showCASE
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Overview: In this issue of showCASE, we look at the planned reform (or, as our analyst argues – deform) of the Polish pension system. We also try to answer the questions how and why did the situation on the Chinese steel market affect Beijing-Brussels climate change talks.

Pension system in Poland deformed, not reformed

By: Krzysztof Głowacki, CASE Economist

The Polish government is preparing a draft reform that will abolish the open pension funds (OFE) and transfer their savings to the public and private pillars of the pension system. The move potentially puts one quarter of future pensioner savings at risk.

Since the landmark reforms of 1999, the Polish pension system has been based on three pillars: the mandatory public pay-as-you-go scheme managed by the Social Insurance Institution (ZUS in Polish), the open pension funds, mandatory until 2014 but voluntary since), and private individual pension accounts, or IKE/IKZE (voluntary). OFE, a funded-pension scheme, was introduced to help maintain sustainability of the pension system, a challenge given the demographic situation in the country. OFE was also supposed to channel additional resources into the country's fledgling financial institutions, as well to improve corporate governance in public companies thanks to the higher involvement of institutional stakeholders (CASE examined these aspects back in 2001). Designed as a mixture of a private and a public pension scheme, OFE operates through individual pension accounts of employees; these accounts are managed by private funds operating in the form of joint stock-companies, which charge investment fees, but contributions to OFE are collected together with other social contributions by the Polish government.

In a much-debated move in 2014, the Civic Platform government decided to transfer treasury bonds held as investment by OFE to ZUS and transform these market-traded debt instruments into pension obligations of the state. While this transfer significantly reduced the budget deficit and helped Poland graduate from the EU's Excessive Deficit Procedure, it also triggered the risk of eroding macroprudential policy and evoked concerns about the state's grip over the assets held in the pension system.

The current draft reform of the Law and Justice government goes several steps further towards re-nationalizing the entire system. The reform aims to dissolve OFE altogether and transfer its assets, currently a total of PLN 175 billion (EUR 42 billion), to the other two pillars of the pension system. Under the plan, individual OFE accounts would be transformed into individual private IKZE accounts, with 75% of OFE's assets retained for holders (details as to how exactly this would be implemented are still pending), and the remaining 25% transferred to the public Demographic Reserve Fund (FRD), ZUS's long-term equivalent.

The proposed allocation of assets to IKZE is not controversial in Poland, as it guarantees preservation of the pension rights of the insured and is not a threat to asset ownership. In contrast, the allocation of approximately PLN 40 billion to the FRD carries with it at least a potential risk of abuse. The assets in the FRD, while in theory dedicated to the future, have already been used in the past to finance ongoing pension payouts. Worse yet, the current draft reform envisages subordinating the FRD to the Polish Development Fund, whose statutory goals are quite different from pension security and instead focus on development projects. This means that the FRD's assets might be used to finance projects that are politically useful but economically irrational, or whose risk premiums are excessive with view to their original purpose. Finally, if the bill goes through, the Warsaw Stock Exchange is also likely to be negatively affected, as the reform may trigger oversupply of stocks to the market by the FRD (or OFE funds before it).

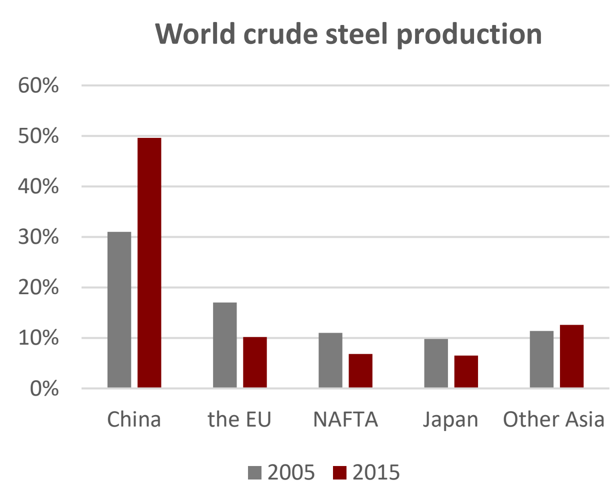
Poland faces a serious demographic challenge: the ratio of employees to pensioners is dwindling fast, as a result of an aging society and insufficient net immigration. The country needs to redesign its pension system accordingly and prepare appropriate financial buffers for future. The government seems to be headed in the opposite direction, however, having first reduced the statutory retirement age and now hijacking a quarter of OFE's assets for unknown use.

The EU-China summit in Brussels: Steely Resolve, No Resolution

By: Givi Gigitashvili, CASE Analyst

The 19th bilateral EU-China summit was held on June 1-2 in Brussels but came to a disappointing end, as both sides failed to adopt a final common communique. This result was to some extent predictable, as the EU has been hesitant to award market-economy status (MES) to China, certifying that domestic prices in China being determined by fair competition rather than the government. Predictably, this stance has caused friction between the two trade powers. In particular, the EU is unhappy about the Chinese government's support for its steelmaking industry, with subsidies creating a flood of Chinese steel imports which may threaten European mills.

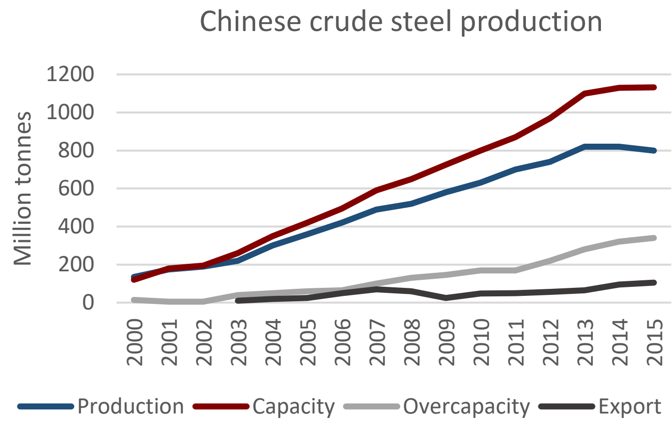
China joined the World Trade Organization (WTO) in December 2001, but the European Parliament adopted a resolution refusing to grant China the market economy status on account of it not meeting the EU's five criteria. These criteria call for MES to be granted only if, in the EU's determination, a government's influence over the allocation of resources and decisions of enterprises is very low; the state does not interfere in the operation of enterprises linked to privatization; there is a transparent and non-discriminatory company law, ensuring adequate corporate governance; and property rights are respected and financial sector operates independently from the state. Despite this framework, however, Beijing claims that, according to Section 15 of the WTO accession protocol, it is automatically entitled to receive MES starting from December 2016, no matter what the EU continues to believe. On these grounds, it legally challenged the EU's refusal by filling a complaint under the WTO framework in early 2017.



Source: World Steel Association.

The EU's position is that Chinese firms have so far failed to prove that they operate by market rules. Somewhat ironically, the same Section 15 allows for the use of non-market methodologies to calculate the so-called "dumping margins" of Chinese goods, which in turn may lead to enforcement of anti-dumping duties. Needless to say, these clashing interpretations make Section 15 highly controversial and could instigate a protracted legal battle between two parties.

Much of the wrangling over China's "market" status is related to an area near and dear to the EU, mainly the Chinese steel industry and the heavy state support provided to this sector. The Chinese government poured vast amounts of money into the steel industry when its economy was booming prior to the 2008 global financial crisis, while growing demand for steel led to high capacity-utilization rates. However, as the slowdown of economic growth has accelerated in China, domestic and external demand for steel has also declined. Driven by political imperatives rather than market ones, Chinese authorities appeared unable to stop the spigot of funds from flowing, and continue to overinvest in industrial steelmaking facilities, pushing them to join the ranks of 'zombie companies'. Ample governmental subsidies, combined with reduced demand, created structural overcapacity in China's steel sector and triggered a flood of cheap Chinese steel on the international markets.



Sources: Duke CGGC; National Bureau of Statistics of China.

One of these markets was the EU, which has been reluctant to turn a blind eye to Chinese dumping. In 2016, the European Commission's (EC) investigation concluded that Chinese companies were selling steel products in the EU well below half of the price of the producers' home market. Moreover, European steel association claimed that Chinese steel dumping has been the key cause of the loss of tens of thousands of steel jobs in Europe in recent years. Seeking to protect European steel producers, last January the EC imposed anti-dumping duties ranging from 30.7% to 64.9% on steel products from China. In total, out of 85 anti-dumping measures that were imposed by the EU against Chinese products between 1995 and 2014, seventeen concerned steel imports.

Overall, the stakes for this dispute are high. Should China obtain MES, importer countries will find it harder to impose anti-dumping measures against Chinese imports, which already are the subject of the largest number of anti-dumping probes in the world. The Chinese government's key aim is naturally to protect jobs in China in order to maintain social stability. To this end, it abundantly subsidizes its internal economy and sell its exports at low prices abroad. So long as the value of Chinese product is largely determined by government interference and not by market prices, the EU is ill-disposed to put its own industries at a disadvantage by granting Beijing MES.

This week: Last week, the Polish government adapted new optimistic budgetary assumptions for 2018. The government hopes the financial stability of the country will be maintained and GDP growth to will accelerate 3.8% (against a forecast 3.6% in 2017). It also projects unemployment falling to 6.4%, which in turn is expected to lead to higher salaries.

GDP (Q1 2017)

4.2% y/y (est.)

Up from 2.9% in Q4

Inflation (Apr 2017)

2.0% y/y

Unchanged from Mar 2017

Unemployment (Apr 2017)

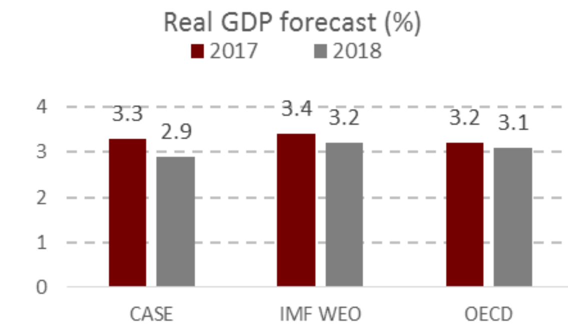
7.7%

Down from 8.1% in Mar

NPB Base rate

1.5%

From 2% Mar 2015



This week: Ethereum, the world's largest cryptocurrency after bitcoin, has caught the attention of Vladimir Putin as a potential tool to help Russia diversify its economy. During a meeting between Putin and the founder of Ethereum, Vitali Buterin, they discussed ways of application of the currency in Russia. Reportedly, the president supported the idea of establishing new business relationships with local partners to implement blockchain technology in the country.

GDP (Q4 2016)

0.3% y/y

Up from -0.4 in Q3

Inflation (May 2017)

4.1% y/y

Down from 4.3% in Mar

Unemployment (Apr 2017)

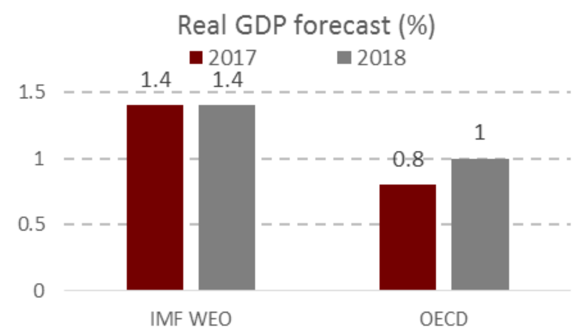
5.3%

Down from 5.4% in Apr 2017

CBR Base rate

9.25 %

Down from 9.75%



This week: Economic sentiment in the country remained positive with both manufacturing PMI and services PMI hovering above the 50 point threshold. Notably, manufacturing PMI reached 59.50 points in May, up from 59.40 during the previous month. Services PMI also recorded an uptick, scaling up to 55.40 points in May from 55.20 in April.

GDP (Q1 2017)

1.7% y/y

Down from 1.8% in Q4

Inflation (Apr 2017)

1.4% y/y (est.)

Down from 2% in Apr

Unemployment (Q4 2016)

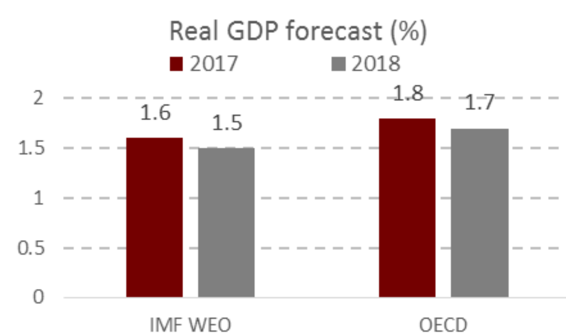
3.9%

Down from 4.15% in Q3

ECB Deposit rate

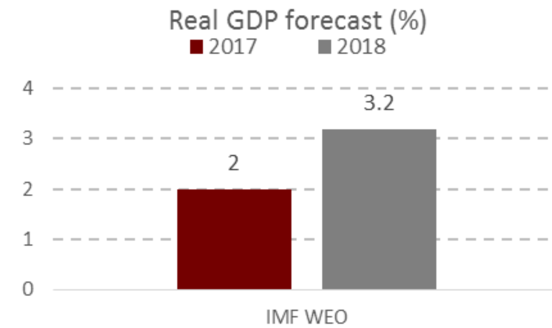
-0.4%

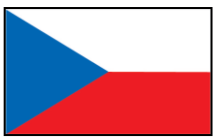
From -0.3% Dec 2015



This week: In a recent forecast, the World Bank predicts that the Ukrainian economy will grow by 2.0% in 2017, down from 2.3% in 2016. This is still an improvement over previous years, where the economy contracted by 9.8% in 2015 and 6.6% in 2014. The current slowdown in growth has been linked to the renewed conflict in Donbas and stepped-up efforts by Russian troops and proxies to destabilize the Ukrainian government.

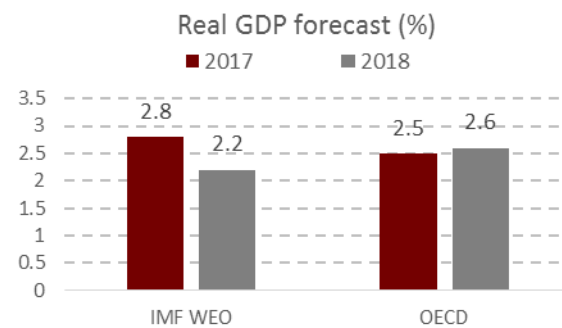
GDP (Q1 2017)	Inflation (May 2017)
2.4% y/y (est.)	13.5% y/y
Down from 4.7% in Q4	Down from 12.2% in Apr
Unemployment (Q4 2016)	**NBU Base rate**
10.0%	12.5%
Up from 9.2% in Q3	From 13.0% in May





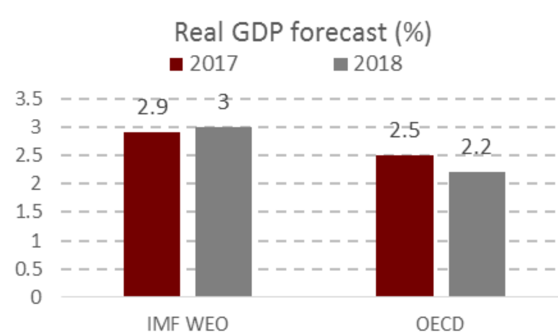
This week: Average monthly wages in the Czech Republic in Q1 2017 grew by 5.3% y-o-y (2.8% on a real basis), fastest since the 2008 financial crisis. Decreasing levels of unemployment and the healthy state of the economy in general are believed to be the main factors behind this growth.

GDP (Q1 2017)	Inflation (May 2017)
2.9% y/y	2.4% y/y
1.9% in Q4 2016	Down from 2.0% in April
Unemployment (Q1 2017)	**CNB Base rate**
3.4%	0.05%
Down from 3.6% in Q4	Unchanged since Nov 2012



This week: Hungary, Russia, and Serbia are renewing talks on the construction of a gas pipeline that would partially mirror the route of the now abandoned South Stream pipeline. Hungary's foreign minister argued that a quick construction of another gas pipeline was a fundamental interest of the country, although the new proposed pipeline will have a smaller capacity than South Stream.

GDP (Q1 2016)	Inflation (May 2017)
3.7% y/y (est.)	2.1% y/y
Up from 1.6% in Q4	Down from 2.2% in Apr
Unemployment (Q1 2017)	**MNB Base rate**
4.7%	0.9%
Up from 4.5% in Q4	From 1.05% May 2016

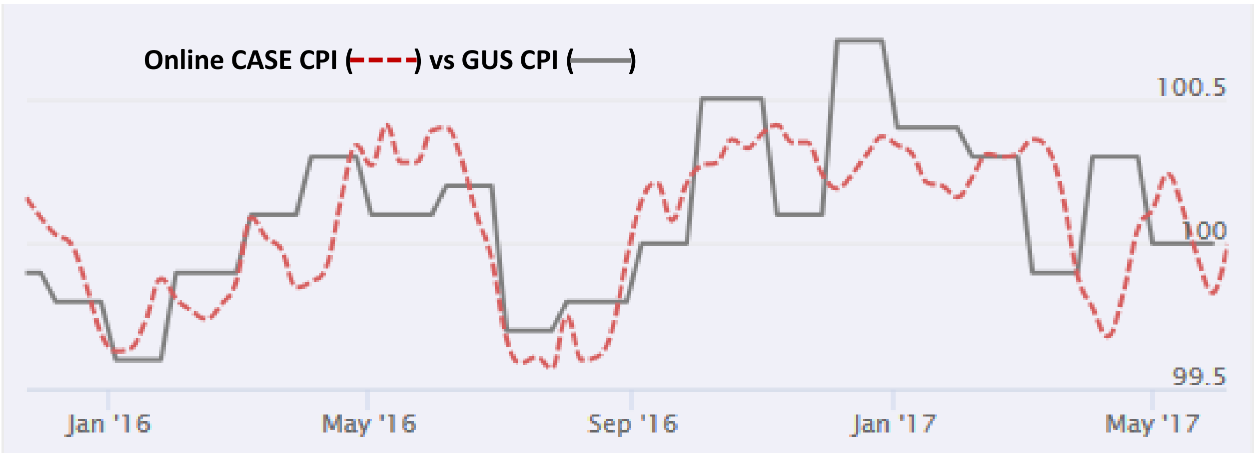


Center for Social and Economic Research

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	3.3	3.5	2.9	3.8	1.9
2018	2.9	3.0	2.7	3.7	2.0
	Nominal monthly wages	**Merchandise exports (USD, bn)**	**Merchandise imports (USD, bn)**	**Merchandise trade balance (USD, bn)**	**CA balance (USD, bn)**
2017	4.7	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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