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Financial Market Report CEE

Volume 1 · October 2007
International Finance Market Data: Assessments and Expectations
ZEW Economic Sentiment Indicator for Central and Eastern Europe, Supported by Erste Bank

ZEW, the Centre for European Economic Research, Mannheim, and Erste Bank der oesterreichischen Sparkassen, Vienna, carry out a monthly survey for Central and Eastern Europe, Austria, and the Eurozone asking financial market experts about their assessment and expectations with regard to economic and financial market data. The results of the present survey conducted between 5 and 24 September 2007 are published in this issue of the "Financial Market Report CEE", October 2007. 68 financial market experts participated in this month's survey.

Improved Prospects for Economic Activity in Central and Eastern European Countries

The financial market experts who take part in the monthly survey conducted by the ZEW, the Centre for European Economic Research, Mannheim, supported by Erste Bank der oesterreichischen Sparkassen, Vienna, predominantly indicate optimistic business cycle expectations for the countries of Central and Eastern Europe. The assessment of the economic situation has worsened slightly. In contrast, for Austria the negative expectations now outweigh the positive expectations markedly. The experts also assess the Austrian economic situation more pessimistic compared to last month's survey.

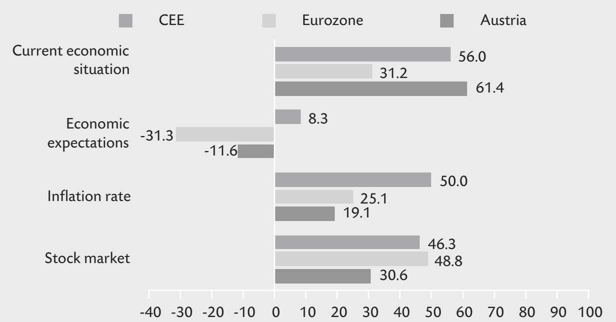
Economic Outlook for CEE countries, Austria and the Eurozone

The ZEW-Erste Bank Sentiment Indicator CEE that gives the balance of positive and negative assessments for the economic development in CEE countries within the next six months has improved considerably from 0 to 8.3 points. The higher balance can be ascribed to a pronounced increase of the share of experts expecting an improved economic development in the next six months. This is the first increase in economic expectations for the CEE region since the beginning of the survey in May 2007. Still, the majority of experts forecasts an unchanged development. The balance for the current economic situation in the CEE region has worsened somewhat and now shows a value of 56 points.

The assessment for the Austrian economy develops in the opposite direction. The balances for the economic expectations as well as for the current situation have decreased by 3.7 and 7.8 points respectively. The lower balance for the expectations can mostly be ascribed to a larger share of experts who forecast a worsening of the economic development, whereas the change in the assessment of the situation can be traced back to a rising share of experts who describe the current economic circumstances as "normal" rather than "good". Still, more experts evaluate the current economic situation in Austria as good than in the countries of Central and Eastern Europe. For the Eurozone, the drop in the balances for the economic expectations and the current situation are even more pronounced than for Austria, -12.1 points and -26.8 points respectively. This development can be traced back to the same changes in answer categories as in the case for Austria.

For Austria and the Eurozone, inflation expectations have increased somewhat. The share of experts who expect a rising inflation rate for the two regions has increased compared to the share of experts who expect a decreasing inflation rate. Inflationary risks for the CEE region also seem to be on the upside. The share of experts forecasting higher inflation rates over a horizon of six months predominates, the balance is positive and higher compared to the August survey. The financial market experts assess the stock market development optimistic. All balances are positive even though lower compared to last month's survey. The highest loss is reported for the NTX where the balance decreased by 15.7 points and the balance for the ATX decreased by 11 points. The balance for the Euro Stoxx 50 in contrast has only lost 2.4 points.

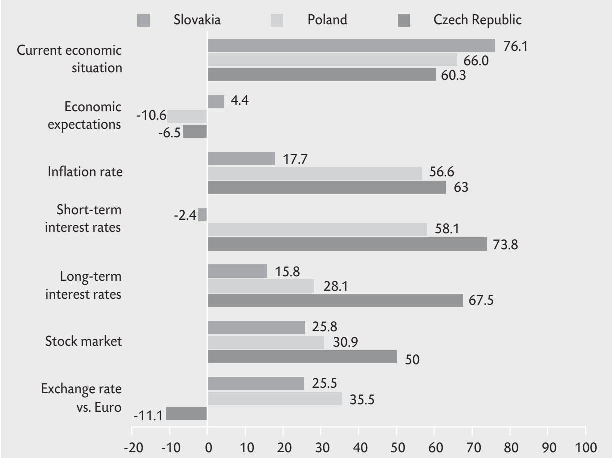
Indicators for CEE, Austria and the Eurozone (balances)



Balance of positive and negative assessment category chosen by respondents of the Financial Market Survey CEE
Source: ZEW

Czech Republic, Poland, and Slovakia: Good Economic Situations, Mixed Expectations

Indicators for the Czech Republic, Poland, and Slovakia



Balance of positive and negative assessment category chosen by respondents of the Financial Market Survey CEE Source: ZEW

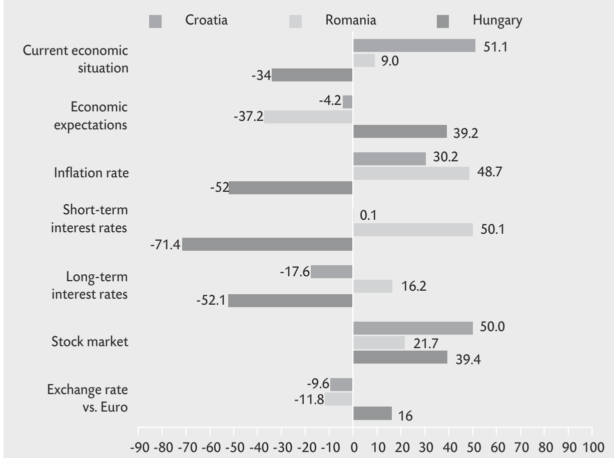
The highest balance for the assessment of the current economic situation is assigned to Slovakia; 76.1 percent of the financial market experts assess it as "good" and no respondent answered "bad". Also, Poland and the Czech Republic show very high balances in this category. The economic expectations for the three countries are mixed. While the experts forecast a further improvement for Slovakia, the survey participants expect a worsening economic development for the Czech Republic and especially Poland; both balances are negative. Compared to last month's survey, the balances for the situation improved for Slovakia and Poland. Expectations also improved for Slovakia by 4.4 points and the Czech Republic by 0.3 points but worsened for Poland.

For the experts, the boom of the Slovakian economy has influenced the assessment of the inflation risks. The balance is now clearly positive and has increased by a considerable amount of 22.2 points; more experts now forecast a rising inflation rate. The balances for inflation expectations in Poland and the Czech Republic are positive too and still much higher than for Slovakia. This view is accompanied by the respective interest rate forecasts. For Slovakia, the share of experts projecting lower short-term rates over the next six months outweighs the share of experts forecasting higher rates. For Poland and the Czech Republic, the expectations for rising short-term rates are much more pronounced. Also, expectations for higher long-term interest rates are not that strongly marked for Slovakia as for Poland and the Czech Republic.

The optimistic view for the stock market development over the next six months still prevails. The balances for all three stock market indices are positive. The share of experts projecting increasing indices outweighs the share expecting indices to decrease. However, the balances are lower compared to previous month's survey but to a different extent. The balance for the WIG has lost 24.3 points, for the SAX 16.4 points and for the PX50 7.2 points.

Croatia, Hungary, and Romania: Mixed Economic Situations and Mixed Expectations

Indicators for Croatia, Hungary, and Romania



Balance of positive and negative assessment category chosen by respondents of the Financial Market Survey CEE Source: ZEW

While the experts assess the current economic situation in Croatia almost unchanged on balance compared to the August survey, the respective values for Hungary and Romania dropped by 13.1 and 18.6 points. Concerning economic expectations, the experts have not changed their view on the Croatian economy. The share of experts expecting a worsening of the development still outweighs the share of experts expecting an improvement by 4.2 points compared to the previous month's 4.6 points. For Hungary, economic expectations are much more optimistic; the balance increased by 22.6 points and now shows a value of 39.2 points. This is the highest value of all considered countries. For Romania, the experts forecast the opposite development; the balance drops by 22.4 points and shows the lowest value of all countries.

The inflation expectations for Croatia and Hungary have not changed by a large amount. For Hungary, the experts predominantly expect decreasing inflation rates for the next six months whereas for Croatia, they expect rising inflation rates. For Romania, the change of the balance regarding inflation is much more pronounced with +16.2 points.

With regard to the interest rate development, the financial market experts clearly project decreasing short-term rates for Hungary; for Romania, the balance is positive indicating the predominance of forecasts for higher short-term rates. For Croatia, the expectations for rising or decreasing rates are almost balanced. Regarding long-term rates, the balances show the same pattern as short-term rates for Hungary and Romania. For Croatia, a higher share of experts expects decreasing rates outweighing the share of experts projecting higher rates by 17.6 points. Also, stock market expectations are positive for all three countries. However, the balance of the BET has dropped by 25.8 points, hinting to the weaker optimism of experts for this index. The balances of the CROBEX and the BUX are lower too, but the losses are more contained and reach 9.1 points and 9.4 points on balance.

Special Question: Effects of the US Subprime Crisis

This month's special question is concerned with the issue responsible for the latest commotion in financial markets and research departments: the U.S. subprime crisis. Its effects on the global and local economy are of major concern to financial markets and the respective supervisory agencies. It has already drained several North American hedge funds of its value, and pictures of panicking customers of the British Northern Rock mortgage bank have evoked almost forgotten images of historic bank crises. Several European banks have been hit by the crisis, but it is difficult to say to what extent. Due to the securitisation of debt into tradable assets and the development of complex financial constructs, the final effects on financial institutions all around the world are hard to assess.

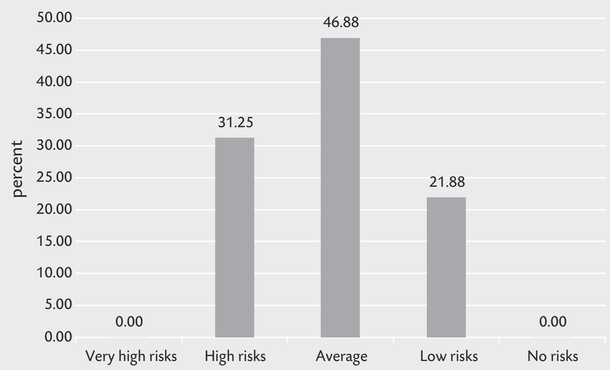
The United States Federal Reserve Bank also cited the subprime crisis and the ensuing financial turmoil as one of the reasons for its cut of the Federal Funds target rate from 5.25 percent to 4.75 percent on September 18th, as the "tightening of credit conditions has the potential to intensify the housing correction and to restrain economic growth." The tightening of credit conditions has been caused by the inability of market participants to quantify the risk each financial institution is carrying, thus causing high risk premiums on the inter-bank lending market. The U.S. Federal Reserve and the European Central Bank reacted by providing liquidity on a massive scale in order to abate the money market tightening. Even the Bank of England has provided liquidity to the markets in the end after the debacle of Northern Rock, beforehand announcing that banks should bear the consequences of taking on too much risk on their own.

The first part of this month's special question is concerned with the risks that the US subprime crisis poses for the stability of the global financial system (see Figure 4a). Almost half of the experts who answered that question, i.e. 30 participants, assess the risk as average. No financial market expert evaluates the risk as extreme neither on the upside nor on the downside. In addition to that, the answers show a bias for a higher risk originating from the developments in the US. Also, 73.4 percent or 47 experts expect further banking defaults because of the subprime crisis. However, in the view of the survey participants these defaults should occur as isolated events and not on a large scale.

The third part of the special question is concerned with the effects of the crisis for the real economy, for the time being for the US economy (see Figure 4c). Again, the majority of experts assess the danger for the business cycle as likely or average; 29 and 20 persons answered these questions in the affirmative. Still, 11 experts indicate that it is very likely that the crisis has effects on the real economy in the USA.

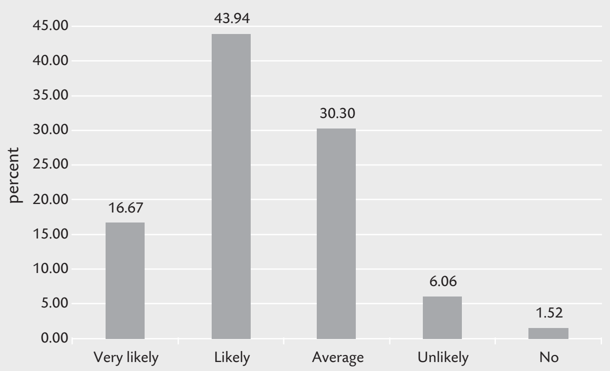
In addition to the global and US-specific effects, the view of the financial market experts on the vulnerability of the banking sector in CEE countries has been queried (Figure 4c). We only report the average for a country if at least five experts expressed their view. All averages are higher than 3 indicating that the experts assess the risk of the respective banking sector below average. This is the case for Hungary (3.83), Croatia (4.00), Romania (4.14), the Czech Republic (4.33), and Slovakia (4.60). Compared to other CEE countries, the survey participants evaluate the risk for these banking sectors as lower. The Slovakian banking sector almost achieves a "much lower" on average. For Austria, the average value of the answers is lowest with 3.60, but still higher than the average indicating lower risk for this banking sector compared to other countries in the CEE region.

Figure 4a: Risk assessment of the US subprime crisis for the stability of the global financial system



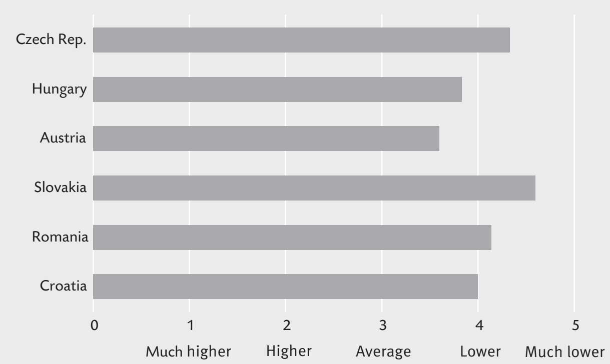
Answers of the participants of the Financial Market Survey CEE Source: ZEW

Figure 4b: Danger of the subprime crisis for the US business cycle



Answers of the participants of the Financial Market Survey CEE Source: ZEW

Figure 4c: Risks for country-specific banking sectors compared to the CEE average (average assessment)



Answers of the participants of the Financial Market Survey CEE Source: ZEW

ZEW-Financial Market Survey: September 2007

Current economic situation	good		acceptable (normal)		bad		balance	
Austria	61.4	(-7.8)	38.6	(+7.8)	0.0	(+/-0.0)	61.4	(-7.8)
Croatia	53.2	(-0.8)	44.7	(+0.7)	2.1	(+0.1)	51.1	(-0.9)
Czech Republic	64.5	(-2.2)	31.3	(-2.0)	4.2	(+4.2)	60.3	(-6.4)
Hungary	4.0	(-4.3)	58.0	(-4.5)	38.0	(+8.8)	-34.0	(-13.1)
Poland	66.0	(+1.6)	34.0	(+5.1)	0.0	(-6.7)	66.0	(+8.3)
Romania	29.5	(-13.0)	50.0	(+7.4)	20.5	(+5.6)	9.0	(-18.6)
Slovakia	76.1	(+3.2)	23.9	(-1.1)	0.0	(-2.1)	76.1	(+5.3)
CEE	56.0	(-2.8)	44.0	(+4.8)	0.0	(-2.0)	56.0	(-0.8)
Eurozone	33.3	(-24.7)	64.6	(+22.6)	2.1	(+2.1)	31.2	(-26.8)

Economic expectations	improve		no change		worsen		balance	
Austria	9.3	(+1.4)	69.8	(-6.5)	20.9	(+5.1)	-11.6	(-3.7)
Croatia	12.8	(-0.8)	70.2	(+2.0)	17.0	(-1.2)	-4.2	(+0.4)
Czech Republic	6.3	(-2.5)	80.9	(+5.3)	12.8	(-2.8)	-6.5	(+0.3)
Hungary	54.9	(+11.2)	29.4	(+0.2)	15.7	(-11.4)	39.2	(+22.6)
Poland	12.8	(-7.2)	63.8	(+6.0)	23.4	(+1.2)	-10.6	(-8.4)
Romania	9.3	(-9.9)	44.2	(-2.6)	46.5	(+12.5)	-37.2	(-22.4)
Slovakia	10.9	(+1.8)	82.6	(+0.8)	6.5	(-2.6)	4.4	(+4.4)
CEE	20.5	(+5.9)	67.3	(-3.5)	12.2	(-2.4)	8.3	(+8.3)
Eurozone	6.2	(-2.3)	56.3	(-7.5)	37.5	(+9.8)	-31.3	(-12.1)

Inflation rate	increase		no change		decrease		balance	
Austria	26.2	(+2.6)	66.7	(-4.4)	7.1	(+1.8)	19.1	(+0.8)
Croatia	39.5	(+4.7)	51.2	(-7.5)	9.3	(+2.8)	30.2	(+1.9)
Czech Republic	65.2	(-9.3)	32.6	(+9.2)	2.2	(+0.1)	63.0	(-9.4)
Hungary	18.0	(+3.1)	12.0	(-5.0)	70.0	(+1.9)	-52.0	(+1.2)
Poland	63.1	(+4.0)	30.4	(-1.4)	6.5	(-2.6)	56.6	(+6.6)
Romania	65.8	(+19.3)	17.1	(-22.4)	17.1	(+3.1)	48.7	(+16.2)
Slovakia	24.4	(+13.3)	68.9	(-4.4)	6.7	(-8.9)	17.7	(+22.2)
CEE	50.0	(+7.5)	50.0	(-1.1)	0.0	(-6.4)	50.0	(+13.9)
Eurozone	33.4	(+7.9)	58.3	(-9.8)	8.3	(+1.9)	25.1	(+6.0)

Short-term interest rates	increase				no change				decrease				balance			
	[abs.]		[rel.]		[abs.]		[rel.]		[abs.]		[rel.]		[abs.]		[rel.]	
Croatia	19.5	(+9.2)	23.6	(+12.7)	61.1	(-3.0)	58.8	(+12.9)	19.4	(-6.2)	17.6	(-25.6)	0.1	(+15.4)	6.0	(+38.3)
Czech Republic	76.2	(+5.4)	51.2	(+24.9)	21.4	(-5.4)	24.4	(-15.1)	2.4	(+/-0.0)	24.4	(-9.8)	73.8	(+5.4)	26.8	(+34.7)
Hungary	10.2	(-10.7)	8.7	(-1.3)	8.2	(+1.2)	10.9	(-6.6)	81.6	(+9.5)	80.4	(+7.9)	-71.4	(-20.2)	-71.7	(-9.2)
Poland	65.1	(+2.6)	50.0	(+15.7)	27.9	(+0.4)	40.0	(-11.4)	7.0	(-3.0)	10.0	(-4.3)	58.1	(+5.6)	40.0	(+20.0)
Romania	58.4	(+20.9)	60.0	(+16.7)	33.3	(-6.7)	28.6	(+9.7)	8.3	(-14.2)	11.4	(-26.4)	50.1	(+35.1)	48.6	(+43.1)
Slovakia	9.5	(-7.6)	21.1	(+5.3)	78.6	(+10.3)	52.6	(+2.6)	11.9	(-2.7)	26.3	(-7.9)	-2.4	(-4.9)	-5.2	(+13.2)
Eurozone	31.4	(-20.7)			51.0	(+13.5)			17.6	(+7.2)			13.8	(-27.9)		

Long-term interest rates	increase				no change				decrease				balance			
	[abs.]		[rel.]		[abs.]		[rel.]		[abs.]		[rel.]		[abs.]		[rel.]	
Croatia	5.9	(-5.2)	15.2	(+9.1)	70.6	(+17.8)	51.5	(+12.1)	23.5	(-12.6)	33.3	(-21.2)	-17.6	(+7.4)	-18.1	(+30.3)
Czech Republic	72.5	(+10.9)	46.1	(+23.9)	22.5	(-10.8)	43.6	(-6.4)	5.0	(-0.1)	10.3	(-17.5)	67.5	(+11.0)	35.8	(+41.4)
Hungary	13.1	(-3.6)	13.4	(+2.9)	21.7	(+0.3)	13.3	(-7.8)	65.2	(+3.3)	73.3	(+4.9)	-52.1	(-6.9)	-59.9	(-2.0)
Poland	38.4	(-1.6)	40.0	(+17.8)	51.3	(+11.3)	32.5	(-9.2)	10.3	(-9.7)	27.5	(-8.6)	28.1	(+8.1)	12.5	(+26.4)
Romania	45.2	(+9.9)	43.3	(+2.1)	25.8	(-15.4)	20.0	(-3.5)	29.0	(+5.5)	36.7	(+1.4)	16.2	(+4.4)	6.6	(+0.7)
Slovakia	26.3	(-17.2)	16.2	(+5.1)	63.2	(+17.0)	51.4	(-6.9)	10.5	(+0.2)	32.4	(+1.8)	15.8	(-17.4)	-16.2	(+3.3)
Germany	47.8	(+0.2)			32.6	(-17.4)			19.6	(+17.2)			28.2	(-17.0)		

Stock market indices	increase		no change		decrease		balance	
EURO STOXX 50	68.3	(+7.8)	12.2	(-18.0)	19.5	(+10.2)	48.8	(-2.4)
ATX (Austria)	55.6	(+0.1)	19.4	(-11.2)	25.0	(+11.1)	30.6	(-11.0)
NTX (CEE)	64.2	(-4.9)	17.9	(-5.9)	17.9	(+10.8)	46.3	(-15.7)
CROBEX (Croatia)	65.0	(-3.2)	20.0	(-2.7)	15.0	(+5.9)	50.0	(-9.1)
PX 50 (Czech Rep.)	67.5	(+3.2)	15.0	(-13.6)	17.5	(+10.4)	50.0	(-7.2)
BUX (Hungary)	62.7	(-0.7)	14.0	(-8.0)	23.3	(+8.7)	39.4	(-9.4)
WIG (Poland)	56.5	(-14.5)	17.9	(+4.7)	25.6	(+9.8)	30.9	(-24.3)
BET (Romania)	51.4	(-11.1)	18.9	(-3.6)	29.7	(+14.7)	21.7	(-25.8)
SAX (Slovakia)	42.9	(-9.8)	40.0	(+3.2)	17.1	(+6.6)	25.8	(-16.4)
SBI 20 (Slovenia)	49.9	(+1.4)	31.3	(-11.6)	18.8	(+10.2)	31.1	(-8.8)

Exchange rates (vs. Euro)	appreciate		no change		depreciate		balance	
Kuna (Croatia)	21.4	(+1.4)	47.6	(-1.3)	31.0	(-0.1)	-9.6	(+1.5)
Koruna (Czech Rep.)	20.0	(-12.6)	48.9	(+5.4)	31.1	(+7.2)	-11.1	(-19.8)
Forint (Hungary)	36.0	(+0.6)	44.0	(-1.8)	20.0	(+1.2)	16.0	(-0.6)
Zloty (Poland)	51.1	(-4.4)	33.3	(+6.6)	15.6	(-2.2)	35.5	(-2.2)
Lei (Romania)	33.4	(-6.6)	21.4	(-3.0)	45.2	(+9.6)	-11.8	(-16.2)
Koruna (Slovakia)	41.8	(-0.4)	41.9	(-9.2)	16.3	(+9.6)	25.5	(-10.0)
US-Dollar	25.6	(-8.4)	25.5	(+4.2)	48.9	(+4.2)	-23.3	(-12.6)

Note: 68 Financial experts participated in the September survey which was conducted during the period 09/05/07-09/24/07. 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 August in parentheses). Balances refer to the differences between positive and negative assessments.

I M P R I N T

Financial Market Report CEE – published monthly

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