ifo WORLD ECONOMIC SURVEY

III
2018

August
Vol. 17

World Economic Climate
ifo World Economic Climate Deteriorates Further

Advanced Economies
Optimism in Advanced Economies Fades

Emerging and Developing Economies
Economic Climate Indicator for Emerging Market and Developing Economies Plunges

Special Topic
How Resilient Are the World's Economies to a New Financial Crisis

ifo INSTITUTE
Leibniz Institute for Economic Research
at the University of Munich

All time series presented in this document plus additional series for about 70 countries may be ordered from the Ifo Institute. For further information please contact Mrs. Ikonomou-Baumann (umfragedaten@ifo.de)

Authors of this publication:
Dorine Boumans, Ph.D., e-mail boumans@ifo.de (ifo Center for Macroeconomics and Surveys)
Survey assistant: Sophia Tröger

ifo World Economic Survey
ISSN 2511-7831 (print version)
ISSN 2511-784X (electronic version)
A quarterly publication on the world economic climate
Publisher and distributor: ifo Institute
Poschingerstr. 5, D-81679 Munich, Germany
Telephone ++49 89 9224-0, Telefax ++49 89 985369, e-mail ifo@ifo.de
Annual subscription rate: €40.00
Single subscription rate: €10.00
Shipping not included

Editor of this issue: Dorine Boumans, Ph.D., e-mail boumans@ifo.de

ifo
WORLD ECONOMIC
SURVEY

VOLUME 17, NUMBER 3, AUGUST 2018

ifo World Economic Climate Deteriorates Further

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 2018, 1,200* economic experts in *120* 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 qualitative questions in the World Economic Survey have three possible categories: "good / better / higher" (+) for a positive assessment resp. improvement, "satisfactory / about the same / no change" (=) for a neutral assessment, and "bad / worse / lower" (−) for a negative assessment resp. deterioration; The individual replies are combined for each country without weighting as an arithmetic mean of all survey responses in the respective country. Thus, for the time t for each qualitative question and for each country the respective percentage shares (+), (=) and (−) are calculated. The balance is the difference between (+)- and (−)-shares. As a result, the balance ranges from -100 points and +100 points. The mid-range lies at 0 points and is reached if the share of positive and negative answers is equal.

The survey results are published as aggregated data. For aggregating the country results to country groups or regions, the weighting factors are calculated using the gross domestic product based on purchasing-power-parity of each country.

ifo World Economic Climate Deteriorates Further

The ifo World Economic Climate deteriorated further in the third quarter. The indicator dropped from 16.5 points to 2.9 points in this quarter, returning to more or less the same level as in the first quarter of 2017 (see Figure 1). Although experts' assessments of the current economic situation deteriorated significantly, they nevertheless remain at a high level. Their economic expectations, by contrast, were scaled back considerably, falling to their lowest level since the end of 2011. The world economy slowed to a crawl this quarter.

The economic climate deteriorated in nearly all regions. Both assessments of the current economic situation and expectations fell significantly in the European Union, Asian emerging and developing economies (including China), and in Latin America. In the USA economic expectations also cooled down. Assessments of the current economic situation, by contrast, improved. In the CIS countries, the Middle East and North Africa experts upwardly revised both their economic expectations and assessments of the current economic situation (see Figure 2). Developments in world trade were dominated by the current conflict over tariffs, with most WES experts predicting lower exports in the months ahead, particularly for the USA and China (see Figure 6). Forecast global investment activity levels fell significantly. The experts surveyed also expect private consumption to stagnate.

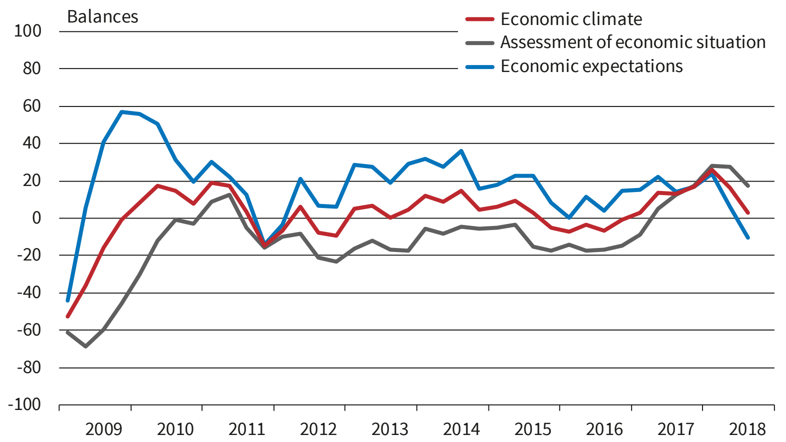
OPTIMISM IN ADVANCED ECONOMIES FADES

The economic climate in **Advanced Economies** as a group continued to lose momentum. Although assessments of the present economic situation remained robust, the expectations for the coming six months, for the second quarter in a row, clearly became less confident (see Figure 8). The outlook indicator fell from -0.5 to -16.8 points, causing the economic climate indicator to drop from 23.4 to 13.4 points on the balance scale (see Figure 2). Experts currently report that the investment and domestic consumption indicators will remain robust, although forecast investment and consumption turned negative.

Sentiment in the **Euro Area** also weakened this quarter. The ifo Economic Climate for the euro area fell from 31.1 balance points last quarter to 19.6 balance points. Although experts' assessments of the current

Figure 1

ifo World Economic Climate

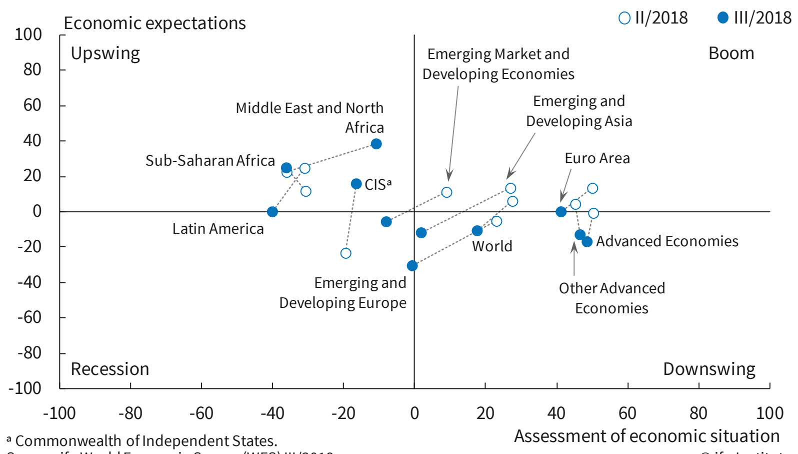


Source: ifo World Economic Survey (WES) III/2018. © ifo Institute

Figure 2

ifo Business Cycle Clock for Selected Aggregates

Change from II/2018 to III/2018; balances



ª Commonwealth of Independent States.
Source: ifo World Economic Survey (WES) III/2018. © ifo Institute

Box1

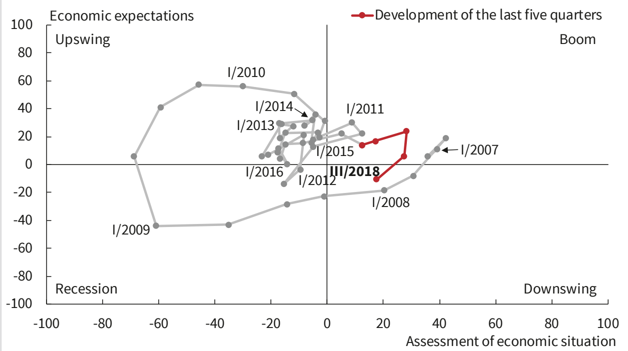
IFO BUSINESS CYCLE CLOCK FOR THE WORLD ECONOMY

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 2018 survey, the ifo Indicator for the world economy dropped again and has now entered the downswing quadrant (see Figure 3). Experts' assessment of the current economic situation, as well as their economic expectations deteriorated significantly, compared to last quarter. The indicator dropped sharply as a result.

Figure 3

ifo Business Cycle Clock World Economy
Balances

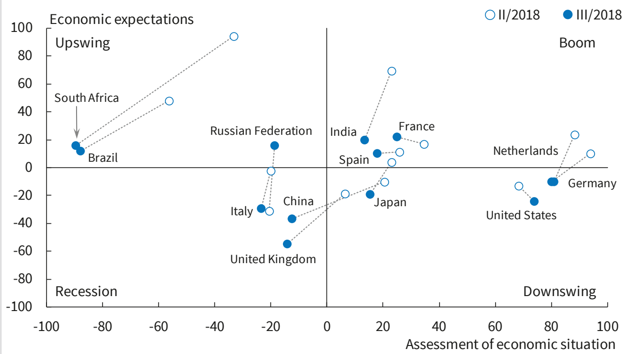


Source: ifo World Economic Survey (WES) III/2018. © ifo Institute

To further analyse which countries are the main drivers behind this global downturn, we plotted the main advanced economies and key emerging markets in the Business Cycle Clock below and visualised the change from last quarter to the current quarter (see Figure 3.1). The main advanced economies are moving away from the boom quadrant. The Netherlands, Germany, the United States and Japan are now in the downswing quadrant, although for these three countries their assessments of their present economic situation remains very favourable. The United Kingdom and Italy are moving further into the recession quadrant. Only France and Spain remain in the Boom quadrant. The largest downwards movement can be seen for South Africa and Brasil, however both countries are staying in the upswing quadrant. The Business Clock shows that only the Russian Federation moves significantly upwards in this quarter, from the recession quadrant to the upswing quadrant.

Figure 3.1

ifo Business Cycle Clock for Selected Countries
Change from II/2018 to III/2018; balances



Source: ifo World Economic Survey (WES) III/2018. © ifo Institute

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 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 current economic situation be assessed as negative but expectations as positive, the world business cycle is in an upswing phase (top left quadrant).

economic situation only deteriorated slightly, their economic expectations clouded over significantly, dropping to their lowest level since the end of 2012. This signals an economic slowdown in the euro area. The economic climate deteriorated in the euro area's five biggest economies, albeit to varying degrees (see Figure 9). In **Germany, Italy** and **The Netherlands** experts significantly scaled back their economic expectations. The indicator for the current economic situation also fell in these three countries. Despite this decline, assessments of the current economic situation in Germany and the Netherlands remain very good. The current economic situation indicator also remains positive in **France** and **Spain**, but is negative in **Italy**. According to WES experts, "the main problem of Italy is political". With populist parties in government threatening to leave the euro area. Moreover, their economic program includes expensive fiscal reforms, which pose risks to the sustainability of a high public debt. In the Baltic states – **Estonia**, **Latvia** and **Lithuania** – economic sentiment remained very robust. WES experts in Lithuania unanimously reported that that the present economic situation was good. The indicator for the current economic situation reached the highest attainable WES score. In Estonia, the current situation was also reported to be very favourable, with the indicator pointing to 85.7 points. In Latvia, WES experts were slightly more pessimistic than in the previous survey, but assessments of economic performance remained very positive at 41.7 points. In **Finland,** the economic climate also remained very robust at 57.7 points on the balance scale. Although expectations followed the overall declining trend in the euro area, they remained positive at 28.6 points. WES experts for the euro area in general expect the dynamic in private consumption to continue to lose impetus. They also expect investment to stagnate for the first time since the end of 2012. The current debate over tariffs and protectionism led to a clear deterioration in export expectations (see Figure 6). WES experts now forecast an annual inflation rate of 1.7 percent for 2018, versus 1.6 percent last year. The supply of credit via the banking system is improving gradually (see Table 2).

The economic climate in the remaining **G7** countries followed suit, as the economic outlook clouded over even further than in the previous survey. Assessments of present economic performance remained very favourable at 49.1 points (see Figure 8). **Japan** saw its economic climate indicator drop significantly. For the first time since summer 2016 the indicator turned negative and now points to -2.7. This is mainly due to an overcast outlook, as the expectations indicator was downwardly revised to -19.2, representing a drop of 23 points. However, present economic performance was also less favourably assessed. The supply of bank credit to firms was reported by participants to be more constrained than in the January survey (see Table 2). In **Canada**, present economic performance was more favourably assessed than in the previous survey, with

Table 1

Inflation Rate Expectations for 2018 and in 5 Years (2023)

Aggregate*/Country	2018	2023	Country	2018	2023
Average of countries	**3.5**	**3.5**	Bosnia and Herzegovina	1.2	2.7
EU 28 countries	1.9	2.4	Brazil	4.1	4.1
Euro area a)	1.7	2.2	Bulgaria	2.4.	3.0
			Cabo Verde	1.9	2.0
Advanced Economies	**1.9**	**2.3**	Chile	2.8	3.0
Australia	2.1	2.6	China	2.2	3.2
Austria	2.0	2.2	Colombia	3.2	3.2
Belgium	1.8	2.0	Croatia	1.9	2.6
Canada	2.1	2.2	Ecuador	1.0	1.9
Czech Republic	2.3	3.1	Egypt	15.0	7.0
Denmark	1.4	1.9	El Salvador	2.6	3.5
Estonia	3.2	2.4	Georgia	3.7	4.6
Finland	1.3	2.6	Guatemala	4.1	4.7
France	1.7	2.1	Hungary	2.8	3.5
Germany	1.9	2.1	India	5.2	4.4
Greece	1.3	2.0	Kazakhstan	6.9	6.1
Hong Kong	2.2	4.0	Kenya	5.7	6.0
Ireland	1.3	2.1	Kosovo	1.2	2.0
Israel	1.5	2.3	Lesotho	5.0	4.8
Italy	1.4	2.1	Malaysia	3.6	5.1
Japan	0.9	1.4	Mexico	4.4	3.8
Latvia	3.1	3.1	Morocco	2.4	2.8
Lithuania	2.9	2.9	Namibia	5.9	7.4
Netherlands	1.6	2.2	Nigeria	11.4	11.3
New Zealand	1.7	2.1	Pakistan	6.8	7.3
Norway	2.3	2.5	Paraguay	4.2	4.2
Portugal	1.5	2.0	Peru	2.5	2.4
Republic of Korea	2.2	3.0	Poland	2.1	2.7
Slovakia	2.4	2.4	Romania	4.8	5.0
Slovenia	1.9	3.1	Russian Federation	4.3	5.6
Spain	2.0	2.7	South Africa	5.4	5.3
Sweden	1.9	2.3	Sri Lanka	4.9	4.0
Switzerland	0.9	1.4	Thailand	1.0	2.3
Taiwan	1.5	1.8	Togo	1.6	2.3
United Kingdom	2.4	2.6	Tunisia	8.3	5.6
United States	2.4	2.6	Turkey	12.5	7.7
			Ukraine	10.6	7.1
Emerging market and developing economies	**4.8**	**4.4**	Uruguay	7.9	7.9
Argentina	29.2	9.5	Zambia	7.8	6.5
Bolivia	3.9	6.0	Zimbabwe	7.4	7.5

* To calculate aggregates, country weights are based on gross domestic product based on purchasing-power-parity (PPP) in international dollars (database IMF's World Economic Outlook). – [a] 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/2018.

the indicator pointing to 46.2 points. Nevertheless, WES experts also turned pessimistic about the future here. The economic expectations indicator dropped by 37.4 points and now points to -23.1. Trade volume of both imports and exports are expected to diminish, with imports expected to contract less than exports. As WES experts in Canada point out, the economy has already been affected by the United States enforced 25% tariff on steel and 10% tariff on aluminium. Due to its proximity to the US, trade relations between Canada and the US have always been closely intertwined. So, Canada's exposure to the impact of these tariffs might be greater than for any other country. In addition, a lot of uncertainty about the six months ahead also depends on how NAFTA will be renegotiated. Inflation rates for 2018 were downwardly revised by 0.2 percentage points to 2.1 percentage (see Table 1). The **United States** saw its economic climate indicator drop slightly from 23.9 to 19.6 points on the balance scale. Assessments of economic performance remained favourably, but confidence about the next six months waned again. The economic expectations indicator now points to –24.0 marking its lowest point since spring 2008. The volume of trade in both imports and exports is also expected to decrease in the United States. The inflation rate for 2018 was upwardly revised from 2.3% in the last survey to 2.4% (see Table 1). US experts on average expect both long and short-term interest rates to increase in the next six months (see Figure 7). Access to bank loans were assessed as unrestrictive, with only 18.8% of the surveyed experts reporting banks to be restrictive about granting credit (see Table 2). The economic climate in the **United Kingdom** remains poor. Assessments of economic performance turned negative once again after a minor upturn in the last survey. Economic expectations hint at further decline in the coming months and dropped by -35.7 to -54-5 points. As in most other advanced countries, volumes of both imports and exports are expected to slim down. Banks willingness to offer credit to businesses is assessed by 58.8% of the experts as being constrained (see Table 2). WES experts continue to stress the strain of Brexit and the uncertainty surrounding the kind of deal will be struck. Experts in these four countries, Japan, Canada, US and UK, expect both demand indicators, consumption and investment, to stagnate in the months ahead.

Economic growth also slowed down further in the **Other Advanced Economies**. Experts remain upbeat about the present economic situation, which improved by 1.5 points and now points to 46.6. However, the confidence indicator for the next six months sank to -13.0 points. **Norway**, **Czech Republic** and **New Zealand**, saw their economic climate improve at an already positive level. This was mainly due to rising optimism about the next six months in these countries. WES experts in the Czech Republic and Norway, like other European countries, report low levels of constraints on bank lending to firms. Experts in New Zealand and Australia, by contrast, report that bank lending is conservative. With 75% of WES experts in Australia and 66.7% in New Zealand reporting that bank lending is constrained (see Table 2). **Australia's** economic climate saw no change at a positive level. **Switzerland**, **Denmark**, **Sweden** and **Israel**, saw their economic climate indicator deteriorate, although it remained positive in all four countries. In Denmark and in Israel both components of the climate indicator edged downwards. In Switzerland and in Sweden only expectations for the coming months were downwardly revised. In both countries, the indicator for domestic consumption improved considerably. Although investment was still reported as favourable, experts expect a slowdown in the months ahead. Bank lending requirements continued to ease in Switzerland, Denmark and Sweden. In contrast, 80.0% of WES Experts in Israel described the supply of bank credit as restrictive (see Table 2).

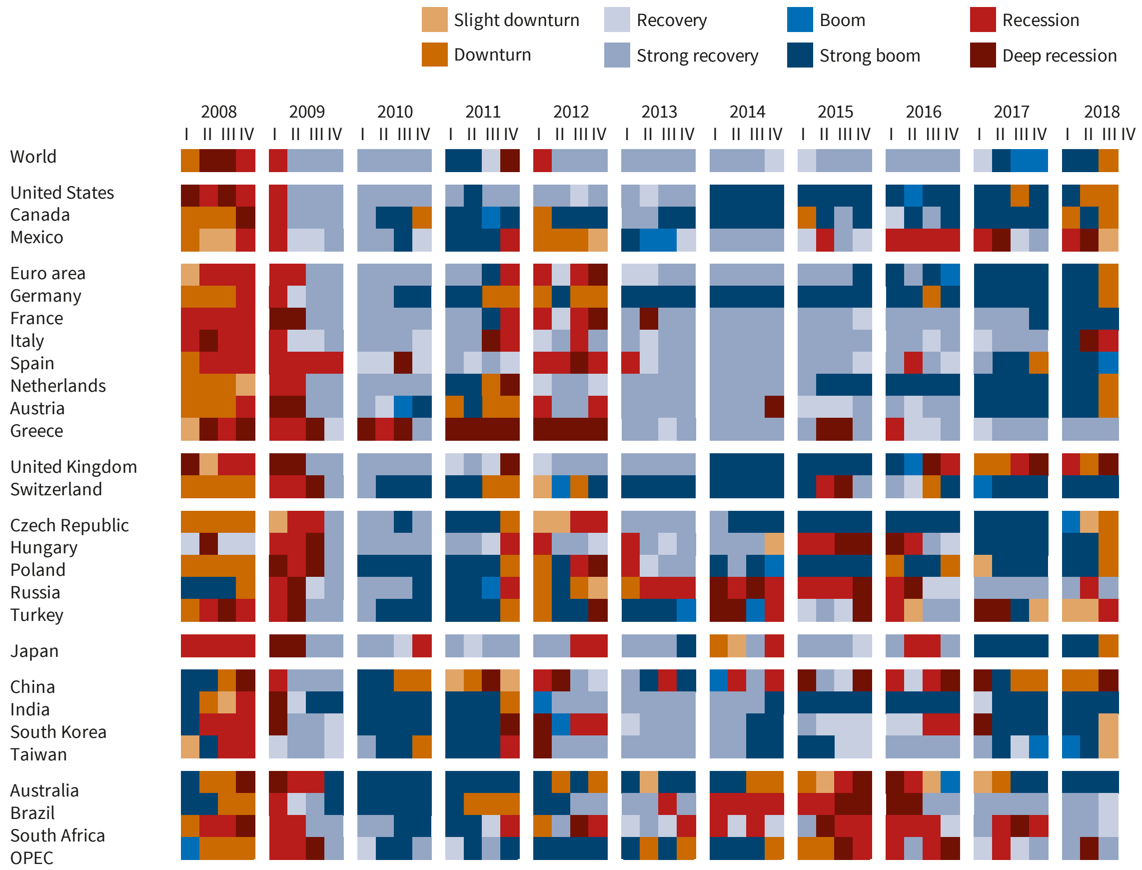
THE ECONOMIC CLIMATE FOR EMERGING MARKET AND DEVELOPING ECONOMIES PLUNGES IN THE THIRD QUARTER

Economic conditions worsened in the Emerging markets and developing economies as a group. The economic climate moved below the crucial line of 0 points on the balance scale that separates expansion from contraction in economic performance. With a drop of -17.0 points, the climate indicator now points to -6.8 on the balance scale. This steep fall came as experts reconsidered their valuations of both components of the climate indicator, current economic situation and economic outlook. The economic outlook turned negative for the first time since January 2012 (see Figure 8).

The main Emerging markets (**Brazil**, **Russia**, **India**, **China** and **South Africa** – **BRICS**) saw their economic performance deteriorate. After five quarters of expansionary economic performance, the Economic climate indicator now worsened considerably by -25.2 points and now sits at -14.1 on the balance scale (see Figure 8). Experts in Brazil, China, and Russia downwardly revised their assessment of current economic performance. Only the Experts in **India** did not change their positive assessments regarding the current economic situation (see Figure 10). Their assessments of the next six months nevertheless deteriorated by -49.2 to 20.0 points. Although the outlook is still favourable, this does potentially signal an economic slowdown in the short term. Out of the main four currencies only the US dollar is considered to be slightly overvalued vis-a-vis the Indian Rupee, the other currencies are assessed as being at their proper value. With 93.3% of the experts reporting constraints on bank lending, it seems a difficult environment for businesses to acquire loans. It is also considered tough to obtain financing in **China**, where 91.7% of the respondents described bank lending as constrained (see Table 2). The economic climate for China was hit considerably, and dropped by -29.5 to -25.0 on the balance scale. Current economic sentiment turned negative (-12.6 points) for the first time since the first quarter of 2017. Although the Chinese respondents have been reporting an unfavourable economic outlook on and off for the past three years, the current indicator now points to -36.5. This marks its lowest value since the first quarter of 2012. Consumption and investment are assessed as weak and are expected to further lose impetus soon. As far as the turn to protectionism and the debate about tariffs is concerned, the weak assessments of export volumes are not surprising. The economic climate in **Brazil** deteriorated further and now points to -45.9 on the balance scale. Assessments of the current situation have not yet recovered after the seven-day nationwide trucker protest in May and, as WES experts point out, the economy is very vulnerable, and optimism over further growth is curbed considerably. The Brazilian Real depreciated against all four main currencies, but especially against the US dollar. The weaker Brazilian Real may be the reason why respondents are expecting trade volume in exports to increase, but imports are expected to weaken in the months ahead. Inflation rates for 2018 were upwardly revised from 3.7 to 4.1% (see Table 1). In **Russia,** the economic climate recovered by 23.6 points, and now points to -2.3, or just barely below the zero line. Although assessments of the current situation did not change, the

Figure 4

World Economic Survey
Heatmap



Notes: The assessments of the current situation and economic expectations for the next six months are visualised as a Heat Map (see Figure 4). The results of the survey are represented by a four colour scheme that illustrates the four phases of a business cycle: boom, downswing, recession, and upswing. These colours are slightly lighter when the values of the assessment of current situation and economic expectations are within the rage of –20 and +20. To emphasise the different extends of the four phases. Due to an improved calculation are the colours of this quarters Heatmap slightly different from previous quarter.

Source: ifo World Economic Survey (WES) III/2018.

experts surveyed are significantly more optimistic about the next six months than in the previous survey. Trade activity is expected to increase for both imports and exports, and the trade balance will move towards a surplus in the next six months. Inflation rates, for this year and in 5 years, were downwardly revised. The inflation rate for this year is expected to be at 4.3% and in five years at 5.6% (see Table 1). Bank lending was described as restrictive by 96.9% of the experts surveyed (see Table 2). **South Africa's** economic climate deteriorated significantly. Both components of the economic climate dropped sharply, resulting in an indicator that points to -45.8 on the balance scale. This represents a drop of 67.1 versus the last survey. This also marks the first deterioration in South Africa's climate since February 2017. This might be related to greater caution in investments due to the uncertain outcome of President Ramaphosa's planned land reform. There are fears among WES experts that the expropriation of landowners will lead to an economic set back. The majority of experts (63.2%) still describe financial lending from banks to firms as restrained (see Table 2).

OTHER EMERGING MARKETS

Within the other aggregates of emerging and developing economies, the **Middle East and Northern Africa** as well as the **Commonwealth of Independent States** saw their economic climate improve compared to the previous survey. In **Sub-Saharan Africa,** the economic climate indicator edged upwards, with respondents expressing more confidence in an economic upturn in the coming months. The climate indicators for **Emerging and developing Europe**, **Emerging and developing Asia** and **Latin America** took a hit, as both indicator components deteriorated (see Figure 8).

In **Latin America**, the sluggish economy is not expected to improve, and the economic outlook also clouded over further in this survey. The outlook indicator points to zero, signalling stagnation and no confidence among respondents in an economic upturn in the near future. The credit supply was assessed as easing compared to the first quarter of this year, with only 50.4% of the respondents reporting a constraint (see Table 2). Experts in Latin America in general did not

Table 2

Supply of Bank Credit to Firms

Percentage of Experts who report Moderate or Strong Constraints	
Hong Kong	100.0
Nigeria	100.0
Togo	100.0
Russian Federation	96.9
Greece	95.5
Portugal	94.1
India	93.3
China	91.7
Ukraine	91.7
Italy	90.2
Cabo Verde	87.5
Zimbabwe	87.5
Romania	86.4
Kazakhstan	83.3
Latvia	83.3
Malaysia	83.3
Bolivia	80.0
Georgia	80.0
Israel	80.0
Kenya	80.0
Ireland	77.8
Australia	75.0
Philippines	75.0
Slovenia	70.0
Bulgaria	69.2
Spain	69.2
New Zealand	66.7
South Africa	63.2
United Kingdom	58.8
Brazil	58.3
Turkey	58.3
Chile	54.5
Pakistan	53.3
Poland	52.9
Belgium	50.0
Egypt	50.0
Hungary	50.0
Namibia	50.0
Netherlands	50.0
Thailand	50.0
Mexico	47.1
France	46.4
Japan	44.0
Norway	42.9
Paraguay	42.9
Austria	42.1
Slovakia	42.1
Argentina	40.0
Lithuania	40.0
Colombia	35.7
Croatia	33.3
Czech Republic	33.3
Sweden	33.3
Uruguay	33.3
Peru	31.3
Germany	29.9
Republic of Korea	25.0
Canada	23.1
Finland	19.0
United States	18.8
Taiwan	18.2
Switzerland	14.3
Lesotho	0.0

Only countries with more than four responses were includedin the analysis.
Source: ifo World Economic Survey (WES) III/2018

seem too worried about trade developments in the months ahead, as the volume of exports is expected to increase. However, imports were projected to weaken in the near future. This might also be due to the depreciation of Latin America currencies against the US dollar and the euro. Inflation expectations for this year were considerably upwardly revised by 0.8 to 6.4% (see Table 1). In **Argentina,** the economic climate indicator plunged by -62.0 points down to -51.3 on the balance scale. This is the first time since July 2016 that the economic climate went negative. Respondents assessed both economic performance and the economic outlook as poor. They also turned very sceptical about the months ahead. Both demand indicators dropped considerably and confidence in the markets seems under pressure. In a press release[1] the IMF stated that it had agreed to a US$50 billion stand-by arrangement for Argentina. According to the IMF, the present economic turmoil has resulted from a severe drought that had led to a sharp decline in agricultural production and export revenues. This was compounded by an increase in world energy prices and a tightening of financial conditions. This interacted negatively with Argentina's economic policies. The inflation rate for 2018 was upwardly revised again to 29.2% this quarter (see Table 1). **Bolivia**, **Colombia** and **Peru** saw their economic climate indicators improve considerably. In Colombia, the economic climate now points to 31.8, marking its highest score since autumn 2014. Respondents reported an improvement in demand conditions, and expect this improvement to continue in the months ahead. Investment, as in the previous survey, is still considered weak, although it improved somewhat this quarter. Both long and short-term inflation rates were downwardly revised by -0.4 and now both lie at 3.2% (see Table 1). The experts surveyed hinted that restrictions on bank lending were somewhat eased as only 35.7% of the experts reported them as restrictive (see Table 2). In **Mexico,** the economic climate also improved compared to the previous survey, but remains at -12.1 on the balance scale. Current economic performance reached the zero line, after being negative since the second quarter of 2013. Nevertheless, the outlook for the months ahead has barely moved and remains very pessimistic at -23.5 points. Inflation rates were downwardly revised, and experts now expect an inflation rate of 4.4% in 2018 and of 3.8% in 2023 (see Table 1). The experts surveyed expect the export sector to show resilience, even with the ongoing NAFTA renegotiations. The Economic Climate in **emerging and developing Europe** deteriorated from 8.3 to -16.1 points on the balance scale. Assessments of the present economic performance also deteriorated significantly. The indicator now points to -0.7. No significant improvement in terms of economic uptake is expected, as the outlook indicator plunged from -5.3 to -30.3 points.

[1] IMF Press Release No. 18/245 https://www.imf.org/en/News/Articles/2018/06/20/pr18245-argentina-imf-executive-board-approves-us50-billion-stand-by-arrangement

This deterioration in the economic climate in emerging and developing Europe is mainly due to **Turkey's** poorer economic performance. Here assessments of the current situation and the economic outlook deteriorated significantly. Assessments of investment at present and in six months fell more sharply than those of domestic consumption. Inflation expectations nonetheless rose to 12.5% for this year (see Table 1). This is the highest expected rate of inflation since 2004. The expectations of domestic share price movements over the next six months dropped by -28.1 points to just above the zero line. According to WES experts, the Turkish lira continues to underperform compared to the four main currencies. A small majority (58.5%) of the experts surveyed reported bank lending as constrained (see Table 2). In **Romania,** the economic climate indicator remained unchanged at -7.5 on the balance scale. The present economic situation was judged as less favourable than in the previous survey, but nevertheless continues to indicate economic stabilisation at 9.1 points. The Romanian Leu considered as undervalued against the euro. Inflation for 2018 was upwardly revised from 4.2% in the previous survey to 4.8% in this survey (see Table 1). Bank lending to firms is considered as constrained by 86.4% of experts (see Table 2). Interest rates are not expected to move downwards, and a rising number of experts expect a further increase in the short and long-term ROBOR, the Romanian interest rate. The economies of **Hungary**, **Poland**, **Croatia** and **Bulgaria** are expected to fare more positively and their economic climate indicators continued to climb. Only **Poland's** indicator dropped considerably, despite remaining at a favourable level. The deterioration was mainly due to waning confidence over the next six months. Investments in particular are expected to lose dynamic in the months ahead. In **Hungary**, the present economic situation was assessed as more favourable than in the previous survey. The economic outlook continued to follow a downward trend, as experts turned pessimistic regarding the future. The outlook indicator fell to -14.3, reaching its lowest level since autumn 2015. The experts surveyed in Hungary expect the trade balance to move a little into surplus as in the previous survey. All of the main currencies, the dollar, euro, yen and the pound, are undervalued compared to the Hungarian Forint. In **emerging and developing Asia**, after four consecutive positive quarters, the economic climate indicator now points to -5.1 points. Confidence waned considerably, turning negative (-11.8) for the first time since the first quarter of 2012. Experts in **India**, **Pakistan** and **China** in particular were more pessimistic about both the present economic situation and the economic outlook.[2] In the **Commonwealth of Independent States** (CIS) the economic climate improved, mainly because experts scaled up their expectations, but the present situation was also assessed as slightly better than in the last survey. Expectations were particularly positive regarding the region's trade volume for the next six months. Higher oil production and solid oil prices may be factors influencing this optimistic outlook. Despite uncertainty over the impact of US sanctions, assessments of the present economic situation and the outlook in **Russia** were more positive than in the previous survey. After **Uzbekistan**, Russia showed the second largest climate improvement of the region. In the Ukraine, Azerbaijan and Georgia, by contrast, the economic outlook was downgraded, while current economic performance improved.

In countries from the **Middle East and North Africa** (MENA) the economic climate improved again. The indicator reached a positive level of 12.4 points on the balance scale for the first time since May 2015. Although still negative, the present situation was assessed as considerably better than in the previous survey and the positive economic outlook brightened further. MENA is the only region where the surveyed experts upwardly revised their trade expectations for the coming months (see Figure 6). Most of the improvement in the economic climate of the region is accounted for by the **United Arab Emirates**. Here the climate increased by 33.4 points, due to significantly better assessments of both the current situation and the economic outlook. The present economic situation of countries of **Sub-Saharan Africa** was assessed as worse than last quarter, but expectations brightened. This resulted in an overall improvement in the economic climate for this region. For the countries **Niger**, **Nigeria** and **Togo** the climate improved the most, with more optimistic expectations playing an important role. In the **Democratic Republic of the Congo** and **Tanzania,** by contrast, the climate improved due to better assessments of the present economic situation. In **Zimbabwe,** the climate in this quarter's survey deteriorated again due to poorer assessments of the present situation and the economic outlook.

[2] For a more detailed description on China and India see the BRICS section.

HOW RESILIENT ARE THE WORLD' ECONOMIES TO A NEW FINANCIAL CRISIS?

Nearly ten years after its outbreak, the 2008–09 financial crisis still weighs heavily on many advanced economies. Triggered by the bursting of the US real-estate bubble, the financial crisis, spread throughout the entire world, although to various degrees. Economic growth slowed down markedly, and in 2009 all major regions were in recession. Ten years later, despite the recovery in employment, private investment and productivity, growth rates are still below pre-crisis levels in many countries, with some exceptions (for example, the US, Germany and the UK). For many emerging and developing countries the financial crisis had an indirect effect; output, exports remittance flows and capital inflows have all been lower than expected.[1] The financial crisis was preceded by a period of exceptional boom in credit growth and leverage in the financial system. Historically low interest rates and abundant liquidity increased the amount of risk and leverage that borrowers, investors and intermediaries were willing to take. In addition, a wave of financial innovation that expanded the system's capacity to generate credit assets and leverage outpaced its capacity to manage the associated risks. This led the authors of the 2009 EEAG report to conclude that "at the root of the crisis lies a fundamental inconsistency between financial globalisation – the process of liberalization and deregulation driving the impressive growth of world financial markets – and existing public rules and policies at both domestic and international levels".[2]

As it was a *global* financial crisis, many countries responded in turn with changes in policy and regulation of their financial sector. To see whether these changes also improved the perceived resiliency of the economies of those countries, we asked the WES experts to give us their assessments. Accordingly, the special question in this quarters WES focused on the policy reforms suggested by the Financial Stability Forum (FSF). The forum was founded in 1999 to promote international financial stability. In relation to the 2008–09 financial crisis, the FSF responded with a report that gives "a comprehensive set of recommendation reflecting a consensus, both internationally and cross-sectorally, on the actions needed to address the fundamental weaknesses that have been at the root of the present turmoil and build a more reliant financial system".[3] The report identified five areas of recommendations that countries could improve upon to become more resilient when faced with another financial crisis (see table 3). To this research, I have added two more policy recommendations that the IMF identified in their policy paper of 2009[4] (see table 3).

The first question we asked the surveyed experts was whether they considered there to be a need for reform in the financial sector of their respective countries. Although the financial crisis emerged in the US housing market, the crisis easily spread throughout the world due to the degree to which national economies, developed and developing, are intertwined. The need for reform is thus not only restricted to the advanced economies. However, as figure 11 shows, experts from the advanced economies are of the opinion that a reform in their financial sectors was needed: 86.2% of the experts in the Euro Area and G7 countries stated that financial regulation needed reform. Nevertheless, experts in some emerging and developing markets were also of the opinion that their countries needed reform. For example, in the Commonwealth of Independent States, 94.0% of the respondents stated that the financial sector needed reforms. Also in the emerging and developing economies of Asia, a high number of experts agreed with this position. By contrast, in Latin America only 45.2% of the surveyed experts responded in a similar manner Latin America had seen considerable policy reforms in the 1990s that seemed to have prepared the region in terms of credibility and stability. Luisa Blanco thus concluded that Latin American was in a good position when faced with the crisis.[5] In the Middle East and northern Africa as well as Sub-Saharan Africa the experts are more divided, with only a small majority agreeing that financial sector reforms were needed. Because they are less integrated in the financial market system, low-income countries were less impacted by the credit crunch than developing countries. Therefore, financial sector reform was seen to be less needed in the African countries.[6]

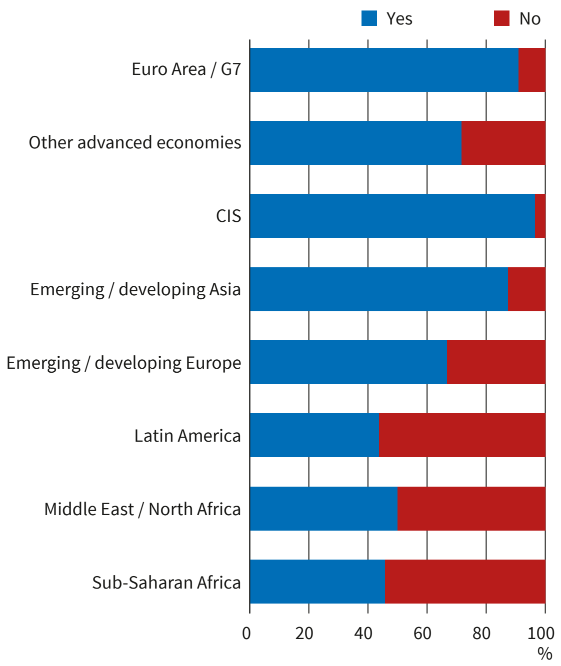
To assess whether the recommendations of the FSF were implemented around the world and whether this, according to the surveyed experts, was done to a satisfactory degree, we take a closer look at the different world regions (see Figure 5 and 5.1). Most experts agree that most improvements are seen with regards to **capital and liquidity regulation as well as risk management** Before the crisis, banks were using an 'orginate and distribute model'. So instead of holding loans on banks' balance sheets, banks repackaged loans and passed them on to various other financial investors, thereby offloading risk. Second, banks increasingly financed their asset holdings with shorter maturity. Specific proposals in the report of the FSF were 1) to raise the Basel II capital requirements for certain complex structured credit products, 2) to introduce additional capital charges for default and event risk in the trading books of banks and securities firms and 3) to strengthen the capital treatment of liquidity facilities to off-balance sheet conduits.[7] In almost all regions more than 60% of the respondents agreed that reforms had been implemented in this policy area. In Latin America, this is assessment was considerably lower, with 40% of the respondents agreeing that reforms were implemented after the global financial crisis of 2007. Nevertheless, as Figure 5.3 shows, most respondents from Latin America consider the current practice to be satisfactory. Especially experts from emerging and developing Asian economies (55.2%) call for more stricter regulation in this area.[8]

Another policy area that the FSF recommended was the **enhancement of the transparency about the valuation of financial instruments.** To offload risk, banks typically create structured products often referred to as collateralised debt obligations (CDOs). These are constructed in two steps. The first step is to form a diversified portfolio of mortgages as well as and other types of loans, corporate bonds and other assets like credit card receivables. Second, these portfolios were sliced up in different tranches. These tranches were then sold to investor groups with different appetites for risk.[9] The underestimated risks of these financially engineered products were one of the factors leading to the financial crisis. The euro area and G7 countries are where most experts state that reforms have been implemented. In emerging and developing Asian economies, also a high number of experts stated that reforms have been implemented, however more reforms are still needed. Around 40% of the experts in the CIS regions said reforms had been implemented, however, more than 50% called for further reforms in this area.

The area of changes to the role and uses of credit ratings has seen the least reforms since the financial crisis of 2008. Credit rating agencies are independent companies that assess the risk of certain types of debt instruments and institutions. The three largest agencies are Standard and Poor's, Fitch Ratings and Moody's. Criticism after the financial crisis focused on the fact that these agencies are employed and paid by the issuers of financial products and not by investors. This creates an incentive for the agency to overstate the creditworthiness of a product in order to build a better

Figure 5

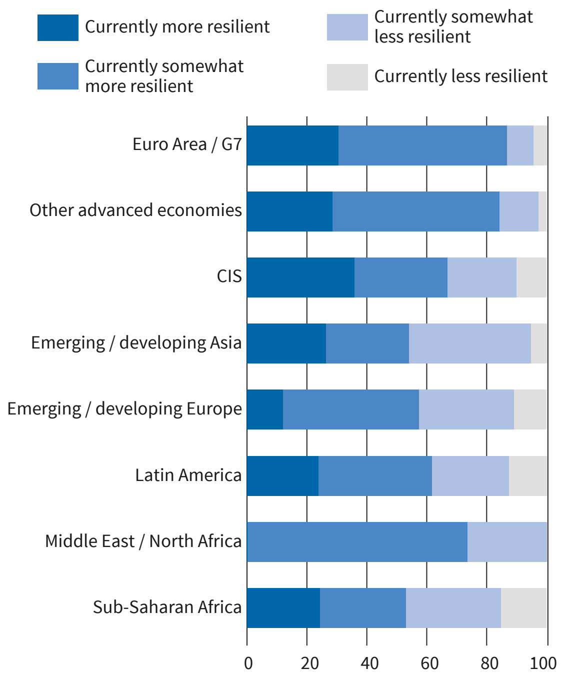
Was There Need for Reform in Your Country After the Financial Crisis?



Source: ifo World Economic Survey (WES) III/2018. © ifo Institute

Figure 5.1

How Does This Resilieny Compare to Before 2007?



Source: ifo World Economic Survey (WES) III/2018. © ifo Institute

Table 3

FSF Areas of Recommendations*

1	Strengthening prudential oversight of capital, liquidity and risk management.
1	Enhancing transparency via improved disclosures about the valuation of financial instruments (e.g. Collateral Debt Obligations (CDOs)).
3	Changes in the role and uses of credit ratings.
4	Reinforcing financial authorities' responsiveness to market risk and the effectiveness of their communication with markets
5	Introduction of robust-cross-border arrangements for dealing with liquidity problems when financial markets are under stress.
IMF policy recommendations**	
6	Tougher regulation and resolution of cross-border financial firms
7	Strengthening the capacity of central banks to provide liquidity.

* Financial Stability Forum 2008
** IMF 2009
Source: ifo World Economic Survey (WES) III/2018

1 Tony Dolphin and Laura Chappell, 'The Effect of the Global Financial Crisis on Emerging and Developing Economies', 2010.

2 EEAG report 2009

3 Financial Stability Forum 2008,'Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience', n.d., 74.

4 IMF policy paper 2009. https://www.imf.org/en/Publications/Policy-Papers/Issues/2016/12/31/Lessons-of-the-Financial-Crisis-for-Future-Regulation-of-Financial-Institutions-and-Markets-PP4316

5 Luisa Blanco, 'The Financial Crisis of 2008 and Latin American Countries - What Did We Learn from the Region?', 2010, https://faculty.isi.org/blog/post/view/id/381/.

6 José Antonio Ocampo and Stephany Griffith-Jones, 'The Financial Crisis And Its Impact On Developing Countries', 2009, 21.

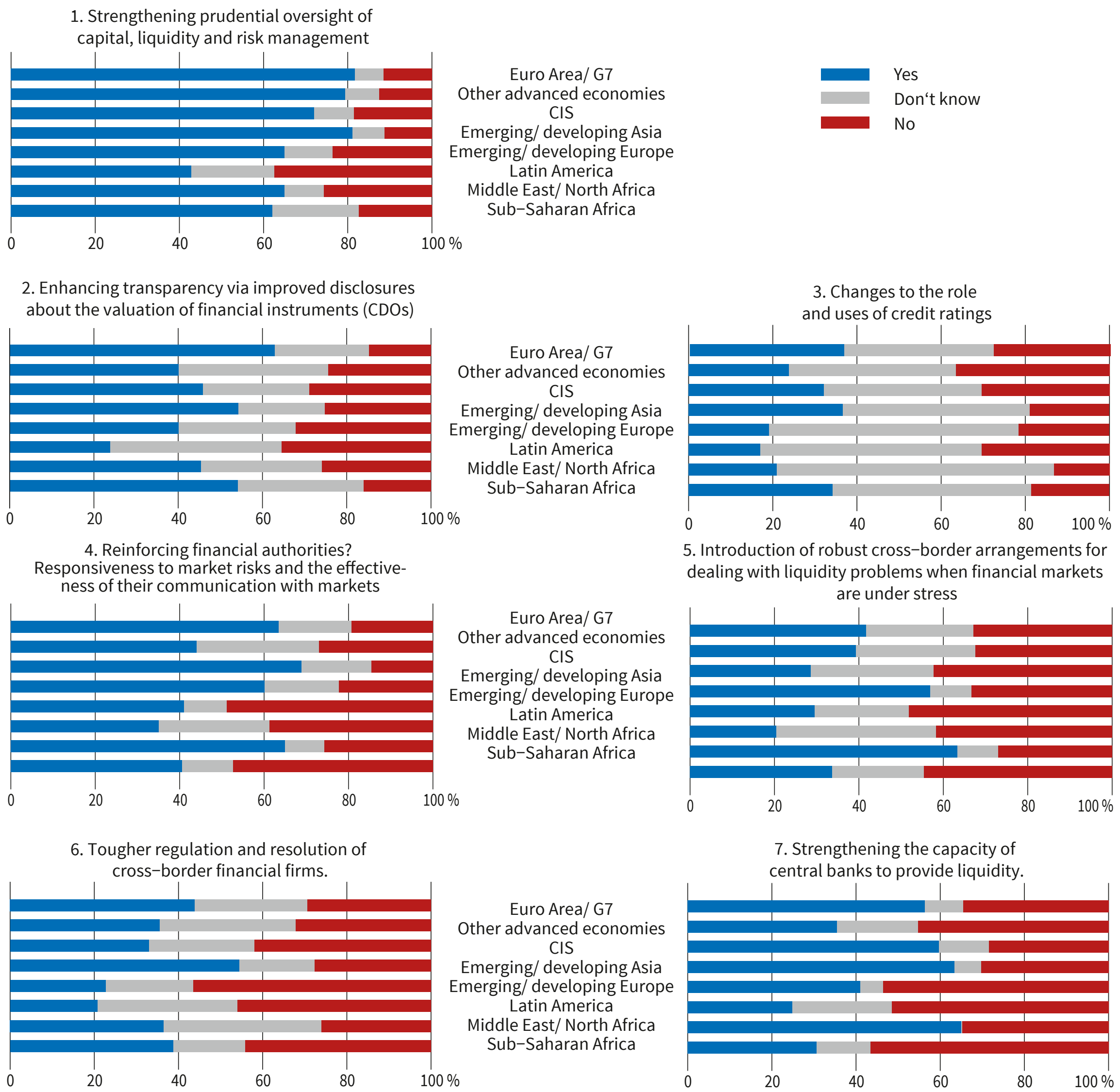
7 Financial Stability Forum 2008, 'Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience'.

8 For a more detailed analysis of developments in Emerging and Developing Asia during the crisis see Ocampo and Griffith-Jones (2009)

9 Markus K. Brunnermeier, 'Deciphering the Liquidity and Credit Crunch 2007-2008', *Journal of Economic Perspectives* 23, no. 1 (March 2009): 77–100, doi:10.1257/jep.23.1.77.

Figure 5.2

In Which Areas Were Reforms Implemented?



Source: ifo World Economic Survey (WES) III/2018.

relationship with its customer. One of the FSF recommendations was to enhance the transparency of credit rating methodologies. This could help encourage more prudent assessments of the vulnerability of financial products.[10] In all regions, less than 40% of the experts stated that reforms had been implemented. Especially in the Middle East and North Africa, the surveyed experts call for more stricter reforms. In all other countries, most of the experts are satisfied with the current practice.

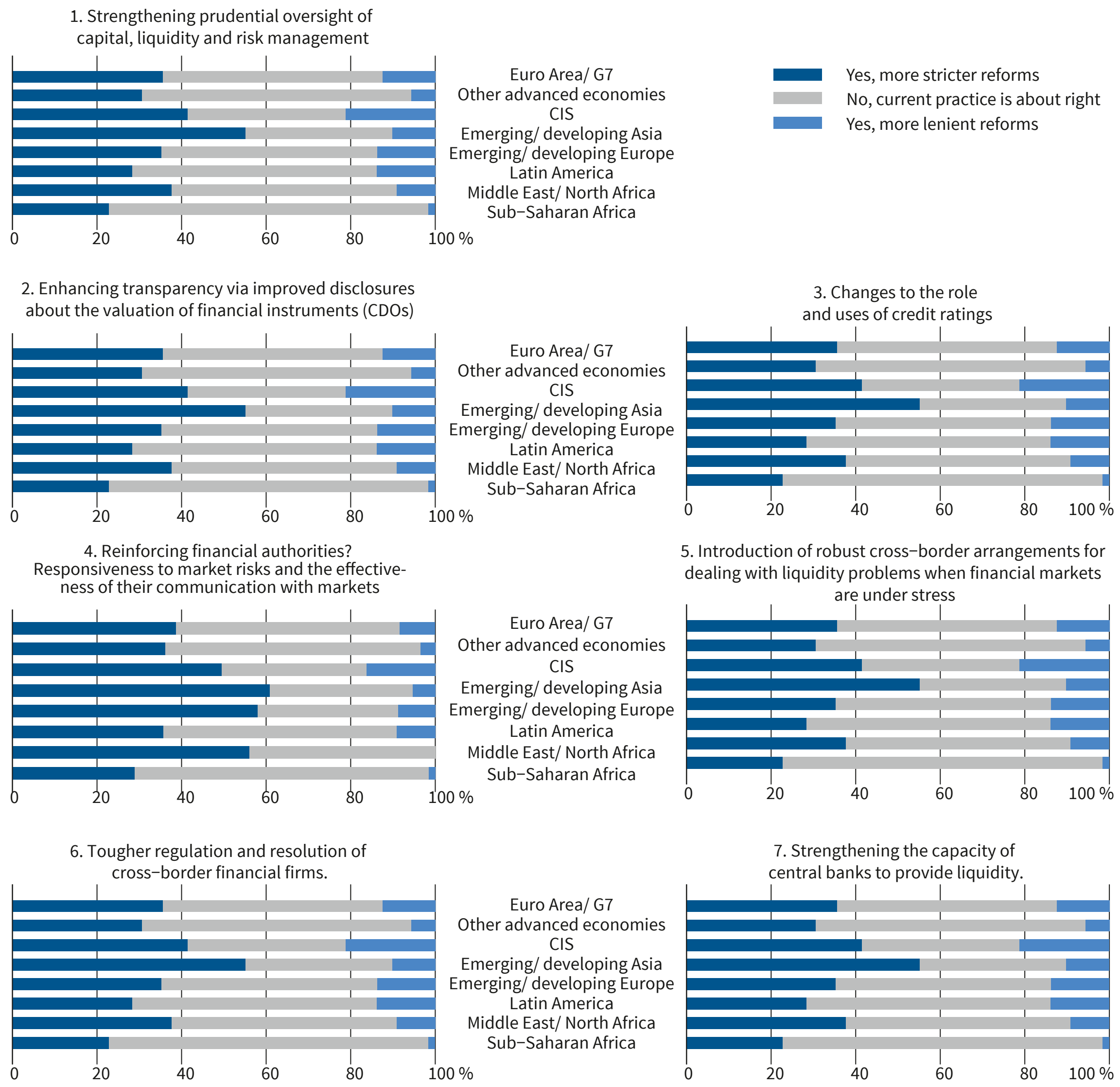
Reinforcing the financial authority's responsiveness to market risks and the effectiveness of their communication with markets – here the weaknesses of the practice of financial companies was known or suspected within the community of financial authorities before the crisis began. However, the international process for agreeing and implementing regulatory and supervisory responses has been too slow given the pace of innovation in financial markets.11 The FSF proposed an international supervisory body that should be expanded so that supervisory colleges exist for each of the largest global financial institutions, building on current practice that is already evident in the BASELII and the European Union. In this policy area reforms are seen to have been implemented by the highest number of experts (more than 60%) in the Euro Area and or G7, as well as the CIS countries, emerging and developing Asian economies, and Middle East and North Africa. Here, however, emerging and developing

[10] Tim Jenkinson et al., 'CESifo Group Munich - The EEAG Report on the European Economy 2009', 2009, https://www.cesifo-group.de/ifoHome/policy/EEAG-Report/Archive/EEAG_Report_2009.html.

[11] Financial Stability Forum 2008, 'Report of the Financial Stability Forum on Enhancing Market and Institutional Resilience - Google Search'.

Figure 5.3

Are Further Reforms In These Areas Necessary?



Source: ifo World Economic Survey (WES) III/2018.

Asian economies as well as emerging and developing European economies are calling for increasing reforms to control policy in this area.

Introduction of robust cross-border arrangements for dealing with liquidity problems when financial markets are under stress. Ahead of the crisis, supervisory authorities did not appear to have been effective in sharing information and identifying the build-up of vulnerabilities in globally active and systemically important financial institutions. An international legal framework that could guarantee a fair resolution in the case of the failure of a global firm was lacking. Therefore, regulation of global firms is an area in need of improvement.[12] With slightly more than 40% of experts of the Euro Area /G7 region stating that reforms have been implemented in this policy area, it is the policy area with the second lowest number of experts that are confident that reforms have been implemented. Experts in emerging and developing Asian economies, by contrast, are clearly more certain that reforms were implemented, nevertheless, more than 40% of the expert's state that reforms did not go far enough and call for further reforms in this area. In the Middle East and Northern Africa, more than 60% of the experts indicated that reforms were implemented in this area. Although the majority agrees that the current practice is about right, more than 40% of the experts call for stricter reforms. Also emerging and developing European countries, where only few experts

[12] IMF, 'Lessons of the Financial Crisis for Future Regulation of Financial Institutions and Markets and for Liquidity Management', *IMF*, 2009,

[12] https://www.imf.org/en/Publications/Policy-Papers/Issues/2016/12/31/Lessons-of-the-Financial-Crisis-for-Future-Regulation-of-Financial-Institutions-and-Markets-PP4316.

stated that reforms were introduced, more than 40% call for wider reforms.

Tougher regulation and resolution of cross-border financial firms. The financial crisis underscored the need to work on international crisis cooperation. Many countries as well as many different types of institutions were affected, meaning that domestic solutions are probably not sufficient. Therefore, national authorities should review their own regulatory frameworks to ensure they have an adequate range of tools to deal with problem banks. International authorities should accelerate work on sharing information on national arrangements and should catalogue cross border issues and address them consistently. The FSF report recommends putting in place an effective depositor compensation arrangement. Such a system can promote public confidence, help to contain the cost of resolving failed institutions and can provide countries with an orderly process for dealing with bank failures. These need to adhere to a set of international principles. Here, again, respondents from emerging and developing Asian economies is the leading group in terms of the most experts that state that reforms have been implemented; nevertheless, room for improvements exist, as more than 40% call for further reforms. Experts in emerging and developing European countries also call for more reforms, however, they indicated that not much had been done since the financial crisis in this policy area.

Strengthening the capacity of central banks to provide liquidity – liquidity risks in the current banking system come from exposure to a range of lending and interbank financial arrangements,[13] rather than from depositors losing faith in their banks and withdrawing their money. In the financial crisis, when a considerable number of banks, hedge funds and other financial institutions were faced with large losses, trust in the interbank market dissipated. Although the European Central Bank and the US Federal Reserve injected liquidity into the interbank market, trust was difficult to restore. Banks were reluctant to borrow from the overnight interest rate market, as it could signal a lack of credit worthiness on the interbank market.[14] The FSF report proposes increasing the flexibility of central banks' available mechanisms to provide loans where no stigma is attached. The euro area countries and G7 indicate that reforms in this area have taken place. Also, in the CIS countries, emerging and developing Asian economies as well as the Middle East and North Africa, most experts are of the opinion that reforms have been implemented. In this area, the response "don't know" is smaller compared to the other policy areas. Although most experts assess the regulations in this area as satisfactory, the highest number of experts in emerging and developing European countries states that more reforms are necessary.

Third, we asked the WES experts to assess whether the economies of their countries are currently resilient when faced with another financial crisis. Taking all experts together, 5.0% stated their economies were very resilient and 61.5% responded with somewhat resilient. Not very resilient was marked by 25.7% and not at all resilient by 3.2% of the experts. Although this leaves still some room of improvement, most experts at least consider their economies to be resilient. When asked to compare this resiliency to conditions before 2007, 22.5% of the experts state that their economies are currently more resilient, and 38.7% considers the state of the economy of their respective country to be currently somewhat more resilient (see Figure X.X), with 24.6% of the respondents assessing their economies to be currently less resilient.[15] When taking a closer look at the different aggregates in most regions, most respondents assess their economy to be somewhat resilient to a future financial crisis. Clearly those countries that have been hit hard, also in the after effects of the financial crisis, seem to be less optimistic. Experts in CIS, emerging and developing European countries as well as Latin America are most pessimistic regarding being resilient in the future. Although when the respondents were asked to put this in comparison to the situation before 2007, the CIS region is the region where experts state that the economies there are currently more resilient than before 2007. Experts in emerging and developing Asian economies as well as sub-Saharan Africa see the least improvement compared to before 2007. Nevertheless, more than 70% of the surveyed experts in these aggregates report that their economy is somewhat resilient.

From this we can conclude that there was clearly a need for reform in financial sectors across the world. Although reforms have been implemented, and according to the opinion of the WES experts, mostly to a sufficient degree, experts from mainly developing countries are still of the opinion that their economies are not sufficiently resilient if faced with another financial crisis. This might, however, also be due to the nature of how emerging and developing countries were affected by the crisis. As most advanced countries went into a recession, there was less foreign direct investment, consumption, foreign aid and trade, which had a long-lasting effect on the growth rates for emerging and developing countries. Most of these countries were not as intertwined with the financial sectors of the advanced countries, except for emerging and developing Asian economies. However, it is important to note that as the financial crisis emerged from the US and the European Union, it is also these regions where more than 80% of the respondents agrees that their economies are currently more resilient to a financial crisis compared to conditions before 2007.

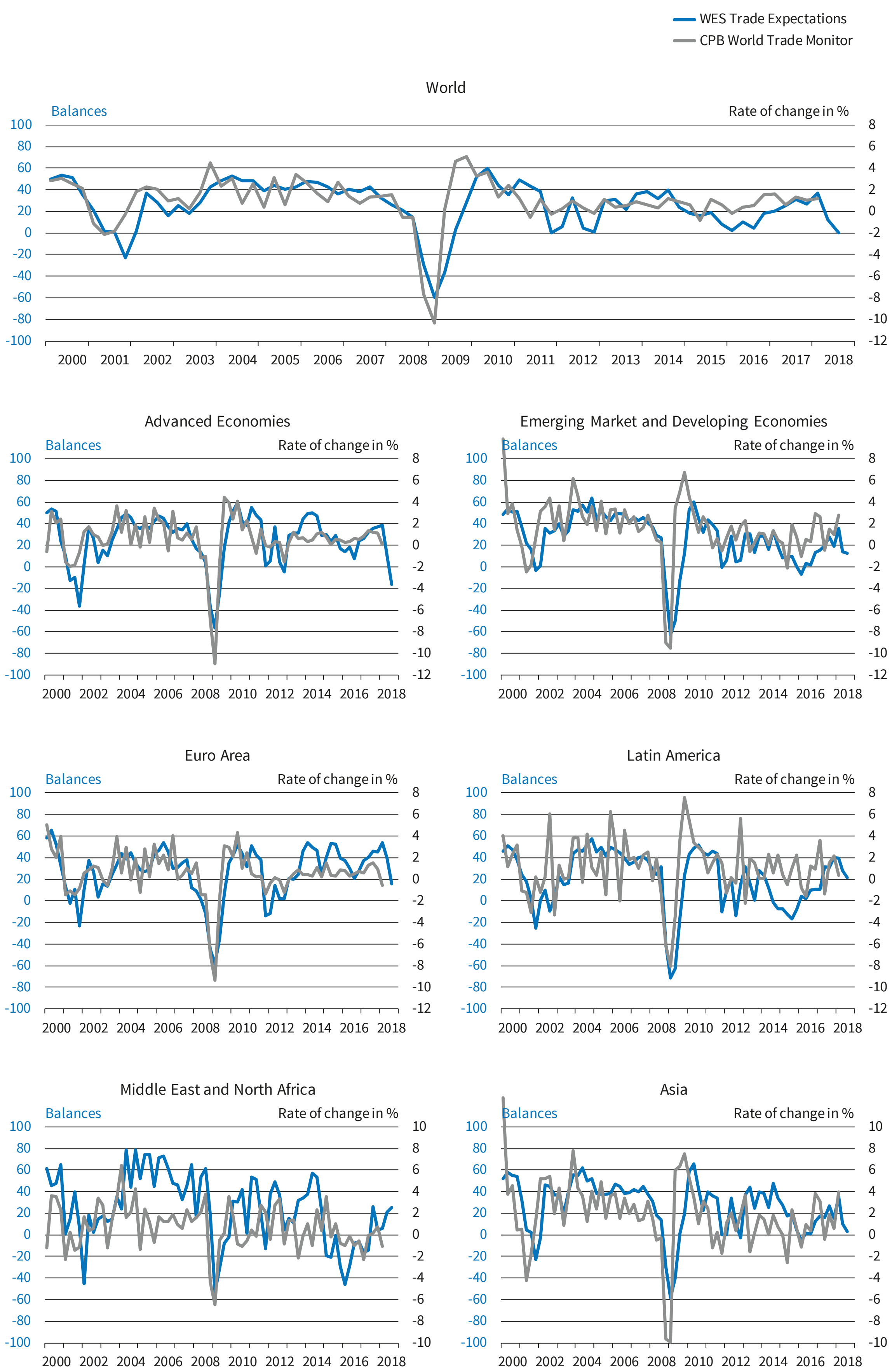
[13] These include undrawn loan commitments, obligations to repurchase securitized assets, margin calls in the derivatives markets, and withdrawal of funds from wholesale short-term financing arrangements.

[14] Brunnermeier, 'Deciphering the Liquidity and Credit Crunch 2007-2008'.

[15] This is taking the "currently somewhat less resilient" and "currently less resilient" categories together.

Figure 6

Comparison of WES Experts Trade Expections and the CPBs World Trade Monitor in Selected Aggregates



Source: ifo World Economic Survey (WES) III/2018; CPB Netherlands Bureau for Economic Policy Analysis (CPB). © ifo Institute

Figure 7

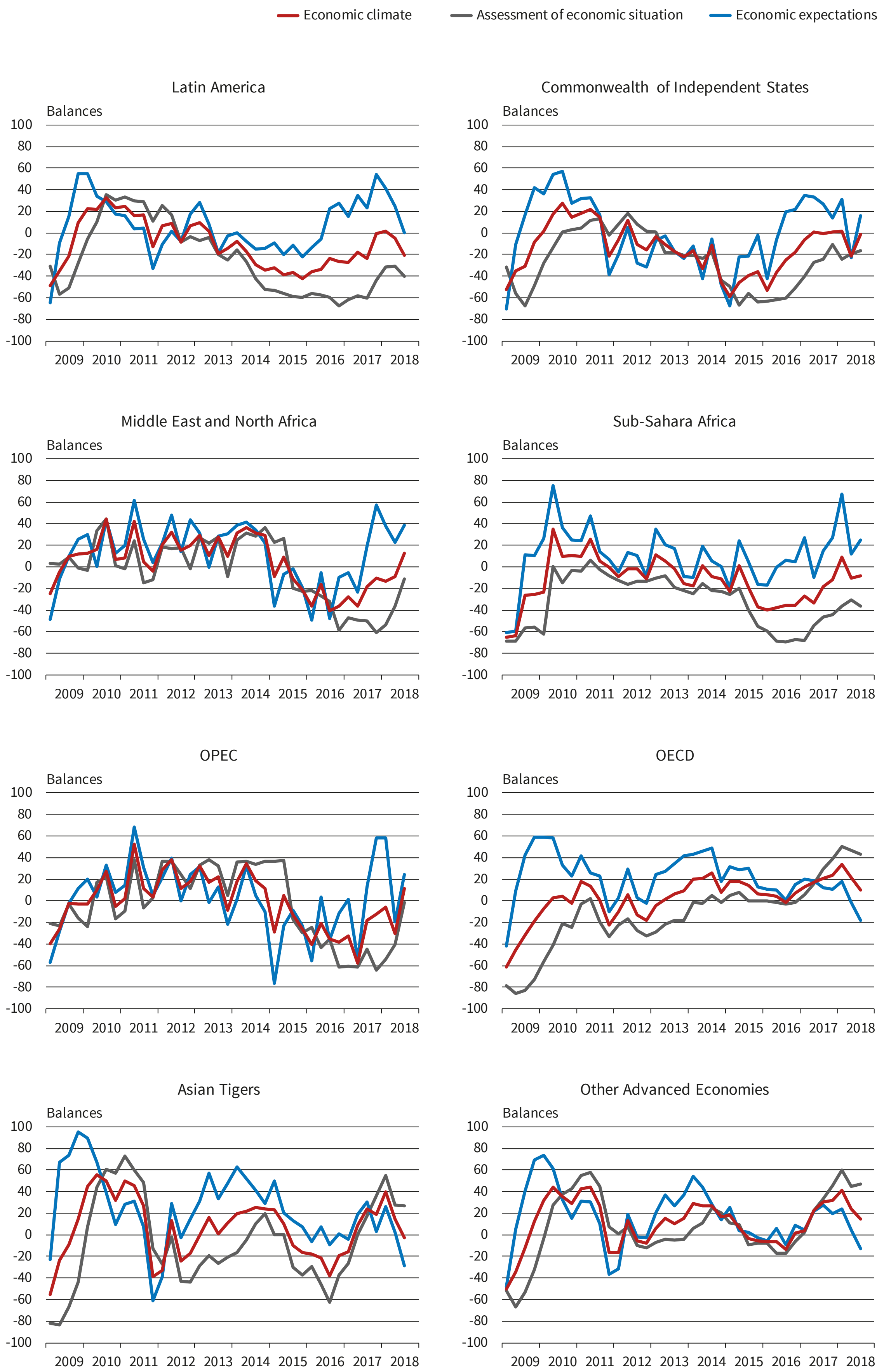
Expected Trend for the next 6 Months for Short- and Long-term Interest Rates

Source: ifo World Economic Survey (WES) III/2018.

© ifo Institute

Figure 8.1

Selected Aggregates

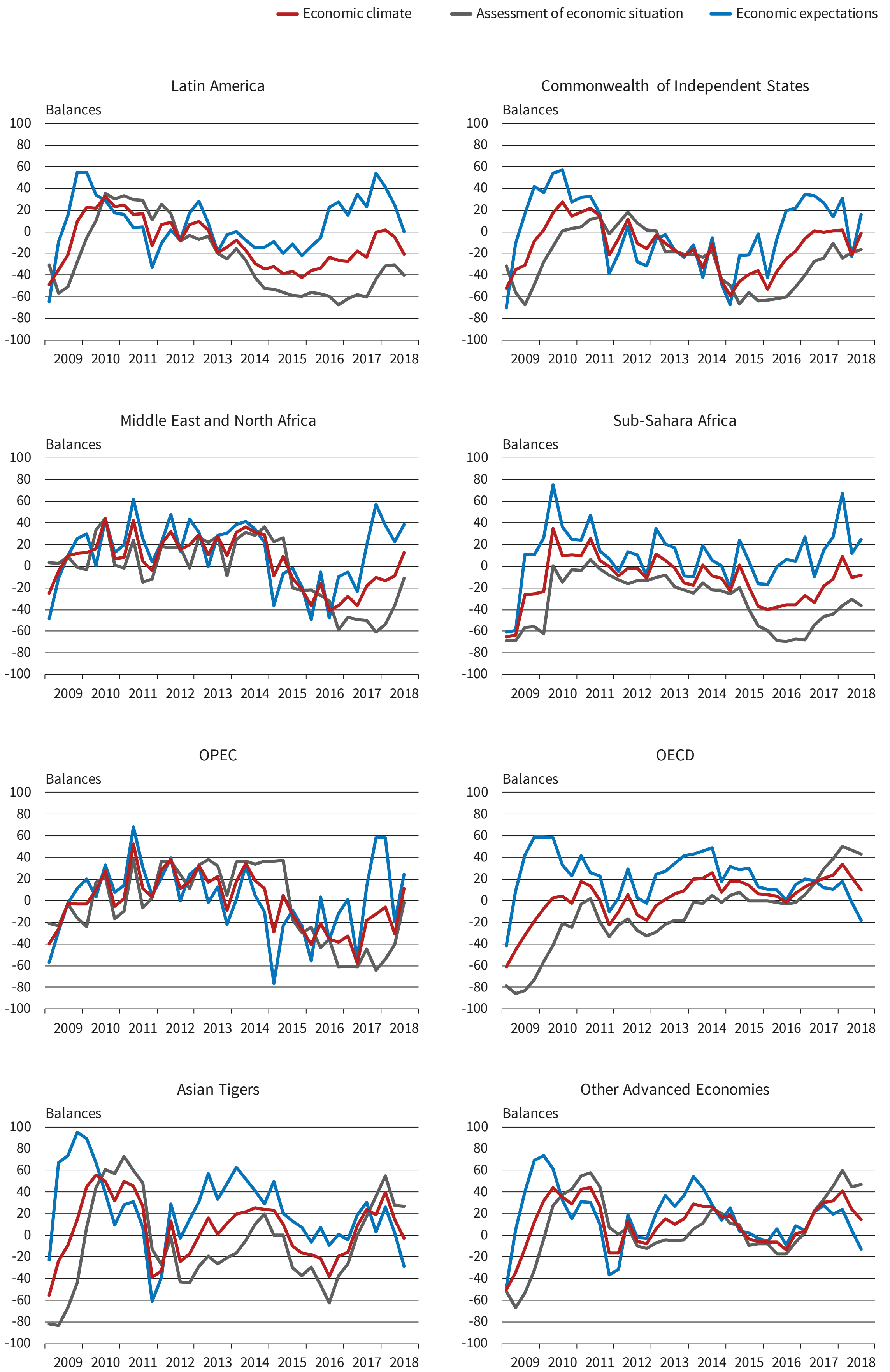


Source: ifo World Economic Survey (WES) III/2018.

© ifo Institute

Figure 8,2

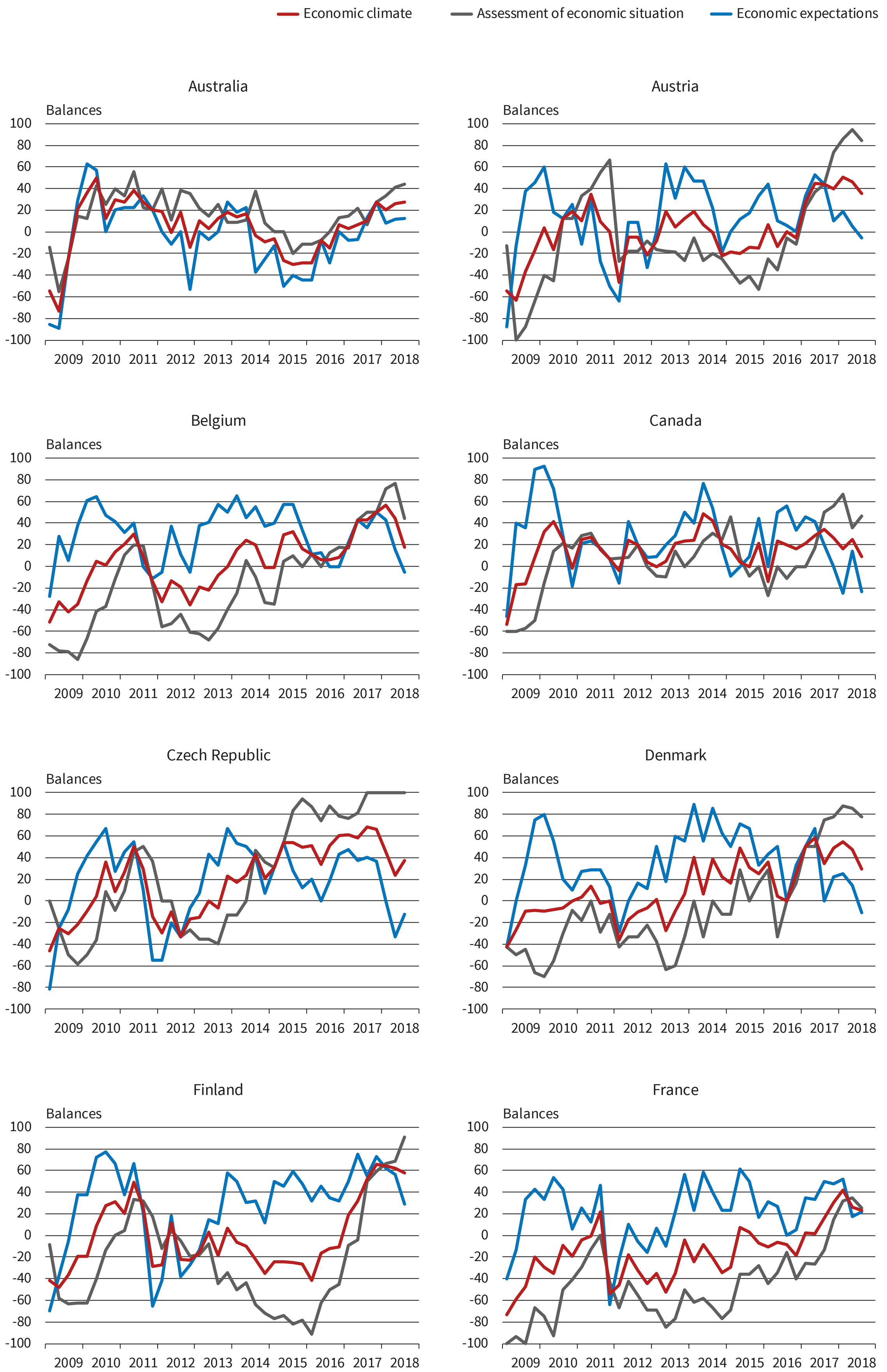
Selected Aggregates



Source: ifo World Economic Survey (WES) III/2018.

Figure 9.1

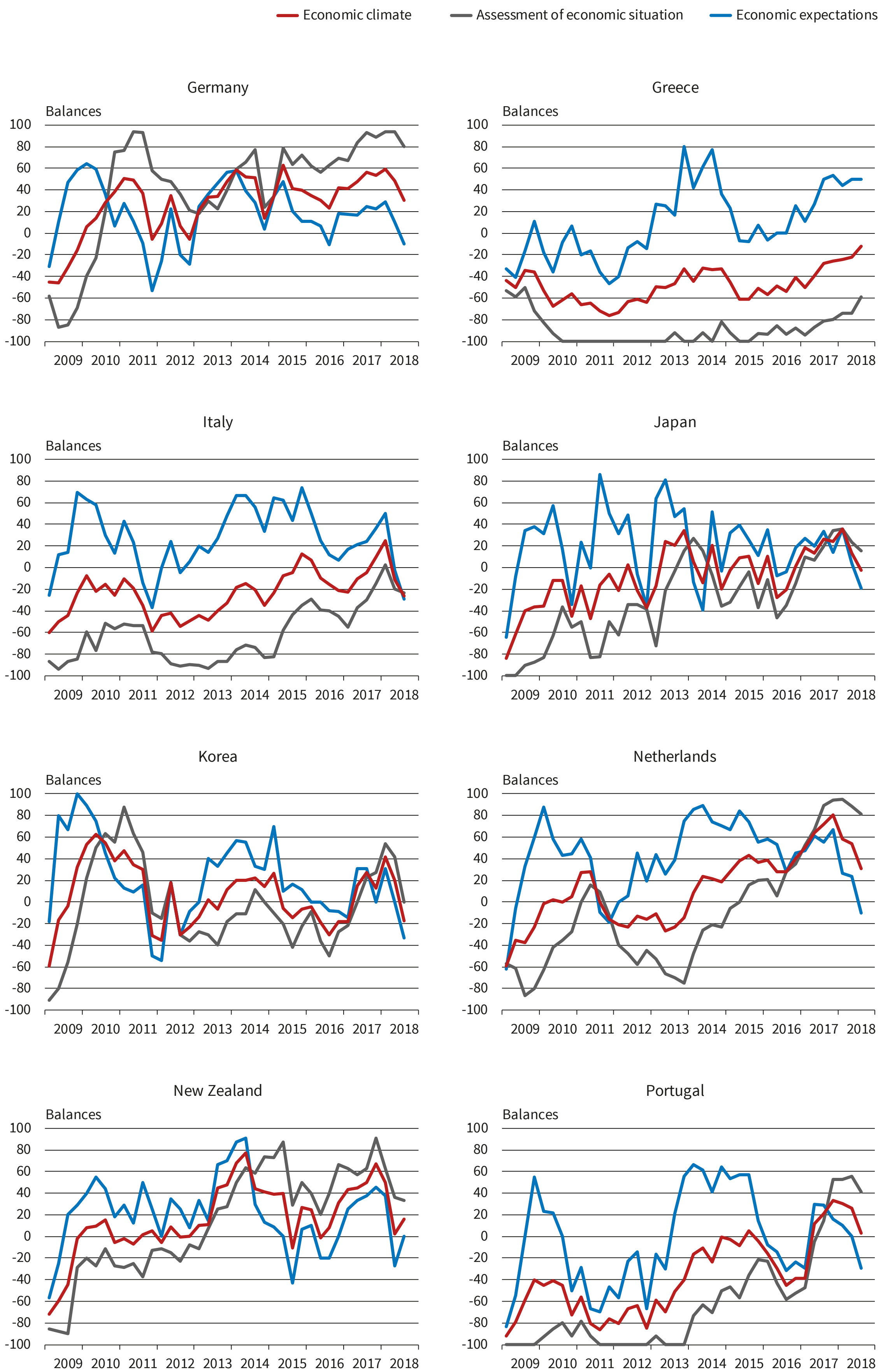
Advanced Economies



Source: ifo World Economic Survey (WES) III/2018.

Figure 9.2

Advanced Economies



Source: ifo World Economic Survey (WES) III/2018.

© ifo Institute

Figure 9.3

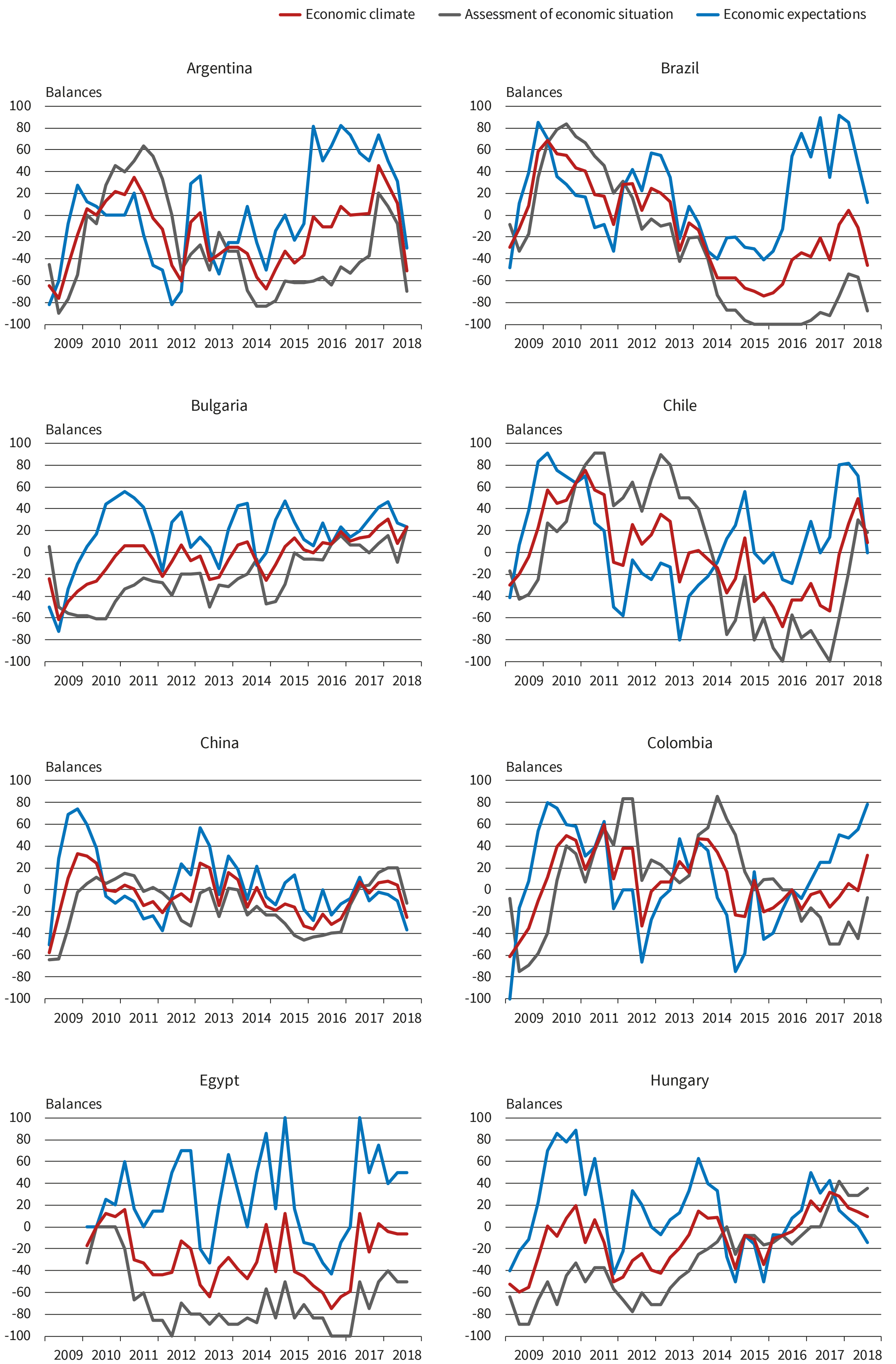
Advanced Economies

Source: ifo World Economic Survey (WES) III/2018.

© ifo Institute

Figure 10.1

Emerging Markets and Developing Economies

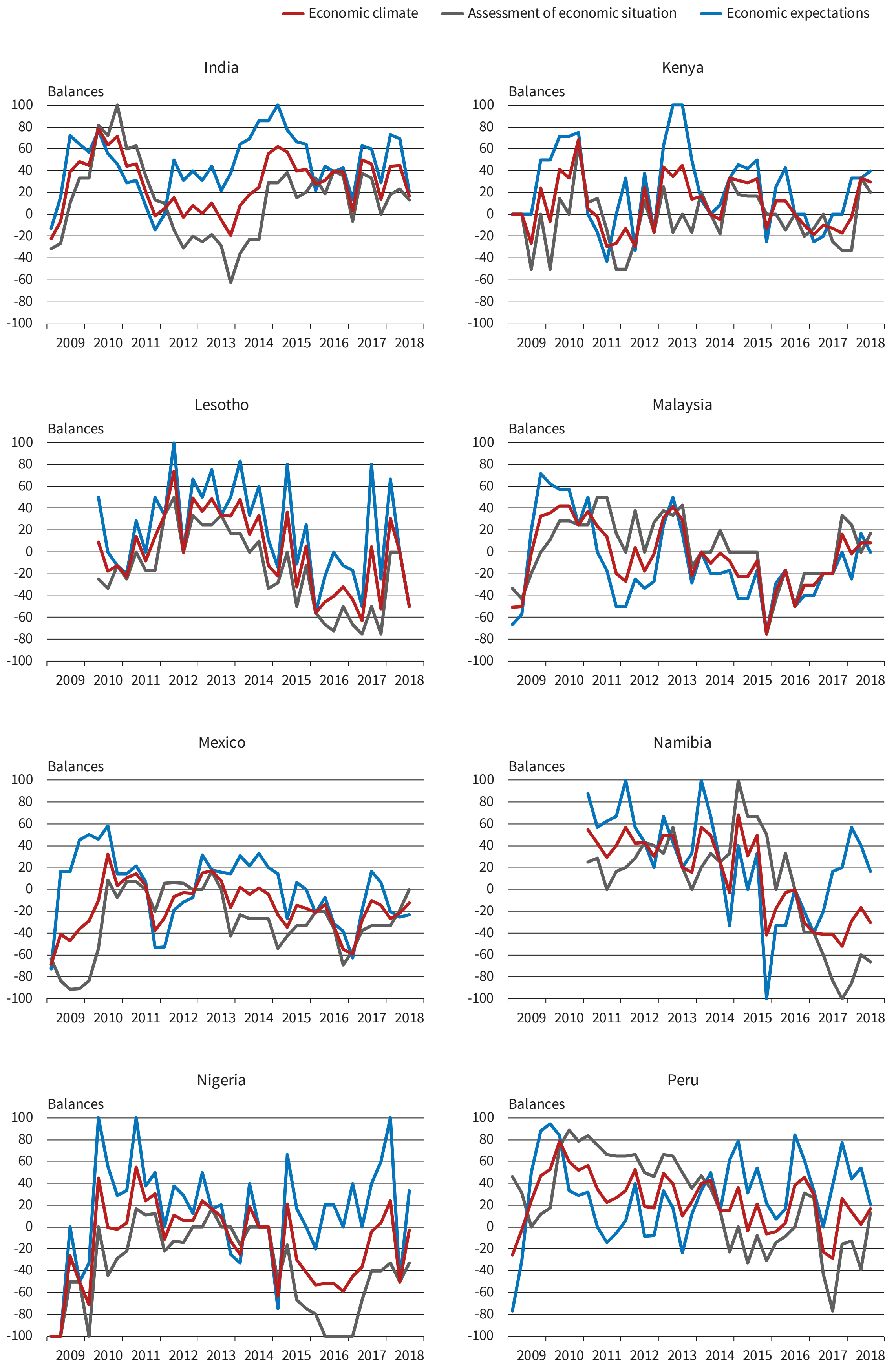


Source: ifo World Economic Survey (WES) III/2018.

© ifo Institute

Figure 10.2

Emerging Markets and Developing Economies

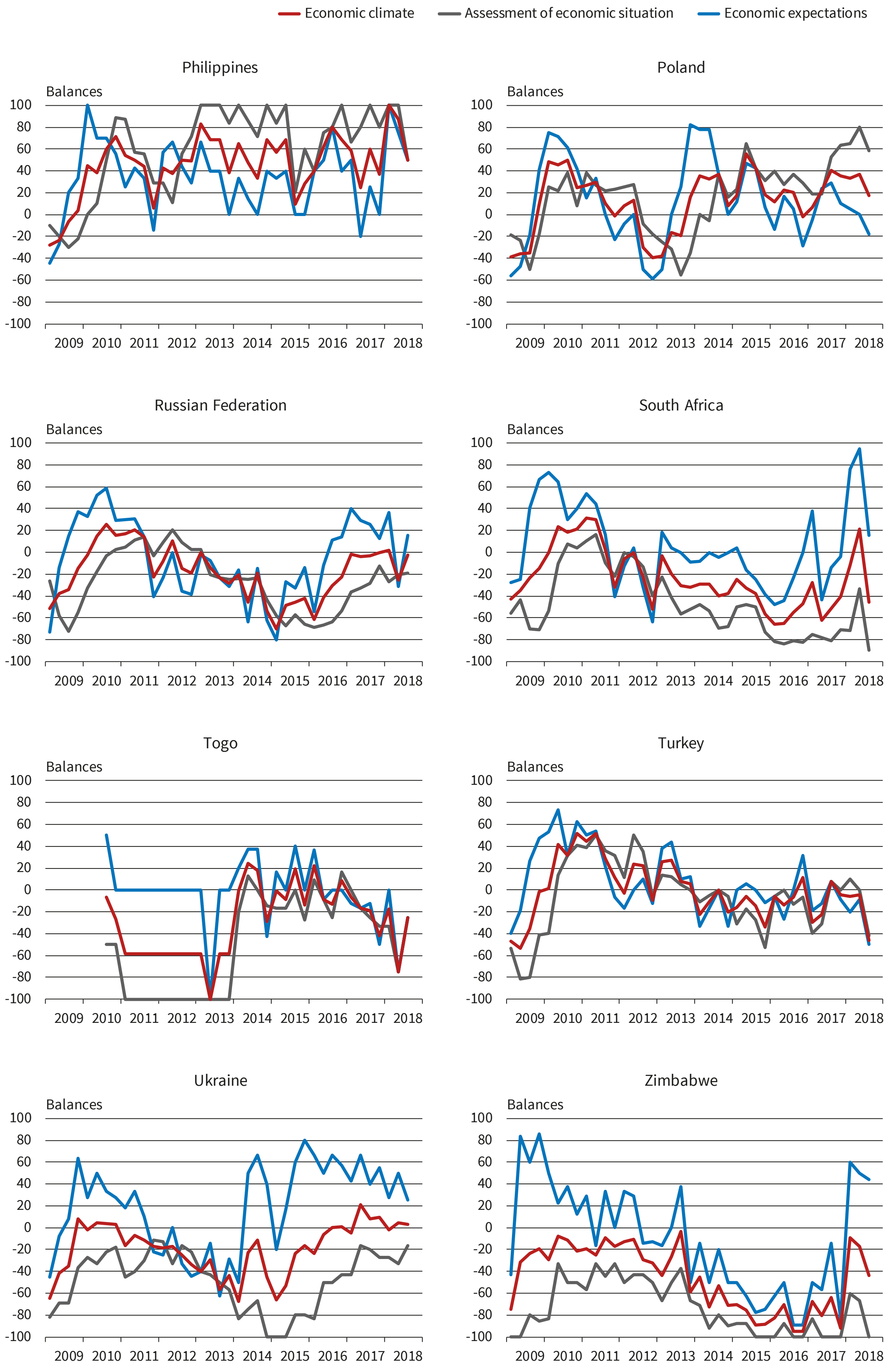


Source: ifo World Economic Survey (WES) III/2018.

© ifo Institute

Figure 10.3

Emerging Markets and Developing Economies



Source: ifo World Economic Survey (WES) III/2018.

© ifo Institute