

CESifo WORLD ECONOMIC SURVEY

VOLUME 5, No. 2

MAY 2006

WORLD ECONOMIC CLIMATE

World Economic Climate remains favourable

ECONOMIC EXPECTATIONS

Assessments of the current economic situation improved again, economic expectations remain optimistic

INFLATION

Expectations continue to weaken somewhat

INTEREST RATES

Rising trend expected

CURRENCIES

Japanese yen seen as somewhat undervalued

SPECIAL TOPIC

World's main economic problems – an unbalanced picture
Counterfeiting and intellectual property protection



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CESifo World Economic Survey ISSN 1613-6012

A quarterly publication on the world economic climate

Publisher and distributor: Ifo Institute for Economic Research

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Annual subscription rate: €40.00

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Ifo World Economic Survey

Regions

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Notes

The Ifo World Economic Survey (WES) assesses worldwide economic trends by polling transnational as well as national organizations worldwide about current economic developments in the respective country. This allows for a rapid, up-to-date assessment of the economic situation prevailing around the world. In April 2006 1,087 economic experts in 91 countries were polled.

WES is conducted in co-operation with the International Chamber of Commerce (ICC) in Paris and receives financial support from the European Commission.

Methodology and evaluation technique

The survey questionnaire focuses on qualitative information: on assessment of a country's general economic situation and expectations regarding important economic indicators. It has proved to be a useful tool, since economic changes are revealed earlier than by traditional 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. 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 share of the specific country's exports and imports in total world trade.

CES – Center for Economic Studies – is an institute within the department of economics of Ludwig-Maximilians-University. Its research concentrates on public finance, aspects of the economy, but also includes many diverging fields of economics.

Ifo Institute for Economic Research is one of the largest economic research institutes in Germany with 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 organizations are published.

WORLD ECONOMIC CLIMATE REMAINS FAVOURABLE

In April 2006 the World Economic Climate improved again somewhat (see Figure 1). The climate indicator stands at 111.0 (after 109.2 in January: 1995=100), considerably above its long-term average (1990–2005: 94.3). This renewed improvement resulted entirely from more favourable assessment of the current economic situation. The economic expectations for the next six months remained unchanged optimistic (see Figure 2).

World economy: Global economic expansion is robust

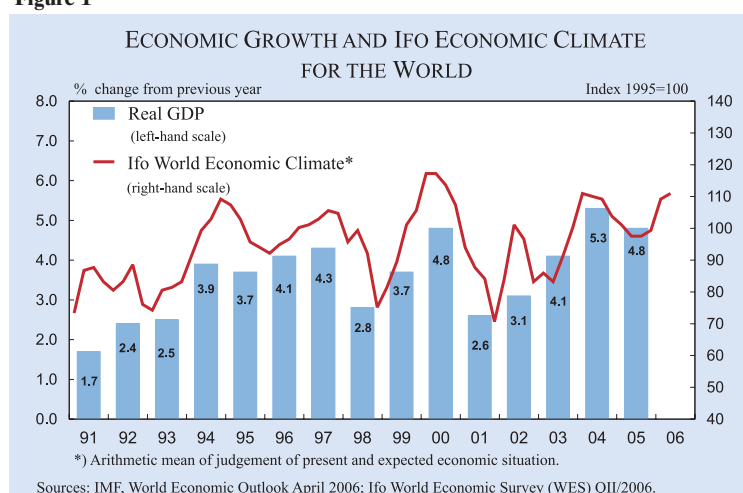
The positive forecasts of the preceding WES polls have proved true and the latest survey results indicate a sound global economic expansion (see Box 1) that will last through this year, according to the panel's projection. This outlook is supported by the fact that the assessments of the present economic situation on average of all 91 countries surveyed by WES, are at their five-year high (see Figure 2). The positive picture applies to all three main economic regions – Western Europe, North America and Asia (see Figure 3). The improvement of the overall climate index in Western Europe has the same pattern as the world average: it resulted from a more favourable assessment of the present economic situation. In North America the improvement was entirely due to more optimistic expectations, while the assessments of the present economic situation remained unchanged positive (see Figure 4). In Asia, both components of the climate index – assessments for the present economic situation and expectations for the coming six months – remained almost unchanged at a favourable level. The global business sentiments are indicating that the economic expansion seems to be robust enough to withstand record oil prices and higher interest rates.

Western Europe: Solid economic upturn

After the moderate cooling down of business sentiments at the end of 2004 and the first half of 2005, the economic climate in Western Europe renewed its recovery course. The assessments of the present economic situation, on average of all Western European countries, have surpassed the „satisfactory” mark. The economic expectations reflect unchanged optimism with respect to a continuation of the economic rebound (see Figure 4). In the euro area, Europe's biggest economy, *Germany*, and its export sector that spurs more and more domestic investment in machinery and equipment and to a lesser degree also in buildings, presently functions as the driving engine behind the region's economic growth.

In the vast majority of the *euro area* countries the assessments of the present economic situation have improved since the January poll, particularly strongly in *Germany*, *Belgium* and the *Netherlands*, and to a certain degree also in *France* and *Spain*. In all these countries, except *France*, the assessments of the present economic performance have overcome the „satisfactory” mark. The economic climate remained highly favourable in the Northern countries of the euro area – *Ireland* and *Finland*. A favourable picture with respect to both the assessment of the present economic state and near-term expectations was drawn in *Austria* and *Greece*. In the euro area there

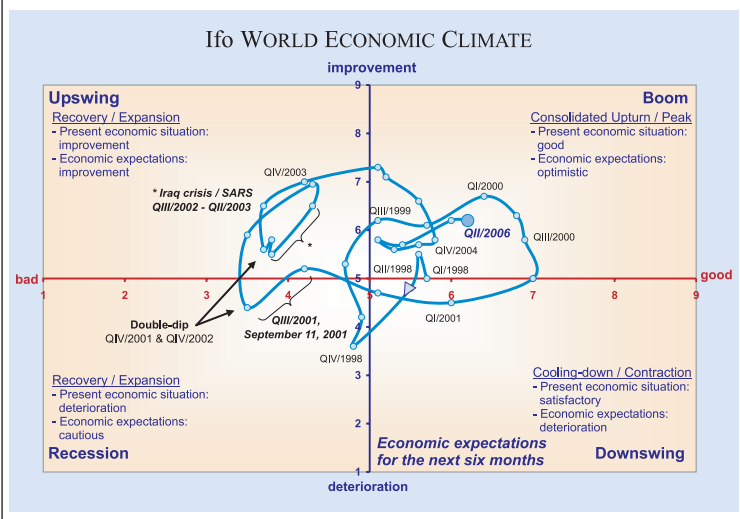
Figure 1



Box 1
Ifo Economic Clock and the World Economic Climate

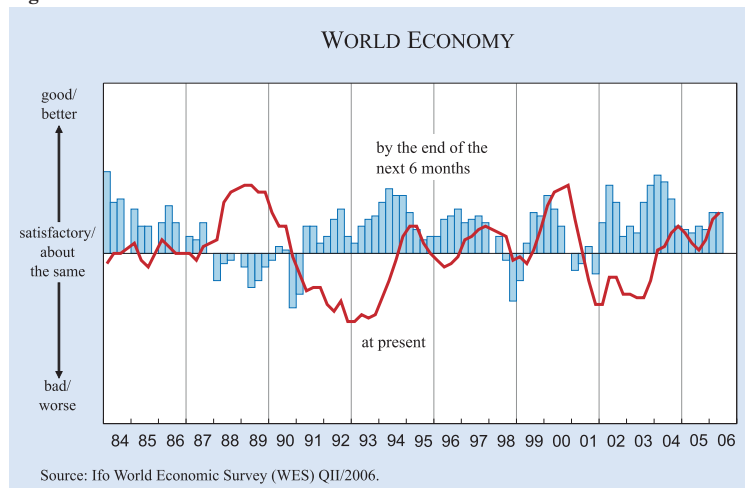
In the second half of 2003, with the end of the main war activities in Iraq, the economic expectations clearly brightened. The strong pace of recovery that started in the second half of 2003 gained more momentum in the first half of 2004. In the second half of 2004 and beginning of 2005 the world business sentiments were cooling, coupled with the rising oil prices, but by the end of 2005 the index strongly bounced back, indicating a solid economic rebound. According to latest forecasts, the global economy in 2006 will remain in a consolidated upturn phase in 2006.

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 Konjunkturuhr"). 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). The business cycle typically goes clockwise in a circle; expectations leading assessments of the present situation.



were only two countries that deviated from the generally positive trend – *Italy* and *Portugal*. In both economies the economic experts assessed the present economic performance more negatively than in the preceding polls, although the economic expectations

Figure 2



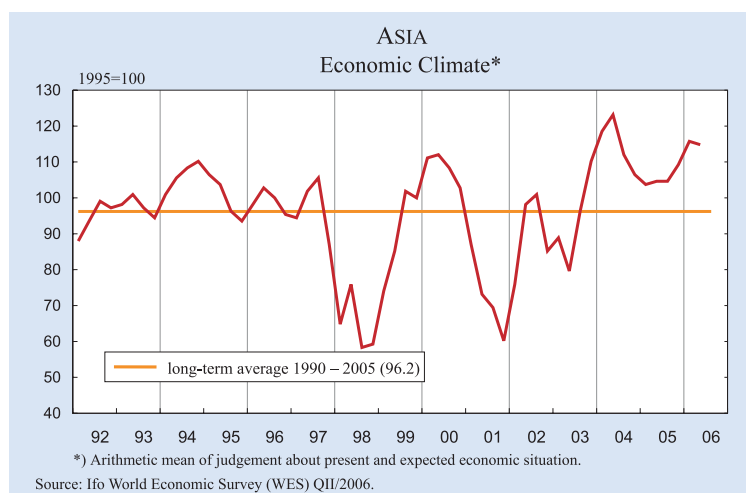
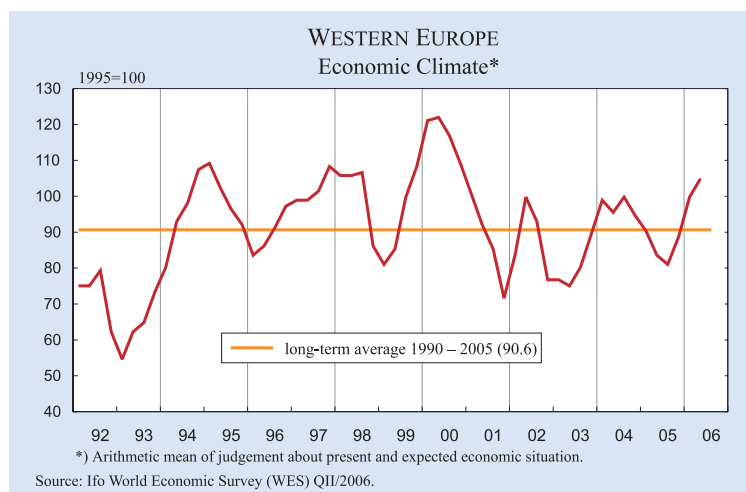
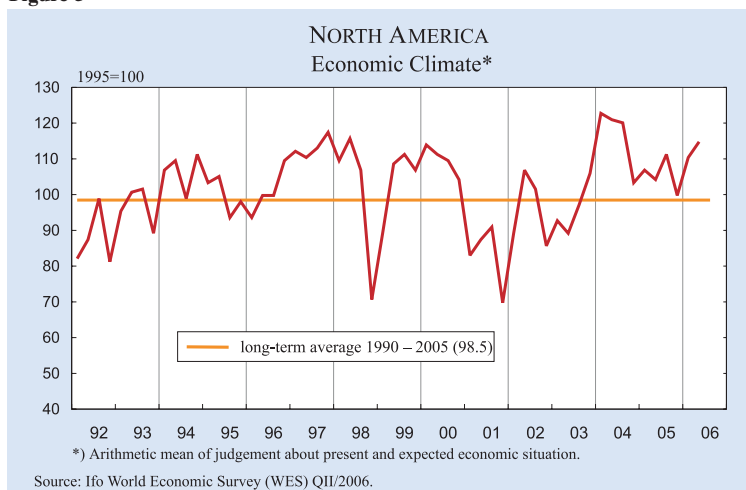
point to a turn-around in the course of the coming six months.

In the countries outside the euro area, *Denmark*, *Norway* and *Sweden*, the present economic situation again received the highest possible marks on the WES scale. The panel's forecast for the coming six months reflects a stabilization of the current positive state of the economy. Also in *Switzerland*, the present economic situation continued to improve, according to the latest results. In the *United Kingdom* the overall climate index points to recovery after sharp economic cooling down during 2005. Growth is set to accelerate again in the second half of 2006, according to the panel's forecast. The economic expansion around the world is expected to continue to help *British* exports.

North America:
Optimistic expectations

According to the April survey results, the economic climate indicator in North America continued to rise (see Figures 3). While in the January poll the improvement resulted from both components – assessment of the current economic situation as well as the economic expectations – in the April survey, only the economic expectations have been slightly upgraded, while the assessments of the present economic situation remained favourable, and on their highest level for more than five years (see Figure 4). However, this pattern applies particularly to the *US*, while in *Canada* the present economic performance continued to improve according to the surveyed economists (see Figure 6). Although the economic growth in the *US* is expected to slow somewhat in the later course of 2006, the positive expectations indicate that the economic climate index will stabilize at the currently high level.

Figure 3



Eastern Europe: Stable economic climate

According to the April survey results the economic climate index slightly declined, particularly due to the somewhat downgraded economic expectations for the next six months (see Figure 4). However, the assessments of the present economic situation were almost unchanged above the satisfactory level, on average of

all countries surveyed in the region.

In all surveyed countries of the European Union in the region, the assessments of the present economic situation remained favourable or even improved somewhat over the last January poll. The only exception among the “new” EU economies was still *Hungary*, where the surveyed economists assessed the present economic performance far below satisfactory and even somewhat weaker than at the beginning of the year. They expect a further decline of economic activity in the course of the coming six months. The highest marks on the WES scale were again given in *Estonia* and the *Czech Republic*, followed by the other Baltic States (*Lithuania*, *Latvia*, *Poland*), and *Slovenia*. The forecasts for the coming six months, although somewhat downgraded compared to the January poll, indicate economic stabilization in the second half of 2006. In *Slovakia*, the current economic performance has been also assessed as good, but somewhat less favourable than in the preceding poll.

Positive marks for the current economic situation have also been given by the surveyed WES experts outside the EU, particularly in *Bulgaria*, *Romania* and *Albania*. The economic expectations for the second half of 2006 are generally positive. In contrast, the economic performance in *Serbia* and *Montenegro* and *Bosnia-Herzegovina* was assessed as below the satisfactory

level by the survey economists. However, the prospects for this year promise some bettering ahead.

CIS: Economic climate further improved

In the CIS countries covered by WES (*Russia*, *Kazakhstan*, *Ukraine* and *Uzbekistan*) the overall cli-

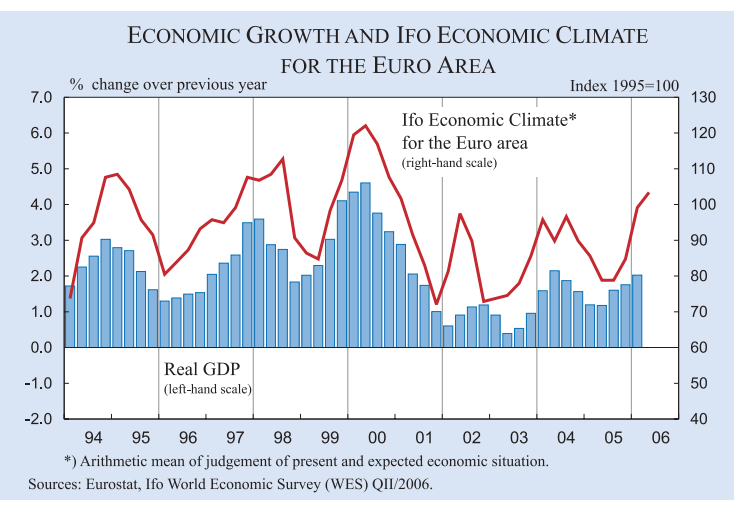
Box 2

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

The Ifo World Economic Climate for the 12 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 coming six months. The April results are based on the responses of 294 experts. As a rule, the trend of the Ifo Economic Climate indicator correlates well with the actual business-cycle trend for the euro area – measured in annual growth rates of real GDP (see Figure).

The Ifo indicator for the economic climate of the euro area rose in the second quarter of 2006, achieving at 103.4 points a five-year high. For the first time since 2001, the present economic situation was assessed as “satisfactory”. The outlook for the coming six months remained clearly optimistic in all countries. The results confirm that the economic recovery in the euro area has further solidified.

The appraisals of the current economic situation improved in the majority of the euro countries against the January survey. Improving trends were reported especially in Germany, Belgium and the Netherlands. Also in France the assessments of the general economic situation were more favourable than in the previous survey but have not yet moved into positive territory. In Ireland and Finland the economic climate continues to be excellent. The experts in Austria were also positive regarding the economic situation and the six-month outlook. The most unfavourable assessments of the economic climate continued to come from Italy and Portugal.



mate index improved slightly. Particularly in *Russia* both components of the climate indicator – assessments of the present economic situation and economic expectations – have been upgraded again (see Figure 6). Also in *Kazakhstan* the present economic situation received somewhat better marks than in January. The outlook for 2006 now points to a continuation of the positive economic development. *Ukraine's* economy, as an oil importer, does not benefit as its two neighbours from the rising oil prices. The economic reforms remain subdued and the assessments of the present economic situation continued to decline; the expectations for this year remained rather cautious.

Asia: Booming markets

According to the April survey results, the economic climate in Asia has remained favourable since the

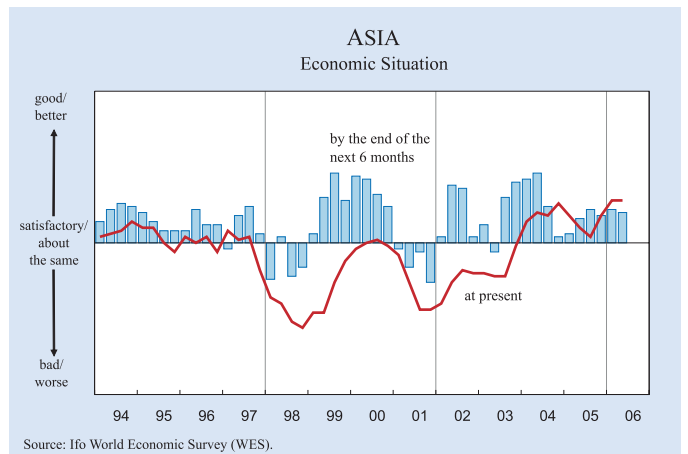
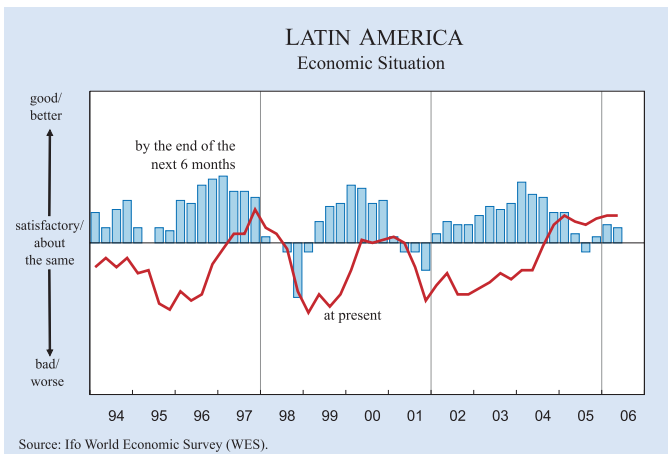
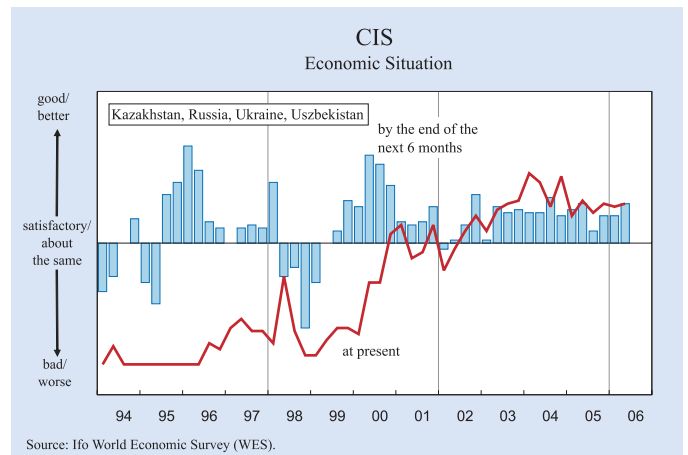
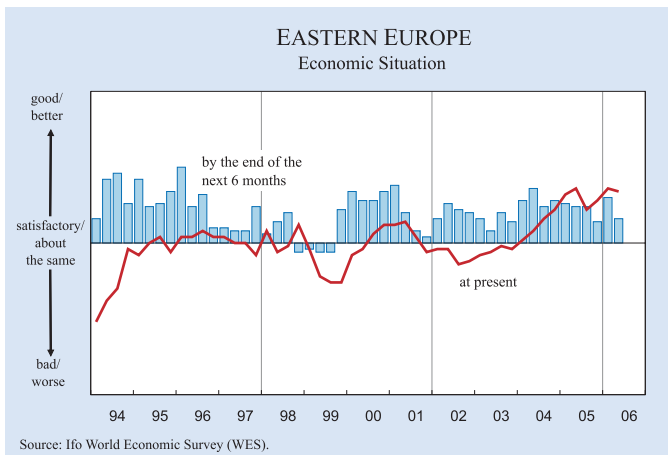
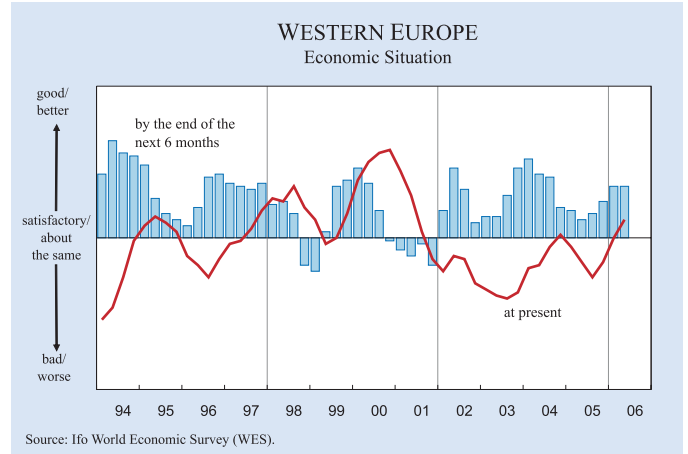
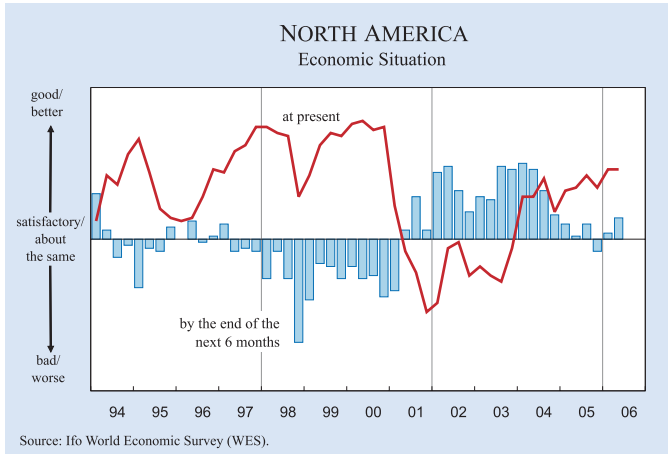
preceding January survey (see Figure 4 and 8). Asia's overall economic performance is assessed with high marks and is expected to remain robust in the near-term future despite the potential risks posed by the rising oil costs, tighter financial markets and the avian flu.

Particularly high marks for the present economic performance have been given by the surveyed economists in *Vietnam, India, Japan, Malaysia* and *Singapore*. The economic expectations for the next six months in all these countries are very optimistic. *Japan's* economy is on expansion course – the country is in its fourth year of economic growth – but unlike in the euro area where the export sector spurs economic growth, the economic expansion in *Japan* is accelerating due to both, foreign and domestic demand. Consumer confidence in *Japan* is now at a 15-year high and corporate investments are also expected to remain robust, according to the WES experts. In *China* the

economic climate index has stabilized for almost two years at a favourable level indicating stable economic growth, led by investment and exports; the widely expected slow-down has not occurred. In *India* both components of the climate index remained at a highly favourable level, *India's* still high agricultural sector's share in GDP growth is progressively shrinking according to official figures, as manufacturing and the services sector continue to expand. The surveyed economists forecast further strengthening of corporate investment and private consumption in the next six months. The present economic situation has been assessed satisfactory or good in *South Korea, Hong Kong, Pakistan, the Philippines* and *Sri Lanka*. The forecast for the second half of this year points to a solid economic upturn. Only in *Thailand*, where the present economic situation is also assessed as “satisfactory”, has the experts' outlook become somewhat clouded.

Figure 4

SELECTED REGIONS



There are only three countries of the region where the present economic situation was assessed below satisfactory in April: *Taiwan*, *Indonesia* and *Bangladesh*. However, the economic climate index in *Taiwan* was at a highly favourable level one year ago and although it has declined since then, the country's outlook for exports, which account for about half of the island's economy, remains upbeat and the overall expectations suggest economic stabilization in the later course of 2006. A completely different pattern concerning business sentiment can be observed for *Indonesia*. According to the panel's expertise the country's economic performance has been steadily improving for more than five years. Although the assessments of the present economic situation have not yet reached a satisfactory level, the economic outlook for 2006 remains optimistic.

Oceania: Economic cooling down continues in New Zealand

In *Australia* the economic climate continues to be highly favourable, with both, the assessments of the present economic situation as well as economic expectations, been up-graded again. However, private consumption was appraised weaker compared to the same time last year and is not expected to strengthen in the course of this year. But, capital expenditures are regarded as strong and are forecast to remain expansive in the next six months. In contrast, in *New Zealand*, the appraisals of the surveyed economists signal recession. The marks for the present economic performance slipped further below the satisfactory level and the outlook for 2006 suggests that this unfavourable development will last during this year, although the export performance is expected to remain stable or even to increase somewhat, according to the surveyed experts (see Figure 6).

Latin America: Economic stabilization

The economic climate in Latin America has stabilized at a favourable level in April. The present economic situation is assessed above the satisfactory level, on average of all countries surveyed in the region. The outlook for the coming six months generally points to an economic stabilization (see Figure 9).

In most countries of the region, the present economic performance is described as good or satisfactory. The present economic situation was assessed in

the two biggest economies of the region, *Mexico* and *Brazil*, more favourable than in the preceding January survey. However, in both economies the panel's forecast has been downgraded somewhat, pointing rather to a stabilization on the current favourable level. Although GDP growth dropped in 2005, *Brazil's* economy has strengthened its export sector, which is expected to remain buoyant in the course of the year. Unchanged positive assessments have again been reported from the two Western coast economies – *Chile* and *Peru*. However, while the economic expectations for the second half of this year remain optimistic in *Chile*, business sentiments in *Peru* have cooled down somewhat. A positive picture has been also drawn in some smaller economies of the region, particularly *Guatemala*, *Panama*, *Colombia*, *Uruguay* and also *Costa Rica*. In all these countries the economic expectations for the coming six months are highly optimistic. The economy of *Venezuela* continues to benefit from the high oil prices. Both components of the climate index – present economic situation and expectations – are in the positive area in April again. In contrast, again below the satisfactory level was the panel's assessment of the present economic performance in *Ecuador*. The expectations for the coming six months are still cautious. Only in *Bolivia* and *Paraguay* did the surveyed economist describe the present economic situation as “bad”. The forecast for the second half of the year promises no turnaround. *Bolivia's* president Evo Morales provoked some concern world-wide on the issue of gas nationalization. *Bolivia* has South America's second-largest natural gas reserves after *Venezuela*, but is the poorest country on the continent. Thus, this plan was supported by other left-leaning governments on the continent, particularly the *Venezuelan*, but the question, of whether state control of resources will be more beneficial to the *Bolivian* economy than corporate control will be answered only over time. Although, nationalization is likely to result in short-term gains, it could have negative effect the country's investment prospects.

Near East: Economic climate remains favourable

According to WES experts the economic climate in the Near East remains favourable despite political turbulences in some parts of the region. The present economic situation is assessed with marks far above the satisfactory level; the economic expectations for 2006 remain very optimistic (see Figure 10).

The present economic situation is assessed as good again in *Saudi Arabia, United Arab Emirates, Kuwait* as well as *Jordan* and *Bahrain*. The outlook suggests stable economic development in the coming six months. The economic situation in *Lebanon* is now regarded as satisfactory. WES experts remained confident concerning a continuation of the positive economic development in 2006. The economic climate continued to be favourable in *Turkey*, with the present economic situation again graded as above the “satisfactory” level on the WES scale. The economic expectations for the coming six months indicate stabilization at the current favourable level in 2006. In contrast, the economic climate index declined somewhat in *Israel*. Although the present economic performance is still assessed as strong, it has received somewhat lower marks than in the preceding January poll. The economic expectations for the coming six months, however point to economic stabilization on the current level. Not so in *Iran*, where the present economic situation was assessed as poor in the January poll and somewhat better in the April poll, but further deterioration is forecast by the surveyed economists for the second half of 2006.

Africa: Diverging economic trends predominate

Africa remains a region with very diverging economic trends. Thus, an aggregated climate index for countries surveyed by WES experts on this continent makes little sense, and the following analysis will focus on particular economic trends in individual countries.

The economic climate index in *South Africa* remained favourable, according to the April WES results (see Figure 10). The business sentiments concerning the current economic situation are still close to the highest possible marks on the WES scale. The expectations point to a further economic stabilization in the second half of 2006. The present economic situation has again been assessed with “satisfactory” marks in the North African countries surveyed by WES experts – *Tunisia, Algeria, Morocco, Egypt*, and also in *Kenya*. The outlook for the coming six months points to stabilization in all these countries. However, *Egypt's* economy, which heavily relies on tourism, has again been shaken by a terrorist attack. As rather weak the surveyed economists described the economic situation in *Nigeria*. However, the outlook gives rise to hopes for improvement in the course of this year. The worst

economic situation of all 91 countries covered by WES was again reported from *Zimbabwe*, where for many years the surveyed experts have been giving the most negative marks that are possible on the WES scale.

World's main economic problems – an unbalanced picture

While in the past years “unemployment” and “insufficient demand” ranked as the most important economic problem around the world, this picture has started to change, according to the latest WES results. “Lack of international competitiveness” ranks first in most of the world's biggest economies, particularly in Western Europe. It was named as the most important economic problem in Belgium, Greece, Ireland, Italy, the Netherlands, Norway and the United Kingdom, and it ranked second in Spain. In the two biggest economies of the region – Germany and France – as well as in Sweden, Finland and Austria WES experts again named “unemployment” as the single most important economic problem.

“Lack of international competitiveness” seems to provide no reason for concern in the new EU countries of Central and Eastern Europe. However, it is the main economic topic in the Eastern European countries outside the EU. “Lack of international competitiveness” ranked first particularly in Russia, and also in Albania. It has been given a certain priority also in the Ukraine and Kazakhstan, as well as in Romania, Serbia and Montenegro and Croatia. In contrast, the new EU countries differ with regard to their most urgent economic problems. “Unemployment” is challenging the economies of Poland and Slovakia, according to the surveyed economists, while it is a “lack of skilled labour” in the Baltic countries – Estonia, Latvia and Lithuania. “Public deficits” burden in particular the economies of the Czech Republic, Hungary and Poland.

Also in the United States – the world's main economy – the surveyed experts expressed no worries about the “lack of international competitiveness”, but emphasized, as expected, the risks posed by the enormous “public deficits”.

In the majority of Asian economies the surveyed experts regard “unemployment” as the main economic issue. This is the case particularly in China, Pakistan and the Philippines. “High public deficits” have been named in India and Japan as a severe

problem. Surprisingly, Asia is the region where “lack of confidence in the government’s economic policy” has been named most often, particularly in Taiwan and Thailand, where it ranked first, but also in Indonesia, Pakistan and the Philippines. “Lack of international competitiveness” does not seem to be an issue in most countries of this region. Exceptions are only Indonesia and Malaysia, where the surveyed economists regarded this aspect as the most important economic problem. In Australia’s booming economy “lack of skilled labour” is seen to be the most important hurdle to stronger economic expansion.

The picture for Latin America is quite homogeneous, with priority given to the problem of “unemployment“. This applies to all countries surveyed in the region, except Costa Rica where „inflation“ appears to be a more important problem. However, “lack of international competitiveness” has also been emphasized in many Latin American countries: the scores were particularly high in Bolivia, Ecuador, Mexico, Argentina and Paraguay. “Lack of confidence in government’s economic policy” now poses an important economic problem in Bolivia, Venezuela, Ecuador and Paraguay.

“Unemployment“ still ranks as the most important problem in all African countries polled by WES. In South Africa “lack of skilled labour” is the second important problem noted by WES experts. On the other hand AIDS still poses a serious downward risk to economic prosperity on the continent.

In the Near East economic problems differ very much from country to country. In Israel “unemployment“ was assessed to be by far the most important problem in the economy. In Turkey the surveyed experts have also emphasized the “foreign debts”. In the oil exporting economies, particularly in Bahrain and the United Arab Emirates “inflation” and “lack of skilled labour” provide the major reasons for concern.

2006: Inflation expectations continue to weaken somewhat

Despite sharply rising prices of energy and raw materials, there are no signs that consumer price inflation (CPI) will accelerate this year. On the contrary, CPI in 2006 is expected to stand at 3.1 percent, in 2006 on the world-wide average, which is slightly lower than expected at the beginning of the year

(3.2 percent) and also somewhat lower than the figure registered in 2005 (3.3 percent). Thus, inflation is expected to cool off somewhat but will stay at a rather high level (see Table 1).

In the *euro area* the inflation outlook for 2006 is slightly brighter than at the beginning of the year (2.1 percent compared to 2.2 percent in the previous survey) but will remain at a level that is somewhat higher than the ECB’s target of “slightly below 2.0 percent”. The worst inflation performance in the euro area will prevail this year again in *Spain* with 3.7 percent, where inflation is now expected to be even somewhat higher than the forecasts in the WES survey at the beginning of the year. Also in *Greece* inflation in 2006 is again expected to be well above the euro area average (3.4 percent compared to 2.1 percent in the euro area). The lowest inflation rates in the euro area in 2006 will continue to prevail according to WES experts in *Finland* and in the *Netherlands* (1.5 percent and 1.6 percent respectively, after an expected 1.7 percent in both cases at the beginning of the year). In *France* and *Germany*, 2006 inflation is seen at 1.9 percent, which in the case of Germany slightly lower than expected at the beginning of the year.

In *Western Europe* outside the euro area, expectations for low inflation rates in 2006 continue to prevail in *Switzerland* (1.0 percent after an expected 1.1 percent at the beginning of 2006) and *Sweden* (1.6 percent; unchanged from the expectations at the beginning of the year). In *Norway* inflation expectations for 2006 now look more favorable than at the beginning of the year (1.5 percent compared with 2.0 percent). In the *United Kingdom* the inflation rate in 2006 will be very close to the one expected for the euro area (2.2 percent compared with 2.1 percent).

In the *United States* inflation in 2006 is not expected to exceed the 3.0 percent-mark after a reported 3.4 percent last year. In *Canada* inflation is expected to weaken further (2.3 percent compared to 2.4 percent expected at the beginning of 2006 and a reported inflation of 2.8 percent in 2005).

In *Asia* consumer price inflation at 2.8 percent is expected in 2006 (unchanged from the expectations at the beginning of the year). The lowest inflation rates in 2006 will continue to prevail in *Japan* (0.5 percent compared to an expected 0.4 percent at the beginning of the year); the ongoing economic recovery in Japan makes the fears of a possible renewed danger of defla-

Figure 5a

EUROPEAN UNION

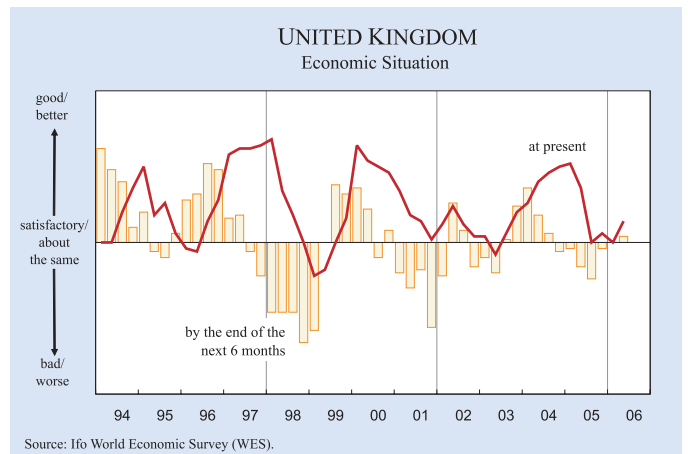
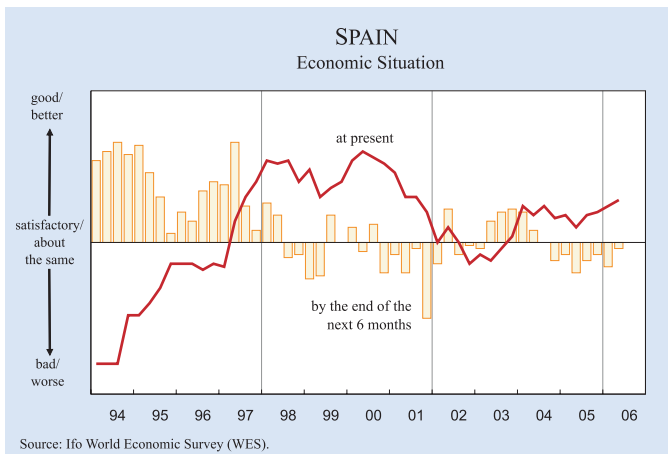
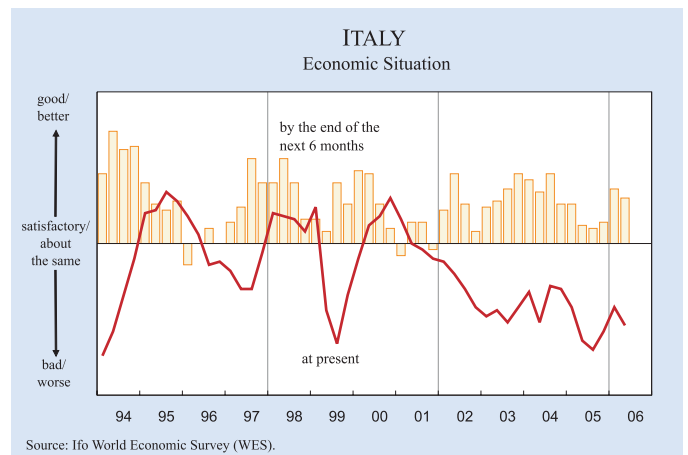
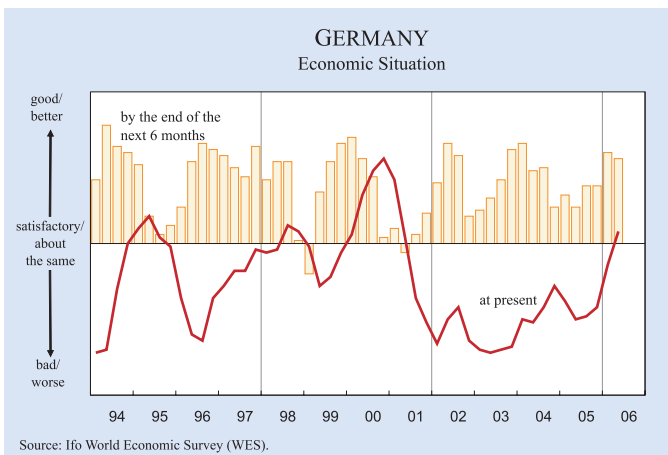
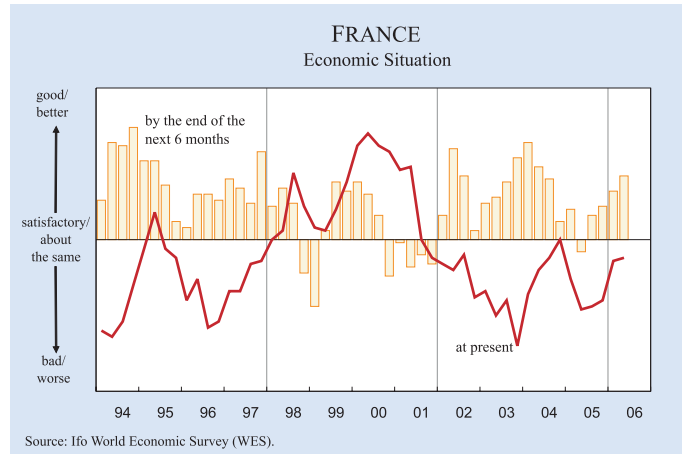
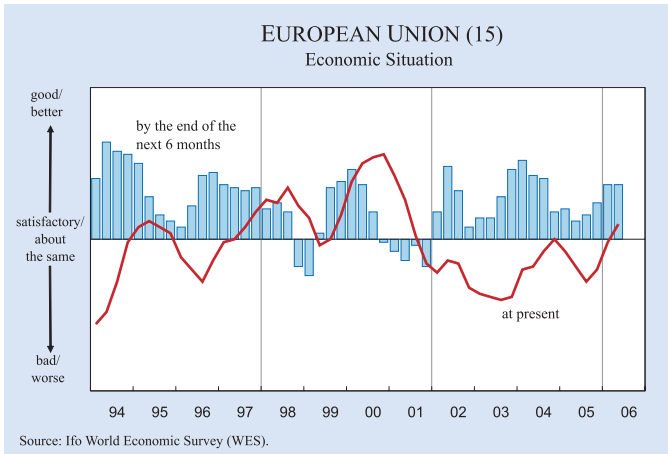


Figure 5b

EUROPEAN UNION

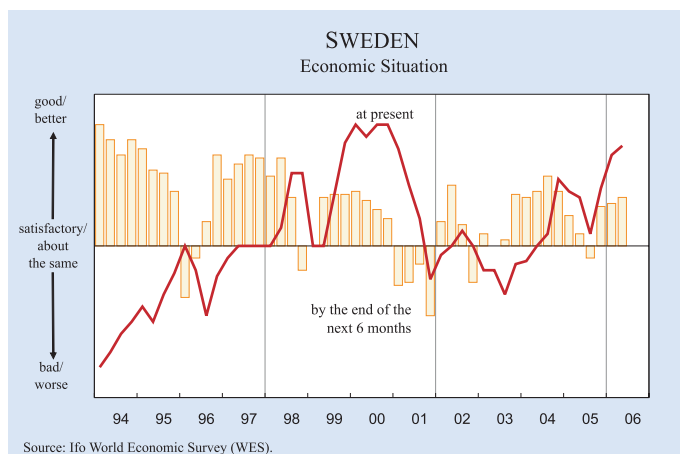
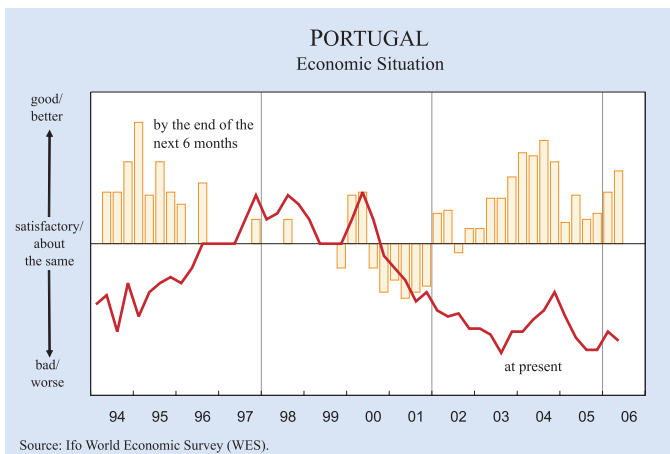
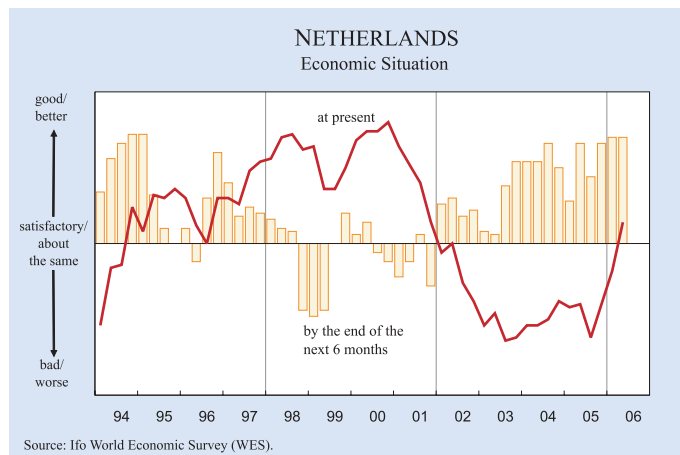
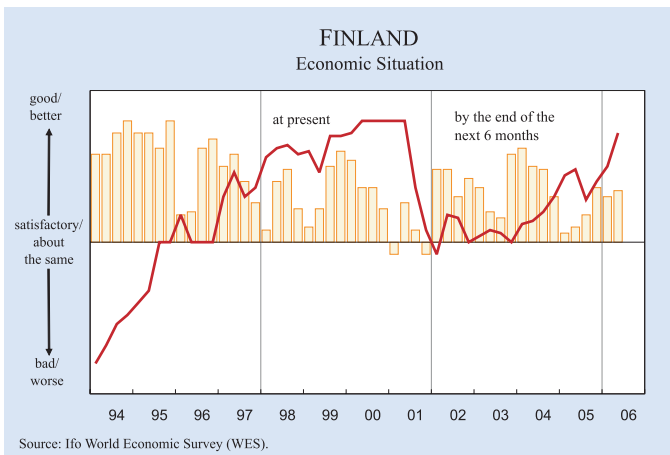
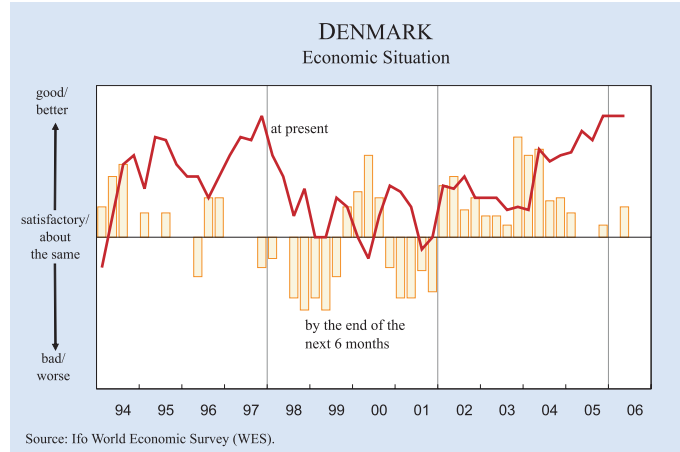
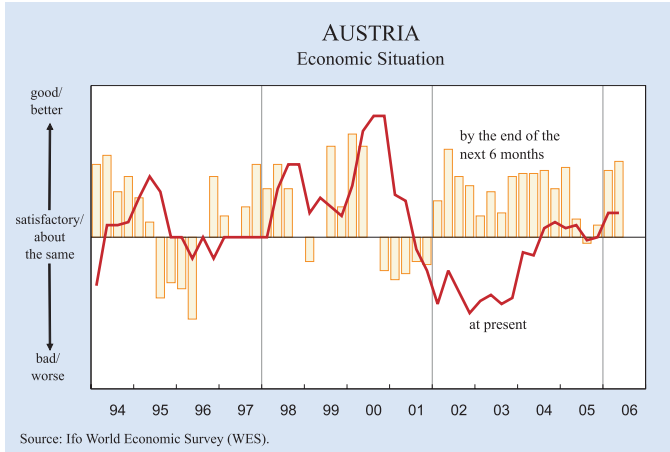


Figure 6

NORTH AMERICA, OCEANIA AND CIS

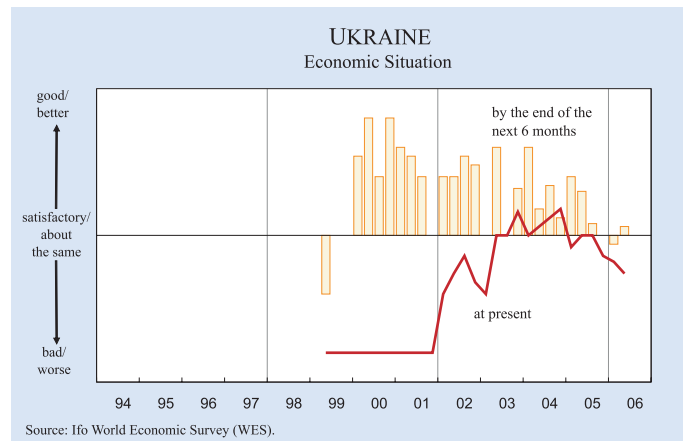
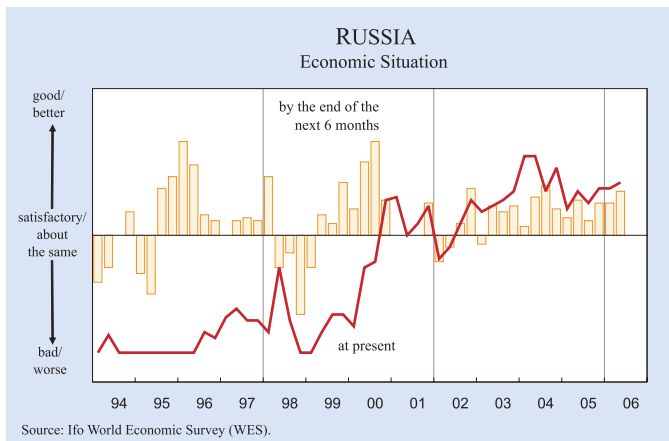
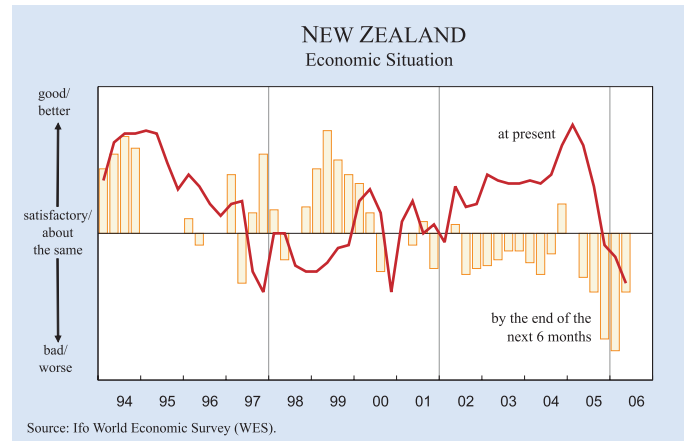
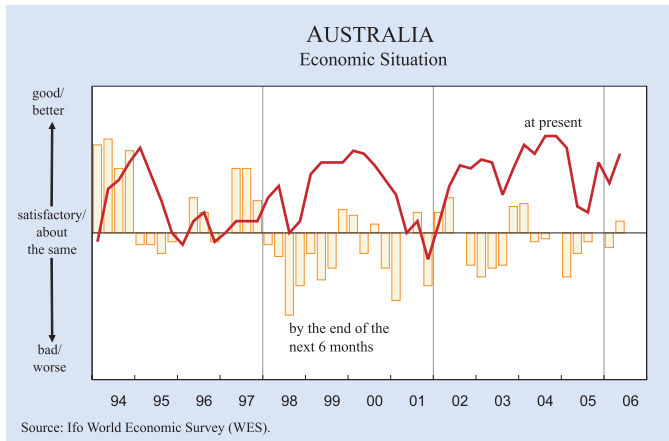
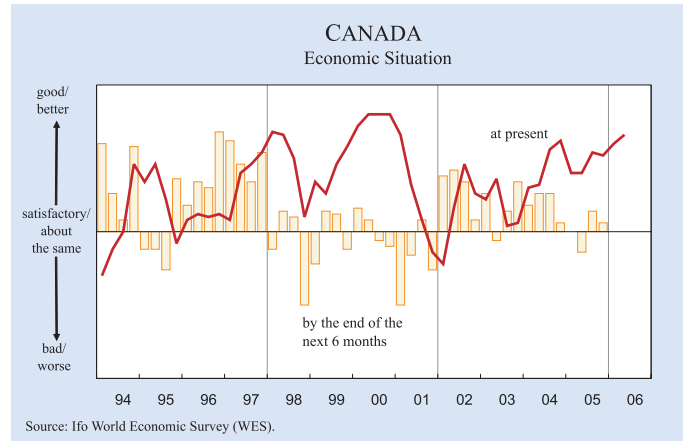
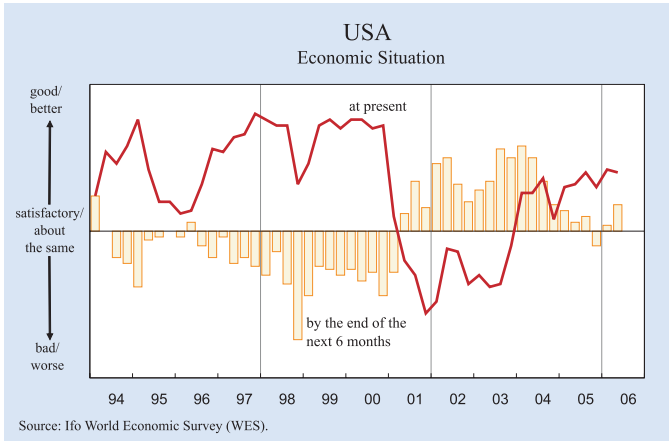


Figure 7

EASTERN EUROPE

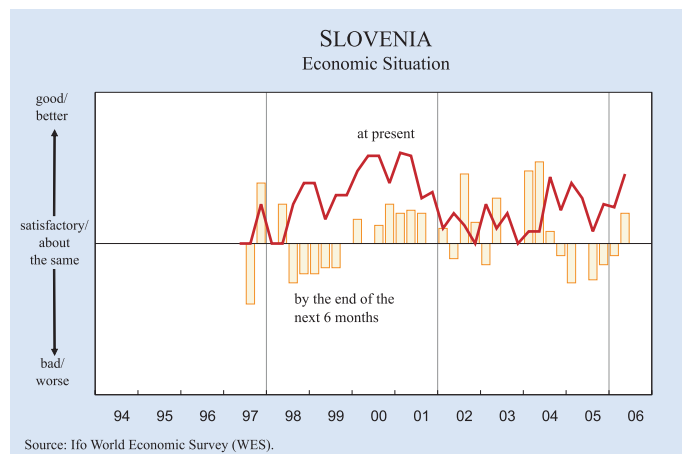
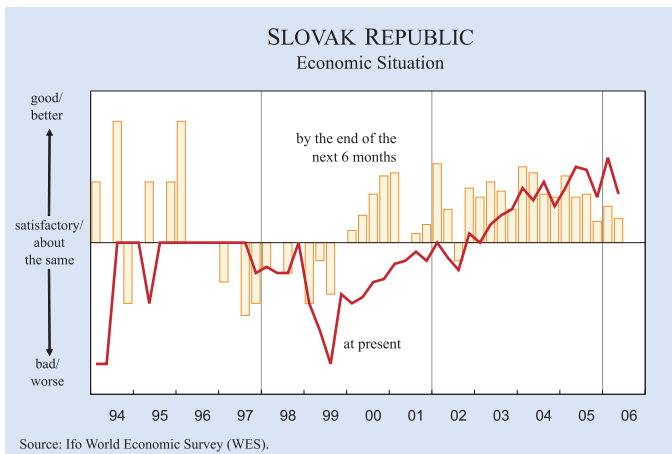
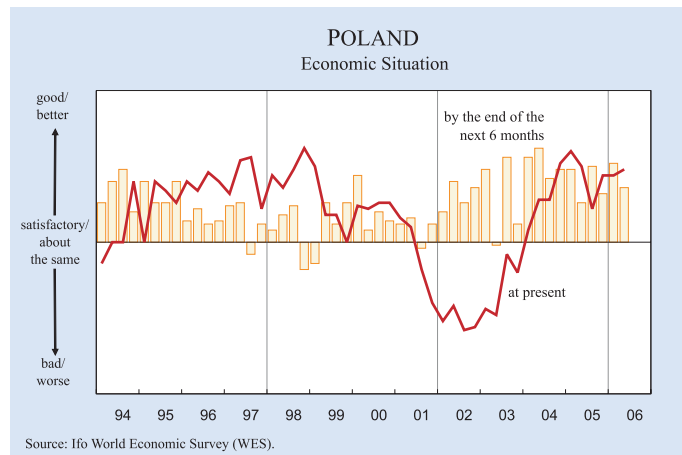
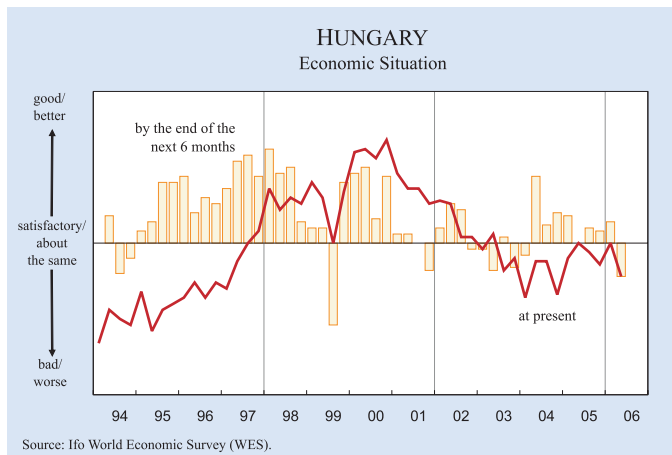
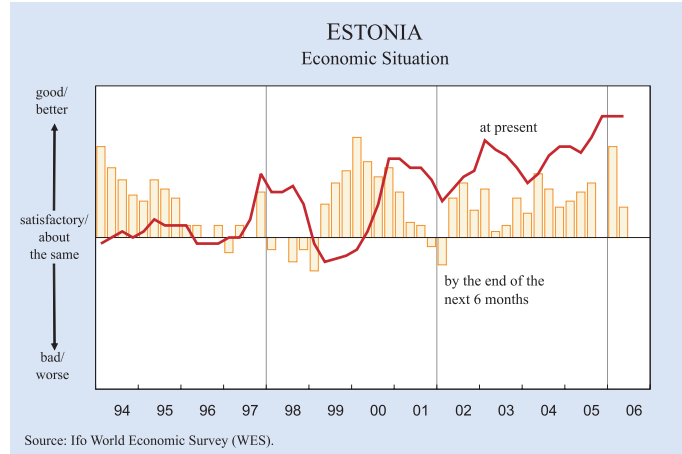
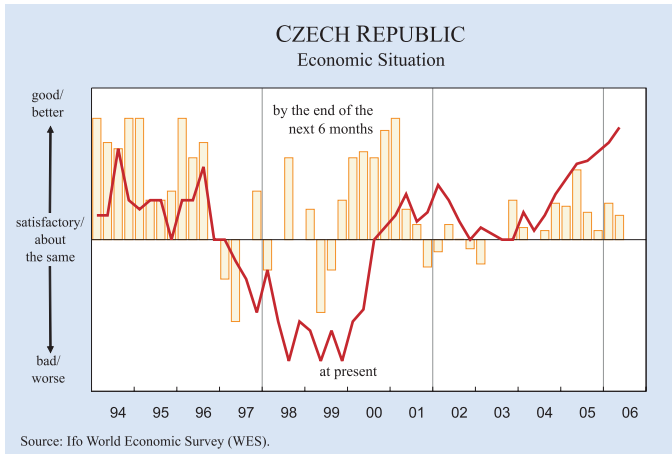


Figure 8

ASIA

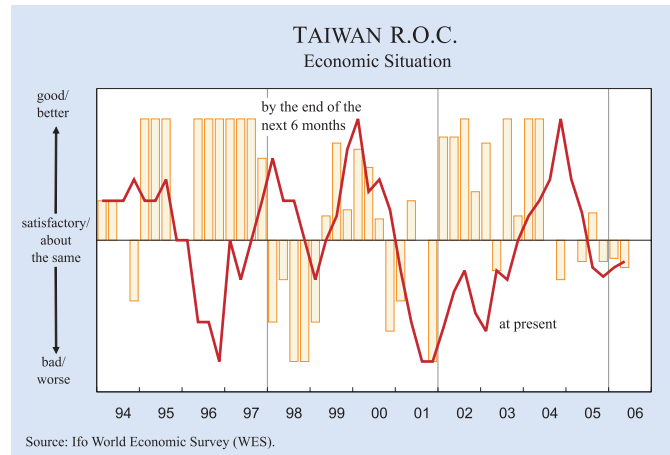
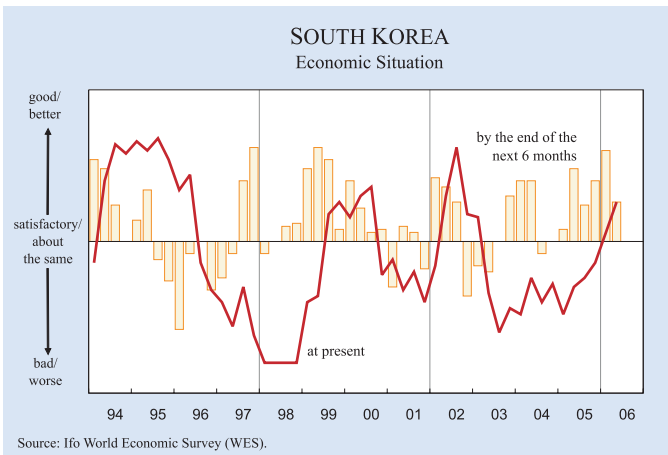
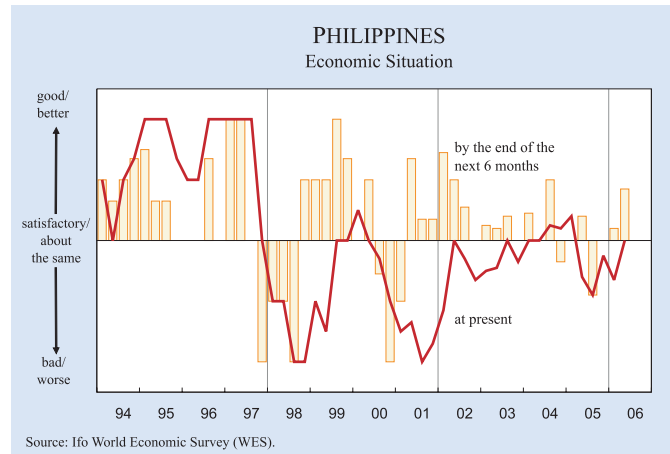
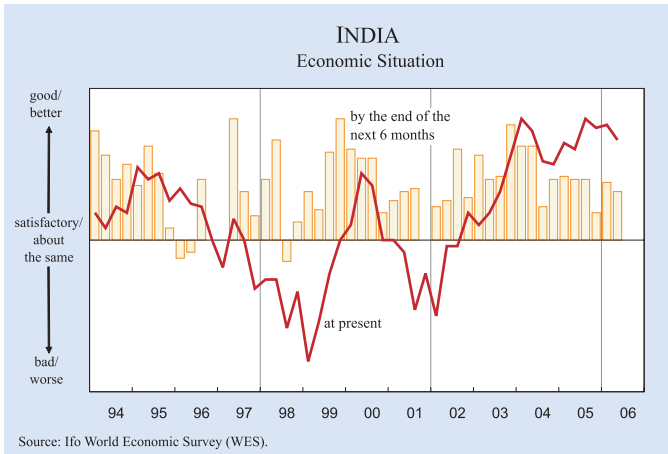
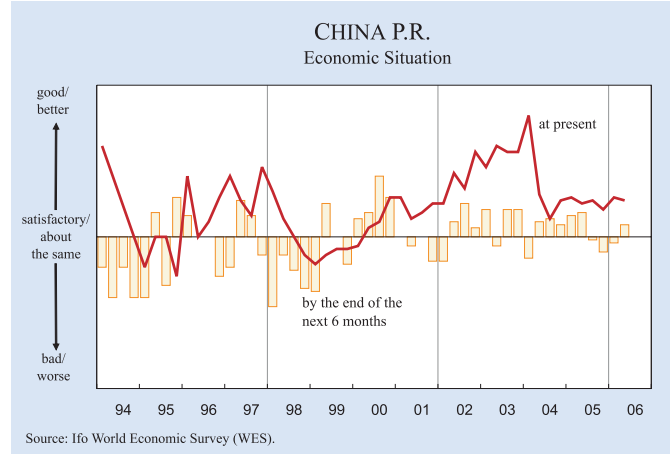
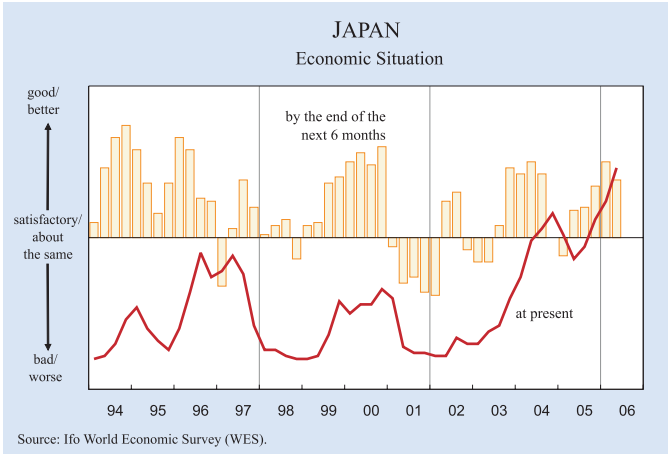


Figure 9

LATIN AMERICA

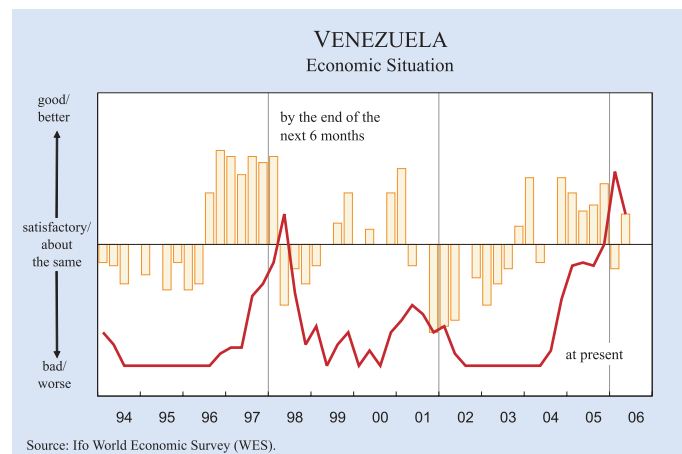
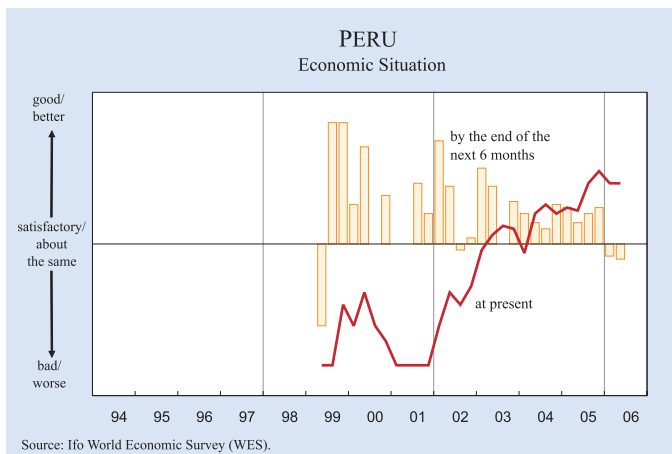
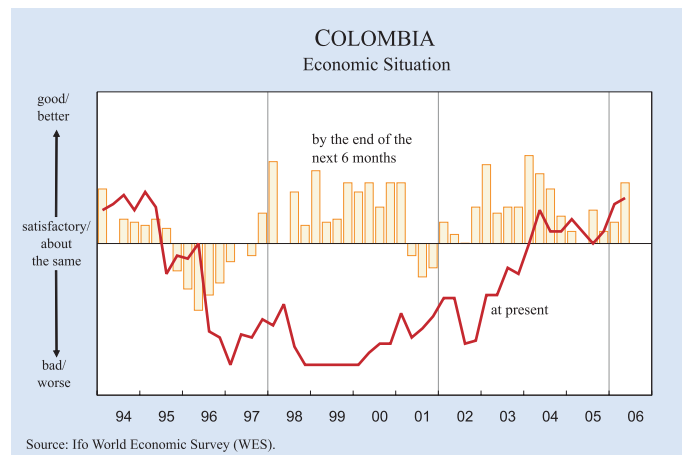
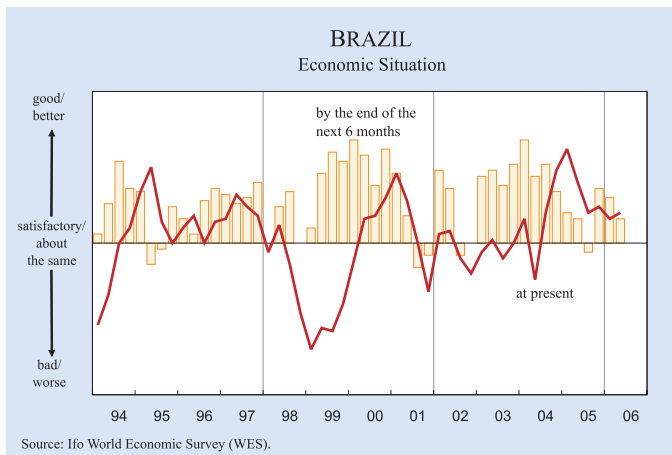
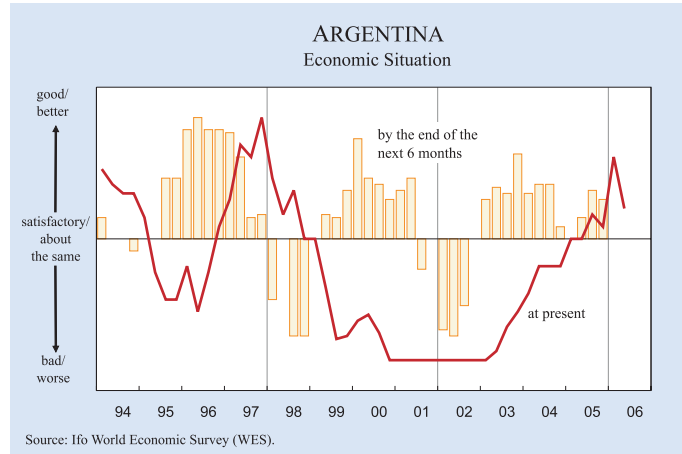
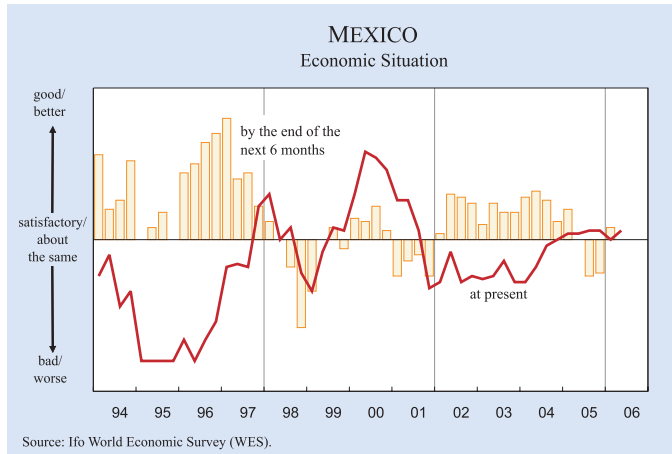


Figure 10

NEAR EAST AND AFRICA

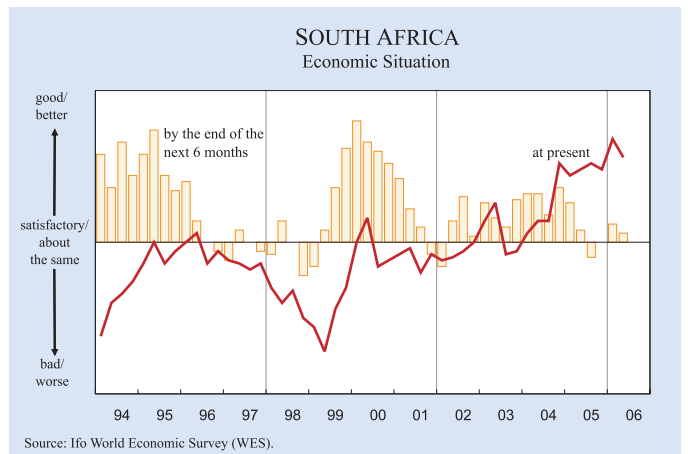
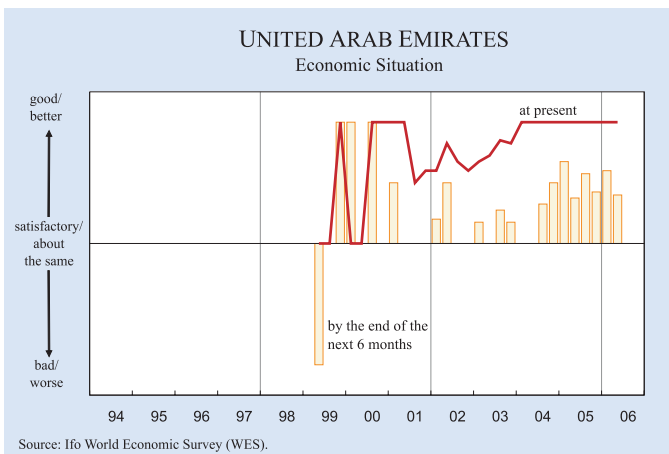
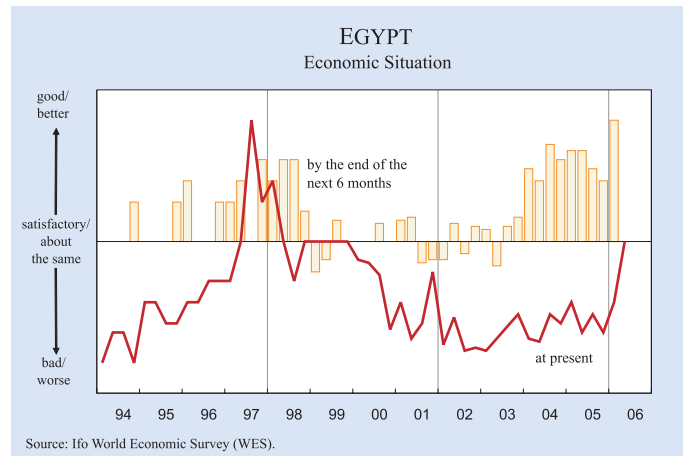
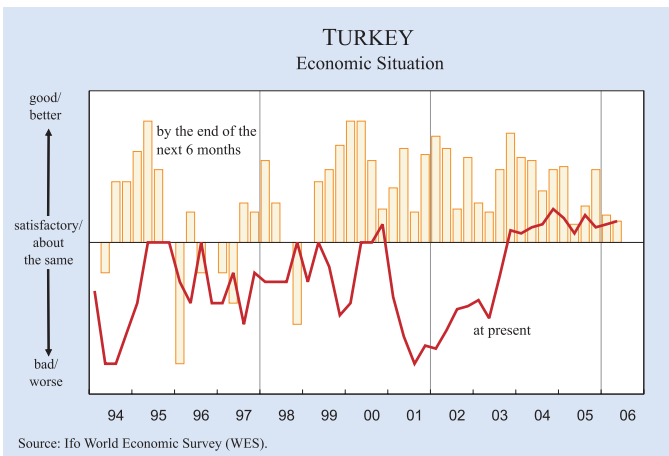
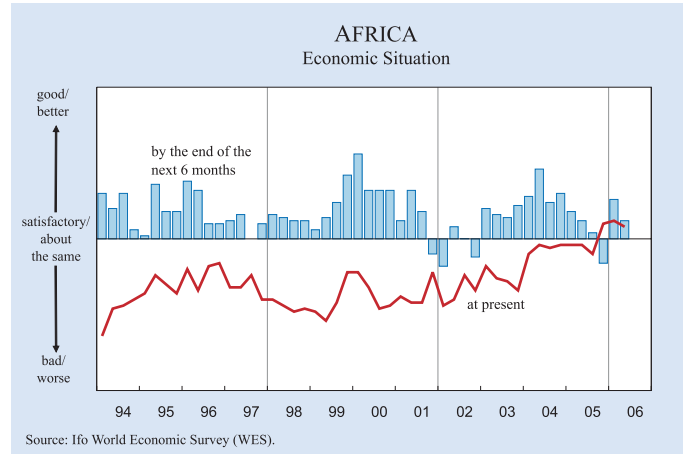
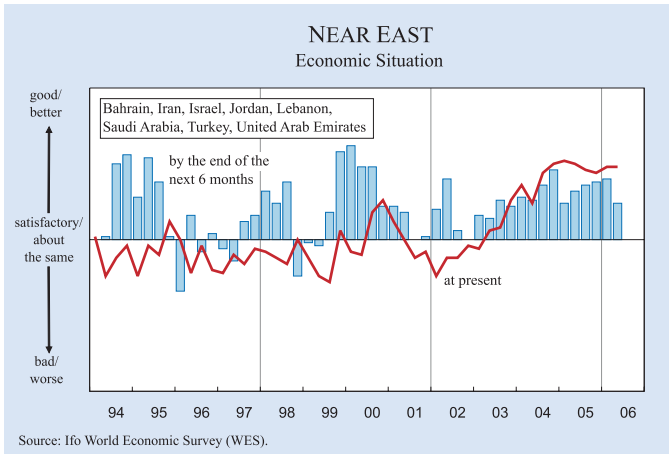


Table 1

Inflation Rate Expectations for 2006
(based on WES QII/2006 and QI/2006)

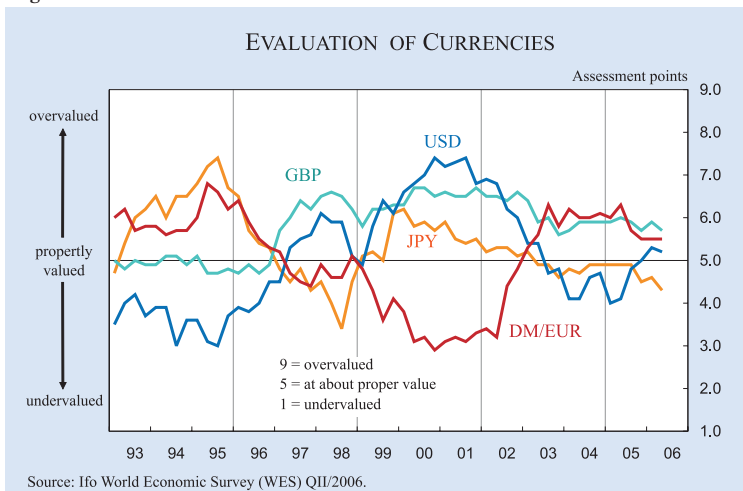
Region	QII/2006	QI/2006	Region	QII/2006	QI/2006
Average of countries	3.1	3.2	Central a. Latin America	5.7	5.5
<i>World Bank classification:</i>			Argentina	15.3	13.0
High-income countries	2.2	2.3	Bolivia	4.0	4.3
Middle-income countries	5.4	5.5	Brazil	4.7	4.9
Upper-middle	5.5	5.3	Chile	3.5	3.4
Lower-middle	5.3	5.8	Colombia	4.9	4.8
Low-income countries	14.4	13.4	Costa Rica	10.8	12.0
EU countries (old members)	2.1	2.2	Ecuador	4.3	4.6
EU countries (new members) ¹	2.7	3.0	El Salvador	4.5	4.4
Euro area ²	2.1	2.2	Guatemala	7.8	-
Asian Pacific Rim ³	3.4	3.4	Mexico	3.9	3.5
Western Europe	2.1	2.1	Panama	2.3	1.7
Austria	2.0	2.1	Paraguay	11.0	10.0
Belgium	2.0	2.3	Peru	2.5	2.6
Cyprus	2.6	2.9	Uruguay	6.8	5.5
Denmark	2.2	2.3	Venezuela	17.3	16.2
Finland	1.5	1.7	Asia	2.8	2.8
France	1.9	1.9	Bangladesh	7.0	7.2
Germany	1.9	2.0	China P.R.	2.4	2.8
Greece	3.4	3.3	Hong Kong	2.8	2.3
Iceland	5.5	-	India	5.0	5.2
Ireland	3.0	2.5	Indonesia	11.4	9.6
Italy	2.2	2.2	Japan	0.5	0.4
Luxembourg	2.6	2.3	Korea	3.1	3.5
Malta	3.1	3.0	Malaysia	3.6	3.2
Netherlands	1.6	1.7	Pakistan	8.9	8.1
Norway	1.5	2.0	Philippines	6.7	6.6
Portugal	2.6	2.5	Singapore	1.3	2.2
Spain	3.7	3.4	Sri Lanka	9.0	12.3
Sweden	1.6	1.6	Taiwan	1.9	1.8
Switzerland	1.0	1.1	Thailand	4.9	5.0
United Kingdom	2.2	2.4	Vietnam	7.0	7.0
Central a. Eastern Europe	3.4	3.5	Near East	4.2	5.6
Albania	3.4	3.2	Bahrain	4.3	6.0
Bosnia Herzegovina	2.0	3.0	Iran	-	14.8
Bulgaria	6.1	5.3	Israel	2.5	2.9
Croatia	2.6	2.9	Jordan	4.1	3.5
Czech Republic	2.6	2.7	Lebanon	2.5	2.5
Estonia	3.8	3.4	Kuwait	3.8	3.3
Hungary	3.1	3.2	Saudi Arabia	0.9	1.2
Latvia	6.1	5.9	Turkey	6.3	6.3
Lithuania	3.0	2.7	United Arab Emirates	6.8	6.4
Poland	1.8	2.8	Africa	n.a.	n.a.
Romania	6.8	6.9	Algeria	5.0	2.8
Serbia a. Montenegro	12.7	11.9	Egypt	-	10.0
Slovenia	2.3	2.3	Kenya	8.5	10.8
Slovakia	3.4	3.7	Mauritius	6.0	6.0
CIS	10.4	10.0	Morocco	2.3	2.3
Kazakhstan	7.4	7.7	Nigeria	12.3	15.0
Russia	10.2	10.0	South Africa	4.7	4.6
Ukraine	12.7	11.3	Tanzania	-	4.0
Uzbekistan	7.0	-	Tunisia	3.1	2.7
North America	2.8	2.8	Zimbabwe	600.0	500.0
Canada	2.3	2.4	Oceania	2.9	3.0
USA	3.0	2.9	Australia	2.9	3.0
			New Zealand	2.9	3.3

* Within each country group the results are weighted according to the share of the specific country's exports and imports in the total world trade.

¹ Czech Rep., Cyprus, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovenia, Slovakia (from 1. May 2004) – ² EU countries without Denmark, Sweden, United Kingdom. – ³ Australia, China P.R., Hong Kong, Indonesia, Korea, Malaysia, New Zealand, Philippines, Singapore Taiwan, Thailand, Vietnam.

Source: Ifo World Economic Survey (WES), QI/2006 and QII/2006.

Figure 11



tion in the near future obsolete. Also low inflation rates continue to characterize *Singapore* (1.3 percent, which is significantly lower than the 2.2 percent expected at the beginning of the year) and *Taiwan* (1.9 percent after an expected 1.8 percent in January 2006). The relatively highest inflation expectations for 2006 prevail again in *Indonesia* and *Pakistan*; in both countries the inflation outlook has even worsened since the beginning of the year (In *Indonesia* from 9.6 percent to now 11.4 percent and in *Pakistan* from 8.1 percent to now 8.9 percent). Also in *Vietnam* and in *Bangladesh* inflation expectations for 2006 are well above the Asian average (7.0 percent compared with 2.8 percent in the average).

In *Central and Eastern Europe* inflation is expected to slow down slightly in 2006 (3.4 percent after 3.5 percent expected at the beginning of the year and a reported 3.8 percent in 2005). The relatively highest rate of inflation will still prevail in *Serbia* and *Montenegro* (12.7 percent, which is even significantly higher than the 11.9 percent expected at the beginning of the year). Also in *Romania*, *Latvia* and *Bulgaria* inflation expectations of around 6 percent are clearly above the average in the region. The lowest rates of inflation are seen in 2006 in *Poland* (1.8 percent, which is significantly lower than the expected 2.8 percent at the beginning of the year), *Bosnia Herzegovina* (2.0 percent after 3.0 percent in January 2006), *Slovenia* (unchanged at 2.3 percent) as well as the *Czech Republic* and *Croatia* (in both cases 2.6 percent, which is slightly lower than expected at the beginning of the year).

In the *CIS* countries the inflation outlook in 2006 will – according to the WES experts – be better than in 2005 (10.4 percent after 11.5 percent in 2005). The downward revision of inflation rates results particularly from lower

inflation expectations in *Russia* (10.2 percent after 11.8 percent in 2005). On the other hand the inflation outlook in the *Ukraine* has clearly worsened (12.7 percent after 11.3 percent expected at the beginning of the year and reported 11.9 percent in 2005). The relatively best inflation performance in the region will prevail again in *Kazakhstan* with an expected 7.4 percent in 2006.

In *Central and Latin America* inflation in 2006 is expected to be about the same as in 2005 (5.7 percent compared with 5.8 percent in 2005). Whereas the inflation rate in *Argentina* is expected to pick up further and reach 15.3 percent in 2006 after an expected 13.0 percent at the beginning of the year and a reported 12.8 percent in 2005, a contrary trend can be observed in *Brazil* where the 2006 inflation rate is now seen at 4.7 percent compared with 5.3 percent in the previous year. Well below the regional average inflation expectations for 2006 are in *Panama* (2.3 percent), *Peru* (2.5 percent) and *Chile* (3.5 percent). Apart from *Argentina* the highest inflation rates in 2006 will prevail again in *Venezuela* (17.3 percent), *Paraguay* (11.0 percent) and *Costa Rica* (10.8 percent).

In the *Near East* the inflation outlook improved somewhat (4.2 percent after 5.6 percent expected at the beginning of the year and a reported 5.9 percent in 2005). In *Turkey* the inflation outlook for 2006 remains significantly better than the performance in 2005 (6.3 percent compared with 7.8 percent in 2005). By far the lowest inflation rate will again prevail in *Saudi Arabia* (0.9 percent and thus even somewhat lower than the 1.2 percent expected at the beginning of the year); also in *Lebanon* (2.5 percent) and *Israel* (2.5 percent) inflation will be significantly lower than the regional average.

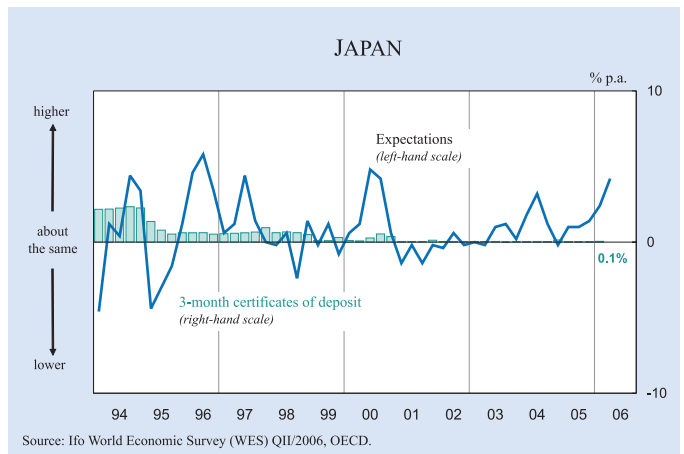
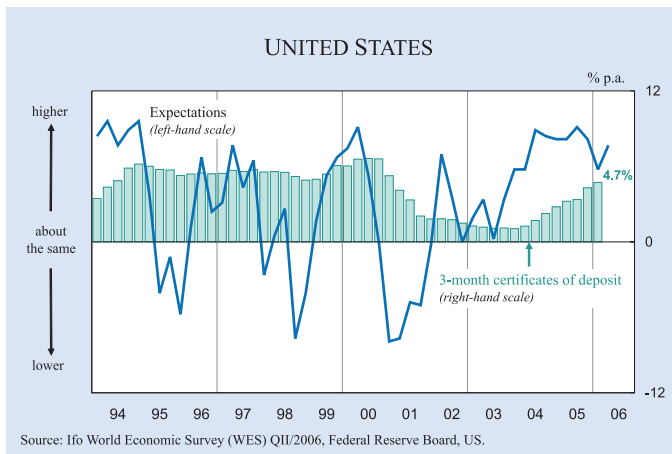
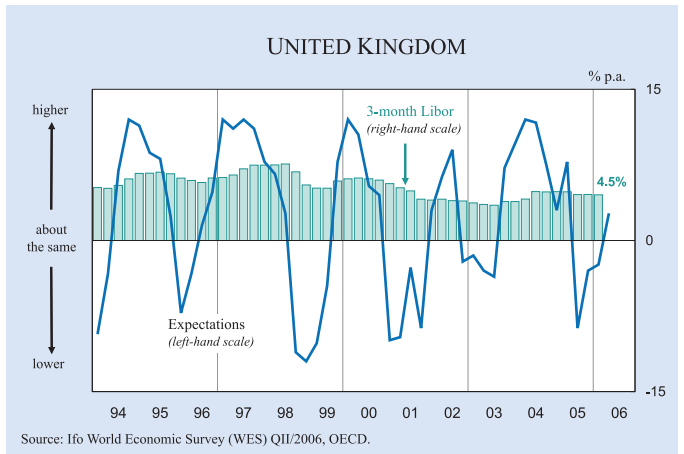
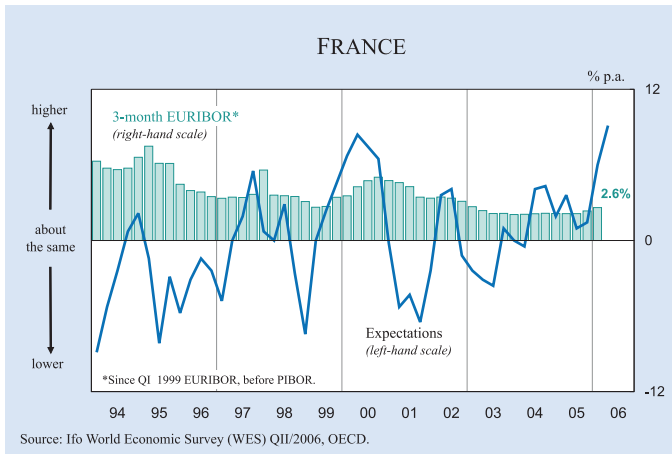
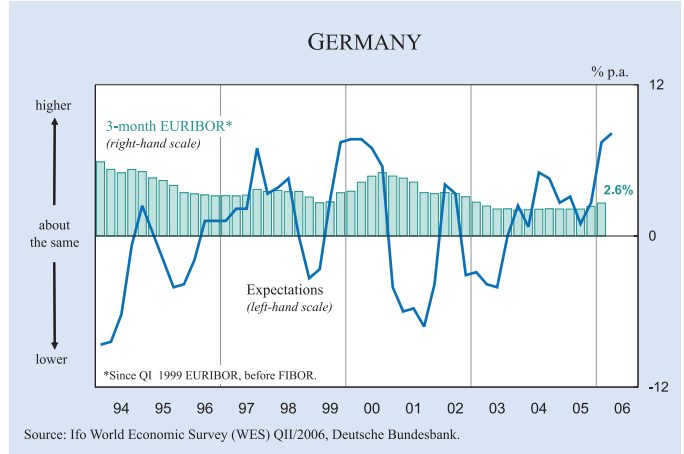
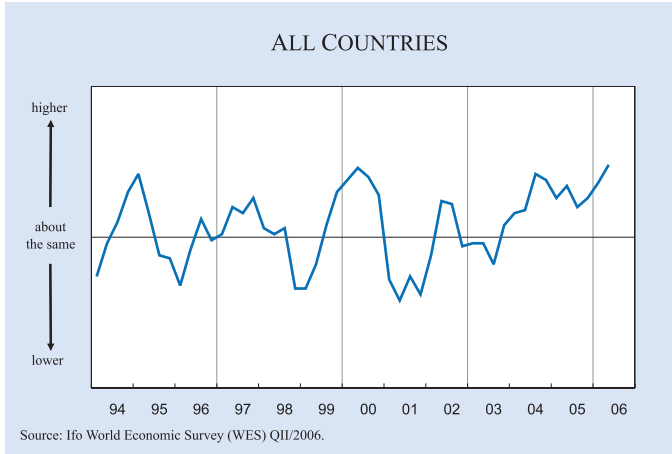
In *Oceania* – both in *Australia* and *New Zealand* – an inflation rate of 2.9 percent is now expected for 2006; this is marginally lower than the inflation figure expected at the beginning of the year and the one reported for 2005.

Japanese yen seen as somewhat undervalued

More than in the previous two surveys the *Japanese yen* was regarded as somewhat undervalued. On the

Figure 12

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



other hand the *US dollar* appeared according to WES experts adequately assessed and the *Euro* and the *British pound* slightly overvalued.

Experience has shown that the actual movement of exchange rates may significantly differ from the one based on fundamental assessments of currencies. For that reason a supplementary survey question has been posed again on the likely development of the *US dollar* in the next 6 months. According to answers to this question a growing number of WES experts forecast a decline of the value of the dollar in relation to other currencies, particularly in Western Europe and Asia, but also in Canada and Russia. Exceptions from this general trend of a weakening US dollar are mainly Eastern European and Latin American countries. However, this trend is not uniform: Within *Eastern Europe*, WES experts of the Czech Republic, Romania and Slovakia expect a strengthening of the countries' own currency vis-à-vis the US dollar in the course of the next six months; the same holds true in Latin America for Colombia. In Asia exceptions from the generally expected trend of a weakening of the US dollar are Bangladesh, Indonesia, Pakistan, the Philippines and Vietnam.

In Africa and the Near East the US dollar is expected to remain stable or even increase its value slightly in comparison to the national currencies in the region.

Interest rates: Rising trend expected

The upward trend of **short- and long-term interest rates** is expected to continue in the coming six months on a worldwide scale. The only exceptions where interest rates will fall in coming months – according to WES experts – are New Zealand, Slovenia, Romania, Russia, Brazil, Colombia, Zimbabwe, Indonesia and Turkey.

In the *Euro area* both short- and long-term interest rates are expected to increase in coming months. Also in *Western Europe* outside the euro area, both types of interest rates are expected to increase, particularly in Denmark. In the United Kingdom, where WES experts had assumed in the past surveys that the peak of the interest rate cycle had been passed, a renewed though moderate increase of both long- and short-term interest rates is now expected for the coming six months. In Norway long-term interest rates, according to WES experts, will show an even stronger increase than short-term interest rates and

in Sweden both short- and long-term interest rates will increase further, though at a reduced pace.

In *North America* – particularly in the USA – there were signs in previous WES surveys that the peak in the interest rate cycle might soon be reached. However, according to the latest WES survey it looks like we have to wait longer for this to happen. A renewed rate hike appears to be the most likely outcome in the coming six months according to WES experts.

In *Eastern Europe* there is more evidence that the former trend of shrinking short-term interest rates will be replaced by higher rates in coming six months. The only exceptions – as already mentioned – are Slovenia and Romania, where expectations point downward both for short - and long-term interest rates.

In *CIS* countries, particularly in *Russia*, the trend of shrinking interest rates will continue in coming months according to WES experts' view. In *Latin America* the declining trend of interest rates has obviously come to an end and will be replaced in coming months by an increase of short-term rates and more or less stable long-term rates. The only exception is Brazil where interest rates still will continue to decline in coming months.

In *Asia* the upward trend of interest rates will slow down somewhat according to the WES experts' view. In Japan, after a long period of zero interest rates, more WES experts than in the previous survey expect the beginning of moderate rate increases in coming months.

Overall economic growth in 2006 of about 3.3 percent

On average of all 91 countries included in the survey, real gross domestic product (GDP in constant prices) is expected to grow by 3.3 percent in 2006. In April last year world economic growth was expected to stand at 3.1 percent (see Table 2). Thus, the 2006 growth outlook by WES experts supports the view that world economic growth is still robust and will result in somewhat higher growth rates this year.

However, this presumable strengthening of growth is restricted mainly to Asia (4.6 percent compared with an expected 4.1 percent in April 2005), Western Europe (2.2 percent compared with 1.9 percent), Eastern Europe (4.7 percent compared with 4.4 percent) and the Near East (6.1 percent compared with 5.6 percent). In North America and Oceania the growth outlook is

Table 2

Expected Growth of Real Gross Domestic Product (GDP) in 2006 and 2005
(based on WES QII/2006 and QII/2005)

Region	QII/2006	QII/2005	Region	QII/2006	QII/2005
Average of 91 countries	3.3	3.1	Central a. Latin America	3.9	4.2
<i>World Bank classification:</i>			Argentina	6.0	6.4
High-income countries	2.9	2.5	Bolivia	4.4	3.8
Middle-income countries	4.9	5.2	Brazil	3.7	3.9
Upper-middle	4.8	4.7	Chile	5.9	6.0
Lower-middle	5.2	5.8	Colombia	4.6	3.9
Low-income countries	6.7	6.2	Costa Rica	4.2	3.2
			Ecuador	3.2	3.5
EU countries (old members)	2.2	1.9	El Salvador	2.9	2.6
EU countries (new members) ¹	4.7	4.2	Mexico	3.3	3.8
Euro area ²	2.1	1.7	Panama	5.5	3.3
			Paraguay	2.9	3.1
Asian Pacific Rim ³	5.0	5.0	Peru	4.9	4.8
			Uruguay	4.7	5.6
Western Europe	2.2	1.9	Venezuela	6.2	6.0
Austria	2.3	2.1			
Belgium	2.2	2.1	Asia	4.6	4.1
Cyprus	3.8	4.0	Bangladesh	6.2	4.8
Denmark	2.7	2.5	China P.R.	8.8	8.5
Finland	3.5	3.0	Hong Kong	5.2	4.8
France	1.9	1.9	India	8.0	6.9
Germany	1.8	1.0	Indonesia	5.4	5.8
Greece	3.4	3.3	Japan	2.4	1.2
Iceland	5.0	6.8	Korea	4.7	4.6
Ireland	4.7	5.2	Malaysia	5.5	5.6
Italy	1.0	1.2	Pakistan	6.4	6.8
Luxembourg	4.0	3.5	Philippines	5.3	5.0
Malta	1.8	1.5	Singapore	5.4	4.4
Netherlands	2.5	1.4	Sri Lanka	5.5	5.2
Norway	3.1	3.4	Taiwan	4.0	4.1
Portugal	1.0	1.4	Thailand	4.5	5.7
Spain	3.0	2.6	Vietnam	7.6	7.3
Sweden	3.4	2.7			
Switzerland	2.0	1.5	Near East	6.1	5.6
United Kingdom	2.3	2.7	Bahrain	5.5	6.0
			Iran	4.5	6.0
Central a. Eastern Europe	4.7	4.4	Israel	4.0	3.6
Albania	5.6	5.2	Jordan	5.3	6.2
Bosnia Herzegovina	6.0	5.5	Lebanon	2.5	2.3
Bulgaria	5.0	5.0	Saudi Arabia	5.6	6.4
Croatia	4.2	3.7	Turkey	5.1	5.0
Czech Republic	4.9	3.8	United Arab Emirates	8.9	7.8
Estonia	8.0	5.7			
Hungary	4.0	3.5	Africa	n.a.	n.a.
Latvia	7.8	6.9	Algeria	6.7	7.0
Lithuania	6.7	6.1	Egypt	5.0	4.8
Poland	4.3	4.5	Kenya	1.5	2.0
Romania	4.6	5.5	Mauritius	3.0	4.0
Serbia a. Montenegro	5.7	5.0	Morocco	5.4	2.5
Slovenia	4.1	3.7	Nigeria	6.5	5.6
Slovakia	5.4	5.0	South Africa	4.6	3.7
			Tunisia	5.5	4.5
North America	3.1	3.0	Zimbabwe	-4.0	-2.0
Canada	3.0	2.4			
USA	3.1	3.2	CIS	5.5	6.7
			Kazakhstan	8.5	8.8
Oceania	2.8	2.7	Russia	5.8	6.0
Australia	3.1	2.7	Ukraine	2.8	8.1
New Zealand	1.3	2.8	Uzbekistan	7.2	-

* Within each country group the results are weighted according to the share of the specific country's exports and imports in the total world trade.

¹ Czech Rep., Cyprus, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovenia, Slovakia (from 1. May 2004) – ² EU countries without Denmark, Sweden, United Kingdom. – ³ Australia, China P.R., Hong Kong, Indonesia, Korea, Malaysia, New Zealand, Philippines, Singapore Taiwan, Thailand, Vietnam.

Source: Ifo World Economic Survey (WES), QII/2005 and QII/2006.

almost identical with the one observed last year in April. In Central and Latin America and in the CIS area (here mainly restricted to the Ukraine) growth is expected to slow down somewhat.

Within Western Europe economic growth in 2006 will be buoyant particularly in Iceland and Ireland, approaching around 5 percent (which nonetheless is in both cases a bit less than in the previous year) and also in Luxembourg, Finland, Cyprus, Sweden and Spain – all countries where 2006 growth is expected to lie between 3 percent and 4 percent. Worth mentioning is also the catching up of growth in the Netherlands and Germany, though expected growth in 2006 is still far from that of the leading group of countries in this region. On the other hand, growth is expected to slow down further and reach only 1 percent in the two “European laggards”, Italy and Portugal.

In Eastern and Central Europe the expected 2006 growth in the region is relatively homogenous with only Estonia (8.0 percent), Latvia (7.8 percent) and Lithuania (6.7 percent) clearly exceeding the average.

In Oceania growth is expected to pick up in Australia from 2.7 percent in 2005 to 3.1 percent in 2006, whereas in New Zealand growth in 2006 is expected to be less than half compared with 2005 (1.3 percent compared with 2.8 percent in 2005).

In Central and Latin America the slight slowdown in 2006 growth is mainly caused by Mexico, where growth this year is expected to be 3.3 percent compared with 3.8 percent last year and also by Uruguay, where growth is expected to slow down somewhat from 5.6 percent in 2005 to 4.7 percent this year. On the other hand Panama’s growth rate this year is expected to clearly exceed last year’s (5.5 percent compared with 3.3 percent); also in Bolivia growth in 2006 is seen by WES experts stronger in 2006 than in 2005 (4.4 percent compared with 3.8 percent).

In Asia the 2006 growth list is headed again by China (8.8 percent) followed closely by India (8.0 percent) and Vietnam (7.6 percent). This year’s expected 2.4 percent growth in Japan is relatively low compared with the Asian average but twice as high as that experienced last year.

In the Near East the higher growth in 2006 than in 2005 is mainly due to the significantly more buoyant growth outlook in the United Arab Emirates (8.9 percent compared to 7.8 percent last year). In

Saudi Arabia growth is expected to slow down from 6.4 percent in 2005 to an expected 5.6 percent this year.

ICC Special Question: Counterfeiting and piracy of intellectual property

The special question asked in April focused on the problems of counterfeit products and the theft of intellectual property worldwide and its impact on foreign investment.

Intellectual property rights¹ are usually divided into two main areas: protection of distinctive signs, in particular trademarks, and protection of inventions, in particular patents. The protection of distinctive signs and trademarks aims to ensure fair competition and to protect consumers from buying goods that are falsely presented as genuine products. The social and economic purpose of protection of inventions is to provide incentives for research and development of new technologies.

Counterfeit products are widespread in many areas of the present marketplace and have a significant impact on almost every industry. According to the latest survey results, the volume of counterfeit products is unchanged in the majority of 72 countries that were surveyed by WES on this question (see Figure 13). However, the market for counterfeit products is increasing somewhat in Latin America, particularly in Bolivia, Peru, Mexico, Argentina, Uruguay as well as Paraguay and in Africa, here particularly in South Africa. But also in some Western European countries the majority of surveyed experts have the impression that the volume of counterfeit products sold in their country is increasing, in particular in the United Kingdom, Italy, Spain, Greece and Ireland. In China the surveyed economists were divided on this question: although 55 percent held to the opinion that the volume is increasing, 18 percent felt that it is decreasing, while the remaining 27 percent think that it is more or less unchanged. However, there was also a group of countries in Asia where the majority of experts see the market for counterfeit products shrinking: Singapore, South Korea, Thailand and Taiwan. This opinion prevailed also in Estonia and Slovenia.

¹ Intellectual property rights were introduced into the multilateral trading system for the first time by the WTO’s Agreement on Trade-Related Aspects of Intellectual Property Right (TRIPS), negotiated in the 1986-94 Uruguay Round. Further information resources:
International Trademark Association – <http://www.inta.org>
WTO information on intellectual property – http://www.wto.org/english/tratop_e/trips_e.htm

Figure 13

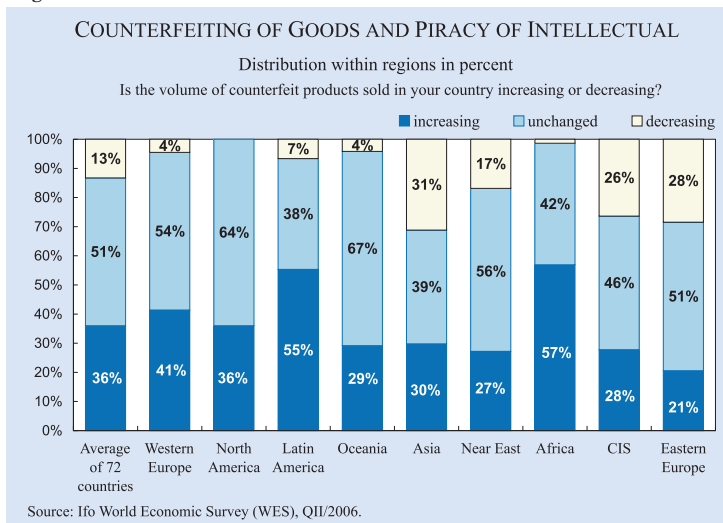


Figure 14

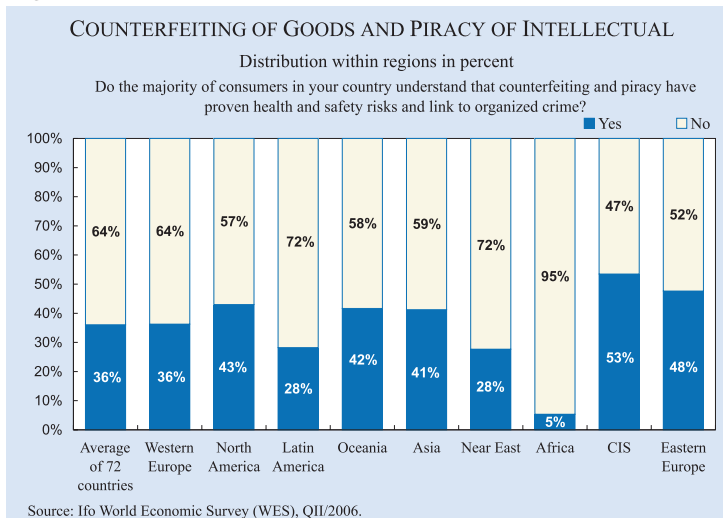
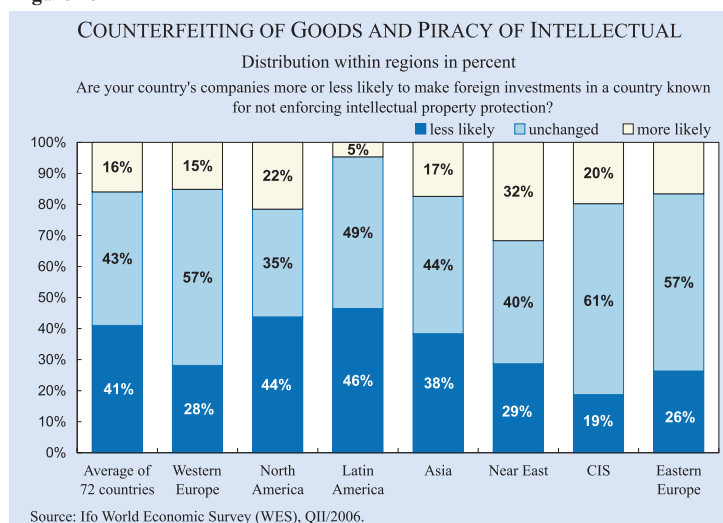


Figure 15



Counterfeit products often not only cause unfair competition but are also unsafe to the consumer (particularly important aspect for pharmaceutical products). However, it is consumer demand that drives counterfeiting: the low household income and the high price of genuine goods. Furthermore, public often perceives counterfeiting as harmless. Thus, the special question of the WES survey asked the experts to judge whether the majority of consumers in their country understands that counterfeiting and piracy have proven health and safety risks and links to organized crime. In most countries the vast majority of consumers is not aware of this fact, according to the surveyed experts (see Figure 14).

The World Intellectual Property Organization emphasizes the correlation between a strong intellectual property regime and foreign direct investment. Low priorities for intellectual property rights in a country can have a negative impact on the growth of economies. Surveyed WES experts were asked to judge whether their country's companies are more or less likely to make foreign investments in a country known for not enforcing intellectual property. The assessment of this question is not straight forward. According to the experts' judgement in the United Kingdom and Japan the companies are less likely to invest in a country with weak intellectual rights protection. But in the majority of countries, in particular in Russia, Norway, Singapore, Taiwan, Belgium, Denmark, Spain, Austria and Mexico, the companies' decisions to invest in another country are influenced by other factors than intellectual property protection (see Figure 15).



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