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

Overview: In this week's showCASE, our experts unpack the results from the Heritage Foundation's latest Index of Economic Freedom publication and highlight CEE countries' performance. CASE also discusses the disagreement between the EU and the IMF regarding the Greek debt restructuring plan and how it could affect the real economy.

Land of the (Mostly) Free

By: Katarzyna Sidło, Political Economist, CASE

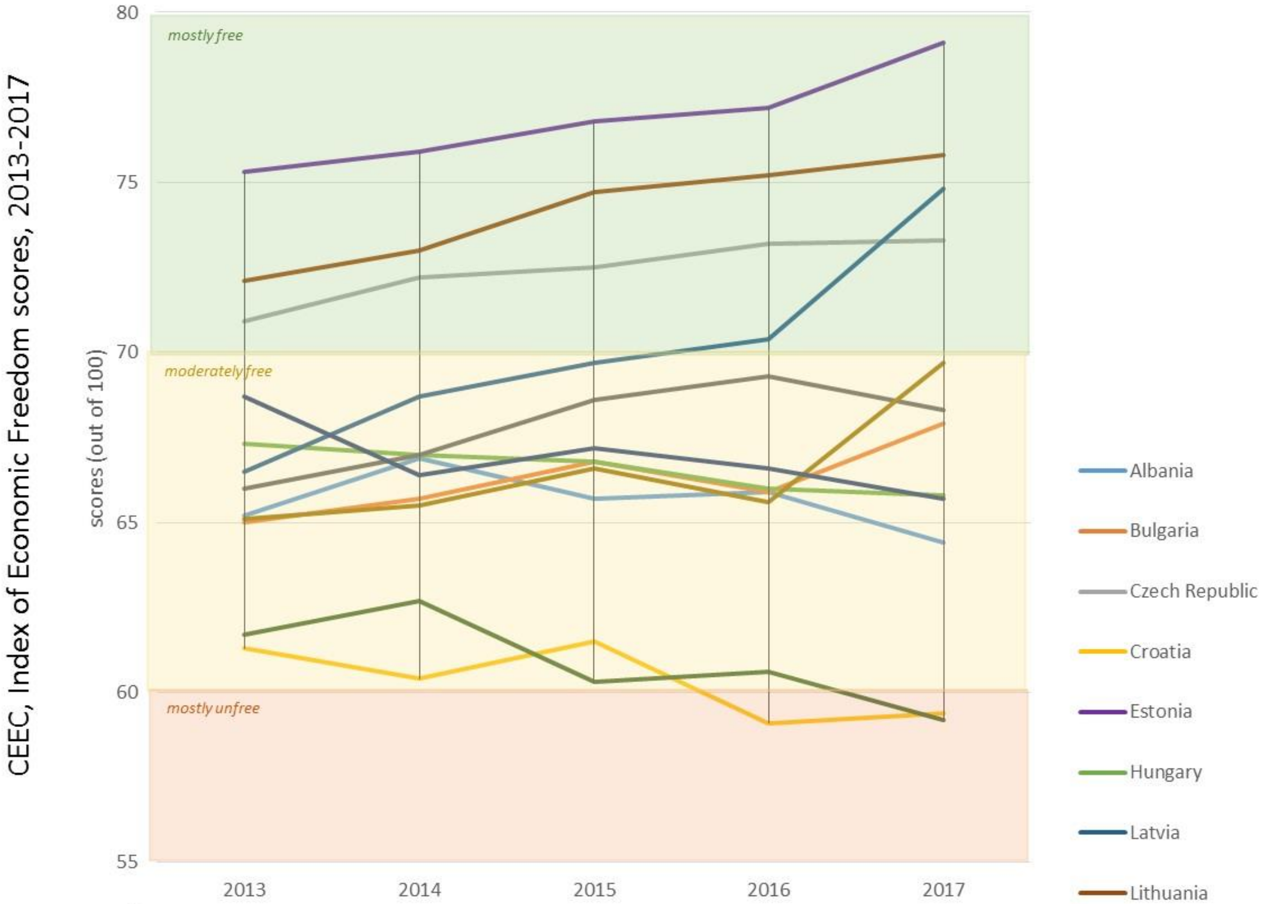
In this year's edition of the Index of Economic Freedom, published jointly by the Heritage Foundation and the Wall Street Journal, Central and Eastern European countries (CEEC) fared relatively well, with an average slightly above that of all of Europe (68.62 versus 68.00). Unfortunately, intra-regional differences among CEE countries have been widening since 2013 in terms of base scores and – with the exception of this year's index – ranking.

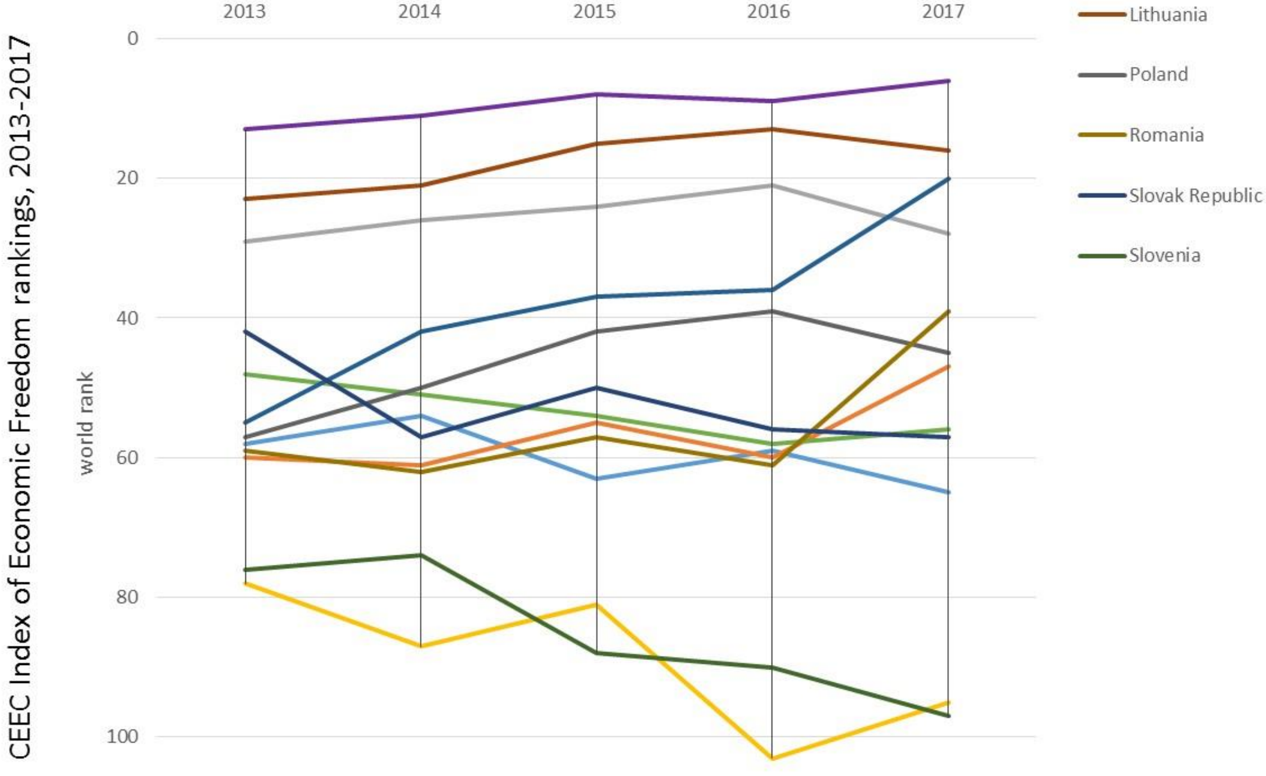
Estonia, for instance, is the only country in the region to consecutively make the top 10, ranking sixth in the world (up from ninth place last year), and second in Europe (behind Switzerland). Their overall score was 79.1 points out of 100. This was closely followed by Lithuania (16th place overall), Latvia (20th place), and the Czech Republic (28th place), each classified as "mostly free" countries. Six countries – Romania, Poland, Bulgaria, Hungary, Slovak Republic, and Albania – were ranked between 39th and 65th and classified as "moderately free." Only two states, Croatia (95th) and Slovenia (97th), were placed in the "mostly unfree" classification.

Regional statistics aside, when assessing the progress towards achieving economic freedom of a single country, these rankings should be interpreted with caution, as they only tell half of the story. The Czech Republic, for instance, was downgraded by seven places (from 21st to 28th) despite actually scoring 0.1 point higher than the previous year. Poland, whose score was 1 point lower than in 2016, was downgraded by six places (from 39th to 45th). Croatia, on the other hand, was upgraded by eight places (from 103rd to 95th), although it gained only 0.3 points in its overall score since the last ranking exercise.

What does all of this tell us? Making small progress is better than losing any points in the aggregates. But in a globalized and highly competitive world, unless competitors are progressing at an even slower rate, a country risks falling behind. Poland, for example, may try to downplay its falling in the rankings by underlining the tiny scale of the change, but the fact remains that, with excessive public spending, diminishing rule of law, and general ubiquity of the government, it will be hard-pressed to catch up with neighbors with less intrusive authorities, such as Estonia.

Prospective investors that are looking for opportunities in the region will most likely be looking at the relative rankings of a given country, especially if some states are consistently ranked highly; Estonia, for one, is ahead of Poland also in World Bank's Doing Business Rankings (by 12 places). Withholding legislation impeding economic freedom would therefore be a good start for many countries in the region (including, but by no means limited to, Poland). Introducing legislation enhancing it would be even better. In the race for economic freedom, if you are not moving forward, you are standing still.



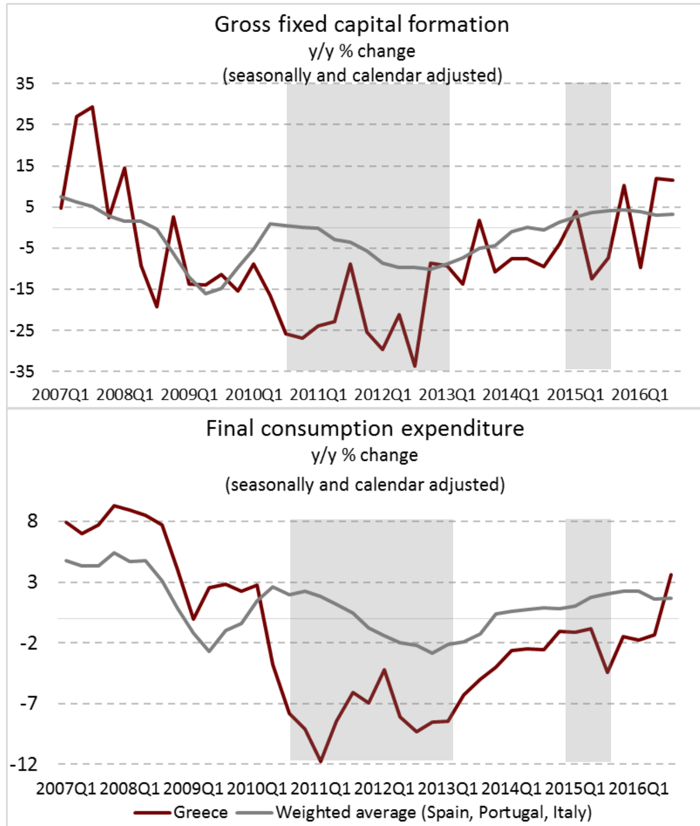


Source: the Heritage Foundation

The hidden costs of Greek bailout negotiations

By: Iakov Frizis, Economist, CASE

This week, yet another act of the Greek drama unfolded. Divisions between the European Union and the International Monetary Fund over the country's debt restructuring plan and new budgetary targets led to the extension of the negotiations' timeframe. This shift of the (potential) deadline to March or April of this year carries potential adverse effects for economic activity in Greece, as economic agents are likely to postpone investment in anticipation of a result that will determine whether or not the country is to maintain its solvency past July 2017, when a EUR 7 billion debt repayment is due.



Source: Eurostat

This turmoil adds to Greece's heightened level of economic uncertainty, an affliction suffered by many EU economies. However, for Greece, the effect in a fragile financing environment is of weakening its economic backbone, the SME sector. This has the potential to widen the existing wedge between actual and potential growth, fostered by the country's extensive product and labour market rigidities, thus furthering an already excessive amount of slack in the economy.

According to the European Commission's 2016 SBA fact sheet, Greece ranks the worst (by a wide margin) in terms of access to financing across the EU-28. These difficulties in obtaining financing squeeze the country's already weak consumer spending. Meanwhile, the decision of Greek insurance companies to halt the provision of new export guarantees further strains SME profitability. The combined effect has been to push the sector, which accounts for 87.3% of Greek employment (well above the 66.8% EU-28 average) and 75.1% of value added (57.4% EU-28 average), to operate at very low profitability. For instance, SMEs reported an unprecedented contraction between 2008 and 2015 (35% in terms of value added and 22% in terms of employment).

Undoubtedly, the return of creditors to Athens this week is a positive sign, as it signals the renewal of discussions on reforms that may help keep Greece closer to its budgetary targets. However, the underlying risks associated with delays in reaching an agreement, through increases in stock price volatility, as well as overall declines in investment, output and employment, further damages an already feeble growth path. Such instances of economic instability are evident in past Greek data, where peaks in a similar type of economic uncertainty both between Q1 2011 and Q1 2013, and during the Q3 2015, as recorded by KEPE'S implied volatility (GRIV) Index, coincide with drops in gross fixed capital formation and consumption.

Correctly paraphrasing the president of the Eurogroup, Mr. Dijsselbloem, reaching an agreement any time before July (when Greece is due to pay its creditors) poses no threat to the country's solvency. However, with each passing week, failure to dissolve uncertainty in the market by reaching an agreement increases the difference between the economy's productive capacity and the actual level of economic output. This should be expected to dampen the country's already-anemic recovery, which in turn will make it more difficult for Greece to adhere to its budgetary targets.

This week: The government has adopted the "Responsible Development Plan," a long-term development strategy for the country. The plan focuses on reindustrialization, innovativeness, and public investments. CASE experts believe that the Plan suffers from a lack of specificity and contains many activities which are unjustified economically. It is likely that the Plan will not achieve its targets in regards to investment.

GDP (Q4 2016)

2.7% y/y

Down from 2.5% in Q3

Inflation (Dec 2016)

0.8% y/y

Up from 0.2% in Nov

Unemployment (Jan 2017)

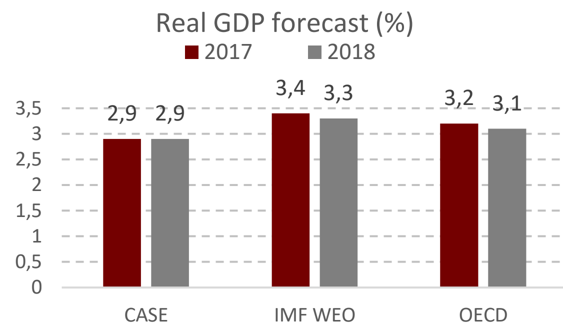
8.6%

Up from 8.3% Dec 2016

NPB Base rate

1.5%

From 2% March 2015



This week: OECD forecasts show that, following two years of recession, the Russian economy is expected to return to growth in 2017. Recent improvements, according to Rosstat, are mainly due to high net export levels. However a strengthening ruble has raised concerns regarding the country's overall competitiveness and pressures it entails for the budget deficit.

GDP (Q3 2016)

-0.4% y/y

Up from -0.6 in Q2

Inflation (Jan 2017)

5% y/y

Down from 5.4% in Dec

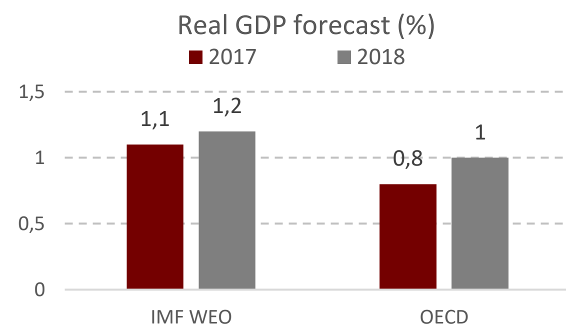
Unemploy. (Jan. 2017)

5.6%

Up from 5.3% in Dec

CBR Base rate

10%



This week: The Ifo Business Climate Index rose to 110.0 points this month (109.9 in January), reaching its highest score since August 2011. In particular, sentiment rose in manufacturing (food producers, mechanical and electrical engineering firms), and wholesale. In retail and construction, sentiment remained positive, despite a slight contraction.

GDP (Q4 2016)

2.5% y/y

Down from 2.8% in Q3

Inflation (Jan 2017)

1.9% y/y

Up from 1.7% in Dec

Unemployment (Q3 2016)

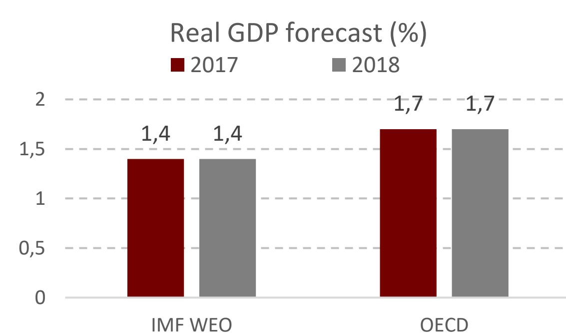
4.2%

Down from 4.28% in Q2

ECB Deposit rate

-0.4%

From -0.3% Dec 2015



This week: Ukraine's GDP grew by between 4.5%-4.8% in Q4 2016 y-o-y according to the preliminary assessment of State Statistics Service. Commenting on the recent increase in agricultural production and exports, the Central Bank's Deputy Governor Dmytro Sologub has described agriculture as "a locomotive of the Ukrainian economy".

GDP (Q4 2016)

4.5-4.8% y/y

Preliminary data

Inflation (Jan 2017)

12.6% y/y

Up from 12.4% in Dec

Unemployment (Q3 2016)

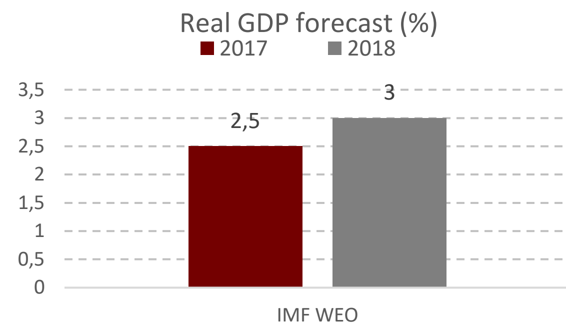
9.2%

Down from 9.3% in Q2

NBU Base rate

14%

Unchanged from Jan 2016



This week: The Czech Statistical Office recently released data putting the overall 2016 growth at 2.3% (y/y), two times less than the year before (4.6% y/y), and below expectations. This is, in part, attributed to a drop in the flow of funds from the EU. In other news, the Czech National Bank re-committed to keep the cap on the koruna/euro exchange rate until mid-2017.

GDP (Q4 2016)

1.7% y/y

Down from 1.9% in Q3

Inflation (Jan 2017)

2.2% y/y

Up from 2.0% in Dec

Unemployment (Q4 2016)

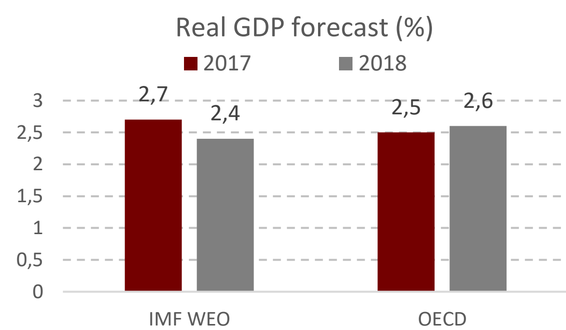
3.6%

Down from 4.0% in Q3

CNB Base rate

0.5%

Unchanged since Nov 2012



This week: According to Hungarian Central Statistics Office, 9,994 new dwellings were built in 2016, up 31% from 2015. Further, the volume of sales in retail shops for December 2016 increased by 3.3% y/y (seasonally adjusted). Increased sales were distributed among food (3.2%), non-food (3.0%), internet/mail order (3.7%), and motor vehicle (9.9%) retailing.

GDP (Q4 2016)

1.6% y/y

Down from 2.2% in Q3

Inflation (Jan 2017)

2.3% y/y

Up from 1.8% in Dec

Unemployment (Q4 2016)

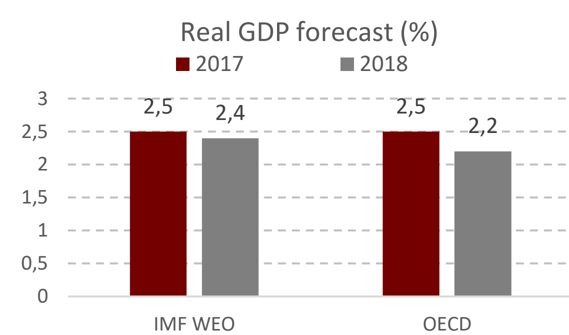
4.4%

Down from 4.9% in Q3

MNB Base rate

0.9%

From 1.05% May 2016



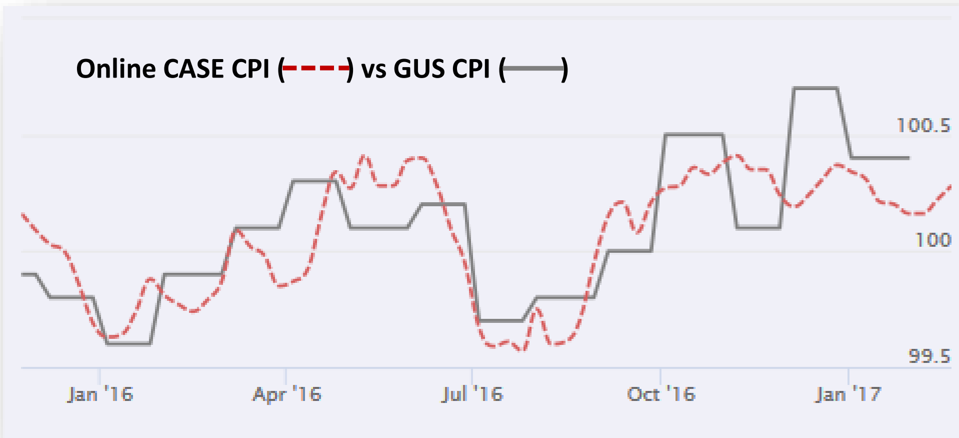
Other CASE products

Center for Social and Economic Research

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	2.9	3.2	2.0	3.5	0.5
2018	2.9	3.0	2.7	3.7	1.0

	Nominal monthly wages	Merchandise exports (USD, bn)	Merchandise imports (USD, bn)	Merchandise trade balance (USD, bn)	CA balance (USD, bn)
2017	4.1	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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