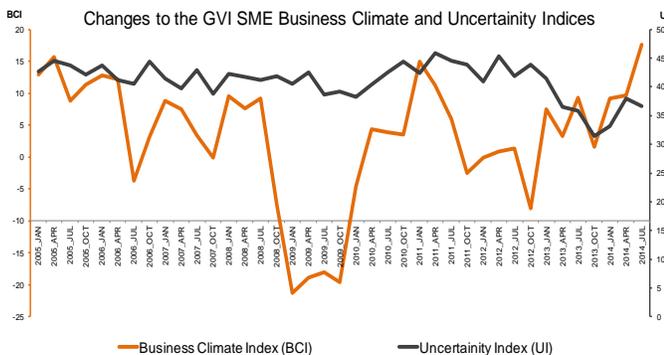
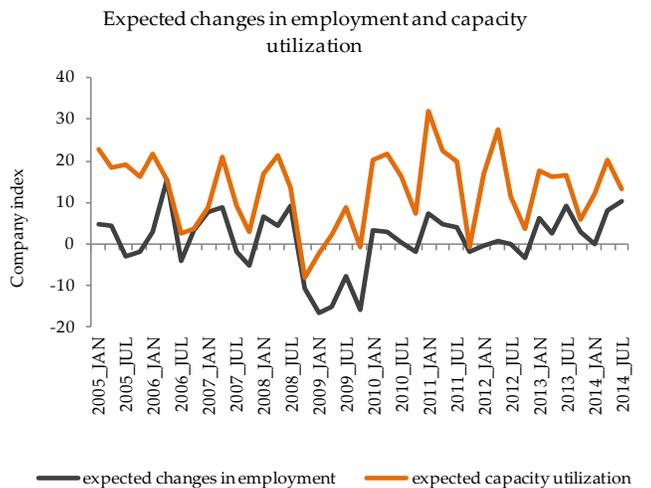
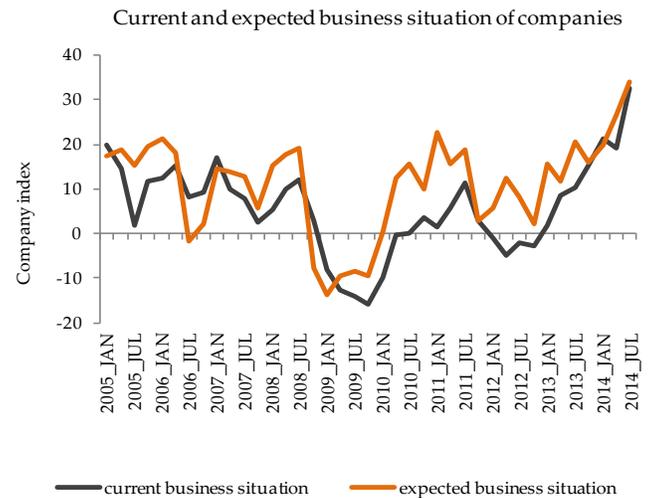


The HCCI Economic and Enterprise Research Institute (GVI) July 2014 edition of SME Perspectives showed that the level of business confidence within the domestic SME sector continued to improve compared to that seen in the previous quarter, thus we have three consecutive quarters in which an improving business climate was detected. Since the indicators showed that business confidence in the second quarter 2014 will continue the improvement apparent since the last quarter of 2013, this represents the best level in the history of the research, that is, the GVI SME Perspectives Business Climate Indicator has reached the best level since 2005. In addition, the uncertainty index value indicates that the current trend is not uniform in the business sector, therefore the recovery will continue to be confined to only one part of the economy and is not apparent for all companies.

The SME Perspectives Business Climate Indicator for April rose 10 points to 18 points. The current 18 points is the highest level since the beginning of our research (2005), the last time the index had a value at a similar level was at the beginning of 2011 (in January 2011 it reached 15 points). The Uncertainty Index stands at a level of 37 points, one point below the April value; this uncertainty suggests stagnation following a sharp rise at the beginning of the year. The current 37-point level is similar to the previous year (in July 2013 the index was 36 points), but lower than the value of two years ago (in July 2012 it was 42 points).

The GVI SME Perspectives Business Climate Indicator consists of ten components. Based on the examination of these elementary indicators it can be said that optimistic expectations about current and future business situations, current profitability, orders and production levels, future investments and employment changes are behind the increases in the SME Perspectives Business Climate Index. In comparison, the expected profitability of companies, their production levels and capacity utilization is considered not as good compared to the value in the previous quarter.

Since 2005 the GVI carries out quarterly research into the business activity of SMEs, which this year took place in July for the thirty-ninth time. On each occasion of the survey managers at 300 firms reported on the business climate of their company.



## Macroeconomic trends: The impact of European Union sanctions against Russia on the Hungarian and EU economies

**A solution to the seven-month running conflict between Russia and Ukraine has not yet emerged. The European Union and the United States tried to persuade Russia to end its military presence and influence in the Ukrainian regions through the use of various economic and financial sanctions, hoping to initiate the peace process in Eastern Europe. However, the EU sanctions that were brought into force on September 12 not only have had an impact on the Russian economy, but on the EU and its member states as well. The following examines the retroactive effects of the restrictions, with changes on the Hungarian economy as a result of the sanctions discussed in detail.**

The Russian-Ukrainian conflict which began in February 2014 is to this day not resolved. Russian forces are still present in the territory of Ukraine, thus the civil war situation in eastern Ukraine hasn't receded. The United States and the European Union have imposed economic sanctions since March in order to try and persuade Russia to withdraw its military forces from the territory of Ukraine.

On September 8 the European Council, acting by a written procedure, adopted further restrictive measures as well as a package tightening the sanctions of July 31, which entered into force on September 12. The new measures which came into force affects capital markets access, the defense industry, dual-use items and sensitive technologies. But what kind of effects do these sanctions have on the European Union economy, and in particular Hungary's economy?

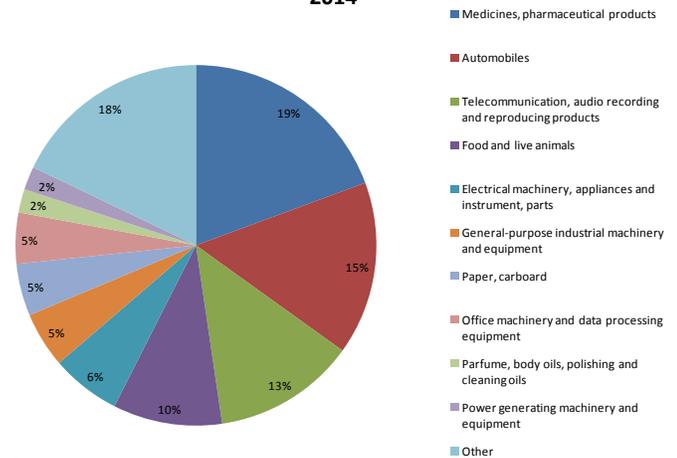
Under the new financial sanctions EU Member States and companies within Member States are not allowed to extend credit to five large state-owned Russian banks, thereby making it difficult for the Russian state to have access to money and capital markets. Through the sanctions on the aforementioned banks the Russian state is also restricted by the prohibited trade of financial instruments issued by these banks with a maturity of longer than 30 days.

The sanctions target the main branches of the Russian economy, thus the trading of financial instruments with more than 30 days maturity from three large defense and energy companies (Rosneft, Transneft and the oil magnate Gazprom) is also prohibited. The sanctions also include ending support drilling for oil in Russia by the EU, as well as exports of dual-purpose goods and technologies (civilian and military).

The EU's exports in 2013 was only 6.8% of the Russian consumer market, hence it can be stated that Russia's trade with the EU is quite modest. However, this does not mean that certain economic areas of Europe are not sensitive to the imposition of sanctions, albeit it does not jeopardize the overall economy.

In the first half of 2014 Hungary exported EUR 1,052 million worth of products to the Russian market, which is modest

**Hungarian exports to the Russian market, first half of 2014**



**EU and Russia foreign trade**



compared to the total exports of € 81 billion in 2013 of the Russian export market. We can mention two important sectors that play a decisive role in Russian exports.

The first is the medicines and pharmaceutical products market, which weighs in at 10.8% of exports of all goods within the range of products. Revenue from the pharmaceutical industry in Russia was 19.36% of export value.

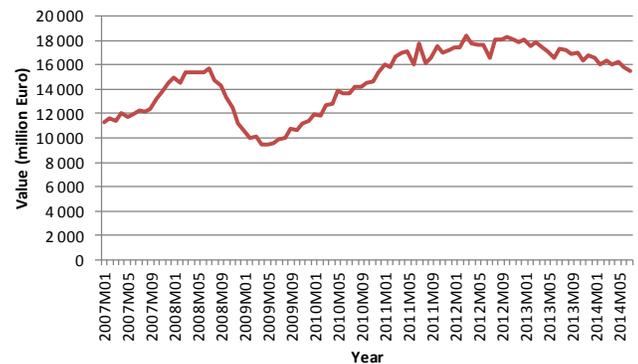
The second sector is the automotive industry. In the first six months of this year, automobile exports to the Russian market was 15%, but it still only makes up 2.5% of the total automotive exports from Hungary. Among manufacturers with the most exposure to the Russian market is Suzuki in Esztergom.

The Russian response to the sanctions in August perhaps had the most significant negative impact on the Hungarian economy. The value of food exports to Russia in the first half of 2014 was EUR 102.9 million, which makes up 3.5% of Hungarian food exports. Looking at the micro level, we can see that the main losers of the Russian embargo on Hungarian foodstuffs were the agricultural sector's vegetable and fruit growers. That is, separate European Union resources allocated as compensation for the damage suffered has run out before it could be distributed to all Hungarian farmers.

The EU and the USA are working with the great effort to build peace in Eastern Europe, which often requires decisive action against Russia. Their measures are temporary in nature, and economic players believe that after a Ukrainian-Russian peace is concluded the sanctions may be lifted. The overall conclusion is that the EU sanctions brought against the Russians show little effect on the economies of the EU and Hungary on the macro-level, while on the micro level there are some industries that are in need of appropriate levels of compensation in order to be able to recover from the loss of income caused by the sanctions.

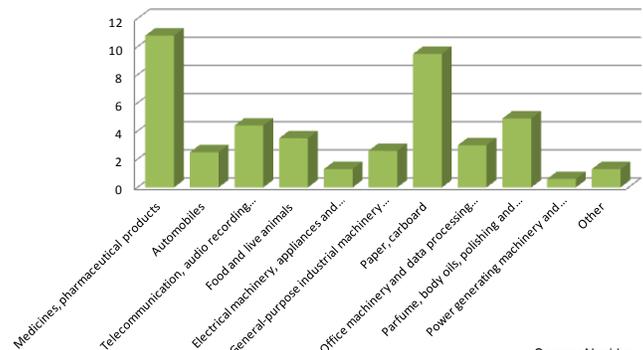
Source: [portfolio.hu](http://portfolio.hu), [napi.hu](http://napi.hu), [KSH.hu](http://KSH.hu), [Eurostat.eu](http://Eurostat.eu)  
European Council website: <http://www.european-council.europa.eu/home-page/highlights/further-economic-sanctions-on-russia?lang=hu>

EU and Russia foreign trade



Source: Eurostat — EU imports from Russia

Share of exports to Russia of a given product group (%)

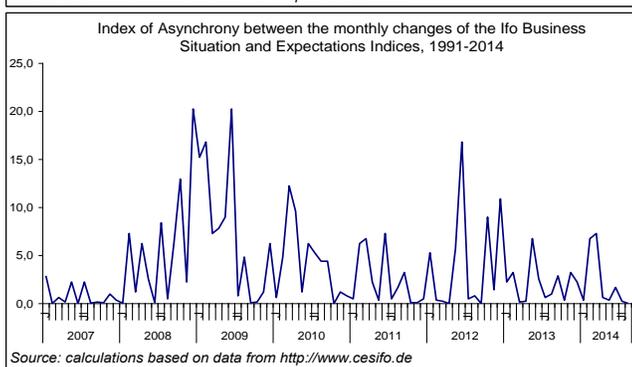
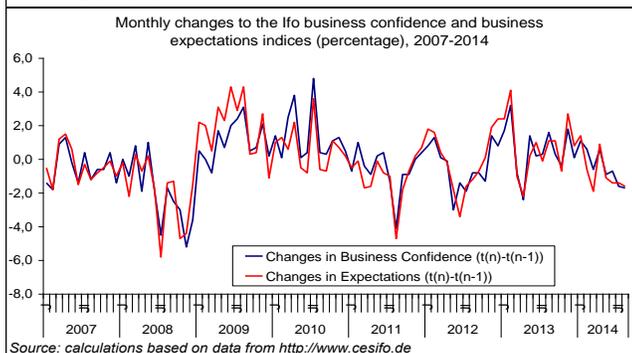
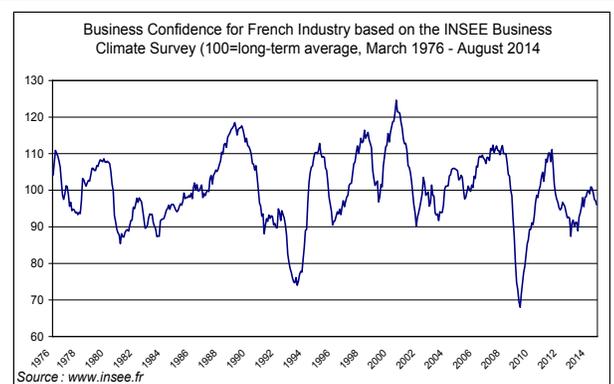
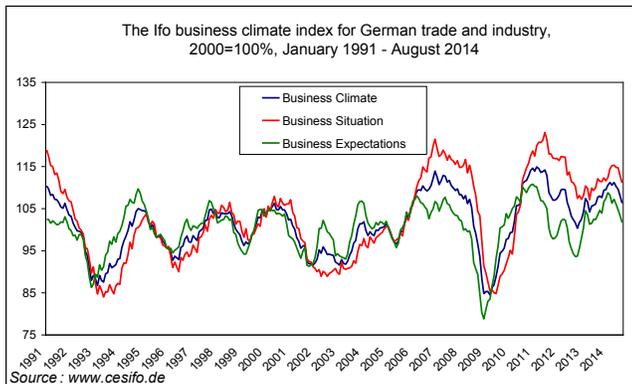


Source: Napi.hu

## International trends

The Ifo Business Climate Index for industry and trade in Germany fell in August to 106.3 points from 108.0 in the previous month. The firms were again less satisfied with their current business situation. Also with regard to the further course of business, they are more sceptical than in the previous month. The gap between the current business situation and the expected developments, as calculated by the IEER Index of Asynchrony, increased in September, so the business confidence index showed higher uncertainty than in the previous month. According to Ifo analysts, the German economy continues to lose steam. (Source: Ifo, <http://www.cesifo-group.de>)

According to the business managers surveyed in August 2014, the business climate in industry has deteriorated compared to the previous month. The composite indicator has decreased by one point and stands at four points below its long-term average. The turning-point indicator is nearly stable compared to July and is in the zone indicating an economic uncertainty. The balance of opinion on past change in production has slightly decreased and is now below its long-term average. The balance of opinion on personal production expectations has sharply gone down: it is now clearly below its long-term average. The balance on general production expectations, which represents business managers' opinion on French industry as a whole, is nearly stable, at a level which is below its long-term average. (Source: INSEE, <http://www.insee.fr>)



Written by: Ágnes Makó (analyst, IEER)  
Zsanna Nyíró (analyst, IEER)  
Miklós Hajdu (analyst, IEER)  
Sződónia Nagy (intern, IEER)  
Zoltán Verba (intern, IEER)  
Emília Kompaktor

In case of publication please cite as follows:  
HCCI IEER: Monthly Bulletin of Economic Trends,  
2014 / September, Budapest,  
2014-10-21