

WORLD ECONOMIC SURVEY

WORLD ECONOMIC CLIMATE DETERIORATES

In July the world economic climate indicator slipped after having risen in the previous two surveys. At 101.1 (1995 = 100), the world economic climate is still somewhat higher than its long-term average.

The deterioration of the overall climate indicator is exclusively due to less optimistic expectations for the next six months which, however, still signal a continuation of the economic recovery. The second component of the world economic climate, the evaluation of the current economic situation, continued to improve. This data constellation points to further economic recovery in coming months, though at a slower pace than expected last spring.

World economy: Slight dip, no severe setback of climate indicator

The strong turbulences in world capital markets were thought likely to have a negative impact on the world economic climate. The indicator declined only marginally, however, signalling that the recovery of the world economy is still on track, although the upswing will have less momentum in coming months than could have been expected on the basis of the April survey (see Figure 1).

The decline of the indicator resulted exclusively from more cautious expectations for the coming six months, whereas the assessments of the current economic situation became a bit more positive. In most countries the recovery in the hard-hit capital expenditure sector is still expected to be somewhat more pronounced than in private consumption.

United States: Economic recovery lost momentum

The economic climate, which had constantly risen since the end of last year, has now experienced a setback. The reason is more negative expectations for the future whereas the current economic situation has slightly improved, reaching a satisfactory level. This is mainly due to the still buoyant consumer sector whereas capital expenditure is seen to remain quite subdued in the third quarter. The results of the survey show clearly that the recovery in the United States has lost momentum. The WES correspondents expect a remarkable improvement in the trade balance, however, mainly caused by falling imports.

Western Europe: Economic recovery temporarily stalled

In about half of the Western European countries the current economic situation remained unchanged or improved modestly (Belgium, Finland, France, Germany, Greece, Ireland, Sweden), whereas in the other half a deterioration was observed (particularly in the Netherlands, Portugal and Italy). Expectations for the next half year worsened almost everywhere, Switzerland, where the outlook brightened somewhat, being the only exception. The economic climate (the combination of the

Figure 1

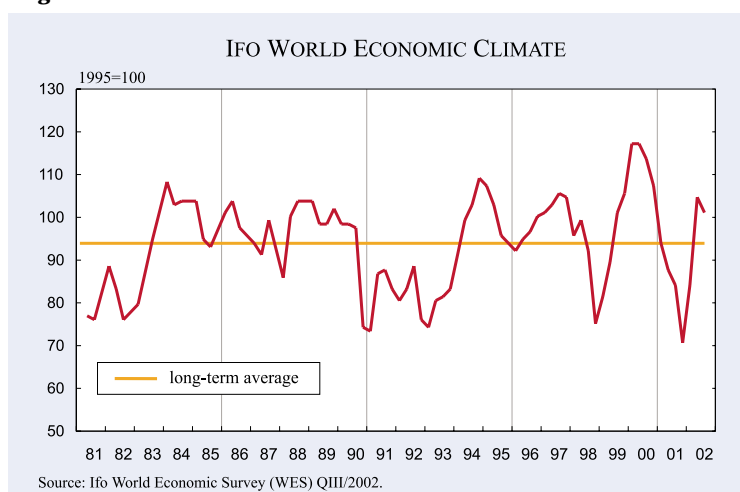
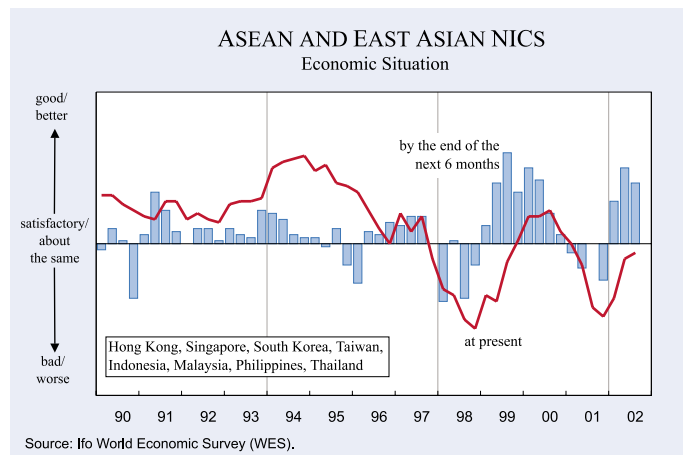
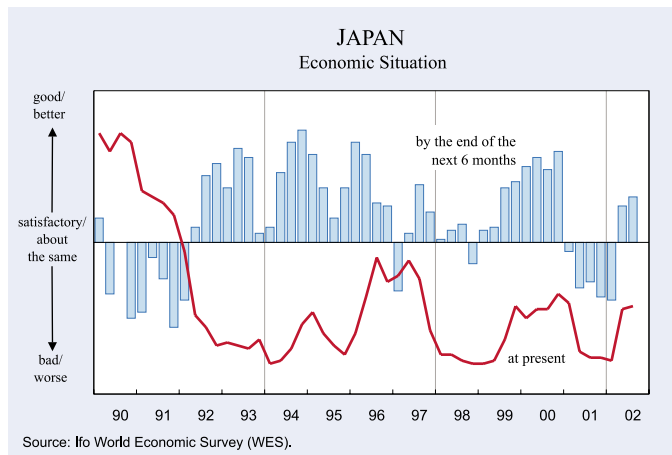
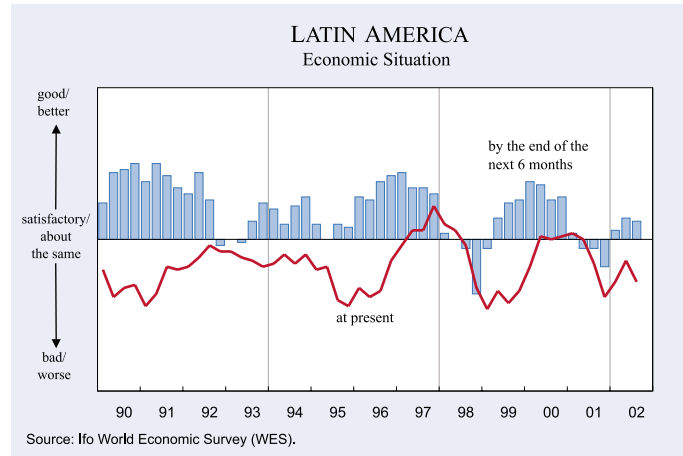
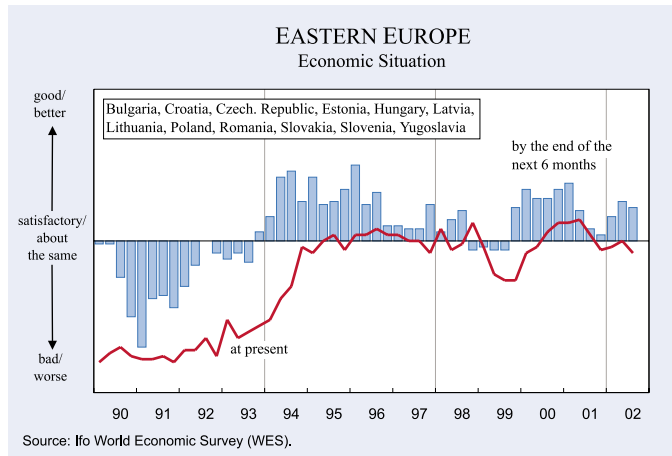
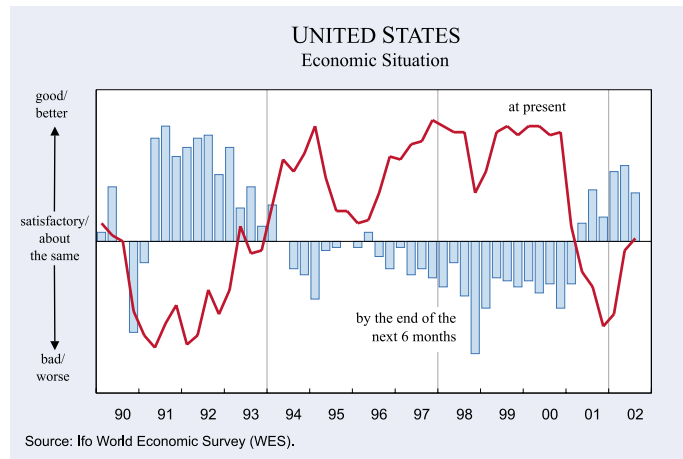
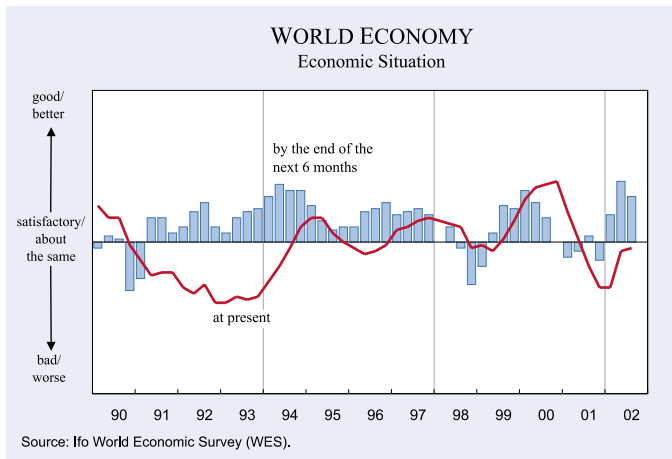


Figure 2



assessment of the current economic situation and the expectations for the next six months) in Norway, Finland and Denmark remained better than the European average. The climate indicator in Western Europe is moving downward towards its long-term average, which is almost entirely due to more negative expectations for the coming months. Germany shows by far the lowest level of capital expenditure and private consumption. Nevertheless, its overall economic situation – still less than satisfactory – is quite surprisingly ranked above that of the Netherlands, Austria or Italy, for example. WES correspondents expect a continuing recovery of the German economy, though at a slower pace than before.

Comparing the Euro area with countries outside the monetary union (i.e. Denmark, Norway, Sweden, Switzerland and the United Kingdom), the current economic situation is judged significantly better in the non-Euro area than in the countries with the single currency. In contrast, economic expectations for the next six months are much more positive on average in the Euro area than outside. According to the WES survey, among the countries with the single currency it is especially Finland and Ireland that have the best economic performance, while Norway and Denmark take first places in the group of European countries outside the Euro area.

Eastern Europe: Economic climate levels off

The assessments of the current economic situation deteriorated, slipping slightly below the satisfactory level which had just been reached last April. On average, the optimism expressed in the last survey regarding the outlook for Eastern Europe waned a bit. The current economic situation continues to be above average, particularly in Latvia, Estonia and Slovenia. Worth mentioning is the ongoing recovery in Croatia, which in the coming six months is expected to continue and to reach or even surpass the satisfactory level for the first time since 1996. On the other hand, in Hungary and the Czech Republic the economic situation worsened and is now just little above the satisfactory level and no longer considered good. In Poland and Bulgaria the present state of the economies remained clearly below satisfactory and is expected to brighten only a little in the course of the next six months.

Latin America: Current economic situation remains unsatisfactory

Brazil and Chile show the comparatively best economic performance at present, although they – like almost all countries in Latin America – are following a negative trend. Uruguay's assessment of its current economic situation is unchanged, and Argentina is showing first signs of a slow recovery from the recent severe currency and banking crises. With regard to the outlook for the next six months, the economic performance on the average of Latin America is expected to improve slightly, with Chile, Mexico and Uruguay having the best prospects. The outlook for Argentina and Brazil seems quite negative and Venezuela's economy is not expected to change much for the better in the coming half year.

Japan: Not out of the woods yet

Japan is still lagging behind the general upward trend in Asia; its current economic situation is rated well below satisfactory, though expectations for the next six months point to some improvement in economic activity.

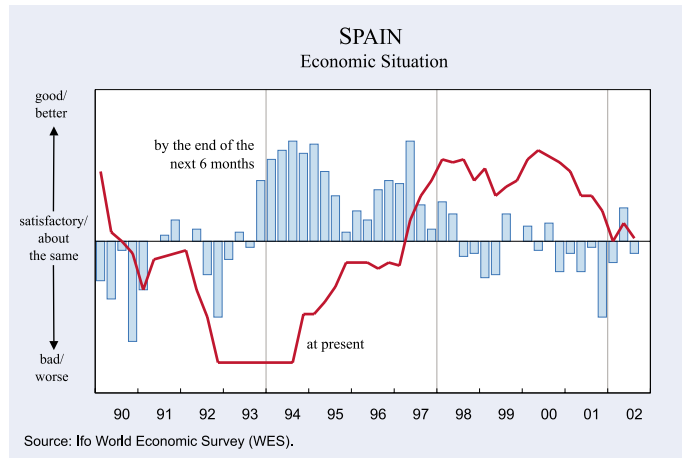
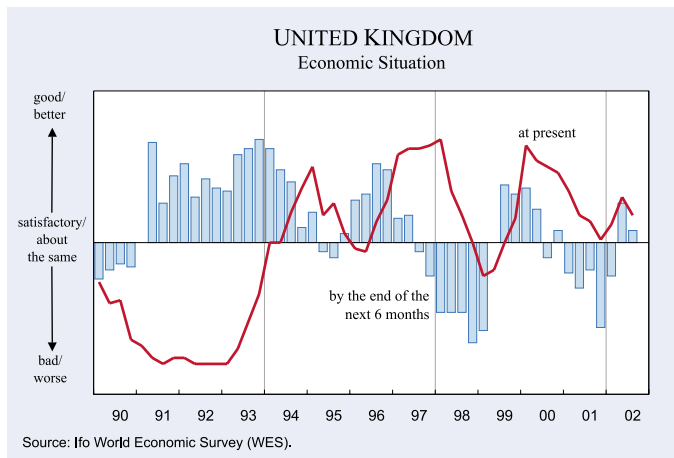
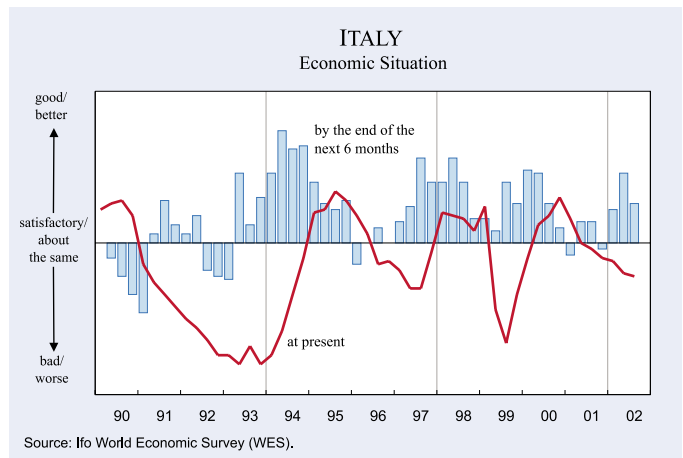
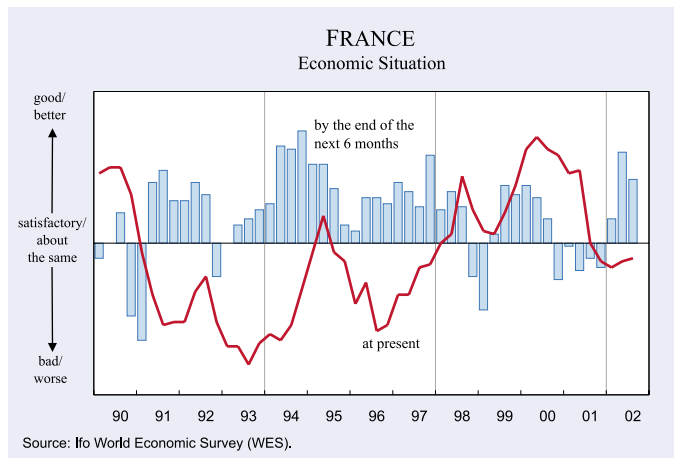
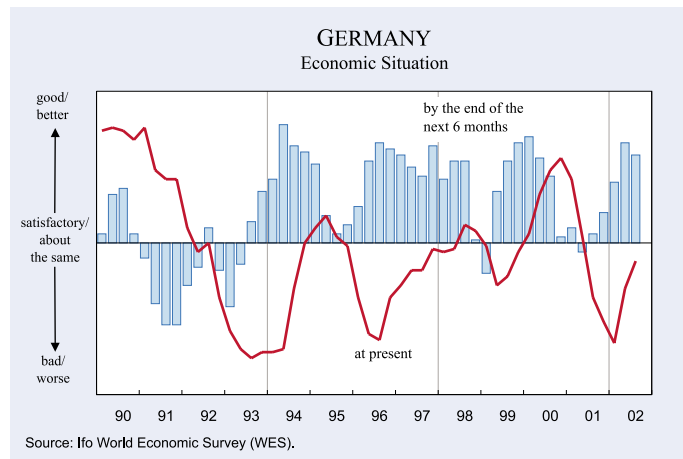
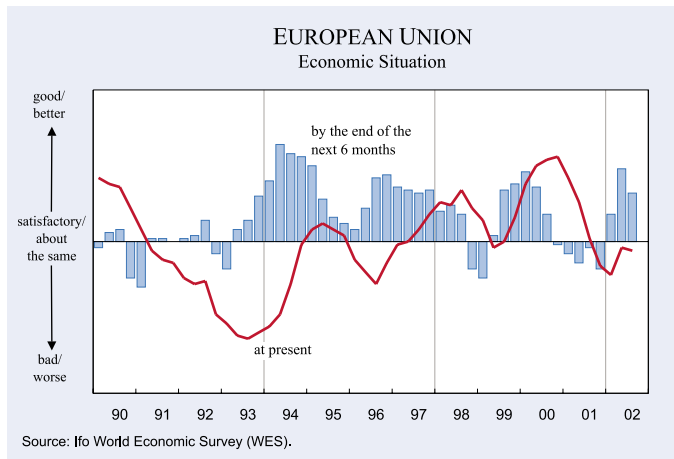
Asean and East Asian NICs: Economic climate continues to improve

According to the new survey, the assessments of the current economic situation improved further while the outlook for the next six months remained practically unchanged. The assessment of the present economic condition is highest for the Republic of Korea, followed by Malaysia, Taiwan and Thailand. Malaysia and Taiwan also have the best prospects for the next six months. The economic recovery in Singapore and the Philippines slowed in recent months, but expectations for the next half year remained clearly positive, especially in Singapore. Indonesia and, even more so, Hong Kong show considerable weakness in present economic performance; the outlook for the next six months is also still clouded. Both countries have a position below the Asian average.

Interest rates: Fewer participants expect increase

In line with the weakening of the economic upswing and the slowdown of inflation, worries about

Figure 3



a tightening of monetary policy were less widespread than in the previous survey. This tendency was particularly pronounced in the United States, whereas in Western Europe, Latin America and Asia expectations of an increase of interest rates in the course of the next six months edged up further. In Eastern Europe the prevailing view is still that short-term interest rates will decline in coming months, though to a somewhat lesser degree than previously.

A similar message is given by the new WES results for the likely trend of long-term interest rates in the next six months. Expectations of rising rates are slightly less widespread than in the previous survey. This tendency is particularly pronounced in the United States, where the expected moderate rise in long-term interest rates is now about the same as in Western Europe. In Latin America and Asia an even weaker rise in interest rates is expected. In Eastern Europe long-term interest rates are seen to decline further in coming months.

Inflation: Expected to slow world-wide

World-wide, consumer price inflation in 2002 is now expected to be 3.3%, slightly less than in the April survey and much less than in 2001. Regarding the Euro zone, the July survey confirms the April results with an expected rate of 2.3% for 2002. About half of the countries in the Euro area (namely Austria, Belgium, Finland, France and Germany) are expected to meet or even fall below the 2% mark, the ECB's target. The rest, except for Italy, will come in at more than 1% above this mark. At 2.1%, the inflation figure for the United States is now expected to be lower than for Europe. Asia continues to have by far the highest degree of price stability. At 1.1%, the Asian data are again suggesting that some countries may face a contracted deflationary process, which already is the case in Japan (expected price change in 2002: - 0.7%) and Hong Kong (- 1.6%). The inflation outlook for Central and Eastern Europe has declined since April, from 6.7% to 5.9%. The sole exception is Yugoslavia with an expected inflation rate of around 20%. In Latin America as a whole, inflation is also expected to fall slightly, although in half of the countries the inflation outlook has increased (Uruguay: 11.5%, Venezuela: 7.8%). In Argentina inflation is also still on the rise, reaching

an expected rate of 87.5% (compared to 82.5% in the April survey).

World currencies: Moving towards equilibrium

On average of the 90 countries polled, the US dollar and British pound sterling are still judged to be overvalued, but significantly less than in the previous surveys. On the other hand, the euro, which for a long time has been assessed to be undervalued, is gradually approaching an "appropriate" level. Such a level has already been reached by the Japanese yen, according to the WES experts.

WES experts in Eastern Europe consider the major world currencies close to "fair value" against their local currencies. In Latin America, the US dollar as well as the euro and the yen are judged undervalued against some local currencies such as the Mexican peso. However, after strong devaluations, the currencies of Brazil and Columbia appear now to be generally undervalued.

Independent of these different assessments of the current situation, the US dollar is predicted to remain unchanged or even to rise within the next six months. This applies again to all regions of the world except for Western Europe and some Asian countries like Taiwan, Thailand, the Philippines and the Republic of Korea. In Japan, where in the previous survey experts had expected the US dollar to strengthen against the yen, the outlook for the next six months has now changed in favour of a likely stabilisation of the yen/US dollar cross-rates at the current level.