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CESifo WORLD ECONOMIC SURVEY

VOLUME 5, No. 1

FEBRUARY 2006

WORLD ECONOMIC CLIMATE

World Economic Climate considerably improved

ECONOMIC EXPECTATIONS

Both assessments of the current economic situation and expectations for the next six months more optimistic

INFLATION

Price expectations for 2006 dampened somewhat

INTEREST RATES

Rising trend expected

CURRENCIES

Japanese yen seen as somewhat undervalued

SPECIAL TOPIC

Reactions to rising oil prices



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Ifo World Economic Survey

Regions

- World economy: Global economic expansion
- Western Europe: Economic rebound
- North America: Economic climate index bounced back
- Eastern Europe: Economic stabilization continues
- CIS: Economic climate remains favourable
- Asia: Booming markets
- Oceania: Economic cooling off
- Latin America: Optimistic expectations
- Near East: Stable economy
- Africa: Diverging economic trends predominate

Notes

The Ifo World Economic Survey (WES) assesses worldwide economic trends by polling transnational as well as national organizations worldwide about current economic developments in the respective country. This allows for a rapid, up-to-date assessment of the economic situation prevailing around the world. In January 2006 1,080 economic experts in 90 countries were polled.

WES is conducted in co-operation with the International Chamber of Commerce (ICC) in Paris and receives financial support from the European Commission.

Methodology and evaluation technique

The survey questionnaire focuses on qualitative information: on assessment of a country's general economic situation and expectations regarding important economic indicators. It has proved to be a useful tool, since economic changes are revealed earlier than by traditional business statistics.

The individual replies are combined for each country without weighting. The "grading" procedure consists in giving a grade of 9 to positive replies (+), a grade of 5 to indifferent replies (=) and a grade of 1 to negative (-) replies. Grades within the range of 5 to 9 indicate that positive answers prevail or that a majority expects trends to increase, whereas grades within the range of 1 to 5 reveal predominantly negative replies or expectations of decreasing trends.

The survey results are published as aggregated data. The aggregation procedure is based on country classifications. Within each country group or region, the country results are weighted according to the share of the specific country's exports and imports in total world trade.

CES – Center for Economic Studies – is an institute within the department of economics of Ludwig-Maximilians-University. Its research concentrates on public finance, aspects of the economy, but also includes many diverging fields of economics.

Ifo Institute for Economic Research ist one of the largest economic research institutes in Germany with a three-fold orientation: to conduct economic research, to offer advice to economic policy-makers and to provide services for the research and business communities. The Ifo Institute is internationally renowned for its business surveys.

CESifo is the name under which the international service products and research results of both organizations are published.

WORLD ECONOMIC CLIMATE CONSIDERABLY IMPROVED

In January 2006 the World Economic Climate has improved strongly (see Figure 1). The climate indicator stands at 109.2 (after 99.3 in October: 1995=100), considerably above its long-term average (1990–2005: 94.3). This strong improvement resulted from both – more favourable assessment of the current economic situation as well as from highly positive expectations for the first half of 2006 (see Figure 2).

World economy: Global economic expansion

The strong improvement of the economic climate index set in already in the second half of 2005. In October 2005 the positive trend gained more momentum, and finally in the January 2006 poll, the upward movement of the indicator became clearly pronounced. According to the expectations for the coming six months, the global economy is foreseen to grow further in the first half of 2006.

The economic climate index strongly rose in all three main economic regions: *North America*, *Asia* and *Western Europe*. While global economic growth in 2004 and the first half of 2005 was mainly driven by the US demand, since the end of 2005 it seems to have become more even across the world, supported by a strong economic revival in the *euro area* and *Japan*. However, also in other parts of the world, primarily in *Eastern Europe* and some *Latin American* countries like *Argentina* and *Chile* a solid economic stabilization is expected for the first half of 2006.

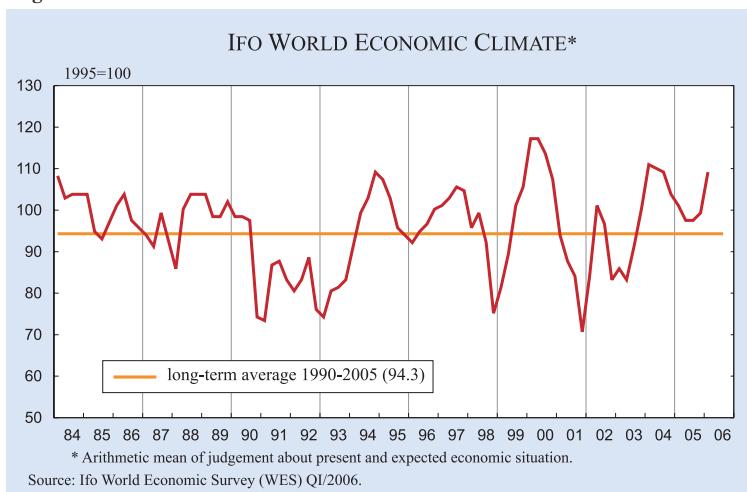
After three consecutive positive survey results with the assessments of the current economic situation following positive economic expectations in almost all regions, the latest survey results can be interpreted as indication of a sound global economic expansion (see Figure 3 and 4).

Western Europe: Economic rebound

The economic climate strongly improved in almost all countries of Western Europe (see Figures 4 and 5a/b). The assessments of the present economic situation are now at a satisfactory level, on average, of all countries in the region. The economic expectations for the first half of 2006 are again highly optimistic, indicating that the economic climate index most likely will remain considerably above its long-term average in the course of the next six months (see figure 3).

In all countries of the *euro area* the assessments of the present economic situation have improved since the October 2005 poll, in particular in the biggest economies of the region (see Table 1), which are *Germany*, *France*, *Italy* and the *Netherlands*. In *Germany*, in particular, where now a new government is in charge, business confidence is strong. However, despite a reported improvement, the assessments of the current economic state have not yet reached the satisfactory level, according to the experts surveyed in these countries. The second biggest economy of the euro area, *France*, is also expected to expand in 2006. In other countries of the euro area – in *Belgium*, *Austria* and *Greece* – assessments of the present economic performance have surpassed the satisfactory level. An economic climate considerably above the satisfactory level has again been reported from *Ireland* and *Finland*. Except for *Spain*, where the economic expectations for

Figure 1

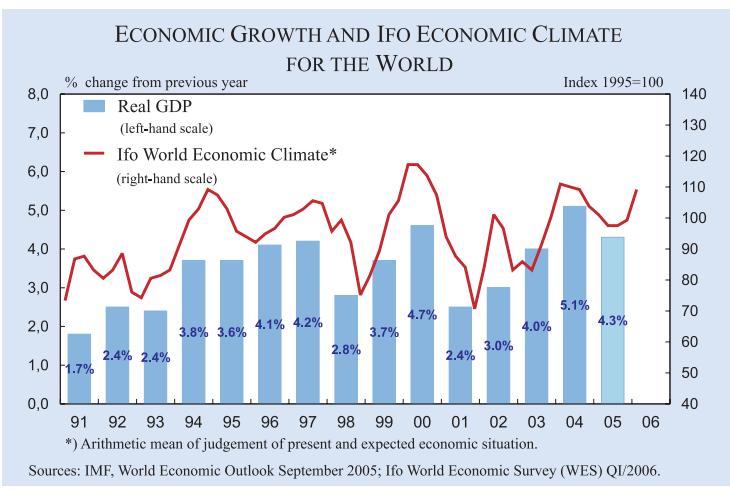


Box 1**World Economic Survey (WES) and GDP Growth in the World Economy**

The Ifo World Economic Climate is the arithmetic mean of the assessments of the general economic situation and the expectations for the economic situation in the coming six months. The January results are based on the responses of 1,080 experts. As a rule, the trend of the Ifo Economic Climate indicator correlates well with the actual business-cycle trend measured in annual growth rates of real GDP (see Figure).

The Ifo indicator for the world economic climate continued its recovery course with stronger momentum, after having weakened since the beginning of 2004. The improvement applies to both the assessments of the current economic situation and to the expectations for the coming six months.

Signs of improvement this time are again especially evident in *Western Europe*, where both the assessments of the current situation and the expectations for the next six months point clearly upwards. Also in *North America*, the trend of the climate indicator is again rising; the setback in October last year was apparently only temporary. In *Asia*, the economic climate also improved: the WES experts assessed the current economic situation clearly more positively, but their expectations were only slightly more favourable.



the coming six months clouded somewhat, experts foresee a continuation of the economic rebound in the euro area for first half of 2006. Spain's economy has been consistently successful in the past decade, but its growth is now expected to slow down, according to WES experts. However, the assessments of the present eco-

nomic situation are still very positive and the economic expectations, although somewhat downgraded, point to economic stabilization rather than decline.

In the Northern countries outside the euro area, *Denmark*, *Norway* and *Sweden*, the present economic situation received the highest possible marks on the WES scale. The panel's forecast for the coming six months reflects a stabilization of the current positive state. Also in *Switzerland*, the present economic situation continued to improve, according to the latest results. In the *United Kingdom* the overall climate index stabilized at the currently satisfactory level, after it had deteriorated strongly in the course of 2005. Positive figures indicate that survey respondents expect a strengthening of export sector, although capital expenditures and private consumption are forecast to remain sluggish in the first half of 2006.

North America: Economic climate index bounced back

According to the latest survey results, the economic climate indicator in North America improved in January, after deterioration had been reported in

October (see Figures 3 and Figure 6). Both components – assessment of the current economic situation as well as the economic expectations – have been upgraded. However, the high *US* current account deficit, which totals 800 billion *US* dollars, is still threatening sustainable economic growth in the medium and long run, as investors at some point in time might begin to lose confidence in the *US* economy. This could cause a fall in the value of the dollar and an increase in *US* interest rates.

Figure 2

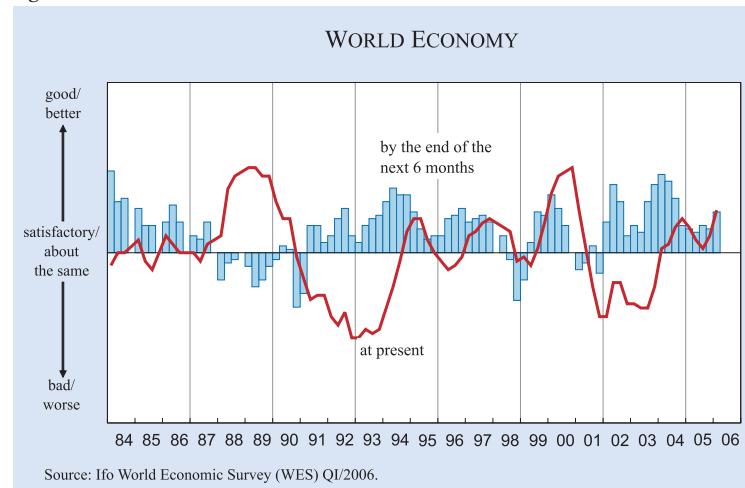
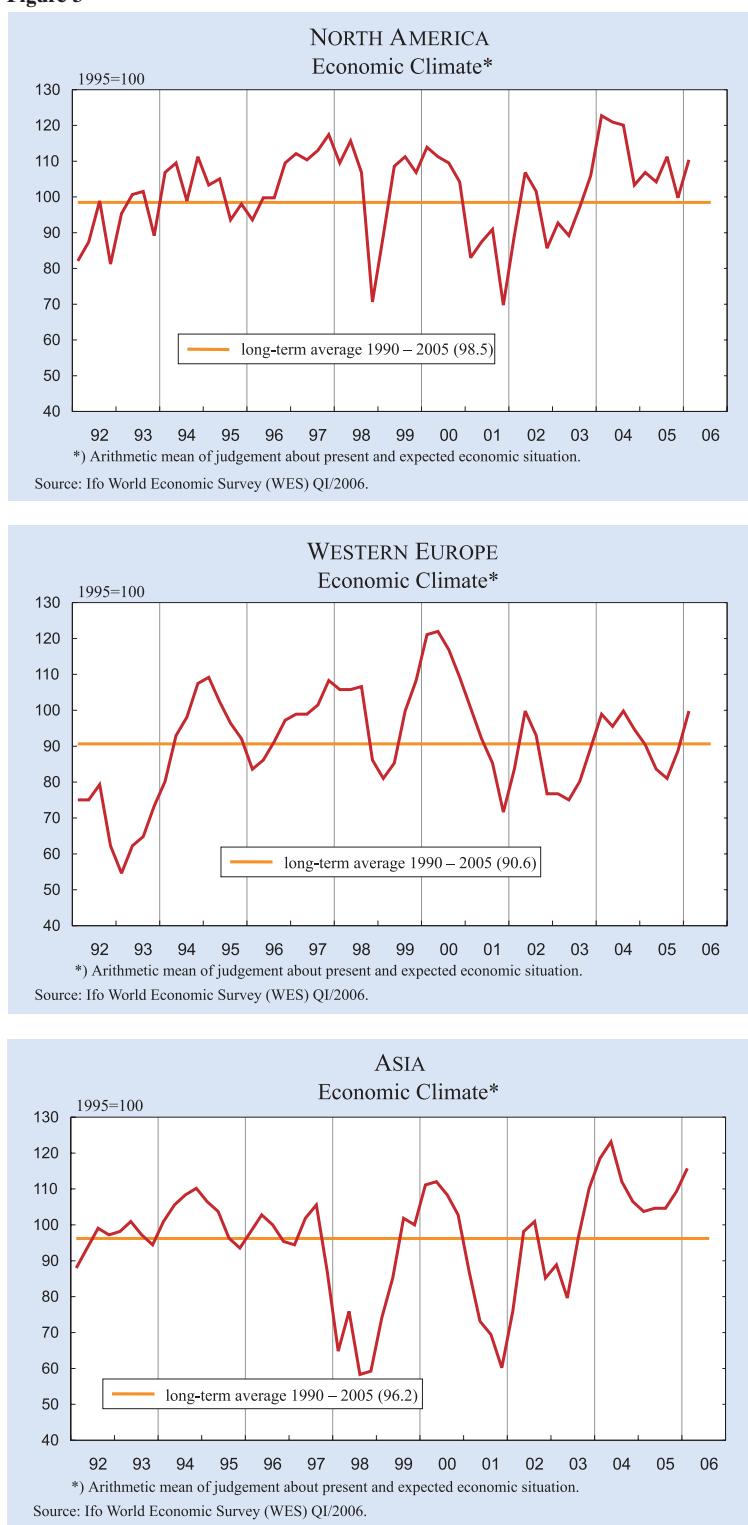


Figure 3



In Canada, the economic climate remained favourable. The current economic situation has again been rated above the satisfactory level and even somewhat better than in the preceding October poll. Canada has recorded a decade of solid business confidence and economic growth. Economic expectations, though slightly downgraded, foresee a stable

economic development in the coming six months. Further supportive factors for the Canadian which economy are the high oil prices have bolstered the country's energy companies.

Eastern Europe: Economic stabilization continues

After two years of economic stabilization, the overall economic climate index of Eastern Europe improved again. The present economic situation is assessed as considerably above the satisfactory level. The economic expectations reflect optimism concerning further economic growth in the first half of 2006 (see Figure 7).

In all surveyed countries of the European Union in the region, the present economic situation has been assessed as favourable. A particular high level of the overall climate index has again been reached in the Baltic States (*Estonia, Lithuania* and also *Latvia*), as well as in the *Czech Republic* and *Slovakia*. The forecasts for the coming six months indicate that the current trend will hold in the second half of 2006 in these countries. But also in the other new members of the European Union, *Poland, Slovenia* and *Hungary*, the current economic performance has been assessed as good or satisfactory, according to the January poll.

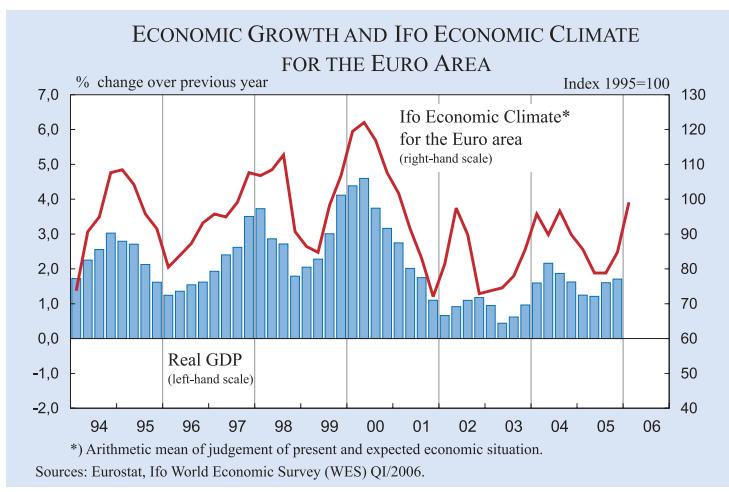
In the other Eastern European countries outside the EU, except *Serbia and Montenegro*, the economic climate became favourable in January. In *Albania, Bulgaria, Croatia* and *Romania*, the present economic situation was assessed as above "satisfactory" with prospects for future development remaining highly positive.

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

The Ifo World Economic Climate for the 12 member countries of the euro area is the arithmetic mean of the assessments of the general economic situation and the expectations for the economic situation in the coming six months. The January results are based on the responses of 314 experts. As a rule, the trend of the Ifo Economic Climate indicator correlates well with the actual business-cycle trend for the euro area – measured in annual growth rates of real GDP (see Figure).

The Ifo indicator for the euro-area economic climate rose clearly in January 2006, continuing the recovery that became evident in mid-2005. Both the assessments of the current economic situation as well as the expectations for the coming six months brightened noticeably. Even though the assessment of the current economic situation is still in negative territory, it is the best survey result in more than three years.

The economies of Ireland, Finland and Luxembourg are still in the top group in the appraisals of the WES experts, followed by Spain, Austria and more recently Belgium. The economic outlook for the coming six months has improved in all countries of the euro area with the exception of Spain. Even in those member states in which the current economic situation is not yet seen as satisfactory, an improvement of the economic climate was registered, being particularly strong in Germany, France and the Netherlands. Only slight improvements were reported for Italy and Portugal, which currently receive the most unfavourable assessments from the WES experts.

**CIS: Economic climate remains favourable**

In *Russia*, WES experts have been rating the economic situation at the satisfactory level for more than three years. With the booming oil sector serving as a growth engine, the *Russian* economy is expected to remain on a stabilization course (see Figure 6). This also holds true in *Kazakhstan*, where the economic climate has stabilized during the years 2004 and 2005. With regard to the future economic development, WES participants remain fairly confident. However, both economies, like most countries in the CIS bloc, are mainly focusing on commodity oriented trade, and only a few enterprises are internationally competitive, making the economies vulnerable to raw material prices. In the *Ukraine*, the economic climate index remained almost unchanged: The assessments of the current economic situation also in January were slightly below satisfactory. The economic expectations remained cautious, indicating

that the recovery process will proceed rather sluggishly in the beginning of 2006.

Asia: Booming markets

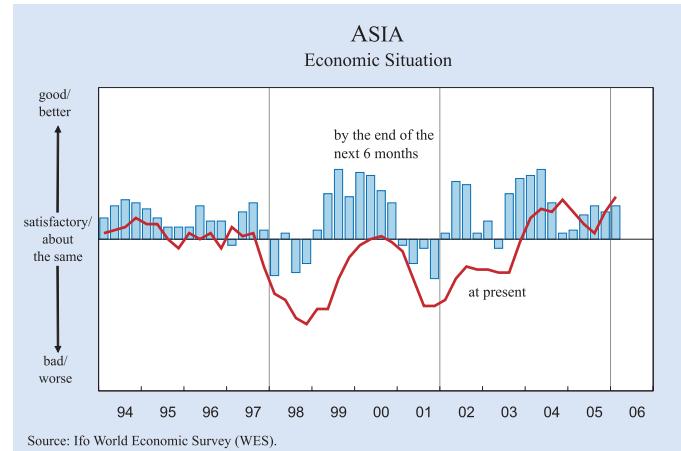
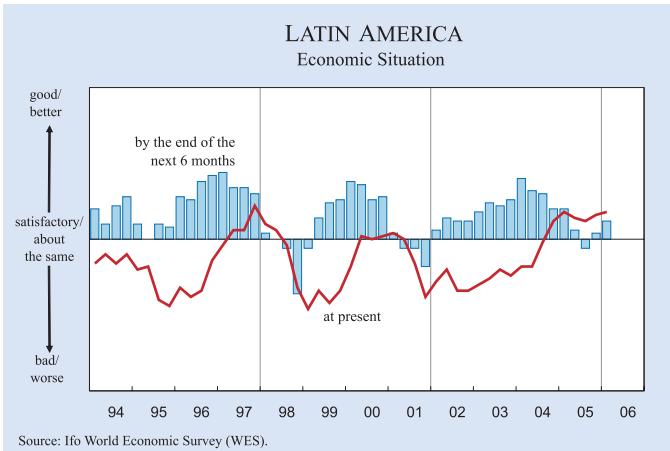
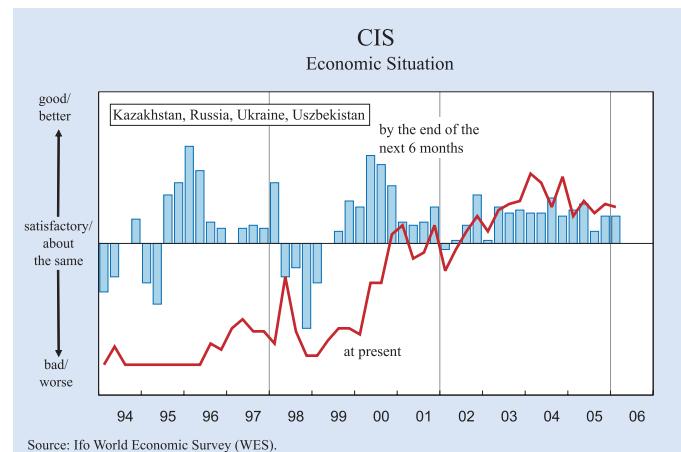
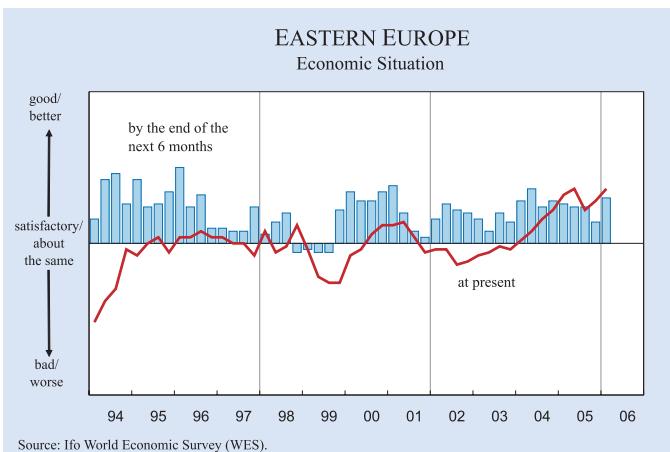
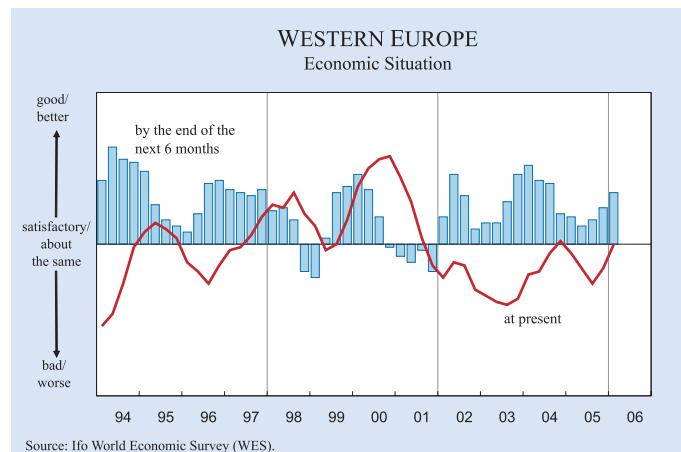
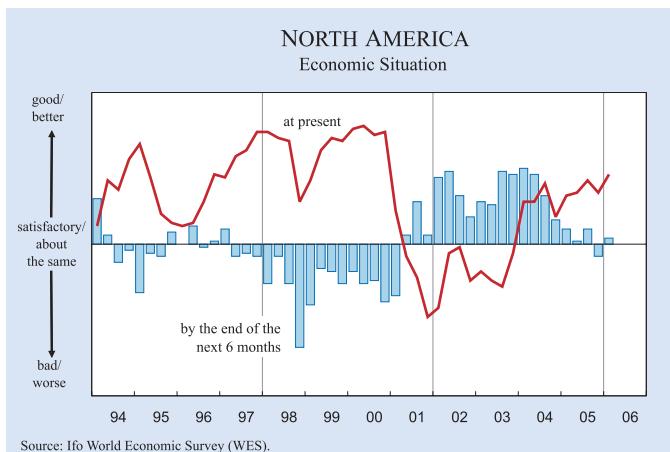
According to the January survey results, the economic climate in Asia improved again, compared with the preceding October survey. Both components of the economic climate index – the assessments of the present economic situation and economic expectations – have been upgraded. This pattern, with domestic demand now driving those economies, reflects quite well the business sentiments in almost all countries of the region (see Figure 8).

Japan's economy in particular, continued to strengthen according to the polled experts: assessments of the present economic situation as well as expectation for the coming six months have again been strongly upgraded. This positive trend already began in spring 2005, and the surveyed experts are fairly optimistic concerning its

continuation. In *China*, the economic climate continues to be highly favourable, though the economic growth rates are expected to moderate in the near-term future, mostly reflecting that Chinese policymakers are undertaking steps to prevent the economy from overheating. With respect to business sentiment, referring both to the assessment of the present economic performance and the near-term expectations, *China* along with *India*, *Singapore* and *Vietnam* are approaching leading positions in the region. Also in *Hong Kong*, the present economic situation was assessed with very high marks. But the economic expectations for the coming six months are rather cautious, in contrast to the optimism that prevails in the other economies of the region. Except for *Bangladesh* and the *Philippines*, where the present economic situation deteriorated compared to the October poll falling further below the satisfactory level and *Pakistan*, where the assessments of the present economic performance have also worsened though remaining in the favourable area, the economic

Figure 4

SELECTED REGIONS



situation in all other countries of the region remained unchanged or improved. In *Taiwan* the economic climate index has risen, although the evaluation of the current economic state has not yet reached the satisfactory level, according to the surveyed experts. The forecasts indicate stabilization on the current level. In *Sri Lanka* the surveyed experts expressed even more concerns relating to prospects for maintaining the currently satisfactory level of the country's economic performance. Very optimistic, in contrast, are the surveyed economists in *Bangladesh, South Korea* and *Pakistan*. The assessments of the present economic situation in *Indonesia* have still not reached the satisfactory level, but the panel's outlook indicates economic stabilization in the coming months. A similar forecast has been given for the economy of *Thailand*, where the present economic situation has remained at the satisfactory level since the October poll.

Oceania: Economic cooling off

Concerning business sentiments *Australia* and *New Zealand* differ from the current global trend. The economic climate index declined in both countries (see Figure 6). An economic slow-down was reported by WES experts surveyed in these countries already in the course of 2005. In October 2005 the economic climate index bounced back in *Australia*. But this improvement seems to have been only of a temporary nature. Both components of the climate index – the assessment of the present economic situation as well as economic expectations – were again downgraded in January. However, the overall economic climate in *Australia* is still regarded as favourable and the expectations for the first half of 2006 point to stabilization on the current level. Not so in *New Zealand*, where the assessments of the present economic state have fallen below the satisfactory level, after more than six years of strong economic growth. According to the polled experts, further deterioration is foreseen for the coming six months. The country's agriculture-dominated exports are expected to deteriorate strongly in the course of the coming six months, as well as capital expenditures and consumer spending.

Latin America: Optimistic expectations

The economic climate in Latin America has improved slightly compared to the preceding October survey. The improvement of the economic

climate index is due to more positive near-term expectations, while the assessments of the current economic situation, on average of Latin American economies, remained unchanged at above satisfactory (see Figure 9).

The economic recovery process in *Argentina* has demonstrated a remarkable robustness over the last three years. The assessments of the present economic situation have been steadily improving and reached an eight-year high in the January poll. The economic expectations indicate further economic stabilization in 2006. *Argentina* began its upturn in 2003, following a 1999-2002 recession, posting growth of 9.0 percent in 2004 and of 8.8 percent in 2005. Now, Latin America's third-largest economy has one of the fastest growth rates in the world. Business confidence level in *Chile* has also been among the highest in the region. In January the surveyed experts again gave the highest possible marks on the WES scale to the present economic situation. The optimism concerning further economic expansion remained unbroken also after the new president, Michelle Bachelet, took over the buoyant economy. In *Colombia* and *Costa Rica* the surveyed experts are fairly confident concerning the current economic situation as well as the trend in coming six months. In *Mexico* the country's economy faltered at the end of 2005 as hurricanes upset tourism, farming and oil exports. In January 2006, business confidence improved over the preceding October poll, but only due to more positive economic expectations while the assessments of the present economic situation have slightly worsened. Exports, however, are expected to recover strongly in the course of the coming six months. In *Brazil* the economic climate index slipped somewhat, according to the January poll. However, the assessments of the present economic situation are still favourable and the outlook for the first half of 2006 remains bright. In *Uruguay, Guatemala* and *El Salvador* the current economic performance has been assessed as "satisfactory" and the near term prospects are also positive. In *Bolivia* the assessments of the present economic situation have further fallen below the satisfactory level. The expectations for the next six months indicate a rather sluggish economic development. Very high marks for the present economic situation have been given by the surveyed experts in *Peru* and *Venezuela*. However, in both economies the near-term expectations for the coming six months reveal some concerns. In *Paraguay* the overall economic climate is less encouraging: the current economic situation was

Table 1
Total Imports and Exports in 2004 and the Country's Share in the Total World Trade, in Million US Dollar*

Country	Exports	Imports	Total Foreign Trade Volume	
90 WES Countries	8,719,134	8,938,831	17,657,965	100.00%
USA	818,520	1,525,680	2,344,200	13.28%
Germany	911,859	718,269	1,630,128	9.23%
China	593,439	560,683	1,154,122	6.54%
Japan	565,743	454,592	1,020,335	5.78%
France	424,036	442,120	866,156	4.91%
United Kingdom	341,621	451,715	793,336	4.49%
Italy	353,785	354,765	708,550	4.01%
Netherlands	317,936	283,734	601,670	3.41%
Belgium	306,536	285,516	592,052	3.35%
Canada	304,456	273,084	577,540	3.27%
Hong Kong	259,314	271,158	530,472	3.00%
South Korea	253,845	224,463	478,308	2.71%
Spain	182,156	257,672	439,828	2.49%
Mexico	189,083	197,347	386,430	2.19%
Singapore	179,611	163,851	343,462	1.95%
Russia	181,648	75,554	257,202	1.46%
Taiwan	135,065	112,602	247,667	1.40%
Malaysia	125,745	105,299	231,044	1.31%
Sweden	123,223	100,437	223,660	1.27%
Switzerland	114,138	106,645	220,783	1.25%
Austria	109,004	108,866	217,870	1.23%
Australia	86,426	109,378	195,804	1.11%
Thailand	97,413	95,353	192,766	1.09%
Saudi Arabia	125,728	44,517	170,245	0.96%
India	71,798	94,070	165,868	0.94%
Ireland	104,202	61,404	165,606	0.94%
Poland	74,831	89,094	163,925	0.93%
Brazil	96,475	65,950	162,425	0.92%
Turkey	61,683	96,368	158,051	0.90%
Denmark	75,617	66,883	142,500	0.81%
Czech Republic	67,198	68,435	135,633	0.77%
Norway	81,716	48,062	129,778	0.73%
Indonesia	71,261	52,076	123,337	0.70%
United Arab Emirates	65,826	51,955	117,781	0.67%
Hungary	54,893	59,636	114,529	0.65%
Finland	60,916	50,677	111,593	0.63%
South Africa	43,707	46,266	89,973	0.51%
Portugal	33,023	49,225	82,248	0.47%
Philippines	39,689	42,345	82,034	0.46%
Israel	38,618	42,864	81,482	0.46%
Greece	14,996	51,559	66,555	0.38%
Ukraine	32,672	28,996	61,668	0.35%
Iran	33,788	27,676	61,464	0.35%
Slovakia	27,605	30,469	58,074	0.33%
Chile	32,025	24,871	56,896	0.32%
Argentina	34,453	22,320	56,773	0.32%
Vietnam	25,625	31,091	56,716	0.32%
Romania	23,485	32,664	56,149	0.32%
Venezuela	33,929	16,679	50,608	0.29%
Nigeria	31,148	14,164	45,312	0.26%
New Zealand	20,373	23,201	43,574	0.25%
Kuwait	28,729	12,005	40,734	0.23%
Slovenia	15,879	17,571	33,450	0.19%
Columbia	16,224	16,746	32,970	0.19%
Kazakhstan	20,093	12,781	32,874	0.19%
Pakistan	13,379	17,949	31,328	0.18%
Algeria	18,530	11,809	30,339	0.17%
Luxembourg	12,180	16,828	29,008	0.16%
Croatia	8,024	16,589	24,613	0.14%
Bulgaria	9,931	14,467	24,398	0.14%
Peru	12,617	9,812	22,429	0.13%
Tunisia	9,685	12,738	22,423	0.13%

*Imports CIF, Exports FOB, sorted by the share of the specific country's exports and imports in the total world trade in 2004.
Source: UNO (2005): Monthly Bulletin of Statistics, No. 1012, pp. 111-141

rated very poorly in October and January and is expected to worsen further in the course of the coming months. Also in *Ecuador* and *Panama* the prospects for 2006 are clouded. In both countries the surveyed experts expect an economic decline.

Near East: Stable economy

According to WES experts the economic climate in the Near East continues to be highly favourable. The assessments of the present economic situation

improved slightly since last year's October poll. Also the outlook for the first half of 2006 remains bright (see Figure 10).

The present economic situation is assessed to be good again in *Saudi Arabia*, *United Arab Emirates*, *Jordan* as well as in *Kuwait* and *Bahrain*. The outlook suggests stable economic development in 2006. The economic situation in *Lebanon* is now regarded as satisfactory. WES experts are fairly confident concerning a continuation of the positive economic development in the coming six months. Not so in *Iran*, where the present economic situation was assessed as poor in the January poll and the surveyed economists expect no turnaround of this negative trend in the first half of 2006. The present economic situation in *Turkey* has again been accessed by the surveyed experts as above the "satisfactory" level on the WES scale. The economic expectations for the coming six months although down-graded somewhat, indicate a stabilization at the current favourable level in 2006. A similar picture of business confidence has been drawn by the panel in *Israel*. Also here the economic situation improved compared with the results of the preceding October poll and the country's economic performance is now seen as "good". The economic expectations for the coming six months are not as optimistic as they were in 2005 but remain generally positive. It is not surprising that the political victory of the Hamas-led government in the elections and the group's overwhelming presence in the Palestinian parliament dampens business sentiment in the politically shaken country.

Africa: Diverging economic trends predominate

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

The economic climate index in *South Africa* has further improved, according to the January WES results (see Figure 10) after a year of prolonged stabilization. The business sentiments concerning the current economic situation are approaching the highest possible marks on the WES scale. The expectations point to further economic strengthening in the first half of 2006. The present eco-

nomic situation has been assessed with "good" marks also in the North African countries surveyed by WES experts – *Tunisia*, *Algeria* and also in *Morocco*. The outlook for the coming six months is optimistic in all these countries. In contrast, the economic recovery in *Egypt* remained rather sluggish, according to economists surveyed in the country. The present economic situation is still assessed as far below satisfactory, though slightly better than in the preceding October survey. But the economic expectations for 2006 remain optimistic. The worst economic situation of all 90 countries covered by WES was again reported from *Zimbabwe* where for many years the surveyed experts have been giving the most negative marks that are possible on the WES scale.

Inflation: Price expectations for 2006 dampened somewhat

Consumer price inflation (CPI) in 2006 is expected to stand at 3.2 percent on the world-wide average compared with 3.3 percent in 2005 and 2.9 percent in 2004. Thus, inflation is expected to cool off somewhat but will stay at a rather high level.

In the *euro area* the inflation outlook for 2006 corresponds with the inflation rate observed in 2005 (2.2 percent) and will thus remain also in 2006 at a level which is markedly higher than the ECB's target of "slightly below 2.0 percent". The worst inflation performance in the euro area will also prevail this year in *Spain* with 3.4 percent (unchanged from the 2005 inflation rate) and *Greece*, though here the inflation outlook for 2006 has slowed down somewhat from 3.6 percent in 2005 to now 3.3 percent. On the other hand the lowest inflation rates in the euro area in 2006 at 1.7 percent are expected in *Finland* and *the Netherlands*. In *Germany* 2006 inflation expectations remain at the level reached in 2005 (2.0 percent).

In *Western Europe* outside the euro area, expectations for low inflation rates in 2005 continue to prevail in *Switzerland* (1.1 percent after 1.2 percent in 2005) and *Sweden* (1.6 percent after inflation rate of 1.1 percent in 2005). In *Norway* the 2006 inflation outlook has deteriorated slightly from 1.9 percent in 2005 to now 2.0 percent. In the *United Kingdom* the inflation rate in 2006 will remain somewhat higher than in the euro area (2.4 percent compared with 2.3 percent).

Figure 5a

EUROPEAN UNION

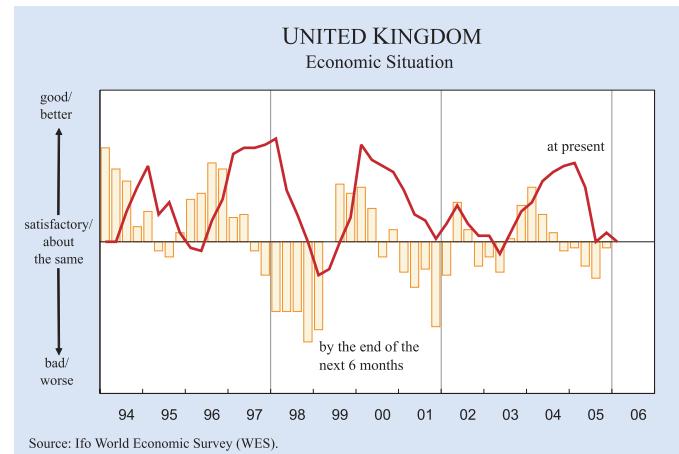
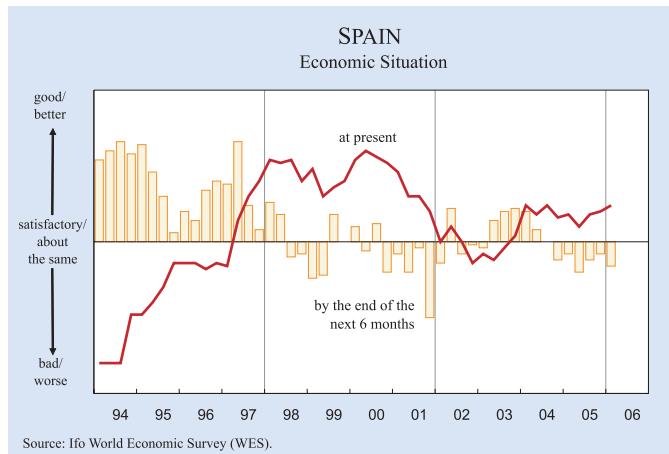
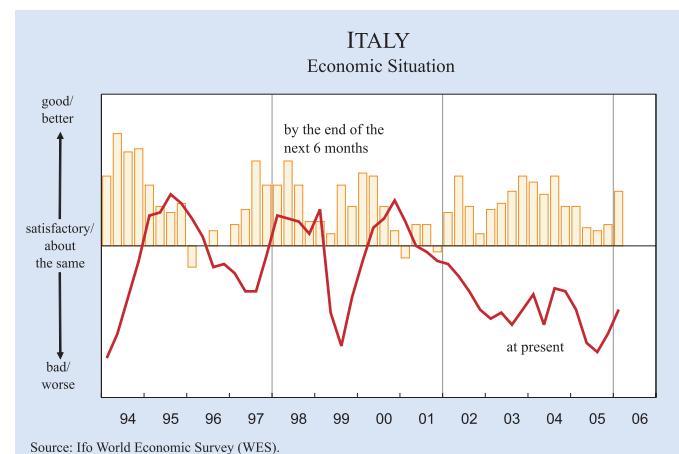
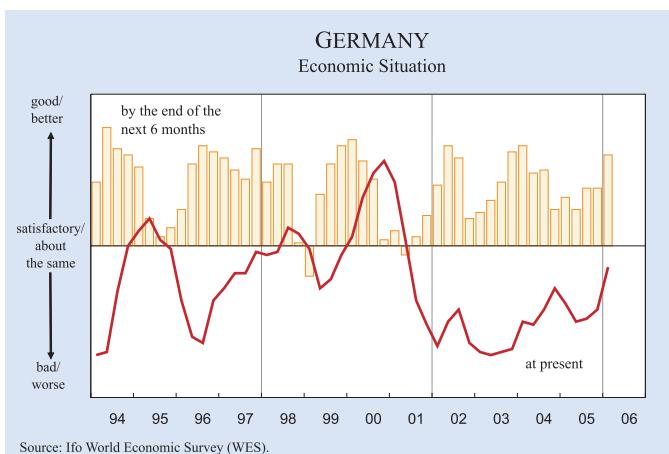
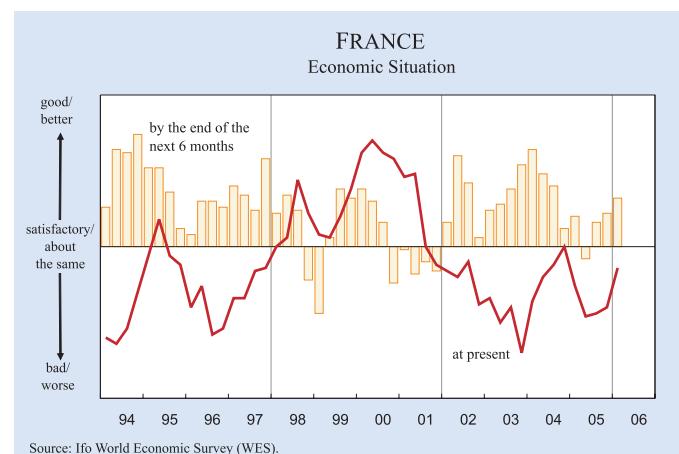
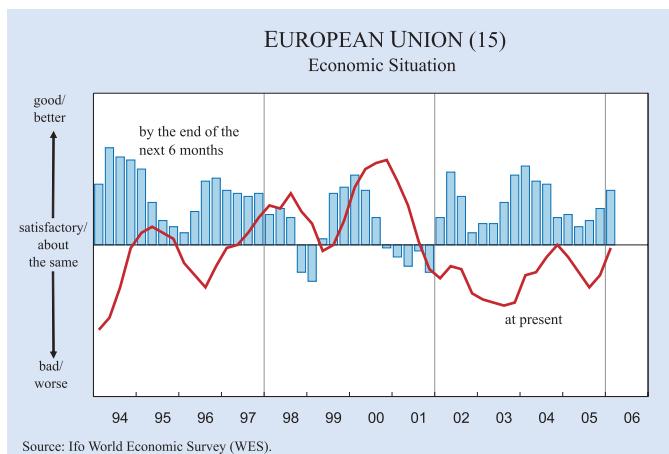


Figure 5b

EUROPEAN UNION

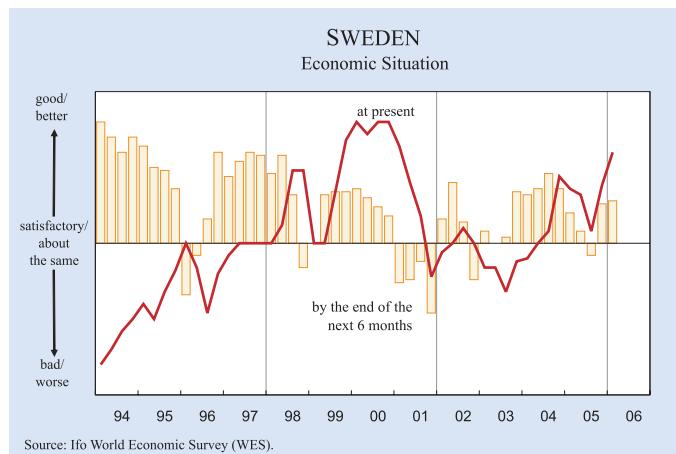
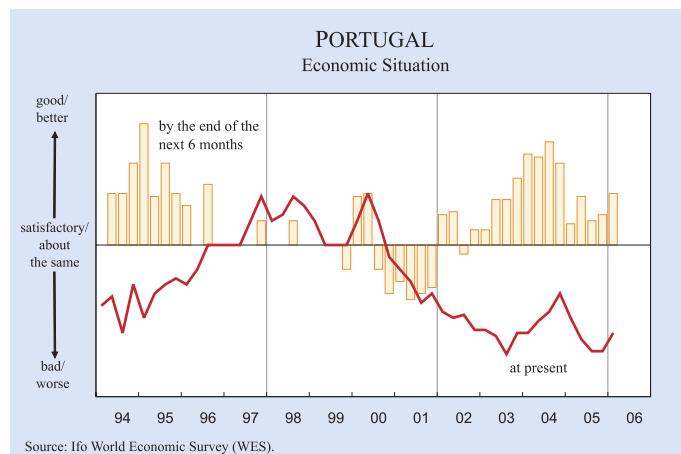
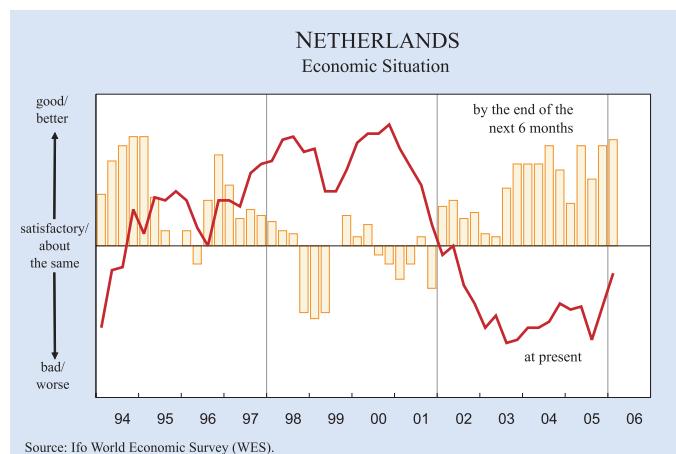
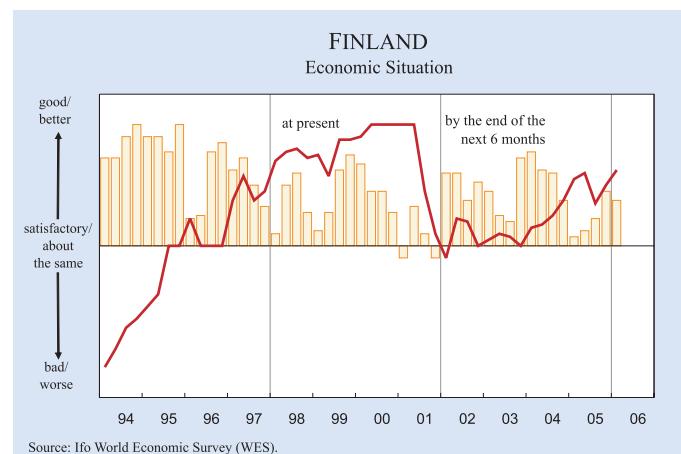
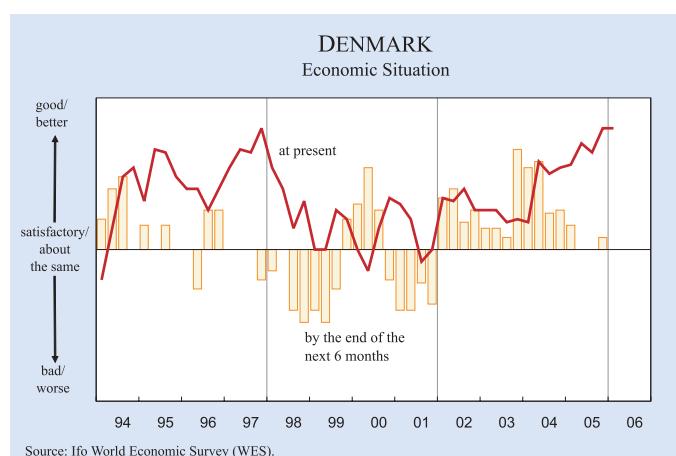
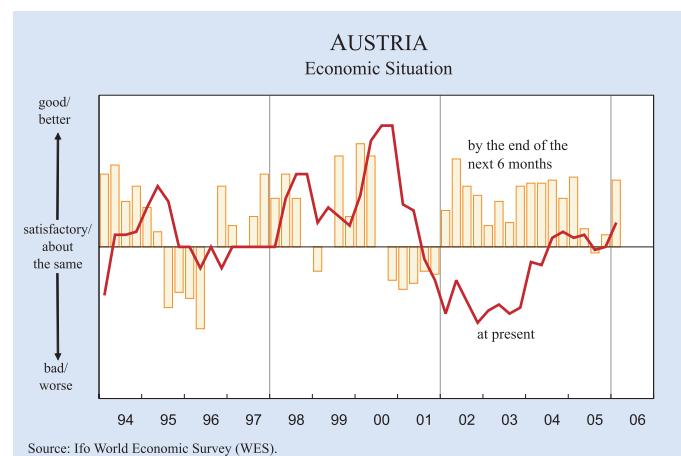


Figure 6

NORTH AMERICA, OCEANIA AND CIS

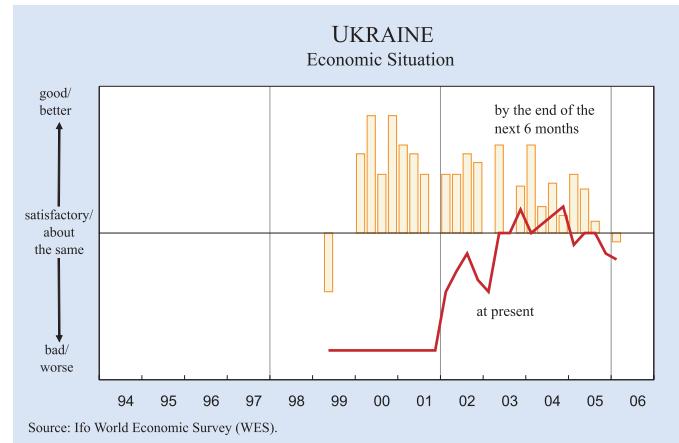
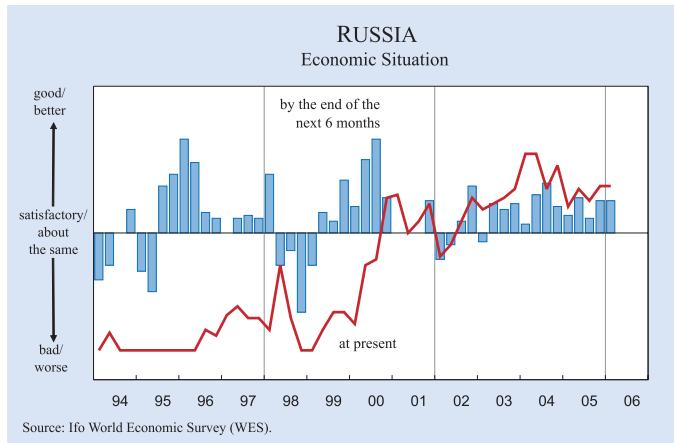
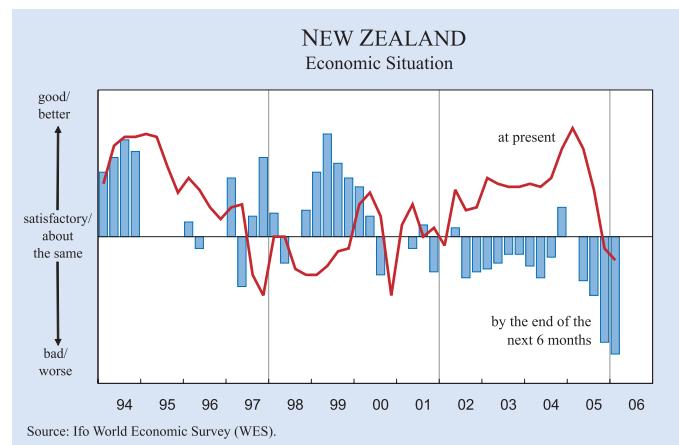
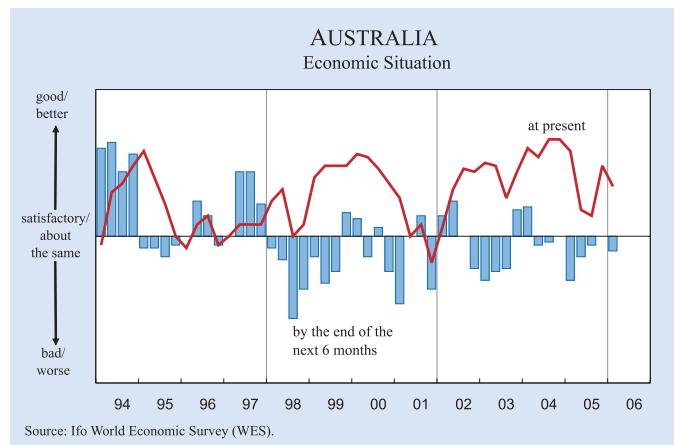
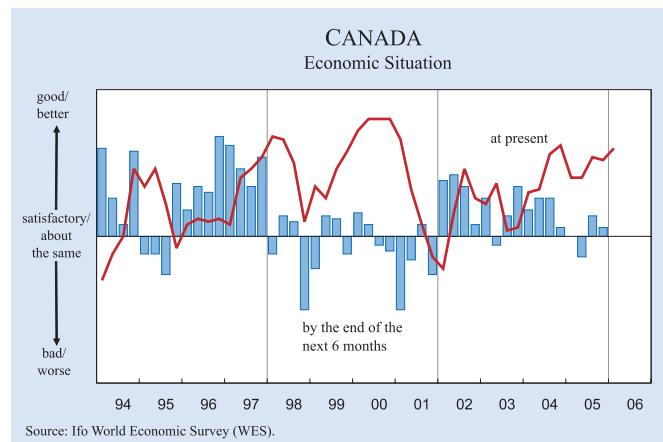
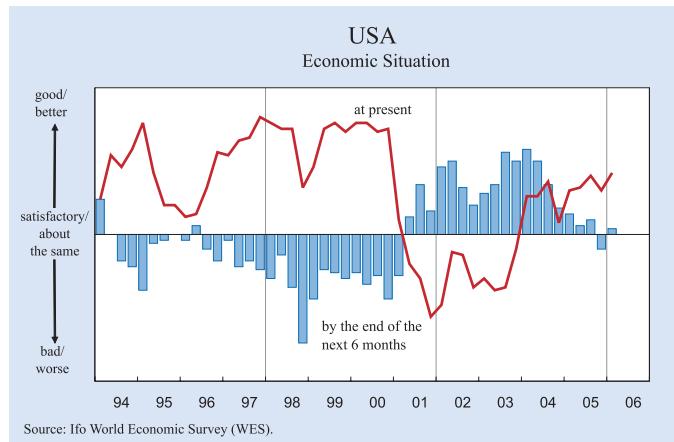


Figure 7

EASTERN EUROPE

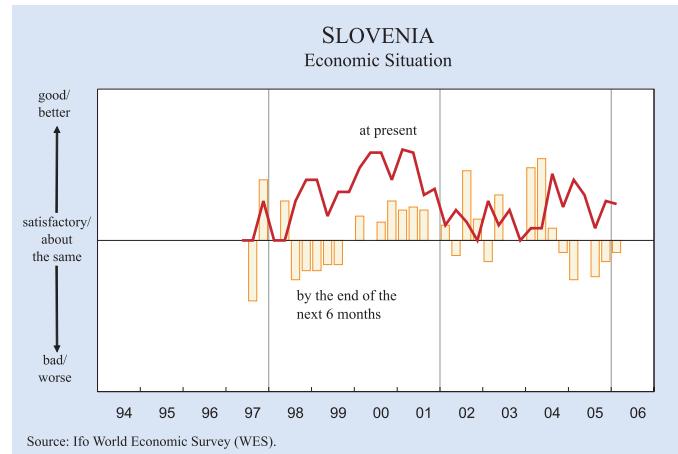
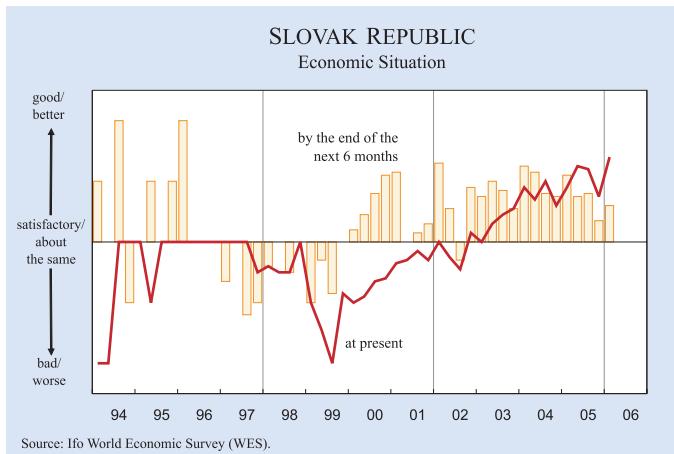
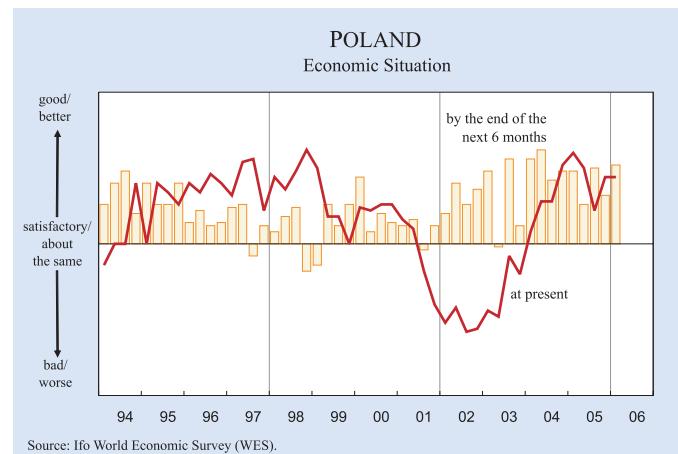
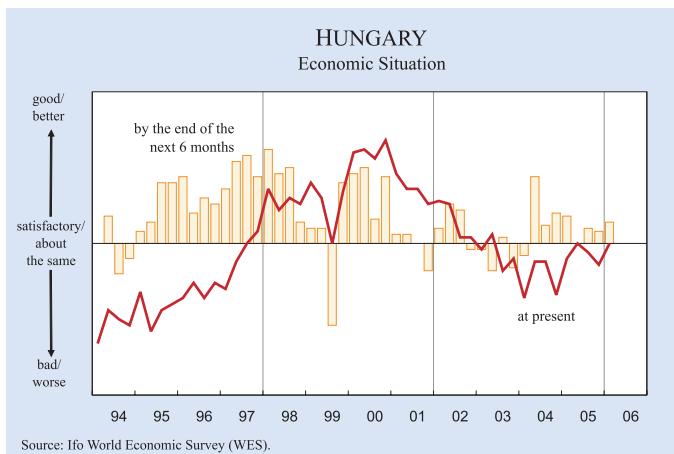
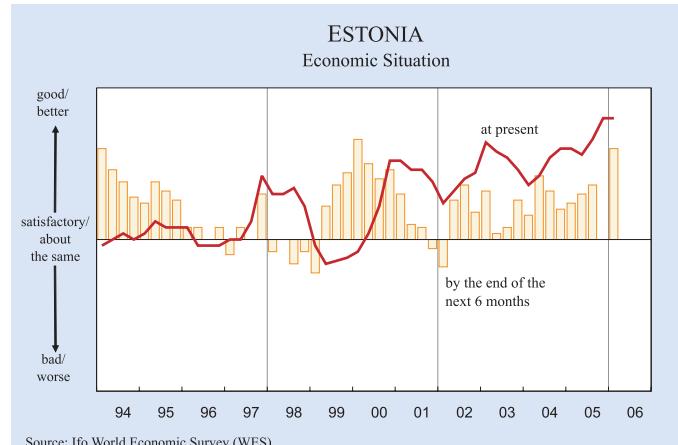
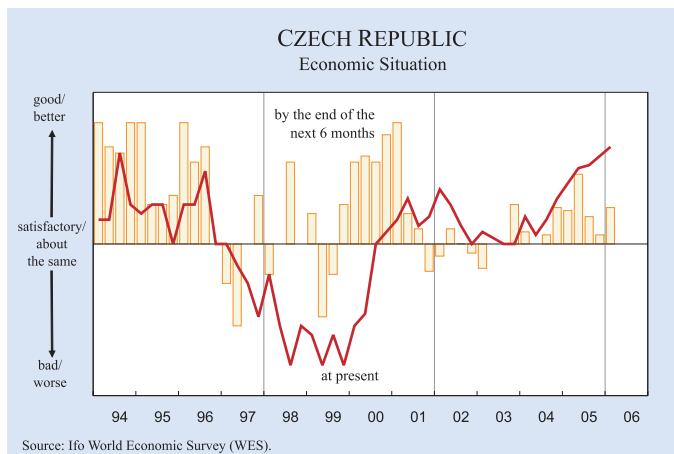


Figure 8

ASIA

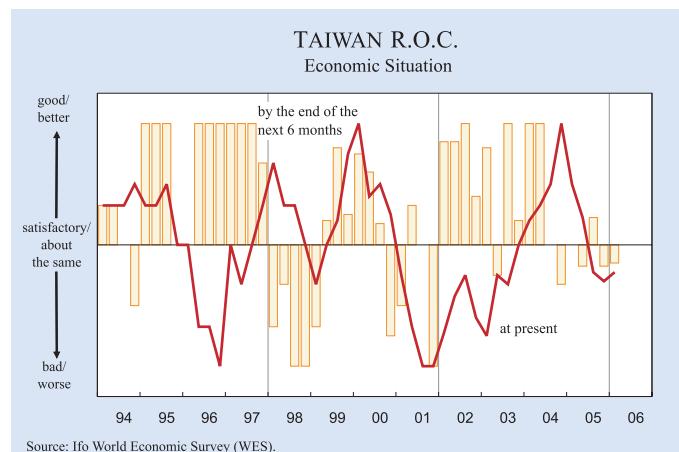
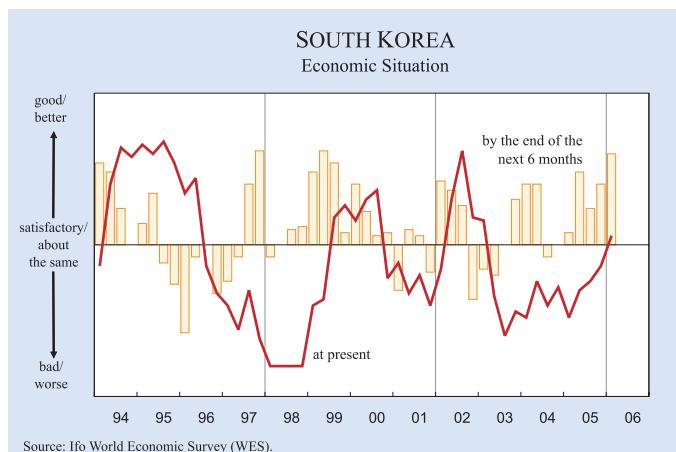
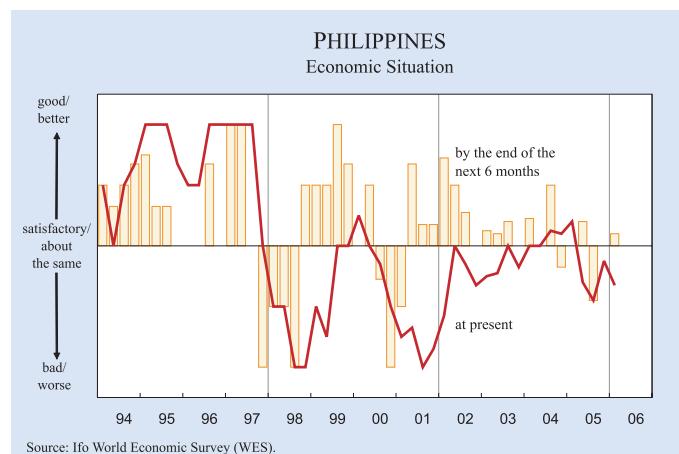
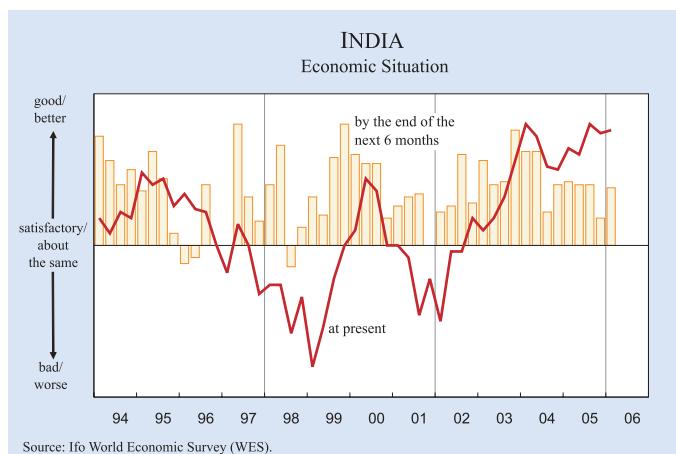
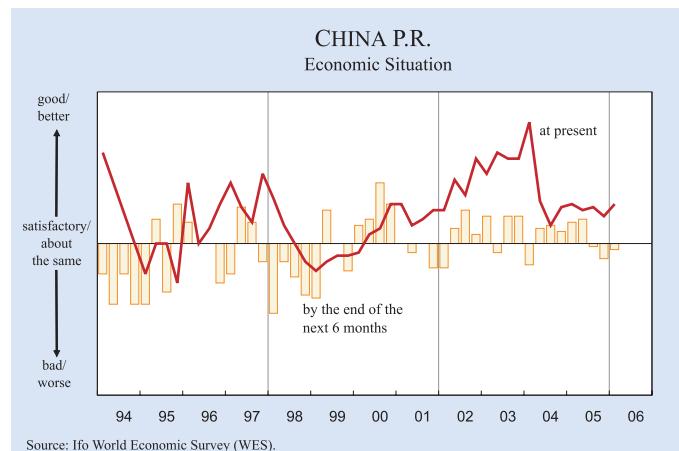
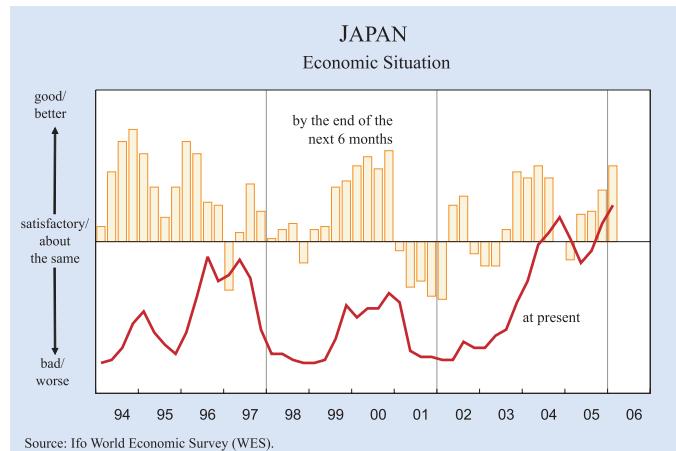


Figure 9

LATIN AMERICA

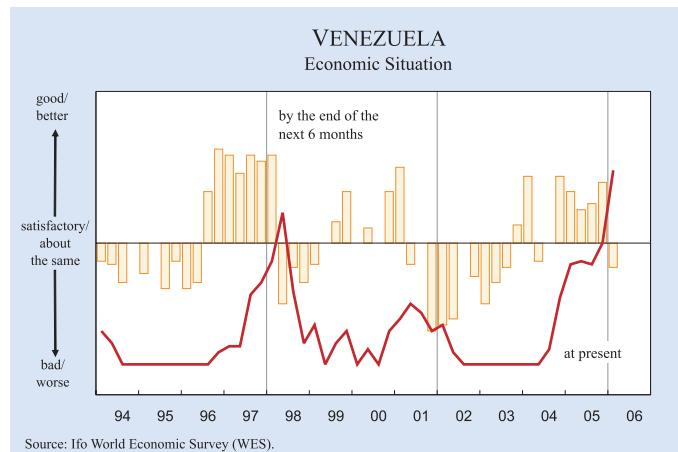
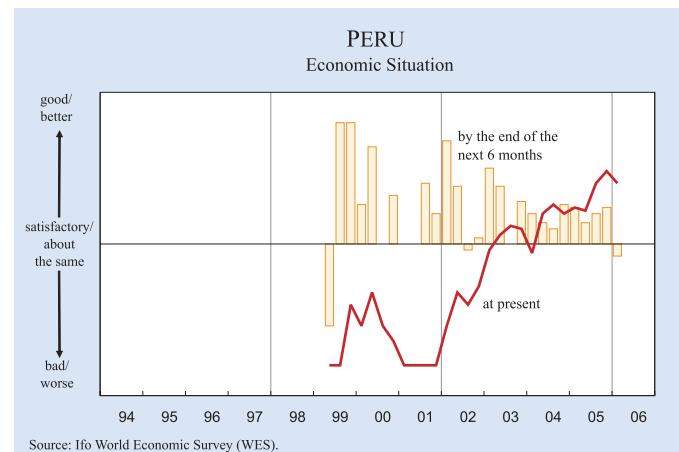
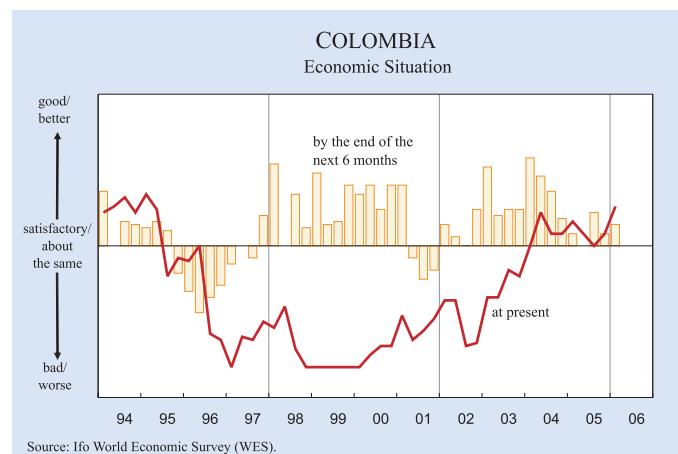
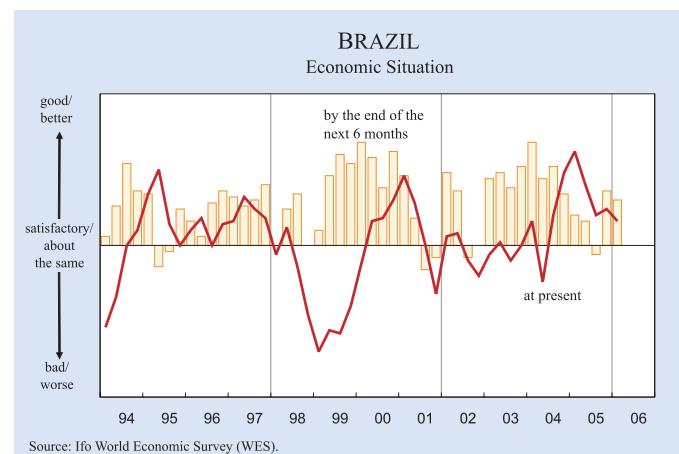
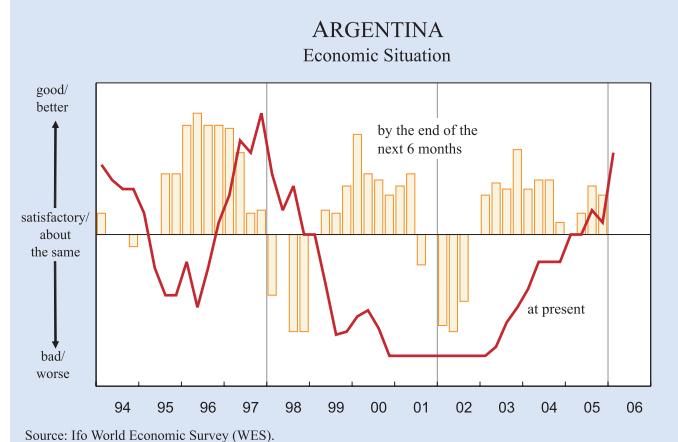
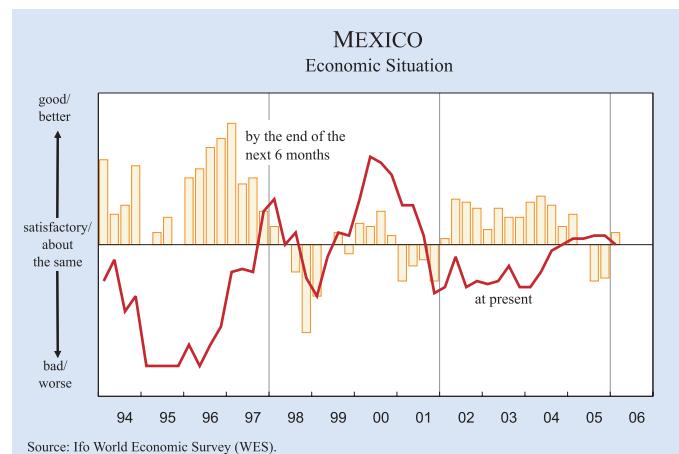


Figure 10

NEAR EAST AND AFRICA

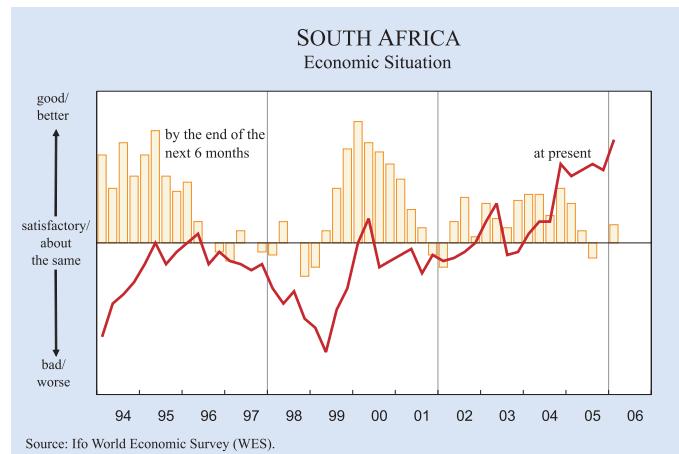
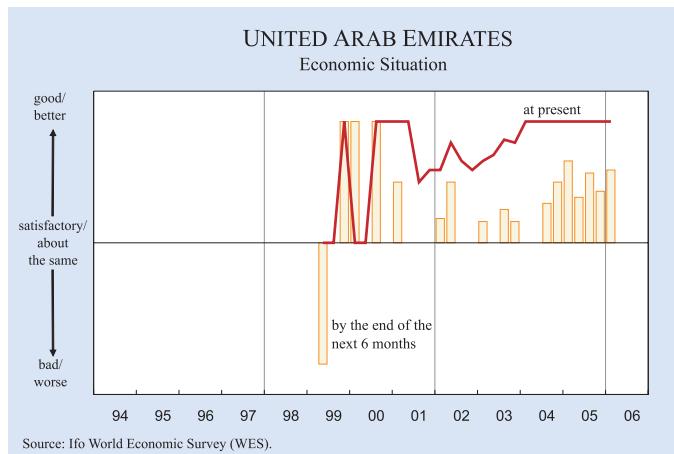
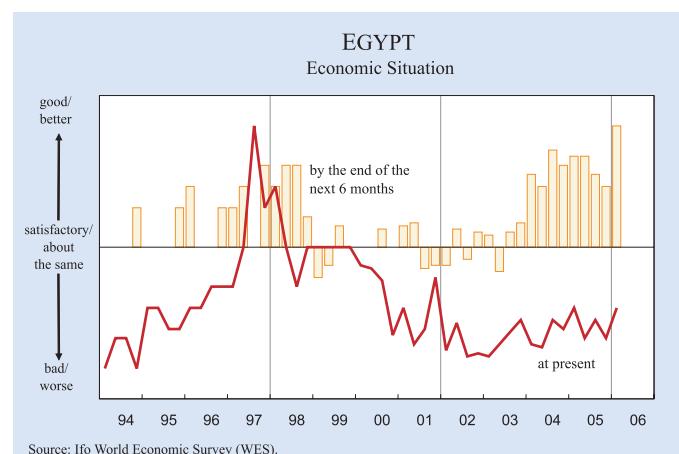
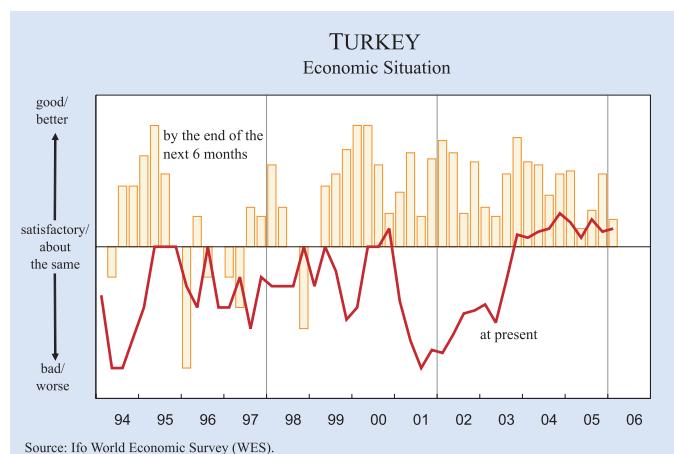
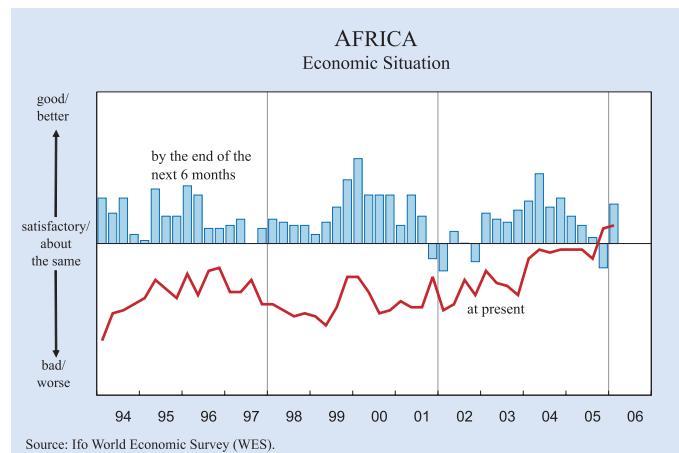
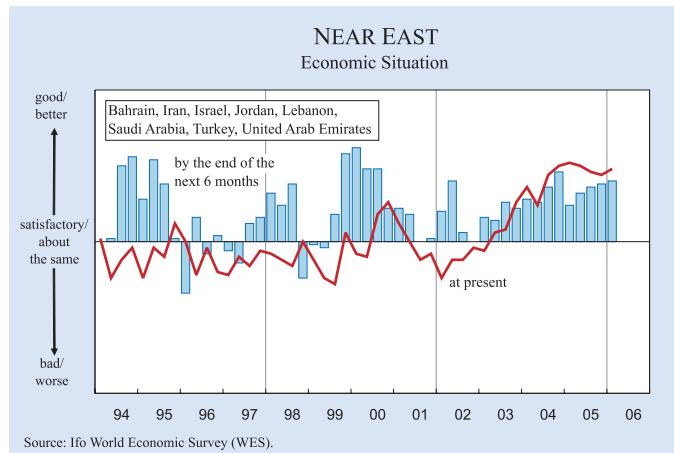


Table 2

Reported Inflation Rate on Average of 2005 and Expectations for 2006

(based on WES QI/2006 and QIV/2005)

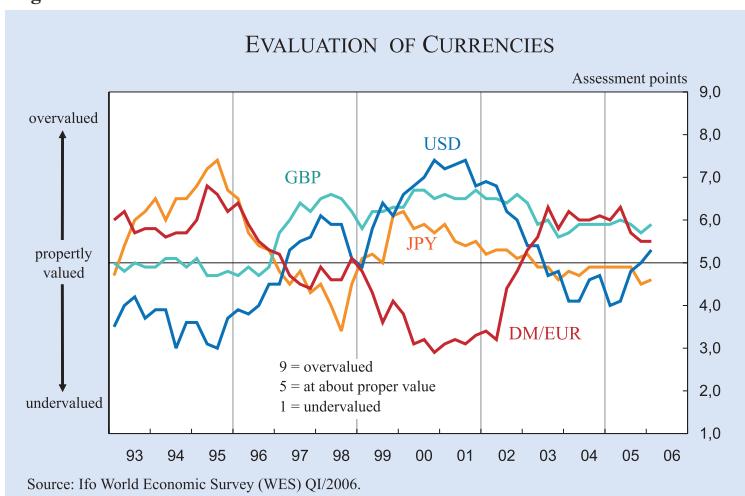
Region	QI/2006	QIV/2005	Region	QI/2006	QIV/2005
Average of countries	3.2	3.3	Central a. Latin America	5.5	5.8
<i>World Bank classification:</i>			Argentina	13.0	12.8
High-income countries	2.3	2.3	Bolivia	4.3	3.9
Middle-income countries	5.5	5.9	Brazil	4.9	5.3
Upper-middle	5.3	5.8	Chile	3.4	3.8
Lower-middle	5.8	6.2	Colombia	4.8	5.2
Low-income countries	13.4	12.8	Costa Rica	12.0	14.2
EU countries (old members)	2.2	2.2	Ecuador	4.6	2.5
EU countries (new members) ¹	3.0	3.1	El Salvador	4.4	5.2
Euro area ²	2.2	2.2	Mexico	3.5	4.0
Asian Pacific Rim ³	3.4	3.4	Panama	1.7	1.6
Western Europe	2.1	2.1	Paraguay	10.0	8.9
Austria	2.1	2.2	Peru	2.6	2.1
Belgium	2.3	2.6	Trinidad and Tobago	-	5.0
Cyprus	2.9	2.5	Uruguay	5.5	6.0
Denmark	2.3	1.9	Venezuela	16.2	17.0
Finland	1.7	1.4			
France	1.9	1.9			
Germany	2.0	2.0			
Greece	3.3	3.6			
Iceland	-	4.0			
Ireland	2.5	2.5			
Italy	2.2	2.2			
Luxembourg	2.3	3.2			
Malta	3.0	2.7			
Netherlands	1.7	1.7			
Norway	2.0	1.9			
Portugal	2.5	2.4			
Spain	3.4	3.4			
Sweden	1.6	1.1			
Switzerland	1.1	1.2			
United Kingdom	2.4	2.3			
Central a. Eastern Europe	3.5	3.8			
Albania	3.2	3.4			
Bosnia Herzegovina	3.0	-			
Bulgaria	5.3	5.1			
Croatia	2.9	3.2			
Czech Republic	2.7	2.6			
Estonia	3.4	3.6			
Hungary	3.2	3.8			
Latvia	5.9	6.8			
Lithuania	2.7	2.7			
Poland	2.8	2.4			
Romania	6.9	7.8			
Serbia a. Montenegro	11.9	15.5			
Slovenia	2.3	2.6			
Slovakia	3.7	3.6			
CIS	10.0	11.5			
Kazakhstan	7.7	7.2			
Russia	10.0	11.8			
Ukraine	11.3	11.9			
North America	2.8	3.2			
Canada	2.4	2.8			
USA	2.9	3.4			
Oceania			3.0	3.1	
Australia			3.0	3.1	
New Zealand			3.3	3.2	

*Within each country group the results are weighted according to the share of the specific country's exports and imports in the total world trade.

¹ Czech Rep., Cyprus, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovenia, Slovakia (from 1. May 2004) – ² EU countries without Denmark, Sweden, United Kingdom. – ³ Australia, China P.R., Hong Kong, Indonesia, Korea, Malaysia, New Zealand, Philippines, Singapore Taiwan, Thailand, Vietnam.

Source: Ifo World Economic Survey (WES), QIV/2005 and QI/2006.

Figure 11



In the *United States* inflation is expected to fall from 3.4 percent in 2005 to 2.9 percent in 2006. Also in *Canada* inflation is expected to slow down somewhat, from 2.8 percent in 2005 to 2.4 percent in 2006.

In *Asia* the period when deflation appeared to be a serious problem is long gone and consumer price inflation at 2.8 percent is expected in 2006, which is slightly higher than the rate observed in 2005 (2.7 percent). In contrast to this general upward trend, inflation in *Taiwan* is expected to slow down and stay at 1.8 percent in 2006 compared with 2.4 percent in 2005. Such a downward revision of the inflation outlook applies also for the *Philippines* (6.6 percent after 7.7 percent in 2005), *Pakistan* (8.1 percent after 9.0 percent) and *Vietnam* (7.0 percent after 8.1 percent). On the other hand, inflation is expected to pick up slightly in *China* (from 2.6 percent in 2005 to 2.8 percent in 2006) and in *India* (from 5.0 percent to 5.2 percent). In *Thailand* inflation is expected to remain almost unchanged (5.0 percent after 5.1 percent in 2005) and in *Japan* consumer prices are expected to increase slightly in 2006 (0.4 percent) after a deflationary period from 2001 to 2003 and a price stagnation since then.

In *Central and Eastern Europe* inflation in 2006 is expected to stay at 3.5 percent which would be somewhat lower than in 2005 (3.8 percent). The relatively highest rate of inflation will still prevail in *Serbia and Montenegro*, though some success in bringing it under control can clearly be seen (11.9 percent in 2006 after 15.5 percent in 2005). The lowest rates of inflation will be seen in 2006 in *Slovenia* (2.3 percent after 2.6 percent in 2005), in the *Czech Republic* (2.7 percent after 2.6 percent

in 2005) and *Lithuania* (unchanged 2.7 percent). In *Poland* inflation is expected to pick up somewhat in 2006 (from 2.4 percent in 2005 to now 2.8 percent this year).

In the *CIS* countries inflation in 2006 is expected to be somewhat lower than in 2005 (10.0 percent after 11.5 percent in 2005). The downward revision results particularly from lower inflation expectations in *Russia* (10.0 percent after 11.8 percent in 2005) and to a lesser degree in the *Ukraine* (11.3 percent after 11.9 percent in 2005). The relatively best inflation performance in the region will prevail with an expected 7.7 percent in 2006 in *Kazakhstan*, though this would be slightly worse than in 2005 when inflation here stood at 7.2 percent.

In *Central and Latin America* inflation in 2006 is expected to be slightly lower than in the previous year (5.5 percent compared with 5.8 percent in 2005). Whereas the inflation rate in *Argentina* is expected to pick up slightly and reach 13.0 percent in 2006 after 12.8 percent in 2005, a contrary trend can be observed in *Brazil* where the 2006 inflation rate is now seen at 4.9 percent compared with 5.3 percent in the previous year. A moderation of inflation is also expected for this year in *Chile*, *Colombia*, *Mexico*, *Uruguay* and even *Venezuela*, though the inflation rate of 16.2 percent will remain the highest in the region. On the other hand, the relatively lowest inflation rates in the region will remain in *Panama* (1.7 percent) and *Peru* (2.6 percent), though in both cases this would mean a slight deterioration compared with 2005.

In the *Near East* the inflation outlook improved slightly (5.6 percent after 5.9 percent in 2005). In *Turkey* the inflation outlook for 2006 was significantly better than the performance in 2005 (6.3 percent compared with 7.8 percent in 2005). Some moderation of the still high inflation rate is expected in *Iran* (14.8 percent after 17.0 percent in 2005). By far the lowest inflation rate will again prevail in *Saudi Arabia* (unchanged 1.2 percent); also in *Lebanon* (2.5 percent), *Israel* (2.9 percent) and *Jordan* (3.5 percent) inflation will be significantly lower than in the average of the region.

Figure 12

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

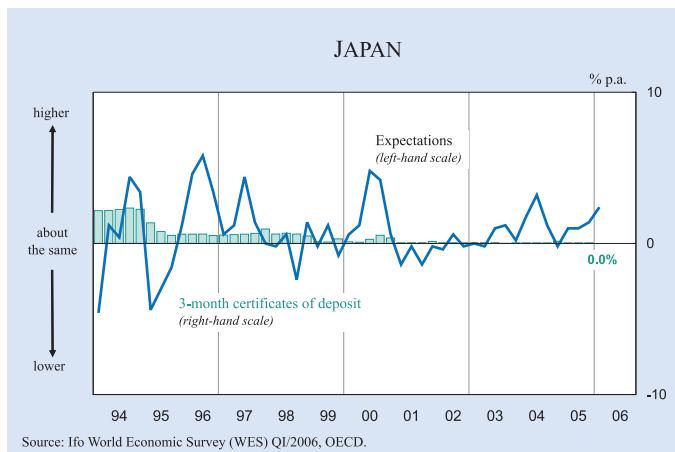
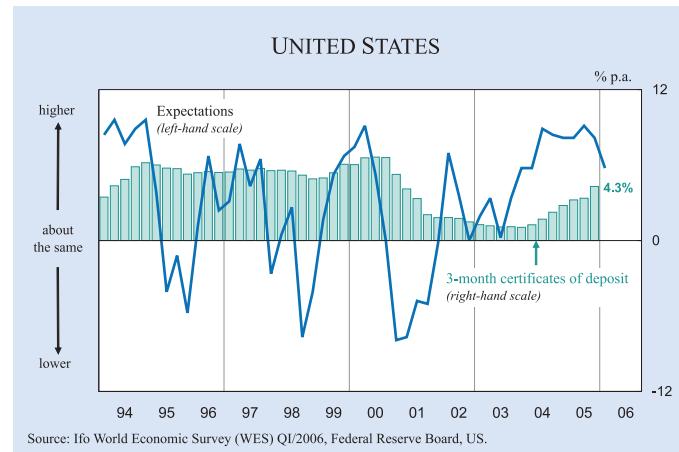
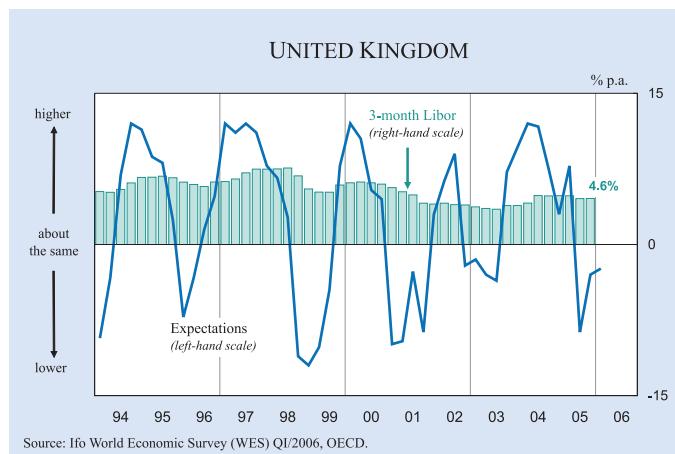
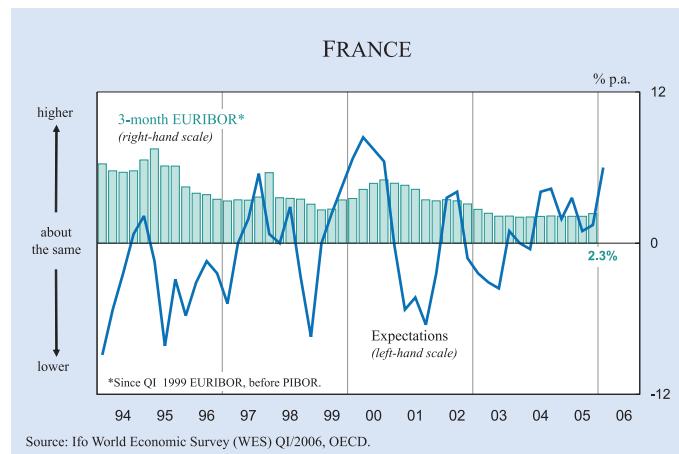
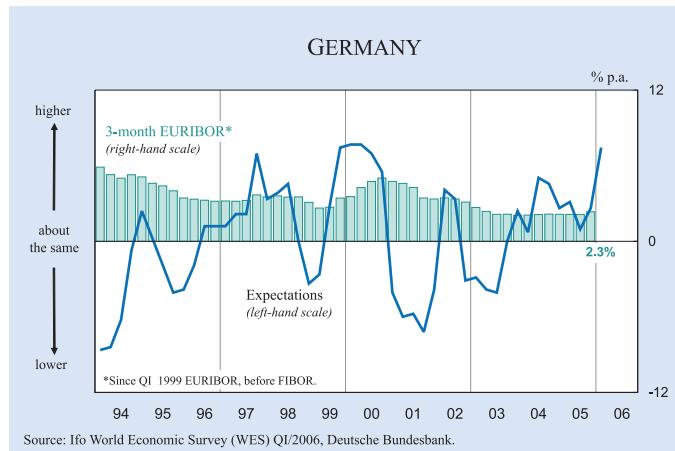
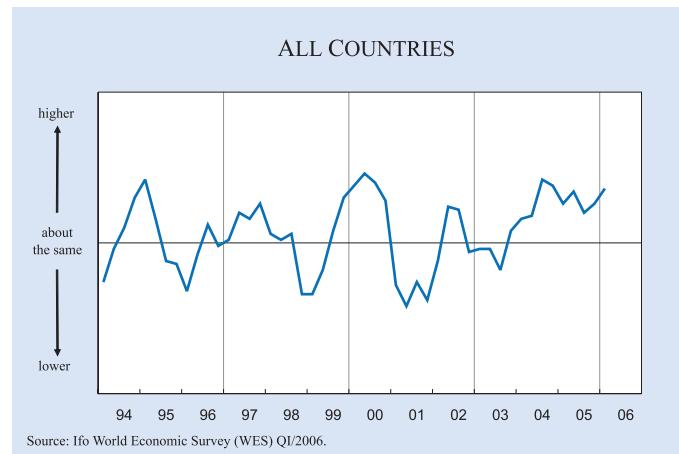


Table 3
**Legal and Administrative Restrictions
for Foreign Firms**

Absent	
Singapore	9.0
Denmark	9.0
Uruguay	9.0
New Zealand	8.2
Finland	8.1
Estonia	8.0
United Kingdom	7.3
Spain	7.1
Ireland	7.0
Rather Low	
Austria	6.9
Portugal	6.9
Chile	6.9
Sweden	6.8
United States	6.7
Romania	6.7
Netherlands	6.7
Latvia	6.6
Serbia and Montenegro	6.3
Panama	6.3
Ecuador	6.3
Bangladesh	6.3
Argentina	6.3
Norway	6.2
Switzerland	6.2
Australia	6.1
Belgium	6.1
Czech Republic	6.0
Canada	6.0
Bolivia	6.0
United Arab Emirates	5.8
Hong Kong	5.8
Germany	5.8
France	5.7
Pakistan	5.7
Poland	5.7
Slovakia	5.6
Japan	5.6
Israel	5.6
South Korea	5.3
Hungary	5.3
Turkey	5.3
Thailand	5.0
Slovenia	5.0
Peru	5.0
Paraguay	5.0
Mexico	5.0
Malaysia	5.0
Lithuania	5.0
Kazakhstan	5.0
Colombia	5.0
Greece	4.8
Bulgaria	4.7
Italy	4.6
India	4.4
Taiwan	4.3
Brazil	4.2
Rather High	
Russia	3.9
Croatia	3.8
Ukraine	3.8
China	3.8
South Africa	3.7
Vietnam	3.5
Costa Rica	3.4
Indonesia	3.0
Albania	3.0
Venezuela	2.6
Philippines	2.6

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

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

Source: Ifo World Economic Survey Q1/2006

In *Oceania*, in 2006 an inflation rate of 3.0 percent is now expected; this is marginally lower than the inflation figure in 2005. The 2006 inflation figure will be slightly lower in *Australia* (3.0 percent) than in *New Zealand* (3.3 percent).

Currency: Japanese yen seen as somewhat under-valued

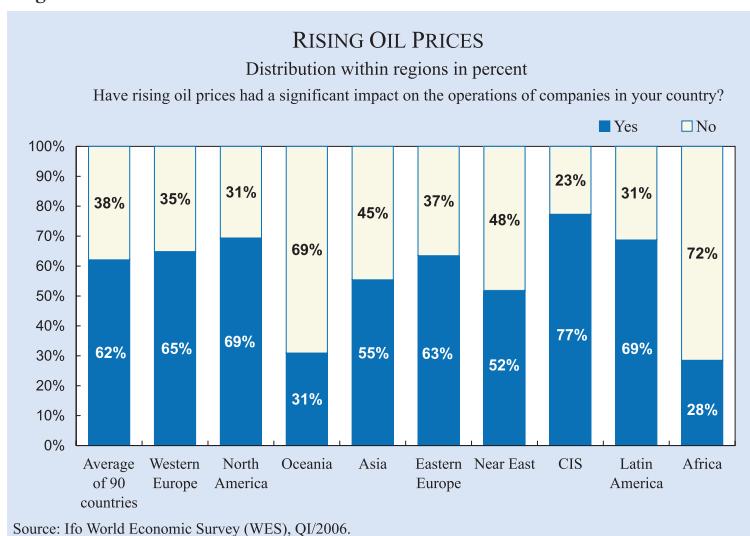
Differently from the previous two years the US dollar was no longer regarded as undervalued vis-à-vis the average of the other currencies covered in the WES panel but as slightly overvalued. This assessment of a perceived overvaluation holds also true for the *euro* and even more for the *British pound*. On the other hand, the *Japanese yen* was again seen as somewhat undervalued (see Figure 11).

This overall picture characterizes the assessments in most countries. Noticeable exceptions from this general view are *Russia*, some *Latin American* countries like *Argentina*, *Bolivia*, *Costa Rica*, *Mexico*, *Paraguay* and *Peru* as well as some *Asian* countries like *China*, *Indonesia*, *Malaysia*, *Pakistan* and the *Philippines* where the main world currencies (*US dollar*, *euro*, *British pound* and *Japanese yen*) were seen as overvalued vis-à-vis the own currency.

On the other hand, the own currency is regarded as generally overvalued compared to the four main currencies particularly in some *Latin American* countries like *Chile*, *Colombia* and *Venezuela* as well as in several *African* countries like *Egypt*, *Kenya*, *Morocco*, *South Africa* and *Zimbabwe* and some *Asian* countries like *Bangladesh*, *South Korea* and *Vietnam*.

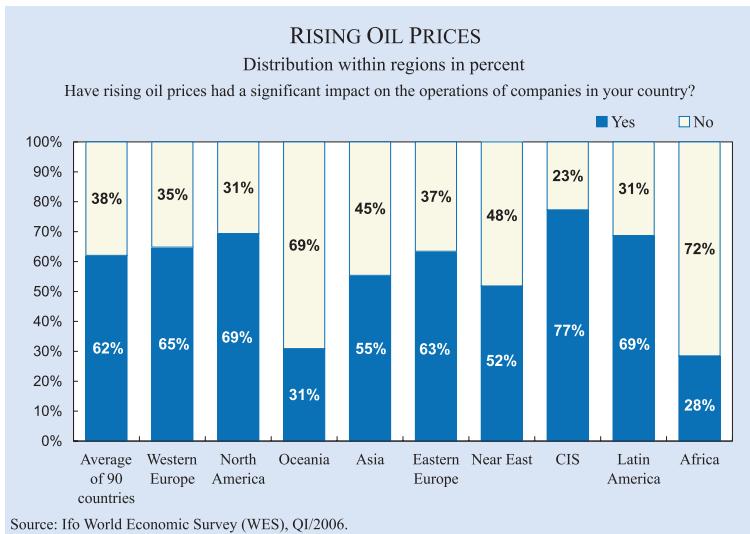
According to the responses to the supplementary survey question on the development of currencies, the *US dollar* is expected to decrease slightly in value in the course of the next six months in most countries. In contrast to this general trend the *US dollar* is expected to increase in the course of the next six months vis-à-vis the currencies of most *Eastern European* countries (except *Czech Republic*, *Slovakia* and *Slovenia*), most *Latin American* countries with the exception of *Uruguay* and in practically all *African* countries covered in the survey. On the other hand, the US dollar is expected to lose in value in the course of the next six months in most *Asian* countries with only a few exceptions like *Bangladesh*, *Pakistan*, *Sri Lanka* and *Vietnam*, where the value of the US dollar is expected to increase.

Figure 13



Source: Ifo World Economic Survey (WES), Q1/2006.

Figure 14



Source: Ifo World Economic Survey (WES), Q1/2006.

Interest rates: Rising trend expected

More WES experts than in the previous four surveys, i.e. since the beginning of 2005, expect further rising **short- and long-term interest rates** in the next six months. This upward trend was particularly pronounced in the *euro area*. But also in the majority of the other *Western European* countries outside the euro area increasing interest rates were expected. The only exception in Western Europe was the *United Kingdom* where short-term interest rates were expected to decline further in the coming six months and the long-term interest rates remain stable or increase only marginally (see Figure 12).

In *North America* (both in the *USA* and in *Canada*) the upward trend of interest rates – at the short end and even more at the long end – is expected to slow

down in the course of the next six months. This slowdown will be even more pronounced, according to WES experts, in *Oceania*, both in *Australia* and *New Zealand*.

In *Eastern Europe* the trend of shrinking short-term interest rates is seen to be replaced by slightly higher rates in coming six months. In contrast to the average only expectations in *Hungary* signal a further – though less pronounced than in the past – decline of interest rates in coming months. In *CIS* countries, particularly in *Russia*, the trend of shrinking interest rates will continue in coming months according to WES experts' view. Also in *Latin America* interest rates will decline in the coming months. However, there are still significant differences from country to country: Whereas the interest rate trend in *Chile* is still up, the contrary is true in *Brazil* and to a lesser degree also in *Mexico* where the declining trend of interest rates will continue.

On average for *Africa* interest rates are expected to remain stable in coming months. However, in *South Africa* and *Zimbabwe* the upward trend of interest rates is expected to go on, though in a somewhat reduced manner.

In *Asia* no end of the upward trend of interest rates is in sight in coming months. Particularly in *India*, *Hong Kong*, *Thailand*, *Korea Republic* and also *Singapore* as well as *Taiwan* interest rates are expected to climb up further in coming months. But also in *China* and *Japan* interest rates are now seen as rising somewhat in coming months. Only in *Indonesia* and the *Philippines* are interest rates expected to decline in the coming six months.

In the *Near East* rather stable interest rates are expected; an exception of this overall trend is mainly *Turkey*, where the trend of declining interest rates will continue.

Table 4

**Assessment of the Following Factors Influencing the Climate for Foreign Investors
For the Next 6 Months**

Climate due to	Change for the next 6 months *	
	Deterioration	Improvement
Legal / administrative restrictions to invest and/or to repatriate profits	Bolivia	Estonia, Singapore, Uruguay, Slovenia, Albania
Political stability	Peru, Mexico, Bolivia, Ecuador, Paraguay, Zimbabwe	Uruguay, Kazakhstan, Singapore, Israel, Costa Rica

In those countries, not mentioned in the table the climate for foreign investors is expected to remain unchanged during the next 6 months (only countries were included in the evaluation that had three or more participants in the WES QI/2006).

Criteria for selection of countries: Deterioration: WES grade between 1 and 3.5
Improvement: WES grade between 6.5 and 9

Source: Ifo World Economic Survey (WES), QI/2006

ICC Special Question: Reactions to rising oil prices

Rising oil prices are seen, along with terrorism and the huge US account deficit, as the greatest threats to the global economic expansion. This quarter's special question focused on how companies worldwide have reacted to the rising oil prices. About 870 economists in over 80 countries responded to the question of whether rising oil prices had a significant impact on the companies' operations in their country (see Figures 13 and 14). The second part of the special question dealt with energy efficiency. WES experts were asked whether the companies have undertaken steps to improve their contribution to energy efficiency as a result of surging oil prices.

According to the surveyed experts, companies in most Western European countries have reacted to the rising oil prices with improvements in energy efficiency, particularly in *Germany, Sweden, the Netherlands, Finland and Belgium*. To a somewhat lesser degree, also in the *United States* and in *Canada*, the majority of surveyed economists reported that companies are undertaking steps to improve their contribution to energy efficiency. In Latin America, particularly in *Chile, Peru and Brazil*, the companies have reacted as well, according to the panel's appraisal. A positive trend to higher energy efficiency has been reported for the majority of Asian countries, particularly for *Japan, Thailand, China, Taiwan, Sri Lanka, Indonesia and South Korea*. For a net gas and coal exporter such as *Australia*, increased export earnings from gas and coal exports partially offset the negative impact of higher oil prices. According to the vast majority of surveyed economists, most com-

panies have not recently undertaken steps to improve energy efficiency. In contrast, the companies in *New Zealand* have been impacted by the surge in oil prices and reacted with improvements of their energy efficiency. The economy of *South Africa*, similarly to *Australia*, has not experienced major constraints as a result of rising oil prices. Nevertheless, WES experts reported that the companies have recently invested in improving their energy efficiency. In *South Africa* a remarkable transformation in the structure of the economy has been witnessed over the past decade. A natural-resource-based economy has given way to a more modern economy, in which higher value-added manufacturing is expanding and companies' energy efficiency is steadily improving. A different picture is drawn for the *CIS* countries, which are mainly focusing on commodity-oriented trade and have also strongly benefited from the rising oil prices. However, companies which are not in the oil sector have had to deal with the negative impact on their operations, but the polled experts stated that the companies' contribution to energy efficiency has been low so far. The reason may be that there are only few companies in the *CIS* countries that can compete on the global market and thus have the financial resources for investments in this area. The picture drawn for Eastern Europe differs between the countries. While high oil prices have had an impact on almost all economies of the region, companies have reacted with improvements of energy efficiency particularly in *Lithuania*, according to WES experts. In the other Eastern European countries, only about half of the experts stated that they could observe major improvements in energy efficiency of domestic companies.

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