

ZEW, the Centre for European Economic Research, Mannheim, and Erste Group Bank AG, Vienna, carry out a monthly survey for Central and Eastern Europe, Austria, as well as the Eurozone, asking financial market experts for their assessments and expectations with regard to economic and financial market data. The results of the current survey, conducted between June 28 and July 12, 2010, are published in the August 2010 issue of the "Financial Market Report CEE." 72 financial market experts participated in this month's survey.

## Cautious Economic Outlook for Central and Eastern Europe

The ZEW-Erste Group Bank Sentiment Indicator CEE decreases by 9.0 points to 11.4 points in July. In the current survey the majority of 43.4 percent of the financial market experts predict no change of the business cycle in the CEE region within the next six months. The economic expectations for the Eurozone decrease by 7.3 points to 13.1 points. In contrast, the economic outlook for Austria improves by 5.1 points to 24.5 points which is the only positive change in this category. The indicator re-

flecting the evaluation of the current economic situation in the CEE region increases by 9.6 points to minus 13.6 points. The relevant indicators for Austria and the Eurozone rise by 3.2 points and 17.8 points to minus 2.2 points and minus 20.8 points, respectively. The indicators which represent the expected development of the stock market indices for the CEE-region (NTX), Austria (ATX) and the Eurostoxx 50 for the next six months demonstrate double-digit increases in July.

### Economic Outlook for the CEE Region, Austria and the Eurozone

The ZEW-Erste Group Bank Economic Sentiment Indicator for Central and Eastern Europe (CEE), which is calculated as the balance of positive and negative assessments of the economic development on a six months time horizon, falls by 9.0 points to 11.4 points in July. However, with a share of 43.4 percent the majority of the survey respondents anticipate an unchanged economic development in the CEE region for the upcoming half year. While the economic expectations for the Eurozone decrease by 7.3 points to 13.1 points the economic outlook for Austria improves by 5.1 points to 24.5 points which is the only positive change in this category in this month.

The results from the analogous surveys for Germany and Switzerland show similar cautious economic expectations of the financial market experts this month. The crisis in sovereign debt and the resulting need for consolidation of budgets in various countries possibly contribute to the restrained economic expectations.

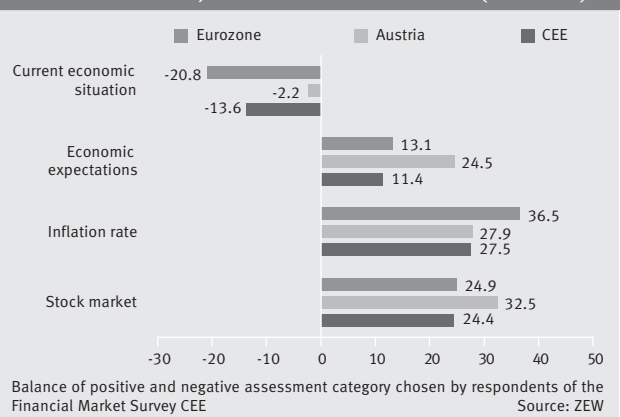
In contrast to the expectations, the assessments of the current business conditions brighten up in July. The respective indicator for the CEE region increases by 9.6 points to minus 13.6 points. The relevant indicators for Austria and the Eurozone rise by 3.2 points and 17.8 points to minus 2.2 points and minus 20.8 points, respectively.

The financial market experts estimate lower inflation risks on a time horizon of six months for the CEE region, Austria and the Eurozone compared to the previous month. More

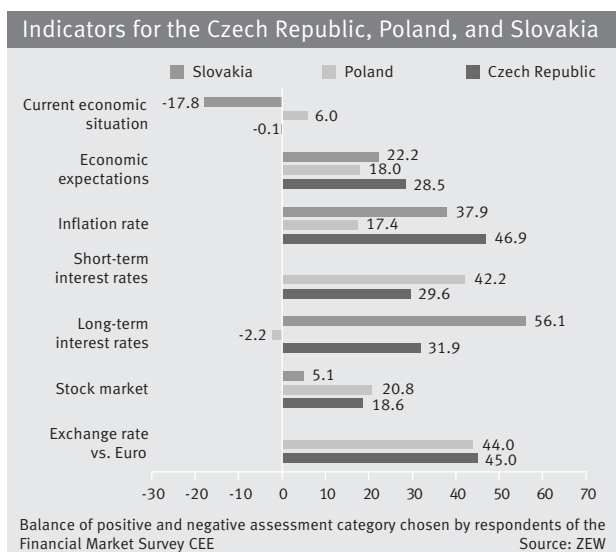
than half of the survey's participants prognosticate unchanging inflation rates.

The predictions for the short-term interest rates for the Eurozone declines by 1.4 points to 38.6 points. The majority of financial market analysts continue to foresee unchanging short-term interest rates in the Eurozone. The indicators which reflect the expected development of the stock market indices for the CEE region (NTX), Austria (ATX) and the Eurostoxx 50 for the next six months demonstrate double-digit increases in July. The relevant balances reach 24.4 points for the NTX, 32.5 points for the ATX and 24.9 points for the Eurostoxx 50.

Indicators for CEE, Austria and the Eurozone (balances)



## Czech Rep., Poland and Slovakia: Appreciation of Koruna and Zloty



Even though the indicator reflecting the economic outlook for the Czech Republic decreases by 9.6 points to 28.5 points in July, the country remains at the leading position among the analysed CEE countries in this category. The economic expectations for Poland and Slovakia decrease by 5.0 points to 18.0 points and by 7.1 points to 22.2 points, respectively.

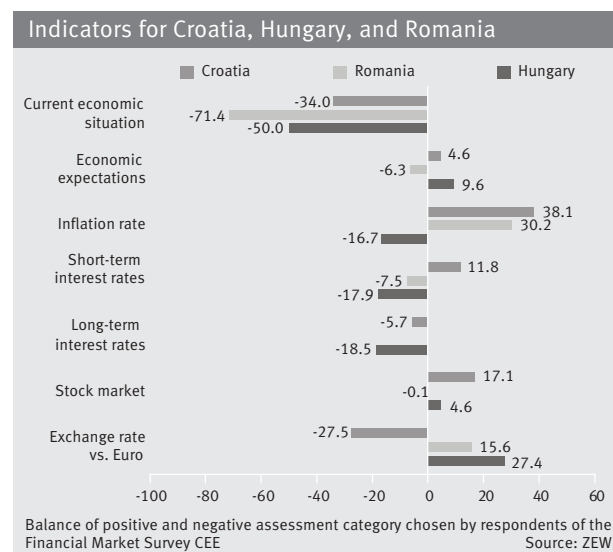
Regarding the appraisal of the current economic situation Poland remains the only country with a positive balance of 6.0 points in spite of the slight decrease in July. The survey participants are in discord concerning the current business conditions in the Czech Republic. 63.3 percent of the analysts assess the current situation to be acceptable and the share of positive and negative assessments are nearly the same. However, the balance of minus 0.1 points is the second best value in country comparison though. The respective balance for Slovakia decreases by 5.8 points to minus 17.8 points.

Even though the indicator reflecting the inflation risks in the Czech Republic experiences a double digit decrease of 10.2 points it still remains the highest value in country comparison with 46.9 points. Nearly half of the financial market analysts still predict increasing inflation risks in the Czech Republic.

In this month's survey a significantly high share of financial market analysts of 63.4 percent anticipates an increase in the long-term interest rate for Slovakia within the next six months. The corresponding balance reaches the highest value in this category with 56.1 points.

The results of the survey in July concerning the development of the exchange rates between the Czech Koruna and the Polish Zloty against the Euro continue to demonstrate a significant high share of analysts who predict an appreciation of the both currencies. Over 60 percent of the surveyed participants foresee an appreciation within the next six months against the Euro. The respective indicators remain the highest values among all the analysed countries at 45.0 points for the Koruna and at 44.0 points for the Zloty.

## Croatia, Hungary and Romania: Weak Economic Outlook for Romania



After the significant decline of the economic expectations for Croatia in the previous month the respective indicator only decreases slightly by 1.2 points to 4.6 points in July. In contrast, the financial market experts are more cautious concerning the expected development of the economy in Hungary and Romania. The indicators reflecting the economic outlook in Hungary and Romania demonstrate the strongest declines in country comparison namely by 23.7 points and by 32.0 points. The respective indicators reach 9.6 points for Hungary and minus 6.3 points for Romania which is the only negative value in this category. The share of analysts advocating worsening economic expectations for Romania increase by 16.1 percentage points and reach 34.0 percent.

While the evaluation of the current economic situation improves by 10.2 points for Croatia and by 8.6 points for Hungary the economic momentum in Romania worsens following the assessment of the analysts. The recently imposed austerity program of the Romanian government which consists of a significant cut of public wages and cut in social benefits as well as a raise of the VAT caused major riots and uproar in the country. In line with this, the indicator reflecting the current situation in Romania reaches a significantly low value of minus 71.4 points. 75.5 percent of the financial market experts assess the current situation in Romania to be bad.

Among all the analysed countries Hungary is the only country where the surveyed participants predict a decreasing inflation rate for the next half year. The respective balance reaches minus 16.7 points. Romania's corresponding indicator displays the highest increase in this category, plus 35.8 points. 48.8 percent of the financial market analysts foresee an increasing inflation rate for Romania. This is in concordance with the statement of the Romanian Finance Minister who also predicts a higher inflation due to the increase of the VAT.

## Special Question: Accession of Turkey to the European Union

Turkey's appliance for its entry into the European Union has been a topic of controversy for many years ever since the accession negotiations opened in October 2005. The EU has been examining Turkey's eligibility to become a member of the European Union according to the Copenhagen Criteria. In order to gain membership into the European Union Turkey has to fulfil the political, economic and *acquis* components of the Copenhagen Criteria. In the context of the Copenhagen Criteria we asked the financial market experts to evaluate how successful Turkey has been in fulfilling these criteria.

According to the results of this month's survey, more than half of the polled participants do not perceive the implementation of the political criteria by the Turkish government to be successful. Aspects such as the guarantee of democracy, the rule of law or the protection of minorities are still immense challenges for Turkey. Especially Ankara's reluctance to recognise the Republic of Cyprus puts a great barrier to Turkey's accession. As a consequence the EU has suspended eight chapters of the accession negotiations necessary for Turkey's membership.

The results of this month's special question show that following the opinion of the survey participants the Turkish government is least successful in protecting minorities. 51 percent of the analysts evaluate the protection as not successful and 29 percent even see no success at all in the protection of minorities. Only 3 percent of the participants believe that the fulfilment of this political component is very successful. 50 percent of the financial market analysts evaluate the guarantee of democracy and rule of law to be unsuccessful and 9 percent even not successful at all.

The fulfilment of the economic component of the Copenhagen Criteria seems to be more successful in the opinion of the polled analysts. 63 percent and 61 percent of the financial market experts regard that Turkey has succeeded in establishing a functioning market economy and in coping with the market competitiveness. 22 percent and 26 percent even evaluate the market economy and the ability to cope with the market competitiveness to be very successful. The surveyed participants have very little doubt in Turkey's economy as only a small fraction of experts, namely 15 percent and 13 percent, assess the economy to be unsuccessful and there are no participants who perceive the fulfilment of the economic component to be not successful at all.

The *acquis* component of the Copenhagen Criteria requires the candidate country to take on all membership obligations such as the free movement of goods, capital and persons. 56 percent to 62 percent of the polled analysts appraise the fulfilment of the *acquis* component of the Copenhagen criteria to be successful. Thus, according to the opinion of the financial market experts, Turkey's attempt to assume the obligations of membership is more successful than its attempt to handle its regional issues and international obligations. This can be depicted also in the higher percentage of financial market analysts evaluating the effort to handle regional issues and international obligations to be unsuccessful, namely 32 percent, while the percentage of analysts evaluat-

Figure A: Assessment of the success of Turkey to fulfil the accession criteria for the EU

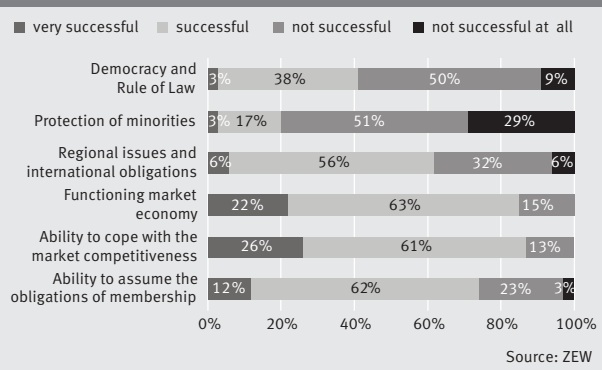
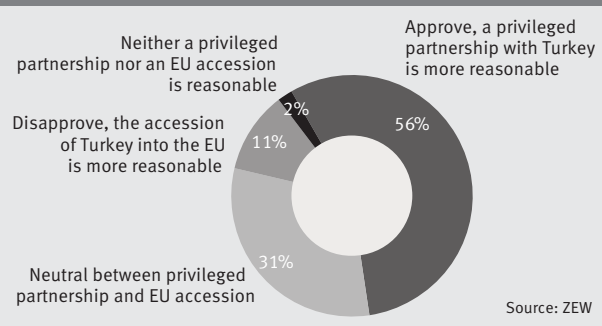


Figure B: Evaluation of the statement for a privileged partnership versus full EU accession of Turkey



ing the attempt to assume membership obligations to be unsuccessful only reaches 23 percent. 12 percent of the surveyed experts even evaluate Turkey's ability to assume membership obligations to be very successful.

Germany's chancellor Angela Merkel and French's president Nicholas Sarkozy voiced their preference of a privileged partnership with Turkey instead of granting full membership into the EU. This means that not all 35 chapters necessary for the full membership should be completed but instead only certain aspects such as economic or military should be fulfilled for the establishment of a privileged partnership between the EU and Turkey. Despite Turkey's arguments against such a privileged partnership the majority of polled participants, namely 56 percent, agree with Merkel and Sarkozy. Only 11 percent of the experts disapprove of a privileged partnership and support Turkey's EU accession. However, 31 percent of the financial market analysts are neutral between an EU accession and a privileged partnership. 2 percent of the surveyed analysts even support the opinion that neither a privileged partnership nor an EU accession is reasonable.

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**ZEW-Financial Market Survey: July 2010**

<b>Current economic situation</b>	<b>good</b>		<b>acceptable (normal)</b>		<b>bad</b>		<b>balance</b>									
Austria	17.8	(+4.3)	62.2	(-5.4)	20.0	(+1.1)	-2.2	(+3.2)								
Croatia	4.6	(+1.7)	56.8	(+6.8)	38.6	(-8.5)	-34.0	(+10.2)								
Czech Republic	18.3	(+2.0)	63.3	(-1.8)	18.4	(-0.2)	-0.1	(+2.2)								
Hungary	1.9	(-2.5)	46.2	(+13.6)	51.9	(-11.1)	-50.0	(+8.6)								
Poland	26.0	(+1.6)	54.0	(-4.5)	20.0	(+2.9)	6.0	(-1.3)								
Romania	4.1	(-3.2)	20.4	(-1.6)	75.5	(+4.8)	-71.4	(-8.0)								
Slovakia	11.1	(-5.5)	60.0	(+5.2)	28.9	(+0.3)	-17.8	(-5.8)								
CEE	7.6	(+0.6)	71.2	(+8.4)	21.2	(-9.0)	-13.6	(+9.6)								
Eurozone	7.5	(+5.2)	64.2	(+7.4)	28.3	(-12.6)	-20.8	(+17.8)								
<b>Economic expectations</b>	<b>improve</b>		<b>no change</b>		<b>worsen</b>		<b>balance</b>									
Austria	37.8	(+1.7)	48.9	(+1.7)	13.3	(-3.4)	24.5	(+5.1)								
Croatia	20.9	(-2.0)	62.8	(+2.8)	16.3	(-0.8)	4.6	(-1.2)								
Czech Republic	42.8	(-9.6)	42.9	(+9.6)	14.3	(+/-0.0)	28.5	(-9.6)								
Hungary	32.7	(-18.4)	44.2	(+13.1)	23.1	(+5.3)	9.6	(-23.7)								
Poland	36.0	(-2.4)	46.0	(-0.2)	18.0	(+2.6)	18.0	(-5.0)								
Romania	27.7	(-15.9)	38.3	(-0.2)	34.0	(+16.1)	-6.3	(-32.0)								
Slovakia	42.2	(-1.7)	37.8	(-3.7)	20.0	(+5.4)	22.2	(-7.1)								
CEE	34.0	(-6.9)	43.4	(+4.8)	22.6	(+2.1)	11.4	(-9.0)								
Eurozone	33.9	(-7.0)	45.3	(+6.7)	20.8	(+0.3)	13.1	(-7.3)								
<b>Inflation rate</b>	<b>increase</b>		<b>no change</b>		<b>decrease</b>		<b>balance</b>									
Austria	34.9	(-9.5)	58.1	(+8.1)	7.0	(+1.4)	27.9	(-10.9)								
Croatia	40.5	(-3.6)	57.1	(+1.2)	2.4	(+2.4)	38.1	(-6.0)								
Czech Republic	49.0	(-10.5)	48.9	(+10.8)	2.1	(-0.3)	46.9	(-10.2)								
Hungary	20.8	(+0.8)	41.7	(+11.7)	37.5	(-12.5)	-16.7	(+13.3)								
Poland	34.8	(-2.1)	47.8	(+3.1)	17.4	(-1.0)	17.4	(-1.1)								
Romania	48.8	(+23.8)	32.6	(-11.8)	18.6	(-12.0)	30.2	(+35.8)								
Slovakia	42.3	(-13.8)	53.3	(+9.4)	4.4	(+4.4)	37.9	(-18.2)								
CEE	31.4	(-9.1)	64.7	(+7.6)	3.9	(+1.5)	27.5	(-10.6)								
Eurozone	42.3	(-4.4)	51.9	(+3.0)	5.8	(+1.4)	36.5	(-5.8)								
<b>Short-term interest rates</b>	<b>increase</b>		<b>no change</b>		<b>decrease</b>		<b>balance</b>									
	<b>[abs.]</b>	<b>[rel.]</b>	<b>[abs.]</b>	<b>[rel.]</b>	<b>[abs.]</b>	<b>[rel.]</b>	<b>[abs.]</b>	<b>[rel.]</b>								
Croatia	26.5	(-3.8)	24.2	(+4.2)	58.8	(+1.2)	51.7	(-5.0)	14.7	(+2.6)	24.1	(+0.8)	11.8	(-6.4)	0.1	(+3.4)
Czech Republic	34.1	(-13.4)	23.1	(-1.2)	61.4	(+11.4)	51.3	(-8.2)	4.5	(+2.0)	25.6	(+9.4)	29.6	(-15.4)	-2.5	(-10.6)
Hungary	17.7	(+0.2)	15.0	(+1.5)	46.7	(+4.2)	37.5	(+2.4)	35.6	(-4.4)	47.5	(-3.9)	-17.9	(+4.6)	-32.5	(+5.4)
Poland	48.9	(-7.9)	32.5	(-8.7)	44.4	(+1.2)	50.0	(+8.8)	6.7	(+6.7)	17.5	(-0.1)	42.2	(-14.6)	15.0	(-8.6)
Romania	22.5	(+4.8)	23.5	(+7.3)	47.5	(+3.4)	32.4	(+3.4)	30.0	(-8.2)	44.1	(-10.7)	-7.5	(+13.0)	-20.6	(+18.0)
Eurozone	42.4	(+0.2)			53.8	(-1.8)			3.8	(+1.6)			38.6	(-1.4)		
<b>Long-term interest rates</b>	<b>increase</b>		<b>no change</b>		<b>decrease</b>		<b>balance</b>									
	<b>[abs.]</b>	<b>[rel.]</b>	<b>[abs.]</b>	<b>[rel.]</b>	<b>[abs.]</b>	<b>[rel.]</b>	<b>[abs.]</b>	<b>[rel.]</b>								
Croatia	28.6	(-7.8)	20.0	(-7.6)	37.1	(+3.8)	33.3	(-4.6)	34.3	(+4.0)	46.7	(+12.2)	-5.7	(-11.8)	-26.7	(-19.8)
Czech Republic	45.5	(-17.0)	15.4	(-14.4)	40.9	(+15.9)	56.4	(+21.3)	13.6	(+1.1)	28.2	(-6.9)	31.9	(-18.1)	-12.8	(-7.5)
Hungary	24.4	(-10.6)	18.2	(-11.6)	32.7	(+7.7)	27.3	(+3.0)	42.9	(+2.9)	54.5	(+8.6)	-18.5	(-13.5)	-36.3	(-20.2)
Poland	26.7	(-7.5)	15.4	(-13.2)	44.4	(+10.2)	43.6	(+17.9)	28.9	(-2.7)	41.0	(-4.7)	-2.2	(-4.8)	-25.6	(-8.5)
Slovakia	63.4	(+1.9)	43.3	(-1.1)	29.3	(-1.5)	45.9	(+7.0)	7.3	(-0.4)	10.8	(-5.9)	56.1	(+2.3)	32.5	(+4.8)
Germany	48.0	(-12.4)			44.0	(+9.1)			8.0	(+3.3)			40.0	(-15.7)		
<b>Stock market indices</b>	<b>increase</b>		<b>no change</b>		<b>decrease</b>		<b>balance</b>									
EURO STOXX 50	45.4	(+4.4)	34.1	(+3.3)	20.5	(-7.7)		24.9	(+12.1)							
ATX (Austria)	52.5	(+12.5)	27.5	(-6.8)	20.0	(-5.7)		32.5	(+18.2)							
NTX (CEE)	43.9	(+3.3)	36.6	(+4.2)	19.5	(-7.5)		24.4	(+10.8)							
CROBEX (Croatia)	36.6	(+13.7)	43.9	(-7.5)	19.5	(-6.2)		17.1	(+19.9)							
PX 50 (Czech Rep.)	44.2	(-0.5)	30.2	(-1.4)	25.6	(+1.9)		18.6	(-2.4)							
BUX (Hungary)	36.4	(-2.0)	31.8	(+1.0)	31.8	(+1.0)		4.6	(-3.0)							
WIG (Poland)	44.1	(-0.3)	32.6	(+2.0)	23.3	(-1.7)		20.8	(+1.4)							
BET (Romania)	30.7	(-13.4)	38.5	(+9.1)	30.8	(+4.3)		-0.1	(-17.7)							
SAX (Slovakia)	28.2	(-10.0)	48.7	(+7.5)	23.1	(+2.5)		5.1	(-12.5)							
SBI 20 (Slovenia)	32.4	(-3.3)	44.1	(+4.8)	23.5	(-1.5)		8.9	(-1.8)							
<b>Exchange rates (vs. Euro)</b>	<b>appreciate</b>		<b>no change</b>		<b>depreciate</b>		<b>balance</b>									
Kuna (Croatia)	15.0	(+1.5)	42.5	(-8.9)	42.5	(+7.4)		-27.5	(-5.9)							
Koruna (Czech Rep.)	61.3	(+1.3)	22.4	(+2.4)	16.3	(-3.7)		45.0	(+5.0)							
Forint (Hungary)	49.0	(-2.1)	29.4	(+16.1)	21.6	(-14.0)		27.4	(+11.9)							
Zloty (Poland)	62.0	(+0.1)	20.0	(-1.4)	18.0	(+1.3)		44.0	(-1.2)							
Lei (Romania)	40.0	(+16.9)	35.6	(-5.4)	24.4	(-11.5)		15.6	(+28.4)							
US-Dollar	42.6	(+5.7)	20.4	(+3.0)	37.0	(-8.7)		5.6	(+14.4)							

Note: 72 Financial experts participated in the July survey which was conducted during the period 06/28/10-07/12/10. Analysts were asked about their expectations for the next 6 months. Numbers displayed are percentages (month-over-month percentage point changes compared to the survey in June in parentheses). Balances refer to the differences between positive and negative assessments.

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