R&C Trendwatch

October 2015

Fighting for Growth in a Sluggish Eurozone

Executive Summary

- *Eurozone governments face important challenges, including high unemployment, investor and consumer uncertainty and high energy and labor costs.*
- *Solid domestic consumption is viewed as a key factor for a broader economic recovery and governments are beginning to think more about how to support consumer spending.*
- *Changes in regulations on credit and debit card fees bode well for the retail and consumer sector.*
- *Several Eurozone member states are allowing Sunday retail openings. Easing the sale of non-prescription drugs will be a boon to supermarkets.*

Introduction

Despite improving external conditions, Eurozone governments continue to face several challenges. High unemployment is burdening welfare states that are already struggling to provide for aging populations. Internal political crises are fueling uncertainty among investors and consumers alike, which in turn holds back growth. Political leaders have optimistically commented that a combination of lower oil prices and a weaker euro should support competitiveness and help besieged economies raise themselves out of the financial crisis. A recovery that follows the German export-based model would be ideal, but pragmatists know that with energy and labor costs still higher than in Asia and the US, the Eurozone will be able to compete only where it is most innovative, and innovation takes time and investment.

Solid domestic consumption is consequently viewed as an important component of a broader economic recovery. Whether consciously or not, European consumers have a bias toward local products, providing a base for each member state's GDP. Any policy encouraging further spending would therefore be a fairly certain guarantee of extra GDP growth. This report explains the retail policies being implemented at the EU level, and it examines the policies that key Eurozone governments are using to help retailers. Lastly, it considers the broader context for manufacturers of consumer goods and possible opportunities arising from the European Commission's investment plan.

*This publication is produced in collaboration with **Eurasia Group (www.eurasiagroup.net).** Eurasia Group is a leading political risk research and consulting company.*

Communal policies from Brussels

While some of the flagship projects of the €315 billion investment package spearheaded by Commission President Jean Claude Juncker, such as broadband investment, will affect consumer behavior, the Commission does not appear to believe that it has much of a role in fostering consumer confidence throughout the continent. The Commission is unlikely to stray from its initial focus on encouraging investment, overseeing trade deals, and making recommendations to individual member states.

Credit cards represent one exception. In March, commissioners were quick to express satisfaction with the European Parliament's adoption of a regulation capping interchange fees for credit and debit card payments. The lack of transparency over fees has limited smaller businesses' bargaining power. Consumers are often not allowed to pay by card below a certain amount or have to pay a surcharge. The Commission justifiably hopes that the cap (and the added transparency around it) will benefit smaller businesses by facilitating casual purchases. The cap may fail to accelerate the deployment of new technologies such as mobile phone payment apps, as there will be a smaller financial incentive to enter the market. High-end consumers will likewise be disappointed to discover that incentive programs such as airline miles will yield fewer perks as credit card companies will be collecting fewer fees. However, the binding regulation is good news for the retail and consumer sector overall.

The unrelenting progress of **e-commerce** is viewed with caution in Brussels. Europeans' readiness to spend money online should be the basis on which its ambitious digital agenda can prosper, but it is hostile toward non-EU companies using their size and complex structure to minimize tax bills. Commission probes into corporate tax arrangements are expected to be completed by the end of 2016 and will lead to changes in the legislation of the states involved (Ireland and Luxembourg). Brussels, meanwhile, continues to advance the prospect of a single telecoms market. The argument behind the fledgling project is well honed: European digital services, including online retail, have been at a disadvantage compared to dominant US counterparts, as these have been able to grow in a much larger unified national market than those starting in the fragmented European market. A more favorable environment for the cross-border expansion of fledgling online retail services can be expected in the years to come.

Retail measures

As they wait for the EU's investment-focused, long-term policies to yield benefits, Eurozone governments have been much more willing to intervene to unleash consumer demand. This can take very different forms.

Retail spaces

EU law allows each member state to set its own policy for opening hours. Arrangements vary across the Eurozone, especially about trading on Sundays. Nine Eurozone members, including Italy, already allow retailers to open on Sundays, often with increased pay to employees. The two biggest markets, France and Germany, have much more rigid laws that make Sunday trading the exception.

The French government is promoting a law increasing the annual number of Sundays any store can be open from five to 12. It also created several "international tourist zones" in various cities, in which stores will be allowed to remain open until midnight and on Sundays year-round, as long as employees are payed at a higher rate. For now, Germany is unlikely to liberalize its Sunday trading laws, which remain strict throughout the country.

Opening markets

A second option being considered by many governments involves connecting supply and demand in ways that are more convenient for the consumer. One result is that supermarkets will be able to sell non-prescription drugs, which were available only in pharmacies.

The Italian government is pushing similar policies for non-prescription drugs and regulated professions through a competition decree that should be implemented by mid-2016. There is less of an effort in Germany, where many of these reforms have already been conducted, except for the sale of non-prescription drugs.

Manufacturing measures

While few policies (either European or national) specifically address issues faced by manufacturers of consumer goods, the general context for European manufacturing is improving thanks to global trends and long-term policies designed to support industry.

Global trends

The limited European appetite for structural reform is evident. National governments are having to proceed bit by bit to get their parliaments to enact necessary changes, from liberalizing opening hours to injecting more flexibility into labor markets. Nonetheless, recent macro developments are expected to offer the Eurozone some respite from the pressing need to reform.

As a result of the European Central Bank's recent monetary policy changes, the Eurozone will be seen more favorably by producers of manufactured goods seeking to invest. Likewise, manufacturers that were considering off-shoring some of their production may decide to stay.

In addition, the falling price of commodities is beginning to affect the spending decisions of Eurozone consumers. With the oil price slump continuing, consumers will begin to consider purchases they have been holding off making. Heightened consumer spending, along with improved export prospects, will accelerate the fall in unemployment, which will begin to create a virtuous cycle of confidence and spending power.

Conclusion

As decision-making in the Eurozone is hampered by its many disparities and imbalances, most of its economies share the challenge of sluggish or no growth. Unable to move quickly on structural reforms, governments are beginning to think systematically about how to support consumer spending without playing with interest rates. While investment remains the priority of the European Commission, few EU-wide policies will affect the retail and consumer sector in the short term. Meanwhile, member states will attempt to dismantle their own bottlenecks to consumer demand.

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