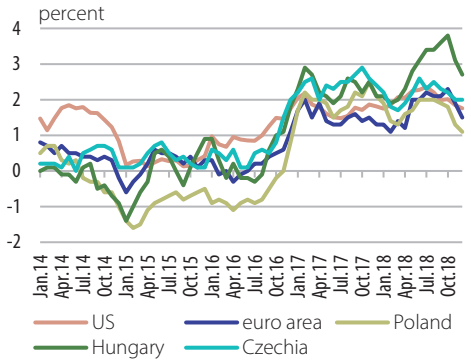
Box 5. The monetary policy stances of the major central banks and of those in the region in 2018

After having climbed and stuck during 2017 to high readings compared with the very low levels prevailing in the previous two years, the annual inflation rates in the US, euro area and the countries in the region witnessed stronger fluctuations in 2018, although tending to remain, with some exceptions, in the vicinity of central banks' targets (Chart A). The fluctuations were quasi-synchronised, having as common factors the downward correction in the early months of the year in the international prices for some agri-food items, as well as the relatively steep subsequent rise in oil prices, followed by an abrupt decline towards the end of the period. By contrast, the core inflation profiles differed significantly, reflecting specific pressures from fundamentals in each of these economies. Thus, while the annual core inflation rate remained well below the central banks' objective in the euro area and Poland, in the US it went up and tended to stick close to the objective, whereas in Czechia and Hungary it climbed markedly in the latter part of the year, reaching the upper bound of the variation band of the target and nearing the midpoint of the target, respectively (Table A).

Chart A
Annual inflation rate in the euro area, US and countries in the region



Note: The annual inflation rate is calculated based on national CPI, except for the US, where it is determined based on the personal consumption expenditure index.

Source: Bloomberg

Table A. Macroeconomic developments and monetary policy stance in advanced economies and in the region

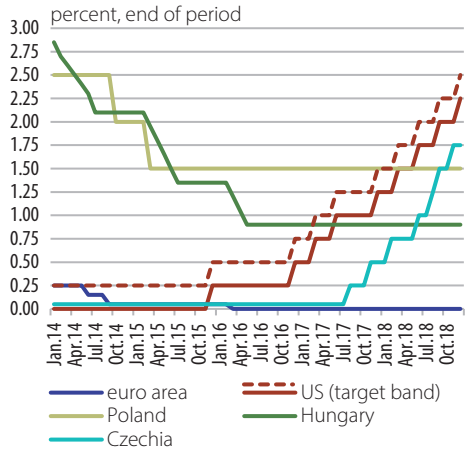
	Inflation target/ objective[b,c]	Annual inflation rate				Monetary policy rate[b,c]		Output gap[b,c]	General government balance, % of GDP**			Current account balance, % of GDP		
				Forecast*,b,c						Forecast*			Forecast*	
		2018 (average)	2018 (end of period)	2019 (average)	2020 (average)	Dec. 2017	Dec. 2018		2018	2019	2020	2018	2019	2020
Euro area	below, but close to 2%	1.8[a]	1.5[c]	1.6 (1.1-2.1)	1.7 (0.9-2.5)	0	0	positive, widening	-0.5[a]	-0.8[d]	-0.7[d]	2.9[c]	2.7[c]	2.6[c]
US	2%	2.0[f]	1.8[f]	1.9***	2.1***	1.25-1.50	2.25-2.50	positive, widening	-3.8[g]	-4.6[g]	-4.6[g]	-2.4[d]	-2.6[d]	-2.8[d]
Poland	2.5% ±1 pp	1.7[e]	1.1[e]	3.2	2.9	1.5	1.5	positive, widening	-0.4[a]	-0.9[d]	-1.0[d]	-0.7[a]	-0.9[d]	-1.3[d]
Hungary	3% ±1 pp	2.9[e]	2.7[e]	2.9	3.0	0.9	0.9	slightly positive	-2.2[a]	(-1.6)-(-1.7)[b]	(-1.4)-(-1.6)[b]	0.4[a]	0.7[b]	1.3[b]
Czechia	2% ±1 pp	2.1[e]	2.0[e]	2.6	2.0	0.50	1.75	positive, narrowing	0.9[a]	1.3[b]	1.5[b]	0.3[a]	0.6[b]	0.6[b]
Romania	2.5% ±1 pp	4.64[e]	3.27[e]	2.9 (end of period)	3.1 (end of period, Q3)	1.75	2.50	positive, widening	-3.0[a]	-3.4[d]	-4.7[d]	-4.5[a]	-4.2[d]	-4.5[d]

*) forecasted values in line with the latest central bank projections in 2018 and with the European Commission's autumn 2018 forecast respectively

**) budget deficit calculated according to the ESA 2010 methodology, except for US

***) average rate in Q4 of year T versus average rate in Q4 of year T-1

Source: a) Eurostat, b) NCBs, c) ECB, d) European Commission (AMECO), e) national statistics institutes/offices, f) Bureau of Labor Statistics, g) US Congressional Budget Office



Source: Bloomberg

Chart B
Monetary policy rate in the euro area, US and countries in the region

Behind the developments stood the faster pace of economic expansion in the US, inter alia under the impact of the fiscal stimulus, but also the moderation in euro area growth after the earlier year's exceptional dynamics, amid the relative weakening of external demand, as well as some adverse influences manifest in certain sectors (the automotive industry in particular) or even at the level of some economies. Regionally, the economic advance remained robust and even accelerated in Poland and Hungary, but slowed in Czechia. Given the specific economic conditions, divergences among monetary policy stances became increasingly clear both across major central banks and in the region (Chart B).

In particular, in order to ensure the sustained convergence of the annual inflation rate towards the Governing Council's aim[1], the European Central Bank preserved the very accommodative monetary policy stance throughout 2018, by keeping the key interest rates at historical lows[2], by further purchasing financial assets under the asset purchase programme (APP) – although the monthly pace was reduced from EUR 60 billion to EUR 30 billion in January[3] –, as well as by adjusting its forward guidance.

At mid-year[4], the Governing Council announced however that, after September 2018, it would reduce the monthly pace of the net asset purchases to EUR 15 billion and then end net purchases in December 2018, amid the ongoing broad-based economic growth in the euro area – the pull-back from the very high levels of growth in 2017 notwithstanding –, while the risks surrounding the euro area growth outlook remained balanced, despite the more prominent risks stemming from financial market volatility and global protectionism. Moreover, high levels of capacity utilisation, tightening labour markets and rising wages were conducive to the further build-up of inflationary pressures, with the Eurosystem staff macroeconomic projections indicating in this context a gradual convergence of the annual inflation rate to the medium-term objective. At the same time, as inflationary pressures from fundamentals were further conditional on a very high degree of monetary policy accommodation, the ECB strengthened the signals on the future path of its key interest rates, announcing and reiterating the intention of maintaining them at their present levels at least through the summer of 2019, and in any case for as long as necessary to ensure the continued sustained convergence of inflation to the medium term aim[5].

1 According to the ECB's definition, the price stability objective – with a medium-term orientation – consists in maintaining annual inflation rates below, but close to, 2 percent.

2 The interest rate on the main refinancing operations was kept at zero percent, while the deposit and lending facility rates were left unchanged at -0.4 percent and 0.25 percent respectively.

3 In line with the decision taken by the Governing Council in October 2017.

4 In June 2018.

5 Previously, the ECB had indicated a status-quo of its key interest rates for an extended period of time, and well past the horizon of the net asset purchases. Adding an explicit date-based and state-contingent component to the forward guidance was meant to provide greater clarity on the future path of policy interest rates.

Afterwards, new information came in weaker than expected, reflecting softer external demand but also some country and sector-specific factors, only partly temporary in nature. The underlying strength of domestic demand continued to underpin the expansion of the euro area economy and gradually rising inflation pressures, but the balance of risks surrounding the growth outlook was moving to the downside owing to geopolitical factors, the threat of protectionism, vulnerabilities in emerging markets and financial market volatility. Under these circumstances, the Governing Council decided to end net asset purchases under the APP in December 2018, as announced in June, but reviewed the forward guidance on the future reinvestment policy of the principal payments from maturing securities purchased under the APP; in line with the announcement, the Governing Council would continue reinvesting, in full, these principal payments for an extended period of time past the date when it starts raising the key ECB interest rates[6], and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation. Against this background, the rate forward guidance, reinforced by the reinvestments of the sizeable stock of acquired assets, would provide the necessary degree of accommodation for the sustained convergence of inflation towards levels that are below, but close to, 2 percent over the medium term.

Conversely, the Fed extended the rate hiking cycle initiated at the end of 2015 – raising the target range for the federal funds rate on four occasions during 2018, by 0.25 percentage points each time, to 2.25-2.50 percent[7] – and continued the balance sheet normalisation process seen since October 2017, via a reduction in the reinvestment of maturing financial assets[8]. Behind the decisions stood the current and anticipated developments in economic conditions, characterised by solid growth in economic activity, also under the influence of the fiscal stimulus, by further labour market consolidation, as well as by the monetary policy-relevant core annual inflation rate climbing and remaining in the vicinity of the 2 percent objective, and by the stability of inflation expectations. In the context of the moderation in the economic advance towards the end of the year and of the considerably higher financial market volatility, the Fed raised the interest rate again in December, but revised downwards both its forecasted path and the economic growth expected for 2019.

At a regional level, the Czech National Bank continued, even more firmly, the rate hiking cycle launched in August 2017, raising the monetary policy rate in five steps of 0.25 percentage points each[9], to 1.75 percent[10]. The decisions were warranted by strong inflationary pressures from fundamentals, reflecting the swift wage

6 According to the earlier rhetoric, the ECB had expected the reinvestments to continue for an extended period of time after the end of the net asset purchases, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation. Linking the reinvestment horizon to the interest rate lift-off confirmed that the key ECB interest rates and the associated forward guidance on their likely future evolution would remain the primary tool to adjust the monetary policy stance going forward.

7 The Fed had previously increased the target range by 0.25 percentage points on one occasion in 2015 and 2016 respectively, and by 0.25 percentage points in three instances during 2017.

8 The monthly pace set at the launch of the programme was of USD 10 billion, which was gradually increased afterwards up to USD 50 billion.

9 In the February, June, August, September and November meetings.

10 At the same time, interest rates on the standing facilities were raised to 0.75 percent (deposit facility) and 2.75 percent (lending facility) respectively.

growth, amid ongoing economic expansion and labour market tensions. Against this backdrop, the annual core inflation rate followed an upward path, which – alongside the rising dynamics of some exogenous CPI components – entailed a step-up in the annual inflation rate in Q2 and its subsequent running in the upper half of the ±1 percentage point tolerance band of the 2 percent target. Moreover, the central bank's assessments and projections updated in the latter part of the year saw the annual inflation rate remaining above the midpoint of the target in the first part of the forecast horizon and afterwards declining in the vicinity thereof over the longer time horizon.

Economic growth was anticipated to decelerate from the high level recorded in 2017, but to remain above 3 percent along the forecast horizon, due to the robust dynamics of private consumption, but also of investment, public investment included, fostered by the faster absorption of EU funds. The fiscal impulse was seen more positive in 2018 and further sizeable in 2019, given inter alia the steep increases in public sector wages and the above-average hikes in some categories of pensions, albeit amid the budget surplus sticking close to the 2017 level. At the same time, the November 2018 forecast pointed to a narrowing of the trade surplus in 2019 – owing to the faster pick-up in domestic absorption, along with the slacker dynamics of external demand –, although it was associated with only a slight probable reduction in the current account surplus against the previous year (to 0.6 percent of GDP), mainly as a result of the expected increase in income from EU funds.

By contrast, the Polish central bank maintained in 2018 as well the monetary policy rate at 1.5 percent – in place since March 2015. The decisions were taken in a context in which the annual inflation rate generally stood in the lower half of the variation band of the target (2.5 percent ±1 percentage point), with episodic declines beneath its lower bound as well, while core inflation dynamics stuck to even lower readings; furthermore, the anticipated upward path of the annual headline inflation rate across the forecast horizon was seen only slightly above the midpoint of the target at the end of the horizon. The inflation outlook reflected the gradual build-up of both cost-push inflationary pressures – with the anticipated wage growth outpacing labour productivity dynamics – and demand-pull ones, given the envisaged further opening of the positive output gap, albeit in the context of a slowdown in economic growth compared to 2017. Moreover, the composition and pace of economic growth were assessed as not likely to trigger domestic or external economic imbalances, as the absence of strong inflationary pressures was accompanied by a persistent trade surplus and a close-to-zero current account balance, alongside a narrowing budget deficit.

The Hungarian central bank also left the base rate and the lending rates[11] unchanged at 0.9 percent during 2018, as well as the deposit rate – which is key for the evolution of short-term yields, given the characteristics of liquidity

[11] ON and 1W.

management[12] – at -0.15 percent, thus further keeping loose monetary conditions in place. In September 2018, the central bank decided, however, to fine-tune the unconventional policy instruments affecting long-term yields, by phasing out the interest rate swap tenders and the mortgage bond purchase programme[13,14] (both launched in January 2018[15]) by the end of the year.

The decisions were taken in a context characterised by a prevailingly upward path of the annual inflation rate – which re-entered in 2018 H1 the variation band of the target (3 percent ±1 percentage points) and then climbed in its upper part –, attributable however mainly to developments in energy prices. At the same time, the annual core inflation rate stayed slightly below the midpoint of the target, reaching the central target only towards the end of the year, with other core inflation measures used by the central bank even trailing behind. Furthermore, the central bank's successive projections and assessments pointed to the sustainable achievement of the inflation target only in mid-2019, as the faster dynamics of wages – amid increasing labour market tensions and the rise in the minimum wage – were seen as not generating significant inflationary pressures, given the opposite effects exerted on firms' costs by the reduction in employers' social contributions in 2018 and in the corporate income tax in 2017.

At the same time, the central bank deemed the GDP level to be only slightly above potential, even amid the significant pick-up in economic expansion during 2018. Economic growth, which was expected to decelerate starting 2019, was primarily driven by domestic demand, underpinned by the dynamics of wage earnings and by the fiscal policy. Against this background, the current account balance as a share in GDP was anticipated to decline from its 2016 historical peak, albeit remaining positive, also on the long term.

12 The central bank of Hungary maintained in the first three quarters the HUF 75 billion quantitative restriction (set in 2017 Q4) on three-month deposits, before deciding in September 2018 to phase out the three-month deposit facility by the end of 2018 Q4. Moreover, with a view to further easing monetary conditions, the central bank set in 2018 and kept in place throughout the year a target of at least HUF 400-600 billion for the liquidity mopped up via the deposit facility.

13 Purchases in the secondary market were scheduled to end on 30 September 2018.

14 In its September meeting, the Hungarian central bank also decided to introduce a Funding for Growth Scheme Fix at the beginning of 2019, with the objective of stimulating longer-term, fixed-rate lending to SMEs.

15 In line with the central bank's decision of November 2017.