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**Article**

## CESifo World Economic Survey August 2014

CESifo World Economic Survey

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# CESifo WORLD ECONOMIC SURVEY

VOLUME 13, No. 3

AUGUST 2014

## WORLD ECONOMIC CLIMATE

World economic climate brightens slightly

## ECONOMIC EXPECTATIONS

Economic expectations remain optimistic

## INFLATION

Persisting low inflation expectations

## CURRENCIES

US dollar expected to rise

## INTEREST RATES

Interest rates expected to remain stable

## SPECIAL TOPIC

Economic impact of the Ukraine crisis

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## Regions

- World Economy: Stable economic developments coupled with risks
- Western Europe: Economic climate indicator remains high, but momentum slows
- North America: US economic climate indicator rises sharply
- Eastern Europe: Economic climate improves further
- CIS: Economic climate indicator remains at a low level
- Asia: Economic climate indicator recovers strongly
- Oceania: Economic climate clouds over
- Latin America: Economic climate index drops to five-year low
- Near East: Favourable present economic situation, but outlook clouds over somewhat
- Africa: No unified economic trend

## Notes

The World Economic Survey (WES) assesses worldwide economic trends by polling transnational as well as national organisations worldwide on current economic developments in their respective countries. Its results offer a rapid, up-to-date assessment of the economic situation prevailing around the world. In *July 2014*, 1,146 economic experts in 121 countries were polled.

## Methodology and evaluation technique

The survey questionnaire focuses on qualitative information: assessments of a country's general economic situation and expectations regarding key economic indicators. It has proven a useful tool, since it reveals economic changes earlier than conventional 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. Overall 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 individual country's exports and imports as a share of total world trade.

*CES – Center for Economic Studies* – is an institute within the department of economics of Ludwig Maximilian University, Munich. Its research, which focuses on public finance, covers many diverse areas of economics.

The *Ifo Institute* is one of the largest economic research institutes in Germany and has 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 organisations are published.

# WORLD ECONOMIC CLIMATE BRIGHTENS

The Ifo Index for the world economy rose to 105.0 points from 102.3 points in the previous quarter (long-term average: 95.5, 1998–2013). Both assessments of the current economic situation, as well as the economic outlook, improved somewhat versus April (see Figures 1 and 2). World economic activity remains on the rise (see Box 1). The risks, however, have grown: almost three quarters of the WES experts believe that rising energy prices and supply shortages in the wake of the Ukraine conflict pose a moderate to high potential threat to the world economy.

other factors, by the monetary policy turnaround in the USA – with interest rate increases. The restrictiveness of fiscal policy will differ significantly across the major advanced economies both this year and in 2015. In the euro area fiscal policy interventions will have very little impact on aggregate economic output. In the USA and Japan fiscal policy is expected to remain restrictive. In the majority of the emerging economies the effect of fiscal policy is mostly expected to be neutral. India and China are the only nations in which public investment programmes are expected to reinforce economic activity this year.

## Stable economic developments coupled with risks

Thanks to developments in the advanced economies, growth in the world economy has started to pick up since mid-2013. The economic recovery in the USA, United Kingdom and Japan gained momentum, while the euro area emerged from a recession that lasted almost two years. Although the emerging economies continued to post higher growth rates than advanced countries, economic expansion in the former remained relatively weak by historical standards, and has slowed down even further since mid-2013 in some areas, like for example Latin America. Monetary policy in the major advanced economies remains very expansionary. Central banks in Japan and the euro area are expected to continue to pursue a highly accommodative policy, whereas initial increases in base rates cannot be ruled out in the USA and the United Kingdom during the forecasting period in view of the strengthening economic recovery. Monetary policy has become more restrictive in key emerging economies since mid-2013. Central banks reacted to the strong depreciation of their currencies – triggered, among

The driving forces behind the world economic climate result primarily from North America with an increase of 3.4 points in the Ifo index (USA: 5.9) and Asia with a

Figure 1

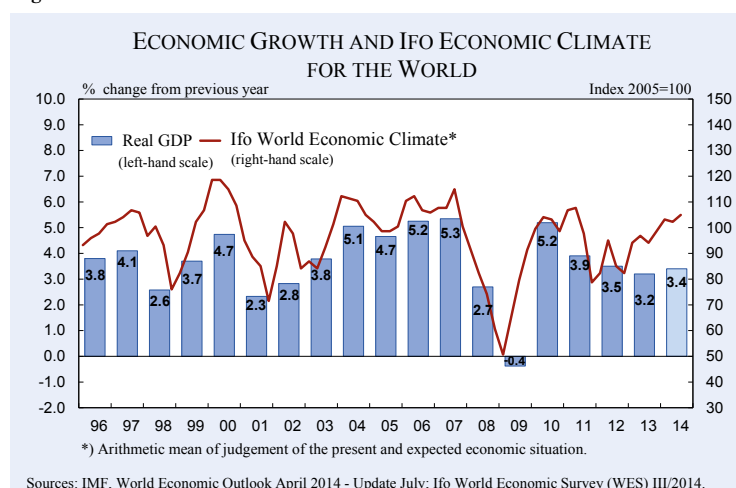
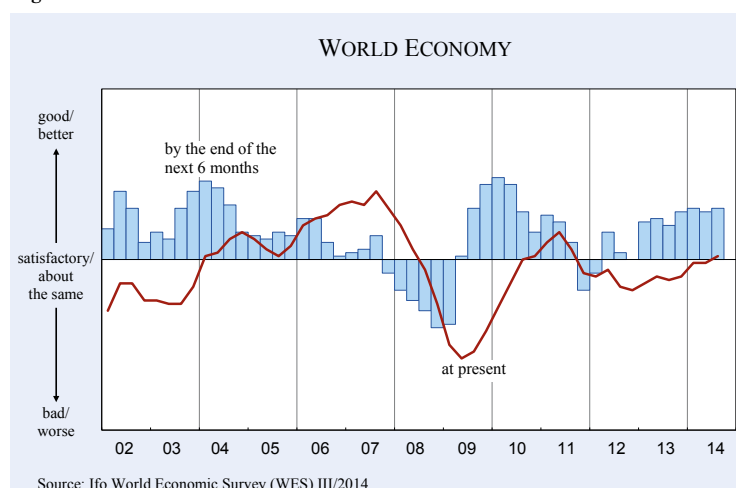


Figure 2

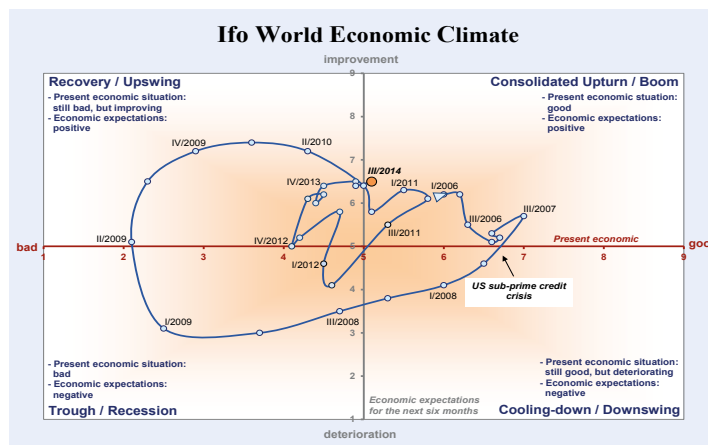


## Box 1

### Ifo Economic Clock and the Ifo World Economic Climate

A glance at the Ifo Economic Clock showing the development of the two components of the economic climate index over the last six years can provide a useful overview of the global, medium-term forecast. The business cycle typically proceeds clockwise in a circular fashion, with expectations leading assessments of the present situation.

According to the July survey, the Ifo indicator for the world economy improved again. Assessments of both components, the current economic situation and the economic expectations for the next six months, are somewhat more positive than three months ago. The indicator started to move into the consolidated upturn quadrant. World economic activity is expected to grow, even although more risks for the world economy have emerged in recent months.



Source: Ifo World Economic Survey (WES) III/2014.

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 Business Cycle Clock"). 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).

plus of almost 10 points. The latter upturn was mainly driven by a better economic outlook in *China* and *India*. The index for *Western Europe*, by contrast fell (-2.0 points), and particularly sharp decreases were reported in the *Near East* (-5.7 points) and *Latin America* (-5.4 points). In *Latin America* the Ifo index fell to its lowest level since the end of 2009. In main economies in this region, *Argentina* and *Brazil*, both the current situation and the outlook deteriorated.

According to a WES special question on the expected negative impact of the Ukraine conflict, experts, especially in direct neighbouring countries, cited negative effects in terms of trade channels, as well as energy prices and supply. Experts in geographically distant regions like *Latin America*, *Oceania*, *Asia* and *Africa*, by contrast, reported that the impact of the conflict is relatively minor.

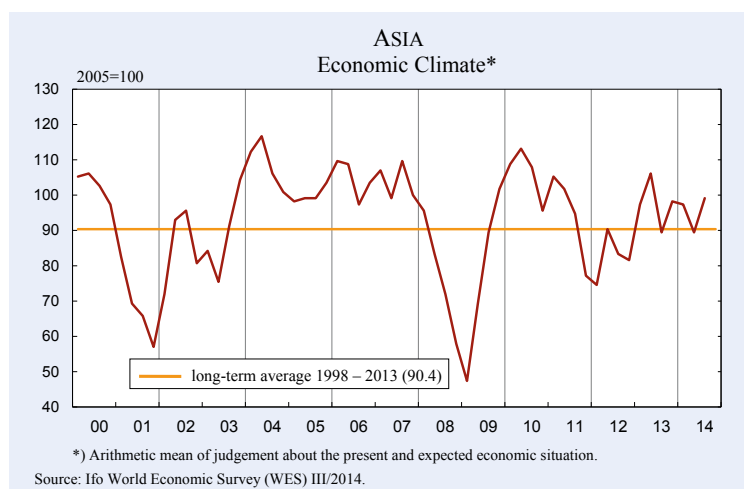
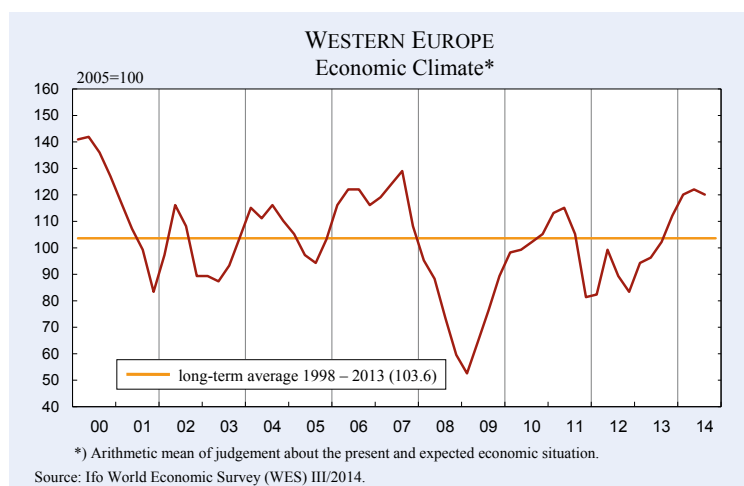
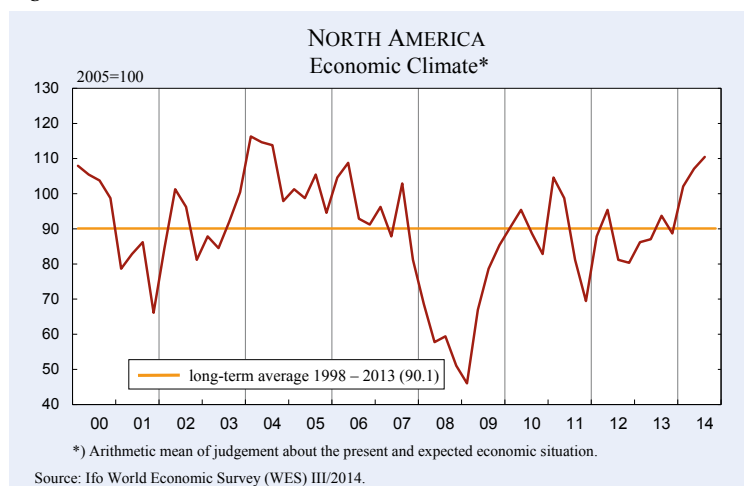
The pace of global economic expansion will pick up moderately over the forecast horizon, primarily driven by the advanced economies. The *US* economy will gain impetus, boosted by an improvement in the asset position of households and companies, further brightening in the labour and real-estate markets, and expansive monetary policy. Economic developments in the *euro area* will remain plagued by complex structural problems that are still present in several member states and will take some time to solve. The recovery in aggregate economic activity will temporarily stabilise, despite the continued existence of major differences between member states. Growth in the *German* economy, in particular, will far outstrip the *euro area* average for the forecasting period, while economic momentum in *France* and *Italy* will be relatively weak. The situation in the crisis-afflicted countries of *Ireland*, *Portugal* and *Spain* is expected to be somewhat more positive, although the economic situation remains fragile. The pace of expansion in emerging economies will barely pick up over the forecasting period. Although they will benefit from the economic upturn in key

advanced economies, the gradual rise in long term interest rates in the *US* will, at the same time, result in a steady deterioration of financing conditions for emerging economies. Nevertheless, aggregate economic production in emerging economies will grow at over twice the rate as in their advanced counterparts.

Finally, surprising results were observed for the *Ukraine* and *Russia*. Experts in the *Ukraine* assess the current situation as very weak, but are still fairly optimistic with respect to future developments. After last quarter's strong deterioration in the economic outlook, expectations in *Russia* even brightened somewhat, although negative responses still prevail. The same holds true for assessments of the current situation. Nevertheless, the crisis in the *Ukraine* remains a central threat to the world economy.



**Figure 3**



**Western Europe: Economic climate indicator remains high, but momentum slows**

The economic climate indicator for *Western Europe* returned from 122.1 to its value of the first quarter at 120.1 (long-term average 103.6 between 1998 and 2013; see

Figure 3). While assessments of the present economic situation improved further, albeit only slightly, economic expectations were downgraded somewhat, but remained on the positive side (see Figure 4). A similar pattern applies to the *euro area*, where the indicator dropped to 118.9 points from 123.0 points (15-year long-term average: 106.8). Appraisals of the present economic situation remained stable below the satisfactory line. Economic expectations are less optimistic than in the previous survey.

In *France, Greece, Italy* and *Portugal*, the slight improvement in assessments of the present economic situation observed in April did not continue in July. In *Ireland, Spain* and *Cyprus*, on the other hand, some improvement with regard to the present economic situation was recorded compared to the previous survey. Overall, however, economic sentiment remains subdued in all of the above mentioned countries (see Figures 5a and 5b). In *Greece, Italy, Portugal* and *Spain*, in particular, the economic experts surveyed reported difficult financing conditions for companies (see Table 1). The most marked downwards revision in light of the present economic situation took place in *Finland* and *Estonia*, two countries that are economically strongly linked with *Russia*. In both countries assessments of the present situation are in unfavourable territory, particularly in *Finland*. In the *Netherlands, Austria* and even more so in *Slovenia*, by contrast, appraisals of the present economic situation were upwardly revised on balance compared to the survey in April, but

on the whole their economic situation is still considered as unfavourable by WES experts. In *Slovenia*, the economic situation remained unchanged at a low level. In *Belgium*, appraisals of the present economic situation were scaled back and economic experts were once again dissatisfied with economic performance. So, while the

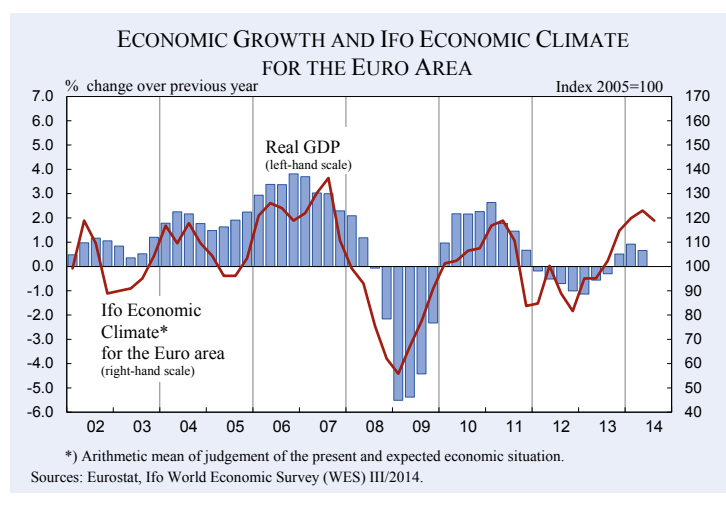


## Box 2

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

The Ifo World Economic Climate for the 18 member countries of the euro area is the arithmetic mean of assessments of the general economic situation and the expectations for the economic situation in the next six months. The July results are based on responses from 302 experts. As a rule, the trend in the Ifo Economic Climate indicator correlates closely with the actual business-cycle trend for the euro area – measured in annual growth rates of real GDP (see Figure).

The Ifo Index for the economic climate in the euro area fell from 123.0 points to 118.9 points in the third quarter. Assessments of the current economic situation remained unchanged at a low level. After three successive quarters of constantly good results, the six-month economic outlook deteriorated for the first time once again. The experts surveyed fear weakening exports and rising energy prices due to the Ukraine conflict. Overall, however, economic expectations remain at a high level. In most euro area countries slightly improved assessments of the economic situation in the second quarter returned to the low level seen at the beginning of the year. In Finland and Estonia, in particular, both of which do a great deal of business with Russia, the economic situation deteriorated significantly. Ireland, the Netherlands and Austria were the only countries where the present economic situation improved slightly, but remained at a subdued level. Germany stands out thanks to its very good economic situation. Although the six-month economic outlook for the euro area remains at a high level, it is less optimistic than last quarter. In Greece, Italy, Portugal, Spain and Slovenia economic experts continued to report constrained access to bank credit for companies, even although these constraints were perceived to be slightly less restrictive than in January. In Germany, by contrast, access to credit was not restrictive



current economic situation is below the neutral level, or unsatisfactory, in all of these countries, economic expectations remain much friendlier and point to improvements in the next six months. However, except for Greece and Belgium, the economic outlook is less positive than three months ago. In Austria, in particular, economic expectations were downwardly revised compared to the previous survey. The present economic situation in Luxembourg, Latvia and Slovakia remains satisfactory, according to WES experts. The best ratings in the euro

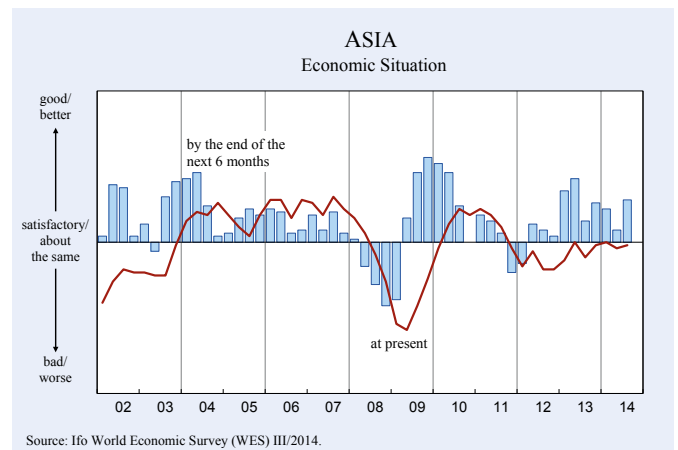
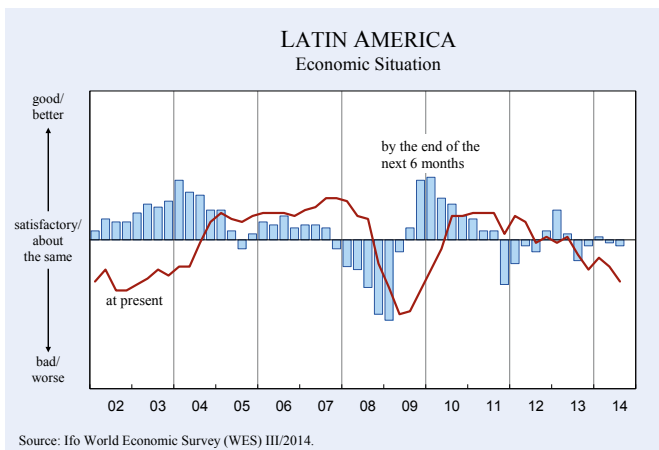
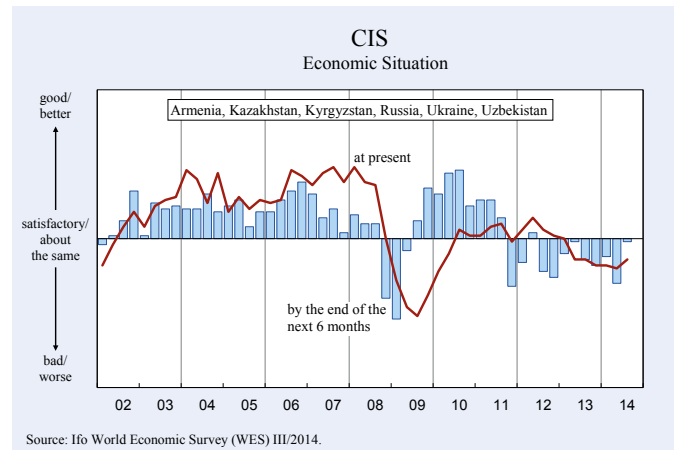
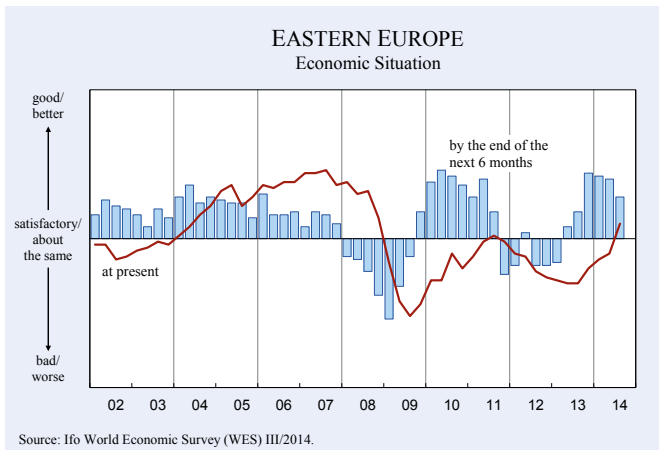
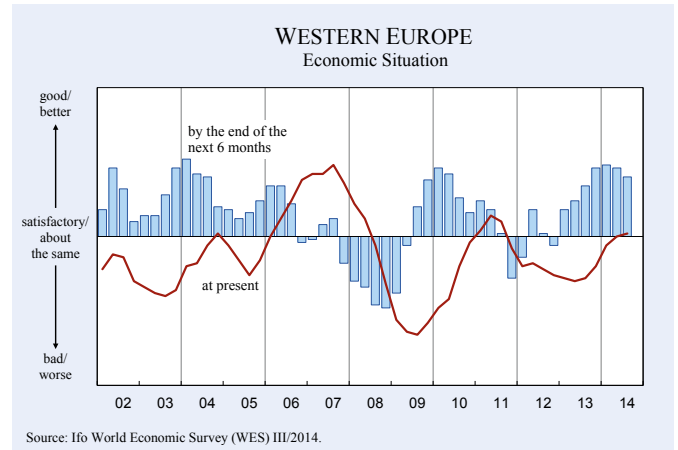
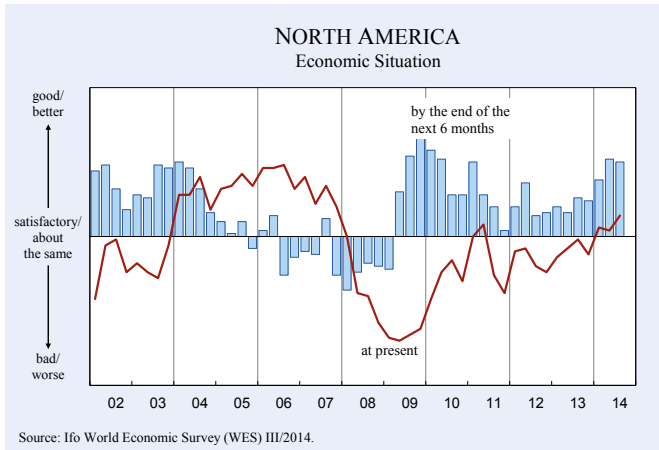
consumption expenditure is concerned, WES experts continue to assess it as weak at present. Both private consumption and overall economic activity is expected to continue to pick up slightly over the next six months, according to WES experts. In Sweden and Monaco the current economic situation was rated as satisfactory again and is expected to remain so over the next six months. In Sweden, private consumption is performing well at present, while WES experts reported unsatisfactory levels of capital expenditure.

area were once again received by Germany, where the already positive economic situation improved further, resulting in the highest assessment seen for three years. However, here, as well as in Slovakia, economic expectations in the next half of this year are less optimistic than in the previous survey. In turn, WES experts in Luxembourg and Latvia have become more positive with regard to future economic developments. In Latvia, in particular, cautious on the part of experts gave way to positive assessments of the six-month outlook.

Outside the euro area the general economic situation appears friendlier, although not to the same extent in all countries. In the United Kingdom the present economic situation showed marked further improvements compared to the previous survey and reached its highest level for about nine years. In Norway and Switzerland assessments of the present economic situation remain favourable on the whole, despite some downward revisions compared to the previous survey. While in the United Kingdom and Switzerland economic expectations are less optimistic than in April, the economic outlook in Norway clearly brightened up and is no longer cautious. After clouding over somewhat in April, assessments of the present economic situation in Denmark improved again and now appear satisfactory. However, as far as private

**Figure 4**

**SELECTED REGIONS**



## North America:

### US economic climate indicator rises sharply

The economic climate index in *North America* continued its rise, climbing to its highest level in nearly ten years at 110.5 points (long-term average: 90.1, 1998-2013). The increase was mainly driven by an improvement in the present economic situation compared to the previous survey. Economic expectations for the region as a whole deteriorated marginally, due to a less positive economic outlook in *Canada* (see Figures 3 and 4). By observing the *US* separately, economic expectations improved slightly and remain highly favourable. The present economic situation improved strongly compared to the previous survey and once again remains at a satisfactory level (see Figure 6). The weather related GDP decrease in the first quarter is expected to be clearly offset in the quarters ahead. In *Canada*, the economic climate indicator fell somewhat due to less favourable economic expectations. Assessments of the current economic situation improved further and attested to a good economic performance at present. Here, in particular, WES experts see no constraints on bank credit for firms (see Table 1).

### Eastern Europe: Economic climate improves further

In *Eastern Europe* the economic climate indicator once again rose to 94.6 (previous survey 91.5), due to more positive assessments of the present economic situation. Economic expectations, by contrast, were downgraded again, but remain in positive territory (see Figures 4 and 7).

The largest upwards revision with regard to the present economic situation took place in the *Czech Republic* and *Poland*, where assessments reached clearly favourable territory. In *Lithuania*, the current economic situation also remains favourable, despite some slight downwards revision compared to the previous survey. All of these countries are likely to perform well in the next six months, even although experts are slightly less positive than three months ago. In *Latvia* and *Slovakia*, those countries belonging to the euro currency system, WES experts once again assessed the present economic situation as satisfactory. In *Estonia*, which does a great deal of business with Russia, the economic situation deteriorated significantly. In all of those Eastern European countries belonging to the *euro area*, economic expectations are largely positive. WES experts in *Latvia* in particular relinquished their cautious view and were positive again in the light of future economic develop-

ments. In *Bulgaria*, *Hungary* and *Romania* assessments of the present economic situation remain in unfavourable territory, despite some slight upwards revision compared to the previous survey. While the situation looks set to improve somewhat in the months ahead in *Hungary*, WES experts in both *Romania* and *Bulgaria* don't expect major changes for the better. In *Croatia* no changes for the better were recorded. Indeed, all of the economic experts surveyed once again unanimously attested to their country's poor economic situation. Economic expectations remain unchanged at neutral levels, which do not signal an easing of the country's currently difficult economy.

In *Albania* and *Macedonia*, the *Eastern European* countries *outside the EU*, the present economic situation was assessed as satisfactory and is expected to remain so for the next six months. In *Bosnia and Herzegovina* and *Kosovo*, the present economic situation deteriorated markedly versus the previous survey and is now considered weak and unfavourable respectively. The six-month economic outlook in both countries does not signal any improvement on the horizon in current economic weakness. In *Serbia* some improvements are visible at a low level, but overall economic activity remains below the satisfactory level. Economic expectations are far more positive than three months ago and point to a further recovery in the months ahead.

### CIS: Economic climate indicator remains at a low level

The Ifo indicator for the *CIS* countries covered by WES (*Russia*, *Ukraine*, *Kazakhstan*, *Kyrgyzstan*, *Uzbekistan* and *Armenia*) rose by 9.0 points, mainly due to upwardly revised economic expectations. These expectations, however, tend to point towards a stabilisation in the current unfavourable situation and do not signal that current economic and political tensions will be overcome in the next six months. Assessments of the present situation improved only marginally (see Figure 4).

In *Russia*, appraisals of the present economic situation remain unfavourable. Capital expenditure is once again considered as weak. Private consumption, which performed satisfactorily in previous surveys, received unfavourable assessments by WES experts in this quarter's survey. As far as future economic developments in the months ahead are concerned, WES experts are surprisingly considerably less negative than three months ago. The economic outlook nevertheless signals no substantial improvements over the next half of this year. As

in the past, legal and administrative restrictions on foreign firms seeking to invest in *Russia* remain relatively high (see Table 2). In addition, political instability increased compared to January's survey and will negatively influence the climate for foreign investors. In the *Ukraine* the present economic situation was again reported as unfavourable. Economic expectations for the next six months were upwardly revised and point to some improvements in economic performance in the months ahead. The export sector in particular is expected to expand somewhat. In *Kyrgyzstan* no changes for the better were reported and appraisals of the economic situation are once again at an unfavourable level. Economic expectations are more negative than three months ago, and do not signal substantial improvements over the next six months. In the remaining countries of the *CIS* region, *Armenia*, *Kazakhstan* and *Uzbekistan*, a far more favourable present economic situation prevails and is expected to persist for the next six months.

#### **Asia: Economic climate indicator recovers strongly**

In *Asia*, the fall in the economic climate indicator was only short-lived. In the third quarter the indicator once again surpassed its long-time average at 99.1 (1998-2013: 90.4). While appraisals of the present economic situation improved only slightly, the economic outlook for the next six months is far more positive than in the previous survey (see Figures 3, 4 and 8).

In *China*, the economic climate improved again due to more positive assessments of both the present economic situation and economic expectations. However, despite the improvement, the current economic state remains below the satisfactory line on the whole, according to WES experts. Capital expenditure in particular is assessed as weak at present. As far as the six-month economic outlook is concerned, more economic experts than three months ago are positive. Overall, the export sector looks set to expand in the months ahead. In *Japan*, the deterioration seen in the present economic situation this quarter was anticipated in the previous survey. However, the downward trend is expected to come to an end, as economic expectations for the next six months improved sharply and turned clearly positive. The financial conditions for firms seem to be highly favourable, as WES experts reported no constraints on access to bank credit. In *India*, no major changes for the better were recorded and the economic situation at present was still assessed as unfavourable. In turn, economic expectations were upwardly revised and stand at

their most optimistic level for over ten years. By far the highest rating in the region for the present economic situation was again received by the *Philippines*. With regard to the next six months, expectations were downgraded somewhat and tend to point to an economic stabilisation at current good levels. The most marked upwards revision in the economic climate took place in *Bangladesh* and *Thailand*. Despite strong improvements in the present economic situation in *Thailand*, it nevertheless remains below the satisfactory-line on the whole. In turn, WES experts in *Bangladesh* started to grade the present state of their economy as good. In both countries, the recovery is expected to continue, as economic expectations stand at very high levels. Positive assessments of the present economic situation of *Hong Kong*, *Indonesia*, *Sri Lanka* remain above the region's average, despite the fact that the present economic situation was assessed as somewhat less positive than in the previous survey. In all of these countries the economic expectations for the next six months remain in positive territory, although in *Sri Lanka* they are somewhat less positive than three months ago. In *Malaysia* and *Singapore*, the present economic situation was again rated as satisfactory. In *South Korea* and *Taiwan* the current economic state also improved compared to the survey in April, reaching a satisfactory level according to the economic experts surveyed. The six-month economic outlook signals further improvements in the next half of this year, except for in *Malaysia*, where WES experts remain sceptical regarding future economic developments in their country. In *Vietnam* the economic climate deteriorated again, due to less favourable assessments of both the present economic situation and economic expectations. In *Pakistan* current economic performance remained weak. Economic expectations, which reached a very high level in the previous quarter, were again downgraded, but remain positive on the whole and point to some improvements of current weak economic conditions.

#### **Oceania: Economic climate clouds over**

In *Oceania* the economic climate indicator fell again to 96.1 index points, which is below its long-term average (100.7, in the period 1998-2013). While the present economic situation improved further and moved into favourable territory, economic expectations deteriorated strongly compared to the previous survey and turned pessimistic. This pattern was particularly true for *Australia*. In this country, the experts surveyed expect some strengthening of their export sector, while capital

expenditure is likely to deteriorate in the six months ahead. Financial conditions for firms are exceptionally good at present, as WES experts reported no constraints on the supply of bank credit. In *New Zealand*, the economy is again performing very well at present. However, economic expectations are less optimistic than in the previous survey.

### **Latin America:**

#### **Economic climate index drops to five-year low**

The Ifo Index for the economic climate in *Latin America* fell to its lowest point since the end of 2009. The indicator continued to fall from 81.4 to 76.0 and dropped further below its long-term average (1998-2013: 91.3). This was mainly due to assessments of the present economic situation, which clouded over further and remain in unfavourable territory. The six-month economic outlook also deteriorated, but less markedly (see Figures 4 and 9).

The deterioration in the region's economic climate was particularly driven by *Brazil* and *Argentina*. In both countries, the present economic situation worsened compared to the previous survey and fell to very low levels, last seen in *Argentina* at the end of 2009 and in *Brazil* during its crisis in 1999. In both countries, capital expenditure in particular is considered to be weak. The economic outlook for the next six months is more negative than in the previous survey. In *Argentina* in particular more experts expressed caution with regard to future economic developments. Legal and administrative restrictions for foreign firms remain high in *Argentina*, according to WES experts, and received the worst appraisals by cross-country comparison (see Table 2). There was no positive news from *Venezuela* nor *El Salvador*, and their economies remain weak, according to WES experts. In *El Salvador* in particular a considerable deterioration in experts' expectations for the next six months was visible. In *Venezuela*, the situation is even expected to deteriorate further. Survey participants warned of rapidly rising inflation in the months ahead. *Venezuela* tops the ranking with an annual inflation rate of nearly 60 percent at present among all countries covered by WES. In *Mexico*, the second most economically important country in this region, the economic climate indicator improved slightly, due to a brighter economic outlook. In turn, assessments of the present economic situation remain unfavourable. In *Bolivia*, *Uruguay* and *Chile* appraisals of the present economic situation were downgraded somewhat compared to the April survey. Despite this downward revision, WES experts in *Bolivia*

and *Uruguay* reported the present economy to be as good as during the last survey. In turn, for *Chile*, the downward movements in assessments of the present economic situation continued, with the indicator falling to its lowest level since early-2010. The economic experts surveyed mainly considered capital expenditure to be weak at present. WES experts' economic expectations point to a stabilisation at current good levels for *Bolivia*, while they signal slowing economic momentum for *Chile* and *Uruguay*. The present economic situation in *Ecuador*, *Paraguay* and *Peru* was again assessed less positively than in the two previous surveys of this year, but remains satisfactory on the whole. In *Paraguay* and *Peru* the economic outlook has been revised downwards and now points to a stabilisation, rather than any expansion of their economies. WES experts in *Ecuador* have become more pessimistic about developments over the next six months. The best present economic performance was reported by WES experts in *Colombia*, where the present economic situation further brightened. In addition to a good prevailing investment climate due to low legal and administrative restrictions for foreign firms and political stability, *Colombia* ranks top of the list of absent credit constraints (see Tables 1 and 2). In *Costa Rica*, *Cuba*, the *Dominican Republic*, *Guatemala* and *Panama* WES experts see the economic conditions of their economies as satisfactory and expect them to remain so over the next six months.

### **Near East: Favourable present economic situation, but outlook clouds over somewhat**

In the *Near East* the economic climate indicator fell from 99.8 to 94.1 points, but remains above its 15-year long-term average of 86.5. While assessments of the present economic situation deteriorated only slightly and remain favourable on the whole, the economic outlook is clearly less positive than three months ago (see Figure 10). In *Israel*, *Jordan*, *Qatar* and *Saudi Arabia* no changes to the previous survey were recorded and the current economic situation remains favourable. This also applies to the *United Arab Emirates*, although to a slightly less positive degree than in the previous survey. Economic expectations have been downgraded somewhat compared to three months ago, but remain on the positive side; except for in *Israel*, where WES experts have turned cautious as far as future economic developments are concerned. In *Lebanon* the economy is performing satisfactorily at present, according to WES experts, and it is expected to remain so in the months ahead. In *Turkey*, the economic climate improved fur-

Figure 5a

## EUROPEAN UNION

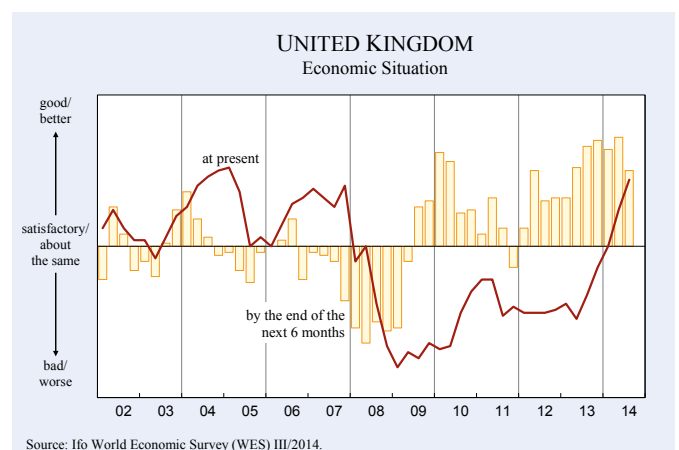
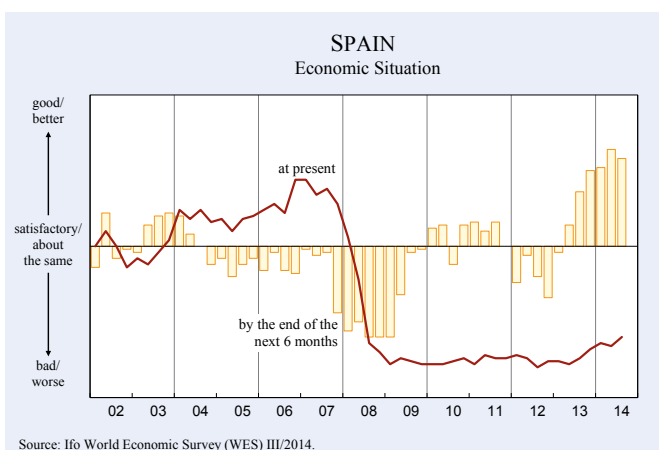
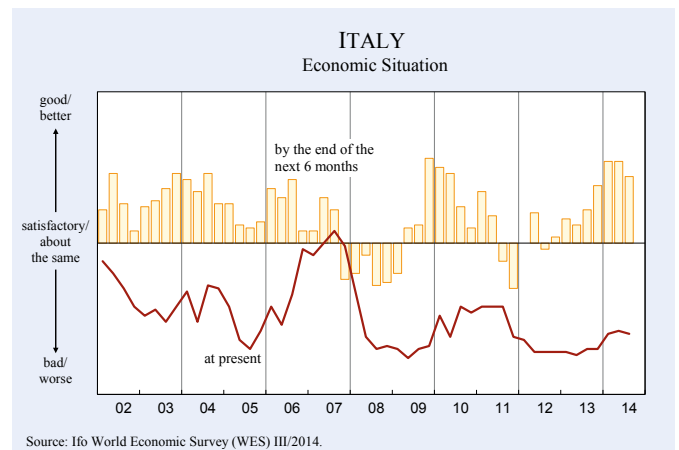
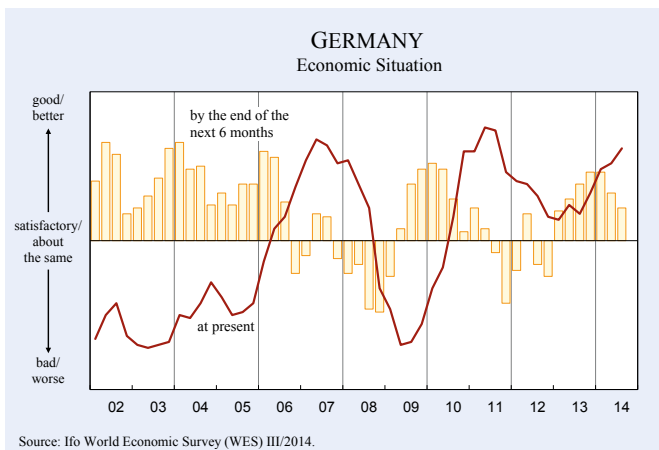
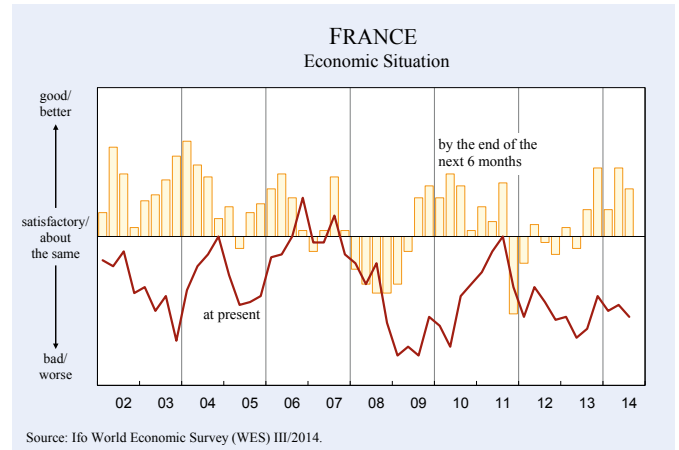
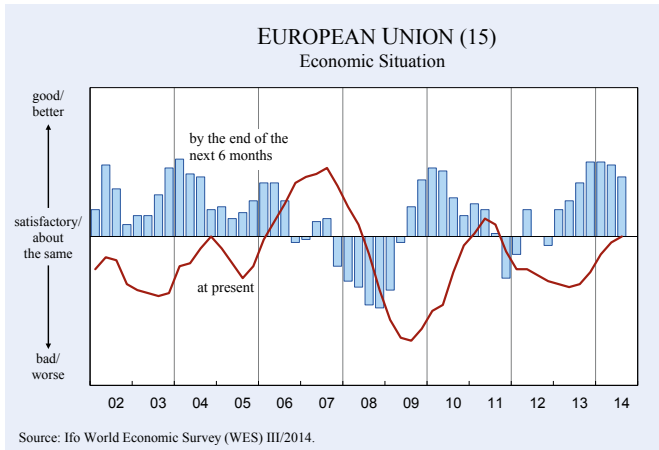
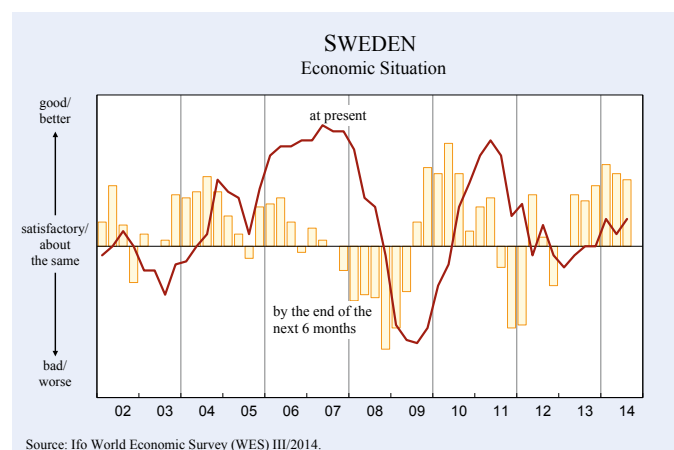
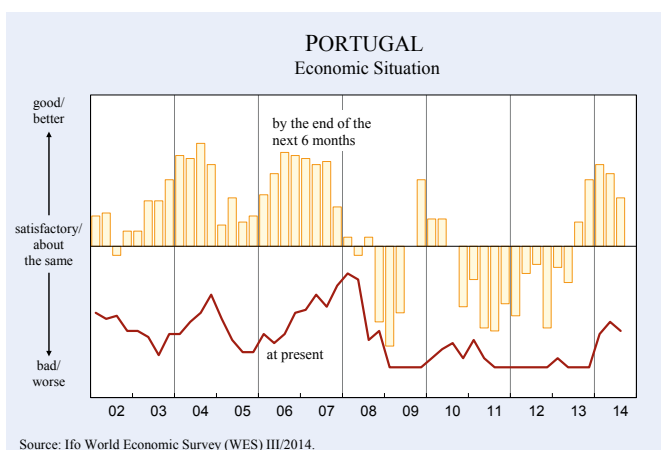
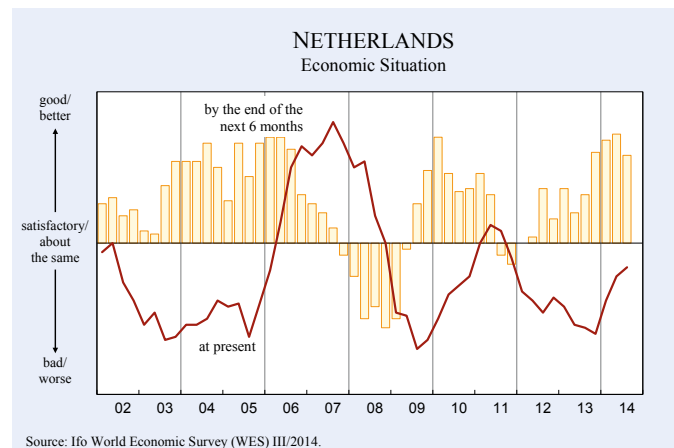
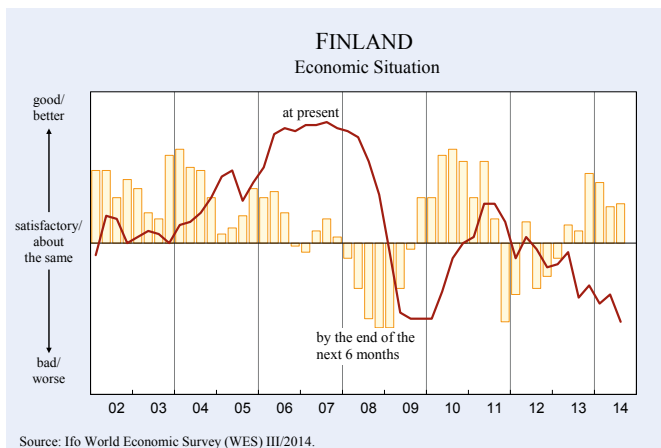
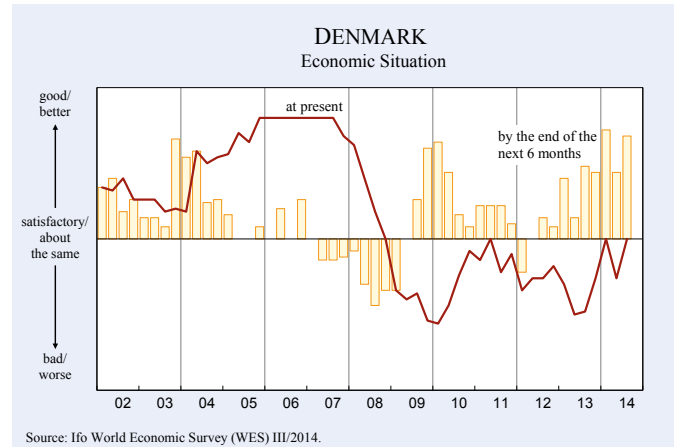
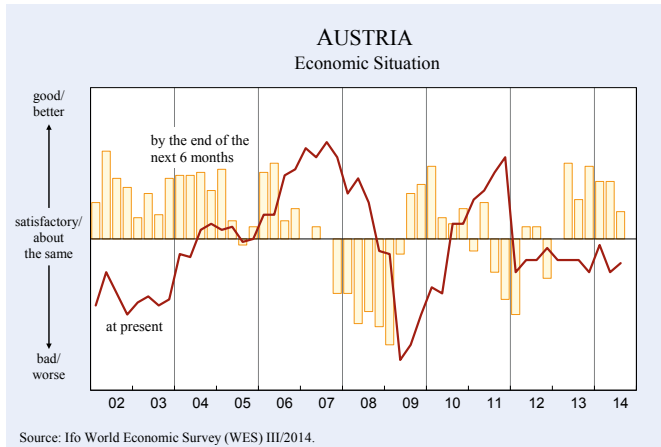


Figure 5b

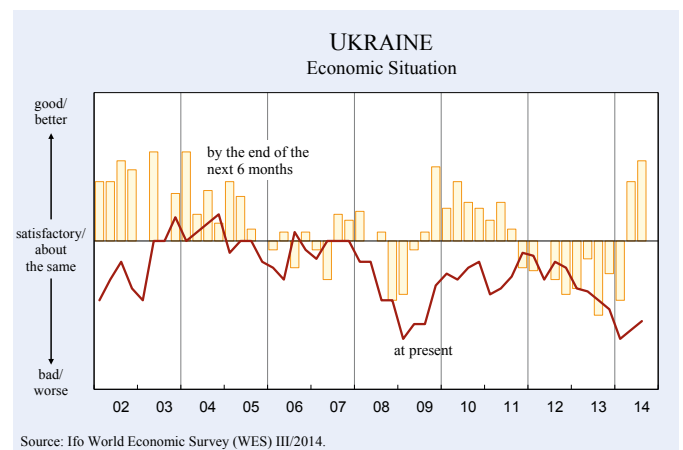
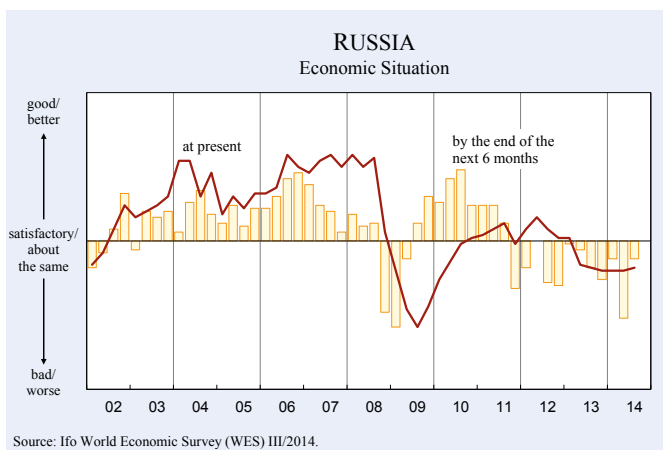
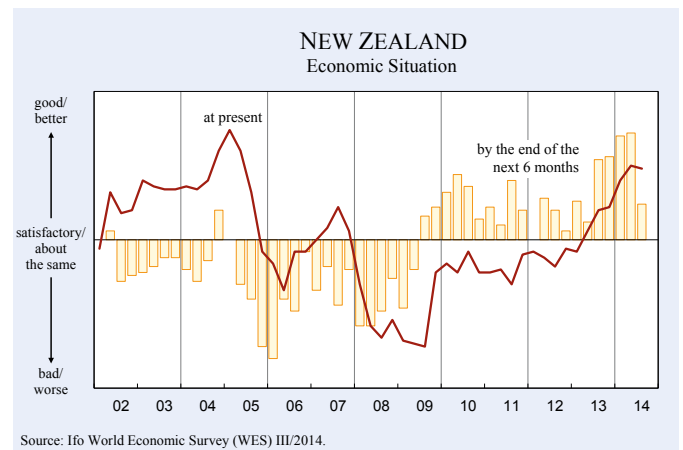
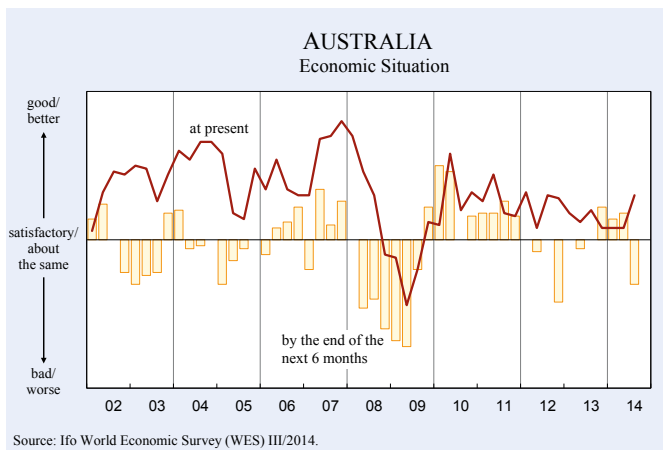
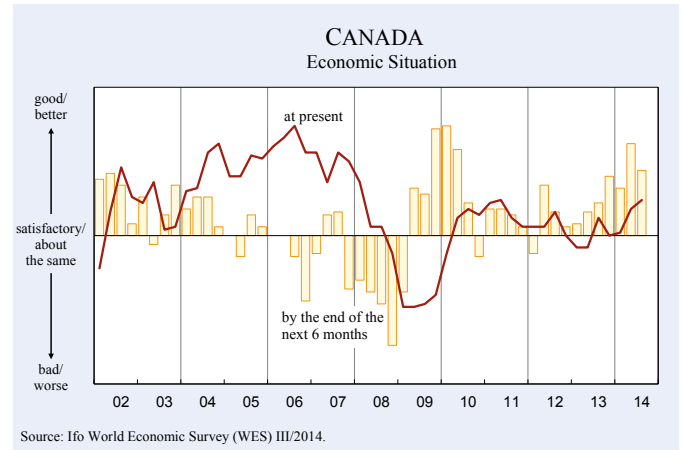
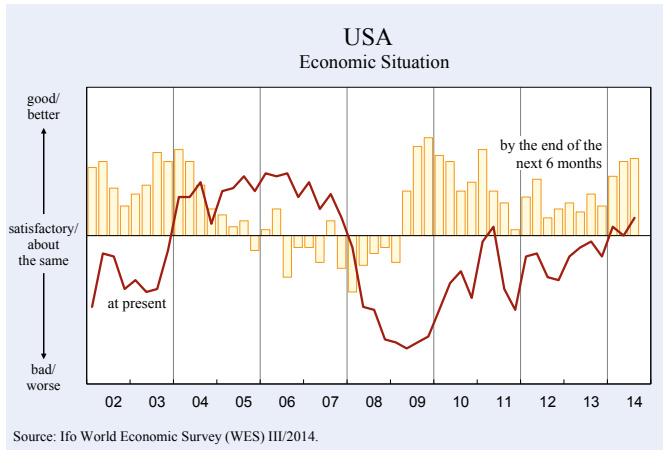
EUROPEAN UNION





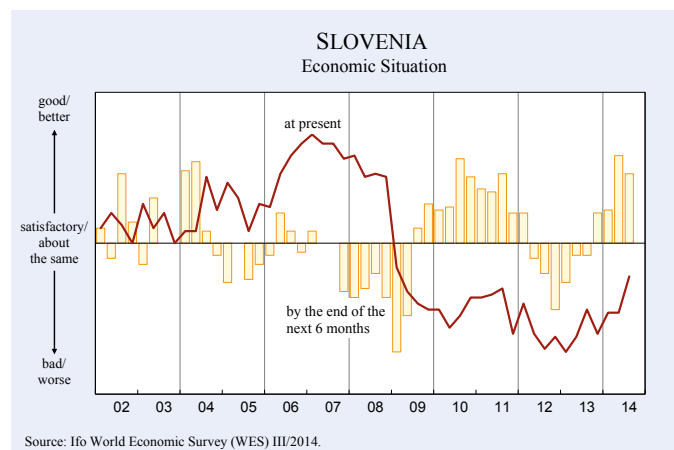
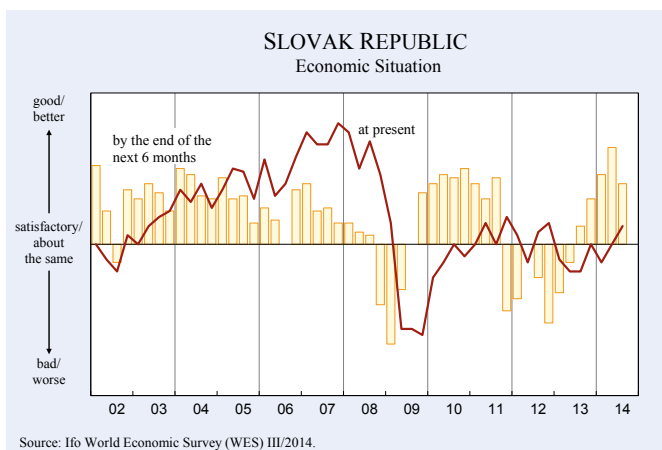
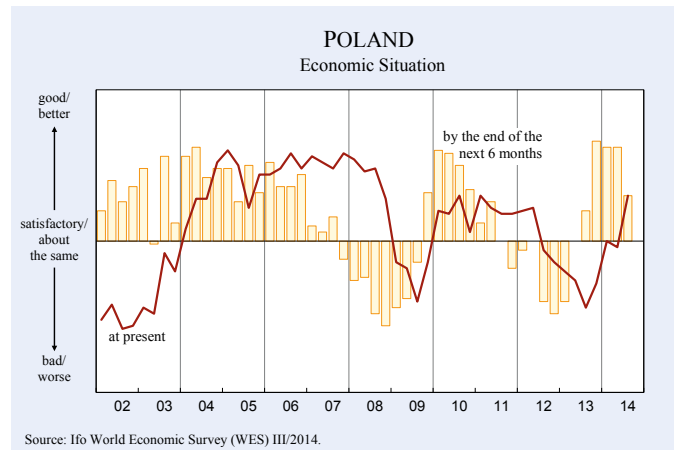
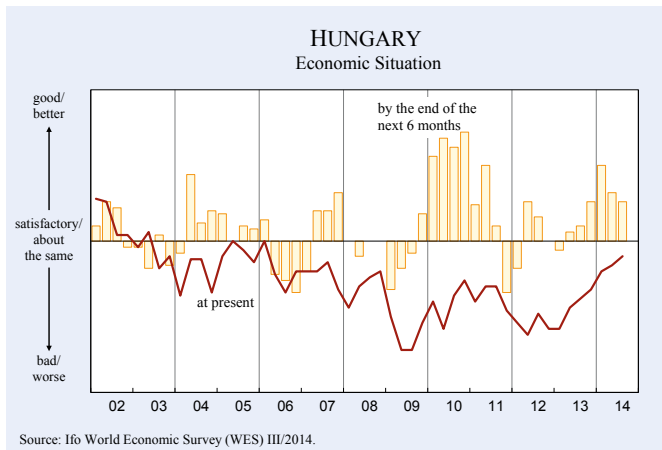
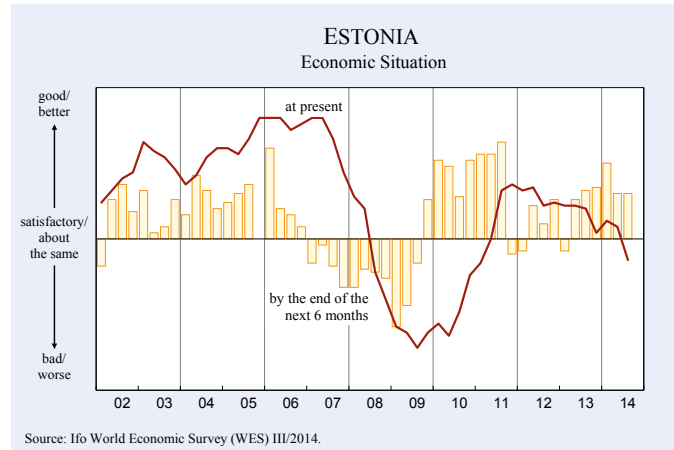
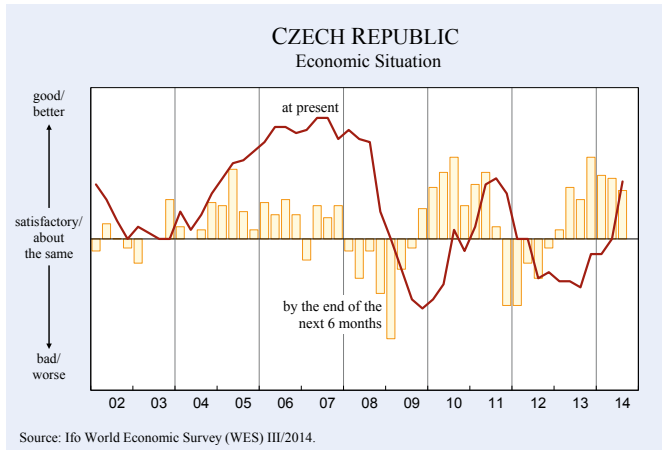
**Figure 6**

## NORTH AMERICA, OCEANIA AND CIS



**Figure 7**

**EASTERN EUROPE**



**Figure 8**

**ASIA**

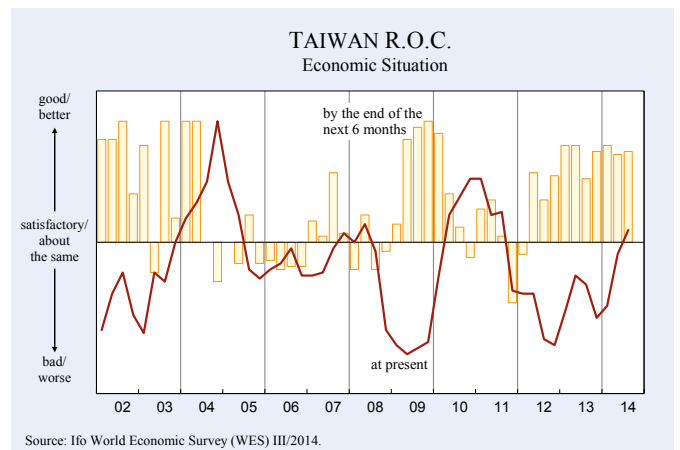
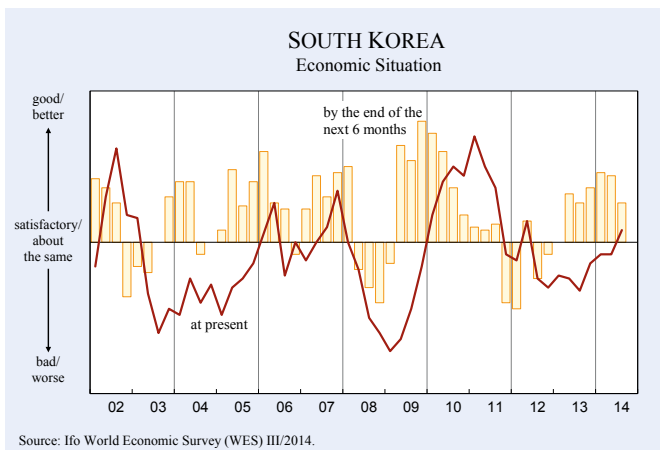
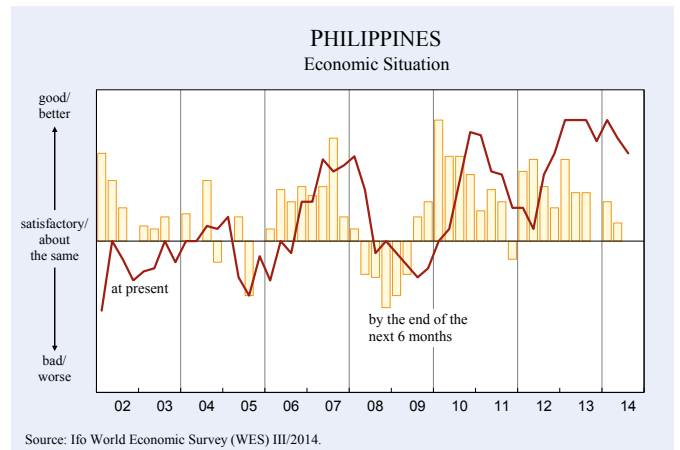
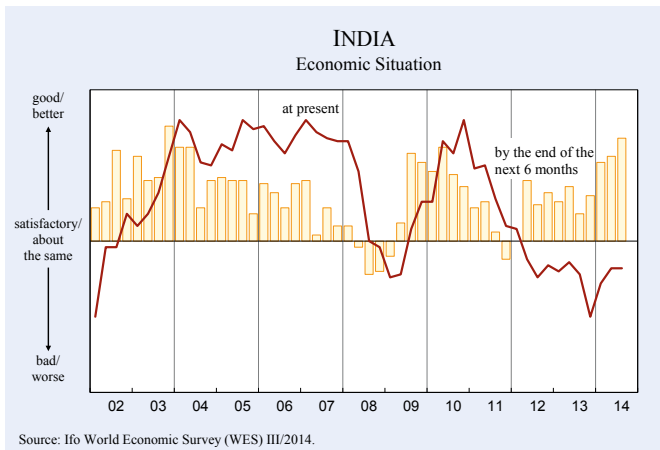
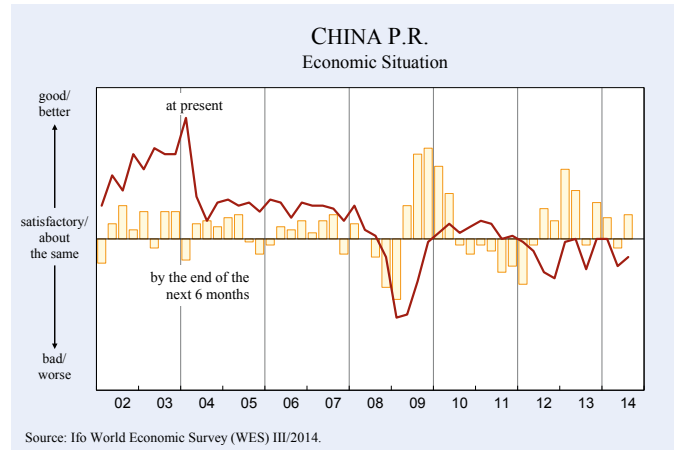
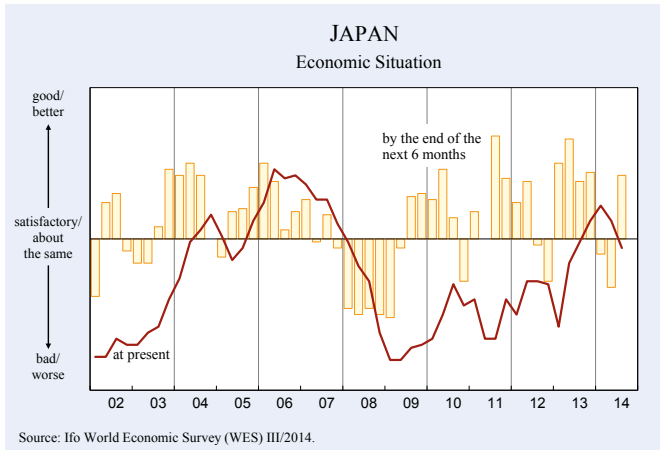
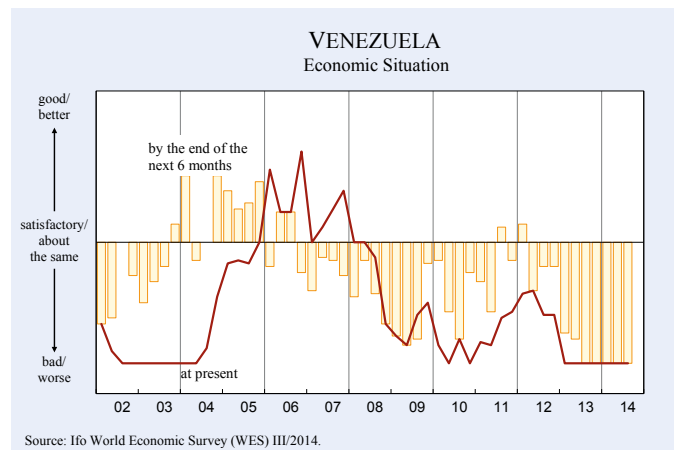
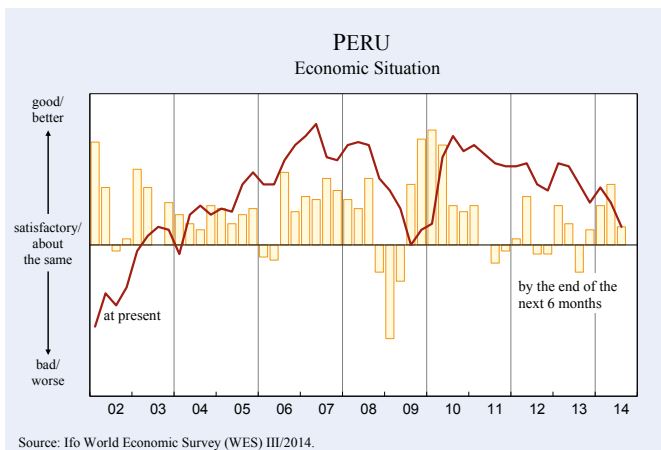
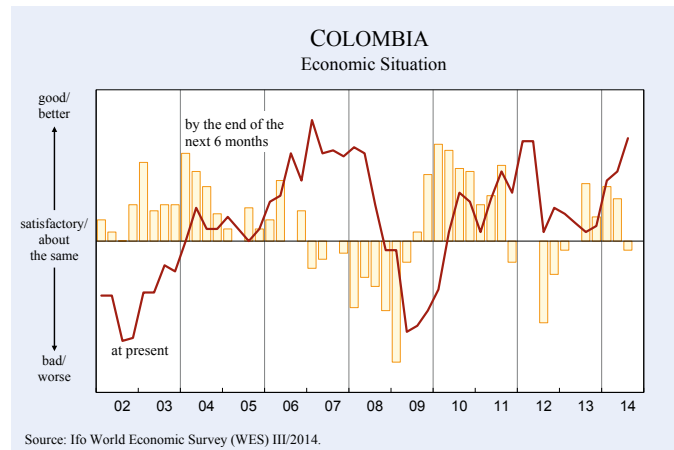
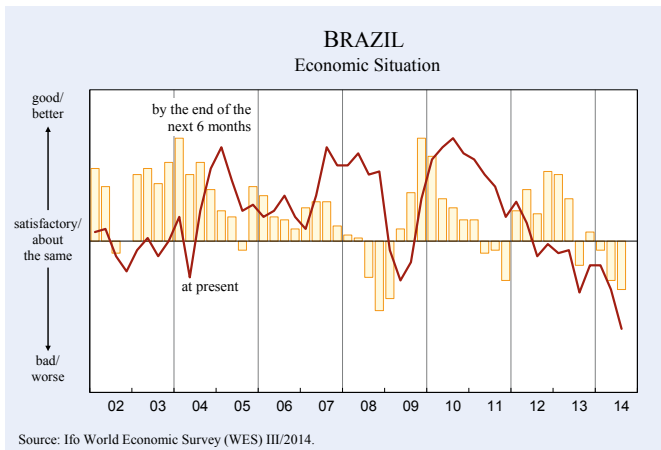
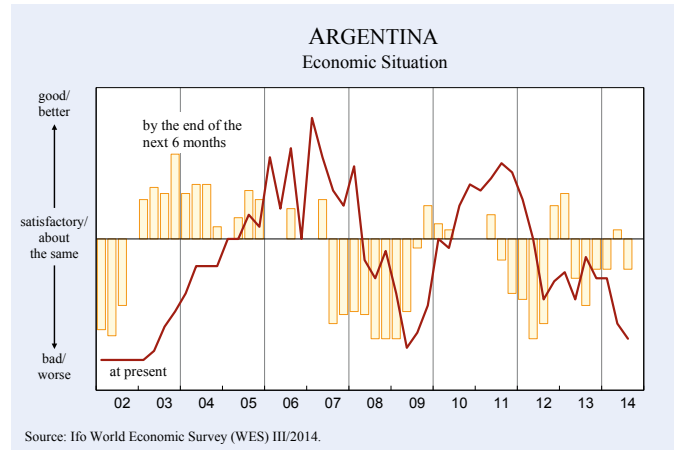
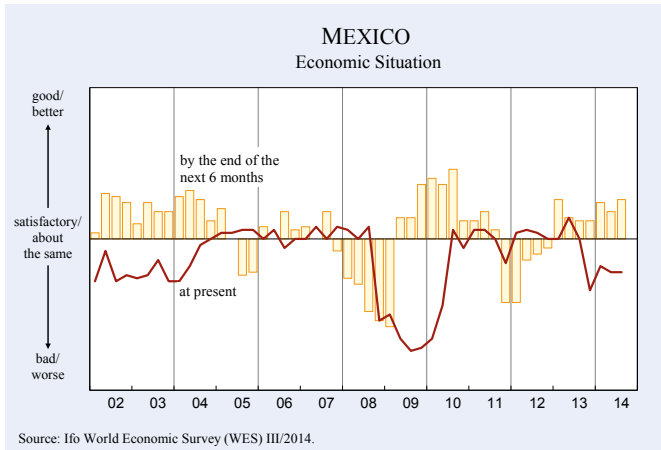


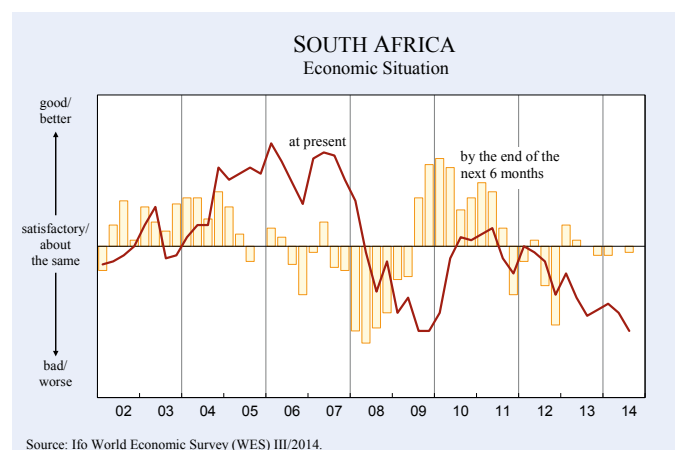
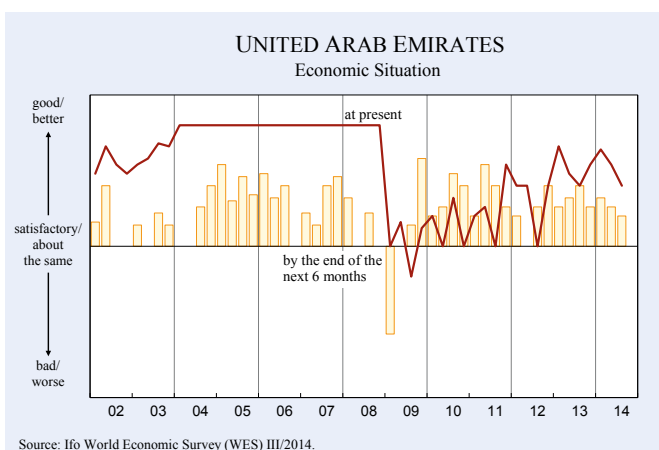
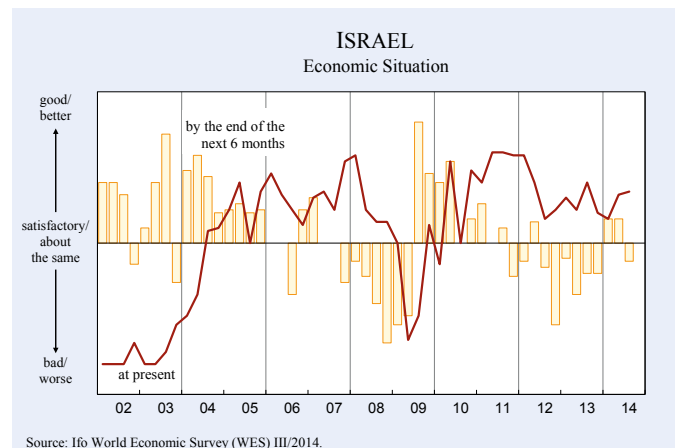
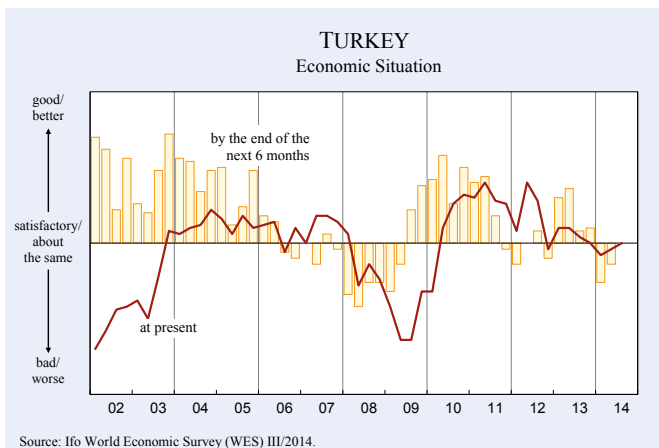
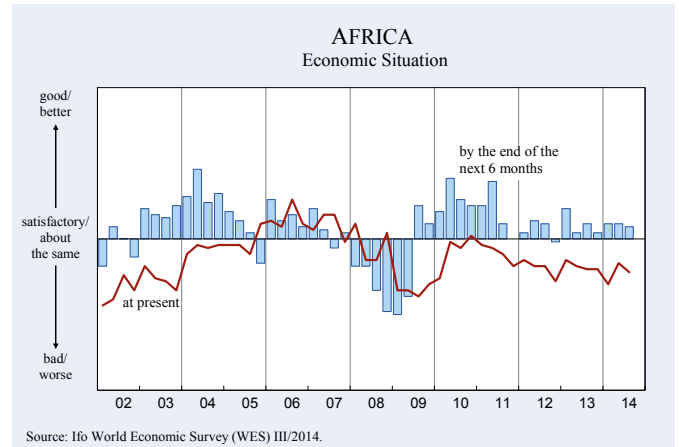
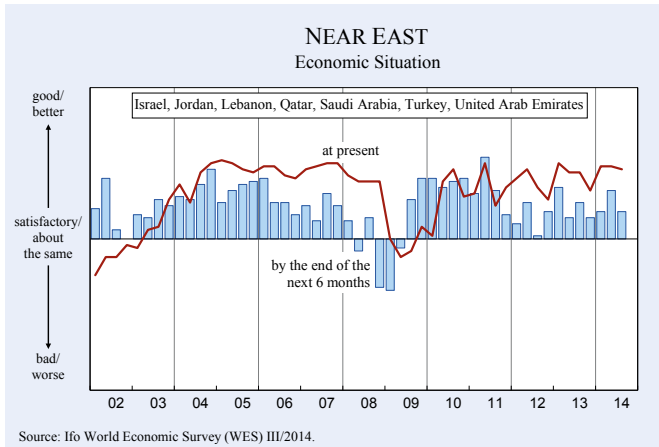
Figure 9

LATIN AMERICA



**Figure 10**

## NEAR EAST AND AFRICA



**Table 1**

Supply of bank credit to firms, extent of constraint	
Not constrained	
Australia	9.0
Canada	8.7
Japan	8.1
Colombia	7.6
Peru	7.6
Taiwan	7.6
Switzerland	7.4
Germany	7.1
Lesotho	7.0
Paraguay	7.0
Moderately constrained	
Czech Republic	6.9
Chile	6.8
Sweden	6.8
United States	6.8
Israel	6.7
Philippines	6.7
New Zealand	6.6
Norway	6.6
Turkey	6.6
Finland	6.5
Uruguay	6.5
Brazil	6.4
Slovakia	6.4
Thailand	6.3
Austria	6.1
France	6.1
Lithuania	6.1
South Africa	6.0
Croatia	5.8
Malaysia	5.8
Kenya	5.7
Poland	5.7
Sri Lanka	5.7
Denmark	5.6
India	5.6
Romania	5.6
Togo	5.5
Belgium	5.4
Pakistan	5.4
Latvia	5.3
Argentina	5.0
Bulgaria	5.0
Hong Kong	5.0
Kosovo	5.0
Mexico	5.0
Morocco	5.0
South Korea	5.0
United Kingdom	5.0
Vietnam	5.0
Kazakhstan	4.5
Netherlands	4.3
Russian Federation	4.1
China	4.0
Egypt	4.0
Zambia	4.0
Strongly constrained	
Hungary	3.9
Nigeria	3.7
Cabo Verde	3.5
Spain	3.3
Portugal	3.1
Italy	2.9
Greece	2.2
Zimbabwe	2.2
Slovenia	2.1

Only countries with more than four responses were included in the analysis.  
**WES scale:** 9 – not-, 5 – moderately-, 1 – strongly constrained  
 Source: Ifo World Economic Survey (WES) III/2014.

ther. Both the present economic situation and economic expectations recovered slightly, and finally returned to positive territories once again.

#### Africa: No unified economic trend

Countries in *Africa* display a highly differentiated pattern as far as the economic climate is concerned. Thus, an aggregated climate index for the countries surveyed by WES on this continent makes little sense, and the following analysis will focus on specific economic trends in the individual countries of *Northern* and *Sub-Saharan Africa*.

The economic climate for *Northern Africa*, which includes *Algeria, Egypt, Morocco* and *Tunisia*, remained unchanged compared to the previous survey. The downturn in assessments of the present economic situation was compensated for by improved economic expectations. In *Algeria*, no changes were recorded and the present situation was assessed as satisfactory and likely to remain so for the next six months. Here, the experts surveyed expect a strengthened export sector by the end of this year. In *Morocco* WES experts downwardly revised their previous assessments of the current state of the economy from satisfactory sentiment in the light of the present state of their economy down in an unfavourable one. The economic outlook also clouded over somewhat and signals caution with regard to future economic developments. In *Egypt* and *Tunisia* the current economic situation was assessed more unfavourably than in the previous survey. The economic outlook in both countries is more positive than three months ago and current weak economic conditions are likely to ease slightly in the months ahead.

The economic climate indicator for *South Africa* clouded over more strongly. The present economic situation deteriorated further and resulted in the lowest assessments by WES experts since the end of 2009. Economic expectations are also less positive, and WES experts do not expect the situation to improve over the next six months (see Figure 10). In *Angola, Comoros, Ethiopia, Liberia, Malawi, Nigeria, Senegal, Tanzania* and *Togo* the current economic situation did not change compared to the previous survey and was once again assessed as satisfactory. In all of these countries, current economic performance is expected to remain good. However, in *Nigeria*, WES experts expect political instability to increase and thus to negatively affect the investment climate for foreign investors (see Table 2). In *Congo*

*Brazzaville, Ivory Coast, Mauritania, Namibia and Uganda*, assessments of the present economic situation were somewhat less favourable than in July. However, with economic expectations in far more positive territory, current good economic conditions are likely to persist. In *Benin, Congo Dem. Republic, Gambia and Sierra Leone* a favourable economic situation continues to prevail, albeit to a greater extent than in the previous survey, according to WES experts. In *Lesotho and Zambia*, more economic experts than three months ago expressed satisfaction with the current economic state of their countries and their respective economic outlooks. In *Kenya and Mauritius*, appraisals of the current economic situation turned unfavourable and are likely to remain subdued in the months ahead. In *Burundi, Cabo Verde, Madagascar, Niger, Sudan, Swaziland and Zimbabwe* the situation remains weak, despite the slight upwards revisions observed in some of these countries. While WES experts forecast some improvement for *Cabo Verde, Madagascar and Sudan* in the months ahead, they remain cautious about the other countries cited above.

#### **Inflation expectations remain low**

On a worldwide average, WES experts' inflation forecasts for the year 2014 remain unchanged at 3.2% (see Table 4).

On average for the *euro area* the presumable inflation rate in 2014 will be 1.1%, which is a tick lower than estimated three months ago (1.2%). Thus, the expected inflation rate for 2014 falls clearly short of the ECB inflation target of slightly below 2.0%. Within the *euro area* the lowest inflation rates in 2014 are again expected in the "crisis countries": namely in *Greece* (-0.4%), *Cyprus* (-0.1%), *Ireland* and *Portugal* (both 0.7%) as well as *Italy* and *Slovenia* (both 0.9%). Above the average of the *euro area* lie the expected inflation rates particularly in *Latvia* (2.4%) and to lesser degree in *Austria* too (1.8%).

In *Western Europe* outside the *euro area* inflation expectations for 2014 range from 0.3% in *Switzerland* to 2.0% both in the *United Kingdom* and in *Norway*. In the preceding survey this span was even larger due to a slight decline in 2014 inflation expectations in the *UK* (see Table 4). In *Eastern Europe* the inflation rate forecast for 2014 continued to shrink somewhat (from 2.0% in early 2014 to 1.7% in April to now 1.3%). The slow-down in inflation expectations compared with last year's estimates (2.4% in mid-2013) is even more pronounced.

**Table 2**

Legal and administrative restrictions for foreign firms	
Absent	
Sweden	7.7
Uruguay	7.7
Lithuania	7.3
Bulgaria	7.0
Germany	7.0
Hong Kong	7.0
Rather low	
Finland	6.9
Chile	6.8
Netherlands	6.8
Denmark	6.7
Norway	6.6
Latvia	6.5
Paraguay	6.5
Kazakhstan	6.3
Poland	6.3
Switzerland	6.3
Belgium	6.2
Spain	6.2
Colombia	6.1
Czech Republic	6.1
Romania	6.1
Slovakia	6.1
Slovenia	6.1
Australia	6.0
New Zealand	5.9
Portugal	5.9
Turkey	5.9
Israel	5.6
Peru	5.6
United Kingdom	5.6
Austria	5.5
Togo	5.5
Japan	5.4
Canada	5.3
Mexico	5.3
France	5.0
Kenya	5.0
Lesotho	5.0
Morocco	5.0
United States	5.0
Vietnam	5.0
Zambia	5.0
South Africa	4.8
Taiwan	4.8
Greece	4.7
India	4.7
Brazil	4.6
South Korea	4.6
Thailand	4.5
Croatia	4.3
Nigeria	4.3
Pakistan	4.3
Kosovo	4.2
Malaysia	4.2
Rather high	
Hungary	3.9
Italy	3.8
Bolivia	3.7
Sri Lanka	3.7
Cabo Verde	3.5
Philippines	3.3
Russian Federation	2.9
China	2.5
Egypt	2.5
Zimbabwe	1.8
Argentina	1.3

Only countries with more than four responses were included in the analysis. **WES scale:** 9 - absent, 5 - low, 1 - high  
Source: Ifo World Economic Survey (WES) III/2014.



WES experts expect the lowest price increases in 2014 to be seen in *Slovakia* (0.8%) and *Slovenia* (0.9%). The highest inflation expectation in the region came once again from *Serbia* (5.8%), where the new estimate even signals some worsening on the inflation front (3.5% in the preceding survey).

In **North America**, the 2014 inflation forecast picked somewhat up over the past three months (2.1% compared to 1.8% in April). The 2014 inflation rate in *Canada* will be slightly lower than in the *USA* (1.9% compared to 2.2%).

In **Asia** inflation expectations for 2014 rose marginally compared to the April survey (from 3.4% to 3.5%). However, by country the changes from the preceding survey are often significantly more pronounced: In *Japan* inflation expectations for 2014 rose to 2.2% from 1.8% according to the previous survey and an estimated 1.5% at the beginning of the year. Thus, the Abe government appears to be reaching its inflation target faster than the medium-term growth target for the real economy. In some other *Asian* countries inflation expectations for 2014 also increased more strongly than on total average since the preceding survey: from 5.5% to 6.3% in *Indonesia*, from 3.7% to 4.1% in *Hong Kong* and from 6.9% to 7.2% in *India*. In *China*, the economically most important country in the region, the inflation outlook for 2014 remains practically unchanged (3.1% after 3.0% in the April survey).

In **Oceania** inflation expectations for 2014 were marginally lower than in the previous survey (2.6% compared to 2.7%). This small change was caused entirely

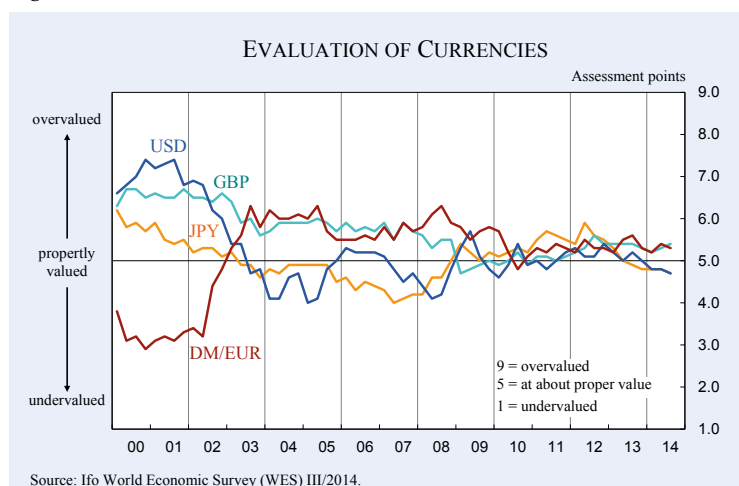
by slightly reduced inflation expectations in *Australia*, whereas these remain unchanged at 2.2% in *New Zealand*.

Inflation expectations for 2014 also declined marginally in recent months (from 10.8% to 10.6%) in **Latin America**. However, this was not a general trend, but was mainly due to a somewhat brighter inflation outlook, particularly in *Guatemala* (4.0% after 4.5%) and *Cuba* (3.0% after 3.5%). The inflation performance in *Venezuela* in particular, by contrast, is expected to worsen further (59.6% after 55.6%). In most other *Latin American* countries like *Brazil* (6.5%), *Colombia* and *Peru* (both 3.1%) as well as in *Mexico* (4.1%), inflation expectations for 2014 remain more or less stable.

In **CIS** countries inflation expectations for 2014 remained largely unchanged (8.7% compared with 8.6% in the previous survey). However, behind this almost stable average a strong increase in price expectations is evident, particularly in the *Ukraine* (from 12.4% to 18.0%), whereas inflation will slow down somewhat according to WES experts in *Kazakhstan* (from 8.6% to 7.5%) and *Kyrgyzstan* (from 7.0% to 5.5%). In *Russia*, WES experts expected an inflation rate of 7.5%, for 2014 compared with 7.7% in April. However, the economic sanctions decided most recently by governments in the EU and in the USA may cause some shortages in Russia, which may ultimately result in stronger price increases than originally expected.

In the **Near East** inflation expectations for 2014 picked up moderately (from 4.4% to 4.6%). The expected increase in inflation came mainly from *Saudi Arabia* (4.3% after 3.4%), *Turkey* (8.6% after 8.2%) and the *United Arab Emirates* (3.4% after 3.0%).

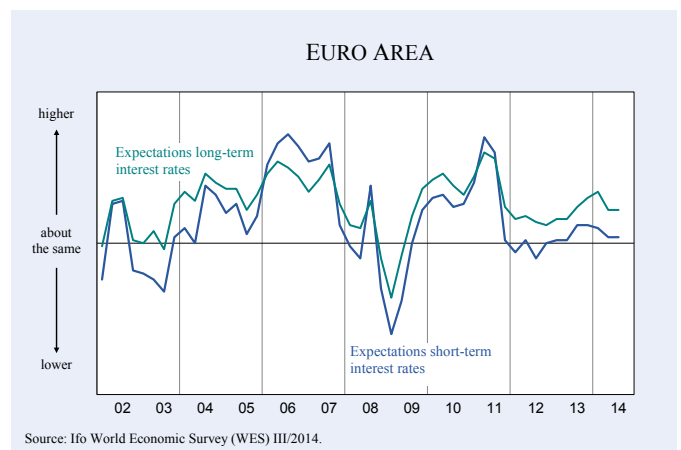
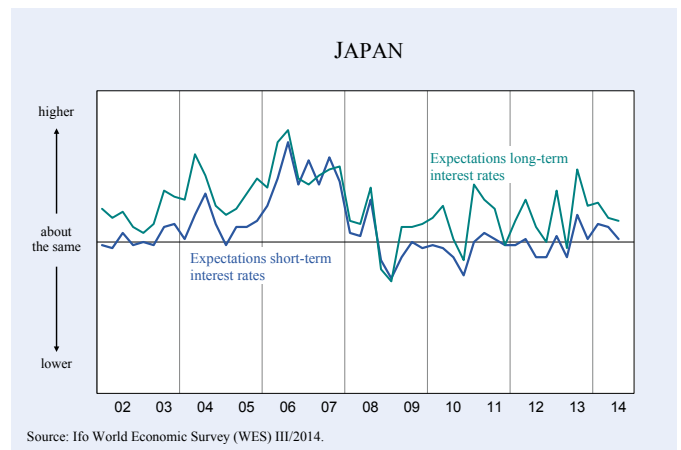
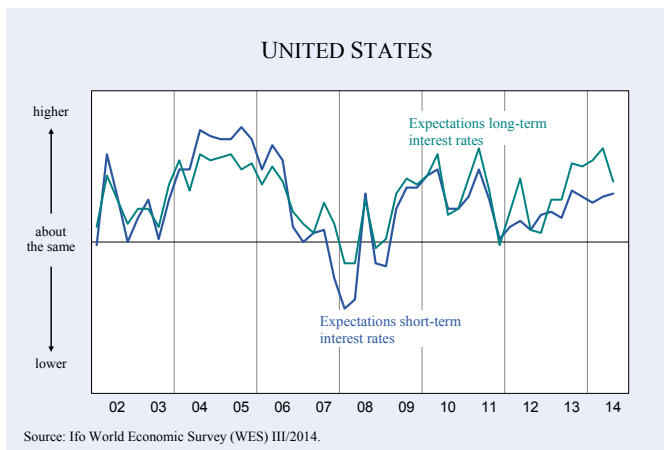
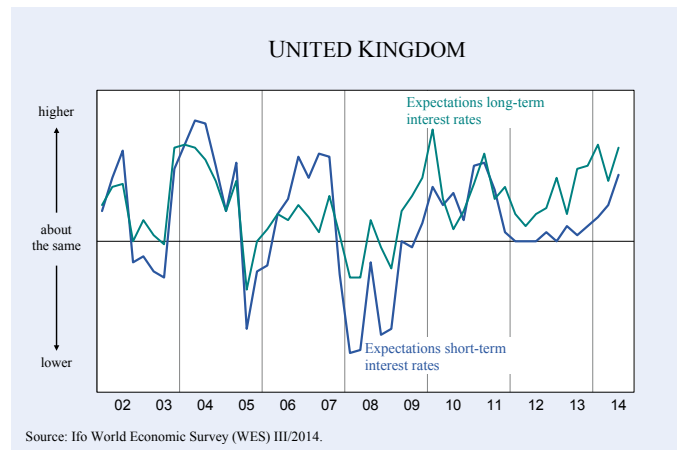
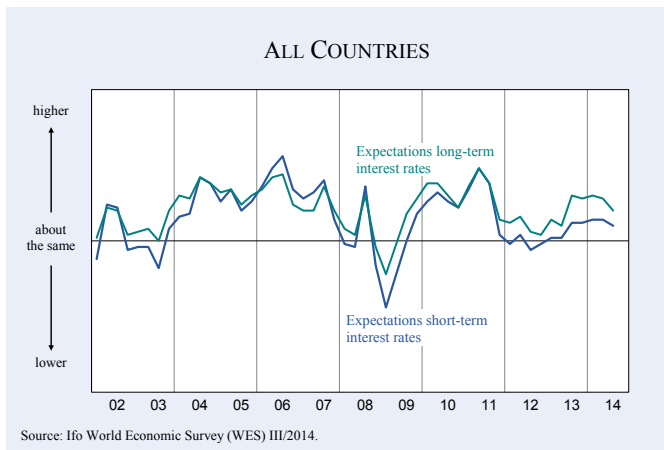
Figure 11



In **Africa** price trends remain very heterogeneous. But generally speaking, the decelerating inflation trend, which had been observed for some time, did not continue. According to the recent survey, inflation expectations for 2014 increased from 6.8% to 7.1%. Price increases were concentrated in a few countries (e.g. *Kenya*, *Malawi*, *Madagascar* or *Sudan*), whereas price expectations remain almost unchanged in the other countries covered in the survey.

**Figure 12**

**EXPECTED TREND FOR THE NEXT 6 MONTHS  
FOR SHORT- AND LONG-TERM INTEREST RATES**



### US Dollar expected to rise

Whereas the *euro* and the *UK pound* continue to be seen by WES experts on worldwide average as somewhat overvalued, the *US dollar* and equally the *Japanese yen* appear undervalued, and slightly more so than in the previous survey (Figure 11).

By country major differences remain in currency evaluation: WES experts assessed their own currency as generally undervalued in some *Eastern European* countries (*Bulgaria* and *Czech Republic*), in some *CIS* countries (*Armenia*, *Kazakhstan* and the *Russian Federation*), in a few *Asian* countries (*India* and the *Philippines*), in the *Latin American* country *Dominican Republic* and in a series of *African* countries (*Namibia*, *Nigeria*, *Sierra Leone*, *Swaziland* and *Uganda*).

In the *USA* the *euro* and the *British pound* appear to be overvalued, whereas the *Japanese yen* is considered as somewhat undervalued. In *Canada*, the *euro*, the *British pound* and the *yen* are also seen as overvalued; however, the *US dollar* vis-à-vis the *Canadian dollar* is seen as undervalued. In *Switzerland* both the *US dollar* and the *euro* still appear to be undervalued, while the *British pound*, in turn, is seen as somewhat overvalued by comparison to the *Swiss franc*.

The answers to a supplementary survey question on the likely development of the *US dollar* in the next six months, regardless of how currencies are assessed from a fundamental point of view, signal on a world-wide average like previous time an expected rising value of the *US dollar* in the course of the coming six months.

On the other hand a weakening of the *US dollar* is expected in *China*, *India*, *South Korea*, *Taiwan* and *Thailand*.

### Only a very moderate rise in long-term interest rates is expected

On a worldwide scale, long-term interest rates are expected to increase somewhat over the course of the next six months; but this is expected by a smaller share of WES experts than in the previous survey. Short-term interest rates will – according to WES experts – remain stable in the remaining part of the year. In the *USA* and in *Oceania* – both in *Australia* and *New Zealand* – a higher share of WES experts than on total average expect both long- and short-term interest rates to increase over the course of the coming six months; but the expected hike in interest rates is also less pronounced than in the previous survey.

*China* and *India* belong to the few countries where interest rates – both short- and long-term rates – are expected to decline in the months ahead. Whereas in *India* this movement had already been expected in preceding surveys, in *China* this signifies a reversal in interest expectations.

### Supply of bank credit to firms

Given the problems encountered by firms in some countries concerning access to bank credit, a specific question was added to the regular questionnaire in 2013 on a bi-annual term (January and July). WES experts are asked to assess to what extent the supply of bank credit to firms in the country they are reporting for is constrained by bank-specific factors (e.g. banks' health or banking regulation). The scale ranges from “not constrained” (9), to “moderately constrained” (5) to “strongly constrained” (1) (see Table 1).

**Table 3**  
Assessment of the following factors influencing the climate for foreign investors in the next six months

Climate due to	Change for the next six months *	
	Deterioration	Improvement
Legal/administrative restrictions to invest and/or to repatriate profits		Cabo Verde, China, India, Mexico, Togo
Political stability	Greece, Israel, Lesotho, Nigeria	Cabo Verde, Egypt, India, Slovenia

\* For the countries that are not mentioned in the table, no major changes relating to the climate for foreign investors are expected during the next six months. Only countries with more than four responses were included in the analysis.

**Criteria for selection of countries:** Deterioration: WES grade between 1.0 and 3.5  
Improvement: WES grade between 6.0 and 9.0

Source: Ifo World Economic Survey (WES) III/2014.

**Table 4 Inflation rate expectations for 2014 (based on WES QIII/2014 and WES QII/2014)**

Region	QIII/2014	QII/2014	Region	QIII/2014	QII/2014
<b>Average of countries *</b>	<b>3.2</b>	<b>3.2</b>	<b>Latin America</b>	<b>10.6</b>	<b>10.8</b>
High-income countries	2.1	2.0	Argentina	36.9	36.2
Middle-income countries	7.4	7.3	Bolivia	6.7	6.7
Upper-middle	7.3	7.3	Brazil	6.5	6.4
Lower-middle	7.8	7.1	Chile	3.9	3.5
Low-income countries	6.5	6.6	Colombia	3.1	2.9
EU 28 countries	1.2	1.4	Costa Rica	(5.5)	(5.0)
EU countries (old members) <sup>a)</sup>	1.2	1.3	Cuba	(3.0)	(3.5)
EU countries (new members) <sup>b)</sup>	1.2	1.7	Dominican Republic	4.4	4.5
Euro area <sup>c)</sup>	1.1	1.2	Ecuador	3.4	3.5
			El Salvador	1.9	1.6
<b>Western Europe</b>	<b>1.2</b>	<b>1.3</b>	Guatemala	4.0	4.5
Austria	1.8	1.8	Mexico	4.1	4.1
Belgium	1.1	1.2	Panama	(5.6)	(5.6)
Cyprus	-0.1	-0.3	Paraguay	5.6	5.4
Denmark	0.9	1.2	Peru	3.1	3.2
Finland	1.3	1.5	Trinidad and Tobago	(6.0)	(6.5)
France	0.8	1.2	Uruguay	8.5	8.4
Germany	1.3	1.5	Venezuela	59.6	55.6
Greece	-0.4	-0.1			
Ireland	0.7	0.7	<b>CIS</b>	<b>8.7</b>	<b>8.6</b>
Italy	0.9	0.9	Armenia	7.5	7.0
Luxembourg	1.2	1.3	Kazakhstan	7.5	8.6
Monaco	1.7	1.3	Kyrgyzstan	5.5	7.0
Netherlands	1.2	1.5	Russia	7.5	7.7
Norway	2.0	2.3	Ukraine	18.0	12.4
Portugal	0.7	0.9	Uzbekistan	(7.0)	(12.6)
Spain	0.8	0.9			
Sweden	0.5	0.8	<b>Near East</b>	<b>4.6</b>	<b>4.4</b>
Switzerland	0.3	0.3	Israel	1.6	2.1
United Kingdom	2.0	2.2	Jordan	(4.8)	4.6
			Lebanon	(4.0)	(6.0)
<b>Eastern Europe</b>	<b>1.3</b>	<b>1.7</b>	Qatar	(3.6)	(4.9)
Albania	(2.0)	2.3	Saudi Arabia	4.3	3.4
Bosnia and Herzegovina	1.7	1.8	Turkey	8.6	8.2
Bulgaria	1.5	1.2	United Arab Emirates	3.4	3.0
Croatia	1.3	1.3			
Czech Republic	1.2	1.4	<b>Africa</b>	<b>7.1</b>	<b>6.8</b>
Estonia	1.3	1.9	<b>Northern Africa</b>	<b>5.6</b>	<b>5.6</b>
Hungary	1.1	1.9	Algeria	2.7	3.3
Kosovo	1.0	1.5	Egypt	12.9	12.1
Latvia	2.4	2.1	Morocco	2.7	2.2
Lithuania	1.2	1.4	Tunisia	5.5	5.4
Macedonia	1.5	2.0	<b>Sub-Saharan Africa</b>	<b>7.9</b>	<b>7.5</b>
Poland	0.9	1.6	Angola	(7.7)	(7.9)
Romania	2.9	3.4	Benin	2.3	2.9
Serbia	5.8	3.5	Burkina Faso	(3.0)	---
Slovakia	0.8	1.2	Burundi	(25.0)	(24.0)
Slovenia	0.9	1.2	Cabo Verde	2.4	2.4
			Comoros	(4.0)	(3.0)
<b>North America</b>	<b>2.1</b>	<b>1.8</b>	Congo Dem. Rep.	2.0	2.1
Canada	1.9	1.7	Congo-Brazzaville Rep.	3.3	3.4
United States	2.2	1.9	Ethiopia	(9.0)	(12.0)
			Gabon	(3.3)	(2.8)
<b>Oceania</b>	<b>2.6</b>	<b>2.7</b>	Gambia	(5.6)	5.4
Australia	2.7	2.8	Ivory Coast	2.9	2.9
New Zealand	2.2	2.2	Kenya	8.3	7.2
			Lesotho	6.1	6.2
<b>Asia</b>	<b>3.5</b>	<b>3.4</b>	Liberia	(9.0)	(8.0)
Bangladesh	7.4	7.1	Madagascar	7.5	7.0
China	3.1	3.0	Malawi	(21.0)	(15.0)
Hong Kong	4.1	3.7	Mauritania	5.9	6.5
India	7.2	6.9	Mauritius	3.9	4.3
Indonesia	6.3	5.5	Namibia	6.0	6.1
Japan	2.2	1.8	Niger	2.5	(2.5)
Malaysia	3.7	3.8	Nigeria	8.2	8.1
Pakistan	9.4	9.9	Sierra Leone	8.3	8.8
Philippines	4.2	3.9	South Africa	6.5	6.3
Singapore	(3.0)	(3.0)	Sudan	38.8	37.3
South Korea	2.3	2.6	Swaziland	6.7	6.4
Sri Lanka	7.0	7.9	Tanzania	8.0	10.8
Taiwan	1.6	1.4	Togo	2.5	2.8
Thailand	2.5	2.8	Uganda	5.3	5.8
Vietnam	5.9	5.9	Zambia	8.5	8.1
			Zimbabwe	1.3	1.8

\* 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. - ( ) The data in brackets result from few responses. - <sup>a)</sup> Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom. - <sup>b)</sup> Czech Rep., Cyprus, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovenia, Slovakia, Bulgaria, Romania, Croatia. - <sup>c)</sup> Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Luxembourg, Malta, Netherlands, Portugal, Spain, Slovenia, Slovakia.

Source: Ifo World Economic Survey (WES) III/2014 and II/2014.

Countries with a high degree of credit constraints comprise – according to WES experts – the “euro crisis countries”, although some improvement is also noticeable here. In *Greece*, for example, the rating increased from 1.0 in the previous two surveys to 2.2 now. In *Spain* (3.3 compared to 2.6 in January 2014 and 1.7 in July 2013), *Slovenia* 2.1, unchanged from January 2014 and 1.4 in July 2013, and *Portugal* (3.1 compared with 2.8 in January and 2.3 in July 2013) there was some improvement, although the credit situation for firms remains still critical. In *Italy* the grade for credit constraint reached 2.9 and is thus almost unchanged from the previous two results (2.7 respectively 2.8 in July 2013).

Apart from the “euro crisis countries” mentioned, *Hungary* and *Zimbabwe* also belong in all three surveys to the group of countries with strongly constrained credit conditions for firms. Newcomers in this problematic category are *Nigeria* and *Cabo Verde* this time. On the other hand, the *United Kingdom* left this group and now belongs, like the majority of countries, to the category “moderately credit constrained”.

The top category “not credit constrained” comprises of countries like *Australia*, *Canada*, *Japan*, *Switzerland*, *Colombia*, *Peru* and *Paraguay*, but also includes *Taiwan*, *Germany* and *Lesotho*, according to the latest survey.

As a general conclusion, it can be stated that credit availability situation has improved somewhat, but is still far from satisfactory in many countries. The main reason for these differences is the fact of a financial crisis recession as experienced in 2008/2009 on a worldwide scale is typically accompanied by a credit crunch, particularly if banks in a country are weak and have to run through a more or less long deleveraging process.

### Special question on the economic impact of the Ukraine crisis

The downing of the Malaysia Airlines flight *MH17* on the 17<sup>th</sup> of July marked a serious escalation of the Ukraine crisis and was immediately followed by a new round of Western sanctions against Russia. Although the crisis is undoubtedly causing a human tragedy in the eastern Ukraine, its economic consequences were, at least until recently, perceived as a regional issue – concerning mainly the Ukraine, Russia and their immediate

neighbours.<sup>1</sup> As assessments of the International Monetary Fund reveal, potential spillovers are assumed to follow established trade and financial linkages and to be largely limited to Eastern Europe and to the Commonwealth of Independent States (CIS).<sup>2</sup> In order to review this belief this quarter’s WES asked economic experts to evaluate three special questions: (1) on the negative impact of the crisis for their host country, (2) on the main transmission channels, and (3) on their risk assessments for the world economy.

Figure 13 at the top presents the experts’ appraisals of the crisis’ negative impact on their host countries. Appraisals are provided on a four-category scale ranging from “not at all” to “weak”, “moderate” and “strong”. At first glance, the figure reveals the expected regional distribution. At the core of the conflict in Ukraine and Russia, experts assess the economic impact to be strong. Indeed, according to the July update of its World Economic Outlook, the IMF downwardly revised its growth forecast for Russia for 2014 once again compared to its April forecast from 1.3% to 0.2%.<sup>3</sup> In addition, the World Bank expects the tensions in Russia and the Ukraine to lower GDP growth in 2014 by 1.7 and 7.0 percentage points for these countries respectively; while the effect on GDP growth for Europe and Central Asia in total is expected to amount to about one percentage point.<sup>4</sup> According to the survey results, the largest spillovers are expected by Finland and Estonia, which also report strong economic impacts, most probably due to their close ties to Russia via trade and supply chain linkages. In addition, for 13 East and South East European economies the effects are assessed to be moderate. However, for Western Europe and the rest of the world, the experts surveyed report rather weak or even no effects at all. Assessments of the impact are lowest for Latin America and Africa in particular. However, due to the timing of the survey, the vast majority of the experts responded before the downing of the Malaysia Airlines flight *MH17* on July 17<sup>th</sup>. Consequently, their responses may reflect a lower bound of likely already deteriorated current beliefs. Thus, the documented widespread perception of the Ukraine crisis having at least some

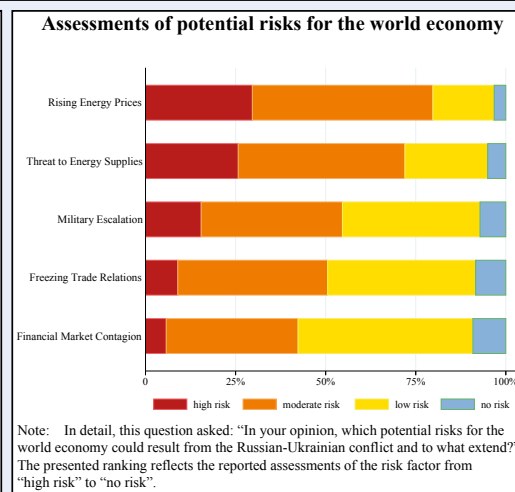
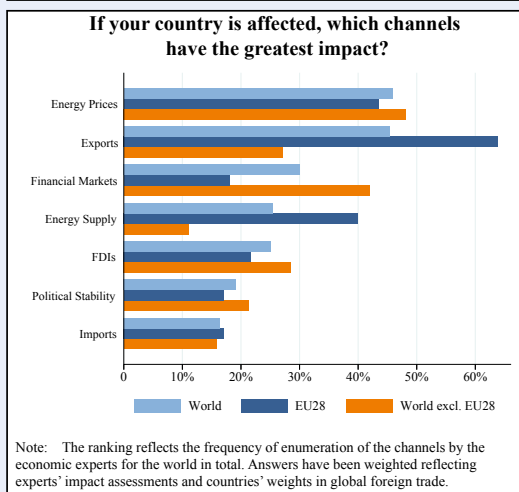
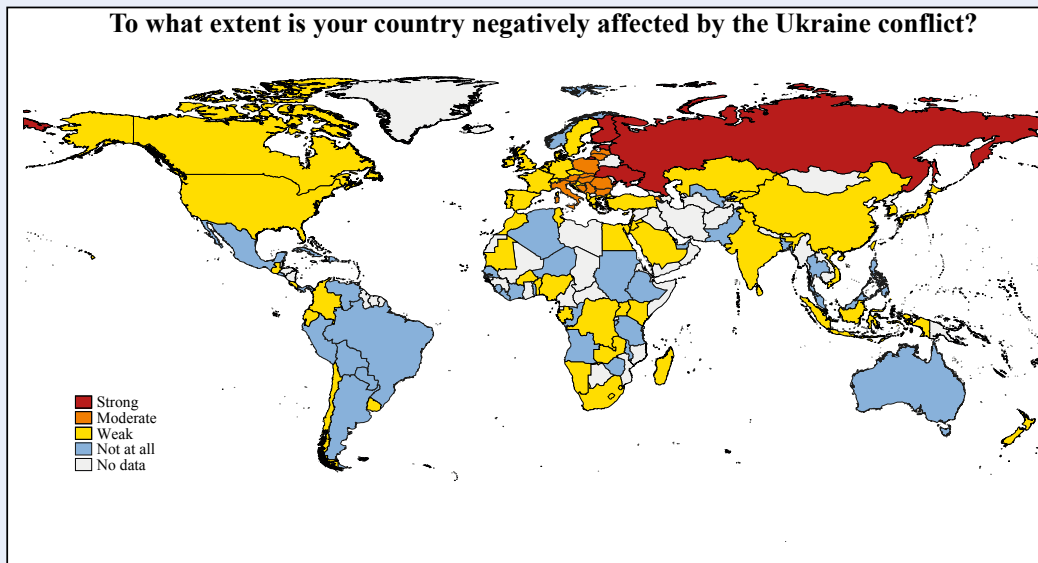
<sup>1</sup> See, for example, the IMF 2014 Spillover Report.

<sup>2</sup> See, for example, Aasim M. Husain, Anna Ilyiana and Li Zeng, “Europe’s Russian Connections”, posted on August 1st, 2014, on iMFDirect, hyperlink: <http://blog-imfdirect.imf.org/2014/08/01/europes-russian-connections/>; and Alberto Behar, “Links and Levers: How the Caucasus and Central Asia Are Tied to Russia”, posted on August 1st, 2014, on iMFDirect, hyperlink: <http://blog-imfdirect.imf.org/2014/08/01/links-and-levers-how-the-caucasus-and-central-asia-are-tied-to-russia/>.

<sup>3</sup> See the transcript of the IMF press briefing on the World Economic Outlook (WEO) Update on July 24<sup>th</sup>, hyperlink: <https://www.imf.org/external/np/tr/2014/tr072414a.htm>.

<sup>4</sup> See the World Bank, Global Economic Prospects, June 2014.

Figure 13



Source: Ifo World Economic Survey (WES) III/2014.

impact, even on more distant economies, is noteworthy and challenges the assumption of locally bounded spillovers to some extent.

Turning to the relevant economic transmission channels, Figure 13 on the left below presents a ranking of seven potential channels that reflects the frequency of their selection by the surveyed experts.<sup>5</sup> According to the ranking, crisis spillovers are expected to largely emerge through higher energy prices and weaker exports, with both channels assessed as among the most important ones by almost half of all survey respondents globally. These are followed by financial market spillovers,

short falls in energy supply, lower foreign direct investments, political stability concerns and adverse effects on imports. However, the channels' relevance varies with economic proximity. In particular, for the European Union (EU28) economies, expected losses through weaker exports into the crisis region seem to weigh much more than a potential rise in energy prices. In addition, worries about energy supply shortfalls are much more evident, while financial market spillovers are of less concern relative to the rest of the world, and particularly related to emerging economies.

Finally, in a third question experts were asked to assess five potential risks for the world economy on a four-category scale ranging from "no risk" to "high risk".

<sup>5</sup> More precisely, experts were asked to choose the most important channels from a preselected list. Multiple answers were allowed.

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According to Figure 13, right below, the highest risk perception is associated with rising energy prices. About one third of the respondents even described the related risk for the world economy as high. In addition, one fourth of the surveyed experts see a high risk stemming from a threat to energy supplies, while 15 percent claim a high risk being associated with a military escalation. This is particularly noteworthy, since the vast majority of the responses to this survey arrived before the downing of the Malaysia Airlines flight *MH17* and the resulting rise in geopolitical tensions in Russia and the Ukraine. Furthermore, fewer than ten percent of respondents identified freezing trade relations or financial market contagion as a source of high risk for the world economy. However, in total, 47 percent of the experts appraised at least one of the five potential risks for the world economy as high.

In summary, this special survey on the Ukraine crisis reveals that the economic impact is concentrated, but not limited to Russia's and Ukraine's immediate neighbours. For Europe and the CIS economies, trade linkages and energy supply shortages are of greater concern than for the rest of the world, while for more distant economies spillovers are expected to emerge from energy prices and financial markets. Finally, although still a local conflict, the Ukraine crisis is perceived as a high risk for the world economy by almost every second survey respondent. This emphasizes the urgent need for the political powers involved to de-escalate the conflict.



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