showCASE
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Overview: In this week's showCASE, our experts discuss the importance of the recently sealed Japan-EU Economic Partnership Agreement. They also examine France's dilemma between sustainable budgeting and the country's addiction to large public spending.

The Japan-EU Economic Partnership Agreement: an apparent win-win situation in the making

By: *Parvathy Annamalai*, CASE Analyst

After four difficult years of negotiations and eighteen rounds of (in)tense talks, two of the world's largest economies, the European Union (EU) and Japan, finally came to a consensus regarding the main elements of the planned Japan-EU Economic Partnership Agreement (JEEPA). After EU Trade Commissioner Cecilia Malmström and Japanese foreign minister, Fumio Kishida, sealed the deal through a symbolic exchange of Japanese Daruma dolls (symbolizing fortune and resolution), Japanese Prime Minister Shinzo Abe, European Council President Donald Tusk, and European Commission (EC) President Jean-Claude Juncker provisionally signed the agreement just before this year's G20 summit. Some details of the pact still need to be further negotiated and then approved by both sides (in case of the EU – all its Member States), but it is hoped that JEEPA will come into effect starting from early 2019.

The importance of this agreement rests on its participants, as the EU and Japan together account for approximately one-third of the global economy. Currently, the EU is Japan's second biggest trading partner (and Japan is sixth with the EU), and JEEPA is expected to increase flows of both goods and services between the two regions, while also providing new investment opportunities. If wholly ratified, JEEPA would create the largest trading bloc in the world, on par with the North American Free Trade Agreement (NAFTA) led by the US

The agreement has a long list of areas in which tariff-free trade would become a reality from 2019 onward, with the main focus on slashing tariffs on cars and agricultural products. The Japanese government is obliged to reduce tariffs on EU's cheese and agricultural exports over the next ten to fifteen years and in return, the EU will phase out its 10% import duty on Japanese automobiles by the end of 2024. Additional benefits include allowing EU exporters to save on annual custom duties, currently amounting to EUR 1 billion, as well as benefit from the reinforcement of international standards on wine additives and motor vehicles, fostering a more efficient rules based international system. It is

expected that, as a result, EU's exports to Japan will increase by between 16% and 24%, while Japan's to the EU by a whopping 29%.

While hurdles still remain in bringing these projections to reality, the EU has become more savvy in anticipating potential opposition. Rather than push for an investor-state dispute settlement (ISDS) mechanism, a somewhat controversial point, JEEPA relies on investor courts instead. While Japan is still reluctant to approve the use of these courts, such a clause is unlikely to be a deal-breaker.

Indeed, both sides have a number of strong incentives to shepherd to agreement through to implementation. Should the agreement come into effect in 2019, both Japan and the EU are expected to reap significant economic benefits; for example, their respective GDPs are predicted to grow by 0.76 p.p. and 0.29 p.p. Moreover, the United Kingdom's decision to leave the EU is a pressing issue for Japan, as more than a thousand Japanese firms have their headquarters across the UK, with investments of over GBP 40 billion. Japanese financial institutions based in the UK fear the loss of the "single passport" which ensures unfettered access to Europe's financial markets, and Japanese exporters are concerned they may see exporting from the UK to the EU become expensive and burdensome. JEEPA has arrived on the scene as a way for Japan to safeguard its access to the EU, even in the face of Brexit.

Perhaps the real value of JEEPA is not measured in direct financial gains, but by a commitment to (relatively) free trade. In a world of growing protectionist and isolationist tendencies, JEEPA represents an opportunity for both sides of the agreement to take a stance for free trade and international cooperation. Japan and the EU appear aware of this symbolism, which only the pressure on both parties to make sure the Agreement is ratified and implemented.

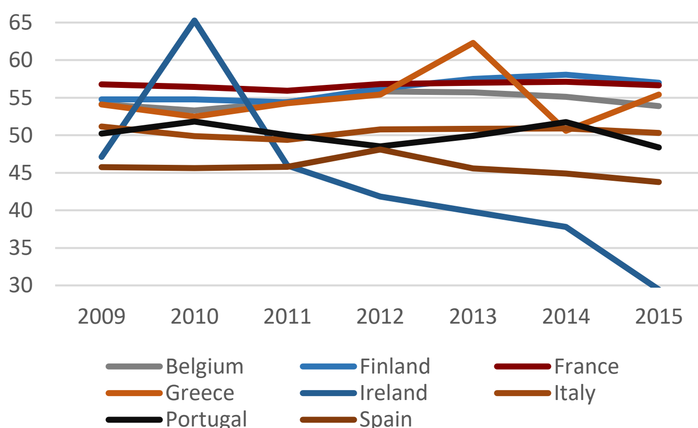
France's budget - a dormant volcano or an approaching eruption?

By: *Anne-Christin Winkler,* CASE Analyst

In his inauguration speech on July 4th, the new French Prime Minister Edouard Philippe addressed the levels of public spending in the country, comparing the current state of affairs to balancing on a volcano that keeps on rumbling louder and louder. To prevent the eruption, he said, comprehensive reforms would be needed to slash expenditures. As so often is the case in France, however, this will be easier said than done, as the French public has proven itself notoriously unwilling to accept any reductions in public spending (and equally notoriously verbal about it).

Source: Reuters

It is possible that France's looming fiscal disaster that may actually change this pattern. Public expenditure in the country has not been cut at any point in recent French history: compared to other Eurozone countries, France has been consistently among the states with highest public spending as a share of the GDP (see Figure 1). Tax euros go mainly to health, housing, and – most importantly – social protection, creating a series of entitlements and entrenched interests. In all of these areas, France is spending significantly more than the OECD average (see Figure 2).



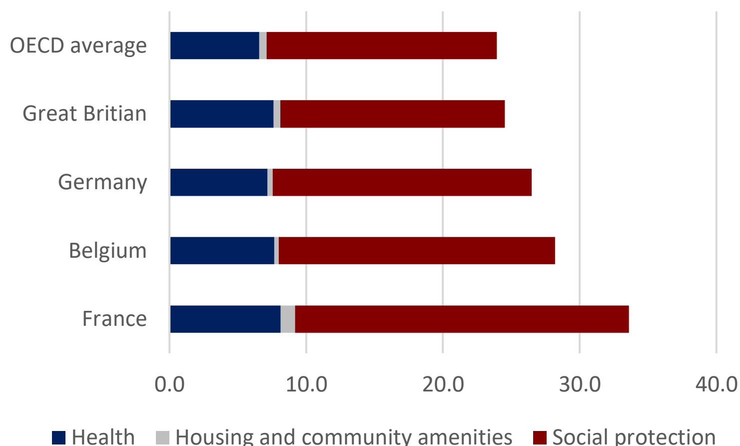
Source: OECD

The results of such continued fiscal profligacy are predictable: high levels of debt and a repeatedly-missed budget deficit cap of 3% of GDP (as defined in the Maastricht Treaty). In fact, the 3% target has not been met since 2007. The EU has already warned France a number of times on its non-compliance and extended the deadline for meeting the target twice since 2013.

But Brussel's displeasure is not Mr. Philippe's principal worry, as it is his electorate that he needs to please, both in the short- and long-term. During his electoral campaign, he outlined his objectives for financial reform, which included reducing public spending as percentage of GDP by

three percentage points by 2022. While offering no details on how exactly these goals would be achieved, Mr. Philippe assured the public his government would audit every Ministry on its efficiency and make sure only prioritized policies were financed. He also pledged to reform unemployment insurance, training, and retirement schemes, although no concretes were given here either.

For the French government, reducing public spending is not only a way of attaining budgetary stability, but also of pleasing its main European ally, Germany. The pair of countries have been striving to strengthen the Eurozone, as well as focusing on invigorating and reinforcing the EU itself.



Source: OECD

Unfortunately, Mr. Philippe will need a lot of strength and perseverance to push for these reforms. His job is complicated by the fact that he has also promised additional handouts; as part of his campaign, he assured the French public that by 2022, taxes will be lowered by a total of EUR 20 billion while EUR 50 billion will be simultaneously invested in various projects, such as youth training, local public transport, and modernization of public administration. It is likely, given France's history and addiction to government spending, that he will find favor in increased spending but not in expenditure cuts. If this scenario were to become a reality, France's position will deteriorate at a much faster pace, and Mr. Philippe may find that he is one of the first to be sacrificed to the volcano.

This week: The Polish government began discussion on raising the administratively-set tax on fuels. The ruling party, Law and Justice (PiS), claims that an increase of PLN 0.2 per liter will bring an additional PLN 4-5 billion to the budget annually. This decision is likely an attempt to finance social spending but may result in increased inflation via a surge in prices of fuel and, as a result, transportation and foodstuffs.

GDP (Q1 2017)

4.2% y/y (est.)

Up from 2.9% in Q4

Inflation (June 2017)

1.5% y/y

Down from 1.9% in May

Unemployment (May 2017)

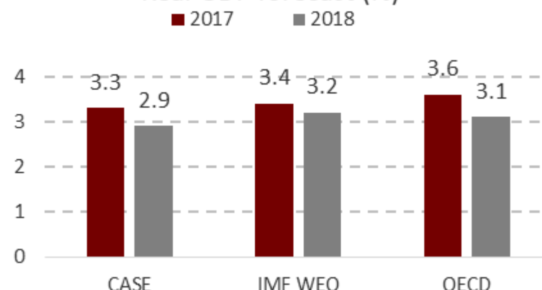
7.4%

Down from 7.7% in Apr

NBP Base rate

1.5%

From 2% Mar 2015



This Week: The Central Bank of Russia (CBR) is anticipated to cut its basic interest rate from 9% to 8.5% by the end of this year. The recent inflation figures caused by price hikes on fruits and vegetables (attributable to bad weather conditions) are unlikely to affect CBR's decision making process.

GDP (Q1 2017)

0.4% y/y

Up from 0.3% in Q4

Inflation (June 2017)

4.4% y/y

Up from 4.1% in May

Unemployment (May 2017)

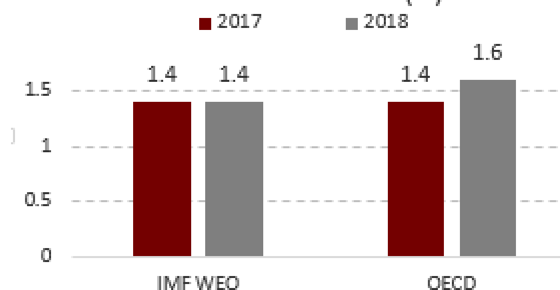
5.2%

Down from 5.3% in Apr 2017

CBR Base rate

9 %

Down from 9.25%



This week: The German parliament introduced legislation designed to exert more control over takeovers of German companies by investors from outside of the European Union (EU). The law is seen as an attempt to keep German know-how within EU borders, but also is a substantial protectionist move. New rules target providers of critical infrastructure (water, energy, hospitals, and transportation), armament manufacturers, and companies developing software for "key" industries.

GDP (Q1 2017)

1.7% y/y

Down from 1.8% in Q4

Inflation (June 2017)

1.5% y/y

Up from 1.4% in May

Unemployment (May 2017)

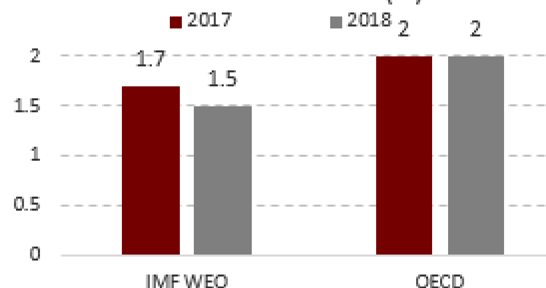
3.7%

Down from 4.2% in April

ECB Deposit rate

-0.4%

From -0.3% Dec 2015



This week: On 11 July 2017, Member States of the European Union (EU) endorsed the EU-Ukraine Association Agreement, the final step in its ratification process. The deal, which will take full effect on 1 September 2017, is supposed to not only align the Ukrainian economy with the EU single market, but also to boost its economy; it is anticipated that trade between the two will maintain the double-digit growth rate it has sustained since 2016, when the agreement was provisionally applied.

GDP (Q1 2017)

2.5% y/y

Down from 4.7% in Q4

Inflation (June 2017)

15.6% y/y

Down from 13.5% in May

Unemployment (Q1 2017)

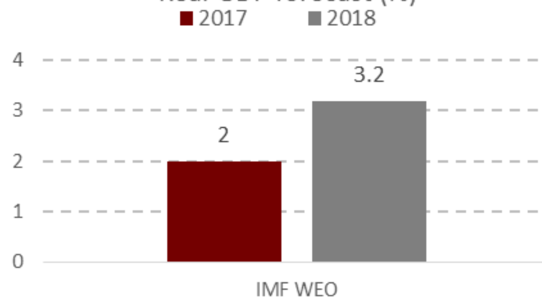
10.5%

Up from 10.0% in Q4

NBU Base rate

12.5%

From 13.0% in May



This week: The unemployment rate in June (4.0%) was the lowest since June 1998. This record-breaking figure is becoming a disadvantage for the Czech economy, as local businesses are having difficulty in finding potential employees. Especially affected are manufacturers, who are increasingly unable to meet delivery deadlines. Employees, on the other hand, are expected to benefit from growing salaries. It is anticipated that the unemployment rate – lowest in the European Union – will decrease even further in the upcoming months on the back of strong labor demand.

GDP (Q1 2017)

3.0% y/y

Up from 1.9% in Q4 2016

Inflation (June 2017)

2.3% y/y

Down from 2.4% in May

Unemployment (Q1 2017)

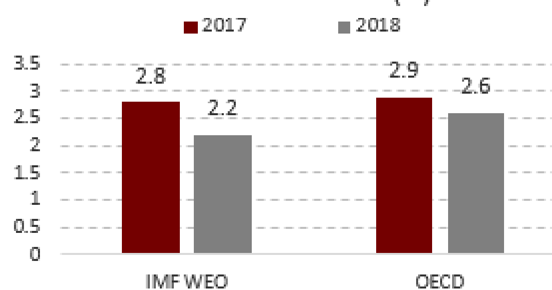
3.4%

Down from 3.6% in Q4

CNB Base rate

0.05%

Unchanged since Nov 2012



This week: Hungarian Minister for National Economy, Mihály Varga, stated during the recent Ecofin session in Brussels that while his country "fully endorses" European Union's attempts at fighting tax evasion, it is concerned that the proposed measures might result in excessive administrative burden for businesses.

GDP (Q1 2017)

3.6% y/y (est.)

Up from 1.6% in Q4

Inflation (May 2017)

1.9% y/y

Down from 2.6% in Apr

Unemployment (Q1 2017)

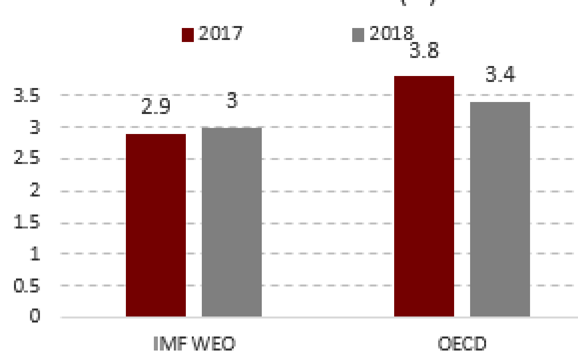
4.4%

Down from 4.6% in Q4

MNB Base rate

0.9%

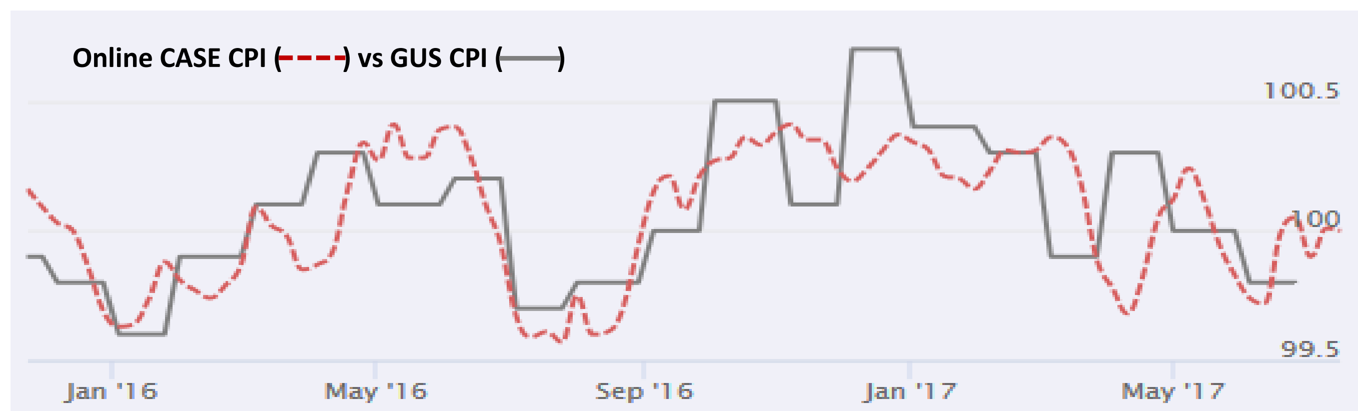
From 1.05% May 2016



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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