

Nerb, Gernot; Stangl, Anna

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CESifo WORLD ECONOMIC SURVEY

VOLUME 9, No. 3

AUGUST 2010

WORLD ECONOMIC CLIMATE

World Economic Climate clouded over slightly

ECONOMIC EXPECTATIONS

Economic expectations downgraded again but remain positive

INFLATION

Stable price trend expected

INTEREST RATES

Short-term interest rates expected to rise less than formerly anticipated

CURRENCIES

Euro appears slightly undervalued

SPECIAL TOPIC

Cross-border trade and investment

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Authors of this publication:

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

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

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Editor: Dr. Gernot Nerb, e-mail nerb@ifo.de
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Ifo World Economic Survey

Regions

- World economy: Economic recovery continues at a slower pace
- Western Europe: Present economic situation strongly improves
- North America: Economic recovery is losing momentum
- Eastern Europe: Economic climate remains clouded
- CIS: High level of business confidence
- Asia: Economic cooling in China
- Oceania: Strong economic fundamentals in Australia
- Latin America: Major differences across countries prevail
- Near East: Favourable economic climate
- Africa: Economic situation strengthening in South Africa

Notes

The Ifo World Economic Survey (WES) assesses worldwide economic trends by polling transnational as well as national organizations worldwide about current economic developments in the respective country. This allows for a rapid, up-to-date assessment of the economic situation prevailing around the world. In July 2010, 1,103 economic experts in 116 countries were polled.

WES is conducted in co-operation with the International Chamber of Commerce (ICC) in Paris.

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, includes many diverging areas of economics.

Ifo Institute for Economic Research is 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 CLOUDED OVER SLIGHTLY

In July 2010 the Ifo World Economic Climate clouded over slightly (see Figure 1). The climate indicator now stands at 103.2 (after 104.1 in April: 2005=100), which is still considerably above its long-term average (1991–2009: 96.9). Similar to the April survey, only the economic outlook for the next six months has again been downgraded, whereas the assessments of the current economic situation have further improved (see Figure 2).

The recovery of the world economy continues, although at a slower pace

According to the July results, the current economic situation continued to improve. The overall economic situation is now judged as “satisfactory”, on a global average. As economic expectations – the second component of the economic climate index – have again been slightly downgraded, the global economic climate deteriorated somewhat (see Figure 1). This pattern of business confidence applies to almost all economic regions. The economic climate index deteriorated due to less optimistic economic expectations in *Asia* and the *US* (see Figure 3). In *Western Europe* the economic climate indicator rose further, but only because the improvement of the present economic situation has offset the decline in economic expectations. The economic expectations have been downgraded also in *Eastern Europe*, *Latin America* and *Australia*. This however does not necessarily mean that the global economy will enter a downward trend. The business-cycle clock (see Box 1) shows that the world economy is entering a consolidated upturn phase, thanks to an improved assessment of the present economic state in *Asia* and *Western Europe*. Growth

is expected to continue also in the second half of 2010, though at a slower pace. Two major factors may contribute to a slowdown of economic growth: tighter monetary policy and a deleveraging of public deficits in the course of fiscal consolidation. A cooling down of *China* economy and *Europe's* debt crisis are also posing downward risks to an ongoing global expansion.

Western Europe: Strong improvement of the current economic situation

The economic climate indicator for *Western Europe* rose in July 2010 (see Figure 3). However, as in the

Figure 1

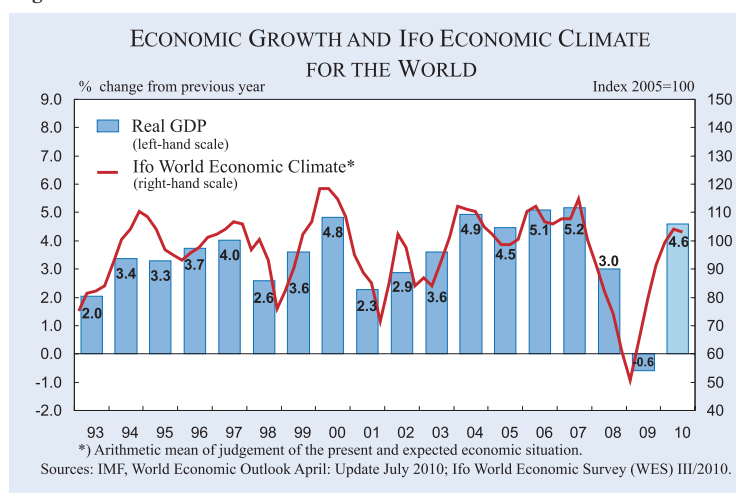
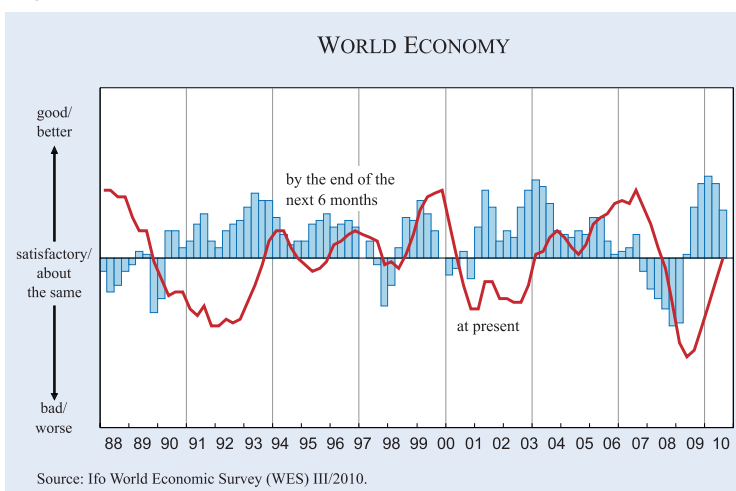


Figure 2

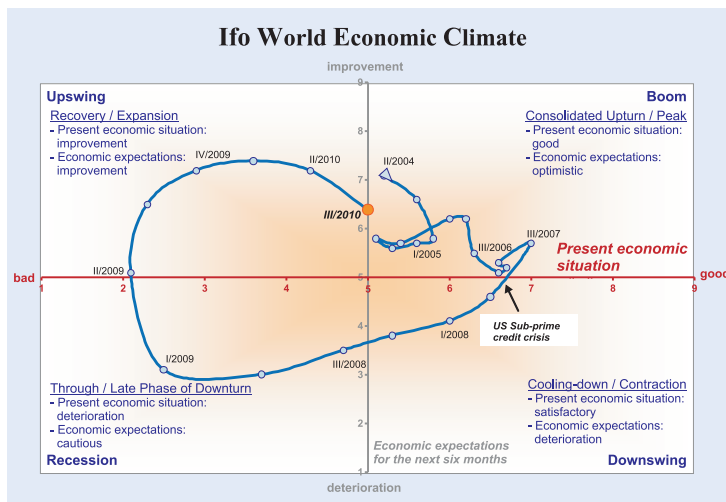


Box 1

Ifo Economic Clock and the Ifo World Economic Climate

For a global, medium-term forecast a look at the Ifo Economic Clock showing the development of the two components of the economic climate index over the last seven years visualizes the trend. The business cycle typically goes clockwise in a circle; expectations leading assessments of the present situation.

The Ifo World Economic Climate clouded over slightly in the third quarter of 2010. Although the surveyed experts have given better assessments of the current economic situation than in the first half of 2010, the economic expectations for the coming six months have been revised downwards. The results indicate that the recovery of world economic activity will continue at a slower pace in the second half of the year.



The Ifo World Economic Climate is the arithmetic mean of the assessments of the current situation and economic expectations for the next six months. The correlation of the two climate components can be illustrated in a four-quadrant diagram ("Ifo Konjunkturuhr"). The assessments on the present economic situation are positioned along the abscissa, the responses on the economic expectations on the ordinate. The diagram is divided into four quadrants, defining the four phases of the world business cycle. For example, should the assessments of the interviewed experts on the present situation be negative, but the expectations became positive, the world business cycle is in an upswing phase (top left quadrant).

other regions only the assessments of the present economic situation improved. The economic expectations, in contrast, have again been downgraded (see Figure 4); however, they remain positive in *Western Europe* on average.

The same pattern of economic climate applies to the *euro area*. In the majority of *euro area* countries the assessments of the present economic situation improved considerably in July over the April survey. The economic expectations, however, have been downgraded somewhat, indicating that economic recovery will continue in the second half of the year, but at a slower pace (see Box 2). The economic climate patterns differ strongly within the euro area, with the bigger economies like *Germany* and *France* benefiting from economic expansion in the emerging markets and low interest rate; and, on the other hand the highly indebted economies like *Greece*, *Spain*, *Ireland* and *Portugal* still struggling with restructuring programmes. So, according to the latest WES results, the current eco-

nomic situation improved and is now judged as satisfactory in *Germany*, *Austria* and *Slovakia*, and to a lesser degree also in *Finland*. The economic expectations for the next six months remain optimistic in all these countries, although less so than in the previous survey. Also much better than in April but still far below the satisfactory level are the assessments of the present economic situation in *France* and *Italy*. With similarly low marks on the WES scale the surveyed economists assessed the present economic performance in *Belgium* and *the Netherlands*, as well as in *Slovenia*. However, the WES experts expect the continuation of economic recovery in the second half of 2010, although also here at a slower pace than before. Only in *Ireland*, have the economic expectations improved further, though the present economic situation is still assessed with the lowest marks on the WES scale. In *Spain*, *Greece* and *Portugal* the economic recovery is expected to remain subdued. Particularly in *Greece* and *Spain* capital expenditures

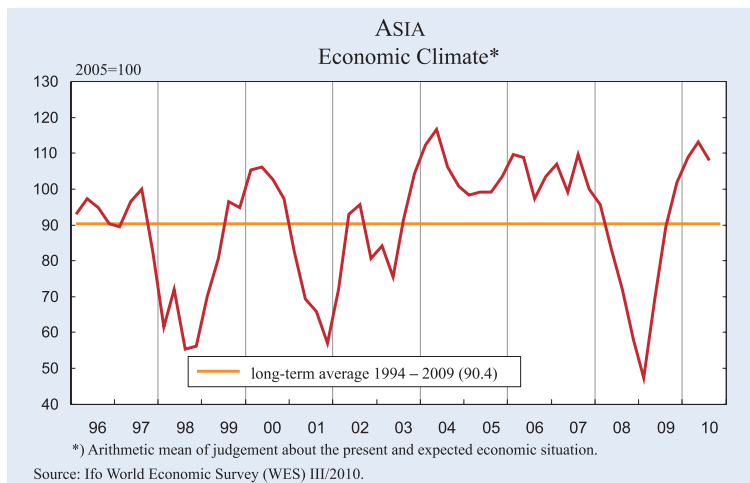
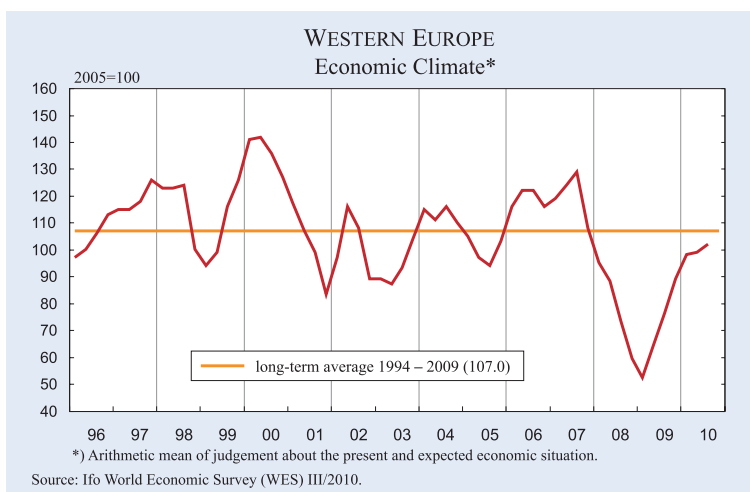
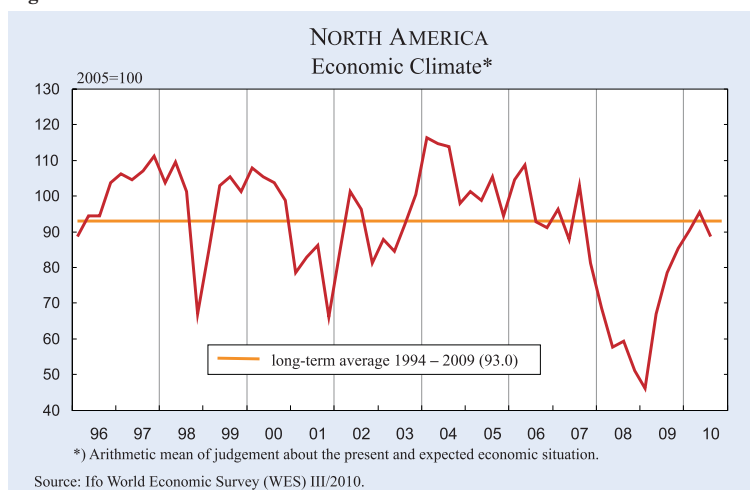
and private consumption are even forecast to deteriorate further in the course of the next six months.

Outside the euro area, a highly favourable economic climate prevails only in *Sweden*, *Norway* and *Switzerland*. In these countries the present economic situation was assessed as above satisfactory in July. In *Denmark* and the *UK* the assessments of the present economic situation have been upgraded considerably but are still negative. The economic expectations for the next six months have been revised downward by the surveyed economists, indicating that the economic recovery will be rather subdued in the second half of the year.

North America: Economic recovery is losing momentum

The economic climate indicator in *North America* deteriorated in July 2010 and has again fallen below

Figure 3



its long-term average (see Figure 3). However, the deterioration was, as in most other countries, only due to less optimistic economic expectations (Figure 6). The assessments of the present economic situation in the *US* have been continuously improving since mid-2009, but the “satisfactory” level has not yet been reached. Economic confidence is depressed by still weaker than expected employment

months remained optimistic, although to a slightly lesser degree than in the first half of the year. In both countries the WES experts forecast a strong rebound of capital expenditures and exports in the near term. In contrast, in the other EU countries of the region (*Lithuania, Latvia, Estonia, Romania, Bulgaria* and *Hungary*), the present economic situation is still assessed as very weak. It even deteriorated further

data. Also private consumption and capital expenditures are still assessed as weak by the surveyed economists. In contrast, in *Canada*, the WES experts now assess the present economic performance as satisfactory. However, the economic expectations have, in both countries, been continuously downgraded in the course of this year, indicating that economic recovery is losing momentum.

Central and Eastern Europe: Economic climate remains clouded

According to the latest WES results, the economic climate improved in the region on average. However, the economic recovery in many countries of *Central and Eastern Europe* is still subdued (see Figure 4 and Figure 8).

In the vast majority of *Central and Eastern European* countries the present economic situation is still assessed as very weak by the WES experts. The only exceptions are *Poland* and the *Czech Republic*, where the economic performance has been continuously improving over the year and is now judged as above satisfactory by the WES experts. In *Czech Republic* also the economic expectations have been further upgraded and are pointing to a pronounced economic recovery in the second half of 2010. In *Poland* the economic expectations for the next six

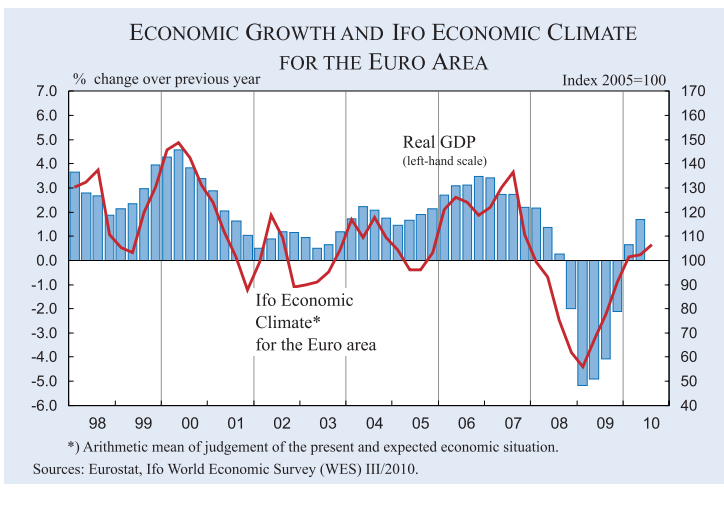
Box 2

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

The Ifo World Economic Climate for the 16 member countries of the euro area is the arithmetic mean of the assessments of the general economic situation and the expectations for the economic situation in the coming six months. The July results are based on the responses of 265 experts. As a rule, the trend of the Ifo Economic Climate indicator correlates well with the actual business-cycle trend for the euro area – measured in annual growth rates of real GDP (see Figure).

The Ifo Economic Climate indicator for the euro area has risen again slightly in the third quarter but has not yet reached its long-term average. The assessments of the current economic situation have improved clearly over the second quarter of 2010. The expectations for the coming six months, however, have weakened again but remain positive on the whole. These survey results indicate that the economic recovery will continue in the second half of the year but at a slower pace.

In the majority of the euro countries, the current economic situation is still assessed as unfavourable. Only in Germany, Austria and Slovakia are the assessments of the current economic situation now in positive territory. In contrast, particularly poor assessments of the current economic situation have been given in Greece, Ireland, Spain and Portugal. In Spain and Greece the WES experts foresee a further worsening of the economic situation in the second half of 2010. In all other countries of the euro area, however, the expectations for the coming six months are positive although they are not quite as optimistic as in the first half of the year.



since the April survey in *Lithuania* and *Romania*, according to WES experts. Particularly in *Romania*, the economic climate is expected to worsen further, accompanied by a pronounced decline of capital expenditures, private consumption and exports in the next six months. However, *Romania* is the only country in the region, where the surveyed economists expect further economic deterioration in the next six months. In *Lithuania*, and in the other two *Baltic countries* (*Latvia* and *Estonia*), as well as in *Bulgaria* and *Hungary*, the WES experts are fairly optimistic that economic recovery will gain momentum in the second half of 2010.

In the *non-EU countries* of the region – *Croatia* and *Serbia* – the surveyed economists still assess the present economic situation with very low marks, in *Croatia* even with the lowest on the WES scale. The economic outlook for the next six months remains

pessimistic. In *Croatia*, the WES experts expect capital expenditures to deteriorate further and in *Serbia* private consumption to weaken considerably in 2010.

CIS: High level of business confidence

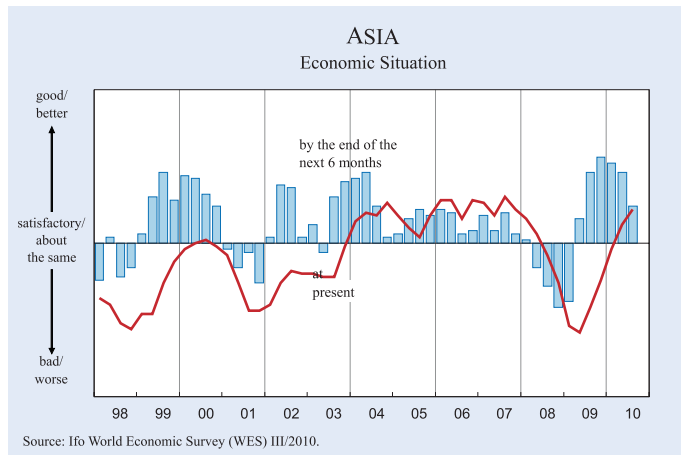
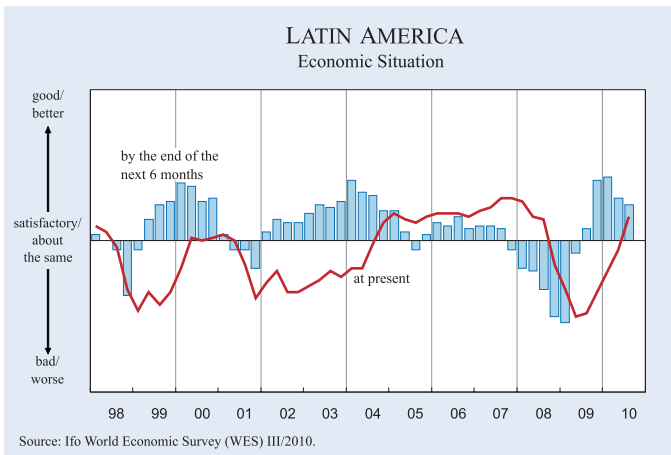
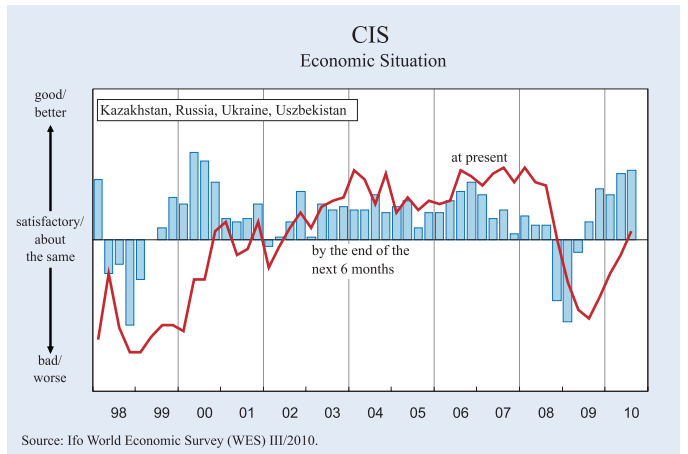
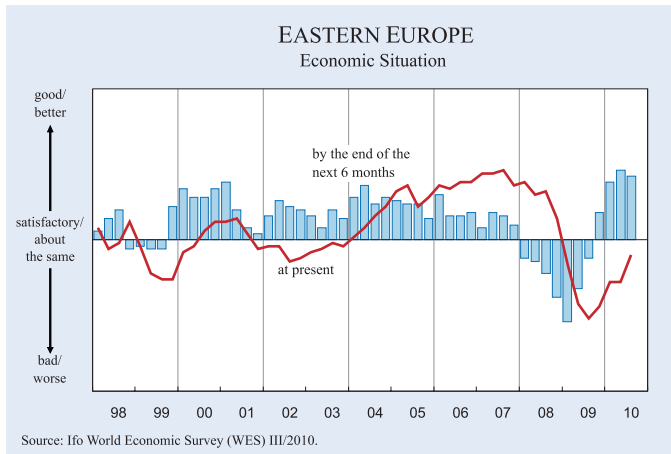
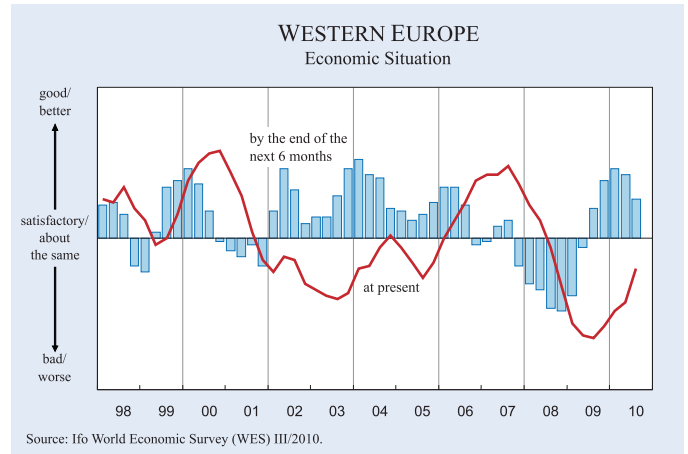
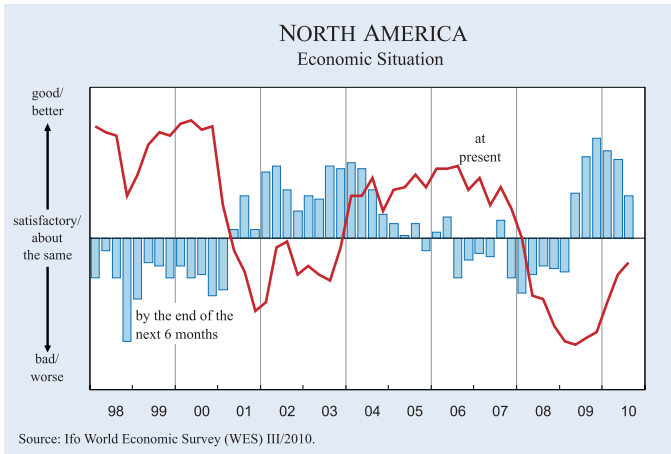
The overall economic climate index for CIS countries covered by WES (*Russia*, *Ukraine*, *Kazakhstan*, *Kyrgyzstan* and *Uzbekistan*) improved further in July (see Figure 6). The improvement resulted from both more positive assessments of the present economic situation as well as unchanged optimistic economic expectations for the coming six months.

This pattern particularly applies to *Russia*. Here the assessments of the present economic situation have been continuously improving since mid-2009 and reached the “satisfactory” level in July. Unlike the other regions, the economic expectations have not been downgraded yet, pointing to an ongoing economic recovery in the second half of 2010. Capital expenditures, private consumption and the export sector are expected to strengthen further in the course of the next six months. However, the survey was conducted before the escalation of the wild fires resulting from the protracted draught in *Russia*. The catastrophe could have a wide-ranging economic impact, including rising food-prices, boosting inflation and, as a consequence, increasing interest rates. It will mainly depend on the duration, scope and the sequel of the draught and fires, whether the economic recovery will be seriously affected in the near term.

A highly favourable economic climate, according to WES experts, prevails in *Kazakhstan*. Here the present economic situation is now judged as highly favourable. The economic expectations remain optimistic.

Figure 4

SELECTED REGIONS



Also in the *Ukraine* the assessments of the present economic situation have been upgraded somewhat, although they have not yet reached the “satisfactory” level. The expectations for the next six months are optimistic, but to a lesser degree than in the first half of the year. WES experts forecast a rather subdued improvement of capital expenditures and private consumption. Only the export sector is forecast to strengthen considerably in the course of the next six months.

In *Uzbekistan* the economic climate remains moderately favourable, according to the surveyed economists. Not so in its neighbour state, *Kyrgyzstan*, where political turmoil still prevails. Here the WES experts assessed the present economic situation as very weak. They expect further deterioration in the next six months, with a pronounced decline of capital expenditures, private consumption and exports.

Asia: Economic cooling in China

In *Asia* the economic climate indicator deteriorated slightly in July, but remained above its long-term average (see Figure 3). However, as in the majority of other regions, only the economic expectations in *Asia* have been downgraded, but the assessments of the present economic situation improved again, on average, for the region (see Figure 8).

The present economic situation is assessed as particularly favourable in *India*, *Hong Kong*, *South Korea*, *the Philippines* and *Vietnam*. The economic expectations for the next six months, have nevertheless been downgraded in almost all these countries, except *South Korea* and *Vietnam*. However, WES experts are still largely optimistic regarding further economic strengthening in the second half of the year. Capital expenditures, private consumption and the export sector are foreseen to remain buoyant in the near term. In *China*, the region’s largest economy, the economic climate cooled considerably, according to WES experts. The present economic situation is now assessed as “satisfactory”. Economic expectations point to further economic slowing in the next six months. *China* escaped recession during the global financial crisis mainly due to credit-driven infrastructure projects. Low interest rates and excess liquidity have inflated real-estate prices. As the government began to reduce its expansionary monetary policy in the second half of 2009, credit conditions tightened. As a result, WES experts expect that par-

ticularly capital expenditures will contract considerably in the next half of the year. In *Japan*, the region’s second largest economy, the economic climate also cooled somewhat in July due to less positive economic expectations for the next six months. However, the assessments of the present economic situation have been continuously improving, although the “satisfactory” mark has by far not yet been reached. *Japan*’s economy is highly dependent on exports, particularly to *China* and other *Asian* emerging economies. A slowdown in external demand raises risks that the fragile economic recovery may stall. In *Taiwan* the present economic situation improved further. It is now rated as favourable by the surveyed economists. The economic expectations for the next six months have been downgraded and are now pointing to economic stabilization and a strengthening of the export sector in the second half of 2010. A favourable economic climate prevails in *Indonesia*, *Thailand*, *Malaysia* and *Sri Lanka*, according to the latest WES results. In all these countries the present economic situation is rated as satisfactory or even favourable. Economic expectations have been even upgraded since the April survey and are pointing to further economic strengthening in the next six months. Capital expenditures, private consumption and exports are forecast to pick up further. Positive economic expectations prevail also in *Bangladesh*, although both the assessments of the present economic situation as well as the forecast for the rest of the year have been downgraded somewhat. The lowest assessment of the present economic performance in *Asia* has again been reported from *Pakistan*. The surveyed economists do not expect a substantial economic turnaround this year. The enormous flood disaster is aggravating the overall situation in the country, posing a further burden on *Pakistan*’s faltering economic recovery.

Oceania: Strong economic fundamentals in Australia

According to the latest WES results the economic climate index for *Australia* deteriorated in July 2010 (see Figure 6). However, *Australia*’s economy appears to be in a very robust state. The country had a short and shallow downturn compared to the other industrial countries. It also numbers among the least indebted industrialized economies, having a debt-to-GDP ratio of only 6 percent (the equivalent figure for the US is 86 percent). Furthermore, *Australia* has, in contrast to other industrialized economies, a buoyant job market

with decreasing unemployment. Given the strong economic fundamentals, the Australian dollar has increased in value, compared to the US dollar, and the Australian Central Bank started very early to tighten monetary policy. In the July survey, the present economic situation was again assessed as favourable, although to a lesser degree than in the previous survey. In light of upward pressures on interest rates, the economic expectations were downgraded somewhat, but continue to point to an upbeat economy in the second half of 2010.

In *New Zealand* the present economic situation improved somewhat, according to WES experts. However, the satisfactory level has not yet been reached. The economic expectations, although downgraded somewhat here as well, remain optimistic. Particularly the export sector and private consumption are expected to strengthen further in the next six months.

Latin America: Major differences across countries prevail

In *Latin America* the economic climate indicator remained stable, at a favourable level. While the assessments of the present economic situation strongly improved again, the economic expectations for the next six months have been downgraded somewhat, on average of all countries surveyed in the region. However, while many countries of the continent managed to withstand the global financial crisis, the economic situation of some others remains faltering (see Figure 9).

A particularly favourable economic climate continues to prevail in *Brazil, Peru* and *Uruguay*. In all three countries the present economic situation is assessed as highly favourable and even better than earlier this year. The economic expectations are also very optimistic, although to a lesser degree than in the preceding survey. The same applies to *Chile, Colombia* and *Paraguay*, where the present economic situation is also assessed as favourable and even better than in the April survey. In all these countries the WES experts expect capital expenditures, private consumption and the export sector to strengthen further in the next six months. As “satisfactory” was how the surveyed economists rated the economic situation in *Mexico, Costa Rica, Panama* and *Bolivia*. However, while in *Mexico* and *Panama* the WES experts have upgraded their expectations

and forecast a pronounced economic strengthening, they expect rather modest economic development in *Costa Rica* and even an economic cooling in *Bolivia* in the next six months. In *Argentina*, the overall economic climate indicator improved somewhat, due to a more positive assessment of the present economic situation, which has now surpassed the “satisfactory” mark. The economic expectations, however, have been downgraded throughout the year. The WES experts expect capital expenditures to contract in the second half of the year. Private consumption is expected to remain stable and the export sector to strengthen in the second half of 2010. As far below the “satisfactory” mark is how the present economic situation was assessed by economists surveyed in *El Salvador, Guatemala* and *Trinidad and Tobago*. However, in all three countries the economic expectations point to economic recovery in the second half of the year. In *Ecuador*, in contrast, the WES experts remain cautious regarding an economic betterment in 2010. In *Venezuela*, they even expect further worsening. The present economic performance was again assessed with the lowest marks of the region. In addition to the economic decline, *Venezuela's* economy is struggling with the highest inflation rate in *Latin America* of around 35 percent. The recession was caused by the high legal and administrative restrictions for private and foreign investment, state expropriations in industry and agriculture, and a poor management of oil sales. As no turnaround of economic policy is in sight, the economic expectations continue to point to further contraction of capital expenditures, private consumption and exports in 2010.

Near East: Favourable economic climate

The economic climate remains favourable in July in most countries of the *Near East* region (see Figure 10). The present economic situation is again regarded as particularly good in *Saudi Arabia* and the *United Arab Emirates*. The WES experts have even further upgraded their economic expectations. They forecast a pronounced strengthening of capital expenditures, private consumption and the export sector in the next six months. Also in *Lebanon* the surveyed economists assessed the present economic situation as favourable. They expect economic stabilization in the course of the second half of the year. In *Jordan*, the present economic situation was assessed as below the “satisfactory” mark, but the WES experts do not expect further economic cool-

ing in 2010. In *Israel*, in contrast, the economic climate deteriorated considerably in July compared to the April survey. Both the assessments of the present economic situation and economic expectations have been downgraded. However, the present economic situation is still regarded as “satisfactory” by the majority of experts. The economic expectations point to stabilization of capital expenditures, but private consumption and the export sector are expected to weaken in the course of the next six months. In *Turkey* the economic situation has been continuously improving, according to WES experts. It is now rated as favourable. The economic expectations, although downgraded somewhat, remain positive. Capital expenditures, private consumption and particularly the export sector are expected to strengthen further in 2010.

Africa: Economic climate improves in South Africa

The countries of the *African region* display a very different pattern of economic climate. Thus, an aggregated climate index for countries surveyed by WES on the continent makes little sense, and the following analysis will focus on particular economic trends in individual countries.

The economic situation continues to improve in *South Africa* (see Figure 10), according to the latest WES results. The assessments of the present economic situation have again been upgraded compared to the preceding April survey. The expectations for the next six months, although less optimistic than earlier this year, point to further economic strengthening. Particularly private consumption and exports are forecast to revive further. Capital expenditures, which were mainly boosted by the soccer World Cup hosted by the country, are expected to stabilize in the next six months.

A favourable economic climate prevails, according to the surveyed economists, in *Sierra Leone, Zambia, Rwanda, Kenya, Mauritius, Uganda, Congo-Brazzaville, Congo Democratic Republic, Niger, Cote d'Ivoire, Malawi* and *Liberia*. Here the WES experts assessed the present economic situation as above the satisfactory level, on average. The economic expectations for the next six months are also positive, pointing to a pick up of capital expenditures, private consumption and exports, except in *Malawi*, where the surveyed economists forecast some weakening of private consumption and the export sector in 2010.

In the surveyed North African countries – *Morocco, Algeria, Tunisia* and *Egypt* – the polled economists rated the present economic situation as satisfactory. The economic expectations for the next six months point to economic stabilization in *Tunisia* and *Egypt* and to further economic strengthening in *Morocco* and *Algeria*. Also in *Mauritania* and *Sudan* the WES experts assessed the present economic performance as satisfactory. However, while in *Mauritania* positive economic expectations prevail, the WES experts in *Sudan* expect an economic deterioration in the second half of the year, with weakening of capital expenditures, private consumption and exports.

As far below the satisfactory level is how the surveyed economists assess the present economic situation in *Nigeria* and *Togo*. However, in both countries the WES experts are optimistic that the economy will continue to recover in the course of 2010. In *Togo*, however, private consumption is expected to remain weak in the next six months.

No substantial improvement of the economic climate is expected by the surveyed economists in *Lesotho, Benin, Tanzania, Gabon, Burundi* and *Madagascar*. In all these countries the present economic situation is assessed as very weak. In *Gabon* and *Madagascar* the surveyed economists expect even further economic deterioration in the next six months.

In *Zimbabwe* the economic climate is gradually improving, according to the WES results. The present economic situation is still assessed as far below the satisfactory level but considerably better than in recent years. Economic expectations for the next six months remain positive, pointing to further economic stabilization. Capital expenditures, private consumption and exports are even expected to pick up somewhat in the next six months.

Stable price trend expected

On a worldwide scale neither inflationary nor deflationary problems are expected to cause major problems in 2010. On average for 2010, WES experts continue to forecast an annual inflation rate of 3.1 percent (see Table 1), on a world average. This forecast implies a moderate slowdown of inflation in the course of the second half of 2010, according to the answers to the additional question on the expected tendency of inflation in the coming months.

Figure 5a

EUROPEAN UNION

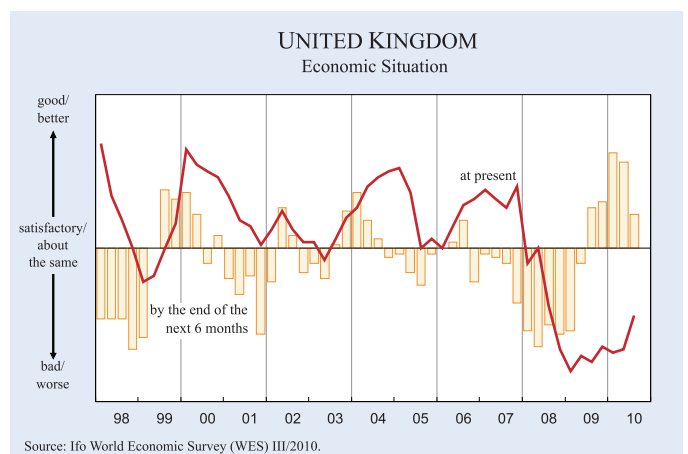
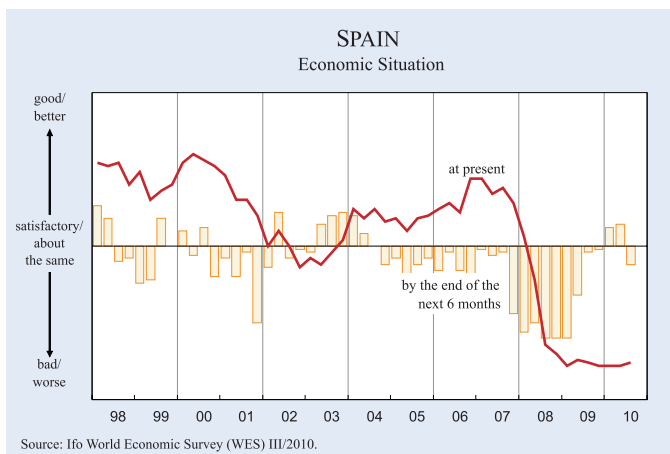
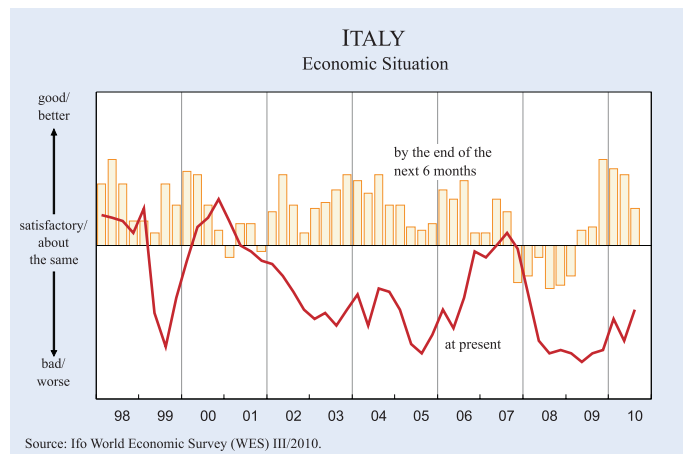
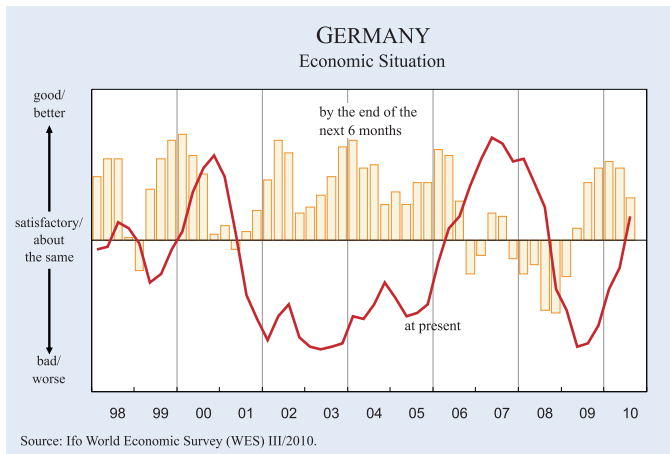
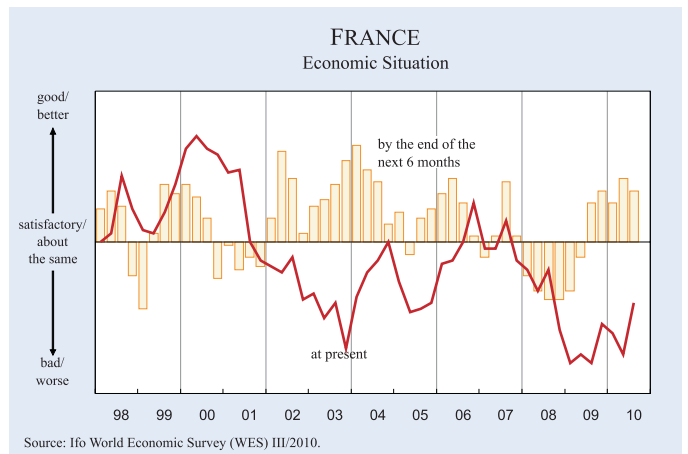
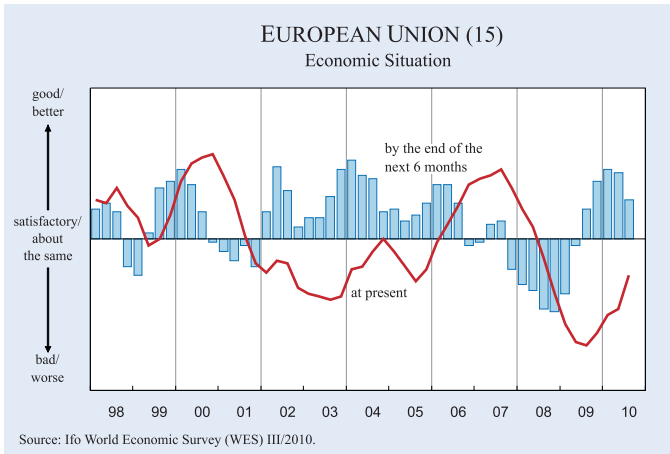
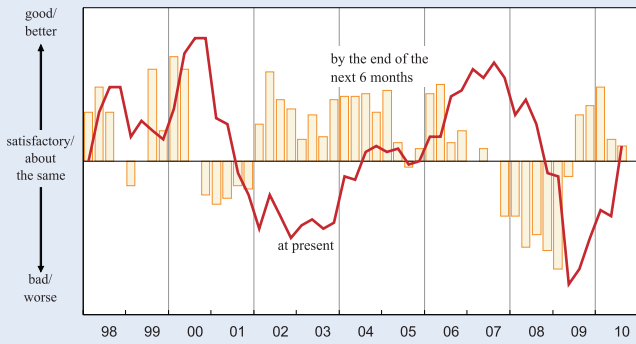


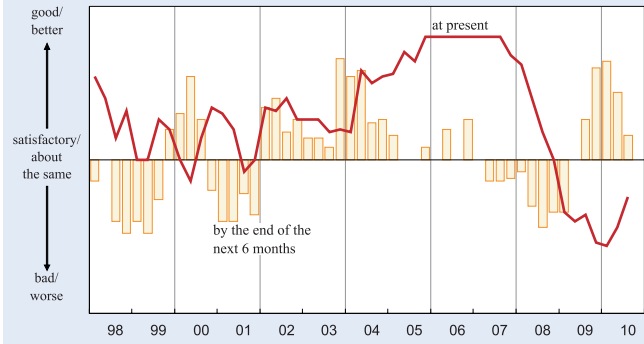
Figure 5b

EUROPEAN UNION

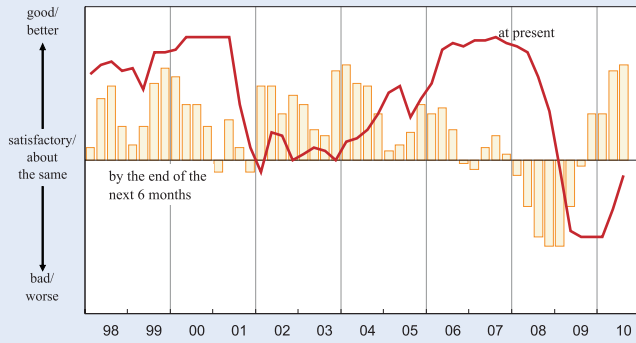
AUSTRIA
Economic Situation



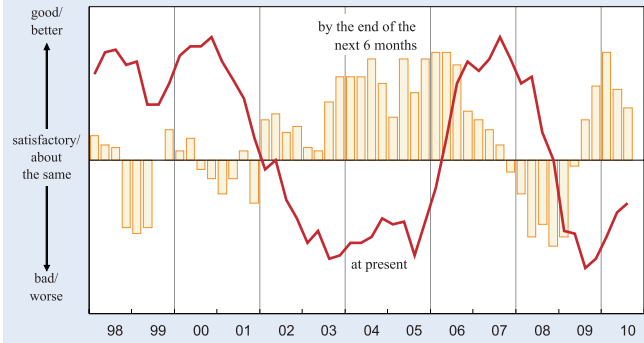
DENMARK
Economic Situation



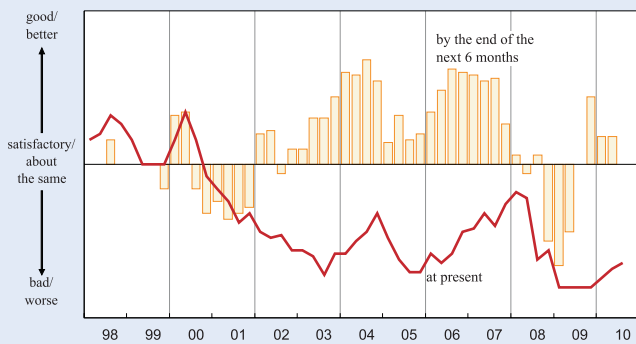
FINLAND
Economic Situation



NETHERLANDS
Economic Situation



PORTUGAL
Economic Situation



SWEDEN
Economic Situation

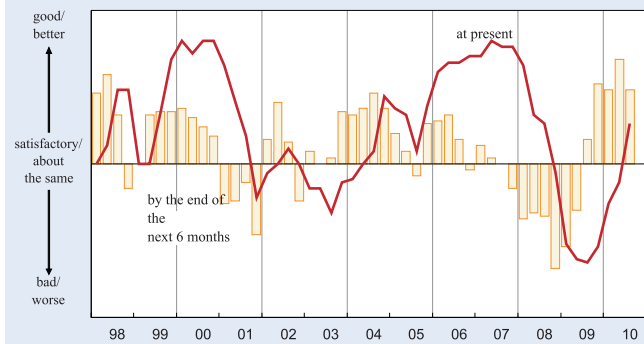


Figure 6

NORTH AMERICA, OCEANIA AND CIS

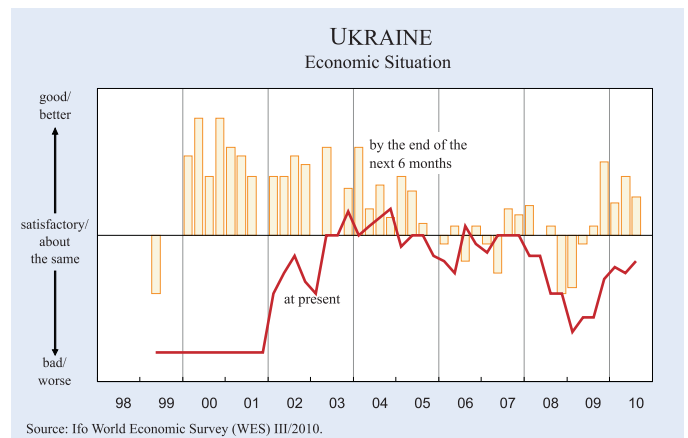
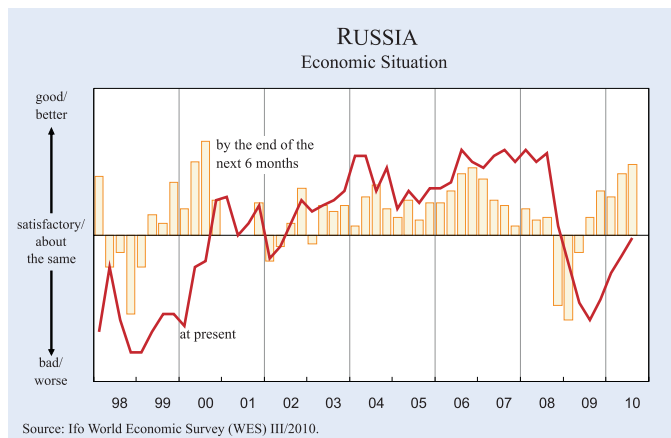
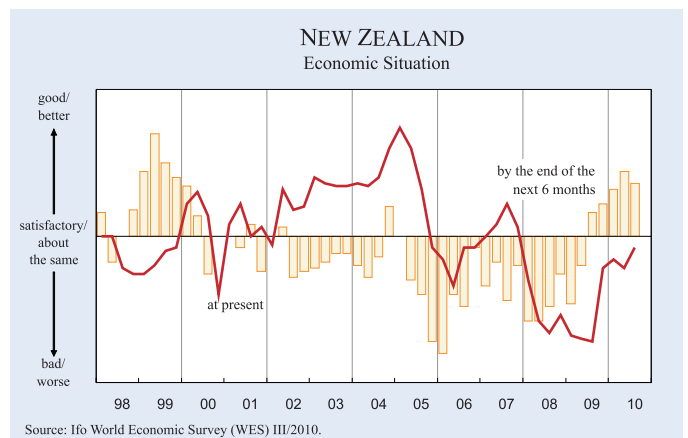
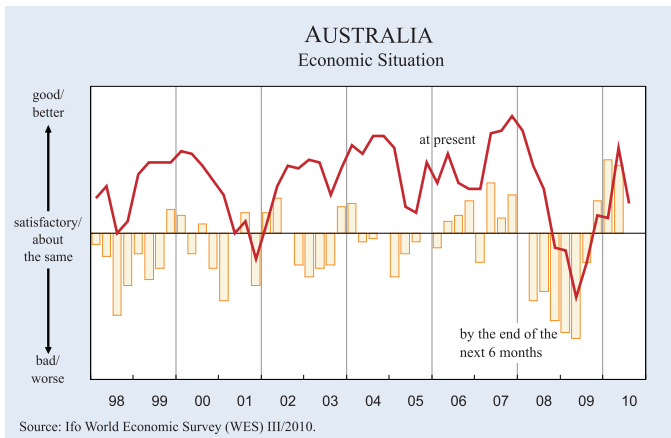
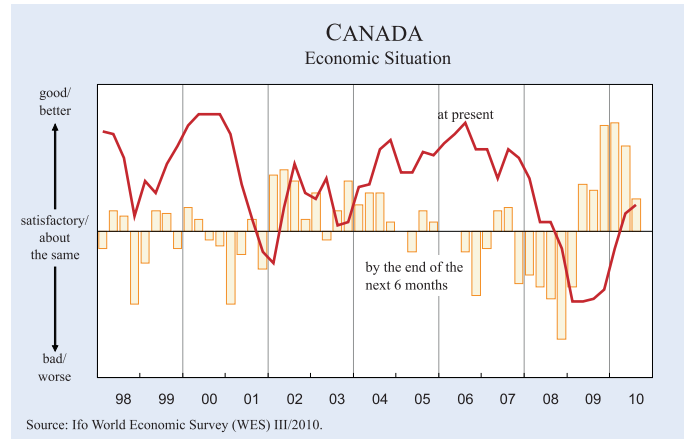
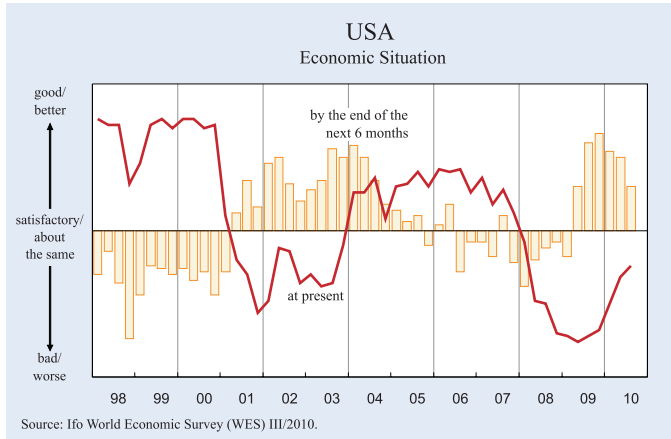


Figure 7

EASTERN EUROPE

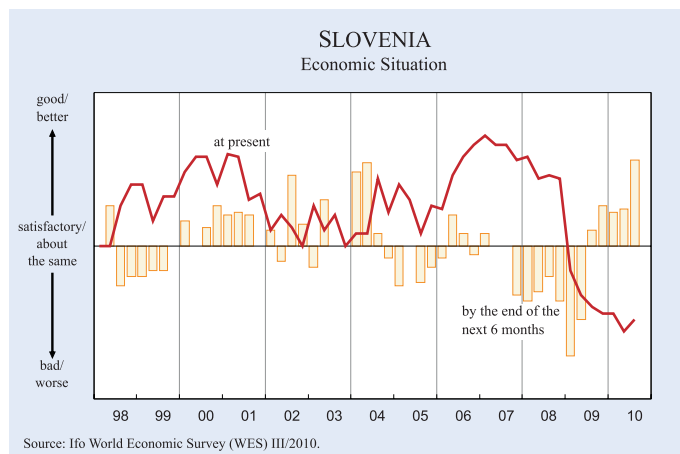
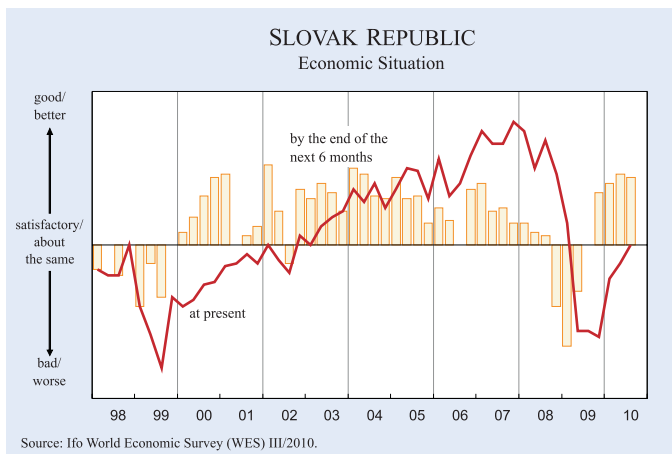
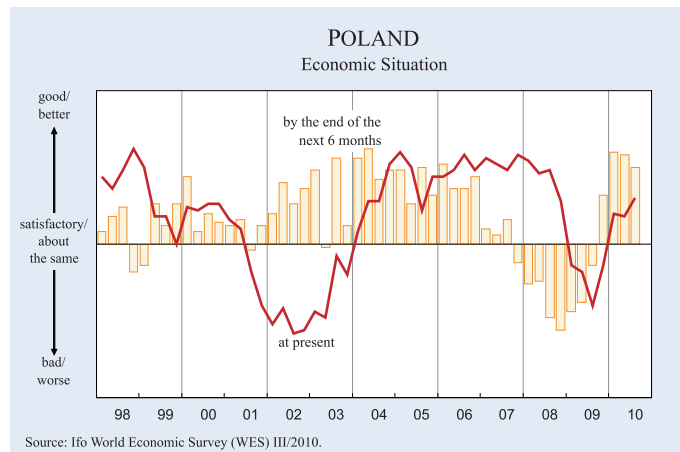
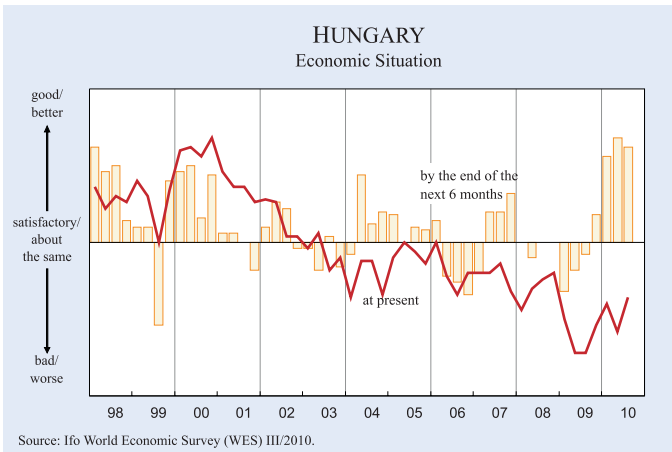
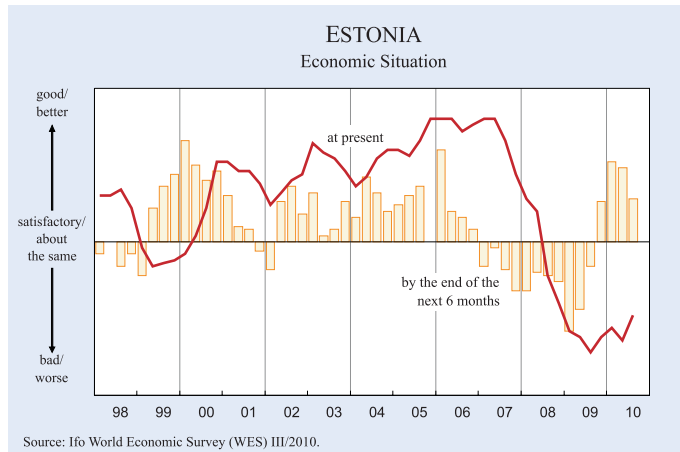
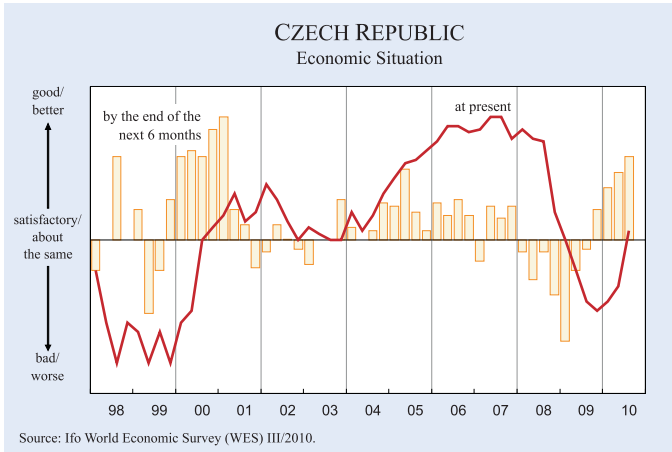


Figure 8

ASIA

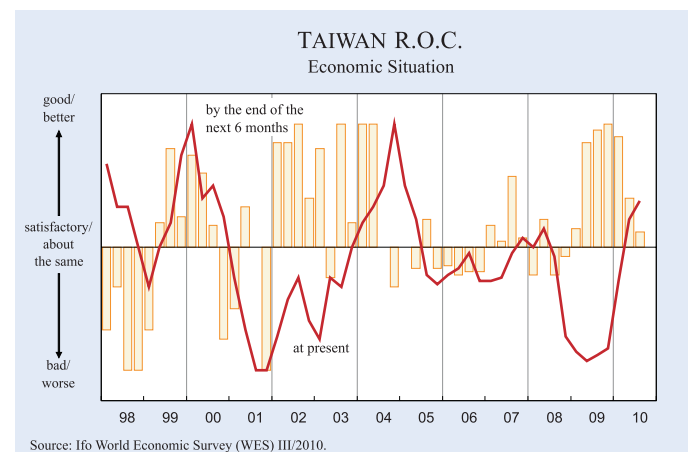
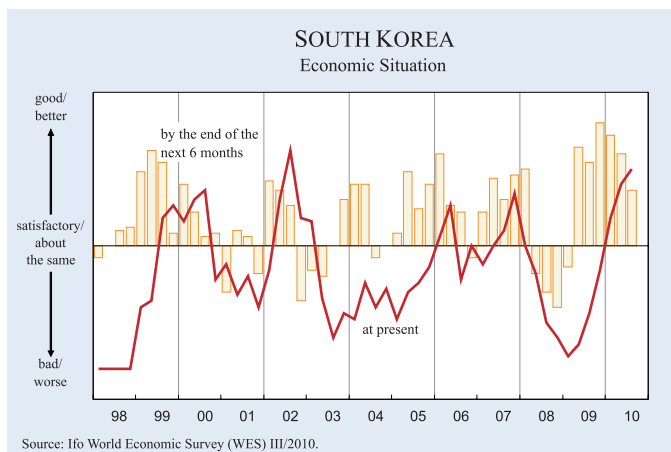
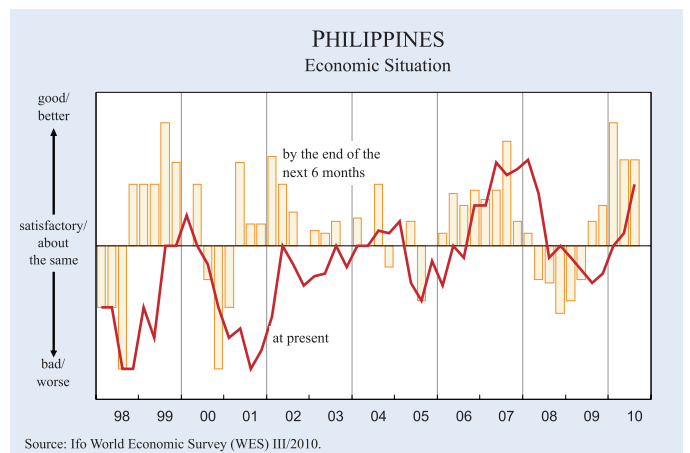
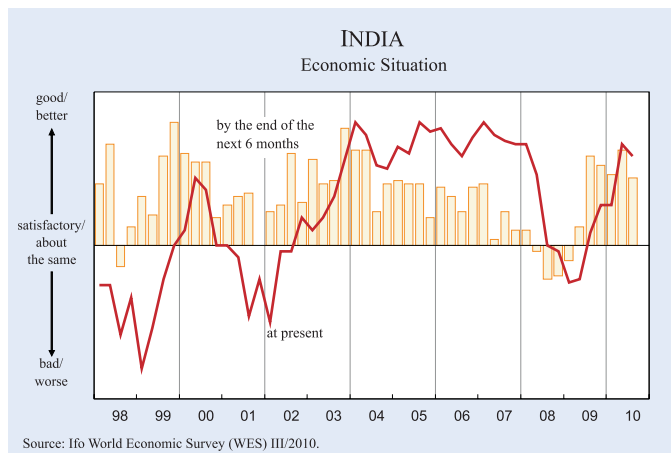
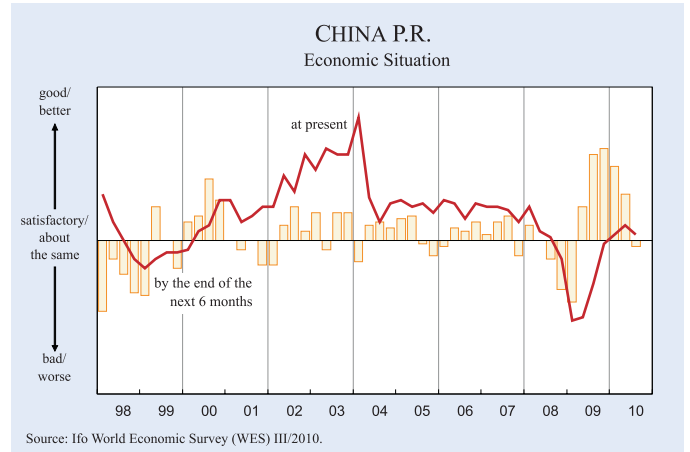
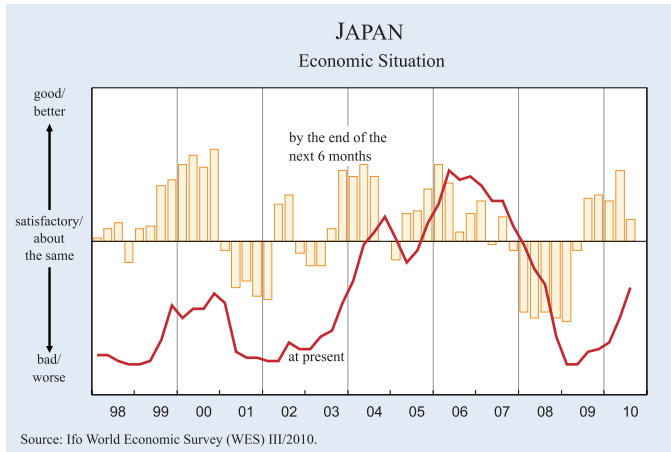


Figure 9

LATIN AMERICA

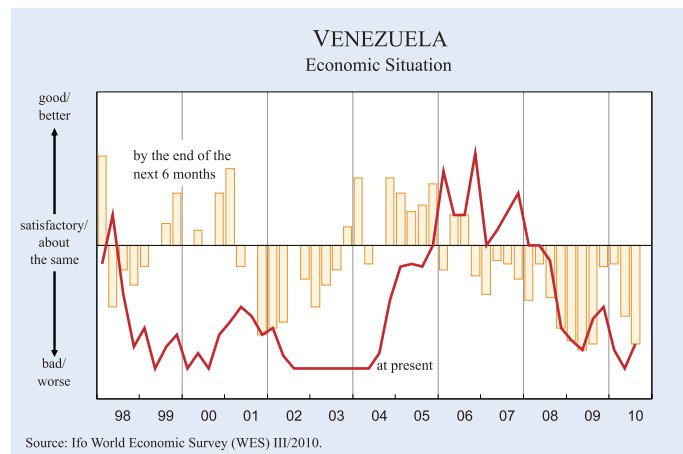
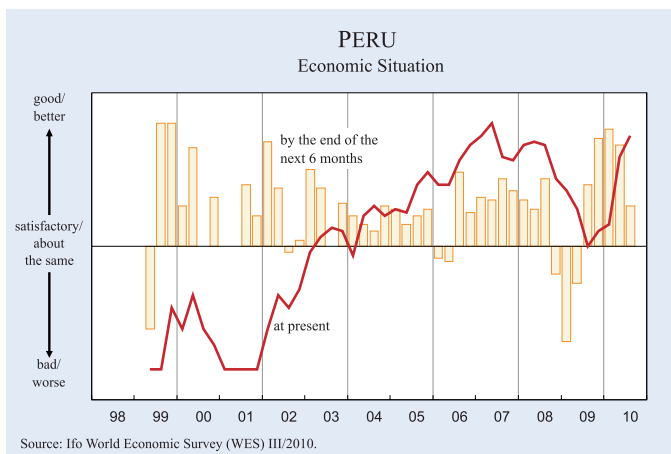
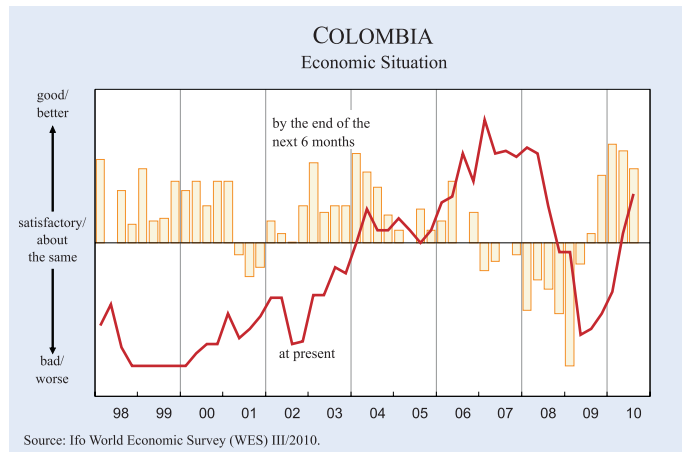
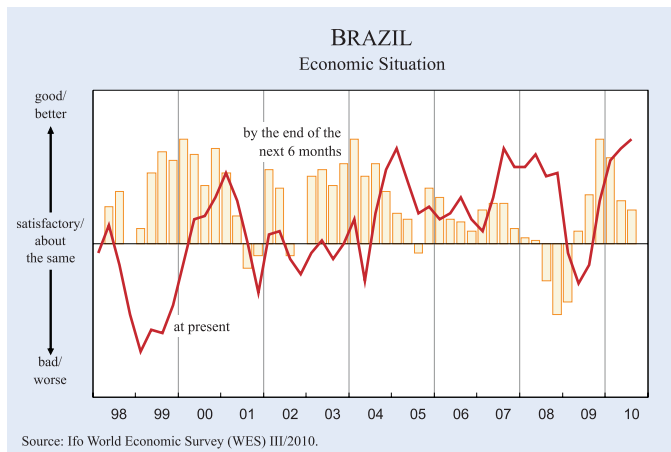
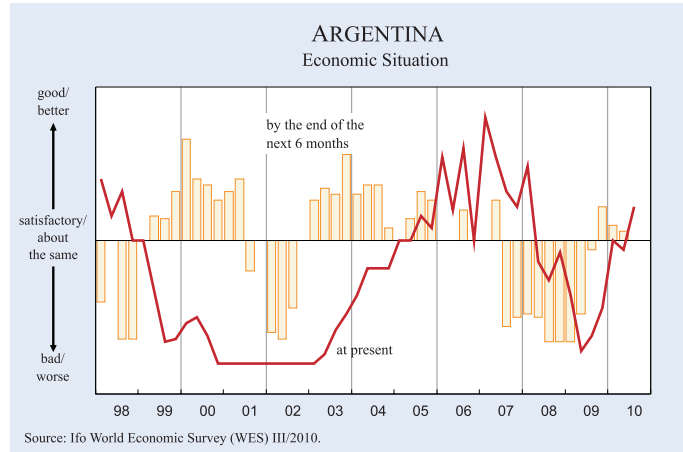
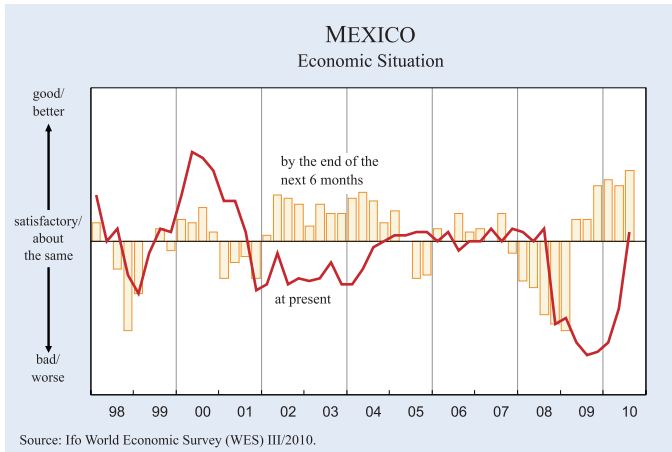


Figure 10

NEAR EAST AND AFRICA

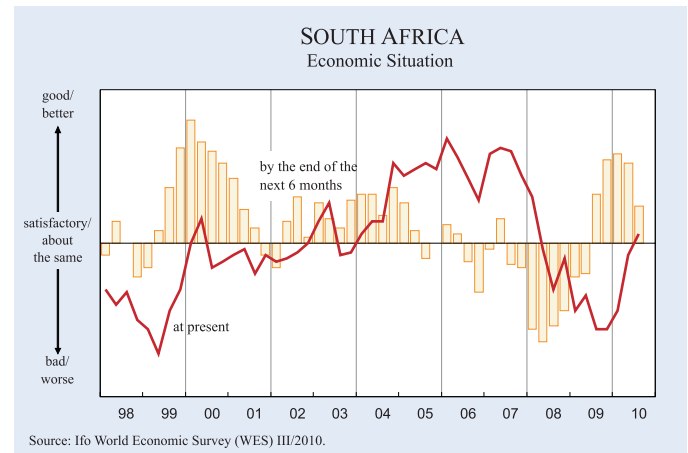
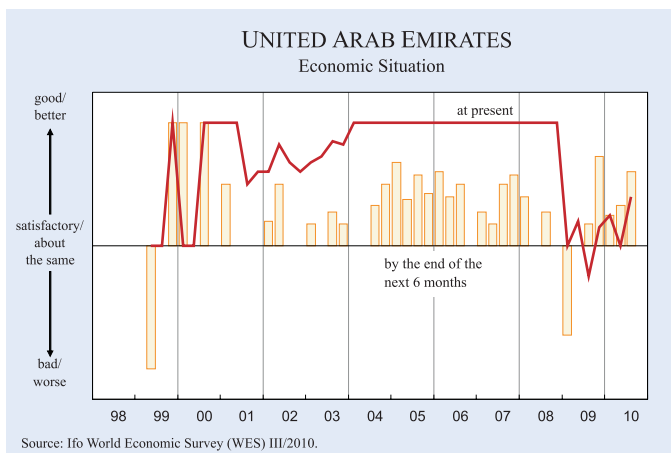
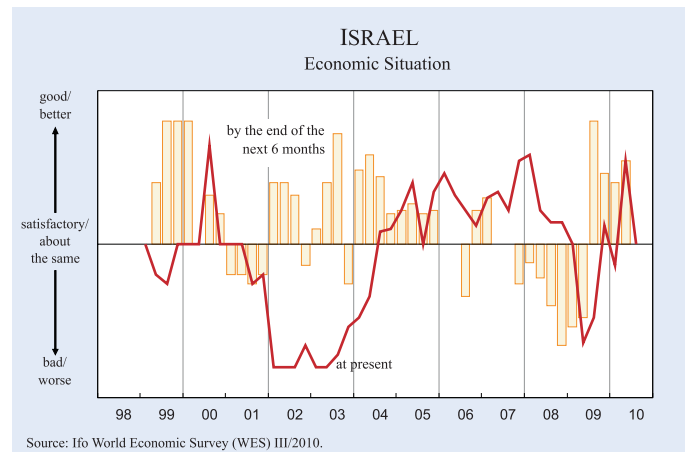
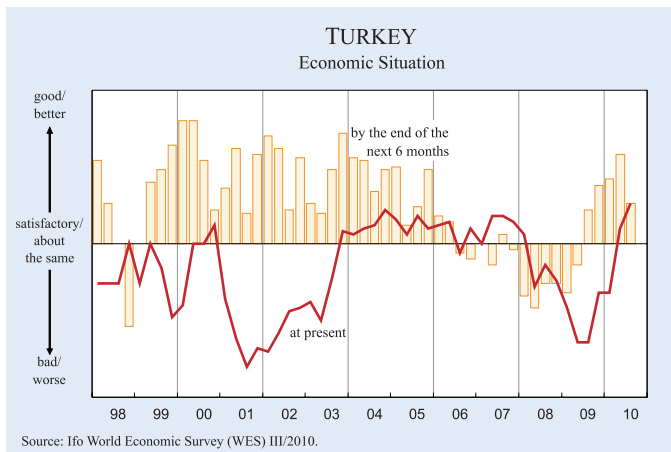
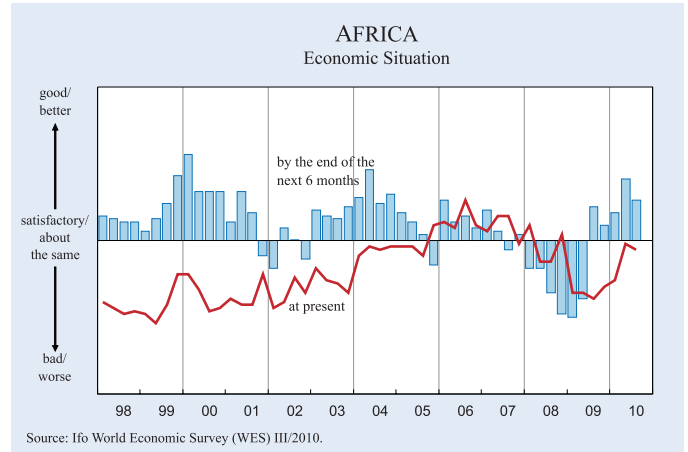
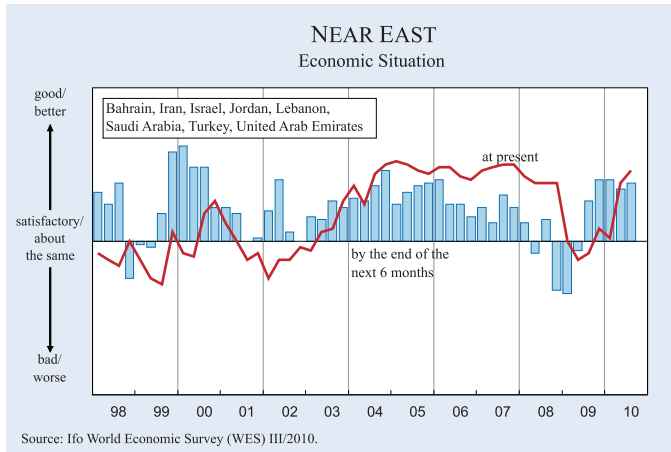


Table 1

Inflation Rate Expectations for 2010
(based on WES QIII/2010 and QII/2010)

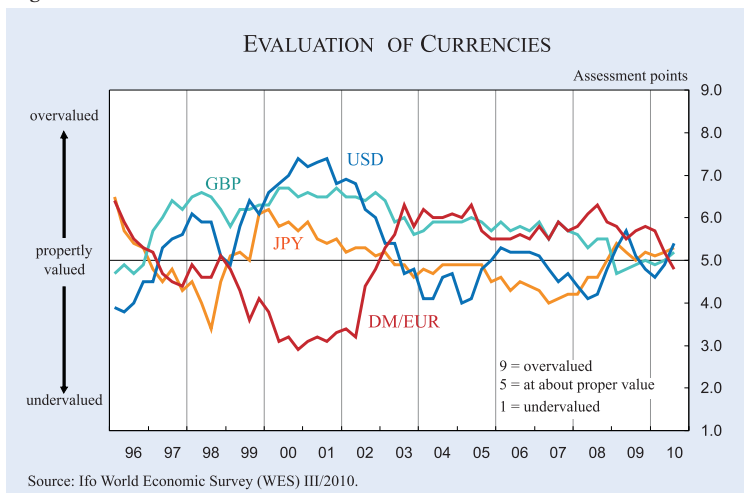
Region	QIII/2010	QII/2010	Region	QIII/2010	QII/2010
Average of countries*	3.1	3.1	CIS	8.3	9.1
High-income countries	1.9	1.8	Kazakhstan	7.7	7.8
Middle-income countries	6.5	7.0	Kyrgyzstan	15.0	10.0
Upper-middle	6.9	7.4	Russia	7.5	8.8
Lower-middle	5.9	6.4	Ukraine	12.0	12.0
Low-income countries	9.9	9.1	Uzbekistan	11.0	11.0
EU 27 countries	1.9	1.8			
EU countries (old members) ^{a)}	1.7	1.6	Latin America	8.4	8.9
EU countries (new members) ^{b)}	3.0	2.8	Argentina	23.0	25.0
Euro area ^{c)}	1.6	1.5	Bolivia	7.3	3.5
			Brazil	5.2	5.3
Western Europe	1.7	1.6	Chile	3.5	3.3
Austria	1.9	1.4	Colombia	3.0	3.4
Belgium	1.9	1.8	Costa-Rica	7.5	8.0
Cyprus	3.5	2.5	Dominican Republic	6.0	6.0
Denmark	1.7	1.9	Ecuador	3.7	4.3
Finland	1.7	1.4	El Salvador	2.2	2.0
France	1.7	1.6	Guatemala	5.8	5.9
Germany	1.3	1.3	Mexico	4.3	5.6
Greece	4.7	3.0	Panama	2.8	3.5
Iceland	6.7	5.7	Paraguay	5.1	4.4
Ireland	0.4	0.3	Peru	2.2	2.4
Italy	1.6	1.5	Trinidad and Tobago	8.5	8.0
Luxembourg	2.3	2.5	Uruguay	6.8	6.7
Malta	2.0	2.0	Venezuela	35.0	31.0
Netherlands	1.4	1.4			
Norway	2.5	2.1	Near East	4.2	5.9
Portugal	1.0	0.9	Israel	2.7	2.5
Spain	1.6	1.6	Jordan	4.9	–
Sweden	1.4	1.7	Lebanon	5.0	3.8
Switzerland	1.0	1.1	Qatar	2.0	–
United Kingdom	3.1	2.8	Saudi Arabia	3.9	4.3
			Syrian Arab Republic	5.0	6
Eastern Europe	3.1	2.9	Turkey	8.3	8.4
Albania	3.4	–	United Arab Emirates	2.4	2.6
Bulgaria	2.8	4.0			
Croatia	2.0	2.5	Africa	7.6	6.8
Czech Republic	1.8	1.7	Algeria	5.2	5.3
Estonia	2.1	0.8	Benin	3.3	2.7
Hungary	4.6	4.8	Burundi	7.1	–
Latvia	0.9	1.4	Comoros	5.2	5.0
Lithuania	2.2	2.6	Congo Dem. Rep.	19.0	22.0
Poland	2.9	2.8	Congo-Brazzavill Rep.	3.5	4.1
Romania	6.3	4.1	Djibouti	3.0	4.0
Serbia	7.4	8.3	Egypt	12.0	10.0
Slovakia	1.7	1.5	Gabon	3.1	2.9
Slovenia	1.9	1.5	Ghana	10.0	–
			Ivory Coast	2.8	2.7
North America	1.8	2.1	Kenya	5.6	7.0
Canada	2.0	2.2	Lesotho	6.8	6.8
United States	1.7	2.1	Liberia	9.0	11.0
			Madagascar	10.0	12.0
Asia	3.1	2.8	Malawi	8.1	–
Bangladesh	6.8	9.0	Mauritania	5.5	4.5
China	3.6	3.8	Mauritius	3.7	3.5
Hong Kong	2.8	2.8	Morocco	3.5	2.0
India	8.2	8.3	Niger	1.6	2.7
Indonesia	5.2	5.3	Nigeria	12.0	8.0
Japan	–0.6	–0.6	Rwanda	6.0	5.2
Malaysia	3.6	3.0	Senegal	1.6	–
Pakistan	13.0	13.0	Sierra Leone	15.0	14.0
Philippines	4.2	4.4	South Africa	5.4	6.0
Singapore	2.5	2.2	Sudan	15.0	13.0
South Korea	3.5	3.5	Swaziland	5.5	17.0
Sri Lanka	5.5	8.3	Tanzania	10.0	9.0
Taiwan	1.4	1.5	Togo	5.7	–
Thailand	3.4	3.5	Tunisia	3.6	4.5
Vietnam	9.3	9.0	Uganda	8.0	–
			Zambia	8.1	10.0
Oceania	3.2	2.9	Zimbabwe	6.9	6.0
Australia	3.2	2.9			
New Zealand	3.1	2.6			

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

^{a)} Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom – ^{b)} Czech Rep., Cyprus, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovenia, Slovakia, Bulgaria and Romania – ^{c)} Austria, Belgium, Cyprus, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Malta, Netherlands, Portugal, Spain, Slovenia, Slovakia.

Source: Ifo World Economic Survey (WES) III/2010 and II/2010.

Figure 11



The lowest rates of consumer price inflation will prevail in 2010 in *Western Europe* (1.7 percent) and also in *North America* (1.8 percent) followed by *Eastern Europe* (3.1 percent), *Asia* (3.1 percent) and *Oceania* (3.2 percent). In the *Near East* (4.2 percent) and particularly in *Africa* (7.6 percent), *CIS* (8.3 percent) and *Latin America* (8.4 percent) inflation will remain, also in 2010, well above the world average.

In most parts of the world, inflation is expected to slow down somewhat in the course of the second half of 2010, particularly in *North America*. On the other hand, in *Eastern Europe* inflation is expected to pick up somewhat in the coming six months, which will result in somewhat higher inflation rates, on average for 2010, than expected at the beginning of the year.

In *Western Europe* price increases in 2010 are now seen at 1.7 percent, which is practically unchanged from the forecast in the previous quarter (1.6 percent). *Ireland*, as a consequence of austerity measures to correct for the huge fiscal imbalances, will show price stability in 2010, following a deflationary trend in the previous year. On the other hand, in *Greece* the increase of taxes and charges as parts of the fiscal consolidation program will lead to a jump of the inflation rate in 2010 (from an originally expected 3.0 percent to 4.7 percent). In most other *European* countries the expected price increases will also remain moderate in the second half of 2010. In the *euro area* the expected inflation rate of 1.6 percent, on average for 2010, remains below the medium term objective of the ECB.

In *Eastern Europe* inflation expectations for 2010 picked up particularly in *Estonia* (2.1 percent com-

pared to an estimated 0.8 percent at the beginning of the year) and in *Romania* (6.3 percent compared to 4.1 percent), which caused a moderate upward revision of the inflation outlook in the region for 2010 (3.1 percent compared to 2.9 percent).

In *North America* consumer price inflation in 2010 is now seen as somewhat lower than in the previous survey (1.8 percent compared to 2.1 percent in April). This price stabilization trend is particularly pronounced in the US (1.7 percent compared to an expected 2.1).

In *Asia* inflation is expected to pick up somewhat in the coming months and to reach 3.1 percent after an expected 2.8 percent in the April survey. An upward revision of inflation expectations occurred mainly in *Malaysia*, *Vietnam* and also in *Singapore*. On the other hand, a tighter monetary policy is showing some effect in *China* where inflation expectations for 2010 are now at 3.6 percent compared with 3.8 percent in the previous survey. Also in *Sri Lanka* a dampening effect of monetary policy on inflation expectations can be observed (5.5 percent compared to 8.3 percent in April). *Japan* is the only *Asian* country where prices are still expected to decline in absolute terms (-0.6 percent).

In *Oceania*, despite tighter monetary policy, inflation expectations for 2010 increased further (to 3.2 percent from 2.9 percent in April and 2.6 percent in January).

In *Latin America* the jump of inflation expectations in the previous survey was corrected down somewhat but still remains rather high (8.4 percent compared with an expected 8.9 percent and 7.9 percent in January). Contrary to the general slight downward revision of inflation expectations, consumer prices in 2010 will pick up more than foreseen by the WES experts in the previous survey in *Bolivia* (7.3 percent compared to 3.5 percent), *Paraguay* (5.1 percent compared to 4.4 percent) and the high inflation country *Venezuela* (35.0 percent compared to 31.0 percent).

In *CIS* countries inflation expectations for 2010 have been coming down somewhat from the high

Figure 12

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

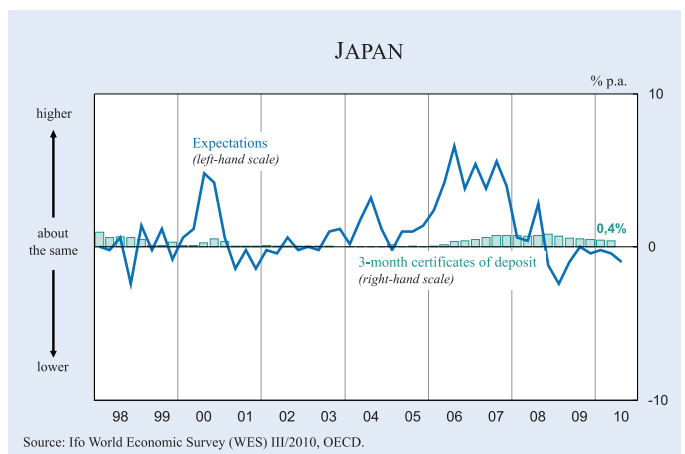
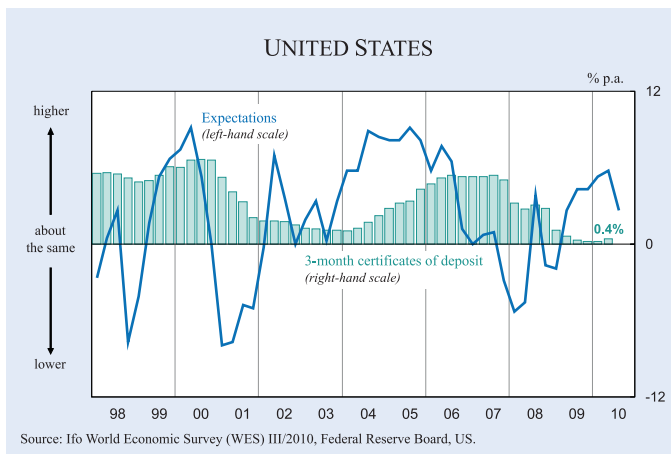
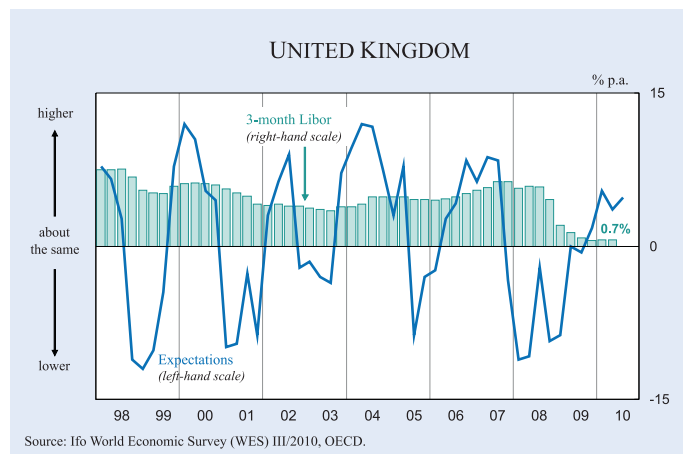
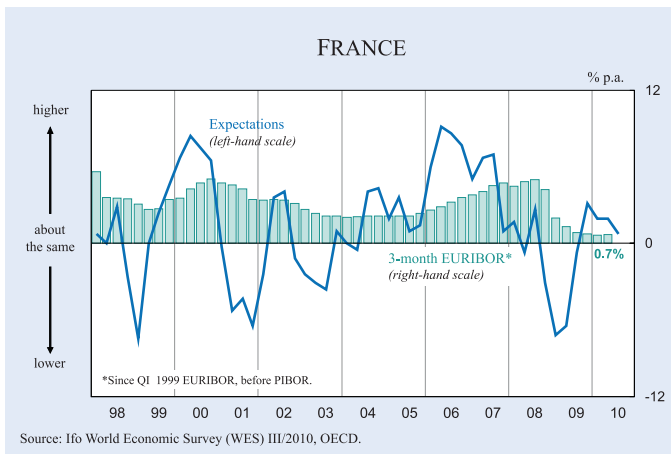
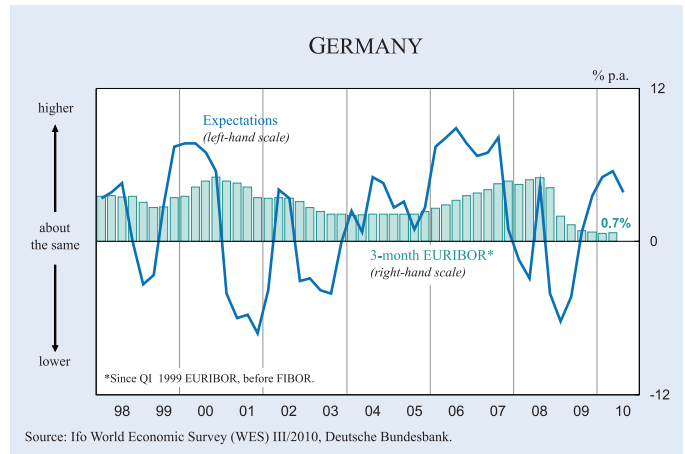
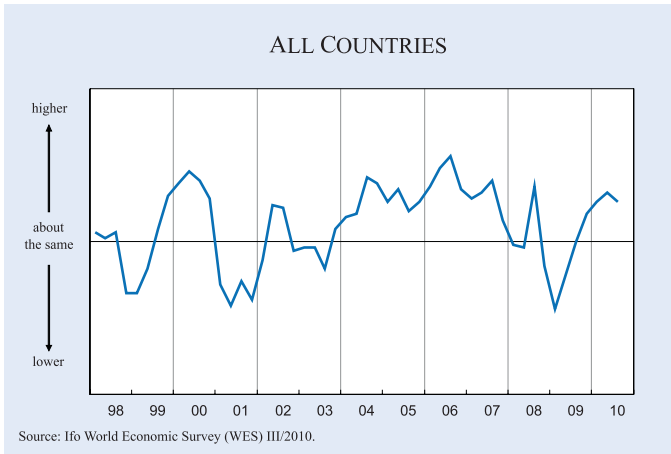


Table 2
Legal and Administrative Restrictions for Foreign Firms

Absent	
Estonia	9.0
Sweden	8.5
Portugal	8.2
Uruguay	8.2
Zambia	8.2
Austria	8.0
Denmark	7.8
Finland	7.7
Switzerland	7.6
United Arab Emirates	7.4
Ireland	7.3
Peru	7.2
Norway	7.0
Serbia	7.0
Hong Kong	7.0
Rather low	
Spain	6.9
Germany	6.8
Hungary	6.8
Chile	6.7
Belgium	6.6
Bulgaria	6.6
Canada	6.4
France	6.3
Romania	6.3
New Zealand	6.3
Latvia	6.3
United States	5.9
Turkey	5.8
Czech Republic	5.7
Italy	5.6
Japan	5.6
Netherlands	5.6
Kazakhstan	5.6
Mauritius	5.6
United Kingdom	5.4
Slovakia	5.4
Slovenia	5.4
Poland	5.3
Brazil	5.2
Thailand	5.0
Paraguay	5.0
Australia	5.0
Malaysia	5.0
Kenya	5.0
Israel	5.0
El Salvador	5.0
Sierra Leone	5.0
Colombia	4.7
Greece	4.7
Pakistan	4.6
South Korea	4.6
Nigeria	4.6
India	4.5
South Africa	4.4
Lithuania	4.2
Venezuela	4.2
Vietnam	4.2
Congo Dem. Rep.	4.2
Ivory Coast	4.2
Madagascar	4.2
Mexico	4.0
Bolivia	4.0
Mauritania	4.0
Rather high	
Taiwan	3.8
China	3.5
Philippines	3.4
Croatia	3.0
Russian Federation	2.9
Argentina	2.8
Indonesia	2.7
Sudan	2.7
Ecuador	2.6
Zimbabwe	2.0
Ukraine	1.0

* Only countries with more than 4 responses have been included into the analysis. WES scale: 9 – absent, 5 – low, 1 – high.

Source: Ifo World Economic Survey (WES) III/2010.

level in the previous survey (from 9.1 percent in April to now 8.3 percent). However, this downward revision of inflation expectations was exclusively due to reports from *Russia*, where estimates declined from 8.8 percent to now 7.5 percent. In *Kazakhstan*, *Ukraine* and *Uzbekistan* inflation expectations remained practically unchanged and even increased markedly in *Kyrgyzstan* (from 10.0 percent to 15.0 percent).

In the *Near East* some reductions in inflation expectations in *Saudi Arabia* and the *Syrian Arab Republic* led to a decline of price expectations on average for the region (from 5.9 percent to 4.2 percent), despite the fact that in *Lebanon* the expected inflation rate in 2010 increased somewhat (from 3.8 percent to 5.0 percent) and remained more or less unchanged in most of the other countries.

In *Africa* the expected inflation rate for 2010 increased from 6.8 percent as reported in the previous survey to now 7.6 percent. However, price trends in *Africa* are very heterogeneous. Relatively low inflation rates for 2010 are again expected in *Niger* (1.6 percent), *Senegal* (1.6 percent), *Ivory Coast* (2.8 percent), *Gabon* (3.1 percent), *Benin* (3.3 percent), *Morocco* (3.5 percent), *Congo-Brazzaville Rep.* (3.5 percent) and *Mauritius* (3.7 percent). In a medium inflation bracket are *Algeria* (5.2 percent), *South Africa* (5.4 percent), *Kenya* (5.6 percent), *Mauritania* (5.5 percent), *Lesotho* (6.8 percent) and the former hyper inflation country *Zimbabwe* (6.9 percent). High inflation rates and no signs of more price stability predominate particularly in *Congo Democratic Republic* (19.0 percent), *Sierra Leone* (15.0 percent), *Egypt* (12.0 percent), *Nigeria* (12.0 percent) *Ghana* (10.0 percent), *Madagascar* (10.0 percent) and *Tanzania* (10.0 percent).

Euro appears slightly undervalued

The strengthening of the *US dollar* vis-à-vis the *euro* in previous months evidently went too far according to WES experts. According to the current WES results the *US dollar* is no longer seen as undervalued but even as somewhat overvalued (see Figure 11). The *euro* was regarded for the first time since 2003 as undervalued, though only very moderately. The *Japanese yen* and the *British pound* are seen only slightly above their equilibrium values according to the polled WES experts.

Table 3

Assessment of the Following Factors Influencing the Climate for Foreign Investors in 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, Ecuador	Chile, Uruguay, Serbia, Congo Dem. Rep., Sierra Leone
Political stability	Sudan, Bolivia, Venezuela, Madagascar, Zambia, Latvia, Argentina, Taiwan, Ecuador, Ivory Coast, Pakistan	Colombia, Indonesia, Uruguay, Philippines, Belgium, Vietnam, Australia, Serbia

In those countries, not mentioned in the table no major changes relating the climate for foreign investors are expected during the next 6 months. (Only countries with more than 4 responses have been included into the analysis.)

Criteria for selection of countries:
Deterioration: WES grade between **1** and **3.5**.
Improvement: WES grade between **6.0** and **9**.

Source: Ifo World Economic Survey (WES) III/2010.

The WES experts regard their own currencies as generally **overvalued** in *Japan, Australia, New Zealand* as well as in *South Africa, Mauritius, Morocco*. On the other hand, experts assessed their own currencies as generally **undervalued**, particularly in *Iceland, Sweden, Latvia, Romania, Ukraine* and *Algeria*, but no longer in *China*. Here now only the *US dollar*, not however the euro, the *UK pound* and the *Japanese yen*, are seen as overvalued compared to the *Chinese renminbi*.

The answers to a supplementary survey question on the likely development of the *US dollar* in the next 6 months, regardless of how currencies are assessed from a fundamental point of view, signal on a world wide average a stability of the *US dollar* in coming months. However, behind this average are diverging trends: An expected **weakening** of the *US dollar* is expected in *Norway, Sweden, Iceland* and some *Asian* countries like *China, Indonesia, the Philippines, South Korea, Taiwan* and *Thailand* as well as in some *Eastern European* and *CIS* countries (*Hungary, Lithuania, Slovenia* and *Uzbekistan*) and a few *Latin American* countries (*Peru, Chile* and *Mexico*). These results contrast with an expected **increase** of the value of the *US dollar* in some countries of the *Near East* (*Israel, Saudi Arabia* and *Turkey*), in a few *Asian* countries (*Pakistan* and *Sri Lanka*), a few *Latin American* countries (*Argentina* and *Venezuela*) as well as in some *Eastern European* countries (here particularly *Serbia* and *Croatia*).

Short-term interest rates expected to rise less than formerly anticipated

The number of WES experts that expect some tightening of monetary policy in the course of the next six months has declined – though only slightly – for the first time since October 2009, both with regard to short- and long-term interest rates (see Figure 12). This result is probably caused by less optimistic expectations of WES experts on the further progress of economic recovery and somewhat less pronounced inflation expectations. The new tendency can be observed worldwide, with some exceptions such as *Denmark* and

several *Eastern European* countries like *Estonia, Hungary, Croatia* and *Slovenia* as well as *Latin American* countries like *Chile, Argentina* and *Colombia* as well as *New Zealand* where the rising trend of interest rates has picked up further.

ICC Special Question: Cross-border trade and investment

Economists world-wide highlight that cross-border trade and investment are vital to sustain the global economic recovery. In this survey's ICC special question, the WES experts were asked about what measures would help to increase current levels of cross-border trade and investment most effectively in their country.

According to the vast majority of WES experts, one of the most important drivers of cross-border trade and investment is *consumer demand* (see Table 4). Though in many countries around the world the economy has stepped out of recession and economic growth is gaining momentum, unemployment remains high and is posing one of the most important economic problems at present. Weak consumer demand is the consequence. In almost all countries WES experts stated that higher private consumption is the crucial factor to more cross-border trade and investment.

However, in many countries WES experts also regard other measures as important. In many *Eastern and Western European* countries, particular-

Table 4

**Assessment of Measures to Increase
the Current Levels of Cross-border Trade and Investment***

Region	Elimination of protectionist practices	Clearer trade terms and rules	Greater availability of trade finance	Increased consumer demand	More balanced currency valuations
Western Europe					
Austria	3.3	4.4	4.4	6.7	3.9
Belgium	3.0	3.2	3.7	5.9	4.6
Denmark	5.8	4.2	5.8	7.0	4.6
Finland	3.9	3.7	4.8	7.3	4.6
France	4.5	2.9	4.2	6.6	5.3
Germany	5.8	4.5	4.0	5.5	3.7
Greece	5.0	5.3	6.3	6.3	4.3
Ireland	2.7	4.4	7.3	7.9	6.7
Italy	4.6	4.9	4.4	6.3	4.9
Netherlands	3.9	3.6	4.7	6.4	4.4
Norway	5.7	3.7	4.3	6.3	3.0
Portugal	4.2	4.6	5.0	5.8	4.6
Spain	5.0	5.8	6.9	7.1	5.0
Sweden	4.4	3.0	4.1	5.0	3.0
Switzerland	5.0	3.5	2.9	5.3	5.5
United Kingdom	5.2	3.1	6.4	7.1	4.5
Central and Eastern Europe					
Bulgaria	4.3	4.1	5.9	7.9	3.9
Croatia	4.5	5.0	5.0	7.5	4.0
Czech Republic	5.7	4.3	6.3	6.3	4.7
Hungary	4.5	5.0	6.5	6.5	5.5
Latvia	3.7	3.0	6.3	7.0	5.7
Lithuania	5.0	5.0	5.0	8.2	3.4
Poland	3.7	5.3	5.0	6.7	5.7
Romania	4.6	5.7	7.2	7.2	5.4
Slovakia	5.7	4.6	4.3	5.4	3.2
Slovenia	5.0	5.0	6.7	7.3	3.9
CIS					
Russia	5.4	4.6	4.8	6.0	3.5
Kazakhstan	3.9	5.0	5.0	7.9	3.9
Ukraine	6.0	5.5	7.0	5.0	4.5
North and Latin America					
Argentina	7.8	6.6	5.4	3.8	2.6
Brazil	6.1	4.7	5.5	5.7	6.4
Canada	6.7	3.9	3.5	6.3	4.2
Chile	5.7	5.0	5.0	5.7	5.0
Colombia	4.1	5.0	4.4	6.5	5.9
Ecuador	5.9	6.3	5.9	4.6	2.5
Mexico	5.7	5.0	6.5	7.5	4.3
Paraguay	5.5	8.0	5.0	4.5	3.0
Peru	5.0	5.2	4.5	5.7	5.0
United States	5.1	4.4	4.7	7.0	4.2
Uruguay	6.3	5.9	3.7	4.6	5.0
Venezuela	5.8	6.6	5.0	4.2	6.6
Asia and Oceania					
Australia	4.0	3.0	5.0	4.5	4.0
China	7.2	4.6	3.7	5.4	5.0
Hong Kong	6.3	5.0	4.3	8.3	3.0
India	4.4	3.3	4.4	5.6	4.1
Indonesia	6.7	5.6	3.9	5.6	3.3
Japan	4.9	3.6	3.1	6.2	5.4
Malaysia	7.3	5.6	4.4	5.6	3.9
New Zealand	5.0	3.5	5.0	7.0	7.0
Pakistan	5.7	5.4	5.0	7.2	5.0
Philippines	5.5	5.0	4.0	4.5	4.5
South Korea	6.6	5.8	3.4	4.6	3.8
Taiwan	7.8	6.3	5.0	6.8	4.8
Thailand	5.9	6.3	6.3	6.3	5.4
Near East and Africa					
Congo Dem. Rep.	7.0	5.8	5.0	4.0	5.0
Cote d'Ivoire	1.8	4.2	6.6	8.2	2.6
Israel	4.2	4.2	5.0	5.8	4.2
Kenya	5.6	7.3	5.6	5.0	3.3
Madagascar	5.0	6.6	5.8	5.0	5.0
Mauritius	7.0	7.0	4.3	7.7	5.7
South Africa	5.2	4.5	5.0	6.7	5.6
Sudan	5.0	6.3	6.6	5.7	7.7
Turkey	3.9	3.7	5.3	6.3	6.3
Zambia	4.2	4.2	6.6	5.0	5.0
Zimbabwe	5.0	5.6	7.9	6.1	3.7

* WES scale: 9 – most important, 5 – important, 1 – less important. Only countries with more than four responses were included in the analysis. More important aspects are shaded.

Source: Ifo World Economic Survey (WES) III/2010.

ly those which were most strongly affected by the financial crisis and credit shortages (*Greece, Ireland, Spain, Bulgaria, Czech Republic, Hungary, Latvia, Romania and Slovakia*), a better *availability of trade finance* would help boost trade and investment.

On the other hand, in countries, where the local currency appears to be overvalued or undervalued compared to the world major currencies such as the US dollar, euro, yen and the UK pound, a *more balanced currency valuation* would help increase cross-border trade and investment, according to WES experts. This applies particularly to *New Zealand, Romania, Colombia, Mauritius, Poland, South Africa, Switzerland, Japan and Sudan*. In these countries the surveyed economists regard the local currency as somewhat overvalued compared to the US dollar, the euro, the Japanese yen and the British pound. In *Brazil, Venezuela, Turkey and Ireland* WES experts see the local currency as undervalued and also highlight the importance of a balanced currency valuation for a better integration of their country into the world market.

In *Asia* and *Latin America* the WES experts also emphasized that *elimination of protectionist practices* would help to stimulate cross-border trade and investment. This opinion prevails in *Asia* particularly in *Taiwan, Malaysia, China, South Korea, Thailand, Hong Kong and Indonesia*, and in *Latin America* in *Argentina, Brazil, Uruguay, Ecuador, Venezuela, Chile and Mexico*. However, also in several *EU countries* WES experts point out that protectionism is one of the most important impediments to international trade and investment; this is the case in *Germany, Denmark, Norway, Czech Republic and Slovakia*.

Clearer trade terms and rules are required, according to WES experts, particularly in *Argentina, Ecuador, Paraguay, Venezuela, Taiwan, Thailand, Kenya, Madagascar, Mauritius and Sudan*.

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RESCUING EUROPE

Hans-Werner Sinn

A large, light gray topographic map of Europe serves as the background for the central text. The map shows the continent's geographical features, including mountain ranges and coastlines.



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