GLOBAL ECONOMIC OUTLOOK - OCTOBER

Monetary Department
External Economic Relations Division

2017

CNB CZECH NATIONAL BANK

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Cut-off date for data
13 October 2017

CF survey date
9 October 2017

GEO publication date
20 October 2017

Notes to charts

ECB and Fed: midpoint of the range of forecasts.
The arrows in the GDP and inflation outlooks indicate the direction of revisions compared to the last GEO. If no arrow is shown, no new forecast is available. Asterisks indicate first published forecasts for given year. Historical data are taken from CF, with exception of MT and LU, for which they come from EIU.
Leading indicators are taken from Bloomberg and Datastream.
Forecasts for EURIBOR and LIBOR rates are based on implied rates from interbank market yield curve (FRA rates are used from 4M to 15M and adjusted IRS rates for longer horizons). Forecasts for German and US government bond yields (10Y Bund and 10Y Treasury) are taken from CF.

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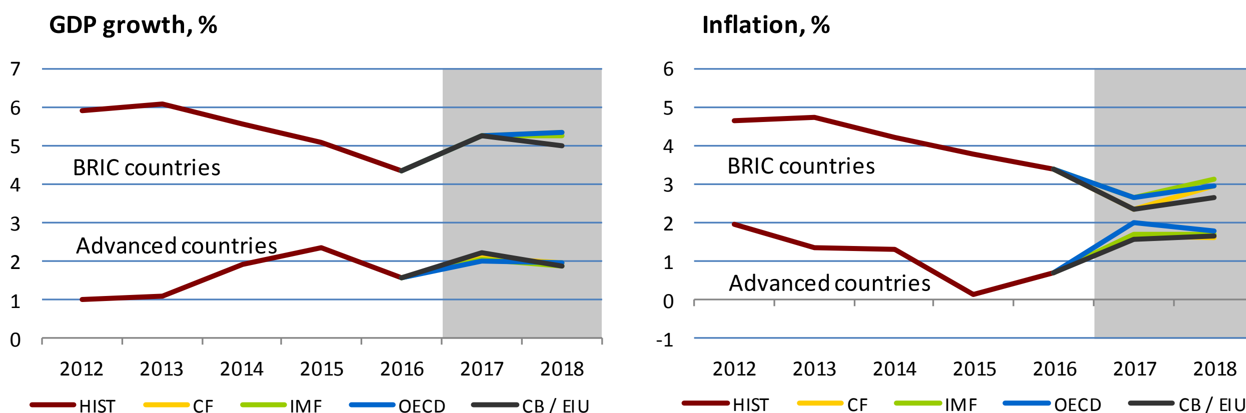
The October issue of Global Economic Outlook presents the regular monthly overview of recent and expected developments in selected territories, focusing on key economic variables: inflation, GDP growth, leading indicators, interest rates, exchange rates and commodity prices. In this issue we take a closer look at the information value of a country's net international investment position. The position is an important indicator of the external balance of an economy. The article focuses on presenting the past evolution of the net investment position and describing potential risks in EU countries. The article concludes with the positive finding that a majority improvement tendency in this economic indicator has been observed in EU countries after the worst effects of the economic and financial crisis eased.

The current economic outlooks for the advanced countries we monitor confirm a trend of rising expected economic growth, especially in the euro area (which even slightly outpaced the US economy), yet with inflation outlooks still below the desired 2%. The only fly in the ointment is that the strongest European economies (Italy, France and Germany) are at the very bottom of the euro area ranking as regards GDP growth outlooks – this has not usually been the case in the recent past, especially as far as the German economy is concerned. However, even the German economy improved in August, which, given its economic strength, is sending further positive signals to its trading partners and the wider world. The US economy grew at its fastest rate in two years in 2017 Q2 and, according to outlooks, is heading for 2.5% growth at the end of 2018. The GDP growth forecasts for the UK and Japan are visibly lower. The UK economy is treading water because of Brexit and other factors, while the Japanese economy saw a substantial increase in growth based on data revisions. Of all the advanced countries under review, only the UK will see inflation exceeding the 2% level in the period up to the end of 2018. This is related to the ongoing Brexit. As usual, the Japanese economy recorded the lowest inflation outlooks.

The September outlooks brought a decline in the growth prospects for the Indian economy, a development, which, in addition to last year's demonetisation, was fostered by the recent major tax reform. However, India's growth outlook for 2018 remains above 7% amid relatively low inflation. Although China's growth outlook for 2018 was increased slightly, the risks associated with economic developments in China persist. The outlooks for the less dynamic BRIC countries (Russia and Brazil) diverged considerably last month. The Russian economy continues to grow and is expected to get close to 2% GDP growth with inflation slightly above 4%. The Brazilian economy saw no major changes from the previous month. GDP is expected to grow by a mere 0.4% amid inflation close to 4%. Some – albeit weakening – optimism is still expected for next year, when the Brazilian economy should see a visible recovery accompanied by slight growth in inflation pressures.

The outlooks for short-term euro area interest rates rose slightly, but three-month rates will remain very low and negative at the one-year horizon. In the case of the USA, the upward pressures on interest rates can be expected to ease and will probably not re-emerge until the very end of this year. According to CF, the US dollar will depreciate slightly further against the euro and the rupee at the one-year horizon. It is expected to remain broadly stable against the yen-rouble currency pair and to appreciate against other currencies, most of all the Brazilian real. The outlook for the average Brent oil price edged up to USD 53.5/bbl at the one-year horizon compared to the August outlooks. Prices of non-energy commodities are expected to rise slightly over the coming 12 months, due mainly to food commodity prices.

GDP growth and inflation development and outlook in monitored countries

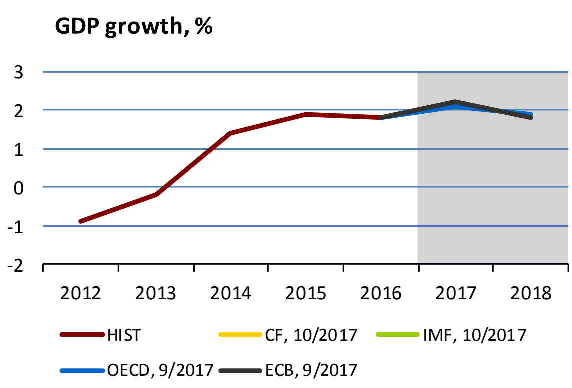


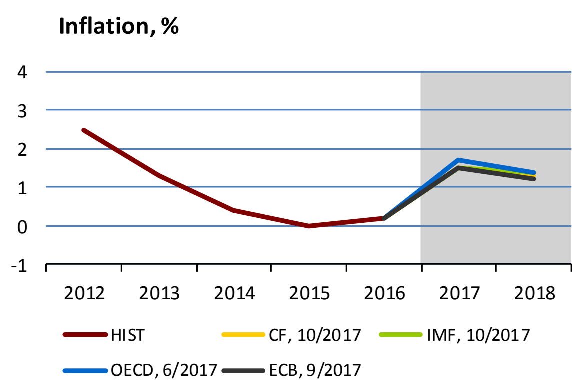
Note: The figures represent the weighted averages of historical series / outlooks in individual countries. The weights are based on nominal GDP measured in USD during 2011–2015 (source: EIU). Advanced countries: euro area, United States, United Kingdom, Japan. BRIC countries: China, India, Russia, Brazil.

II.1 Euro area

Euro area GDP growth rose to 0.6% in Q2 (2.3% year on year) and probably kept the same pace in Q3 (the first official estimates are to be released at the end of October). Despite company holidays, industrial production increased in both July and August (by 0.3% and 1.4% month on month respectively), reflecting domestic demand as well as a recovery in external demand. Retail sales were up by 0.3% in July and August. The September survey of purchasing managers confirmed satisfaction with developments in Q3. The survey signals a continued economic recovery for the coming quarter. A recovery is expected across all the euro area countries. All of the economies under review were in the expansion band in the PMI – both in the composite index (56.7 for the euro area as a whole) and in its individual sectoral components (manufacturing 58.1, services 55.8 and retail 52.3). The encouraging outlook is complemented by rising economic sentiment indicators. CF, the IMF and the OECD thus raised their GDP growth estimates. Growth is expected to reach around 2.2% this year and then slow slightly in 2018. It will thus fluctuate above the CF respondents' long-term outlook (1.3% at the ten-year horizon).

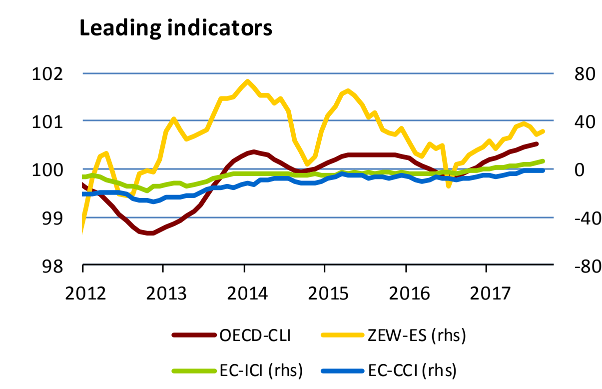
According to the flash estimate, the HICP increased by 1.5% year on year in September. Inflation thus stayed at the August level. Its core component meanwhile slowed slightly to 1.1%. However, price trends remain mixed across countries. In August, prices recorded the fastest growth in the Baltic states (3.2%–4.6%) and the slowest growth in Ireland (0.4%). Euro area inflation is expected to dip at the year-end due to an energy price base effect. It will then go up gradually. Consumer price inflation is expected to reach 1.5% this year, fall in 2018 and rebound to 1.5% in 2019. Concerns about the anti-inflationary effect of the strengthening euro diminished after the single currency stopped appreciating further in September. In early October, the euro lost some of its previous gains due to the constitutional crisis in Spain. According to CF, however, the euro should gradually start to firm again. The outlook for short-term market rates at the one-year horizon shifted marginally upwards.

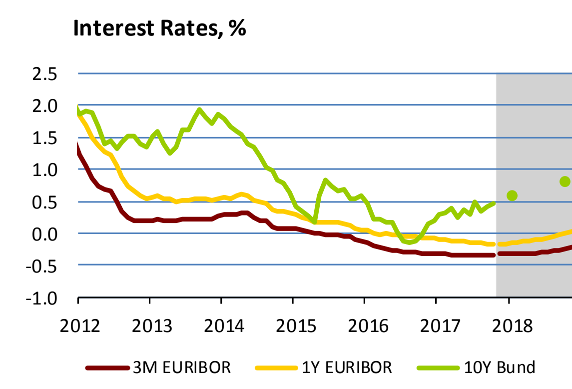




	CF	IMF	OECD	ECB
2017	2.2	2.1	2.1	2.2
2018	1.8	1.9	1.9	1.8

	CF	IMF	OECD	ECB
2017	1.5	1.5	1.7	1.5
2018	1.3	1.4	1.4	1.2

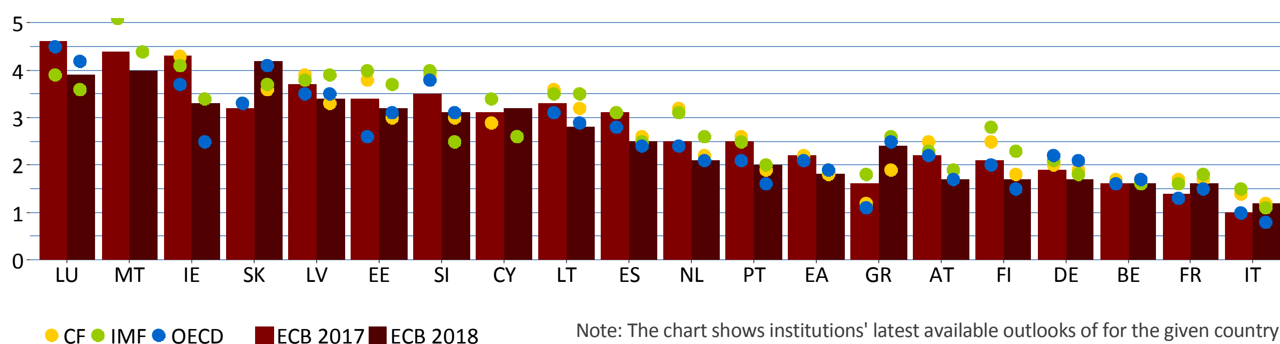




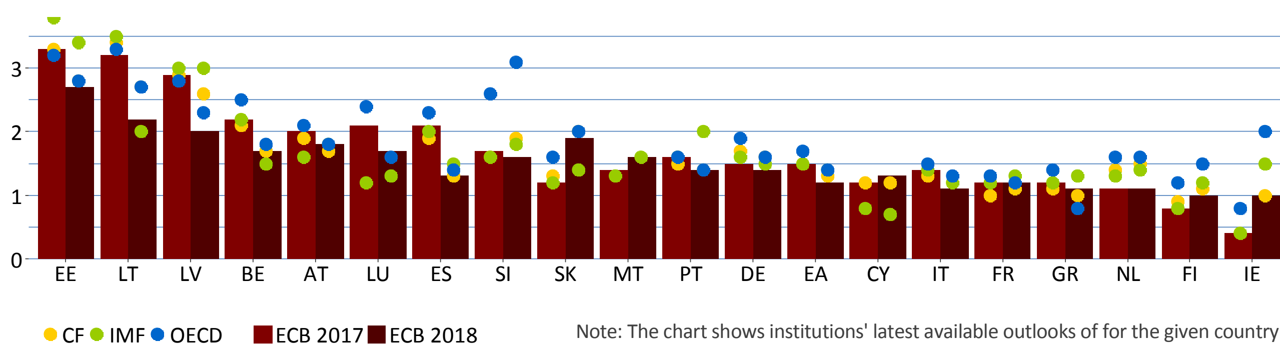
	OECD-CLI	ZEW-ES	EC-ICI	EC-CCI
7/17	100.5	35.6	4.5	-1.7
8/17	100.5	29.3	5.0	-1.5
9/17		31.7	6.6	-1.2

	09/17	10/17	01/18	10/18
3M EURIBOR	-0.33	-0.33	-0.32	-0.24
1Y EURIBOR	-0.17	-0.17	-0.15	0.00
10Y Bund	0.41	0.46	0.60	0.80

GDP growth outlooks in the euro area countries in 2017 and 2018, %

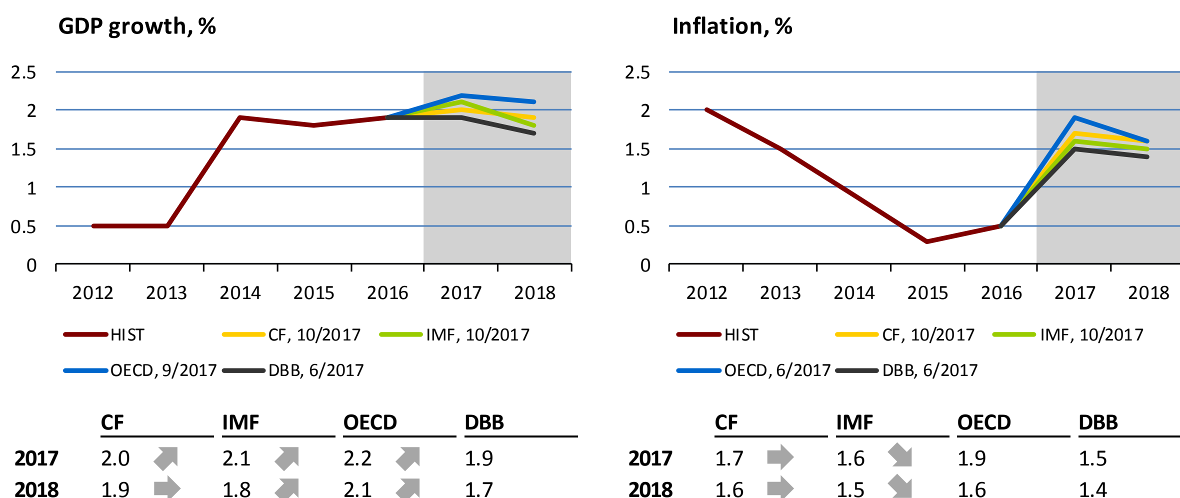


Inflation outlooks in the euro area countries in 2017 and 2018, %



II.2 Germany

The German GDP growth outlook was raised for both this year and the next. The revision was due to favourable developments in Q2, when growth was driven by household consumption and investment. By contrast, net exports contributed negatively to GDP growth. Strong growth in industrial production in Q3, a further decline in unemployment, a higher-than-expected ZEW business confidence index and the PMI in manufacturing, which rose again in September, promise buoyant economic growth in the rest of the year despite the stronger euro. However, wage growth remains subdued, reflected in still only moderate inflationary pressures. CF expects wages in the production sector to grow by 2.4% this year. In September, headline inflation was flat at 1.8% while core inflation slowed slightly to 1.5%. The inflation outlook was thus revised downwards (IMF). Inflation is not expected to converge towards 2% this year or the next.



	CF	IMF	OECD	DBB
2017	2.0	2.1	2.2	1.9
2018	1.9	1.8	2.1	1.7

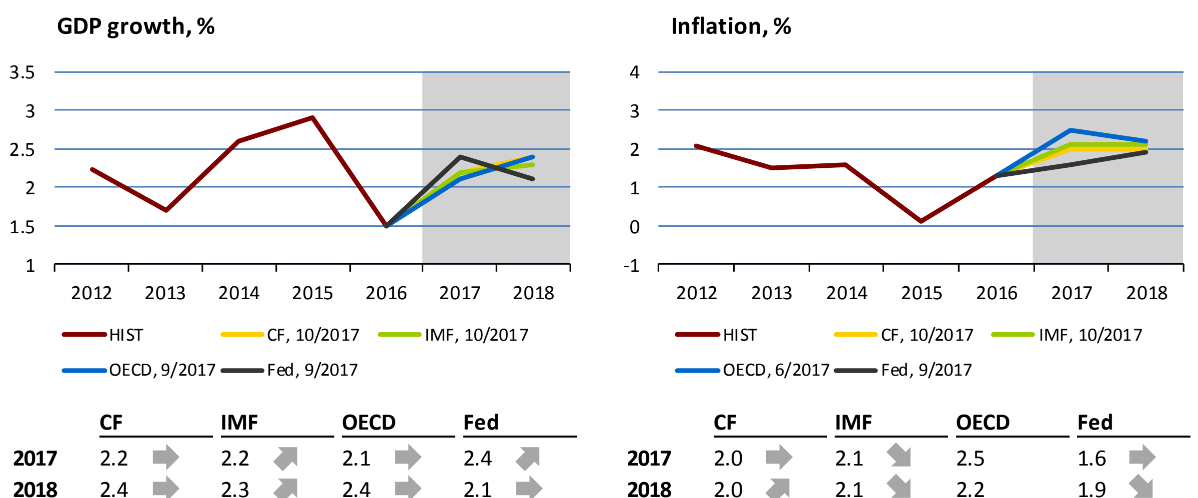
	CF	IMF	OECD	DBB
2017	1.7	1.6	1.9	1.5
2018	1.6	1.5	1.6	1.4

II.3 United States

The final US growth estimate for 2017 Q2 was revised upwards again (to 3.1% in quarter-on-quarter annualised terms). However, a slowdown can be expected in Q3. The US economy (and especially industry) was hit hard in August and September by the strongest-ever hurricane season (Hurricanes Harvey, Irma and Maria). According to the New York Fed, growth will drop to just 1.3% in Q3 and then rebound to 2.5% in Q4.

The hurricanes affected the labour market and industry data. Annual industrial production growth slowed to 1.5% in August. Capacity utilisation also fell. Non-farm payrolls went down by 33,000 in September (the financial markets had expected a rise of 80,000). However, the unemployment rate fell to 4.2% and wage pressures increased slightly, with average hourly wage growth rising to 2.9% year on year. According to the Conference Board survey, consumer confidence declined mainly in areas affected by the hurricanes. Retail sales growth slowed in August, but the 4% growth recorded in September suggests a recovery in domestic demand. Optimism persists in the business sector. Leading indicators are signalling continued expansion of the US economy. According to the ISM PMI, the economy has been growing for 100 consecutive months and the manufacturing index increased in September to its highest level since May 2004 (60.8).

Inflation reached 2.2% in September and has been rising for four straight months now. Core inflation remains stable (1.7%), as do households' inflation expectations (2.5%). The Fed left rates unchanged at its September meeting, but the dot plot clearly shows that the majority of central bankers would support one more rate hike this year. In October, the Fed will initiate a balance-sheet normalisation programme in line with its previously announced plan, i.e. total monthly reinvestments of yields on debt and mortgage-backed securities before maturity will be reduced by USD 10 billion. The October CF only raised the inflation outlook for 2018. The Fed's new forecast revised GDP growth upwards for 2017 and downwards for 2018, while the IMF improved the economic outlook for both years and similarly lowered the inflation outlook.

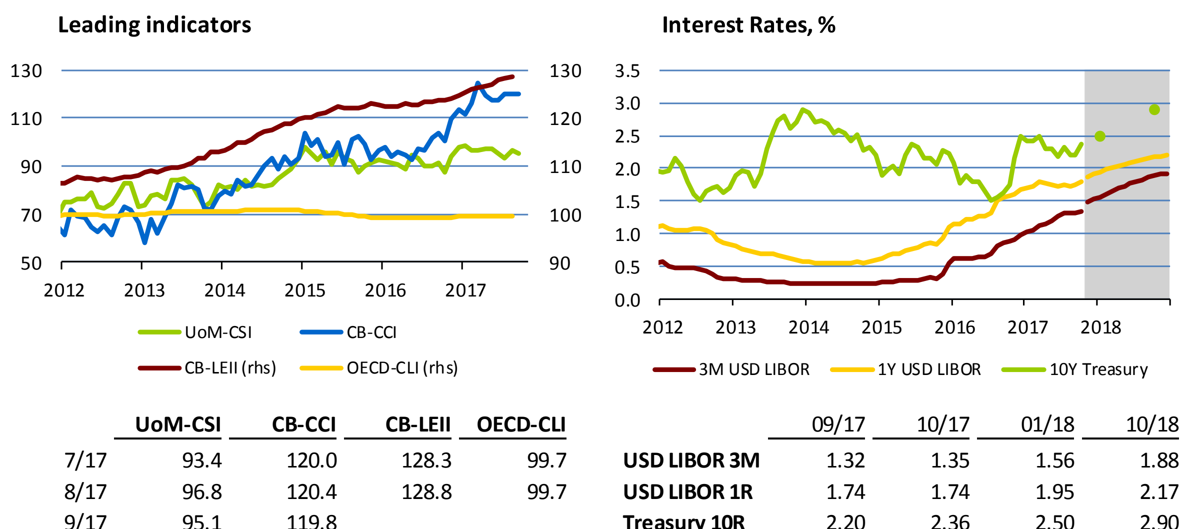


GDP growth, %

	CF	IMF	OECD	Fed
2017	2.2	2.2	2.1	2.4
2018	2.4	2.3	2.4	2.1

Inflation, %

	CF	IMF	OECD	Fed
2017	2.0	2.1	2.5	1.6
2018	2.0	2.1	2.2	1.9

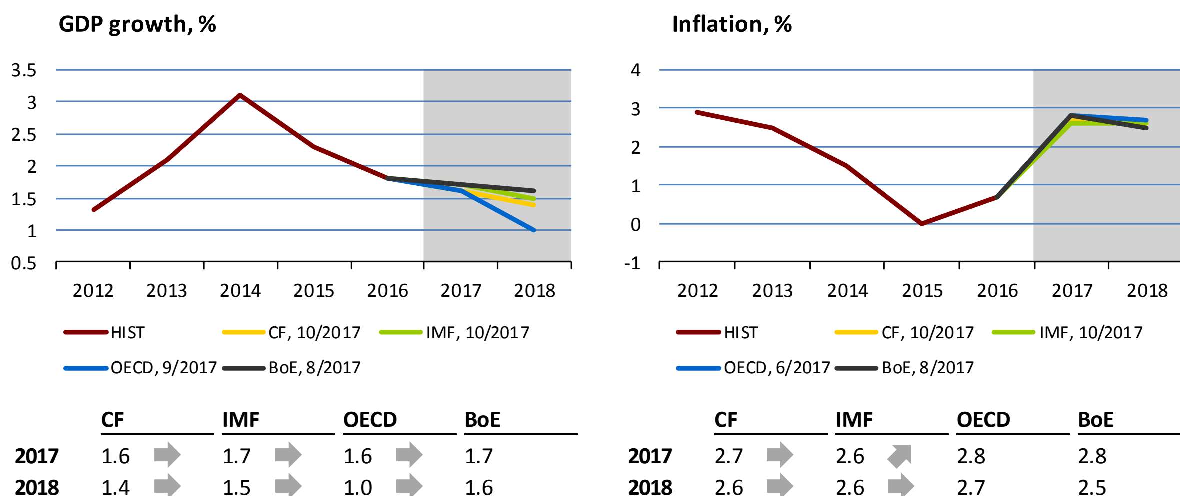


	UoM-CSI	CB-CCI	CB-LEII	OECD-CLI
7/17	93.4	120.0	128.3	99.7
8/17	96.8	120.4	128.8	99.7
9/17	95.1	119.8		

	09/17	10/17	01/18	10/18
USD LIBOR 3M	1.32	1.35	1.56	1.88
USD LIBOR 1R	1.74	1.74	1.95	2.17
Treasury 10R	2.20	2.36	2.50	2.90

II.4 United Kingdom

The UK economy grew by 0.3% in Q2. This was due mainly to fixed investment, which rose by 0.6%, while household consumption increased by just 0.2%. The annual GDP growth figure was lowered to 1.5% as a result of revisions of historical values. Economic growth probably improved slightly in Q3. Retail sales growth rose to 1.0% month on month in August (from 0.6% in July) and consumer confidence increased in September for the second time in a row. Moreover, the weak pound and concerns surrounding the post-Brexit arrangements attracted a record number of tourists. According to NIESR estimates, UK GDP growth rose to 0.4% in Q3. The October CF expects annual GDP growth of 1.6% this year and 1.4% in 2018. The new IMF and OECD outlooks expect similar figures, except for the OECD forecast for 2018, which remains markedly more pessimistic. The pound has been weakening again since mid-September. Inflation will stay noticeably above the BoE's target this year and the next. The BoE is expected to raise rates in November.

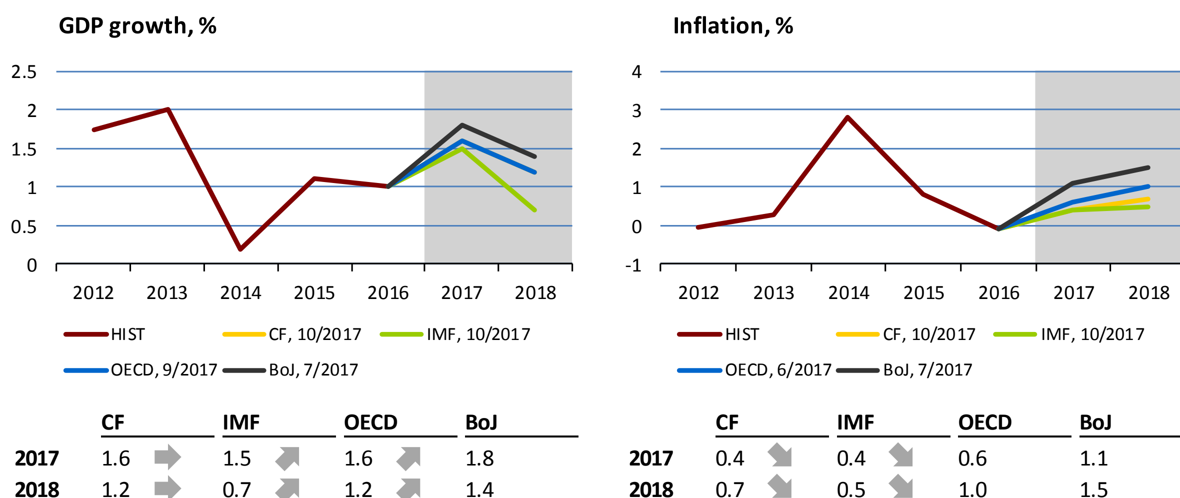


	CF		IMF		OECD		BoE
2017	1.6	→	1.7	→	1.6	→	1.7
2018	1.4	→	1.5	→	1.0	→	1.6

	CF		IMF		OECD	BoE
2017	2.7	→	2.6	↗	2.8	2.8
2018	2.6	→	2.6	→	2.7	2.5

II.5 Japan

The economic situation in Japan was very favourable in August despite mounting geopolitical pressures (missile testing by North Korea). Annual retail sales growth slowed only slightly. By contrast, household spending and wage growth rose substantially. Unemployment is at its lowest level in 23 years (2.8%). Industrial production strengthened and the PMI in manufacturing increased again in September, when, according to purchasing managers, output, new orders and exports grew faster. The IMF and the OECD revised their GDP growth outlooks upwards – both by 0.2 pp for this year and by 0.1 pp and 0.2 pp respectively for 2018. Headline inflation rose to 0.7% in August, buoyed by faster growth in food and energy prices. Nevertheless, CF and the IMF decreased their inflation outlooks for both years monitored. At its September meeting the BoJ left its monetary policy stance unchanged.

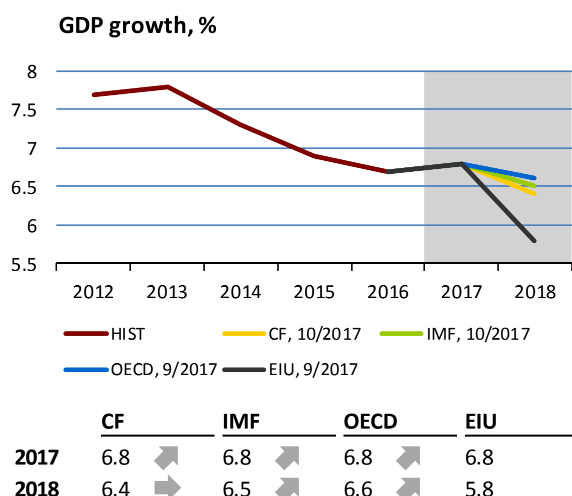


	CF		IMF		OECD		BoJ
2017	1.6	→	1.5	↗	1.6	↗	1.8
2018	1.2	→	0.7	↗	1.2	↗	1.4

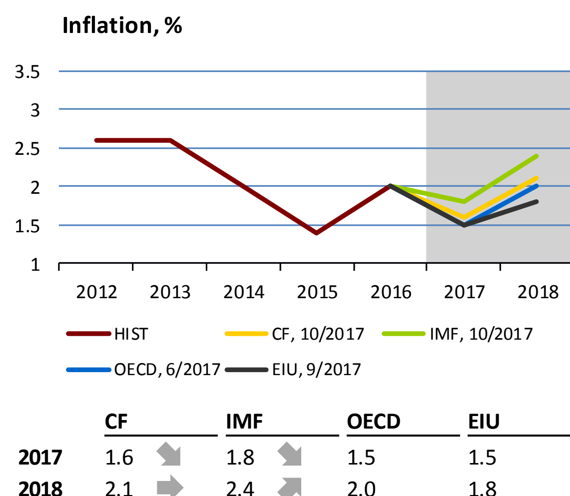
	CF		IMF		OECD	BoJ
2017	0.4	↘	0.4	↘	0.6	1.1
2018	0.7	↘	0.5	↘	1.0	1.5

III.1 China

New data from the economy confirm a modest but stable expansion. The PMI leading indicator recorded growth in all its components in September, while corporate profitability also improved. Year-on-year retail sales growth stayed above 10% in August. Positive news is welcome, as the Chinese communist party congress, which takes place every five years, is due to start on 18 October. Though concerns about a hard landing for the Chinese economy lowered, doubts surrounding the level of debt persist. In September, Standard & Poor's lowered China's default rating by one notch to A+ due to higher risks associated with buoyant loan growth. According to S&P, the Chinese government's efforts to reduce these risks are not working as fast as expected and growth in loans is still too sharp. The new CF, IMF and OECD forecasts revised the GDP growth outlook upwards for both years (with the exception of CF for 2018). The IMF and CF foresee lower inflation pressures this year, but inflation is expected to rise again in 2018.



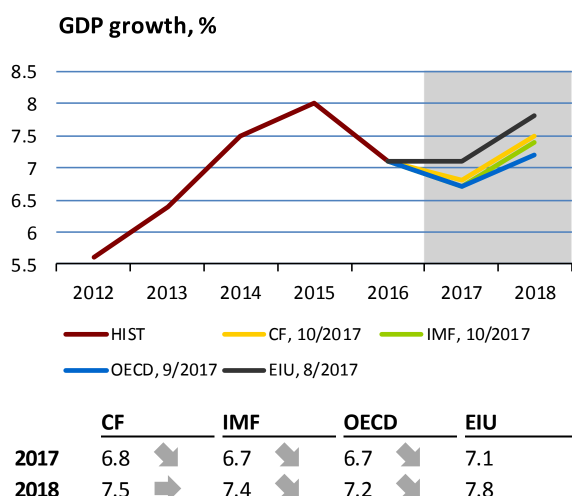
	CF	IMF	OECD	EIU
2017	6.8	6.8	6.8	6.8
2018	6.4	6.5	6.6	5.8



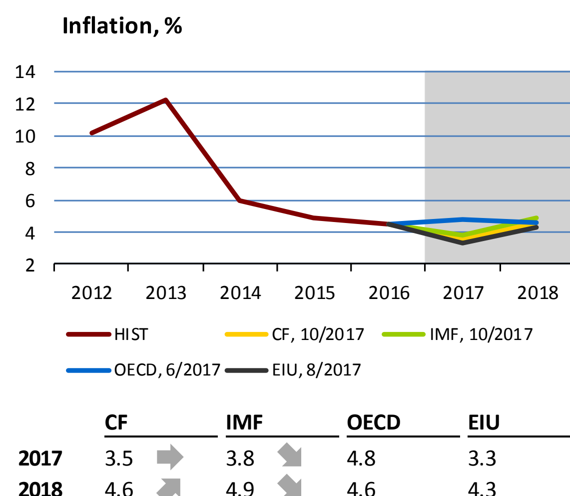
	CF	IMF	OECD	EIU
2017	1.6	1.8	1.5	1.5
2018	2.1	2.4	2.0	1.8

III.2 India

Annual growth in industrial production surged in August on the back of stronger growth in manufacturing, electricity generation and mining. However, the PMI in manufacturing stayed at 51.2 in September. According to purchasing managers, employment recorded its strongest growth since October 2012 and confidence strengthened, but growth in output, new orders and exports slowed. The CF, IMF and OECD forecasts expect economic growth to slow below 7% this fiscal year. Inflation remained at the previous month's revised level in September (3.3%). Growth in food prices slowed unexpectedly, but their lower contribution was offset by stronger growth in prices of other consumer basket items. The IMF revised its inflation outlooks for both fiscal years downwards – by a full 1 pp for this year. By contrast, CF, which expects lower figures than the IMF, revised its inflation forecast slightly upwards for 2018/2019. The two organisations' outlooks thus converged. The RBI left its policy rate at 6% as expected.



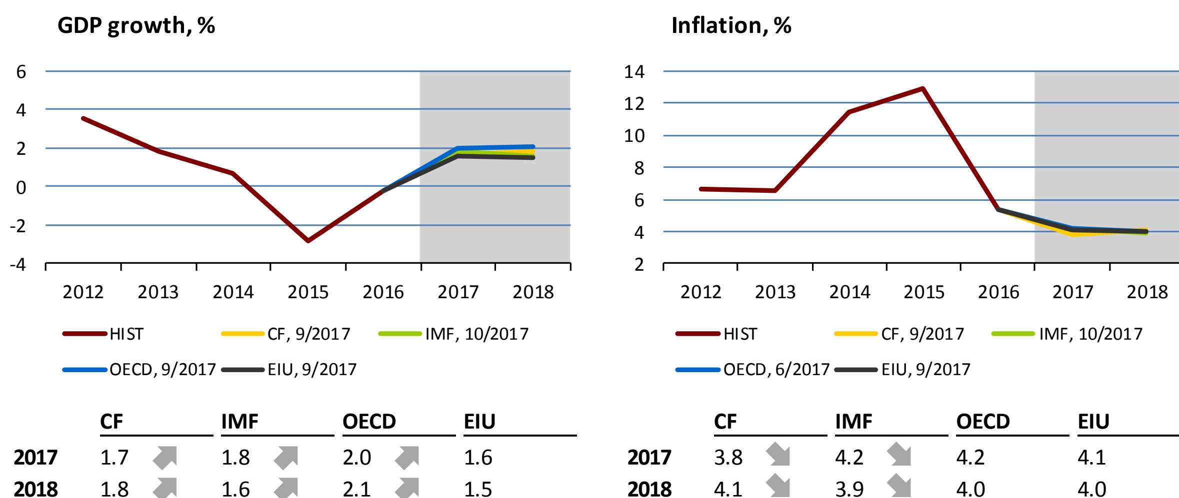
	CF	IMF	OECD	EIU
2017	6.8	6.7	6.7	7.1
2018	7.5	7.4	7.2	7.8



	CF	IMF	OECD	EIU
2017	3.5	3.8	4.8	3.3
2018	4.6	4.9	4.6	4.3

III.3 Russia

Annual industrial production growth in Russia edged up in August but remains broadly subdued (1.5%). Nonetheless, leading indicators continue to suggest a further recovery. The PMI in manufacturing rose slightly in September (51.9) due to growing production and new orders. Moreover, export orders grew for the first time since 2013. Positive developments are also expected in services: the September PMI rose to 55.2 due to the growth in new orders and an upswing in employment growth in services. Total employment went up in line with declining unemployment (4.9% in August compared to 5.1% in July). Looking ahead, the new CF, IMF and OECD forecasts expect economic activity to accelerate to 1.7%–2.0% this year. Moreover, CF and the OECD expect GDP to grow slightly faster next year as well. Inflation is projected to be hovering around 4% at the end of 2018.

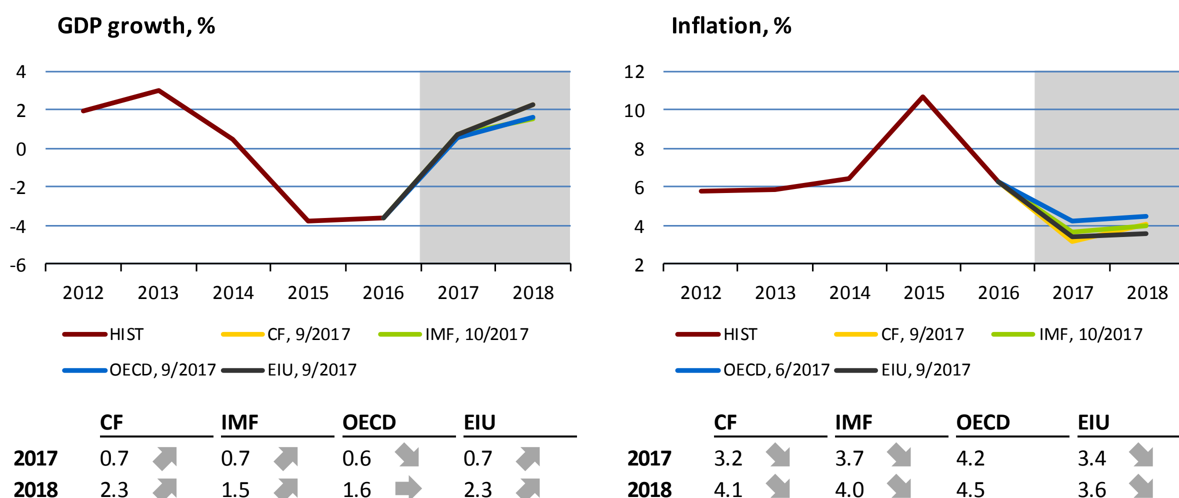


GDP growth	CF	IMF	OECD	EIU
2017	1.7	1.8	2.0	1.6
2018	1.8	1.6	2.1	1.5

Inflation	CF	IMF	OECD	EIU
2017	3.8	4.2	4.2	4.1
2018	4.1	3.9	4.0	4.0

III.4 Brazil

The most recent short-term indicators of the Brazilian economy signal favourable developments. Industrial production growth rose to 4% in August, while unemployment fell marginally. The September composite PMI returned to the expansion zone. Annual inflation went up slightly in August compared to July, but remains very low from the long-term perspective (2.5%). Food inflation has been negative for three months now. Moreover, the decline in food prices is gradually gaining pace; in September it exceeded 2.1%. CF, the IMF and the OECD revised their outlooks towards higher economic growth and weaker inflation. The OECD reduced its GDP outlook for this year and left it unchanged for 2018. Overall, economic growth will strengthen from 0.6%–0.7% this year to 1.5%–2.3% next year; inflation at the close of next year (3.6%–4.1%) will be slightly below the 4.5% target but inside the tolerance band.

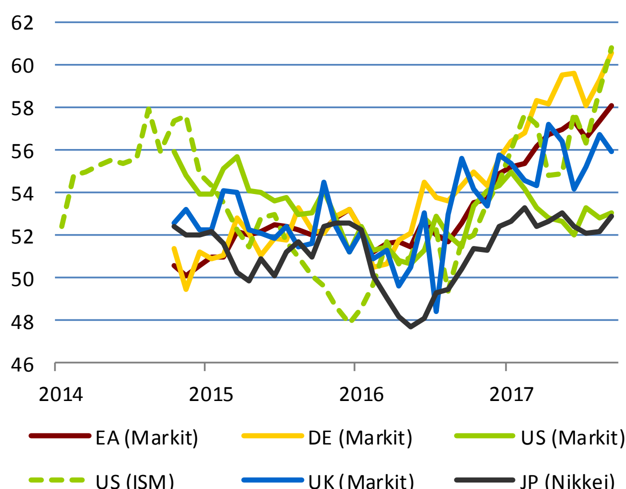


GDP growth	CF	IMF	OECD	EIU
2017	0.7	0.7	0.6	0.7
2018	2.3	1.5	1.6	2.3

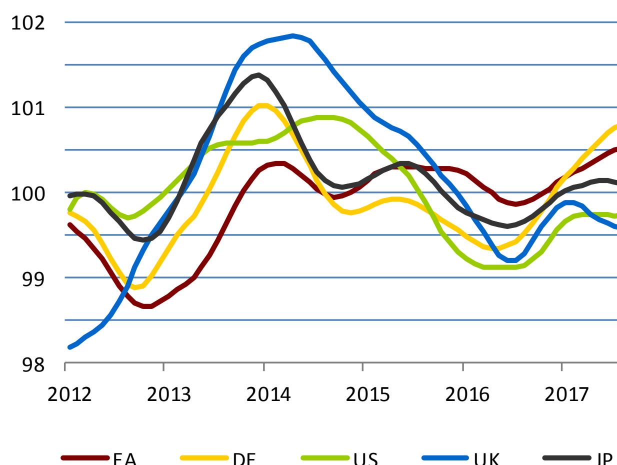
Inflation	CF	IMF	OECD	EIU
2017	3.2	3.7	4.2	3.4
2018	4.1	4.0	4.5	3.6

IV.1 Advanced economies

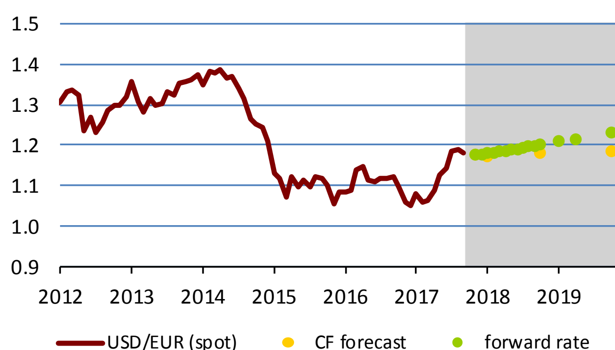
PMI in manufacturing



OECD Composite Leading Indicator

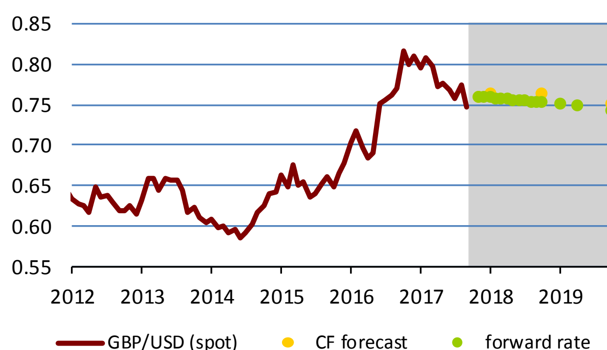


The US dollar (USD/EUR)



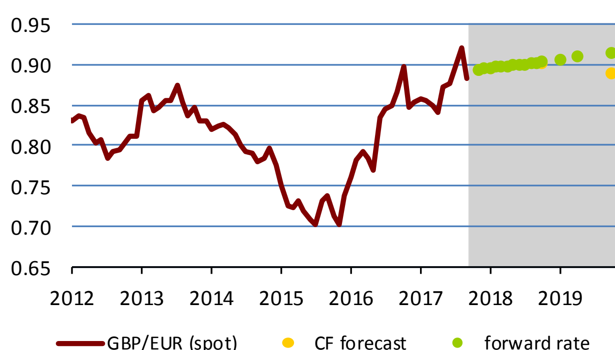
	9/10/17	11/17	01/18	10/18	10/19
spot rate	1.174				
CF forecast		1.176	1.174	1.180	1.185
forward rate		1.176	1.180	1.201	1.230

The British pound (GBP/USD)



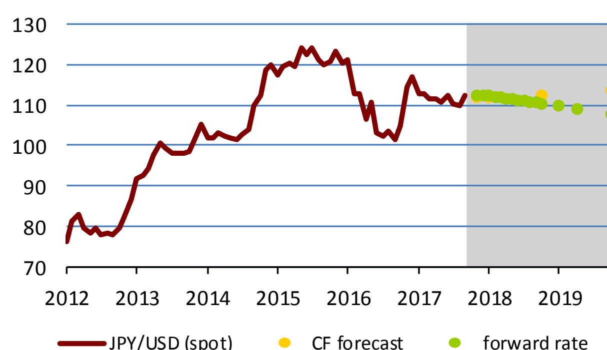
	9/10/17	11/17	01/18	10/18	10/19
spot rate	0.762				
CF forecast		0.760	0.763	0.765	0.750
forward rate		0.760	0.759	0.752	0.744

The British pound (GBP/EUR)



	9/10/17	11/17	01/18	10/18	10/19
spot rate	0.894				
CF forecast		0.894	0.895	0.902	0.889
forward rate		0.894	0.895	0.903	0.915

The Japanese yen (JPY/USD)

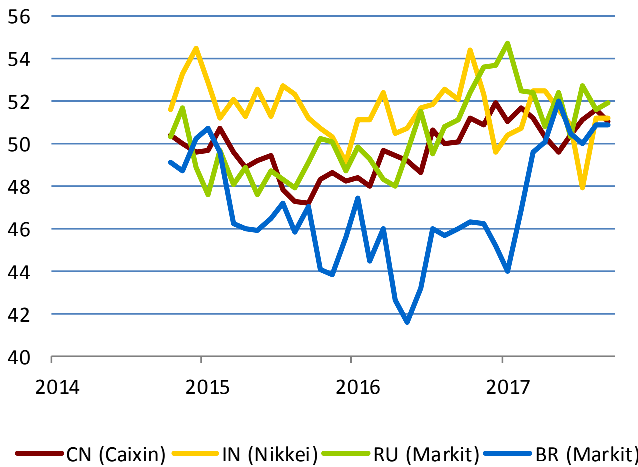


	9/10/17	11/17	01/18	10/18	10/19
spot rate	112.7				
CF forecast		111.8	112.0	112.5	113.4
forward rate		112.5	112.1	110.3	107.6

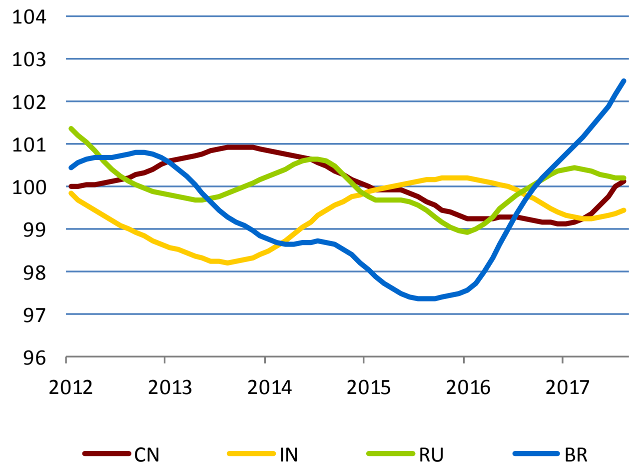
Note: Exchange rates as of last day of month. Forward rate does not represent outlook; it is based on covered interest parity, i.e. currency of country with higher interest rate is depreciating. Forward rate represents current (as of cut-off date) possibility of hedging future exchange rate.

IV.2 BRIC countries

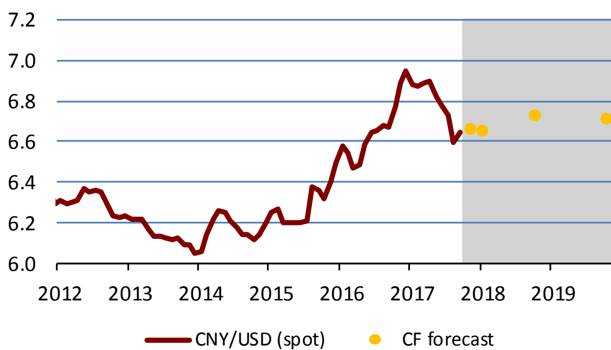
PMI in manufacturing



OECD Composite Leading Indicator

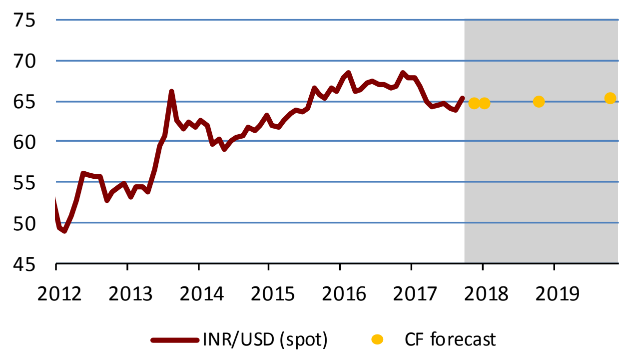


The Chinese renminbi (CNY/USD)



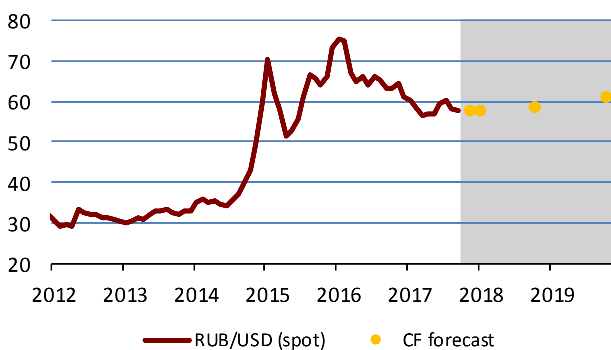
	9/10/17	11/17	01/18	10/18	10/19
spot rate	6.629				
CF forecast		6.658	6.652	6.732	6.710

The Indian rupie (INR/USD)



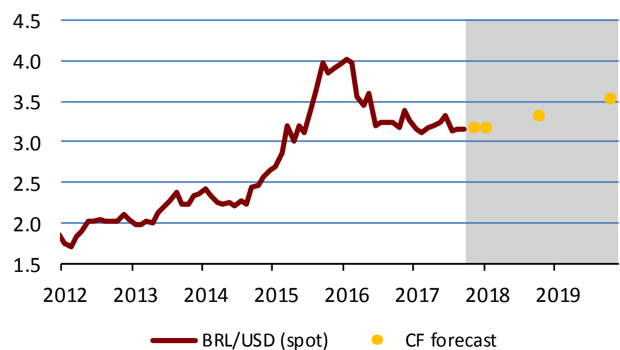
	9/10/17	11/17	01/18	10/18	10/19
spot rate	65.38				
CF forecast		64.71	64.74	64.96	65.41

The Russian rouble (RUB/USD)



	9/10/17	11/17	01/18	10/18	10/19
spot rate	58.46				
CF forecast		57.89	57.88	58.41	61.03

The Brazilian real (BRL/USD)

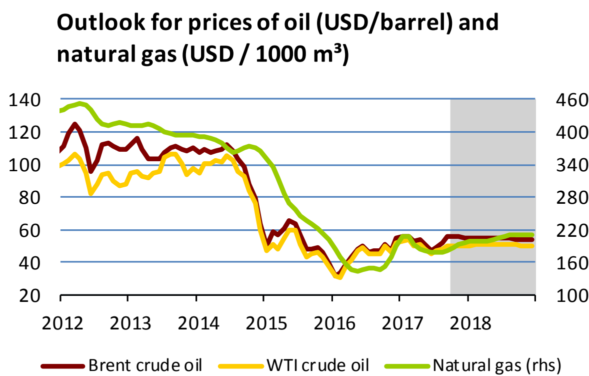


	9/10/17	11/17	01/18	10/18	10/19
spot rate	3.178				
CF forecast		3.186	3.175	3.32	3.54

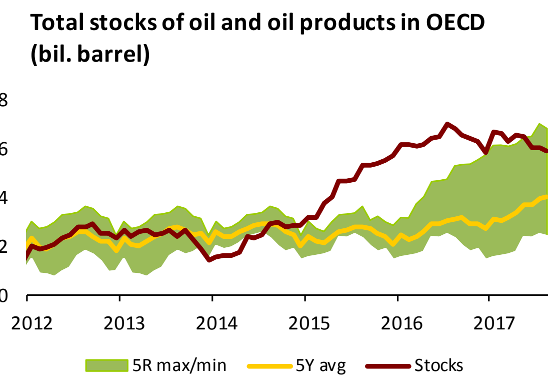
Note: Exchange rates as of last day of month.

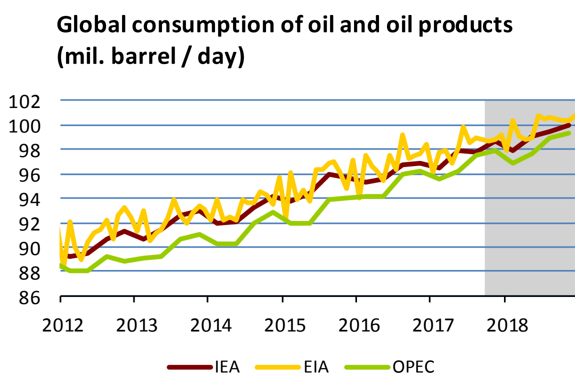
V.1 Oil and natural gas

After having been flat in August, the Brent crude oil price started rising again in September and was just below USD 60/bbl in the second half of the month (its highest level since July 2015). By the month-end, it had partly reversed its previous growth (due to profit-taking by hedge funds and appreciation of the dollar), but in the first half of October it was still relatively high at close to USD 56/bbl. The oil market is meanwhile showing clear signs of a return to balance. The slowly diminishing stocks of crude oil are still high from the historical point of view, but stocks of refined products are now approaching their five-year seasonal average and stocks of distillates (diesel and heating oil) are already below their average level. This is pushing their price quickly upwards on expectations of a cold winter. The market futures curve implies an average Brent crude oil price of USD 55.5/bbl for the rest of the year and USD 54.6/bbl next year. Its backwardation until the end of 2019 also signals that the excess of oil in the market is gradually disappearing. The low stocks of refined products should also maintain refinery activity at high levels for the rest of the year and thus keep demand for oil strong. The robust growth of the global economy is being accompanied by expanding global trade. This is leading to stronger demand for fuels (especially diesel oil). The optimism on the oil market is also underpinned by signals that OPEC and other major producers are willing to extend their agreement to cut output until the end of 2018 or reduce production even more. The IEA, too, sees an extension of the deal as a prerequisite for continued rebalancing of the oil market, as a price in excess of USD 50/bbl will lead to renewed growth in oil production in the USA. The price of US (WTI) crude oil is currently well below that of Brent crude oil, and exports of light crude oil from the USA are therefore surging.

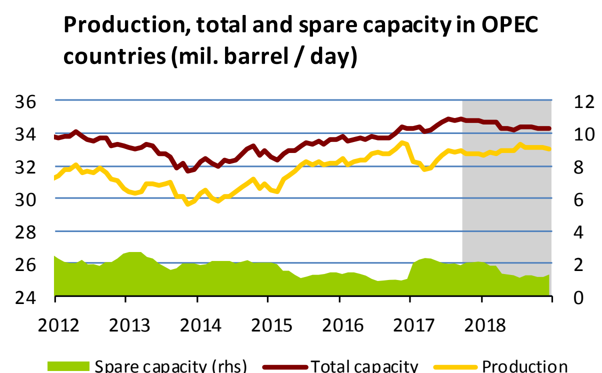


	Brent		WTI		Natural gas	
2017	53.32	↗	49.60	↗	188.97	↗
2018	54.58	↗	50.57	↗	204.98	↗





	IEA		EIA		OPEC	
2017	97.72	↗	98.31	↗	96.80	↗
2018	99.10	↗	99.90	↘	98.18	↗



	Production		Total capacity		Spare capacity	
2017	32.50	↗	34.59	↘	2.10	↘
2018	32.99	→	34.41	→	1.42	→

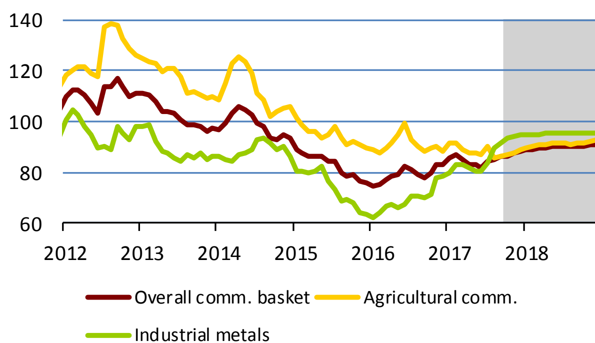
Source: Bloomberg, IEA, EIA, OPEC, CNB calculation
Note: Oil price at ICE, price of Russian natural gas at German border – IMF data, smoothed by the HP filter. Future oil prices (grey area) are derived from futures and future gas prices are derived from oil prices using model. Total oil stocks (commercial and strategic) in OECD countries – IEA estimate. Production and extraction capacity of OPEC – EIA estimate.

V.2 Other commodities

The aggregate non-energy commodity price index has been rising since July. This is due mainly to the industrial metals price sub-index, which has gone up by 50% since January 2016 and in mid October reached its highest level since February 2013. In September and the first half of October, the food commodity price sub-index, which has a rising outlook, also contributed to the rise in the overall index. The outlook for prices of industrial metals is flat.

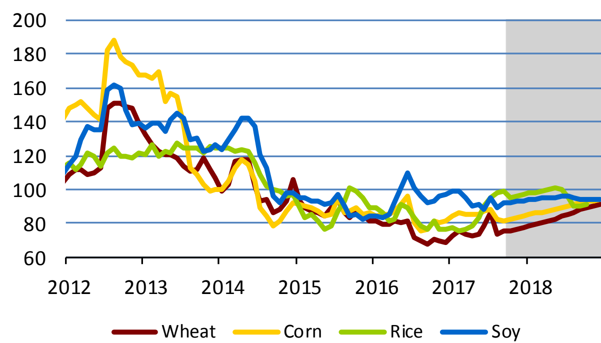
Prices of basic metals continue to be supported by favourable prospects for industrial activity, with the J.P.Morgan Global Manufacturing PMI reaching its highest level in 75 months (53.1). A slight slowdown in Chinese industry was offset by improving activity in the USA and Europe. Prices of aluminium and zinc continued to grow, with a further slight rise expected for aluminium and a strong downward correction predicted for zinc. The price of copper declined in mid September due to growing stocks at the LME, while the slowdown of the Chinese economy was reflected in a decrease in prices of iron ore and nickel. Following a decline in August, wheat prices went up in September as droughts in some parts of the USA hampered the harvest there. Conditions also worsened in Australia and Argentina. The weak dollar fostered higher demand from importing countries. By contrast, corn and soya prices remain at lower levels due to bumper harvests and high stocks. Despite a modest reversal of its previous growth, the price of rice remains relatively high. Following a decline, pork prices stagnated and are expected to switch to seasonal growth. A similar pattern is expected for beef. Rubber prices dropped sharply.

Non-energy commodities price indicies



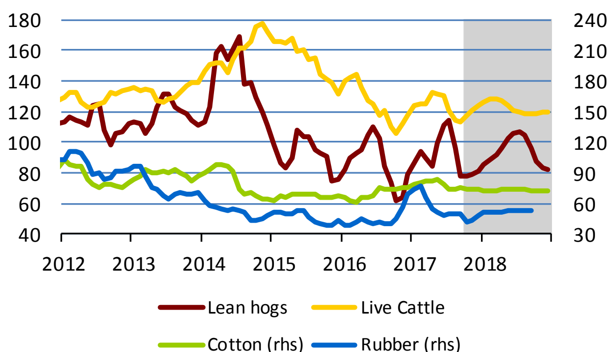
	Overall	Agricultural	Industrial
2017	85.3	88.3	86.4
2018	90.0	91.3	95.4

Food commodities



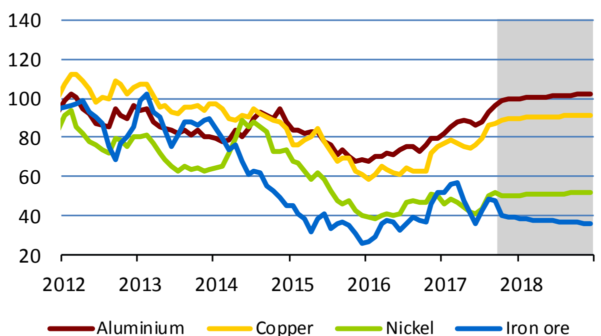
	Wheat	Corn	Rice	Soy
2017	76.0	84.7	88.5	93.1
2018	84.8	89.7	96.3	94.8

Meat, non-food agricultural commodities



	Lean hogs	Live Cattle	Cotton	Rubber
2017	91.1	123.5	77.8	54.6
2018	94.2	122.6	73.4	52.6

Basic metals and iron ore



	Aluminium	Copper	Nickel	Iron ore
2017	91.0	81.6	47.0	45.5
2018	101.1	90.6	51.2	37.1

Source: Bloomberg, CNB calculations.
Note: Structure of non-energy commodity price indices corresponds to composition of The Economist commodity indices. Prices of individual commodities are expressed as indices 2010 = 100.

The investment position – a composite indicator of a country's net position vis-à-vis the rest of the world[1]

This article discusses an important external balance indicator – the international investment position – and compares it with other indicators used in this area. It is also a response to media neglect of the investment position in favour of the indicator of gross debt (which has been rising sharply in the Czech Republic over the last two years). It goes on to examine investment position trends and potential related risks both in the Czech Republic and in EU countries.

1 What is the investment position

The investment position is the most aggregate expression of the international financial relations of a country's residents. It expresses the value of residents' assets in the form of claims on non-residents[2] (or gold) and the value of residents' liabilities to non-residents structured in the same manner as of a specified date (usually the quarter or year end). The difference between a country's claims and liabilities vis-à-vis the rest of the world expresses its net international investment position.

Investment position assets and liabilities are divided into the following categories:

- direct investment
- portfolio investment (in a basic breakdown: equity – shares and investments – and debt)
- financial derivatives
- other investment (in a more detailed breakdown: currency and deposits, loans, insurance, pension and guarantee schemes, trade credits and advances, other accounts receivable or payable, and special drawing rights)
- reserve assets

The structure of the investment position is the same as that of the financial account of the balance of payments. However, while the financial account captures flows of capital between residents and non-residents, the investment position, as mentioned above, expresses stocks on a specific date. The balance of payments is much more commonly used to express relations between residents and non-residents. As it is compiled on a monthly to yearly basis, it is more suitable for assessing a country's current international relations or selected sub-items thereof. To evaluate the risks to a country or its sectors, however, one would have to analyse the balance of payments over a longer period. Conversely, the investment position reflects a country's overall position on a specified date.[3] Moreover, unlike the balance of payments, it reflects additional factors such as exchange rate changes (the investment position is compiled using the exchange rates prevailing on the compilation date) and any revaluation of assets and liabilities.

Another indicator of a country's "external balance" is gross external debt. It is used more often than the investment position, especially with regard to the general public. It is published with the same frequency as the investment position, i.e. quarterly. Some of its items are the same as those of the investment position, but others are significantly different. The two main differences are that gross debt deals solely with the liability side, i.e. it ignores the country's assets, and it only takes account of debt capital, i.e. it does not monitor other forms of international liabilities such as direct investment, shares and equity. The absence of those items significantly reduces the information content of this indicator in today's globalised world, especially for more advanced countries (such as OECD members), which are heavily involved in the international division of labour. As a result, the indicator is currently suitable only for assessing the sustainability of developing countries. Despite this, it often unjustly enjoys more media attention than the investment position, even in advanced countries.

The limited information content of this indicator can be simply demonstrated using the recent path of the Czech Republic's gross external debt (see Chart 1). It has shot up over the last year, due mainly to inflows of short-term capital. The gross external debt indicator has thus been signalling that the country has an acute external imbalance. However, the rise in debt was solely a result of the exchange rate regime applied by the CNB (an exchange rate commitment where the CNB decided to stop the koruna appreciating beyond CZK 27 to the euro). The above-mentioned strong inflow of capital, i.e. growth in liabilities, was purchased by the CNB and invested back abroad as international reserves. The growth in liabilities was thus fully reflected in growth in assets. Despite the surge in debt, the Czech Republic's investment position improved significantly in the said period due to other effects. In its complexity, therefore, it far better reflects the Czech Republic's actual external relations than gross external debt.

[1] Author: Vladimír Žďárský. The views expressed in the article are those of the author and do not necessarily reflect the official position of the Czech National Bank.

[2] In the form of debt or equity instruments.

[3] It can therefore be viewed as accumulated past liabilities (debt) or claims. It thus indicates how well or badly the economy has been managed in the past up to the specified date.

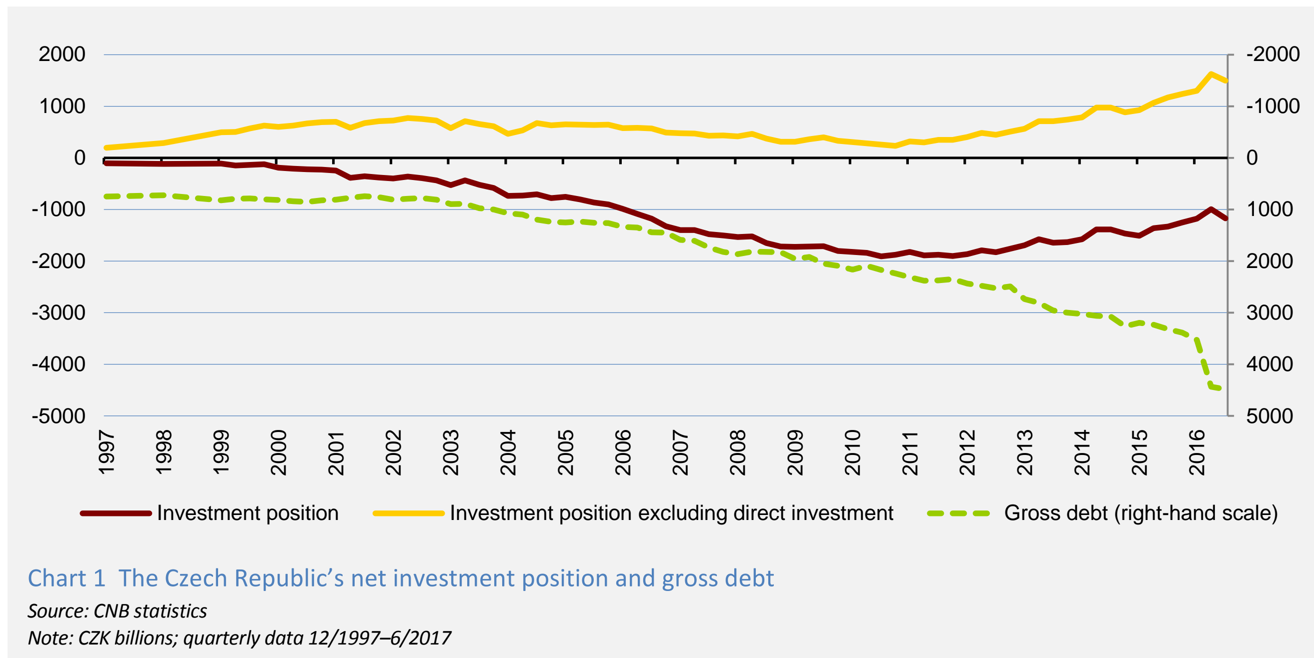


Chart 1 The Czech Republic's net investment position and gross debt

Source: CNB statistics

Note: CZK billions; quarterly data 12/1997–6/2017

2 The investment position – the story of the Czech Republic

At the start of the economic transformation, the Czech (Czechoslovak) economy was characterised by low external competitiveness, but for a long time its international investment position was only slightly negative[4], albeit with a steady deterioration tendency, due to Czechs' cautious approach to borrowing. The Czech Republic's negative investment position started to grow more strongly in 1995, when rising domestic demand caused the trade deficit to widen and hence the current account deficit to rise above 5% of GDP. This undermined confidence in the sustainability of the koruna's fixed exchange rate regime. A subsequent outflow of short-term capital in 1997 led to an exit from this regime and a weakening of the koruna. This, coupled with problems in the domestic banking sector, sparked a minor economic and financial crisis.

Strong currency restrictions gradually reined in domestic demand and reduced the current account deficit. The strategy for accessing foreign capital also changed. On the one hand, the introduction of support for foreign direct investment (FDI) and a preference for selling state-owned property (holdings of which were still relatively large at the time) to non-residents led to a relatively rapid deterioration in the investment position under the direct investment sub-item. On the other hand, the economy's external competitiveness began to improve, fostering initially a decline in the trade deficit and later even trade surplus. The economy gradually started to generate relatively large export surpluses, although for many years these were offset on the current account by rising direct investment earnings of non-residents. The Czech Republic's negative investment position therefore widened further, albeit in a less risky manner thanks to the FDI inflows.

Nevertheless, the inflow of new direct investment by non-residents almost halted after the onset of the economic and financial crisis in Europe in 2008. The investments made before the crisis, however, generated high direct investment earnings for non-residents, keeping the current and capital accounts negative for quite some time,[5] and the Czech Republic's negative investment position continued to rise until 2013, when the cumulative deficit reached almost CZK 2 trillion (see Chart 1).

At the end of 2013, however, a major reversal occurred and the negative net investment position dropped by around 40% in absolute terms over the next three years. This was due to a combination of factors, some of them only temporary. They included a big increase in net drawdown of EU funds related to absorption of funds under the 2007–2013 subsidy programme, a sharp decline in energy commodity prices (prices of oil and natural gas on global markets) and a further rise in the trade surplus, due mainly to growth in

[4] The Czech Republic had a positive investment position from when it was established until 1995. This was due to the inclusion of a claim on countries mainly from the former Eastern Bloc, including Slovakia, converted into convertible currency in the Czech Republic's investment position assets. However, the real value of these assets was significantly lower on average. This article therefore uses data adjusted for these specific factors. Nonetheless, the current investment position contains, on the asset side, claims that arose several decades ago whose actual value is very different from the reported one. However, they make up less than 1% of assets.

[5] The life cycle of foreign direct investment as applied to the Czech Republic was examined by Filip Novotný (2015): Profitability Life Cycle of Foreign Direct Investment and its Application to the Czech Republic, CNB WP 11/2015. A summary of his findings was also presented an article in the January 2016 issue of Global Economic Outlook.

machinery exports.[6] At the end of 2016, the Czech Republic's negative investment position was just CZK 1.18 trillion, or 24.6% of GDP. Its net debt currently consists solely of direct investment debt (see Chart 3), which amounts to around CZK 2.5 trillion. This form of debt is far less risky than debt capital.

Turning to the sectoral breakdown of assets and liabilities, the international investment positions of the central bank and the business sector are highly positive. On the other hand, the government and commercial banks have negative positions. A relatively large proportion of the debt of the government and banks and part of the central bank's surplus were generated only in the last two years and are associated with speculation by non-residents on a strengthening of the koruna after the exit from the CNB's exchange rate commitment in an environment of extremely accommodative ECB policy. However, this speculation had no effect on the Czech Republic's net position at the end of 2016.

3 What is the situation in the other EU Member States?

Looking at the investment positions of euro area countries, it should be noted that the overall data do not include individual countries' operations with the ECB, which are not included in the investment position.

Based on their overall investment positions, the EU Member States can be divided into three broad categories: creditor countries, borrower countries and countries which are "approximately in balance". Creditor countries usually have long-term current account surpluses, while borrower countries show long-term current account deficits. However, a majority improvement tendency in the net investment position has been observed in recent years after the worst effects of the economic and financial crisis eased.

The strong creditor countries have long included Belgium, joined, in the last decade, by Germany, the Netherlands, Malta and Denmark (see Chart 2). Their creditor positions are high at around 50% of GDP, and much higher in the case of the Netherlands (almost 70% of GDP). These countries are characterised by high external competitiveness of their goods and services even though their exports are not based on cheap labour. It is apparent from investment position developments in recent years that, with the exception of Belgium, these countries have benefited significantly from the "weak euro" policy ordained by the ECB[7] for

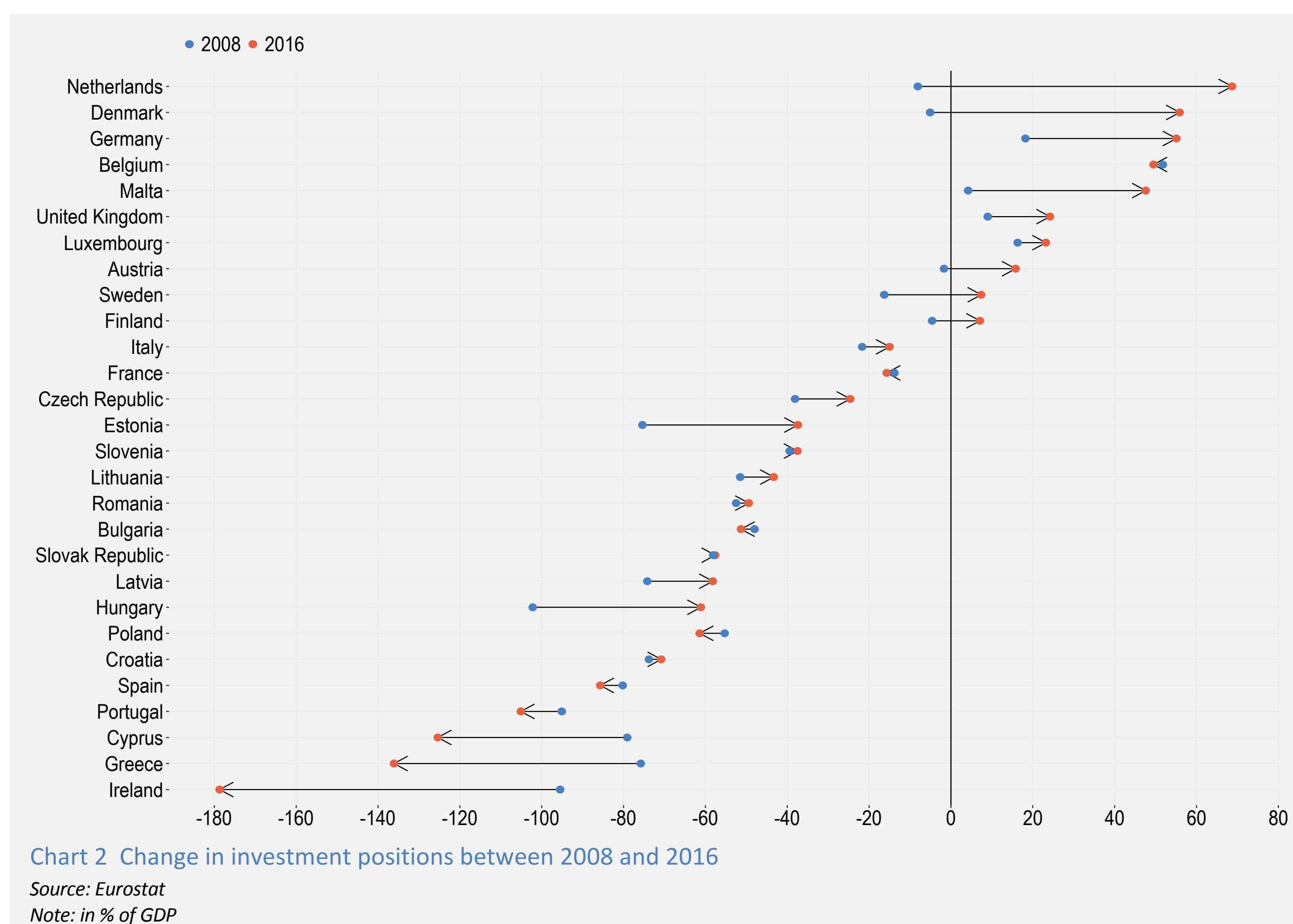


Chart 2 Change in investment positions between 2008 and 2016

Source: Eurostat
Note: in % of GDP

[6] However, the Czech Republic's net investment position would have continued to worsen moderately in the absence of the net inflow of EU capital and the halving of energy commodity prices.

[7] Denmark is not a euro area member, but its currency is essentially fixed to the euro.

the problems of the Southern European countries and naturally, like most countries, from the decline in energy commodity prices. Their investment position surpluses have thus been increasing in recent years. Interestingly, exports of direct investment capital predominate in the Netherlands and Denmark,[8] while Germany and Belgium are mostly exporters of debt capital (see Chart 3).

The second category consists of countries with slight surplus positions of up to 25% of GDP. This includes the small economies of Luxembourg, Austria, Sweden and Finland. Of the large countries, the UK has joined this category as a result of developments there in the last year (a visible sharp improvement in its position and a switch from a slight deficit to a relatively sizeable surplus[9]).

Most EU countries (18 last year) have long had negative investment positions. However, there are large differences between them in terms of a) deficit size, b) deficit structure[10] and c) the current investment position trend (upward, downward, flat). This notwithstanding, the following breakdown of the countries into subcategories may be rather subjective.

A negative investment position consisting mostly of direct investment liabilities can certainly be considered sustainable. Adjusted for the direct investment sub-position, the residual position shows a surplus for countries such as Bulgaria, the Czech Republic and Estonia, and only a slight deficit for Romania and Slovakia. These countries thus do not face external debt financing risks, but are forced to accept a long-term outflow of part of the funds generated in the country via dividends or other forms of capital outflow.

The situation is also relatively comfortable in Italy and France, whose negative investment positions are made up of debt liabilities[11] but whose net debt does not exceed 25% of GDP (net debt currently stands at around 15% in both countries; in Italy, moreover it is showing a significant downward tendency, while in France it is stable). It is thus clear that the two countries' high public debt (over 130% and almost 100% of GDP respectively) is financed predominantly from domestic sources. As Italy currently has a relatively large current account surplus, it is heading towards balancing its position if it can sustain the current trend. The two countries' problem is thus not their external imbalance or the financing thereof, but that it is coming at the cost of very weak growth, high unemployment and generally subdued domestic demand. On top of that, although their high public debt is financed predominantly – as in Japan[12] – from domestic sources, the two countries are euro area members and, unlike Japan, are not guaranteed low interest rates forever.[13]

The situation in Slovenia and Lithuania also seems problem-free, with debt ratios of around 40% of GDP with a gradual downward trend. The case of Slovenia is quite interesting. At the start of the millennium, it was the most advanced of the Central and Eastern European economies joining the European Union. Slovenia's investment position was virtually balanced at that time. Nevertheless, the country was hit hard by a banking sector crisis at the start of the economic and financial crisis and its external debt liabilities surged. Its negative investment position was almost 50% of GDP in 2010. Since then, however, it has decreased to less than 40% of GDP due to a constant current and capital account surplus.

The third category contains countries with relatively high negative investment positions of 50%–85% of GDP. These are countries of Central and Eastern Europe (Latvia, Hungary, Poland and Croatia). Spain can also be included given its relatively favourable trend over the last three years. The relatively high negative investment positions of all these countries have been reduced at various rates in recent years by current and capital account surpluses. This lowers the risk of future adverse developments. Note, however, that this is going on in an environment of a) extremely accommodative ECB monetary policy, which is temporarily reducing debt financing costs (including, partially, for non-EU area countries), b) very low energy commodity prices on global markets, as all the above countries are net importers of such commodities, and c) a relatively high surplus of transfers vis-à-vis the EU, which is very likely to drop significantly for all these countries post-2020. Of the countries mentioned above, Hungary, which has reduced its negative investment position from around 100% of GDP by more than one-third over the last eight years, is heading the most strongly towards a sustainable external balance path.

The last and most risky category consists of countries whose investment position deficit exceeds 100% of GDP. Not surprisingly, this category contains the countries that were hit hardest by the economic and financial crisis (Portugal with a deficit of around 100% of GDP, Greece and Cyprus with deficits of around 130% of GDP, and Ireland, whose net investment position deficit exceeded a record 200% of GDP in

[8] The position of the Netherlands may also be affected by the fact that it is a tax haven. It is the domicile of multinational firms that collect dividends (which improve the current account), part of which are provided as direct investment to subsidiaries as exports of capital.

[9] The 2016 data are still subject to revisions. The abrupt change in the UK's net investment position of almost 30 percentage points is difficult to explain from the economic point of view.

[10] There is a big difference between a liability in the form of direct investment or equity, and debt financing.

[11] This is probably related predominantly to the high public debt levels of both countries.

[12] The share of domestic public debt financing is even higher in Japan.

[13] Contrary to expectations, the presented investment position data are also probably relatively positive because the bonds of these countries purchased by the ECB are not included in their debtor positions.

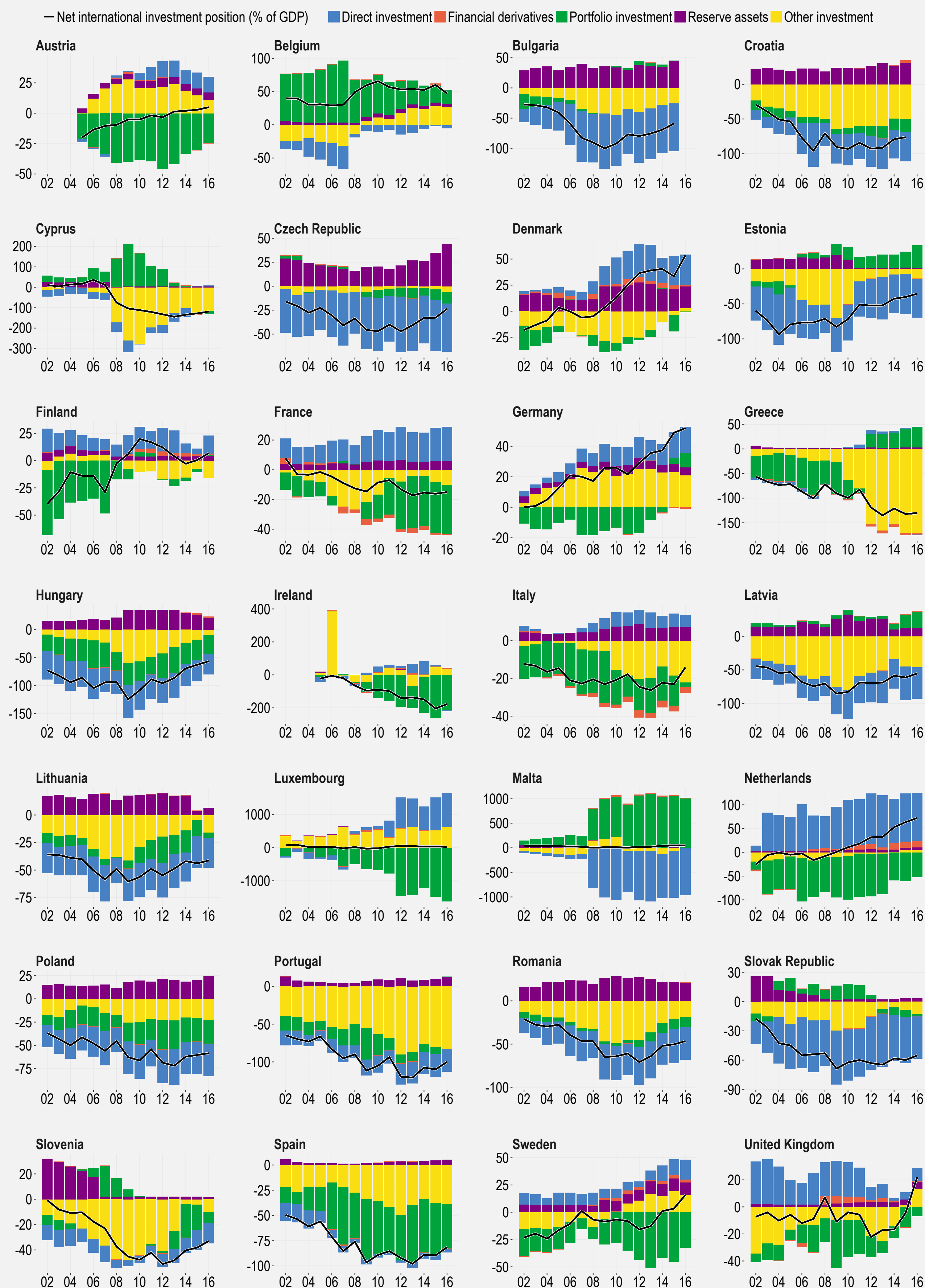


Chart 3 Comparison of the investment position structures of EU countries

Source: IMF, EIU

2015[14]). Only Portugal has shown a clear downward trend in its negative position in recent years. All four countries are thus very sensitive to changes in debt capital flows and remuneration, which may be triggered by economic or political problems occurring outside these countries.

4 Conclusion

The international investment position is the most aggregate external balance indicator and additionally reflects a country's long-term trends.

The Czech Republic has long had a negative investment position. However, it is not at risk of external imbalance. This is due on the one hand to the structure of its investment position, as its net negative position is solely a result of a negative direct investment position, and on the other hand to the current trend in its investment position (its negative position has decreased by more than one-third over the last three years). Adjusted for the direct investment position, the Czech Republic's net investment position is in surplus to the tune of more than 25% of GDP.

Countries with negative investment positions strongly predominate among the EU Member States. This by no means implies, however, that all these "indebted" countries are at significant risk. Those which have significant negative positions and which may be very sensitive to even small changes in, for example, interest rates or commodity prices on global markets or growth in risk aversion, include, not surprisingly, the countries that were hit hardest by the recent economic and financial crisis and, to a lesser extent, certain Central and Eastern European countries which in the past made too much use of debt financing in order to temporarily boost domestic consumption.

[14] It then dropped by almost 25 percentage points, but the same may apply to this figure as to that for the UK.

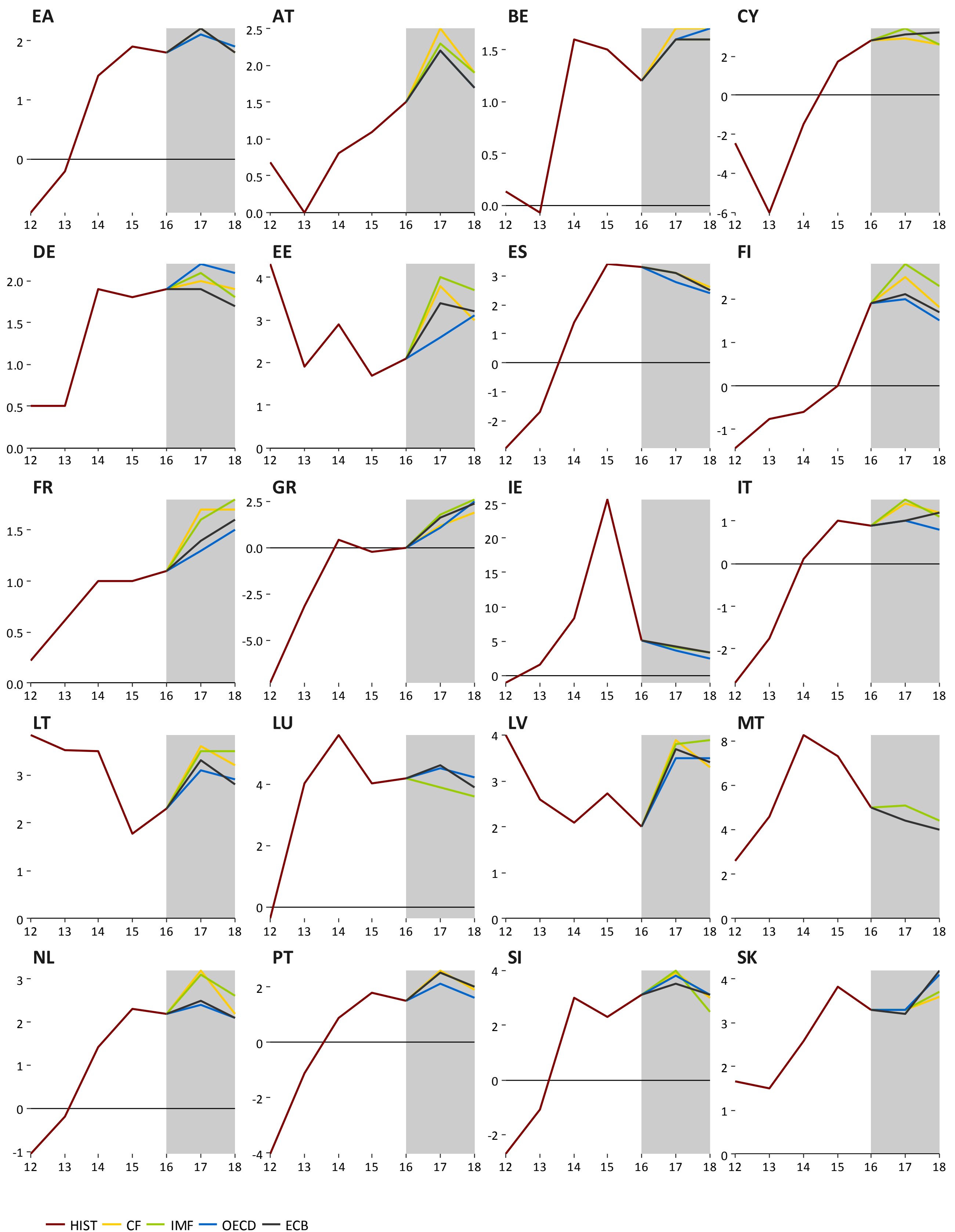
A1. Change in GDP predictions for 2017

	CF		IMF		OECD		CB / EIU	
EA	+0.1	2017/10 2017/9	+0.2	2017/10 2017/7	+0.3	2017/9 2017/6	+0.3	2017/9 2017/6
DE	+0.1	2017/10 2017/9	+0.3	2017/10 2017/7	+0.2	2017/9 2017/6	+0.1	2017/6 2016/12
US	0	2017/10 2017/9	+0.1	2017/10 2017/7	0	2017/9 2017/6	+0.2	2017/9 2017/6
UK	0	2017/10 2017/9	0	2017/10 2017/7	0	2017/9 2017/6	-0.2	2017/8 2017/5
JP	0	2017/10 2017/9	+0.2	2017/10 2017/7	+0.2	2017/9 2017/6	+0.2	2017/7 2017/4
CN	+0.1	2017/10 2017/9	+0.1	2017/10 2017/7	+0.2	2017/9 2017/6	0	2017/9 2017/8
IN	-0.2	2017/10 2017/9	-0.5	2017/10 2017/7	-0.6	2017/9 2017/6	-0.2	2017/8 2017/8
RU	+0.2	2017/9 2017/8	+0.4	2017/10 2017/7	+0.6	2017/9 2017/6	0	2017/9 2017/7
BR	+0.3	2017/9 2017/8	+0.4	2017/10 2017/7	-0.1	2017/9 2017/6	+0.5	2017/9 2017/8

A2. Change in inflation predictions for 2017

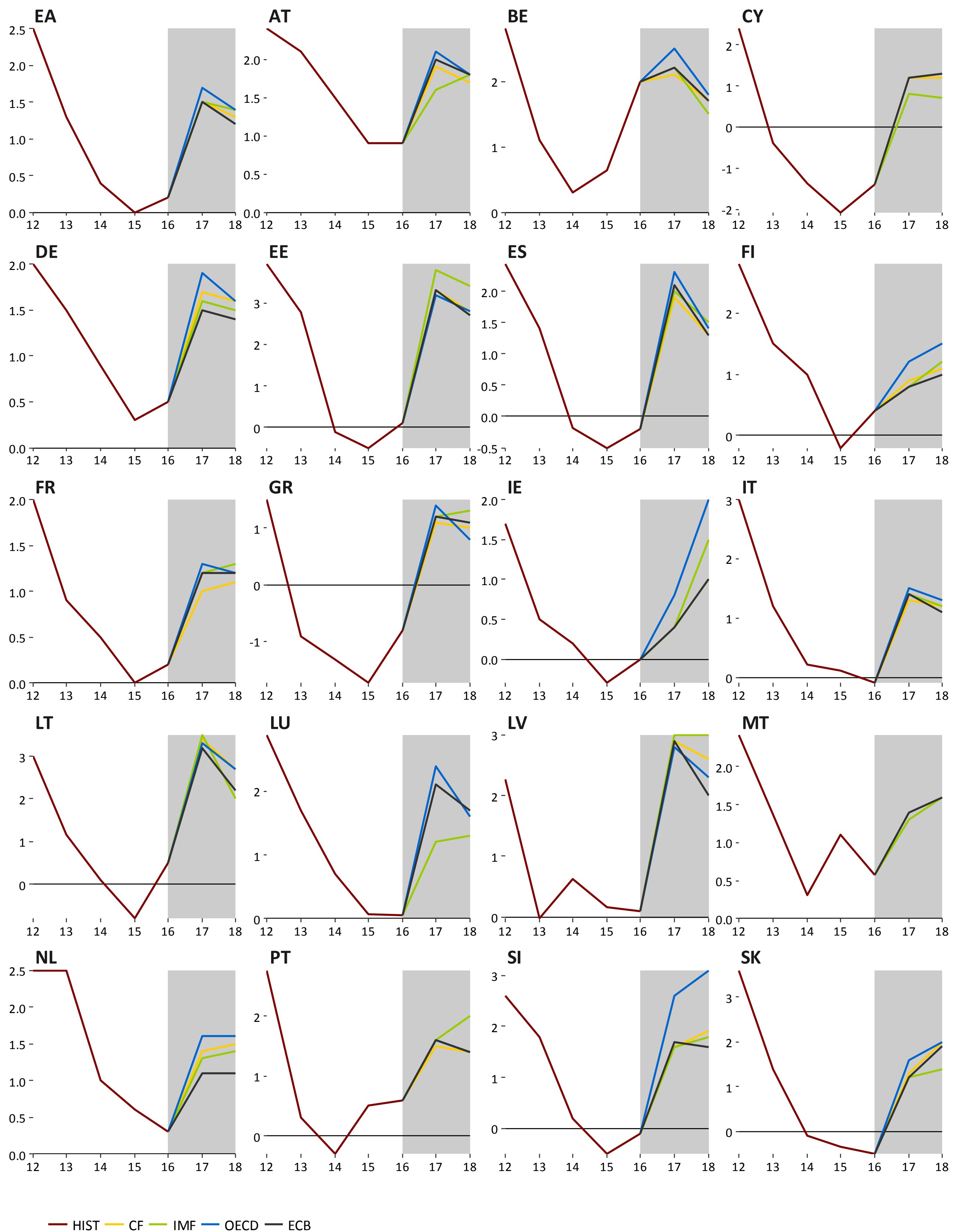
	CF		IMF		OECD		CB / EIU	
EA	0	2017/10 2017/9	-0.2	2017/10 2017/4	+0.5	2017/6 2016/11	0	2017/9 2017/6
DE	0	2017/10 2017/9	-0.4	2017/10 2017/4	+0.5	2017/6 2016/11	+0.1	2017/6 2016/12
US	0	2017/10 2017/9	-0.6	2017/10 2017/4	+0.6	2017/6 2016/11	0	2017/9 2017/6
UK	0	2017/10 2017/9	+0.1	2017/10 2017/4	+0.4	2017/6 2016/11	0	2017/8 2017/5
JP	-0.1	2017/10 2017/9	-0.6	2017/10 2017/4	+0.3	2017/6 2016/11	-0.3	2017/7 2017/4
CN	-0.1	2017/10 2017/9	-0.6	2017/10 2017/4	-0.7	2017/6 2016/11	-0.3	2017/9 2017/8
IN	0	2017/10 2017/9	-1.0	2017/10 2017/4	-0.4	2017/6 2016/11	0	2017/8 2017/8
RU	-0.3	2017/9 2017/8	-0.3	2017/10 2017/4	-1.7	2017/6 2016/11	0	2017/9 2017/7
BR	-0.3	2017/9 2017/8	-0.7	2017/10 2017/4	-1.8	2017/6 2016/11	-0.2	2017/9 2017/8

A3. GDP growth in the euro area countries



Note: The chart shows institutions' latest available outlooks of for the given country (in %).

A4. Inflation in the euro area countries



Note: The chart shows institutions' latest available outlooks of for the given country (in %).

A5. List of abbreviations

AT	Austria
bbl	barrel
BE	Belgium
BoE	Bank of England
BoJ	Bank of Japan
bp	basis point (one hundredth of a percentage point)
BR	Brazil
BRIC	countries of Brazil, Russia, India and China
BRL	Brazilian real
CB	central bank
CB-CCI	Conference Board Consumer Confidence Index
CB-LEII	Conference Board Leading Economic Indicator Index
CBR	Central Bank of Russia
CF	Consensus Forecasts
CN	China
CNB	Czech National Bank
CNY	Chinese renminbi
CY	Cyprus
DBB	Deutsche Bundesbank
DE	Germany
EA	euro area
ECB	European Central Bank
EC-CCI	European Commission Consumer Confidence Indicator
EC-ICI	European Commission Industrial Confidence Indicator
EE	Estonia
EIA	Energy Information Administration
EIU	Economist Intelligence Unit
ES	Spain
EU	European Union
EUR	euro
EURIBOR	Euro Interbank Offered Rate
Fed	Federal Reserve System (the US central bank)
FI	Finland
FOMC	Federal Open Market Committee
FR	France
FRA	forward rate agreement
FY	fiscal year
GBP	pound sterling
GDP	gross domestic product
GR	Greece
ICE	Intercontinental Exchange
IE	Ireland
IEA	International Energy Agency
IMF	International Monetary Fund
IN	India
INR	Indian rupee
IRS	Interest Rate swap
ISM	Institute for Supply Management
IT	Italy
JP	Japan
JPY	Japanese yen
LIBOR	London Interbank Offered Rate
LME	London Metal Exchange
LT	Lithuania
LU	Luxembourg
LV	Latvia
MT	Malta
NL	Netherlands
OECD	Organisation for Economic Co-operation and Development
OECD-CLI	OECD Composite Leading Indicator
PMI	Purchasing Managers' Index
pp	percentage point
PT	Portugal
QE	quantitative easing
RU	Russia
RUB	Russian rouble
SI	Slovenia
SK	Slovakia
TLTRO	targeted longer-term refinancing operations
UK	United Kingdom
UoM-CSI	University of Michigan Consumer Sentiment Index
US	United States
USD	US dollar
USDA	United States Department of Agriculture
WEO	World Economic Outlook
WTI	West Texas Intermediate (crude oil used as a benchmark in oil pricing)
ZEW-ES	ZEW Economic Sentiment