NÁRODNÁ BANKA SLOVENSKA
EUROSYSTÉM

Report on the International Economy

September 2015

Published by:
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Discussed by the NBS Bank Board on 29 September 2015.

ISSN 1339-9616 (online)

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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 remained slow and uneven in the second quarter of 2015. In some advanced countries activity accelerated or stayed stable in comparison with the first quarter of the year, while across emerging economies there was greater heterogeneity.

Among advanced countries, the United States contributed positively to global growth, as its economy accelerated owing mainly to consumption as well as to investment. The performance of the US economy therefore confirmed that the temporary slowdown earlier in the year was due mainly to the weather and disruptions to west coast ports. Going forward the US economy is expected to continue benefiting from low oil prices, benign financial conditions, further improvement in the labour market, and a neutral fiscal stance. In the UK, too, GDP growth increased, reflecting positive contributions from private consumption, investment and, most significantly, net exports. While fiscal consolidation may have dampened growth to some extent, falling energy prices are expected to have supported real incomes and private consumption. As for the euro area GDP, its growth was slightly lower in the second quarter than in the previous quarter, but still solid. Unlike in the first quarter, the main driver of growth was export performance. After growing strongly at the beginning of the year, the Japanese economy contracted as a result of declines in private consumption and exports. Outlooks remain upbeat, however, reflecting assumptions that the benefits of low energy prices will extend to Japanese households and that previous yen depreciation will stimulate the economy through the export channel.

Turning to emerging economies, China's economy surprisingly accelerated in the second quarter, after slowing late last year and early this year. The economy continued to be supported by fiscal policy, through stimuli and tax relief, as well by monetary policy, through reductions in the base rate and the minimum reserve requirement. Furthermore, the central bank devalued the exchange rate in August in order to support Chinese exports. The recent stock market turmoil and exchange rate volatility in China have heightened uncertainty about the future situation in the country. Measures taken to address macroeconomic imbalances are also widely expected to subdue growth. Elsewhere in Asia, India saw its GDP growth decrease after being the fastest growing large economy in the world in the previous quarter. The slowdown was caused by lower capacity utilisation and a weaker pick-up in investment. Even so, the economic outlook remains positive owing to low oil prices and recovery in advanced economies. Among emerging countries, Brazil reported a marked contraction of GDP in the second quarter, as adverse trends in the energy sector weighed on both activity and confidence. In Russia, the recession deepened in the second quarter. Although the Russian economy was previously showing signs of stabilisation, its prospects remain inauspicious in the midst of a depreciating currency, falling oil prices, continuing geopolitical tensions and the further extension of sanctions.

Across OECD countries, economic growth moderated to 0.4% in the second quarter of 2015, from 0.5% in the first quarter. The annual growth rate remained flat, at 2.0%. The OECD's average Composite Leading Indicator (CLI)[1] for its member countries is not pointing to an acceleration of global growth in the short-term horizon, as the index continued its downward path in the second quarter and fell slightly further in July.

Short-term leading indicators imply a moderate slowdown in global GDP growth, while the longer-term horizon is expected to see a gradual pick-up in the world economy. Its progress will be largely determined by advanced economies, with growth in the emerging world assumed to be lower than previously expected. The brightening prospects for advanced economies are underpinned by low oil prices, further easing of financial conditions, less extensive fiscal consolidation and improving labour market conditions. On the other hand, the outlook for emerging economies is more pessimistic, given structural obstacles and macroeconomic

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

Chart 1 GDP growth and the CLI

Source: OECD.
Note: Composite Leading Indicator (CLI).

imbalances as well as, in some countries, the slow adjustment to lower commodity prices, political instability and deterioration in external financing.

The recent falling trend in global inflation has reflected the slump in oil prices. The average rate of consumer price inflation across OECD countries remained relatively stable in the second quarter. By contrast, disinflationary pressures persisted in China and India, while inflation accelerated in Brazil and Russia, as import prices were pushed up by currency depreciation and as the diminishing credibility of domestic monetary policy raised inflation expectations.

The OECD's headline inflation rate fell slightly at the beginning of the second quarter, with its movement broadly based across all components. The rate then returned to its March level (0.6%) and remained there in June. This trend was entirely accounted for by the subdued rate of decrease in energy prices, since core inflation remained stable and food price inflation fell. The core inflation rate edged down from 1.7% in March to 1.6% in June. In July, the core rate returned to 1.7%, but food price inflation fell again and the decline in the energy prices accelerated, so the headline rate remained at the June level.

The global inflation rate is expected to increase only gradually. Over the short-term horizon, the recent decline in prices of oil and other commodities is expected to curb inflationary pressures, but then the negative base-effect impact of energy prices should fade. With oil prices expected to increase, it is assumed that energy prices will put upward pressure on the overall inflation rate. At present, however, the slow recovery of the global economy will lead to only a gradual reduction in slack in the economy, with the result that cost- and wage-related inflation pressures remain subdued.

2 Commodities

The oil price showed a rising trend at the beginning of the second quarter of 2015, and despite falling slightly over the rest of the period, its average level increased by around USD 9 per barrel in comparison with the previous quarter. The main factors putting downward pressure on the oil price in the early part of the quarter were the news of a preliminary deal on Iran's nuclear programme and information about record oil production levels in Saudi Arabia. In this period, however, the conflict in the Middle East was a having a greater upward impact on the oil price. With the escalation of tensions in Syria and Yemen, as well as reduced production in the United States, the oil price climbed to USD 68 per barrel. Oil prices followed a slight downward trajectory over the rest of the quarter, in response to the end of military operations in Yemen and to expectations of an increase in US oil inventories. Despite these developments, however, the oil price ended in the second quarter above its first-quarter average. Oil prices continued falling after the second quarter, but far more sharply. This was caused mainly by the collapse of the Chinese stock market in early July and the signing of the Iranian nuclear deal later in that month – raising the prospect of an increase in Iranian oil exports at a time of global oil surpluses. Amidst increasing US oil reserves, expectations of a Chinese economic slowdown, and repeated turbulences in the Chinese stock market, the oil price came under further downward pressure and towards the end of August it was averaging below USD 43 per barrel. In early September the oil price increased to around USD 50 per barrel, as stock markets rallied and oil inventories fell.

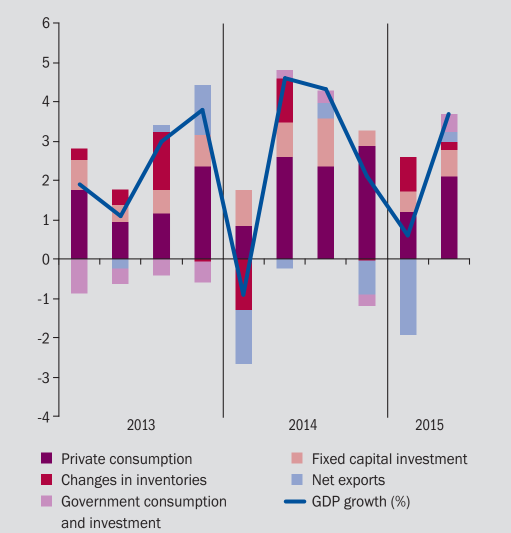
Non-energy commodity prices maintained their downward trend in the second quarter of 2015, as the parallel decline in prices of metals and agricultural commodities continued. Thus non-energy commodity prices were responding to ongoing oversupply and high stock levels. Although metal prices experienced a brief rally in May, their average level for the quarter remained below that of the previous quarter owing mainly to the effects of the financial crisis in Greece and weak demand in China. Tin, nickel, and iron ore recorded the largest price decreases in the second quarter. Metal prices continued to fall in July and August, with July's drop being greater owing mainly to falling prices of iron ore, as well as copper, nickel and zinc. Agricultural commodity prices decreased in April and May, but although they rose slightly in June, in response to reduced supply, their average was lower in the second quarter than in the first. Despite poor weather in North America during the second quarter, prices of edible oils and cereals fell, as did meat prices. Agricultural commodity prices continued to decrease in the next two months, as supply outstripped demand.

3 The United States

The US economy accelerated substantially in the second quarter, growing at an annualised rate of 3.7% after expanding by 0.6% in the previous quarter. This confirmed that the temporary slowdown earlier in the year was caused mainly by the weather (a severe winter in the north-east of the country). Although year-on-year GDP growth fell slightly to 2.7%, from 2.9% in the first quarter, the US economy was not significantly affected by the slowdown in emerging countries and by the general increase in global volatility. Despite wages remaining flat, consumer spending contributed positively to US economic growth, as households benefited from low energy prices and an improving labour market. Private consumption was thus markedly higher in the second quarter than in the first and its impact on the annualised growth rate was a full two percentage points. Fixed capital investment also made a positive contribution. Investment increased in industrial plant and machinery and in research and development, while residential investment also maintained its strong growth. Gross government investment also had a positive impact on US GDP growth, as did net exports, with export performance picking up and import growth falling. Based on these economic indicators, as well as the labour market situation, the short-term outlooks for the US economy remain bright.

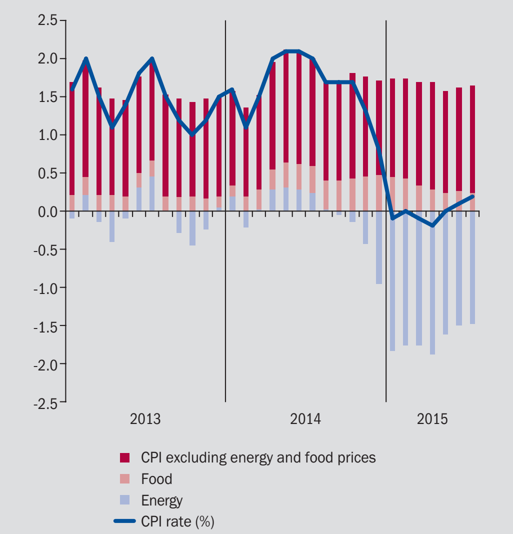
Annual consumer-price inflation in the United States, which in March stood at -0.1%, stayed negative in the early part of the second quarter, before turning positive and reaching 0.1% in June. As in the first quarter, the inflation rate was affected mainly by energy prices, which in turn reflected energy commodity prices. The marked decrease in energy prices became more pronounced in April but moderated thereafter, and – with food price inflation falling and core inflation remaining flat – these prices were a key factor in the return of inflation to positive territory. The moderating trend in energy prices continued in July and therefore contributed to a slight increase in the headline inflation rate, to 0.2%. The core inflation rate was the same in June (1.8%) as it had been in March, and it remained at that level in July. With commodity prices having fallen again, the months ahead will see sustained downward pressure on inflation. In early next year, however, consumer prices are expected to begin rising as the effect of the decrease in energy prices fades.

Chart 2 Annualised GDP growth (%) and its composition (p.p.)



Source: Bureau of Economic Analysis.

Chart 3 Annual consumer price inflation (%) and its composition (p.p.)



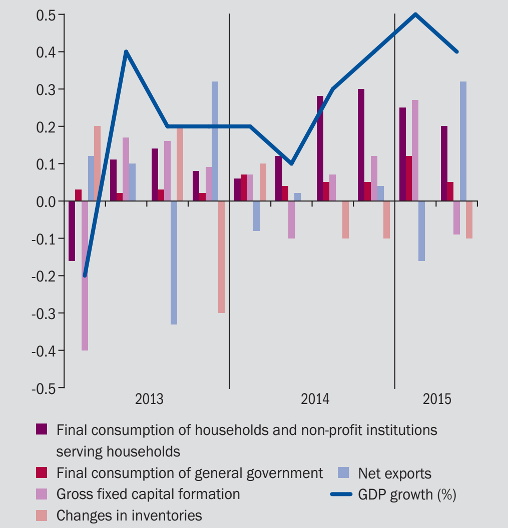
Sources: Bureau of Labor Statistics, NBS calculations.

The US Federal Open Market Committee (FOMC) decided at its meetings in April, June, July and September to leave its target range for the federal funds rate unchanged, at 0% to 0.25%. The FOMC stated that in determining how long to maintain this target range, it would assess progress – both realised and expected – towards its objectives of maximum employment and two 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 and international developments. At all four meetings, the FOMC anticipated that it would be appropriate to raise the target range when it had seen a further improvement in the labour market and was reasonably sure that inflation would move back to its two per cent objective over the medium term.

4 The euro area

The euro area's economic growth remained relatively solid in the second quarter, although it slowed marginally to 0.4% (from 0.5% in the first quarter). The most marked slowdowns among the larger national economies were observed in France (from 0.7% to 0 %), the Netherlands (from 0.6% to 0.1%), and, to a lesser extent, Italy (from 0.4% to 0.3%). By contrast, GDP growth accelerated in Germany (from 0.3% to 0.4%) and Spain (from 0.9% to 1.0%). The continuing recovery of the euro area economy in the second quarter of 2015 was reflected in its annual growth rate, which increased from 1.2% to 1.5%.

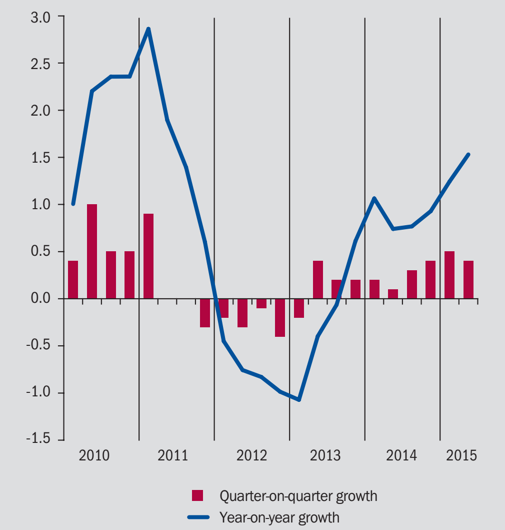
Chart 5 Quarterly GDP growth (%) and its composition (p.p.)



Sources: Eurostat, NBS calculations.

The main driver of euro area GDP growth in the second quarter was net exports, whereas in the previous three quarters it had been domestic demand. This positive impact stemmed from a relatively strong increase in export growth and a slowdown in import growth. It is assumed that exports continued to benefit from the weaker euro. Looking at domestic demand components, both private and government consumption continued to have a positive impact on GDP growth in the second quarter, albeit, in each case, slightly lower than in the previous quarter. Investment demand contributed negatively to second-quarter growth, as it fell for only the second quarter in two years. Its drop may be partly related to concerns about global economic trends, as well as to tensions over how to deal with the Greek debt crisis. Overall GDP growth was also negatively affected by destocking.

Chart 4 Economic growth (at constant prices, per cent)

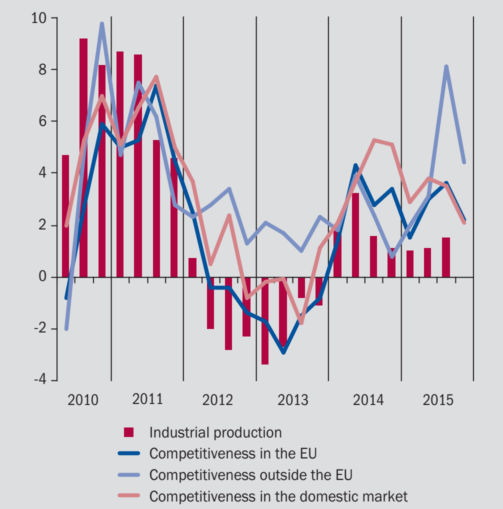


Source: Eurostat.

Although exports had a large impact on the second-quarter GDP growth, the major export sector of manufacturing reported a quarter-on-quarter slowdown to 0.2% (from 0.8% in the first quarter). At the same time, however, its year-on-year growth increased slightly. Within industry, firms' assessments of their competitive position primarily outside EU countries deteriorated in the third quarter, and consequently so did export expectations. Nevertheless, export expectations are relatively high, and therefore it may be assumed that manufacturing output will continue to grow, but probably not accelerate.

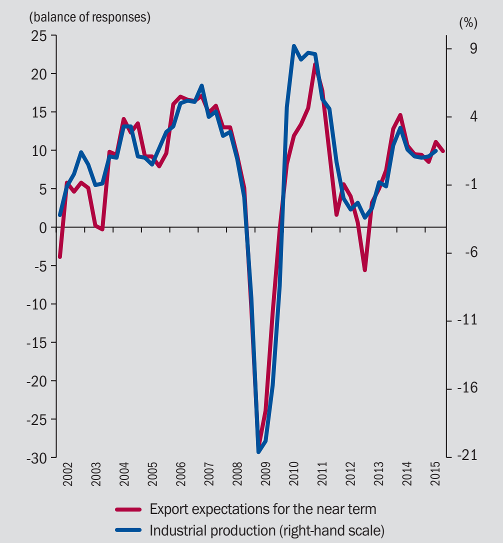
Amid falling investment demand, the third quarter saw an end to the lessening trend in assessments of demand as a factor limiting production. At the same time, assessments of financial constraints as a factor limiting production increased slightly, after previously easing in response to a series of non-standard monetary policy measures of the ECB as well as to cuts in retail interest rates and a pick-up in lending activity. The perceived worsening of the impact of financial constraints on production may simply, however, be a response to previously excessive optimism. What may, however, be a positive sign for the economy is the increased importance of supply-side factors – shortage of labour force and shortage of material/equipment

Chart 6 Competitiveness in industry (balance of responses) and industrial production (annual percentage changes)



Sources: European Commission, Eurostat, NBS calculations.

Chart 7 Export expectations in industry (balance of responses) and industrial production growth (annual percentage changes)

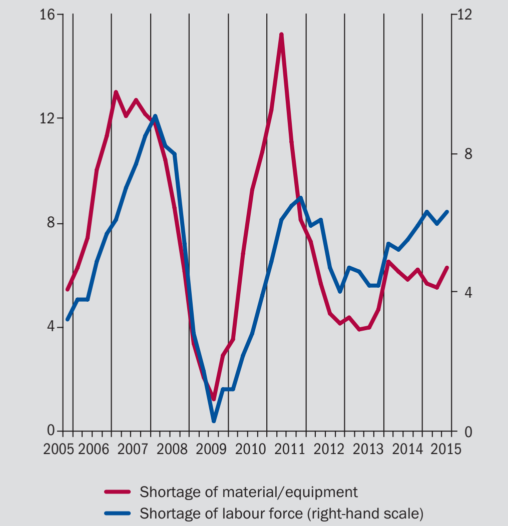


Sources: European Commission, Eurostat, NBS calculations.

Chart 8 Factors limiting production in industry (%)

Source: European Commission.

Chart 9 Factors limiting production in industry (%)



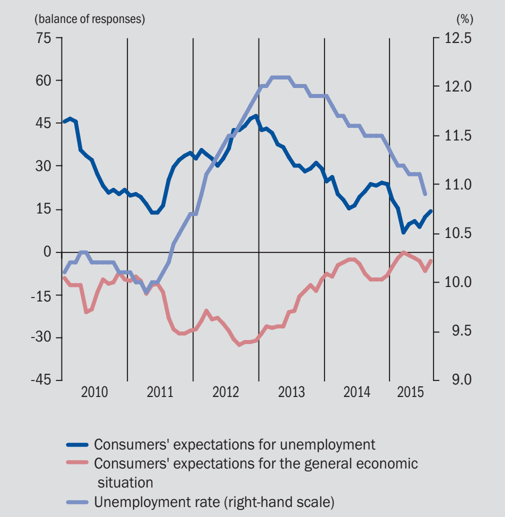
Source: European Commission.

– as constraints on production, since it may indicate strengthening of the labour market and a need for investment activity.

The labour market situation improved further in the second quarter, with the unemployment rate falling by 0.1 percentage point, to 11.1%. The decrease occurred in April and the rate remained unchanged in the next two months. In July the unemployment rate returned to its downward trend as it fell to 10.9%, its lowest level since February 2012.

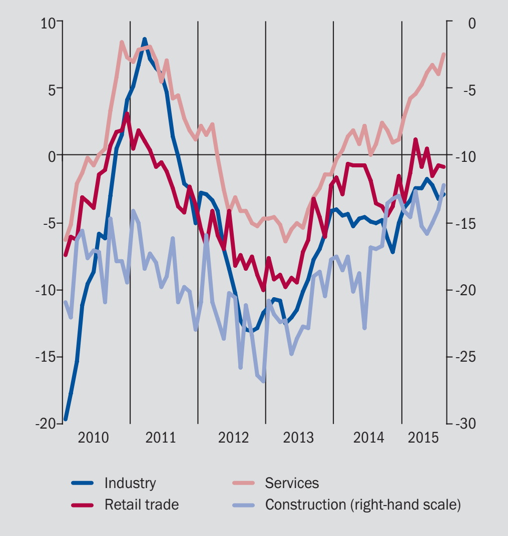
Despite the drop in jobless rate, consumers' expectations for unemployment deteriorated slightly in July and August. July also saw a worsening of consumers' expectations for the general economic situation, although in August these returned to their previous level. In the services sector, assessments of future employment improved markedly, apparently in response to consumption growth. In the construction sector, too, employment expectations became brighter from June. The assumption here may be that construction activity will increase at a time when the cost of borrowing from banks is low and lending activity is picking up. In the retail trade and industry sectors, by contrast, the employment outlook is less optimistic. In industry, assessments of future employment deteriorated significantly in June and July, after following an upward trend from the end of 2014, and they rebounded only moderately in August. Despite favourable employment developments in the second and third quarters, the labour market remains relatively fragile.

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



Sources: European Commission and Eurostat.

Chart 11 Employment expectations by sector (balance of responses)

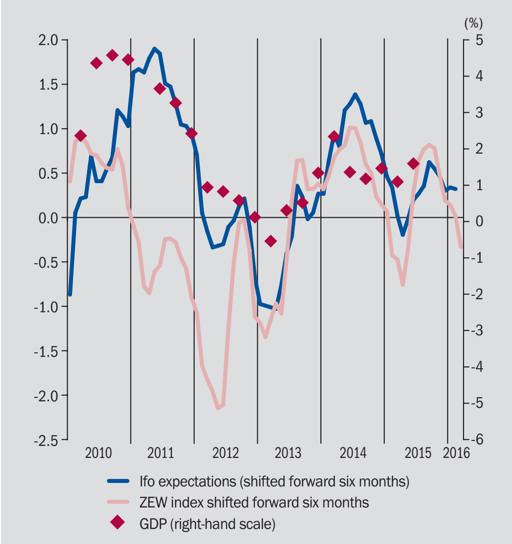


Source: European Commission.

Several leading indicators worsened in the second quarter, reflecting to some extent uncertainty over how to resolve the Greek debt crisis as well as surprisingly adverse reports from the United States, published in May, suggesting that the US economy shrank in the first quarter (the data were revised at the end of June to show modest growth). In the first months of the third quarter, however, a number of indicators rebounded from their earlier deterioration. After its somewhat volatile movement in previous months, the euro area's composite PMI strengthened in August to its highest level since May 2011. The economic sentiment indicator (ESI) for the euro area also recovered from its declines in April and May, and in August reached relatively high levels not observed for more than two years. The Eurocoin index, too, is pointing to a pick-up in activity, but although it increased gradually from December 2014 to August 2015, the rate of increase moderated. Whereas leading indicators for the euro area as a whole are sending positive signals, those for Germany are less encouraging. Although the Ifo index picked-up in July and August after falling in May and June, its recovery was entirely accounted for by assessments of the current economic situation, while assessments of the future situation remained flat. Furthermore, Germany's ZEW index fell in September for a sixth successive month, to its lowest level since October 2014. The ESI for Germany was somewhat more favourable, since after falling in April, it strengthened moderately over the following three months. In August, however, it edged down again. The only German indicator showing an upward trend is the PMI, which after decreasing in April and May, increased gradually in the three months to August, reaching its highest level for five months. Most of the leading indicators still, however, have not reflected the turbulences besetting the Chinese stock market at the end of August (and subsequently also European and US stock markets), which stemmed from mounting risks of economic slowdown in China and from concerns about the country's stock market bubble.

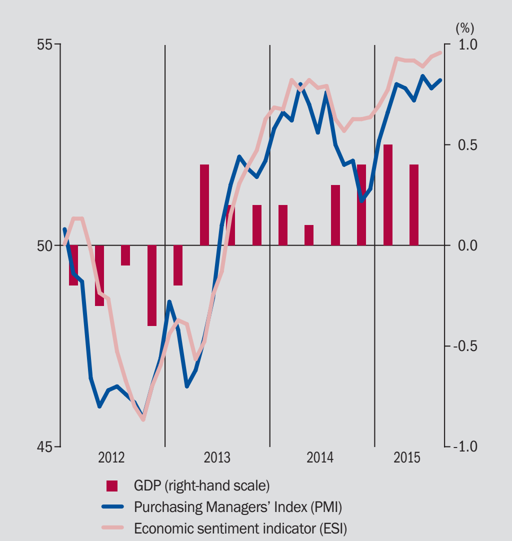
After its downward trend ended in the first quarter, the consumer price inflation rate accelerated in the second quarter and returned to positive figures, increasing from -0.1% in March to 0.2% in June. This shift was based partly on a lessening of the downward impact of energy prices (following developments in global oil markets) and an increase in food price inflation. In addition, inflation excluding energy and food increased slightly, driven mainly by non-energy industrial goods inflation. The headline rate remained unchanged in July and then edged down to 0.1% in August. The inflation developments in July and August were determined by the opposite impacts of particular

Chart 13 German leading indicators and annual GDP growth



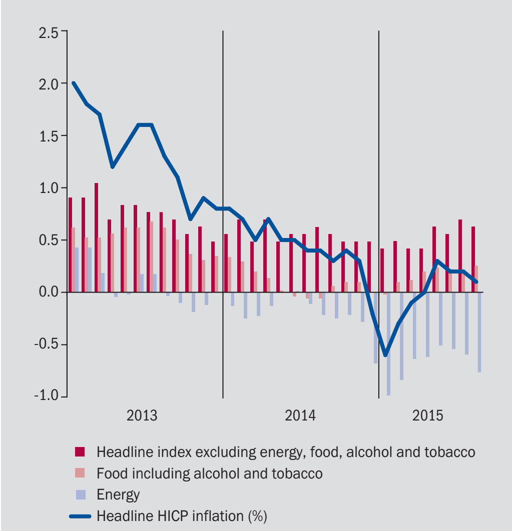
Sources: Ifo Institute, ZEW Centre, Eurostat, and NBS calculations.
Note: Ifo, ZEW – normalised indices, deviations from the long-term average.

Chart 12 Euro area leading indicators and quarterly GDP growth



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

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



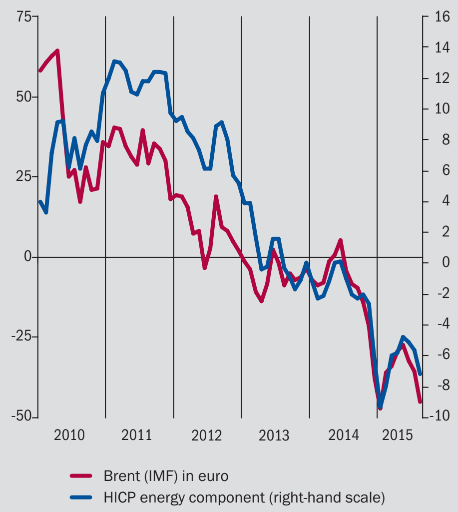
Sources: Eurostat, NBS calculations.

sub-aggregates in the consumption basket. The drop in energy prices gathered pace again, after a renewed decline in world oil prices. In July, however, there was a slight increase in market components of the inflation rate, in particular non-energy industrial goods and, to a lesser extent, services. In August the rates of change of these components remained flat.

Oil prices in euro continued to pass quickly through to consumer price inflation via the energy component. In the first quarter and in April the impact on energy prices of an easing rate of decrease in US dollar oil prices was supported by euro depreciation, whereas in the next two months, as the euro began to strengthen, the difference between the rate of change in euro and US dollar oil prices narrowed considerably. The euro's appreciation partly explained why the acceleration in the annual rate of decrease in global oil prices in euro was around three percentage points greater than the corresponding drop in US dollar oil prices.

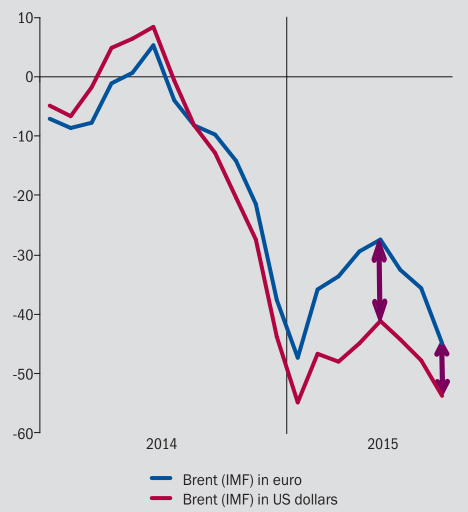
Unprocessed food price inflation accelerated in the second quarter, as it reflected, with a lag, increased inflation in global prices of food commodities (in euro) during previous months. From May, however, commodity prices started to drop and their annual rate of increase also slowed, meaning they are not putting upward pressure on unprocessed food price inflation. Nevertheless, the pass-through of commodity price movements to food producer prices and processed food prices is not significant, possibly because of the strong competition within this market segment. After easing slightly at the end of the first quarter, the rate of decrease in food producer prices accelerated again until July,

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



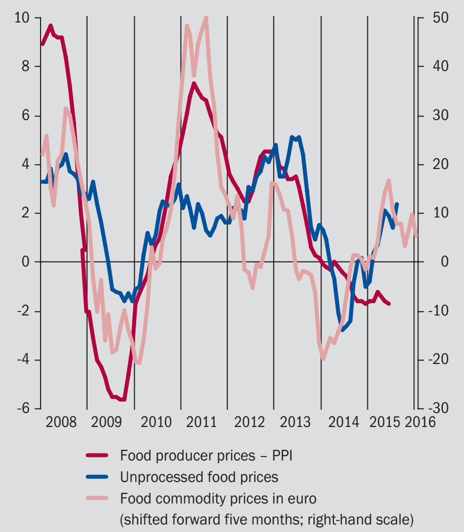
Sources: IMF, ECB, and NBS calculations.

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



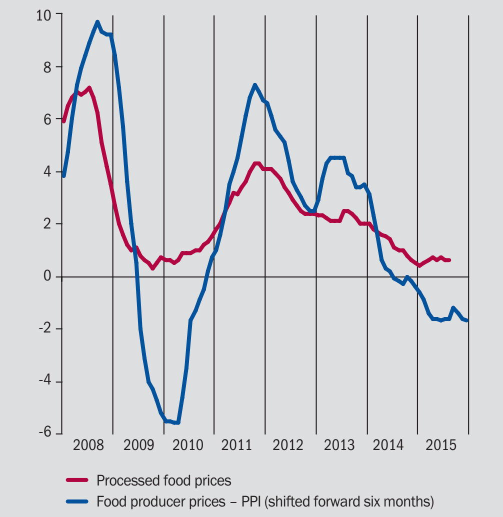
Sources: IMF, ECB, and NBS calculations.

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



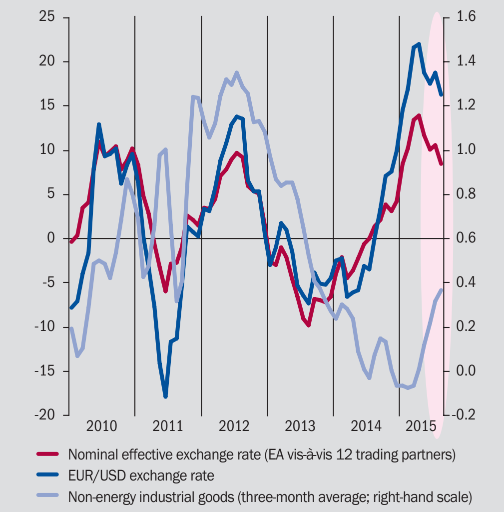
Sources: Eurostat and ECB.

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



Sources: Eurostat and ECB.

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



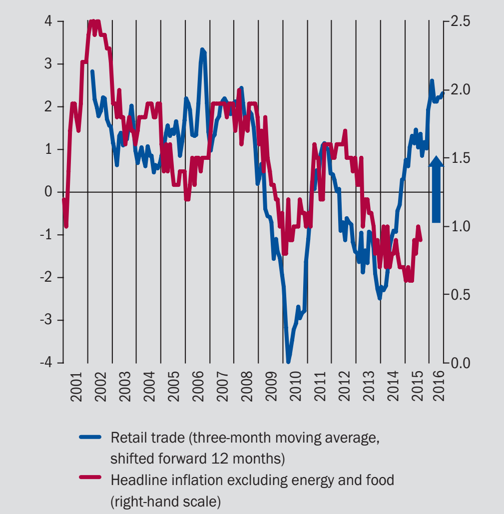
Sources: Eurostat and ECB.
Note: Positive values for the EUR/USD exchange rate denote depreciation of the euro.

while processed food price inflation remained broadly unchanged.

The inflation rate excluding energy, food, alcohol and tobacco prices, which includes the components most sensitive to demand, increased gradually in the second quarter, from 0.6% in March to 0.8% in June. In July it climbed to 1.0%, but in August it edged back down to 0.9%.

The market components of the inflation rate continued to be affected by an environment of strong competition and by the relatively low, albeit rising, level of consumer demand. Prices of non-energy industrial goods were affected, via import prices, by the euro's depreciation (in effective terms, too) against the dollar. This pass-through gradually began to have an upward impact on non-energy industrial goods inflation, which in the second quarter moved into positive territory (from 0.0% in March to 0.3% in June). It increased further in July, to 0.4%, and remained at that level in August. Services price inflation did not show any marked trend in either the second quarter or the next two months, as it fluctuated within a range of 1.0% to 1.3%. The gradual pick-up of consumer demand is expected to be supported in the period ahead by a further decline in oil prices and its positive impact on household disposable income.

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



Sources: Eurostat and ECB.

Price expectations of economic agents remain subdued. After showing signs of an upward trend in the second quarter, expectations for selling prices fell in both July and August, particularly in industry but also in retail trade and services. The drop in selling price expectations in industry, which may be due in part to the turbulences

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

Sources: European Commission and Eurostat.

Chart 22 Producer prices (annual percentage changes) and selling price expectations

Sources: European Commission and Eurostat.

in China, suggests that producer price inflation will not be accelerating. Therefore the pick-up in consumer price inflation, as well as other price indicators, remains fragile.

During the second and third quarters 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%. The negative deposit facility rate is intended to discourage banks from accumulating funds in their accounts with the ECB.

From March to August 2015, the average value of monthly purchases under the expanded asset purchase programme (APP) was at the targeted level (€60 billion). The ECB's purchases in May, June and July were higher than the target level (by around €6.7 billion in total) in anticipation of lower purchases during the holiday season. In August, as expected, the amount of purchases was lower (at around €52 billion).

So far in 2015 the ECB has conducted two target longer-term refinancing operations (TLTROs), one in March and the other in June, with a total allotment of around €170 billion (the next TLTRO is scheduled for the end of September). This has brought cumulative allotment under the TLTRO programme since September 2014 to around €384 billion.

Box 1

NON-STANDARD MONETARY POLICY MEASURES HAVE CONTRIBUTED TO A REDUCTION IN BORROWING COSTS AND HELPED STIMULATE LENDING ACTIVITY

In January 2015 the European Central Bank (ECB) announced the latest enhancement of its set of non-standard monetary policy measures, namely that the existing asset purchase programme (APP) would be expanded to include a public sector asset purchase programme (PSPP),[2] commonly referred to as quantitative easing. Besides this "expanded APP", the set of non-standard measures includes, among other measures, targeted longer-term refinancing operations (TLTROs).

2 In addition to the PSPP, the expanded APP includes the following previously-adopted private sector asset purchase programmes: the asset-backed securities purchase programme (ABSPP) and the third covered bond purchase programme (CBPP3).

The ECB's target amount for monthly purchases under the expanded APP is €60 billion. The purchases began in March 2015 and are due to continue at least until the end of September 2016, and, in any case, 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 termination of the programme is therefore open-ended.

New non-standard monetary policy measures have been phased in since June 2014. Unlike previous such measures, which were aimed mainly at redressing impairments in the monetary policy transmission mechanism, the new measures are to be a means of actively steering the size of the ECB's balance sheet to larger levels, in order to prevent the risks of too prolonged a period of low inflation at a time when interest rates have reached their lower bound.

The new non-standard measures are expected to support demand by signalling the ECB's commitment to maintain an accommodative monetary policy for an extended period, and so foster an increase in inflation expectations. At the same time, the use of TLTROs as non-standard monetary policy measures should stimulate economic activity by reducing banks' funding costs and improving access to such funding. It is also assumed that by strengthening banks' balance sheets and reducing constraints arising from the structure of their assets and liabilities, TLTROs will indirectly ease access to, and reduce the cost of, bank loans. The rest of this box looks at the impact of the new non-standard measures on banks' interest rates and lending activity.

The pass-through to borrowing costs of the non-standard monetary policy measures adopted gradually from June 2014 has been relatively rapid. By July 2015 lending rates for both households and non-financial corporations had fallen cumulatively by around 0.7 percentage point. The announcement of TLTROs and the subsequent adoption of other measures has helped to restore the impaired mechanism by which the main refinancing rate (the ECB's key rate) is transmitted to retail interest rates. In 2013 retail rates were largely unaffected by cuts in the key rate (amounting to 50 basis points in total), and the spread between the two widened. The non-standard measures have helped re-establish the transmission of monetary policy settings to borrowing costs for the real economy.

Chart A Composite lending rates and the main refinancing rate (%)

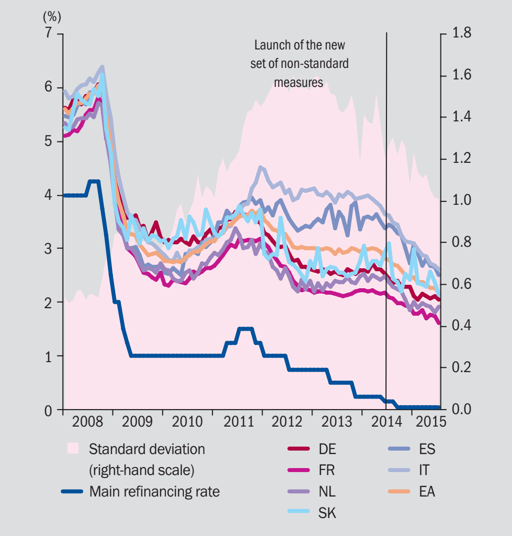
Source: ECB.

The non-standard measures have contributed to reducing the disparity between bank lending rates across countries, and there has been a gradual pass-through of the key rate even in those stressed countries[3] where the impairment of the transmission mechanism was most severe.

The pass-through of non-standard monitory policies to bank lending rates has occurred in almost all countries, but it has been most pronounced in stressed countries, since it was in these countries that the functioning of the transmission mechanism was more seriously impaired (Chart D). Before the introduction of non-standard measures in June 2014, interest rates in stressed countries were unresponsive to key rate changes, but afterwards they fell sharply.

3 These include the countries hardest hit by the financial crisis, namely Greece, Portugal, Spain, Ireland, Slovenia, Cyprus and Italy.

Chart B Lending rates for non-financial corporations and their standard deviation

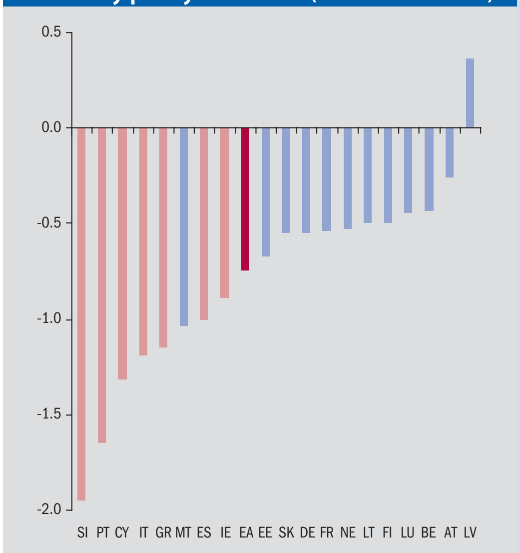


Sources: ECB, NBS calculations.
Note: The standard deviation is calculated from interest rates in EA12 countries.

Chart D Median cumulative change in lending rates for non-financial corporations in stressed countries and non-stressed countries and the cumulative change in the main refinancing rate (September 2011 = 100)

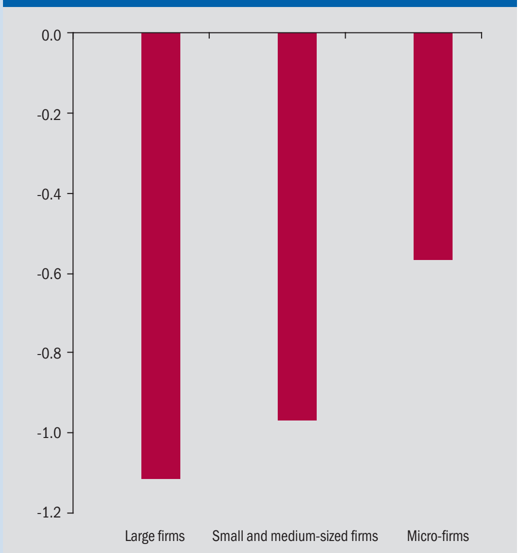
Sources: ECB, NBS calculations.
Note: After a short-lived increase in the main refinancing rate, the ECB began to reduce it again from November 2011.

Chart C Cumulative change in borrowing costs for non-financial corporations following the adoption of a new set of monetary policy measures (since June 2014)



Sources: ECB, NBS calculations.
Note: Stressed countries are marked in pink.

Chart E Cumulative interest rates from June 2014 (p.p.)

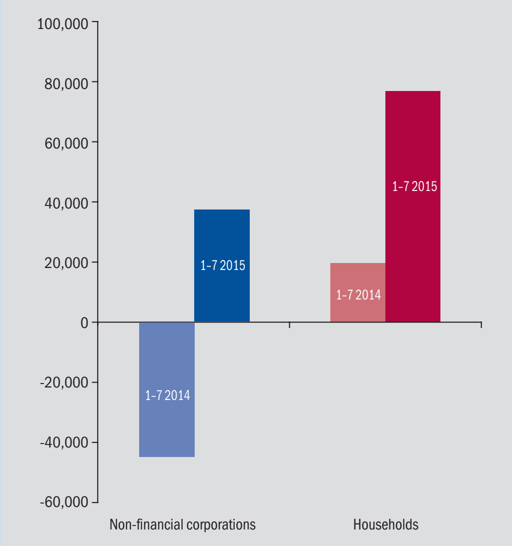


Sources: ECB, NBS calculations.
Note: The size of firms is approximated by the amount of their borrowing, as follows: borrowings of more than €1 million – large firms; from €0.25 million up to €1 million – small and medium-sized firms; up to €0.25 million – micro-firms.

Further evidence that the functioning of the transmission mechanism has been enhanced by the non-standard measures adopted since June 2014 is provided by the fall in lending rates for firms across the spectrum of sizes. The largest rate cuts have been provided to large firms, but those for small and medium-sized enterprises have not been much lower. Even the smallest firms have experienced interest rate reductions that improved their access to bank credit.

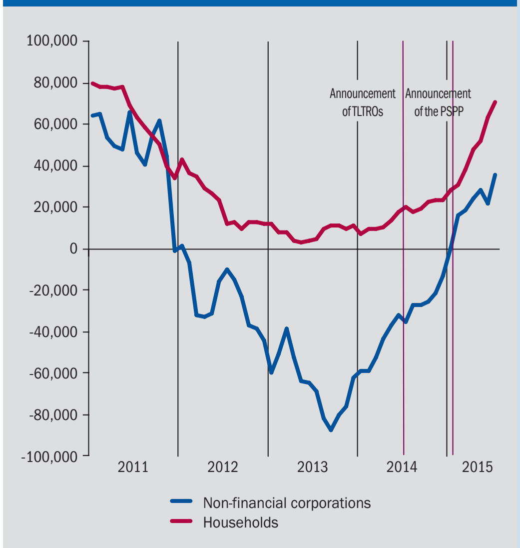
Non-standard monetary policies have eased banks' access to favourable sources of funding, supported the recovery of banking sector balance sheets, and enabled lending rate reductions. At the same time, improved lending conditions have stimulated demand for loans.[4] The result has been a gradual end to the adverse trend in lending activity, especially in lending to non-financial corporations (the outstanding amount of these loans was falling, year-on-year, for a prolonged period). In the non-financial corporate sector, with the support of the non-standard measures, the negative net flow of loans (the difference between the amount of loans provided and loans repaid) moderated and gradually moved into positive figures; in other words the amount of loans provided was greater than the amount repaid. The net flow of loans to households also improved. The cumulative net flow of loans was far higher in the first seven months of this year than in the same period of the previous year.

Chart G Cumulative flow of loans in the period January–July in 2014 and 2015 (EUR millions)



Source: ECB.

Chart F Cumulative six-month net flow of loans (EUR millions)



Source: ECB.

Chart H Annual rate of change in loans (%)

Source: ECB.

4 *According to the ECB's Bank Lending Survey, firms' demand for loans began to pick up in the second quarter of 2014 after falling for more than two years.*

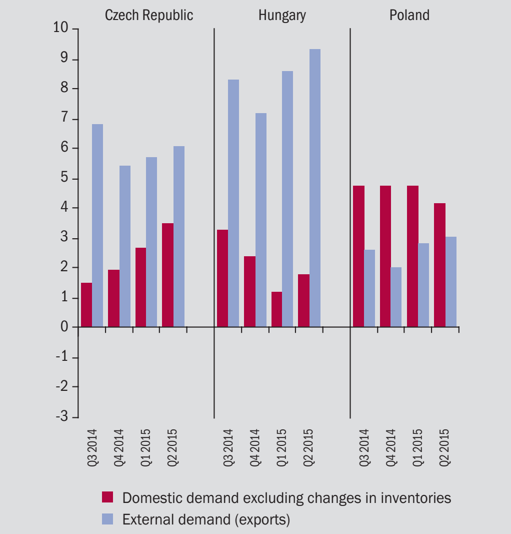
The pick-up in lending activity has been reflected in the annual rate of change in loans to households (their growth rate increased) and in loans to non-financial corporates (their rate of change turned positive towards the end of the first half of 2015 after a long period in negative figures). The recovery of lending is expected to support economic activity and to strengthen demand in the euro area economy. The substantial fall in borrowing costs and recovery of lending to the real economy indicate that the aims behind the adoption of the new non-standard monetary policy measures have so far been fulfilled.

5 The Czech Republic, Hungary and Poland

In the Czech Republic, annual GDP growth was 0.4 percentage point higher in the second quarter than in the first quarter (at 4.4%) and in Poland it increased by 0.2 percentage point (to 3.6%). In Hungary, economic growth slowed by 0.7 percentage point, to 2.5%.

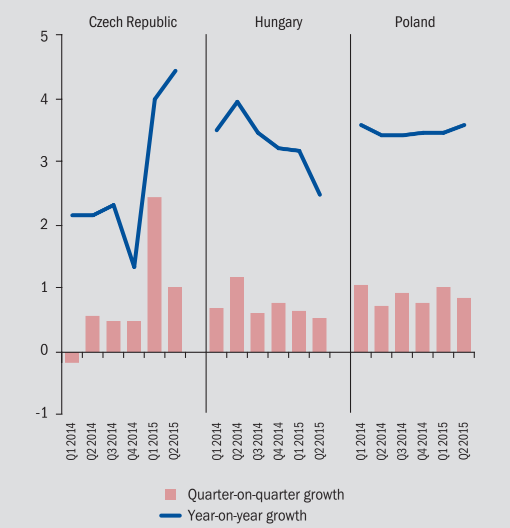
In quarter-on-quarter terms, economic growth decreased in the second quarter in each of the three economies under review – by 1.4 percentage point in the Czech Republic (to 1.0%), by 0.2 percentage point in Hungary (to 0.5%), and by 0.1 percentage point in Poland (to 0.9%). In the **Czech Republic**, the slowdown was largely caused by changes in inventories, as their contribution shifted from strongly positive in the first quarter to negative in the second. Net exports also had a negative impact, with exports increasing significantly more slowly than imports, and household final consumption expenditure growth was surprisingly lower than in the first quarter. The main positive contributors to growth were investment and, to a lesser extent, government final consumption expenditure. In **Hungary,** net exports were largely responsible for the drop in GDP growth, as export growth slowed and import growth accelerated. The increase in household final consumption expenditure moderated. There were positive contributions to overall GDP growth from government final consumption expenditure, investment, and changes in inventories. The slowdown in **Poland** was accounted for by lower growth in private consumption and in investment. On the other hand, general government consumption made a positive contribution, as did net exports (the fall in export growth being less pronounced than the decrease in net exports). Changes in inventories had a neutral impact in the second quarter.

Chart 24 Contributions to quarterly GDP growth (p.p.)



Sources: Eurostat, NBS calculations.

Chart 23 GDP growth (%)



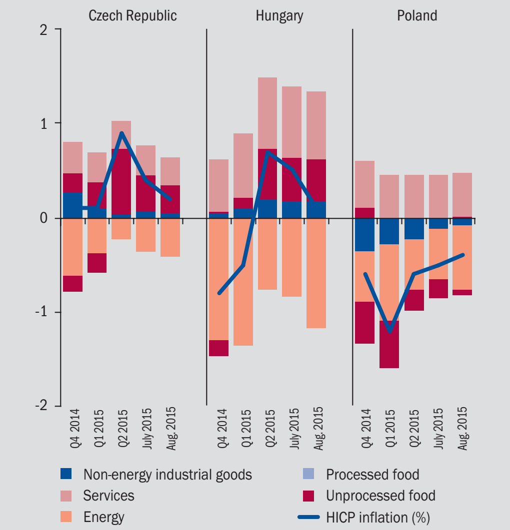
Source: Eurostat.

In the Czech Republic, annual consumer price inflation was higher in the second quarter of 2015 than in the first, and in Hungary it turned positive after recording a negative level in the previous quarter. In Poland, the negative headline inflation rate moderated. The acceleration of the **Czech Republic's** headline inflation rate (by 0.8 percentage point, to 0.9%) was driven mainly by prices of food (unprocessed and processed) and also reflected less negative contribution from the energy component. Services prices inflation remained unchanged from the previous quarter. The only component to record a slowdown was non-energy industrial goods inflation. In July inflation in the Czech Republic fell to 0.4%, owing mainly to a decline in unprocessed food prices. The rate fell further in August, to 0.2%, mostly reflecting a drop in processed food price inflation. In **Hungary,** consumer price inflation entered positive territory in the second quarter with a rate of 0.7% (representing a swing of 1.2% from its negative rate in the previous quarter). Although this turnaround was broadly based across all inflation components, it was unprocessed food prices that made the largest contribution. The negative rate of energy price inflation moderated, while both non-energy industrial goods inflation and services price inflation accelerated. In July Hungary's consumer price inflation rate decelerated (to 0.5%), largely owing to an increase in the unprocessed food component and a more pronounced fall in energy prices. This trajectory continued in August, with the headline rate of 0.1% accounted for mainly by energy prices. The negative headline inflation rate in **Poland** moderated in the second quarter of 2015 (by 0.6 percentage point) to -0.6%, as prices of unprocessed food, energy, and non-energy industrial goods decreased more slowly. The decline in processed food and services prices was unchanged from the end of the previous quarter. In July the headline inflation rate again became less negative (-0.5%), largely because the negative rate of non-energy industrial goods inflation moderated. A similar trend was observed in August as the decline in the headline rate eased to -0.4%.

Looking at the currencies of the three countries under review, only the Czech koruna was stronger against the euro (by 1.02%) at the end of the second quarter than at the end of the first quarter, while both the Hungarian forint and Polish zloty were trading weaker against the single currency (by 5.18% and 2.59%, respectively). It remains the case that the koruna is constrained to follow a largely strengthening trajectory, since the Czech central bank is still committed to using foreign-exchange interventions to maintain accommodative monetary policy conditions. In the second quarter the exchange rates of all three currencies, but in particular the forint and zloty, were affected by the adverse impact on financial market sentiment of the uncertainty surrounding the situation in Greece (the debt crisis and how to resolve it). This negative sentiment was later exacerbated by turbulences in the Chinese stock market and their impact on global financial markets.

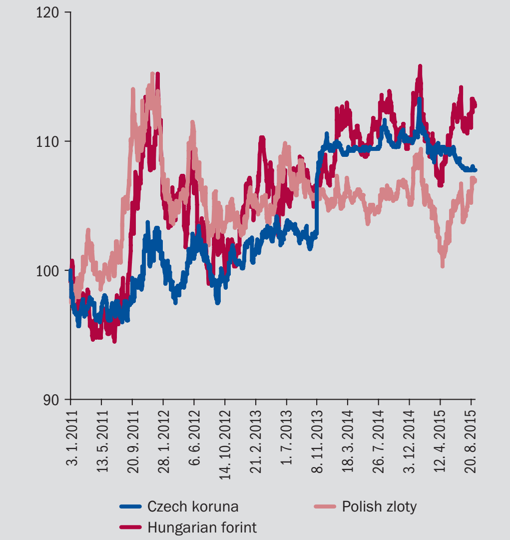
After appreciating somewhat in the first quarter, owing mainly to the ECB's announcement of the launch of quantitative easing, the Czech koruna's exchange rate stabilised in the second quarter at around 27.4 korunas per euro. Towards the

Chart 25 HICP inflation (%) and its composition (p.p.)



Sources: Eurostat, NBS calculations.

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

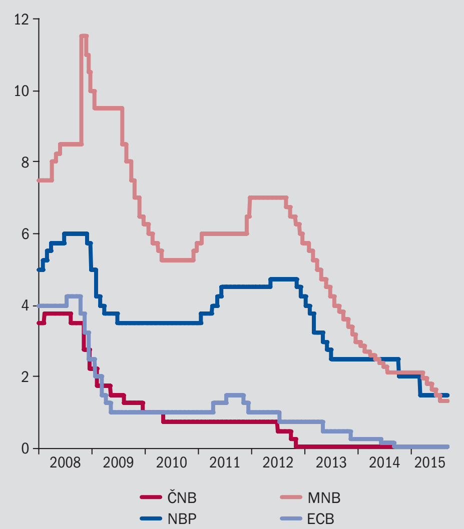


Sources: Eurostat, NBS calculations.
Note: A fall in value denotes appreciation.

end of the period, however, the koruna began to appreciate again based mainly on positive macroeconomic data for the Czech economy. To counter the koruna's appreciation, Česká národní banka (ČNB) intervened on the foreign-exchange market in the second half of July. Despite its interventions, however, the exchange rate ended July stable at just above 27.0 korunas per euro, and remained at that level until September. 2015. In August, ČNB reiterated its commitment to use the exchange rate as an instrument of monetary policy and to defend the EUR/CZK 27 floor. The movement of the forint and zloty against the euro in April appeared to be positively affected by economic data for the euro area, which offset the adverse impact of political developments in Greece. From the end of the month, however, investor sentiment appeared to deteriorate in response to the unclear situation in Greece (unsuccessful negotiations with creditors), and both the forint and zloty followed a strong depreciation trend until July and the easing of tensions related to the Greek crisis (on 12 July a third bailout package worth €86 billion was agreed between Greece and its creditors). In August the two currencies came under negative pressure also from the turmoil in China's financial markets (as the country's central bank changed the exchange rate regime) and its potential repercussions for the global economy (the risk of lower economic growth in China) as well as for the US Federal Reserve's monetary policy (the postponement of rate increases).

As regards monetary-policy settings in the three countries, only the Hungarian central bank made any changes in the second quarter of 2015. In the Czech Republic, Česká národní banka kept its base rate unchanged at 0.05% (zero lower bound). At its policy meetings in the second quarter, **ČNB** reaffirmed its commitment to use the exchange rate as an additional instrument for easing monetary policy, at least until the second half of 2016 (therefore over the whole projection horizon). At its June meeting, ČNB's Bank Board also reiterated its readiness to adjust the exchange rate commitment in the event of an extended strengthening of deflationary pressures capable of causing a slump in domestic demand or a broadly-based lowering of inflation expectations. The **Magyar Nemzeti Bank (MNB)** cut its main interest rate on three occasions in the second quarter, by a total of 45 basis points, leaving it at 1.50% with effect from 24 June 2015. Based on data in its June Inflation Report, the MNB took the view that the ongoing accommodative monetary policy was consistent with the objective of price stability over the medium-term horizon. In June the MNB announced changes to its monetary policy instruments, namely that from 23 September 2015 its three-month fixed-rate deposit rate will become the main policy instrument, replacing the two-week deposit facility (although the two-week facility will remain part of the bank's monetary policy instruments, it will be offered with limited quantity). On 9 June 2015 the MNB announced its readiness to set aside €1.1 billion for banks and other financial service providers in order to ensure the conversion of households' foreign currency loans into forints. On 19 August 2015, the central bank and Hungarian Banking Association signed an agreement on the forint conversion. In July the MNB launched a ten-year interest rate swap (IRS) facility for commercial banks in addition to the three- and five-year maturities already available. The MNB loosened its monetary policy further in July, when it reduced the key rate by 15 basis points, to 1.35%. In Poland, **Narodowy Bank Polski (NBP)** left its monetary-policy settings unchanged in the second quarter of 2015 (keeping the reference rate at 1.5%). It reasoned that the risk of inflation undershooting its medium-term target was receding amid assumptions of

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



Sources: National central banks and the ECB.

stable economic growth in Poland over the near term, taken along with the recovery in the euro area and sound developments in the domestic labour market. In September, however, the NBP cautioned that the growing risks of a stronger economic slowdown in emerging economies and the declining commodity prices were raising uncertainty about the pace of inflation returning to target. In September the Polish parliament debated a draft law under which loans denominated in foreign currency (especially Swiss francs) may be converted into the domestic currency. This measure is expected to cause significant losses to banks in Poland.

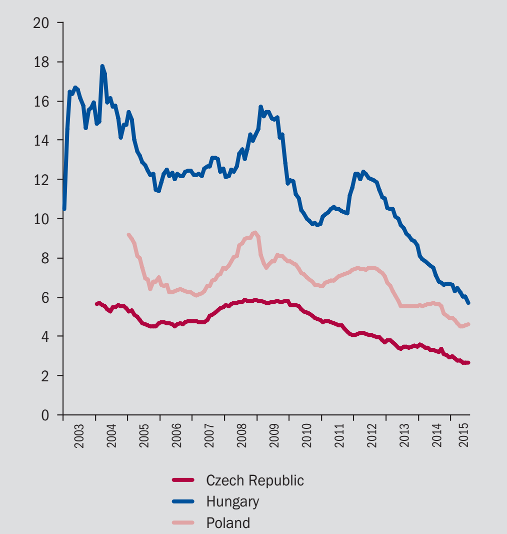
Box 2

LOANS AND INTEREST RATES IN THE CZECH REPUBLIC, HUNGARY AND POLAND

Like other central banks in Europe, those in the Czech Republic, Hungary and Poland have been gradually loosening monetary policy conditions in response to concerns about mounting deflationary pressures. Since November 2012 ČNB's key rates have been at zero lower bound, and since November 2013 the central bank has been using the exchange rate as an additional instrument for easing monetary conditions. Both the MNB and NBP have followed an accommodative monetary policy since 2012, after raising interest rates moderately in 2011. The MNB has cut its key rate by 7% (565 basis points) since August 2012, to its current level of 1.35%, and it has also deployed non-standard monetary-policy measures (such as its support for bank lending to SMEs through the Funding for Growth Scheme). NBP launched a cycle of monetary-policy easing in November 2012, during which it reduced the main reference rate by 325 basis points (from 4.75% to the current 1.5%).

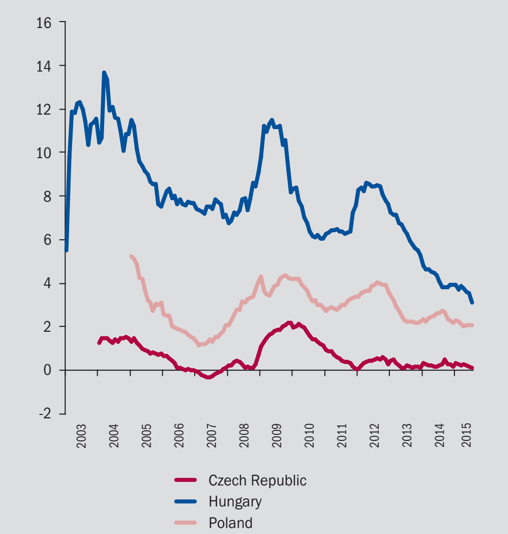
The pass-through of accommodative monetary conditions to the banking sector has resulted in reductions in lending rates for households and firms. In the case of housing loans to households, interest rate differentials against the euro area have fallen substantially in Hungary, while in Poland they are at the pre-crisis level and in the Czech Republic they are at zero. For loans to firms, this trend is even more pronounced, as the differentials in Hungary and Poland are less than two percentage points and the differential in the Czech Republic is actually negative.

Chart A Interest rates on housing loans to households (%)



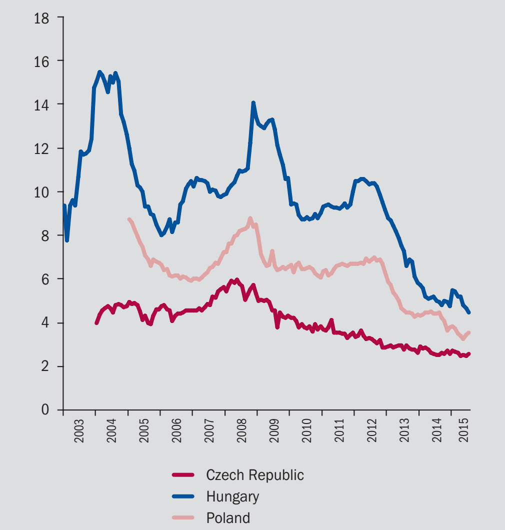
Source: ECB.

Chart B Interest rate differentials against the euro area (housing loans) (p.p.)



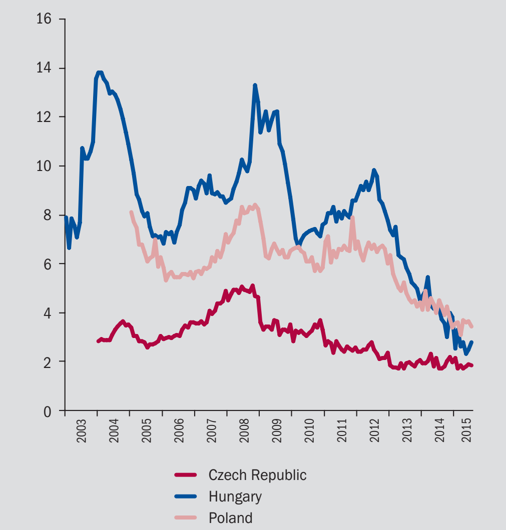
Source: ECB.

Chart C Lending rates for non-financial corporations on loans of up to one year and up to €1 million (%)



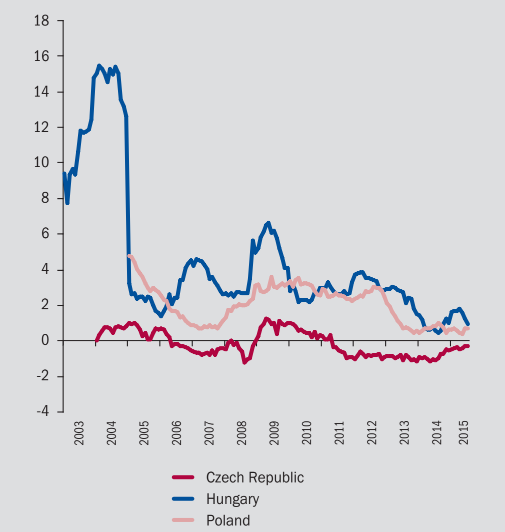
Source: ECB.

Chart E Lending rates for non-financial corporations on loans of up to one year and more than €1 million (%)



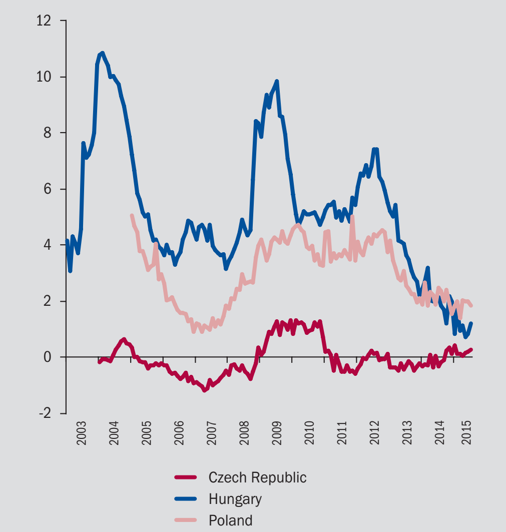
Source: ECB.

Chart D Interest rate differentials against the euro area on loans to non-financial corporations of up to one year and up to €1 million (p.p.)



Source: ECB.

Chart F Interest rate differentials against the euro area on loans to non-financial corporations of up to one year and more than €1 million (p.p.)

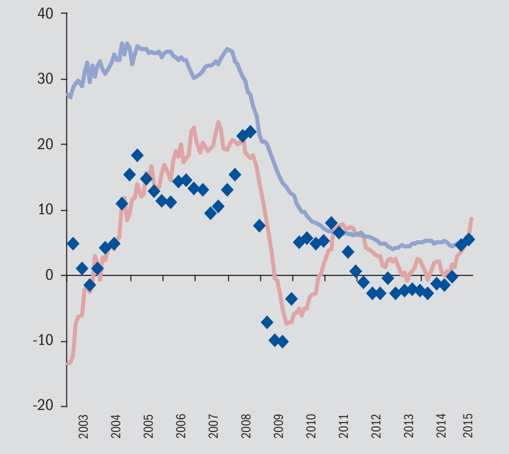


Source: ECB.

In Europe, the economic crisis of 2008 that resulted in slumps in consumption and investment in the real economy turned into a debt crisis in 2012. The collapse of demand and related deterioration in confidence among both consumers and investors, on the one hand, and the process of reviving the banking sector and related introduction of new banking standards (including tightening of the regulatory and supervisory framework), on the other hand, was reflected in the amount of loans provided by the banking sector. In the Czech

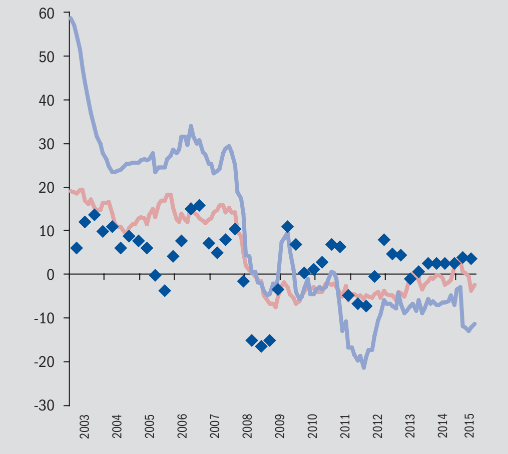
Republic, Hungary and Poland the amount of lending to households and firms fell. In the Czech Republic, lending growth moved in parallel with the growth curve of nominal GDP and generally stayed above that level, the only exception being the growth rate of loans to non-financial corporations for a short period in 2010. In Hungary, the growth rates of loans to firms and households fell below nominal GDP growth and remain in that position up to now. In Poland, lending growth mirrored GDP growth except in the case of loans to firms in 2011 and 2012, and at present it does not exceed nominal GDP growth. The current low interest rate environment and gradual recovery of economic growth in the

Chart G Annual growth rate of loans to non-financial corporations and households in the Czech Republic (%)



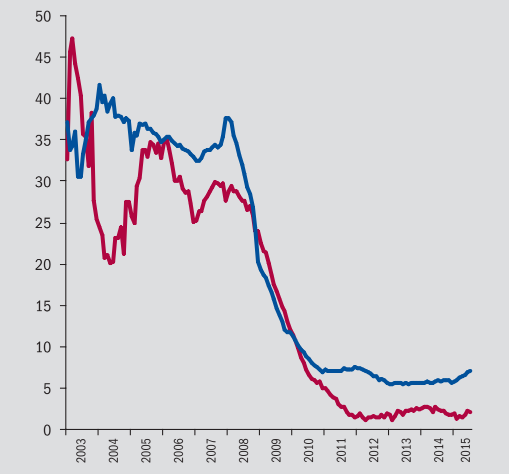
Sources: ECB and Eurostat.

Chart I Annual growth rate of loans to non-financial corporations and households in Hungary (%)



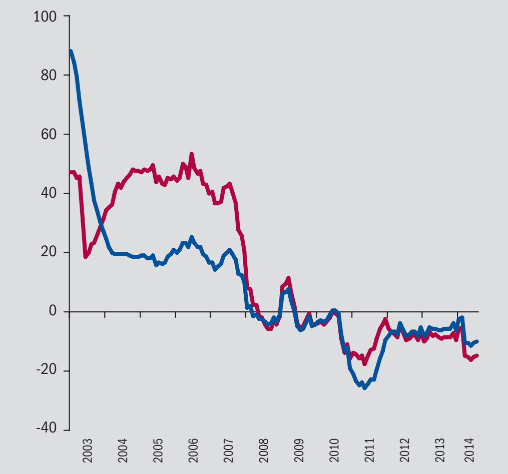
Zdroj: ECB a Eurostat.

Chart H Annual growth rate of loans to households in the Czech Republic (%)



Sources: ECB and Eurostat.

Chart J Annual growth rate of loans to households in Hungary (%)

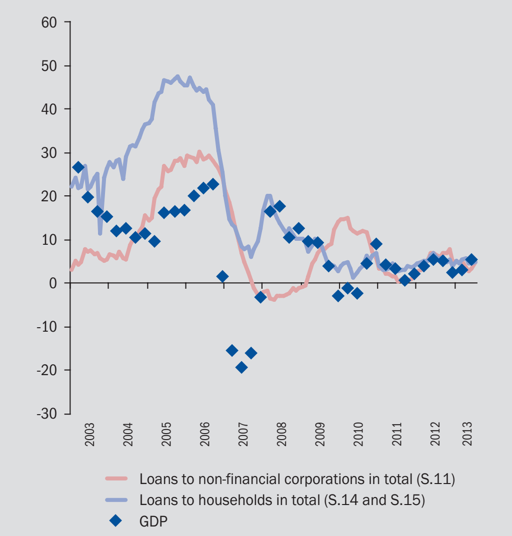


Sources: ECB a Eurostat.

countries under review has not yet translated into substantial lending growth (except in the Czech Republic and the increased growth in loans to firms observed since the beginning of 2015).

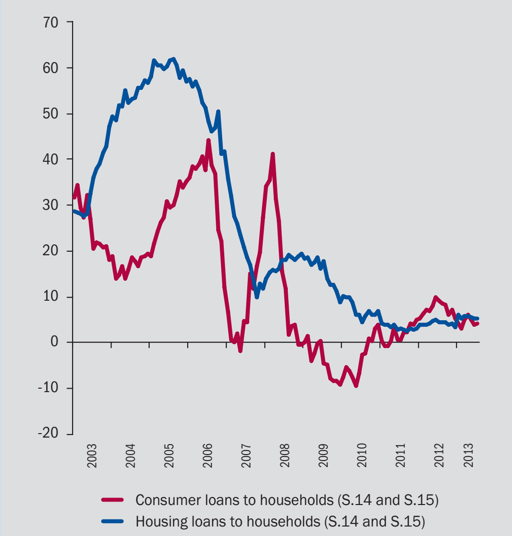
The implementation of accommodative monetary policy in conjunction with gradual economic recovery could heighten the risk of excessive lending growth and the associated risks to macroeconomic stability. Although such risks are low at present, it is important that trends in the banking sector are monitored, that preventive macroprudential policies are rigorously implemented, and that the strict regulatory and supervisory regime for the banking sector is complied with on a consistent basis.

Chart K Annual growth rate of loans to non-financial corporations and households in Poland (%)



Sources: ECB and Eurostat.

Chart L Annual growth rate of loans to households in Poland (%)



Sources: ECB and Eurostat.

SUMMARY OF GDP GROWTH PROJECTIONS OF SELECTED INSTITUTIONS

Table 1 Global economy

	Release	2015		2016	
IMF	July 2015	3.3	(-0.2)	3.8	(=)
OECD	September 2015	3.0	(-0.1)	3.6	(-0.2)
EC	May 2015	3.5	(-0.1)	3.9	(-0.1)
ECB 1)	September 2015	3.2	(-0.2)	3.8	(-0.3)

Table 2 United States

	Release	2015		2016	
IMF	July 2015	2.5	(-0.6)	3.0	(-0.1)
OECD	September 2015	2.4	(0.4)	2.6	(-0.2)
EC	May 2015	3.1	(-0.4)	3.0	(-0.2)
Federal Reserve	September 2015	2.15	(0.25)	2.4	(-0.15)

Table 3 Euro area

	Release	2015		2016	
IMF	July 2015	1.5	(=)	1.7	(0.1)
OECD	September 2015	1.6	(0.1)	1.9	(-0.2)
EC	May 2015	1.5	(0.2)	1.9	(=)
ECB	September 2015	1.4	(-0.1)	1.7	(-0.2)

Table 4 Czech Republic

	Release	2015		2016	
IMF	April 2015	2.5	(=)	2.7	(0.3)
OECD	June 2015	3.1	(0.8)	2.5	(-0.2)
EC	May 2015	2.5	(=)	2.6	(=)
ČNB	August 2015	3.8	(1.2)	2.8	(=)

Table 5 Hungary

	Release	2015		2016	
IMF	April 2015	2.7	(0.4)	2.3	(0.5)
OECD	June 2015	3.0	(0.9)	2.2	(0.5)
EC	May 2015	2.8	(0.4)	2.2	(0.3)
MNB	June 2015	3.3	(0.1)	2.5	(=)

Table 6 Poland

	Release	2015		2016	
IMF	April 2015	3.5	(0.2)	3.5	(=)
OECD	June 2015	3.5	(0.5)	3.7	(0.2)
EC	May 2015	3.3	(0.1)	3.4	(=)
NBP	July 2015	3.6	(0.2)	3.4	(0.1)

1) Global economic growth excluding the euro area.
Notes: Data in brackets denote the change in percentage points from the previous projection.
The July 2015 IMF forecast and September 2015 OECD forecast cover only large economies.