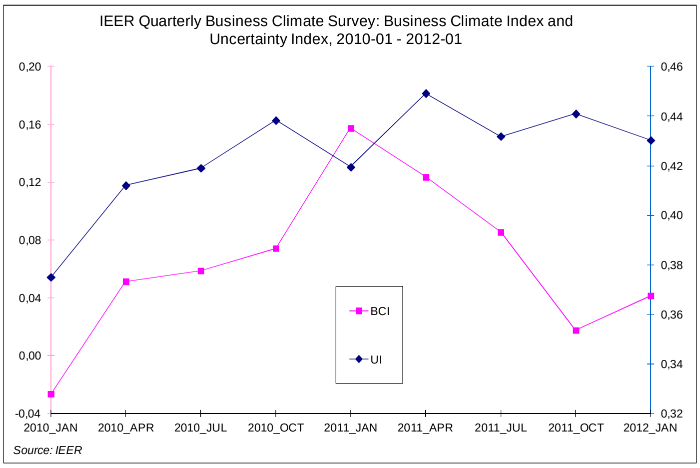
IEER Monthly Bulletin of Economic Trends March 2012

January 2012 was the ninth occasion of the IEER quarterly business climate survey. In this analysis, on a quarterly basis, we engaged in a total of 400 firms in the manufacturing, construction, and service industries being representative of the economic performance and sector distribution of companies operating in Hungary.
The January 2012 survey showed that all the business climate indicators related to the current state of business of Hungarian firms fell in the last quarter of 2011, following a less favourable macroeconomic situation. The short-term expectations of companies, however, show a significant positive change: with the exception of expected investment activity, all indicators rose for the next half year. As a result, the quarterly GVI Business Climate Index increased in the last quarter 2011, while the Uncertainty Index declined compared to the previous quarter.
A somewhat more favourable expected business situation for the next six months was observed compared to the previous quarter: 26% of firms count on a good business situation, while 17% say it will be bad. Expected production level indicators for the next half year were higher than the previous quarter. As for employee numbers over the next half year, businesses can count on the positive trends observed in the previous quarter to continue, especially among companies producing for the domestic market. As for investment activity, the data points to a decline as being likely in the coming months among businesses operating within Hungary.

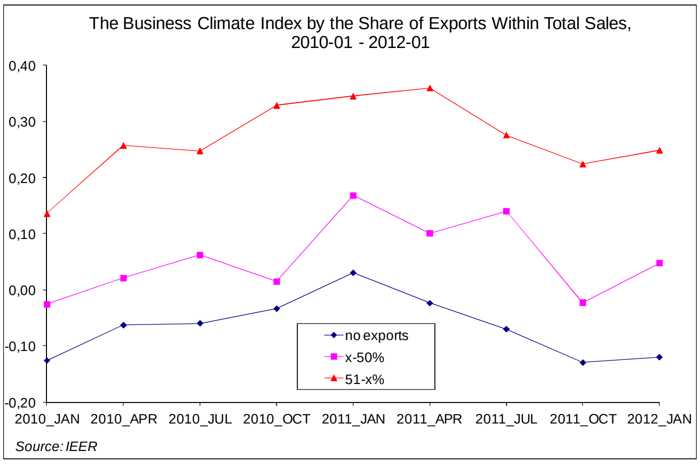
Business Climate and Uncertainty Index

The business climate indicators of Hungarian firms in the previous quarter reflected a less favourable macroeconomic situation: all business climate indicators declined. In addition, In the last quarter of 2011 all indicators reached lower levels compared to the year earlier. Despite the less favourable assessment for the current state of business, the short-term expectations of companies are almost uniformly positive toward the changes which took place in late 2011: all indicators for the next half year increased with the exception of anticipated investment activity, which fell slightly. As a result, the quarterly IEER Business Climate Index rose - breaking with the negative trend of the past few quarters. The Uncertainty Index slightly declined compared to the previous quarter indicating a decrease in the diversity of opinions on the current and expected business situation of the enterprises concerned.

In the last quarter of year 2011 the business climate index rose within all employee-related categories with the exception of companies employing between 20 to 49 persons, for which a decline in the index can be observed. Categories related to the proportion of foreign ownership all registered steady growth. A breakdown by economic sectors shows a decline among service companies while for other categories there is a growth. In terms of exports an increase can be observed in the business climate index for all categories. In addition, what is noticeable is that companies which produce only for the domestic market in Hungary witnessed an increase after a decline for the first three quarters of 2011.



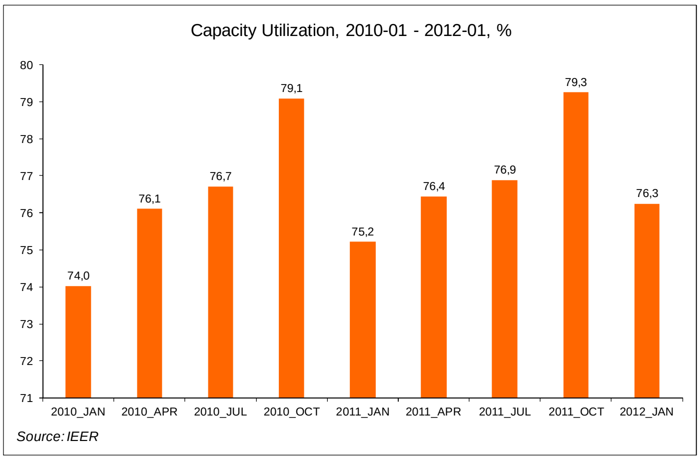
Source: IEER



Source: IEER

The current level of capacity utilization

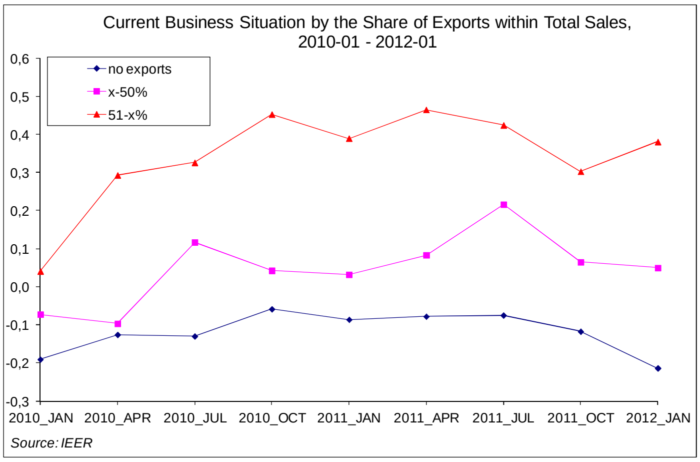
Last quarter's increase in the average capacity utilization level was broken and now stands at 76%, which is one percentage point higher than this time last year.



Over the past three months, capacity utilization increased only for employee categories with over 250 workers. In terms of export activity, the capital utilization ratio increased among those companies that mainly produce for foreign markets. In addition, capacity utilization increased for wholly and partially foreign-owned firms while for domestic-owned companies it declined by 5 percentage points. With regards to economic activity, capacity utilization of companies within the construction sector fell by 14 percentage points, while for manufacturing and retailing a smaller decrease could be observed along with stagnation among service providers.

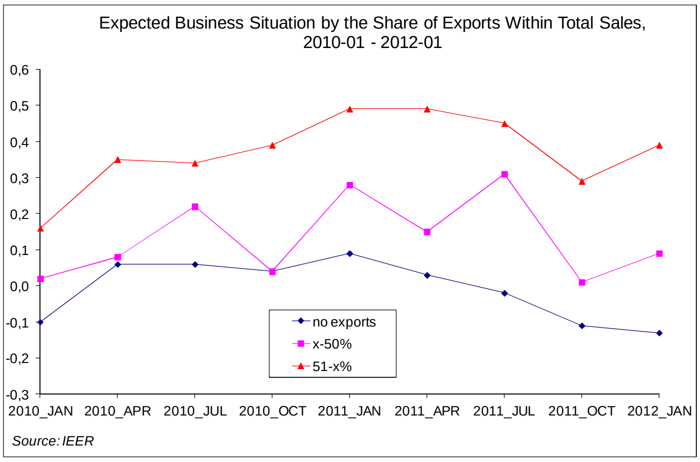
Orders, production level and business situation

The orders index indicates that the demand for products and services of firms fell short of the previous quarter, 26% of companies reported a low level of orders while 19% reported a high of level of orders (in the previous quarter these figures were 22% and 20% respectively).



The production level indicator decreased in the past quarter. The upward trend of production levels from the last quarter of 2009 to the first quarter of 2011 broke, and a negative trend has continued ever since. In January 2012, 25% of firms reported an expansion of production while 33% reported a decline, whereas in October 2011 this was 30% and 31% respectively.

Based on company responses, in terms of business situation a decline over the past two quarters can be observed. Compared to the last quarter, 25% said it was good, which was 1 percentage point lower than before, and 22% said it was bad, which was 3 percentage points higher. Compared to the same period last year, the proportion of firms reporting a good business situation was four percentage points lower while those reporting a bad business situation remained largely unchanged.

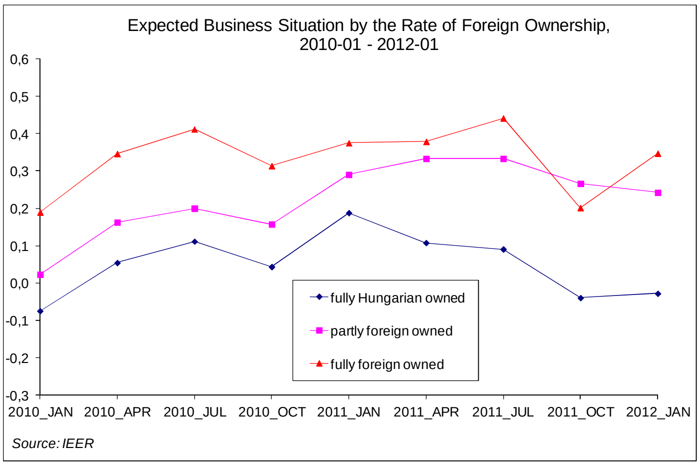


Business Expectations

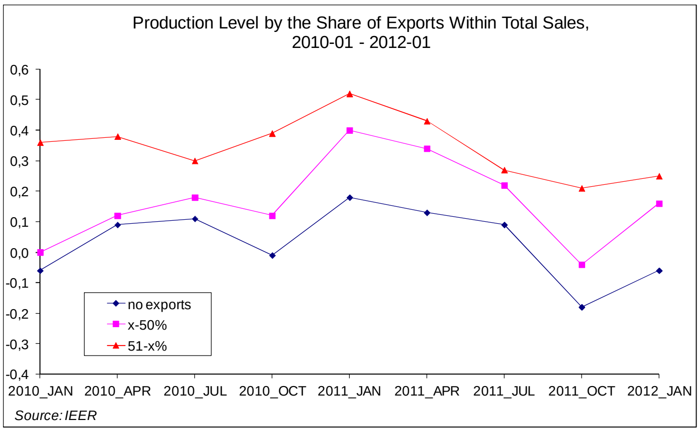
Compared to the observations from the previous quarter, firms believe the expected business situation to be slightly better over the next six months. Overall, 26% expect a positive, 17% a negative, business situation.

The results show that a large proportion of companies which expect a good business situation are those with over 250 employees. Within this group 33% are such, which is three percentage points higher than encountered in previous studies. Within all employee categories, only firms employing 50-99 people can be said to have decreased in the last three months.

As for share of exports within sales, exporting firms have a more optimistic look for the next six months, as producers for the domestic market, while the most favourable expectations come from predominantly export-oriented companies, with the latter showing a marked increase over the last quarter. The expected business situation for companies that produce predominantly for the domestic market also increased in the last quarter after a sharp decline. Business expectations deteriorated in January only for companies which produce exclusively for the domestic market – as was the case the previous three quarters.

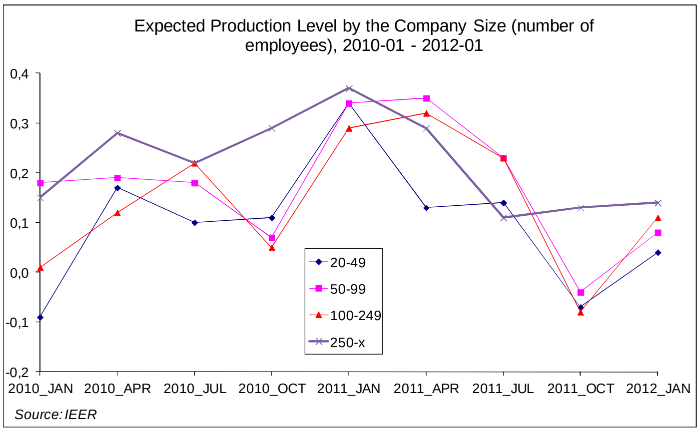


With regards to economic activity, the expectations of construction firms stagnated, whereas an improvement was observed over the previous quarter among companies within services, manufacturing and retailing. The most optimistic businesses were in the manufacturing sector, of which 33% expect a good business situation. The most pessimistic are construction companies, among them the proportion of companies with a good business situation outlook fell 7 percentage points to 13% since the last quarter – a satisfactory status, however, would be an increase from 13 percentage points to 63%.



The production level indicator for the next half-year is also expected to increase over the previous quarter: the index is still in positive territory. Thirty percent of managers are confident in production level growth after reaching 24% the previous quarter, while 20% are expecting it to decline (which is 5 percentage points lower than in the previous quarter).

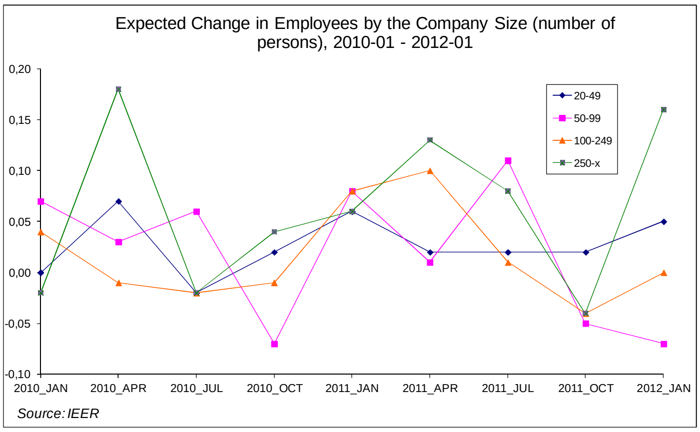
In terms of categories related to export activity, expected production levels increased for all. Production levels are expected to increase 23% among producers for the domestic market only (in the previous quarter, this figure was only 17%) while 30% forecast a decline. Of companies which are primarily export-oriented, 39% expect a good business situation, which is four percentage points higher than the last quarter.



Analyzing the data based on the number of employees, we can see that for all categories production level expectations over the next six months have improved. With regards to economic activity, production level expectations improved for almost all business categories, with the exception of the service sector – where stagnation has been observed. Our data shows that construction companies are the most pessimistic in terms of expected production levels: only 23% expect growth in the next six months, while in the previous quarter this rate was 14%.

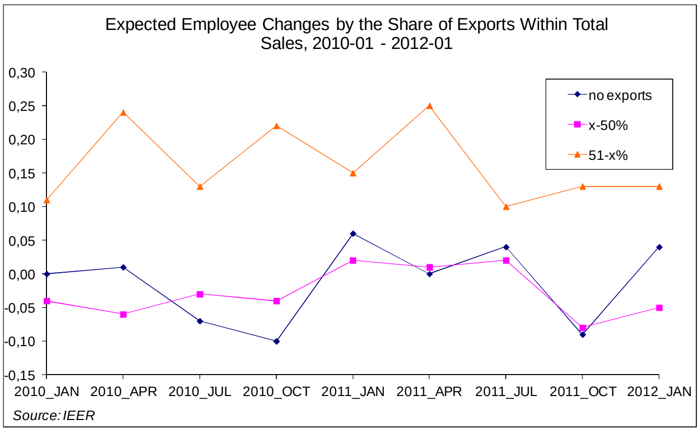
Employee numbers and the anticipated growth of investments

Over the next six months, smaller changes in employee numbers can be expected as was observed in the previous quarter within enterprises: about 15% of companies plan to hire while 11% plan layoffs, which is two percentage points higher and five points lower respectively than the previous quarter.



In terms of export activity, it can be seen that among domestic producers the proportion of enterprises hiring more workers rose from 7% to 15% in the last quarter of 2011. Among companies that primarily produce for the domestic market the data points to stagnation. For companies that primarily sell abroad, the proportion of firms planning to hire declined compared to the previous quarter (26% to 20%).

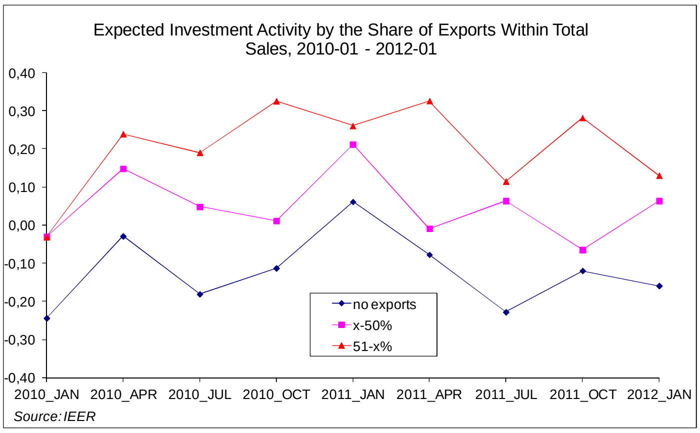
An analysis of employee categories shows an increasing tendency in all classes, especially among firms employing more than 250 people.



With reference to economic activity, a downturn compared to the third quarter of 2011 can be observed only among companies within the service sector, while significantly stronger growth can be seen in the indicators for the construction sector: 22% of firms planned to hire more workers in the next six months - as opposed to11% three months earlier.

A decline in the development of investment activity can be expected in the coming months. The results showed that 25% of companies planned investments, 19% planned reductions and 18% want to increase their volume of investments.

Investment activity indicators for domestic market producers and export-oriented companies have shown a significant decline (34% for the former, 20% for the latter for planned investment in the next period). On the other hand, a pick-up in investment activity among companies that produce predominantly for the domestic market can be observed: among these companies, 18% predicted investment growth and 18% also a decline, while in October 2011 this ratio was 13% and 28% respectively.



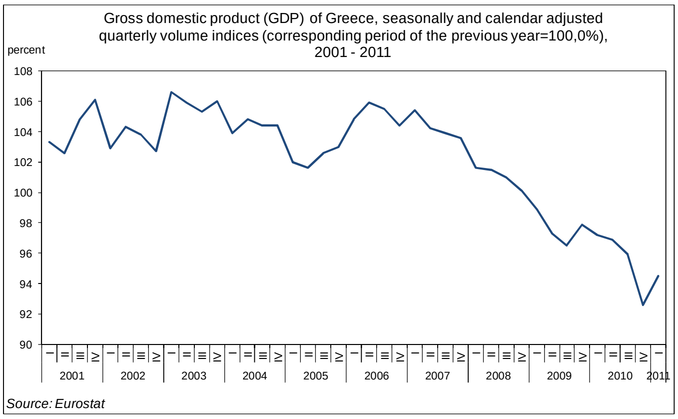
A decline in investment activity indicators can be observed in firms with 20-49 employees as well as those with 100 to 249 employees. Indicators for companies with 50 or fewer employees have the lowest rate: among them only 11% plan to increase investments with 36% not planning to invest, which is 5 and 7 percentage points lower respectively than the previous quarter. A pick-up in planned investment activity can be observed in only the retail and construction industries, for all other sectors a decline can be seen.

Macro-economic trends:
the economic situation in Greece

The Greek statistics office estimates that for all of 2011 the GDP decline was 6.8 percent, which represents the fifth consecutive year of recession in Greece. Analysts do not expect GDP growth until the second half of next year.
The euro zone Finance Ministers Council in March declared that the country's bond-exchange program to reduce the debt level was a success; therefore it paid 35.5 billion Euros to Greece as the first instalment of a 130 billion rescue package. As a result of the bond-exchange program, private creditors swapped their bonds for ones with a reduced face value and more favourable longer-term. While Greece may have thus avoided actual bankruptcy, Standard & Poor's, Fitch Ratings and Moody's all declared Greece to be insolvent.
The creditors' troika of experts consisting of the European Commission, the International Monetary Fund and the European Central Bank believe that following the first 110 billion Euro program in 2010 and after the recently approved second one, Athens may need at least another 50 billion after 2015. Economic analysts feel that because of weak macro results due to the stringent austerity measures, the ratio of Greek public debt to GDP may increase to 140 percent by the end of the decade.

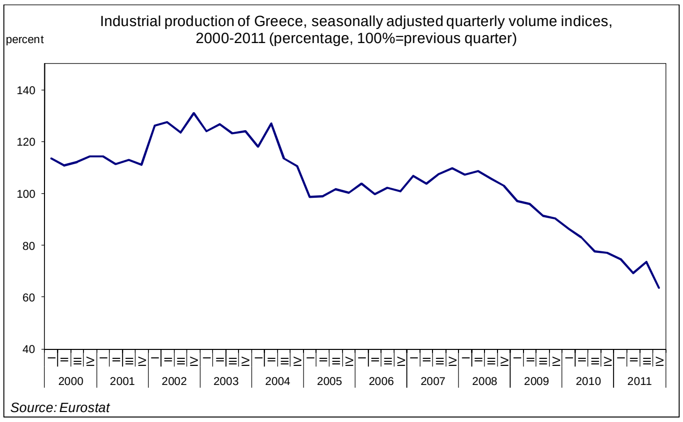
Economic Situation

According to the Greek statistics office's flash estimate, the Greek economy contracted in the last quarter of 2011 by 7.5 percent per annum. Greek GDP declined by 5 percent in the third, 7.3 percent in the second and 8 percent in the first quarter of last year. Based on data not yet seasonally adjusted, the drop in Greek GDP was 6.8 percent for the whole of 2011, while previous estimates talked of 5.5 to 6.0 per cent. At current rates, Greek GDP decreased by EUR 215 billion for all of last year; economists feel that practically only net export data showed growth. Greece is in the fifth consecutive year of a recession, and GDP growth is not expected before the second half of next year.



The first rescue package

The euro zone Finance Ministers Council (Eurogroup) in early March declared the bond exchange program aimed at reducing the country's level of debt to be a success and therefore chose to transfer 35.5 billion Euros to Greece as the first instalment of a 130 billion rescue package.



Within the framework of the bond-exchange program, private creditors agreed to the face value of 95.7 percent of the Greek sovereign debt held by their portfolios to be reduced by 53.5 percent and swapped for long-term bonds with favourable conditions. In return, these investors received up to 30 billion Euros of the euro zone's guaranteed short-term bonds. The euro zone ministers said that they counted on a significant contribution from the International Monetary Fund (IMF) for the implementation of a second rescue package for Greece.

Greece thus avoided immediate, actual bankruptcy. Without the transferred amount Greece would have filed for actual bankruptcy on March 20 since 14.5 billion Euros in debt would have been due and it wouldn't have been able to cover this amount on its own. Holders of 85.8 percent of the 177 billion worth of bonds issued pursuant to Greek law chose to participate in the bond swap between private investors and Athens, resulting in a net worth loss of more than 70 percent because of the debt-restructuring.

For the nearly 20 billion in bonds issued under foreign law, 69 percent of investors joined in the bond exchange. The Athens Government decided that for bonds issued under Greek law it would activate the so-called co-action clause (collective action clauses - CAC), which means that those who refused to participate in the bond exchange would be forced to take part. This was possible for Athens because the number of investors that signed up for the bond swap exceeded 66 percent. By applying the CAC the overall number of bond-holders involved in the exchange rose to 95.7 percent. This 206 billion Euros worth of bonds held by private investors is covered by 197 billion in government bonds. Although Greece avoided actual bankruptcy, after the bond swap Standard & Poor's, Fitch Ratings and Moody's declared Greece insolvent based on their own criteria.

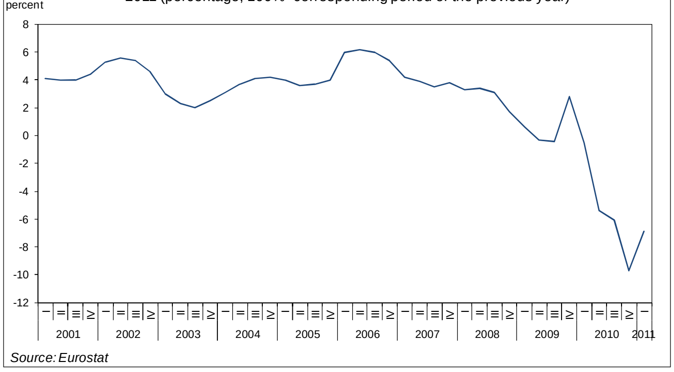
Downgrades

In late February, Standard & Poor's declared Greece to be partially insolvent, claiming that in the process of restructuring its debt the Greek government would retroactively initiate collective action clauses for each bond series. The rating agency stated that the reason for the downgrade was because if an issuer of a debt obligation unilaterally modifies the original terms and a condition of an issue, the firm regards this as a factual debt restructure and therefore qualifies as a default. Standard & Poor's feels that if a sufficient number of bondholders rejected the debt-exchange offer made by the Greek government, then Greece would be faced with an immediate and total bankruptcy situation since there is no access to market financing, and in this case it is likely that official refinancing - that is, the EU and the IMF, along with other organizations as sources international funding – would be unavailable.

In early March, Fitch Ratings also downgraded Greece to the partially insolvent category after the Greek government and euro zone leaders confirmed that the bond swap program would take place as planned. The largest European credit rating said that it would further lower the long-term domestic and foreign sovereign debt rating of Greece from a "C" (extreme investor risk) to a "RD" (restricted default) rating. Fitch Ratings statement about the reason for the downgrade: according to the firm's criteria, the sovereign debt exchange program was a default event.

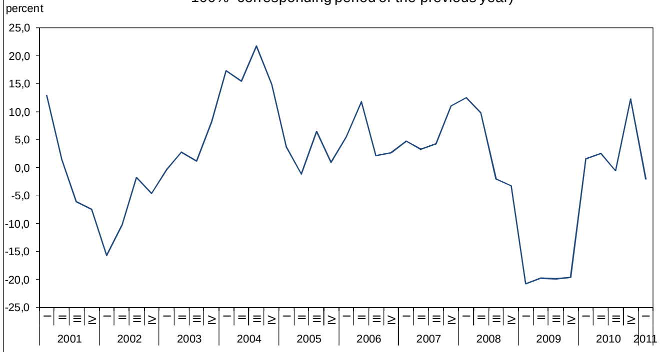
Moody's meanwhile downgraded the rank for Greece to "C", its worst possible rating. Moody's also said that there is no need to establish a new outlook for Greece, since it can't get worse. According to the company, investors will suffer significant losses as a result of the debt-exchange offer from

Domestic Consumption, in Greece, seasonally adjusted volume indices, 2001-2011 (percentage, 100%=corresponding period of the previous year)



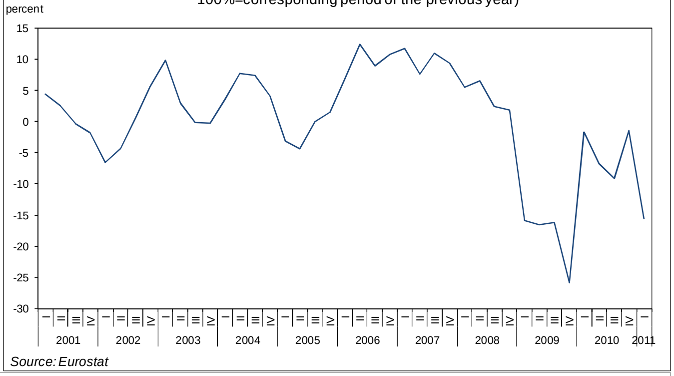
Source: Eurostat

Exports of Greece, seasonally adjusted volume indices, 2001-2011 (percentage, 100%=corresponding period of the previous year)



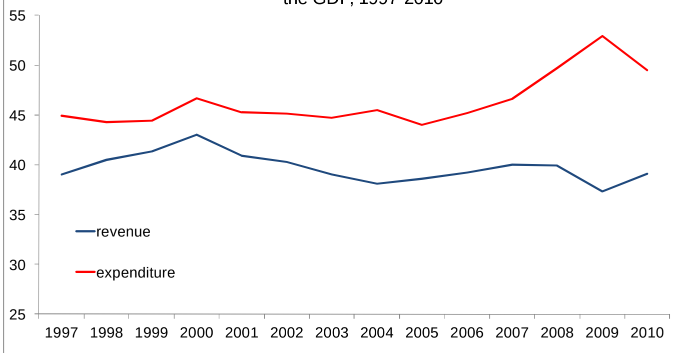
Source: Eurostat

Imports of Greece, seasonally adjusted volume indices, 2001-2011 (percentage, 100%=corresponding period of the previous year)



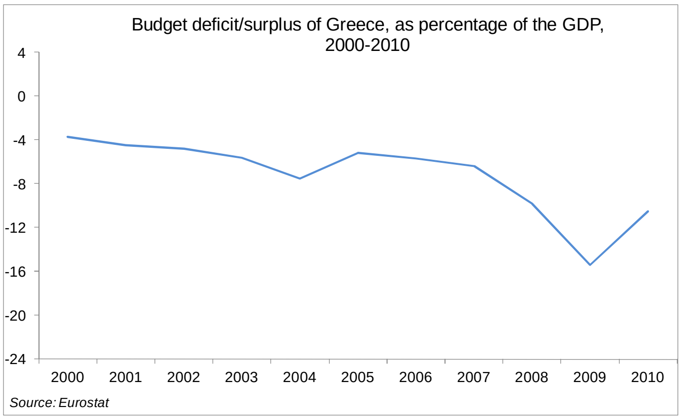
Source: Eurostat

Government revenue and expenditure of Greece, as percentage of the GDP, 1997-2010



Source Eurostat

the government in Athens, which may exceed 70 percent. In addition, even after the EU program and the completion of the bond swap the risk of bankruptcy remains high, in particular if there is a lack of confidence in the implementation of reforms.

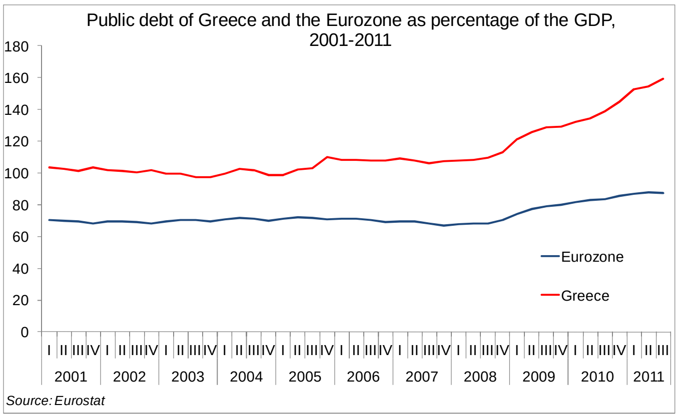


New rescue package

In mid-March the IMF approved a $28 billion emergency loan for Greece, as part of a broader international aid package. The IMF announced that of this sum, which by 2014 will support the financing of the Greek economy, 1.65 billion Euros will be immediately transferred to Athens. With this approval from the IMF Executive Board, several months of Greece-related uncertainty came to an end. Athens has a series of painful economic reforms while the result of the bond swap insured access to the package provided by the IMF-EU.

Analysts' expectations

Der Spiegel has learned that the creditors' troika of experts, made up of the European Commission, the International Monetary Fund and the European Central Bank, believe that following the first 110 billion Euro program in 2010 and after the recently approved second one, Athens may need at least another 50 billion after 2015. According to the latest data from the EU's statistical office, the government debt of Greece was 347.2 billion Euros at the end of the third quarter last year; this is equivalent to 159.1 percent of GDP. Greece owes about 200 billion of debt to private creditors. Analysts expect that the stringent austerity measures will lead to weak macro results and that by the end of the decade the public debt to GDP ratio will again increase 140 percent, despite that 120 percent has been set as the target for this period.



Source: hvg.hu, vg.hu privatbankar.hu

International trends

The industry and trade confidence index value of the German Institute for Economic Research Ifo in Munich showed for the forth month an increase in February 2012. A more favourable current business situation of firms was reported than in January, and the near-term expectations have also improved significantly. According to the IEER asynchrony index Ifo business confidence index shows less uncertainty compared to the past month. Researchers also point out that the German economy is currently supported by domestic demand.

The February survey results from the French statistical office (INSEE) show that the business climate in France has stabilized. The business confidence index based on the accumulated opinion of business leaders remained unchanged, and stays well below the long-term average. The economic turning point indicator still points to an unfavourable economic situation. The overall outlook index increased slightly, but can be said to be still very low.

Germany (Ifo)

Following improvements over the past three months, the industry and trade confidence index value of the German Institute for Economic Research Ifo in Munich once again showed a positive shift in February 2012. Several respondent firms indicated a more favourable current business situation compared with January, and expectations for the next half-year showed improvement for the fourth consecutive month. Ifo analysts see the German economy now being supported by domestic demand.

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

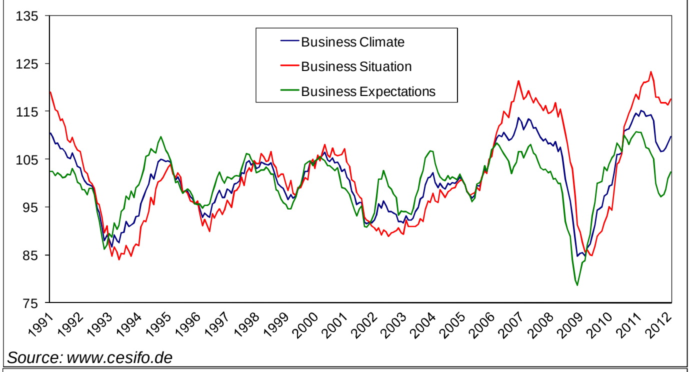
Among industrial enterprises the business confidence index continued to rise slightly following an improvement in the past month. For the third month in a row, managers considered the outlook for the next six months to be better than in the past. The current business situation is seen as somewhat less favourable, however, as compared to January. Export demand remains at a relatively high level. Businesses continue to plan for an expansion in employee numbers.

The retail and wholesale trade confidence index increased significantly in the past month. The current business situation of firms in both groups has improved. As for short-term business prospects, managers of both retailing and wholesaling firms have become a bit more positive.

The business confidence index for the construction industry has shown improvement for the fourth month in a row, with a specifically significant increase seen in February. The construction contractors surveyed reported a more favourable current business situation than in the past month and expectations for the next half year have become more optimistic.

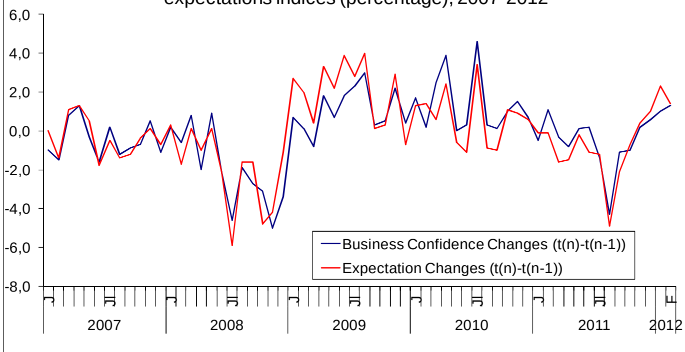
Source: Ifo (http://www.cesifo-group.de)

The Ifo Business Climate Index for German trade and industry, 2000=100%, Jan.1991 - Feb. 2011



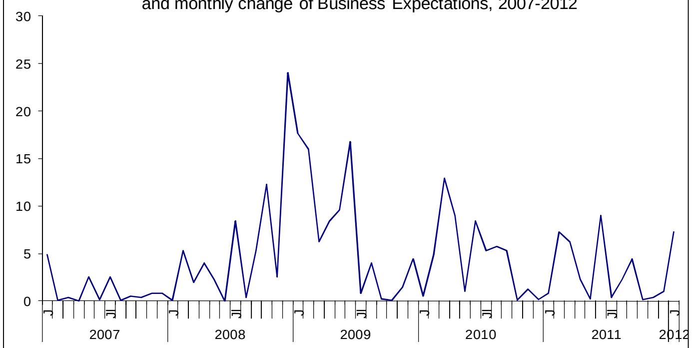
Source: www.cesifo.de

Monthly changes to the Ifo business confidence and business expectations indices (percentage), 2007-2012



Source: calculations based on data from http://www.cesifo.de

Index of Asynchrony between monthly change of Business Situation and monthly change of Business Expectations, 2007-2012



Source: calculations based on data from http://www.cesifo.de

France (INSEE)

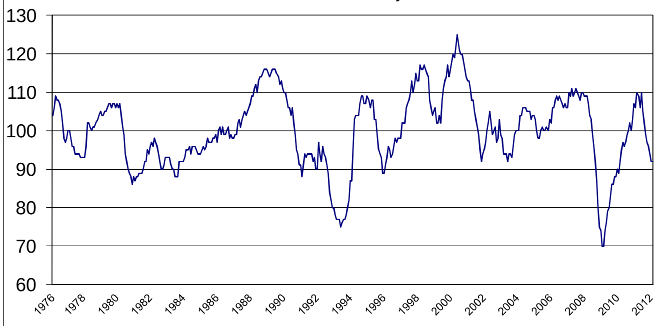
Based on a survey by the French statistical office (INSEE), in the opinion of French business leaders interviewed in February the business climate in France has stabilized compared to last month: the INSEE business confidence index for January – which was well below its long-term average - remained stable.

The economic turning point indicator remained in the unfavourable area.

Business leaders also noted that output from the previous period continued to decline in February, so the balance of opinions index is significantly below its long-term average. As for stocks of finished products, company managers believe they remained stable and slightly above average levels. February domestic and export stock order indicators have not improved, and remains at a low level. The export orders index fell significantly in February.

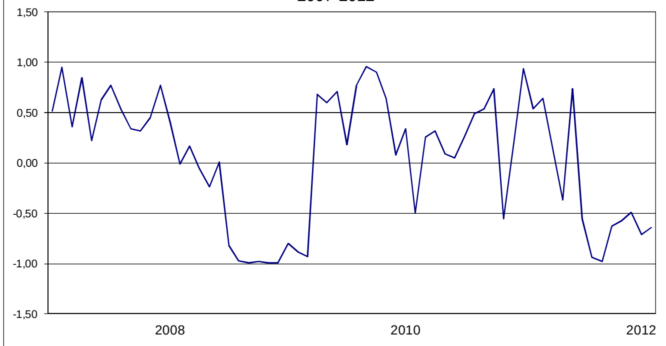
French economic growth in the coming months is not expected to be dynamic: the individual business operations forecast of company executives (which summarizes the business prospects of the coming months) improved slightly in February, but still remains below its long-term average. The general business outlook index -- which reflects the sum of opinions related to the business activity of respondents – shows some improvement, but is still well below its long-term average.

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



Business Confidence for French Industry based on the INSEE Business Climate Survey (synthetic index, 100=long-term average), March 1976 - February 2012

Source: www.insee.fr



Turning-point indicator for the French business sector (INSEE), 2007-2012

Forrás: www.insee.fr

Written by: Ágnes Makó (analyst, IEER)
E-mail: agnes.mako@gvi.hu

In case of reproduction please acknowledge the source as follows:
IEER: Monthly Economic Newletter,
March / 2012, Budapest,
2012-03-24