CONFIDENCE DURING THE ECONOMIC AND FINANCIAL CRISIS

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Our study aims to examine the issue of confidence during the financial and economic crisis in Hungary. Although we address issues of the concept of trust, the analysis is mainly based on the definition of trust related to the socio-economic expectations and prospects that the general public and businesses have.

This study presents an analysis of the changing levels of consumer trust during the global economic crisis with special regard to the trust in banks.

Keywords: trust research, global financial and economic crisis, banking system, trust index.

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Understanding levels of trust is key to an analysis of the global economic crisis. Trust is a complex phenomenon and Trust Research is an interdisciplinary field of study; with its roots in psychology it has received wider attention since the 1990s. Its early focus on Interpersonal Research lent it significant relevance to Organisation Studies, with academics such as Tyler, Kramer and Lind working in conjunction with private businesses. Trust Research is now central to Conjecture and Market Research, where consumer trust and economic 'mood' are examined using several indexes. Noteworthy among these are the Michigan Consumer Sentiment Index of The University of Michigan and in Hungary, the Kozgaz Consumer Trust Index and its successor, the GfK Shopper Trust Index. The creation of the indexes was strongly influenced by the seminal work of economists Richard T.Curtin and George Katona, whose studies are core to Trust Research today.

Real economic and financial market background

Several excellent studies deal with the background to the development of the financial crisis and with the analysis of its course from a macroeconomic perspective. Since the conjunctural analysis of the Hungarian and other various markets is not the aim of this article but it provides an important professional background, it will only be mentioned marginally within the framework of the present study, acknowledging the limits of the inquiry.

The presentation of the real economy and the financial market as the background in our study is a brief snapshot of the global economy and the situation of the Hungarian economy, mainly based on the figures in the Kopint-Tarki 2010/3 conjuncture report (Palócz 2010). The background analyses are available in the conjuncture report, including the domestic and international economic summary and projections together with an analysis of the fiscal, monetary, financial and capital market trends.

The data available in the autumn of 2010 suggest that the crisis has passed its low point. However, even two years after the fall of Lehman Brothers, major uncertainties arise in connection with the further developments in the global economy. The growth which started in the previous six months seems to slow down primarily due to underlying tensions in money markets.

The international trade in goods may reach a record 14% growth this year after the fall of 2009; however, his growth rate can decrease to 7% depending on the implementation of protectionist measures in 2011. The current acceleration in growth is followed by a moderate inflation apart from a few countries (e.g. Japan).The prices of raw materials are increasing moderately, while the market prices of precious metals show a sharply rising tendency.

Besides the improving climate for investments and exports, the long-lasting decline in domestic consumption and the unfavourable labour market situation may prove an obstacle to the recovery from the crisis in the United States. No significant change is expected in connection with the approximately 1.32 USD / EUR exchange rate in the forthcoming year.

In the European Union, the growth rate is expected to slow down owing to the decline in orders, the weakening exports and the less bright economic outlook. The budgetary consolidation measures necessary in several Member States carry the potential danger of another recession. In the euro zone, last year's 4.1% decline is expected to turn into a growth of approximately 1.5% this year. Nowadays, Germany has been one of the most dynamically developing countries of the euro zone (3.4% increase!) and it seems that the recession of the labour market is coming to an end.

The external trade performance of Central and Eastern European countries has increased and they are assessed more favourably on the money markets.

Despite the fiscal stimulus measures adopted for 2011 the pace of economic growth will probably fall back somewhat throughout Europe. The assessment of our region on the money market has improved. However, it is true that international financial markets feature hectic, unexpected changes to different extents, but with still significant differences in the amplitude. The financial and financing problems of individual countries discourage investors. Central banks usually have to keep the base rate low and at the same time they try to support conjuncture stimulus using liquidity management tools and encourage lending practices.

After the outbreak of the financial crisis, foreign investors did not want to buy Hungarian government securities, therefore bond auctions stopped and banks did not obtain foreign resources either (Palócz 2010b).In this situation, Hungary was saved by the IMF credit line from a bank crisis. The fact that the Hungarian public debt had been high before the crisis and that the government's credibility had been shaken due to its failure to control the deficit played a significant role in the situation that the Hungarian economy has become one of the least creditworthy countries. During the first adjustment attempts, they tried to reduce the deficit by increasing taxes, which on the other hand may have a negative effect on economic growth.

According to the Financial Supervisory Authority's Risk Outlook (HFSA 2009) report, the financial sector's risks are primarily concentrated in credit markets. The banking sector underwent a process of important portfolio decline in 2009. However, it remained significantly profitable and a few key structural indicators improved noticeably, such as the credit / deposit ratio. The weight of the potentially risky foreign currency credit could not be reduced. In connection with portfolio assessment, the uncertainty in the need for depreciation and the expected decline in profits represent a significant risk for banks this year.

The bank tax of 2010 might be an even more significant problem for banks. This type of tax has existed since 2007 in form of a special bank tax representing 13 billion forints annually. In 2010, however, this turned into a crisis tax and according to the initial directive it was intended to provide the Hungarian budget with nearly 200 billion forints of income (out of which HUF 120 billion was the initial share of commercial banks).Therefore, the aim of the increased bank tax was to reduce the budget deficit (target of 3.8%), but it was not followed by a well-founded introduction of structural and organizational reforms. The tax rate also raises further questions: the bank tax is 0.5% for the banks with a bottom line over 50 billion HUF, compared with 0.04% in France. In Western Europe, governments' bank rescue packages provided legitimacy to the introduction of a bank tax, which did not happen in the case of Hungary. Besides the rate of increase in bad loans, increased provisioning requirements also reduced banks' ability to produce income. The reduction in earning capacity is linked to a reduction in banks' lending capacity, which is a particularly dangerous tendency for economic growth. Trust is an issue in the reduced predictability of economic policy, which also manifests in resource allocation of international parent banks and other international investors. Moreover, it can also lead to higher country risk premiums. To create long-term growth and balance (for minimum ten-year periods), one of the most important factors is a predictable economic policy.

The different approaches to the concept of trust in the literature

Obviously, it would be a daring undertaking to seek to express all possible factors numerically. Especially given that trust research entered the scope of management science from the field of psychology and the initial interpersonal research focus gradually shifted towards firms.

Most psychological studies relating research on trust link the source of trust to personality traits such as being impartial, fair, tactful, loyal, professionally or socially competent and consistent in behaviour.

According to Hosmer (1995), trust is our expectation of a morally and ethically appropriate behaviour from the part of the other party. Burt and Knez (1995) define it as a strategic understanding, where the trustee assumes the trusted's future cooperative behaviour.

According to Tyler and Blander (2006), personal tone, real attention to the other, the understanding of their viewpoint, goodwill and impartiality are the skills and attributes that make people trust someone.

Several authors use an operationalized framework for their trust research, for example (while highlighting the dimensions of trust they defined, as well):
§   Ganesan (1994), and Doney and Cannon (1997) credibility, benevolence
§   Aulakh et al. (1996) confidence, reliability, integrity
§   Sako and Helper (1998) goodwill trust, contract trust, competence trust
§   Zaheer et al. (1998), reliability, predictability, fairness

It is interesting to note that in connection with the notion of trust the following dimensions appear in the background structure of both the organizational level, more integrative psychological research and the trust indexes used for macro studies: (a) the need for predictability and a behaviour following certain common rules, (b) expectations and related uncertainty, and (c) goodwill.

Trust, the measurement of trust and the crisis

Katona (1974) discusses the analysis of consumer behaviour in a flourishing economic environment and during a crisis separately. In his article of 1974, he highlights the need for the measurement of expectations even if it means working with data filtered from subjective statements. He also addresses the question that the majority of people do not generally perceive a real change in income to an extent that would be necessary to adapt to the changed circumstances on the expenditure side.

Curtin (1984) emphasizes the important role of consumer choice on the macroeconomy and he draws up a regression equation to describe expenditures, one of the factors being consumer sentiment.

The notion of trust has many factors - further clarifications are necessary even if it is divided into the sub-categories of corporate and consumer trust.

Corporate trust may be examined from inter-organizational and intra-organizational aspects, which are completed with the expectations the businesses regarding market processes and demand.

§   the development of companies' business expectations (real economy),
§   the expected developments of domestic investments made by international banking groups, i.e. the extent of trust of the parent banks and their allocation of resources in Hungary, and the consequences of this willingness to lend (to retail clients, and to the business sector)

The issue of trust in public and professional regulatory bodies represents a special category within the category of inter-organizational trust. The importance of this cannot be overemphasized and from the aspect of an exit strategy out of the crisis and long-term effectiveness of markets. Its development has an impact on:
§   medium-and long-term strategic planning at a regional level, and also in the medium and short run in case of real economy and banks (for example, on the question whether a parent bank should focus on the operation of its Hungarian affiliate, or whether it should play a central or a peripheral role)
§   the development of business unit level strategies (e.g. how a bank shapes its investment or lending policy depending on the system of regulatory bodies
§   the harmonization process of the European Union - according to statement of the European Parliament on 22 September 2010 a new European financial supervisory system will be implemented (EP 2010) [1]

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[1] After the European Parliament's law entered into force three new authorities were created to supervise the activities of financial institutions, financial markets, insurance companies and pension funds, and a fourth body to monitor the risks to the EU's economy. The supervisory authorities will be able to put a temporary ban on risky financial products. In case of the inaction of national supervisors, the EU authorities will have the right to make decisions applicable

§   the semi-formal and formal behaviour (or more precisely that expected by the legislator and recommended based on social norms and ethical considerations) of market participants, and especially banks (e.g. the Code of Conduct for Hungarian banks)

§   the fairness of market competition, including the consumers' ability to negotiate, as well

This last point leads us to the following approach to the issue of trust, and this is consumer confidence. To measure consumer confidence, various consumer confidence indexes have been developed, which are aimed at analysing the consumers' expectations about their own and their country's financial-economic situation. In relation to consumer confidence, we would like to mention our concerns about the limited explanatory power of the general dimensions of consumer confidence indexes. Lessons from TÁRKI's 2010 Social Report (Tóth I. Gy. 2010) are that a lack of confidence is contagious: it spreads easily between different political institutions. The study shows that the deterioration of the EU's image is not primarily the result of a disappointment in the EU, but is rather connected to the decrease in general trust in institutions and to the increase in general discontent. Thus, when measuring consumer confidence, we have to take into account underlying factors that are seemingly not related to consumer confidence. The exploration of these factors and the assessment of their impact seems to be an exciting and complex task in the field of marketing research.
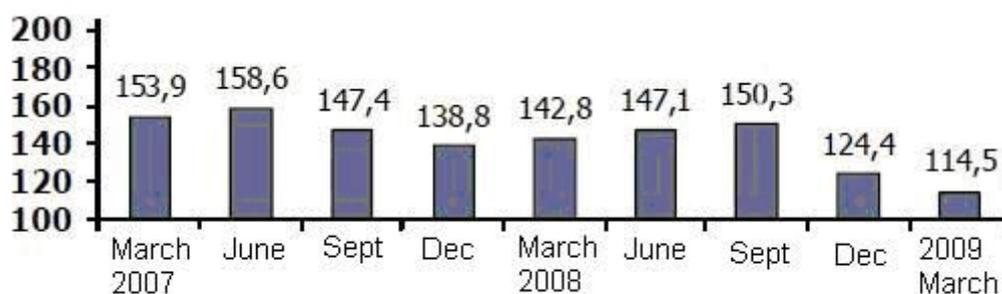
Just to mention a few consumer confidence indices: the *Nielsen Global Consumer Confidence Index* is widespread in the international practice of market research, the *Consumer Confidence Index,* the *University of Michigan "Consumer Sentiment Index",* and the *Consumer Confidence Index Average are well-known trust indexes in the United States,* the *GfK NOP Consumer Confidence Barometer* is perhaps the most common the United Kingdom and in Germany, we would like to highlight GfK's *Konsumklimaindex*.

We would like to draw attention to the Közgáz Consumer Confidence Index, which has been published by GfK Hungária and the Corvinus University together.

According to Agard et al. (2003), the licence of Közgáz Consumer Confidence Index was given to the Marketing Department of BKÁE by the Centre for Research of the University of Michigan. The calculation of the index is based on the following topics: the degree of consumer satisfaction with their financial situation, the consumers' expectations about the incomes; the expectations about the country's economic situation for the next 12 months and for the next 5 years and the intent to purchase durable consumer goods. The index is made up of three indexes, which are as follows: Consumer Confidence Index (the main index, which includes all five above mentioned issues), the Consumer Expectations Index, which includes the expectations about personal and national financial situation, and the Index of Propensity to Buy, which represents the assessment of the present financial situation and the willingness to purchase durable consumer goods.

According to the GfK Hungária report (GfK 2009), the Consumer Confidence Index (CCI) measured jointly by GfK Hungária and Corvinus University of Budapest, continued to decline as a result of the global economic crisis compared to the end of 2008, scoring nearly 10 points less than before. Hungarian households' perception of our current financial and economic situation and the country's economic prospects was less favourable. The most important decline occurred in the Index of Propensity to Buy, reaching an unprecedented low point.

Figure 1. *Consumer Confidence Index between March 2007 and March 2009*

Source: GfK Hungária, Consumer Confidence Index, March 2009

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indirectly to financial institutions. Source: European Parliament, the Hungarian-language official website, www.europarl.europa.eu / en

Figure 2. *Index of Propensity to Buy between March 2007 and March 2009*

*Source: GfK Hungária, Consumer Confidence Index, March 2009*

The relationship between trust and the GDP

Out of the different confidence indexes, there are two major groups: the consumer confidence index and the sentiment index measuring the expectations of the corporate sector. Consumer confidence indexes are indicators based on research conducted among thousands of consumers regarding their assessment of the current situation and their expectations about the economic climate. The index may prove useful as a tool to reveal sudden changes in consumption patterns. From time to time, it is examined jointly with corporate trust indexes, which are based on a similar methodology; however, they consider companies as the respondent entities.

The Kopint-Tarki 2010/2 conjuncture report (Kopint-Tarki 2010) shows definitely improving expectations of the population and of businesses in the second quarter of 2010 compared to previous quarters. The growing optimism is present in the prospects of the population and the companies as well as the country's outlook. Regarding the recovery from the crisis, the positive expectations represent positive signs, since these positive expectations and predictions may be self-fulfilling.

The evolution of trust in the economic situation between the second quarter of 2008 and 2010 is illustrated by the figure below.

Figure 3. *Outlook compared to the current situation (difference on a scale between 0 and 100 in percentage points)*
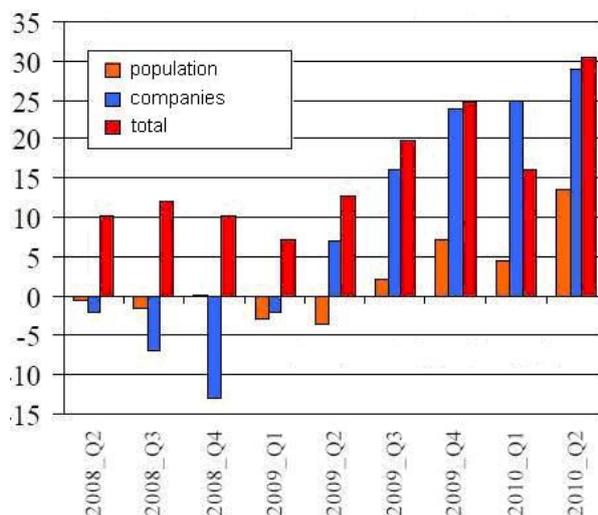

Source: Kopint-Tarki: Conjuncture report
The situation and outlook of the global and the Hungarian economy in the summer of 2010 (2010 / 2)

Generally, confidence indexes and GDP move closely together. Of course, confidence indexes as an indicator of GDP should be taken with a pinch of salt, as a variable degree of uncertainty is present due to their predictive nature, but experience shows that the confidence indexes have a non-negligible explanatory power.

To illustrate this relation, it is worth comparing GKI's consumer and business confidence index in addition to its conjuncture index.

Figure 4. *Business confidence and conjuncture index*
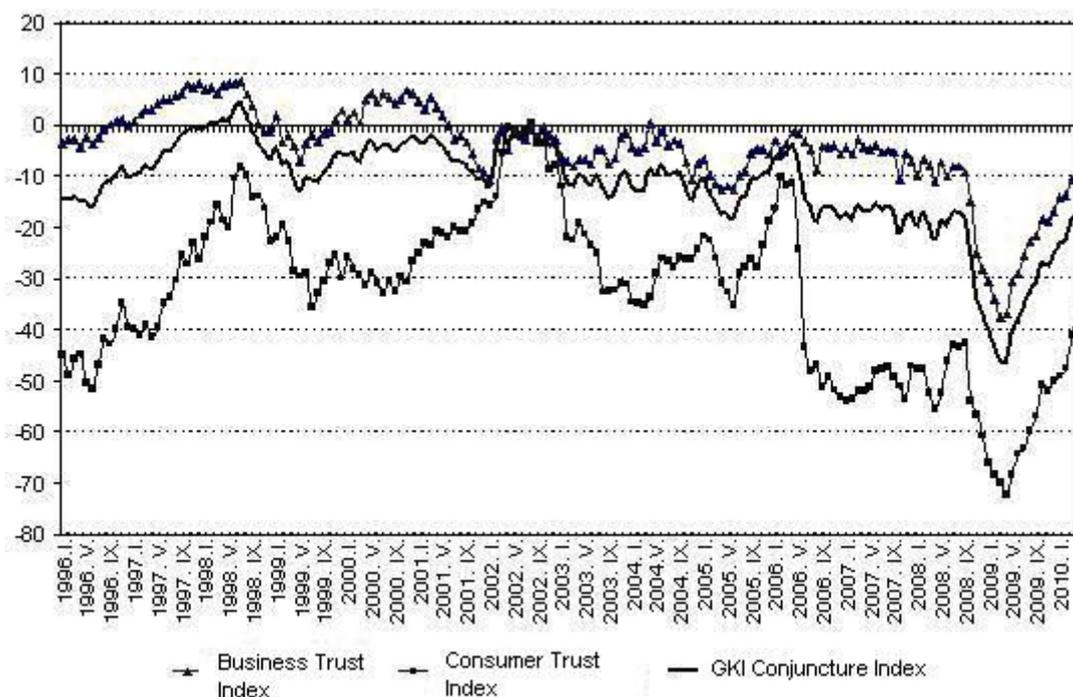
Source: GKI Economic Research Co., www.gki.hu

In the autumn of 2009 a sharp decrease can be observed in both the conjuncture and confidence indexes. From the spring of 2009, the government's emergency measures relatively rapidly strengthened confidence in the Hungarian economic policy, delivering quick results in the financial market, as well. A process of stabilization can be seen, however, it cannot be claimed that the current situation of the Hungarian economy has stabilized.

The subtle underlying factors: financial and media culture

Well-informed consumers can make decisions more easily and know who (which service provider) to trust under what circumstances (in case of which parameters) and who they can turn to in case of problems (problem solving method between client and bank, and advocacy organizations).

Hungarian consumers and bank customers need help to find information and to acquire the skills necessary to do so. Primarily those consumers are capable of looking after themselves who are aware of their rights, opportunities and responsibilities.

According to McKinsey's study entitled *The intensity of competition in the Hungarian retail banking market and the possible directions of increasing customer's value* (McKinsey & Company, 2007), about three million individuals over 16 do not have any banking relationship. Over the past few years this situation has not changed considerably. Consequently, the costs of postal cheques that seem free to individuals but are in fact more expensive than bank payments are covered by the state itself, and thus indirectly by the taxpayers. In the future, it would be interesting to do research on the proportion of the population who know the basic financial indicators (APR, AER ... etc) and financial processes besides the current assessment of the density of bank connections.

To do this, the reading test related to medication guides used in pharmaceutical marketing research and the further quantitative and qualitative analysis of the typical difficulties of interpretation could serve as a methodological example (Simon 2010).

A significant potential lies in the media as a source of information and financial knowledge. It is also necessary to incorporate financial literacy into elementary and secondary education. Already there are some examples in this field (the Financial Supervisory Authority deals with such things), but the problem is that it is not clear how big part should the state, the financial sector, and the civil society take in financing and running this activity. The current circumstances suggest that the parties are waiting for each other to do something.

We would like to emphasize the role of the media and politics in informing people. If the people are not informed appropriately, however, trust in financial institutions may be damaged easily, and in such cases it is much more difficult to regain confidence.

A registry of positive debtors would help the work of financial institutions and the long-term client-bank relationship, which is based on trust. However, the proposal coming from the banks was adjourned by the legislature citing privacy concerns. So currently only a bar list of problem debtors is used, positive discrimination is not yet possible.

Supervisory authorities play a vital role in strengthening trust. The EU's current law alignment points towards the appreciation of the authorities' work, and in the future the company's ownership or management rights may be restricted, where appropriate.

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