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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

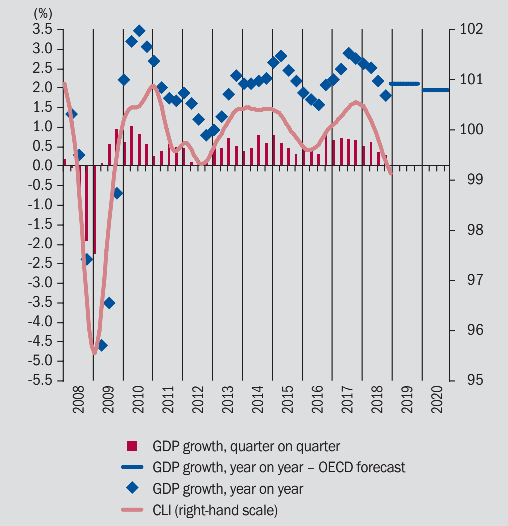
Compared with the previous quarter, global economic growth moderated in the fourth quarter of 2018. The world economy continues to slow, and the main risks to its outlook – the downward growth trend in China and substantial weakening of Europe's economy (amid the dampening of global trade and global manufacturing industry, high political uncertainty, and financial market risks) – remain in place and, depending on the extent to which they deepen, could have a far greater negative impact on the world economy. At the same time, however, growth may be supported by the easing of financial conditions, with major central banks signalling a slower process of monetary policy normalisation. Furthermore, labour market developments imply wage growth acceleration and a potential upward impact on household spending.

In the United Kingdom, economic growth slowed significantly in the last quarter of 2018 due to declining investment demand. Meanwhile, a slight pick-up in exports was accompanied by an acceleration of imports, to the extent that net trade had a dampening effect on economic growth. There was also a decline in inventories. The only positive contributions to the UK's GDP growth in that quarter came from household and government consumption expenditure. The risks of a further slowdown in the country's growth have been heightened by the UK Parliament's rejection of the EU Withdrawal Agreement, a marked decline in confidence and the easing of global economic growth. Against the backdrop of a partial federal government shutdown, US economic growth weakened in the fourth quarter of 2018. While the country's strong labour market, still favourable financial conditions, and fiscal stimulus continued to support growth, the softening of household and government consumption, as well as a decline in inventories built up in the previous quarter, had the opposite impact. In addition, export performance was dented by a fall in exports of food commodities. The fading impact of the fiscal stimulus and further tightening of monetary policy are expected to keep the US economy subdued in the near term. In Japan, the fourth quarter of last year saw a recovery from the previous quarter, when the country experienced adverse weather conditions and natural disasters. The impact of solid domestic demand growth, underpinned by both private consumption and investment, was offset by the negative contribution of net exports and by falling inventories. Yet despite the downward pressure on exports caused by the slowdown of China's economy and also by the trade war between the United States and China, the Japanese economy recorded positive growth. This indicates the economy's robustness to external pressures and the continuation of its growth in the near term. Domestic demand in Japan will, however, come under pressure from October, when consumption tax is due to be raised. Euro area economic growth was subdued in the fourth quarter, albeit slightly higher compared with the previous quarter. Fixed investment and government consumption performed particularly strongly, but net exports made the largest positive contribution to GDP growth, as export growth increased and import growth slowed. Household consumption remained weak. Changes in inventories weighed significantly on GDP growth. The euro area's economic activity growth in the second half of 2018 was accompanied by increasing divergence between the performance of the region's largest economies. The euro area may be adversely affected in the near term by the uncertainty surrounding the escalation of protectionist measures and by any no-deal Brexit, as well as by unfavourable domestic developments in certain European countries. After these factors have faded, economic growth is expected to be boosted by accommodative monetary policy, rising wages, recovering foreign demand and fiscal easing.

China's economic growth remained on a downward trend in the fourth quarter of 2018, reporting its lowest year-on-year growth since early 2009. The economy reflected the effects of deleveraging and of the decline in economic sentiment resulting from the country's trade dispute with the United States. Household concerns about the future situation were evident from retail trade sales that implied a slowdown in private consumption growth. On the other hand, investment activity is expected to have picked up in the fourth quarter on the back of increasing government stimuli. In foreign trade there was a notable slowdown in import growth, resulting from yuan depreciation; at the same time, however, export growth fell even more sharply owing to the trade dispute with the United States. In India, economic activity growth accelerated slightly in the fourth quarter of 2018. Falling oil prices did not have an upward impact on household consumption, which may have been affected by lending restraint in the financial sector. In addition, there was a sharp drop in government consumption expenditure. India's GDP growth was therefore driven by investment demand and by net exports (while export growth slowed, imports declined). The Indian economy is expected to remain on a robust growth path, but there are downside risks to the outlook, namely that the global economy will lose further momentum, that financial conditions will be tightened and that investment decisions will be deferred due to political instability. Brazil's economic growth remained broadly unchanged in the fourth quarter, with the impact of declines in investment demand and government consumption being offset by net exports and private consumption. Recovering confidence, an accommodative monetary policy stance and falling unemployment will be conducive to economic revival in 2019. Furthermore, the slower tightening of monetary policy in the United States may have a positive impact on Brazilian assets. What remains crucial for the Brazilian economy, however, is the flexible implementation of fiscal reforms and the overhauling of the country's pension system.

Economic activity growth across the OECD area slowed to 0.3% in the fourth quarter of 2018, down from 0.4 % in the previous quarter. In year-on-year terms, growth moderated from 2.2% in the third quarter to 1.8% in the fourth quarter. The Composite Leading Indicator for the OECD area[1] continued its downward trend in the fourth quarter and fell again in January 2019, thus implying a further slowdown of the global economy in the near term. A similar signal is provided by the latest reading of the Global Composite Purchasing Managers' Index (PMI), whose average level for January and February 2019 was below its average for the fourth quarter of 2018.

Chart 1 GDP growth and the CLI for the OECD area



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

Global consumer price inflation moderated in the fourth quarter of 2018; the inflation rate in the OECD area fell, year on year, from 2.9% in September to 2.4% in December. Energy inflation, which declined due to energy commodity prices movements, was the main cause of the slowdown, but all the principal components of headline inflation contributed to it to some extent. Core inflation fell slightly, from 2.3% in September to 2.2% in December. In January 2019, OECD headline inflation continued to slow appreciably, down to 2.1% year on year, with core and food inflation remaining unchanged and energy prices falling.

1 *The CLIs for OECD countries are published on a monthly basis, and the most recent, published in March 2019, are for the period up to January 2019.*

2 Commodities

The average commodity price index was lower in the fourth quarter of 2018 than in the previous quarter, owing to a more pronounced decrease in average energy commodity prices. Non-energy commodity prices fell only marginally.

Looking at energy commodities, the average price of a barrel of Brent crude oil declined in the fourth quarter. At the start of October, with Iranian oil exports still declining and amid concerns about the replacement of that output by OPEC and Russia, the oil price climbed to a four-year high. Subsequently, however, the oil price fell sharply both because certain countries were exempted from the sanctions reimposed on Iran and because there were signs of a global economic slowdown in conjunction with elevated volatility in financial markets. The oil price was also under downward pressure owing to Russia and Saudi Arabia raising output, to Venezuela's output falling at a more moderate pace, and to increasing inventories in the United States. The end of November and early December saw a brief period of oil price stability, when OPEC members and non-OPEC oil producers agreed to respond to the increasing imbalance between global oil supply and demand by cutting oil output by 1.2 million barrels per day for an initial period of six months from January 2019. Nevertheless, the price fell sharply again at the end of the year amid concerns that the agreed output cut would not be enough to compensate for weakening demand and expected increases in US oil output. The oil price turned upwards in January 2019, due to the previously mentioned output cut by OPEC members and non-OPEC oil producers as well as to the continuation of US sanctions on Iran and Venezuela. The price was further boosted by expectations that the United States and China would strike a trade deal that could have a positive impact on global economic growth.

As in the previous quarter, signs of a slowdown in global economic growth were evident in the fourth quarter of 2018 in the continuing, albeit moderating, decrease in non-energy commodity prices. Lower growth in manufacturing industry weighed on metal prices in general and on aluminium and nickel prices in particular. Aluminium prices reacted to the lifting of sanctions on the Russian producer Rusal and on increases in production and exports from China, while nickel prices declined amid concerns about oversupply in 2019 and softening demand from China. Prices of copper, tin and zinc did not move significantly during the fourth quarter. Food commodity prices were, on average, slightly higher in the fourth quarter than in the previous quarter, mainly because prices of sugar, maize and coffee increased strongly in October. Sugar prices may have been affected by subdued outlooks in key producer countries, including India and Indonesia. Despite subsequently correcting in November and December, coffee and sugar prices remained higher than their level in the previous quarter. In January, non-energy commodity prices came to the end of the downward trend, as metal prices rebounded on the basis of improving sentiment in financial markets and expectations about Chinese government stimulus measures. Food commodity prices continued to rise in January, with maize prices increasing as consequence of adverse weather conditions in South America.

3 The United States

In the United States, the annualised rate of GDP growth slowed to 2.6% in the fourth quarter of 2018, after dropping to 3.4% in the previous quarter. The year-on-year growth rate remained relatively stable (edging up from 3.0% in the third quarter to 3.1% in the fourth). The performance of the US economy in late 2018 was affected by a partial federal government shutdown that began on 22 December and lasted for 35 days (making it the longest shutdown in the country's history).

Another factor behind the weakening of GDP growth was private consumption growth, which, despite an uptick in real disposable income growth, eased due to lower growth in household spending on services and non-durable goods. The rate of increase in government consumption and investment also moderated, owing to a decline in non-defence spending which is expected to be related to the government shutdown. By contrast, fixed investment had a positive impact on GDP growth, supported by corporate investment in equipment and intellectual property. Changes in inventories made only a marginal positive contribution to GDP growth in the last quarter of 2018. As for foreign trade, exports picked up following their decline in the previous quarter, but their growth was contained by a significant drop in exports of agricultural commodities to China (for example, China ended imports of soybeans from the United States). Import growth slowed significantly, but not sufficiently to prevent net exports from contributing negatively to economic growth. Their impact, however, was less negative compared with the previous quarter. After the positive impact of the fiscal stimulus has faded, and with interest rates rising, US economic growth is expected to be lower in 2019 than in 2018.

The fourth quarter of 2018 did not see significant changes in trade relations between the United States and China. In November the US President announced that a 10% tariff imposed on USD 200 billion worth of Chinese imports would not be raised to 25% from 1 January 2019 as had originally been planned. Furthermore, both the United States and China pledged to immediately begin negotiations on structural changes with respect to forced technology transfer, intellectual property protection, non-tariff barriers, cyber intrusions and cyber theft, services, and agriculture. Both sides agreed to endeavour to reach a deal within the next 90 days. By the end of this period, at the beginning of March 2019, the two sides had not concluded a deal to resolve their trade dispute. According to the information available, their negotiations are expected to continue into April.

Also in the area of foreign trade, the US reiterated its threat to impose tariffs on European carmakers and auto parts suppliers. In mid-February the US Commerce Department sent the US President a report (not published) on whether imports of cars and auto parts constitute a national security threat. The President has 90 days to decide whether to act on the report's recommendations. If the US took action damaging to European exports, the European Commission would respond with countermeasures.

Annual consumer price index (CPI) inflation in the United States began falling in August 2018 and continued its downward trend in the last months of the year. This trend was interrupted in October, when headline CPI inflation increased on the basis of a rise in the energy component, which outweighed the impact of slowdowns in core inflation and food inflation. Energy inflation was boosted by petrol prices, which rose markedly in response to a peaking of oil prices in this period. The subsequent slump in oil prices also passed through quickly to energy prices, which fell in December for the first time in more than two years. This was reflected in headline inflation, which fell from 2.3% in September to 1.9% in December. Food prices, by contrast, put moderate upward pressure on headline inflation, while the core CPI rate, excluding food and energy, was the same in December as in September (2.2%). In January, annual CPI inflation continued to decrease, with food inflation and core inflation remaining unchanged and the rate of decrease in energy prices becoming more pronounced. As a result, headline inflation fell to 1.6% in January, which may imply a postponement of further tightening of US monetary policy.

At its meeting in November 2018, the US Federal Open Market Committee (FOMC) decided to leave the target range for the federal funds rate unchanged at 2.00% to 2.25%. At its meeting in December, however, in view of realised and expected labour market developments and inflation, the Committee decided to raise the target range to 2.25% to 2.50%. The Committee made no further change to the policy rate when it met in January 2019.

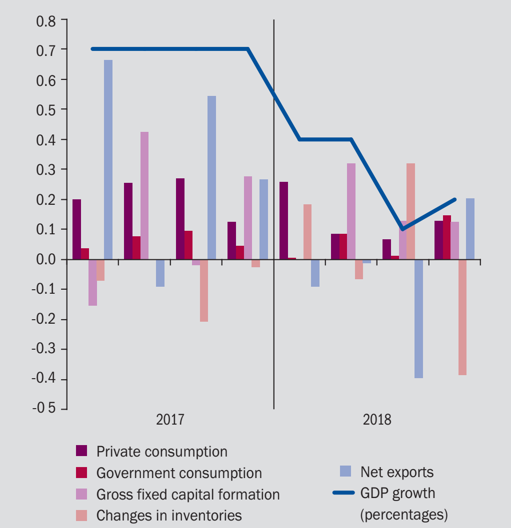
4 The euro area

Euro area GDP grew by 0.2%, quarter on quarter, in the fourth quarter of 2018. This was slightly higher than the corresponding rate for the third quarter (revised down from 0.2% to 0.1%). Looking at the region's largest economies, GDP growth increased in the Netherlands (by 0.4 percentage point, to 0.5%) and Spain (by 0.1 percentage point, to 0.7%), while remaining unchanged in France (at 0.3%) and also in Germany (after falling in the previous quarter). In Italy, however, the economy contracted for a second successive quarter (by 0.1% in each case). In year-on-year terms, euro area GDP growth was notably lower in the fourth quarter than in the previous quarter, down by 0.5 percentage point to 1.1%. In 2018 as a whole, the euro area economy expanded by 1.8%, after growing by 2.4% in the previous year.

All GDP components apart from changes in inventories supported the moderate acceleration of economic growth in the fourth quarter. Compared with the previous quarter, growth accelerated in both private and government consumption, while investment demand maintained moderate growth. Whereas in the previous two quarters net exports had a dampening effect on economic growth, in the fourth quarter they made a relatively strong positive contribution. The turnaround stemmed from an acceleration of export growth in conjunction with a slowdown in import growth. Inventories declined significantly, so contributed negatively to GDP growth. The composition of GDP growth suggests that a large proportion of exports were sourced from inventories. This is also indicated by the fact that the largest export sector, industry, saw production fall sharply (by 1.3%). The production decline was probably reflected in less demand for imports.

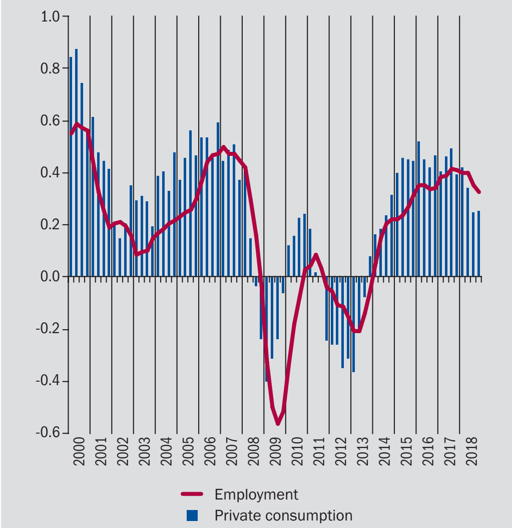
Consumer spending growth was slightly higher in the fourth quarter of 2018 than in the previous quarter (by 0.1 percentage point, at 0.2%), but still fell short of the levels reached in the years 2015 to 2017 (0.5% on average). Private consumption growth continued to be supported by the favourable labour market situation. Employment continued to grow, and its growth rate was moderately higher in the fourth quarter than in

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



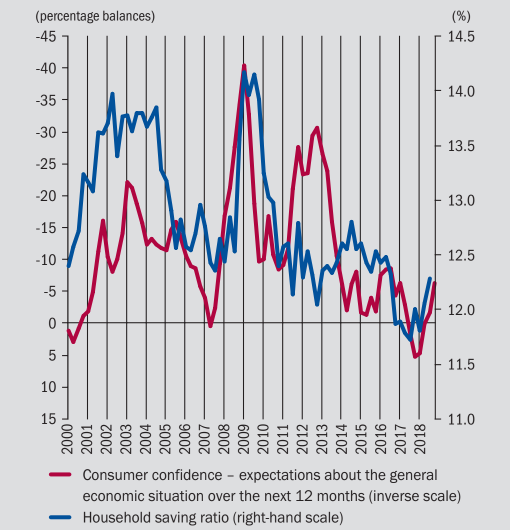
Sources: Macrobond and NBS calculations.

Chart 3 Private consumption and employment (quarter-on-quarter percentage changes)



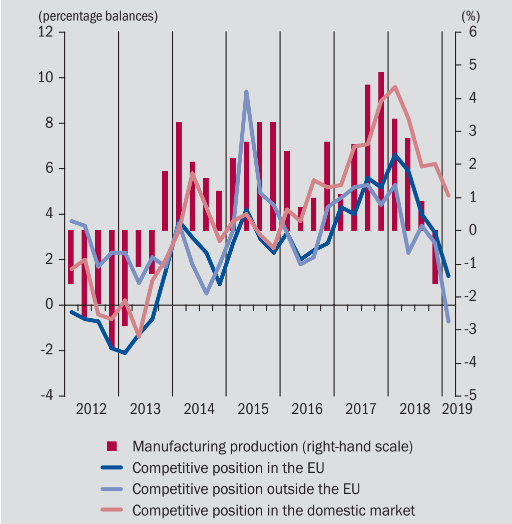
Source: Macrobond.
Note: Calculated from moving averages for four quarters.

Chart 4 Annual private consumptions growth and consumers' expectations about the general economic situation



Source: Macrobond.

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



Sources: European Commission, Eurostat and NBS calculations.

the previous quarter (by 0.1 percentage point, at 0.3%). By contrast, deteriorating expectations for the future economic situation are gradually putting upward pressure on the saving ratio. The ratio increased slightly in the third quarter (the data for the fourth quarter are not available) and has been on a broadly upward path since the last quarter of 2017. The rising saving ratio may act as a constraint on consumer spending growth.

Euro area economic developments in the fourth quarter were accompanied by industrial production falling more sharply (by 1.3%) compared with the third quarter (0.2%). Its decline was to some extent still caused by the impact of the car industry's adaptation to new emission standards; in other words, the fading of this impact (and the return to previous production levels) is progressing only slowly. Although car production increased in the fourth quarter, it did not make up the ground lost in the first quarter. At the same time, production declined across the main industrial groupings, most notably in the production of energy, investment goods and consumption goods. The first quarter of 2019 saw a further deterioration in industrial firms' assessments of their competitive position as well as in export expectations for the months ahead, which again points to relatively weak outlooks in this sector.

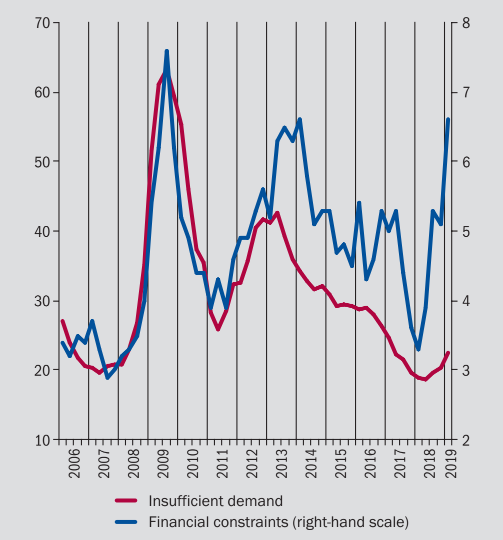
Chart 6 Export expectations in industry (percentage balances) and manufacturing production (annual percentage changes)

Sources: European Commission, Eurostat and NBS calculations.

Industrial firms' assessments of the factors limiting their production also imply a slowdown in economic activity growth. Survey results for the first quarter, as for the previous two quarters, showed an increase in the percentage of respondents reporting 'insufficient demand' as a factor limiting production. The importance of 'financial constraints' also increased appreciably, possibly affected by the ending of the ECB's asset purchase programme. These surveys, however, do not yet reflect the impact of measures adopted at the March 2019 meeting of the ECB's Governing Council. As for production factors – 'shortage of material and/or equipment' and 'shortage of labour force' – there was a drop in the share of respondents who see them as limiting production. On the one hand, this implies an easing of labour market tightness as well as less demand for new investment in equipment, but on the other hand, the importance of these factors remains relatively elevated.

The unemployment rate continued its moderate downward trend in the fourth quarter, falling

Chart 7 Factors limiting production in industry (percentages)

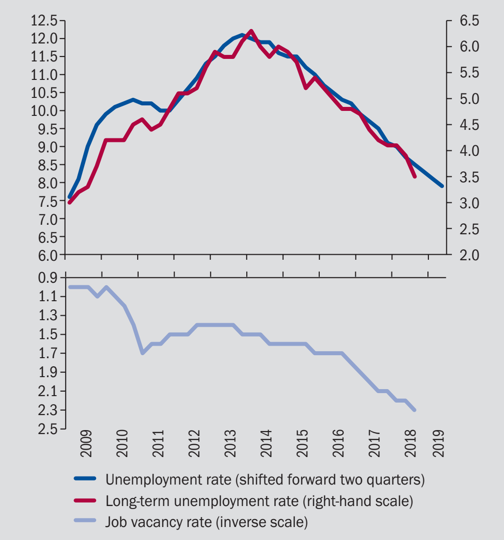


Source: Macrobond.

Chart 8 Factors limiting production in industry (percentages)

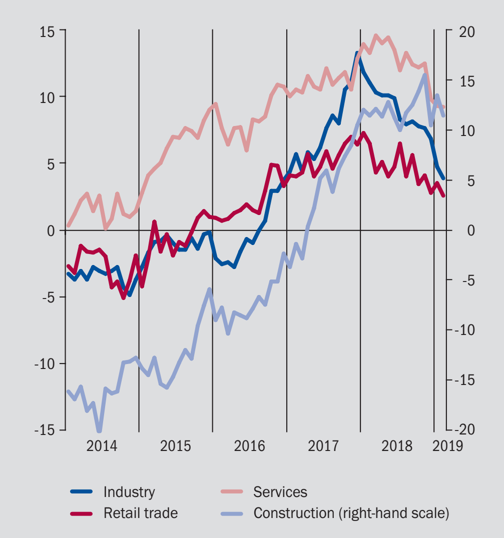
Source: Macrobond.

Chart 9 The unemployment rate, long-term unemployment rate, and job vacancy rate (percentages)



Source: Macrobond.

Chart 10 Employment expectations by sector (percentage balances)



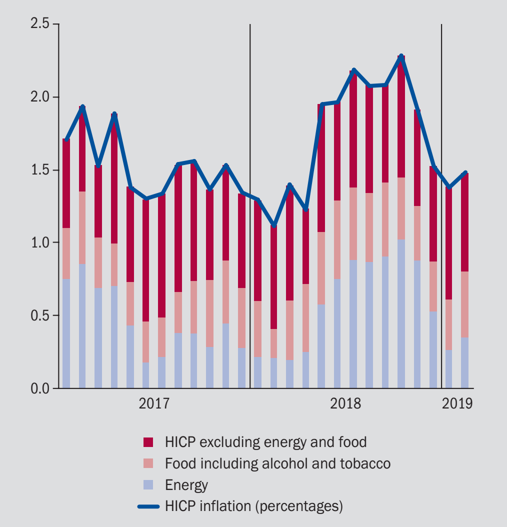
Source: Macrobond.

from 8.0% in September to 7.8% in December. It remained unchanged in January 2019. The unemployment rate therefore stood only slightly above its lowest levels of the pre-crisis period. At the same time, the job vacancy rate continued to increase in the third quarter (the data for the fourth quarter are not yet available). But although the labour market situation remains favourable, employment expectations in individual sectors imply a slight easing of job growth. The weakening of employment expectations was notably more marked around the turn of the year, particularly in the industry and services sectors. In retail trade too, however, outlooks became more subdued.

Euro area annual HICP inflation slowed in the fourth quarter of 2018 after accelerating in the previous quarter. The rate of change in headline inflation continued to be determined by energy prices, which at the start of the quarter supported a moderate acceleration of inflation and in subsequent months had a dampening effect. Inflation in food and services prices also moderated, marginally, in the fourth quarter. Headline HICP inflation fell from 2.1% in September to 1.5% in December. Core inflation (HICP inflation excluding energy and food) was 0.1 percentage point lower in December than in September, at 0.9%. Headline inflation continued its downward trend in January, when it fell to 1.4%, again due largely to the impact of energy price movements. In February, however, energy inflation picked up and so too did food inflation. As a result, headline inflation returned to its December 2018 level (1.5%). Core inflation fluctuated in the first two months of 2019; in January it rose to 1.1% on the back of an increase in services inflation, and then in February it moderated to 1.0%.

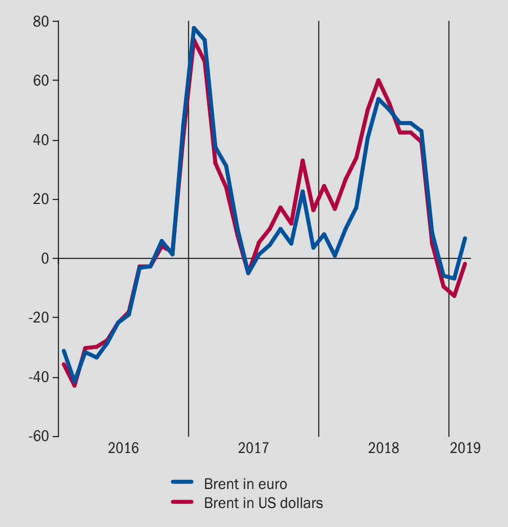
After rising in previous months, oil prices fell significantly in November and December. From a peak of around USD 80 per barrel in October, oil prices fell to less than USD 60 per barrel in December (by almost 30%). This turnaround was quickly reflected in consumer energy price inflation, which fell from 11% in October to around 6% in December. Oil prices then increased moderately in the first two months of 2019 and their annual rate of change also increased. Consumer energy price inflation fell again in January, before accelerating moderately in February, to 3.5%.

Chart 11 HICP inflation and selected components (annual percentage changes; percentage point contributions)



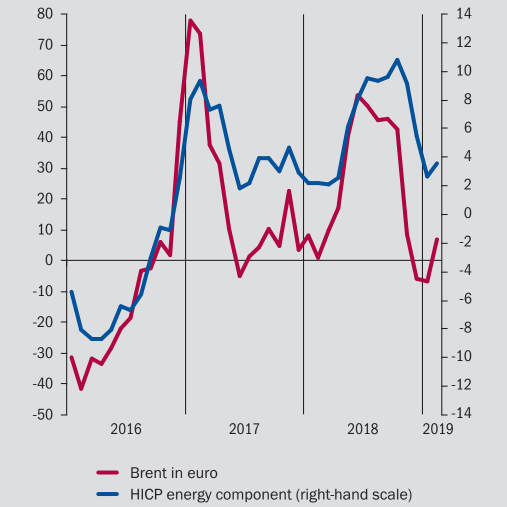
Source: Macrobond.

Chart 12 Oil prices in euro and US dollars (annual percentage changes)



Sources: Macrobond and NBS calculations.

Chart 13 Oil prices in euro and the HICP energy component (annual percentage changes)



Sources: Macrobond and NBS calculations.

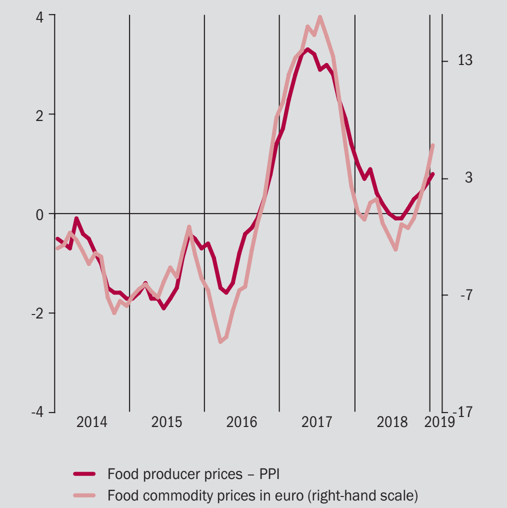
Chart 15 Food commodity prices and processed food prices (annual percentage changes)

Source: Macrobond.

Owing to the previous decline in commodity prices, the annual rate of increase in consumer food prices slowed further in the fourth quarter of 2018, so had a dampening effect on the headline inflation rate. In February, however, food inflation accelerated, as it was already reflecting upward cost pressures from commodity prices and producer prices.

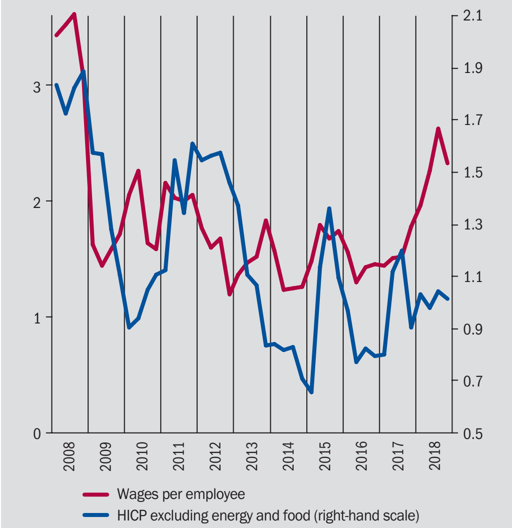
Core inflation did not change significantly in the fourth quarter, and after increasing briefly in October (by 0.2 percentage point, to 1.2 percent), it slowed back to 0.9% and remained at that level until the end of the year. The temporary increase in core inflation was the result of volatile services items, in particular services related to recreation (especially package tours) and to transport.

Chart 14 Food commodity and producer prices (annual percentage changes)



Source: Macrobond.

Chart 16 Indicator of negotiated wages vis-à-vis core inflation (annual percentage changes)



Sources: Macrobond and NBS calculations.

Non-energy industrial goods inflation remained unchanged throughout the fourth quarter (at 0.2%, its level since August 2018). Therefore, the gradual increase in import prices for consumer goods – supported by the gradually moderating annual appreciation, and eventual depreciation, of the euro – did not have an upward impact on consumer inflation. In the first months of 2019, however, non-energy industrial goods inflation accelerated, possibly reflecting the pass-through of increasing import prices. The moderate acceleration of core inflation in the first months of 2019 was driven by the non-energy industrial goods component. January's increase in the core rate was also supported by services prices, but, similarly as in October 2018, the rise in services inflation was based on volatile items, in particular prices of package tours and transport-related services. In February, services inflation fell back to its December 2019 level, probably owing to the fading of the aforementioned effects. So, after accelerating to 1.1% in January, the core inflation rate edged down to 1.0% in February. Wage growth acceleration was therefore still not putting upward pressure on consumer price inflation.

Chart 17 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.

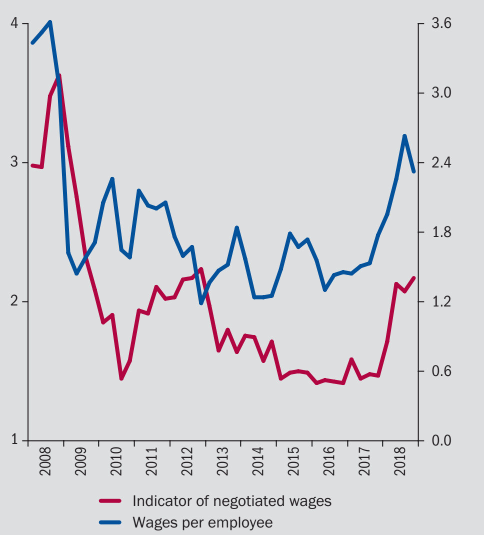
Box 1

PRICES ARE NOT REFLECTING THE STRENGTHENING LABOUR MARKET AND RISING WAGES

Although growth in wages per employee slowed in the fourth quarter of 2018, it remained relatively elevated. The slowdown occurred after six quarters of acceleration. The indicator of negotiated wages is also pointing to relatively favourable wage growth, although no longer to its further acceleration. Despite the softening of economic growth in 2018 and the weakening of growth outlooks, the labour market situation remains favourable. The unemployment rate is now at its lowest levels (7.8% in January 2019) since October 2008 and stands only just above the pre-crisis levels (the average unemployment rate in 2007 was 7.5%).

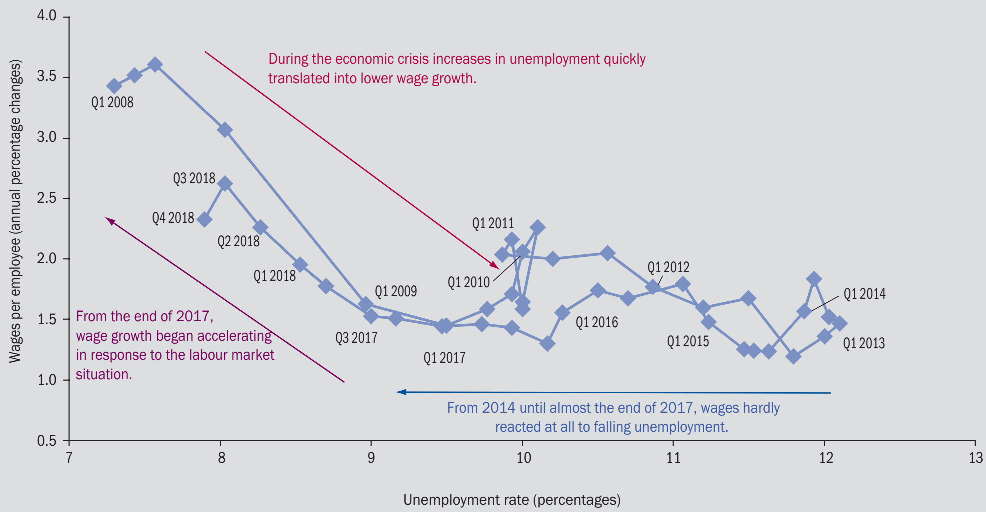
During the Great Recession, the economic downturn was reflected in rising unemployment and subsequently also in decelerating wage growth. The post-crisis economic

Chart A Indicator of negotiated wages vis-à-vis wages per employee (annual percentage changes)



Source: Macrobond.

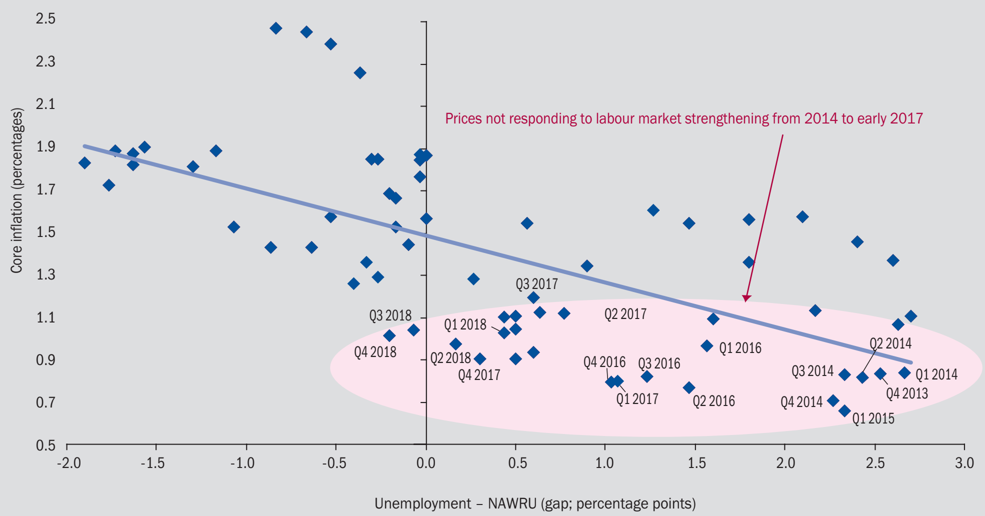
Chart B Unemployment vis-à-vis wages (annual percentage changes)



Source: Macrobond.

recovery and strengthening of the labour market was not, however, accompanied by a pick-up in wage growth. Unemployment fell from more than 12% in 2013 to 9% in the third quarter of 2017. Nevertheless, wage levels did not respond to that improvement. Chart B shows that the decline in unemployment from 2014 to mid-2017 was not reflected in wage growth. It was not until the end of 2017 that labour market buoyancy started to have an impact on wage developments. Subsequent quarters saw wage growth accelerate at a relatively fast pace. Thus, the relationship between the labour

Chart C Labour market vis-à-vis price developments (2002-2018)



Source: Macrobond.
Note: NAWRU – non-accelerating wage rate of unemployment; data published by the European Commission.

market situation and wages became gradually stronger.

Although rising wage growth is conducive to higher inflation, core inflation has so far remained subdued. Even after wage growth acceleration, core inflation has remained broadly unchanged in recent quarters, in the region of 1.0%. Compared with the lows recorded in late 2014 and early 2015 (0.7% to 0.8%), the inflation rate increased moderately.

The absence of pass-through from improving labour market conditions to prices may be partly explained by the ratio of gross operating surplus to value added in the non-financial corporation (NFC) sector. This ratio, which proxies for profitability, declined during the Great Recession and then gradually increased from 39.0% in 2013 to more than 41.0% in 2017. Since the last quarter of 2017 the ratio has been falling moderately; nevertheless, it is probably still providing a sufficient buffer to ensure that rising wage costs are not passed on to selling prices. At the same time, however, the downward trend in profitability in recent quarters implies that the period ahead could see the return of a closer relationship between the labour market, wage developments and consumer price inflation. This process may, however, be limited by a slowdown in euro area economic activity as well as by a deterioration in outlooks.

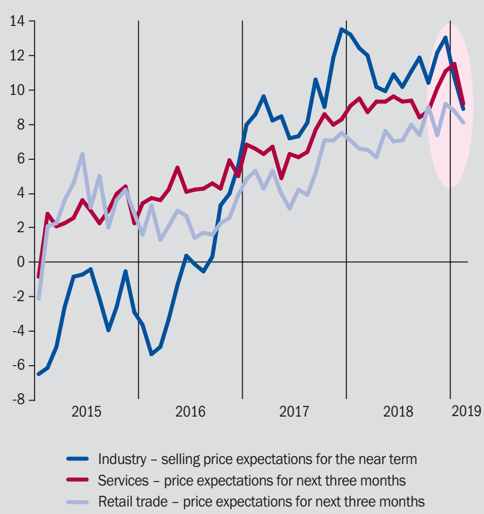
Chart D Ratio of the gross operating surplus to value added in the NFC sector

Source: Macrobond.

The moderation of economic activity is likely to have weighed on selling price expectations in the first two months of 2019. At the beginning of 2019 these expectation began falling across sectors, most markedly in industry and more moderately in services and retail trade. Meanwhile, for the first time in two years the ECB Survey of Professional Forecasters (for the first quarter of 2019) showed a downward revision of inflation expectations, both for this year and 2020. The weakening of inflation expectations probably reflects lower cost pressures from commodity prices, but stems above all from a slowdown in economic activity as well as persisting risks in the global economy.

At its monetary policy meetings between September 2018 and March 2019, the ECB's Governing Council decided to leave the interest rates on the main refinancing operations, the

Chart 18 Price expectations in industry, services and retail trade (percentage balances)



Source: Macrobond.

Chart 19 Expectations for HICP inflation according to the ECB Survey of Professional Forecasters

Source: Macrobond.

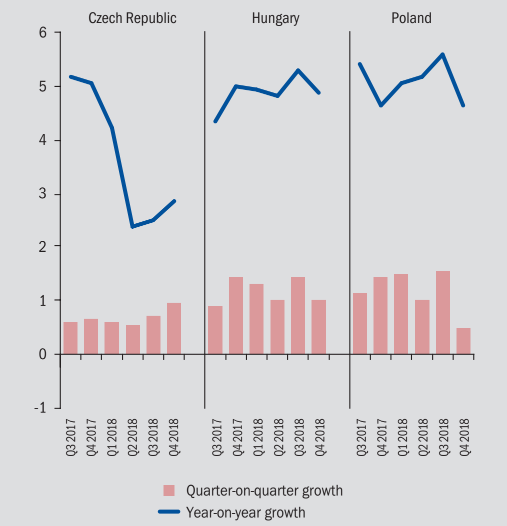
marginal lending facility and the deposit facility unchanged at 0.00%, 0.25% and -0.40% respectively. The Governing Council expects that rates will remain at their present levels at least through the end of 2019, and in any case for as long as necessary to ensure the continued sustained convergence of inflation to levels that are below, but close to, 2% over the medium term.

Regarding the ECB's non-standard monetary policy measures, net purchases under the ECB's asset purchase programme (APP) continued at a reduced monthly pace of €15 billion from October to December 2018 (from January to September the monthly pace had been €30 billion). At its meeting in December, the Governing Council decided to end net purchases under the APP in December 2018, and at the same time to enhance its forward guidance on reinvestment. In its post-meeting statement, the Governing Council said that principal payments from maturing securities purchased under the APP would continue to be reinvested, in full, for an extended period of time past the date when the key ECB interest rates started to be raised, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation. At the same time, the ECB also published the Governing Council's decision on the technical parameters of the reinvestments. After its meetings in January and March 2019, the Governing Council confirmed its intention to continue reinvesting on the basis agreed at its December meeting. In March the Governing Council also decided to launch a new series of quarterly targeted longer-term refinancing operations (TLTRO-III), starting in September 2019 and ending in March 2021, each with a maturity of two years. These new operations will help to preserve favourable bank lending conditions and the smooth transmission of monetary policy. Under TLTRO-III, counterparties will be entitled to borrow up to 30% of the stock of eligible loans as at 28 February 2019 at a rate indexed to the interest rate on the main refinancing operations over the life of each operation. Like the outstanding TLTRO programme, TLTRO-III will feature built-in incentives for credit conditions to remain favourable. Further details on the precise terms of TLTRO-III will be communicated in due course. In addition, the Governing Council said the Eurosystem would continue conducting lending operations as fixed rate tender procedures with full allotment for as long as necessary, and at least until the end of the reserve maintenance period starting in March 2021.

5 The Czech Republic, Hungary and Poland

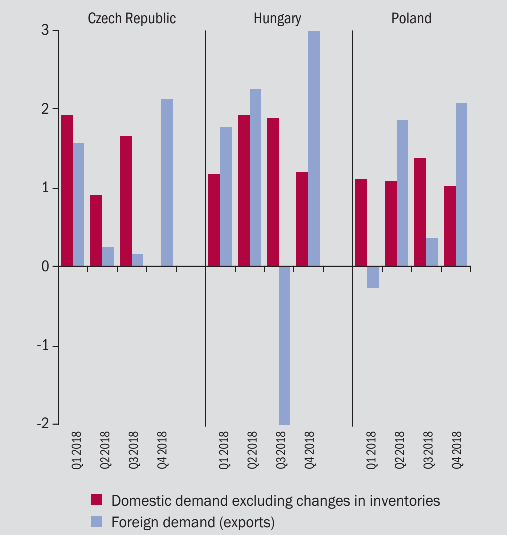
Among the countries under review, only the Czech Republic recorded higher annual GDP growth in the fourth quarter of 2018 than in the third quarter. While Czech GDP accelerated by 0.3 percentage point, to 2.8%, Hungary's economic growth slowed by 0.4 percentage point, to 4.9%, and Poland's moderated by 1.0 percentage point, to 4.6%.

Chart 20 GDP (percentage changes)



Source: Eurostat.

Chart 21 Contributions to quarterly GDP growth (percentage points)

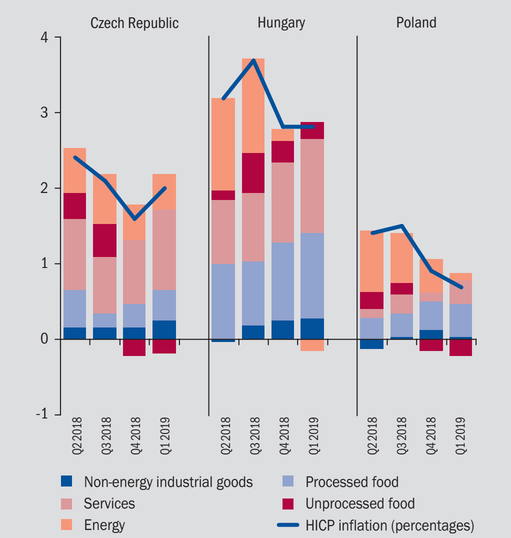


Sources: Eurostat and NBS calculations.

As for quarter-on-quarter GDP growth in the three countries, the only acceleration was again in the Czech Republic, where it increased by 0.2 percentage point to 0.9%. In Hungary, quarterly GDP growth slowed by 0.4 percentage point, to 1.0% and in Poland it eased by 1.1 percentage point, to 0.5%. The increase in Czech GDP growth was driven mainly by net exports, which in the previous quarter had made a negative contribution. Investment demand and also changes in inventories had a dampening effect on growth. Government consumption expenditure remained flat and household consumption growth moderated. In Hungary, the slowdown in GDP growth was largely caused by a destocking and by a more pronounced easing of investment demand growth. Government consumption also had a slightly negative impact. By contrast, net exports contributed positively to growth (with export growth outpacing import growth), and so, to a lesser extent, did household consumption. In Poland, the notable slowdown of GDP growth stemmed mainly from destocking and from a softening of investment demand growth. Government consumption also increased more slowly compared with the previous period. Net exports made the largest positive contribution to GDP growth, owing mainly to a stronger export performance. Private consumption also had a moderately positive impact.

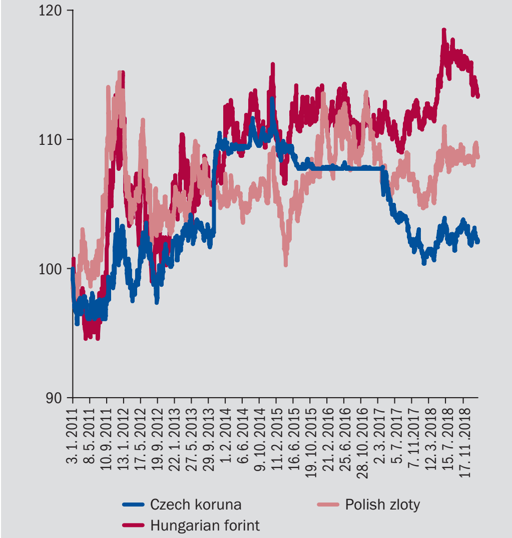
In all three countries, annual consumer price inflation was lower in December 2018 than in September, slowing in the Czech Republic by 0.5 percentage point, to 1.6%, in Hungary by 0.9 percentage point, to 2.8 %, and in Poland by 0.6 percentage point, to 0.9%. In the Czech Republic, headline inflation was lower owing mainly to a sharp drop in unprocessed food prices and, to a lesser extent, to lower energy inflation. There was, however, upward pressure on the inflation rate from the processed food component and services component. Non-energy industrial goods inflation remained the same. In January, compared with December, Czech headline infla-

Chart 22 HICP inflation and its components (annual percentages; percentage point contributions)



Sources: Eurostat and NBS calculations.

Chart 23 Exchange rate indices of national currencies vis-à-vis the euro (index: 3 January 2011 = 100)



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

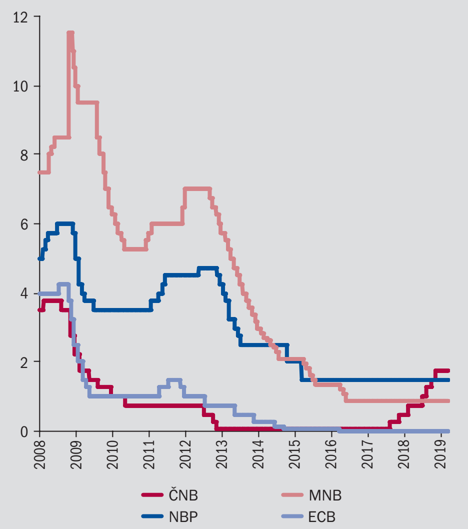
tion accelerated due mainly to increasing services prices and also to increases in the non-energy industrial goods and processed food components. In Hungary, the energy and, to a lesser extent, unprocessed food components accounted for the slowdown in annual headline inflation. On the other hand, there was upward pressure from the other components (services, non-energy industrial goods, and processed food), as they accelerated. In January, Hungary's headline inflation rate remained unchanged, as the impact of a decline in energy inflation was offset by higher inflation in prices of services, non-energy industrial goods and processed food. In Poland, as in the other countries, the slowdown in annual consumer price inflation was caused mainly by energy and unprocessed food prices, but unlike in the other countries, services inflation also had a dampening effect. The other components had an upward impact on headline inflation. In January 2019, Poland's inflation rate continued to moderate, due largely to the movements of energy and unprocessed food prices. By contrast, services inflation more than doubled.

Comparing their exchange rates against the euro at the end of the fourth quarter of 2018 and at the end of the previous quarter, none of three countries' currencies showed any significant change. The Czech koruna was 0.03% stronger, while the Hungarian forint and Polish zloty were weaker by 1.04% and 0.56% respectively.

After appreciating moderately in the previous quarter, the currencies under review did not display any significant volatility against the euro during the fourth quarter of 2018. Investor sentiment in financial markets remained subject to market expectations about the monetary policy stances of the world's major central banks, about the threat of trade war escalation following the introduction of new protectionist measures in world trade, and about oil supplies. Towards the end of the year in Europe, other factors also came into play, specifically the uncertainty about the Italian budget for 2019 and the turbulence surrounding Brexit. Financial markets responded to gradually mounting concerns about global economic growth in 2019 and 2020, when the projected slowdown could weigh on the exports of individual countries. Meanwhile, the currencies of central and eastern European countries have been largely resistant to the pressures buffeting the currencies of other emerging market economies, thanks to favourable trends in their domestic economies (strong domestic demand supported mainly by domestic consumption but also by investment). The Czech economy is still showing the impact of the Czech koruna's 'overboughtness', which is containing appreciation pressures on the exchange rate. The Polish zloty's exchange rate during the quarter reflected also domestic factors (turbulence stemming from a corruption scandal in the Polish banking sector).

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 2018. **Česká národní banka** (ČNB) increased its base interest rate (two-week repo rate) by 25 basis points, to 1.75%, with effect from 2 November 2018. It also raised the lombard rate and discount rate by 25 basis points, to 2.75% and 0.75% respectively. In its statement issued after the decision, the central bank said that a continued rise in interest rates towards their long-run neutral level was consistent with the bank's new macroeconomic forecast. It further stated that the risks to the forecast at the monetary policy horizon were slightly inflationary. Among the main domestic risks is uncertainty about the koruna's exchange rate, and among the main external risks is possibility of a hard Brexit and an increase in protectionist measures in world trade. In Hungary, the **Magyar Nemzeti Bank** (MNB) left its key interest rates unchanged in the fourth quarter of 2018, with the base rate, overnight collateralised lending rate and one-week collateralised lending rate all standing at 0.9%, and the overnight deposit rate in negative territory at -0.15%. According to the central bank, it remained necessary to keep the base rate unchanged and to maintain an accommodative monetary policy stance, in order to achieve the inflation target in a sustainable manner. The bank also said it was prepared for the gradual and cautious normalisation of monetary policy, which would begin with the modification of unconventional instruments. Looking ahead, the bank plans to adjust the monetary conditions necessary for achieving the inflation target in a sustainable manner, principally by creating an optimal combination of two instruments: the stock of swap instruments providing forint liquidity and the interest rate corridor. As part of its approved strategy for the setting of unconventional monetary policy instruments, the central bank phased out its three-month deposit facility by the end of 2018 and set the rate of remuneration of required reserves as the main interest rate. By the end of the year the bank had also ended its purchases of mortgage bonds. In January 2019, in order to support the provision of long-term fixed-rate lending, the MNB launched the Funding for Growth Scheme Fix with a total amount of HUF 1,000 billion. In Poland, **Narodowy Bank Polski** (NBP) left its monetary policy rates unchanged in the fourth quarter of 2018 (the reference rate has been at 1.5% since 5 March 2015). The central bank reiterated its view, based on incoming data and forecasts, that the current level of interest rates was conducive to keeping the Polish economy on a sustainable growth path and maintaining macroeconomic stability.

Chart 24 Key interest rates of national central banks (percentages)



Sources: National central banks and the ECB.

SUMMARY OF GDP GROWTH PROJECTIONS OF SELECTED INSTITUTIONS

Table 1 Global economy

	Release	2018		2019		2020		2021	
IMF	January 2019	3.7	(=)	3.5	(-0.2)	3.6	(-0.1)	-	-
OECD	March 2019	3.6	(-0.1)	3.3	(-0.2)	3.4	(-0.1)	-	-
EC[1)]	November 2018	4.0	(-0.2)	3.8	(-0.3)	3.8	-	-	-
ECB[2)]	March 2019	3.7	(-0.1)	3.5	(=)	3.6	(=)	3.6	(=)

Table 2 United States

	Release	2018		2019		2020		2021	
IMF	January 2019	2.9	(=)	2.5	(=)	1.8	(=)	-	-
OECD	March 2019	2.9	(=)	2.6	(-0.1)	2.2	(0.1)	-	-
EC	November 2018	2.9	(=)	2.6	(-0.1)	1.9	-	-	-
Federal Reserve	December 2018	3.05	(-0.05)	2.4	(-0.15)	1.9	(-0.05)	1.75	(-0.05)

Table 3 Euro area

	Release	2018		2019		2020		2021	
IMF	January 2019	1.8	(-0.2)	1.6	(-0.3)	1.7	(=)	-	-
OECD	March 2019	1.8	(-0.1)	1.0	(-0.8)	1.2	(-0.4)	-	-
EC	February 2019	1.9	(-0.2)	1.3	(-0.6)	1.6	(-0.1)	-	-
ECB	March 2019	1.9	(=)	1.1	(-0.6)	1.6	(-0.1)	1.5	(=)

Table 4 Czech Republic

	Release	2018		2019		2020		2021	
IMF	October 2018	3.1	(-0.4)	3.0	(=)	-	-	-	-
OECD	November 2018	3.0	(-0.8)	2.7	(-0.5)	2.6	-	-	-
EC	February 2019	2.9	(-0.1)	2.9	(=)	2.7	0.1	-	-
ČNB	February 2019	2.8	(-0.3)	2.9	(-0.4)	3.0	(-0.3)	-	-

Table 5 Hungary

	Release	2018		2019		2020		2021	
IMF	October 2018	4.0	(0.2)	3.3	(0.3)	-	-	-	-
OECD	November 2018	4.6	(0.2)	3.9	(0.3)	3.3	-	-	-
EC	February 2019	4.8	(0.5)	3.4	(=)	2.6	(=)	-	-
MNB	December 2018	4.7	(0.3)	3.5	(=)	3.0	(=)	3.0	-

Table 6 Poland

	Release	2018		2019		2020		2021	
IMF	October 2018	4.4	(0.3)	3.5	(=)	-	-	-	-
OECD	November 2018	5.2	(0.6)	4.0	(0.2)	3.3	-	-	-
EC	February 2019	5.1	(0.3)	3.5	(-0.2)	3.2	(-0.1)	-	-
NBP	March 2019	5.1	(0.3)	4.0	(0.4)	3.7	(0.3)	-	-

1) Global economic growth excluding the EU.
2) Global economic growth excluding the euro area.
Notes: Data in brackets denote the percentage point change from the previous projection. The IMF projections of January 2019 and OECD projections of March 2019 cover only large economies. The European Commission's forecast of February 2019 covers only EU countries.