

CESifo WORLD ECONOMIC SURVEY

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WORLD ECONOMIC CLIMATE

World Economic Climate cools down somewhat

ECONOMIC EXPECTATIONS

Assessments of the current economic situation improved again, but economic expectations downgraded

INFLATION

Expectations edge up

INTEREST RATES

Stronger increase at the short than at the long end

CURRENCIES

Japanese yen still seen as somewhat undervalued

SPECIAL TOPIC

Who should govern the Internet?

Ifo World Economic Survey

Regions

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- North America: US economy cools
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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 July 2006 1,005 economic experts in 89 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 ist 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 COOLS

In July 2006 the World Economic Climate deteriorated for the first time in more than a year (see Figure 1). The climate indicator now stands at 105.6 (after 111.0 in April: 1995=100), which is still considerably above its long-term average (1990–2005: 94.3). The present downward movement resulted entirely from less optimistic expectations for the coming six months, while the assessments of the current economic situation further improved, on a world-wide average (see Figure 2).

World economy sets for a downswing

According to the July results, the index of the current economic situation continued to improve. But, as economic expectations – the second component of the economic climate index – have been downgraded, the overall economic climate deteriorated somewhat (see Figure 2).

Over the past two years, the world economy has been growing very strongly. But during the same time there was a mixture of problems imposing downward pressures on future global economic growth: sharp currency fluctuations, interest rate hikes, the huge US current account deficit and the latest jump in fuel prices (that have already more than doubled over the last three years), triggered by continuing war activities in the Near East and the Israel-Hezbollah conflict in Lebanon. Particularly in the US, the world's biggest economy, economic expectations for the second half of this year have been depressed. In Western Europe and Japan the economy has just started to show signs of revival, but the global economic cooling has dampened the forecasts of the major economic aggregates here as well. However, in both economic regions the assessments of the current economic situation remained at a highly favourable level, as was also the case for the world average.

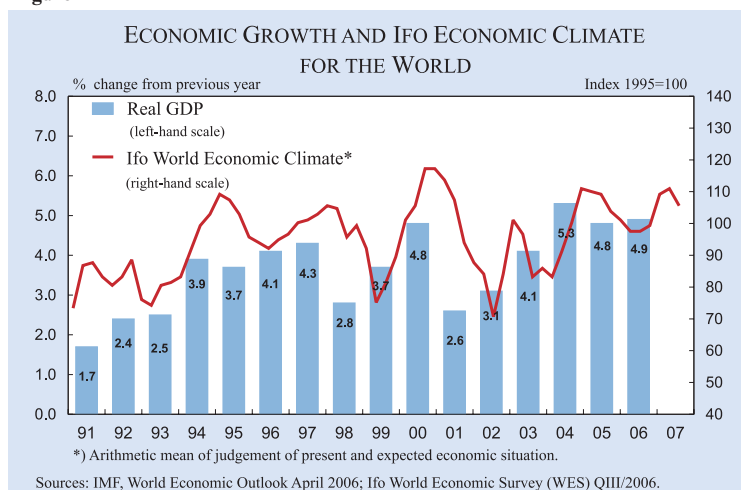
For a global medium-term forecast it is crucial to know where we are now in the business cycle. According to the Ifo Business Cycle Clock (see Box 1), the present trend set in already in the second quarter of 2006, when the present economic situation was still assessed as very favourable, but economic expectations already started to deteriorate following downward pressures caused by the rising oil prices. The latest results indicate that the world economy is approaching a cooling-down phase of a growth cycle.

Western Europe: Economic performance remains strong

The overall economic climate indicator in Western Europe stabilized in July at a favourable level (see Figure 3). However, the economic expectations for the next six months have been downgraded, although they still remained optimistic in almost all Western European countries. As the panel's assessments of the current economic situation have continued to follow a positive trend that set in one year before, in July 2005 (see Figure 5a/b) the overall climate index, which is an arithmetic mean of the two components, remained unchanged.

In almost all countries of the euro area the same pattern of business sentiments could be observed in

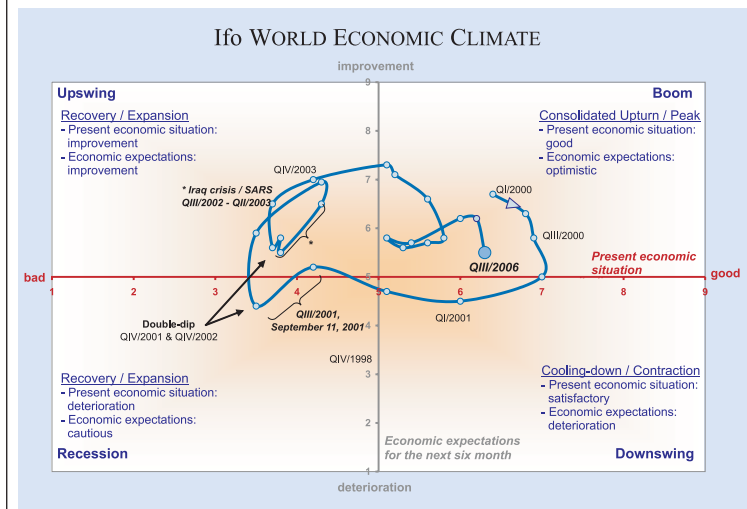
Figure 1



Box 1
Ifo Economic Clock and the World Economic Climate

According to the Ifo Business Cycle Clock, the present trend set in already in the second quarter of 2006, when the present economic situation was still assessed as very favourable, but economic expectations already started to deteriorate following downward pressures caused by the rising oil prices. The latest results indicate that the world economy is approaching a regular cooling-down phase of a growth cycle.

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.



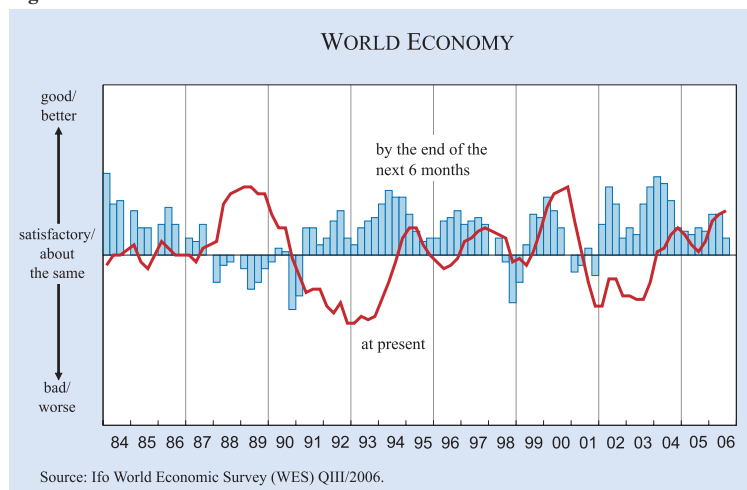
July: The assessments of the present economic situation improved, but the economic expectations have been downgraded. The present economic situation has been upgraded particularly strongly in the *Netherlands* and *Austria*, where it is now assessed to be on a very favourable level. Spain was the only country in the euro area where the panel's assess-

ments of the present economic situation deteriorated slightly over the April survey. The economic expectations improved in only three countries of the euro area: *Luxembourg*, *Portugal* and *Italy*. However, *Portugal* and *Italy* were the only countries in this region where the assessments of the present economic situation have not yet reached the satisfactory level. In all the other countries of the euro area, the economic forecasts for the coming six months have been downgraded, particularly strongly in *Germany* and *Austria* (see Figure 5a/b).

The economic climate in the Nordic countries outside the euro area (*Denmark*, *Sweden* and *Norway*) has also deteriorated somewhat, due to downgraded economic expectations for the next six months. However, the assessments of the present economic situation remained on the highest possible level on the WES scale in *Denmark* and *Norway*, and slightly below it in *Sweden*, indicating that the surveyed economists expect economic stabilization rather than deterioration. Also very positive assessments have been received from the *United Kingdom*, where the current economic situation has been assessed well above satisfactory.

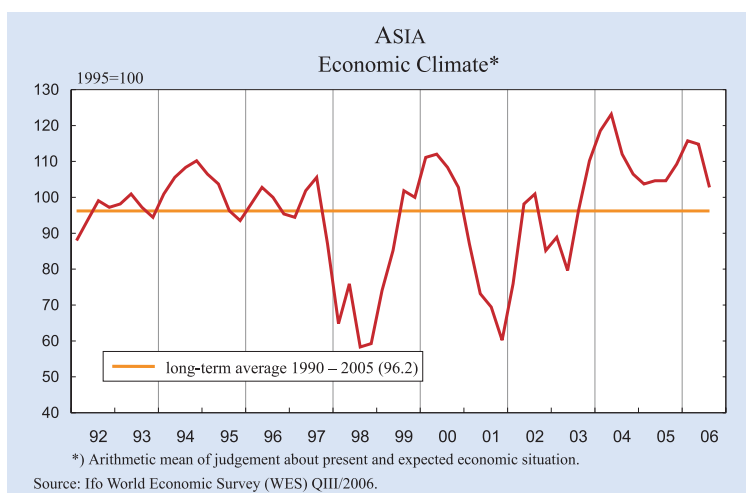
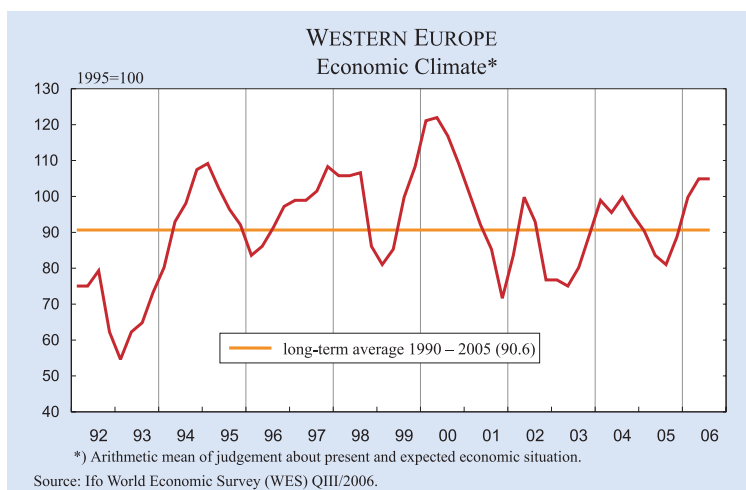
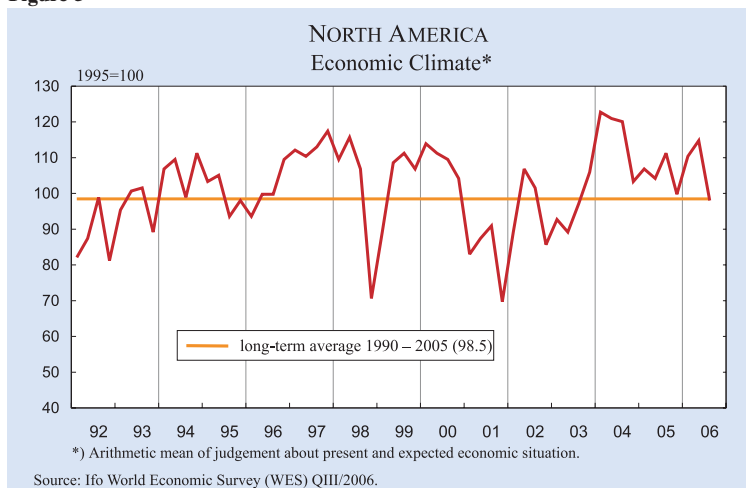
The economic expectations for the coming six months here have even further improved, unlike in the majority of other Western European countries. Also in *Switzerland* the economic rebound is gaining further momentum, according to the July survey: the assessments of the current economic are far above the satisfactory threshold. The economic outlook for the coming six months, though slightly downgraded here as well, still points to a continuing improvement.

Figure 2



Source: Ifo World Economic Survey (WES) QIII/2006.

Figure 3



North America: US economy cools

According to the latest survey results, the economic climate indicator in North America slowed sharply in the three months since the April survey (see Figures 3). In the *US* the decline was particularly due to negative economic expectations, while the current

economic situation is still regarded as above satisfactory by the majority of experts polled by WES, indicating that the economy is in transition to a slower but sustainable expansion. However, some economists forecast economic stagnation, given several downward pressures including higher oil and commodities prices and rising interest rates. In addition, most surveyed experts expect a rise in inflation. This constellation makes some worry that rising inflation April force the Federal Reserve to keep raising interest rates even as the economy slows, which brings the term “stagflation” to mind, which last was in parlance in the late 1970s.

Business sentiments are also cooling in *Canada*. Similarly to the *US*, the assessments of the current economic situation again improved and have almost reached the highest possible marks on the WES scale. But economic expectations have been strongly downgraded here as well.

Eastern Europe: Economic climate improves

Unlike the other major economic regions, the overall economic climate in Eastern Europe improved, according to the July survey results (see Figure 7). The present economic situation was assessed somewhat more favourably than in the previous April survey, on average of all countries surveyed in the region. The economic expectations remain optimistic.

In the majority of surveyed countries of the European Union in the region, the assessments of the present economic situation remained favourable or have even improved somewhat over the last April poll, particularly in the *Czech Republic, Lithuania, Poland, Slovenia* and *Slovakia*. In two Baltic countries, *Estonia* and *Latvia*, the assessments of the present economic situa-

Box 2

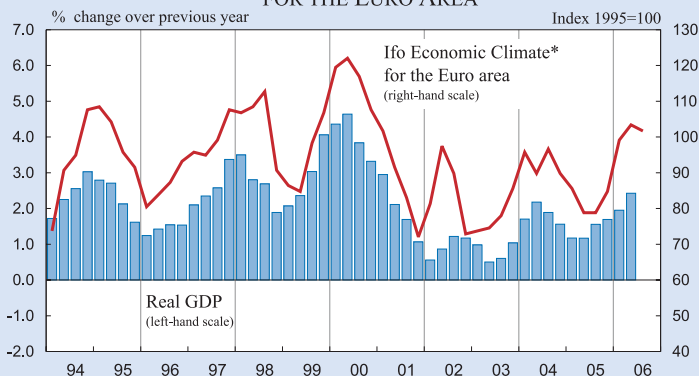
World Economic Survey (WES) and GDP Growth in the Euro Area

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 July results are based on the responses of 279 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 in the euro area fell somewhat in the third quarter of 2006, after having reached a five-year high in the second quarter. The decline in the climate indicator was solely due to less optimistic expectations for the coming six months. The assessments of the current economic situation continued to improve. These survey results indicate a continuation of the economic recovery, which will weaken slightly in the course of the second half year.

The assessments of the current economic situation improved over the April survey in the majority of the euro countries, with particularly noticeable improvement in Austria and the Netherlands. Whereas the six-month outlook worsened in most euro-area countries, in Portugal and Italy the surveyed experts were more optimistic than they were in the second quarter. However, these are the two euro-area countries in which the current economic situation is still assessed as unsatisfactory.

ECONOMIC GROWTH AND IFO ECONOMIC CLIMATE FOR THE EURO AREA



tion remained almost unchanged very positive. *Hungary* was again the only exception among the “new” EU economies where the surveyed economists assessed the present economic performance far below satisfactory and again somewhat weaker than in the first half of the year. The country’s economic forecasts promise no turnaround in 2006. The expectations for the coming six months have been downgraded in almost all countries except the two biggest economies of the region, *Poland* and the *Czech Republic*. The decline was particular strong in the Baltic states – *Latvia*, *Lithuania* and *Estonia*. However the overall pattern points more to an economic stabilization than to decline in the near-term future.

In countries beyond the European Union, the present economic performance was assessed more favourably than in the preceding survey and above the satisfactory level in *Bulgaria*, *Romania* and *Croatia*. The outlook for the coming months also improved further.

The surveyed economists described the economic situation in *Bosnia-Herzegovina* as “satisfactory”. In contrast, in *Serbia and Montenegro* and in *Albania* the assessments of the present economic situation have not yet reached the satisfactory level. While fewer economists than in the April poll expect further improvement of the economic performance in *Albania*, the surveyed experts in *Serbia and Montenegro* displayed more optimism in the July survey.

CIS: Favourable economic climate

Also in the CIS countries covered by WES (*Russia*, *Kazakhstan*, *Ukraine* and *Uzbekistan*) the overall climate index has further improved. 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). In *Kazakhstan*, the present economic situation was assessed somewhat less favourably, but still far above satisfactory,

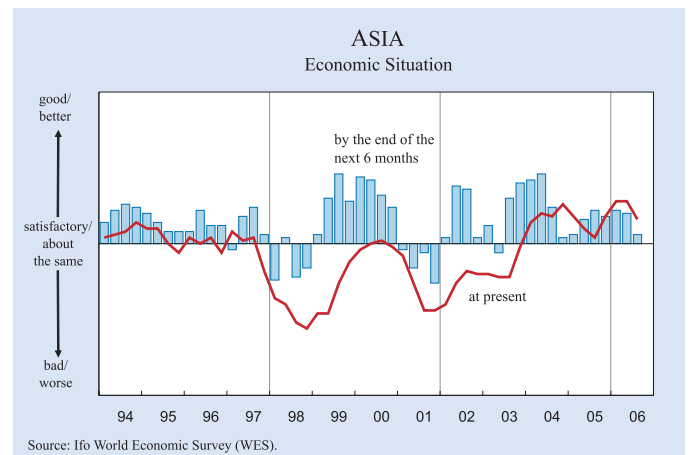
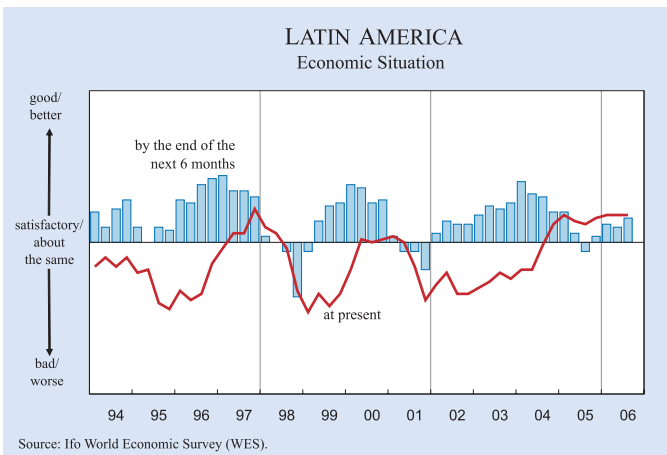
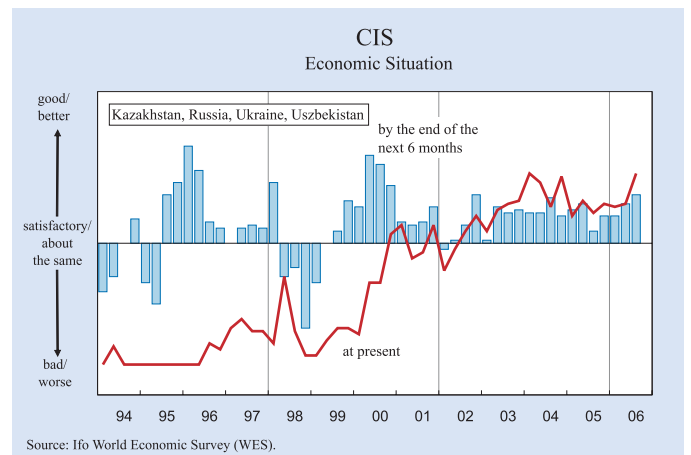
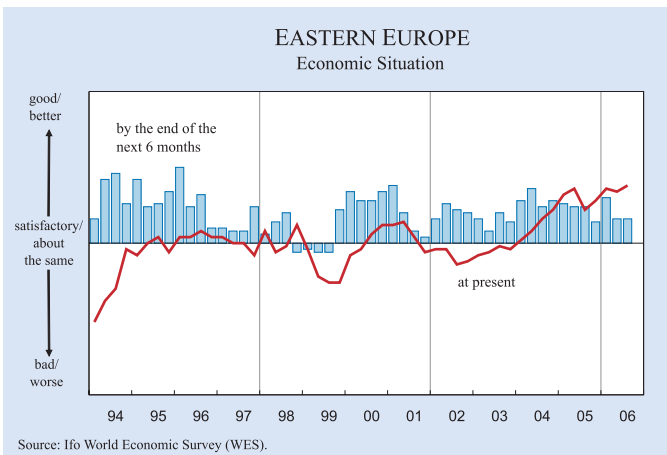
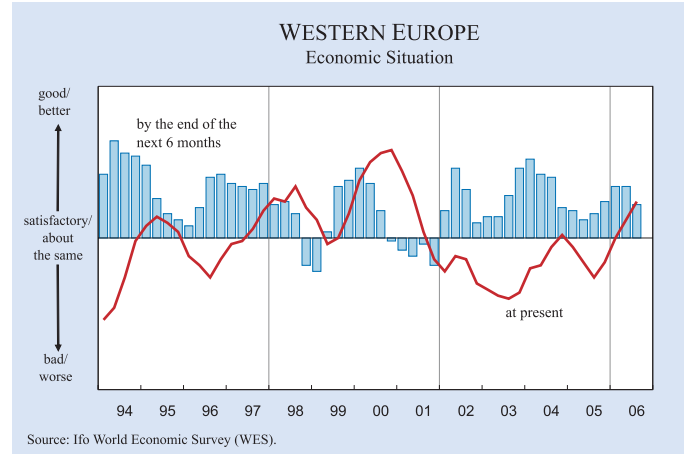
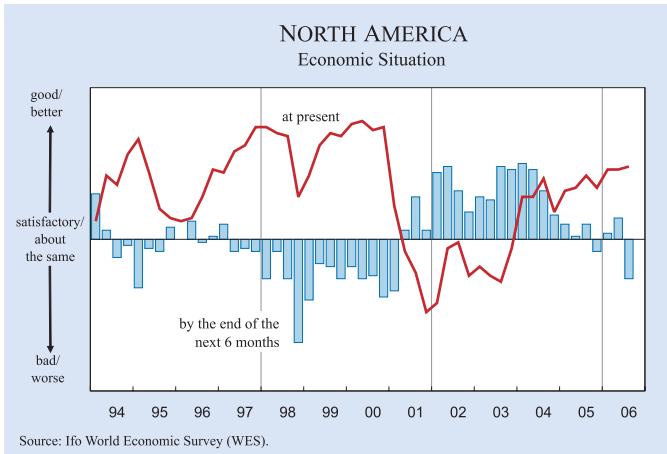
while the economic expectations for the next six months further improved. Positive signals have been also reported from the *Ukraine*. The present economic situation has been described by WES experts as satisfactory. However, the prospects for the coming six months remained clouded. The surveyed economists in *Uzbekistan* described the country’s present economic situation also as “satisfactory” and remained confident relating to the near-term prospects.

Asia: Economic slow-down

In July, the economic climate index in Asia deteriorated for the second time in succession (see Figure 3). The deterioration resulted from both less favourable assessments of the present economic situation and downgraded economic expectations for the coming six months.

Figure 4

SELECTED REGIONS



The above pattern could be observed in nine economies of the region, including the main economies – *Japan*, *China* and *India*. However, the overall economic situation is still assessed as above the satisfactory level, on average for all surveyed countries in the region. The forecasts point to an economic stabilization in Asia in the course of the coming months. In *Japan* the surveyed economists forecast a continuation of economic recovery led by private-sector demand and upbeat capital spending. However, given a slowdown in the US economy lower projections for *Japanese* exports are likely.

Although the present economic situation was assessed less favourable in July than in the preceding April survey, it again received particularly high marks in *Vietnam*, *India* and *Singapore*. The outlook for the next six months indicates that the economies will continue to expand although at a slower pace than before. In contrast, the lowest marks for the present economic situation were given by surveyed experts in *Thailand*, *South Korea*, *Indonesia* and the *Philippines*. However, except for *Thailand*, the economic expectations, though downgraded here as well, point to the continuation of economic recovery in 2006. In *South Korea* exports are expected to serve as the key driver to economic growth. Positive signals were reported in July again from *Taiwan*, where the economic climate index continued to improve, with its both components – assessments of the present economic situation and economic expectations – pointing upward. The present economic situation, which has been worsening for more than a year, is now again assessed with “satisfactory” marks. The present economic performance improved according to the latest survey results also in *Sri Lanka*. However, the panel’s forecast for the next six months has become clouded. Not so in *Pakistan*, where favourable economic climate prevailed also in July, although both components have been downgraded somewhat, as in the Asian region in general. This trend also holds true for *Hong Kong* and *Malaysia*, where the present economic performance is still assessed as above satisfactory. The economic expectations, however, slipped into negative territory, forecasting economic slow-down.

Oceania: Buoyant markets

In *Australia*, the economic expectations for the coming six months have not worsened, as in the other regions, but even further improved, while the present economic situation was further assessed as strong.

The rise in oil prices has not hit *Australia’s* economy too hard, as the country is over 70 percent self-sufficient in oil, an exporter of natural gas and also an exporter of an alternative energy source – coal. Further supportive factors for the *Australian* economy are boosting capital expenditures due to the buoyant market conditions and the export sector, given Japan's economic rebound.

In *New Zealand*, the economic climate index improved for the first time for more than a year. Although the marks for the present economic situation have not yet reached the satisfactory level, these survey results indicate that the economy is heading for a soft landing. Particularly the export sector is forecast to recover strongly. However the outlook for private consumption and business investment in 2006 remained rather cautious, suggesting that the economy is still struggling to overcome the recent recession.

Latin America: Economic stabilization

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

In *Argentina*, the economic climate index rebounded strongly, after a set back in April this year. The assessments of the present economic situation are approaching the highest possible level of the WES scale. The outlook for the rest of 2006 brightened again. Also in *Ecuador* and *Colombia* the present economic situation was assessed with higher marks in July than in the April poll. In both countries the surveyed economists expect the economic situation to stabilize at the favourable level. The assessments of the present economic situation improved somewhat also in *Brazil*, with economic expectations for the next six months remaining optimistic. However, *Brazil’s* forecasts of the capital expenditures and exports are losing momentum. A favourable economic climate still prevails, according to the surveyed economists, also in *Uruguay*, *Guatemala* and *Venezuela*, with both components of the climate index – present economic situation and economic expectations – being very positive. In *Peru* both components, and consequently the climate index, improved strongly over the April survey. Particularly the economic expectations have become highly optimistic, while the assessments of the present

Table 1	
Legal and Administrative Restrictions for Foreign Firms	
Absent	
Finland	8.4
Hong Kong	8.3
Denmark	7.9
Ireland	7.8
Estonia	7.7
Spain	7.0
Latvia	7.0
Rather Low	
United Kingdom	6.9
Belgium	6.8
Switzerland	6.7
Australia	6.7
Chile	6.6
Oceania	6.6
Netherlands	6.5
Canada	6.5
Portugal	6.4
Norway	6.3
Sweden	6.3
Hungary	6.3
Austria	6.3
Poland	6.3
United States	6.2
Japan	6.2
Serbia and Montenegro	6.1
Germany	6.1
Czech Republic	6.0
Romania	5.9
New Zealand	5.8
Slovakia	5.8
Costa Rica	5.8
Nigeria	5.8
Turkey	5.8
Asia	5.6
Lithuania	5.5
Thailand	5.4
France	5.4
Slovenia	5.4
Bulgaria	5.3
Albania	5.0
Croatia	5.0
Kazakhstan	5.0
Argentina	5.0
Mexico	5.0
Paraguay	5.0
Korea Rep.	5.0
Sri Lanka	5.0
United Arab Emirates	5.0
Malaysia	4.5
Greece	4.5
Russia	4.4
Italy	4.4
Ukraine	4.4
Brazil	4.3
Israel	4.3
India	4.2
Bolivia	4.0
Rather High	
Pakistan	3.9
Colombia	3.9
Peru	3.8
Philippines	3.7
Vietnam	3.7
Taiwan	3.4
Ecuador	3.3
China	3.3
Zimbabwe	2.0
Indonesia	2.0
Venezuela	1.0
Egypt	1.0

* Only countries with more than 3 responses have been included into the analysis

WES scale: 9 - absent, 5 - low, 1 - high

Source: Ifo World Economic Survey QIII/2006

economic situation approaching the highest possible marks on the WES scale. In contrast, in *Chile* both the assessments of the present economic performance and economic expectations have been downgraded somewhat. However, the present economic situation received the highest marks in the whole region. The economic outlook suggests that the enormous economic growth rates will slow down somewhat in the course of 2006. Also in *Costa Rica* and *El Salvador* the economic expectations have been downgraded somewhat compared to the April survey results. However, the present economic situation is still assessed as above the satisfactory level and also here the overall pattern points to an economic stabilization in the near-term future. A similar picture has been drawn by the surveyed economists *Panama*, where the present economic situation has been assessed as still close to satisfactory albeit somewhat weaker than in the preceding survey. Possibly due to electoral turbulences in *Mexico* economic activity has slowed down slightly in July (Felipe Calderon won in the July 2 presidential vote, but an official winner hasn't been declared because second-place candidate Andres Manuel Lopez Obrador is challenging the results in court). Relating the future near-term prospects, the surveyed economists displayed confidence. *Bolivia* and *Paraguay* were the only countries in the region where the present economic situation was assessed as below the satisfactory level, although somewhat better than in the preceding survey. While in *Bolivia* the economic expectations are optimistic, they remained rather cautious in *Paraguay*.

Near East: Armed conflicts

Despite armed conflicts and an unstable political environment in several countries of the region, the economic climate remained stable in July (see Figure10). However, as the escalation of the Israel-Hezbollah conflict in Lebanon started after the deadline for the July survey, its impact on business sentiments may not be yet entirely caught by the data.

The economic climate stayed highly favourable in oil-exporting countries that remained untouched by the hostilities in the region: *Saudi Arabia*, *United Arab Emirates*, *Kuwait* as well as *Jordan* and *Bahrain*. The outlook suggests stable economic development in the coming six months. Also in the two countries that are indirectly involved in the Israel-Hezbollah war – *Iran* and *Syria* –, the surveyed economists report a stable economic performance in July. But, in the two countries in the fire front of this war, *Israel* and *Lebanon*,

Table 2

**Assessment of the Following Factors Influencing the Climate for Foreign Investors
For the Next 6 Months**

Climate due to	Change for the next 6 months *	
	Deterioration	Improvement
Legal / administrative restrictions to invest and/or to repatriate profits	Bolivia, Venezuela, Zimbabwe	India, Serbia and Montenegro
Political stability	Bolivia, Venezuela, Paraguay, Sri Lanka, Israel, Zimbabwe	Czech Republic

In those countries, not mentioned in the table the climate for foreign investors is expected to remain unchanged during the next 6 months (only countries were included in the evaluation that had three or more participants in the WES QIII/2006).

Criteria for selection of countries: Deterioration: WES grade between 1 and 3.5
Improvement: WES grade between 6.5 and 9

Source: Ifo World Economic Survey (WES), QIII/2006

the economic climate strongly deteriorated. Only in April, WES experts were confident concerning a continuation of economic recovery in *Lebanon* in 2006. This positive development has been literally undermined by the Hezbollah attacks on *Israel*, and its defence reaction to them on *Lebanese* territory.

The economic climate deteriorated also in *Turkey*, with both the assessments of the present economic situation and economic expectations being downgraded. The export sector is expected to strengthen further in the coming six months, but private consumption and capital expenditure rather to weaken.

Africa: Economic climate stabilizes in most surveyed countries

An aggregate climate index for Africa makes little sense, due to the diversity of economic trends on the continent and due to the fact that only nine of more than 50 existing African countries are regularly surveyed by WES. In the majority of the surveyed countries, the economic climate remained stable in July. This applies particularly to the North African countries – *Algeria*, *Morocco* and *Tunisia*, but also to *Nigeria*, *Kenya* and *Mauritius*, where the surveyed experts assessed the present economic situation as satisfactory and expect further economic strengthening or stabilization in the near-term future. In *Egypt* the assessments of the present economic state have fallen again below the satisfactory level, but according to the poll's forecast the economy, particularly the export sector, will strengthen in the coming six months. In *South Africa*, the strongest economy of the continent, the

economic climate index continued to decline (see Figure 10). Economic growth over the past three years has been driven mainly by strong consumer demand, favourable monetary policy, tax relief and low inflation. However, the recent tightening of monetary policy has dampened the business sentiments. With inflation trending higher, as fuel prices rise, consumer demand is forecast to slow in coming months.

2006: Inflation expectations edge up

After some delay higher energy and raw material prices seem to have fed through to consumer price inflation (CPI). For the average of 2006, WES experts expect on a worldwide scale 3.5 percent inflation compared with 3.1 percent in to the previous survey in April.

In the *euro area* the inflation outlook for 2006 is still rather moderate, only slightly up from the previous survey (2.2 percent compared to 2.1 percent in April) and relatively close to the ECB's target of "slightly below 2.0 percent". The highest inflation rates in the euro area in 2006 are still seen in Spain (3.7 percent) and in Greece (3.4 percent); in both countries expectations remained at least stable. The case is different in Ireland, which also belongs to the group of high inflation countries within the euro area: here inflation expectations rose from 3.0 percent in April to now 3.4 percent. In contrast, the lowest inflation rates in the euro area in 2006 will continue to prevail in Finland (1.5 percent; unchanged from previous survey) and also in the Netherlands (1.5 percent) where inflation expectations for 2006 were revised slightly downwards. In France and Germany 2006 inflation is

Figure 5a

EUROPEAN UNION

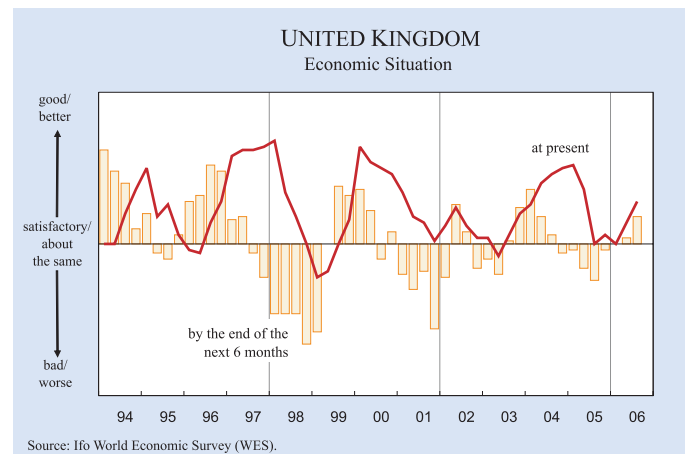
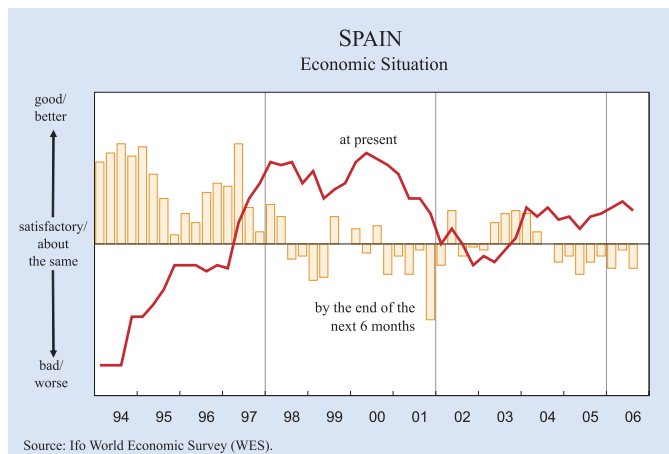
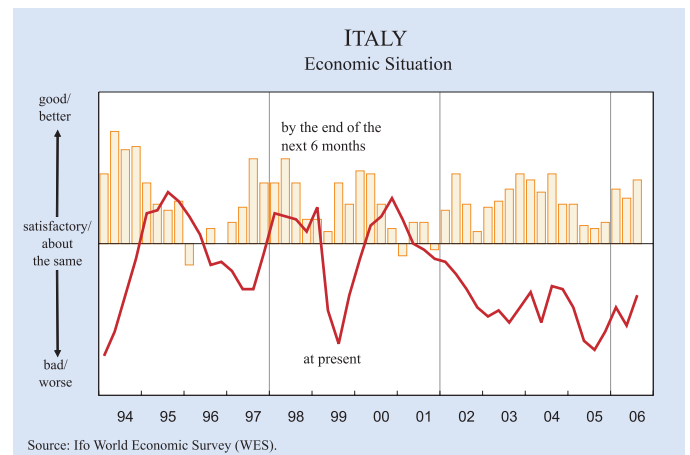
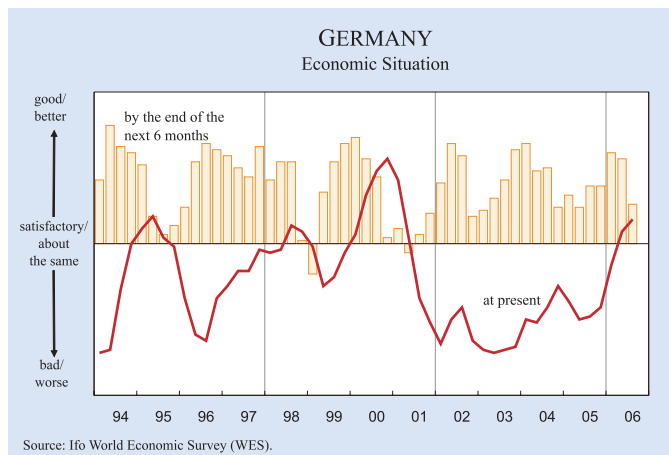
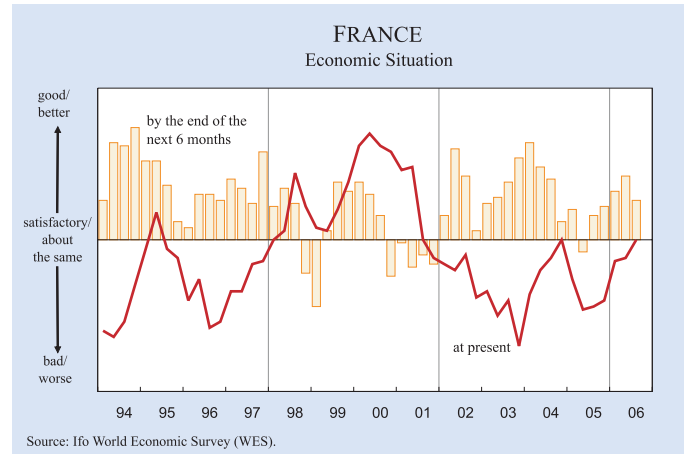
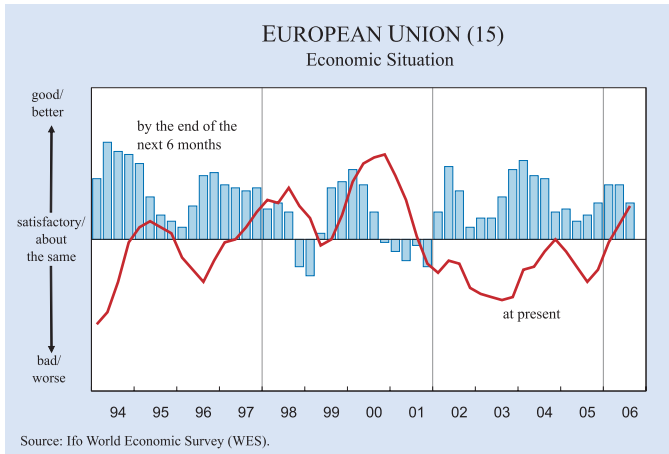


Figure 5b

EUROPEAN UNION

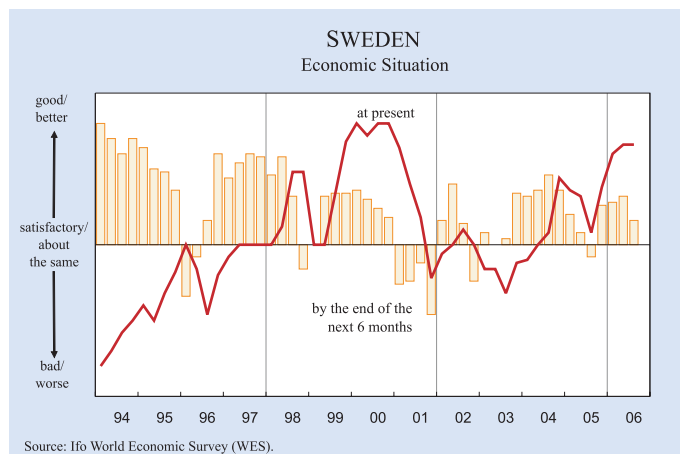
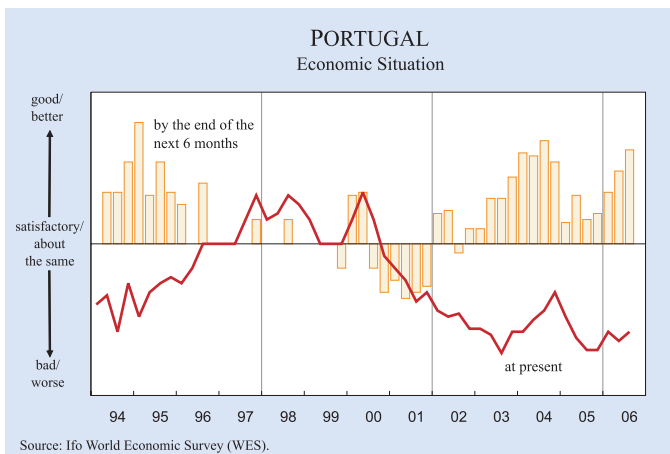
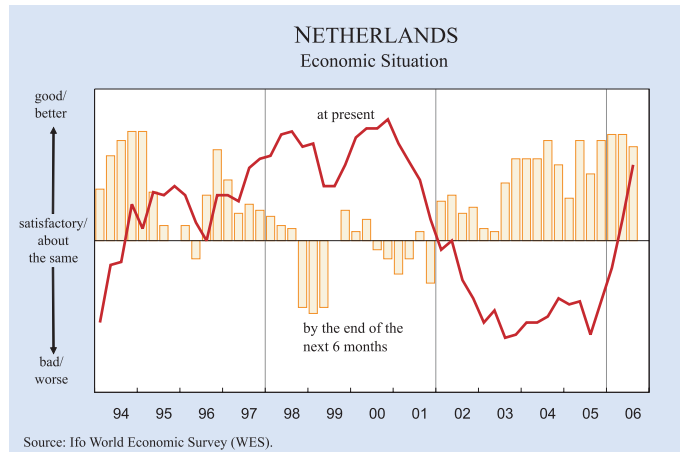
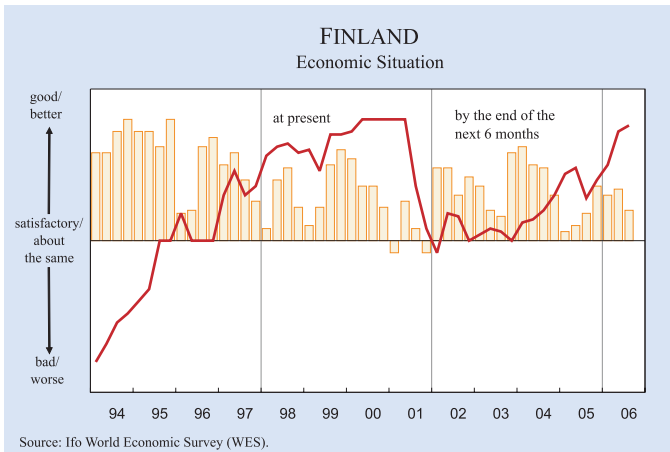
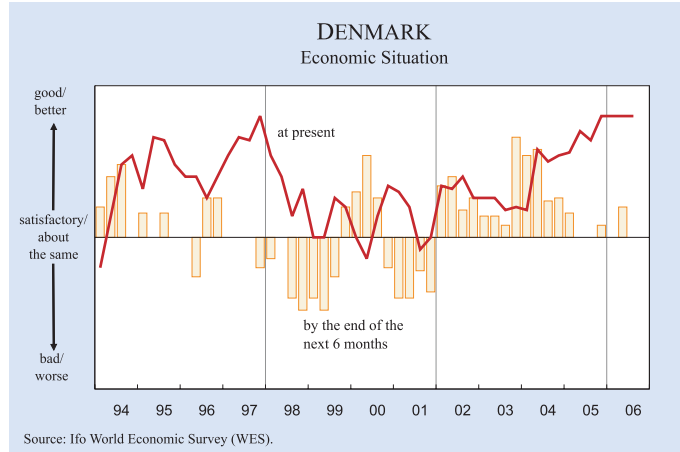
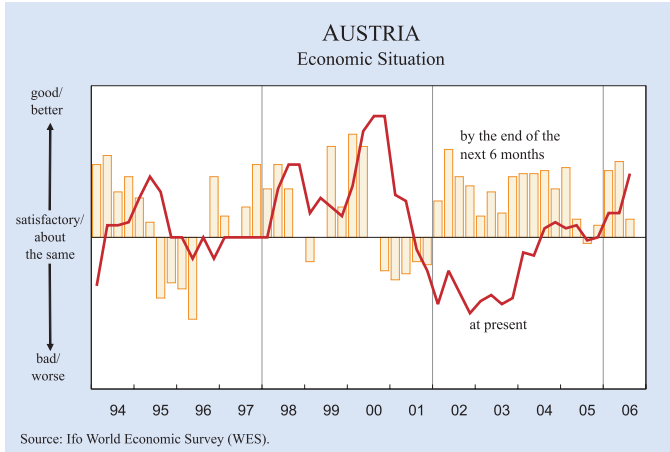


Figure 6

NORTH AMERICA, OCEANIA AND CIS

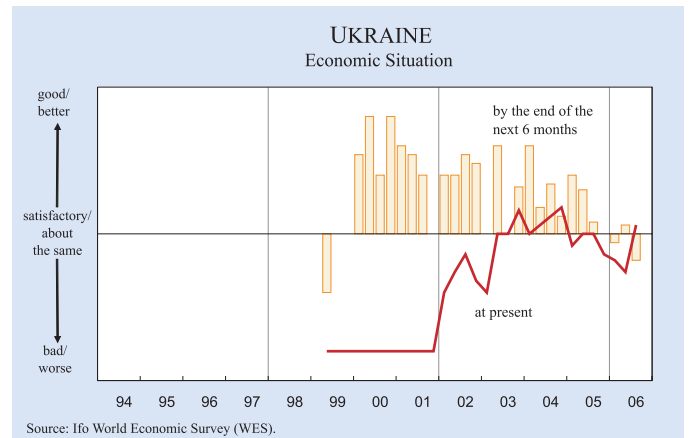
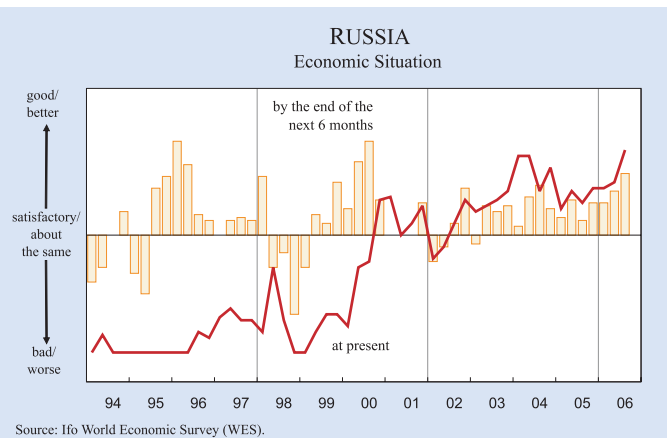
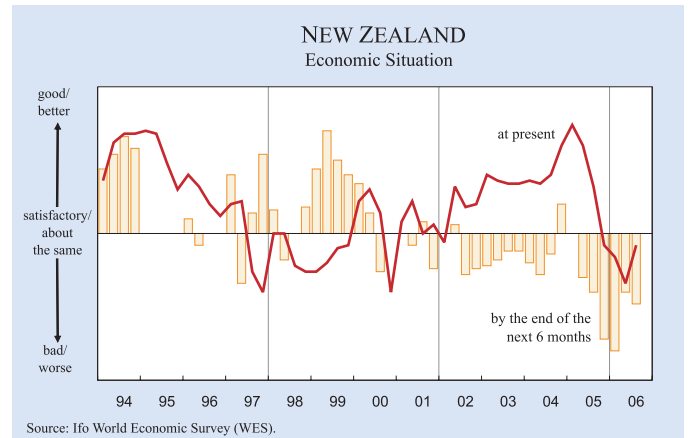
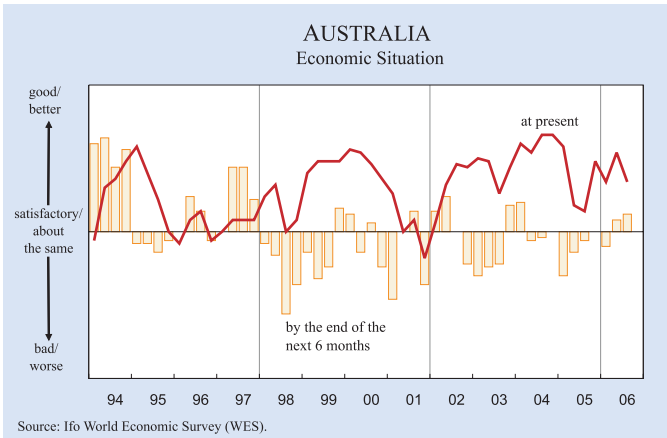
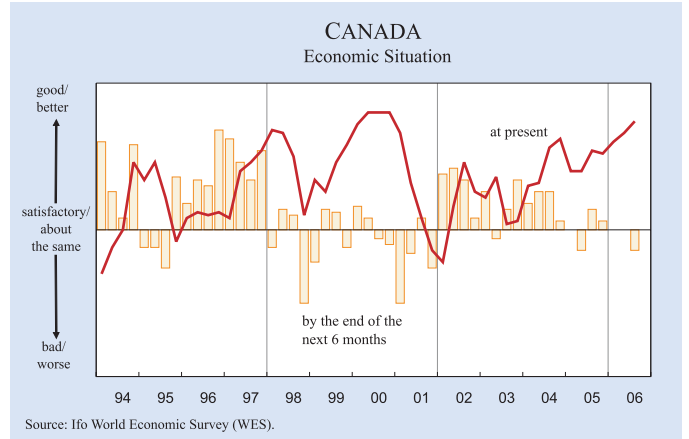
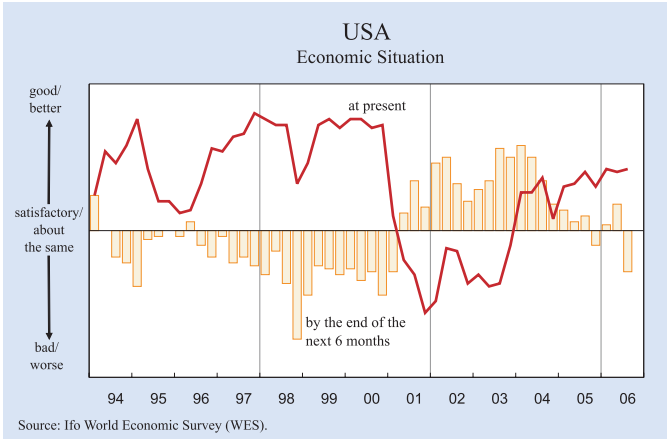


Figure 7

EASTERN EUROPE

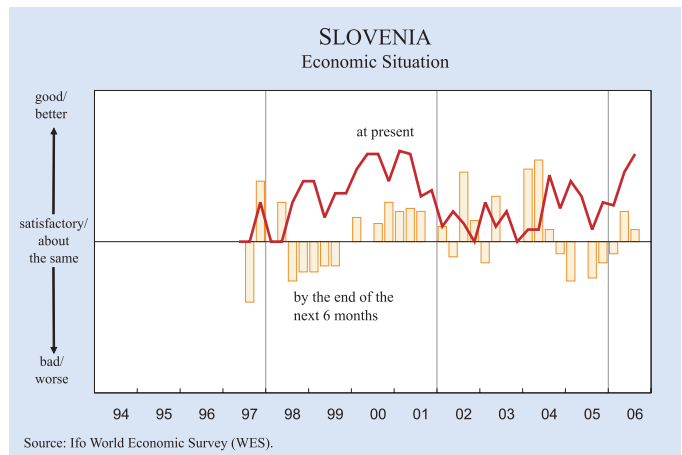
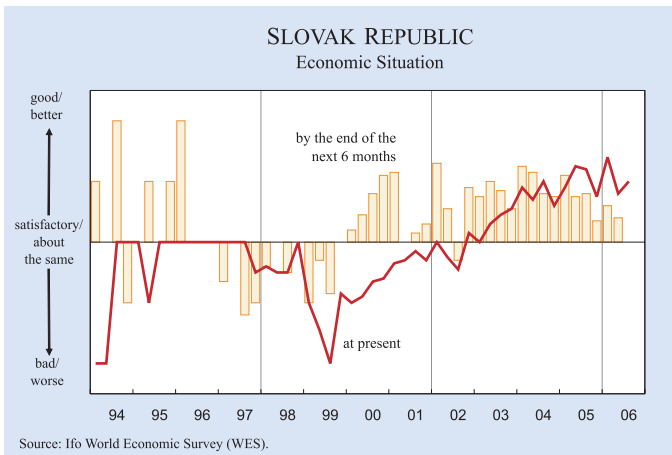
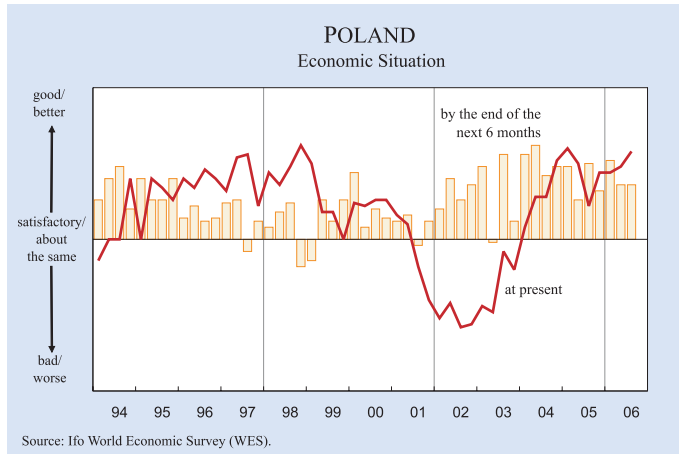
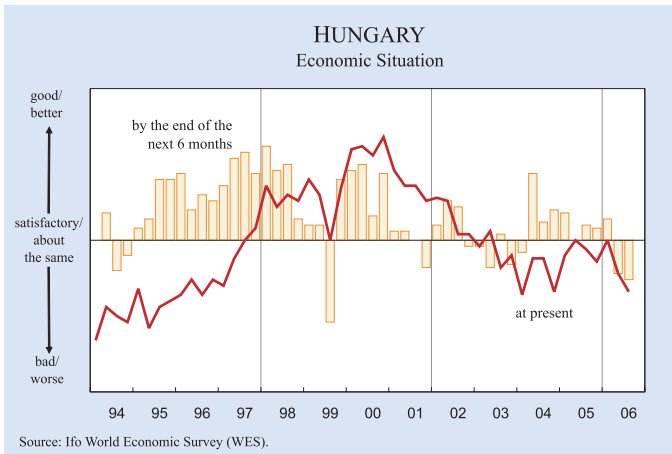
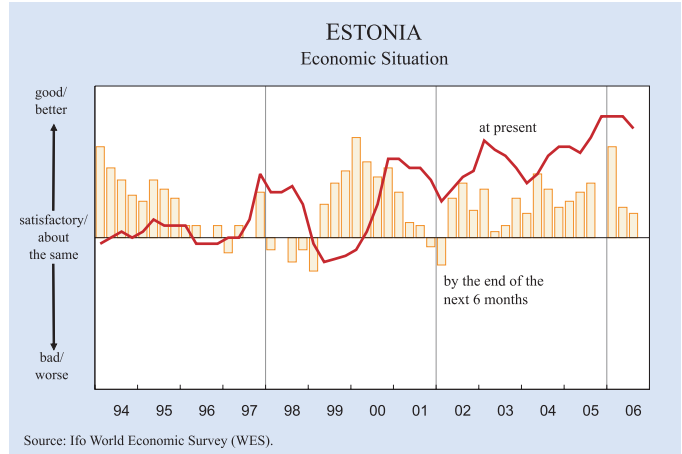
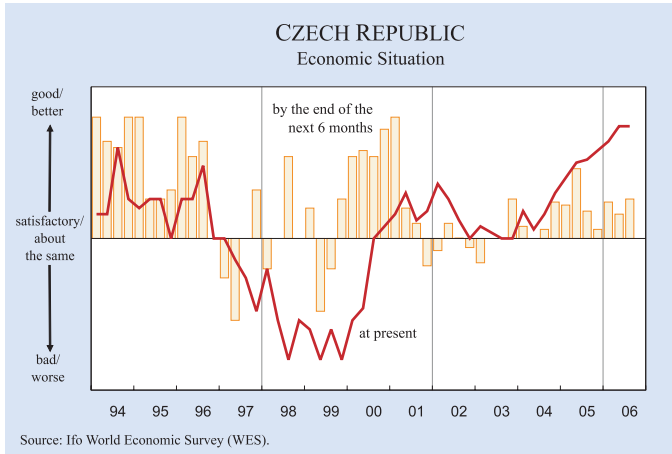


Figure 8

ASIA

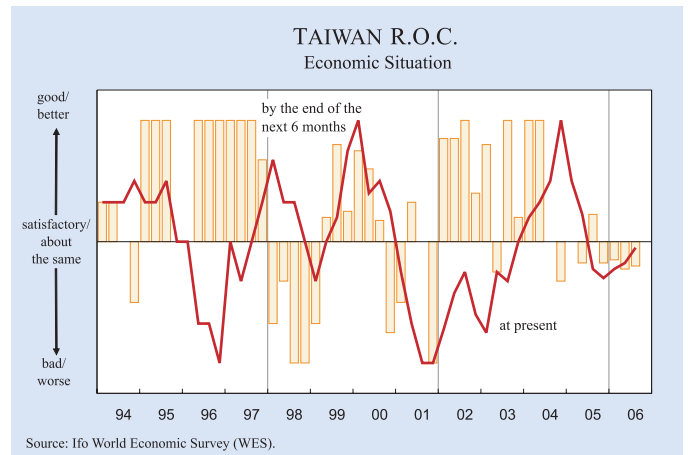
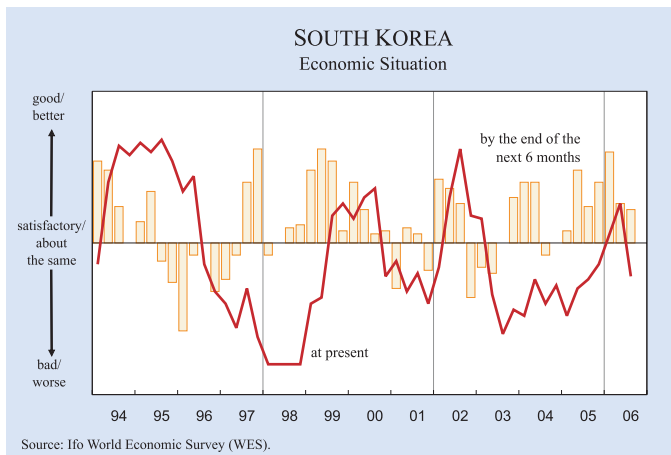
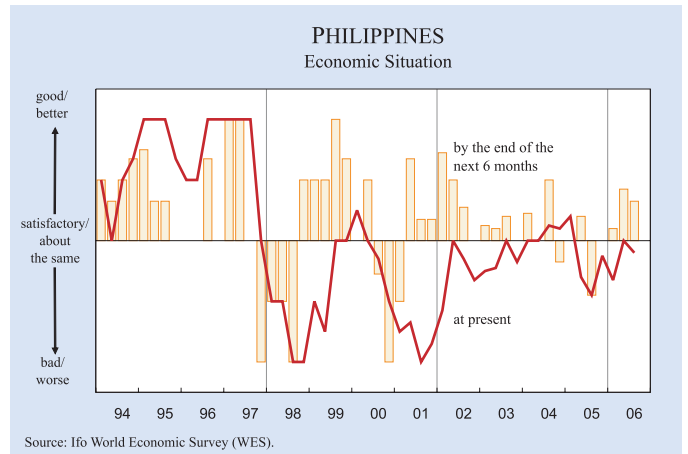
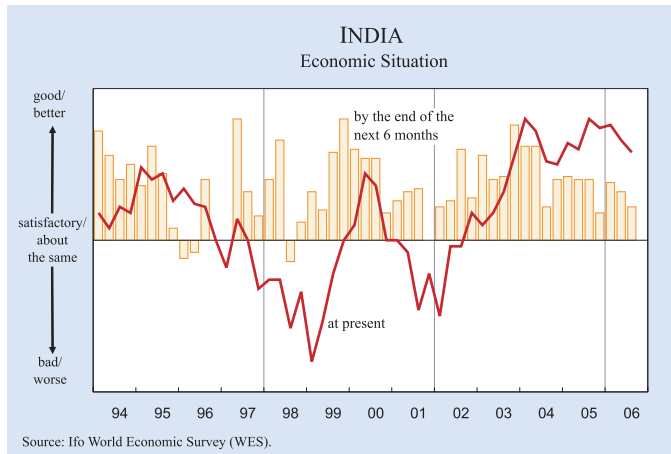
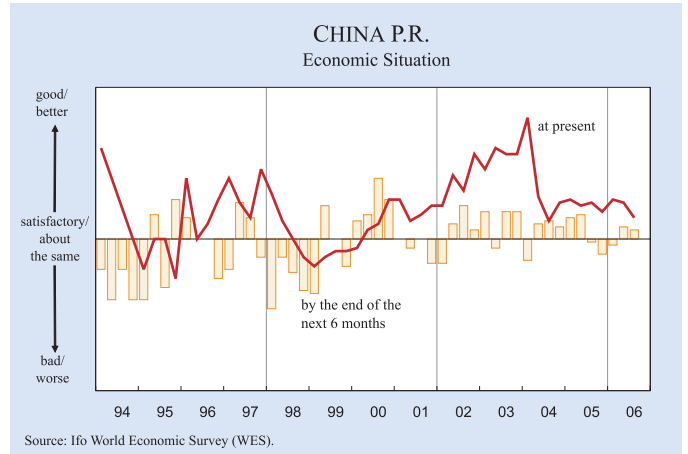
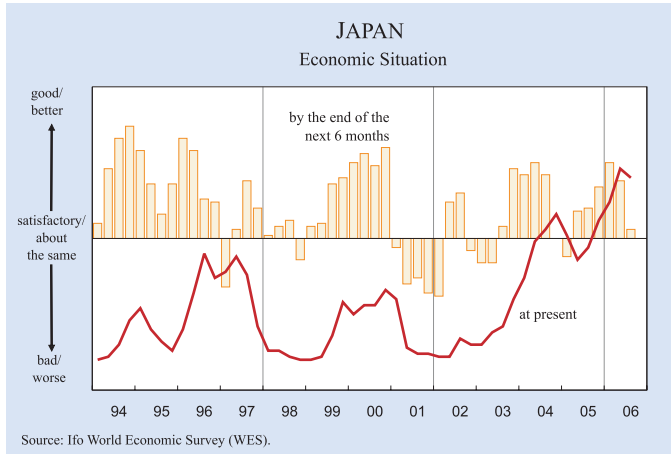


Figure 9

LATIN AMERICA

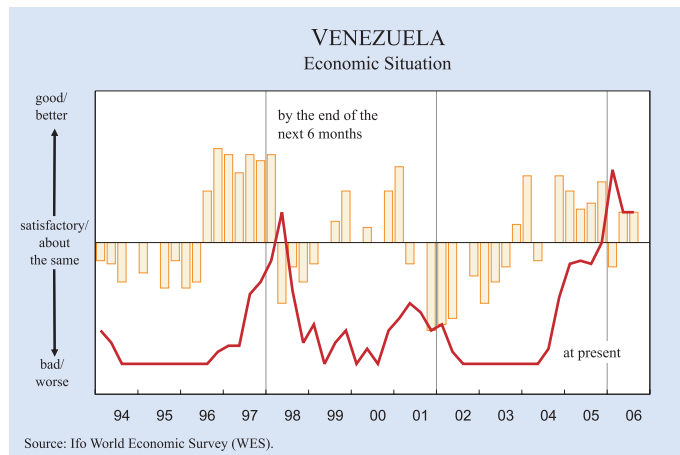
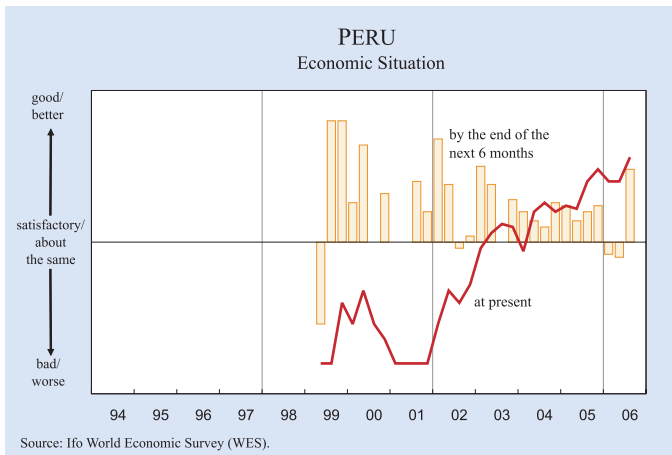
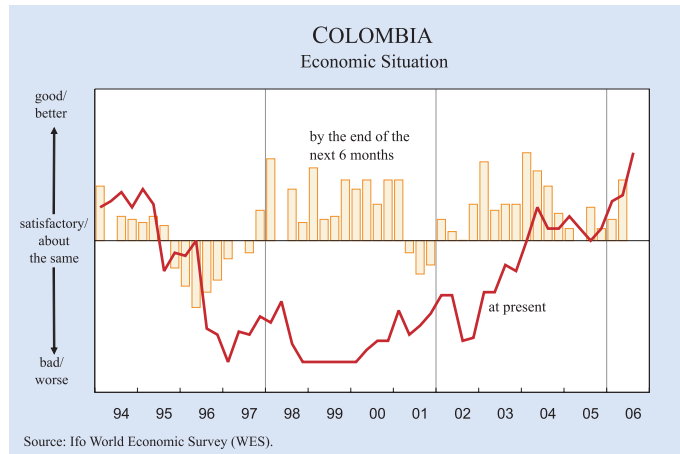
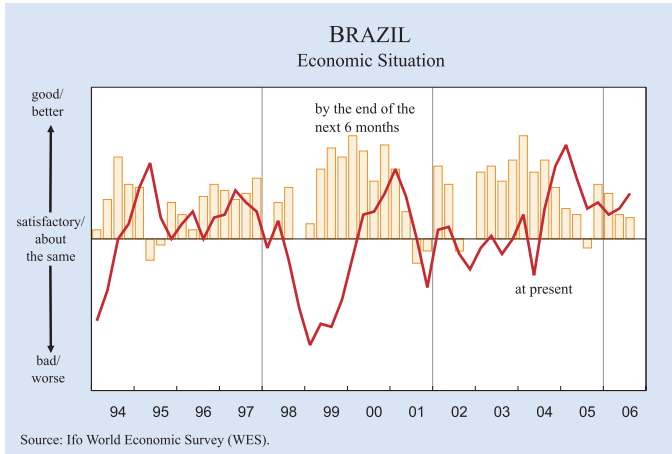
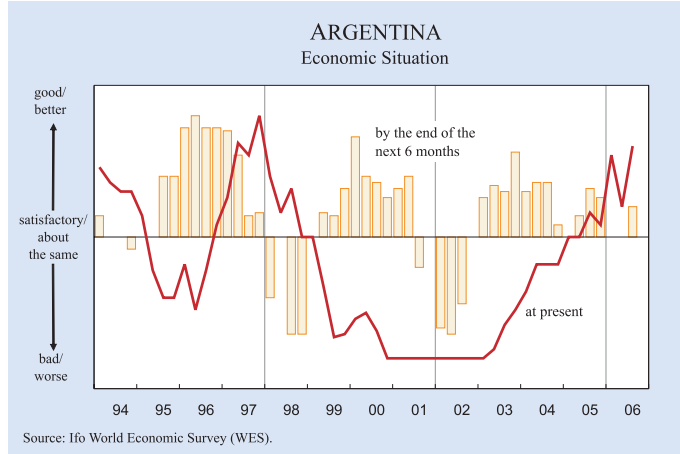
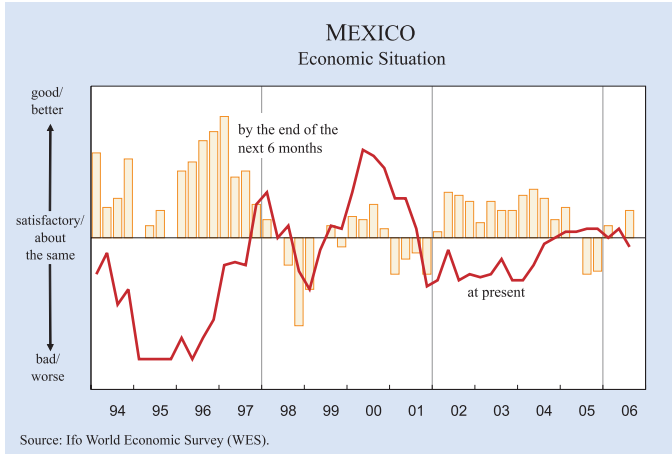


Figure 10

NEAR EAST AND AFRICA

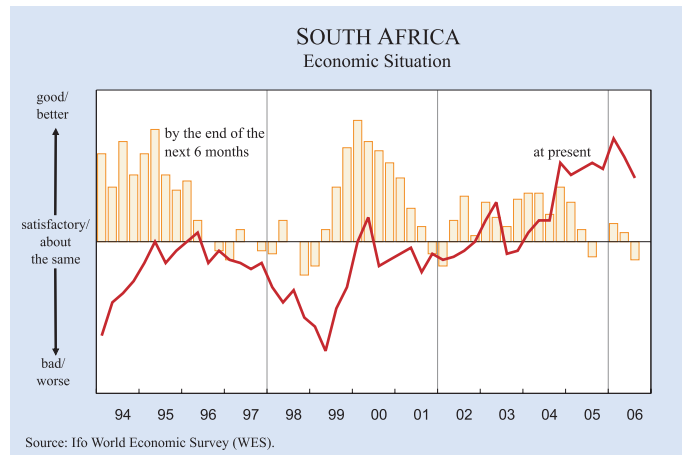
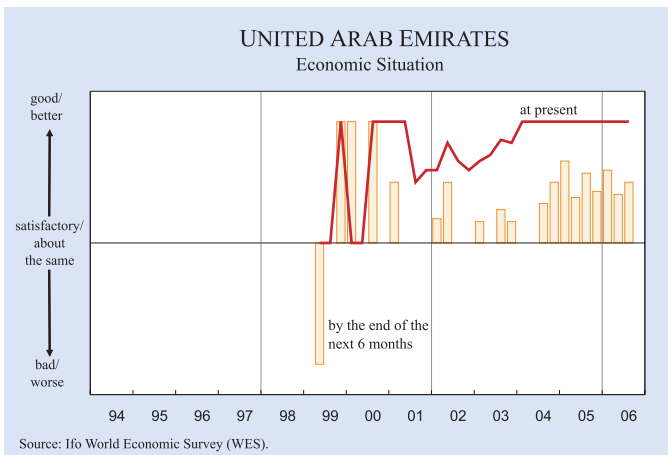
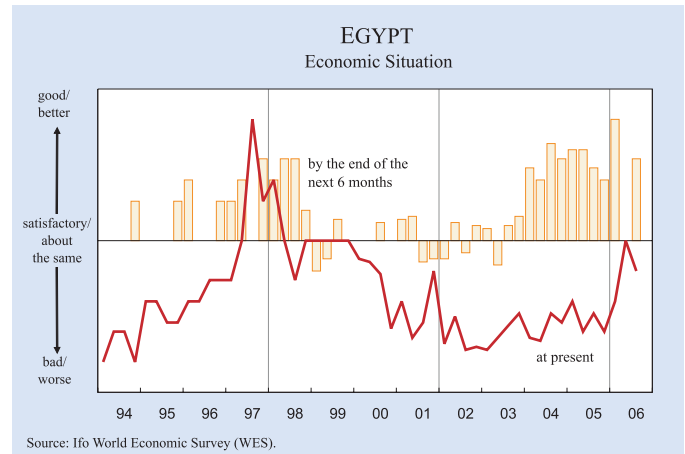
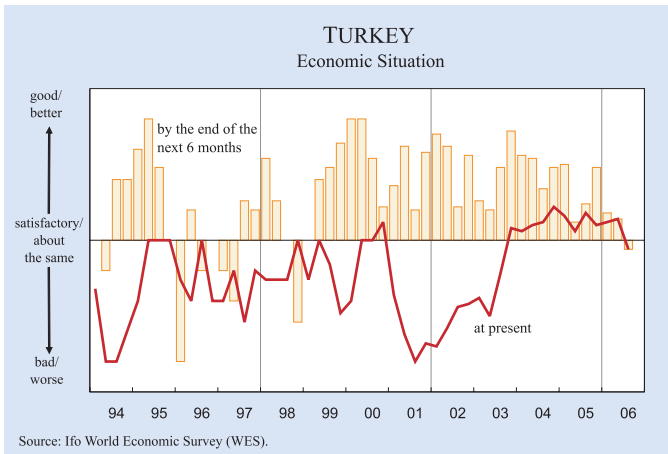
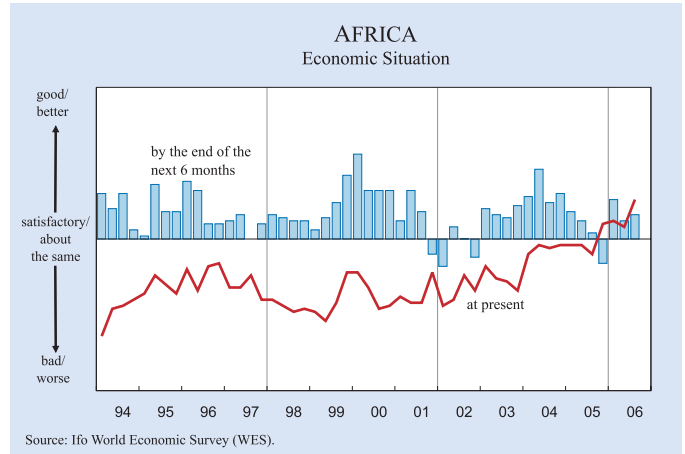
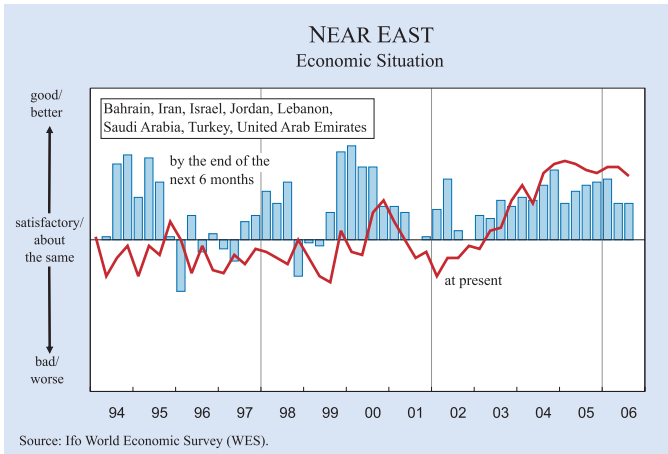


Table 3

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

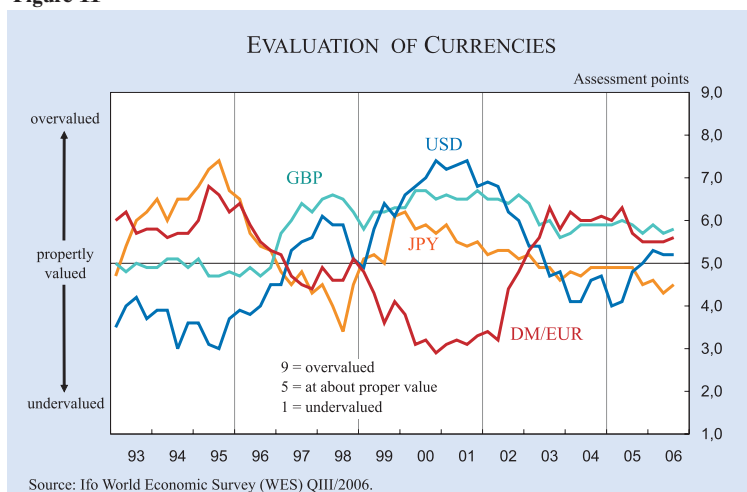
Region	QIII/2006	QII/2006	Region	QIII/2006	QII/2006
Average of countries	3.5	3.1	Central a. Latin America	4.9	5.7
<i>World Bank classification:</i>			Argentina	11.3	15.3
High-income countries	2.3	2.2	Bolivia	4.6	4.0
Middle-income countries	5.8	5.4	Brazil	4.2	4.7
Upper-middle	5.6	5.5	Chile	3.8	3.5
Lower-middle	6.2	5.3	Colombia	5.0	4.9
Low-income countries	20.2	14.4	Costa Rica	11.8	10.8
EU countries (old members)	2.2	2.1	Ecuador	3.6	4.3
EU countries (new members) ¹	3.4	2.7	El Salvador	4.0	4.5
Euro area ²	2.2	2.1	Guatemala	7.4	7.8
Asian Pacific Rim ³	3.5	3.4	Mexico	3.5	3.9
Western Europe	2.2	2.1	Panama	2.3	2.3
Austria	2.2	2.0	Paraguay	8.9	11.0
Belgium	2.3	2.0	Peru	2.6	2.5
Cyprus	3.1	2.6	Uruguay	6.4	6.8
Denmark	2.4	2.2	Venezuela	12.9	17.3
Finland	1.5	1.5	Asia	2.9	2.8
France	2.0	1.9	Bangladesh	7.6	7.0
Germany	2.0	1.9	China P.R.	2.3	2.4
Greece	3.4	3.4	Hong Kong	2.5	2.8
Iceland	-	5.5	India	5.6	5.0
Ireland	3.4	3.0	Indonesia	10.0	11.4
Italy	2.3	2.2	Japan	0.7	0.5
Luxembourg	2.8	2.6	Korea	3.3	3.1
Malta	3.0	3.1	Malaysia	3.7	3.6
Netherlands	1.5	1.6	Pakistan	8.0	8.9
Norway	1.7	1.5	Philippines	6.8	6.7
Portugal	2.6	2.6	Singapore	2.4	1.3
Spain	3.7	3.7	Sri Lanka	13.5	9.0
Sweden	1.6	1.6	Taiwan	1.9	1.9
Switzerland	1.3	1.0	Thailand	5.5	4.9
United Kingdom	2.4	2.2	Vietnam	7.6	7.0
Central a. Eastern Europe	3.9	3.4	Near East	6.3	4.2
Albania	4.7	3.4	Bahrain	4.2	4.3
Bosnia Herzegovina	3.0	2.0	Iran	15.0	-
Bulgaria	7.0	6.1	Israel	2.8	2.5
Croatia	3.0	2.6	Jordan	4.3	4.1
Czech Republic	2.9	2.6	Lebanon	3.0	2.5
Estonia	3.9	3.8	Kuwait	2.8	3.8
Hungary	4.4	3.1	Saudi Arabia	1.0	0.9
Latvia	6.6	6.1	Turkey	10.0	6.3
Lithuania	2.9	3.0	United Arab Emirates	6.1	6.8
Poland	2.7	1.8	Africa	n.a.	n.a.
Romania	6.6	6.8	Algeria	4.0	5.0
Serbia a. Montenegro	11.6	12.7	Egypt	8.6	-
Slovenia	2.2	2.3	Kenya	10.5	8.5
Slovakia	4.4	3.4	Mauritius	7.0	6.0
CIS	10.0	10.4	Morocco	2.6	2.3
Kazakhstan	8.4	7.4	Nigeria	14.5	12.3
Russia	9.9	10.2	South Africa	5.0	4.7
Ukraine	11.3	12.7	Tanzania	-	-
Uzbekistan	12.0	7.0	Tunisia	3.0	3.1
North America	3.1	2.8	Zimbabwe	1100.0	600.0
Canada	2.5	2.3	Oceania	3.1	2.9
USA	3.2	3.0	Australia	3.0	2.9
			New Zealand	3.4	2.9

*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), QIII/2006 and QII/2006.

Figure 11



now seen at 2.0 percent, which is only marginally higher than in the previous survey (1.9 percent).

In *Western Europe* outside the euro area, expectations for inflation in 2006 continue to be particularly low in *Switzerland* (1.3 percent after an expected 1.0 percent in the previous survey) and *Sweden* (1.6 percent; unchanged from the expectations in the previous two surveys). In *Norway* inflation expectations for 2006 edged up somewhat but at 1.7 percent are still significantly lower than the Western European average. In the *United Kingdom* the inflation outlook for 2006 deteriorated somewhat from 2.2 percent to now 2.4 percent.

In *North America*, the *United States* inflation is now expected to again exceed the 3 percent-mark this year (3.2 percent compared to 3.4 percent last year). Also in *Canada* inflation is expected to pick up somewhat but at 2.5 percent will remain lower in 2006 than in 2005 when it stood at 2.8 percent.

In *Asia* consumer price inflation in 2006 is expected to be 2.9 percent, which is only slightly higher than in the previous two surveys (2.8 percent). The lowest inflation rates in 2006 will continue to prevail in *Japan* (0.7 percent compared to 0.5 percent expected in the previous survey and 0.4 percent at the beginning of the year). The slight upward revision of inflation expectations in *Japan* signals that fears of deflation seem to have come to an end. Moderate inflation rates continue to characterize *Taiwan* (1.9 percent unchanged from the previous survey). In *Singapore*, another traditionally low inflation country in the region, expectations for 2006 edged up somewhat (from 1.3 percent according to the survey in April to now 2.4 percent). The relatively highest inflation expectations for 2006 prevail again in *Sri Lanka*, *Indonesia* and *Pakistan*. Whereas in *Sri Lanka* inflation

expectations for 2006 increased from 9.0 percent in April to now 13.5 percent, the opposite was true in *Pakistan* and *Indonesia* where inflation expectations for 2006 were revised downwards from 8.9 percent to 8.0 percent, respectively from 11.4 percent to 10.0 percent. Also in *Vietnam* and in *Bangladesh* inflation expectations for 2006 remained well above the average in Asia (7.6 percent compared with 2.9 percent in the Asian average).

In *Central and Eastern Europe* inflation in 2006 is now seen to be

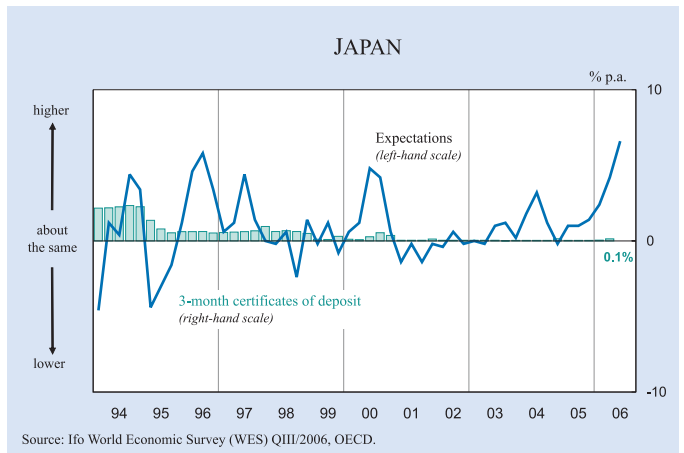
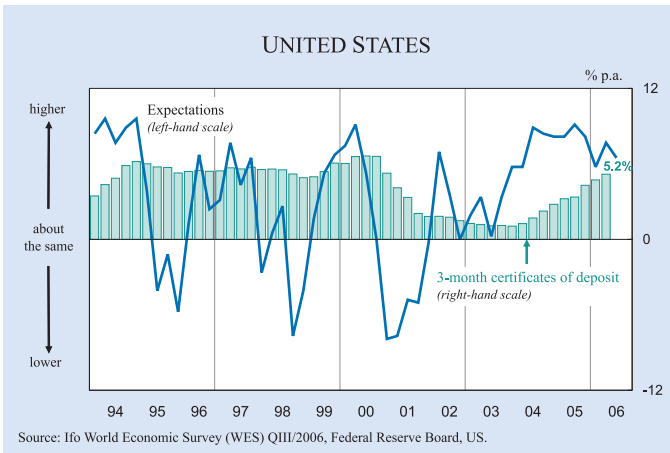
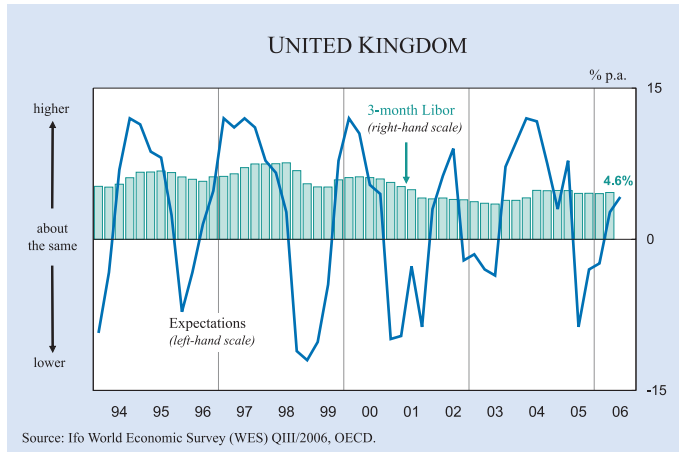
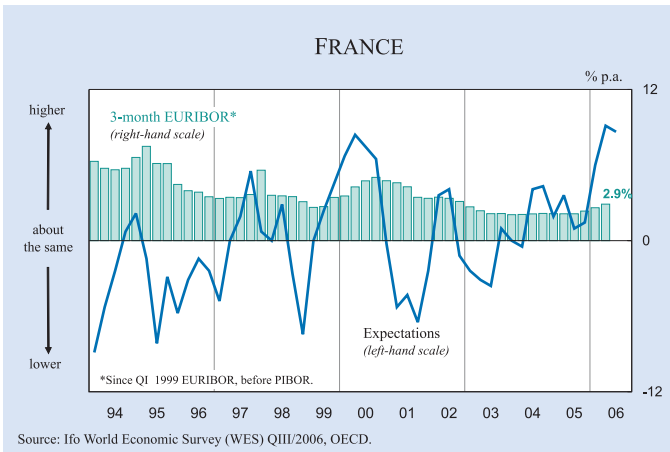
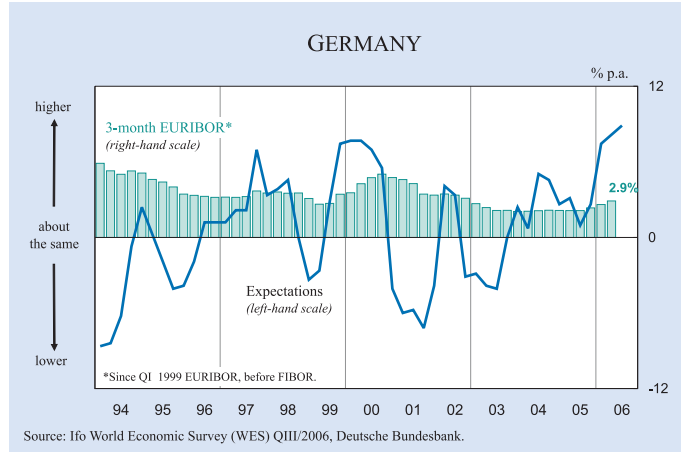
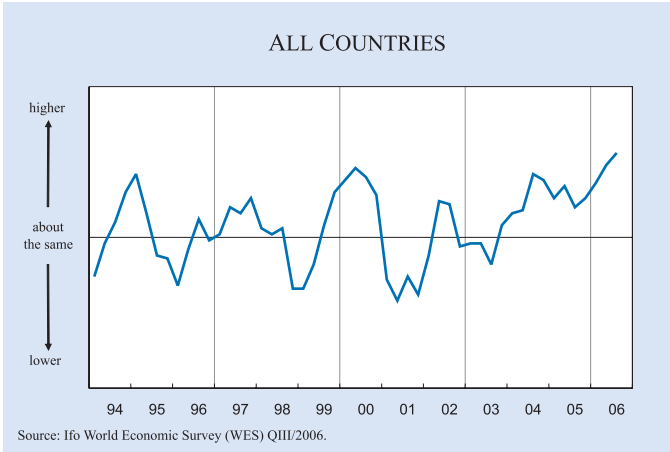
half a percentage point higher than expected in the spring survey (3.9 percent after 3.4 percent). The relatively highest rate of inflation will still prevail in *Serbia and Montenegro* despite the fact that expectations have been revised downwards somewhat (11.6 percent after 12.7 percent according to the survey in April). Also in *Romania*, *Latvia* and *Bulgaria* inflation expectations of around 7 percent are clearly above the average in the region. The lowest rate of this year's inflation is seen in *Slovenia* (2.2 percent which is even slightly lower than the expected 2.3 percent in the previous survey). In *Poland* the inflation outlook for 2006 has deteriorated somewhat (from 1.8 percent to now 2.7 percent) but is still significantly lower than the average of the region.

In the *CIS* countries the inflation outlook in 2006 will - according to the WES experts - remain around 10 percent. In *Russia* the trend of downward revisions of inflation expectations has continued (9.9 percent after 10.2 percent in April and 11.8 percent in 2005). On the other hand the inflation outlook in *Uzbekistan* has clearly worsened (12.0 percent after 7.0 percent expected in the spring survey). The relatively best inflation performance in the region will prevail this year again in *Kazakhstan* (8.4 percent), though this estimate is one percentage point higher than in the April survey.

In *Central and Latin America* 2006 inflation expectations have been revised downwards in the majority of countries in this region. Particularly pronounced was the improved inflation outlook in *Argentina* (from 15.3 percent in April to now 11.3 percent) and in *Venezuela* (from 17.3 percent in April to now 12.9 percent). To a somewhat lesser degree, downward revisions of this year's inflation rate were also observed in *Brazil* (from 4.7 percent to 4.2 percent), *Ecuador* (from

Figure 12

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



4.3 percent to 3.6 percent), *Mexico* (from 3.9 percent to 3.5 percent), *El Salvador* (from 4.5 percent to 4.0 percent) and *Uruguay* (from 6.8 percent to 6.4 percent).

In the *Near East* the inflation outlook worsened mainly due to the expected higher inflation in *Turkey* (10.0 percent after 6.3 percent) and the inclusion of *Iran*, with an expected inflation rate of 15.0 percent in 2006. By far the lowest inflation rate in the region will prevail again in *Saudi Arabia* (1.0 percent).

In *Oceania* an inflation rate of 3.1 percent is now expected for 2006; this is slightly higher than the inflation figure expected at the beginning of the year. The upward revision resulted mainly from *New Zealand* (3.4 percent after 2.9 percent in spring). In *Australia* inflation expectations remained close to 3 percent.

Japanese yen still seen as somewhat undervalued

As in the previous two surveys the *Japanese yen* was regarded as somewhat undervalued. On the other hand the US dollar appeared more or less adequately assessed according to WES experts and the euro and the *British pound* slightly overvalued.

As is well known, the actual movement of exchange rates April significantly differ from the one based on fundamental assessments of currencies. For that reason a supplementary survey question was again asked on the likely development of the *US dollar* in the next 6 months. According to the responses on balance, a declining tendency of the value of the dollar in relation to other currencies is expected in the course of the next six months. This is particularly the case in Western Europe, in some Asian countries like *China*, *Taiwan* and *South Korea*, but also in *Canada* and *Russia*.

Exceptions from the general trend of a weakening US dollar are again mainly Eastern European and Latin American countries as well as countries in Africa and the Near East, where the US dollar is expected to gain in value. However, this trend is not uniform: Within Eastern Europe WES experts of the *Czech Republic*, *Latvia*, *Croatia* and *Albania* expect some weakening of the US dollar vis-à-vis their own currencies in the course of the next six months; the same holds true in Latin America for *Peru*, *Colombia* and *Bolivia*.

In Asia exceptions from the generally expected trend of a weakening US dollar are mainly *India*, *Indonesia*, *Bangladesh*, *Pakistan*, *Sri Lanka* and

Vietnam where the own currencies are expected to lose in value compared with the US dollar.

Interest rates: stronger increase at the short than at the long end

The upward trend of short-term and long-term interest rates was 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 again *Russia*, *Indonesia* and *Brazil*.

In the *euro area* more WES experts than in the previous survey expected that short-term interest rates will increase further in coming months. However, in the case of long-term interest rates it is expected that the upward trend will slow in coming months. In *Western Europe* outside the euro area both types of interest rates are expected to increase, particularly in *Denmark*. In the *United Kingdom* and in *Sweden* a similar picture arises to that in the euro area with long-term interest rates expected to increase less than short-term interest rates in the course of the next six months.

In *North America* – both in the *USA* and in *Canada* – the upward trend of short- and long-term interest rates is expected to slow down.

In contrast, in *Eastern Europe* the trend of both short and long-term interest rates is increasing.

In *CIS countries*, particularly in *Russia*, the trend of shrinking interest rates is expected to level off in the coming months according to WES experts' view.

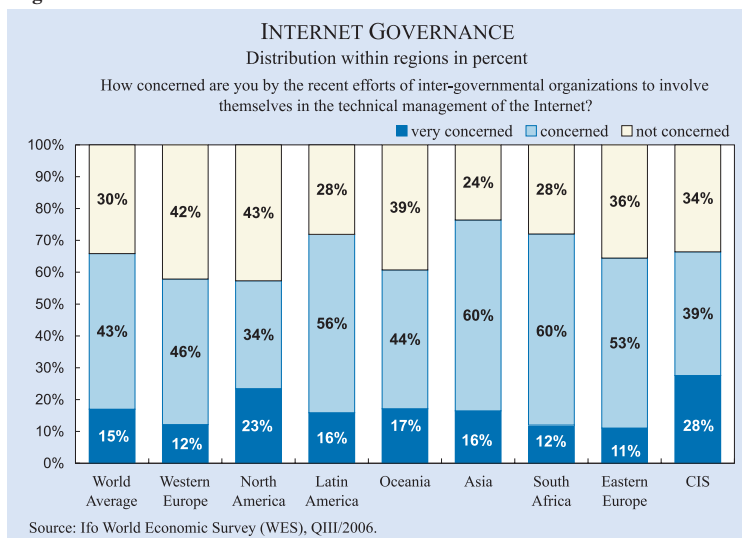
In *Latin America* an increase of short-term rates and stable long-term rates characterize the prevailing trend. The only exception is *Brazil*, where interest rates – both short-term and long-term – will continue to decline in coming months according to the WES experts.

In *Asia* the upward trend of interest rates will continue in coming months. This holds now true also for *Japan*, where interest rates recently began to increase slightly after a long period of zero interest rates.

ICC special question: Internet governance

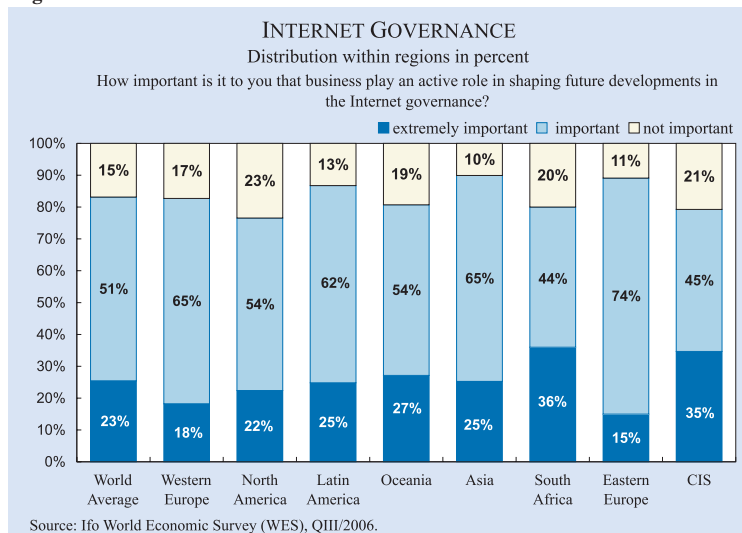
In little more than a decade the Internet has developed from a tool used mainly in academia to being

Figure 13



The special question asked in the July poll dealt with the issue of who should govern the global networks: business (a global multi-stakeholder forum) or governments. The question was divided into two parts. The first part evaluated how concerned the surveyed economists are by the recent efforts of intergovernmental organizations to involve themselves in the technical management of the Internet. The second question tried to assess the importance of business playing an active role in shaping the future developments of the Internet governance.

Figure 14



In several countries a considerable share (over 35 percent) of surveyed economists would be very concerned if intergovernmental organizations involve themselves in the technical management of the Internet, particularly in China, Mexico, Lithuania, Kazakhstan, Bolivia, Zimbabwe and Nigeria. More confidence regarding successful governance of the Internet by intergovernmental organizations was expressed by the surveyed experts in Europe (in the Netherlands, Denmark, Portugal, Ireland, Slovenia, Czech Republic, Latvia and Albania) and Latin

America (particularly in Argentina, Peru and Colombia) as well as in Russia, New Zealand and the United Arab Emirates (see Figures 13 and 14). In the United States about 44 percent of the surveyed economists would not mind if their country's government interfered more strongly in the regulation of the Internet. This opinion most likely reflects the increasing tendency of illegal or harmful online contents and spam.

part of everyday life and one of the major sources of information. Politically this was marked by the United Nations deciding in 2001 to hold the World Summit on the Information Society (WSIS). The first meeting took place in Geneva in December 2003. The second phase took place in Tunis in November 2005. A main conflict at the WSIS was over the question "Who governs the global networks?" There are particular difficulties in dealing with this question, as the Internet was designed to be an open and democratic source of information and today almost all Internet infrastructure is provided and owned by the private sector. However, since no general agreement existed even on the definition of what comprised Internet governance, the summit participants agreed to establish an Internet Governance Forum, to be convened by the United Nations Secretary General before the end of the second quarter of 2006.

However, at the same time in the majority of countries the surveyed experts think that it is important that business plays an active role in shaping future developments in Internet governance (see Figure 14). In India, Zimbabwe, Nigeria, Kazakhstan, Paraguay, Costa Rica, Peru, United Kingdom, Norway, Lithuania and New Zealand, more than 40 percent of experts think that it is even extremely important that business plays the crucial role.

ENERGY SECURITY

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