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CESifo WORLD ECONOMIC SURVEY

VOLUME 14, No. 3

AUGUST 2015

WORLD ECONOMIC CLIMATE

World Economic Climate cools down

ECONOMIC EXPECTATIONS

Economic expectations remain positive

INFLATION

Low inflation expectations,
particularly in Europe

CURRENCIES

US Dollar seen as overvalued,
but expected to rise further

INTEREST RATES

Interest rates set to diverge

SPECIAL TOPIC

Seniority expectations of rescue funds
in Europe

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Regions

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- Africa: Economic climate clouds over heavily

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 2015*, *1,101* economic experts in *117* 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.

Ifo WORLD ECONOMIC CLIMATE COOLS DOWN

After recovering somewhat in the first half of the year, the Ifo Index for the world economy fell in the third quarter. The indicator's present level of 95.9 is now slightly below its long-term average of 96.1. While assessments of the current economic situation were downgraded compared to last quarter, expectations remained positive (see Figures 1 and 2). The economic climate deteriorated in nearly all regions, and demonstrates the currently lacking momentum in the ongoing upswing of the world economy (see Box 1).

Still waiting for a consolidated upturn

The pace of world economic growth slowed markedly at the beginning of this year. In line with this development, the expansion rate of industrial production – both in industrial and emerging economies – slowed down considerably compared to the end of 2014. Moreover, after a sharp increase in the second half of 2014, there was a slowdown in world trade in the first quarter of 2015. However, there are strong indications that the weakening in the world economy is only of a short-term nature and will be largely overcome in the latter course of this year. The slowdown in the first quarter was largely due to one-off special factors in the USA, which will not have any further impact in the forecasting period. Moreover, the world economy is expected to benefit from developments in oil prices. The price of a barrel of Brent fell from 112 US dollars in June 2014 to 48 US dollars in January 2015, recovered early this year to reach 65 US dollars, but fell again recently to a comparatively low level of nearly 50 US dollars. The massive reduction in the price of this key commodity is

expected to give those countries and regions that are net oil importers a strong economic boost. Monetary policy in the major advanced economies remains very expansive. Trends in the degree of monetary policy expansion in recent months have diverged significantly. While an interest rate turnaround will most likely be introduced during the forecasting period in the USA and the United Kingdom, the European Central Bank and the Bank of Japan have massively expanded their bond-buying programmes in recent months, and have signaled their readiness to leave base rates at their current level of almost zero beyond the forecasting period. This monetary policy divergence has given rise to marked exchange rate fluctuations since the

Figure 1

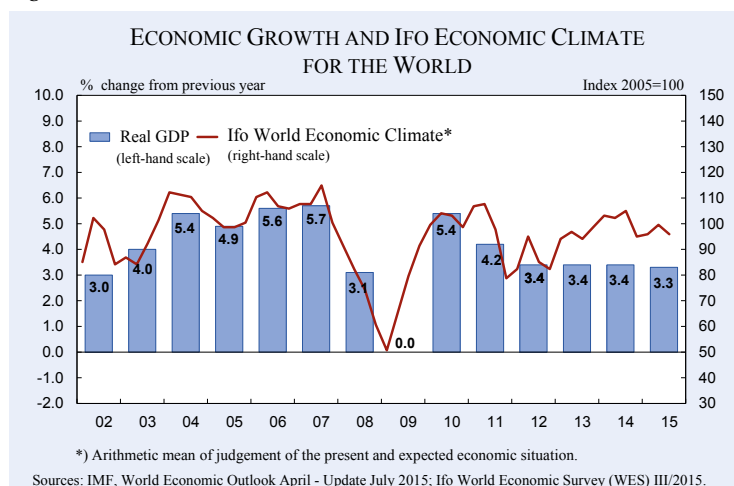


Figure 2

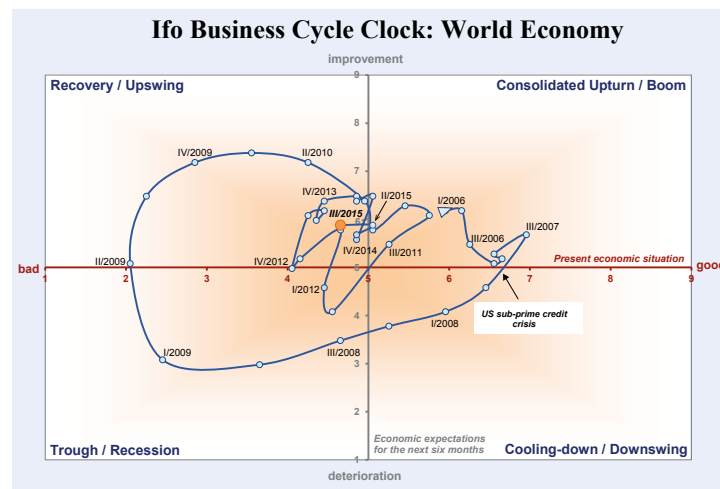


Box 1

Ifo Business Cycle Clock for the World Economy

A glance at the Ifo Business Cycle Clock, showing the development of the two components of the economic climate in recent 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 fell slightly. Assessments of the current economic situation turned negative again on balance. Economic expectations remained as positive as in the previous survey. As a result, the indicator showed a sideward movement from the “consolidated upturn”-quadrant back to the recovery/upswing quadrant. The upturn in the global economy, which seemed to have consolidated in the second quarter, has suffered a setback.



Source: Ifo World Economic Survey (WES) III/2015.

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 upswinging phase (top left quadrant).

both regions, although the climate remains very undercooled. While less favourable assessments of the current economic situation led to a clouding over of the economic climate in *North America, Oceania, Asia* and the *Near East*, the deterioration in *Europe* and *Africa* was due to less positive economic expectations.

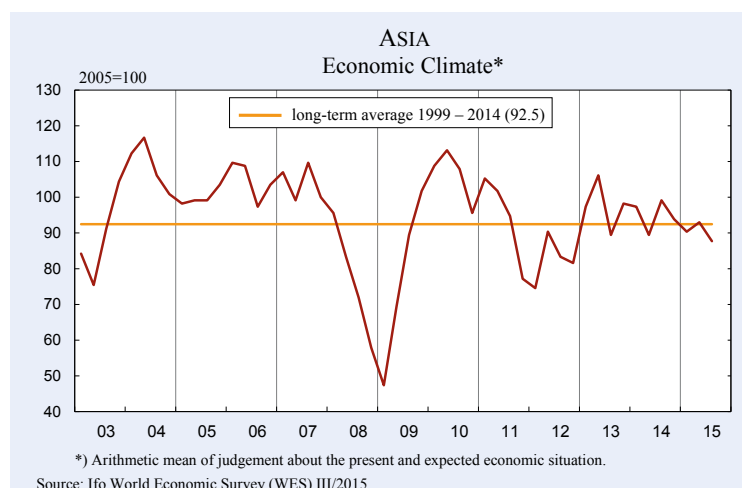
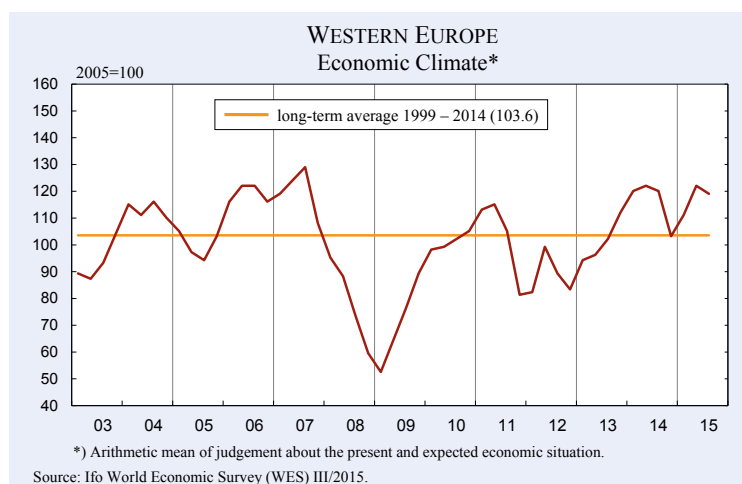
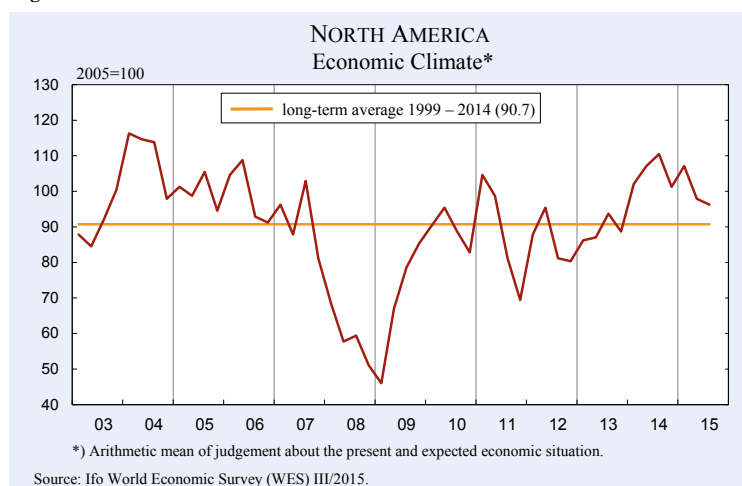
After a temporary setback in early 2015, world economic activity is expected to have picked up considerably in the second quarter and looks set to expand over the course of the year. This expansion is not contradicted by the slight cooldown in the economic climate, as it will be driven by the delayed effect of the sharp fall in oil prices at the end of last year. Although oil exporting countries are partly plagued by massive income losses, the majority of economies that are net oil importers – including the major advanced countries, as well as key emerging economies – are comparatively willing to spend their money. Oil price developments will accordingly have a positive net effect on the world economy. Since this effect will gradually fade over the year ahead, the pace of world growth will probably slow slightly. The economic development of

middle of last year. The euro and the Japanese yen have depreciated massively, while the reverse was seen in the US dollar and the British pound. The degree of expansion in monetary policy also differed considerably in emerging economies over the second half of last year.

The Ifo World Economic Climate deteriorated in nearly all regions. Nonetheless the indicator in *Europe* and *North America* still remained at a relatively high level, while it sank below its long-term average in *Asia* and *Africa*. The index continued to fall in the *Near East* and *Oceania*, dropping to its lowest level in six years. In the *CIS* states and *Latin America*, however, the indicator’s descent ground to a halt, with a slight recovery seen in

the major advanced economies will also be influenced by strong adjustments in nominal exchange rates that began in mid-2014. Developments in US exports are expected to remain constrained by the strengthening of the dollar. Demand for goods and services from the *euro area* and *Japan*, by contrast, is expected to grow increasingly dynamically. The *USA*’s aggregate economic output will nevertheless expand more sharply than that of the *euro area* and *Japan* over the forecasting period. Domestic demand in the *USA* will benefit from the improved asset situation of households and companies, a brightening in the labour and real-estate market, expansive monetary policy and a fiscal policy that is hardly restrictive any longer. In the *euro area*, by contrast, economic developments will continue to

Figure 3



be weakened by several structural problems, although the burdens resulting from structural reforms in the banking sector, the labour markets and the goods market implemented in several member countries will gradually lessen this load. *Japan's* economy is also only expected to expand moderately over the forecast-

ing period. Monetary policy in *Japan* is admittedly extremely expansive and the planned gradual commissioning of a series of nuclear power stations, which were taken down from the network after the Fukushima disaster, will reduce the need for energy imports. However, a clearly restrictive financial policy will prevent a sharper upswing.

Developments in oil prices nevertheless represent a major risk for the world economy in the quarters ahead. This risk may be of a positive or a negative nature. The prospect of rapid growth in global oil supply cannot be ruled out if *Iran*, for example, which has the tenth biggest production capacity in the world, were to regain access to the international commodity markets by finally settling its quarrel over nuclear weapons with the West. Such a scenario would be accompanied by another drop in oil prices and would provide further positive impulses for the world economy. An unexpected escalation in political conflicts involving important oil-producing countries (in the *Near East*, *Libya* or *Russia*), by contrast, would lead to a drop in oil extraction levels and a clear rise in the cost of this key commodity. A potential widening of political rifts between *Russia* and the West also poses major threats to the gas supply of several members of the European Union. Additional risks are related to the gradual tightening of monetary policy in the *USA*. The Fed is expected to implement its first interest rate increases in the second half of this year. This would increase the relative attractiveness

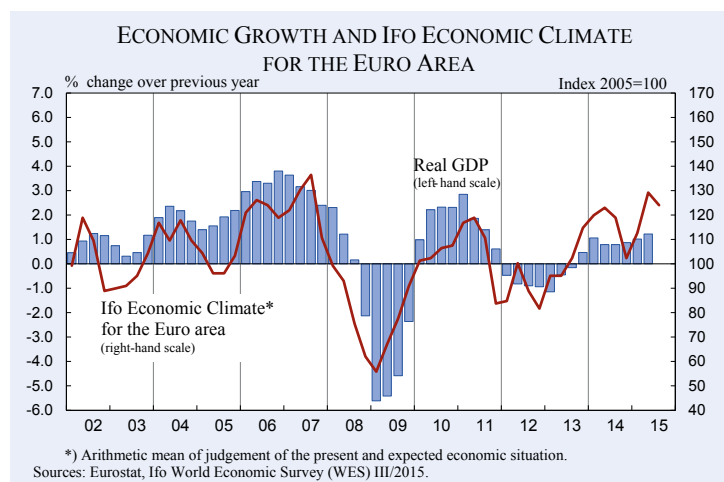
of the *USA* as an investment location and should entail portfolio shifts at the expense of other regions. In an extreme case, this could give rise to massive capital outflows from the emerging economies, leading to huge fluctuations in the financial market, and even triggering exchange rate crises.

Box 2

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

The Ifo Economic Climate for the 19 member countries of the euro area is the arithmetic mean of assessments of the general economic situation and the economic expectations for the next six months. The July results are based on responses from 297 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 edged downwards in the third quarter of 2015, dropping to 124.0 points from 129.2 points last quarter. While assessments of the current economic situation brightened slightly, the six-month economic outlook clouded over markedly. The economic recovery in the euro area is expected to lose momentum. Assessments of the current economic situation improved everywhere with the exception of *Germany*, *Finland* and *Lithuania*. It nevertheless remains favourable in *Germany*. In *Greece* and *Finland*, as well as in *France*, *Italy*, *Spain*, *Austria*, *Portugal* and *Cyprus* assessments of the current economic situation remained negative on balance. According to experts, the situation remains satisfactory in most other euro countries. The six-month economic outlook in most countries was less positive than three months ago. In the Eastern European members states of *Estonia*, *Slovenia* and *Slovakia* in particular, optimistic expectations about future economic developments were strongly downwardly revised. Economic expectations only improved slightly in *Finland*, *Lithuania*, *Austria* and *Cyprus*. The forecast of the average inflation rate for 2015 increased to 0.8 percent from 0.6 percent in the euro area. Mid-term (2020) inflation expectations for most euro countries remain at 2 percent.



Western Europe: Economic upswing loses momentum

The economic climate index for *Western Europe* declined slightly from 122.1 in April to 119.1 this quarter, but remains above its long-term average of 103.6 (1999-2014, see Figure 3). While the present economic situation was assessed as satisfactory, the economic outlook is slightly less positive than three months ago (see Figure 4). A similar pattern was seen in the euro area, where the downturn in the climate indicator was even more pronounced due to fading

optimism over expectations. However, at 124.0, the indicator remains way above its 16-year average of 106.1. The best economic performance in the euro area was attributed to *Germany*, despite the fact that the situation was less positively assessed than three months ago. In *France*, the second largest member country, the economic situation remains unfavourable, according to the experts surveyed. Although the economic situation in *Italy*, *Portugal* and *Spain* continued to improve, assessments remain below a satisfactory level (see Figures 5a and 5b). As far as the six-month economic outlook is concerned, optimism in all of the countries cited above waned somewhat, especially in *Germany*. WES experts for *Portugal*, in turn, remain as confident as in the previous survey. Here, the bank credit situation seems to have improved considerably, as fewer experts reported the supply of bank credit to firms to be strongly constrained. In *Italy* and *Spain* credit constraints are also lower than six months ago. This is not true of *Greece*, where access to credit deteriorated again (see Table 1). According to WES experts, the economic conditions remain bad in *Greece* and are not expected to improve significantly in the months ahead. In *Ireland*, the situation seems to have

improved somewhat, as WES experts once again turned more positive after the slight setback in the second quarter. Expectations, although slightly less positive than three months ago, continued to signal further improvements over the next six months. The economic situation in *Austria*, *Cyprus* and *Finland* remained below the satisfactory line, despite some slight improvements versus the survey three months ago in *Austria*. Economic expectations brightened slightly and point to some improvements over the next six months. According to WES experts, the economies of *Belgium*, *Netherlands*, *Estonia*, *Latvia*, *Slovakia* and *Slovenia*

Figure 4

SELECTED REGIONS

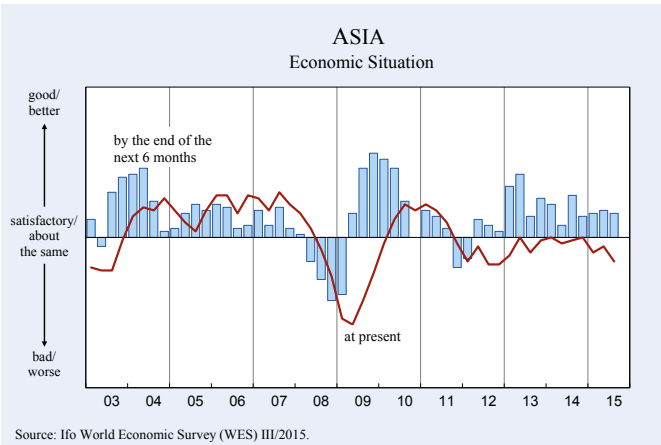
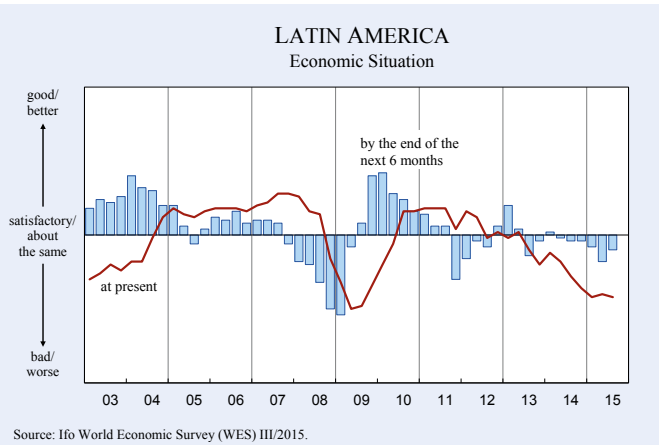
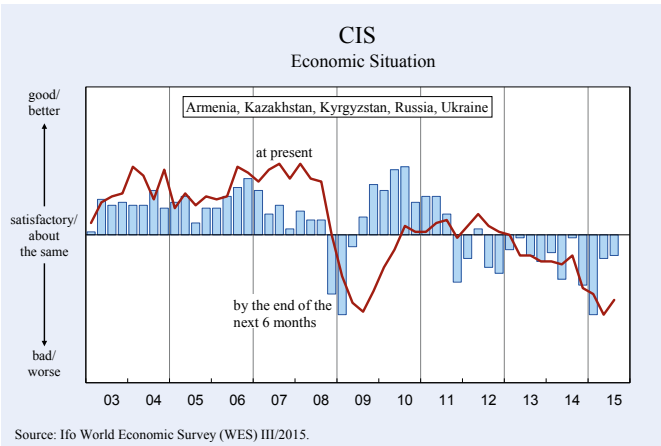
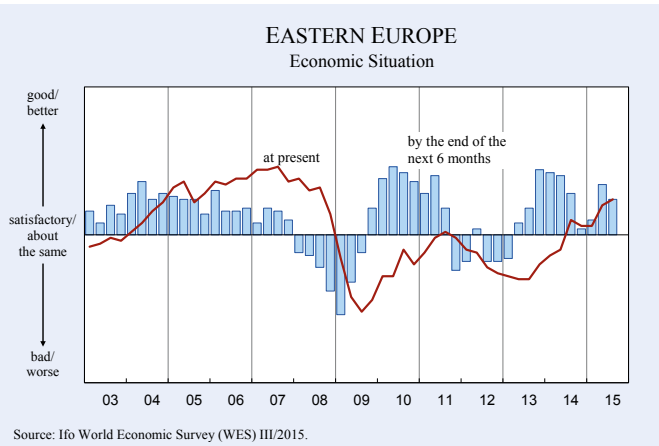
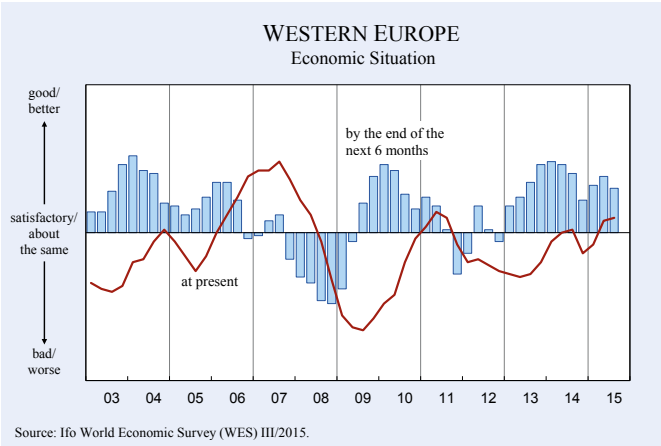
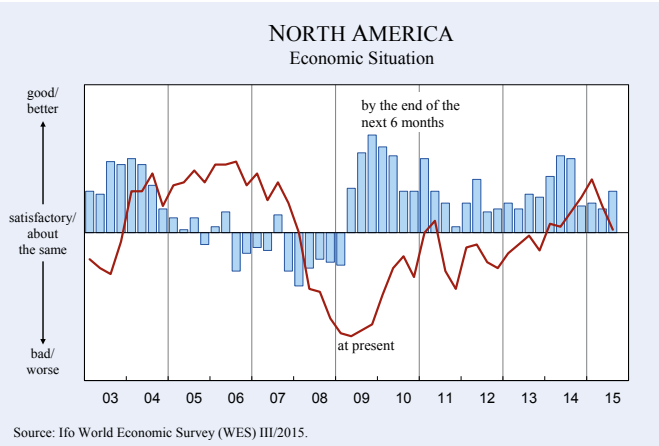


Table 1

Supply of bank credit to firms, extent of constraint	
Not constrained	
Peru	8.1
Colombia	8.0
Sweden	8.0
New Zealand	7.9
Taiwan	7.9
Japan	7.5
United States	7.5
Bolivia	7.4
Kosovo	7.4
South Korea	7.4
Finland	7.3
Switzerland	7.3
Canada	7.2
Germany	7.2
Pakistan	7.2
Paraguay	7.2
Czech Republic	7.1
Australia	7.0
Chile	7.0
Hong Kong	7.0
Sri Lanka	7.0
Turkey	7.0
Moderately constrained	
Uruguay	6.8
Latvia	6.7
South Africa	6.7
Guatemala	6.6
Mauritius	6.6
France	6.4
Poland	6.4
Slovakia	6.4
Belgium	6.3
Kenya	6.3
India	5.9
Mexico	5.9
Denmark	5.7
Lithuania	5.7
Malaysia	5.7
Thailand	5.7
Zambia	5.7
Netherlands	5.6
Bulgaria	5.5
Croatia	5.4
Austria	5.3
United Kingdom	5.3
Brazil	5.2
Egypt	5.0
Italy	5.0
Spain	4.9
Cabo Verde	4.4
Hungary	4.4
Portugal	4.4
Argentina	4.3
Nigeria	4.3
Congo Dem. Rep.	4.2
Strongly constrained	
Slovenia	3.9
Romania	3.7
Kazakhstan	3.4
Morocco	3.4
China	3.3
Lesotho	3.2
Russian Federation	3.2
Togo	2.2
Greece	1.6
Zimbabwe	1.4

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/2015.

continued to perform satisfactorily, even to a somewhat higher degree than last quarter in most countries. As far as the next six months are concerned, economic expectations were scaled back somewhat. Despite this downward revision, WES experts remain optimistic on the whole for *Belgium* and *Netherlands*, and positive for *Estonia*, *Slovakia* and *Slovenia*. In turn, caution continues to prevail among experts in *Latvia*. In *Lithuania*, the present economic situation was assessed less positively than three months ago. The economic outlook is again more optimistic than in April. Behind *Germany*, the countries showing the next best economic performance in the *euro area* were *Luxembourg* and *Malta*. Economic expectations also stand at a high level in both countries.

Outside the *euro area* the general economic situation appears friendlier than in the countries of the currency union. The strongest upwards revision in assessments of the current economic situation was seen in *Norway*. But assessments of the situation were also more positively assessed than three months ago in *Sweden*, too. In terms of economic developments over the next six months, WES experts in *Norway* are no longer pessimistic and expect the favourable current situation to continue. Economic expectations for *Sweden* are somewhat less positive than in April. In *Monaco* and the *United Kingdom* the present economic situation was once again assessed as favourable, and included a positive economic outlook. After a strong improvement in the second quarter, the economic situation in *Denmark* deteriorated again, although assessments remain satisfactory on average. The economic outlook is still optimistic. Legal and administrative restrictions for foreign firms are absent in this country and the investment climate is one of the most favourable in Europe, according to WES experts (see Table 3). *Switzerland* is the only country outside the *euro area* where assessments of the present economic situation are below the satisfactory line. Economic expectations continue to decline, reaching a three-year low in terms of pessimism about the future.

North America: Soft patch deepens

The economic climate indicator for *North America* continued to fall from 97.9 in the second quarter of 2015 to 96.2 this quarter, but nevertheless remains above its 16-year average of 90.7. The decline in the climate indicator was mainly driven by less favourable assessments of the present economic situation. Economic expectations, by contrast, were considerably

upwardly revised compared to the previous survey (see Figures 3 and 4). While in the *US* the economic situation – despite the downwards revision compared to the survey in April – remains satisfactory on the whole, the current situation in *Canada* is no longer favourable. WES experts expect no substantial improvements in *Canada* over the next six months. Expectations in the *US*, by contrast, brightened up again and signal a further recovery in the months ahead. According to WES experts, credit constraints for *US* companies seem to be absent and thus financing conditions for firms are good. WES experts also see no constraints on bank credit for firms in *Canada*, despite their less positive assessments of conditions than at the beginning of the year.

Eastern Europe: Favourable economic climate, despite minor adjustments

In *Eastern Europe* the economic climate index fell slightly to 98.6 from 101.0, but nevertheless remains at a high level and far above its long-term average (85.2 in the period 1999–2014). While assessments of the present economic situation improved slightly and point to a favourable situation, economic expectations are slightly less positive than three months ago (see Figures 4 and 7).

The region's best performing economies currently remain the *Czech Republic* and *Poland*, although some downward revision in assessments of the current situation was visible in the case of *Poland*. Experts, in turn, gave the *Czech Republic* the highest rating for the present state of the economy in seven years. Their economic expectations, by contrast, were scaled back considerably, but remain positive on the whole. WES experts are also slightly less positive than three months ago with regard to future economic developments for *Poland*. The *Eastern European* countries that belong to the *euro area* (*Baltic States*, *Slovakia* and *Slovenia*) are also performing very well at present, and also boast a positive economic outlook. *Latvia* is an exception to this rule, as WES experts there remain sceptical with regard to economic developments in the months ahead. The economic situation in *Bulgaria* and *Romania* continued to improve considerably. In *Bulgaria*, assessments of the present economic situation finally reached the satisfactory line for the first time in six years. In *Romania*, the experts surveyed also attested to a satisfactory situation. Economic expectations in both countries are, however, slightly less positive than in April. In *Romania*, firms' access to bank credit remains strongly constrained, despite some slight improvement

versus to the survey in January. The economic situation in *Hungary* remained below the satisfactory line, according to survey participants. WES experts expect no major changes to economic conditions in the months ahead and retain their sceptical outlook. In *Croatia* the present economic situation continued to improve, but remains weak on average. Economic expectations are slightly less positive, but signal some further easing of the current weak economic conditions in the months ahead.

In the *Eastern European* countries outside the EU the economic climate is far bleaker. There was no positive news from *Bosnia and Herzegovina* and *Macedonia*, concerning the current economic situation, which is still weak and is expected to remain so in the months ahead, despite some upward revision in expectations in the case of *Macedonia*. In *Kosovo* the situation deteriorated and turned unfavourable, according to the experts surveyed. However, this change in negative appraisals might only be short-lived, as economic expectations remain confident for the months ahead. By contrast, the present economic situation in *Serbia* improved significantly and was assessed as satisfactory, as was the case in *Albania*. The situation is expected to improve further in both countries.

CIS: Economic improvements at a low level

The economic climate indicator for the *CIS* countries covered by WES (*Russia*, *Ukraine*, *Kazakhstan*, *Kyrgyzstan*, *Uzbekistan* and *Armenia*) continued to recover from 53.8 to 58.8 points, but still remains far below its long-time average of 88.1 points. Although assessments of the present economic situation improved considerably, they remain subdued. Negative voices regarding economic expectations continue to prevail (see Figure 4). In *Russia*, WES experts rated the supply of bank credit to firms as heavily constrained; while the legal and administrative restrictions on foreign firms seeking to invest remain relatively high (see Tables 1 and 3). The present economic situation is still weak, despite some slight upwards revision in assessments. This fairly poor economic performance is likely to last or deteriorate even further, as the majority of *Russian* experts expect the situation to get worse in the months ahead. By contrast, the economic climate for the *Ukraine* improved considerably, as economic expectations clearly turned optimistic. However, the current state of the economy remains very difficult and the investment climate for foreign firms is still

unfavourable. On a brighter note, legal and administrative restrictions on investments are likely to decrease in the next six months (see Table 4). In *Armenia* and *Kyrgyzstan* the situation was once again assessed as unfavourable. In *Kazakhstan* the economic situation improved somewhat, but remains below the satisfactory line, according to WES experts. In all of these countries, economic expectations point to no substantial positive changes in the months ahead.

Asia: Heavyweight China drags the region down

The economic climate index for *Asia* fell again this quarter, after having improved in the previous survey. At 87.7, the indicator now lies clearly below its long-term average of 92.5. As in other regions, the downturn was mainly due to downgraded appraisals of the present economic situation. The decline in economic expectations was less pronounced (see Figures 3, 4 and 8).

In *China*, the economic situation deteriorated further and was once again assessed as unfavourable. Capital expenditure in particular was considered as weak. As far as the next six months are concerned, WES experts are more positive, but still expect the economy to stabilise at best, rather than to expand. Constraints on bank credit for firms were still assessed as heavy. Legal and administrative restrictions for foreign firms are particularly severe at present. However, some improvements for foreign investors in these areas are expected in the course of the next half year (see Tables 1, 3 and 4). In *Japan*, the mild economic recovery continued and the present economic situation received a satisfactory rating from WES experts. Economic expectations were scaled back, but nevertheless signal further improvements in the months ahead. The most pronounced downward revisions in assessments of the present economic situation took place in the *Philippines*, *Taiwan* and *Indonesia*. But WES experts in *India* also rated the situation less positively than in April. While assessments of the present economic situation remain satisfactory in the *Philippines*, *Indonesia* and *India* despite the downward correction, they turned negative for *Taiwan*. Economic expectations were also downwardly revised once again. Economic sentiment for the next six months nevertheless remains positive for *India* and *Indonesia*. In the *Philippines* a stabilisation of current satisfactory levels is likely, while in the case of *Taiwan* the weak situation is expected to last for the next six months. In the latter two countries, WES experts expect political instability

to increase and thus to negatively affect the investment climate for foreign investors (see Table 4). In *Bangladesh*, *Hong Kong*, *Malaysia*, *Singapore*, *Sri Lanka* and *Vietnam* the present economic situation remained satisfactory, despite some slight downward correction in the case of *Bangladesh*, *Hong Kong* and *Sri Lanka*. In most of these countries, the situation is also expected to remain at its present good levels in the months ahead. An exception to this rule is *Malaysia*, where WES experts again expressed a note of caution about the six-month economic outlook, although to a lesser degree than three months ago. In *South Korea*, assessments of the present economic situation continued to deteriorate. Economic expectations for the next six months improved slightly, but still point to no substantial improvements in the months ahead. Economic performance remained weak in *Pakistan*, and assessments were even more negative in *Thailand*. While WES experts for *Pakistan* turned less optimistic about the next six months, they remain fairly confident for *Thailand*. In both countries expectations signal the chance of improvements in the months ahead.

Oceania: Economic climate cools to six-year low

In *Oceania* the economic climate index continued to tumble to 72.3, which marks its lowest value in six years (long-term average 101.6). After slightly improving in the previous survey, assessments of the present economic situation deteriorated again markedly. Economic expectations remain nearly unchanged at a low level. This pattern was particularly true for *Australia*. Here, the present economic situation was no longer deemed satisfactory any more. Although economic expectations improved somewhat compared to the survey in April, the outlook is still dominated by pessimism. *New Zealand*, which reportedly performed very well economically in the previous surveys, finally seemed to follow *Australia's* struggling economic activity (see Figure 6). Both components of the economic climate deteriorated considerably, with expectations falling deep into negative territory. *New Zealand's* situation, which is currently still satisfactory, is likely to deteriorate in the months ahead.

Latin America: Region may not have hit bottom yet

There was little movement seen in the economic climate indicator, with a slight recovery seen in *Latin America*. The indicator edged upwards from 64.3 to 67.0, and still

Figure 5a

EUROPEAN UNION

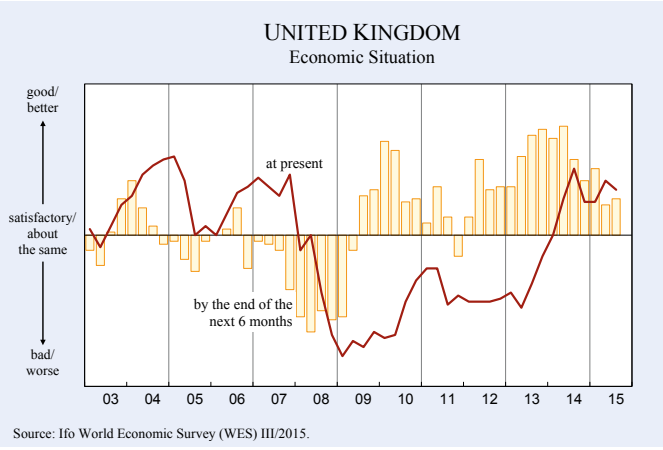
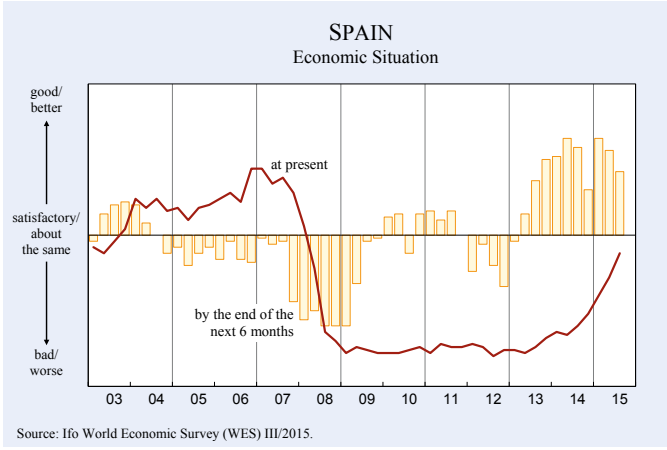
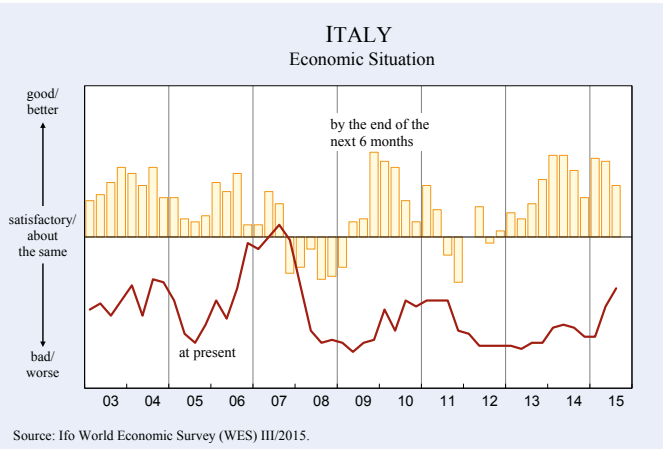
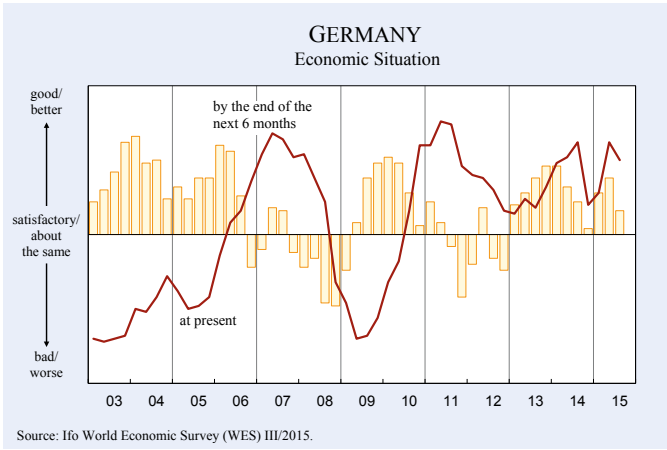
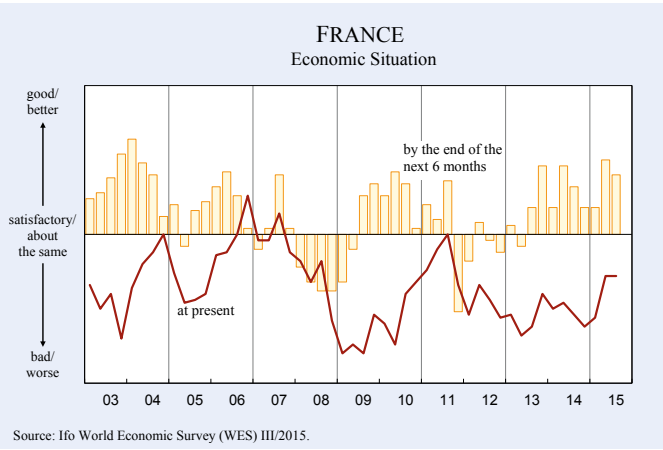
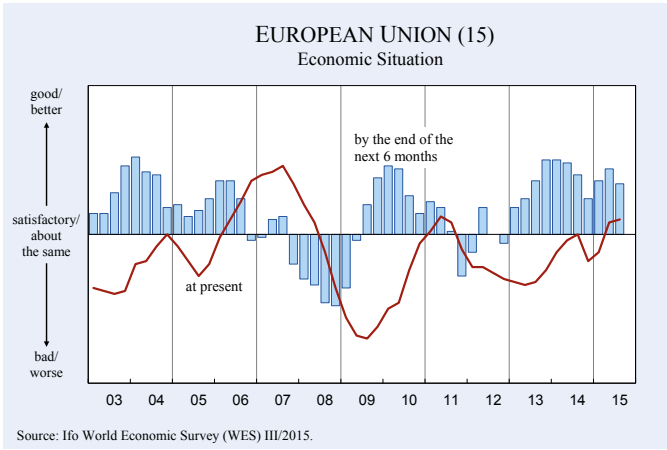


Figure 5b

EUROPEAN UNION

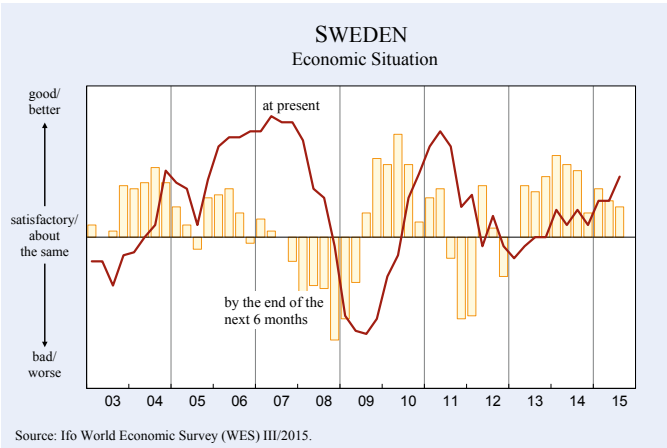
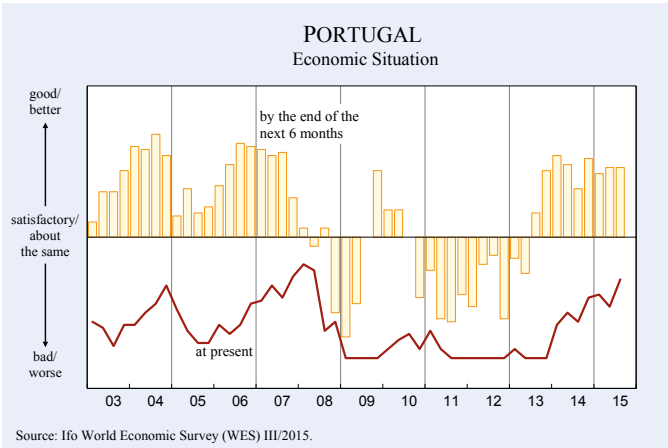
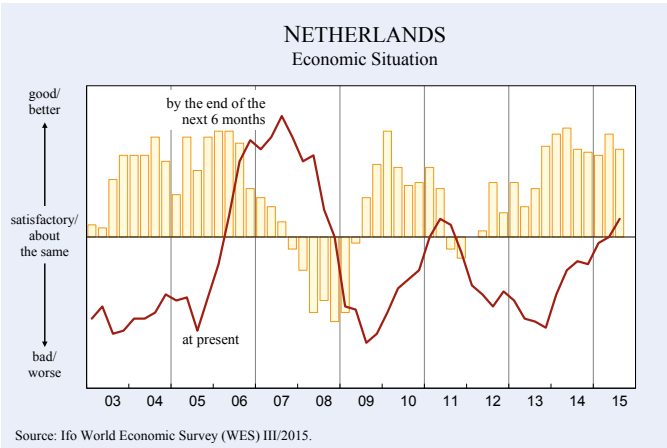
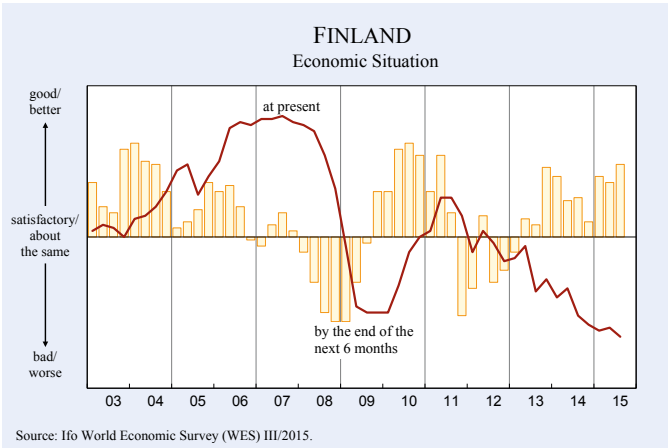
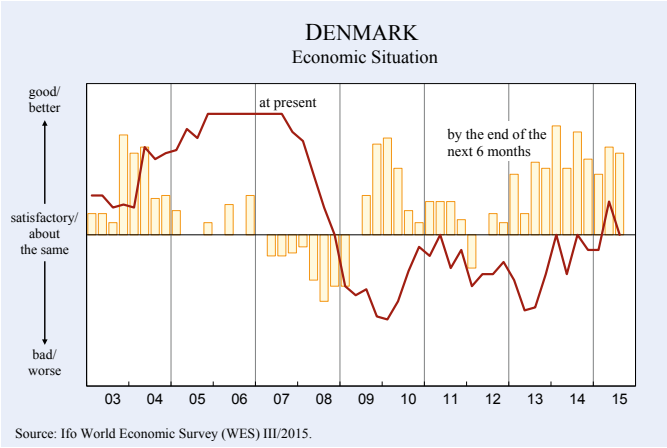
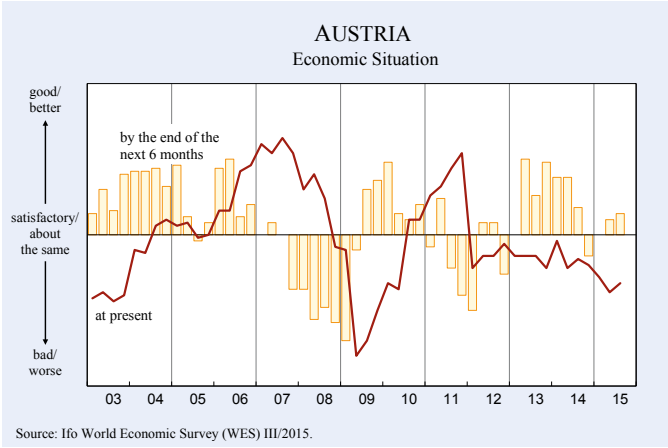


Figure 6

NORTH AMERICA, OCEANIA AND CIS

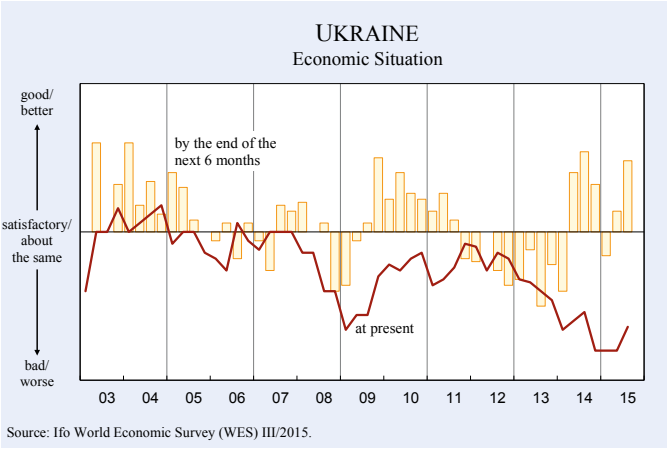
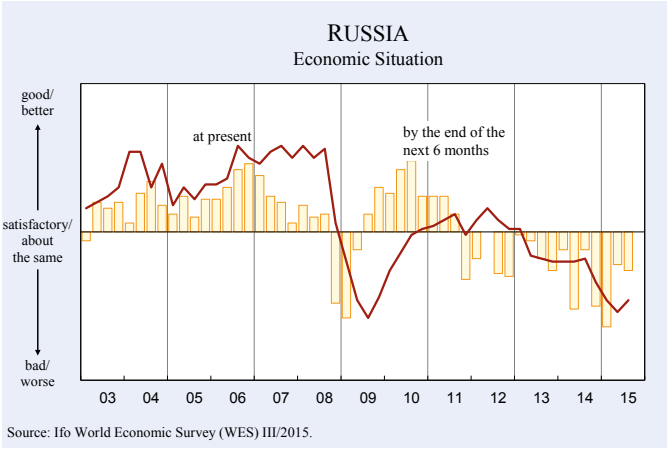
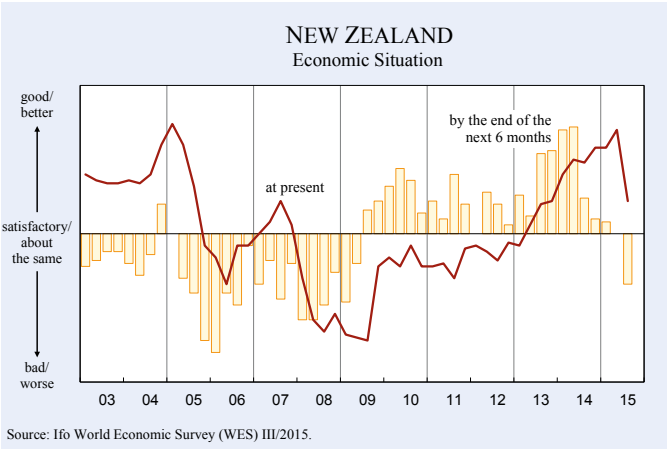
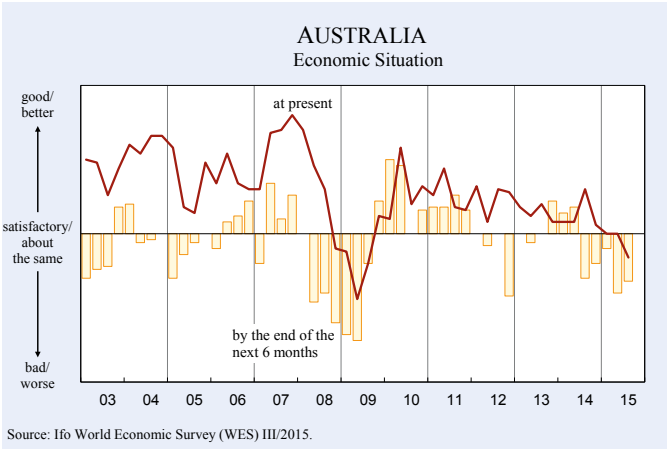
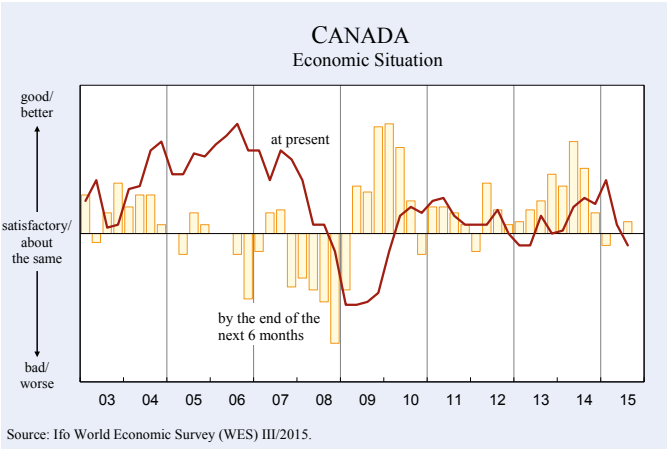
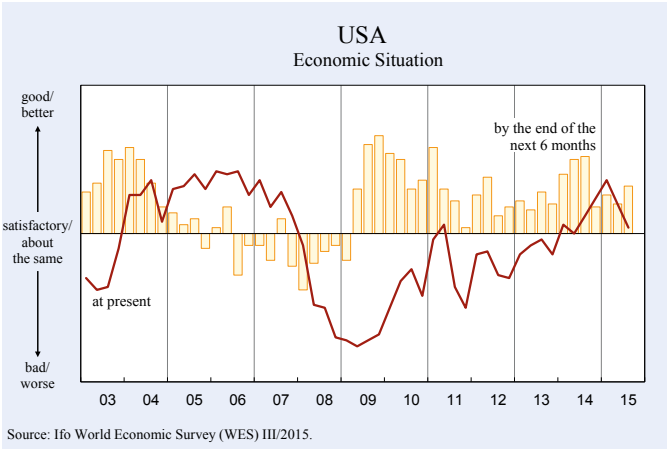


Figure 7

EASTERN EUROPE

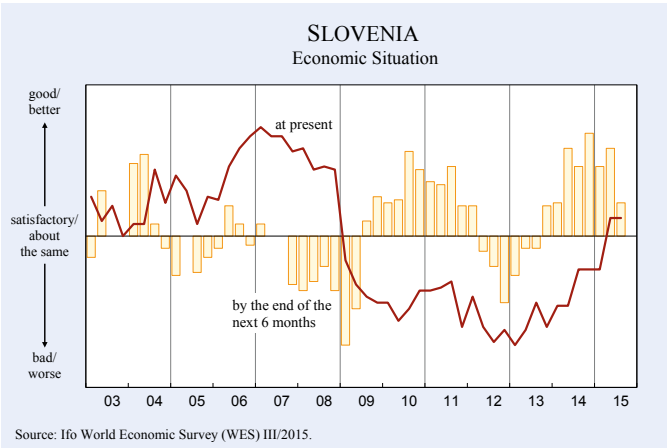
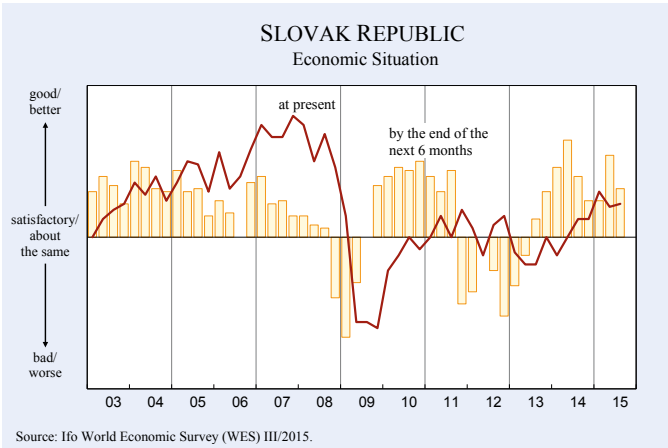
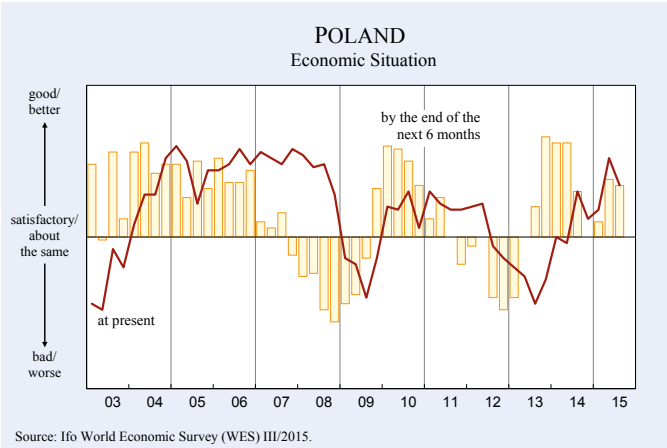
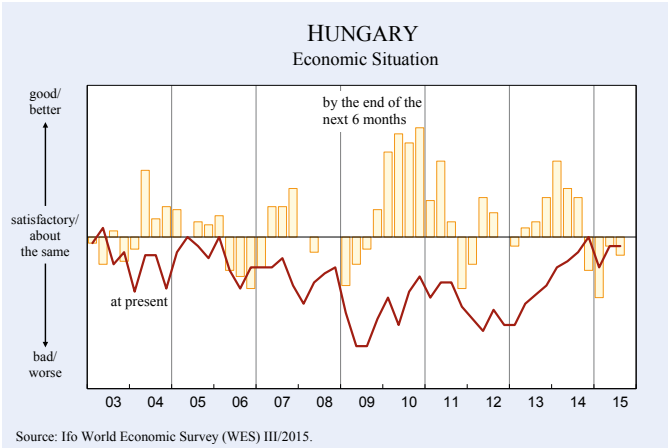
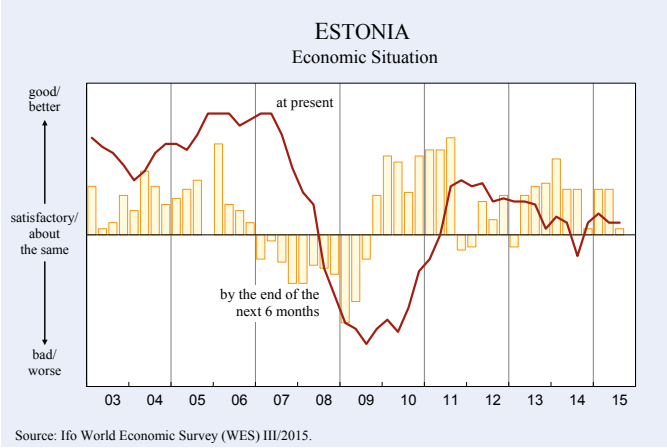
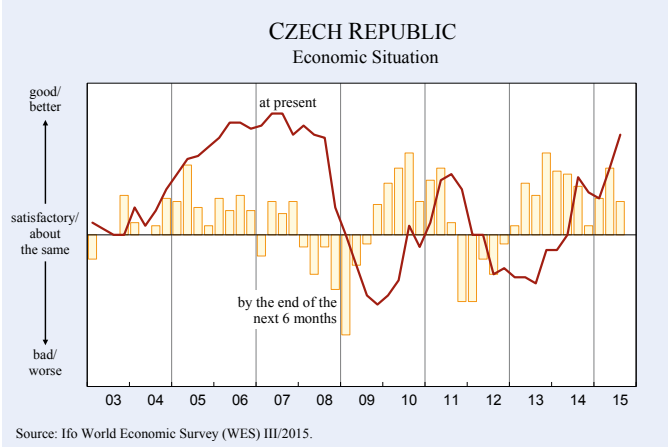


Figure 8

ASIA

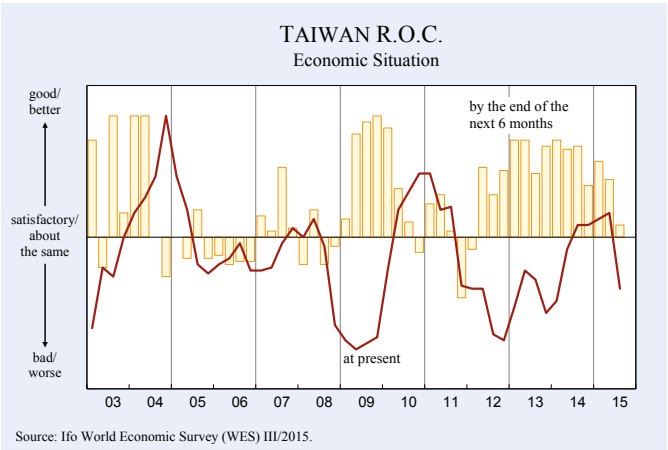
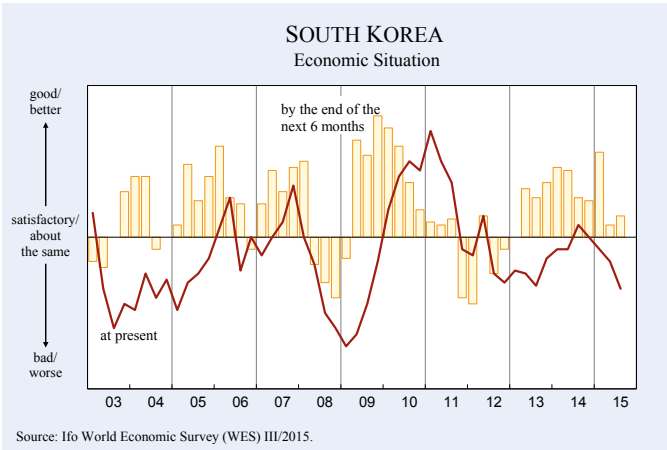
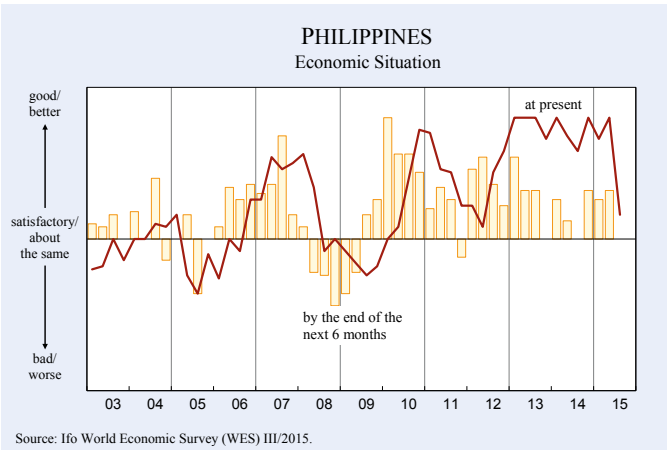
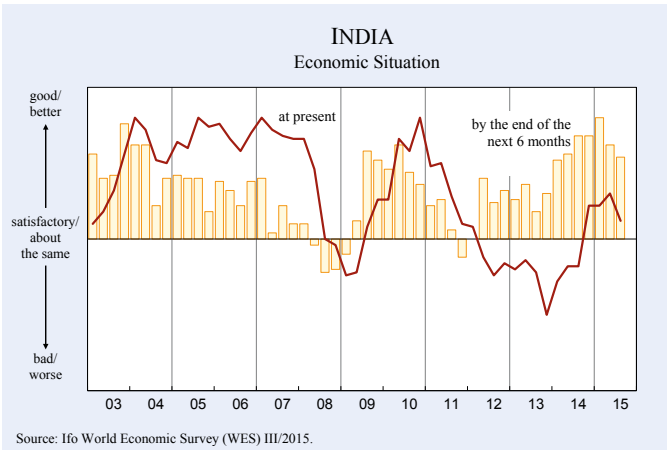
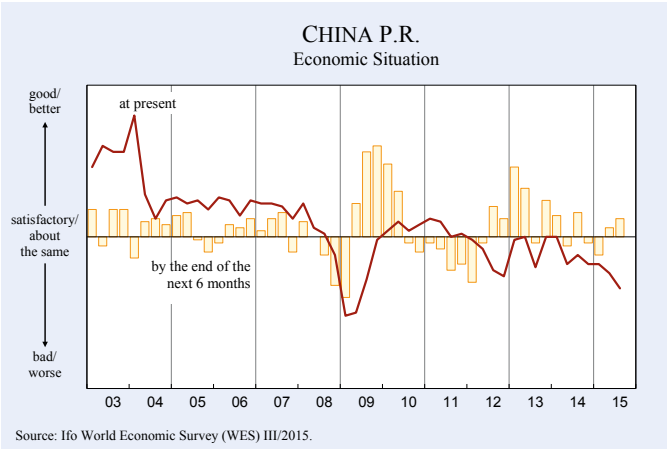
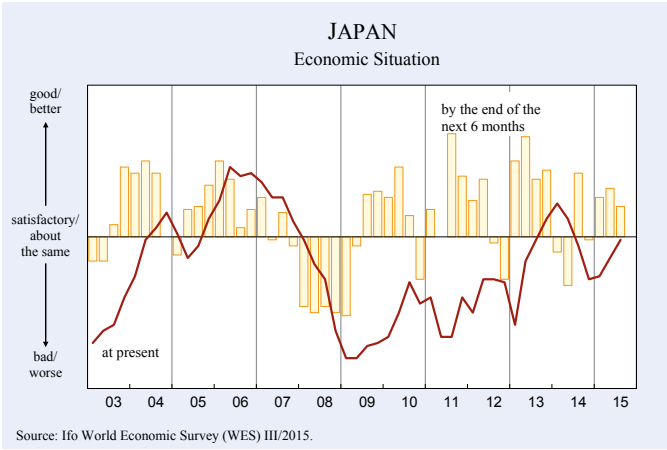


Figure 9

LATIN AMERICA

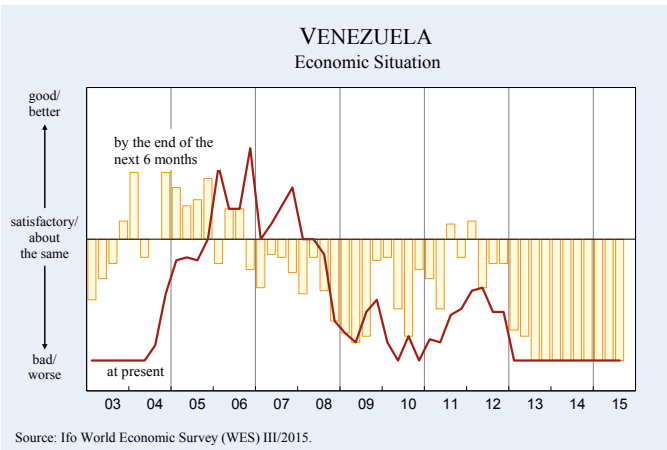
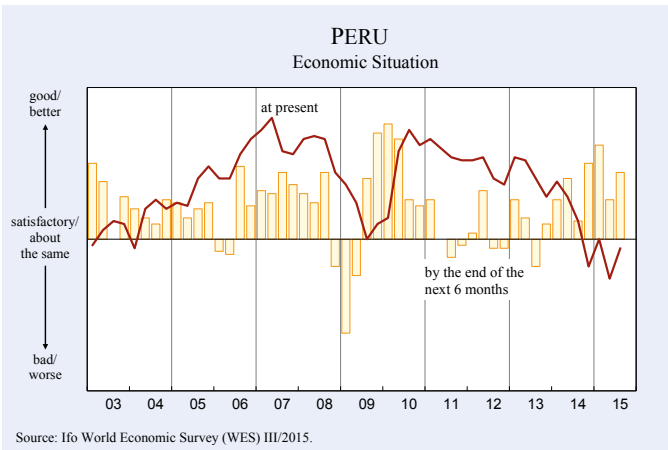
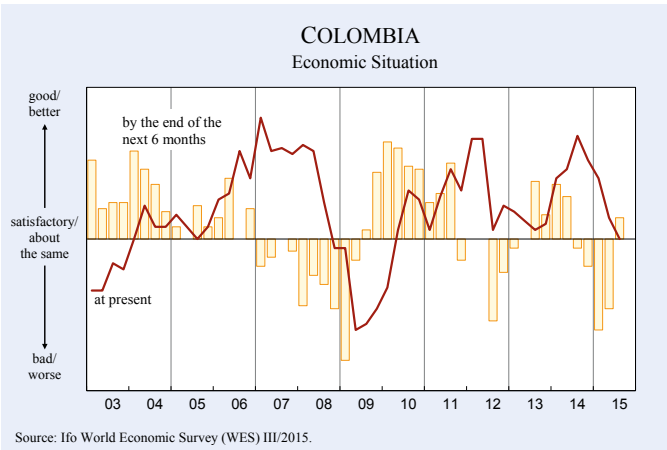
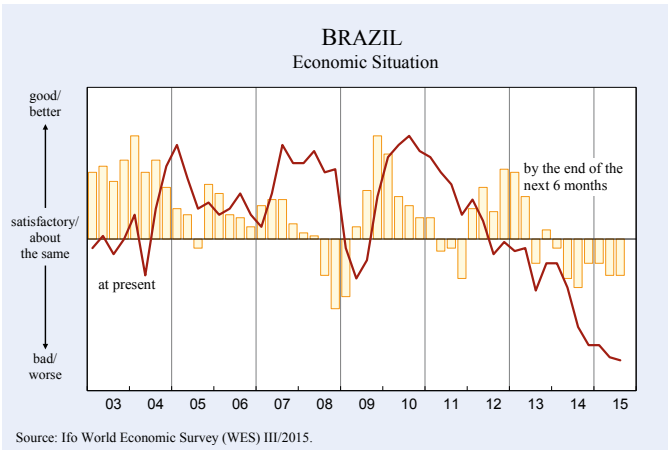
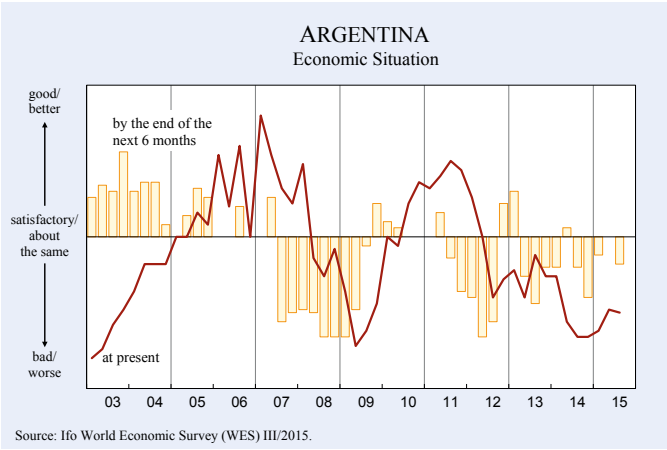
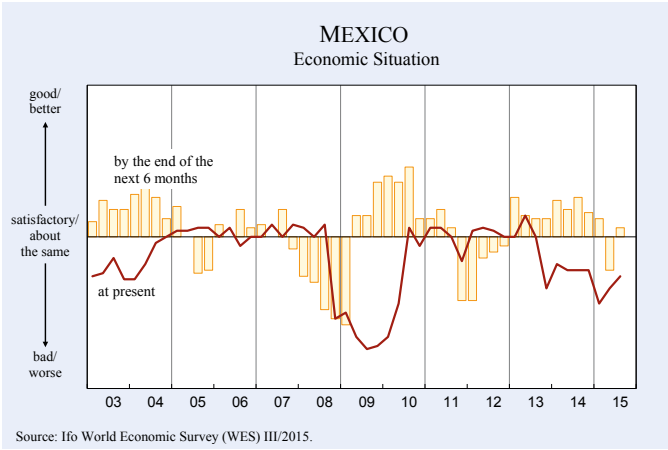
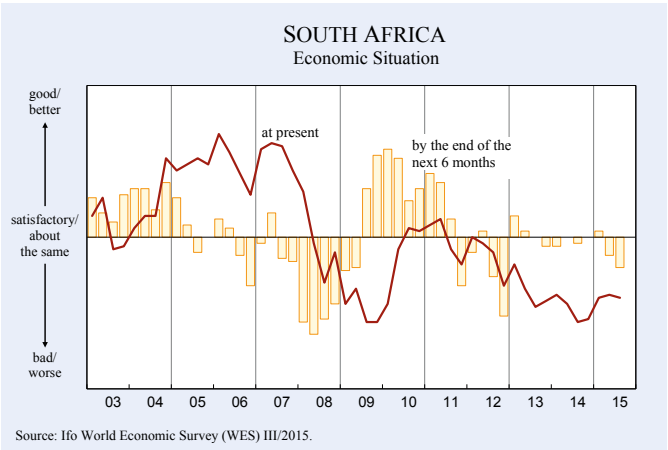
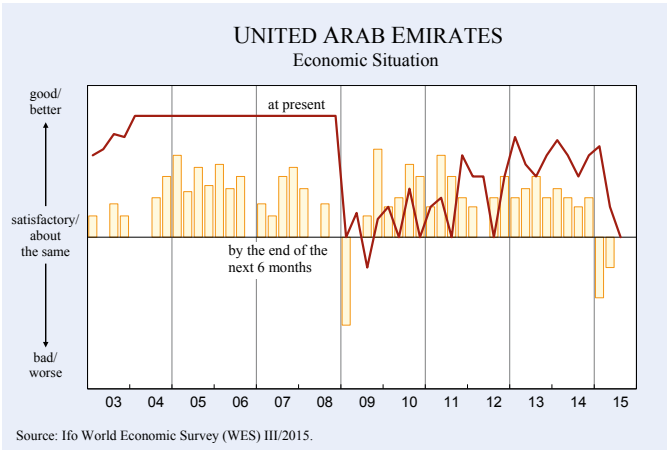
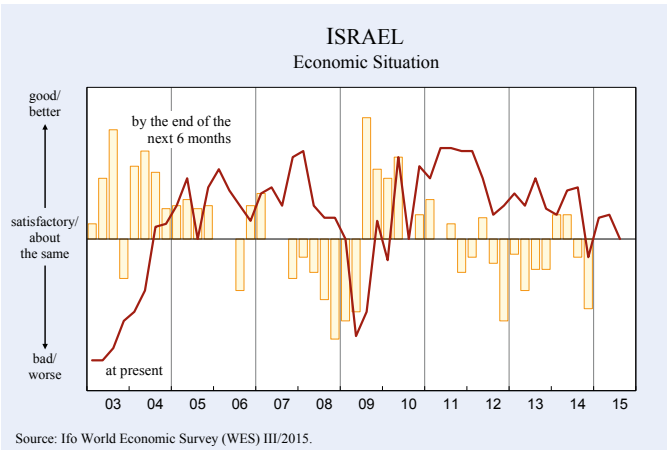
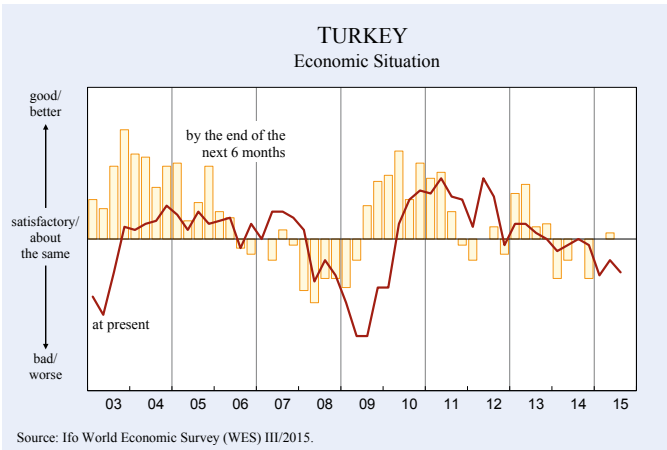
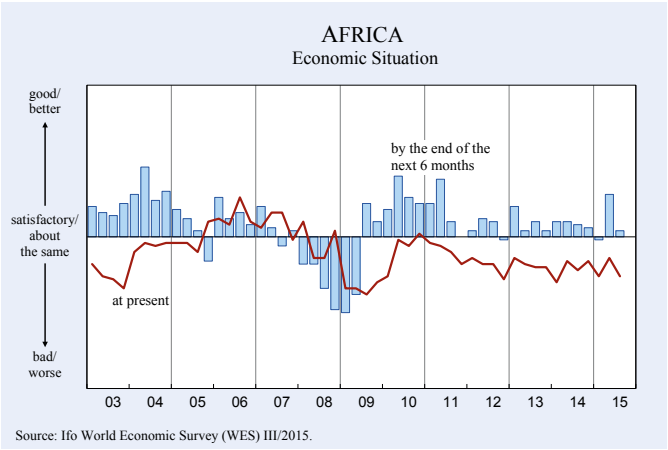
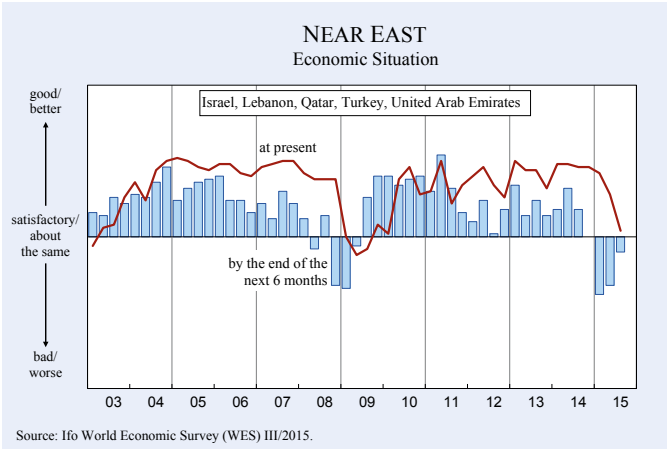


Figure 10

NEAR EAST AND AFRICA



stands far below its long-term average (1999-2014: 91.0). Assessments of the present economic situation deteriorated again, but economic expectations are less negative than in April. However, as they still haven't reached positive territory on balance, it is too early to expect an economic turnaround (see Figures 4 and 9).

In *Brazil*, no major changes for the better were observed compared to the survey in April. The present economic situation remains fairly weak and the economic outlook is still bleak. Firms' access to bank credit seems to have deteriorated in comparison to the beginning of the year, with WES experts reporting it to be moderately constrained. The present economic situation in *Mexico* and *Argentina* also remains unfavourable, despite some slight improvements compared to the previous survey in the case of *Mexico*. While for *Mexico* the economic outlook turned positive again, signalling the chance of further improvements in months ahead, economic expectations for *Argentina* deteriorated again. According to WES experts, the present economic situation remains weak in *Venezuela*, *Ecuador* and *El Salvador*. In *Venezuela* and *Ecuador*, the economic situation is expected to deteriorate further, as these countries are struggling with lower revenues from the oil sector due to low oil prices. Currency depreciation in *Venezuela* is likely to continue in the months ahead, accompanied by a rising and stubborn inflation rate. As in the previous survey, experts even expressed fear of hyperinflation (see Table 2). Economic expectations for *El Salvador* are once again less positive than in the two previous surveys. The strongest downwards revision in the economic climate took place for *Chile* and resulted in the worst level seen in this country for six years. Appraisals for the present economic situation are clearly negative and the current weakness in this economy is expected to last for the next six months. The economic situation in *Guatemala* and *Trinidad and Tobago* deteriorated and is no longer satisfactory, according to WES experts. The situation in *Peru* remains below the satisfactory marker too, despite some slight upwards revision compared to the survey in April. In *Peru* and *Guatemala*, the experts surveyed stated that capital expenditure is particularly weak at present. While WES experts expect no major positive changes for *Guatemala* or *Trinidad and Tobago*, they turned more optimistic for *Peru* regarding future economic developments. The situation in *Bolivia*, *Costa Rica*, the *Dominican Republic* and *Panama* did not change and these economies continue to perform satisfactorily, according to WES experts. In all of these countries, the current good situation is likely to consolidate in the months ahead;

except for in *Bolivia*, where WES experts remain sceptical about the six-month outlook. The current economic situations in *Colombia*, *Paraguay* and *Uruguay* were far less favourably assessed than in April. Negative voices predominate in terms of the economic outlook in the case of *Paraguay* and *Uruguay*; and the situation in both countries is likely to continue to deteriorate further in the months ahead. For *Colombia*, optimism finally returned and economic expectations are positive again on balance.

Near East: Economic climate stabilises at a low level

The strong descent of the economic climate indicator for the *Near East*, which started in mid-2014, came to a halt. Less favourable assessments of the present economic situation were compensated for by upwardly revised economic expectations. As a result, the climate indicator stabilised at 69.2 after 69.9, and remains far below its long-term average 87.8 (see Figure 10). In *Israel* and the *United Arab Emirates* assessments of the present economic situation were slightly downgraded compared to the survey in April, but nevertheless remained satisfactory. In *Lebanon* and *Qatar* WES experts reported favourable present economic conditions too. In all of these countries the current satisfactory situation is expected to prevail in the months ahead; except for in *Qatar*, where WES experts expressed caution regarding developments over the next six months. The present economic situation in *Turkey* deteriorated again, after having slightly recovered in the previous survey. On balance it is still assessed as negative. Capital expenditure is considered to be the economy's main weakness at present. Economic expectations do not signal major changes for the better in the months ahead.

Africa: Economic climate clouds over heavily

The economic climate indicator for *Africa* plunged below its long-term average. Assessments of both components of the economic climate are far less positive than three months ago. The present economic situation was rated as unfavourable. The six-month economic outlook points to no substantial improvements in the months ahead. This reflects the development in both parts of the continent – *Northern* and *Sub-Saharan Africa*. Apparently, however, economic expectations in the countries part of *Northern Africa* were more strongly downwardly revised than in the South. In *Algeria* and *Morocco* the present economic situation was again as-

Table 2

Inflation rate expectations for 2015 and in 5 years (2020)

Region	2015	2020	Region	2015	2020
Average of countries *	3.0	3.1	Latin America	12.3	6.7
High-income countries	2.2	2.7	Argentina	28.1	10.6
Middle-income countries	5.7	4.8	Bolivia	5.5	6.2
Upper-middle	4.5	4.3	Brazil	8.8	5.3
Lower-middle	7.7	5.6	Chile	4.0	3.0
Low-income countries	4.5	5.5	Colombia	3.8	3.1
EU 28 countries	0.8	2.1	Costa Rica	(3.5)	(5.0)
EU countries (old members) ^{a)}	0.8	2.0	Dominican Republic	2.3	4.3
EU countries (new members) ^{b)}	0.6	2.3	Ecuador	4.2	3.1
Euro area ^{c)}	0.8	2.0	El Salvador	1.3	2.3
Western Europe	0.8	2.0	Guatemala	3.2	4.2
Austria	1.3	2.3	Mexico	3.9	3.8
Belgium	0.8	2.0	Panama	(4.0)	(3.0)
Cyprus	-0.3	1.8	Paraguay	4.5	4.9
Denmark	1.2	2.1	Peru	3.1	2.7
Finland	0.4	1.5	Trinidad and Tobago	(9.0)	(12.0)
France	0.5	1.9	Uruguay	8.4	7.1
Germany	0.9	2.0	Venezuela	116.2	68.3
Greece	-0.4	2.1	North America	1.6	2.5
Ireland	1.0	2.1	Canada	1.8	2.2
Italy	0.9	2.1	United States	1.6	2.6
Luxembourg	1.0	2.2	Oceania	1.8	2.8
Malta	(1.0)	(3.5)	Australia	1.9	2.9
Monaco	0.9	2.0	New Zealand	1.1	2.3
Netherlands	1.1	2.0	Near East	4.4	4.2
Norway	1.8	2.3	Israel	1.4	2.9
Portugal	0.6	1.6	Lebanon	3.6	5.3
Spain	0.8	2.1	Qatar	(2.0)	(3.5)
Sweden	0.6	2.0	Turkey	8.1	5.7
Switzerland	-0.8	0.9	United Arab Emirates	3.4	3.7
United Kingdom	1.0	2.3	Africa	7.2	6.5
Eastern Europe	0.7	2.3	Northern Africa	6.3	5.8
Albania	(2.2)	(3.0)	Algeria	5.0	5.4
Bosnia and Herzegovina	2.1	2.4	Egypt	12.0	9.2
Bulgaria	0.7	2.6	Morocco	2.1	3.1
Croatia	0.5	2.3	Tunisia	5.2	5.0
Czech Republic	0.8	2.1	Sub-Saharan Africa	7.7	6.8
Estonia	0.4	2.4	Angola	(11.0)	(8.0)
Hungary	1.0	3.0	Benin	1.5	2.5
Kosovo	2.0	2.6	Burkina Faso	(2.0)	(2.5)
Latvia	1.5	3.0	Burundi	(35.0)	(6.5)
Lithuania	0.6	2.6	Cabo Verde	1.5	2.2
Macedonia	0.5	2.0	Comoros	(2.0)	(5.0)
Poland	-0.1	2.1	Congo Dem. Rep.	1.2	5.9
Romania	1.8	2.1	Congo-Brazzaville Rep.	2.7	3.7
Serbia	3.3	3.7	Gabon	(3.8)	(3.0)
Slovakia	0.5	2.1	Gambia	(7.7)	(5.5)
Slovenia	0.5	2.1	Ivory Coast	(4.0)	(5.0)
CIS	15.2	8.5	Kenya	8.6	6.8
Armenia	6.3	7.3	Lesotho	5.1	6.1
Kazakhstan	5.3	5.1	Liberia	(8.5)	(6.0)
Kyrgyzstan	9.0	6.5	Madagascar	8.4	8.1
Russia	13.6	9.2	Malawi	(19.0)	(15.0)
Ukraine	37.7	7.3	Mauritania	6.5	8.5
Asia	2.5	3.1	Mauritius	3.5	4.1
Bangladesh	6.4	6.1	Namibia	4.6	(4.2)
China	2.4	3.4	Niger	2.5	3.8
Hong Kong	3.7	4.1	Nigeria	11.9	8.8
India	5.6	4.8	Senegal	(1.6)	(1.5)
Indonesia	6.2	5.3	Sierra Leone	8.8	6.0
Japan	0.8	1.4	South Africa	5.5	5.8
Malaysia	4.3	4.3	Sudan	26.5	16.5
Pakistan	6.5	8.1	Swaziland	5.3	5.6
Philippines	2.8	4.3	Tanzania	7.5	6.3
Singapore	(0.0)	(2.0)	Togo	1.9	2.7
South Korea	1.6	2.3	Uganda	7.5	5.0
Sri Lanka	5.1	5.9	Zambia	8.6	7.5
Taiwan	0.4	1.5	Zimbabwe	-0.6	5.1
Thailand	1.4	3.3			
Vietnam	5.0	5.3			

* 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. – ^{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, Romania, Croatia. –

^{c)} Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Lithuania, Luxembourg, Malta, Netherlands, Portugal, Spain, Slovenia, Slovakia.

Source: Ifo World Economic Survey (WES) III/2015.

sessed as satisfactory. However, the economic outlook in both countries is less favourable than three months ago. For *Morocco*, WES experts stated that firms' access to bank credit was as strongly constrained as in the January survey. In *Egypt* and *Tunisia* the respective current economic situation deteriorated again and is rated as weak. In *Egypt*, legal and administrative restrictions on foreign firms are very high at present, but some improvements are expected in the next six months (see Tables 3 and 4).

The economic climate indicator for *South Africa* continued to deteriorate due to further downwardly revised economic expectations, which signal scepticism for the next six months. The present economic situation was once again assessed as unfavourable (see Figure 10). In *Congo Democratic Republic*, *Gambia*, *Kenya*, *Malawi*, *Mauritius*, *Senegal* and *Tanzania* the current economic situation remained satisfactory. In all of these countries, current economic performance is expected to remain positive, except for in *Tanzania*, where WES experts turned sceptical about the six-month economic outlook. In *Congo-Brazzaville*, *Ivory Coast*, *Namibia* and *Uganda* a favourable economic situation continued to prevail, including a positive economic outlook. Economic expectations brightened markedly, especially in the latter two countries. Major positive changes were recorded for *Togo*. In the opinion of WES experts, the current economic situation in this country returned to a satisfactory level and is expected to improve further in the months ahead. The respective current economic situation for *Benin*, *Lesotho*, *Mauritania*, *Nigeria*, *Sierra Leone* and *Zambia* deteriorated considerably and is rated on balance as clearly negative in all cases. Only WES experts in *Benin* expect the situation there to improve within the next six months. In all other countries the unfavourable economic conditions are likely to last, or even to deteriorate further in the next six months in the case of *Zambia*. In *Cabo Verde* and *Madagascar* the economic situation remains unfavourable, despite some improvements compared to the survey in April. While economic expectations for *Cabo Verde* clearly brightened, WES experts turned sceptical for future economic developments in *Madagascar*. In *Angola*, *Burundi*, *Gabon*, *Liberia*, *Niger*, *Sudan*, *Swaziland* and *Zimbabwe* the situation was once again assessed as weak. This time *Burkina Faso* and *Comoros* also joined the group of countries with current weak economic conditions. WES experts continued to forecast an improvement for *Swaziland* in the short term. In the other countries the situation is likely to remain subdued, or even to deteriorate further.

Table 3

Legal and administrative restrictions for foreign firms	
Absent	
Denmark	7.7
Hong Kong	7.7
Netherlands	7.7
Portugal	7.6
Finland	7.5
Sweden	7.3
Peru	7.2
Uruguay	7.2
Germany	7.0
Rather low	
Chile	6.6
Guatemala	6.6
Mauritius	6.6
Colombia	6.5
Latvia	6.5
Kosovo	6.3
Lithuania	6.3
Paraguay	6.3
Switzerland	6.3
Australia	6.2
Spain	6.2
Slovenia	6.1
United States	6.1
Poland	5.9
Belgium	5.8
Slovakia	5.8
Bulgaria	5.7
Zambia	5.7
Austria	5.5
Canada	5.4
Mexico	5.3
New Zealand	5.3
United Kingdom	5.3
Czech Republic	5.2
Taiwan	5.2
Turkey	5.2
France	5.0
Kenya	5.0
Lesotho	5.0
Morocco	5.0
South Korea	5.0
Togo	5.0
Japan	4.8
South Africa	4.8
Croatia	4.7
Hungary	4.7
Pakistan	4.6
Italy	4.5
Brazil	4.4
Cabo Verde	4.4
Nigeria	4.3
Romania	4.3
Sri Lanka	4.3
Philippines	4.2
Rather high	
Thailand	3.9
India	3.8
Malaysia	3.7
Kazakhstan	3.4
Greece	3.2
China	2.7
Russian Federation	2.7
Bolivia	2.6
Congo Dem. Rep.	2.6
Ukraine	2.6
Zimbabwe	1.9
Argentina	1.3
Egypt	1.0

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/2015.

Table 4

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		China, Egypt, Greece, India, Kenya, Kosovo, Lithuania, Ukraine
Political stability	Congo Dem. Rep., Lesotho, Spain, Taiwan, Philippines	Greece, Sri Lanka

* 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/2015.

Inflation expectations remain low, particularly in Europe

On worldwide average, the WES experts' inflation forecast for the year 2015 is unchanged from that of the preceding survey (3.0%).

It is interesting to note that in high-income countries, mainly industrialized countries in *Western Europe*, *North America* and the *Near East*, this year's inflation forecast was slightly upwardly revised, whereas in most emerging economies like *Latin America* and *Asia*, it was the other way around. This seems to reflect the ongoing economic recovery in the industrialized world and the difficult economic situation in many emerging countries, which depends heavily on raw material prices, which remain weak.

In the medium term (2020), a global average inflation rate of 3.1% is expected, implying a pick-up in inflation particularly in *Western- and Eastern Europe* to 2.0 and 2.3% respectively, and a slowdown of the currently high inflation in many *CIS* and *Latin American* countries (see Table 2).

The inflation rate for the *euro area* on average in 2015 is estimated at 0.8%, and is thus slightly higher than according to the preceding survey (0.6%), but still far below the ECB inflation target rate (lower, but close to 2.0%). However, like in the previous survey, WES experts don't expect the inflation rate to remain at its current extremely low level for long. The medium-term inflation expectations (year 2020) stand unchanged at 2.0%. Within the *euro area* the lowest inflation rates in 2015 are again expected in two "crisis countries" *Cyprus* (-0.3%) and *Greece* (-0.4%). Inflation expectations also

remain below the overall price increase in *Finland* and *Estonia* (0.4% each), as well as in *France*, *Slovakia* and *Slovenia* (0.5% each). Inflation expectations somewhat above the overall average prevail mainly in *Latvia* (1.5%), *Austria* (1.3%) and the *Netherlands* (1.1%).

In *Western Europe outside the euro area* the span of inflation expectations for 2015 ranges from -0.8% in *Switzerland* to 1.8% in *Norway*.

A low-inflation trend will also continue in *Eastern Europe*. The expected 2015 inflation rate stands at 0.7% and is thus lower than expected at the beginning of the year (1.2%). Like in *Western Europe* the present very moderate inflation rate is seen as a transitory phenomenon; in the next five years inflation is expected to move again to more "normal" levels (2020: 2.3%). Apart from *Poland*, where even a minimal decrease in the price level (-0.1%) is expected, the lowest price increases in the region will be seen in 2015, according to WES experts in *Croatia* and *Macedonia*, as well as in the two euro member countries *Slovakia* and *Slovenia* (0.5% each). On the other hand, inflation will remain highest in the region again in *Serbia* (3.3%) as well as in *Bosnia and Herzegovina* (2.1%) and *Kosovo* (2.0%).

In *North America*, the latest inflation forecast for 2015 picked up slightly and is now close to that of the beginning of the year (1.6% compared with 1.7%). The medium-term inflation outlook (2020) was 2.5%, signalling that deflation appears to be no threat in the medium-term according to WES experts.

In *Asia* inflation expectations for 2015 continued to slow down further (from 3.0% at the beginning of the year to 2.7% in April and 2.5% this quarter). The medium-term

inflation rate remained unchanged at 3.1%. Some pronounced differences exist by country: in *China* the expected inflation rate for 2015 picked up slightly and now corresponds to that estimated at the beginning of the year (2.4%). On the other hand, the expected 2015 price increase in *India* is somewhat lower than according to the preceding survey (5.6% compared to 5.8%). In *Japan* inflation expectations for 2015 stand at 0.8% and thus remain somewhat lower than according to the survey at the beginning of the year (1.1%), and well below the 2% increase targeted by the Bank of Japan. In the medium-term this target-level will not be reached either according to WES experts (2020: 1.4%). The highest inflation rates in the region will prevail in *Pakistan* and *Bangladesh* (6.5 respectively 6.4%) this year, according to WES experts, while the lowest rate will be seen in *Taiwan* (0.4%).

In *Oceania* inflation expectations for 2015 stand at 1.8% and are thus lower than at the beginning of the year (2.3%), reflecting the weakness of raw material prices, which are important to economic performance in *Australia* and *New Zealand*. The mid-term inflation estimate remained unchanged (2.8% in 2020).

In *Latin America* inflation is expected to stay high (2015: 12.3%). However, this figure is again heavily influenced by the two high inflation countries *Venezuela* (116.2%) and *Argentina* (28.1%). In many other countries in the region, by contrast, the 2015 inflation outlook continues to be relatively moderate, particularly in *El Salvador* (1.3%) and in the *Dominican Republic* (2.3%). In *Brazil*, the largest economy in the region, inflation expectations for 2015 increased further to 8.8% and are thus significantly higher than at the beginning of the year (6.7%). The poor current inflation outlook will cause the Brazilian Central Bank to keep interest rates high, despite the on-going weakness in the real economy.

In *CIS* countries inflation expectations for 2015 are still rather elevated (15.2%). The highest rate of inflation in the region is again expected in the *Ukraine* (37.7%). The expected inflation rate in *Russia* this year of 13.6% is also significantly higher than the past five year average (8.1%).

In the *Near East* inflation expectations for 2015 picked up only moderately and remained slightly above 4%, a figure that also characterises

the mid-term inflation outlook. The highest inflation rate in the region is still expected in *Turkey* (8.1% in 2015 and 5.7% in 2020) and the lowest one in *Israel* (1.4% in 2015 and 2.9% in 2020).

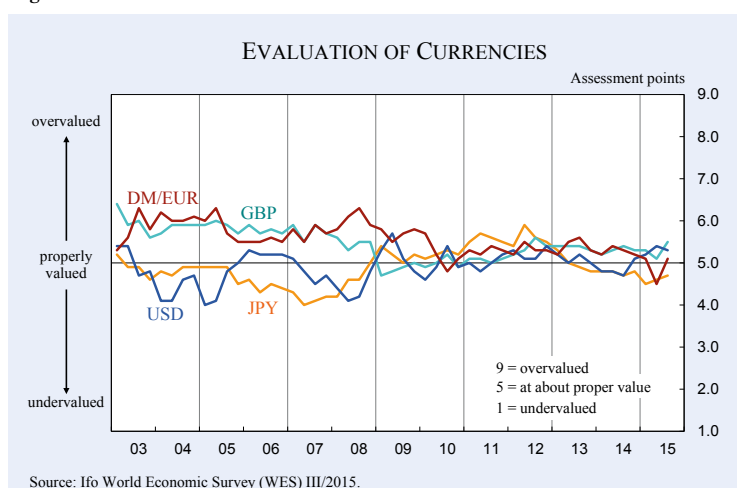
The *African* inflation outlook for 2015 remained largely unchanged at 7.2%. The mid-term inflation outlook only changed very little (6.5% compared with 6.3%). However, as in preceding surveys, the nationwide picture remains very heterogeneous: the expected 2015 inflation rate in the biggest economy in the region, *South Africa*, ranks well below the overall average at 5.5%. Apart from *Zimbabwe*, where the consumer price level is even expected to decline in 2015 (-0.6%), the lowest inflation rates in 2015 will prevail in *Congo Democratic Republic* (1.2%), *Cabo Verde* and *Benin* (1.5% each), *Togo* (1.9%) and *Morocco* (2.1%). The highest inflation expectations in the region are again reported by WES experts in *Sudan* (26.5%).

US Dollar still seen as somewhat overvalued, but expected to rise further

The *US dollar*, and to an even greater degree the *British pound*, are seen by WES experts as somewhat overvalued, while the *Japanese yen*, on the other hand, is seen as undervalued. According to WES experts, the course of the *euro* is largely in line with fundamental considerations (see Figure 11).

Major differences in currency evaluation remain from country to country. WES experts assessed their own currency as generally overvalued in *Switzerland*, the *CIS* countries of *Kazakhstan* and *Armenia*, in some

Figure 11



Asian countries like *Pakistan* and *Sri Lanka*, as well as in *Israel*, *Egypt*, *Argentina* and *Uruguay*. WES experts in the *Czech Republic*, *Poland*, *Bosnia and Herzegovina* and *Croatia*, *Turkey*, *South Africa*, the *Dominican Republic*, as well as the *Ukraine* and *Venezuela*, on the other hand, regarded their own currency as generally undervalued vis-à-vis the four leading world currencies the *US dollar*, *euro*, *British pound* and *yen*.

The answers to the supplementary survey question on likely trends in the *US dollar* in the next six months, regardless of how currencies are assessed from a fundamental point of view, signal again – and even a little more markedly than in the preceding survey – that the value of the *US dollar* is expected to rise over the course of the next six months on worldwide average. Some of the few countries that buck this trend are *Kenya*, *Algeria* and *Nigeria*, where a weakening of the *US dollar* is expected in the months ahead.

Interest rates set to diverge

On a worldwide scale, short-term and to a slightly more pronounced degree, long-term interest rates are expected to increase somewhat over the next six months. Interest rate increases in the *USA* were the most pronounced. In *Australia*, *New Zealand*, *Russia*, *Chile*, as well as in some important *Asian* countries (*China* and *India*), by contrast, interest rates are expected to decline over the next six months. Whereas in most of *euro area* countries long-term interest rates – like in most other parts of the world – are expected to pick up slightly over the next six months, this will not be the case in the two “crisis” countries *Greece* and *Portugal*, where interest rate spreads are expected to shrink in the months ahead. The expected increase in long-term interest rates in the average of the *euro area*, although still moderate, is at a first glance surprising, given the ECB’s on-going purchasing programme (“quantitative easing”). Obviously, the economic recovery stimulated by low interest rates will exert a stronger impact on the level of long-term interest rates than the interest rate dampening effect of the ECB purchasing programme in the months ahead, according to WES experts.

Supply of bank credit to firms continues to improve

Given the problems of firms in some countries concerning access to bank credit a specific question was added to the regular questionnaire in 2013 on a bi-

annual basis (January and July). WES experts are asked to assess the extent to which the supply of bank credit to the 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) and “strongly constrained” (1) (see Table 1).

Within the group of countries with a high degree of credit constraints there are – according to WES experts – still two “euro crisis countries” (*Greece* and *Slovenia*). In *Spain*, *Portugal* and *Italy*, which belonged to this group one year ago, external financing has become obviously easier in the meantime, which is reflected by the fact that these countries are now in the category of “moderately constrained supply of bank credits to firms”. The same holds true for *Hungary*. On the other hand, the *Russian Federation* and *China* are still in the group of countries where the supply of bank credit to firms is assessed as “strongly constrained”. New in this group are *Kazakhstan* and *Togo*. For the time being other members of this problem group include *Morocco*, *Lesotho*, *Romania* and *Zimbabwe*.

The top category “not credit constrained” has contained countries like *Canada*, *Australia*, *Japan*, *Switzerland*, *Colombia*, *Peru* and *Paraguay* from the outset, which were joined by *Germany* over a year ago and the *United States* as of the beginning of 2015. This group now comprises of 22 countries versus only 10 one year ago, reflecting improved economic conditions and a healthier banking sector.

As a general conclusion it can be stated that the credit availability situation shows a trend towards normalisation in the majority of countries, but there is a significant group of countries, amongst them “heavy weights” like *Russia* and *China*, where credit restrictions still pose a great problem to firms.

The IMF strengthened its preferred credit status; all other rescue funds are weakened¹

Two years ago, in April 2013, the Ifo Institute asked WES experts about the seniority status of various parts of the rescue funds in Europe for the first time. The results largely confirmed that multilateral lenders would have preferred credit status in case of insolvency. However, there were clear differences between the insti-

¹ Prof. Frank Westermann, Ph.D. / Director of the Institute of Empirical Economic Research, University of Osnabrück.

Figure 12

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

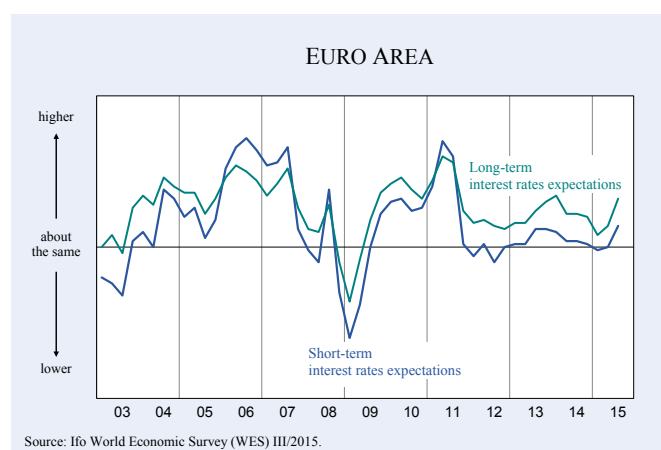
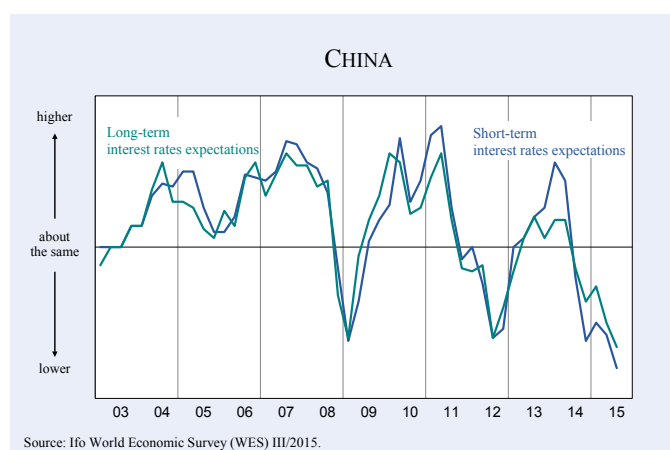
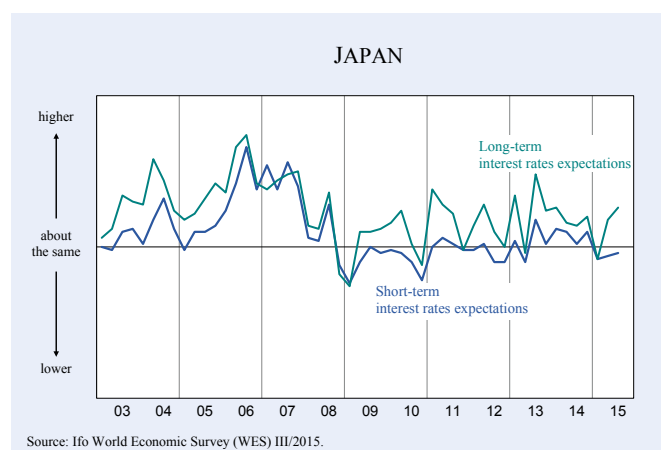
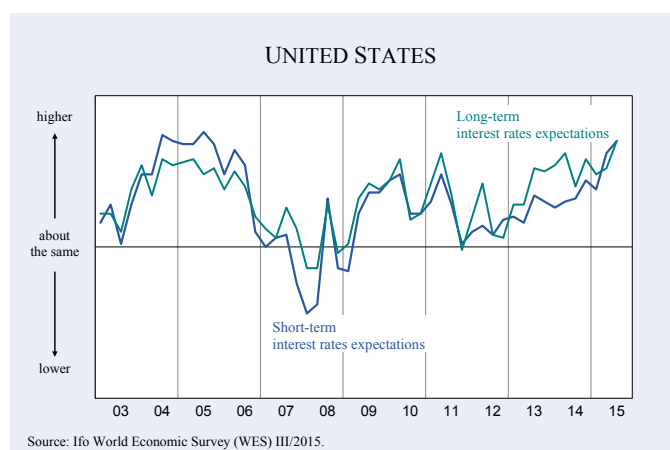
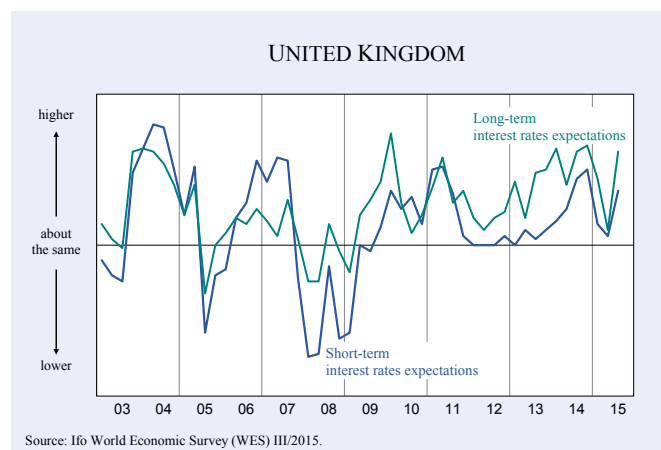
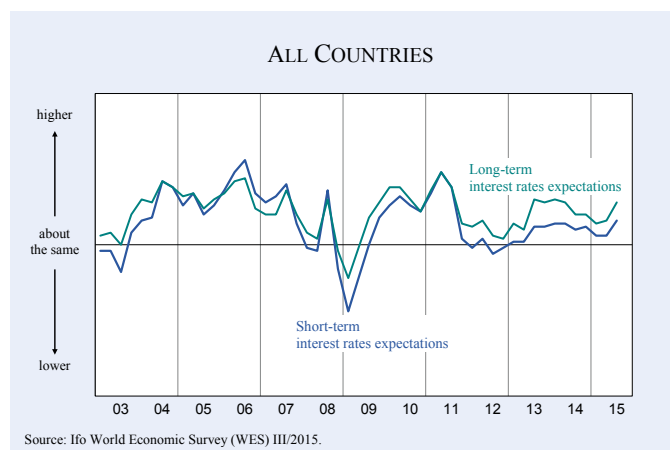
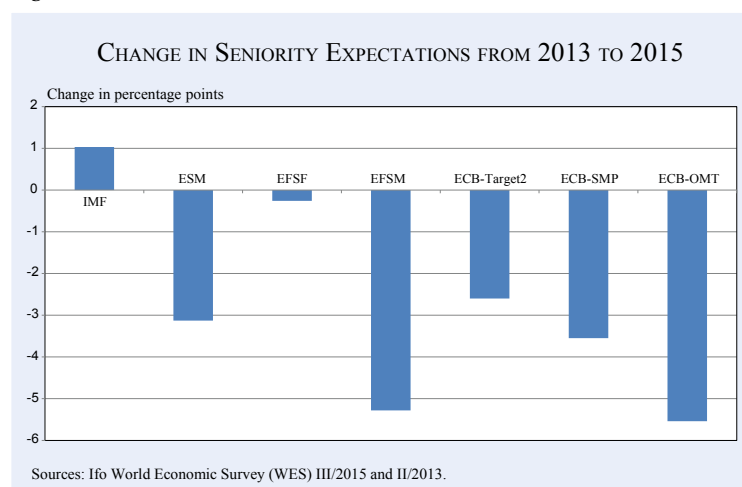


Figure 13



tutions. While the IMF was viewed as the most senior creditor, the ECB's debt-buybacks under the SMP Program, as well as TARGET2 claims, were viewed as least senior. In the new survey, conducted in July 2015, it is now possible to see how these expectations have evolved over time. The main finding is that the IMF has further strengthened its position vis-à-vis private creditors, while all other institutions have weakened their status.

In the meantime the original survey has been analysed in a formal regression analysis and the results were published in Steinkamp and Westermann (2014)². A remarkable feature of the survey results was that seniority expectations were correlated with interest rate expectations that were also part of the questionnaire. At the time, the vast majority of market participants had expected falling interest rates, an anticipation that from today's perspective turned out to be correct. However, the sub-group of survey participants that expected the institutions to be senior to private markets shared this expectation to a much lesser extent. Those who expected the multilateral creditors to be treated *pari passu* with private markets clearly expected falling interest rates. This difference was found to be statistically significant in a Probit-Regression analysis that also included other variables from the survey like expectations regarding GDP, current account and public debt.

The differences across institutions that came out even more markedly in the new survey are quite interesting from both institutional and theoretical perspectives. From an institutional perspective, it is interesting that the IMF is viewed as most senior, although it does not

formally have any seniority clauses in its lending contracts. Its preferred creditor status simply derives from past experience and from the fact that the IMF – unlike other institutions – lends only rather short term. The ESM, on the other hand, is formally a senior creditor. In its preamble this is stated as a mutual understanding of all members that, in case of insolvency, the ESM will have a preferred creditor status. However, the rather long-term lending, combined with the lack of a track-record of enforcement,

appear to make this de-Jure status not very credible. Only about half of the survey participants believe it will be implemented.

From a theoretical perspective, these findings are also quite relevant as they help us to understand what kind of economic model is underlying the current euro crisis. The period of high interest rates in Europe from 2010 to 2013 has often been explained as a multiple equilibria phenomenon. Several researchers have documented that interest rate spreads were hard to reconcile with underlying fundamentals such as GDP or public deficits. They were thus attributed to bounded rationality in financial markets, as well as herding behaviour and overreactions in a panic. The clear evidence of seniority expectations offers a different view: private creditors may have been worried about being pushed into a junior-lender position when the official rescue package grew large. Accordingly, they charged a higher marginal interest rate. In some of the crisis countries, the rescue packages accounted for over half of total public debt at the peak of the crisis. Thus, concerns about subordination could well have been responsible for at least part of the interest rate hike.

The changes from the first to the second survey are in some cases not very large, but mostly point in the same direction (see Figure 13). The IMF has slightly improved its status: 70.6% of the participants expect a preferred creditor status compared to 69.6% in 2013. The ESM and EFSF displayed values of 50.3 and 52.7%, respectively. In the case of the ESM, this represents a decline of 3.1 percentage points compared to the last survey, while the EFSF remained nearly unchanged (-0.3). The EFSM (bilateral loans) experienced a decline from 64.8% to 59.5%. Finally, the ECB continues to have the

² Steinkamp, Sven & Frank Westermann, "The role of creditor seniority in Europe's sovereign debt crisis", *Economic Policy* Vol. 29 (79), July 2014.

lowest seniority expectations. For TARGET2 claims, the share has dropped from 42.4% to 39.8%. In the case of SMP bonds, it has declined from 39.1% to 35.5%. The not yet implemented OMT and the new QE programme displayed values of 39.9 and 40.9%, respectively – in the case of the OMT, a decline of 5.5 percentage points.

This decline in seniority expectations about most of the rescue institutions is consistent with the decline in the level of interest rates over the recent two-year period. It also reflects recent changes in de-Jure seniority stance. In the OMT announcement, as well as in the QE programme that is currently being implemented, the ECB had stated for the first time that it would be treated *pari passu* with private creditors. The IMF, on the other hand, is currently defending its senior stance in debt-negotiations with Greece.