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Financial Market Report CEE

Volume 1 · August 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 4 and 23 July 2007 are published in this edition of the "Financial Market Report CEE", August 2007. 81 financial market experts participated in this month's survey.

Almost neutral economic outlook for CEE countries

The financial experts who take part in the survey carried out by the ZEW, the Centre for European Economic Research, Mannheim, and Erste Bank der oesterreichischen Sparkassen, Vienna, do not expect a significant change in the economic development of the CEE countries in the next six months. The experts assess the current economic situation in the Central and Eastern European region as good. For Austria, the situation is also evaluated as good. However, the expectations of the experts concerning the economic development in the next six months have worsened by now.

Economic Outlook for CEE countries, Austria and the Eurozone

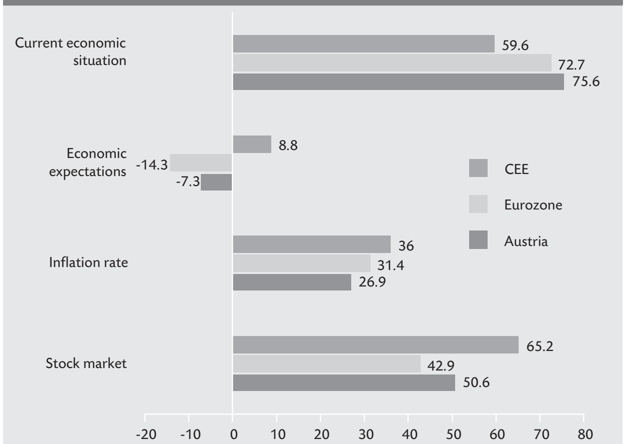
The ZEW-Erste Bank Sentiment Indicator CEE, that gives the balance of positive and negative assessment for the economic development within the next six months, has dropped again in the July survey by 1.8 points and now stands at 8.8 points. Still, the majority of financial experts projects no change of the economic development for the next six months (70.2 percent). This share has decreased by 8.4 points. The share of respondents expecting an improvement of the economic development increases by 3.3 points. The unaltered economic expectations start from a high level. The share of financial experts assessing the current economic situation in the CEE countries as good is a bit lower compared to last month's survey; the balance stands now at 59.6 points.

For Austria, even more experts assess the current economic situation as good; the balance is higher than for the CEE countries (75.6 points). However, the economic outlook has worsened; the balance is now negative (-7.3 points). This means that the share of experts forecasting a decline of the business cycle in the next six months outweighs the share of optimistic experts. For the Eurozone, the picture is very similar to the Austrian situation. The majority of experts evaluates the current economic situation as "good" (72.7 percent). The projections have clearly worsened by 21.6 points and the pessimistic economic expectations outweigh the optimistic ones on balance (-14.3 points).

Because of the good business cycle development in the CEE region as well as in the Eurozone, some inflationary pressure could arise from the real side of the economy. The experts forecast increasing inflation rates for the CEE countries as well as for Austria and the Eurozone. The balances increased compared to the June survey.

The optimistic expectations of financial experts for stock market development have again decreased in the July survey for some countries. The balances are however still clearly positive for the development of all three stock market indices. Nevertheless, the balances are smaller compared to last month, especially for the EURO STOXX 50 (-7.1 points) and the NTX. The balance for the assessment of the ATX has almost not changed compared to the expectations last month.

Indicators for the CEE, Eurozone and Austria (balances)

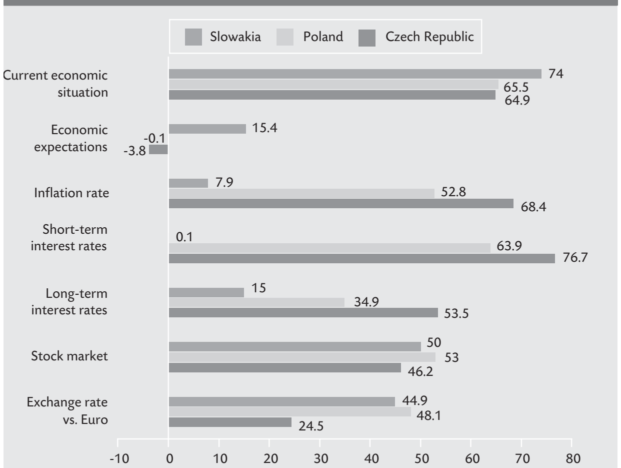


Balance of positive and negative assessment category chosen by respondents of the Financial Market Survey CEE

Source: ZEW

Czech Republic, Poland and Slovakia: Expectations for further development are mixed

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

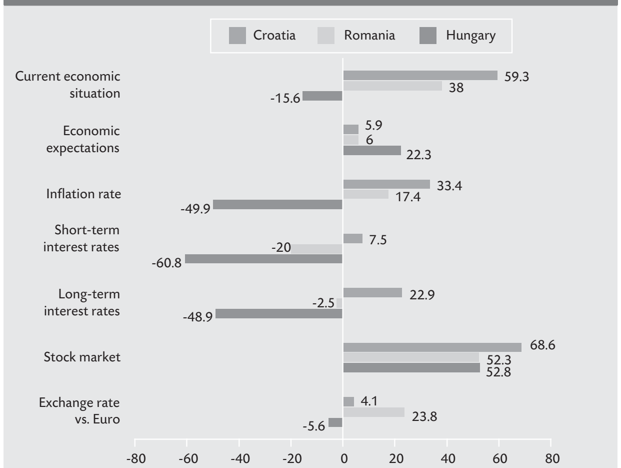
The Czech Republic, Poland, and Slovakia are characterized by a good economic situation. This is confirmed by the majority of experts. Only a minor share does not judge the situation as satisfactory. However, the expectations for the economic development within the next six months are somewhat mixed. The experts expect no change of the economic development in Poland. For Slovakia, a further improvement would be in line with the expert expectations. The economic expectations for the Czech Republic are still negative on balance, but have improved compared to last month's survey by 3.6 points.

The good economic situation that is not expected to decline much in the next six months seems to shape inflation expectations for the three countries. The indication for rising inflation rates is particularly pronounced for the Czech Republic and Poland, where the balances are 68.4 and 52.8 points respectively. For Slovakia, the share of experts forecasting rising inflation is outweighed by the share expecting a decreasing inflation rate in the next six months by only 7.9 points. Consistent with this view, the respondents project higher short- and long-term interest rates for Poland and the Czech Republic. For Slovakia, the experts also expect long-term interest rates to rise on balance over the next six months. For short-term rates, the survey participants do not expect a change.

The extrapolation of the good economic situation also determines the assessment of the stock market development. All balances are clearly positive, even if somewhat lower for the Czech Republic and Hungary and almost the same for Slovakia compared to the June survey. For Poland and the Czech Republic, a further improvement of the stock market indices would continue a development that is going on since some time. A very similar picture applies for the exchange rate expectations of the financial experts. The survey participants expect all three currencies to appreciate against the Euro. The appreciation expectations have strengthened for Poland compared to last month by 9.3 points.

Croatia, Hungary and Romania: Improvement of economic development in the next six months is likely

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 financial market experts assess the current economic situation in Romania and especially Croatia as good, the picture for Hungary is rated rather negative. However, the survey participants expect a positive economic development in the next six months for all three countries even if the current situation is assessed differently. Especially for Hungary, the share of experts expecting a better economic development in the next six months outweighs the share of pessimistic respondents by 22.3 points. For Croatia and Romania, the positive outlook is a little bit more constrained.

For Croatia and Romania, the expert forecast a higher inflation rate in six months on balance, whereas the survey participants expect the Hungarian inflation rate to decrease. Consistent with this view, expectations for the short and long run indicate lower interest rates. For Romania, the number of experts projecting lower short- and long-term interest rates exceeds the number expecting higher rates. However, the occupation of the three categories, rising, unchanged and decreasing interest rates, is almost uniformly distributed for long-term rates. For Croatia, more experts forecast long-term rates to rise more than short-term rates on balance.

For the stock market, the optimism of financial experts is unbroken. All balances are clearly positive. The survey participants expect especially the CROBEX to rise over a horizon of six months; the balance rises by 26.8 points compared to last month's survey. The other two balances are almost unchanged, +0.8 points for the BUX and -4.4 points for the BET. As for the assessment of the economic situation and inflation expectations, the exchange rate expectations for the three countries vary. For Romania, the share of experts expecting an appreciation against the Euro clearly outweighs the share expecting depreciation (balance: 23.8 points). The value is not as pronounced for the Croatian Kuna with 4.1 points. For Hungary, the depreciation expectations prevail; the balance stands at -5.6 points.

Special Question: Portfolio allocation for the second half of 2007

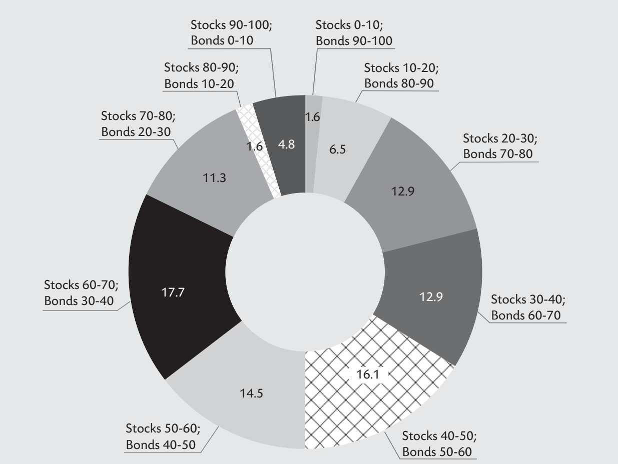
Every month, the experts express their point of view on a special question. This month's special question is concerned with portfolio allocation for the second half of 2007. Up until now, the European stock markets have performed well, including most of the CEE states' stock markets. Naturally, the strong economic situation contributed to the stock market development. Compared to last year's values, all indices in the considered countries have risen. The only exception is the SAX for Slovakia. On the other hand, the average yield for the government benchmark calculated by Eurostat has risen over the last few months for Poland, Slovenia, Slovakia, and the Czech Republic. Against this background, the survey participants are asked about their choice for a portfolio allocation.

In the first part of this month's special question, the financial experts were asked to indicate their preferred portfolio allocation, given the choice between stocks and bonds. So far, the Eurozone bond markets' performance has been weak, whereas the CEE bond markets have stood up well. A possible economic slowdown could add to the bond markets' prospects. Figure 4 shows the relative frequencies of allocations between stocks and bonds for different categories. Only a minority of experts would choose an extreme allocation with mostly bonds or stocks. Beginning with the class of 70 up to 80 percent stocks/20 up to 30 percent bonds and vice versa, the experts would select a more balanced allocation of stocks and bonds in the portfolio. The category with the highest relative frequency is the one with 60 up to 70 percent stocks and 30 up to 40 percent bonds.

In the second part, the survey participants were supposed to give their preferred stock allocation, given the choice between the Eurozone and the CEE states. Since the CEE financial market survey has been launched, more experts have predicted that the CEE states' stock markets would improve than the EURO STOXX 50. The CEE states also repeatedly received a better assessment concerning economic expectations. Therefore, the results of the portfolio allocation between Eurozone and CEE stocks are not surprising. Most of the participants, 32.3 percent, would choose to allocate 60 up to 70 percent of their portfolio to stocks from the CEE region and 30 up to 40 percent to the stocks from the Eurozone (see Figure 5). Again, the extreme positions are occupied thinly. No financial expert would invest the whole portfolio into Eurozone stocks; the category 0 up to 10 percent stocks from CEE countries is not occupied at all.

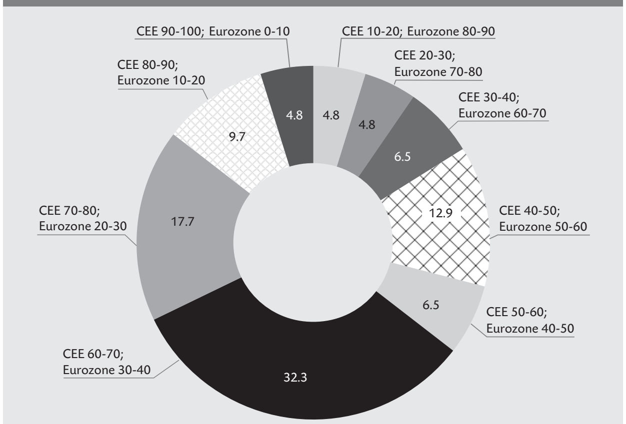
In the third and final part, the financial experts stated how they would spread their optimal stock portfolio over the CEE region. They were given the choice of nine countries (see Figure 6). Because the displayed values are averages, they do not add up to 100 percent. The highest weight in the CEE stock portfolio would be given to Poland, followed by Hungary and Romania. Stocks from Croatia and the Czech Republic would receive the same weight of about 13 percent. Bulgaria, Slovakia, Slovenia and Serbia would receive each a weight of lower than 10 percent on average. For each country, there is a considerable magnitude between the answers. The minimum is always no inclusion in the portfolio. The maximum varies between 100 percent for Croatia and Romania, 50 percent for Hungary and Poland, 40 percent for the Czech Republic, 30 percent for Slovakia and Serbia, 25 percent for Slovenia and 20 percent for Bulgaria.

Figure 4: Portfolio allocation between stocks and bonds in the second half of 2007 (relative frequencies)



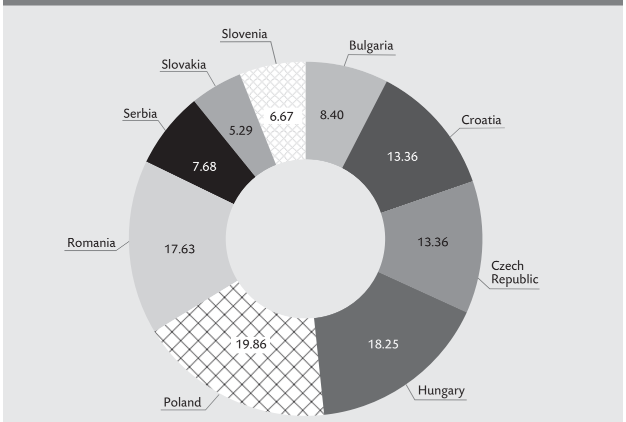
Answers of the participants of the Financial Market Survey CEE Source: ZEW

Figure 5: Portfolio allocation of stocks between CEE and Eurozone in the second half of 2007 (relative frequencies)



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

Figure 6: Portfolio allocation of stocks for CEE countries in the second half of 2007 (averages)



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

ZEW-Financial Market Survey: July 2007

Current economic situation	good		acceptable (normal)		bad		balance	
Austria	75.6	(+1.1)	24.4	(-1.1)	0.0	(+/-0.0)	75.6	(+1.1)
Croatia	59.3	(+3.3)	40.7	(-3.3)	0.0	(+/-0.0)	59.3	(+3.3)
Czech Republic	64.9	(-3.6)	35.1	(+7.3)	0.0	(-3.7)	64.9	(+0.1)
Hungary	10.3	(+6.9)	63.8	(-4.5)	25.9	(-2.4)	-15.6	(+9.3)
Poland	67.3	(+/-0.0)	30.9	(+/-0.0)	1.8	(+/-0.0)	65.5	(+/-0.0)
Romania	48.0	(+1.9)	42.0	(+1.6)	10.0	(-3.5)	38.0	(+5.4)
Slovakia	75.9	(+2.7)	22.2	(-2.8)	1.9	(+0.1)	74.0	(+2.6)
CEE	61.4	(-2.4)	36.8	(+2.3)	1.8	(+0.1)	59.6	(-2.5)
Eurozone	72.7	(+3.7)	27.3	(-3.7)	0.0	(+/-0.0)	72.7	(+3.7)

Economic expectations	improve		no change		worsen		balance	
Austria	12.2	(+5.6)	68.3	(-20.8)	19.5	(+15.2)	-7.3	(-9.6)
Croatia	19.6	(+2.6)	66.7	(-12.0)	13.7	(+9.4)	5.9	(-6.8)
Czech Republic	12.9	(+5.5)	70.4	(-7.4)	16.7	(+1.9)	-3.8	(+3.6)
Hungary	48.2	(-0.9)	25.9	(-0.4)	25.9	(+1.3)	22.3	(-2.2)
Poland	16.3	(-0.4)	67.3	(-1.2)	16.4	(+1.6)	-0.1	(-2.0)
Romania	26.0	(-6.7)	54.0	(+7.1)	20.0	(-0.4)	6.0	(-6.3)
Slovakia	25.0	(+3.9)	65.4	(-7.7)	9.6	(+3.8)	15.4	(+0.1)
CEE	19.3	(+3.3)	70.2	(-8.4)	10.5	(+5.1)	8.8	(-1.8)
Eurozone	12.5	(-5.7)	60.7	(-10.2)	26.8	(+15.9)	-14.3	(-21.6)

Inflation rate	increase		no change		decrease		balance	
Austria	34.2	(+4.7)	58.5	(-2.9)	7.3	(-1.8)	26.9	(+6.5)
Croatia	41.7	(+2.1)	50.0	(+2.1)	8.3	(-4.2)	33.4	(+6.3)
Czech Republic	74.0	(+11.2)	20.4	(-12.9)	5.6	(+1.7)	68.4	(+9.5)
Hungary	19.7	(+1.9)	10.7	(+5.3)	69.6	(-7.2)	-49.9	(+9.1)
Poland	58.5	(-6.2)	35.8	(+6.4)	5.7	(-0.2)	52.8	(-6.0)
Romania	43.5	(+7.2)	30.4	(-6.0)	26.1	(-1.2)	17.4	(+8.4)
Slovakia	25.5	(+10.4)	56.9	(+4.1)	17.6	(-14.5)	7.9	(+24.9)
CEE	42.0	(+2.0)	52.0	(+2.0)	6.0	(-4.0)	36.0	(+6.0)
Eurozone	40.7	(+6.7)	50.0	(-4.7)	9.3	(-2.0)	31.4	(+8.7)

Short-term interest rates	increase				no change				decrease				balance			
	[abs.]		[rel.]		[abs.]		[rel.]		[abs.]		[rel.]		[abs.]		[rel.]	
Croatia	32.5	(-1.7)	29.8	(+4.8)	42.5	(-4.9)	40.5	(-6.7)	25.0	(+6.6)	29.7	(+1.9)	7.5	(-8.3)	0.1	(+2.9)
Czech Republic	78.8	(+3.2)	42.8	(+19.0)	19.1	(-0.9)	31.0	(-19.0)	2.1	(-2.3)	26.2	(+/-0.0)	76.7	(+5.5)	16.6	(+19.0)
Hungary	13.7	(+7.5)	12.7	(+1.8)	11.8	(-0.7)	12.8	(-0.2)	74.5	(-6.8)	74.5	(-1.6)	-60.8	(+14.3)	-61.8	(+3.4)
Poland	66.0	(-2.1)	34.1	(+5.2)	2.1	(-9.3)	52.3	(-5.6)	2.1	(-9.3)	13.6	(+0.4)	63.9	(+7.2)	20.5	(+4.8)
Romania	28.9	(+11.4)	30.0	(+9.5)	22.2	(-15.3)	30.0	(+9.5)	48.9	(+3.9)	40.0	(-19.0)	-20.0	(+7.5)	-10.0	(+28.5)
Slovakia	19.2	(-0.8)	11.9	(+2.9)	61.7	(+3.9)	61.9	(+16.4)	19.1	(-3.1)	26.2	(-19.3)	0.1	(+2.3)	-14.3	(+22.2)
Eurozone	59.0	(-22.1)			33.9	(+20.7)			7.1	(+1.4)			51.9	(-23.5)		

Long-term interest rates	increase				no change				decrease				balance			
	[abs.]		[rel.]		[abs.]		[rel.]		[abs.]		[rel.]		[abs.]		[rel.]	
Croatia	40.0	(+4.7)	36.4	(+10.7)	42.9	(-4.2)	33.3	(-9.6)	17.1	(-0.5)	30.3	(-1.1)	22.9	(+5.2)	6.1	(+11.8)
Czech Republic	65.1	(+1.7)	40.6	(+10.6)	23.3	(-3.5)	35.1	(-19.9)	11.6	(+1.8)	24.3	(+9.3)	53.5	(-0.1)	16.3	(+1.3)
Hungary	14.9	(+1.6)	15.5	(+2.2)	21.3	(+3.5)	8.9	(+/-0.0)	63.8	(-5.1)	75.6	(-2.2)	-48.9	(+6.7)	-60.1	(+4.4)
Poland	44.2	(+0.3)	26.8	(-0.7)	46.5	(+9.9)	65.9	(+15.9)	9.3	(-10.2)	7.3	(-15.2)	34.9	(+10.5)	19.5	(+14.5)
Romania	34.3	(+19.2)	29.4	(+14.7)	28.9	(-10.5)	26.5	(-20.6)	36.8	(-8.7)	44.1	(+5.9)	-2.5	(+27.9)	-14.7	(+8.8)
Slovakia	27.5	(-14.0)	16.7	(+/-0.0)	60.0	(+21.0)	63.9	(+4.4)	12.5	(-7.0)	19.4	(-4.4)	15.0	(-7.0)	-2.7	(+4.4)
Germany	43.2	(-4.6)			39.2	(+2.2)			17.6	(+2.4)			25.6	(-7.0)		

Stock market indices	increase		no change		decrease		balance	
EURO STOXX 50	55.1	(-7.4)	32.7	(+7.7)	12.2	(-0.3)	42.9	(-7.1)
ATX (Austria)	62.8	(-0.9)	25.0	(+1.2)	12.2	(-0.3)	50.6	(-0.6)
NTX (CEE)	73.4	(-1.6)	18.4	(-4.3)	8.2	(+5.9)	65.2	(-7.5)
CROBEX (Croatia)	74.9	(+16.8)	18.8	(-6.8)	6.3	(-10.0)	68.6	(+26.8)
PX 50 (Czech Rep.)	57.7	(-0.1)	30.8	(-9.2)	11.5	(+9.3)	46.2	(-9.4)
BUX (Hungary)	67.9	(+9.9)	17.0	(-19.0)	15.1	(+9.1)	52.8	(+0.8)
WIG (Poland)	67.3	(+2.1)	18.4	(-9.9)	14.3	(+7.8)	53.0	(-5.7)
BET (Romania)	65.3	(-2.8)	21.7	(+1.2)	13.0	(+1.6)	52.3	(-4.4)
SAX (Slovakia)	59.5	(+4.8)	31.0	(-9.5)	9.5	(+4.7)	50.0	(+0.1)
SBI 20 (Slovenia)	50.0	(+1.3)	37.5	(-1.0)	12.5	(-0.3)	37.5	(+1.6)

Exchange rates (vs. Euro)	appreciate		no change		depreciate		balance	
Kuna (Croatia)	34.7	(-5.7)	34.7	(-10.0)	30.6	(+15.7)	4.1	(-21.4)
Koruna (Czech Rep.)	43.4	(-1.5)	37.7	(-3.1)	18.9	(+4.6)	24.5	(-6.1)
Forint (Hungary)	18.5	(-15.5)	57.4	(+15.9)	24.1	(-0.4)	-5.6	(-15.1)
Zloty (Poland)	57.4	(+2.3)	33.3	(+4.7)	9.3	(-7.0)	48.1	(+9.3)
Lei (Romania)	43.4	(-14.4)	37.0	(+14.8)	19.6	(-0.4)	23.8	(-14.0)
Koruna (Slovakia)	51.0	(-1.2)	42.9	(-0.6)	6.1	(+1.8)	44.9	(-3.0)
US-Dollar	28.5	(-3.6)	30.4	(+4.0)	41.1	(-0.4)	-12.6	(-3.2)

Note: 81 Financial experts participated in the July survey which was conducted during the period 04/07/07-23/07/07. 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 June in parentheses). Balances refer to the differences between positive and negative assessments.

I M P R I N T

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