

From the Editor: This week, in the first issue of showCASE on a bi-weekly basis, CASE President Przemysław Kowalski provides a broader context for what seems like a looming global trade war.

Remaining Lucid at an Outbreak of a Global Trade War

By [Przemysław Kowalski](#), CASE President

The current trade tensions are worrying ...

This week marks the introduction of the latest round of US import tariffs aimed at protecting US producers against what is seen by the US administration as “unfair” competition from abroad, mainly China.¹ July also marks the implementation of some of the retaliatory tariffs introduced by China,² Canada,³ and the EU⁴ in response to US tariffs imposed earlier this year on imports of washing machines, solar panels, and steel and aluminum products. Other countries such as Japan and the Russian Federation have also threatened to respond with import duty increases, and the US administration is currently considering yet another set of tariffs on imports of selected products from China and on imports of cars and car parts from all countries (Table 1).

Table 1. Recent US and other import tariff impositions

Panel A. By US

Exporting partners	Product	Increased tariff	Implemented or considered
All	Washing machines and solar panels	20-30%	Implemented
All	Steel	25%	Implemented
All	Aluminum	10%	Implemented
All	Cars and car parts	25%	Considered
China	818 different goods	25%	To be partially implemented in July
China	Discussed	10%	Considered

Panel B. Retaliation by other countries

Importing partner	Product	Increased tariff	Implemented or considered
Canada	Various goods, including steel, aluminum, and consumer products	10%, 25%	To be implemented in July
China	659 different goods, including soybean and pork	25%	To be partially implemented in July
European Union	Various goods, including whisky, steel, and agri-food products	10%, 25%, 35%, 50%	To be implemented in July
Mexico	Various goods, including steel, whisky, and pork	20%, 25%	Implemented
Turkey	Various goods, including whisky and coal	Up to 40%	Implemented

Source: Cheng et al. (2018).

¹ Coming into force on July 6.

² To be partially implemented on July 6.

³ They will be implemented on July 1.

⁴ EU tariffs will also be implemented this July.

Many of us are increasingly confused and worried about this escalation of trade tensions between the world's major economic powers. International trade is one of those age-old economic activities which grew throughout millennia with the history of human kind and which have an intuitive appeal to the general public. Most of us see the value in being able to exchange goods and services across borders in much the same way as we see the value in daily exchange of products and services with our domestic peers. We trade in order to be able to focus on what we produce best, to benefit from the greater efficiency with which our trading partners produce other products, and for the greater variety trade offers. Moreover, today, the most advanced firms draw heavily on parts and inputs coming from abroad; it is impossible to produce competitive products without trading intermediate inputs.

... also because of trade's historical correlation with peace

History has also taught us that periods of openness to trade and orderly international economic co-operation go hand in hand with international peace. This was famously the case with the first wave of globalization, which started around 1870 and coincided with unusual peace among nations, which nevertheless came to a sudden end with the outbreak of two devastating World Wars following a period of rising nationalism and economic tensions. In the post-WWII history, a growing number of countries were again opening their economies to international trade and investment, as testified by successive multilateral, regional and unilateral liberalization initiatives, and the pro-market and pro-trade reforms that followed the collapse of the Iron Curtain and the gradual opening of emerging economies in Asia, Latin America, and Africa.

Today, with almost daily announcements of new restrictive trade and foreign direct investment measures by the US and other major economic powers, it is increasingly possible that the current golden trade and investment era, which many of us have been taking for granted, may be coming to an end. All this occurs in an environment of rising economic and social nationalisms. One is beginning to ponder whether the looming trade war will not lead to more serious political or military tensions.

The move by the US is shocking but also telling...

The fact that it is the US that has initiated this trade confrontation is both shocking and telling. The US has been one of the key shapers of the post-WWII international economic order – for example, it was a proponent of the General Agreement on Tariffs and Trade (GATT) and the WTO. More recently, the US was also the main driving force behind the negotiations of the Trans-Pacific Partnership (TPP) agreement since 2008 – one of the most advanced contemporary FTAs, which was supposed to regulate a wide range of commercial issues between twelve countries in the Asia-Pacific Rim – and the Transatlantic Trade and Investment Partnership (TTIP), an agreement negotiated since 2013 with an aim to complement the TPP and secure similarly beneficial trading conditions between the US and the EU. Returning to the topic of import tariffs, it is also quite revealing that before the onset of the current tensions the US market was more open to imports of many of the currently affected products as compared the EU, China or Japan (Table 2).

Table 2. MFN applied tariffs in 2017 (before the onset of the tensions)

Product/Importing country		China			European Union			Japan			US		
Product name	Product HS code	Avg.	Min	Max	Avg.	Min	Max	Avg.	Min	Max	Avg.	Min	Max
Aluminum	76	8.8%	1.5%	30%	6.4%	0%	10%	3.8%	0%	7.5%	3.5%	0%	6.5%
Apparel, knitted or crocheted	61	16.2%	14%	25%	11.7%	8%	12%	9%	5%	10.9%	12.8%	0%	32%
Motorcycles	8711	42.1%	30%	45%	6.6%	6%	8%	0%	0%	0%	0.5%	0%	2.4%
Passenger cars	8703	25%	25%	25%	9.8%	5%	10%	0%	0%	0%	2.5%	2.5%	2.5%
Steel and iron	72	5%	0%	10%	0.3%	0%	7%	0.3%	0%	6.3%	3.1%	0%	10%
Whisky	220830		10%		0%			0%			0%		

Source: WTO (https://www.wto.org/english/tratop_e/tariffs_e/tariff_data_e.htm). HS refers to Harmonized System nomenclature.

It may thus seem surprising that it is the US that seems to be throwing a spanner in the works of the multilateral trading system that it has itself shaped. The election of Donald Trump as the US President in late 2016, his strong views on international trade and his impetuous personality certainly come to mind as important factors, but it is not helpful to see the current trade tensions purely as the “Trump effect”. Understanding the complex, but not unrelated, international competitive context is key for finding a constructive way forward.

...and occurs in a wider context of long-standing concerns about the international level playing field

Critical views regarding globalization and trade integration have been expressed more and more frequently on both the left and the right side of the political spectrum not only in the US but also in a number of other states, including the United Kingdom, France, and Germany. To some extent, this globalization backlash reflects public dissatisfaction with effects of a broader suite of policies, not just trade. But a number of trade-specific concerns have also been raised in recent years, and these have become an important focus for the public, business and policy makers. The questions of equal opportunities, the respective roles of states and markets, state ownership, subsidization, monopolistic practices, and a level playing field in international markets are at the heart of this debate. They precede the US elections in 2016 and are among the key concerns that the US administration is raising as a justification for its recent trade policy actions.⁵

In essence, the economic argument against state intervention in an international context is that for gains from international trade to materialize, state policies should not play too large a role in subsidizing or otherwise influencing a trade pattern. In the post-WWII period, the majority of countries have been deciding to take advantage of the benefits of trade and to gradually open their economies to international trade and investment, assuming⁶ that international commerce was being conducted on an increasingly competitive market-dominated basis and as such had a potential to boost their economic growth.⁷

In the last decade or so it has become increasingly apparent nevertheless that state-induced trade distortions have all but disappeared. The emergence of the significantly state-influenced economy of China⁸ as a world trade power, the financial and economic crisis of 2008-2009, when states and markets have gotten closer to each other on the wave of various bailouts and interventions, and the emergence of state-owned enterprises (SOEs) in some countries as

⁵ National security concerns are the official reason behind the new US steel and aluminum tariffs, but the evidence given in the US Department of Commerce reports on the effects of imports of steel and aluminum on the national security (US Department of Commerce, 2018a and 2018b respectively) suggest strongly that issues of capacity, competitive conditions and state intervention abroad are at the heart of these concerns.

⁶ Establishing special rules disciplining various trade-distorting practices such as dumping and subsidies was an integral part of this process although the subsequent rounds of WTO, multilateral, and regional trade negotiations have tended to focus on further liberalization of market access and reduction of various trade costs rather than strengthening of rules.

⁷ Fundamental economic theories – most notably the theory of comparative advantage, supported by evidence of better economic performance of open economies, provided a strong economic case for reduction of trade barriers.

⁸ Most recently, the significant extent of state-induced distortions in the economy of China has been documented by the European Commission: http://trade.ec.europa.eu/doclib/docs/2017/december/tradoc_156474.pdf. Other examples include, Kowalski et al. (2013) who have shown that on average more than nine out of the ten largest Chinese companies are majority state-owned. Kowalski, Rabaioli and Vallejo (2017) have shown also that China is one of the countries with the most wide-spread use of potentially trade-distorting policies related to international technology transfer.

prominent international actors are some of the factors that shed a new light on the issue of state distortions and prompted discussions on the need to address them. In the presence of state-induced distortions the economic case for free trade cannot be made as easily; trade which is distorted by government policies can be demonstrated to have a potential to reduce economic welfare in trading countries, including in the country undertaking the intervention.⁹ For trade to be beneficial, the initial relative productivity differences underlying comparative advantage and trade have thus to be “organic” and either stem from differences in relative labor productivities or natural country endowments.

The ongoing crisis and tensions in the steel sector are a telling example of concerns about the role of states in shaping market conditions in today’s global economy. The strategic nature of the sector and the co-existence of different approaches to its management by the state,¹⁰ as well as several market developments in recent years (including in the aftermath of the 2008-2009 economic and financial crisis), have led to major international commercial frictions. Due to shortages of internationally comparable data on state support in steel and related sectors, it is not clear to what extent exactly state-induced distortions are at the heart of this problem, but there are several indications that the observed developments have been worse due to sizable state intervention. These include the continued capacity expansion in China (but also other countries such as Russia) at times of low profitability, often undertaken by state-owned or state-financed firms, and contrasting starkly with capacity reductions by privately-owned steel firms in economically advanced countries.¹¹

Concerns about international level playing span across many industrial sectors and are shared more widely, including by the EU, Japan, and Canada. They seem to transcend the current tensions about import tariffs as illustrated by the general intensification of trade defense actions in recent years and the increasing number of complaints and calls for action on issues such as state subsidies, competition infringements, forced technology transfer, regulatory discrimination, and state ownership and control in various policy fora.¹²

What might be the effects of US tariffs and how should other countries react?

The first shots in what seems like a looming trade war have already been fired, and we have already seen the first responses. It is however unclear whether we will see a further escalation and, if so, what a fully-blown trade war may look like.

The first question that has often been voiced is whether the US will be able to sustain its own new steel and aluminum tariffs. As testified by the recent Harley-Davidson controversy,¹³ where the iconic US motorcycle producer announced plans to shift a part of additional motorcycle production overseas as a response to President Trump’s decision to impose tariffs on US imports of steel and aluminum, the new tariffs are likely to be politically very problematic for the US administration. Even the US metal industry itself relies to a significant degree on imported metal inputs and might be affected negatively. In other economically important US industries such as autos, construction and computer and electronic equipment sectors, which rely on imported steel and aluminum even more (Figure 1) and are not protected by import tariffs on their final products, the effects of higher tariffs on steel and aluminum inputs will clearly be negative. The US administration is therefore likely to face significant pressures from other US industries to remove these tariffs going forward.

⁹ See Deardorff (2011) for a summary of main arguments.

¹⁰ The sector has traditionally occupied a special place in economic policy due to its role in industrialization, high entry and exit costs, strong upstream and downstream linkages to other economic sectors, as well as its military importance.

¹¹ See e.g. Kowalski and Rabaïoli (2017).

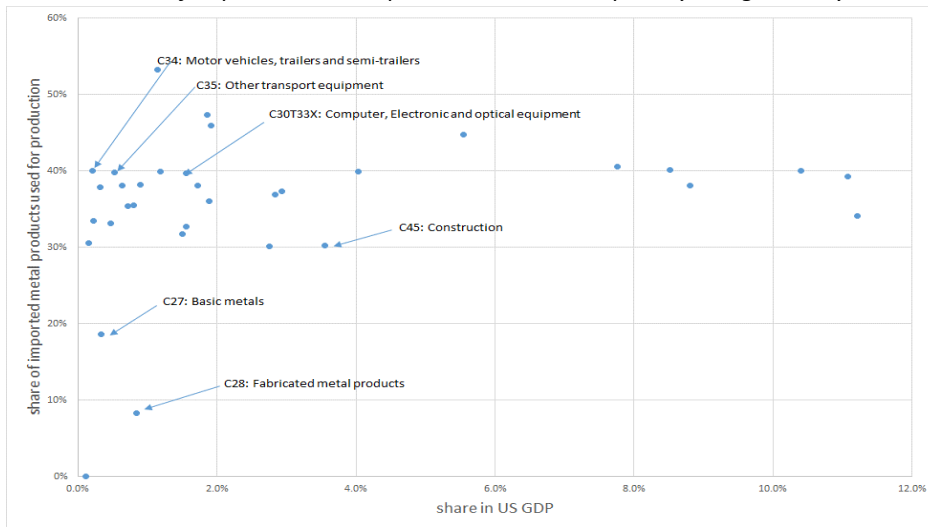
¹² One recent example of like-mindedness of the major advanced countries on this matter is the Joint Statement on Trilateral Meeting of the Trade Ministers of the United States, Japan, and the European Union at their meeting in Paris on May 31, 2018. It can be accessed at:

http://trade.ec.europa.eu/doclib/docs/2018/may/tradoc_156906.pdf

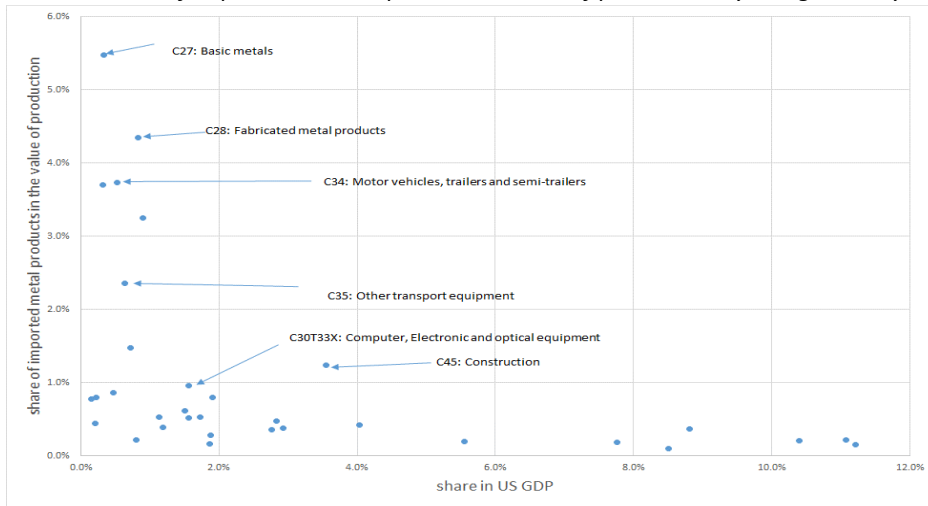
¹³ See Bown et al. (2018).

Figure 1. Reliance on imported metal products across the US economy

Panel A. Share of imported metal inputs in total metal inputs by using industry



Panel B. Share of imported metal inputs in the value of production by using industry



Source: OECD Trade in Value Added and Structural Analysis Databases.

Note: data for both series are for 2011 – the latest year available for trade in value added data.

Somewhat paradoxically, the US new tariffs on steel and aluminum, are also those tariffs that prompted the European Union to retaliate on June 22 by raising its tariff on US motorcycle exports to Europe from 6 to 31%, including on those produced by Harley-Davidson. It has been assessed that this would mean that to sell a US-produced Harley to one of the European Union’s consumers, the US motorcycle maker would now need to add an estimated USD 2,200 to the cost of its vehicle, a cost which would not be borne by a European competitor such as BMW.¹⁴

This is a striking example of how efficient world-class producers and technology leaders are caught in the cross fire of a trade war when emotions and political posturing take precedence over economic reasoning. While it is really hard to defend the initial US tariffs on steel and aluminum, and, particularly, the way that they were extended to such market-oriented producers as the EU, Canada or Mexico, the introduction of retaliatory tariffs by other countries is also puzzling. Targeting not only steel and aluminum products but also US consumer goods exported on a large scale to Europe such as motorcycles, bourbon or peanut butter, the EU tariff retaliation has been heralded by some as the only

¹⁴ Bown et al. (2018)

option to force the US to rethink its policies.¹⁵ However, this does not change the fact that these tariffs will still have similar negative welfare effects on EU consumers and will also negatively affect US producers who may have been against the introduction of the US tariffs in the first place. Moreover, retaliation with tariffs on a wider range of products bears a risk of an uncontrolled domino effect-like spread of the trade war to other product markets and countries, where similar measures may be considered to contain the disruptive effects of deflection of trade from the already-protected markets. Moreover, others argue that, from a strictly economic point of view, constraining EU exports of metal products to the US through the so-called voluntary export restraints (VERs) could allow the EU to minimize economic losses associated with higher US duties while leaving in place the deterrent harmful effects of the US tariffs on US economy. This would also be closer to meeting the original US demands to reduce exports to the US, although it would also admittedly be at odds with the spirit of the EU competition rules and the position of the EU vis-à-vis VERs in the WTO.¹⁶

A fully-fledged tariff war between the major trading powers could be quite costly. In a recent study using a computable general equilibrium model of the world economy, the OECD estimated for example that a tariff increase of 10 percentage points by all G20 economies, would result in a fall in real GDP by around 1% in the US, Germany, and France, and by as much as 2% in Canada and 5% in Korea.¹⁷

Is there hope for a more constructive way forward?

It is becoming increasingly clear that, to avoid further escalation, a more cold-blooded approach to trade policy is needed on both sides of the Atlantic as well as in Asia. In a highly integrated world economy, characterized by increasingly fragmented and mobile global value chains, where comparative advantage is increasingly determined not at a national, but firm, level, the effects of tariffs and other border-based policies targeting products based on their “nationality” are hard to predict and often counterintuitive. They certainly do not deliver the same effects as decades ago when trade and communication costs were much higher, production was more geographically-localized and had a much higher tangible content.

If state-induced distortions, subsidization and capacity issues are really the main concern behind the escalating tariff war, these should be rigorously and objectively assessed (possibly by an international body) and, to the extent possible, addressed directly through targeted and legal trade remedies. The longer-term solution lies clearly in amending the relevant rules on subsidies and other forms of state-related trade distortions in a concerted and systemic manner, i.e. at the multilateral level in the WTO or in plurilateral contexts. Market-oriented democracies such as the US and the EU should try and speak with one voice in this effort and should try to jointly and constructively engage countries such as China, which also increasingly seek economically efficient and sustainable solutions in a global context.

CASE - Center for Social and Economic Research is a long-standing advocate of free trade. Building on nearly three decades of experience in implementing projects focused on trade policies, CASE continues to research the effects of trade liberalization, trade barriers and trade rules. In the past, we have tackled many of the themes relevant to the subject the current showCASE article, including in studies commissioned by the European Commission and the European Parliament, and covering subjects such as trade-related aspects of institutional reforms and corporate governance, industrial restructuring, labor market reforms, free trade negotiations between the EU and its partners, and countries' WTO accessions. Currently we are carrying out a cost and benefit [analysis](#) for the European Parliament of the Free Trade Agreements signed by the European Union. As a member of the [THINK initiative](#), we are also researching the potential trade effects of the Chinese Belt and Road Initiative. We also have a number of other pending project applications in the area of trade policy.

¹⁵ Krugman (2018), for example, called on the game-theoretical nature of this confrontation and argued that this was a rational option to pursue for the EU.

¹⁶ See Gros (2018).

¹⁷ See Flaig et al. (2018).

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This week: According to the flash estimate, inflation increased in June to 1.9%, compared to 1.7% in May. Retail sales in May increased by 6.1% y/y after growing by 4% y/y in April. The Current Consumer Confidence Indicator published by the Central Statistical Office increased to 6.1 in June from 5.9 in May. Employment increased in May by 3.7% y/y, and the average salary increased by 7% y/y. Unemployment rate fell in May to 6.1% from 6.3% in April. Sold production of industry increased in May by 5.4% y/y, compared to 9.3% y/y in the previous month.

GDP (Q1 2018)

↑ 5.2% y/y

Up from 4.9% in Q4 2017

Unemployment (May 2018)

↓ 6.1%

Down from 6.3% in Apr 2018

Inflation (Jun 2018)

↑ 1.9% y/y (est.)

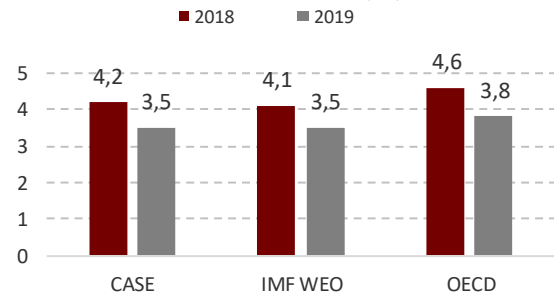
Up from 1.7% in May 2018

NBP Base rate

1.5%

From 2% in Mar 2015

Real GDP forecast (%)



This week: Russia and Saudi Arabia have agreed to expand their cooperation on oil and gas matters and will seek OPEC to increase oil output by 1.5 million barrels a day. The move will serve to address the eventuality that the US sanctions on Iran push prices too far and disturb the reserves. According to Russia's Energy Minister Aleksandr Novak, the operation will last throughout the third quarter of 2018, with a re-evaluation scheduled to take place in fall.

GDP (Q1 2018)

↑ 1.3% y/y

Up from 0.9% in Q4 2017

Unemployment (May 2018)

↓ 4.7% (est.)

Down from 4.9% in Apr 2018

Inflation (May 2018)

■ 2.4% y/y

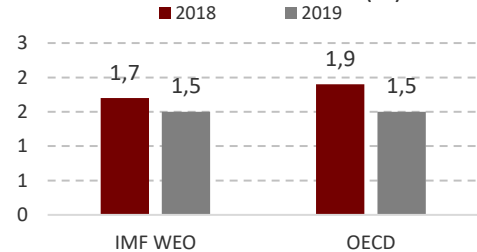
Unchanged since Mar 2018

CBR Base rate

7.25 %

From 7.5% in Feb 2018

Real GDP forecast (%)



This week: In response to a parliamentary question from the Green Party, the German government released figures showing that Germany had earned EUR 2.9 billion from interest payments on its holdings of Greek debt since the beginning of the eurozone crisis, despite having initially planned to return the interest income to Athens in exchange for necessary reforms. The revelation comes as Greece prepares to end its third bailout program and return to market financing.

GDP (Q1 2018)

↓ 2.3% y/y

Down from 2.9% in Q4 2018

Unemployment (May 2018)

↓ 3.4%

Down from 3.6% in April 2018

Inflation (June 2018)

↓ 2.1% y/y

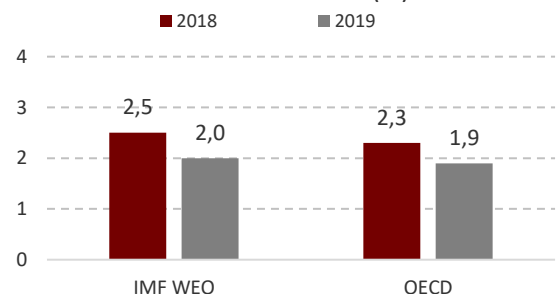
Up from 2.2% in May 2018

ECB Deposit rate

-0.4%

From -0.3% in Dec 2015

Real GDP forecast (%)





This week: On June 19, the State Statistics of Ukraine published data on economic activity in Q1 2018. The data confirms that the Ukrainian economy followed a path of growth in Q1 2018. Private consumption expanded by 5.6% y/y (Q4 2017: 11.1% y/y), easily offsetting a 1.4% y/y drop in government consumption (Q4 2017: 3.2% y/y). Total consumption expanded by 4% y/y in Q1 (Q4 2017: 8.8% y/y). Fixed investment growth reached 17% in Q1 2018 (Q4 2017: 16.7%).

GDP (Q1 2018)

↑ **3.1% y/y**

Up from 2.2% in Q4 2017

Unemployment (Q1 2018)

↑ **9.9%**

Up from 8.9% in Q4 2017

Inflation (May 2018)

↓ **11.7% y/y**

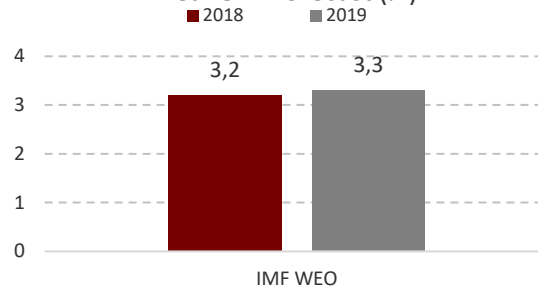
Down from 13.1% in Apr 2018

NBU Base rate

17.0%

From 16.0% in Jan 2018

Real GDP forecast (%)



This week: The acting Czech government has approved draft state budget for 2019 as well as a mid-term economic outlook for the years 2020-2021. According to Acting Minister of Finance Alena Schillerová, the approved deficit of CZK 50 billion (EUR 1.93 billion) will not be exceeded. The draft budget foresees increased funding for teachers' salaries and pensions as well as reduced social welfare benefits. More expenditure will be allocated to most offices and ministries with the exception of the Ministry of Health, which is expected to receive more income from health insurers.

GDP (Q1 2018)

↓ **4.2% y/y (est.)**

Down from 5.5% in Q4 2017

Unemployment (Q1 2018)

■ **2.4% (est.)**

Unchanged since Q4 2017

Inflation (May 2018)

↑ **2.2% y/y**

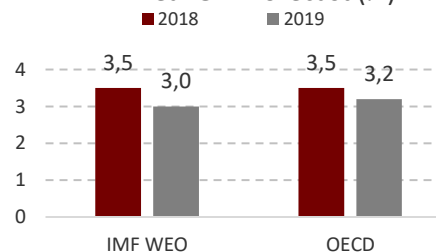
Up from 1.9% in April 2018

CNB Base rate

1%

From 0.75% in Feb 2018

Real GDP forecast (%)



This week: In its recent quarterly inflation report, the National Bank of Hungary said that the structure of growth would remain balanced. The dynamic increase in investment activity is expected to continue until 2019, and the growth will be supported by continuously increasing domestic demand. Although the Hungarian economy's fundamentals are assessed as stable, and interest rates stay at record lows, the Monetary Council flagged an eventual end to its six-years-old loose monetary policy, given recent substantial depreciation of the forint and a surge in government bond yields.

GDP (Q1 2018)

↑ **4.7% y/y (est.)**

Up from 4.4% in Q4 2017

Unemployment (Q2 2018)

↓ **3.7%**

Down from 3.8% in Q1 2018

Inflation (May 2018)

↑ **2.8% y/y**

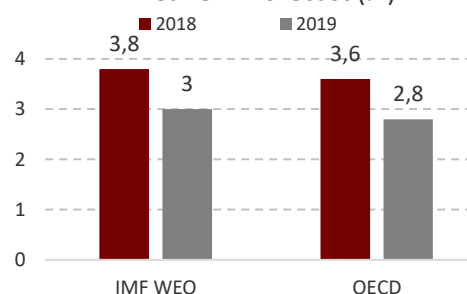
Up from 2.3% in Apr 2018

MNB Base rate

0.9%

From 1.05% in May 2016

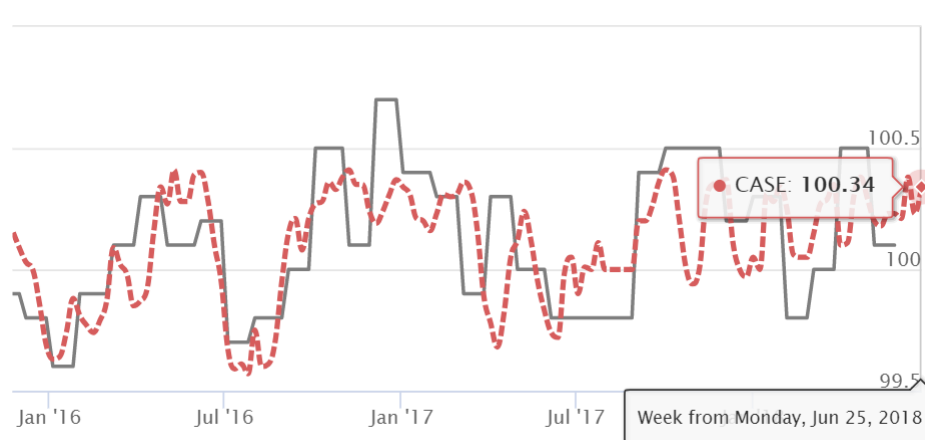
Real GDP forecast (%)



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, and the CPI.

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
2018	4.2	4.1	4.9	3.7	2.5
2019	3.5	3.6	3.3	3.8	2.3
	Nominal monthly wages	Merchandise exports (USD, bn)	Merchandise imports (USD, bn)	Merchandise trade balance (USD, bn)	CA balance (USD, bn)
2018	4.5	233.4	235.2	-1.8	-3.9
2019	3.7	242.7	244.6	-1.9	-4.1

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