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ERSTE BANK

Financial Market Report CEE

Volume 2 · August 2008

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, 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 present survey conducted between 26 June 2008 and 14 July 2008 are published in the August 2008 issue of the "Financial Market Report CEE". In this month's survey 73 financial market experts participated.

Downward movement of the economic expectations for CEE slows down

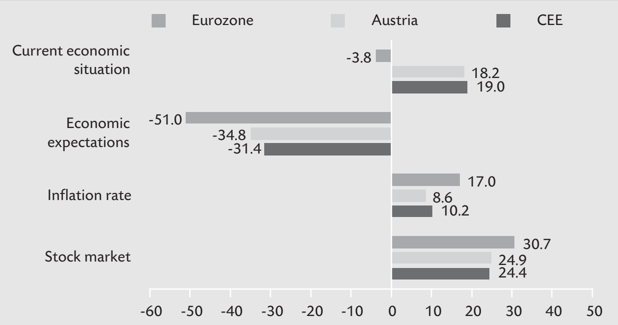
The downward trend of the sentiment indicator for Central and Eastern Europe (CEE) flattens in July. The economic expectations of the financial market experts for the CEE region worsen by 2.7 points to currently minus 31.4 points. In contrast to this rather moderate decline, the outlook for the Eurozone dropped 14.7 points to an all-time low of minus 51.0 points in July. Thus, the financial market experts assess the economic development in the CEE region within the next six months much less critically than those of the Eurozone. The indicator for Austria decreases by 4.0 points to minus 34.8 points.

Economic outlook for CEE countries, Austria and the Eurozone

Due to the decline of the proportion of financial market experts who expect an improvement of the economic development in the CEE region for the benefit of the experts who expect no change in the economic situation within the next six months, the ZEW-Erste Bank CEE indicator slightly decreases in July. The letter proportion that increases by 6.1 points to 49.0 points in July constitutes the majority of analysts.

The current situation in the CEE region is assessed by 66.0 percent of the financial experts as "normal" and 26.5 percent of the participants consider the current economic conditions in the CEE region to be "good" (minus 8.0 points compared to the previous month). In contrast, 7.5 percent of the analysts are more pessimistic and evaluate the current situation as "bad", even though not a single expert had made such a negative statement in June. As a consequence, the balance of the positive and negative answers decreases by 15.5 points. However, the indicator remains positive, now standing at 19.0 points, which means that the proportion of the optimistic valuations still outweighs the pessimistic ones. When asked to appraise the current economic situation in the Eurozone, the financial experts are again more critical than in the case of the CEE region. The balance for the Eurozone turned negative, declining by 15.6 points to minus 3.8 points. Despite a drop of 19.0 points, the indicator for Austria remains positive and amounts to 18.2 points.

Indicators for CEE, Austria and the Eurozone (balances)



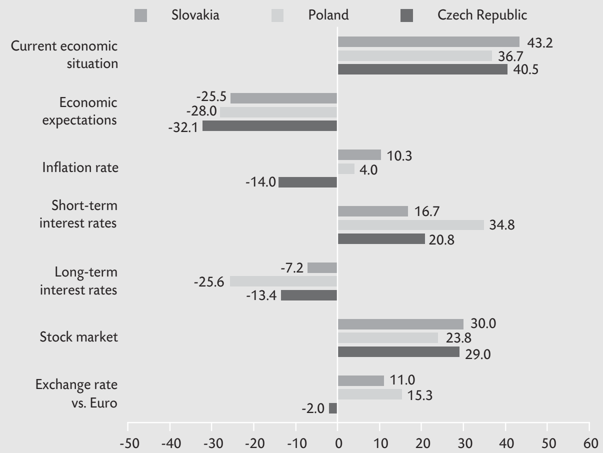
Balance of positive and negative assessment category chosen by respondents of the Financial Market Survey CEE
Source: ZEW

The sharp rise of the expected inflation rates in the surveyed CEE countries in June did not continue this month. The balance for the CEE region as a whole decreases by 4.4 points to 10.2 points in July. The Austrian balance recedes by 7.4 points to 8.6 points. As already expected, the European Central Bank (ECB) raised the key interest rate by 25 basis points to 4.25 percent in July. However, this decision did not seem to have much impact on the experts' forecast for the inflation rate in the Eurozone. The respective balance remains unchanged at 17.0 points. Since the ECB interest rate decision was already anticipated in the balance for the short-term interested rate in June the balance for July changes only marginally increasing by 1.8 points to 5.6 points. 50 percent of the analysts (an increase by 13.0 percentage points compared to the previous month) expect that the short-term interested rate will stay constant for the next six months.

More than half of the survey participants predict a rise of stock market indices in the CEE region, Austria and the Eurozone. In spite of decreasing balances the optimistic view concerning the stock market development in the following six months preponderates the pessimistic one.

Poland and Slovakia: economic expectations keep on recovering

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

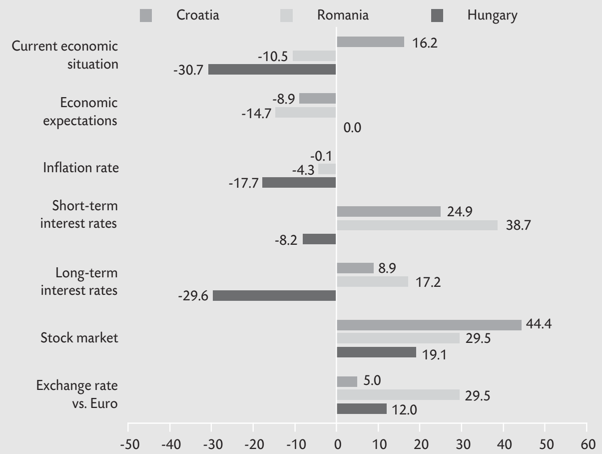
Consistent with last month's survey, the economic expectations for Poland and Slovakia keep on recovering. The balance for Slovakia increases by 6.0 points to minus 25.5 points, the Polish indicator gains 3.4 points now standing at minus 28.0 points. The forecast for the Czech Republic remains unchanged at minus 32.1 points. Although all balances are in the red, the majority of analysts expect the economies of the three countries neither to improve nor to worsen but to stay unchanged within the next six months.

With regard to the assessment of the current economic situation in the Czech Republic, Poland and Slovakia, the majority of financial market experts still evaluate the current situation as "good" and, consequently, all indicators remain clearly positive. Nonetheless, the slight downward trend of the previous month continues in July. In the current survey few respondents consider the present economic conditions in the three countries to be "bad", whereas not a single analyst made this assessment in June. However, the Czech Republic, Poland and Slovakia still obtain the highest balances (40.5 points, 36.7 points and 43.2 points respectively) within the analysed countries.

The financial market experts hold a mixed view concerning the inflation rates for the three countries. While a decreasing inflation rate is predicted for the Czech Republic, the analysts expect the inflation rates in Poland and Slovakia to rise. In contrast, a relatively strong tendency towards rising short-term interest rates is perceivable, as all three indicators increased markedly. The Polish balance even soars by 26.0 points to currently 34.8 points. Although the National Bank of Poland raised the key reference rate in June many respondents expect further adjustments. The balance for the Czech Republic reaches 20.8 points (plus 7.9 points) and the balance for Slovakia gains 12.2 points obtaining 16.7 points. In the long-run, however, a growing majority of the financial experts anticipate falling interest rates in all three countries.

Economic expectations for Croatia improve significantly

Indicators for Croatia, Hungary, and Romania



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

According to the financial market experts, the economic prospects for Croatia change for the better. The Croatian indicator climbs by 18.3 points to minus 8.9 points in July. The analysts' assessment of the economic potential of the Romanian and Hungarian economies did not change much compared to the previous month. The Hungarian balance declines by 3.4 points to 0.0 points and stays, as opposed to all other indicators, nonnegative. The view of the experts on Romanian perspectives remains nearly unchanged resulting in a marginal rise of its balance by 0.1 points to minus 14.7 points.

The evaluation of the current economic situation in Croatia, Hungary and Poland is mixed. While the assessment on the state of the Croatian economy is predominantly positive, the current situation in Hungary and Romania is viewed more sceptically.

The sharp rise in the analysts' inflation rates forecast for the three countries in June did not continue this month. The proportion of experts anticipating falling inflation rates increases markedly and consequently, the balances for the anticipated inflation rates decline. After the rise of the key interest rate in Romania, this month's results are dominated by the share of respondents anticipating a decline of the inflation rate. The indicator drops by 9.7 points to minus 4.3 points. A vast majority of survey participants expect further hikes of the key interest rate in Romania in the following six months. The corresponding balance for the short-term interest rate rises markedly by 25.9 points to 38.7 points, which is the highest value among the analysed countries. Furthermore, as a consequence of the recent raise of the interest rate the majority of the financial analysts expect an appreciation of the Romanian Leu.

With regard to the development of the stock markets, the financial experts expect the highest potential for Croatia. The balance for the Croatian stock-index CROBEX increases by 16.4 points to 44.4 points. The prospects for the other stock markets remain also clearly positive.

Special Question: Credit crisis

Since 2007, the subprime mortgage crisis and its effects on the financial markets are omnipresent. We have already dedicated two special questions, namely in October and November 2007, to the possible implications of the crisis. This month, we consulted the financial market experts again on this topic, focussing on the stage of the financial crisis and the impact it had and may still have on the economy.

We were particularly interested in the experts' assessment of the progress of the consequences of the credit crisis. Have we already seen the worst?

Half of the respondents (50.7 percent) share this opinion believing that the financial crisis is in a later stage at present. Many politicians and leading bankers, for instance the US Secretary of the Treasury Henry Paulson and Deutsche Bank Chief Executive Officer Josef Ackermann, expressed a similarly optimistic view within the last weeks.

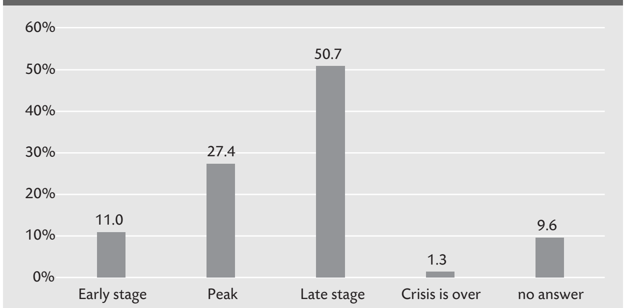
Nonetheless, 27.4 percent of the experts reckon that the credit crisis has just reached its peak and 11.0 percent of the survey participants fear that most of the negative effects are yet to come. It seems probable that the current problems of the two largest US mortgage banks Freddie Mac and Fannie Mae and their influence on the financial markets have some impact on the respondents in their evaluation. Only one financial expert holds the view that the credit crisis is already over.

According to Jaime Caruana, head of the IMF's Monetary and Capital Markets Department, three main factors induce the remaining uncertainty of the financial markets: the weakening balance sheets of financial institutions, the continuing deleveraging process and falling asset prices, and, finally, the weakening global growth. Taking this into account we wanted to find out, whether the financial market experts have already anticipated the impact of the credit crisis on the real economy in the CEE region. For this purpose, we asked the financial experts to compare their current assessment of the likely influence of the crunch on the business cycle to their estimation in autumn 2007.

This question led to rather heterogeneous results: The majority of participants (39.7 percent) stated that their current assessment of the effects of the credit crisis on CEE economies is in accordance with their former expectations. 30.1 percent take the view that the impact of the financial crunch on the real economies is larger than initially expected, followed by a slightly smaller proportion of experts (23.3 percent) being positively surprised that the influence on the CEE countries is less pronounced than suspected last year.

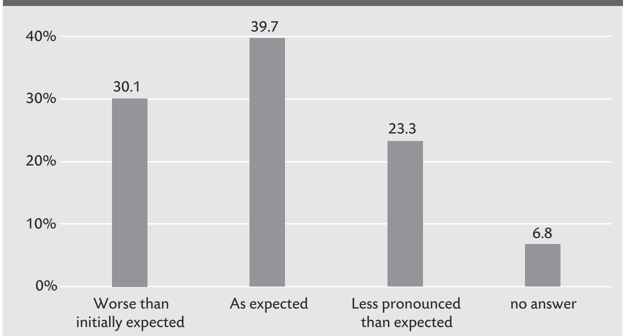
Finally, we asked the financial experts to characterise the specific impact of the credit crisis on the economies in selected regions, namely the CEE region, the Eurozone, the USA and Asia. A large majority of respondents (69.9 percent) evaluate the impact of the credit crisis on the economies in the CEE countries as "modest". Remarkably, 5.5 percent of the analysts even state that the credit crunch had no bearing on the economic development in Central and Eastern Europe at all. As expected, the participants believe that the US business cycle is most strongly affected. Nearly 90.0 percent of the respondents regard the influence of the credit crisis on the US economy as "strong" or "very strong". It is striking that almost half of the answers (49.3 percent) concern the latter assessment. According to the evaluation of the analysts, the Eurozone is caught in the maelstrom of the credit crunch as well. 61.6 percent of the experts describe its influence on the economic situation as "strong", though only 5.5 percent believe that the crisis affects the Eurozone "very strongly". In contrast, the majority of analysts (47.9 percent) take the view that the impact on Asian economies is rather "modest".

Figure A: At which stage does the financial market crisis stand at present?



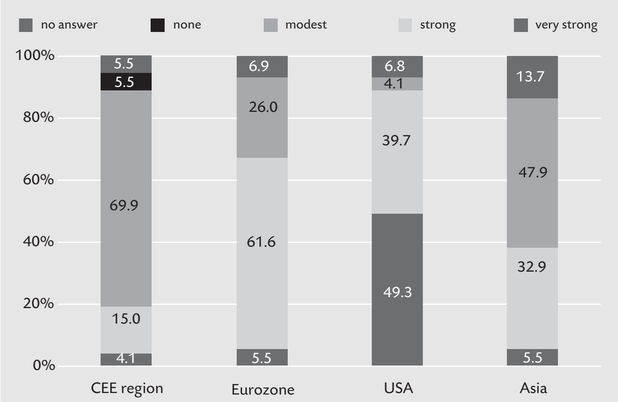
Answers of the participants of the Financial Market Survey CEE Source: ZEW

Figure B: Compared to autumn 2007, what is your current assessment of the likely impact of the credit crisis on the real economy in the CEE region?



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

Figure C: How strong will the impact of the credit crisis be on following economies?



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

ZEW-Financial Market Survey: July 2008

Current economic situation	good		acceptable (normal)		bad		balance	
Austria	25.0	(-14.2)	68.2	(+9.4)	6.8	(+4.8)	18.2	(-19.0)
Croatia	20.9	(+6.6)	74.4	(-9.3)	4.7	(+2.7)	16.2	(+3.9)
Czech Republic	44.3	(-9.3)	51.9	(+5.5)	3.8	(+3.8)	40.5	(-13.1)
Hungary	3.9	(-3.1)	61.5	(+8.9)	34.6	(-5.8)	-30.7	(+2.7)
Poland	44.9	(-5.1)	46.9	(-3.1)	8.2	(+8.2)	36.7	(-13.3)
Romania	16.6	(-7.4)	56.3	(+4.4)	27.1	(+3.0)	-10.5	(-10.4)
Slovakia	51.0	(+2.8)	41.2	(-8.8)	7.8	(+6.0)	43.2	(-3.2)
CEE	26.5	(-8.0)	66.0	(+0.5)	7.5	(+7.5)	19.0	(-15.5)
Eurozone	11.3	(-3.9)	73.6	(-7.8)	15.1	(+11.7)	-3.8	(-15.6)

Economic expectations	improve		no change		worsen		balance	
Austria	8.7	(-0.9)	47.8	(-2.2)	43.5	(+3.1)	-34.8	(-4.0)
Croatia	22.2	(+7.7)	46.7	(+2.9)	31.1	(-10.6)	-8.9	(+18.3)
Czech Republic	9.4	(-4.9)	49.1	(+9.8)	41.5	(-4.9)	-32.1	(+/-0.0)
Hungary	28.3	(-1.0)	43.4	(-1.4)	28.3	(+2.4)	0.0	(-3.4)
Poland	6.0	(-7.0)	60.0	(+17.4)	34.0	(-10.4)	-28.0	(+3.4)
Romania	16.6	(-7.5)	52.1	(+15.1)	31.3	(-7.6)	-14.7	(+0.1)
Slovakia	9.8	(+2.4)	54.9	(+1.2)	35.3	(-3.6)	-25.5	(+6.0)
CEE	9.8	(-4.4)	49.0	(+6.1)	41.2	(-1.7)	-31.4	(-2.7)
Eurozone	9.4	(-0.9)	30.2	(-12.9)	60.4	(+13.8)	-51.0	(-14.7)

Inflation rate	increase		no change		decrease		balance	
Austria	36.9	(-1.1)	34.8	(-5.2)	28.3	(+6.3)	8.6	(-7.4)
Croatia	41.4	(-2.4)	17.1	(-16.2)	41.5	(+18.6)	-0.1	(-21.0)
Czech Republic	30.0	(-3.9)	26.0	(-2.6)	44.0	(+6.5)	-14.0	(-10.4)
Hungary	33.3	(+1.7)	15.7	(-7.1)	51.0	(+5.4)	-17.7	(-3.7)
Poland	36.0	(+1.4)	32.0	(-0.7)	32.0	(-0.7)	4.0	(+2.1)
Romania	37.0	(-0.5)	21.7	(-8.7)	41.3	(+9.2)	-4.3	(-9.7)
Slovakia	36.8	(+/-0.0)	36.7	(-7.2)	26.5	(+7.2)	10.3	(-7.2)
CEE	40.8	(+2.6)	28.6	(-9.6)	30.6	(+7.0)	10.2	(-4.4)
Eurozone	47.2	(+6.5)	22.6	(-13.0)	30.2	(+6.5)	17.0	(+/-0.0)

Short-term interest rates	increase				no change				decrease				balance			
	[abs.]		[rel.]		[abs.]		[rel.]		[abs.]		[rel.]		[abs.]		[rel.]	
Croatia	30.5	(-4.5)	40.6	(+11.2)	63.9	(+13.9)	46.9	(-3.1)	5.6	(-9.4)	12.5	(-8.1)	24.9	(+4.9)	28.1	(+19.3)
Czech Republic	37.5	(+5.5)	28.6	(-4.7)	45.8	(-3.1)	38.1	(+/-0.0)	16.7	(-2.4)	33.3	(+4.7)	20.8	(+7.9)	-4.7	(-9.4)
Hungary	30.6	(+5.1)	28.9	(+2.2)	30.6	(-2.7)	33.3	(-8.9)	38.8	(-2.4)	37.8	(+6.7)	-8.2	(+7.5)	-8.9	(-4.5)
Poland	50.0	(+10.8)	55.0	(+17.5)	34.8	(+4.4)	35.0	(-12.5)	15.2	(-15.2)	10.0	(-5.0)	34.8	(+26.0)	45.0	(+22.5)
Romania	54.6	(+9.9)	51.2	(+11.2)	29.5	(+6.1)	26.8	(-5.7)	15.9	(-16.0)	22.0	(-5.5)	38.7	(+25.9)	29.2	(+16.7)
Slovakia	26.2	(-0.5)	18.4	(-1.6)	64.3	(+13.2)	57.9	(+7.9)	9.5	(-12.7)	23.7	(-6.3)	16.7	(+12.2)	-5.3	(+4.7)
Eurozone	27.8	(-5.6)			50.0	(+13.0)			22.2	(-7.4)			5.6	(+1.8)		

Long-term interest rates	increase				no change				decrease				balance			
	[abs.]		[rel.]		[abs.]		[rel.]		[abs.]		[rel.]		[abs.]		[rel.]	
Croatia	32.4	(+10.5)	31.3	(+19.9)	44.1	(-9.6)	53.1	(-1.2)	23.5	(-0.9)	15.6	(-18.7)	8.9	(+11.4)	15.7	(+38.6)
Czech Republic	22.2	(-3.3)	13.9	(-5.7)	42.2	(+3.9)	53.5	(+7.2)	35.6	(-0.6)	32.6	(-1.5)	-13.4	(-2.7)	-18.7	(-4.2)
Hungary	22.7	(+2.2)	18.6	(+2.7)	25.0	(+2.6)	25.6	(+0.6)	52.3	(-4.8)	55.8	(-3.3)	-29.6	(+7.0)	-37.2	(+6.0)
Poland	18.6	(-7.5)	17.1	(+2.1)	37.2	(+2.4)	46.3	(+1.3)	44.2	(+5.1)	36.6	(-3.4)	-25.6	(-12.6)	-19.5	(+5.5)
Romania	34.3	(-8.5)	41.2	(+1.2)	48.6	(+22.4)	38.2	(+1.1)	17.1	(-13.9)	20.6	(-2.3)	17.2	(+5.4)	20.6	(+3.5)
Slovakia	21.4	(-7.5)	17.9	(+7.3)	50.0	(-1.1)	51.3	(-9.2)	28.6	(+8.6)	30.8	(+1.9)	-7.2	(-16.1)	-12.9	(+5.4)
Germany	28.6	(-9.5)			46.9	(+10.5)			24.5	(-1.0)			4.1	(-8.5)		

Stock market indices	increase		no change		decrease		balance	
EURO STOXX 50	53.1	(-2.3)	24.5	(+1.3)	22.4	(+1.0)	30.7	(-3.3)
ATX (Austria)	52.2	(-5.8)	20.5	(+0.5)	27.3	(+5.3)	24.9	(-11.1)
NTX (CEE)	53.3	(+0.4)	17.8	(-7.7)	28.9	(+7.3)	24.4	(-6.9)
CROBEX (Croatia)	62.2	(+12.2)	20.0	(-8.0)	17.8	(-4.2)	44.4	(+16.4)
PX 50 (Czech Rep.)	53.4	(+4.4)	22.2	(-7.2)	24.4	(+2.8)	29.0	(+1.6)
BUX (Hungary)	46.8	(-3.2)	25.5	(+1.4)	27.7	(+1.8)	19.1	(-5.0)
WIG (Poland)	52.1	(+0.1)	19.6	(-4.4)	28.3	(+4.3)	23.8	(-4.2)
BET (Romania)	54.5	(+1.4)	20.5	(-4.0)	25.0	(+2.6)	29.5	(-1.2)
SAX (Slovakia)	50.0	(+5.8)	30.0	(+2.1)	20.0	(-7.9)	30.0	(+13.7)
SBI 20 (Slovenia)	57.5	(+7.5)	25.0	(+/-0.0)	17.5	(-7.5)	40.0	(+15.0)

Exchange rates (vs. Euro)	appreciate		no change		depreciate		balance	
Kuna (Croatia)	27.5	(+2.5)	50.0	(-8.3)	22.5	(+5.8)	5.0	(-3.3)
Koruna (Czech Rep.)	30.0	(+10.4)	38.0	(-1.2)	32.0	(-9.2)	-2.0	(+19.6)
Forint (Hungary)	34.0	(+1.9)	44.0	(-6.9)	22.0	(+5.0)	12.0	(-3.1)
Zloty (Poland)	37.0	(+3.0)	41.3	(-2.7)	21.7	(-0.3)	15.3	(+3.3)
Lei (Romania)	50.0	(+6.9)	29.5	(-5.8)	20.5	(-1.1)	29.5	(+8.0)
Koruna (Slovakia)	15.3	(-1.0)	80.4	(+0.8)	4.3	(+0.2)	11.0	(-1.2)
US-Dollar	63.5	(-3.2)	26.9	(+7.6)	9.6	(-4.4)	53.9	(+1.2)

Note: 73 Financial experts participated in the July survey which was conducted during the period 06/26/08-07/14/08. 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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