showCASE
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CASE – Center for Social and Economic Research

Overview: In this week's showCASE, CASE experts discuss the Walloon vote against the EU-Canada Comprehensive Economic and Trade Agreement. CASE also dissects the implications a hard Brexit could have on Central and Eastern Europe and the EU more generally.

The Future of CETA: Gloomy Days or Sunny Ways?

By: Paul Lirette

On October 14, Members of Parliament in Belgium's French-Speaking region, Wallonia, voted against the signing of the EU-Canada Comprehensive Economic and Trade Agreement (CETA). Despite Federal Government support in Belgium, Walloon regional officials voiced concerns that CETA grants too much power to multinationals, fails to provide clear safeguards for human rights and sustainable development, and lacks protection or handouts for EU farmers.

If ratified, the CETA would eliminate roughly 98% of tariffs between Canada and the EU, making it the biggest bilateral initiative since NAFTA for Canada and one that could generate up to €5.8 billion a year for the EU by some estimates. European Union trade ministers' met in Luxemburg on October 18, in an attempt to iron out concerns and reach unanimous support for the deal, but were unsuccessful.

The agreement's approval is coming down to the wire, as official signing of the agreement is scheduled to held on October 27 during an EU-Canada summit with Canadian Prime Minister Justin Trudeau in Brussels. As a result, the EU has set a deadline of Friday October 21 for an agreement to be reached, which also marks the end of a two-day EU Summit in Brussels. But the head of the Walloon region, President Paul Magnette, has claimed that the region will not be able to sign by Friday and that they will not succumb to pressure.

While Wallonia's opposition to the deal has gained a lot of media presence over the past week, it is not the only region that seems opposed to CETA. For instance, on Saturday, protests against both CETA and Transatlantic Trade and Investment Partnership (TTIP) broke out in front of the Polish Agriculture Ministry in Warsaw and a collective 40,000 people took the streets in multiple cities across France.

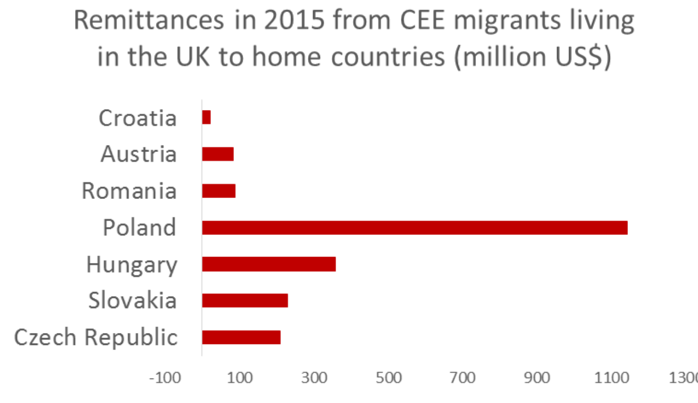
This also raises general questions about the future of other EU trade negotiations. For example, will the TTIP, a much bigger deal between the United States and the EU, and future trade negotiations with the United Kingdom face similar pushback? As European Council president Donald Tusk tweeted during the first day of this week's EU summit in Brussels "CETA could be our last free-trade agreement, if we are not able to convince people that we negotiate to protect their interests."

As with any trade deal, there will be winners and there will be losers. In the case of CETA, the former are more numerous - as demonstrated by the near unanimous vote to ratify the deal - but the latter are more passionate (also a characteristic of trade policy). Nonetheless, a last-minute withdrawal from a deal that took 7 years to negotiate due to a regional veto would be a lost opportunity, especially given the much-needed opportunities for job creation that freer trade is capable of creating for both Canada and the EU.

Hard Brexit and its Impacts on Central and Eastern Europe

By: Katarzyna Mirecka

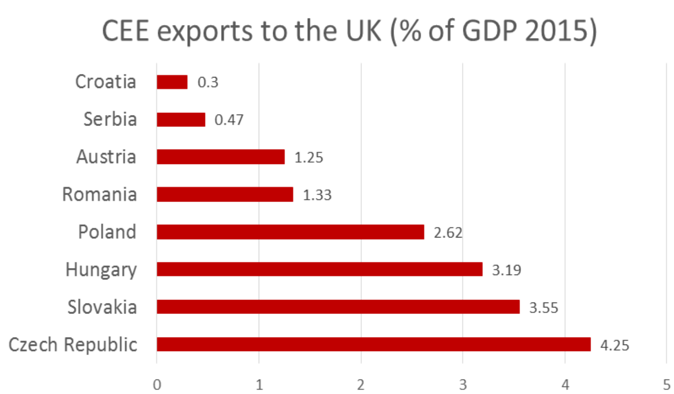
Discussions about Brexit - Great Britain's exit from the EU voted in June - seem to be endless. As Britain does not have a written constitution, we do not know yet whether it can use article 50 of the EU Treaty with or without a parliamentary vote. In any case, two possible scenarios seem to be emerging that illustrate what is at stake for the future of EU-UK ties: a soft and a hard Brexit. In general, a soft Brexit would mean maintaining some tariff-free access to the EU's single market, while a hard Brexit would pull Britain entirely out of the single market and customs union, meaning that companies would be subjected to WTO rules.



Source: World Bank

A hard Brexit would have profound impacts on the entire EU. But the impacts on CEE countries might be particularly hard hitting. Should the UK gain full control of its borders and immigration policies, as the new Prime Minister Theresa May promoted on Oct.2, the future of numerous migrants from CEE and the remittances they are sending home remains unclear. What is more, the UK is a big contributor to the EU budget (4-9%), of which Hungary, Poland and Romania are the largest recipients. It is also not yet clear whether or not the Multiannual Financial Framework 2014-2020 will be renegotiated.

On the other hand, a hard Brexit might mark the beginning of an important increase in investment opportunities for CEE countries. For instance, Hungary is already thinking about ways to attract companies leaving the UK. A big question also concerns the financial sector – London will certainly suffer from a hard Brexit and some banks might leave the capital to move to cities like Frankfurt or Dublin, but specialists are also adding Warsaw's name to the list. There is also a possibility that a hard Brexit would be followed by a shift of the UK's car industry to central and south-eastern Europe. On the export side, Brexit does not seem to be much a threat to CEE, with exports to UK representing roughly 4.4% of the region's total exports, (as opposed e.g. to 23% of total CEE exports destined for Germany). CEE countries also have minimal exposure to UK FDI, that doesn't exceed 2% of GDP in any of the CEE countries.



Source: Erste Group Research, Eurostat

Looking forward, the most uncertain factor remaining is the political impact of Brexit: CEE countries fear that with Britain gone, Germany's EU influence could increase further but the overall influence of the Union could fall, a reality which might be especially welcomed by Russia. Even though specialists' opinions in this matter differ, the reality of Brexit is becoming more apparent daily and it will have implications for the future of Europe in ways which will be hard to ignore.

At a glance

Earlier this week, the Polish government released its draft budget for 2017. In the budget, the Polish economy is expected to grow by 3.6%, with inflation pegged at 1.3% and a budget deficit that should not exceed PLN 60 billion (EUR13.9 billion). However, CASE experts believe the growth forecasts in the budget appear optimistic. CASE's GDP forecasts expect the economy to grow by 3.4% (y/y) in 2017. Other issues also persist, such as high deficit levels which are currently forecasted at 2.9% of GDP in 2017, just below the EU's 3% cap. Should actually GDP growth in 2017 be less than forecasted, this could create significant roadblocks for the new government's inflated social spending promises.

Aug. current account deficit widens to EUR 1047 bn from EUR 635 bn

Real GDP forecast (%)	2016	2017
CASE	3.1	3.4
IMF WEO	3.1	3.4
OECD	3.0	3.5

According to the Federal State Statistics Service, Russian GDP contracted by -0.6% (y/y) in Q2, the smallest contraction in six quarters, due in part to an increase in manufacturing production. According to the preliminary estimate of Bank of Russia, the external debt as of September 30, 2016 equals $516.1 billion, representing a decrease of 0.5% compared to the end of last year. After double digit inflation growth in 2015, the economy seems to be stabilizing with annual inflation slowing to 6.4% in September. This seems to be a timid but positive sign for the country's economy after six quarters of contraction, caused in large part by low oil prices and economic sanctions, the latest being currently discussed in Brussels at the EU Summit.

Sept. unemployment unchanged at 5.2%

Sept. real wages increase to 2.8% (y/y) from -1%

Real GDP forecast (%)	2016	2017
IMF WEO	-0.8	1.1
OECD	-1.7	0.5

A balanced German economy continues to grow on positive market sentiment, profiting from the economy's cyclical upswing. The only black cloud, on an otherwise blue German sky, is the uncertainty that the Deutsche Bank woes instils in the German financial sector, which is enhanced by a profitability hurdle posed by EAPP and the ECB's decision to keep deposit rate at -0.40 and refinancing rate at 0.00. Despite this financial backdrop, the latest BLS report largely indicates no change in credit standards for loans to enterprises and consumers in the country. Overall, GDP forecast of the Bundesbank remains at 1.7% for 2016 and at 1.4% for the year to come. This week, month to month price indices were reported with HICP and CPI remaining fixed at 0% and 0.10% respectively, while PPI dropped this month by 0.10% into further negative territory, at - 0.20.

HICP% m/m remained at 0.00 in Oct.

Real GDP forecast (%)	2016	2017
IMF WEO	1.7	1.4
OECD	1.6	1.7

At a glance

Ukraine's economy grew by 1.4% (y/y) in Q2. This positive development builds on Q1 growth of 0.1% (y/y), the first quarter of growth in two years. Headline inflation decreased to 7.9% (y/y) in September and stood at 1.8% m/m. The benchmark interest rate remains at 15% following a 50 bps cut on September 16th. The Central Bank has announced that household UAH deposits are on the increase, having risen by 12.1 billion (6.7%) since the beginning of the year. In the meantime, Ukrainian parliament passed a bill that upholds the moratorium on sales of agricultural land, putting off an important land reform at least until 2018.

Real GDP forecast (%)	2016	2017
IMF WEO	1.5	2.5
OECD	-	-

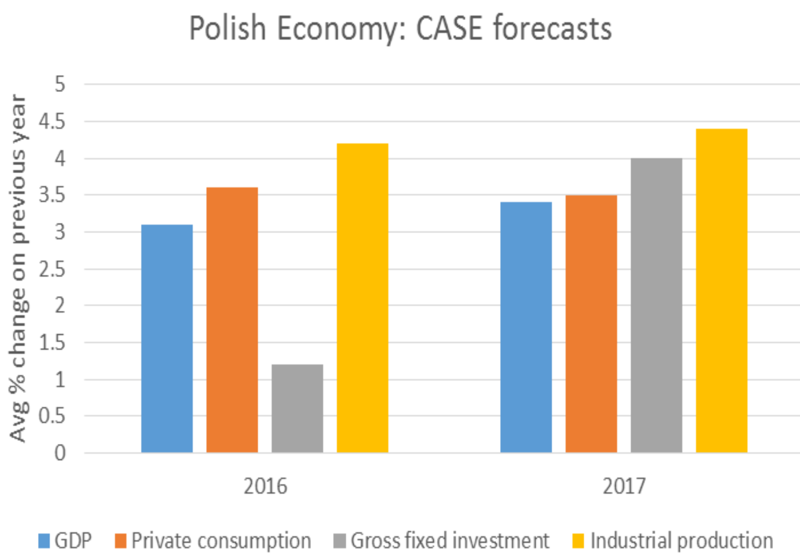
Czech bond yields remain one of the lowest in the world. In fact, this week they briefly fell even below Swiss bond yields, reaching -0.94%; although they quickly rebounded back to above -0.9%. Some experts predict we shall witness a drop below -1% in the near future. The demand for Czech bonds is usually explained by the Czech National Bank's (CNB) expansionary monetary policy and relatively good state of the country's economy. Indeed, despite expectations of economic slowdown prevailing until the end of the year (2.4%), a rebound up to 3.0% is expected in 2017 and 2018. The CNB's forecast for annual consumer price inflation remain unchanged at 2.2% for Q3 2017 and 2.4% for Q4 2017. The balance of payments for August 2016 released this week showed, among others, a current account deficit amounting to -0.74 billion (compared to -4.48 billion the same time last year), and a surplus of balance of goods and services of CZK 25.6 billion.

Aug current account narrows to CZK -0.74bn

Real GDP forecast (%)	2016	2017
IMF WEO	2.5	2.7
OECD	2.4	2.6

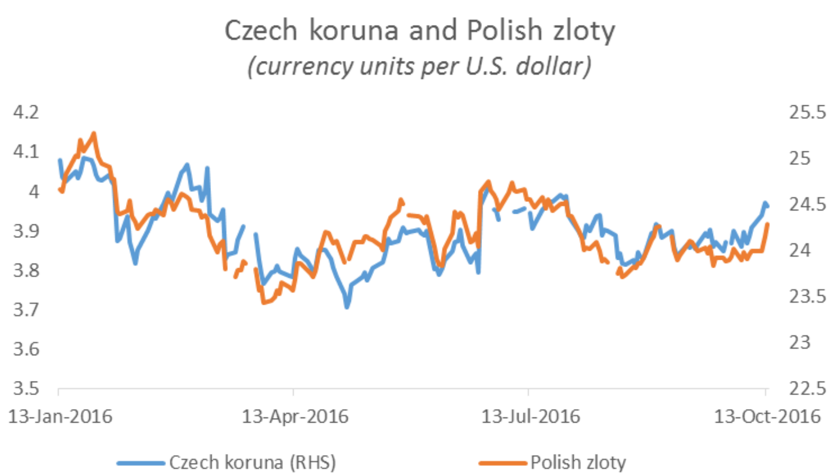
According to a report released by the Hungarian Central Bank, higher household income, lower unemployment, deleveraging and low interest rates have contributed to an increase in overall demand for the economy. The rise in household income has also led to a narrowing of household debt. Further, lower lending rates have increased the attractiveness of real estate. Overall, the Hungarian economy has made progress in reducing macroeconomic imbalances, but its economic growth path for 2016 was recently marked down by IMF to 2.0%. Main drivers of growth in the economy include business capital accumulation, supported by inward FDI and EU structural funds, which have so far mitigated weak domestic investment caused by barriers to entry for SMEs and ever-changing regulations.

Real GDP forecast (%)	2016	2017
IMF WEO	2.0	2.5
OECD	1.6	3.1

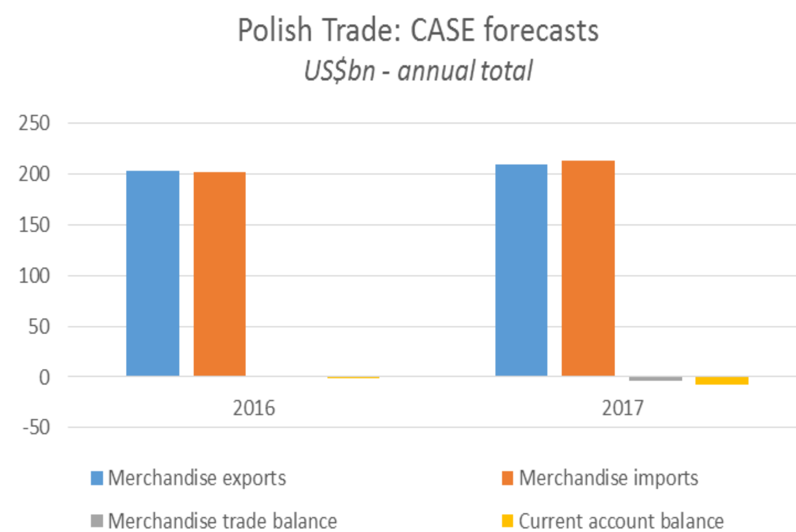


Source: CASE forecasts

Source: CASE. Most recent observation Oct 10, 2016



Source: IMF



Source: CASE forecasts

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