

# KPMG Pulse of Economy 2014

## Survey report

Czech Republic, Estonia, Hungary,  
Latvia, Lithuania, Poland, Romania,  
Slovakia

[kmpgpulsesurvey.com](http://kmpgpulsesurvey.com)

KPMG in Central & Eastern Europe

## ENT

GLOBAL

A collage of magazine covers featuring business management and success themes. The visible text includes 'GLO', 'Management', 'Targeting Success', and 'Partners'.

A collage of overlapping text elements. The words 'Partners', 'Success', 'Leadership', and 'Innovation' are visible, though partially obscured by each other. The text is in a bold, sans-serif font, with 'Success' in a light green box, 'Partners' in a light blue box, 'Leadership' in a white box with a black border, and 'Innovation' in a light orange box.



## *cutting through complexity*

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# Foreword

## Dear Reader,

After several years of carrying out this survey, first in Estonia and later in all three Baltic states, KPMG has now extended the survey to include the Czech Republic, Hungary, Poland, Romania and Slovakia. As previously, we have collected opinions from business leaders across all 8 ("CEE8") countries on the state of their national economies and the outlook for their companies. Based on the feedback from 456 respondents we have charted trends, developments and projections in these countries.

As in previous years in the Baltics alone, there are clear signs of confidence among the CEE8 business leaders, indicated either by further expectations of continued GDP growth ranging from one to three percent, and an intention to further invest in their businesses. However, most business leaders were more cautious than the official estimates, especially in the matter of GDP growth. Nevertheless, it may be that confidence will have deteriorated somewhat since, due to uncertainty about the effects of the Ukraine crisis and sanctions on and by Russia.

According to the survey, conditions for doing business in the CEE8 countries are seen as satisfactory, although respondents were keen that simplified tax systems, especially flat-rate income taxes, be maintained or introduced. Key issues in the immediate future will be retention of talent, but also competitiveness and relatively slow growth in local demand. There is a strong case made for nuclear to play its part in energy policy.

We hope and expect that the survey results will be of interest to you and provide focus on the issues significant to the business community leaders.

Yours faithfully,



**Stephen Spill**

COO, KPMG in CEE

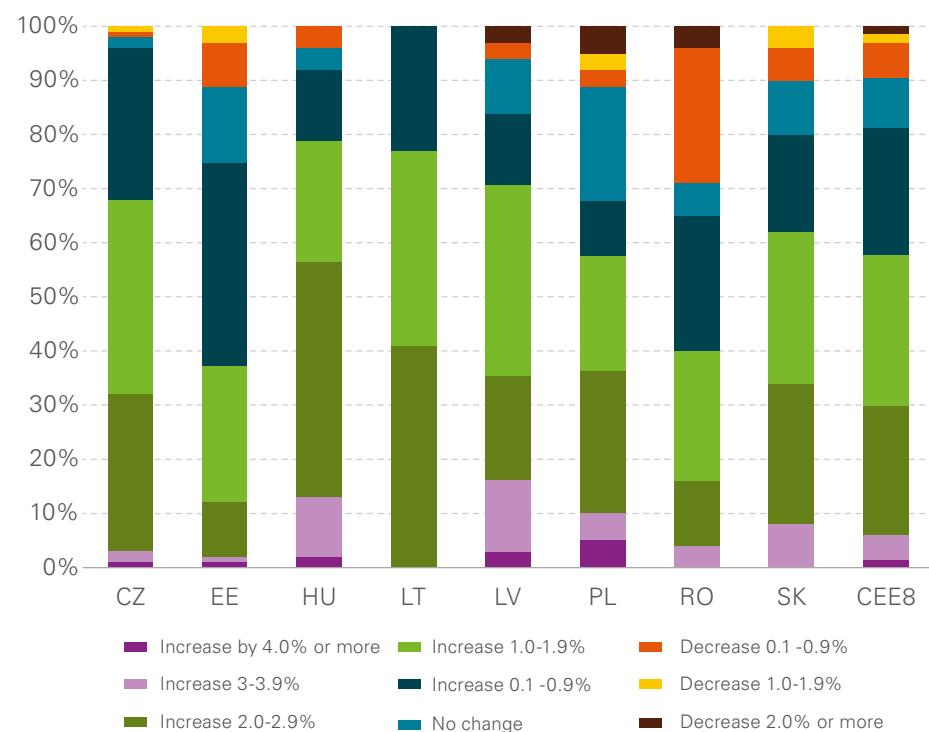


# Outlook for the economy

## GDP expected to grow in all countries

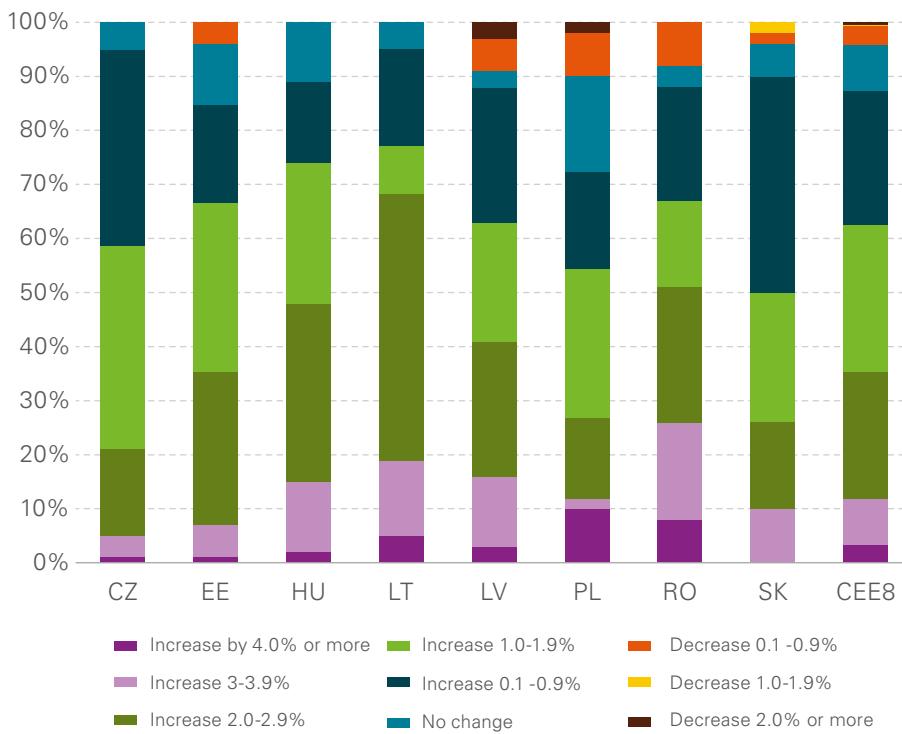
Despite the challenging economic environment in many EU countries, the CEE8 economies are expected to grow in 2015. As the region's average, 52% expect the GDP to grow from 1.0 to 2.9% and only 9% predict a decrease. The most upbeat mood, which may be driven by upcoming euro adoption, prevails in Lithuania where 77% envision the economic growth between 1.0 and 2.9%, followed by the Czech Republic and Hungary with 65%. Confidence levels are slightly lower in Estonia and Romania with about 35% estimating the GDP will increase from 1.0 to 2.9%. Estonia also has the highest share of respondents (51%) who think GDP will increase by less than 1% even or remain unchanged. In Romania, 29% predict that the GDP will fall next year, 11% share that sentiment in Estonia as do 10% in Slovakia. As the region's average, only 9% of the respondents see GDP contracting.

### Expected GDP change in 2015



## Keeping inflation below, but close to 2%

### Expected consumer price index change in 2015



"To maintain inflation rates below, but close to, 2% over the medium term" is the quantitative definition of price stability in the euro area, as established by the European Central Bank. Although not all euro countries, the CEE8 seem to follow the same pattern if we are to believe assessments from the survey participants.

Inflation is generally estimated to stay below 2%, most firmly in the Czech Republic and Slovakia, where 73% and 64%, respectively, think inflation will remain between zero and 1.9%. The highest price increases are expected in Lithuania, which may be related to the euro adoption again, with 69% believing inflation should exceed 2%, followed by Hungary at 48%. Deflationary moods can be perceived in Latvia, Poland and Romania with about 8-9% of respondents expecting prices to fall.



## When comparing with official forecasts...

The views of business leaders do not overlap with the European Commission's official forecasts, especially as concerns GDP growth projections. Although a moderate growth is expected in the CEE8, decision-makers see some downside risks for 2015, while inflation assessments do not deviate to such an extent.

Country	GDP forecast*	% of the same opinion	Inflation forecast*	% of the same opinion
<b>Czech Republic</b>	2.7	29%	1.4	37%
<b>Estonia</b>	2.0	10%	1.6	31%
<b>Hungary</b>	2.5	43%	2.5	33%
<b>Latvia</b>	2.9	19%	1.8	22%
<b>Lithuania</b>	3.1	0%	1.3	9%
<b>Poland</b>	2.8	26%	1.1	28%
<b>Romania</b>	2.4	12%	2.1	25%
<b>Slovakia</b>	2.5	8%	0.7	40%

\* European Commission autumn forecast, November 2014

## Euro stability predicted with a number of struggles

Although public discussion about the fate of the euro currency is not as dominant as it was some years ago, views on the euro's future are relevant for business. Looking at the results, responses indicate a common belief that after Lithuania's adoption of the euro in 2015 hardly any countries will join the euro zone by 2020.

However, business leaders in the Czech Republic, Lithuania (both 27%) and Romania (24%) think the euro will maintain a

leading position globally and new countries will join by 2020 – it may be also an indication that the other two countries mentioned would like to follow Lithuania's suit in coming years.

While virtually no one believes in the euro's demise, many respondents predict stable years for the currency without any countries joining after Lithuania. This position is strongly expressed in Poland (62%), but also in Slovakia (48%) and Estonia (46%).

### The future of the euro by 2020



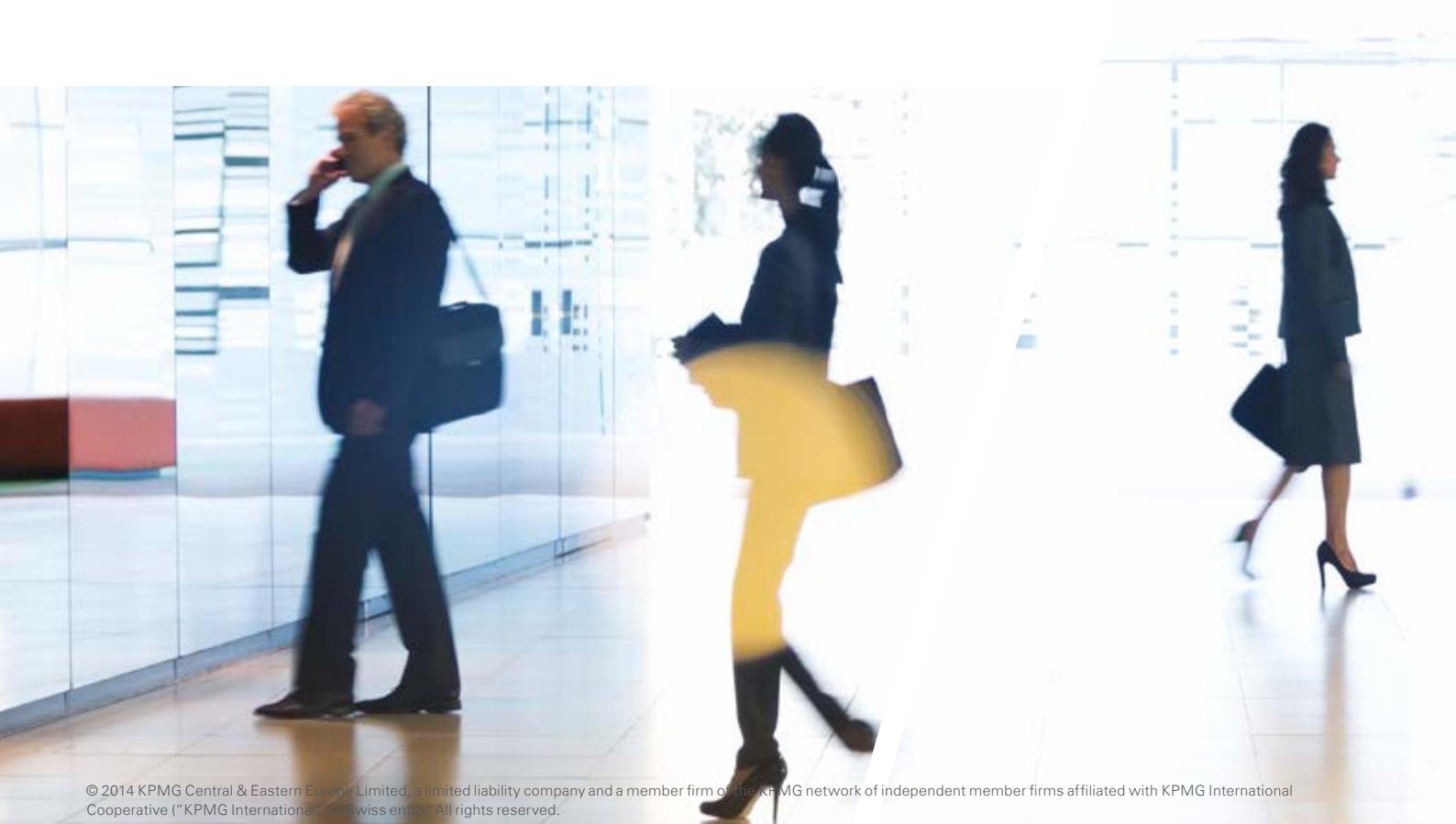
## Simplified tax procedures requested, sentiment for no progressive tax

Across the region, when asked about the importance of tax policy issues that should be tackled by the government, a vast majority of respondents deem simplified tax payment and administration procedures as the most vital topic. On a 5-point scale, the CEE8 average for the issue reaches 4.2 points, receiving the highest marks in Poland and Slovakia (4.6 on average). Implementing or keeping a progressive

personal income tax system receives the least support, most notably in Estonia (1.6) while the CEE8 average remains at 2.3 points. Correspondingly, a flat tax is deemed most important in Estonia and in Romania (4.1) while lowering the main VAT rate enjoys support in Romania (4.3). Survey respondents in many countries would also like to see their tax burdens aligned with neighbouring countries'.

Relevance of tax policy issues to the government	CZ	EE	HU	LT	LV	PL	RO	SK	CEE8
Implementing simplified tax payment and administration procedures	<b>4.4</b>	<b>4.4</b>	<b>4.4</b>	<b>4.2</b>	<b>4.2</b>	<b>4.6</b>	<b>2.3</b>	<b>4.6</b>	<b>4.2</b>
Implementing/keeping progressive personal income tax system	<b>2.0</b>	<b>1.6</b>	<b>2.6</b>	<b>2.2</b>	<b>2.6</b>	3.4	<b>2.3</b>	<b>2.1</b>	<b>2.3</b>
Implementing/keeping flat personal income tax system	3.7	4.1	3.2	3.2	3.1	3.2	<b>4.1</b>	3.8	3.7
Lowering main VAT rate	3.4	3.1	3.7	3.6	3.0	3.9	4.3	3.5	3.5
Lowering corporate income tax rate	3.5	3.0	<b>2.6</b>	3.3	3.1	3.5	3.3	3.9	3.3
Aligning the tax burden with that of the neighbouring countries	3.2	2.9	4.1	4.1	4.1	<b>3.0</b>	3.4	4.0	3.4

■ Highest ■ Lowest

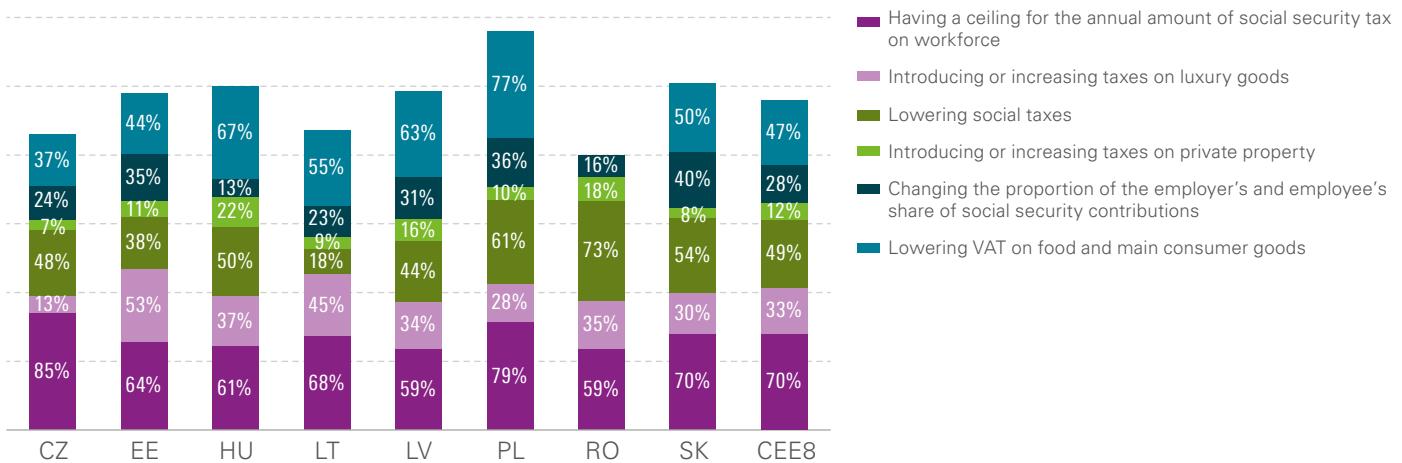


## Setting a ceiling for social security tax on workforce crucial

With a mind toward providing further advice to government, the survey panel assessed some ideas for tax-related changes. These business leaders support setting a ceiling for the social security tax on workforce, most strongly in the Czech Republic, where it receives 85% support of respondents, while the CEE8 average amounts to 70%. Of importance are other social security tax issues too, like lowering the social tax and changing the proportion of the employer's and employee's share of social security contributions, at 49% and 28%, respectively.

The VAT rate on food and consumer items seems to hurt in Poland (77% pledge for a lower rate), in Hungary (67%), Latvia (63%) and Lithuania (55%). Not surprisingly, new or higher taxes on private property are not welcome, while in Estonia (53%) and Lithuania (45%) many respondents selected higher taxing on luxury goods, which may be an awkward idea in the Czech Republic (13%).

### Tax policy suggestions to the government

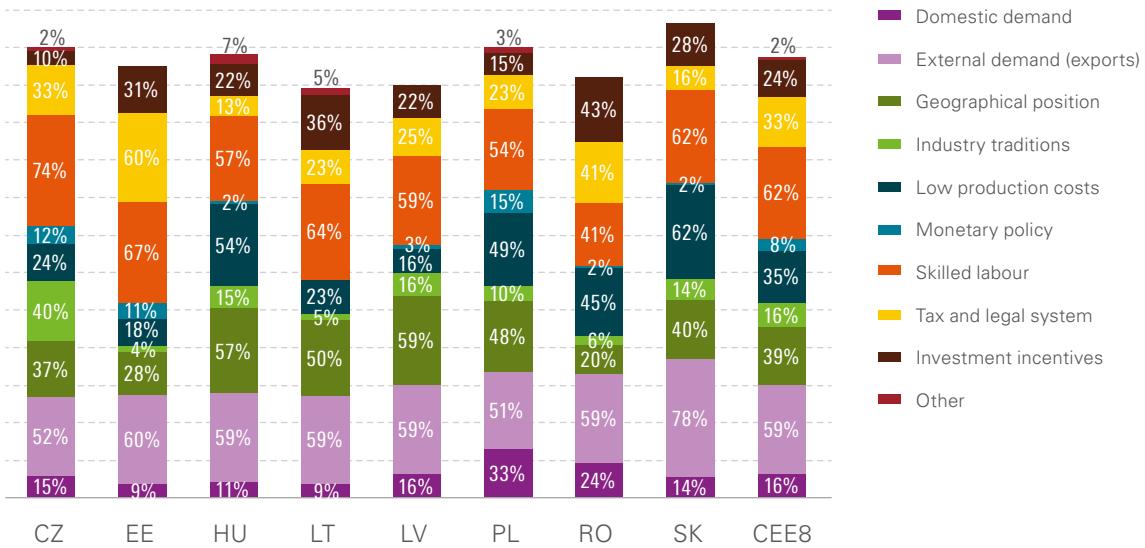


## Competitiveness: Skilled labour, exports and location the key

Across the region, skilled labour (62%) and exports (59%) are seen as key drivers of economic competitiveness, while industry traditions, domestic demand (both at 16%) and monetary policy (8%) play a minor role. However, industrial traditions are noted in the Czech Republic (40%) and domestic demand in larger markets like Poland (33%) and Romania (24%).

Views on production cost as an advantage fluctuate according to country, being more important in Slovakia (62%) and least important in Estonia and Latvia (18% and 16%). The tax and legal system's benefits are highlighted in Estonia (60%) and geographical position in Latvia (59%), Hungary (57%) and Lithuania (50%).

### Key drivers of economic competitiveness



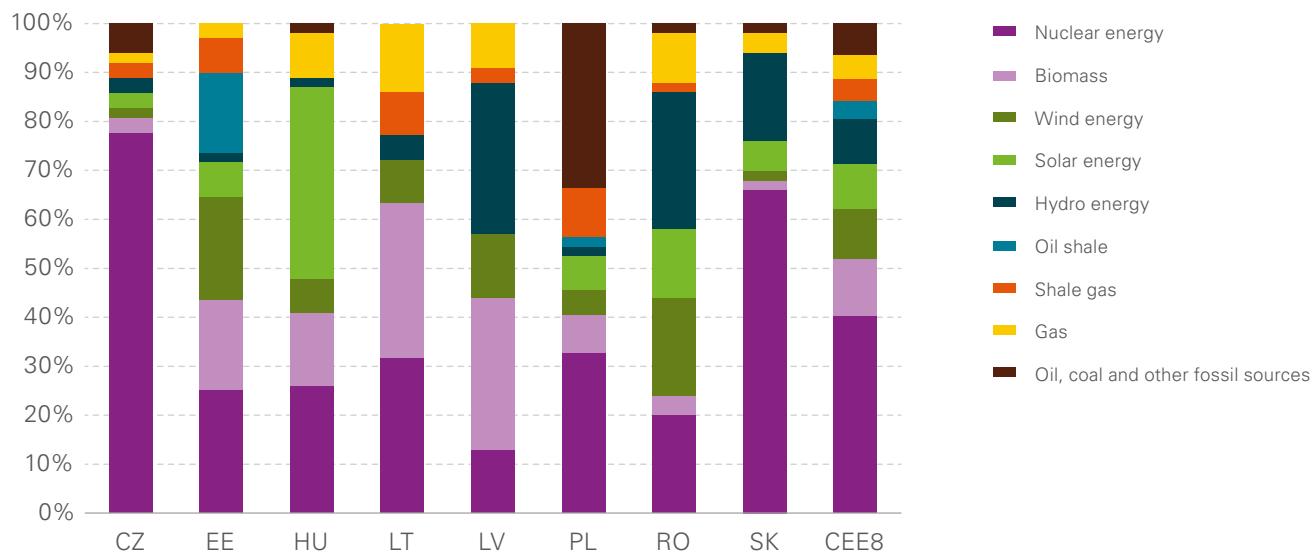
## Nuclear preferred in the energy portfolio

Strong support for nuclear in the Czech Republic (77%) and Slovakia (66%), as well as in many other countries, means that nuclear energy looks to play a pivotal role in the region's energy sector portfolio – on average 40% are of this opinion in the CEE8.

Not surprisingly, renewables hold a strong position with biomass coming in second (12%) in the ranking, mainly because of

notable support in Lithuania (32%) and Latvia (31%). Sentiment for solar energy dominates in Hungary (39%), and for hydro energy in Latvia (31%) and Romania (28%). With the exception of "national treasures", like oil shale in Estonia (16%) and coal in Poland (34%), fossil fuel sources are not relevant for the future according to survey respondents.

### Preferred energy sources

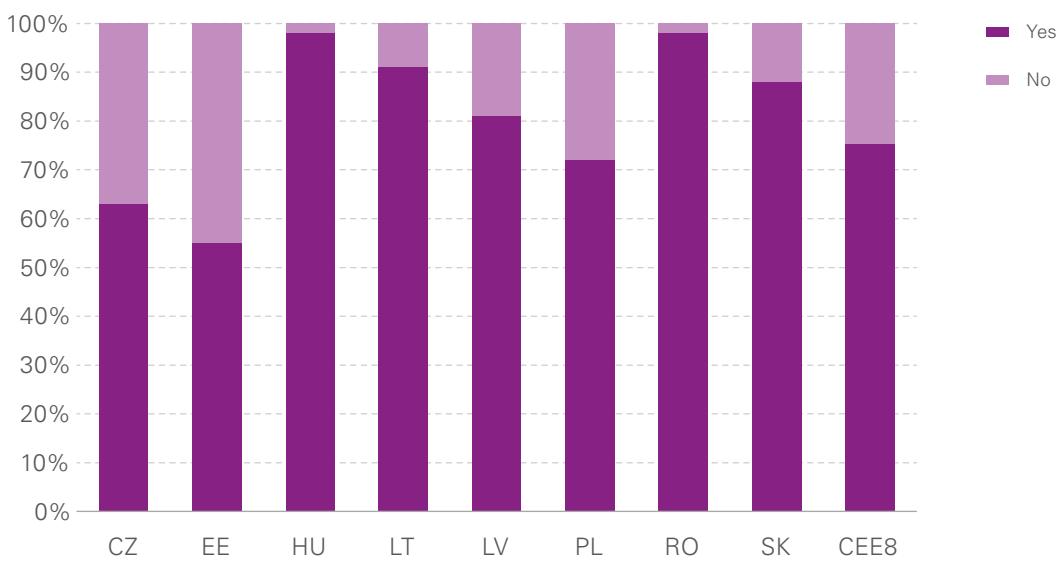


## "Black income" and VAT fraud concerns

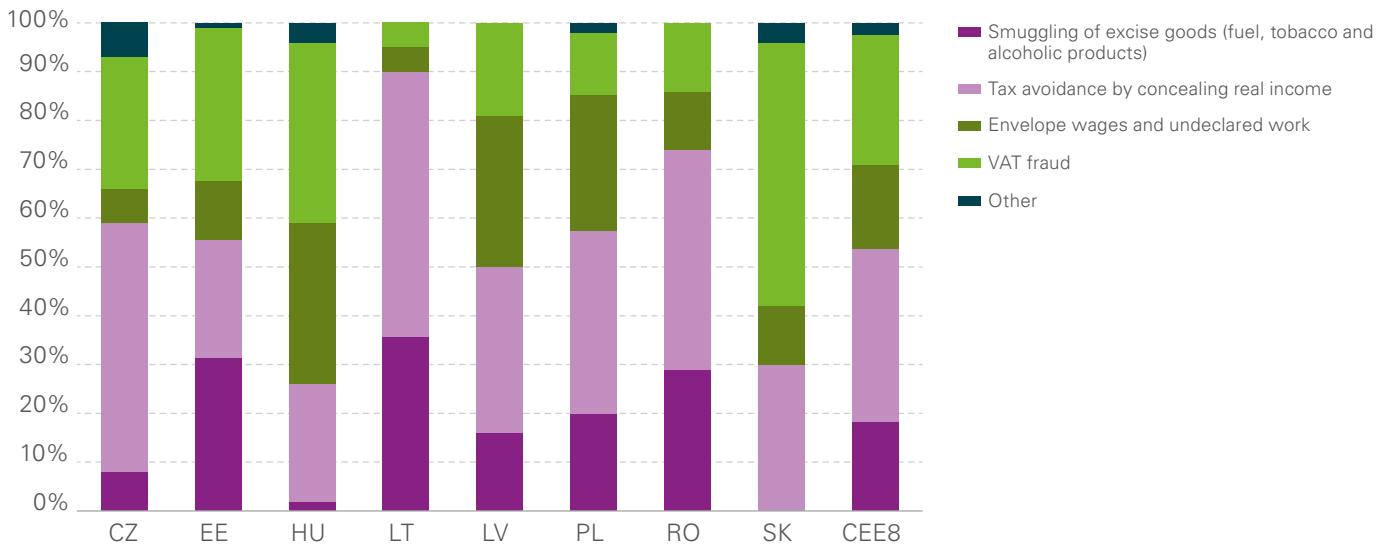
As the CEE8 average, 75% of the respondents think that the shadow economy is a problem. By country, 98% in Hungary and in Romania believe it is an issue, while in Estonia only 55% share the same opinion. Ranking different forms of the shadow economy, tax avoidance by concealing real income is the most pressing issue, especially in Lithuania (55%), in the Czech Republic (51%) and in Romania (45%).

About a quarter of the respondents see VAT fraud as a problem, more frequently in Slovakia (54%), in Hungary (37%) and in Estonia (31%). According to the survey, the smuggling of excise goods happens mostly in Lithuania (36%) and in Estonia (31%), while envelope wages and undeclared work pose problems in Hungary (33%) and in Latvia (31%).

### Shadow economy: An issue or not?



### Sources of shadow economy



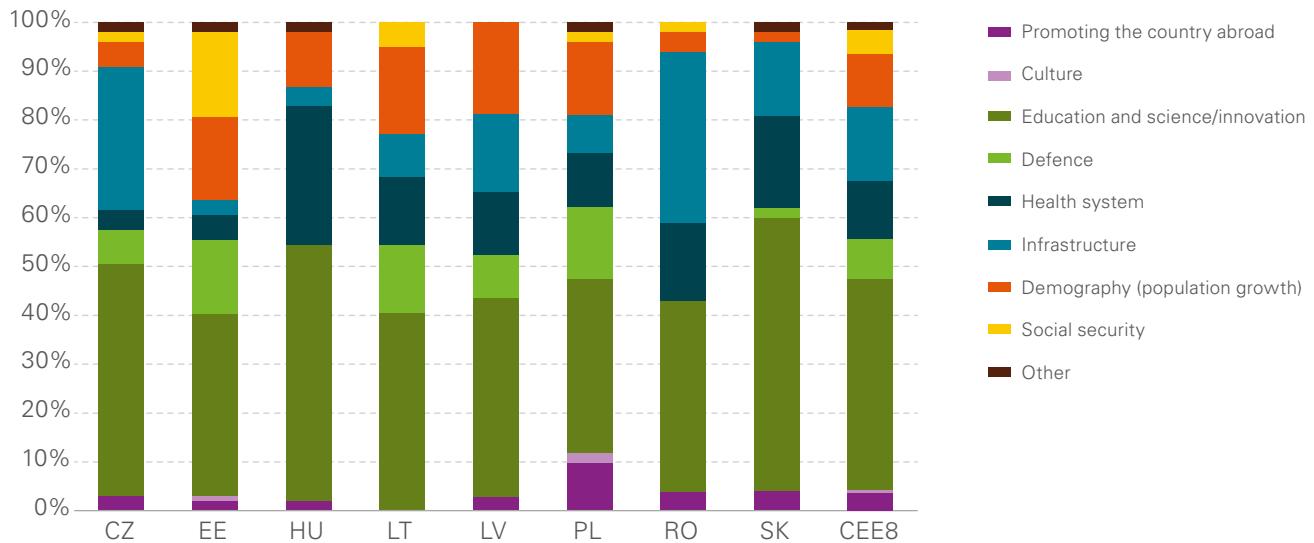
## More fiscal funds suggested for education, science and innovation

Governments have often only difficult choices regarding how to distribute funds for state budgets. The survey respondents made a number of suggestions as to which areas they would like to see governments increase fiscal expenditure between 2015 and 2018.

By a large margin, education and science is the preferred field where fiscal spending should increase by 2018 – in the CEE8, on

average 43% are in favour of this, most prominently in Slovakia (56%) and Hungary (52%). Infrastructure (15%), health care (12%), and demography (11%) receive considerable support, while culture hardly requires any additional funds, according to the respondents. While in Estonia 17% believe social security needs more funds, in other countries the support remains under 5%.

### Preferred growth areas in fiscal expenditure 2015-2018





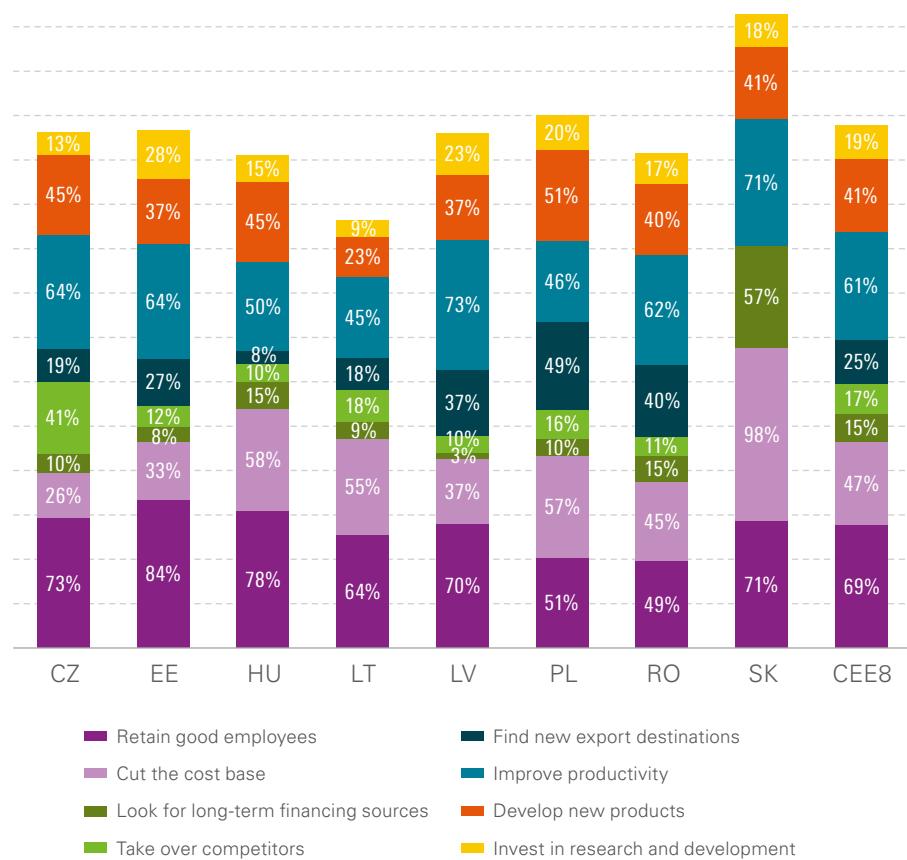
# Outlook for enterprise

## Keeping good people

Qualified and motivated staff are vital for business sustainability, which is why companies should focus on retaining good employees – the key aspect that receives the highest, 69% support among different options, followed by productivity growth (61%) and cutting the cost base (47%). Surprisingly, only 19% of the respondents in the CEE8 support investing in R&D – while those surveyed expect that governments should spend more in this field.

In Slovakia, 98% say cutting the cost base is important while the respondents in Estonia (33%) and in the Czech Republic (26%) think it is not so relevant. Taking over competitors and looking for long-term financing sources are not of essence, mentioned in only about 15% of cases in the CEE8. Poland (49%), Romania (40%) and Latvia (37%) are eager to find new export markets.

## Key focus aspects for the companies

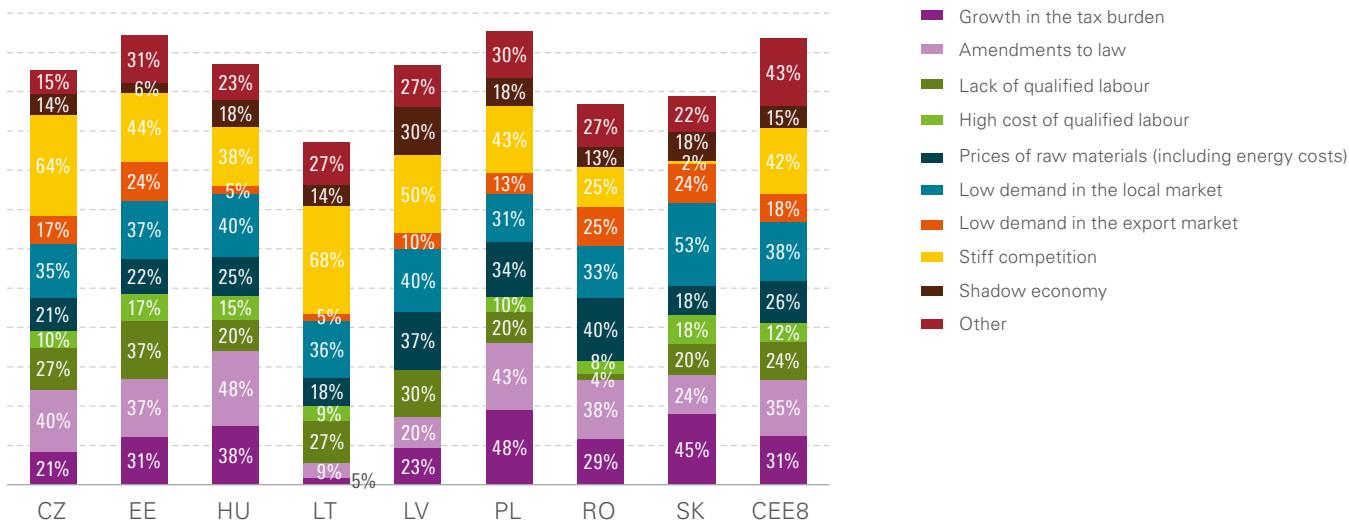


## Stiff competition and low domestic demand causes for concern

Stiff competition (cited by 42% of the respondents) and low demand in the local market (38%) are the issues most often restricting turnover growth in the CEE8, say survey participants. In addition, legal amendments (35%) and growth in the tax burden (31%) are seen as restrictive factors. Despite results showing the shadow economy's relevance, only 15% of respondents say it affects turnover growth.

Stiff competition was most often mentioned in Lithuania (68% of the respondents) and in the Czech Republic (64%). In Slovakia, competition is not deemed as restrictive (cited by only 2% of the respondents), but low domestic demand (53%) is. Concerns with the tax burden can be seen in Poland and Slovakia (by 48% and 45% of the respondents in respective countries).

### Key issues restricting turnover growth by year-end 2015

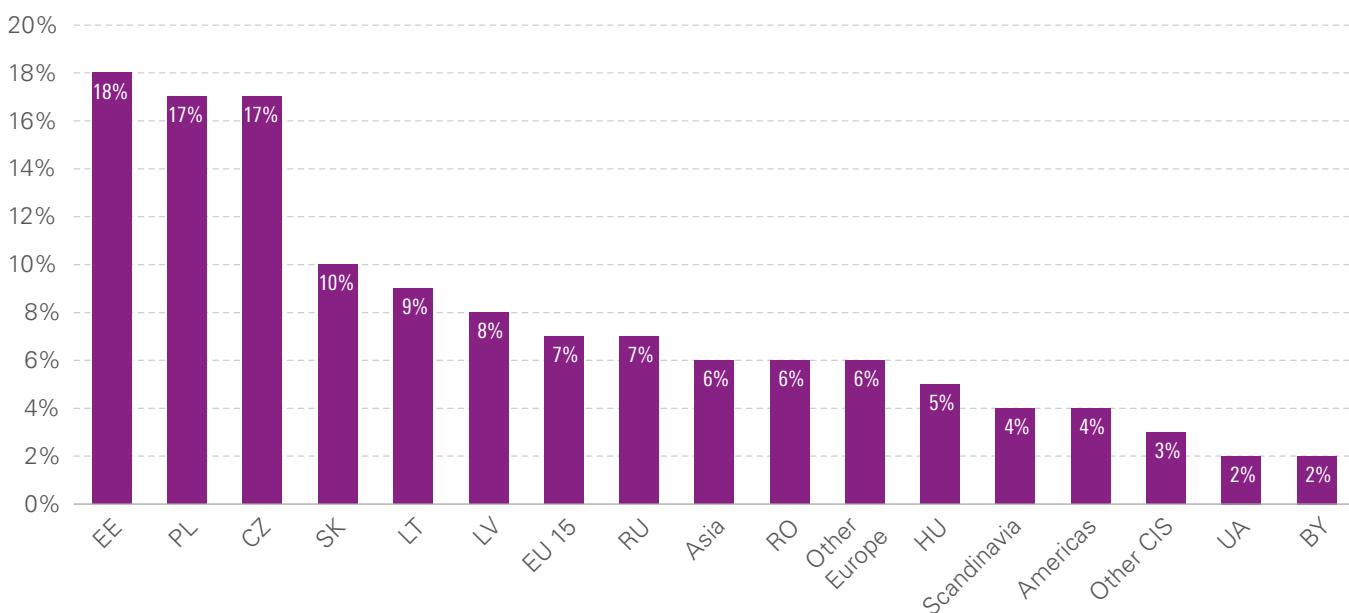


## Sixty-nine per cent of polled business leaders plan investments in 2015-2017

A vast majority of respondents say they plan investments over the next 3 years, with the activity concentrated on home market and on neighbouring countries. More often investments in Estonia (18% of respondents), Poland and in the Czech Republic

(both at 13%) are mentioned. In the domestic market, companies in Poland (84% of respondents investing in their home country), in Estonia (64%) and in the Czech Republic (63%) are active.

### Geographical investment plans in 2015-2017

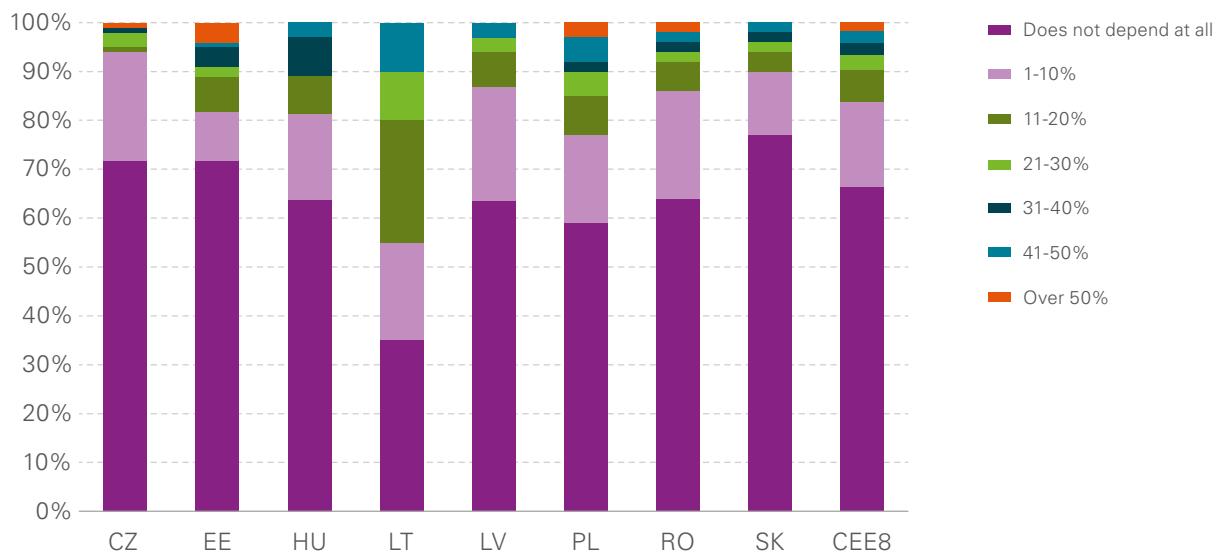


## EU funding not relevant for the business in big picture

Thirty-four per cent of respondents say their company turnover does depend on EU funding or public procurements for EU-funded projects. However, about 65% of Lithuanian business leaders admit the turnover of their companies depends on EU funding, while in Slovakia the corresponding indicator is 23%,

the lowest among the countries included in the survey. A limited number say the actual impact is above 20% of turnover, in the CEE8 average 17% say up to 10% of the turnover depends on EU funding.

### Dependence on EU funding

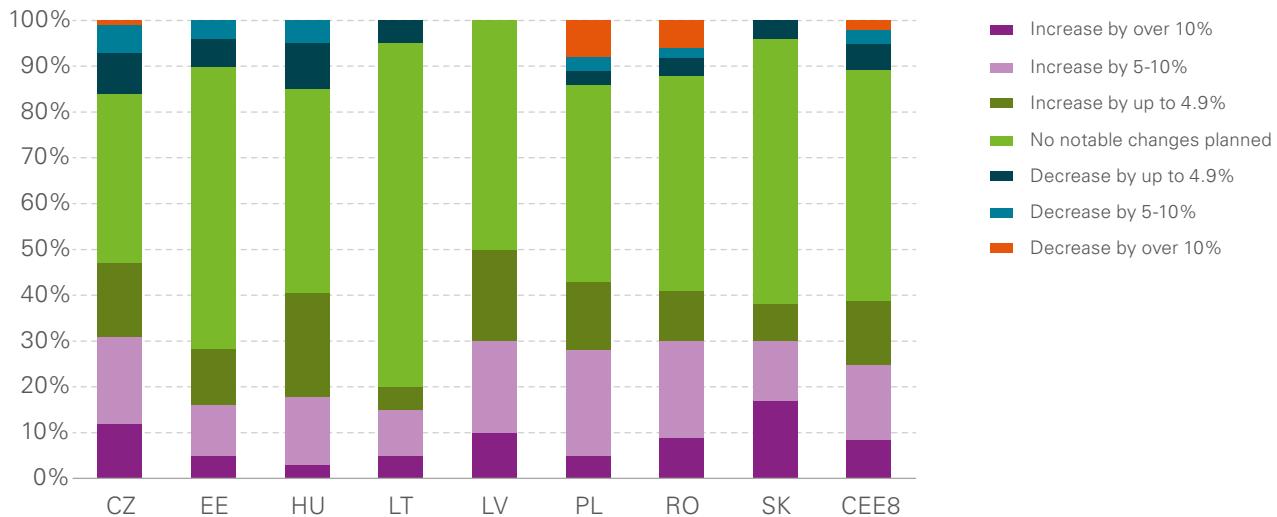


## Mostly good news for employment

While in the CEE8 on average 50% say no notable staff changes are planned, in some countries vast majority of respondents plans to hire people: 50% in Latvia and 47% in the Czech Republic plan to hire followed by Poland with 43%.

The most static situations are in Lithuania and Estonia, where 75% and 61%, respectively, say they do not see any notable changes in staff composition for 2015. Slight staff decreases are predicted in the Czech Republic (by 16% of respondents) and Hungary (15%), and to a lesser extent in Latvia, Lithuania and Slovakia.

### 2015 trends for staff numbers

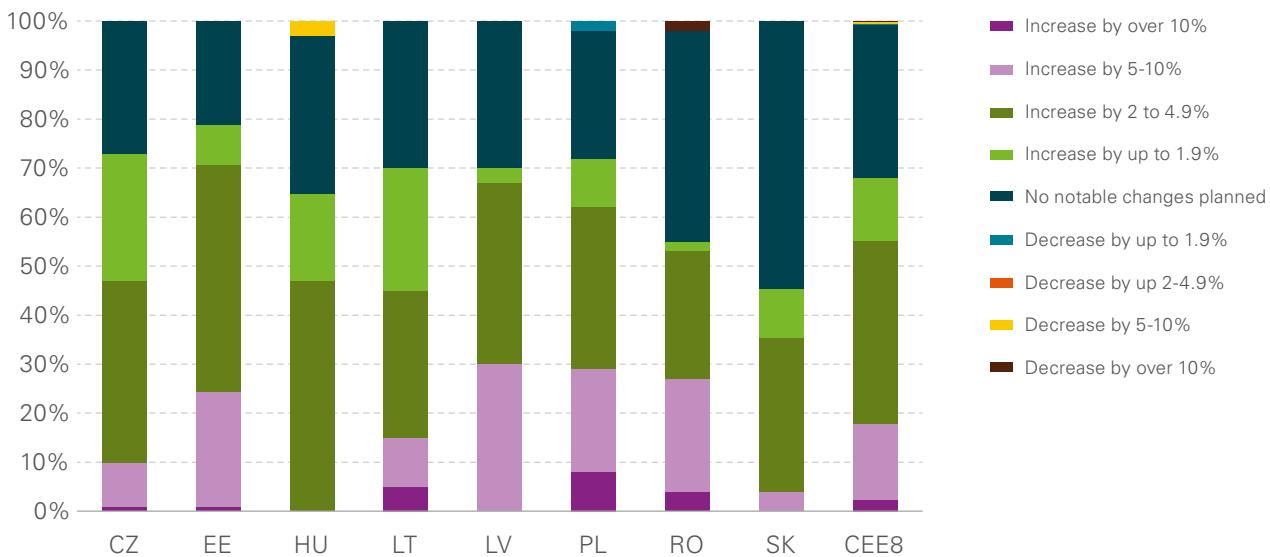


## Salaries continue to rise slightly

On average, 69% of respondents plan to raise salaries in 2015, with 50% of them saying the increase will be limited to 5%. The most likely increase, as indicated by 37% in the CEE8, will be from 2.0% to 4.9%. More generous pay increases, over 5%, are expected in Latvia (30% of respondents), Poland (29%) and Romania (27%). In Poland, 8% even say they plan to raise salaries over 10%.

In Slovakia, 54% do not plan any changes, the same for 43% in Romania, while in Estonia only 21% are of the same opinion. Virtually no pay cuts are planned any of the surveyed countries, according to the results of the survey.

### 2015 trends for staff salaries

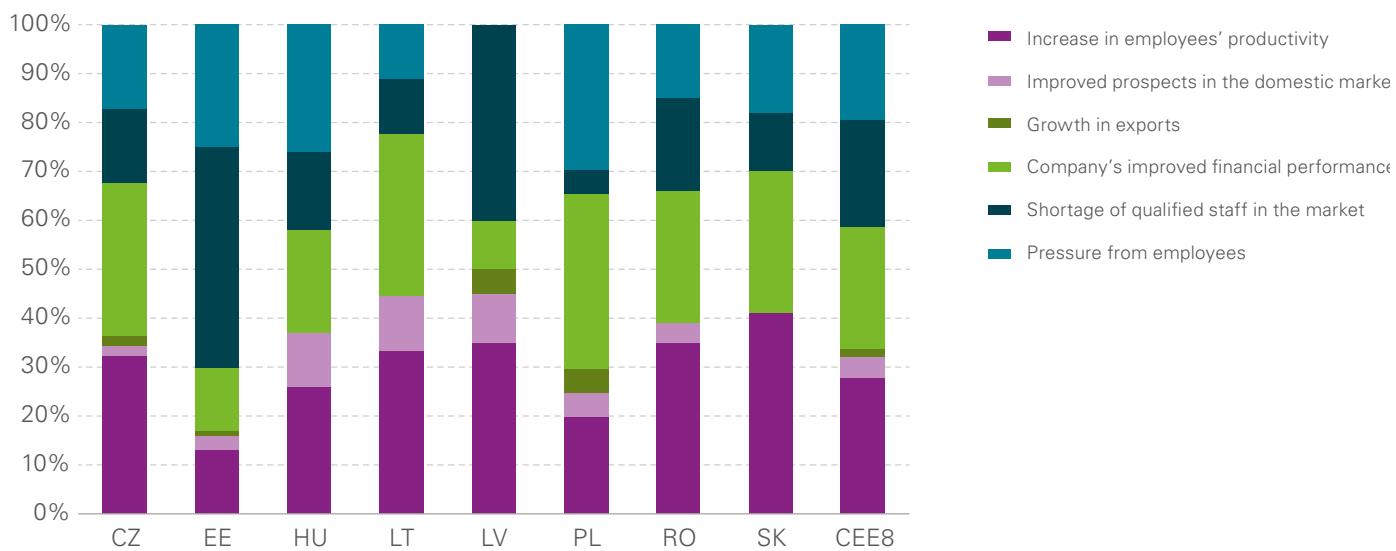


## Salaries driven by higher productivity but also by tight job market

For 28%, higher productivity is the main driver for employee salary increases. In addition, improved financial performance (25%) helps, while increased exports do not play a major role in pay raises, rather domestic sales do. A shortage of qualified staff and pressure from employees tallied 41% as a driver for pay

rises, whereas in Estonia 70% of respondents admit lack of staff and employee pressure drive salaries. In Poland (36%), Lithuania (33%) and in the Czech Republic (31%) companies' improved financial performance will more likely lead to higher salaries.

### Main drivers for salary increases, 2015

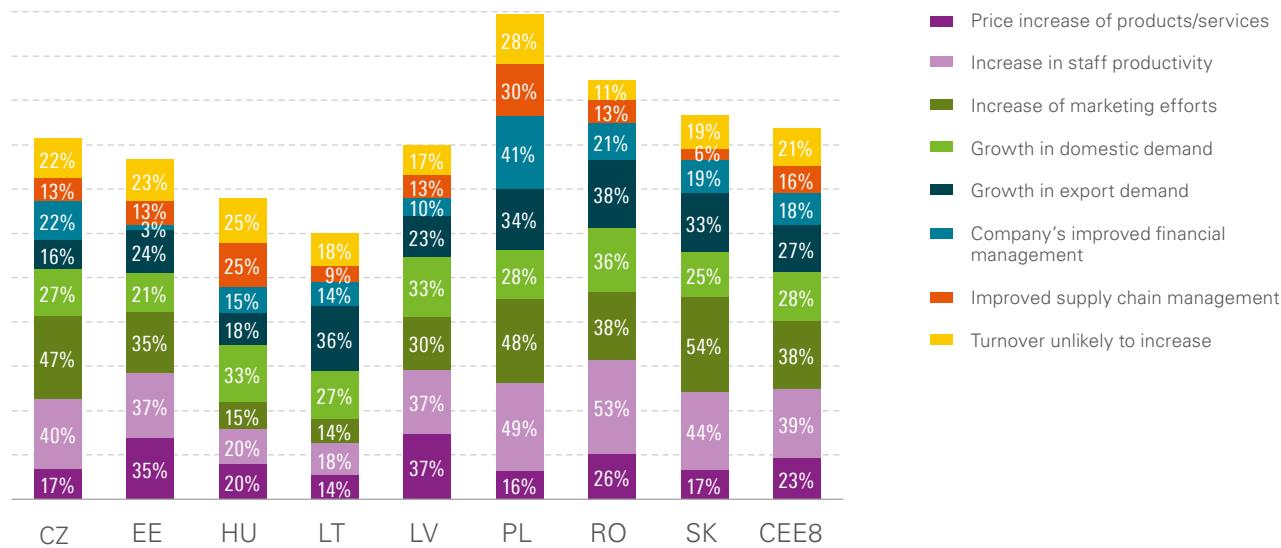


## Better productivity and marketing to boost turnover

Apart from 21% of the respondents in the CEE8, business leaders in the region expect turnover to grow in 2015, mainly driven by higher staff productivity (39% of the respondents) and more intense marketing efforts (38%). Companies' improved financial management (18%) and better supply chain management (16%) are seen not as essential.

More often than in the others, in Latvia and Estonia the respondents plan to implement price increases, by 37% and 35% respectively, while marketing efforts are a preferred solution by Slovak (54% of respondents), Polish (48%) and Czech (47%) companies. In Romania, 53% of those surveyed believe in higher productivity.

### Main drivers for the turnover growth in 2015

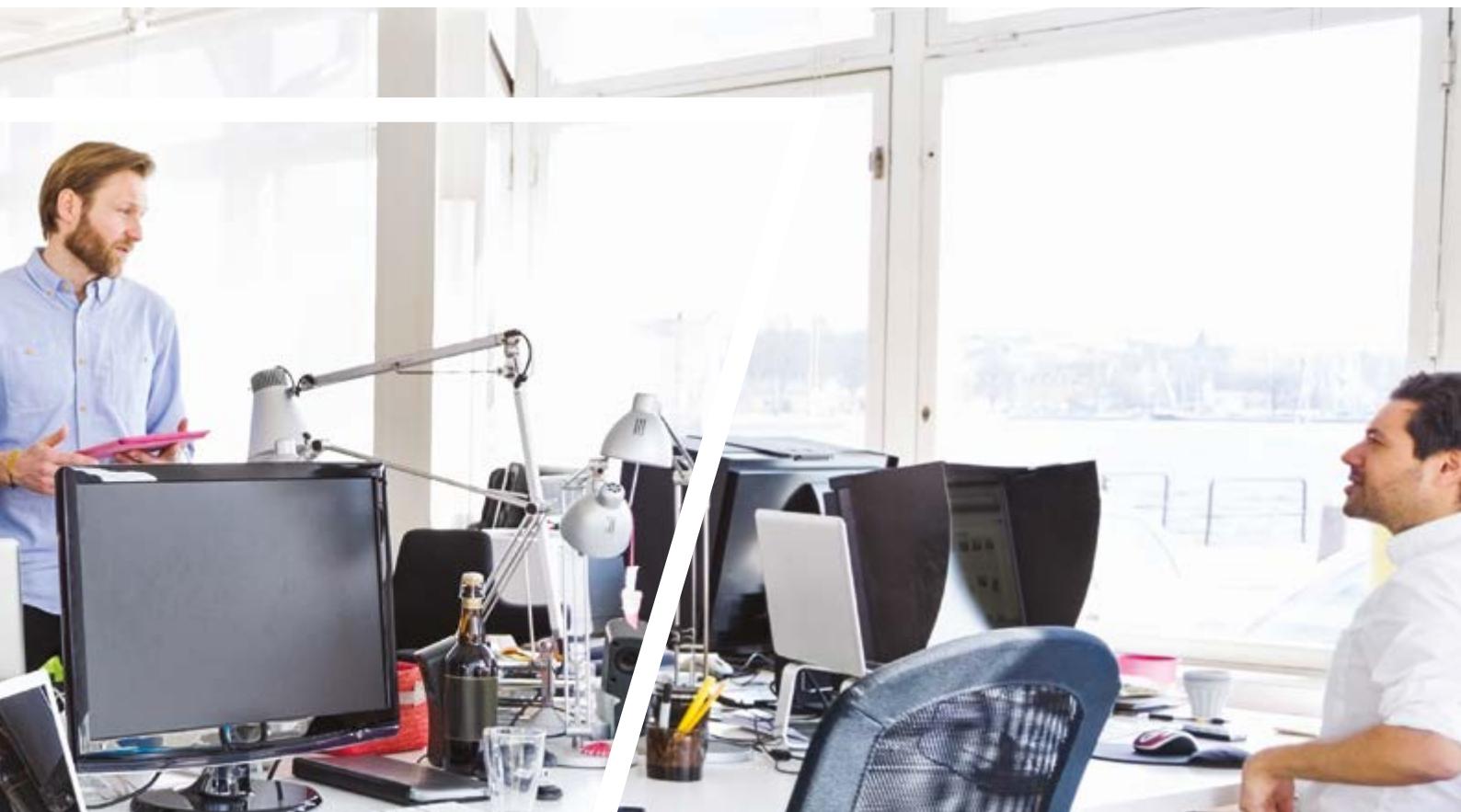
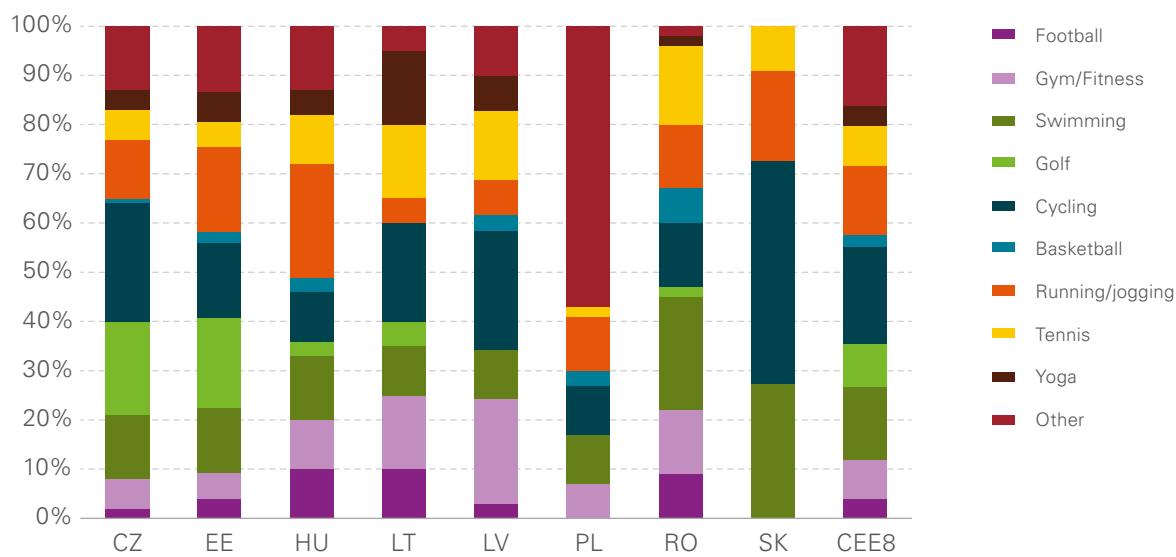


## Top managers fond of cycling

Last but not the least, as a person's pulse rate is one of the key indicators of physical activity, business leaders who took part in the KPMG survey were asked about their favourite exercises. This assumes that business leaders are able to take part in the recreational side of life. Across the region, for 20% cycling proved to be the most popular, followed by swimming (15%) and

running/jogging (14%). Football (4%) and basketball (2%) placed near the bottom. Cycling is the most popular in Slovakia (at 45%), Czech Republic (24%) and Latvia (24%), running in Hungary (23%) and swimming in Romania (23%), while Estonians prefer golf (18%).

### Favourite physical activity



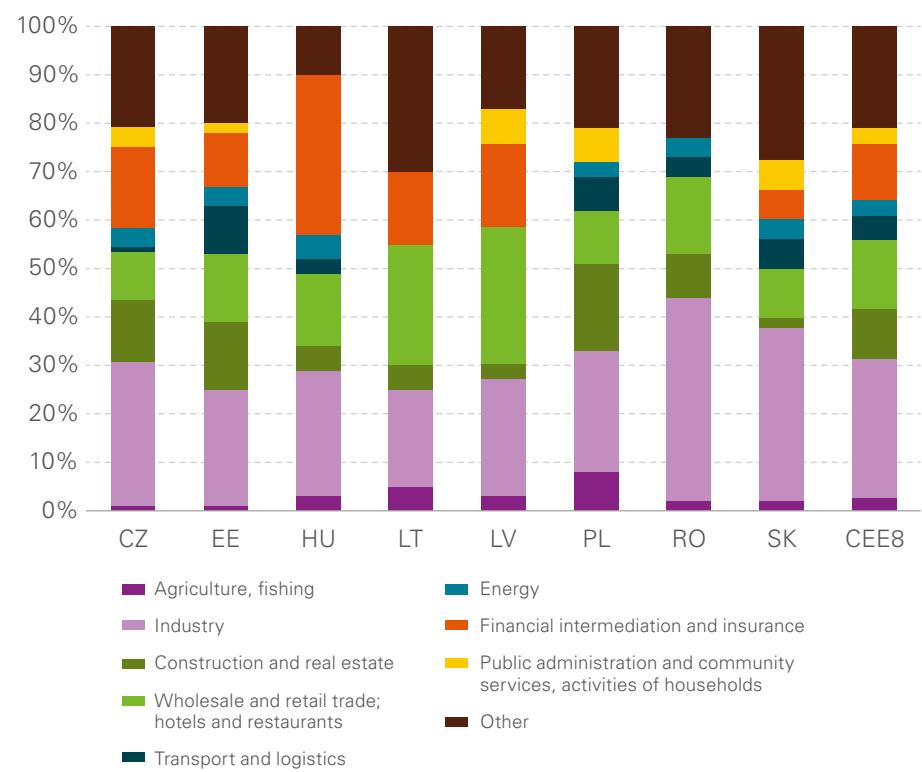


# Profile of respondents

## The lion's share coming from industry

A total of 456 responses were collected in the survey. By business sector, industry accounted for 29% of responses, followed by wholesale and retail trade (14%) and financial intermediation and insurance (11%).

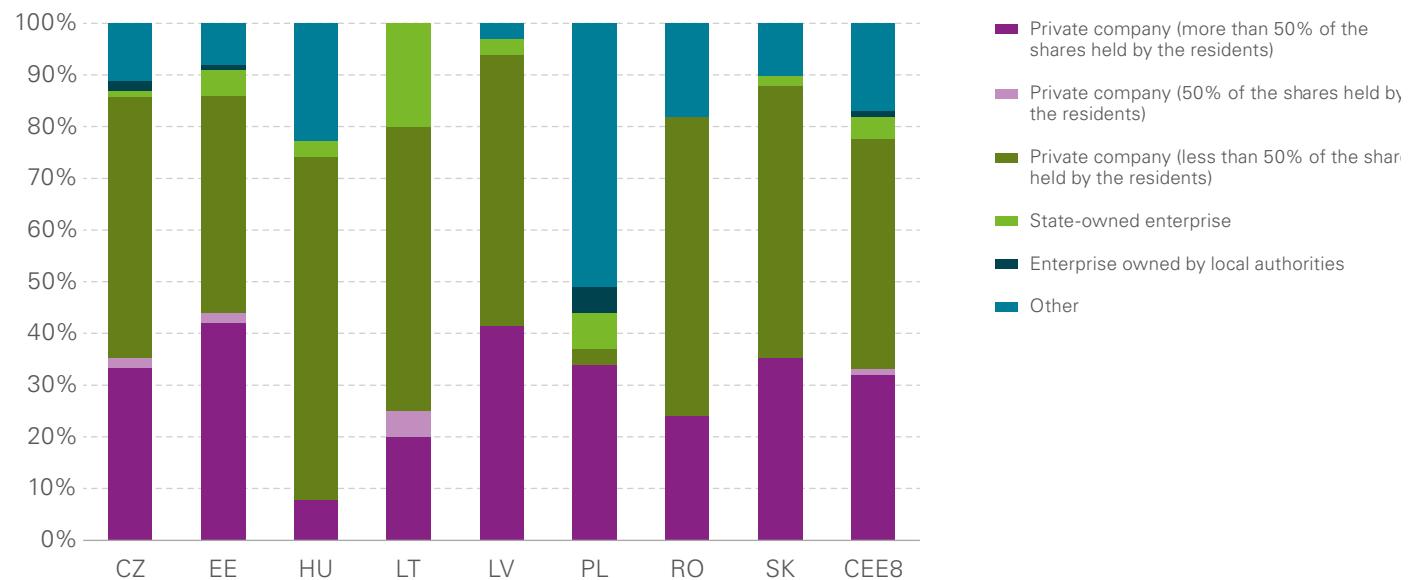
### Fields of business



## Foreign-owned companies dominate

Forty-four per cent of respondents came from companies where less than 50% of the shares are held by residents, their share being the highest in Hungary (67%). The share of local private companies was the highest in Estonia (42%), followed closely by Latvia (41%).

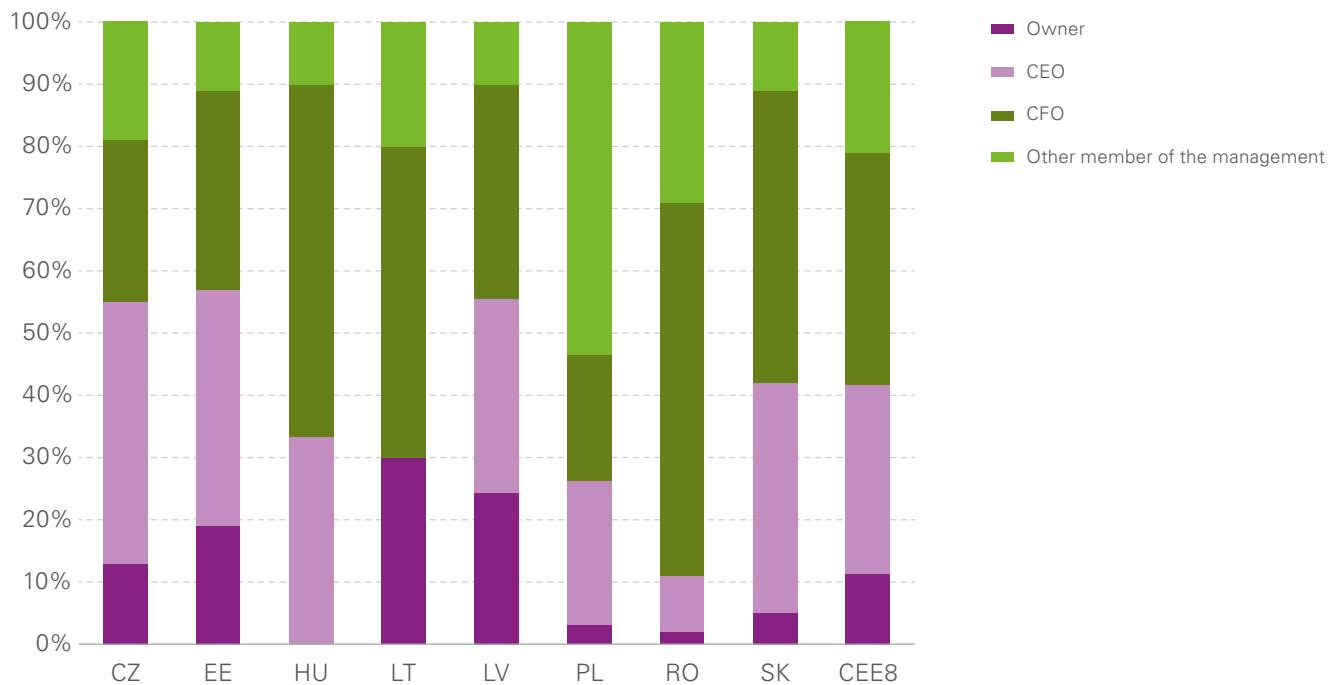
### Type of organisation



## The views of top management

Thirty-seven per cent of respondents are CFOs, 30% CEOs, 21% other members of management and 11% company owners. The share of owners was higher in the Baltics (from 19% to 30%) and in the Czech Republic, where mostly CEOs (42%) took the survey.

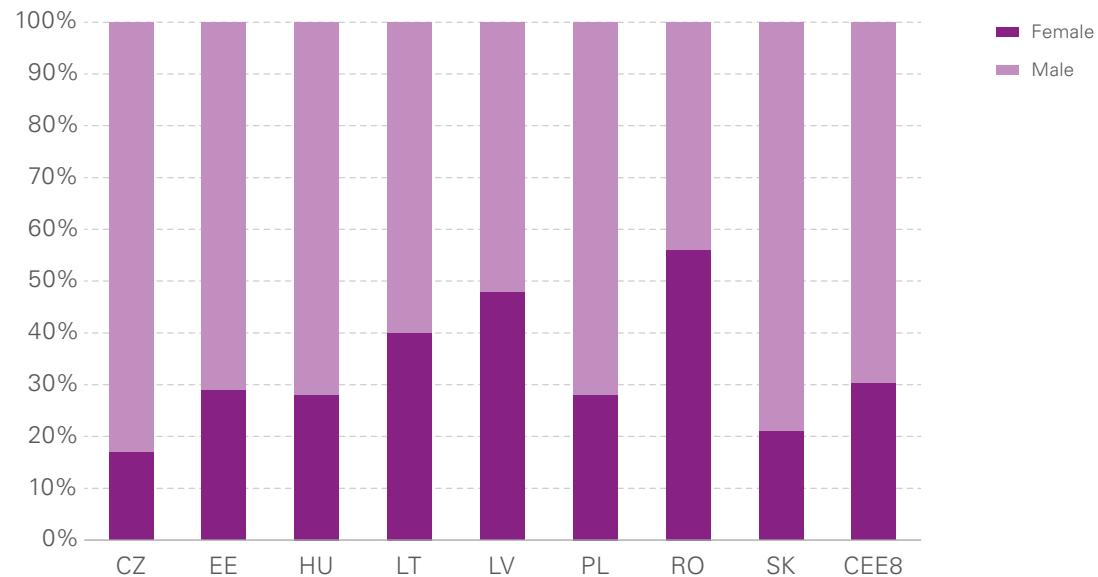
### Respondent's position



## Women make up one-third of respondents

Although male respondents dominate in the sample, 30% of the respondents are females – the highest share in Romania (56%) and Latvia (48%), the lowest in the Czech Republic (17%) and Slovakia (21%).

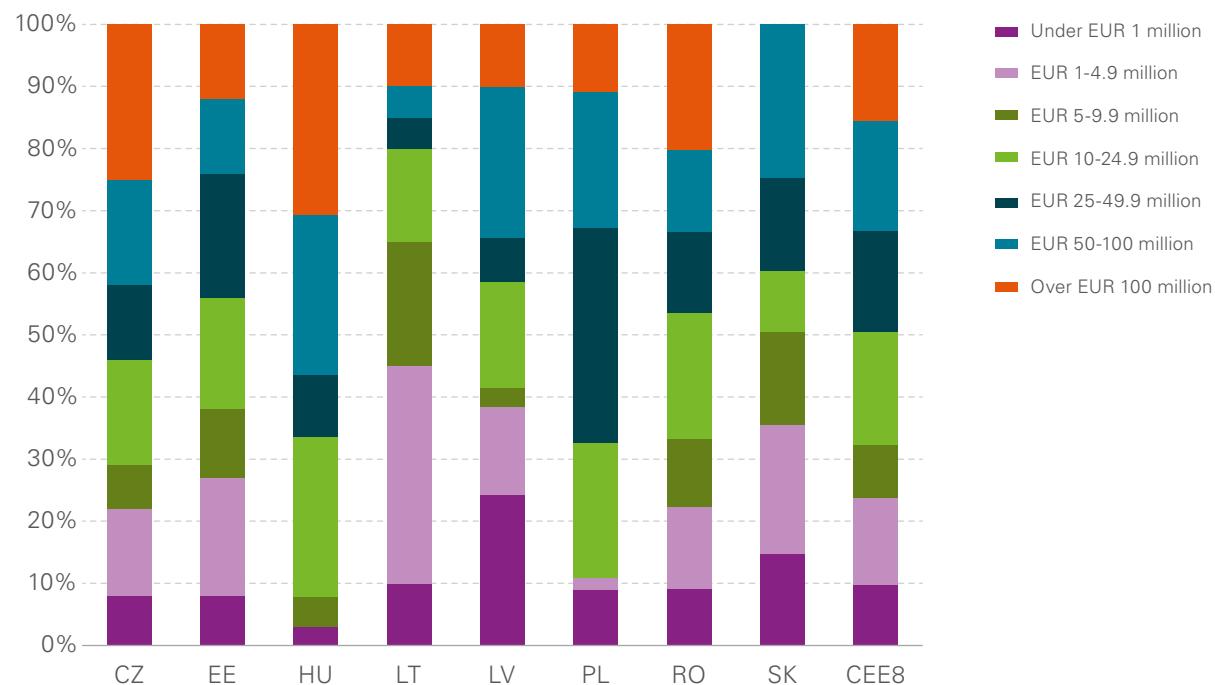
### Gender



## Larger countries excel with larger turnovers

The survey offers a cross-section of the corporate landscape in each country. The share of companies with turnovers exceeding EUR 100m is the highest in Hungary (31%), Czech Republic (25%) and Romania (20%), while 24% of the respondents in Latvia represent companies with annual turnover under EUR 1m – and in the same 24% belonging to the group from EUR 50 to EUR 100m.

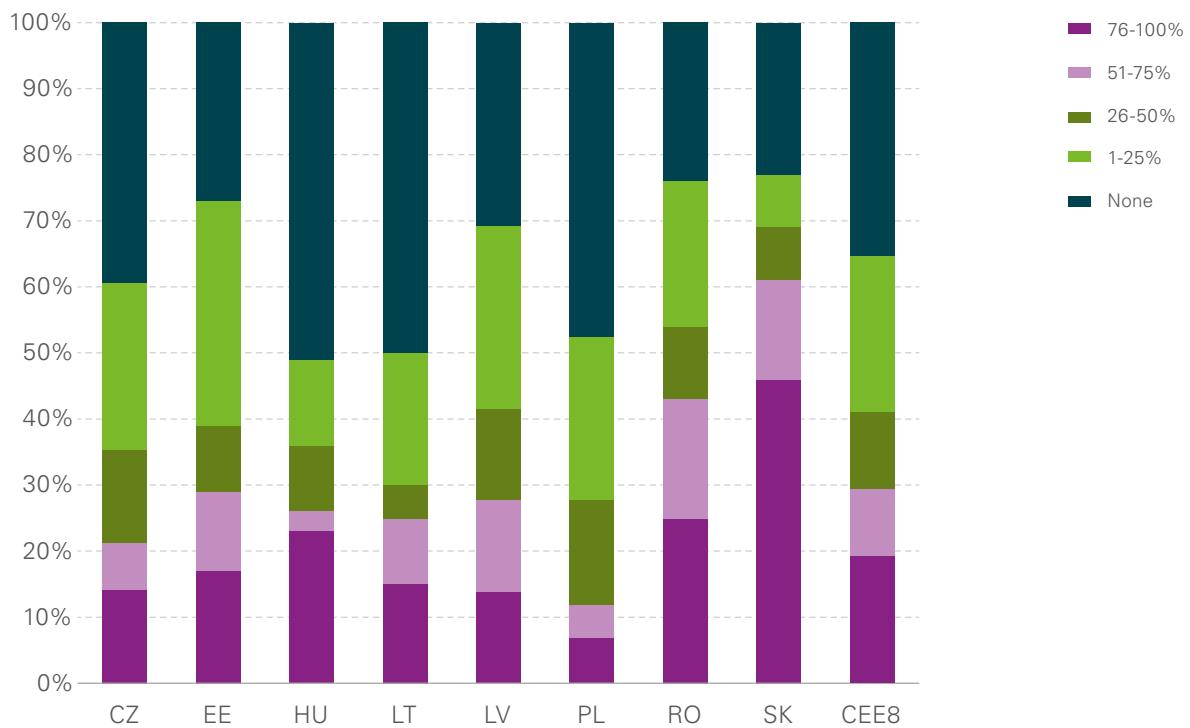
### Respondents by company turnover (2013)



## About two-thirds are exporting companies

The majority, 65%, of companies in the survey are active in export markets: 77% in Slovakia, 76% in Romania and 73% in Estonia. In Hungary, Lithuania and Poland about one-half are exporting companies. When comparing companies acquiring over 50% of their turnover in export markets, Slovakia comes first with 61%, followed by Romania (43%).

### Share of exports in company sales (2013)





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