

Overview: In this week's showCASE, our experts look behind the scenes of Greece's "In Principle" bailout. They are also trying to establish whether Germany's housing market is already bubbling, or still just simmering.

The Greece's "In Principle" bailout

By: [Parvathy Annamalai](#), CASE Analyst

Greece may finally be facing some temporary relief in its long-running fiscal saga, albeit at the expense of European taxpayers. After a long game of "chicken" with the European Union (EU), on June 15th the International Monetary Fund (IMF) swerved first and acquiesced to the EU's demands by approving the bailout "in principle". This move finally unlocked bailout funds from the [EUR 86 billion-rescue package](#),



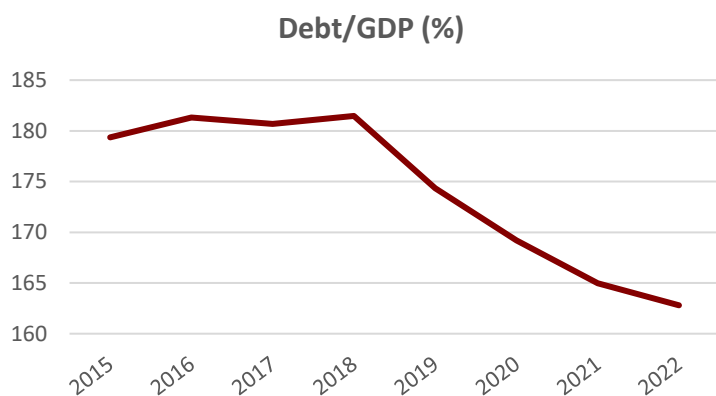
funds which are essential for Greece *Source: Reuters*

to continue fulfilling its domestic liabilities and fund a [EUR 8.5 billion](#) debt repayment in July.

Unfortunately, the recent bailout only serves as a tentative solution to avert any stress on the permanent ward of Eurozone, doing little to [guarantee the economic and financial sustainability](#) of Greece in the near term. Indeed, this is the third bailout for Greece since 2010 by the European Commission (EC), IMF, and the European Central Bank (ECB) – also sometimes referred to as the "Troika of Greek creditors" – to aid Greece in getting out of its crisis. Moreover, the revival of the Approval in Principle (AIP) procedure, last seen during the Argentinian debt crisis in the 1980s, points to the ambivalence the Fund has towards the financial reassurances coming from EU creditors.

Through the AIP, the IMF is saying both "yes" and "no" at the same time, as the approach slants towards policy endorsement without promising financial participation in the program. The recent use of the procedure aims at preventing an [impasse between Germany and the IMF](#), at least for now. Alternatively, the IMF would have to put further pressure on Germany, where [some parties are unwilling](#) to restructure Greece's debt in a fear of losing popularity, especially with elections looming in September. While the IMF would prefer not to be partially on-board with the bailout, [their main concern](#) is to get Greece back on the path of sustainable growth without having to [write off the debt](#) of the country. As such, the AIP aims to

approve and safeguard the reform process in Greece without any monetary disbursement from the side of the IMF and hopefully serve as an avenue to [catalyze a sustainable debt relief arrangement](#) between Greece and its creditors.



Source: IMF, World Economic Outlook Database (April 2017)

While recent pension cuts and tax increases have been greatly unpopular among Greeks, there is no doubt that Greece has improved its primary budgetary surplus, currently at [3.9% of GDP](#), up from [0.7%](#) in 2015. While the EC is very optimistic in its outlook for Greece maintaining this figure, the IMF questions the ability of Greece to continue on a path of [stringent fiscal expenditure](#) and repay its debt – currently at 180% of GDP – which, although forecasted to decline by the latter, will likely remain high in the coming years.

Clearly, as Christine Lagarde, the Managing Director of IMF emphasized, [more needs to be done in Greece in terms of debt sustainability](#), the so-called “second leg” of the bailout program. Extending loan maturities, deferring interest payments, and reducing interest rates, as the [proposal of the IMF](#) underscores, could be helpful but only in the short-run. If the goal is to get Greece back into the commercial debt market, a [write down of nearing maturity debt](#) would be a much better alternative, as the market is stalled; this is mainly due to the Greek [government’s lack of a coherent approach to the financial sector’s bad loans \(combined with deficiencies in tax collection and privatization of state-owned assets](#) in the country).

Lacking a credible debt restructuring plan and facing a huge (albeit admittedly declining) debt burden, the IMF has perhaps acquiesced to a third-best solution. Without addressing the root causes of Greece’s malaise, this approach may only be positioned to cajole stronger commitments to debt relief by European creditors for the *next* Greek bailout.

Germany's housing market – fears and challenges of an emerging bubble

By: [Anne-Christin Winkler](#), CASE Economist

Housing bubbles have resurfaced as a worry for governments worldwide but especially in Europe, where eight countries (Austria, Belgium, Denmark, Finland, Luxembourg, the Netherlands, Sweden, and the United Kingdom) received [warnings from the European Systemic Risk Board at the end of 2016](#). Although Germany was not one of the countries deemed to be at risk, the chief banking supervisor of the country's central bank (Bundesbank), Andreas Dombret, recently [expressed his concerns](#) that in fact Germany may be facing a similar challenge.

Housing bubbles are characterized by three distinct but overlapping phenomena: a credit expansion, often fueled by low interest rates, which then creates a rush into real estate and a concomitant increase in prices. Finally, with money plentiful, banks may lower their credit standards or cut back on due diligence, leading to even more money flowing into the real estate sector.

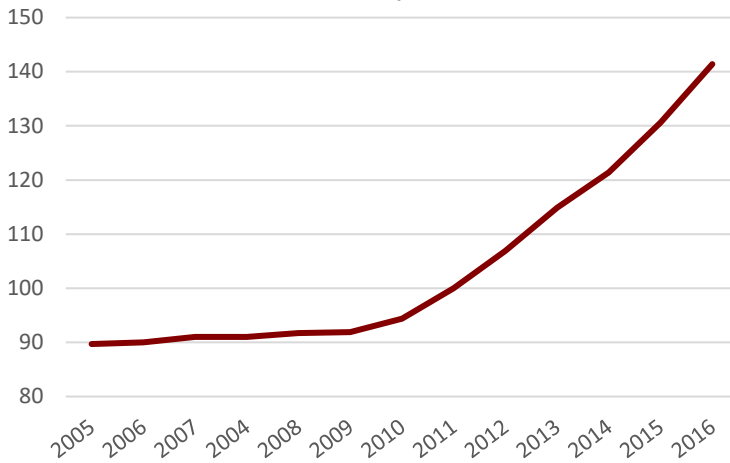
[Two years ago](#), when warnings about a rising bubble in Germany emerged, only the increase in real estate prices seemed to be a concern. This time around, however, soaring prices are just a part of the story (albeit admittedly an important one). The [Bundesbank index](#), which covers 127 cities in Germany, suggests that real estate prices have risen by almost 50% since 2010, with the increase accelerating over the past year from 4.5% to 6%. These increases can be partially



Source: Pixabay

explained by larger migration inflows and increased urbanization, leading to a higher demand for housing. Even though the construction sector is booming (as reported in [showCASE 29](#)), there is still demand to be satisfied, as only [around 53% of needed apartments have been built](#) between 2011 and 2015. Despite this increase in demand, however, the Bundesbank notes that the observed price increases have [outweighed any expected increase explained by the rising demand](#), leading to fears of a bubble.

Residential property price index in 127 German cities, 2010=100



Source: [Bundesbank](#).

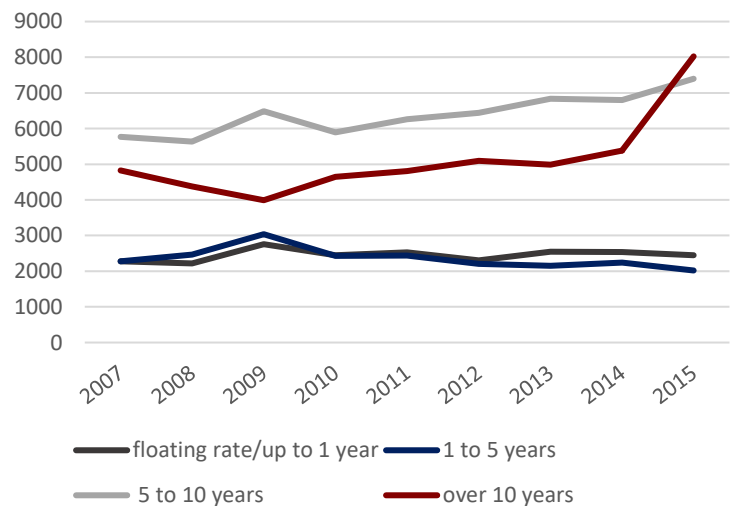
A look at Germany's credit boom in real estate makes these fears credible. The amount of real estate loans has been [increasing in Germany since 2009](#), with low interest rates a key driver. A mortgage at a fixed rate of only 0.94% over a period of ten years ([as offered by one of the major German lending banks](#)) opens the possibility of home ownership to a broad range of people. Since returns on savings and traditional retirement plans have ceased as a result of prolonged low interest rates, investing in a house has become an attractive alternative. Moreover, increased demand for real estate properties not only raises prices for new construction, it also feeds through to higher valuations of the existing housing stock.

As a result, real estate loans do not only surge in their amount, but also in their volume; additionally, household lending against the value of immovable assets also may increase.

While the credit boom is definitely underway in Germany, it is more difficult to draw a conclusion regarding bank credit standards. On the one hand, the results of the [Bank Lending Survey](#) suggest standards have been tighter since 2011 (although this finding is attenuated by data limitations). On the other hand, the profit margin of banks and financial institutions has been squeezed by low interest rates, and to compensate for this loss, increasingly [riskier conditions for loans are being accepted. This process has been](#) additionally fueled by inter-bank competition on the housing loans market. One consequence of this is a higher share of riskier long-term loans (as it can be seen in the Figure 2).

All of these factors have led the Bundesbank and the German Federal Financial Supervisory Authority to develop a stabilizing plan in order to tackle overvaluation in the housing market. According to the [IMF's appeal for a policy toolkit of 2014](#), raising interest rates could be a powerful measure to cool down the market on the side of monetary policy. However, Germany's room for maneuver is limited, as the European Central Bank (ECB) has been keeping inflation rates low in hope of accelerating growth. As a consequence, Berlin had to turn to alternative measures, such as allowing bank

Housing loans to households with varying initial periods of fixation of the interest rate (EUR mln)



Source: [Bundesbank](#).

supervisors to raise capital requirements for financial institutions, increase risk-weights, and – should financial stability be under threat – introduce the default ratio to the banking system leading recurrently to higher capital requirements.

Dombret might be therefore right in raising the state of alert even if there is no acute bubble in the housing market... yet. Indeed, the signs of an emerging bubble should not be underestimated, as the individual components of such a bubble are evident in the German housing market. However, ECB's policies make the Bundesbank's task considerably more difficult, and taking adequate steps to prevent the market from overheating in the face of loose money will be a daunting challenge.



This week: New data released by the Polish Central Statistical Office points to a significant increase in labour demand in the country. The number of vacancies in 2016 reached 89.3 thousand, roughly twice as many as in 2013, with almost 90% found in the private sector. The most sought-after professions in 2016 were manual workers and artisans, highly qualified specialists, and machine operators, in demand especially in Mazowieckie, Śląskie, and Wielkopolskie voivodships.

GDP (Q1 2017)

↑ **4.2% y/y (est.)**

Up from 2.9% in Q4

Inflation (May 2017)

↓ **1.9% y/y**

Down from 2.0% in Apr

Unemployment (May 2017)

↓ **7.4%**

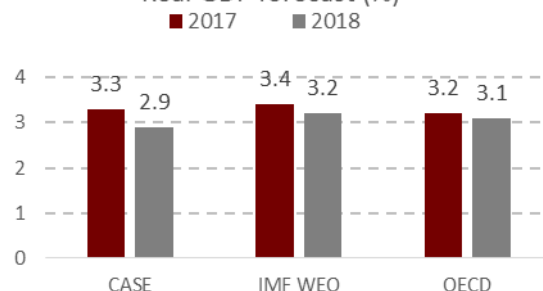
Down from 7.7% in Apr

NPB Base rate

1.5%

From 2% Mar 2015

Real GDP forecast (%)



This week: Russia reached its highest level of borrowing since 2013, with debt totaling USD 52 billion. A recent USD 3 billion sovereign bond sale contributed to a total of USD 17 billion worth of Russian bonds issued during 2017 alone; the sale also marked the first official offering since the return of the country to the international debt market in 2016. Russia's appetite for reserves is largely defensive, aimed at offsetting uncertainty linked to lower oil prices, geopolitics, and reduced market access in the event of new sanctions.

GDP (Q1 2017)

↑ **0.4% y/y**

Up from 0.3 in Q4

Inflation (May 2017)

↓ **4.1% y/y**

Down from 4.3% in Mar

Unemployment (May 2017)

↓ **5.2%**

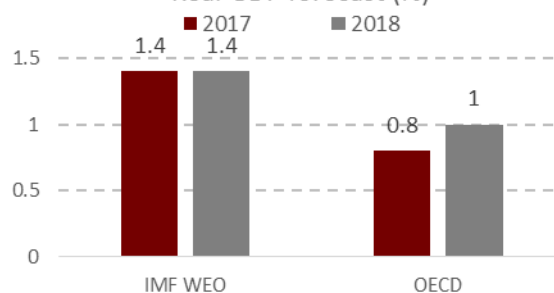
Down from 5.3% in Apr 2017

CBR Base rate

9%

Down from 9.25%

Real GDP forecast (%)



This week: German businesses are viewing the future optimistically. The Ifo Business Climate Index reached a new high this past month, climbing from 114.6 points in May to 115.1 points in June. While the index for construction fell, it was offset by a rise in manufacturing. Wholesaling and retailing attained their highest levels since September 2017 and 2015 respectively.

GDP (Q1 2017)

↓ **1.7% y/y**

Down from 1.8% in Q4

Inflation (June 2017)

↑ **1.5% y/y (est.)**

Up from 1.4% in May

Unemployment (May 2017)

↓ **3.7%**

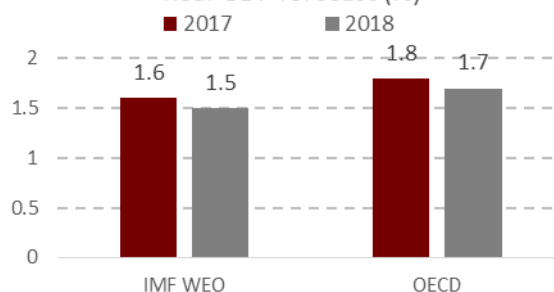
Down from 4.2% in April

ECB Deposit rate

-0.4%

From -0.3% Dec 2015

Real GDP forecast (%)





This week: Ukraine was severely affected in a cyber-attack that left its banks, airports, and plants (including the nuclear plant in Chernobyl) paralyzed for hours. While Ukraine was the primary target of the attack, the cyber contagion spread across the world, including to the EU and the US. The attack, which utilized Petya malware, was designed to terrorize rather than to ransom, and it is suspected originated in Russia.

GDP (Q1 2017)



2.5% y/y

Down from 4.7% in Q4

Inflation (May 2017)



13.5% y/y

Down from 12.2% in Apr

Unemployment (Q1 2017)



10.5%

Up from 10.0% in Q1

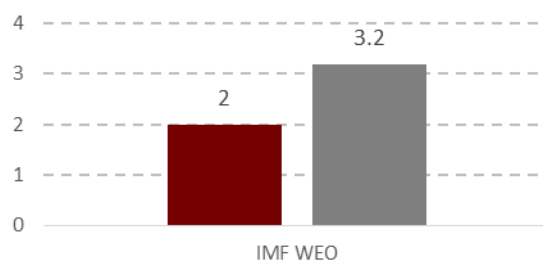
NBU Base rate

12.5%

From 13.0% in May

Real GDP forecast (%)

■ 2017 ■ 2018



This week: The financial market inflation expectations survey released by the Czech National Bank (CNB) shows that markets are optimistic and expect both the Czech GDP and nominal wages to increase, while also expecting inflation to rise as well. In other news, the CNB, as was expected, postponed plans to revise interest rates upward due to appreciation of the Czech koruna.

GDP (Q1 2017)



2.9% y/y

1.9% in Q4 2016

Inflation (May 2017)



2.4% y/y

Down from 2.0% in April

Unemployment (Q1 2017)



3.4%

Down from 3.6% in Q4

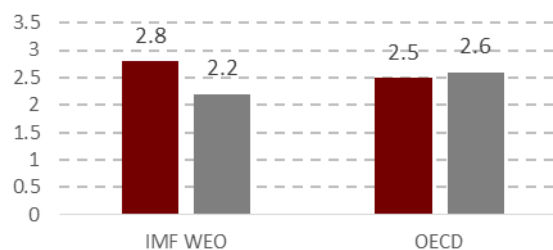
CNB Base rate

0.05%

Unchanged since Nov 2012

Real GDP forecast (%)

■ 2017 ■ 2018



This week: The Hungarian Central Statistical Office released data on external trade in goods; their report showed a 0.6% (y/y) terms of trade deterioration for April, which contributed to a 1.9% (y/y) drop in the value of exports and a 0.6% (y/y) drop in the value of imports. The trade surplus of the country also decreased, dropping to EUR 865 million from EUR 876 million in April 2016.

GDP (Q1 2017)



3.6% y/y (est.)

Up from 1.6% in Q4

Inflation (May 2017)



2.1% y/y

Down from 2.6% in Apr

Unemployment (Q1 2017)



4.5%

Up from 4.4% in Q4

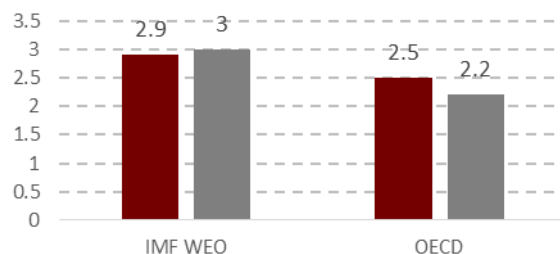
MNB Base rate

0.9%

From 1.05% May 2016

Real GDP forecast (%)

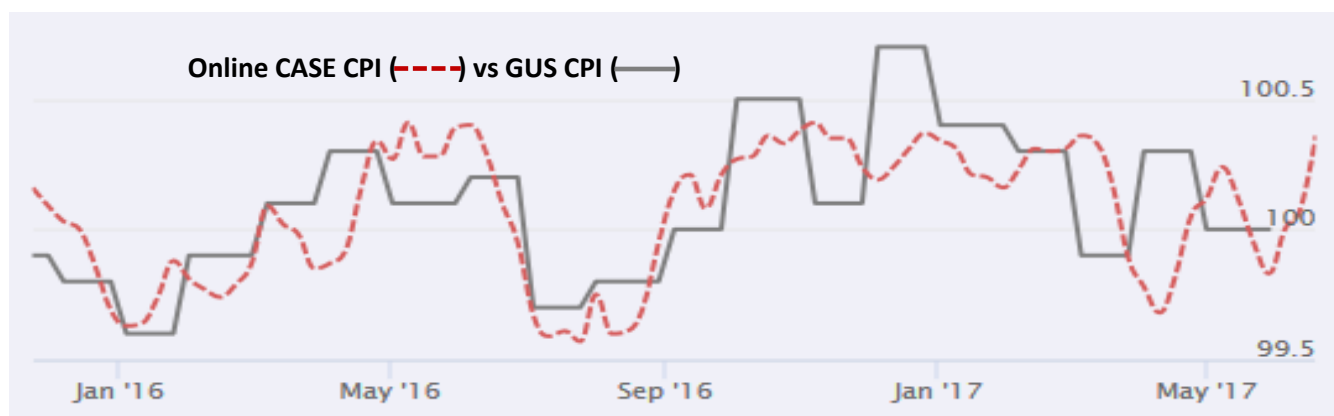
■ 2017 ■ 2018



The weekly online CASE CPI

The online CASE CPI is an innovative measurement of price dynamics in the Polish economy, which is entirely based on online data. The index is constructed by averaging prices of commodities from the last four weeks and comparing them to average prices of the same commodities from four weeks prior. The index is updated weekly.

Our weekly online CASE CPI



Monthly CASE forecasts for the Polish economy

Every month, CASE experts estimate a range of variables for the Polish economy, including future growth, private consumption, and foreign trade, current account balance, CPI, among others.

CASE economic forecasts for the Polish economy

(average % change on previous calendar year, unless otherwise indicated)

	GDP	Private consumption	Gross fixed investment	Industrial production	Consumer prices
2017	3.3	3.5	2.9	3.8	1.9
2018	2.9	3.0	2.7	3.7	2.0
	Nominal monthly wages	Merchandise exports (USD, bn)	Merchandise imports (USD, bn)	Merchandise trade balance (USD, bn)	CA balance (USD, bn)
2017	4.7	201.6	201.8	-0.2	-4.7
2018	3.5	211.3	213.1	-1.8	-5.9

For more information on our weekly online CASE CPI, please visit: <http://case-research.eu/en/online-case-cpi>
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