a disorderly fashion, then the contagion could spread to Ireland and Portugal, and even further to Italy and Spain. Should this happen, the global economy would almost certainly be pitched back into recession. A frightening prospect less than three years after emerging from the last one.

[1] 'S&P downgrades eurozone bail-out fund' – Financial Times: http://www.ft.com/cms/s/0/66647cd2-4068-11e1-8fcd-00144feab49a.html#axzz1jcXroZOa

Have we been here before?

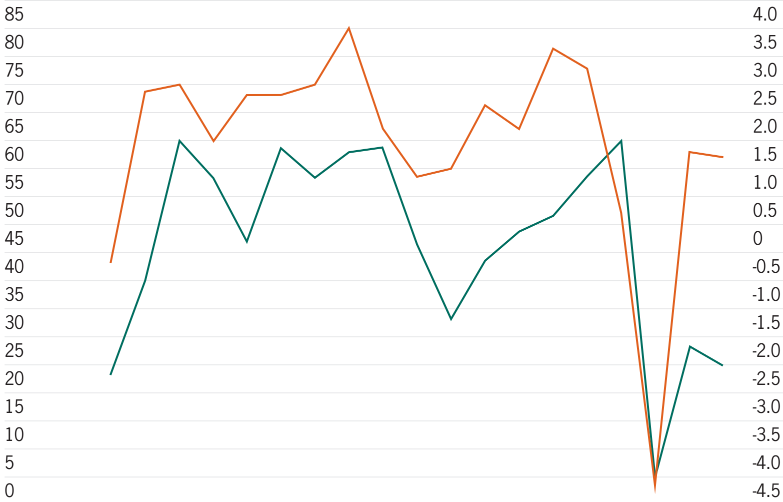
Using IBR data on expected revenue growth over the past two decades to track economic growth, close correlation between the two becomes clear. Clearly the relationship works both ways – increased revenues boost GDP, whilst higher economic growth rates boost businesses and consumer confidence.

Since the survey began in 1993, business revenue expectations for the year ahead have been a good predictor of where economic growth will end up that year. For example, revenue expectations in the 1993 survey (conducted in the final months of 1992) were extremely subdued, following recession, but 1994 saw an improvement which was matched by the European economy as it bounced back strongly.

Similarly, revenue expectations fell sharply at the turn of the millennium as the dotcom bubble burst and economic output across the continent dropped. Revenue expectations then started to climb in the so-called 'boom' years leading up to the recession (although it is noticeable in 2008 that businesses did not realise how severe the crisis was going to be).

Looking forward to 2012, business expectations for revenue are down – which supports growth forecasts showing stagnation or a mild contraction – although still well above the depths plunged in 2009. Across the region there is some variation with some of the EU neighbours – Georgia (84%), Armenia (62%) and Turkey (58%) – all positive about increasing revenues – but much of Southern Europe – Spain (-9%), Greece (4%) and Italy (12%) – much less so.

FIGURE 5: BUSINESS REVENUE EXPECTATIONS VS ECONOMIC GROWTH
NET PERCENTAGE OF BUSINESSES EXPECTING AN INCREASE; GDP % GROWTH; EU



	93	94	95	96	97	98	99	00	01	02	03	04	05	06	07	08	09	10	11
Revenue	23	40	65	58	47	64	58	63	64	46	33	44	49	51	59	65	5	28	25
GDP growth	-0.2	2.9	3.0	2.0	2.8	2.8	3.0	4.0	2.2	1.4	1.5	2.6	2.2	3.6	3.3	0.7	-4.2	1.8	1.7

SOURCE: GRANT THORNTON IBR 2012; IMF 2011

FIGURE 6: REVENUE EXPECTATIONS FOR 2012
NET PERCENTAGE OF BUSINESSES INDICATING AN INCREASE LESS THOSE INDICATING A DECREASE

Georgia	84
Armenia	62
Turkey	58
Denmark	54
Germany	50
Sweden	46
United Kingdom	34
EU	25
Poland	24
Belgium	22
Netherlands	20
Finland	18
Ireland	15
France	14
Italy	12
Greece	4
Switzerland	2
Spain	-9

SOURCE: GRANT THORNTON IBR 2012

> "The single currency has benefitted businesses in Germany, perhaps more than most. However a lack of competitiveness and fiscal imbalances in other eurozone economies are threatening the future of the European project."
>
> **KLAUS-GÜNTER KLEIN**
> WARTH & KLEIN GRANT THORNTON, GERMANY

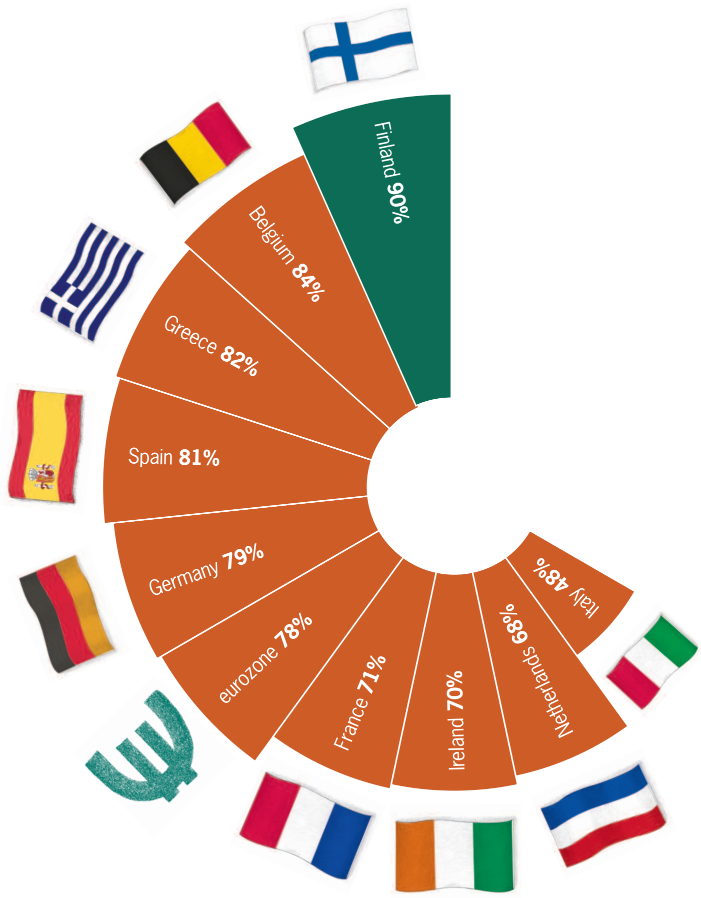
The single currency: good for business?

In light of the current difficulties in the eurozone, the IBR asked business leaders to reflect on how positive an impact the introduction of the single currency has had on their operations. Overall, more than three-quarters of business leaders (78%) believe joining the euro has had a positive impact on their business. Business leaders in Germany (79%) and France (71%), the two largest economies in the eurozone, sit either side of the regional average.

The most positive country is Finland, where 90% are positive about the impact of joining the single currency, followed by Belgium (84%), Greece (82%) and Spain (81%). At the other end of the scale, less than half of businesses in Italy (48%) are positive about the euro's impact on their operations. Italy's loss of competitiveness is well documented: exports grew by just 0.4% in the period 1998-2009 – compared to the EU average of 3.8% – whilst only Zimbabwe and Haiti had lower GDP growth rates in the decade to 2010.[2]

Those business leaders citing the positive impact of the euro on their operations are fairly split as to what particular aspects of the single currency have been most beneficial. Boosting trade with other countries in the currency bloc (23%) was cited by the most businesses, followed by the elimination of exchange rate risk (15%), more transparency (12%) and lower transaction costs (10%).

FIGURE 7: POSITIVE IMPACT OF ENTRY TO EUROZONE
PERCENTAGE OF BUSINESSES



SOURCE: GRANT THORNTON IBR 2012

PERCENTAGE OF BUSINESSES CITING POSITIVE IMPACT OF EURO:

78%

"The loss of France's AAA bond rating was a significant blow, both to Nicolas Sarkozy's government ahead of the election in May and also to the ability of the EFSF to build a firewall round the most indebted eurozone economies."

JEAN-JACQUES PICHON
GRANT THORNTON FRANCE

[2] 'The man who screwed an entire country' – The Economist: http://www.economist.com/node/18805327

“In the long term, it remains to be seen what impact David Cameron’s veto has on our relationship with Europe. But right now, the eurozone is the UK’s biggest trading partner so the crisis there is affecting our economy. Businesses need to continue to challenge the way things are done to find new, creative ways to ride out, or even rise above the numerous challenges.”

SCOTT BARNES
GRANT THORNTON UK

FIGURE 8: IMPACT OF ENTRY TO THE EUROZONE
PERCENTAGE OF BUSINESSES

SOURCE: GRANT THORNTON IBR 2012

In terms of negative impacts, eurozone members are more in agreement. More than one in two cite costs and price rises (57%) as the major drawback of joining the single currency, followed by an inability to devalue to boost export competitiveness (13%) and increased competition from inside the eurozone (12%).

Outside the eurozone, other EU businesses identified the elimination of exchange rate risk (31%) as having the greatest potential positive impact on their operations should their country join. A further 20% cite additional transparency/better price comparison as the greatest benefit of single currency membership.

Of those less keen to join the euro, 40% cited the costs of preparation to enter as the principal drawback. A further 12% of business leaders cited both increased competition and a need to set prices at a lower level.

Amongst the EU’s neighbours, 62% believe that further integration between their country and the EU would be good for business. Business leaders in Turkey (88%) are the strongest advocates of more collaboration, followed by Georgia (86%) and Armenia (61%). Business leaders in Switzerland are more circumspect (24%).

An increased opportunity for exports (55%) is the major draw for those businesses seeing further integration with the EU as an advantage, followed by a decrease in regulations and red tape (30%). However, those businesses seeing further integration as a disadvantage actually cite a need to follow EU regulations as the major problem (41%), followed by more competition (26%).

PERCENTAGE OF BUSINESSES THAT WOULD LIKE TO SEE SOME COUNTRIES EXIT THE EURO:

24%

What next for the single currency?

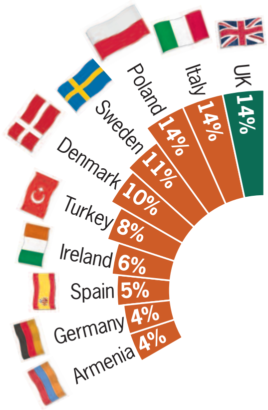
The idea that Greece may end up having to leave the euro becomes more plausible with every day that passes without a clear resolution to the crisis. However, there is no mechanism in place to leave the single currency. Instead Greece would have to exit the EU completely. Should this happen the question would be who next: Portugal or Ireland? Even Spain or Italy? Where would their departures leave the European project?

The European Union remains the world's largest single market so it is perhaps no surprise to see that businesses wish to see the currency underpinning much of that market survive. Of all businesses surveyed, 89% want the euro to survive in some form or another. However this ranges from 92% amongst businesses within the eurozone to 79% of those in the EU-only.

Relatively few businesses believe the euro should break up. Given the likelihood that even a disorderly default by Greece would pitch the global economy back into recession, this reflects economic realism from business leaders. That said, 13% of businesses in the EU-only do believe the currency union should be disbanded, ranging from 14% in the United Kingdom and Poland to 11% in Sweden and 10% in Denmark. Italian businesses (14%) are also more open to a break up than most; just 5% of eurozone businesses agree.

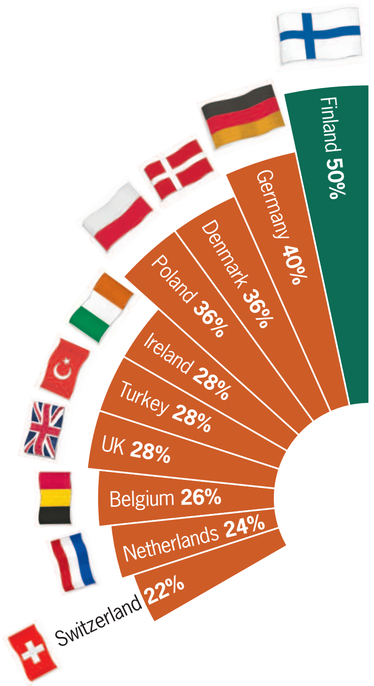
However, support for certain countries leaving the single currency (rather than a full break up) is much stronger. Almost a quarter of eurozone businesses (24%) would like to see some countries dropping out; 28% of EU-only businesses agree. This is the preferred option for businesses in Finland (50%) and Germany (40%), along with the Netherlands (24%) the only remaining eurozone members with sovereign debt rated as AAA by Standard & Poor's. More than a third of businesses in Denmark, which has already joined the Exchange Rate Mechanism II but maintains an opt-out, and Poland, which is obliged to join the euro under the terms of its accession, also cite this option. Interestingly, in Greece – the economy most likely to drop out – just 2% of businesses support this option, suggesting a severe lack of enthusiasm for the return of the drachma.

FIGURE 9: WOULD YOU LIKE TO SEE THE EURO SURVIVE? NO, IT SHOULD BREAK UP
PERCENTAGE OF BUSINESSES, BY COUNTRY



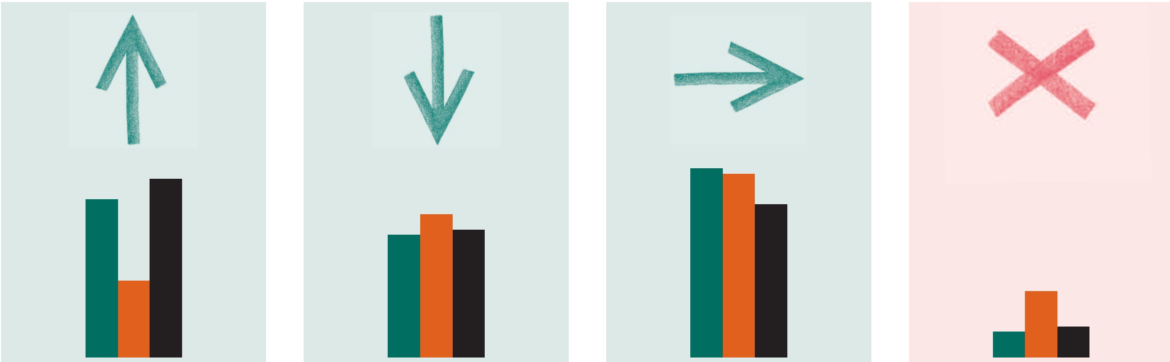
SOURCE: GRANT THORNTON IBR 2012

FIGURE 10: WOULD YOU LIKE TO SEE THE EURO SURVIVE? YES, BUT WITH SOME COUNTRIES DROPPING OUT
PERCENTAGE OF BUSINESSES, BY COUNTRY



SOURCE: GRANT THORNTON IBR 2012

FIGURE 11: WOULD YOU LIKE TO SEE THE EURO SURVIVE?
PERCENTAGE OF BUSINESSES, BY GROUP

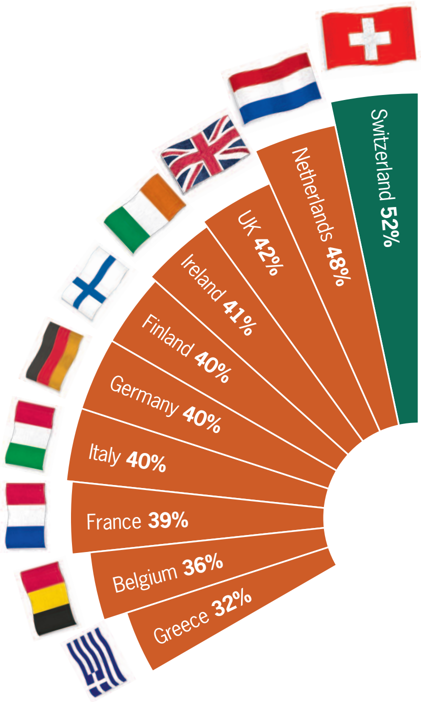


	Yes, and continue to expand	Yes, but with some countries dropping out	Yes, but with no more countries joining in the near future	No, it should break up
Euro	**31**	**24**	**37**	**5**
EU only	**15**	**28**	**36**	**13**
Neighbours	**35**	**25**	**30**	**6**

SOURCE: GRANT THORNTON IBR 2012

The marginal preference of businesses overall would be to maintain the euro, but with no more countries either leaving or indeed joining in the near future. Just over a third of businesses in both the eurozone (37%) and the EU-only (36%) believe this would be the best way forward. Inside the eurozone, businesses in the Netherlands (48%), Ireland (41%), Germany (40%), Italy (40%) and France (39%) all cite this as their preferred option. Outside the eurozone, this is the preferred option for businesses in Switzerland (52%) and the United Kingdom (42%) which both rely heavily on trade with the rest of Europe.

FIGURE 12: WOULD YOU LIKE TO SEE THE EURO SURVIVE?
YES, BUT WITH NO MORE COUNTRIES JOINING IN THE NEAR FUTURE
PERCENTAGE OF BUSINESSES, BY COUNTRY



SOURCE: GRANT THORNTON IBR 2012

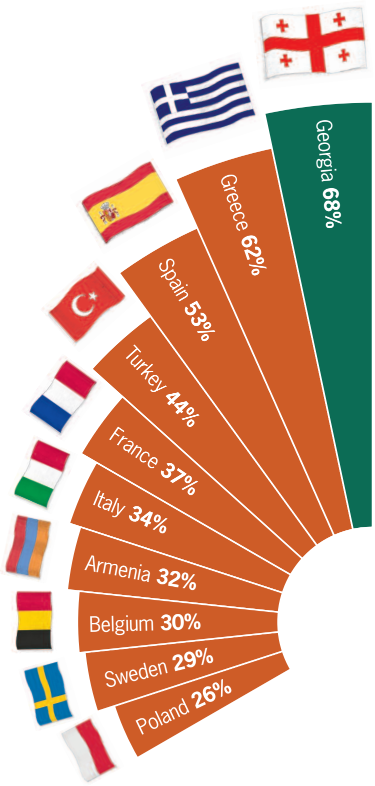
> "Sweden only avoided joining the euro by 55% to 42% in 2003. The gap would certainly be much wider if a referendum on membership were held tomorrow."
>
> **PETER BODIN**
> GRANT THORNTON SWEDEN

Whilst any further expansion of the euro is unlikely to happen any time soon, 31% of businesses in the eurozone would like to see the single currency expand further. Businesses in Greece (62%), Spain (53%), France (37%), Italy (34%) and Belgium (30%) would like to see further expansion, but just 20% in Ireland and 15% in Germany agree.

The proportion of the EU's neighbours wanting to see further expansion climbs to 35%, led by Georgia (68%) and Turkey (44%), suggesting that despite the eurozone travails the single currency remains an attractive option. However, when asked directly about their own economy, just 32% of businesses in Turkey would eventually like to join the euro, as would 28% in Armenia and 18% in Georgia.

Support for eventually joining the euro amongst EU-only countries is polarised between Poland (64%) and Denmark (62%) on the one hand, and Sweden (28%) and the United Kingdom (12%) on the other. However, whilst 40% of business leaders in Poland think they will join the euro by 2016, just 8% of their peers in Denmark agree. More than half of business leaders in Sweden (53%) and Denmark (52%), as well as 36% in Poland, think they will join the euro beyond 2016, but 78% in the United Kingdom believe they will never join.

FIGURE 13: WOULD YOU LIKE TO SEE THE EURO SURVIVE? YES, AND CONTINUE TO EXPAND
PERCENTAGE OF BUSINESSES, BY COUNTRY



SOURCE: GRANT THORNTON IBR 2012

FIGURE 14: WOULD YOU LIKE YOUR COUNTRY TO ADOPT THE EURO?
PERCENTAGE OF BUSINESSES

SOURCE: GRANT THORNTON IBR 2012

PERCENTAGE OF EU-ONLY BUSINESSES THAT WOULD LIKE TO JOIN THE EURO:

24%

The Grant Thornton International Business Report (IBR) is a quarterly survey of around 2,800 senior executives in privately-held and listed businesses all over the world. Launched in 1992 in nine European countries the report now surveys more than 11,500 business leaders in 40 economies on an annual basis providing insights on the economic and commercial issues affecting companies globally.

The 2012 data in this report are drawn from interviews conducted in November/December 2011, with at least 50 business leaders surveyed in each economy.

IBR 2012 METHODOLOGY

	NUMBER OF INTERVIEWS	COUNTRIES INTERVIEWED
Eurozone	575	Belgium, Finland, France, Germany, Greece, Ireland, Italy, Netherlands, Spain
EU only	525	Denmark, Poland, Sweden, United Kingdom
EU neighbours	200	Armenia, Georgia, Switzerland, Turkey

To find out more about IBR and to obtain copies of reports and summaries visit: **www.internationalbusinessreport.com**. The site also allows users to complete the survey and benchmark their results against all other respondents by territory, industry type and size of business.

Participating economies

Argentina
Armenia
Australia
Belgium
Botswana
Brazil
Canada
Chile
Mainland China
Denmark
Finland
France
Georgia
Germany
Greece
Hong Kong
India
Ireland
Italy
Japan
Malaysia
Mexico
Netherlands
New Zealand
Peru
Philippines
Poland
Russia
Singapore
South Africa
Spain
Sweden
Switzerland
Taiwan
Thailand
Turkey
United Arab Emirates
United Kingdom
United States
Vietnam

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