

**Overview:** In this week's showCASE, our experts discuss the ongoing protests in Romania and the calls for increased efforts to tackle corruption. CASE also takes an in-depth dive on Poland's 2016 budget report and shares its views on the challenges that officials could face in implementing the 2017 budget plan.

## Officials repeal contentious decree, but Romanians want more

By: [Paul Lirette](#), Senior Economist, CASE, and [Ada Rachfalska](#)

An estimated [half a million Romanians took to the streets](#) to protest against the coalition government's recent efforts to weaken penalties against corruption, marking the [biggest protest since the fall of the communist regime](#) in the country in 1989. After six days of protesting, officials withdrew the bill. So why are many Romanians still protesting?

The demonstration began as a national response to a [hastily-imposed executive order](#) that could undermine the rule of law by decriminalizing smaller-scale corruption. The decree, which was ordered without parliamentary consultation, was designed to decriminalize budgetary losses due to official misconduct of less than 200,000 lei (44,000 euro). In addition, [the new order would have](#) released some officials currently awaiting trial for corruption, ended the investigation of a number of pending corruption related offenses, and, to some degree, protected politicians from prosecution moving forward.

The newly appointed Romanian Prime Minister succumbed to the pressure of the protests, announcing his intentions to [scrap the contentious decree](#) on February 4<sup>th</sup>. "I do not want to divide Romania. Romania can't be split into two. Right now Romania seems broken in two. My last desire is to witness this," [claimed Romanian Prime Minister Sorin Grindeanu](#), justifying the decree as a [bid to relieve pressure on the prison system](#).

Coincidentally, the decree would have also benefited Liviu Dragnea, President of the ruling Social Democrat Party, who is [currently under investigation for abuse of office allegations](#) and previously [received a two-year suspension](#) for attempting to rig a national referendum calling for the impeachment of the country's president.

As demonstrated by the [ongoing protests](#), repealing the decree is viewed as too little, too late, and an atmosphere of public distrust in the government's willingness to tackle corruption continues to prevail. Even the [resignation of Romania's justice minister Florin](#), who drafted the controversial bill, does not appear to have



Source: Flickr cc

satiated protestors' need for change. For many Romanians, corruption and bribery – at hospitals, schools, and public institutions – [is a part of everyday life](#) and more needs to be done to stop it.

Whether or not the protestors' ongoing efforts will be enough to potentially overthrow the current leftist cabinet and/or incite institutional change is unclear. As for the decree, protests have won the battle, but the war on corruption continues.

## Implementing Law and Justice's 2017 budget could be easier said than done

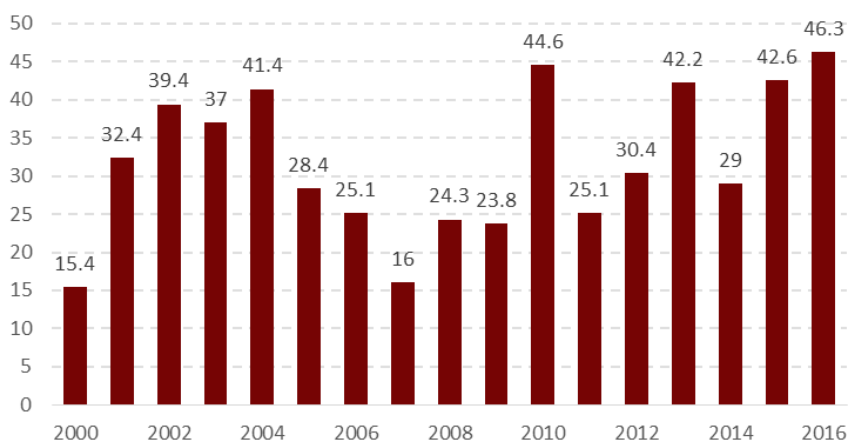
By: [Krzysztof Głowacki](#), Economist, CASE

*With inflated social spending and the tax gap that seems impossible to close, the Polish government will face a daunting task in implementing the 2017 budget.*

The provisory macroeconomic data [released by the Central Statistical Office](#) and the preliminary budget report [published by the Ministry of Finance](#) on January 31 give a perspective on Poland's potential fiscal standing after 2016. Revenues last year were PLN 314.6 billion, while expenditures amounted to PLN 360.9 billion, resulting in a budget deficit that was the highest in Poland's modern history, at PLN 46.3 billion (roughly 2.8-2.9% of GDP). The expenditure side was inflated by [the many social programs introduced by the conservative Law and Justice Government](#), including universal cash grants for children, subsidization of medicines, and the reduction of the retirement age.

At the same time, the revenue side struggled to keep up. VAT collections, the most important source of tax revenue, have increased from PLN 123.1 billion to PLN 126.6 billion, or by 2.8% in nominal terms. However, given the growth of consumption by 3.6% (3% in nominal terms), the VAT collection rate effectively [dropped by around 0.2%](#). The effect is not large in magnitude, but runs counter to the government's plan of narrowing Poland's [huge VAT gap](#) in search of additional revenues. The income from the newly-instituted tax on financial institutions yielded less than planned, and the tax on trade yielded naught, as it failed to be enacted among legal squabbles with the European Union.

Poland's budget deficit (PLN billion)



Source: Polish Ministry of Finance

apparent lack of successes so far and a dearth of ideas on how to improve collections. As a result, the budget deficit, now estimated at around 2.8-2.9% of GDP, might soon breach the 3.0% threshold and trigger the EU's excessive deficit procedure.

Fiscal policy must also be seen as part of the broader economic environment. Poland's economic growth in 2016, at 2.8%, is below expectations (including the 3.8% assumed in the Budget Act) and far from the pace needed to continue its economic convergence with the West. While most macroeconomic conditions are reasonably sound, with growth led by consumption, the drop in investment of 5.5% will have deleterious effects for future growth. It is also a clear signal that businesses are holding back due to the [political uncertainty prevailing in the country](#). Seemingly Poland has a lot of housekeeping to do in order to maintain its position as a favored destination for foreign investment. As of right now, the government's spending spree is having the opposite effect.

The outlook for 2017 presents a challenging task. The extravagant social programs introduced halfway through 2016 will now have to be financed year-round. One-time money injections such as the Central Bank's profit payout of around PLN 8 billion, which greatly helped the budget in 2016, are unlikely to be repeated in 2017. To address the challenge, the government again plans to rely on narrowing the VAT gap, but the 13.3% growth in VAT revenues that it anticipates seems unfeasible given the



**This week:** According to flash GDP growth estimates published on January 31, the Polish economy grew by 2.8 % y/y in 2016. While private consumption increased by 3.6% for the same period, investment activity remained more subdued (-5.5%). Moreover, in contrast to the government's plan, VAT compliance declined in 2016.

### GDP (Q3 2016)

↓ **2.5% y/y**

Down from 3.1% in Q2

### Inflation (Dec 2016)

↑ **0.8% y/y**

Up from 0.2% in Nov

### Unemployment (Q4 2016)

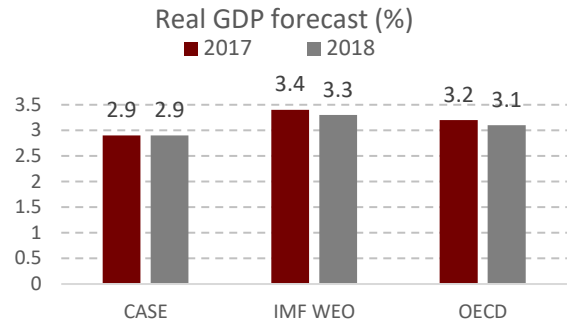
▬ **8.3% y/y**

Unchanged from Q3

### NPB Base rate

↓ **1.5%**

From 2% March 2015



**This week:** Recent OECD forecasts show that, following two years of recession, the Russian economy is expected to return to growth in 2017. Russia's Central Statistics Office surprised observers by reporting a GDP contraction of only 0.2 % in 2016. Russia's recent growth turnaround, according to Rosstat, is mainly due to high net export levels.

### GDP (2016)

↑ **-0.2% y/y**

Up from -2.8 in 2015

### Inflation (Jan 2017)

↓ **5% y/y**

Down from 5.4% in Dec

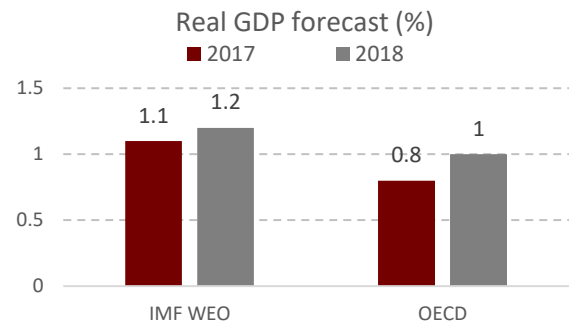
### Unemploy. (Dec 2016)

↓ **5.3% y/y**

Down from 5.4% in Nov

### CBR Base rate

▬ **10%**



**This week:** Germany's Manufacturing PMI diverted from its upward trend in January, declining by 0.1 points to 56.40. Conversely, sentiment in the service sector exceeded expectations, as Services PMI grew to 53.40 from last month's 53.20.

### GDP (Q3 2016)

↓ **0.2% y/y**

Down from 0.4% in Q2

### Inflation (Dec 2016)

▬ **1.7% y/y**

Unchanged from Nov

### Unemployment (Q4 2016)

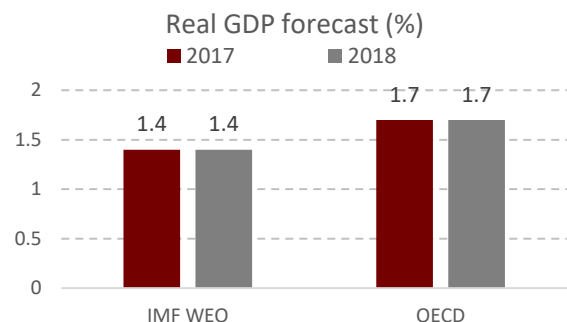
↓ **6% y/y**

Down from 6.1% in Q3

### ECB Deposit rate

↓ **-0.4%**

From -0.3% Dec 2015





**This week:** According to recent forecasts published by the National Bank of Ukraine, GDP will grow by 2.8% in 2017 and by 3.0% in 2018. Inflation is expected to increase by 9.1% in 2017 and by 6% in 2018. The present forecasts of GDP and CPI have been revised upward to account for the entry into force of the minimal wage of UAH 3,200 (111 EUR) as of January 1st, 2017.

### GDP (Q3 2016)

**↓ 0.5% y/y**

Down from 0.6% in Q2

### Inflation (Jan 2017)

**↑ 12.6% y/y**

Up from 12.4% in Dec

### Unemployment (Q3 2016)

**↓ 9.2% y/y**

Down from 9.3% in Q1

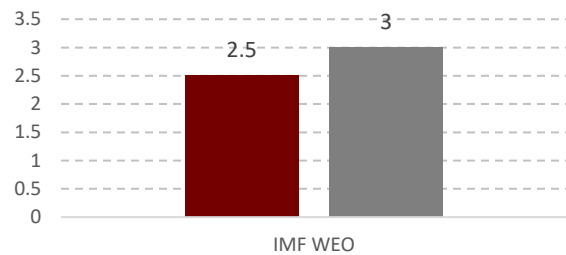
### NBU Base rate

**↓ 14%**

Down from 15% Oct 2016

### Real GDP forecast (%)

■ 2017 ■ 2018



**This week:** The Czech National Bank (CNB) released a new inflation forecast, according to which annual consumer price inflation is expected to reach 2.5% for Q1 2018 (up from 2.4%) and 2.3% for Q2 2018. Forecast for real GDP growth in 2016 and 2017 were also upgraded, from 2.4% to 2.5% and from 2.5% to 2.6%, respectively.

### GDP (Q3 2016)

**↓ 1.9% y/y**

Down from 2.6% in Q2

### Inflation (Dec 2016)

**↑ 2.0% y/y**

Up from 1.5% in Nov

### Unemployment (Q4 2016)

**↓ 3.6% y/y**

Down from 4.0% in Q3

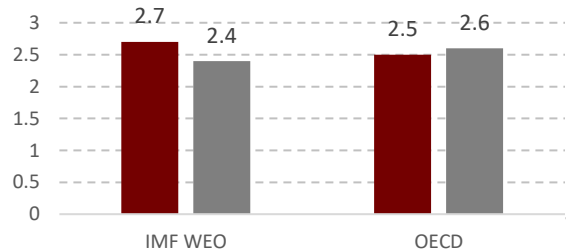
### CNB Base rate

**■ 0.5%**

Unchanged since Nov 2012

### Real GDP forecast (%)

■ 2017 ■ 2018



**This week:** According to the World Bank Group's recent Global Economic Prospects report, Hungarian GDP could grow by 2.6% (real annual growth) in 2017 with a recovery in public investment (including EU infrastructure funds). This is slightly more optimistic than the World Bank Group's previous reporting, which anticipated 2.4% growth for the same period.

### GDP (Q3 2016)

**↓ 2.2% y/y**

Down from 2.8% in Q2

### Inflation (Dec 2016)

**↑ 1.8% y/y**

Up from 1.1% in Nov

### Unemployment (Q4 2016)

**↓ 4.4% y/y**

Down from 4.9% in Q3

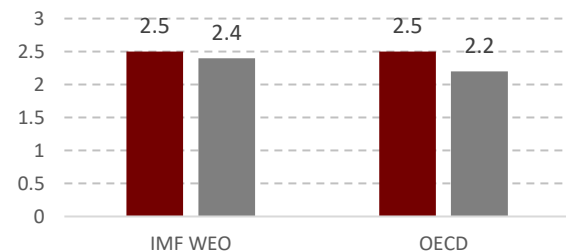
### MNB Base rate

**↓ 0.9%**

From 1.05% May 2016

### Real GDP forecast (%)

■ 2017 ■ 2018

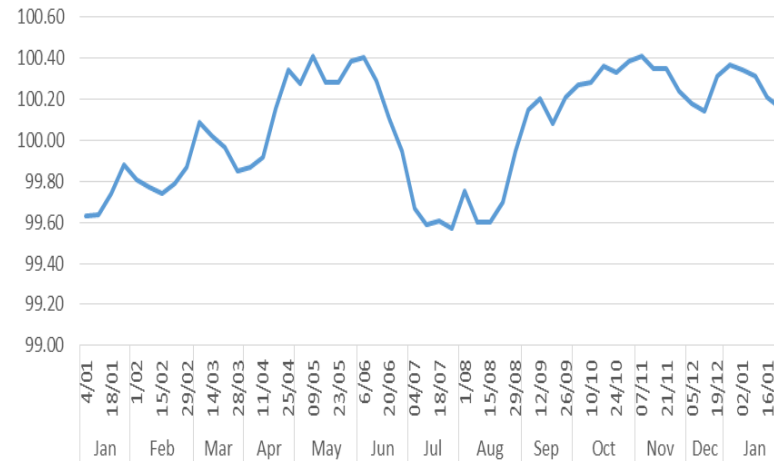


### Polish Economy: CASE forecasts



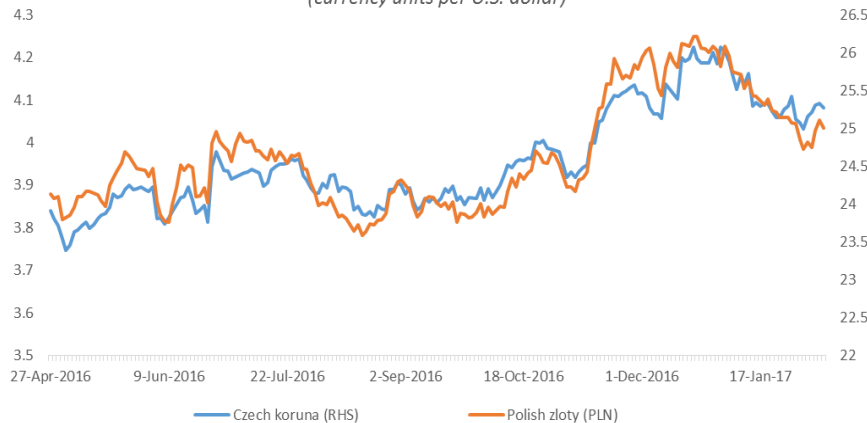
Source: CASE forecasts, forecast updated December 23, 2016

### Polish Online CPI



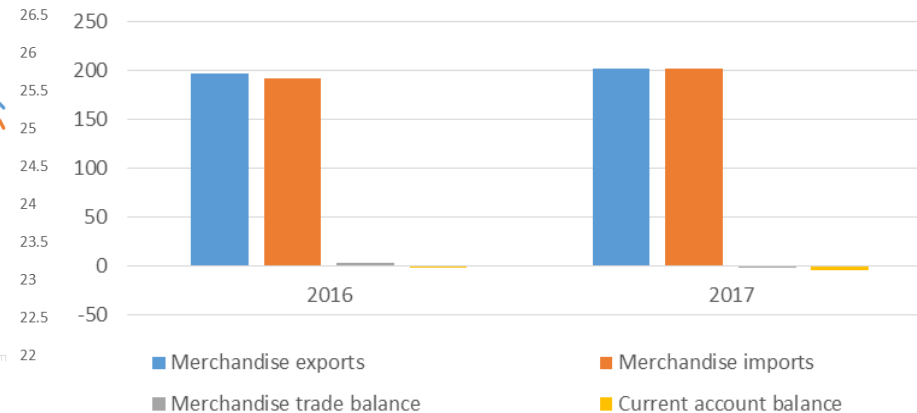
Source: CASE, most recent observation January 16, 2017

### Czech koruna and Polish zloty (currency units per U.S. dollar)



Source: IMF, most recent observation February 9, 2017

### Polish Trade: CASE forecasts US\$bn - annual total



Source: CASE forecasts, forecast updated December 23, 2016

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