Europe's growing pains

Europe has struggled to keep pace with other major economies since the pandemic, and still has deep-rooted challenges to address. But UHY experts are cautiously optimistic that barring further geopolitical shocks, the worst may be over.

> In Poland the demand for innovative products is still growing.

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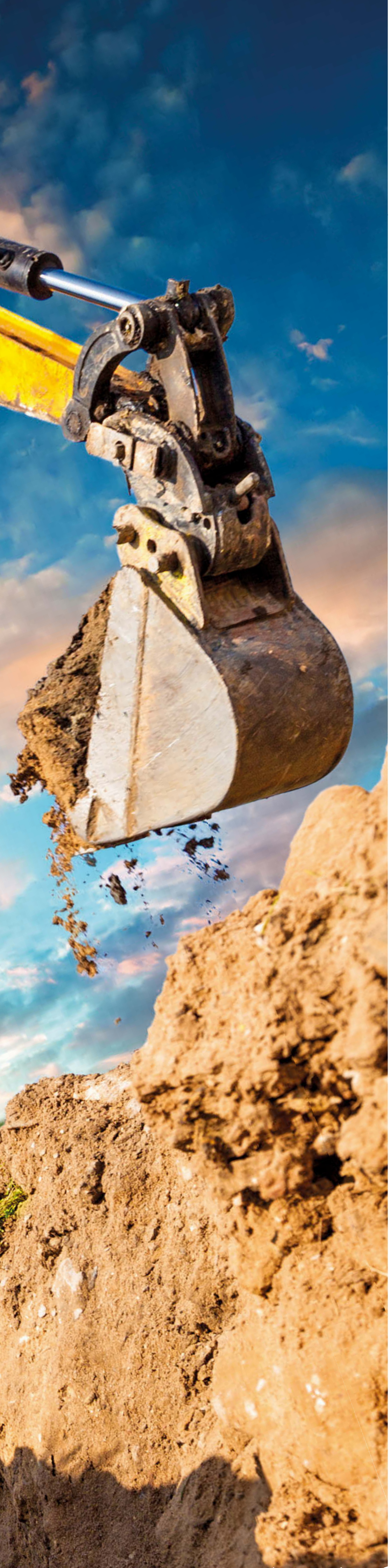

In its October 2024 World Economic Outlook the International Monetary Fund (IMF) revised the 2025 eurozone growth forecast down by 0.3% from its July forecast, to 1.2%. At the same time, the organisation predicted US economic growth of 2.2% next year.

The divergence of two of the main drivers of the global economy is not new. In 2023, the US economy posted 2.9% growth, against the eurozone's anaemic 0.4%. In 2024 the figures are predicted to be 2.8% and 0.8% respectively.

The contrast reflects differing pandemic responses and the impacts of Russia's invasion of Ukraine, as well as some long-standing structural weaknesses in EU economies. But, as inflation in Europe comes under control and interest rates nudge downwards, has the continent turned a corner? We asked UHY members in the eurozone for their expert opinions.

Higher prices, lower growth

All our members agree it has taken time to wean the continent off its reliance on Russian gas, which was necessary but painful.

"We have the still-shadowing effects of the pandemic, and we also have a war just outside the borders of the European Union - which, in addition to the measurable effects that can be included in tables, also has an additional psychological aspect," says Katarzyna Machnik, key account manager for Polish member firm UHY ECA Group.

Bas Pijnaker, managing partner at UHY Netherlands, and a UHY International board member, agrees that the "EU has been more vulnerable to this crisis because of its dependency on Russian energy".

He adds: "As a result, prices of energy increased in the EU. These high prices placed a significant burden on households, which has led to lower demand for products and services, and on businesses, which has led to the delay of economic growth."

But not all the blame for the current malaise lies with Russia's invasion of Ukraine. Bas also cites demographic factors in the US that allowed a more rapid expansion of the workforce, while Bernard Fay, managing partner of Spanish member firm UHY Fay & Co and former UHY chairman, says contrasting fiscal responses to the pandemic have been key.

"The US implemented much more aggressive fiscal stimuli, with direct payments to citizens and large-scale business support packages," he says. "In Europe, although the Next Generation EU recovery funds are a powerful tool, their distribution has been slower, and in countries like Spain, bureaucracy has complicated their implementation."
Katarzyna adds: "More technical

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aspects are also important, such as poor performance and productivity gaps caused by European companies' difficulties in adapting to new technologies compared to their US peers."

Reasons for optimism

Some of the eurozone's pain has undoubtedly been caused by high inflation and the interest rate hikes imposed to tame it. The good news is that the European Central Bank (ECB) has now embarked on what is hoped will be a sustained period of rate cutting. Given that, our experts admit to at least a cautious optimism, though the emphasis is on 'cautious'.

"The ECB has been nudging interest rates downward, which could relieve some of the pressure on businesses and consumers. This will encourage investment and spending," says Bas.

Katarzyna agrees: "Experts are cautiously optimistic. On the one hand, it seems that the Polish economy is gaining momentum. Household consumption, the engine of GDP growth, is growing, and the expected inflow of funds from the National Reconstruction Plan and EU cohesion funds will also have a major impact. Lower interest rates will help as well.

"At the same time, investment remains low and foreign demand is weak. According to economists, the medium-term macroeconomic prospects currently look less optimistic – especially in the context of Poland's external environment."

This sums up the mood quite succinctly. UHY professionals are hoping for the best, but accept that EU economies face deep rooted challenges that need to be overcome before they can be confident that the economic uptick will be sustained.

"Inflation in the eurozone appears to be stabilising, and interest rates are slightly decreasing, but it's too soon to declare that the EU and Spain are on a path to sustained growth," says Bernard. "While controlling inflation is key, energy and food prices remain a risk, and structural challenges, such as high unemployment and delays in deploying EU recovery funds, also hinder long-term growth potential.

"Both Spain and the EU need to address these deeper issues to ensure a lasting economic recovery."

Risk and opportunity

As Bernard explains, Spain has suffered from an overreliance on tourism, which is recovering strongly after being decimated by Covid.

Meanwhile, the Netherlands is a major exporting economy, making it vulnerable to any escalation of global geopolitical tensions. In Poland, businesses are struggling to invest in the technology that will make them more competitive on the international stage.

> The changing geopolitical situation will make it difficult to make business decisions at the international level.

But our specialists see opportunities as well as challenges. Europe remains a huge and advanced market, with an innovative and forward-looking business sector.

"Innovating and investing in renewable energy like solar, wind and hydrogen, is a big opportunity for the EU," says Bas. "Artificial intelligence (AI) and automation technologies are likely to continue expanding in the EU. Furthermore, the pandemic has spurred innovation in the healthcare and biotechnology sector. The urgency of innovating in pharmaceuticals and medical devices is clear."

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In Poland, most experts believe construction can be a major driver of growth, as the sector benefits from the country's National Reconstruction Plan. "The IT and modern technology industries also have great development opportunities, because the demand for innovative products is still growing," says Katarzyna.

Spain's tourism focus is an obvious channel for growth, as the number of travellers continues to rebound. "In 2023, tourism surpassed pre-pandemic levels, and this upward trend is expected to have continued in 2024, especially as international travel normalises," says Bernard. "As far as the wider economy goes, Spain is already a leader in solar and wind energy, and the global shift towards sustainability presents a unique opportunity to capitalise on this advantage."

However, these opportunities are only likely to be fully grasped if wider challenges are met. High unemployment, bureaucratic delays and elevated energy costs are still undermining economic potential in many eurozone economies.

The outlook for 2025

According to the IMF, the gap between growth in the US and EU will narrow in 2025, even if it remains quite wide. With that in mind, how do our experts view the prospects for Europe's economy in the year ahead?

To a limited extent, the answers are positive. "The economic prospects for the EU in 2025 appear cautiously optimistic," says Bernard. "On the positive side, inflation is expected to be more controlled, and many EU countries will likely benefit from investments tied to the EU's Next Generation funds. These investments should boost innovation, productivity and long-term growth potential across member states."

Bas agrees that there is cause for hope, if external factors do not add to downside risk. "If no big risks

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manifest themselves, like further geopolitical and demographic risks, I believe the global economy will grow in 2025. That economic growth will be stimulated by technological advancements, the transition to green energy and the recovery of global trade in particular."

The eurozone stands to benefit from any global rebound, but uncertainty in international relations may limit any gains. "The changing geopolitical situation will make it difficult to make business decisions at the international level," says Katarzyna, "and analysts in Poland recognise that the ageing population, reconstruction of supply chains (friendshoring), decarbonisation and digitalisation present further challenges."

A mixed picture

Overall, our professionals paint a mixed picture of Europe's potential over the next 12 months. The continent has yet to throw off the shackles of pandemic lockdowns and the energy price shock caused by Russia's invasion of Ukraine.

Economists also see more systemic challenges in ageing populations, overarching bureaucracy and underwhelming investment. Europe is a large and diverse region and countries have their own particular problems and opportunities, which can make central decision-making difficult.

But, while growth remains sluggish, it is likely to pick up in 2025, according to most recent forecasts. All else being equal, the next 12 months could see a more energetic business environment emerge from a highly uncertain era. There is at least hope that the second half of this disrupted decade will be considerably more positive than the first. ■

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