Report on the International Economy

September 2019

NÁRODNÁ BANKA SLOVENSKA
EUROSYSTÉM

www.nbs.sk

Published by
Electronic version
https://www.nbs.sk/en/publications-issued-by-the-nbs/reports-on-the-international-economy-and-slovak-economy
Address
Národná banka Slovenska
Imricha Karvaša 1
813 25 Bratislava
info@nbs.sk
Discussed by the NBS Bank Board on 24 September 2019.

The cut-off date for data included in this report was 12 September 2019.
ISSN 1339-9616 (ONLINE)

Contents

List of tables

List of charts

Abbreviations

CPI	consumer price index
ČNB	Česká národní banka
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
MNB	Magyar Nemzeti Bank
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
NBP	Narodowy Bank Polski
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

Global economic growth remained subdued in the second quarter of 2019 amid the escalating US-China trade dispute, the slowdown in the technology sector, and persisting uncertainty surrounding Brexit. Looking at global activity from a sectoral perspective, services output weakened and manufacturing activity growth continued to slow in the second quarter, as firms reined in their spending (on machinery and equipment) and households did likewise on durable goods (e.g. cars). These trends indicate that firms and households are curbing their long-term expenditures in response to heightened political uncertainty. As for the situation in advanced and emerging market economies, activity growth softened across both groups.

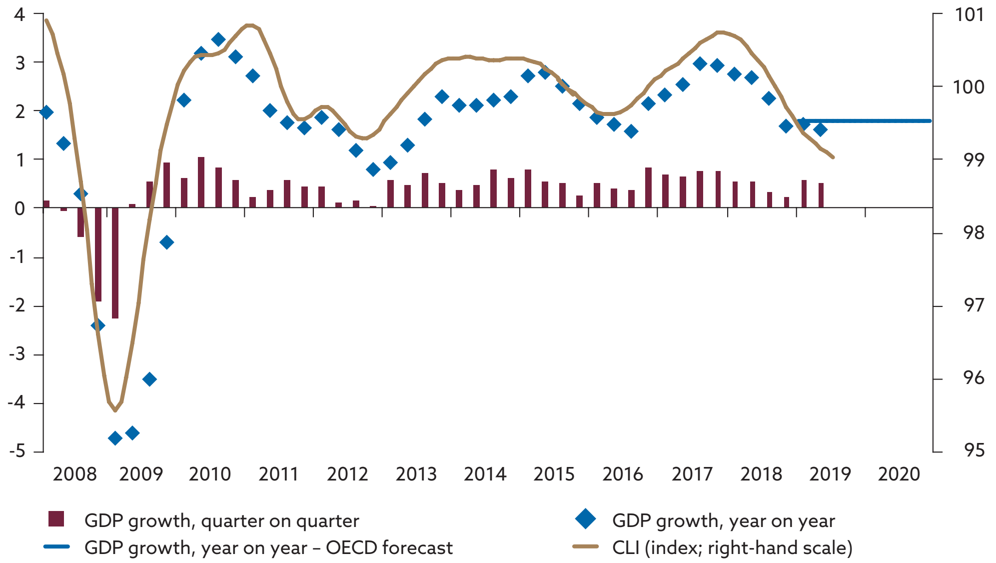
Notwithstanding the highest consumer spending growth since the last quarter of 2014 and elevated government spending, GDP growth in the **United States** slowed in the second quarter of 2019 as the ongoing trade war caused a contraction of exports which partially offset the impact of the strong positive contributions. Unemployment remained at low levels, but job creation weakened and investment fell significantly, amid fears of recession in other economies and the escalation of the trade war with China. In response to the impact of global developments on the US economic outlook, as well as to subdued inflationary pressures, the Federal Reserve cut interest rates in July and increased expectations of further monetary policy accommodation. **Japanese** economic growth was lower in the second quarter than in the first quarter, but it was still higher than expected owing to one-off factors. Private consumption was boosted by the Golden Week holidays, which were extended to fete the imperial succession. Household consumption was further supported by frontloading of durable goods purchases ahead of the VAT hike scheduled for October. Investment growth also accelerated and government consumption growth was robust. Only net trade had a negative impact on GDP growth, as exports stagnated and import growth picked up. In **Europe**, too, net trade contributed negatively to economic activity growth, causing it to drop to half the level of the previous quarter's growth. In other words, GDP growth was driven entirely by domestic demand. The **United Kingdom's** economy unexpectedly contracted in the second quarter, as inventories built up in the previous quarter (ahead of the original end-of-March Brexit deadline) were reduced. A decline in investment also had a negative impact on GDP growth. In an environment of strong wage growth and solid job creation, however, private consumption growth remained favourable and, together with significant government spending, limited the extent of the economic contraction. Although net trade contributed positively to GDP growth, it did so only because imports fell far more sharply than exports; imports were affected by the fading of the frontloading effect, and exports reflected global economic developments. Continuing consumer spending and the build-up of inventories in preparation for Brexit are expected to support economic growth in the next quarter and thus prevent a technical recession.

In **China**, the economy grew at its slowest pace in 27 years in the second quarter of 2019. Markets had been expecting lower growth rate, foreshadowed by previous data releases. The escalation of the country's trade dispute with the United States affected both business and consumer confidence and led to a slowdown in industrial production that continued into the beginning of the third quarter. In the services sector, however, growth remained robust. The Chinese authorities expressed their readiness to stimulate the economy with measures to finance local government investment. At the same time, the central bank announced a programme to support small banks. **Indian** GDP growth decelerated sharply in the second quarter on the back of slower growth in private consumption and virtual stagnation in manufacturing industry. The car industry has seen massive lay-offs in recent months and consumer goods firms have been facing falling prices as a result of weakening demand. Indian GDP growth's downward spiral has already lasted a year, and the unemployment rate has risen to its highest level in ten years. After contracting in the first quarter, the **Brazilian economy** avoided a technical recession mainly thanks to strong investment growth and sustained household consumption growth amid rising job creation. Government consumption expenditure had a negative impact on economic growth, as did the decline in exports due to the softening of demand from Argentina. Reflecting the positive effect of a common strategy for economic and fiscal policies on macroeconomic stability and on resilience to external shocks, the **Russian economy** experienced growth acceleration. According to short-term indicators, the economy benefited from stronger industrial production and from rising consumer demand in the context of moderate price pressures and low unemployment. On the other hand, the external environment had a dampening effect on GDP growth, with exports declining for the first time in almost three years owing to oil production restraint.

The economic slowdown in advanced economies in particular was reflected in economic activity across the OECD area, which moderated to 0.5% in the second quarter of 2019, down from 0.6 % in the previous quarter. In year-on-year terms, GDP growth for the OECD area fell from 1.7% in the first quarter to 1.6% in the second quarter. The Composite Leading Indicator for the OECD area[1] declined for a sixth successive quarter in the second quarter of 2019 and fell again in July, so implying that the slowdown of the global economy will continue 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 July and August was slightly below its average for the second quarter of 2019. With the global economic slowdown being exacerbated by tensions between the United States and China, the IMF called on the two countries to resolve their dispute quickly "through a comprehensive agreement that avoids undermining the international system".

Chart 1

GDP growth and the CLI for the OECD area



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

Global consumer price inflation decreased in the second quarter of 2019. The inflation rate in the OECD area fell from 2.3% in March to 2.0% in June. This slowdown was driven mainly by energy prices, which were still rising in March, but slumped in June in response to a large year-on-year decrease in oil prices. The core inflation rate increased from 2.1% in March to 2.2% in June. In July, the core rate rose further, to 2.3%, and this increase, together with stagnating energy prices, pushed the headline rate up to 2.1%.

[1] The CLIs for OECD countries are published on a monthly basis, and the most recent, published in September 2019, are for the period up to July 2019.

2 Commodities

Average commodity prices were higher in the second quarter of 2019 than in the previous quarter. Their trend reflected an increase in average energy commodity prices, which outweighed the impact of a slight decline in average non-energy commodity prices. Price developments over the quarter were somewhat heterogeneous, with prices of both non-energy and energy commodities standing lower in June than in March.

Looking at energy commodity prices, the average Brent crude oil price in the early part of the second quarter was maintaining the uptrend it had been on since the start of the year. This was supported by the United States announcing the end of exemptions from sanctions for countries still buying oil from Iran. The price came under further upward pressure from the reduction in Russian oil supplies to Europe. Towards the end of May in particular, the oil price declined strongly in response to the escalating US-China trade war and fears of a global slowdown in demand for oil. June saw the oil price stabilise and correct slightly, given the mounting tensions between the United States and Iran and the expectations of US interest rate cuts. At the start of July OPEC and allied oil producers (OPEC+) agreed to extend their oil supply cut pact by a further nine months, a move that was surprisingly followed by a brief drop in the oil price. This decline reflected prevailing fears of weakening global demand. The oil price also fell relatively sharply at the beginning of August, when the US President announced that tariffs would be imposed on the rest of Chinese imports.

As regards non-energy commodity prices, a majority of metal prices declined over the course of the second quarter of 2019. Their trend stemmed from the ongoing slowdown in industrial activity and the escalating tension between the United States and China. In the case of copper, the price decline was caused also by increasing inventories. There was, though, a sharp rise in iron ore prices, resulting from reduced production in Brazil and Australia. Food commodity prices had an upward impact on the non-energy commodity price index, largely through rising prices of maize, cocoa, milk and meat. On the other hand, soybean prices had a dampening effect.

3 The United States

US economic activity has been reflecting the fading of the positive fiscal stimulus effects, the impact of the trade war with China, and the global economic slowdown. The US economy expanded at an annualised rate of 2.0% in the second quarter of 2019, down from 3.1% in the previous quarter. The year-on-year growth rate also decelerated, from 2.7% in the first quarter to 2.3% in the second quarter.

But for the contributions from the government sector and from private consumption growth, which recorded its highest level in four and a half years, the US economy's slowdown would have been even more pronounced. Households were the main driver of economic growth, as the increase in their spending on durable goods reflected the impact of the escalating US-China trade war and resulted in a strong acceleration of private consumption. This had a downward effect on the saving ratio, which nevertheless remains elevated and conducive to the maintenance of solid private consumption growth. Economic growth was further supported by military expenditure and by the payment of back pay to federal government employees furloughed during the partial government shutdown around the turn of the year. On the other hand, investment demand had a dampening effect on growth, with declines in both residential and non-residential investment. Investor fears of recessions in other economies represent a downside risk to the US investment outlook, as does the trade war with China. Government expenditure and investment surprised on the upside with their highest growth rates in a decade, owing mainly to non-defence spending growth (which on annualised basis increased to 16%). Net trade had a large negative impact on GDP growth, with exports declining and imports remaining broadly unchanged. Changes in inventories also made a significantly negative contribution.

Annual consumer price index (CPI) inflation was, on average, higher in the second quarter than in the first quarter, but its overall trend in the second quarter was downward. Headline CPI inflation peaked in April, at 2%, but owing partly to the increasing year-on-year decline in oil prices, which quickly passed through to energy prices, it slowed to 1.6% in June. May's increase in tariffs on Chinese imports did not yet have any significant impact on CPI inflation. In July, core inflation components accelerated and the decline in energy prices moderated, with the result that headline inflation increased to 1.8%.

At its meetings in April/May and June 2019, the US Federal Open Market Committee (FOMC) decided to leave the target range for the federal funds rate unchanged, at 2.25% to 2.50%. In reaching its decision, the Committee took into account the strength of the labour market, the growth in economic activity, current inflation trends, and inflation expectations. At its meeting in July, however, the Committee decided to lower its key interest rate by 25 basis points, to a range of 2.00% to 2.25%, basing its decision on the implications of global developments for the economic outlook as well as on muted inflation pressures. The rate cut was the first since December 2008, more than ten years earlier. In its post-meeting statement, the Committee said it would continue to monitor the implications of incoming information for the economic outlook and would act as appropriate to sustain the expansion, with a strong labour market and inflation near its symmetric 2% objective. The Committee also said that in August, two months earlier than previously indicated, it would conclude the reduction of its aggregate securities holdings in the System Open Market Account (i.e. Securities accumulated during the global financial crisis).

The trade war between the United States and China continued in the second quarter of 2019. On 10 May 2019 the US Administration increased tariffs from 10% to 25% on USD 200 billion worth of Chinese goods.[2] According to the US, the tariff hike was a response to Chinese attempts to backtrack on commitments under a draft US-China trade pact. China retaliated on 1 June 2019 by raising import tariffs of 5% or 10% on USD 60 billion worth of US goods to 10% or 25%. The trade dispute escalated further when the US President indicated that a 25% tariff would be imposed on the remaining Chinese imports, worth approximately USD 300 billion. At the start of August, the President announced that the new tariff would be imposed with effect from 1 September, at a level of 10%. In response, China allowed its currency to depreciate past the seven yuan per dollar level, to its weakest level since May 2008. This prompted the United States to accuse China of currency manipulation. Responding partly to concerns of business and consumer groups about its latest moves in the trade war, the US Administration delayed the introduction of the tariff on certain goods until mid-December 2019 in order to protect shoppers from higher prices during a time of increased consumption (the start of the school year and the holiday shopping season). After deciding to raise the new tariff to 15%, the US Administration began imposing it on USD 125 billion worth of Chinese goods from 1 September 2019. Also in August, the US President announced that the existing tariffs of USD 250 billion of Chinese goods would be increased from 25% to 30% from 1 October 2019. The move came on the heels

[2] The US Administration was originally planning to raise tariffs from 1 January 2019. This deadline was postponed initially by three months, following a temporary trade truce agreed between the two countries in December 2018, and then again in February, following progress in bilateral talks.

of China's imposition of tariffs on USD 75 billion of US goods (including US crude oil for the first time), introduced in retaliation for the US tariff increase announced earlier in the month.

As regards its plans for applying tariffs to other trading partners, the Administration announced on 17 May 2019 that it was postponing for 180 days a decision on whether to impose tariffs on imported cars and auto parts,[3] so as to allow for more time for trade talks with the European Union and Japan. The US is therefore expected to take a decision on this issue in November 2019.

[3] In mid-February 2019, after completing an investigation initiated in May 2018, 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. In May 2019 the President announced that he agreed with report's findings that such imports do constitute a national security threat.

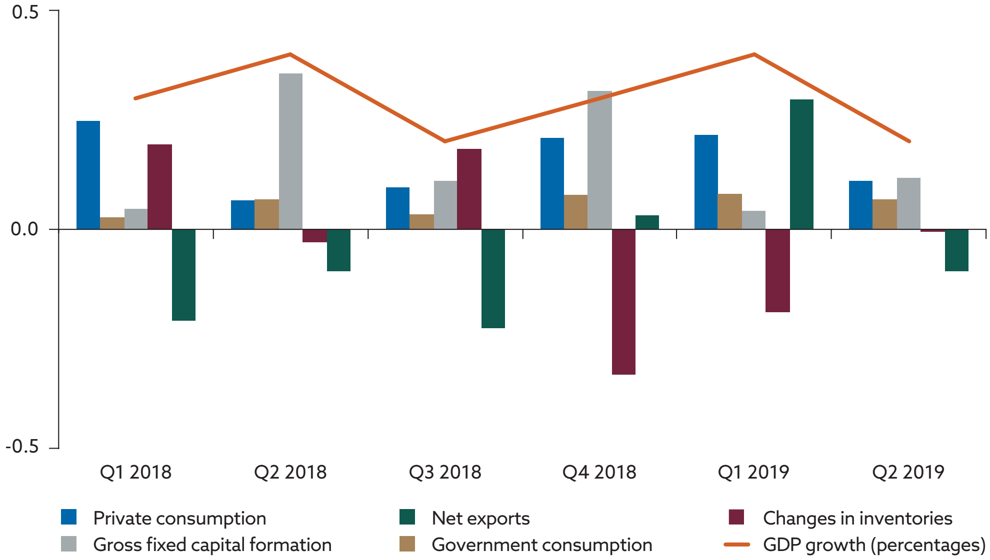
4 The euro area

Euro area GDP growth slowed, quarter on quarter, to 0.2% in the second quarter of 2019, from 0.4% in the previous quarter. Looking at some of the region's larger economies, the German economy contracted by 0.1% in the second quarter after growing by a relatively strong 0.4% in the first; Spain's economic growth moderated from 0.7% to a still solid 0.5%, while Italy's GDP remained flat, after increasing by a moderate 0.1% in the first quarter, and the Netherlands recorded the same rate of GDP growth in the second quarter as it did in the first (0.5%). In year-on-year terms, euro area GDP growth edged down to 1.2% in the second quarter (from 1.3% in the first quarter).

The euro area's economic slowdown was caused mainly by exports, which stagnated in the second quarter after recording relatively favourable growth in the previous quarter. That growth was probably due in part to stock-building in the United Kingdom ahead of the original end-of-March Brexit deadline, which translated into a surge in euro area exports to the UK. Given the extent of that inventory build-up and the subsequent postponement of Brexit, exports to the UK fell significantly in the second quarter. Euro area imports also softened slightly during the period under review. Overall, net trade reduced GDP growth, whereas in the previous quarter it had a positive impact. Economic growth continued to be supported by domestic demand; however, unlike in the first quarter, private consumption growth weakened significantly and government consumption growth also moderated slightly. By contrast, investment demand accelerated, with the most significant increases being observed in machinery and equipment investment and in intellectual property product investment. Construction investment remained flat. As for changes in inventories, their contribution to GDP growth was neutral in the second quarter, after being negative in the previous two quarters.

Chart 2

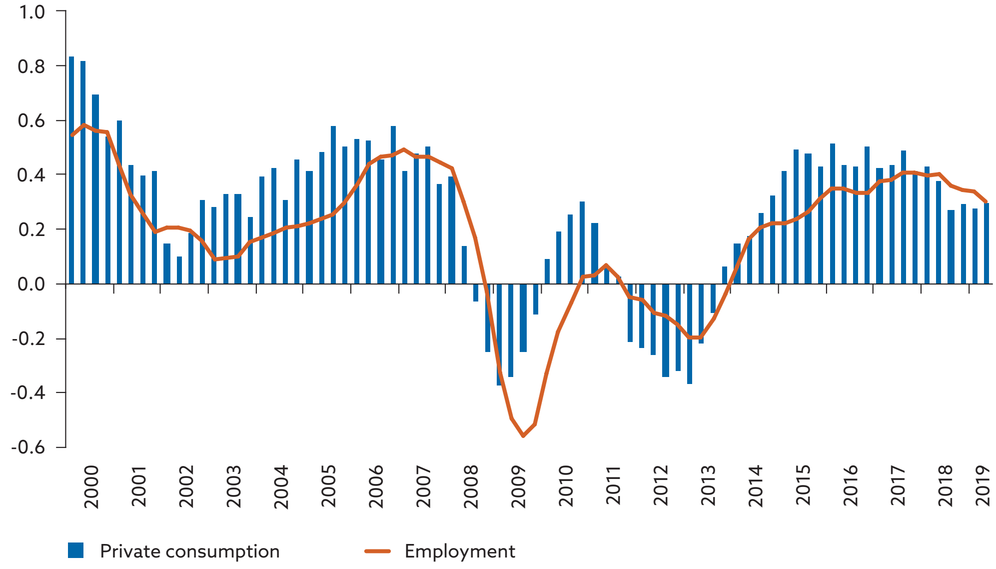
Euro area GDP and its components (quarter-on-quarter percentage changes; percentage point contributions)



Sources: Macrobond, and NBS calculations.

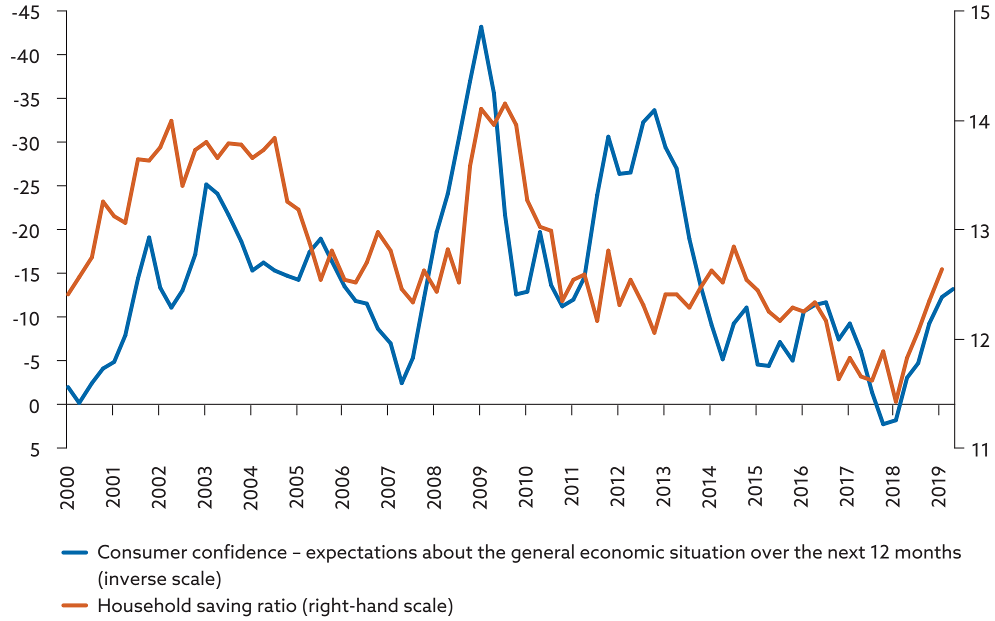
Private consumption growth slowed by 0.2 percentage point in the second quarter, to 0.2%, and was probably affected by signs of a slight weakening of the labour market. Employment growth slowed to 0.2% in the second quarter, from 0.4% in the previous quarter. Wage growth remained relatively favourable but decelerated somewhat. Owing to the softening of economic activity, particularly in manufacturing industry, and to mounting fears of a global slowdown, consumers' expectations about the general economic situation continued to deteriorate. This downtrend has been reflected in the saving ratio, which increased for a fourth successive quarter in the first quarter (the most recent quarter for which the ratio has been published). Continued weakening of labour market conditions could further dent consumer sentiment and therefore weigh on consumer demand.

Chart 3
Private consumption and employment (quarter-on-quarter percentage changes; calculated from moving averages for four quarters)



Sources: Macrobond, and NBS calculations.

Chart 4
The saving ratio and consumers' expectations about the general economic situation (percentages and percentage balances)

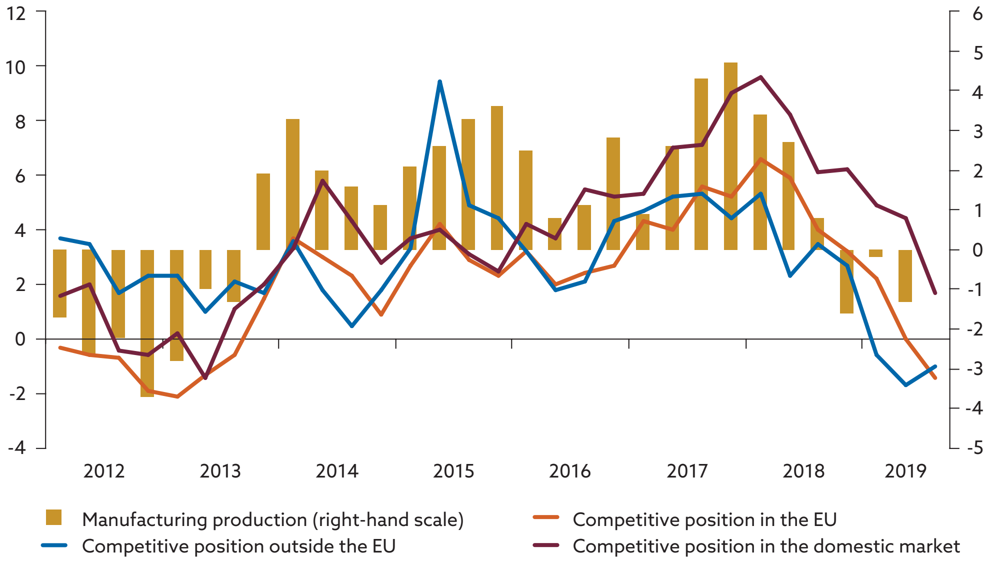


Source: Macrobond.

After a temporary pick-up in the first quarter, industrial production returned to its downward path in the second quarter (falling by 0.5%). Adversely affected by increasing protectionism and gloomy outlooks for the global economy, industry remains the weak link in the euro area economy. Furthermore, the economic slowdown in individual euro area economies was reflected in the third quarter in a further drop in industrial firms' assessments of their competitiveness in both their domestic markets and EU markets. On the other hand, their assessments of their competitiveness in extra-EU markets stopped declining, but nevertheless remained at low levels. The downtrend in export expectations also ended, which may indicate that manufacturing production is stabilising.

Chart 5

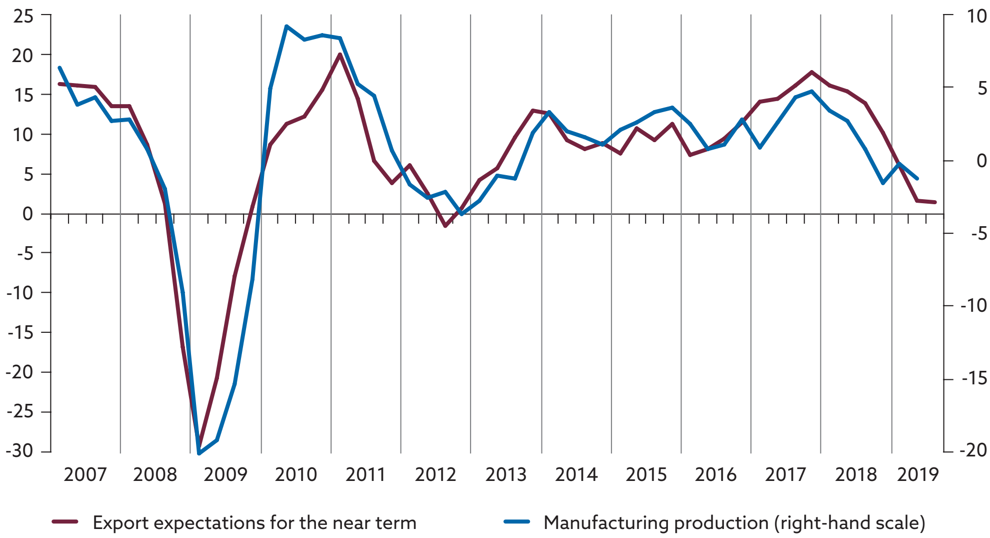
Industrial competitiveness and manufacturing production (percentage balances; annual percentage changes)



Sources: Eurostat, European Commission, and NBS calculations.

Chart 6

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

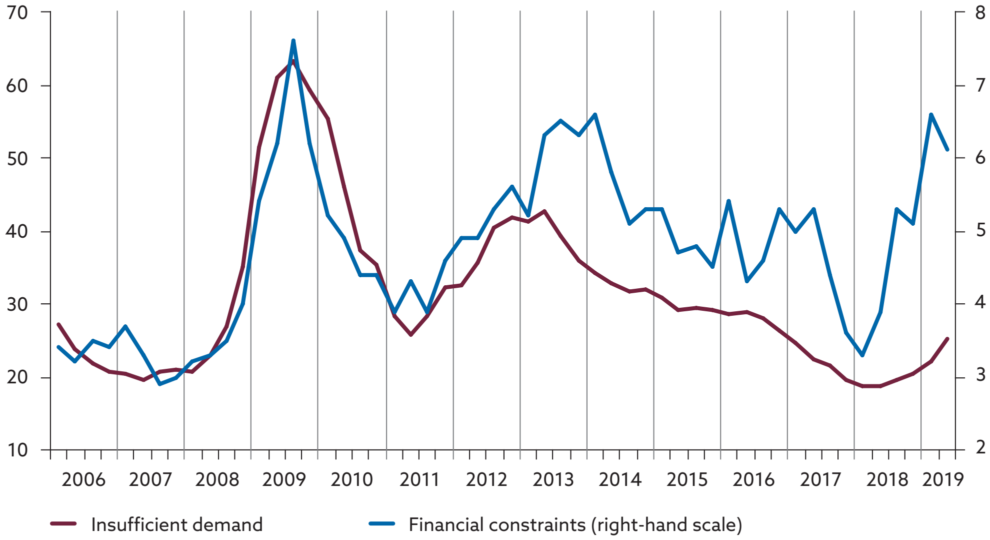


Sources: Eurostat, European Commission, and NBS calculations.

Industrial firms' assessments of the factors limiting their production also imply a weakening of economic activity in the third quarter. Survey results for the third quarter, as for the previous four quarters, showed an increase in the percentage of respondents reporting 'insufficient demand' as a factor limiting production. For a second successive quarter, however, the importance of 'financial constraints' decreased; responses may have been swayed by measures that the ECB has taken and is expected to take in order to support the economy and meet its price stability objective. As for production factors – 'shortage of material and/or equipment' and 'shortage of labour force' – the share of respondents who see them as limiting production decreased again, implying a lower level of production capacity utilisation. This may in future be reflected in a loosening of labour market conditions, as well as in a lessening of the impetus for future investment.

Chart 7

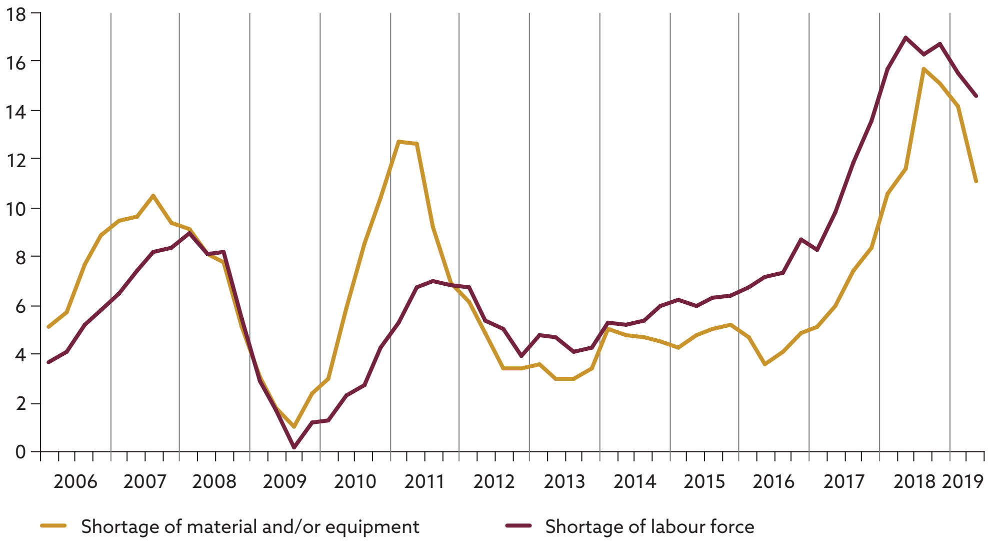
Factors limiting production in industry (percentages)



Source: Macrobond.

Chart 8

Factors limiting production in industry (percentages)

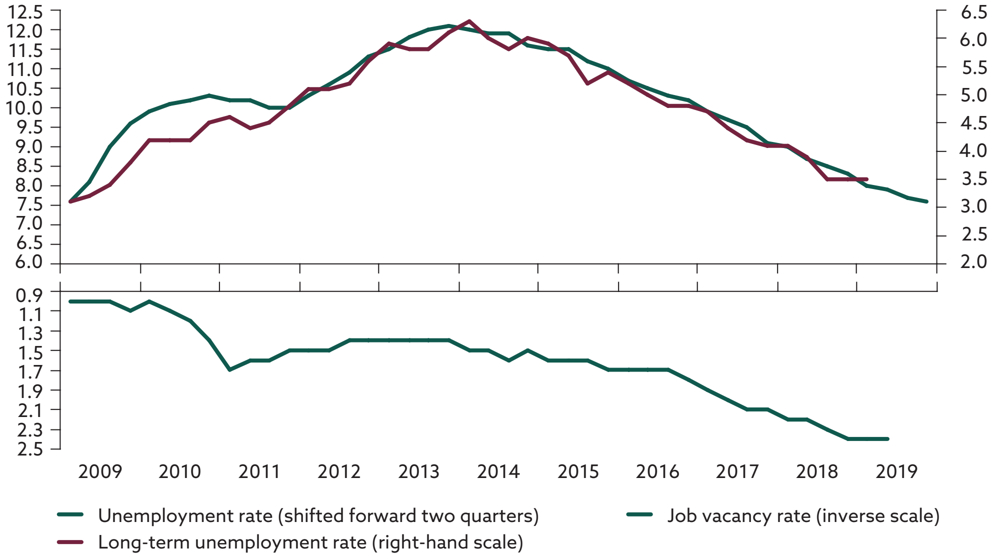


Source: Macrobond.

The unemployment rate continued to fall moderately in the second quarter, down to 7.6% (from 7.7% in the first quarter). At the same time, though, the job vacancy rate stopped decreasing and remained unchanged from the previous quarter (at 2.4%). This, together with the slower rate of employment growth, suggests that labour market conditions are starting gradually to loosen. Employment expectations also imply that these conditions are easing.

Chart 9

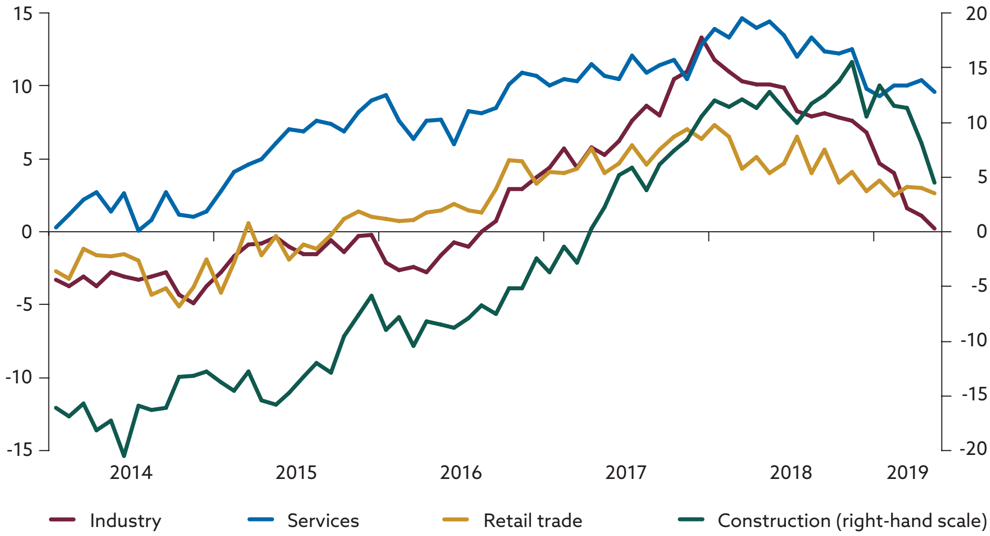
The unemployment rate, long-term unemployment rate, and job vacancy rate (percentages)



Source: Macrobond.

Chart 10

Employment expectations by sector (percentage balances)

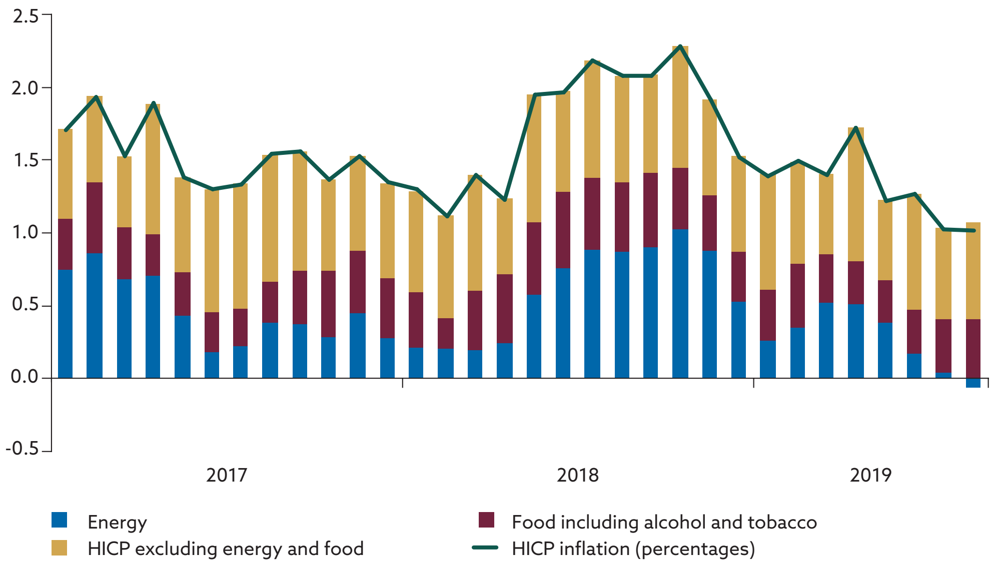


Source: Macrobond.

Euro area annual HICP inflation did not change significantly in the second quarter, and its 1.3% rate in June was just below its 1.4% rate in March. The later timing of Easter this year affected price-level changes in the second quarter, most notably causing greater volatility in services prices. As a result, core inflation (HICP inflation excluding energy, food, alcohol and tobacco increased from 0.8% in March to 1.1% in June. Unlike in the previous quarter, energy inflation eased in the second quarter and thus had a dampening effect on the headline rate. Food inflation also slowed. The energy component continued to moderate in the first two months of the third quarter, and this was reflected in the headline rate, which fell to 1.0% in July and remained at that level in August. The inflation slowdown in the summer months was also supported by core inflation, which fell to 0.9% on the back of lower services inflation. On the other hand, food inflation accelerated slightly.

Chart 11

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

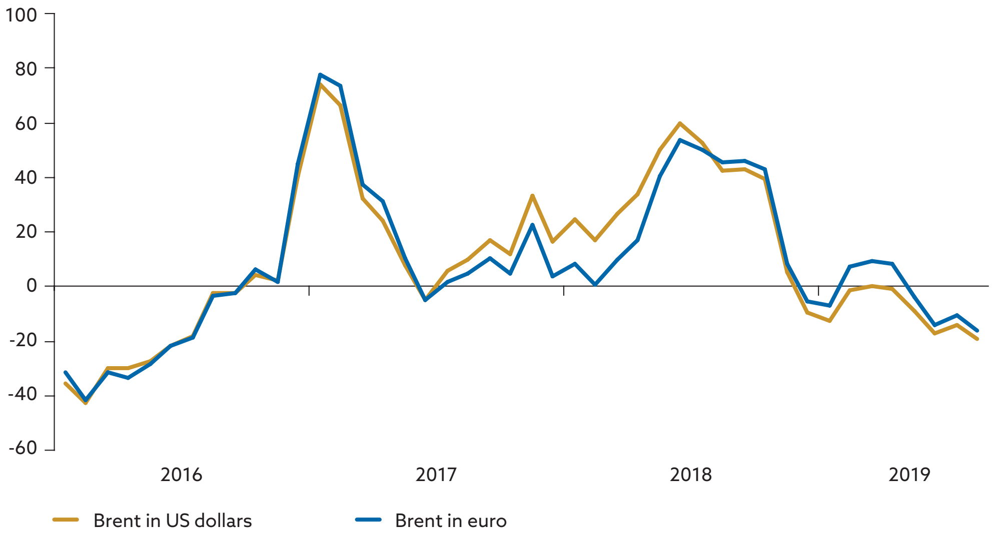


Source: Macrobond.

Consumer energy prices responded quickly to commodity market developments as well as to the moderation of the euro's year-on-year depreciation, as their rate of increase slowed from more than 5% in March to less than 2% in June. This trend continued in the next two months, to the point that consumer energy prices declined moderately in August (by 0.6% year on year).

Chart 12

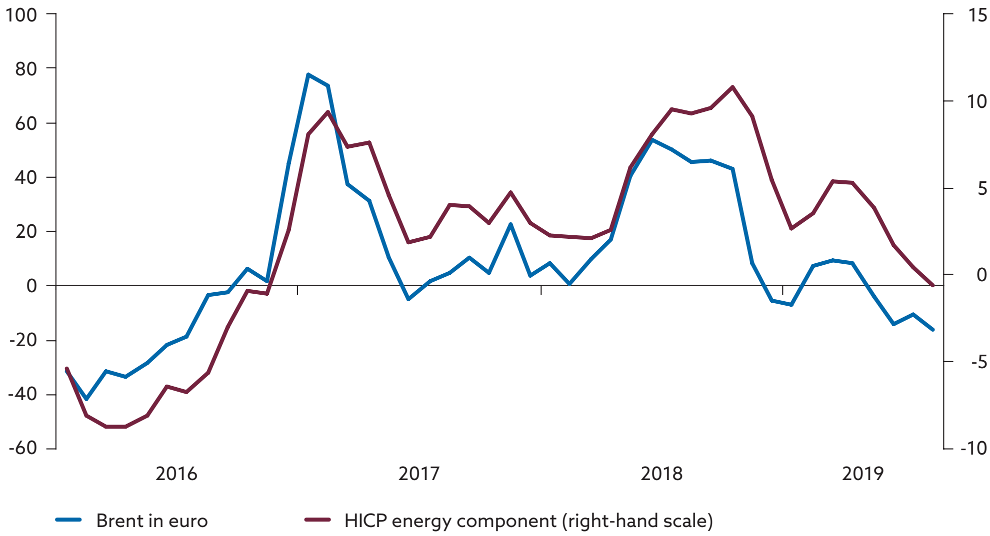
Oil prices in euro and US dollars (annual percentage changes)



Sources: Macrobond, and NBS calculations.

Chart 13

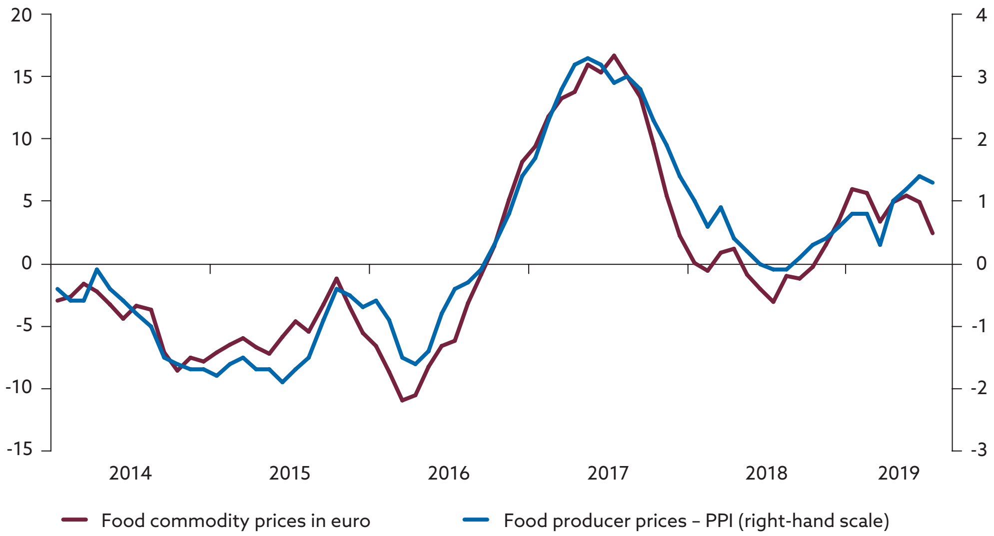
Oil prices in euro and the HICP energy component (annual percentage changes)



Sources: Macrobond, and NBS calculations.

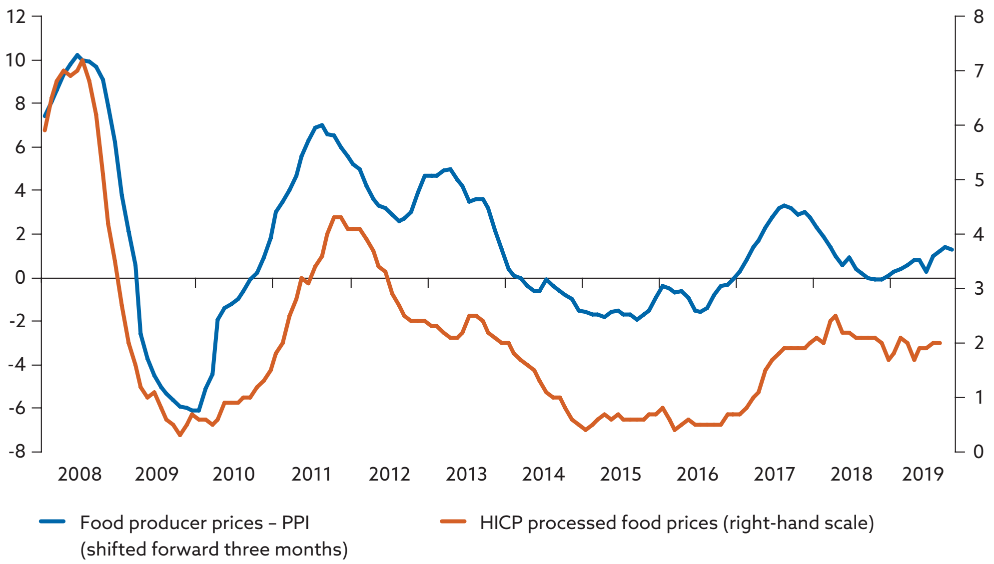
After rising in the first two quarters of 2019, food commodity price inflation remained largely unchanged in the second quarter. Nevertheless, food producer prices continued to accelerate gradually in the second quarter, reflecting the pass through of past commodity price movements. In July, food commodity price inflation slowed and the producer price inflation stopped increasing. The acceleration of food producer prices in the first half of 2019 was still not having a significant impact on consumer food price inflation, which remained largely unchanged.

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



Source: Macrobond.

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

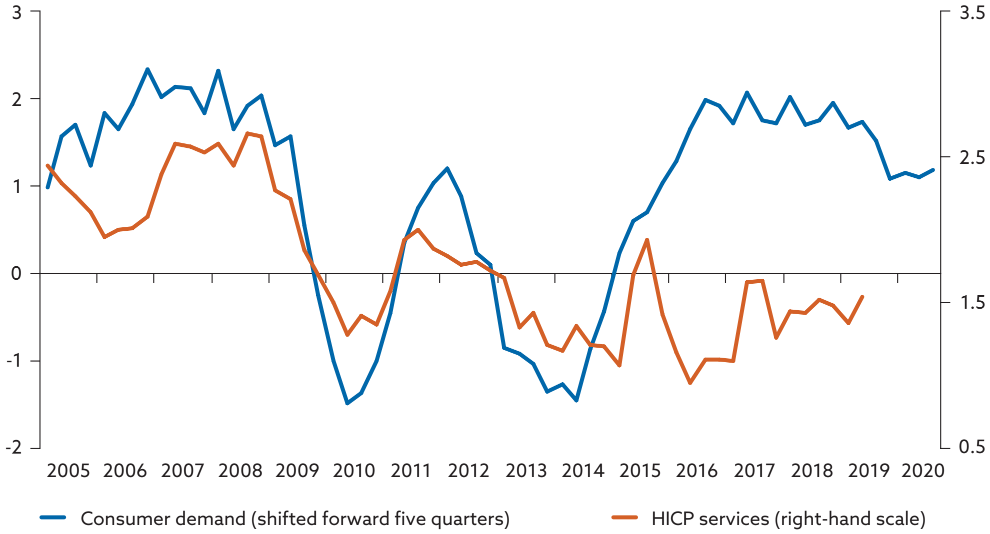


Source: Macrobond.

Non-energy industrial goods inflation picked up in the second quarter, owing to previous depreciation of the nominal effective exchange rate (NEER) and the related acceleration of import prices. This trend continued in July and August. As the rate of depreciation gradually began to weaken, however, it had a downward impact on import price inflation, which may also have curbed non-energy industrial goods inflation. At the same time, consumer demand was gradually moderating and did not have a significant upward impact on core inflation even when the core rate was at relatively high levels. The slowdown in consumer demand will therefore probably represent an inflation-limiting factor.

Chart 16

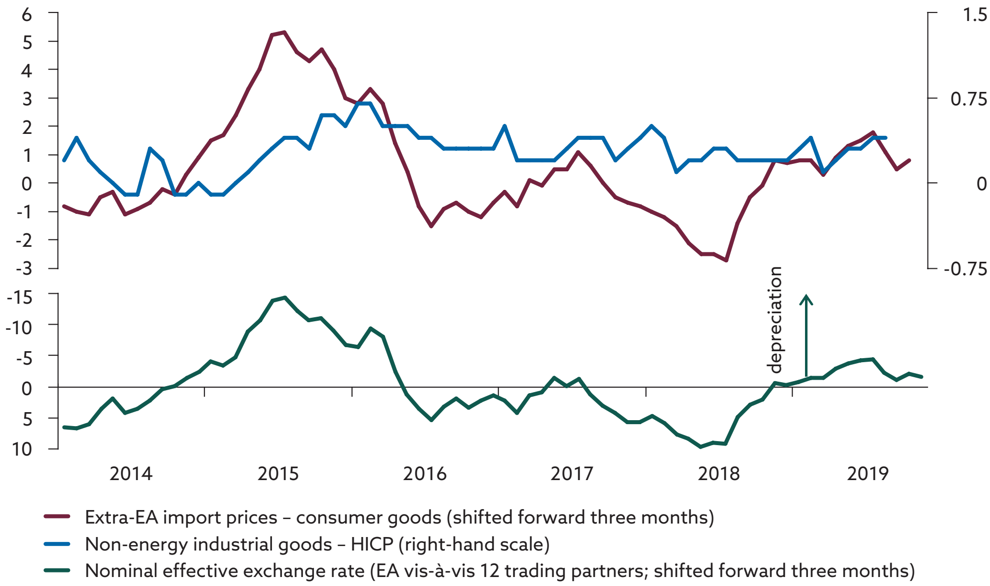
Consumer demand and HICP services (annual percentage changes)



Sources: Macrobond, and NBS calculations.

Chart 17

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

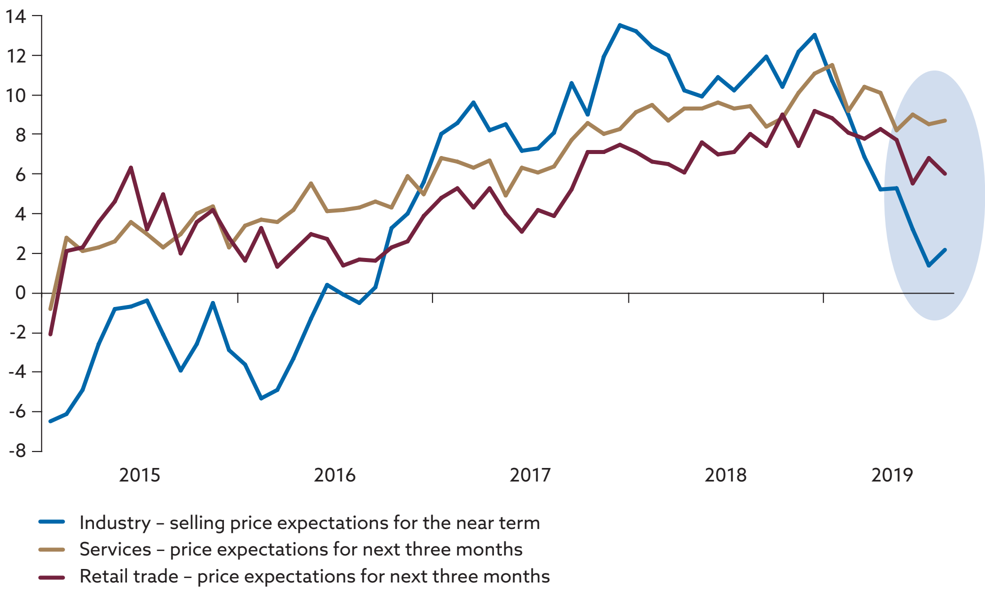


Source: Macrobond.

Price expectations are being affected by increasing concerns about the implications of the US-China trade war and about the global economic slowdown, as well as by the adverse situation in manufacturing industry. The most marked declines in expectations have been in industry and, to a lesser extent, retail trade. The ECB Survey of Professional Forecasters for the third quarter of 2019 showed a decline in inflation expectations for a third successive quarter, including a more pronounced drop in expectations for the year ahead.

Chart 18

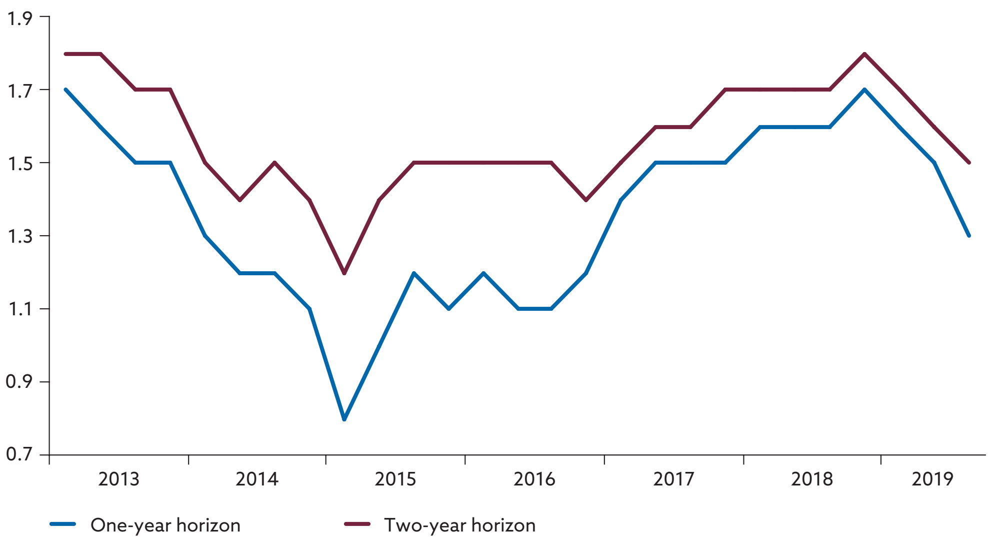
Price expectations in industry, services and retail trade (percentage balances)



Source: Macrobond.

Chart 19

Expectations for HICP inflation according to the ECB Survey of Professional Forecasters (percentages)



Source: Macrobond.

At its monetary policy meetings between April and June 2019, 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. When it met in September, the Governing Council decided to lower the deposit facility rate by 10 basis points to -0.50% and to keep the other two rates unchanged. According to the post-meeting statement, the Governing Council expects that the key ECB interest rates will remain unchanged at their present or lower levels until the Governing Council has seen the inflation outlook robustly converge to a level sufficiently close to, but below, 2%, and such convergence has been consistently reflected in underlying inflation dynamics.

Also at the September meeting, the Governing Council decided to restart net purchases under its asset purchase programme (APP) at a monthly pace of €20 billion as from 1 November 2019. It expects them to run for as long as necessary to reinforce the accommodative impact of the ECB policy rates, and to end shortly before it starts raising the key ECB interest rates.

At the same time, the Governing Council announced its intention to continue reinvesting, in full, the principal payments from maturing securities purchased under the APP for an extended period of time past the date when it starts raising the key ECB interest rates, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

The Governing Council further decided at the September meeting to change the modalities of the new series of quarterly targeted longer-term refinancing operations (TLTRO III) to preserve favourable bank lending conditions, ensure the smooth transmission of monetary policy and further support the accommodative stance of monetary policy. (The previous modalities were set in June 2019.) These changes included reducing the interest rate in each TLTRO III operation, which will set at the level of the average rate applied in the Eurosystem's main refinancing operations (MROs) over the life of the respective TLTRO (in June the interest rate was set at a level of 10 basis points above the average MRO rate). For counterparties whose eligible net lending between the end of March 2019 and the end of March 2021 exceeds their benchmark net lending, the rate applied to TLTRO III operations will be lower, and can be as low as the average interest rate on the deposit facility prevailing over the life of the respective TLTRO III operation. A second change was to extend the maturity of TLTRO III operations to three years as of their settlement date, with the longer maturity being better aligned with that of bank loans used to finance investment projects. Thirdly, following the extension of the maturity of TLTRO III operations, counterparties will be able to repay the amounts borrowed under TLTRO III earlier than their final maturity, at a quarterly frequency starting two years after the settlement of each operation. These changes will apply as of the first TLTRO III operation to be allotted on 19 September 2019 and will be implemented in an amendment to the Decision of the ECB of 22 July 2019 on a third series of targeted longer-term refinancing operations (ECB/2019/21).

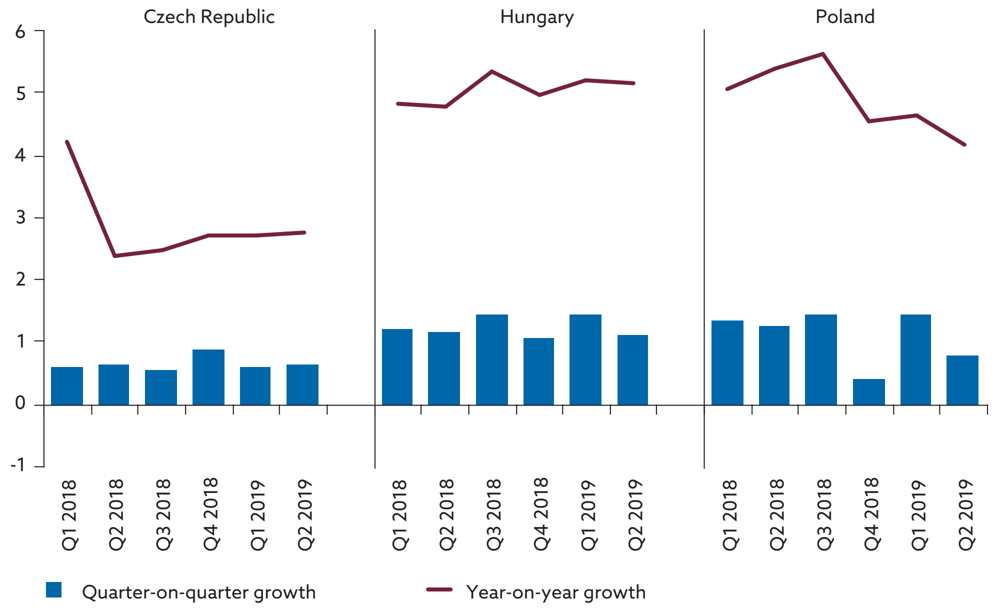
Another decision of the September meeting was to introduce a two-tier system for remunerating excess liquidity holdings. Part of credit institutions' excess liquidity holdings will be exempt from negative remuneration at the rate applicable on the deposit facility (this tier will be remunerated at an annual rate of 0%). The volume of reserve holdings in excess of minimum reserve requirements that will be exempt from the deposit facility rate will be determined as a multiple of an institution's minimum reserve requirements. The multiplier will be the same for all institutions. The multiplier may be adjusted by the Governing Council in line with changing levels of excess liquidity holdings, and any such adjustment will be announced and will apply as of the following maintenance period after the decision is made. The two-tier system will first be applied in the maintenance period starting on 30 October 2019, and the multiplier that will be applicable as of that maintenance period will be set at 6.

5 The Czech Republic, Hungary and Poland

Compared with the first quarter, annual GDP growth in the second quarter was unchanged in the Czech Republic (at 2,7%) and Hungary (5.2%), while in Poland it fell by 0.4 percentage point, to 4.2%.

Chart 20

GDP (percentage shares)

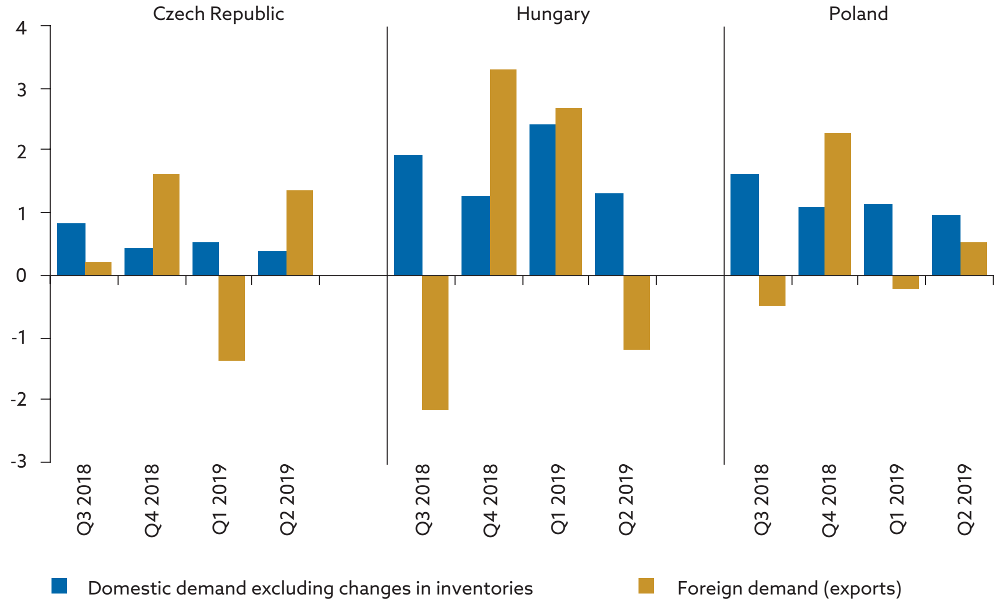


Source: Eurostat.

In quarter-on-quarter terms, GDP growth increased only in the Czech Republic, rising by 0.1 percentage point to 0.7%. In Hungary, quarterly GDP growth slowed by 0.3 percentage point, to 1.1%, and in Poland it eased by 0.6 percentage point, to 0.8%. The increase in Czech GDP growth was driven mainly by net exports, which climbed strongly after declining in the previous quarter. Government consumption also had a positive impact, albeit more moderate than before. On the other hand, investment demand and changes in inventories had a dampening effect on GDP growth. So did private consumption growth, which moderated slightly. The slowdown in Hungary's quarter-on-quarter GDP growth was broad-based across all components apart from changes in inventories, which, after falling in the previous quarter, increased sharply. Negative net exports weighed heavily on economic growth, and growth in both consumption and investment moderated. There was a more pronounced drop in GDP growth in Poland, owing mainly to the weakening of investment demand. Government consumption growth also decelerated. Due to a pick-up in exports, the impact of net trade on GDP growth went from negative in the first quarter to neutral in the second quarter. On the other hand, there were positive contributions from private consumption and from changes in inventories.

Chart 21

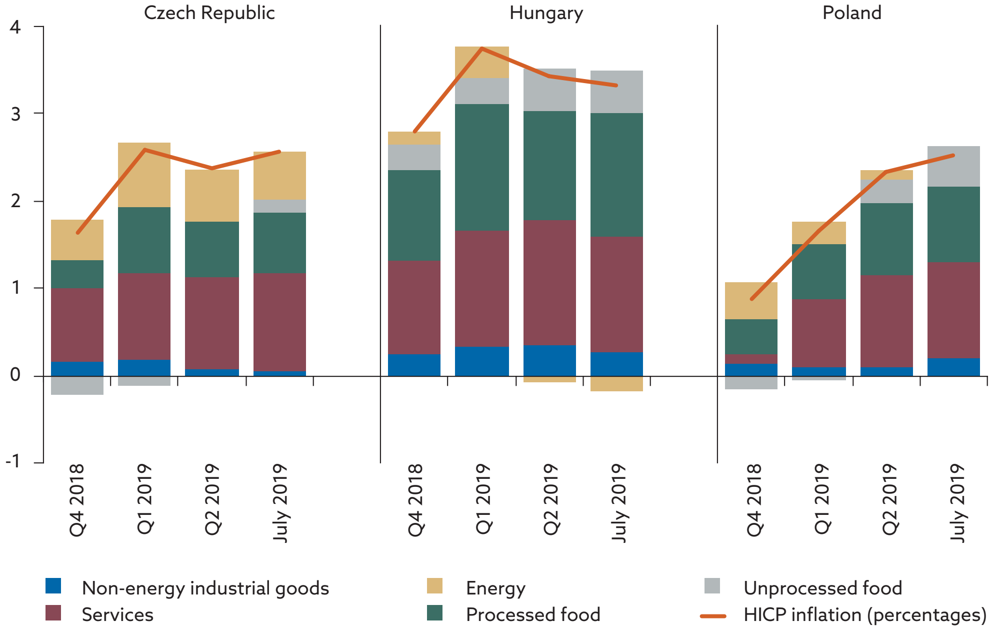
Contributions to quarterly GDP growth (percentage points)



Sources: Eurostat and NBS calculations.

Compared with the first quarter, annual consumer price inflation decreased in the second quarter in both the Czech Republic (by 0.2 percentage point, to 2.4%) and Hungary (by 0.4 percentage point, to 3.4%), and it increased in Poland (by 0.6 percentage point, to 2.3%). In the Czech Republic, the slowdown in headline inflation was largely accounted for by processed food prices, energy prices, and non-energy industrial goods prices. By contrast, the services component had an upward impact. In July, Czech consumer price inflation accelerated moderately, pushed up mainly by the food component (by both processed and unprocessed food prices). In Hungary, the energy and processed food components were the main causes of the drop in consumer price inflation in the second quarter. On the other hand, prices of unprocessed food, non-energy industrial goods, and services all had a positive impact on the headline inflation rate. In July, inflation eased further due mainly to the impact of the energy, services, and non-energy industrial goods components. In Poland, the acceleration of consumer price inflation in the second quarter was driven mainly by prices of food (both processed and unprocessed) and services. The principal negative contribution came from energy prices. In July, Poland's headline inflation rate continued to accelerate, with positive contributions from all components other than energy.

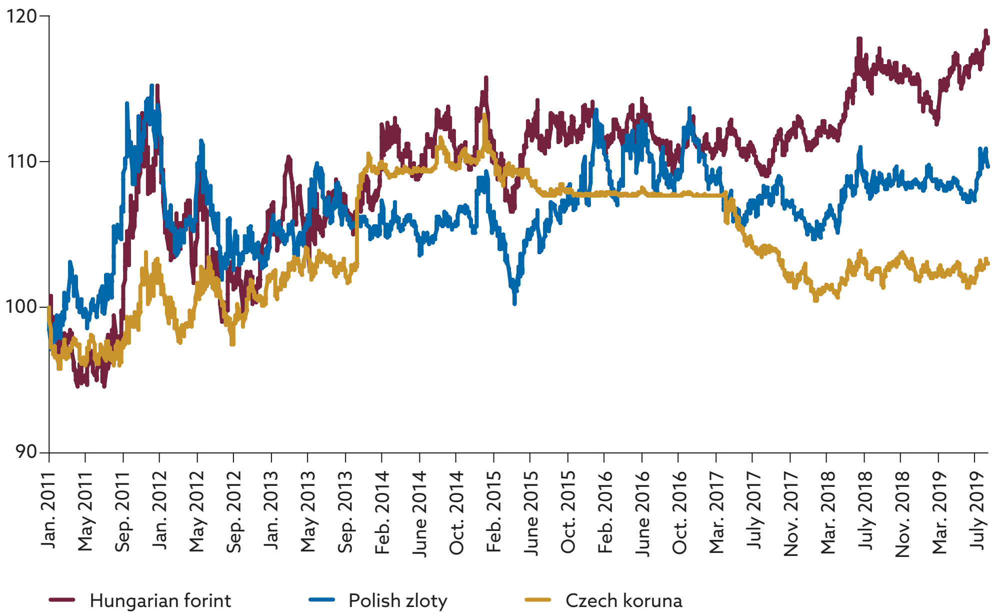
Chart 22
HICP inflation and its components (annual percentages; percentage point contributions)



Sources: Eurostat and NBS calculations.

The Czech koruna and Polish zloty were both stronger against the euro at the end of the second quarter than at the end of the first quarter, by 1.38% and 1.19% respectively, while the Hungarian forint was weaker, by 0.83%.

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



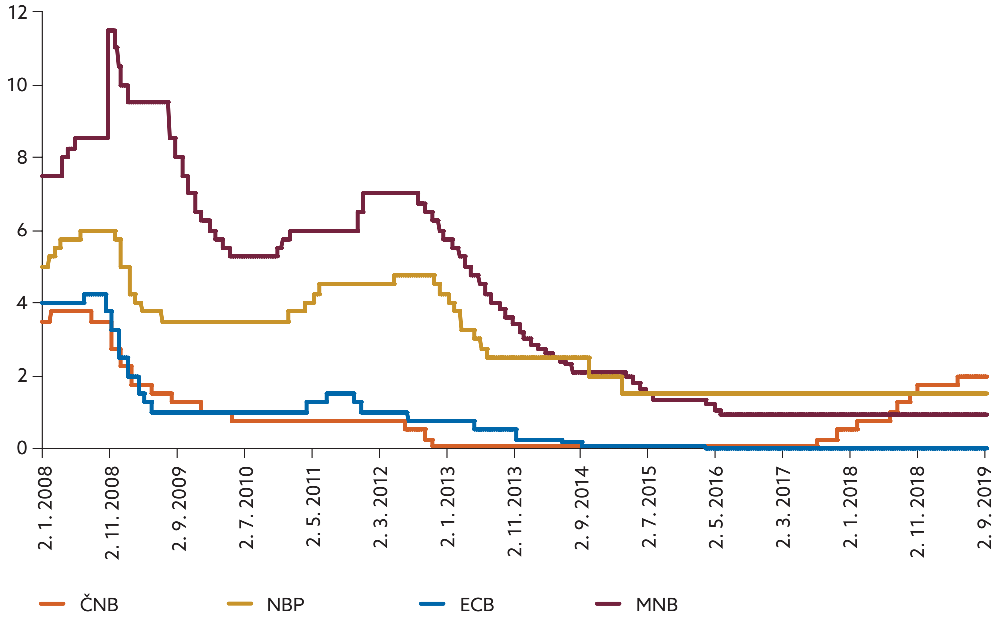
Sources: Eurostat and NBS calculations.
Note: A fall in value denotes appreciation.

All three currencies depreciated over April and May 2019 and then appreciated in June, the koruna and zloty strengthening beyond the level at which they ended the previous quarter. As in the first quarter, the currencies' exchange rates were affected by external factors, in particular by negative financial market sentiment, which, despite positive interest differentials, prevented the currencies from appreciating to any significant extent. Market sentiment was influenced mainly by the increasing risk of a global economic slowdown, which also resulted in international institutions making downward revisions to their outlooks. The depreciation of the three currencies was caused mainly by signs of a greater than expected slowdown of the German economy (especially in manufacturing industry), since Germany is the principal trading partner of the three reviewed countries. Other factors behind the negative sentiment included the escalation of trade conflict and the increasing fears of a possible "no-deal" Brexit (following the appointment of a new UK prime minister). The currencies' subsequent appreciation against the euro stemmed from domestic factors, most notably from favourable trends in the domestic economies (strong domestic demand and resulting inflation pressures - inflation in these countries is at above-target levels).

The Czech central bank was the only one of the three countries' central banks that adjusted its monetary policy rates in the second quarter of 2019. **Česká národní banka** (ČNB) increased its base interest rate (two-week repo rate) by 25 basis points, to 2.00%, with effect from 3 May 2019. It also raised the lombard rate and discount rate by 25 basis points, to 3.00% and 1.00% respectively. According to the bank's statement on the reasons for the decision, the Bank Board assessed the risks to the inflation forecast over the monetary policy horizon as being broadly balanced. With the domestic economy running above potential, the principal downside risks to the outlook are in the external environment (global economic trends, increasing trade protectionism, Brexit). Consistent with these developments is a rise in domestic interest rates followed by broad interest rate stability until mid-2020, says the bank. In Hungary, the **Magyar Nemzeti Bank** (MNB) left its key interest rates unchanged in the second quarter of 2019, 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 -0.05%. In explaining the decision, the MNB noted that domestic demand was boosting inflation, while weakening economic activity in Europe was having a restraining effect, particularly in the second half of the year. In assessing its monetary policy stance over the second half of 2019, the bank will focus on the spillover of the disinflationary effects of decelerating European economic activity, changes in the monetary policies of the world's leading central banks, the effect of the new retail government security on savings, and the economic consequences of countercyclical fiscal policy. In addition, the MNB reduced the average amount of liquidity to be crowded-out for the third quarter of 2019 by HUF 100 billion, to at least HUF 200-400 billion, and will take this into account in setting the stock of swap instruments providing forint liquidity. To improve the effectiveness of monetary policy transmission, the bank launched a corporate bond purchasing programme – the Bond Funding for Growth Scheme (BGS) – on 1 July 2019, with a total amount of HUF 300 billion. By introducing this non-standard monetary policy instrument, the bank aims to promote the diversification of funding to the domestic corporate sector. The BGS complements the Funding for Growth Scheme Fix launched at the beginning of 2019. In Poland, **Narodowy Bank Polski** (NBP) left its monetary policy rates unchanged in the second quarter of 2019 (the reference rate has been at 1.5% since 5 March 2015). In the bank's assessment, the outlook for the Polish economy remains favourable, while inflation will remain at a moderate level and close to target over the monetary policy horizon. The bank reiterated its view, based on incoming data and forecasts, that the current level of interest rates is conducive to keeping the Polish economy on a sustainable growth path and maintaining macroeconomic stability.

Chart 24

Key interest rates of the Czech, Polish and Hungarian central banks and the ECB (percentages)



Sources: ČNB, NBP, MNB and ECB.

Summary of GDP growth projections of selected institutions

Table 1 Global economy

	Release	2018		2019		2020		2021	
IMF	July 2019	3.6	(=)	3.2	(-0.1)	3.5	(-0.1)	-	-
OECD	May 2019	3.5	(-0.1)	3.2	(-0.1)	3.4	(=)	-	-
EC1)	July 2019	3.8	(-0.1)	3.4	(-0.2)	3.6	(-0.2)	-	-
ECB2)	September 2019	3.8	(=)	3.1	(-0.2)	3.4	(-0.2)	3.5	(-0.1)

Table 2 United States

	Release	2018		2019		2020		2021	
IMF	July 2019	2.9	(=)	2.6	(0.3)	1.9	(=)	-	-
OECD	May 2019	2.9	(=)	2.8	(0.2)	2.3	(0.1)	-	-
EC	May 2019	2.9	(=)	2.4	(-0.2)	1.9	(=)	-	-
Federal Reserve	June 2019	-	-	2.1	(0.05)	2.0	(0.1)	1.90	(0.05)

Table 3 Euro area

	Release	2018		2019		2020		2021	
IMF	July 2019	1.9	(0.1)	1.3	(=)	1.6	(0.1)	-	-
OECD	May 2019	1.8	(=)	1.2	(0.2)	1.4	(0.2)	-	-
EC	July 2019	1.9	(=)	1.2	(=)	1.4	(-0.1)	-	-
ECB	September 2019	1.9	(0.1)	1.1	(-0.1)	1.2	(-0.2)	1.4	(=)

Table 4 Czech Republic

	Release	2018		2019		2020		2021	
IMF	April 2019	2.9	(-0.2)	2.9	(-0.1)	2.7	-	-	-
OECD	May 2019	2.9	(-0.1)	2.6	(-0.1)	2.5	(-0.1)	-	-
EC	July 2019	3.0	(0.1)	2.6	(=)	2.5	(0.1)	-	-
ČNB	August 2019	2.9	(0.1)	2.6	(0.1)	2.9	(0.1)	3.0	-

Table 5 Hungary

	Release	2018		2019		2020		2021	
IMF	April 2019	4.9	(0.9)	3.6	(0.3)	2.7	-	-	-
OECD	May 2019	5.0	(0.4)	3.9	(=)	3.0	(-0.3)	-	-
EC	July 2019	4.9	(=)	4.4	(0.7)	2.8	(=)	-	-
MNB	June 2019	4.9	(=)	4.3	(0.5)	3.3	(0.1)	3.3	(0.3)

Table 6 Poland

	Release	2018		2019		2020		2021	
IMF	April 2019	5.1	(0.7)	3.8	(0.3)	3.1	-	-	-
OECD	May 2019	5.1	(-0.1)	4.2	(0.2)	3.5	(0.2)	-	-
EC	July 2019	5.1	(=)	4.4	(0.2)	3.6	(=)	-	-
NBP	July 2019	5.1	(=)	4.5	(0.5)	4	(0.3)	3.5	(=)

1) Global economic growth excluding the EU.
2) Global economic growth excluding the euro area.
Note: Data in brackets denote the percentage point change from the previous projection. The IMF projections of July 2019 cover only large economies. The European Commission's projections of July 2019 cover only EU countries.