showCASE
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Overview: In this week's showCASE, our experts examine what would the creation of a separate Eurozone budget mean for Member States inside and outside the currency union.

A Eurozone budget: Taking a "Two-speed" Europe to the Next Level?

By: *Aleksandra Polak, Communications Officer*

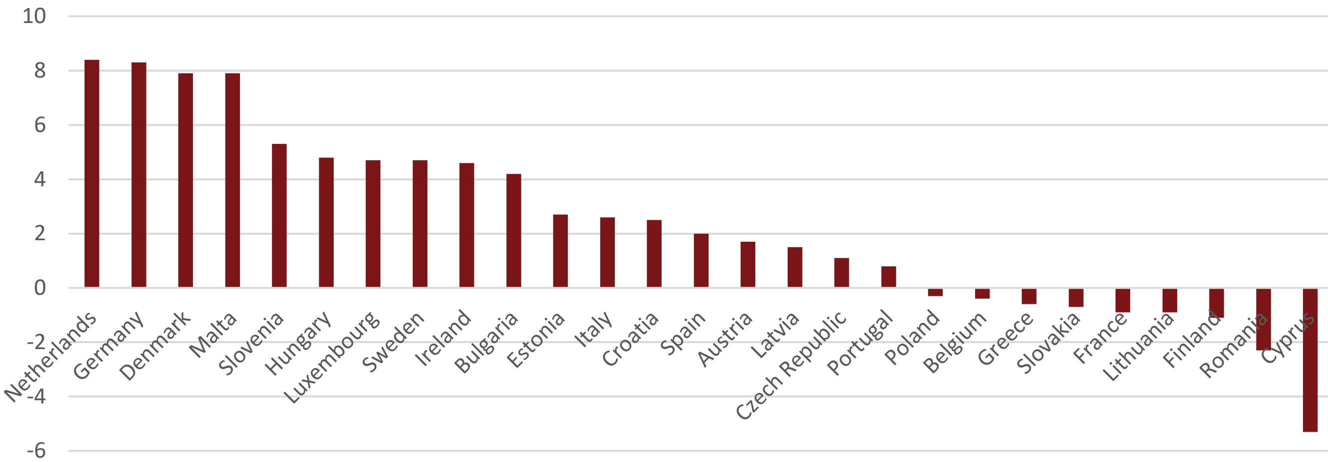
Source: Pixabay

Spanish Prime Minister Mariano Rajoy recently announced that Spain will advocate for deepening the Economic and Monetary Union (EMU), creating a euro area budget, and introducing Eurobonds. Rajoy is not the first European leader to reinforce an idea that has been around for years: a separate budget for the Eurozone was one of French President Emmanuel Macron's slogans during his electoral campaign, and calls for deeper integration have been repeatedly mooted as a solution for the Eurozone crisis. Furthermore, the concept has been endorsed by the European Commission and by the European Parliament. But what would the creation of a separate Eurozone budget mean for Member States outside the currency union?

A possible Eurozone budget, also labeled the "euro area fiscal stabilization capacity," would be a step toward much deeper integration (and is argued would be the way to complete the Economic and Monetary Union). Based on principles of counter-cyclicality and stabilization, it would remain distinct from the European Stabilization Mechanism, the instrument for severe crisis management. Indeed, the Eurozone budget's role would be to guard against asymmetric macroeconomic shocks in the euro area. Moreover, it is also envisaged as a mean of reducing economic divergences between Member States – a prerequisite for ensuring sustainability of the single currency and containing rising populism, according to the European Commissioner for Economic and Financial Affairs Pierre Moscovici, another high-level advocate of a euro zone budget.

Creating a euro area fiscal stabilization capacity, as well as implementing other means of deepening Eurozone economic integration (such as introduction of a position of an EU finance minister, a European treasury emitting Eurobonds, or euro-area unemployment insurance), will inevitably lead to growing divergences between euro area Member States and the remaining EU countries. Adoption of new supranational instruments will bring on a progressive federalization of economic and fiscal governance in the Eurozone, with non-euro countries excluded from this process and lagging behind. Marginalization and decreasing impact on decision-making will likely also make it politically more difficult domestically for the peripheral countries to join the Eurozone later on. On the other hand, non-euro EU countries are strongly economically tied to the Eurozone, so the single currency area’s improved resilience against shocks and crises could be beneficial to its economic partners as well. Moreover, countries such as Poland are reluctant toward adopting the single currency precisely to protect their economies from crises. Therefore, making the Eurozone more crisis-resistant could be an incentive for those Member States to join in.

Economic divergence in the EU:
Current account balance in 2016 (percentage of GDP)



Source: Eurostat

The European Commission “opened a debate about a fully-fledged euro area budget” in its latest Reflection Paper on the Future of EU Finances. Introducing such a budget is a complex and problematic issue. Firstly, the idea is highly politically sensitive in Germany, averse to the possibility of debt pooling and subsidizing fiscally profligate southern Member States. Secondly, it is estimated that for an effective stabilization role, the budget would have to be as high as 5 to 7% of euro area GDP. A consensus concerning the source of financing (options include an assigned tax, a fee-based system or contributions from Member States) will be difficult to reach. Thirdly, introducing this kind of instrument would require a transfer of certain national competences to supranational level, which would be a controversial and difficult step. The budget could be probably only be introduced after 2025, following completion of other parts of the Economic and Monetary Union, such as the Banking Union and the Capital Markets Union.

Nevertheless, it seems that the euro area leaders are determined to press forward with the euro project and its apparently necessary complement. Despite the political challenges, euro area members appear determined to deepen economic integration and introduce instruments meant to increase convergence in the euro area (whether or not this will occur is open to debate, however). This should be taken into account by countries which still have their own currencies but are legally obliged to join the Eurozone: Bulgaria, Croatia, Czech Republic, Hungary, Poland and Romania. For now, they are not hurrying to adopt the single currency, appreciating a greater degree of flexibility that stems from independent monetary policy. However, if the Eurozone takes the EMU reform forward, these countries might find themselves on the political peripheries of the EU with no easy way back.

This week: Central Statistical Office of Poland released a preliminary estimate of GDP for the second quarter of 2017. Seasonally adjusted GDP grew by 4.4% y-o-y and was 1.1% higher than in the first quarter of 2017. Analysts attribute this growth to an increase in investment, particularly in the construction sector.

GDP (Q2 2017)

4.4% y/y (est.)

Up from 4.2% in Q1

Inflation (July 2017)

1.7% y/y

Up from 1.5% in June

Unemployment (Jun 2017)

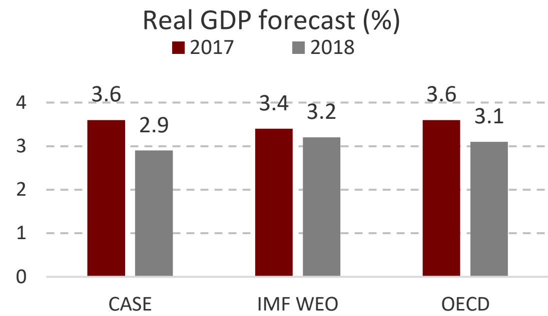
7.1%

Down from 7.4% in May

NBP Base rate

1.5%

From 2% Mar 2015



This week: The Russian government announced a GDP growth of 2.5% y-o-y for the second quarter of 2017 which is in line with the expected growth for 2017 forecasted by the Federal State Statistical Office. In contrast, the Central Bank only expects a 1.5% growth in 2017 and highlights the necessity for structural reforms to keep the pace of the growth in the long run.

GDP (Q2 2017)

2.7% y/y (est.)

Up from 0.5% in Q1

Inflation (July 2017)

3.9% y/y

Down from 4.4% in June

Unemployment (Jun 2017)

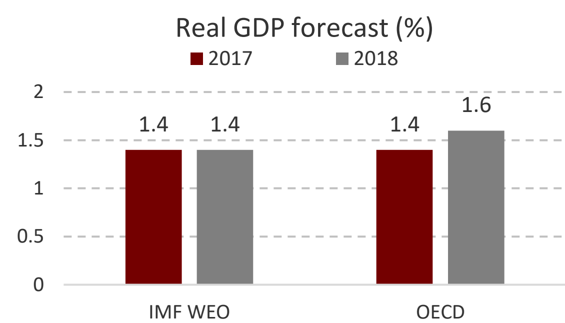
5.1%

Down from 5.2% in May 2017

CBR Base rate

9 %

Down from 9.25%



This week: After the German government granted a EUR 150 mln loan to Germany's insolvent airline Air Berlin, Ryanair lodged a complained with the European Commission accusing Berlin to help Lufthansa taking over the airline and therefore to violate competition rules. Moreover, the Federal Statistical Office announced that the GDP went up from 2.0% in Q1 (after it has been revised up from 1.8%) to 2.1% in Q2 due to a high domestic demand resulting from increased state investments and private consumption.

GDP (Q2 2017)

2.1% y/y

Up from 2.0% in Q1

Inflation (July 2017)

1.5% y/y

Unchanged from June

Unemployment (June 2017)

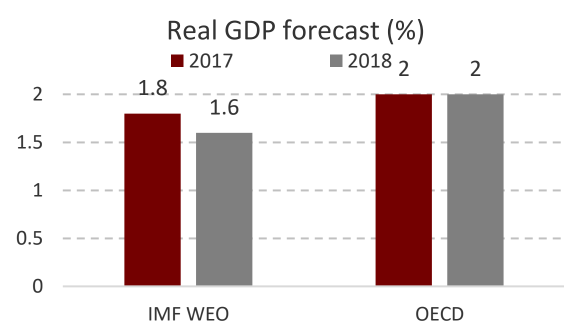
3.6%

Down from 3.7% in May

ECB Deposit rate

-0.4%

From -0.3% Dec 2015



This week: Based on the preliminary estimate of the State Statistics Service of Ukraine (Ukrstat), GDP in Q2 grew by 0.6% q-o-q, and 2.4% y-o-y. The growth has been driven by domestic demand, investments (predominately in agriculture) and private consumption, influenced by the January rise of the minimum wage.

GDP (Q2 2017)

2.4% y/y

From 2.5% in Q1

Inflation (July 2017)

15.9% y/y

Up from 15.6% in June

Unemployment (Q1 2017)

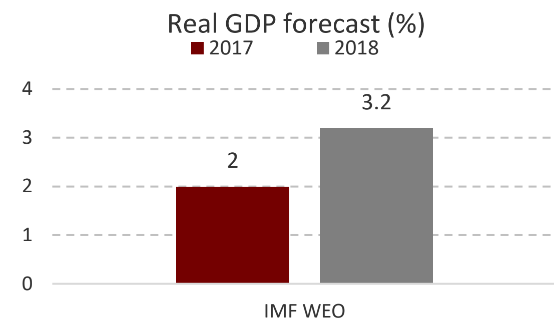
10.5%

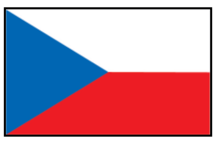
Up from 10.0% in Q4

NBU Base rate

12.5%

From 13.0% in May





This week: According to the preliminary estimate of the Czech Statistical Office (CZSO), GDP in Q2 grew by 2.3% q-o-q, and 4.5% y-o-y. The growth was predominantly driven by domestic demand, supported by an increasing consumption of households and a growth of investments. Not only manufacturing, but all major industries grew in the given period. It is expected that the economy will maintain its Q2 growth in the second part of 2017, exceeding the 4% yearly growth mark.

GDP (Q2 2017)

4.5% y/y (est.)

Up from 3.0% in Q1 2017

Inflation (July 2017)

2.5% y/y

Up from 2.3% in June

Unemployment (Q2 2017)

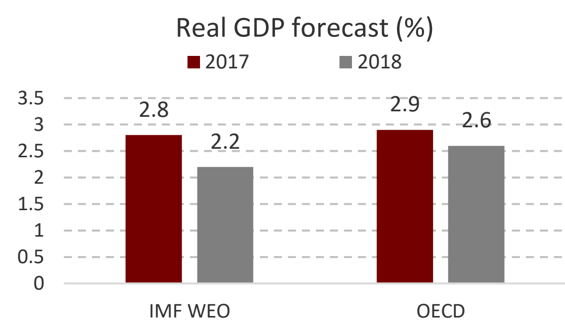
3.0% (est.)

Down from 3.4% in Q1

CNB Base rate

0.25%

From 0.05% (4 August 2017)



This week: According to the Hungarian Central Statistical Office, the Hungarian GDP grew by 4.2% y-o-y in Q1 buoyed by market-based services and industry. This is the second highest growth rate in the past ten years. The government expects further growth in the long run as a result of pro-competitiveness measures, tax reductions and a recent wage agreement that included a 15% increase in the minimum wage."

GDP (Q1 2017)

4.2% y/y

Up from 1.6% in Q4

Inflation (July 2017)

2.1% y/y

Up from 1.9% in June

Unemployment (Q1 2017)

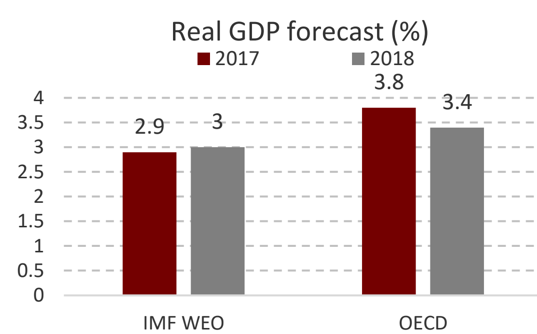
4.3%

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, and the CPI.

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	3.6	3.9	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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