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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

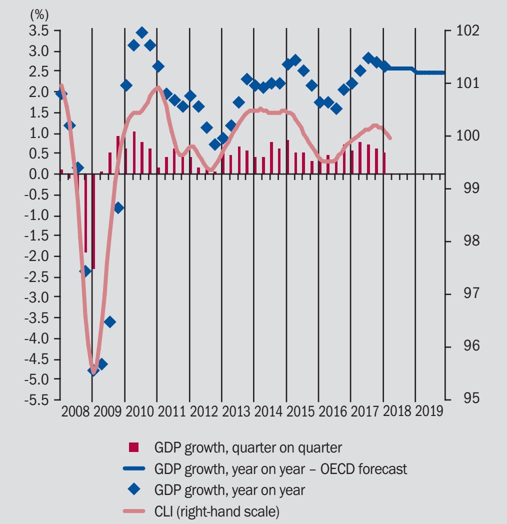
The positive global economic trends of 2017, when world GDP growth was higher than in any year since 2011, continued at the beginning of 2018. Although global activity growth was slightly lower in the first quarter of 2018 than in the fourth quarter of 2017, it continued to be supported by favourable financial conditions, investment recovery, and strong sentiment.

Advanced economies had a dampening impact on global growth in the first quarter of 2018. In Japan, GDP growth moderated after a two-year rising trend, and that expansion was driven almost entirely by net trade. Although export growth softened significantly in response to weakening foreign demand, import growth fell to a far greater extent. Domestic demand made a negative contribution. Investment remained virtually flat for a third successive quarter, and private consumption fell, thereby making the inflation target more difficult to achieve. Government consumption made only a marginal contribution to growth. Japan's economic expansion is expected to decelerate over the next years as fiscal support wanes and spare capacity diminishes. Japan may also become much more vulnerable if trade wars escalate, given its position as a strongly export-oriented economy. Among advanced economies, the United Kingdom registered a significant drop in economic growth. Almost unchanged from the previous quarter, the country's GDP recorded its lowest growth for five years. This outturn reflected a slowdown in private consumption growth, which may stem partly from elevated levels of household debt. Investment growth also fell moderately. While cold weather in February and March may have had a negative impact on domestic demand, it cannot fully explain the economy's marked deceleration. The UK's economic growth is expected to remain modest, given the uncertainty about the eventual result of the 'Brexit' negotiations. Subdued domestic demand is expected to weigh on growth, but that impact should be offset by net trade supported by a weaker pound. The euro area, too, saw its economic growth momentum slow in the early part of the year. Net trade made the largest negative contribution to GDP growth, as export growth fell more markedly than import growth. Investment demand growth also moderated, owing largely to a decline in investment in equipment and machinery. By contrast, private consumption growth accelerated and had a positive impact on overall GDP growth. The impact of government consumption was neutral. In the United States, the lowest growth in consumer spending for almost five years ensured a drop in GDP growth. This result is expected to have been only temporary, given current labour market trends, the strength of consumer confidence, and fiscal stimulus from the US administration. Declines in residential investment and equipment investment also weighed on growth. In the first quarter of 2018 the US administration imposed import tariffs on steel and aluminium on grounds of national security. The measures themselves are not expected to have a significant impact on the US economy, but if trade tensions escalate and other countries respond to the US tariffs with their own protectionist measures, the global economy could be adversely affected.

As for emerging market economies (EMEs), China's economic growth fell slightly in the first quarter of 2018. Both exports and investment demand decelerated. The past driver of GDP growth – infrastructure investment – had the largest negative impact on investment demand. Infrastructure investment growth is expected to remain subdued amid the tightening of monetary policy and a stricter approval processes for local investment projects. China's efforts to reduce pollution also imply a slowdown in industrial production growth. China's first-quarter growth was supported mainly by private consumption in an environment of rising real income and falling unemployment. This was also indicated by stronger-than-expected retail sales. In India, the positive effects of reforms were apparent in the first quarter, as GDP growth was higher than that of any other G20 country. Investment accelerated on the back of increasing capacity utilisation, the recovery of corporate profitability, and the recapitalisation of state banks. By contrast, private consumption remained subdued amid low consumer confidence and rising unemployment. Brazil's economic growth also increased moderately at the beginning of 2018, driven by private consumption despite a rising unemployment rate. GDP growth was also supported by the upward impact of low interest rates and reforms on investment, albeit to a lesser extent compared with the previous two quarters. Export growth also picked up at the beginning of the year, but import growth accelerated even more. The government sector was another negative contributor to GDP growth, since in seeking funds to meet fiscal objectives, it initiated the privatisation of Electrobras, the largest energy company in Latin America. The Russian economy's revival continued against a backdrop of elevated oil prices, improving macroeconomic stability, an accommodative monetary policy stance, and positive trends in the global economy. GDP growth was based largely on domestic demand, as improving business confidence and financial conditions had an upward impact on private investment. Private consumption was supported by public sector wage growth and by households' strengthening expectations. Public spending, which increased thanks to expenditure related to the football World Cup being held in Russia in 2018, also contributed positively to GDP growth. Exports, however, were curbed by Russia's commitment to the OPEC/non-OPEC members' agreement on oil output restraint.

Quarter-on-quarter GDP growth in the OECD area edged down to 0.5% in the first quarter of 2018, from 0.6% in the previous quarter. Growth also declined in year-on-year terms, from 2.7% in the fourth quarter of 2017 to 2.6% in the first quarter of 2018. The Composite Leading Indicator for the OECD area[1] fell slightly in the first quarter of 2018 and dropped again in April, possibly indicating a global economic slowdown in the near term. Nevertheless, the global economy continues to show positive trends, as indicated, for example, by the Global Composite Purchasing Managers' Index (PMI), which after falling notably in March has rebounded and points to the continuation of robust global growth.

Chart 1 GDP growth and the CLI for the OECD area



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

In the near term, broad-based growth is expected to continue supporting global activity. Monetary policy and favourable financial conditions are expected to have a positive impact on advanced economies. The US fiscal stimulus provided by the tax reform and spending increases constitutes, along with the expansionary fiscal policies pursued by other advanced countries, a stimulus for the global economy. The recovery of global trade is expected to benefit emerging market economies, in particular the export-oriented Asian EMEs. At the same time, commodity exporters should be supported by the stabilisation of commodity prices. Downside risks to the global economic outlook include the possibility of further import tariffs that could disrupt international trade links.

In early 2018 the US administration adopted measures aimed at reducing its bilateral trade deficits. In January it imposed import tariffs on solar panels and washing machines, and in March it slapped tariffs on imported steel (25%) and aluminium (10%). These steps were aimed mainly against China, with which the US has long had its highest bilateral trade deficit. A number of trading partners were exempted temporarily (until 1 May 2018) from the tariffs, including Canada, Mexico, the European Union, Australia, South Korea, Brazil and Argentina. The only one of those countries for which the exemption was made indefinite before the deadline was South Korea, after it agreed to a revision of the United States-Korea Free Trade Agreement. An in-principle agreement was also reached with Argentina, Brazil, and Australia. For these countries, the tariff exemption was subsequently made indefinite in exchange for quotas on their exports of steel to the United States, which had been contrib-

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

uting to elevated US steel inventories. Canada, Mexico and the European Union were given an additional 30 days to negotiate permanent exemptions from the steel and aluminium tariffs, but with no deal being reached by the deadline, the tariffs on these countries were imposed with effect from 1 June. Since US imports of products subject to the tariffs amounted to only a marginal share of total US imports, the impact of these measures on the global economy is expected to be limited. If, however, other countries respond to the US tariffs with retaliatory measures, the adverse impact on global trade and, by extension, the global economy could be more severe. Both the International Monetary Fund and OECD have identified possible trade wars as a downside risk to the hitherto favourable outlook for global economic growth.

Global inflation remained relatively stable in the first quarter of 2018. Annual consumer price inflation in the OECD area was the same in March 2018 (2.3%) as in December 2017. The headline inflation rate fell slightly in January and February due to lower energy inflation, and the January rate also came under downward pressure from core inflation. The rebound of headline inflation in March stemmed entirely from the acceleration of inflation excluding food and energy, with food inflation remaining subdued and energy inflation decelerating. Core inflation reached 2.0% in March, which compared with December 2017 was higher by 0.1 percentage point. In April, OECD inflation remained unchanged (2.3%), as the impact of the continuing decline in food inflation and a drop in core inflation (to 1.9%) was offset by an oil-price-driven pick-up in energy inflation.

2 Commodities

The average commodity price index was higher in the first quarter of 2018 than in the fourth quarter of 2017, 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 first quarter of 2018 by around USD 6 quarter on quarter, to USD 67. Its rise reflected several factors: ongoing growth in global demand; rising tensions in the Middle East and concerns about Iranian oil exports; and, above all, the continuing commitment of OPEC and non-OPEC producers led by Russia to their output restraint agreement, and signs that the agreement may be extended to the end of 2019. A brief dip in the oil price during the period under review was caused by an increase in US oil inventories. According to the International Energy Agency (IEA), the oil price's recent rally is leading to a major second wave of shale oil production in the United States, such that could see the United States become the world's largest oil producer in 2019. In 2014 the first wave of US shale oil supply prompted OPEC to squeeze higher-cost producers in order to improve its market share. History could now be repeating itself, warns the IEA. The oil price continued its upward trend into the second quarter, hitting USD 80 per barrel in mid-May in response to such factors as the trade dispute between the United States and China, the economic crisis in Venezuela, the US withdrawal from the 2015 Iran nuclear deal, and concerns about the effect that sanctions on Iran will have on global oil supplies. The oil price corrected at the end of May amid indications that OPEC and non-OPEC producers are scaling back oil production cuts. As for non-energy commodity prices in the first quarter of 2018, average metal prices increased and food commodity prices fell. After increasing in January, the Industrial Metals Index began to fall; nevertheless, its average level for the quarter remained above its average for the fourth quarter of 2017. Metal prices were thus responding to the continuing favourable outlooks for processing industry. The average prices of nickel, tin and zinc rose sharply, and the prices of copper and aluminium increased to a lesser extent. The iron ore price went up at the start of the year as Chinese steelmakers prepared for the lifting of government-imposed production restrictions. At the end of the period under review, however, the ore price was falling amid a cooling of the Chinese real estate market, rising inventories, and the trade dispute between the United States and China. The decline in the food commodity price index was driven mainly by milk prices, which fell owing to overproduction. There were also negative contributions from sugar and coffee prices. Wheat and meat prices remained broadly unchanged, with the impact of falling beef prices being offset by rising pork prices.

3 The United States

In the United States, the annualised rate of GDP growth fell to 2.2% in the first quarter of 2018, down from 2.9% in the fourth quarter of 2017. Thus, expectations that the economy would be boosted by the new tax reform did not materialise. The year-on-year growth rate edged up to 2.8% in the first quarter, from 2.6% in the previous quarter.

The US economy's notable slowdown in the first months of 2018 was caused mainly by private consumption, its growth rate weakened largely by a decline in household spending on durable goods, especially motor vehicles. That spending declined owing to the base effect of its strong growth in late 2017, which was a one-off consequence of the hurricane season. In the fourth quarter of 2017 spending on motor vehicles accounted for 0.5 percentage point of overall GDP growth, but in the first quarter it had a negative impact of 0.3 percentage point. Another cause of the overall slowdown in private consumption growth was weaker growth in spending on non-durable goods and on services. Investment demand also softened, as the impact of accelerating growth in non-residential investment (due to strengthening growth in infrastructure investment and in intellectual property product investment) was more than cancelled out by the decline in residential investment. Government consumption and investment, at both the federal and state levels, also contributed negatively to US economic growth in the first quarter. In contrast to the previous quarter, when its contribution was highly negative, net trade had an almost neutral impact on GDP growth in the first quarter, as import growth fell markedly amid a moderate drop in export growth. Going forward, it is expected that private consumption will gain momentum on the back of positive labour market trends, a falling tax burden and rising real disposable income, and that investment will be supported by the tax reform and still favourable financial conditions. A further boost to the US economy is expected to come from the increase in the ceilings on government expenditure for the next two fiscal years, following its approval in February 2018.

Consumer price inflation in the United States accelerated in the first quarter of 2018. In January and February the headline inflation rate was broadly unchanged from its level in December 2017, with core inflation at the same rate and with the impacts of energy and food price dynamics cancelling each other out. In March, however, inflation climbed to a 12-month high owing entirely to higher rates of change in core inflation components. Both energy and food inflation fell slightly and therefore so did their contributions to headline inflation. The increase in inflation excluding food and energy resulted mainly from prices of wireless telephone services, as their year-on-year rate of change became significantly less negative. Prices of housing-related services accelerated, and so, to a lesser extent, did prices of healthcare services. Core inflation in the United States thus increased from 1.8% in December 2017 to 2.1% in March 2018, and the headline rate climbed from 2,1% to 2.4%. In April, consumer prices maintained their upward trend, with overall inflation edging up to 2.5%. In this case, however, the increase was driven solely by energy inflation (increasing in response to markedly higher energy commodity prices) and food inflation (pushed up mainly by meat prices). Inflation excluding food and energy remained unchanged in April, at 2.1%.

The US Federal Open Market Committee (FOMC) decided at its meeting in January 2018 to leave the target range for the federal funds rate unchanged, at 1.25% to 1.5%. At its meeting in March, however, in view of realised and expected labour market developments and inflation, the Committee decided to raise the target range to 1.5% to 1.75%. At its next meeting, in May, the Committee made no further change to the policy rate. At the June meeting, the target range was increased to 1.75% to 2.0%. According to the Federal Reserve press release issued after that meeting, the stance of monetary policy remains accommodative, thereby supporting strong labour market conditions and a sustained return to 2% inflation.

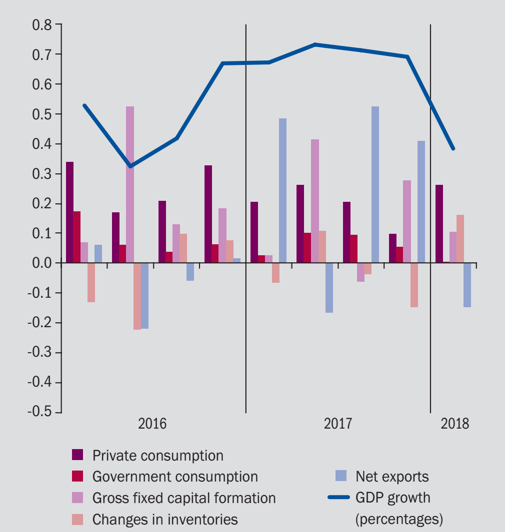
4 The euro area

Euro area GDP growth slowed markedly in the first quarter of 2018, to 0.4%, following growth of 0.7% in the previous five quarters. Looking at the larger economies within the euro area, growth fell most sharply in France (by 0.5 percentage point, to 0.2%) and Germany (by 0.3 percentage point, to 0.3%), and more moderately in the Netherlands (by 0.2 percentage point, to 0.5%) and Italy (by 0.1 percentage point, to 0.3%). In Spain, economic growth in the first quarter was the same as in the previous two quarters, a robust 0.7%. The softening of the euro area's quarterly growth was reflected in the year-on-year GDP growth rate, which fell by 0.3 percentage point, to 2.5%.

Net trade accounted for most of that decline, as exports fell by 0.4%, their first quarterly drop for around five years. With exports declining, imports also fell moderately, partly mitigating the negative impact of net trade on overall GDP growth. By contrast, domestic demand continued to support output expansion, with private consumption accelerating by 0.3 percentage point (to 0.5%) after slowing slightly in the second half of 2017. Government consumption, which throughout 2017 contributed positively to GDP growth, remained flat in the first quarter of 2018. Investment demand increased at a slower pace, owing mainly to a decline in investment in machinery and equipment. There was, however, a moderate acceleration in construction investment and in intellectual property investment. The impact of falling exports, as well as the weakening of investment demand, was partly offset by a relatively strong positive contribution from changes in inventories, which in the previous quarter had a negative impact.

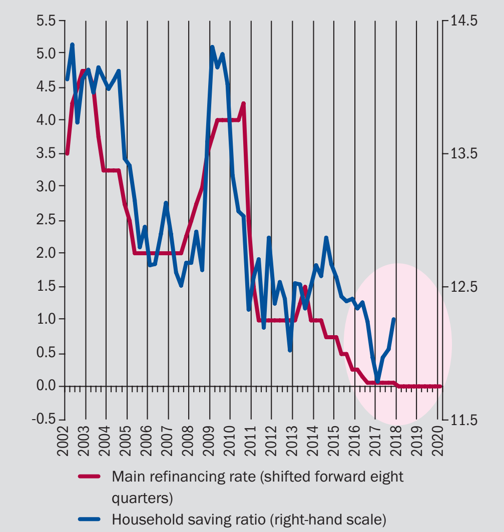
Consumer demand continues to be supported by low interest rates resulting from the accommodative monetary policy stance, as well as by the strengthening labour market situation. But although interest rates remain very subdued, the saving ratio increased moderately in the last three quarters of 2017 (while nevertheless remaining at a low level). Going forward, the saving ratio's upward trend could act as a drag on private consumption growth. The share of survey respondents who agree that the present time is the right time to make major purchases fell slightly, but remained just below its historical highs. Consumption growth is expected to remain relatively strong, supported by the favourable labour

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



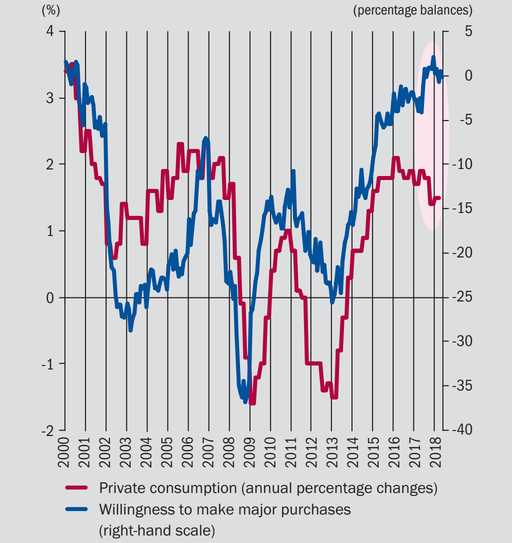
Sources: Macrobond and NBS calculations.

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



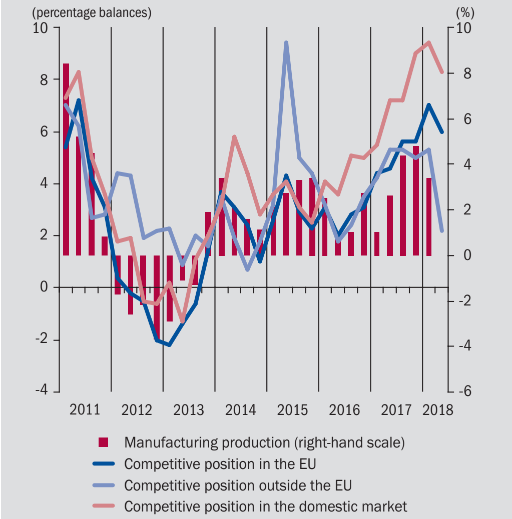
Source: Macrobond.

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



Source: Macrobond.

Chart 5 Industrial competitiveness (percentage balances) and manufacturing production (annual percentage changes)



Sources: European Commission, Eurostat and NBS calculations.

market situation. At the same time, the annual growth rate of the ECB's indicator of negotiated wages increased for a third successive quarter (from 1.48% in the second quarter of 2017 to 1.86% in the first quarter of 2018), thus pointing to an acceleration in overall wage growth. The indicator's relatively large first-quarter increase of 0.3 percentage point was its highest for around five years. Accelerating wage growth would also put upward pressure on private consumption.

From around the third quarter of 2016 until the first quarter of 2018, industrial firms' assessments of their competitive position, particularly in domestic and EU markets, were improving; in the second quarter of this year, however, they deteriorated significantly. Even so, assessments of competitiveness in domestic and EU markets remained relatively bright. The most pronounced deterioration was in assessments of competitiveness in extra-EU markets. This related to the expiry of the temporary exemption for EU countries from US import tariffs on steel and aluminium, as well as to mounting concerns that any escalation of protectionist policies, or possible tariff wars, would hurt global trade and output. Such concerns may also explain the further worsening of export expectation in the first quarter of 2018 and may imply a slowdown in industrial production growth.

Chart 6 Export expectations in industry (percentage balances) and manufacturing production (annual percentage changes)

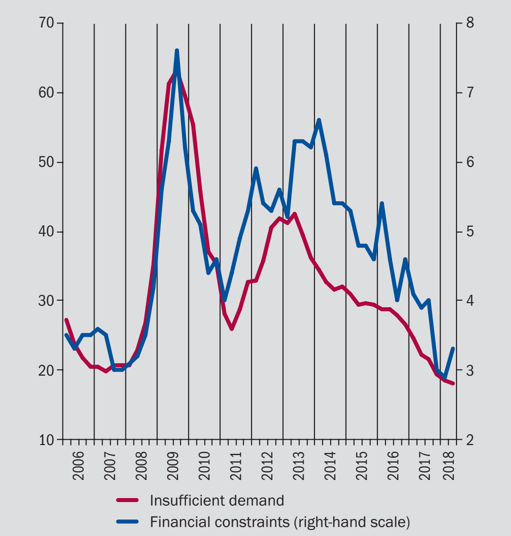
Sources: European Commission, Eurostat and NBS calculations.

Industrial firms' latest assessments of what factors are limiting their production follow the trends seen in previous quarters. Survey results in the first quarter showed that the impact of 'insufficient demand' was at an all-time low, despite a deterioration in export expectations and in competitive position assessments. This indicates that demand remains strong. Concerns about 'financial constraints' increased slightly but were still very muted. The gradual shift in the economy's cyclical position was evident from further increases in the importance of production factors: 'shortage of material and/or equipment' and 'shortage of labour force'. Firms' assessments of material and equipment shortages and their favourable assessments of demand could translate into a gradual pick-up in capital investment and therefore in investment growth.

The percentage of respondents that saw labour shortages as a production-limiting factor was still at historically high levels and points to further labour market tightening going forward. Past experience suggests that if labour force shortages are having a strong impact, they will be accompanied by accelerating wage growth. At present, however, wage growth remains subdued, although it increased moderately in 2017. At the same time, however, the continuing tightening of the labour market could have an upward impact on wage growth in the next period and on inflation thereafter. The indicator of negotiated wages is beginning to signal increasing wage pressures, with its annual rate of change increasing from 1.6% in the fourth quarter of 2017 to 1.9% in the first quarter of 2018.

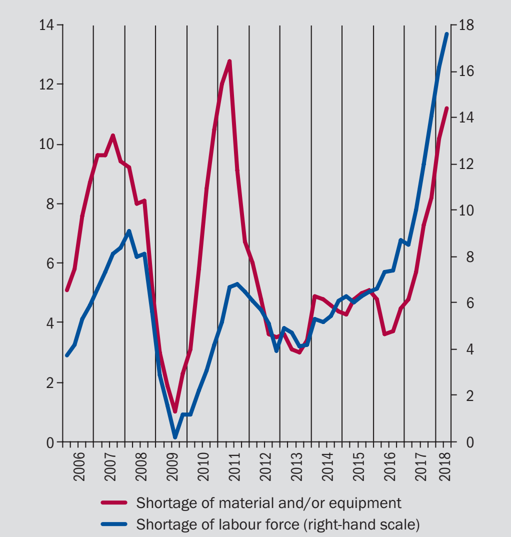
The continuing tightening of labour market conditions is also evident from the unemployment rate, which maintained its downward trend in the first quarter of 2018. In April, the rate edged down again, to 8.5%, 0.2 percentage point below its level in December 2017. As the unemployment rate is falling, the job vacancy rate[2] is rising, indicating an increase in labour supply

Chart 7 Factors limiting production in industry (percentages)



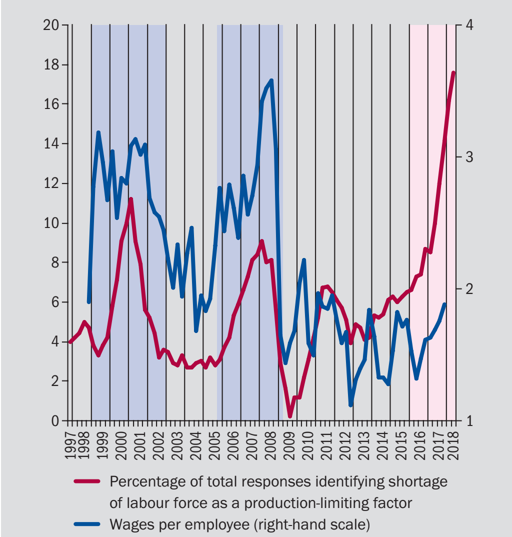
Source: Macrobond.

Chart 8 Factors limiting production in industry (percentages)



Source: Macrobond.

Chart 9 Assessment of labour shortages as a production-limiting factor and year-on-year growth in wages per employee (percentages)



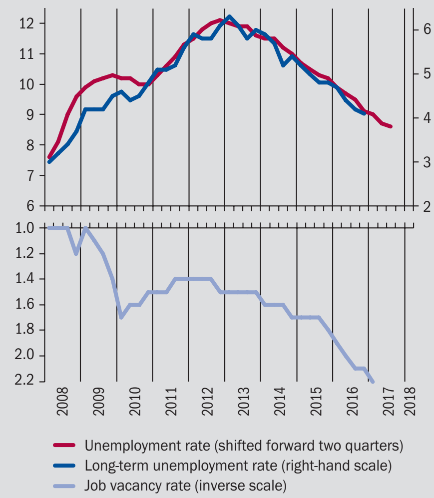
Source: Macrobond.

2 *Job vacancy rate data have been available since 2008.*

bottlenecks. It is therefore becoming more difficult to recruit new employees. Survey results show a lowering of expectations for future employment in the industry and retail trade sectors, possibly related to just such recruitment difficulties. These expectations, especially in industry, may also be influenced by uncertainty about whether protectionism will escalate. In the construction sector, however, expectations for future employment continued their upward trend in May. In the services sector, employment expectations remained largely unchanged, at elevated levels as in other sectors.

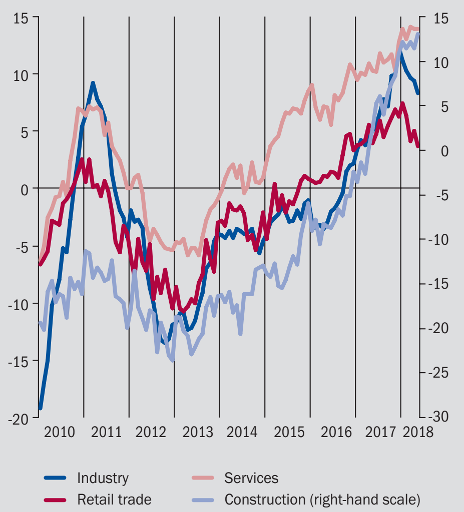
Compared with their exceptionally high levels at the turn of the year, leading indicators for the euro area have fallen markedly. Nevertheless, they remain relatively elevated and suggest that the economy will continue to expand in 2018, albeit probably not to the extent that it did in 2017. The European Commission's Economic Sentiment Indicator (ESI) fell quite sharply in the first quarter of 2018, albeit from a 17-year high. The ESI's decline moderated in April and almost came to a halt in May. The composite Purchasing Managers' Index (PMI) for the euro area likewise slumped in the first quarter, and it continued falling in April and May. The PMI's level in May (54.1) was still above the threshold (50) consistent with continuing economic expansion, as well as being above the indicator's long-run average. The Eurocoin indicator also declined, but its level remains relatively favourable. The leading indicator trends probably reflected increasing geopolitical tension (the United States' withdrawal from the Iran nuclear deal), mounting political uncertainty (Italy), and the risk that protectionism will escalate and weigh on global trade.

Chart 10 Unemployment, long-term unemployment, and job vacancy rates (percentages)



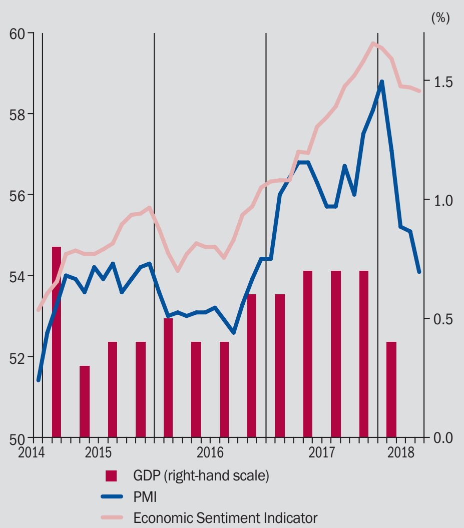
Source: Macrobond.

Chart 11 Employment expectations by sector (percentage balances)



Source: Macrobond.

Chart 12 Leading indicators and quarterly euro area GDP growth

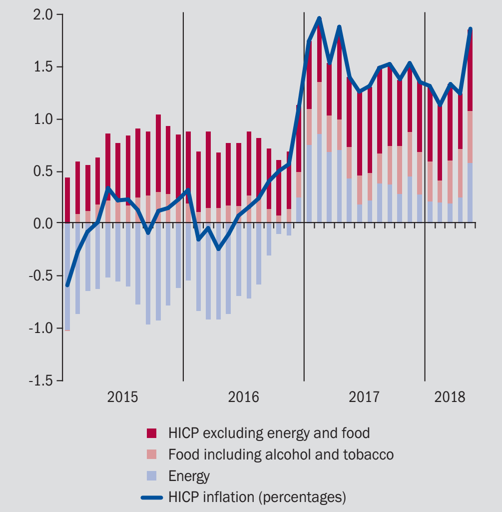


Sources: Macrobond, IHS Markit and NBS calculations.

Chart 13 The Eurocoin indicator and quarterly euro area GDP growth

Source: Macrobond.

Chart 14 HICP inflation and selected components (annual percentage changes; percentage point contributions)

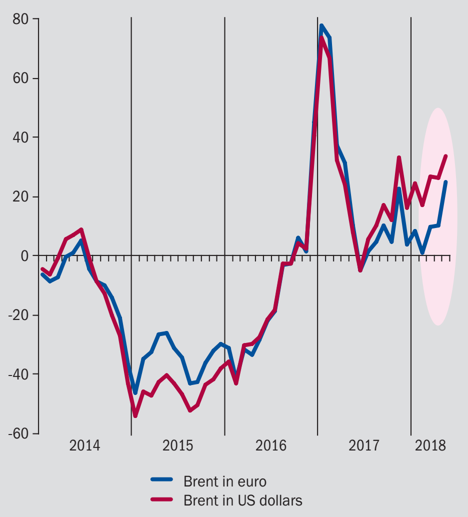


Source: Macrobond.

Euro area annual HICP inflation remained broadly stable in the first quarter of 2018, with its rate only slightly lower in March than in December 2017. This stability stemmed mainly from the fact that both food price inflation and energy price inflation moderated in the first quarter. The headline rate was 1.3% in March, 0.1 percentage point lower than in December 2017. Inflation excluding energy and food (core inflation) edged up from 0.9% in December 2017 to 1.0% in January 2018 due to slightly higher non-energy industrial goods inflation. The core rate remained unchanged in the next two months, with non-energy industrial goods inflation gradually decelerating and services price inflation accelerating. The pick-up in services inflation was most pronounced in March, and stemmed mainly from the different timing of Easter. As a result of this calendar effect, service inflation slowed significantly in April and thus had a marked impact on core inflation in that month (it fell by 0.3 percentage point, to 0.7%). By May, this calendar effect had faded and core inflation rose again, to 1.1%. At the same time, a strong increase in energy inflation passed through to the headline rate, which accelerated from 1.2% in April to 1.9% in May, its highest level since April 2017 (when it was also boosted by the energy component).

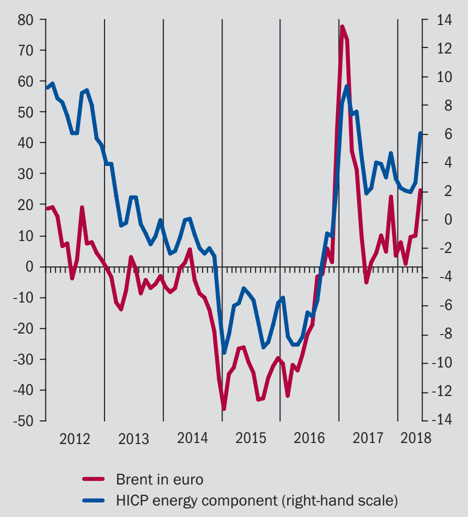
Consumer energy prices were responding to annual rates of change in global oil prices, as well as to changes in the nominal exchange rate of the euro against the US dollar. Oil prices maintained their upward trend in the first quarter of 2018, except for a brief dip in February. At the same time, however, the euro's year-on-year appreciation against the US dollar dampened the impact of oil prices on consumer energy prices. The benchmark oil price rose again in April and increased markedly in May in response to geopolitical events. Concurrently, the euro depreciated against the US dollar (due to the impact of political tensions in Italy and favourable outlooks for the US economy) and its year-on-year appreciation moderated. Both these factors contributed to a substantial acceleration in the euro-denominated oil price. Whereas the year-on-year change in the oil price denominated in US dollars was higher in May than in April by 7.5 percentage points, the euro-denominated price was higher by 15 percentage points. This acceleration passed through almost immediately to consumer energy price inflation, which increased to 6.1% in May (up by 3.5 percentage points from April).

Chart 15 Oil prices in euro and US dollars (annual percentage changes)



Sources: Macrobond and NBS calculations.

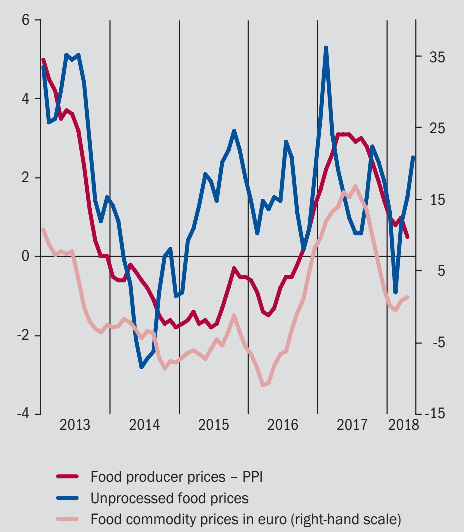
Chart 16 Oil prices in euro and the HICP energy component (annual percentage changes)



Sources: Macrobond and NBS calculations.

Food commodity prices in the euro area[3] began to increase moderately in March 2018 and carried on rising in April, thus ending a downward trend going back to October 2017. These price rises also had an upward impact on the annual rate of food commodity price inflation and, gradually, on the annual rate of unprocessed food price inflation, which until February had been responding to the declining commodity price inflation. Commodity price movements passed through to processed food prices with a certain lag. In the first quarter, processed food inflation was still reflecting a previous acceleration in commodity prices. Overall, therefore, food price inflation was 2.1% in March, the same as in December 2017. In the next two months, however, annual food price inflation gradually picked up (reaching to 2.6% in May), owing mainly to rising unprocessed food inflation supported by the upswing in commodity prices. By contrast, the pass-through of these movements to processed food prices, as well as to food producer prices, has been lagged. Processed food price inflation and food producer price inflation were accelerating until April and then moderated in May. The current upturn in commodity prices has therefore yet to be reflected in food producer prices and in processed food prices. If it continues, it will probably dampen the impact on consumer prices of past declines in food commodity prices and of the significant slowdown in food commodity inflation.

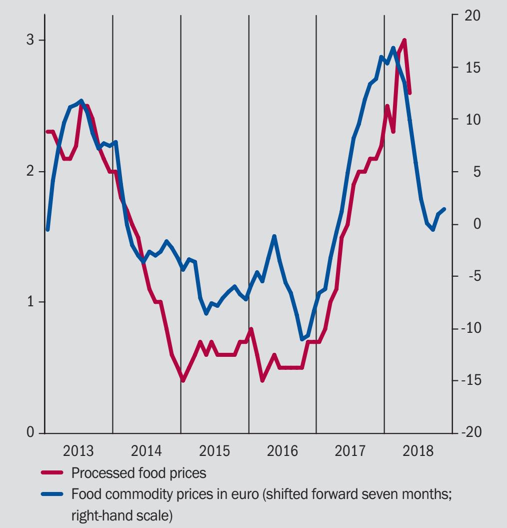
Chart 17 Food prices: commodity, producer and consumer prices (annual percentage changes)



Sources: Macrobond, ECB and NBS calculations.

3 *Farm gate and Wholesale Market Prices, ECB.*

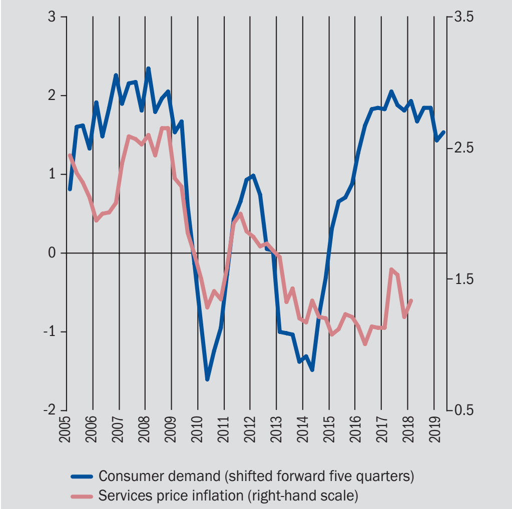
Chart 18 Food commodity prices and processed food prices (annual percentage changes)



Source: Macrobond.

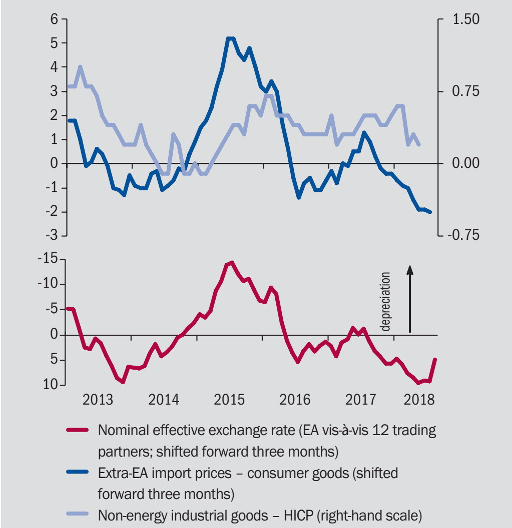
Core inflation – meaning annual HICP inflation excluding energy and food – increased slightly in January as a result of a moderate increase in non-energy industrial goods inflation. This component continued to increase in February even while the year-on-year appreciation of the nominal exchange rate became more marked. In March, however, the annual rate of non-energy industrial goods inflation slowed significantly (from 0.6% to 0.2%), owing mainly to lower prices of semi-durable goods, especially clothing. Annual rates of inflation for this sub-component of goods are relatively volatile and may reflect changing seasonal sales patterns. It is also likely that the euro's strong appreciation (almost 8% in March) was beginning to pass through to goods prices. That appreciation resulted in a greater decrease in the annual rate of change in import prices for consumer goods. By contrast, services price inflation increased significantly in March, due to the above-mentioned calendar effect of the different timing of Easter (this affected mainly transport service prices, tour prices, and hotel and restaurant prices). Thus core inflation, after rising modestly in January (by 0.1 percentage point), remained unchanged for the next two months, at 1.0%. In April, services inflation was temporarily dampened by the Easter effect, but in May, after that effect had faded, it rose back to its March level. As a result, core inflation accelerated to 1.1% in May (from 0.7% in April), its highest rate since September 2017. The depreciation of the euro's nominal effective exchange rate in May substantially moderated its year-on-year appreciation (from more than 9% to just under 5%). This could, in coming months, serve to limit the further decline in import prices and

Chart 19 Consumer demand and services price inflation (annual percentage changes)



Source: Macrobond.

Chart 20 Non-energy industrial goods prices and the nominal exchange rate (annual percentage changes)



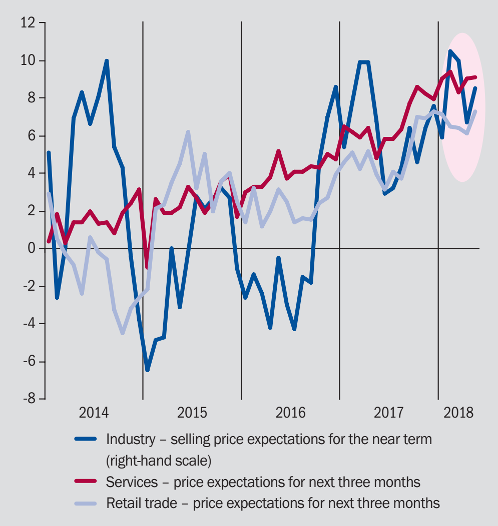
Source: Macrobond.
Note: Positive values for the exchange rate denote depreciation of the euro.

slowdown in non-energy industrial goods inflation. At the same time, the continuing buoyancy of consumer demand could put upward pressure on services inflation.

Selling price expectations, although volatile, remain on a broadly upward trend. In the first part of 2018, these expectations dipped temporarily in almost all sectors and then rebounded. Hence they are probably reflecting the expectations of continuing economic growth and relatively favourable demand, as well as the possible cost impacts of higher oil prices or higher wages. Compared with the January edition of the ECB Survey of Professional Forecasters, the April edition showed no change in inflation expectations.

At its meetings between January and June 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 says it expects that rates will remain at their present levels at least through the summer of 2019 and in any case for as long as necessary to ensure that the evolution of inflation remains aligned with the Governing Council's current expectations of a sustained adjustment path.

Chart 21 Price expectations in industry, services and retail trade (percentage balances)



Sources: European Commission and Eurostat.

Chart 22 HICP inflation – expectations according to the ECB's Survey of Professional Forecasters

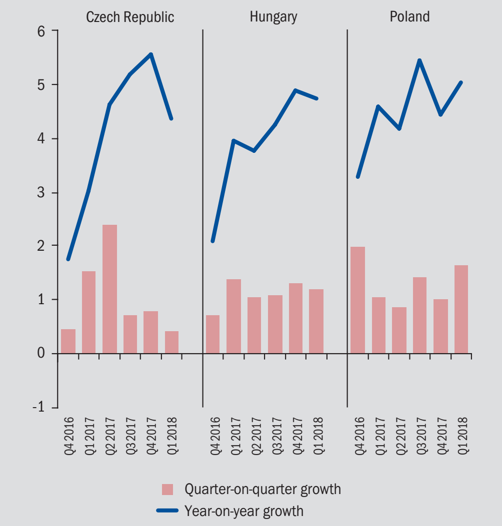
Source: Macrobond.

In accordance with the decision taken at the Governing Council's meeting in October 2017, the monthly pace of purchases under the ECB's asset purchase programme (APP) was reduced to €30 billion in January 2018 (from €60 billion) and will remain at that pace until the end of September 2018. According to the statement issued after its June 2018 meeting, the Governing Council anticipates that, after September 2018, subject to incoming data confirming its medium-term inflation outlook, it will reduce the monthly pace of the net asset purchases to €15 billion until the end of December 2018 and then end net purchases. At the same time, the Governing Council intends to maintain its policy of reinvesting the principal payments from maturing securities purchased under the APP for an extended period of time after the end of the net asset purchases, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation. The Governing Council stands ready to adjust all of its instruments as appropriate to ensure that inflation continues to move towards the Governing Council's inflation aim in a sustained manner.

5 The Czech Republic, Hungary and Poland

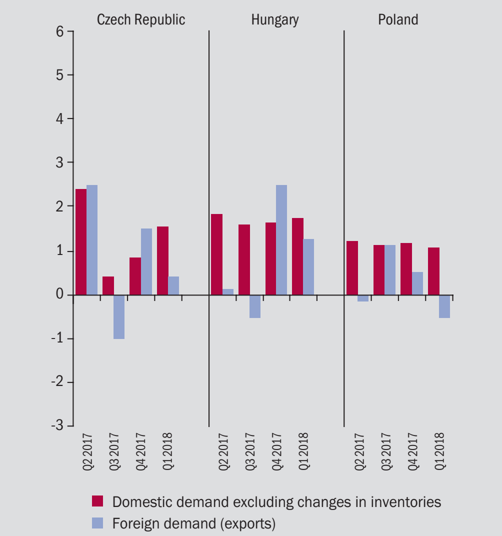
In the first quarter of 2018, annual GDP growth increased in Poland by 0.6 percentage point (to 5.0%) and fell in the other two countries under review: by 1.1 percentage point in the Czech Republic (to 4.4%) and by 0.2 percentage point in Hungary (to 4.7%).

Chart 23 GDP (percentage changes)



Source: Eurostat.

Chart 24 Contributions to quarterly GDP growth (percentage points)



Sources: Eurostat and NBS calculations.

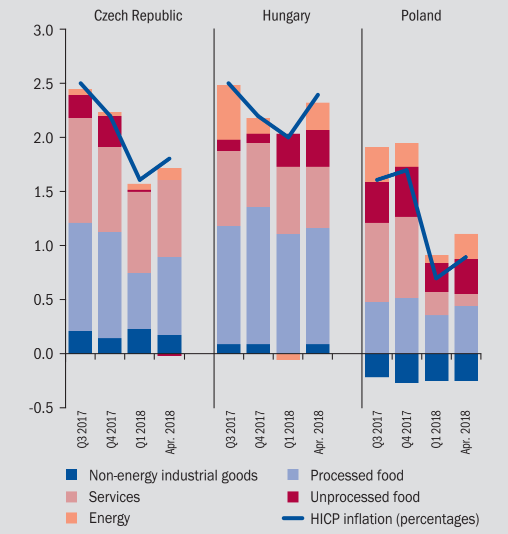
As for quarter-on-quarter GDP growth in the first three months of 2018, Poland was the only one of the reviewed countries in which it increased (by 0.6 percentage point, to 1.6%). Quarterly growth decelerated in both the Czech Republic (by 0.4 percentage point, to 0.4%) and Hungary (by 0.1 percentage point, to 1.2%). In the Czech Republic, the slowdown was caused primarily by net trade, whose contribution was more negative in the first quarter than in the previous quarter. Changes in inventories also had a dampening impact. Upward pressure on GDP growth came from private consumption and in particular from investment. The impact of government consumption was the same as in the previous quarter. In Hungary, the modest slowdown in GDP was, as in the Czech Republic, due mainly to net trade, with export growth falling and import growth increasing. Government consumption had a negative impact, while household consumption growth slowed slightly. The contribution of changes in inventories was negative, but less so compared with the previous quarter. Investment demand, by contrast, had a positive impact on GDP growth. In Poland, the acceleration in economic expansion was driven largely by changes in inventories. The contributions of household consumption and investment demand were unchanged from the previous quarter, while government consumption growth was slightly lower. Net trade contributed negatively to economic growth, with exports decreasing far more than imports.

Annual consumer price inflation in all three countries was lower in March 2018 than in December 2017, with the Czech Republic recording a drop of 0.6 percentage point (to 1.6%), Hungary, 0.2 percentage point (2.0%), and Poland, 1.0 percentage point (0.7%). In the **Czech Republic**, food prices accounted for most of the slowdown in inflation, as both processed food inflation and unprocessed food inflation fell significantly. Energy inflation had a neutral impact on the headline inflation rate, as its level in March was similar to that in December. The non-energy industrial goods component made a slightly positive contribution, while the services component was largely unchanged. In April 2018, Czech consumer price inflation accelerated moderately, pushed up mainly by higher processed food prices and energy prices. In **Hungary**, energy prices were largely responsible for the deceleration in inflation, as they began to decline in year-on-year terms. There was also downward pressure from non-energy industrial goods inflation and processed food inflation, each of which declined. By contrast, the unprocessed food component made a more positive contribution compared with the previous quarter, while the services component remained unchanged. In April 2018, Hungary's headline inflation rate accelerated, with the energy component beginning to have a positive impact and non-energy industrial goods inflation accelerating. In **Poland**, the slowdown in headline inflation was broad-based across almost all components. The most pronounced decline was in services inflation. The non-energy industrial goods component continued to have a negative impact. In April, consumer price inflation in Poland, as in the other countries under review, accelerated moderately thanks mainly to energy price movements.

In its exchange rate against the euro, the Czech koruna was 0.43% stronger at the end of March 2018 than at the end of December 2017, while both the Hungarian forint and Polish zloty were weaker, by 0.58% and 0.8% respectively.

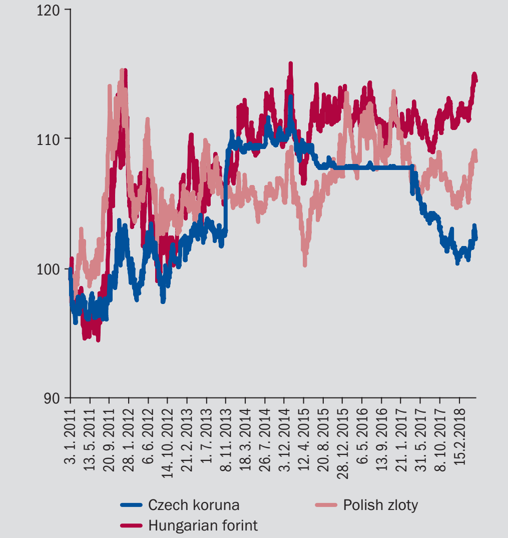
The koruna's appreciation course that began in mid-December 2017 continued in the early part of 2018. This strengthening stemmed mainly from favourable Czech economic data, but also from expectations of monetary policy tightening and the actual tightening of that policy through increases in the Czech central bank's key interest rates at the beginning of February (raising the positive interest rate differential vis-à-vis the euro area). Following the rate hike, however, the koruna stopped appreciating in response to a shift in investor and market expectations about the further pace of rate-based monetary policy tightening during 2018. The movements of the forint and the zloty in the first quarter of 2018 were affected to a greater extent than the koruna by the deterioration in financial market sentiment and consequent increase in market

Chart 25 HICP inflation and its components (annual percentages; percentage point contributions)



Sources: Eurostat and NBS calculations.

Chart 26 Exchange rate indices of national currencies vis-à-vis the euro (index: 3 January 2011 = 100)

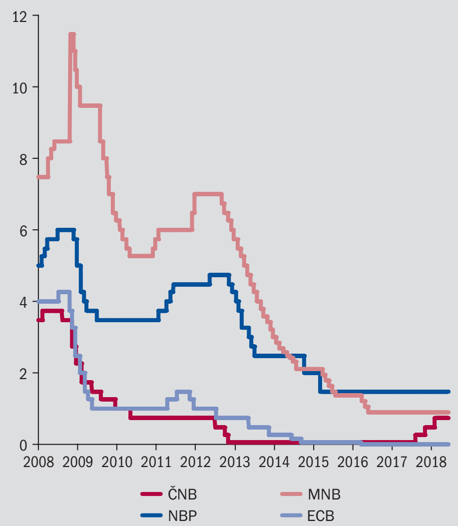


Sources: Eurostat and NBS calculations.
Note: A fall in value denotes appreciation.

volatility. Investment risk was affected in particular by market expectations about the monetary policy stances of the world's major central banks (the Federal Reserve raising its policy rate in March; the ECB persevering with an accommodative stance) and the cooling of favourable sentiment about the euro area economy, as well as by the danger that the new US import tariffs on steel and aluminium could trigger a trade war. In the case of the forint, its depreciation was also supported by the Hungarian central bank's further loosening of monetary policy from the start of 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 first quarter of 2018. **Česká národní banka** (ČNB) decided to increase its base interest rate (the two-week repo rate) by 25 basis points, to 0.75%, with effect from 2 February 2017. At the same time, it increased the Lombard rate, by 50 basis points, to 1.50% and kept the discount rate unchanged at 0.05%. According to the statement issued after the rate-setting meeting, the ČNB Bank Board assessed the risks to the inflation forecast at the monetary policy horizon as being balanced. The rate hike was considered warranted in view of inflation developments, the labour market situation, and the phase of the business cycle, as well as other macroeconomic variables. In the February 2018 edition of its macroeconomic forecast (entitled the *Inflation Report*), ČNB resumed the publication of forecasts for the koruna-euro exchange rate. The exchange rate forecast does not imply a commitment by the ČNB, nor can it be interpreted as the preferred or desired exchange rate level; it is merely an endogenous variable conditional on the assumptions adopted for the macroeconomic forecast. According to ČNB, the exchange rate forecast helps make monetary policy decision-making more transparent and comprehensible. The interest rate forecast envisaged the raising of policy rates in the first quarter of 2018 policy rates and envisages them remaining stable until the end of the year. If, however, the koruna's appreciation is more moderate than expected, there may be scope to raise them again before then. In Hungary, the **Magyar Nemzeti Bank** (MNB) left its key interest rates unchanged in the first quarter of 2018, with the base rate, overnight collateralised lending rate and one-week collateralised lending rate all standing at 0.90%, and the overnight deposit rate in negative territory at -0.15%. In explaining its stance, the MNB Monetary Council reiterated that leaving 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. The HUF 75 billion upper limit set on the stock of three-month deposits from the end of 2017 remained in force in the first quarter of 2018. In December 2017 the MNB Monetary Council set a HUF 400-600 billion band for the targeted average liquidity crowded-out for the first quarter of 2018, and in March 2018 it set the same band for the second quarter. From the beginning of 2018 the MNB began implementing a further two unconventional monetary policy measures: i) unconditional interest rate swap facilities with five-year and ten-year maturities (with the maximum allotted amount set at HUF 600 billion for the first half of 2018; and ii) a tar-

Chart 27 Key interest rates of national central banks (percentages)



Sources: National central banks and the ECB.

geted programme for the purchase of mortgage bonds with a maturity of three years or more. Under the programme, the MNB purchased mortgage bonds with a nominal value of HUF 150 billion up to the middle of April, according to a statement issued by the central bank. As a result of these measures, spreads of mortgage bonds over yields in the government securities market fell sharply and turned negative on average. **Narodowy Bank Polski** (NBP) left its monetary policy rates unchanged in the first quarter of 2018 (the reference rate has remained at 1.5% since 5 March 2015). In the central bank's judgement, taking current information into account, inflation will remain close to the inflation target over the projection period. As a result, according to the NBP, the current level of interest rates is conducive to keeping the Polish economy on a sustainable growth path and maintaining macroeconomic stability.

SUMMARY OF GDP GROWTH PROJECTIONS OF SELECTED INSTITUTIONS

Table 1 Global economy

	Release	2017		2018		2019		2020	
IMF	April 2018	3.8	(0.1)	3.9	(=)	3.9	(=)	-	-
OECD	May 2018	3.7	(=)	3.8	(-0.1)	3.9	(=)	-	-
EC	May 2018	3.7	(0.2)	3.9	(0.2)	3.9	(0.2)	-	-
ECB[1)]	June 2018	3.8	(=)	4.0	(-0.1)	3.9	(=)	3.7	(=)

Table 2 United States

	Release	2017		2018		2019		2020	
IMF	April 2018	2.3	(=)	2.9	(0.2)	2.7	(0.2)	-	-
OECD	May 2018	2.3	(=)	2.9	(=)	2.8	(=)	-	-
EC	May 2018	2.3	(0.1)	2.9	(0.6)	2.7	(0.6)	-	-
Federal Reserve	June 2018	2.3	(=)	2.85	(0.05)	2.4	(=)	1.9	(-0.05)

Table 3 Euro area

	Release	2017		2018		2019		2020	
IMF	April 2018	2.3	(-0.1)	2.4	(0.2)	2.0	(=)	-	-
OECD	May 2018	2.6	(0.1)	2.2	(-0.1)	2.1	(=)	-	-
EC	May 2018	2.4	(=)	2.3	(=)	2.0	(=)	-	-
ECB	June 2018	2.5	(=)	2.1	(-0.3)	1.9	(=)	1.7	(=)

Table 4 Czech Republic

	Release	2017		2018		2019		2020	
IMF	April 2018	4.3	(0.8)	3.5	(0.9)	3.0	-	-	-
OECD	May 2018	4.6	(0.3)	3.8	(0.3)	3.2	(=)	-	-
EC	May 2018	4.4	(-0.1)	3.4	(0.2)	3.1	(0.2)	-	-
ČNB	May 2018	4.6	(0.1)	3.9	(0.3)	3.4	(0.2)	-	-

Table 5 Hungary

	Release	2017		2018		2019		2020	
IMF	April 2018	4.0	(0.8)	3.8	(0.4)	3.0	-	-	-
OECD	May 2018	4.0	(0.1)	4.4	(0.8)	3.6	(0.8)	-	-
EC	May 2018	4.0	(0.2)	4.0	(0.3)	3.2	(0.1)	-	-
MNB	March 2018	4.0	(0.1)	4.2	(0.3)	3.3	(0.1)	2.7	(=)

Table 6 Poland

	Release	2017		2018		2019		2020	
IMF	April 2018	4.6	(0.8)	4.1	(0.8)	3.5	-	-	-
OECD	May 2018	4.6	(0.3)	4.6	(1.1)	3.8	(0.6)	-	-
EC	May 2018	4.6	(=)	4.3	(0.1)	3.7	(0.1)	-	-
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.
Note: Data in brackets denote the percentage point change from the previous projection.