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Financial Market Report CEE

Volume 1 · Novenber 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 2 and 22 October 2007 are published in this issue of the "Financial Market Report CEE", November 2007. 70 financial market experts participated in this month's survey.

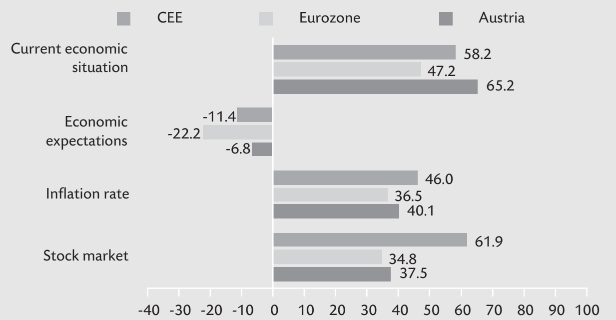
Economic Expectations for CEE Region Resume Downward Trend

In October, the results of the survey among financial market experts conducted by the ZEW, the Centre for European Economic Research, Mannheim, supported by Erste Bank der oesterreichischen Sparkassen, Vienna, indicate a resumed downward trend of the economic expectations for the CEE region after interruption in the previous month. The rating of the current economic situation in the CEE countries has improved, however. For Austria, the pessimistic expectations for economic development also prevail combined with a positive assessment of the current situation.

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 declined markedly this month. The drop of the balance by 19.7 points overcompensates the interim increase of the September survey. Now the share of experts expecting a worsening of the economic development outweighs the share of experts forecasting an improvement. However, a considerable majority of 69.8 percent of respondents projects no change in the economic development of the Central and Eastern European region for the following six months. The assessment of the current economic situation for the CEE countries has improved slightly compared to the previous month's survey, the majority of financial market experts evaluates it as „good".

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

For Austria too, experts state pessimistic economic expectations on balance; the value of the indicator is still negative. However, this balance does not exhibit a downward trend anymore. On the contrary, the value has increased by 4.8 points compared to the September survey. The experts have not changed their assessment of the economic situation in Austria much (+3.8 points). For the Eurozone, financial market experts are more optimistic concerning the future economic development; the balance increased by 9.1 points. Also, more experts assess the current economic situation as "good".

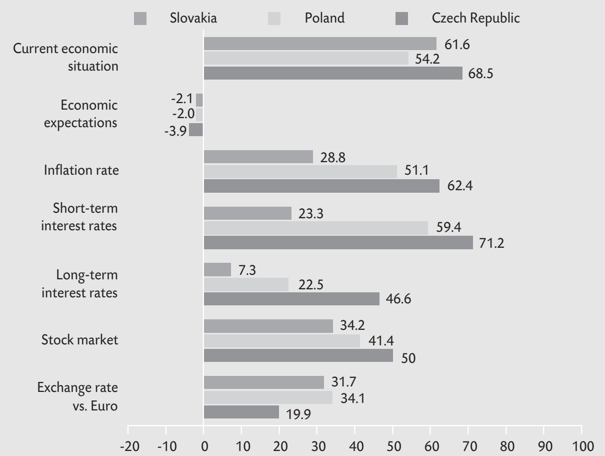
A comparison of the three economic regions shows the same qualitative picture. For Austria, the Eurozone as well as for the CEE region, the financial market experts assess the current situation as good, but economic expectations are rather pessimistic from the experts' point of view.

Inflation expectations for the Eurozone and especially Austria have increased markedly this month. The balance for the CEE countries also shows that the share of experts expecting rising inflation rates over the next six months outweighs the share assuming increasing rates. However, this value is lower compared to the previous month's survey.

The experts' stock market expectations are considerably more optimistic for the NTX than for the ATX and the Eurostoxx 50. Comparing the balances with their previous month's value, there is an increasing difference between the expert's assessments of the stock market developments. The balances for the ATX and the NTX have increased, whereas the balance of the Eurostoxx 50 has decreased.

Czech Republic, Poland, and Slovakia: Good situation, weaker economic 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

As in the previous surveys, the financial market experts attest the economies of the Czech Republic, Poland and Slovakia to be in a good state. There are some adjustments in the assessment, but the overall picture is quite the same as last month. For the Czech Republic, the experts assess the current economic situation better than last month whereas the balances for Slovakia and Poland have lost 14.5 and 11.8 points respectively. For economic expectations, all balances are negative indicating a higher share of experts projecting a worsening of the economic development than the share forecasting a further improvement of the economies. However, the balances are not very large and the majority of experts still does not expect any change at all for the further course of the business cycle development.

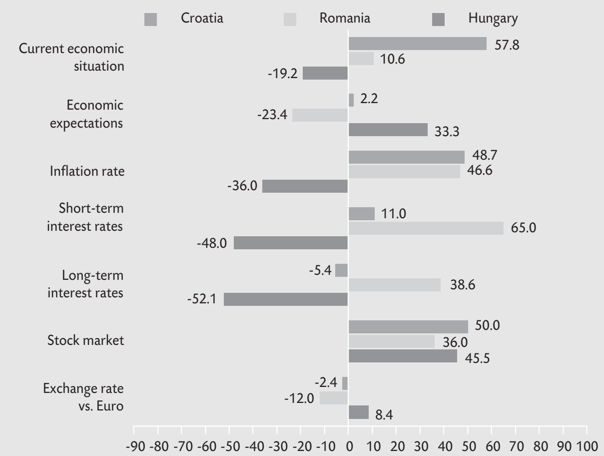
Financial experts see inflation risks to be on the upside for all three countries. The balances for inflation expectations are positive, with the Czech Republic showing the highest and Slovakia the lowest value. The same picture arises for the short-term as well as the long-term interest rate balances. For the Czech Republic, expectations for increasing interest rates are most pronounced and Slovakia shows the lowest balances. The assessments for the developments of long-term interest rates are quite the same compared to the previous month's survey, whereas the expectations for declining short-term interest rates in Slovakia have turned into expectations of increasing rates.

The participants of the survey are more optimistic for the stock market development in Poland and Slovakia; the balances are higher compared to the September survey. For the Czech Republic, the assessment has not changed compared to the previous month's survey.

The experts now expect all three currencies to appreciate against the Euro over the next six months on balance. The most noticeable change occurred for the Czech Koruna. Last month, depreciation expectations prevailed, while in the October survey, experts forecast an appreciation on balance.

Croatia, Hungary, and Romania: Mixed situation, mixed outlook

Indicators for Croatia, Hungary, and Romania



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

The financial market experts still assess the current economic situation in Croatia much better than in Romania and Hungary. The economic expectations for Croatia are more optimistic. In this month, the share of experts forecasting an improved economic development in the next six months exceeds the share of experts forecasting a worsening of the Croatian economy. For Hungary, the experts expect an improvement in the middle term on balance whereas the balance of economic expectations for Romania is markedly negative.

The qualitative picture for inflation expectations did not change compared to the September survey. The experts forecast rising inflation in Croatia and Romania, but expect lower inflation rates for Hungary within six months' time. For the short-term interest rate, the balances are positive for Croatia and Romania again and negative for Hungary. For Croatia, more experts forecast rising short-term interest rates on balance and for Romania, the expectations of rising short-term rates is even more pronounced compared to last month's survey. The expectation of lower Hungarian short-term interest rates is more contained than in the September survey. The qualitative picture for long-term interest rates did not change for the three countries.

The experts' expectations with regard to the stock market development are optimistic. For Croatia, their expectations did not change, and for Hungary and Romania their forecasts improved for the respective stock market indices. Financial market experts apparently expect that the current upward trend of the CROBEX and the BUX will continue and the current sideward movement of the BET will change into a rise during the next six months.

The experts project the exchange rate development for the three currencies to differ from one another. For the exchange rate against the Euro, the survey participants expect the Kuna and the Lei to appreciate on balance whereas they project the Hungarian Forint to depreciate.

Special Question: Further Assessment of the US Subprime Crisis

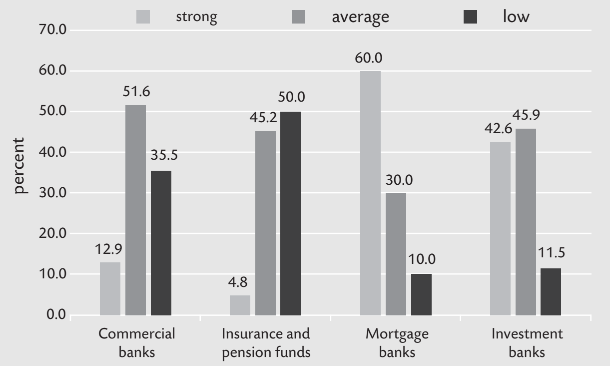
The U.S. subprime crisis is still the most worrisome issue for financial investors around the globe. Therefore, this month's special question is concerned with the further assessment of the crisis. Financial markets around the world are still trying to cope with the illiquidity of certain assets and resulting problems of ascertaining their market value. Uncertainty prevails about how much this will affect commercial banks and the real economy. So far, only central banks have actively tried to counter the subprime crisis. But on October 15th three of the largest private banks (Citigroup, JP Morgan Chase and Bank of America) announced their plan of setting up a new fund, designed to buy back highly rated but illiquid assets from so-called structured investment vehicles (SIVs). SIVs, e.g. hedge funds, borrow in order to invest in higher yielding assets. They have been especially hit by the illiquidity of their assets and further negative effects could hit the financial markets and, ultimately, the economy. We will have to see whether this fund will be implemented as planned and whether it will be a success.

Besides the efforts of the financial sector itself to cope with the effects of the subprime crisis, it is of special interest how the effects are distributed across different types of financial intermediaries. The financial market experts are asked to assess how different kinds of financial institution are affected by the subprime crisis (see Figure 4a). Not surprisingly, the experts expect the strongest influence on mortgage banks. Also, investment banks seem to be exposed to the risks emanating from the subprime crisis; 43 percent of the respondents say that the influence on this type of bank might be strong and 46 percent of the answers indicate an average influence. The financial market experts assess the risk for commercial banks as well as insurance companies and pension funds to be rather contained. Especially for the latter, 50 percent of the respondents assess the risk of an negative impact of the crisis to be low.

Most of the experts think that effects of the subprime crisis will surface for lesser than a year from now (see Figure 4b). However, still 12 percent of the experts forecast that the effects will be felt in the financial system longer than one year. This is a considerable time span and makes clear that the uncertainty with regard to the distribution of risks from mortgage backed securities as well as the liquidity shortages and loss of confidence within the financial sector should not be underestimated.

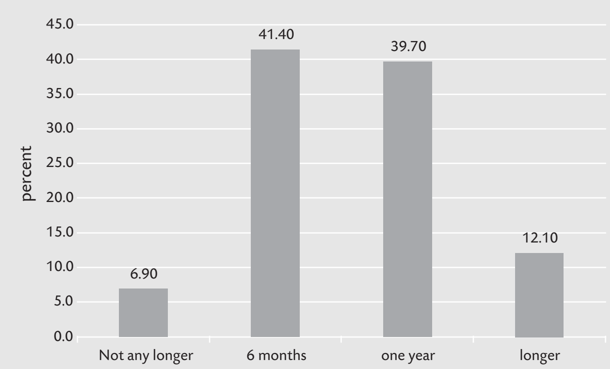
There is a discussion going on about the role of central banks in acting as a lender of last resort to troubled banks and about the regulation of the financial system as a whole with regard to ensuring liquidity and solvency. Especially the liquidity issue is now in the focus of attention. The Federal Reserve and the European Central Bank acted swiftly by providing liquidity to the market and cutting, respectively not rising, policy rates. The Bank of England had to take criticism in first denying additional liquidity and then giving in and providing liquidity to the market. The Bank of Japan took also part in the liquidity providing actions and did not raise interest rates in August as it was expected by financial markets. Japanese policy rates were also not changed in September and October. The financial market experts are asked to assess the behaviour of these central banks to cope with the crisis (see Figure 4c). Apparently, the Federal Reserve and the ECB get good grades. Almost 50 percent of the experts rate the behaviour of the Fed as "good". For the ECB, the assessments are a bit more spread with 36 percent of experts saying that the ECB acted "good" and 39 percent of the answers stating "satisfying" actions. For the Bank of England and the Bank of Japan, the picture is more skewed towards "satisfying".

Figure 4a: Distribution of effects within the financial sector



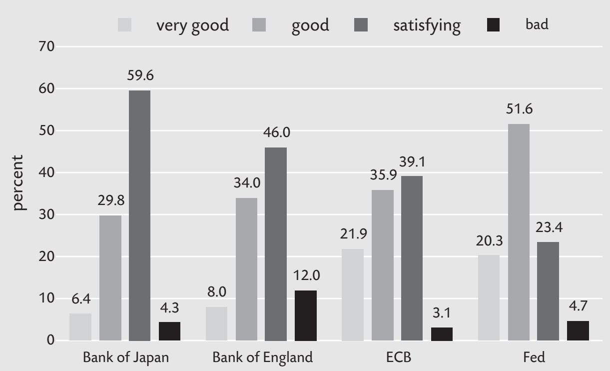
Answers of the participants of the Financial Market Survey CEE Source: ZEW

Figure 4b: Time horizon of possible subprime crisis effects



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

Figure 4c: Performance of major central banks



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

ZEW-Financial Market Survey: October 2007

Current economic situation	good		acceptable (normal)		bad		balance	
Austria	65.2	(+3.8)	34.8	(-3.8)	0.0	(+/-0.0)	65.2	(+3.8)
Croatia	57.8	(+4.6)	42.2	(-2.5)	0.0	(-2.1)	57.8	(+6.7)
Czech Republic	70.5	(+6.0)	27.5	(-3.8)	2.0	(-2.2)	68.5	(+8.2)
Hungary	7.7	(+3.7)	65.4	(+7.4)	26.9	(-11.1)	-19.2	(+14.8)
Poland	62.5	(-3.5)	29.2	(-4.8)	8.3	(+8.3)	54.2	(-11.8)
Romania	25.5	(-4.0)	59.6	(+9.6)	14.9	(-5.6)	10.6	(+1.6)
Slovakia	65.9	(-10.2)	29.8	(+5.9)	4.3	(+4.3)	61.6	(-14.5)
CEE	58.2	(+2.2)	41.8	(-2.2)	0.0	(+/-0.0)	58.2	(+2.2)
Eurozone	47.2	(+13.9)	52.8	(-11.8)	0.0	(-2.1)	47.2	(+16.0)

Economic expectations	improve		no change		worsen		balance	
Austria	8.8	(-0.5)	75.6	(+5.8)	15.6	(-5.3)	-6.8	(+4.8)
Croatia	16.2	(+3.4)	69.8	(-0.4)	14.0	(-3.0)	2.2	(+6.4)
Czech Republic	11.8	(+5.5)	72.5	(-8.4)	15.7	(+2.9)	-3.9	(+2.6)
Hungary	45.1	(-9.8)	43.1	(+13.7)	11.8	(-3.9)	33.3	(-5.9)
Poland	18.4	(+5.6)	61.2	(-2.6)	20.4	(-3.0)	-2.0	(+8.6)
Romania	14.9	(+5.6)	46.8	(+2.6)	38.3	(-8.2)	-23.4	(+13.8)
Slovakia	12.8	(+1.9)	72.3	(-10.3)	14.9	(+8.4)	-2.1	(-6.5)
CEE	9.4	(-11.1)	69.8	(+2.5)	20.8	(+8.6)	-11.4	(-19.7)
Eurozone	11.1	(+4.9)	55.6	(-0.7)	33.3	(-4.2)	-22.2	(+9.1)

Inflation rate	increase		no change		decrease		balance	
Austria	44.5	(+18.3)	51.1	(-15.6)	4.4	(-2.7)	40.1	(+21.0)
Croatia	58.5	(+19.0)	31.7	(-19.5)	9.8	(+0.5)	48.7	(+18.5)
Czech Republic	68.7	(+3.5)	25.0	(-7.6)	6.3	(+4.1)	62.4	(-0.6)
Hungary	26.0	(+8.0)	12.0	(+/-0.0)	62.0	(-8.0)	-36.0	(+16.0)
Poland	62.2	(-0.9)	26.7	(-3.7)	11.1	(+4.6)	51.1	(-5.5)
Romania	64.4	(-1.4)	17.8	(+0.7)	17.8	(+0.7)	46.6	(-2.1)
Slovakia	44.4	(+20.0)	40.0	(-28.9)	15.6	(+8.9)	28.8	(+11.1)
CEE	50.0	(+/-0.0)	46.0	(-4.0)	4.0	(+4.0)	46.0	(-4.0)
Eurozone	42.3	(+8.9)	51.9	(-6.4)	5.8	(-2.5)	36.5	(+11.4)

Short-term interest rates	increase				no change				decrease				balance			
	[abs.]		[rel.]		[abs.]		[rel.]		[abs.]		[rel.]		[abs.]		[rel.]	
Croatia	27.7	(+8.2)	8.6	(-15.0)	55.6	(-5.5)	71.4	(+12.6)	16.7	(-2.7)	20.0	(+2.4)	11.0	(+10.9)	-11.4	(-17.4)
Czech Republic	75.6	(-0.6)	44.2	(-7.0)	20.0	(-1.4)	37.2	(+12.8)	4.4	(+2.0)	18.6	(-5.8)	71.2	(-2.6)	25.6	(-1.2)
Hungary	18.7	(+8.5)	10.9	(+2.2)	14.6	(+6.4)	13.0	(+2.1)	66.7	(-14.9)	76.1	(-4.3)	-48.0	(+23.4)	-65.2	(+6.5)
Poland	64.2	(-0.9)	48.7	(-1.3)	31.0	(+3.1)	41.5	(+1.5)	4.8	(-2.2)	9.8	(-0.2)	59.4	(+1.3)	38.9	(-1.1)
Romania	72.5	(+14.1)	57.9	(-2.1)	20.0	(-13.3)	31.6	(+3.0)	7.5	(-0.8)	10.5	(-0.9)	65.0	(+14.9)	47.4	(-1.2)
Slovakia	25.6	(+16.1)	21.9	(+0.8)	72.1	(-6.5)	61.0	(+8.4)	2.3	(-9.6)	17.1	(-9.2)	23.3	(+25.7)	4.8	(+10.0)
Eurozone	40.4	(+9.0)			48.1	(-2.9)			11.5	(-6.1)			28.9	(+15.1)		

Long-term interest rates	increase				no change				decrease				balance			
	[abs.]		[rel.]		[abs.]		[rel.]		[abs.]		[rel.]		[abs.]		[rel.]	
Croatia	21.6	(+15.7)	17.2	(+2.0)	51.4	(-19.2)	57.1	(+5.6)	27.0	(+3.5)	25.7	(-7.6)	-5.4	(+12.2)	-8.5	(+9.6)
Czech Republic	55.5	(-17.0)	45.2	(-0.9)	35.6	(+13.1)	50.0	(+6.4)	8.9	(+3.9)	4.8	(-5.5)	46.6	(-20.9)	40.4	(+4.6)
Hungary	13.1	(+/-0.0)	11.4	(-2.0)	21.7	(+/-0.0)	15.9	(+2.6)	65.2	(+/-0.0)	72.7	(-0.6)	-52.1	(+/-0.0)	-61.3	(-1.4)
Poland	35.0	(-3.4)	27.1	(-12.9)	52.5	(+1.2)	45.9	(+13.4)	12.5	(+2.2)	27.0	(-0.5)	22.5	(-5.6)	0.1	(-12.4)
Romania	56.5	(+11.3)	48.5	(+5.2)	25.6	(-0.2)	28.6	(+8.6)	17.9	(-11.1)	22.9	(-13.8)	38.6	(+22.4)	25.6	(+19.0)
Slovakia	19.5	(-6.8)	13.5	(-2.7)	68.3	(+5.1)	62.2	(+10.8)	12.2	(+1.7)	24.3	(-8.1)	7.3	(-8.5)	-10.8	(+5.4)
Germany	38.3	(-9.5)			48.9	(+16.3)			12.8	(-6.8)			25.5	(-2.7)		

Stock market indices	increase		no change		decrease		balance	
EURO STOXX 50	60.4	(-7.9)	14.0	(+1.8)	25.6	(+6.1)	34.8	(-14.0)
ATX (Austria)	60.0	(+4.4)	17.5	(-1.9)	22.5	(-2.5)	37.5	(+6.9)
NTX (CEE)	76.2	(+12.0)	9.5	(-8.4)	14.3	(-3.6)	61.9	(+15.6)
CROBEX (Croatia)	67.5	(+2.5)	15.0	(-5.0)	17.5	(+2.5)	50.0	(+/-0.0)
PX 50 (Czech Rep.)	64.3	(-3.2)	21.4	(+6.4)	14.3	(-3.2)	50.0	(+/-0.0)
BUX (Hungary)	61.4	(-1.3)	22.7	(+8.7)	15.9	(-7.4)	45.5	(+6.1)
WIG (Poland)	63.4	(+6.9)	14.6	(-3.3)	22.0	(-3.6)	41.4	(+10.5)
BET (Romania)	53.9	(+2.5)	28.2	(+9.3)	17.9	(-11.8)	36.0	(+14.3)
SAX (Slovakia)	50.0	(+7.1)	34.2	(-5.8)	15.8	(-1.3)	34.2	(+8.4)
SBI 20 (Slovenia)	61.1	(+11.2)	25.0	(-6.3)	13.9	(-4.9)	47.2	(+16.1)

Exchange rates (vs. Euro)	appreciate		no change		depreciate		balance	
Kuna (Croatia)	21.4	(+/-0.0)	54.8	(+7.2)	23.8	(-7.2)	-2.4	(+7.2)
Koruna (Czech Rep.)	35.5	(+15.5)	48.9	(+/-0.0)	15.6	(-15.5)	19.9	(+31.0)
Forint (Hungary)	29.2	(-6.8)	50.0	(+6.0)	20.8	(+0.8)	8.4	(-7.6)
Zloty (Poland)	50.0	(-1.1)	34.1	(+0.8)	15.9	(+0.3)	34.1	(-1.4)
Lei (Romania)	30.9	(-2.5)	26.2	(+4.8)	42.9	(-2.3)	-12.0	(-0.2)
Koruna (Slovakia)	43.1	(+1.3)	45.5	(+3.6)	11.4	(-4.9)	31.7	(+6.2)
US-Dollar	35.3	(+9.7)	23.5	(-2.0)	41.2	(-7.7)	-5.9	(+17.4)

Note: 70 Financial experts participated in the October survey which was conducted during the period 10/02/07-10/22/07. 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 September in parentheses). Balances refer to the differences between positive and negative assessments.

I M P R I N T

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