NÁRODNÁ BANKA SLOVENSKA
EUROSYSTÉM


# Report on the International Economy

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# Contents

## Abbreviations

| | |
|---|---|
| CPI | consumer price index |
| EA | euro area |
| ECB | European Central Bank |
| EC | European Commission |
| EMEs | emerging market economies |
| EONIA | euro overnight index average |
| ESA 2010 | European System of Accounts 2010 |
| ESI | Economic Sentiment Indicator (European Commission) |
| EU | European Union |
| EUR | euro |
| EURIBOR | euro interbank offered rate |
| Eurostat | statistical office of the European Union |
| FDI | foreign direct investment |
| GDP | gross domestic product |
| GNDI | gross national disposable income |
| GNI | gross national income |
| HICP | Harmonised Index of Consumer Prices |
| IMF | International Monetary Fund |
| MFI | monetary financial institutions |
| MF SR | Ministry of Finance of the Slovak Republic |
| MMF | money market fund |
| MTF | NBS's Medium-Term Forecast (published on a quarterly basis) |
| NACE | Statistical Classification of Economic Activities in the European Community (Rev. 2) |
| NARKS | National Association of Real Estate Offices of Slovakia |
| NBS | Národná banka Slovenska |
| NEER | nominal effective exchange rate |
| NFC | non-financial corporation |
| NPISHs | non-profit institutions serving households |
| OECD | Organisation for Economic Co-operation and Development |
| p.a. | per annum |
| p.p. | percentage point |
| PMI | Purchasing Managers' Index |
| REER | real effective exchange rate |
| SASS | Slovenská asociácia správcovských spoločností – Slovak Association of Asset Management Companies |
| SME | small and medium-sized enterprise |
| SO SR | Statistical Office of the Slovak Republic |
| ULC | unit labour costs |
| ÚPSVR | Ústredie práce, sociálnych vecí a rodiny – Central Office of Labour, Social Affairs and Family |
| ÚRSO | Úrad pre reguláciu sieťových odvetví – Regulatory Office for Network Industries |
| USD | US dollar |
| VAT | value-added tax |

Symbols used in the tables

. – Data are not yet available.

- – Data do not exist / data are not applicable.

(p) – Preliminary data

# 1 The global economy

The outlook for an upturn in global economic growth has been shifted to 2017, notwithstanding a slight softening of world GDP in the first months of the year. According to incoming data, GDP growth dipped across both advanced economies and emerging market economies (EMEs). Confidence and other surveys point to global growth accelerating in the near term, underpinned by accommodative monetary policies in advanced economies as well as by fiscal stimuli in the United States. EMEs, and in particular commodity exporters, are rebounding, although their recovery is expected to be gradual amid the continuing need to adjust to past trading conditions. In some cases, moreover, fiscal consolidation needs may weigh on growth. Asian EMEs are expected to maintain relatively robust growth.

Looking at advanced economies, the United Kingdom's GDP growth declined in the first quarter of 2017. As inflation outpaced nominal wage growth, real disposable income growth slowed and therefore private consumption growth fell. Moreover, while past depreciation of the pound significantly supported export performance towards the end of 2016, that impact did not continue into 2017. Exports even declined and, owing to import intensity, net exports weighed significantly on GDP growth. The government sector contributed positively, and, surprisingly, so did investment demand, although its further development is surrounded by heightened uncertainty related to the UK's withdrawal negotiations with the European Union. The US economy also decelerated in the first quarter, as households trimmed their spending and thus dampened private consumption. Investment demand grew quite strongly, but not enough to offset the impact of subdued retail sales and destocking. The labour market situation remained favourable, with the economy operating at close to full employment. Despite rising inflation, solid real income in the next period is expected to support household final consumption. Although the arrival of the new US administration has boosted confidence indicators, their improvement has not been notably reflected in hard data. In general, the administration's proposed reforms are increasing uncertainty about the future economic course of the United States. The Japanese economy had a positive impact on global growth in the first quarter of 2017. The recovery of international trade with Asia continued to support Japanese exports at the start of the year, and they, together with stimulus programmes adopted in 2016, are expected to further boost GDP growth in the period ahead. Besides exports, private consumption also firmed and there was a modest increase in investment, too. In the medium term, the inadequacy of supply-side structural reforms, particularly in regard to the labour market and demographics, could weigh on Japan's potential output growth. In the euro area, too, economic activity strengthened in the first quarter, in this case driven by domestic demand. Owing to growing global trade and past depreciation of the euro, exports maintained strong growth, but their impact was fully offset by import growth. Domestic demand is expected, given the accommodative monetary policy, to continue underpinning euro area GDP growth. Activity is also expected to be boosted by fiscal policy in those countries focused on long-term growth supporting measures.

As for EMEs, China's economic growth slowed in the first quarter on a quarter-on-quarter basis, but increased in year-on-year terms. The composition of growth on the demand side showed the gradual rebalancing off the economy away from investment to a consumption-driven model. The investment component itself also displayed a more balanced composition. Although government investment growth continued to exceed private investment, the gap was far narrower than in the past. Despite restrictions such as tighter mortgage conditions, investment in real estate increased appreciably. Through fiscal and monetary stimuli, China is expected to maintain strong economic growth in the years ahead, albeit below the 2016 level. India's economic growth accelerated in quarter on quarter terms, but slowed sharply year on year. Its performance reflected the waning effects of the November 2016 demonetisation of the highest-denomination banknotes and a pick-up in motor vehicle sales. As for investment, however, it did not show any significant recovery, notwithstanding the implementation of government measures to support infrastructure projects and the easing of business conditions. Investment was curbed by spare capacity, a weak financial situation, and non-performing loans. Going forward, however, India is expected to benefit from the upward impact of public sector wage increases on consumption growth and from investment growth driven by structural reforms in the area of goods and services taxes. In Russia, the economy is gradually recovering from a recession caused by a slump in oil prices as well as by sanctions imposed by Western countries. In the first quarter of 2017 Russia's domestic demand rebounded on the back of an appreciating rouble and falling inflation. At the same time, exports firmed owing mainly to an upturn in oil prices. While the economic recovery is expected to be supported by oil price stabilisation, GDP growth may be constrained by fiscal consolidation measures and structural headwinds. The situation in Brazil also improved in the first quarter, as the economy emerged from a two-year recession. A stronger export performance and a more moderate decline in consumer spending contributed positively to GDP growth, while the government sector and investment components had a negative impact. Brazil's low inflation is conducive to monetary policy accommodation, which could support investment growth. Nevertheless, Brazil continues to have a relatively closed economy as well as persisting trade barriers, all of which is weighing on competitiveness. Tax reforms, the easing of administrative burdens, and infrastructure investments are expected to boost growth and increase the economy's openness.

**Chart 1 GDP growth and the CLI for the OECD area**


*Source: OECD.*
*Note: CLI – Composite Leading Indicator.*

Quarterly GDP growth in the OECD area slowed to 0.4% in the first quarter of 2017, from 0.7% in the previous quarter. Year-on-year GDP growth remained stable at 2.0%. Despite a moderate slowdown in global economic growth in the first quarter of 2017, the Composite Leading Indicator (CLI) for the OECD area[1] is pointing to a gradual recovery.

Global economic growth is expected to pick up moderately in the period ahead, with growth across advanced economies expected to be supported by monetary and fiscal policies in an environment of continuing cyclical recovery and a narrowing output gap. In the global context, EME developments in particular will have an important role in the years ahead. While the Chinese and Indian economies will maintain strong growth, it is above all the recovery of commodity exporters that will provide a significant boost to world GDP growth.

The rebound in commodity prices passed through relatively quickly to global inflation growth. The acceleration of annual consumer price inflation was most pronounced in advanced economies, where on average it was more than twice as high as the average for 2016, owing mainly to the impact of energy prices. In EMEs there was no significant increase in headline inflation, as the impact of higher energy commodity prices has only recently started to outweigh downward pressure from the fading of earlier exchange rate depreciation. Another cause of global inflation growth was the increase in food commodity prices. Annual consumer price inflation in the OECD area therefore increased from 1.8% in December 2016 to 2.3% in March 2017, and edged further upwards in April, to 2.4%. At the same time, however, core inflation remained

1 *The CLIs for OECD countries are published on a monthly basis, and the most recent, published in June 2017, are for the period up to April 2017.*

at the same level in March as in December (1.8%) and stayed below 2% in April (at 1.9%).

The recent decline in prices of oil and other commodities is expected to weigh on global headline inflation in the short term. Over the longer term, however, it is expected that a gradual decline in spare capacity will push up consumer prices. However, the current oil futures curve implies relatively stable prices and therefore suggests a subdued contribution of energy prices to the headline inflation rate.

# 2 Commodities

The average commodity price index increased in the first quarter of 2017 at the same pace as in the previous quarter. While the rate of increase in non-energy prices accelerated, the rate in the energy component slowed.

Looking at non-energy commodities, the agricultural commodity price index increased in the first quarter after falling in the previous period, and metal prices recorded a slightly stronger increase. Agricultural commodity prices reflected increases in food prices and in agricultural raw material price growth. In that category, wheat prices increased the most, amid concerns about lower wheat production in 2017, while pigmeat prices increased on the back of growing demand from China, the world's largest pigmeat consumer. Among other components of the non-energy commodity price index, rubber prices had a strong positive impact. The increase in metal prices was boosted by aluminium prices, which increased in response to China's adoption of new air pollution control regulations. Uranium prices also accelerated in the first months of the year. As for energy commodities, the average price of a barrel of Brent crude oil increased to USD 54 in the first quarter, around USD 4 higher than in the previous quarter. Although most OPEC members cut production in line with a recent OPEC and non-OPEC members' agreement, some countries exempted from that agreement, notably Libya and Nigeria, increased oil output substantially. This, together with strong US oil production, saw the oil price come under downward pressure towards the end of the quarter and curbed oil price growth for the quarter as a whole. Coal prices had a negative impact on the energy commodity price index, as the resolution of supply disruptions and the stabilisation of demand in China resulted in a downward correction of the previous quarter's strong growth in coal prices. In April, commodity price index remained broadly at the March level, with a decline in non-energy commodity prices offset by an increase in energy commodity prices.

# 3 The United States

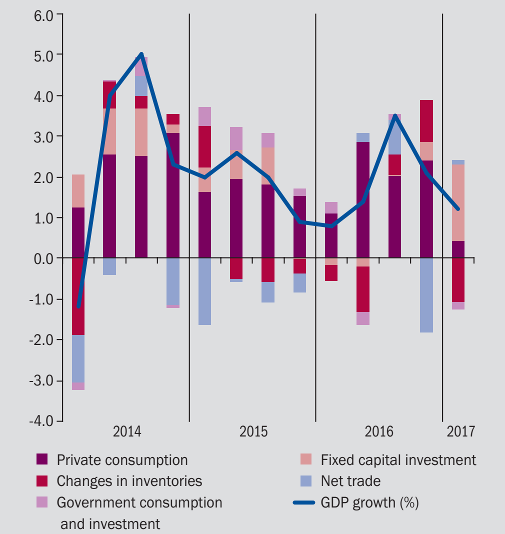
In line with past experience, US economic growth softened in the first months of the year. The annualised rate of GDP growth fell to 1.2% in the first quarter of 2017, from 2.1% in the previous quarter. In year-on-year terms, US economic growth was unchanged from one quarter to the other, at 2.0%.

The US economy's slowdown in early 2017 stemmed mainly from a deceleration in private consumption growth. Household spending growth fell from historical high levels at the end of year, reflecting weaker car sales and warm weather (resulting in lower home-heating bills). Changes in inventories dampened GDP growth with a significant negative impact of around 2 percentage points. There were also negative contributions from government consumption and investment at both the federal and state levels. On the other hand, a firming of exports and slower import growth ensured that net exports made a moderately positive contribution to growth. Investment demand was notably stronger at the start of the year, with increases in both residential and non-residential investment, the latter including unexpectedly strong structural investment growth in extractive industry. Both survey and economic data suggest that US GDP growth will be higher in the next period. Consumer sentiment is elevated, while real disposable income growth points to a pick-up in private consumption. At the same time, the effects of global recovery in China and Europe are expected to buoy US exports.

The acceleration in US consumer price inflation observed in the second half of 2016 continued in the first quarter of 2017. The annual CPI rate increased from 2.1% in December 2016 to 2.4% in March 2017. In between it reached 2.7% in February, its peak for the quarter. The slowdown in March did not prevent the average headline rate for the first quarter from being significantly higher than for the fourth quarter of 2016.

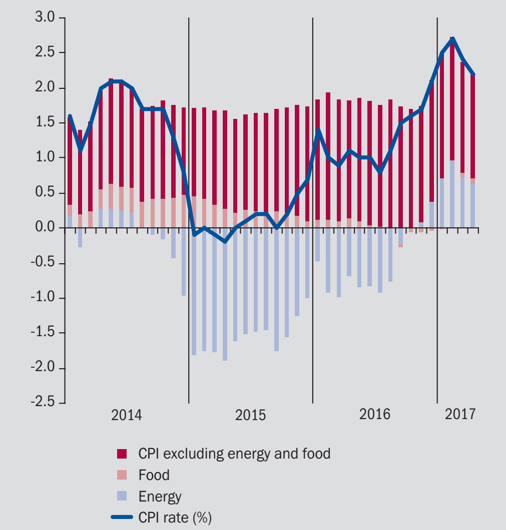
The March slowdown stemmed partly from lower energy inflation and partly from core inflation, which was lower in March (at 2.0%) than in the previous December (2.2%). Headline inflation fell further in April (to 2.2%), reflecting slight drops in energy inflation and in core inflation (to 1.9%).

**Chart 2 Annualised GDP growth and its composition (percentages; percentage point contributions)**




*Source: Bureau of Economic Analysis.*

**Chart 3 Annual consumer price inflation and its composition (percentages; percentage point contributions)**



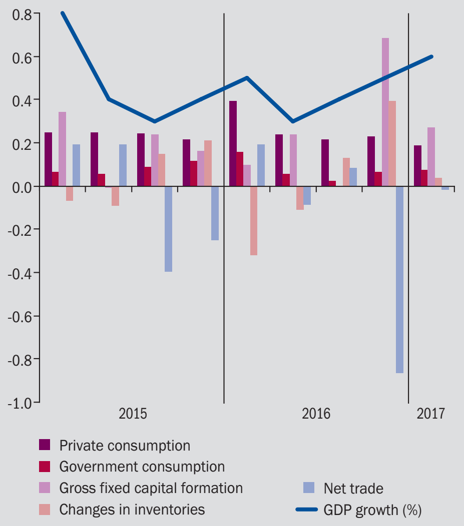

*Sources: Bureau of Labor Statistics and NBS calculations.*

The US Federal Open Market Committee (FOMC) decided at its meeting in February 2017 to leave the target range for the federal funds rate unchanged at 0.50% to 0.75%. In March, however, in view of realised and expected labour conditions and inflation, the Committee decided to raise the target range to 0.75% to 1.00%. At its May meeting, the Committee left the federal funds rate unchanged. The stance of monetary policy remains accommodative.

# 4 The euro area

The euro area's economic recovery continued in the first quarter of 2017. GDP increased by 0.6%, quarter on quarter, which was 0.1 percentage point higher than its growth in the previous quarter. Looking at the larger economies within the euro area, Spain and Germany experienced the highest growth, 0.8% and 0.6% respectively (each higher compared with the previous quarter, by 0.1 percentage point and 0.2 percentage point). Italy's quarter-on-quarter GDP growth also increased (by 0.1 percentage point, to 0.4%), while both the Dutch and French economies saw growth fall (the former by 0.2 percentage point, to 0.4%, and the latter by 0.1 percentage point, to 0.4%). The increase in the euro area's quarterly GDP growth had an upward impact on its year-on-year growth rate for the first quarter, which increased to 1.9 % (up by 0.1 percentage point from the previous quarter).

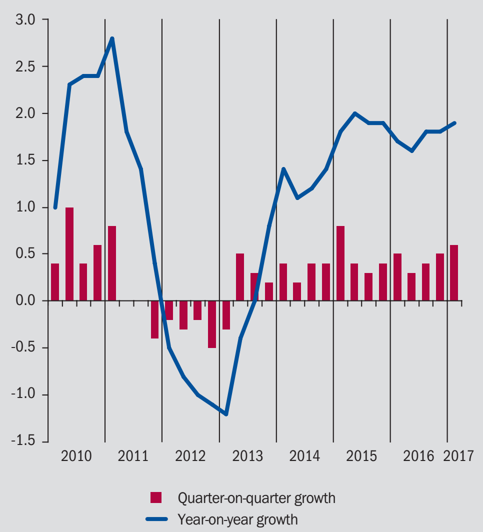
Chart 5 Quarterly GDP growth and its composition (percentages; percentage point contributions)




*Sources: Macrobond and NBS calculations.*

Domestic demand remained the main driver of economic expansion in the first quarter of 2017, although to a lesser extent compared with the previous quarter. There were declines in both consumption growth and, more markedly, in investment demand growth. Private consumption increased by 0.3% quarter on quarter, 0.1 percentage point less than in the previous quarter. Gross fixed capital investment growth fell from an exceptionally high 3.4% in the fourth quarter of 2016, to 1.3% in the first quarter, which was nevertheless an above-average increase. Construction output growth remained relatively solid, and investment in machinery and equipment also increased. Net trade made a neutral contribution.

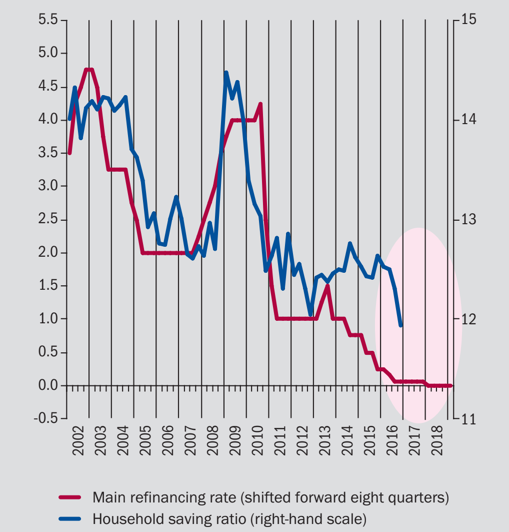
Chart 4 GDP growth (constant prices; percentages)




*Source: Macrobond.*

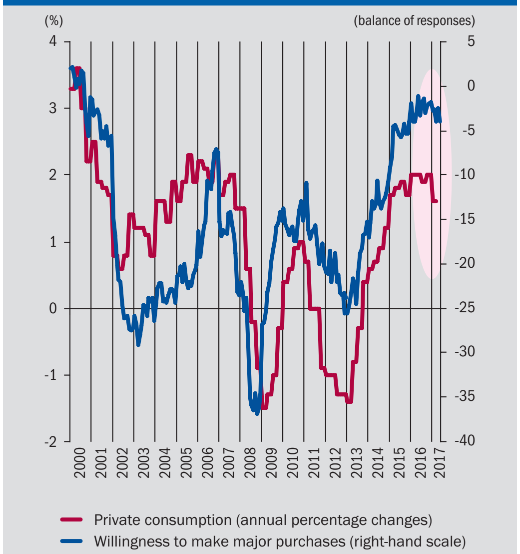
The low interest rate environment has gradually begun, with a lag, to have a downward impact on the saving ratio. Its decline was more pronounced in the fourth quarter of 2016 than in the previous quarter. This trend is conducive to further consumption demand growth and supports overall economic growth. After its temporary dip in February, consumer confidence picked up in the following months and so supported favourable outlooks for consumer demand. Despite weakening slightly, the willingness of consumers to make major purchases remains elevated and provides further impetus to consumer demand, which may also benefit from the continuing upturn in the labour market.

**Chart 6 Monetary policy rates and the household saving ratio (percentages)**



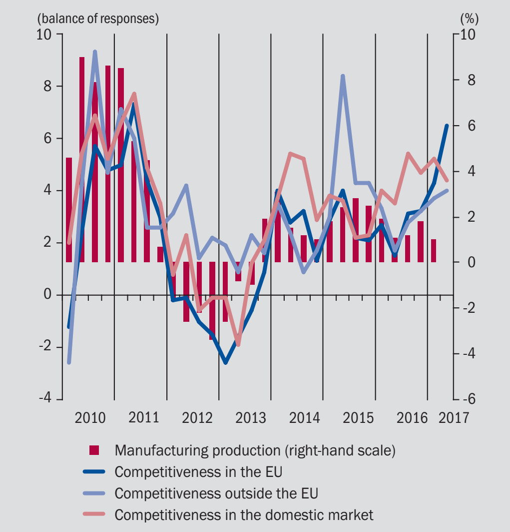

*Source: Macrobond.*

**Chart 7 Private consumption and consumers' willingness to make major purchases**



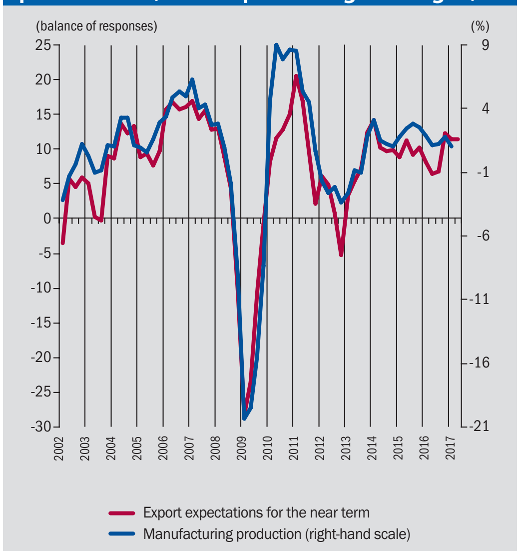

*Source: Macrobond.*

**Chart 8 Industrial competitiveness (balance of responses) and manufacturing production (annual percentage changes)**




*Sources: European Commission, Eurostat and NBS calculations.*

**Chart 9 Export expectations in industry (balance of responses) and manufacturing production (annual percentage changes)**

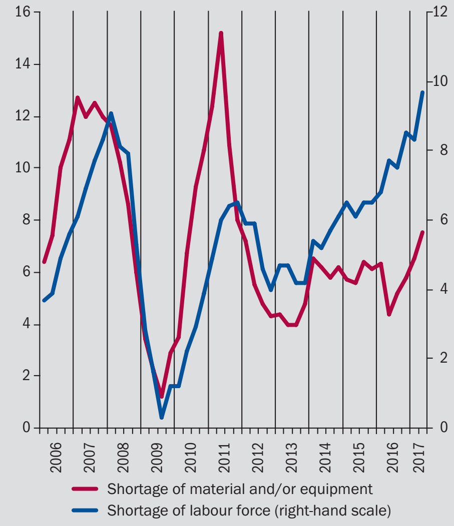



*Sources: European Commission, Eurostat and NBS calculations.*

Industrial firms' assessments of their competitive position within the EU improved in the first quarter for a fourth successive quarter and bode well for industrial production and exports. Export expectations are also relatively favourable and, despite decreasing slightly in the first quarter of 2017, remain at relatively robust levels.

The euro area's economic revival is further evident from industrial firms' assessments of what factors are limiting their production. Survey results for the second quarter of 2017 showed a further drop in the impact of 'insufficient demand', which was the largest drop since the fourth quarter of 2013 and left this factor's level close to pre-crisis levels. Concerns about 'financial constraints' rose marginally, but still remain at relatively benign levels. Both the importance of 'shortage of labour force' and 'shortage of material and/or equipment' – i.e. production factors – continued to increase, and therefore pointed to the ongoing tightening of the labour market and an overall upward trend in capacity utilisation across the economy. This may be reflected in wage growth and consequently in inflation. At the same time, the increasing importance of material constraints on production implies an increasing need for new investment.

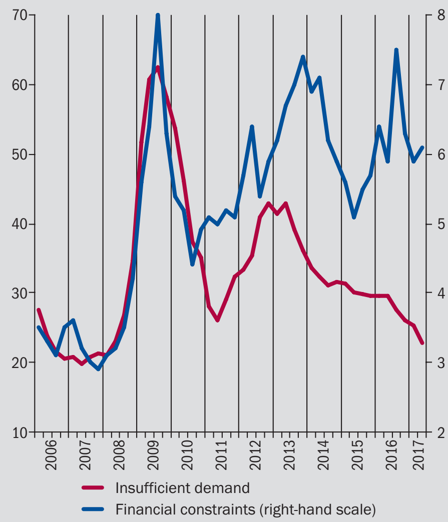
**Chart 11 Factors limiting production in industry (percentages)**




*Source: Macrobond.*

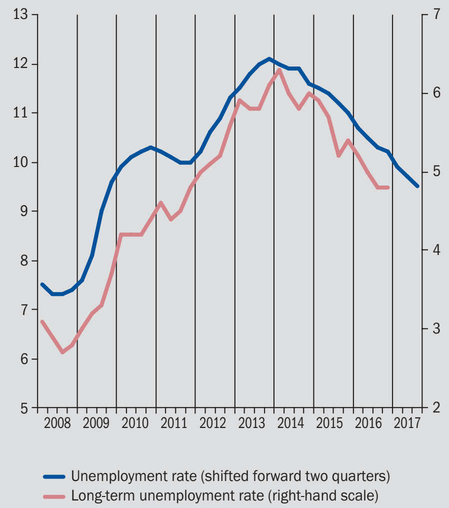
The labour market continued to strengthen in the first quarter, with the rate of unemployment falling from 9.6% in December to 9.4% in March, and then to 9.3% in April. The firming of the labour market is conducive to the further recovery of the euro area economy, in particular domestic demand. Employment expectations in several sectors continued to improve in the first months of the second quarter, with the most marked increase in expectations observed in construction and, to a lesser extent, industry. Expectations in services and retail trade were more volatile, but also suggested that the favourable employment trends will continue.

**Chart 10 Factors limiting production in industry (percentages)**



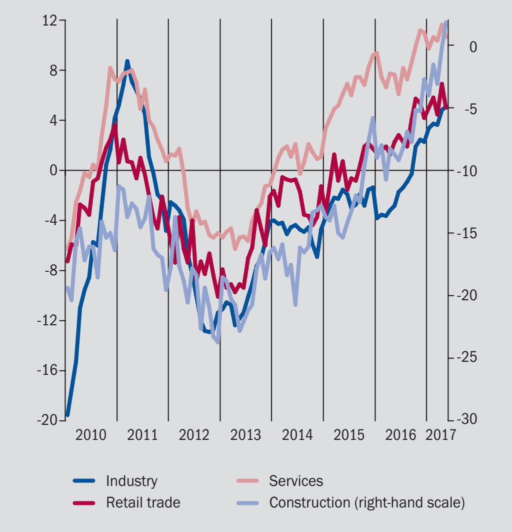

*Source: Macrobond.*

**Chart 12 Unemployment rate and long-term unemployment rate (percentages)**




*Source: Macrobond.*

**Chart 13 Employment expectations by sector (balance of responses)**



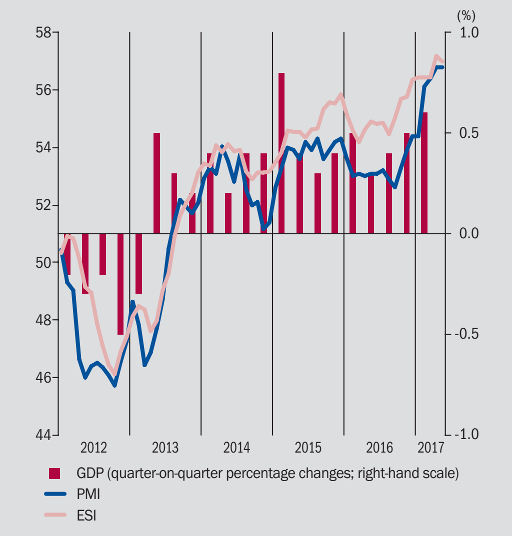

*Source: Macrobond.*

**Chart 15 Eurocoin indicator and quarterly euro area GDP growth**


*Source: Macrobond.*

Leading indicators for the euro area remain relatively bright and, despite a slight weakening of the Economic Sentiment Indicator (ESI) and the Eurocoin indicator, they suggest that economic activity growth may accelerate in the second quarter. After remaining flat in the first quarter, the ESI for the euro area increased appreciably in April, before correcting slightly downwards in May. The ESI is nevertheless is relatively elevated at levels similar to those of autumn 2007. The Eurocoin indictor fell in May for a third successive month, but remains at a high level. The composite Purchasing Managers' Index (PMI) also signalled favourable economic trends, as it increased throughout the first four months to reach its highest level since April 2011. The PMI remained unchanged in May.

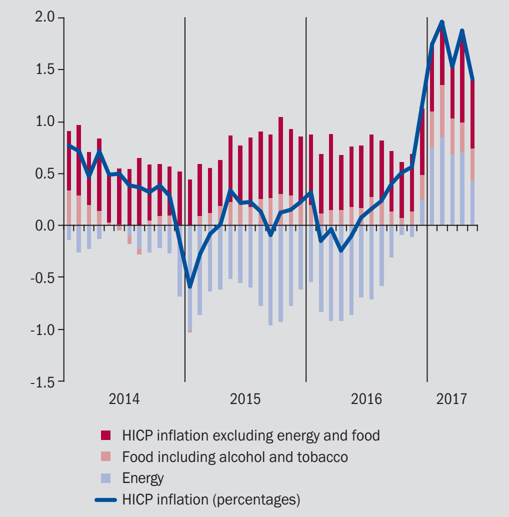
**Chart 14 Leading indicators and quarterly euro area GDP growth**




*Sources: Macrobond, Eurostat, Bloomberg and NBS calculations.*

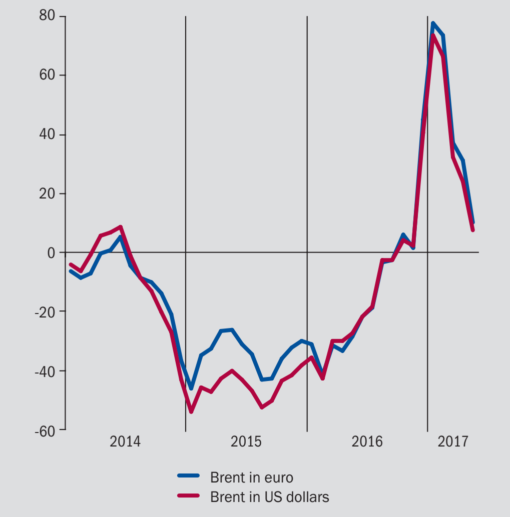
Euro area annual HICP inflation maintained its upward trend in the first two months of 2017, owing mainly to increases in energy inflation and, to a lesser extent, food inflation. The headline rate climbed to 2.0% in February, up from 1.1% at the end of 2016, before slowing in March. The slowdown reflected declines in the energy and food components, as well as the impact of oil prices subdued by a base effect and by recent developments. Services inflation also fell slightly in March, principally due to the fact that Easter fell in March this year and April last year. The impact of this calendar effect was most pronounced in package holiday prices, with the differences in their year-on-year level having an impact on overall services inflation until May. The headline HICP rate in March was 1.5%, 0.4 percentage point higher than the rate in December 2016. Headline inflation in April

Chart 16 Annual HICP inflation rate and the contributions of selected components (percentages; percentage point contributions)




*Sources: Macrobond and NBS calculations.*

Chart 17 Oil prices in euro and US dollars (annual percentage changes)




*Sources: Macrobond and NBS calculations.*

and May continued to be affected by the Easter calendar effect, but as the effect faded, services inflation rebounded in May, back to its February level. The headline rate, however, also came under downward pressure from decreases in energy inflation and, to a lesser extent, food inflation, with the result that it dropped to 1.4% in May. Inflation excluding energy and food reflected the volatility of services prices, but in May it was back to the level of December 2016 (0.9%).

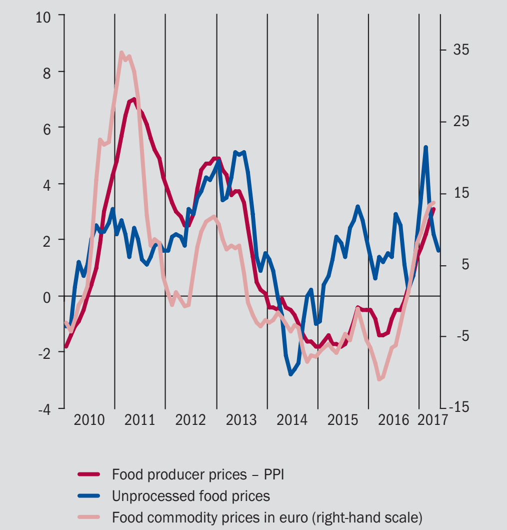
Energy prices remained responsive to year-on-year global oil price growth, which was falling from February. The annual rate of increase in the Brent crude oil price fell from almost 80% in January to around 10% in May, reflecting, on the one hand, the recent slight decline in the price per barrel of Brent crude oil, from around USD 56 in January and February to less than USD 52 in May, and, on the other hand, the base effect of the oil price acceleration a year earlier (when the price climbed from less than USD 32 in January 2016 to almost USD 48 in May 2016). Energy price movements are therefore indicating a moderation of cost-push inflation pressures.

Chart 18 Oil prices in euro and the HICP energy component (annual percentage changes)


*Sources: Macrobond and NBS calculations.*

The recovery of the food commodity market stalled in the first quarter, and from February the market prices were broadly stable or slightly falling. In year-on-year terms, however, prices con-

**Chart 19 Food prices: commodity, producer and consumer prices (annual percentage changes)**




*Sources: Macrobond, ECB and NBS calculations.*

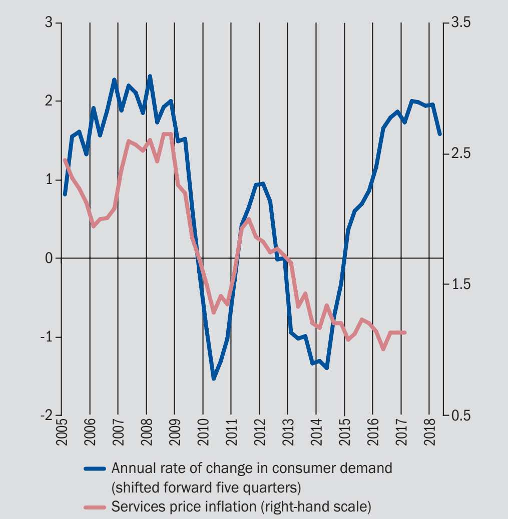
**Chart 20 Food commodity prices and processed food prices (annual percentage changes)**


*Source: Macrobond.*

tinued rising moderately until April. This trend was reflected in processed food inflation which accelerated in the first quarter, by 0.3 percentage point to 1.0%, and then again in April and May (to 1.5%). The increase in the annual rate of food commodity inflation is expected to pass through, with a lag, to processed food inflation, supporting its further growth in the months ahead. Unprocessed food prices showed a more volatile trend in the first quarter and the subsequent two months. After their inflation rate increased significantly in January and February (by 3.2 percentage points, to 5.3%), it then decreased, down to 1.6% in May, and therefore had a dampening effect on overall food inflation.

The rate of inflation in the demand-sensitive component of the consumption basket remained subdued, reflecting the fact that strong competition was inhibiting price increases. Services inflation was significantly affected by the different timing of Easter in 2017 compared with 2016. The annual rate of services inflation thus experienced volatility, before stabilising in May at 1.3%, the same level it posted in February. Although consumer demand growth slowed slightly, its level would ordinarily imply a more elevated rate of services inflation. It is likely that services inflation has been constrained by strong competition and by a tendency for service providers to focus on market share gains at the expense of higher profits. Non-energy industrial goods inflation accelerated in January and slowed in February, before steadying at 0.3%. Further moderation of the euro exchange rate's year-on-year appreciation, or its slight depreciation, supported infla-

**Chart 21 Consumer demand and services price inflation (annual percentage changes)**

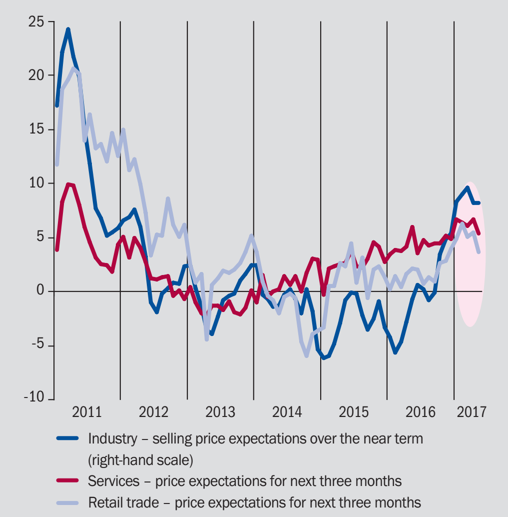



*Source: Macrobond.*

**Chart 22 Non-energy industrial goods prices and the nominal exchange rate (annual percentage changes)**


*Source: Macrobond.*
*Note: Positive values for the exchange rate denote depreciation of the euro.*

**Chart 23 Price expectations in industry, services and retail trade (balance of responses)**

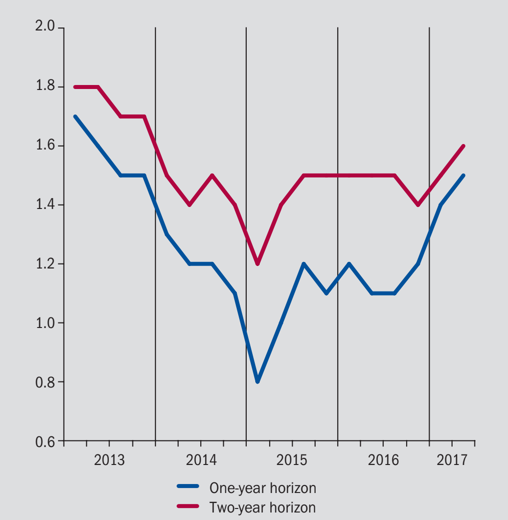



*Sources: European Commission and Eurostat.*

tion in consumer goods imports, but without yet having an impact on non-energy industrial goods inflation. Furthermore, the nominal effective exchange rate began to appreciate again in May. As a result, inflation in market components of the consumption basket remains contained. The continuing recovery of both the economy and the labour market, supported by an accommodative monetary policy, could, however, lead to upward pressure on inflation in this segment.

The upward trend in selling price expectations came to a halt in virtually all sectors at the end of the first quarter or in the next two months. This was probably related to the moderate decline in oil prices, as well as to the continuing strength of competition. On the other hand, according to the *'The ECB Survey of Professional Forecasters'*, expectations for HICP inflation are increasing slightly, especially at the one-year horizon.

**Chart 24 HICP inflation – expectations according to The ECB Survey of Professional forecasters**




*Source: Macrobond.*

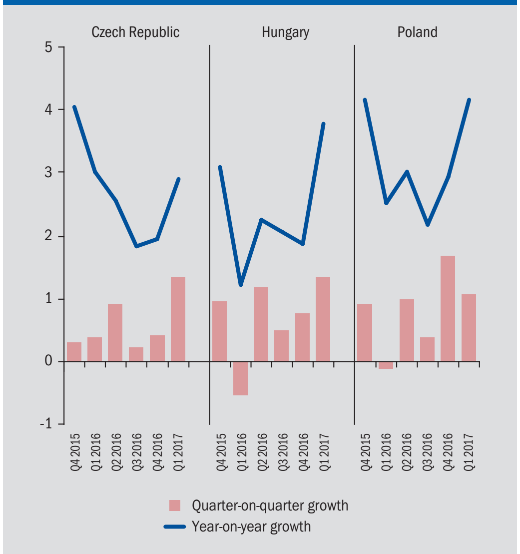
At its meetings in the first half of 2017, the ECB's Governing Council decided to leave the interest rates on the main refinancing operations, the marginal lending facility and the deposit facility unchanged at 0.00%, 0.25% and -0.40% respectively. According to the statement issued after its June meeting, the Council expects the rates to remain at their present levels for an extended period of time, and well past the horizon of the ECB's net asset purchases.

The Council also confirmed that the ECB's net asset purchases, at the current monthly pace of €60 billion, are intended to run until the end of December 2017, or beyond, if necessary, and in any case until the Council sees a sustained adjustment in the path of inflation consistent with its inflation aim. (Under a decision taken last year, the amount of the purchases was reduced from €80 billion to €60 billion as from April 2017.) If the outlook becomes less favourable, or if financial conditions become inconsistent with further progress towards a sustained adjustment in the path of inflation, the Council stands ready to increase the asset purchase programme (APP) in terms of size and/or duration. The net purchases will be made alongside reinvestments of the principal payments from maturing securities purchased under the APP.

# 5 The Czech Republic, Hungary and Poland

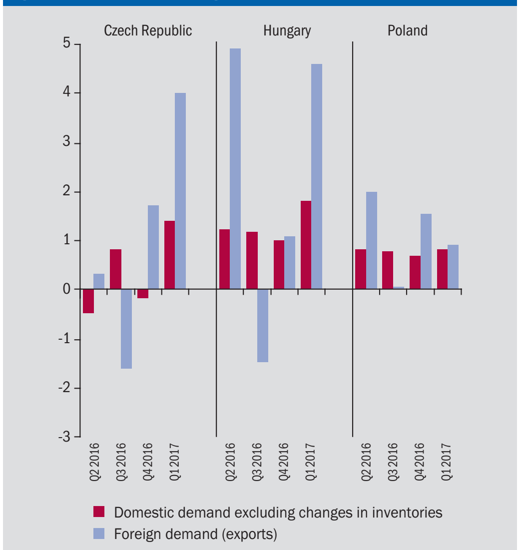
In all of the reviewed countries, annual economic growth was higher in the first quarter of 2017 than in the previous quarter. In the Czech Republic, year-on-year GDP growth accelerated by 1.0 percentage point, to 2.9%, while in Poland it increased by 1.9 percentage points, to 3.8%, and in Hungary by 1.3 percentage points, to 4.2%.

**Chart 25 GDP growth (percentages)**




*Source: Eurostat.*

**Chart 26 Contributions to quarterly GDP growth (percentage points)**

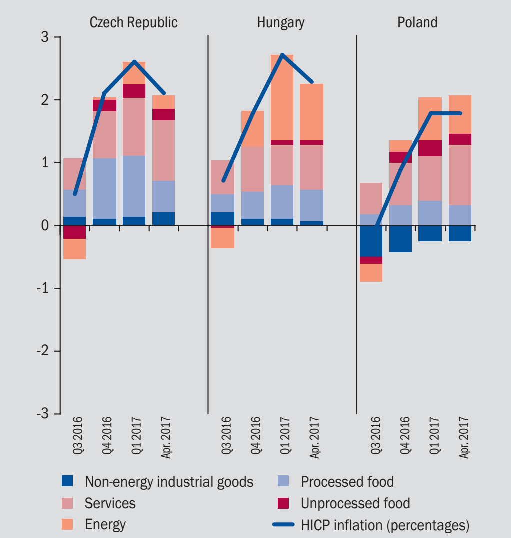



*Sources: Eurostat and NBS calculations.*

In quarter-on-quarter terms, Czech economic growth was 0.9 percentage point higher in the first quarter of 2017 than the fourth quarter of 2016, and Hungary's GDP growth increased by 0.6 percentage point, to 1.3%. Poland's growth slowed by 0.6 percentage point, to 1.1%. Czech GDP growth included positive contributions from investment and government consumption, two components that had contributed negatively in the previous quarter. In contrast to the previous quarter, when it has a substantial positive impact, net trade had a neutral impact as exports and imports increased at similar rates. Hungary's GDP growth was driven by investment demand and changes in inventories, while net exports had a sizeable negative impact due to import growth outstripping export growth. The slowdown in Poland's GDP growth was largely attributable to net exports, as imports increased far more than exports.

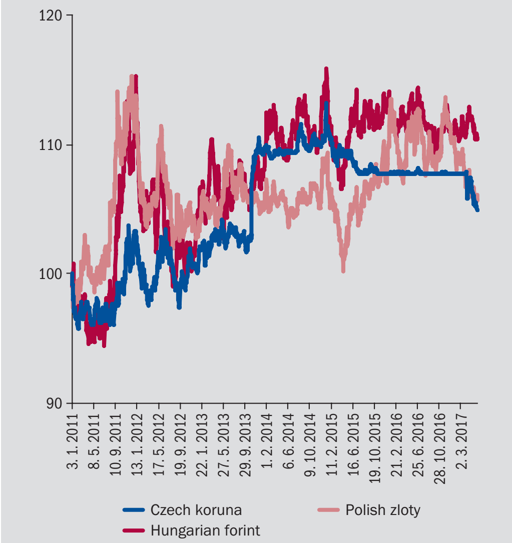
Annual consumer price inflation in all three reviewed countries was higher in March 2017 than in December 2016. In the Czech Republic it accelerated by 0.5 percentage point, to 2.6%, in Hungary by 0.9 percentage point, to 2.7%, and in Poland by 0.9 percentage point, to 1.8%. The inflation growth in the **Czech Republic** stemmed mainly from energy and services prices. In April, the Czech headline inflation rate slowed slightly owing mainly to lower rates of energy and unprocessed food inflation. In **Hungary**, the first-quarter increase in annual consumer price inflation was driven mainly by energy prices and, to a lesser extent, food prices (unprocessed food inflation turned positive after an extended period in negative territory). In April, Hungary's headline inflation rate slowed, largely as a result of a notable drop in energy inflation. In **Poland**, the increase in consumer price inflation was also led by energy inflation and was further supported by processed food inflation. Non-energy industrial goods infla-

**Chart 27 HICP inflation and its composition (percentages; percentage point contributions)**




*Sources: Eurostat and NBS calculations.*

**Chart 28 Exchange rate indices of national currencies vis-à-vis the euro (index: 3 January 2011 = 100)**




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

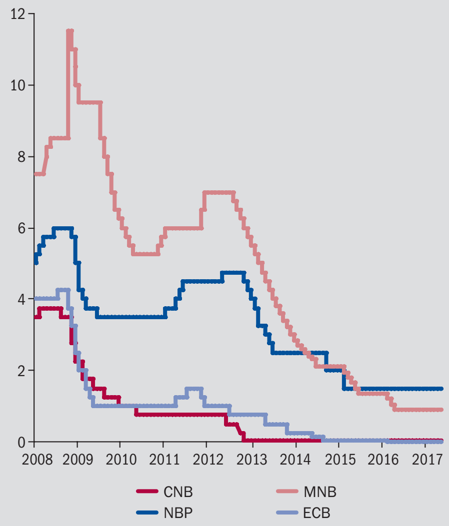
tion again made a negative contribution, albeit more moderate compared with the previous quarter. In April, Poland's headline inflation remained unchanged, as the impact of higher services inflation was offset by lower food and energy inflation.

The Czech koruna's exchange rate vis-à-vis the euro at the end of the first quarter of 2017 was virtually unchanged from its level in December (a mere 0.03% weaker), while both the Hungarian forint and Polish zloty were trading stronger, by 0.71% and 4.17% respectively.

The koruna was constrained to strengthen in the first quarter, given that the Czech central bank was still committed to using foreign exchange interventions to maintain accommodative monetary conditions. At an extraordinary monetary policy meeting on 6 April 2017, the ČNB Bank Board decided to end the exchange rate floor forthwith and to let the euro-koruna exchange rate be determined by supply and demand on foreign exchange markets. Thus the koruna returned to a managed floating exchange rate regime. In the period following ČNB's removal of the floor, the koruna began to appreciate, largely in response to favourable domestic economic news. A more robust strengthening was prevented mainly by the 'overboughtness' of the koruna market. The movements of the forint and zloty during the fourth quarter reflected financial market sentiment that was shaped mainly by the monetary policy divergence between major central banks (the Federal Reserve and the ECB), as well as by political uncertainty (elections in certain euro area countries). Both currencies, but more so the zloty, strengthened on the back of bright economic news in the respective countries (rising inflation, firming demand).

None of the central banks of the three reviewed countries altered its monetary policy rates in the first quarter of 2017. In the Czech Republic, **Česká národní banka** (ČNB) kept its base rate unchanged at 0.05% (zero lower bound). In the statements issued after its monetary policy meetings in the first quarter, the **ČNB Bank Board** confirmed its commitment to using the exchange rate as an additional instrument for easing monetary policy (its interventions on the foreign exchange market during the first quarter amounted to €41.877 billion). In Hungary, **Magyar Nemzeti Bank** (MNB) left each of its base rate, overnight collateralised lending rate and one-week collateralised lending rate unchanged at 0.9% in the first quarter, and its overnight deposit rate unchanged at -0.05 % (its level since 23 March 2016). In March 2017 the MNB ended its Funding for Growth Scheme (FGS), which was launched in June 2013 to provide financing to small and medium-sized enterprises (SMEs). The FGS started to be phased out from January 2016 and gradually replaced with the central bank's Market-Based Lending Scheme, under which banks should adjust the financing of SMEs to market conditions. With the aid of these schemes, lending to SMEs increased in 2016 by 12% year on year, and the MNB expects it to increase by between 5% and 10% in 2017. Since October 2016 the MNB has capped the use of its three-month deposit facility, seeing the cap as an integral element of its monetary policy toolkit. The upper limit on the stock of three-month deposits held with the MNB as at the end of the first quarter of 2017 was set at HUF 750 billion. The measure is intended to crowd out additional liquidity from the deposit facility. According to the MNB, the settings of its monetary policy are consistent with fulfilling the medium-term inflation target while ensuring commensurate support to the economy. At the same time, the central bank has stated that it stands ready to further ease monetary conditions, if necessary using unconventional instruments. In Poland, **Narodowy Bank Polski** (NBP) left its monetary policy rates unchanged in the first quarter of 2017 (keeping the reference rate at 1.5%). The NBP Monetary Policy Council (MPC) stated that the acceleration in price growth was due mainly to higher global commodity prices, i.e. factors beyond the direct impact of domestic monetary policy. Core inflation remained close to zero, pointing to still low demand pressure. The MPC also took the view that, given the available data and forecasts, the current level of interest rates was conducive to keeping the Polish economy on a sustainable growth path and to maintaining macroeconomic equilibrium.

**Chart 29 Key interest rates of national central banks (percentages)**




*Sources: National central banks and the ECB.*

**Box 1**

## ČNB ENDS EXCHANGE RATE FLOOR

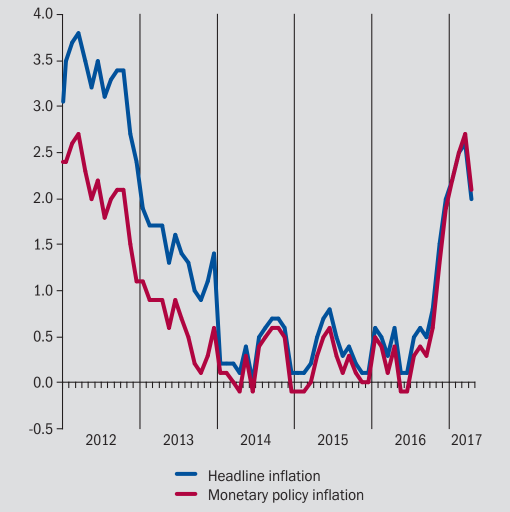
On 7 November 2013 the ČNB Bank Board decided to use the exchange rate as an additional instrument for easing monetary policy conditions, after having deployed its principal monetary policy instrument – interest rates – to the limit by cutting them to the zero lower bound (0.05%) in late 2012. The rate cuts were a response to the recession that the Czech economy had found itself in that year. Alongside the cuts, the ČNB signalled its readiness to leave the rates at the zero lower bound for as long as necessary, and also its readiness, if necessary and in accordance with its statutory mandate, to use additional instruments as a means of maintaining price stability. In November 2013 it took that step and the instrument it used was the exchange rate. The exchange rate did not become a new ČNB monetary policy target, but merely a non-standard instrument for ensuring the necessary further easing of monetary policy.

The announcement of the exchange rate floor meant that ČNB stood ready to intervene on the foreign exchange market – automatically and without any time or volume limits – in order to prevent the exchange rate from appreciating below CZK 27 to the euro. The floor was asymmetric in nature, i.e. ČNB undertook to stop the koruna appreciating below the limit, but to let any further depreciation above the limit be determined by supply and demand on foreign exchange markets.

From the outset of the exchange rate floor, ČNB explicitly stated that the floor would be discontinued at such time that conditions were met for sustainable fulfilment of the 2% inflation target over the medium term. This represented clear forward guidance that the floor would end at a certain time on the basis of economic developments and the outlook set out in ČNB's Inflation Report. In the light of economic conditions (the ability to meet the medium-term inflation target), the exit date for the floor was eventually postponed until the first half of 2017.

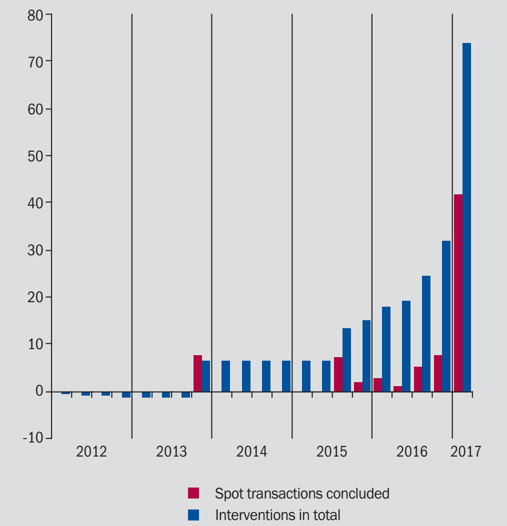
The ČNB Bank Board's decision to end the exchange rate floor was taken at an extraordinary monetary policy meeting on 6 April 2017, with ČNB stating afterwards that the conditions had been met for sustainable fulfilment of the 2% inflation target in the future. According to ČNB, inflation was now around the level

**Chart B Inflation in the Czech Republic (percentages)**



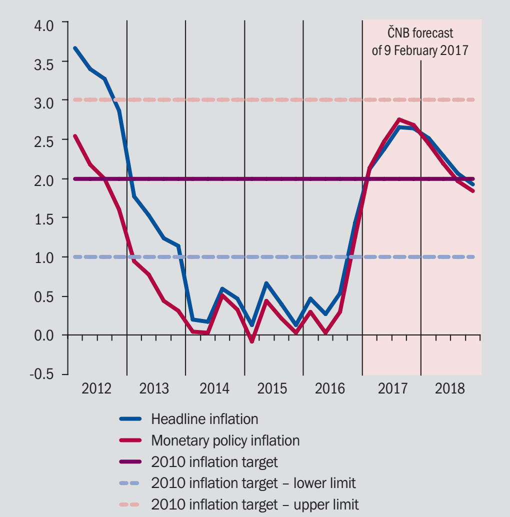

*Source: Macrobond.*

**Chart A ČNB interventions (EUR billions)**




*Source: Macrobond.*

**Chart C ČNB inflation outlook of 9 February 2017 (percentages)**




*Source: ČNB.*

that the Bank Board had considered optimal when introducing the floor. The inflation outlook continues to confirm that inflation expectations are well anchored, while economic sentiment is also on a favourable path. ČNB said the exchange rate floor had proved to be an effective monetary policy instrument in the conditions of the Czech economy and that therefore the possibility of its reintroduction, although highly unlikely at the present time, could not be ruled out for the future. ČNB has thus returned to a managed floating exchange rate regime.

Soon after removing the exchange rate floor, ČNB predicted that the exchange rate may come under pressure to appreciate (from the modest positive interest rate differential vis-à-vis the euro) or depreciate (from, among other things, the fact that the koruna was slightly overvalued before the floor was adopted and that financial investors would be closing koruna positions after the floor's removal). At the same time, ČNB has made clear that it is ready to use monetary policy instruments to suppress longer-term excessive fluctuations of the koruna-euro exchange rate ('excessive fluctuations' are not defined in advance, but will be gauged on specific conditions).

In discussions of ČNB's removal of the exchange rate floor, similarities have frequently been drawn with the exchange rate floor that the Swiss National Bank (SNB) recently had in place, notwithstanding the several differences between these strategies. One difference is the respective monetary policy regimes, with ČNB conducting policy under an inflation targeting regime and the SNB fixing a target range for the reference interest rate (the LIBOR for three-month interbank loans in Swiss francs). This range constitutes the third element of the SNB's monetary policy strategy in addition to the definition of price stability and the conditional inflation forecast (with the overall economic situation also taken into account). A second difference is that the ČNB adopted the floor in response to concerns about substantial deflationary pressures and long-term undershooting of the inflation target, while SNB's floor was directed against excessive overvaluation of the Swiss franc (a safe haven currency) and the harm that this could cause the Swiss economy (via lost competitiveness).

**Chart D ČNB exchange rate floor and the EUR/CZK exchange rate**


*Source: Macrobond.*

**Chart E Comparison of ČNB and SNB exchange rate floors**


*Source: Macrobond.*

A third key difference was the way in which the policy exits were communicated. ČNB was clear from the outset about when the floor would be discontinued (i.e. when the inflation target could be sustainably met over the medium term), while the SNB did not lay down any terms for ending its floor, but rather took a discretionary approach. Another difference is in the post-exit exchange rate regimes, with ČNB returning to a managed floating exchange rate and SNB officially returning to a free floating exchange rate.

It is certainly too soon to assess, in macroeconomic terms, the success or effectiveness of ČNB's use of the exchange rate as a non-standard way to enable sustainable fulfilment of the 2% inflation target in a zero lower bound environment. For the purposes of this policy, ČNB adopted clear and comprehensible forward guidance and communicated the conditions under which the floor was set and the conditions under which it would be discontinued (foreseeable and intelligible for economic agents). In doing so, ČNB confirmed the credibility of its monetary policy. At least from this perspective, the use of the exchange rate as a non-standard monetary policy instrument appears to have so far been successful. It remains to be seen how investors will react in the 'overbought' koruna market (whether they will close their koruna positions immediately, defer closing them, or transform them into another type of investment).

## SUMMARY OF GDP GROWTH PROJECTIONS OF SELECTED INSTITUTIONS

### Table 1 Global economy

| | Release | 2016 | | 2017 | | 2018 | | 2019 | |
|---|---|---|---|---|---|---|---|---|---|
| IMF | April 2017 | 3.1 | (=) | 3.5 | (0.1) | 3.6 | (=) | - | - |
| OECD | June 2017 | 3.0 | (=) | 3.5 | (0.2) | 3.6 | (=) | - | - |
| EC | May 2017 | 3.0 | (=) | 3.4 | (=) | 3.6 | (=) | - | - |
| ECB[1)] | June 2017 | 3.2 | (0.1) | 3.5 | (=) | 3.8 | (=) | 3.8 | (=) |

### Table 2 United States

| | Release | 2016 | | 2017 | | 2018 | | 2019 | |
|---|---|---|---|---|---|---|---|---|---|
| IMF | April 2017 | 1.6 | (=) | 2.3 | (=) | 2.5 | (=) | - | - |
| OECD | June 2017 | 1.8 | (0.2) | 2.1 | (-0.3) | 2.1 | (-0.7) | - | - |
| EC | May 2017 | 1.6 | (=) | 2.2 | (-0.1) | 2.3 | (0.1) | - | - |
| Federal Reserve | March 2017 | - | - | 2.1 | (=) | 2.05 | (0.05) | 1.9 | (=) |

### Table 3 Euro area

| | Release | 2016 | | 2017 | | 2018 | | 2019 | |
|---|---|---|---|---|---|---|---|---|---|
| IMF | April 2017 | 1.7 | (=) | 1.7 | (0.1) | 1.6 | (=) | - | - |
| OECD | June 2017 | 1.7 | (=) | 1.8 | (0.2) | 1.8 | (0.2) | - | - |
| EC | May 2017 | 1.8 | (0.1) | 1.7 | (0.1) | 1.8 | (=) | - | - |
| ECB | June 2017 | 1.7 | (=) | 1.9 | (0.1) | 1.8 | (0.1) | 1.7 | (0.1) |

### Table 4 Czech Republic

| | Release | 2016 | | 2017 | | 2018 | | 2019 | |
|---|---|---|---|---|---|---|---|---|---|
| IMF | April 2017 | 2.4 | (-0.1) | 2.8 | (0.1) | 2.2 | (-0.2) | - | - |
| OECD | June 2017 | 2.3 | (-0.1) | 2.9 | (0.4) | 2.6 | (=) | - | - |
| EC | May 2017 | 2.4 | (=) | 2.6 | (=) | 2.7 | (=) | - | - |
| ČNB | May 2017 | 2.3 | (-0.1) | 2.9 | (0.1) | 2.8 | (=) | - | - |

### Table 5 Hungary

| | Release | 2016 | | 2017 | | 2018 | | 2019 | |
|---|---|---|---|---|---|---|---|---|---|
| IMF | April 2017 | 2.0 | (=) | 2.9 | (0.4) | 3.0 | (0.6) | - | - |
| OECD | June 2017 | 1.9 | (0.2) | 3.8 | (1.3) | 3.4 | (1.2) | - | - |
| EC | May 2017 | 2.0 | (0.1) | 3.6 | (0.1) | 3.5 | (0.3) | - | - |
| MNB | March 2017 | 2.0 | (-0.8) | 3.6 | (=) | 3.7 | (=) | 3.2 | - |

### Table 6 Poland

| | Release | 2016 | | 2017 | | 2018 | | 2019 | |
|---|---|---|---|---|---|---|---|---|---|
| IMF | April 2017 | 2.8 | (-0.3) | 3.4 | (=) | 3.2 | (-0.1) | - | - |
| OECD | June 2017 | 2.7 | (0.1) | 3.6 | (0.4) | 3.1 | (=) | - | - |
| EC | May 2017 | 2.7 | (-0.1) | 3.5 | (0.3) | 3.2 | (0.1) | - | - |
| NBP | March 2016 | 2.8 | (-0.2) | 3.7 | (0.1) | 3.3 | (=) | 3.2 | - |

*1) Global economic growth excluding the euro area.*
*Note: Data in brackets denote the percentage point change from the previous projection.*