Report on the International Economy

December 2019

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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 was stabilising in the third quarter of 2019, but remained subdued against the backdrop of the escalating trade dispute between the United States and China, tensions in the technology sector, and persisting uncertainty surrounding Brexit. Looking at global activity from a sectoral perspective, services activity continued to decelerate, as did manufacturing output.

The **US economy** in the third quarter reflected the impact of elevated uncertainty, weak external demand, and the trade dispute with China, as investment declined and export performance weakened. Nevertheless, the economy's growth was similar to that in the previous quarter, with households stepping up their consumption in anticipation of a further hike in import duties. The US economy was also supported by the Federal Reserve's monetary policy easing, which continued into the last quarter of the year. The shifting expectations about the timing and character of Brexit had some impact on the **United Kingdom's economy** in the third quarter. Weakening investment evidenced a further decline in investment demand, which is a risk to survey-based outlooks for the longer term. The impact of these negative developments were offset by private and public consumption as well as by a pick-up in export performance, thanks to which the UK economy averted falling into a technical recession. **Euro area** economic growth remained subdued in the third quarter. Consumption, though, continued to be solid, largely on the back of positive trends in Germany which were underpinned by a one-off wage growth factor. Investment also increased moderately. Net exports contributed negatively to economic growth, as import growth slightly outpaced export growth. **Japan's economy** was virtually stagnant, as the ongoing trade war and muted global demand resulted in its weakest quarterly performance of 2019. What growth there was continued to be driven by private consumption, as households frontloaded spending on durable goods ahead of the October hike in value-added tax. Investment growth also remained robust. On the other hand, with exports declining, net exports had a negative impact on GDP growth. Besides the release of weak economic performance data, there was the Japanese government's announcement of a fiscal stimulus package aimed at supporting the economy.

In **China,** economic growth continued to slow in the third quarter, recording a rate which was the lowest for almost three decades and was at the lower end of the target range. But although the Chinese authorities have been expediting steps to stimulate the economy – by cutting taxes and interest rates, by lifting restrictions on foreign investment, and by injecting liquidity into the financial system – it was the cooling of domestic demand and the ongoing trade war with the United States that had the greater impact on economic growth. On the domestic side of its economy, China also faces further challenges (swine fever) which are stoking inflation and thus weighing on consumer spending. **India** is also seeking to stimulate its economy, via recent and announced reforms that include the lifting of foreign investment restrictions in key sectors, tax cuts, and a privatisation programme aimed at reviving state-owned firms. This objective should be further supported by the Indian central bank's accommodative monetary policy stance (there have been five base rate cuts in 2019). These measures, however, have still not rekindled consumer confidence, and with the unemployment rate rising, they have not yet had a positive impact on private demand. As a result, the country's economic growth this year has been the lowest since 2013. In **Brazil**, according to the latest available data, economic activity has continued to recover. Confidence has picked up due to the approval of a pension reform that translates into government expenditure savings over the next ten years and to improved prospects for progress in the area of structural reforms, while investment is also being supported by the easing of financial conditions. **Russia's** economic growth also accelerated in the third quarter, benefiting from favourable developments in agriculture, industry and wholesale trade. The economy is being further aided by monetary policy accommodation. The central bank cut interest rates on two occasions in the third quarter and reduced them again in October, in response to a notable slowdown in consumer price inflation and to a decline in inflation expectations.

Economic activity growth across the OECD area edged down, quarter on quarter, to 0.3% in the third quarter of 2019, from 0.4% in the preceding period. In year-on-year terms, GDP growth for the OECD area remained unchanged, at 1.6%. Although the Composite Leading Indicator for the OECD area[1] fell further in the third quarter, it appears to have stabilised in recent months, which may signal the end of the global economic slowdown. Another sign that global economic performance has been stabilising in last quarter is provided by the Global Composite Purchasing Managers' Index (PMI), whose average level for October and November was only just lower than its level for the previous quarter, November's Global Manufacturing PMI returned back above 50, into territory indicating expansion, and the Global Services PMI moved further above that level, thus indicating moderate optimism in the short term.

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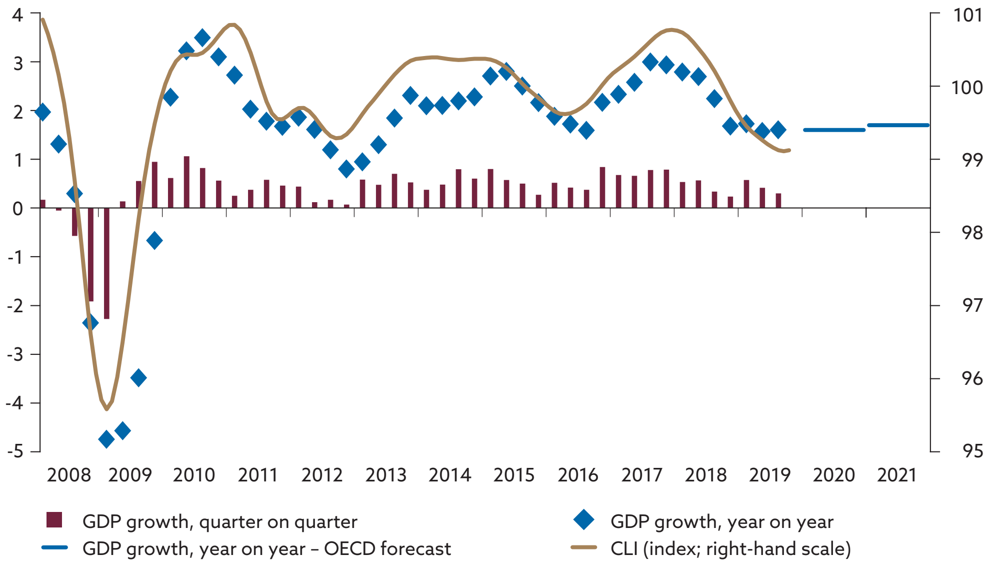
[1] The CLIs for OECD countries are published on a monthly basis, and the most recent, published in December 2019, are for the period up to October 2019.

Chart 1
GDP growth and the CLI for the OECD area



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

Global consumer price inflation slowed in the third quarter of 2019. The annual inflation rate in the OECD area fell from 2.1% in June to 1.6% in September. The slowdown was largely caused by energy prices, whose annual rate of decrease became more pronounced during the third quarter owing to oil price developments. Headline inflation also came under downward pressure from decreases in food price inflation and in core inflation (excluding food and energy), which fell from 2.2% in June to 2.1% in September. In October, core inflation fell to 2.0% and the decrease in energy prices accelerated; nevertheless, the impact of these factors was largely cancelled out by a moderate increase in food inflation, so the headline rate remained the same as in September.

2 Commodities

Average commodity prices were lower in the third quarter of 2019 than in the previous quarter. Their trend reflected a large decrease in average energy commodity prices as well as a moderate drop in non-energy commodity prices.

The average Brent crude oil price fell in the third quarter, as the deterioration of global economic outlooks amid the US-China trade dispute led to increasing concerns that oil demand would weaken. The oil price slump in August was exacerbated when the US President announced the imposition of further tariffs on Chinese imports from September. The US Administration's subsequent postponement of some of these planned tariffs until December had an upward impact on oil prices. There was a brief spike in oil prices in mid-September following attacks on two Saudi Arabian oil facilities, which raised fears about the security of global oil supply. These fears were assuaged, however, as Saudi Arabia restored production within a relatively short time, and the oil price corrected accordingly. Its downward path continued until the end of September, when weaker outlooks for global economic growth began to proliferate again. In October and November, the oil price increased on the basis of the rising optimism that surrounded US-Chinese talks on ending the trade dispute, as well as OPEC's expectations about adopting market-balancing measures.

As regards non-energy commodity prices, the third quarter saw a decline in average metal prices. Their path was determined in August, when they responded to the threat of further tariffs being imposed on Chinese imports. The price of copper in particular was affected by the US-China trade dispute, though it also reflected rising inventories and the pessimistic outlook for manufacturing industry. Among the other metals whose price declined in the third quarter were aluminium, zinc and tin. Metal prices increased in September, upon an easing of US-China trade tensions; nevertheless, their average level for the quarter remained lower compared with the previous quarter. Nickel prices soared by almost one-third following Indonesia's decision to ban exports of nickel ore from 2020. Food commodity prices also had a dampening effect on the non-energy commodity price index. This movement stemmed largely from pork prices, whose sharp drop in the third quarter was a correction after their strong increase in the previous quarter. Average prices of wheat, maize, sugar and cocoa also decreased.

3 The United States

The US economy's expansion increased moderately in the third quarter of 2019, with an annualised growth rate of 2.1% (up from 2.0% in the previous quarter). The year-on-year growth rate decelerated by 0.2 percentage point, to 2.1%.

As in the previous quarter, GDP growth was driven mainly by private consumption. Although private consumption growth slowed, demand for goods, and in particular durable goods, remained solid owing to the escalation of the US-China trade dispute. The government sector's positive contribution rose further, based on an increase in non-defence spending. Changes in inventories had a moderately positive impact on GDP growth, though it was completely offset by a decline in investment. The investment result reflected a significant drop in infrastructure investment in extractive industry, probably in response to the downtrend in oil prices. Equipment investment also declined. On the other hand, the pick-up in residential investment contributed positively to GDP growth and may indicate that interest rate cuts are starting to benefit activity in certain sectors. Net exports had a slightly dampening effect, as import growth picked up and export growth moderated.

Average consumer price index (CPI) inflation was the same in the third quarter as in the previous quarter (1.8%). Energy prices had a negative impact on headline CPI inflation, as they reflected the quick pass-through of the accelerating year-on-year decline in oil prices. Their impact, however, was cancelled out by average core inflation, which, due to strong growth in healthcare services prices, was 0.2 percentage point higher in the third quarter (at 2.3%) than in the second quarter. Food price inflation was stable during the period under review. In October, headline inflation remained at 1.8%, as the upward impact of less negative energy inflation and higher food inflation was offset by lower core inflation.

At its meeting at the end of July, the US Federal Open Market Committee (FOMC) decided to lower the target range of its federal funds rate by 25 basis points, to 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. The Committee further reduced the key interest rate at its meetings in September and October, by 25 basis points on each occasion. The second of these cuts left the target range at 1.50% to 1.75%. In its post-meeting statements, the Committee also said it would continue to monitor the implications of incoming information for the economic outlook as it assessed the appropriate path of the target range.

In the second half of September the Federal Reserve intervened in the interbank market in order to keep short-term interest rates under control. Banks had been facing a shortage of short-term liquidity owing to firms withdrawing funds to pay tax bills as well as to a recent issue of US government bonds. These had drained banks mandatory reserve funds and led to an increase in short-term rates.[2] In response, the Federal Reserve began offering daily repo operations, which was the first time it had intervened in this way since during the global financial crisis.

The third quarter of 2019 saw a further escalation of the US-China trade conflict. At the start of August the US President announced that the United States would be imposing an additional 10% tariff on USD 300 billion worth of Chinese imports with effect from 1 September 2019. In response to this announcement, China halted purchases of US agricultural products and also allowed its currency to depreciate past the seven yuan per dollar level, to its weakest level since May 2008. This prompted the US Administration 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 15 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). Later in August, China announced it would impose retaliatory tariffs of 5% or 10% against USD 75 billion worth of US goods. On the heels of that move, the US decided to raise the upcoming 10% tariff to 15% and announced that existing tariffs on USD 250 billion of Chinese goods would be increased from 25% to 30% from 1 October 2019 (later changed to 15 October). On 1 September 2019, the US starting imposing 15% tariffs on USD 125 billion worth of Chinese imports, and China starting imposing tariffs of 5% or 10% on USD 75 billion of US imports.

The United States and China resumed top-level trade talks on 10 October 2019. These resulted in the first phase of a deal, which covers purchases of agricultural products (China agreed to make purchases of USD 40 billion to USD 50 billion per year in US agricultural goods), the currency issue (China should issue guidelines on how it manages its currency) and some aspects of intellectual property protections. At the same time, the US President announced that the planned increase in tariffs on USD 250 billion worth of

[2] The overnight repo rate temporarily rose to 10% – significantly above the upper end of the federal funds target range.

Chinese goods, from 25% to 30% from 15 October, would be suspended. The interim deal represented the most significant effort to date to resolve the trade conflict between the world's largest economies. In early December, however, the US President announced that a trade deal with China might have to wait until after the US presidential election in November 2020.

As regards US plans for applying tariffs to other trading partners, it was expected that the Administration would decide in November to impose tariffs on imported cars and auto parts.[3] Then in November it was reported that the decision would be deferred for a further six months, though the Administration did not issue an official statement on the matter. At the same time, the Administration indicated that it may impose tariffs of up to 100% on USD 2.4 billion worth of imports from France, on the grounds that France's new digital services tax would harm US tech firms.

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[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 the report's findings that such imports do constitute a national security threat. At the same time, it was announced that a decision on the tariffs would be postponed for 180 days, so to allow more time for trade talks with the European Union and Japan.

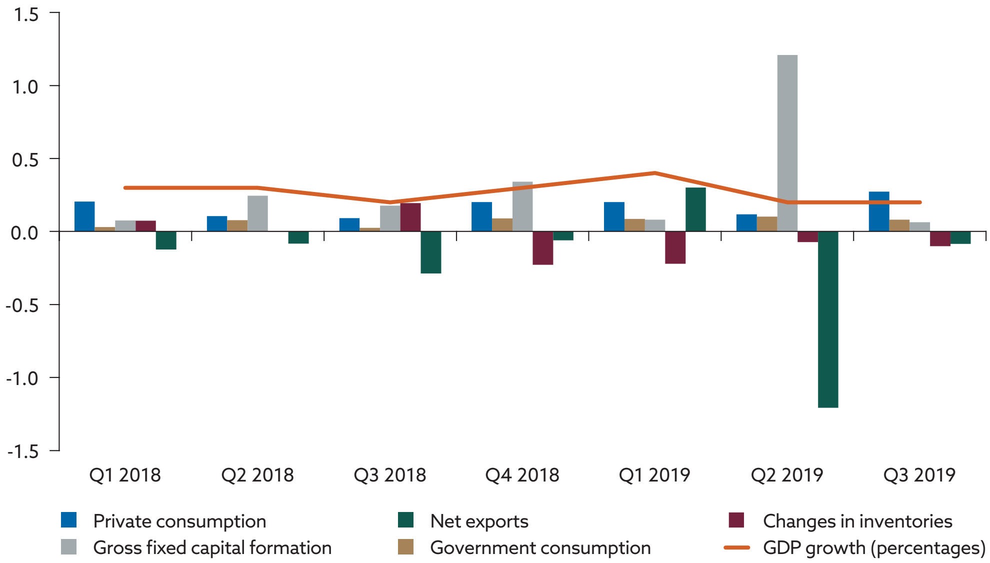
4 The euro area

Euro area GDP growth stood at 0.2%, quarter on quarter, in the third quarter of 2019, which was unchanged from the previous quarter. After contracting in the second quarter (by 0.2%), the German economy avoided falling into a technical recession in the third quarter, when it expanded by 0.1%. In the other major euro area economies, GDP growth remained the same as in the second quarter (at 0.4% in Spain and the Netherlands, at 0.3% in France, and at 0.1% in Italy. In year-on-year terms, euro area GDP growth was the same in the third quarter as in the second quarter, at 1.2%.

Euro area economic growth continued to be underpinned by domestic demand, mainly in the form of private consumption. The year-on-year growth rate for private consumption was slightly higher compared with the previous quarter, probably because the labour market situation continued to be favourable. There were also increases in government consumption and investment demand.[4] Net exports slightly dampened overall growth, as import growth outpaced export growth. The decline in inventories had a similar impact.

Chart 2

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



Sources: Macrobond, and NBS calculations.

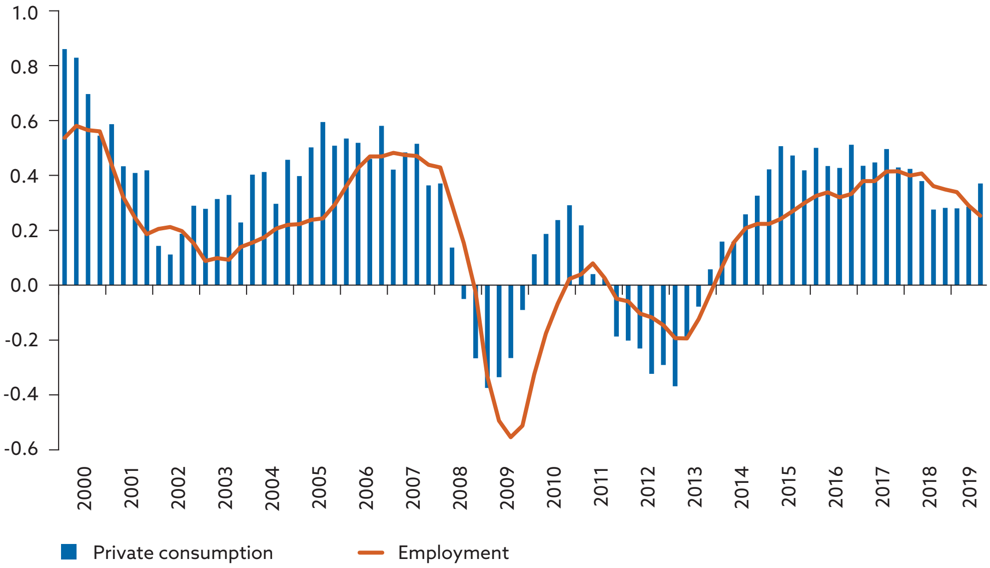
Private consumption growth accelerated quite strongly in the third quarter (by 0.3 percentage point to 0.5%), notwithstanding the deteriorating eco-

[4] In the second quarter, the composition of euro area GDP growth was affected by the effects of globalisation on investment and imports in Ireland (investment in intellectual property). Fixed investment there increased by more than 180% and imports by more than 40%. These two effects more or less cancelled each other out without having a significant impact on GDP growth.

nomic outlook. It continued to be supported by the favourable situation in the labour market, despite signs of slight cooling there. The slowdowns in economic growth and manufacturing industry, together with the increasing climate of uncertainty, are gradually having a downward impact on consumer expectations about the general economic situation. Their gradual upward effect on the saving ratio may weigh on consumer demand.

Chart 3

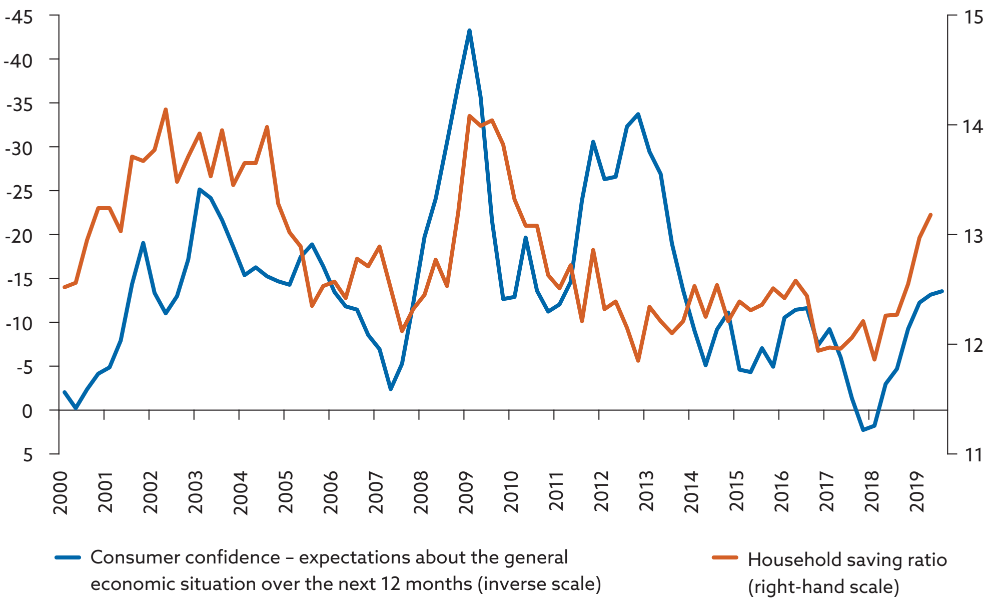
Private consumption and employment (quarter-on-quarter percentage changes; calculated from moving averages for four quarters)



Sources: Macrobond, and NBS calculations.

Chart 4

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

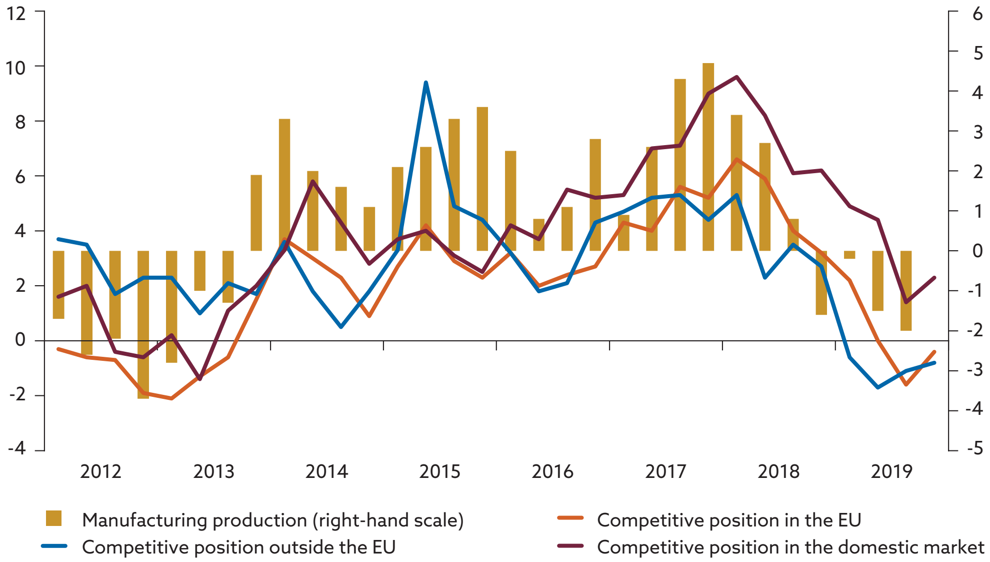


Source: Macrobond.

Industrial production declined further in third quarter, and remains the main factor behind the euro area's subdued economic growth. According to survey data, the downtrend in firms' assessments of their competitiveness has stopped in the fourth quarter, as firms' views on their competitiveness in the domestic market, the EU market, and the extra-EU market have shown a slight improvement in each case. Nevertheless, competitiveness assessments remain very subdued. Furthermore, industrial firms' export expectations indicate a further softening of exports with a potential impact on manufacturing production.

Chart 5

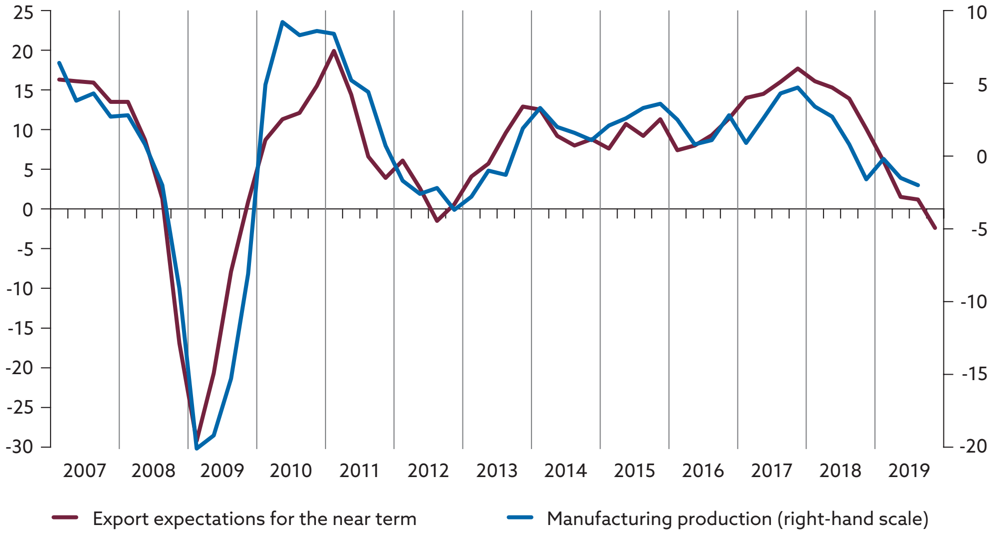
Industrial competitiveness and manufacturing production (percentage balances; annual percentage changes)



Sources: Eurostat, European Commission, and NBS calculations.

Chart 6

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

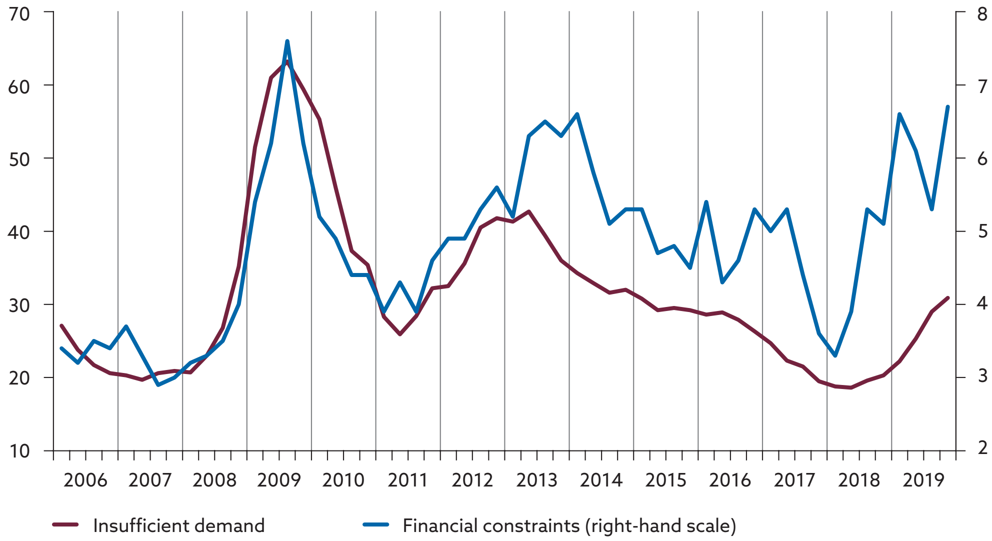


Sources: Eurostat, European Commission, and NBS calculations.

A weakening of economic activity is also implied by industrial firms' assessments of the factors limiting their production, according to survey results for the fourth quarter. After temporarily decreasing – probably in response to the package of monetary policy measures unveiled by the ECB in September – the importance of 'financial constraints' as a factor limiting production increased again. The percentage of respondents reporting 'insufficient demand' as such a factor maintained its uptrend. 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. This implies a lower level of production capacity utilisation and may therefore be reflected in a weakening of investment activity and a loosening of labour market conditions.

Chart 7

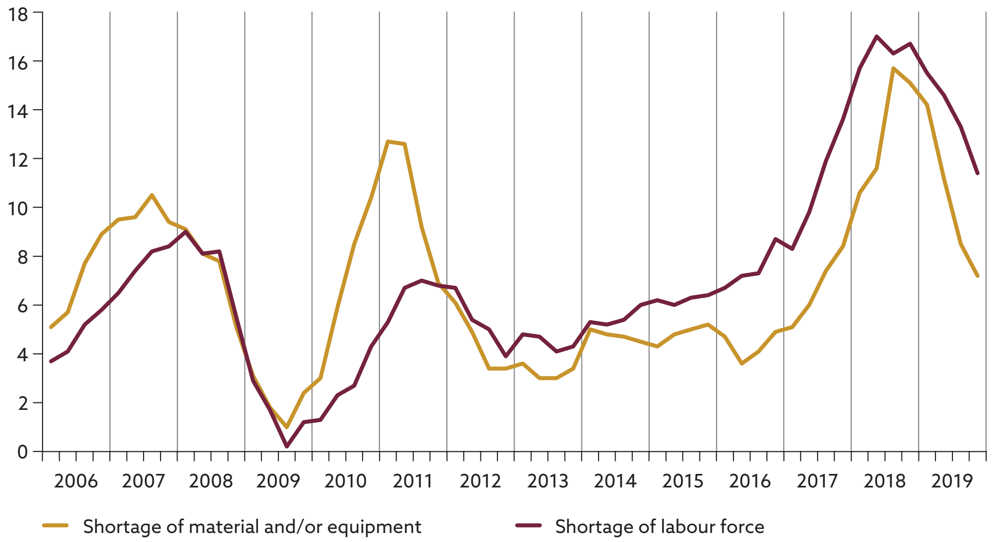
Factors limiting production in industry (percentages)



Source: Macrobond.

Chart 8

Factors limiting production in industry (percentages)

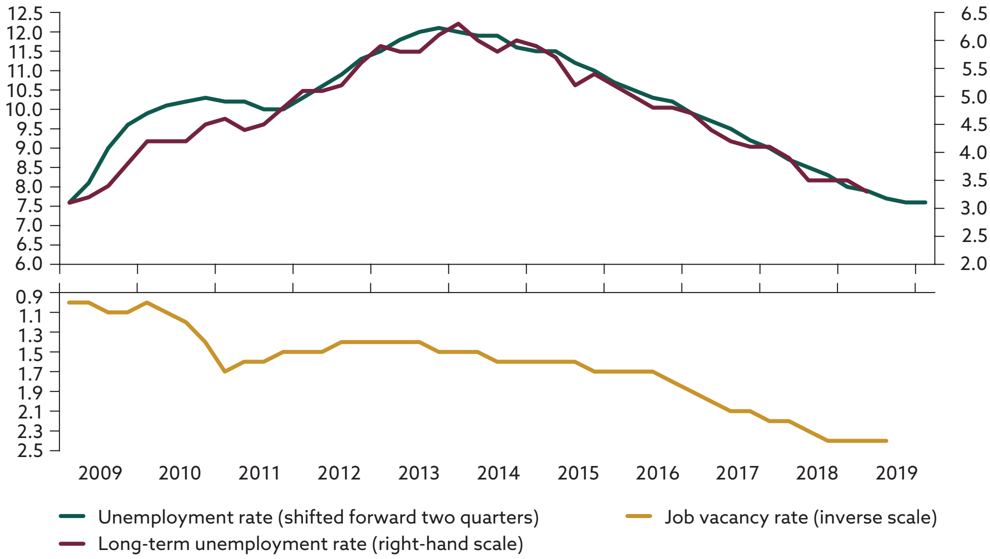


Source: Macrobond.

After decreasing continually for more than five years, the unemployment rate remained the same in the third quarter as in the previous quarter (at 7.6%). The job vacancy rate also remained unchanged. It would therefore appear that the economic slowdown is gradually having an impact on labour market indicators. This view is further supported by employment expectations in individual sectors. The most marked decline in these expectations was in industry, while in other sectors they largely stabilised after decreasing in the previous period.

Chart 9

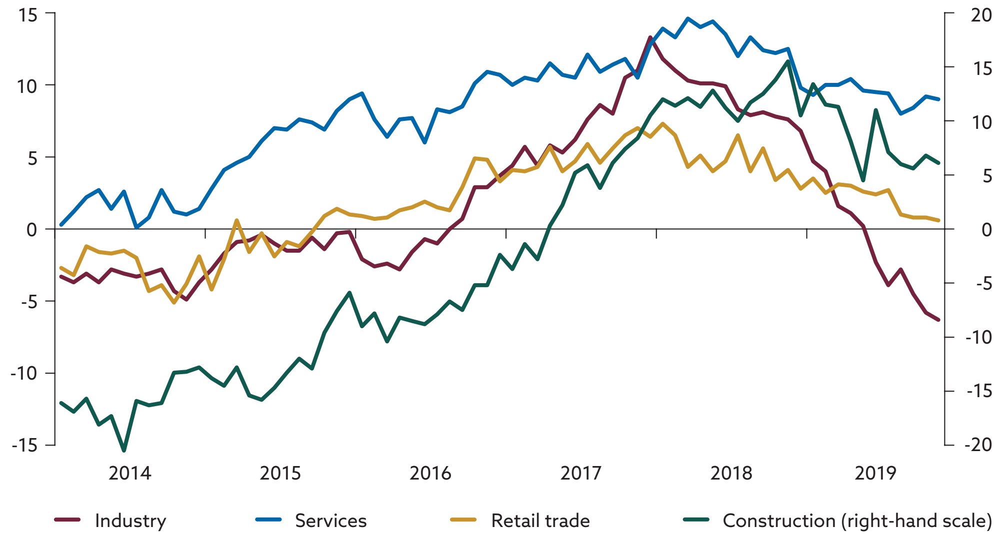
The unemployment rate, long-term unemployment rate, and job vacancy rate (percentages)



Source: Macrobond.

Chart 10

Employment expectations by sector (percentage balances)

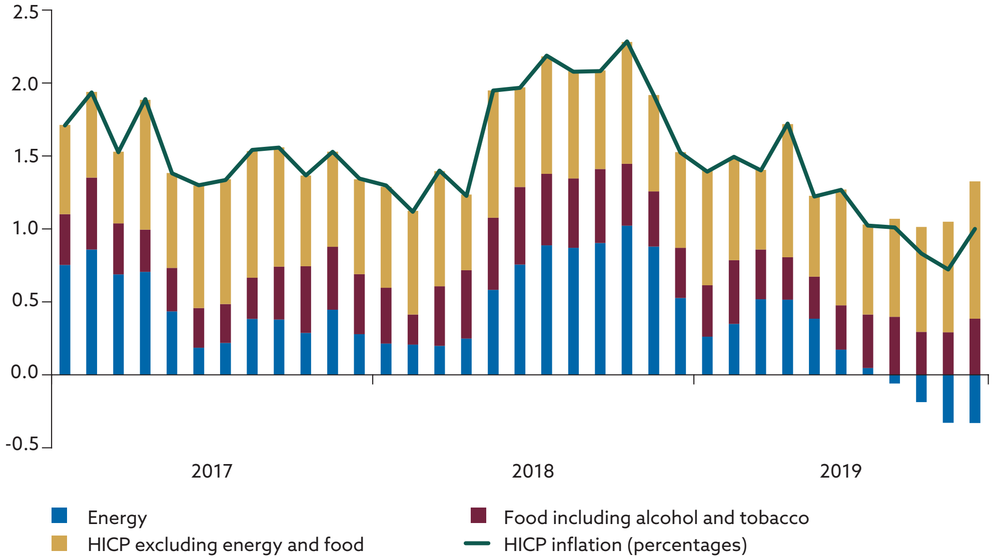


Source: Macrobond.

Euro area annual HICP inflation slowed to 0.8% in September, 0.5 percentage point lower than its rate in June. The slowdown reflected mainly the impact of energy prices, which began decreasing in August and fell more sharply still in September. Services inflation decelerated moderately, causing core inflation to edge down by 0.1 percentage point, to 1.0%. The downtrend in energy prices became more pronounced in the first two months of the fourth quarter, though their impact on headline inflation in November was more than offset by increases in food inflation and, in particular, core inflation, which climbed to 1.3%, 0.3 percentage point above its September level.

Chart 11

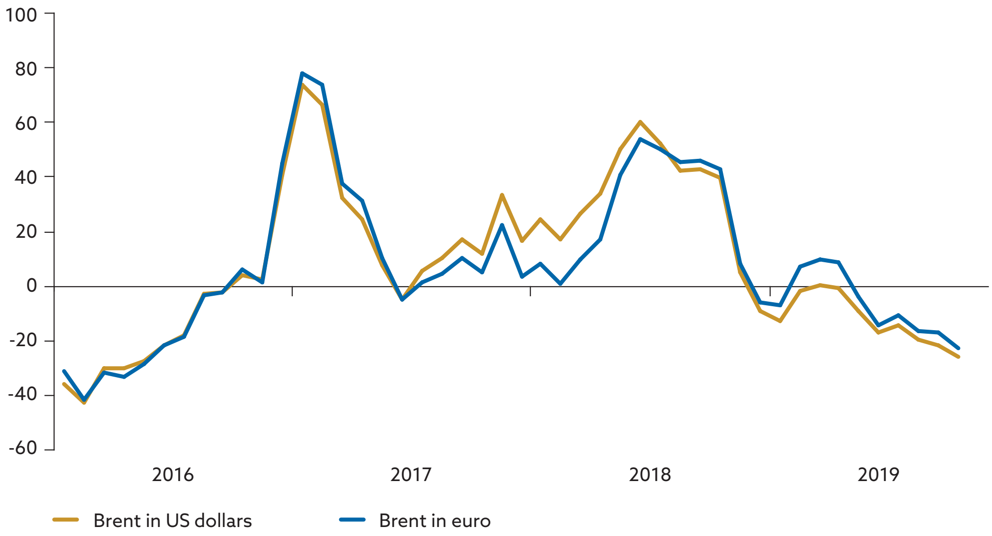
HICP inflation and selected components (annual percentage changes; percentage point contributions)



Source: Macrobond.

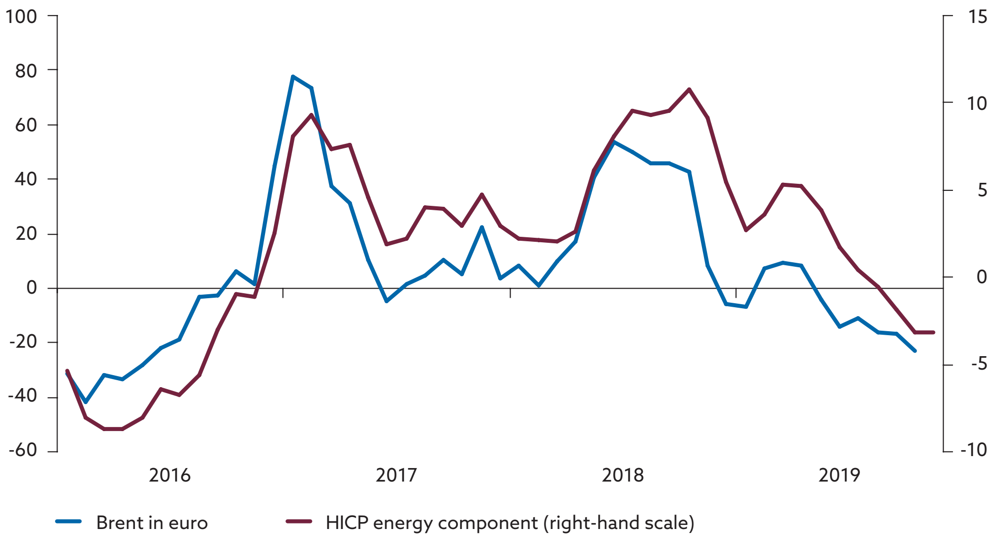
The global economic cooling and deterioration of outlooks for global growth were reflected in the year-on-year decline in world oil prices. The drop in oil prices in euro passed through quickly to consumer energy prices, which decreased, year-on-year, in August and then continued falling at a gradually accelerating pace.

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



Sources: Macrobond, and NBS calculations.

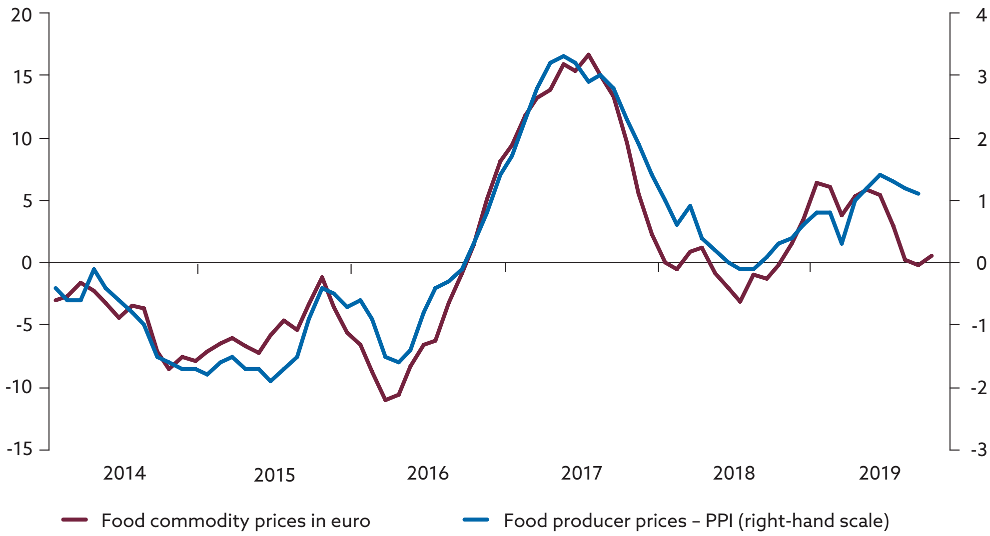
Chart 13
Oil prices in euro and the HICP energy component (annual percentage changes)



Sources: Macrobond, and NBS calculations.

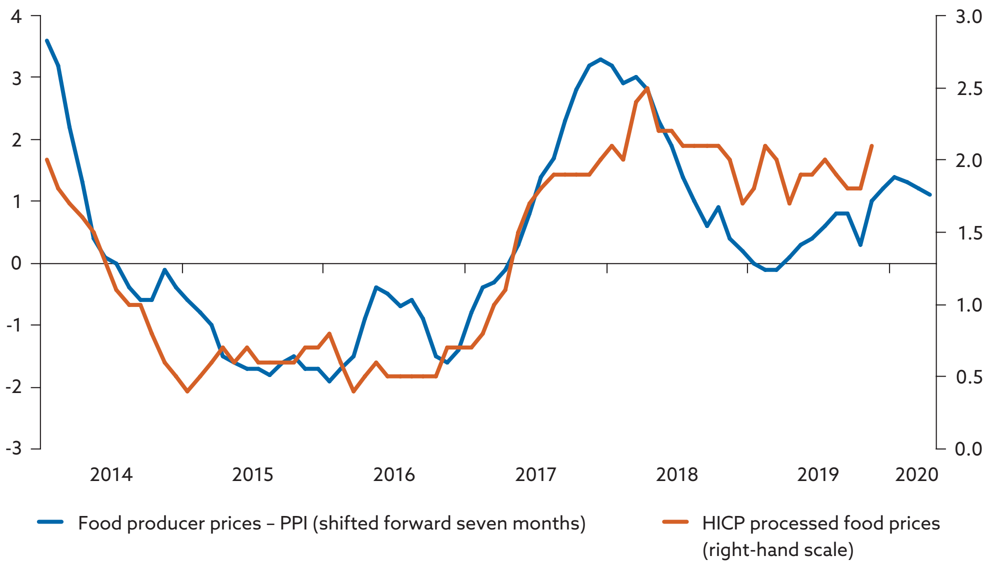
Food commodity price inflation gradually moderated during the third quarter, and its slowdown is expected gradually to pass through to food producer prices, whose accelerating trend came to an end in September. Consumer food prices were still not responding significantly to the increase in food producer price inflation, which was generally displaying greater volatility in the first half of the year.

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



Source: Macrobond.

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

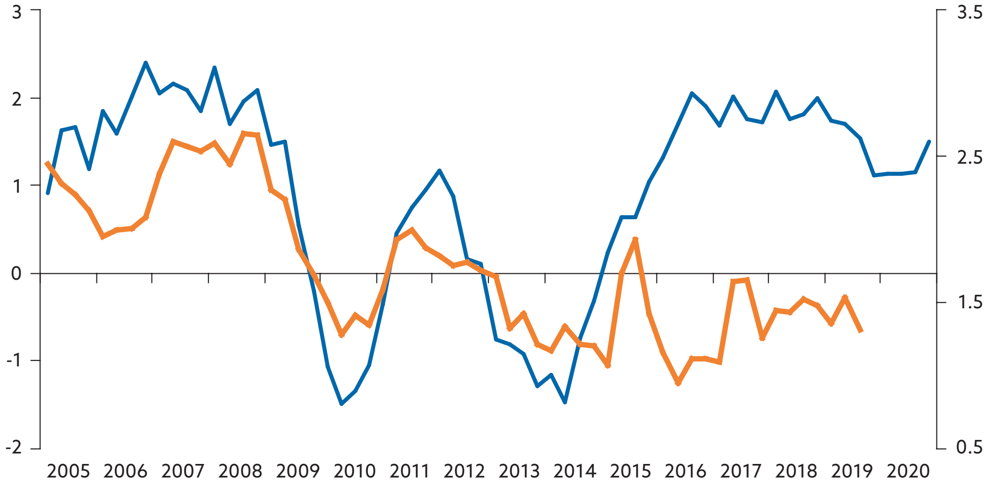


Source: Macrobond.

Core inflation did not change significantly during the third quarter. Its rate for September was 1.0%, 0.1 percentage point lower than its rate in June, but by November it had risen back to 1.3%. Its third-quarter slowdown was largely attributable to non-energy industrial goods inflation, which moderated by 0.1 percentage point, to 0.2%, in response to import price movements. Their trend probably reflected the less pronounced depreciation of the nominal effective exchange rate. In November, non-energy industrial goods inflation increased slightly (by 0.2 percentage point, to 0.4%) despite import price inflation remaining broadly stable. The third quarter also saw a marginal drop in services inflation, to 1.5% in September (0.1 percentage point lower than in June). By November, however, services inflation had accelerated to 1.9%. Consumer demand remained strong, but still without having a significant impact on headline inflation.

Chart 16

Consumer demand and core inflation (annual percentage changes)

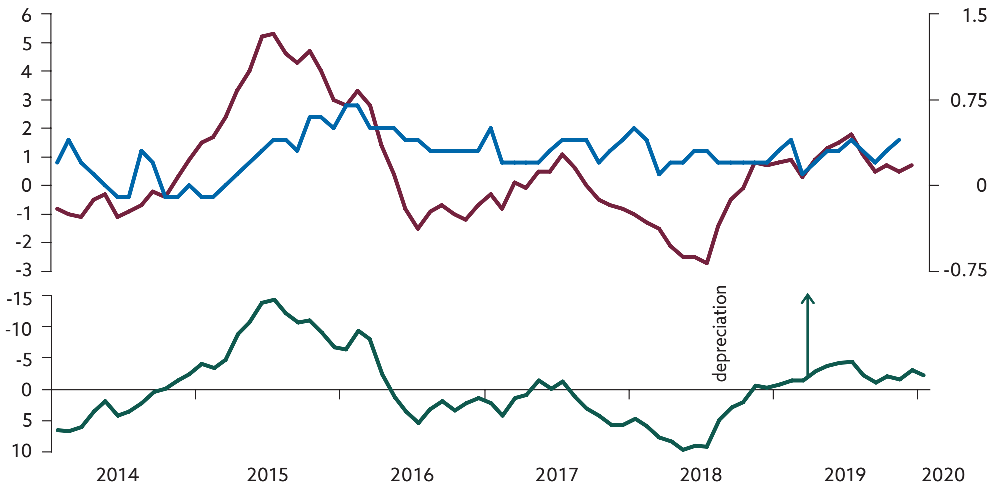


Consumer demand (shifted forward five quarters)
HICP services (right-hand scale)

Sources: Macrobond, and NBS calculations.

Chart 17

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



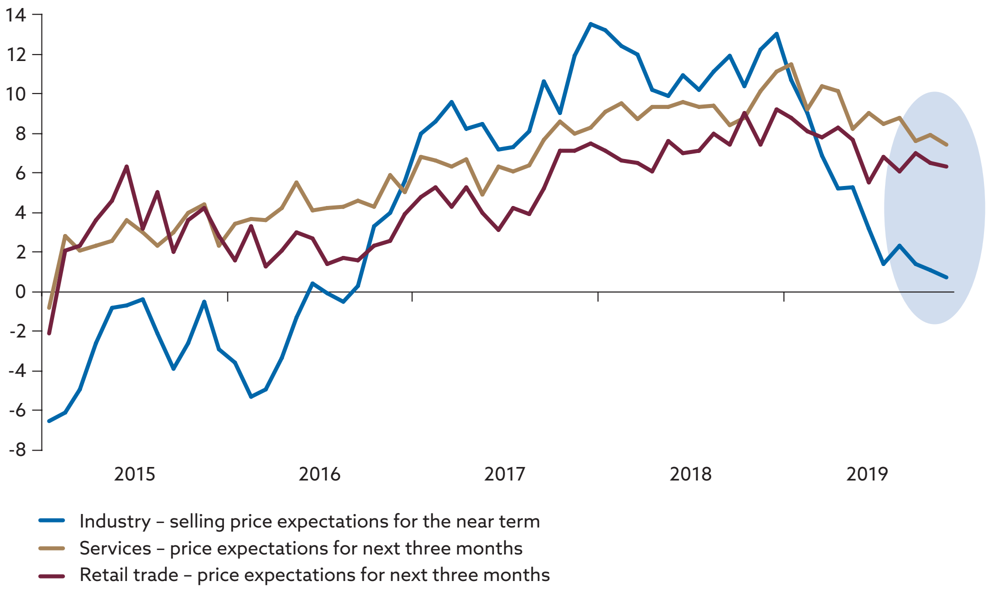
Extra-EA import prices – consumer goods (shifted forward three months)
HICP non-energy industrial goods (right-hand scale)
Nominal effective exchange rate (EA vis-à-vis 12 trading partners; shifted forward three months)

Source: Macrobond.

Persisting concerns about the global economic slowdown, about protectionist measures, and about heightened political uncertainty are affecting price expectations, which continue to decline. This impact is most apparent in industry, the sector hardest hit by the global slowdown. Price expectations have also been falling in services, however, possibly because of the pass-through from industry's weak performance. The ECB Survey of Professional Forecasters for the fourth quarter of 2019 showed a further decline in inflation expectations.

Chart 18

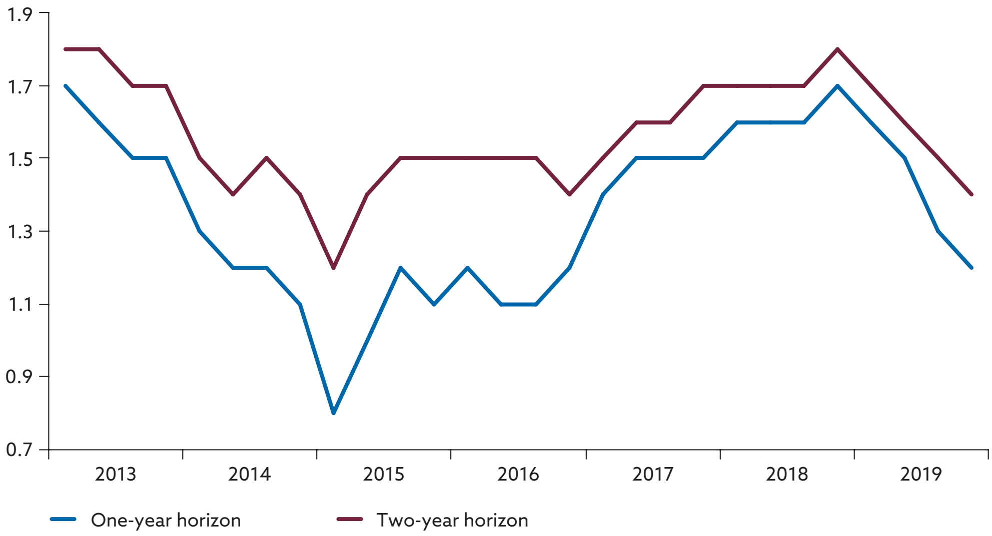
Price expectations in industry, services and retail trade (percentage balances)



Source: Macrobond.

Chart 19

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



Source: Macrobond.

At its meeting in September, the ECB's Governing Council decided to lower the interest rate on the deposit facility by 10 basis points, to -0.50%, and to keep the main refinancing rate and the marginal lending rate 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. At its meetings in October and December the Governing Council decided to keep all the key interest rates unchanged.

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.

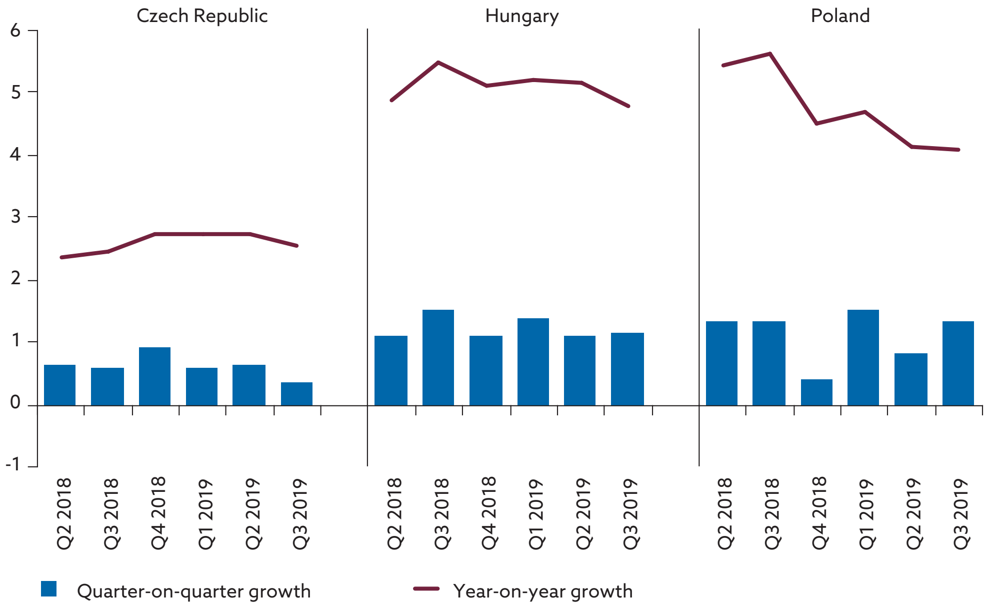
In response to economic developments, the Governing Council further decided at the September meeting to change the modalities of the new series of quarterly targeted longer-term refinancing operations (TLTRO III) to preserve favourable bank lending conditions, ensure the smooth transmission of monetary 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, and they applied as of the first TLTRO III operation to be allotted on 19 September 2019.

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 second quarter, annual GDP growth in the third quarter of 2019 was unchanged in Poland (at 4.1%), while in the Czech Republic and Hungary it slowed, respectively, by 0.2 percentage point (to 2.5%) and 0.4 percentage point (to 4.8%).

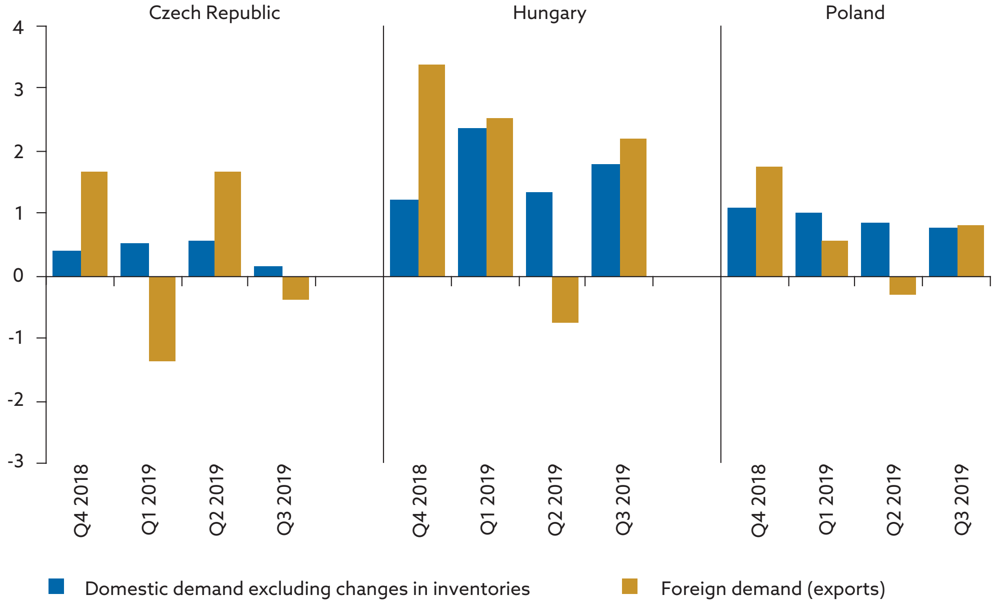
Chart 20
GDP (percentage shares)



Sources: Macrobond, and NBS calculations.

In quarter-on-quarter terms, GDP growth increased only in Poland, rising by 0.5 percentage point to 1.3%. In Hungary, quarterly GDP growth was the same as in the previous quarter (1.1%), and in the Czech Republic it moderated by 0.2 percentage point, to 0.4%. The main contributor to the Czech economy's slowdown was a decline in net exports, which followed a sharp increase in that component in the second quarter. Investment demand also had a dampening effect (the same as in the previous quarter). Domestic consumption remained flat after an extended period of solid growth. Changes in inventories, by contrast, had a positive impact on GDP growth. In Hungary, the largest positive contribution to economic growth was from investment demand, whose rate of increase was significantly higher in the third quarter than in the second quarter. Also contributing positively were government consumption, whose rate of increase accelerated, and private consumption, which grew at a slightly slower pace. Net exports stagnated. Changes in inventories had a negative impact on overall GDP growth. The acceleration of the Polish economy in the third quarter was driven mainly by net exports, which, after declining in the previous quarter, returned to positive territory. There was a slight slowdown in private consumption growth, though its impact was more than offset by accelerations in investment demand and government consumption. Changes in inventories made a negative contribution to GDP growth.

Chart 21
Contributions to quarterly GDP growth (percentage points)

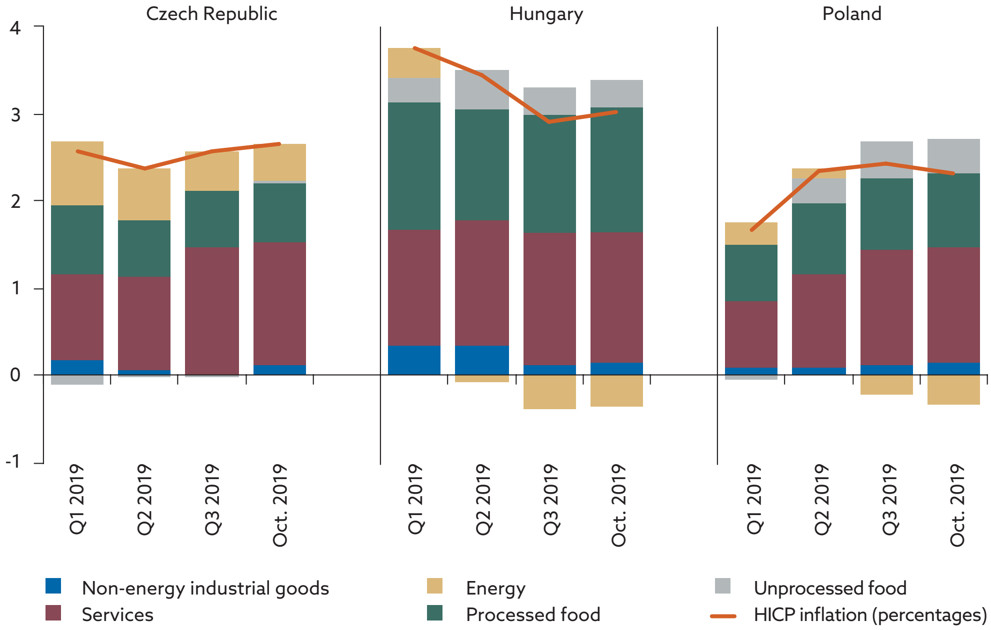


Sources: Macrobond, and NBS calculations.

Compared with the second quarter, annual consumer price inflation increased in the third quarter in both the Czech Republic (by 0.2 percentage point, to 2.6%) and Poland (by 0.1 percentage point, to 2.4%), and it slowed in Hungary (by 0.5 percentage point, to 2.9%). The acceleration of Czech headline inflation was caused by services prices. The unprocessed food and non-energy industrial goods components each had a neutral impact, while energy prices had a dampening effect. In October, Czech consumer price inflation accelerated slightly further, mainly due to food prices and to non-energy industrial goods prices. In Hungary, the slowdown in headline inflation in the third quarter stemmed mainly from energy prices, as their rate of decrease accelerated, and from prices of non-energy industrial goods and prices of unprocessed food, as their rate of increase moderated. There were, by contrast, positive contributions to headline inflation from the services and processed food components. In October, Hungary's headline inflation remained almost unchanged, owing mainly to processed food prices. In Poland, the acceleration of consumer price inflation in the third quarter reflected largely the fact that the impact of accelerating services prices and unprocessed food prices was outweighed by a drop in energy prices. In October, Poland's headline inflation slowed slightly, owing mainly to an increasing rate of decline in energy prices.

Chart 22

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

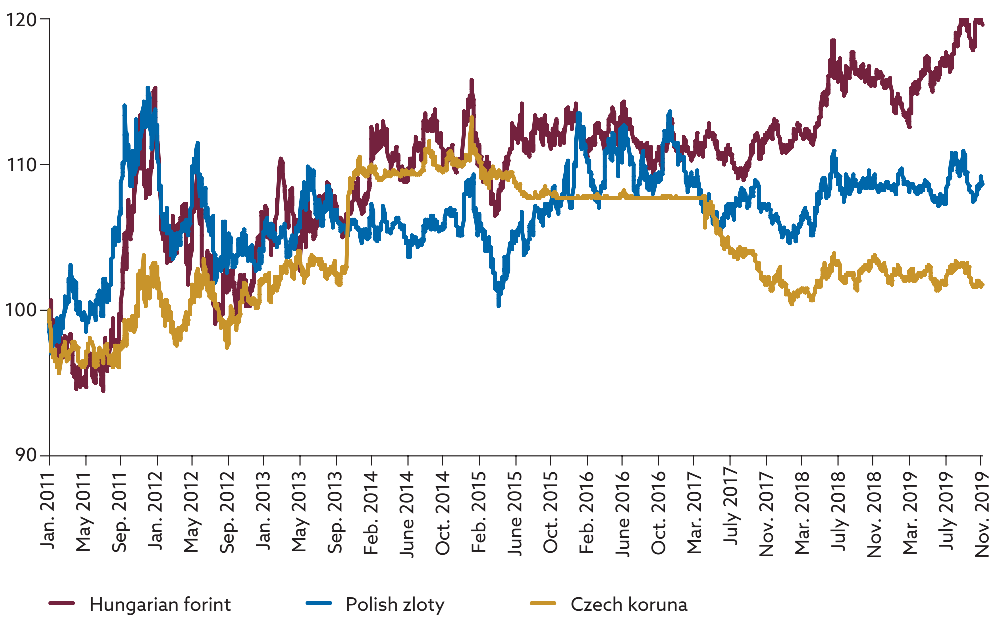


Sources: Macrobond, and NBS calculations.

In terms of their exchange rate against the euro, the currencies of all three countries were weaker at the end of the third quarter than at the end of the second quarter, with the Czech koruna having depreciated by 1.45%, the Hungarian forint by 3.54% and the Polish zloty by 3.03%.

Chart 23

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



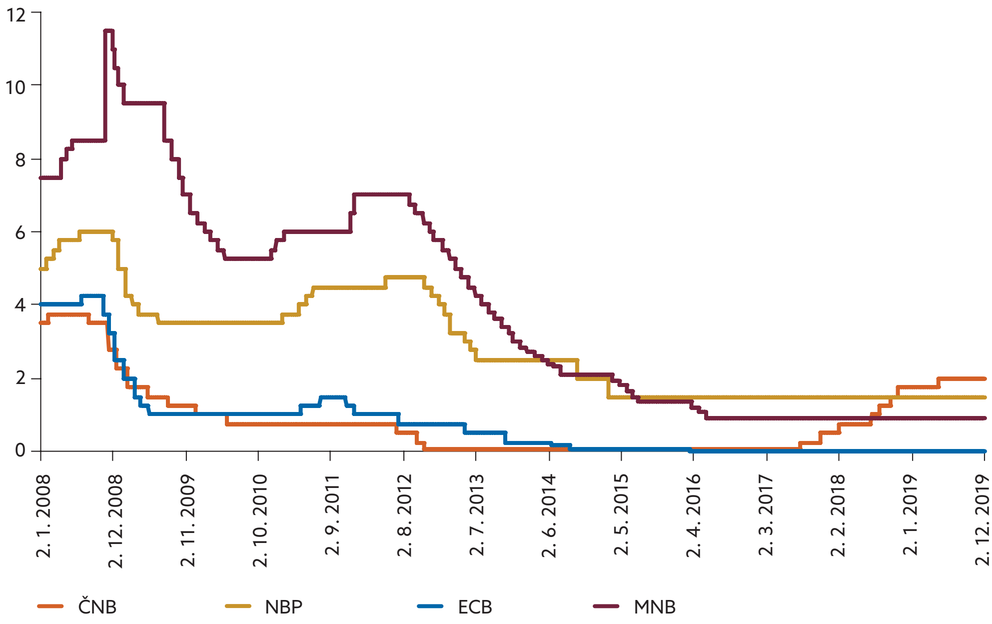
Sources: Eurostat, and NBS calculations.
Note: A fall in value denotes appreciation.

During the third quarter, the exchange rates of the three currencies were affected mainly by external factors that largely weighed on financial market sentiment. Among the most significant of these factors were expectations for, and the implementation of, further monetary policy easing by major central banks and their subsequent impact on the EUR/USD exchange rate. (The Federal Reserve cut the federal funds rate target range on 1 August and 17 September, while the ECB decided on 18 September to cut interest rates and resume its asset purchase programme.) The three central European currencies under review were also weakened by the global economic slowdown and the outlook for global growth, especially economic growth in the euro area and in particular in Germany, the principal trading partner of all three countries under review. Negative sentiment stemmed also from uncertainty related to trade tensions, from fears about a potential "no-deal" Brexit, and, towards the end of the quarter, from the geopolitical situation in the Middle East. The Hungarian forint and Czech koruna were affected by domestic factors to a greater extent than the Polish zloty was. The negative financial market sentiment resulting from external factors did not, however, allow the positive interest rate differential in the reviewed economies to be fully reflected in the currencies' exchange rates. Furthermore, a comparison of monetary policy stances and their future trends shows clear differences between the Czech central bank (tightening) and the Hungarian central bank (loosening).

None of the three countries' central banks adjusted their monetary policy rates in the third quarter of 2019. In the Czech Republic, **Česká národní banka** (ČNB) kept its base interest rate (the two-week repo rate) at 2.00% and its lombard rate and discount rate at 3.00% and 1.00% respectively (their levels since 3 May 2019). According to the ČNB Bank Board, the risks to inflation forecast at the monetary policy horizon are slightly inflationary overall; the main upside risk is a weaker-than-forecasted koruna exchange rate, while the main downside risks are a slowdown in the external economy resulting in softer foreign demand growth and a weakening of external inflation pressures. Leaving the key interest rates unchanged was consistent with these developments and with maintaining a high-level of transparency in the Bank Board's decisions. In Hungary, the **Magyar Nemzeti Bank** (MNB) likewise left its key interest rates unchanged in the third quarter, with the base rate, overnight collateralised lending rate and one-week collateralised lending rate all standing at 0.90%, and the overnight deposit rate staying in negative territory at -0.05%. According to the MNB, there remains a dichotomy between the factors determining likely developments in inflation: strong domestic consumption is boosting inflation, while the weakening of economic activity in Europe is having a restraining effect. 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. The BGS, which complements the Funding for Growth Scheme Fix launched at the beginning of 2019, is specifically intended to promote the diversification of funding to the domestic corporate sector. In September the bank made its first purchases of corporate bonds under the BGS. Given the interest in the scheme, the bank expects that three-quarters of the amount available thereunder will be used by the end of 2019. Also in September, the MNB raised the average amount of liquidity, to be crowded out for the fourth quarter by HUF 100 billion, from the previous HUF 200-400 billion band to at least HUF 300-500 billion, and will take this into account in setting the stock of central bank swap instruments used to supply forint liquidity. In Poland, **Narodowy Bank Polski** (NBP) left its monetary policy rates unchanged in the third quarter (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; nevertheless, uncertainty about the scale and persistence of the slowdown abroad and its impact on domestic economic activity has increased. According to the bank, inflation will remain moderate and, after rising temporarily in the first quarter of 2020, will stay close to target over the monetary policy transmission 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.

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Summary of GDP growth projections of selected institutions

Table 1 Global economy

	Release	2018		2019		2020		2021	
IMF	October 2019	3.6	(=)	3.0	(-0.2)	3.4	(-0.1)	-	-
OECD	November 2019	3.5	(=)	2.9	(=)	2.9	(-0.1)	3.0	-
EC[1)]	November 2019	3.8	(=)	3.2	(-0.2)	3.3	(-0.3)	3.4	-
ECB[2)]	September 2019	3.8	(=)	2.9	(-0.2)	3.1	(-0.3)	3.3	(-0.2)

Table 2 United States

	Release	2018		2019		2020		2021	
IMF	October 2019	2.9	(=)	2.4	(-0.2)	2.1	(0.2)	-	-
OECD	November 2019	2.9	(=)	2.3	(-0.1)	2.0	(=)	2.0	-
EC	November 2019	2.9	(=)	2.3	(-0.1)	1.8	(-0.1)	1.6	-
Federal Reserve	September 2019	-	-	2.2	(0.1)	1.95	(-0.05)	1.9	(=)

Table 3 Euro area

	Release	2018		2019		2020		2021	
IMF	October 2019	1.9	(=)	1.2	(-0.1)	1.4	(-0.2)	-	-
OECD	November 2019	1.9	(=)	1.2	(0.1)	1.1	(0.1)	1.2	-
EC	November 2019	1.9	(=)	1.1	(-0.1)	1.2	(-0.2)	1.2	-
ECB	September 2019	1.9	(0.1)	1.2	(0.1)	1.1	(-0.1)	1.4	(=)

Table 4 The Czech Republic

	Release	2018		2019		2020		2021	
IMF	October 2019	3.0	(0.1)	2.5	(-0.4)	2.6	(-0.1)	-	-
OECD	November 2019	2.9	(=)	2.6	(=)	2.1	(-0.4)	2.3	-
EC	November 2019	3.0	(=)	2.5	(-0.1)	2.2	(-0.3)	2.1	-
ČNB	November 2019	2.9	(=)	2.6	(=)	2.4	(-0.5)	2.8	(-0.2)

Table 5 Hungary

	Release	2018		2019		2020		2021	
IMF	October 2019	4.9	(=)	4.6	(1.0)	3.3	(0.6)	-	-
OECD	November 2019	5.1	(0.1)	4.8	(0.9)	3.3	(0.3)	3.1	-
EC	November 2019	5.1	(0.2)	4.6	(0.2)	2.8	(=)	2.8	-
MNB	September 2019	4.9	(=)	4.5	(0.2)	3.3	(=)	3.3	(=)

Table 6 Poland

	Release	2018		2019		2020		2021	
IMF	October 2019	5.1	(=)	4.0	(0.2)	3.1	(=)	-	-
OECD	November 2019	5.1	(=)	4.3	(0.1)	3.8	(0.3)	3.0	-
EC	November 2019	5.1	(=)	4.1	(-0.3)	3.3	(-0.3)	3.3	-
NBP	November 2019	5.1	(=)	4.3	(-0.2)	3.6	(-0.4)	3.3	(-0.2)

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.