Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Box A: QB 2 – June 2024

This Box content is extracted from the Quarterly Bulletin – Q2 2024

The International Economic Outlook

By the Monetary Policy Division

The global economy continues to tread an uncertain path marked by continued geopolitical tensions and a risk of global fragmentation in trade. After a period of tightening of monetary policy across the world in response to a global post-pandemic surge in inflation, central banks in a number of jurisdictions (e.g. euro area, Switzerland, Brazil, Canada) have started to reduce interest rates, with many others expected to follow suit as inflationary pressures are expected to recede globally. However, uncertainty remains over the speed of convergence of inflation towards national targets and the associated monetary policy responses; expectations of interest rate reductions have generally been significantly revised since the beginning of the year, with fewer now expected in several economies by year-end. A number of risks face the world economy, with an escalation in geopolitical tensions and a fragmentation in global trade being key potential inflationary and recessionary risks. Growth in China might cause surprise in either direction due to policy and property sector dynamics, while strong labour markets and more persistent inflationary pressures could be seen in advanced economies.

The June ECB staff macroeconomic projection exercise revised up euro area growth projections for this year compared to the March exercise, expecting GDP growth of 0.9, 1.4 and 1.6 per cent in 2024, 2025 and 2026 (vs 0.6, 1.5 and 1.6 previously); private consumption is seen as the main contributor to growth, as real wages rise. The inflation forecasts have also been revised upwards to 2.5, 2.2 and 1.9 per cent, respectively, (against 2.3, 2.0 and 1.9 per cent in the March projections). The outlook for the global economy (excluding the euro area)

has remained broadly stable, with GDP projected to grow by 3.3, 3.3 and 3.2 per cent respectively in 2024 to 2026. This is slightly below the rate of growth observed over the past decade. Trade – which has been weak in the past years also partly due to geopolitical tensions – is expected to grow more in line with GDP. Global CPI inflation is projected to continue reducing gradually, from 5.0 per cent in 2023 to 4.2, 3.3 and 2.9 per cent, respectively, in the following years. This pace of disinflation is only slightly slower compared to the March projections.

The euro area economy, while continuing to contend with sluggish domestic demand partly due to the effects of restrictive monetary policy (and despite record low levels of unemployment) as well as lagging productivity, returned to growth after a technical recession in the second half of 2023. In the first quarter of 2024, euro area GDP grew by 0.3 per cent on a quarterly basis, following growth of -0.1 per cent in the previous two quarters. Compared to Q1 2023, GDP was 0.3 per cent higher. Labour market dynamics remained strong, with employment growing by 0.3 per cent quarterly (1.0 per cent annually) in Q1 2024. The unemployment rate reached a record-low level of 6.4 per cent in April, from a steady 6.5 per cent in the previous five months. Euro area inflation remains close to, but above, the ECB target of 2 per cent. HICP Inflation ticked up to 2.6 per cent in May after two months at 2.4 per cent, with core inflation (i.e. excluding food and energy) rising to 2.9 per cent from 2.7 per cent in April, after it had been steadily declining. The increase in both measures of inflation was primarily due to an acceleration in services inflation to 4.1 per cent in May, up from 3.7 per cent.

The Governing Council (GC) of the ECB decided in June to reduce the three ECB reference interest rates by 25 basis points, bringing the deposit facility rate (the main policy rate) to 3.75 per cent. The key ECB rates had been kept unchanged since September 2023, after cumulative increases of 4.5 per cent since the summer of 2022. The Governing Council deemed it appropriate to moderate the degree of policy restriction on the basis of an updated assessment of the inflation outlook, the dynamics of underlying inflation and the strength of monetary policy transmission. However, cautioning that domestic price pressures remained strong and pointing to upward revisions in its inflation forecasts, it reiterated that it will keep policy rates at a sufficiently restrictive level to ensure the return of inflation to its 2 per cent target in the medium term. The GC will remain data dependent and therefore is not pre-committing to any specific path for interest rates. The holdings within the Asset Purchase Programme continue to be reduced gradually in line with expectations by not reinvesting

maturing securities. Holdings under the Pandemic Emergency Purchase Programme, starting from July, will be only partially re-invested so as to obtain a reduction in the portfolio of the order of €7.5bn per month; all PEPP reinvestments will be discontinued at the end of 2024.

Despite restrictive levels of interest rates and above-target inflation, the US economy remains resilient although growth has slowed down considerably in recent months. In the first quarter of 2024, the US economy expanded at an annualised rate of 1.3 per cent (corresponding to 0.3 per cent quarter-on- quarter), a significant slowing down compared to annualised growth of 3.4 per cent in Q4 2023. The labour market continues to remain tight, with historically low levels of unemployment arising. The unemployment rate was 3.9 per cent in April 2024, only marginally above 3.8 per cent the previous month and 3.4 per cent in April 2023. A few months of higher-than-expected inflation have prompted markets to revise expectations of rapid interest-rate reductions by the Federal Reserve, leading to higher bond yields and a stronger dollar. The annual US inflation rate has moved in a range of 3-3.5 per cent since October 2023, most recently declining to 3.3 per cent in May from 3.4 per cent the previous month. Core inflation, however, has displayed a steadier, albeit gradual, downward trend over the same period, falling to 3.4 per cent in May 2024 from 4.0 per cent in October 2023.

In June, the Federal Open Market Committee of the Federal Reserve maintained the target range for the federal funds rate at 5.25-5.5 per cent. The FOMC does not see it appropriate to reduce the target range until it has more confidence that inflation is sustainably moving towards its 2 per cent target; to determine this, the FOMC will carefully assess the incoming data and evolving outlook. Holdings of Treasury securities, agency debt and agency mortgage-backed securities continue to be reduced.

After a recession in the second half of 2023 (with quarterly GDP contracting by 0.1 and 0.3 per cent in Q3 and Q4 2023), the UK economy rebounded in the first quarter of 2024, growing by 0.6 per cent. The unemployment rate stood at 4.5 per cent in March. As with other advanced economies, this is a historically low level although it increased from a recent low of 3.8 per cent in December 2023. The UK CPI inflation rate dropped significantly in April to 2.3 per cent, from 3.2 per cent a month before and 8.7 per cent in April 2023. In April, the Monetary Policy Committee of the Bank of England decided with a majority of 7-2 to maintain the Bank Rate at 5.25 per cent, a level that was set in August 2023. The Committee indicated that it would keep under review for how long the rate should be maintained at the current level.

For the first time since it lowered its official interest rate to -0.1 per cent in 2016, in March 2024 the Bank of Japan decided to increase it to a range of 0-0.1 per cent. It cited positive developments in the establishment of a virtuous cycle between wages and prices that would lead to its 2 per cent inflation target being reached in the medium term. It has also stopped targeting a specific yield for 10-year Japanese Government Bonds but will continue its purchases of those bonds. Both headline and core inflation in Japan have been above but close to 2 per cent since 2022, with a declining trend since 2023. GDP, meanwhile, contracted by 0.5 per cent in Q1 2024 (after stagnating the previous quarter), mostly due to declining consumer demand.

Growth in China performed better than expectations in Q1 2024, partly thanks to stimulus measures, with GDP growing by 1.6 per cent (5.3 per cent higher year-on-year) in the quarter after growing by 1.2 per cent in Q4 2023. The property sector, however, continues to weigh down on activity, with new house prices falling by 3.1 per cent annually in April, the decline in prices accelerating from previous months. Despite monetary and fiscal stimulus, inflation remains low, at 0.3 per cent in April 2024. The country had been in deflation between October 2023 and January 2024, however core inflation, while below 1 per cent, remains firmly above zero.