

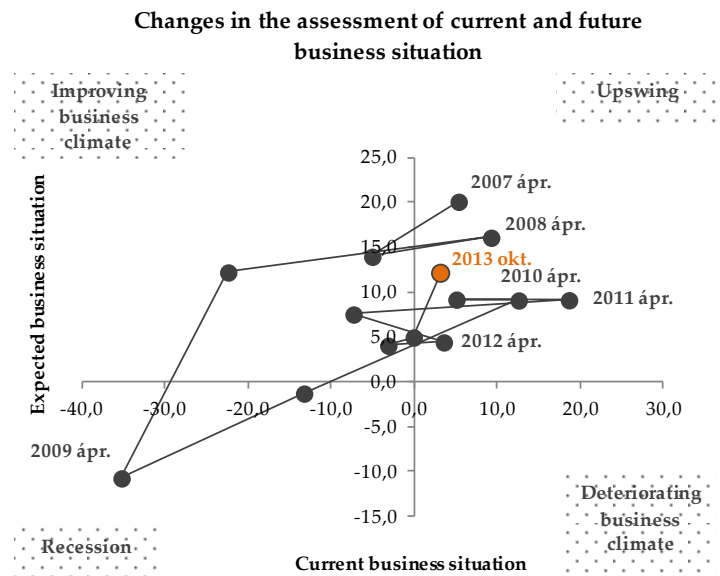
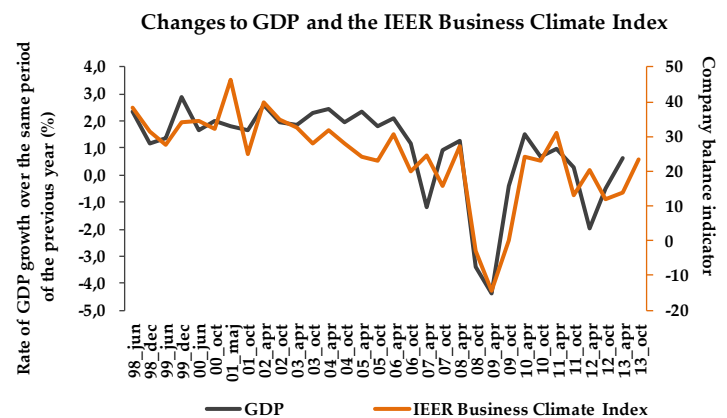
IEER Monthly Bulletin of Economic Trends November 2013

October 2013 was the thirty second instance of the HCCI Institute for Economic and Enterprise Research (IEER) business climate survey in which more than 14,000 companies are examined every year in April and October, with the assistance of regional chambers. In Hungary this is the largest study of its kind. This research is a part of the Eurochambres business climate survey, which is an approximately 14 million enterprise-wide study of European business. In October this year 3,514 companies filled out our questionnaire. The IEER Business Climate Index rose almost 10 points to +23 points from April's +14 points. This represents a medium-high value; the last time a similar level was reached was in 2010. The value of the Uncertainty Index is also very high at a 55-point level. The latter suggests that within the business community readings of positive trends for the year are still not quite clear or uniform. For many firms the business situation has not improved, and their expectations are not positive. Meanwhile, the available data for the current performance of the Hungarian economy, together with the IEER business climate survey data – amidst a high degree of uncertainty surrounding this year and next – project rising GDP growth rates.

The business climate index of IEER has risen since April in all economic sectors (industry: 40 points, retail: 19 points, services: 15 points), whereas for the construction industry the indicator tripped into the positive territory (5 points). When examining companies by ownership structure, the most positive outlook was reflected by predominantly foreign-owned firms (51 points). The business sentiment of predominantly domestically-owned firms – due to the large increase of the index – is similar (48 points), whereas entirely Hungarian-owned companies are much less optimistic (11 points). Looking at the export activity of firms it can be concluded that companies with foreign links have a more optimistic expectation for the next six months compared to those that produce only for the domestic market. Among those that produce mostly for foreign markets the level is 54 points, for firms with a smaller percentage of their sales abroad it was 33 points, while for those producing only for the domestic market it was only 7 points. In terms of company size the results show that larger companies are more optimistic: while the business climate index for companies with less than nine employees was negative (-17 points), for the 10-49 category it was 16 points, for the 50-249 group it was 35 points, while the leading value was 47 points for companies with more than 250 employees.

According to the October data, the view of companies toward their current and future business expectations point to a recovery in their situation. This is consistent with observations on the improving business climate of April and October last year. Taking into account both results, for this year between April and October the views of Hungarian companies are more strongly in the "Upswing" category than in the past and the index currently resides in this area.

The current business situation of companies is more favorable compared to the spring results by seven points, with the index rising to 12 points. Industrial companies reported the most favorable situation (28 points), whereas the least favorable were those of construction companies (-6 points). The positive impact of the presence on foreign



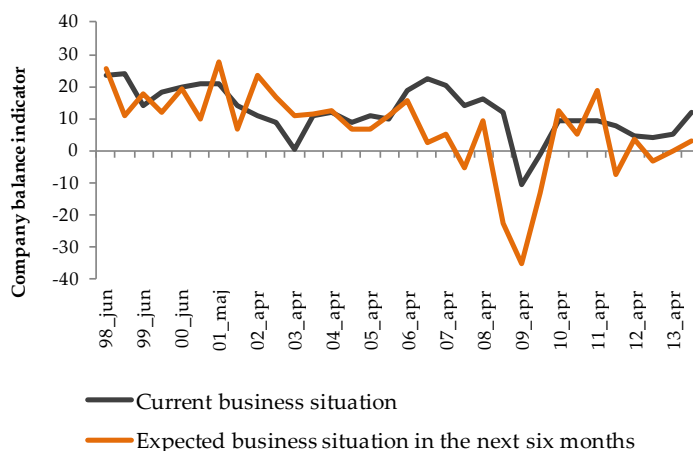
markets and of the foreign capital on the situation of a company can be clearly seen: companies that produce mainly for exports and those mostly owned by foreign markets have index values which are generally higher than those that produce exclusively for the domestic market and are domestically owned (45 and 48 points respectively, and -4 and -1 points respectively). In terms of number of employees, significant discrepancies exist in the index: while businesses with up to nine persons are extremely negative, characterized by -24 points, companies with 10-49 employees stand at 5 points, companies with staff of between 50-249 have 16 points, while large companies with 250 or more employees have 30 points.

The business expectations index in terms of economic sectors was positive only among industrial companies (19 points), other sectors were either pessimistic or were characterized by a lack of change (construction: -13 points, retail: -12 points, services: 0 points). Aside from this, an improvement can be highlighted among the expectations of construction companies as the index in April was -25 points. With regard to the business situation once again the predominantly foreign owned (35 points) and export-oriented companies (also 35 points) had the most positive expectations – meanwhile among firms with a minority stake of foreign ownership the index left the negative territory and jumped to 27 points. The index for companies with less than 50 employees was characterized by a negative value (those with less than 9 as well as the 10-49 categories at -32 and -7 points respectively), while for larger firms there was a positive value (from 50 to 249 employees: 11 points, for those with more than 250: 20 points).

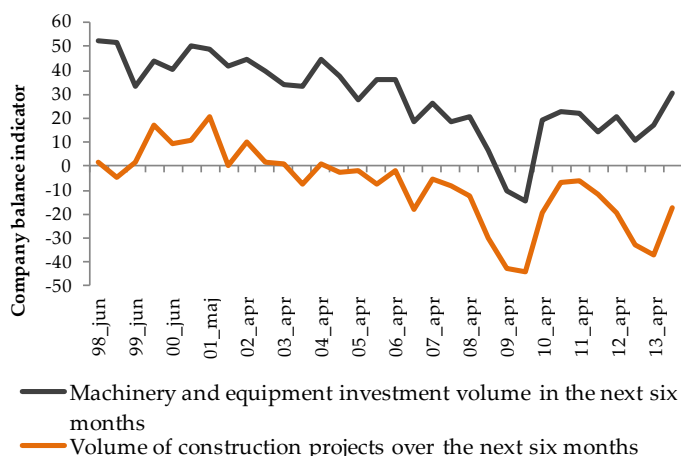
The index measuring investment intentions increased from the 6 point level of April to 12 points; thus, a growth of investment activity is expected for the next six months. Compared to the expectations of April, construction and retail companies have become more pessimistic (among them the October index value was 5 and 11 points respectively), while industrial and services companies have become more optimistic (13 and 14 points respectively). Increased investment activity was apparent for all segments of those with foreign market sales: among firms with a small share of exports the index stood at 17 points, for those with a major share of exports the value of the indicator rose to 14 points, while for firms that produce exclusively for the domestic market the index fell by 6 points. A noticeable improvement in investment activity for the next six months is therefore expected among exporting firms.

Looking at a breakdown by ownership structure, the index stood at around 10 points for purely domestic firms as well as mostly foreign-owned companies, while companies with a minority stake of foreign ownership showed a measurable increase in investment activity (41 points). Meanwhile, with the exception of micro-enterprises (2 points), the index

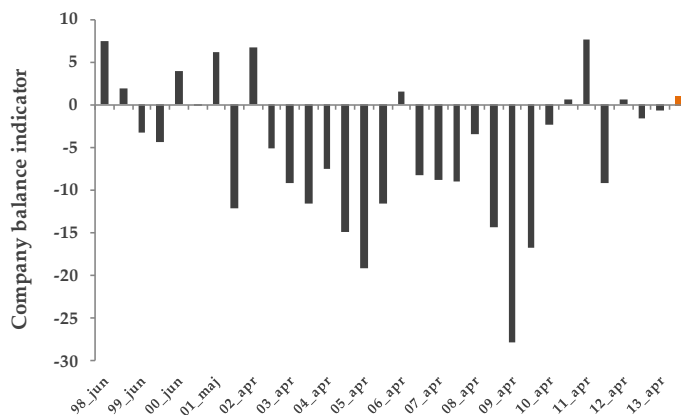
Business situation



Investments



Expected labour demand



increased for all employee number categories (10-49: 16 points, 50-249: 15 points, 250 and more employees: 13 points).

Companies expect further stagnation in labour demand over the next six months (the index is around 0 points), which is similar to the expectations surveyed last year and this spring. Accordingly, in the next six months growth in labor demand for the private sector cannot be expected.

Macroeconomic trends: The economies of the Visegrad countries

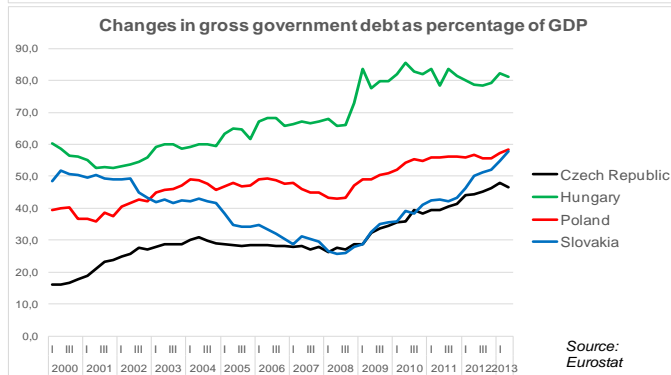
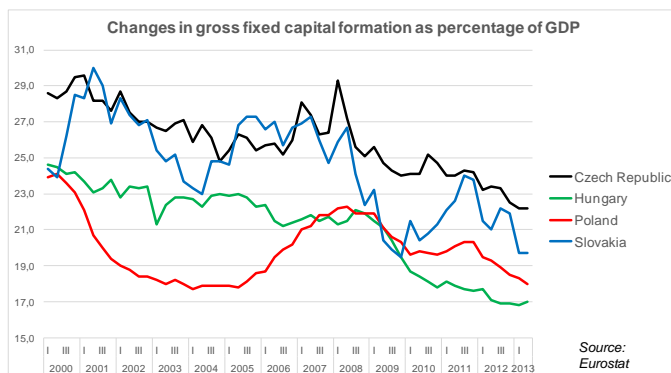
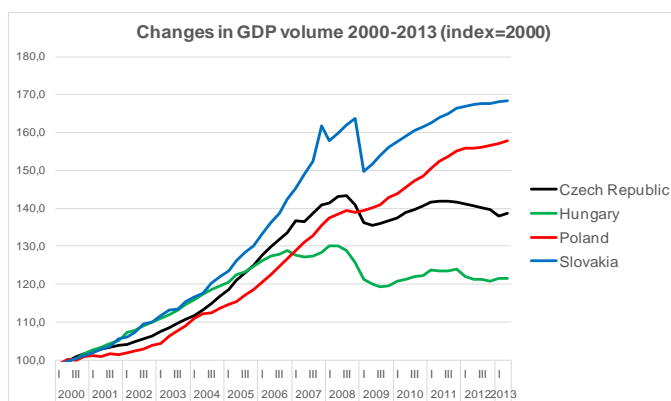
In the following brief analysis we present the development of macroeconomic indicators for the economic performance of the Czech Republic, Poland, Slovakia and Hungary between 2000 and 2013. Our aim was mainly to show which supplementary factors can be added when observing the differences in the gross domestic product (GDP) performances. Our question is whether Hungary is lagging behind other countries in the region and, if so, in what ways. We present the economic performance of the four countries over the last 13 years via the gross domestic product and labour market activity rates, as well as gross debt and investment rates, using Eurostat data. The development of institutional factors is illustrated by the World Economic Forum's Global Competitiveness data and reports. In addition, we examine the expected values of the main economic indicators for the next three years based on forecasts by the European Commission. Currently, a more thorough explanation is not provided as the analysis is merely a descriptive presentation of data of the subject at hand.

The subject of the following short analysis is an examination of the macro indicators pertaining to the economic development of the Visegrad Group of countries (V4). The Czech Republic, Poland, Slovakia and Hungary in the early 2000s experienced a rapid economic growth, but the crisis partially or entirely interrupted or even put an end to this. It can be seen that Slovakia and Poland were able to stay on a higher economic growth path, while Hungary and the Czech Republic moved along a slower growth path. Hungary is apparently lagging behind the growth of each examined country. The figure shows that the lag in the development of the volume of GDP have become significant since 2005, and differences with the Czech Republic also accumulated in the 2005 to 2008 period.

In terms of Hungary's economic growth the low investment rate poses a significant risk. It can be seen that each of the V4 countries are currently experiencing a decline, so Hungary is not an exception, but its level is nevertheless the lowest of the four. It can be seen that over the last 13 years the difference with respect to Slovakia and the Czech Republic has practically existed from the beginning.

The rate of government debt to GDP has become a central economic risk indicator due to the 2007-2008 economic crisis and the related European sovereign debt crises. It can be seen that Hungary's debt position began to diverge from the region in 2001 and the negative consequences of the crisis merely aggravated the already high level of government debt. This was contrast to other countries in the region which had the opportunity to continue a more or less loose fiscal policy after the crisis.

The low activity rate in Hungary has been a labour market problem since the regime change: for the 13 years since 2000 the Hungarian activity rate was always lower than in the other three V4 countries despite the fact that it increased from 59% to 65%. The augmentation of the level of activity is crucial for the long-term growth of the Hungarian economy. The absence of a long-term solution will more likely lead to a further decline



of the Hungarian economy compared to the other countries in the region.

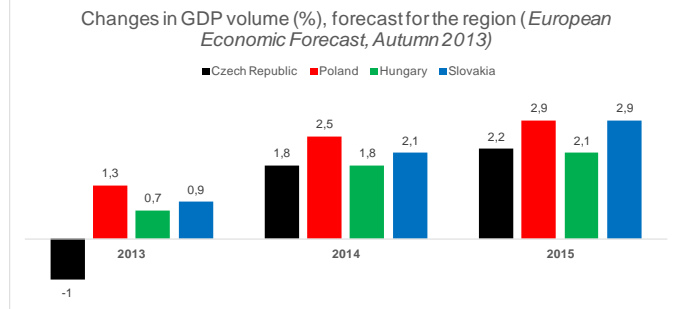
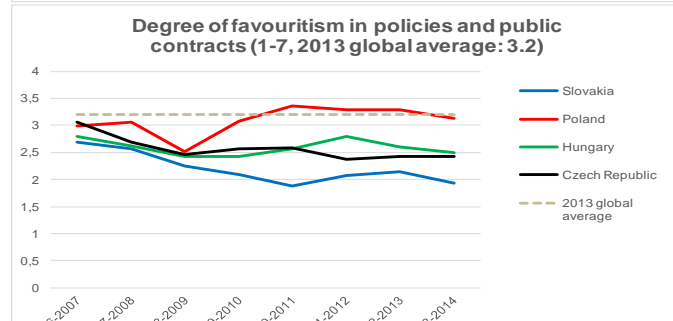
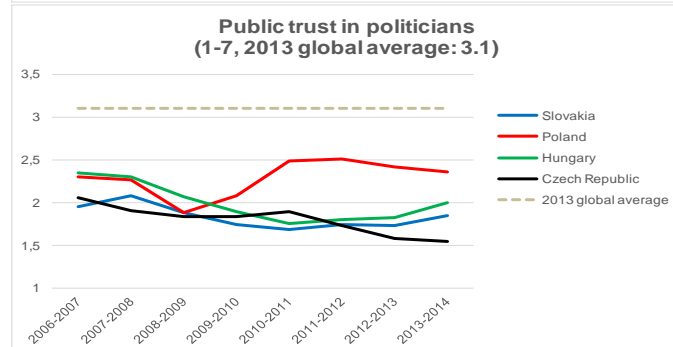
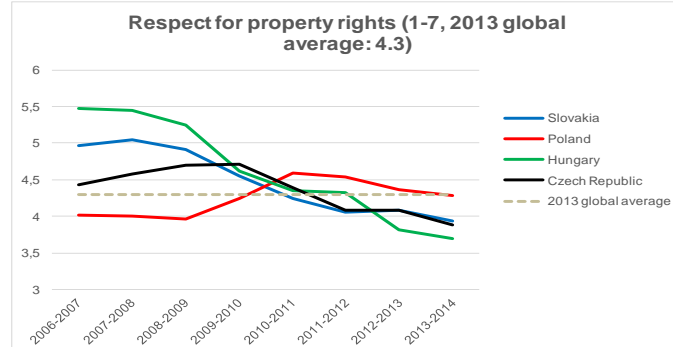
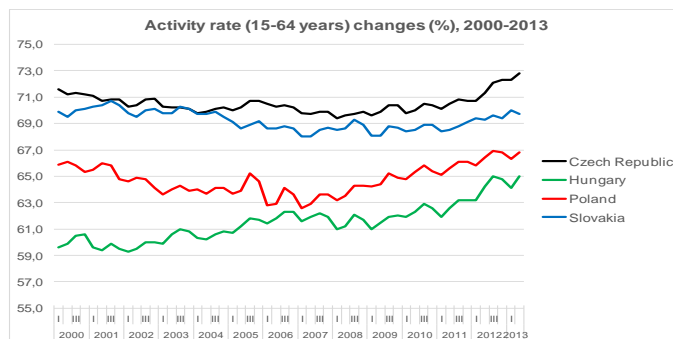
It is worth noting some of the changes in institutional factors which also may affect the economic performance of countries. We examined those factors where sufficient data is available from the past and which have the potential to affect a country's "attractiveness" in economic terms. Our data comes from the World Economic Forum's Global Competitiveness Index database. With the exception of Poland, since 2006 the safety of property has deteriorated in all countries. Hungary has fallen from the highest position to the lowest in the region, but in the last two years the safety assessment of property has deteriorated in each country.

Public confidence in the political elite in each of the V4 countries is low in terms of global values. It can be seen that Hungary, the Czech Republic and Slovakia are at a lower level than Poland, and here also Hungary slipped from the top position to second place; however, in appraising the political elite of each country an enormous deficit exists.

In examining related political favouritism, the V4 countries are below average in the world and, in this respect, Poland is a positive exception. For the other three countries we can speak about more or less the same situation. Summarizing institutional factors, therefore, it appears that in the last three years Poland gradually left behind its associate countries, and so is poised for better growth prospects; meanwhile key institutional factors of the other three countries in recent years has seen a deterioration.

Overall, it appears that the crisis fundamentally split the Visegrad countries which had until then all progressed on the same track. According to the fundamental data the situation in Poland seems to be the most promising, thus it can gain an advantage compared to the other three countries. What can we expect for the future? According to the European Commission's November forecasts the countries of the region are facing slow growth and it is perceived that, as in previous years, the Slovak-Polish and Czech-Hungarian growth rates will be markedly different, hence the growth pace of Hungary lagging behind compared to other countries in the region will become fixed.

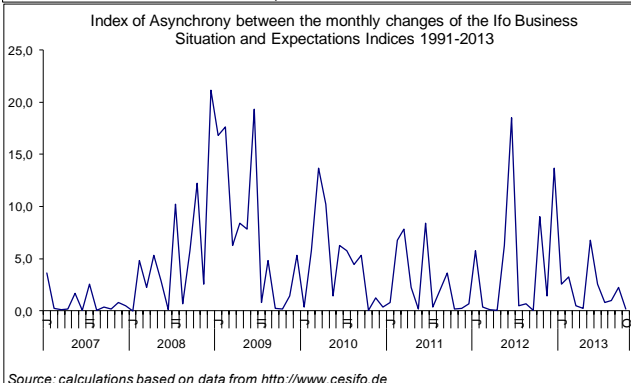
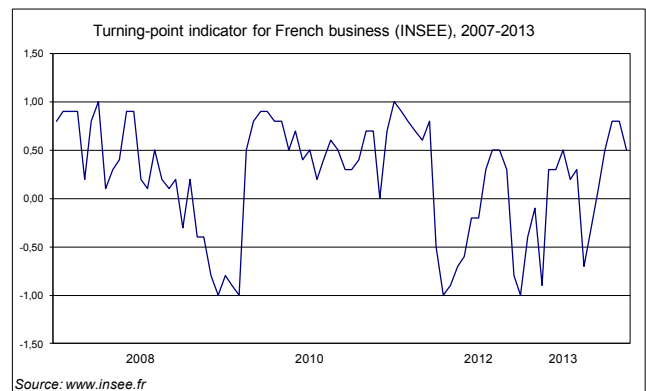
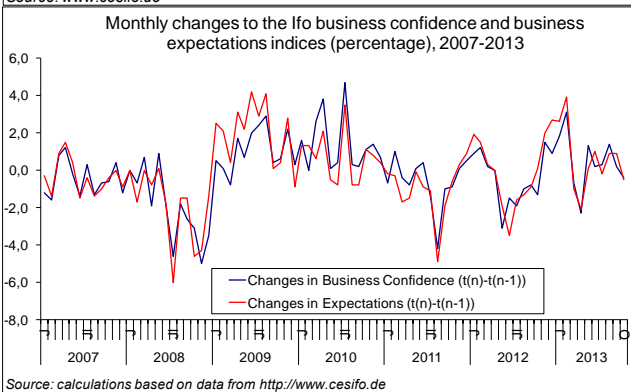
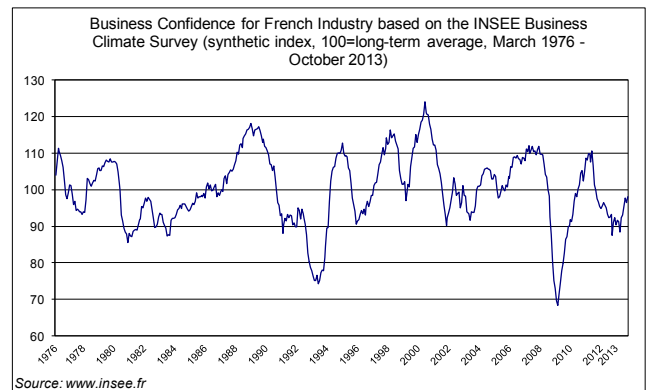
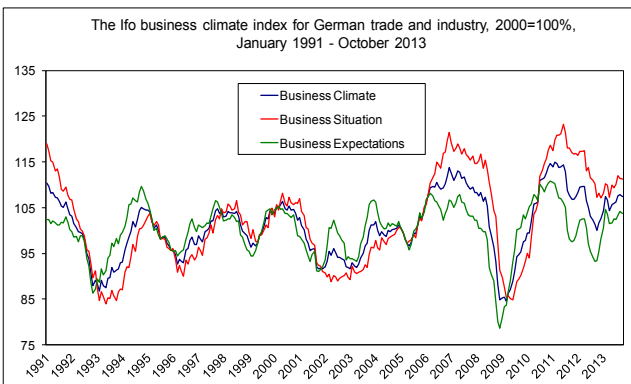
Source: Eurostat, European Economic Forecast – Autumn 2013, the World Economic Forum's Global Competitiveness Index database, World Economic Forum Global Competitiveness Report 2013-2014



International trends

The Ifo Business Climate Index for German industry and trade showed a slight decline in October 2013 after five months of growth. The current business situation deteriorated slightly, but remained above the long term average. Expectations for the next six months were slightly less optimistic than in September. The gap between the current business situation and expected developments, as calculated by the IEER index of asynchrony, fell in October thus the business confidence index showed less uncertainty than in the previous month. Analysts at Ifo see the German economy continuing to accelerate. (Source: Ifo, <http://www.cesifo-group.de>)

Based on the survey of the French statistical office (INSEE), business leaders interviewed in October reported that the position of French industrial activity is stable. The INSEE business confidence index rose by one point compared to the previous month, so is at the August level again. The value of the turning point indicator has not changed and is still in the positive business climate zone. The individual business forecast index decreased, but is still higher than the long term average. The overall outlook index – which represents a summary of respondent opinions on French industrial activity as a whole – continued to rise in October and has done so since April, hence the index – for the first time since July 2011 – exceeded its long term average. (Source: INSEE, <http://www.insee.fr>)



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