IEER Institute for Economic and Enterprise Research

IEER Monthly Bulletin of Economic Trends October 2011

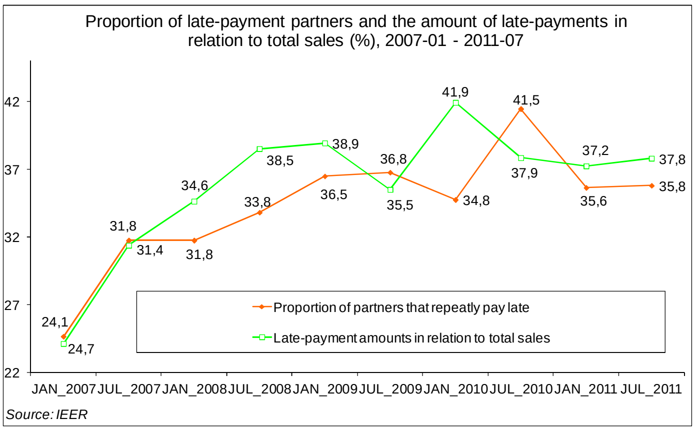
For the twenty seventh time the SME Outlook, a joint research project of the MKIK Institute for Economic and Enterprise Research (IEER), the Observatory (Figyelő) and the Volksbank, examined in July 2011 the Hungarian small and medium enterprise sector, its financial position, prospects, and the factors that influence an individual company's business position. In addition to questions related to the current business situation some current topics and issues and the corporate responses to these are analyzed which have an important role to play in this sector's adaptability, financial standing and development. In the July 2011 survey problems of late payments and debt queues were examined among Hungarian firms.
The July 2011 survey found that one third of the business partners of small and medium-sized enterprises pay after the payment deadline routinely and that these late payments represent 38% of total sales, thus the breadth and depth of late payments in mid-2011 was similar to that of six months ago. The problem of late payments mostly affects construction companies; firms mainly involved in exporting are among the least affected by this problem. The rate of companies taking part in a debt queue rose to 45% in the last six months. The problem of the debt queue most frequently occurs at construction companies: more than 70% of them are afflicted with this.

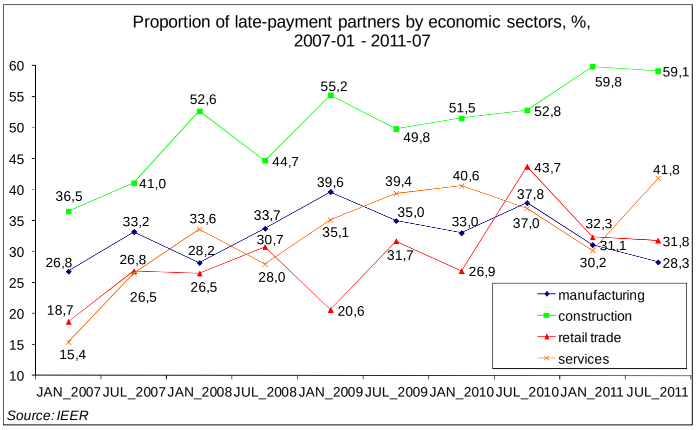
Late Payments

More than one third of the business partners of the surveyed small and medium-sized enterprises pays routinely after the deadline: in July 2011 the average rate of late paying business partners was 36%; hence the rate has not changed since January 2011. The total amounts paid late represent 38% of total sales, thus overall we can say that the breadth and depth of late payments in mid-2011 is similar to that of half a year ago.

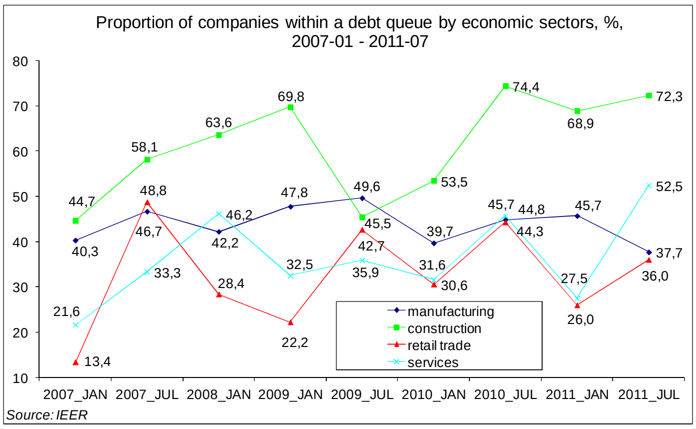
In terms of economic sectors, construction companies are most concerned with the problems caused by late payments: the ratio of partners that the continually pay late is still close to 60% while the rate of amounts received late fell slightly below 50%. Concerning the changes of the last half year, we draw attention to a significant deterioration in the position of the service sector as well.

The proportion of late paying business partners continues to be the lowest among exporting firms: in 2011 the share of partners that paid late was 24%, which is 4 percentage points less than six months ago. Thus, with respect to the proportion of the amounts received late we can say that the situation of exporting firms has improved over the past six months.





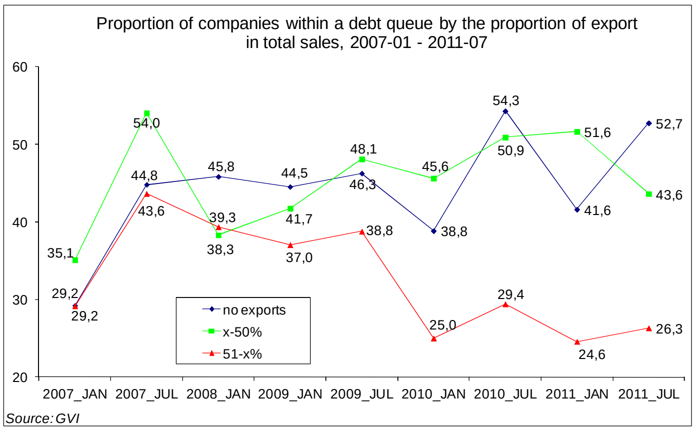
Debt Queues



The proportion of companies caught within a debt queue has increased over the last six months: while in January 2011 42% of the surveyed companies were not able to pay suppliers on time because they had not been paid by their customers on time, in July this figure was over 45%.

In addition to late payments, being part of debt queues most frequently occur among construction companies: more than 70% are mired in a debt queue. This rate is only 38% for the manufacturing industry, the services sector increased sharply to 53%, and for retail companies it is 36%.

A higher proportion of smaller businesses are affected by debt queues than larger ones: firms with less than 50 employees have a rate of 51% while only 41% of companies with more than 100 employees paid late because they had not been paid on time.



In terms of exports, 53% of companies that produce exclusively for the domestic market were affected by a debt queue while only 26% of companies that produce predominantly for export have been influenced by it. Exclusively foreign-owned companies are even less affected by debt queues: only 18% of them indicated that they had not been able to pay on time because they have not been paid on time (in July 2010 this figure was 34%).

The data cited above suggest that debt queues affect a bigger proportion of firms in the SME sector, as a half year earlier. The question is whether the managers of companies are aware of this or not. We found that they are; as in January 2011 the proportion of companies that believe that the problem of debt queues has increased was 32% and now stands at 34%, whereas the rate of those who believe that it has gotten better declined from 7% to 5%.

Institute for Economic
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Macroeconomic trends:
the Euro crisis

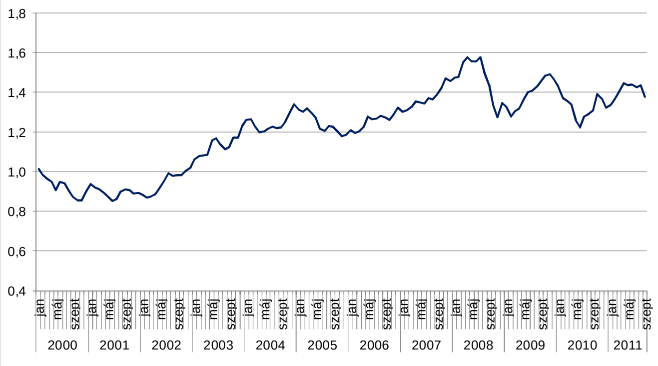
Following the downturn caused by the 2008 economic crisis, global macro-economic indicators significantly improved in the second half of 2009 and 2010 and it appeared that in a few years we would return to pre-crisis levels. In the second half of 2011, however, experts see a serious possibility for the beginning of a new phase to the recession and to the crisis. The first sign of this was the Greek crisis of 2010, which shook the fiscal trust between European countries. After this, some serious fears appeared concerning the Irish banking system and the situation of Portugal, which drew attention to the vulnerability of the euro zone. Later, the fiscal position of other states was viewed as risky (e.g., Italy, Spain).
In July 2011 it was revealed that U.S. economic growth in 2011 probably will not exceed 1 percent. A few days after this announcement came the U.S. debt ceiling agreements. The two events caused the tenth largest drop in the history of the Dow Jones Index and a panic mood reigned on global equity and currency markets. In wake of the weak macro data and sentiment indices published in late summer, London financial analysts significantly worsened their euro zone growth projections.
According to emerging market analysts the deepening of the euro zone debt crisis will spread to Eastern Europe in a more "aggressively epidemic" form, as demand for the region's exports is expected to decrease significantly in the major markets – especially Germany – because of a slowdown in growth. According to the new forecasts for Hungary, economic growth this year will be 1.8 percent for the entire year, 1 percent in 2012, and 1.5 percent in 2013.

Background

Government responses to the 2008-2009 global economic crisis – bank rescue packages and economic stimulus – increased public debt and in almost all developed Western countries state deficits increased significantly. Although some analysts had already drawn attention to the dangers of high public debt – many spoke of a double-dip recession – after 2008 a relatively optimistic picture of the market was formed. Macroeconomic indicators improved spectacularly, and it seemed that in a few years we would return to pre-crisis levels. Today, many experts see a serious possibility for the beginning of a new phase to the recession and to the crisis.

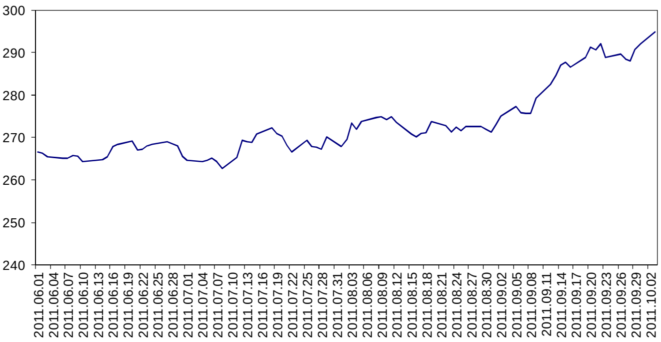
The first sign of this was the 2010 crisis in Greece. As it turned out the country's leadership had misled EU officials and the situation was worse than previously believed: as a result of the huge budget deficit and public debt the country's solvency was in doubt. This became an important milestone of shattering of trust between countries. Then came to the fore some serious fears concerning the Irish banking system and the situation of Portugal, which drew attention to the vulnerability of the euro zone. The problem here is that culturally and economically different countries that follow different economic policies have formed a monetary union, and the irresponsibility of one country may threaten others. Subsequently, more and more states have turned out to be in a risky fiscal position, with now Italy and Spain also watched suspiciously by investors.

Euro versus US Dollar monthly average exchange rate,
January 2000 - September 2011.



Source: Eurostat

The HUF versus euro daily exchange rate,
June 1, 2011 - October 3, 2011



Source: MNB

In addition to this, in spring 2010 oil prices increased together with the recovery of the global economy, which had begun in mid 2009. The price of oil was at a level that had already begun to cool down the U.S. economy. Then the price of oil began to drop, which was expected to further support the economy. However this did not happen, and deteriorating consumer and business confidence indices along with long-term bond yields also indicated a worsening outlook for economic growth.

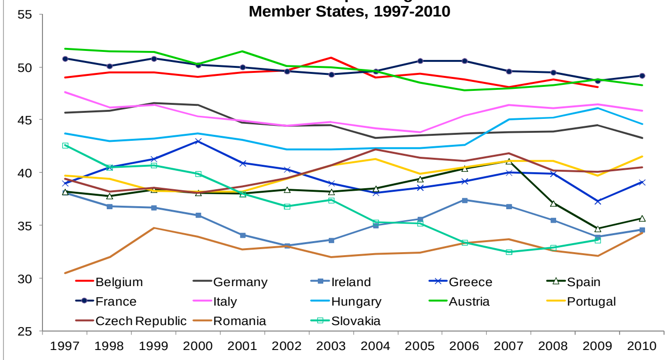
The Crisis

Fears of a renewed crisis came true when U.S. GDP data published in July revealed that there will be no more than 1 percent growth of the U.S. economy in 2011. A few days after the publication of this report came the U.S. debt-ceiling agreement, which was a choice between the lesser of two evils: if there wasn't an agreement on the debt-ceiling, then an unsustainable debt load would have scared away investors; with the debt-ceiling agreement, fears of an economic slowdown continues.

In the middle of the summer investors already priced-in the fact that instead of 2-3 percent economic growth developed countries will only be able to muster growth of 1 to 1.5 percent. This partly coincided with the Greek debt crisis and the American debate on the debt-ceiling, all of which had a negative psychological effect and caused a dramatic decline in stock prices. Panic reigned on equity and currency markets and the New York Stock Exchange Dow Jones Index experienced its tenth largest drop in history. The Swiss franc increased in value by 22 percent against all major currencies.

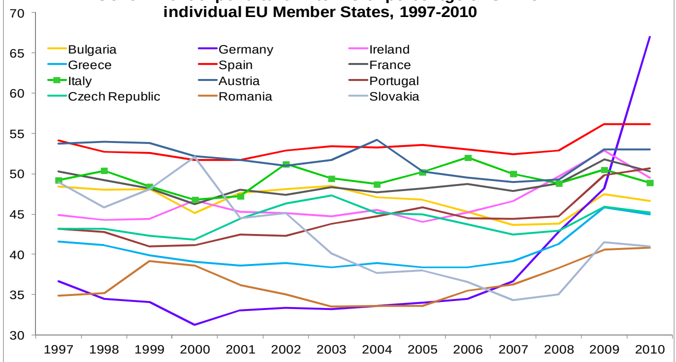
In August financial analysts of London worsened sharply their growth projections for the euro zone in wake of the weak macroeconomic data and sentiment indices. According to the most recent assessment of London's largest economic and financial analysis company, Capital Economics, it cannot be ruled out that the euro zone is on its way toward a new recession. They estimate that the latest euro zone economic sentiment indicator for annual economic growth is only around 0.7 percentage points, which would mean a 0.5 percent third-quarter downturn compared to the second quarter. This suggests that the euro zone has already begun to sink back into a recession. Commerzbank investment analysts in London issued a new forecast for the euro zone, in that the expected annual GDP growth of 1.5 percent for 2012 has been revised downward to 0.8 percent. In such a weak environment for future growth, they estimate that the unemployment rate will rise above 10 percent in the euro-zone as a whole.

Government revenue in terms of percentge of GDP of individual EU Member States, 1997-2010



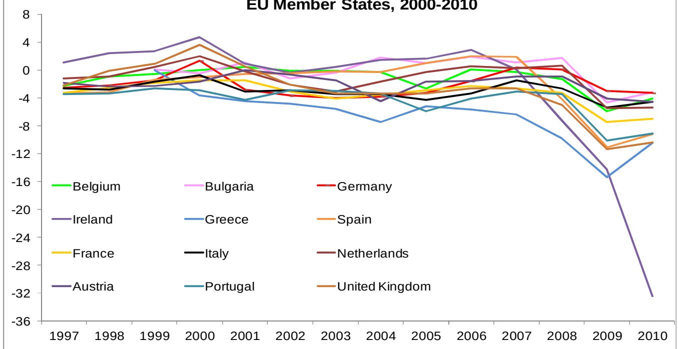
Source: Eurostat

Government expenditure in terms of percentge of GDP of individual EU Member States, 1997-2010



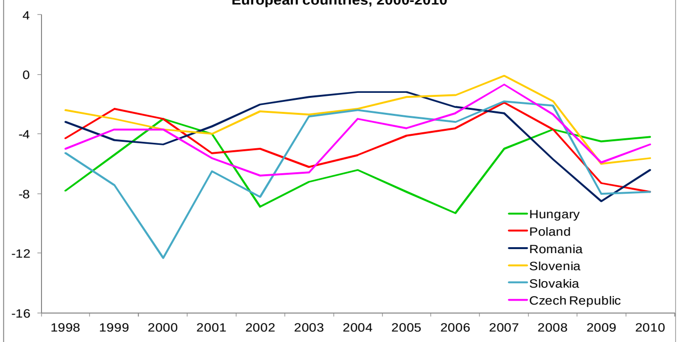
Source: Eurostat

Budget deficit/surplus in terms of percentge of GDP of individual EU Member States, 2000-2010



Source: Eurostat

Budget deficit/surplus in terms of percentge of GDP of Central and Eastern European countries, 2000-2010



Source: Eurostat

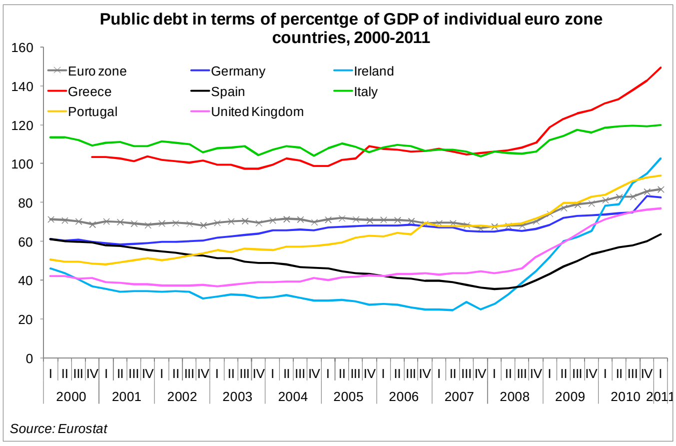
Impact on the Hungarian economy

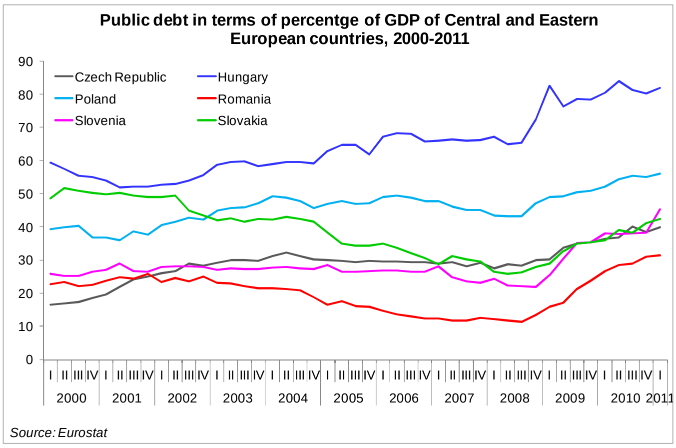
According to emerging market analysts of Capital Economics, the deepening of the euro zone debt crisis will start to spread to Eastern Europe in a more "aggressively epidemic" form, and because of these negative effects the economic performance within the emerging markets of Europe will be much slower than currently forecasted for the next two years.

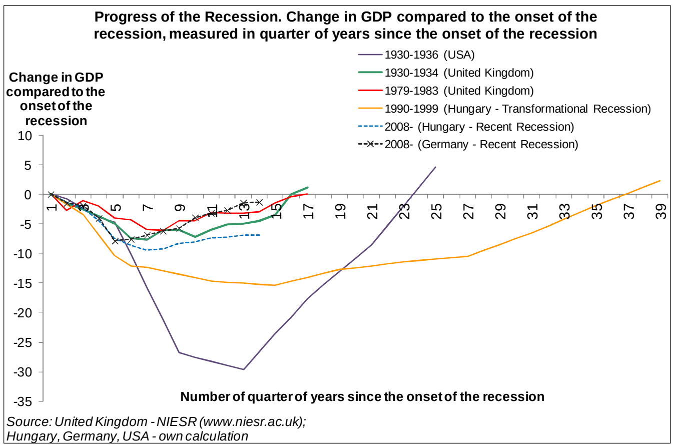
They expect that for the EU economies of Central and Eastern Europe, as well as Croatia, Russia, Ukraine and Turkey, average growth will be 1.8 percent next year in place of this year's 4 percent. The company notes, however, that the actual extent of the slowdown will depend on developments in the euro zone, and therefore it can’t be ruled out that the Central and Eastern European region as a whole will fall into a recession again. One of the reasons of this pessimistic prognosis is the expected fall of demand for exports in the major markets (especially in Germany) because of the economic slowdown. This affects the most the open economies of Central Europe: Hungary, Slovakia and the Czech Republic. The company's new growth forecast in real terms for Hungary is 1.8 percent this year for the entire year, 1.0 percent for 2012, and 1.5 percent for 2013.

Other big investment houses and analysts have similarly downgraded their growth forecasts for Central European economies because their main export market (the euro zone) has poor future prospects. In their latest regional forecast economists from the Goldman Sachs bank group reported that because of weakened growth prospects from the euro zone, the growth of the Hungarian economy expected for 2011 will be 1.9 percent instead of the former 2.4 percent expectation. For 2012 Hungary's growth forecast has declined from 2.6 percent to 2.2 percent. Meanwhile analysts from the London division of the global investment group RBC Capital Markets predict that in Hungary the present forecast of 1.8 percent economic growth for this year will be reduced to 1.4 percent for the entire year, while the prognosis for next year is 1.9 percent, a drop from 2.4 percent.

Source: vg.hu, gazdasagiradio.hu, index.hu







International Business Trends

The Ifo Business Climate Index referring to the German industry and trade continued the negative trend of the past few months as September 2011 also showed a decline. Companies are just as satisfied with their current business situation as in the past month. However, expectations for the near future significantly worsened. According to the IEER asynchrony index the Ifo Business Climate Index indicated a bit more uncertainty now than in the past than month. The researchers report, however, that the German economy has so far been able to fend off political turbulence.
Results from the September survey of the French statistical office (INSEE) show that the business climate in France deteriorated once again. The business climate index, a compilation of the opinions of business leaders, fell six points and thus it is below its long-term average. The turning-point indicator foresees an unfavourable business situation. The overall outlook index has significantly worsened.

Germany – Ifo

The Ifo Business Climate Index for German industry and trade declined once again in September. The business expectations for the coming half year once more deteriorated markedly. The current business situation, however, was assessed just as positively as in the previous month. The continuing favourable situation of companies shows that the German economy has so far managed to decouple from political turbulence.

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

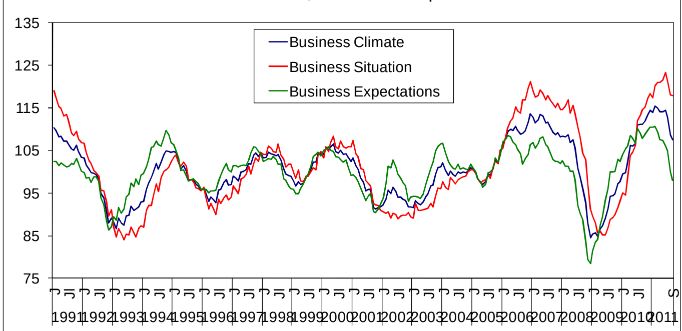
In manufacturing the business climate index has again cooled off. The current business conditions are rated as mostly good, but not as favourable as previously. The proportion of firms reporting scepticism regarding their business prospects for the coming half year has increased. They expect no further impulse from their export business. That notwithstanding, they still plan to increase the number of employees.

The business climate improved in both retailing and wholesaling, after markedly losing ground in previous months. Wholesalers rated their current situation more favourably than in August. Their six-month business outlook is also more optimistic. Retailers continue to assess their current business situation as favourable. They also regard their prospects for the coming half-year with renewed optimism.

In construction the business climate deteriorated once more, but due entirely to distinctly lower expectations. The current situation, however, was rated by the polled companies as somewhat more favourable than in the previous month.

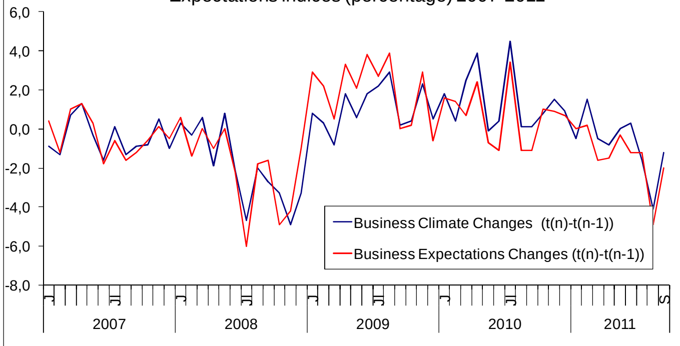
Source: Ifo (http://www.cesifo-group.de)

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



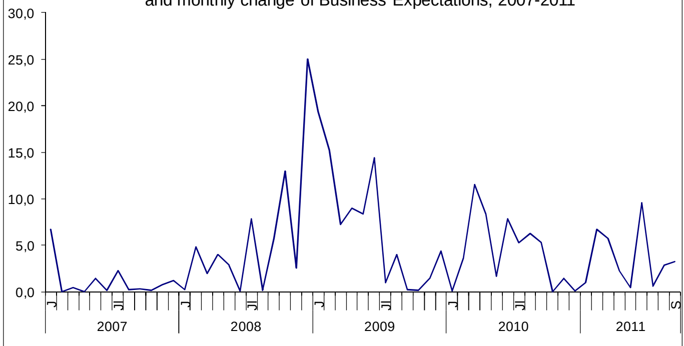
Source: www.cesifo.de

Monthly changes in the Ifo Business Climate and Business Expectations indices (percentage) 2007-2011



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

Index of Asynchrony between monthly change of Business Situation and monthly change of Business Expectations, 2007-2011



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

France – INSEE

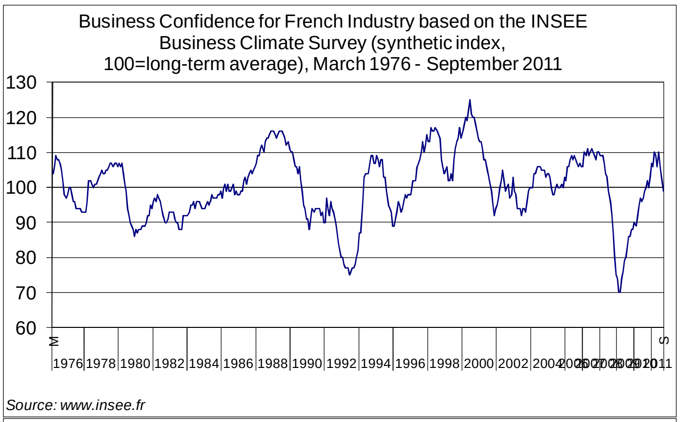
According to business leaders surveyed in September by the French statistical office (INSEE), the industrial economic climate in France continued to deteriorate: the INSEE synthetic indicator of business climate weakened by six points compared to July and is just below its long-term average.

The turning-point indicator reached its lower limit, thus it is now in the unfavourable zone.

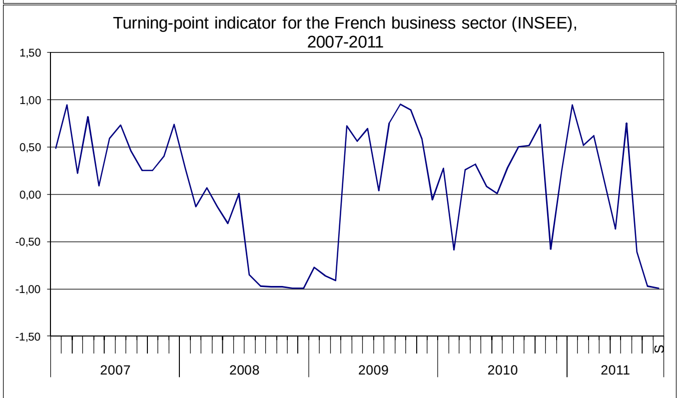
Business leaders reported that their past activity had slowed down anew in September, but the balance index of opinions stays just above its long-term average, however. Stocks of finished products rose and are rated near to their normal level. Total and export order books continue to decrease and are rated near to their average level.

French economic growth is expected to stagnate in the coming months: the prognosis of managers of their individual businesses (from which the business outlook for the coming months is derived) stayed near to its long-term average. The overall outlook index, which represents business leaders' opinion on French industry as a whole, weakened significantly.

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



Source: www.insee.fr



Source: www.insee.fr

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

For publications, please refer to this paper as follows:

MKIK GVI: Monthly Bulletin of Economic Trends,
October/2011 Budapest
October 10 2011