

“Beyond the second wave of the crisis: improving expectations – decreasing uncertainty” is the title that summarizes the results of the IEER April 2014 Business Climate Survey. The results of the study indicate a strengthening of the positive changes, the business climate indicator increased and reached the level of April 2011. The increase of the index value was derived from the improved expectations of stock orders and business situation of enterprises. These positive changes are accompanied by a low and declining level of investment activity. According to the results, after a long period of stagnation labour demand in the following half year is expected to rise in the Hungarian private sector.

In April 2014 the thirty-third occasion of the IEER Business Climate Survey took place. This is **the largest business climate survey of its kind in Hungary**, and is part of the European business climate survey by Eurochambres of 14 million companies.

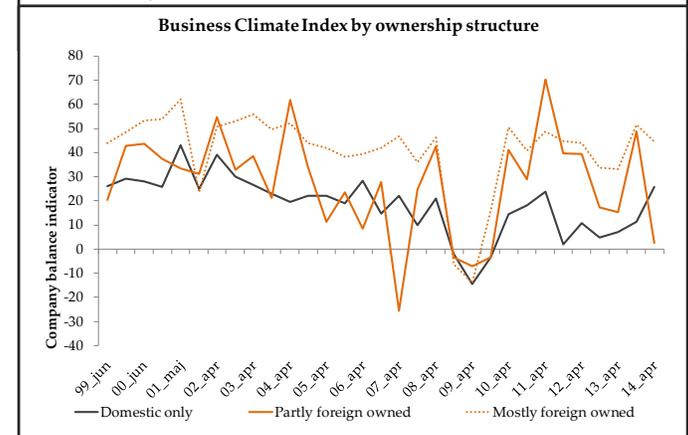
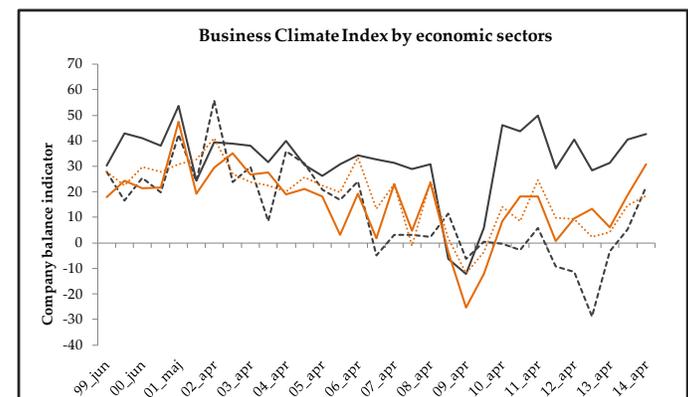
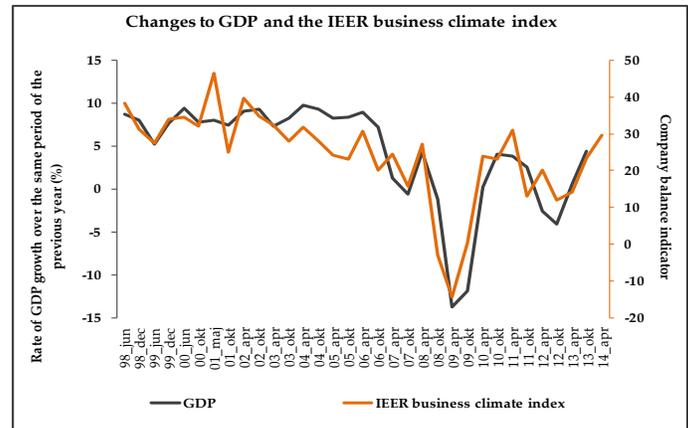
This year’s April survey was based on the responses from 2,606 company executives with regards to the information on business situation of firms and short-term business expectations. The companies participating in the analysis are a representative sample of economic sectors, regions and size (number of employees). Compared with the recession of 2012, the results for 2014 report on the changes taking place and anticipates a further improvement of the business climate. The **business expectations** of Hungarian companies **have become even more optimistic** following last year’s improvement, indicating a more favourable business climate compared to the previous half year.

The business climate index rose in the last half of the year, reaching the level of 2011. The uncertainty index fell, suggesting **a uniform positive assessment of the businesses situation of firms**, and their appraisal of positive trends for this year. Data on the current performance of the Hungarian economy as well as **results from the business climate survey project an increasing rate of GDP growth**.

The **business climate index have risen for all economic sectors** since October of 2013, and especially for the construction industry we can see a big leap. Based on ownership structure, it can be concluded that companies with the most positive outlook are predominantly foreign-owned firms whereas for those that are predominantly domestically owned the business climate has become less favourable. Only entirely Hungarian-owned companies were more optimistic than in October 2013. Exporting companies are more optimistic in their expectations for the next six months, as producers solely for the domestic market are. In terms of company size, the **larger the enterprise is the more optimistic they are**.

Among the different business climate index components **the expected business situation indicator shows a clear and significant improvement**, while in the case of **expected**

investment activity companies can count on a **worsening**



situation. The observed positive shift in the expected business situation indicator is certainly related to expectations with respect to the economic policy of the new government.

Current business situation

The average capacity utilization of the examined companies was 78%, which was two percentage points higher than in October last year. In line with that, the previous six-months net sales ratio also increased and reached a +7 point level, which refers to an expansion of sales. **The business situation of companies is more favourable compared to the autumn results. Industrial companies reported the most favourable situation,** while the least favourable was the one of construction companies. From the data it can be clearly seen that the presence on foreign markets and foreign capital has a positive impact on the business situation of a company. The indicators for mainly exporting and predominantly foreign owned companies tended to be higher as opposed to producers only for the domestic market and domestic owned companies.

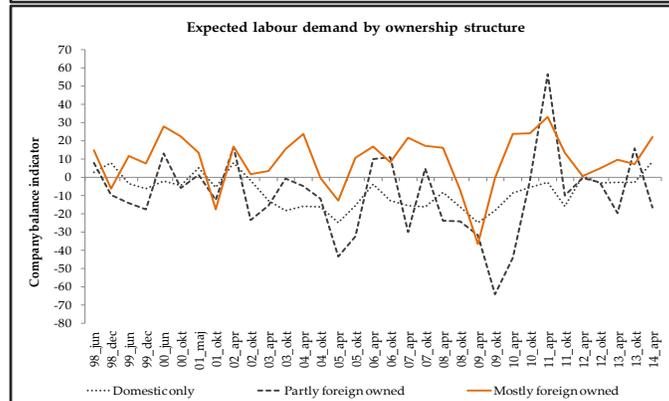
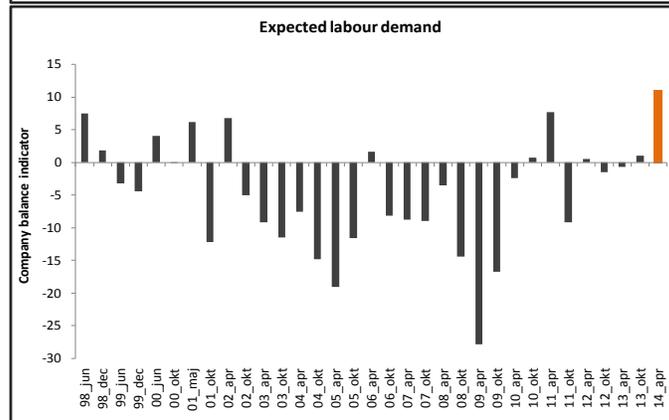
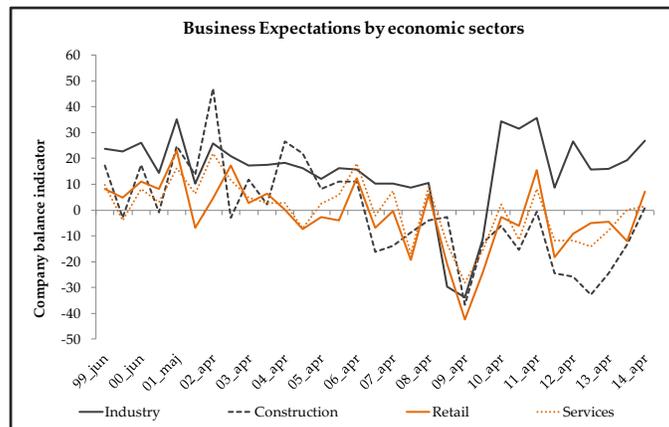
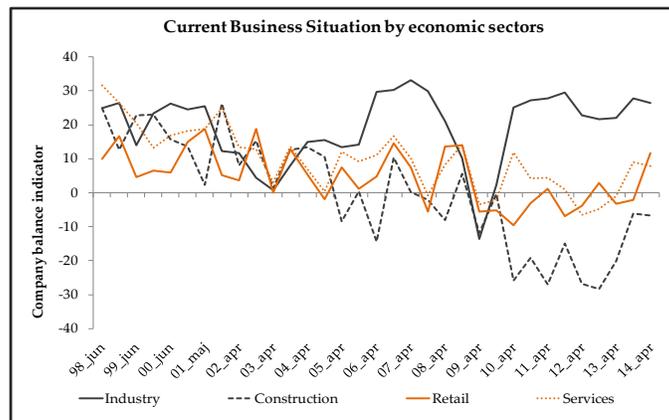
Business Expectations

Examining the business expectations index in terms of economic sectors, industrial companies reached the highest value (27 points), while for other sectors it was much less favourable (construction: 1 point, retail: 7 points, services: 1 point). In addition, **what is notable is the improvement in the expectations of retail companies,** for in October 2013 the value was -12 points. Concerning business situation, again predominantly foreign-owned firms and export-oriented companies tend to have the most positive expectations. Meanwhile among minority foreign-owned companies the index sank into the negative territory.

Labour demand

After a long period of stagnation businesses count on growth in the demand for labour for the next six months (the index rose to +11 points), which is the highest positive value measured thus far. Accordingly, in the next six months, **the demand for labour can be expected to expand in the Hungarian private sector.** The process will be most likely and in large part moved by an increase in labour demand from **purely foreign-owned companies (mostly multinationals),** but domestically-owned companies also reported an increase in this regard. Conversely, firms with minority foreign-owned ownership expect cutbacks. Looking at companies by economic sector, increased labour demand among construction and retail companies can be highlighted. A bigger labour demand is expected at companies selling abroad, as is the case of producers for the domestic market.

The full study can be viewed by clicking on the link below (in Hungarian):
http://gvi.hu/data/research/konj_141_elemzes_140516.pdf



Macroeconomic trends: The impact of the crisis in the Ukraine on the Russian economy

A few weeks ago, it was still uncertain to what extent the Ukrainian crisis as well as the sanctions imposed by the United States and the European Union would have on the Russian economy. What is becoming clear is that the crisis will have serious consequences for the Russian economy. In a press conference at the end of April, the International Monetary Fund (IMF) announced that the Russian economy was in recession.

In the first quarter of 2014 Russian gross domestic product (GDP) increased by 0.8 percent. The Minister of Economic Affairs in December indicated that by 2014, they expect a growth of 2.5 percent, but in April he announced that growth will be around 0 (similar to IMF forecasts, which calculated 0.2 percent Russian GDP growth). The outflow of capital from the private sector in the first quarter of 2014 was 51 billion dollars -- in 2013, capital outflows reached 60 billion dollars for the entire year. In recent months, the ruble depreciated significantly against the dollar and the euro, whilst inflation has steadily increased since January. The Moscow Stock Exchange benchmark indicators also weakened. The manufacturing purchasing managers' index has now decreased for the fifth consecutive month, indicating a contraction in manufacturing.

Economic climate

The Russian economy has been characterized by a slowdown in growth before the Crimean crisis, which is primarily due to **a lack of structural reforms and, subsequently, a decline in business and consumer confidence**. The World Bank says the Russian economic growth model – which is based on large investment projects and the financing of public employee wages and benefits from oil revenue – was periodically able to mask the lack of reforms. However, due to the events in the Crimea the pre-existing uncertainty became more severe, and highlighted the weaknesses of the Russian economy model.

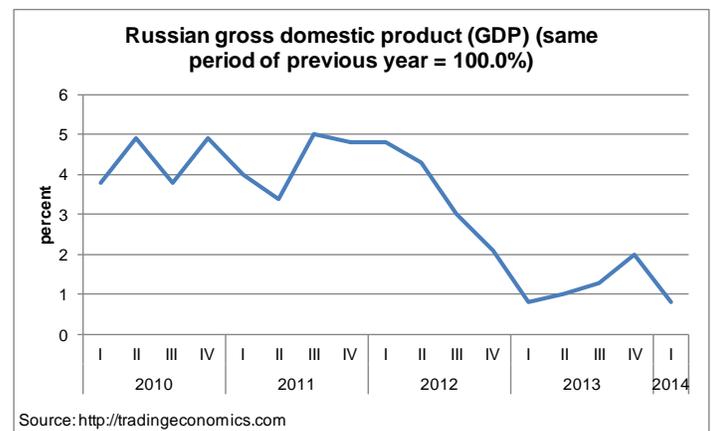
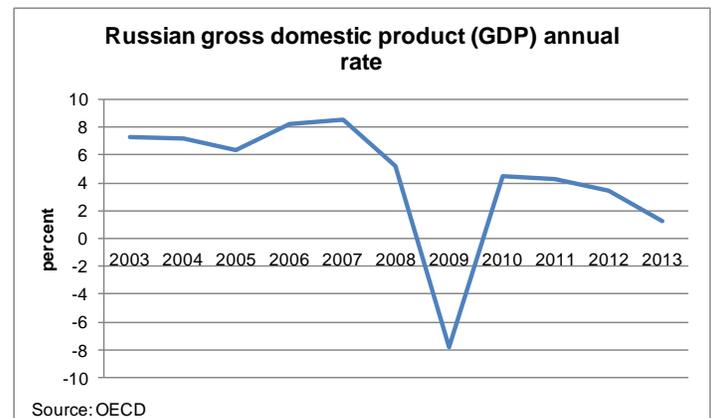
In recent months, there was a doubt that the Ukrainian crisis and **sanctions from the United States and the European Union would seriously affect the Russian economy**. Today, it seems more likely that **the Ukrainian crisis will pose serious economic consequences for Russia**. The International Monetary Fund (IMF) at an April 30th press conference stated that **the Russian economy was in recession**.

The following is a brief overview on the development of Russian gross domestic product (GDP) at the beginning of 2014, capital outflows, the ruble exchange rate, inflation and other economic indicators in Russia. In addition, we will discuss how the Ukrainian events affected consumption, investment, capacity utilization and the labour market.

Gross domestic product

Russian economic growth in recent years was on a slowing trend: while in 2012 Russia's gross domestic

product grew by 3.4 percent in 2013 this figure was only 1.3



percent. According to the latest data from the Russian statistical agency in the first quarter of 2013 GDP grew by 0.8 percent, in the second quarter by 1.0 percent, in the third quarter by 1.3 percent, and in the fourth quarter by 2.0 percent. In the first quarter of 2014 Russian GDP grew only by 0.8 per cent. In a March 2014 analysis by the World Bank, two possible scenarios are outlined regarding the further development of the Russian economy as a result of the uncertainty of the political situation. In the optimistic scenario, the Crimean crisis will have only limited and short-term effects: in 2014 Russian gross domestic product will grow by 1.1 percent and in 2015 it will reach again the level of 1.3 percent as it was in 2013. However, the World Bank announced that the Crimean crisis could have more severe consequences for the Russian economy. If this happens, it is estimated that **in 2014 Russia's GDP will suffer a 1.8 percent decline and in 2015 this will grow to 2.1 percent.**

A report from the Russian Minister of Economic Affairs in December 2013 stated that by 2014 they expect a growth of 2.5 percent, but in April 2014, it has been found that the growth will be below 0.5 percent, at about stagnation level. According to IMF forecasts an increase in GDP growth of only 0.2 percent is expected in 2014.

Capital outflow

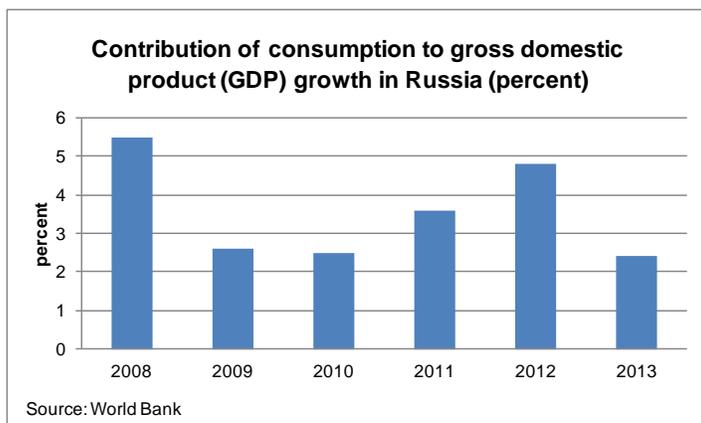
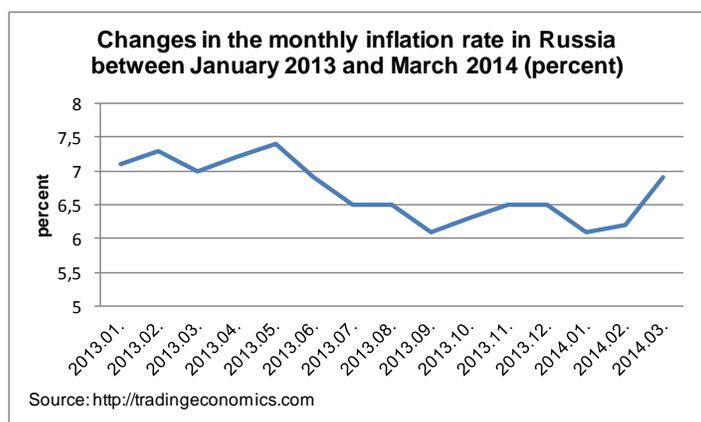
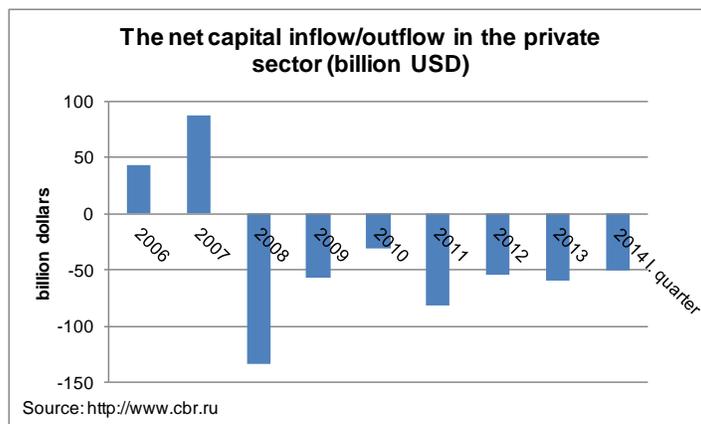
According to the Russian central bank, the net outflow of capital from the private sector in the first quarter of 2014 was \$51 billion – in 2013, capital outflows reached \$60 billion for the entire year. Net capital outflows regarding the banking sector was \$8 billion in 2013, in the first quarter of 2014 this value was already significantly exceeded: the outflow of capital here was \$19 billion. Net capital outflows affecting other sectors in 2013 during the full year reached 52 billion U.S. dollars, while in the first quarter of 2014 this value was \$32 billion. **The primary reason for the high level of capital flight is that investments fell significantly and business confidence worsened because of the Ukrainian crisis.**

According to a statement by the Russian Minister of Finance at the end of April 2014, this year capital flight will reach \$80 billion. However, the Russian Ministry of Economic Development – also in April – stated that the outflow will be \$100 billion. The IMF also gave this latter figure in its forecast at the end of April.

Due to external financing risks caused by large-scale capital flight, Standard&Poor's downgraded Russia's foreign currency debt to its lowest investment grade level.

After the downgrade the Russian central bank – despite the fact that it previously announced it would not raise interest rates until June – raised its key interest rate to 7.5

per cent. The increase was justified on the grounds that the risk of exceeding the year-end inflation target of 5 percent



had increased significantly. However, according to the global investment advisory firm TD Securities, **the rate increase was not designed to contain inflation, but to stabilize capital flow, which means a further increase of the interest rate may be necessary as well.**

Financial Position

In recent months, there was a significant weakening of the ruble exchange rate against the dollar and the euro. The low point was in mid-March, when there was a rate of 36.65 rubles to the dollar, and 50.94 rubles to the euro, according to Russian central bank data. In March, the ruble weakened on average 3.5 percent against the basket of currencies compared to the previous month. The ruble has weakened before the Ukrainian crisis, but **the outbreak of the crisis significantly increased a devaluation of the Russian currency.**

In a January 2014 statement the chairman of the Russian central bank refuted the assumption that Russia deliberately let the ruble devalue in order to stimulate economic growth.

Annual inflation in Russia was 6.08 percent in January, in February it was 6.20 percent, and in March it was 6.91 percent. In April the Russian Ministry of Economic Affairs has increased its year-end inflation expectation from 4.8 percent to 6 percent. However, the central bank's inflation target number has not been changed, and it continues to perceive that the upper limit of 5-6 percent can be achieved.

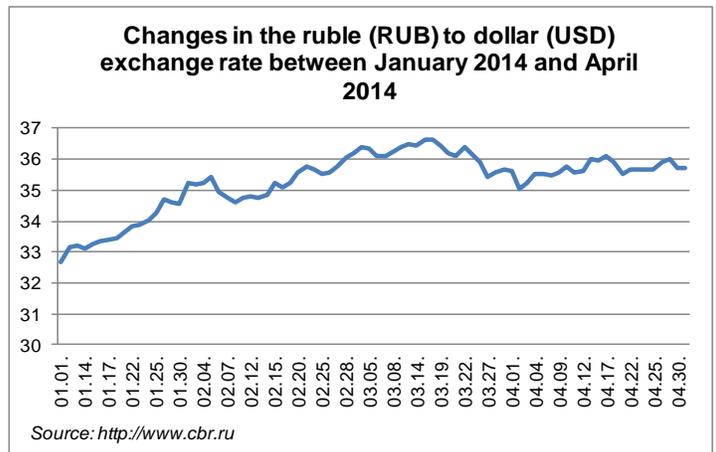
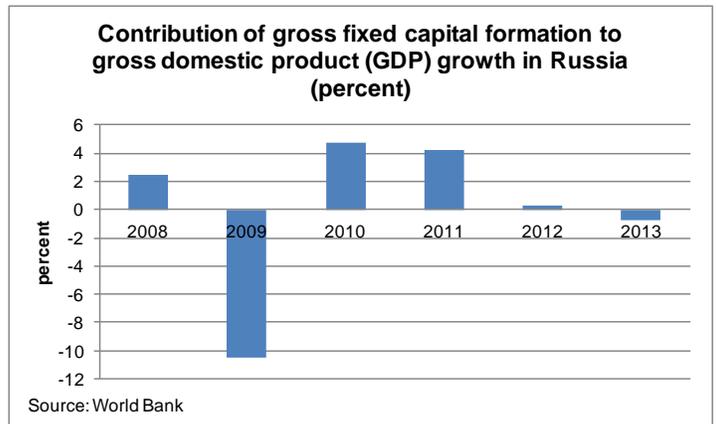
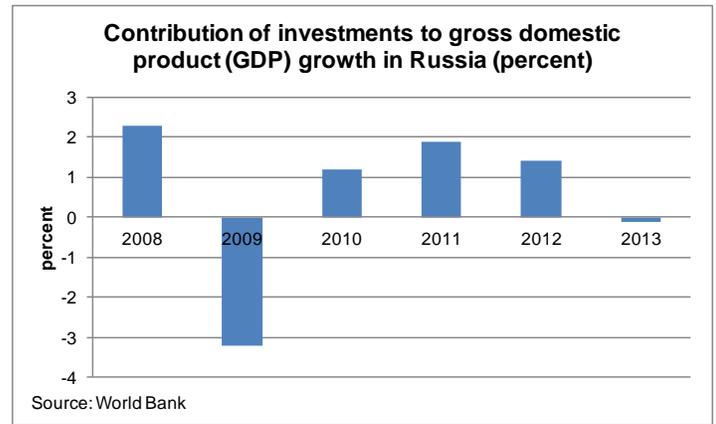
Moscow's stock market benchmark indicators also weakened because of the Crimean crisis and the slowdown in Russian economic growth. The RTS index, which reflects the trading of shares quoted in dollars, had fallen about 21 percent by the end of March.

Consumption

The reason of the slowdown in consumption is also that the economy is facing a crisis in confidence. In addition to the fact that consumption is the main thrust of Russian economic growth, household and government consumption contributed much less to economic growth in 2013 than in 2012. The contribution of consumption to gross domestic product was reduced by half: from 4.8 percent to 2.4 percent. The main reason for the decline in household consumption was, on the one hand, a slowdown in real income growth and, on the other hand, increased household indebtedness.

Growth in consumption in 2012 was 6.9 percent; in 2013 it fell by 3.4 percent. According to World Bank forecasts it is expected to decline further. The optimistic estimate is for a

2.2 percent increase in consumption in 2014 and a 2.0 percent rise in 2015. According to the pessimistic estimate a 0.8 percent growth can be expected for 2014 and 1.1 for 2015.



The **decline in investments** – from the second half of 2013 – can be attributed to the shutdown of major infrastructure projects and deteriorating business confidence. In 2013 the contribution of investments to gross domestic product was negative (-0.1%) compared to the 2012 figure of 1.4 percent. As a result, the contribution of gross fixed capital formation growth was also negative: from 0.3 percent in 2012 to -0.8 percent (in 2011 it was 4.2 percent).

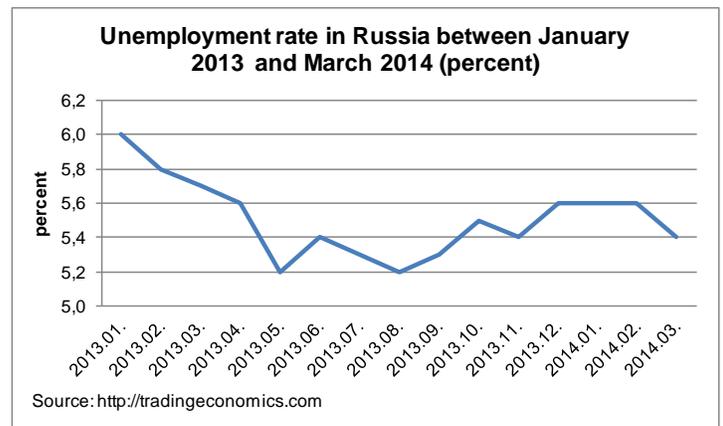
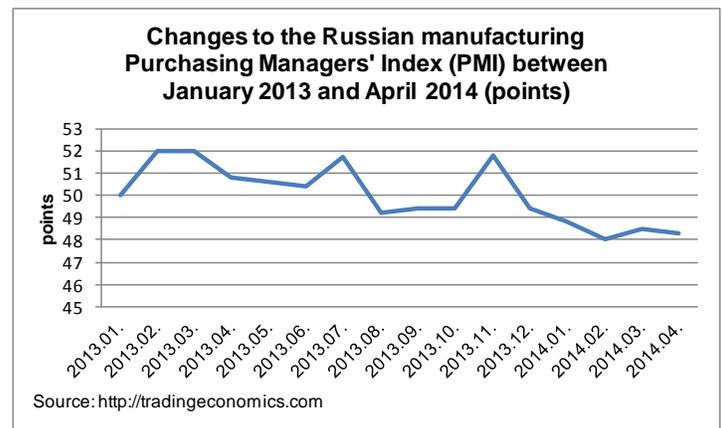
Capacity utilization

Average **capacity utilization** of the Russian economy **declined significantly by the end of 2013**. During the year 2012 capacity utilization levels remained largely unchanged. In the first half of 2013 it was nearly 80 percent; however it began to decline in the second half of the year. World Bank analysts believe that these reductions are caused by the pessimistic expectations of producers. The Russian (seasonally adjusted) manufacturing purchasing managers' index (PMI) is now in the fifth consecutive month of decline. Since the end of 2013, the index is below the 50 points level, indicating a contraction in manufacturing.

Labour market

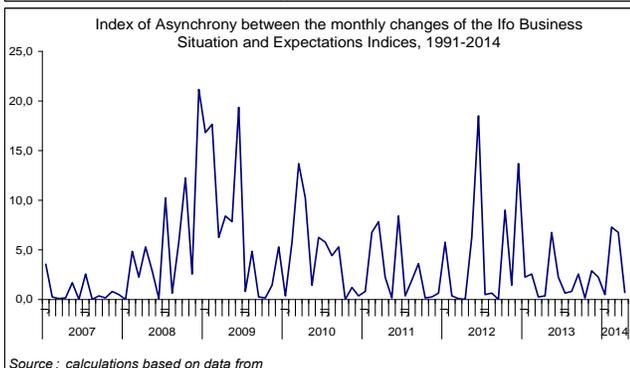
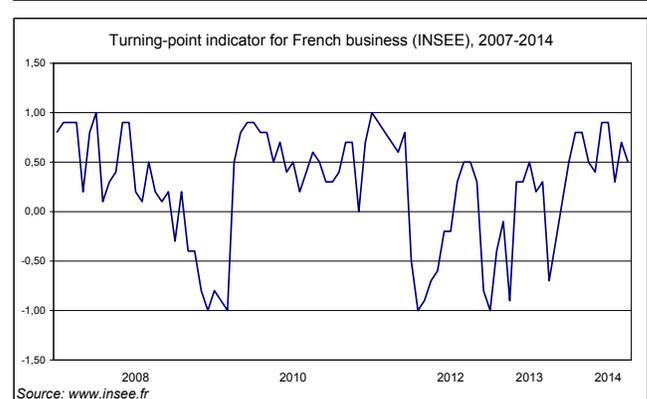
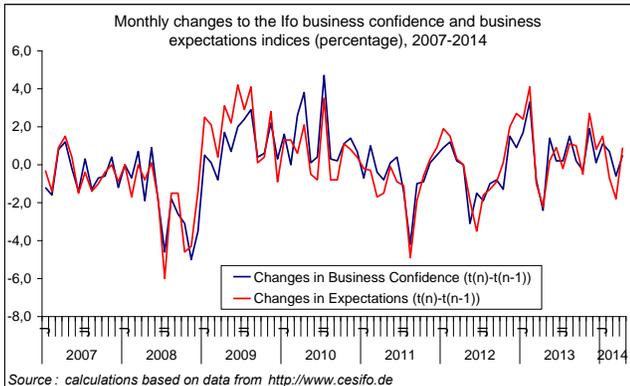
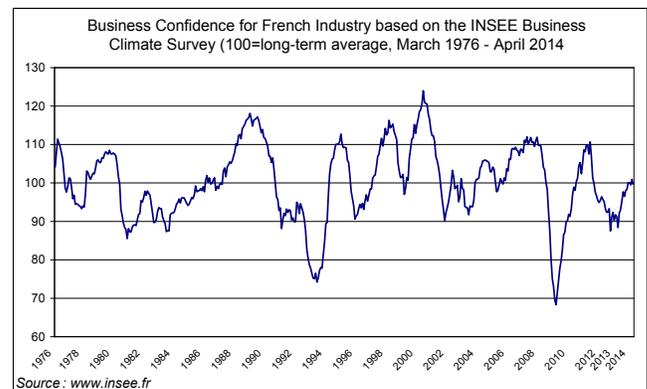
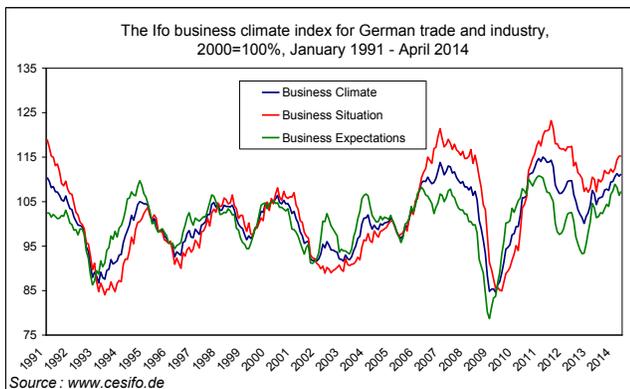
The characteristics of the Russian labour market and labour demand – if the vacancy rate is measured – did not change significantly in 2013. The number of employees decreased significantly in the first half of 2013, meanwhile for the seasonally adjusted index at the end of the year it was 71.2 million people whereas in 2012 it was 71.8 million. Thus in the second half of 2013 the unemployment rate had not changed: the seasonally adjusted rate was 5.5 percent, indicating a balanced labour market. However, regional unemployment rates are strongly heterogeneous: while in big cities unemployment is very low (e.g., in Moscow and St. Petersburg it is only 2.0 percent), for example in parts of the North Caucasus Federal District (e.g., Ingushetia, Chechnya) more than a quarter of the population are unemployed.

Source: World Bank, OECD, Central Bank of Russia, tradingeconomics.com



The Ifo Business Climate Index for industry and trade in Germany rose in April to 111.2 points from 110.7 points last month. Assessments of the current business situation, which were already favourable, improved somewhat. Companies are also more confident about future business developments. The gap between the current business situation and the expected developments, as calculated by the IEER Index of Asynchrony, decreased in April, so the business confidence index showed lower uncertainty than in the previous month. According to Ifo analysts, despite the crisis in Ukraine, the positive mood in the German economy prevails. (Source: Ifo, <http://www.cesifo-group.de>)

According to the business managers surveyed in April 2014, the business climate in industry is nearly stable compared to the previous month. The composite indicator has decreased by one point and stands at its long-term average. The turning-point indicator has slightly decreased compared to March and is now in the zone indicating a favourable outlook. The balance of opinions on personal production expectations remains good-biased: it is nearly stable and stands above its long-term average. The balance on general production expectations, which represents business managers' opinion on French industry as a whole, has weakened and has reached a level below its long-term average. (Source: INSEE, <http://www.insee.fr>)



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