

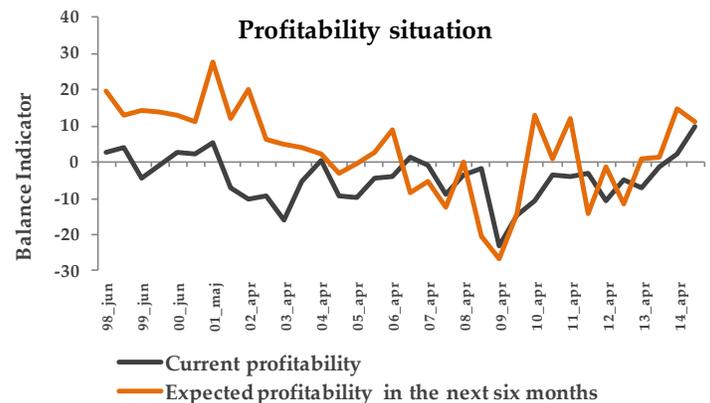
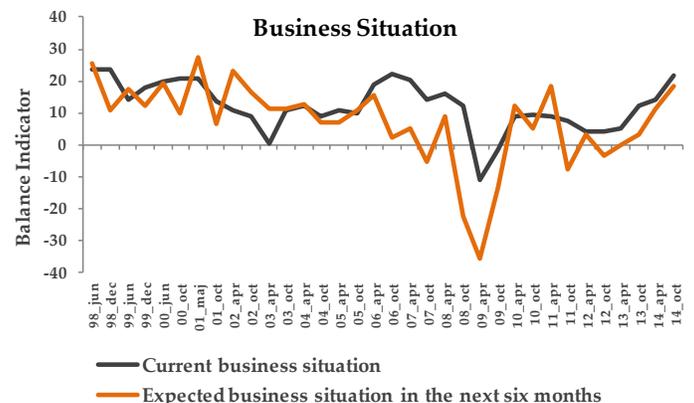
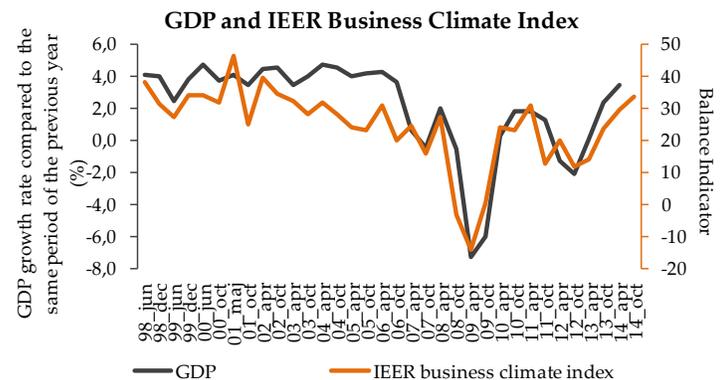
October 2014 was the thirty-fourth occasion of the business climate survey of HCCI Institute for Economic and Enterprise Research (IEER), which is Hungary's largest business climate survey. This year's October survey is based on the responses of 2,853 company managers. The survey results show the business situation and the short-term expectations of managers. The following analysis summarizes the results of the October survey based on a representative sample by economic sectors, regions and number of employees. Compared to the 2012 recession the results confirm that in 2014 a turnaround occurred and a further improvement of the business climate is anticipated. The Hungarian firms' business expectations improved once again after the rise of last year, indicating a more favourable business climate compared to the previous half year.

The IEER business climate index rose 7 point to +30 points from +23 points in October. This is considered to be a moderately high value; the last time this indicator was at a similar the level was in 2011. The Uncertainty Index increased 50 points at the same time. The latter suggests that differences in business situation assessments increased slightly, therefore the evaluation of business trends of the second half of 2014 are less uniform.

Since April the business climate index rose in all sectors of the economy except for construction (industry: +49 points, trade: +38 points, services: 20 points); for construction we saw a slight decline (+19 points). Looking at companies by ownership structure it can be concluded that the most positive outlook was of mainly foreign-owned businesses (+56 points); the economic situation of primarily domestically owned firms, following a large increase of the index, was again more positive (+36 points), while Hungarian-owned companies were confident to the same extent as they were in April (+27 points). By the export activity of companies, we can see that export-oriented companies are considered to have more optimistic expectations for the next six months than companies producing only for the domestic market. Producers mostly for foreign markets reached +56 points, companies with an export that is minor part of their sales got +40 points, while among producers for the domestic market it was only +20 points. Considering the size of companies, larger companies were more optimistic. The business climate index at firms with less than nine employees was less negative (-2 points), while for those with 10-49 employees was +27 points, for 50-249 workers it was +46 points, and for the largest companies with staff of more than 250 persons it was +50 points.

The components of the business climate index

The IEER business climate index consists of four components: (1) the business situation in the next four months, (2) the volume of orders for the next 6 months, (3) the expected volume of machinery investments compared to the previous year, (4) expected construction investments compared to the previous year. In addition, during the



business climate survey other relevant indicators were also assessed (e.g. labour demand, production levels).

Among the business climate index components those related to business situation expectations show a clear and significant improvement, as well as for the expected investment activity growth. But in the context of expected orders companies were less optimistic compared to the situation in April.

Business situation and expectations

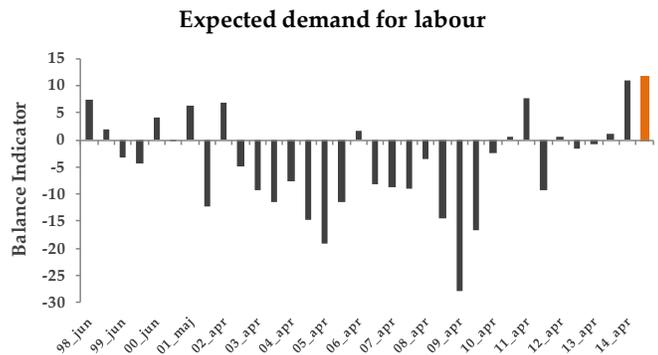
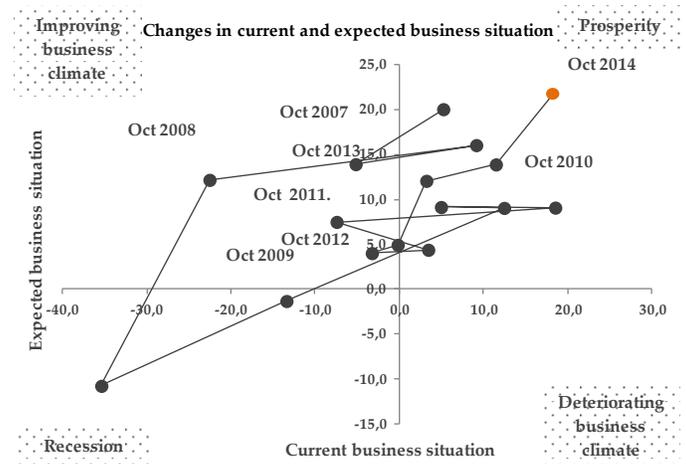
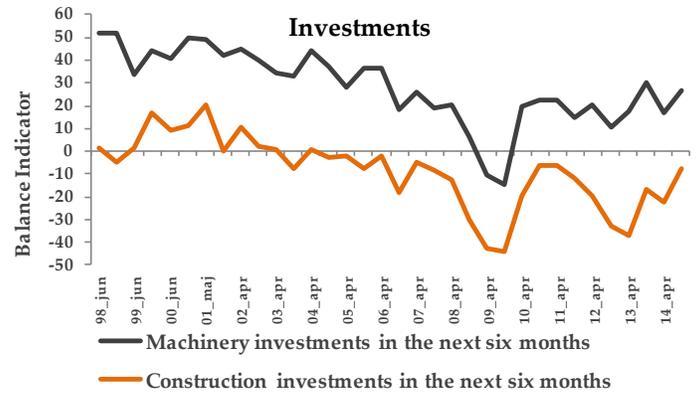
According to the October data, company managers' opinion of the current and future business situation forecasts a recovery period. This is consistent with the observations in April and October last year. Taking into account the values from both indicators, this year between April and October the opinion of Hungarian enterprises have shifted more towards 'Prosperity', and currently resides in this area.

Average capacity utilization of the responding firms was 81%, which is 3 percentage points higher than in April. Capacity utilization remains the highest in industry, at large companies, firms with a majority foreign ownership, and mainly exporting companies (84%, 86%, 89%, 88%) while the lowest are in services, at micro companies, producers for only the domestic market and purely Hungarian-owned companies (76%, 67%, 77% and 78%).

For the business expectations index, in terms of economic sectors industry reached the highest value (36 points), while other sectors reported much less favourable expectations (construction: 0 points, trade: 17 points, services: 6 points). Examining the companies by foreign influence and connections we can see that regarding business expectations predominantly foreign-owned (49 points) and export-oriented firms (48 points) are the most optimistic – meanwhile companies with a minority share of foreign-ownership broke out of the negative territory of the index. The index for firms with less than 10 employees had a negative value (-15 points) while in the case of larger-sized companies it had a positive value (10-49 employees: 8 points, 50-249: 28 points, 250 more persons: 34 points).

Labour demand

Businesses are counting on an increase in the demand for labour for the next half-year (the index rose to +12 points), which is the highest value thus far measured in our survey. According to this, we can expect an increase in the demand for labour in the next six months within the private sector. This process is mainly being stimulated by increased demand for labour on the part of foreign-owned firms -- the index for these companies was -17 points in April, while in October it jumped to 31 points.



Macroeconomic trends: Economic Forecasts for the European Union and Hungary

In the following, the macroeconomic forecasts for 2015 for the European Union and Hungary are detailed. The European Union is Hungary's main trade partner and export market, so first we need to review the forecasts regarding the Union and then turn our analysis to Hungary. The economic situation of the EU and the euro zone area is characterized by a low rate of growth over the short term forecast. Growth is expected to accelerate in the coming year, with 1.5 percent for the EU as a whole and around 1.1 percent growth for the euro zone. Growth differences between the member states are expected to decrease in the next two years. The unemployment rate is expected to improve significantly only in 2016, but the differences between countries remain high. In the analysis for Hungary, a slowdown is expected next year after this year's high (about 3.15 to 3.5 percent) GDP growth. The main limitations to the country's GDP growth are weak demographic indicators, a poor investment climate, and low employment rate compared to the region.

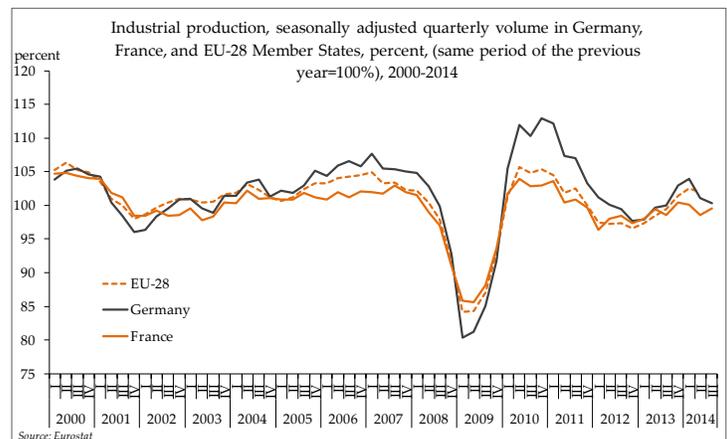
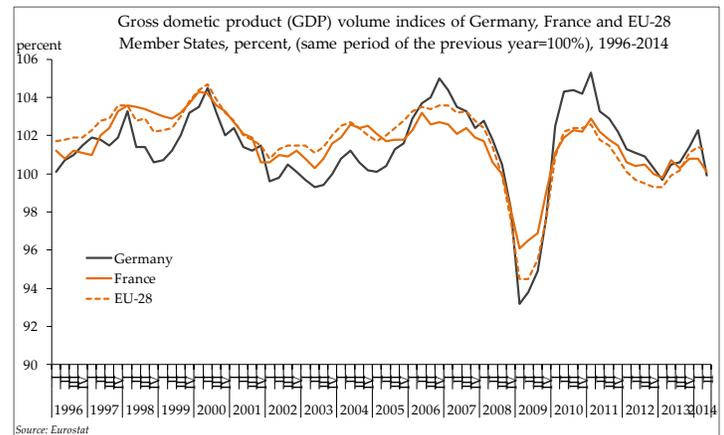
The economy of the EU and the euro area

According to the European Commission's 2014 Autumn Forecast, the EU and the euro area economy is characterized by a low rate of growth in the short term. Looking at the year 2014, real GDP growth is expected to be 1.3 per cent in the EU as a whole and around 0.8 percent in the euro area. It is expected that economic growth will gradually accelerate due to improving domestic and foreign demand, so in 2015 economic growth in the EU is expected to be at 1.5 percent, while for the euro zone it will be around 1.1 percent. In 2016, estimated growth in the EU could reach 2 percent and in the euro zone analysts expect 1.7 percent.

Steps taken towards a banking union for strengthening the financial sector as well as the initial results of structural reforms are expected to result in the acceleration of economic growth. As a result of this process internal and external demand is expected to improve. Over the next two years the growth differences between member states will narrow.

Labour market developments in the EU and in the euro area

Labour market changes typically occur at least half a year later to GDP changes, thus economic activity is expected to lead to job creation only gradually. The unemployment rate is expected to show significant improvement at the end of 2016. Then, within the EU it is expected to decline to 9.5 percent, while for the euro zone it will be at a rate of 10.8 percent, meanwhile the differences between countries remain high.



Inflation increases only marginally

-Inflation is expected to increase over the forecast horizon: in 2015 for the EU it will be 1 percent and 1.6 percent in 2016. Inflation in the euro zone as measured by the consumer price index will be 0.8 percent in 2015 and in 2016 it will be close to 1.5 percent.

Projections for Hungary's economy

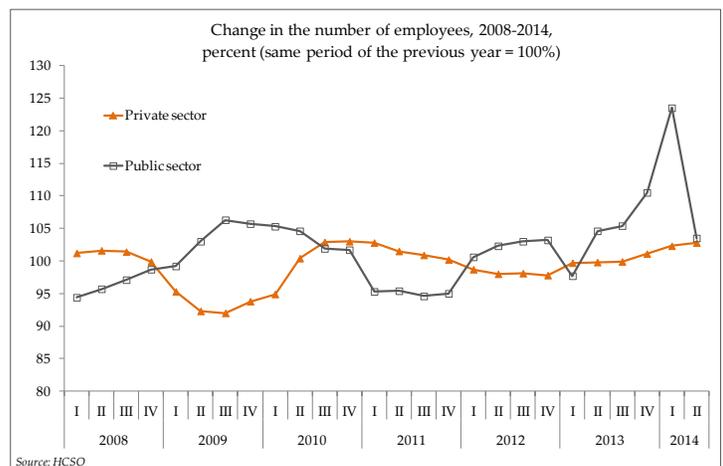
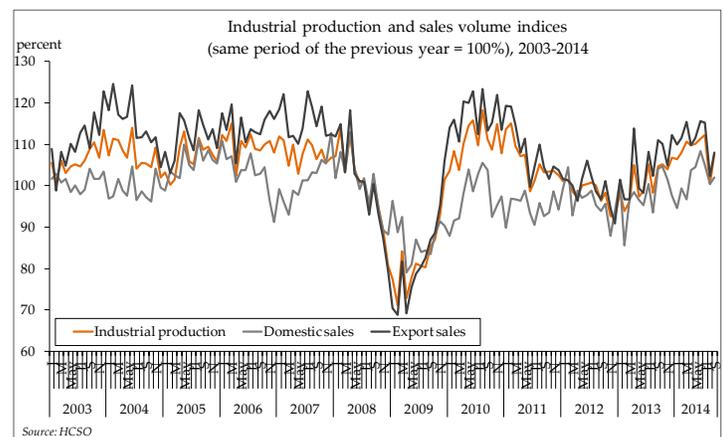
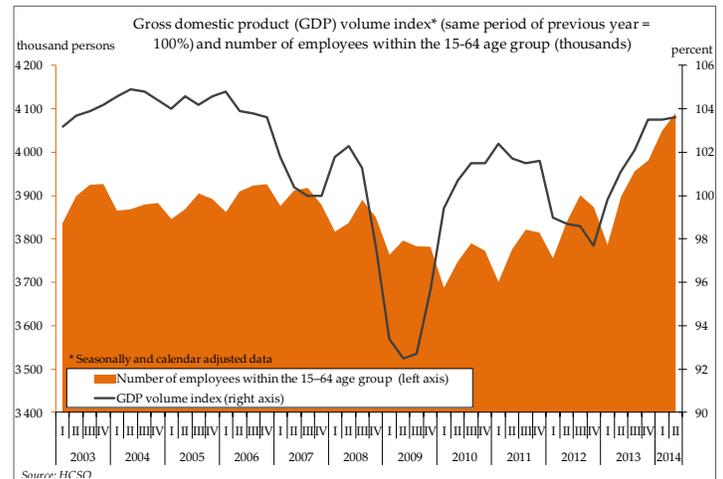
In their autumn analysis for Hungary, analysts established a slowing growth rate for the economy. After this year's high of 3.15 percent, in 2015 a 2.25 percent GDP growth rate is expected. According to Moody's autumn country statement, the medium-term growth prospects of the Hungarian economy improved but the pace will be slow, which will make it difficult to reduce the debt burden. The value of investments is on a growth path, which is a signal of the better use of EU funds as well as reactions to the government's economic policy measures. However, growth is restricted by certain structural factors such as weak demographic indicators, a poor investment climate and a low rate of employment compared to the region.

According to the autumn 2014 economic report from the Kopint-Tárki Economic Research Institute, following this year's growth of around 3.5 percent the Hungarian economy in 2015 will be weaker at 2.7 percent growth. Export sales played a dominant role in the establishment of industrial growth in 2014, but the slight acceleration is due to hitherto declining domestic consumption turning into growth. Gross industrial production growth this year is expected to be around 9.5 percent. Construction output in the first seven months of this year has become stronger. For the entire period under study the dynamism of building construction was higher than the development other types of construction. Increase in the gross output of the construction industry in 2014 may reach 20 percent while in 2015 experts predict a 14-15 percent increase.

Source: European Commission's Autumn Report
(http://europa.eu/rapid/press-release_IP-14-1362_hu.htm)

Moody's report
(http://mfor.hu/cikkek/Alacsony_magyar_novekedesi_utm_et_var_a_Moody_s.html)

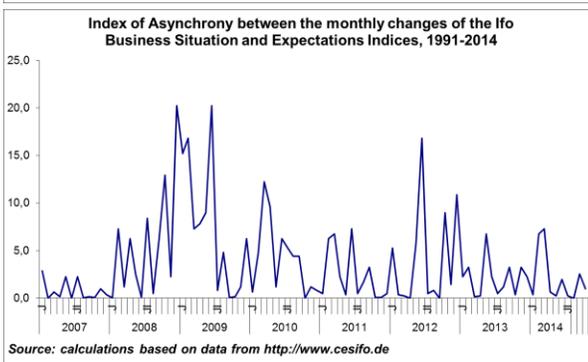
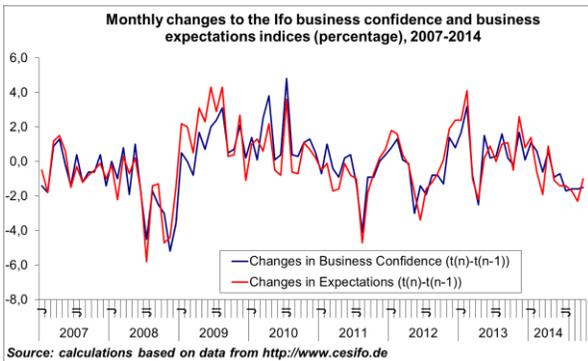
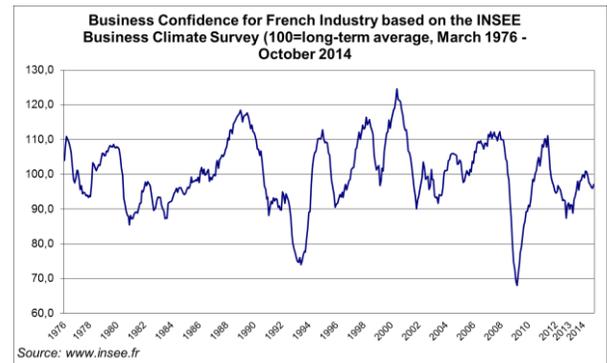
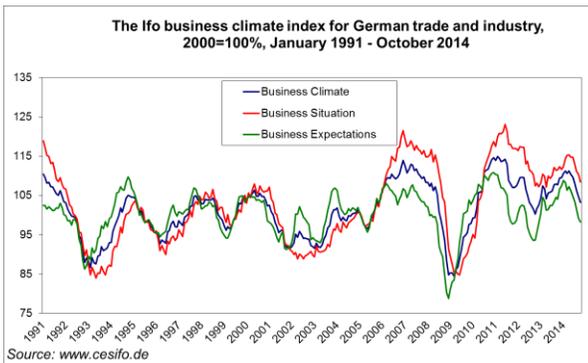
Kopint-Tárki business climate report
(http://www.kopint-tarki.hu/wp-content/uploads/2014/09/Konjunkt%C3%BArajelent%C3%A9s_2014_03_final.pdf)



International trends

The Ifo Business Climate Index for industry and trade in Germany fell in October to 103.2 points from 104.7 points in the previous month. Assessments of the current business situation were once again less favourable than last month. Expectations with regard to the six-month business outlook continued to cloud over. The gap between the current business situation and the expected developments, as calculated by the IEER Index of Asynchrony, decreased in October, so the business confidence index showed lower uncertainty than in the previous month. According to Ifo analysts, the German economy deteriorated once again. (Source: Ifo, <http://www.cesifo-group.de>)

Based on the survey of the French statistical office (INSEE), according to the business managers surveyed in October 2014, the business climate in industry has slightly risen compared to the previous month (+1 point). The composite indicator stands at three points below its long-term average. The turning-point indicator is nearly stable compared to September and is in the zone indicating an economic uncertainty. The balance of opinion on past change in production has increased by three points but is below its long-term average. The balance of opinion on personal production expectations keeps its improvement started in September: it is now significantly above its long-term average. The balance on general production expectations, which represents business managers' opinion on French industry as a whole, has declined, and remains below its long-term average. (Source: INSEE, <http://www.insee.fr>)



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