EUROPEAN CENTRAL BANK
EUROSYSTEM

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Summary of the Non-Financial Business Sector Dialogue on 21 November 2018 in Frankfurt am Main

Participants

- Members of the Governing Council of the ECB or their alternates.
- Representatives of Acerinox Group, Air France, Borealis AG, La Doria Group, Edison S.p.A., Ed. Züblin AG, Eni S.p.A., E.ON SE, Euronics International Geie, Ford Motor Company, Grimaldi Group S.p.A., Logwin AG, Miele & Cie. KG, Royal Dutch Shell plc, Salini Impregilo S.p.A., The Adecco Group, TUI AG, Vitol Group, Vos Logistics, Ziegler Group.
- Senior ECB officials from the Directorate General Economic Developments, Directorate General Monetary Policy, Directorate General Communications and Directorate General Secretariat, and the ECB's Chief Compliance and Governance Officer.

At the beginning of the meeting, the ECB President reminded participants of the nature of the Non-Financial Business Sector Dialogue as a forum for interaction at the highest level between the ECB and non-financial companies. The dialogue helps to inform the ECB about the business sector's views on the economic situation and thereby deepen its understanding of economic developments and issues relevant to policymakers. It complements similar high-level dialogues that the ECB maintains with representatives of financial sector institutions. As with these other dialogues, the same standards of transparency are to be followed, including publication of the agendas, list of participating companies and summary minutes.

Outlook for the euro area and the global economy

The discussion focused on (i) the nature of the slowdown in economic activity in 2018, (ii) the outlook for growth and investment in a context of uncertainty, (iii) the gradual building of inflationary pressures and their pass-through to prices, and (iv) structural challenges for businesses in the medium term.

Regarding economic activity, there was widespread acknowledgement that overall growth had slowed over the course of 2018, both globally and within the euro area. However, the views of participating companies on the extent of this slowdown and on the outlook varied depending on the main sectoral and geographical focus of their activities. While a number of participants still saw continuing growth and/or encouraging signs in recent data, others observed a flattening or a decline in their business and were less

confident or more uncertain about the outlook for 2019. In this respect, compared with one year previously, growth and expectations had become less synchronised, even if the overall outlook remained one of expanding activity.

Businesses were having to contend with a number of geopolitical tensions and uncertainties, which were weighing on the investment outlook in affected sectors and regions as more companies were adopting a "wait-and-see" approach. The imposition of tariffs on steel by the United States had created considerable volatility in this sector, not least due to the diversion of Asian steel exports away from the United States and towards Europe. Other sectors were also affected by retaliatory measures and disruption to supply chains.

Brexit, and in particular the risk of a "no-deal" scenario, was cited as a key concern by some participating companies. In this context it was observed that even small delays in customs clearance would cause major congestion at ports. Fears of disruption to supplies were causing some UK customers to increase their orders for stockpiling purposes, which was increasing demand for scarce warehouse capacity and also increasing costs for their continental European suppliers. More generally, there was the risk of a sharp fall in UK demand and knock-on effects for the euro area.

Turning to prices and costs, there was some discussion of the recent volatility in oil prices. The fall in the price of oil between mid-October and mid-November was seen as being supply driven, reflecting a combination of OPEC's increased production since June and the postponement of US sanctions on Iranian oil exports. There was, at the same time, a general view that developments in the price of oil were becoming less predictable, driven not only by supply and demand but also by geopolitical factors and financial markets. The oil market was now dominated by non-industry players, notably hedge funds, with most trades determined by algorithms. Looking beyond short-term fluctuations in the price of oil, upward pressure on energy prices for European consumers was driven by a combination of strong demand for liquid gas from China in order to reduce coal consumption, and under-investment in European energy infrastructure.

Besides energy, broader cost pressures in the economy were also gradually building, albeit to varying degrees. Most notably, wages were growing very strongly in some sectors and geographical areas where labour markets were tight, in particular in central and eastern Europe and Germany, where trade union demands included an element of catch-up after several years of subdued wage growth. By contrast, in geographical areas where the economic recovery was less mature and unemployment still high, wage growth remained subdued. Migration was a factor that had helped contain wage growth in countries facing labour shortages, but the supply of imported labour was gradually drying up. Similarly, where the business cycle was more mature and labour markets were tighter, a shift away from temporary employment and towards permanent employment was observed, as employees would prioritise obtaining permanent employment status over wage increases, which would come later.

While cost pressures were gradually building, the ability of companies to pass higher costs through to prices varied. Significant, if not full, pass-through was feasible in some areas of transport and logistics, where capacity was limited. However, in many other sectors of the economy, overcapacity and/or strong international competition made pass-through difficult, so margins were being squeezed.

Despite factors such as geopolitical uncertainty and fluctuating oil prices causing hesitance with respect to traditional fixed investment, participating companies emphasised the importance of continued investment in digital technologies to drive up productivity. If companies did not invest, they would not be ready for the future. In this regard, it was essential to invest in an improved workforce as the labour market was exhibiting a "skills imbalance" with respect to the needs of digital transformation.

A further major challenge for businesses over the medium term was that posed by the transition to an environmentally friendly economy. Most governments were committed to this transition, as reflected by the Paris Agreement on Climate Change, and European governments' lead in this respect was welcome. At the same time, the implications of this transition were not yet widely understood. The shipping industry, for example, would have to abide by new rules coming into force on 1 January 2020 which would reduce permissible sulphur emissions by 85%. Meanwhile, the automotive sector had to deal with consumers turning away from diesel while still being cautious about purchasing new hybrid/electric vehicles, as well as a shift in social attitudes towards mobility which implied a likely decline in car ownership over time. In general terms, businesses faced the challenge of helping to solve the world's environmental problems while generating a return for investors.