Ifo Economic Survey International

Economic climate drops to all-time low

According to the latest Ifo world survey (74th Economic Survey International of October 2001 questioning 833 economists of multinational corporations in 79 countries), the World Economic Climate indicator fell sharply (70.7 in October 2001 vs. 84.1 in July 2001 an 117.2 at the peak of this cycle in April 2000; 1995 = 100). The overall indicator marked the lowest level since the introduction of this survey in spring 1981. Inflation expectations receded almost everywhere whereas lack of demand gained further in importance and is regarded as the currently most important problem. Despite the gloomy overall picture there are some positive spots like expectations pointing to some economic recovery in the course of the next six months particularly in the USA, Norway, Germany as well as most Eastern European and CIS countries. More ESI experts than in the previous survey expect short- term interest rates to decline further in the next six months.

World economy: sharp slowdown

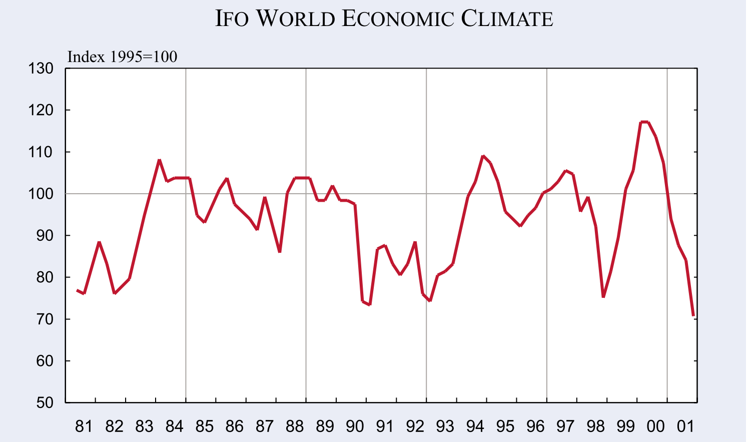
The World Economic Indicator continued its decline for the sixth time in a row and has lost about forty percent since its peak of reached in April, last year (see Figure 1).

The sharp decline from July to October was caused by the simultaneous fall of both components of the climate indicator: the assessment of the current economic situation and the expected trend for the next six months. Taken by itself, the current business situation is still not so bad as at the height of the last world-wide recession in the early 1990s, not to mention the situation in January 1983 after the second oil-price shock. Worrying are the sharply more pessimistic expectations, reversing the slight upward trend seen in the spring and summer survey of this year. At this stage it cannot be ruled out that part of the deterioration in expectations is only of a temporary nature, triggered by the tragic events of September 11 in New York and Washington, and may be reversed at least partly in the coming survey rounds when the growth stimulating effects of lower energy prices in the non-oil producing world and the drastically lower interest rates become more evident.

Asia: economic climate deteriorates strongly

According to the new survey, expectations for the development in the next six months deteriorated significantly whereas the assessment of the current economic situation remained unsatisfactory but did not worsen further. Although China is also caught up in the declining trend of expectations, the current business situation was assessed somewhat more favourably than in previous surveys. The performance of the economic indicators for India is relatively positive, with the current economic situation showing some signs of improvement and expectations deteriorating but not having entered negative

Figure 1



Source: Ifo Economic Survey International (ESI).

territory, as is the case in most other countries in the region. Similarly low levels of the current economic situation as during the past Asian crisis can be seen in Taiwan, the Philippines, Singapore and also Japan. In other Asian countries like the Republic of Korea, Malaysia, Thailand, Indonesia and Hong Kong, the current economic climate is still not as bad as during the 1997/98 crisis.

Hopes delayed for a bottoming out in Western Europe

The assessment of the current situation in most Western European economies deteriorated further and is now – with the exception of Finland, the Netherlands, Ireland, Spain Greece, Switzerland – below the »satisfactory« threshold. Expectations for the next six months deteriorated almost everywhere after having shown some signs of improvement in the previous two surveys (see Figure 2).

The lowest relative grades for the current situation were again given by ESI correspondents in Germany and Portugal. On the other hand, economic assessments remained better than the European average particularly in Norway and Greece. The slowdown in economic growth is more pronounced in capital expenditures than in private consumption. However, the six-month outlook for private consumption is as bleak as that for capital expenditures.

Eastern Europe remains relatively robust

The assessments of the current economic situation deteriorated somewhat but remained very close to the »satisfactory« level. The expectations for the next six months even showed – in contrast to all other regions – some improvement. The current economic situation continues to be more positive than average particularly in Estonia, Hungary, Latvia and Slovenia. On the other hand, in Poland, Romania, Croatia and particularly in Yugoslavia the current situation remained below the »satisfactory« level, though the expectations still point to some recovery.

In Russia both the current economic situation and the economic outlook for the next six months showed some improvement and both are clearly in positive territory. It remains to be seen to what extent the lower oil price will disturb this positive picture in the near future. Also in Kazakhstan the assessment of the current economic situation and the outlook for the next few months remained quite positive. In contrast, the economic situation is still unsatisfactory in the Ukraine.

Sharp slowdown but still positive expectations in the United States

The current economic situation in the U.S. cooled off sharply, reaching now only 2.2 on a nine-point scale, which is significantly lower than in Western Europe (4.3) and the world average (3.5). However, expectations for the next six months remain positive despite some deterioration (5.8 compared to 6.7). This constellation of data still supports our view that the U.S. economy will be the first to pull out from the cyclical trough. A positive signal is the somewhat improved outlook for capital expenditures, which have been hit particularly hard in the recent downswing. On the other hand, growth of private consumption is expected to slow down further in the course of the next six months.

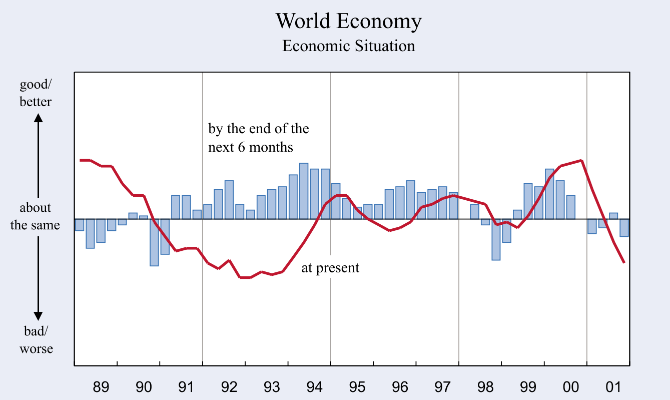
World-wide slowdown increasingly affects Latin America ...

The synchronised slowdown in the G7 area is showing increasing spillover effects on emerging markets, mostly in Asia but more noticeably also in Latin America. By far the most negative assessments concerning the current economic situation came from Argentina and Bolivia. In the next six months only a stabilisation at the currently low activity levels is expected. The relatively best economic developments were reported again for Chile.

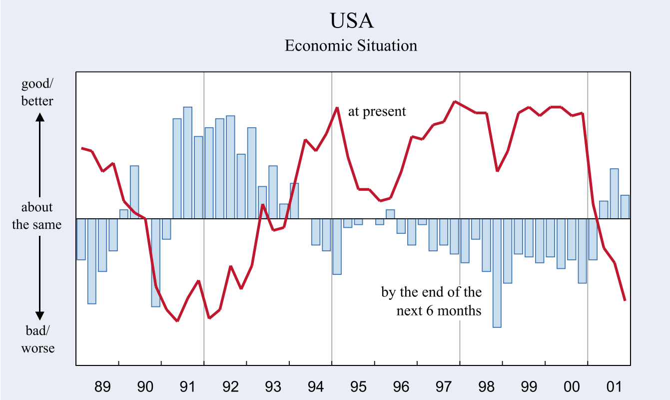
... and also Oceania (Australia and New Zealand)

The current economic situation remained satisfactory in New Zealand but declined in Australia in line with the world-wide trend. Expectations for the next six months point to an increasing weakness of economic performance. The assessments of the most important problems facing the economy at present differt between these two countries. Whereas *lack of demand* and *unemployment* are seen as the two most important problems in Australia, *lack of skilled labour* and *lack of confi-*

Figure 2



Source: Ifo Economic Survey International (ESI).



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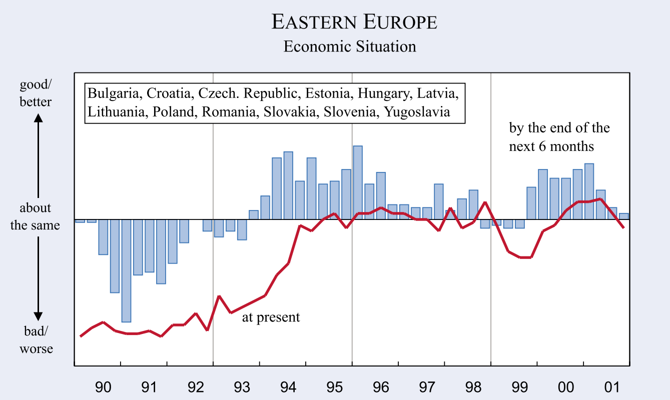

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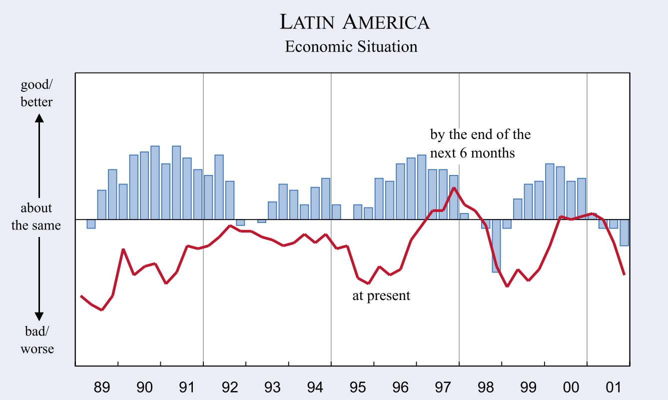

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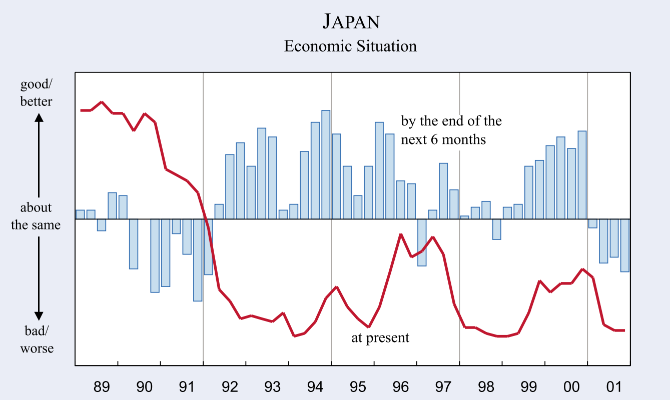

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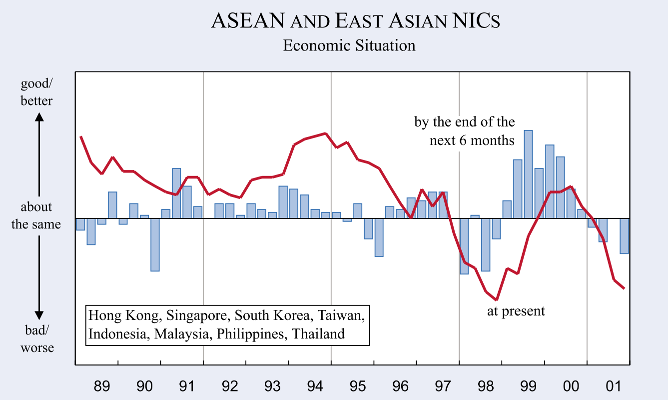


Source: Ifo Economic Survey International (ESI).

dence in government's economic policy top the list in New Zealand.

No further economic deterioration of the unsatisfactory situation in Africa

In most African countries the economic situation improved moderately but still remained in negative territory. Expectations for the next six months point to a stabilisation at the low level already reached. In South Africa the current economic situation is better than the African average and has almost reached the »satisfactory« level, where it is expected to remain for the next six months. A relatively positive picture can also be drawn again for the economies of Tunisia and Morocco, where the satisfactory economic situation is expected to continue in the next six months. In most other African countries in the ESI sample (Kenya, Nigeria and Zimbabwe), the economic situation is far below a satisfactory level, and no improvement is expected in the next six months.

Downward trend of economic activity continues in the Near East

The economic situation was assessed slightly better than in the previous survey but remains unsatisfactory. An optimistic view of the current situation prevails again only in the United Arab Emirates and in Saudi Arabia but here, too, a deterioration is expected in the course of the next six months. In Turkey and Lebanon the current economic situation is considered bleak; however, in the case of Turkey some improvement is expected in the course of the next six months. In Iran the economic situation remained unsatisfactory; for the next six months a stabilisation at the current low level is expected.

Both short-term and long-term interest rates expected to decline

More ESI experts than in the previous survey expect the downward trend of short-term interest rates to continue in the coming months. Also at the long end more scope for a decline is seen than in the last survey. Thus, ESI participants – unlike many bank economists – don't think that the downward trend of long-term interest rates is already coming to an end. Further cuts of short-term rates are expected in the euro area, in the United Kingdom and Australia. Also in the U.S., where short-term rates after 10 cuts have already reached a rather low level, a further decline below the 2% mark appears likely. On the other hand, in Latin America short-term interest rates are expected to increase, particularly in Brazil and Venezuela.

Inflation expected to slow down in coming months

On a world-wide scale consumer price inflation in 2001 is now expected to be 3.6% compared with 3.8% according to the previous survey. Thus, ESI experts expect a strong slowdown in inflation which is only partly reflected in the annual figure for 2001 but will influence inflation behaviour next year. In the euro area the inflation rate in 2001 is now expected to reach 2.8%, the same rate as in the US. Asia will show the highest degree of price stability (1.6%), influenced heavily by deflationary trends in Japan and Hong Kong (in both cases consumer prices will decline by 0.7% in 2001) and a low inflation rate of 1.6% in China.

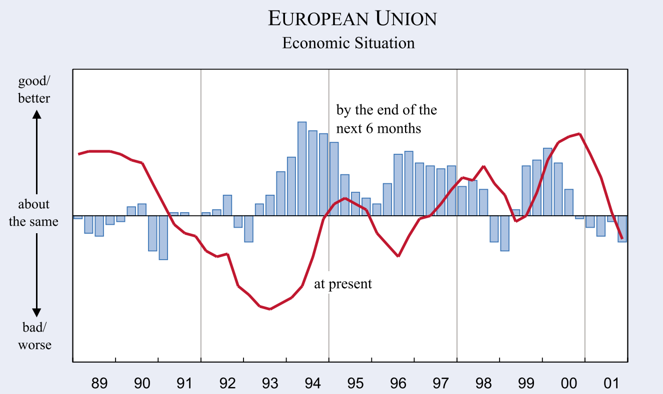
Euro is still regarded as clearly undervalued

The euro was still seen as clearly undervalued against practically all currencies, though somewhat less so than in the previous survey. Conversely, the U.S. dollar is seen to be overvalued, though somewhat less than in the previous survey. The British pound appears to be increasingly overvalued in the majority of countries included in the survey. The Japanese yen is still regarded as somewhat overvalued though significantly less than the US dollar and the British pound. Particularly in the euro area, a decline of the value of the dollar appears likely. In Asia the dollar is expected to keep its value in relation to national currencies or to increase even slightly. Albeit with a declining tendency, in most Eastern European, but particularly in CIS countries as well as in Latin America and Africa, the dollar, according to ESI experts, will strengthen further in the course of the next six months.

Insufficient demand has gained top position amongst economic problems

The most striking change compared with the previous survey is the even more predominant role of

Figure 3



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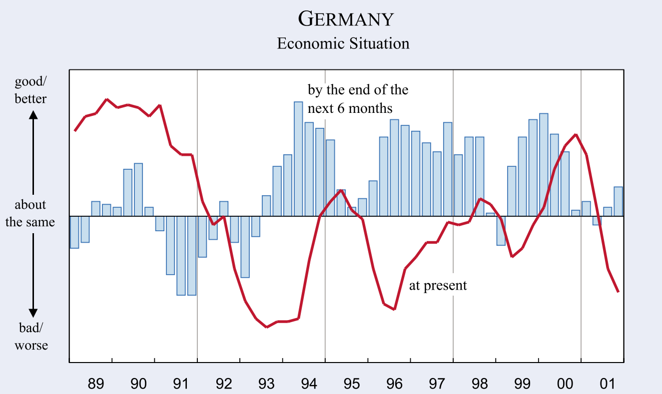

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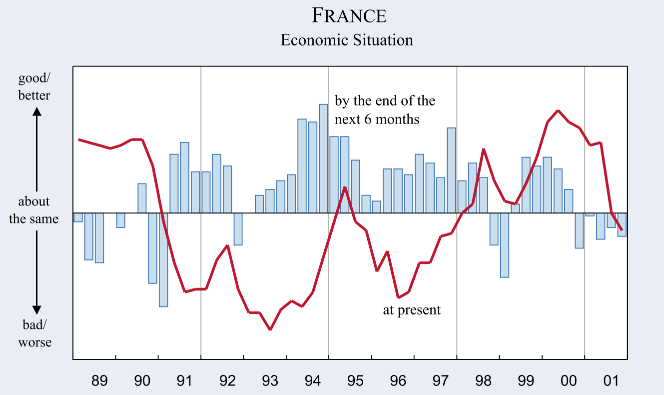

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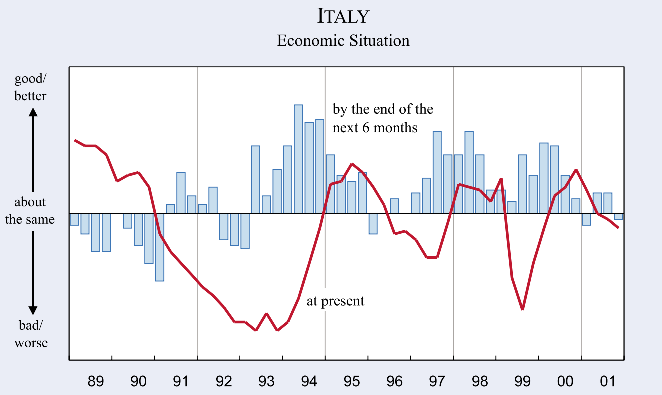

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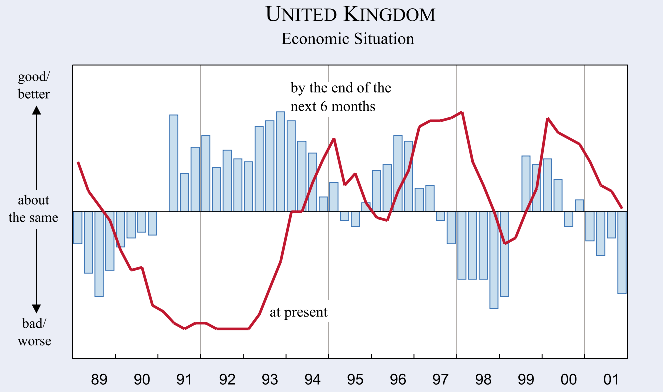

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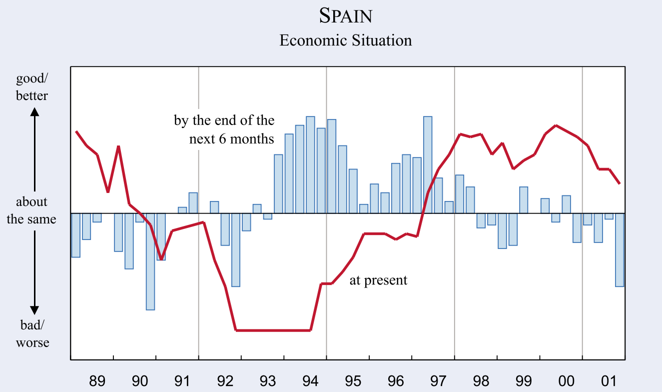

Source: Ifo Economic Survey International (ESI).

insufficient demand as the single most important problem followed by *unemployment*. In contrast, Inflation lost further in importance as one of the most urgent problems and now ranks 8 out of 10. Also *lack of skilled labour* which headed the world-wide list of problems one year ago is further losing its urgency and is now, together with *public deficits*, at rank 5; only in Western Europe, Africa and the Near East does *lack of qualified staff* appear to still be a major problem. *Lack of confidence in government's economic policy* continues to be of particular importance in the Near East and in Asia. First position on the list of problems is taken by *capital shortage* followed by *lack of international competitiveness* in the CIS. *Public deficits* and *capital shortage* rank high on the list of problems in Eastern Europe.

World economic growth will average about 2.5% in the next 3 to 5 years

Compared with October of last year the outlook for medium-term economic growth has deteriorated dramatically. Compared with expected annual growth of 3.7% a rate of only 2.5% now appears to be most likely. This downgrading process of growth expectations can be observed almost everywhere with the exception of CIS countries where an upward revision can be observed (4.5% after 4.1%) and Eastern Europe where it remained almost unchanged (3.8% after 3.9%). In the United States and Western Europe only a moderate average growth rate of 2.2% is now expected in the next 3 to 5 years. Above the international average will be China (6.6% after 7.6%), Vietnam (5.5% after 6.5%), and India (4.9% after 6.1%). In general, Eastern European and CIS countries remain on the list of the fastest growing economies in a medium-term perspective – Hungary: 4.2% after 5.2%, Poland: 3.6% after 4.0%, Russia: 4.7% after 4.3%, Kazakhstan: 4% unchanged.

Economic performance will lag behind the world average particularly in Japan (0.2% after 1.9%), Switzerland (1.6% after 2.1%), United Kingdom (1.9% after 2.9%), Italy (1.6% after 2.9%), Sweden (1.9% after 4.0%) and some Asian countries which in the past belonged to the group of »tigers« like Singapore (1.7% after 5.5%), Taiwan (1.4% after 4.5%) and Thailand (1.6% after 3.9%). Zimbabwe is still at the bottom of the list (– 3.5% after – 2.9%).