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CESifo World Economic Survey

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World Economic Climate

World economic climate suffers setback

Economic Expectations

Economic expectations less positive

Inflation

Lower price expectations

Currencies

Yen and British pound
seen as overvalued

Interest Rates

Decline in short-term interest rates
expected

Special Topic

Growing protectionism endangers
cross-border investment

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Ifo World Economic Survey

Regions

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- North America: Economic climate indicator drops again
- Eastern Europe: Economic climate bleakens
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The survey is jointly conducted by the Ifo Institute and the Paris-based International Chamber of Commerce (ICC).

Notes

The World Economic Survey (WES) assesses worldwide economic trends by polling transnational and national organisations worldwide on current economic developments in their respective countries. Its results offer a rapid, up-to-date assessment of the economic situation prevailing around the world. In July 2012, 1,079 economic experts in 123 countries were polled.

WES is conducted in co-operation with the International Chamber of Commerce (ICC) in Paris.

Methodology and evaluation technique

The survey questionnaire focuses on qualitative information: assessments of a country's general economic situation and expectations regarding key economic indicators. It has proven a useful tool, since it reveals economic changes earlier than conventional business statistics.

The individual replies are combined for each country without weighting. The grading procedure consists in giving a grade of 9 to positive replies (+), a grade of 5 to indifferent replies (=) and a grade of 1 to negative (-) replies. Overall grades within the range of 5 to 9 indicate that positive answers prevail or that a majority expects trends to increase, whereas grades within the range of 1 to 5 reveal predominantly negative replies or expectations of decreasing trends.

The survey results are published as aggregated data. The aggregation procedure is based on country classifications. Within each country group or region, the country results are weighted according to the individual country's exports and imports as a share of total world trade.

CES – Center for Economic Studies – is an institute within the department of economics of Ludwig Maximilian University, Munich. Its research, which focuses on public finance, covers many diverse areas of economics.

The *Ifo Institute* is one of the largest economic research institutes in Germany and has a three-fold orientation: to conduct economic research, to offer advice to economic policy-makers and to provide services for the research and business communities. The Ifo Institute is internationally renowned for its business surveys.

CESifo is the name under which the international service products and research results of both organisations are published.

World Economic Climate suffers setback

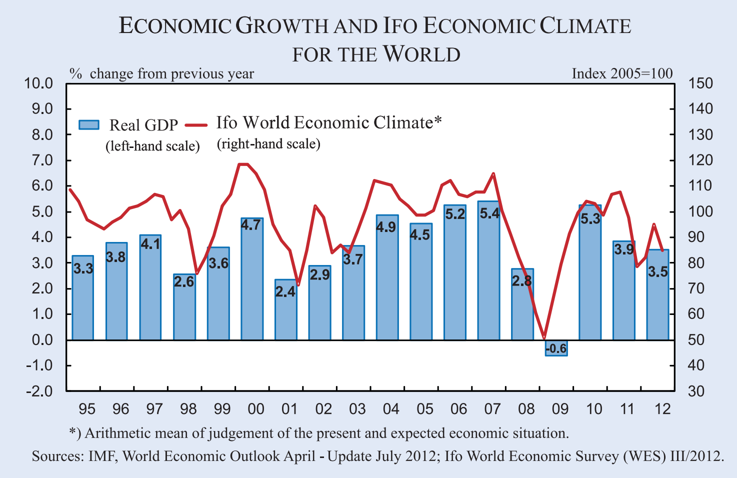
The Ifo World Economic Climate Indicator fell again, after two successive increases in the previous quarter. At 85.1 the indicator stands well below its long-term average of 96.7 (1996–2011). The decline was due to both unfavourable assessments of the current economic situation and a less positive six-month economic outlook (see Figures 1 and 2). The results imply a setback in the recovery of world economy, which is also reflected in the business-cycle clock (see Box 1).

Economic climate deteriorates across almost all continents

In the last quarter the improvement in the economic climate was mainly driven by a positive outlook, but in July both assessments of the current situation and expectations concerning future developments clouded over considerably across all major continents. In *North America* the climate indicator once again fell below its long-term average. WES experts reported a much worse outlook, but the level remains above the most recent lower turning point in the fourth quarter of last year. A similar pattern can be observed for *Western Europe* and the *euro area*. Both assessments of the current situation and the six-month outlook declined. In *Asia* the outlook is slightly less optimistic and the improvement in the current situation seen in the previous quarter was almost canceled out. The *Asian* economy is experiencing a lateral movement. Nevertheless the current situation in *Asia's* two main economies, *India* and *China*, has been assessed with increasing pessimism in recent quarters. In *Latin America* both climate components fell. Responses of survey participants in terms of expectations and assessments point towards a constant development of the economy.

Since mid-2011 the world economy has been in the grip of an economic slowdown that has affected all key regions, albeit to differing degrees. This was reflected in a slump in many confidence indicators towards the end of last year. Although the mood of consumers, producers and WES experts recovered briefly for a short time at the beginning of this year, it nevertheless remains at a far lower level than in early 2011, and has resumed a downward trend in some places. In addition to restrictive economic policy in a large number of emerging economies up until mid-2011 and the restrictive financial policy implemented in many European countries, the decisive factor in the weakening of the global economy was primarily great uncertainty due to the renewed escalation of the European debt crisis. Far-reaching economic policy interventions in the *euro area* initially

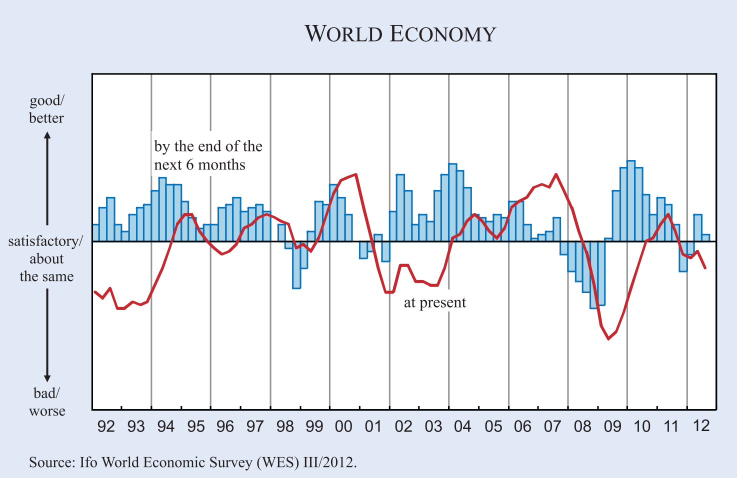
Figure 1



*) Arithmetic mean of judgement of the present and expected economic situation.

Sources: IMF, World Economic Outlook April - Update July 2012; Ifo World Economic Survey (WES) III/2012.

Figure 2



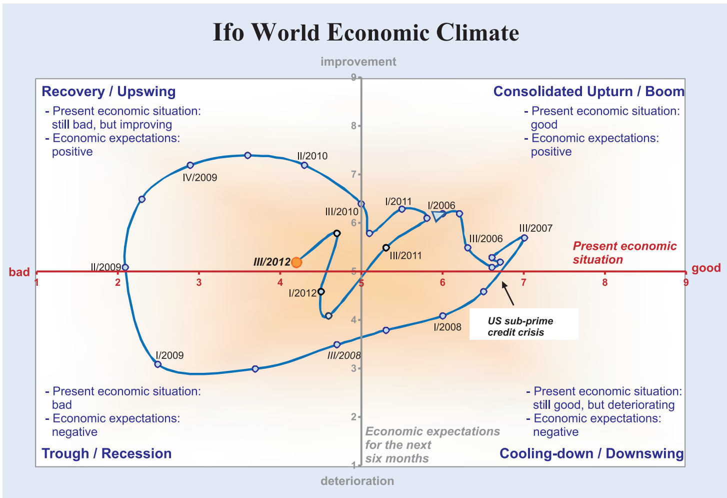
Source: Ifo World Economic Survey (WES) III/2012.

Box 1

Ifo Economic Clock and the Ifo World Economic Climate

A glance at the Ifo Economic Clock showing the development of the two components of the economic climate index over the last six years can provide a useful overview of the global, medium-term forecast. The business cycle typically proceeds clockwise in a circular fashion with expectations leading assessments of the present situation.

According to the July survey, the Ifo indicator for the world economic climate showed a considerable downturn, after two successive increases. Both assessments of the current economic situation and economic expectations for the next six months deteriorated in equal parts compared to the second quarter of 2012. The indicator is still located in the "recovery" quadrant, but is approaching the "recession" quadrant. The new survey results confirm a setback to the recovery of the world economy.



Source: Ifo World Economic Survey (WES) III/2012.

The Ifo World Economic Climate is the arithmetic mean of the assessments of the current situation and economic expectations for the next six months. The correlation of the two climate components can be illustrated in a four-quadrant diagram ("Ifo Business Cycle Clock"). The assessments on the present economic situation are positioned along the abscissa, the responses on the economic expectations on the ordinate. The diagram is divided into four quadrants, defining the four phases of the world business cycle. For example, should the assessments of the interviewed experts on the present situation be negative, but the expectations became positive, the world business cycle is in an upswing phase (top left quadrant).

calmed the situation. The European Central Bank (ECB) massively extended its unconventional measures. Additional fiscal consolidation measures were also implemented in many *euro area* countries, where decisions were taken to accelerate structural reforms in order to restore investor confidence. However, these economic policy measures only calmed the situation temporarily since the underlying structural problems remained unresolved. Risk premiums on the government bonds of crisis countries in the *euro area* started to rise again as early as April 2012. Uncertainty increased in all key financial markets, pulling share prices down worldwide. This renewed escalation was primarily triggered by disconcerting signals.

A further escalation of the European debt crisis nevertheless remains the main risk to global economic development. The probability of a risk scenario materializing currently seems just as great as that of a baseline scenario, where the crisis can be solved in the medium-term. For the structural problems to be tackled by the *euro area*'s crisis countries (*Greece*, *Ireland*, *Portugal*, *Spain* and *Italy*) remain enormous and will negatively impact their performance, and thus their solvency, far beyond the next two years. The positive signals from the Ifo World Economic Climate from the previous quarter faded away. The outlook is less optimistic mainly due to overriding uncertainty induced by the crisis in the *euro area*. The upcoming development can be described by several scenarios, whose occurrence probability is determined in many cases by political decisions, which are quite hard to forecast.

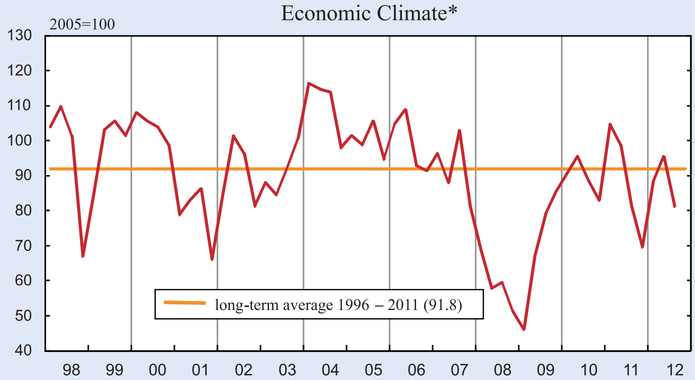
Western Europe: Economic climate clouds over

The economic climate indicator for *Western Europe* has fallen considerably, and, at 89.3, it now stands well below its long-term average (of 105.7 in the period 1996–2011; see Figure 3). Assessments of the present economic situation were clearly downgraded along with economic expectations for the next six months to an even greater degree (see Figure 4). The same pattern applies to the *euro area* (see Box 2). Here, the indicator for the *euro area* moved down to 88.9 (long-term average: 109.0, 1996–2011), due to significantly less positive appraisals of both components: the present economic situation and expectations for the next six months.

Within the *euro area*, the economies of *Germany*, *Estonia* and *Finland* continue to perform well, according to WES experts. Despite some downwards revision versus the previous survey, the present economic si-

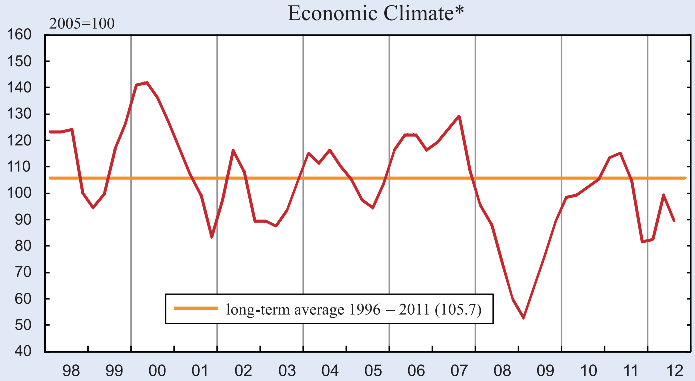
Figure 3

NORTH AMERICA
Economic Climate*



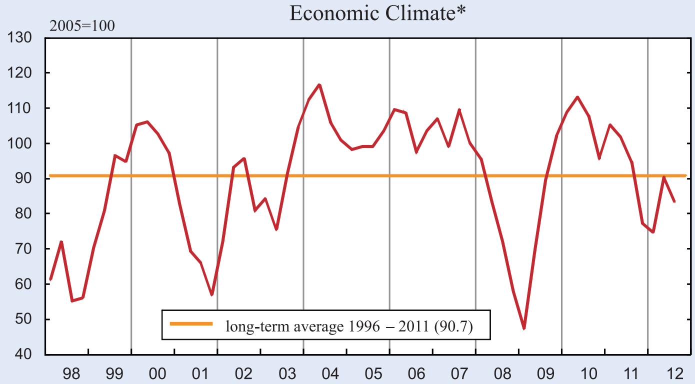
*) Arithmetic mean of judgement about the present and expected economic situation.
Source: Ifo World Economic Survey (WES) III/2012.

WESTERN EUROPE
Economic Climate*



*) Arithmetic mean of judgement about the present and expected economic situation.
Source: Ifo World Economic Survey (WES) III/2012.

ASIA
Economic Climate*



*) Arithmetic mean of judgement about the present and expected economic situation.
Source: Ifo World Economic Survey (WES) III/2012.

tuation in *Germany* and *Estonia* continues to be assessed as "good", and as "satisfactory" in *Finland* (see Figures 5a and 7). However, the six-month outlook in both *Germany* and *Finland* deteriorated considerably: WES experts have become rather cautious regarding future economic development in both countries.

In *Estonia*, economic expectations point to an economic stabilization at the current good level. In all three economies, the experts surveyed expect dynamics from the export sector to weaken in the next six months. In *Malta* and *Slovakia*, appraisals of the present economic situation are seen as "satisfactory". While the expectations for *Malta* are optimistic for the next half year, the WES experts in *Slovakia* have become rather cautious with regard to the future economic development. In *Austria*, no changes to April's survey results were reported: participants continued to assess the present economic situation as unfavourable, but expect some improvement in the overall economy within the next six months. There were reports of poor economic performance from the economic experts surveyed in *Belgium, France, Ireland, Luxembourg*, the *Netherlands* and *Slovenia*. Concerning the six-month outlook, only WES experts in *Ireland* and the *Netherlands* became more confident on the back of an expected strengthening of the export sector. In *Cyprus, Greece*, *Italy*, *Portugal* and *Spain* the experts continued to describe the present economic situation as fragile. Capital expenditure and private consumption are subdued and are expected to remain so over the next six months. As far as future economic developments over the next half year are concerned, WES experts in the respective countries remain cautious and do not expect economic performance to improve. They nevertheless expect exports to strengthen within the next six months in all of these countries with the exception of *Cyprus.*

In most of the countries outside the *euro area* a somewhat friendlier economic climate prevails. WES experts gave *Norway* the region's best rating. Here

Box 2

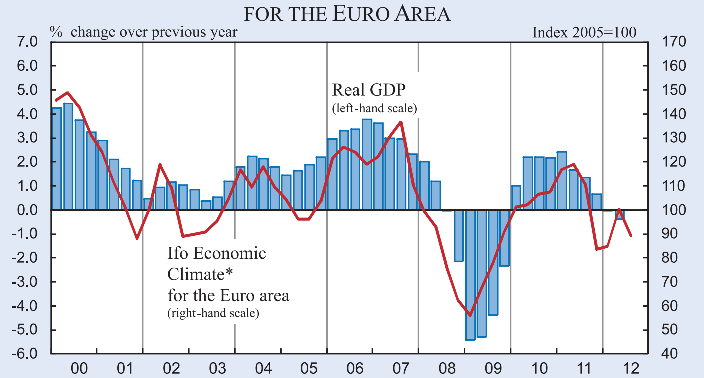
World Economic Survey (WES) and GDP Growth in the Euro Area

The Ifo World Economic Climate for the 17 member countries of the euro area is the arithmetic mean of the assessments of the general economic situation and the expectations for the economic situation in the next six months. The July results are based on the responses of 274 experts. As a rule, the trend of the Ifo Economic Climate indicator correlates closely with the actual business-cycle trend for the euro area – measured in annual growth rates of real GDP (see Figure).

After two successive increases the Ifo Economic Climate Indicator for the *euro area* fell in the third quarter of 2012 and is now significantly below its long-term average value. Assessments of the current economic situation and expectations were both poorer than in the second quarter. The economy is not expected to pick up in the next six months. The debt crisis has flared up again and is hampering economic activity in the *euro area.*

In *Greece, Italy, Portugal, Spain* and *Cyprus* assessments of the current economic situation remain at recession level. Assessments of the situation in *Belgium, France, Ireland*, the *Netherlands* and *Slovenia* are only slightly better. In *Germany, Estonia* and *Finland* the majority of participants continued to assess the current economic situation positively, although to a lesser degree that in last quarter's survey. The six-month economic outlook clouded over in most member countries compared to last quarter. *Ireland* and the *Netherlands* are the only countries where expectations have risen and pointing to a modest recovery in economy activity.

ECONOMIC GROWTH AND IFO ECONOMIC CLIMATE FOR THE EURO AREA



*) Arithmetic mean of judgement of the present and expected economic situation.

Sources: Eurostat, Ifo World Economic Survey (WES) III/2012.

the present economic situation has been assessed as highly favourable and is expected to remain so in the next six months. However, a favourable current situation prevails in *Sweden* and *Switzerland* too, and to an even greater degree than in the previous survey. Economic expectations, on the other hand, have been downgraded somewhat in both countries, however there are no signals of a major departure from the currently favourable economic situation. In *Iceland* and *Monaco*, experts reported a satisfactory present economic situation and a positive outlook. In *Denmark* and the *United Kingdom* no change to the present economic situation was reported versus the previous survey, which is still assessed as unfavourable in both countries. The economic experts surveyed are nevertheless relatively positive with regard to the six-month outlook.

North America: Economic climate indicator drops again

After two successive rises in the first half of the year, the economic climate indicator in *North America* fell to 81.2 and thus well below its long-term average of 91.8 (in the period 1996–2011; see Figure 3). Both assessments of the present situation, and to an even greater degree economic expectations, have been downgraded considerably (see Figure 4). This pattern particularly applies to the *United States*: the present economic situation deteriorated compared to the previous survey and is once again assessed as unfavourable. WES experts are also less positive about the six-month outlook compared to the survey in April (see Figure 6). They do not expect any major changes in economic developments until the presidential elections in November. In *Canada*, the present economic situation has improved somewhat and still remains at a satisfactory-level. In contrast, the economic expectations for the next six months are less favourable than in the previous survey, but remain in positive territory.

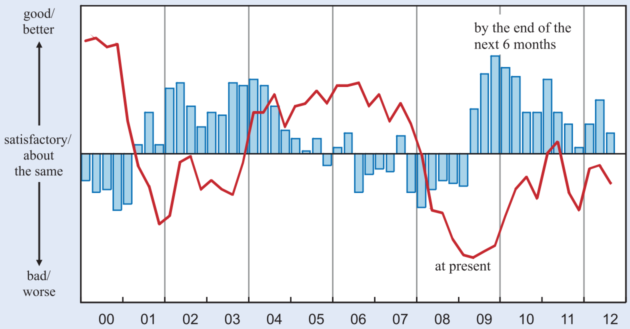
Eastern Europe: Economic climate bleakens

The economic climate indicator in *Eastern Europe* fell again after its temporary rise in the second quarter and at 63.6 has fallen to its lowest level since the end of 2009. The assessments of both components, the pre-

Figure 4

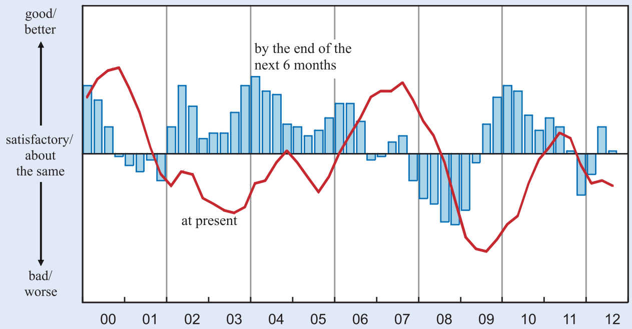
Selected Regions

North America
Economic Situation



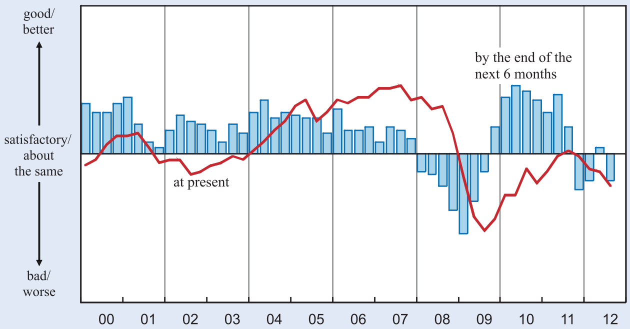
Source: Ifo World Economic Survey (WES) III/2012.

Western Europe
Economic Situation



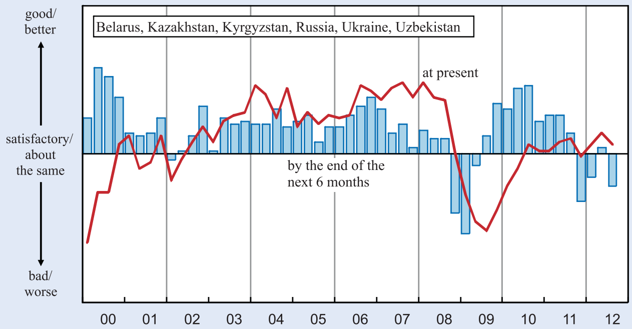
Source: Ifo World Economic Survey (WES) III/2012.

Eastern Europe
Economic Situation



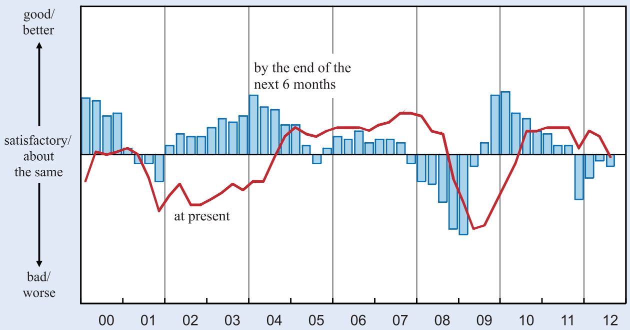
Source: Ifo World Economic Survey (WES) III/2012.

CIS
Economic Situation



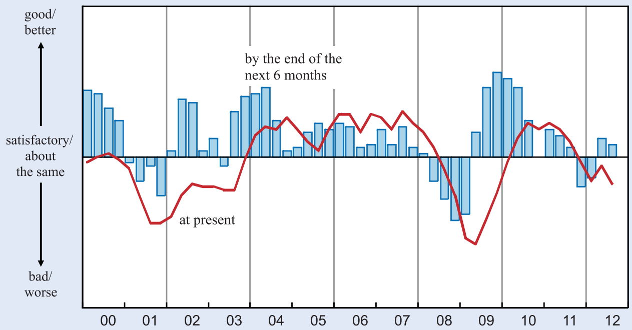
Source: Ifo World Economic Survey (WES) III/2012.

Latin America
Economic Situation



Source: Ifo World Economic Survey (WES) III/2012.

Asia
Economic Situation



Source: Ifo World Economic Survey (WES) III/2012.

sent economic situation and economic expectations, have worsened remarkably: the present economic situation is seen as unfavourable, and the WES experts in the region have also become cautious and expect no improvement in the economy in the next six months (see Figures 4 and 7).

The relatively strongest economic performance at present in this region was reported in *Latvia* and *Lithuania*. WES experts see the present economic situation as favourable in *Latvia*, and as satisfactory in *Lithuania*. However, optimism has evaporated with regard to expectations for the next six months. In *Latvia* private consumption is particularly weak at present and is expected to remain subdued for the next six months. According to WES experts, *Poland*, whose economy appeared to be robust in previous quarters, experienced a stronger downturn in July. Their assessments of the present economic situation have worsened considerably and now lie below the satisfactory-level. For the next six months the economic experts surveyed have become pessimistic with regard to future economic developments and expect capital expenditure and private consumption to weaken considerably. In the *Czech Republic* and *Bulgaria* the present economic situation was seen as unfavourable, while in *Hungary* and *Romania* it was reported as clearly weak. In all these countries, the economic expectations for the next half year have been downgraded somewhat compared to the previous survey, except for *Bulgaria*: While WES experts in the *Czech Republic* and *Romania* now have a more sceptical view with regard to economic performance over the next six months, they remain confident in *Hungary* and *Bulgaria*.

The economic situation in countries outside the *EU* like *Albania, Bosnia and Herzegovina, Croatia* and *Serbia* was also assessed as very weak. WES experts in most of these countries do not expect any substantial improvement in their economies over the next six months, except for *Serbia*, where some bettering within the next half year is foreseen. The present economic situation only remains satisfactory in *Montenegro*. The economic experts surveyed here remain fairly confident about the six-month outlook.

CIS: Expectations sharply downgraded

The economic climate indicator for the *CIS countries* covered by WES (*Russia, Belarus, Ukraine, Kazakhstan, Kyrgyzstan* and *Uzbekistan*) has fallen, mainly due to considerably downgraded economic expectations, which now signal scepticism about future economic development. The assessments of the present situation were also less positive than in the previous quarter, but remain in favourable territory (see Figure 4). This development is particularly true for *Russia*, which is the largest country in this region (see Figure 6).

The assessments of the present economic situation differ strongly within the countries. While the current economic situation in *Kazakhstan* remains good – and even better than in *Russia* – the present economic situation is rated as unfavourable in the *Ukraine* and as weak in *Kyrgyzstan*. In *Belarus, Uzbekistan* and *Georgia*[1] the economic experts surveyed once again described the economic situation as satisfactory. For the next six months the experts interviewed in these three countries expect their national economies to stabilize at their respectively good present levels. In *Russia, Kazakhstan, Kyrgyzstan* and the *Ukraine* economic expectations were downgraded and a more cautious view for the next six months now prevails. At least, in the *Ukraine* the export sector is expected to pick up slightly over the next six months.

Asia: Economy slows down

After having nearly reached its long-term average (1996–2011: 90.7) in the previous quarter, the economic climate indicator in *Asia* has begun to fall again in July and now stands at 83.3. Assessments of both the present economic situation, and to a lesser extent of economic expectations, have been downgraded somewhat (see Figures 3, 4 and 8).

The economies of *Indonesia, Papua New Guinea*, the *Philippines* and *Thailand* are performing well at present, and even better in most of these countries than in the previous survey, according to WES experts. Overall, WES experts expressed greater optimism with regard to future economic developments over the next six months and expect the economic situation to stabilize at the present good levels in all of these countries. In *Bangladesh, Hong Kong* and *Malaysia*, the present economic situation was still assessed as satisfactory, despite some downwards revision compared to the previous survey. While in *Bangladesh* and *Hong Kong* no major economic changes are anti-

[1] Georgia, which is not a member of the Commonwealth of Independent States, is included in this group for reasons of geography and similarities in economic structure.

cipated within the next six months, WES experts in *Malaysia* expect the economic situation to deteriorate somewhat. In *India*, *China*, *Sri Lanka* and *South Korea* the appraisals of the present economic situation worsened compared to the previous survey, especially in *South Korea* and *Sri Lanka*, and are now in unfavourable territory. In most of these countries private consumption and capital expenditure are regarded as weak. However, for the next six months, *Chinese* WES experts have become considerably more positive and expect economic development to improve slightly. This is also the case for *India*. In *South Korea* and *Sri Lanka*, on the other hand, experts expressed greater caution with regard to economic developments in the next half year. In *Japan* the present economic situation is still assessed as unfavourable. The economic expectations of the experts surveyed are less positive than in the April survey and indicate no major improvement within the next six months. The economic situation in *Vietnam* has deteriorated significantly compared to the previous survey and is now regarded as weak, as is the situation in *Pakistan* and *Taiwan*. However, for the next six months, WES experts expect some improvement in the general economic situation in all of these countries. While in *Taiwan* the export sector is expected to strengthen slightly in the course of the next half year, in *Vietnam* capital expenditure is expected to grow.

Oceania: Economic climate indicator rises

Oceania is the only region in which the economic climate indicator rose in the third quarter. This was mainly due to upgraded assessments of the present economic situation, which is now regarded as favourable. The six-month outlook is also somewhat more positive and points to an economic stabilization at the current good level. However, this is only the case in *Australia* (see Figure 6). Here the economy is performing well, according to WES experts: a favourable economic situation prevails and is expected to continue to do so for the next six months. Exports in particular are expected to expand strongly. In contrast, the experts surveyed in *New Zealand* continue to assess the present economic situation as unfavourable. The outlook for the next six months has been slightly revised downwards versus the previous survey, but nevertheless remains in positive territory. While capital expenditure looks set to strengthen slightly in the course of the next six months, exports are expected to slow somewhat.

Latin America: Renewed downturn

In *Latin America* the economic climate indicator has started to fall again, after two successive increases. Like in *Asia*, assessments of the present situation, and to a lesser extent economic expectations, deteriorated remarkably compared to the previous survey (see Figures 4 and 9). In most of the region's countries on average a satisfactory present economic situation prevails, and no major changes are foreseen for the next six months.

In *Chile, Ecuador, Peru* and *Uruguay* a favourable economic situation still prevails, although to a slightly lesser degree than in the survey in April. In all of these countries private consumption in particular is the driving force at present. Economic expectations have been downgraded somewhat by WES experts, who have become rather cautious in all of these countries, except for *Uruguay*, where a positive outlook persists. In all of the countries cited above, fewer impulses from exports are expected within the next six months. *Bolivia, Colombia, Costa Rica, Cuba, Guatemala, Mexico* and *Panama* belong to the group of economies, whose current economic performance is observed as satisfactory by WES experts. In most of these countries no major changes are anticipated in the next six months. *Colombia* is the only country in which WES experts have become pessimistic regarding future economic developments. In *Brazil*, the present economic situation deteriorated considerably compared to the previous survey and is now assessed as unfavourable. Experts gave similar assessments for *El Salvador* and *Paraguay*. While in *Brazil* and *El Salvador* capital expenditure is considered weak at present, in *Paraguay* the weak economic factor is private consumption. WES experts in *Brazil* and *El Salvador* are less confident about the six-month outlook than in the previous survey, but remain on average positive regarding future economic performance. Contrary to these negative trends, the economic experts surveyed in *Paraguay* have revised their economic outlook considerably upwards. In *Argentina, Venezuela*, the *Dominican Republic* and *Trinidad and Tobago* the present economic situation deteriorated significantly versus the previous survey and is considered as weak by the experts surveyed. In *Argentina*, capital expenditure is even regarded as very weak. In addition, the investment climate for foreign investors at present – and also for the next six months – is assessed as unfavourable, as legal and administrative restrictions for foreign firms are particularly high and political instability is foreseen to increase (see Tables 2 and 3). Thus, the economic outlook in *Argentina* for the next half year remains pessimistic, according to WES experts. In *Trinidad and Tobago*, on the other hand, some improvement in economic performance is expected within the next six months, while in the *Dominican Republic* and *Venezuela* no major changes for the better are anticipated.

Near East: Favourable economic climate

In the *Near East* a favourable economic climate persists, despite some downwards revision of both the present economic situation and economic expectations (see Figure 10). Similar to *Western* and *Eastern Europe*, *CIS* countries and *North America*, the economic expectations in this region also declined about twice as much as assessments of the current situation, compared to the previous quarter.

In *Israel, Jordan, Qatar, Saudi Arabia* and *Turkey* a favourable present economic situation prevails. In *Turkey* in particular the situation improved considerably versus the previous survey. For the next six months WES experts in *Qatar, Saudi Arabia* and *Turkey* expect an economic stabilization at the current good levels of their respective countries. In *Turkey*, the export sector is expected to strengthen in the months ahead. In *Israel*, on the other hand, the economic outlook has been revised considerably downwards and the experts surveyed have become rather cautious with regard to future economic performance. In *Jordan* some deterioration in the economic situation is expected in the next six months. In *Kuwait, Lebanon* and the *United Arab Emirates* the current economic situation is considered as satisfactory. The economic outlook for the next six months remains positive in *Lebanon* and the *United Arab Emirates.* In contrast, the experts surveyed in *Kuwait* expect the economic situation to deteriorate somewhat in the course of the next half year. In *Syria* – not surprisingly – a weak economic performance was reported once again. No substantial improvement in economic performance is expected over the next six months, as the political conflict and violence continues.

Africa: No unified economic trend

Countries in *Africa* display a highly differentiated pattern as far as the economic climate is concerned. Thus, an aggregated climate index for the countries surveyed by WES on this continent makes little sense, and the following analysis will focus on particular economic trends in the individual countries of *Northern* and *Sub-Saharan Africa*.

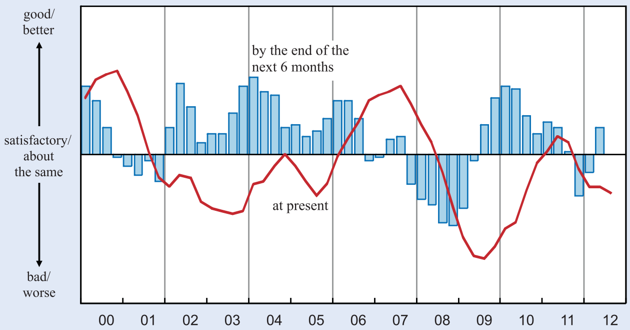
In the *Northern African* countries of *Libya* and *Morocco* no changes in comparison to the previous survey have been recognized. The current economic situation of both countries is still assessed as satisfactory, and is expected to remain so in the coming months. In contrast, in *Algeria*, the present economic situation deteriorated significantly and is now assessed as weak, as is the situation in *Egypt* and *Tunisia*. At least the economic outlook in *Egypt* and *Tunisia* remains positive. In *Tunisia* in particular a strengthening of private consumption in the next half year is likely. In *Algeria*, however, no substantial economic improvement is expected within the next six months.

The economic climate in *South Africa* deteriorated somewhat. Assessments of the present economic situation, and to an even greater degree economic expectations, have been downgraded compared to the previous survey. The present economic situation is now rated below the satisfactory-level. WES experts expressed scepticism with regard to future economic performance over the next six months (see Figure 10). In *Angola, Congo Democratic Republic, Congo-Brazzaville, Kenya, Liberia, Namibia, Rwanda, Sierra Leone* and *Zambia*, assessments of the present economic situation have been upgraded and a favourable present economic situation prevails in all of these countries. With regard to the economic outlook for the next six months, most WES experts in *Congo-Brazzaville, Kenya, Namibia, Rwanda* and *Sierra Leone* revised their expectations slightly upwards and have become fairly confident. In *Angola, Congo Dem. Rep., Liberia* and *Zambia* experts' economic expectations for the next six months remain in positive territory. In *Comoros, Ethiopia, Gabon, Ivory Coast, Lesotho, Malawi, Mauritania, Mauritius* and *Senegal* WES experts assessed the current economic situation as satisfactory. In all of these countries the respective economies are expected to stabilize at their current satisfying levels, with the exception of *Mauritius*, where some worsening of the economic performance is anticipated. The present situation in *Nigeria* remains unfavourable, in the opinion of WES experts. However, they expect some improvement in future economic developments in the next six months. In *Benin, Burkina Faso, Madagascar, Niger, Sudan* and

Figure 5

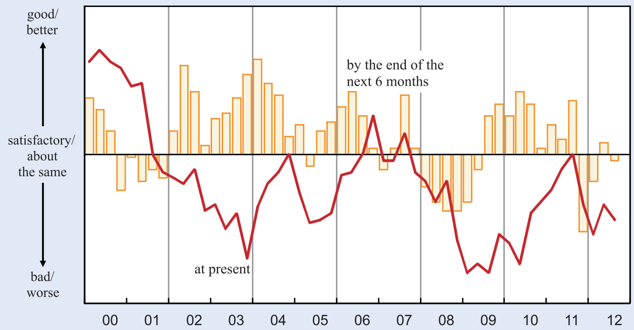
European Union

EUROPEAN UNION (15)
Economic Situation



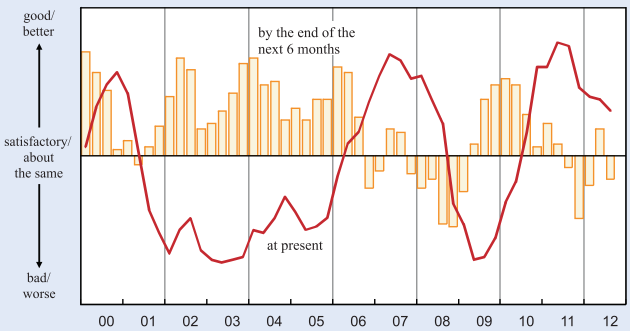
Source: Ifo World Economic Survey (WES) III/2012.

FRANCE
Economic Situation



Source: Ifo World Economic Survey (WES) III/2012.

GERMANY
Economic Situation



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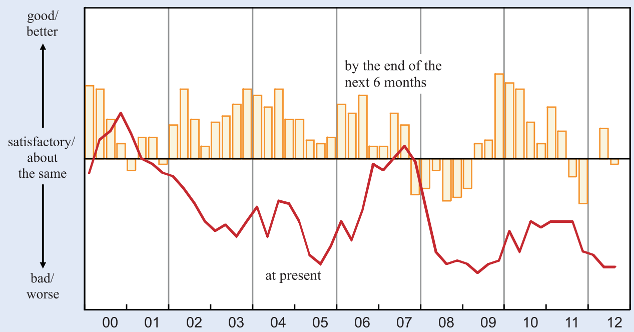
ITALY
Economic Situation



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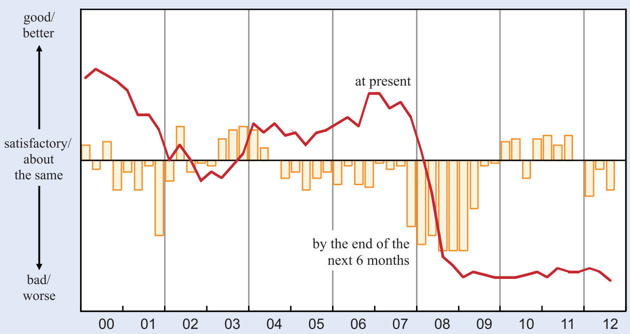
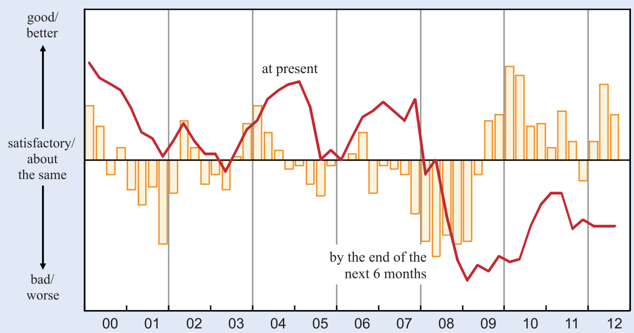
SPAIN
Economic Situation



Source: Ifo World Economic Survey (WES) III/2012.

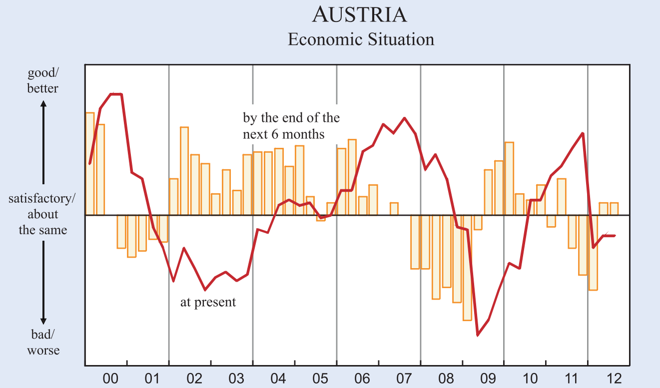
UNITED KINGDOM
Economic Situation



Source: Ifo World Economic Survey (WES) III/2012.

Figure 5b

EUROPEAN UNION



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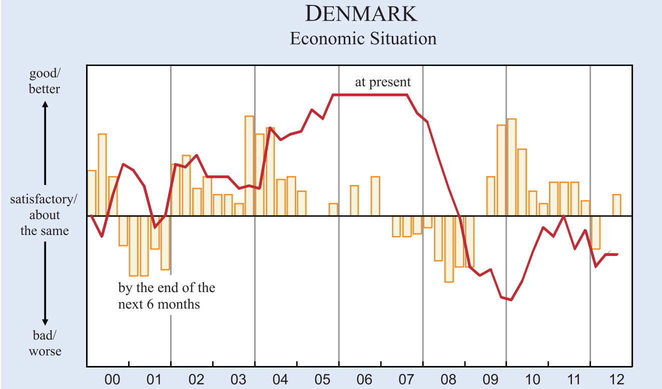

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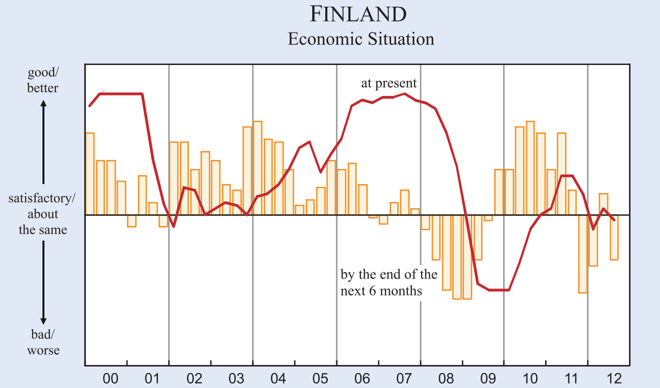

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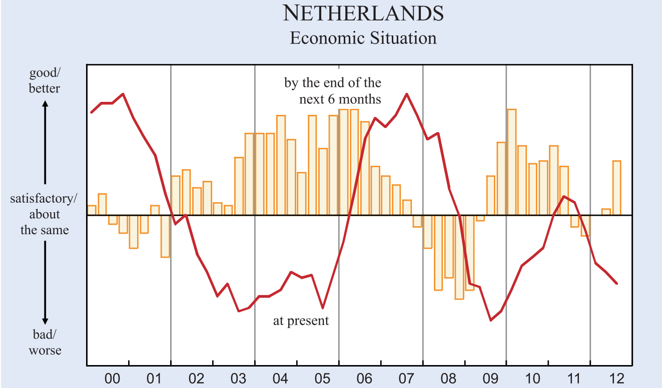

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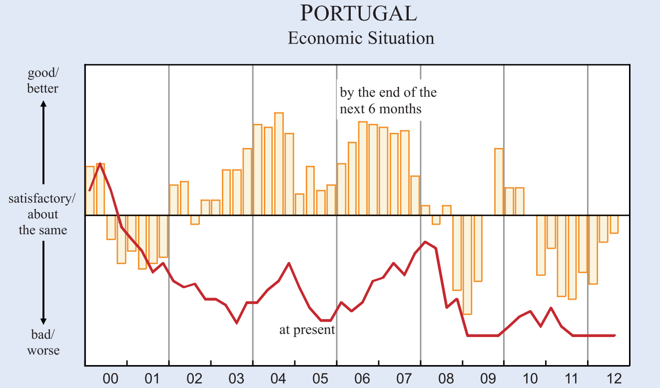

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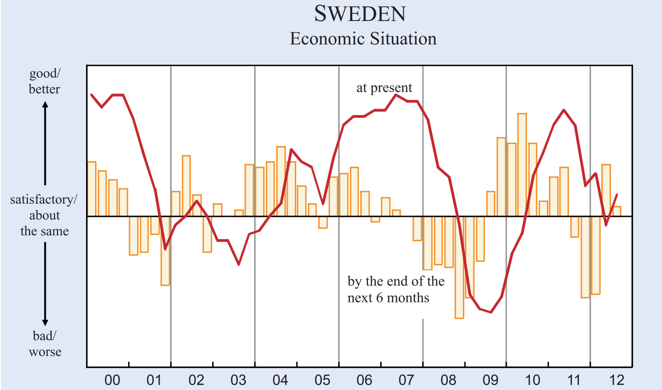
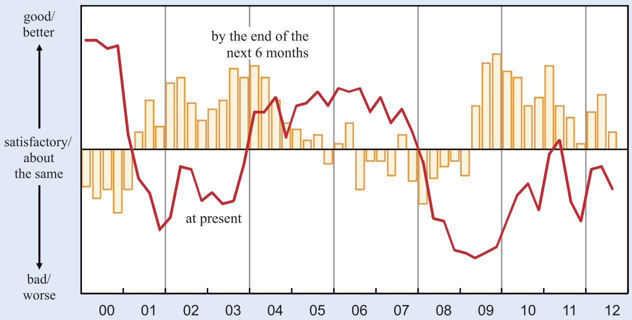


Source: Ifo World Economic Survey (WES) III/2012.

Figure 6

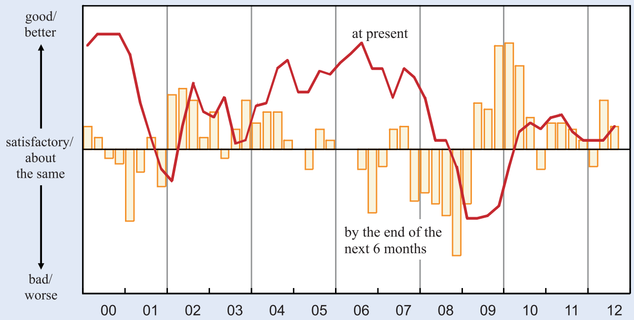
North America, Oceania and CIS

USA
Economic Situation



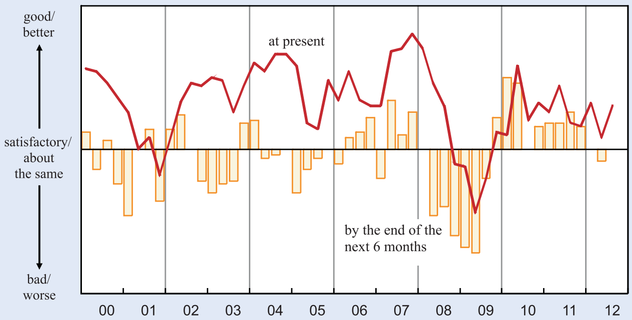
Source: Ifo World Economic Survey (WES) III/2012.

CANADA
Economic Situation



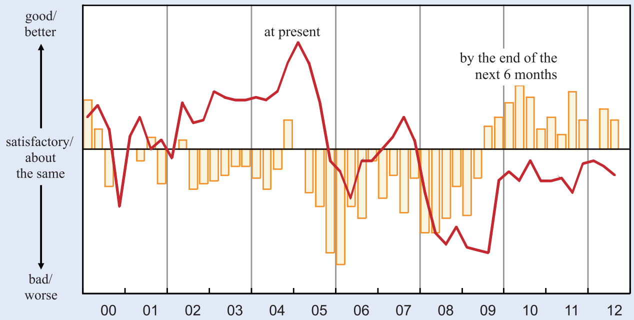
Source: Ifo World Economic Survey (WES) III/2012.

AUSTRALIA
Economic Situation



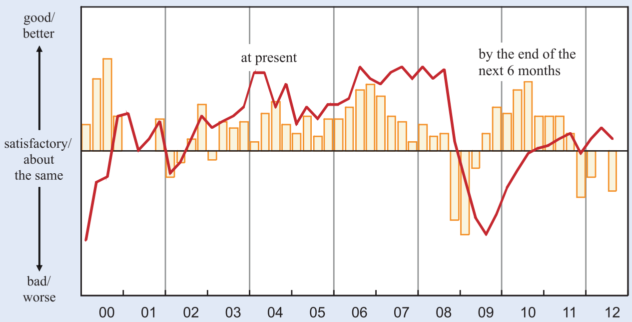
Source: Ifo World Economic Survey (WES) III/2012.

NEW ZEALAND
Economic Situation



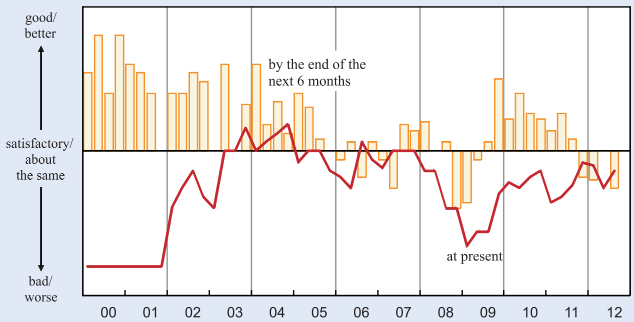
Source: Ifo World Economic Survey (WES) III/2012.

RUSSIA
Economic Situation



Source: Ifo World Economic Survey (WES) III/2012.

UKRAINE
Economic Situation

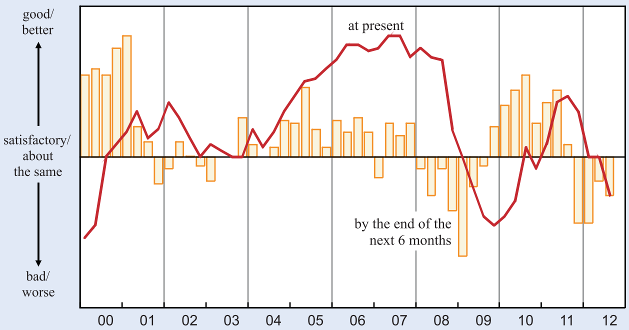


Source: Ifo World Economic Survey (WES) III/2012.

Figure 7

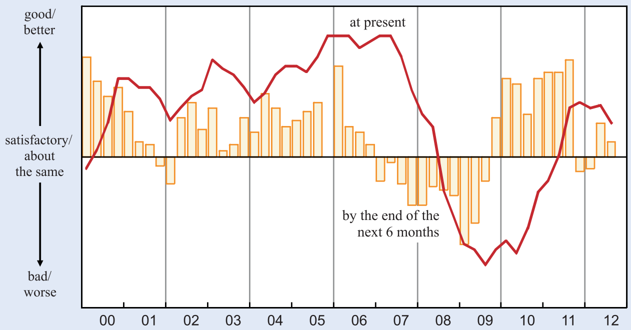
Eastern Europe

Czech Republic
Economic Situation



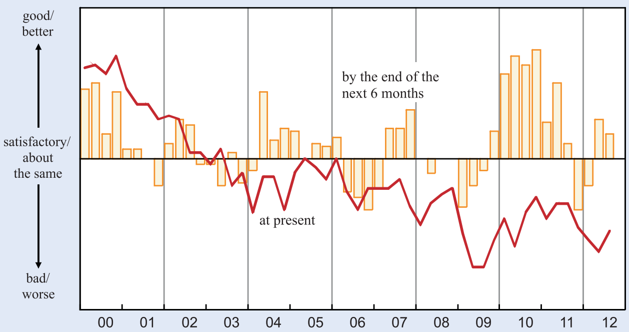
Source: Ifo World Economic Survey (WES) III/2012.

Estonia
Economic Situation



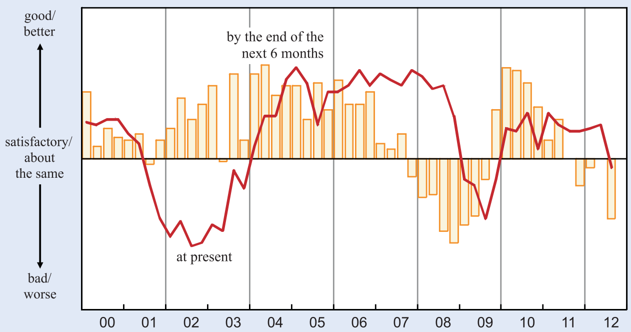
Source: Ifo World Economic Survey (WES) III/2012.

Hungary
Economic Situation



Source: Ifo World Economic Survey (WES) III/2012.

Poland
Economic Situation



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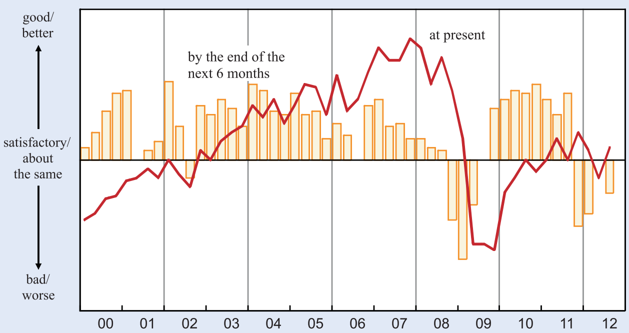
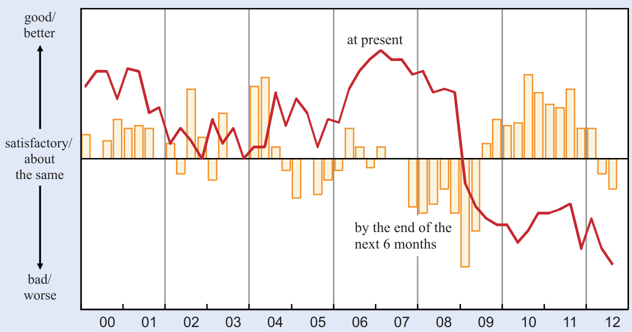
Slovak Republic
Economic Situation



Source: Ifo World Economic Survey (WES) III/2012.

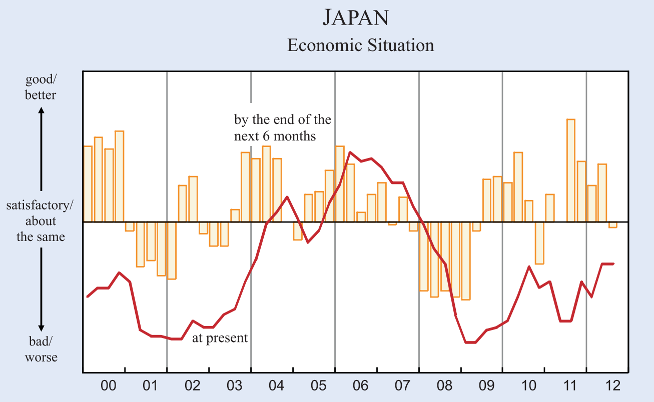
Slovenia
Economic Situation



Source: Ifo World Economic Survey (WES) III/2012.

Figure 8

Asia



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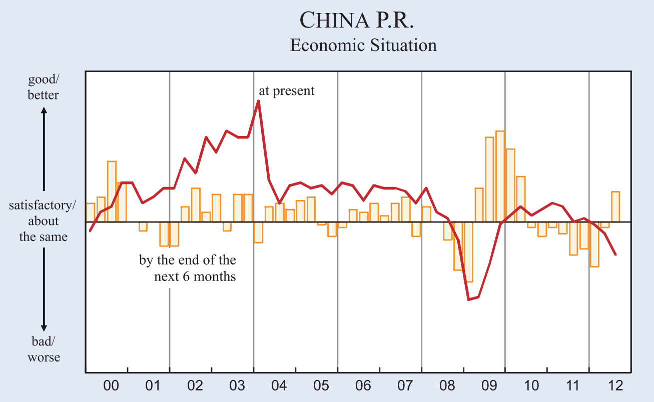

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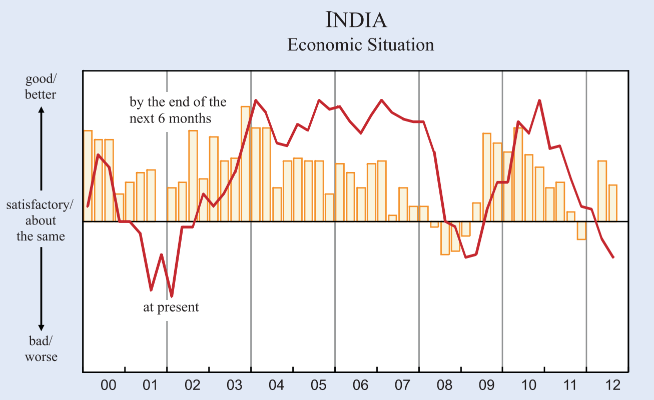

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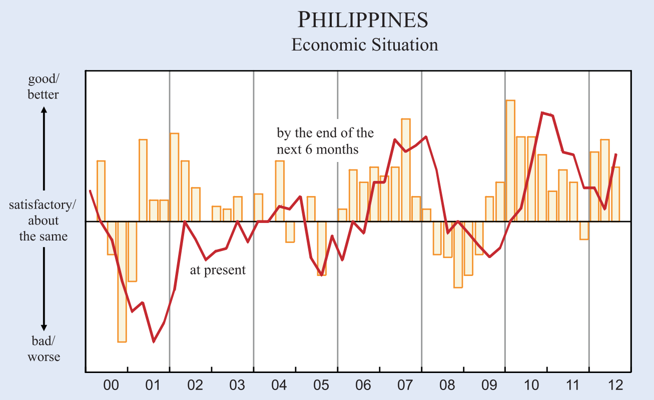

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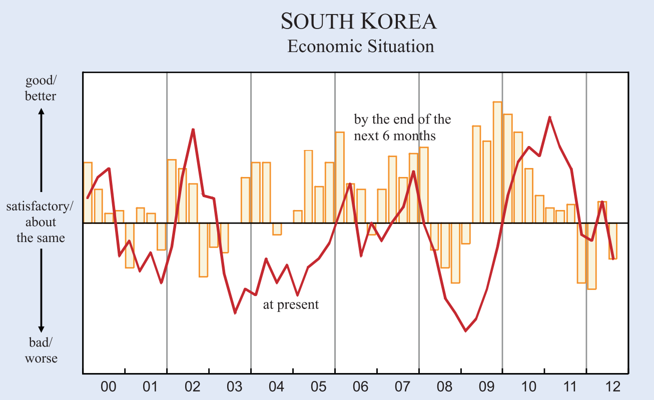

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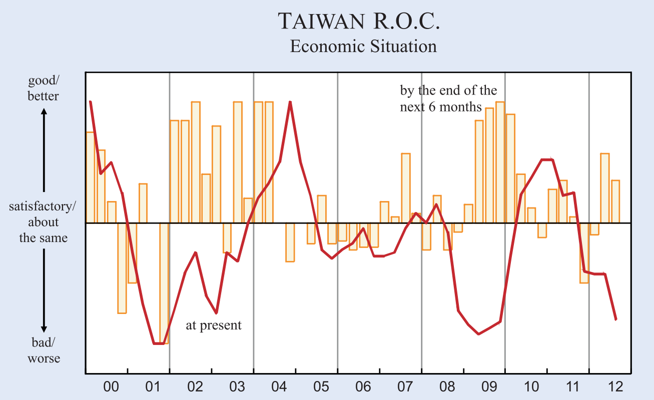

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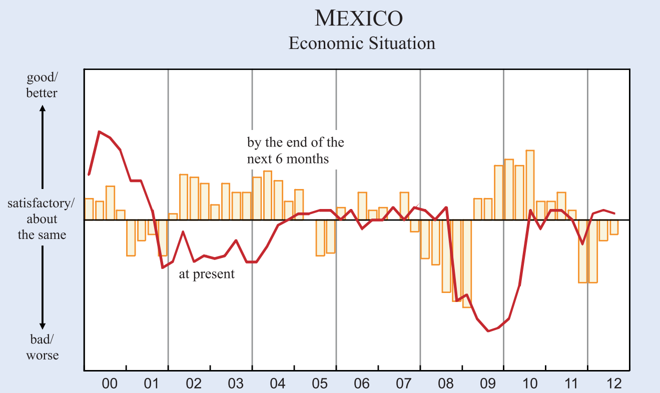
Figure 9

Latin America



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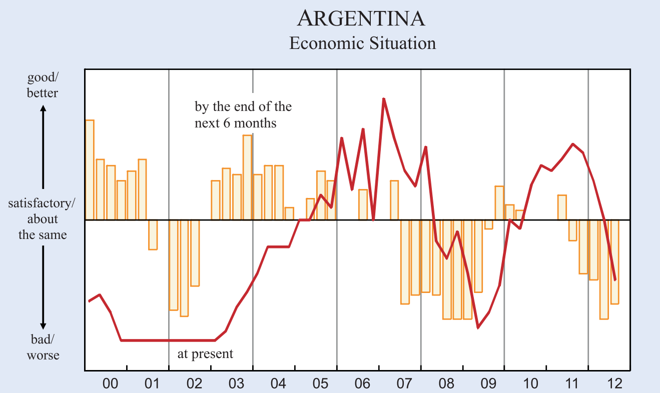

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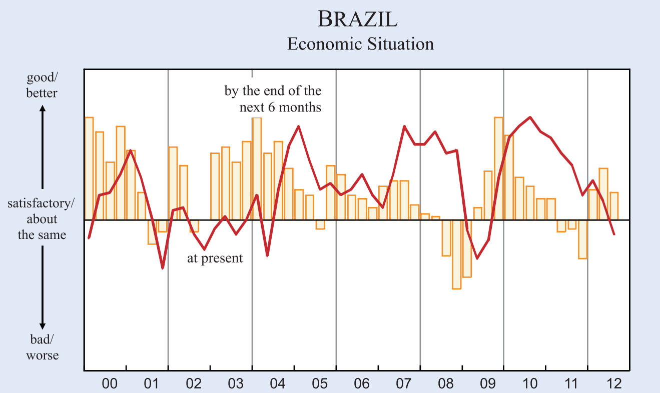

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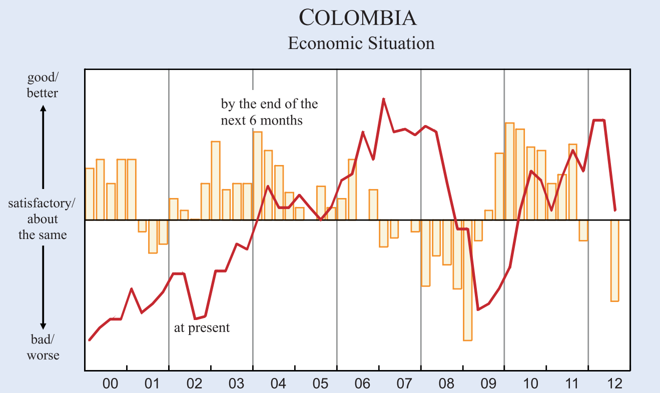

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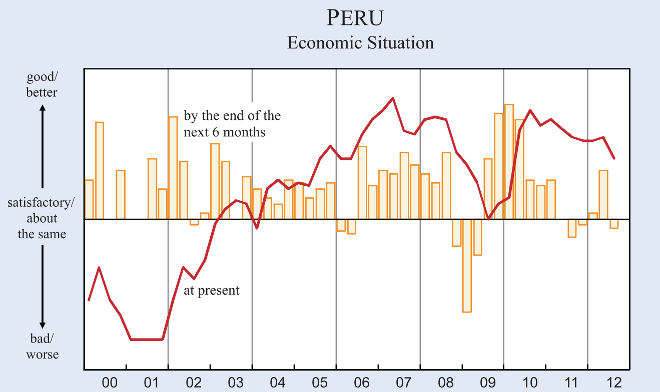

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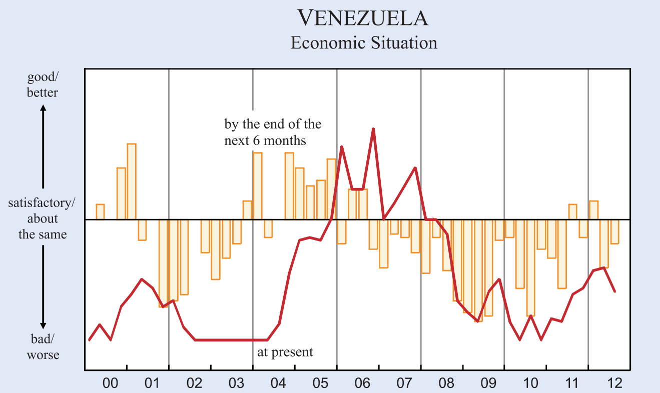
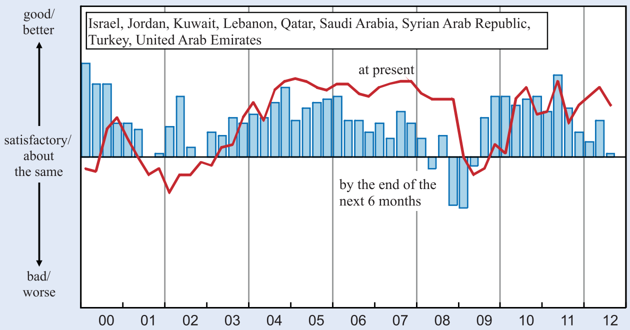


Source: Ifo World Economic Survey (WES) III/2012.

Figure 10

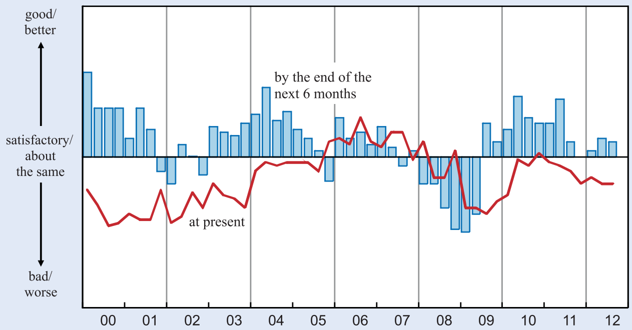
Near East and Africa

NEAR EAST
Economic Situation



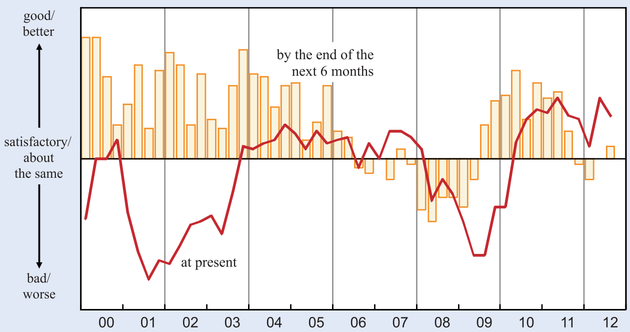
Source: Ifo World Economic Survey (WES) III/2012.

AFRICA
Economic Situation



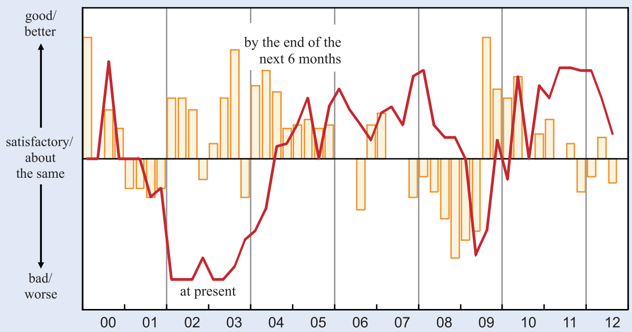
Source: Ifo World Economic Survey (WES) III/2012.

TURKEY
Economic Situation



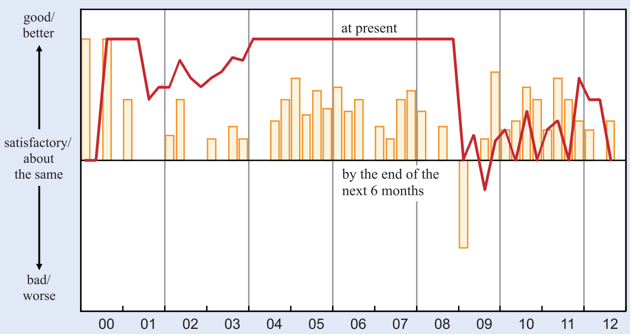
Source: Ifo World Economic Survey (WES) III/2012.

ISRAEL
Economic Situation



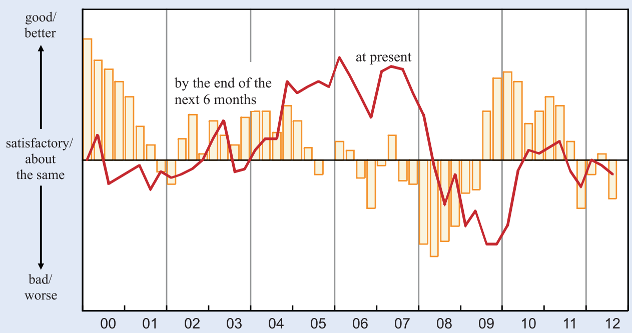
Source: Ifo World Economic Survey (WES) III/2012.

UNITED ARAB EMIRATES
Economic Situation



Source: Ifo World Economic Survey (WES) III/2012.

SOUTH AFRICA
Economic Situation



Source: Ifo World Economic Survey (WES) III/2012.

Zimbabwe the economic experts surveyed see the present economic situation still as weak. In all these countries no substantial economic improvement is expected within the next six months, except for *Niger*, where a slight improvement is anticipated along with a strengthening of private consumption and exports. By far the lowest rating on the WES scale was given again to the remaining *Sub-Saharan* countries of *Burundi, Swaziland* and *Togo*, where the present situation is regarded as very weak. Moreover, no improvement in economic performance is expected in all of these countries over the next six months, and WES experts in *Burundi* even forecast a deterioration in the situation.

Lower price expectations

General trends

On a worldwide average, the WES experts' inflation forecasts for the year 2012 slowed down to 3.4% from an expected 3.6% CPI increase according to the April survey (see Table 1). This downward trend can be seen worldwide with the exception of *Eastern Europe* and *Africa*, where the inflation forecasts remained unchanged.

The decline in inflation expectations in most countries in the world is also reflected in the qualitative answers to the question on the expected inflation rate at the end of the next six months.

Price trends by regions and countries

On average for the ***euro area***, the expected inflation rate in 2012 will be 2.2% (versus 2.4% in the previous survey). Within the *euro area* the lowest inflation rates in 2012 are expected in *Ireland* and *Greece* (both 1.8%) and *France* (1.9%). Expected inflation rates lie above the average of the *euro area* once again particularly in *Estonia* (3.7%), *Cyprus* (3.2%), *Slovakia* (3.4%) as well as *Italy* and *Portugal* (both 2.8%).

In ***Western Europe*** outside the *euro area* the two extremes of presumed price development in 2012 remain *Switzerland* (0.1%) at the low end of the range and the *United Kingdom* (2.8%) at the top end.

In ***Eastern Europe*** the inflation rate forecast for 2012 remained unchanged at 3.7%. In *Serbia* inflation expectations came down somewhat, but remained by far the highest in the region (6.0% after 9.1% according to the April survey) followed again by *Hungary* (5.3%). According to WES experts, the lowest inflation in the region will prevail in *Albania* and in the *euro* country *Slovenia* in that region (in both cases 2.2%).

In ***North America,*** the 2012 inflation forecast for the *United States* stands at 2.2% (versus 2.6% according to the previous survey in April) and for *Canada* at 1.9% (following 2.2% in the April survey).

In ***Asia*** inflation expectations for 2012 slowed down to 3.3% after 3.6% in the previous survey. According to WES experts by far the highest inflation rates in the region will prevail again in *Pakistan* (12.9%) and *Vietnam* (9.8%), which nevertheless means – particularly in *Vietnam* – lower rates than previously expected. In *China* inflation expectations for 2012 stand at 3.2% and are thus significantly lower than according to the April survey (4.0%). In *South Korea* a significant drop in inflation expectations for the full year 2012 can be observed (from 3.9% in the April survey to 2.7% at present). The inflation rate in *India*, on the other hand is expected to increase from 6.8% to now 7.5% in 2012. In *Taiwan* the traditionally moderate inflation climate will also prevail in 2012 (1.9%). In *Japan* the price trend will remain flat (0.2%).

In ***Oceania*** inflation expectations for 2012 declined from 2.7 to 2.1%, thanks to reduced inflation expectations both in *Australia* (from 2.8% to 2.1%) and in *New Zealand* (1.8% compared with 2.1% in the April survey).

In ***Latin America*** inflation expectations for 2012 decreased only marginally from 7.6% to 7.3%. Countries with the worst inflation outlook in the region – despite some improvement – remain *Venezuela* (27.9%) and *Argentina* (23.7%). At the other extreme, countries with inflation rates below the regional average are again expected to be *Colombia* and *Chile* (both 3.2%), as well as *Peru* (3.3%). In *Brazil*, the largest country in the region, an inflation rate of 5.0% is expected for 2012.

In ***CIS*** countries inflation expectations for 2012 also declined only marginally from 8.9% to 8.6%. The expected inflation rate for 2012 in *Kazakhstan* (6.5%), in *Kyrgyzstan* (7.7%) and *Russia* (7.4%) remains somewhat lower than the regional average. Significantly higher than the regional average are the 2012 infla-

Table 1

Inflation Rate Expectations for 2012 (based on WES QIII/2012 and QII/2012)

Region	QIII/2012	QII/2012	Region	QIII/2012	QII/2012
Average of countries *	**3.4**	**3.6**	**North America**	**2.2**	**2.5**
High-income countries	2.2	2.5	Canada	1.9	2.2
Middle-income countries	6.7	6.9	United States	2.2	2.6
Upper-middle	6.3	6.5			
Lower-middle	7.7	8.2	**Oceania**	**2.1**	**2.7**
Low-income countries	8.8	11.2	Australia	2.1	2.8
EU 27 countries	2.4	2.6	New Zealand	1.8	2.1
EU countries (old members) [a)]	2.2	2.5			
EU countries (new members) [b)]	3.6	3.6	**Latin America**	**7.3**	**7.6**
Euro area [c)]	2.2	2.4	Argentina	23.7	24.1
			Bolivia	6.5	6.5
Western Europe	**2.1**	**2.4**	Brazil	5.0	5.2
Austria	2.3	2.5	Chile	3.2	3.9
Belgium	2.4	3.1	Colombia	3.2	3.6
Cyprus	3.2	3.2	Costa Rica	(6.0)	(5.0)
Denmark	2.5	2.7	Cuba	(3.0)	(5.0)
Finland	2.6	2.7	Dominican Republic	5.0	6.0
France	1.9	2.2	Ecuador	5.1	5.7
Germany	2.1	2.3	El Salvador	4.1	5.1
Greece	1.8	2.0	Guatemala	4.9	6.0
Iceland	(5.4)	---	Mexico	4.4	4.2
Ireland	1.8	1.9	Panama	(8.5)	(5.0)
Italy	2.8	2.9	Paraguay	5.0	5.4
Luxembourg	2.5	2.5	Peru	3.3	3.4
Monaco	1.8	2.1	Uruguay	8.1	7.7
Netherlands	2.0	2.2	Venezuela	27.9	30.6
Norway	1.7	2.0			
Portugal	2.8	3.1	**Near East**	**4.8**	**5.5**
Spain	2.0	1.8	Israel	2.5	3.0
Sweden	1.5	1.4	Jordan	(3.8)	(5.0)
Switzerland	0.1	0.3	Kuwait	---	(5.0)
United Kingdom	2.8	3.1	Lebanon	(6.0)	(6.0)
			Qatar	(2.5)	(2.5)
Eastern Europe	**3.7**	**3.7**	Saudi Arabia	(5.4)	(5.3)
Albania	2.2	2.3	Turkey	8.5	8.8
Bosnia and Herzegovina	2.6	3.6	United Arab Emirates	1.3	(2.5)
Bulgaria	2.8	3.3			
Croatia	3.2	2.6	**Africa**	**7.8**	**7.8**
Czech Republic	3.2	3.1	**Northern Africa**	**6.4**	**5.8**
Estonia	3.7	3.7	Algeria	6.7	3.8
Hungary	5.3	5.2	Egypt	10.7	11.5
Latvia	3.5	4.4	Libya	(12.0)	(5.0)
Lithuania	2.8	2.8	Morocco	(2.5)	(2.5)
Montenegro	(3.0)	(3.0)	Tunisia	4.9	4.9
Poland	3.8	3.9	**Sub-Saharan Africa**	**8.7**	**9.2**
Romania	3.6	3.7	Angola	(10.5)	---
Serbia	6.0	9.1	Benin	4.6	4.3
Slovakia	3.4	3.0	Burkina Faso	3.3	(4.0)
Slovenia	2.2	2.2	Burundi	14.3	14.0
			Comoros	(5.0)	(6.0)
CIS	**8.6**	**8.9**	Congo Dem. Rep.	11.2	12.4
Belarus	(20.0)	(20.0)	Congo-Brazzaville Rep.	2.9	2.5
Georgia [x)]	(6.0)	(6.0)	Ethiopia	(25.0)	(25.0)
Kazakhstan	6.5	6.5	Gabon	(3.8)	(3.1)
Kyrgyzstan	7.7	7.3	Ghana	---	9.0
Russia	7.4	7.6	Ivory Coast	3.2	(3.0)
Ukraine	8.4	11.3	Kenya	11.4	15.2
Uzbekistan	(18.6)	(12.7)	Lesotho	6.0	5.7
			Liberia	(8.0)	8.4
Asia	**3.3**	**3.6**	Madagascar	8.5	8.8
Bangladesh	(9.0)	9.3	Malawi	(20.0)	(15.0)
China	3.2	4.0	Mauritania	6.3	6.5
Hong Kong	4.0	4.1	Mauritius	5.1	5.4
India	7.5	6.8	Namibia	6.1	6.9
Indonesia	5.2	5.8	Niger	3.1	2.5
Japan	0.2	0.1	Nigeria	12.6	12.0
Malaysia	3.3	3.8	Rwanda	(11.0)	(8.0)
Pakistan	12.9	13.4	Senegal	(2.5)	(1.8)
Papua New Guinea	(4.0)	---	Sierra Leone	12.9	14.2
Philippines	3.4	3.9	South Africa	5.6	6.1
South Korea	2.7	3.9	Sudan	29.3	23.8
Sri Lanka	8.4	9.3	Swaziland	8.5	6.8
Taiwan	1.9	2.0	Tanzania	---	(18.0)
Thailand	3.6	3.6	Togo	(3.0)	(3.1)
Vietnam	9.8	13.0	Zambia	7.7	7.6
			Zimbabwe	4.7	5.3

* Within each country group or region the country results are weighted according to the share of the specific country's exports and imports in the total world trade. – ( ) The data in brackets result from few responses. [x)] Georgia, which is not member of the Commonwealth of Independent States, is included in this group for reasons of geography and similarities in economic structure. [a)] Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom. – [b)] Czech Rep., Cyprus, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovenia, Slovakia, Bulgaria, Romania. – [c)] Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, Netherlands, Portugal, Spain, Slovenia, Slovakia.

Source: Ifo World Economic Survey (WES) III/2012 and II/2012.

tion expectations in *Belarus* (20.0%), *Uzbekistan* (18.6%) and the *Ukraine* (8.4% versus 11.3% in the previous survey).

In the ***Near East*** the expected regional inflation rate for 2012 also declined considerably from 5.5% in the previous quarter to 4.8% in the July survey. In a country by country comparison the inflation outlook has improved slightly since April in *Turkey* (from 8.8% to 8.5%), *Jordan* (from 5.0% to 3.8%) and has remained practically unchanged in *Saudi Arabia* (5.4%). In the *United Arab Emirates* and *Israel* fairly low inflation expectations declined even further to 1.3%, respectively 2.5%.

In ***Africa*** price trends are still very heterogeneous. Relatively low inflation rates for 2012 are expected again in *Morocco, Congo-Brazzaville Rep., Ivory Coast, Niger, Senegal* and *Togo* (in all cases around 3% or slightly lower). In a medium inflation bracket lie again *Benin* (4.6%), *Tunisia* (4.9%), *South Africa* (5.6%), *Namibia* (6.1%), *Mauritania* (6.3%) and *Algeria* (6.7%). High inflation rates of 10% or more will continue to predominate particularly in *Sudan* (29.3%), *Ethiopia* (25.0%), *Malawi* (20.0%), *Sierra Leone* (12.9%), *Kenya* (11.4%), *Congo Dem. Rep.* (11.2%) and *Egypt* (10.7%).

Yen and British pound seen as overvalued

On a worldwide scale the *US dollar* and the *euro* currently appear to be close to their fundamentally appropriate values, according to assessments by WES experts. The *Japanese yen* and the *British pound*, on the other hand, are regarded by WES experts as overvalued (see Figure 11).

Major differences between countries remain in currency evaluation. WES experts regard their own currency as generally **overvalued** in *Norway*, *Switzerland* (not, however, compared to the *yen*), *Australia* and *New Zealand*, as well as in some *African* countries like *Egypt, Algeria, Lesotho* and *Benin* and in some *Latin American* countries like *Argentina, Colombia* and *Peru*. On the other hand, experts assessed their own currencies as generally **undervalued** in *India*, *China*, *Hong Kong*, the *Philippines*, *Turkey*, the *Dominican Republic, Mexico* and *Paraguay*. For the second time in a row WES experts in the *United States* also assessed their currency, the *US dollar*, as undervalued vis-à-vis the *yen, euro* and the *British pound*.

Table 2

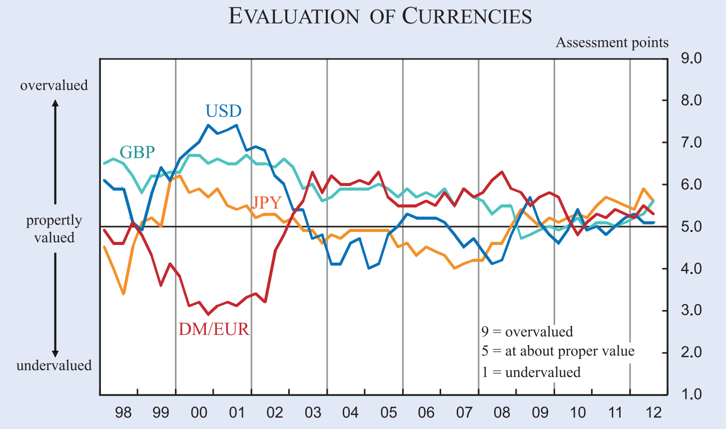
Legal and Administrative Restrictions for Foreign Firms

Absent	
Sweden	8.3
Chile	8.0
Finland	8.0
Austria	7.9
Hong Kong	7.9
Latvia	7.7
Slovakia	7.4
Uruguay	7.4
Denmark	7.0
Rather low	
Czech Republic	6.8
Germany	6.7
Peru	6.7
Poland	6.7
Romania	6.7
Bulgaria	6.6
Cyprus	6.6
Ireland	6.6
Spain	6.6
Netherlands	6.4
Switzerland	6.3
Zambia	6.1
Turkey	6.0
United Kingdom	5.9
Japan	5.8
Norway	5.8
Paraguay	5.8
South Korea	5.8
Mexico	5.7
Portugal	5.6
Canada	5.4
Colombia	5.4
France	5.4
Hungary	5.4
Kazakhstan	5.4
Brazil	5.3
United States	5.3
Belgium	5.2
South Africa	5.2
Australia	5.0
El Salvador	5.0
Guatemala	5.0
Mauritius	5.0
Namibia	5.0
New Zealand	5.0
Nigeria	5.0
Slovenia	5.0
Italy	4.8
Pakistan	4.7
Bolivia	4.3
China	4.3
Taiwan	4.2
Vietnam	4.2
Greece	4.1
Rather high	
India	3.7
Malaysia	3.7
Philippines	3.7
Sri Lanka	3.7
Thailand	3.7
Croatia	3.5
Kenya	3.5
Egypt	3.4
Madagascar	3.4
Bosnia and Herzegovina	2.7
Indonesia	2.6
Israel	2.6
Russia	2.6
Ecuador	2.3
Ukraine	2.3
Venezuela	1.8
Argentina	1.0
Zimbabwe	1.0

Only countries with more than four responses were included in the analysis. **WES scale: 9** - absent, **5** - low, **1** – high

Source: Ifo World Economic Survey (WES) III/2012.

Figure 11



Source: Ifo World Economic Survey (WES) III/2012.

The answers to a supplementary survey question on the likely development of the *US dollar* over the next six months, regardless of how currencies are assessed from a fundamental point of view, again signal that the value of the *US dollar* is expected to rise slightly on a worldwide average over the next six months. However, behind this average are diverging trends: the *US dollar* is expected to weaken in *Norway*, *Sweden*, the *United Kingdom*, in some *Asian* countries (particularly *China*, *Malaysia*, the *Philippines, Thailand, Taiwan* and *South Korea*), *Hungary* and *Latvia* as well as *Peru* and *Namibia*. These results contrast with an expected increase in the value of the *US dollar* in the *euro area*, as well as in some *Western Europe*an countries outside the *euro area*, *Denmark* and *Switzerland*, in *Eastern European* countries (with the exceptions of *Hungary* and *Latvia*), in *CIS* countries, in the *Near East*, as well as in most *African* countries including *South Africa*, but not *Namibia*.

Table 3

Assessment of the Following Factors Influencing the Climate for Foreign Investors in the Next Six Months

Climate due to	**Change for the next six months *** **Deterioration**	**Improvement**
Legal/administrative restrictions to invest and/or to repatriate profits	Argentina, Zimbabwe	Greece, India, Romania
Political stability	Argentina, El Salvador, Kenya, Madagascar, Pakistan, Ukraine, Zimbabwe	China, India, Uruguay, Venezuela

* For the countries that are not mentioned in the table, no major changes relating to the climate for foreign investors are expected during the next six months.
Only countries with more than four responses were included in the analysis.
Criteria for selection of countries:
Deterioration: WES grade between **1.0** and **3.5**
Improvement: WES grade between **6.0** and **9.0**

Source: Ifo World Economic Survey (WES) III/2012.

WES experts expect lower short-term and stable long-term interest rates over the next six months

Unlike in the previous survey in April, short-term interest rates are expected to decline over the next six months. Widespread expectations that central banks will cut rates in coming months are in line with the more sceptical economic outlook of WES experts in most of the countries surveyed, as well as with the decline in worldwide inflation expectations (see Figure 12). All of these factors have obviously also dampened expectations of rising long-term interest rates in the near future. In *Asia* – particularly in *China*, *Indonesia* and *South Korea* – and even more pronouncedly in *Latin America* – particularly in *Brazil* and *Colombia* – long-term interest rates are expected to decline. In some *Eastern European* countries like *Bulgaria*, *Estonia* and *Hungary* long-term interest rates are also expected to decline over the course of the next six months.

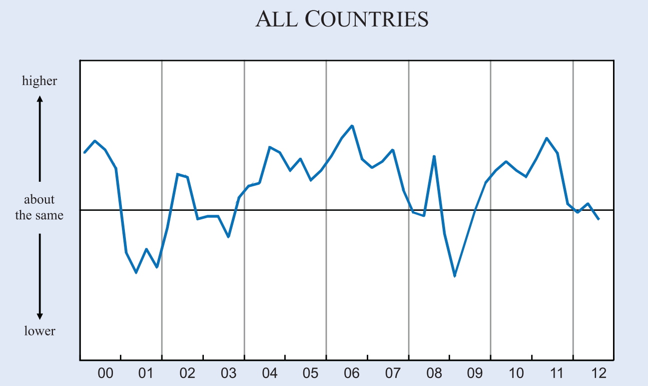
In the *euro area* there are signs of slightly calmer developments in capital markets to be seen in the fact that WES experts continue to expect interest rates spreads in *Portugal*, *Greece* and *Italy* to shrink in the near future. In *Spain* – at least – a stabilisation and no further increase of long-term interest rates is expected. WES experts expect an increase in long-term interest rates in the next six months in only a few countries more than in the last survey, namely in *Norway*, the *United Kingdom*, *Australia, Russia, Croatia* and *Thailand*.

ICC Special Question: Growing protectionism endangers cross-border investment

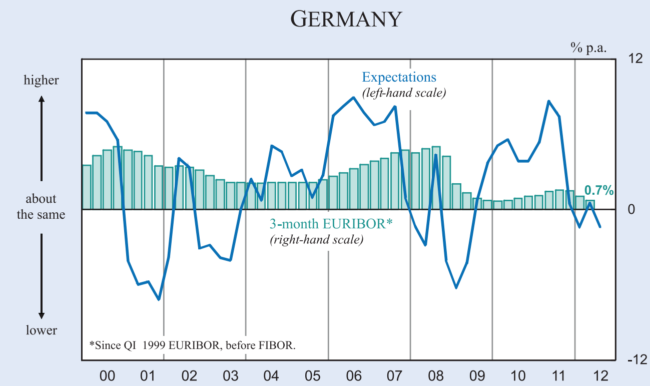
Every half year, WES experts are asked to assess the investment climate for foreign investors in their respective countries. Generally, legal and administrative restrictions for foreign firms in most of the countries covered by WES are absent or rather low, according to the

Figure 12

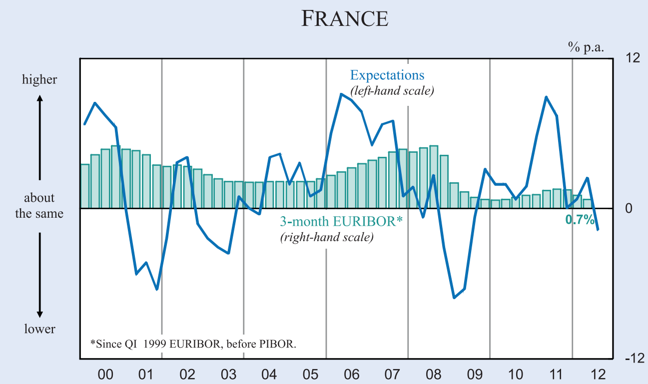
ACTUAL SHORT-TERM INTEREST RATES AND EXPECTED TREND FOR THE NEXT 6 MONTHS (QUARTERLY DATA)



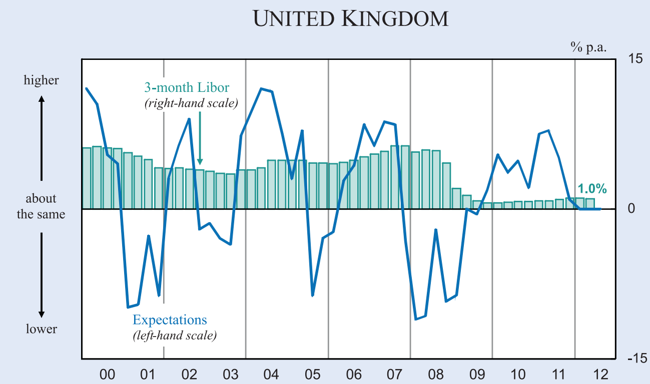
Source: Ifo World Economic Survey (WES) III/2012.



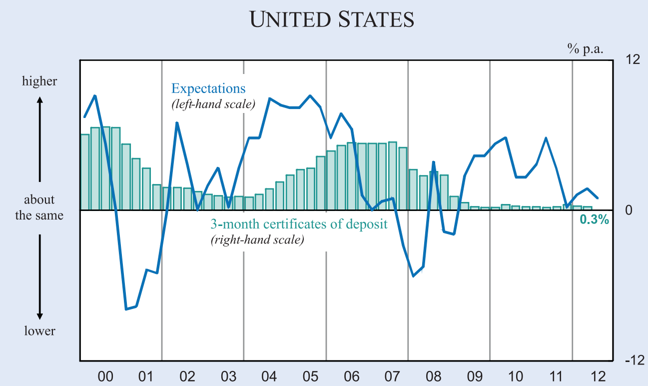
Source: Ifo World Economic Survey (WES) III/2012, Deutsche Bundesbank.



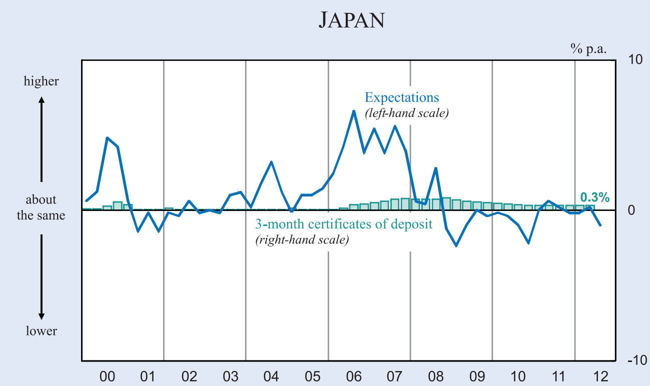
Source: Ifo World Economic Survey (WES) III/2012, OECD.



Source: Ifo World Economic Survey (WES) III/2012, OECD.



Source: Ifo World Economic Survey (WES) III/2012, Federal Reserve Board, US.



Source: Ifo World Economic Survey (WES) III/2012, OECD.

Box 3

Capital and Deposit Withdrawals in Spain

Since mid-2011 capital markets have increasingly thrown a spotlight on Spain. By November 2011, spreads between German and Spanish 10-year government bonds had reached 5 percentage points. Quantitative easing measures by the ECB in December and February only helped temporarily. Spreads have returned to values of over 5 percentage points. In addition, since the second half of last year, deposits by non-banks in the Spanish banking sector have decreased, reinforcing worries about a pending bank-run in Spain.

Foreign investors pull out

One of the main reasons for the drop in Spanish bond prices was the withdrawal of foreign capital from Spain. Between June 2011 and March 2012, net asset holdings by foreign investors in Spain dropped by 163 billion euros. In addition to the sale of Spanish government and bank bonds with a value of 36 and 38 billion euros, respectively, the decrease in accounts receivable against Spanish banks by 101 billion euro was one of the main drivers of this development. According to the MFI balance sheet statistic, cross-border interbank credits accounted for two thirds of this amount. The rest consisted of repatriations of foreign deposits by non-banks. The only noteworthy capital flow towards Spain was foreign direct investments. In addition to this large scale repatriation of foreign capital, there has been a growing flight of Spanish capital abroad since the beginning of this year, which totaled 39 billion euros between January and March 2012. This capital export was almost exclusively due to the placement of other capital (deposits, credits, 34 billion euro) and bonds (8 billion euros) by Spanish banks abroad. In contrast to widespread beliefs, there is no evidence of capital flight from Spanish private households and firms into safe foreign bonds or deposits. Although Spanish private households and firms have acquired 10 billion euros in foreign assets since mid-2011, they have also sold 25 billion euros worth of foreign securities, therefore, on balance, repatriating wealth. In total, across all sectors (excluding the central bank) the Spanish capital account shows a net capital export of around 200 billion euros since June of last year, of which most is related to the banking sector, and not to the sale of Spanish government bonds by foreign investors. To finance the persistent current account deficit of Spain, which totaled 30 billion euros in the period June 2011 to March 2012, the Eurosystem stepped in and offset the net outflow of capital from Spain. During the same period, the target liabilities of the Spanish central bank against the euro system rose by 223 billion to 276 billion euros; most recently (April), a further increase to 303 billion euros was recorded. However, the majority of the target loans were used to finance the capital withdrawal from the Spanish banking system. Since mid-2011, foreign investors have reduced their claims by 139 billion euros through the sale of bank bonds, the withdrawal of deposits and the reduction of interbank loans. In addition to lending by the Eurosystem through the Target system, the ECB program to purchase securities, which was eventually resumed in August 2011, helped to mitigate the effects caused by capital flight. By the end of March 2012 the Eurosystem had acquired government bonds of euro-crisis states totaling 140 billion euros and thus increased the amount of securities to over 200 billion euros, of which Spain's share (kept secret by the ECB) should be substantial.[1] Without this program, the massive decline in net foreign capital investments in Spain would probably have been much greater because it can be assumed that a significant share of the securities was purchased from non-Spanish banks. In view of the large-scale sale of Spanish securities by foreigners, the purchase of securities by the ECB slows the flight of capital.[2]

Asset reallocation instead of a bank-run

Concurrent with the flight of capital from Spain that began in the second half of 2011, there was a decline in deposits by non-banks in the Spanish banking system. Between June 2011 and March 2012 depositors withdrew funds totaling 121 billion euros. Of this amount, 37 billion euros belonged to non-banks outside the euro area, 4 billion euros to non-banks in the rest of the euro area and 80 billion euros to Spanish non-banks.[3] The financing statistics show that the decline in deposits in the second half of 2011,[4] was only in small part (10 billion euros) caused by private households. By far the larger portion was withdrawn by the government and companies, each accounting for 23 billion euros. The withdrawal of Spanish deposits has been widely interpreted as a 'silent' bank run, which, similar to the situation in Greece, has come about not abruptly, but over a long period of time. If the money actually did leave the banking sector, concerns regarding the liquidity of Spanish banks, and thus the stability of its banking system, were appropriate. However, financial accounts data available so far show that at least a portion of the deposits withdrawn during the second half of the year were shifted into bank securities. One reason for the reallocation of savings within the banking system could be the modification of Spanish deposit insurance, which took place in mid-2011. According to this modification, certain deposits require increased contributions to the Deposit Protection Fund.[5] To avoid these costs there seems to be an incentive for Spanish banks to offer alternative forms of investment. Another indication that no strong bank run will occur is the fact that no cash hoarding has been observed in Spain to date. Unlike Greece, where the currency in circulation - possibly

[1] According to estimates by Buiter and Rahbari (2012), Looking into the deep pockets of the ECB, Global Economics View, Citibank, it amounted to 41 billion euros in February.

[2] Government bonds bought by the Banco de España from Spanish banks would have no effect on the financial account. Since the share of Spanish government bonds held by Spanish banks rose significantly, however, recently, it can be assumed that most of the purchases of securities from banks by the Eurosystem was conducted outside Spain.

[3] In April, deposits by non-banks from the euro area (i.e. including Spain) fell again by 39 billion euros. Other data are quarterly; the latest available observation is the stock at the end of March 2012.

[4] Data for the first quarter of 2012 were not yet available at the time of preparation of this fore-cast.

[5] See Banco de España (2011), Economic Bulletin, July, pp. 144.

out of concern of an imminent euro exit - has nearly doubled since the beginning of 2010, the amount of cash issued by the Spanish central bank is even decreasing. Taken together, these facts tend to point to a recession-induced decline in the money supply. Finally, cross-border transfers by the Spanish private non-banking sector are also being kept in check. According to the balance-of-payments statistic, other investments abroad, which include deposits and loans from non-banks (i.e. trade credits), totaled 10 billion euros since the middle of last year. However, in the pre-crisis this item in the capital account also shows a capital outflow of 6 billion euros per year on average, a crisis-related increase can therefore hardly be detected.

Conclusions

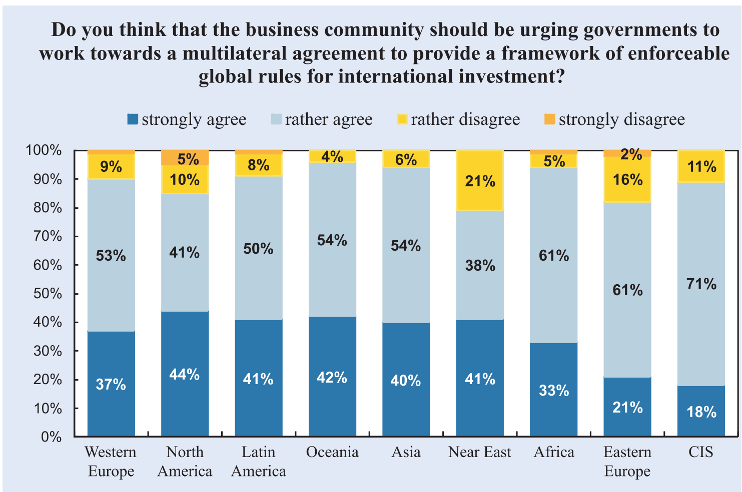
To conclude, the Spanish banking system is suffering from a massive cash drain. Above all, foreign investors are reducing their commitment significantly in Spain, but there are signs of growing concerns about the solvency of the Spanish banking system among domestic depositors. The loss of confidence in Spanish banks is now almost completely offset by the Eurosystem. The banks reduce their foreign debt, and the Eurosystem takes over the claims. Recently, the growth of Target-claims against the Banco de España accelerated significantly. Even if ECB assistance provides temporary, relief to the Spanish banking system, the fundamental problems will still be far from corrected. As a result of the bursting of the real-estate bubble, the volume of doubtful loans on bank balance sheets, and thus the potential write-downs, are increasing constantly. While 3.3% of the outstanding loans of Spanish banks had been classified as endangered by the end of 2008, this percentage rose to 8.4% in the first quarter of 2012. The consequences of a collapse of the Spanish banking system are difficult to assess. Over the past year, European banks have reduced their presence in Spain significantly. Claims against Spanish banks fell by 46 billion euros and amounted to just over 100 billion euros in late 2011. German banks accounted for 15 billion euros of this reduction. At the end of 2011 they had 41 billion euros in claims against the Spanish banking system on their books, representing just over 10% of the balance sheet equity capital of the German banking system. This means the direct cost to the German banking sector would be high in the case of an escalation of the crisis in Spain, where a large proportion of these assets would have to be written off.

surveyed economic experts. However, in July – in comparison to the results in February – *legal and administrative investment restrictions and/or impediments to repatriate profits* were reported in a slightly higher number of countries (see Table 2). In a significantly higher number of *Asia*n countries than usual (e.g. *India*, the *Philippines, Sri Lanka* and *Thailand*) the investment climate deteriorated due to high legal/administrative restrictions to invest and/or impediments. This trend towards growing protectionism can be observed in many parts of the world.

Against this background, ICC recently issued its 2012 Guidelines for International Investment to encourage a more secure environment for cross-border investment. This quarter's ICC special question asked the economic experts surveyed whether they think that the business community should be urging governments to work towards a multilateral agreement to provide a framework of enforceable global rules for international investment. The majority of the WES experts in all regions clearly agree ("strongly" respectively "rather agree") that a framework of enforceable global rules for international investment is reasonable (see Figure 13). The share of agreement ranges from 79% in the *Near East* up to 96% in *Oceania*. Votes against enforceable global rules amount to less than 10% in most world regions. This share only ranges between 11 and 21% in *North America*, *Near East*, *Eastern Europe* and *CIS* countries.

In short, the vast majority of the economic experts surveyed are asking the business community to urge governments to implement enforceable global rules to create a more favourable and secure investment climate.

Figure 13



Source: Ifo World Economic Survey (WES) III/2012.

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