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EUROSYSTÉM

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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

In line with expectations, the global economy's growth picked up in the second quarter of 2017, based on strengthening activity in both advanced and emerging market economies. After softening temporarily at the beginning of the year, confidence indicators, and later also hard data, began pointing to an improvement in global economic growth supported by favourable financial conditions, accommodative monetary policies, flexible financial markets and robust capital flows.

Looking at the advanced world, Japan's economic growth in the second quarter was notably higher than expected, reaching its highest level for two years. The strengthening of the country's domestic demand was supported mainly by domestic consumption as well as by capital expenditure. Previously weak consumption has prompted the central bank, on several occasions since the introduction of quantitative easing in April 2013, to put back the date when it expects the inflation target to be met. Net exports had a negative impact on second-quarter GDP growth, whereas previously they were driving activity growth as a result of the revival in foreign trade with Asian countries. A supportive economic policy combined with loosening of financial conditions and growing foreign demand are expected to boost the Japanese economy in the short term. However, the gradual fading of fiscal stimuli, as well as subdued growth, may act as a drag on GDP growth. In the United States, too, economic growth accelerated in the second quarter, as a marked pick-up in private consumption and the neutral impact of changes in inventories outweighed the negative contribution of a slowdown in investment growth. Going forward, activity growth is expected to gain further momentum as dollar depreciation and increasing global demand boost net exports. At the same time, upward trends in property and share prices, alongside elevated consumer confidence and a tightening labour market, could support private consumption. Moreover, the favourable trend in business confidence implies a positive contribution from investment demand. As in the previous quarter, the moderate acceleration in euro area economic growth had a positive impact on the global economy. Activity growth in the euro area was driven mainly by domestic demand, as the positive contributions of both private and public consumption increased and the impact of investment demand returned to positive territory. Export growth continued to exceed import growth, but since the gap was lower compared with the previous quarter, net exports' positive contribution to GDP growth fell. Changes in inventories continued to have a negative impact on activity growth. The euro area economic recovery is expected to be maintained on the basis of an accommodative monetary policy stance, progress in balance sheet adjustment across sectors, and the upward impact of favourable labour market developments on domestic demand. Despite the euro's current appreciation trend, euro area exports are expected to benefit from the global recovery. In the United Kingdom, economic growth remained subdued in the second quarter, with households reining in spending in an environment of rising inflation and falling real incomes. In the period ahead, these trends are expected to continue and, furthermore, private consumption may curb any further depreciation of the pound sterling. Investment growth also slowed, while heightened uncertainty surrounding the future terms of trade deals represent a downside risk to the investment demand outlook. Foreign trade also failed to support UK growth in the second quarter, as the equal levels of export and import growth resulted in net trade having a neutral impact. Although the UK's vote to leave the European Union did not have serious repercussions on the UK economy in the immediate wake of the referendum, expectations of a deterioration in its economic performance are beginning to be fulfilled, partly owing to a decline in the country's openness.

The overall performance of emerging market economies (EMEs) in the second quarter of 2017 included a strong positive contribution from China's economy. Its growth gathered pace in the period under review, driven by strong consumption supported by government policies, the revival of private investment, and a robust property market. While the policy of reducing interbank market liquidity in response to the non-financial sector's rising indebtedness has resulted in a tightening of financial conditions, its impact has not yet been reflected in the broader economy. In view of political factors later in the year (the presidential election), the Chinese authorities' short-term focus is on keeping economic growth stable and meeting the growth target of 6.5%. Over the medium term, the gradual introduction of structural reforms is expected to slow economic growth. As for risks to financial stability in China, they include the consequences of continuing strong credit growth and potential capital flight. India's economic growth in the second quarter was similar to that in the previous quarter, but its pace remained lower than last year's rates owing to the lagged impact of the November 2016 demonetisation of the highest denomination banknotes and the effects of goods and services tax reforms. Domestic demand was the engine of economic growth, with investment, after its decline at the beginning of the year, once again making a positive contribution. Net trade, however, had a negative impact. Once the effects mentioned above have ceased weighing it, India's economic growth is expected to pick up significantly, supported by favourable financial conditions and various reform initiatives aimed at bolstering productivity. According to preliminary data, Russia's GDP growth also increased in the second quarter, probably driven by private consumption and investment and with net trade making a positive contribution. Leading indicators point to favourable trends in industrial production and construction. Furthermore, looking ahead, oil prices may support recovery while increasing real wages and improving consumer confidence may stimulate private consumption. At the same time, looser monetary policy may increase households' propensity to consume at the expense of saving. In the medium term, however, economic growth will be below its long-run average as underinvestment and structural deficiencies weigh on productivity. Brazil's economy growth was lower in the second quarter than in the first, but the fact that it was positive for a second successive quarter is evidence of the country's emergence from recession. Brazil's growth was based mainly on private consumption and its recovery is expected to continue amid stabilising business confidence, looser financial conditions and an

Chart 1 GDP growth and the CLI for the OECD area

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

accommodative monetary policy stance. In the medium term, however, political instability and fiscal consolidation could act as a drag on growth.

Quarterly GDP growth in the OECD area increased to 0.7 % in the second quarter of 2017, from 0.5% in the previous quarter. In year-on-year terms, GDP growth accelerated from 2.1% in the first quarter of 2017 to 2.4% in the second. The Composite Leading Indicator for the OECD area[1] continued to increase in the second quarter of 2017, and also in July, thus suggesting that global economic growth will accelerate in the short term.

Going forward, global economic growth is expected to pick-up gradually. The moderate recovery across advanced economies reflects the ongoing support of monetary and fiscal policy amid continuing cyclical recovery and narrowing of the output gap. As for EMEs, China and India are expected to maintain strong growth, but it is above all the strengthening activity of commodity exporters that is expected to drive global output growth.

Global inflation moderated in the second quarter of 2017, owing to the fading impact of past com-

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

modity price increases. Annual consumer price inflation in the OECD area slowed to 1.9% in June 2017, from 2.3% in March. Energy prices were the main determinant of the headline inflation rate, and although their positive impact moderated, it was not offset by the increase in food inflation. Core inflation (excluding energy and food) remained relatively stable in the period under review, with its level in June the same as that in March (1.8%). The disinflationary trend came to an end in July, when the OECD inflation rate rose to 2.0% on the back of increases in the energy and, to a lesser extent, food components. The core rate remained unchanged in July, at 1.8%.

The decline in prices of oil and other commodities in the second quarter is expected to weigh on global inflation in the short term. Over the longer term, however, it is envisaged that a gradual decline in spare capacity will push up consumer prices. Furthermore, the current oil futures curve implies slightly rising prices and therefore indicates that the energy component will make a moderate contribution to headline inflation.

2 Commodities

The average commodity price index fell, quarter on quarter, in the second quarter of 2017, reflecting declines in both energy and non-energy commodity prices.

Looking at energy commodities, the average price of a barrel of Brent crude oil fell to USD 50 in the second quarter, around USD 4 lower than in the previous quarter. The oil price drop stemmed mainly from an increase in US production and concerns about its further increase. Although the oil price increased briefly in mid-May in response to the decision of the largest oil producers to extend their supply restraint beyond the term set out in the recent OPEC and non-OPEC members' agreement, the price started falling again on the back of oil production figures in Libya and Nigeria. These raised doubts about whether the above-mentioned production cuts would be sufficient to drain excess inventories. As for other energy commodities, prices of both coal and gas also fell, owing to a slowdown in demand. In the category of non-energy commodity prices, all the principal components fell in quarter-on-quarter terms. In the case of food commodities, the price level reflected declines in prices of cocoa, coffee, vegetable oils, sugar and soya, the impact of which was not offset by increases in meat and cereal prices. As for the price level of agricultural commodities, its fall stemmed mainly from a drop in rubber prices. The metal component of the non-energy commodity price index fell mainly on the back of a decline in iron ore prices, a consequence of weakening demand in China caused by a squeeze on lending and a gradual decline in steel consumption. Nickel prices fell amid a reduction in China's imports of the commodity and an increase in supply from Indonesia and the Philippines.

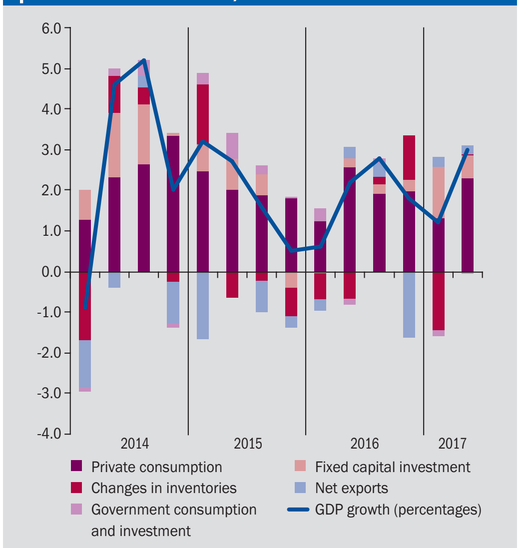
3 The United States

US economic growth rebounded in the second quarter of 2017 after two quarters of deceleration. The annualised rate of GDP growth increased to 3.0%, from 1.2% in the first quarter, while the year-on-year rate increased to 2.2%, from 2.0%.

The acceleration in US activity growth was driven mainly by private consumption, in particular households' increasing demand for durable goods (mainly clothing and footwear) and non-durable goods (mainly recreational goods and motor vehicles). Changes in inventories had a neutral impact on GDP growth in second quarter GDP after making a sizeably negative contribution in the previous quarter. Investment demand continued to increase, albeit more moderately compared with the previous quarter. Non-residential investment maintained robust growth, with an acceleration in investment in equipment offsetting a slowdown in structural investment growth. Residential investment weighed on headline growth, as it corrected after strong growth in the first quarter. Buoyed by global economic growth, as well as by dollar depreciation, net exports made a moderately positive contribution. The government sector continued to have slightly negative impact owing to declining consumption and investment at both the federal and state levels. US GDP growth is expected to gain further momentum in the next period, as the continuing favourable labour market trends support real consumption and in the light of survey indicators pointing to a revival in investment.

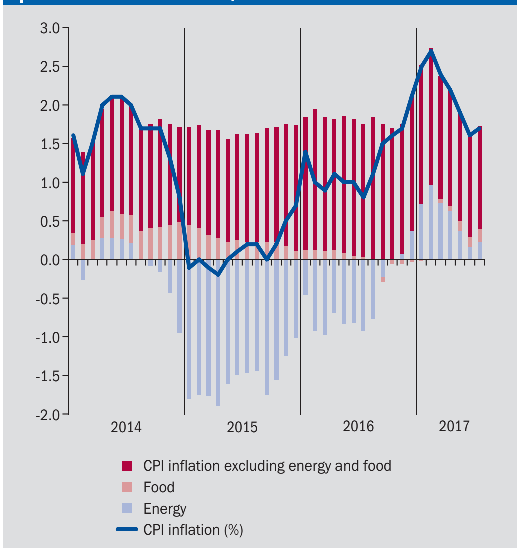
US consumer price inflation softened appreciably in the second quarter of 2017, owing mainly to increasing competition; the impact of demand-side factors was limited. The impact of accelerating food inflation on the headline rate in the second quarter was more than offset by the negative contributions of energy inflation and core inflation, the latter falling to below 2% and hitting a two-year low in May. Energy prices reflected developments in energy commodity prices, while inflation excluding food and energy came under downward pressure from a drop in prices for mobile telephone services. The core rate was further dampened by prices of end-of-lease vehicles, as the market surplus of these vehicles slowed the rate of increase in

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.

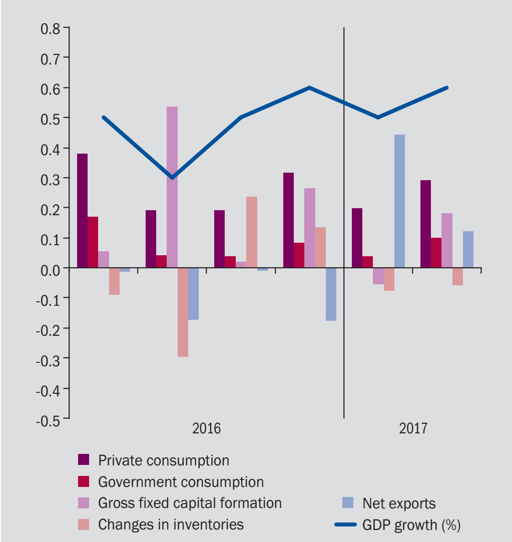
prices of second-hand cars and eventually also prices of new cars. Annual CPI inflation fell from 2.4% in March to 1.6% in June, while the core rate dropped from 2.0% to 1.7%. This disinflationary trend came to an end in July, when the headline rate edged up to 1.7%. While the core rate remained stable (at 1.7%), the food and energy components both increased.

The US Federal Open Market Committee decided at its meeting in May 2017 to leave the target range for the federal funds rate unchanged at 0.75% to 1.00%. In view of realised and expected labour market conditions and inflation, the Committee decided at its June meeting to raise the target range for the federal funds rate for the second time this year and the third time in six months, to 1.00 % to 1.25 %. The Committee left the range unchanged when it met in July. The stance of monetary policy remained accommodative. According to its June press release, the Committee expects to begin implementing a balance sheet normalisation program this year, provided that the economy evolves broadly as anticipated. This program is expected to gradually reduce the Federal Reserve's securities holdings by decreasing reinvestment of principal payments from those securities.

4 The euro area

Euro area economic growth remained relatively robust in the second quarter of 2017, at 0.6% quarter on quarter, 0.1 percentage point higher compared with the previous quarter. Looking at the larger economies within the euro area, the strongest growth was in the Netherlands (1.5%, up by 0.9 percentage point from the previous quarter) and Spain (0.9%, up by 0.1 percentage point). In France and Italy, GDP growth remained unchanged from the previous quarter (at 0.5% and 0.4% respectively), while Germany's economic expansion slowed slightly (by 0.1 percentage point, to 0.6%) but still remained relatively strong. The increase in the euro area's quarterly GDP growth was reflected in the year-on-year growth rate, which accelerated for a third successive quarter from 2.0% in the first quarter to 2.3% in the second.

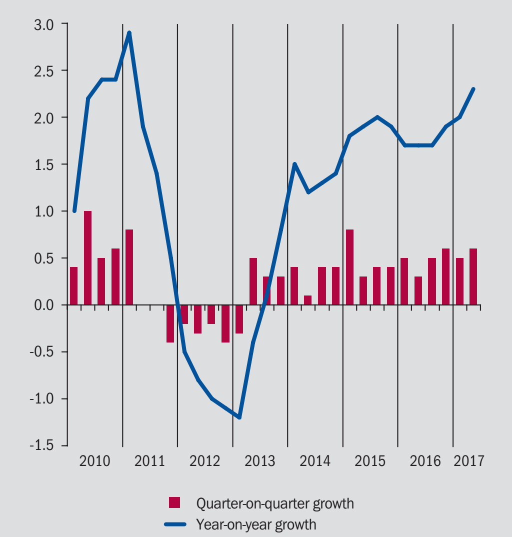
Chart 5 Quarterly GDP growth and its composition (percentages; percentage point contributions)



Sources: Macrobond and NBS calculations.

Domestic demand was the main driver of euro area GDP growth in the second quarter of 2017. Among domestic demand components, only inventories did not make a positive contribution (they fell slightly), while private consumption registered growth of 0.5% (up by 0.1 percentage point from the previous quarter) and investment demand also accelerated, by 0.9%, after falling moderately in the first quarter. According to incoming data on the composition of investment demand, construction investment continued to grow in the period under review, as did investment in machinery and equipment. Net exports contributed positively, but their impact was lower than in the first quarter, as growth in goods and services exports slowed slightly and import growth increased appreciably.

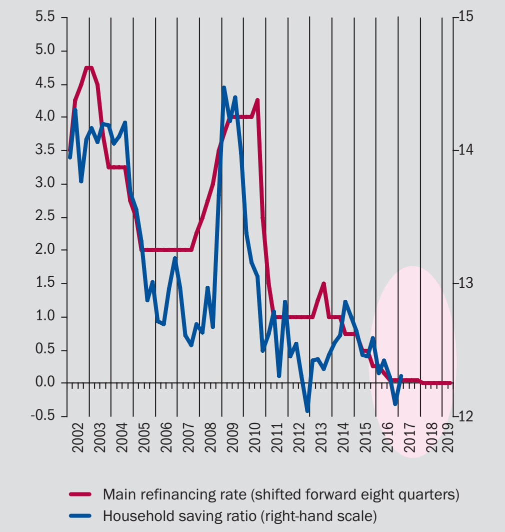
Chart 4 GDP growth (constant prices; percentages)



Source: Macrobond.

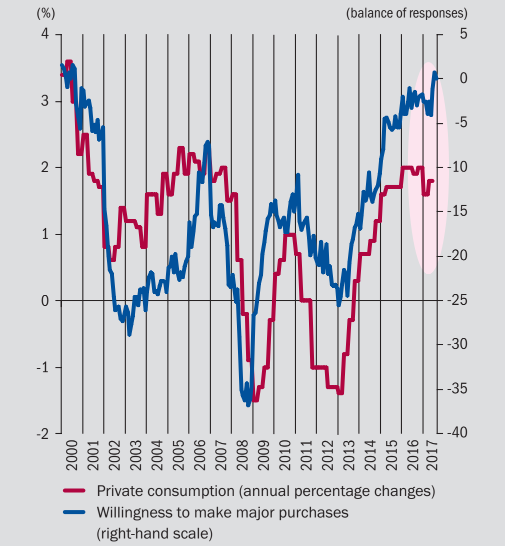
The significant lowering of monetary policy rates, supported by asset purchases as well as other non-standard monetary policy measures, has gradually been reflected in a decline in the saving ratio, a situation conductive to consumption demand growth. Likewise, the willingness of consumers to make major purchases also increased markedly in the summer months, thus boosting outlooks for consumer demand growth in coming quarters. The continuing strengthening of the labour market is also expected to support private consumption.

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



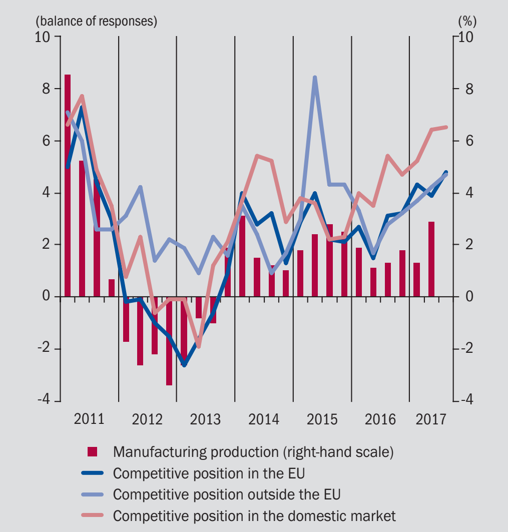
Source: Macrobond.

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.

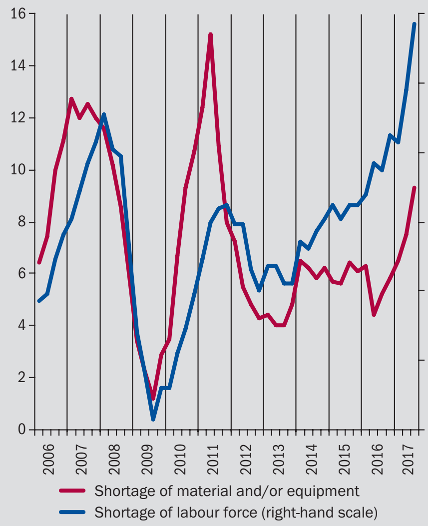
Chart 9 Export expectations in industry (balance of responses) and manufacturing production (annual percentage changes)

Sources: European Commission, Eurostat and NBS calculations.

Looking at industrial firms' assessments of their competitive position in domestic, EU and extra-EU markets, their assessments regarding all three areas continued to improve in the third quarter, thus maintaining an upward trend that now goes back several quarters. These signals are further strengthened by export expectations, which in the third quarter recorded their largest improvement for three and half years and reached their highest level since the second quarter of 2011.

The euro area's economic revival is also evident from industrial firms' assessments of what factors are limiting their production. Survey results for the third quarter of 2017 showed a further drop in the impact of 'insufficient demand', continuing a downward trend that began in the first quarter of 2015 and leaving this factor's level only marginally above pre-crisis levels. Concerns about 'financial constraints' rose marginally, probably in relation to expectations about the ending of the ECB's asset purchase programme. The changing economic situation was evident in the relatively marked third-quarter increases in the importance of 'shortage of labour force' and 'shortage of material and/or equipment', i.e. production factors. The tendency to see these factors as limiting production have been increasing over an extended period and accelerated in the most recent two quarters. The importance of shortage of labour force is now greater than its pre-crisis levels. The overall assessment of production constraints may point to further tightening of the labour market, which may be reflected in wage growth and inflation. At the same time, this assessment implies continuing growth in investment demand.

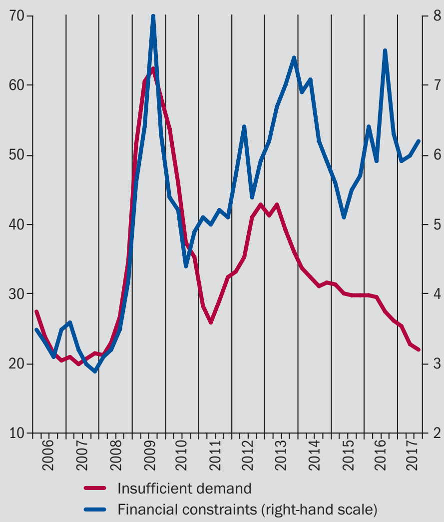
Chart 11 Factors limiting production in industry (percentages)



Source: Macrobond.

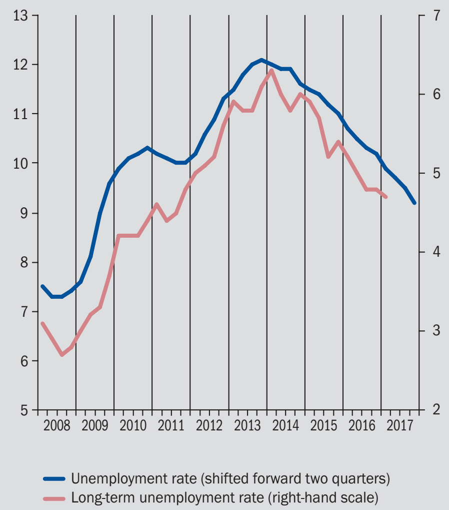
The labour market continued to strengthen in the second quarter of 2017, as the unemployment rate fell gradually, by 0.3 percentage point, to 9.1%. The rate remained at that level in July. Employment expectations in all sectors remain relatively elevated, and although their firming in July was followed by a slight correction in August, their overall trend continues to be upward. Employment expectations in the construction sector improved markedly in July, and stand at their highest level in the post-crisis period. Expectations are very favourable in other sectors, too, with those in services and retail trade approaching pre-crisis levels. In industry, employment expectations increased in both July and August, to reach their highest level since August 2011.

Chart 10 Factors limiting production in industry (percentages)



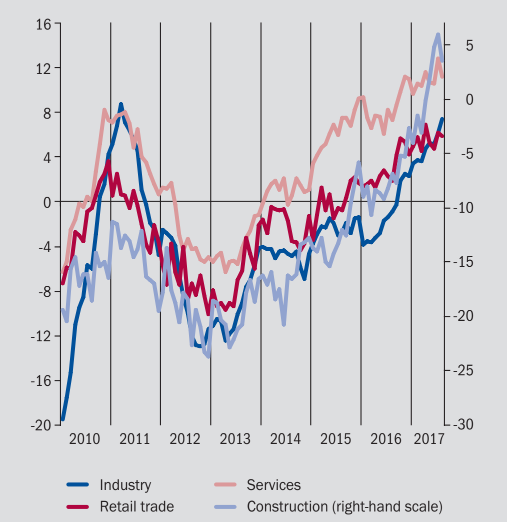
Source: Macrobond.

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



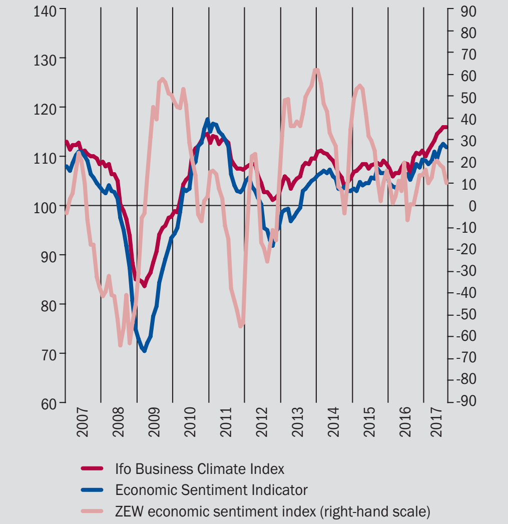
Source: Macrobond.

Chart 13 Employment expectations by sector (balance of responses)



Source: Macrobond.

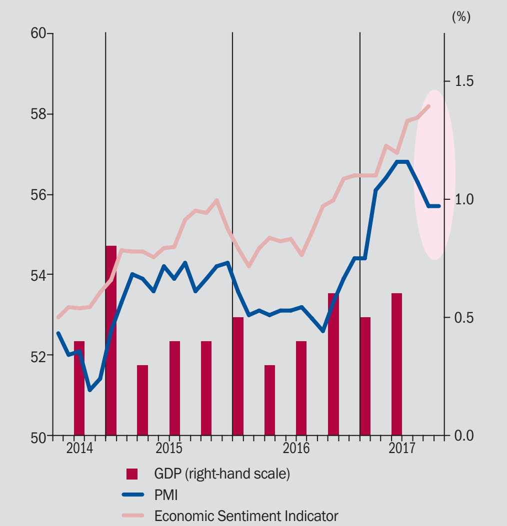
Chart 15 Leading indicators for Germany



Source: Macrobond.

Leading indicators for the euro area in the next period are relatively favourable, pointing to the continuance of relatively strong economic growth. Clearly, however, they are not signalling a further acceleration of economic expansion. While the Eurocoin and the European Commission's Economic Sentiment Indicator (ESI) posted three successive monthly increases, suggesting that euro area GDP growth may gain momentum in the third quarter of 2017, other indicators showed slightly more heterogeneity. The composite Purchasing Managers' Index (PMI) for the euro area was lower in July than in June and remained flat in August. Its average level for those two months was lower than its average for the second quarter, but nevertheless remained consistent with relatively strong economic growth (similar to the growth rate for the second quarter). As regards indicators for the Germany economy, the ZEW economic sentiment index fell for a fourth successive month in August. After declining significantly in July, the PMI for Germany corrected only slightly in August, but although its level was lower than the average for the previous quarter it remained elevated. Both the ESI for Germany and the Ifo Business Climate Index for Germany deteriorated slightly in August, but, unlike the PMI, remained above their average for the second quarter and high in historical terms: the Ifo indicator is at its highest levels since its time series began (1991) and the ESI since July 2011.

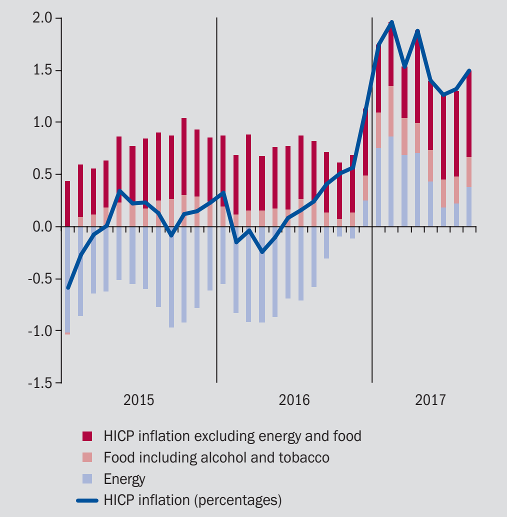
Chart 14 Leading indicators and quarterly euro area GDP growth



Sources: Macrobond, Eurostat and NBS calculations.

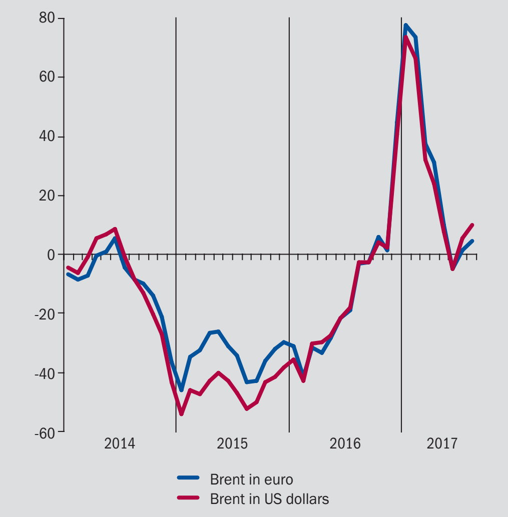
Euro area annual HICP inflation increased to 1.9% in April, from 1.5% in March, owing to Easter-related calendar effects (the holiday fell in April this year and in March last year), which caused volatility in services inflation. After this

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



Sources: Macrobond and NBS calculations.

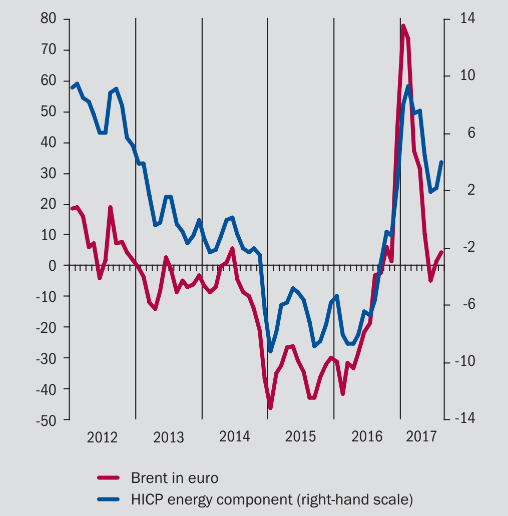
Chart 17 Oil prices in euro and US dollars (annual percentage changes)



Sources: Macrobond and NBS calculations.

factor faded, headline inflation slowed in May and again in June, falling gradually to 1.3%. Although services inflation (calendar effects) contributed the most to May's slowdown in annual inflation, it remained higher compared with March and even accelerated slightly in June. The drop in the headline rate in the other two months of the quarter therefore reflected not only the fading of the calendar effects, but also an appreciable moderation in the annual rate of increase in energy prices and, to a lesser extent, in food prices. Inflation excluding energy and food reflected the volatility in services inflation. Given, however, the heightened rate of increase in both the services component and non-energy industrial goods component, the core inflation rate accelerated gradually, from 0.7% in March to 1.1% in June. Headline inflation continued to accelerate slightly in July and again in August, when it reached 1.5% owing mainly to an increase in energy inflation. Core inflation also edged up in July, to 1.2% (by 0.1 percentage point), its highest level for more than three years.

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



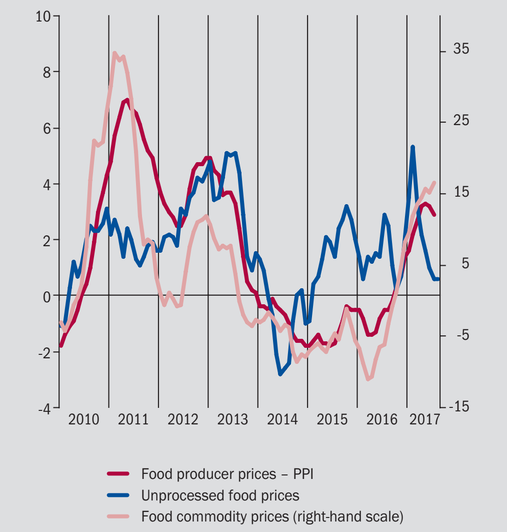
Sources: Macrobond and NBS calculations.

Energy prices remained responsive to annual oil price inflation in the second quarter, which fell quite markedly and turned negative in June. Oil price inflation began accelerating gradually from July, but its pass-through to energy prices in July and August was dampened by the euro's appreciating exchange rate against the dollar. Due to that strengthening, the increase in euro-denominated oil prices in these months was around five percentage points lower than the increase in US dollar-denominated oil prices.

After remaining broadly flat in the first quarter of 2017, food commodity prices in the euro area began to rebound in the second quarter and their year-on-year inflation rate also accelerated. The upturn in food commodity inflation had a gradual impact on processed food price inflation, which accelerated from 1% in March to 1.6% in June, and then up to 2% in August. In addition, current developments in the food commodity market suggest that processed food inflation may increase further. By contrast, unprocessed food inflation slowed throughout the second quarter and subsequent two months, from 3.1% in March to 0.6% in August. Its rate reflected mainly a notable slowdown in the rate of increase in fruit and vegetable prices. Overall, food inflation including alcohol and tobacco moderated from 1.8% in March to 1.4% in August, making a negative contribution to the headline inflation rate.

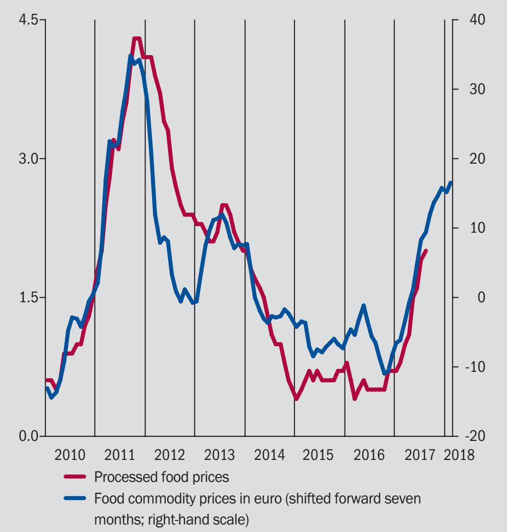
After stagnating for a relatively long period, the demand-sensitive component of the headline inflation rate began to increase gradually in the second quarter and in July and August. Disregarding the volatility caused by Easter-related calendar effects, inflation excluding food and energy reached 1.1% in June and 1.2% in each of the next two months, after five years in which it had broadly oscillated between 0.7% and 1.0 %. Its current upward trend may indicate the start of an upturn in headline inflation. Services inflation accelerated during the second quarter, up to 1.6% in June, i.e. 0.3 to 0.4 percentage point higher than its rate in the period unaffected by calendar effects. The services prices that recorded the largest increase were those related to package tours and accommodation. The signs of acceleration in services inflation may be indicative of increasing consumer demand, which until recently was not having an impact on services inflation. To some extent, however, services inflation may be reflecting the impact of increasing oil inflation. As for non-energy industrial goods inflation, it was 0.1 percentage point higher in June than in March, at 0.4%. The rate then accelerated to 0.7% in July and remained there in August. Its increase was probably supported by the earlier acceleration of import price inflation. The recent strengthening of the euro's nominal effective exchange rate, however, is expected in the months ahead to weigh on both import price inflation and non-energy industrial goods inflation.

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



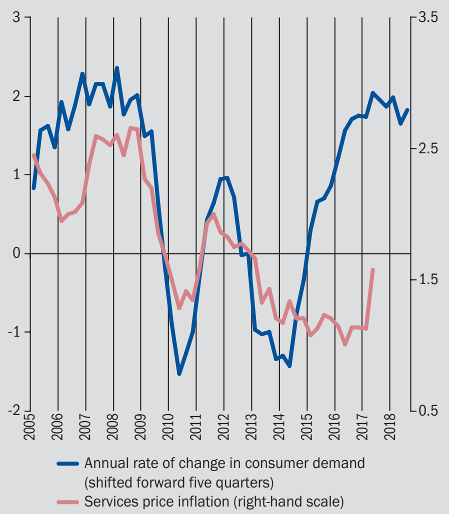
Sources: Macrobond, ECB and NBS calculations.

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



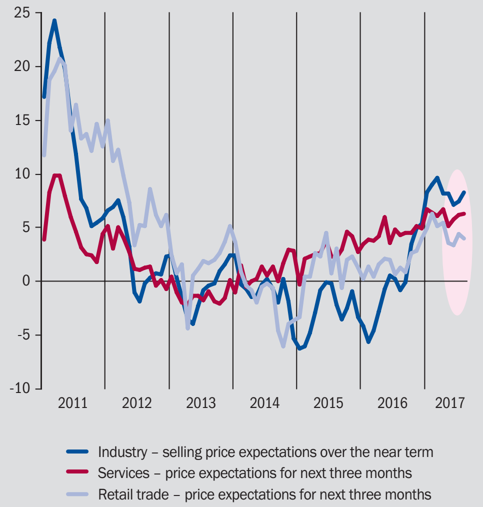
Source: Macrobond.

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



Source: Macrobond.

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

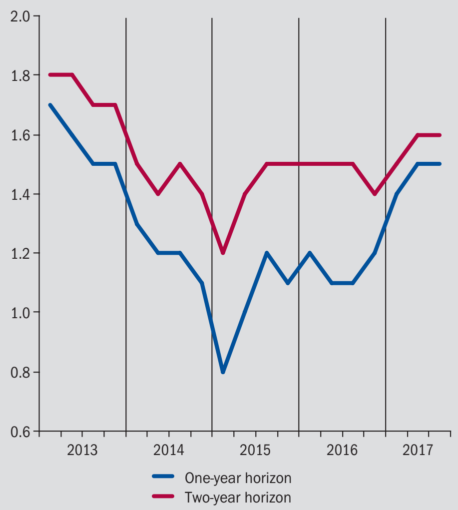


Sources: European Commission and Eurostat.

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 24 HICP inflation – expectations according to The ECB Survey of Professional Forecasters



Source: Macrobond.

Selling price expectations in industry and services increased moderately in the third quarter after their previous decline. The turnaround was least marked in retail trade. Price expectations are expected to have reflected an increase in commodity prices as well as relatively favourable demand and, in the case of industry expectations, an improving competitive position. At the same time, however, some uncertainty may surround future price developments owing to the recent, relatively strong, appreciation of the euro, which from mid-May to the cut-off for this report strengthened by around 7% against the US dollar. This factor was probably reflected in the inflation expectations expressed in the '*The ECB Survey of Professional Forecasters*', which remained unchanged in the third quarter.

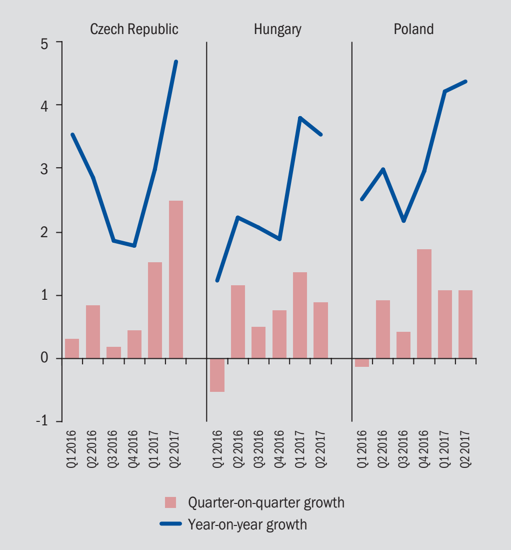
At its meetings in July and September 2017, the ECB's Governing Council decided to leave the interest rates on the main refinancing operations, the marginal lending facility and the deposit facility unchanged at 0.00%, 0.25% and -0.40% respectively. The Council expects the rates to remain at their present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

The Council also confirmed at its July and September meetings 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. At the same time, the net purchases will be made alongside reinvestments of the principal payments from maturing securities purchased under the asset purchase programme (APP). 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 APP in terms of size and/or duration.

5 The Czech Republic, Hungary and Poland

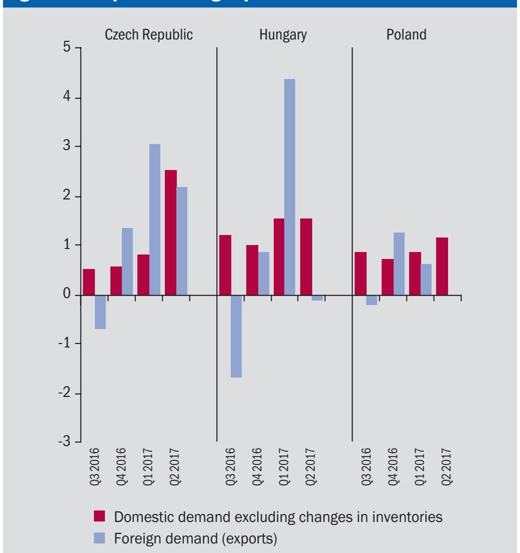
In the Czech Republic, annual GDP growth was significantly higher in the second quarter than in the previous quarter, up by 1.7 percentage points to 4.7%. In Poland the growth rate moderated by 0.2 percentage point, to 4.4%, and in Hungary it slowed by 0.3 percentage point, to 3.5%.

Chart 25 GDP growth (percentages)



Source: Eurostat.

Chart 26 Contributions to quarterly GDP growth (percentage points)

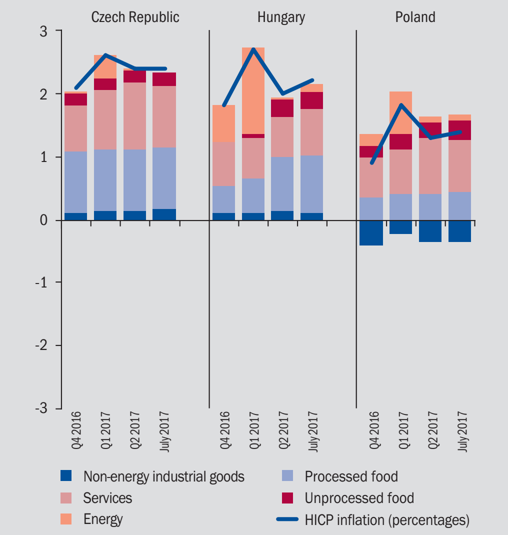


Sources: Eurostat and NBS calculations.

In quarter-on-quarter terms, the Czech Republic was the only one of the reviewed countries to report an acceleration of GDP growth, with the rate increasing by 1.0 percentage point to 2.5%. Hungary's economic expansion eased by 0.5 percentage point, to 0.9% and Poland's remained unchanged, at 1.1%. In the Czech Republic, all expenditure components apart from net exports contributed to quarterly GDP growth, with investment and household final consumption making the largest contributions (each significantly higher compared with the previous quarter). General government consumption accelerated only slightly. Net exports had a negative impact, as import growth was moderately higher than export growth. In Hungary, the slowdown in economic growth was accounted for mainly by investment demand, which recorded a lower rate of increase, and inventories, which declined. On the other hand, the positive contributions of household consumption and general government consumption were both higher compared with the previous quarter. Net exports also contributed positively, as the decline in import growth was greater than the decline in export growth. In Poland, household consumption and changes in inventories made the largest positive contributions to the unchanged quarterly GDP growth. Investment also had a positive impact, as did general government consumption, which accelerated. The negative impact of net exports moderated.

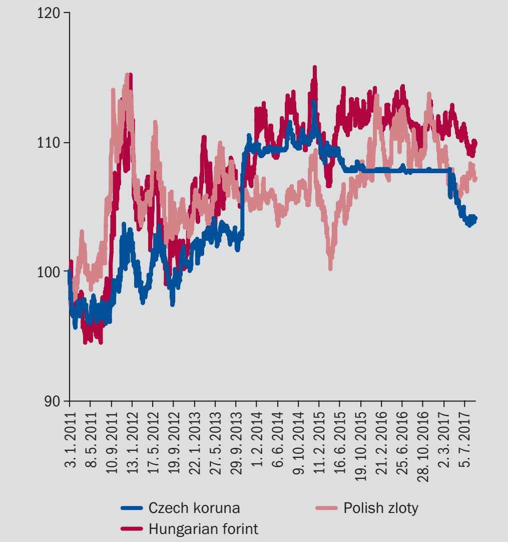
Annual consumer price inflation in all three reviewed countries was lower in June 2017 than in March. In the Czech Republic it slowed by 0.2 percentage point, to 2.4%, in Hungary by 0.7 percentage point, to 2.0%, and in Poland by 0.5 percentage point, to 1.3%. In **the Czech Republic**, energy prices were the largest drag on the inflation rate. Non-energy industrial goods

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.

inflation and food inflation (prices of both processed and unprocessed food) were largely unchanged from the previous quarter. Only the services component increased its contribution to overall inflation. In July, the Czech headline inflation rate remained unchanged from June, with a slight increase in the non-energy industrial goods component offset by a modest drop in services inflation. In **Hungary,** the fall in annual consumer price inflation between March and June was largely accounted for by lower energy inflation, the impact of which was not offset by increases in food inflation and non-energy industrial goods inflation. Services inflation stayed at the same level. In July, Hungary's headline inflation rate increased moderately, owing mainly to an increase in food inflation (both processed and unprocessed food inflation). In **Poland**, the fall in consumer price inflation between March and June was caused mainly by the moderation of energy inflation and to a lesser extent by non-energy industrial goods inflation, which moved further into negative territory. Services inflation made a positive contribution. In July, Poland's headline inflation rate increased slightly, largely on the back of higher food inflation.

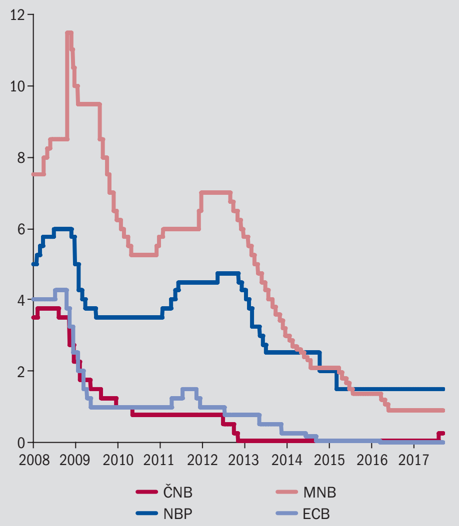
The Czech koruna's exchange rate vis-à-vis the euro at the end of the second quarter was stronger than its rate at the end of the previous quarter (by 3.1%), while the Hungarian forint was weaker (by 0.44 %) and the Polish zloty was largely unchanged (a mere 0.01% stronger).

At an extraordinary monetary policy meeting on 6 April 2017, the Czech central bank decided to end the koruna's exchange rate floor forthwith and to let the euro-koruna exchange rate be determined by supply and demand on foreign exchange markets. While the central bank continued to conduct foreign exchange interventions in April (spending €0.653 billion in the process), it did not make any interventions in subsequent months. Thus the koruna returned to a managed floating exchange rate regime. The koruna's appreciation against the euro in the second quarter was largely a response to favourable domestic economic news, and it was contained to some extent by the 'overboughtness' of the koruna market. The movement of the forint and zloty in the second quarter of 2017 was shaped mainly by favourable trends in financial market sentiment, stemming largely from the French presidential election results (April and May), and

OPEC's agreement on extending production cuts (May), as well as from the monetary policy divergence between major central banks (the Federal Reserve and the ECB). In the case of the Polish zloty, appreciation pressure from favourable domestic economic developments (strengthening domestic demand, rising employment and wages) would have been greater but for political factors (new legislation on the Polish judicial system).

None of the central banks of the three reviewed countries altered its monetary policy rates in the second quarter of 2017. In the Czech Republic, **Česká národní banka** (ČNB) kept its base rate unchanged at 0.05% ("technical zero") throughout the period. At an extraordinary meeting on 6 April 2017, however, the ČNB Bank Board decided that it would immediately end the use of the exchange rate floor as an additional, non-standard instrument of monetary policy, on grounds of the latest available macroeconomic data (inflation reaching the level that the ČNB had considered optimal when it introduced the floor). According to the central bank, the ending of the floor is a first step towards a neutral monetary policy stance and to the implementation of monetary policy via the interest rate channel, and it expects to raise monetary rates gradually in the second half of 2017. In August, the ČNB raised its two-week repo rate by 25 basis points. In Hungary, the **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 second 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), a source of financing for small and medium-sized enterprises (SMEs). The FGS had started to be phased out from January 2016 and was gradually replaced with the central bank's Market-Based Lending Scheme (MLS), under which banks should adjust the financing of SMEs to market conditions. Phase 2 of the MLS was launched on 24 May 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 measure is intended to crowd out additional liquidity from the deposit facility. The upper limit on the stock of three-month deposits held with the MNB as at the end of the second quarter of 2017 was HUF 500 billion (set at the MNB Monetary Council meeting in March). At its meeting in June the Monetary Council set a new upper limit as at the end of the third quarter of 2017. According to the MNB, the settings of its monetary policy (interest rates and changes in monetary policy instruments) 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 second quarter of 2017 (keeping the reference rate at 1.5%). The NBP Monetary Policy Council (MPC) stated that inflation would remain moderate amid fading effects of the past increase in global commodity prices, with only a gradual rise in domestic inflationary pressure stemming from improving domestic economic conditions. The MPC added 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.

SUMMARY OF GDP GROWTH PROJECTIONS OF SELECTED INSTITUTIONS

Table 1 Global economy

	Release	2016		2017		2018		2019	
IMF	July 2017	3.2	(0.1)	3.5	(=)	3.6	(=)	-	-
OECD	June 2017	3.0	(=)	3.5	(0.2)	3.6	(=)	-	-
EC	May 2017	3.0	(=)	3.4	(=)	3.6	(=)	-	-
ECB[1)]	September 2017	3.2	(=)	3.7	(0.2)	3.8	(=)	3.8	(=)

Table 2 United States

	Release	2016		2017		2018		2019	
IMF	July 2017	1.6	(=)	2.1	(-0.2)	2.1	(-0.4)	-	-
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	June 2017	-	-	2.15	(0.05)	2.0	(-0.05)	1.9	(=)

Table 3 Euro area

	Release	2016		2017		2018		2019	
IMF	July 2017	1.8	(0.1)	1.9	(0.2)	1.7	(0.1)	-	-
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	September 2017	1.8	(0.1)	2.2	(0.3)	1.8	(=)	1.7	(=)

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	2.5	(0.2)	3.6	(0.7)	3.2	(0.4)	3.1	-

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	June 2017	2.0	(=)	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	July 2017	2.7	(-0.1)	4.0	(0.3)	3.5	(0.2)	3.3	(0.1)

1) Global economic growth excluding the euro area.
Notes: Data in brackets denote the percentage point change from the previous projection.
The IMF projections of July 2017 cover only large economies.