managing risk, enabling trade

market monitor

Adapting to the challenging economic environment

April 2010

Economic springtime for some after the long freeze

The extremely cold winter certainly hasn't helped the pace of economic recovery in some European countries, and especially so in the long suffering construction sector. But, as signs of springtime begin to emerge, so does some optimism about the prospects for 2010 – with Germany expected to register a growth rate of 1.7% (the highest growth rate in Western Europe) and the UK technically out of recession.

There are still plenty of April showers around, though, with restricted bank lending causing headaches for Spanish companies, corporate insolvencies in Ireland continuing their upward trend - the construction industry, not surprisingly, the worst affected sector – and Hungary struggling to reduce its debt burden.

'Austerity measures' is the buzz phrase for 2010. As political pundits debate the possible outcome of the UK's forthcoming general election, it's clear that, whichever party wins, it will inherit a huge budget deficit, and the need for further spending cuts, which could, in turn, hamper recovery.

Across the pond there's some good news, as Mexico basks in the economic sunlight from the upturn in the US economy. It may be a little early for a celebratory hat dance, though, as the government still needs to make major reforms to ensure long-term recovery.

In this issue…

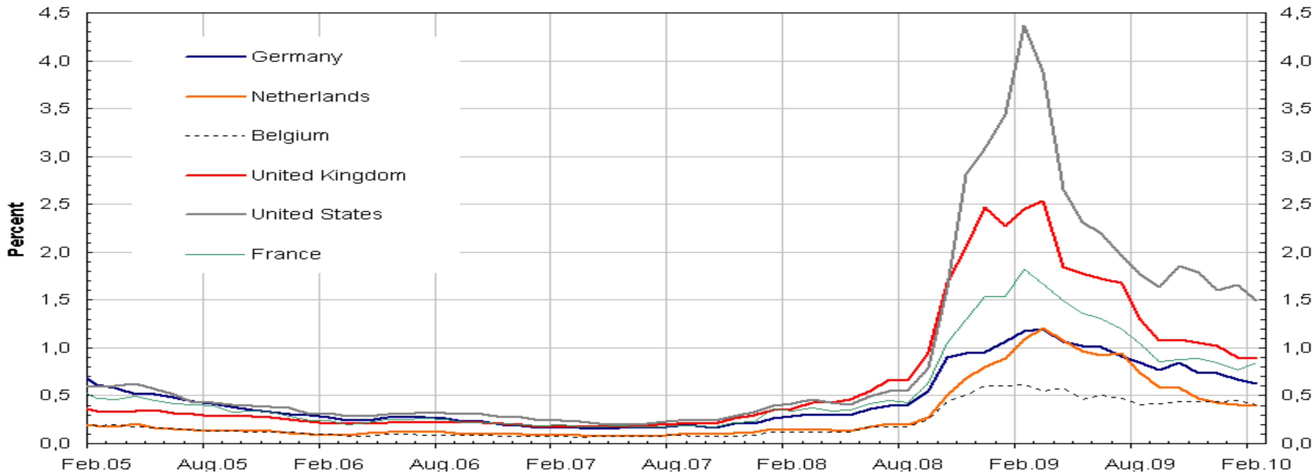
…we feature the following markets:

- United Kingdom – with a spotlight on the food and steel sectors
- Mexico – with a spotlight on the pharmaceuticals and construction sectors
- Germany
- Spain
- Denmark
- Ireland
- Hungary

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

In February 2010 the median EDF for some European economies showed some signs of stagnation after the generally improving trend that we have seen for several months. UK and Netherlands figures barely changed, while France recorded an 8 basis point increase, but its median EDF is still below the December 2009 level. Germany and Belgium registered modest decreases of 4 basis points- in the case of Belgium it has been the first (albeit modest) decrease since September 2009. Again the US recorded a double-digit decline of 17 basis points, and its median EDF is now below 150 basis points – the lowest figure in 18 months.

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

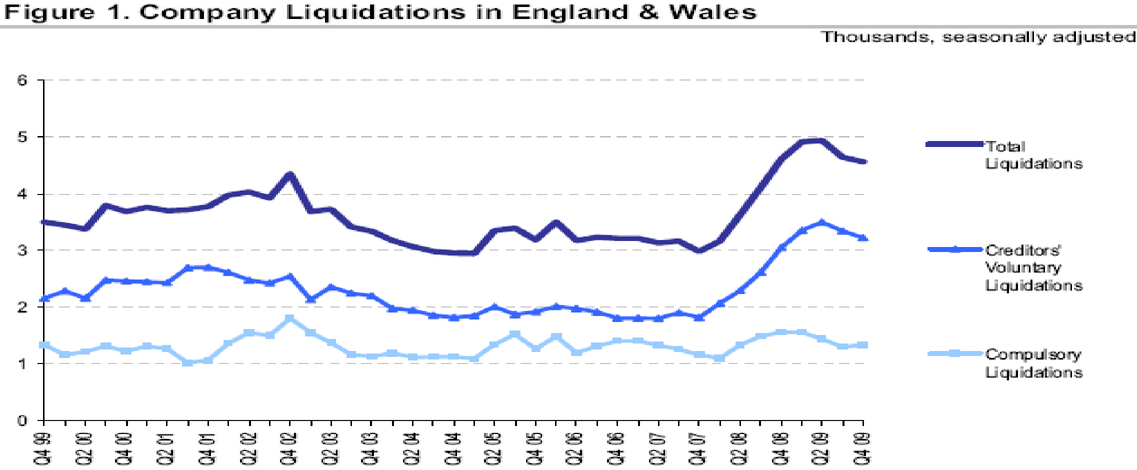
United Kingdom

Out of recession, but recovery remains fragile

With GDP growth of 0.4% in Q4 of 2009 (revised upwards from an original estimate of 0.1%) the UK has, technically, emerged from recession. But Britain's return to growth will be fragile, and forecasts for 2010 GDP growth vary between 1.2% and 1.4%. According to the Office for National Statistics manufacturing output rose 0.8% in Q4 of 2009, following its decline of 0.3% in the previous quarter. Construction output fell 0.9% compared to Q3, while services output increased 0.5%, with the strongest growth in the distribution, transport and business services subsectors. Unemployment has levelled off for the time being, and, for the period November 2009 to January 2010, it actually decreased 0.1% from the previous quarter - to 7.8%.

In 2009 there were 19,077 compulsory liquidations and creditors´ voluntary liquidations in England and Wales: a 22.8% increase year-on-year. However, the situation improved as the year progressed, such that, in Q4, there were just 4,566 company insolvencies: a decrease of 1.1% year-on-year and 1.7% compared to Q3 (see chart below).

Figure 1. Company Liquidations in England & Wales



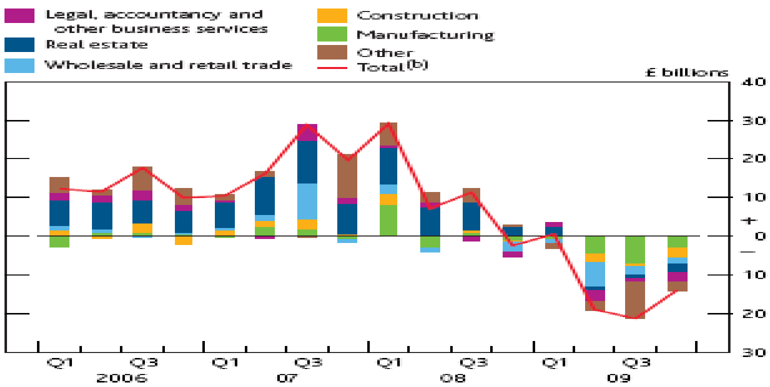
Source: Insolvency Service and Companies House

According to the upcoming Atradius Payment Practices Barometer - Winter 2000 (to be released end of April), some 74% of UK companies surveyed assessed domestic payment behaviour as "good" or better. On average, domestic payments took 27 days: just one day beyond the average contractual payment term. Payments from foreign business partners even took, on average, only 26 days. UK respondents assessed foreign payment behaviour as "good to very good". That said, the UK construction industry is still experiencing a relatively high volume of payment problems and these are expected to continue because of the prevailing economic conditions.

It is clear that the availability of credit has fallen considerably in the UK since the onset of the financial crisis. A number of foreign domiciled lenders have left the UK market, taking out a level of capacity, and UK banks clearly have a reduced appetite for lending: corporate lending figures for December 2009 show that lending by UK banks and building societies fell £4.3 billion. The twelve-month growth rate of the stock of loans fell to its lowest figure since 1999, and information from major UK lenders suggests that January net funding flows also remained weak. The decline in lending since Q2 of 2009 continued to be broad-based across all main sectors (see chart next page).

United Kingdom

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



Source: Bank of England

The value of syndicated loans granted in the second half of 2009 was less than half of that provided in the first half of the year and considerably below that provided between 2003 and 2007. There has been a trend, for larger companies with access to the equity markets, to use different methods of raising funds: notably, by raising cash from new equity to fill the void of reduced lender appetite. Smaller companies, without access to equity markets, have fewer options and, as a result, many face higher costs in servicing debt, with significantly increased bank interest rates and commitment fees.

Budget blues ahead

Economically, the most concerning issue currently is the drop in public finance. In 2009, the UK general government deficit ballooned to £159.2 billion - equivalent to 11.4% of GDP. In the run up to the general elections on May 6th, all major political parties have expressed their recognition that this deficit needs to be reduced, most likely through a combination of tax rises and government spending cuts. The major area of conflict between the parties is timing. The current Labour government believes that cutting too soon will stifle the delicate recovery, while opposition parties believe that cuts should start sooner. That said, it is generally accepted that, following the election, steps will need to be taken to address the deficit. Despite the recent budget, there is likely to be a second budget following the election. If there is a change of government, the new incumbent will want to rebalance the books with its own initiatives, and, even if the current government is re-elected, a comprehensive spending review planned for the summer may result in a second budget.

After the steep rise in 2009, we expect business insolvencies to decrease 5% year-on-year in 2010. However, there is still uncertainty about the extent of future budget cuts – including a decrease in government initiatives designed to assist companies - after the general election. Construction provides a good example of why the spectre of future spending cuts is so important. Construction sector output was approximately £ 120 billion at its 2007 peak. This is likely to decline to £ 80/85 billion due to the fall in building demand. As government expenditure makes up around 35-40% of spend in the sector, clearly any curtailment here would have a significant impact on the construction sector and overall UK GDP.

Food

How has the food industry performed since the beginning of the economic crisis?
As food is naturally a staple requirement with a characteristically short shelf life, demand has remained relatively robust throughout the downturn. While there was always the potential for consumers to move 'down market' to less expensive own-label brands to reduce their outlay, we have seen a smaller shift than assumed at the onset of the crisis, with certain branded products proving more resilient than expected. In addition, and following an easing of the unprecedented food price inflation seen in early 2008, a major challenge for the UK food sector is the weakness of Sterling. While this has made the UK market attractive to overseas buyers, it has also led to reduced local product availability for domestic consumption. As a result, imports have increased, and this has proved costly because of the adverse exchange rate.

What is the current trend in payment delays, payment default and insolvencies?
Overall, the number of insolvencies in this sector has remained quite low. However, despite its relative resilience, there are sporadic, and surprising, high profile casualties (e.g. British Seafoods). The strength of the sector and its solid revenue and cash flow streams has attracted private equity and, as such, there are many large players in the market with highly leveraged balance sheets that need to be closely monitored.

What should companies selling products into the food industry pay particular attention to?
They need to understand their buyers' market position, and recognise the balance of power in the food market. They need to ensure that service standards and deliveries can be met, if they are to build solid relationships with customers.

What is Atradius' short term (6 months outlook) for the food industry?
We expect a continuing relatively stable outlook for the sector. As with other sectors, it will remain highly competitive and, as we have seen over the past 18 months, there may be occasional corporate failures. However, again due to the relative stability of the market, we do not expect to see high volumes of insolvencies.

Steel

How has the steel industry performed since the beginning of the economic crisis?

The steel sector has been severely hit by the recession. Mid 2008 steel prices were high, following a period of sustained strong demand fuelled by robust global economic growth. However, at the end of 2008 and early 2009, steel prices fell (by mid 2009, European flat product prices were down 47% from the summer of 2008) and demand almost completely dried up. Two of the major end users of steel are automotive and construction, and both sectors fell victim to the recession, with an immediate and serious impact on the steel sector. All areas within the steel sector were affected, with major global manufacturers experiencing a sudden fall in demand and significant price reductions. Steel stockholders were also hit hard, finding themselves over-stocked with over-priced steel - a double blow. The recognition of reduced demand resulted in a period of destocking in the first half of 2009, which again had a significant impact on steel producers. However, the steel channel boosted working capital and cash flow by reducing stocks, albeit often at written down values. While demand has recovered somewhat, it is still below recent peaks, but there are positive signs of restocking, together with some recovery in prices.

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

At the end of 2008 and beginning of 2009 - at the height of the problems in the sector - we were notified of high levels of non-payment. There was clearly an understanding that companies in the sector would require more time to pay for steel for which demand had fallen so significantly and so quickly. Unfortunately, some players in the sector did not have the financial wherewithal to manage their way through the downturn, but now the sector appears to have settled and the number of non-payment notifications has fallen.

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

Steel has many uses, and some areas will remain subdued while others are likely to see some improvement. The automotive industry remains difficult and, with car scrappage schemes coming to an end, there are concerns that 2010 sales will suffer as a result of the scrappage schemes of 2009 and early 2010. Large publicly funded projects are also likely to come under pressure as the UK and many other governments reign in their large budget deficits. Pockets of stable growth include utility and energy markets, where regulatory spending demand continued investment from which steel will benefit. The 2012 London Olympics will also contribute significantly to demand for steel.

What is Atradius' short term (6 months outlook) for the steel industry?

Many companies in the sector have survived the severe downturn through efficient and prudent management. As the market settles at new levels of demand, we anticipate insolvencies and notifications of non-payments to decrease, but remain cautious, as demand from key end markets like construction remains subdued. According to Eurofer, activity in the EU steel-using industries will increase 0.6% this year, but construction, with a 27% share of steel consumption, will decrease 1.3%.

Mexico

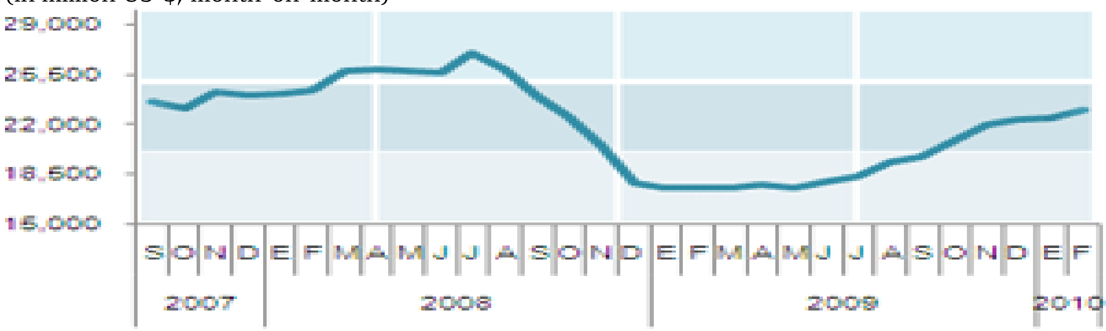
A strong rebound in 2010

Economically, 2009 was a disastrous year for Mexico, with the highest GDP contraction in almost eight decades (-6.8%). Nevertheless, 2010 will be a better year, with both the IMF and Economist Intelligence Unit expecting GDP to grow between 3% and 4%, while other optimistic forecasts are for an increase of between 4% and 5.5%, thanks to the expected strong rebound of US economic performance and of domestic consumption and investment.

With Mexico's high dependence on demand from the US, the recent good news about the US economy – in particular, the increase in discretionary spending by US consumers - is a very positive sign, especially for companies located at the US border – the so-called "maquiladoras" - many of whom had had to suspend production over the past 18 months. Exports have picked up again since autumn 2009 (see chart below).

Mexican exports

(in million US-$, month-on-month)



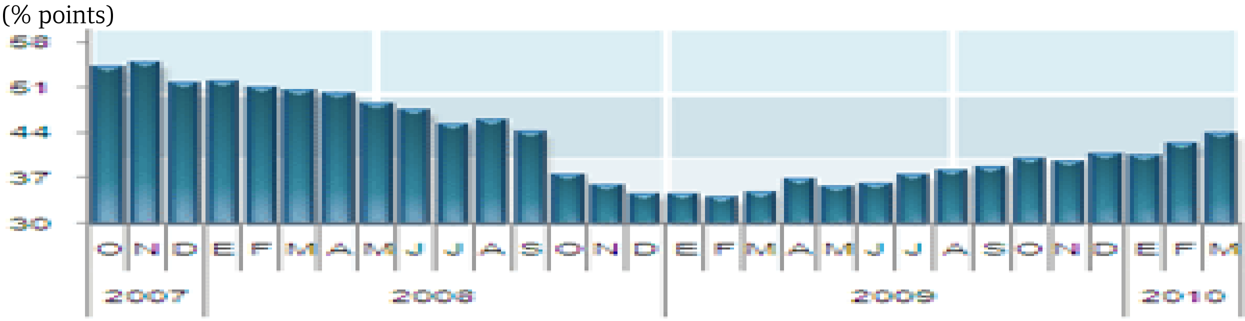
Source: Mexican Statistics Office

The Mexican stock exchange index is tracking the Dow Jones, gaining 5.2% by early April, and as much as 12.7% when related to the US-$. The Mexican peso has regained some strength against the US-$ (5.54% in Q1 of 2010: its best development in any first quarter), making it currently one of the best performing currencies in Latin America. For 2010, the peso to US-$ exchange rate is expected to be MXN 12.8 to the US-$ (13.8 at the beginning of the year). Even though the Central Bank is selling options for US-$ 600million, reserves remain high, at US-$ 95.7 billion, which, together with expectations of increased foreign investment and actions by the central bank, is helping to further strengthen the peso.

The nominal interest rate is 4.50% - down from 8.25% in December 2008 - and the central bank has confirmed its intention to keep interest rates low in 2010 to support the recovery. However, future monetary policy will obviously depend mainly on growth and inflation, with the latter expected to increase to more than 5% in 2010. Despite the low key interest rates, banks are still reluctant to lend, restricting financing options for businesses and making loans expensive. For SMEs in particular, but also for some larger companies, obtaining bank credit or new credit lines, or even renewing existing credit lines, is a struggle. In most cases, strict covenants are added and securities demanded. In general, even large and healthy companies cannot obtain credit for less than 10% interest, and SMEs, if they manage to get credit at all, will probably pay over 20%. Currently, only 23.7% of companies have bank loans to finance their activities (17.2% of SMEs and 46.7% of large corporations). That said, business confidence in the manufacturing sector has increased in recent months (see chart below).

Business confidence indicator manufacturing sector

(% points)



Source: Mexican Statistics Office

In the last 10 years, only 360 companies filed for insolvency, of which16 happened in H2 of 2008, 21 in H1 of 2009 and 26 in H2 of 2009. 55% of these filings were made by the companies themselves while 45% were involuntary. One of the reasons why there are so few filings for insolvency is the time it takes for the initial case to become an official bankruptcy – or to be rejected: an average of 219 days – over 7 months. Moreover, business failure is not the problem: the main reason for non-payment in Mexico is protracted default, not insolvency.

Structural reforms necessary for long-term growth

When viewing the short-term recovery in 2010, it needs to be borne in mind that, in large part, this will be the result of inventory replenishment and therefore not sustainable in the long-term. We therefore expect growth to slow in 2011 – to around 3%. That said, long-term growth could improve if the Mexican government were to introduce the necessary reforms to make companies more competitive and productive (e.g. labour reforms), support internal demand and overcome structural weaknesses of its public finances. Mexico is highly dependent on the energy sector and oil price development, as oil accounts for about a third of fiscal income. The lack of sufficient reforms in that sector (such as permission for the state-owned oil company Pemex to co-operate with private foreign investors for joint exploration) is also causing problems, as reserves are depleting and Mexico does not have the technology to search for oil in deep offshore areas.

Mexico's tax base is very narrow, with limited government revenues. The growth of the black economy since the end of 2008 has made this problem worse. The new VAT, introduced in January, has been very unpopular and is already being reconsidered, as many consumers are turning to the black economy to avoid the tax.

There is also growing insecurity arising from the government's battle against the organised drug mafia. Drug trafficking, kidnapping, robberies and killings have increased in the last two years, especially in the areas bordering the US, and are increasingly hampering the economy.

Pharmaceuticals

How has the pharmaceutical industry performed since the beginning of the economic crisis?
We consider the pharmaceutical industry to be one of those least affected by the economic crisis. The swine flu outbreak in 2009 actually improved sales volumes and profitability margins for many companies in this sector.

What is the current trend in payment delays and payment defaults?
We expect this sector to keep on performing well, simply because it has fared well throughout 2009's economic turmoil, as evidenced by our healthy claims experience.

What should companies selling products into the pharmaceuticals industry pay particular attention to?
For sales to Mexico we would always recommend a promissory note (Pagaré), which is usually easy to obtain and makes recoveries much simpler, especially when the supplier is based abroad and the debt is in foreign currency.

What is Atradius' short term (6 months outlook) for the pharmaceuticals industry?
Growth is expected to slow down, with a forecast of 7.1% year-on-year growth in 2010 compared with 9.8% in 2008-2009. Pharmacies are now selling other consumables unrelated to healthcare to compensate for a lack of sales.

In the long-term, pharmaceutical companies will be challenged by the growth of the market in generic products, over the counter drugs and 'similar' items that will eventually cause a slowdown in sales of the main brands. For the time being, these new products still play only a minor role, with an expected 5% market share in 2010. However, patients are increasingly turning to this market as it is so much cheaper than patented products. The annual growth rate of generic products is expected to be 23.9% between 2009 and 2010.

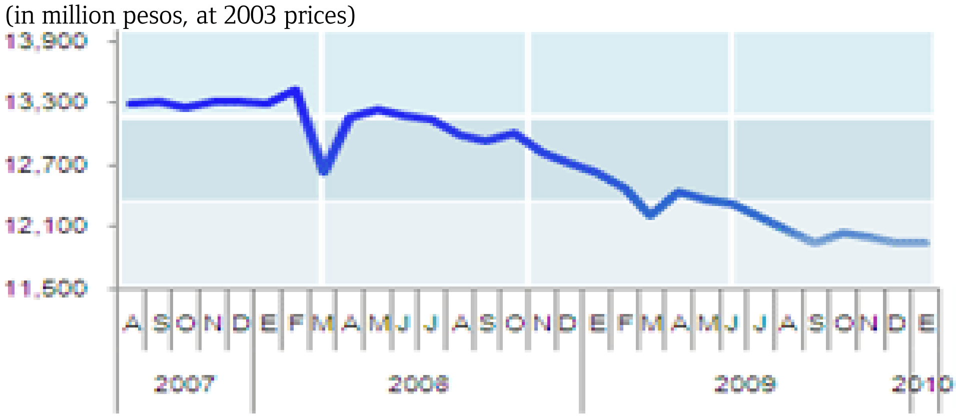
Construction

How has the construction industry performed since the beginning of the economic crisis?

Declining employment, increasing interest rates and, especially, the tightening of credit have caused a 42% drop in housing demand. The credit crisis severely diminished the ability of contractors to raise long-term capital to finance infrastructure projects. Construction output suffered 18 months of constant decrease up to the end of 2009, with the production value generated by this sector decreasing 5.3% year-on-year (see chart below). In January 2010, production decreased 0.11% year-on-year, even though employment increased by 0.77%. However, in contrast to the housing construction subsector, those engaged in infrastructure construction reported favourable results at the end of 2009.

Production in the construction sector

(in million pesos, at 2003 prices)



Source: Mexican Statistics Office

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

The public sector plays an important role in the construction industry. Therefore, it is vital to obtain details of the projects that your products will be involved in: such as the final client, duration of the project and payment terms. Additionally, it is important to obtain the most recent financial information (2009 audited accounts with notes and Q1 of 2010) as well as a promissory note – Pagaré – from buyers of this sector.

What is Atradius' short term (6 months outlook) for the construction industry?

Compared to 2009, expectations for the construction industry for 2010 are positive, with expected growth of 2.3% that would represent 1.2% of the GDP.

Growth rebounds after a winter of stagnation

After a short period of economic stagnation end of 2009 (partly due to adverse weather conditions) Germany has returned on its path to recovery. According to the Federal Ministry of Economics, manufacturing recorded a 5.1% month-on-month increase in new orders in January 2010, and this level remained unchanged in February. Especially foreign orders rose, as German exports increasingly profit from a weaker Euro exchange rate: according to the Federal Statistical Office, German exports increased 9.6% year-on-year in February 2010. That said, private consumption remained weak in the first two months of 2010. The OECD forecasts German growth to increase 0.7% in Q2 of 2010 compared to Q1. Overall, Consensus Economics estimates German GDP to grow 1.7% this year.

The Ifo business climate for industry and trade rose steeply in March 2010, by 2.9 to 98.1 points: nearing its level of summer 2008. Both the current business situation and future indicators have again improved on previous months. According to Ifo-survey responses, manufacturing companies recorded a definite rise in demand and an expansion of production. This trend is expected to continue in the coming months. The outlook for wholesalers and retailers alike has also improved after its dip in February, with respondents from both sectors reporting a lessening of the pressure on inventory. Contractors in the construction industry are quite optimistic about the next six-months´ business outlook. Construction output and the rate of equipment usage increased, with only some 30% of the surveyed firms dissatisfied with their order stocks. In the service sector, firms expect turnover to increase in the near future.

According to the German Statistics Office, the number of corporate insolvencies increased 11.6% year-on-year - to 32,687 - in 2009. The courts estimate the value of expected outstanding receivables to be Euro 85 billion (2008: Euro 33.5 billion), due mainly to the increase in large company insolvencies (notable cases include Arcandor, Escada and Schiesser). Despite the increased momentum of Germany's economic recovery, we still expect corporate insolvencies to rise by 10% in 2010 compared to 2009, with automotive suppliers, metals/steel, transport and engineering the main victims. In contrast, insolvencies in ICT (information and communication technology) and chemicals will probably stabilise. While further large insolvencies cannot be ruled out, we expect a lower figure of large company failures than in 2009, with the consequence that the value of outstanding receivables will decline considerably.

In February 2010, the Expected Default Frequency (EDF) indicator for listed companies in Germany dropped again from the previous month: by four basis points, to 63 points (see chart page 2). This was 54 basis points lower than in February 2009, but still 34 points higher than in February 2008, i.e. before the credit crisis took hold.

According to the upcoming Atradius Payment Practices Barometer - Winter 2010 (to be released end of April) average payment terms of German companies have reduced further to 19 days, a clear sign that suppliers have tightened their credit management in order to protect their liquidity. For domestic sales, the average payment took 22 days, an average delay of 3 days past due date. Payments from foreign business partners took, on average, 25 days in the winter of 2009/10, 6 days longer than the average contractual term of payment.

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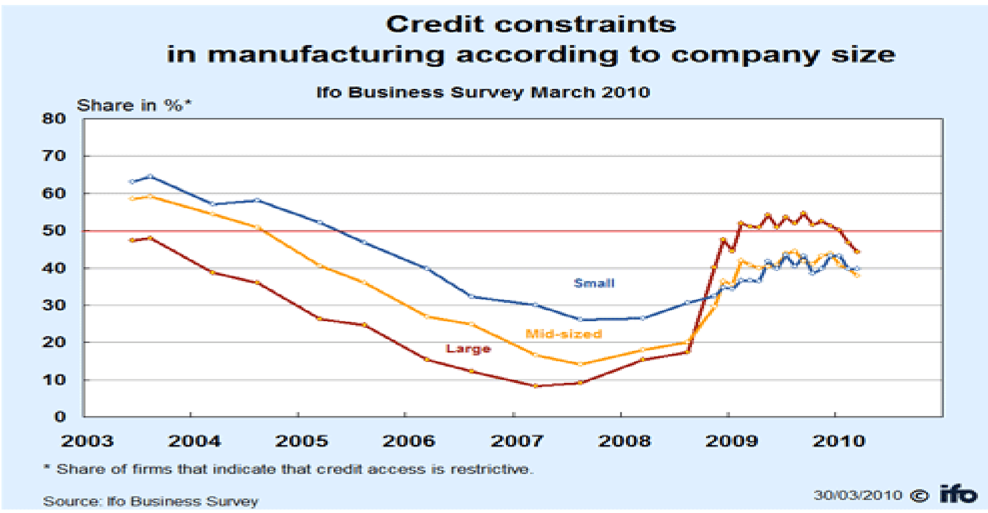
An easing of credit conditions on the horizon?

According to the monthly Ifo institute Credit Constraint Indicator, in March 2010 38.7% of firms assessed banks' lending policies as restrictive, 1.2% less than in February 2010 and 5.6% less than in December 2009 – indicating that it has become easier for German businesses to obtain loans in recent months. However, the proportion of complaints from the construction sector about difficult access to bank loans increased, while remaining largely unchanged from small manufacturers (see chart below).

Share of firms that indicated that credit access is restricted

	03/09	04/09	05/09	06/09	07/09	08/09	09/09	10/09	11/09	12/09	01/10	02/10	03/10
Industry and Trade	42.0	41.6	42.9	42.4	45.1	44.2	43.7	41.7	42.9	44.3	42.4	39.9	38.7
Manufacturing Firms:													
large	51.1	50.9	54.2	50.9	53.6	51.8	54.5	51.5	52.5	51.2	49.9	46.7	44.3
medium-sized	40.8	39.9	40.4	40.7	43.8	44.5	41.7	40.8	43.3	43.7	40.8	39.7	37.8
small	36.6	36.5	41.8	39.7	43.5	40.4	43.2	38.3	39.6	43.2	43.1	39.7	39.6
Construction	46.5	45.4	47.2	45.5	47.0	46.5	46.5	47.1	47.4	50.6	47.8	42.7	44.6
Trade	39.0	38.9	38.9	39.9	42.5	41.7	39.9	37.6	38.6	40.0	38.5	36.8	35.0

Source: Ifo Business Survey



In general, it seems that business lending conditions have gradually eased since our last Market Monitor report three months ago. Thanks to new issues in recent months, the securitisation market, which is pivotal for banks´ refinancing and equity relief, has been revived, albeit on a lower level than before the credit crisis. Worries voiced six months ago - that banks will cease to support many of the less promising or more cumbersome companies' restructuring with additional liquidity - have not materialised. In most restructuring cases, banks have continued their support, as overdraft have been turned into secured credit lines and loans from the state-owned KfW banking group have been included.

Despite signs of a slight relaxation in the German credit market, it is still too early to talk of a turnaround. In particular, in the sectors mainly hit by the crisis, a large number of small and medium-sized enterprises still complain of difficulties in accessing loans. In its latest survey of German banks´ lending to domestic businesses, the Bundesbank expects new lending to be higher in 2010, but it remains to be seen if the volume of loans will be enough to satisfy increased business demands for finance triggered by the economic recovery. Thanks to active and prudent working capital management, many companies have closed the business year 2009 with a positive cash flow, and their demand for credit will be much higher this year, particularly as sales rebound. At the same time, businesses have yet to disclose their 2009 annual accounts to their banks, which, especially in troubled sectors, will be negative or even worse than in 2008. Therefore, it still remains to be seen how banks will respond to the deterioration of many borrowers´ ratings. Tighter equity regulations for banks could restrict their lending in cases where a company's creditworthiness has diminished, but it is hard to predict at the moment whether banks will limit lending based on borrowers' past performance or take a more forward looking approach based on improved business expectations in 2010.

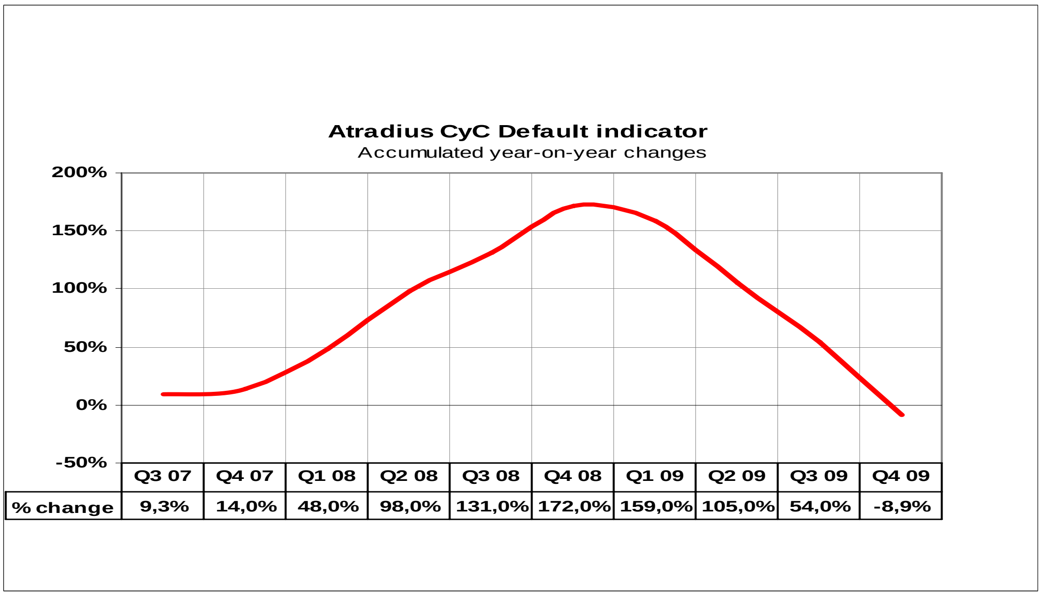
Overall, continuing restrictions on lending cannot be ruled out, and this would probably hamper company investments. However, there is a trend of banks adopting different options to help companies, e.g. by providing loan renewals and extensions coupled with additional collateral, and by offering suspension of interest and repayments for a stipulated period instead of 'new' money.

Spain

Decreasing payment delays

The Spanish economy continues on its gradual, if slow, path to recovery. Although the main indicators of economic activity and employment remain negative, the downturn has slowed since the third quarter 2009. According to the National Statistics Institute, in the last quarter of 2009 GDP contracted by just 0.1% quarter-on-quarter compared to 0.3% in Q3 and 1.1% in Q2, signalling a possible end to technical recession in the coming months. While household consumption suffered a 5% year-on-year decrease in Q3 of 2009, it improved by 0.3% in the last quarter compared to Q3 – due mainly to fiscal stimulus. A persistent problem is high unemployment. Although the increase has softened in recent months, it is still very high - at 18.8% - and will remain so for the near future. To tackle the structural deficiencies in the labour market, the government now plans labour reforms. Another major impediment to Spain's recovery is the extremely high public deficit - 11.4% of GDP in 2009, - the result of rising expenditure on unemployment benefits and anti-crisis measures.

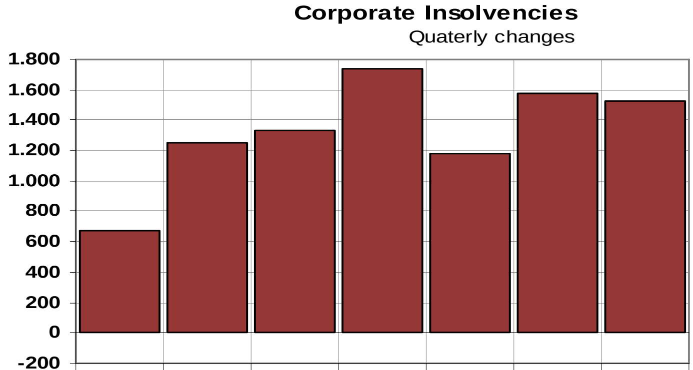
Nevertheless, since our last Market Monitor analysis in January, we have seen indications of a changing pattern of payment delays by Spanish companies. In the last quarter of 2009, the median of payment default decreased 8.9% year-on-year, according to the Atradius Crédito y Caución Default Indicator. This is the first year-on-year decline since the beginning of the economic crisis, although it should be borne in mind that, since payment defaults had reached their peak in Q4 of 2008, the default rate is still high (see chart below). Despite this fact, the decreasing trend continues.



Source: Atradius

Corporate insolvencies decrease, but remain high

Spanish companies still tread a perilous path because of the adverse insolvency environment. However, our data, based on figures published by the Official State Gazette (Boletín Official del Estado), show 1,530 business failures in Q1 of 2010 - 2.9% less than the previous quarter and lower than the insolvency peak in Q2 of 2009 (see chart below).



	Q3 08	Q4 08	Q1 09	Q2 09	Q3 09	Q4 09	Q1 10
Total	678	1.249	1.335	1.741	1.180	1.576	1.530
% change	12,0%	84,2%	6,9%	30,4%	-32,2%	33,6%	-2,9%

Source: Atradius

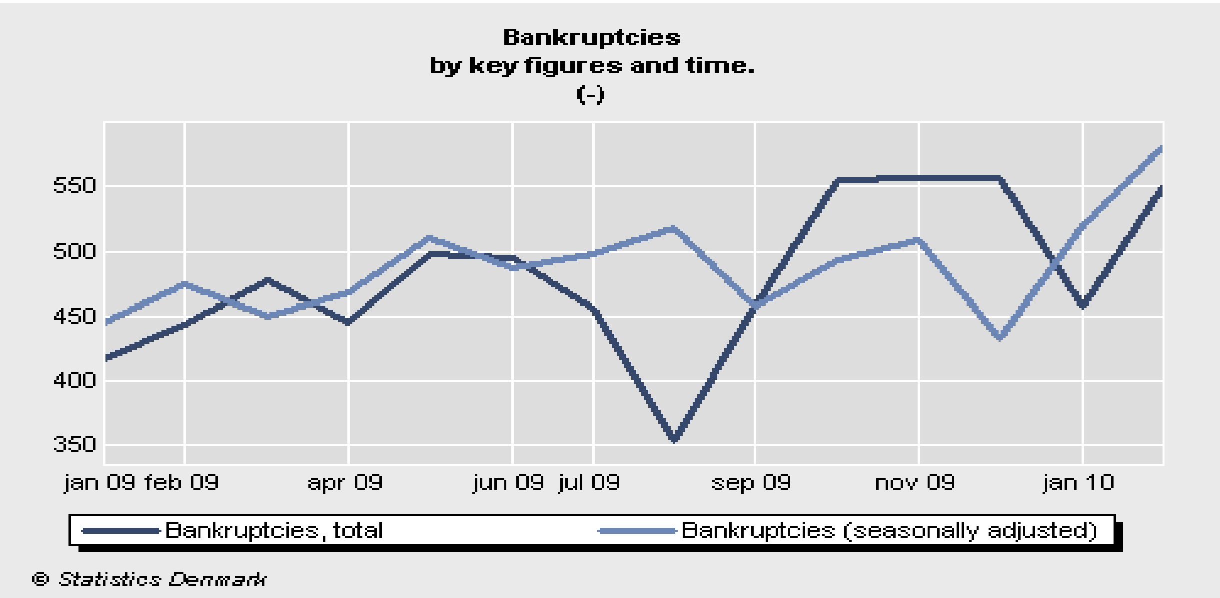
In February 2010, the Expected Default Frequency (EDF) indicator for listed companies in Spain dropped by one basis point from the previous month, but is still higher than in the period July 2009 to January 2010, during which the median EDF of most European major economies decreased significantly. The current Spanish EDF levels remain more than twice as high as in the summer of 2008, indicating continued elevated default risk among listed companies.

Restricted access to bank loans prevents many Spanish companies from financing their current assets and improving their overall financial situation. This is a major cause of many insolvencies, which in nine out of ten cases end in company liquidation, and this situation will persist as long as access to credit remains restricted. According to the European Central Bank, of all the major economies of the eurozone, Spain has the highest rate of refusal of SME loan applications, and the Bank of Spain has reported that new bank loans to business decreased 28% year-on-year in January 2010.

Rising insolvencies despite recovery

As a small open economy, Denmark has understandably felt the force of the global crisis on its business environment. In 2009, GDP contracted 5.1% and private consumption shrank 4.6%, and, in January this year, unemployment shot up to 4.2%. At the same time, Danish exporters witnessed a loss of their share of a declining global market. That said, Denmark officially emerged from recession in Q3 of 2009 (with 0.4% GDP growth), and in Q4 the trend of minimal but still positive growth continued (0.2% growth). The slow and fragile recovery continued in the first months of 2010, and job losses in the Danish manufacturing industry appear to have come to a halt. In February 2009 unemployment decreased slightly to 4.1%. Record-low interest rates and a reduction in personal taxes for many Danes are also taking effect, with private consumption finally starting to pick up pace, as consumers start to again buy cars and other consumer durables, and companies are generally more confident.

However, for many businesses, this change of sentiment has come too late. After corporate insolvencies increased 52% year-on-year in 2009, bankruptcies have not returned to their pre-crisis level, and in fact have risen again in the first two months of 2010 (see chart below). Seasonally adjusted figures for February 2010 show an all time high of 581 registered bankruptcies, and this figure does not take into account the large number of smaller bankruptcies, where creditors have not launched legal proceedings as there is little possibility of recovering their debts.



Blame for both the high number of bankruptcies and the minimal growth has been directed towards the banks. Many Danish banks were overexposed to the booming construction/property sector and have therefore had problems with a poor loan book. Fortunately, the banking sector received strong support from two government-aid packages: the first offering an unlimited, temporary guarantee for deposits in Danish banks, and the second giving banks the opportunity to raise subordinated loan capital from the Danish state for a period of 2 to 3 years. Despite this, a number of small and medium-sized banks have had to file for bankruptcy, and have been taken over by a state-owned special purpose vehicle to manage their dissolution.

The payment patterns of Danish companies have changed, especially in the manufacturing sector. The increased focus on liquidity has meant that quite a few large and medium-sized companies have contacted their suppliers and informed them, in so many words, that “due to internal adjustments, we are now changing from 30 days credit terms to 60 days. We count on your continued co-operation and intend to make this change from next month”. There seems also to be a tendency for companies that used to pay on due date to delay paying their suppliers until they receive payment from their own customers. Consequently, companies that had always in the past paid on time will now pay a week later to avoid using their own bank facility.

Still a long way to go

Denmark is paying a high price for the crisis, as the very large public surpluses of former years have suddenly turned into a public budget deficit of 3% in 2009. In 2010 this deficit could reach 6%. And, while public deficits mushroom, GDP growth for 2010 (0.9% expected by the International Monetary Fund) will remain low compared to most other EU countries. While this does not give rise to optimism, fortunately it seems that most Danish companies have done a good job of adapting their structure to the new business environment. As a result, most companies feel confident that they have emerged from the crisis in good shape. The challenge - for Atradius and for suppliers - is now to identify the companies that have not made the transition: and many companies are still in danger.

After the major rise of 52% in 2009, we expect corporate insolvencies to increase 8% this year. In February 2010, the Expected Default Frequency (EDF) indicator for listed companies in Denmark increased slightly, by 6 basis points, to 90. This is 72 basis points lower than at its peak in March 2009, but still 70 points higher than in August 2008, i.e. before the start of the credit crisis.

Ireland

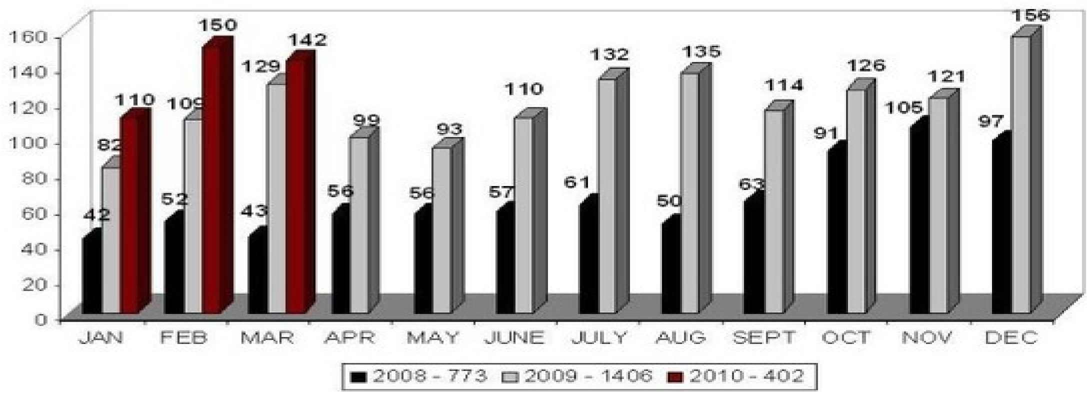
Insolvencies continue to rise

The last months of 2009 brought no relief to the Irish economy. According to the Irish Central Statistics Office, GDP declined 7.1% year-on-year and unemployment was 13.1% in 2009. In Q4 of 2009, consumer spending decreased 5.2%, capital investment declined 28.2% and the volume of industry output decreased 6%, with construction showing the sharpest fall (32.3%). Output of distribution, transport and communications fell 7%, and, of other services, output was 2.3% lower than in Q4 of 2008. That said, the Bank of Ireland noted, in their latest research, that Ireland outperformed most European states in its export performance in 2009. Net exports increased by Euro 2,042 million year-on-year in Q4 of 2009, and export orders are still rising.

According to AIB Global Treasury, house building has continued to decline, with just over 2,000 new registrations in the three months to February 2010, at a seasonally adjusted annualised rate, compared to 7,000 at the beginning of 2009 - and over 70,000 at the height of the housing market boom. This fall in new building will assist with the disposal of the surplus stock of unsold accommodation that built up over the boom years.

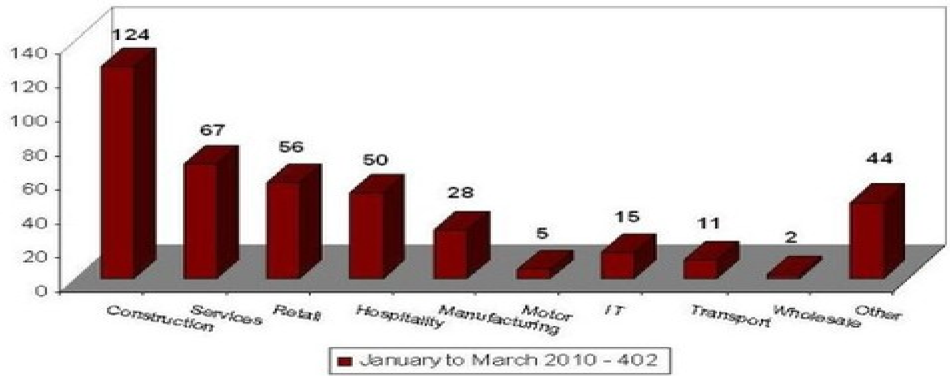
House prices continue to fall, albeit at a slower pace than in the past. According to daft.ie (the Irish property website), the average nationwide asking price of a house was slightly below Euro 235,000 in the first three months of 2010, down one third from the peak of early 2007. The decrease in the first quarter of 2010 was 3.4%, the smallest quarterly decline in almost two years. Year-on-year, the fall in the first quarter of 2010 was 18%, a slight decline on the record year-on-year fall of 19% in the third quarter of 2009. In contrast, motor sales recorded a year-on-year increase of 31.15% in Q1 of 2010, rising to 42,554 units – total unit sales for 2009 were 57,460. Similar increases are noted in the sales of light commercial vehicles – up 42.87% to 4,976.

In the first quarter of 2010 corporate insolvencies continued to rise; by 25% year-on-year, to 402 cases (see chart below). Annualising this figure, we can expect an increase this year of at least 16% on the 2009 figure unless the business environment for Irish companies improves in the coming months.



Source: Insolvency Journal

It comes as no surprise that construction suffered a further increase and accounts for most of the failures, followed by services and retail, both of which were affected by consumer restraint (see chart below).



Source: Insolvency Journal

Massive support for the troubled financial sector is underway

In March 2010 the start of the transfer of 'bad loans' from troubled Irish banks to the National Asset Management Agency (NAMA) began. It is expected that up to Euro 80 billion of loans will be purchased by NAMA by the end of the year, with average discounts of up to 50% on the loan value. NAMA will acquire around 14,000 loans, with the 100 largest borrowers accounting for 50% of the portfolio. About 67% of NAMA's 'assets' are based in the Republic of Ireland and 27% in the UK. 43% of these 'assets' are land, 26% development and 31% commercial properties. As, currently, access to bank credit is very difficult, it is hoped that, following the transfer of the 'assets', banks will begin the process of lending to businesses to spur the recovery. Anecdotal evidence suggests that late payments will continue to be an issue until companies get access to working capital from banks.

Ireland's fiscal deficit was 11.7% of GDP in 2009, so fiscal consolidation has become of paramount importance. To stabilise government finance and restrict the massive increase in public debt, tough austerity measures were introduced at the end of last year, including harsh public service pay and social welfare payment cuts. The aim is to cut the deficit by more than a half, to 4.9%, in 2013. Experts' comments on the budget are generally favourable, with some commentators suggesting that this approach to controlling national debt should be used as a blueprint by other struggling EU economies in Southern Europe.

There are tentative signs that the worst is over and that the overall economy will rebound in the second half of the year. The rate of job losses has slowed in the first months of 2010, and manufacturing industries recently showed some signs of improvement: according to the Irish Central Statistics Office, industrial production increased 13.7% year-on-year in February 2010. The seasonally adjusted turnover index was 4.3% higher in the period December 2009 to February 2010 than in the preceding three months period.

Hungary

Some stabilisation after a deep recession

After years of private and public sector overspending, resulting in strong GDP growth, but also in high twin deficits, the economy has fallen into deep recession. The sharp drop of the forint at the end of 2008 increased commercial credit risks, as the debt service burden for heavily euro-indebted household/corporate/public debtors rose steeply. A massive standby package of US-$ 25.8 billion, from the EU and the IMF, was introduced to shore up the forint and the strongly eroded international reserves. In the second half of 2009 the forint exchange rate recovered, and the government supported a shift to forint-denominated loans, but the foreign currency loan stock still represents a significant risk.

In 2009, GDP contracted 6.3% as domestic demand-oriented sectors were hit by budgetary tightening and industrial exports suffered as a result of the economic meltdown in the eurozone. However, IMF-monitored fiscal consolidation led to a reduction in the budget deficit from a record 9.4% of GDP in 2006 to 3.9% of GDP in 2009, as the government introduced further austerity measures, curbing public sector spending even more and raising taxes - especially VAT.

The construction sector is still under considerable strain, with a fifth consecutive year of contraction expected, due to falling demand coupled with tightened conditions for project financing. The steel and automotive sectors have fallen victim to the worldwide decline in demand, and consumer electronics has been severely hit by the reduction in consumer spending. All these industries are still considered to be high risk sectors in Hungary.

In 2009, Hungarian companies suffered from banks' reluctance to provide credit. Generally, banks were very cautious in their lending: withdrawing cover, increasing prices, and imposing stricter conditions. Besides the economic crisis, the main reasons for this were historically low savings and increasing financing costs. The construction sector and SMEs have been particularly affected by loan restrictions, although, in the last six months, we have seen that, with growing economic stabilisation, banks have increased their lending and eased conditions.

Recovery expected in the second half of 2010

Payment delays are prevalent in all sectors, with even public buyers such as municipalities and ministries paying late. Generally, the number of non-payments increased in 2009 because of the crisis - and the overall trend is still negative. However, a slow improvement is likely in the second half of the year.

According to Creditreform, corporate insolvencies increased 29.3% year-on-year in 2009 - to 14,637. This trend has continued into 2010, with more than 4000 registered in the first quarter. We expect a further increase this year, with construction, food, consumer durables, IT, and retail sales mainly affected.

Hungary

The economy may well bottom out in the first quarter or half year of 2010, and experts predict a slow recovery in the second half of the year. For the whole of 2010, GDP is expected to contract between 0.5% and 1%. Tight fiscal discipline is necessary to keep the budget deficits under control, and austerity measures will continue to curb domestic demand. After the general elections on April 11 we do not expect the new centre-right government, under designated Prime Minister Viktor Orbán, to radically change the course of the economic policy: with the strict criteria for the economic policies - permanently monitored by the IMF - and the need for positive investor sentiment, the new administration has little room to manoeuvre.

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