NÁRODNÁ BANKA SLOVENSKA
EUROSYSTÉM

Report on the International Economy

March 2015

Published by:

Address:
Národná banka Slovenska
Imricha Karvaša 1, 813 25 Bratislava
Slovakia

Contact:
+421/2/5787 2146

http://www.nbs.sk

Debated by the NBS Bank Board on 31 March 2015.

ISSN 1339-9616 (online)

Contents

Abbreviations

CPI	Consumer Price Index
EA	euro area
ECB	European Central Bank
EC	European Commission
EIA	Energy Information Administration
EMU	Economic and Monetary Union
EONIA	euro overnight index average
ESA 95	European System of National Accounts 1995
EU	European Union
Eurostat	Statistical Office of the European Communities
FDI	foreign direct investment
Fed	Federal Reserve System
EMU	Economic and Monetary Union
EURIBOR	euro interbank offered rate
FNM	Fond národného majetku – National Property Fund
GDP	gross domestic product
GNDI	gross national disposable income
GNI	gross national income
HICP	Harmonised Index of Consumer Prices
IMF	International Monetary Fund
IPI	industrial production index
IRF	initial rate fixation
MFI	monetary financial institutions
MF SR	Ministry of Finance of the Slovak Republic
MMF	money market fund
NARKS	National Association of Real Estate Offices of Slovakia
NBS	Národná banka Slovenska
NEER	nominal effective exchange rate
NPISHs	Non-profit Institutions serving households
OIF	open-end investment fund
p.a.	per annum
p.p.	percentage points
qoq	quarter-on-quarter
PPI	Producer Price Index
REER	real effective exchange rate
SASS	Slovenská asociácia správcovských spoločností – Slovak Association of Asset Management Companies
SO SR	Statistical Office of the Slovak Republic
SR	Slovenská republika – Slovak Republic
ULC	unit labour costs
VAT	value-added tax
yoy	year-on-year

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 slowed moderately in the fourth quarter of 2014, but nevertheless remained relatively robust. However, the heterogeneity in growth rates among both advanced and emerging economies continued.

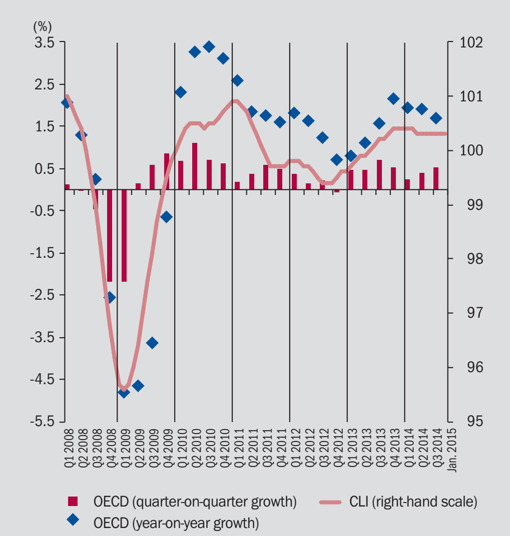
In the United States, economic growth moderated in the fourth quarter of 2014, but thanks to a marked increase in domestic demand (particularly in private consumption and residential investment), growth was still relatively solid. In the United Kingdom, GDP growth also fell, but remained buoyed by household consumption, supported by the easing of lending conditions. Japan's economy returned to a growth path after two quarters of contraction. Investment, as well as household consumption, remained anaemic after consumption tax was hiked in April. Nevertheless, the Japanese economy avoided recession thanks to its export performance, which was boosted by strong external demand, especially from the United States. The euro area's economic growth increased moderately in the fourth quarter of 2014, but it remained lower than rates in other advanced economies.

The situation among emerging economies was also heterogeneous. In Asia, as projected, China's GDP growth fell, reflecting a weakening property market and excess capacity in heavy industry, as well as gradually fading fiscal stimuli. In India, by contrast, growth accelerated, with confidence remaining at a high level. Since the country is a net importer of oil, its economy benefited from the global fall in oil prices. Divergent trends were also observed in Latin America. Whereas weak business and consumer confidence in Brazil and continuing domestic imbalances in Argentina inhibited economic growth in these countries, Mexico experienced rising external demand. Towards the end of 2014, financial turbulences in Russia had a negative impact on the world economy. The rouble's marked depreciation and subsequent tightening of monetary policy will continue to affect the Russian economy in the period ahead.

Across OECD countries, economic growth moderated to 0.5% in the fourth quarter of 2014, from 0.6% in the previous quarter. The annual growth rate remained unchanged from the third quarter, at 1.8%. Signs that the global economy will pick up moderately in the short-term horizon can be found in the OECD's average Composite Leading Indicator (CLI)[1] for its member countries, which after remaining flat in the fourth quarter, rose slightly at the beginning of 2015.

Looking ahead, the world economy will be affected by several factors. The collapse of oil prices, as a result of supply outstripping demand, is expected to boost global activity since its positive impact on oil-importing countries should outweigh the adverse impact on oil-exporting countries. At the same time, the world economy is expected to be supported by the continuing revival of, and bright outlook for, the US economy. Downside risks to the global growth outlook include the negative repercussions of sanctions and falling oil prices on the Russian economy, as well as substantial exchange rate fluctuations resulting from divergent monetary policy stances, and slowing growth in certain emerging economies.

Chart 1 GDP growth and CLI for OECD countries



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

1 *The CLIs for OECD countries are published on a monthly basis, and the most recent, published in March, are for the period up to January 2015.*

Global consumer price inflation fell further in the fourth quarter of 2014, in comparison with the previous quarter. Declining price growth in the last months of the year was observed in advanced economies as well as in a majority of emerging countries (not including Russia, where inflation climbed due to depreciation of the rouble). In January 2015 most advanced countries continued to report falling inflation; one exception was Japan, where prices stabilised. The reverse situation appeared in emerging countries, where inflation picked up at the beginning of the year. In this case the exception was China, as its disinflationary trend continued.

Consumer price trends in OECD countries in the fourth quarter were determined entirely by energy prices, which fell at a gradually accelerating pace owing to the collapse of oil prices. Food prices at this time were broadly stable. The average rate of consumer price inflation for OECD countries fell from 1.7% in September, to 1.1% in December, while core inflation was unchanged over the quarter, at 1.8%. The fall in energy prices became more marked in January, and consequently the headline CPI rate fell to 0.5%. The OECD's core inflation rate also decreased, to 1.7%.

At the global level, inflation is expected to remain subdued in an environment of continuing excess capacity as well as greatly reduced oil prices. In advanced countries in particular, sluggish narrowing of the output gap points to excess capacity. At the same time, the slump in oil prices is expected to have a downward effect on prices of other commodities. Although oil prices are projected to have a rising tendency, they should remain relatively low and therefore subdue price pressures over the medium-term horizon.

2 Commodities

The Brent oil price plunged by almost 40% in the fourth quarter of 2014, from around USD 94 per barrel at the start of the period, to USD 57 per barrel at the end of December. Its average level for the last quarter, USD 77 per barrel, was around USD 25 lower than that for the previous quarter. The downward pressure on oil prices came mainly from the supply side. Shale oil production in North America increased significantly, and oil deliveries from Russia, Iraq and Libya were stable despite geopolitical tensions in these regions. Oil supply was further boosted by the decision of OPEC members in November to keep their production target unchanged in order not to relinquish market share. The oil price slump was also due in part to demand-side factors, related to decelerating economic growth in Russia and other economies of emerging Asia. The oil price continued to fall in the first days of 2015, reaching a low of USD 46 per barrel, before beginning to rise again in February. The increase was a response to spending cuts in the oil industry as well as to rising demand, and by the end of the month the oil price stood at USD 63 per barrel.

Non-energy commodity prices fell further in the fourth quarter of 2014, owing to decreasing prices of metals and food commodities. Since commodity prices are sensitive to energy costs, they are also likely to have been affected by the slump in oil prices. The downward trend in metal prices was partly related to fears of a slowdown in global demand, particularly in China. At the same time, metal exports from certain emerging economies remained robust, and the growing supply added further downward pressure on prices. Supply factors affected agricultural commodity prices, too, as increasing production and exports of cereals from Russia, as well as bumper soya harvests in the United States, kept the prices of these crops low. Metal prices fell in both January and February, in response to weaker demand in China's construction sector as well as in global manufacturing. Similarly during the first two months, agricultural commodity prices continued to fall as supply outstripped demand.

3 The United States

After accelerating in the second and third quarters of 2014, US economic growth slowed in the fourth quarter. The annualised quarterly growth rate fell to 2.2%, from 5.0% in the previous quarter. In year-on-year terms, growth slowed slightly, from 2.7% to 2.4%. Improving labour market conditions continued to be boosted by private consumption, in which the most marked growth was in spending on durable goods, as well as on services (particularly health care). Investment, and especially non-residential investment, also contributed significantly to the growth rate, while changes in inventories had only a marginally positive impact. Owing to a significant pick-up in imports, net exports made a negative contribution to fourth-quarter growth. Government consumption and investment also had a negative impact, resulting from cuts in spending on national defence.

US consumer price inflation fell significantly in the fourth quarter of 2014, from 1.7% in September to 0.8% in December. Declining energy commodity prices in particular were passed through to energy prices, which after decreasing slightly in September, fell much more sharply at the end of the year. Energy prices in general were the key determinant of the headline inflation rate, and probably also affected the core inflation rate, which edged down from 1.7% in September to 1.6% in December. In contrast, food price inflation accelerated during the quarter under review. Energy prices remained the key factor in the inflation rate in January 2015, as their annual rate of decrease (almost 20%) pushed consumer price inflation into negative territory. This development was also due in part to a slowdown in food price inflation. Core inflation remained unchanged in January (1.6%).

The US Federal Open Market Committee (FOMC) decided at its meetings in October 2014, December 2014 and January 2015 to leave its target range for the federal funds rate unchanged, at 0 to 0.25 per cent. At the October meeting, the FOMC also decided to conclude its asset purchase programme.

The FOMC stated that in determining how long to maintain this target range, it would assess progress – both realised and expected – toward its objectives of maximum employment and 2 per cent inflation. This assessment would take into account a wide range of information, including measures of labour market conditions, indicators of inflation pressures and inflation expectations, and readings on financial developments. At the same time, in the forward guidance provided in its statements after the October and December meetings, the FOMC said it anticipated that it likely would be appropriate to maintain the current target range for the federal funds rate for a considerable time following the end of the asset purchase programme, especially if projected inflation continued to run below the Committee's 2 per cent target, and provided that longer-term inflation expectations remained well anchored. In the statements after the December and January meetings, the FOMC added that it could be patient in beginning to normalise the stance of monetary policy. In all three statements, however, the FOMC said that if incoming information indicated faster progress towards the employment and inflation objectives, then increases in the federal funds rate target range would be likely to occur sooner than currently anticipated. Conversely, if progress proved slower than expected, then increases in the target range would be likely to occur later than currently anticipated.

4 The euro area

Developments in the last quarter of 2014 showed a euro area economy that was probably rebounding. After slowing sharply in the second quarter, GDP growth accelerated to 0.2% in the third quarter and then 0.3% in the fourth quarter, thus reaching levels observed at the turn of the 2013-2014 year. Among the larger national economies in the euro area, the most marked increases in growth, quarter-on-quarter, were in Germany (0.7%), Spain (0.7%) and the Netherlands (0.5%), while France reported a moderate slowdown in activity (to a relatively low 0.1%). The Italian economy continued to struggle, with GDP remaining unchanged in the fourth quarter after three quarters of contraction. The euro area's somewhat stronger economic performance was also reflected in its annual rate of growth, which increased to 0.9% (from 0.8% in the third quarter).

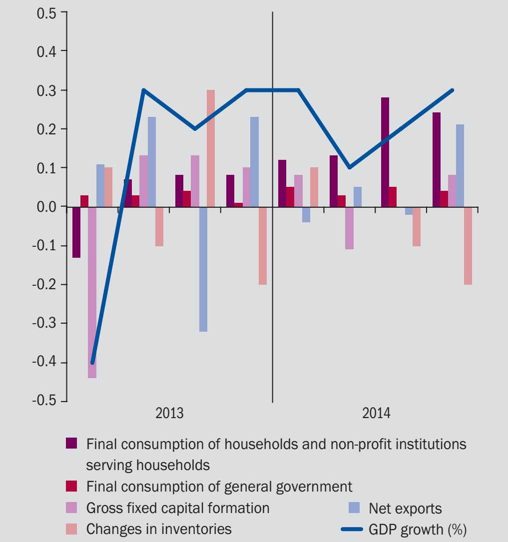
Economic growth in the fourth quarter was driven mainly by domestic demand and in particular by private consumption. Consumer demand grew for a seventh successive month, probably supported by the upward impact of low oil prices on household disposable income. Despite the positive trends in private consumption, its level did not approach pre-crisis levels (2007 average) until recent quarters. Government final consumption also increased moderately. Investment demand picked up modestly in the fourth quarter, after two quarters of decline or stagnation. Investment was likely boosted by further easing of monetary and lending conditions, as well as slight improvement in sentiment. Although export growth slowed, import growth fell further, and therefore the contribution of net exports to GDP growth was positive. It is likely that demand, both domestic and external, was to some extent met out of inventories, whose decline had a dampening effect on GDP growth.

Looking at GDP from the production approach, value added increased by 0.2%. The sectors of trade and services made the largest contributions to that growth, while value added in industry fell slightly. Increases in value added were also observed in the government sector and, after two months of decline, in construction.

Chart 2 Economic growth (at 2010 constant prices, per cent)

Source: Eurostat.

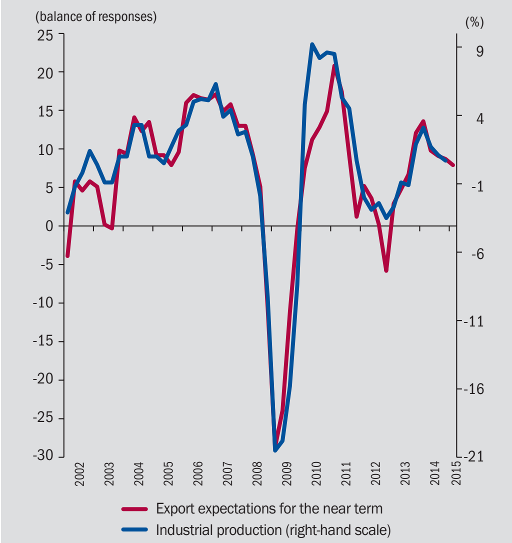
Chart 3 Quarterly GDP growth and its components (p.p.)



Source: Eurostat, NBS calculations.

In the manufacturing sector, which is considerably export oriented, production fell in the second and third quarters (and its annual growth rate slowed) amid deteriorating sentiment and mounting geopolitical tensions. At the same time, perceptions of industry's competitiveness in non-EU markets deteriorated. In the fourth quarter, however, firms' assessments of their competitiveness in non-EU markets brightened, and in the first quarter of 2015 they improved further. This upturn was probably related to the weakening of the euro and consequent strengthening of price competitiveness. The first quarter of 2015 also saw more optimistic assessments of competitive positions in EU and domestic markets, which appears to stem from stabilising and moderately improving sentiment as well as from growing domestic demand. Despite the improved appraisals of competitiveness, however, export expectations continued to deteriorate moderately in the first quarter of 2015.

Chart 5 Export expectations in industry (balance of responses) and annual industrial production growth (%)

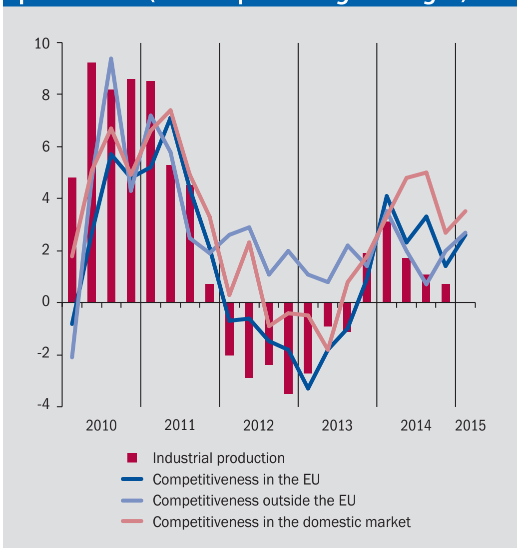


Source: European Commission, Eurostat, NBS calculations.

The gradual easing of demand-side constraints on production came to a halt in the fourth quarter of 2014 and, despite relatively favourable economic developments towards the end of the year, it had shown no clear signs of reappearing by the cut-off date for this report.

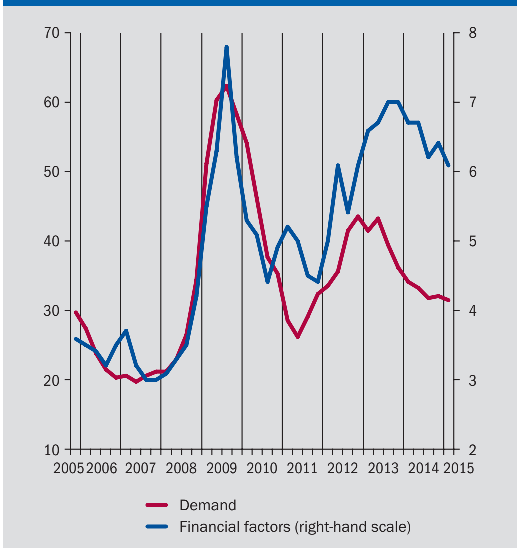
In the case of financial factors, however, the easing of constraints picked up again at the beginning of 2015 after stalling in the fourth quarter. This upturn stemmed from measures aimed at loosening lending conditions which the ECB's Governing Council adopted in stages

Chart 4 Competitiveness in industry (balance of responses) and industrial production (annual percentage changes)



Source: European Commission, Eurostat, NBS calculations.

Chart 6 Production-limiting factors in industry (%)



Source: European Commission.

Chart 7 Production-limiting factors in industry (%)

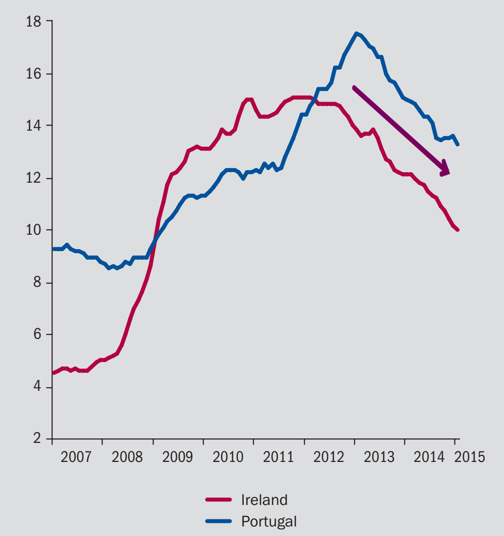
Source: European Commission.

Chart 8 Unemployment rate in Greece and Spain (%)

Source: Eurostat.

from June 2014 – including targeted longer-term refinancing operations (TLTROs), an asset-backed securities purchase programme (ABSPP) and a third covered bond purchase programme (CBPP3). Another factor may have been January's decision of the Governing Council to launch an expanded asset purchase programme for public sector securities – the public sector purchase programme (PSPP). Industrial firms also did not perceive plant capacity as a significant production-limiting factor in the first quarter of 2015, in view of the relatively high level of spare capacity. As for assessments of labour as a production-limiting factor, they increased for a third quarter in a row, indicating that the labour market situation, although still weak, is gradually improving.

Chart 9 Unemployment rate in Ireland and Portugal (%)

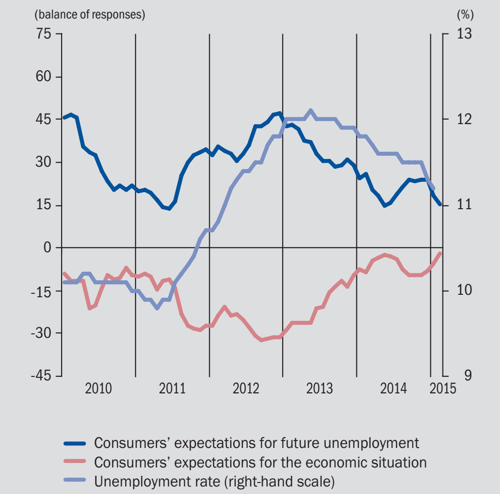


Source: Eurostat.

The labour market remains a weak link in the economy, with the unemployment rate still relatively high despite some improvement. The rate remained unchanged in the first two months of the fourth quarter of 2014, at 11.5%, before edging down to 11.3% in December and then to 11.2% in January, its lowest level for almost three years. Although unemployment is exceptionally high in several euro area countries, it has fallen over the last two years in some of those whose labour markets were hard hit by the economic crisis (Greece, Spain, Portugal and Ireland).

After deteriorating from June 2014, consumers' expectations for the future economic situation

Chart 10 The unemployment rate (%) and consumers' expectations for the economic situation and unemployment in the next 12 months (balance of responses)

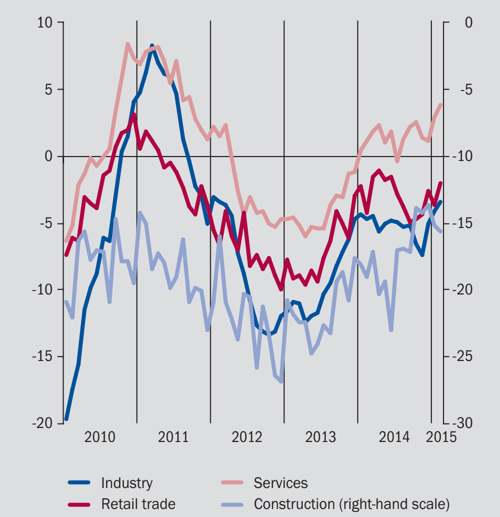


Source: European Commission and Eurostat.

stopped worsening in the last quarter and then picked up in the first two months of 2015. Their expectations for unemployment improved proportionally. There were also more positive assessments of future employment in individual sectors, particularly in services and industry as well as in retail trade.

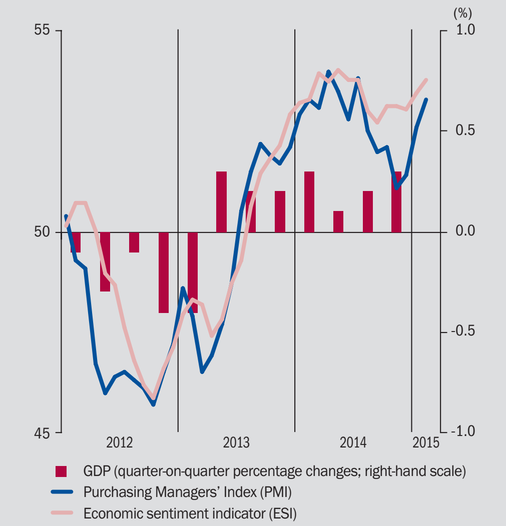
In the fourth quarter of 2014 most forward-looking indicators ceased deteriorating, and in the first quarter of 2015 they were already pointing to a brightening of sentiment among economic agents. The composite PMIs for both the euro area and Germany improved in January and February. The economic sentiment indicator (ESI) for the euro area increased in the first two months of 2015, boosted mainly by rising confidence in retail trade and among consumers, which may signal continuing growth in private consumption. As for Germany, the ZEW index improved markedly from November 2014 to March 2015, as did the Ifo index (to February, the most recent data available), with increasingly optimistic assessments of the economic situation both at present and in the next six months. Despite strengthening economic sentiment, the euro area's economic recovery is fragile and is accompanied by several risks related mainly to geopolitical developments. Economic growth is expected, however, to benefit significantly from the ECB's accommodative monetary policy stance, as asset purchases under the public sector purchase programme began in March and will last at least until September 2016.

Chart 11 Employment expectations by sector (balance of responses)



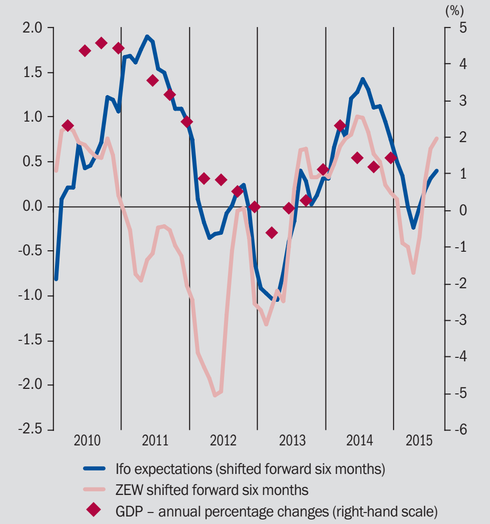
Source: European Commission.

Chart 12 Euro area forward-looking indicators and GDP growth



Source: European Commission, Eurostat, Bloomberg and NBS calculations.
Note: ESI – normalised index.

Chart 13 German forward-looking indicators and GDP growth



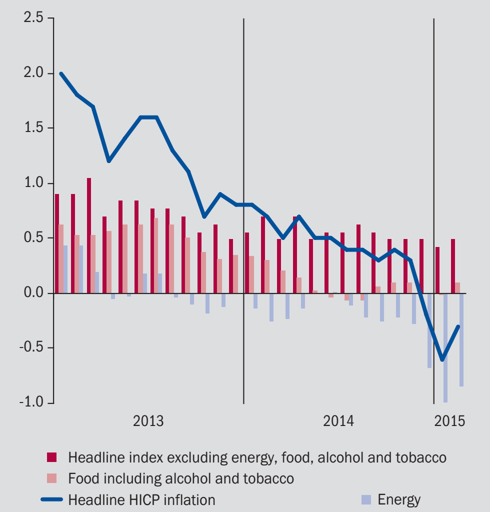
Source: OECD and Eurostat.
Note: Ifo, ZEW – normalised indices, deviations from the long-average.

Inflation declined more markedly in the fourth quarter of 2014 after following a broadly downward trend from 2011. A collapse in global oil prices was passed through to consumer energy prices, and this was the main reason that the inflation rate turned negative, from 0.3% at the end of the third quarter to -0.2% in December. The pass-through of oil prices to consumer prices continued in January, when the price level fell by 0.6%. In February, oil prices began rising and contributed to a more moderate decrease in consumer prices (-0.3%).

As noted above, consumer price inflation in the last quarter of 2014 and the first two months of 2015 was primarily affected by oil price movements. The average oil price had been falling gradually since July, before it plunged in December and January (by around 55% compared with its level in September). The oil price in euro fell more moderately owing to the euro's exchange rate against the US dollar, which by February had depreciated more than 12% (monthly averages) from its level at the end of the third quarter. This weakening of the euro also had a considerable mitigating impact on the annual rate of change in food commodity prices, which was negative for prices denominated in US dollars but positive in euro.

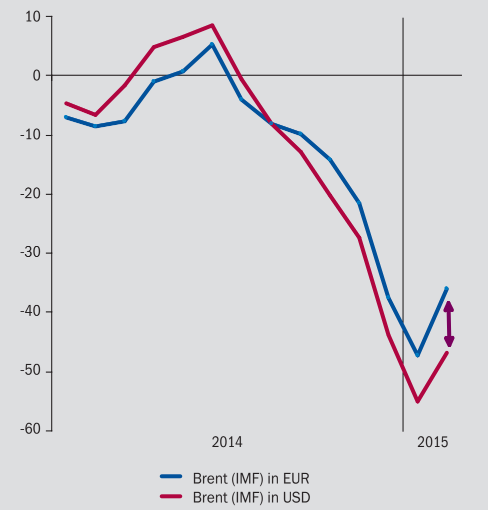
The decline in oil prices in euro was passed on almost immediately to consumer energy prices, which recorded their highest year-on-year decrease for more than five years. By contrast, food commodity prices denominated

Chart 14 Annual headline HICP inflation rate (%) and contributions of selected components (p.p.)



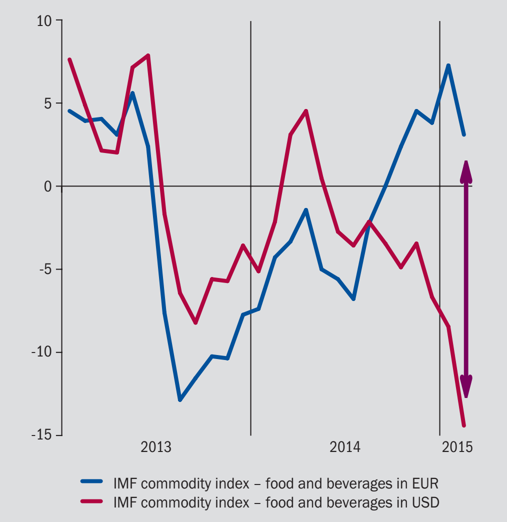
Source: Eurostat, NBS calculations.

Chart 15 Oil prices in EUR and USD (annual percentage changes)



Source: IMF, ECB and NBS calculations.

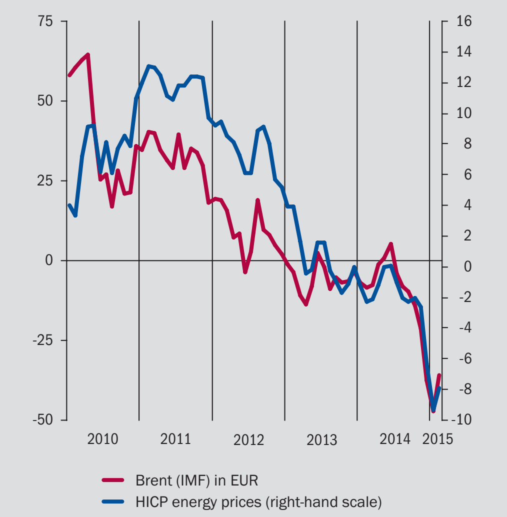
Chart 16 Food commodity prices in EUR and USD (annual percentage changes)



Source: IMF, ECB and NBS calculations.

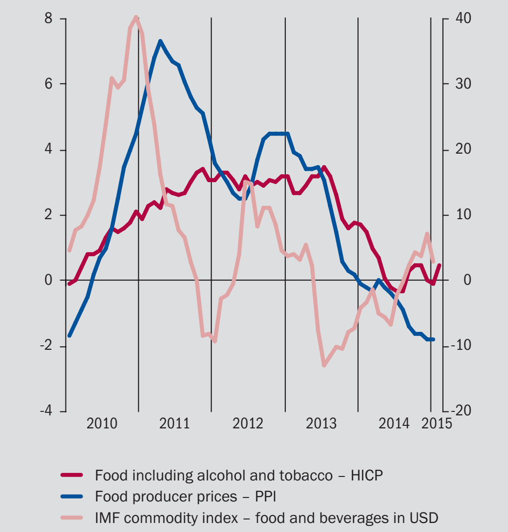
in euro increased after October owing to the depreciation of the euro's exchange rate. This in turn appears to have contributed to the halting of the gradual downward trend in annual food price inflation, which nevertheless remained relatively low.

Chart 17 Oil and energy prices in the HICP (annual percentage changes)



Source: Eurostat and IMF.

Chart 18 Impact of food commodity prices on producer prices and consumer prices (annual percentage changes)

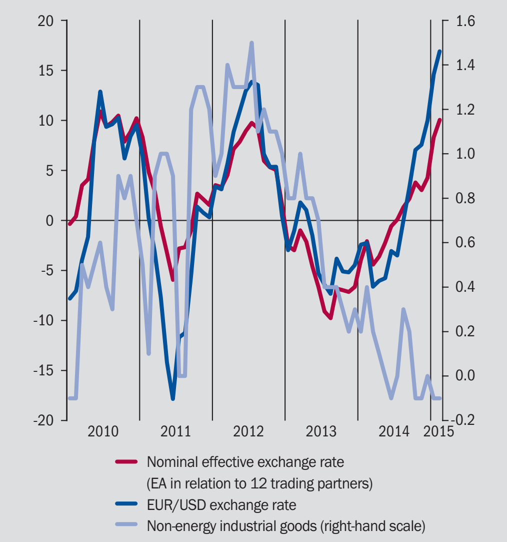


Source: Eurostat and IMF.

The inflation rate excluding energy, food alcohol and tobacco, which includes the components most sensitive to demand, fell by 0.1 percentage point in the fourth quarter of 2014, to 0.7%. In January it decreased to 0.6%, and in February it increased back to December's level.

Inflation in prices of demand-sensitive items continued to be dampened by strong competition and the sluggish pick-up in consumer demand. While annual inflation in services was relatively stable in the fourth quarter and subsequent two months, within a range of 1.0% and 1.2%, non-energy industrial goods inflation fell into negative territory (from 0.2% in September to -0.1% in February). Although the nominal exchange rate of the euro depreciated quite substantially, both against the US dollar and in effective terms, it has not yet had an impact on the rate of inflation in non-energy industrial goods. This suggests business entities are striving to maintain market share even at the expense of profit margins. Although consumer demand remains highly subdued, it is slowly picking up, as is indicated by the gradual acceleration in retail trade turnover. That acceleration has not yet been accompanied by an upturn in demand-pull inflation, but it is

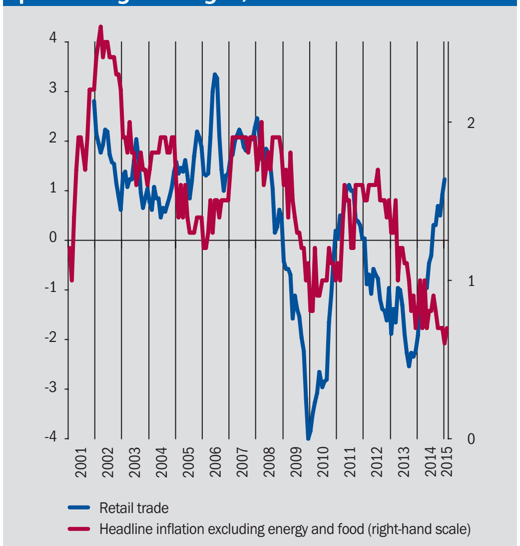
Chart 19 Non-energy industrial goods prices and the nominal exchange rate (annual percentage changes)



Source: Eurostat.

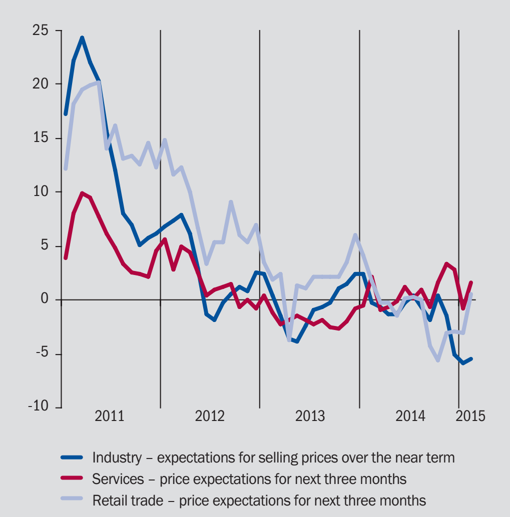
assumed that the weakening exchange rate and revival of consumer demand (supported by the ECB's monetary-policy measures) will put upward pressure on this component of the consumer price index.

Chart 20 Retail trade and the inflation rate excluding energy and food (annual percentage changes)



Source: Eurostat and ECB.
Note: Retail trade – three-month moving average shifted forward nine months.

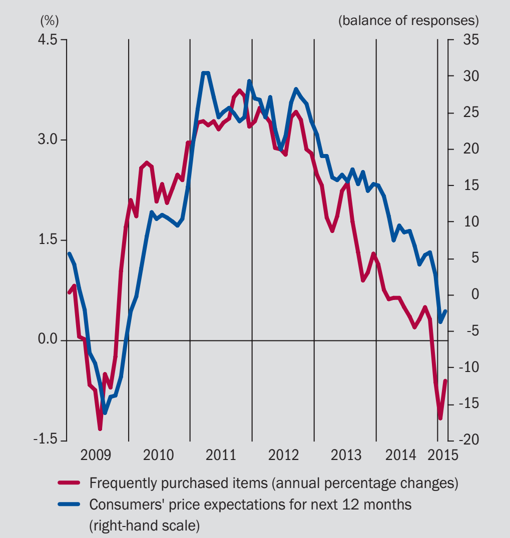
Chart 21 Price expectations in industry, services and retail trade (balance of responses)



Source: European Commission and Eurostat.

Although price expectations of economic agents remain at low levels, recent months have seen an increase in expectations for future selling prices, especially in retail trade, which may stem from the growth in consumer demand. According to

Chart 22 Prices of frequently purchased items and consumers' price expectations



Source: European Commission and Eurostat.

surveys conducted in January and, especially, in February, price expectations in industry did not continue to decline after their relatively sharp drop towards the end of 2014. The downward trend in consumers' inflation expectations also ended in February, although they to a large extent tend to reflect developments in prices of frequently purchased items, which in recent months have been substantially affected by energy prices.

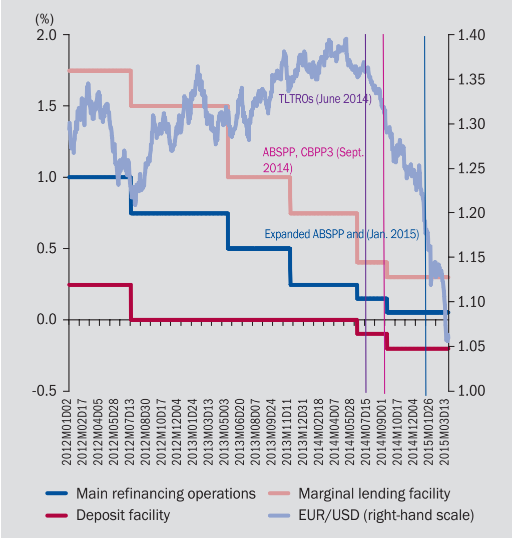
At its monetary policy meetings in the fourth quarter of 2014 and the first quarter of 2015, the ECB's Governing Council left the key ECB interest rates unchanged. The interest rates on the main refinancing operations and the marginal lending facility remained at 0.05% and 0.30%, respectively, and the rate on the deposit facility at -0.20% (zero lower bound). In setting a negative deposit facility rate, the Governing Council aimed to discourage banks from accumulating funds in their accounts with the ECB.

At its meeting in July 2014, the Governing Council decided on specific modalities for the series of targeted longer-term refinancing operations (TLTROs) that began in September 2014 and will continue until June 2016. The aim of the TLTROs is to enhance the functioning of the monetary policy transmission mechanism by supporting banks' lending to the real economy, i.e. to households (excluding loans for house purchase) and non-financial corporations. In the first TLTRO, conducted on 18 September 2014, a total of €82.6 billion was allotted, and in the second TLTRO, on 11 December 2014, a total of €130 billion, bringing the cumulative allotment in the two tenders to €212 billion.

After the Governing Council approved two new programmes in September 2014 – a third covered bond purchase programme (CBPP3) and asset-backed securities purchase programme (ABSPP) – interventions under the CBPP3 and ABSPP began in the following October and November, respectively. These programmes added to the range of monetary policy measures taken in previous months, serving to support, in particular, the forward guidance on key ECB interest rates, as well as the functioning of the monetary policy transmission mechanism and provision of credit to the broad economy. Each programme is expected to run for two years at a minimum. These measures were adopted with a view to underpinning the firm anchoring of medium to long-term inflation expectations, in line with the aim of maintaining inflation rates below but close to 2%. By 6 March 2015 the total amount of securities purchased under the two programmes was €57.8 billion.

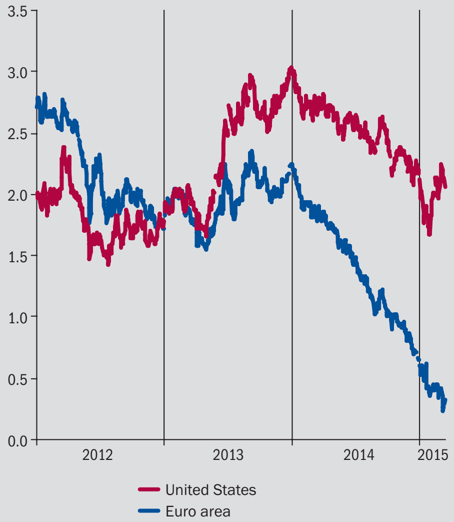
At its first meeting in 2015, in January, the Governing Council decided to launch an expanded asset purchase programme for purchases of securities issued by euro area governments, agencies and institutions. Entitled the secondary markets public sector asset purchase programme (PSPP)the programme encompasses the ABSPP and CBPP3. The combined monthly purchases will amount to €60 billion. They are intended to be carried out at least until September 2016 and will in any case be conducted until the Governing Council sees a sustained adjustment in the path of inflation which is consistent with its aim of achieving inflation rates below, but close to, 2% over the medium term. The PSPP is aimed at fulfilling the ECB's price stability mandate and addressing the risks of a too prolonged period of low inflation. The Governing Council retains control over all the design features of the programme and the ECB will coordinate the purchases, thereby safeguarding the singleness of the Eurosystem's monetary policy. The Eurosystem

Chart 23 Key ECB interest rates (%) and the EUR/USD exchange rate



Source: ECB.

Chart 24 Yield to maturity on 10-year government bonds (%)



Source: ECB and Federal Reserve.

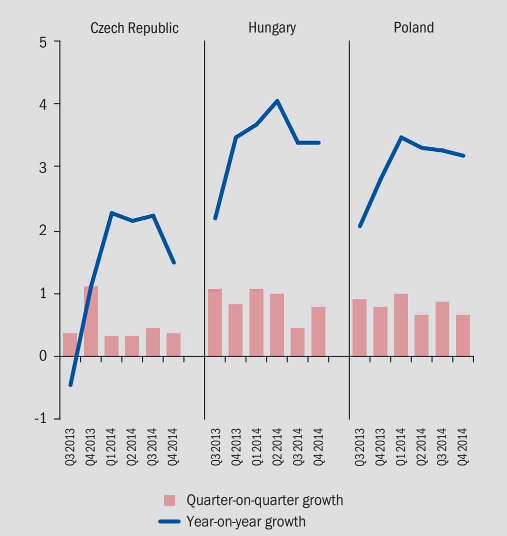
will make use of decentralised implementation to mobilise its resources. After the Governing Council's meeting in March, it was announced that purchases under the PSPP of securities issued by euro area governments, agencies and institutions would begin on 9 March 2015. The implementation of the programme is expected to stimulate economic activity in the euro area over the short-term and medium-term horizon, and this assumption was reflected in the March 2015 ECB staff economic projections for the euro area. Over the horizon of these projections, the ECB expects inflation to rise gradually towards the target rate (below, but close to, 2%).

5 Poland, the Czech Republic and Hungary

Comparing the countries' annual GDP growth in the fourth quarter of 2014, the Czech Republic's economy slowed the most, to 1.5% (from 2.2% in the third quarter), while Hungary's growth rate was unchanged, at 3.4%, and Poland's edged down to 3.2% (from 3.3%).

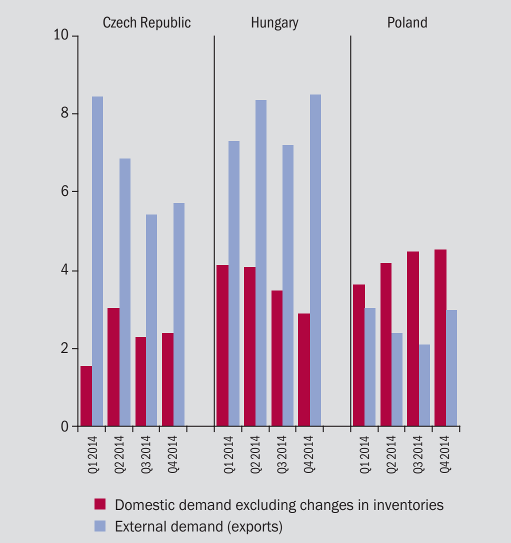
In terms of quarter-on-quarter change in the fourth quarter, GDP growth in Hungary increased by 0.4 percentage point, to 0.8%, while the Czech rate remained flat, at 0.4%, and the Polish rate slowed by 0.1 percentage point, to 0.7 %. In the **Czech Republic,** economic growth was based mainly on consumption, both private and public, as well as on net exports (with exports growing more than imports). Investment growth remained the same as in the previous quarter, while changes in inventories made a negative contribution (after a positive impact in the previous quarter). In **Hungary,** the principal drivers of economic growth were household consumption and net exports (with export growth exceeding import growth). The growth rate of government final consumption was unchanged from the previous quarter. Investment demand slowed, and changes in inventories also made a negative contribution to overall GDP growth. The slight decrease in **Poland's** economic growth was caused primarily by net exports (with exports increasing more moderately than imports) and also by a slowdown in investment demand. On the other hand, changes in inventories contributed positively to growth. Both private and public consumption were unchanged from the previous quarter.

Chart 25 GDP growth (%)



Source: Eurostat.

Chart 26 Contributions to annual GDP growth (p.p.)

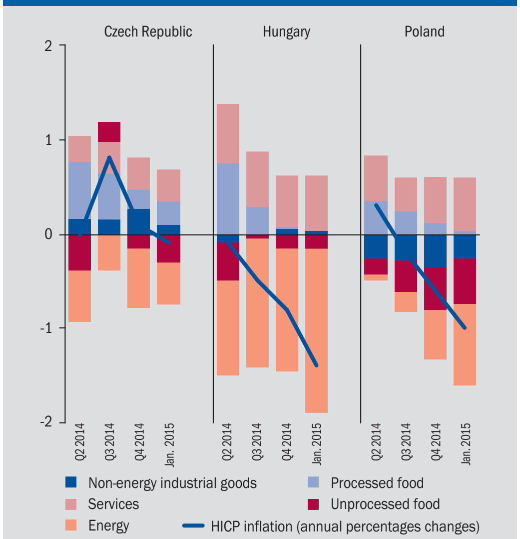


Source: Eurostat and NBS calculations.

Turning to annual consumer price inflation in the fourth quarter of 2014, the rate in the Czech Republic slowed towards the end of the period in comparison with the third quarter, while the negative rates in both Hungary and Poland moved further in that direction. In the Czech Republic, inflation fell by 0.7 percentage point, to 0.1%, owing mainly to energy prices, as they fell further in the fourth quarter than in the third quarter. Food prices also made a negative contribution, since unprocessed food prices decreased (after rising towards the end of the previous quarter) and processed food prices increased at a slower pace. Services price inflation remained unchanged. Only prices of non-energy industrial goods had a positive impact on the headline inflation rate, as their growth rate increased. In January 2015 the Czech inflation rate turned negative (-0.1%), and in February it remained at that level. In Hungary, decline in consumer prices accelerated (by 0.3 percentage point) to -0.8%. This stemmed largely from food prices, as unprocessed food prices fell (after rising towards the end of the third quarter) and processed food price inflation decelerated. Among all inflation components, energy prices decreased the most (due mainly to reductions in administered prices of electricity and heat), but less than they did in the previous quarter. Services price inflation was broadly unchanged, while non-energy industrial goods inflation registered the only positive contribution to the headline rate. In January 2015 the price level in Hungary decreased further (by 1.4%), and in February it fell more moderately (by 1.0%). Poland, like Hungary, saw its inflation rate fall further into negative territory at the end of the fourth quarter (by 0.4 percentage point, to -0.6%). All components other than services contributed negatively to the overall rate, as prices of non-energy industrial goods, energy and unprocessed food decreased further, while inflation in food prices moderated. Services price inflation increased. In January and February 2015 the price level in Poland continued to decrease (by 1.0% and 1.3%, respectively).

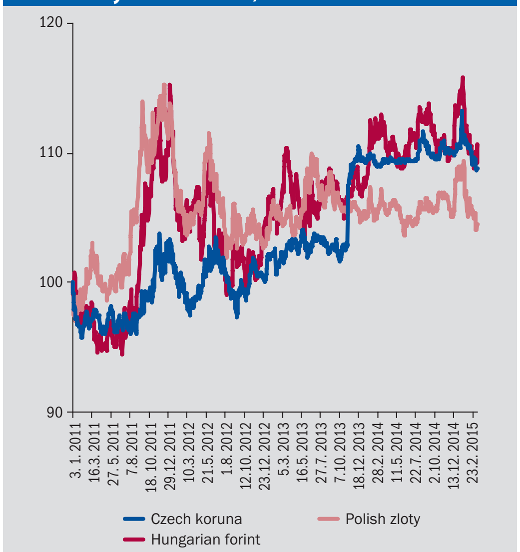
The currencies of all three countries under review were weaker against the euro at the end of the fourth quarter than at the end of the third quarter, with the Czech koruna having depreciated by 0.85%, the Hungarian forint by 1.6% and the Polish zloty by 2.29%. Constraints on the koruna's exchange rate, particularly in its scope for appreciation, continued to stem from the Czech central bank's decision to use foreign-exchange interventions as a means of maintaining accommodative monetary policy conditions. The most significant factors to affect the three exchange rates in the fourth quarter were the volatility in Russian financial markets towards the end of the period (when the rouble depreciated sharply against the US dollar and euro) and, to a lesser extent, the political events in Greece. The currencies also faced negative pressure from economic factors (for example, low and still-falling oil prices and the consequent impact on economic recovery and price developments in the EU).

Chart 27 Contributions to HICP inflation (p.p.)



Source: Eurostat, NBS calculations.

Chart 28 Exchange rate indices of the V4 currencies vis-à-vis the euro (index: 3 January 2011 = 100)

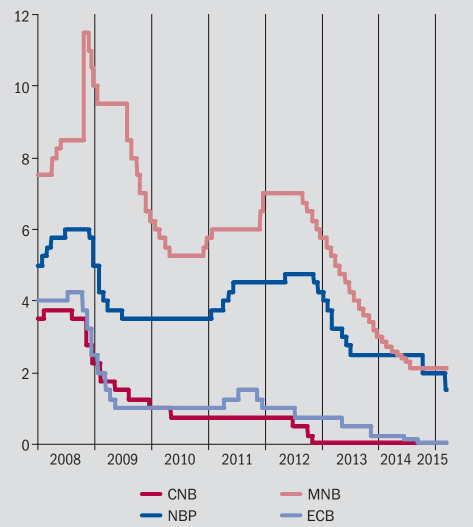


Source: Eurostat, NBS calculations.
Note: A fall in value denotes appreciation.

The Czech koruna was fluctuating at around 27.5 CZK/EUR at the beginning of the quarter, similar to its level in the previous quarter (with Česká národní banka committed to using the exchange rate as a monetary policy tool and keeping it weaker than 27 CZK/EUR). In late October the exchange rate began to depreciate moderately, owing mainly to concerns about the economic situation (a heightened risk of deflation). In December the koruna was not significantly affected by turbulences in Russian financial markets. At the start of 2015, however, the currency depreciated sharply due largely to concerns that the central bank might respond to rising deflationary risks in the economy by using the exchange rate to further ease monetary policy conditions (by adjusting the intervention level). Over the course of January and February the exchange rate gradually appreciated back to its former level at the beginning of the fourth quarter of 2014. The forint and zloty were more greatly affected than the koruna by the turmoil in Russian financial markets and the political situation in Greece (and the repercussion of these developments on the euro area economy). Each currency depreciated markedly against the euro towards the end of the year. Further downward pressure on the currencies came in January when the Swiss central bank unexpectedly unpegged the Swiss franc from the euro. This affected mainly the zloty, owing to the high share of foreign-currency denominated loans in Poland. In February, the three currencies were gradually appreciating, in response to the ECB's decision to expand its asset purchase programme with the aim of reaching the inflation target in the medium-term horizon.

Among the central banks of the three countries, the only one to adjust its key interest rate in the fourth quarter was Narodowy Bank Polski. In the Czech Republic, **Česká národní banka** kept its base rate unchanged at 0.05% (zero lower bound) at each of its monetary policy meetings in the fourth quarter. The central bank also reiterated its commitment to use the exchange rate as an additional instrument for easing monetary policy, meaning that it would continue to intervene, when necessary, in foreign exchange markets to prevent the koruna appreciating beyond 27 CZK/EUR, at least until the first quarter of 2016. At its meeting in February 2015, ČNB extended the duration of that commitment to the end of 2016, i.e. over the whole of the projection horizon. In Hungary, the **Magyar Nemzeti Bank** left its interest rates unchanged, considering them to be consistent with the inflation target over the medium-term horizon, and at an appropriate level to support the real economy. Following the adoption of a law requiring the conversion of foreign-exchange consumer loans into forints, the MNB earmarked HUF 9 billion for the banking sector to cover the hedging of conversion-related foreign exchange risk. The bank made no rate changes in January and February 2015. **Narodowy Bank Polski** adjusted monetary policy conditions in the fourth quarter, when it cut key rates by 50 basis points with effect from 9 October 2014, bringing the benchmark rate down to 2.0% (the deposit rate was left unchanged, and so the spread between the lending "lombard" rate and deposit rate narrowed). The stated justification for the decision was the slowdown in economic growth and the increasing risk of inflation undershooting its target rate in the medium-term horizon. The central bank would not rule out further adjustments to monetary policy settings if the inflation risk continued. In January and February it left the key rates unchanged, but in March it further eased monetary policy conditions by cutting the benchmark rate by 50 basis points, to 1.5%, with effect from 5 March 2015.

Chart 29 Key interest rates of the national central banks V4 (%)



Source: National central banks and ECB.

SUMMARY OF GDP GROWTH PROJECTIONS OF SELECTED INSTITUTIONS

Table 1 The global economy

	Release	2014		2015		2016	
IMF	January 2015	3.3	(=)	3.5	(-0.3)	3.7	(-0.3)
OECD	November 2014	3.3	(-0.1)	3.7	(-0.2)	3.9	-
EC	February 2015	3.3	(=)	3.6	(-0.2)	4.0	(-0.1)
ECB[1)]	March 2015	3.3	(=)	3.5	(-0.2)	3.8	(-0.1)

Table 2 USA

	Release	2014		2015		2016	
IMF	January 2015	2.4	(0.2)	3.6	(0.5)	3.3	(0.5)
OECD	November 2014	2.2	(0.1)	3.1	(=)	3	-
EC	February 2015	2.4	(0.2)	3.5	(0.4)	3.2	(=)
Federal Reserve	December 2014	2.35	(0.3)	2.8	(=)	2.75	(=)

Table 3 Euro area

	Release	2014		2015		2016	
IMF	January 2015	0.8	(=)	1.2	(-0.2)	1.4	(-0.3)
OECD	November 2014	0.8	(=)	1.1	(=)	1.7	-
EC	February 2015	0.8	(=)	1.3	(0.2)	1.9	(0.2)
ECB	March 2015	0.9	(0.1)	1.5	(0.5)	1.9	(0.4)

Table 4 Czech Republic

	Release	2014		2015		2016	
IMF	October 2014	2.5	(0.6)	2.5	(0.5)	2.4	(0.3)
OECD	November 2014	2.4	(1.1)	2.3	(-0.1)	2.7	-
EC	February 2015	2.3	(-0.2)	2.5	(-0.2)	2.6	(-0.1)
Česká národní banka	February 2015	2.3	(-0.2)	2.6	(0.1)	3	(0.2)

Table 5 Hungary

	Release	2014		2015		2016	
IMF	October 2014	2.8	(0.8)	2.3	(0.6)	1.8	(0.1)
OECD	November 2014	3.3	(1.4)	2.1	(0.5)	1.7	-
EC	February 2015	3.3	(0.1)	2.4	(-0.1)	1.9	(-0.1)
Magyar Nemzeti Bank	December 2014	3.3	(=)	2.3	(-0.1)	2.1	-

Table 6 Poland

	Release	2014		2015		2016	
IMF	October 2014	3.2	(0.2)	3.3	(=)	3.5	(0.2)
OECD	November 2014	3.3	(0.4)	3	(-0.4)	3.5	-
EC	February 2015	3.3	(0.3)	3.2	(0.4)	3.4	(0.1)
Narodowy Bank Polski	March 2015	-	-	3.4	(0.4)	3.3	(=)

1) 1) Global economic growth excluding the euro area.
Note: Data in brackets denote the change in percentage points from the previous projection.
The IMF projection of January 2015 includes only forecasts for major economies.