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CASE – Center for Social and Economic Research

Overview: In this issue of showCASE, we analyze the plans that the French President Emmanuel Macron and the German Chancellor Angela Merkel have for reforming the Eurozone. We try to predict how realistic these plans are and assess their implications for the non-Eurozone countries.

Will Macron and Merkel Reform the Eurozone?

By: Aleksandra Polak, CASE Analyst

Even though the French President Emmanuel Macron and the German Chancellor Angela Merkel have been repeatedly pledging to work together on reforming the European Union and the Eurozone, their diverging visions of reforms as well as an unstable political situation in Germany prevented them from stepping up to the plate. Amid their indecisiveness, on January 17, fourteen leading German and French economists published a joint manifesto, in which they called for driving the Economic and Monetary Union reform forward. Will academics persuade political leaders to proceed with the deepening of the integration? And what would such an integration mean for countries outside the Eurozone, such as Poland?

Angela Merkel and Emmanuel Macron during a press conference at Elysee Palace, 18/01/18. Source: Reuters

There has been a consensus among experts that the Economic and Monetary Union (EMU) is an unfinished project and should be completed to prevent further crises. The 2009 debt crisis in the euro area revealed flaws in its construction. By adopting the common currency, the participating states surrendered the national monetary policy instruments used to stabilize the economy in favor of the policy pursued by the European Central Bank (ECB). Meanwhile, the divergences in the development and structure of the euro area economies, as well as the insufficiently integrated economic and fiscal policies, meant that the level of interest rates set by the ECB using the "one size fits all" method could not be adjusted to the situation of all the euro countries at once. When the crisis occurred, a uniform monetary policy has aggravated the economic problems of some countries (such as Greece). Other EMU problems include the limited capacity of macroeconomic stabilization and shock absorption of euro area countries as well as the lack of risk-sharing between countries and the private sector.

In order to improve the situation, the French President Emmanuel Macron, the forerunner of the debate on the EMU reform, called for a deeper integration of the euro countries: the creation of a separate budget and a parliament of the euro area, as well as the appointment of a Eurozone finance minister. According to Mr. Macron, the Eurozone's budget should amount to several percent of the euro area's GDP (the entire EU budget now accounts for about 1% of the EU's GDP), be financed from the tax revenues of the states belonging to the zone, and serve for fiscal transfers aimed at mitigating the effects of asymmetric shocks. The budget would be overseen by the finance minister of the euro zone. The French President also proposed the creation of eurobonds.

Decisive for any further steps in the discussion on the EMU reform is the position of Germany. Although Chancellor Angela Merkel does not reject the idea of a separate Eurozone budget, she emphasizes that such a budget should be small and only serve to support structural economic reforms in the EU countries. She also sees the role for the finance minister of the euro area as a limited one: he or she would ensure consistency of economic policies and work towards greater competitiveness of the euro area. Germany supports the transformation of the European Stability Mechanism into the European Monetary Fund – an idea that originated with the former German finance minister Wolfgang Schäuble.

Germany traditionally rejects the possibility of fiscal transfers between countries, fearing that they would burden the German budget. The Merkel government could therefore hinder Macron's vision, focusing on promoting fiscal discipline and structural reforms instead. On the other hand, Germany's European policy will be influenced by CDU's coalition partner, the social democratic SDP. SDP's leader Martin Schulz is a supporter of Emmanuel Macron's ideas for the Eurozone, therefore likely to push for more daring reforms.

What does this political situation mean for Poland – which is not planning to adopt the euro in the near future – and for the other countries outside the euro area? The most serious risk is the deepening of the "two-speed union" and the marginalization of countries outside the euroland. The proposals of Emmanuel Macron, who believes that the euro area should be the heart of the EU, could be perceived as worrisome. In addition, the budget of the euro area postulated by Mr. Macron, which would be competitive with respect to the EU budget, may raise concerns about reducing funds for the "new" Member States, and the deepening integration within the euro area may make it difficult for Poland and other countries to adopt the euro in the future. It remains to be seen if the economists' manifesto will be heard by politicians and if there will be enough political will to truly reform the Eurozone.

This week: The National Bank of Poland announced that funds transferred abroad by foreigners working in Poland in Q3 2017 equalled PLN 3.5 billion, that is 49% more than in the corresponding period of the previous year. This significant increase has been brought about by the growing inflow of short-term Ukrainian economic migrants to Poland: transfers to Ukraine amounted to PLN 3.2 billion, or 91% of all transferred funds.

GDP (Q3 2017)

5.2% y/y (est.)

Up from 4.2% in Q2

Inflation (Dec 2017)

2.1% y/y

Down from 2.5% in Nov

Unemployment (Dec 2017)

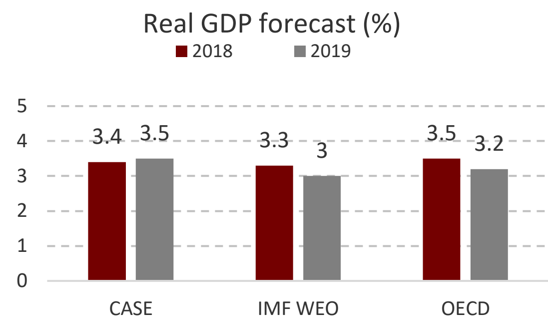
6.6%

Up from 6.5% in Nov

NBP Base rate

1.5%

From 2% in Mar 2015



This week: According to the Federal State Statistics Service, the consumer price inflation in Russia fell from 2.5% in December 2017 to 2.2% in January 2018, y/y. This is below both the market expectations and the Central Bank's target of 4%. The low level of inflation allowed the Central Bank to cut its key rate for the second time in two months, making credits cheaper before the presidential elections in March.

GDP (Q3 2017)

1.8% y/y

Down from 2.5% in Q2

Inflation (January 2018)

2.2% y/y

From 2.5% in Dec 2017

Unemployment (Nov 2017)

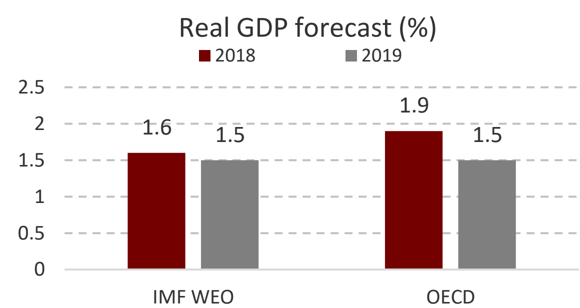
5.1%

Unchanged since Oct 2017

CBR Base rate

7.5 %

From 7.75% in Jan 2018



This week: The German industry appears unsatisfied with the published draft of the coalition agreement between CDU and SPD. Criticisms include the apparent propensity towards redistribution of resources and a lack of incentives for research and development and for digitalization.

GDP (Q3 2017)

2.8% y/y

Up from 2.3% in Q2

Inflation (Jan 2018)

1.4% y/y (est.)

Down from 1.6% in Dec

Unemployment (Dec 2017)

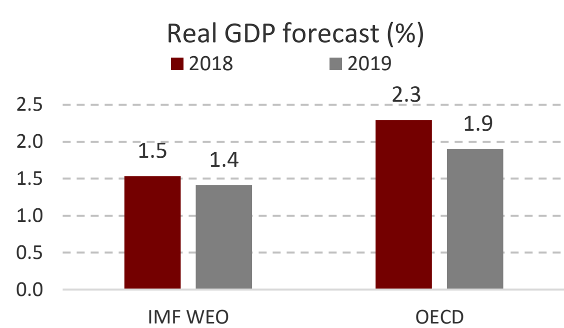
3.5%

Up from 3.4% in Nov 2017

ECB Deposit rate

-0.4%

From -0.3% in Dec 2015



This week: Ukraine's foreign exchange reserves amounted to USD 18,444 million at the beginning of February, that is 2% less than a month earlier. The National Bank of Ukraine said that the decrease of the reserves had been caused by foreign currency debt repayments and servicing in the amount of USD 565.6 million. The NBU also conducted currency interventions in January to smooth out excessive exchange rate fluctuations of the hryvnia, whose causes were described as temporary.

GDP (Q3 2017)

2.1% y/y

Down from 2.3% in Q2

Unemployment (Q3 2017)

8.9%

Down from 9.1% in Q2 2017

Inflation (Dec 2017)

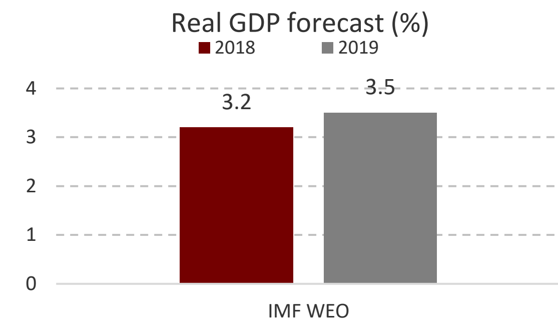
13.7% y/y

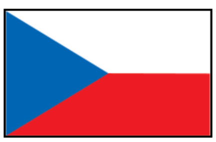
Up from 13.6% in Nov

NBU Base rate

16.0%

From 14.5% in Dec 2017





This week: In 2017, Budvar's beer production has increased by 8.5% relative to the previous year. The company's capacities are not sufficient to meet the increasing demand. This year, Budvar plans to invest around 600 million Czech koruna's to expand the existing capacities. In 2017, investments reached around 700 million Czech koruna's.

GDP (Q3 2017)

5.0% y/y

Up from 4.7% in Q2 2017

Unemployment (Q4 2017)

2.4%

Up from 2.8% in Q2 2017

Inflation (Dec 2017)

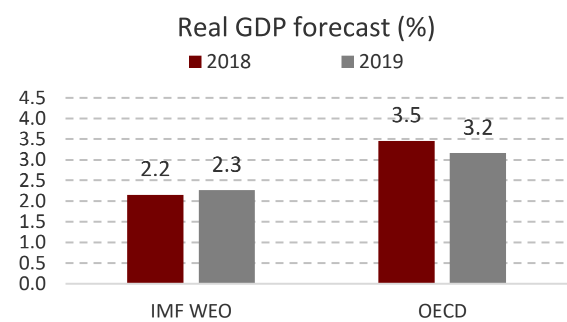
2.4% y/y

Down from 2.6% in November

CNB Base rate

0.75%

From 0.50% (2nd January 2018)



This Week: Last week, the Hungarian Ministry for National Economy organized a conference on designing a strategy for increasing competiveness of Hungarian SMEs. The strategy is being prepared by the Ministry for National Economy in cooperation with the Organisation for Economic Cooperation and Development (OECD). The guests included Alvaro Pereira, an OECD Acting Chief Economist, and László Parragh, the President of the Hungarian Chamber of Commerce and Industry.

GDP (Q3 2017)

3.9% y/y (est.)

Up from 3.3% in Q2

Unemployment (Q3 2017)

3.8%

Down from 4.3% in Q2

Inflation (Nov 2017)

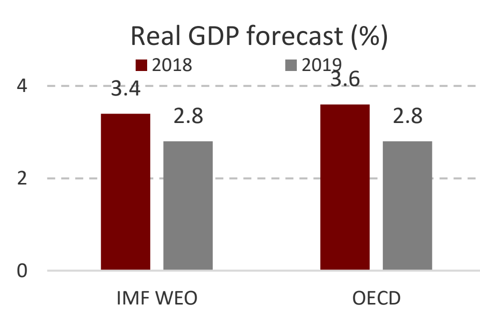
2.5% y/y

Up from 2.2% in October

MNB Base rate

0.9%

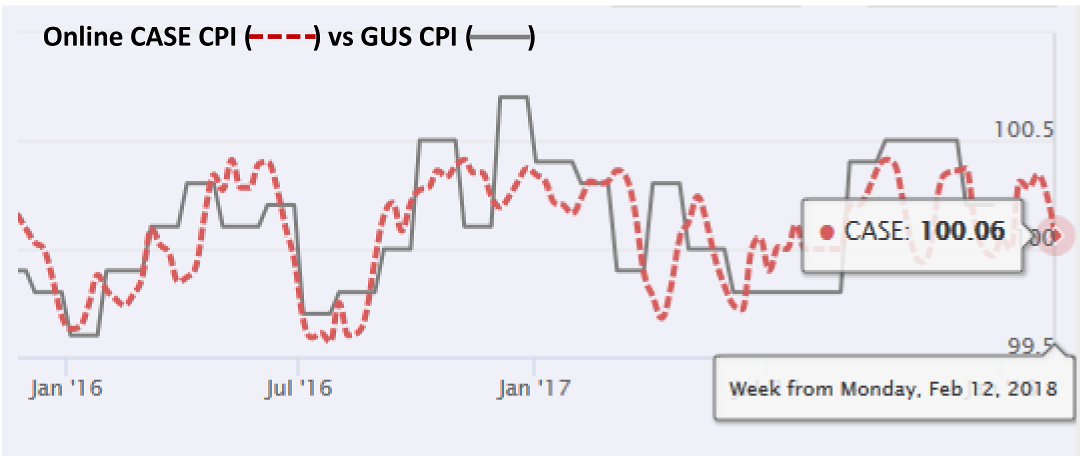
From 1.05% in May 2016



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, 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	3.4	3.5	3.1	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	3.5	233.4	235.2	-1.8	-3.9
2019	3.7	242.7	244.6	-1.9	-4.1

For more information on our weekly online CASE CPI, please visit: http://case-research.eu/en/online-case-cpi To **subscribe** to our weekly showCASE newsletter, please click here. To see **previous issues** of showCASE, please visit: http://case-research.eu/en/showcase

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