

IFO WORLD ECONOMIC SURVEY

World Economic Climate

WORLD ECONOMIC CLIMATE BRIGHTENS

Economic Expectations

ECONOMIC EXPECTATIONS FOR THE NEXT SIX MONTHS IMPROVED, BUT CURRENT ECONOMIC SITUATION REMAINS UNSATISFACTORY

Inflation

INFLATION EXPECTED TO SLOW DOWN

Interest Rates

RENEWED DECLINE OF INTEREST RATES EXPECTED

Currencies

EURO SEEN AS OVERVALUED

Special Topic

SARS EPIDEMIC HAD TEMPORARY NEGATIVE IMPACT ON ECONOMIC SENTIMENT WORLDWIDE

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Ifo World Economic Survey ISSN 1619-5132

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

- World economy: Begin of economic recovery?
- Asia: Economic climate indicator bounces back
- Western Europe: Economic climate improves
- Eastern Europe: Favourable economic climate
- CIS: Strong economic growth
- North America: Slight improvement of economic climate
- Oceania: Economic slowdown expected
- Latin America: Improvement of the overall economic situation
- Africa: Climate indicator remains almost unchanged
- Near East: Economic climate continues to improve

The survey is jointly produced by the Ifo Institute and the Paris-based International Chamber of Commerce (ICC).

Notes

The World Economic Survey (WES) assesses worldwide economic trends by polling transnational 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 2003 some 1,144 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 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.

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 ECONOMY: WORLD ECONOMIC CLIMATE BRIGHTENS

In July 2003 the World Economic Climate indicator continued its recovery, which set in already in January and was interrupted by the escalation of the Iraq crisis in March and early April (see Figure 1). At 91.3, compared with 83.2 in the previous survey, the climate indicator is now approaching its long-term average (1989 – 2002: 93.7). The assessment of the current economic situation remained unchanged at an unsatisfactory level, whereas the expectations for the next six months clearly brightened.

World economy: Begin of economic recovery?

In July 2003 the new upward movement of the economic climate index, which had already set in by the end of April, became more apparent.¹ The world economy is now at the crossroads; however, it is still too early to interpret this improvement already as the onset of a global economic recovery. For such an assertion experience dictates three consecutive positive survey results of both assessments of the economic situation as well as the economic expectations for the next six months. Whereas, according to the latest survey results, the assessments of the current economic situation remained below satisfactory on the world average, mostly reflecting the situation in the USA and Western Europe, the economic expectations for the next six months clearly picked up.

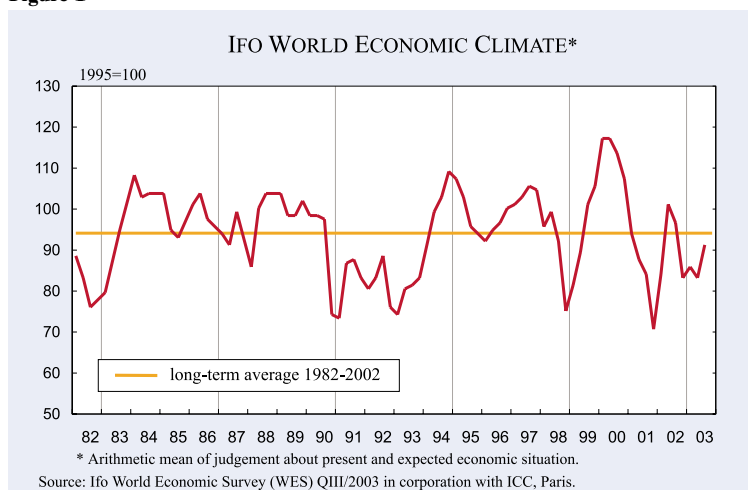
Thus, in the majority of other countries polled in the survey, the chances for a economic upturn are on the horizon.

For the interpretation of the current improvement of the economic climate a review of its development over the last two years can offer valuable clues. In October 2001, after the terrorist attacks in New York, the economic climate indicator reached an all-time low. Already in January and April 2002 the overall indicator bounced back, mainly driven by optimistic expectations. However, apprehension at this stage that the initial improvement of the indicator was not yet signaling the onset of a world-wide recovery proved true, and in July and October 2002 the world economic index slipped into a so called “double dip”. This renewed, strong setback of the economic climate was mostly aggravated by the escalation of the Iraq crisis. With the end of the main war activities in Iraq after April 9, the economic expectations clearly brightened compared to the period of the looming geopolitical crisis in 2002 and the beginning of 2003. This positive trend of economic expectations gained more momentum in July, but as mentioned, it is still too early to draw conclusions concerning the strength and the length of the upturn.

Asia: Economic climate indicator bounces back

While in the April survey the Asian region experienced the strongest deterioration of the economic climate indicator compared with other regions of the world, in the July survey the economic climate bounced back considerably and even slightly surpassed its long-term average.

Figure 1

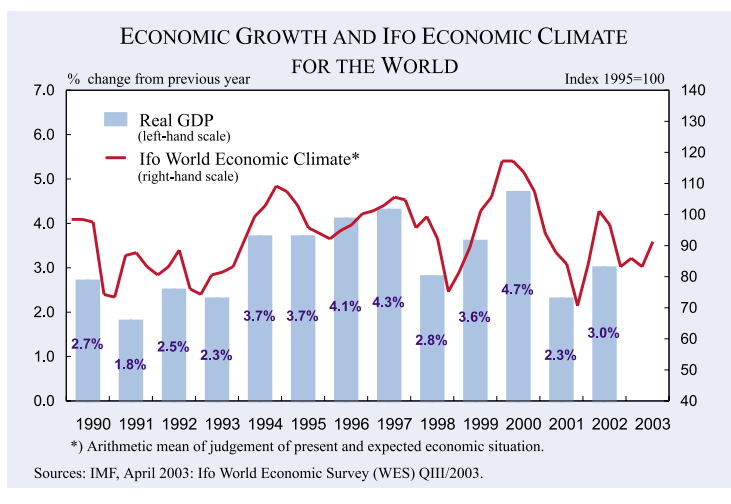


¹ A separate analysis of survey data that came before and after 15 April 2003 showed striking differences. In the first group, world economic climate was significantly lower than in the January survey (79.6 compared to 85.9). In the second group, i.e. responses submitted after April 15, the overall indicator stood at 86.8 and thus slightly higher than in January 2003 (85.9).

**Box 1:
World Economic Survey (WES) and Growth in the World Economy**

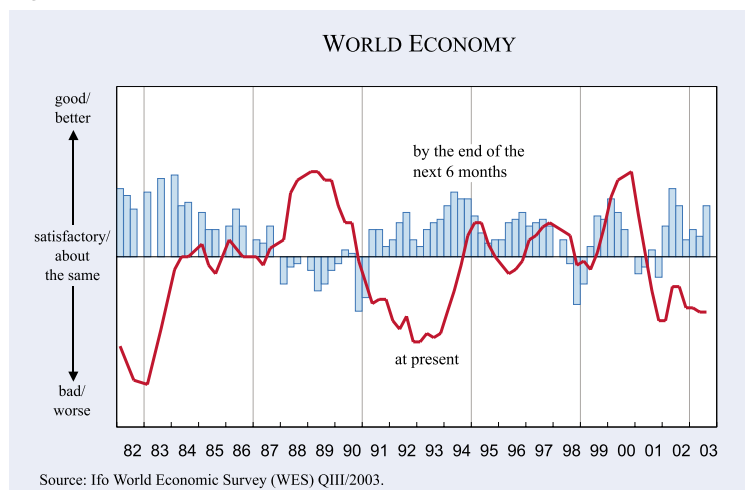
The World Economic Climate indicator closely tracks the growth of the world economy (see Figure below). The WES World Economic Climate indicator in July improved clearly over the results of the preceding survey of April 2003. The strengthening of the indicator was solely the result of more favourable expectations for the next six months; assessments of the current economic situation remain reserved. Since the expectations tend to lead the assessments of the present situation, there is some hope that also the world economic situation will improve in the second half of 2003.

A regional breakdown shows that the economic climate improved clearly in North America and Asia but only to a lesser extent in Western Europe. Whereas the long-term average for the economic climate was again reached in North America and Asia, in Western Europe the climate index is clearly below the long-term average (see Figure 3).



The recent pick-up is mostly attributed to the optimistic forecasts in all WES countries of the region for the coming six months (see Figures 3 and 4). The positive impetus most likely derived from the fast containment of the SARS epidemic which developed quickly and threatened not only the economies in Asia. However, the overall pattern of economic activ-

Figure 2



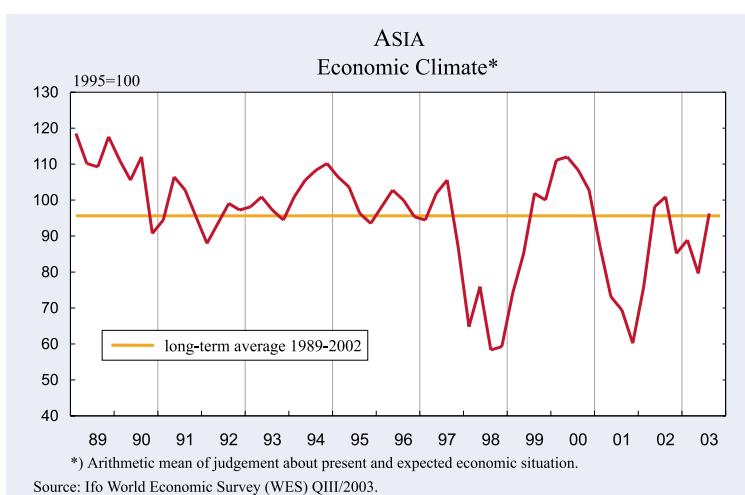
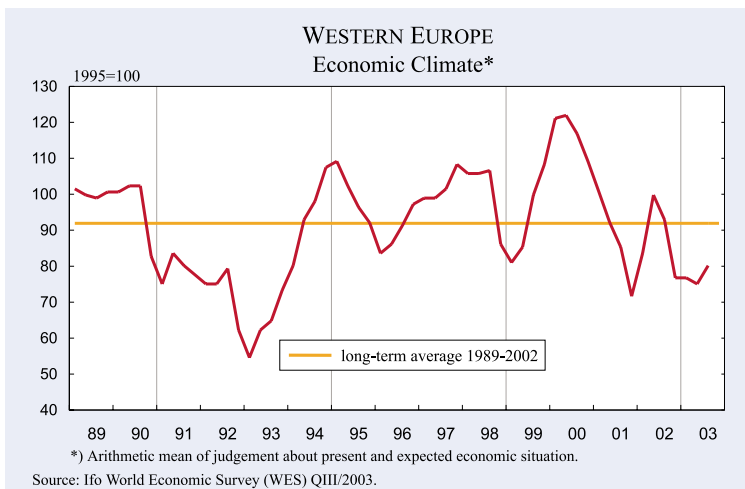
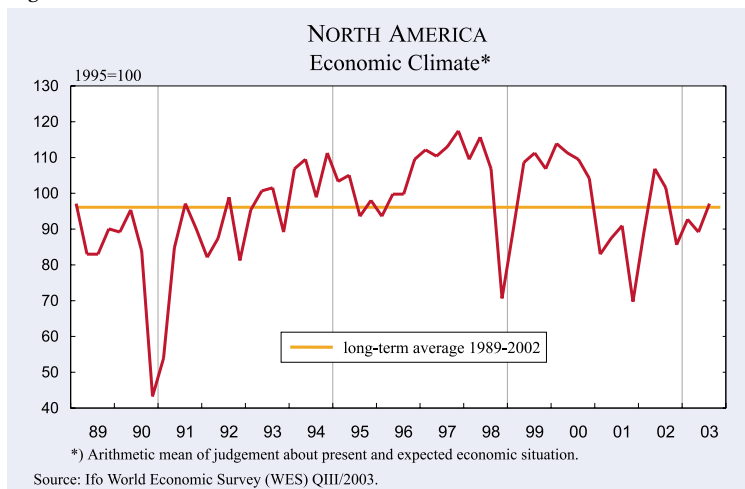
ity shows divergence between the countries polled in the region.

In *India, Pakistan, Thailand and Vietnam* the present economic situation as well as economic expectations remained at a high level, with capital expenditures, private consumption and the export sector set to grow in the course of the next six months. In *Malaysia* the present economic situation remained almost unchanged, being judged slightly above satisfactory. The economic expectations point to positive changes in the course of the next six months. In the *Philippines* the current economic situation reached the “satisfactory” level and is expected to continue its stabilization course. Also in *China*, WES experts were satisfied with the present overall economic performance. The expectations for the next six months point to further improvement of the overall economy in the country, in particular in capital investment, private consumption and

exports. The current economic development in *Singapore* changed for the better, confirming the optimistic expectations of the previous surveys (see Figure 9).

In *Japan* the depressed economic situation still shows only weak signs of improvement, according to WES experts. Also in *South Korea, Bangladesh, Taiwan and Indonesia* our panel’s responses concerning present economic performance in July remain in the negative territory. The outlook for the next six months in *Indonesia and South Korea* is lackluster. In *Bangladesh and Taiwan*, the short-term expectations are positive. The current economic performance, deteriorated also in *Hong Kong*. But the private consumption sector, which felt the negative impact from the SARS epidemic worst, is expected to recover like the overall economy in general in the coming months.

Figure 3



Western Europe: Slight improvement of the economic climate

The assessment of the current economic situation in most Western European economies remained below satisfactory. However, expectations for the next six months improved relatively strongly in

almost all European countries (see Figure 3 and 4).

The lowest marks for the current situation were given by WES correspondents in *Portugal, Germany and the Netherlands*. Also in other countries in the euro area the economic performance remains feeble, with *Finland, Greece, Luxembourg and Spain* being positive exceptions. The near-term prospects generally became positive in all Western European countries, except *Ireland*, where WES correspondents expect the slowing down of economic growth to continue in the coming months (see Figure 7a/b and Box 2). Despite the continued appreciation of the euro, sentiment regarding the export outlook became more optimistic in almost all countries of the euro area, except *Belgium, Ireland and Spain*.

Among the non-euro countries, *Denmark and United Kingdom* appear to be faring significantly better economically than all the other European countries, with a bright outlook for the next six months. In *Switzerland* the current economic situation continued to deteriorate, though the economic outlook for the coming six months point to a slight improvement. As reported by WES correspondents in *Norway*, the offshore-based oil sector, which mostly produces for export, will remain unchanged, while the mainland economy is going through a slowdown

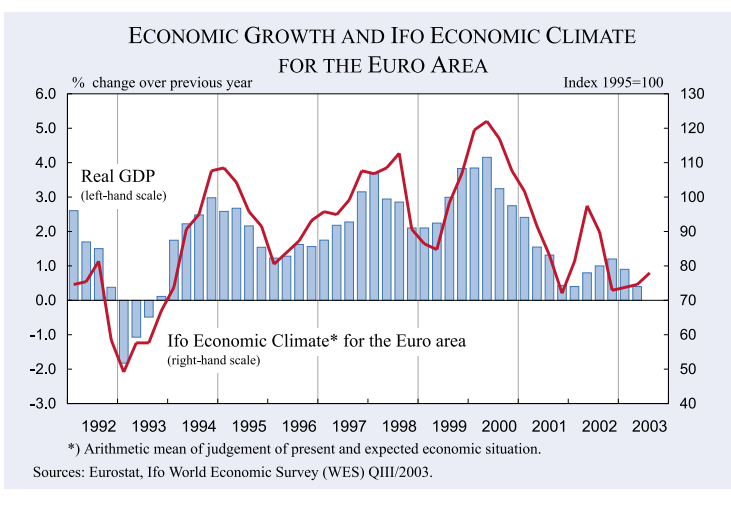
period. Our panel's assessments of the current economic situation in *Norway* have worsened again in July. However, the present economic situation was still assessed only slightly below the "satisfactory" level. The outlook for the coming six months is bright concerning both private consumption and capital expenditures.

**Box 2:
World Economic Survey (WES) and GDP Growth in the Euro Area**

The 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 264 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 rose slightly in July 2003. The improvement was solely attributable to more optimistic expectations for the next six months, whereas the assessments of the present economic situation continued to deteriorate. Since the expectations tend to lead the assessments of the current situation, hopes are justified that an economic recovery will take shape in the remaining two quarters of 2003.

Within the euro area, more unfavourable assessments of the current economic situation were made for Portugal, Germany and the Netherlands, with relatively positive assessments for Finland, Greece, Luxembourg and Spain. The expectations for the coming six months have improved throughout the euro area with the exception of Ireland, where a continued weakening of still relatively high growth rates is expected.



Eastern Europe: Favorable economic climate remains

Having been almost unaffected by the general economic downturn in Western Europe during 2002, the economic climate in Eastern Europe remained favorable also in July 2003 (see Figure 4 and 8).

The majority of Eastern European economies have shown considerable robustness in recent years, despite their thorough restructuring processes. In particular in the Baltic States – *Estonia, Lithuania and Latvia* – the economic situation was assessed by WES experts to be on a highly satisfactory level over the recent two years. The outlook for the coming six months suggests stabilization of these economies at the current “good” level. Also in *Slovenia, Slovakia, Albania, Bulgaria and the Czech Republic* the present economic situation was assessed as “satisfactory” with prospects for future

development remaining highly positive. To a lesser degree this holds true for *Poland*, where nevertheless the still depressed overall economic climate continues to improve. In *Croatia and Serbia and Montenegro* the present economic situation was assessed by WES experts below the “satisfactory” level. In *Croatia*, no major changes are expected in capital expenditures and private consumption, whereas the export sector could strengthen in the coming months. In *Serbia and Montenegro* the overall outlook point to an improvement. The assessments of the current economic situation in *Romania and Hungary* worsened in July and are now also slightly below the “satisfactory” mark. Fixed investment is predicted to remain stable, while the export sector is, however, expected to pick up in the coming months.

CIS: Strong economic growth

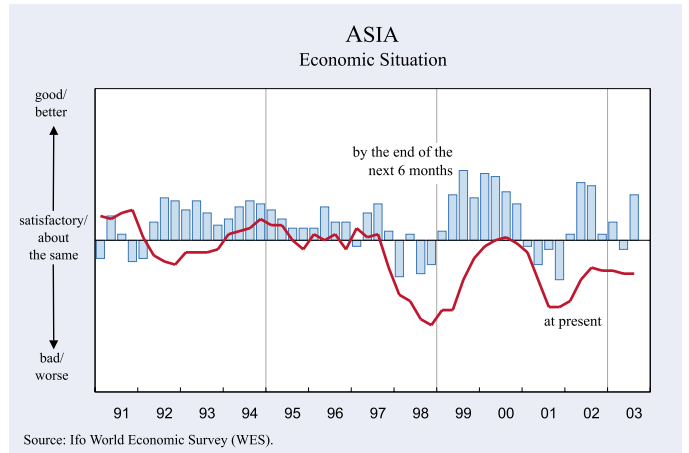
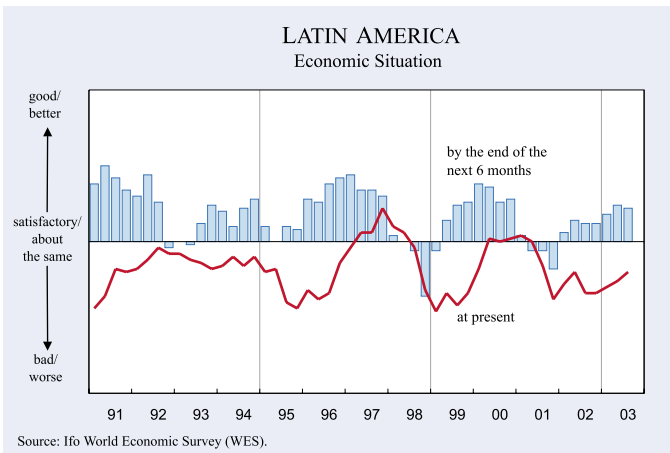
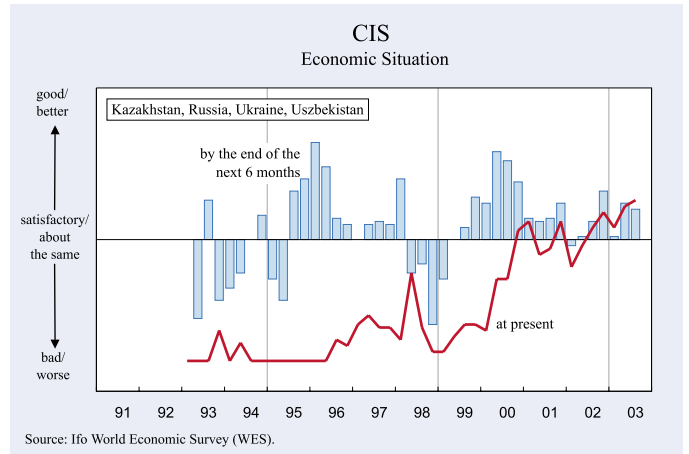
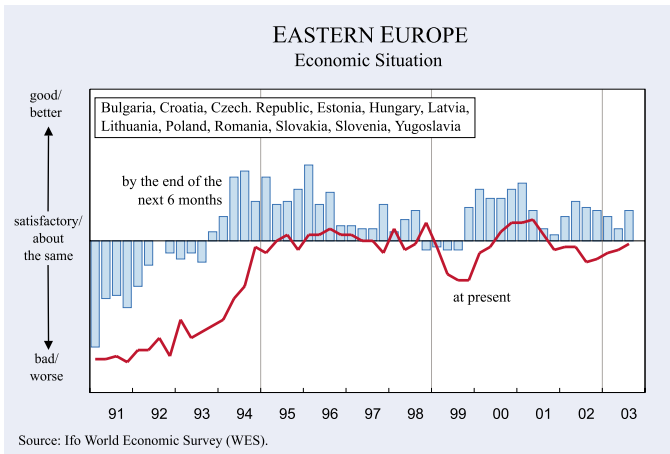
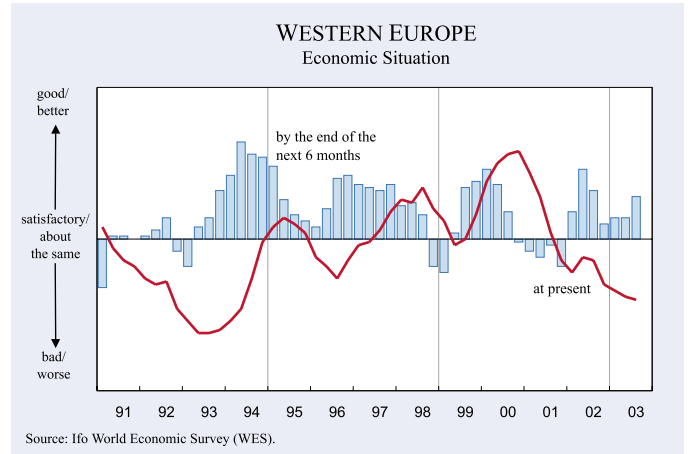
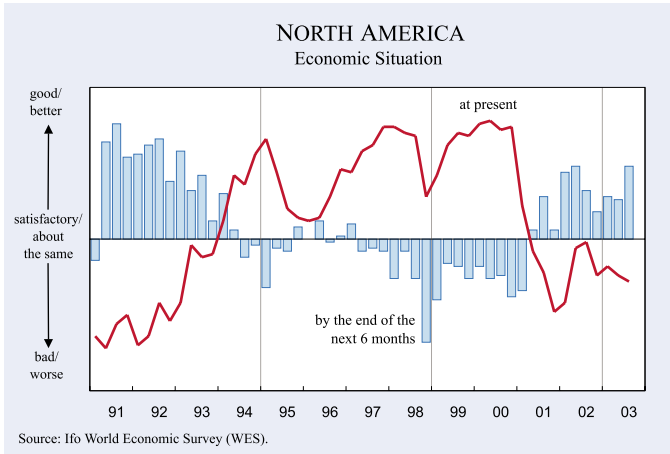
The assessments of the current economic situation in the CIS countries are among the most positive in the WES July survey. The good overall economic situation, on average, of CIS countries covered by the survey in July is expected to improve even further in the coming six months (see Figure 4).

In particular in *Russia* the panel’s responses in July reflect a continuation of the boom phase. During the first administration period of President Putin, Russia’s economy demonstrated remarkable growth, accompanied by continued stabilization of economic conditions and adaptation of the statutory framework to Western norms. Both forecasts for the private sector as well as capital expenditures have further risen. However, exports, mostly composed of raw materials, are now projected to decline slightly in the course of the coming months.

Also for the *Ukraine*, WES experts report a modest economic climate. The expectations concerning future developments point to further stabilization at the cur-

Figure 4

SELECTED REGIONS



rent “satisfactory” level, with higher forecasts for private consumption, capital expenditure and exports.

In *Kazakhstan and Uzbekistan* the economic performance was assessed to be at a highly favorable level. WES experts are optimistic concerning further development of the overall economy in the next six months.

North America: Improvement of the economic climate

In North America, the assessments of the current economic situation remained almost unchanged, while the economic expectations became clearly optimistic. However, WES experts from the *USA and Canada* reported somewhat different economic trends that are related to the different present economic policy. The war economy accompanied by high public deficits has strained economic climate in the *USA*. Accordingly, the present economic performance in the *USA* remained weak in July, but the prospects for further development reflect a post-war recovery in business sentiment. In particular capital expenditures and private consumption are expected to improve. In *Canada* the overall economy slipped from a highly favorable to a “satisfactory” level. However, as in the *USA*, the near-term expectations are positive for both the private sector as well as for capital expenditures (see Figure 3 and 4).

Oceania: Economic slowdown expected

In *Australia and New Zealand* the slowdown of economic activity from a relatively high level, which was already suggested by the panel’s responses in the preceding surveys seems to have set in. Forecasts for the next six months still remained cautious. However, the assessments of the current economic situation are at the highest level in the WES July survey; though in *Australia* considerably lower than in the April survey. The economic expectations suggest a moderate cooling down of the economic climate in the next six months.

Latin America: Improvement of the overall economic situation

According to the recent survey, both the assessment of the current economic situation and the

expectations for economic development in the next six months point to an improvement of economic climate in South America. However, the vast majority of WES experts surveyed in this region judged the present economic situation of their country to be below a “satisfactory” level (see Figure 4).

The economic climate in *Brazil*, the largest economy in this area, though slightly less favorable than in the previous April survey, will remain very moderate in the course of the coming six months. Fixed investment, private consumption and in particular exports, due to a rich harvest, are expected to strengthen by the end of the year. In *Chile* the assessment of the current economic situation has left the negative territory, and expectations for the next six months improved even more. Growth of domestic demand is expected to become more dynamic. Positive assessments concerning present economic performance came also from *Peru*. The panel’s forecast for the coming six months reflects a stabilization of the current positive state. In *Colombia* the economic situation has shown signs of recovery since the four preceding polls. In the July survey the assessments of the current economic performance almost reached the “satisfactory” level. The optimism in the expectations for the future development, in particular of the export sector, provides reason to hope for a continuation of this positive trend. Somewhat better than the Latin American average is the economic climate in *Mexico*. Since the beginning of 2003 the economic situation has slightly improved according to WES experts and was close to satisfactory in July. This trend will continue in the coming months, reflecting a rather stable state of the economy, in particular the corporate investment sector (see Figure 10).

In *Argentina*, the long-expected recovery from the economic crises has become more dynamic, according to the recent survey results. The assessments for the current economic situation are better than in the previous two surveys, though far below the satisfactory level. Exports are expected to pick up strongly in the coming months, as well as private consumption and capital expenditures.

In other countries of the region, in particular in *Panama, Paraguay and Uruguay*, the assessment of the current economic fell below “satisfactory”. But as in the April survey stronger economic growth is forecast in the coming months. Less encouraging is the present economic situation in *Bolivia, Ecuador*

and Venezuela. Also the short-term expectations point instead to further deterioration. In *Bolivia and Ecuador*, the export sector provides some impetus for more dynamic economic development. The only country in the region where WES experts expect the currently satisfactory economic situation to deteriorate considerably in the coming months is *El Salvador*.

Africa: Economic climate indicator remained almost unchanged

The weakness of the world economy during 2002 and the first half of 2003 had a negative impact on the economic situation in Africa. On average for the African countries polled in the July survey, the economic climate remained almost unchanged since the April poll at below satisfactory.

The slowdown of the average of African countries basically results from the weak economic performance reported in North Africa, in particular in *Egypt and Algeria*. Also in *Nigeria* the present economic performance in July is well below “satisfactory”, according to WES experts. Only in *Algeria* does the outlook for the coming six months point to an improvement (see Figure 11).

More positive signals were reported by WES experts from *South Africa and Tunisia*, where the outlook for the coming six months points to stabilization at the current level, with private consumption being the driving factor for the economic recovery process.

The panel’s responses for *Zimbabwe* draw again a very bleak picture of the economic situation. Due to President’s Mugabe catastrophic governance the economic output has been shrinking from year to year. Public spending greatly surpassing revenues has led to hyperinflation and chaotic conditions. This gloomy situation will presumably last as long as the government fails to undertake serious efforts to improve the current situation. However, lack of confidence in the government’s economic policy based on the experience of previous years leave only little room for hope.

Near East: Economic climate continues to improve

According to the panel’s responses, the current economic situation in the Near East has continued

to improve since the beginning of 2003. On average, the forecast for the coming six months points to positive developments in almost all countries of the region included in the survey.

The current economic situation continues to be very good particularly in the *United Arab Emirates*. In *Saudi Arabia* the assessments of the economic performance in July were less favorable than in the April survey, but still at the “satisfactory” level. The less optimistic forecast also refers to the capital expenditure sector, which is expected to weaken somewhat in the course of the coming six months (see Figure 11).

Economic activity in *Turkey*, that has been very unstable since the beginning of 2002, strengthened according to the recent survey results. In contrast, *Israel* is still muddling through a recession. Almost all WES experts polled in *Israel* assessed the current economic situation as “bad”. However, the outlook for the next six months remains optimistic.

The economic situation in *Iran* is now regarded as “good”. According to WES experts, also the economic outlook for the coming six months has brightened since the April survey. In *Bahrain and in Jordan* the current economic situation in July as in April was clearly assessed below the “satisfactory” level. The short-term forecasts are – as in the Near East region in general – optimistic.

Inflation expected to slow down

On a world-wide scale, consumer price inflation in 2003 is now expected to be 2.8%, significantly lower than the estimate in the two surveys in the first half of the year (each 3.2%). In the euro area the 2003 inflation rate is now seen for the first time below the 2% mark (1.9% compared with 2.1% in the April survey). Within the euro area a higher inflation rate than in the previous April survey is only expected in *Italy* (2.6% compared with 2.4%). *Switzerland and Germany* remain in 2003 the two countries with the presumably lowest inflation rate in *Western Europe* (0.7% in the case of *Switzerland* and 1.1% in the case of *Germany*).

According to the latest WES results, 2003 inflation figures in the *United States* at 2.0% are lower than in the April survey (2.3%). Thus, the disinflation process is expected to continue here in the second

Table 1

Expected Inflation Rate 2003 (based on WES QII/2003 and QIII/2003) *

Region	QIII/2003	QII/2003	Region	QIII/2003	QII/2003
AVERAGE OF 91 COUNTRIES	2,8	3,2	CENTRAL & LATIN AMERICA	9,0	10,7
HIGH-INCOME COUNTRIES	1,6	1,9	ARGENTINA	16,9	23,1
MIDDLE-INCOME COUNTRIES	6,9	7,5	BOLIVIA	6,0	4,3
UPPER-MIDDLE	6,5	7,4	BRAZIL	10,4	11,6
LOWER-MIDDLE	7,7	8,0	CHILE	3,1	3,3
LOW-INCOME COUNTRIES	5,2	5,1	COLOMBIA	7,1	6,7
HIGH-INCOME OECD COUNTRIES	1,8	2,0	COSTA RICA	10,7	11,5
MIDDLE-INC. OECD COUNTRIES	5,1	5,6	ECUADOR	8,1	8,2
MIDDLE-INC. OIL EXPORTERS ¹	16,4	15,7	EL SALVADOR	2,8	3,0
EU COUNTRIES	2,0	2,2	GUATEMALA	-	-
EURO-LAND ²	1,9	2,1	MEXICO	4,4	4,9
MEDITER. (NON-EU) COUNTR. ³	9,3	11,3	PANAMA	1,3	1,1
ASEAN AND EAST ASIAN NICs ⁴	1,5	2,1	PARAGUAY	15,0	18,7
ASIAN PACIFIC RIM ⁵	1,5	2,0	PERU	2,6	2,6
ARABIAN OPEC COUNTRIES ⁶	5,9	5,2	URUGUAY	18,0	26,0
			VENEZUELA	45,8	51,1
WESTERN EUROPE	1,9	2,2	ASIA	1,1	1,4
AUSTRIA	1,4	2,0	BANGLADESH	4,4	4,6
BELGIUM	1,5	1,8	CHINA P.R.	1,0	1,3
CYPRUS	4,8	4,5	HONG KONG	-1,6	-1,1
DENMARK	2,3	2,5	INDIA	4,7	4,8
FINLAND	1,6	1,7	INDONESIA	8,7	8,9
FRANCE	1,7	2,0	JAPAN	-0,5	-0,5
GERMANY	1,1	1,3	KOREA	3,4	3,5
GREECE	3,6	3,8	MALAYSIA	2,0	2,1
ICELAND	2,0	2,0	MONGOLIA	1,9	-
IRELAND	3,7	4,7	NEPAL	-	4,0
ITALY	2,6	2,4	PAKISTAN	4,4	5,3
LUXEMBOURG	2,0	2,2	PHILIPPINES	4,5	4,2
NETHERLANDS	2,4	2,5	SINGAPORE	1,0	1,4
NORWAY	2,1	2,5	SRI LANKA	11,1	9,2
PORTUGAL	3,3	3,4	TAIWAN R.O.C.	0,1	0,7
SPAIN	2,9	3,3	THAILAND	2,1	2,6
SWEDEN	1,9	2,5	VIETNAM	3,7	4,3
SWITZERLAND	0,7	0,9			
UNITED KINGDOM	2,5	2,7	OCEANIA	2,9	2,9
CENTRAL & EASTERN EUROPE	4,3	4,3	AUSTRALIA	3,0	3,0
ALBANIA	5,2	-	NEW ZEALAND	2,3	2,4
BOSNIA HERCEGOVINA	2,5	3,0	NEAR EAST	8,7	9,2
BULGARIA	4,3	4,8	BAHRAIN	2,0	1,0
CROATIA	2,8	3,2	IRAN	17,7	18,7
CZECH REPUBLIC	1,6	1,9	ISRAEL	1,6	3,0
ESTONIA	3,3	3,6	JORDAN	2,0	2,3
HUNGARY	5,4	5,2	KUWAIT	2,5	-
LATVIA	2,4	2,7	LEBANON	5,0	5,0
LITHUANIA	1,1	1,5	SAUDI ARABIA	2,2	1,6
POLAND	1,6	1,6	TURKEY	25,8	28,4
ROMANIA	14,2	13,6	UNITED ARAB EMIRATES	2,8	2,7
SERBIA AND MONTENEGRO	8,9	9,2			
SLOVENIA	5,5	5,6	AFRICA	17,4	14,6
SLOVAKIA	8,4	7,9	ALGERIA	5,0	4,0
CIS	12,6	12,4	EGYPT	4,6	6,6
GEORGIA	-	5,0	GHANA	-	-
KAZAKHSTAN	-	6,0	KENYA	8,5	3,2
RUSSIA	13,3	14,3	MAURITIUS	6,0	-
UKRAINE	5,8	6,3	MOROCCO	-	2,3
UZBEKISTAN	25,0	-	NIGERIA	15,0	13,0
NORTH AMERICA	2,1	2,4	SOUTH AFRICA	7,3	8,3
CANADA	2,7	2,9	TANZANIA	4,5	5,0
UNITED STATES	2,0	2,3	TUNISIA	2,7	-
			ZIMBABWE	525,0	378,0

* Compared to average of previous year.

¹ Algeria, Indonesia, Iran, Saudi Arabia, Venezuela. – ² EU countries without Denmark, Sweden, United Kingdom.³ Algeria, Bosnia-Herzegovina, Croatia, Cyprus, Egypt, Israel, Lebanon, Malta, Morocco, Slovenia, Tunisia, Turkey, Yugoslavia. – ⁴ Hong Kong, Indonesia, Korea, Malaysia, Philippines, Singapore, Taiwan, Thailand, Vietnam. – ⁵ Australia, China P.R., Hong Kong, Indonesia, Korea, Malaysia, New Zealand, Philippines, Singapore Taiwan, Thailand, Vietnam. – ⁶ Algeria, Iran, Saudi Arabia, United Arab Emirates.

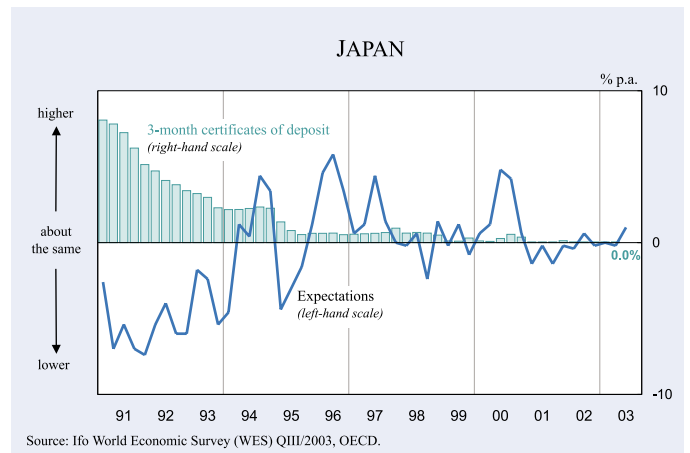
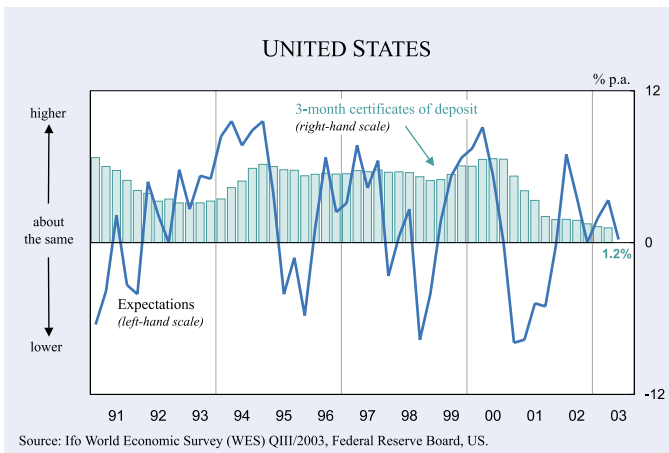
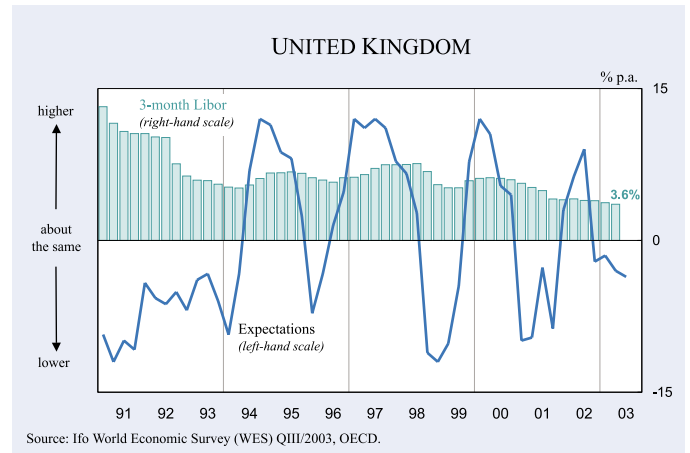
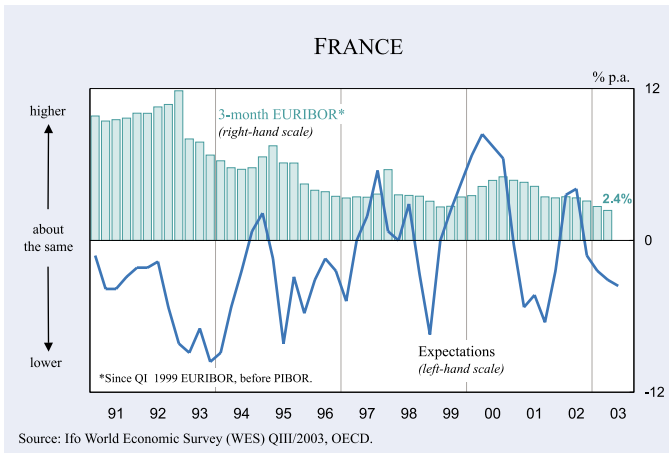
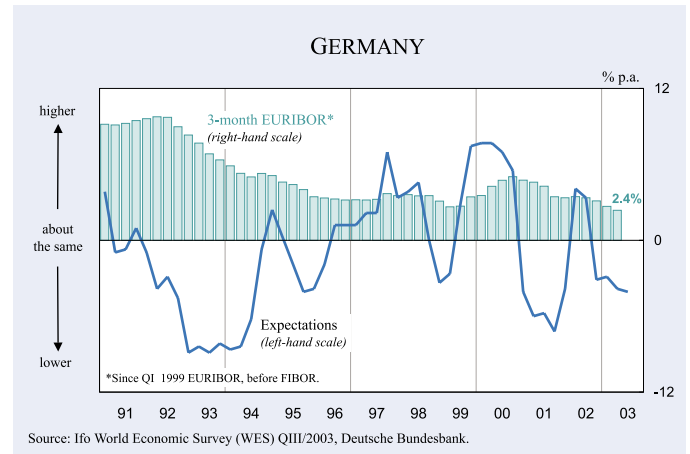
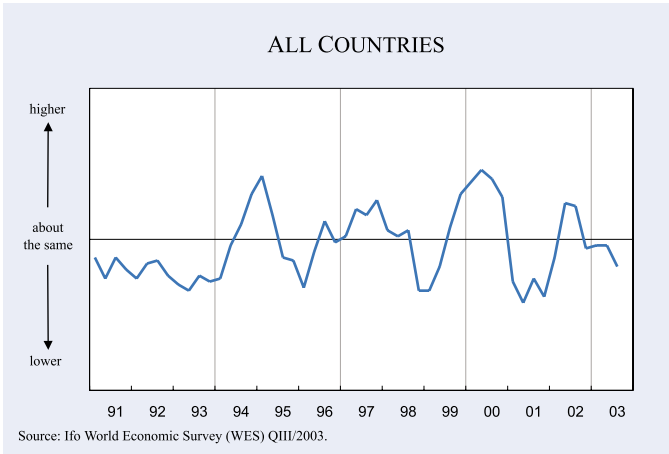
Source: Ifo World Economic Survey (WES), QIII/2003.

half of this year. Asia still shows by far the highest degree of price stability (1.1% compared to 1.4%

in April 2003). Deflationary trends still prevail in *Japan* (unchanged – 0.5% in 2003) and *Hong Kong*

Figure 5

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



(- 1.6% compared with - 1.1% in April). Also in *Taiwan*, where consumer prices are expected to stagnate in 2003 the danger of slipping into a deflationary cycle is still not completely averted.

The 2003 inflation outlook for *Central and Eastern Europe* remained unchanged (4.3%). The only countries in this bloc still having very high inflation rates are *Romania* (14.2%), *Serbia and Montenegro* (8.9%) and *Slovakia* (8.4%).

In *Central and Latin America* overall inflation is now expected to be somewhat lower than in the April survey (9.0% compared with expected 10.7% in the April survey). By far the highest inflation rate in this region still prevails in *Venezuela* (45.8%) though here too the inflation trend is expected to slow down somewhat. The inflation outlook for *Africa* is worsening (17.4% after expected 14.6% in the April survey). However, this is mainly due to the catastrophic situation in *Zimbabwe* where a hyperinflation of now about 525% is expected in 2003 following a hike of about 135% last year. In *South Africa* 2003 inflation is expected to settle at 7.3% (compared with 8.3% in the April survey), down from 9.5% in 2002 (see Table 1).

Interest rates: Renewed decline expected

More WES experts than in the previous three surveys expect a further decline of **short-term interest rates** (see Figure 5). In *North America*, in *Canada* even more pronounced than in the *USA*, the previously expected rise of short-term rates in the

course of the next six months has disappeared and is now replaced by an expected trend of stable or even slightly declining rates. In *Australia*, as correctly foreseen in the previous survey, short-term interest rates, after a longer period of increase, began to sink and will level off further in the course of the next six months. In *Western and Eastern Europe* the downward trend of short-term interest rates is still intact and expected to continue in coming months. In *Western Europe* even more experts than in the April survey expect short term rates to decline further. Thus, amongst the participants from the Euro zone a further monetary easing by the European Central Bank appears to be likely. In *Africa*, particularly in *South Africa*, there is still seen a high likelihood for rate cuts in coming months. Also in *Latin America* the trend of rising short-term interest rates appears to be broken; in coming months short-term interest rates will decline somewhat, with the exception of a few countries like *Colombia and Venezuela*.

Long-term interest rates are expected to remain stable in the coming six months or decline even somewhat after the abrupt increase in previous weeks. This world-wide trend characterizes also *Western Europe and the USA*. In *Canada and Australia*, where according to the April survey a pronounced increase of long-term interest rates was correctly anticipated, the expected trend of capital market rates for the coming six months is now pointing to a more or less stable development. In *Latin America* WES experts see room for a decline of long term interest rates, particularly in *Brazil*. In *Asia* capital market rates are expected to remain stable or decline somewhat with the excep-

tion of *Japan* where the increase of rates is expected to continue. In *Eastern Europe and CIS* countries long-term interest rates are expected to show a falling trend also in the coming six months.

Euro seen as overvalued

The *euro* is regarded as overvalued – even more than in the previous survey. The felt degree of overvaluation is now almost as pronounced as

Figure 6

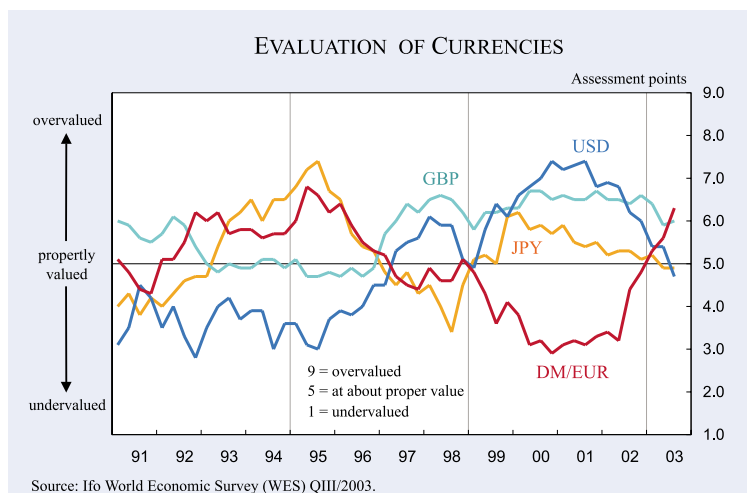


Figure 7a

EUROPEAN UNION

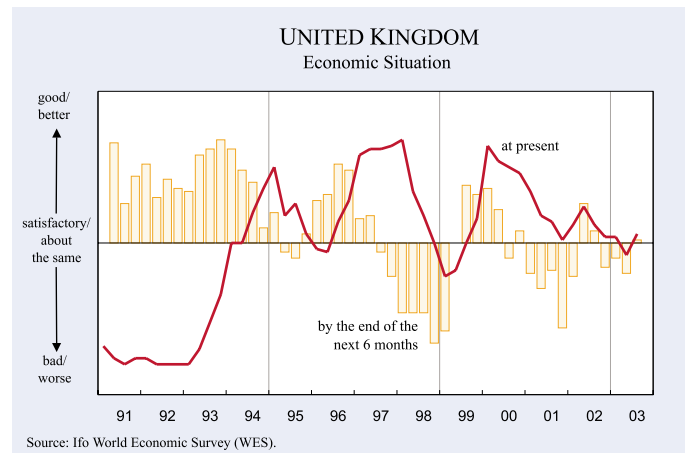
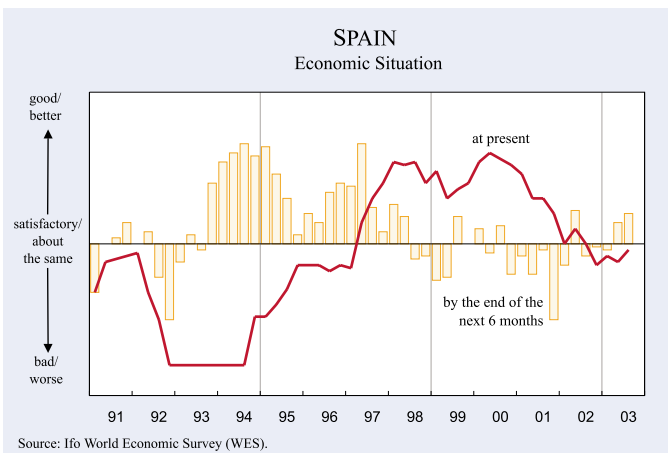
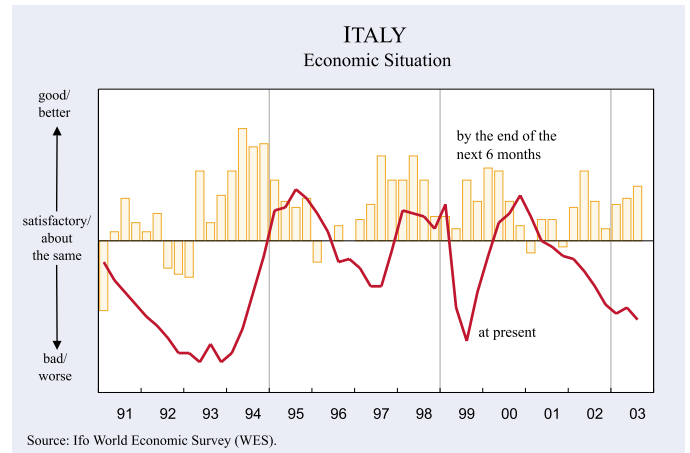
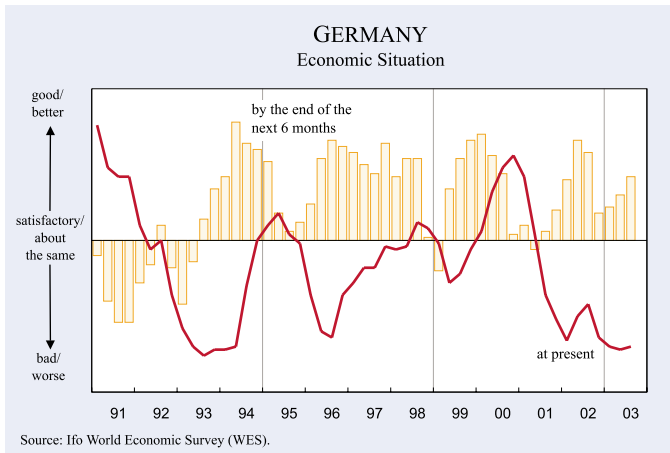
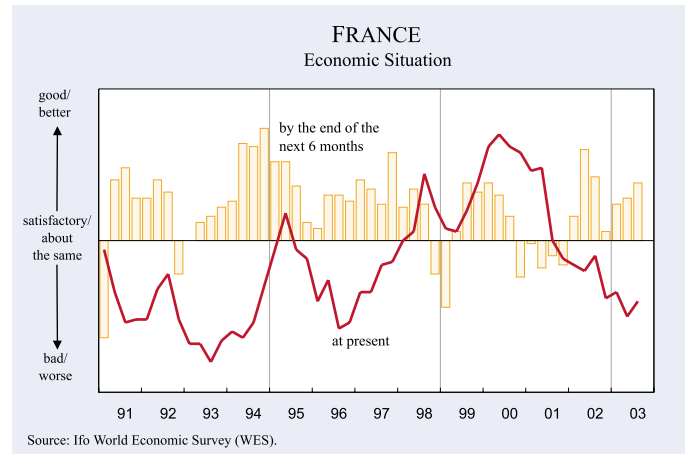
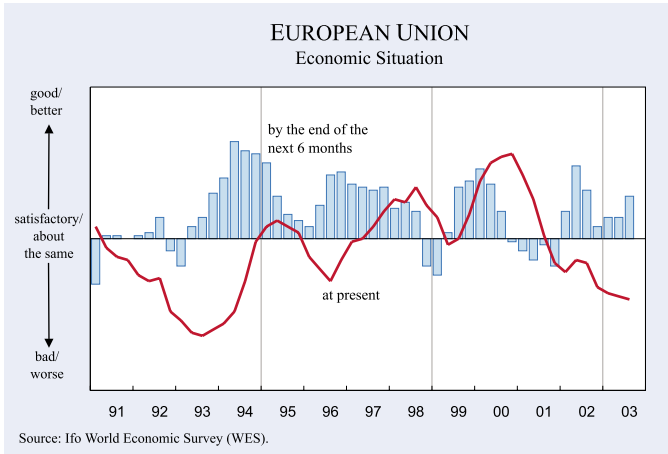


Figure 7b

EUROPEAN UNION

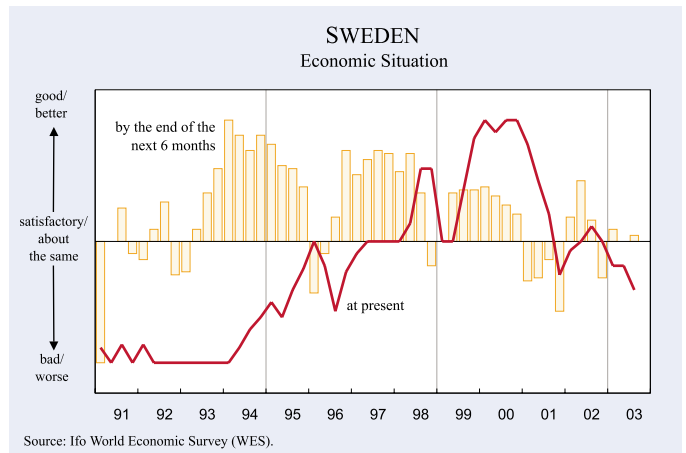
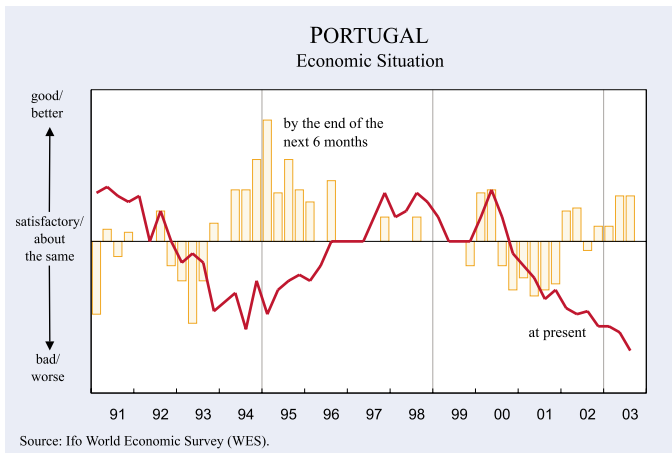
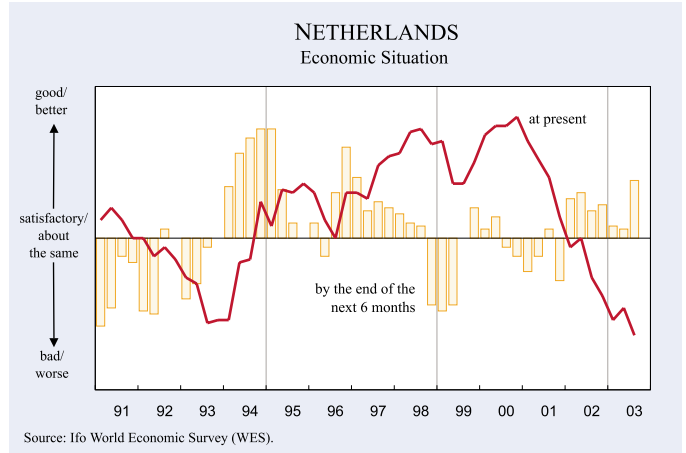
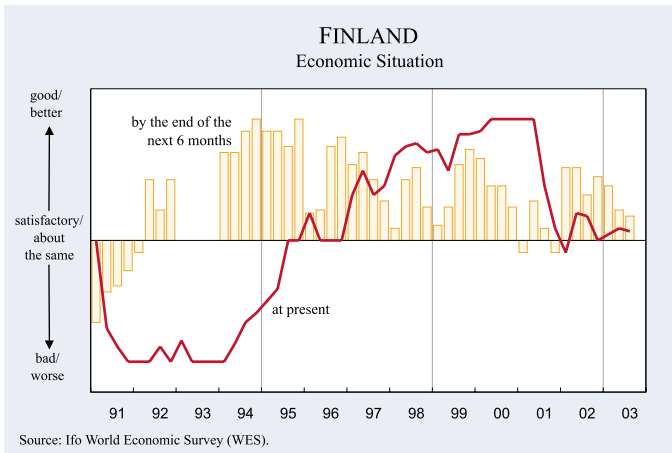
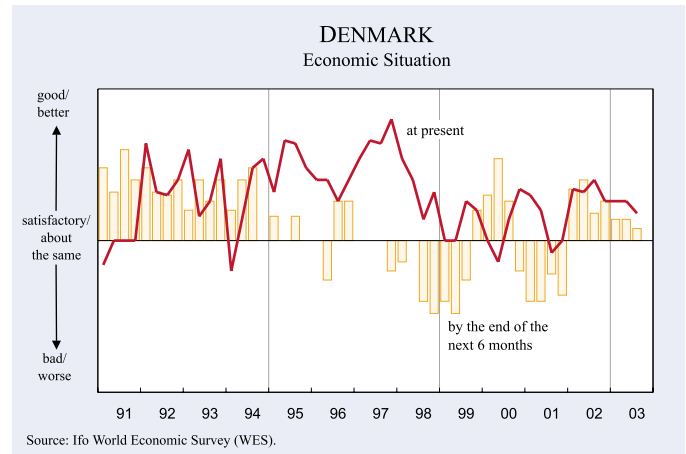
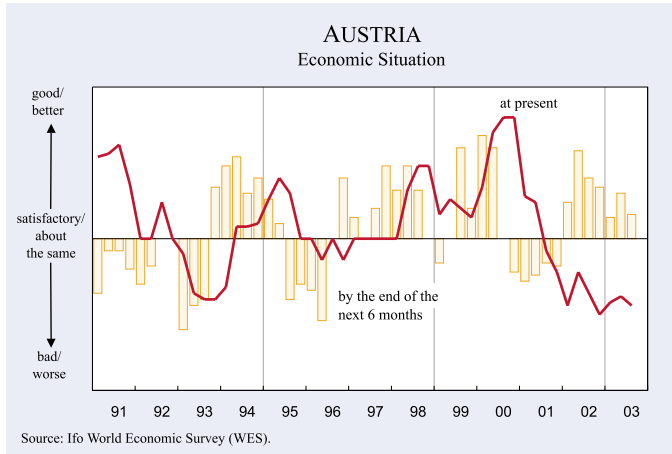


Figure 8

EASTERN EUROPE

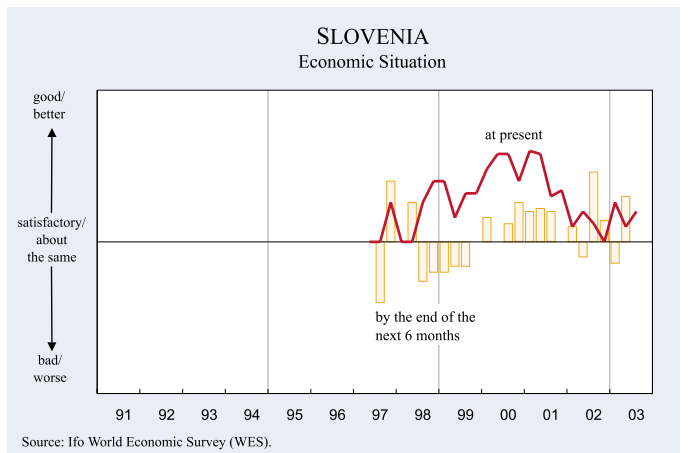
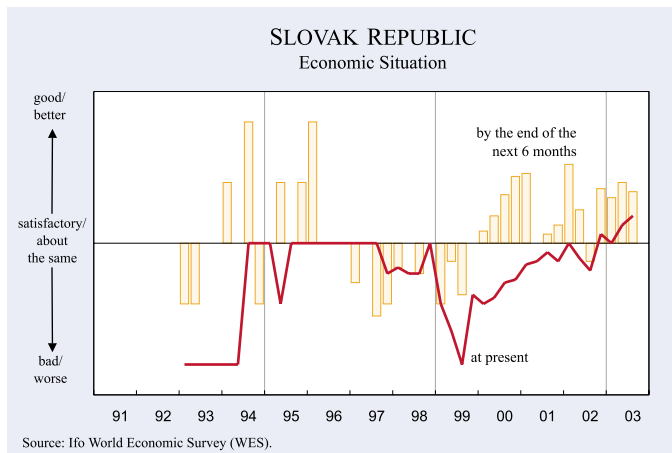
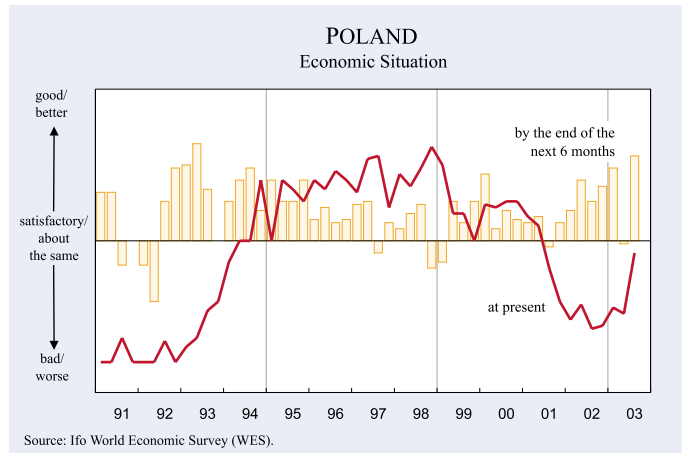
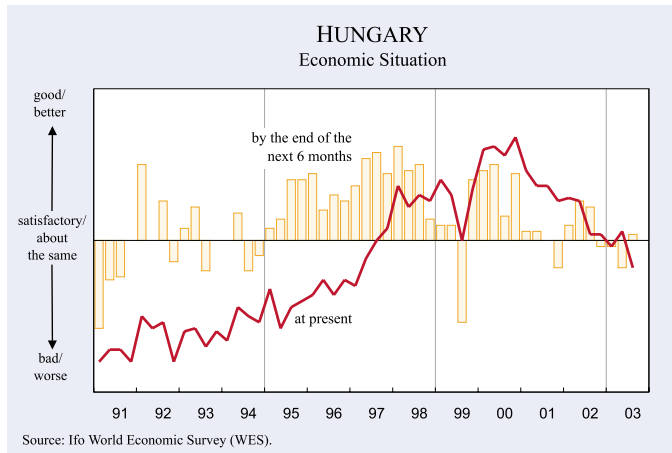
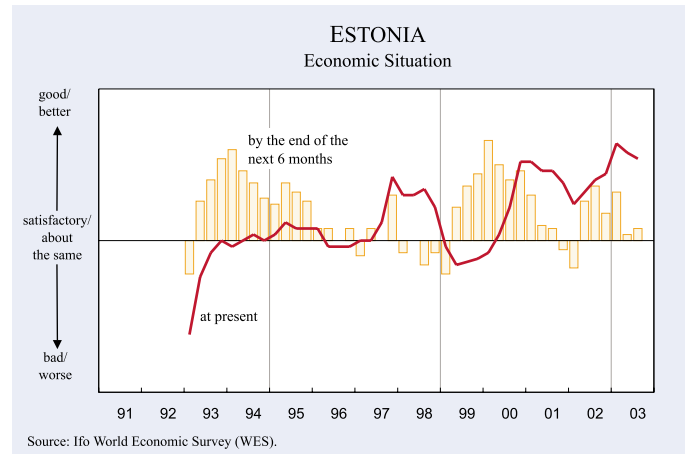
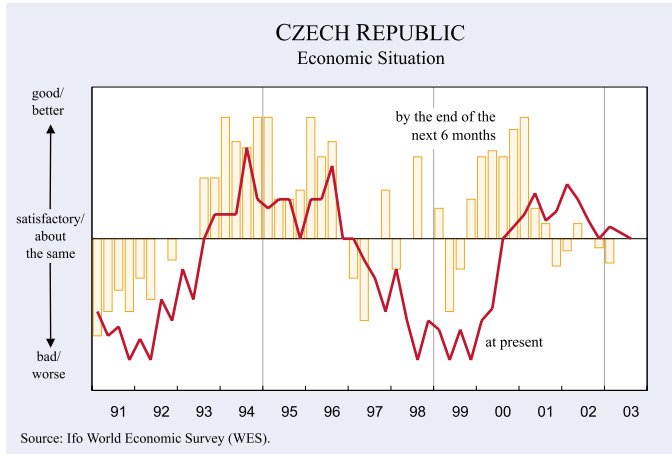


Figure 9

ASIA

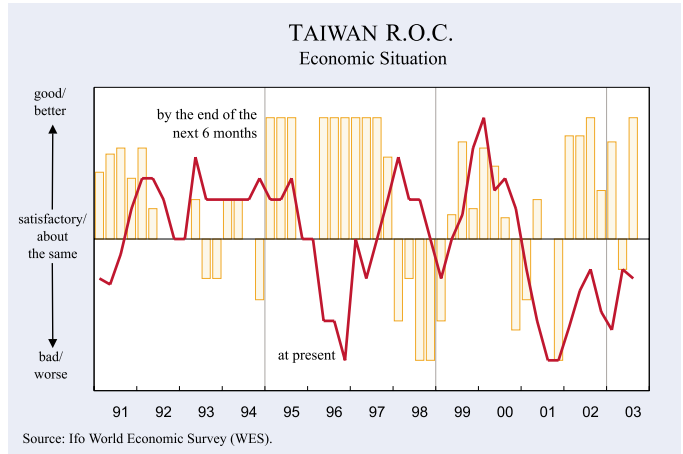
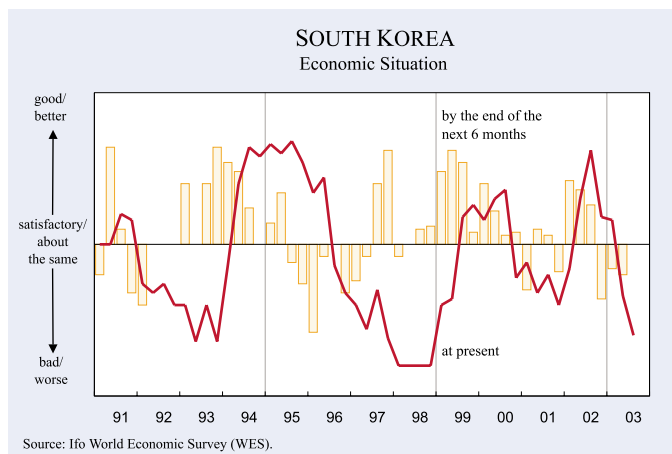
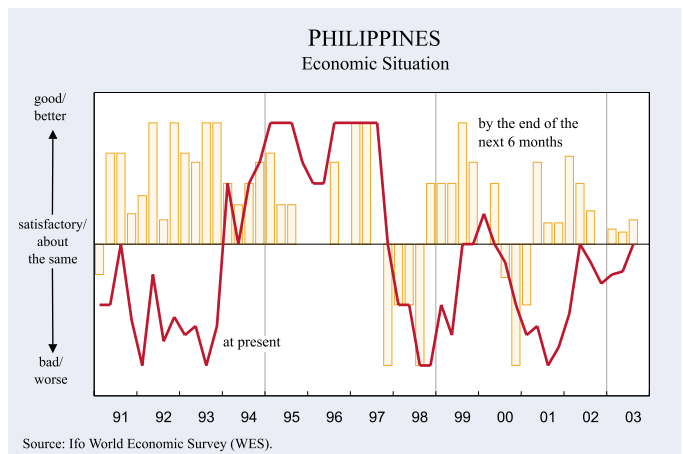
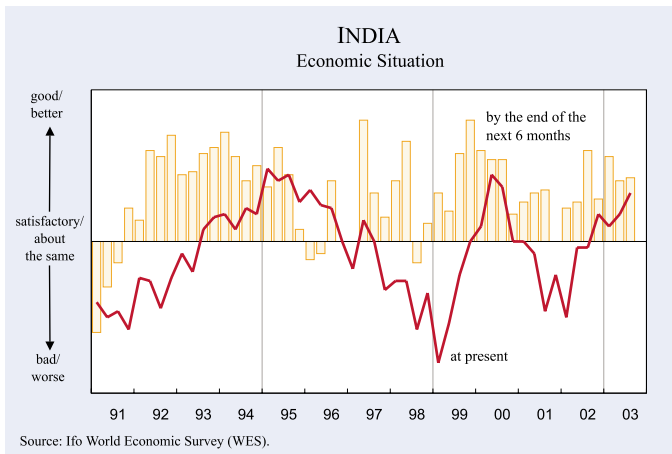
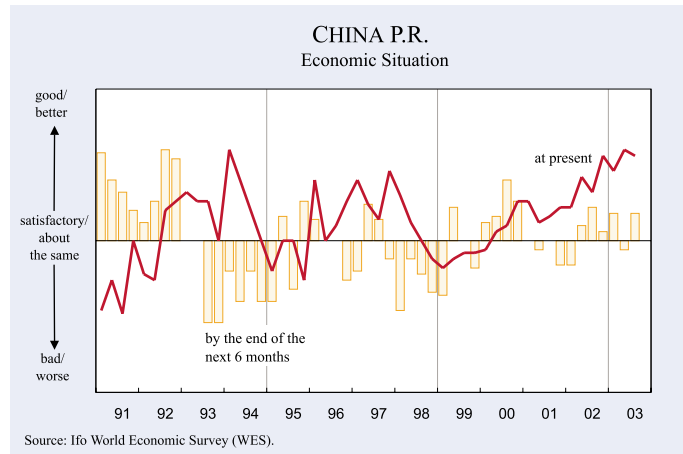
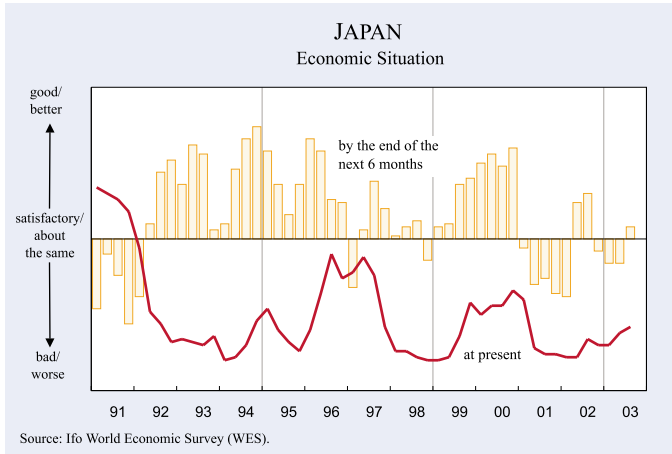


Figure 10

LATIN AMERICA

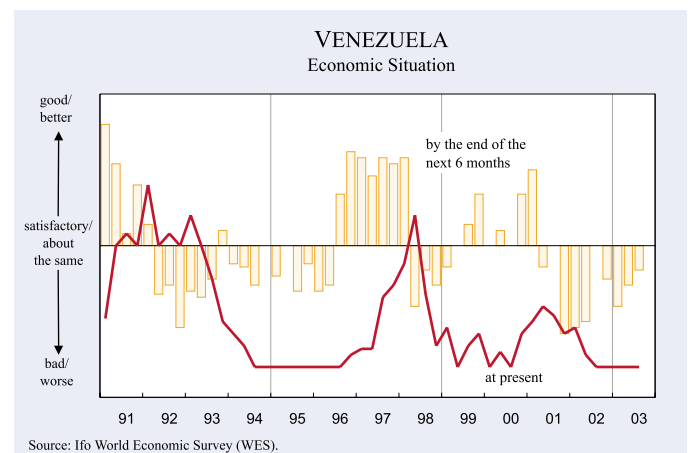
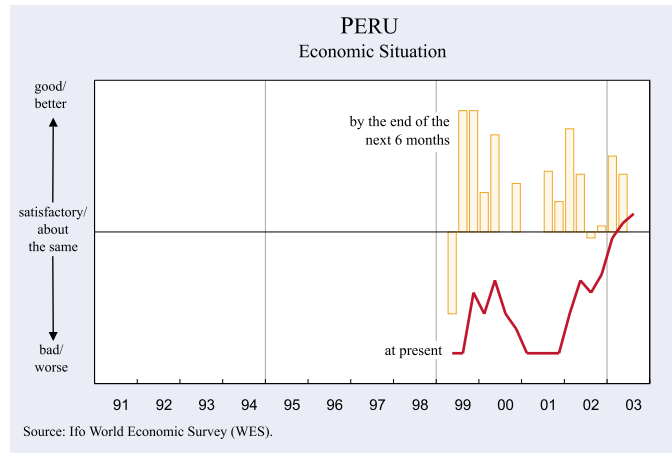
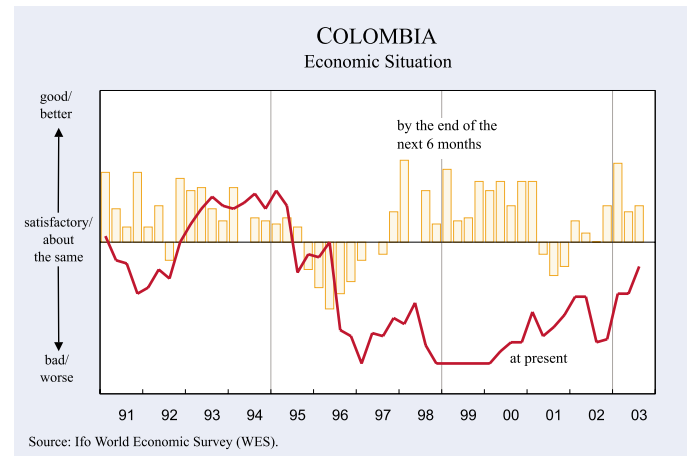
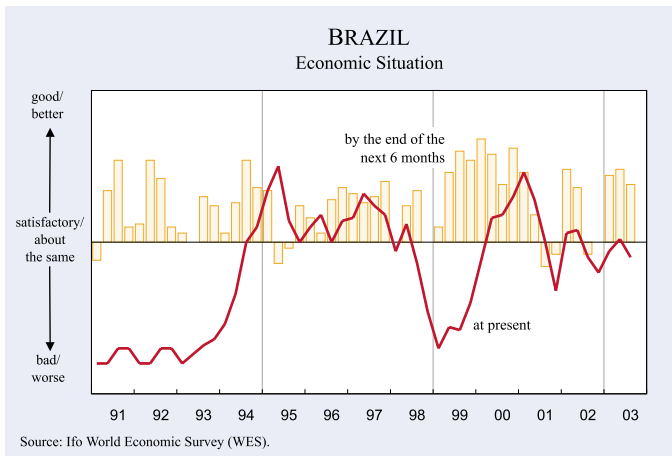
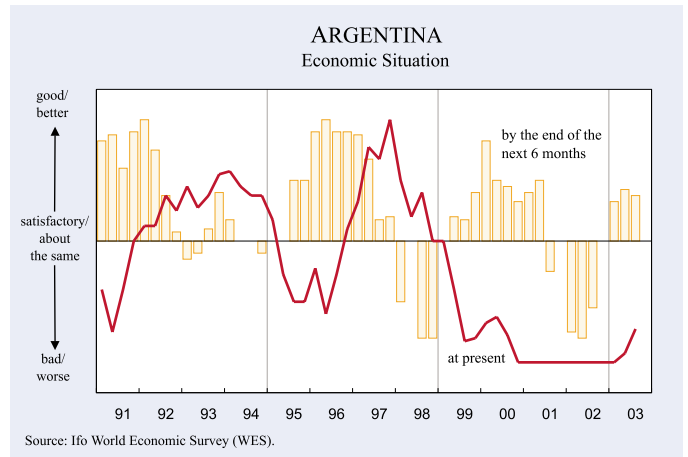
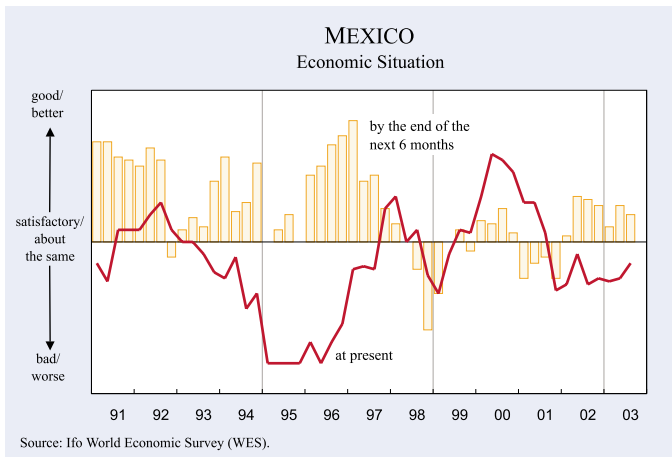


Figure 11

NEAR EAST AND AFRICA

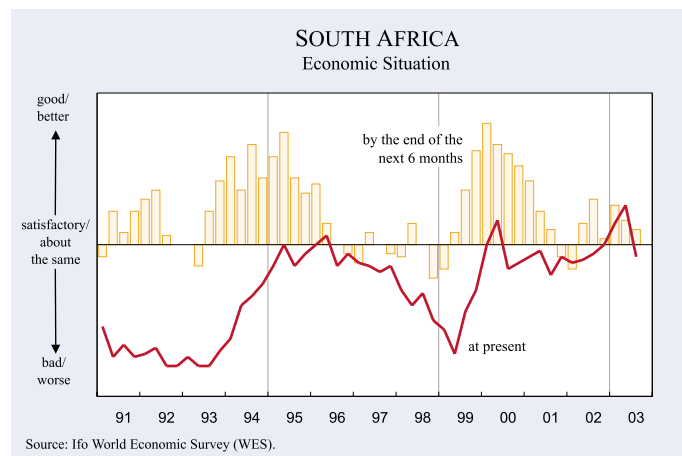
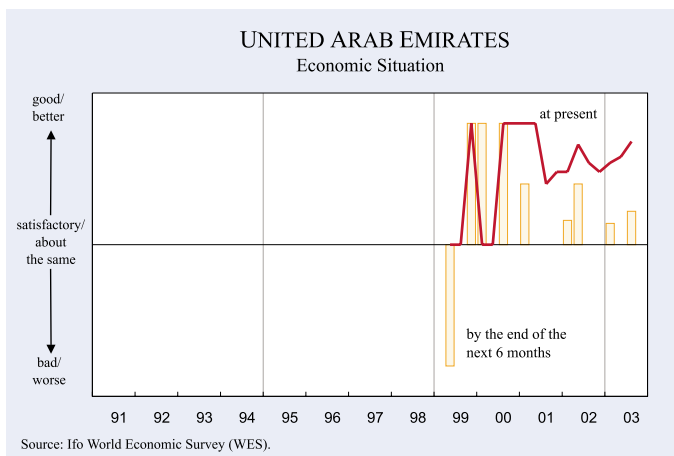
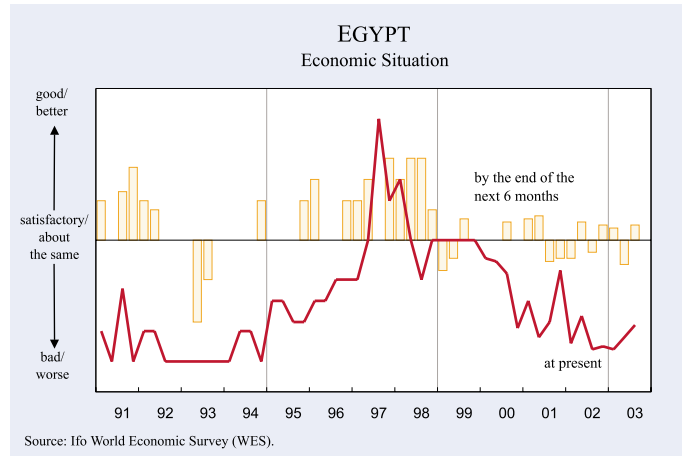
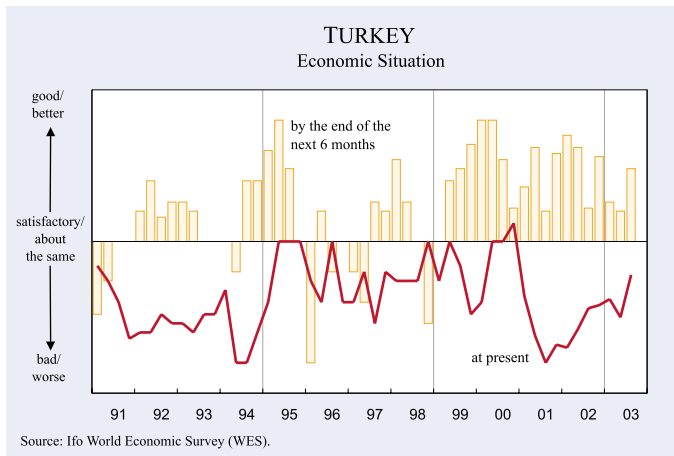
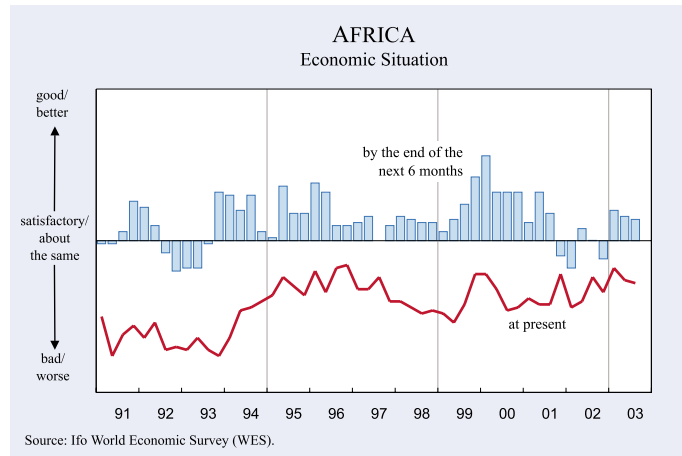
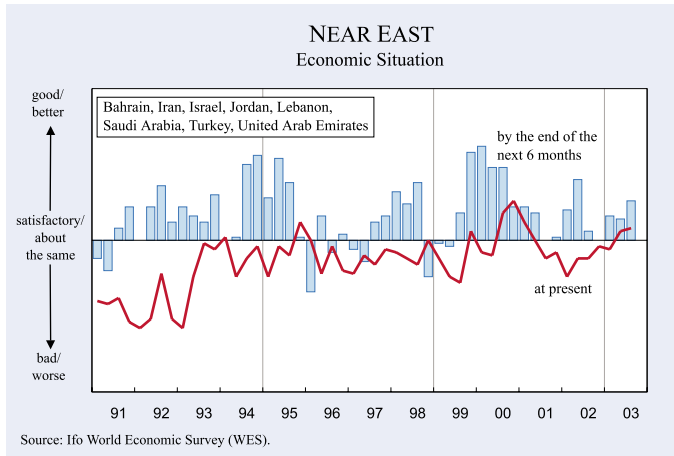


Table 2

Assessment of the Importance of the Following Factors Influencing the Climate for Foreign Investors in the Concerned Country *

Region	legal / administrative restrictions	political instability	Region	legal / administrative restrictions	political instability
WESTERN EUROPE			ASIA		
AUSTRIA	8,3	7,8	CHINA P.R.	2,2	5,3
BELGIUM	6,1	6,1	HONG KONG	8,3	5,0
CYPRUS	6,3	6,3	INDIA	3,6	5,2
DENMARK	7,7	8,1	INDONESIA	3,5	2,5
FINLAND	7,6	7,8	JAPAN	6,8	6,8
FRANCE	5,4	7,4	KOREA	4,7	3,0
GERMANY	5,7	7,4	MALAYSIA	5,0	5,8
GREECE	4,8	7,5	PAKISTAN	4,7	2,5
IRELAND	5,0	6,5	PHILIPPINES	1,8	2,6
ITALY	6,0	5,5	SINGAPORE	6,3	8,3
NETHERLANDS	6,9	8,0	SRI LANKA	4,2	1,8
NORWAY	5,0	6,7	TAIWAN R.O.C.	5,0	3,7
PORTUGAL	6,3	8,2	THAILAND	4,5	6,0
SPAIN	6,9	7,8	VIETNAM	2,5	6,5
SWEDEN	6,3	6,6	CENTRAL & LATIN AMERICA		
SWITZERLAND	7,2	8,0	ARGENTINA	3,2	2,5
UNITED KINGDOM	7,3	8,1	BOLIVIA	7,0	2,0
CENTRAL & EASTERN EUROPE			BRAZIL	5,0	5,5
ALBANIA	2,6	2,2	CHILE	7,2	7,8
BULGARIA	5,4	4,8	COLOMBIA	5,0	3,8
CROATIA	5,0	5,0	COSTA RICA	5,0	5,0
CZECH REPUBLIC	6,7	5,9	ECUADOR	4,0	2,0
ESTONIA	8,0	8,0	MEXICO	5,5	6,0
HUNGARY	6,0	6,0	PANAMA	5,0	5,0
LATVIA	7,0	4,3	PARAGUAY	6,3	3,7
LITHUANIA	7,0	7,2	PERU	5,2	2,0
POLAND	2,6	3,6	URUGUAY	9,0	8,0
ROMANIA	5,0	6,8	VENEZUELA	1,0	1,0
SERBIA AND MONTENEGF	3,9	2,7	NEAR EAST		
SLOVENIA	5,0	8,0	BAHRAIN	5,0	6,3
SLOWAKIA	6,1	5,0	IRAN	3,7	3,7
NORTH AMERICA			ISRAEL	6,5	1,7
CANADA	5,0	8,0	JORDAN	5,0	5,8
UNITED STATES	6,1	7,5	KUWAIT	5,0	9,0
OCEANIA			LEBANON	9,0	1,0
AUSTRALIA	5,9	7,9	SAUDI ARABIA	4,0	5,0
NEW ZEALAND	5,3	7,0	TURKEY	5,4	4,5
CIS			UNITED ARAB EMIRA	7,3	7,9
RUSSIA	2,9	4,7	AFRICA		
UKRAINE	4,0	2,0	EGYPT	2,2	4,6
			GHANA	-	-
			KENYA	3,4	3,4
			NIGERIA	5,0	3,0
			SOUTH AFRICA	4,5	6,5
			ZIMBABWE	2,0	1,0

* WES scale: 1 - high; 5 - low; 9 - absent

(Only countries were included in the evaluation that had three or more participants in the WES QIII/2003)

Source: Ifo World Economic Survey (WES), QIII/2003.

in the case of the *British pound sterling*. The *US dollar* appears to be undervalued for the first time in about five years. The current level of the *Japanese yen* is assessed as more or less appropriate, with a small bias toward an undervaluation (see Figure 4).

The perceived overvaluation of the *euro* is a widespread phenomenon, particularly pronounced in Northern America and CIS countries. The *US dollar* is seen as undervalued against own currencies particularly in Western and Eastern Europe as well

as in Latin America. The own currency appears to be generally undervalued in Canada, Australia, New Zealand, Estonia, Latvia, Serbia and Montenegro, Saudi Arabia and Colombia. On the other hand the own currency is seen as generally overvalued particularly in Venezuela, Nigeria, Turkey and again most pronounced in Zimbabwe.

In addition to the general assessment, WES experts have again been asked about the likely trend of the *US dollar exchange rate* in the next six months. On average for all 91 countries included, the *US dollar*

Table 3

Assessment of the Following Factors Influencing the Climate for Foreign Investors by the End of 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	—	China, Cyprus, India, Iran, Israel, Jordan, Korea Rep., Malaysia, Portugal, Slovenia, Slovakia, Serbia and Montenegro, Paraguay, Taiwan, Turkey, Uruguay
Political instability	Albania, Philippines, Indonesia, Venezuela, Zimbabwe	Belgium, Colombia, Cyprus, Israel, Jordan, Korea Rep., Paraguay, Serbia and Montenegro, Turkey, Uruguay

In those countries, not mentioned in the table the climate for foreign investors is expected to remain unchanged during the next 6 months

* **Criteria for selection of countries:** Deterioration: WES grade between **1** and **3.5**
Improvement: WES grade between **6.0** and **9**

(Only countries were included in the evaluation that had three or more participants in the WES QIII/2003)

Source: Ifo World Economic Survey (WES), QIII/2003

is expected to gain somewhat in value. The main exceptions from this general trend are mainly Australia and New Zealand as well as Norway.

Assessment of factors influencing the climate for foreign direct investment

Table 2 contains information on the current *assessment of legal/administrative restrictions* and *political instability* from the viewpoint of a foreign investor for the full list of countries covered in the July survey, excluding only those countries where the number of participants is below three. In Table 3 only those countries with expected significant changes concerning the two assessed factors influencing the attractiveness for foreign investment are presented.

**Special Question:
Impact of SARS on business sentiment**

SARS (Severe Acute Respiratory Syndrom) is the first severe and readily transmissible new disease to threaten the globalized society. The global inter-

connectedness and mobility offers favorable conditions for both, the devastating spread but also the solidarity in containment. SARS had its origin in southern China and spread internationally. From 1 November 2002 to 11 July 2003, some 8,437 cases with 813 deaths were reported by the WHO², showing an overall case fatality in the range of 14% to 15% and exceeding 50% in persons over the age of 65. Around the beginning of May, more than 200 new cases from 30 countries were being reported each day. However, the global outbreak, at least in the initial phase, has clearly come under control, and starting with 14 July, WHO no longer daily publishes the numbers of reported, probable cases of SARS.

The special question asked in the July poll focused on the impact of SARS on business sentiment worldwide. The question was divided into three parts: The first dealt with the *impact of SARS on economic growth in the respective country*. The second part focused on changes in business behavior, in particular, *reductions of business travel as a*

² Source: Materials on the website on SARS of the World Health Organization – WHO, August 2003: <http://www.who.int/csr/sars/en/index.html>

result of SARS. The third part assessed whether the SARS epidemic will have a negative impact on business relationships or foreign direct investments in countries affected by the epidemic.

1. What has been the impact of SARS on economic growth in your country?

Some 46% of 1,117 experts polled in 91 countries consider that SARS had an impact on economic growth in their country: 8% of all participants worldwide see a severe or very severe and 38% a slight impact of SARS on business in their countries. Of course, the share of participants that see the economic growth of their country affected by the disease outbreak is particularly pronounced in regions with the highest ratio of reported cases. So in Asia, Oceania and North America the overwhelming majority of experts polled expect a slight (58% in Asia, 76% in Oceania and 52% in North America) or a severe and very severe impact (30% in Asia, 10% in Oceania and 26% in North America) from the epidemic on the economic growth in their countries (see Figure 12). Country break downs show that experts in Hong Kong (75%), followed by China (54%) and Canada (53%) see economic growth in their countries severely affected by the disease outbreak. In Singapore, all six experts polled held to the opinion that the impact of SARS on economic growth was severe or very severe. But

Figure 12

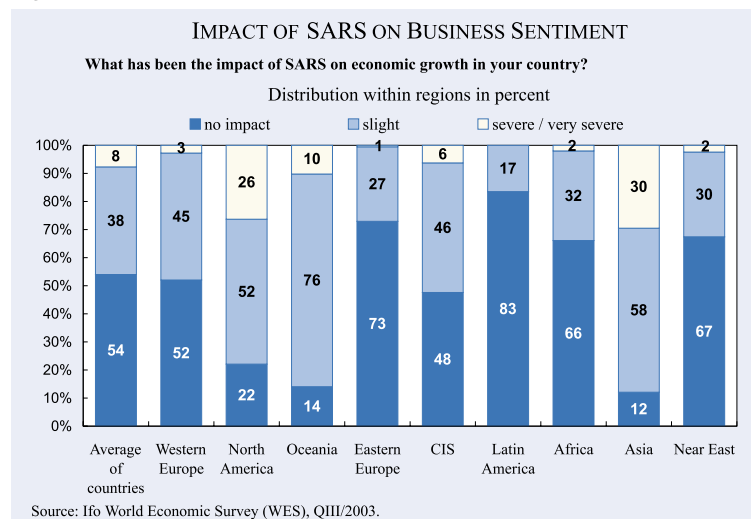
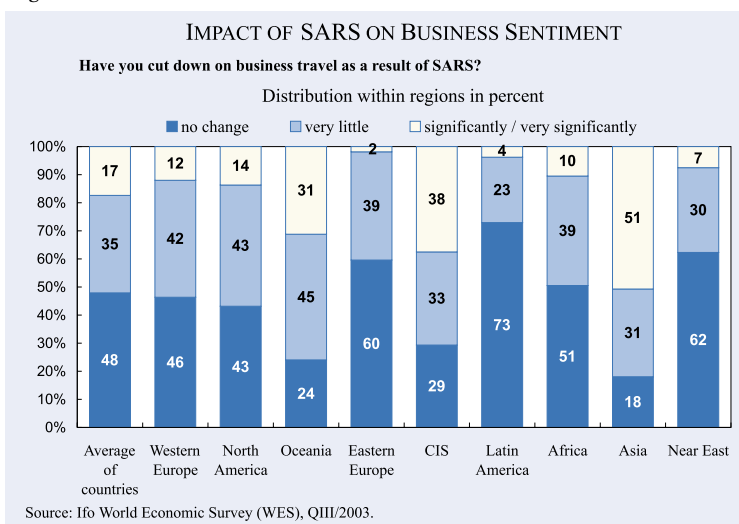


Figure 13



also in some countries with relatively few SARS cases, WES experts have seen an impact on growth; in Australia, for example, where the WHO reported six SARS victims, 12 of 15 WES experts think that SARS has a slight and two experts see a severe or very severe impact on economic growth. Also in some Western European countries, in particular Belgium, Finland, Sweden, Switzerland and Italy, about 75% of experts polled expect a slight impact of SARS on their countries' economy.

2. Have you cut down on business travel as a result of SARS?

SARS has shown a clear capacity for spreading with international air travel. Thus, every country with an international airport, or bordering an area having local transmission, has a potential risk of an outbreak. As SARS has been brought to defeat by the consequent application of centuries-old control measures – isolation, contact tracing and travel restrictions – the business traffic has also been affected by the outbreak.

17% of 1,117 experts polled all over the world have significantly or very significantly cut down on business travel as a result of SARS. In Asia 51% of all experts polled in the July survey reduced their business travel significantly and 31% a little (see Figure 13). Similar results were produced by a survey conducted by the German Chamber

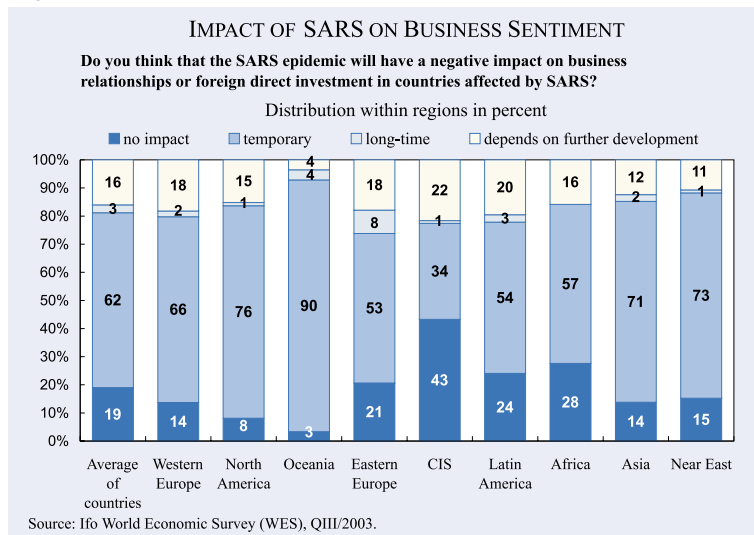
of Commerce (Deutscher Industrie und Handelstag – DIHK) among German enterprises with representative entities in SARS-affected countries (China, Hong Kong, Malaysia, Singapore, Taiwan, Thailand, Vietnam and Canada).³ About 84% of polled enterprises minimized or completely cut business travel. Unfortunately, only 20% were able to substitute the reduced mobility by other ways of communication (e-mail, phone, and fax).

Both survey data suggest that the recent disease outbreak had a considerable impact on international business activity worldwide. However, preventative measures to avoid transmission of the disease via trans-border traffic were differently applied from region to region. Russia, for example, totally closed the majority of border crossing points to China and Mongolia during the outbreak. The authorities in Kazakhstan even prohibited citizens from leaving for China. This although no SARS cases were reported by the WHO, either in Russia or in Kazakhstan. Other countries relied predominantly on health controls, like measuring for fever of passengers arriving in airports.

3. Do you think that the SARS epidemic will have a negative impact on business relationships or foreign direct investments in countries affected by SARS?

The third part of the special question referred to the psychological impact of SARS on business relationships and international co-operation. Only 19% of 1,117 experts see no impact of the epidemic on business relationships to countries affected by SARS. The vast majority (62%) expects only a temporary impact on investment activity, and 16% think that the scope of international investment in affected regions will depend on further developments (see Figure 14). Particularly in Eastern Europe, practically not affected by the epidemic at all, a relatively large share of participants (8%) expects a long-time impact of SARS on foreign direct investment (FDI) in regions, strongly hit by the epidemic. This opinion most likely

Figure 14



derives from the competitive advantage that Eastern European experts now see, as the safety risk added by SARS (as well as the terrorist threats) does not apply for their region. However, according to the DIHK survey, the majority of German enterprises with representative entities in SARS-affected countries will abide by their investments plans, but 38% have delayed business decisions until the situation becomes clearer and 12% plan to review their investment plans for these countries.

To draw conclusions about the impact of SARS on the global economy, it is crucial to know whether SARS will return as many other respiratory diseases return when the season turns colder. The dramatic reduction in the number of cases is, according to the WHO, not a “natural phenomenon” but a result of high-level political commitment, of monumental efforts on the part health care staff and responsible reporting in the media. The outbreak demonstrated that even an advanced public health system can turn out to be defenseless, as failure to detect and to manage disease threats in any country can put many lives worldwide at risk. Therefore preventative measures are needed that would strengthen public health systems, in particular in countries mostly affected by disease outbreaks, as SARS is only one of around 50 internationally important outbreaks to that WHO has annually to respond. Thus, SARS was a somber reminder of the urgent need of international co-operation not only in terms of business but also human responsibility.

³ Source: Deutscher Industrie und Handelstag (DIHK): „DIHK-Blitzumfrage: SARS hinterlässt Spuren – dennoch: kein Grund zur Panik“, 27.05.03, http://www.dihk.de/inhalt/download/blitzumfrage_sars.doc



Economic Studies

Formerly *ifo Studien*

Vol. 49, No. 2/2003

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CRISES?**

JÖN DANIELSSON
London School of Economics

**ON THE FEASIBILITY OF RISK BASED
REGULATION**

CLAUDIO BORIO
Bank of International Settlements, Basel

**A FRAMEWORK FOR FINANCIAL
SUPERVISION AND REGULATION**

MISA TANAKA
University of Oxford

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OF THE NEW BASEL ACCORD**

HANS GERSBACH, JAN WENZELBURGER
University of Heidelberg, University of Bielefeld

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A MACROECONOMIC PERSPECTIVE**

MARC QUINTYN, MICHAEL W. TAYLOR
International Monetary Fund

**REGULATORY AND SUPERVISORY INDE-
PENDENCE AND FINANCIAL STABILITY**

DICE REPORT

Journal for Institutional Comparisons

VOLUME 1, No.2

SUMMER 2003

	Forum
LABOUR MARKET INSTITUTIONS AND UNEMPLOYMENT	Michèle Belot Jan C. Van Ours Lars Ljungqvist Stephen Nickell Ronald Schettkat Franz Traxler
	Research Reports
EVASION OF VALUE-ADDED TAXES	Andrea Gebauer/ Rüdiger Parsche
TAXES AND FDI	Andreas Haufler/ Sven Stöwhase
DEPRECIATION RULES AND INVESTMENT	Chang Woon Nam/ Doina Maria Radulescu
	Reform Models
WELFARE TO WORK IN THE UK	Wolfgang Ochel
	Database
LABOUR DISPUTE RULES FISCAL MONITORING PARENTING: A WORK CONSTRAINT WAITING FOR SURGICAL OPERATIONS EDUCATIONAL POLICY PUBLIC DEBT	
	News
NEW REPORTS ON REGULATIONS CONFERENCES	



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