GLOBAL ECONOMIC OUTLOOK - DECEMBER

2017

Monetary Department
External Economic Relations Division

CZECH NATIONAL BANK

Cut-off date for data
8 December 2017

CF survey date
4 December 2017

GEO publication date
15 December 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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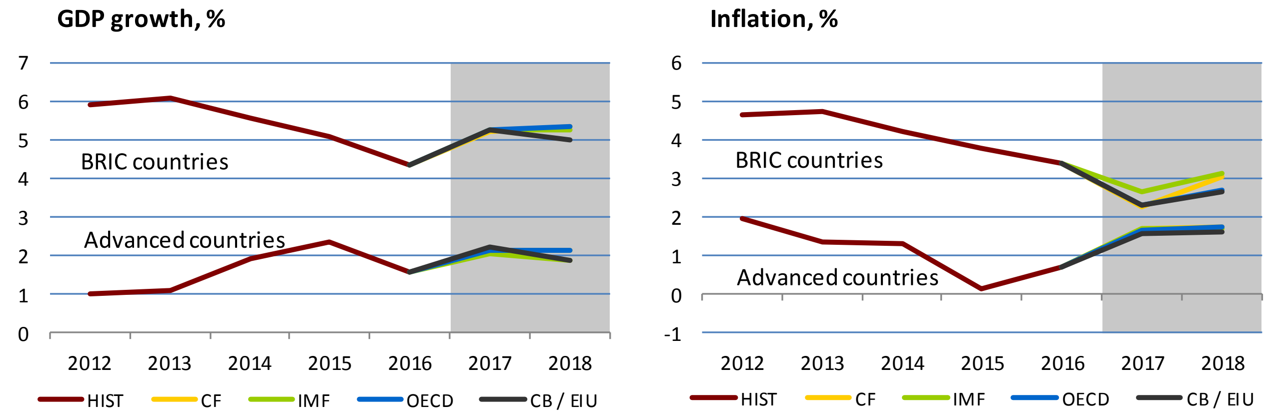
This year's final issue of Global Economic Outlook presents the regular monthly overview of recent and expected developments in selected territories, focusing on key economic variables: inflation, GDP growth, leading indicators, interest rates, exchange rates and commodity prices. In this issue, we also focus on direct investment dividends from the perspective of EU countries' balances of payments. Besides taking an aggregate view of the balance, we look at the debit side, with an emphasis on outflows of dividends arising from foreign direct investment.

This year has been more favourable than last year for the advanced countries we monitor, and especially for the USA, the euro area and Germany. Economic growth has been higher and inflation rates have gradually neared the notional 2% ideal. The exception is the UK, where growth has steadily weakened and inflation has been visibly above the Bank of England's target. The outlooks for 2018 indicate that the US economy will continue to record robust growth (of 2.5%). The euro area will also show solid growth (of 2.1%), even though two of its largest economies – France and Italy – are at the bottom of the euro area growth rankings. In addition, inflation in the euro area will remain subdued in 2018, reaching just 1.4% despite the extension of the ECB's quantitative easing programme. Again, the inflation outlooks for France and Italy lie below the euro area average. As usual, Japan will record the lowest inflation, approaching 1% from below.

This year has also seen favourable trends in major emerging economies, trends which will continue into the future. China and especially India are still showing robust growth, although the growth of the Chinese economy has been gradually weakening for several years now. India has seen a similar trend, but its economic growth is expected to increase towards 7.5% again in 2018. Both economies are expected to record stable inflation. A figure of 2% is forecasted for China, while a higher level (of around 4.5%) is projected for India, although this is consistent with its high pace of economic growth. The two other BRIC economies, Russia and Brazil, have performed considerably better this year. Both economies have emerged from the recessions they were suffering from, albeit for different reasons. In 2018, they are expected to record similar growth rates close to 2% (Russia) or slightly above that level (Brazil) at rates of inflation of around 4%.

The outlooks for euro area short-term interest rates declined slightly following the ECB's recent decision to ease monetary policy further. An increase in US interest rates can be expected at the Fed's next meeting in December. According to CF, the dollar will depreciate against the euro and to a lesser extent against the yen, the rupee and the pound at the one-year horizon. By contrast, it will appreciate slightly against the rupee, the real and the renminbi. The outlook for the average Brent crude oil price in 2018 increased to around USD 58/bbl and is slightly falling. Prices of non-energy commodities are expected to rise slightly over the coming 12 months, due mainly to expected growth in prices of some food commodities (wheat, corn, coffee and pork).

GDP growth and inflation development and outlook in monitored countries



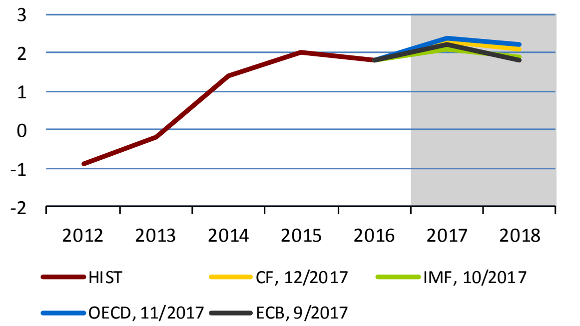
Note: The figures represent the weighted averages of historical series / outlooks in individual countries. The weights are based on nominal GDP measured in USD during 2011–2015 (source: EIU). Advanced countries: euro area, United States, United Kingdom, Japan. BRIC countries: China, India, Russia, Brazil.

II.1 Euro area

The euro area economy continued to recover robustly across countries and sectors in 2017 Q3. Quarterly GDP growth – again driven mainly by domestic demand – slowed slightly to 0.6%. The annual rate of growth, by contrast, rose to 2.6%. The incoming data from the economy suggest continued solid growth at the year-end. The November PMI in manufacturing, for example, rose to its highest level since April 2000 (60.1), reflecting growing production and new orders supporting job creation. The unemployment rate fell to 8.8% in October. However, the labour market recovery has yet to lead to stronger wage growth, which was flat at 2% year on year in Q3. The monitored outlooks expect GDP growth of 2.1%–2.4% in 2017 as a whole (the highest post-crisis level), slowing to about 2% next year.

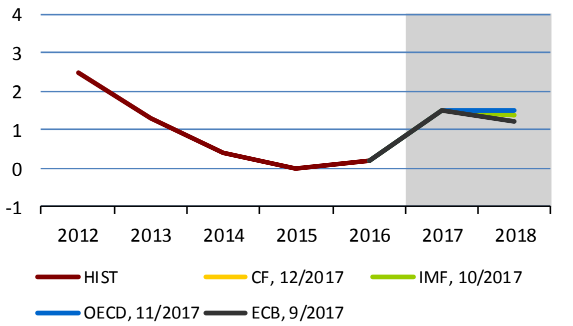
Inflation in the euro area remains subdued despite the solid pace of recovery. Headline HICP inflation went up slightly to 1.5% in November due to a rise in fuel prices in October and November. However, core inflation remains below 1% and its components have yet to indicate any major inflationary pressures from the real economy. The individual components of producer prices suggest no such pressures either – prices of consumer goods excluding food, for example, rose by just 0.2% in October. Overall, inflation is expected to reach 1.5% this year and drop next year due to a lower expected contribution of energy prices. The ECB's monetary policy will thus remain highly accommodative due to the low inflation outlook. According to the ECB's October statement, asset purchases will continue until September 2018 (at a lowered monthly pace of EUR 30 billion) and rates will remain at the current level for significantly longer. The markets expect the first increase in monetary policy rates to come in mid-2019. Ten-year German bond yields fell slightly compared to the previous issue of GEO, and their outlook is also rather lower.

GDP growth, %



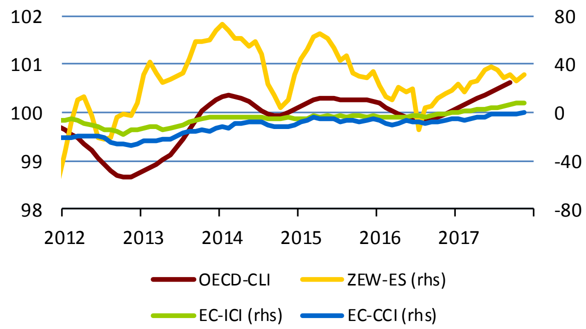
	CF	IMF	OECD	ECB
2017	2.3	2.1	2.4	2.2
2018	2.1	1.9	2.2	1.8

Inflation, %



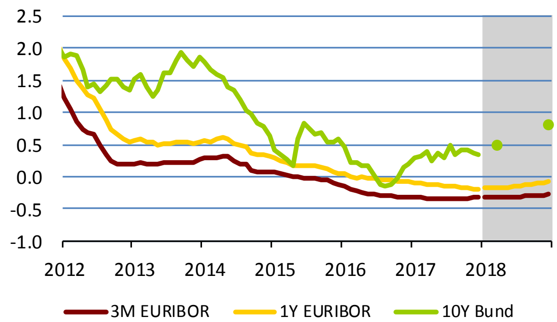
	CF	IMF	OECD	ECB
2017	1.5	1.5	1.5	1.5
2018	1.4	1.4	1.5	1.2

Leading indicators



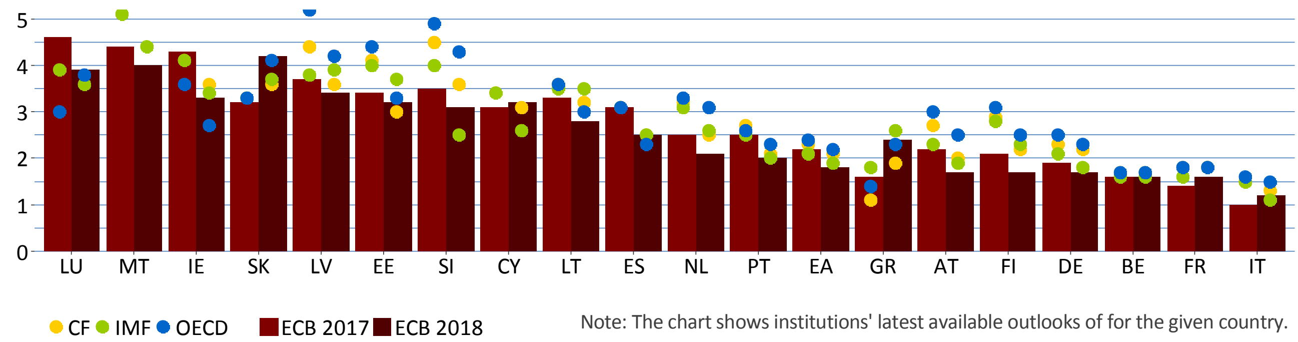
	OECD-CLI	ZEW-ES	EC-ICI	EC-CCI
9/17	100.6	31.7	6.7	-1.2
10/17		26.7	8.0	-1.1
11/17		30.9	8.2	0.1

Interest Rates, %

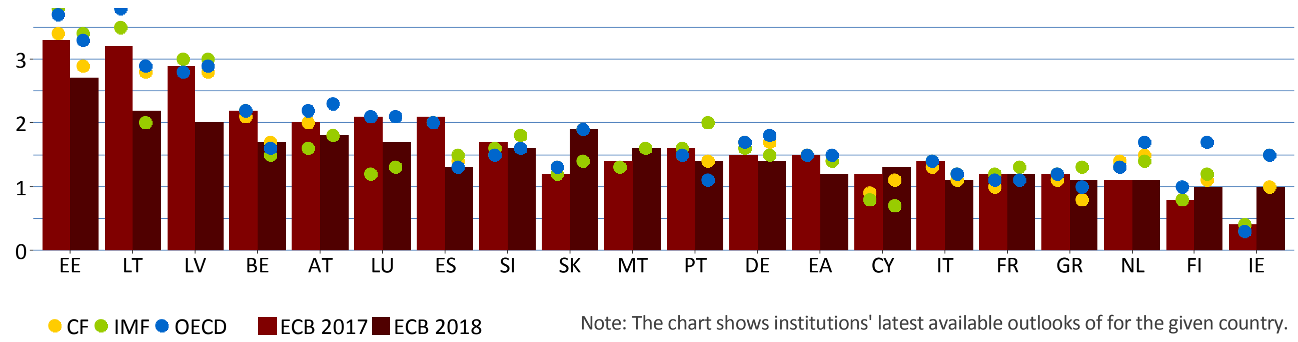


	11/17	12/17	03/18	12/18
3M EURIBOR	-0.33	-0.33	-0.31	-0.27
1Y EURIBOR	-0.19	-0.19	-0.18	-0.06
10Y Bund	0.37	0.36	0.50	0.80

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



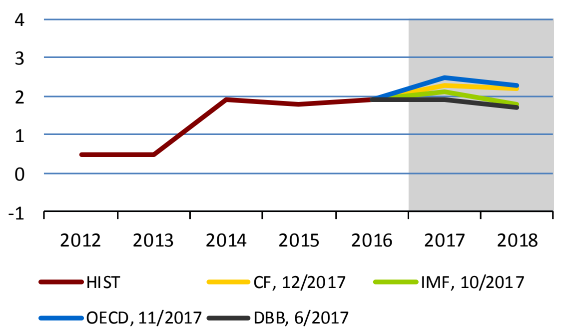
Inflation outlooks in the euro area countries in 2017 and 2018, %



II.2 Germany

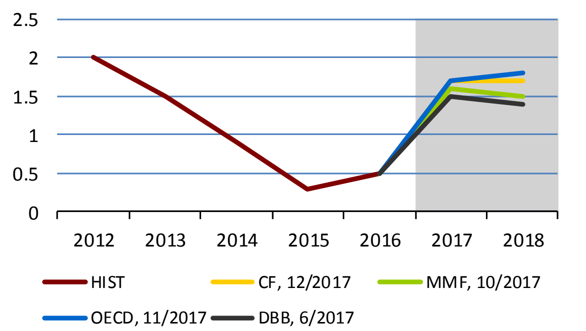
Strong growth of the German economy in Q3 (2.8% y-o-y, 0.8% m-o-m.), driven by exports and investment, led to an increase in the growth outlooks for both this year and the next (CF, OECD). The growth is expected to accelerate slightly further in Q4. The PMI leading indicator in manufacturing stayed high in November, and the other leading indicators also remained favourable. The unemployment rate fell slightly further to 5.3% in November. By contrast, wage growth is very subdued. Hourly labour costs rose by just 2.2% year on year in Q3, indicating no significant growth in cost pressures from the labour market as yet. According to a flash estimate, annual consumer price inflation was 1.8% in November, slightly higher than in the previous month. The monitored institutions continue to expect prices to rise only moderately.

GDP growth, %



	CF	IMF	OECD	DBB
2017	2.3	2.1	2.5	1.9
2018	2.2	1.8	2.3	1.7

Inflation, %



	CF	IMF	OECD	DBB
2017	1.7	1.6	1.7	1.5
2018	1.7	1.5	1.8	1.4

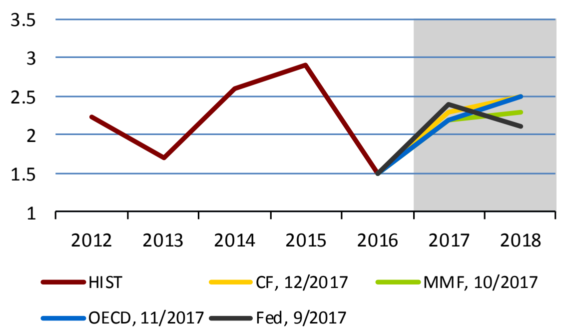
II.3 United States

The US economy grew by more than 3% for the second consecutive quarter. According to the second estimate, quarterly annualised GDP growth reached 3.3% in 2017 Q3, the highest level in three years despite the negative impact of hurricanes. Lower household consumption growth (2.3%) was offset by an upward revision of inventories and equipment spending by firms, with total corporate investment rising by 4.7% (in quarter-on-quarter annualised terms). According to the short-term forecast issued by the New York Fed, the positive effect of investment activity in the USA will continue into Q4, when the economy is again expected to grow by more than 3%.

The continuing expansion in industry is putting upward pressure on producer price inflation, which rose to 2.8% year on year in October, amid growing capacity utilisation (77%). Capacity constraints then fostered a slight drop in the PMI leading indicators (both Markit and ISM) in November, according to the panellists. However, new orders – both domestic and foreign – were assessed positively, while prices continue to rise in all production segments. Labour market conditions remain favourable, with unemployment staying at a very low level of 4.1% in November. Non-farm payrolls rose by 228,000 in October (as against an expected 195,000). However, year-on-year growth in the average hourly wage (2.5%) is still lagging behind, so no marked increase in inflation pressures can be expected. Core inflation rose in October (to 1.7%) for the first time since the start of this year, with most of its components recording growth. By contrast, annual headline inflation slowed due to a drop in energy prices.

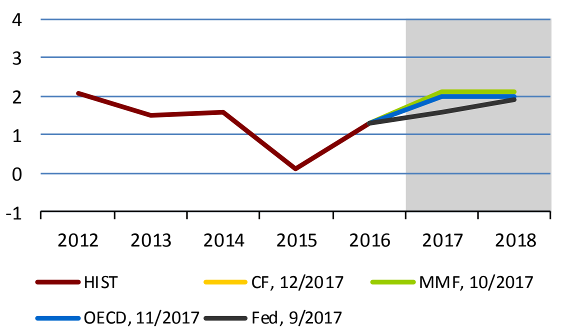
The positive labour market developments favourably affected consumer sentiment, which improved further in November according to the Conference Board survey. In particular, consumers' confidence regarding employment and inflation increased. The December CF revised upwards only the growth outlook for this year, whereas the OECD expects higher growth and lower inflation in both years. The unclear impacts of the tax reform pushed through the Senate by President Trump in early December are a new risk to the outlook. Its definitive form will still be affected by negotiations in both chambers of Congress, but the reform can be expected to substantially reduce the tax burden on firms and simplify the tax system for individuals.

GDP growth, %



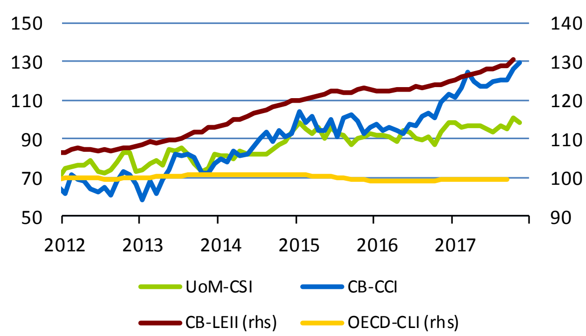
	CF	IMF	OECD	Fed
2017	2.3	2.2	2.2	2.4
2018	2.5	2.3	2.5	2.1

Inflation, %



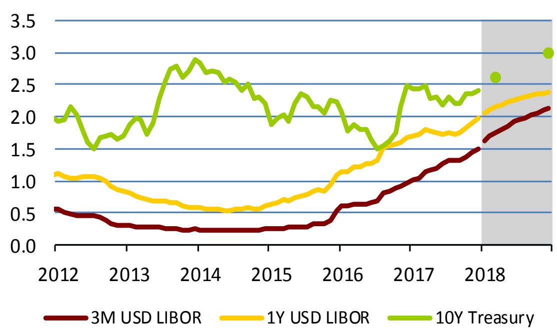
	CF	IMF	OECD	Fed
2017	2.1	2.1	2.0	1.6
2018	2.1	2.1	2.0	1.9

Leading indicators



	UoM-CSI	CB-CCI	CB-LEII	OECD-CLI
9/17	95.1	120.6	128.9	99.8
10/17	100.7	126.2	130.4	
11/17	98.5	129.5		

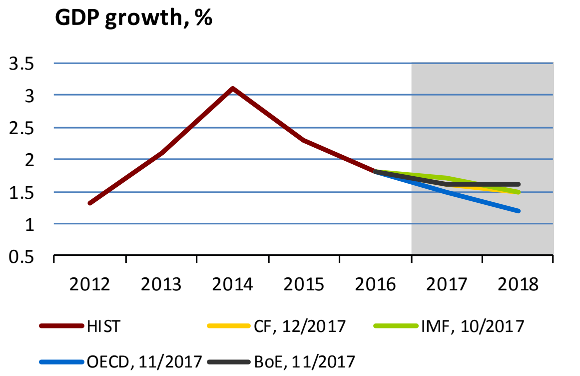
Interest Rates, %



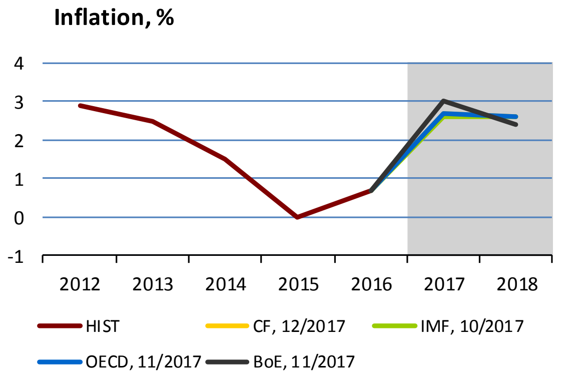
	11/17	12/17	03/18	12/18
USD LIBOR 3M	1.43	1.51	1.74	2.12
USD LIBOR 1R	1.90	1.90	2.15	2.38
Treasury 10R	2.36	2.40	2.60	3.00

II.4 United Kingdom

Economic growth in the UK continues to lag behind most other advanced economies. The second estimate of GDP growth in Q3 confirmed the preliminary figures. The UK economy is growing at the slowest year-on-year rate in four and a half years, due mainly to subdued investment growth. By contrast, annual growth in industrial production and construction output has been rising since April. Although the October month-on-month data are indicating a halt in this trend, the leading PMI indicator for both sectors increased in November. The slowdown is thus likely to be only temporary. However, UK GDP is driven more by the service sector, whose PMI decreased. Consumer confidence remains very low. Household debt is high and, despite very low unemployment, household income is continuing to fall in real terms due to higher inflation. Economic growth at the end of the year is thus expected to be roughly the same as in Q3 or only slightly higher. As a result, CF slightly revised its outlooks.



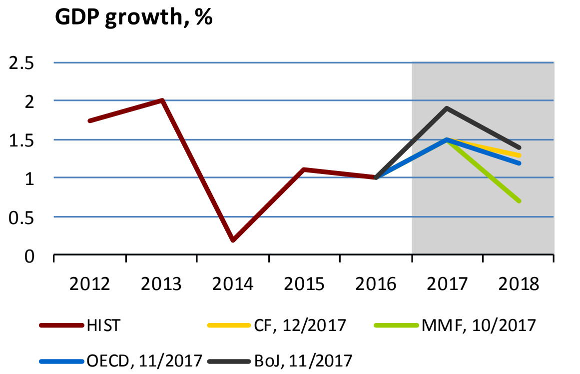
	CF	IMF	OECD	BoE
2017	1.6	1.7	1.5	1.6
2018	1.5	1.5	1.2	1.6



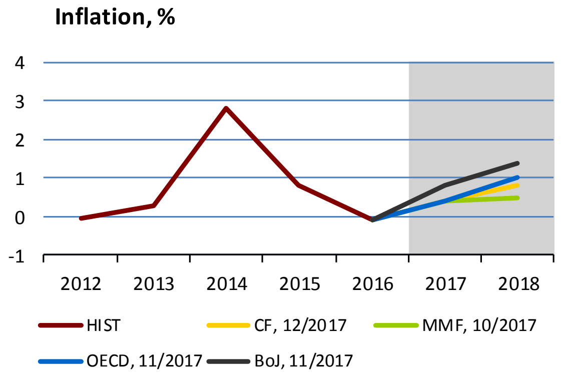
	CF	IMF	OECD	BoE
2017	2.7	2.6	2.7	3.0
2018	2.6	2.6	2.6	2.4

II.5 Japan

The Japanese economy grew by 2.5% (in quarter-on-quarter annualised terms) in Q3, i.e. at the same pace as in the previous quarter. The growth was driven by net exports and investment. By contrast, private consumption made a negative contribution to the growth. CF and the OECD expect the Japanese economy to grow by 1.5% this year and slow slightly the following year. Industrial output growth rose to 5.9% year on year in October, mainly on the back of growth in mining and manufacture of tools and furniture. The PMI in manufacturing went up to 53.6 points in November. According to purchasing managers, this was due to faster growth in all the monitored components. Annual inflation fell to 0.2% in October due to flat growth in transport prices, a continued drop in housing prices and a fall in prices of food, especially fresh food. Predictions suggest that inflation will stay below 1% in 2018, but will rise slightly compared to 2017.



	CF	IMF	OECD	BoJ
2017	1.5	1.5	1.5	1.9
2018	1.3	0.7	1.2	1.4

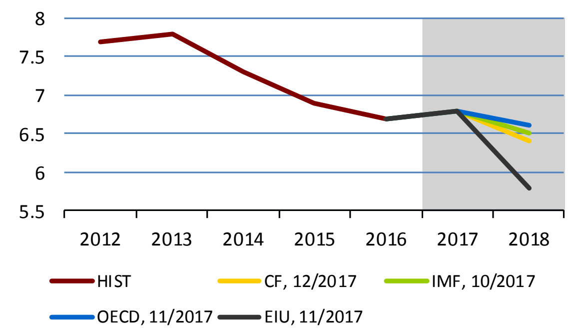


	CF	IMF	OECD	BoJ
2017	0.4	0.4	0.4	0.8
2018	0.8	0.5	1.0	1.4

III.1 China

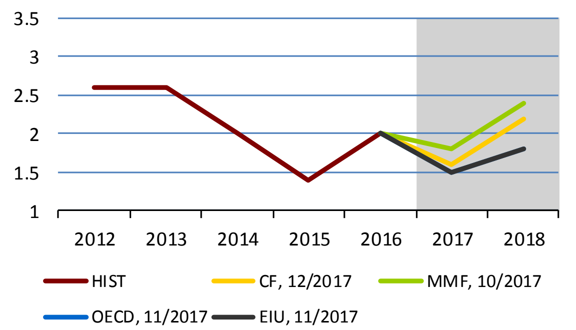
The Chinese economy could slow further in year-on-year terms in 2017 Q4 due to the government's continued efforts to close down inefficient factories and mines, reduce excess capacity and cut pollution in cities. These actions were reflected in a drop in industrial production growth, with mining even recording a year-on-year decline in October. The leading PMI indicator went down again in November, mainly because of lower orders and worse business confidence. Retail sales growth also slowed further in October, whereas annual consumer price inflation rose further to 1.9%. The new CF and OECD forecasts brought no revisions to the GDP growth outlook, but the inflation outlook saw changes. The new CF expects higher inflation in 2018, while the OECD lowered its outlook.

GDP growth, %



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

Inflation, %

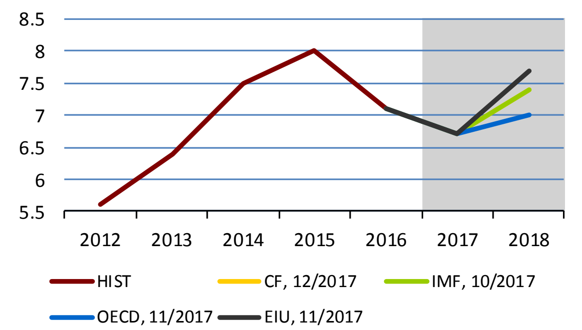


	CF	IMF	OECD	EIU
2017	1.6	1.8	1.5	1.5
2018	2.2	2.4	1.8	1.8

III.2 India

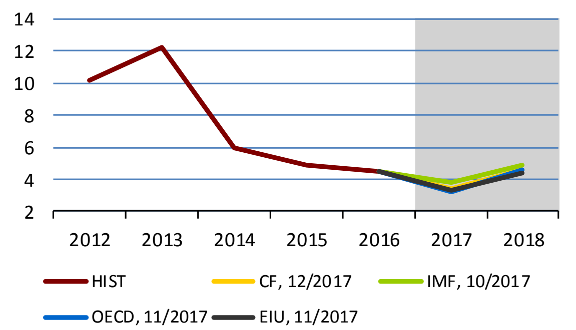
The Indian economy rose by 6.3% in the second quarter of fiscal year 2017/2018, accelerating by 0.6 pp compared to the previous quarter. This was due to higher growth in investment and inventories. By contrast, household consumption slowed further and government expenditure growth also fell significantly. The monitored institutions expect the Indian economy to grow by 6.7% this fiscal year and accelerate above 7% the next. Moody's raised its India rating for the first time in almost 14 years. The increase by one notch (to Baa2) with a stable outlook is due to implemented economic and institutional changes supporting the country's growth potential. Inflation increased to 3.6% in October, driven by accelerating growth in food and fuel prices. The RBI left its policy rate at 6% at its December meeting. Like other institutions, it expects inflation to stay in the target range.

GDP growth, %



	CF	IMF	OECD	EIU
2017	6.7	6.7	6.7	6.7
2018	7.4	7.4	7.0	7.7

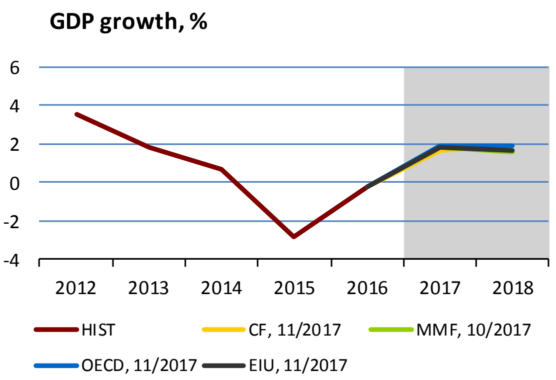
Inflation, %



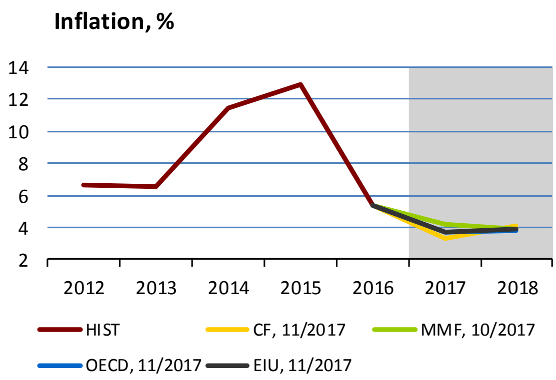
	CF	IMF	OECD	EIU
2017	3.4	3.8	3.2	3.3
2018	4.6	4.9	4.6	4.4

III.3 Russia

GDP growth slowed from 2.5% to 1.8% year on year in Q3, and the latest short-term Russian macroeconomic indicators brought mixed news this time. Industrial production increased in October at a rate of 5.7% year on year, but recorded zero growth in month-on-month terms. The stronger month-on-month output growth fed through to the November PMI in manufacturing, fostering overall growth (to 51.5) despite rising costs and inflation. The PMI in services reached a nine-month high (57.4). On the other hand, unemployment went up rose slightly in October. Wage growth slowed a little, but significantly exceeded expectations (partly because of a further slowdown in consumer price inflation). However, real disposable income declined. According to the new outlooks, overall economic growth will stay below 2% next year, while consumer prices will rise by about 4%.



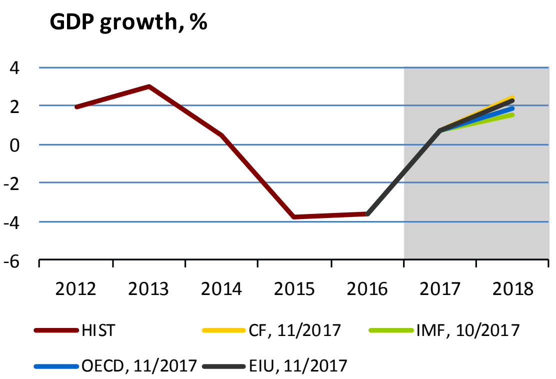
	CF		IMF	OECD		EIU
2017	1.7	→	1.8	1.9	↘	1.8
2018	1.9	↗	1.6	1.9	↘	1.7



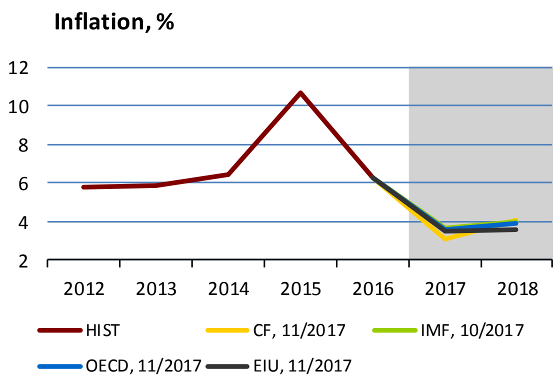
	CF		IMF	OECD		EIU
2017	3.3	↘	4.2	3.7	↘	3.7
2018	4.1	→	3.9	3.8	↘	3.9

III.4 Brazil

The Brazilian economy slowed significantly for the second consecutive quarter. Annual GDP growth was just 0.1% in Q3. Moreover, the slowdown was intensified by a revision of the Q2 GDP growth figure from 0.4% to 0.7%. Inflation is expected to return to an upward trend, but the acceleration is only slight for now – inflation stood at 2.8% in November, lagging slightly behind expectations. As expected, the Brazilian central bank cut its policy rate again in early December to a historical low of 7%. Despite the current sluggish growth, the new outlooks expect the economy to accelerate to 1.9%–2.4% next year. Inflation is expected to fluctuate around 4%.



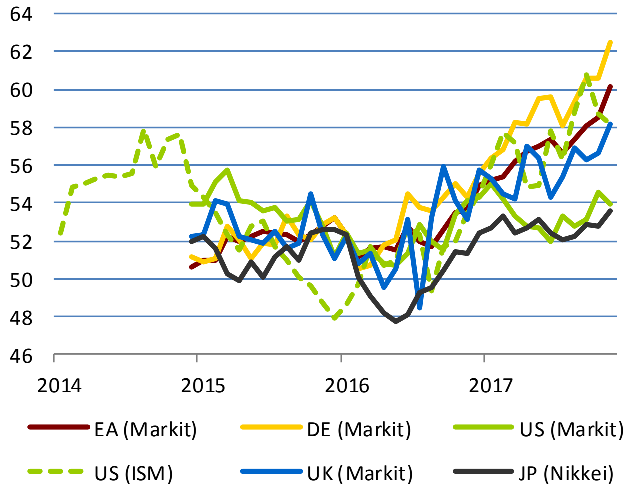
	CF		IMF	OECD		EIU
2017	0.7	↘	0.7	0.7	↗	0.7
2018	2.4	→	1.5	1.9	↗	2.3



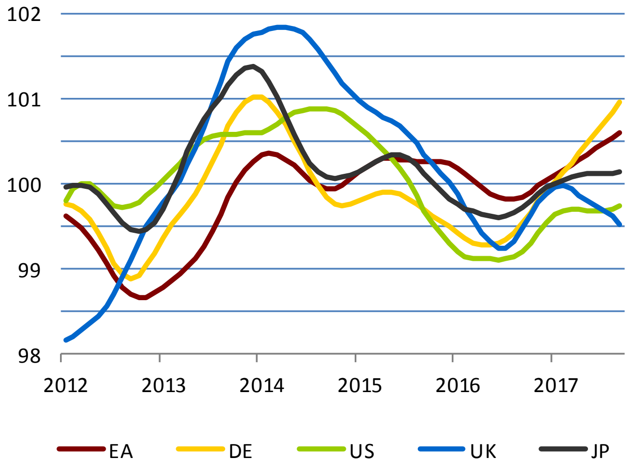
	CF		IMF	OECD		EIU
2017	3.1	→	3.7	3.6	↘	3.5
2018	4.1	↗	4.0	3.9	↘	3.6

IV.1 Advanced economies

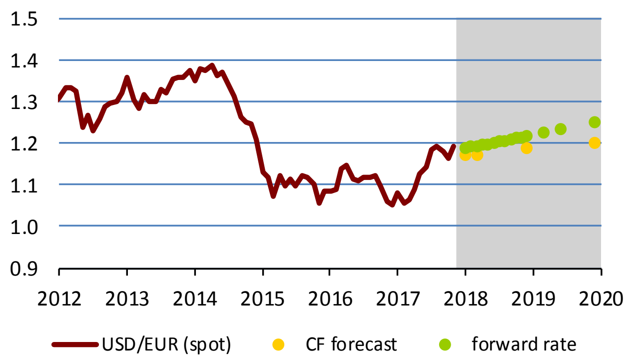
PMI in manufacturing



OECD Composite Leading Indicator

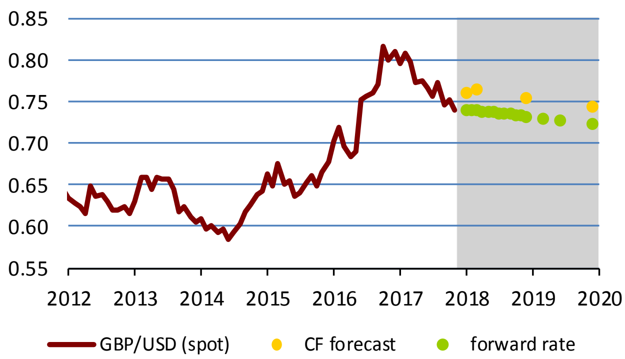


The US dollar (USD/EUR)



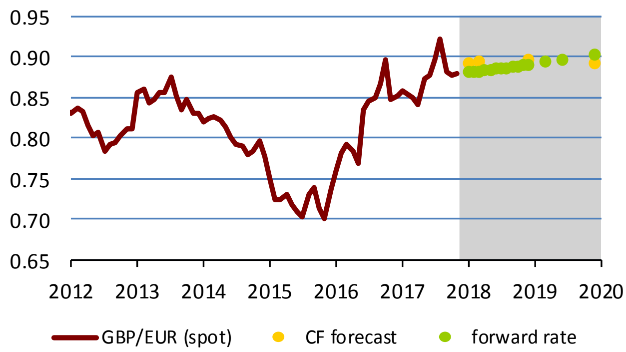
	4/12/17	01/18	03/18	12/18	12/19
spot rate	1.185				
CF forecast		1.173	1.172	1.190	1.202
forward rate		1.190	1.194	1.216	1.250

The British pound (GBP/USD)



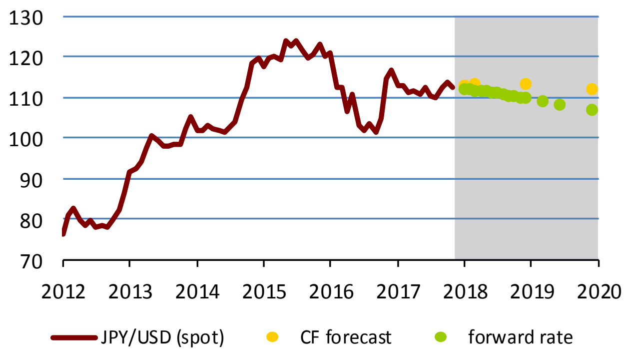
	4/12/17	01/18	03/18	12/18	12/19
spot rate	0.742				
CF forecast		0.760	0.764	0.754	0.743
forward rate		0.741	0.739	0.732	0.723

The British pound (GBP/EUR)



	4/12/17	01/18	03/18	12/18	12/19
spot rate	0.879				
CF forecast		0.891	0.895	0.897	0.893
forward rate		0.881	0.883	0.891	0.903

The Japanese yen (JPY/USD)

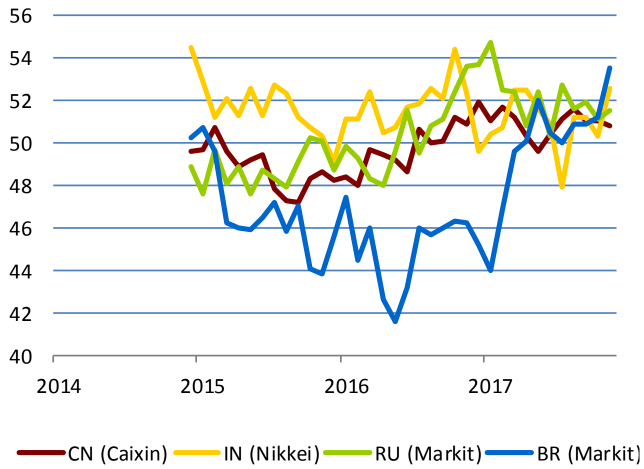


	4/12/17	01/18	03/18	12/18	12/19
spot rate	112.7				
CF forecast		113.1	113.5	113.2	112.1
forward rate		112.2	111.8	109.9	107.0

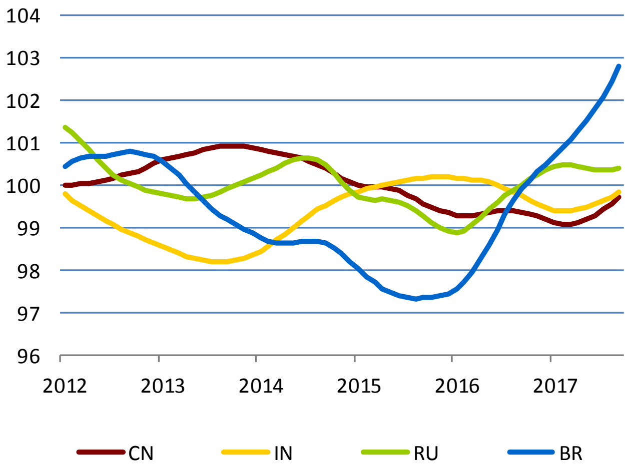
Note: Exchange rates as of last day of month. Forward rate does not represent outlook; it is based on covered interest parity, i.e. currency of country with higher interest rate is depreciating. Forward rate represents current (as of cut-off date) possibility of hedging future exchange rate.

IV.2 BRIC countries

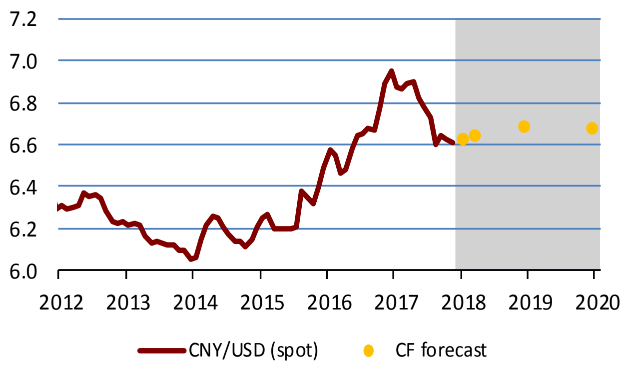
PMI in manufacturing



OECD Composite Leading Indicator

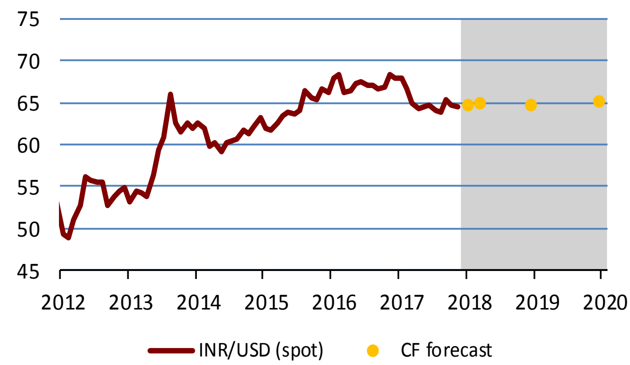


The Chinese renminbi (CNY/USD)



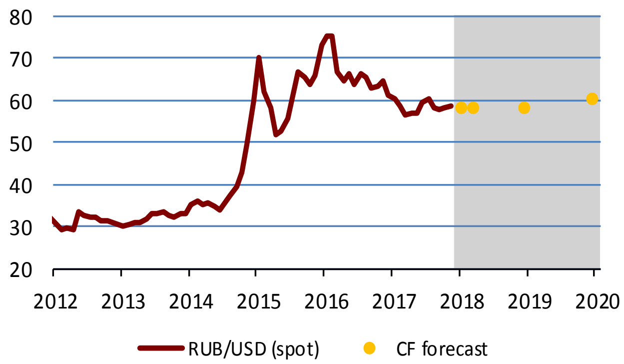
	4/12/17	01/18	03/18	12/18	12/19
spot rate	6.619				
CF forecast		6.623	6.642	6.687	6.679

The Indian rupie (INR/USD)



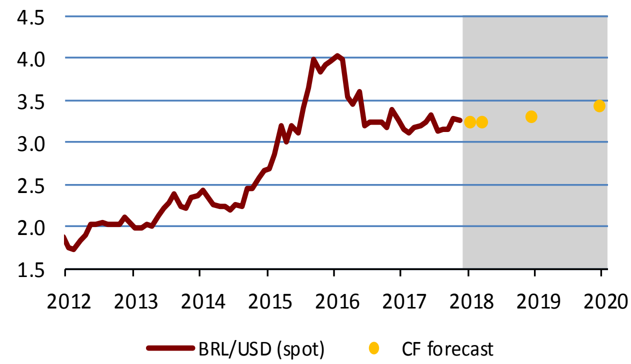
	4/12/17	01/18	03/18	12/18	12/19
spot rate	64.40				
CF forecast		64.77	64.86	64.81	65.13

The Russian rouble (RUB/USD)



	4/12/17	01/18	03/18	12/18	12/19
spot rate	58.89				
CF forecast		58.3	58.34	58.17	60.23

The Brazilian real (BRL/USD)



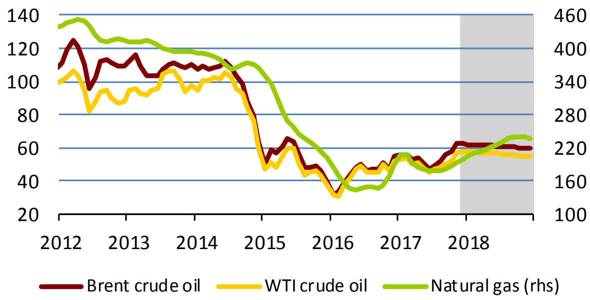
	4/12/17	01/18	03/18	12/18	12/19
spot rate	3.250				
CF forecast		3.248	3.238	3.294	3.438

Note: Exchange rates as of last day of month.

V.1 Oil and natural gas

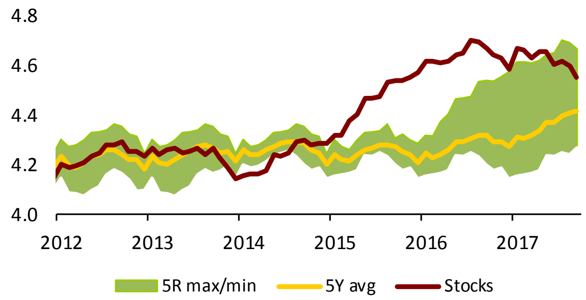
The strong oil price growth observed in October accelerated further in early November. On 6 November, the Brent crude oil price was just shy of USD 65/bbl, its highest level since June 2015. However, nervousness over whether OPEC would meet general expectations at its upcoming meeting and extend the agreement to reduce output until the end of 2018 then started to creep into the market. Russian representatives fear that excessive price growth would lead to a renewed rise in US shale extraction. Brent thus fluctuated mostly in the range of USD 62–64/bbl for the rest of the month. The deal between OPEC and other major producers was ultimately extended at the Vienna meeting on 30 November. However, the participants did not rule out ending it earlier if the oil market were to show signs of overheating. Russia is lobbying for a transparent exit mechanism, while Saudi Arabia regards considerations of an exit as premature and expects the market situation to be reviewed at the June 2018 OPEC meeting and the quotas to be phased out gradually. The only thing that might still support the price is the news that output in Niger and Libya will also be subject to limits next year and their combined production should not exceed 2.8 million barrels a day. The market futures curve was almost unchanged from the previous month and remains downward-sloping, implying average Brent crude oil prices of USD 61.0 and 58.4/bbl in 2018 and 2019 respectively. The December CF expects a price of USD 57.9/bbl at both the three-month and one-year horizons. However, the expectations of analysts and agencies differ significantly as regards the speed of US oil output growth and the return of oil stocks to normal. Hedge funds' large speculative positions represent a risk of a downward correction in oil prices.

Outlook for prices of oil (USD/barrel) and natural gas (USD / 1000 m³)

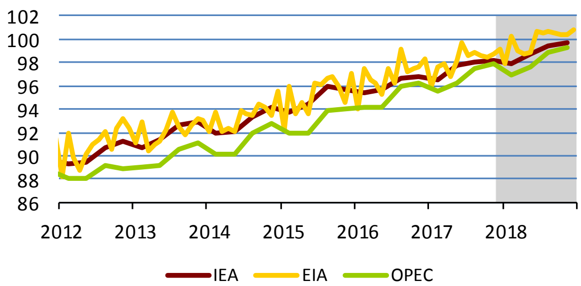


	Brent	WTI	Natural gas
2017	54.69	50.91	189.45
2018	60.96	56.23	226.63

Total stocks of oil and oil products in OECD (bil. barrel)

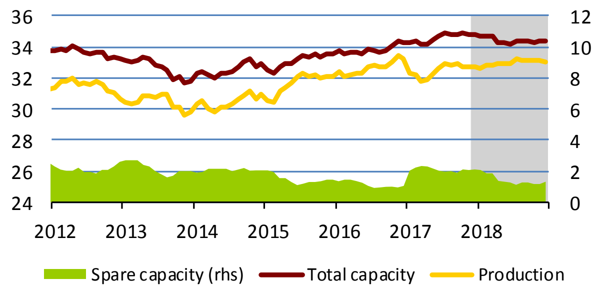


Global consumption of oil and oil products (mil. barrel / day)



	IEA	EIA	OPEC
2017	97.65	98.20	96.80
2018	98.93	99.87	98.18

Production, total and spare capacity in OPEC countries (mil. barrel / day)



	Production	Total capacity	Spare capacity
2017	32.50	34.60	2.10
2018	32.99	34.41	1.42

Source: Bloomberg, IEA, EIA, OPEC, CNB calculation

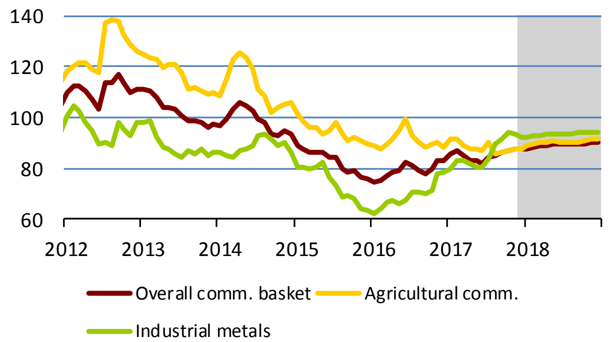
Note: Oil price at ICE, price of Russian natural gas at German border – IMF data, smoothed by the HP filter. Future oil prices (grey area) are derived from futures and future gas prices are derived from oil prices using model. Total oil stocks (commercial and strategic) in OECD countries – IEA estimate.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

V.2 Other commodities

The aggregate non-energy commodity price index rose in November to its highest level since February 2015 and stayed just below that level in the first half of December. The industrial metals price sub-index peaked at an almost five-year high in October. It then dropped slightly, but its market outlook is flat, as metal prices continue to be supported by an improving manufacturing outlook (the J.P.Morgan Global Manufacturing PMI increased further in November to its highest level since March 2011) and a weaker dollar. The World Bank, which derives its forecast from economic developments in China, also expects the industrial metals price index to stabilise after this year's strong growth. China's share in global metal consumption has risen from 10% to more than 50% over the past 20 years. However, it is now attempting to redirect its economic growth into services and private consumption and to reduce mining and commodity processing. According to the World Bank, the price of iron ore will fall by 10% next year due to weaker growth in steel production. This drop will be offset in the index by a rise in prices of other metals (lead, nickel and zinc) due to limited supply. The risk is tilted to the downside if demand from China weakens more than expected or if China relaxes its limits on metals mining. The price of coal, which has risen by more than 100% over the last two years due to mining limits in China, is also expected to drop next year.

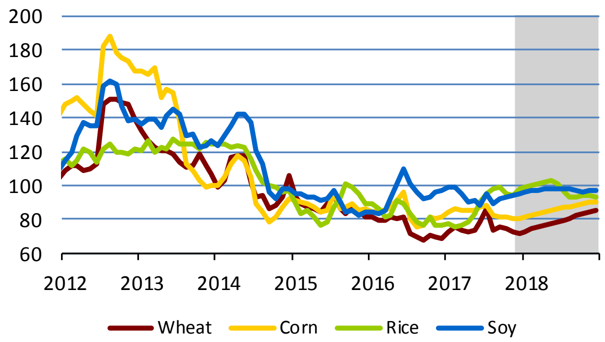
By contrast, the food commodity price sub-index remains close to its lowest level since 2010 despite a moderate rise in September–November. Its outlook is slightly rising thanks to expected growth in prices of wheat, corn, coffee and pork. However, higher grain price growth is still being counteracted by high global stocks and relatively good weather in the main growing areas.

Non-energy commodities price indicies



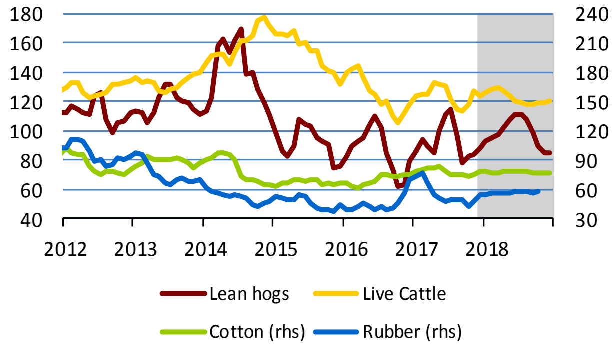
	Overall	Agricultural	Industrial
2017	85.3	88.2	86.2
2018	89.3	90.5	93.5

Food commodities



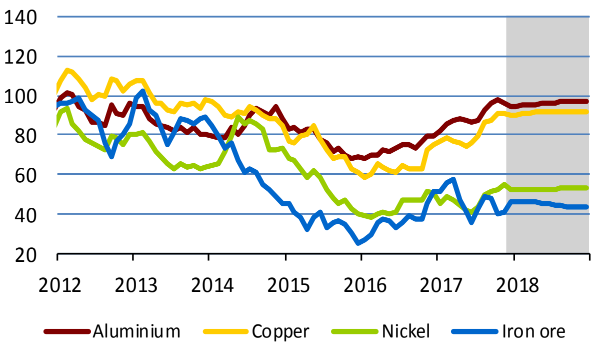
	Wheat	Corn	Rice	Soy
2017	75.1	84.0	88.4	93.4
2018	79.2	86.1	97.5	97.3

Meat, non-food agricultural commodities



	Lean hogs	Live Cattle	Cotton	Rubber
2017	92.4	124.1	78.3	55.5
2018	98.6	122.5	77.6	56.8

Basic metals and iron ore



	Aluminium	Copper	Nickel	Iron ore
2017	90.3	81.9	47.7	46.2
2018	96.1	91.5	52.6	44.9

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 position of direct investment dividends in EU countries' balances of payments[1]

The sharp acceleration in economic globalisation and the geographical transfer of economic activity (aimed mainly at minimising costs and optimising taxes) seen in advanced market economies since the 1980s has logically been associated with sharp growth in overall financial flows. Flows relating to investment income, and hence also direct investment dividend income, form a major part of the total. This article sets out to define the position of direct investment dividends in total investment income and total primary income (a current account item) in EU countries in recent years. Besides the balance of payments perspective, we look at the debit side, i.e. outflows of primary income items, with an emphasis on outflows of dividends arising from foreign direct investment. We also outline the structure of dividends paid to non-residents by new Member States.

1 Introduction

A process of globalisation – associated with huge transfers of production of goods and services and with capital flow liberalisation – has been visible in Central and Eastern European countries since the 1990s, when they embraced market economics and later joined the EU. The growth in their performance and competitiveness driven by the structural changes was strongly linked with inflows of foreign direct investment (FDI). The foreign investments gradually started to generate profits, and those profits have increased in the following years. FDI earnings have thus become a major debit (and hence also credit) item in EU countries' current accounts, initially as income in the form of reinvested earnings and later more as dividend income. For this and other reasons, there are differences between Central and Western European countries in terms of both the position of primary income in their current accounts and the position of direct investment income in their investment income and direct investment dividends themselves in their direct investment income.

For the purposes of this article, the 28 EU Member States are broken down as follows:

- category 1 – the large and (in terms of GDP) most important original EU Member States (five countries whose GDP at current prices exceeds EUR 1 trillion)
- category 2 – the other original EU Member States (ten countries)
- category 3 – the new Member States that joined the EU in 2004 or later (13 countries)[2]

To eliminate any large annual fluctuations, our international comparisons are based on the average annual indicators for the period of 2011–2015, for which final statistical data are available.[3] The direct investment income data for 2016 are only estimates, i.e. preliminary data. The additional comparison of the sectoral

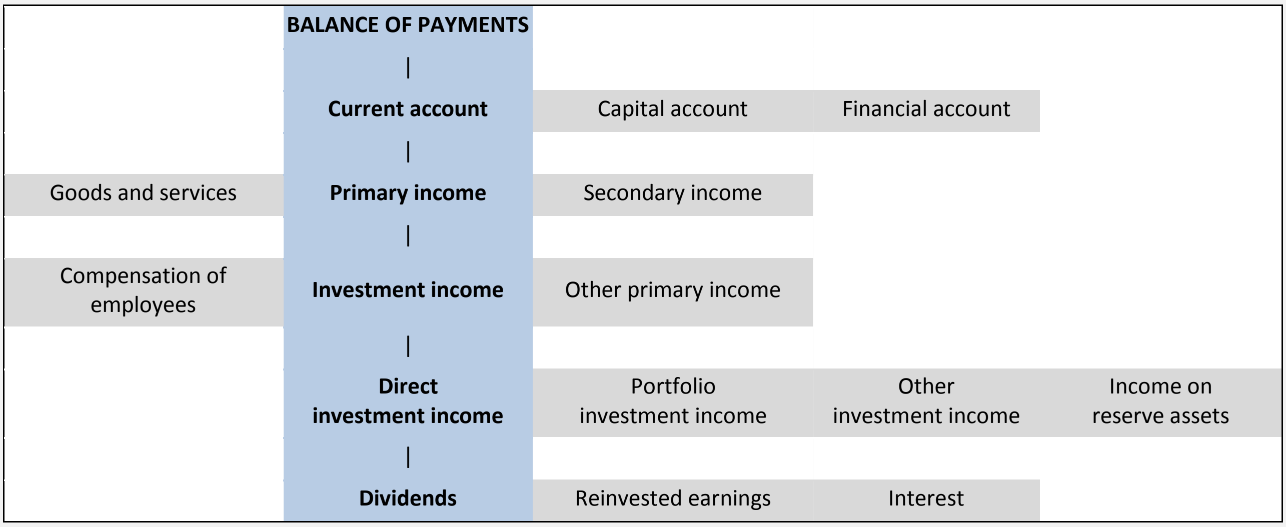


Figure 1: The position of direct investment dividends in the balance of payments structure

[1] Author: Ladislav Prokop. 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] The breakdown of countries into categories can be seen in the charts below. Standard abbreviations are used for country names: Belgium BE, Bulgaria BG, Czech Republic CZ, Denmark DK, Germany DE, Estonia EE, Ireland IE, Greece EL, Spain ES, France FR, Croatia HR, Italy IT, Cyprus CY, Latvia LV, Lithuania LT, Luxembourg LU, Hungary HU, Malta MT, Netherlands NL, Austria AT, Poland PL, Portugal PT, Romania RO, Slovenia SI, Slovakia SK, Finland FI, Sweden SE, United Kingdom UK.

[3] Whole time series are not available in some cases. The average is thus calculated on the basis of published data.

and geographical structures of dividend outflows is limited to just one year: 2015.[4] In order to have a uniform statistical source, the analysis is based on the Eurostat database. However, the section on the dividend structure draws on national statistics from the V4 central banks.

2 From primary income to direct investment dividends

In the following text, we will attempt to put the direct investment dividend item into the broader context of the primary income balance and the current account as a whole. Figure 1 clearly illustrates the structural levels of the decomposition.

Position of primary income in the current account

The primary income balance is one of the main current account items. It comprises income from labour, capital, funds provided and non-produced non-financial assets (wages and salaries, dividends, reinvested earnings, interest and annuities, and also taxes and subsidies on production and imports, which represent a part of the financial flows vis-à-vis the EU budget). It differs greatly in value across the EU countries' current accounts, especially as regards the large original Member States (category 1). In these countries, primary income shows both high surpluses (which in Germany and France are by far the biggest in the entire EU) and deficits (especially in the UK). The primary income balances of the other original EU countries (category 2) likewise vary. In this category (and in the EU as a whole), Ireland has far and away the largest deficit due to previous massive inflows of foreign investment. By contrast, the new Member States constantly recorded more or less average annual deficits in 2011–2015.

The primary income balance has the same sign as the current account balance in about half of the Member States. In the other countries, the two balances show opposing trends (especially in France, where a high primary income surplus is far outweighed by goods and secondary income deficits). Chart 1 presents a cross-country comparison using the ratios of the current account and primary income to GDP (a measure of a country's economic activity). The same approach is applied in the subsequent charts. From this perspective, Denmark recorded the biggest primary income surplus and Luxembourg the largest deficit. The explanation can be found in a more detailed analysis of their structures.

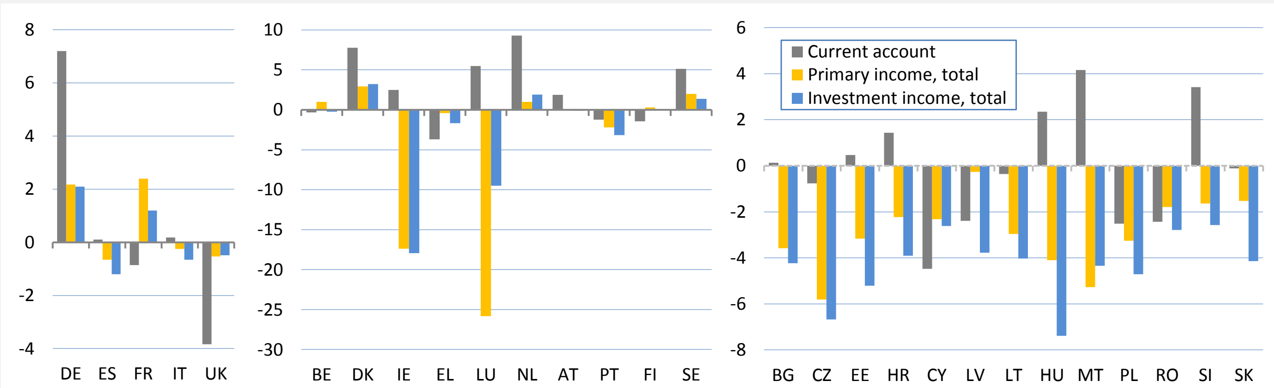


Chart 1 Position of the primary income of EU countries in the current account

Source: Eurostat, authors' calculations

Note: Balances by country category, % of GDP, annual averages for 2011–2015

Position of investment income in primary income

Broken down in more detail, primary income consists of the following three items:

- compensation of employees, consisting mainly of wages
- investment income
- other primary income, including annuities and taxes and subsidies on products and imports

The globalisation of economic processes is most apparent in the investment income balance (see also Chart 1). It is the item that most strongly determines the level and direction of the overall primary income balance in 24 EU countries. The only notable exceptions in this regard are Belgium, where the largest primary income item is a surplus on compensation of employees (due probably to the location of the central EU authorities in that country), while investment income conversely shows a moderate deficit in the period under review, and Luxembourg, where compensation of employees is also the largest primary income item.

[4] Except for Slovakia, for which the most recent available data were those for 2014.

Position of direct investment income in investment income

Diving even deeper into the balance of payments structure, we can subdivide investment income into:

- direct investment income (see below)
- portfolio investment income (dividends, reinvested earnings and interest)
- other investment income (mainly interest)
- income on reserve assets (mostly dividends and interest)

Direct investment income is generally the largest balance under investment income. It is the item that most strongly determines the level and direction of the overall investment income balance in 19 EU countries. However, the direct investment income balances of the original EU Member States are mostly significantly offset by portfolio investment income. This is due mainly to either external debt (Spain, Italy and France) or a highly developed financial sector allowing the country to operate as a tax haven where many financial institutions locate their headquarters (Luxembourg and the Netherlands). By contrast, direct investment income and portfolio investment income in the new EU Member States generally show much less contrasting trends (see Chart 2).

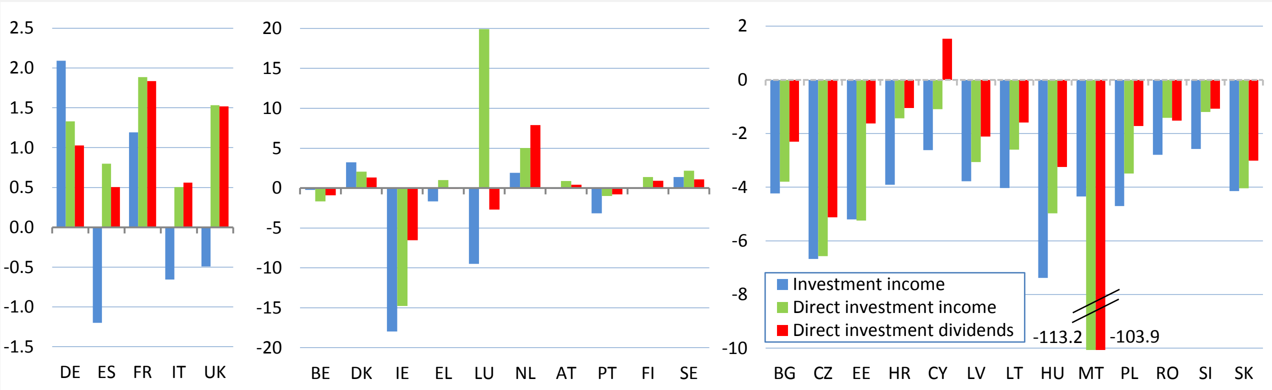


Chart 2 Position of the direct investment income of EU countries in investment income

Source: Eurostat, authors' calculations

Note: Balances by country category, % of GDP, annual averages for 2011–2015

Position of dividends within direct investment income

Direct investment income comprises income on equity and debt instruments and can be further broken down into:

- dividends (including withdrawals of income from quasi-corporations)
- reinvested earnings
- interest

In general, dividends are money paid by joint-stock companies to shareholders at the decision of the general meeting. Chart 2 shows that the dividend balance tends to be the largest item of the direct investment income balance in the categories of EU Member States monitored. Due to its tax policies, the Netherlands recorded by far the biggest average annual dividend surplus in the period under review (EUR 52 billion). It was followed by France, the UK and Germany. By contrast, Ireland recorded the largest deficit.

In the first country category, the direct investment dividend balance ended more or less in surpluses, while the new Member States, by contrast, showed deficits. The only exception in this regard is tax haven Cyprus, where dividends recorded a small surplus and reinvested earnings an average annual deficit in the period under review. The analysis thus clearly shows that in the case of firms registered in the largest original countries, direct investment income – mainly in the form of dividends – dominates payments, whereas in the new Member States, payments – again mainly in the form of dividends – dominate direct investment income. The direct investment dividend balances in the other original Member States (category 2) were generally mixed. The ratio of dividends to GDP across the EU countries was influenced to a large degree by whether or not they were tax havens. This fact is particularly significant in the case of Malta.[5]

3 Primary income debit side

Investment income payments are associated with the transfer of part of the value added created in host countries and hence with the transfer abroad of potential sources of future investment that would deliver

[5] Malta is a symbol of a universal tax haven. The main advantage of the Maltese tax system is that it provides exemptions to holding companies. Among the countries under review, Luxembourg, the Netherlands, Cyprus and Ireland stand out as other major tax havens.

economic growth. The gap between the traditional GDP and GNI measures can thus widen markedly in either direction. This effect is visible in the item of dividends (and not only direct investment dividends) – in the case of the new EU Member States in the negative direction. So, let's look in more detail at the debit side of investment income and especially at direct investment dividend payouts to foreign owners.

Structure of primary income debit items

Consistent with the dominant position of investment income, total primary income debits were dominated by investment debits, which exceeded 90% on average in the country categories under review. However, the ratios of direct investment debits (including in the monitored tax havens) to investment debits were very mixed. Direct investment debits accounted on average for less than 30% of total investment debits in the large original Member States and just over 40% in the other original Member States, whereas in the new Member States the figure was almost two-thirds (see Chart 3). In the large original EU countries, the dominant component was portfolio investment debits. The share of portfolio investment payments in the other original EU countries only slightly exceeded the share of FDI debits on average. An exception in this regard was the Netherlands, a popular tax haven, with a 71% share of FDI debits in total investment debits. FDI payments in the new Member States generally represent the largest proportion of investment income paid to non-residents. Only in Croatia, Romania and Slovenia was the share of FDI debits below 50%. The higher share of FDI income in total investment income in the new Member States reflects, among other things, a higher rate of return on FDI in these countries related to ongoing economic convergence processes and investment incentives.

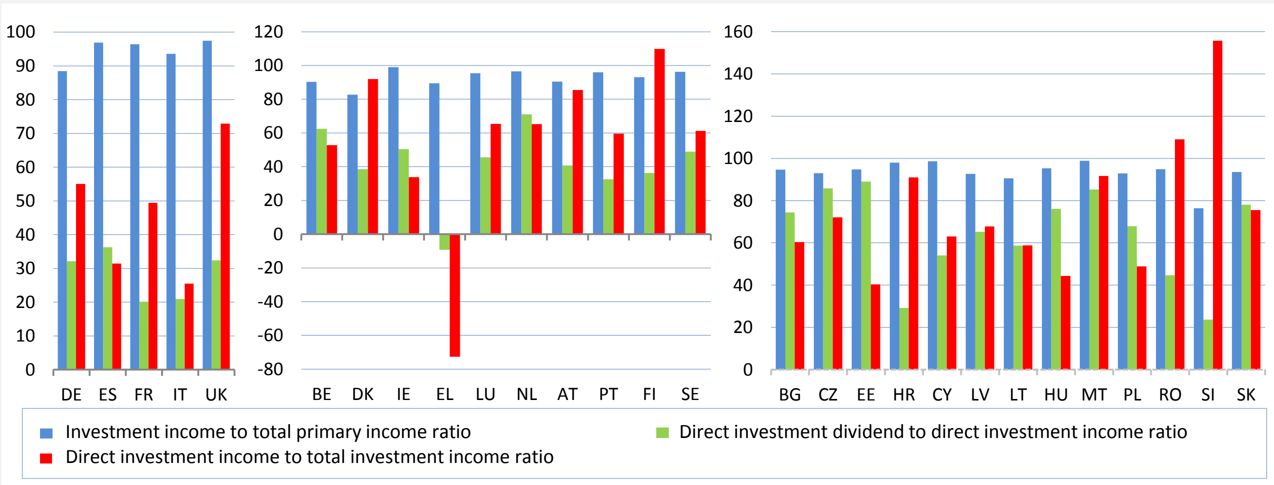


Chart 3 Structural characteristics of the primary income debit side

Source: Eurostat, authors' calculations

Note: By country category, %, annual averages for 2011–2015. Negative average annual reinvested earnings (losses) were recorded by seven Member States in the period under review. In the case of Greece, negative reinvested earnings also affected direct investment income. The ratio of FDI income to investment income and the ratio of (positive) dividends to FDI income are therefore both negative. Negative reinvested earnings also significantly influenced the dividend-to-FDI income ratios in Finland, Romania and especially Slovenia, which have ratios in excess of 100%. The calculations for Croatia, Denmark and Luxembourg were also affected by negative reinvested earnings.

The FDI income structure itself is mostly a result of investment strategies and reflects the various stages of the investment life cycle in different countries. Study results show that the annual return on new FDI initially rises, then peaks in approximately the seventh year and subsequently gradually declines until the sixteenth year after the initial investment, when the investment cycle is completed. There is a broad consensus that reinvested earnings dominate in the first stages of the life cycle and that dividends gain in importance only gradually.[6] Differences can be seen in the ratio of dividends to reinvested FDI earnings both between and inside the country categories. Moreover, in some countries (such as Italy, Luxembourg and Germany), total payments arising from FDI are significantly affected by interest on debt instruments. To sum up, the average ratio of dividend payouts to FDI debits was lowest in the large original EU countries at just under 50%. It was 55% on average in the other original EU countries and was highest in the new EU countries, where dividends accounted for three-quarters of total FDI payments (see Chart 3).

FDI dividend payouts

As Chart 4 shows, the dividend-to-GDP ratios are very low – mostly below 1% – in the large original Member States due to their lower FDI-to-GDP ratios. Only in the UK was the dividend-to-GDP ratio higher than 2% (although with an average annual dividend payout of almost EUR 50 billion). By contrast, the highest ratios are recorded by tax havens and countries with stable legal frameworks, such as Malta and

[6] Comparisons are given, for example, in Brada and Tomšík (2003), Novotný and Podpiera (2008) and Novotný (2015). The main findings of the last-mentioned study were also presented in *Focus* in the January 2016 Global Economic Outlook.

Luxembourg (with dividend-to-GDP ratios of over 100%) and the Netherlands, Cyprus and Ireland, whose ratios are, however, much lower. When we exclude those five countries from the sets of other original and new EU Member States, the annual dividend-to-GDP ratio in the new EU countries is only slightly higher on average than that in the other original countries (2.6% and 2.1% respectively). However, the average dividend payment in the original EU countries is two and a half times higher than that in the new ones. In addition to exchange rate effects, this is due mainly to a large difference in the extent of FDI in the new Member States. This is also evidenced by a smaller spread of the dividend-to-GDP ratios in the original Member States (despite the very low ratio in Greece) than in the new ones, where the ratios ranged between 1.1% (in Croatia) and 5.4% (in the Czech Republic).[7]

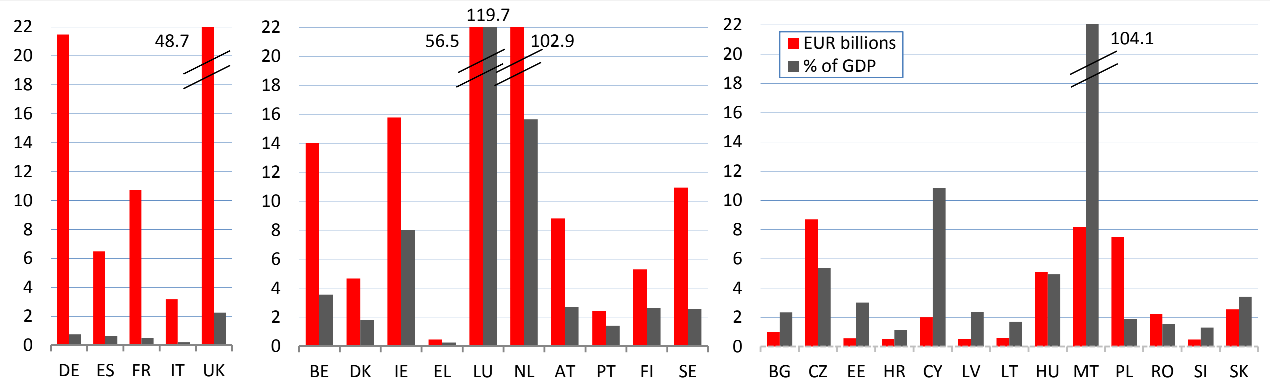


Chart 4 FDI dividends paid to non-residents

Source: Eurostat, authors' calculations

Note: By country category, EUR billions and %, annual averages for 2011–2015

4 Structure of FDI dividend outflows from the Visegrád Four countries[8]

To conclude, we will outline the structure of FDI dividend outflows in the new EU Member States. As the highest absolute dividend payouts were made by the Visegrád Four (V4) countries (disregarding Malta), we will focus on this representative category. We will describe first the sectoral and then the geographical structure of dividends – for illustration for 2015 only (or 2014 in the case of Slovakia).

The sector structure analysis reveals above all that the services sector paid out the bulk of dividends (almost two-thirds on average) in Poland, Hungary and Slovakia, whereas manufacturing paid out more than half of dividends in the Czech Republic (see Table 1). Within manufacturing, dividend payouts were more diversified across production segments in the Czech Republic, Hungary and Poland than in Slovakia, where more than half of dividends arose from the manufacture of transport equipment, specifically motor vehicles. However, transport equipment manufacture generates a substantial proportion of dividends in the other three countries as well. Total payments from the petrochemical and chemical industries are also significant. A specific feature is the relatively high dividend payout from food sectors in Poland. In services, particularly high outflows are observed in the financial sector, trade, professional, scientific and technical activities and, in the case of Hungary and Slovakia, administrative and support services.

Czech Republic	(2015)	Hungary	(2015)	Poland	(2015)	Slovakia	(2014)
Manufacturing	53.5	Manufacturing	29.4	Manufacturing	37.5	Manufacturing	27.1
Services	38.8	Services	66.6	Services	55.8	Services	69.8
Other	7.7	Other	4.0	Other	6.7	Other	3.1

Table 1 Sectoral structure of FDI dividend payouts in the V4 countries

Source: CNB, MNB, NBP, NBS, authors' calculations

Note: NACE sector structure, %, for 2015/2014

Turning to the geographical structure (see Table 2), the lion's share of the V4 countries' dividends (almost 90% on average) go to other EU countries. A sizeable percentage head directly to parent investors in the large original EU Member States, especially Germany and France. However, efforts to optimise taxes are also apparent in the case of dividend outflows from the new Member States. The Netherlands receives the

[7] The high dividend-to-GDP ratio in the Czech Republic stems, among other things, from extensive FDI in sectors with above-average profitability, often with regulated entry, coupled with an absence of tax measures to limit high FDI earnings.

[8] In the case of Hungary and Poland, special purpose entities are explicitly excluded.

largest proportion of total dividend payouts (about a quarter). Luxembourg also ranks among the biggest recipients. Finally, the third-largest set of dividend recipients is formed of neighbouring countries, especially Austria. This is due to previous investments aimed, among other things, at minimising logistics costs. The only significant non-EU, non-European dividend recipient is South Korea in the case of Slovakia.

Czech Republic	(2015)	Hungary	(2015)	Poland	(2015)	Slovakia	(2014)
EU	87.2	EU	84.1	EU	92.5	EU	86.2
Netherlands	25.7	Netherlands	21.8	Netherlands	25.6	Netherlands	24.8
Austria	13.8	Austria	20.9	Germany	19.1	Austria	18.5
Germany	12.5	Germany	14.1	France	9.0	Germany	15.5
Switzerland	10.9	France	8.5	Italy	6.6	South Korea	11.8
Luxembourg	9.0	United Kingdom	5.5	Luxembourg	6.2	Poland	6.5
France	8.3	Luxembourg	4.2	United Kingdom	5.1	Czech Rep.	5.9
other	19.8	other	25.0	other	28.4	other	17.0

Table 2 Geographical structure of FDI dividends in the V4 countries

Source: CNB, MNB, NBP, NBS, authors' calculations
Note: %, for 2015/2014

5 Conclusion

Direct investment dividends are a major primary income item in EU countries and are particularly relevant in the case of debits. They are a major debit item in the new EU Member States, especially the Czech Republic, where the ratio of FDI dividend outflows to total primary income debits has recently been running at almost 60%. High ratios of dividends to total debits are also observed in the other new EU Member States (especially Slovakia, Romania and Bulgaria). However, their absolute amounts remain low. Besides the Czech Republic, Malta had a dividend-to-debit ratio of well over 50%. There are greater differences in the ratios of FDI dividends to GDP in the new EU countries than in the original ones. This is due mainly to asynchronicity of investment cycles. From a general perspective, however, the economic interpretation of the high dividend payouts abroad seems very ambiguous. On the one hand it reflects positive effects, mainly in the form of economic growth and stimulation of employment, but on the other it is linked with outflows of funds to non-residents, i.e. part of the value added – representing a potential source of further development and growth in living standards – is escaping from the economy.

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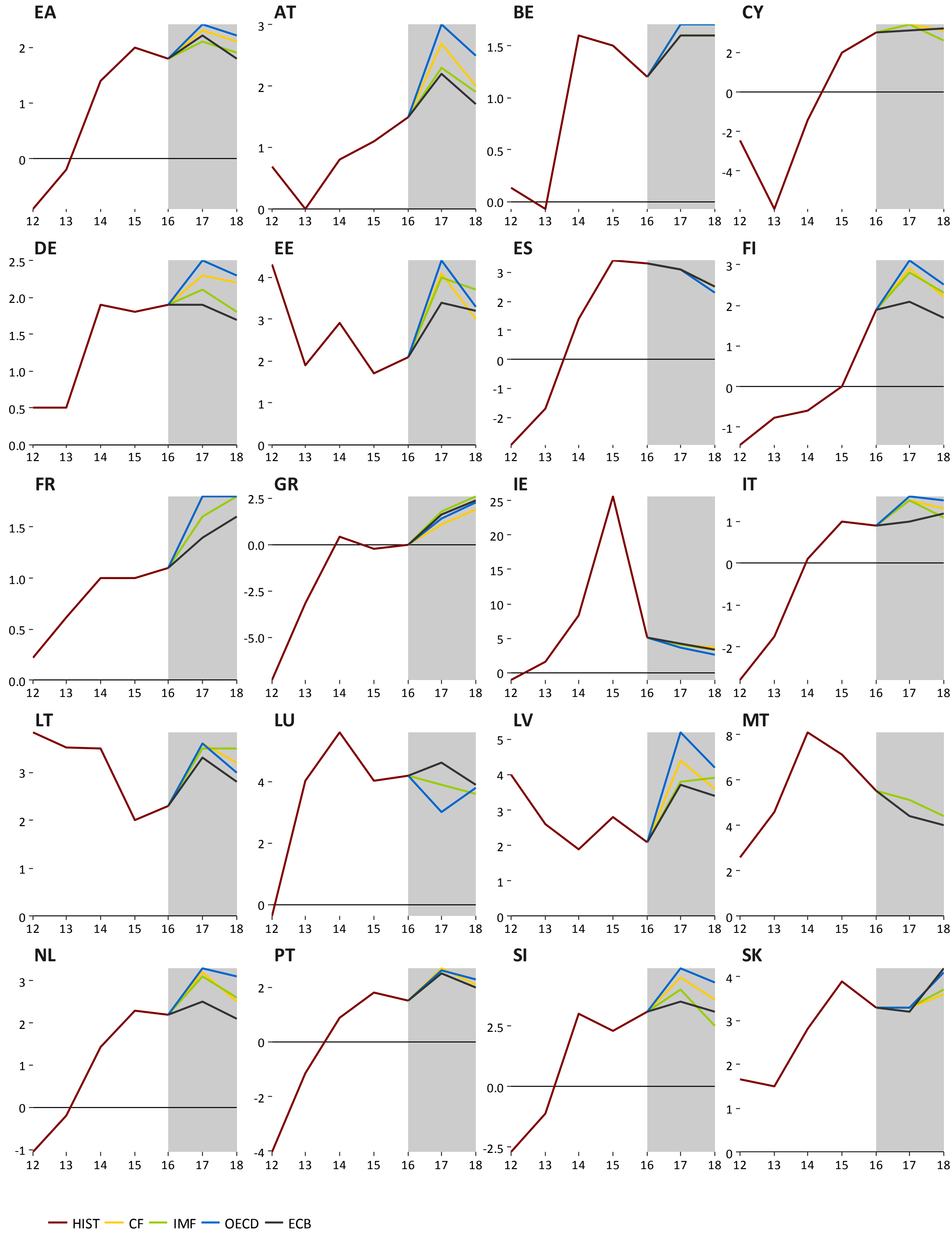
A1. Change in GDP predictions for 2017

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

A2. Change in inflation predictions for 2017

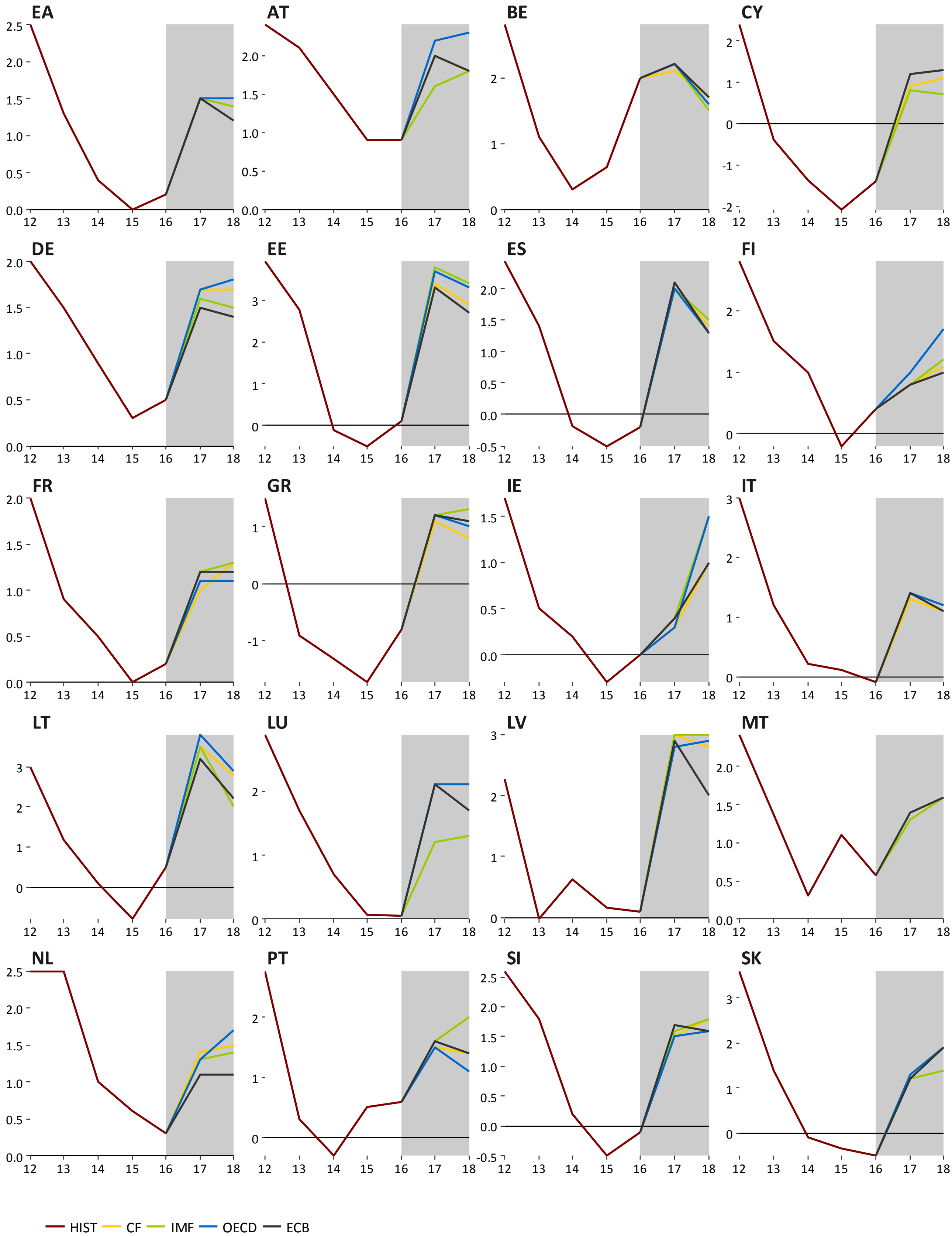
	CF		IMF		OECD		CB / EIU	
EA	0	2017/12 2017/11	-0.2	2017/10 2017/4	-0.2	2017/11 2017/6	0	2017/9 2017/6
DE	0	2017/12 2017/11	-0.4	2017/10 2017/4	-0.2	2017/11 2017/6	+0.1	2017/6 2016/12
US	0	2017/12 2017/11	-0.6	2017/10 2017/4	-0.5	2017/11 2017/6	0	2017/9 2017/6
UK	0	2017/12 2017/11	+0.1	2017/10 2017/4	-0.1	2017/11 2017/6	+0.2	2017/11 2017/8
JP	0	2017/12 2017/11	-0.6	2017/10 2017/4	-0.2	2017/11 2017/6	-0.3	2017/11 2017/7
CN	0	2017/12 2017/11	-0.6	2017/10 2017/4	0	2017/11 2017/6	0	2017/11 2017/10
IN	0	2017/12 2017/11	-1.0	2017/10 2017/4	-1.6	2017/11 2017/6	0	2017/11 2017/10
RU	-0.3	2017/11 2017/10	-0.3	2017/10 2017/4	-0.5	2017/11 2017/6	-0.1	2017/11 2017/10
BR	0	2017/11 2017/10	-0.7	2017/10 2017/4	-0.6	2017/11 2017/6	+0.1	2017/11 2017/9

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