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EUROSYSTÉM

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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

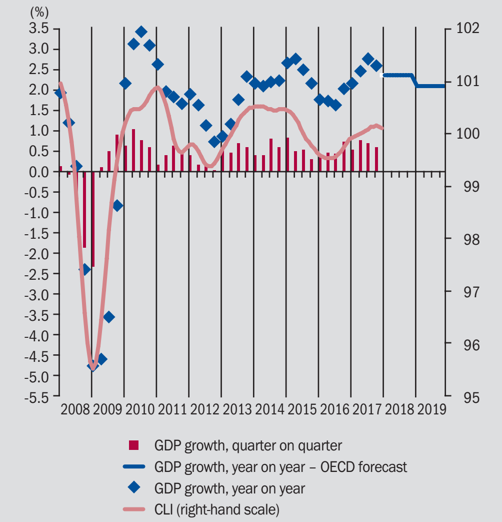
The global economy maintained its growth momentum in the final months of 2017. Although global GDP growth slowed slightly in the fourth quarter of 2017, its rate in the second half of the year was higher than in the first half thanks to the effects of supportive economic policies, favourable financing conditions, rising stock markets and strengthening sentiment.

Looking at advanced economies, GDP growth in the United States fell in the fourth quarter of 2017 as the positive impact of recovering private consumption and investment was more modest than the negative contributions from net trade and inventories. It is expected, however, that the tightening labour market supported wage growth, and consequently also household consumption, and that investment demand continued to grow. Going forward, the US economy is likely to benefit in particular from the fiscal stimulus provided by the new tax reform as well as from the raising of the government debt ceiling. Export growth may be boosted by recent dollar depreciation. In the euro area, GDP growth fell slightly in the fourth quarter of 2017, with the pick-up in investment demand being more than offset by the softening of private and government consumption growth. At the same time, the continuing improvement in exports was accompanied by strong import growth, to the extent that net trade contributed negatively to economic growth. In the United Kingdom, too, GDP growth moderated, as the pick-up in investment demand and government consumption could not offset the impact of lower household consumption growth. At the same time, exports fell and import growth increased, resulting in a strong negative contribution from net trade. In the next period, private consumption may be stimulated by expectations for inflation, which is projected to fall gradually amid the fading impact of the pound sterling's past depreciation. Japan's economic growth also eased in the last quarter, but remained relatively strong compared with its rates in the previous year. The accommodative monetary policy stance and solid job creation supported the recovery of household consumption and investment demand. Export growth increased in response to foreign demand, but it was lower than import growth. The period ahead is expected to see Japanese GDP growth fall further amid declining fiscal policy support and decreasing spare capacity.

Among emerging market economies (EMEs), China maintained robust GDP growth in the fourth quarter of 2017, predicated on strong consumption, government support, a thriving housing market, and export performance. Looking ahead, China's economic performance will depend on the steps that the authorities take to support steady growth and financial stability. The gradual implementation of structural reforms is expected to weigh on growth, and there are downside risks to the growth outlook in the form of high credit growth and potential capital flight. In India, according to available data, the effects on the economy of demonetisation and the goods and services tax reform are gradually fading. Economic growth remained robust in the fourth quarter of 2017, with the year-on-year rate hitting its highest level of the year. The main driver of activity growth was accelerating investment demand; private consumption growth remained stable. Net trade had a negative impact as export growth slowed and imports picked up. Economic growth in the period ahead should reflect mainly the strengthening of the domestic side of the economy, as the above-mentioned reform boosts business investment and productivity. Data for the Russian economy in the fourth quarter of 2017 were not available for this report, but short-term indicators for the period suggest that economic activity growth slowed. These indicators included falls in industrial production and retail sales. At the same time, however, improving consumer and business confidence point to more favourable economic developments. Going forward, the Russian economy is expected to benefit from the accommodative monetary policy, higher oil prices, and the firming of household consumption amid falling inflation. On the other hand, exports will be dented by the country's participation in the OPEC/non-OPEC members' agreement on oil output restraint. The Brazilian's economy's growth rate continued to fall in the final months of 2017, recording its lowest level of the year. The only drivers of GDP growth during the period were investment demand and the government sector, where expenditure increased after six quarters of decline. Private consumption remained flat, while net trade made a negative contribution to growth (although import growth moderated, exports fell). In the following period, the Brazilian economy is expected to be boosted by recovering domestic demand, attributable to improving business and consumer confidence, lower unemployment and favourable financial conditions. On the other hand, the outlook for the Brazilian economy is being undermined by a lack of support for reforming the pension system, which in recent years has been exacerbating the fiscal deficit.

Quarter-on-quarter GDP growth in the OECD area edged down to 0.6% in the fourth quarter of 2017, from 0.7 % in the previous quarter. In year-on-year terms, growth dropped from 2.8% in the third quarter to 2.6% in the fourth. The Composite Leading Indicator for the OECD area[1] increased in the fourth quarter of 2017; however, its monthly figures at end of the year and in early 2018 showed a slight decline that may imply a global economic slowdown in the short-term horizon. Nevertheless, the world economy is maintaining favourable trends, as has been seen in the recent performance of the Global Composite Purchasing Managers' Index (PMI), as well as historically high business confidence indicators, all of which suggest that global growth will remain robust in the beginning of 2018.

Chart 1 GDP growth and the CLI for the OECD area



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

Global GDP growth is expected to remain relatively stable in the first quarter of 2018 and then to begin easing moderately. Global growth is expected to be supported by advanced economies and in particular by the United States, which should be boosted by the fiscal impact resulting from the new tax reform. In some economies, growth may slow going forward owing to positive output gaps. The outlook for EMEs is expected to be supported by strengthening activity among commodity exporters like Brazil and Russia, as well as by the growth momentum in India. In China, however, economic growth will continue to slow.

Global inflation trends moderated in the fourth quarter of 2017. Annual consumer price inflation in the OECD area was marginally higher in the fourth quarter than in the third quarter, although the rate in December was the same as in September (2.3%). The monthly figures basically mirrored the trend in energy inflation, which responded to movements in energy commodity prices. The gradual decline and acceleration of energy inflation therefore determined the course of the headline rate. In October and November food inflation also had an impact on the overall inflation trend. Core inflation contributed positively to the headline rate during the period under review, and its rate in December, 1.9%, was 0.1 percentage point higher compared with September. In January OECD inflation slowed, with the food component remaining unchanged and energy prices again having a key negative impact. With core inflation also falling (back to 1.8%), the annual headline rate dropped to 2.2% in January.

Global inflation is expected to rise in the short term, largely on the back of rising energy infla-

1 *The CLIs for OECD countries are published on a monthly basis, and the most recent, published in March 2018, are for the period up to January 2018.*

tion that will reflect the recent increase in oil prices. Since the current oil futures curve anticipates falling oil prices in the period head, the energy price contribution to global consumer price inflation is expected to be negative. Over the longer term, however, it is envisaged that a gradual decline in spare capacity will push up consumer prices.

2 Commodities

The average commodity price index was higher in the fourth quarter of 2017 than in the previous quarter, reflecting increases in prices of both energy and non-energy commodities.

Looking at energy commodities, the average price of a barrel of Brent crude oil increased in the fourth quarter of 2017 by around USD 9 quarter on quarter, to USD 61. Its trend stemmed partly from the continuing robust growth in global demand but mainly from expectations ahead of the decision to extend the OPEC/non-OPEC output restraint agreement. The rising oil price stoked concerns that the United States will raise shale oil production and thus increase global oil supply. Although the oil price stabilised temporarily in response, November's decision to extend the OPEC/non-OPEC agreement until the end of 2018 triggered strong growth in the oil price, which continued in the beginning of 2018 up to the level of USD 70. The increase was partly supported by output disruptions as well as by geopolitical tensions in the Middle East. In early February the price fell slightly amid increasing US shale oil production. As for non-energy commodity prices, metal prices increased in the latter part of 2017 amid positive industrial activity outlooks. Improving outlooks for processing industry were reflected mainly in increasing prices of aluminium, copper, nickel and zinc. Tin prices, on the other hand, declined. Iron ore prices also fell on average, owing to rising supply and to expectations of a slowdown in Chinese steel production. Food commodity prices had only a moderate impact on the non-energy commodity price index; the declines in the average prices of wheat, maize coffee and soya owing to abundant global stocks and favourable weather were offset by increases in meat, milk and sugar prices.

3 The United States

In the United States, the annualised rate of GDP growth fell to 2.5% in the fourth quarter of 2017, down from 3.2% in the previous quarter. The year-on-year growth rate edged up from 2.3% in the third quarter to 2.5% in the last quarter.

Private consumption picked up strongly towards the year-end, but it was investment demand, boosted by the reconstruction efforts after the autumn hurricanes in the third quarter, which had the greatest positive impact. A turnaround in residential investment (recording double-digit growth in the fourth quarter after falling in the previous two quarters), together with investment in extractive industry and investment in equipment, ensured that fixed investment made a significant positive contribution to US economic growth. In contrast with previous periods, the government sector, at both the federal and state levels, had a positive impact on growth. A three-year high in consumer spending was reflected in strong imports. Since export growth was more moderate than import growth, net trade had a sizeable downward impact on GDP growth. The strengthening of private consumption also resulted in destocking.

In December the most extensive tax reform in the United States for thirty years was approved. The reductions in the corporate tax rate, from 35% to 21%, and individual income taxes are expected to increase the US fiscal deficit. According to the reform's authors, however, the higher deficit should be covered by revenue resulting from stronger economic growth. The impacts of the reform should start to be seen in the short term. Given, however, the deficit increase and the need to finance it, some international institutions are warning that the tax reform may destabilise the current global economic recovery via its impact on asset prices and threat to financial stability. The US fiscal deficit could be further widened by the approval by Congress in February 2018 of an increase in the ceilings on government expenditure for the next two fiscal years. Another factor that may affect the US economy in the period ahead is the tariffs on imported steel (25%) and aluminium (10%) that the Trump administration announced in March 2018. This measure could adversely affect US trading partners, which may retaliate with their own protectionist measures against the United States.

Inflation in the United States was relatively stable in the fourth quarter of 2017 compared with its trend in previous quarters. After accelerating strongly in the third quarter, annual CPI inflation remained at, or slightly above, 2%. The path of headline inflation mirrored that of its energy component, which responded to movements in energy commodity prices. Energy inflation was largely determined by petrol price inflation, which decreased at the beginning of the fourth quarter owing to the pick-up in oil production after the hurricane season. Petrol prices subsequently reflected an oil price surge, which moderated towards the year-end. Although food prices accelerated in the final months of the year, the impact of food inflation on the headline rate was only marginal, similar to its impact in the previous quarter. After falling or remaining flat in each of the previous months of the year, core inflation increased in October and remained steady during the period under review with the exception of November. Its trend partly reflected a slower rate of decline in used vehicle prices (following the destruction of large numbers of vehicles during the hurricane season) and partly prices of health care goods. Annual CPI inflation in December stood at 2.1%, slightly lower than in September (2.2%), while core inflation increased from 1.7% to 1.8%.

In January 2018 both CPI inflation and core inflation were unchanged from December (at 2.1% and 1.8%). The impact of higher energy inflation on the core rate was offset by lower food inflation. Recent dollar depreciation is gradually feeding through to industrial producer prices and may consequently have an impact on consumer price inflation in 2018. The labour market, too, is indicating inflation pressures, as the decline in unemployment during 2017 could translate into stronger wage growth.

The US Federal Open Market Committee (FOMC) decided at its meeting in October/November 2017 to leave the target range for the federal funds rate unchanged, at 1.00% to 1.25%. At its meeting in December, however, in view of realised and expected labour market conditions and inflation, the Committee decided to raise the target range for a third time in 2017, to 1.25% to 1.5%. Convening again in January 2018, the Committee kept the target range unchanged and continued to evaluate the monetary policy stance as accommodative. In October 2017 the Committee initiated the balance sheet normalisation programme, under which it is gradually reducing the Federal Reserve's securities holdings by decreasing the reinvestment of the principal payments it received from these securities.

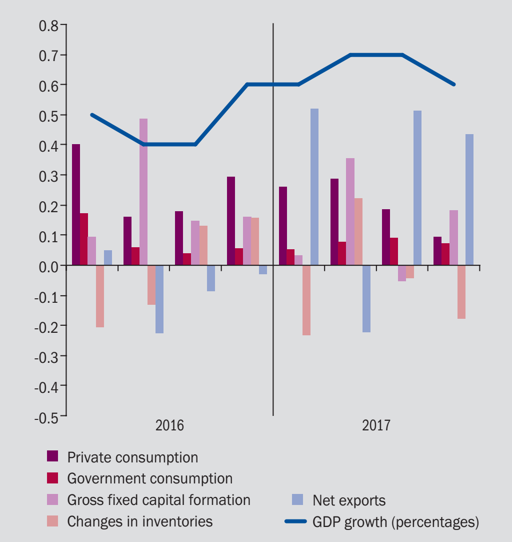
4 The euro area

Euro area economic growth slowed slightly in the fourth quarter of 2017 to 0.6% quarter on quarter (0.1 percentage lower compared with a third quarter rate that was revised up by 0.1 percentage point). Among the larger economies within the euro area, growth moderated in Germany and Italy (by 0.1 percentage point in each case), to stand at 0.6% and 0.3% respectively. Despite the slowdown, Germany's GDP growth remained relatively high. In Spain, growth was unchanged at a strong 0.7%. Growth increased substantially in the Netherlands (by 0.4 percentage point, to 0.8%) and moderately in France (by 0.1 percentage point, to 0.6%). In year-on-year terms, euro area economic growth remained unchanged in the fourth quarter, at 2.7%. GDP growth for the year as a whole stood at 2.3%.

Foreign demand was the main driver of activity growth in the euro area during the fourth quarter. Quarterly export growth accelerated by 0.3 percentage point, to 1.9%, its highest rate in almost three years. Amid rising exports, import growth also increased significantly. As a result, net trade's contribution to economic growth was marginally lower in the fourth quarter than in the third, although it exceeded the contribution of domestic demand. Among domestic demand components, the largest positive contribution to overall growth was made by investment demand, which increased by 0.9% after falling by 0.2% in the third quarter;[2] this turnaround was supported by investment in intellectual property products, which fell sharply in the previous quarter and increased moderately in the last period. Construction investment and investment in machinery and equipment continued to rise, but at a lower pace. On the other hand, investment in transport equipment fell for a second successive quarter. Household consumption slowed for a second quarter running (by 0.1 percentage point, to 0.2%). Government consumption also increased at a slightly slower rate. Inventories, which fell, contributed negatively to economic growth in the fourth quarter.

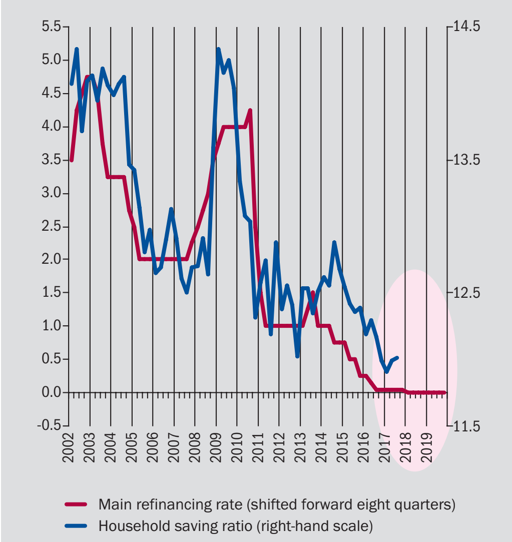
The ECB's accommodative monetary policy implemented through large interest rate cuts and non-standard monetary instruments has resulted in a decline in the saving ratio and has therefore added impetus to consumer demand. Although the saving ratio stopped falling in the second

Chart 2 Euro area GDP and its components (quarter-on-quarter percentage changes; percentage point contributions)



Sources: Macrobond and NBS calculations.

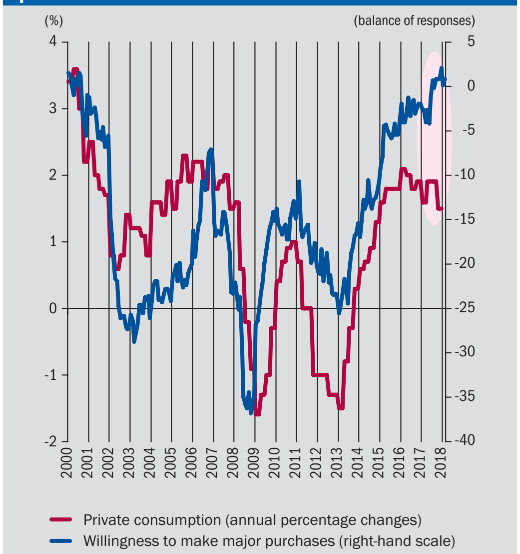
Chart 3 Monetary policy rates and the household saving ratio (percentages)



Source: Macrobond.

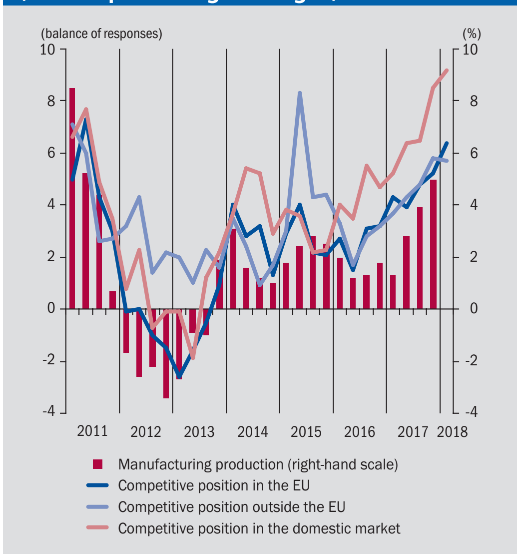
2 *The rate of change in investment demand (gross fixed capital formation) in the third quarter was revised from 1.1% to -0.2% (according to the Eurostat news releases of 7 December 2017 and 7 March 2018 on the GDP and main aggregates estimate).*

Chart 4 Private consumption and consumers' willingness to make major purchases



Source: Macrobond.

Chart 5 Industrial competitiveness (balance of responses) and manufacturing production (annual percentage changes)



Sources: European Commission, Eurostat and NBS calculations.

and third quarters,[3] it remained at historically low levels and is likely to have spurred household consumption behaviour in the next period. Despite waning slightly, households' willingness to make major purchases remains elevated. This supports the still relatively robust outlook for consumer demand growth in the months ahead. After easing slightly in the second half of 2017, consumption growth is expected to increase moderately, supported also by further improvement in the labour market situation as well as by signs of accelerating wage growth. The ECB's indicator of negotiated wage rates points to moderate acceleration of wage growth in the third and fourth quarters (the indicator's year-on-year rate of change increased from 1.47% in the second quarter to 1.55% in the fourth quarter).

The further improvement in industrial firms' assessments of their competitive position in both domestic and EU markets implies that the economy will continue gathering momentum. The current strengthening of industrial firms' market position may allow them to raise selling prices without denting sales. Firms' assessments of their competitive position in extra-EU markets has not changed, remaining at a relatively elevated level that implies a favourable impact on production. As for export expectations, they have fallen slightly, but also remain high.

Chart 6 Export expectations in industry (balance of responses) and manufacturing production (annual percentage changes)

Sources: European Commission, Eurostat and NBS calculations.

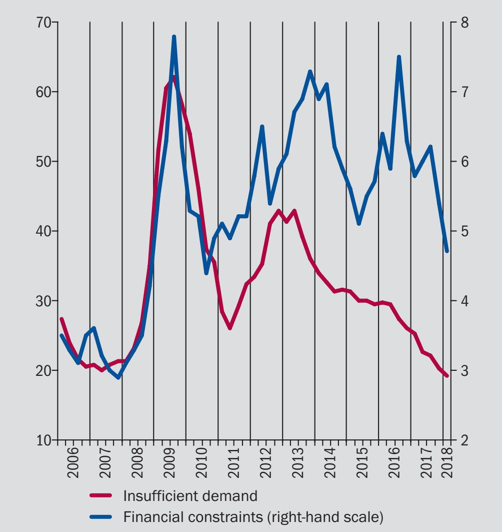
Industrial firms' assessments of what factors are limiting their production point to a continuation of the positive trends in the euro area economy. Survey results in the first quarter of 2018 show rising demand, and improvement in financing conditions, but also increasing capacity utilisation and therefore increases in the impact of

3 *The saving ratio data were available only up to the third quarter of 2017.*

production factors, i.e. 'shortage of material and/or equipment' and 'shortage of labour force'. The importance of 'shortage of demand' fell for an eighth successive quarter, reaching its lowest level since the second quarter of 2001. Concerns about 'financial constraints' also decreased, probably to some extent in response to the ECB Governing Council's decision of October 2017 to prolong the ECB's asset purchase programme until September 2018. On the other hand, the marked increase in the importance of production factors reflects the economic recovery and the economy's changing cyclical position. On the one hand, this implies that investment will be required in order to meet a shortage of equipment/material and should consequently support economic growth. On the other hand, the percentage of responding firms that saw labour shortages as a factor limiting production reached an all-time high in the first quarter of 2018, and that fact indicates further strengthening of the labour market and will probably, after a lag, result in gradual upward pressure on wages and prices.

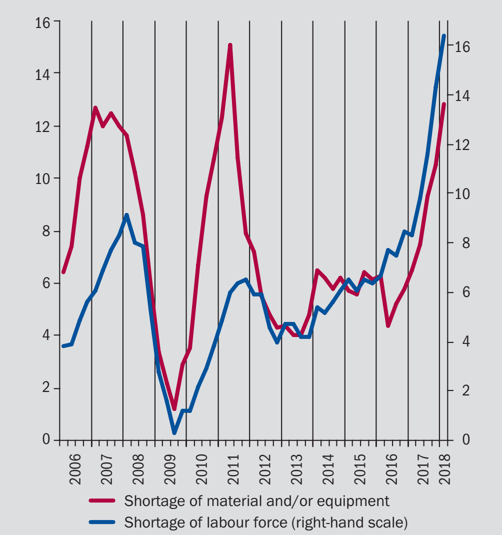
The labour market situation continued to improve in the fourth quarter of 2017, with the unemployment rate falling from 8.9% in September to 8.6% in December. It remained at that level in January 2018. The upward trend in employment expectations, observed across all sectors during the fourth quarter of 2017, came to an end in the first two months of 2018. In industry, the employment outlook began deteriorating in January, while in most other sectors it began doing so in February. Nevertheless, employment outlooks remain relatively elevated, implying the continuation of the favourable labour market situation.

Chart 7 Factors limiting production in industry (percentages)



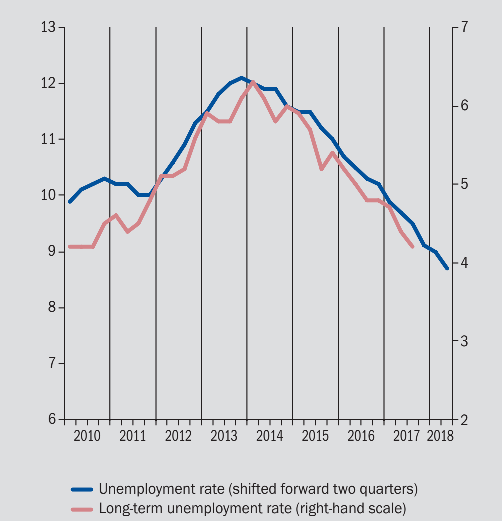
Source: Macrobond.

Chart 8 Factors limiting production in industry (percentages)



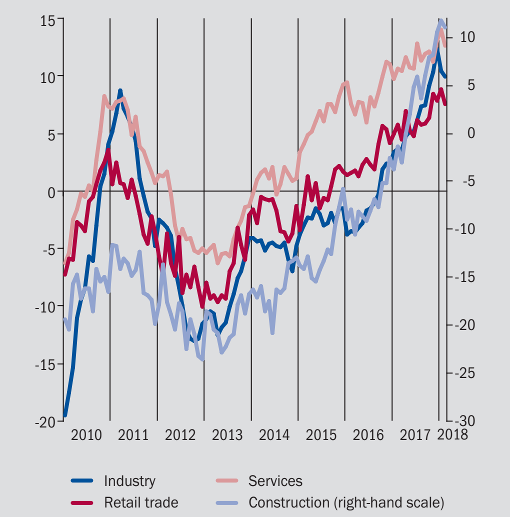
Source: Macrobond.

Chart 9 Unemployment rate and long-term unemployment rate (percentages)



Source: Macrobond.

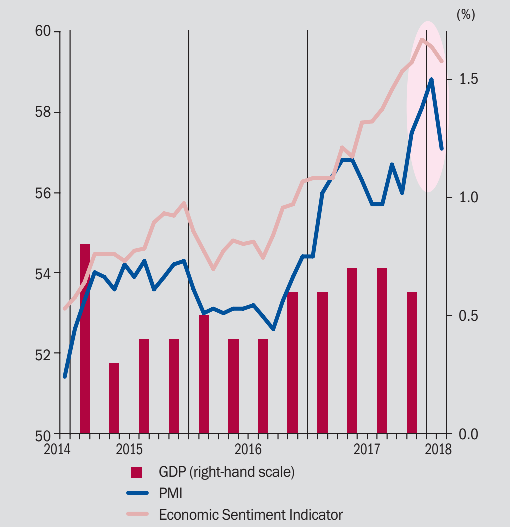
Chart 10 Employment expectations by sector (balance of responses)



Source: Macrobond.

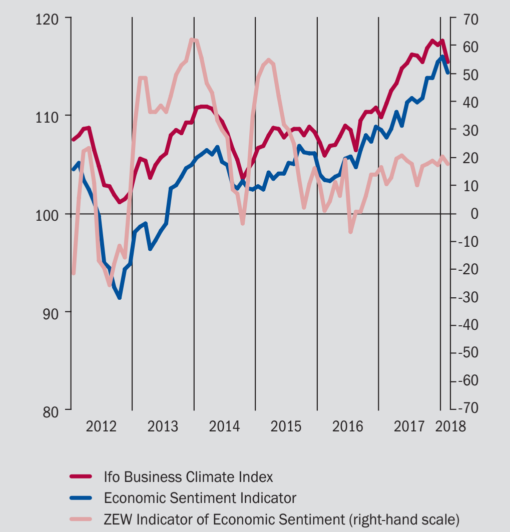
Leading indicators[4] for the euro area remain bright, suggesting that the economy's growth trend will continue. The European Commission's Economic Sentiment Indicator (ESI) increased continuously from June 2017 to December 2017, reaching its highest level for 17 years. Despite falling slightly in the first two months of 2018, it remained relatively high and its average level for those months was marginally above its average for the fourth quarter of 2017. The composite Purchasing Managers' Index (PMI) for the euro area rose sharply in January, and although its level fell slightly in February (to 57.1) it remained well above the threshold (50) indicating economic expansion. The PMI's average for the first two months of 2018 was also above the average for the previous quarter. The Eurocoin indicator increased gradually in both January and February, to extend its upward trend to nine months and approach an all-time high. Like economic activity indicators for the euro area, those for the German economy fell slightly in February, but in the case of the PMI and ESI, remained elevated. The largest drop in February was recorded by the Ifo Business Climate Index, which nevertheless remained only slightly below its historical high. For an extended period now, the ZEW Indicator of Economic Sentiment has been sending less optimistic and less clear signals. After rising significantly in January, it fell in February, and for thirty consecutive months it has been below its long-run average. In general, however, most of the leading indicators for the euro area and for Germany point to a continuation of favourable economic trends, although the prospect of a further acceleration in growth has become less likely.

Chart 11 Leading indicators and quarterly euro area GDP growth



Sources: Macrobond, IHS Markit and NBS calculations.

Chart 12 Leading indicators for Germany



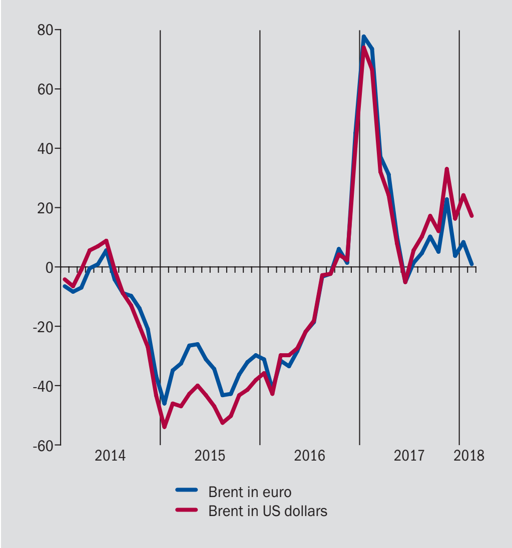
Source: Macrobond.

4 *The indicators' movements reflect their different respondent bases (this may be a reason why responses to the ZEW survey were more pessimistic than those to other surveys).*
The Ifo Business Climate Index (index: 2000 = 100; seasonally adjusted) is conducted on around 7,000 respondents from German firms in industry, construction, wholesale trade, and retail trade.
The ZEW Financial Market Survey is conducted on around 350 experts from banks, insurance companies and financial departments of selected corporations in Germany.
The PMI® for the euro area, published by IHS Markit, is based on original survey data collected from a representative panel of around 5,000 manufacturing and services firms in the euro area.
The ESI is based on the European Commission's harmonised business and consumer surveys, which use a common methodology and are conducted at the national level by partner institutes. For the euro area ESI, the respondents comprise consumers (around 30,000) and representatives of firms in the following sectors: industry (around 25,500), investment (around 29,700), services (around 25,900), retail trade (around 17,900) and construction (around 10,600).

Euro area annual HICP inflation remained broadly stable during the fourth quarter of 2018. The energy and, to a lesser extent, food components had the greatest impact on the headline rate, which was 0.1 percentage point lower in December, at 1.4%, than in September. While food inflation increased slightly, energy inflation moderated. HICP inflation excluding food and energy also fell slightly in the fourth quarter (by 0.2 percentage point, to 0.9%), owing to a drop in services inflation. Energy inflation continued to slow in the first two months of 2018, and with food inflation also falling, the headline inflation rate declined to 1.2% in February. On the other hand, non-energy industrial goods inflation rose both in January and February and services inflation increased in February. Their movement was reflected in the inflation rate excluding food and energy, which edged up to 1.0% and partly moderated the slowdown in the headline rate.

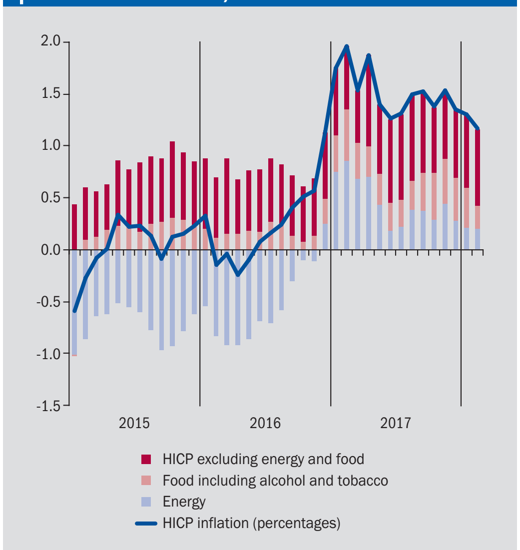
Energy prices reflected year-on-year changes in global oil prices. The rate of increase in the Brent crude oil price (in US dollars per barrel) was approximately twice as high in November as in September, at more than 33%. Partly owing to a base effect, annual oil price inflation for the first two months of 2018 fell back to around the previous September's level (around 17%). In euro terms, annual oil price inflation was significantly dampened by the euro's year-on-year appreciation (whereas in September the euro strengthened by around 6% against the dollar, in December it appreciated by more than 12% and in February by more than 16%). In Novem-

Chart 14 Oil prices in euro and US dollars (annual percentage changes)



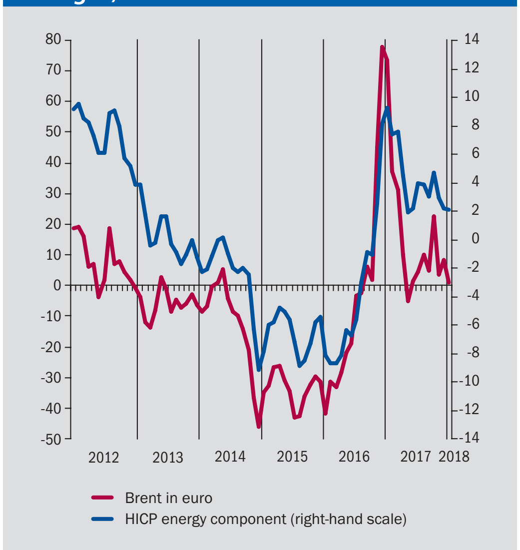
Sources: Macrobond and NBS calculations.

Chart 13 HICP inflation and its components (annual percentage changes; percentage point contributions)



Source: Macrobond.

Chart 15 Oil prices in euro and the HICP energy component (annual percentage changes)

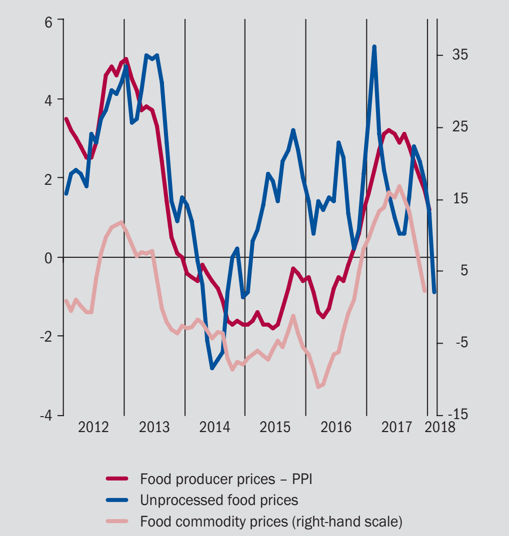


Sources: Macrobond and NBS calculations.

ber, the year-on-year increase in the oil price in euro was around 23% (some 10 percentage points less than the rise in dollar terms). While the rate of increase was more than twice as high in November as in September, it declined in subsequent months, down to only 1% in February. After accelerating significantly in November, consumer energy price inflation slowed gradually in each of the next three months and so did its positive contribution to headline inflation.

After reaching their highest level for more than three and a half years in September 2017, food commodity prices in the euro area[5] began a gradual downward trend. Their year-on-year rate of increase also moderated and began passing through to food producer prices and food consumer prices. Even at the beginning of the fourth quarter, earlier increases in food consumer prices were having an upward impact on food consumer price inflation (it rose from 1.9% in September to 2.3% in October), but the rate declined steadily in subsequent months, falling to 1.1% in February 2018. It was only unprocessed food inflation that fell year on year; processed food inflation accelerated in the fourth quarter

Chart 16 Food prices: commodity, producer and consumer prices (annual percentage changes)



Sources: Macrobond, ECB and NBS calculations.

Chart 17 Food commodity prices and processed food prices (annual percentage changes)

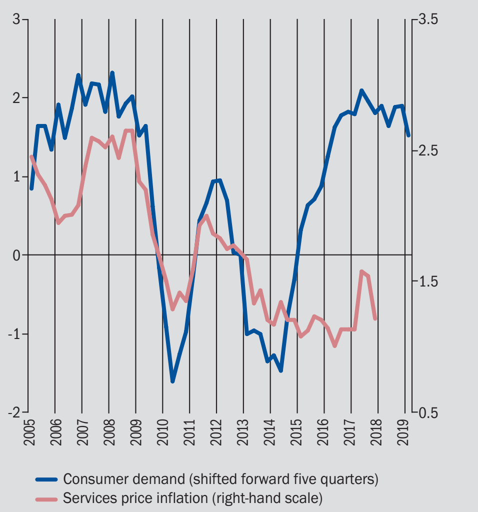
Source: Macrobond.

and also in January 2018, before falling in February. The slowdown in food commodity price inflation also had an impact on food producer prices, and its pass-through to processed food prices is expected to become more pronounced in subsequent months.

Annual HICP inflation excluding energy and food fell by 0.2 percentage point in October, to 0.9%, and remained at that level until the year-end. The main cause of its decline was an appreciable drop in services inflation (from 1.5% in September to 1.2% in subsequent months), reflecting mainly prices of package tours and transport services. Non-energy industrial goods inflation also fell moderately in October, probably reflecting a decline in import price inflation. In December 2017 and the first two months of 2018, the rate of increase in non-energy tradable goods began to moderate, despite falling import prices of consumer goods. In the months ahead, however, import prices will weigh on tradable goods inflation. Services inflation accelerated slightly in February, while the inflation rate excluding energy and food increased to 1.0% in January and was unchanged in February.

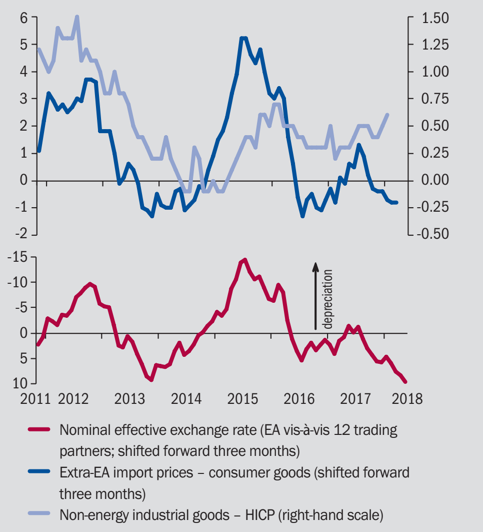
5 *Farm-gate and wholesale market prices, ECB.*

Chart 18 Consumer demand and services price inflation (annual percentage changes)



Source: Macrobond.

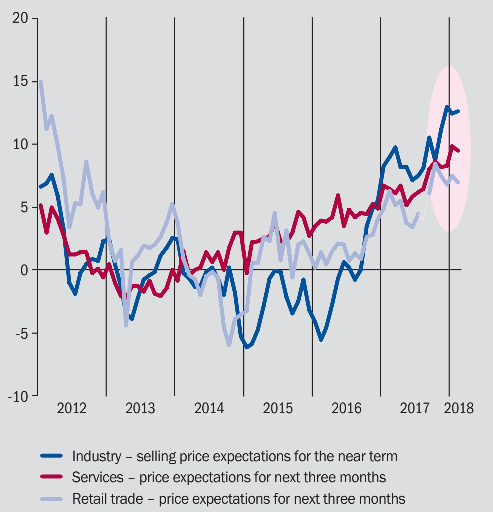
Chart 19 Non-energy industrial goods prices and the nominal exchange rate (annual percentage changes)



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

Selling price expectations in industry and services are following a broadly upward trend, at relatively high levels, albeit with some volatility. In retail trade, however, the expectations stopped rising in late 2017. Overall, selling price expectations have probably been influenced by the ongoing economic growth and the improving competitive position of industry, as well as by the slowdown in consumer demand growth in the third and fourth quarters of 2017. According to the latest ECB Survey of Professional Forecasters, short-term inflation expectations (for a one-year-ahead horizon) have increased moderately, while inflation expectations for a two-year-ahead horizon remain unchanged.

Chart 20 Price expectations in industry, services and retail trade (balance of responses)



Sources: European Commission and Eurostat.

Chart 21 HICP inflation – expectations according to the ECB's Survey of Professional Forecasters

Source: Macrobond.

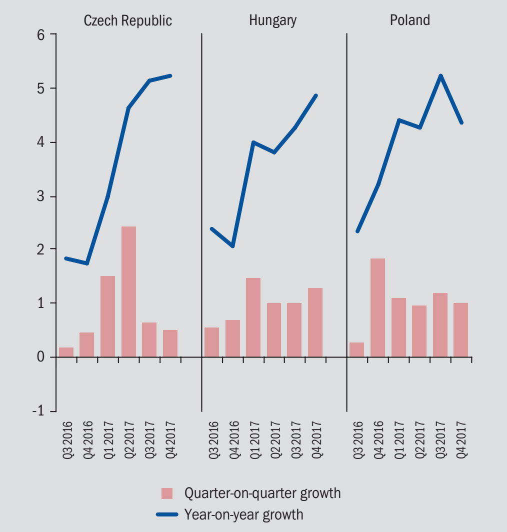
At its meetings in the period from October 2017 to March 2018, the ECB's Governing Council decided to leave the interest rates on the main refinancing operations, the marginal lending facility and the deposit facility unchanged at 0.00%, 0.25% and -0.40% respectively. The Governing Council continued to expect that rates would remain at their present levels for an extended period of time, and well past the horizon of the ECB's net asset purchases.

At its October monetary policy meeting, the Governing Council decided that purchases under the asset purchase programme (APP) would continue at the monthly pace of €60 billion until the end of December 2017 and at a reduced rate of €30 billion from January 2018 until the end of September 2018, or beyond, if necessary, and in any case, until the Governing Council sees a sustained adjustment in the path of inflation consistent with its inflation aim. The Governing Council also decided that the Eurosystem would reinvest the principal payments from maturing securities purchased under the APP for an extended period of time after the end of its net asset purchases, and in any case for as long as necessary. Furthermore, it was decided to continue to conduct the main refinancing operations and three-month longer-term refinancing operations as fixed rate tender procedures with full allotment for as long as necessary, and at least until the end of the last reserve maintenance period of 2019. At the same time, the Governing Council decided to provide additional data on redemptions, as well as information about reinvestments and the role of private sector purchase programmes, with a view to supporting a continued smooth implementation of asset purchases. Also at the October meeting, the Governing Council decided to preserve the very favourable financing conditions that were still needed for a sustained return of inflation rates towards levels that are below, but close to, 2%. At its meetings in December, January and March, the Governing Council confirmed that it intended to make net asset purchases under the APP at a monthly pace of €30 billion until the end of September 2018, or beyond, if necessary, and in any case until it sees a sustained adjustment in the path of inflation consistent with its inflation aim. It also confirmed that the Eurosystem would reinvest the principal payments from maturing securities purchased under the APP for an extended period of time after the end of its net asset purchases, and in any case for as long as necessary. According to the official post-meeting statements, this will contribute both to favourable liquidity conditions and to an appropriate monetary policy stance. The monetary policy meeting statement in March was the first since December 2016 to omit the sentence saying that 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 Governing Council stands ready to increase the APP in terms of size and/or duration.

5 The Czech Republic, Hungary and Poland

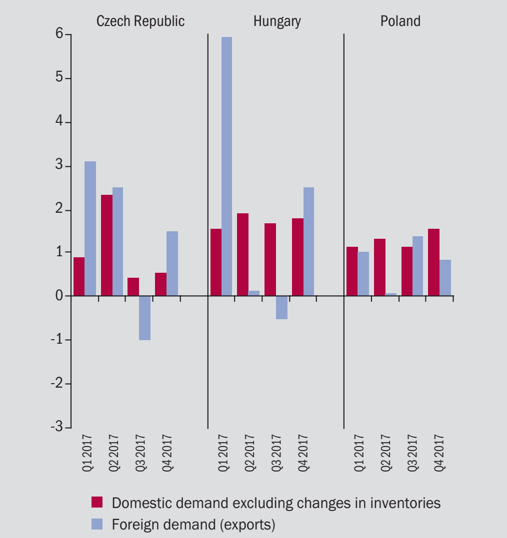
In the fourth quarter of 2017, annual GDP growth increased moderately in the Czech Republic (by 0.1 percentage point, to 5.2%) and markedly in Hungary (by 0.6 percentage point, to 4.9%), but fell in Poland (by 0.9 percentage point, to 4.3%).

Chart 22 GDP (percentage changes)



Source: Eurostat.

Chart 23 Contributions to quarterly GDP growth (percentage points)



Sources: Eurostat and NBS calculations.

Looking at quarter-on-quarter GDP growth in the fourth quarter of 2017, Hungary was the only one of the reviewed countries in which it increased (by 0.3 percentage point, to 1.3%). Quarterly growth fell in both the Czech Republic (by 0.1 percentage point, to 0.5%) and Poland (by 0.2 percentage point, to 1.0%). In the Czech Republic, the slight slowdown was caused mainly by changes in inventories and private consumption growth, which fell slightly quarter on quarter. The negative contribution of net trade to overall growth was more moderate compared with the third quarter; both exports and imports picked up after falling in the previous period, and import growth was slightly higher than export growth. There were positive contributions from government consumption and investment demand. In Hungary, the modest uptick in GDP growth was driven mainly by net trade, as export growth increased significantly and import growth slowed. Both private consumption and investment demand also contributed positively to the acceleration of overall economic growth, while changes in inventories had a negative impact. In Poland, the modest easing of GDP growth stemmed mainly from net trade, which made a negative contribution on the back of accelerating import growth and falling export growth. Changes in inventories also contributed negatively, but to a lesser extent compared with the previous quarter. Other GDP components made positive contributions, with the most notable acceleration observed in investment demand and, to a lesser extent, government consumption. Private consumption growth was unchanged from the previous quarter.

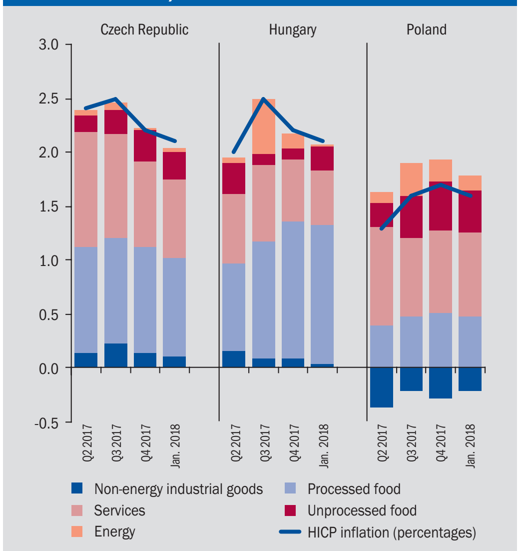
In both the Czech Republic and Hungary, annual consumer price inflation was 0.3 percentage point lower in December than in September, at 2.2% in each case. In Poland, the headline inflation rate was 0.1 percentage higher, at

1.7%. In the **Czech Republic**, the fall in inflation stemmed mainly from the services component, as well as from the non-energy industrial goods and energy components. Processed food inflation was unchanged from the previous quarter, while unprocessed food inflation was the only component that increased. In January 2018, Czech consumer price inflation edged further down, reflecting mainly the impact of the services and unprocessed food components. In **Hungary,** energy prices and, to a lesser extent, services prices made the largest contribution to the decrease in headline inflation. The positive contributions of non-energy industrial goods inflation and unprocessed food inflation were unchanged from the previous quarter, and processed food inflation was the only component to register an increase. In January 2018, Hungary's headline inflation rate slowed slightly further, with non-energy industrial goods inflation and energy inflation remaining flat, services inflation slowing, and only unprocessed food inflation accelerating. In **Poland,** the marginal increase in consumer price inflation was attributable mainly to food prices (in particular unprocessed food prices) and partly also to the services component. On the other hand, non-energy industrial goods inflation moved further into negative territory and energy inflation slowed. In January 2018, the Polish headline inflation rate fell by 0.1 percentage point, owing to energy inflation, which continued easing, and to unprocessed inflation, which declined after increasing in December.

The currencies of all three reviewed countries stood stronger against the euro at the end of the fourth quarter of 2017 than at the end of the third quarter, with the Czech koruna having appreciated by 1.72%, the Hungarian forint by 0.20%, and the Polish zloty by 2.96%.

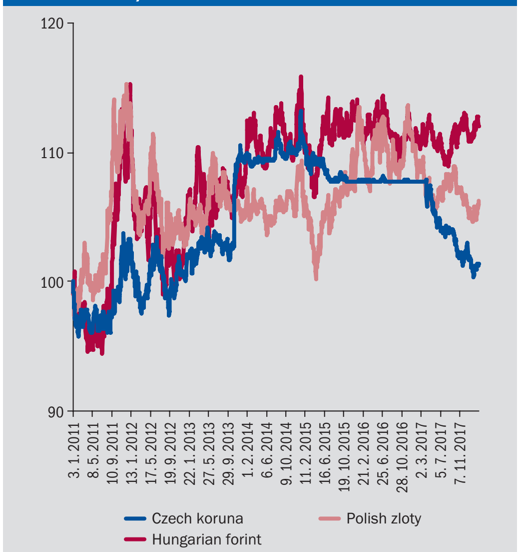
After its relative stability in the third quarter of 2017, the Czech koruna returned to a notable appreciation trend in the fourth quarter, supported by favourable Czech economic data as well as by the anticipation and implementation of monetary policy tightening via increases in the Czech central bank's key interest rates (raising the positive interest rate differential vis-à-vis the euro area). On the other hand, further significant strengthening of the koruna may be unlikely given that the koruna market remains heavily overbought by financial investors and also that domestic exporters were hedging against the koruna prior to the abandonment of the ex-

Chart 24 HICP inflation and its components (annual percentages; percentage point contributions)



Sources: Eurostat and NBS calculations.

Chart 25 Exchange rate indices of national currencies vis-à-vis the euro (index: 3 January 2011 = 100)

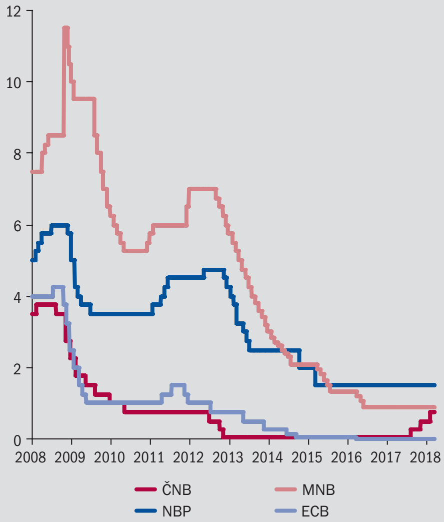


Sources: Eurostat and NBS calculations.
Note: A fall in value denotes appreciation.

change rate floor. The movement of the forint and zloty in the fourth quarter of 2017 reflected mostly financial market sentiment, which in respect of central European currencies was generally favourable. Investment risk was affected mainly by expectations surrounding the monetary policy stances of major world central banks (expectations for an increase in the target range for the US federal funds rate and for tightening of ECB monetary policy), favourable macroeconomic data for the euro area economy and for central European countries, and a positive shift in the 'Brexit' negotiations between the United Kingdom and the European Union. The forint's depreciation also stemmed from the Hungarian central bank's forward guidance about further easing of monetary policy in 2018, via the introduction of unconditional interest rate swap facilities with five-year and ten-year maturities and a targeted programme aimed at purchases of mortgage bonds with maturities of three years or more.

The Czech central bank was the only one of the three countries' central banks that adjusted its monetary policy rates in the fourth quarter of 2017. **Česká národní banka** (ČNB) decided to increase its base interest rate (the two-week repo rate) by 25 basis points, to 0.50%, with effect from 3 November 2017. Also at its November meeting, the ČNB Bank Board increased the Lombard rate, by 50 basis points, to 1.00%, while keeping the discount rate unchanged at 0.05%. According to the Bank Board's explanation, the adjustments were made in response to modest upside risks to the latest inflation forecast at the monetary policy horizon, with the impact of the low inflation environment abroad being insufficient to outweigh domestic inflation pressures. Since inflation expectations are anchored to the inflation target, no surprise increase in interest rates is necessary for now. The ČNB Bank Board also decided to resume publication of the koruna-euro exchange rate forecast, beginning with its publication in the first Inflation Report of 2018. The exchange rate forecast does not imply a commitment to that path and cannot be interpreted as the intended or preferred exchange rate, only as an endogenous variable contingent on the forecast assumptions. In February, the Bank Board raised the base rate by 25 basis points. In Hungary, the **Magyar Nemzeti Bank** (MNB) left its key interest rates unchanged in the fourth quarter of 2017, with the base rate, overnight collateralised lending rate and one-week collateralised lending all standing at 0.90%, and the overnight deposit rate in negative territory at -0.15%. In explaining its stance, the MNB Monetary Council said that leaving its interest rates unchanged and maintaining accommodative monetary conditions for an extended period of time (using also non-standard monetary instruments) was necessary in order to meet the mid-2019 inflation target in a sustainable manner. 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. This measure is intended to crowd out additional liquidity from the deposit facility. The Monetary Council decided that the upper limit on the stock of three-month deposits held with the MNB, which in September it reduced to HUF 75 billion with effect from the end of 2017, would not be reduced further. The Monetary Council also stressed the importance of accommodative monetary policy conditions being effective not only at the short end of the yield curve, but also at the longer end. For that reason, it decided in November that a further two unconventional monetary policy measures would be introduced from January 2018, namely, unconditional interest rate swap facilities with five-year and ten-year maturities (with the maximum allotted amount set at HUF 300 billion for the first quarter of 2018), and a targeted programme for the purchase of mortgage bonds with a maturity of three years or more. Both measures are expected to contribute to an increase in the share of loans with long periods of interest rate fixation. In Poland, **Narodowy Bank Polski** (NBP) left its monetary policy rates unchanged in the fourth quarter of 2017 (the reference rate has remained at 1.5% since 5 March 2015). According to the NBP Monetary Policy Council (MPC) inflation will remain moderate in subsequent quarters. Given incoming data and projections, the MPC said it considered the current level of interest rates to be conducive to keeping the Polish economy on a sustainable growth path and maintaining macroeconomic stability. At its November meeting, the MPC adopted a resolution to reduce the minimum reserve ratio for domestic

Chart 26 Key interest rates of national central banks (percentages)



Sources: National central banks and the ECB.

credit institutions in respect of funds received for at least a two-year period. The ratio was cut to 0% with effect from 1 March 2018. In December the MPC adopted a resolution on the remuneration of minimum reserves, setting the level at 0.50% with effect from 1 January 2018.

SUMMARY OF GDP GROWTH PROJECTIONS OF SELECTED INSTITUTIONS

Table 1 Global economy

	Release	2017		2018		2019		2020	
IMF	January 2018	3.7	(0.1)	3.9	(0.2)	3.9	(0.2)	-	-
OECD	March 2018	3.7	(0.1)	3.9	(0.2)	3.9	(0.3)	-	-
EC	February 2018	-	-	-	-	-	-	-	-
ECB[1)]	March 2018	3.8	(0.1)	4.1	(0.2)	3.9	(0.1)	3.7	(=)

Table 2 United States

	Release	2017		2018		2019		2020	
IMF	January 2018	2.3	(0.1)	2.7	(0.4)	2.5	(0.6)	-	-
OECD	March 2018	2.3	(0.1)	2.9	(0.4)	2.8	(0.7)	-	-
EC	February 2018	-	-	-	-	-	-	-	-
Federal Reserve	December 2017	2.45	(0.1)	2.4	(0.25)	2.1	(0.20)	1.85	(0.05)

Table 3 Euro area

	Release	2017		2018		2019		2020	
IMF	January 2018	2.4	(0.3)	2.2	(0.3)	2.0	(0.3)	-	-
OECD	March 2018	2.5	(0.1)	2.3	(0.2)	2.1	(0.2)	-	-
EC	February 2018	2.4	(0.2)	2.3	(0.1)	2.0	(0.1)	-	-
ECB	March 2018	2.5	(0.1)	2.4	(0.1)	1.9	(=)	1.7	(=)

Table 4 Czech Republic

	Release	2017		2018		2019		2020	
IMF	October 2017	3.5	(0.7)	2.6	(0.4)	-	-	-	-
OECD	November 2017	4.3	(1.4)	3.5	(0.9)	3.2	-	-	-
EC	February 2018	4.5	(0.2)	3.2	(0.2)	2.9	(=)	-	-
ČNB	February 2018	4.5	(=)	3.6	(0.2)	3.2	(0.1)	-	-

Table 5 Hungary

	Release	2017		2018		2019		2020	
IMF	October 2017	3.2	(0.3)	3.4	(0.4)	-	-	-	-
OECD	November 2017	3.9	(0.1)	3.6	(0.2)	2.8	-	-	-
EC	February 2018	3.8	(0.1)	3.7	(0.1)	3.1	(=)	-	-
MNB	December 2017	3.9	(0.3)	3.9	(0.2)	3.2	(=)	2.7	-

Table 6 Poland

	Release	2017		2018		2019		2020	
IMF	October 2017	3.8	(0.4)	3.3	(0.1)	-	-	-	-
OECD	November 2017	4.3	(0.7)	3.5	(0.4)	3.2	-	-	-
EC	February 2018	4.6	(0.4)	4.2	(0.4)	3.6	(0.2)	-	-
NBP	March 2018	4.6	(0.4)	4.2	(0.6)	3.8	(0.6)	3.6	-

1) Global economic growth excluding the euro area.
Notes: Data in brackets denote the percentage point change from the previous projection. The projections of the IMF in January 2018 and the OECD in March 2018 cover only large economies. The European Commission's forecast of February 2018 includes only projections for EU Member States.