showCASE

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Overview: In this week's showCASE, our experts study the implications the outcome of the recent U.S. election could have for the Europe, particularly in Poland. CASE also reports on the recent 16+1 Summit, an initiative that aims to increase discussions about economic cooperation in the region.

American roulette

By: Katarzyna Mirecka and Krzysztof Głowacki

When all is said and done, and the dust settles, nothing is as it was before, and yet nothing is certain. What is to be expected from Trump's victory in the US Presidential election for the world and specifically for Central and Eastern Europe?

Many politicians in the region share the same political mindset as Trump, with the leaders of Hungary and Poland appearing particularly content with his election. Most probably, the new American administration will be putting less pressure on the cabinets in Poland and Hungary to abandon recent populist actions, a relaxation which will strengthen their position at home and abroad. However, there are real fears of a rapprochement with Russia, leading to cancellations in military assistance: in particular, NATO's anti-missile complex *Aegis Ashore*, scheduled to go live in 2018 in Radzikowo, Northern Poland, has a high chance of being scrapped. Likewise, the 2016 NATO Summit in Warsaw resulted in a decision to allocate four NATO battalions in Poland and the Baltics, but the deal is now far from certain, and the same applies to the prospective allocation of a US armored brigade in Poland. On the other hand, Trump's condemnation of Western Europe for neglecting its defense spending and his praise of Poland for doing the opposite means that neither route is certain.

Source: Radio Poland

Economically, Trump's election likely means a much harder road for the Transatlantic Trade and Investment Partnership (TTIP), a lost chance for needed liberalization and perhaps a harbinger of protectionism. In general, though, the political turmoil in the US has less potential to affect Central and Eastern Europe economically than it will Western Europe and the Asia-Pacific. Currencies in the CEE region depreciated slightly in the wake of the election, as usually happens with peripheral currencies in the times of uncertainty, but the effect of this shock was absorbed by the appreciation of the euro.

For Ukraine, Trump's election may be a catastrophe if the rapprochement with Russia means a total US disengagement. Russia, in the meantime, is preparing for a strategic pause to catch its breath, including a possible lift of Western sanctions. In the longer run, as Putin proceeds to capitalize on a new set of options, the picture may become inverted. Trump's erratic approach to policy makes him a good target for provocations, which are a favorite tool in Russia's political toolbox.

Trump was an eccentric candidate, and it remains to be seen whether he can become a political leader. In the process, he will face a plethora of state institutions that are keen on keeping the country on its current course, including Congress, the intelligence community, and the military. The ultimate outcome of his administration will be how Trump's governing style can overcome political inertia in the US. Both of them are about to be put to a hard test.

The new, not-so-Silky Road

By: Katarzyna Sidło

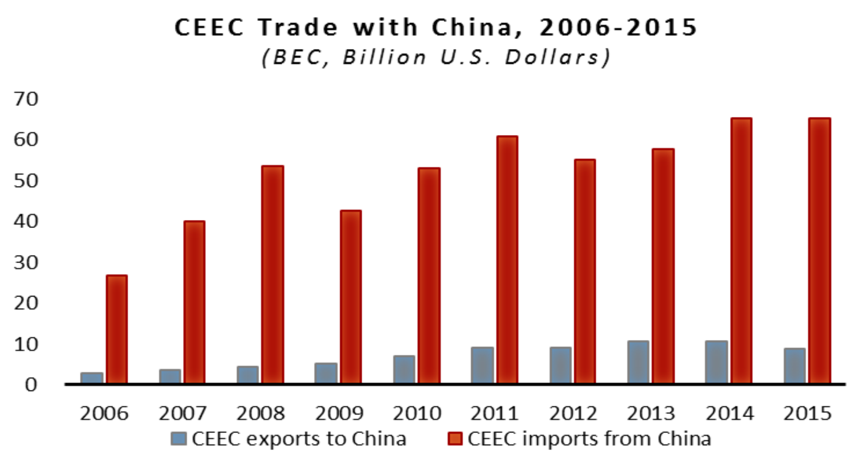
On November 5, the Summit for China and Central and Eastern European Countries (CEE), more commonly referred to as the 16+1 Summit[1], was held in Riga, Latvia. This was the group's fifth gathering to discuss economic cooperation.

This year, the main theme of the meeting was transportation and inter-connectivity. Accordingly, talks about strengthening the "Adriatic-Baltic-Black Sea Seaport Cooperation" were at the top of the agenda. The Chinese Prime Minister Li Keqiang and his Latvian counterpart Maris Kucinskis also confirmed their commitment to create a new holding company (Sino-CEE Financial Holding Limited), in which both countries, as well as Poland and the Czech Republic, would be involved (although the role each country will play has yet to be confirmed). The holding company would control an investment fund of EUR 10 billion, designed for the purposes of attracting funding, of which officials expect to raise nearly EUR 50 billion. During the meeting, the group also touted the 28% increase in trade (up to EUR 56.2 billion) between China and the CEE 16 as compared to before the group was launched (although, admittedly, the trade balance has decidedly been negative for the CEE group, see below).

Amongst amicable talks on working towards common goals, widening cooperation and synergizing needs, and the general "welcoming", "reaffirming" and "supporting", the only sour note was Slovak PM reportedly being snubbed by his Chinese counterpart. This gesture is apparently China's way of displaying displeasure with the Slovak president's meeting with the Dalai Lama earlier this year; a seemingly insignificant, yet sobering reminder that China can be a petulant partner.

The CEE 16, as a group, is by no means the easiest partner either, as the individual countries seem to prefer bilateral solutions over the multilateral ones and oftentimes compete rather than cooperate with each other in search for FDI. Additionally, most members have to make sure the EU rules are being respected at all times, which can often create additional costs. There is also a pervasive distrust towards Chinese plans for the region that some of the Western EU members display. And then, of course, there is Russia, who does not like to be excluded from the goings-on in the region. In fact, directly after the meeting, Mr. Keqiang left for Moscow to hold talks with Russian President Vladimir Putin and Prime Minister Dmitry Medvedev.

The future of the China – CEE 16 cooperation will therefore highly depend not only on purely economic variables but also more political considerations. In what follows, diverse as the CEE 16 group is, it will fare much better in a bid to revive trade with China if the individual countries play as a team. Alone they are not equal partners in the relationship, but rather suitors left at the vagaries of the capricious bride-to-be.



Source: UN Comtrade

[1] Countries include: China, Latvia, Poland, Estonia, Lithuania, Czech Republic, Slovakia, Hungary, Romania, Bulgaria, Slovenia, Croatia, Serbia, Bosnia and Hercegovina, Montenegro, Albania and FYRM.

At a glance

Earlier this week, the European Commission cut its 2016 economic growth forecast for the Polish economy to 3.1%, more than 0.5 percentage points lower than its spring forecast. While private consumption has been increasing, due in large part to accelerating wages and higher welfare spending, investment activity remains subdued, weighing on growth expectations. CASE experts share the same view as the European Commission, forecasting 2016 growth at 3.1%. CASE experts anticipate that the economy may accelerate slightly in 2017, reaching 3.4% growth, due in large to a pickup in investment. However, high deficit levels, forecasted at 2.9% of GDP in 2017, could create significant roadblocks for the new government's inflated social spending promises.

NBP MPC – Base rate % unchanged at 1.5%

Real GDP forecast (%)	2016	2017
CASE	3.1	3.4
IMF WEO	3.1	3.4
OECD	3.0	3.5

According to the Federal State Statistics Service, Russian GDP contracted by -0.6% (y/y) in Q2, the smallest contraction in six quarters, due in part to an increase in manufacturing production. Preliminary estimates of October's inflation rate are even more optimistic, declining to 6.1% (y/y) - the lowest level in 3 years, surpassing market expectations. The Ministry of Economy announced its plans to raise up to 1 trillion roubles from selling state stakes in major companies between 2017 and 2019. Despite the positive forecasts, the World Bank adds a note of caution that Western sanctions over Crimea and intervention in Ukraine could still be an obstacle for Russia's economic recovery.

Oct inflation rate down to 6.1% y/y from 6.4%

Real GDP forecast (%)	2016	2017
IMF WEO	-0.8	1.1
OECD	-1.7	0.5

Germany remains the EU's economic powerhouse through October, although a small slump in industrial output occurred during the month. Put into perspective, October's 1.8% contraction in industrial production follows an above-expectations 3% expansion in August. The country's trade surplus rose to €21.3bn, prompted by a 1.4% m/m drop in imports and a 0.9% m/m growth in exports, as a weaker euro boosted exports to non-Eurozone countries by 2.2%. Record low unemployment and a 2-year high inflation rate of 0.8% support expectations for accelerated economic activity over the coming months. Deutsche Bank turmoil remains one of the economy's principal concerns, as new charges could be looming in relation to the bank's handling of American Depositary Receipts. Meanwhile, Berlin's decision to block a Chinese takeover of local tech group raised concerns of protectionist backlash and has caused discontent in Beijing.

Oct Services PMI index rose to 54.2 from 54.1

Sept Industrial Production contracted by 1.80% m/m following 2.5% expansion

Real GDP forecast (%)	2016	2017
IMF WEO	1.7	1.4
OECD	1.6	1.7

At a glance

On November 8, Ukraine's Central Bank (NBU) released its updated macroeconomic forecasts, which left 2016 GDP growth forecasts unchanged at 1.1%. Growth for 2017 and 2018 were both revised down to 2.5% and 3.5%, respectively. The NBU kept headline inflation expectations unchanged at 12% for 2016, 8% for 2017, and 6% for 2018, further supporting the Central Bank's decision to cut key interest rates by 100 bps to 14% on October 27, which reflected decreased price stability risks. On November 7, the release of preliminary data suggested that Ukraine's international reserves amounted to the equivalent of US$ 15.514 billion, expanding 20% over the past 12 months. However, this increase was offset somewhat due to repayment and servicing of public guaranteed debt denominated in foreign currency, amounting to nearly US$ 366 million, including US$ 310 million in principle and interest payments on domestic sovereign bonds.

Oct CPI increased to 12% y/y from 7.9%

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

According to figures released this week by the Czech National Bank's (CNB), as of the end of October 2016 inflation stood at 0.8%, remaining below the official target, albeit slightly exceeding the CNB's expectations. Following the publication of the inflation figures, the CNB confirmed that it is going to maintain a fixed lower limit on EUR/CZK exchange rate until mid-2017, when inflation is projected to reach the 2% target (and then, in Q4 2017 and Q1 2018, exceed it by 0.3% and 0.4%, respectively). Another set of data released this week shows a CZK 57.6 bn y/y rise in a foreign trade surplus between January and September 2016, which reached a cumulative total of CZK 164.9 bn. The surplus is mostly due to imports falling faster than exports.

Oct inflation increases to 0.8% y/y from 0.5%

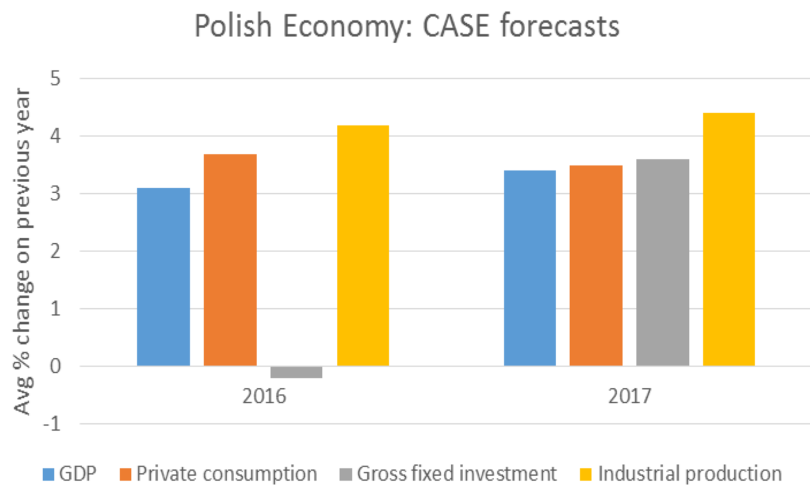
Real GDP forecast (%)	2016	2017
IMF WEO	2.5	2.7
OECD	2.4	2.6

On November 4, the credit rating agency Moody's upgraded Hungary's government bond ratings from Ba1 to Baa3. Main factors driving the upgrade include declining government debt burdens, due in part to a lower share of foreign currency denominated debt, and significant overall reductions in external vulnerabilities. The outlook from the rating agency remains stable, due in large part to a more predictable and growth friendly policy environment than in the past. The credit rating boost builds on already stronger economic growth in Q2, supported by buoyant private consumption and an improved external sector. Moving forward, the economy should benefit from growing business capital accumulation, inward FDI and increasing demand. EU structural funds have also played a role in mitigating weak domestic investment caused by barriers to entry for SMEs and ever-changing regulations.

Oct CPI increased 1% y/y from 0.6% in Sept

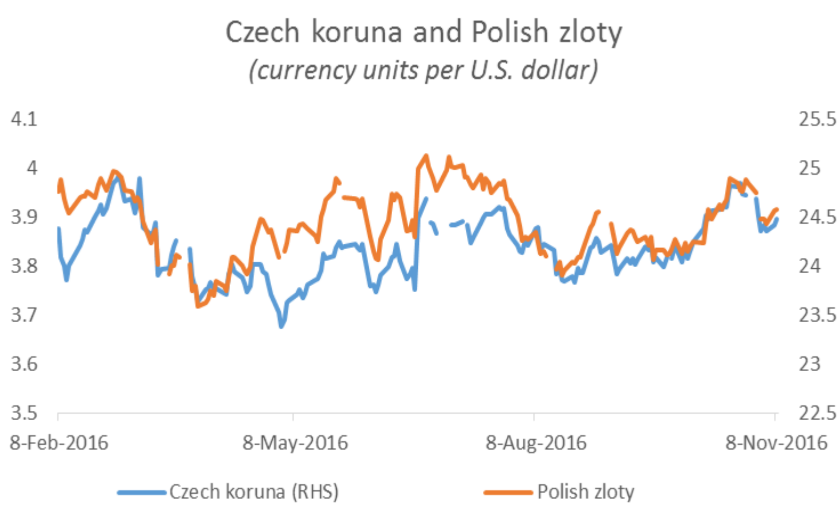
Sept industrial output fell by -3.7% y/y after increasing 3.2% in Aug

Real GDP forecast (%)	2016	2017
IMF WEO	2.0	2.5
OECD	1.6	3.1

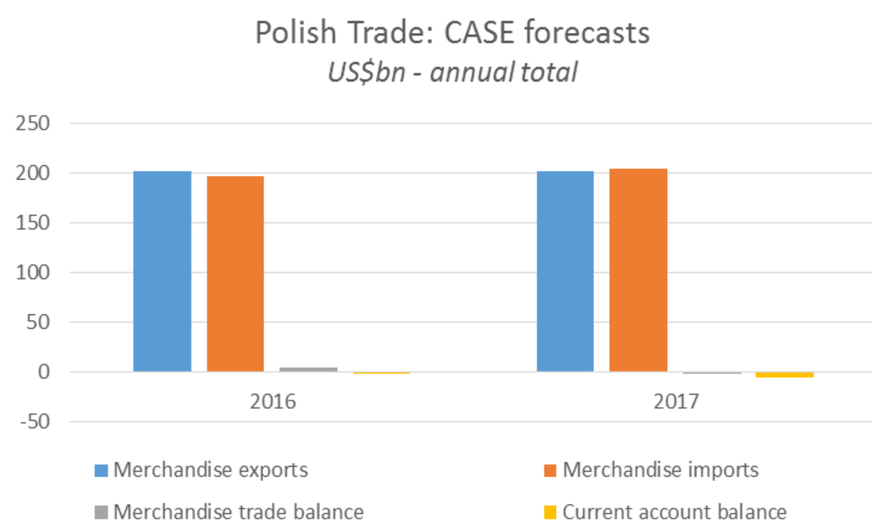


Source: CASE forecasts, updated October 17, 2016

Source: CASE. Most recent observation Nov 07, 2016



Source: IMF



Source: CASE forecasts, updated October 17, 2016

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