showCASE

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

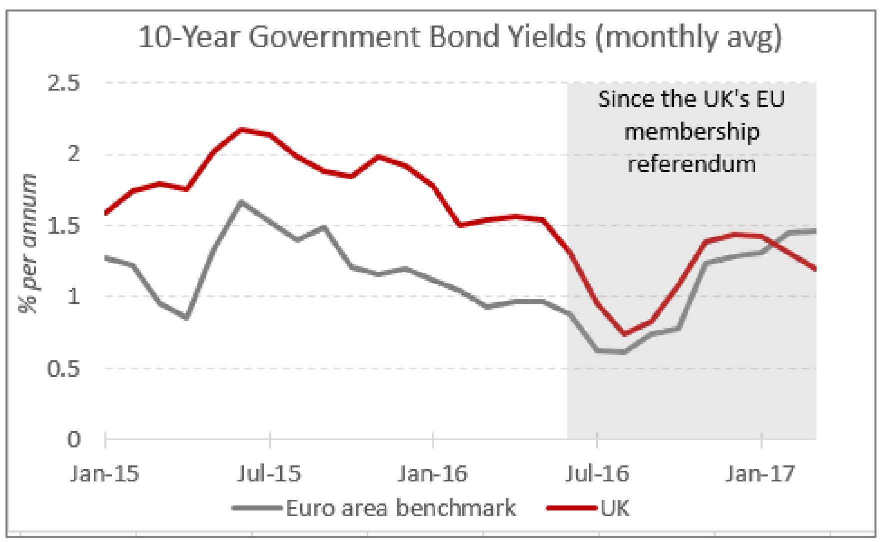
Overview: In this week's showCASE, our experts analyze how waning confidence in the Eurozone could be prompting investors to shift towards the UK in search of a new regional safe haven. CASE also discusses the recent presidential elections in Serbia and tries to gain an understanding of why thousands are still protesting, seven days later.

The rising costs of the Eurozone's persistent institutional deficit

By: Iakov Frizis, Economist, CASE

The findings of the HSBC Reserve Management Trends 2017 report, released on April 3rd, seem to indicate that Eurozone uncertainty is prompting markets to search for new regional safe havens. Responses from 80 central banks surveyed disclose that the majority of them have been reducing exposure to the euro over the past months, pointing to sterling as a safer alternative.

Despite not having adopted the single currency, the British economy closely entangled its economic future with that of continental Europe via the European Union. This link is best showcased by the financial integration between the island nation and the continent. To date, London retains the deepest markets for over-the-counter Euro foreign exchange transactions and interest rate derivatives, with daily turnover reaching close to EUR 1 trillion. In this context, under normal conditions, the practice of dumping euros in favor of British pounds reflects strong opportunities to reduce risk through diversification.



Source: European Central Bank and the Bank of England

However, standard hedging explanations fall short when one analyzes recent EU and UK capital flows. Instead, waning confidence in the Eurozone better describes the recent impetus for portfolio rebalancing, as markets shift towards the UK in search of a new regional safe haven. Since June, when the results of the Brexit referendum were announced, the yield on a representative European security has jumped by a whopping 66%, to a monthly average of 1.45% for March. Over the same period, the analogous British security decreased by 8.89%, dropping to 1.19% for March, following a 1.43% peak in December.

Source: Reuters

On the back of a heightened level of global uncertainty, this reversal in valuations reflects the rising importance of institutions for economic stability. In this respect the UK, a financial, trading and monetary powerhouse since the dawn of the first wave of globalization in the 1820s, dwarfs the Eurozone, a young currency amongst European states that exhibit sporadic cyclical synchronicity and fading political motivation for joint action. This gap in terms of institutional quality leads to significant differences in the way uncertainty is perceived between the two sides of the English Channel. In particular, markets view Brexit-related volatility as ephemeral, but are gravely concerned with consistent stagnation faced by the Eurozone. Notably, according to the HSBC survey, current sluggish growth rates, the persistence of negative interest rates, and political instability across the Eurozone are the main sources for concern in 2017.

In a sense, the recent impetus of rebalancing exposure away from the single currency comes as little surprise. Despite presenting itself to the world as an economic behemoth, the Eurozone still lacks significant institutional ground before it becomes a well-functioning (if still sub-optimal) currency area. As long as the institutional status quo remains unchanged, markets will be looking towards (as it turns out, a not-so-isolated) Britain for a safer regional alternative.

Serbia: Has the rider on the white horse just arrived?

By: Katarzyna Sidło, Political Economist, CASE

Despite “some procedural shortcomings“ reported during last week’s presidential elections in Serbia, the results were far from surprising – current Prime Minister Aleksandar Vučić won by a large margin, leaving the second most popular candidate, Saša Janković, almost 39 percentage points behind. Both the EU and Russia were quick to congratulate Mr. Vučić on his election victory; the president elect, for his part, underlined his commitment both to EU-accession talks and “maintaining traditional friendships with Russia and China".

Not all Serbians are happy with the elections results, though, and many (including segments of the large diaspora) seem to be growing tired of Mr. Vučić’s balancing act. As this article goes to press, protests in Belgrade and other places (among them Novi Sad, Nis, Zrenjanin, and Jagodina) in the country carry on for a seventh day in a row. The crowds, apparently consisting mostly of thousands of young people, accuse Mr. Vučić of rigging the election and of having dictatorial inclinations. The protesters, using social media to organize themselves, have also been bringing up the issue of the Serbian Progressive Party’s possible influence over traditional media outlets. Indeed, according to one media analysis agency, a whopping 51.15 % of all Serbian media air-time reporting on the elections was dedicated to the incumbent Prime Minister.

Mr. Vučić does not seem to be treating the protests seriously, downplaying the level of discontent by saying that “everyone has the right to be (…) unhappy” with the results, adding “imagine [how big the gatherings would be] if I were to call on all my supporters to go and celebrate”.

While his nonchalance is not surprising, completely ignoring the protests might be unwise. Mr. Vučić may have won the election, but his mandate could be tarnished by the fact that third place was taken by a fictional character. And any country in which a white-suit-cladded, horse-riding, corruption-praising parody of a politician (Ljubiša Preletačević aka Beli) wins 9.4% of all the votes, it is hard to say that political institutions are fully functional. This is a fact that the protesters and Mr. Vučić are likely in agreement on. It is only the solution to the problem that they see differently.

Source: YouTube screenshot

This week: In a meeting last Wednesday, the Monetary Policy Council decided to keep the base rate unchanged at 1.5% (with the deposit rate at 0.5% and the Lombard rate at 2.5%). The Council concluded that inflation, which accelerated at the beginning of 2017, would stabilize in the coming months, and the Central Bank's inflation target of 2.5% would be attainable without the need to increase the interest rate in the medium-term.

GDP (Q4 2016)

2.7% y/y

Up from 2.5% in Q3

Inflation (Feb 2017)

2.2% y/y

Up from 1.8% in Jan

Unemployment (Feb 2017)

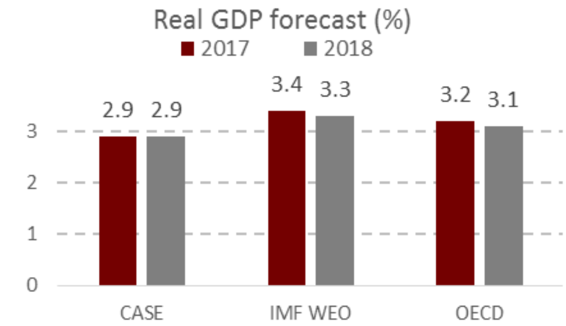
8.5%

Down from 8.6% in Jan

NPB Base rate

1.5%

From 2% March 2015



This week: According to the Russian Federal State Statistics Service (Rosstat), Russia's economy grew by 0.3% in Q4 2016 (y/y). However, last week, Rosstat also released numbers on 2016 poverty rates in Russia, which showed a decade-high of 19.8 million Russians living in poverty. This compares to 16.1 million in 2014, just before the current economic crisis began.

GDP (Q4 2016)

0.3% y/y

Up from -0.4 in Q3

Inflation (Mar 2017)

4.3% y/y

Down from 4.6% in Feb

Unemployment (Feb 2017)

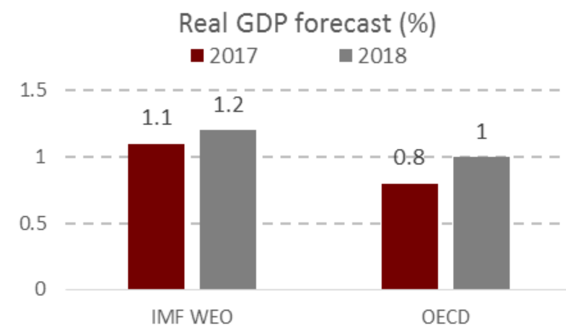
5.6%

No changes from Jan

CBR Base rate

9.75 %

Down from 10%



This week: The German economy remains a top performer, with unemployment at its lowest level since reunification, and economic growth expanding at its fastest rate since 2016. Industrial production in February retained January's 2.2% m/m growth rate. However, retail sales did not follow suit, recording a 2.1% m/m contraction in February.

GDP (Q4 2016)

1.2% y/y

Down from 1.5% in Q3

Inflation (Feb 2017)

2.2% y/y

Up from 1.9% in Jan

Unemployment (Q4 2016)

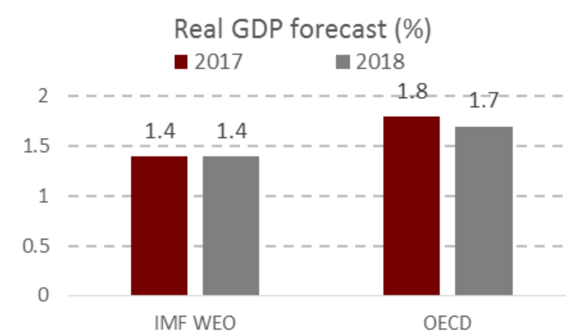
3.9%

Down from 4.15% in Q3

ECB Deposit rate

-0.4%

From -0.3% Dec 2015



This week: On April 3, the International Monetary Fund approved the disbursement of a fourth tranche of financial assistance to Ukraine in the value of USD 1 billion. The IMF said that it welcomed Ukraine's gradual recovery from the deep economic crisis of 2014-15 and acknowledged some reform progress, including in the banking sector. At the same time, the IMF stressed the need to step up other reforms, particularly in the area of good governance.

GDP (Q4 2016)

4.7% y/y

Up from 2.1% in Q3

Inflation (Feb 2017)

14.2% y/y

Up from 12.6% in Jan

Unemployment (Q4 2016)

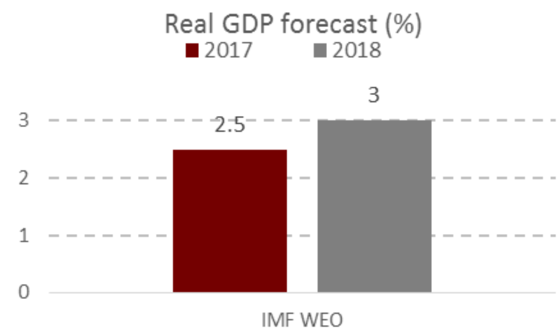
10.0%

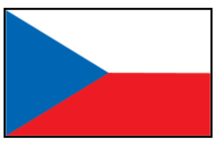
Up from 9.2% in Q3

NBU Base rate

14.0%

Unchanged from Jan 2016





This week: During an extraordinary Bank Board meeting on April 6, the Czech National Bank announced that it would remove its upper cap on the EUR/CZK exchange rate, effective immediately. Interest rates were not discussed during the meeting, and they remain unchanged for the time being (i.e. the two-week repo rate at 0.05%, the discount rate at 0.05%, and the Lombard rate at 0.25%).

GDP (Q4 2016)

1.9% y/y

1.9% in Q3

Inflation (Feb 2017)

2.5% y/y

Up from 2.2% in Jan

Unemployment (Q4 2016)

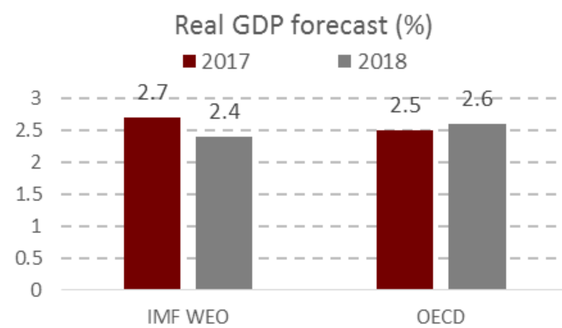
3.6%

Down from 4.0% in Q3

CNB Base rate

0.05%

Unchanged since Nov 2012



This week: On April 5, policy makers as well as economic and financial market leaders met in Budapest for the third Budapest Renminbi Initiative Conference. These conferences aim to further promote Chinese-Hungarian economic partnerships by expanding investment opportunities and financing sources. According to the Hungarian National Bank's executive director, Daniel Palotai, Chinese exports towards Hungary reached 4.4 billion euros last year.

GDP (Q4 2016)

1.6% y/y

Down from 2.2% in Q3

Inflation (Feb 2017)

2.9% y/y

Up from 2.3% in Jan

Unemployment (Q4 2016)

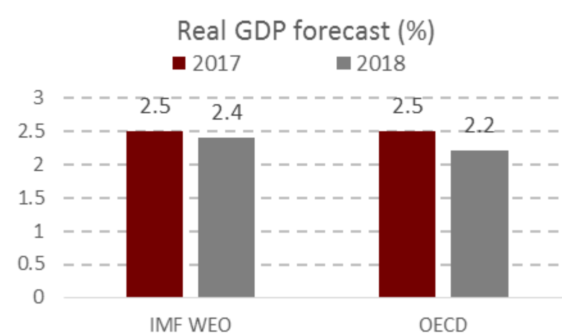
4.4%

Down from 4.9% in Q3

MNB Base rate

0.9%

From 1.05% May 2016



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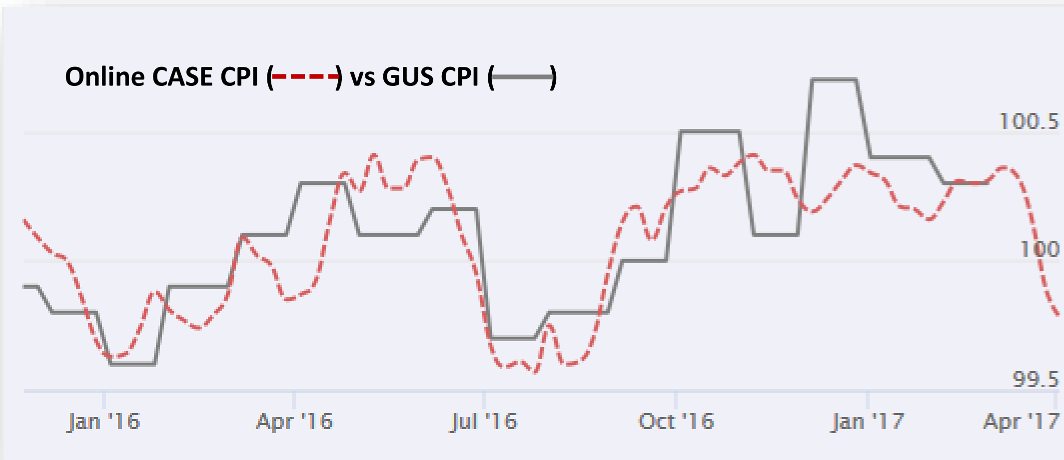
Center for Social and Economic Research

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

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