

The purpose of the business climate research carried out by the Institute for Economic and Enterprise Research (IEER) is to provide an empirical study of business surveys conducted on a quarterly basis and analyze the situation of the Hungarian corporate sector, the current state of business, future prospects, and factors affecting the situation of companies. In addition to questions related to the business climate of companies, other issues and problems -- and the reactions of companies to these -- are explored which play an important role in the adaptability of enterprises in terms of financial status and development. October 2011 was the eighth in a series of survey data collected.

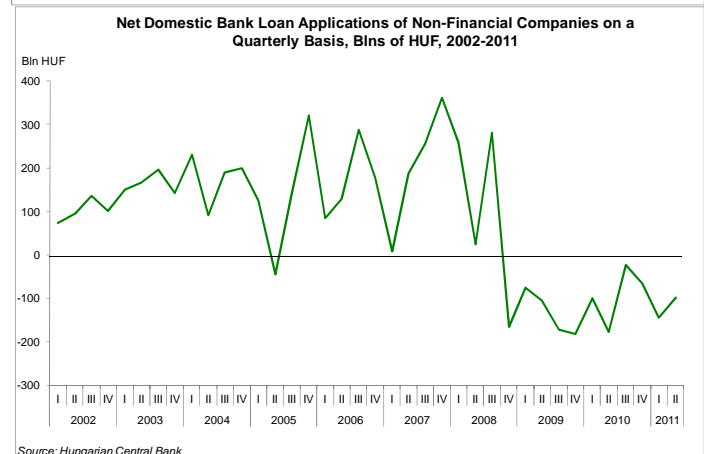
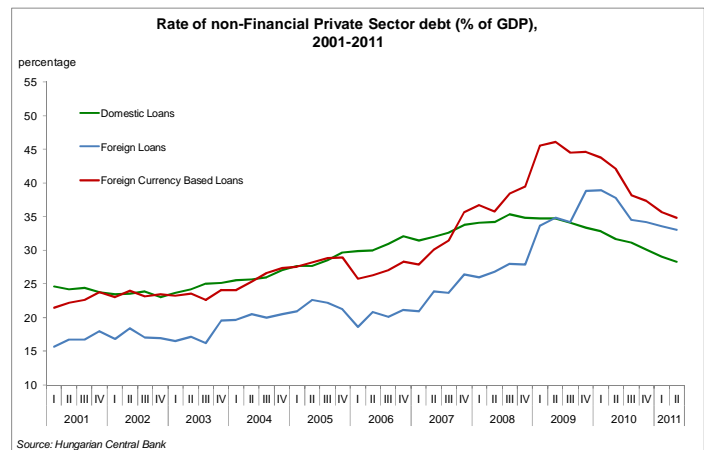
In late 2011 Hungarian companies faced very difficult economic circumstances, and as a result no significant improvement is expected for 2012. Currently, a major obstacle for companies to expand their production and marketing activities is a contraction of credit. This unfavourable process was already underway at the beginning of the economic crisis, and in 2011 access to credit became ever more difficult as banks were put into a difficult situation because of the early payoffs of foreign currency based loans and the bank tax.

In the October 2011 survey we asked participating companies about their borrowing habits and their expectations in light of the credit crunch. The results show that because of the deterioration of credit conditions over the past 6 months 7% of the companies surveyed postponed making investments. Changes in the conditions for accessing credit in 2011 were viewed very negatively by Hungarian business leaders. For 28% of respondents it has become more difficult in recent years to obtain a loan. In addition, respondents expect even more difficult conditions for 2012 than in 2011. As a result of these loan conditions, the vast majority of companies surveyed (81%) expressed a very pessimistic outlook and don't plan to obtain a bank loan in 2012.

The Macroeconomic Environment of a Bank Loan

Companies in Hungary at the end of 2011 were forced to confront very difficult economic circumstances, and in this regard no significant improvement is expected in the coming year. While the recovery from the economic crisis can be said to have been completed, an economic slowdown is expected in the near future, with domestic demand not expected to grow next year either. Expectations of foreign market demand within the European Union, as well as recent forecasts for the euro zone, worsened: most projections warn of a slowdown in growth and the possibility of a deep recession because of the European debt crisis. In Hungary, the combination of declining external demand and a restrictive fiscal policy has had a negative impact on business prospects. Changes in income tax rules and an increase in the minimum wage both threaten the profitability of firms, especially small and medium enterprises.

For businesses, the contraction of credit is a major impediment to the expansion of production and turnover. This unfavourable process was already underway at the beginning of the economic crisis, as the crisis shook trust in the foundations of the financial world. The level of Hungarian corporate loans began to decline in the first quarter of 2009; what foremost lay behind this trend were the liquidity problems of commercial banks and the tightening of credit conditions. Foreign currency based loans fell the most. In 2011, banks were put into a difficult situation because of the early payoffs of foreign currency based loans and the bank tax, and it was not easy for them to receive credit from their parent institutions either. As a result, it had become more difficult for companies to access credit.



Companies Obtaining Loans

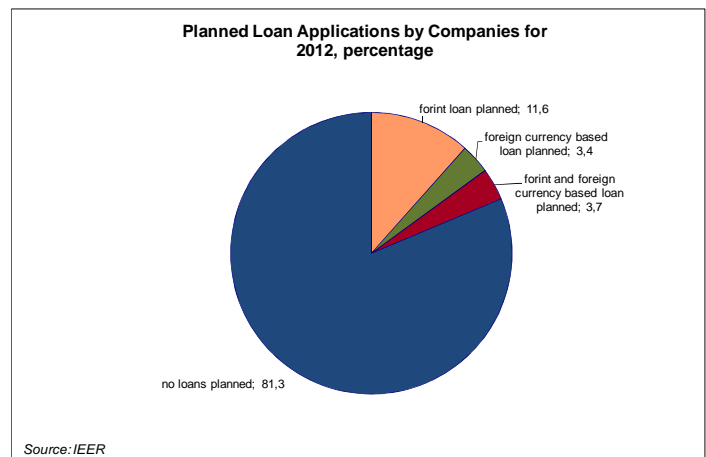
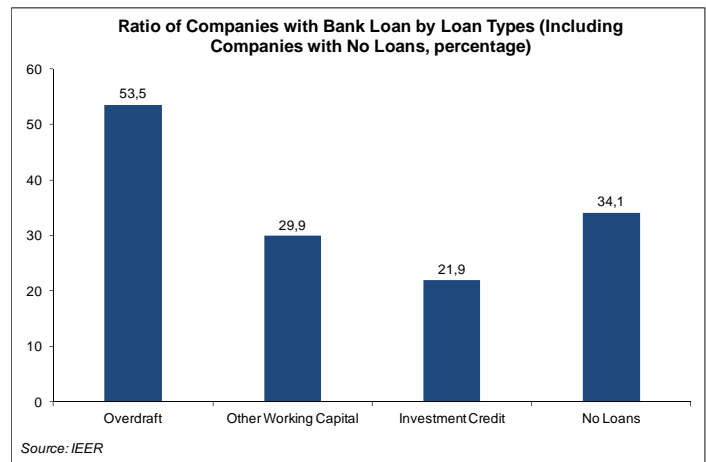
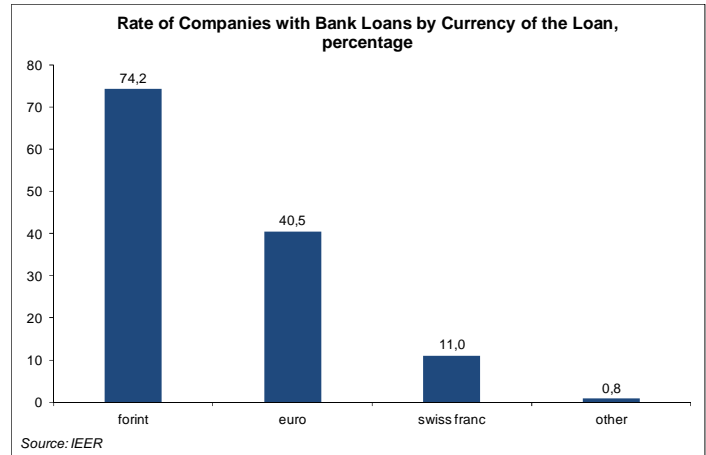
The 407 companies which responded to our October 2011 survey were asked of their borrowing habits and how the credit crunch was affecting their expectations. Among the companies surveyed 262 said that they had a bank loan, 137 said they didn't have a loan and 8 refused to answer the question.

The data indicates that because of the deterioration of credit conditions over the past 6 months 7% of the companies surveyed postponed making investments. (It is also possible that this figure is much higher if the question covers a longer time span. Of the companies surveyed, many were already in difficult economic and financial circumstances earlier, and in 2009-2010 held back making investments.) Those who postponed making investments the most were producers for the domestic market, construction companies, and firms employing up to 49 people.

The changes in conditions for accessing credit in 2011 is viewed very negatively by Hungarian business leaders. For 28% of respondents it has become more difficult in recent years to obtain a loan (on a scale of 1 to 5 this represents a score of 1). Another 27% gave a score of 2, while 38% gave a score of 3. Only 6% gave a score of 4, and less than 1% felt that in 2011 it was a lot easier (a score of 5) to obtain a loan. In other words, 93% of companies gave a score of 3 or less, which means they felt it was more difficult to borrow. The average company score was 2.25. The lowest average score was with companies of 20-49 employees (2.01) and companies producing for the domestic market (2.04).

Business leaders were also asked their opinion on how the conditions for accessing credit will change in 2012. Respondents expect even more difficult conditions in the coming year than in 2011. In all, 32% said it will be much more difficult to access credit than in the recent past. A score of 2 was given by 22% and a further 41% think the expected loan conditions will be moderately difficult in 2012. Only 4% gave a score of 4 and one gave a score of 5. So we can say that 95.5% of companies gave at most a score of 3 to the question. Taking into account the responses from all companies, the average score was 2.18. The lowest average score was from firms with over 250 employees (1.88), manufacturing (2.09), and wholly foreign owned companies (2.10).

Of the companies surveyed, more than half (54%) have an overdraft loan, 30% have various working capital loans, 22% have an investment loan, and 34% of companies don't have any bank loans at all. Borrowing is most common among construction companies, retailers, those with more than half of their revenues from foreign markets, enterprises with 50-249 employees, and partly foreign-owned companies.

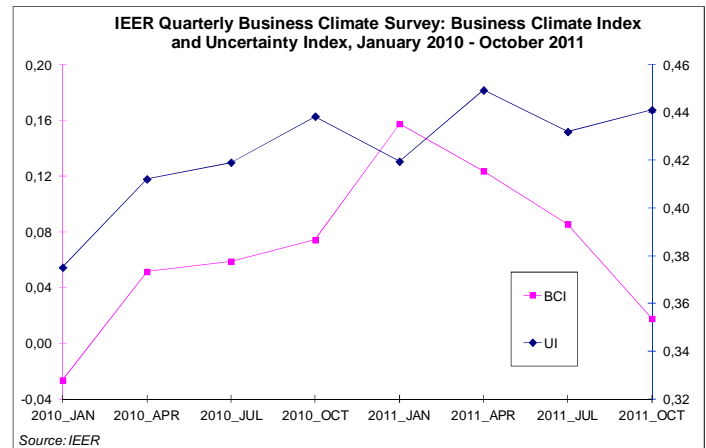


Of the 264 companies with loans, 74% indicated that they have a forint loan; 41% reported having a euro loan and 11% a Swiss franc based loan. As for other currencies, almost 1% of all firms (two companies) have such a loan. Companies with forint-denominated loans are found mostly in the construction industry, producers for the domestic market, and Hungarian-owned companies; export companies and large enterprises with over 250 employees usually have euro denominated loans. Swiss franc based loans are mostly found among service sector companies, entirely Hungarian-owned producers for the domestic market, and companies with up to 49 employees. Based on this data, it can be concluded that firms with a loan have a lower score on the GVI Quarterly Business Climate Index (-0.009) than firms without a loan (0.056), thus the current and expected business situation of companies with loans can be said to be worse.

Of firms with a loan 8% reported that a delay in the payment of a loan instalment had occurred at least once in the past six months. This is frequently the case for those engaged in retail, those with small employee numbers, and those with at least half of their sales in the domestic market.

According to the responses from company executives, 23% of them inquired into the possibility of obtaining a loan in the past six months. The most common are those in the construction industry and partly foreign-owned firms. Most of these 90 companies (58 companies, 65%) also received a loan or an application was pending at the time of the interview. A total of 16 companies (18%) didn't apply for a loan because of the unfavourable loan conditions. Another 8 companies (9%) didn't apply for a loan because eventually they didn't need one. Finally, 7 companies (8%) applied for one but were refused.

The circumstances for obtaining a loan with respect to the conditions on offer together with the very pessimistic expectations for the future has led the vast majority of companies surveyed (81%) to forego plans for a bank loan in 2012. Of companies that intend to obtain a loan, 12% plan for a forint loan, 3% for a foreign currency based loan, and 4% plan for both types of loans. Generally those in the construction field, firms with 50 to 99 employees, and wholly or partially owned domestic firms reported that in 2012 they intend to borrow money.



Macro-economic trends: the Italian debt crisis

The dramatic loss of market confidence during the Italian debt crisis in November 2011 led to the resignation of Prime Minister Berlusconi and the formation of a government of experts led by Mario Monti. In addition to the role of prime minister, Monti also undertook the post of Finance Minister, meanwhile the development of the economy was the responsibility of the former president of Intesa Sanpaolo, Italy's largest bank.

Monti introduced on December 4 the government's first austerity package. It had a target of 12 to 15 billion Euros in budget cuts and a 30 billion increase in revenues. The important part of the package was the tax increases: from autumn 2012 the value-added tax will be increased by two per cent, and a luxury tax and tax on financial investments will be introduced. In addition, property taxes will be reintroduced which were abolished by Berlusconi's government. The package will introduce contributions for the pension system and next year the retirement age will be raised. The Italian Chamber of Deputies approved the austerity package. Although Italian trade unions immediately began to protest against it, this had no effect.

At the end of December Monti put forward a new economic stimulus package for economic reform, in where the main priorities were competition and liberalization, while the Labour Code and social security would be transformed, as well as a more robust development program for the disadvantaged southern provinces of Italy.

Looking at the last month and a half of financial data we can say that the markets have calmed down somewhat since the new Italian Government began its work and Italian bond yields began to fall.

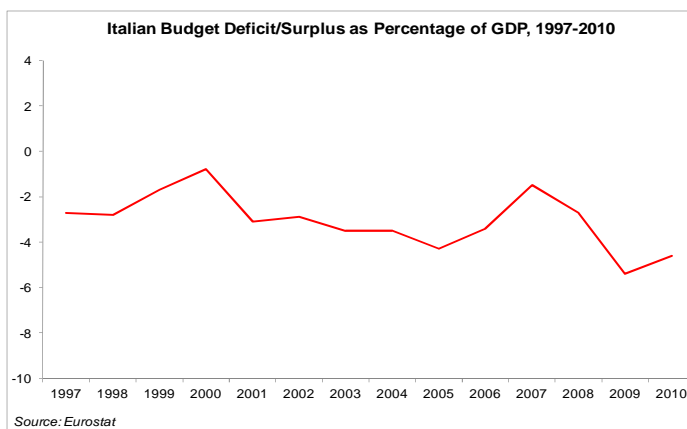
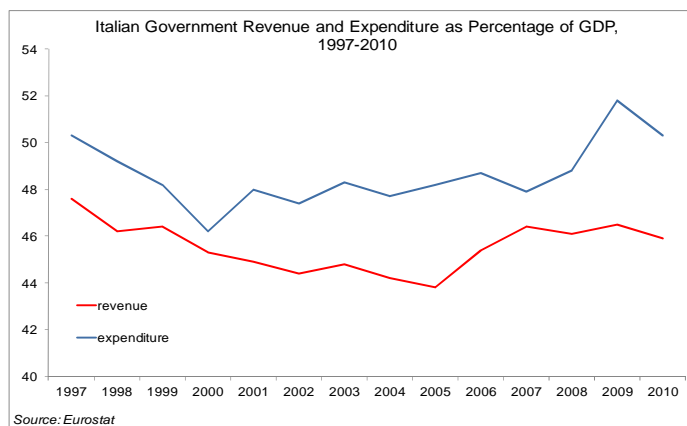
Background

In November 2011 Italy's massive public debt became unsustainable when the deteriorating macroeconomic outlook and loss of market confidence caused a crisis situation in the country. Prime Minister Berlusconi's government was in a minority and submitted its resignation on November 12. The President asked economist Mario Monti to form a government. The formation of a technocratic government signalled to the market that it would see through significant reforms and also opened the way for structural adjustments for the Italian government, hence the Milan stock exchange and financial markets also welcomed Monti's nomination.

New Government

On November 16, Monti established a government entirely of experts. Monti consulted with the parliamentary parties over the composition of the Government, and won the political support of the two largest factions. However, both the larger governing party and opposition, the left-wing Democrats, asked that politicians not be part of the government.

Within the 17-member cabinet Monti retained not only the post of prime minister but the top economic portfolios as well, including that of finance. When Monti announced the new government the name Corrado Passer, who was the President of Italy's largest bank, Intesa Sanpaolo, was highlighted and given the most important and strategic post



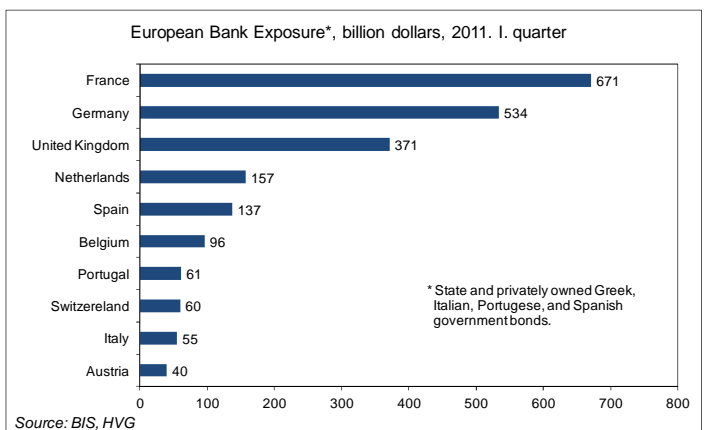
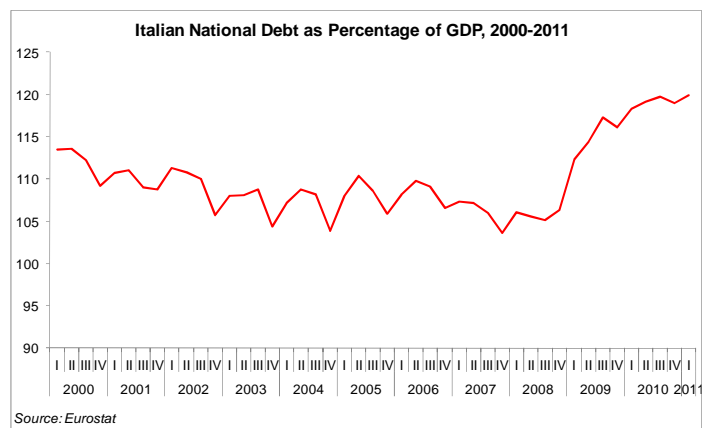
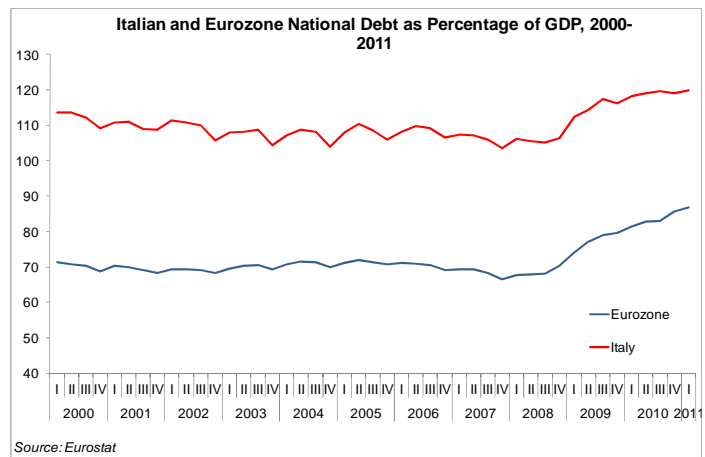
within the government: he was responsible for economic development, infrastructure and transport. The 56 year old Passeig was an experienced business manager, and was competent in the fields of industry and finance as well.

The first austerity package

After consulting with the parties and social partners, on December 4 Monti unveiled the government's austerity package. "Save Italy" was a 12-15 billion euro package of measures aimed at reducing costs, in addition to 30 billion in extra revenue. According to the package members of the government had to declare their personal assets. Monti would forego his remuneration as finance minister and head of government. The salaries of ministers, cabinet chiefs, and department managers were all reduced. The number within county administrative bodies was reduced to ten and the number of independent members of the public authorities almost halved. It liberalized the pharmaceutical industry, which was already privatized, the transport industry, and shopping hours. From September 2012 the 21 percent VAT will be increased by two percent. A mandatory use of credit cards was introduced for transactions over a thousand Euros. Business investment and the promotion of employment for young people and women were rewarded with tax cuts. A once only, one and a half percent tax was introduced for assets brought back to Italy from foreign tax havens. Luxury taxes were levied on vehicles greater than 170 kw, helicopters, private jets, luxury villas, and 10 meter long boats. In addition to the usual bank account fees, deposits, bonds and any other financial investment are to be taxed. Abolished by the Berlusconi government, estate taxes on first homes (0.4%) were reintroduced and the property tax was increased (0.75%). The book value of real estate was increased by sixty percent. Income tax rates were not changed, however the regional tax rate was increased (between 0.9 to 1.23%). A new tax raised the price of fuel. Contribution payments for the pension system was introduced. From next year the minimum retirement age for men will be raised to 66 and for women to 62 years, and by 2018 this will also increase to 66 years. Women with 40 years of contributions +1 month and men with 42 years +1 month can retire. Those who retire early, whether they fulfilled the required contributions or not, will have 3 percent deducted annually from their pension until they reach the mandatory retirement age. In the Italian Chamber of Deputies 404 voted for the austerity package, with 75 against and 22 abstentions.

Strikes

The Italian trade unions immediately began to protest against Monti's austerity package. The CGIL, CISL and UIL trade union federations launched a series of strikes and for the first time in six years demonstrated together in the streets. In the factories during the last three hours of a shift work came to a stop. They joined the non-essential service transport workers (freight, highway employees, and port



workers) and funeral company employees as well. The Fiom railway union members went on strike for eight hours to protest the closure of the Fiat plants. The strikes, however, didn't achieve their aims; Monti refused to compromise on the measures.

The second austerity package

After the first austerity package came into force in December, Monti came up with a new economic stimulus package of economic reforms. On December 29 he announced the government's program to open a "second phase" and introduced so-called growth phase measures. The main priorities of the "Grow Italy" austerity package were competition and liberalization, while the Labour Code and social security would be transformed, as well as a more robust development program for the disadvantaged southern provinces of Italy. Among the specific measures is the increased fight against tax evasion, and within this context a reduction in cash transactions. Monti said this can be achieved with market competition, transformation of the judicial system, and a reduction of red tape. According to press reports, this liberalization affects the media, journalists, notaries, architects, lawyers, professional chambers, taxi drivers, the Italian post office and pharmacies, as well as 675 local government-owned companies, of which 72 are energy providers and 52 airports as well. Monti plans to work on the second phase of reforms, which was agreed upon with the unions on January 9, with the euro zone members on January 23 and at the European Council meeting on January 30.

Market impact of the austerity measures

With news of the austerity measures Italian bond yields began to fall and in the first days of December were around 6.2%. This is quite a good performance taking into account that a week before the yields for Italian bonds were at 7.4%.

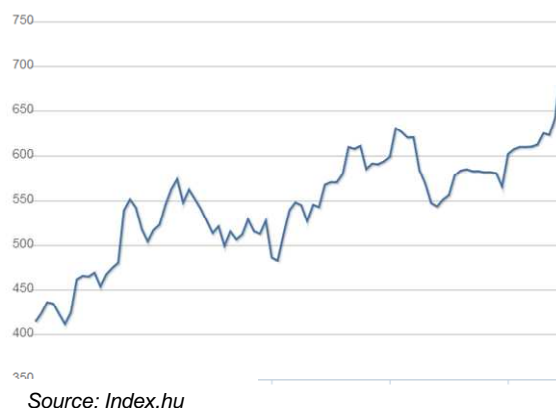
It can be said that the markets calmed down somewhat since the new Italian Government began its work. By the end of December a three-year term bond was sold at a yield of 5.62 percent, while in November it could only be sold at 7.89 percent. The interest rate of all ten-year bonds fell; at the end of December the yield came out to 6.98 percent whereas a month ago the yield was 7.56 percent.

Source: hvg.hu, privatbankar.hu, index.hu, mfor.hu, nol.hu

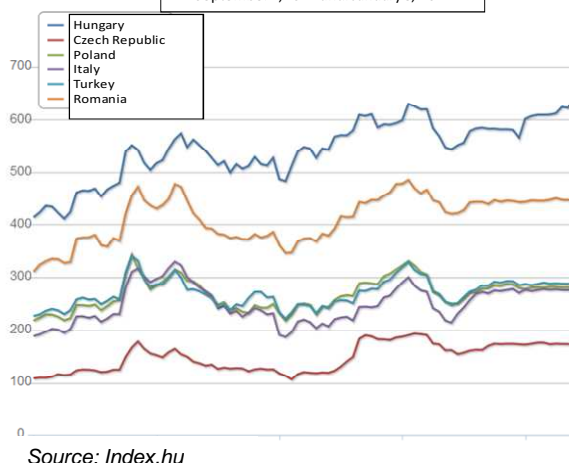
Italian CDS Spreads, August 2011 - January 2012



Hungarian CDS Spreads
September 1, 2011 until January 4, 2012



Regional CDS Spreads
September 1, 2011 until January 3, 2012



International trends

Results for the Ifo German industry and trade confidence index of the Institute for Economic Research in Munich showed an increase in December 2011 following the stabilization which had occurred the previous month. Enterprises reported a current favourable business situation in the near future and expectations improved again. According to the IEER asynchrony index the Ifo business confidence index shows more uncertainty than in the past month. Analysts feel that the German economy is able to successfully resist the negative impact of the global economic downturn.

The December survey results from the French statistical office (INSEE) show that the outlook for French industrial activity deteriorated again. In the assembled opinion of business leaders the business confidence index fell two points, and remains below its long-term average. The economic turning point indicator continues to indicate a negative cyclical situation. The overall outlook index fell further and is also below its long-term average.

The Ifo Business Climate for trade and industry in Germany continued to improve in December after stabilising in the previous month. Survey participants' responses showed that their assessment of the current business situation continues to remain favourable. Business expectations improved for the second time in succession. The German economy seems to be successfully countering the downturn in Western Europe.

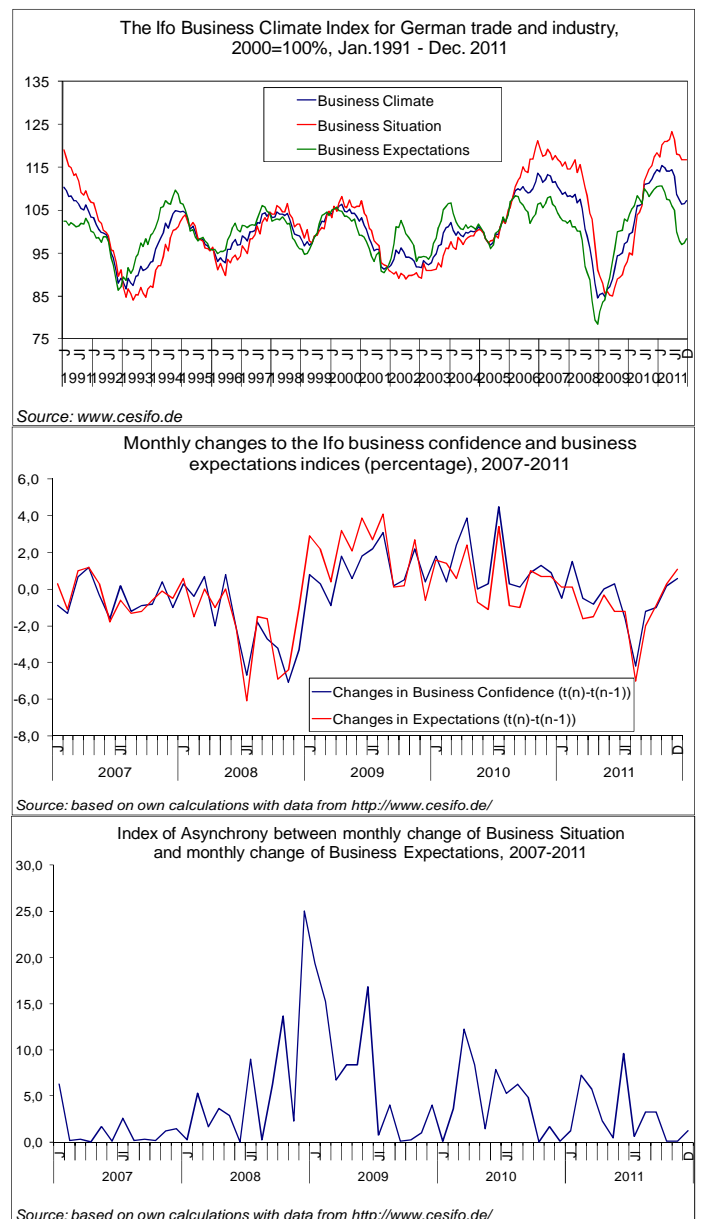
Measuring the gap between the business situation and expected developments, the asynchrony index calculated by IEER increased in December, thus the business confidence index showed a higher level of uncertainty compared to last month.

In manufacturing the business climate remains unchanged. Manufacturing firms may assess their current business situation as slightly less positive than in November, but there is no question of a meltdown comparable to that of 2008. On the contrary, the German economy is showing signs of stabilisation. Firms even view their six-month business outlook more favourably. They also see greater opportunities in the export business. The overhang of firms wishing to increase their staff numbers has nevertheless fallen slightly.

The business climate index increased somewhat in wholesaling and clearly in retailing. The business situation is assessed more positively than previously at both levels of trade. In addition, retailers and wholesalers are more optimistic. This suggests brisk Christmas trade.

The business climate continued to improve further in construction. The firms surveyed reported a slightly more favourable business situation than in November. Moreover, they expressed greater optimism regarding their six-month business outlook.

Source: Ifo (<http://www.cesifo-group.de>)



France (INSEE)

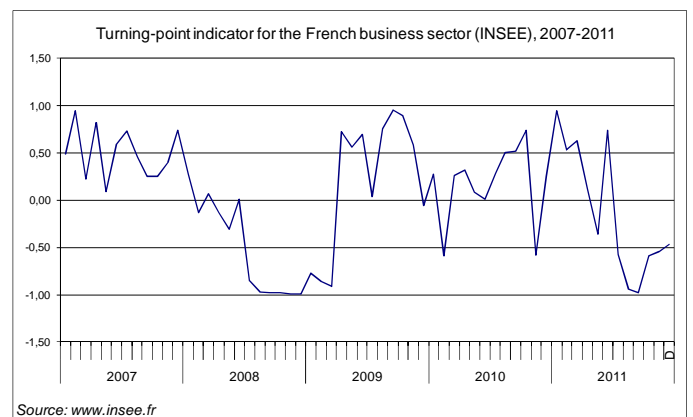
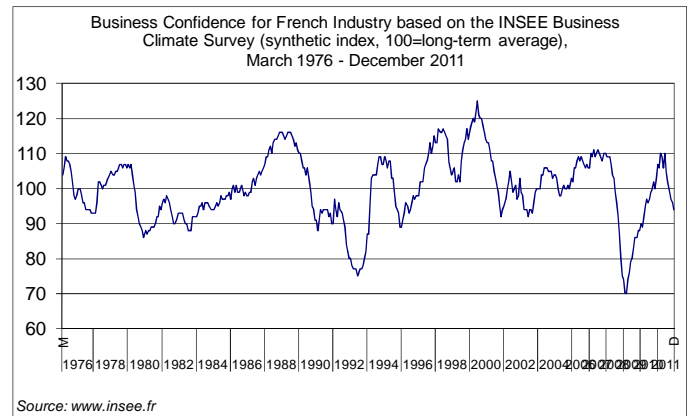
In the view of business leaders surveyed by the French statistical office (INSEE) in December the deterioration of the French business climate since July has continued: the INSEE business confidence index fell two points compared to November. The value of the indicator is below its long-term average.

The economic turning point indicator remained in the unfavourable area.

According to industry leaders output in the previous period declined significantly in December and the balance of opinion indicator is well below its long-term average. Company managers estimate that stocks of finished products increased slightly and can be considered to be at an average level. The index value for orders noticeably decreased and now remains at a low level. The export orders index rose slightly in December, but can be still considered to be at a low level.

French economic growth is expected to slow in the next three months: the individual business operations forecast of company executives (which summarizes the business prospects of the coming months) in December improved very slightly, but remained within the range indicating a negative situation. The general business outlook index -- which reflects the sum of opinions related to the business activity of respondents -- declined further and is well below its long-term average.

Source: INSEE (<http://www.insee.fr>)



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