showCASE
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Overview: In this week's showCASE our experts discuss what a two-speed European Union could entail for the Visegrad Four and other Central and Eastern European countries. CASE then investigates the implications of the recent Organization of Petroleum Exporting Countries' deal to reduce oil output starting in the New Year.

Will a Two-speed European Union Sideline the Visegrad Four?

By: Aleksandra Polak

On December 9, during a summit marking the 25th anniversary of the Maastricht Treaty, the President of the European Commission, Jean-Claude Juncker, called for moving forward with a two-speed Europe. If implemented, this approach would create a different orbit for those EU Member States who do not wish to take part in all facets of EU integration.

Visegrad Group's leaders: Robert Fico, Beata Szydło, Bohuslav Sobotka, Viktor Orbán Source: P. Tracz/ KPRM, Flickr, CC

Juncker is not the first European leader to support the concept that different Member States should be able to integrate at different paces, with 'core' countries being the *avant-garde* of European integration. This idea, first proposed by Wolfgang Schäuble in 1994, however has resurged during pre-Brexit negotiations and has been endorsed by the six founding EU members states and key European players such as Federica Mogherini and François Hollande.

In the wake of the Eurozone crisis, there has been a growing consensus the countries on the Euro share an informal status as a "Eurozone government," and that this status should be formalized via closer political union within the Eurozone is needed. The recent proposal of Paolo Gentiloni, Italian foreign minister and now soon-to-be Prime Minister, where the EU should contain a smaller circle of countries which would share the single currency, the Schengen Treaty and, especially, a better coordination of defence, seems to be the most plausible scenario. Such intensified integration within Eurozone core countries could include policies such as adopting common eurobonds, collectivizing debt, and completing the banking union.

The EU leaders' determination to proceed with a two-track Europe, apart from the political will to advance economic and political integration in the Eurozone, has been largely influenced by the lack of agreement between Central and Eastern European (CEE) countries and the EU during the ongoing migration crisis. Creating two tiers of EU membership could be seen as a way of circumventing the countries of the Visegrad Group, an alliance of four Central European States (Czech Republic, Hungary, Poland and Slovakia), and other CEECs because of their reluctance toward instituting a migrant quota.

Nonetheless, the Visegrad Four's significance and its influence on the decision-making process in the EU would considerably diminish in the two-speed European Union. Even though Poland and Hungary have recently called for a cultural counter-revolution to reform the EU and have claimed that the Visegrad Four holds "enormous potential" and "a recipe for the EU", CEE countries are likely to become even more removed from Europe if the core countries decide to proceed with closer integration.

Oil Prices on the Rise as More Producers Join the OPEC Deal

By: Krzysztof Głowacki

Last Saturday, the Organization of Petroleum Exporting Countries (OPEC), together with a number of other affiliated oil producers, signed a deal to reduce oil output starting from January 1st, 2017. The deal is the first global oil pact since 2001, and, if implemented, may bring a sustained increase in global oil prices.

At an earlier meeting in November, OPEC countries had agreed to reduce oil production by a total of 1.2 million barrels per day (bpd) starting on January 1st, 2017. The deal has now been extended to encompass a further reduction of 558,000 bpd, split amongst Russia (300,000 bpd), Mexico (100,000 bpd), Kazakhstan (50,000 bpd), and nine other countries. Both deals are supposed to put the brakes on oil overproduction, which saw the oil price plummet from $115 in mid-2014 to below $50 and even $30 in 2015. Following the announcement of the agreement, the price of Brent crude increased to its 16-month peak to almost $58, although it has since fallen below $54 as the dollar appreciated over the Fed's interest rate increase. In any case, no oil shortage or dramatic price surges are expected, as oil production is set to remain at a high enough level to prevent such an eventuality.


Source: Flickr CC

Politically, the new deal strengthens Russia, whose economy and political system has relied on oil income since Putin's rise to power in 2000, and which took a hard hit from the fall in global oil prices. Although its economy is still ailing, Moscow is now likely to be more forceful in its dealings with Europe. But there seems to be another winner: US shale oil producers. They, too, had been affected by the low price levels of the past two years, with many forced to close business. Now the deal comes as a positive externality for US producers, with the higher world price expected to increase output and boost profits while attracting new entrants and stimulating technological development. In this way, a portion of the gains from the deal will be captured by a non-OPEC member.

Of course, all of the above is subject to the agreement's implementation. OPEC deals traditionally suffer from compliance problems, being a textbook example of how cartels fail over individual members' incentive to cheat. Both OPEC and non-OPEC parties have been notorious for their non-compliance with output reduction agreements, and mutual mistrust among the parties was a major source of delay in the negotiations over the past months. It remains to be seen whether the current deal will elicit more compliance that the one fifteen years ago, which eventually collapsed.

At a glance

Last week, during its monthly MPC meeting, the National Bank of Poland decided to hold policy rates steady, as expected. The Central Statistical Office reports Q3 GDP increased by 2.5% y/y in real terms, much lower than expectations. While private consumption has increased (4.2% y/y), due in large part to accelerating wages and higher welfare spending, investment activity remains subdued (-7.3% y/y), weighing on growth expectations. Moreover, import growth has been stronger than export growth, dragging down the current account balance. CASE experts forecast 2016 growth at 2.8% and anticipate that the economy may accelerate slightly in 2017. However, high deficit levels caused by inflated social spending could likely lead to deficits exceeding three percent threshold, which, together with increasing policy uncertainty, may hamper future GDP growth.

Nov inflation grows from 0.1% to 0.2% y/y

Real GDP forecast (%)	2016	2017
CASE	2.8	3.4
IMF WEO	3.1	3.4
OECD	2.6	3.2

Recent OECD forecasts show that Russia is expected to return to growth in 2017, following two years of recession. Russian GDP contracted by 0.4% in Q3 y/y, its smallest contraction in 7 quarters, reflecting accelerated growth in mining, quarrying and agriculture, as well as slowing declines in construction, public administration and transport. However, the Russian unemployment rate reached 5.4% in Q3 and is expected to continue growing, reaching 5.7% in Q4, which will play a role moving forward. The strength of the recovery also depends on whether or not oil prices rebound. Further, some degree of political uncertainty remains for the Russian economy, particularly issues relating to Western sanctions that are to be extended, as announced by Angela Merkel earlier this week.

Q3 GDP contraction of 0.4% y/y confirmed

Real GDP forecast (%)	2016	2017
IMF WEO	-0.8	1.1
OECD	-0.8	0.8

Germany remained Europe's powerhouse in December, with the ZEW current economic conditions indicator increasing to 63.50 from 58.80 in November. Positive expectations for economic growth in the country is underscored by an increase in Manufacturing PMI, from 54.30 in October to 55.50 in November. Meanwhile, a drop in services PMI, from 55.10 in October to 53.80 in November, as well as a lower score (compared to forecasts) in the ZEW's economic sentiment indicator, does not appear to have significantly impacted the positive evaluation of the economy. The principal factors supporting German economic growth are considered to be an increase in capacity utilisation, growing orders in the manufacturing sector, increased export expectations in industry, a lively construction sector, and favourable labour market conditions.

Dec ZEW Current Conditions up to 63.50 from 58.80 in November

Nov. HICP (final) m/m stable at 0%

Real GDP forecast (%)	2016	2017
IMF WEO	1.7	1.4
OECD	1.74	1.65

At a glance

In its Financial Stability Report, released on December 13th, the National Bank of Ukraine (NBU) discussed the macroeconomic developments of 2016, such as real GDP growth, reasonable headline inflation, and a reduced budget deficit. The NBU also observed that sluggish progress with crucial institutional reforms, such as creditor right protection and the judiciary reform, pose long-term risks to financial stability. On December 8th, the NBU announced that it will keep its discount rate unchanged at 14%, in an attempt to mitigate inflationary pressure in the economy. In October, headline inflation stood at 2.8% m/m, while, in November, inflation slowed to 1.8% m/m, gradually converging to the NBU's targeted path. The NBU's projections for economic growth over 2016 remain moderate, with real GDP forecasted to grow by 1.1% y/y, while for 2017 and 2018 growth is expected to reach 2.5% y/y and 3.5% y/y, respectively.

Real GDP forecast (%)	2016	2017
IMF WEO	1.5	2.5
OECD	-	-

The Czech Republic's gross central government debt fell to $64.44 billion at the end of September, down from $65.33 billion at the end of June. However, the Czech economy experienced an economic growth slowdown in Q3 2016, expanding 0.2 % q/q or 1.9% y/y, which was 0.6 pp lower than forecasts in both year-on-year and quarter-on-quarter terms. The Czech economy is suffering from an increasing outflow of funds from foreign owned companies, which according to the latest report prepared by the Czech Government own a significant share of businesses in some of the most profitable sectors of the economy. Nonetheless, economic growth in 2017-18, as forecasted by the OECD, is expected to remain stable, reflecting solid labor demand, which is expected to push down unemployment and drive up wages.

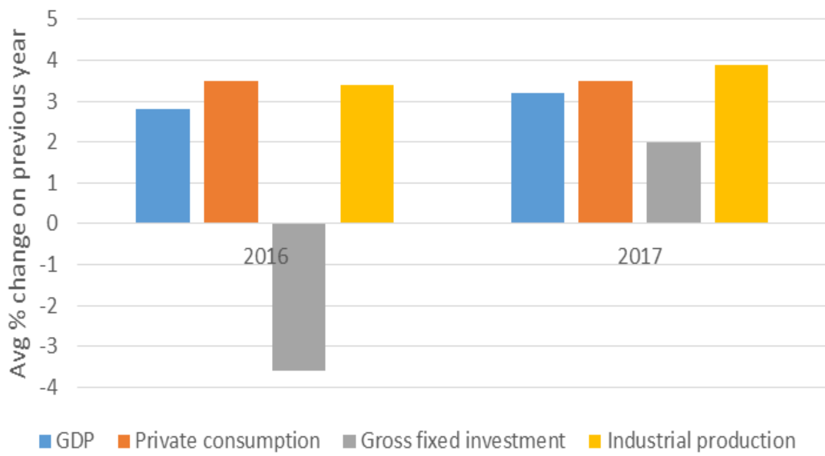
Nov inflation increased by 1.6%

Real GDP forecast (%)	2016	2017
IMF WEO	2.5	2.7
OECD	2.4	2.5

Recent OECD forecasts expect Hungarian growth to pick up in 2017, reaching 2.5%, as a new cycle of EU structural funding should give rise to new infrastructure projects. Growth in 2017 will also benefit from increased bond ratings, from Ba1 to Baa3, and declining government debt burdens coupled with significant overall reductions in external vulnerabilities. Meanwhile, inflation continues to remain below the 3% Central Bank target with little signs that it will increase above target levels in 2017, a reality which could incite further rate cuts in the near future (although none are currently planned). Moving forward, the economy should benefit from growing business capital accumulation, inward FDI and increasing demand.

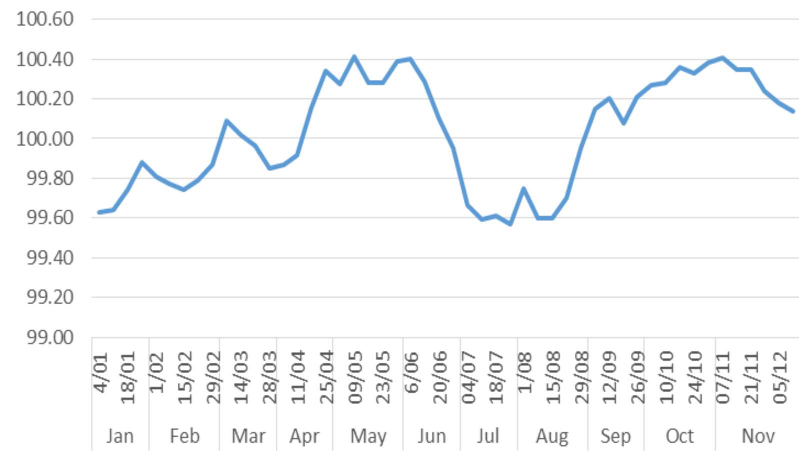
Real GDP forecast (%)	2016	2017
IMF WEO	2.0	2.5
OECD	1.7	2.5

Polish Economy: CASE forecasts



Source: CASE forecasts, updated December 16, 2016

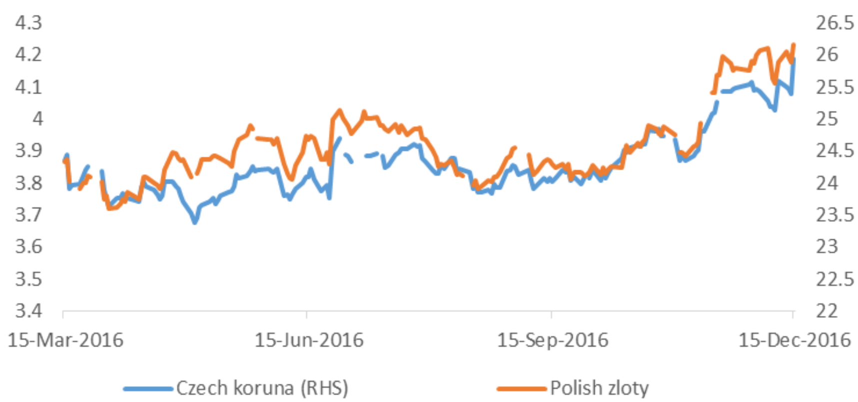
Polish Online CPI



Source: CASE, most recent observation December 16, 2016

Czech koruna and Polish zloty

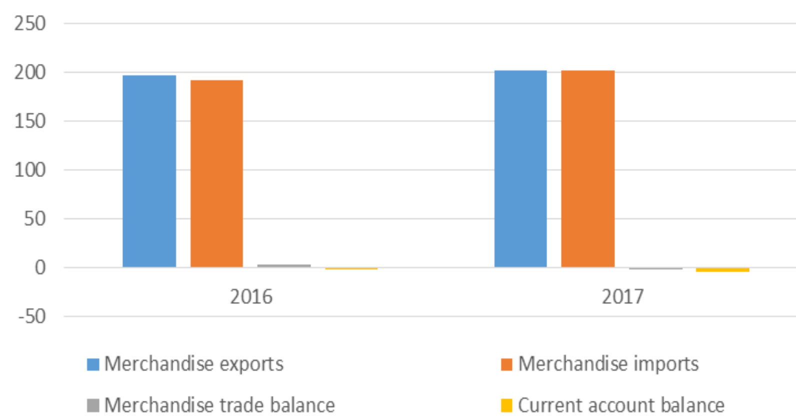
(currency units per U.S. dollar)



Source: IMF, most recent observation December 16, 2016

Polish Trade: CASE forecasts

US$bn - annual total



Source: CASE forecasts, updated December 16, 2016

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