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

Overview: In this week's showCASE, our analysts examine the actions that the European Union plans to take in order to protect the rule of law and democratic standards in Hungary. Our experts then discuss the result of the presidential elections in Iran in the context of the country's relations with the US and the EU, as well as the nuclear agreement signed by the country two years ago.

European Union vs. Hungary: Where there's a will, there's a way?

By: *Aleksandra Polak*, Communications Officer

During its plenary session on May 17th, the European Parliament has called for launching the "Article 7" mechanism that could lead to far-reaching EU sanctions against Hungary. In theory, the procedure may result in the suspension of Hungary's voting rights in the Council.

Viktor Orbán speaks at the European Parliament on April 26. 2017 | Source: Reuters

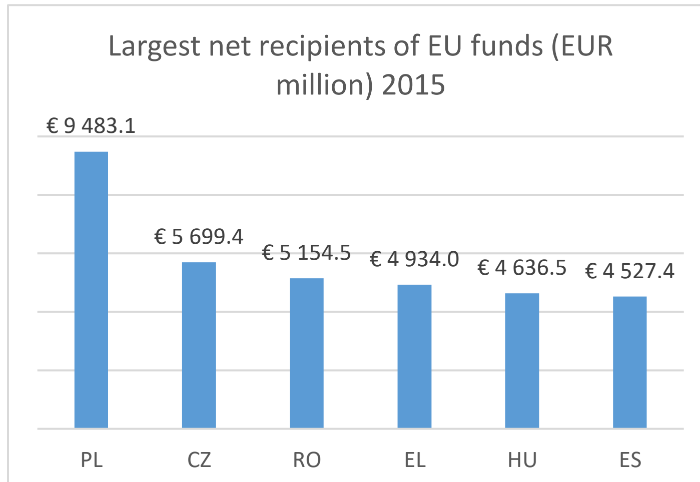
The European Parliament is the first European Union (EU) institution in history that has openly called for triggering a mechanism to protect "EU values" in case of a risk of a serious breach by a Member State. In a resolution adopted by 393 to 221 votes with 64 abstentions, Members of the European Parliament condemned the serious deterioration of rule of law and democracy in Hungary. The broad support for the historically-unprecedented resolution stemmed from MEPs' outrage over Victor Orbán's higher education bill targeting the Budapest-based Central European University (CEU). The bill, written in a way to affect CEU almost uniquely, has been seen as a clear attack on academic independence in the country. The European Parliament furthermore disapproved of laws tightening rules against asylum-seekers and non-governmental organizations (NGOs).

The legal basis for this vote stems from Article 7 of the Treaty on European Union, which allows for the possibility of suspending the voting rights of the representative of the government of a Member State in the Council of the European Union. The actual suspension of Hungary's voting rights in the Council is unlikely – to proceed with sanctions, all the remaining Member States would have to agree that there has been a serious and persistent breach of EU values.

Unanimity in the Council will be extremely difficult to reach, as Poland – another country at risk of the Article 7 procedure – will in all likelihood oppose the sanctions against Hungary.

However, while serious political sanctions against Hungary are improbable, Brussels has another ace up its sleeve: money. In its resolution, the European Parliament urged the European Commission "to strictly monitor the use of EU funds by the Hungarian government." Hungary is one of the countries that benefits the most from EU funding, with EU investment generating 6.3% of Hungarian GNI and co-financing 95% of all Hungarian public investments.

In the past, Brussels has frozen money transfers to Hungary due to concerns over the public procurement system and other administrative issues. Hungary could now expect even harsher scrutiny of the country's institutional system of distributing EU monies, potentially resulting in suspensions of EU funds. Moreover, EU funding for Hungary might be substantially reduced when Member States discuss the next multiannual financial framework. With its economy heavily dependent on transfers from Brussels, this is a threat that Hungary should not disregard.



Source: European Commission

The EP's resolution is also a warning sign to other non-compliers that they may face a similar fate in the future. As mentioned, Poland, Hungary's political ally, is the largest net destination of EU funds and is also currently subject to the Commission's "rule of law" procedure. While the European Union lacks effective political instruments to enforce compliance with its myriad of Treaties, it may find defending EU values is easier through economic means. The Hungarian case will show whether there is political will to do so, or if European institutional organs are content to merely pass resolutions.

Diplomatic ping-pong between Teheran and Washington

By: Katarzyna Sidło, Political Economist

In an unsurprising, yet reassuring, turn of events, Iranian President Hassan Rouhani last week was re-elected in a landslide, beating rival Ebrahim Raisi by 18.5% (almost 8 million votes). It is believed that Rouhani, a conservative turned quasi-reformist, managed to mobilize vast numbers of supporters yet again (the turnout was estimated at 73%, roughly equal to turnout in the previous election in 2013), mostly thanks to some harsh and unprecedented criticism against his hardline opponent during the last days of campaign. Most pointedly, Rouhani took aim at Mr. Raisi and his father-in-law Ayatollah Ahmad Alamolhoda, commenting on their influence in one of the country's most important cities, Mashhad; famously, he asked, "[y]ou [once] told people to leave Mashhad if they wanted art. Now you want to have the whole country and tell people to leave Iran?" Although this may not exactly look savage from a European perspective, by Iranian standards it came as close to crossing a red line as one can get. Moreover, in a sign of the effectiveness of this approach, Mr. Rouhani's reformists swept seats in local elections in Mashhad which ran simultaneously with the presidential election.

Source: Reuters.

Alas, not everyone was impressed by his performance. US President Donald Trump, who learned about Iranian President's victory during his first presidential trip abroad to Iran's arch-enemy Saudi Arabia, lashed out against Teheran. President Trump accused Iran of "fueling the fires of sectarian conflict and terror" and calling "all nations (…) to work together to isolate it." Mr. Rouhani, immediately joined in with insults of his own, deriding Mr. Trump's ostentatious support for a monarchy (in Saudi Arabia) that has "never seen a ballot box" while criticizing a country where citizens have just elected a reformist president in a democratic process.

While calling Iranian elections fully democratic would be an overstatement (if only because the candidates need to be approved by an unelected Guardian Council), the increasing closeness between the United States and Saudi Arabia is likely not about promoting democratic values either; Mr. Rouhani does have a point regarding President Trump calling for an international isolation of a country whose citizens *de facto* voted for greater openness to the world. Indeed, the elections were largely seen as a test of popularity of the Joint Comprehensive Plan of Action (JCPOA), better known as the Iranian nuclear deal, which Mr. Rouhani actively helped to design. The agreement, signed on July 14, 2015 between Iran, the US, the EU, and other partners, committed Iran to using its nuclear program for peaceful purposes only. In exchange, nuclear-related sanctions imposed on Iran by the US and the EU were to be lifted, which in turn was hoped to boost the country's economy (on the top of giving an end to the country's pariah status).

Thus far the economic turnaround has not materialized quite as fast as hoped, though, mostly due to the hesitance of financial institutions to finance any business venture in Iran before all the sanctions are indeed lifted (which the American administration, pressured by the in-built deadlines, in fact reluctantly did two weeks ago). However, Mr. Trump's calls for isolation of Iran, as indeed his calling the deal a "disaster" on numerous previous occasions, does not bode well for the future of the agreement.

Understandably, the EU, another major side to the deal, is concerned. Federica Mogherini, the EU High Representative, while congratulating Mr. Rouhani on his victory on Twitter, underlined that the EU is "ready to continue work for full JCPOA implementation, [and] bilateral engagement (…)." As in so many other foreign policy arenas, however, the EU seems to believe that announcements and social media may substitute for actual policy, and it is therefore perhaps time for the EU to make an effort to safeguard the deal it worked so hard to orchestrate. This may help in giving Rouhani some political cover to make the hard economic reforms that Iran desperately needs.

This week: Unemployment in April fell to 7.7%, 0.4 pp. below the previous month's level. All regions of Poland recorded a drop in unemployment, with the lowest figure in Wielkopolskie in the west of the country (4.6%), and the highest one in Warmińsko-Mazurskie in the north-east (13.3%). Further falls of unemployment are expected, and they may translate to wage increases.

GDP (Q1 2017)

4.1% y/y (est.)

Up from 2.9% in Q4

Inflation (Apr 2017)

2.0% y/y

Unchanged from Mar 2017

Unemployment (Apr 2017)

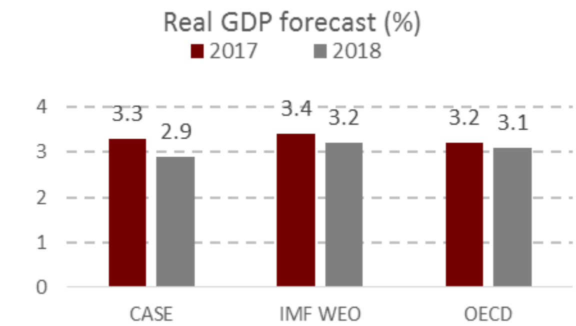
7.7%

Down from 8.1% in Mar

NPB Base rate

1.5%

From 2% Mar 2015



This week: The Bank of Russia is going to classify and tax cryptocurrencies, including the bitcoin, as digital commodity. Russia plans to adopt formal regulations on cryptocurrency in a month for the sake of monitoring and taxing transactions. However, there is no unified position in the country with regard to recognition of the bitcoin, and introduction of the abovementioned regulations is not to be seen as a legalization of the currency.

GDP (Q4 2016)

0.3% y/y

Up from -0.4 in Q3

Inflation (Apr 2017)

4.1% y/y

Down from 4.3% in Mar

Unemployment (Mar 2017)

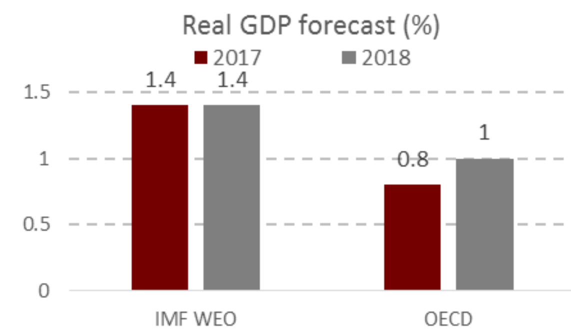
5.4%

Down from 5.6% in Feb 2017

CBR Base rate

9.25 %

Down from 9.75%



This week: A recent report of the German Bundesbank pointed to private consumption, helped by the robust labor market, as the key contributor to the robust economic growth in the country. Increases in industry's order intake over Q4 2016 and Q1 2017, as well as higher construction activity due to rising demand for housing further supported the uptick in growth.

GDP (Q1 2017)

2.9% y/y

Up from 1.3% in Q4

Inflation (Apr 2017)

2% y/y

Up from 1.5% in Mar

Unemployment (Q4 2016)

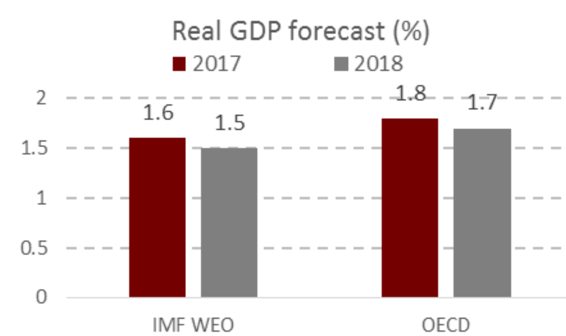
3.9%

Down from 4.15% in Q3

ECB Deposit rate

-0.4%

From -0.3% Dec 2015



This week: The National Bank of Ukraine cut its key policy rate to 12.5% from 13%, effective as of May 26th. The decision is motivated by the inflation figures being largely in line with the Bank's expectations, and is intended to stimulate the economy. Further cuts are probable if inflation remains under control, according to the Bank.

GDP (Q1 2017)

2.4% y/y (est.)

Down from 4.7% in Q4

Inflation (Apr 2017)

12.2% y/y

Down from 15.1% in Mar

Unemployment (Q4 2016)

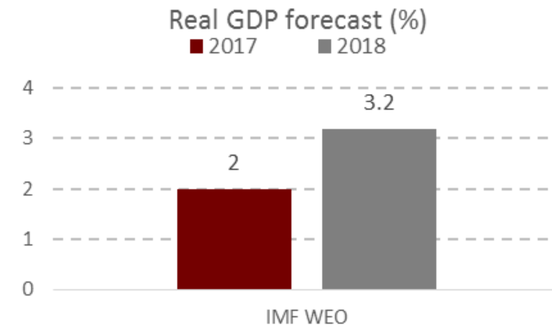
10.0%

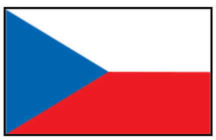
Up from 9.2% in Q3

NBU Base rate

12.5%

From 13.0% in May





This week: The economic sentiment indicator compiled by the Czech Statistical Office weakened by 0.2 points to 97.2 m-o-m in May. The drop was caused by a decrease in confidence of entrepreneurs in industry, construction, and trade; consumers' confidence remained unchanged.

GDP (Q1 2017)

2.9% y/y

1.9% in Q4 2016

Inflation (Apr 2017)

2.0% y/y

Down from 2.6% in Mar

Unemployment (Q1 2017)

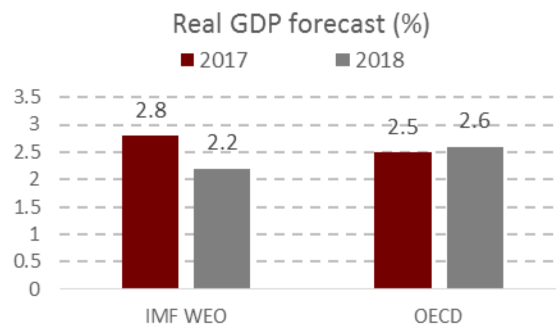
3.4%

Down from 3.6% in Q4

CNB Base rate

0.05%

Unchanged since Nov 2012



This week: Hungary's central bank announced that the country's base interest rate could remain unchanged until 2019 or longer. Deputy Governor of the National Bank of Hungary Márton Nagy has stated that inflationary expectations are anchored at low levels despite the significant wage growth.

GDP (Q4 2016)

1.6% y/y

Down from 2.2% in Q3

Inflation (May 2017)

3% y/y

Up from 2.2% in Apr

Unemployment (Q1 2017)

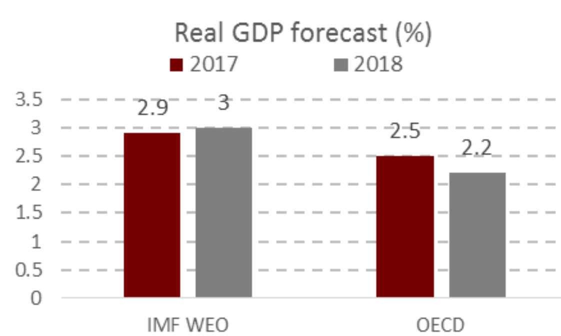
4.7%

Up from 4.5% in Q4

MNB Base rate

0.9%

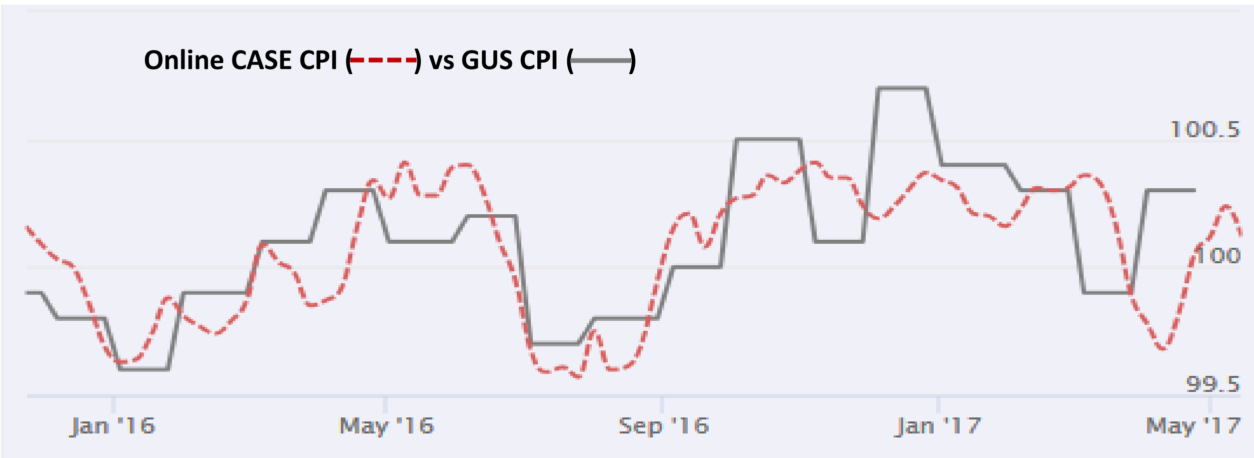
From 1.05% May 2016



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

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