



market monitor

Adapting to the challenging
economic environment

May 2010

Swings and roundabouts

According to the old saying 'What you gain on the swings, you lose on the roundabouts'. And that aptly characterises the economic reviews in this month's Market Monitor. Our reports show that economic recovery continues its upward trend, with all the countries reviewed expecting higher growth in 2010 than had been forecast at the end of last year.

But... and there's so often a but ...it's also clear that, in many of those countries, this positive movement is driven by some elements of their economies, while others are still hampering recovery.

In the US, for instance, the rebound in the first three months of this year has been generated by consumer spending and business inventories, while construction remains in the doldrums. Building has also prevented a stronger recovery in the Czech Republic, although overall business and consumer sentiment is improving. In Austria, Belgium and the Netherlands it is domestic consumption that is currently dampening a comprehensive economic revival, while exports begin to blossom again.

In this issue...

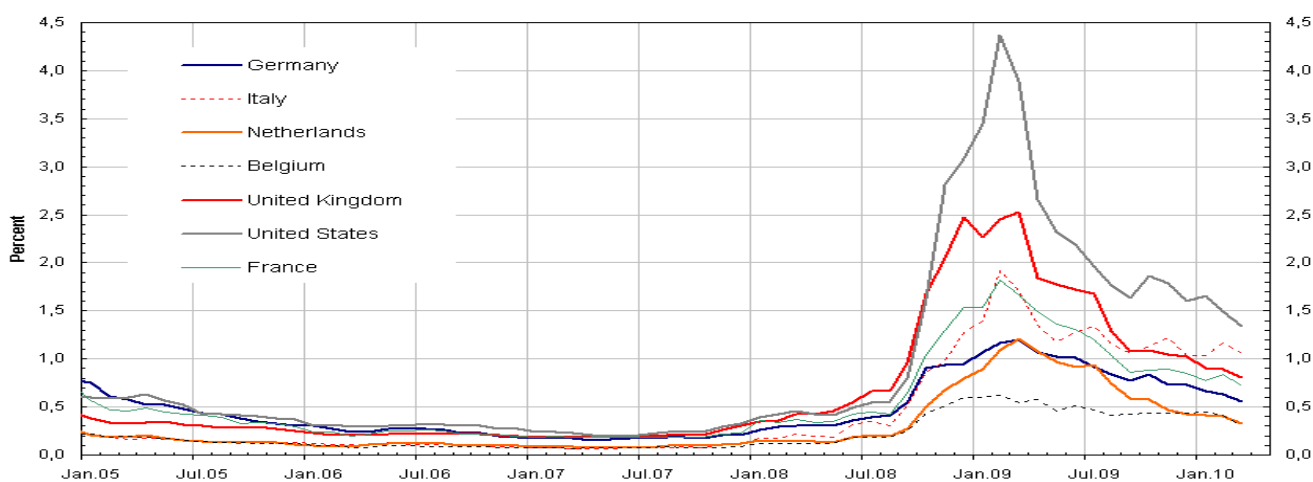
...we feature the following markets:

- United States – with a spotlight on the retail and IT sectors
- Belgium – with a spotlight on the construction and metals sectors
- The Netherlands
- Austria
- Finland
- Czech Republic

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

After the median EDF for some European economies showed some signs of stagnation last month, it came back to the generally improving downward trend that we have seen for several months. In March 2010, Germany and the UK recorded 7 and 8 basis point decreases, while all other countries registered even more encouraging double-digit EDF falls. After several months without movement, the modest Belgian EDF improvement seen in February 2010 accelerated to an 11 basis points decrease in March. Again the US recorded the best figures (15 basis points), and its median EDF is now below 140 basis points.

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

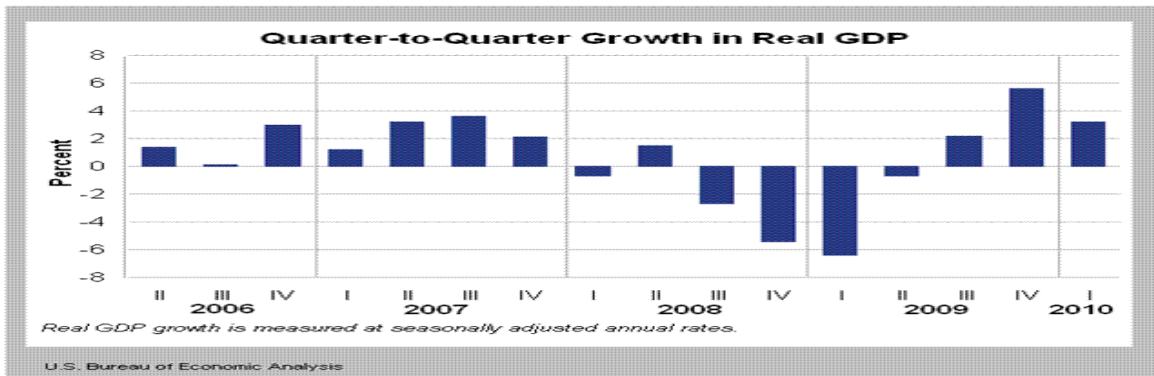


Bleak



The recovery continues

In Q1 of 2010, the US economy expanded at a rate of 3.2% year-on-year and 2.5% on the previous quarter (see chart below). While this represents a slower rate of growth than in Q4 of 2009, and was perhaps slightly weaker than many expected, it nonetheless provides further evidence that a sustainable economic recovery is taking hold.



Key drivers were:

Consumer spending: An element that usually represents about 70% of U.S. economic activity, this added almost 2.6% to GDP – its biggest contribution since Q4 of 2006.

Business inventories: Increased by US-\$ 31.1 billion in Q1 of 2010, adding 1.57% as businesses restocked to meet growing demand. This represents the first increase in inventories since Q1 of 2008.

Business investment: Businesses continued to invest capital in software and equipment.

While these are certainly very positive indicators, growth was somewhat inhibited by some of the following factors, especially the deterioration in construction:

New home construction: this proved to be a drag on growth in the first quarter of 2010. Residential investment contracted at a rate of 10.9%, despite tax incentives for home purchasers.

Business spending on property structures: output declined 14% year-on-year in Q1 of 2010.

Export growth: slowed sharply while imports rose, leaving a trade deficit that shaved 0.61% from Q1's GDP.

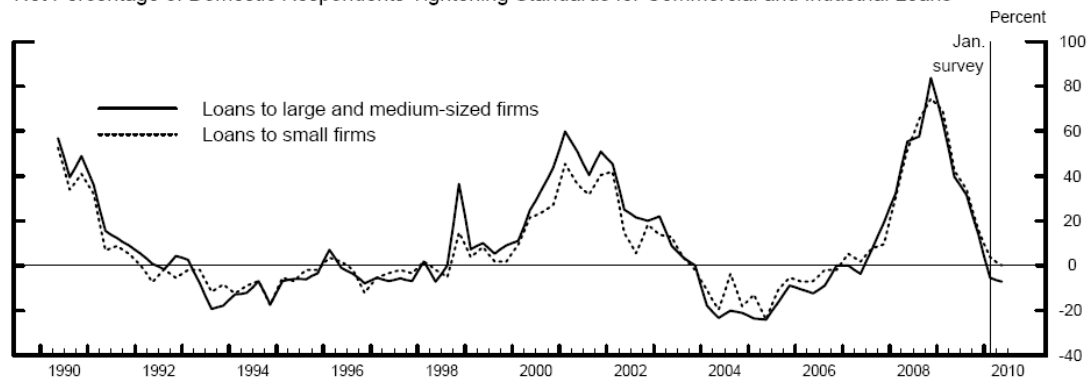
The Federal Reserve's April 2010 Senior Loan Office Opinion Survey on Bank Lending Practices addresses changes in the supply of, and demand for, bank loans to businesses and homes over the preceding three months. The April survey indicated:

- Most banks kept their lending standards unchanged in Q1 of 2010.
- However, a small number actually tightened many terms on loans to businesses.
- Of those banks that eased lending standards, most, if not all, were larger domestic institutions, providing Commercial and Industrial (C&I) loans to large and medium sized firms.
- None of the small banks interviewed (representing around 50% of respondents) indicated that they had eased standards.
- While standards on C&I loans to small firms were more or less unchanged, terms were, in fact, tightened in many instances.
- Credit card lines offered to small firms were, according to most respondents, subject to tightening lending standards and terms – both for new and existing accounts.



Commercial Lending Standards

Net Percentage of Domestic Respondents Tightening Standards for Commercial and Industrial Loans



Source: Federal Reserve

So, while there is some stabilisation in terms of lending standards, smaller businesses are still finding it a challenge to secure or maintain financing – at least on terms that are competitive. This continues to place small firms in a difficult position as they seek to finance their climb out of the recession and capitalize on the opportunities of recovery.

Based on data compiled by Automated Access to Court Electronic Records (AACER), Chapter 11 filings for companies seeking to reorganize or liquidate totalled just over 1,200 in April 2010. Through the end of April 2010, and assuming a simple run-rate basis, there will be only 3% fewer Chapter 11 cases filed than in 2009, the midst of recession. Including Chapter 11 liquidations, business bankruptcy filings reached just over 29,000 in the first four months of 2010. States with the largest increases in average monthly filings over the last year include Hawaii, California, Virginia and Vermont. Florida, though reporting a slight improvement in 2010, still shows historically high levels.

In March 2010, the Expected Default Frequency (EDF) indicator for listed companies in the US again dropped compared to the previous month (see chart page 2) by 15 basis points, to 134. Between January and March 2010 it declined by 32 basis points.

Steady but fragile rebound of domestic consumption

Positive signs of recovery are definitely appearing. However, the rate of recovery is something we will monitor with interest. Consumers drive US GDP and, while there are signs of stabilising unemployment levels, consumer sentiment remains fragile. The Thomson Reuters / University of Michigan's Surveys of Consumers indicated that sentiment fell in April 2010 compared to March, as consumers - while perceiving the recovery to be well under way - felt that progress was slow. Still high unemployment rates, increasing consumer credit card burdens and eradication of a savings 'safety-net' for many families continue to temper the growth of consumer spending. Consumer demand for bank loans is not increasing and, with home equity reduced or totally wiped out in many instances, there is not likely to be a significant upturn in consumer spending in the short-term.



While we believe that improvements in the contribution of consumer spending to GDP will be slow but steady in the coming months, consumer sentiment remains susceptible to their perception of possible negative economic events such as further mortgage defaults, increasing foreclosures or indeed any regression or slowdown in the improving jobless rate.

On the corporate side, and as mentioned earlier, many smaller businesses, which can often be the innovative engines of growth in a recovery, are still struggling to achieve or maintain financing to capitalise on growth opportunities, or even to fund their current business scope. In view of the still high bankruptcy expectations for 2010, we expect many to fall by the wayside, irrespective of the current recovery trends and as lending attitudes and consumer appetite continue to lag behind that recovery. That said, a positive side to the story is that medium to larger businesses are seeing some stabilisation in lending standards, and Atradius has seen at first hand some positive examples of previously challenged businesses adopting effective operating and credit management disciplines during the recession that have helped them secure new or extended financing at rates that are acceptable by today's standards.

Our experience of payment delinquency trends and external agency scores, together with a levelling in the number of insurance claims received, does suggest a tentative improvement. Opportunities will present themselves for business growth. Central to assessing the credit risk of current or new buyers is an understanding of their liquidity - be it positive organic cash flow generation, or in the form of committed external liquidity provided at serviceable rates, with a degree of flexibility for the borrower and with manageable terms and covenants.

Where such characteristics can be clearly identified in a buyer, along with positive operational management steps to improve inventory and cost management, then the ingredients are there to forge a successful commercial relationship and for Atradius to provide committed and sustainable cover.



Retail

How has the retail sector performed in the last couple of months?

Overall, the retail sector has continued to stabilise since our last analysis in November 2009. In the 2009 holiday season, consumers spent a little more, following a long spell of austerity, and the industry has been eagerly monitoring the sustainability of this upturn ever since. The consensus is that spending is increasing, a view buoyed by a positive (pre-Easter) picture in March 2010, when most major publicly held retail players posted positive same-store sales comparisons with 2009. In fact, the majority of retailers have exceeded expectations as shoppers' purchasing increased in Q1, amid signs of an improving economy.

Reports for April 2010 offer a mixed bag of results across different segments, and this raises a slight question mark about the overall sustainability of improving trends. Sales of luxury items (excluding jewellery) showed a third straight month of double-digit growth in April. High profile gadgets (such as Apple Inc's iPad) helped consumer electronics sales to rise 9.7% in April - up 4.5% from March. However, this was offset by weak clothing sales, as women's and speciality clothing fell 4.1% and 3.9% respectively compared to March. This may be due to automotive sales, spurred by dealer incentives, displacing spending on items like clothing as financing payments start to kick in.

What is the current trend in payment delays and insolvencies?

Many major retailers are posting better comparable same-store results, suggesting that the likelihood of significant, major-name business failures has abated to a degree in the short to medium term. Smaller, individual retailers will however continue to face challenges, especially those that are unable to compete on price with the larger stores which have greater purchasing leverage. Therefore, we expect a continuation of insolvencies at the lower end, certainly at least in respect of those entities struggling to maintain effective credit lines against a backdrop of slow recovery.

What is Atradius' short term (six months) outlook for the retail industry?

Our view is that we will continue to see a modest recovery during the course of the year, though the potential for expansive growth is heavily tempered by continued record high jobless rates, personal debt loads and a relatively tight consumer credit environment.



Information technology (IT)

How has the IT sector performed in the last couple of months?

Computer manufacturers and chip makers faced a tough first half of 2009, as demand for computers and chip sets weakened significantly. However, by the third quarter of 2009, most companies reported results showing the first sequential improvements, despite continued year-on-year declines. This trend has continued, with sectors that were hardest hit during the steep downturn (semiconductors, components, and hardware) showing the most improvement. Sales in the final quarter of 2009 were supported by healthy demand in a variety of end markets including PCs, cell phones, and consumer electronics.

What is the current trend in payment delays and insolvencies?

Payment delays have moderated in the past six months in the IT sector as the economy has shown signs of recovery. Overall, the sector is rebounding and returning to moderate growth, which should assist companies that have been struggling to generate cash flow. That said, corporate insolvencies typically lag a recovering economy, so it is not expected that insolvencies would subside in the near term.

What is Atradius' short term (six months) outlook for the IT industry?

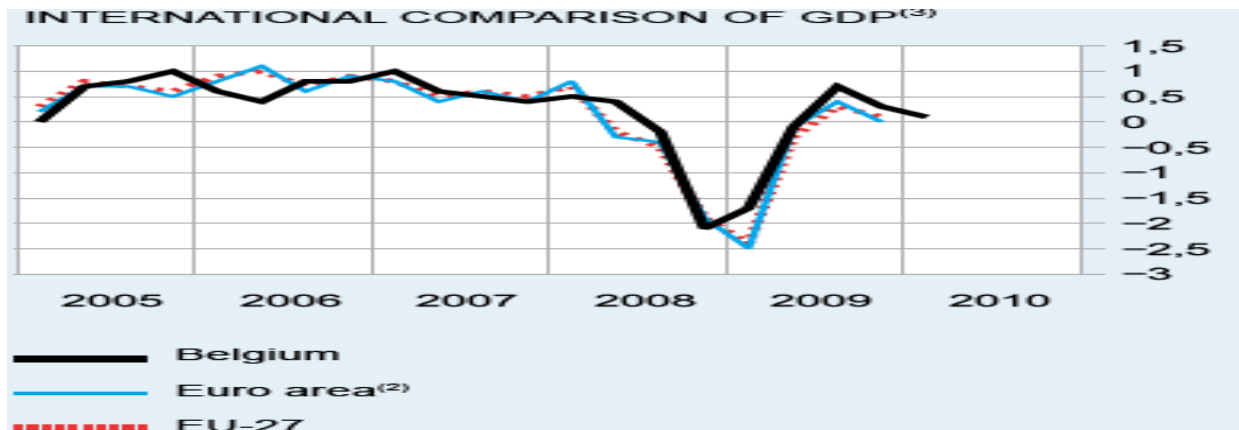
It is anticipated that IT spending will recover in 2010 to around mid-single-digit growth rates. The cell phone category is expected to have a strong 2010, becoming the primary driver for the industry. Smartphones and netbooks are also primed for strong growth as consumers continue to seek efficient portable devices.

The outlook for semiconductor demand for 2010 is more positive, given the strong improvement in memory chip pricing and healthy demand in a variety of end markets including PCs, cell phones, and consumer electronics. According to the Semiconductor Industry Association (SIA), unit sales of personal computers and cell phones (which account for approximately 60 percent of total semiconductor consumption) will grow in the low-to-mid teens in 2010, providing a solid platform for chip sales. In addition, consumer electronics are expected to grow in the mid-single digits. Consumer electronics sales for the 2010 holiday season will be robust. Price cuts will be the biggest attraction to consumers, but this will also result in margin pressures for both retailers and manufacturers.



Out of recession, but still in a weak state

Belgium continues on its path of modest recovery. According to the National Bank of Belgium (NBB), in Q1 of 2010 GDP grew 1.0% year-on-year and 0.1% on the previous quarter. For the whole of 2009, Belgium output decreased 3%, compared to a 4.1% decline for the Euro area (see chart below)



Source: NBB

While exports still declined year-on-year in the last quarter of 2009 (-2.7%), this was a great improvement on the two-digit rates recorded in previous quarters. In April 2010, the NBB business confidence indicator for trade, construction and the manufacturing industry strengthened further, reflecting the improvement in new orders. Unlike our last report on Belgium, which showed a deterioration in consumer confidence at the end of 2009, the index has rebounded each month in 2010, reaching its highest level in two years in April (see chart below), as consumers' expectations for a recovery of the Belgian economy have become more optimistic and their fears of a massive rise in unemployment have subsided. The unemployment rate was 8.1% in March – practically unchanged since September 2009 and lower than the Eurozone average (10%).

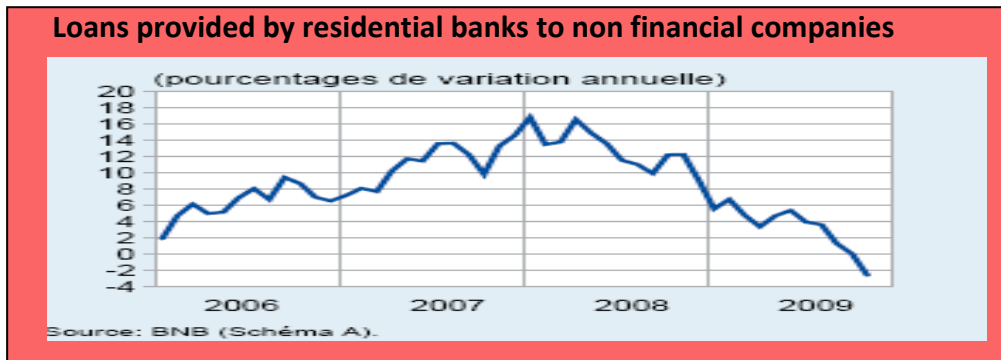


Source: NBB

The budget deficit for last year is expected to reach 6% of GDP, due to the government's fiscal stimulus measures, and the government debt ratio is forecast to increase - from 97.8% of GDP in 2009 to 100.8% in 2010 and 102.5% in 2011. In the coming years, austerity measures will be needed to restore robust public finances.



According to the latest NBB figures, loans provided by banks to non financial companies decreased in 2009 (see chart below). While still negative year-on-year, net loans provided by banks increased again, month-on-month, in the first two months of 2010, after 6 months of decline.



Source: NBB

Payment morale has improved

According to the latest Atradius Payment Practices Barometer*, the average payment term set by Belgian companies was 31 days last winter. 71% of Belgian companies surveyed assessed domestic payment behaviour in the range 'fair' to 'good', and domestic payment times consistently shortened since the previous winter - to 38 days on average. This was due mainly to improved payment behaviour by state related bodies throughout 2009, and in the construction and some industrial sectors since the last quarter of 2009. According to our own observations and experience, businesses in construction, construction materials, retail and finance have improved their payment behaviour during the first quarter of 2010. In contrast, businesses in printing & publishing, timber, flowers & plants, and fruit & vegetables showed a worsening trend. In response to our payment practices survey, Belgian exporters perceived a worsening of foreign payment behaviour, with payments from foreign business partners taking, on average, 45 days, i.e. 14 days beyond the average contractual payment term, compared to 11 days over the course of 2009.

The Statistics Belgium reports that corporate insolvencies increased only slightly - 0.7% year-on-year - in Q1 of 2010, to 2,584 cases. Those most affected were manufacturing (20.6% increase), transport/other services (11.0%) and retail (4%). Insolvencies in the construction sector rose a modest 0.7%, while hotels/restaurants saw a 9.4% decrease. In absolute figures, insolvencies are still highest in the transport/other services sector (747), retail (721), hotels/restaurants (472) and construction (406), while manufacturing recorded 170 cases in the first quarter of the year. We expect corporate insolvencies to increase by up to 5% this year, compared to 2009. In March 2010, the Expected Default Frequency (EDF) for Belgium decreased substantially after several months of stagnation (see chart page 2). While still indicating elevated default risk among listed companies, the Belgian median EDF is now back to 30 basis points, the lowest figure in 18 months.

For the current year, the International Monetary Fund (IMF) forecasts Belgian GDP to grow 1.2%, but the unemployment rate (estimated to rise to 9.3% in 2010) could have a negative impact on the still weak domestic consumption in the later part of the year.

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



Construction

How has the construction industry performed in the last couple of months?

The sector recorded negative growth of -0.4% in 2008 and -3.4% in 2009. Private and industrial building investment will decrease further in 2010, while public investment continues to support the sector. At corporate level, construction companies are benefiting from the government's supportive measures, including a temporary unemployment scheme (by which companies can lay off workers for a certain period of time, during which their personnel costs are taken over by the state). This has proved invaluable in recent months, as the harsh winter has meant low - or no - building activity. Thanks to these measures, construction companies have escaped the worst of the downturn so far, but, for some, this could change in the coming weeks as they feel the impact of the lack of revenue but continuing operating costs from that period of inactivity.

What is the current trend in payment delays and insolvencies?

As already mentioned, we have seen an improvement in payment behaviour in the construction and construction materials sectors in Q1 of 2010. However, the latest Atradius Payment Practices Barometer shows that the Belgian companies surveyed rated the construction industry as the second worst payer, after the public sector.

According to Statistics Belgium, the number of insolvencies in the construction sector increased 16.1% year-on-year in 2009, to 1,361 cases (following the steep increase to 1,172 in 2008). In Q1 of 2010, construction insolvencies increased 0.7%.

What is Atradius' short term (6 month outlook) for the construction sector?

Our 2010 forecast is for a contraction of 2.5%, with positive growth not expected until the second half of 2011. Our short term outlook therefore remains negative, but we do expect an improvement in the insolvency situation by the end of 2010, and we are already seeing a levelling off in our receipt of insurance claims.



Metals

How has the metals industry performed in the last couple of months?

The metals industry has suffered as a result of the fall in demand from customer sectors such as construction and automotive. The industry has also been hit by a sharp drop in prices coupled with a collapse in sales, leaving some metals companies in financial difficulty. Companies have also had to considerably depreciate the value of their stock.

In 2009, metals and steel companies and their customers worked mainly with their existing stocks. However, as those stocks became exhausted, orders started to increase again in the second half of 2009. Shipments have also started to rise slightly since Q3 of 2009, but this positive sign has been negated by low prices. That said, since Q4 of 2009, both shipments and prices have increased, and the main players in the market have reported a capacity utilisation of about 70%, after its fall to just 50% in the first half of 2009. Thanks to demand from China, metals consumption is actually at a higher than expected level and, overall, the situation is expected to improve decisively by mid-2010.

What is the current trend in payment delays and insolvencies?

Surprisingly, the overall payment delays in the sector remained quite stable in 2009, with an improvement at the end of 2009 and beginning of 2010. The main reason for this has been the reduction in working capital requirements caused by the drop in activity. We will monitor developments in the coming months, and hope that the increase in trading activity – with its related increase in working capital requirement – will not upset this positive trend.

While payment delays remained stable in 2009, we received and paid significantly more claims than usual. Insolvencies in this sector have increased, and, according to Statistics Belgium, the metal products manufacturing subsector recorded a 50% rise.

What is Atradius' short term (6 month) outlook for the metals industry?

The metals industry is now recovering monthly, but that rebound has started from a very low level. While the situation has improved since our last analysis in November 2009, it will take time to reach pre-crisis levels. The current improvement is due mainly to demand from some major emerging markets, but a full recovery will depend on the ability of Europe and the USA to stimulate their domestic recovery. So, while we do not expect a full recovery this year, there is at least some evidence of a modest upturn in the domestic consumption of some European economies and the US, which in turn will support the sector's ongoing recovery.



Two contrasting faces of the Dutch economy

Since early this year, two developments have shaped Dutch economic performance. On the one hand, export recovery has gathered speed since December 2009, with substantial increases both in volume and value in the first two months of 2010. In February 2010 double digit growth in volume (11%) and value (13%) year-on-year was recorded (see chart below). Overall, Dutch exports rose 8% in Q1 of 2010.

Goods exports (volume)



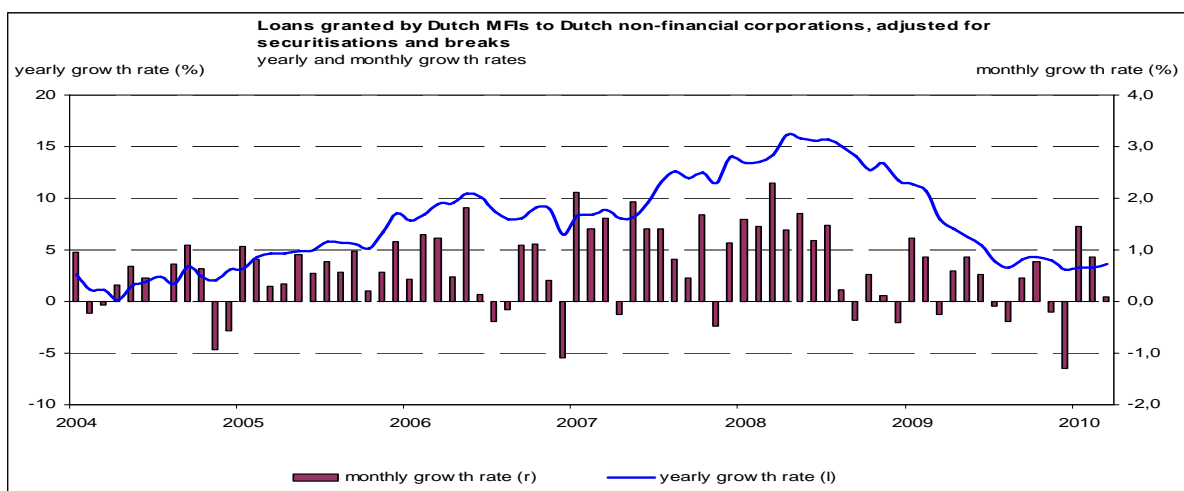
Sectors such as commodities and oil related products, machinery, transport, chemicals, metals and the semi conductor industry have been the main beneficiaries of increased external demand. In line with this development, industrial production is growing: according to Statistics Netherlands (CBS), manufacturing output increased 4% in February 2010 and 7% in March year-on-year. In March 2010, output increased 15% for petroleum, chemical, rubber and plastic products, 10% for electro-technical products and machinery and 15% for the metals industry (basic metals and metal products). Suppliers to the semi conductor industry have seen historic growth figures of both turnover and results in recent months. Unsurprisingly, the producer confidence index improved from -8.1 in December 2009 to -3.1 in March and -1.4 in April 2010. Dutch manufacturers have reported a substantial increase in the value of orders received in April.

But, on the other hand, while export is currently driving economic growth, weaker private consumption and the housing industry are acting as a brake. Both are feeling the effects of a higher jobless rate (which rose from 5.3% in Q4 of 2009 to 6.1% in March 2010), and increased uncertainty since the break-up of the governing coalition in February and the snap elections scheduled for June 9th. With a higher budget deficit of 5.3% of GDP in 2009, there is understandable nervousness about the extent of future budget cuts, with public debate on the possible options fuelling speculation of harsh austerity measures by a new government, which in turn dampens consumer sentiment. According to CBS, retail turnover declined 4% year-on-year in February, continuing its downward trend of 13 consecutive months. In March it increased 2.9%, but the overall figure for Q1 of 2010 was still negative with a 1.3% decline.



As the election approaches, all parties are voicing their views on possible scenarios, including the abolition of the current tax deductibility of house mortgage interest. The impact is that the recovery of house sales, which began in the last quarter of 2009, stalled in Q1 of 2010, with a 25% decline in new mortgages compared to Q4 of 2009. As a result, construction remains under pressure.

According to the Nederlandsche Bank (DNB), month-on-month growth in business lending by Dutch banks has resumed in the early months of 2010 after a decline in November and December 2009 (see chart below). The total amount outstanding has risen to a record high of Euro 333.3 billion in March 2010.



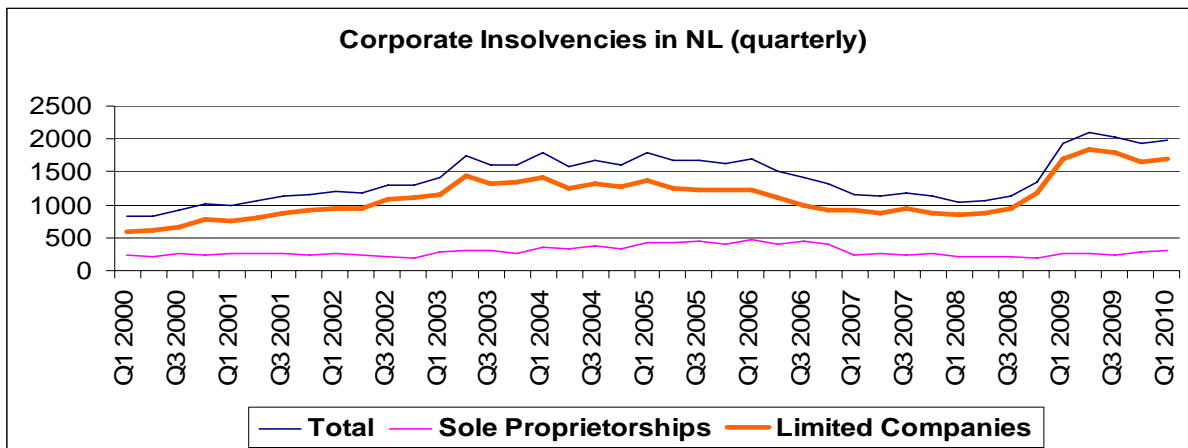
Source: Dutch Central Bank (DNB)

According to the latest Atradius Payment Practices Barometer*, some 78% of Dutch companies surveyed assessed domestic payment behaviour as ranging from 'fair' to 'good', with domestic payment delays occurring less often than in previous survey periods: an indication that businesses have tightened their credit management processes. On average, domestic payments took 36 days in Winter 2010: 6 days beyond the average contractual payment term. Payments from foreign business partners took, on average, 40 days. We note that payment problems in the Netherlands are comparatively higher in retail, construction, transport, and the public sectors.

Decreasing insolvency rate in the course of 2010

For the whole of 2009, corporate insolvencies increased 73%, to more than 8,000. In Q1 of 2010, the figure rose slightly to 1,987 cases compared with the last quarter of 2009 (1,925 cases) and 1,939 cases in Q1 of 2009 (see chart next page).

* You can download the Atradius Payment Practices Barometer from www.atradius.com



Source: Statistics Netherlands (CBS)

This continued high level of insolvency resulted mainly from adverse winter conditions, leading to a substantial 30% year-on-year increase in the construction sector in the first two months of the year, while the transport sector recorded a 32% increase. Corporate failures in manufacturing levelled off, while financial services/leasing and trade showed slight decreases. The insolvency rate is expected to fall later this year - an improvement on the same period in 2009.

Consensus Economics forecasts Dutch GDP to grow 1.3% this year and 1.6% in 2011. According to the 'Trends in Export 2010' survey by Atradius and the export association Fenedex, Dutch exporters expect an 8% growth in their exports in 2010 - a further boost for manufacturing and trade. However, the paper and printing sector may suffer further from increasing paper prices, while a positive impact on growth by consumer spending will probably not materialize until the last quarter of 2010.



Recovery thanks to rising exports

Austria's GDP declined 3.4% in 2009, due mainly to a drop in economic activity in the first half of last year. However, recovery gained momentum in the second half of the year and in the first months of 2010, thanks to increased stock investments and rejuvenated exports. According to the Austrian Statistics Office, private consumption has been robust in the first quarter of 2010, with retail turnover increasing 4.1% year-on-year. The Austrian National Bank expects growth to pick up 0.8% in Q1 and 1.9% in Q2 of 2010, quarter-on-quarter.

Nevertheless, the recovery in industrial production remains fragile, not least because business loans have decreased substantially. According to the Austrian National Bank, new business lending by banks fell 1.7% in 2009, and this continued into 2010, with the volume of new business loans decreasing by Euro 1.5 billion from January to February, to 5.7 billion. However, in a recent survey, bank credit managers have said that they expect business loan conditions to relax in Q2 of 2010.

Will corporate insolvencies decrease further?

According to credit agency KSV, there were 1,870 corporate insolvencies in 2009, an increase of 9.3% year-on-year, but fortunately less than the 12-15% expected in the autumn of 2009. Construction, machines and metals recorded very high increases. In Q1 of 2010 the corporate insolvencies decreased 5.6% year-on-year to 1,604 cases, and the related outstanding receivables shrank by 27%. The number of construction insolvencies has decreased, while the number of insolvencies in the machines and metals sectors has levelled off. However, it is still too early to assume this to be a trend, as many companies still have to close their annual accounts and some sectors, such as consumer goods, that have so far avoided a drop in business, could feel the effects this year of rising unemployment and an end to income tax relief.

After much consultation, the reformed Austrian corporate insolvency legislation will come into force on 1 July 2010 (originally scheduled for 1 January 2010), and is designed to overcome troubled companies' inhibitions about filing for bankruptcy. Its main objective is the timely initiation of insolvency proceedings to improve the likelihood of successful financial restructuring and of creditors' receiving satisfaction for their claims. This will be achieved primarily by amending the procedural laws governing forced composition and bankruptcy proceedings, but the reform means considerable interference in the rights and powers of both secured and unsecured creditors.

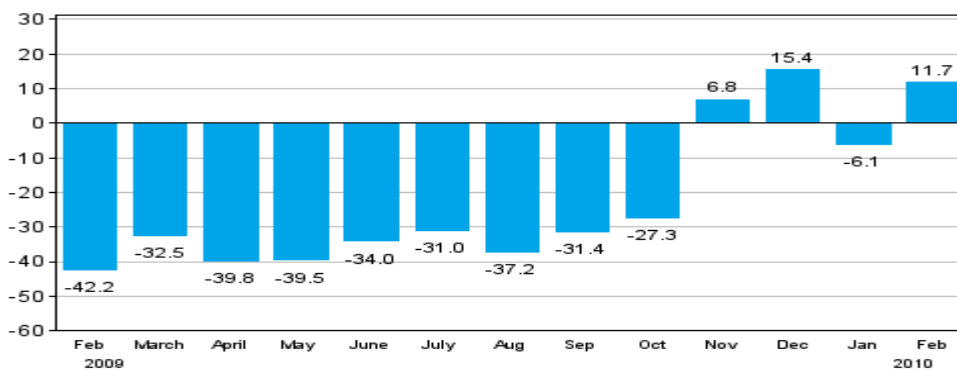
The IMF forecasts that Austria's growth will recover 1.3% in 2010. While companies' investments will probably remain weak, due to still low capacity utilisation, industrial production will rise 4% this year after the 13% decrease in 2009, and exports will rebound further. That said, the recovery could lose some steam in the second half of the year, when the governmental stimulus packages expire. It is also uncertain how private consumption will develop in the second half of the year.



A modest recovery on the way

With its high export dependence, Finland has been among the European countries hardest hit by the credit crisis and the subsequent massive deterioration of world trade in 2009. As Finnish exports fell by 24% year-on-year, its GDP shrank 7.8% last year, according to Statistics Finland. While there are tentative signs of a recovery, such as an increase in new orders in manufacturing, this must be viewed in its proper context, starting as it does from an extreme low point (see chart below).

New orders in manufacturing (month-on-month change)



Source: Statistics Finland

Electronics, machinery, and paper, as the main export sectors, suffered severely from the recession. Towards the end of 2009, there were some signs of a rebound, as paper production and metal refining began to recover. Monthly export volumes in the paper industry have been growing steadily in recent months, but are still below their pre-recession level. The recovery lost some ground in March due to a stevedores' strike which blocked all of Finland's harbours, but attempts were made to reduce the impact by transferring some production to plants outside Finland.

The outlook for the engineering sector is not yet clear. Companies have started publishing their interim reports for Q1 of 2010, and one important issue in this reporting is the development of order books. Generally speaking, there is no improvement in new orders yet, but, of course, there is variation between companies and across subsectors. However, what is clear is that overall growth of engineering order books is not yet back to pre-recession levels. As a result, once existing orders have been processed and invoiced, there is a risk of a further drop in business volumes, creating a negative chain-reaction throughout the supply chain.

Overall, the construction sector contracted 12% last year. After a steep decline in 2008 and early 2009, residential construction recovered in the second half of the year. The situation is now back to normal, thanks to three drivers. Firstly, renovation-construction performed quite strongly throughout the recession. Secondly, there is clear demand for new housing. And thirdly, the tight lending criteria imposed by banks did not last long and, together with margins, are now back to the low pre-recession levels. As a result, there is actually a risk of a housing bubble in the greater-Helsinki area. Residential construction is expected to increase 2% during 2010 compared to 2009. However, construction of commercial property is still hampered by the fact that both institutional investors and construction companies are wary of starting new projects, even though the vacancy rate has not worsened dramatically. Civil engineering (infrastructure construction) has so far fared quite well, as it is financed by the public sector. Expectations



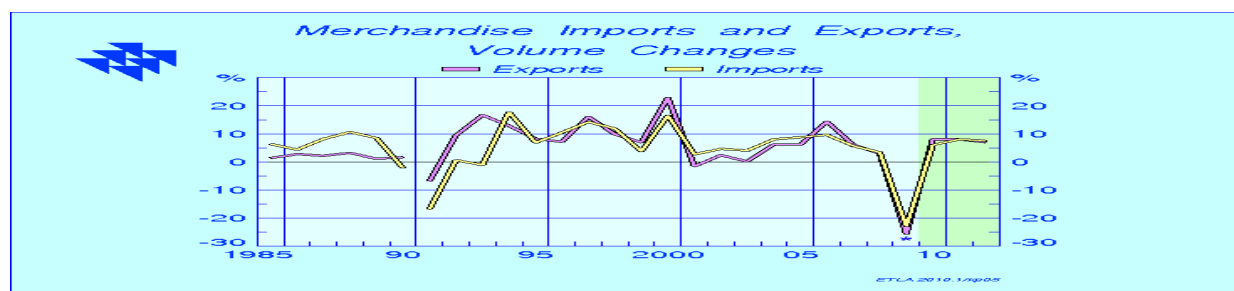
are that the volume of civil engineering will increase 5% in 2010 as the full impact of stimulus packages take effect. The sharp contraction in production in 2009 accounted for higher unemployment, the rate of which increased in the second half of the year. The number of jobs fell 3% in 2009 and in March 2010 the jobless rate reached 9.1%. The Research Institute of the Finnish Economy (ETLA) expects this figure to reach 10.3% by the end of the year, and already unemployment is seriously hampering private consumption.

Fewer corporate insolvencies in 2010

According to credit information agency Suomen Asiakastieto Oy, late payments increased 28% year-on-year in 2009. Of the 31,000 companies monitored, 109,000 late-payment incidents were recorded: the highest number for 10 years. But, after a 23% increase in corporate insolvencies in 2009, the number of business failures has decreased 14% in the period January to April 2010 across all sectors except transport, which recorded a 10% increase. One explanation of this is that transport companies have always operated on very small margins and with balance sheets containing low solvency ratios. As a consequence, they do not have adequate reserves to protect them in turbulent times when business volumes decrease. However, for the rest of the year we expect overall insolvency decrease to continue.

Finnish banks have not been hit by bad debts to the same extent as banks in some other countries. One important factor is the small exposures which the Finnish banks had in the Baltic region. They did tighten their credit policies briefly at the end of 2008 and beginning of 2009, but relaxed them again, for both corporate and household borrowing, during 2009. There are currently no financing-related problems for either corporations or households, and one leading bank announced in April that it has resumed its aim of increasing market share in housing loans.

The IMF forecasts that the Finnish economy will grow 1.5% in 2010, in the expectation that export demand will increase considerably in the second half of the year. For the whole of 2010, ETLA expects exports of goods to increase 7-8% as international demand strengthens to the benefit of all the important trade sectors (see chart below).



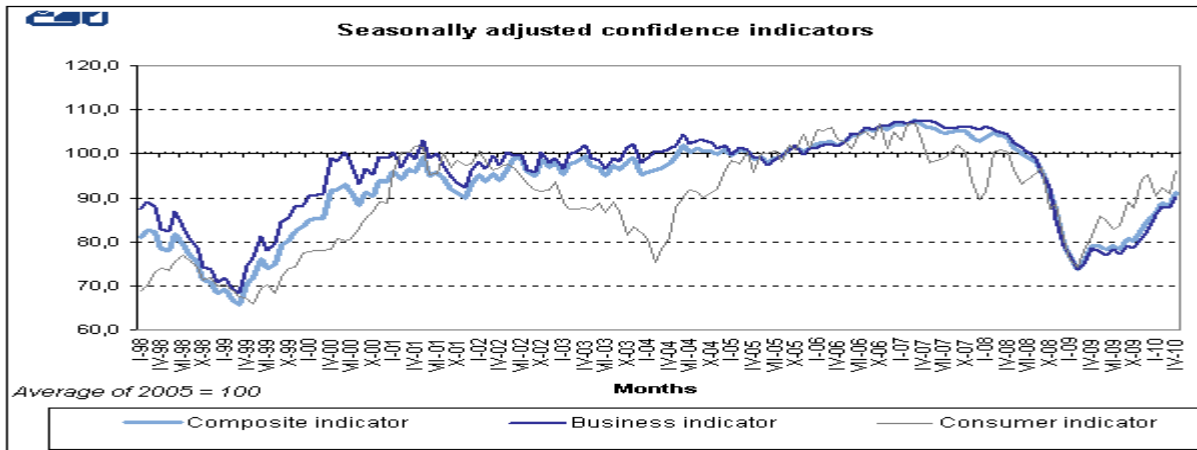
Revised quarterly account since 1990. Source: Statistics Finland, Quarterly National Accounts

There is potential for a much more positive outcome if the export of mobile phones recovers even partially from its collapse. That said, private consumption will increase only 1%, according to ETLA, contributing only modestly to the recovery. For private households, signs for the near future appear contradictory. On one hand, a housing bubble is developing in the greater-Helsinki area, due to the banks' low credit criteria and high demand for housing. The average amount of housing-related debt is approximately Euro 100 k, the burden falling mainly on the younger population. On the other hand, unemployment is high and consumer confidence is low.



Overall business and consumer sentiment is improving...

The economic situation and outlook has improved considerably since our last Market Monitor analysis of the Czech Republic in October 2009. According to the Czech Statistical Office, confidence in the domestic economy rose further in April 2010, by 3.4 points, and is now 14 points above its lowest level of April 2009 (see chart below).



Source: Czech Statistical Office

In the business sector, confidence has increased in manufacturing, trade and services. Industrial production rose 7% year-on-year in February 2010 (mainly for motor vehicles, metals and plastics), while the value of new orders increased 7.8% (mainly for motor vehicles, computers and electronics).

Despite increased unemployment (standing at 9.7% in March 2010), consumer confidence picked up again in April 2010, by 5.2 points, as people expect the economic situation to improve in the next 12 months and do not foresee a further rise of the jobless rate. Consequently, private consumption is expected to rebound in the coming months.

...but problems in the construction sector remain

That said, the construction sector remains the economy's problem child. In February 2010, construction output decreased 23.6% year-on-year, mainly due to the adverse weather conditions last winter and the drop in new construction orders. Building construction declined 29.5%, while civil engineering performed better with only a 5.5% decrease. It is little wonder, therefore, that April business confidence in construction remained subdued in contrast to other sectors. Business failures in the construction industry increased above average last year.



Payment behaviour has deteriorated during the economic crisis, especially in the construction, transport and textile sectors, and we do not expect a major improvement in the next 6 months. According to Creditreform, corporate insolvencies rose again in February 2010 (15% year-on-year to 424 cases) with trade (a 32% share) and construction (15%) the main victims. The situation will probably not improve throughout 2010, with further rises in both business and household insolvencies expected.

As elsewhere, many Czech companies suffer from a shortage of bank loans to finance new orders, as banks remain extremely cautious. Only a few very successful companies can obtain 'pre-crisis' terms, while smaller and newly-established enterprises in particular still face problems. From a sector perspective, companies in textiles, transport, construction, automotive, machines, furniture and chemicals have the most difficulty accessing loans. Nevertheless, banks in general are looking at the creditworthiness of individual companies, and their approach is to stay with companies with sufficient equity and with those whose commitments are so high that a rapid decrease of credits would cause losses for the banks.

The country's heavily export-oriented economy will further benefit from the recovery of some of its major trading partners (especially the machinery, engineering and automotive-related sectors). In February 2010, exports increased 11% year-on-year. At the same time, domestic demand is expected to rebound. After a 4.1% GDP contraction last year, current forecasts for output growth this year vary from 1.7% to 2.4%. Inflation will rise in 2010/11, due to the recovery in domestic demand (which will restore pricing power to producers) and stronger growth of nominal wages. However, it is likely to remain around the official target rate of 2%.





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Atradius
3 Harbour Drive
Capital Waterside
Cardiff CF10 4WZ
UK

www.atradius.co.uk