

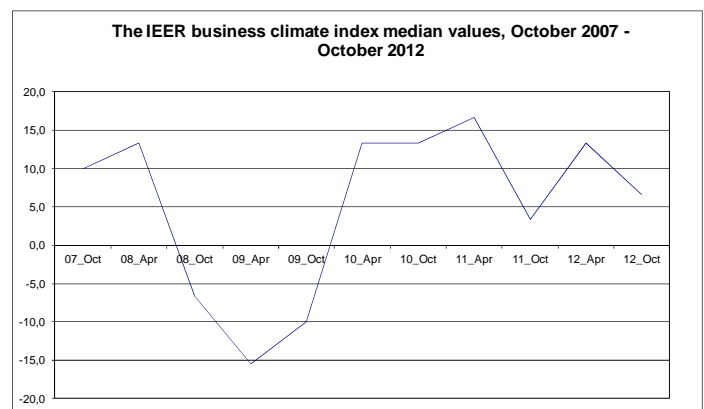
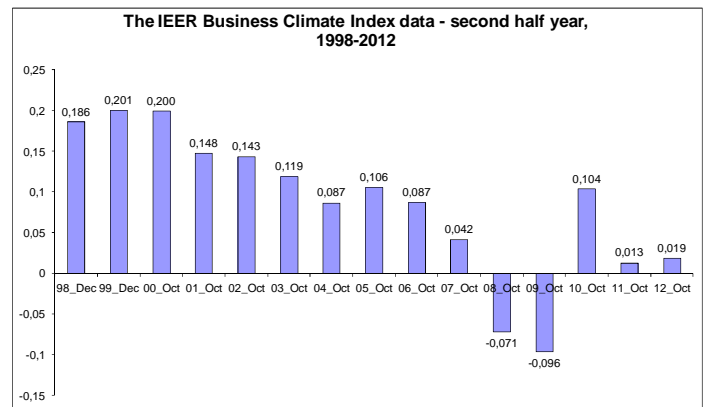
October 2012 was the thirtieth occasion of the IEER business climate survey which is based on the cumulative response of more than 14,000 companies conducted in April and October of each year with the participation of regional chambers. It is the largest and most extensive business climate survey in Hungary. The research is part of the 14 million enterprise-wide Eurochambres survey of the European economy. In October this year 3,182 firms filled out our questionnaire -- our study is based on the responses of these companies.

The results inform us of the worsening business prospects and expectations surrounding a high level of uncertainty felt by Hungarian companies. Based on the expectations of firms, stagnation and a worsening business climate are expected in late 2012 and early 2013 for the Hungarian economy. Although the IEER Business Climate Index remained in the positive territory, the value declined from +8.7 points in April to +1.9 points. The IEER Uncertainty Index has not changed significantly since April, and is still at a high level. The economic crisis has strongly affected all sectors, with the construction industry in particular still reeling from the impact of the economic crisis. This sector has so far not shown any signs of recovery.

According to the October 2012 survey results, business confidence deteriorated in Hungary: after an upswing in April companies have become more pessimistic. The IEER Business Climate Index fell 6.8 points, from 8.7 points in April to 1.9 points. If the data is compared to the levels in October of each year, then this represents the fourth lowest score since the survey began (1998). These results clearly show a negative turning point, while the uncertainty related to the assessment of the current business situation and of future expectations remain quite significant. The median value of the business climate index also decreased in the last half of the year, falling from a previous value of +13.3 points to +6.7 points in October. The data, therefore, clearly confirms the observation that the economic recovery in Hungary -- which began in October 2009 – ended in April 2011.

The IEER Uncertainty Index did not change significantly compared to the results of the April survey: it continued to be high, at a 45-point level. This, in turn, suggests that business leaders are still much divided on the Hungarian economy: there are companies that feel their business prospects have improved, but many see a further deterioration in their business situation as likely. In other words, within the business sphere a unanimous view of current trends and an interpretation of long-term tendencies are still not clear.

In addition, it should be noted also that the economic crisis is still visible in many detailed indices; in particular, sectors strongly affected by the crisis, such as the construction industry. This year, while capacity utilization for the construction industry increased in October to 71.1% (from 64.4%), seasonal effects nevertheless also played a role: in October last year, the value was 70.7%. Meanwhile, the value of the Sales Volume Indicator has barely moved, from -3.4 points to -4.1 points, which indicates a continuation in the decline of the construction industry.



A further negative sign is the Current Profitability Index, which after a decline from -15.8 last October to -35.7 in April of this year, it was able to rise to only -30 points this autumn. The data clearly indicate a profound crisis in the Hungarian construction industry, and the fact is that this sector is expected to decrease further. The business climate indicator in the construction industry, which over the past year has been at particularly low levels, has also fallen 12.5 points surpassing the minimum measured this spring: -33.3 points.

Comparing current and future business outlook indicators, Hungarian business prospects are projected to stagnate, but a declining business climate is not that far off.

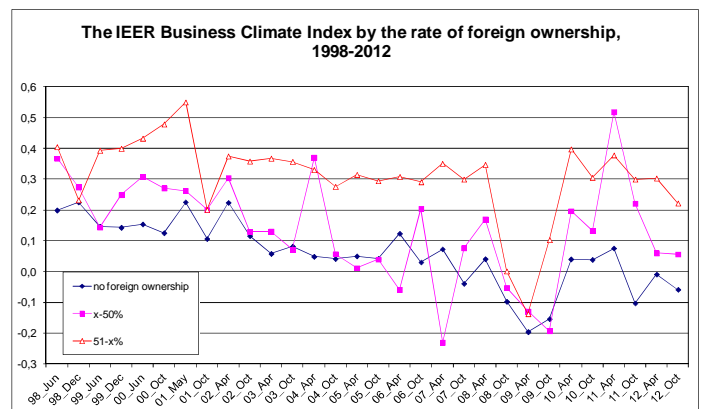
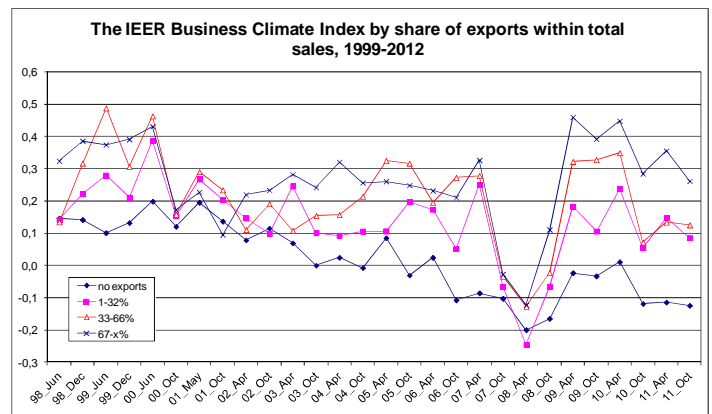
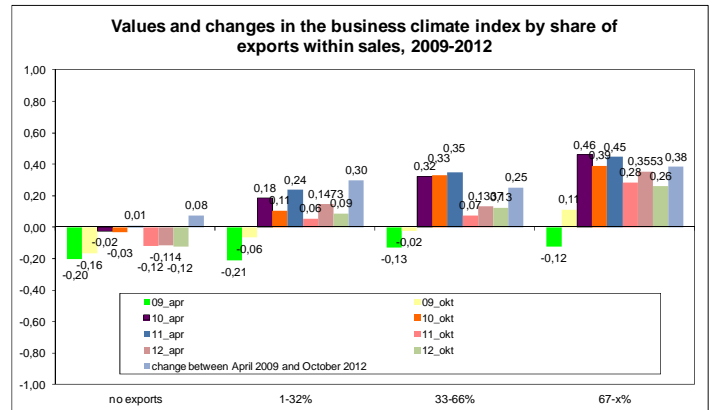
Thus, according to the results of the October survey, the Business Climate Index fell, but is still in the positive territory. The expected level of investments in machinery and the level of expected construction investment activity declined. The expected labour demand index was in negative territory again.

In terms of ownership structure, the IEER Business Climate Index declined for both firms owned by foreigners and Hungarian-owned companies alike, while for those with a majority Hungarian ownership as well as partly foreign-owned companies, we can speak of stagnation.

As for company size, a decline for firms of all sizes can be noted. The worst situation remains those reported by owners of micro-businesses. The business climate indicator fell for big companies from 23 points to 17 points, for medium firms from 11 points back to 3 points, while for small firms (10-49 employees) it fell to -13 points from -6 points, and for micro-enterprises the indicator stood around the -35 level.

Grouped by the export activity of firms, a homogeneous picture also appears: a decline can be observed for all groups. This occurs at different levels and to varying degrees: prospects have deteriorated most for firms producing for both export and also the domestic market, while it was the least for those that produce solely for the Hungarian market. Alongside this there is a tendency that the higher proportion of exports a company has the more favourable their economic prospects are.

From the export activity of firms it can be concluded that the IEER Business Climate Index remained unchanged for firms that produce solely for the domestic market and those with a 33-66% share of exports within sales, while for all other categories it declined. This decline is mainly apparent with large exporting firms as well as those with less than a third of their production geared for foreign markets. Following the changes over the past six months, it can not be stated with certainty that the greater the proportion of a company's exports, the more its economic outlook has improved.



In terms of economic sectors, the highest value for the Business Climate Index in October remains manufacturing. The construction industry is still characterized by the crisis and a deteriorating situation. The index for retail companies increased by one point, but for the services sector a decline from -4 points to -8 points can be seen.

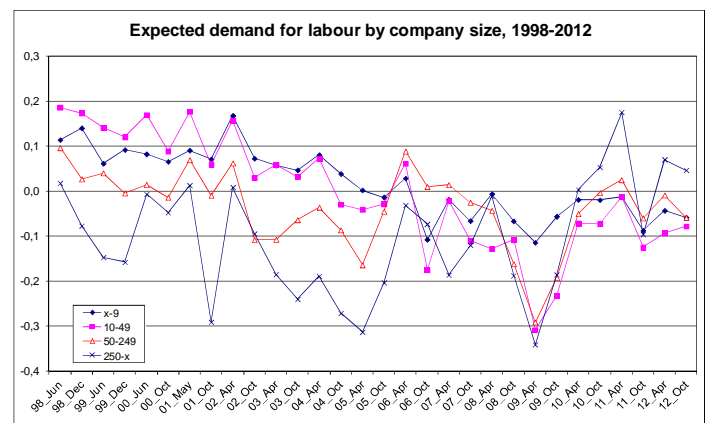
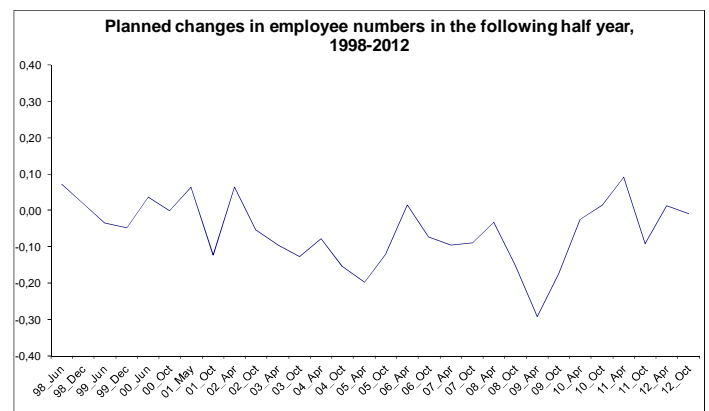
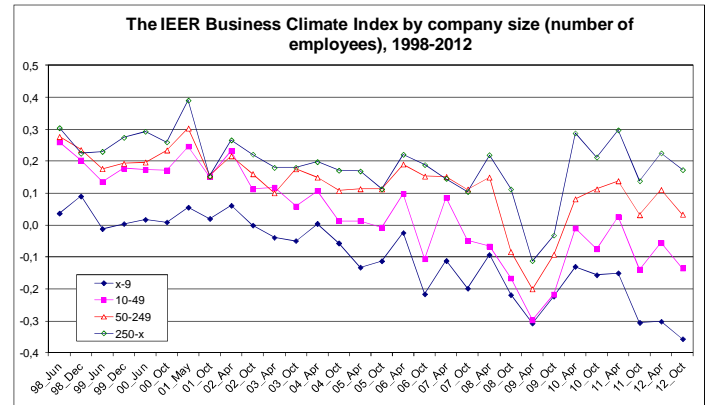
Investments

It's a negative sign that more than one-third of businesses don't plan machinery investments for the next six months, while in 2010 this figure was around 25%. The level of investment activity in machinery is expected to decline, therefore, although in the past six months it has reached pre-crisis levels. Indicators for the expected level of investments in new construction projects have also declined since April. It appears that companies continue to wait, and typically don't dare to undertake new developments. The decrease in machinery investment activity is mainly characteristic of domestic and foreign-owned firms, while for the majority of domestic-owned firms an increase can be observed in this regard.

Labour demand

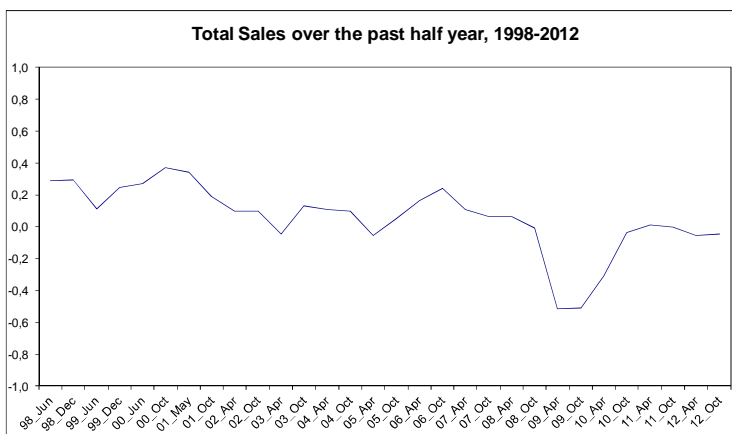
The survey data from October indicate that a small decline in labour demand is expected in the next six months for the business-sector. The previous balance between those being hired and those being fired from 1% to -1% has declined in such a way that 18% of the firms plan dismissals, 66% did not change the number of employees, and 17% are planning to hire more workers. (Half a year ago, these rates were 15%, 69% and 16%, respectively).

Employment growth remains more typical of manufacturing companies (23%), while firms within the construction sector are least likely to increase the number of employees (6%). According to the data from October, 16% of manufacturing companies plan further dismissals while for construction companies this rate is 27%. Most large companies, mainly exporters and those predominantly foreign-owned, planned staff increases (23%, 27% and 22%). Labour demand is once again increasing after a large contraction measured over the past year. Nevertheless, regardless of company size all feature a decline in the demand for labour, with the exception of the small business community.



The average level of capacity utilization increased since April, and now stands at 77%. Highest capacity utilization is still found at large enterprises, those within the manufacturing sector, mostly foreign-owned companies, as well as mainly exporting firms (81%, 79%, 82% and 82%). The lowest are in the construction industry, micro firms, domestic producers and entirely Hungarian-owned firms (71%, 60%, 73% and 74%).

In the evolution of total sales over the past six months, compared to October last year the weakening trend or stagnation that was observed continued, with the level measured in April showing a minimal improvement (-4 points). This also means that the proportion of firms with an increasing sales volume is still smaller than those suffering a decrease (29% and 33%). Summarizing the data over the past year, therefore, the components that play an important role in the business situation of firms indicate an unchanged level – showing signs of stagnation.



Macro-economic trends: A short review of "The Euro Crisis - ten roots but fewer solutions" by Zsolt Darvas

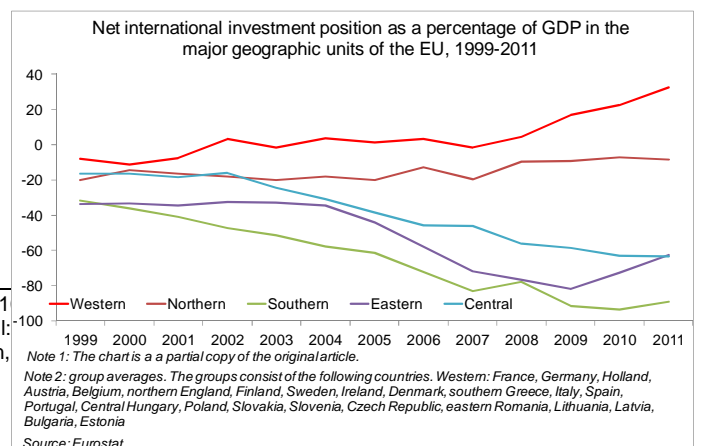
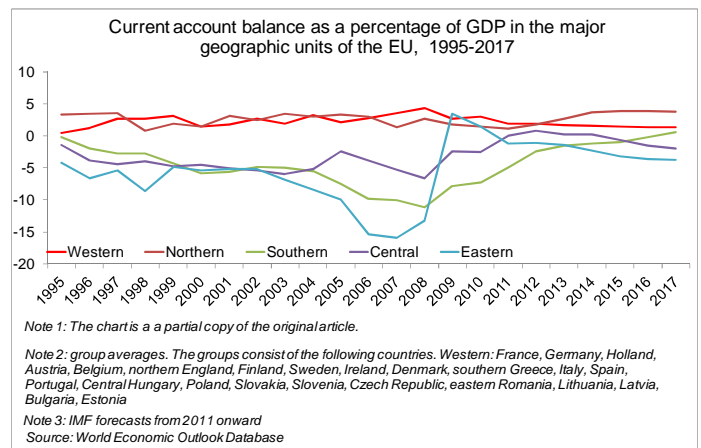
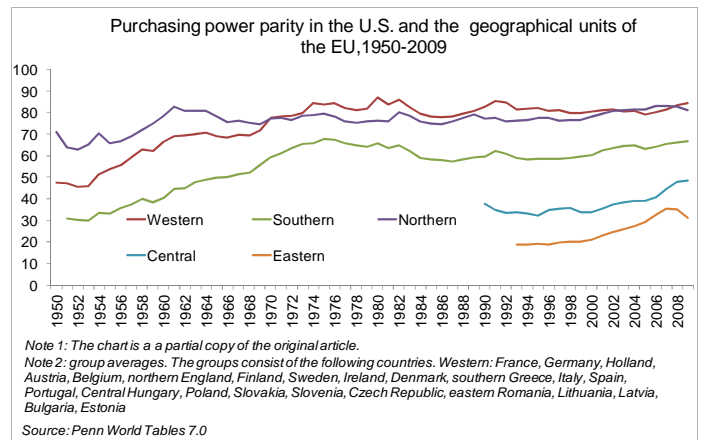
Zsolt Darvas, researcher at the Brussels-based Bruegel Institute, published in October of this year a 10 point summary of the causes and factors complicating the euro zone debt crisis. In addition, we get an overview of the consequences, current ideas and, from the perspective of a recovery, the important factors for a solution. The following is a brief summary of this paper.

The author summarizes in ten points the source of the euro crisis¹:

1. The rules that were laid down by the Stability and Growth Pact criteria have not proved to be suitable to maintain fiscal discipline.
2. Vulnerability coming from the private sector was ignored.
3. There is no effective way of promoting structural adjustments. There are many negative examples of countries which can not sustain them, and very few good examples.
4. Lack of crisis management mechanisms. There is no established procedure for the euro area sovereign debt crisis. In addition, the treatment mechanisms of minor issues have already been agreed in advance.
5. Banking sector and the government sector interdependencies. As the government debt of Member States are largely in the hands of the banking sector of the same Member State, because of this interdependency when one is in a difficult situation it then drags the other along with it.
6. The interdependence of Member States. As with the interdependency of banks and governments, other countries can be strongly affected if a larger euro zone government becomes insolvent.
7. The European Central Bank has no role as a last resort, so it can not buy government debt, for example, like the U.S. Federal Reserve. The Bond Market Program is a partial solution to this problem.
8. Negative feedback. For the weaker southern states balancing the budget is a burden and weakens the

¹ The original text of the study can be found on the Bruegel Institute website:

<http://www.bruegel.org/download/parent/755-the-euro-crisis-ten-roots-but-fewer-solutions/file/1621-the-euro-crisis-ten-roots-but-fewer-solutions/>



economy, which makes it even more difficult to balance the budget. For the otherwise strong economies of better performing countries the threat of the euro crisis makes investments risky.

9. Lack of a common fiscal policy. Therefore there is no responsible body, and the effect of many decentralized budgets, meanwhile, is hardly optimal in terms of the entire euro zone.

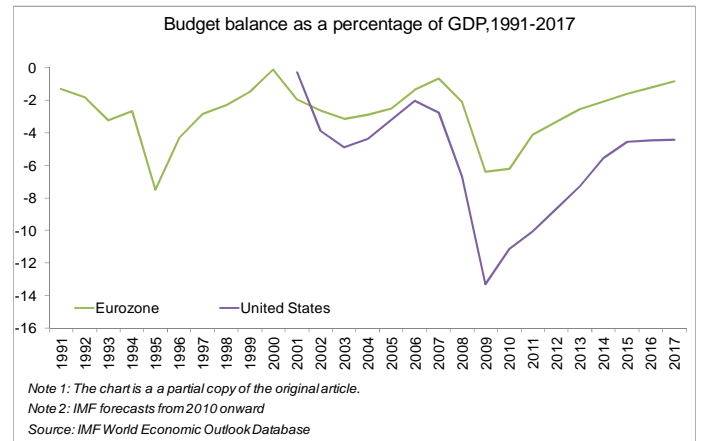
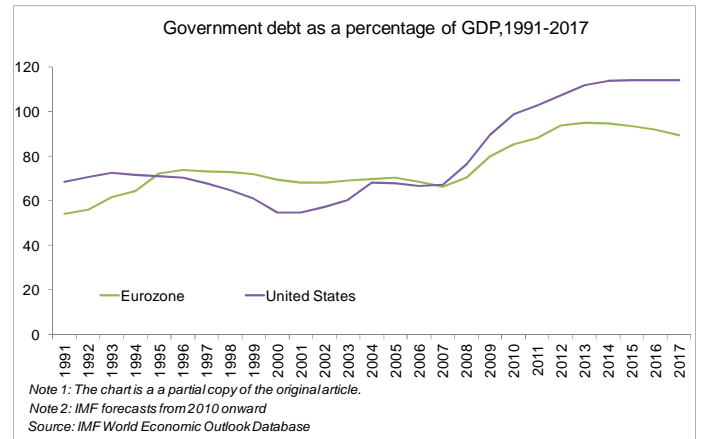
10. Joint government and the democratic deficit: as decision-makers were not able to sufficiently respond to the challenges of the crisis, they lost much of their credibility.

Darvas feels an exit from the euro zone would be so painful that it would not be in the interest of any Member State. Instead, he sees a slow move towards a more integrated euro area as more likely. Crucial steps and factors are being taken with this scenario in mind.

There is cause for hope that among states in a bad condition with a weak economy some possess a high export potential, for example Spain, Ireland and Portugal. In addition, productivity in some economic sectors is also in a better position to meet or exceed the stronger members of the euro zone. This is important because Darvas feels that the depth of the recession in the southern states will be the most determining factor of how the euro crisis progresses. If, for example, these productive sectors support growth in weaker Member States, it would decrease the need for fiscal consolidation and most of the above-mentioned ten problems would come to an end in a chain-like reaction.

Source: Darvas Zsolt (2012): *The Euro Crisis: Ten roots, but fewer solutions*, in *Bruegel Policy Contributions 2012/17*, October 2012

Data Sources: IMF World Economic Outlook Database, Eurostat, Penn World Tables 7.0



International trends

The Ifo Index, Germany's industry and trade confidence index of the Institute for Economic Research in Munich showed a further decline in October 2012, now in a sixth consecutive month of decline. The current business situation assessment deteriorated further, and expectations for the next half year it is expected to remain at the low level of the previous month. According to the IEER asynchrony index, the Ifo business confidence index indicated higher uncertainty than in the previous month. Researchers have a more sombre outlook for the German economy.

Results from the October survey by the French statistical office (INSEE) showed that French industrial activity has worsened significantly. The business confidence index, a compilation of the opinions of business leaders, fell 5 points compared to September. French economic growth over the next few months is expected to be at a weak pace, but the pessimism decreased compared to the previous month. The general outlook index dropped significantly and has a very low value.

Germany (Ifo)

The Ifo Business Climate Index for German industry and trade fell in October for the sixth time in succession. Companies again expressed growing dissatisfaction with their current business situation. The business outlook nevertheless remained unchanged at last month's low level. The clouds over the German economy are darkening.

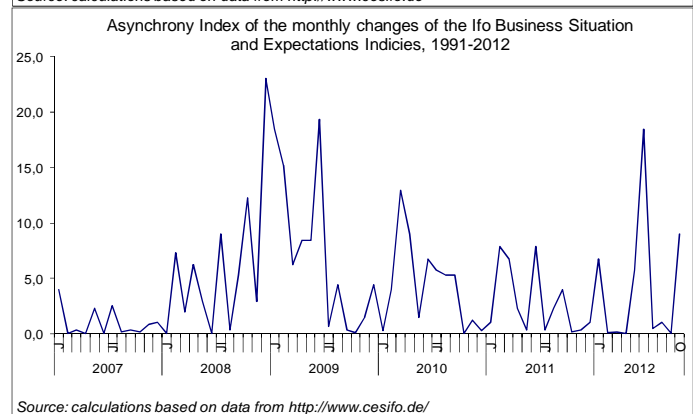
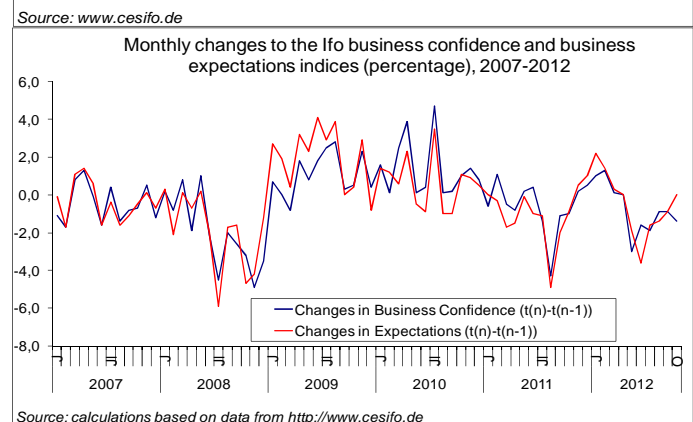
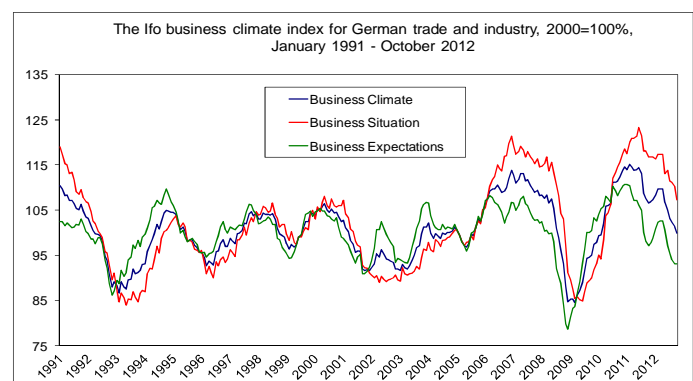
Measuring the gap between the business situation and expected developments, the asynchrony index calculated by IEER increased in October, thus the business confidence index showed a higher level of uncertainty compared to last month.

In manufacturing last month's deterioration in the business climate continued in October. Assessments of the current business situation were significantly poorer and now approximately correspond to the long-term average value. Business expectations recovered slightly for the first time in six months and are less pessimistic. According to manufacturers' reports capacity utilization rates were considerably lower than in the previous quarter. This marks the third drop in succession.

After staging a recovery last month, the business climate index in both retailing and wholesaling dropped this month. The retailers surveyed were much more satisfied with their current business situation, but expressed far greater pessimism about their six-month business outlook. Wholesalers reported slightly improved expectations, but their assessments of the current business situation cooled down significantly.

In construction the business climate indicator fell further. Although the construction companies surveyed expressed less pessimism about their six-month business outlook, they were far less satisfied with their current business situation.

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



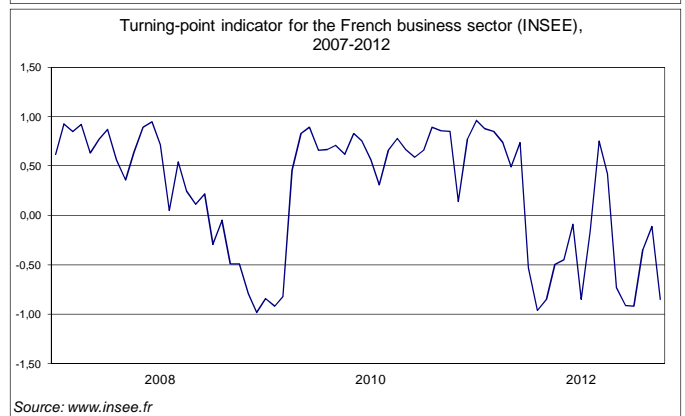
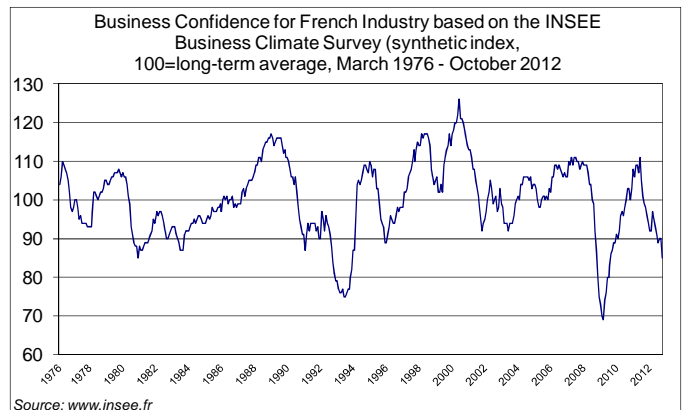
Based on the survey of the French statistical office (INSEE), in the opinion of French business leaders interviewed in October the business climate in France has deteriorated. The INSEE business confidence index fell 5 points compared to September.

The economic turning point indicator remained in the unfavourable zone.

Managers of manufacturing companies see output continuing to be weak: the balance indicator is very low. Business leaders feel stocks of finished products to have increased and reached a long-term average. The total orders index and foreign orders index both decreased and remained at very low levels.

French economic growth over the next few months is expected to be at a weak pace according to the individual business forecast of company executives (which summarizes the business prospects of the coming months), but the pessimism decreased compared to the previous month. The general business outlook index – which reflects the sum of opinions related to the business activity of respondents – once again declined significantly compared to the previous month, and is at a very low value.

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



Written by: Makó Ágnes (analyst, GVI)
 E-mail: agnes.mako@gvi.hu
 Nyíró Zsanna (intern, GVI)
 Türei Gergely (intern, GVI)

In case of publication, please cite the source as follows:
 MKIK GVI: IEEE Monthly Newsletter,
 2012 / November, Budapest,
 2012-12-20