Escalating crisis having an impact on Europe

NUREMBERG, GERMANY: Faced with the ongoing debate about a Greek bailout and the worsening debt crisis in France and Italy, European consumers are noticeably unsettled once again.

This is one of the findings of the *GfK Consumer Climate Europe* survey which provides an overview of the development of economic, price and income expectations and willingness to buy among consumers in Austria, Bulgaria, the Czech Republic, France, Germany, Greece, Italy, Poland, Portugal, Romania, Spain and the UK. These 12 countries account for around 80% of the total population of the 27 EU member states.

While in spring most countries in the European Union were optimistic that the crisis would be overcome in the foreseeable future, there has been a considerable change in sentiment over the summer. In the second quarter it appeared that the recession had bottomed out in Europe, as the economies of most European countries started to recover from the deepest recession since the Second World War and economic results in many countries returned to a slight upward trend for the first time. However, debates on further aid and loan guarantees for Greece severely unsettled European consumers once again this summer. As a result of their high level of debt, Italy and France are at risk of having their credit ratings downgraded by the major rating agencies. Economic growth in the major European countries is not as strong as experts had predicted in spring. Only Germany is still registering extremely good economic results, but even here growth expectations have recently markedly declined.

For the continued economic recovery of the European Union it is essential that the individual countries reduce their debt levels quickly and with lasting effect. How the EU tackles the Greek crisis in the coming weeks and what cost this generates for individual countries will certainly be a decisive factor in whether and how fast European consumers start to believe in the economic recovery of Europe again.

Economic expectations: UK fighting for economic recovery

Since June, economic expectations have more or less collapsed in almost all the European countries included in the survey, with the most marked declines recorded in Germany (from 50.3 to 4.8 points), Austria (from 19.6 to -26.2 points) and France (from -15.3 to -42.2 points). The only countries able to evade this trend to a certain extent were Poland (from -13.9 to -10.2 points), Bulgaria (from -10.8 to -15.3 points) and Romania (from -26.2 to -32.8 points).

In the UK, economic recovery has been significantly slower and more variable than in the two previous recessions between 1979 and 1981 and 1990/91. In the second quarter, economic growth was up 0.7% in comparison with the prior year. The tsunami in Japan was one of the reasons that a higher level of growth was not achieved, with vehicle imports in particular affected by the disaster. The British government's austerity measures are slowly starting to have an impact and public spending has been reduced to almost zero, although this is having a negative effect on economic growth. Low economic growth is also attributable to the increased thrift demonstrated by British consumers in recent weeks and months. Higher rates of inflation, negligible salary raises and increased unemployment all mean that consumers do not currently hold an optimistic view of the future. In September, the International Monetary Fund made a downward correction to the UK's predicted economic growth from 1.5% to 1.1% and also revised the outlook for 2012 by 0.7 percentage points to 1.6%. Development of the economic expectations of UK consumers followed a similar trend. After a recovery from the low in April to -17.4 points in June, the indicator once again dropped in the last few months and now stands at -29.7 points.

Greeks have lost all confidence that economic recovery will occur in the foreseeable future: economic expectations reached a new record low of -58.7 points. A lower value has only been recorded once, in December 2010, when the indicator stood at -59 points. Greece's economic performance declined by 5.5% in the second quarter of this year and a similar figure is anticipated for the year as a whole. Public spending has continued to rise and consequently put any plans proposed by the EU and International Monetary Fund to help Greece overcome the crisis at risk. Greece's government has a deficit of around 9% at present and more than one in every six Greeks are currently unemployed, a statistic which is expected to rise to one in five by the end of the year and, by 2012, to one in four. Contributions to the national budget have fallen spending has risen and measures such as liberalisation and privatisation of the economy and reduction in civil servants are not being implemented quickly and forcefully enough by the Greek government. Public enterprises and state authorities that are surplus to requirements have not been closed and agreed cuts have not been executed. By the end of the year, the government deficit will in all likelihood have risen to more than 8.6% of GDP. In light of the high level of unemployment and increasing taxes and contributions, consumption is also not bolstering the economy because Greeks are currently only making essential purchases. An additional major problem is low productivity and an extremely high deficit in the combined current and capital account. It remains to be seen whether Greece is able to recover with the help of the EU and the International Monetary Fund. At present, anything is possible and a great deal of time, patience and money will continue to be required from the "euro rescuers" in order to keep Greece in the currency union, should the desire to do so remain.

In contrast, Bulgaria has successfully remained on a positive path and registered economic growth of around 2% in comparison with the prior year. This growth has primarily been driven by export activities and the tourism industry, which created many jobs over the summer. However, in comparison with 2008 the growth rates are relatively modest and this is also reflected in economic expectations. In light of the European debt and financial crisis, consumers are not convinced that the situation will continue to have as little impact on Bulgaria as has been the case so far. At present, the indicator stands at -15.3 points, but its development in recent months has been rather variable, which is also attributable to discussions surrounding the Greek bailout and the anticipated rescue package. This year, Bulgaria has successfully reduced its government deficit and stabilised its general economic results. It was subsequently rewarded with an upgrade of its credit rating by the rating agency Moody's.

Income expectations: Italians anticipate higher taxes

In the wake of greater economic uncertainty, income expectations have also fallen across Europe. As is to be expected, the most pessimistic nations were Greece (-59.3 points) and Portugal (-58.5 points), although a significant reduction in income is also anticipated in France (-51.9 points).

In the last three months, Italian consumers have become aware for the first time that there is a real threat of national bankruptcy. They have evidently faced up to this situation and are prepared to make sacrifices in order to confront the crisis. Italians are as unwilling as other countries to pay higher taxes voluntarily, but in the current situation they are prepared to suffer cutbacks in income if this will help reduce government debt to a reasonable level. Despite the state already receiving 42.8% of their salaries, higher earners in particular are willing to accept tax increases. There is a much greater concern about cuts in social services and the impact of economic growth being too low. In general, Italians do not expect the economic situation to improve in the foreseeable future. Overall unemployment is currently at around 8% and is even higher among young people at almost 28%, one of the highest rates in Europe. This trend is also clearly reflected in income expectations, which have fallen by around 15 points since June and, at -43 points, are now among the lowest of all the countries in the study. A lower indicator value was last recorded in August 2008.

A varied picture also emerges in the development of income expectations in Poland. On the one hand, employment levels have been rising and economic growth is good in Poland, with experts forecasting growth of around 4.5% for 2011 as a whole and a predicted increase of 0.5% in private consumption. On the other hand, unemployment is still extremely high at 11.8% and here too the greatest factor causing unease is the ongoing developments in Greece and their potential consequences for the EU, and therefore also Poland. At the time of the survey, additional uncertainty was caused by imminent general elections for a new national government. Citizens in Poland were very sensitive to communications prior to the election and apprehension of political developments always generates a degree of unease among consumers. These conflicting factors have also had an effect on income expectations, which have fluctuated considerably over the last three months. The indicator level has risen a little again and currently stands at -19.9 points.

Willingness to buy: France must increase income

Rising taxes and duties and a slowdown in economic growth in the European Union are also having an impact on consumers' willingness to buy. The highest values for the indicator continue to be recorded in Germany (29.7 points) and Austria (26.0 points), followed at a significant distance by Bulgaria at -2.2 points. Hesitation in regard to whether or not make to major purchases now, or if it is better to delay such spending is greatest in Portugal (-49.6 points), the UK (-49.1 points) and Romania (-37.6 points).

The situation in Romania is changeable at present. Although Romania was able to overcome the crisis this year, with year-on-year growth of 0.2% in the second quarter, and unemployment falling slightly to just under 5%, these improvements have not yet trickled down and had a positive effect on Romanians' everyday life. Inflation is at 7.9% and VAT is at 24%. Salaries of civil servants were cut by up to 25% as part of saving measures over the past year and it has not yet been possible to reverse these reductions. Consumers are having to spend the majority of their income on food and non-alcoholic drinks, consequently spending is limited to the absolute necessities. This is confirmed by the willingness to buy indicator, which currently stands at -37.6 points. After a slight recovery to -20.9 points in August, it has again dropped in the last two months as a result of general uncertainty surrounding the development of the debt crises in Europe and the USA.

Portugal is battling through the crisis and is systematically implementing the cost-cutting program set by the European Union troika. The initial minor achievements are already evident: government finances have improved slightly and inflation is steady at between 2% and 3%. However, the austerity measures are placing extremely high demands on citizens, with the average tax rate already at 40% and set to rise even further on account of the troika measures. Salary increases are also not to be expected. In addition, the 2011 Christmas bonus is being reduced by 50% across the board, which will have a severe impact on consumers at this important time of year. Portuguese consumers have responded accordingly, only spending money on the necessary everyday items and postponing major purchases where possible. For example, car sales have fallen by 30% and demand for consumer durable goods in general has also declined by 10%. Although consumers do not expect the situation to deteriorate further, they are extremely conscious of the fact that the road out of the crisis will be long and arduous. Willingness to buy has therefore only fluctuated slightly in the last few months and currently stands at -49.6 points.

France is making efforts to maintain its highest possible credit rating with the rating agencies at the moment. National debt is currently at 88% of GDP. The additional loan guarantees to prop up Greece have primarily been shouldered by Germany and France and could cause the French government deficit to increase even further in the near future. Added to this is the fact that economic growth has been much slower than was anticipated, which means that the government is receiving less money from taxation and social contributions. President Nicolas Sarkozy must make savings and increase income and

French citizens therefore anticipate that both taxes and contributions will rise further. Consequently, they are only spending on items that are absolute necessities for everyday life and are postponing major purchases for as long as possible. At -32 points, the willingness to buy indicator clearly reflects this mindset.

Spain has managed to keep inflation somewhat at bay and, at 3%, it is currently the lowest it has been since the end of last year. This is primarily attributable to reduced fuel prices, which have taken pressure off consumers' wallets. Despite this, Spaniards are not too optimistic and are not planning to make major purchases in the near future. Firstly, unemployment will increase again and many of those who had a seasonal job over the summer will have to tighten their budgets in the coming weeks and months. Secondly, the general economy is still very far away from overcoming its phase of weakness. Economic researchers expect it to take at least three years for the economy to recover fully from the crisis. In addition, there is uncertainty about how the debt crisis will develop in the European Union as a whole. These factors are directly affecting consumers, who are cautious when it comes to expenditure above and beyond their daily needs. Overall, the willingness to buy indicator has been relatively stable over the past three months and currently stands at -15.9 points.

The survey

These findings are taken from the *GfK Consumer Climate MAXX survey*, which is based on consumer interviews conducted in all European Union countries each month on behalf of the EU Commission.