

CESifo WORLD ECONOMIC SURVEY

VOLUME 4, No. 3

AUGUST 2005

WORLD ECONOMIC CLIMATE

World Economic Climate stabilizes

ECONOMIC EXPECTATIONS

Assessments of current economic situation slightly downgraded, economic expectations somewhat more positive

INFLATION

Stable rate expected in 2005

INTEREST RATES

Trend of rising rates will level off

CURRENCIES

Euro seen to a lesser degree as overvalued

SPECIAL TOPIC

The role of the Internet

All time series presented in this document
plus additional series for about 80 countries
may be ordered from the Ifo Institute.
For further information please contact
Mrs. Stallhofer (stallhofer@ifo.de)

For further information apply to:

Anna Stangl, e-mail stangl@ifo.de
(Responsible for statistical processing and analysis)

Dr. Gernot Nerb, e-mail nerb@ifo.de
(Head of Industry Branch Research)

CESifo World Economic Survey ISSN 1613-6012

A quarterly publication on the world economic climate

Publisher and distributor: Ifo Institute for Economic Research

Poschingerstr. 5, D-81679 Munich, Germany

Telephone ++49 89 9224-0, Telefax ++49 89 9224-1463, e-mail ifo@ifo.de

Annual subscription rate: € 40.00

Editor: Dr. Gernot Nerb, e-mail nerb@ifo.de

Reproduction permitted only if source is stated and copy is sent to the Ifo Institute

Ifo World Economic Survey

Regions

- World economy: Stabilization at a favourable level
- Western Europe: Economy shows a spark of recovery
- North America: Economic climate brightens
- Eastern Europe: Economic stabilization at a high level
- CIS: Economic climate satisfactory
- Asia: Optimistic forecasts
- Oceania: Economic decline levels off
- Latin America: Moderate economic climate remains
- Near East: Economic climate remains favourable
- Africa: Diverging economic trends predominate

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 2005 some 1,051 economic experts in 95 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 ECONOMY: WORLD ECONOMIC CLIMATE STABILIZES

In July 2005 the World Economic Climate stabilized at a still favourable level despite a year of economic cooling (see Figure 1). The climate indicator stands at 97.5 (1995=100), still higher than its long-term average (1990–2004: 94.0). However, the two components of the economic climate index show a divergent pattern: while the assessments of the current economic situation have continued to deteriorate, the expectations for the coming six months have been upgraded somewhat (see Figure 2).

World economy: Stabilization on a favourable level

By mid 2004 the world economy entered a cooling-down phase. On average for 2004 the world economy still managed a growth rate of around 5 percent during the year, according to IMF figures, its fastest rate for almost thirty years. The steep path of global economic growth was led by very high growth in China and other Asian countries as well as in the biggest economy of the world, the USA, and the economic revival in Japan. According to the latest survey results the economic slow-down is expected to level off in the second half of 2005. For the first time since the beginning of 2004 the economic expectations for the coming six months showed a pick-up. This seems to reconfirm earlier expectations of WES experts that the slowdown in the second half of 2004 and in the first part of 2005 will only be of a temporary nature and will be followed by some strengthening of the world economy starting around the middle of 2005.

The United States still leads the global economic expansion. However, the economic climate brightened also in Germany, the world's second largest economy by its share in the world trade, while in the euro zone, on average, it still remained sluggish. Also China's decision to revalue its currency upward had a positive impact on business sentiments (Chinese authorities

had pegged the yuan to the dollar since 1998). An improvement of both climate index components – present economic situation and economic expectations – has been also reported in Japan.

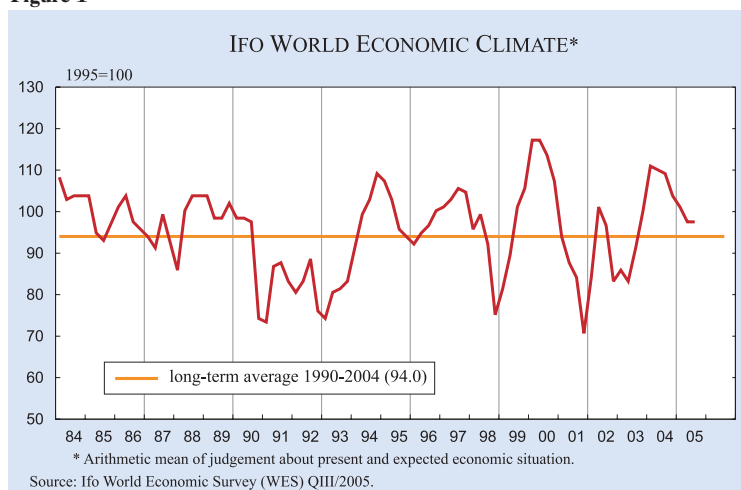
However, this overall positive picture was overshadowed by the recent terror threats in London, Egypt and Turkey. Though the terror seems to pose no threat to the health of the global economy, the fear of terror remains a drag on business sentiments.

Western Europe: Economy shows some sparks of recovery

Growth in Western Europe has lagged behind America and most other countries for a long time (see Figures 3 and 4). The overall economic climate indicator slipped again in July, on average of the Western European countries covered by the survey. However, the deterioration of the climate index results only from the less positive assessments of the present economic situation, while the economic expectations for the coming six months brightened somewhat. However, a breakdown of the data confirmed diverging trends among euro zone economies, revealing some economic bright spots.

In the two biggest economies of the euro zone – Germany and France – both the assessments of the

Figure 1

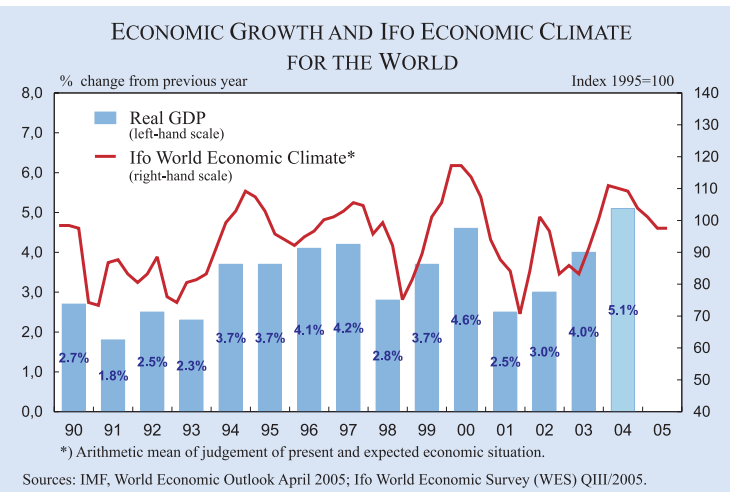


Box 1

World Economic Survey (WES) and GDP Growth in the World Economy

The Ifo World Economic Climate 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 1,051 experts. As a rule, the trend of the Ifo Economic Climate indicator correlates well with the actual business-cycle trend measured in annual growth rates of real GDP (see Figure).

The indicator for the Ifo World Economic Climate stabilized in July at the level of the April survey, after having fallen five times in succession. More favourable expectations for the coming six months were offset by again worsened assessments of the current economic situation. This confirms the impression that the slowdown in world economic growth since mid-2004 is a temporary disturbance and not the beginning of a decline in world-wide economic activity. In the course of the second half of 2005, a further revival of the world economy is expected, according to the WES results.



present economic situation as well as economic expectations improved over the previous April survey. The economic growth in *Germany*, the euro zone's biggest economy, is again primarily due to a pick-up in exports while private consumption remained weak. However, WES experts forecast that private consumption and the investment sectors will strengthen in the second half of the year, while

Belgium, Portugal and Italy. However, the economic expectations for the coming six months point to some economic stabilization in all these countries.

In the Western European countries beyond the euro zone, the economic climate index further improved only in *Norway* due to more positive assessments of the present economic situation. In *Denmark, Sweden*

and *Switzerland* both components of the climate index, assessments of the present economic situation as well as expectations for the coming six month, have been downgraded, though they remained above satisfactory. In the *United Kingdom*, economic growth was also subdued in the first half of the year, according to WES experts. The expectations for the second half of the year were rather cautious here, with household spending and business investment foreseen to decline.

Figure 2

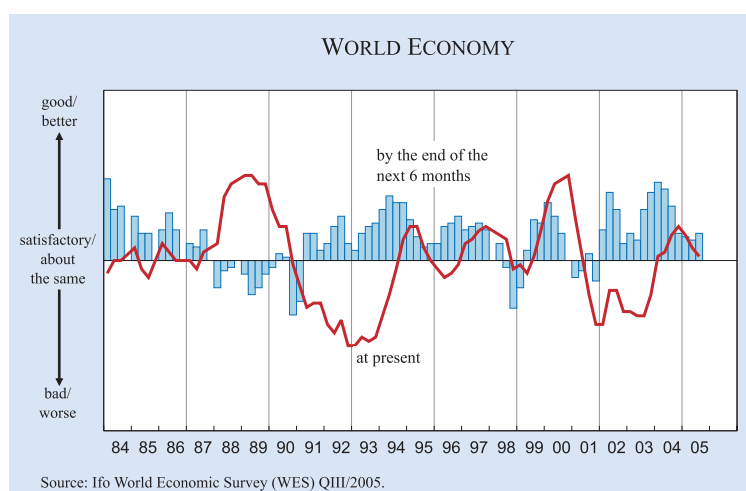
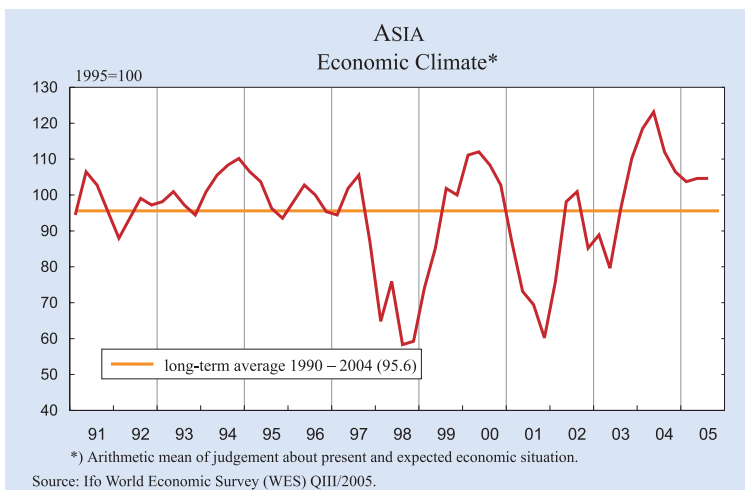
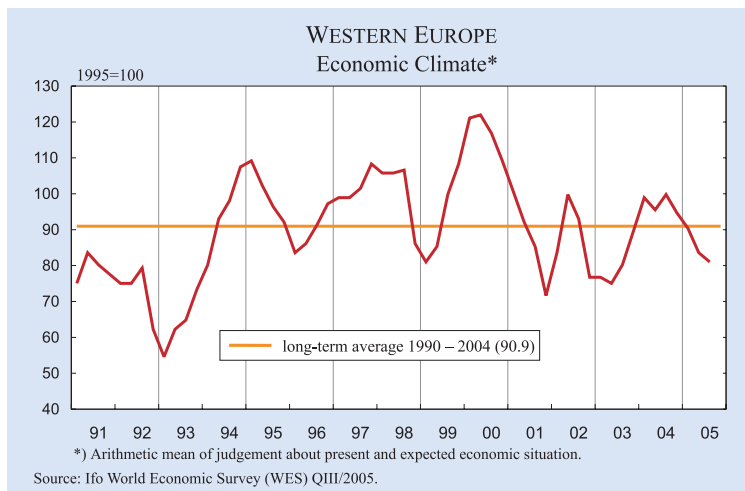
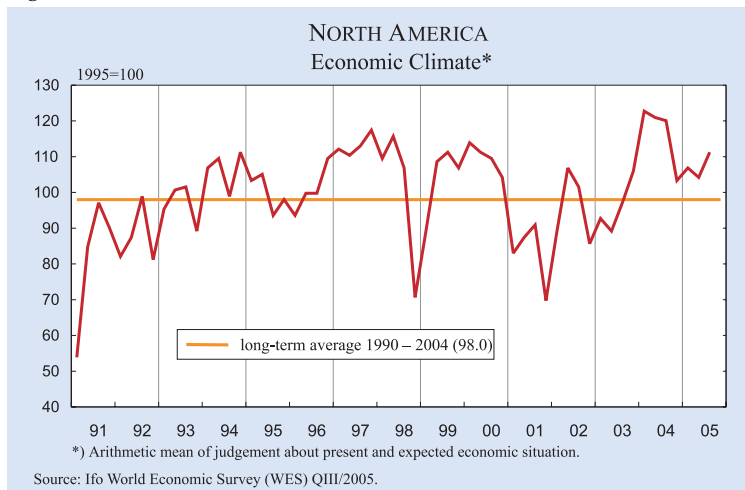


Figure 3



North America: Economic climate brightens

According to the latest survey results, the economic climate indicator in North America brightened in July (see Figures 3 and 4). In the two economies of the continent – the *US* and *Canada* – the improvement of the climate index was due to both

– more favourable assessments of the present economic performance as well as more optimistic expectations for the coming six months. In both countries WES experts reported that consumer spending is expected to stabilize at the current high level. Also business fixed investment has been assessed as highly favourable, bearing even more potential for further growth. The outlook for exports remained very bright as well in both economies. Despite surging energy costs and the huge US trade deficit that is mainly seen as a result of the lack of domestic saving, the favourable business climate in North America is expected to remain.

Eastern Europe: Economic stabilization

In July 2005, the overall economic climate index in Central and Eastern Europe declined slightly, with the assessments of the current economic situation deteriorating somewhat and the economic expectations for the coming six months remaining favourable (see Figure 4 and Figure 6).

In all the eight new EU members (*Poland, Hungary, Czech Republic, Slovakia, Slovenia, Estonia, Lithuania* and *Latvia*) the present economic situation was again rated above the satisfactory level in July. However, an improvement of the economic climate was only reported from the surveyed experts in *Estonia* and *Latvia*.

Among the other countries, the assessments of the present economic situation improved only in the *Czech Republic*. However, the near-term prospects remained generally positive in all new EU members, except *Slovenia*.

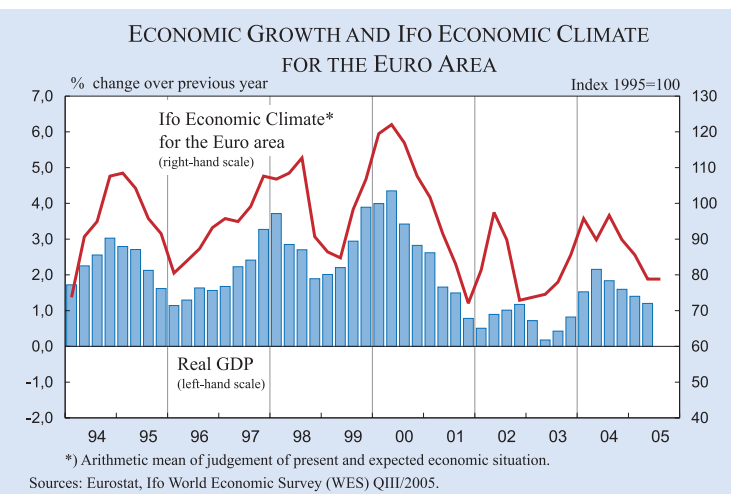
Box 2

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 275 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 Economic Climate indicator for the euro area remained stable in July 2005 after having fallen three times in succession. While the assessments of the current economic situation continued to worsen, the expectations for the coming six months improved.

The economy of Ireland continues to hold the top position in the appraisals of the WES experts: The assessments of the current economic situation here reached the highest possible level on the WES scale. The already positive expectations also improved. Except for Ireland the macroeconomic situation is viewed positively only in Finland and Spain. In Austria, Greece and Luxembourg, the present economic situation was at least considered to be satisfactory. For the first time in many months, the judgments of the current economic situation improved somewhat also in Germany and France, and the economic expectations for the next six months also brightened. But despite these positive results, the economic climate in both countries is still in negative territory, according to the WES survey experts. The same applies to Belgium and even more so to the Netherlands, Italy and Portugal.



In the Eastern European countries outside the EU, the present economic situation was assessed as above satisfactory in *Albania*, *Bulgaria* and *Romania*. The economic expectations for the coming six months point to further stabilization in all three countries. In *Croatia* and *Serbia* and *Montenegro* the present economic situation was seen less positively than in April. However, the polled experts expect a turnaround in the coming six months. A less optimistic picture was drawn by experts in *Bosnia-Herzegovina*.

CIS: Economic climate satisfactory

The economic climate index slipped in *Russia*, according to the recent WES results. However, both components – present economic situation and

expectations – remained above the satisfactory level. While oil is still very important, *Russia's* economy has been stimulated by buoyant private consumption which is expected to fuel economic growth also in the remaining months of the year. A highly favourable economic climate has been reported again for *Kazakhstan*. With regard to future economic development, the participants remained fairly confident. According to the surveyed experts in the *Ukraine*, economic developments after the “Orange Revolution” took a positive direction: the present economic performance in July has been assessed again as satisfactory. For the coming six months economists forecast further stabilization. However, while President Yushchenko's government has been successful in its first six months in office in some political areas, it is still facing challenges in economic terms. Particularly the enterprises' fixed investments have been described as weak and no turnaround is expected by the surveyed experts in the near-term.

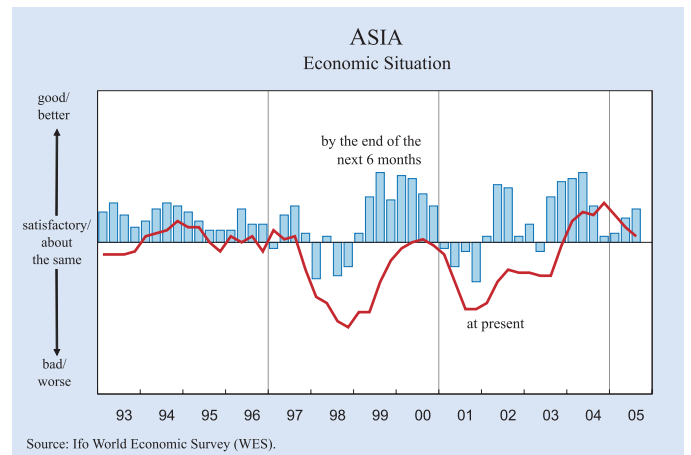
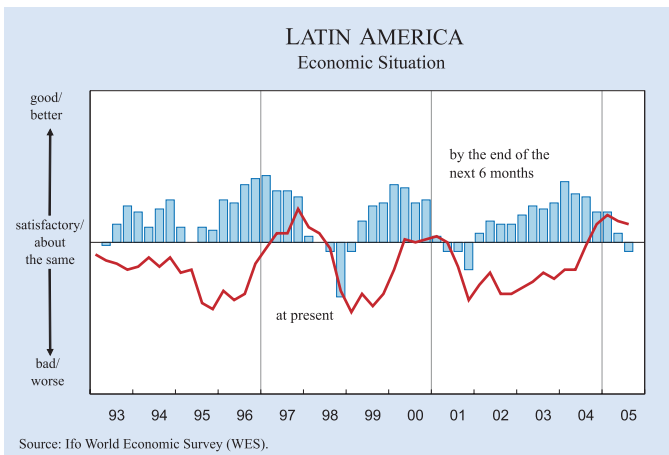
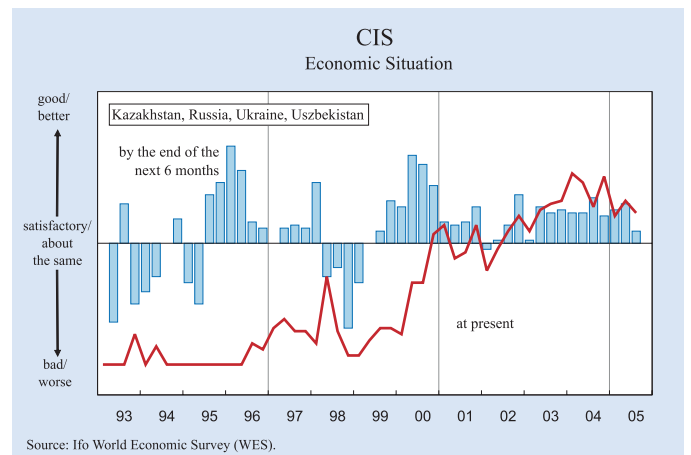
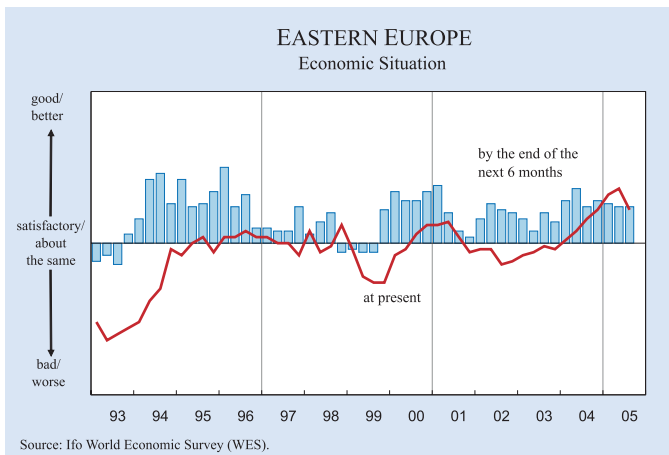
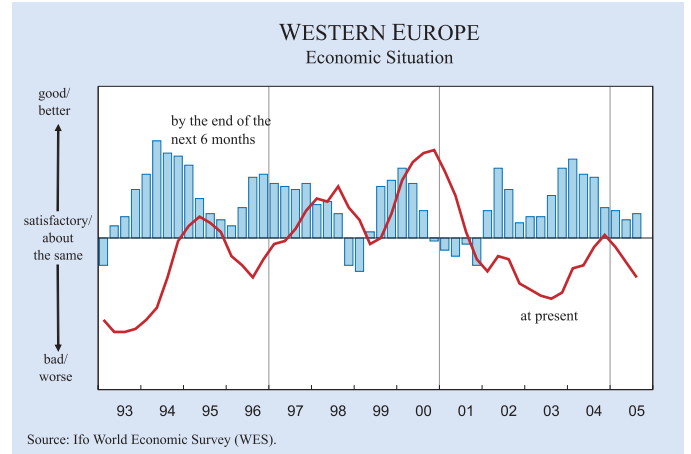
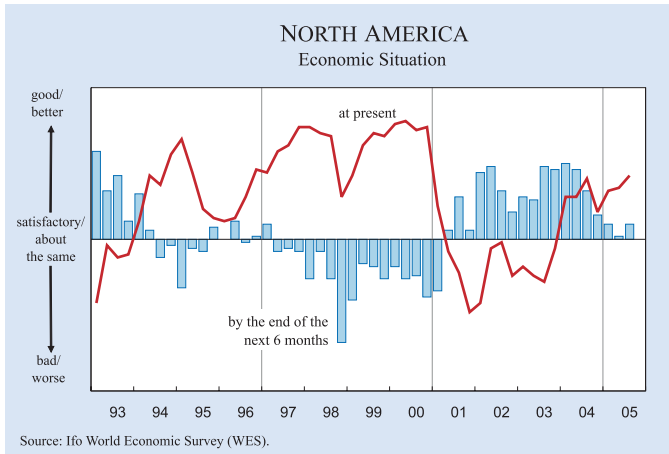
Asia: Optimistic forecasts

According to the July survey results, the economic climate in Asia remained unchanged at a favourable level, compared to the preceding April survey. However, only the economic expectations for the coming six months continued to improve, while the assessments of the present economic situation have been again slightly downgraded. But this pattern doesn't apply to all countries surveyed in the region.

Japan's economy in particular seems to have strengthened in the third quarter of 2005: both components of the economic climate indicator bounced back in July after the spring lull. Corporate and consumer spending are foreseen to strengthen in coming months. More favourable assessments of the present

Figure 4

SELECTED REGIONS



economic situation were also given by the surveyed experts in *China*, where business sentiments are expected to stabilize further in the coming six months. *China's* economy is very open to the rest of the world, in terms of trade and foreign direct investment. However, it is worth pointing out that over the past decade, *China's* imports have risen at the same pace as its exports, thus giving a boost to other economies worldwide. For the coming six months experts expect this trend to continue, while growth of exports is expected to be dampened somewhat as a result of revaluation of the yuan against the dollar (though some economists expect that the recent 2 percent revaluation of the yuan will be absorbed by Chinese manufacturers, diminishing their profit margins, and not be passed on export prices). *India*, Asia's fourth-largest economy, topped again the list of the best performing economies with regards to business sentiments. *India's* economy has grown since the 1990s more quickly (at about 7 percent) than any other major economy apart from *China's*, fuelling not only the global supply but also the global demand. The present economic situation was assessed with the highest possible marks, and the prospects for the second half of 2005 point to further improvement. Also here the surveyed economists expect imports to rise stronger than exports in the course of 2005. A moderate improvement of the assessments of the present economic performance has been also reported for *South Korea*. The marks have not yet reached the satisfactory level, but the polled economists expect that the economy will hold to the recovery in the course of the second half of 2005. Above the satisfactory level though somewhat lower than in the preceding April survey were the assessments of the present economic state in *Hong Kong, Malaysia, Pakistan, Singapore* and *Vietnam*. In all these countries experts expect stabilization on the currently still favourable level in the course of the coming six months. In *Bangladesh, Indonesia, Philippines, Taiwan* and *Thailand* the marks for the present economic situation fall below the satisfactory line. While in *Bangladesh, Indonesia* and *Taiwan* experts were optimistic with regard to an economic recovery in 2005, a less positive scenario was given by the polled economists in the *Philippines, Sri Lanka* and *Thailand* (see Figure 7).

Oceania: Economic decline levels off

Australia witnessed a profoundly positive economic performance during the last five years. However, at

the end of 2004 the economic climate index entered a cooling down phase, following a global economic slow-down. Growth was slowing, due to lower consumer spending and higher interest rates and oil prices. According to the latest survey results, the economic slump is expected to level off in the second half of 2005, which will lead the economy into a soft-landing. The export sector is expected to strengthen further, driven by increased exports of commodities, which make up more than 50 percent of *Australia's* exports, providing some counterbalance to the weakened private consumption sector.

In contrast, in *New Zealand* the polled experts remained cautious with regard to an early end of the current economic cooling down phase. The assessments of the present economic situation continued to deteriorate though remained clearly above the satisfactory level. The economic expectations point to further economic slow-down in the coming six months. A combination of factors is contributing to the present trough in business sentiments: higher interest rates, a slowing housing market and inflationary pressures that dampen private demand and a strong currency that hampers the export performance.

Latin America: Economic climate remains moderate

According to the latest survey results, the economic climate deteriorated somewhat in Latin America in July. Both the assessments of the current economic situation and economic expectations have been slightly downgraded since the April survey (see Figure 4). However, both components of the economic climate index remained at the favourable level.

Chile leads Latin America in growth; according to the Economic Commission for Latin America and the Caribbean (ECLAC) it will be the only country in Latin America with GDP growth rates higher than 5 percent. The country's present economic situation was assessed as highly favourable and WES experts' expectations for the near-term future remained confident. *Chile's* positive forecast reflects the country's solid economy, with rising exports, strong capital expenditures and private consumption and the growing number of foreign investments being made in the country. The economic situation further improved in *Argentina*, according to the surveyed experts. Here, the near-term prospects also remained highly optimistic. A similarly positive picture was drawn by the

Table 1**Legal and Administrative Restrictions
for Foreign Firms**

Absent	
Tanzania	9.0
Denmark	8.2
Latvia	8.2
Finland	7.9
Sweden	7.9
Hong Kong	7.5
Peru	7.5
Hungary	7.4
United Kingdom	7.2
Ireland	7.0
Rather Low	
Portugal	6.9
Chile	6.7
Romania	6.7
Spain	6.7
Norway	6.6
Netherlands	6.6
United States	6.5
Switzerland	6.5
Austria	6.4
Estonia	6.3
Slovakia	6.3
Japan	6.2
United Arab Emirates	6.1
Lithuania	6.0
Uruguay	6.0
Belgium	5.9
Turkey	5.9
Germany	5.8
Australia	5.7
France	5.4
Serbia and Montenegro	5.4
Canada	5.3
Malaysia	5.3
Czech Republic	5.3
Bulgaria	5.3
Albania	5.0
Bolivia	5.0
El Salvador	5.0
Iran	5.0
Kazakhstan	5.0
Kenya	5.0
New Zealand	5.0
Poland	5.0
Sri Lanka	5.0
Taiwan	5.0
Brazil	4.8
Israel	4.5
Italy	4.5
Colombia	4.4
Ecuador	4.4
India	4.4
Pakistan	4.4
Thailand	4.4
China	4.1
Mexico	4.1
Greece	4.1
Saudi Arabia	4.0
Rather High	
South Africa	3.9
Slovenia	3.8
Philippines	3.7
Croatia	3.5
Argentina	3.4
Russia	3.4
South Korea	3.4
Indonesia	3.2
Costa Rica	3.0
Vietnam	2.7
Zimbabwe	2.5
Venezuela	2.3
Ukraine	2.2
Paraguay	2.0
Egypt	1.8

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

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

surveyed economists in *Peru*, where the present state of economy was assessed as highly favourable. Particularly the export sector, with traditional mining and fishing industries, is expected to strengthen further in the course of the coming six months. Also in *Uruguay* the present economic performance was assessed as far above the satisfactory level, though somewhat lower than in the preceding April survey. The outlook for the coming six month remained bright. In *Brazil*, the economic climate index slipped in July compared to the April survey. Both components of the index – present economic situation and economic expectations for the coming six months – have been downgraded somewhat. The cooling in business sentiments is most likely associated with the recent period of "political turbulence", related to a corruption scandal. However, the country's economy is still seen as strong. The present economic situation in *Mexico* stabilized at a favourable level in the first half of 2005, according to the experts polled in the country. The increase in private and corporate spending and the rise in exports are seen as the main drivers of growth. However, the near-term prospects became clouded. A more optimistic outlook on chances for economic stabilization was given by the panel in *Panama, Colombia, Costa Rica, El Salvador* and *Venezuela*. Among all surveyed countries of the region, only in *Ecuador, Bolivia* and *Paraguay* do WES experts expect no turnaround of the presently weak economic performance in the remaining months of 2005 (see Figure 8).

Near East: Economic climate remains favourable

The economic climate continues to be highly favourable in the Near East region, according to the latest survey results. Although the assessments of the current economic situation have been slightly downgraded, on average of the countries polled in the region, the near-term expectations remained very positive (see Figure 9).

According to the panel's responses, the current economic situation in *Bahrain, Kuwait, Jordan, Qatar* and the *United Arab Emirates* remained favourable. The assessments of economic performance in July were above the "satisfactory" level in all these countries. Also in *Saudi Arabia* – the country that owns the largest oil reserves in the world (estimated at a quarter of the world reserves) – both the assessments of the present economic situation and the prospects for the coming six months remained very bright, sig-

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	Albania, Argentina, Brazil, Costa Rica, Croatia, Ecuador, Israel, Mexico, Paraguay, Peru, Philippines, Taiwan, Venezuela, Zimbabwe	Australia, Austria, Chile, Denmark, Finland, Greece, Hong Kong, Ireland, Japan, Kazakhstan, Malaysia, Netherlands, Norway, Spain, Sweden, Switzerland, United Arab Emirates, United Kingdom, United States, Uruguay
Political stability	Bolivia, Colombia, Costa Rica, Mexico, Sri Lanka, Ukraine, Zimbabwe	Albania, Bulgaria, Germany, Kazakhstan, Poland, Serbia and Montenegro, United Arab Emirates

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/2005).

* **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/2005

nalling that the country's new leader King Abdullah Bin Abdulaziz will probably continue the course taken by the deceased King Fahd Bin Abdulaziz. The economy of *Turkey* also strengthened further according to the latest WES results. In 2004 the economy had reached a growth rate of 9.9 percent. Surveyed economists are fairly confident that 2005 will be the fourth consecutive year that a high growth rate is achieved. The present economic situation was assessed as satisfactory in *Iran* and *Lebanon* and further economic stabilization is forecast for the second half of 2005. The economic climate index slipped somewhat in *Israel*, according to the July survey. However, the economic expectations, though slightly downgraded, remained optimistic here as well.

Africa: Diverging economic trends predominate

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

In *South Africa* (see Figure 9) the economy has experienced steady growth over the past decade. The economic climate indicator continuously improved during 2004. In the beginning of 2005 the climate index stabilized at a highly favourable level. According to the July survey, business sentiment concerning the current economic situation has improved further and the expectations for the coming six months point to no sig-

nificant change of the currently positive economic situation. Further progress in the economic recovery process has been also reported for *Egypt* and *Kenya*. Private consumption and exports of goods, which served as a motor for the current economic recovery of *Egypt*, are expected to strengthen, according to surveyed analysts. However, the risk of bomb attacks in Red Sea resorts might have a negative impact on tourism, an important part of Egyptian exports. In *Algeria* the present economic situation has been assessed as rather poor, but the near term expectations raise hopes for betterment. In *Tunisia* the economic performance was described as currently satisfactory and is expected to stabilize further in the coming six months. Less positive signals came from the other countries surveyed in the region. In *Cote d'Ivoire*, *Mauritius*, *Morocco*, *Nigeria* and *Zimbabwe*, WES experts don't expect any considerable improvement of the present low economic performance in 2005.

2005: No change of inflation rate expected

As in the previous survey in April consumer price inflation (CPI) in 2005 is expected to stay at 2.9 percent on the world-wide average, which is exactly the rate registered in 2004. Thus, there is no sign or a pick-up of inflation in the world economy despite significantly higher oil prices (see Table 3).

In the *euro area* the inflation outlook for 2005 remains identical with the 2004 inflation rate (2.0 percent) and is also unchanged from the estimate in the first two

Figure 5a

EUROPEAN UNION

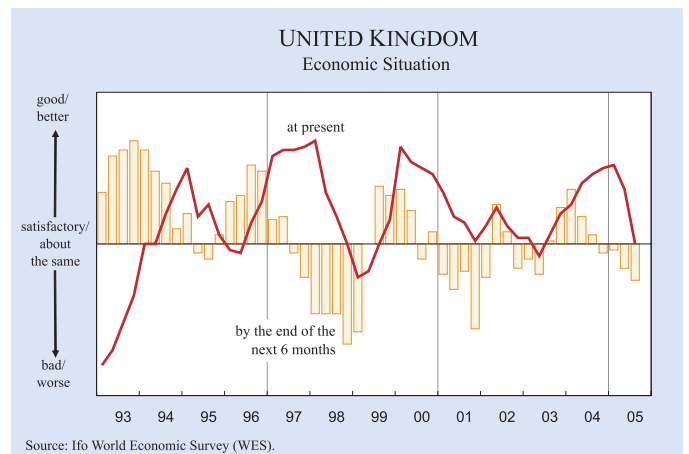
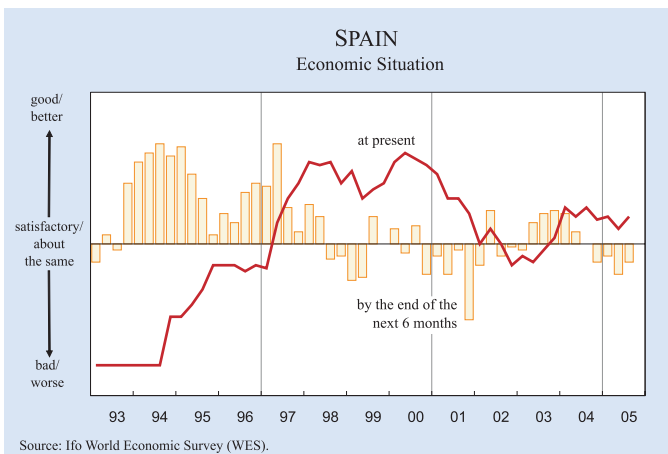
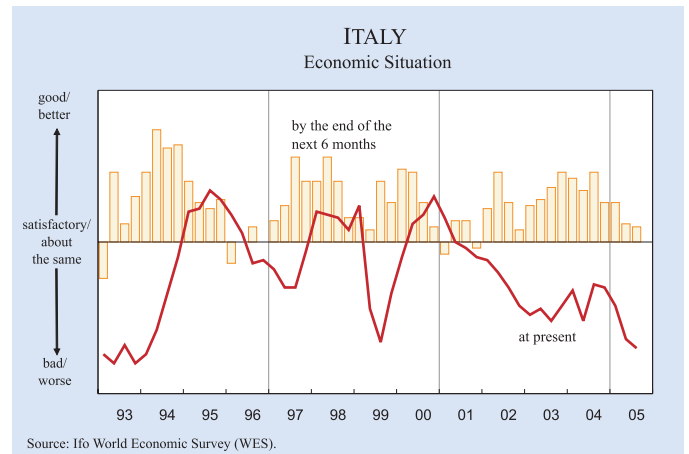
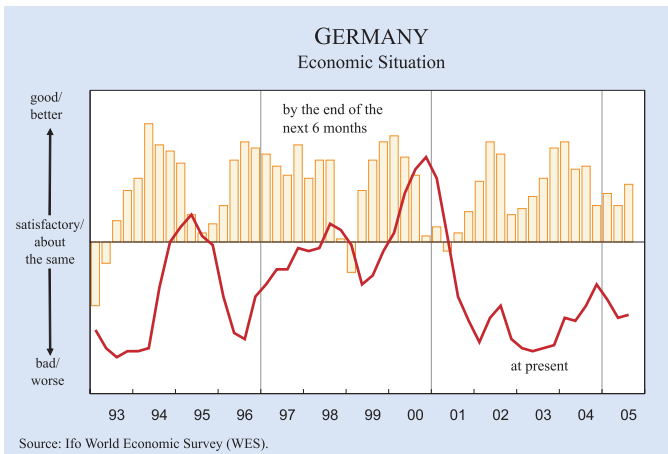
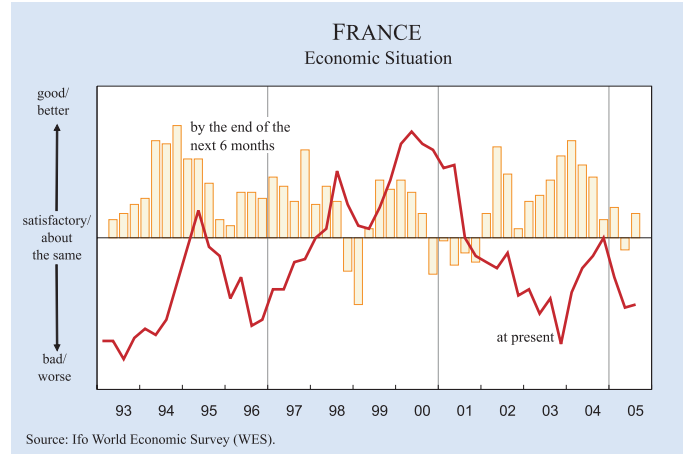
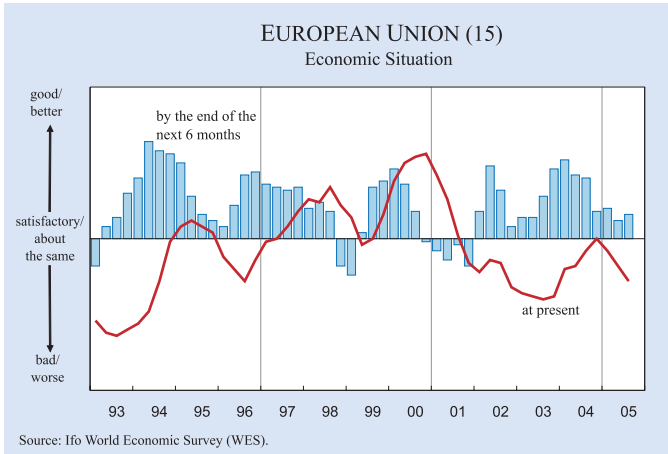


Figure 5b

EUROPEAN UNION

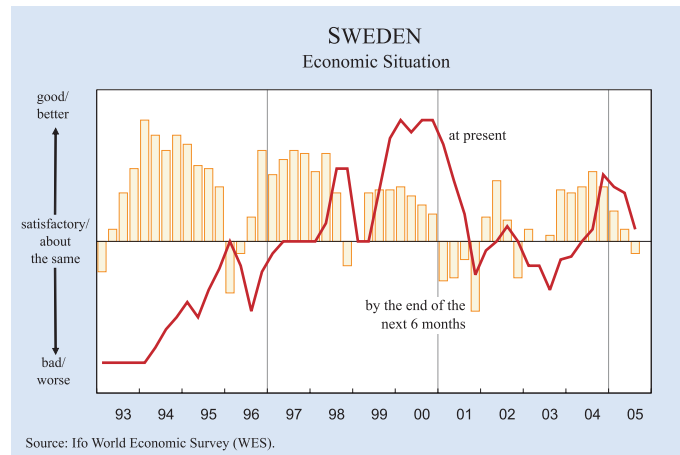
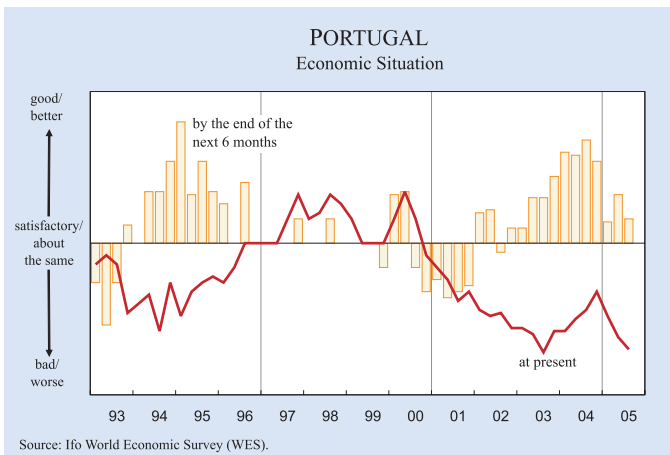
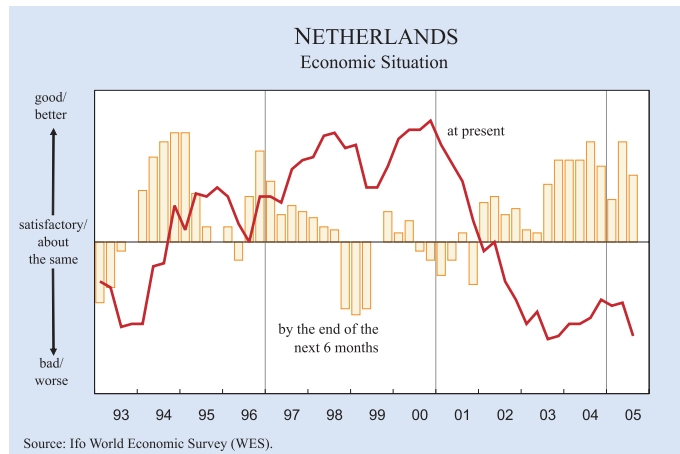
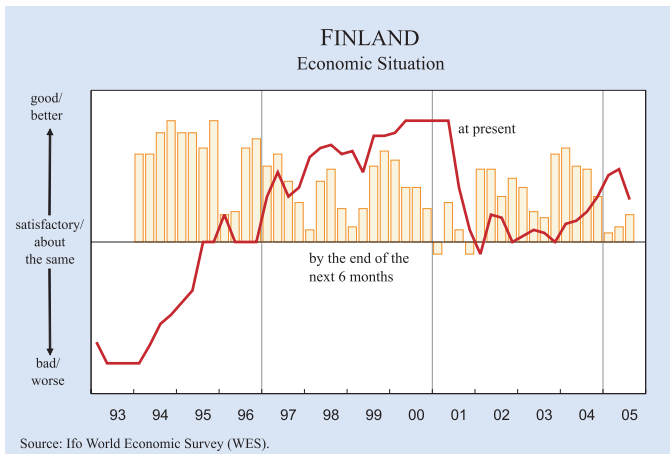
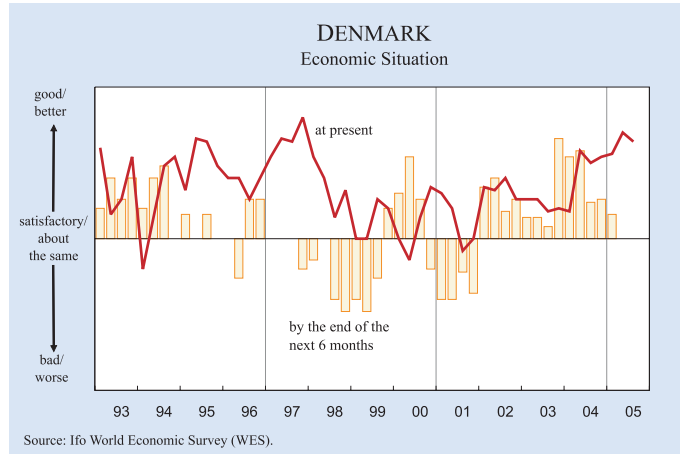
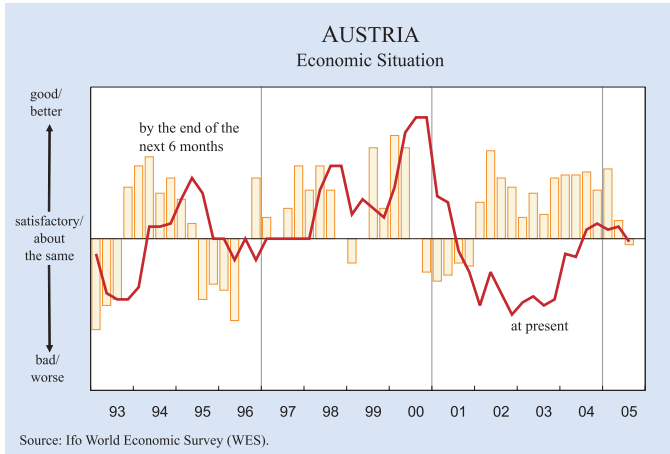


Figure 6

EASTERN EUROPE

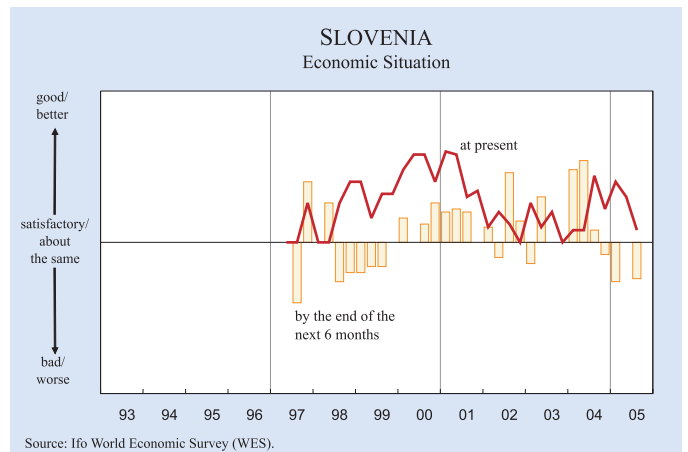
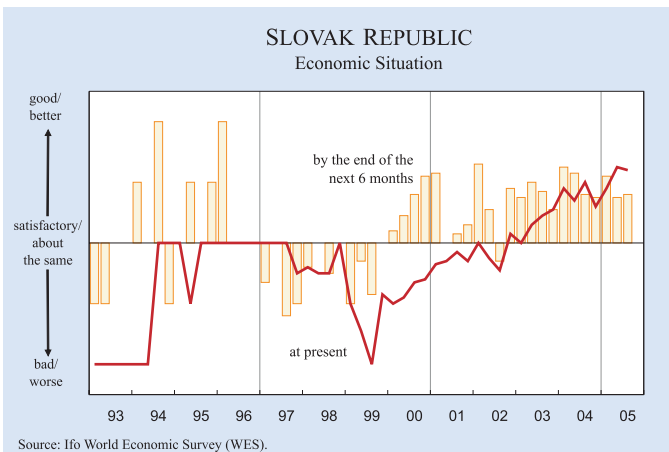
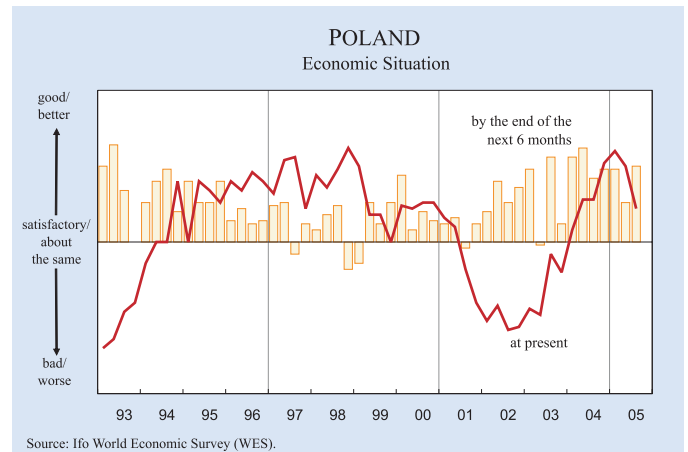
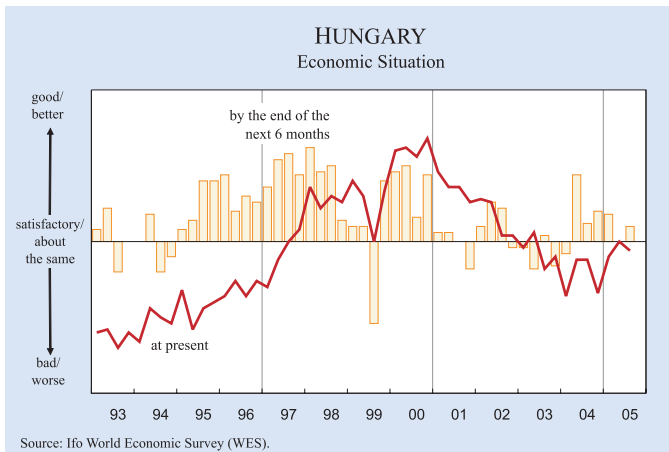
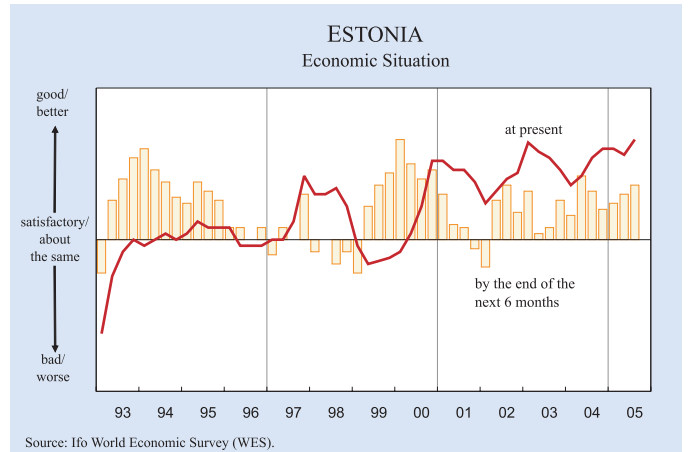
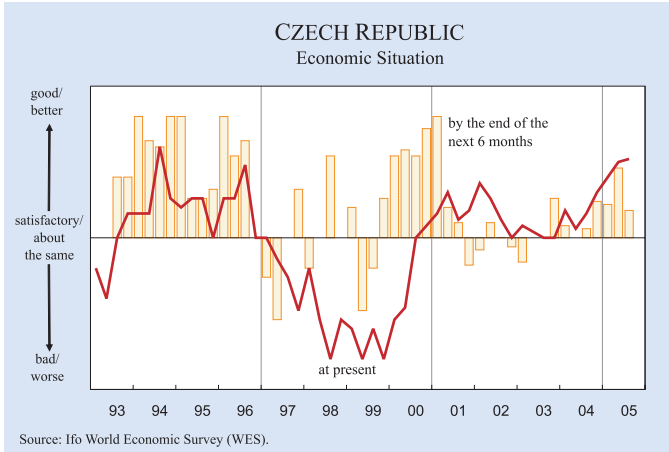


Figure 7

ASIA

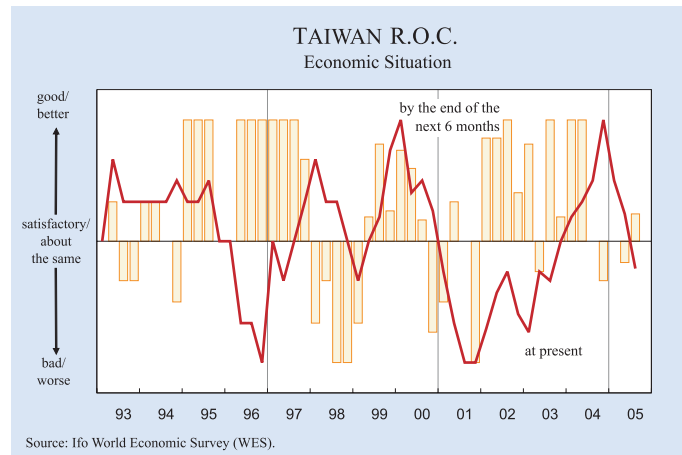
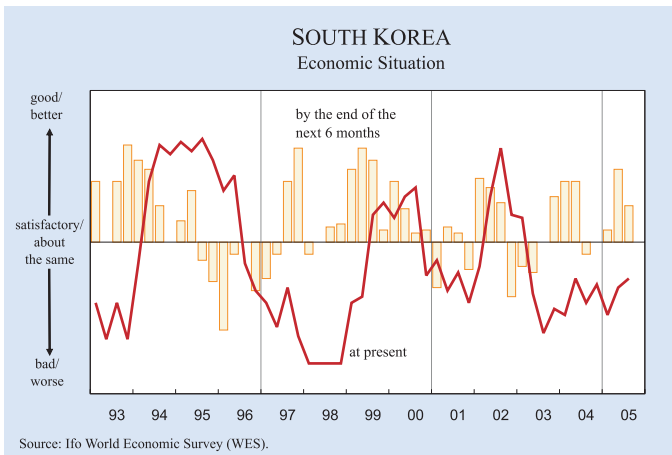
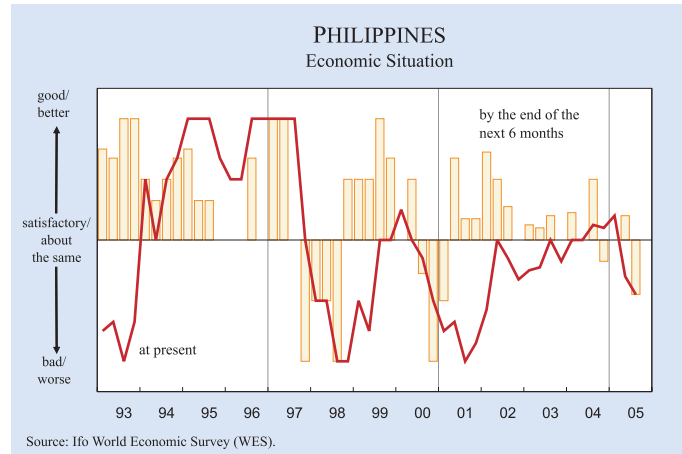
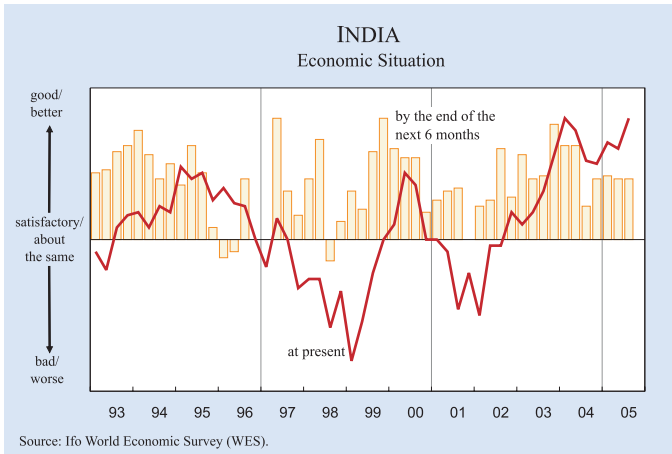
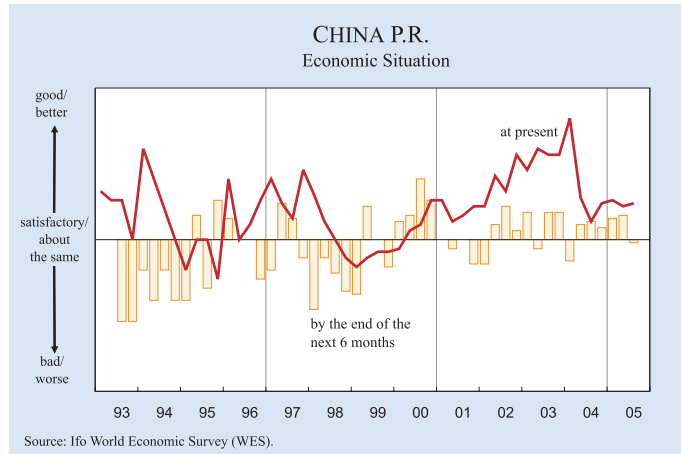
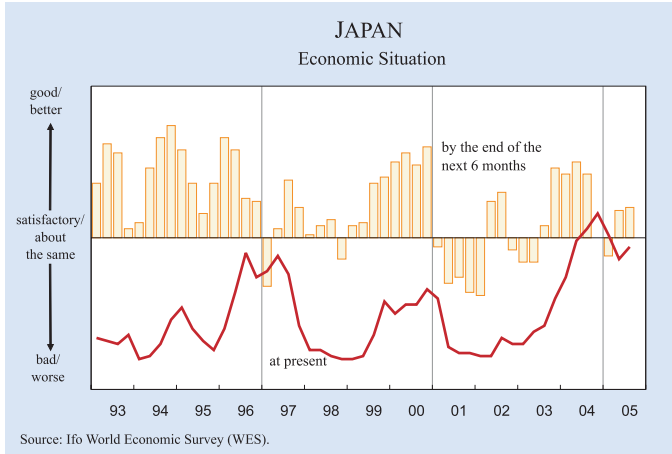


Figure 8

LATIN AMERICA

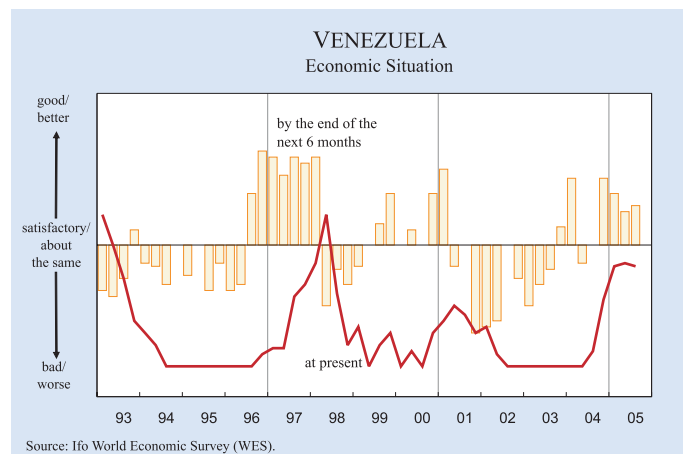
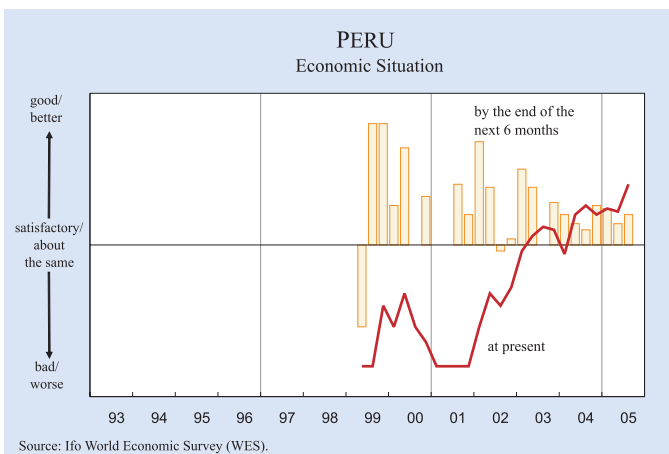
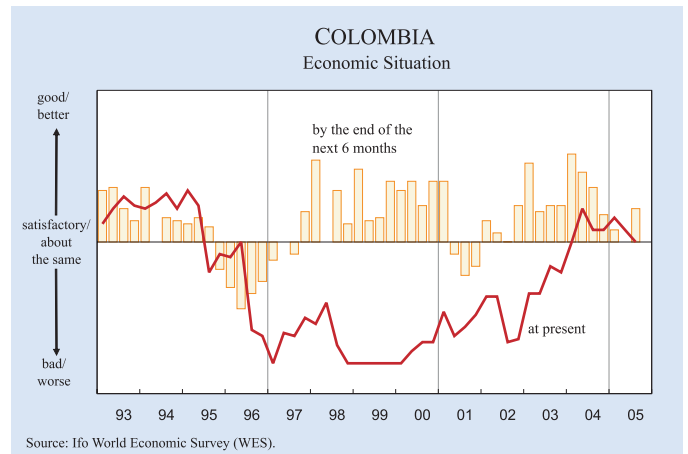
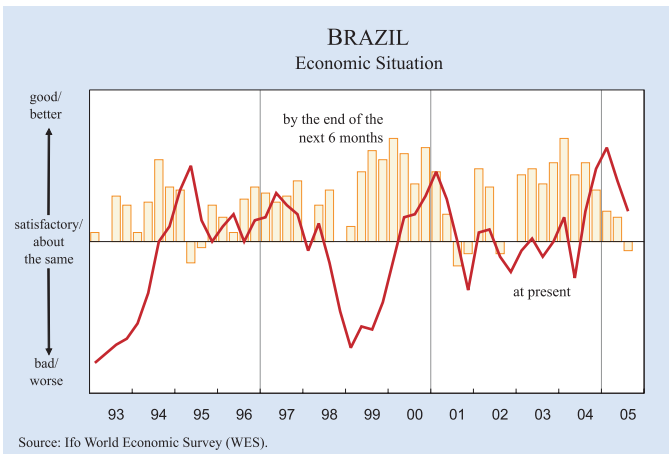
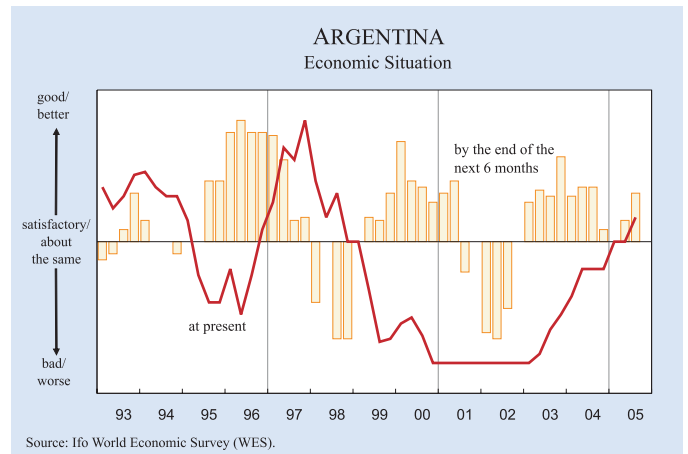
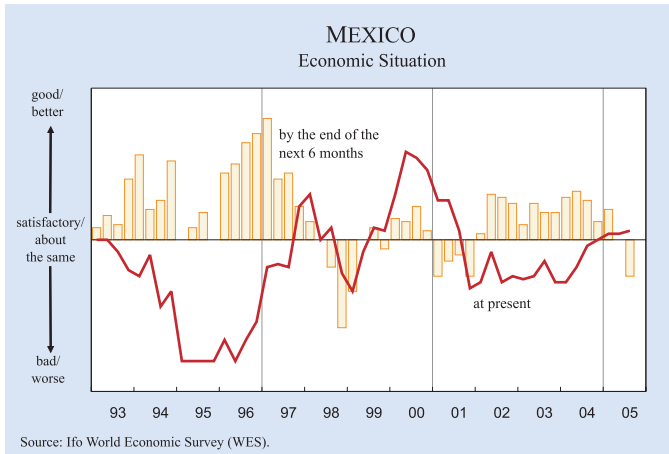
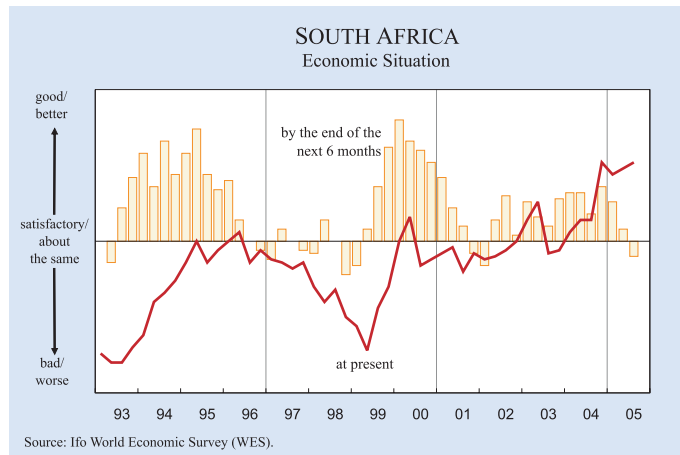
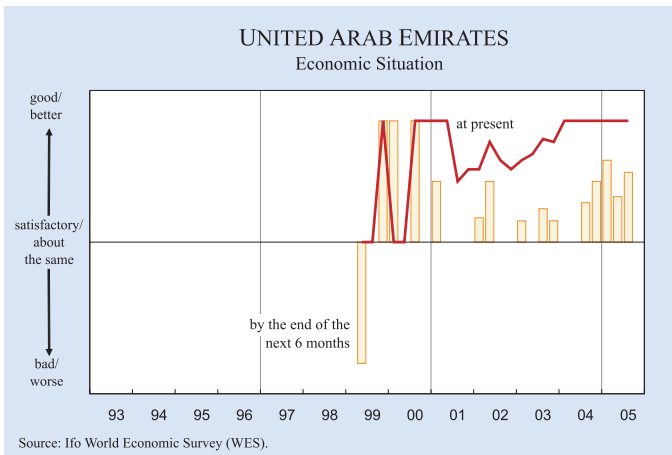
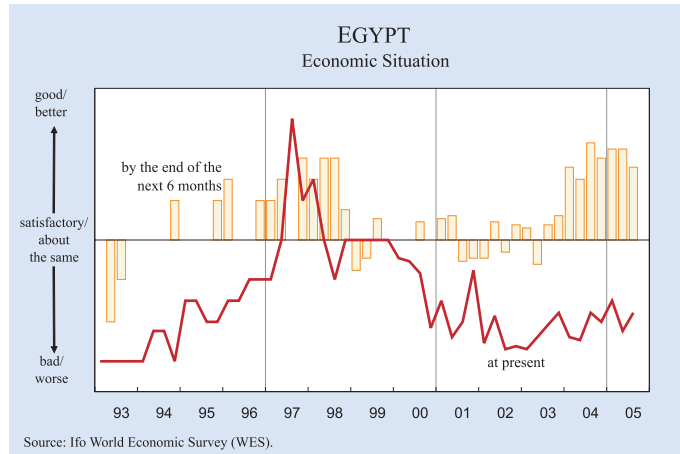
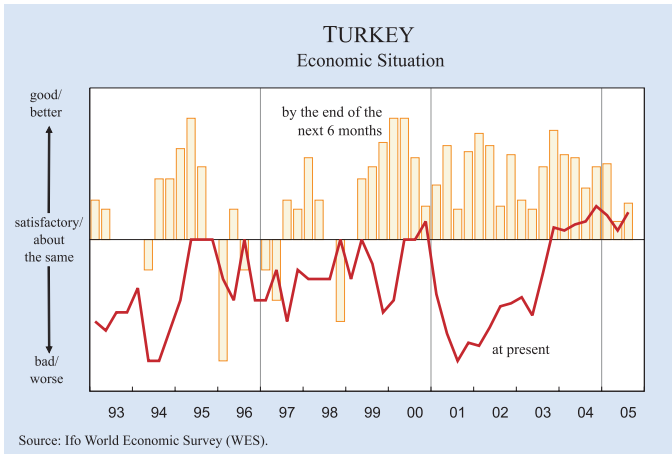
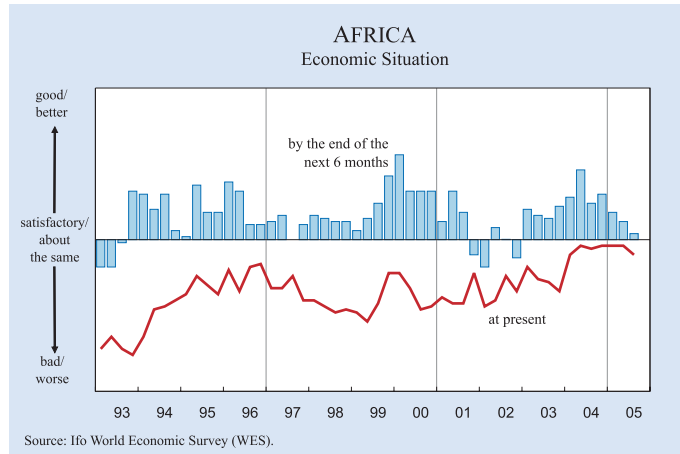
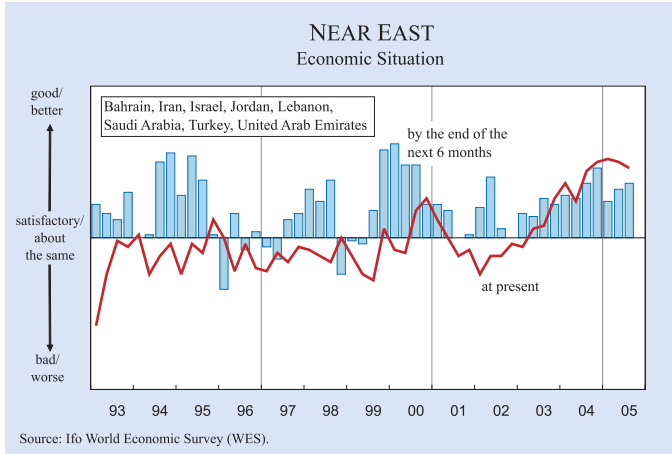


Figure 9

NEAR EAST AND AFRICA



quarters of this year. The worst inflation performance in the euro area will prevail again in Greece in 2005, where the inflation outlook remained at the same level reported in the previous survey in April (3.4 percent), followed by Spain (3.2 percent). The lowest inflation rates in the euro area in 2005 are again expected in Finland (1.4 percent), the Netherlands (1.6 percent) and Germany (1.7 percent).

In *Western Europe* outside the euro area, expectations for low inflation rates in 2005 continue to prevail in Switzerland (1.1 percent after an expected 1.0 percent in the April survey), Sweden (1.0 percent after an previously expected 1.2 percent) and Norway (1.4 percent as in the previous survey). In the United Kingdom the inflation rate in 2005 will be identical with the euro area figure (2.0 percent).

In the *United States* inflation in 2005 is expected to stand at 2.9 percent, the same figure which had already been reported in the April survey. Thus, it looks very likely that the US inflation rate in 2005 will remain somewhat above the 2.5 percent mark that the FED considers still acceptable.

In *Asia* consumer price inflation in 2005 is expected to be 2.4 percent, which is slightly higher than for the April Survey (2.3 percent) but still lower than in 2004 (2.6 percent). A decline of the inflation rate is expected particularly in China (2.9 percent after a previously expected 4.1 percent) and to a lesser degree also in India (5.2 percent after a previously expected 5.5 percent) as well as in South Korea (3.6 percent after a previously expected 3.9 percent). On the other hand, inflation is expected to pick up particularly in the Philippines (8.0 percent after a previously expected 6.8 percent) and in Vietnam (7.7 percent after a previously expected 6.1 percent). In Japan deflation appears to have come to an end, though consumer prices are seen as hardly rising (expected increase of 0.1 percent in 2005; unchanged from the estimates of the first two surveys of this year).

In *Central and Eastern Europe* inflation is expected to stabilize in 2005 at 3.7 percent, which would be significantly lower than in 2004 (5.1 percent). The relatively highest rate of inflation still prevails in Serbia and Montenegro and – what is particularly worrying – the inflationary trend seems to be accelerating further (13.8 percent after a previously expected 10.9 percent). The lowest rates of inflation are seen in 2005 in Bosnia Herzegovina (2.0 per-

cent), the Czech Republic (2.6 percent), in Slovenia (2.7 percent), in Poland (2.8 percent), Croatia (2.8 percent) and in Lithuania (2.9 percent).

In the *CIS* countries inflation in 2005 is expected to be higher than in the two previous surveys (12.5 percent compared with 11.2 percent in April and 10.0 percent at the beginning of the year). The upward revision results mainly from higher inflation expectations in Russia (12.2 percent after a previously expected 11.3 percent and 10.3 percent at the beginning of the year).

In *Central and Latin America* inflation in 2005 is seen to be slightly lower than in the previous survey in April and at beginning of the year (5.9 percent compared to previously expected 6.1 percent respectively 6.4 percent). This result is again strongly influenced by Venezuela where the high inflation rate of last year (22 percent) is levelling off somewhat (17.7 percent after an expected 19.7 percent in April this year). But also in Argentina inflation in 2005 is expected to come in at a lower rate than expected in the April survey (10.9 percent compared with 12.2 percent in the previous survey). On the other hand the inflation outlook has worsened somewhat in Costa Rica (13.7 percent after a previously expected 12.7 percent) and in Paraguay (9.0 percent compared to 7.6 percent). In Brazil the inflation outlook for 2005 remained more or less stable (6.3 percent compared to a previously expected 6.4 percent).

In *Africa* the inflation outlook for 2005 deteriorated somewhat (10.5 percent after a previously expected 9.0 percent). This is mainly due to Zimbabwe where the hyperinflation – after a slight cooling down in spring this year – is expected to pick up again and reach in the average for 2005, not less than 190 percent (after an expected 170 percent according to the April survey). But also in Kenya and in Nigeria the 2005 inflation rate is now seen to be somewhat higher than in the previous survey (10.7 percent compared to 10.0 percent and 14.0 percent compared to 13.5 percent). The same holds true for South Africa where inflation in 2005 is now seen at 4.3 percent compared to 4.1 percent some months ago. In Tunisia inflation will remain contained at an expected 2.7 percent in 2005 after 2.5 percent in 2004.

In the *Near East* the inflation rate in 2005 will be lower than in 2004; this view was reinforced by the latest survey (5.3 percent after previously an expected 5.6 percent and an actual rate of 6.2 percent in

Table 3

Expected Inflation Rate on Average of 2005

(based on WES QIII and QII 2005)

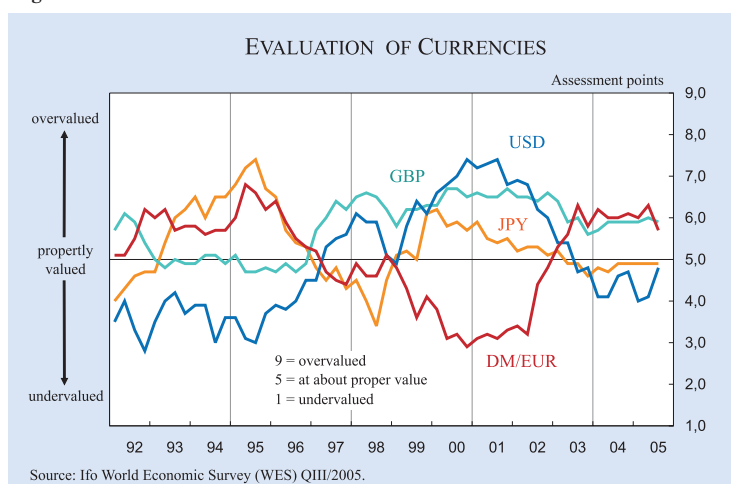
Region	QIII/2005	QII/2005	Region	QIII/2005	QII/2005
Average of 95 countries	2.9	2.9	Central a. Latin America	5.9	6.1
<i>World Bank classification:</i>			Argentina	10.9	12.2
High-income countries	2.1	2.0	Bolivia	4.4	4.4
Middle-income countries	5.6	5.6	Brazil	6.3	6.4
Upper-middle	4.2	4.2	Chile	2.8	2.7
Lower-middle	7.1	7.1	Colombia	5.0	5.3
Low-income countries	10.1	9.0	Costa Rica	13.7	12.7
EU countries (old members)	2.0	2.0	Ecuador	2.4	1.9
EU countries (new members) ¹	3.1	3.2	El Salvador	3.8	4.4
Euro area ²	2.0	2.0	Mexico	4.3	4.6
Asian Pacific Rim ³	3.1	2.9	Panama	1.3	1.3
Western Europe	1.9	1.9	Paraguay	9.0	7.6
Austria	2.2	2.2	Peru	2.5	2.8
Belgium	2.1	2.0	Trinidad and Tobago	5.0	4.5
Cyprus	2.5	3.0	Uruguay	6.6	6.3
Denmark	1.6	1.8	Venezuela	17.7	19.7
Finland	1.4	1.4	Asia	2.4	2.3
France	1.9	2.0	Bangladesh	6.5	6.0
Germany	1.7	1.6	China P.R.	2.9	4.1
Greece	3.4	3.4	Hong Kong	1.5	1.4
Iceland	-	4.0	India	5.2	5.5
Ireland	2.4	2.3	Indonesia	7.5	6.9
Italy	2.2	2.1	Japan	0.1	0.1
Luxembourg	2.3	2.3	Korea	3.6	3.9
Malta	2.6	2.4	Malaysia	2.9	2.3
Netherlands	1.6	1.6	Pakistan	8.9	9.0
Norway	1.4	1.4	Philippines	8.0	6.8
Portugal	2.5	2.2	Singapore	2.5	2.0
Spain	3.2	3.1	Sri Lanka	12.0	13.0
Sweden	1.0	1.2	Taiwan	1.9	1.7
Switzerland	1.1	1.0	Thailand	3.5	3.3
United Kingdom	2.0	2.1	Vietnam	7.7	6.1
Central a. Eastern Europe	3.7	3.7	Near East	5.3	5.6
Albania	3.2	3.4	Bahrain	3.0	-
Bosnia Herzegovina	2.0	-	Iran	16.6	16.5
Bulgaria	4.5	3.9	Israel	2.6	2.3
Croatia	2.8	2.7	Jordan	3.9	3.1
Czech Republic	2.6	2.4	Lebanon	3.5	2.0
Estonia	3.3	3.5	Qatar	6.0	-
Hungary	3.9	4.2	Saudi Arabia	1.3	1.4
Latvia	5.6	5.9	Turkey	7.7	8.4
Lithuania	2.9	2.6	United Arab Emirates	5.3	4.7
Poland	2.8	2.9	Africa	10.5	9.0
Romania	7.8	7.5	Algeria	5.3	5.0
Serbia a. Montenegro	13.8	10.9	Egypt	7.3	8.1
Slovenia	2.7	3.0	Kenya	10.7	10.0
Slovakia	3.2	3.7	Mauritius	5.5	4.0
CIS	12.5	11.2	Morocco	1.9	3.0
Kazakhstan	-	6.6	Nigeria	14.0	13.5
Russia	12.2	11.3	South Africa	4.3	4.1
Ukraine	12.4	13.2	Tanzania	4.0	-
North America	2.8	2.7	Tunisia	2.7	2.8
Canada	2.1	2.2	Zimbabwe	190.0	170.0
USA	2.9	2.9	Oceania	2.6	2.8
			Australia	2.6	2.8
			New Zealand	2.6	2.6

* 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. – ⁴ Algeria, Iran, Kuwait, Saudi Arabia, Qatar, United Arab Emirates.

Source: Ifo World Economic Survey (WES), QIII/2005.

Figure 10



2004). In Turkey the inflation outlook for 2005 improved further (7.7 percent compared to 8.4 percent according to the April survey and 8.6 percent expected at the beginning of the year). On the other hand inflation is expected to pick up somewhat in the United Arab Emirates where CPI in 2005 is now expected to be 5.3 percent after somewhat lower estimates in the previous survey and at the beginning of the year (4.7 percent respectively 3.7 percent) The highest rate of inflation in the region still prevails in Iran with an expected consumer price increase of 16.6 percent in 2005.

In *Oceania*, in 2005 an inflation rate of 2.6 percent is now expected; this is exactly the same figure estimated at the beginning of the year (2.6 percent). The 2005 inflation figure will be identical in Australia and New Zealand according to WES experts' estimates.

Euro seen to a lesser degree as overvalued

After its strengthening in the past couple of months the *US dollar* was no longer regarded as clearly undervalued vis-à-vis the average of the other currencies covered in the survey as was the case in the previous two WES rounds. It is now seen as more or less appropriately valued. On the other hand, the euro and the *British pound* continue to appear to be overvalued, but – particularly in the case of the Euro – to a significantly lesser degree than in the past surveys. The *Japanese yen* is seen again as more or less fairly assessed, according to most WES experts (see Figure 10).

This overall picture characterizes the assessments in most countries. Noticeable exceptions from this gen-

eral view are Norway and Switzerland where the *US dollar*, the *euro* and the *British pound* were seen as overvalued vis-à-vis the own currency; only the *Japanese yen* was here regarded as fairly assessed or even slightly undervalued. Outside Western Europe the own currency is judged as generally undervalued in Lithuania, in Romania, Slovakia and in Russia (however in Romania with the exception of the *US dollar*, in Slovakia with the exception of the *Japanese yen* and in Russia with the exception

of the *euro* which appear to be correctly assessed). Also seen as undervalued are currencies in some Latin American countries (Brazil, Mexico, Peru, Paraguay and Chile; in the last two cases with the exception of the *Japanese Yen* which appears according to WES experts correctly assessed or even somewhat undervalued) and in some Asian countries (particularly China, India, Japan, Indonesia, the Philippines, Thailand and also Vietnam).

On the other hand the own currency is regarded as generally overvalued compared to the four main currencies particularly in South Africa, Kenya, Egypt, Iran, Lebanon, Turkey, Croatia, the United Arab Emirates, Uruguay, Venezuela, Colombia, Hong Kong, Taiwan and also Sri Lanka.

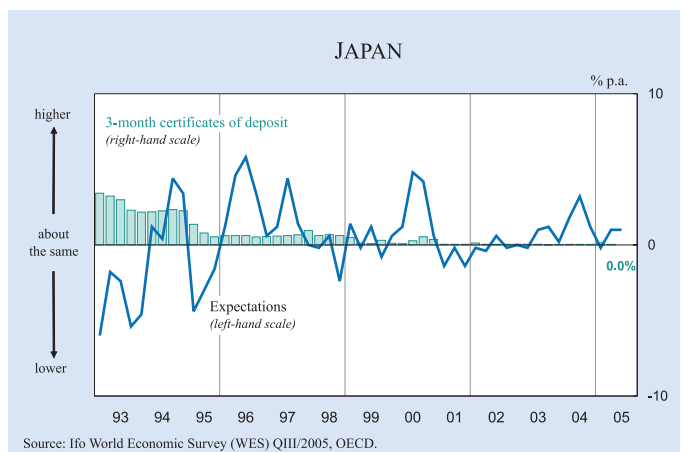
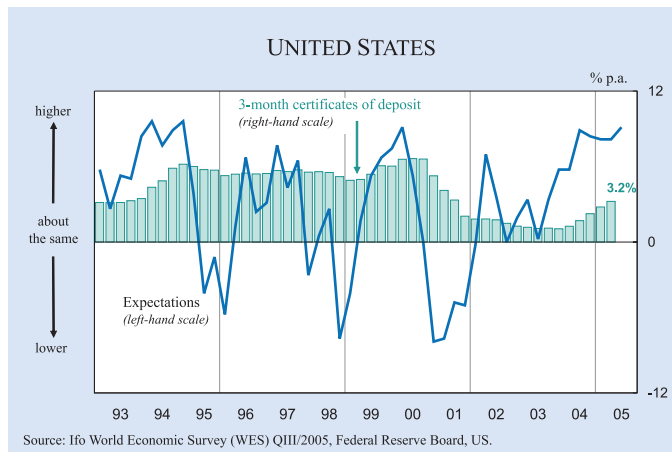
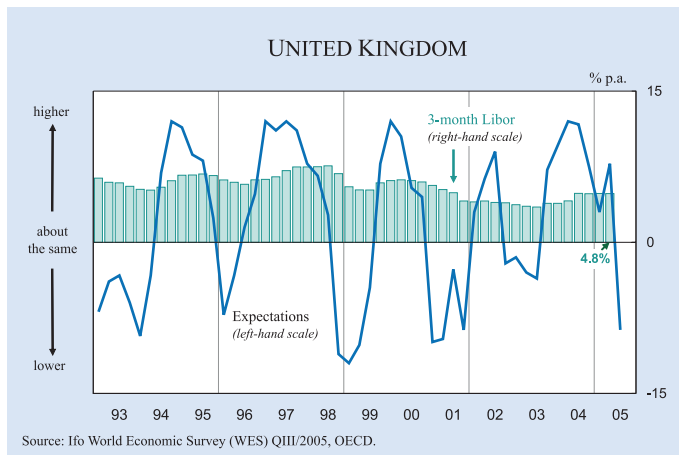
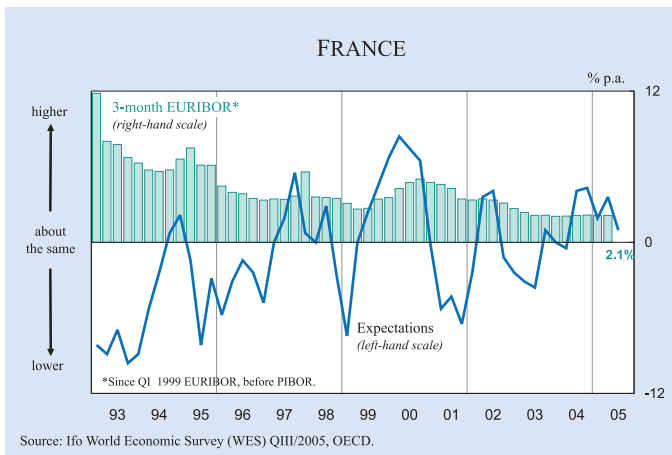
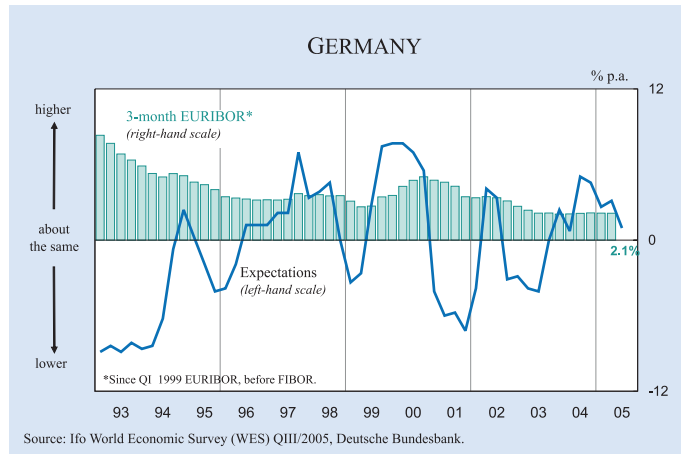
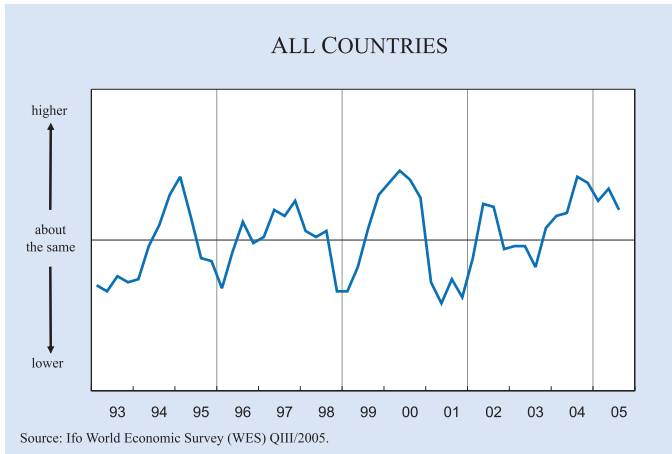
According to the responses to the supplementary survey question on the development of currencies, the *US dollar* is expected to increase in value in the course of the next six months in most countries. In contrast to this general trend the *US dollar* is expected to fall in the course of the next six months vis-à-vis the currencies of Norway, Latvia, Canada, Peru, New Zealand, China, Japan, Malaysia and Taiwan. To some extent this change has already occurred since the latest revaluations of the Chinese Renminbi and Malaysian Ringgit.

Interest rates: Trend of rising rates is levelling off

The expectations of rising **short-term interest rates** in the next six months are fading in the euro area as well as in Oceania (Australia and New Zealand). However, in North America, both in the USA and in Canada, the share of WES experts

Figure 11

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



expecting higher short term interest rates has increased even further and remained almost unchanged high in Asia. On the other hand, for the first time in almost two years a cut in short term interest rates is now expected in the United Kingdom (see Figure 11). To a lesser degree sinking short term interest rates are also seen by WES experts in coming months in Sweden and New Zealand. In Eastern Europe the trend of shrinking short-term interest rates is expected to continue, with the exception of Latvia and also Estonia and the Czech Republic where short-term interest rates are expected to increase further somewhat in the near future. In Latin America a decline in short-term interest rates is mainly expected in Brazil, Mexico and Venezuela, whereas in most other Latin American countries the direction of short term interest rates is still up.

Also in the case of **long term interest rates** a further rise is seen by fewer WES experts than in the previous five survey rounds. This decline in expectations characterizes nearly all markets. It is most pronounced in the euro area and in Denmark, Sweden and the United Kingdom. In the UK for the first time since the end of 2004 not only a slowdown of the upward trend but even an absolute decline of long-term interest rates is now expected. In most Eastern European countries, capital market rates will remain more or less unchanged in the next six months. On the other hand, in the United States the expected upward trend of long-term interest rates is hardly losing momentum, and in Canada this trend appears to be even reinforced according to the latest WES results. In Latin America, on average, stable or even slightly shrinking long-term interest rates are expected in the course of the next six months; however there are significant differences by country. In Brazil and to a lesser degree also in Mexico capital market rates are seen by the WES experts as declining in coming months, whereas particularly in Chile but to a lesser degree also in Argentina the upward trend of long-term interest rates will continue. Also in Asia, capital market rates will increase further in coming months according to WES experts' expectations. The upward trend is particularly pronounced in Indonesia, Hong Kong, Singapore, Thailand, Taiwan and South Korea. On the other hand, in China, Malaysia and the Philippines the expected upward trend has slowed down significantly according to the new survey results.

ICC Special Question:

The role of the Internet for the knowledge, information, business and governments

In little more than a decade the Internet has developed from a tool used mainly in academia to being part of everyday life and one of the major sources of information. Politically this was honoured by the United Nations decision in 2001 about holding a World Summit on the Information Society (WSIS). The first meeting took place in Geneva in December 2003. The second meeting will take place in Tunis from 16 to 18 November 2005. It is seen as an important venue for all stakeholders of the information society – the private sector, civil society, governments and others – to discuss issues that relate to the continued evolution of the Internet, though like all UN summits WSIS is basically an intergovernmental process.

The special question asked in the July poll focused on the role of the Internet for knowledge, information, business and development. The question was divided into four parts. The first part evaluated the importance of the Internet for private and professional use in the respective countries. The second question tried to assess the degree of world-wide digital divide, i.e. socio-economic gap between people who have and people who don't have access to Internet and the information, educational or business opportunities tied to this access. The third and the fourth parts dealt with the question, who should govern the global networks: a global multi-stakeholder forum or the governments.

1) The importance of the Internet for private and professional use at present.

In most regions world-wide the Internet is regarded to be very important for business and professional use as well as for the private use (see Figure 12 and 13). Unexceptional in all countries covered by WES the vast majority of experts stated that the Internet became very important or important for the professional use. The Internet is also gaining importance for the private use, as means for communication, learning and information access. However, a limited access to Internet does not seem to pose a constraint in the private life, as result from the poll in Paraguay, Albania, Hungary, Turkey, Ecuador and Indonesia. On the other hand, access to Internet is regarded to be very important for professional and private use in Sweden, Finland, South Korea, Norway, Denmark,

Table 4

Importance of the Internet for Private and Professional Life and the Degree of Digital Divide

REGION	N	Importance of the Internet a)	Degree of digital divide b)	REGION	N	Importance of the Internet a)	Degree of digital divide b)
AVERAGE OF 95 COUNTRIES	945	6.9	7.3				
Western Europe	349	7.3	6.1	Oceania	22	7.9	6.1
Austria	32	7.1	6.4	Australia	12	7.7	6.1
Belgium	17	6.3	6.6	New Zealand	10	8.2	6.2
Cyprus	2	7.0	5.0				
Denmark	5	8.6	5.8	Asia	163	6.8	7.9
Finland	24	8.6	4.8	China	13	5.2	8.7
France	20	6.5	8.2	Hong Kong	8	6.5	5.0
Germany	64	7.4	6.0	India	15	7.1	8.5
Greece	17	5.2	7.6	Indonesia	10	5.3	9.0
Ireland	11	7.7	6.8	Japan	30	7.3	6.5
Italy	23	6.7	7.4	Korea Rep.	10	8.4	6.2
Netherlands	18	6.8	5.4	Malaysia	13	5.8	7.2
Norway	10	8.2	4.6	Pakistan	14	7.6	8.7
Portugal	15	6.5	7.9	Philippines	9	7.0	9.0
Spain	29	6.5	7.3	Sri Lanka	3	4.3	9.0
Sweden	21	8.5	6.0	Taiwan	18	8.1	6.3
Switzerland	19	7.2	6.3	Thailand	7	6.1	9.0
United Kingdom	18	8.0	5.4	Vietnam	7	5.3	9.0
North America	45	7.9	5.9	CIS	27	5.0	8.9
Canada	12	7.8	6.0	Russia	15	5.8	9.0
United States	33	7.9	5.7	Ukraine	10	6.0	8.6
Central a. Eastern Europe	137	6.6	7.7	Latin America	105	7.0	8.0
Albania	9	3.9	7.7	Argentina	5	8.2	9.0
Bulgaria	14	7.0	7.6	Bolivia	3	6.3	9.0
Croatia	8	7.3	9.0	Brazil	24	7.4	8.3
Czech Republic	14	7.1	7.3	Chile	14	7.1	8.1
Estonia	3	7.7	7.7	Colombia	7	6.1	8.4
Hungary	15	5.5	7.7	Ecuador	7	5.0	8.4
Latvia	5	7.4	7.4	Mexico	14	6.6	9.0
Lithuania	8	7.3	9.0	Paraguay	5	4.6	9.0
Poland	18	6.7	8.5	Peru	8	8.3	8.0
Romania	12	5.8	7.7	Uruguay	4	6.5	9.0
Slovenia	10	7.2	7.8	Venezuela	6	6.3	8.3
Slowakia	10	6.2	7.0				
Serbia a. Montenegro	10	6.4	8.2	Africa	54	5.9	8.1
Near East	43	7.4	7.4	Algeria	2	3.0	7.0
Iran	3	7.0	9.0	Egypt	4	6.7	9.0
Israel	8	7.8	5.6	Kenya	3	7.0	9.0
Saudi Arabia	4	6.5	8.0	South Africa	26	6.8	8.8
Turkey	13	5.6	9.0	Zimbabwe	11	4.8	9.0
United Arab Emirates	7	7.0	5.0				

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

N: Number of Responses

a) Assessment of the importance of the Internet for private and professional use in the country at present.

WES scala: 9 - very important, 5 - important, 1 - not important

b) Assessment of the degree of digital divide in a country. The term digital divide describes the socio-economic gap between people who have and people who don't have access to the Internet, and the information, educational or business opportunities tied to this access.

WES scala: 9 - very high / high, 5 - low, 1 - absent

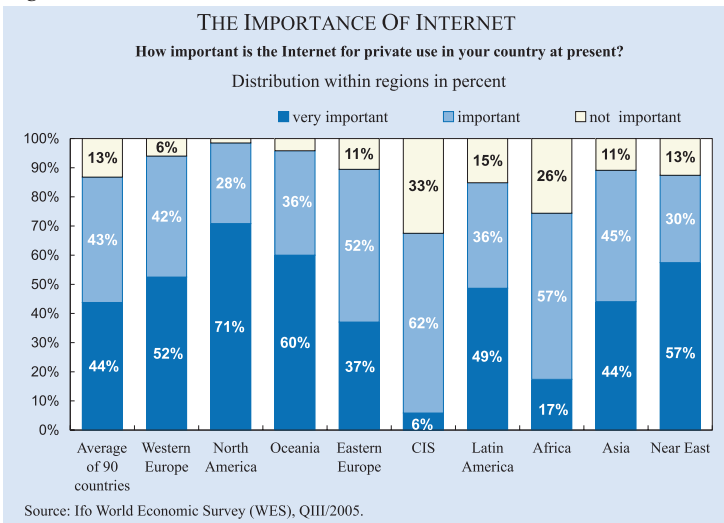
Peru, Canada, Taiwan, New Zealand, US, Israel, Argentina, United Kingdom, Pakistan and Japan (see Table 4).

2) The degree of digital divide world-wide

While the Internet has become the media of choice in private and professional life, digital divide – the socio-

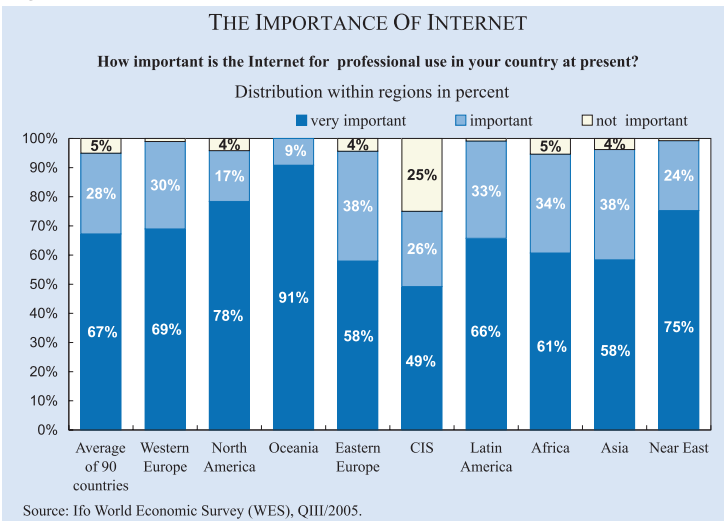
economic gap between people who have and people who don't have access to Internet – has become a gap between the poor and the rich. Access to information and knowledge is an important aspect of achieving the Millennium Development Goals, as it is contributing to higher living standards. Moreover, education and communication between people may help to resolve conflicts. The degree of digital divide strongly

Figure 12



differs across regions (see Figure 14 and Table 4) and it is regarded to be rather high on the world average (60 percent of experts surveyed world-wide stated that the degree of digital divide is very high or high in their countries). Particularly in Russia and the Ukraine, in all Eastern European countries, in Latin America, Africa and in all Asian countries polled, except Hong Kong, South Korea, Japan and Taiwan the surveyed experts stated that there is a big socio-economic gap between people who have and those who don't have access to the Internet.

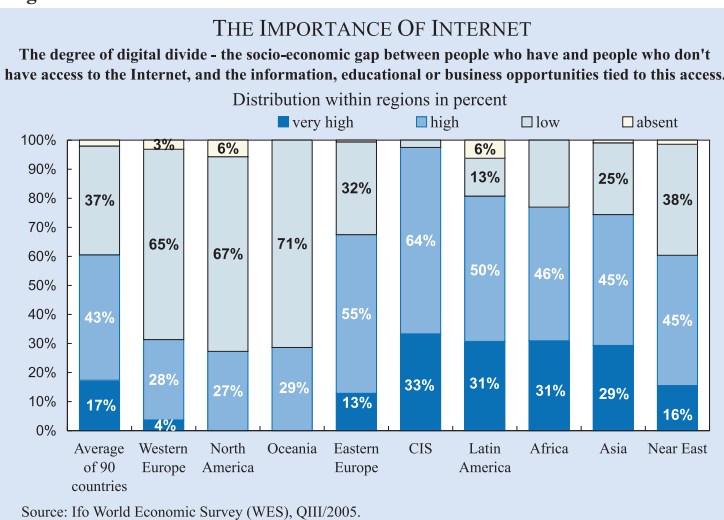
Figure 13



3) *Who should govern the global networks?*

One important and at the same time difficult issue of the WSIS is the question how the Internet should be governed in the future. There are particular difficulties in dealing with this question, as the Internet was designed to be an open and democratic source of information. A number of countries want that the regulation of the Internet to be done by the United Nations, where every country is participating. Civil society is insisting on transparency, user-involvement and a multi-stakeholder approach. According to the WES survey, the vast majority (92 percent) of experts polled world-wide think that the Internet should function as it currently does, with a coalition of stakeholders involved (civil society, business, experts and governments). Thus, a multi-stakeholder forum to discuss issues that relate to the continued evolution of the Internet would be a good idea. However, in many regions of the world, except Western Europe, North America and Oceania, WES experts think that their

Figure 14



country's governments should stronger interfere into the regulation of the Internet, this is particularly the case in most countries of Eastern Europe, Russia and the Ukraine, where more than 90 percent of surveyed experts would support a shift towards more control of the Internet by the respective national government. This opinion most likely reflects the increasing tendency of illegal or harmful contents online and Spam. Also in some Latin American countries (particularly in Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico and Paraguay), in Asia (in China, India, Japan, Thailand, Vietnam, Pakistan and South Korea), in Turkey and Spain experts see an increasing need for action on the side of the governments to regulate the Internet and to promote business and public confidence in its use.

New online information services of the CESifo Group, Munich



The Ifo Newsletter is a free service of the Ifo Institute and is sent by e-mail every month. It informs you (in German) about new research results, important publications, selected events, personal news, upcoming dates and many more items from the Ifo Institute.

If you wish to subscribe to the Ifo Newsletter, please e-mail us at: newsletter@ifo.de.



CESifo publishes about 20 working papers monthly with research results of its worldwide academic network. Every month, the CESifo Newsletter presents selected working papers (in English) in an easily understandable style with the goal of making its research output accessible to a broader public.

If you wish to subscribe to the CESifo Newsletter, please e-mail us at: saavedra@cesifo.de.

If you wish to receive our current press releases, please e-mail us at: presseabteilung@ifo.de.

You can also request these services by fax:

Ifo Institute for Economic Research, fax: (089) 9224-1267

Please include me in your mailing list for:

Ifo Newsletter CESifo Newsletter Ifo Press Releases

Name:

Institution:

Street:

City:

Telephone:

Fax:

E-mail:



Additional CESifo Journals

