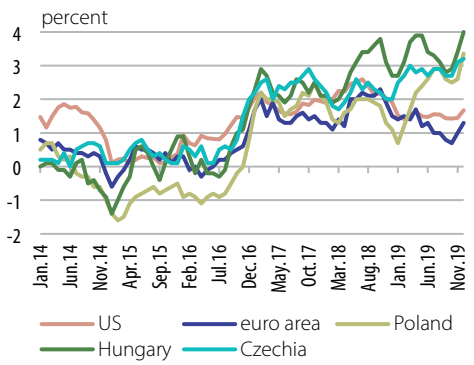
Box 8. The monetary policy stances of the major central banks and of those in the region in 2019

After a relatively synchronised path in recent years and quasi-anchored to central banks' targets starting 2017, the annual inflation rates in the euro area and US, and those in the countries in the region tended to follow divergent trajectories in 2019 (Chart A). Beyond some specific influences, the evolution reflected primarily the different strength of inflationary pressures from fundamentals: moderate or weak in developed countries, yet significant in the region, in line with the cyclical position of the economy and the labour market tightness.



Note: The annual inflation rate is calculated based on national CPI (Czechia, Hungary, Poland), HICP (euro area) and personal consumption expenditure index (US).

Source: Eurostat, national institutes of statistics, FRED

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

Thus, the annual inflation rate in the euro area departed from the higher readings, close to the central bank's objective, which were seen towards end-2018, declining slowly and almost steadily until the beginning of 2019 Q4. Afterwards, this fall was only partly corrected, with contributions from services and food items components, so that inflation came in slightly above 1 percent at the end of the period. The pattern was relatively similar in the US, although the overall decline in the annual inflation rate was more subdued. Looking at countries in the region, the annual inflation rates had, however, re-embarked ever since the beginning of the year on the upward path temporarily discontinued at end-2018 and then extended it, coming close to the upper bound of the variation band of the target (or even exceeding it in Czechia) at the end of the period.

As regards the annual core inflation rate, it witnessed somewhat more sizeable fluctuations in the euro area in the first half of the year, before trending slowly upwards and slightly exceeding 1 percent only at the end of the year; in the US, it stabilised around 1.6 percent. At the same time, annual core inflation rates in countries in the region climbed visibly compared to those recorded in 2018, running consistently in the upper half of the variation band of the target in Hungary and Czechia and advancing almost uninterruptedly in Poland, from levels below the lower bound of the target band to the vicinity of its upper bound.

These developments occurred in a context in which the pace of economic growth slowed against the previous two years' exceptional dynamics, more visibly in the US and in the euro area, yet more moderately in countries in the region, where it even remained above potential. Behind the deceleration stood mainly the slower advance in manufacturing output, while activity in the services sector remained robust.

The European Central Bank increased gradually the degree of monetary policy accommodation during 2019, amid the annual inflation rate staying further below the medium-term objective, including in the period ahead, owing to the weakening of economic activity and heightened adverse risks thereto. Thus, in its March meeting, the Governing Council decided to shift out the calendar-based leg of its forward guidance on policy rates, expecting to keep the key ECB interest rates

at their present levels at least through the end of 2019[1], and announced a new series of quarterly targeted longer-term refinancing operations (TLTRO III[2]), starting in September 2019 and ending in March 2021. In the same meeting, the ECB left unchanged the interest rate on the main refinancing operations[3] and the interest rates on standing facilities[4], while reiterating the intention to continue reinvesting, in full, the principal payments from maturing securities purchased under the asset purchase programme (APP) for an extended period of time past the date when it started raising the key interest rates, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation. Moreover, the Governing Council decided to continue to conduct the main refinancing operations as fixed rate tender procedures with full allotment for as long as necessary, and at least until the end of the reserve maintenance period starting in March 2021. The decisions were taken in a context in which the annual inflation rate had stayed around 1.5 percent at the beginning of the year and its anticipated path had been revised significantly downwards. The annual core inflation rate fluctuated slightly around 1 percent, also in the absence of manifest inflationary pressures anticipated to stem from the increase in wage costs, while long-term inflation expectations posted a renewed decline; the growth outlook deteriorated, amid the slowdown in economic activity at end-2018, but also due to the heightening of geopolitical tensions and of risks induced by trade rows.

The economic activity invalidated expectations of a standstill/deterioration in Q2, yet exclusively due to the influence of temporary factors, its anticipated dynamics over the longer term being again revised downwards in mid-year, *inter alia* amid weakness in international trade. Furthermore, the annual inflation rate continued to run visibly below the 2 percent level, against the background of developments in energy and services prices, but also of modest fluctuations in core inflation.

Under the circumstances, the Governing Council revised its forward guidance at the July meeting, indicating that it expected key ECB interest rates to remain at their present or lower levels at least through the first half of 2020[5]. The Governing Council also underlined the need for a highly accommodative stance of monetary policy for a prolonged period of time, as inflation rates, both realised and projected, had been persistently below levels that were in line with its aim. At the same time, the Governing Council stated that it stood ready to adjust all of its instruments to ensure that inflation moved towards its aim in a sustained manner, indicating as potential options: reinforcing the forward guidance on policy rates, introducing a tiered system for reserve remuneration, and carrying out new net asset purchases.

Afterwards, the annual inflation rate witnessed a slightly steeper decline, amid modest changes in core inflation, while its anticipated path was revised downwards, under the impact of probable developments in crude oil prices, but

1 Previously, the Governing Council expected them to remain at their present levels through the summer of 2019.

2 The details of the terms of TLTRO III were set in the June monetary policy meeting.

3 At zero percent.

4 At -0.40 percent for the deposit facility and 0.25 percent for the lending facility.

5 In its June meeting, the Governing Council expected the key ECB interest rates to remain at their present levels at least through the first half of 2020.

also of weaker inflationary pressures expected to stem from fundamentals, to which added the lower inflation expectations. Economic growth was envisaged to decelerate further, given the weak international trade and the protracted uncertainties about trade rows and geopolitical tensions. Against this backdrop, the ECB decided in September to reduce the deposit facility rate by 10 basis points to -0.50 percent, while keeping unchanged the interest rate on the main refinancing operations[6] and the rate on the marginal lending facility[7]. In addition, the Governing Council reformulated its forward guidance on the expected path of policy rates. Specifically, it removed the calendar-dependence and strengthened the state-contingent forward guidance, expecting key interest rates to remain at their present or lower levels until it has seen the inflation outlook robustly converge to the central bank's aim. The Governing Council also decided to restart net asset purchases under its APP at a monthly pace of EUR 20 billion as from 1 November 2019[8]. In order to preserve favourable bank lending conditions, ensure the smooth transmission of monetary policy and further support the accommodative stance of monetary policy, the ECB changed the modalities of the new series of quarterly targeted longer-term refinancing operations (TLTRO III). Moreover, in order to support the bank-based transmission of monetary policy, the Governing Council decided to introduce, as of October 2019, a two-tier system for reserve remuneration in which part of banks' holdings of excess liquidity[9] is exempt from the negative deposit facility rate.

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]		GDP – 2019 –		General government balance, % of GDP**			Current account balance, % of GDP		
				Forecast*[b,c]							Forecast*			Forecast*	
		2019 (average)	2019 (end of period)	2020 (average)	2021 (average)	Dec. 2018	Dec. 2019	Annual dynamics[a,b]	Gap[b,h]	2019	2020	2021	2019[d]	2020	2021
Euro area	below, but close to 2%	1.2[a]	1.3[c]	1.1 (0.6-1.6)	1.4 (0.7-2.1)	0	0	1.3	slightly positive, narrowing	-0.6[a]	-0.9[d]	-1.0[d]	2.7	2.4[c]	2.3[c]
US	2%	1.5[f]	1.7[f]	2.1***	2.1***	2.25-2.50	1.50-1.75	2.3	positive, slightly widening	-4.6[g]	-4.6[g]	-4.3[g]	-2.3	-2.5[d]	-2.5[d]
Poland	2.5% ±1 pp	2.3[e]	3.4[e]	2.8	2.6	1.5	1.5	4.1	positive, widening	-0.7[a]	-0.2[d]	-0.9[d]	-0.5	-0.4[d]	-0.1[d]
Hungary	3% ±1 pp	3.4[e]	4.0[e]	2.9	3.0	0.9	0.9	4.9	positive, widening	-2.0[a]	(-1.6)-(-1.7)[b]	(-1.4)-(-1.6)[b]	-0.8	0.7[b]	1.3[b]
Czechia	2% ±1 pp	2.8[e]	3.2[e]	2.6	2.0	0.50	1.75	2.6	positive, narrowing	0.3[a]	0.8[b]	0.5[b]	-0.4	0.6[b]	0.6[b]
Romania	2.5% ±1 pp	3.83[e]	4.04[e]	2.9	3.1****	2.5	2.5	4.1	positive, widening	-4.3[a]	-4.4[d]	-6.1[d]	-4.6	-5.3[d]	-5.4[d]

*) forecasted values refer to the latest central bank projections in 2019 and to the European Commission's autumn 2019 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

****) the end of the forecast horizon is 2021 Q3

Source: a) Eurostat, b) NCBs, c) ECB, d) European Commission (AMECO), e) national statistics institutes, f) US Bureau of Economic Analysis, g) US Congressional Budget Office, h) IMF

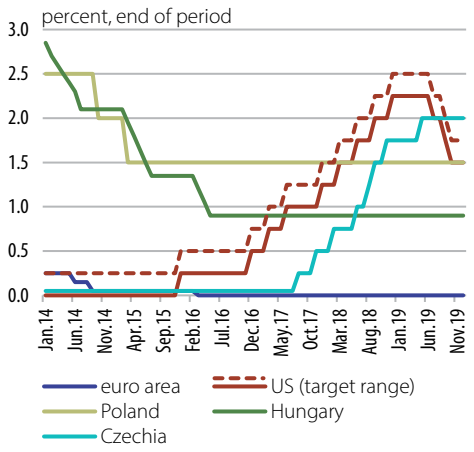
6 At zero percent.

7 At 0.25 percent.

8 They were expected to run for as long as necessary to reinforce the accommodative impact of the ECB's policy rates and to end shortly before the ECB started raising key interest rates.

9 Determined as a multiple of an institution's minimum reserve requirements. The multiplier was set at 6 and can be changed over time.

In turn, the Fed changed the course of monetary policy in 2019, lowering the target range for the federal funds rate in three steps (in July, September and October) of 0.25 percentage points each, to 1.50-1.75 percent (Table A; Chart B), after having extended the rate hiking cycle in the previous year and then preserved the rate status-quo until June 2019. Furthermore, the central bank brought to a halt in September the reduction in the volume of financial instruments held in its portfolio and, in fact, slowed as early as May the pace of the balance sheet normalisation process. The shift in monetary policy conduct was decided in a context in which the policy-relevant annual inflation rate generally stood below the 2 percent symmetric goal, on account of developments in volatile components (food items, fuels), but also against the background of weaker demand-side inflationary pressures. Furthermore, the pace of economic activity moderated, following the deceleration in investment dynamics. At the same time, the uncertainties and risks surrounding the outlook for economic growth – which remained however positive, *inter alia* as a result of favourable labour market conditions – rose considerably, amid heightened trade and geopolitical tensions, whose influences fed through to inflation expectations as well.



Source: NCBs

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

At a regional level, the Czech National Bank slowed considerably the monetary policy tightening cycle – launched in August 2017 and steepened in 2018 –, raising the policy rate on only one occasion in 2019, by 0.25 percentage points, to 2.0 percent[10]. The increase was decided in May, as the annual inflation rate had re-embarked on an upward path and climbed markedly in the first three months of the year, primarily on the back of the core component, reaching in March the upper bound of the tolerance band. The central bank's new forecast expected it to stay in the upper half of the band until year-end, amid the higher dynamics of administered prices and the hike in food prices, but especially as a result of persistent inflationary pressures from fundamentals. However, the latter were expected to moderate in the second part of the forecast horizon, on the back of developments in import prices, as well as under the impact of decelerating economic growth and pay rises. Under the circumstances, the annual inflation rate was seen declining close to the midpoint of the target in 2020, prompted *inter alia* by the reduction in the annual dynamics of administered prices and by the tightening of monetary conditions, on account of both components – interest rate and exchange rate.

Following the decision, the annual inflation rate remained in the vicinity of the upper bound of the tolerance band of the target and even exceeded it slightly in the closing two months of 2019, amid the pick-up in the dynamics of administered, food and energy prices, but also as an effect of the step-up in core inflation. The successive forecasting rounds reconfirmed the prospects for the annual inflation

[10] At the same time, interest rates on the standing facilities were raised to 1.0 percent (deposit facility) and 3.0 percent (lending facility) respectively.

rate to remain below the upper bound of the target band in the near run, before returning towards the midpoint of the target, due to the gradual abatement of inflationary pressures. The positive output gap was anticipated to close gradually, mainly as a result of the slight moderation in consumption dynamics, while the fiscal impulse – positive in 2019 – was seen turning neutral in 2020-2021, as the increases in wages and pensions envisaged over the medium term were to be offset by some rises in taxes and excise duties. At the same time, the uncertainties associated with external developments were conducive to tilting the balance of risks to inflation slightly to the downside, without however eroding the surplus on the goods and services balance until the end of the forecast horizon.

The Polish central bank maintained in 2019 as well the monetary policy rate at 1.50 percent – in place since March 2015. The status-quo was decided in a context in which the annual inflation rate climbed almost steadily during the year, from readings below the variation band of the target (2.5 percent ±1 percentage point)[11] towards its upper bound. Aside from the influence of some volatile components, the developments reflected the uninterrupted upward path of core inflation, indicating the build-up of inflationary pressures from fundamentals. In fact, economic growth remained robust in 2019, the slight moderation notwithstanding, underpinned by household consumption, amid the fast wage growth, the low unemployment rate and positive consumer sentiment. According to the successive macroeconomic forecasts, the annual inflation rate was expected to climb further in the near run, but to stay inside the variation band of the target – under the impact of the high dynamics of wage costs and aggregate demand pressures –, before returning close to the midpoint of the target, due to the softening of inflationary pressures from fundamentals, associated with the slowdown in economic growth, but also with the subdued dynamics of import prices. Moreover, according to the assessments conducted towards the end of the year, the anticipated weakening of economic growth amid the slower advance in the economies of major foreign partners was not likely to entail an obvious worsening of the economy's external position.

The Hungarian central bank also left the base rate and the lending rate unchanged at 0.9 percent during 2019. The deposit rate was, however, raised by 0.10 percentage points in March, to -0.05 percent, and was kept there afterwards. Also in March, the central bank took further unconventional monetary policy measures, announcing the launch of the Bond Funding for Growth Scheme (BGS) in July, with the aim of enhancing monetary policy transmission and increasing the liquidity of the corporate bond market.

The decisions were taken in a context in which the annual inflation rate broadly stood in the vicinity of the midpoint of the target, fluctuating primarily as a result of food and fuel price volatility, whereas the annual core inflation rate ran steadily close to the upper bound of the variation band of the target. At the same time, the inflation outlook was marked, on one hand, by significant inflationary pressures stemming from the swift dynamics of domestic demand and, on the other hand, by

[11] 0.7 percent in January.

pressures in the opposite direction from relatively weaker external developments, with implications also for import price dynamics. In addition, the successive forecasts pointed to the annual inflation rate running in line with the target, as well as to anchored inflation expectations and to a slight deceleration of core inflation by the end of the projection horizon.