

WORLD ECONOMIC SURVEY*

WORLD ECONOMIC CLIMATE HAS IMPROVED CONSIDERABLY

In October 2003 the world climate indicator surpassed its long-term average (1989 to 2002: 93.7) and now stands at 100.2 compared to 91.3 in the July survey. This strong improvement resulted from both, a more favourable assessment of the current economic situation and highly positive expectations for the coming six months (see Figure 1).

World economy: Onset of a global economic recovery

The improvement of the economic climate index had already set in by late April, after the end of the Saddam regime in Iraq. In July the positive trend of economic expectations gained momentum, and finally in the October 2003 poll, the upward movement of the indicator became clearly pronounced. After three consecutive positive survey results and the fact that the assessments of the current economic situation are beginning to follow the positive economic expectations in almost all regions, the latest survey results may be interpreted as signalling the onset of a global economic recovery.

United States: Economic upswing takes hold

In the *United States* as in *Canada*, the economic upswing gained momentum in the second half of 2003 (see Figure 2). In the *United States* the impetus derived from private consumption, which is expected to keep growing during coming months. The assessment of the present economic condition as well as

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

the projections of corporate investment and export volume were upgraded in October compared to the July results. However, the public deficit is seen to be a main source of instability. In *Canada* the economic climate index improved slightly, indicating that the previous economic setback is expected to be overcome.

Western Europe: Economic climate improves

According to the most recent survey results, both the assessment of the current economic situation and the expectations for economic developments in the next six months point to an improvement of the economic climate in Western Europe (see Figure 3).

Despite the overall improvement of the economic climate in October, the vast majority of WES experts surveyed in this region judged the present economic situation of their countries to be still below the “satisfactory” level. In particular, in *Belgium, Austria, Germany, Italy, Portugal, the Netherlands* and *Switzerland* the assessments of the present economic situation – though slightly more favourable than in the previous survey – remained in negative territory. In all of these countries, the outlook for the first half of 2004 is very optimistic, however.

Figure 1

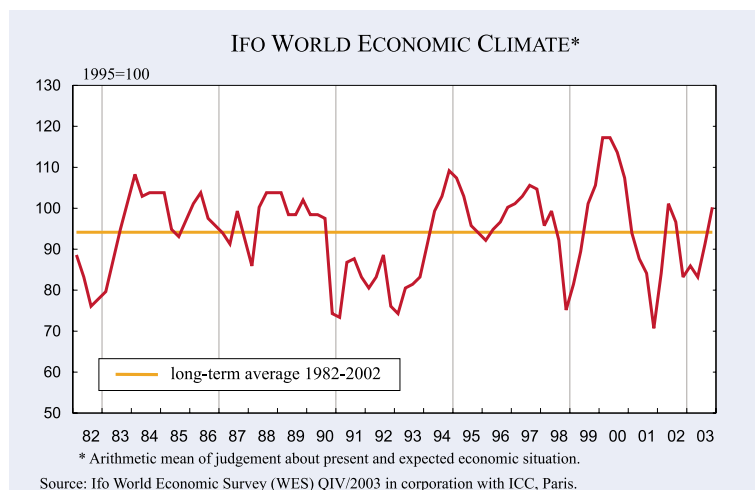
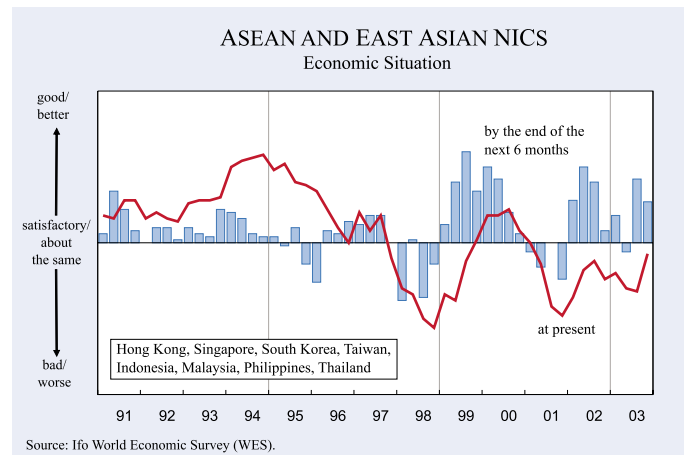
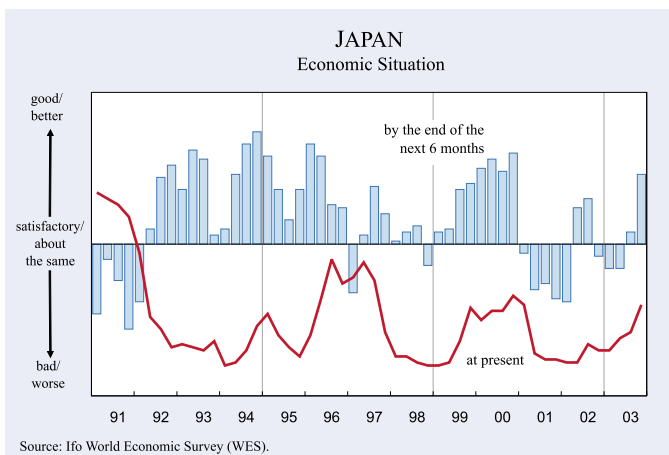
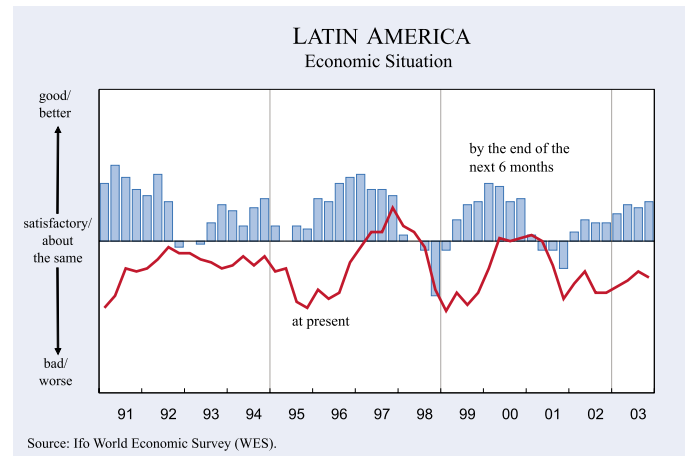
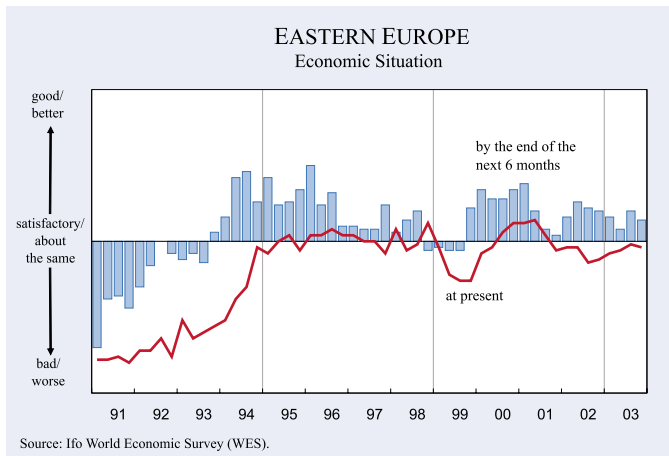
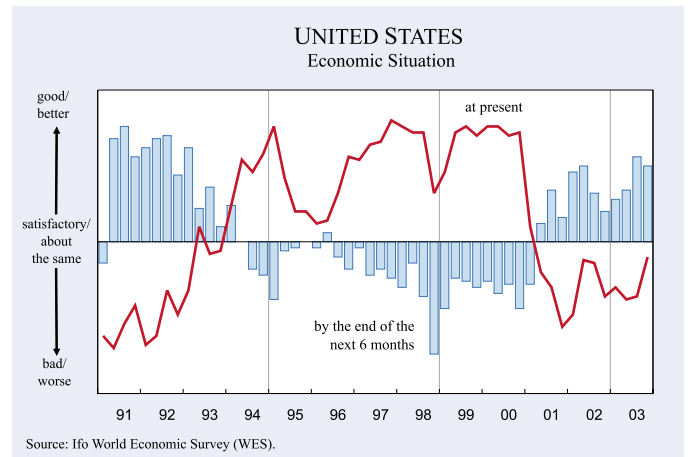
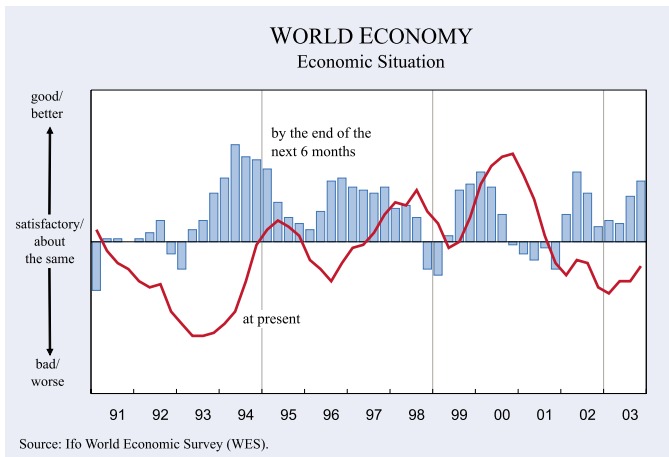


Figure 2



In the Scandinavian countries, that is in *Denmark*, *Finland*, *Norway* and *Sweden*, and also in the *United Kingdom* and *Ireland*, the present economic situation was judged satisfactory. The panel's forecast for the coming six months is for a stabilization of the current positive state of affairs. In two Southern European countries – in *Greece* and *Spain* – the downturn of the economic climate index that had set in by the end of 2000 reversed well before reaching negative territory in line with general economic sentiment in Europe. The only exception to this positive trend was France, the second largest economy of the region. Its present economic performance worsened in October, according to French WES experts. But the prospects for the coming six months are very positive, which is also true for the euro area in general.

Eastern Europe: Economic prospects point to further growth

According to the panel, the current economic situation in Eastern Europe remained stable in October. On average, the forecasts for the coming six months point to an economic stabilization in almost all countries of the region (see Figure 2).

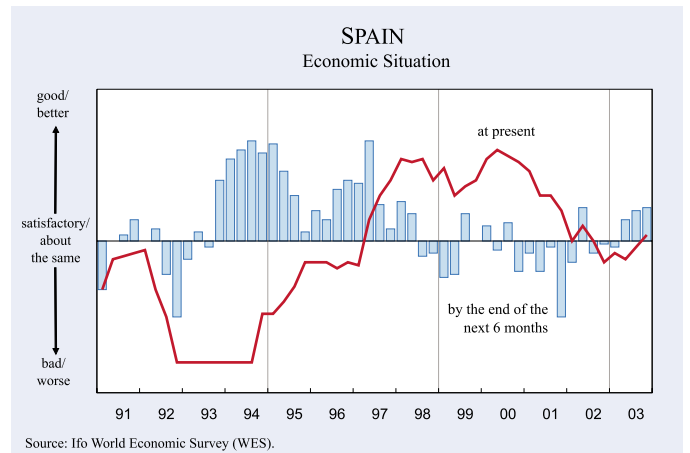
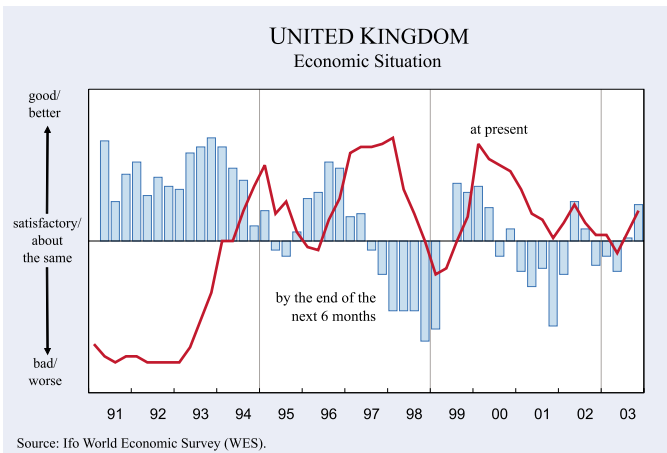
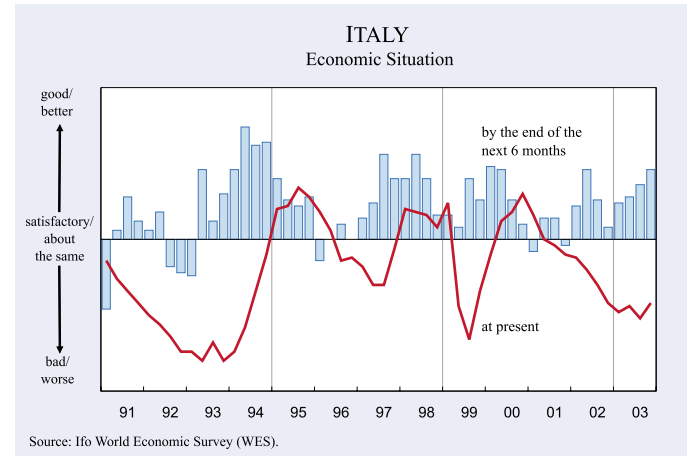
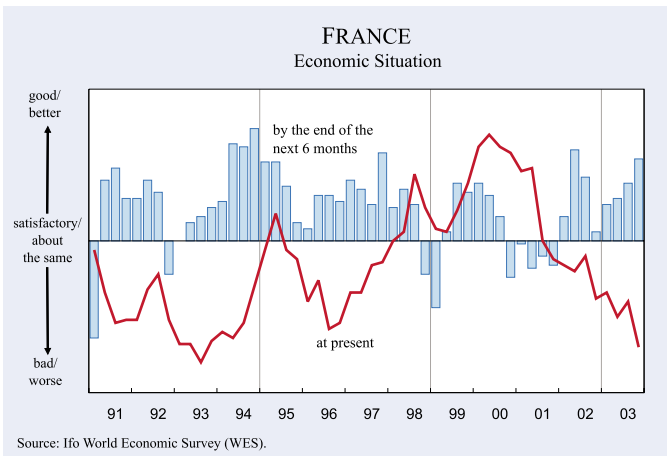
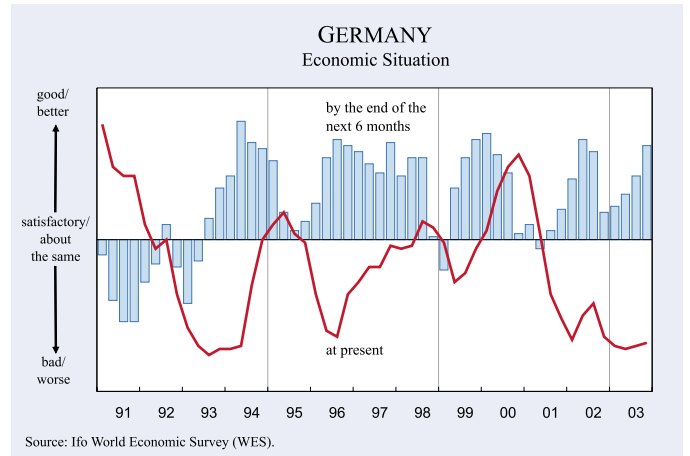
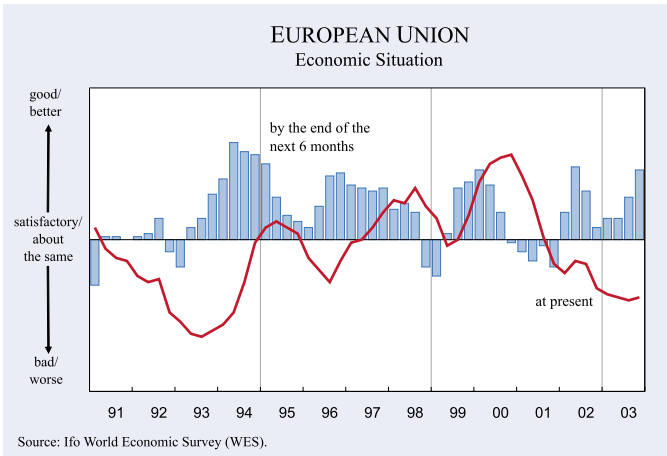
The economic climate index of the ten EU accession countries – *Czech Republic*, *Cyprus*, *Estonia*, *Hungary*, *Latvia*, *Lithuania*, *Malta*, *Poland*, *Slovenia* and *Slovakia* – averaged above the satisfactory level. Especially in the Baltic States (*Estonia*, *Latvia* and *Lithuania*) the assessments of the present economic situation remained at a highly satisfactory level, demonstrating considerable robustness over the past two years. WES experts are very optimistic concerning the further development of these economies. In the other prospective new EU members, too, recent data suggest a stabilization of these economies at the current “good” level in the next six months. The only exception is *Hungary*, where WES experts are less optimistic concerning the recovery of the economy in coming months. A strong decline in private consumption is forecast for the next half year. In *Poland* the recovery process is also proceeding rather sluggishly. To a greater degree than in *Hungary*, WES experts there expect exports to grow in coming months. In both countries public deficits, and – probably related to this – *lack of confidence in government economic policy*, are regarded the most important impediments to economic recovery.

In *Croatia* the economy is trending up. Since the end of 1999 the assessments of the present economic situation have steadily improved, and almost reached the satisfactory level in the October survey. The outlook for the next six months points to a continuation of the economic recovery. In *Bulgaria*, too, WES experts expect a stabilization of the economy at the current satisfactory level. In *Romania* and *Serbia and Montenegro*, the present economic performance is well below “satisfactory”, but the outlook for the coming six months is for an improvement. A much less encouraging economic situation still prevails in *Bosnia Herzegovina*, where the presently depressed economy is not expected to improve in the near future.

Latin America: Disparity of economic trends

The assessments of the current economic situation of Latin American economies deteriorated slightly, whereas near-term expectations improved somewhat (see Figure 2). Economic trends in the individual countries of the region diverged widely. In *Brazil*, the panel's responses reflect a continuation of economic stabilization. The prospects for the first half of 2004 are very positive. Private consumption as well as capital expenditures and exports are expected to continue rising. During the first nine months of the administration of President Lula da Silva, the *Brazilian* economy has demonstrated a remarkable robustness. However, *unemployment* and *insufficient demand* remain the main problems of the country, whereas *inflation*, which was the second most important economic problem at the beginning of 2003, seems to have been brought under control. WES experts also reported a moderate economic climate for *Chile* and *Peru*. Expectations point to further stabilization at the current “satisfactory” level, with higher forecasts for private consumption, capital expenditure and exports. To a lesser degree this also holds true for the economic climate in *El Salvador*. In all these three countries, *unemployment* is listed as the major economic problem. In *Argentina*, the recovery process is continuing, according to the recent survey results. Assessments of the current economic situation steadily improved during 2003, although they have not reached a satisfactory level. The outlook indicates a continuation of this positive trend. A similar picture can be observed in *Colombia*. Less favourable assessments concerning the present economic situation were given by WES

Figure 3



experts in *Mexico, Paraguay, Panama* and *Uruguay*. However, the near-term prospects are positive there. In all these countries the private consumption as well as business investment are expected to pick up strongly in coming months. The export sector is forecast to strengthen, too.

In other countries of the region the overall economic situation is less encouraging. In *Ecuador*, the current economic situation was rated very poorly in October and is expected to worsen further in the course of the next months. *Venezuela* is recovering only sluggishly from the recent political crisis with a protracted general strike that affected many industrial sectors. The assessments of the current economic situation are still very low, but for the first time in over two years near-term expectations entered positive territory. The worst marks concerning the overall economic climate were given by WES experts in *Bolivia*, where a political crisis was triggered by a controversy surrounding the *Bolivian* petroleum industry, the second largest in Latin America after *Venezuela's*. The violent conflict is expected to ease somewhat now that Carlos Mesa has succeeded Gonzalo Synchez de Lozada as president. However, since *lack of confidence in government's economic policy* is ranked as the foremost economic problem of the country, the political and economic situations are still far from stable.

Asia: Economic climate indicator rises

In the October survey the economic climate indicator in Asia reached the highest level compared to its long-term average among all WES regions. The recovery process had already begun quite strongly in 2002. The ensuing growth was interrupted by the geopolitical uncertainties relating to the conflict in Iraq, by the outbreak of SARS and by the economic weakness in the West. In July and October 2003, however, the economic climate index bounced back, significantly surpassing its long-term average. Whereas the July pick-up was mostly attributed to the optimistic forecasts for the coming six months, the October improvement is due to both, positive assessments of the current economic situation as well as to a positive outlook for the next six months.

In *Japan* the recovery from the long recession gained momentum in the second half of 2003.

Economic expectations for the next six months point to further improvement of the overall economy, especially in business investment, private consumption and exports.

In *India*, economic growth strengthened further. Macroeconomic stabilization and fiscal reforms, trade liberalization, industrial deregulation and privatization have pushed *India* to the forefront in terms of business sentiments among the Asian countries covered by WES. Improved performance was seen across all sub-sectors: capital expenditure and private consumption as well as exports. Thus, the foundations for further growth in the coming six months are seen to be good, and growth is approaching the Chinese level. However, in *Japan*, where the recovery process from the recession gained momentum in the second half of 2003. The economic 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. *China*, however, retains its central position as the driving force of growth in the region. The economic climate remained highly favourable in October. Apart from continued export growth, private consumption is expected to strengthen further.

ASEAN and the East Asian Nics are now showing better current assessments and continued good prospects. *Thailand* posted solid economic growth of 5.2 percent in 2002. In October 2003 the economic situation was assessed to be at a highly satisfactory level and is expected to improve further in 2004. WES experts from *Vietnam* and *Malaysia* also reported that 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. Though the assessments of the current economic situation in *Hong Kong* and *South Korea* have not yet reached a satisfactory level, the current economic assessments and hence the overall economic climate changed for the better, confirming the optimistic expectations of the previous surveys. The present economic situation in *Indonesia* is now judged as satisfactory, but the outlook for the next six months is still cautious, implying a rather sluggish economic recovery. In *Taiwan*, WES experts were satisfied with the present overall economic performance. The prospects for further development are moderately positive.

Inflation: To remain moderate

An average 2.9 percent increase in consumer prices is expected for the world economy in 2003, which is only insignificantly higher than in July (2.8 percent) and much lower than the estimates in Spring 2003 (3.2 percent). Inflation in the *euro area* in 2003 is seen to be under the 2 percent mark (1.9 percent). Inflation estimates range from 1.1 percent in Germany to 3.6 percent in Ireland. At 0.7 percent, Switzerland will have the lowest inflation rate of *Western Europe* according to the WES experts.

In the *United States* a slightly higher inflation rate is expected than in the July survey (2.2 percent after 2.0 percent). Contributing factors are in particular the economic recovery and the weakening of the dollar vis-à-vis important currencies such as the yen and the euro, which will lead to higher import prices. On the whole, however, the expected US inflation rate clearly remains below the 2.5 percent mark that the Federal Reserve would still consider acceptable. Of all the surveyed country blocs *Asia* displays the highest price stability. In comparison with the July survey a marginally higher inflation rate is expected now (1.3 percent instead of 1.1 percent), due to a higher inflation prospects in China (1.6 percent instead of only at 1.0 percent in July). In Japan and Hong Kong a deflationary price trend is expected to continue but to be weakening, particularly in Japan.

The inflation outlook for *Central and Eastern Europe* remained virtually unchanged (4.2 percent after 4.3 percent in July). The strongest price increases by far are likely to be registered in Romania (13.8 percent), Serbia-Montenegro (9 percent) and the Slovak Republic (8.7 percent).

In *Central and Latin America*, inflation continues to slow down, with an average rate of 7.8 percent now expected for 2003, after 9.0 percent in the July survey. The highest inflation rate persists in Venezuela, but it is also slowing (31.9 percent after an expected 45.8 percent in July).

Interest rates: Trend expected to reverse

The present round of interest rate cuts has come to an end, according to the WES panelists. In the course of the next six months, short-term interest

rates are expected to rise for the first time since the July 2002 survey. Central-bank interest-rate increases are seen to be more likely in the *United States* than in the euro area, where the majority of experts anticipate that the European Central Bank will leave interest rates unchanged. In the United Kingdom and in Australia the increase in interest-rates expected by the WES participants have already occurred. In Western Europe outside the euro area, rising interest rates are expected in Denmark and Switzerland. In Sweden the WES participants expect interest rates will to fall slightly, and in Norway the central bank is expected to leave interest rates unchanged. In *Eastern Europe* most survey participants indicated that interest rates will continue to fall. Only in the Czech Republic Estonia, Bulgaria and Croatia are slight interest-rate increases expected in coming months.

In the other WES regions, short-term interest-rates are likely to decline further, but not as strongly as indicated in the July survey. In *Latin America* on average, stable central-bank interest rates are expected. This includes both the expectation of central-bank interest-rate cuts in Brazil and Uruguay as well as rising central-bank rates especially in Colombia and Venezuela. In Asia the WES experts see little need for rate changes by the central banks. Deviating from this general trend, interest rates are expected to increase in India, Indonesia and Thailand and also in China (for the first time since mid-1996).

Parallel to the expected increase of short-term interest rates, bond rates are also likely to rise with the exception of Eastern Europe, where a further drop in long-term rates is expected. Slightly declining bond rates are expected in Latin America and slightly increasing rates in Asia.

Currencies: Euro still considered overvalued

As in the July survey, the euro was again assessed as overvalued, along with the British pound, on average for all 91 included countries. The US dollar and the yen were seen as undervalued. This overall assessment also holds for Western and Eastern Europe. In the United States, too, the exchange rates of the euro and the British pound were considered overvalued and that of the yen as slightly undervalued. Experts in Australia and in Russia regarded the home currencies to be overvalued vis-

à-vis the dollar, the euro, the British pound and the yen. In the Asian countries, on average, the exchange rate of the dollar is considered appropriate, that of the euro slightly overvalued and that of the yen overvalued.

The responses to the supplementary survey question on the likely development of the US dollar during the next six months indicate no appreciable change in parities. This conclusion also holds for Western Europe. In Canada and Australia a further weakening of the US dollar is expected. In Eastern Europe as well as in Russia and the Near East, the WES experts see their home currencies weaken vis-à-vis the dollar over the next six months. The same applies to Latin America and Africa, where a depreciation of the home currencies relative to the dollar is expected. WES experts see a weakening dollar predominate in China, Japan, Taiwan and Thailand.

Medium-term growth outlook: A little more positive

A year ago, WES experts expected average annual growth of GDP of 2.7 percent for the next three to five years. This forecast has now been raised to 2.9 percent. While the WES panelists in Western Europe only expect a 2 percent average rate of growth, expectations in the United States increased perceptibly from 2.5 percent to 3.1 percent. In Asia the expected average growth rate increased from 3.5 percent to 3.8 percent. In Eastern Europe the expected growth rate remained at approximately 3.5 percent. In Latin America the growth chances are considered slightly more positive than a year ago (2.5 percent after 2.3 percent), but in Argentina an acceleration to 3.3 percent is foreseen. The expected growth rates in the Near East (4.1 percent after 3.1 percent) and in Africa (3.6 percent after 3.1 percent) continue to be relatively high.