showCASE
No. 56 | 11.12.2017

CASE – Centrum Analiz Społeczno-Ekonomicznych
CASE – Center for Social and Economic Research

Overview: In this issue, our experts report on the ongoing negotiations between Greece and its creditors as the country tries to graduate from its bailout program in 2018. We also discuss the significance of the 16+1 summit of 16 Central and Eastern European countries and China, which took place at the end of November.

Greece Seeks to Leave the Bailout, but More Reforms Needed First

By: Krzysztof Głowacki and Klaudia Wolniewicz-Slomka, CASE Economists

Greece eyes graduation from its bailout program in less than nine months, but the EU and the IMF recommend less haste, more reform.

On Saturday, December 2nd, Greece's Minister of Finance Euclid Tsakalotos announced that the country had reached an agreement with the European Union (EU) and the International Monetary Fund (IMF) on disbursement of a EUR 5 billion tranche of its bailout program, conditional on further progress with reforms. Specifically, Greece is supposed to push through two legislative packages encompassing fiscal measures, privatization, energy and labor market reforms, one before Christmas and one in January. All nineteen Eurozone Ministers of Finance gave a green light to the deal early last week, and Greek officials expressed hopes of leaving the current, third bailout program in August 2018 and making it their final one.

Photo: Reuters

Greece's problems were exposed by the global financial crisis, but pre-dated it: severe structural imbalances, in particular a bloated public sector harboring a sky-high public debt and a broken pension system, as well as poor international competitiveness, were all issues before 2008. To avoid imminent state bankruptcy – which could spill over and affect other Eurozone countries – the European Commission, the European Central Bank, and the International Monetary Fund, collectively known as the Troika, have sustained the country since the true extent of its sovereign debt issues became known. In return, the country had to live up to a range of macroprudential conditions, including on spending cuts, tax increases, and reforms, with the overall goal of bringing back financial stability and returning to market financing. Greece succeeded in implementing a number of socially painful but economically indispensable changes, including increasing VAT, raising the retirement age to 67 years old, and simplifying the process of bank liquidation.

The enactment of the latest series of legislative packages will be far from a formality, however, as portions of Greek society continue to resent or openly oppose the country's cooperation with international financial institutions. This resentment has not gone unnoticed by the government. In fact, on December 4th, two days after reaching the deal, the cabinet withdrew a bill containing one of the agreed-on reforms, which would put a check on the right to strike by requiring that at least half of union members (rather than 20%), must support it for it to be legal. Despite the government's capitulation, the next day saw riots in the streets, as protesters from the Greek Communist Party broke into the building of the Labor Ministry, clashing with the police in a violent display of retroactive and infantile fury.

In the meantime, 70% of the 110 prerequisites that Greece must complete in order to graduate from the current bailout program remain unfulfilled, according to Declan Costello, chief representative of the European Commission for the program. On this list are, among others, further pension cuts scheduled for 2019 and a lower personal allowance threshold scheduled for 2020. Painfully aware of the challenges that still lie in front of the country, the EU and the IMF advised its officials to focus on gradual progress in the reform effort rather than expecting ambitious graduation deadlines. The EU and IMF also reminded a somewhat optimistic Greece that it would have to comply with its obligations even after it graduates (or even if the International Monetary Fund steps down its support along the way).

Today, after many years of belt-tightening to compensate for its unsustainable pre-crisis spending, Greece is closer than ever to standing on its feet again. For the Greek government to finish this process, it must resist those who advocate the very same policies that put Greece in trouble in the first place.

The 16+1 Summit: Exercises in Diversification

By: Sara Skejo, CASE Analyst

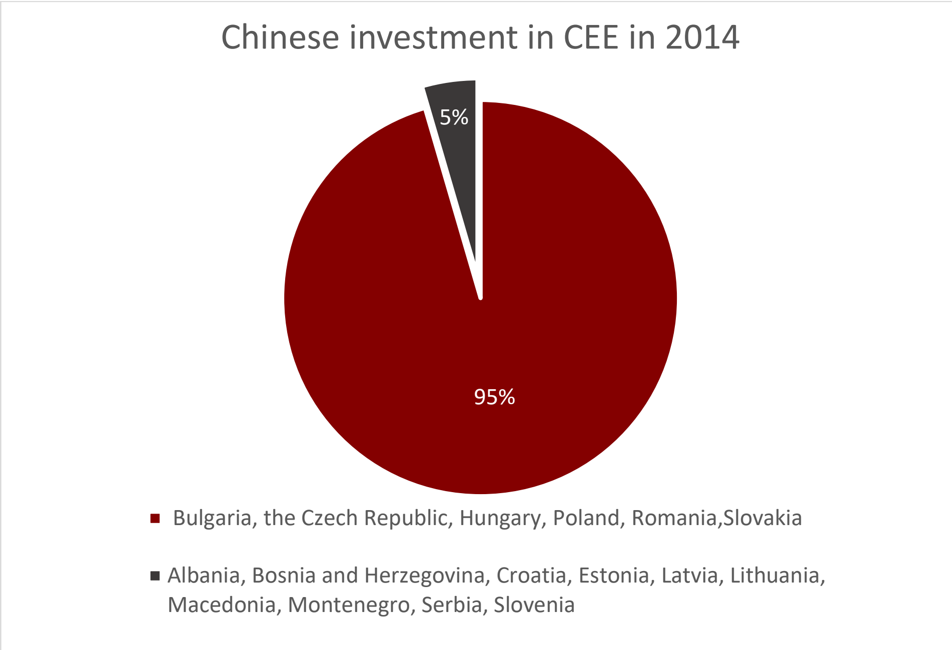
On November 27th, the sixth annual 16+1 summit of Central and Eastern European (CEE) countries and China was held in Budapest. As with previous years, this summit contained many promises but was critically low on tangible results or concrete measures for the future.

The 16+1 initiative was established in Warsaw in 2012 by the Chinese government as a framework of initiatives focused on bolstering cooperation between China and the Central and Eastern European (CEE) countries. The group includes eleven EU countries (Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia) and five non-EU Balkan countries (Albania, Bosnia and Herzegovina, Macedonia, Montenegro and Serbia), as well as (of course) China.

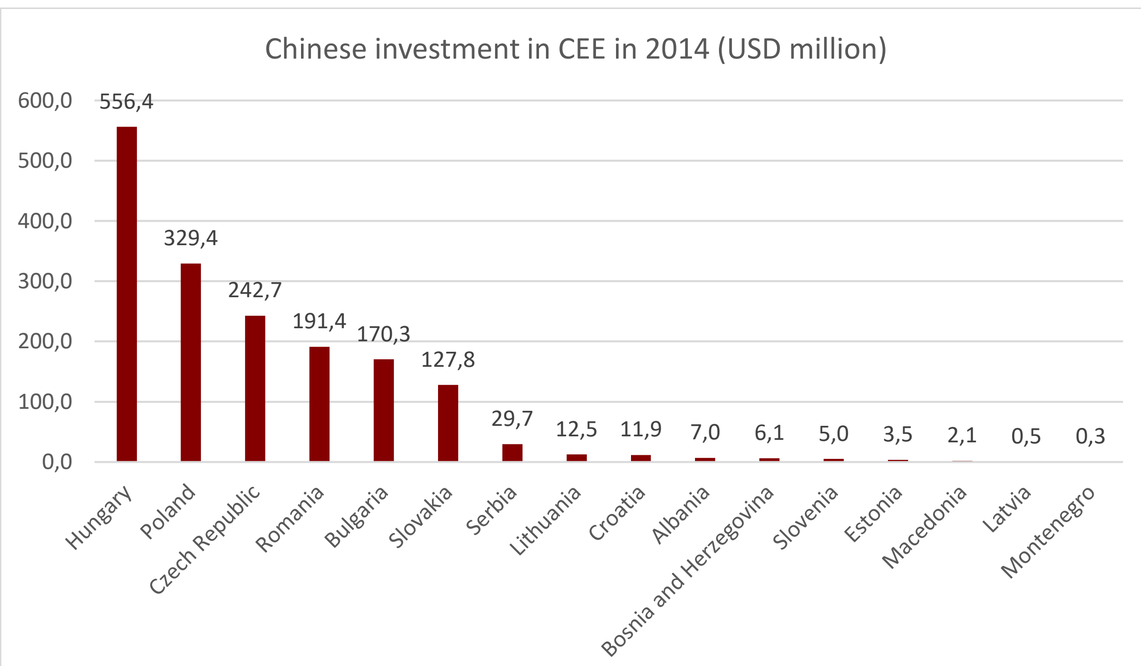
Photo: Reuters

The different countries of the CEE region see China as an opportunity for different reasons. Some are especially interested in the infrastructure investments that China can offer, as China's "Silk Road Economic Belt and the 21st Century Maritime Silk Road" project plans to connect Europe, Asia, and Africa. New hopes of additional spending on this goal were raised at the summit with the signing of the second phase of the China-CEE Investment Cooperation Fund worth USD 1 billion. Moreover, some projects are already underway: in Serbia, China is financing a railway reconstruction project, which will create a transport route between Belgrade and Budapest. The route will be an important section to connect the Greek port of Piraeus with the rest of Europe, and is part of Beijing's strategy to unlock alternative energy routes to overcome the limitations of the Strait of Malacca and boosting its trade.

Hungary, the host of this year's summit, will also avail itself from Chinese infrastructure projects, with the construction of the Hungarian section of the Belgrade-Budapest railway scheduled for 2020. Moreover, Hungary aspires to create strong financial links with China and increase its business significance in the region. Earlier this year, Hungary issued state bonds in China amounting to RMB 1 billion (USD 151 million).



Source: European Council on Foreign Relations



Source: European Council on Foreign Relations

Poland, the largest country and economy of CEE, a founding member of the Asian Infrastructure Investment Bank, and an important transportation hub, is also perceived by China as politically and economically influential in the region, and hence a strategic partner. According to Mao Yinhui of the Guangdong University of Foreign Studies, the main reasons for Poland to foster relations with China are investment and trade opportunities. In 2016, trade between China and Poland reached EUR 23.4 billion, but the Polish exports (EUR

1.7 billion) were almost thirteen times lower than the imports (EUR 21.7 billion). A heavy trade deficit with China is not specific to Poland, but present in every CEE country.

However, despite predictions, trade between CEE and China was still below USD 100 billion as of 2016. Moreover, trade is almost entirely concentrated in five countries: the Czech Republic, Hungary, Poland, Romania, and Slovakia account for about 80% of the total exchange. China's investment in the region increased as of late compared to the overall Chinese investment in the world economy, but it still accounted for only 2.7% of total Chinese investment in 2016. Similarly to trade, China's investment in the region is concentrated in select countries, with Bulgaria, the Czech Republic, Hungary, Poland, Romania and Slovakia absorbing 95% of the financing.

The real reason behind the Chinese economic interest in the CEE region is political. In the light of the EU-China Investment Agreement negotiations, China is looking to enhance its position by fostering competition for foreign investments between the sixteen European countries. EU-China relations have reached a critical point and are becoming a stepping stone for China-CEE cooperation. Although China is the EU's second largest export market, and trade between the two has reached EUR 1 billion a day, the EU is facing difficulties when it comes to enforcing fair trade principles. The European Commission is also worried that China will use its investment funds to influence the countries in the region, and that member states will lead divergent foreign policies.

Despite these concerns, the total amount of funds invested in CEE countries is still marginal, and it is very unlikely that European countries will profit more from Chinese capital than from the EU funds. When political factors are combined with economic ones, it can be argued that China remains focused on the Asian market, and the 16+1 initiative is to be seen as a pilot project to test the waters in Europe. Thus, the opportunities created by China in the CEE region must be taken for what it is: a useful complement to integration with the Western economies, not a substitute for it.

This week: The Monetary Policy Council of the National Bank of Poland (NBP) decided this past week to keep its base interest rate unchanged. NBP President Adam Glapiński assured markets that the Polish economy is not at risk for overheating; despite dynamic growth in output (estimated at 5.2% in Q3) and the tight labor market, inflation is expected to remain in check.

GDP (Q3 2017)

5.2% y/y (est.)

Up from 4.2% in Q2

Inflation (Oct 2017)

2.1% y/y

Down from 2.2% in Sep

Unemployment (Oct 2017)

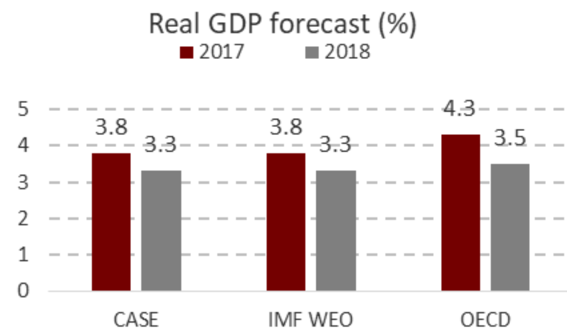
6.6%

Down from 6.8% in Sep

NBP Base rate

1.5%

From 2% Mar 2015



This week: Russia has commenced operations at the Yamal LNG plant in northern Siberia. The project, worth USD 27 billion, is a result of cooperation with Chinese investors and will enable Russia to up its game on the LNG market against competitors Qatar and the US. On December 8, the first ship was loaded with LNG from the plant.

GDP (Q3 2017)

1.8% y/y (est.)

Down from 2.5% in Q2

Inflation (Nov 2017)

2.5% y/y

Down from 2.7% in Oct

Unemployment (Oct 2017)

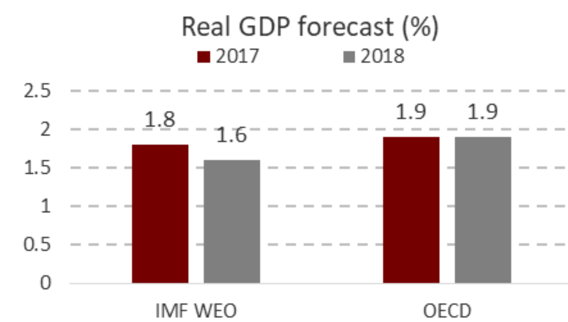
5.1%

Up from 5.0% in Sep 2017

CBR Base rate

8.25 %

From 8.5% in Oct 2017



This week: German businesses markedly reduced output in October. Industry, construction, and energy suppliers produced 1.4% less than in the preceding month, and industry production alone declined by 2%. Fewer working days and a dearth of skilled workers are considered key factors behind the diminished production. However, domestic demand remains high, and a rebound in production may follow.

GDP (Q3 2017)

2.8% y/y

Up from 2.3% in Q2

Inflation (Nov 2017)

1.8% y/y (est.)

Up from 1.5% in Sep

Unemployment (Oct 2017)

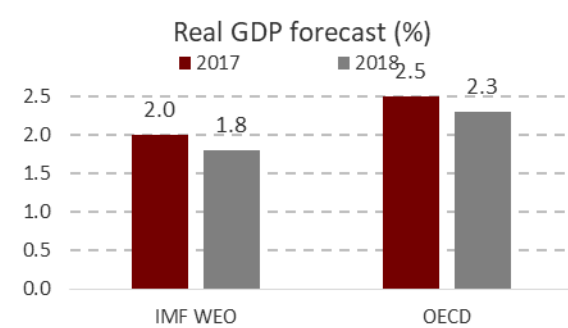
3.7%

Up from 3.5% in Sep

ECB Deposit rate

-0.4%

From -0.3% Dec 2015



This week: The Parliament of Ukraine has adopted the state budget for 2018. The document foresees budget revenues of UAH 913.6 billion (EUR 28.6 billion), including general fund revenues of UAH 839.8 billion (EUR 26.3 billion) and special fund revenues of UAH 73.8 billion (EUR 2.3 billion). Budget expenditures for the next year are projected at UAH 988.634 billion (EUR 31 billion).

GDP (Q3 2017)

2.1% y/y

Down from 2.5% in Q1

Inflation (Oct 2017)

14.6% y/y

Down from 16.2% in Aug

Unemployment (Q2 2017)

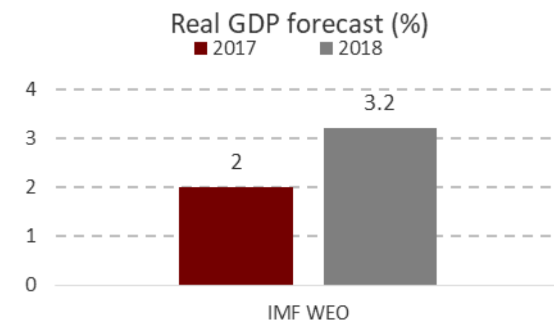
9.1%

Down from 10.5% in Q1 2017

NBU Base rate

13.5%

From 12.5% in Sep 2017



This week: Easy access to low-interest mortgages is contributing to a strong increase in the prices of real estate in the Czech Republic. In Prague alone, prices of new apartments increased by 40% on average within the last two years. This increase of real estate prices has been closely followed by an increase in the prices of rentals.

GDP (Q3 2017)

5.0% y/y

Up from 4.7% in Q2 2017

Inflation (Oct 2017)

2.9% y/y

Up from 2.7% in September

Unemployment (Q3 2017)

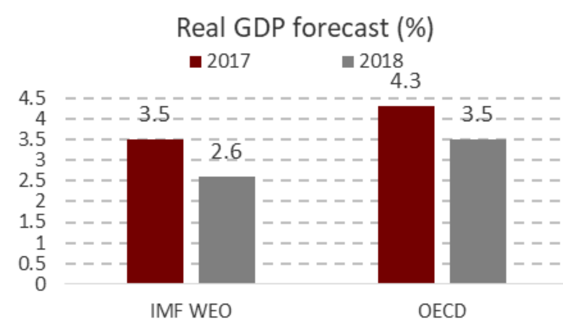
2.8% (est.)

Down from 3.0% in Q2

CNB Base rate

0.50%

From 0.25% (3rd November 2017)



This Week: Hungary and Iran continue to develop business relations, as Hungarian Minister of National Economy, Mihály Varga, visited Iran with a business delegation from December 1st to 2nd. During the visit, several business-oriented memoranda of understanding were signed between companies from the two countries, including with the Hungarian manufacturer Ikarus on a delivery of 1,000 buses to Iran.

GDP (Q3 2017)

3.9% y/y (est.)

Down from 4.2% in Q1

Inflation (Oct 2017)

2.2% y/y

Up from 2.1% in July

Unemployment (Q2 2017)

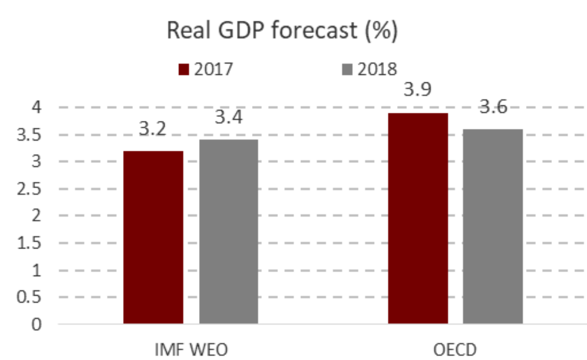
4.1%

Down from 4.3% in Q2

MNB Base rate

0.9%

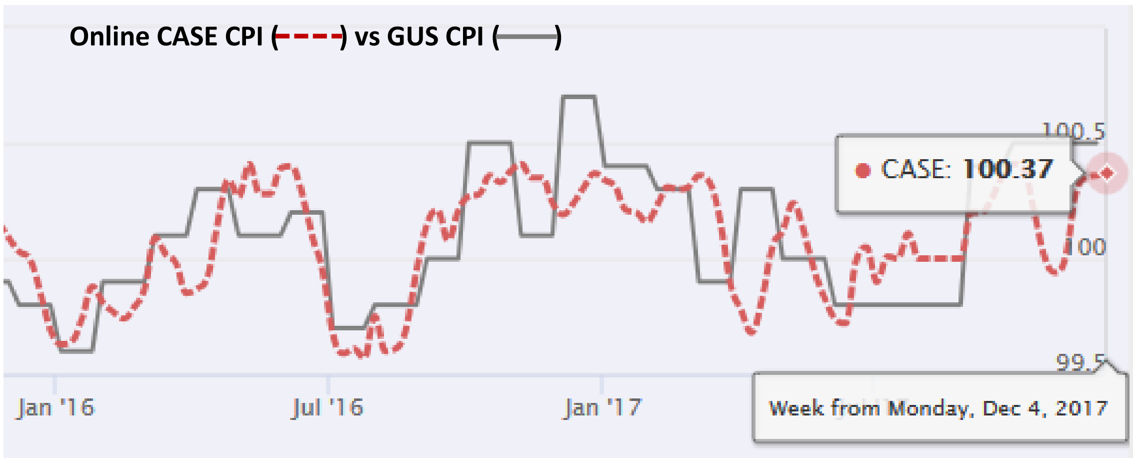
From 1.05% May 2016



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	3.9	4.4	2.8	4.3	1.9
2018	3.3	3.3	3.1	3.7	2.1
	Nominal monthly wages	**Merchandise exports (USD, bn)**	**Merchandise imports (USD, bn)**	**Merchandise trade balance (USD, bn)**	**CA balance (USD, bn)**
2017	5.1	211.7	211.9	-0.2	-2.7
2018	3.5	221.9	223.8	-1.9	-3.9

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