

## marketmonitor

adapting to the challenging  
economic environment



September 2009

### The immediate outlook for key markets and sectors

Every month, Atradius brings you an up to the minute snapshot report on a range of export markets and key trade sectors. Our underwriters have a specialist view of the world economy – and the industries that make that economy tick - that you won't find in the general press coverage of events, so we hope that you will find our summary reviews a useful addition to your Atradius credit insurance.

Even more importantly, our underwriters use their expertise and experience to look to the future. In each edition of Atradius Market Monitor you'll find our outlook for a number of key market economies.

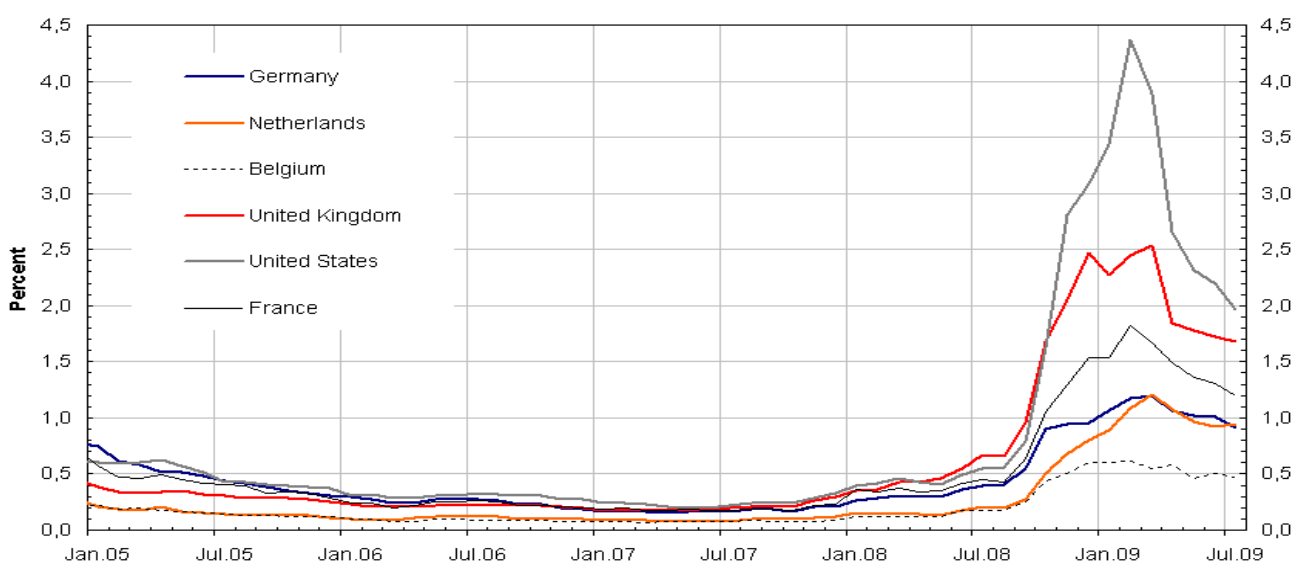
### In this issue...

...we feature the following markets:

- Italy – with a spotlight on the ICT and food sectors
- Australia – with a spotlight on the mining and construction sectors
- France
- Switzerland
- Sweden
- China
- India

## Expected default in Western Europe and USA

One of the most important factors that any business needs to know is the trend of 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%.



Source: KMV Credit Monitor and Atradius Economic Research

The rebound in equity prices and a significant reduction of stock market volatility have translated into lower model-generated corporate default forecasts. EDFs have fallen back significantly in recent months, in both North America and Europe. In July 2009, the median EDF of nearly all major Western economies dropped again compared to the previous month. While the Netherlands showed a modest increase and Belgium and the UK decreased slightly, France, Germany and the US decreased even more than in the previous month. The median corporate EDF in the US pool is now back below 200 basis points, after peaking at around 440 basis points in the first quarter of 2009. Despite this, it is worth bearing in mind that it is still well above its long term level. The same holds true for the recent EDF developments across European markets. While generally decreasing, the current EDF levels remain in line with readings from late 2008, indicating elevated default risk among listed companies.

On the following pages, we assess the impact of expected default in key markets

## Signs that the low point has been reached

After a severe GDP contraction of 2.4% in Q1 of 2009, a much more moderate reduction of 0.5% in the second quarter indicates that the recession is about to bottom-out. In July, the Italian purchasing managers' index reached 45.4 points: its highest level since the end of last year. The more positive environment is also signalled by a slower decrease of fiscal flows (-1.9% at the end of June compared to - 3.4% at the end of May). In addition, the number of liquidated companies has decreased in Q2 of 2009 compared to the last two years' results (see chart below).

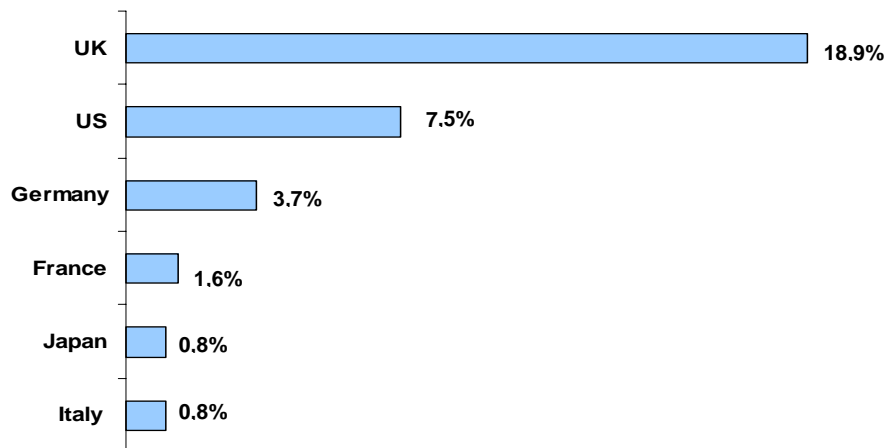
<b>Company registrations and liquidations (annually, Q2 of each year)</b>						
Absolute and percentage values						
Year	Registrations	Liquidations	Balance	Registration rate	Ceasing rate	Growth rate
2003	97,013	56,762	40,251	1.67%	0.92%	0.74%
2004	118,217	68,983	49,234	2.00%	1.10%	0.90%
2005	116,057	73,618	42,439	1.94%	1.10%	0.84%
2006	109,599	68,838	40,761	1.81%	1.13%	0.67%
2007	116,338	76,041	40,297	1.90%	1.25%	0.66%
2008	112,550	75,681	36,869	1.84%	1.24%	0.61%
2009	97,841	69,835	28,006	1.61%	1.15%	0.46%

Source: InfoCamere

However, there is still clear evidence of a strong deterioration in payment morale, with protested bills in H1 of 2009 reaching €2.2 billion, a 12.7% increase year-on-year. Corporate insolvencies have continued to increase and this trend is expected to persist in the coming months. While the median corporate Expected Default Frequency for Italy decreased from March to May, it has increased again since June. The July 2009 EDF for Italy is 100 basis points above its July 2008 level, and this elevated default risk among listed companies is in line with the current and expected level of overall corporate insolvencies in Italy.

The Italian banking sector has hardly been touched by the subprime crisis, as most focus more on traditional banking. As a result, unlike other countries, the Italian government has not been forced to provide large capital injections to prop up its financial system (see chart 2 below). Italian banks' troubled assets stood at €47.7 billion at the end of May, and, while this is a 6.1% increase year-on-year, it still constitutes a mere 3.15% of total assets compared to 3% for the same period of 2008.

Chart 2 - Governmental support to financial systems in GDP percentage



Source: Il Sole24 Ore

Because of high public debt, the government's options to boost the economy are more restricted than in other European countries. Its stimulus package amounts to €65 billion – 4.2% of GDP – to be spent over three years. 55% of this is earmarked for new investments, 26% to extend the public redundancy fund, the so called “cassa integrazione” (Italy unemployment rate in July was 7.9%) and 11% to encourage consumption. The government is currently in discussion with the National Banking Association (ABI) to extend banks' payment terms (up to 270 days) on short-term facilities (mainly factoring or advanced payments on invoices). Those financial institutions that would be part of such an agreement would receive fiscal benefits for potential losses. We await the outcome of the negotiations.

### Stabilisation at low level expected

We expect a stabilisation of the economy in the coming months - albeit on a low level - as growth rates of some of Italy's important commercial partners are improving (both France and Germany showed positive growth in Q2 of 2009). This will help sectors like metal manufacturing and machines to recover. Both industries have been hit by the recession. Overall, Consensus Economics expects 2009 GDP contraction of 4.8%, with any positive growth expected no earlier than Q1 of 2010.

### Information and Communication Technology (ICT)

#### How has the economic downturn impacted the ICT industry?

The ICT sector encompasses B2B information technology and consumer electronics: more precisely, traditional IT products (desktop PCs, notebooks, printers, servers, standard software); consumables (cartridges, tapes, toners); networking products (modems, routers, mobile phones); and digital and entertainment products (photo cameras, video camera, and videogames). The global economic downturn negatively impacted the sector, at home and abroad, as many end users (80% corporates, 15% public, 5% consumers) had to cut their costs and postpone investments. Companies have spent less on IT consultants, sought new agreements with IT suppliers to reduce costs, postponed hardware updates, and stopped investment in new and advanced technologies. As many financial institutions, which are important ICT clients, have faced tough reorganisation and cost reduction programmes, this has been a major blow to the industry.

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

Between January and July 2009, notification of non-payment in the ICT sector received in Italy increased by 5% in value - much less than in other sectors. Despite this, there have been some major defaults, including one large IT distributor and others in the distribution subsectors, triggered by weaker demand and the insolvency of end-users. The sector has also been impacted by stricter fiscal controls designed to avoid fiscal frauds and VAT evasion.

#### What should companies selling products into the ICT industry pay particular attention to?

While analysing these defaults, a common factor that we have found is that the failed companies always paid all their suppliers on time - until they suddenly filed for bankruptcy/liquidation. This suggests that simply monitoring the regularity of payments is not always enough. We recommend, instead, checking the turnover trend: be wary if there are major order decreases. It is also advisable to refuse all requests for extended payment terms. As there have been many fraud cases in this sector, be suspicious if a customer places an order without trying to negotiate a price reduction, or if his claims about his company's financial strength seem exaggerated.

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

Until the end of the year we expect a decrease in sector turnover close to 10%. While this decrease is not that dramatic, for many companies it means that they will not reach breakeven, that they will have increased stock (which will fall in value) and that their bank exposure is also likely to increase. Some products, such as mobile phones, notebooks, and desktop computers, will show a stronger decrease both in quantity and price, spelling real danger for companies specializing in them. We expect market adjustment to continue, leading to an increased average size of distributors/retailers. Larger companies will enjoy better payment conditions from vendors and more options for cost reduction through economies of scale.

## Food

### How has the economic downturn impacted the food industry?

The Italian food industry has shown only a slight reduction in volumes, but at the same time has suffered a serious deterioration in profitability, with negative consequences on the fragile financial structure typical in this sector. Demand has switched to cheaper products, depressing the margins of many producers and retailers. We have seen higher demand for white meat, pasta and white label products, while beef, wine, olive oil and more expensive goods have lost market share.

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

Italian banks have reduced their exposure to the food industry, as well as to other sectors, by 10% to counterbalance the worsening liquidity scenario (see chart below). As a consequence, the level of bad debt has not deteriorated significantly, but is still high compared to the Italian average. Larger stocks and longer collection times, caused by stagnant demand, are financed with trade credit, increasing credit risk within the industry.

	Mar - Jun 09			Mar - Jun 2008			Δ number of grantees	Δ bad debt	Δ granted	Bad debt / Granted 09	Bad debt / Granted 08
	Units	Million euro	Million euro	Units	Million euro	Million euro					
	Number grantees	Bad debt	Granted	Number grantees	Bad debt	Granted					
Total	199.020	35.357	948.766	221.647	36.266	916.280	-10,2%	-2,5%	3,5%	3,7%	4,0%
Food products	6.771	1.469	30.673	7.522	1.800	36.362	-10,0%	-18,4%	-15,6%	4,8%	5,0%
Agriculture products	11.677	2.060	37.335	12.926	2.093	31.024	-9,7%	-1,6%	20,3%	5,5%	6,7%

Source: Banca d'Italia, Atradius

### What should companies selling products into the food industry pay particular attention to?

Any deterioration in payment experience should immediately alert a supplier, especially when buyers pay close to 100 days. A further risk factor that could affect companies' liquidity is the unexpected volatility of raw material prices. This applies especially to dairies and mills. Finally, keep in mind the relatively high fraud risk in this sector. We recommend a cautious approach to new customers, particularly when operating in the Southern regions of the country.

### What is Atradius short term outlook for the food sector?

In the second quarter of 2009, consumer confidence increased for the first time since 2007, signalling positive expectations of a rebound in consumption level. We are cautiously confident about a recovery of sales during the Christmas period. Nevertheless, some subsectors will remain structurally weaker than international competition and will lose more market share. For example, beef and pork are both cheaper abroad than in Italy, leading to increasing meat imports and hence more difficult market conditions for Italian farmers and animal feed producers.

## Swift action to avoid recession

Australia is faring well, in comparison to other OECD countries, in the current global economic environment as, technically, it has avoided a recession. Thanks to the accumulation of budget surpluses in earlier years, the Australian government was well positioned and reacted quickly to the onset of the financial crisis. A three-tiered structured stimulus package worth 70 billion Australian-\$ (about €41 billion) was implemented in Q4 of 2008, supporting consumers with cash incentives paid in 2008 and 2009. This has both improved consumer confidence and cushioned the retail sector against possible decline. The business community and the country's infrastructure have also benefited from the government's actions, with positive effects evident across the economy.

The Reserve Bank of Australia (RBA) quickly decreased rates, which are now at historical lows. The RBA agreed on 1st September to maintain the cash rate at 3%, indicating that, while rates are held for the time being, they expect interest rates to rise before the end of this year in line with signs of an economic revival. The major Australian banks have been resilient throughout the economic cycle and have not required any government support. In recent times all have successfully raised significant capital in the marketplace. We have seen an increase in the number of insolvencies, but the year-on-year seasonal insolvency trends tend to follow the same pattern. This is also true of payment delays, with some sectors, such as the steel industry, seeing greater delays than others.

The unemployment rate increased to 5.7 percent in May 2009, according to the Australian Bureau of Statistics, and is forecast to reach 6.5% by the end of the year. This is significantly less than originally expected at the beginning of the economic downturn.

## Positive – but delicately balanced

All the signs are that the Australian economy is set to improve. Consumer and business confidence is returning, GDP grew by 0.4% in Q1 of 2009 and by a higher than expected 0.6% in the three months to June, thanks to both household spending and business investment in machinery and equipment. Companies are no longer de-stocking their inventory, but are now cautiously restocking as demand improves. The Australian government has announced that its fiscal stimulus may be reduced gradually in the last quarter of the year if the economic situation improves further. However, the positive trends in the economy remain delicately balanced: Australia is still faced with some mid-term imponderables such as the further movement in export demand and commodity prices.

### Mining

#### **How has the economic downturn impacted the Australian mining industry?**

This sector experienced a number of failures and project closures in late 2008 and early 2009, resulting from the slump in base metal prices and a lack of available funding.

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

Over the past 6 months we have seen a number of failures and near failures of significant mining operators. This is affecting all sectors from start-ups, to juniors and more established players. In the last 6 months, 85 payment default cases have been registered - an increase by 15% on the previous 6 months. In terms of value, those 85 cases totalled € 11.66 million, an alarming increase of 287% over the € 2.75 million total of the previous 6 months. While no official figures are published on a regular basis, we are now seeing a slowdown in the number of notifications of insolvencies involving miners.

A trend that has started to emerge is that of miners proposing and adhering to repayment plans. This is a positive change from Q4 of 2008/ Q1 of 2009, at which time, although possible in principle, such plans were impractical because of low commodity prices.

#### **What should companies selling products into the mining industry pay particular attention to?**

As local bankers still remain cautious of this sector, it is most important for a supplier to ensure that the customer has sufficient banking facilities to cover cash flow and project finance for at least the next twelve months. It is also necessary to have an understanding of the customer's "cash cost" of unit mined compared to spot price, in order to determine their viability.

#### **What is Atradius' short term (6 month) outlook for the mining industry?**

Base metal prices have experienced substantial increases from their lows over the last five months. Copper has almost doubled in price while the spot price for iron ore has increased by 30%. Despite the pricing improvements, the short-term outlook for the mining sector remains cautious, as we wait to see if recent price gains are due to restocking or a more sustainable underlying increase in demand.



### Housing & Construction

#### **How has the economic downturn impacted the Australian housing & construction industry?**

This sector has been impacted largely by the lack of available funding, with the commercial and industrial sector continuing to struggle with demand and availability of funding for new projects. This will persist, as companies scale back their growth aspirations and look to conserve cash to strengthen their balance sheets, while banks and finance houses continue to apply stringent conditions to their lending.

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

The construction sector has traditionally been the first area of the economy to be hit in a downturn. Therefore, although we are seeing a continued deterioration in payment delays, it has not been as dramatic as seen in other parts of the economy over the last 6 months - simply because this area has been under pressure for the past 12 months.

While there have been some large failures, most of the companies that have failed tend to be smaller operations. Irregular payment patterns are prevalent to this type of business, and we have not seen any increase in proposed re-payment plans. In the last 6 months, 411 payment default cases have been registered (valued at € 10.76 million), a 23% increase over the previous 6 months, when only 334 cases were registered (at a value of € 8.71 million).

#### **What should companies selling products into housing & construction pay particular attention to?**

Having the confidence that you are dealing with a reputable company is important. Manage your receivables very closely and keep outstanding debts to a minimum. Understanding how projects are funded is key: suppliers should be wary of large projects for small businesses and take director/owner guarantees where possible.

#### **What is Atradius' short term (6 month) outlook for the housing & construction industry?**

The residential sector was specifically targeted by the government's stimulus package. The first home buyers' grant, historically low interest rate and a waiver of stamp duty have combined to increase housing approvals and stimulate the housing market. Approvals were up by 2.5% in Q2 of 2009. Government initiatives will continue to benefit the construction sector over the coming months and years, with infrastructure projects and specific targets such as renovating and improving schools across the country.

## Growth returned in the second quarter of 2009...

After a contraction of 1.3% in Q1 of 2009, French GDP picked up by 0.3% in the second quarter. This growth was supported by relatively dynamic exports and increased private consumption, encouraged by government subsidies on car purchases and make-work schemes in the public sector. In June the index measuring the receipt of orders for all industries remained weak, but nevertheless there was some improvement in individual industries such as chemicals, pharmaceuticals, and textiles. While state subsidies have given a boost to the automotive industry, it is still difficult to accurately forecast the sector's mid-term prospects.

The construction sector has shown more resilience than forecast in our last analysis. Although the general outlook for building and construction still remains rather muted, the order book has almost stabilised at 5.3 months' worth of future orders (against 5.6 months in March 2009). Thanks to moderate but still positive consumption, the retail sector is improving.

According to the business leaders of the main economic sectors, the French business climate has continued improving, albeit slightly, in July 2009. Business climate indicators show a rise to 75 points, compared to 74 in June, and a full 7 points above the record low reached in March (see chart below). Nevertheless, it remains far below its long-term average.

### Business climate indicators

	Mar. 09	Apr. 09	May 09	Jun. 09	Jul. 09
<b>Business climates</b>					
France	68	69	71	74	75
Industry	69	71	73	76	78
Wholesale trade	69	-	71	-	73
Building	95	92	92	92	91
Retail trade	85	79	84	83	88
Services	60	60	64	68	69

Source: INSEE, Business tendency surveys

Overall, French industry still suffers from production over-capacity. As a result, capital expenditure is expected to decline by more than 20% in 2009. Access to credit (both consumer and corporate) has continued to shrink since autumn 2008. After a 21% increase in corporate insolvencies in the first quarter of 2009 (15,000 judgements), the trend has continued to deteriorate. Figures from Altares show that corporate insolvencies increased by 15% year-on-year in Q2 of 2009 (with 14,000 judgements). That said, it is worth noting that, after further deterioration during the first three months of the year, the latest figures show a decelerating trend for several key sectors such as building, retail, agriculture and the food industry.

### **...but still mixed signals for the French economy**

Despite some positive signs, the overall outlook for the rest of the year remains uncertain. While the decline bottomed-out in the first quarter of the year, French GDP is expected to level off in the third quarter. Consensus Economics predicts GDP contraction of 2.9% in 2009 and a slight recovery in 2010 with 0.3% growth. After 9 months of massive de-stocking, we expect an increase in domestic orders, supported by the foreign demand. In July, the French purchasing managers' index reached its highest level in over a year, at 48.1 points. Despite that, unemployment is expected to increase in the coming months, and this may negatively affect private consumption as a main pillar of economic activity. As a consequence, while we can see the start of a recovery, it will remain weak for the rest of the year.

We expect corporate insolvencies to remain high in H2 of 2009, severely affecting all industries except agriculture, food and pharmaceuticals, although there could be a slight deceleration compared to the last months. The French Expected Default Frequency remains above its long-term level, indicating high default risk among listed companies, while showing some continued improvement (see chart page 2).

### **Rising insolvencies and worsening payment behaviour**

Swiss manufacturing and service companies are currently feeling the pinch much more than expected in recent months. The country's export-driven economy has been severely affected by adverse developments in the eurozone and the US. Corporate insolvencies have increased sharply in H1 of 2009 (2500 cases), leading to a monthly all-time high of 550 cases in July. The sectors most severely affected are the export-dependent machinery sector, with an 80% increase in insolvencies year-on-year, wholesale, investment companies (150% increase due to a collapse of the value of their holdings and lack of refinancing options) and recruitment agencies (a 250% rise, mainly due to the widespread hiring freeze).

While there are no signs of an overall credit crunch, Swiss banks are increasingly reluctant to lend to companies with financial problems. The growing liquidity squeeze experienced by an increasing number of companies has led to a rapid deterioration in payment behaviour over recent months. According to Dun & Bradstreet, between January and April 2009 late payment in Switzerland peaked at 20.1 days (compared to 10.8 days in Q1 of 2007). We expect payment morale to deteriorate further in the coming months, as liquidity strains on many Swiss companies persist.

### **Bottom-out for some sectors on the horizon**

Assuming production in the eurozone levels off or even recovers slightly in H2 of 2009, we forecast that the downward trend in sales by Swiss export-driven sectors, so badly hit by the recession at the beginning of the year, will either slow, reach the bottom of the curve or even recover modestly in the coming months. Expectations for a bottoming-out of the recession are also reflected in recent purchase manager indexes. Thanks to the government's stimulus package, the construction sector will experience a modest revival, with public works/civil engineering set to grow for the remainder of the year.

However, we expect other sectors, which to date have not been severely affected by the recession, to face more problems in the coming months. Rising unemployment (forecast to be 3.8% this year and 5.5% in 2010) will negatively affect private consumption and, consequently, hurt retail trade. We therefore expect sharply rising insolvencies (30-40%) among SMEs in retail, companies in the handicraft industry, and in the catering and hotel sector. As a result, and despite a potential recovery of the export sector, we see no easing of the tense insolvency situation in Switzerland. The number of corporate insolvencies may rise to more than 5,000 this year, and the prospect of a general recovery in 2010 remains uncertain. But, at least, the likelihood of a continuing downward trend is receding. Overall, the Swiss State Secretariat for Economic Affairs SECO forecasts GDP to contract by 2.7% in 2009 and 0.4% in 2010.

## A high number of insolvencies expected in 2009

According to Statistics Sweden, GDP decreased by 6.0% year-on-year in Q2 of 2009, but increased by 0.2% compared to the previous quarter. After initially misjudging the severity of the credit crisis by keeping interest rates high, the Swedish central bank swiftly took strong action to improve the economic situation, reducing the repo interest rate (the rate that the central bank charges commercial banks) to 0.25%. To help stimulate the economy, low interest rates are expected to continue throughout this year and in 2010. The Swedish stock market has rebounded since March with many stocks, including those of all four major banks, recovering from their extreme lows. The recovery in equity prices since March has also translated into a decreased median corporate Expected Default Frequency (EDF). Nevertheless, the July 2009 EDF for Sweden is still 95 basis points above its July 2008 level, and this elevated default risk is reflected in the current level of insolvencies. According to Upplysningscentralen UC, the number of corporate insolvencies increased sharply by 36% in H1 of 2009 to 4,279. For the whole year we forecast a year-on-year increase of at least 40%.

**Automotive:** Demand for new cars and trucks is still low, negatively affecting production at Volvo, Saab Automobile and Scania. Saab Automobile's reconstruction period (the Swedish equivalent of the US's Chapter 11) officially ended on August 20th. If and how the company will survive is still not clear as the financing measures for a takeover by Swedish sports car manufacturer Koenigsegg are still unclear.

**Construction:** The private housing industry has had a surprisingly good year, as some manufacturers have registered all time high order books thanks to low interest rates. DIY markets are also doing well due to a quickly implemented tax reduction programme and people choosing to stay at home rather than travel abroad.

**Wood/timber:** Production volumes have decreased less than in other European countries, with the sawmill industry recovering, as both delivery volumes and prices have increased. Customers have re-stocked with Swedish timber, as prices have become very competitive due to favourable currency exchange rates. The overall order situation is satisfactory.

**Retail:** In July 2009, retail sales of consumables increased by 1.4% year-on-year, while sales for durables rose by as much as 8.7%, thanks in large measure to a rather rainy summer.

## Companies' confidence is rising again

Although many Swedish companies are still facing low demand and some sectors are suffering from overproduction, there are now more positive signs than in the first quarter of the year as overall demand has picked up slightly. New orders increased by 8.3% from June to July. Some listed companies again reported encouraging figures in their interim reports, and company and institutional confidence in the Swedish economy has risen since the early part of the year. According to the National Institute of Economic Research (Konjunkturinstitutet), GDP will contract by 5% in 2009, but a rebound of 1.5% in growth is forecast for next year.

## Some signs of recovery

China's government has turned around its economy faster than most analysts thought possible. China's economy grew by 7.9% year-on-year in Q2 of 2009, rebounding from 6.1% in the first quarter. This puts China back on target to meet the government's forecast of overall growth of 8% for 2009. GDP is forecast to accelerate further to 8.5% in the third quarter, thanks to continuous stimulus spending and a moderately loose monetary policy.

In the first half of the year, China's banking system pumped out Yuan 7.37 trillion (US-\$ 1.08 trillion) in new loans, an increase of more than 28% year-on-year. The loans have been credited with helping the economy expand in the first six months of 2009. China's stimulus programme goes mainly to infrastructure construction, such as railway and road building and other public works. That has boosted revenues for construction companies, most of them state-owned, and some private suppliers of cement and tools.

While state-owned enterprises have benefited greatly from China's loose monetary policy, it does not favour private business and has failed to create enough new jobs to offset the impact of the financial crisis. Middle and small sized enterprises (which account for about 60% of China's GDP) remain starved of credit, despite the boom, as banks are very reluctant to lend to them because of the relatively high risk of private business (business size, insufficient fixed assets, unreliable financial information, and uncertainty of private shareholders).

In spite of the great efforts that the Chinese government has made, China's economy still relies heavily on the recovery of its major export markets in America and Europe. Between January 2009 and July 2009, Chinese exports decreased by 22% year-on-year. Although we see a slight improvement in export markets, the current weak overseas demand will not recover to any great extent in the coming months. Consequently, the problem sectors in China are dominated by export-oriented business, such as clothing/textiles, toy, steel/metal and shipbuilding. After deteriorating sharply at the end of 2008/early 2009, those sectors showed some signs of modest recovery in Q2 of 2009. However, companies are still struggling to achieve bottom line profitability. As a result, many small and medium-sized private players have now closed down.

The steel/metal sector still faces the problems of declining orders (especially export orders), falling prices, and serious overcapacity. The Chinese government has encouraged mergers and restructuring in the industry to improve economies of scale and overall competitiveness, and have asked commercial banks to cut their loans, by as much as half, to steelmakers who report obsolete capacities or expand production blindly.

## **Investment-driven growth to continue**

There will be little change in the overall situation in the second half of the year, with no expectation of an early recovery in the export market. State-directed investments will remain the major driving force of the Chinese economy, with stimuli for domestic infrastructure growth and other initiatives designed to improve the circumstances of the very many people engaged in rural areas. This includes a scheme to upgrade electrical appliances by trading in old appliances for new ones – very similar to the schemes adopted by Western governments to stimulate new car sales.

We remain cautious over the impact of China's economic strategy, and continue to monitor if it will have an effect on increasing non-performance loans, inflationary pressure and volatility in property prices or the stock market. We are paying close attention to any over-capacity in certain trade sectors, particularly steel.

## Recovery in the manufacturing sector

In Q2 of 2009, India's growth again accelerated, by 6.1% year-on-year, compared to 5.8% in the first quarter of the year. Nevertheless, the business environment in India is currently mixed. While there is a recovery in manufacturing, led by the automotive sector, the late and weak monsoon rains have proved a setback for both the agricultural sector and rural areas. In August, it was reported that automotive sales had increased for the sixth successive month, due to new car launches, a revival in bank lending and lower interest rates. This combination of increased consumer demand and a greater willingness by the banks to lend is helping the Indian manufacturing industry, which saw a 7.8% year-on-year increase in industrial production in June 2009. An analysis of the results of 150 metals companies for the year ending June 2009 showed that, while sales fell by 12%, net profit fell by up to 30%, largely due to higher raw materials prices. Metal prices were 30-50% lower in Q2 of 2009 compared to the same period in 2008, and companies that have recently signed long term supply contracts should therefore see higher profits.

Government spending on badly needed infrastructure projects has also given a boost to domestic demand. There is a clear need for additional power generation, and the growth of the telecommunications sector is driving the expansion of telecom networks throughout India. The housing sector is picking up, and government spending on services such as education are also expected to increase this year.

The agriculture sector, which accounts for a sixth of GDP, reported growth of only 2.4% in Q2 of 2009. Evidence received from Indian companies suggests that the rate of growth in demand in rural areas has been high, but from a lower sales base. The weak monsoon is likely to reduce rural incomes, increase food prices and therefore drive rural demand downwards, and we do not expect even the lower growth figure to be maintained in the second half of this year. While the Indian government still expects 2009 GDP growth of between 6.25% and 7.75%, more independent research institutions forecast a growth rate of between 5% and 6%, due to the effects of the weak monsoon.

## Payment experience in India

Notifications of slow payments increased in March/April 2009 as a result of a lending freeze by the banks and the impact that it has had, particularly on factored receivables. Generally, experience of Indian payment performance and commercial morality has been good, although extensions to payment dates are sometimes requested to cover short term cash flow problems. However, there have been widespread reports of substantial frauds involving Indian companies, and these demonstrate the need for us and our credit insured customers to get reliable up-to-date information on buyers. This is particularly difficult in the case of private companies, partnerships or sole proprietorships, which are not required to publish such information, and so we rely increasingly on our customers to help in obtaining recent financial information on their buyers.



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