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# Financial Market Report CEE

Volume 4 · September 2010

International Finance Market Data: Assessments and Expectations
ZEW Economic Sentiment Indicator for Central and Eastern Europe, Supported by Erste Group Bank AG

**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 July 27 and August 16, 2010, are published in the September 2010 issue of the "Financial Market Report CEE." 70 financial market experts participated in this month's survey.**

## Economic Sentiment Indicators for Central and Eastern Europe Recover

The ZEW-Erste Group Bank Sentiment Indicator CEE increases by 9.1 points in August. Thus, the economic expectations reach the 20.5 points mark. The predictions for the economic development in Austria and the Eurozone improve this month as well. However, the relevant indicators rise slightly compared to the CEE indicator. The current economic situation in the CEE region, Austria and the Eurozone receives a significantly better evaluation by the surveyed analysts compared to the previous month. The indicator which depicts the current economic conditions in the CEE region climbs 13.6 points and reaches the 0.0 points threshold in August. In the current survey, the financial market experts predict higher inflationary risks for the CEE region and Austria within the next six months. In contrast, the respective predictions for the Eurozone remain nearly unchanged. The expectations concerning the development of the stock market index for the CEE region (NTX) on a six months time horizon improve significantly this month.

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

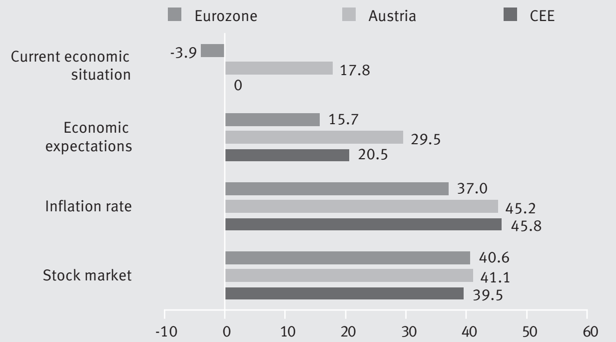
The ZEW-Erste Group Bank Economic Sentiment Indicator for Central and Eastern Europe (CEE), which is calculated as the balance of positive and negative assessments of the economic development on a six months time horizon, increases by 9.1 points to 20.5 points in August. Still, the majority of 55.1 percent of the survey respondents predict an unchanged economic development in the CEE region for the upcoming half year. The predictions for the economic development in Austria and the Eurozone improve this month as well. The relevant indicator for Austria rises by 5.0 points to 29.5 points. The economic expectations for the Eurozone take on the last place among all indicators after a slight increase by 2.6 points to 15.7 points.

The current economic situation in the CEE region, Austria and the Eurozone receives a significantly better evaluation in August compared to the previous month. The indicator which depicts the current economic situation in the CEE region rises by 13.6 points and reaches the 0.0 points threshold in August. The respective indicator for Austria changes to a positive value of 17.8 points after an immense growth by 20.0 points. The assessment of the current business situation in the Eurozone improves by 16.9 points to minus 3.9 points.

As a consequence of the increasing prices of several resources and agricultural products the financial market experts predict higher inflationary risks for the CEE region and Austria within the next six months. The respective indicators rise by 18.3 points to 45.8 points for the CEE-region and by 17.3 points to 45.2 points for Austria. However, the relevant indicator for the Eurozone remains nearly unchanged at 37.0 points.

The indicators which represent the expected development of the stock market indices for the CEE region (NTX), Austria (ATX) and the Eurostoxx 50 on a six months time horizon improve in the current survey once again. About 60 percent of the survey participants foresee a rise of the three stock indices within the next half year.

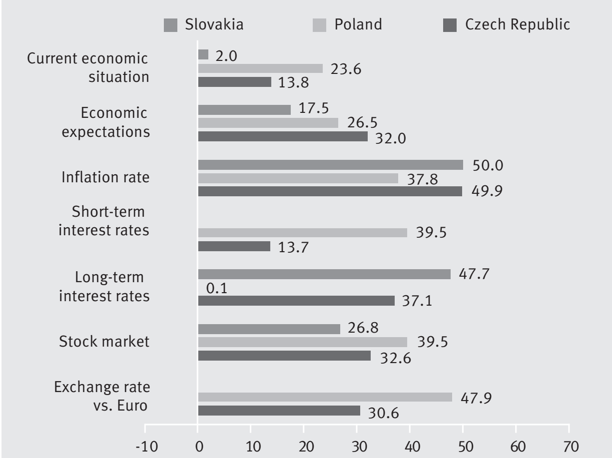
Indicators for CEE, Austria and the Eurozone (balances)




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

## Czech Republic, Poland and Slovakia: Higher Inflation Rates Predicted

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

Unlike last month's expectations for the economic development on a six months time horizon the economic forecasts in August show a much more positive picture for almost all analyzed countries. After a slight increase of the sentiment indicator by 3.5 points to 32.0 points the Czech Republic remains at the first place in country comparison. The economic expectations for Poland rise by 8.5 points to 26.5 points in this month's survey. As the only country which depicts a decline in the economic outlook in August, Slovakia takes up the last place among all the CEE countries in this category. Its respective indicator decreases by 4.7 points to 17.5 points.

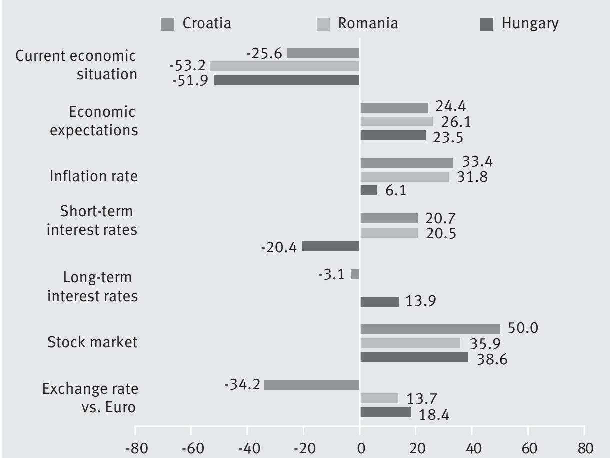
The evaluation by the financial market analysts regarding the current economic situation in the Czech Republic, Poland and Slovakia improves significantly as well. All respective indicators display double-digit increases and positive values in the August survey. After an increase by 17.6 points to 23.6 points Poland defends its leading position in this category. The evaluation of the current business conditions in the Czech Republic improves by 13.9 points reaching 13.8 points. Even though the survey participants are cautious concerning the economic outlook of Slovakia they are very positive regarding the current business conditions in Slovakia. The respective balance shows the strongest growth among all the analysed CEE economies by 19.8 points and reaches 2.0 points.

Predictions of higher inflationary risks for the Czech Republic, Poland and Slovakia increase in August. More than half of the financial market experts expect a higher inflation rate in the Czech Republic and Slovakia for the next half year. The inflation indicator for Poland increases most strongly by 20.4 points and reaches 37.8 points. The inflation indicator for Slovakia rises by 12.1 points to 50.0 points reaching the highest value in this category.

A distinctive majority of participants, namely 62.5 percent, predict an appreciation of the Polish Zloty against the Euro. Therefore its currency indicator continues to be at the first place in country comparison with a value of 47.9 points.

## Croatia, Hungary and Romania: Outlook Improves 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

In line with the expectations for the remaining CEE countries the economic outlook for Croatia, Hungary and Romania recovers significantly in the current survey. The economic sentiment indicators for these countries experience double-digit increases. The prediction of the economic development for Croatia rises by 19.8 points to 24.4 points. The balance capturing the economic development in Hungary rises by 13.9 points reaching 23.5 points. While in the July survey the economic outlook for Romania still displayed the highest decline in country comparison in the August survey the indicator experiences the highest increase among all the other analysed countries. The respective indicator rises by 32.4 points to 26.1 points. This prediction is supported by the Romanian National Bank which foresees that the negative output gap will be narrowing and even predicts a positive growth rate in 2011.

The evaluation of the current business cycle for Romania changes significantly as well. The respective indicator increases by 18.2 points reaching minus 53.2 points. Nonetheless, it is still the lowest value in this category. The assessment of the current economic situation in Croatia increases by 8.4 points reaching minus 25.8 points. Hungary is the only country where the indicator representing the current business conditions declines. The relevant balance drops by 1.9 points reaching minus 51.9 points.

Hungary remains to be the only county for which the financial market experts predict decreasing short-term interest rates for the next six months. The respective indicator decreases slightly by 2.5 points to minus 20.4 points.

The six months forecast for the Croatian stock indices CROBEX continues to improve significantly. Its respective indicator increases by 32.9 points to 50.0 points which is the highest value in country comparison. After an immense climb by 36.0 points the indicator which reflects the expected development of the Romanian stock market index BET reaches a positive value of 35.9 points in August.

# Special Question: Austerity Programs in CEE Countries

During the last months many countries worldwide including also several CEE countries as Slovakia, Hungary, the Czech Republic and Romania introduced austerity programs aiming to reduce their budget deficits. This month's special question examines the success of the austerity program in the CEE countries. Additionally, the financial market experts were asked to evaluate several austerity measures regarding their success in providing a long-term solution to reducing the budget deficit.

The results of this month's special question show that the success of all the austerity programs in Slovakia, Hungary, the Czech Republic and Romania is acknowledged by more than 50 percent of the financial market experts. A fairly small percentage of participants do not believe in the success of each austerity program even though some austerity measures did not have a significant impact in reducing the budget deficit or have caused social riots and dissatisfaction within the people for (e.g. Romania). According to the "Public Finances Report in EMU" from April 2010 by the European Commission an excessive deficit is evident in Slovakia, Hungary, the Czech Republic and Romania which exceeds the boundaries of the Stability and Growth Pact (SGP) required for every member state of the European Union, therefore, a successful implementation of austerity measures in each country is crucial.

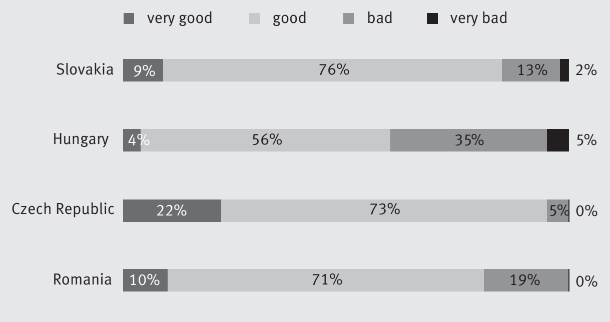
73 percent of the polled experts assess the austerity program of the Czech Republic to be good and 22 percent even evaluate the measures to be very good. Only 5 percent of the surveyed analysts appraise the program to be bad and no survey participant regards it to be very bad. The Czech Republic's austerity program is therefore evaluated as most effective in country comparison.

The survey results for Slovakia and Romania are quite positive as well. 85 percent of the financial market experts believe in the success of Slovakia's austerity measures from which 76 percent evaluate the measures as good and 9 percent as very good. Only 15 percent of the polled participants appraise the measures to be bad or even very bad. This result is very favourable for Slovakia as its deadline for reducing the budget deficit below the 3 percent target is in 2013. Its current deficit is 5.4 percent of the GDP.

Despite the recent street riots in reaction to the severe austerity package implemented by the Romanian government which consisted of a 25 percent cut in public wages and a 15 percent reduction in pension and social benefits, 71 percent of the surveyed experts still judge the Romanian austerity package as good and 10 percent of the polled experts even predict very good prospects of success. The accomplishments of the austerity measures are indeed evident as the Romanian government succeeded in fulfilling several conditions of the 20 billion Euro IMF support loan. However, 19 percent of the participants are still doubtful concerning Romania's austerity package as Romania still has to overcome a recession and is experiencing a contraction of its GDP.

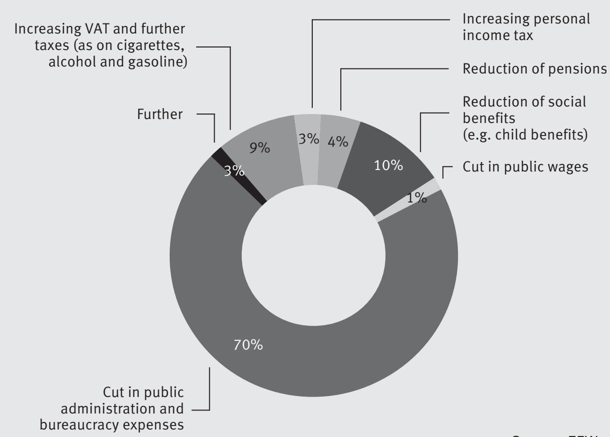
The evaluation of Hungary's austerity program is most cautious in country comparison. 40 percent of the financial market experts do not believe that the austerity measures will reduce the budget deficit successfully as they evaluate Romania's austerity measures to be either bad or very bad. 56 percent of the surveyed analysts predict the prospects of success to be good and only 4 percent evaluate them to be very good.

Figure A: Success of the austerity programs in each country




Source: ZEW

Figure B: Most effective long-term solution for reducing the budget deficit in the CEE countries




Source: ZEW

The results of the second part of the special question are very distinctive. A significant majority of 70 percent evaluate the cut in public administration and bureaucracy expenses to be the most effective long-term solution for reducing the budget deficit. Since this measure includes the single solutions reduction in pensions and cut in public wages, it is not surprising that the single measures receive only few answers, 4 percent and 1 percent of the survey participants, respectively. 10 percent and 9 percent of the analysts consider the reduction of social benefits or the rise of value-added tax as a long-lasting solution to the budget deficit problem. Only 3 percent of the financial market experts refer to the rise of personal income tax as the most effective solution. Some survey participants suggest further ways to improve the budget situation such as the reduction of corruption, improvement of Eurofunds usage, improvement of the tax collection and structural reforms on the expenses side.

*Melissa Li, Mariela Borell*

## ZEW-Financial Market Survey: August 2010

| Current economic situation | good | acceptable (normal) | bad | balance |
|---|---|---|---|---|
| Austria | 28,9 ( +11,1 ) | 60,0 ( -2,2 ) | 11,1 ( -8,9 ) | 17,8 ( +20,0 ) |
| Croatia | 9,3 ( +4,7 ) | 55,8 ( -1,0 ) | 34,9 ( -3,7 ) | -25,6 ( +8,4 ) |
| Czech Republic | 21,6 ( +3,3 ) | 70,6 ( +7,3 ) | 7,8 ( -10,6 ) | 13,8 ( +13,9 ) |
| Hungary | 3,7 ( +1,8 ) | 40,7 ( -5,5 ) | 55,6 ( +3,7 ) | -51,9 ( -1,9 ) |
| Poland | 31,4 ( +5,4 ) | 60,8 ( +6,8 ) | 7,8 ( -12,2 ) | 23,6 ( +17,6 ) |
| Romania | 8,5 ( +4,4 ) | 29,8 ( +9,4 ) | 61,7 ( -13,8 ) | -53,2 ( +18,2 ) |
| Slovakia | 18,7 ( +7,6 ) | 64,6 ( +4,6 ) | 16,7 ( -12,2 ) | 2,0 ( +19,8 ) |
| CEE | 14,0 ( +6,4 ) | 72,0 ( +0,8 ) | 14,0 ( -7,2 ) | 0,0 ( +13,6 ) |
| Eurozone | 15,7 ( +8,2 ) | 64,7 ( +0,5 ) | 19,6 ( -8,7 ) | -3,9 ( +16,9 ) |

| Economic expectations | improve | no change | worsen | balance |
|---|---|---|---|---|
| Austria | 47,7 ( +9,9 ) | 34,1 ( -14,8 ) | 18,2 ( +4,9 ) | 29,5 ( +5,0 ) |
| Croatia | 36,6 ( +15,7 ) | 51,2 ( -11,6 ) | 12,2 ( -4,1 ) | 24,4 ( +19,8 ) |
| Czech Republic | 44,0 ( +1,2 ) | 44,0 ( +1,1 ) | 12,0 ( -2,3 ) | 32,0 ( +3,5 ) |
| Hungary | 33,3 ( +0,6 ) | 56,9 ( +12,7 ) | 9,8 ( -13,3 ) | 23,5 ( +13,9 ) |
| Poland | 36,7 ( +0,7 ) | 53,1 ( +7,1 ) | 10,2 ( -7,8 ) | 26,5 ( +8,5 ) |
| Romania | 43,5 ( +15,8 ) | 39,1 ( +0,8 ) | 17,4 ( -16,6 ) | 26,1 ( +32,4 ) |
| Slovakia | 30,5 ( -11,7 ) | 56,5 ( +18,7 ) | 13,0 ( -7,0 ) | 17,5 ( -4,7 ) |
| CEE | 32,7 ( -1,3 ) | 55,1 ( +11,7 ) | 12,2 ( -10,4 ) | 20,5 ( +9,1 ) |
| Eurozone | 39,2 ( +5,3 ) | 37,3 ( -8,0 ) | 23,5 ( +2,7 ) | 15,7 ( +2,6 ) |

| Inflation rate | increase | no change | decrease | balance |
|---|---|---|---|---|
| Austria | 50,0 ( +15,1 ) | 45,2 ( -12,9 ) | 4,8 ( -2,2 ) | 45,2 ( +17,3 ) |
| Croatia | 38,5 ( -2,0 ) | 56,4 ( -0,7 ) | 5,1 ( +2,7 ) | 33,4 ( -4,7 ) |
| Czech Republic | 56,2 ( +7,2 ) | 37,5 ( -11,4 ) | 6,3 ( +4,2 ) | 49,9 ( +3,0 ) |
| Hungary | 40,8 ( +20,0 ) | 24,5 ( -17,2 ) | 34,7 ( -2,8 ) | 6,1 ( +22,8 ) |
| Poland | 46,7 ( +11,9 ) | 44,4 ( -3,4 ) | 8,9 ( -8,5 ) | 37,8 ( +20,4 ) |
| Romania | 47,7 ( -1,1 ) | 36,4 ( +3,8 ) | 15,9 ( -2,7 ) | 31,8 ( +1,6 ) |
| Slovakia | 56,5 ( +14,2 ) | 37,0 ( -16,3 ) | 6,5 ( +2,1 ) | 50,0 ( +12,1 ) |
| CEE | 50,0 ( +18,6 ) | 45,8 ( -18,9 ) | 4,2 ( +0,3 ) | 45,8 ( +18,3 ) |
| Eurozone | 43,5 ( +1,2 ) | 50,0 ( -1,9 ) | 6,5 ( +0,7 ) | 37,0 ( +0,5 ) |

| Short-term interest rates | increase | | no change | | decrease | | balance | |
|---|---|---|---|---|---|---|---|---|
| | [abs.] | [rel.] | [abs.] | [rel.] | [abs.] | [rel.] | [abs.] | [rel.] |
| Croatia | 23,6 ( -2,9 ) | 20,7 ( -3,5 ) | 73,5 ( +14,7 ) | 62,1 ( +10,4 ) | 2,9 ( -11,8 ) | 17,2 ( -6,9 ) | 20,7 ( +8,9 ) | 3,5 ( +3,4 ) |
| Czech Republic | 18,2 ( -15,9 ) | 13,1 ( -10,0 ) | 77,3 ( +15,9 ) | 55,3 ( +4,0 ) | 4,5 ( +/-0,0 ) | 31,6 ( +6,0 ) | 13,7 ( -15,9 ) | -18,5 ( -16,0 ) |
| Hungary | 18,2 ( +0,5 ) | 17,9 ( +2,9 ) | 43,2 ( -3,5 ) | 38,5 ( +1,0 ) | 38,6 ( +3,0 ) | 43,6 ( -3,9 ) | -20,4 ( -2,5 ) | -25,7 ( +6,8 ) |
| Poland | 46,5 ( -2,4 ) | 40,6 ( +8,1 ) | 46,5 ( +2,1 ) | 37,8 ( -12,2 ) | 7,0 ( +0,3 ) | 21,6 ( +4,1 ) | 39,5 ( -2,7 ) | 19,0 ( +4,0 ) |
| Romania | 35,9 ( +13,4 ) | 41,2 ( +17,7 ) | 48,7 ( +1,2 ) | 38,2 ( +5,8 ) | 15,4 ( -14,6 ) | 20,6 ( -23,5 ) | 20,5 ( +28,0 ) | 20,6 ( +41,2 ) |
| Eurozone | 43,7 ( +1,3 ) | | 54,2 ( +0,4 ) | | 2,1 ( -1,7 ) | | 41,6 ( +3,0 ) | |

| Long-term interest rates | increase | | no change | | decrease | | balance | |
|---|---|---|---|---|---|---|---|---|
| | [abs.] | [rel.] | [abs.] | [rel.] | [abs.] | [rel.] | [abs.] | [rel.] |
| Croatia | 24,2 ( -4,4 ) | 20,7 ( +0,7 ) | 48,5 ( +11,4 ) | 41,4 ( +8,1 ) | 27,3 ( -7,0 ) | 37,9 ( -8,8 ) | -3,1 ( +2,6 ) | -17,2 ( +9,5 ) |
| Czech Republic | 51,1 ( +5,6 ) | 18,0 ( +2,6 ) | 34,9 ( -6,0 ) | 48,7 ( -7,7 ) | 14,0 ( +0,4 ) | 33,3 ( +5,1 ) | 37,1 ( +5,2 ) | -15,3 ( -2,5 ) |
| Hungary | 37,2 ( +12,8 ) | 30,7 ( +12,5 ) | 39,5 ( +6,8 ) | 30,8 ( +3,5 ) | 23,3 ( -19,6 ) | 38,5 ( -16,0 ) | 13,9 ( +32,4 ) | -7,8 ( +28,5 ) |
| Poland | 33,4 ( +6,7 ) | 29,8 ( +14,4 ) | 33,3 ( -11,1 ) | 24,3 ( -19,3 ) | 33,3 ( +4,4 ) | 45,9 ( +4,9 ) | 0,1 ( +2,3 ) | -16,1 ( +9,5 ) |
| Slovakia | 54,8 ( -8,6 ) | 36,9 ( -6,4 ) | 38,1 ( +8,8 ) | 44,7 ( -1,2 ) | 7,1 ( -0,2 ) | 18,4 ( +7,6 ) | 47,7 ( -8,4 ) | 18,5 ( -14,0 ) |
| Germany | 51,1 ( +3,1 ) | | 40,0 ( -4,0 ) | | 8,9 ( +0,9 ) | | 42,2 ( +2,2 ) | |

| Stock market indices | increase | no change | decrease | balance |
|---|---|---|---|---|
| EURO STOXX 50 | 59,6 ( +14,2 ) | 21,4 ( -12,7 ) | 19,0 ( -1,5 ) | 40,6 ( +15,7 ) |
| ATX (Austria) | 61,6 ( +9,1 ) | 17,9 ( -9,6 ) | 20,5 ( +0,5 ) | 41,1 ( +8,6 ) |
| NTX (CEE) | 58,1 ( +14,2 ) | 23,3 ( -13,3 ) | 18,6 ( -0,9 ) | 39,5 ( +15,1 ) |
| CROBEX (Croatia) | 60,0 ( +23,4 ) | 30,0 ( -13,9 ) | 10,0 ( -9,5 ) | 50,0 ( +32,9 ) |
| PX 50 (Czech Rep.) | 53,5 ( +9,3 ) | 25,6 ( -4,6 ) | 20,9 ( -4,7 ) | 32,6 ( +14,0 ) |
| BUX (Hungary) | 56,8 ( +20,4 ) | 25,0 ( -6,8 ) | 18,2 ( -13,6 ) | 38,6 ( +34,0 ) |
| WIG (Poland) | 58,1 ( +14,0 ) | 23,3 ( -9,3 ) | 18,6 ( -4,7 ) | 39,5 ( +18,7 ) |
| BET (Romania) | 56,4 ( +25,7 ) | 23,1 ( -15,4 ) | 20,5 ( -10,3 ) | 35,9 ( +36,0 ) |
| SAX (Slovakia) | 43,9 ( +15,7 ) | 39,0 ( -9,7 ) | 17,1 ( -6,0 ) | 26,8 ( +21,7 ) |
| SBI 20 (Slovenia) | 47,2 ( +14,8 ) | 36,1 ( -8,0 ) | 16,7 ( -6,8 ) | 30,5 ( +21,6 ) |

| Exchange rates (vs. Euro) | appreciate | no change | depreciate | balance |
|---|---|---|---|---|
| Kuna (Croatia) | 14,6 ( -0,4 ) | 36,6 ( -5,9 ) | 48,8 ( +6,3 ) | -34,2 ( -6,7 ) |
| Koruna (Czech Rep.) | 40,8 ( -20,5 ) | 49,0 ( +26,6 ) | 10,2 ( -6,1 ) | 30,6 ( -14,4 ) |
| Forint (Hungary) | 44,9 ( -4,1 ) | 28,6 ( -0,8 ) | 26,5 ( +4,9 ) | 18,4 ( -9,0 ) |
| Zloty (Poland) | 62,5 ( +0,5 ) | 22,9 ( +2,9 ) | 14,6 ( -3,4 ) | 47,9 ( +3,9 ) |
| Lei (Romania) | 29,6 ( -10,4 ) | 54,5 ( +18,9 ) | 15,9 ( -8,5 ) | 13,7 ( -1,9 ) |
| US-Dollar | 44,3 ( +1,7 ) | 26,9 ( +6,5 ) | 28,8 ( -8,2 ) | 15,5 ( +9,9 ) |

Note: 70 Financial experts participated in the August survey which was conducted during the period 07/27/10-08/16/10. 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 July in parentheses). Balances refer to the differences between positive and negative assessments.

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