



market monitor

Adapting to the challenging
economic environment

October 2010

The rocky road to recovery

If proof were ever needed that the route to economic recovery is less a smooth highway than a rocky road, this month's Market Monitor provides that proof lucidly.

In the UK, the new coalition government has adhered to its promise (if promise is the right word) of harsh austerity measures to reduce the onerous budget deficit, and, though it is hard to argue with the overall logic of their intent, some of the measures have proved less than welcome, such that the government must tread a fine line if it is to retain public support and avoid adversely affecting business opportunities.

The tenacity with which the Germans have determinedly dragged their economy out of the doldrums is very evident, helped in great part by foreign demand for its products. But a question mark still hangs over continuing success, as global growth, and therefore demand for German goods, declines. Nevertheless, rising domestic consumption may fill the gap.

The revival of the German economy is proving to be a lifeline of sorts for Hungarian exports, but this pales in comparison to Hungary's massive government debt and its reliance on EU/ IMF support to keep it afloat. Denmark's manufacturing sector too has benefited from its exports to neighbouring Germany, though this is countered by longstanding problems in its construction sector.

Two distinct pictures emerge from Latin America. Chile's President Pinera has delved deep into public coffers to fund vital reconstruction following February's earthquake, but, thanks to its enviable copper reserves and prudent economic management, Chile will remain an economic leader in the region. While Chile still has to grapple with the problem of social inequality, Mexico's troubles run much deeper, inextricably linked as they are to the pace of economic recovery in the US, and now dogged by the plague of drug related violence spreading from the north, and undermining many aspects of the economy, not least tourism.

In this issue...

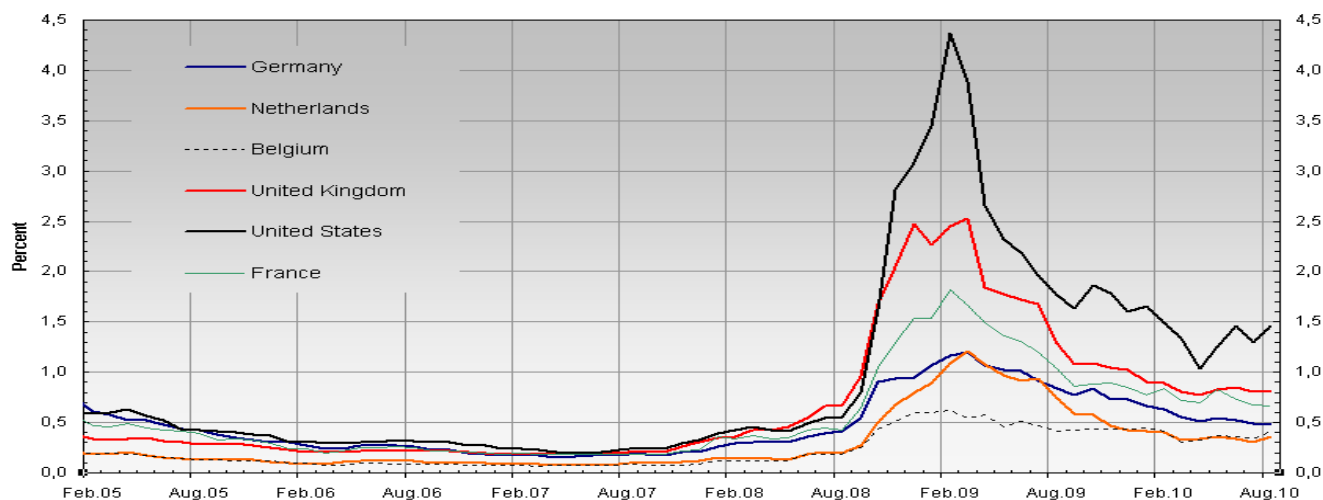
...we feature the following markets:

- UK – with a spotlight on the print and consumer durables/retail sectors
- Mexico – with a spotlight on the consumer durables/retail and machinery sectors
- Germany
- Denmark
- Hungary
- Chile

Expected default in Western Europe and USA

One of the most important factors that any business needs to know is the trend in insolvencies in their markets. The following Expected Default Frequency (EDF) chart is based on listed companies in the markets referred to, and the likelihood of default across all sectors within the next year. In this context, default is defined as a failure to make a scheduled payment, or the initiation of bankruptcy proceedings. Probability of default is calculated from three factors: market value of a company's assets, its volatility and its current capital structure. As a guide, the probability of one firm in a hundred defaulting on payment is shown as 1%.

Median EDF evolution by country



Source: KMV Credit Monitor and Atradius Economic Research

Since the beginning of the year, the EDF values of most of the countries surveyed have shown some volatility from month to month. Nevertheless, the general tendency since January has been that of overall improvement. The August 2010 median EDFs for France and Germany are the lowest since the start of the worldwide credit crisis, in September 2008, and the latest figures for Belgium, the Netherlands, the UK and the US are, despite some increases on the previous month, still lower than in December 2009.

On the following pages, we assess the impact of expected default in key markets. As well as the expert view of our underwriters, we indicate the general outlook for each market and sector featured using these 'weather' symbols:



Excellent



Good



Fair



Gloomy



Bleak



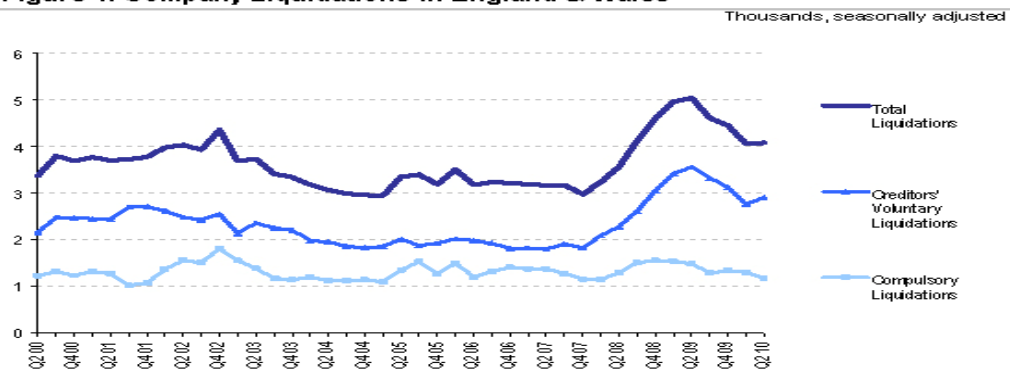
Growth picks up, despite a disappointing export performance

The UK's GDP grew 1.2% in Q2 of 2010, following 0.3% growth in Q1. The level of growth came as a surprise to many and was very much down to a better than anticipated performance in both construction and services (finance). There are many conflicting views on forecasts for the rest of the year, but most analysts believe that we will probably see growth of around 1.5% for the 12 month period - and so effectively flat for the remainder of the year. The UK trade deficit widened again in July 2010, to £4.9 billion, an increase on the £3.9 billion deficit seen in June. This is disappointing, as it again emphasises that growth is not coming from an increase in exports, which is itself surprising in view of the continuing weakness of Sterling against other major currencies. There are signs that many businesses have maintained their prices and increased their margin, but have not driven volume to take advantage of the favourable exchange rate. The good news is that early indicators suggest that exports did pick up in August, as a result of an increase in world demand brought about by a combination of rapid growth in emerging markets and a slight improvement in the Eurozone.

According to the current Atradius Payment Practices Barometer*, businesses in Great Britain were still susceptible to payment delays throughout the supply chain, and regardless of size. Around half of the British businesses surveyed told us that they had experienced delays, requests for extended terms and increased credit, indicating potential additional payment risk.

The latest insolvency figures show that there were 4,080 compulsory liquidations and creditors' voluntary liquidations in England and Wales in Q2 of 2010 (see chart below): an increase of 0.5% on Q1 and a decrease of 19.1% on the 2009 figure. Compared to previous recessions, this comes as a surprise as, generally, insolvencies continue to rise for a number of months even after the economy has returned to growth. It is highly likely that the HM Revenue and Customs' (HMRC) 'time to pay' scheme (allowing viable customers who cannot pay by due date to make payments over a longer period) continues to artificially improve the insolvency figures, but only time will tell, as some companies will struggle to catch up with their deferred tax payments. We also know that HMRC are taking a far less lenient stance with new businesses that are now looking to take advantage of this scheme. Nevertheless, we expect corporate insolvencies to decrease 10% year-on-year this year and further 5% in 2011.

Figure 1. Company Liquidations in England & Wales



Source: Insolvency Service and Companies House

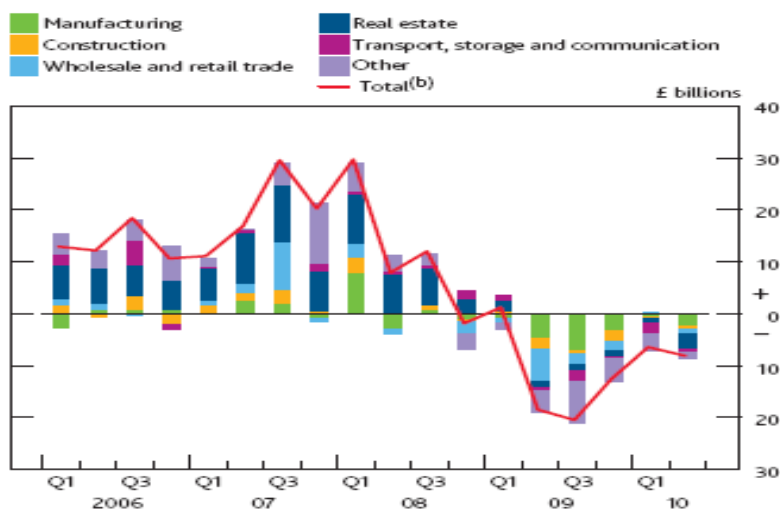
* You can download the Atradius Payment Practices Barometer: www.atradius.com/paymentpracticesbarometer



Business loans remain a problem

The availability of bank lending to UK businesses continues to be a real problem (see chart below), especially for SMEs as they attempt to come out of the cycle and return to growth. June figures showed a net monthly contraction of £3.5 billion, following the £3.3 billion contraction of the previous two months. Early indications are that figures for July were also weak and are unlikely to provide any evidence of a more lenient approach being taken by financial institutions. While some overseas banks are now looking beyond their own domestic markets, indications are that they are looking to grow their portfolios in emerging markets rather than reopening the door in traditional markets such as the UK.

Chart 1.1 Sectoral breakdown of quarterly net lending flows^(a)



- (a) Lending by UK monetary financial institutions to UK PNFCs. Data cover lending in both sterling and foreign currency, expressed in sterling terms. Data are non seasonally adjusted. For this reason and that noted in footnote (b) below, the total quarterly flows will not exactly equal the data for PNFCs in Table 1.A.
- (b) Data for PNFCs have been estimated by subtracting elements of the industrial breakdown for non-financial corporations thought to contain mainly lending to the public sector (public administration and defence, education, health and social work and recreational, personal and community services).

Source: Bank of England

In the last Market Monitor UK report, we referred to the decision by the new coalition government to take immediate action in an attempt to reduce the deficit by means of an emergency budget. There is no doubt that public sector spending cuts have already started to have a negative impact, especially on those industries heavily reliant on public sector contracts, such as construction and IT. To give some idea of the scale of the cuts, while total government spending in 2008 and 2009 was £620 billion, the new government has asked all its departments to come up with business plans that identify cuts of 40%, even though the likelihood is that this will ultimately be reduced to 25%.

While there are some signs of an improvement in the UK economy, the biggest challenge is finding the correct balance to reduce national debt without having a negative impact on growth. The coalition government has taken strong and decisive action, but only time will tell if this was too much too soon. In the meantime, we continue to take an optimistic but cautious approach. Overall, the IMF recently forecast 2% GDP growth for the UK in 2011.



Print

What is the current trend in insolvencies?

There has been a general decline in the consumption of printing and writing paper as the shift to electronic communication and e-invoicing has evolved. It is unclear whether this trend has accelerated during the recession or is structural, but cuts in advertising revenue have led to a drop in the number of newspaper pages, and a decline in printed media, such as direct mail, and catalogue production. Rates of insolvency remain high (see chart below).

Key Insolvency Statistics

Sector	Insolvencies August 10	Insolvencies August 09	% of business population failing Aug 10	% of business population failing Aug 09	Financial Strength Score Aug 10	Financial Strength Score Aug 09
Printing, Paper and Packaging	6	6	0.19%	0.24%	78.64	79.42

Source: Experian

The most notable failure so far in 2010 has been the Print Factory (London) 1991 Ltd, a business that had a turnover of £63m in 2008. The business had HMRC arrears of £4.5m and unsecured creditors of £18.7m. Its failure can be traced back to the loss of a major contract in 2008.

What is Atradius' short term outlook for the print sector?

There is likely to be some rebound in paper consumption as the UK moves out of recession, but in the long term the downward trend is expected to continue. Currently pulp prices are about US\$ 1,300 per tonne. Driven by lower production capacity and increased demand, this price level is not believed to be sustainable and print companies will have problems passing on these costs. There remains overcapacity in the UK, compounded by price deflation created by Phoenix companies (where the assets of one failed limited company are moved to another legal entity) chasing volume.

What is the Atradius approach to the sector?

Our underwriting approach is to try to identify the added value component that a company can offer, whether it be a security component, such as internal strips for a smart card, or a bar code for those offering design, print and finishing capability, and others in niche markets printing certificates, gift vouchers and licences.



Consumer durables/retail

What is the current trend in insolvencies?

The relatively low level of insolvencies within this sector in the UK has been one of the positive elements of the recessionary climate over the past 18 months. That said, it has not been without its failures, and particular sectors and subsectors (e.g. furniture and mid-market clothing retailers) have borne the brunt of much of the pain. To give some impression of the profile and scope of retail insolvencies since 2007, the following table shows the number of medium or large retail businesses that failed during that period:

	Companies failing	Stores affected	Employees affected
Jan-August 2010	17	795	9,250
2009 (12 months)	37	6,536	26,688
2008 (12 months)	54	5,793	74,539
2007 (12 months)	25	2,600	14,083

Source: Centre for Retail Research

According to PricewaterhouseCoopers, retail insolvencies fell over 26% in the second quarter of 2010, to their lowest level since Q4 of 2007. Equifax reported that, although the total number of company failures fell 13.2% year-on-year in August, the number of retailers failing decreased only 9.6% year-on-year. When compared to July 2010 they had in fact risen 3.2%.

Relative to the rest of the UK economy, however, retailers have accounted for just 5.5% of corporate insolvencies in 2010, according RSM Tenon, and it is in this context that we should look at the outlook for the next 6 months.

What is Atradius' short term outlook for the consumer durables/retail sector?

Despite the positives that can be drawn from these statistics, the outlook is still clearly mixed and analysts are generally predicting growth in retail spend of approximately 2% in 2011. We believe that retailers' recovery from recession could fall short of these expectations, as public sector cuts, tax rises and fears over job prospects and earnings growth force shoppers to tighten their purse strings yet again. This will make the market even more competitive and differentiation yet more important.

The businesses facing particular challenges are those with a significant bias towards UK regions worst affected by public sector cuts, such as the North East and South Wales, and those selling big ticket consumer durable items and home improvement products.

What is the Atradius approach to the sector?

Our aim is to identify those risks that are behind the current negative trends, whether those are trends in performance or in a market position that are vulnerable to any of the threats mentioned in this report.

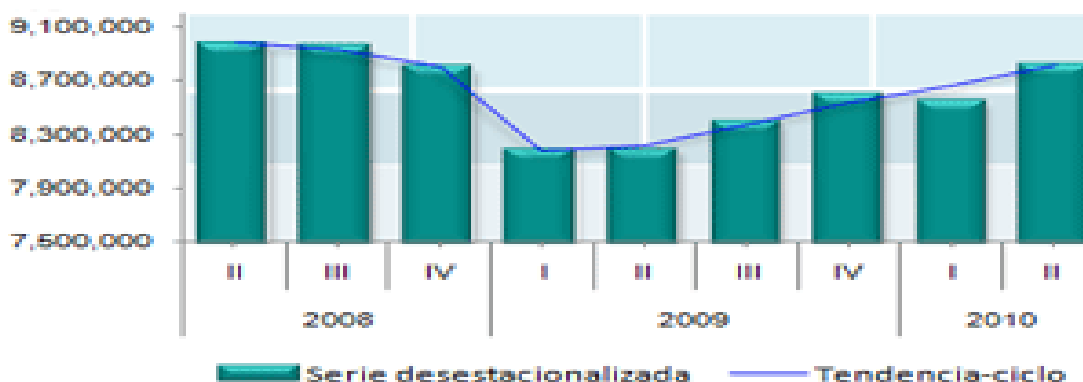


A more stable currency – but insecurity persists

While the Mexican economy has technically been out of the recession since the first quarter of 2010, the economy has still to fully recover, and a rebound to pre-crisis levels may take one or two years yet. According to the Mexican Statistics Office (INEGI), in Q2 of 2010 GDP grew 3.2% on the previous quarter (see chart below). Overall, GDP growth for this year is expected to be between 4.6% (Economist Intelligence Unit) and 5% (IMF).

Real GDP growth

Millions of pesos at 2003 prices



Source: INEGI

Production capacity remains low, due to lack of structural changes, weakness of long-term growth factors such as savings, investments and productivity, and technical changes. Overall, Foreign direct investment (FDI) represents 17% of Mexico's GDP. FDI increased 28% in the first half of 2010, after a 42% decline in 2009, but this was due mainly to the purchase of the beer division of FEMSA by Heineken. On 1st October, Mexico entered the World Government Bond Index, which should increase investment in financial products.

Unemployment is still high and the informal economy has grown since the beginning of the crisis. There has also been an increase in registered sole proprietorships, often set up by people who have lost their jobs. But the fact that many of these firms have been created more out of desperation than market demand can only result in their subsequent failure.

The number of overdue accounts has improved, decreasing from 4% in June 2009 to 3% in August 2010. Late credit card payments also decreased to 5.38% in August, while late repayments to banks declined to 2.61%. However, banks are still reluctant to lend to companies, and 52% of exporters still have no access to bank loans.

Currency volatility affects both Mexican importers and exporters. The peso suffered significant devaluation in September 2008 – by about 25% - triggering a wave of defaults in 2009 by those companies with US\$ denominated debt and/or trade credit obligations. However, the peso has regained strength since then, mainly due to the sluggishness of the US economy, and is now at its strongest level in 3 months: at 12.49 pesos to the US\$. While,



at the beginning of this year, the exchange rate was forecast to close between MXN 13.1/US\$ and MXN 13.5/US\$ at year end, it is now expected to close at MXN 12.2/US\$. That said, private companies' external debt in the first half of this year is at an all-time high, at US\$ 68,106 million, and this needs to be closely monitored as it could lead to repayment problems if the peso were to depreciate again in the future.

In recent months, the security situation has worsened, with killings of mayors, police and drug cartel members. Add to that the rise in kidnappings, and the fact that the violence is spreading from northern areas like Nuevo León to more central areas such as Michoacán, and even to Monterrey and Mexico City itself, and it is understandable that people tend to stay at home rather than go out for dinner, to bars and clubs, or to shop. But of course this has had a negative effect on the economy: for example, in the city of Tijuana near the US border 81% of companies report lower sales. Violence and insecurity are also forcing companies to close down, while tourism, already hit by lower discretionary spending, is now also suffering as a result of this drug related crime.

Growth to slow down in 2011

Prospects for the Mexican economy are less positive than they were three months ago. The slowdown of the US recovery is affecting Mexico in many ways: lower production, lower revenues from tourism and workers' remittances – all important sources of foreign exchange. However, we are expecting an increase in business for companies that depend on government purchases in the coming months, as budgets need to be used before year-end. Banco de Mexico's 2011 GDP projections have been revised downward for the 4th time this year - to 3.5% - due to lower global economic growth. The IMF currently expects a slightly better result, at 3.9%. What is clear is that the economic pace will depend on recovery of the still depressed domestic demand and US economic performance.



Consumer durables/retail

How has the consumer durables/retail sector performed in the last six months?

In the period January-August 2010 the sales trend for self service, department and specialized stores in Mexico was positive, with an 8.9% increase year-on-year. These results were driven mainly by the department stores, which increased their sales 14.7% and 11.5% for same-store sales (SSS). The Mother's day festivities and pre-World Cup purchases helped to boost the results. In terms of type of merchandise, clothing/shoes (+11.9% year-on-year total sales / +8.3% SSS), and general merchandise (+10.1% / +5.7%) have registered higher increases than groceries (+7.7% / +0.8%).

What is the current trend in payment delays, payment defaults and insolvencies?

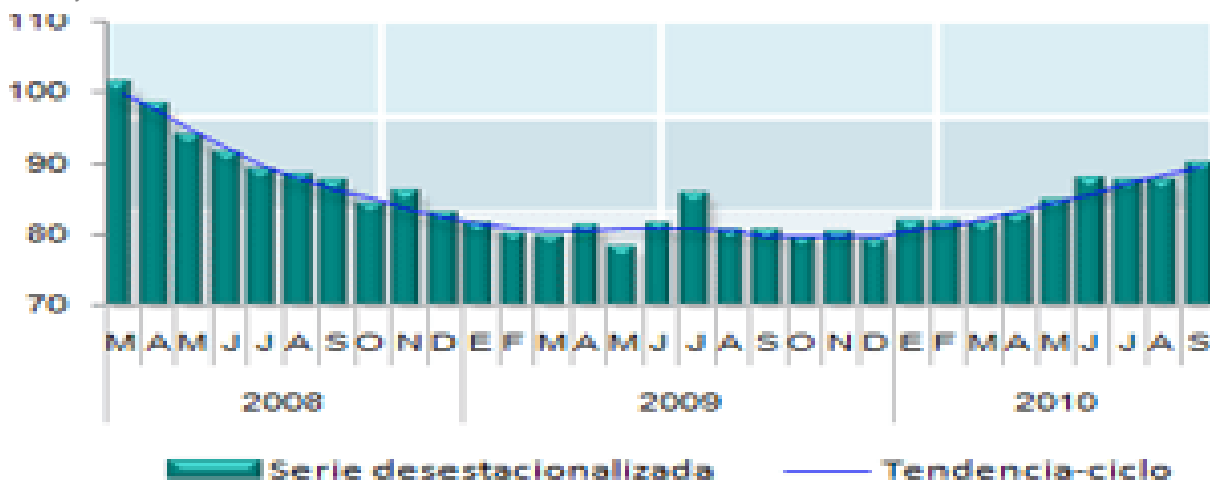
We have not registered many payment delays in this sector. However, many companies selling consumer durables had a hard time last year, as their debtors were not paying on time and thus causing higher overdue account ratios, with a consequent deterioration in cash flow. Any suppliers who had a concentrated portfolio by region or social level would have had serious problems generating cash.

What is Atradius' short term outlook for the consumer durables/retail sector?

The consumer confidence index (CCI) rose to 91.6 points in September, the highest level since May 2008, when it was at 94.2 points (see chart below).

Consumer confidence

January 2003 = 100



Source: INEGI

This improvement is driven by consumers' sentiment that the Mexican economic performance and their own financial situation will be better in 12 months' time. However, consumers' confidence is still below pre-crisis levels because, while they expect an improved situation in the future, consumers are still cautious about how to spend their income. Another positive indicator is that, in September, consumer credit lending stopped falling - after 22 months of contraction - and is expected to increase again in the coming months. Therefore, we expect a further improvement in this sector.



Machinery

How has the machinery sector performed in the last six months?

In the machinery sector, performance varies substantially depending on subsectors. In Q2 of 2010 manufacturing of machines and equipment increased 31.9% year-on-year; manufacturing of computer equipment, communication and other electronic accessories 10.6%; electricity generation equipment and other electric accessories 11%; and transport machines and equipment 40.4%. However, this year-on-year growth must be viewed in the context that, in Q2 of 2009, production was at extremely low levels.

What is the current trend in payment delays, payment defaults and insolvencies?

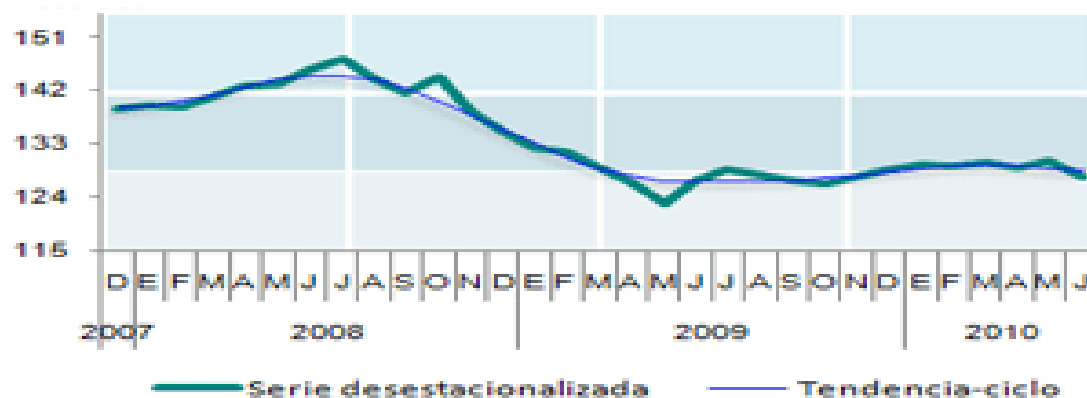
We do not receive many payment delays from companies in this sector, because buyers of machinery generally have longer terms of sales and therefore more flexibility to raise finance. Our claims ratio has stayed low for the last three years with hardly any insolvencies or defaults. Most machinery in Mexico is imported, so when there are defaults or insolvencies these are usually triggered by peso devaluation against the US\$.

What is Atradius' short term outlook for the machinery sector?

In the first half of this year, manufacturing in the printing, paper, leather and food industries returned or even exceeded pre-crisis levels. However, the index of investment in fixed assets for the construction sector is at the same level as it was a year ago, and indeed as it was in the first half of 2008, and the index for machinery, while slightly higher than in the first half of 2009, was 24% lower than in the first half of 2008. The investment of fixed assets in Mexico declined substantially during the credit crisis (see chart below) and will continue to be extremely limited as the economy recovers only slowly and while those industries reliant on domestic markets continue to show no significant improvements. This will certainly affect future demand for machinery. However, we are expecting an increase in business for machinery companies that depend on government purchases in the coming months, as government bodies exhaust their remaining budgets

Gross fixed investment

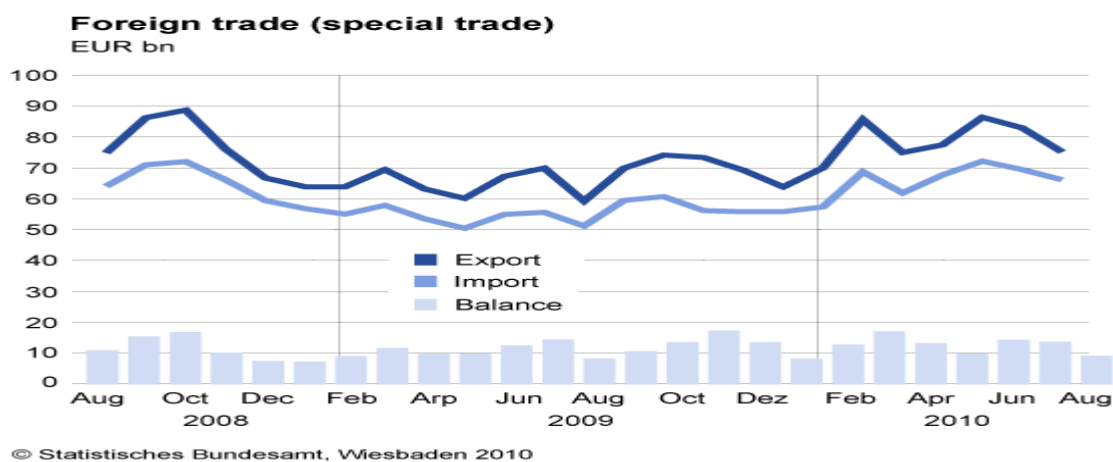
2003 = 100





Highest quarter-on-quarter growth since reunification

While most major European economies record only modest growth rates, Germany's recovery has gained momentum in the last couple of months. According to the German Statistics Office, GDP grew 2.2% in Q2 of 2010 on the previous quarter, driven mainly by investments in equipment and construction, increased consumer spending, and thriving exports - which increased 17.1% in the first half of the year. Exports to Brazil (+61.3%) and China (+55.5%) showed particularly high growth rates, while those to the Eurozone and the US increased by a still respectable 10.1% and 14,1% respectively.



Source: German Statistics Office

In the main, the export boom has benefited those sectors that had suffered a massive slump during the crisis, such as automotive and metals. Export of cars and car components alone increased 40.8% year-on-year in the first half of the year, while metal products exports rose 31.4%. In comparison, machinery exports rose only 6.8% in the same period but, according to the German Engineering Federation VDMA, high demand continues, with new domestic orders increasing 45% year-on-year in June and July, while new orders from abroad rose by a massive 56%.

This rise in orders and turnover has heightened German companies' financing requirements since the beginning of the year. In order to finance their increased business in advance and to bridge short-term liquidity gaps lingering after the downturn, companies have increasingly tended to rely on trade credit, either by agreement or simply by late payment. According to the latest Atradius Payment Practice Barometer*, the payment behaviour of German buyers has declined slightly over the last six months. More than half of German respondents to the Atradius survey reported that their customers had delayed payment without prior agreement, a third had been asked for extended payment terms, and one in five respondents said that customers asked for an increase in the amount of credit.

* You can download the Atradius Payment Practices Barometer: www.atradus.com/paymentpracticesbarometer



As rising capacity utilisation will increase businesses' willingness to invest, demand for bank loans will no doubt increase accordingly. To meet that demand, it follows that access to bank finance should become easier – and the signs are that it is. According to the monthly Ifo institute Credit Constraint Indicator, in September, barriers to finance again fell, indicating that in recent months it has become easier for German businesses to obtain bank loans. The KfW bank expects a turnaround of the credit market soon, such that, in Q4 of 2010, the volume of new business loans may rise again for the first time since the end of 2008. Moreover, a survey by the Bundesbank shows that the volume of business loans will increase over the next 12 months, especially for SMEs.

A 5% decrease in corporate insolvencies next year

The surprisingly good economic performance so far in 2010 manifested itself in a slowdown in rising insolvencies. According to the German Statistics Office, the number of corporate insolvencies still increased 6.7% year-on-year in Q1 of 2010, but for the first half of this year they rose just 2%. During that same period our experience is of a substantial decrease in the volume and number of payment defaults and of notifications of non-payment across all sectors. This, together with the good economic outlook, has allowed us to revise our forecast for insolvencies downwards, to 3-5% for 2010. For next year, we expect a 5% decrease year-on-year.

This positive development is also reflected in the Expected Default Frequency (EDF) indicator for listed companies in Germany. In August the EDF decreased to 48 basis points – the lowest figure since the start of the worldwide credit crisis in September 2008 (see chart page 2).

After its strong performance in the first half of the year, the German economy will probably lose some momentum. Global growth is expected to cool down to a degree in the coming months, which will lead to lower demand for German exports. In September, Consensus Economics forecast GDP growth of 1.9% next year for Germany, following 3.2% in 2010.

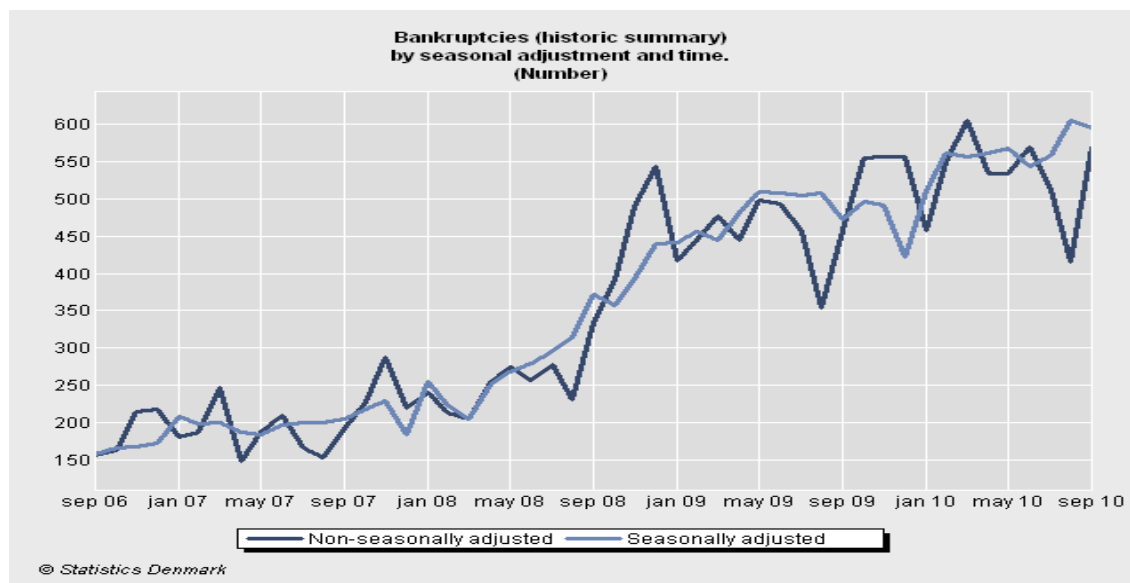
Potential risks for the German economy lie in a massive decline of world economic growth (especially in the US and China) and increased volatility of financial markets resulting from the public debt problems of some EU countries. However, it appears that private consumption, which grew 0.6% in Q2 of 2010 after weak performance in the previous nine months, will at last support economic growth. A lower jobless rate (7.5% in September), rising consumer sentiment and increasing purchasing power will trigger further private consumption growth in the coming months. This should lead to increasing turnover in the retail sector, which, after a longer period of weakness, should finally provide a substantial contribution to economic growth.



The construction sector remains troubled

The Danish economy continues to recover slowly from its deepest recession since the Second World War. After moderate growth in the last three quarters, GDP grew 2.8% in Q2 of 2010. However, output is still 3-4 % lower than in Q2 of 2008, and this is also reflected in the loss of 155,000 jobs since 2008. The main drivers of the strong growth in GDP in Q2 were a replenishment of stocks and an increase in public consumption. However, private consumption lost some pace again in Q2, despite record low interest rates and improved household liquidity thanks to a cut in the household tax bill. The consumer confidence indicator dropped several points from August to September, confirming that consumers are still uncertain about the future and are therefore conserving their personal finances. Nevertheless, the most recent indicators of business confidence reflect a more positive sentiment towards a possible upswing in the economy. This is true especially for the service and manufacturing sectors, the latter benefiting from the rebound in neighbouring Germany and Sweden. On the downside, business sentiment in the construction sector is still negative, even though the indicator is showing some signs of improvement.

After a massive 54% year-on-year increase in 2009, and 54.5% in 2008, the number of corporate insolvencies still remains high in 2010 (see chart below).



Over the last 6 months, no trade sector has recorded a significant improvement in its insolvency rate, and the number of corporate failures continues substantially above pre-crisis levels. Figures published by Statistics Denmark show that the number of bankruptcies continues to be very high among the smallest businesses: those that went bankrupt in September employed 2.5 persons on average. After the massive double-digit increases in the last four years, we expect corporate insolvencies to decrease 10% year-on-year in 2011.

The building and construction industries, which were hard hit not only by the economic crisis but also by the bursting of the housing bubble, continue to experience the largest number of insolvencies compared to other industries. Those



mainly affected are small enterprises, while medium sized and large businesses have been able to downscale their operations and remain in business.

Building and construction

Total building and construction investments decreased 11% in 2009, according to the Danish Construction Association, and a further decline of 9% and 3% respectively is expected in 2010 and 2011. The deterioration in activity is caused mainly by continued low demand for new private houses, offices and industrial buildings. That deterioration began as long ago as the building peak of 2006, since then construction of private houses/apartments and business premises has declined by 70% and 45% respectively. The sector is currently supported only by increased public investments.

Construction materials

A recent survey of businesses in the construction materials sector shows that expectations for future sales and employment remain negative, even though the sector is less dependent on the domestic market than the building and construction sector. However, an 11% increase in export sales since January 2010 has contributed to optimism, at least in some subsectors.

Retail

Sales decreased 0.7% year-on-year in August, with sales of textiles down 1.3%, sales of foodstuffs down 1.1% and other consumer goods down 0.1%. The overall decline in sales of foodstuffs is due to the hardcore discount market, which has gained market share from independent retailers and supermarkets during the economic crisis.

Agriculture

The Danish agro industry remains large and is an important factor for Danish exports. However, many farmers are highly indebted, and in 2009 the inflated price of farmland plummeted. The effect on both farmers and related industries will be seen shortly.

Machines

Many Danish suppliers to international companies suffered at least a 30% drop in turnover during the crisis. Besides low demand for their products, their competitiveness has been eroded by a strong Danish Krone and weak productivity. A large number of these companies have therefore not yet regained their previous market share of export markets and are left with weak balance sheets, because of their typically large fixed cost base.

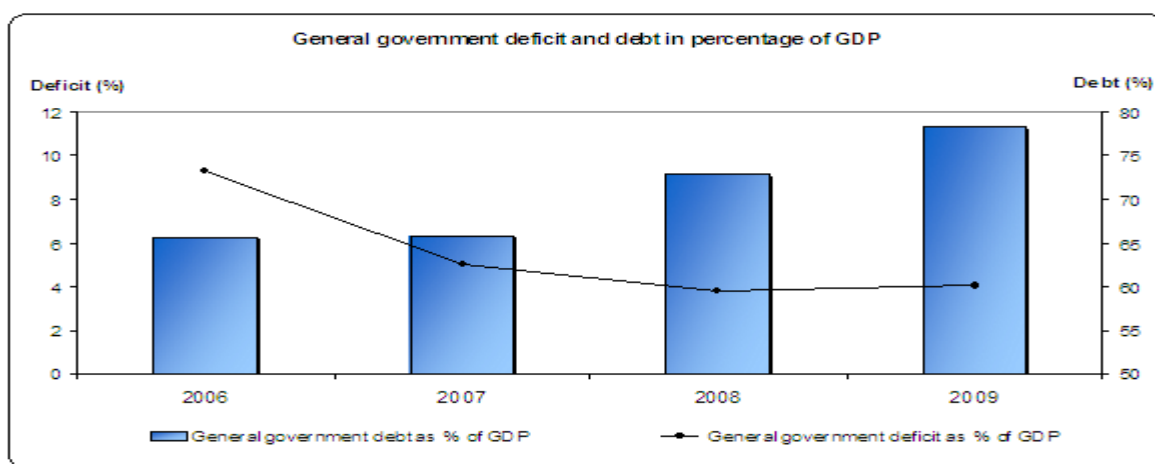
Still a long way to go

The government has pursued an expansive fiscal policy since the economic crisis started. That, combined with a loss of revenues from income tax, VAT and other taxes, due to the reduction in GDP and consumer spending, has turned the large public surpluses of previous years into a budget deficit of 3% of GDP in 2009 and probably above 5% of GDP in 2010. The EU Commission has therefore called upon Denmark to counter this development, and the Danish government has consequently announced a stabilisation programme which aims to reduce the budget deficit substantially in 2011-2013. Despite the reduction in public spending, the National Bank of Denmark expects GDP to grow 1.7% in 2011 and 2.0% in 2012, though this is still below the pre-crisis level. Due to its open economy, Denmark's recovery is still highly dependent on developments in the outside world.



A modest recovery in the first half of 2010

In 2009, Hungary's GDP contracted 6.3%, as domestic demand-oriented sectors were hit by budgetary tightening and industrial exports suffered as a result of the economic meltdown in the Eurozone. A massive standby package of US\$ 25.8 billion, from the EU and the IMF, was introduced to shore up the forint and Hungary's considerably eroded international reserves. IMF-monitored fiscal consolidation led to a reduction in the budget deficit from a record 9.4% of GDP in 2006 to 3.9% of GDP in 2009, as the government introduced further austerity measures: curbing public sector spending even more and raising taxes - especially VAT. However, government debt as a percentage of GDP has increased (see chart below).



Source: Hungarian Central Statistical Office

Hungary's GDP recovered modestly in the first half of 2010 (GDP growth was 0.2% year-on-year in Q1 and 0.8% in Q2). While export-oriented manufacturing increased 12.1% in Q2, the performance of construction (-14.1%) and agriculture (-13.6%) declined: the latter due to adverse weather conditions.

In the first eight months of this year, both export and import values increased in euro terms, by 22% and 19% respectively, due mainly to a rise in the volumes of exports and imports of general industrial machinery and equipment, electrical machinery & appliances, as well as road vehicles, which between them account for half of Hungary's imports and two fifths of its exports. During this period a trade surplus of € 3.4 billion was recorded, compared to € 2.0 billion between January and August last year.

However, domestic demand is still very weak, with expenditure on household consumption decreasing 4.9% in Q2. The contraction of the construction sector persists, with output declining 12.3% year-on-year in the first seven months of 2010. While performance will remain subdued for the rest of this year, a slight recovery is expected in 2011. The number of construction insolvencies has decreased since July 2010, when it reached its peak of 393 cases. but, at the same time, the number of new companies established is also very high (467 in August), suggesting that the



construction industry remains the preferred choice for those entrepreneurs who leave behind failed or indebted companies.

In 2009, Hungarian companies suffered from banks' reluctance to provide credit. After some easing of lending conditions in early 2010, we expect bank lending to become tighter and more expensive again in 2011, due to a new tax to be imposed on banks. When that happens, financial institutions will either restrict lending or pass the tax burden on to their clients. However, small and medium-sized enterprises (SMEs) should be able to access loans from public sources more readily than in the past, thanks to the New Széchenyi Plan (a 29-point government action plan designed to boost the economy), which it is said will provide forint 1 trillion of loans from both EU subsidies and national financing.

Low payment morale and increasing insolvencies

Payment delays are still prevalent in all sectors, including public buyers such as municipalities and ministries. Construction and transport in particular are notorious for their very late payment record. According to Creditreform, corporate insolvencies increased 29.3% year-on-year in 2009 - to 14,637. This trend has continued into 2010, with more than 13,000 cases registered in the first three quarters. We expect a further increase in the coming months, with construction, food, consumer durables, IT, and retail sales the main victims.

After moderate growth in the first half of 2010, experts don't anticipate significant acceleration in the second half. The IMF currently forecasts 0.6% GDP growth this year and 2% in 2011. Industrial production growth is still driven by external demand, as Hungary's exporters profit from the strong rebound in Germany.

The government is unlikely to meet its fiscal deficit target of 3.8% in 2010 and this, together with Hungary's unsustainable debt burden, is a major source of contention with international donors, such as IMF and the EU. The administration under prime minister Viktor Orban refuses to negotiate a new stand-by agreement with the IMF, arguing that it cannot impose new austerity measures that will meet the tight budget deficit targets set for 2011. This stance could trigger adverse sentiment from the financial markets but, on the positive side, the government currently enjoys large public support, enabling it to make progress with vital economic reforms and thus decrease of the public deficit.



Recovery from the earthquake aided by strong public finances

Chile remains Latin America's fifth largest economy, and continues to benefit from the region's strongest macroeconomic fundamentals, with an attractive investment climate, a high level of transparency, and strong fiscal discipline. Chile's open economy and trade agreements have resulted in a steady rise in foreign trade such that this remains one of the region's major recipients of foreign investment.

The earthquake which struck Chile in February 2010 caused widespread destruction across central regions, leaving the new President Sebastián Piñera, elected in March, with a mighty reconstruction task. While the humanitarian impact was of course significant, from an economic perspective Chile's strong public finances have allowed it to overcome the disaster, with the country's rapid response and contingency planning confirming its status as one of the region's most sophisticated economies. Overall, it is expected that reconstruction costs will be around US\$ 8 billion, funded initially from the country's substantial reserves, built on Chile's mineral wealth and years of strong copper prices.

As well as the construction industry, the retail and material sectors will profit from the reconstruction efforts, with renewable energy development and IT also promising good growth prospects. The Chilean mining sector suffered only minor damage and disruption from the earthquake, as the copper belt is located in the north of the country which was relatively unaffected. Chile continues to be the world's largest producer of copper, molybdenum and natural nitrates, with its copper reserves estimated at around 38% of total world reserves. 27% of foreign investment is concentrated in the mining sector, equivalent to an investment of around US\$ 50 billion. From January to May 2010, copper prices rose 9.4% year-on-year, returning to pre-financial crisis levels, driven by signs of a global recovery and demand from China. Growth in copper production in Chile is estimated to reach around 2.4% in 2011.

Chile will remain a leading economy in South America

While the impact of the earthquake is expected to have slowed the economy in the first half of this year, it should not derail overall 2010 economic growth, and the solid macroeconomic fundamentals will remain in place. GDP is forecast by the IMF to grow 5.0% this year and 6.0% in 2011. Strengthened domestic demand and a market friendly government will keep Chile at the top of the region's economic rankings.

Although President Piñera's victory in March marked a further step in the country's move towards liberal democracy, Chile still faces problems of deeply rooted social inequality and a challenging external economic environment. However, we can safely assume that it will continue to follow a moderate political course to counter these problems – a course that has so far proved to be successful. The short term focus will be on the task of reconstruction and, while much of the initial funding will come from the government, it will also be keen to encourage as much private investment as possible. Private and overseas investment, especially in the mining and construction sectors, is expected to help fund the reconstruction effort and reduce the government's financial burden.

Atradius Copyright 2010

The information contained in this report is provided for information purposes only. The information is not intended as a recommendation as to particular transactions, investments or strategies in any way to any reader of the report. Readers of the information contained in this report must make their own independent decisions, commercial or otherwise regarding the information provided. While we have made every attempt to ensure that the information contained in this report has been obtained from reliable sources, Atradius is not responsible for any errors or omissions, or for the results obtained from the use of this information. All information in this report is provided 'as is', with no guarantee of completeness, accuracy, timeliness or of the results obtained from the use of this information, and without warranty of any kind, express or implied. In no event will Atradius, its related partnerships or corporations, or the partners, agents or employees thereof be liable to you or anyone else for any decision made or action taken in reliance on the information in this report or for any consequential, special or similar damages, even if advised of the possibility of such damages.

Atradius Credit Insurance N.V

Postbus 8982
1006 JD Amsterdam
David Ricardostraat 1
1066 JS Amsterdam

www.atradius.com