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Contents

Abbreviations

CPI	Consumer Price Index
EA	euro area
ECB	European Central Bank
EC	European Commission
EIA	Energy Information Administration
EMU	Economic and Monetary Union
EONIA	euro overnight index average
ESA 95	European System of National Accounts 1995
EU	European Union
Eurostat	Statistical Office of the European Communities
FDI	foreign direct investment
Fed	Federal Reserve System
EMU	Economic and Monetary Union
EURIBOR	euro interbank offered rate
FNM	Fond národného majetku – National Property Fund
GDP	gross domestic product
GNDI	gross national disposable income
GNI	gross national income
HICP	Harmonised Index of Consumer Prices
IMF	International Monetary Fund
IPI	industrial production index
IRF	initial rate fixation
MFI	monetary financial institutions
MF SR	Ministry of Finance of the Slovak Republic
MMF	money market fund
NARKS	National Association of Real Estate Offices of Slovakia
NBS	Národná banka Slovenska
NEER	nominal effective exchange rate
NPISHs	Non-profit Institutions serving households
OIF	open-end investment fund
p.a.	per annum
p.p.	percentage points
qoq	quarter-on-quarter
PPI	Producer Price Index
REER	real effective exchange rate
SASS	Slovenská asociácia správcovských spoločností – Slovak Association of Asset Management Companies
SO SR	Statistical Office of the Slovak Republic
SR	Slovenská republika – Slovak Republic
ULC	unit labour costs
VAT	value-added tax
yoy	year-on-year

Symbols used in the tables
. – Data are not yet available.
- – Data do not exist / data are not applicable.
(p) – Preliminary data

1 Summary[1]

The euro area economy grew by 0.2% in the third quarter of 2014, according to the revised estimate. Among the larger national economies of the euro area, the fastest-growing were Spain (0.5%) and, showing somewhat surprising acceleration, France (0.3%). In Germany, by contrast, GDP edged up by only 0.1% in the third quarter, after falling in the second quarter. Looking at the composition of euro area growth, the main contributors were private and public consumption, while investment demand had a negative impact. With slack in production capacity still relatively sizeable, investment demand is likely to have been more affected than other components by rising geopolitical tensions and associated deterioration in economic sentiment. The assumption now, based on forward-looking indicators, is that euro area growth will continue to decelerate in the short term.

Slovakia's economic growth in the third quarter stood at 0.6%, driven mainly by investment demand and supported also by private and public consumption. Exports, on the other hand, continued to decline. The monthly GDP figures for October showed a similar pattern. Activity continued to grow, with increases in both production and sales. After picking up in September, exports fell again in October. Sentiment improved, therefore mirroring the situation in the euro area.

Employment increased by 0.3% in the third quarter, and the unemployment rate fell moderately. The services sector saw a shift away from job creation and towards increasing hours worked. Annual wage growth remained relatively high in the third quarter, albeit lower than in the second quarter since it more closely reflected labour productivity growth.

Annual HICP inflation remained at zero in November. The fall in energy prices was caused mainly by the continuing drop in fuel prices. Services price inflation slowed significantly following the introduction of free rail travel for students and pensioners. Exchange rate depreciation was reflected in a moderate increase in non-energy industrial goods prices. The continuing downward trend in oil prices represents a downside risk to the inflation forecast for next year.

1 *All month-on-month and quarter-on-quarter changes mentioned in the text have been seasonally adjusted using NBS internal models.*

2 THE REAL ECONOMY

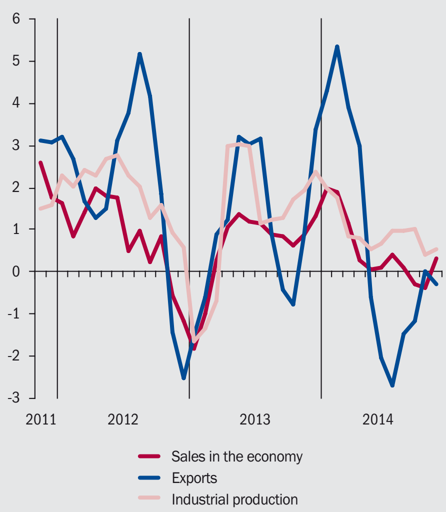
2.1 "HARD" INDICATORS OF ECONOMIC ACTIVITY

Average sales for the three months to end-October increased in comparison with the corresponding average three months earlier. Their growth was driven by the domestic economy, while sales in export industries remained flat. Industry sales stagnated despite an appreciable increase in industrial production.

Although industrial production increased, its growth, according to preliminary figures, was not export-led. Indeed, average exports for the period August–October fell on a three month on-basis, which may indicate that production is being stored and also that export figures will be revised up in months ahead. Production for storage would follow the tendency observed in the third quarter of this year, when key exporters reported weaker export performance and increased their inventories. In terms of GDP, the build-up of inventories could to a moderate extent compensate for the weakening of exports in October.

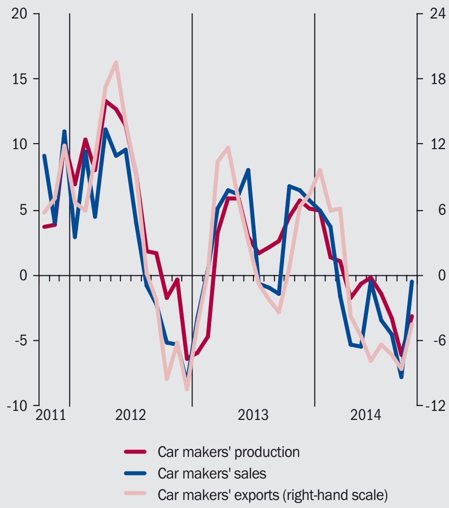
A cause of concern is that the slackening of exports in October was more pronounced than would be expected from a correction after September's stronger exports. Export developments to date simply confirm the grounds on which projected exports for the fourth quarter were revised down in NBS's latest Medium-Term Forecast (MTF-2014Q4), from the previous forecast (MTF-2014Q3).

Chart 1 Sales, industrial production and exports (percent; three month-on-three month; moving average; constant prices)



Source: SO SR, NBS calculations.

Chart 2 Automotive industry indicators (percent; three month-on-three month; moving average; constant prices)



Source: SO SR, NBS calculations.

The largest differences between production and exports are in the metal manufacturing industry and the petrochemical industry. In fact, the metal manufacturing industry, which was the main engine of industrial production growth in October, completely dampened export growth. The pick-up in refinery output in October continued the positive trend of September (albeit less markedly), but this industry's export growth remained unchanged from the previous month. If such slackening in exports is followed by a drop in production, the result could be persisting losses of shares of foreign markets.

Domestic trade and services prevented decline in overall sales

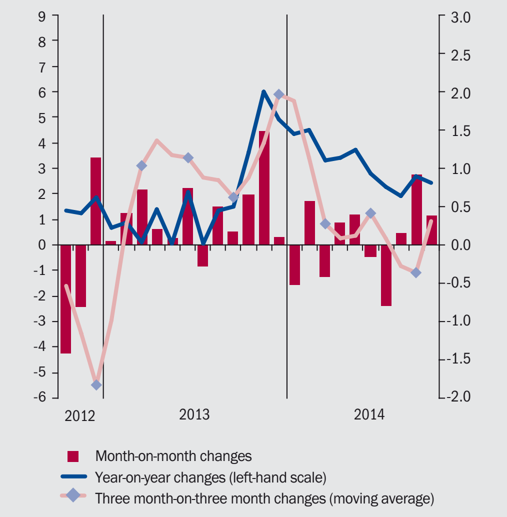
With sales in the economy increasing, month-on-month, in October (by 0.4%), their average for the period August-October was 0.3% higher on a three month-on-three month basis (after a decline of 0.4% for the period July-September). This growth was largely accounted for by domestic trade and services, i.e. the domestic economy. Average industry sales for the three months to end-October remained flat compared to the corresponding average three months earlier.

The overall figure for industry sales growth included positive contributions from the petrochemical and metal manufacturing sectors and negative contributions from the car and electricals/electronics industries.

Production growth based largely on metal manufacturing

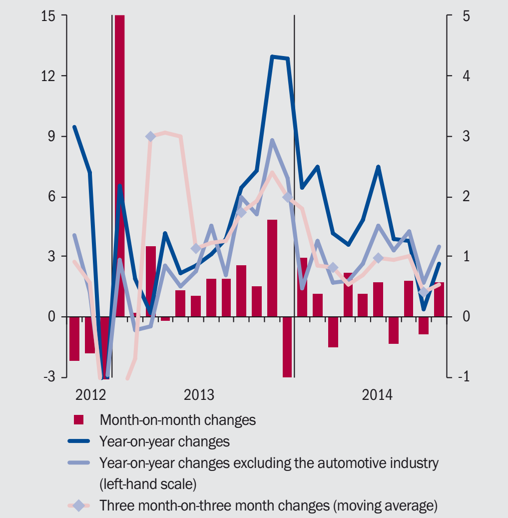
As industrial production was higher in October than in September (by 0.6%), its average for the period August-October increased slightly against the corresponding average three months earlier, by 0.5%. Most of that growth was accounted for

Chart 3 Total sales at constant prices (percent; constant prices)



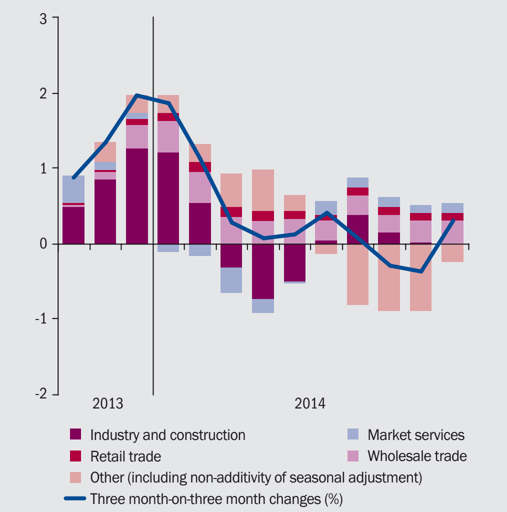
Source: SO SR, NBS calculations.

Chart 5 Industrial production (%)



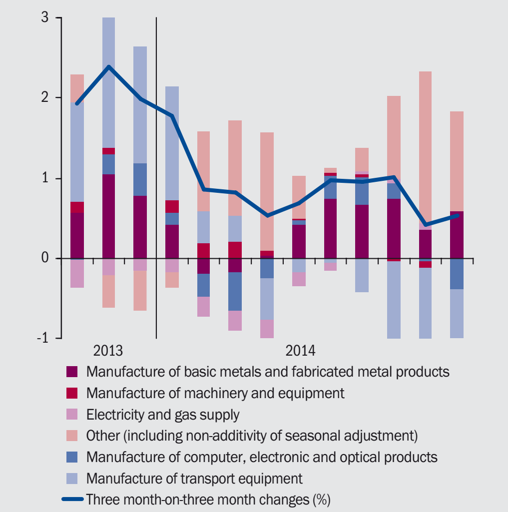
Source: SO SR, NBS calculations.

Chart 4 Total sales by contributions of selected sectors to three month-on-three month rate of change (p.p.; constant prices)



Source: SO SR, NBS calculations.

Chart 6 Industrial production – principal contributions to three month-on-three month rate of change (p.p.; moving average)



Source: SO SR, NBS calculations.

by the metal manufacturing industry, while the car industry's negative contribution moderated in comparison with the previous period. In year-on-year terms, industrial production accelerated to 2.7% in October, from 0.4% in September.

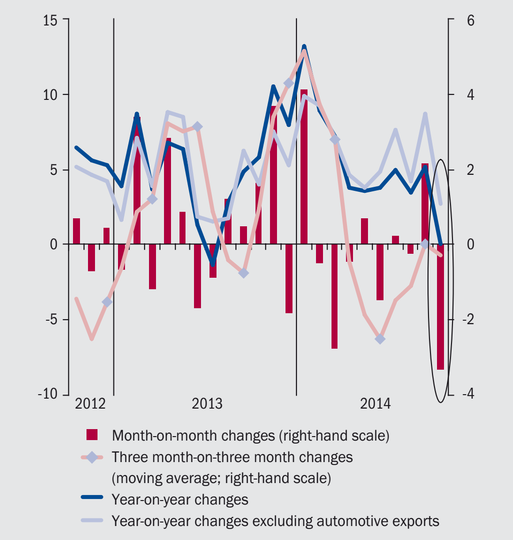
The current trend in industry is not fully consistent with the subdued external trade figures.

Goods exports fell in October, confirming the deteriorating outlook for Slovak exports

As regards goods exports, their three-month average for August-October was 0.3% lower than that for May-July. Lower exports in October may to some extent have represented a correction after relatively stronger figures in September. Nevertheless, the underwhelming export performance in October confirms the grounds on which projected exports for the fourth quarter were revised down in NBS's latest Medium-Term Forecast (MTF-2014Q4), from the previous forecast (MTF-2014Q3).

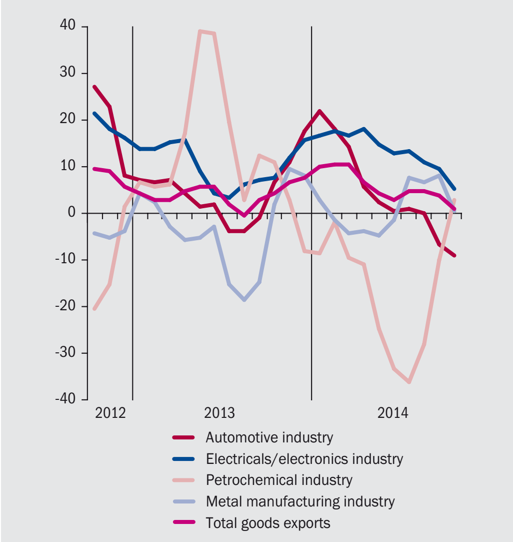
The return of exports to negative territory, after stabilising in September, was attributable to falling exports of cars and car accessories, as well as to the other sectors in which exports either grew more slowly (electricals/electronics) or fell (metal manufacturing). The amount of car makers' exports, at constant prices, declined down to their 2012 level. Although the remaining volume of exports also declined in October, exports in total remained above their levels of previous years.

Chart 7 Goods exports (percent; constant prices)



Source: SO SR, NBS calculations.
Note: Converted by NBS into constant prices.

Chart 8 Exports – annual percentage changes in selected sectors (three-month moving average; percent; constant prices)



Source: SO SR, NBS calculations.
Note: Converted by NBS into constant prices.

Imports and domestic trade may indicate that the favourable situation in private consumption will continue towards year-end

Imports, measured at constant prices, fell from September to October less markedly than did exports. Their average for the three months to end-October was a modest 0.6% higher than the average for the previous three months (after falling by 1.3% in the three months to end-September). Nevertheless, imports for the automotive and electricals/electronics industries remained subdued. The growth in overall imports was supported by imports for retail chains, which, along with rising sales in domestic trade (especially in wholesale and retail trade), suggests that household consumption will accelerate in the latter part of the year, in line with projections in the MTF-2014Q4 forecast.

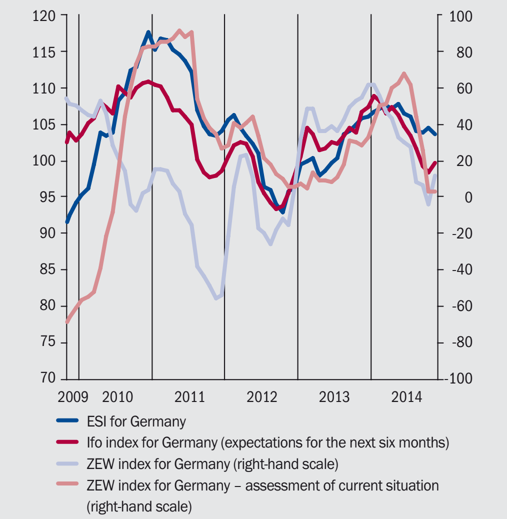
The nominal trade surplus in October stood at a seasonally-unadjusted €519.4 million, which was €96.8 million higher than the surplus in October 2013, owing mainly to a decline in imports at current prices. Nominal goods imports and goods exports both fell year-on-year, by, respectively, 5.9% and 3.9%.

2.2 FORWARD-LOOKING "SOFT" INDICATORS

Positive signals for the euro area and German economies

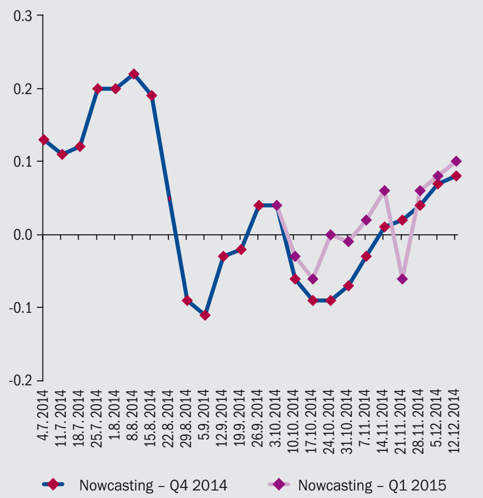
In November, the economic sentiment indicator (ESI) for the euro area remained broadly unchanged from the previous month (edging up by 0.1 point, to 100.8), while the ESI for Germany fell by 0.7 point (to 103.7). Similarly, the composite PMIs for both the euro area and Germany declined in November. Germany did, however, see significant increases in both its ZEW and Ifo indexes.

Chart 9 Economic sentiment indicators for Germany



Source: European Commission, Ifo institute, ZEW Centre.
Note: ESI (long-run average = 100), Ifo index (2005 = 100), ZEW (balance of responses).

Chart 11 Euro-area GDP growth estimate for Q4 2014 and Q1 2015 (quarter-on-quarter percentage changes)

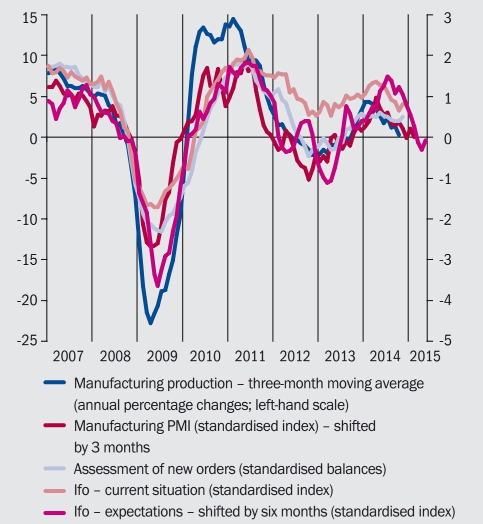


Source: Now-Casting Economics Ltd.

Chart 10 Economic sentiment indicator (long-run average = 100)

Source: European Commission.

Chart 12 Germany – industrial production and forward-looking indicators



Source: Eurostat, Ifo institute and Markit.

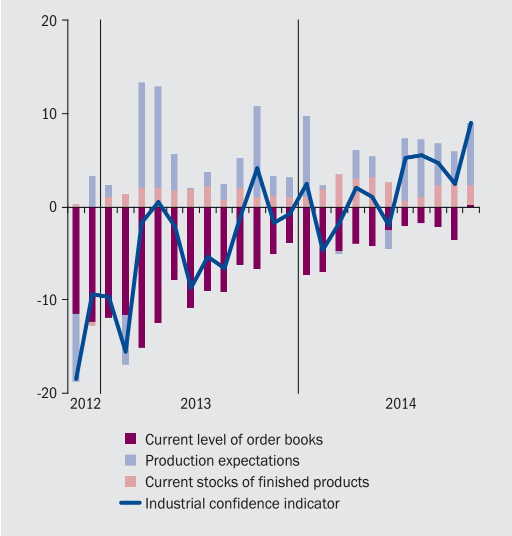
Despite their heterogeneous developments, forward-looking confidence indicators are implying that economic growth in both Germany and the euro area as a whole may be stronger in the fourth quarter than in the third quarter.

Confidence in the Slovak economy increased appreciably

The economic sentiment indicator for Slovakia increased, month-on-month, in November by 4.9 points, to 105.4, to reach its highest level since January 2011. Confidence improved in all component sectors except for retail trade.

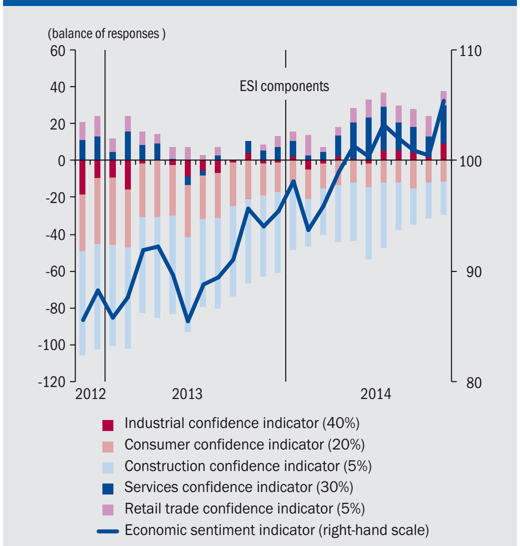
Services confidence increased the most, based mainly on service providers' improved assessments of the business situation, especially in the sectors of transportation and storage, financial and insurance activities, and accommodation and food service activities. The positive development in industry confidence was fuelled largely by brighter assessments of the level of order books, particularly in the industries manufacturing computer, electronic and optical products, chemicals and chemical products, and motor vehicles. Similarly in the construction sector, appraisals of order books were more positive and overall confidence reached its highest level for five years. The moderate pick-up in consumer confidence was based on improved assessments of future unemployment and the future economic situation. The decline in retail trade reflected negative assessments of the expected business situation.

Chart 14 Industrial confidence indicator for Slovakia (balance of responses)



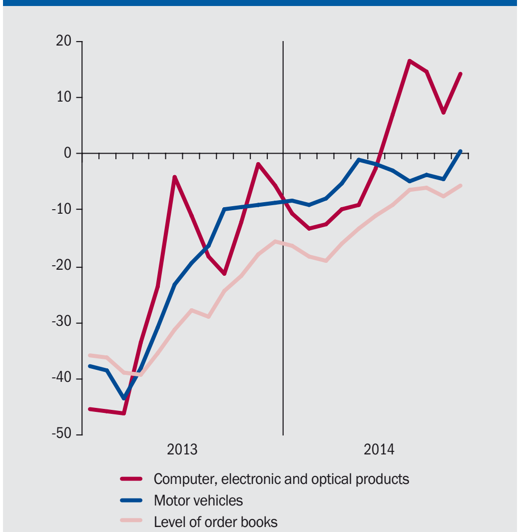
Source: European Commission.

Chart 13 Economic sentiment indicator for Slovakia (long-run average = 100)



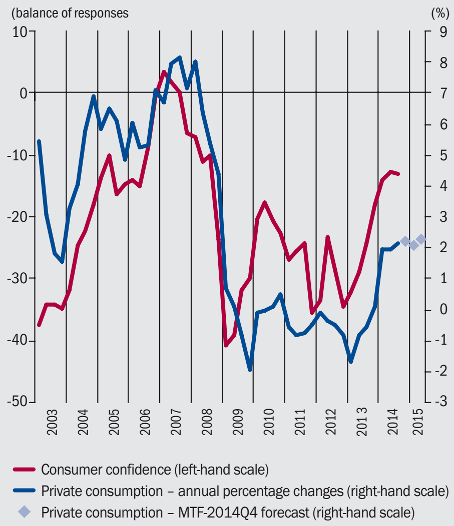
Source: European Commission.
Note: The percentages in the legend represent the weights of the respective components in the ESI.

Chart 15 Level of order books (3-month moving average; balance of responses)



Source: European Commission.

Chart 16 Consumer confidence and private consumption (%)



Source: SO SR, European Commission and NBS.

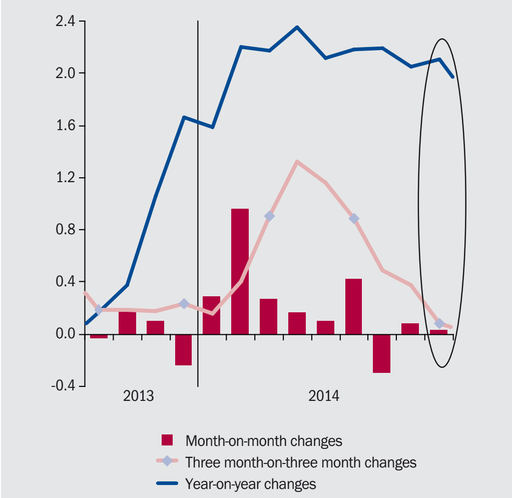
After last month's improvement in euro area confidence indicators, economic sentiment firmed significantly in Slovakia, too, thus restoring optimism that the country's economy can continue growing in the last quarter, albeit at a slower pace.

3 Labour market

Employment growth continues to slow on a three month-on-three month basis, as the figure for the August-October period confirms. In month-on-month terms, employment in the selected sectors edged down by 0.1%, and this drop was reflected in the annual rate of increase, which fell to 1.8% (from 2.1% in September). Most sectors of the economy saw a drop in employment growth. Trade saw the largest deceleration, and in industry, too, the slowdown in October was greater than in September. In construction, the annual rate of change in employment remained negative, but moderated for a second successive month.

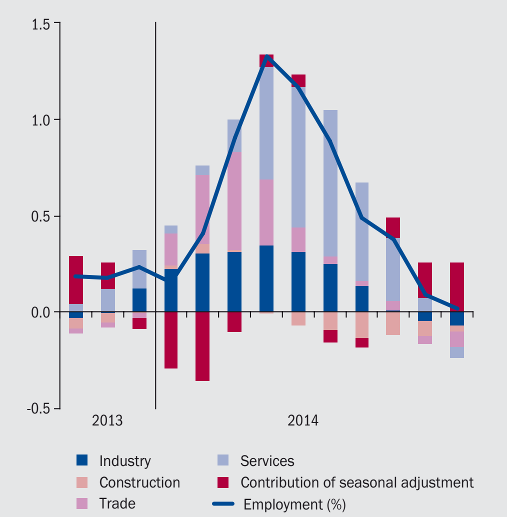
Average wages in the selected sectors for the three months to end-October increased by 0.5%, as against the corresponding average three months earlier. That growth rate was higher than the one for July-September (0.1%). In month-on-month terms, wages in October decreased by 0.5%, while year-on-year they increased by 2%, which compared with September's growth was lower by 1.8 percentage points. After

Chart 18 Rates of change in employment (%)



Source: SO SR, NBS calculations.
Note: In January, upward revisions were made to employment growth in the segments of business activities, accommodation, and restaurants. At the same time, the figures for 2013 were not revised and hence there was probably no upward effect on the labour market situation.

Chart 17 Employment – sectoral contributions to the three month-on-three month rate of change (moving average; p.p.)

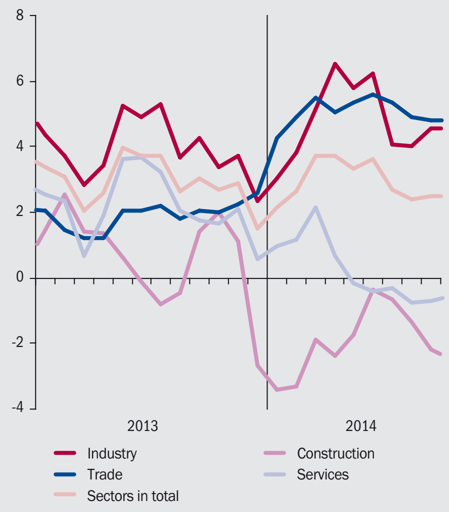


Source: SO SR, NBS calculations.

Chart 19 Wage developments in the economy (annual percentage changes)

Source: SO SR.
Note: The wage growth figures for the economy as a whole in Q4 2014 are the projections given in the MTF-2014Q4 forecast. The nominal labour productivity figures follow the MTF-2014Q4 forecast.

Chart 20 Wage growth (annual percentage changes; three-month moving average)



Source: SO SR.

increasing briskly early in the year, wage growth is cooling towards the end of the period. Wage growth remains positive in industry, and in October wages in the trade sector also rose. In construction and services, however, wages made negative contributions to the overall growth rate.

4 Prices

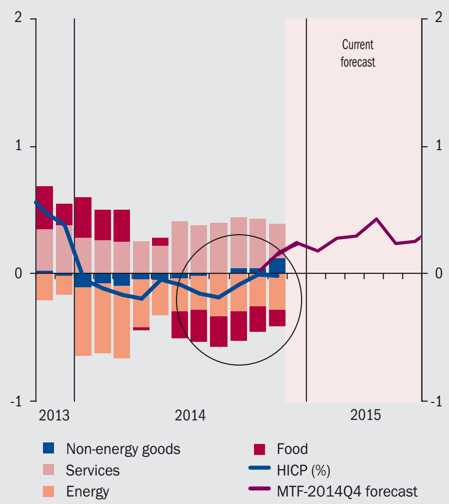
Annual inflation remained at zero in November

Annual HICP inflation was at zero in November, unchanged from October, while in month-on-month terms the inflation rate was negative, at -0.2%. NBS had expected the annual rate to increase slightly.

The stagnation in November's annual inflation rate reflected lower inflation in prices of services and non-energy industrial goods and falling energy and food prices.

Services price inflation in particular was lower than expected. This was due to the introduction of free rail travel for students and pensioners, which affected overall services prices a month earlier, and more pronouncedly, than had been anticipated. Food and energy price inflation, reflecting the situation in commodity markets, remain in negative territory and have contributed significantly to the low-inflation environment in 2014. The pass-through of the downward trend in oil and oil derivative prices accounted for November's substantial month-on-month drop in fuel prices. The current collapse of oil prices could be reflected with a lag in administered prices of energy (gas for households) in 2015, in the form of a markedly negative annual rate of change. Low prices of basic agricultural commodities, subdued by this year's abundant harvests and the relatively large build-up of global stocks, are expected to continue affecting

Chart 21 Composition of annual inflation (p.p.)



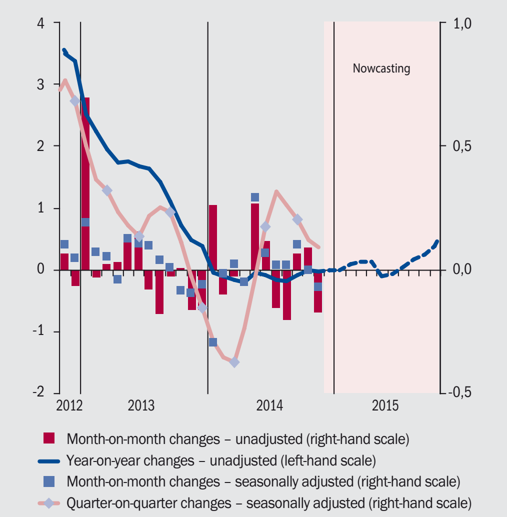
Source: SO SR, NBS calculations.

Table 1 HICP components – comparison of projected and actual rates of change (in percent unless otherwise stated)

			Non-energy industrial goods	Energy	Food	Services	HICP	Net HICP inflation excluding fuel
Month-on-month change	A	November 2013 – actual figure	-0.1	-0.3	-0.4	0.0	**-0.2**	0.0
	B	November 2014 – forecast	0.0	-0.2	0.0	0.1	**0.0**	0.0
	C	**November 2014 – actual figure**	**0.2**	**-0.5**	**-0.2**	**-0.4**	**-0.2**	**0.2**
	BC	**Difference in contribution to month-on-month rate of change (p.p.)**	**0.06**	**-0.04**	**-0.04**	**-0.15**	**-0.17**	**0.08**
Year-on-year change	D	October 2014 – actual figure	0.2	-1.6	-0.8	1.3	**0.0**	0.7
	E	November 2014 – forecast	0.2	-1.5	-0.4	1.4	**0.2**	0.8
	F	**November 2014 – actual figure**	**0.4**	**-1.7**	**-0.5**	**0.9**	**0.0**	**0.9**
	AC	Base effect	moderate	insignificant	insignificant	significant	**moderate**	moderate
	EF	**Difference in contribution to month-on-month rate of change (p.p.)**	**0.05**	**-0.04**	**-0.04**	**-0.15**	**-0.17**	**0.08**

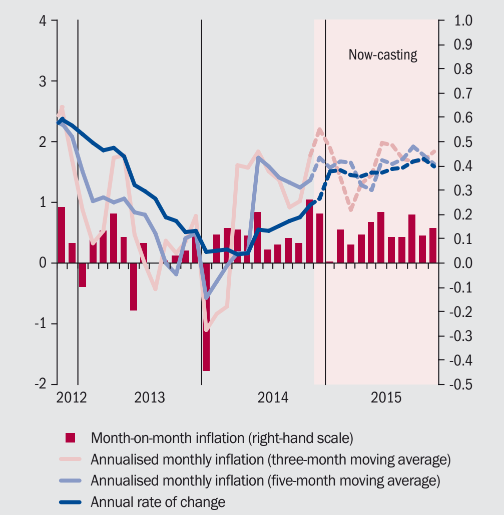
Source: SO SR, NBS calculations.

Chart 22 Headline inflation rate (%)



Source: SO SR, NBS calculations.

Chart 23 Annualised net inflation excluding fuel prices (percent; seasonally adjusted) (%)



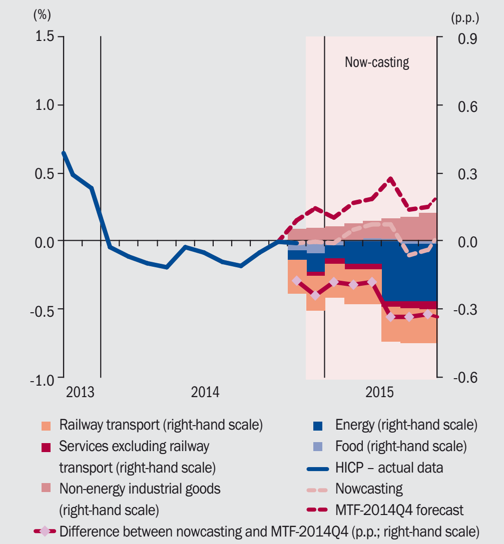
Source: SO SR, NBS calculations.
Note: Net inflation comprises non-administered prices of services and non-administered prices of non-energy industrial goods.

certain categories of food prices in the first half of 2015, either dampening their growth or pushing them down.

Net inflation excluding fuel increased gradually in the second half of 2014. In prices of non-administered services (therefore excluding inter alia prices of railway transport) and of non-energy industrial goods, inflation maintains a steady upward trajectory. The assumed pass-through of wage developments, the acceleration of import prices, and gradually increasing inflation expectations are expected to cause net inflation to be slightly higher in 2015 than in 2014.

Oil prices constitute the most significant risk to the inflation outlook in the short-term horizon. The Regulatory Office for Network Industries (ÚRSO) has moderately reduced maximum household gas prices, by around 1%, with effect from 1 January 2015, while the annual rate of decrease in oil prices in 2015 is expected to be more than 20%. Hence there is wide room for ÚRSO to cut gas prices further during the course of next year. Inflation is expected to be very low in 2015, due largely to falling energy prices and muted food price inflation in the first half of the year.

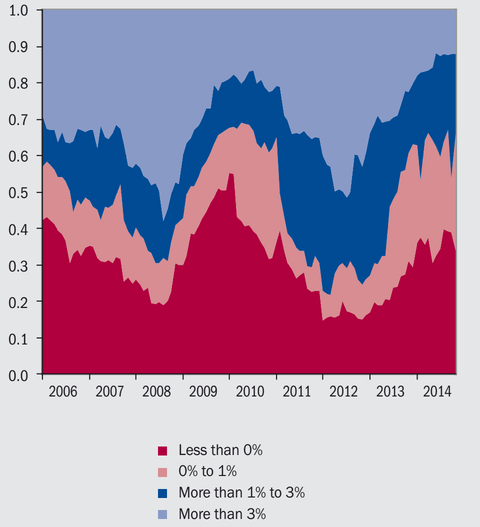
Chart 24 Price developments compared with forecast (MTF-2014Q4)



Source: SO SR, NBS calculations.

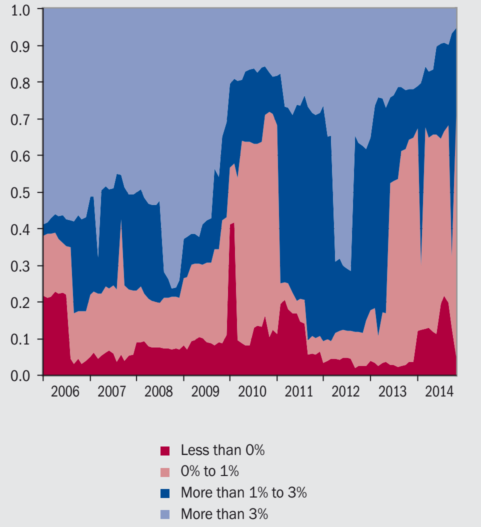
Spot oil prices have now fallen below USD 64 per barrel with a downward impact on oil futures prices for 2015 delivery. The average for these futures prices is more than 20 % lower than the average oil futures prices for 2014 delivery. That difference is markedly greater than the

Chart 25 CPI broken down by price-change intervals



Source: NBS calculations.
Note: Price-change intervals refer to annual percentage changes: less than 0%; 0% to 1%; more than 1% to 3%; more than 3%.

Chart 26 CPI market services component broken down by price-change intervals



Source: NBS calculations.
Note: Price-change intervals refer to annual percentage changes: less than 0%; 0% to 1%; more than 1% to 3%; more than 3%.

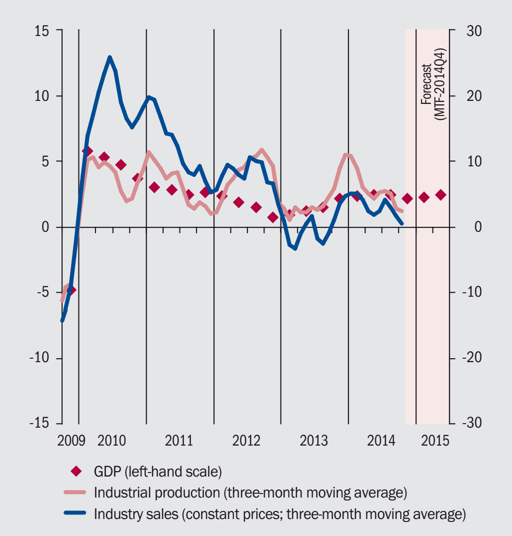
announced reduction in household gas prices, of 1% (with effect from 1 January 2015). Nowcasting based on updated data for oil futures and the exchange rate as at 11 December 2014 shows that gas prices, after being cut by 1% at the start of the year, will be further reduced in April 2015 to reflect (albeit not fully) the expected sizeable drop in oil prices.

Since mid-2013, the consumer price index has featured a noticeably increasing share of items whose price growth has been lower than 1%. A major factor in this regard has been the rising share of market services prices with an inflation rate of less than 1%. This development implies a risk that the low-inflation situation will continue.

5 Qualitative impact on the forecast

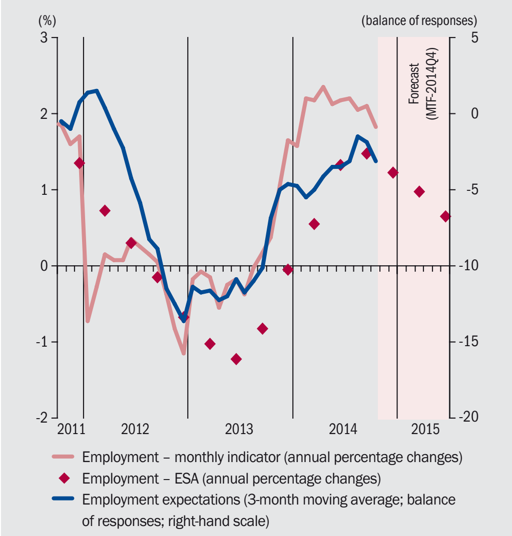
The recently published national accounts figures were incorporated into NBS's latest forecast (MTF-2014Q4) and therefore do not represent new information. The composition of GDP growth was in line with projections, while the monthly data available for incorporation in the forecast provided a relatively reliable estimate of current developments in the given

Chart 27 GDP, industrial production and sales (annual percentage changes)



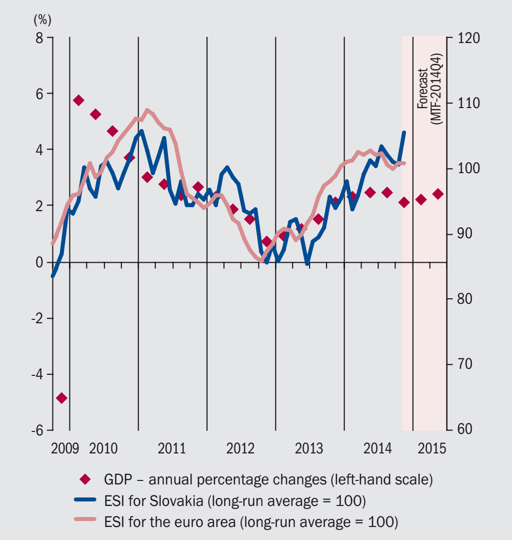
Source: SO SR and NBS.

Chart 29 Employers' expectations and the annual rate of change in employment



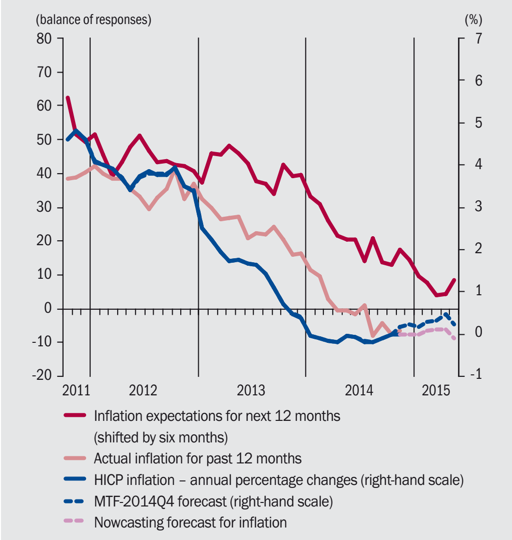
Source: SO SR, NBS and European Commission.

Chart 28 GDP and the economic sentiment indicator



Source: SO SR, NBS and European Commission.

Chart 30 Consumers' inflation perceptions (balance of responses) and HICP inflation



Source: SO SR, NBS and European Commission.

period. October's labour market figures were broadly in line with projections and therefore no revisions to the employment and wage outlooks are required. Current developments in oil prices constitute a downside risk to the inflation forecast for next year.

QUARTERLY REPORT ON THE INTERNATIONAL ECONOMY

THE GLOBAL ECONOMY

The global economy continued along a gradual recovery path in the third quarter of 2014. This path, however, was rather uneven across both advanced and emerging market economies.

The American economy grew at a slower pace than in the previous quarter, but sustained robust growth. This stemmed from the narrower range of balance-sheet adjustments in the private sector and of fiscal restrictions, as well as from the improving labour market conditions and recovering domestic demand. The British economy also experienced solid, but somewhat slower growth, which was driven by private consumption growth in an environment of relatively eased lending conditions. The slowdown was to some extent caused by the weak economic activity in the euro area, which is Britain's main trading partner. Economic growth in the euro area accelerated slightly in comparison with the previous quarter, but remained dampened by the weakening sentiment, mainly as a result of the persisting geopolitical tensions. The Japanese economy declined still further in the third quarter of 2014. This was a surprise to some extent, because, after an excise tax increase at the beginning of the previous quarter had caused a sharp contraction in economic activity, the Japanese economy was expected to experience a revival. Investment contracted still further and the persisting effect of the tax increase, coupled with the consequences of the cool summer, caused a fall in spending on private consumption. The central bank's expansive monetary policy, however, was supposed to support Japan's economic recovery.

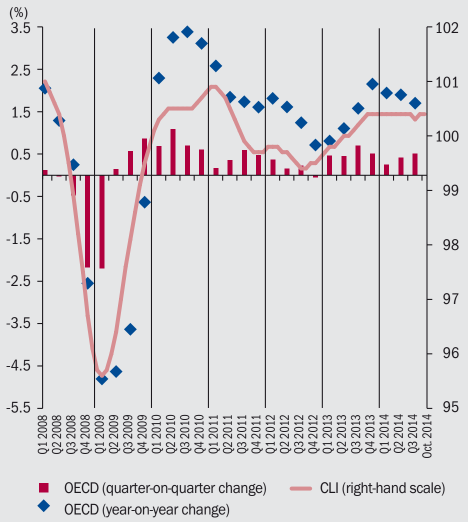
Emerging economies also underwent heterogeneous developments during the third quarter of 2014. A certain slowdown was recorded in the Chinese economy, which had experienced accelerated growth over the previous quarter as a result of fiscal stimuli and strong credit growth. In year-on-year terms, however, it still grew at a pace exceeding 7%. The best performer among Asian countries was India, where economic activity was supported by the improved post-election sentiment. Central and Eastern European economies profited from domestic demand and investment in particular, but were to some extent dampened by the geopolitical conflict between Russia and Ukraine. In Latin America, Brazil managed to recover from recession owing to investment and government consumption, while Mexico maintained less dynamic but solid growth.

Overall, the rate of economic growth in OECD countries increased in the third quarter of 2014 to 0.5%, from 0.4% in the previous quarter. In year-on-year terms, however, economic growth slowed somewhat (by 0.2 percentage point to 1.7%). The Composite Leading Indicator[2] of economic confidence in OECD countries suggested that the global economy was unlikely to experience a major revival over the short-term horizon. It was more or less stagnant throughout the third quarter and remained virtually unchanged in October, too.

Over the medium-term horizon, global economy activity is expected to strengthen gradually, but the pace of recovery is likely to remain moderate. Domestic demand and confidence in advanced countries are expected to be strengthened by the gradual fiscal consolidation and improving labour market conditions. In most of the countries under review, investment is supposed to return to a level that is in line with historical standards. The growing demand in advanced countries is also expected to have a positive effect on emerging economies. Their growth, however, is likely to remain below the pre-crisis level, because the potential growth of these economies will be dampened by structural changes and by the solution of macroeconomic imbalances. In addition, emerging economies will have to conform to the tightened fiscal conditions and standardised monetary policies of advanced countries. On the other hand, these economies may profit from the low commodity prices. Global economic developments, however, may also be influenced in the future by the interaction between geopolitical risks and oil prices, which is essential for confidence building and for shaping the economic cycle at

2 *The CLI indicators are published by OECD on a monthly basis – the latest available data, released in December 2014, are for October 2014.*

Chart 31 Annual/quarterly percentage changes in GDP as implied by CLIs



Source: OECD.
Note: CLIs – Composite Leading Indicators.

the global level. Overall, the global economy will be influenced by several factors, including oil prices, the strategies of OPEC countries, effects on inflation, and monetary policy responses.

The global consumer price increase slowed in the third quarter of 2014, compared with the previous quarter. Thus, price developments in advanced countries in particular remained subdued in the light of persisting free capacities, declining oil and other commodity prices, and anchored inflation expectations. Slower price increase in recent months was recorded in the majority of advanced countries. Price developments in emerging economies were rather heterogeneous. Price inflation in China and India slowed down, while Russia and Brazil recorded a dynamic rise in consumer prices.

In the period under review, consumer prices in OECD countries were determined mainly by energy prices, which had been rising at a decelerating pace before they started to decline at the end of the quarter. By contrast, the rise in food prices accelerated gradually. Headline inflation fell from 2.1% in June to 1.7% in September, while core inflation remained virtually unchanged (it fell by only 0.1 percentage point to 1.8%). In OECD countries, both headline and core inflation rates remained unchanged in October, at their September levels.

In the period ahead, global inflation will be determined by developments in the global economy and oil prices. Overall, however, the current price developments involve upside risks to inflation. Although inflation may be hindered by a potential slowdown in global economic growth, it will be determined first and foremost by oil prices. Over the short-term horizon, oil supply disruptions can be compensated for from the growing oil reserves in Saudi Arabia. Over the medium-term horizon, however, the geopolitical tensions may affect the growth in oil production capacity in the future and cause a rise in oil prices.

COMMODITIES

The Brent oil price followed a falling trend throughout the third quarter of 2014, from roughly US$111/barrel at the beginning of the quarter to US$94.5 /barrel at the end of September. The average price stood at US$102/barrel and was roughly US$8/barrel lower than in the previous quarter. The fall in oil prices at the beginning of July was caused primarily by a decrease in concerns about the supply of oil from Iraq. This trend came to a halt in the second half of the month, when the geopolitical risks in Ukraine and the Middle East increased. Subsequently, at the beginning of August, when it became clear that the conflicts in Iraq and Libya had caused no restriction in the oil supply, the falling trend in oil prices continued until the end of September. Oil prices were also affected by other factors in that period. The dynamically growing oil production, especially in the United States, accompanied by a marked slowdown in demand resulting from developments in China, and the unwillingness of OPEC countries to reduce oil production for fear of a decrease in their market share, caused an increase in global oil reserves with an impact on prices. Oil prices were also affected by these factors in the subsequent period, with the Brent oil price falling to roughly US$70/barrel at the beginning of December.

The average prices of non-energy commodities followed a falling trend over the third quarter of 2014, when price developments were influenced mostly by demand-side factors. Food commodity prices reacted to the abundant wheat, maize, and soybean crops in the United States, resulting from the favourable growing conditions. At the same time, a fall in certain food commodity prices was caused by the Russian import ban on selected agri-food products. The slowing pace of economic growth in China was influenced by global demand and resulted in a fall in metal prices. Metal prices also fell in reaction to the growing stocks of metals in certain countries. The falling trend in metal prices continued in the following period, while the decline in food commodity prices slowed in October. November saw another rise in these prices.

UNITED STATES

After increasing strongly in the second quarter of 2014, economic activity in the United States contracted in the third quarter, but the economy continued to show robust growth. The annualised quarterly rate of growth slowed in quarter-on-quarter terms, from 4.6% to 3.9%. The annual rate of growth also slowed somewhat, from 2.6% to 2.4%. In the period under review, the US economy continued to profit from the Fed's accommodative monetary policy and smaller range of fiscal restrictions. Private consumption continued to be stimulated by the improving labour market conditions. Dynamic growth was observed mainly in spending on durable goods. Spending on services also increased more rapidly than in the previous period. Economic growth was also influenced positively by fixed investment (non-residential fixed investment in particular). Government consumption and investment increased considerably as a result of defence investments. The continuing growth in exports, accompanied by a moderate decline in imports, resulted in net exports, which made a relatively strong contribution to economic growth. The only component that had a dampening effect on the US economy in the period under review was a change in inventories.

Inflation in the United States slowed in the third quarter of 2014, from 2.1% in June to 1.7% in September. The effect of falling commodity prices as they were reflected in consumer prices was probably stronger than the pressure for a steeper price increase as a result of stronger demand and diminishing free capacities. An upward effect on inflation was only exerted by food prices, the dynamics of which increased over the period under review, up to a two-year maximum. On the other hand, the consumer-price increase was moderated by energy prices, which reflected the trends seen in energy commodity prices. The year-on-year rise in energy prices slowed in the course of the third quarter and turned into a fall in September. Core inflation also contributed to the slower rise in consumer prices, when it fell from 1.9% in June to 1.7% in September. Its course in that period was determined by a fall in air transport prices and in the prices of used motor vehicles, as well as by a slower rise in the prices of tobacco products and clothes. Health care prices also increased more slowly than in the previous quarter, but their year-on-year increase stabilised during the last few months. In October, the US inflation rate remained at 1.7%, while the food price increase accelerated and the energy price decline deepened still further. Core inflation rose slightly, to 1.8%.

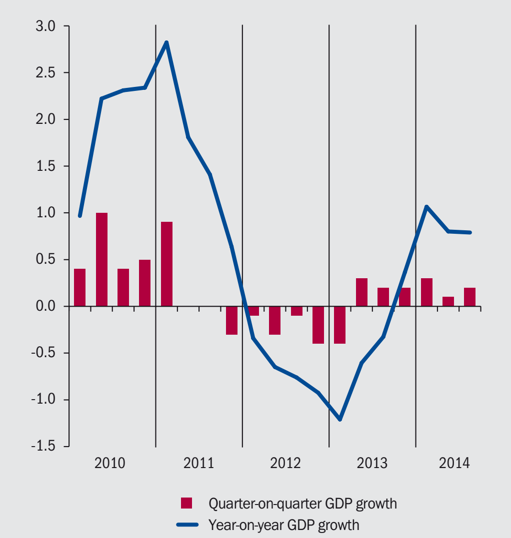
At its meetings in July, September and October, the Federal Open Market Committee (FOMC) decided to leave its target range for the federal funds rate unchanged, at 0% to 0.25%. The Committee signalled, that in determining how long to maintain the current rate at this level, the FOMC would assess progress (both realised and expected) towards its objectives of maximum employment and 2% inflation. The said assessment will also take into account additional information such as labour market conditions, inflationary pressure indicators, inflationary expectations, and financial performance. As regards its monetary policy stance, the Committee confirmed that it likely would be appropriate to maintain the current target range for the federal funds rate for a considerable time after the asset purchase programme ended, especially if projected inflation continued to run below the Committee's 2% longer-term goal, and provided that longer-run inflation expectations remained well anchored. At its October meeting, however, the FOMC added in connection with its monetary policy stance that if incoming information indicates faster progress towards the Committee's employment and inflation objectives than the Committee now expects, then increases in the target range for the federal funds rate are likely to occur sooner than currently anticipated. Conversely, if progress proves slower than expected, then increases in the target range are likely to occur later than currently anticipated.

Within the asset purchase programme, the Committee decided at its July and September meetings to reduce the amount of asset purchases again by US$10 billion with effect from August and/or October. Thus, subsequent to the September meeting, the amount of asset purchases was reduced to US$15 billion. At the October meeting, the FOMC decided to end the asset purchase programme.

THE EURO AREA

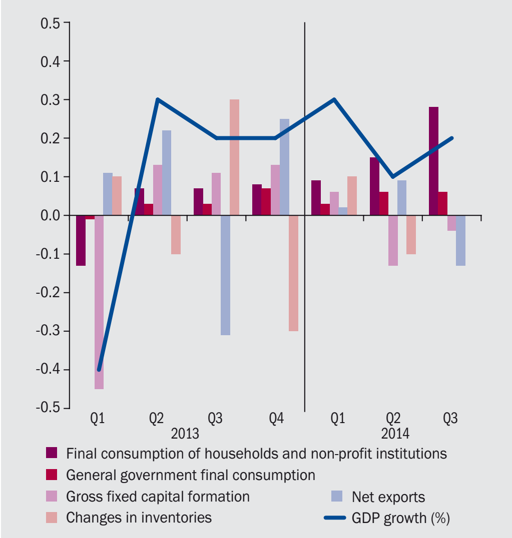
After slowing in the second quarter of 2014, economic growth in the euro area accelerated somewhat in the third quarter, from 0.1% to 0.2%. This, however, was accompanied by a deterioration in sentiment among economic entities, which indicates that economic growth in the coming quarters is anticipated to remained moderate. Among the large euro area economies, Spain achieved a growth rate of 0.5% and France recorded a surprising acceleration of 0.3%. By contrast, the German economy expanded only slightly in the third quarter (by 0.1%), after contracting in the previous quarter. The Italian economy continued to decline, by 0.1%. The annual rate of GDP growth remained unchanged in quarter-on-quarter terms, at 0.8%.

Chart 32 Economic growth (at 2005 constant prices, percentage changes)



Source: Eurostat.

Chart 33 Contributions to quarterly GDP growth by component (percentage points)



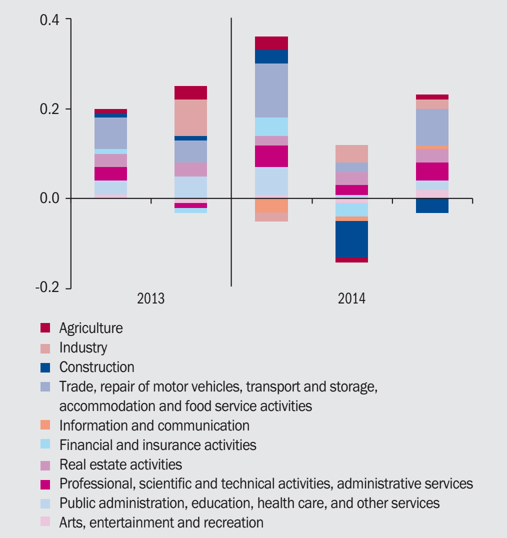
Source: Eurostat and NBS calculations.

In terms of structure, economic growth was driven primarily by private consumer demand. Household consumption grew for the sixth quarter in a row and its growth accelerated in the third quarter to a significant extent. Government consumption also grew for the fifth consecutive quarter, indicating that the dampening effect of fiscal consolidation on the economy was fading. Inventories had a neutral effect on economic growth. By contrast, investment demand continued to decline. After a modest revival in 2013 and at the beginning of 2014, investment demand declined for the second consecutive quarter. Owing to the persistently high level of unused production capacities, probably investment demand reacted most sensitively to the growing geopolitical tensions and the resulting deterioration in economic sentiment. Economic growth was also dampened by net exports, resulting from a slowdown in export growth accompanied by virtually unchanged growth in imports.

On the supply side of the economy, value added increased by 0.2%. This increase took place mostly in trade and services. Value added in industry rose only slightly. Construction again recorded a fall in value added.

Manufacturing production, which is an export-oriented sector, declined for the second

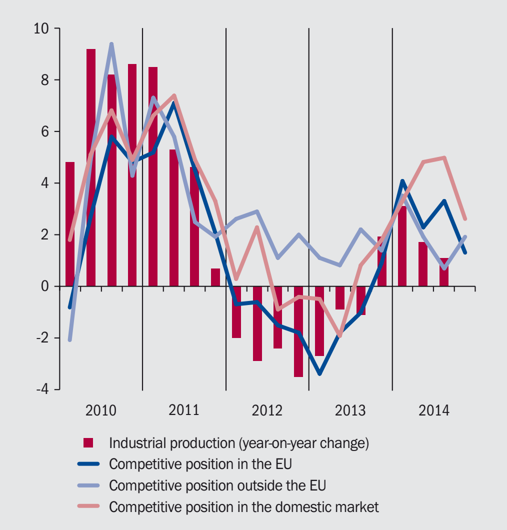
Chart 34 Contributions of value added by sector to quarterly GDP growth (percentage points)



Source: Eurostat and NBS calculations.

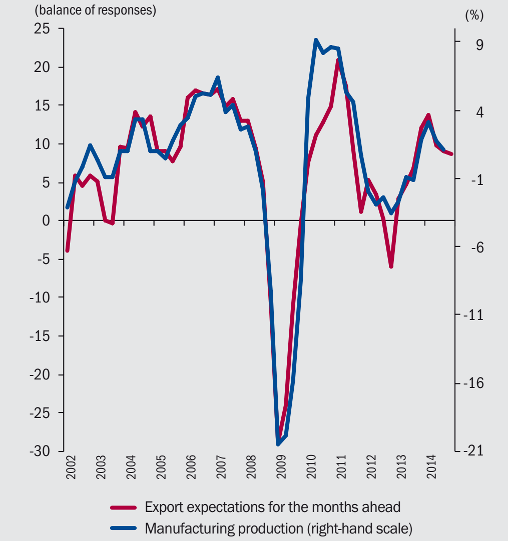
consecutive month (by 0.5%). The latest surveys indicate that, in the last quarter of the year, industrial enterprises have perceived a deterioration in their competitive position in the domestic market as well as in EU markets, and thus their optimism from the previous quarter has weakened. By contrast, the sector's competitive position as perceived in non-EU markets has improved, probably as a result of

Chart 35 Competitiveness in industry (balance of responses) and industrial production (annual percentage changes)



Source: European Commission, Eurostat and NBS calculations.

Chart 36 Export expectations in industry (balance of responses) and year-on-year growth in manufacturing production (%)

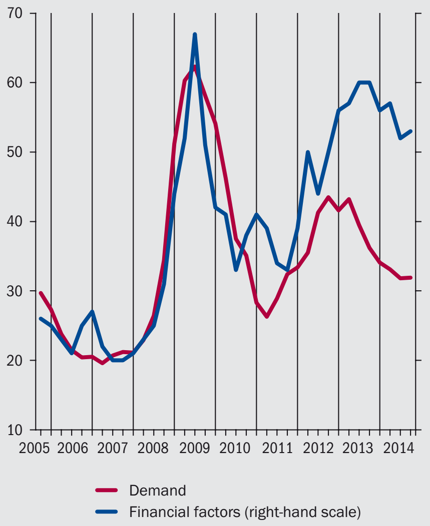


Source: European Commission, Eurostat and NBS calculations.

the competitive advantage enjoyed by euro area exporters (due to the weakening euro). Despite this, export expectations in industry for the coming months have weakened again as a sign of subdued activity in manufacturing.

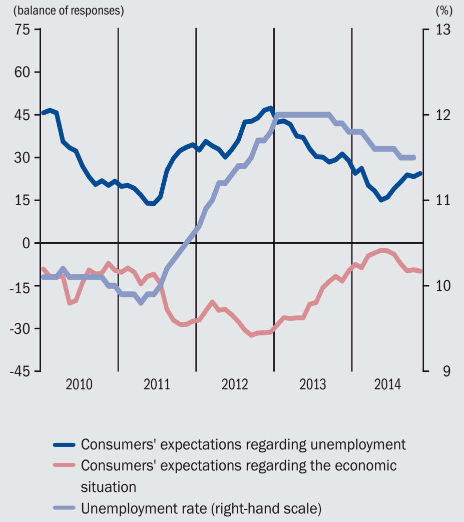
After the perception of demand as a production-limiting factor in industry weakened for five quarters in a row, this trend came to a halt in the fourth quarter of 2014 and, consequently, the perception of demand-side limitations strengthened somewhat. This perception probably reflects the weakening export dynamics and the falling investment demand. The perception of financial factors as limitations to production also deteriorated in the fourth quarter. After weakening considerably in the previous quarter, this perception experienced a certain correction in the fourth quarter, despite the adoption of a package of other monetary policy measures approved by the Governing Council at the beginning of September. By contrast, the perception of equipment as a production-limiting factor strengthened slightly. This indicates that investment demand may be stabilised through an improvement in economic sentiment. Although the limitations on the equipment side increased, they remained at very low levels by historical standards. Thus, investment demand can only be expected to experience a very modest revival. The perception

Chart 37 Production-limiting factors in industry (%)



Source: European Commission.

Chart 39 Unemployment (%) and consumers' expectations regarding the economic situation and unemployment in the next 12 months (balance of responses)

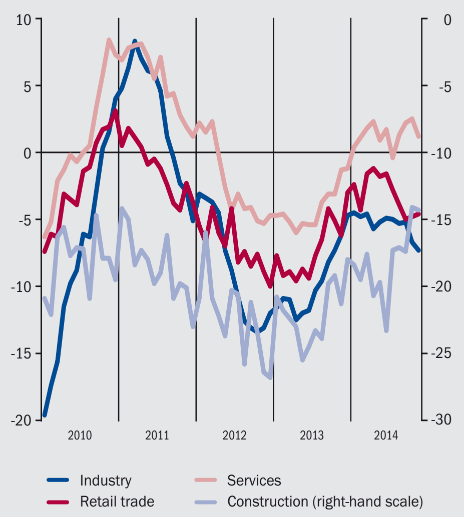


Source: European Commission and Eurostat.

Chart 38 Production-limiting factors in industry (%)

Source: European Commission.

Chart 40 Employment expectations by sector (balance of responses)



Source: European Commission.

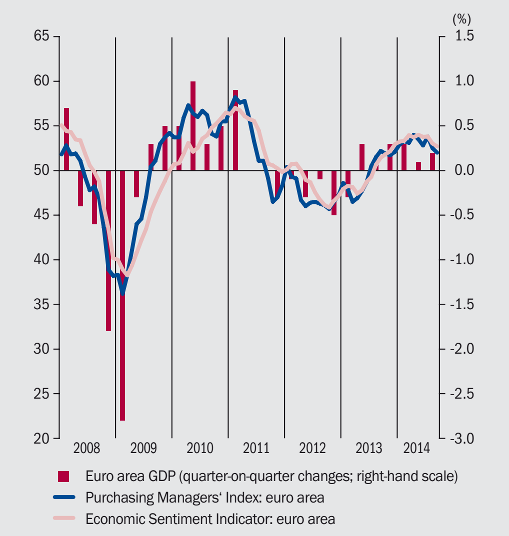
of labour as a production-limiting factor strengthened still further in the fourth quarter of 2014, probably as a result of the slightly improved labour market conditions.

The labour market shows some signs of improvement but still represents a weak link in the economy. The unemployment rate fell by 0.1 percentage point over the third quarter (to 11.5%), then stagnated in September and October at the August level. Since June, however, the weakened economic sentiment as a result of geopolitical tensions has been reflected in the deteriorated expectations of consumers regarding unemployment in the future. This trend persisted throughout the third quarter and, after an improvement in October, continued in November, too. The expectations of consumers also deteriorated in respect of the economic situation in the period ahead. The expectations of individual sectors regarding the future trend in employment are not optimistic either. In industry, these expectations have been worsening since July, except for a period of stagnation in September. October and November saw a marked deterioration in these expectations. In November, a pronounced deterioration, preceded by an improvement, was also recorded in services. Overall, expectations regarding employment in the future are still at low levels, so they signal no major improvement in the labour market.

The available forward-looking indicators give mixed signals in respect of the euro area economy and its future prospects. Most of these indicators pointed to a deterioration in the third quarter and, in certain cases, continued to signal a deterioration for the fourth quarter as well. The composite Purchasing Managers' Index (PMI) had been falling gradually since September, but its November value (51.4) remained at a level signalling moderate economic growth. The Composite Leading Indicator (OECD) also signalled a slowdown in economic growth. However, it overestimated the pace of recovery during the first half of 2014, so its current decrease does not necessary signal a marked slowdown. By contrast, the weakening of the economic sentiment indicator (ESI), which started in August, came to a halt in October and November. Consumer confidence strengthened most significantly in industry and in retail trade. The ZEW and Ifo indicators for Germany increased, while PMI and ESI decreased in the period under review. Some of the indicators for the euro area as a whole and for Germany signal that the decline in sentiment may have bottomed out, other indicators signal that economic growth is likely to remain fragile. The sentiment of economic entities is still influenced substantially by the current geopolitical developments, with investment demand reacting most sensitively to a change in sentiment. A positive stimulus for economic growth could come from an accommodative monetary policy stance, supported by standard and non-standard measures (adopted in June and September), as well as from the weakening euro. In November, the euro depreciated in relation to the US dollar by 10% in comparison with May, after depreciating from September to November by more than 6%. The depreciation of the euro is supposed to strengthen the competitiveness of euro area exporters.

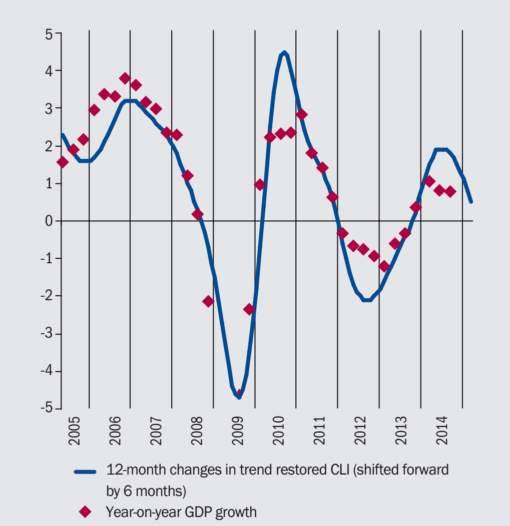
The inflation rate slowed during the third quarter of 2014 by 0.2 percentage point, to 0.3% in September. This represented the lowest inflation observed since November 2009. After a modest

Chart 41 Euro area forward-looking indicators and GDP growth



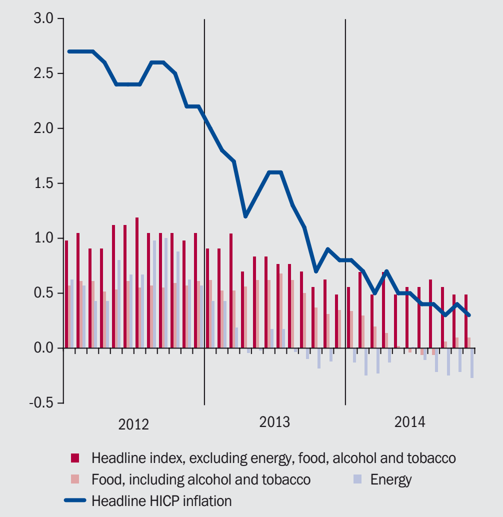
Source: European Commission, Eurostat, Bloomberg, and NBS calculations.

Chart 42 The OECD Composite Leading Indicator (expectations) and annual GDP growth (%)



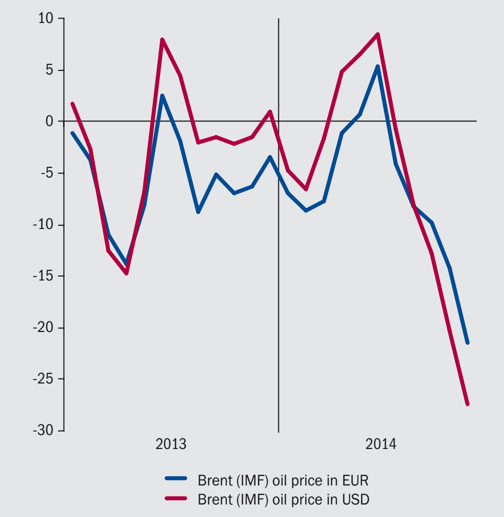
Source: OECD and Eurostat.

Chart 43 Annual headline HICP inflation (%) and contributions of selected components (percentage points)



Source: Eurostat and NBS calculations.

Chart 45 Oil prices in EUR and USD (year-on-year growth in %)

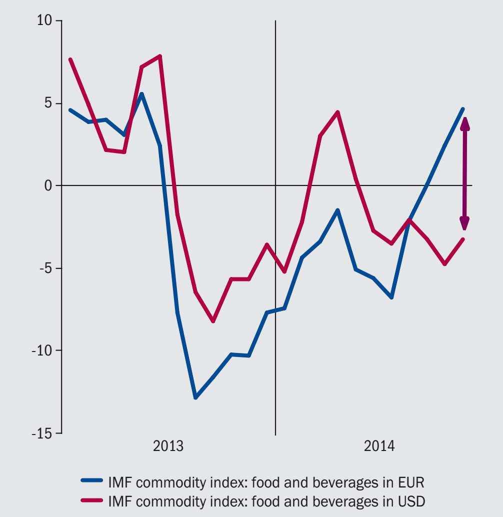


Source Eurostat and IMF.

acceleration in October, inflation remained at 0.3% in November, too.

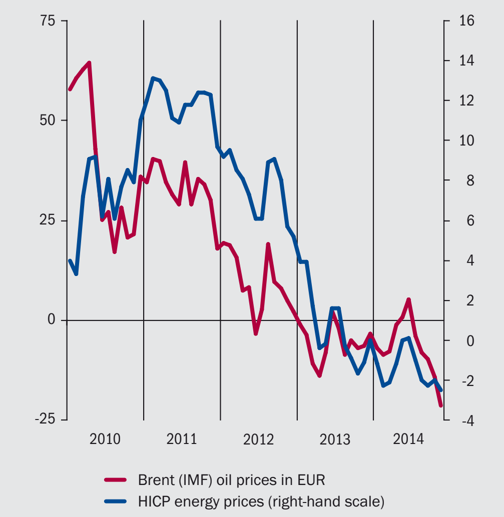
During the quarter under review, consumer prices were influenced strongly by global oil prices and food commodity prices. Their impact on price levels in the euro area, however, was partly determined by the EUR/USD exchange rate, which had been weakening since April. In the last few months, the annual rate of depreciation deepened still further. Global oil prices had been falling relatively steeply since August and, consequently, their year-on-year decline accelerated. This, however, was offset partly by the effect of currency depreciation (the weakening euro). Food commodity prices also followed a downward trend. The deepening year-on-year decline was more than offset by the depreciation of the euro, and thus food commodity prices in euro increased in year-on-year terms.

Chart 44 Food commodity prices in EUR and USD (year-on-year growth in %)



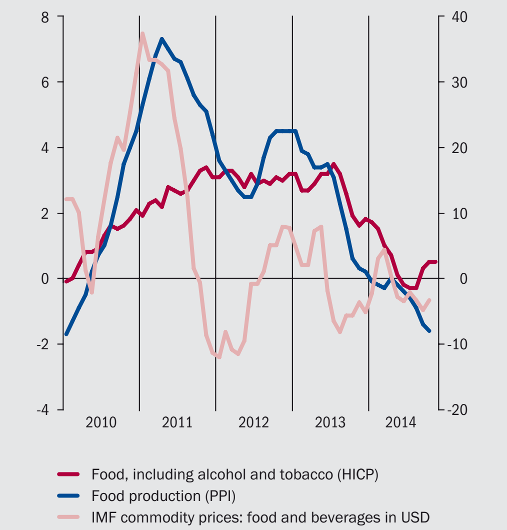
Source: Eurostat and IMF.

Chart 46 Oil and energy prices in the HICP (annual percentage changes)



Source: Eurostat and IMF.

Chart 47 Impact of food commodity prices on producer prices and consumer food prices (annual percentage changes)



Source: Eurostat and IMF.

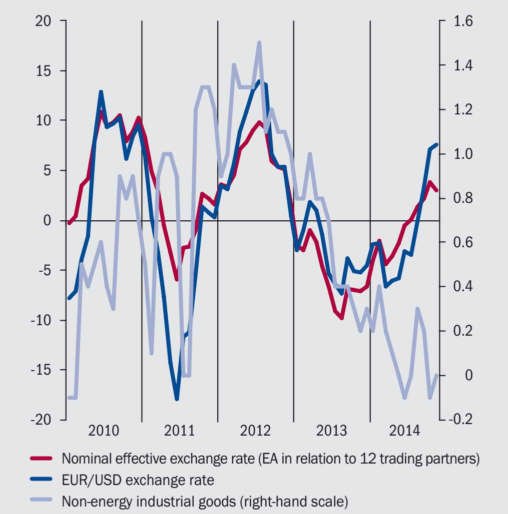
Chart 48 Goods and services prices (annual percentage changes)

Source: Eurostat.

Even with the impact of the EUR/USD exchange rate taken into account, oil price developments in the world markets had a dampening effect on HICP energy prices, the year-on-year decline of which deepened in the third quarter of 2014. After a certain correction in October, the rate of decline accelerated still further in November. By contrast, the year-on-year decline in food prices turned into a moderate rise and thus contributed positively to headline inflation. In the following months, food prices continued to rise at a moderate pace.

Inflation, excluding energy, food, alcohol, and tobacco prices, but including the components most sensitive to demand, remained virtually unchanged over the third quarter, and ended the period at 0.8% in September. In October, inflation slowed to 0.7% as a result of developments in non-energy industrial goods prices, and remained at that level until end-November.

Chart 49 Non-energy industrial goods prices and the nominal exchange rate (annual percentage changes)



Source: Eurostat and ECB.

The rise in the prices of demand-sensitive items continued to be dampened by intense competition and weak consumer demand. After a marked acceleration in August and September, the inflation of non-energy industrial goods prices slowed considerably in the following month, then changed only slightly in November. Developments in July and August indicated that the slowdown in the annual appreciation of the euro started to be reflected in the dynamics of non-energy industrial goods prices, but this was not confirmed by developments observed in the following months. Since August or September, the euro has been weakening year-on-year in both effective terms and in relation to the US dollar, but this is not reflected in non-energy industrial goods price inflation, which fell to a new historical low at the beginning of the last quarter. Overall, the dynamics of non-energy industrial goods prices have increased slightly since the end of the second quarter, when a year-on-year fall was recorded in these prices. In November, they stagnated in year-on-year terms. Services prices fell somewhat in the third quarter, then remained more or less unchanged in the following months, at their September levels. The deepening year-on-year decline in energy prices was, to some extent, reflected indirectly in services prices, too.

Selling price expectations are still depressed, though developments seen in the last few months suggest that they have stabilised. In the third quarter, price expectations continued to fall in retail trade and industry. The fall in selling price expectations in industry was mainly connected with their decline in food and beverage production, which was a reflection of commodity market developments. Selling price expectations also decreased in the production of consumer goods. In October and November, the selling price expectations stabilised more or less, or increased slightly. Price expectations continued to rise in services, while those in retail trade rose as well. In industry, selling price expectations remained virtually unchanged in October and November. The price expectations of consumers continued to be influenced by the weakening dynamics of prices for frequently

Chart 50 Price expectations in industry, services, and retail trade (balance of responses)

Source: European Commission and Eurostat.

Chart 51 Prices of frequently purchased items and consumer expectations

Source: European Commission and Eurostat.

purchased items. These prices have stabilised in recent months and thus the decrease in consumers' price expectations came to a halt in October and November.

At its September meeting, the Governing Council lowered the key ECB interest rates by 10 basis points with effect from 10 September 2014 as follows: the interest rate on the main refinancing operations of the Eurosystem was cut to 0.05%, the rate on the marginal lending facility to 0.30%, and the rate on the deposit facility to -0.20%. Thus, the ECB practically hit the zero lower bound. The negative rate for the deposit facility is supposed to serve as a preventive measure against the accumulation of free liquidity on ECB accounts. In the fourth quarter, the Governing Council left the key interest rates unchanged.

At its meeting on 3 July 2014, the Government Council announced a change in the schedule of monetary policy meetings. The frequency of these meetings will change to a six-week cycle, with effect from January 2015. Other meetings will be held at least once a month. The reserve maintenance period will be extended to six weeks to match the new schedule, from 2015. Moreover, the Governing Council announced a commitment to publish regular accounts of its monetary policy meetings, with effect from the January 2015 meeting. Such accounts will be published before the next monetary policy meeting. The Governing Council also decided on specific modalities for the targeted longer-term refinancing operations (TLTROs), which were introduced to enhance the functioning of the monetary policy transmission mechanism by supporting bank lending to the real economy.

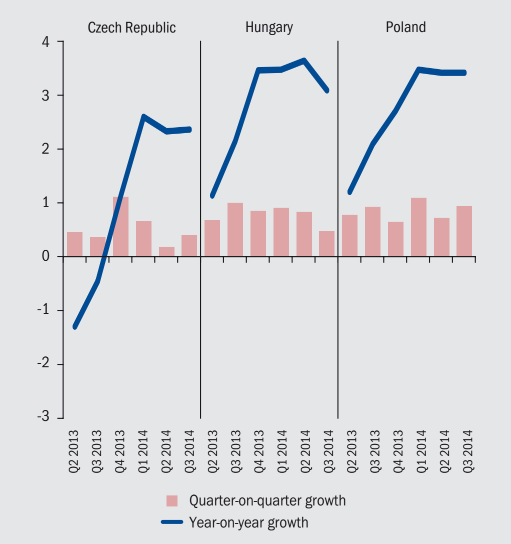
At its monetary policy meeting in September, the Governing Council decided to purchase a broad portfolio of simple and transparent asset-backed securities (ABSs) with underlying assets consisting of claims against the euro area non-financial private sector under an ABS purchase programme (ABSPP). The Governing Council also decided to purchase a broad portfolio of euro-denominated covered bonds issued by monetary financial institutions domiciled in the euro area under a new covered bond purchase programme (CBPP3). Interventions under these programmes (CBPP3 and ABSPP) started in October and November 2014 respectively. These decisions will add to the range of monetary policy measures adopted in the recent period. In particular, they will support the forward guidance on the key ECB interest rates, the functioning of the monetary policy transmission mechanism, and the provision of credit to the broad economy. Both programmes will last for at least two years. These decisions, together with the other measures in place, have been taken with a view to underpinning the firm anchoring of medium to long-term inflation expectations, in line with the aim of maintaining inflation rates below, but close to 2%.

The purchase of assets under the ABSPP and CBPP3 programmes, together with the targeted longer-term refinancing operations which will be carried out by June 2016, will have a sizeable impact on the ECB balance sheet. The Governing Council assumes that its volume will grow to a level close to that recorded at the beginning of 2012. Should it become necessary to further address the risks of too prolonged a period of low inflation, the Governing Council is unanimous in its commitment to using additional unconventional instruments within its mandate.

DEVELOPMENTS IN THE CZECH REPUBLIC, HUNGARY, AND POLAND

In the third quarter of 2014, the only country that recorded a slight improvement in its economic performance in year-on-year terms was the Czech Republic whose economy grew by 2.4% (in the previous quarter by 2.3%). The Polish economy maintained its growth dynamics from the previous quarter (3.4%), while the rate of growth in the Hungarian economy slowed to 3.1%, from 3.6% in the previous quarter.

Chart 52 GDP growth (%)



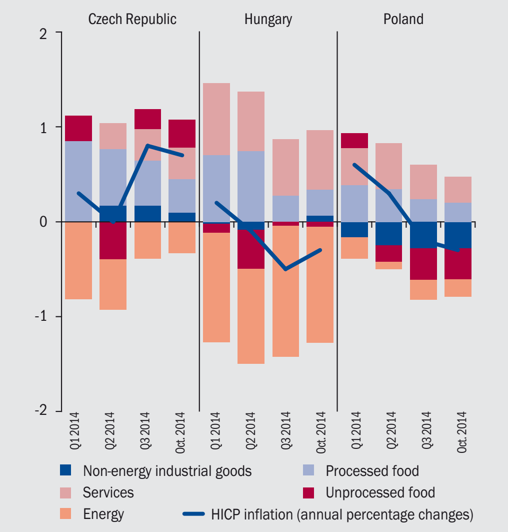
Source: Eurostat.

In quarter-on-quarter terms, economic growth accelerated over the third quarter by 0.2 percentage point in both the Czech Republic (to 0.4%) and Poland (to 0.9%). In Hungary, the quarterly rate of economic growth slowed by 0.3 percentage point, to 0.5%. Economic growth in the **Czech Republic** was stimulated by household final consumption, though its dynamics weakened somewhat; by investment demand, which maintained its growth rate from the previous quarter; and by inventories. A negative contribution to growth came from general government consumption, which fell sharply in comparison with the previous quarter. A minor negative contribution was also made by net exports, with exports and imports decreasing at roughly the same pace. Their dampening effect on economic growth, however, weakened considerably in comparison with the previous quarter, causing the rate of growth to accelerate slightly. The slowdown in the **Hungarian economy** was supported by a decline in private consumption, accompanied by slower growth in investment demand. By contrast, economic growth was stimulated by net exports and government spending. Economic growth in **Poland** was influenced positively by investment demand in particular, which showed much faster growth than in the previous quarter. A positive contribution also came from household final consumption, which maintained its growth dynamics, and from general government spending, which slowed somewhat. Economic growth was dampened by net exports, resulting from imports growing more rapidly than exports.

In the third quarter of 2014, the annual rate of consumer-price inflation accelerated in quarter-on-quarter terms in the Czech Republic, while price levels in Hungary declined still further and those in Poland fell as well (after a modest rise in the previous quarter). The accelerated inflation in the Czech Republic (by 0.8 percentage point to 0.8%), which was preceded by price stagnation in the previous quarter, was caused mainly by unprocessed food prices, which, after falling in the previous quarter, rose considerably in September. The rise in services prices accelerated, too. The rise in processed food prices slowed somewhat, but non-energy industrial goods prices maintained their dynamics. By contrast, the price increase was still dampened by energy prices, though to a lesser extent. In October, the overall consumer-price increase in the Czech Republic slowed slightly, by 0.1 percentage point. The consumer-price decline in Hungary deepened by 0.4 percentage point, to -0.5% as at the end of the quarter under review. This was caused primarily by energy prices, which fell still further compared with the end of the previous quarter. Inflation was also moderated by unprocessed food prices, but at a much slower pace. The rise in processed food prices and services slowed, too. By contrast, non-energy industrial goods prices stagnated over the third quarter, after falling in the previous quarter. In October, the consumer-price decline in Hungary moderated. In Poland, as in Hungary, consumer-price inflation slowed by 0.5 percentage point, to -0.2% as at the end of the third quarter. Price inflation was dampened by unprocessed food prices, energy prices, and non-energy industrial goods prices, the decline of which deepened in comparison with the previous quarter. The rise in processed food prices and services prices slowed, too. The consumer-price decline in Poland deepened in October.

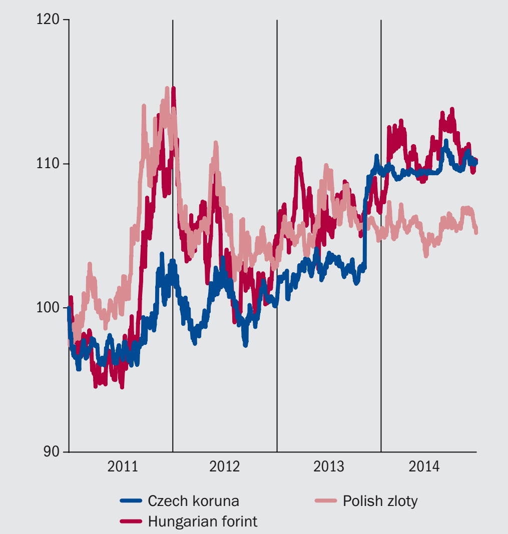
The currencies of all countries under review were depreciating gradually over the third quarter of 2014, compared with the previous quarter. The exchange rate of the Czech koruna was still

Chart 53 Contributions to HICP inflation (percentage points)



Source: Eurostat and NBS calculations.

Chart 54 Exchange rate indices of the V4 currencies vis-à-vis the euro (3 January 2011 = 100)



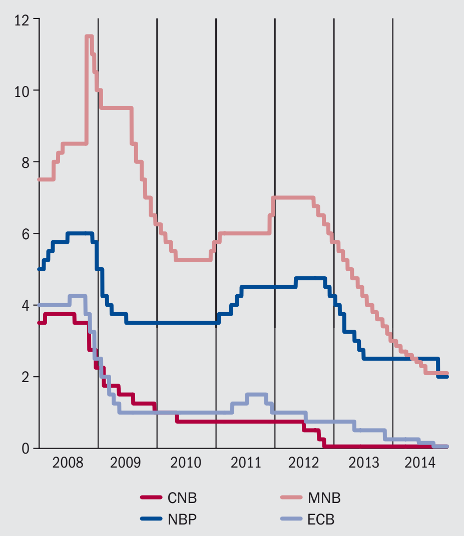
Source: Eurostat and NBS calculations.
Note: A fall in value denotes appreciation.

limited to appreciation, owing to the central bank's commitment to use foreign exchange interventions to maintain the eased monetary policy conditions. The exchange rates under review were influenced in that period by financial market volatility, mainly at the beginning of the quarter, and by the geopolitical tensions arising from the conflict between Russia and Ukraine (the EU/US sanctions against Russia and the retaliatory measures taken by Russia). Further negative factors were uncertainty regarding the prospects for economic recovery in Europe and concerns about deflation.

At the beginning of the third quarter, the Czech koruna fluctuated around the level of CZK/EUR 27.5, as in the previous quarter (owing to the CNB's commitment to use the exchange rate as a monetary policy tool and to keep it to below CZK/EUR 27). At the beginning of August, the Czech koruna started to weaken in reaction to the increased geopolitical tensions arising from the EU's additional sanctions against Russia and Russia's retaliatory measures against the EU. Towards the end of the quarter, the exchange rate of the Czech koruna gradually returned to its level seen at the beginning of the quarter. Subsequently, the Czech koruna was unfavourably affected by the expected tightening of the CNB's exchange rate commitment. However, the CNB only postponed the expiration date of its commitment to use the exchange rate as a monetary policy instrument until the first quarter of 2016. The Hungarian forint was also affected adversely over the quarter under review by the consequences of geopolitical developments, which replaced the positive influence of a potential reduction in the key ECB interest rates. The appreciating trend was later stopped by concerns about the introduction of a package of allowances for mortgages in foreign currency. The exchange rate of the Polish zloty against the euro was negatively affected during the third quarter by the imposition of retaliatory measures by Russia against the EU (including a ban on fruit and vegetable imports). The depreciating trend in the zloty was also supported by concerns about the sustainability of economic growth and the increased risk that the inflation target will not be achieved over the medium-term horizon, to which the Polish central bank responded by lowering its base rate.

In the third quarter of 2014, the only central bank within the group of countries under review to use its base rate to change the monetary policy conditions was the Hungarian central bank. The Polish central bank reduced its base rate only in October. In the Czech Republic, the central bank rate remained unchanged, at 0.05% (zero lower bound). At its meetings held in the third quarter of 2014, **Česká národní banka** (CNB) confirmed its commitment to use the exchange rate as a monetary policy instrument and to conduct foreign exchange interventions with the aim of maintaining price stability in the Czech economy in line with the inflation target. Under this commitment, the exchange rate of the Czech koruna was to be kept at a level close to CZK/EUR 27 until 2016. At its November meeting, however, the CNB postponed the expiration date of the exchange rate commitment until the first quarter of 2016. **Magyar Nemzeti Bank** (MNB) lowered its base rate only on one occasion in the third quarter of 2014 (by 0.2 percentage point to 2.10%) and announced that the almost two-year-long process of monetary policy easing aimed at achieving the inflation target was considered to have been completed. At its meetings, the MNB stated that the reduced value of the base rate was consistent with the achievement of the inflation target over the medium-term horizon. After adopting new monetary policy instruments for reducing the foreign currency debt (interest

Chart 55 Key interest rates of the V4 national central banks (%)



Source: National central banks and ECB.

rate swaps, long-term credit facilities with a flexible interest rate, and securities swaps with effect from 16 June 2014), the MNB began to use a two-week credit facility with an interest rate equalling the base rate as its main monetary policy instrument (starting from 1 August 2014). The MNB kept its base rate unchanged for both October and November. In the third quarter of 2014, **Narodowy Bank Polski** (NBP) left its base rate unchanged at 2.50%, but emphasised that the heightened uncertainty surrounding the external and internal economic environment may increase the degree of uncertainty regarding the achievement of the inflation target over the medium-term horizon. The NBP took this risk so seriously that, at its October meeting, it lowered its base rate and reduced the spread between the Lombard and deposit rates. At the same time, the NBP did not exclude the possibility of changing its monetary policy stance in the future if the inflation target cannot be achieved in the medium term.

QUARTERLY REPORT ON THE REAL ECONOMY

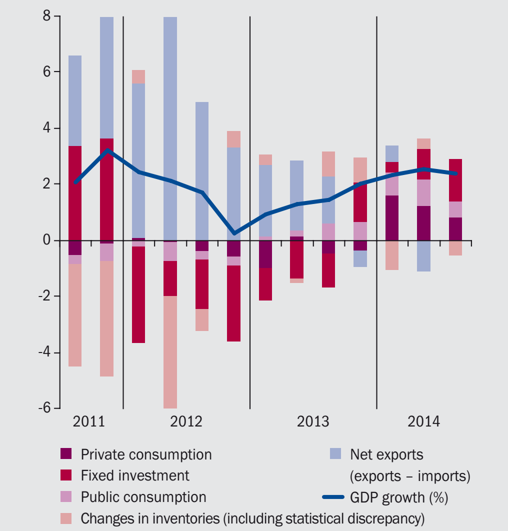
THE REAL ECONOMY IN THE THIRD QUARTER OF 2014

GROSS DOMESTIC PRODUCT

The Slovak economy maintained its dynamics throughout the third quarter of 2014 and continued growing for the fifth quarter in a row, by 0.6% quarter-on-quarter. In year-on-year terms, seasonally unadjusted GDP expanded by 2.4%, after growing in the second quarter by 2.6%.

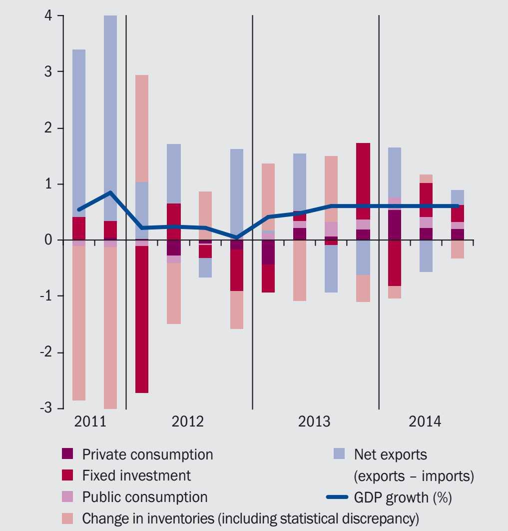
Economic growth in the third quarter was driven mainly by domestic demand, which contributed 0.6 percentage point to the quarterly rate of economic growth (0.6%). A modest positive contribution (+0.2 percentage point) also came from net exports. The other GDP components made a negative contribution (-0.3 percentage point) as a result of negative statistical discrepancies and non-additive seasonal adjustments. Changes in inventories, representing another GDP component, increased in the quarter under review. This increase was probably an indication of lower exports, for inventories accumulated mostly in sectors with weaker export performance.

Chart 56 Contributions to annual GDP growth (percentage points)



Source: SO SR.

Chart 57 Contributions to quarterly GDP growth (percentage points)



Source: SO SR.

Table 2 GDP by expenditure (quarter-on-quarter percentage changes; at constant prices)

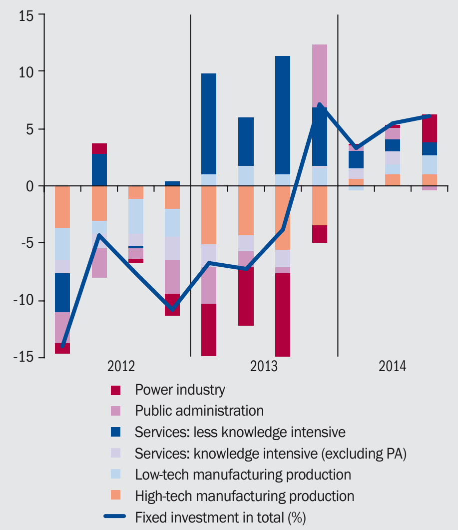
	2013					2014		
	Q1	Q1	Q3	Q4	Year	Q1	Q2	Q3
Gross domestic product	**0.4**	**0.5**	**0.6**	**0.6**	**1.4**	**0.6**	**0.6**	**0.6**
Final consumption	-0.4	0.5	0.5	0.5	**0.0**	1.0	0.6	0.4
Households and NPISHs	-0.8	0.4	0.1	0.4	**-0.7**	1.0	0.4	0.4
General government	0.8	0.8	1.5	0.9	**2.4**	1.2	1.1	0.7
Gross fixed capital formation	-2.4	0.8	-0.4	6.7	**-2.7**	-3.8	2.9	1.5
Exports of goods and services	-0.5	4.0	1.0	2.6	**5.2**	4.0	-2.7	-2.0
Imports of goods and services	-0.5	3.1	2.1	3.5	**3.8**	3.3	-2.3	-2.4

Source: SO SR.

Increases were recorded in all basic components of domestic demand, especially in fixed investment. Investments were made across the whole spectrum of sectors and grew by 1.5% quarter-on-quarter. After more than two years, industrial investments made a more significant contribution to the annual growth in investment (a contribution of 2.6 percentage points) than investments in services (0.9 percentage point). Export-oriented sectors, especially the electrical, metal-working, and petrochemical industries, and, to a lesser extent, the manufacture of transport vehicles, contributed to economic growth through their investments (excluding imported investments), rather than through exports. Firms were probably having to replace capital stock after years of underinvestment. As far as technology intensity is concerned, however, it is not possible to state that investment activities have shifted towards high-tech activities, which had been limiting investment substantially until the end of 2013. Investments in high-tech and low-tech industries were relatively balanced in the last two quarters. The desired shift in investment towards knowledge intensive services did not take place in the services sector either. Such services made no contribution to investment growth in the third quarter, mainly as a result of weak investment activity in telecommunications.

A significant increase in investment in the third quarter took place in the power industry (+2.4 percentage points). Investment in construction increased by 0.3 percentage point, representing the largest increase since the beginning of 2011. The general government sector (public administration) reported a decrease in investment (Chart 58). The general government sector, including public transport, health services, and other publicly beneficial activities, however, recorded an increase in investment (Chart 59). Fixed investment was driven mainly by the private sector.

Chart 58 Year-on-year changes in investment by technology intensity (percentage points, at current prices, seasonally unadjusted)



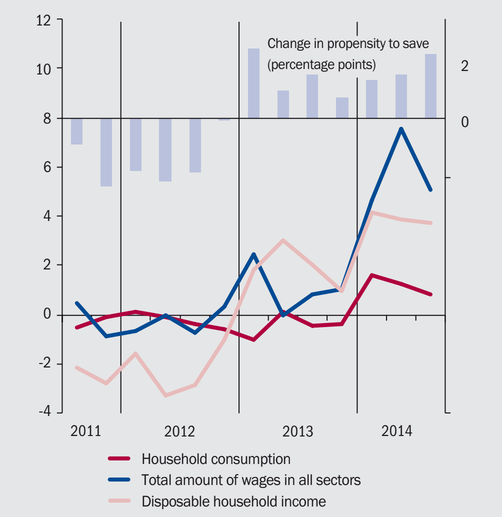
Source: SO SR and NBS calculations.

Chart 59 Year-on-year changes in investment by sector (percentage points, at current prices, seasonally unadjusted)

Source: SO SR and NBS calculations.

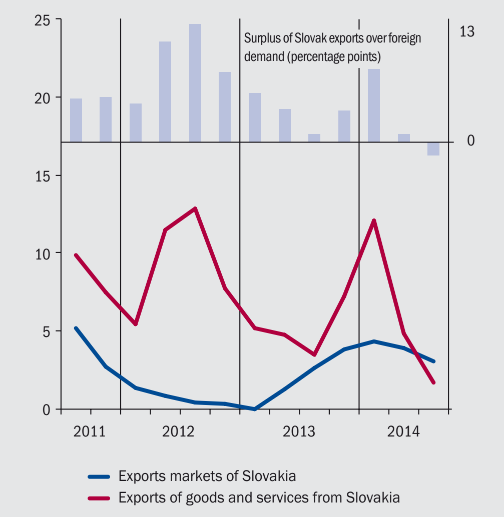
Besides investment demand, consumer demand also contributed positively to economic growth. Private consumption grew at the same pace as in the previous quarter (by 0.4% quarter-on-quarter). The source of this growth was disposable income growth. Consumption growth was also supported by the low inflation. The price decline in the food and energy segments probably created conditions for households to spend more on other goods and services. Government consumption continued growing more rapidly than household consumption (by 0.7% quarter-on-quarter), mainly as a result of employee compensation growth.

Chart 60 Sources of household consumption growth (annual percentage changes, at constant prices)



Source: SO SR and NBS calculations.

Chart 61 Developments in Slovakia's export markets compared with Slovak exports (annual percentage changes, at constant prices)



Source: SO SR and NBS calculations.

Exports declined in the third quarter by 2% quarter-on-quarter. The decrease recorded in the previous quarter (-2.7%) was not compensated for even by the increased exports of oil refineries after their investment-related shutdowns. The export decline continuing for the second consecutive quarter can be attributed to the slowdown in emerging Asian economies, the conflict between Russia and Ukraine, and the slowdown in exports to the Czech market. The persisting weak economic activity in the euro area could not create conditions for the correction of these negative factors. Imports fell more sharply than exports (by 2.4%) as a result of lower gas imports, and thus net exports contributed 0.2 percentage point to the quarter-on-quarter rate of economic growth.

On the production side, GDP growth at constant prices was dampened by manufacturing production, while being positively influenced by the public sector, trade, and, after a long break, by construction.

Table 3 GDP growth by component (quarter-on-quarter changes in % points, at constant prices)

	2013					2014		
	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3
Year-on-year GDP growth in %	**0.4**	**0.5**	**0.6**	**0.6**	**1.4**	**0.6**	**0.6**	**0.6**
Gross value added in percentage points	0.2	0.3	0.2	0.9	**1.0**	0.4	0.6	0.5
of which:								
Manufacturing	-0.5	0.2	0.1	0.5	**-0.1**	0.8	-0.1	-0.8
Construction	-0.3	0.3	-0.1	0.0	**-0.3**	-0.2	-0.3	0.2
Trade	0.1	0.2	-0.1	0.2	**0.3**	0.2	-0.2	0.3
Business and administrative services[1)]	1.2	-0.1	0.1	-0.7	**0.4**	0.4	0.5	-0.5
Public administration, health, education	0.6	-0.3	0.3	0.0	**0.5**	0.5	-0.3	0.5

Source: SO SR.
1) Professional, scientific, and technical activities; administrative and support service activities.

WAGES AND LABOUR PRODUCTIVITY

The relatively favourable developments in the labour market continued in the third quarter of 2014. Employment increased, but more moderately than in the first half of the year. This was also reflected in the slower decrease in the number of unemployed (according to the *Labour Force Survey* methodology). In services, an increase was recorded in the number of hours worked, rather than in the number of vacancies. The number of self-employed persons continued to decrease, owing to their shift to employment or to other forms of undertaking. Wage growth remained relatively strong in year-on-year terms, but its dynamics weakened in comparison with the second quarter, which pointed to a modest rise in labour productivity.

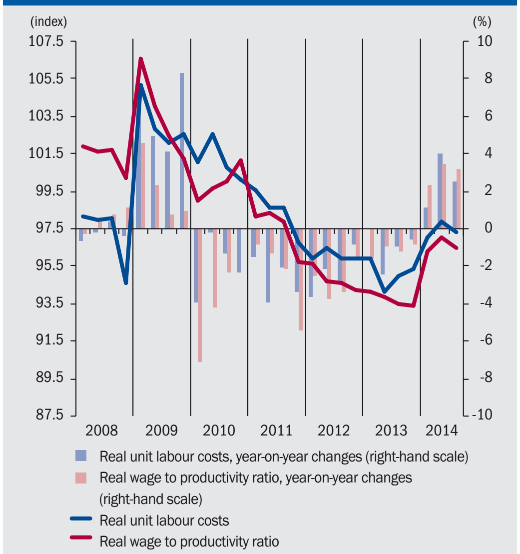
Nominal wage growth slowed in the third quarter by 0.6 percentage point, to an average of 4.2%. Wage growth is expected to return gradually to a level corresponding to the current weak labour productivity growth. In quarter-on-quarter terms, the rate of wage growth slowed to 0.3%. This was due partly to the fading effect of bonus payments from the first half of the year. The year-on-year rate of wage growth slowed in both the private and public sectors (including education and health services). In the former sector, only a slight slowdown was recorded, compared with a slowdown of 1.6 percentage points to 3.6% in the latter. Owing to the absence of inflation, real wages also increased (by 4%) for the third quarter in a row.

In the private sector, slower wage growth was recorded in industry, but the year-on-on rate of this growth remained at 4.4%. By contrast, slightly accelerated wage growth was observed in services (including business activities). Within the services sector, wages increased mainly in wholesale and retail trade, real estate activities, professional activities, and other services. Wage growth in this sector slowed mainly in transport, administrative and support service activities, and financial services. Negative wage dynamics are currently observed in tourism (accommodation and restaurant services), as well as in construction. Wage growth in public sector activities slowed in all sub-sectors (administrative activities, education, and health care).

Wages as defined in the ESA methodology followed a trend that was very similar to that observed in wages according to statistical reports. Despite this, compensation per employee, including social contributions from employees, experienced a significant slowdown in dynamics, from 4.9% to 3%. This was attributable to a similar contrast seen in several sectors. Since there was no tax reform underway in the period under review, only one of the common short-term fluctuations could occur in this case. After increasing by an average of 1.3% in the first half of the year, employee compensation decreased in the third quarter by 0.3% quarter-on-quarter. As in the case of wages, a downward correction was observed in the dynamics of compensation growth. Real compensation per employee rose by 3.1% year-on-year.

The moderation in wage and compensation growth has led to a certain moderation in the growth of unit labour costs, too. In order to improve the competitiveness of the domestic economy, wage growth should be adjusted to labour productivity growth. Developments in the third quarter indicated that this could be arranged in view of the marked wage increase recorded in the first half of the year. After the slowdown in wage dynamics, the year-on-year rate of growth in nominal labour productivity accelerated slightly, from 0.8 to 0.9%.

Chart 62 Real labour productivity and real labour costs (index 2004Q1 = 100, %)



Source: SO SR and NBS calculations.
Note: Real unit labour costs as defined in the ESA 2010 methodology. CPI deflated real wages from quarterly statistical reports. All data are seasonally adjusted.

HOUSEHOLD INCOME AND EXPENDITURE

The current income of households increased by 3.5% year-on-year, to €15.8 billion in the third quarter of 2014. Compared with the second quarter, the annual growth rate slowed by 0.4 percentage point. This slowdown was caused by the compensation of employees and, to a lesser extent, by gross mixed income, which both showed weaker dynamics in year-on-year terms. By contrast, the growth in current income was driven by social benefits and property income.

Like income, the current expenditure of households (expenses paid to other sectors and not used for direct consumption) showed weaker dynamics in the third quarter, but increased year-on-year by 2.9%. Compared with the previous quarter, the growth rate slowed by 2.1 percentage points. This was due mainly to slower growth in social contributions paid.

The gross disposable income of households (current income less current expenditure) increased over the third quarter by 3.7% year-on-year, to €11.5 billion. This represented an

Table 4 Generation and use of income in the household sector (current prices)

Item	EUR billion		Annual rate of change (%)		Percentage share	
	2013 Q3	2014 Q3	2013 Q3 / 2012 Q3	2014 Q3 / 2013 Q3	2013 Q3	2014 Q3
Employee compensation (all sectors)	7.1	7.4	1.9	5.1	46.5	47.2
of which: Gross wages and salaries	5.5	5.8	1.5	6.0	35.9	36.8
Gross mixed income	4.7	4.7	2.6	0.5	30.7	29.8
Property income – received	0.4	0.4	23.9	10.0	2.6	2.7
Social benefits	2.6	2.7	1.1	3.3	16.9	16.8
Other current transfers – received	0.5	0.5	2.4	4.8	3.4	3.5
Current income in total	15.2	15.8	2.5	3.5	100.0	100.0
Property income – paid	0.1	0.1	-45.9	45.0	2.0	2.8
Current taxes on income, property, etc.	0.6	0.6	-1.1	1.5	14.5	14.3
Social contributions	2.8	2.8	2.9	2.0	66.4	65.8
Other current transfers – paid	0.7	0.7	4.2	2.9	17.1	17.1
Current expenditure in total	**4.2**	**4.3**	**0.7**	**2.9**	100.0	100.0
Gross disposable income	**11.1**	**11.5**	**3.1**	**3.7**	-	-
Adjustment arising from changes in net assets of households in pension fund reserves	0.1	0.2	-50.3	25.6	-	-
Household final consumption	10.4	10.6	0.1	1.6	-	-
Gross household savings	0.8	1.1	29.7	35.0	-	-

Source: SO SR.

Table 5 Gross disposable income (index, same period a year earlier = 100, at current prices)

	2013					2014		
	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3
Gross disposable income (1)	103.9	104.5	103.1	101.8	103.3	103.3	103.4	103.7
Adjustment (pension funds) (2)	50.9	41.2	49.7	58.0	49.1	111.6	109.4	125.6
Household final consumption (3)	100.3	101.7	100.1	100.1	100.6	102.0	101.8	101.6
Gross household savings (4)	313.8	118.9	129.7	106.0	120.0	140.5	123.9	135.0
Savings ratio [%, (4)/((1)+(2))]	3.5	7.4	7.1	16.9	9.0	4.8	8.9	9.2

Source: SO SR and NBS calculations.
Note: The savings ratio is expressed as an average for the given period.

acceleration of 0.3 percentage point compared with the previous quarter. Despite the slower wage growth, the slowdown in current expenditure caused an acceleration in gross disposable income growth. After a seasonal adjustment by NBS, a quarter-on-quarter increase of 0.5% was recorded. This, together with an increase in the value of household assets held in pension funds, created conditions for an acceleration in the growth rate of gross savings, from 23.9% to 35%. On the other hand, household consumption increased, but less dynamically than income. This caused a rise in the ratio of household savings in the third quarter.

EMPLOYMENT AND UNEMPLOYMENT

The third quarter saw a slowdown in job creation, while employment as defined in the ESA methodology increased by 0.3%, which was 0.2 percentage point less than the figure for the second quarter. The slowdown in employment growth occurred at a time when the indicators of Slovakia's economic performance worsened. The annual rate of employment growth remained unchanged in quarter-on-quarter terms, at 1.4%. According to statistical reports, the quarter-on-quarter rate of growth slowed from 0.4% to 0.3%. According to the Labour Force Survey (LFS) methodology, employment continued to grow in quarter-on-quarter terms at a pace of 0.5% as in the second quarter. This was due to a marked increase in the number of persons participating in activation work programmes (such persons are classified as employed only according to the LFS methodology). Under the legislative amendments adopted this year, it is desirable that more people receiving benefits in material need should be involved in such programmes.

Regarding the structure of employment, the previous trend continued throughout the third quarter: the number of people employed increased by 0.7% quarter-on-quarter. By contrast, the number of self-employed decreased by 2%. This trend can be ascribed to the recent legislative changes that have reduced the attractiveness of self-employment in comparison with employment and/or other forms of income-earning activity. As a result, the annual rate of growth in the number of employees accelerated by 0.1 percentage point, to 2.4%. At the same time, the decrease in the number of self-employed persons deepened by 0.6 percentage point, to 3.8%.

The increase in employment took place mostly in industry. In sectors related to the general government, employment also rose to a significant extent, mainly as a result of developments in health services and to a lesser extent in public administration. After declining steeply in the previous quarters, employment in construction fell only slightly in the third quarter. Employment also fell somewhat in services and trade (by a total of 0.1%). This fall, however, was offset by an increase in the number of hours worked by existing employees and by an increase in wage dynamics in this sector. Within the services sector, employment grew only in administrative and support service activities and in entertainment and recreation.

After stagnating in the previous quarter, the number of hours worked increased by 0.7% quarter-on-quarter. The average length of a working week thus increased by 0.4% (from 36.7 to 36.8 hours). This took place mostly in services and trade, where employers gave preference to increasing the working hours of their existing employees, rather than to hiring new employees. The length of a working week also increased in sectors related to the general government. By contrast, the length of a working week in industry was shortened, probably in connection with the creation of new jobs. The length of a working week was also shortened in construction, owing to a shortage of orders. In year-on-year terms, the number of hours worked increased by 0.9%, representing an acceleration of 0.6 percentage point compared with the previous quarter.

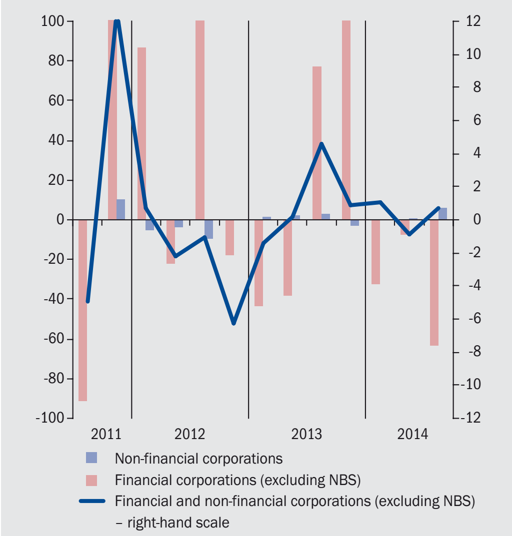
According to the LFS methodology, the number of unemployed decreased in the third quarter by 8.2% year-on-year, to 350,600 persons. This represented a quarter-on-quarter decrease of 6,900 persons, which, as in the case of employment, was less than the figure recorded in the second quarter (-9,400 persons). The favourable trend in the labour market continuing since 2013 was thus confirmed. At the same time, a marked increase was recorded in the number of economically active persons. This may be explained with the efforts of labour offices to involve persons receiving benefits in material need in activation work programmes, because a marked increase/decrease in the number of active/inactive persons was recorded in this category. The increase in labour force participation, combined with a decrease in the number of unemployed, led to a fall of 0.3 percentage point in the unemployment rate (to 13.1%). The seasonally adjusted number of unemployed registered with labour offices decreased by 4,300. This represented a fall of 0.16 percentage point in the unemployment rate. The average rate of registered unemployment reached 12.56%, representing a year-on-year fall of 1.28 percentage points.

FINANCIAL RESULTS

In the third quarter of 2014, the total profit generated by financial and non-financial corporations (excluding NBS), expressed in seasonally adjusted terms, increased by 0.7% quarter-on-quarter, after falling in the previous quarter by 0.9%. Profits in the non-financial *corporations* sector increased, while those in the financial corporations sector (excluding NBS) decreased.

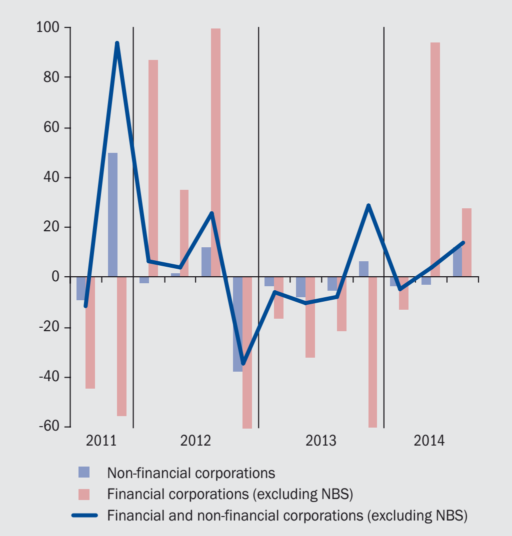
The financial performance of non-financial corporations improved in the third quarter by 6.2% quarter-on-quarter (the previous quarter saw an improvement of 0.7%). This was attributable to the positive financial results of corporations in manufacturing and in electricity and gas supply. The increase in profits in these sectors was partly offset by a decrease in profits in trade, construction, agriculture, transport, and restaurant services.

Chart 64 Profit developments in the economy (quarter-on-quarter percentage changes)



Source: SO SR and NBS calculations.

Chart 63 Profit developments in the economy (excluding NBS)(annual percentage changes)

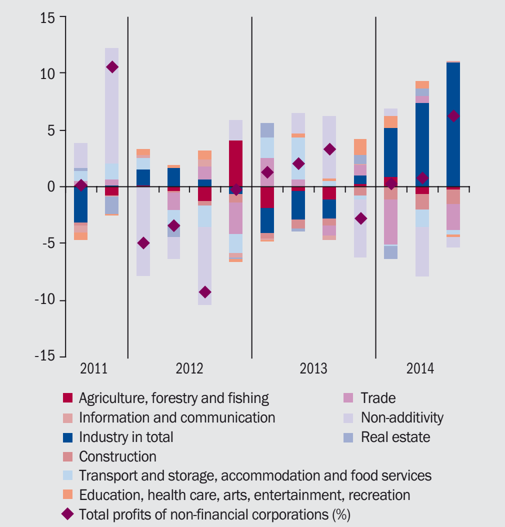


Source: SO SR and NBS calculations.

Chart 65 Investments and profits of non-financial corporations (annual percentage changes)

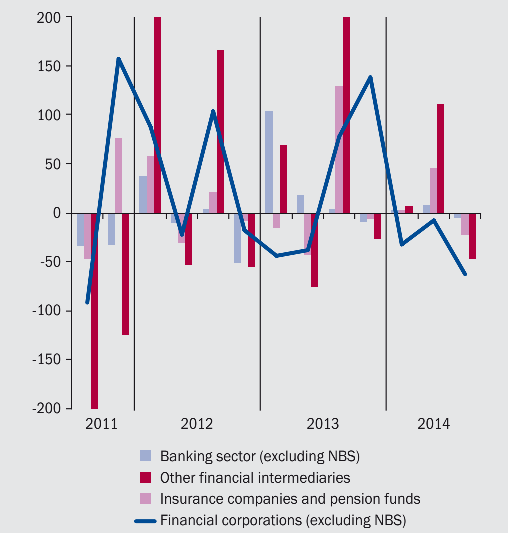
Source: SO SR and NBS calculations.

Chart 66 Profits of non-financial corporations and their quarterly rate of change by sector (percentage points)



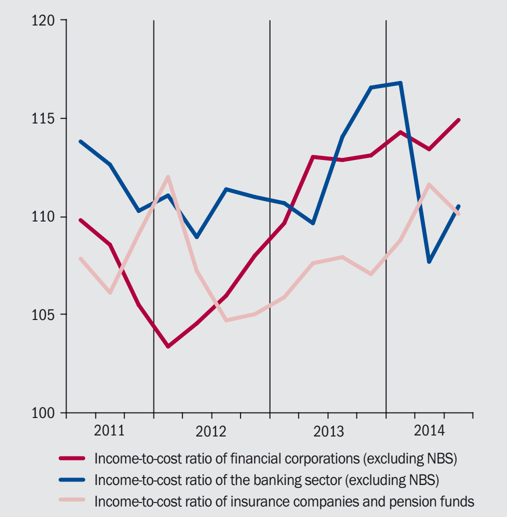
Source: SO SR and NBS calculations.

Chart 68 Total profits of financial corporations and their quarterly rate of change (%)



Source: SO SR and NBS calculations.

Chart 67 Income-to-cost ratios of financial corporations (%)



Source: SO SR and NBS calculations.

The financial sector (excluding NBS) reported a marked deterioration in its financial result for the third quarter of 2014 (the sector's total profit dropped by more than 60% compared with the previous quarter).This deterioration was reflected in the falling profits of all types of institutions, mostly in the other financial intermediaries sector, where profits decreased by 46.3% quarter-on-quarter. The financial result of the banking sector was affected negatively (-5.7% quarter-on-quarter) by net income from fees and commissions and by net interest income, the growth of which slowed down in the period under review.

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Overview of main macroeconomic indicators for Slovakia

Table 6 Selected economic and monetary indicators for the SR

(annual percentage changes, unless otherwise indicated)

	Gross domestic product	HICP	Industrial producer prices	Employ-ment ESA 2010	Unem-ployment rate	Industrial produc-tion index	Total sales of sectors	Economic Sentiment Indicator (long-term average=100)	M3[1] (for ana-lytical use)	Loans to non-financial corpora-tions	Loans to house-holds	State budget balance (EUR mil.)	Deficit ratio (general govern-ment deficit as % of GDP)	Debt ratio (general govern-ment gross debt as % of GDP)	Current account (% GDP)	Balance of trade (% GDP)	USD/EUR ex-change rate (average for the period)
	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17
2006	8.3	4.3	6.4	2.1	13.3	15.6	-	112.5	15.3	-	-	-1,051.5	-3.2	30.5	-7.7	-4.6	1.2556
2007	10.7	1.9	1.8	2.1	11.0	16.7	-	114.6	12.9	25.4	28.6	-781.0	-1.8	29.6	-5.2	-1.2	1.3705
2008	5.4	3.9	6.1	3.2	9.6	2.9	-	99.1	4.9	15.3	25.3	-704.2	-2.1	27.9	-5.9	-1.1	1.4708
2009	-5.3	0.9	-2.6	-2.0	12.1	-15.4	-18.2	78.0	-2.8	-3.3	11.0	-2,791.3	-8.0	35.6	-2.5	1.5	1.3948
2010	4.8	0.7	-2.7	-1.5	14.4	8.0	7.5	98.7	7.8	1.6	12.5	-4,436.1	-7.5	41.0	-3.6	1.2	1.3257
2011	2.7	4.1	2.7	1.8	13.6	5.4	9.0	98.6	2.9	7.6	11.1	-3,275.7	-4.8	43.6	-3.7	1.4	1.3920
2012	1.6	3.7	3.9	0.1	14.0	7.7	5.1	94.0	8.8	-2.3	10.3	-3,810.7	-4.2	52.1	2.2	4.9	1.2848
2013	1.4	1.5	-0.1	-0.8	14.2	5.3	2.3	90.6	5.2	1.7	10.2	-2,023.3	-2.6	54.6	2.1	5.8	1.3281
2013 Q4	2.0	0.5	-1.7	0.1	14.2	10.9	4.4	95.0	5.2	1.7	10.2	-	-5.3	54.6	-0.9	3.5	1.3610
2014 Q1	2.3	-0.1	-3.4	0.6	14.1	6.0	3.9	95.9	4.1	0.8	10.9	-	-2.8	57.8	2.5	6.8	1.3696
2014 Q2	2.6	-0.1	-3.7	1.4	13.2	5.2	2.4	100.2	3.7	2.4	11.6	-	-1.7	56.1	1.0	6.3	1.3711
2014 Q3	2.4	-0.1	-3.4	1.4	12.9	2.6	1.4	102.1	2.0	3.9	12.1	-	.	.	-0.9	3.8	1.3256
2013 Dec.	-	0.4	-1.7	-	13.5	12.9	4.5	95.4	5.2	1.7	10.2	-60.5	-	-	-	-	1.3704
2014 Jan.	-	0.0	-2.5	-	13.6	6.4	4.9	98.1	4.8	2.8	10.3	-122.9	-	-	-	-	1.3610
2014 Feb.	-	-0.1	-3.7	-	13.5	7.6	3.5	93.7	4.9	0.2	10.5	-754.2	-	-	-	-	1.3658
2014 Mar.	-	-0.2	-4.0	-	13.3	4.1	3.3	95.9	4.1	0.8	10.9	-208.7	-	-	-	-	1.3823
2014 Apr.	-	-0.2	-4.4	-	13.0	3.5	2.1	99.0	3.6	2.6	11.1	-430.4	-	-	-	-	1.3812
2014 May	-	0.0	-3.6	-	12.8	4.7	2.6	101.3	3.7	2.8	11.3	-362.8	-	-	-	-	1.3732
2014 June	-	-0.1	-3.3	-	12.8	7.5	2.6	100.4	3.7	2.4	11.6	-90.6	-	-	-	-	1.3592
2014 July	-	-0.2	-2.8	-	12.7	4.0	1.8	103.3	4.0	4.6	11.7	-182.9	-	-	-	-	1.3539
2014 Aug.	-	-0.2	-3.6	-	12.6	3.8	0.8	102.0	2.9	5.7	11.8	-266.9	-	-	-	-	1.3316
2014 Sep.	-	-0.1	-3.8	-	12.4	0.4	1.7	100.9	2.0	3.9	12.1	579.6	-	-	-	-	1.2901
2014 Oct.	-	0.0	-3.9	-	12.3	2.7	2.1	100.5	-0.2	4.5	12.2	-283.8	-	-	-	-	1.2673
2014 Nov.	-	0.0	.	-	.	.	.	105.4	.	.	.	-181.2	-	-	-	-	1.2472

Sources: Statistical Office of the Slovak Republic, MF of the SR, the European Commission and NBS.
1) Currency in circulation in M3 refers to money held by the public (according to methodology in place prior to 2008).

More detailed time series for selected macroeconomic indicators
http://www.nbs.sk/_img/Documents/_MonthlyBulletin/2014/StatisticsMB1214.xls