

July 2011 marked the seventh occasion of the MKIK Institute for Economic and Enterprise Research (IEER) quarterly business climate survey. This study involves 400 listed companies involved in manufacturing, construction and services, which are representative of Hungary's economic performance and sector distribution, and is done on a quarterly basis.

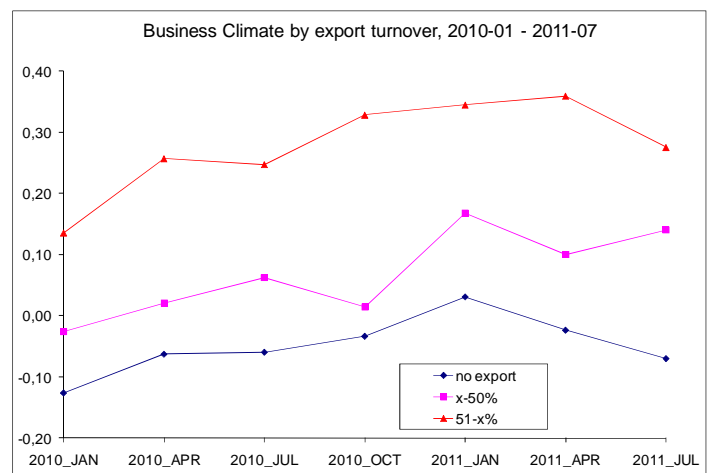
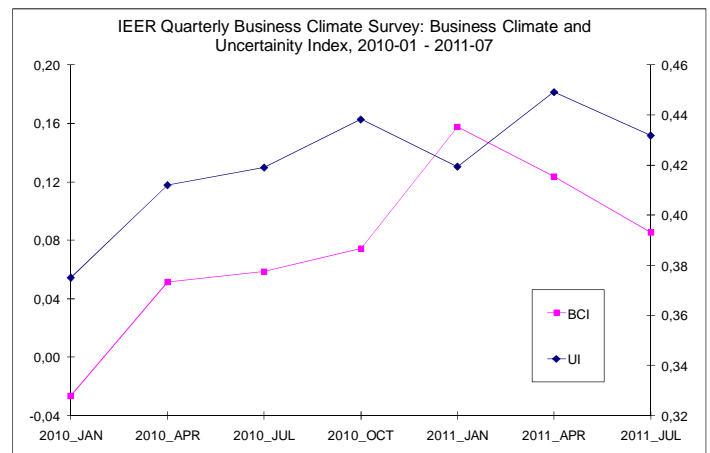
According to the results from the July 2011 survey, the business climate indicators pertaining to the current situation of Hungarian enterprises – with the exception of production level indicators – all showed an increase in July 2011, leaving only a partial indication of the less favourable macroeconomic situation. The short-term expectations of companies, however, show a significant negative shift: with the exception of the expected state of business situation, all other indicators for the next six months fell. As a result, the IEER quarterly Business Climate Index continued to decline in the second quarter after a peak in January, and the Uncertainty Index is in decline compared to the previous quarter.

Looking at the export turnover of businesses it was mostly the exporting firms that showed the highest score in the business climate index. The steady increasing tendency of the index since July 2010, however, turned negative in the summer of 2011. Exporters as well as producers for the domestic market are generally more optimistic in their outlook of their business situation for the next half-year; however, job creation will come from domestic firms only. As for the development of investment activity, the data suggests that it is more likely to decline in the coming months among companies operating in Hungary.

Hungarian business climate indicators only partially reflect the less favorable macroeconomic situation as compared to the previous quarter: of all indicators pertaining to the current state of business, only the level of production declined; order books, capacity utilization, and profitability indicators all increased. In addition to this, there were higher scores on all indicators in the second quarter of 2011 compared to the same period of the previous year. Despite this favorable perception toward the current state of business, however, short-term business expectations are almost uniformly negative in the changes of the summer of 2011: for the next half year, all indicators fell except for the assessment of the expected state of business situation, which rose very slightly. In light of this, the IEER Economic Quarterly Business Climate Index declined further in the second quarter following a peak in January 2011. The Uncertainty Index declined slightly compared to the preceding quarter, indicating a decrease in the discrepancy of opinions among enterprises toward the current and future state of business.

In terms of exports, the business climate index has increased only among companies that export less than half of their production. In addition to this, it is important to note that after a steady rise since July 2010 the trend turned downward for the firms that export the majority of their production.

In comparison to the expectations observed in the previous quarter, the expected business situation is slightly better. Overall, 33% of companies expect a good business situation while 13% expect it to be bad. In terms of the proportion of export sales, exporting firms are more optimistic in their outlook for the next six months compared to producers for the domestic market. The highest level of expectations have come from firms that are geared predominantly toward



exports, although the last two quarters have shown a slight decrease among them. Only for enterprises predominantly geared toward domestic production did the expected business situation index rise, reaching the highest level in the survey's history. The business expectations of companies producing exclusively for the domestic market deteriorated in July – as it had in the last quarter.

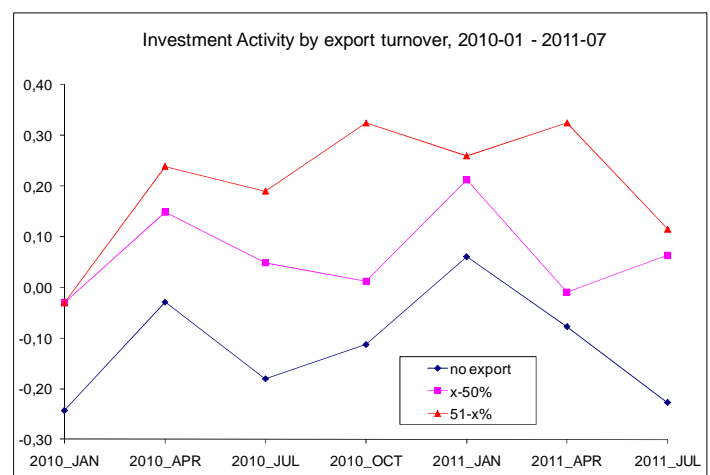
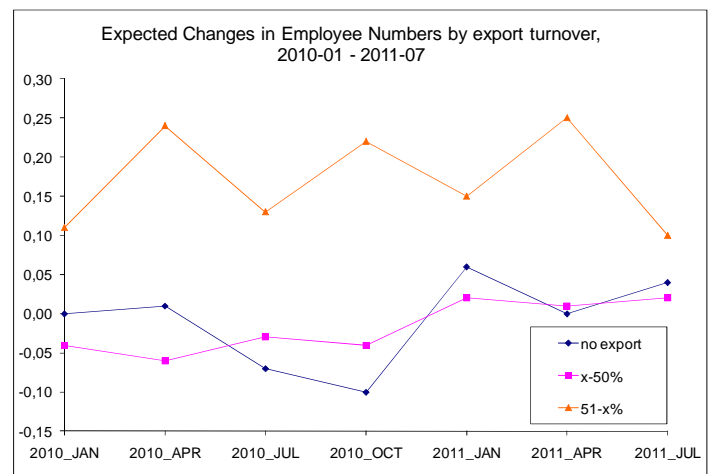
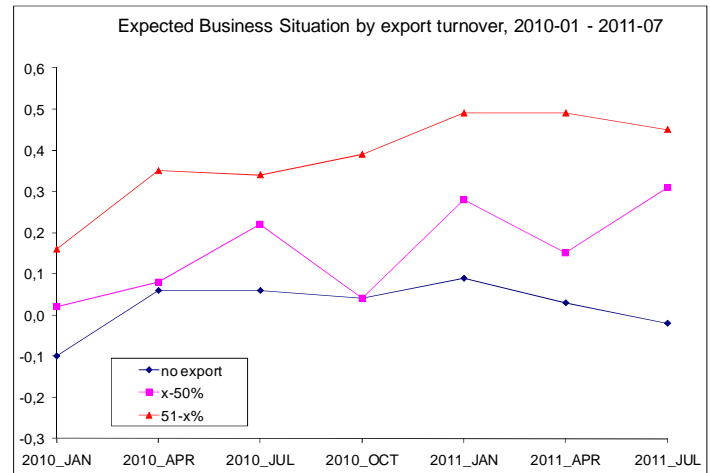
For the next half year, the expected production level indicator shows a significant drop compared to the previous quarter: the index is now in the negative zone. 31% of CEOs have confidence in the growth of the production level compared to 40% in the previous quarter, while 14% expect it to decline (which is a 1-percentage point increase over the previous quarter).

All the categories of companies made up by export activity show a decline in expected production levels for the following period. Producers exclusively for the domestic market expect a 26% increase in production levels (in the previous quarter the ratio was 31%) while 17% forecast a decline. As for companies producing predominantly for export, 35% expect good business prospects, which is a 15-percentage point decrease from the previous quarter.

Compared to the first quarter we can observe a smaller change in employee numbers within businesses concerning the next half year: 15% of companies plan to hire more staff while 10% will reduce the number of employees, which is 3 and 2 percentage points lower than the previous quarter respectively.

In terms of export activity, job creation will most likely come from producers geared exclusively for the domestic market. Data of companies that predominantly produce for the domestic market show stagnation in hiring. Companies that primarily sell abroad, we can observe a significant decrease in the number that plan to hire new employees compared to the previous quarter (33% to 21%).

Investment activity is likely to slow down in the coming months. The results show that 36% of companies aren't planning any new investments, 9% plan a reduction, while 23% want to increase the volume of investments (in the previous quarter the corresponding ratio was 27%, 12% and 24% respectively). The investment activity index of IEER shows a significant decline of 10 percentage points among producers for the domestic market and export-oriented companies (25% of the former and 46% of the latter don't plan any investments for the next period). As for companies that produce predominantly for the domestic market, on the other hand, a rebound in investment activity is observable: 28% of companies predicted investment growth and 9% a decline, while in April 2011 this ratio was 22% and 18% respectively.



Macroeconomic trends: the state of the U.S. economy

After a long debate, the U.S. House of Representatives in early August adopted legislation for an increase of the debt ceiling, thus avoiding insolvency in the technical sense of the word. At the same time, lawmakers approved a proposed 10-year plan for a 2,100 to 2,400 billion dollar deficit reduction framework as well. According to some analysts, despite the debt ceiling increase the U.S. economy has the chance to slide into a new recession as preliminary first-quarter GDP data showed much weaker growth while the numbers for consumption, industrial production and jobs also give cause for pessimism. The University of Michigan Consumer Sentiment Index for August is at its lowest level since May 1980. For the first time ever the Standard & Poor's international credit rating agency has downgraded the debt rating of the U.S., as analysts foresee the deficit-reduction package passed by the Congress as falling short of what would be required for American debt consolidation in the medium-term. News of the U.S. downgrade led to a significant drop in stock exchanges around the world.

Raising the Debt Ceiling

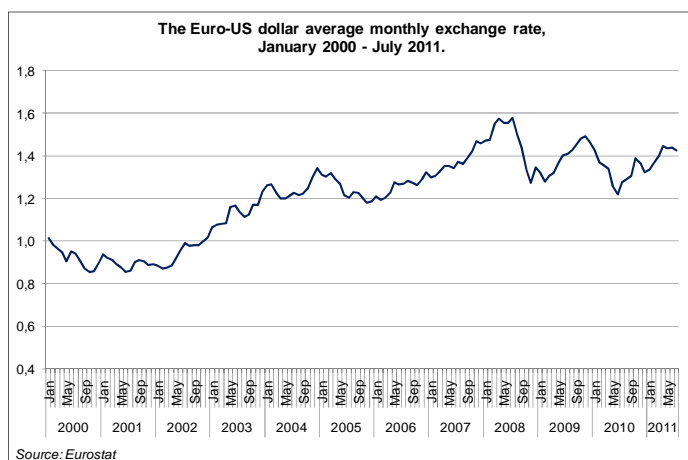
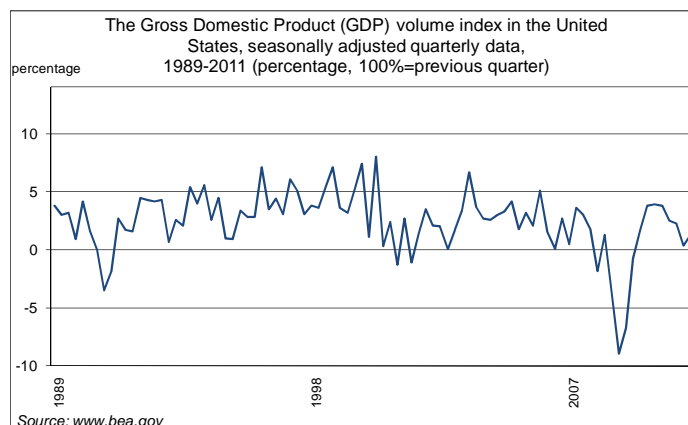
The U.S. House of Representatives, after a long debate, adopted on August 1 legislation to allow the debt ceiling to be raised. Without this, on August 2, the U.S. would have become technically insolvent, because the actual expenditure of the Treasury on that day would have reached the previous statutory cap of \$14,300 billion – that is, it would have had to put a freeze on some federal funding. The solution for legislators was to raise the debt ceiling further and that this, in addition to the adoption of the medium-term deficit reduction framework, has solved the problem for the time being. The 10-year package will carry out a 2,100 to 2,400 billion dollar deficit reduction plan in several steps together with an increase in the debt ceiling of the same order of magnitude in 2013.

As far as American analysts are concerned, with the debt ceiling raised now comes the hard part: debate in congress will focus on which specific areas will be a part of the deficit reduction plan and will it contain a tax increase. Some analysts feel that despite the raised debt ceiling, America will slide into a recession again, as the economic indicators for consumer spending, industrial production, employment and GDP growth all point in this direction.

Real economy

The U.S. first-quarter GDP figures for 2011 in comparison to the previous period project much weaker growth, which analysts conclude is because the pumping of state funds into the economy, which started in 2008, was essentially ineffective and that only higher debt was the result.

The US Consumer Confidence Index, prepared by the University of Michigan, dropped to 54.9 points in August compared with market expectations of around 61-63 points (in July the actual figure was 63.7 points). The August Consumer Confidence Index and the sub-index, which



reflects consumer outlook, have reached their lowest levels since May 1980. The current outlook sub-index fell to 69.3 points from July's 75.8 points (the expectations was around 74 points), which is the lowest level since November 2009. The sub-index, which measures expectations for the coming months, fell 45.7 points compared to the previous month figure of 56 points. An essential part of the survey – also used by the U.S. Federal Reserve to support the monetary policy – is the consumer inflation expectations for the next year and for the next five-year average. Recent data showed an annual value of 3.4% and for the five-year figure, it was stagnant at 2.9%.

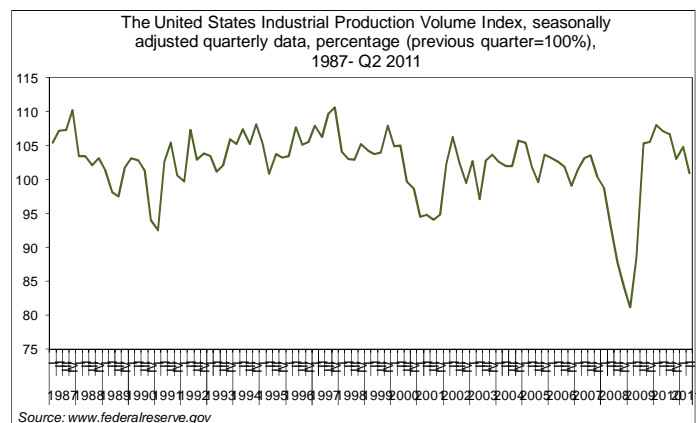
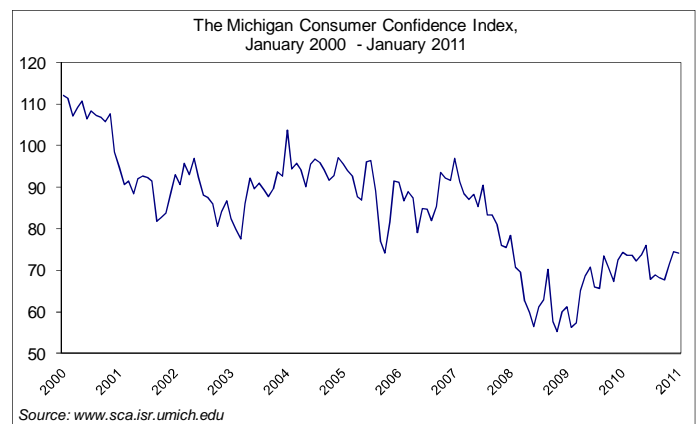
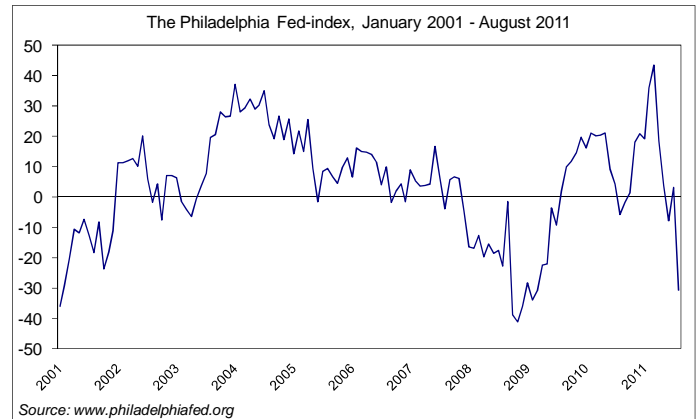
U.S. retail was in line with analysts' expectations of a 0.5% increase in July 2011. The 0.1% growth reported by the Ministry of Commerce for June changed to 0.3%, which means a substantially faster growth in retail sales. Excluding car sales the volume of retail sales rose by 0.5%, representing a dynamic increase, although for this indicator market expectation was 0.2%, which was the same rate for June. Just as important are data excluding fuel sales, which showed a 0.3% increase compared to an increase of 0.5% in June. While unemployment, the housing market and consumer confidence data were all negative, statistics for July retail sales showed the biggest monthly gain since March.

Downgrade

For the first time ever the United States lost the best possible "AAA" long-term debt rating when Standard&Poor's international credit rating agency worsened it to an "AA-plus" level. The S&P said in a statement that concerns over the growing U.S. budget deficit ruined the U.S. credit rating; in addition to this, the negative outlook toward this new classification means that within the next 12-18 months a further downgrade is possible. The S&P statement stressed that the fiscal consolidation plan passed by the U.S. government and Congress falls short of what the House believes is necessary for consolidation of U.S. debt in the medium-term. Following the downgrade, the debt category that U.S. Treasury debt now belongs to, is worse than the British, German, French or Canadian government bonds. For this reason, American debt service funding will be expensive.

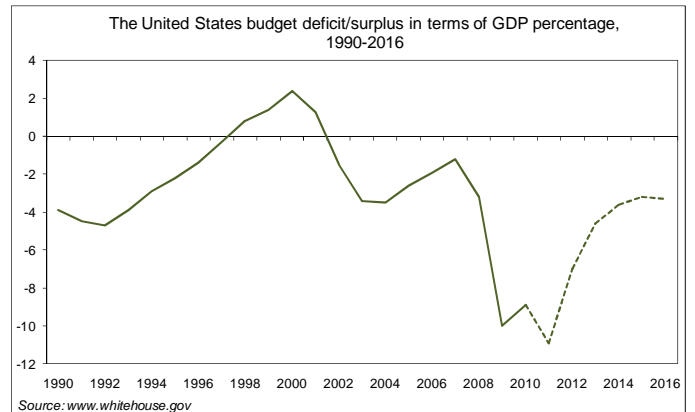
Reaction of the stock markets

Following the news of the U.S. debt rating downgrade, the world's stock markets began to fall on August 8, Monday. The securities markets in the second half of the previous week already suffered serious losses. The Tel-Aviv stock exchange fell considerably – which was partly for political reasons – thus Asian and European analysts felt that this was a forerunner of sharp declines elsewhere. Asian stock markets experienced a 3-4 percent loss at the close of the day and the loss of the Australian Stock Exchange was



above 3 percent. At the Budapest Stock Exchange, all stocks opened lower and its index, the BUX began trading at 19,183.1 points, which was 550 points or 2.8 per cent lower than the previous Friday's close; but from there in a quarter of an hour it shot up to 19,500 points at the close, which was minus 1.2 per cent for the day. Major West European stock markets also began to drop on August 8, but picked again soon after the open. The London Stock Exchange's main index, the FTSE-100, was 1.27 percent in the red and fell short of forecasts, the Frankfurt DAX-30 lost 0.87 percent and was in line with expectations, while the Paris CAC-40 was 0.91 percent lower after the open compared to Friday's close.

Source: index.hu, hvg.hu, portfolio.hu



The Ifo Business Climate Index referring to the German industry and trade fell significantly in August, continuing a negative trend from the previous month. Companies are less satisfied with the current business situation compared to last month, and expectations for the near future have greatly deteriorated. The IEER asynchrony index increased in August, so the Ifo business confidence index compared to the previous month reveals more uncertainty. Researchers feel that the German economy is not immune to the disruptions of the global economy.

Germany – Ifo

The Ifo Business Climate Index for German industry and trade has declined significantly in August. The companies have scaled back their expectations of business developments in the coming half year. The current business situation, however, continues to be assessed overall as good, although the situation appraisals in recent months were significantly more favourable. The German economy is not immune to current worldwide turbulences.

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

In manufacturing the business climate index has again lost ground. The firms no longer assess the current business conditions quite so often as favourable. The business prospects for the coming half year have been appraised significantly more cautiously than before. The firms have downgraded further their expectations for export business. Their personnel plans continue to call for an increase in the number of employees, but they are not as expansive as they were in the past few months.

The business climate has cooled in retailing and even more so in wholesaling. In both distribution sectors, the business situation is no longer assessed as positively as last month. The optimism of the distributing firms regarding the six-month business outlook has largely dissipated.

In construction the business climate has also worsened. The companies are no longer quite so satisfied with their business situation as before. Also regarding developments in the near future, the contractors are more reserved than they were in July.

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

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For publications, please refer to this paper as follows:

MKIK GVI: Monthly Bulletin of Economic Trends,
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