Inflation And Sovereign Debt Rein In Economic Upturn In Europe

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Results of GfK Consumer Climate Europe for the first quarter of 2011

European consumer sentiment is currently being driven primarily by rising inflation and high sovereign debt. With the GfK Consumer Climate Europe, for the first time GfK is providing an overview relating to expectations on the development of the economy, inflation and income as well as propensity to buy in Austria, Bulgaria, the Czech Republic, France, Germany, Great Britain, Italy, Poland, Rumania and Spain.

These ten countries make up approximately 80% of the population in the 27 EU countries.

The impact of the financial and economic crisis is being felt to very different extents in the countries of the European Union. Whereas Germany completely decoupled itself from the development of the other European countries in the past year, Spain, Great Britain and most Eastern European countries in particular are still suffering greatly under the aftermath of the most severe recession since the Second World War.

The predominant topic in Europe is currently inflation. Rising consumer prices, high costs for gas and crude oil are negatively impacting the wallets of European consumers. Great Britain is particularly impacted. There inflation rose from 3.3% in November last year to 4.4% in February 2011.

Recently the European Central Bank reacted to rising inflation, raising key interest rates for the first time since the start of the finance crisis, by 25 basis points to 1.25%.

The second large problem is the high level of sovereign debt in the countries. On the one hand it is especially the large European countries which must pay large amounts into the European Rescue Fund, while on the other hand all national governments have made much money available for stabilizing or stimulating the economy.

Italy has the highest level of state debt in the EU at a level of 118.9% of the gross national product.

Economic expectations: Austerity measures to combat recession in Great Britain highly disputed
In the countries tracked, only Germany and Austria expect that their economies will continue to grow strongly. In Austria the indicator showed 38.2 points, in Germany as much as 49.5. After a strong upturn of economic expectations of approximately 60 points from June to November2010, since December it has fallen again in Germany by approximately 15 points. The indicator value ranges between -100 and +100 points.

In Spain, Rumania and Austria, the indicator even improved. On the other hand, it experienced considerable losses in the Czech Republic and Bulgaria. Currently Rumania seems to be stabilizing at a very low level. Here economic expectations have improved since the middle of last year by roughly 34 indicator points, and currently stands at a figure of -37.3.

The financial crisis had far-reaching repercussions on the economy in Great Britain. Private consumption financed to a large extent via loans still made up a very high share in the gross domestic product.

As a result of the economic crisis, consumers as well as many companies were no longer able to pay their loans, something which impacted the entire economy. Property prices dropped dramatically, with a parallel sharp upturn in unemployment.

Many companies went bankrupt. Consumer expectations posted a low of -57.8 points at the beginning of 2009. Since then the economy recovered over the course of the year. 31.4 points in February 2010 was the highest value the indicator has had since October 1997.

Since last year, the government has been trying to get to grips with the high level of new debt on the back of a stringent austerity program, particularly in the public sector and by tax increases. The public fears that these austerity measures will result in drifting into the next recession, before the economy has recovered from the finance crisis.

However, the population is deeply divided in relation to the right policy for combating the recession.

One side recognizes that it is necessary for the government to take a radical stance of saving, while the other side favors a policy more aligned to a Keynesian approach, which would stimulate the economy with public funds.

This discussion about the right way out of the recession is also evident in the assessment of the current development of

the economy. Last year, and again in the first quarter of this year, economic expectations receded dramatically and are currently at -29.9 points.

The economy of the Czech Republic is gradually recovering from the economic crisis. This was impacted considerably by Skoda, the automobile manufacturer. It is one of the companies which has a major impact on the development of the Czech economy.

In the first quarter of 2011, Skoda increased revenues by 21.4%. Even so, overall consumer sentiment has declined considerably since the beginning of the year.

The current government wants to combat the high level of sovereign debt for the first time. However, it is unclear if the government can push through its reforms.
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This uncertainty is reflected in the assessment as to how well the Czech economy will develop over the next few months. The public has real fears that planned austerity measures and tax increases will weaken the slowly recovering economy again and that unemployment will rise further. As a result, economic expectations have slumped since the beginning of the year.

In January the index posted a figure of 9.6 points. By March, this had slumped to -29.6. What is more, the Czechs also see their personal financial situation being jeopardized by the planned reforms.

Price expectation: Sharply higher across Europe
In all countries being tracked in the European Union, price expectations increased in March. The only exception is Bulgaria. Here after a sharp increase, the indicator has declined again slightly since December last year, recording a figure of 7.6 points in March. Key drivers for inflation are currently higher commodity and energy prices.

There was a particularly sharp upturn in France, Italy and Rumania. In France consumer price expectations increased by 12.4 points in March to the current level of 46.9 points. This is the highest figure for some 20 years.

Since August 2009, the indicator has been rising dramatically.

At that time it recorded a figure of -32.3 points. Since the economic and finance crisis, French consumers fear a huge decline of their purchasing power.

In Italy the Index is currently at -11.1 points after -22 points in February. As in France, the Italians have been expecting prices to rise since the middle of 2009. In July 2009, the Index recorded a figure of -60.8 points. Even though the price expectations figure is relatively low, the Italians have become much more price-sensitive during the finance and economic crisis.

In December 2010, a good third of consumers were concerned about inflation, three months later it was already 58% of them. However, at 2% inflation in Italy is still moderate low in comparison to other countries.

The indicator is currently showing 19.7 points in Rumania. In the middle of 2010, the Rumanians had to cope with sales tax increasing by 5 percentage points. In the ensuring discussion, price expectations rose to 14 points in August. However, the indicator subsequently calmed, moving down to -15.3 points in January.

Currently the Rumanians are concerned about further increases in taxes and charges, so that that price expectations rose in March by 29.7 points. As it has received financial assistance from the International Monetary Fund, the European Central Bank and the EU, strong international pressure is being exerted on the Rumanian government to reduce its national deficit. This is compounded by inflation which is currently running at approximately 6%.

Income expectations: France fears loss of purchasing power
Rising concern of European consumers about inflation is also impacting expectations on income. The indicator is currently declining on a broad basis. The only exception here is Rumania which posted a marginal increase, after the indicator had recorded an all-time low of -72.7 points in June 2010.

In order to get to grips with state finances, last year the government introduced a stringent austerity package with social benefits being cut combined with increases in taxes and levies. What is more, civil servant salaries were slashed by 25%. The consequence was income expectations of its citizens slumping. Since the middle of the year, cautious hope for an early end of the recession resulted in a steady increase of the indicator.

Currently at -31.3 points it is stabilizing at a very low level.
In February civil servants received a salary increase of 15% which at least partially compensated for the reductions in the previous year. For the remaining nine months of this year, experts are expecting a slight economic recovery.

In Germany income expectations stabilized at a very high level and have currently reached 40.5 points. Germany coped with the economic crisis astonishingly well. Due to the extended possibility for reduced working hours and state economic stimulation programs, companies laid off virtually no staff, even during the recession.

They were thus able to react immediately last year which global demand picked up again. Due to the excellent general economic conditions with unemployment declining steadily, strong gross domestic product growth and increasing demand for private consumption, the Germans are expecting tangible salary increases this year, some of which have already been realized.

At -39.2 points France has the worst figure of the EU countries being tracked. Since January 2010, the indicator figure has fallen by some 30.6 points. It is true that France came through the economic crisis better than many other European countries, but this is partly due to its enormous state economic programs.

As a result new debt increased to 7.8% of gross national product (GDP) in 2010. In line with the stability criteria for the Eurozone only 3% is allowed. State debt has since reached 84% of GDP, after 68% in 2008. The French governmentâ€™s primary objective this year is reducing new debt. Thus consumers fear that there will be further increases in taxes and levies, which will directly impact their disposable income and thus their standard of living.

In addition to increasing taxes and levies, other privileges are also being examined as a way to restore state finances. Last year, accompanied by strong protest from the population the government raised the pension age from 60 to 62. As a comparison - in Germany the threshold is already 67. The 35-hour week established by law is likely to be questioned in the medium and long-term.

Propensity to buy: Spaniards are holding on to their money
In line with expectations on income, propensity to buy is also declining across Europe. Only in the Czech Republic, Austria and Italy did this indicator rise. Since slumping last year, Rumania has recovered slightly and is currently stabilizing, albeit at a very low level.

In March, the indicator was at -35.1 points. By far the highest figures were recorded in Austria at 30.9 points and Germany with 34.3 points.

Contrary to the other developments in the Czech Republic, in March propensity to buy increased by 7.8 points to -2.9 points. The economic crisis made its presence felt among Czech consumers late: not until the end of 2009, but then quite tangibly. The Czechs radically changed their buying behavior â€“ from one driven by spontaneity and current requirements to well-considered purchases.

Quality became much more important as opposed to quantity. However, since the end of last year, purchasing restraint seems to be declining again. Since November, propensity to buy has increased by a good 17 points.

The Polish economy is strongly driven by domestic demand. The economic crisis therefore had less of a negative effect on Poland than in European countries whose economies depend more strongly on the development of exports. As early as the end of 2009, Poland had tangibly recovered from the economic downturn.

This is shown quite clearly in the buying propensity trend. At the end of 2008, the indicator fell from 23.1 points in November to -26.7 points in April 2009. However, since then the propensity to buy has risen steadily, reaching an interim high of 25.5 points in February. Currently, the indicator is again moving downward and is currently recording a figure of 16 points. However, the economic data of the country are good.

This year, the government deficit is set to fall from 7.9% to 5.8% and to approximately 4% next year. Experts are forecasting economic growth this year of 4.1%. For this reason, it is likely that the decline in propensity to buy will be short term only.

Since the finance crisis, the economy in Spain has been suffering greatly from the fact that the property bubble has burst. The key focus of the government currently is controlling state finances. As a result public spending was drastically reduced, pay and pensions of civil servants cut as were social benefits.

On the other hand, sales tax was increased by 2 percentage points. The situation is compounded by high unemployment without the prospect of any considerable reduction this year. No-one knows what is in store for them over the next few months. As a result, the Spaniards are trying to hold on to their money as long as possible and make only the most urgently required purchases.

This means the savings ratio is correspondingly high, currently at roughly 16%. Even so, propensity to buy has increased at a low level over the last few months. From December 2010 to February 2011, the indicator increased from -11.2 points to 37.5 points.

However the recurring discussions about whether Spain will actually have to utilize the EU financial rescue package is causing disquiet among consumers. This drove down the indicator to -10.7 points in March.

The survey
The results are an excerpt from the international extension of the "GfK Consumer Climate MAXXâ€• survey, based on consumer interviews carried out in all countries of the European Union on a monthly basis. The monthly interviews are distributed as follows among the countries observed:

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