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Ifo World Economic Survey March 2003

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IFO WORLD ECONOMIC SURVEY

World Economic Climate

THE CURRENT SITUATION OF THE WORLD
ECONOMY REMAINS UNCHANGED

Economic Expectations

ECONOMIC EXPECTATIONS FOR THE NEXT SIX
MONTHS SLIGHTLY IMPROVED

Inflation

NO PICK UP OF INFLATION EXPECTED IN 2003

Interest Rates

DOWNWARD TREND OF SHORT-TERM AND
LONG-TERM INTEREST RATES EXPECTED TO
LEVEL OFF

Currencies

MAJOR WORLD CURRENCIES NOW CLOSE TO
SUSTAINABLE EQUILIBRIUM

Special Topic

WES EXPERTS IN DISAGREEMENT ABOUT THE
THREAT OF WIDESPREAD DEFLATION AT A
GLOBAL LEVEL

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Ifo World Economic Survey

Highlights

- The current situation of the world economy remains unchanged
- Economic expectations for the next six months slightly improved
- No pick up of inflation expected in 2003
- Downward trend of short-term and long-term interest rates expected to level off
- Major world currencies now close to sustainable equilibrium, although the UK pound still overvalued
- WES experts in disagreement about the threat of widespread deflation at a global level. But clear signs of isolated deflationary tendencies in some countries.

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

Notes

The World Economic Survey (WES) assesses worldwide economic trends by polling transnational as well as national organizations worldwide about current economic developments in the respective country. This allows for a rapid up-to-date assessment of the economic situation prevailing around the world. In January 2003 about 1 120 economic experts in 90 countries were polled.

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

Methodology and Evaluation Technique

The questionnaire used asks mainly for qualitative information, that is to say for the assessment of the country's general economic situation and expectations regarding important economic indicators. It has proved to be a useful tool since economic changes are revealed earlier than by traditional business statistics.

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

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

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

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

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

WORLD ECONOMY: DOWNWARD TREND STOPPED?

In January 2003 the world economic climate improved slightly. At 85.9 (1995=100) it is still significantly below its long-term average (93.6 in the period 1982 to 2002), though slightly higher than in the previous survey (83.2). The somewhat brighter economic climate is solely attributable to the slightly improved expectations for the next six months, whereas the assessment of the current economic situation, the second component of the world economic climate, remained negative and has not changed since October 2002.

At this stage, given the geopolitical instability, it is not possible to interpret the current small increase of worldwide economic climate already as a clear sign for the beginning worldwide recovery. It cannot be ruled out that the downward trend has just been interrupted. Of crucial importance will be the next survey in April, which will most likely take place in a situation of diminished geopolitical uncertainty with fundamental economic trends becoming clearer.

World economy: Slight improvement of climate indicator

The downturn of the economic climate indicator, which accelerated in the period August to October 2002, was reversed in January 2003. The slight

improvement of the overall climate indicator resulted exclusively from somewhat more positive expectations for the coming six months, whereas the current economic situation remained at the low October 2002 level (see Figure 1 and 2).

The capital expenditure sector is still performing worse than the consumption sector.

Asia: The economic climate somewhat better

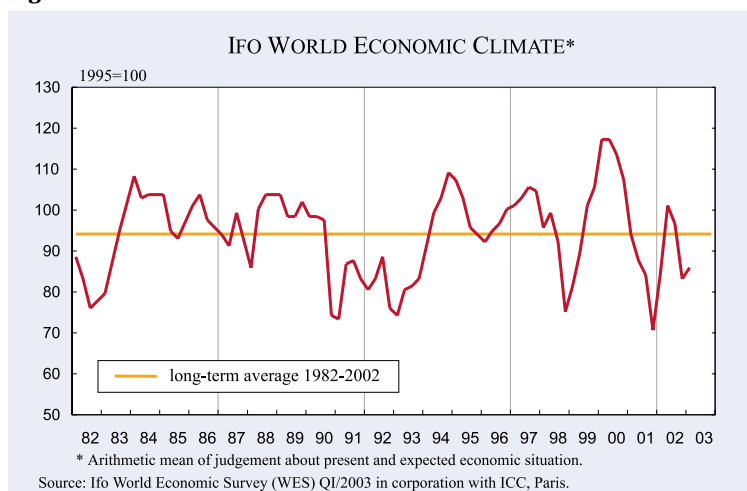
According to the new survey, the expectations for the economic development in the next six months improved, whereas the assessment of the current economic situation remained unchanged. Compared with the previous survey, the overall economic climate indicator for Asia slightly improved but still remained below its long-term average (see Figure 3 and 4).

Concerning the present economic situation, *China* maintained the leading position in Asia, followed by *Vietnam*, where optimistic expectations reported in the previous survey proved true again and stayed positive for the next six months as well. The expectations for the future developments in *China* are mostly positive. The economic situation of *South Korea* was rated as more than satisfactory in January.

Also the economies of *India*, *Thailand* and *Pakistan* performed at a highly satisfactory level according to WES experts. This might be related to the increased domestic private consumption in recent months, which is also expected to remain buoyant in the course of the next six months.

The economic climate in *Japan* and *Indonesia* is still rough. The assessment of the current economic situation followed the negative expectations of the last quarter and is well below

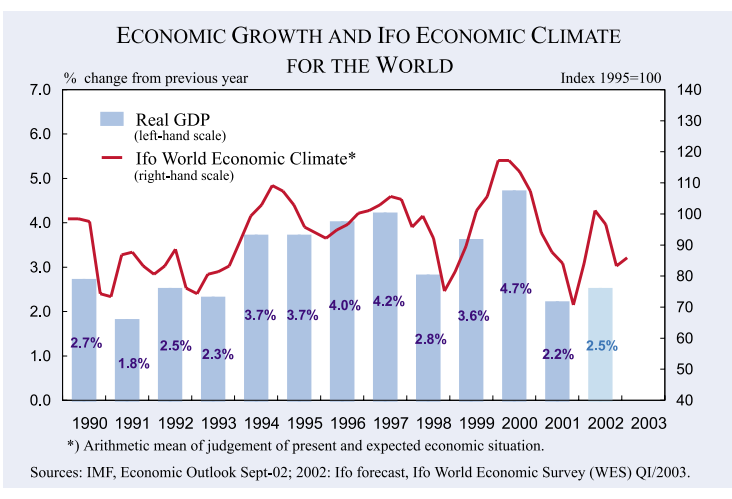
Figure 1



Box: Ifo/ICC World Economic Survey (WES) and Growth in the World Economy

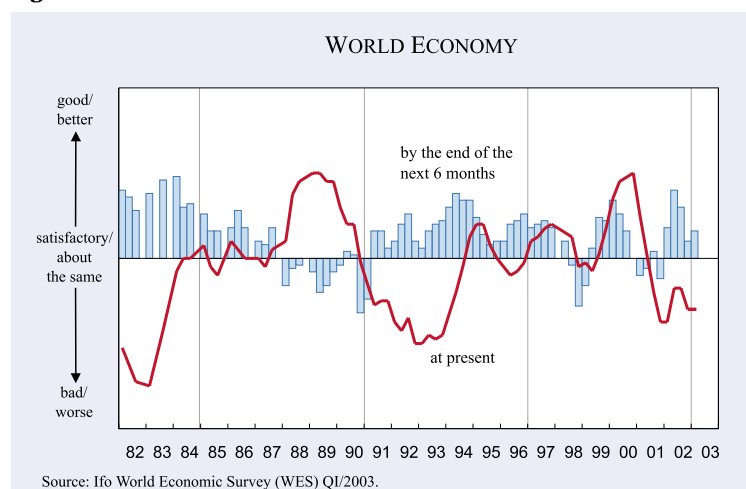
The Ifo/ICC World Economic Climate indicator closely tracks the growth of the world economy (see Figure). The WES World Economic Climate indicator slightly improved in January 2003 after having weakened strongly in the preceding survey of October 2002. Nevertheless the most recent values for the economic climate remain well below the long-term average. The improvement in the indicator as a whole resulted exclusively from more positive expectations for the next six months, the assessments of the current economic situation remained unchanged. Despite the geopolitical uncertainties, on the whole the WES participants expect a slight recovery of the world economy.

A regional breakdown shows that the economic climate stabilised at its low level particularly in Western Europe and marginally improved in North America and Asia. The new WES results indicate that growth in Europe in the next six months will continue to lag behind the world average.



the »satisfactory« level. Also the short-term expectations point to further deterioration. The less optimistic forecast for the next six months is probably related to the fact, that WES experts in *Japan* do not expect significant recovery of the consumption sector that could dampen the deflationary trend in the country. Only the export sector in *Japan* is providing some impetus.

Figure 2



Also in *Taiwan* assessments of the present economic situation experienced a slight deterioration, but more dynamic economic growth than in the recent past is seen ahead. In the *Philippines* the present economic situation remained slightly below satisfactory, but the expectations for the next half year improved and are now close to the Asian average. In *Singapore* the economic situation deteriorated in past months but is expected to improve. *Hong Kong* again showed a considerable weakness in economic performance, which is reflected in the low level of the assessment of the present economic situation, and no significant change to the better is expected in the next six months. The present economic situation in *Mongolia* is rated clearly below satisfactory. The short-term expectations point to no major changes although the private consumption sector is expected to continue to improve (see Figure 9).

Western Europe: Downward trend of the economic climate comes to a halt

In contrast to the world average, the climate indicator in Western Europe has not increased since the October 2002 survey. This stagnation results from more negative assessment of the present economic situation, whereas the expectations for the coming months improved slightly since the previous October 2002 survey (see Figure 3).

In contrast, the non-euro countries *Denmark*, *United Kingdom* and *Norway* appear to be faring significantly better economically than the other European countries. Only in *Sweden*, which is also not in the euro area, the current economic situation deteriorated slightly, though remaining

Figure 3



Among the countries with the single currency only *Finland*, *Spain* and *Ireland* assess the present economic performance as satisfactory or good. The economic short-term expectations in *Finland* remained optimistic, probably due to the high level of private consumption and continuously favorable growth rates of exports in the coming months. In *Ireland* and *Spain* the economic performance is expected to remain on the satisfactory level in the next six months.

As in the previous survey, *Germany* again shows the lowest level by far of assessments of the present economic situation and together with *Austria*, *Portugal*, *Italy* and the *Netherlands* was in the bottom group of EU countries. However, there is some hope for the second half of the year: WES experts see signs of an economic recovery in the next six months particularly in *Italy* and *Germany*, in the later cases many thanks to positive prospects for exports. In the other countries, the short-term expectations are moderately positive, although they do not really raise hopes for a reversal of the negative trend.

WES experts in *France* and *Belgium* assessed the present economic performance as poor, whereas the expectations remained positive for the next six months (see Figure 7a/b).

close to the satisfactory level. On the other hand, in *Norway* the economic expectations for the next six months are worse than the Eurozone average. In the *United Kingdom* the economic development is still characterized by falling exports, and therefore a further deterioration of the trade balance is expected in the next six months.

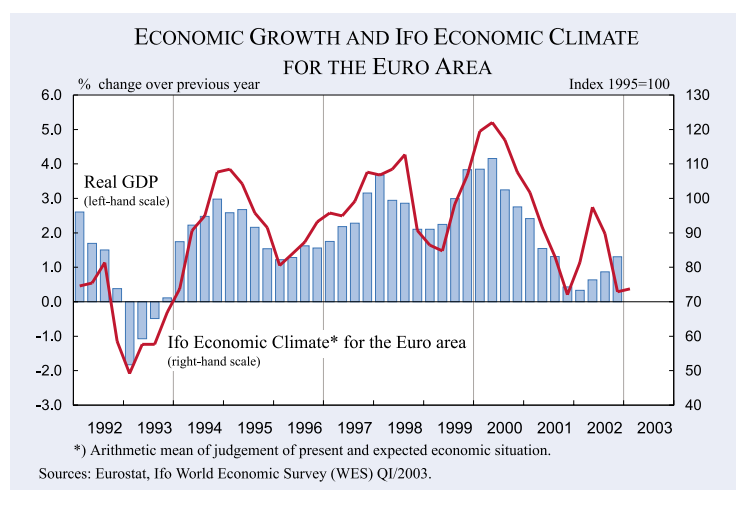
Eastern Europe: Stabilization of economic climate continues

According to WES experts the current economic situation in Eastern Europe improved slightly since the October 2002 poll. On average, the outlook remained mostly unchanged, reflecting the

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

The Ifo World Economic Climate for the 12 member countries of the euro area is the arithmetic mean of the assessments of the general economic situation and the expectations for the economic situation in the coming six months. The January results are based on the responses of 293 experts. As a rule, the trend of the Ifo Economic Climate indicator correlates well with the actual business-cycle trend for the euro area – measured in annual growth rates of real GDP (see Figure).

The Ifo indicator for the economic climate in the euro area improved marginally in January 2003 compared with the WES results of October 2002. The moderate increase of the WES euro area indicator resulted exclusively from slightly better expectations for the next six months. The assessments of the present economic situation, the second component of the climate indicator deteriorated further. In summary the latest development of the euro climate indicator points to an weak growth in the coming six months.



general uncertainty concerning future economic development (see Figure 8).

The current economic situation continues to be good particularly in the Baltic countries (*Estonia, Lithuania* and to a lesser degree *Latvia*) and in *Slovenia*. Also the expectations for the next six months remained bright in these countries.

The economic development in *Croatia* continues to be on the upward trend and is assessed as almost satisfactory. The prospects for future development remain highly positive. Similarly in *Bulgaria* the assessment of the present situation improved considerably. To a lesser degree this holds true also for the *Czech Republic*, where the economic situation is now regarded as satisfactory. However, according to WES experts the economic outlook for the *Czech* economy appears to be clouded; growth of capital expenditures, private consumption and exports is expected to slow down in the course of the next six months.

In *Poland, Romania* and *Yugoslavia* the present state of the economies remained clearly below the

“satisfactory” level but is expected to brighten up somewhat the course of the next six months. The reason for the optimistic forecast is probably the more buoyant consumption sector in these countries, which is expected to grow further in the coming months.

CIS: Economic situation remains satisfactory

In *Russia*, the assessment of the current economic situation remained above the “satisfactory” level. WES experts expect a stable economic performance in the next six months. Although the assessment of capital expenditures deteriorated since the previous October poll, both private investment as well as consumption is likely to grow faster in the next six months. WES experts also expect exports to increase in the coming months.

Positive signals also come from *Kazakhstan*, where the economic performance remains highly satisfactory with bright expectations for a further recovery in the course of the next six months. Especially exports are expected to rise in the next half year.

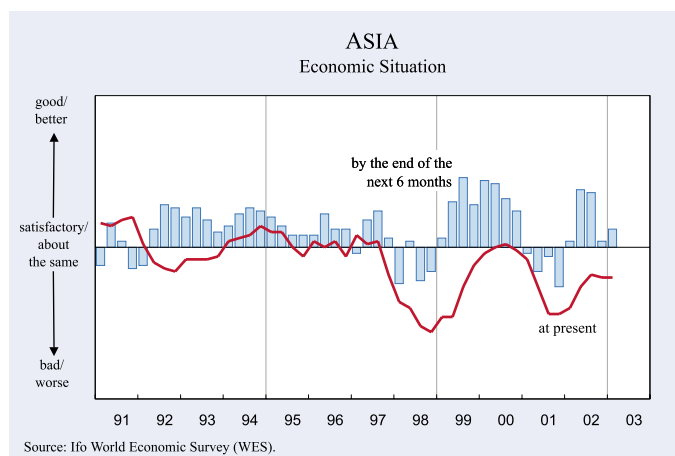
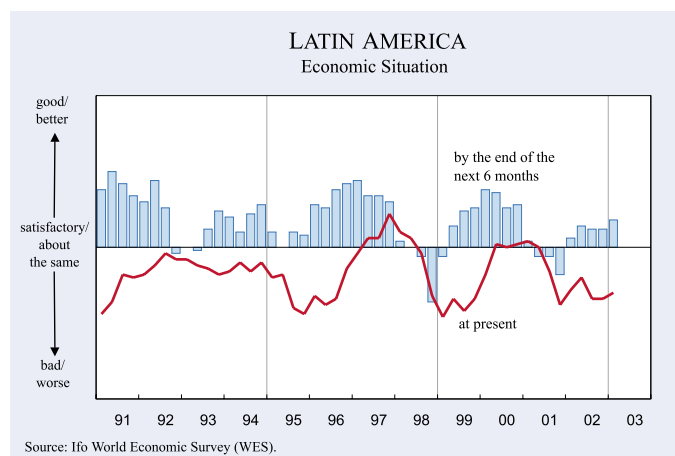
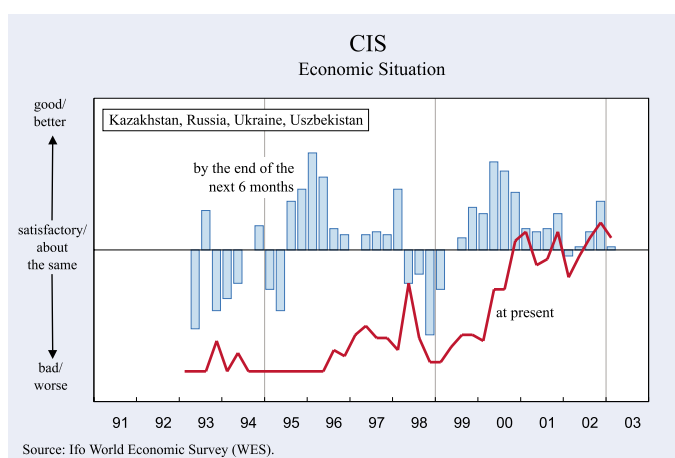
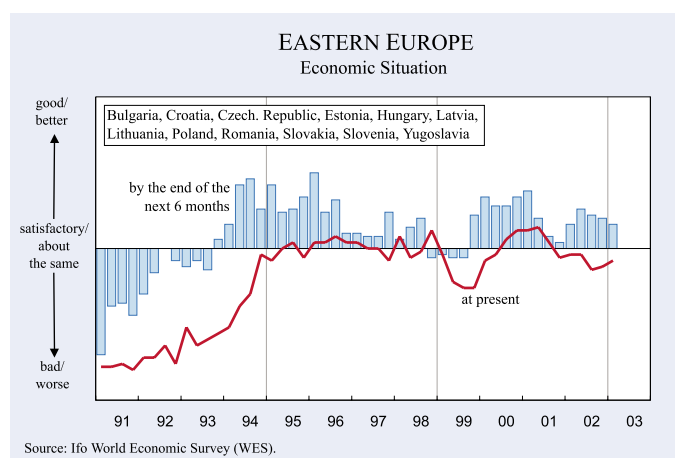
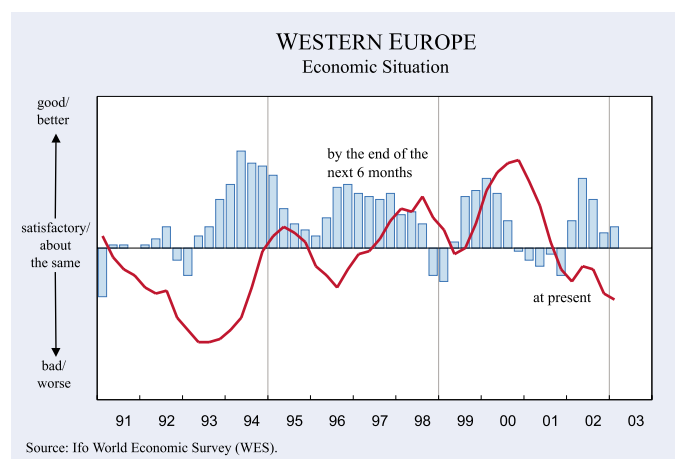
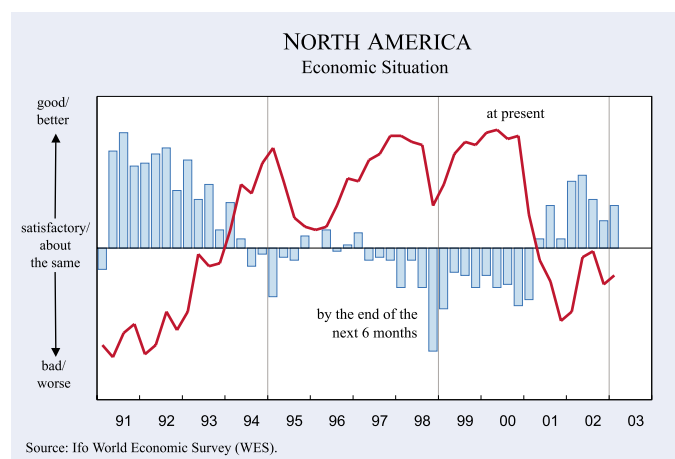
In contrast, the picture for *Ukraine, Georgia* and *Uzbekistan* is characterized by low economic performance at present. The expectations concerning future developments point to no major changes in the coming months (see Figure 4).

North America: Slight improvement of economic climate

After a setback of the economic climate in the fourth quarter of last year, a slight improvement was recorded in January 2003. Both the assessment of the present economic situation as well as the expectations for the next six months point upwards. The positive tendency is more pronounced in *Canada* than in the *United States*, where

Figure 4

SELECTED REGIONS



the present economic situation is still regarded as below satisfactory. This is mainly due to the still unsatisfactory level of the hard-hit capital expenditure sector, which, however, is expected to improve within the next six months, giving hope to a brighter outlook for the whole *US* economy (see Figure 3 and 4).

Oceania: Upward trend continues despite cautious expectations

Australia's and *New Zealand's* upward trend, which had already set in at the end of 2001, continued also in January 2003, despite negative expectations of the WES correspondents in the previous poll. The overall economy prospered steadily, despite massive ecological and environmental problems in *Australia* due to the drought during the summer period. However, both in *Australia* and *New Zealand* the outlook of WES experts for private consumption, as well as for capital expenditures and exports remained cautious.

Latin America: Current economic situation still unsatisfactory

Brazil, Chile, Peru, Costa Rica and *El Salvador* currently show the relatively best economic performance – the majority of WES experts here judged the current economic situation as almost satisfactory (see Figure 10). The general economic expectations became highly positive particularly in *Brazil, Chile, Peru* and *El Salvador*, which is also reflected in a relatively optimistic view of future trend of capital expenditures, consumer outlays and exports.

In *Argentina* the present economic performance still remains at a very low level. However, the expectations for the next six months have improved somewhat. Especially the export sector in *Argentina* is expected to pick up in the coming months. Also in *Uruguay* and *Paraguay* the current economic performance is rated as poor but is expected to improve in the near future. In *Panama* and *Mexico* the economic situation remains clearly below the “satisfactory” level. However, in both cases expectations are positive.

In summary, almost all countries in Latin America expect the overall economy to strengthen in the

coming months, accompanied by more dynamic growth of capital expenditures, private consumption and export. The only exception, according to the WES poll of Latin America, is *Venezuela*: The current economic situation here is rated very poorly and is expected to worsen even further in the course of the next months. The economic crisis is to be seen in the context of the political turmoils and the negative effects of the protracted general strike that affected several industrial sectors, especially the petroleum industry.

Africa: Diverging economic trends prevail

On average for the African countries polled in the survey, the economic performance has slightly improved during recent months and is now approaching the satisfactory level (see Figure 11). In particular the economies of *Morocco* and *Tunisia* were regarded by WES experts as satisfactory or good and there appears to be a good chance for a continuation of these positive trends in coming months.

South Africa's present economic situation is again regarded by WES experts to be above the satisfactory level and the prospects for the next six months point to a continuation of this positive trend, despite negative expectations concerning export performance.

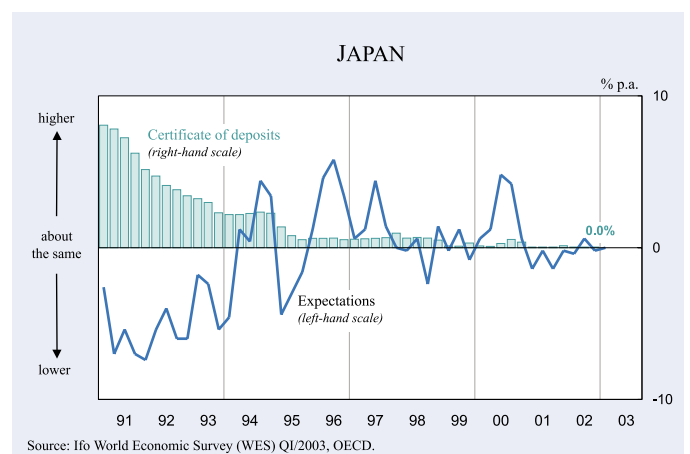
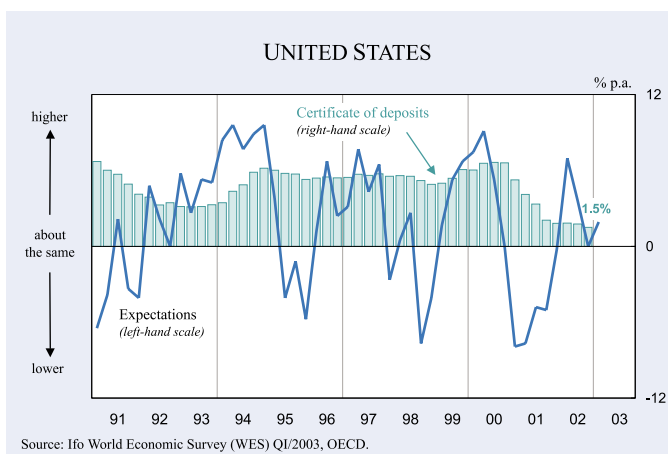
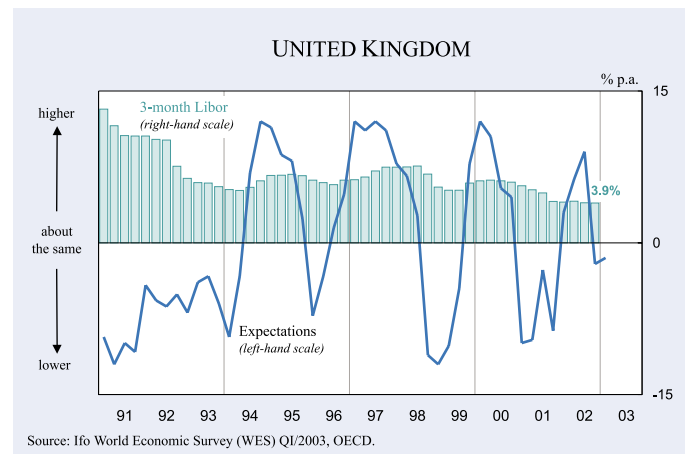
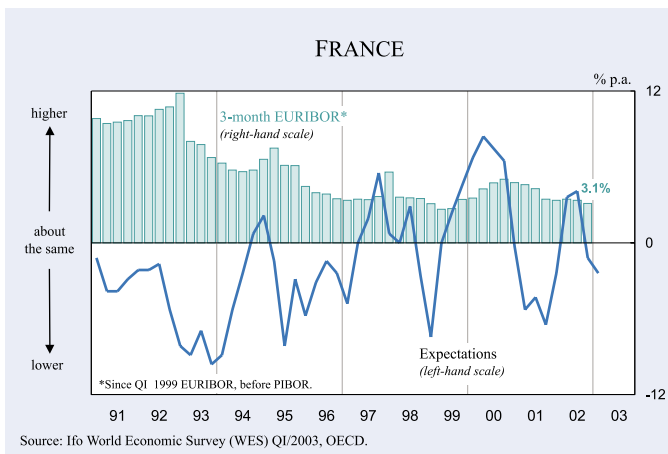
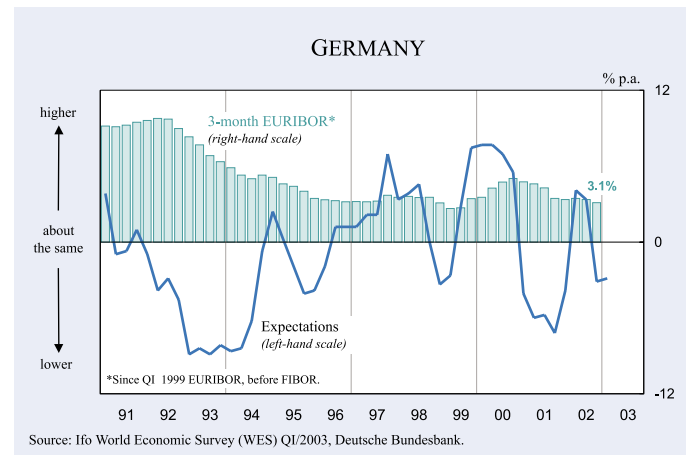
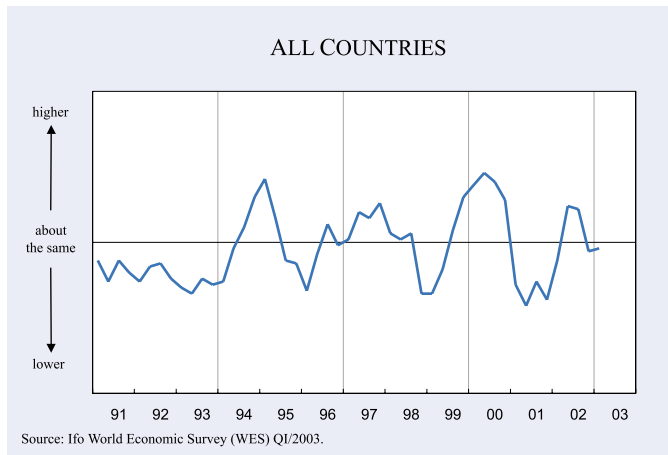
The worst economic situation was again reported from *Zimbabwe* where the outlook also remained very bleak. The present economic situation in *Nigeria* and *Algeria* is again rated as bad. Also in *Egypt* and *Kenya* the assessments of WES experts are considerably below the satisfactory level; whereas in *Kenya* the expectations of WES correspondents point to a recovery of the country's economy, there will hardly be a change for the better in *Egypt*.

Near East: Economic climate improved slightly

The overall assessment of the current economic situation in the Near East remained close to the satisfactory level (see Figure 11). By far the best economic performance is shown by *United Arabian Emirates*, followed by *Saudi Arabia* where the outlook for the coming six months – like the average for the Near East – signals an improvement of eco-

Figure 5

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



economic activity. The economy of *Bahrain* was rated as satisfactory, though expectations for the next six months are clouded. The recent economic situation in *Iran* and *Jordan* is expected to remain at a satisfactory level. *Turkey's* current situation slightly improved, although still remaining well below satisfactory. However, the expectations for the next six months in *Turkey* are clearly positive. *Israel* continues to suffer from political and economic crisis; WES experts don't expect a noticeable improvement in the next six months, although they see a chance for export growth.

Interest rates: Trend of sinking short-term interest rates expected to slow

The phase of sinking **short-term interest rates** is expected to level off in the course of the next six months (see Figure 5). In *North America* – as well in the *USA* as in *Canada* – no further cuts are expected. Instead, in both cases short-term rates should pick up slowly in the course of the next six months. A stabilisation or even a slight increase of rates appears to be also likely in *Australia* in the coming months. In Asia and particularly in *Western and Eastern Europe* the downward trend of short-term interest rates is still intact and expected to continue almost unchanged in the coming months. In *Africa*, particularly in *South Africa*, there is now a high likelihood for rate cuts, contrary to the survey results of last October. In Latin America expectations still prevail of rising short-term interest rates, though the trend is not homogeneous: In countries like *Brazil*, *Peru*, *Bolivia*, *Ecuador* and *El Salvador* short-term rates, according to WES experts, are likely to decline in the coming months, whereas in most other Latin American countries, including *Argentina*, *Mexico* and particularly *Venezuela*, a further increase of short-term rates appears to be more likely.

Long-term interest rates should remain stable or increase at best marginally in the course of the next six months. This picture characterizes in particular the situation in Western Europe. In contrast, an upward trend of long-term interest rates is expected again particularly in *North America* and *Australia* as

well as in some *Latin American* countries like *Argentina*, *Mexico* and *Venezuela* and in some Asian countries like the *Philippines* and *Vietnam*. On the other hand, a continued downward trend of long-term interest rates will prevail, according to WES experts, in most Eastern European as well as *CIS countries* and some Asian countries like *China*, *India*, *Pakistan*, *Taiwan* and *Thailand*. More pronounced than in the past surveys, a declining trend of long-term interest rates is expected in most African countries, *South Africa* included. A downward bias of capital market rates prevails also in the Near East, most clearly in *Turkey* and *Lebanon*.

World currencies seen relatively close to equilibrium

On average of the 90 countries polled, only the British pound sterling is still judged to be overvalued. The US dollar appears to be only slightly higher than fundamentally justified. For the first time since its existence, the euro is regarded as slightly overvalued. The current level of the Japanese yen is assessed as appropriate by the vast majority of WES experts (see Figure 6).

In Western Europe, *Canada* and *Australia* the US dollar is still seen as overvalued against own currencies, though to a lesser degree than in the previous surveys. WES experts in Eastern Europe and Russia consider the major world currencies close to "fair value" against their local currencies, except *Poland*, *Slovenia* and *Slovakia*, where the experts rated the US dollar and the euro as being clearly overvalued against own currencies. In Latin

Figure 6

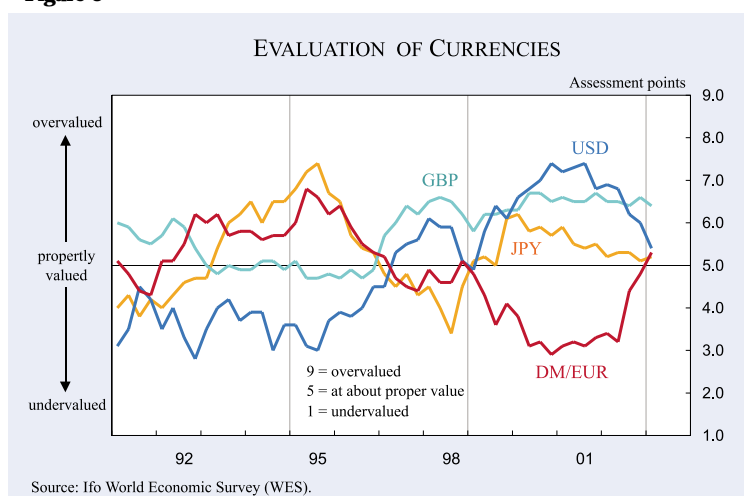


Figure 7a

EUROPEAN UNION

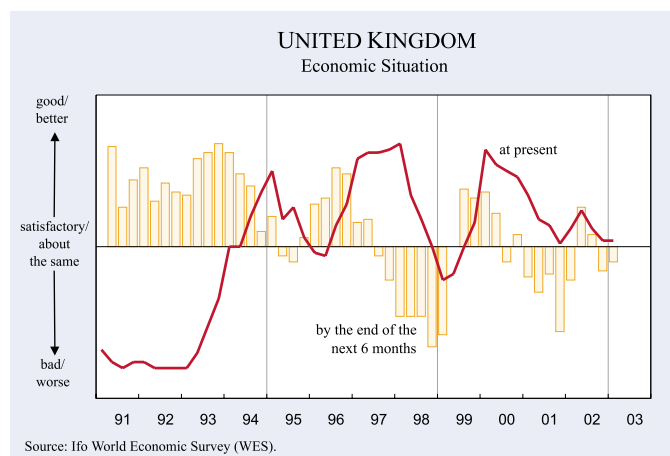
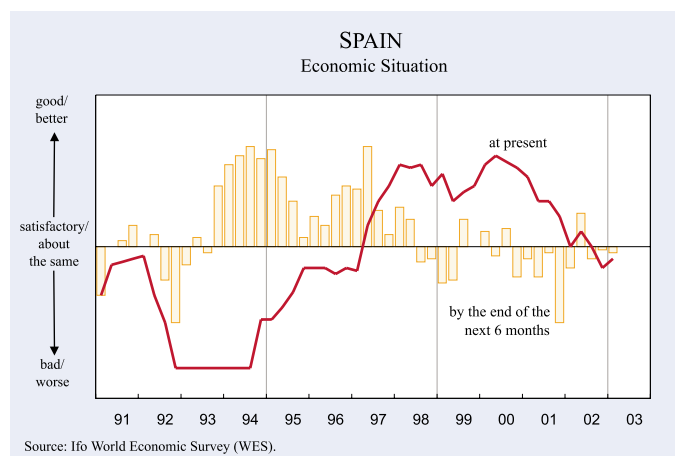
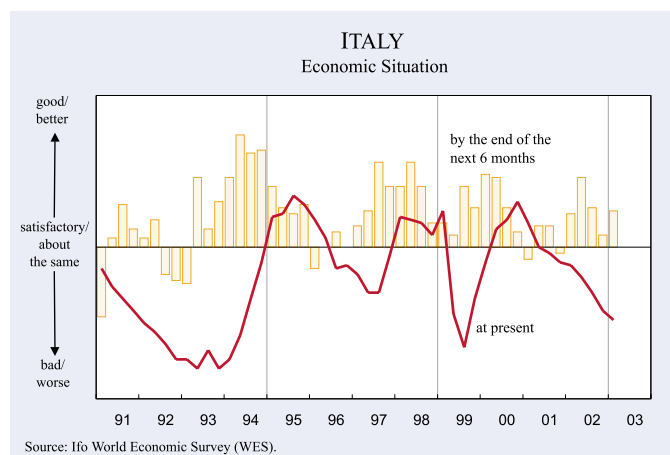
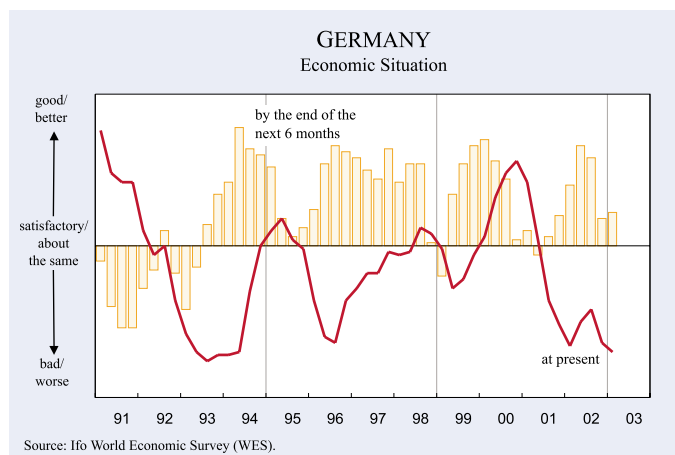
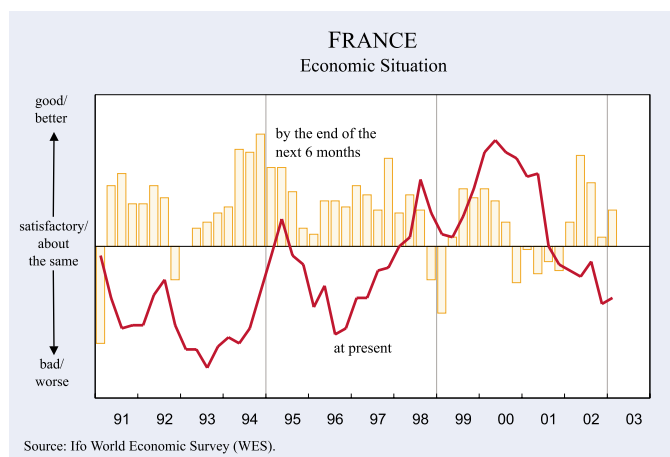
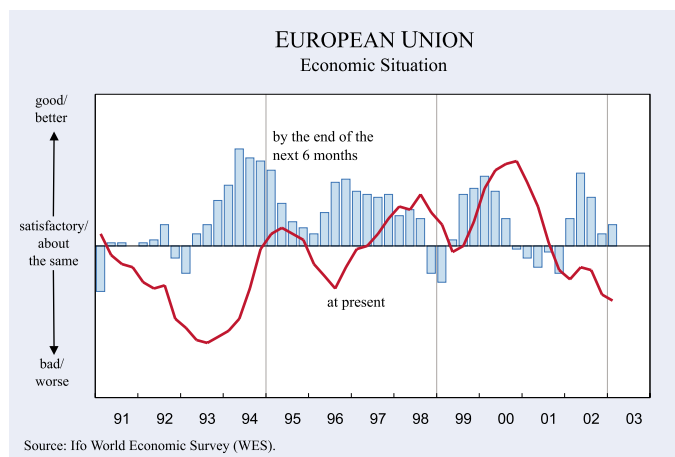


Figure 7b

EUROPEAN UNION

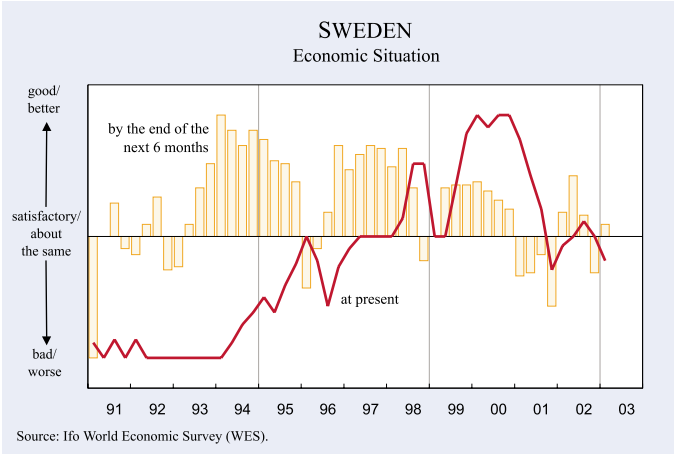
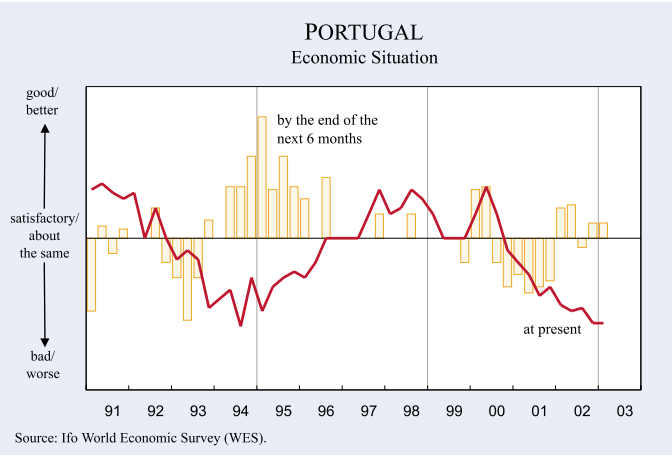
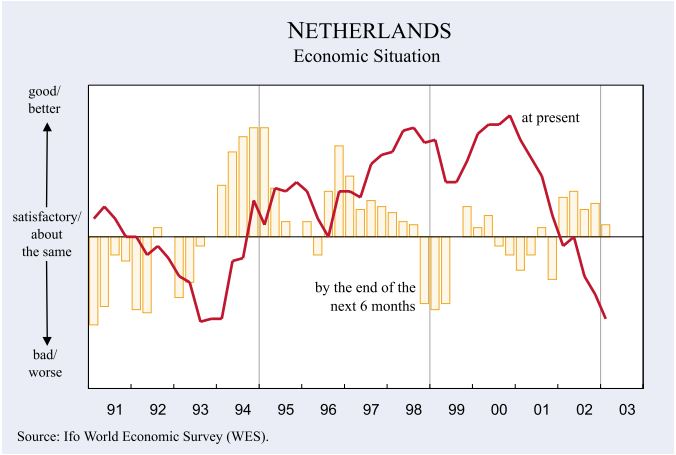
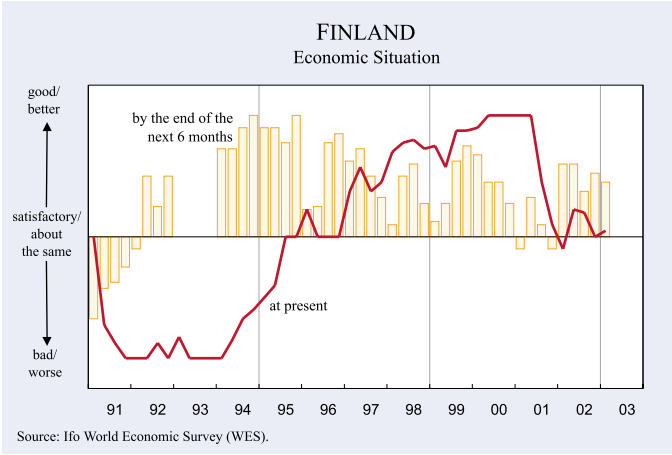
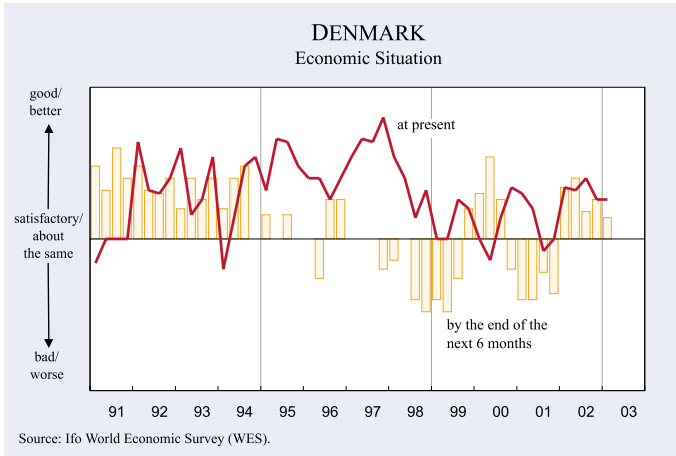
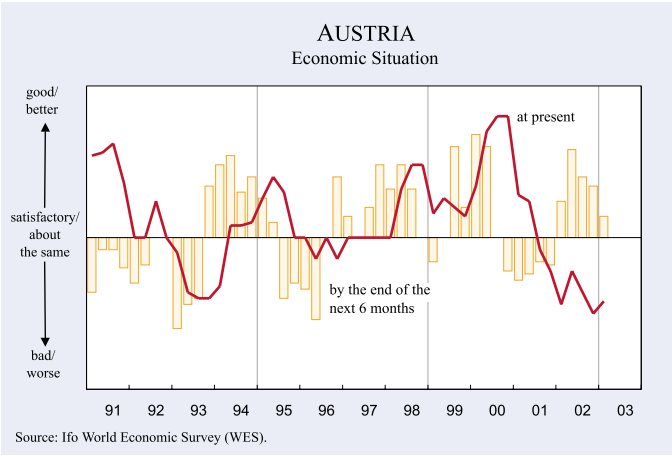


Figure 8

EASTERN EUROPE

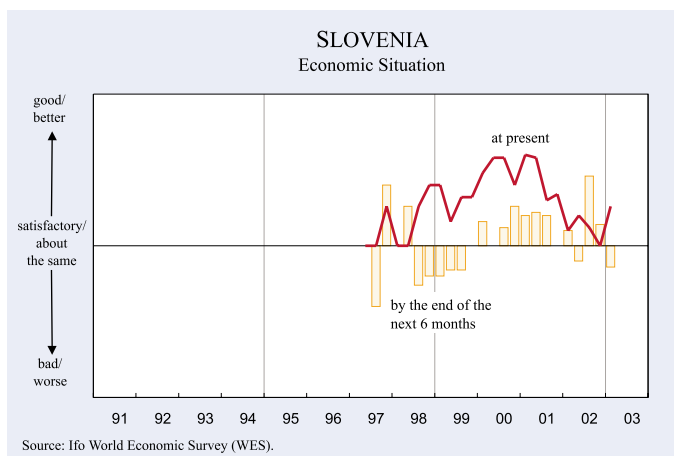
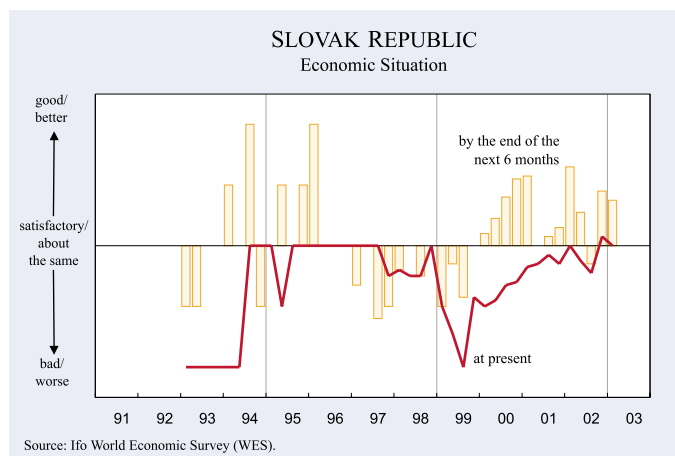
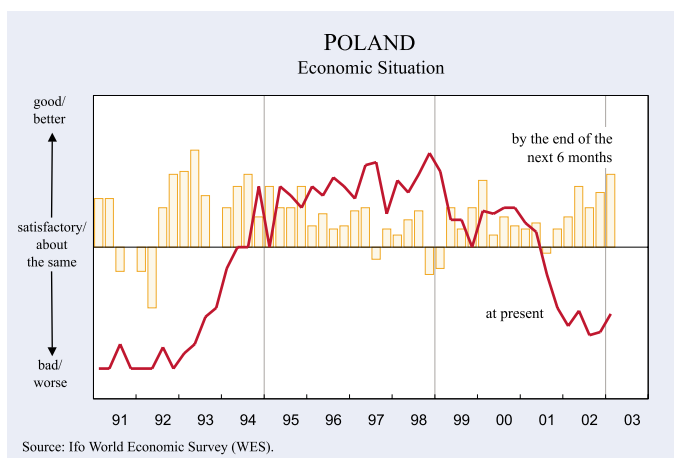
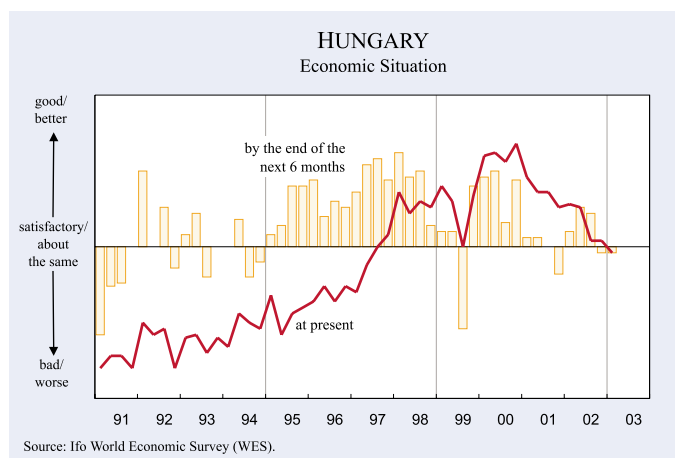
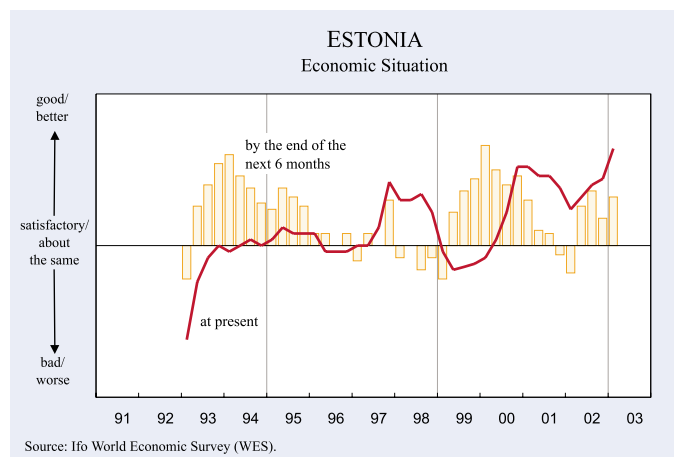
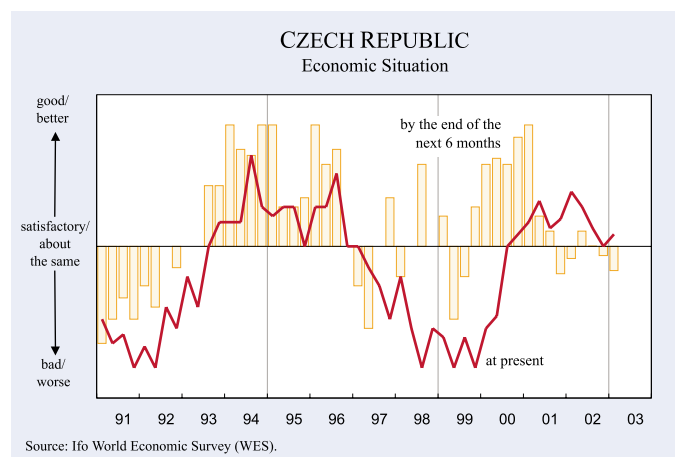


Figure 9

ASIA

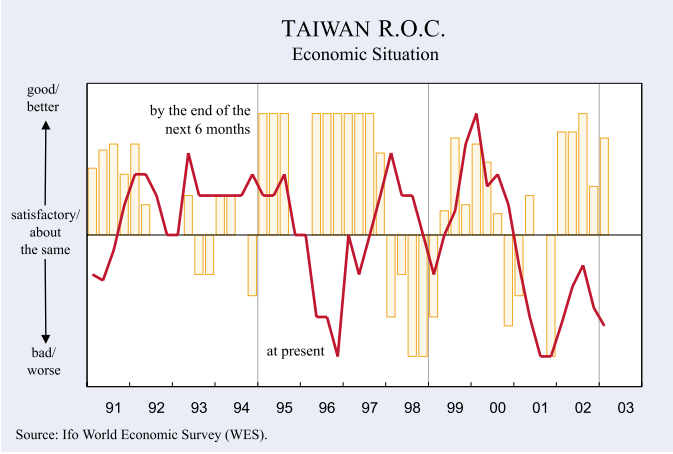
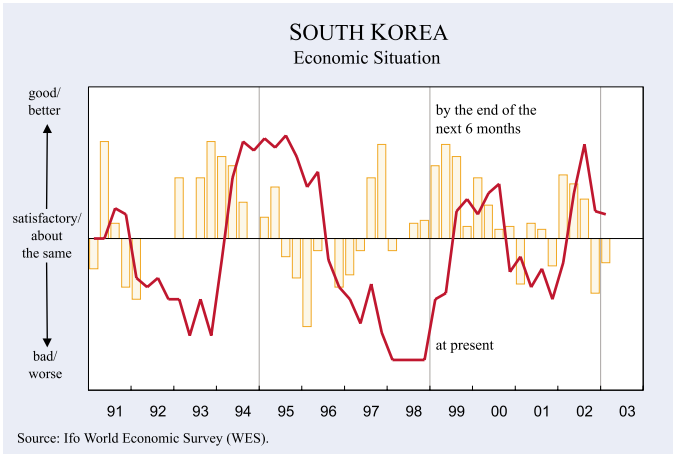
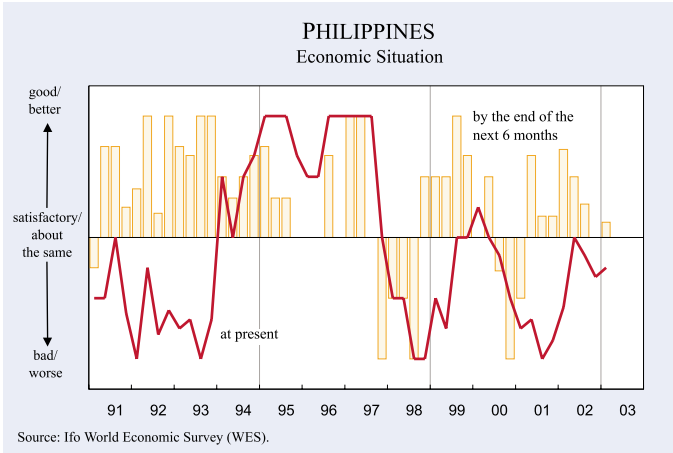
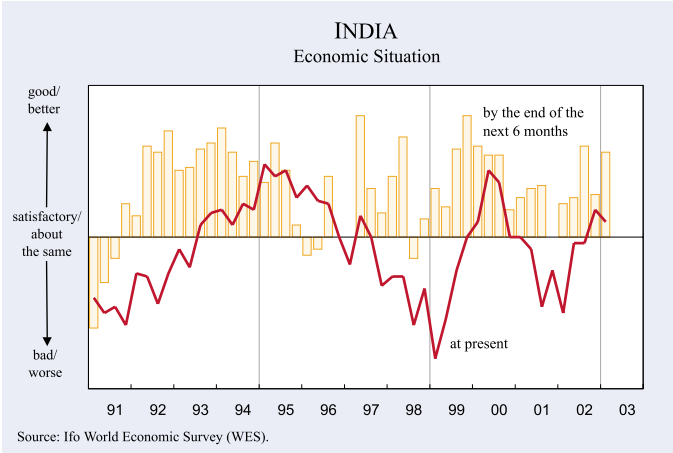
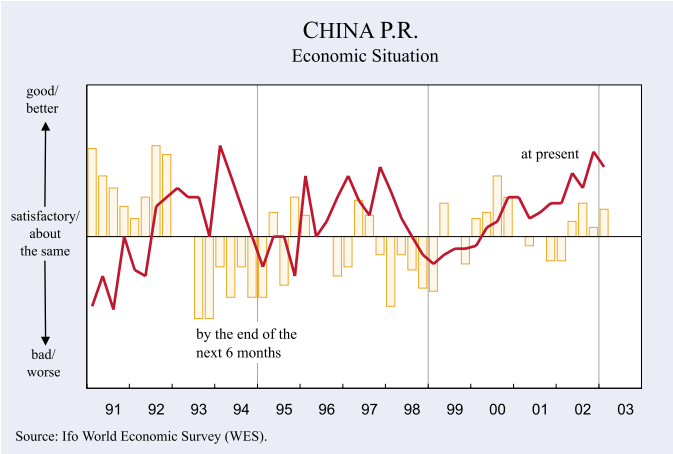
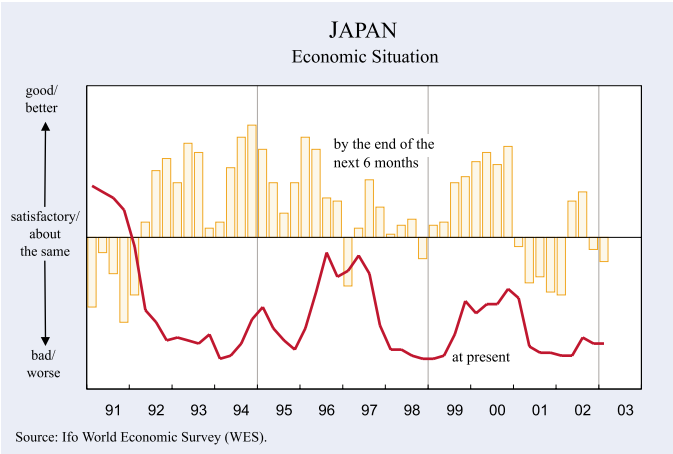


Figure 10

LATIN AMERICA

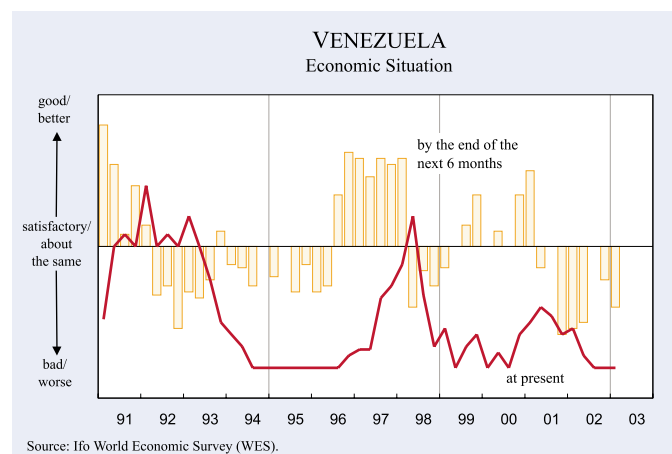
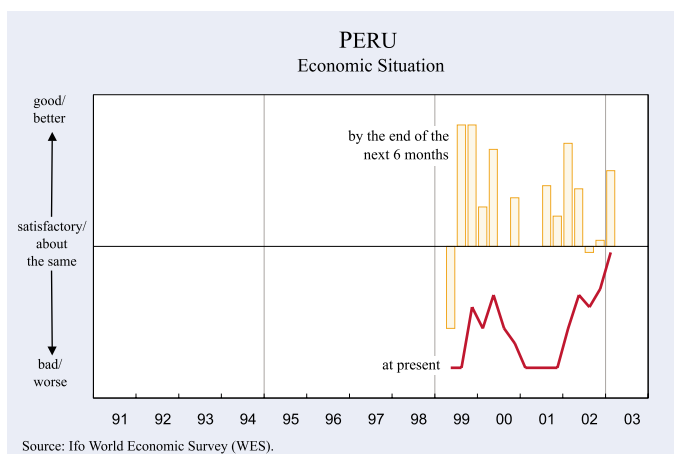
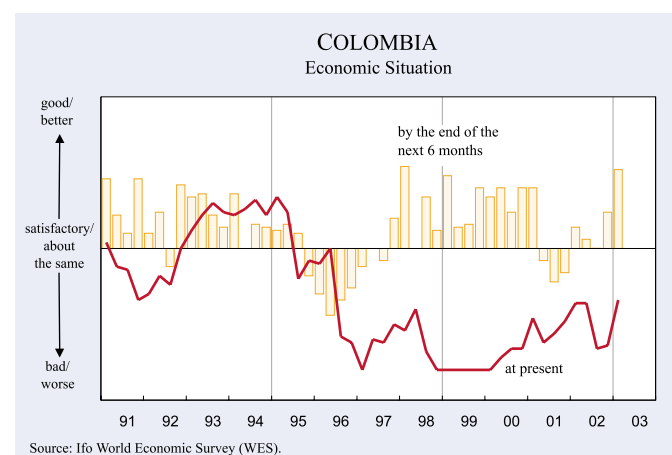
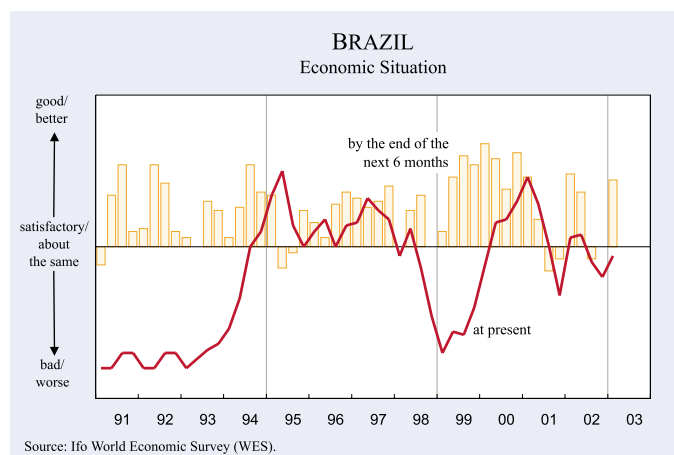
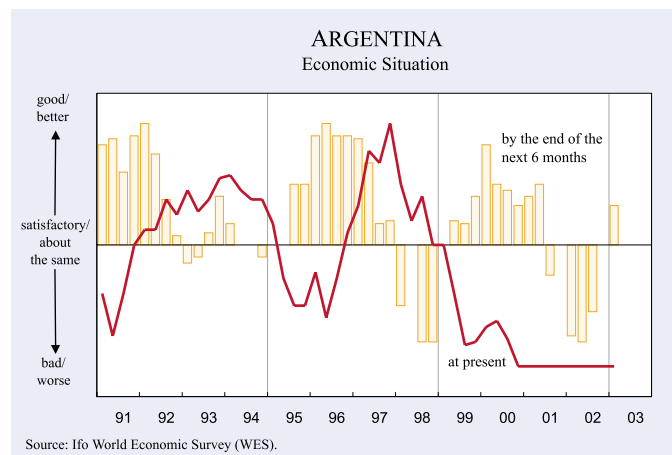
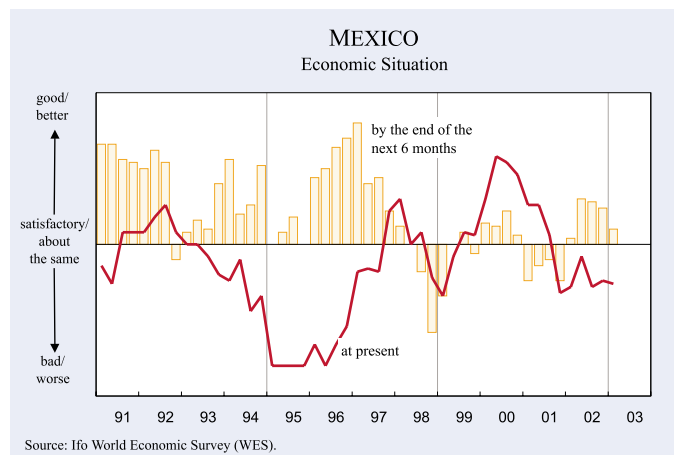
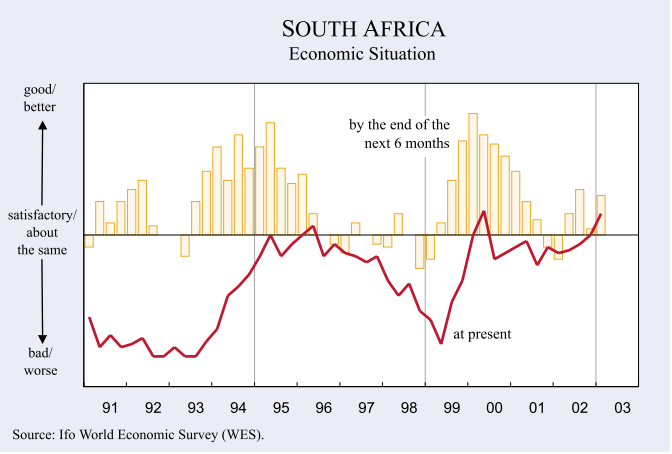
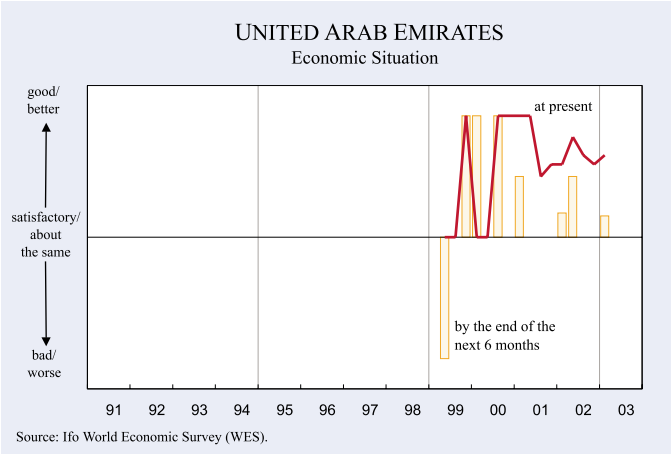
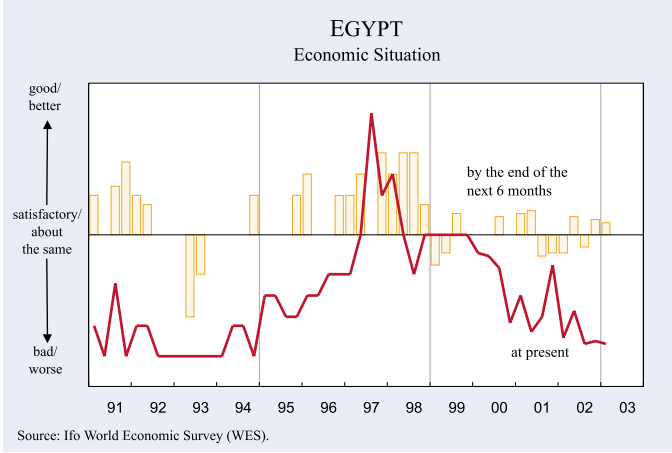
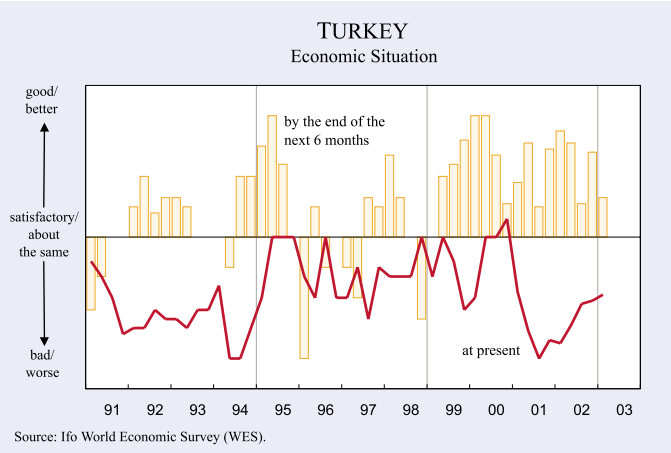
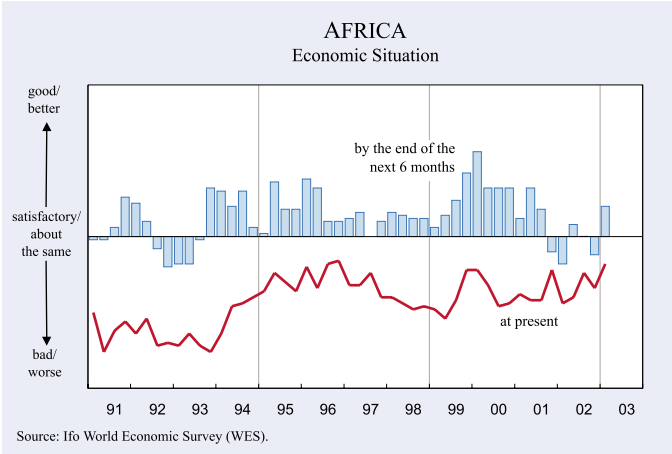
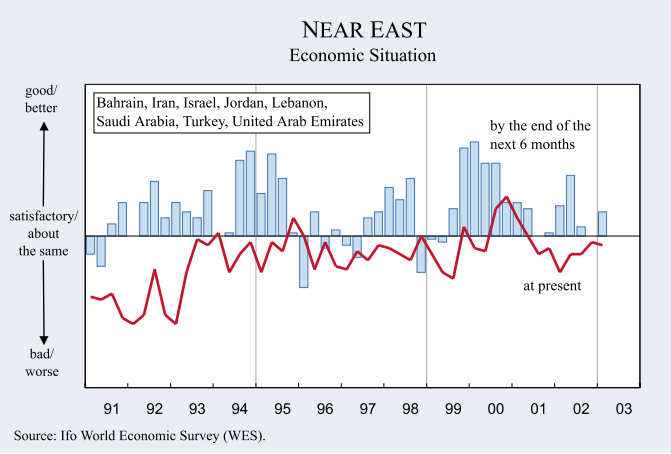


Figure 11

NEAR EAST AND AFRICA



America, the US dollar as well as the euro and the British pound are judged as somewhat overvalued, whereas the yen is seen to be near "fair value". This trend is particularly pronounced in *Argentina* and *Brazil*. Contrary to the overall average, in *Mexico*, *Guatemala*, *Costa Rica* and also *Peru* country currencies are still seen as overvalued in relation to the major world currencies. According to the latest survey, in most African countries, the local currencies appear to be at a proper value in relation to the major world currencies. The only exceptions are *Zimbabwe* and *Egypt*, where the country currencies are seen to be overvalued.

In addition to the general assessment, WES experts have again been asked about the likely trend of the US dollar exchange rate in the next six months. On average for all the 90 countries, the US dollar is still seen as remaining unchanged. However, there are strongly differing trends by regions and countries: In the majority of *CIS* countries, *Russia* included, the US dollar is expected to gain strength. The same holds true for most countries in Latin America, the Near East and Africa. In contrast, in Western Europe as well as in *Canada* and *Australia* the US dollar is expected to devalue further.

Inflation is expected to remain at the same level (3.2%) in 2003 as in 2002

On a world-wide scale consumer price inflation in 2003 should stand at 3.2%, identical with the estimate for last year's inflation. In Western Europe as a whole as well in the euro area specifically, the January survey sees the 2003 inflation rate remaining at last year's level of 2.2%. However, disparity across European countries is still quite large – about half of the countries within the euro area (namely *Austria*, *Belgium*, *Finland*, *France*, *Luxembourg* and *Germany*) are expected to meet or mostly fall below the 2% mark, whereas the remaining countries (*Greece*, *Ireland*, *Italy*, *the Netherlands*, *Portugal* and *Spain*) lie again clearly above the set limit. To some extent the higher inflation in the second group is due to stronger productivity growth in the process of catching up to the productivity levels of the established industrialized countries in the first group. As this process of relative price adjustment will go on for some time, the present ECB overall inflation target of below 2% appears to be too stringent. As pointed out by the latest report of the European Economic Advisory Group at CESifo, it would be preferable to increase the medium-term average inflation target to 2.5%.¹

According to the latest WES results, 2003 inflation expectations for the *United States* at 2.2% are again within the range regarded as normal by the US Fed (around 2.5%), whose priority lies equally on price stability and economic growth.

Asia continues to show by far the highest degree of price stability, though this year's expected inflation rate is moving up slightly (1.5% compared to 1.1% in October 2002). Deflationary trends still prevail in *Japan* (– 0.6% in 2003 compared with – 0.8% in 2002) and *Hong Kong* (– 0.7% in 2003 compared with – 2.1% in 2002), though to a somewhat lesser degree than last year. In *China* and *Taiwan*, inflation in 2003 is expected to pick up marginally (from 0.7 in 2002 to presumably 1.1% in 2003), though the danger of getting into a deflationary cycle is still not completely averted.

The inflation outlook for Central and Eastern Europe has decreased from 5.3% in 2002 to 4.7% in 2003. The only countries in this bloc still having very high inflation rates are *Yugoslavia* (9.3% expected this year compared with 17.3% last year) and *Romania* (14.3% compared with 21.2% last year).

Overall, inflation is also expected to lessen further in Central and Latin America (from 12.5% in 2002 to 9.6% in 2003), although some countries are moving against this trend and expect rates to rise. The greatest changes have been recorded in *Venezuela* (from 34.5% in 2002 to 45.0% in 2003); whereas in other countries the expected acceleration of inflation is more modest: in *Brazil* (from 8.6% in 2002 to 10.1% in 2003), in *Paraguay* (from 15.0% to 17.0% in 2003) and in *Uruguay* (from 26.6% to 29.7% in 2003). Some success in fighting inflation is reported from *Argentina*, where the sky-rocking inflation in 2002 (62.3%) is expected to slow down to about 26% in 2003. The inflation outlook for Africa is expected to worsen (from 11.9% to 17.3% in 2003). However, this is mainly due to the catastrophic situation in *Zimbabwe* where a hyperinflation of about 350% is expected in 2003 following a hike of about 135% last year. In *Nigeria* inflation is likely to increase from 15.5% in 2002 to 18.8% in 2003. In most other African countries the inflation out-

¹ European Economic Advisory Group at CESifo (EEAG), Report on the European Economy 2003, published by the Ifo Institute for Economic Research, 2003, p. 4.

Table 1

Expected Inflation Rate 2002 (based on WES QIV/2002) and 2003 (based on WES QI/2003) *

	WES			WES	
	QI/2003	QIV/2002		QI/2003	QIV/2002
AVERAGE OF 90 COUNTRIES	3.2	3.2	CENTRAL & LATIN AMERICA	9.6	12.5
30 HIGH-INCOME COUNTRIES	1.9	1.7	ARGENTINA	25.8	62.3
47 MIDDLE-INCOME COUNTRIES	7.0	8.6	BOLIVIA	4.3	4.8
22 UPPER-MIDDLE	6.8	8.5	BRAZIL	10.1	8.6
25 LOWER-MIDDLE	7.6	8.9	CHILE	2.9	2.9
13 LOW-INCOME COUNTRIES	6.3	4.4	COLOMBIA	6.4	6.4
HIGH-INCOME OECD COUNTRIES	2.0	1.9	COSTA RICA	9.5	10.3
MIDDLE-INCOME OECD COUNTRIES	5.6	6.6	ECUADOR	9.0	11.4
MIDDLE-INCOME OIL EXPORTERS ¹	11.4	11.9	EL SALVADOR	2.7	2.8
EU COUNTRIES	2.2	2.2	GUATEMALA	12.0	-
EURO-LAND ²	2.2	2.2	MEXICO	4.9	5.2
MEDITERRANEAN (NON-EU) COUNTRIES	10.6	13.9	PANAMA	1.6	1.3
ASEAN AND EAST ASIAN NICs ⁴	2.4	1.8	PARAGUAY	17.0	15.0
ASIAN PACIFIC RIM ⁵	2.1	1.7	PERU	2.2	2.5
ARABIAN OPEC COUNTRIES ⁶	3.4	4.7	URUGUAY	29.7	26.6
			VENEZUELA	45.0	34.5
WESTERN EUROPE	2.2	2.2	ASIA	1.5	1.1
AUSTRIA	1.8	1.9	BANGLADESH	3.5	3.0
BELGIUM	1.7	1.7	CHINA P.R.	1.1	0.7
CYPRUS	4.0	3.3	HONG KONG	-0.7	-2.1
DENMARK	2.5	2.1	INDIA	4.5	4.7
FINLAND	1.9	1.7	INDONESIA	11.0	10.8
FRANCE	1.9	1.9	JAPAN	-0.6	-0.8
GERMANY	1.3	1.5	KOREA	3.0	3.3
GREECE	3.4	3.5	MALAYSIA	2.3	2.1
ICELAND	2.3	-	MONGOLIA	6.5	-
IRELAND	4.9	4.6	PAKISTAN	5.0	5.9
ITALY	2.6	2.4	PHILIPPINES	4.6	4.5
LUXEMBOURG	2.0	2.0	SINGAPORE	1.8	1.0
NETHERLANDS	2.7	3.4	SRI LANKA	10.9	10.8
NORWAY	1.2	1.7	TAIWAN R.O.C.	1.1	0.7
PORTUGAL	3.0	3.4	THAILAND	2.1	1.5
SPAIN	3.4	3.4	VIETNAM	4.3	3.6
SWEDEN	2.4	2.2			
SWITZERLAND	1.0	0.8	OCEANIA	2.9	3.1
UNITED KINGDOM	2.6	2.1	AUSTRALIA	3.0	3.2
			NEW ZEALAND	2.3	2.6
CENTRAL & EASTERN EUROPE	4.7	5.3	NEAR EAST	7.7	10.7
BOSNIA HERCEGOVINA	3.5	2.0	BAHRAIN	5.0	1.5
BULGARIA	4.4	5.6	IRAN	14.5	22.5
CROATIA	3.2	3.9	ISRAEL	4.5	6.1
CZECH REPUBLIC	2.6	2.6	JORDAN	2.4	3.0
ESTONIA	3.9	3.8	LEBANON	3.5	3.8
HUNGARY	5.1	5.6	SAUDI ARABIA	1.1	1.5
LATVIA	2.2	3.0	TURKEY	25.7	37.9
LITHUANIA	1.7	0.6	UNITED ARAB EMIRATES	2.3	2.5
POLAND	2.0	2.3			
ROMANIA	14.3	21.2	AFRICA	17.3	11.9
SLOVENIA	5.8	7.0	ALGERIA	6.0	5.0
SLOVAKIA	7.8	4.8	EGYPT	4.0	3.5
YUGOSLAVIA	9.3	17.3	GHANA	10.0	10.0
			KENYA	4.9	5.0
CIS	13.3	14.4	MAURITIUS	7.0	6.0
GEORGIA	5.0	-	MOROCCO	2.7	2.0
KAZAKHSTAN	5.8	7.0	NIGERIA	18.8	15.5
RUSSIA	13.8	16.7	SOUTH AFRICA	8.2	9.5
UKRAINE	5.0	5.4	TUNISIA	3.0	3.0
UZBEKISTAN	50.0	-	ZIMBABWE	351.1	135.8
NORTH AMERICA	2.3	2.2			
CANADA	2.7	2.3			
UNITED STATES	2.2	2.2			

* Compared to average of previous year.

¹ Algeria, Indonesia, Iran, Saudi Arabia, Venezuela. – ² EU countries without Denmark, Sweden, United Kingdom.³ Algeria, Bosnia-Herzegovina, Croatia, Cyprus, Egypt, Israel, Lebanon, Malta, Morocco, Slovenia, Tunisia, Turkey, Yugoslavia.⁴ Hong Kong, Indonesia, Korea, Malaysia, Philippines, Singapore, Taiwan, Thailand, Vietnam. – ⁵ Australia, China P.R., Hong Kong.⁶ Indonesia, Korea, Malaysia, New Zealand, Philippines, Singapore, Taiwan, Thailand, Vietnam. – ⁶ Algeria, Iran, Saudi Arabia, United Arab Emirates.

Source: Ifo World Economic Survey (WES), QI/2003.

look for 2003 does not differ much from the dismal outcome in 2002; a positive exception is *South Africa* where inflation in 2003 is expected to slow down to 8.2% from 9.5% in 2002 (see Table 1).

Special Topic: How big is the threat of worldwide deflation?

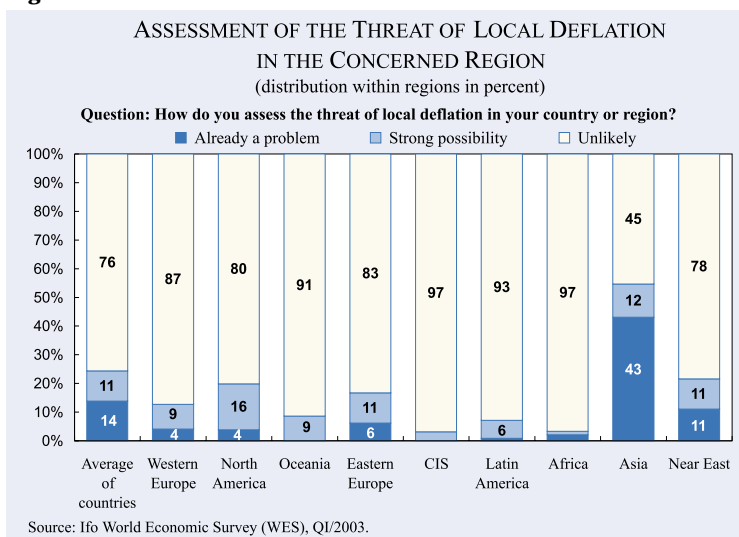
The special question asked this time focused on the “D” word, the threat of deflation, meaning sustained decreases in prices over the entire economy. The question was split in two parts: The first one dealt with the threat of global, i.e. worldwide recession. The second part focused on the specific country or region the WES expert is reporting from.

An obvious example of country-specific deflation is *Japan* in the 1990s when the economy moved into a phase of sustained deflation caused by the collapse of the stock market and the burst real-estate bubble at the end of the 1980s and aggravated by the lack of appropriate monetary and fiscal policy as well as the implementation of necessary structural reforms.²

Is the *Japanese* case of deflation only an isolated “accident” or do we face problems of this type also in other regions or even worldwide? This was the motivation for asking the “D” question in this survey.

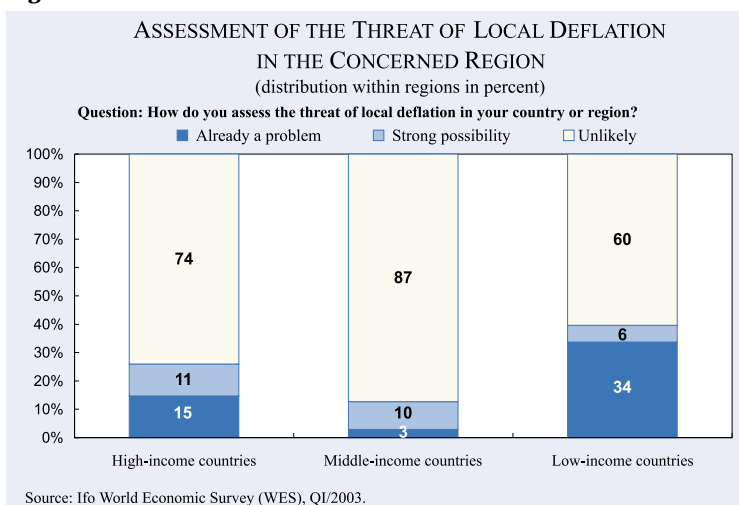
About one quarter of approximately 1,100 WES experts in 90 countries assess the threat of a local deflation in their concerned region as very realistic. Amongst them, 14% report that deflation is already a problem in the country they cover and another 11% assess a strong possibility of the outbreak of deflation. The worldwide average is strongly influenced by the answers from Asia, where

Figure 12



about half of the respondents assess deflation as an imminent threat. In other parts of the world, the share of respondents fearing deflation in the region lies between 3% and 22%, with the CIS and Africa marking the lower end and the Near East the upper end (see Figures 12 and 13). In Western Europe this percentage is only 13% and thus lower than in North America (20%) and the world average (25%). Within Western Europe this share is particularly high in *Germany* (about 30%). The elevated share in the Near East (22%) is mainly influenced by responses from Israel and also from Turkey. On the other hand economies in Latin America and Africa frequently struggling with high inflation, the risk of deflation is not seen as very great (8% and 9% respectively). For

Figure 13



² See e.g., Alan Ahearne et al., Preventing Deflation: Lessons from Japan's Experience in the 1990s, International Finance Discussion Papers, Number 729, June 2002, Board of Governors of the Federal Reserve System, USA.

Table 2

Assessment of the Threat of Local Deflation in the Concerned Country or Region *

	A	B	C	TOTAL		A	B	C	TOTAL		A	B	C	TOTAL
WESTERN EUROPE	14	30	339	386	LATIN AMERICA	6	10	127	144	EASTERN EUROPE	10	22	126	158
AUSTRIA	1	-	16	17	ARGENTINA	-	-	11	11	BOSNIA-HERCEGO	-	-	1	1
BELGIUM	-	-	18	19	BOLIVIA	2	1	4	7	BULGARIA	-	2	13	15
CYPRUS	-	-	1	1	BRAZIL	-	-	29	29	CROATIA	2	-	7	9
DENMARK	-	1	11	12	CHILE	-	1	11	12	CZECH REPUBLIC	-	2	18	20
FINLAND	-	-	24	25	COLOMBIA	1	1	12	14	ESTONIA	-	-	2	2
FRANCE	1	1	24	26	COSTA RICA	-	1	7	8	HUNGARY	2	-	13	15
GERMANY	6	15	51	72	ECUADOR	-	1	6	8	LATVIA	-	1	5	6
GREECE	-	3	14	17	EL SALVADOR	-	1	2	3	LITHUANIA	1	7	2	10
ICELAND	-	-	3	3	GUATEMALA	-	-	1	1	POLAND	3	7	39	49
IRELAND	-	-	11	11	MEXICO	-	1	14	15	ROMANIA	-	1	6	7
ITALY	1	1	25	28	PANAMA	-	-	4	4	SLOVENIA	1	1	4	6
LUXEMBOURG	-	-	2	2	PARAGUAY	1	-	1	2	SLOWAKIA	-	-	13	13
NETHERLANDS	-	-	19	19	PERU	2	1	14	17	YUGOSLAVIA	1	1	3	5
NORWAY	1	1	9	11	URUGUAY	-	-	3	3					
PORTUGAL	-	2	15	17	VENEZUELA	-	2	8	10	AFRICA	4	2	61	67
SPAIN	2	2	34	38	ASIA	57	19	101	177	ALGERIA	-	-	3	3
SWEDEN	-	-	21	21	BANGLADESH	-	-	1	1	EGYPT	-	1	8	9
SWITZERLAND	1	-	22	23	CHINA	7	1	6	14	GHANA	-	-	1	1
UNITED KINGDOM	1	4	19	24	HONG KONG	5	2	2	9	KENYA	1	-	6	7
NORTH AMERICA	2	9	46	57	INDIA	1	1	12	14	MAURITIUS	-	-	2	2
CANADA	-	2	13	15	INDONESIA	1	-	11	12	MOROCCO	-	-	3	3
UNITED STATES	2	7	33	42	JAPAN	38	1	1	40	NIGERIA	-	-	3	3
CIS	-	1	22	23	KOREA REP.	-	1	9	10	SOUTH AFRICA	1	-	22	23
GEORGIA	-	-	1	1	MALAYSIA	-	1	14	15	TUNISIA	-	-	2	2
KAZAKHSTAN	-	-	2	2	MONGOLIA	1	1	1	3	ZIMBABWE	2	1	11	14
RUSSIA	-	-	14	14	PAKISTAN	-	3	11	14	NEAR EAST	5	9	39	53
UKRAINE	-	1	3	4	PHILIPPINES	1	3	4	8	BAHRAIN	-	2	2	4
UZBEKISTAN	-	-	2	2	SINGAPORE	-	-	8	8	IRAN	-	1	4	5
OCEANIA	-	2	25	27	SRI LANKA	-	-	5	5	ISRAEL	2	2	5	9
AUSTRALIA	-	1	10	11	TAIWAN	2	2	1	5	JORDAN	-	-	2	2
NEW ZEALAND	-	1	15	16	THAILAND	-	3	6	9	LEBANON	-	1	2	3
					VIETNAM	1	-	9	10	SAUDI ARABIA	1	-	4	5
										TURKEY	2	3	14	19
										UNITED ARAB EM.	-	-	6	6

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

A Deflation is already a problem in the concerned country or region

B There is a strong possibility of deflation in the concerned country or region

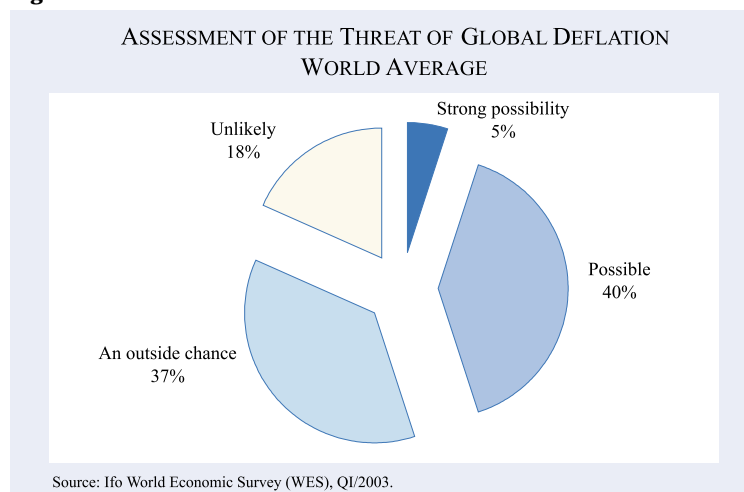
C Deflation in this country has an outside chance or is unlikely

Source: Ifo World Economic Survey (WES), Q1/2003.

a country breakdown please see Table 2, where the absolute numbers for countries that participated in the January survey are listed. Economic experience shows that the behavior of entrepreneurs and consumers is not only influ-

enced by the assessment of risks in their own countries and regions but increasingly also by the assessment of more global risks. And here deflation appears to be a major threat to the global economy, with 45% of all WES experts surveyed

Figure 14



worldwide thinking that global deflation is possible, though only 5% speak of a “strong” possibility (see Figure 14). A breakdown by regions shows that WES experts in Asia (68%) and the Near East (67%) are much more worried about the spread of deflation worldwide than the others. Particularly in Asia this can be explained with own deflationary experience in the region; also in the Near East the pronounced economic problems in *Israel* and *Turkey* obviously have influenced the rather pes-

Table 3

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

REGION	legal / administrative restrictions	political instability		legal / administrative restrictions	political instability
WESTERN EUROPE			CENTRAL & LATIN AMERICA		
AUSTRIA	7,6	7,6	ARGENTINA	3,7	1,3
BELGIUM	5,9	7,5	BOLIVIA	5,0	3,0
CYPRUS	5,0	5,0	BRAZIL	5,0	5,0
DENMARK	8,7	8,3	CHILE	6,2	6,5
FINLAND	7,7	8,3	COLOMBIA	5,0	3,0
FRANCE	5,9	8,1	COSTA RICA	4,5	6,0
GERMANY	4,9	6,5	ECUADOR	4,5	1,6
GREECE	5,0	8,5	EL SALVADOR	7,7	9,0
ICELAND	5,0	9,0	GUATEMALA	1,0	1,0
IRELAND	5,0	7,6	MEXICO	5,0	5,3
ITALY	6,6	5,4	PANAMA	5,0	6,0
LUXEMBOURG	9,0	9,0	PARAGUAY	6,3	1,0
NETHERLANDS	6,6	5,7	PERU	5,2	3,4
NORWAY	6,1	7,2	URUGUAY	7,7	6,3
PORTUGAL	6,9	7,6	VENEZUELA	3,8	1,8
SPAIN	6,8	7,6			
SWEDEN	6,5	7,6	AFRICA		
SWITZERLAND	7,4	7,6	ALGERIA	2,3	3,7
UNITED KINGDOM	7,0	7,8	EGYPT	3,0	6,0
			GHANA	9,0	9,0
NORTH AMERICA			KENYA	5,0	3,9
CANADA	5,3	7,4	MAURITIUS	5,0	9,0
UNITED STATES	6,6	7,2	MOROCCO	7,0	6,3
			NIGERIA	6,3	3,7
OCEANIA			SOUTH AFRICA	4,7	5,7
AUSTRALIA	6,6	7,8	TUNISIA	7,0	5,0
NEW ZEALAND	5,5	6,0	ZIMBABWE	1,8	1,0
CENTRAL & EASTERN EUROPE			ASIA		
BOSNIA HERCEGOVINA	1,0	5,0	BANGLADESH	9,0	9,0
BULGARIA	5,3	4,7	CHINA P.R.	2,4	4,4
CROATIA	5,0	5,0	HONG KONG	7,7	6,3
CZECH REPUBLIC	6,3	6,0	INDIA	5,2	5,0
ESTONIA	9,0	9,0	INDONESIA	4,0	1,3
HUNGARY	6,9	7,4	JAPAN	6,4	6,6
LATVIA	6,3	5,0	KOREA REP.	5,0	4,2
LITHUANIA	6,2	5,8	MALAYSIA	4,2	4,7
POLAND	3,0	5,3	MONGOLIA	3,7	5,0
ROMANIA	4,5	6,8	PAKISTAN	4,7	3,3
SLOVENIA	5,7	5,7	PHILIPPINES	3,5	3,0
SLOVAKIA	5,7	5,3	SINGAPORE	7,5	8,5
YUGOSLAVIA	1,8	1,0	SRI LANKA	5,8	3,4
			TAIWAN R.O.C.	5,0	4,2
NEAR EAST			THAILAND	4,1	5,9
BAHRAIN	6,0	5,0	VIETNAM	2,6	7,4
IRAN	3,4	3,4			
ISRAEL	5,9	1,9	CIS		
JORDAN	7,0	5,0	GEORGIA	5,0	1,0
LEBANON	6,3	3,7	KAZAKHSTAN	5,0	5,0
SAUDI ARABIA	1,8	5,0	RUSSIA	3,9	5,5
TURKEY	4,2	4,2	UKRAINE	2,0	4,0
UNITED ARAB EMIRATES	6,3	7,7	UZBEKISTAN	3,0	5,0

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

Source: Ifo World Economic Survey (WES), Q1/2003

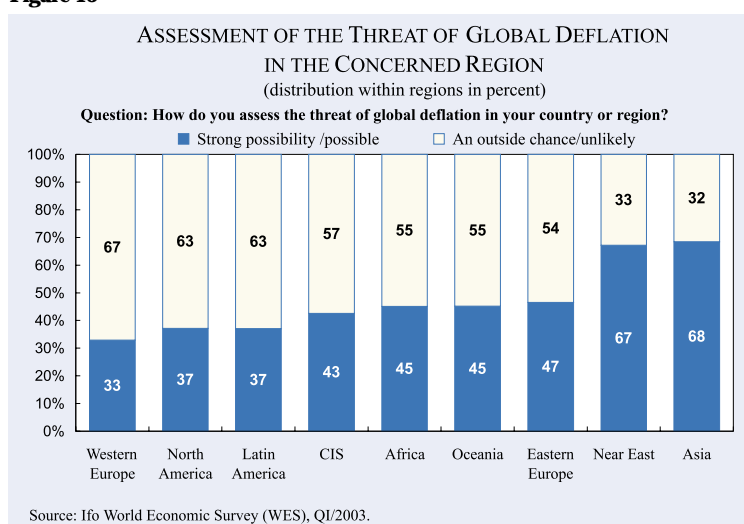
simistic view of likely developments in the world economy (see Figure 15).

What conclusions can be drawn from this? The widespread fear of deflation at the global level but also the more isolated problems in a specific country or region should be taken serious by economic

policy. Self-fulfilling prophecies can be a problem. For this reason the FED study on what went wrong in *Japan* gives important advice on how the spread of the *Japanese* disease can be avoided.

The *Japanese* case shows that deflation can be very difficult to predict in advance. For that reason

Figure 15



monetary policy must provide sufficient insurance against downside risks through a precautionary loosening of monetary policy. The costs of excessive monetary loosening appear to be relatively limited compared with the costs of entering into deflation. Should monetary policy later prove to have been overly expansionary, a correction causes much less problems than the move from a too restrictive monetary to a more expansionary policy should a deflationary process already have started. In an advanced stage of deflation, consumers and

entrepreneurs come to expect price declines and thus favor postponing purchases in order to benefit from the expected future price reduction. On a global level, widespread postponement of purchases helps to accelerate the weakness of the economy and the increase of unemployment. The result would be a deflationary spiral. We are fortunately far from this point. As the recent WES results have shown, relatively few experts assess the possibility of deflation as strong on a concrete country level, excluding Asia and Japan in particular. However, on a more general level, assessing the worldwide risk of deflation, the respective share of experts is significantly larger. In order to avoid self-fulfilling expectations, monetary policy is well advised to display an easing bias. Only after having resolved the Iraq crisis and after investor and consumer confidence has strengthened and with world economic growth having gathered more steam with a sustainable upswing should excess liquidity be absorbed cautiously by central banks.

Table 4

Assessment of the Following Factors Influencing the Climate for Foreign Investors by the End of the Next 6 Months

Climate due to	Change for the next 6 months *	
	Deterioration	Improvement
Legal / administrative restrictions to invest and/or to repatriate profits	Venezuela, Zimbabwe	Chile, China P.R., Iran, Korea Republic, Portugal, Saudi Arabia, Sri Lanka, Taiwan R.O.C., Turkey, Vietnam, Yugoslavia
Political instability	Iran, Ukraine, Zimbabwe	Estonia, Turkey

In those countries, not mentioned in the table the climate for foreign investors is expected to remain unchanged during the next 6 months

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

(Only countries were included in the evaluation that had three or more participants in the WES Q1/2003)

Source: Ifo World Economic Survey (WES), Q1/2003

Assessment of Factors Influencing the Climate for Foreign Direct Investment

Table 3 contains information on the current assessment of *legal/administrative restrictions* and *political instability* from a viewpoint of a foreign investor for the full list of countries covered in the January survey, excluding only those countries where the number of participants is below three. In Table 4 only those countries with expected significant changes concerning the two assessed factors influencing the attractiveness for foreign investment are presented.

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