showCASE
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CASE – Center for Social and Economic Research

Overview: In this week's showCASE, our experts commemorate Germany's late Chancellor Helmut Kohl, looking into his political and economic legacy. They are also investigating the latest cyber-attack on Ukraine and its consequences both for the country and cyber security policies in general.

The Passing of a Giant and the EU's (Hollow) Core

By: *Christopher A. Hartwell, President of CASE Management Board*

Germany's larger-than-life former Chancellor Helmut Kohl passed away in mid-June but his legacy still looms large over the Union he so tirelessly championed. The architect of Germany's unification, EU expansion, the euro, and strong trans-Atlantic ties, Kohl was honored with an unprecedented ceremony in the European Parliament's chamber in Strasbourg in early July. The first person to lie in state, Kohl's casket was covered in only an EU flag while dignitaries from around Europe and globally offered their encomia for his leadership. But while the pomp and circumstance surrounding Kohl's ceremony may have been meant to signal a united Europe, the reality is far different. In fact, the Europe of today appears to have diverged from the idea of Europe which Helmut Kohl fought for.

Helmut Kohl in 1978. *Source:* Reuters

Born in 1930, Kohl represented a different generation of EU politicians, one who had lived through the dual horrors of fascism and communism and were instrumental in fighting the Cold War. Kohl 's passing means the last major Western Cold Warrior has left the stage, taking his place alongside Margaret Thatcher, Ronald Reagan, and Pope John Paul II once again. But even before his death at the age of 87, Europe and the world had been changing rapidly, with the some of the changes due to Kohl's own efforts. For example, in the years since Kohl left Germany's political scene in 1998, the EU has transformed itself from a common market allowing the free movement of goods and people into a tighter union, based on a common currency.

Indeed, since the global financial crisis started in 2007, the EU been consumed with the Euro project almost to the exclusion of all else. Serious flaws in the currency's design, exposed by Greece and with cracks continuing to appear due to Italy and Spain, have not deterred EU policymakers from an almost-fanatical dedication to "ever greater integration." This approach has focused on pushing more integration schemes across-the-board, whether in capital markets, banking, or fiscal rules, rather than addressing the root causes of the Euro's issues, including the wide disparities amongst Eurozone members or the self-defeating policies of the European Central Bank (ECB). Economically, while the Eurozone is finally showing signs of life ten years after the global crisis begun, the structural issues that continue to plague the region remain, and the liberalization Europe needs has been done only haltingly.

This failure to deliver growth has opened the door for many issues which did not exist when Kohl was Chancellor; with a narrow focus on the euro and redressing macroeconomic imbalances, the EU has been blindsided by a refugee crisis, Russia's invasion of Ukraine, Brexit, and the rise of populism. Unfortunately, while the response to these issues has also been "more integration," it is just this integration which has fueled the fire. The immigration crisis, in which Germany took a lead role in setting the EU's policies, created a huge backlash in the eastern members of the EU and the UK and set the stage for the rise of populist parties. Similarly, Russia's invasion of Ukraine, seen as a major threat by these same countries in the east, has been confronted with milquetoast sanctions (and a continuous push by German businesses and the German left, as well as the French Assembly, to drop those same sanctions). While Kohl also hoped that European integration would lead to a common security and foreign policy in Europe, Russia's moves in the Eastern Neighborhood have exposed a decided lack of unity between western and eastern EU members.

It is this reality that is perhaps the biggest challenge to Kohl's vision, and that is the fact that the EU has been becoming a two-speed Europe ever since the Euro was introduced. With countries such as Poland delaying Euro accession, perhaps forever, and with worries about national sovereignty in economic and other policies across Central Europe, it appears that the Franco-German axis appears to have the last say in the EU. Despite Kohl's push to forge a strong European core via the Franco-German alliance, Kohl's championing of EU enlargement was never meant to let Poland, Hungary, or Slovenia into the EU only to have them relegated to the back of Europe's bus. The impression that Kohl left on the region was apparent during his ceremony in Strasbourg, as Central and Eastern European leaders showed up in force to praise his legacy and perhaps send their own message about the desirability of a two-speed Europe.

Of course, the irony in all of this posturing is that Europe already is "two-speed," but the speeds are not delineated by the euro ins and outs, but by growth. In that sense, Central and Eastern Europe is the first speed and the rest of the continent is the slower track. Bulgaria, Poland, the Czech Republic, Slovakia, and Croatia all far outpace the EU average, show much more dynamism in their economies (in spite of their governments), and (for the most part) are much more forward-looking in their external economic policies. Perhaps then, this is Kohl's greatest accomplishment, in unlocking the potential that existed in these economies by shepherding them into the EU's legal and institutional structure. Whether these institutional structures can survive the latest round of existential challenges and even more integration remains to be seen; as Kohl himself said, "*Entscheidend ist, was hinten rauskommt*" (what is important is what remains at the end).

Money is not always the answer. What do we know about latest cyber-attack on Ukraine

By: *Givi Gigitashvili,* CASE Analyst

A message related to the Petya ransomware. *Source*: Reuters

A wave of 'unprecedented' cyber-attacks hit Ukraine last week, targeting state institutions, banks, underground network, major firms, and airports, and causing disruptions on a massive scale. From the outset, the NotPetya virus seemed to be a typical ransomware attack, encrypting important files in infected computers and requiring victims to pay in exchange for decrypting their blocked files. However, it soon appeared that the attackers merely wanted to disguise their virus as a ransomware in order to mislead the public and media and hide their real intentions. What was the real rationale behind the attack?

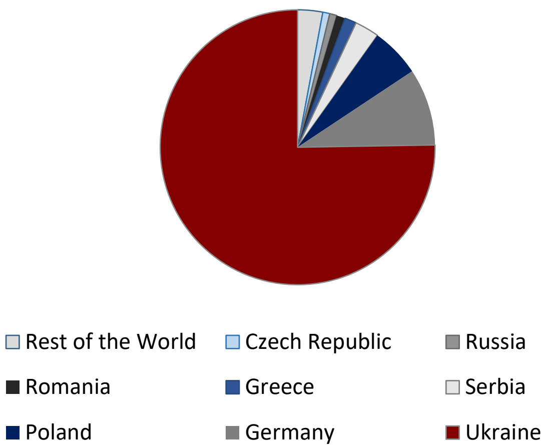
Although a full investigation will take months (and whether any definite results will be reached remains doubtful), two things are already certain: first, the attack was primarily aimed at Ukraine. Despite the virus spreading to 65 countries, 75.2% of all infected computers in the world could be found in Ukraine (Cisco's Talos cyber security division asserted that the other 24.8% were merely "collateral damage," as, like a real virus, hackers are unable to completely control the virus once launched). Government officials estimated that one in every ten computers at private companies and state offices in Ukraine was hit by the virus, which was seeded through a Ukrainian accounting software M.E.Doc, used by 80% of state institutions and businesses in the country. Ukrainian sources have estimated that this attack would have far-reaching economic effects, costing Ukraine 0.5% of GDP for this year.

The second peculiar aspect of the attack is that it appears it was not motivated by financial gain. Experts agree that NotPetya is a destructive "wiper" malware designed to destroy data and disrupt the workflow of state and business institutions rather than a ransomware created for financial gains. One of the clues that led them to this conclusion was the payment mechanism the virus routed users to, which, for such a well-engineered malware, looked far too amateurish. For instance, the ransom note generated by the virus contained the same payment address for every victim, whereas typically a customized address is created for every victim separately. Moreover, victims were required to contact the attackers to send confirmation of payment to a single "customer service" email, which was immediately shut down by the German provider

Posteo once they learnt about the attack. Consequently, it was technically impossible for the victims who made the required payment to contact attackers in order to receive the decryption key to unlock blocked files.

Furthermore, as the Tallinn-based NATO Cooperative Cyber Defense Centre of Excellence suggested last week, the attack itself was so expensive and complex that it would impossible for individual hackers to launch it. Based on available data, including that obtained from international antivirus companies, the Ukrainian state security service argued last week that the attack was organized by the same hackers who were involved in the cyber-attack against Ukrainian power grid in December 2016.

All computers infected by the virus



Source: Gordonua.com

Amidst the attack, NATO Secretary General Jens Stoltenberg claimed that, since the Warsaw NATO summit last year, cyber space has become a "military domain;" NATO member countries also agreed that cyber-attacks against any member of the alliance would trigger the mutual defense clause in the same way as a conventional military assault. This constitutes a major change in NATO policy as past cyber-attacks – partially due to their novelty – were not treated as seriously. Indeed, when Russia unleashed a series of large-scale cyber-attacks against NATO member Estonia back in 2007, the alliance did not enact its mutual defense clause. It appears that the threshold for such an enactment would need to be high, and merely affecting companies operating in many NATO member countries is not a reason enough to enact Article 5 of the Washington Treaty. In reality, the consequences of cyber-attack would have to be equivalent of an armed attack.

Despite the growing support for the theory that the attack was orchestrated by state actors (and suspicions on who the state in question might be), NATO-led countermeasures for this particular attack may never happen. Failure to act may send a clear message to the attackers – you are free to violate a country's sovereignty as long as you do it online. Such an eventuality could create grave disruptions for the global economy, and the NotPetya virus should serve as a wake-up call for the need for increased cyber-security. If such an investment is not made, the next cyber-attack could have as its main targets other European countries or even NATO members.

This week: The highly-publicized visit of US President Donald Trump to Poland did not result in any major shift in bilateral economic relations. While promises have been made regarding prospective liquified natural gas (LNG) deliveries to Poland, no details have been agreed on and no contracts have been signed so far. Although experts admit that the stop-over in Poland might have attracted the attention of investors, it remains to be seen if any results will materialize.

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)

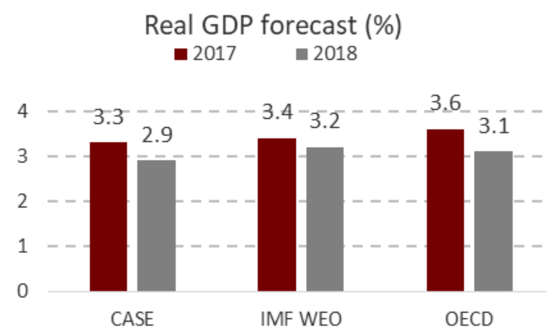
7.4%

Down from 7.7% in Apr

NPB Base rate

1.5%

From 2% Mar 2015



This Week: The Russian Direct Investment Fund and China Development Bank signed an agreement to set up a joint investment Russia-China RMB Cooperation Fund. The fund will be worth USD10 billion and aims to finance cross-border infrastructure projects as part of China's Belt and Road and Russia-led Eurasian Economic Union initiatives. The fund intends to facilitate the establishment of a simplified framework for direct investments with settlements in national currencies.

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)

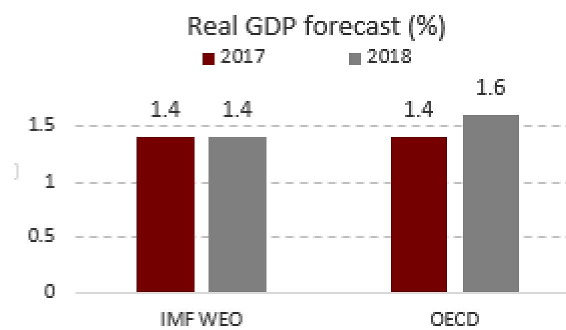
5.2%

Down from 5.3% in Apr 2017

CBR Base rate

9 %

Down from 9.25%



This week: The employment rate in Germany continues to improve as the number of employees in May grew to EUR44.1 million (a 1.5% increase since April), reaching a peak since reunification in 1989. However, the Bundesbank current monthly report, despite maintaining a positive outlook for the economy in the medium term (growing exports and rising corporate investment), notes that rising wages may impair the strength of economic growth in coming years.

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)

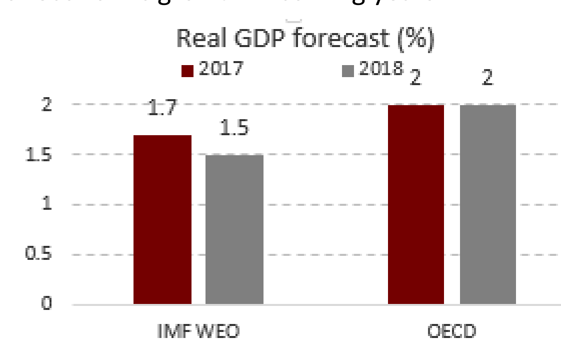
3.7%

Down from 4.2% in April

ECB Deposit rate

-0.4%

From -0.3% Dec 2015



This week: Ukraine plans to implement a much-needed pension reform by September 2017, according to Ukraine's Finance Minister Oleksandr Danyluk. The prime feature of the reform will be an increase in the retirement age. Currently, on average, men retire at 58.5 and women at 56 (compared to the EU average of 63.6 and 62.6 respectively). Presently, there are 12 million pensioners in Ukraine (nearly 30% of the population), putting the system's sustainability at risk.

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)

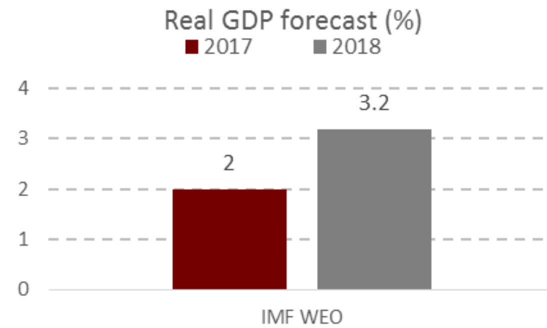
10.5%

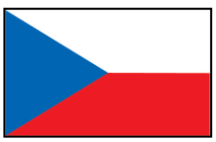
Up from 10.0% in Q4

NBU Base rate

12.5%

From 13.0% in May





This week: According to preliminary data, exports in the Czech Republic in May grew by 10.2% (to CZK 309.3 billion) and imports by 11.9% (to CZK 295.0 billion) y-o-y, its second-highest growth in history. The positive trade balance has been largely influenced by the growth of car exports, driven by a steady recovery of demand in Germany and the rest of the EU. It is anticipated that this surge in exports will continue to favorably influence the country's growth in the short- to medium-term.

GDP (Q1 2017)

3.0% y/y

Up from 1.9% in Q4 2016

Inflation (May 2017)

2.4% y/y

Down from 2.0% in April

Unemployment (Q1 2017)

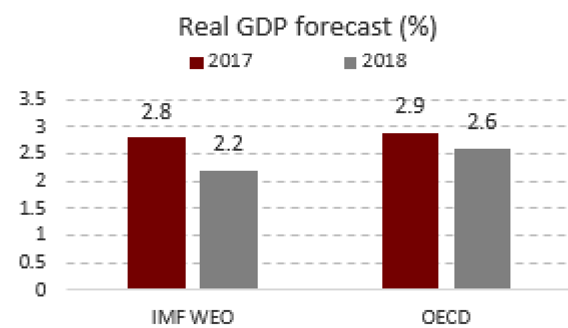
3.4%

Down from 3.6% in Q4

CNB Base rate

0.05%

Unchanged since Nov 2012



This week: The Hungarian National Trading House (MNKH) held a Hungarian-Egyptian Business Forum, where Egyptian President Abdel Fattah al-Sisi and Hungary's Prime Minister Viktor Orban discussed ways to consolidate economic cooperation and boost trade exchange between the two countries. Agriculture, industry and energy were mentioned as priority fields for the future cooperation.

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)

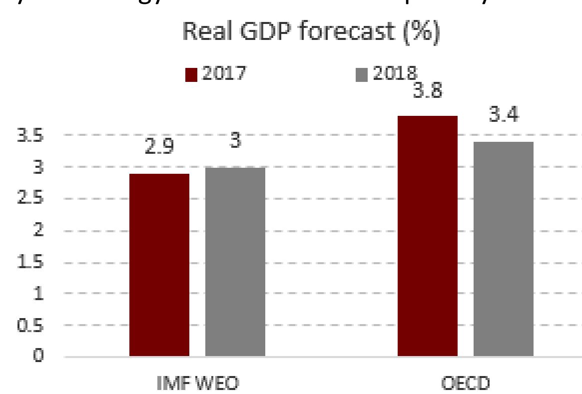
4.4%

Down from 4.6% in Q4

MNB Base rate

0.9%

From 1.05% May 2016

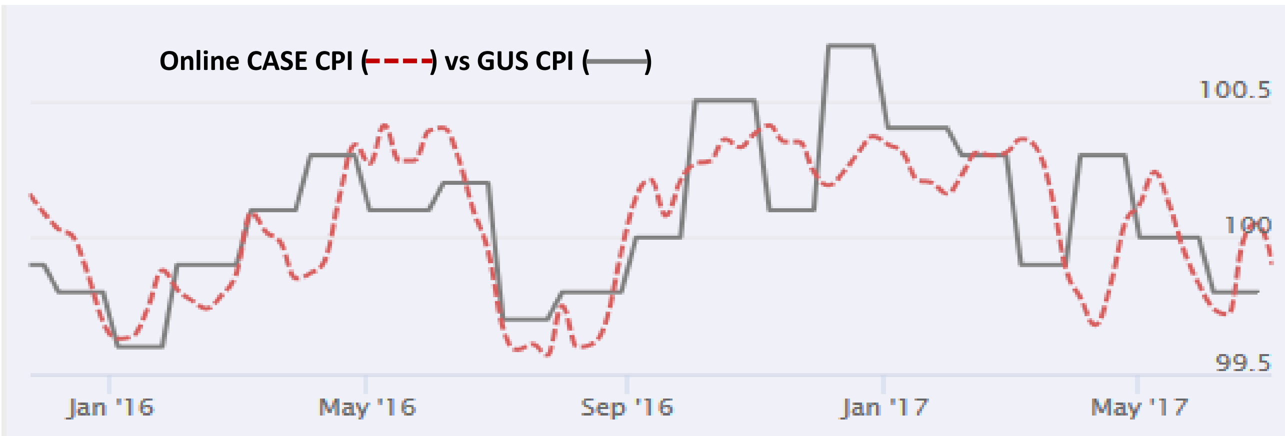


Other CASE products

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

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