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Article

CESifo World Economic Survey February 2004

CESifo World Economic Survey

Provided in Cooperation with:

Ifo Institute – Leibniz Institute for Economic Research at the University of Munich

Suggested Citation: Nerb, Gernot; Stangl, Anna (2004) : CESifo World Economic Survey February 2004, CESifo World Economic Survey, ISSN 2190-720X, ifo Institut für Wirtschaftsforschung an der Universität München, München, Vol. 03, Iss. 1, pp. 1-22

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CESifo WORLD ECONOMIC SURVEY

VOLUME 3, No. 1

FEBRUARY 2004

WORLD ECONOMIC CLIMATE

World Economic Climate considerably improved

ECONOMIC EXPECTATIONS

Economic expectations for the next six months are highly optimistic

INFLATION

Inflation will remain moderate

INTEREST RATES

Begin of tightening cycle expected

CURRENCIES

Growing overvaluation of the euro

SPECIAL TOPIC

Fear of terrorism has affected business prospects for 2004 in several regions

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CESifo World Economic Survey ISSN 1619-5132

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

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Ifo World Economic Survey

Regions

- World economy: Global economy gains strength
- Western Europe: Returning confidence
- Eastern Europe: Stabilizing markets
- North America: Growth will continue
- CIS: Strong growth in Russia
- Asia: Economic expansion continues
- Oceania: Boom continues
- Latin America: Continuing recovery
- Near East: Sound economy
- Africa: Economic conditions improve

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

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 January 2004 some 1,114 economic experts in 92 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 (in English).

WORLD ECONOMY: GLOBAL ECONOMY GAINS STRENGTH

In January 2004 the World Economic Climate continued the upward trend that set in at the beginning of 2003 (see Figure 1). After the third improvement in succession the overall climate indicator is at 111.0 (1995 = 100), considerably higher than its long-term average (1982–2003: 92.97) and is now approaching its all-time high reached in the beginning of 2000 (117.2 in January and April 2000). As in the October survey, the improvement resulted from both more favourable assessments of the current economic situation as well as from highly positive expectations for the coming six months.

World economy: Sustained economic growth ahead

The overall climate indicator continued its upturn in January 2004. On the world average, the economic expectations for the coming six months are – with a rating of 7.3 on the WES grading scale (which goes from 1 to 9) – at the highest level since 1985, pointing to a pronounced upswing of the world economy. Also the assessments of the present economic situation improved considerably and have now surpassed the “satisfactory” level. However, though the climate indicator is approaching the past boom level reached in 2000, the pattern of its components is quite different (see Figure 2): The appraisals of the current state of the economy are significantly less positive than in 2000 and the high level of the climate index results

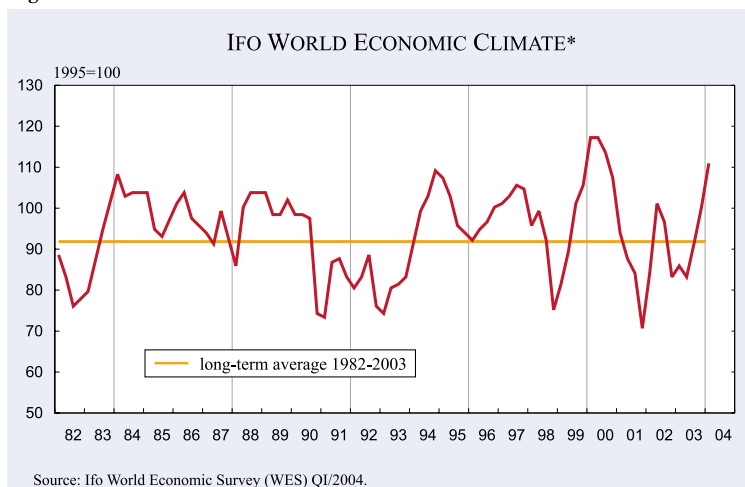
mainly from very optimistic economic expectations. Nevertheless, the data provided by the new World Economic Survey point to continuing economic upswing in all surveyed regions of the world. The favorable global conditions are also expected to have beneficial effect on export and import performance worldwide and thus on the world trade. In most countries it is expected that in the course of the next half year the recovery in the hard hit capital expenditure sector will be more pronounced than in private consumption.

Western Europe: Returning confidence

According to the panel's responses, confidence in economic recovery is returning in Western Europe (see Figures 3 and 4). Though the current situation is not yet seen to be satisfactory, the panel's assessments have followed a positive trend since July 2003. An improvement of the current economic state has been reported from all Western European countries, except *Denmark*, where it remained unchanged at a highly satisfactory level, and *Portugal*, where the still far below satisfactory assessments of the present economic situation deteriorated somewhat more. The economic expectations have been upgraded significantly in all Western European countries and are, among all WES regions, the most optimistic. Both

growth of capital expenditures as well as increasing private consumption are expected to support economic recovery in the coming year. In the *United Kingdom*, growth of private consumption – after strong performance in the recent past – is expected to slow down somewhat in the course of the next six months. Owing to the region's economic recovery, imports are expected to strengthen. As the export sector should recover as well, the trade balance will remain mostly unchanged in all coun-

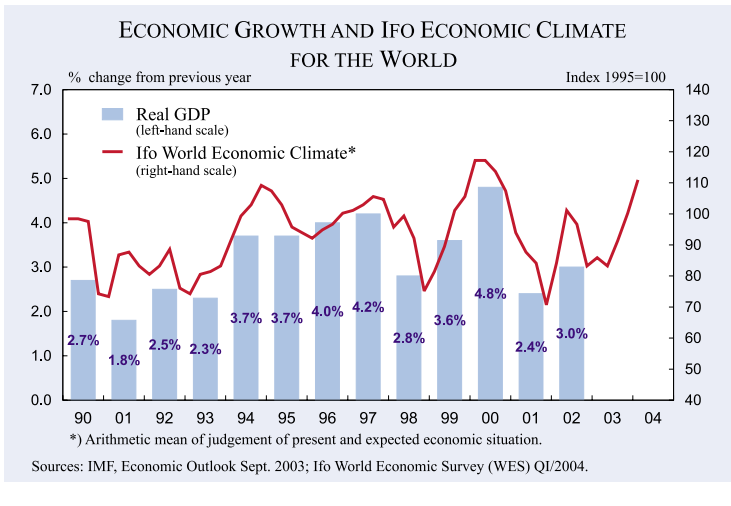
Figure 1



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

The Ifo World Economic Climate indicator closely tracks the growth of the world economy (see Figure). In January 2004 the indicator took a sharp rise in comparison to the last survey of October 2003. The uninterrupted increase in the world indicator since July 2003 this time was particularly due to the more favourable assessments of the current situation. The already optimistic expectations for the next six months again slightly improved. Overall, the latest survey results are a further indication that the upswing in economic activity worldwide is solidifying and will gain strength in the coming months.

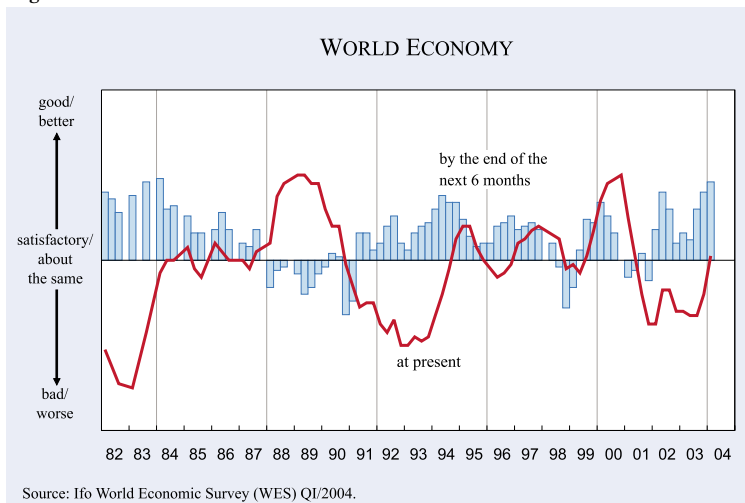
The breakdown across regions shows that the indicator rose most strongly in North America and in Asia, but it is also pointed clearly upwards in Western Europe and in the other areas of the world.



tries of the region, except *Greece* and *United Kingdom*, where WES experts expect an increasing trade balance deficit.

In the euro area, *Austria, Belgium, Finland, Greece, Ireland* and *Spain* appear to be faring significantly better economically than the other countries, in particular *France, Germany, Italy, the Netherlands* and

Figure 2



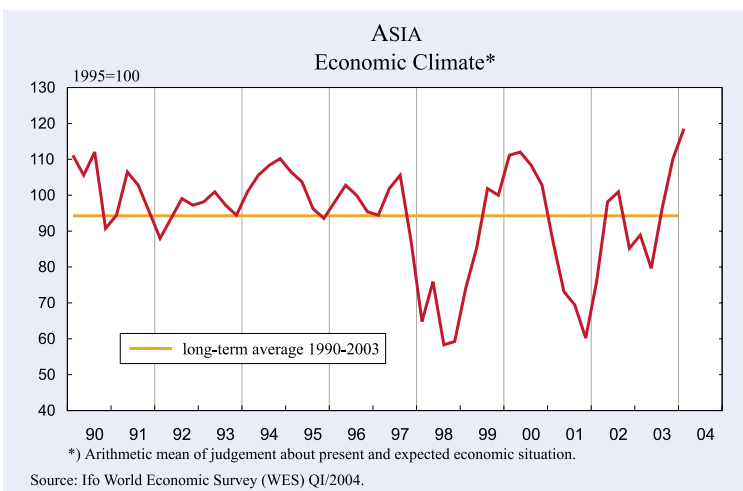
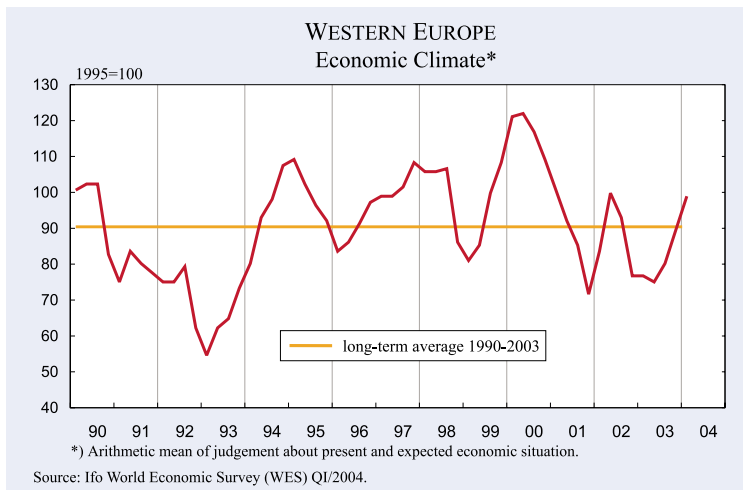
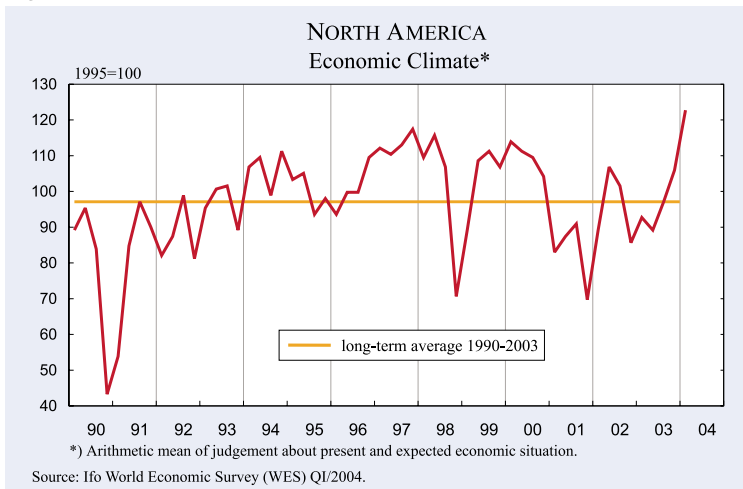
Portugal, where the present economic situation is still assessed as far below the satisfactory level.

Among the non-euro countries, only in *Sweden, Switzerland* and *Cyprus* have the assessments of the current economic situation not yet reached the positive territory, but they are on the right track, while in *Denmark, Iceland, Norway* and the *United Kingdom* the present economic situation remained good or further improved.

North America: Growth will continue

The latest survey results indicate that the economy in North America will remain strong (see Figures 3 and 4). The economic climate indicator reached an all-time high of 1985. In particular, the *US* economy demonstrated, according to WES experts, a strong performance in January. Given the high level of consumption and corporate investments, which are foreseen to underpin further growth, the foundations for further improvement remain favourable. Exports are expected to grow stronger than imports in the coming six months. However, given the huge gap between the volume of exports and imports this will only have a very limited impact on trade-deficit reduction. In *Canada*, as a result of strong import growth and decline in exports, the trade balance is likely to deteriorate. The assessments of the present economic situation received from *Canadian* WES participants show some improvement in January, after having been slightly downgraded in the second half of 2003. The economic prospects for the coming months remain encouraging; in particular investment activity is

Figure 3



expected to be resilient, though to a slightly lesser degree than in the *US*.

Eastern Europe: Stabilizing markets

Since the beginning of 2000 the markets in Eastern Europe have been on a stabilizing course (see

Figure 4). Business sentiments in the region were almost untouched by the world-wide economic slow-down of the recent years and demonstrated remarkable robustness against external shocks. Nevertheless, diverging economic trends were observed in the Eastern European countries polled by WES (see Figure 8).

The assessments of the present economic situation in the ten EU accession countries – *Czech Republic, Cyprus, Estonia, Hungary, Latvia, Lithuania, Poland, Slovenia* and *Slovakia* – rated above the satisfactory level in January, on average. The forecasts for the coming six months point to further economic improvement in all new EU member states, except *Hungary*, where also the present economic situation has been rated below the satisfactory level. The Baltic States (*Estonia, Latvia* and *Lithuania*) remained the strongest economies of the region, according to WES participants. However, since 2000 also *Slovakia* is steadily approaching a high level of business confidence. In all ten countries, experts expect marked increases in corporate investments for the first half of 2004.

In the other Eastern European countries, economic trends observed in January strongly differ. In *Bosnia Herzegovina* and *Serbia-Montenegro* the overall economic climate is still signaling recessionary trends.

The near-term prospects remain cloudy. In contrast, in *Albania* and *Bulgaria* the overall economic trend points to recovery. In *Croatia* and *Romania*, the present economic performance was rated below “satisfactory”, by the WES panel, but the outlook for the next six months raises hope for an economic revival.

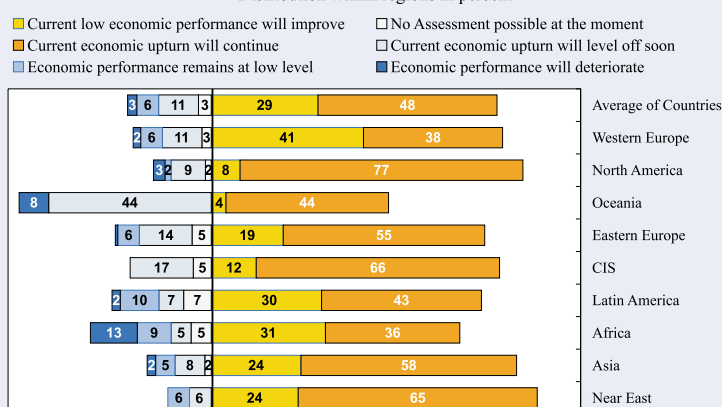
Box 2:
Sustained economic growth expected in the next 1 to 2 years

World Economy: Current economic upturn appears sustainable

According to a broad majority of WES experts the current worldwide upswing is not a short-lived phenomenon, but is expected to continue in the next 1 to 2 years. This judgment prevails in almost all regions; only in Oceania (Australia and New Zealand) the strong growth in the recent past is expected to cool down somewhat. In North America – both the USA and Canada – a clear majority of experts expect the current strong economic upturn to continue beyond 2004. Similar assessments of the economic outlook came from Asia, CIS countries (Russia, Kazakhstan, Georgia and Ukraine) and Eastern Europe. In Western Europe the until now mostly weak recovery will gain more momentum in coming 1 to 2 years, according to WES participants. Latin America and Africa will also benefit from the world wide growth and will show increasing signs of recovery and economic stabilization.

ECONOMIC PROSPECTS FOR THE NEXT 1 TO 2 YEARS

Distribution within regions in percent



Source: Ifo World Economic Survey (WES), Q1/2004.

The export sector is expected to stimulate economic growth in all Eastern European countries without exception, but also imports will continue to grow strongly. Private consumption, which markedly increased in the recent past, will expand somewhat less dynamically in coming months, particularly in *Czech Republic* and *Hungary*, to a lesser degree also in *Albania* and *Croatia*. On the other hand, growth of capital expenditures is generally expected to pick up in the next six months, laying the groundwork for more growth in the future.

CIS: Strong growth in Russia

The economic upturn in Russia is gathering momentum, according to the recent WES results. Domestic demand is already performing highly satisfactorily, and its growth is expected to continue. Following this trend, imports are expected to increase stronger than exports in the coming six months, resulting in a moderate deterioration of the trade balance. Corporate investment performance is expected to remain solid.

Also in *Kazakhstan* the recovery is picking up. The current situation is already judged as above satisfactory, and the economy should gain momentum during the next six months. Exports are likely to remain the main driving force. The favorable general economic outlook also implies further growth of corporate activity.

A much better economic climate than in the previous October poll has been reported from *Georgia*. Both the assessments of the current situation and the outlook for the first half of 2004 have been revised upward. The overall improvement of business confidence is probably related to the fact that the new president of *Georgia*, Mikhail Saakashvili, has assumed office. Though the main economic aggregates – capital expenditures and private consumption – are still judged below the satisfactory level, *Georgian* participants are fairly optimistic concerning the near

future. Also the export sector is expected to show resilience.

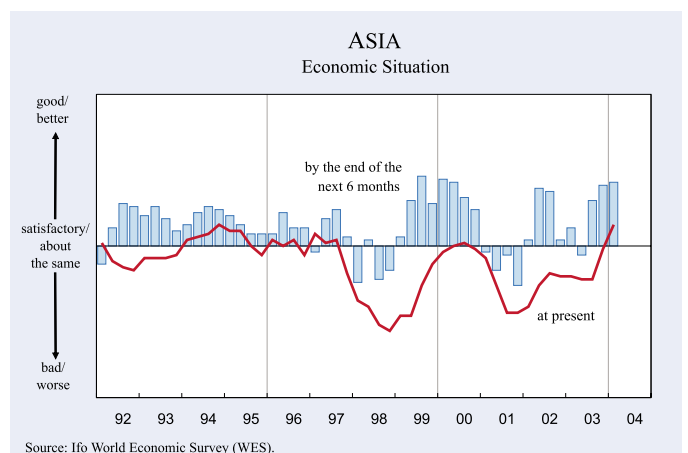
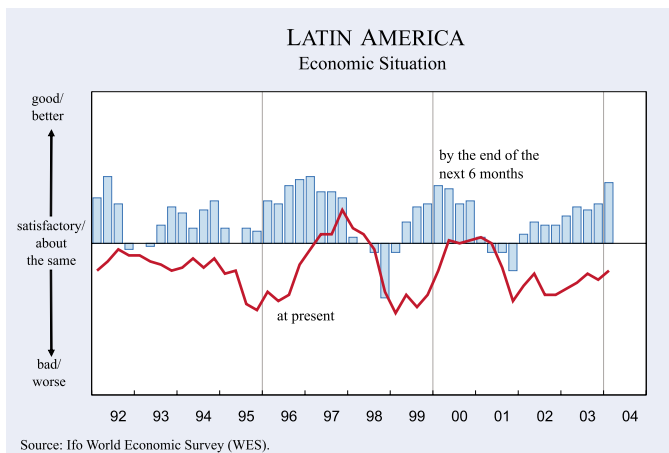
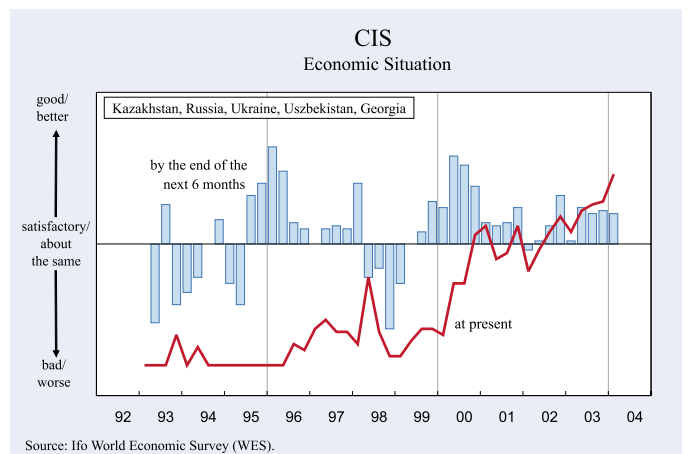
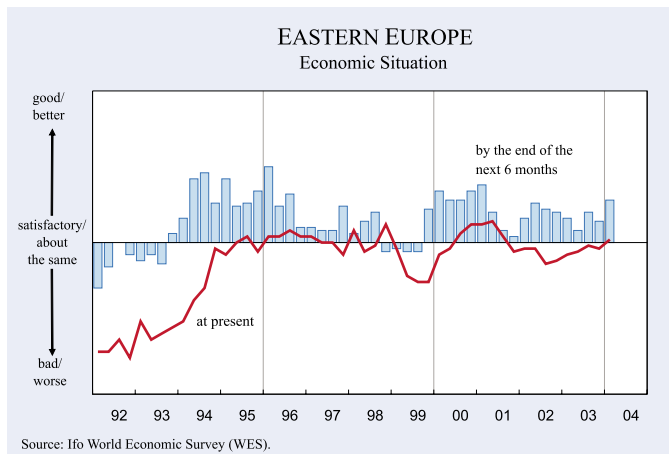
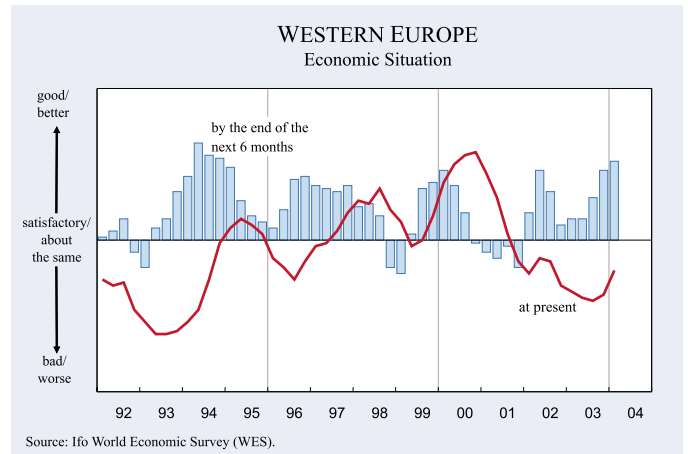
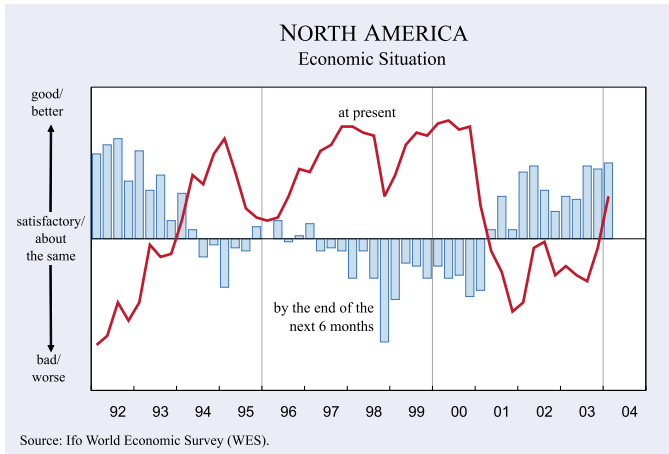
Positive signals have also been reported from the *Ukraine*. The present economic situation has been described by WES experts as at the satisfactory level; the prospects for the coming six month – are considered as relatively bright. Foreign trade performance – both exports and imports – is expected to revive, as well as capital expenditures and private consumption.

Asia: Economic expansion continues

According to the January survey results, economic expansion in Asia will likely soon achieve an all-time high (see Figure 3). The overall economic climate improved due to a better assessment of the current economic situation, on an Asian average. The expectations concerning the economic development in the coming six months remained very optimistic. Domestic demand is forecast to strengthen in almost all countries. Thus, the improved global and regional environment is expected to have further positive

Figure 4

SELECTED REGIONS

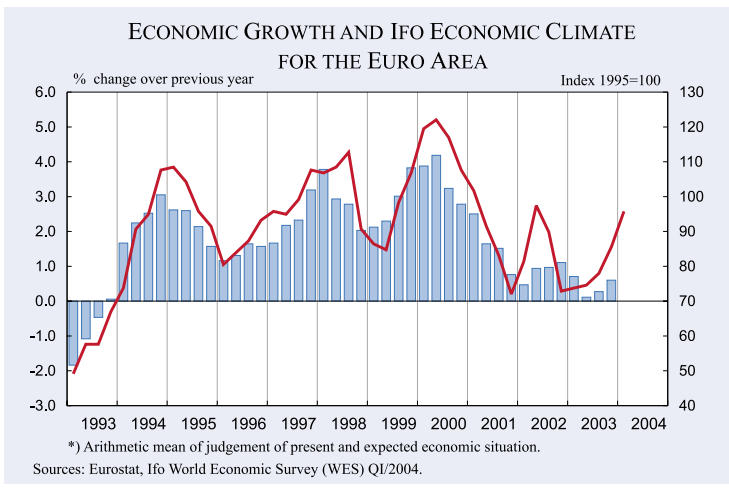


**Box 3:
Ifo World Economic Survey (WES) and GDP Growth in the Euro Area**

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 January results are based on the responses of 316 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 WES indicator for the economic climate in the euro area rose in January 2004 for the fifth time in succession. The assessments of the current economic situation improved even more notably than the already quite optimistic expectations for the next six months. In spite of the more favourable appraisals, the current economical situation, however, is still a good way from reaching a satisfactory level. On the whole, the latest survey results indicate that the economic recovery in the euro area will speed up in the course of the next six months.

Within the euro area the economic climate is most favourable in Finland, Ireland, Belgium, Spain, Greece, and Austria. The countries where the climate index lies below the euro area average are the Netherlands, Portugal, Italy, Germany, and also France.



impact on exports of all Asian countries. Bird flu has devastated the region's poultry industry, but the region's overall economy appears not to have been noticeably affected.

Among the Asian countries surveyed by WES, *India* has become the "shining star" economically. The recovery course taken already in the beginning of 2002 was undisturbed by the conflict in Iraq or the economic weakness in Western countries and has escaped the outbreak of SARS in Asia. The present economic performance has been assessed unanimously with the highest possible marks on the WES rating scale by all 14 surveyed economists. The conditions for acceleration of the upswing are considered favorable as well. *China*, though, has lost the leading position in Asia concerning business confidence, but remains amongst the strongest economies in the region. The marks for the present economic

situation are at the highest possible level here too. Alongside with the export sector, the import sector is also expected to pick up further, as the growing economy has an enormous demand for raw materials and fuel. Buoyant household earnings do also serve as growth stimulant in *China*. However, according to experts' expectations, a moderate slow down is possible in the coming six months (see Figure 9).

The economy in *Hong Kong* has obviously recovered from the severe crisis of 2003 faster than initially expected. Assessments of the present economic state climbed above the satisfactory level. With regard to the future economic development the participants are fairly confident. The economic climate index in *Japan* also demonstrated a sharp upturn. Capital expenditures as well as private consumption are expected to strengthen in both countries.

The economic situation in *South Korea* and *Mongolia* remained unstable, but WES experts fore-

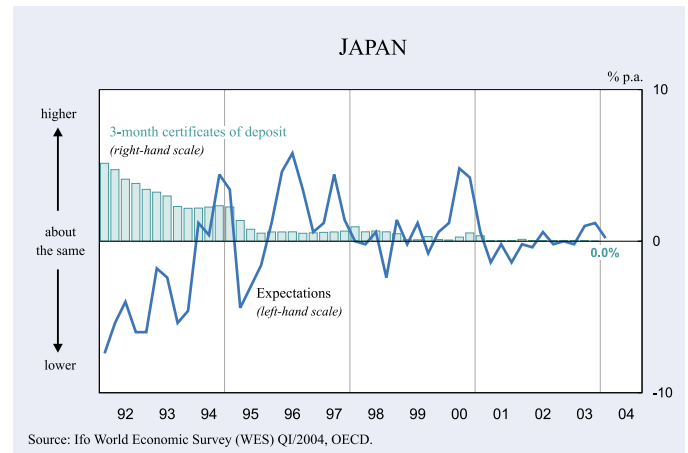
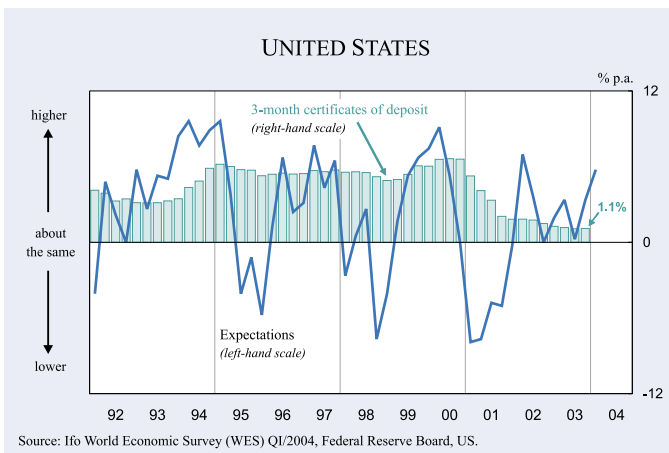
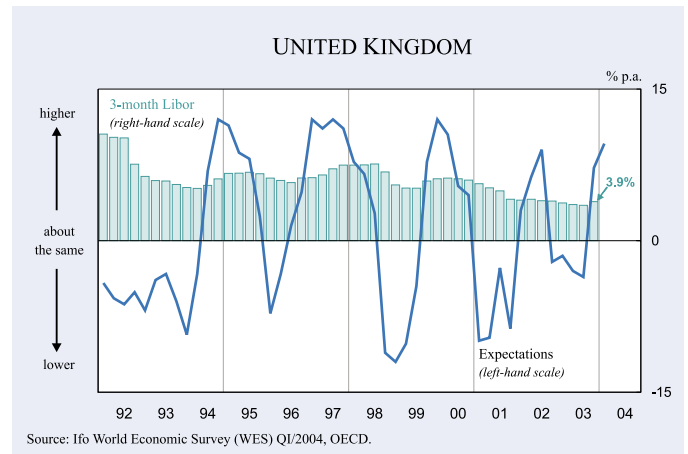
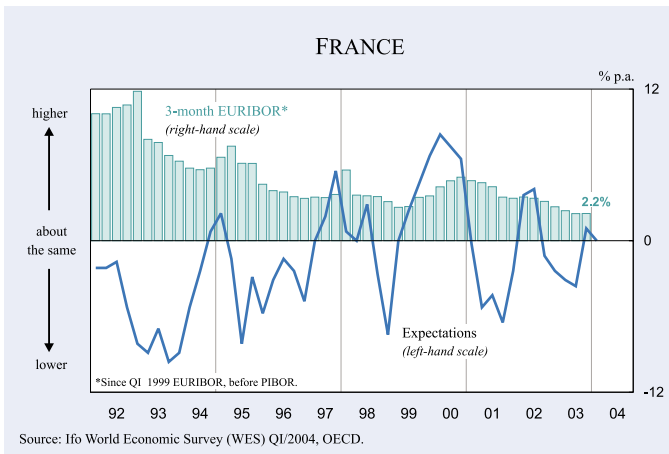
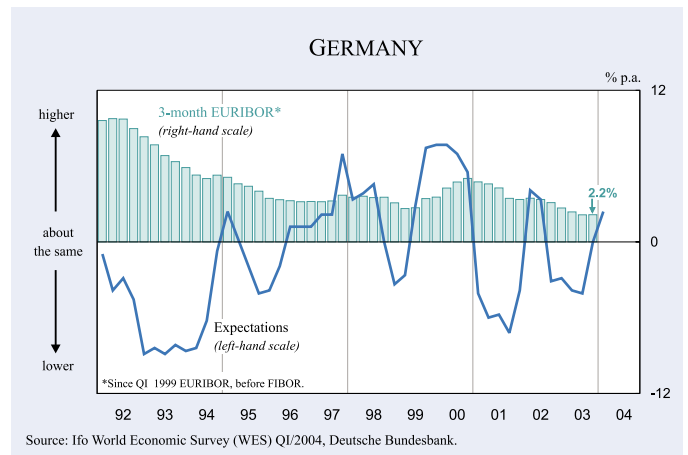
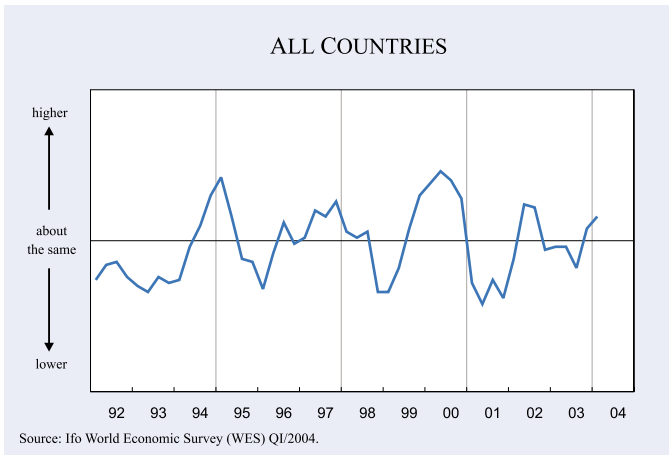
cast improvement resulting mainly from a revival of investment and private consumption in the coming months. In *South Korea* exports are expected to continue to serve as a growth engine.

The bird flu crisis has damaged *Thailand's* poultry exports and has had some negative impact on the tourism industry. However, according to the January survey results WES experts see no risk of damage for the entire economy. The present economic situation has been assessed highly positively, and for the near future the market prospects still look good.

The other Asian economies – *Singapore*, *Taiwan*, *Malaysia* and the *Philippines* – continued to demonstrate fundamental health, according to WES participants. These countries belong economically to the midfield of the region. The present economic state is already considered more than satisfactory and is expected to improve further. Among all Asian coun-

Figure 5

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



tries only experts in *Indonesia* and *Sri Lanka* became somewhat skeptical concerning the near-term economic rebound.

Oceania: Buoyant economy

After a period of cautious expectations, business confidence in Oceania is likely to benefit from the worldwide economic rebound. The marks for the present economic state have been for more than two years highly positive. The downturn feared in 2003 has not materialized, and business confidence has returned particularly in *Australia*, driving the climate indicator to the highest level since 1995. WES experts forecast stabilization of capital expenditures and private consumption at the currently high level.

In *New Zealand*, however, economic expectations remained subdued, while the current economic situation has been assessed here very positively too. The economic development in the country is twofold. On the one hand, bolstered by the strong New Zealand dollar, the export sector continues to suffer. Consequently, WES experts forecast further deterioration of the trade balance. On the other hand, branches not affected by the appreciation of the currency can benefit from the increased domestic demand in the coming months.

Latin America: Continuing recovery

The latest survey results confirm economic recovery in Latin America. Both, the current economic situation as well as economic expectations have been upgraded, though to a slightly lesser degree than in other WES regions (see Figure 4).

Increasing confidence was reported by *Brazilian* experts. The assessments of the present economic situation are above satisfactory, and the prospects for the next six months point to further economic growth. Government's economic policy is succeeding in restoring investors' confidence; thus, WES experts reckon on increasing corporate investments. An even brighter picture of the economic climate has been drawn by

experts in *Chile*. The economic performance in the country is remarkably strong, since all demand aggregates are performing satisfactorily and are expected to gather further speed in the first half of this year. *Colombia* and *Costa Rica* also count among the group of buoyant economies. The present economic performance is already seen to be satisfactory and is expected to remain on the upward trend.

Although there were no further improvements of the economic climate in *El Salvador* in January, experts questioned in the survey basically confirmed the favorable results of the October survey. No remarkable improvement of the less favorable economic conditions has been reported by experts in *Mexico*. However, the economic expectations have been slightly upgraded, promising increasing dynamics in the corporate investment sector for the coming months (see Figure 10).

In *Argentina*, both the current economic situation as well as the near-term expectations have been upgraded, but the economic recovery remains sluggish, indicating that the economy is not yet out of the woods. The shaky economic state relates to the fact that private consumption and corporate expenditures are still weak, however, some strengthening is expected in the course of coming months.

The economic situation deteriorated in *Peru* slightly, but is likely to recover in the foreseeable future, with exports being the driving economic engine. In *Venezuela*, *Paraguay* and *Uruguay* the assessments of the current economic situation also deteriorated or remained unchanged negative since the October poll. The prospects in these countries, however, are

Figure 6

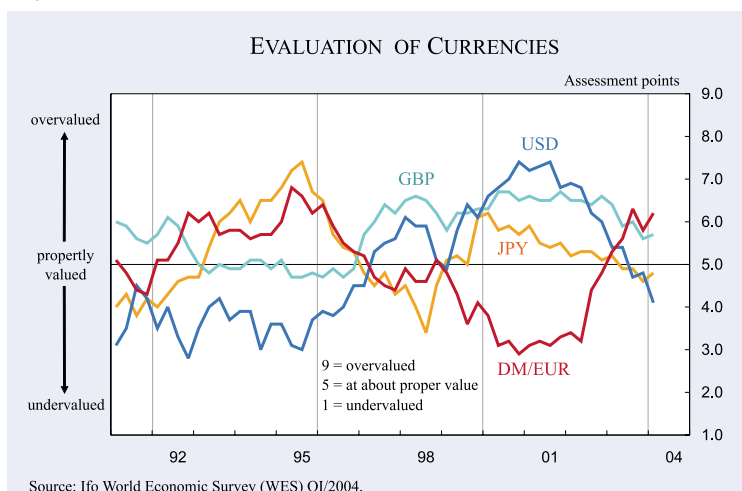


Figure 7a

EUROPEAN UNION

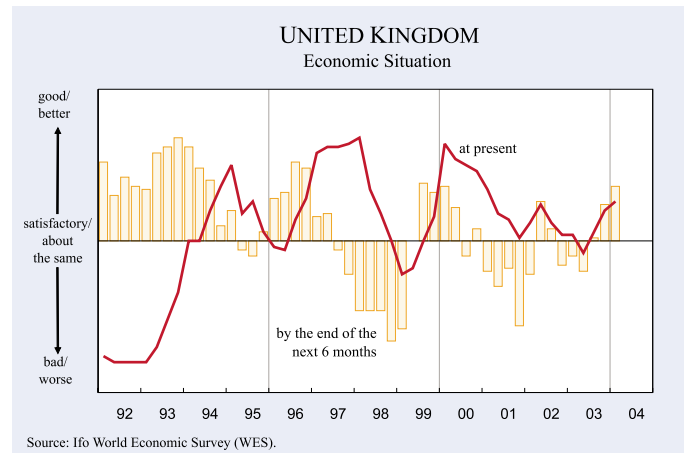
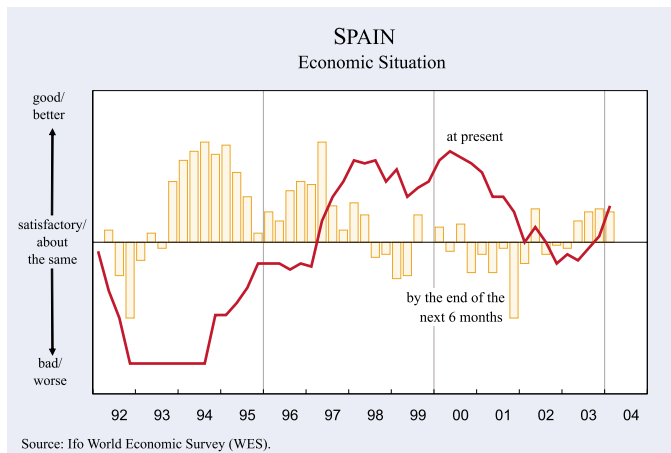
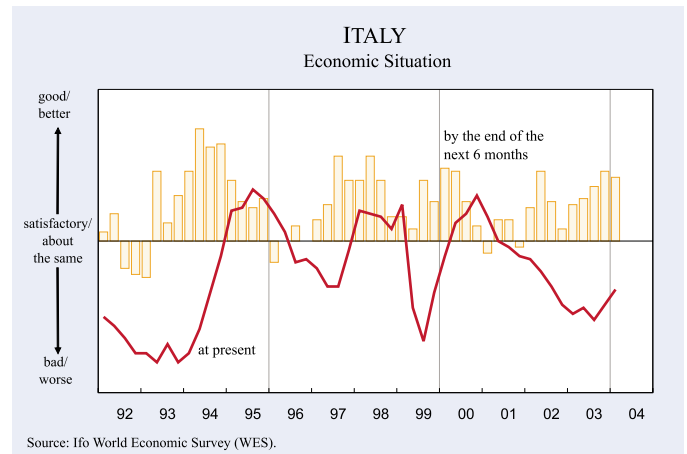
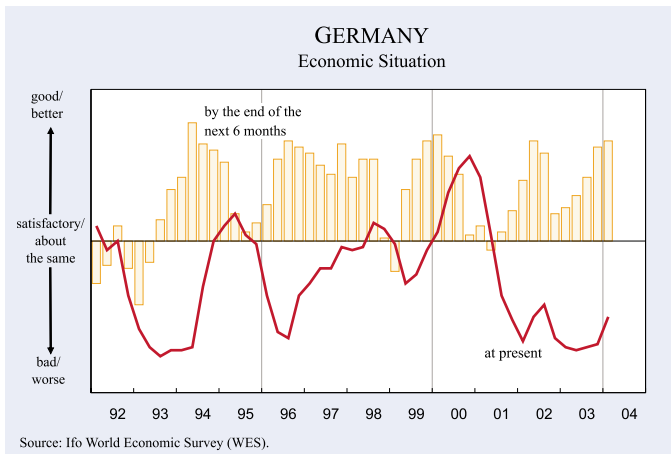
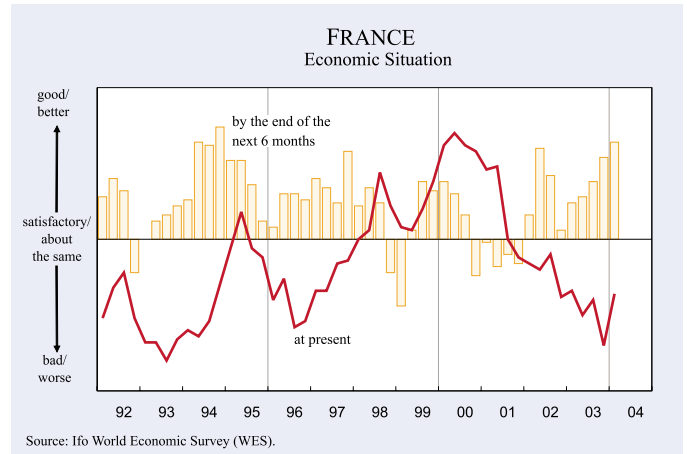
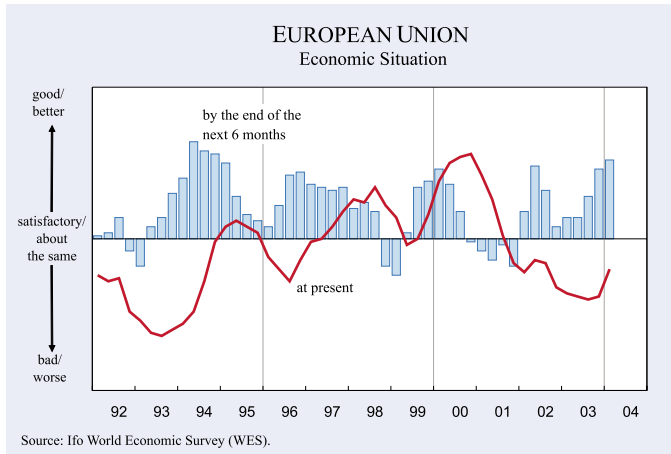


Figure 7b

EUROPEAN UNION

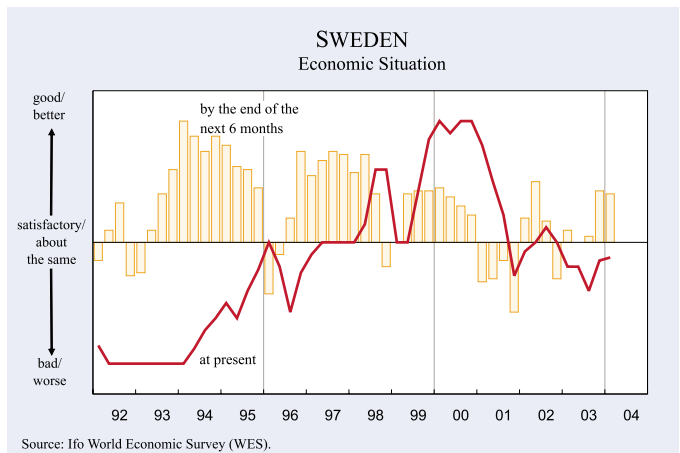
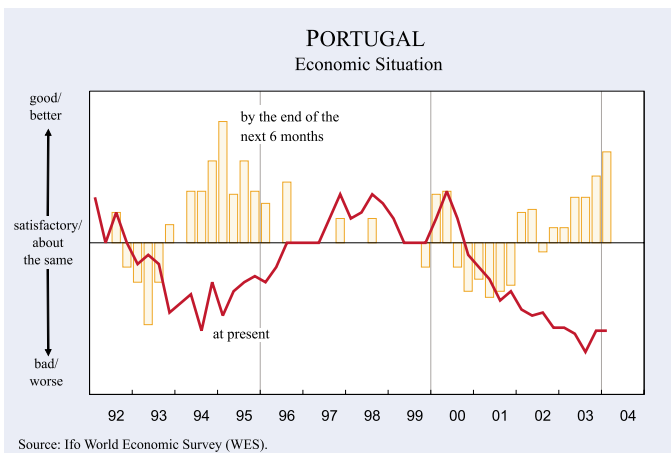
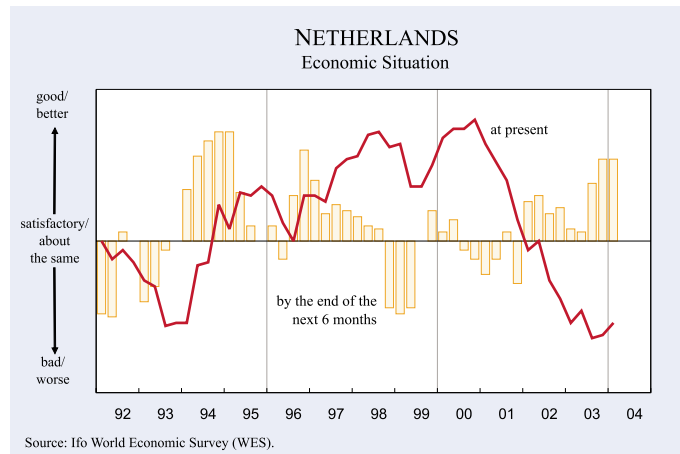
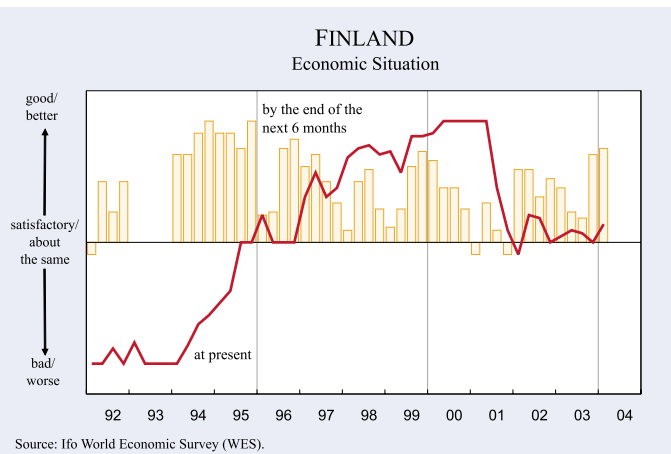
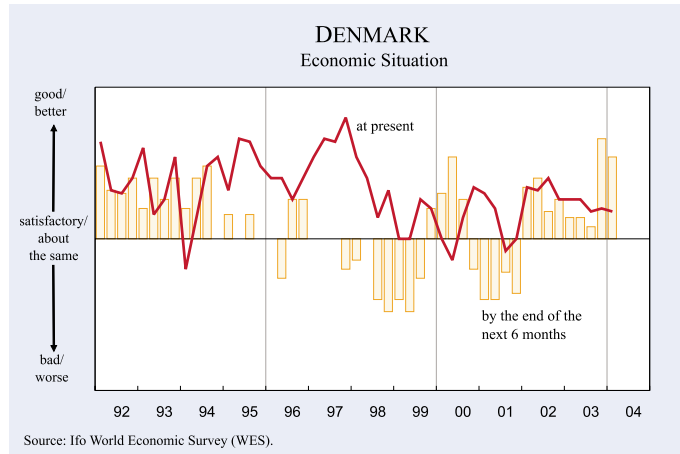
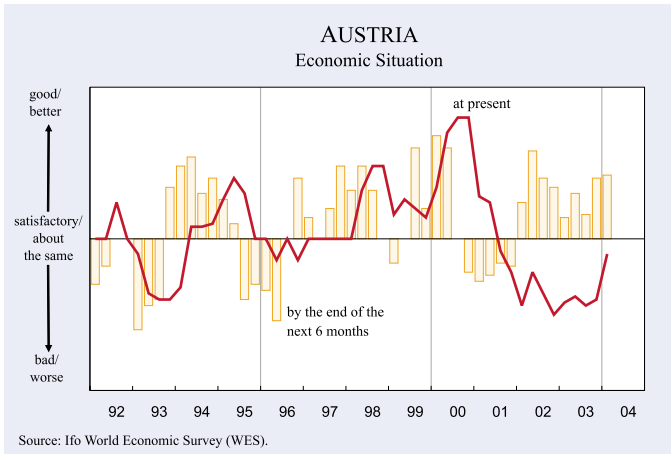


Figure 8

EASTERN EUROPE

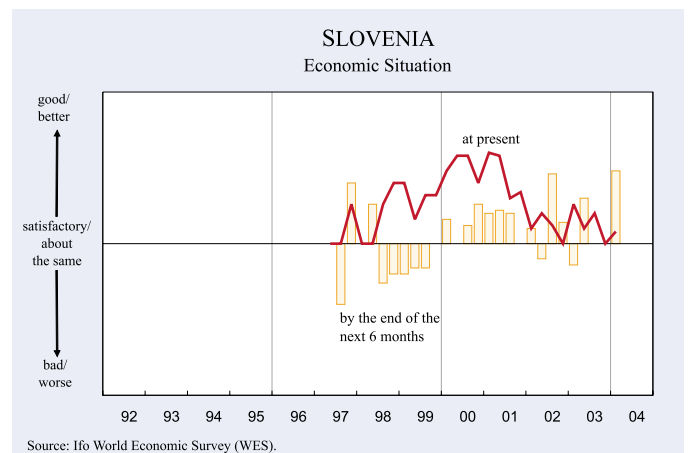
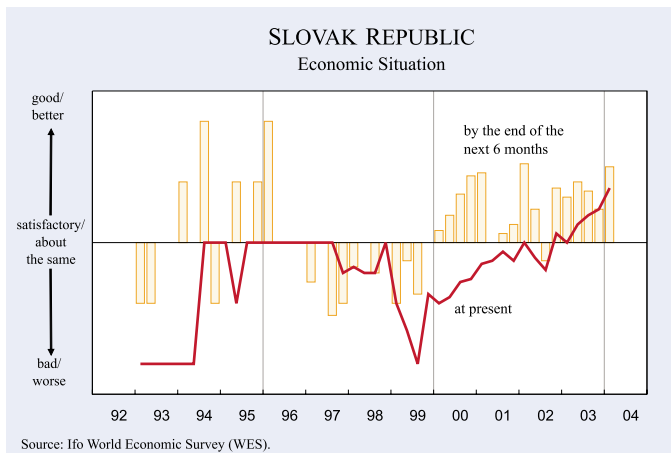
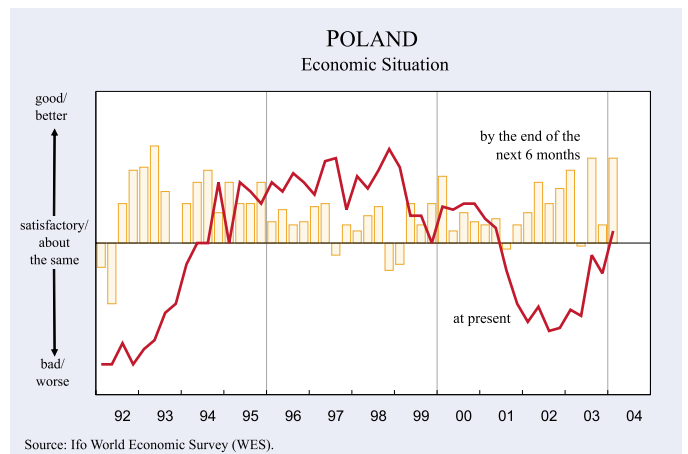
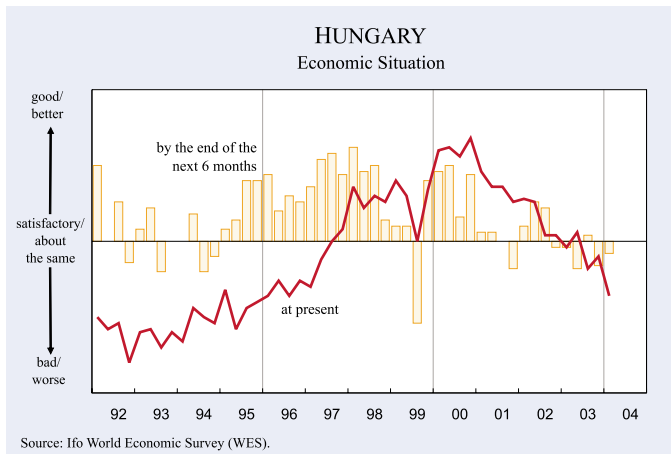
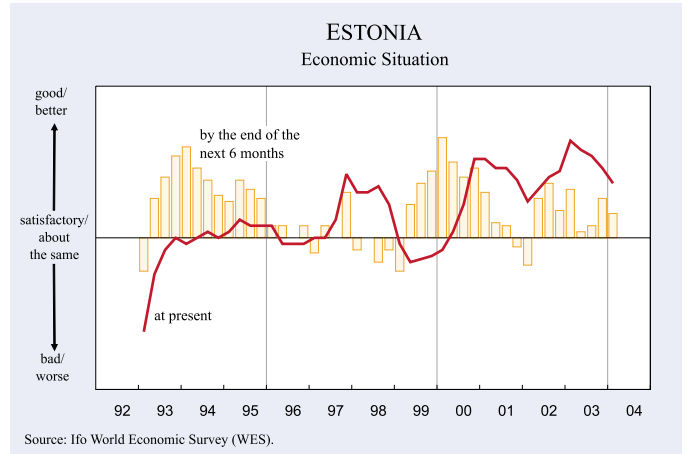
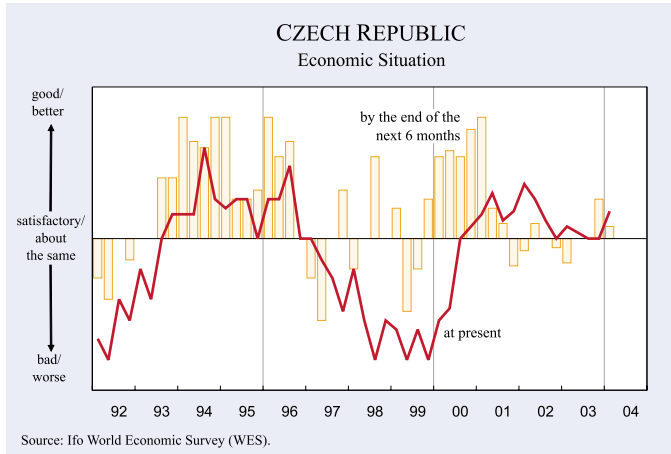


Figure 9

ASIA

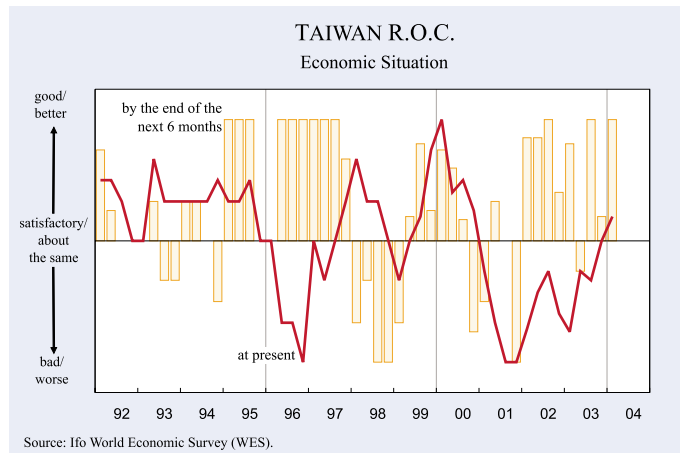
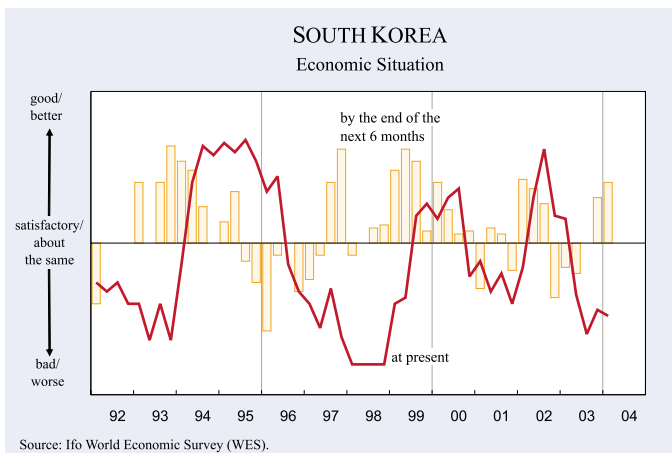
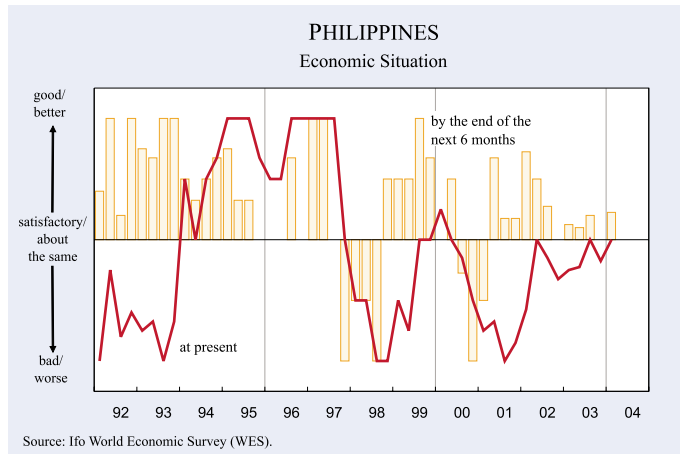
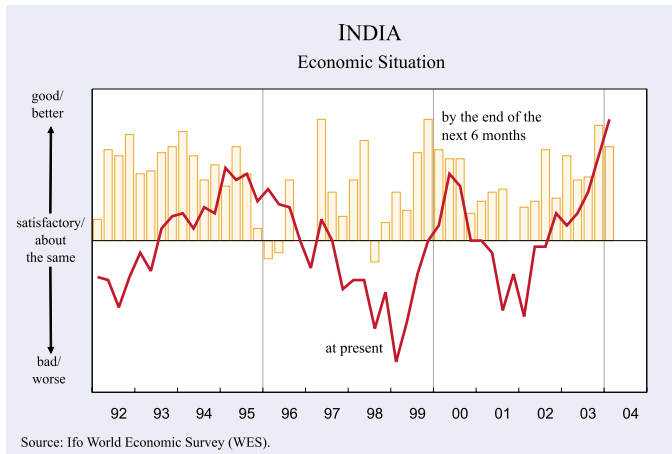
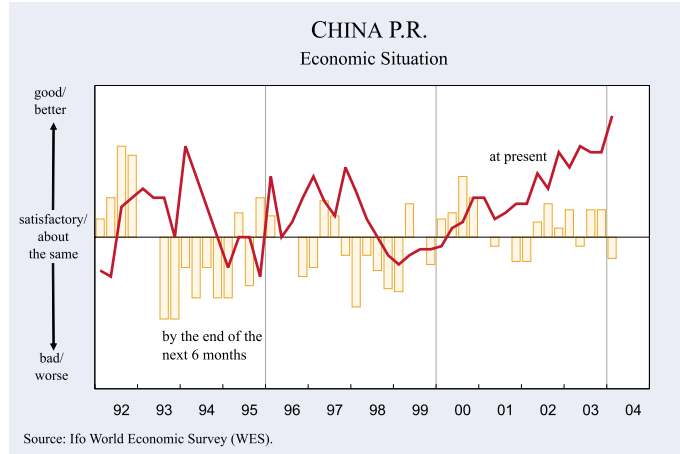
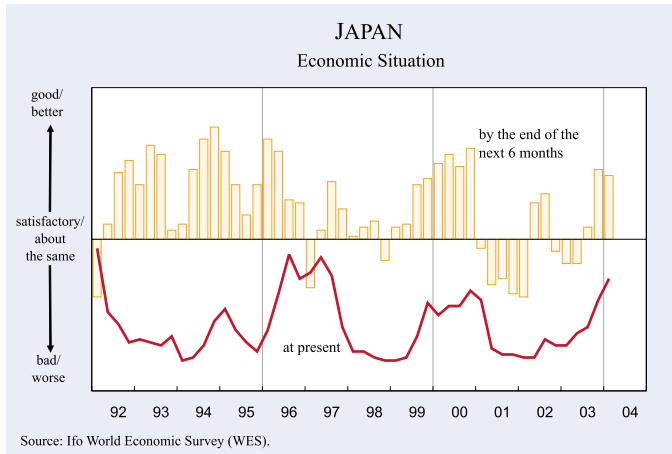


Figure 10

LATIN AMERICA

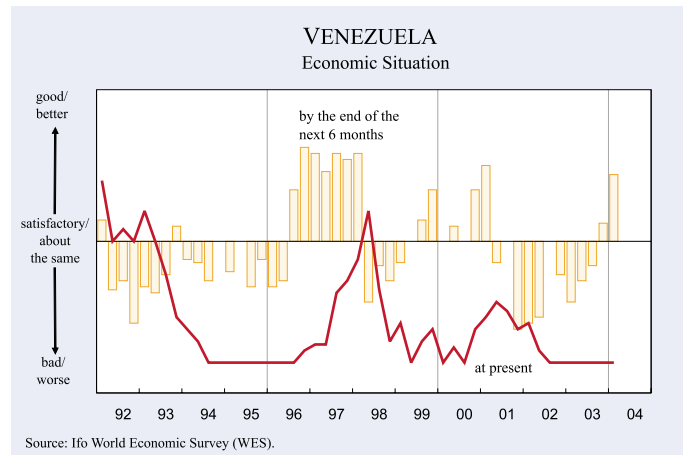
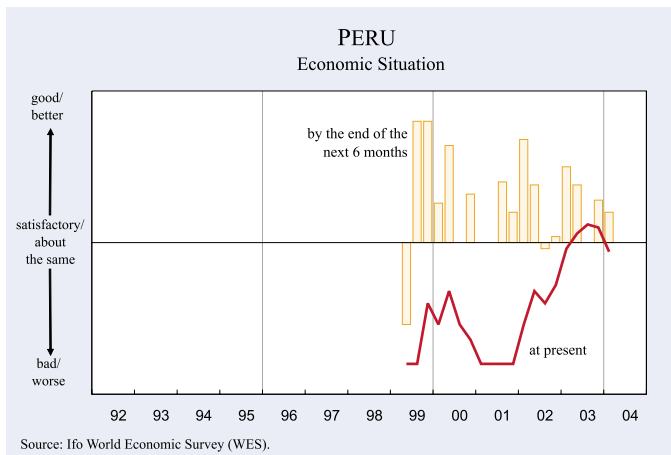
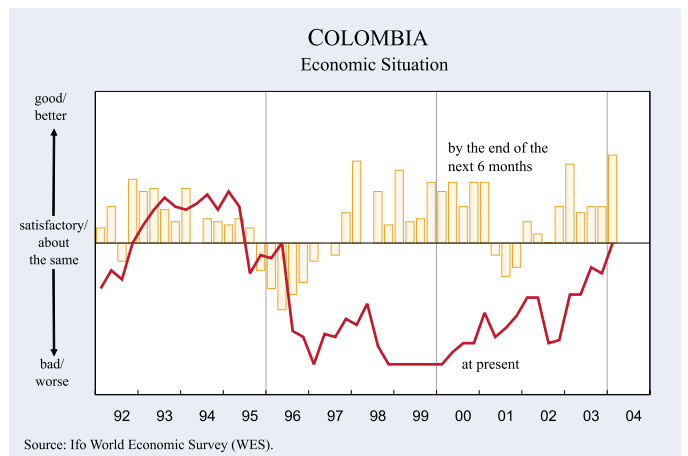
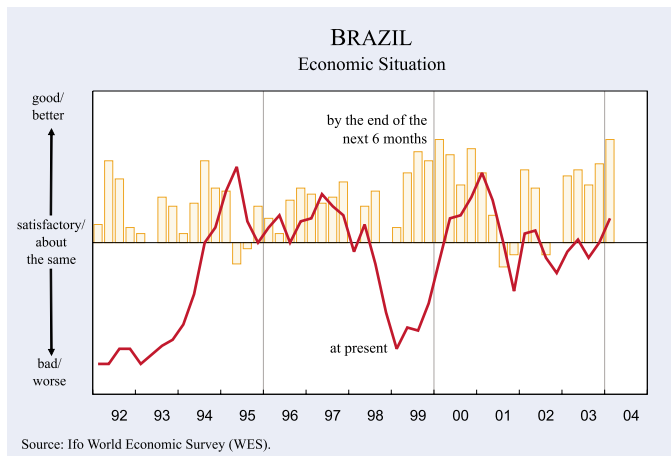
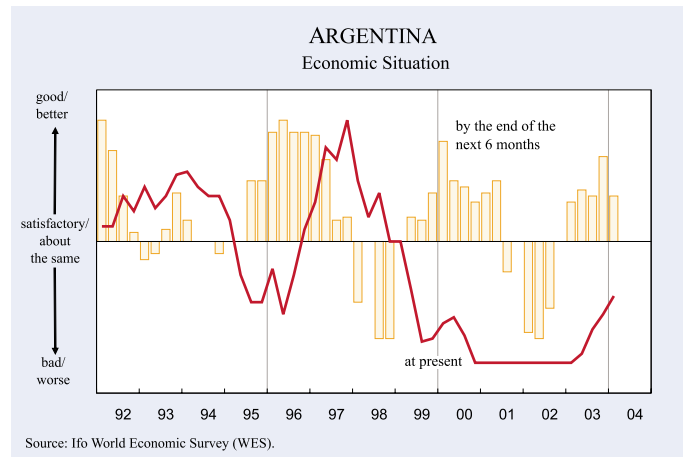
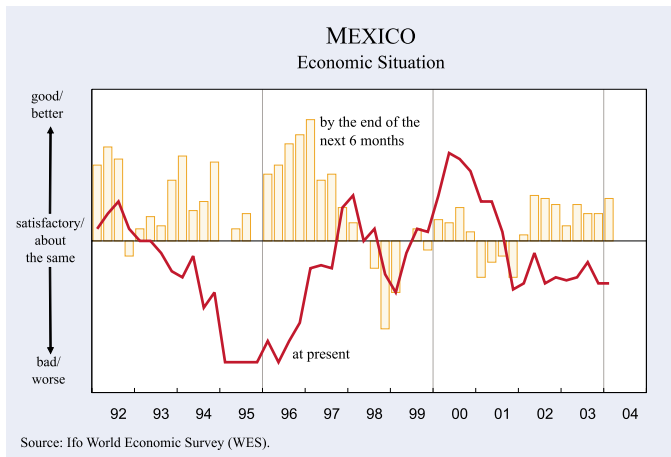
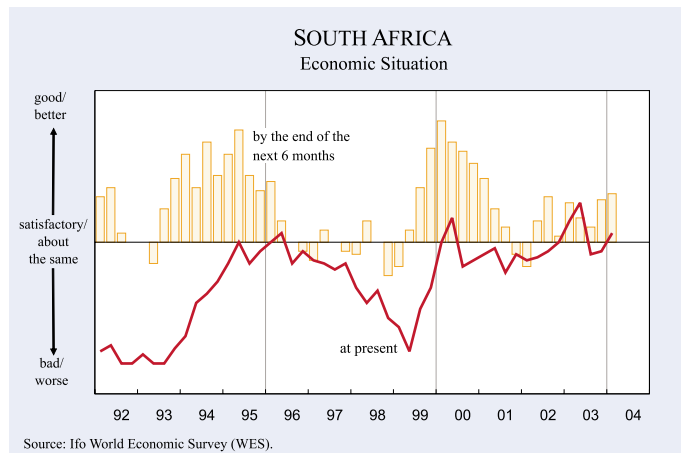
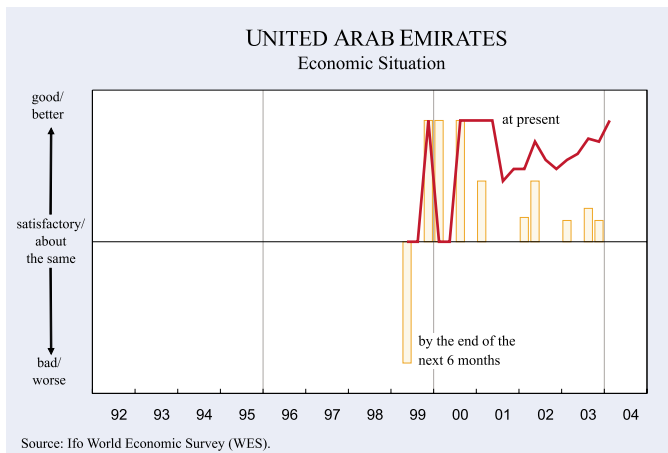
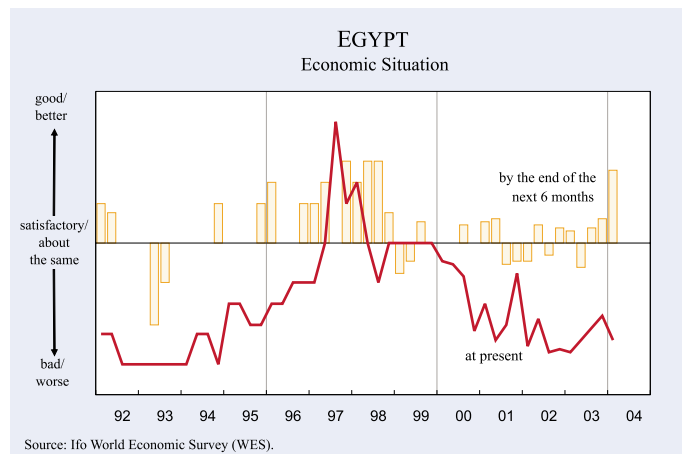
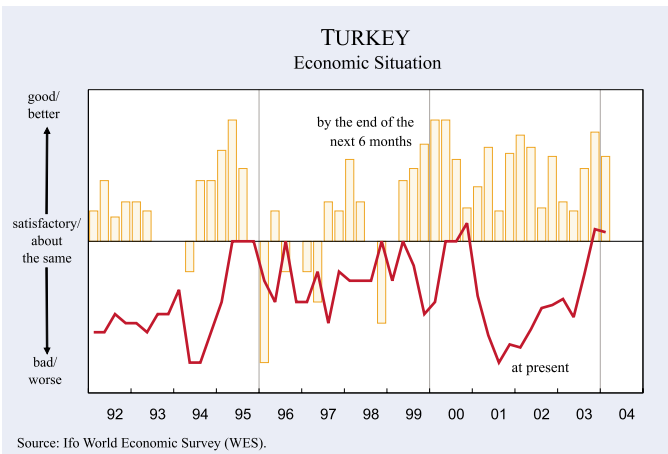
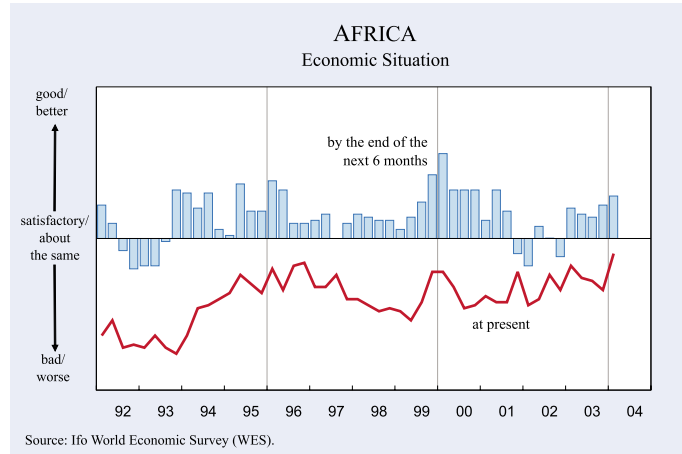
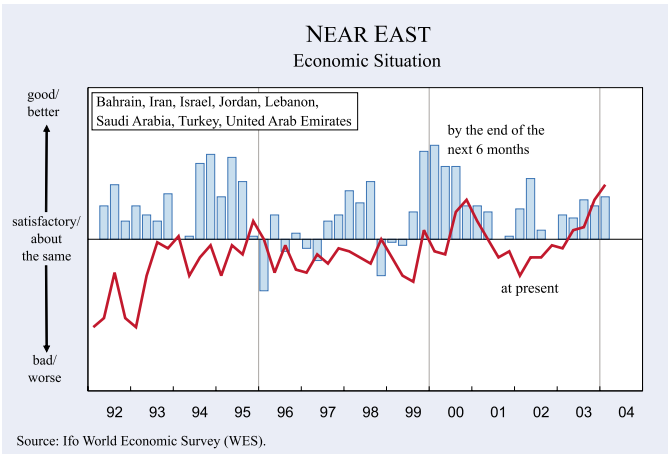


Figure 11

NEAR EAST AND AFRICA



optimistic, as in Latin America in general. Only in *Bolivia*, *Panama* and *Ecuador* do participants still not see clear signs of a marked economic upturn in the near future.

Near East: Sound economy

Considering the survey results, the economic climate continues to be highly favourable for countries covered by WES in the Near East region, on average. The improvement of the climate indicator is due to both more favorable assessments of the current economic situation as well as of the near-term expectations (see Figure 11).

According to WES indicators, the economy in *Turkey* has overcome the recession and has been on a continuous recovery course for almost two years. Already in October 2003 the assessments of the current economic situation reached a satisfactory level. Though neither the assessments of the present economic state, nor economic expectations for the coming six months were upgraded in January, the overall economic climate remains favourable for the coming months. Also experts in *Saudi Arabia* see no cooling down of the highly favorable economic climate, though the export volume is expected to decline slightly in the near term. In the *United Arab Emirates* the current overall situation as well as private consumption and capital expenditures have once again reached the highest possible marks, and in *Iran* the same economic indicators follow closely behind. Thus, optimism for the first half of 2004 seems to be fairly justified.

A satisfactory economic state has been reported from *Bahrain* and *Jordan*, but not so in *Israel* and *Lebanon*: Though the assessments of the current economic situation improved in both countries, the recovery remains sluggish. However, in *Israel* particularly positive expectations were expressed by WES experts concerning the development of the export sector; improvement of private and corporate spending is also expected to continue.

Africa: Economic conditions improve

After a period of weak confidence Africa is likely to profit from the global economic rebound. The improvement of the climate indicator is due to both significantly better assessments of the present economic performance and more optimistic expectations

for the next six months. However, the major part of the regional improvement can be attributed to the increase of the climate index in *South Africa*, the largest economy on the continent (see Figure 11).

According to the panel's opinion, the current economic performance in *Egypt* has shifted downward slightly. The confidence in the coming recovery, however, strengthened. Whereas the weak investment performance and private consumption are not expected to strengthen, exports should take on a faster pace. In the other North African countries – *Algeria*, *Morocco* and *Tunisia* – the overall economic climate brightened, and the marks of the present economic state have reached or surpassed the “satisfactory” level. Particularly *Algeria* is seeking to expand its markets for oil and gas exports and has launched drastic reforms of its once state-managed economy. Slight improvement has been also reported from *Kenya*. According to the panel's responses, in the coming six months the country will be on course for sustained recovery. The still sluggish investment performance and the exports are not expected to improve, but the private consumption should get moderately better. In *Nigeria* the assessments of the current economy have not been upgraded; the outlook, however, remains relatively optimistic. The situation in *Zimbabwe* has been bleak for more than six years.

Inflation will remain moderate

An average 2.7 percent increase in consumer prices is expected for the world economy in 2004, which is slightly lower than the latest estimate for 2003 (2.9 percent) and much lower than the estimate at the beginning of last year (3.2 percent). In the euro area, inflation for 2004 is seen to remain close to the 2 percent mark (1.9 percent). The range of inflation estimates in the euro area is expected to shrink; in Ireland, where inflation was highest within the euro area in 2003 (3.6 percent), a rate of 2.6 is expected for 2004. The lowest inflation rate within the euro area will still prevail in Germany with an expected rate of 1.3 percent after 1.1 percent in 2003. The low German inflation rate will in Western Europe again only be beaten by Switzerland with a rate of 0.8 percent after 0.7 percent in 2003, according to the WES experts (see Table 1).

In the United States no change of the inflation rate is expected (2.2 percent in 2004 and 2003). Thus, the expected inflation rate in the US remains clearly under the 2.5 percent mark that the Federal Reserve

Table 1

**Expected Inflation Rate on Average of 2004 and 2003
(based on WES Q1/2004 and QIV/2003) ***

Region	Q1/2004	QIV/2003	Region	Q1/2004	QIV/2003
Average of 91 countries	2.7	2.9	Central a. Latin America	6.6	7.8
<i>World Bank classification:</i>			Argentina	8.5	9.9
High-income countries	1.8	1.7	Bolivia	3.9	5.2
Middle-income countries	5.3	6.3	Brazil	7.2	10.0
Upper-middle	4.9	4.8	Chile	2.5	2.9
Lower-middle	5.5	9.1	Colombia	6.1	7.0
Low-income countries	10.9	5.3	Costa Rica	8.9	10.5
EU countries (old members)	2.0	2.0	Ecuador	4.9	7.5
EU countries (new mem-	4.3	3.3	El Salvador	2.6	2.6
Euro area ²	1.9	1.9	Guatemala	12.0	10.0
Asian Pacific Rim ³	2.1	1.7	Mexico	4.2	4.3
Arabian OPEC countries ⁴	5.4	5.8	Panama	1.2	1.2
Western Europe	1.9	2.0	Paraguay	8.8	8.3
Austria	1.6	1.4	Peru	2.3	2.1
Belgium	1.6	1.6	Trinidad and Tobago	5.0	-
Cyprus	2.4	4.5	Uruguay	8.0	12.0
Denmark	2.1	2.2	Venezuela	29.4	31.9
Finland	1.4	1.5	Asia	1.6	1.3
France	1.9	1.9	Bangladesh	5.0	4.0
Germany	1.3	1.1	China P.R.	2.0	1.6
Greece	3.3	3.4	Hong Kong	-0.2	-1.6
Iceland	2.5	2.2	India	5.3	4.5
Ireland	2.6	3.6	Indonesia	5.9	7.7
Italy	2.5	2.7	Japan	-0.2	-0.4
Luxembourg	2.0	2.0	Korea	3.4	3.1
Netherlands	2.0	2.2	Malaysia	2.6	2.1
Norway	2.1	2.4	Mongolia	7.8	4.5
Portugal	2.7	3.2	Pakistan	4.1	4.2
Spain	2.7	3.0	Philippines	4.4	3.8
Sweden	1.6	1.9	Singapore	1.2	1.1
Switzerland	0.8	0.7	Sri Lanka	8.0	8.3
United Kingdom	2.3	2.7	Taiwan	0.7	0.7
Central a. Eastern Europe	4.9	4.2	Thailand	2.2	2.2
Albania	4.1	4.6	Vietnam	4.7	3.8
Bosnia Herzegovina	3.0	4.0	Near East	6.2	7.8
Bulgaria	4.1	4.2	Bahrain	1.6	0.8
Croatia	2.6	2.2	Iran	16.7	16.5
Czech Republic	2.8	1.3	Israel	1.7	2.2
Estonia	2.5	2.8	Jordan	1.9	1.9
Hungary	6.9	5.3	Kuwait	2.5	-
Latvia	3.6	2.9	Lebanon	2.5	3.0
Lithuania	1.9	0.8	Saudi Arabia	2.0	1.4
Poland	2.3	1.4	Turkey	13.7	21.0
Romania	10.8	13.8	United Arab Emirates	4.2	3.4
Serbia a. Montenegro	5.8	9.0	Africa	12.7	16.9
Slovenia	4.5	5.6	Algeria	5.0	7.0
Slovakia	7.9	8.7	Egypt	8.8	10.2
CIS	9.8	12.0	Kenya	8.8	7.0
Georgia	4.5	2.0	Mauritius	4.0	6.3
Kazakhstan	6.2	10.6	Morocco	1.9	1.3
Russia	10.7	12.9	Nigeria	12.0	14.5
Ukraine	7.9	6.2	South Africa	4.6	6.3
North America	2.2	2.2	Tanzania	4.0	4.0
Canada	2.0	2.4	Tunisia	2.7	2.7
USA	2.2	2.2	Zimbabwe	550.0	500.0
			Oceania	2.5	2.7
			Australia	2.6	2.9
			New Zealand	2.0	2.1

* Compared to average of previous year.

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), Q1/2004.

(Fed) would still consider acceptable. From this side there is no need for the Fed to start the monetary tightening process soon. Of all surveyed country blocs, Asia again displays the highest price stability. However, in comparison with last year a somewhat higher inflation rate is expected now (1.6 percent instead of 1.3 percent). This slight increase of the Asian average is broadly based; in China inflation is expected to stand at 2.0 percent in 2004 after 1.6 percent in 2003 and in South Korea at 3.4 percent after 3.1 percent in 2003. Japan is gradually leaving the deflationary phase with an expected decline of consumer prices of only 0.2 percent after a minus of about 0.4 percent in 2003 and – 0.8 percent in 2002.

Inflation in Central and Eastern Europe is expected to increase from 4.2 percent in 2003 to 4.9 percent in 2004. The likely pickup of prices, according to WES experts, is particularly strong in Hungary, with a presumable rate of 6.9 percent in 2004 after 5.3 percent in 2003. On the other hand, a slowdown of the relatively high inflation appears likely in Romania (from 13.8 percent in 2003 to 10.8 percent in 2004) and in Serbia-Montenegro (from 9.0 percent to 5.8 percent in 2004).

In Central and Latin America the still strong inflation trend is likely to decrease further, with an average of 6.6 percent in 2004 after 7.8 percent in 2003. The highest inflation rate persists in Venezuela, but the curve is flattening here too (29.4 percent after 31.9 percent in 2004). In Africa – starting from a still high inflation level – a further weakening in the rate of price increases is recognisable (12.7 percent after 16.9 percent in 2003). However, the average for Africa is still distorted by the persisting hyperinflation in Zimbabwe (550 percent); without Zimbabwe the average inflation rate for Africa would be slightly below 7 percent. In South Africa, the inflation estimate declined from 6.3 percent in 2003 to 4.6 percent in 2004.

Growing overvaluation of the Euro

More than in the previous survey the *euro* was assessed as overvalued on average of all 92 included countries (see Figure 6). To a lesser degree this judgement holds true for the *British pound*. On the other hand, the *US dollar* was seen by even more WES experts than in the previous two surveys as undervalued. A similar result was last observed at the end of 1996. The *Japanese yen* appeared to be close to its fair value. This overall pattern of currency assessments also characterises Western Europe. It

was remarkable, however, that the *US dollar* and the *yen* were seen more often as undervalued by Western Europe experts than on the world average. In the United States the exchange rates of the *euro*, the *British pound* and also the *yen* are seen as overvalued. In Australia the own currency appears to WES experts as slightly undervalued vis-à-vis the *British pound* and the *yen*; the *euro* and also the *US dollar* were seen as fairly valued. WES experts in South Africa continue to assess the *rand* as overvalued, in general. In the Asian countries, on average, the *dollar* is seen as undervalued, the *euro* and the *British pound* as somewhat overvalued and the exchange rate of the *yen* as largely appropriate.

According to the responses to the supplementary survey question on the development of currencies, the *US dollar* will slip further vis-à-vis most currencies in the course of the next six months. This conclusion holds particularly with regard to currencies in Canada and Australia but also for those in Western Europe, Russia and the majority of Asian countries.

Interest rates: Begin of tightening cycle expected

More than in the previous survey **short-term interest rates** are expected to start rising in the course of the next six months (see Figure 5). Central-bank interest-rate hikes are still seen as more likely in the US than in the euro area. In the United Kingdom and in Australia the monetary tightening course is expected to continue. In Western Europe outside the euro area, also increasing interest rates are expected in Denmark and Switzerland. However, in Sweden and Norway the WES participants continue to assume that interest rates will fall slightly. In Eastern Europe most survey participants indicated that interest rates will remain stable in the course of the next six months, whereas until now expectations of sinking short term rates prevailed. However, within the Eastern European countries there remain large differences in the likely central bank policy. In Slovenia, Slovakia, Hungary and also Bulgaria cuts of short-term rates are expected in the course of the next six months, whereas rising rates appear to WES experts more likely in the other Eastern European countries like the Czech Republic, Estonia, Croatia, Poland, Lithuania and Latvia. In Latin America sinking short-term rates are expected in Brazil and stable central-bank interest rates in most other countries of this region. Only in Venezuela, Peru and also Mexico are raising central-bank on the horizon, according to WES experts. In most Asian coun-

Table 2

Cost Increases for Business Resulting from Government Security Measures*

Region	Total	A	B	C	Region	Total	A	B	C
Average of 91 Countries	1084	612	423	49	Central a. Eastern Europe	157	105	50	2
Western Europe	398	228	153	17	Albania	11	9	2	-
Austria	31	24	7	-	Bosnia Herzegovina	2	2	-	-
Belgium	15	9	6	-	Bulgaria	15	11	4	-
Cyprus	4	3	1	-	Croatia	8	6	2	-
Denmark	9	6	3	-	Czech Republic	9	4	5	-
Finland	26	17	8	1	Estonia	3	3	-	-
France	23	12	9	2	Hungary	11	6	4	1
Germany	71	33	37	1	Latvia	7	7	-	-
Greece	16	8	6	2	Lithuania	8	8	-	-
Iceland	3	1	2	-	Poland	45	22	23	-
Ireland	15	9	5	1	Romania	11	8	3	-
Italy	32	15	14	3	Serbia a. Montenegro	10	7	3	-
Luxembourg	1	1	-	-	Slovenia	11	9	2	-
Netherlands	21	13	7	1	Slovakia	6	3	2	1
Norway	10	4	6	-	Central a. Latin America	135	85	48	2
Portugal	21	18	3	-	Argentina	13	7	6	-
Spain	37	20	14	3	Bolivia	5	5	-	-
Sweden	23	13	9	1	Brazil	21	18	3	-
Switzerland	15	11	4	-	Chile	14	10	4	-
United Kingdom	25	11	12	2	Colombia	11	3	6	2
Asia	172	92	77	3	Costa Rica	8	6	2	-
Bangladesh	1	1	-	-	Ecuador	9	6	3	-
China P.R.	11	8	3	-	El Salvador	3	2	1	-
Hong Kong	16	11	5	-	Guatemala	1	1	-	-
India	14	8	6	-	Mexico	17	5	12	-
Indonesia	13	2	10	1	Panama	3	-	3	-
Japan	35	16	19	-	Paraguay	3	3	-	-
Korea	10	7	3	-	Peru	12	7	5	-
Malaysia	10	5	5	-	Trinidad and Tobago	1	1	-	-
Mongolia	6	3	2	1	Uruguay	4	3	1	-
Pakistan	13	4	8	1	Venezuela	10	8	2	-
Philippines	9	4	5	-	Africa	56	41	13	2
Singapore	4	2	2	-	Algeria	1	-	1	-
Sri Lanka	6	5	1	-	Egypt	5	3	1	1
Taiwan	5	2	3	-	Kenya	4	1	2	1
Thailand	9	6	3	-	Mauritius	1	1	-	-
Vietnam	10	8	2	-	Morocco	1	-	1	-
North America	64	9	43	12	Nigeria	4	4	-	-
Canada	13	4	8	1	South Africa	25	19	6	-
USA	51	5	35	11	Tanzania	2	1	1	-
Oceania	25	13	10	2	Tunisia	1	1	-	-
Australia	12	7	5	-	Zimbabwe	12	11	1	-
New Zealand	13	6	5	2	Near East	36	16	15	5
CIS	41	23	14	4	Bahrain	2	2	-	-
Georgia	11	2	5	4	Iran	3	3	-	-
Kazakhstan	2	1	1	-	Israel	5	-	3	2
Russia	24	17	7	-	Jordan	3	1	2	-
Ukraine	4	3	1	-	Kuwait	1	1	-	-
					Lebanon	3	2	1	-
					Saudi Arabia	2	-	-	2
					Turkey	13	5	7	1
					United Arab Emirates	4	2	2	-

* Distribution within countries and regions (total numbers of experts answered alternative A, B or C).

A - Negligible cost increases; **B** - Moderate cost increases; **C** - Heavy or very heavy cost increases.

Source: Ifo World Economic Survey (WES), Q1/2004.

tries – after an extended period of falling and later on stable interest rates – now a switch to monetary tightening appears likely. In contrast, in the Near East and also in Africa as a whole, especially in South Africa, the interest-rate trend continues to point downward.

Parallel to the expected increase of short-term interest rates, an increasing trend is also reckoned with

quite clearly for **capital market interest rates**. The only exceptions are South Africa, Latin America (here particularly Brazil), the CIS countries including Russia and some Eastern European countries, particularly Slovenia, Slovakia, Hungary and Bulgaria, where a further drop in long-term rates is expected.

Table 3

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

Region	legal / administrative restrictions	political instability	Region	legal / administrative restrictions	political instability
Average of 91 countries	6.0	6.7	CIS	3.2	5.4
Western Europe	6.6	7.3	Georgia	5.4	5.0
Austria	6.6	7.8	Kazakhstan	5.0	9.0
Belgium	5.8	6.3	Russia	3.0	5.3
Cyprus	5.0	6.0	Ukraine	3.0	4.0
Denmark	7.7	8.1	North America	6.3	7.8
Finland	8.5	8.7	Canada	5.6	8.1
France	6.2	7.8	USA	6.5	7.7
Germany	6.4	7.1	Oceania	5.9	8.1
Greece	3.5	8.0	Australia	6.0	8.3
Iceland	3.7	7.7	New Zealand	5.6	6.9
Ireland	5.8	7.9	Central a. Latin America	5.1	5.1
Italy	5.7	5.3	Argentina	3.2	3.5
Luxembourg	9.0	9.0	Bolivia	5.0	1.0
Netherlands	6.9	7.7	Brazil	5.2	6.1
Norway	7.4	7.8	Chile	7.3	9.0
Portugal	5.8	8.6	Colombia	4.3	3.9
Spain	7.3	7.1	Costa Rica	5.5	7.9
Sweden	7.1	7.4	Ecuador	4.1	1.4
Switzerland	7.1	8.2	El Salvador	7.7	6.3
United Kingdom	7.2	8.0	Guatemala	1.0	5.0
Central a. Eastern Europe	5.9	5.7	Mexico	5.5	5.2
Albania	3.9	2.5	Panama	6.3	6.3
Bosnia Herzegovina	5.0	5.0	Paraguay	5.0	2.3
Bulgaria	6.1	5.0	Peru	3.3	1.7
Croatia	3.0	5.0	Trinidad and Tobago	5.0	9.0
Czech Republic	7.2	5.9	Uruguay	9.0	8.0
Estonia	7.0	5.0	Venezuela	3.2	1.0
Hungary	6.1	6.8	Near East	5.4	5.0
Latvia	6.7	5.0	Bahrain	3.0	7.0
Lithuania	6.0	4.5	Iran	5.0	3.7
Poland	6.0	5.2	Israel	6.0	3.0
Romania	5.0	6.5	Jordan	5.0	6.3
Serbia a. Montenegro	4.3	1.0	Kuwait	1.0	1.0
Slovenia	4.6	8.2	Lebanon	6.3	1.0
Slovakia	5.0	4.6	Saudi Arabia	5.0	5.0
Asia	5.5	5.7	Turkey	4.4	5.3
Bangladesh	9.0	5.0	United Arab Emirates	8.0	8.0
China P.R.	3.7	5.7	Africa	3.4	4.2
Hong Kong	8.1	5.9	Algeria	1.0	1.0
India	5.0	5.6	Egypt	3.4	4.2
Indonesia	2.9	2.9	Kenya	4.0	4.0
Japan	6.6	7.0	Mauritius	5.0	5.0
Korea	5.0	3.4	Morocco	1.0	1.0
Malaysia	5.4	4.6	Nigeria	6.0	3.0
Mongolia	5.0	7.0	South Africa	3.7	6.1
Pakistan	5.3	3.9	Tanzania	7.0	9.0
Philippines	3.2	1.4	Tunisia	5.0	9.0
Singapore	7.0	9.0	Zimbabwe	1.7	1.0
Sri Lanka	5.0	1.0			
Taiwan	5.0	4.2			
Thailand	3.7	5.9			
Vietnam	1.4	6.6			

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

Source: Ifo World Economic Survey (WES), Q1/2004

ICC Special Question: Growth of terrorism and its effect on business

According to the recent survey results, a global economic upturn has set in. On the other hand, as has been demonstrated by 11 September 2001 and later terrorist attacks, terrorism not only hits the stock markets but can also cloud the business climate and weaken growth prospects. The special question asked in the January poll focused on the growth of terrorism and its impact on business. The first part of the question analyzed *how the fears of terrorist attacks have affected business prospects for 2004 for the respective country*. The second part dealt with *the impact of cost increases for business resulting from government security measures implemented after the 11 September 2001 attack on the World Trade Center*.

Have fears of terrorist attacks affected business prospects for 2004?

The main objective of terrorism is to hit psychologically and to create fear. The major negative impact on business from the terrorist attack of September 11 derived not from the collapse of the towers but from global uncertainty. Some sectors were particularly affected by the fear of terrorism, such as the airline industry and tourism, as people were afraid to travel. The majority (51 percent) of 1088 WES experts polled in over 90 countries see a slight impact from the fear of terrorism on business prospects in 2004. Worldwide 7 percent of all participants see a severe or very severe impact on economic recovery (see Figure 12). In CIS and the Near East, the share of WES participants who were concerned about a severe or very severe impact of terrorism on the business climate in the region was particularly pronounced (25 percent). But also in Asia and in North America the share of participants expecting severe or very severe impact on business prospects in 2004 was relatively high at 9 percent (in Indonesia even 38 percent).

Figure 12

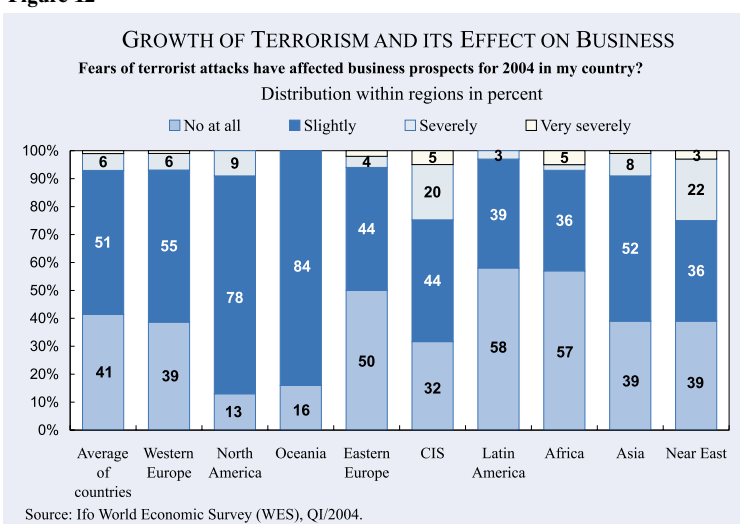
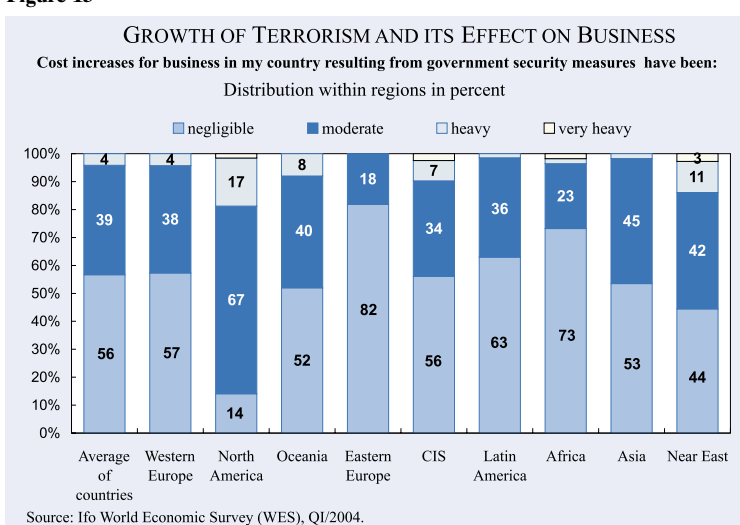


Figure 13



How big are the cost increases for business resulting from government security measures implemented after the 11 September 2001 attack on the World Trade Center?

For the majority of countries, experts polled by WES reported negligible (56 percent) or only moderate (39 percent) cost increases for business resulting from government security measures (see Figure 13). However, the share of experts who stated that cost increases have been heavy or very heavy is considerable, in particular in North America (19 percent), the Near East (14 percent), in CIS (9 percent) and in Oceania (8 percent). In general, countries are differently affected worldwide by governments' security measures (see Table 2 for the country breakdown).

Additional CESifo Journals

