Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Box A: QB 3 – September 2024

This Box content is extracted from the Quarterly Bulletin – Q3 2024

The International Economic Outlook

By the Monetary Policy Division

The global economy continues to be relatively resilient, with the IMF's July World Economic Outlook update forecasting world GDP growth of 3.2 and 3.3 per cent in 2024 and 2025 respectively (it grew by 3.3 per cent in 2023). This however conceals wide variation across regions, with growth in emerging markets outpacing advanced economies. A number of economies, such as the euro area and China, are facing cyclical weaknesses in demand, and potentially longer-term structural issues due to slowing productivity growth and trade frictions, while others, notably the US, have continued to grow.

Global inflation continues to decline, but at a slowing pace, with services inflation in particular slowing progress towards national inflation targets. An easing in the monetary policy stances of a large number of central banks is underway, with several having started to cut rates in response to moderating inflation. There is, however, uncertainty around the speed of convergence of inflation towards target, with most policymakers remaining in a 'data-dependent' mode.

The September ECB staff macroeconomic projection exercise remained broadly in line with the previous round of forecasts in June. Projections for headline HICP inflation are unchanged, at 2.5, 2.2 and 1.9 per cent respectively for 2024-2026. Core inflation has been slightly revised upwards to 2.9, 2.3 and 2.0 per cent. Euro area GDP growth has been adjusted downwards by 0.1 per cent for each year of the 2024-2026 projection, to 0.8, 1.3 and 1.5 per cent. The pickup in growth in 2025 and 2026 is seen as consumption-led, supported by robust (but moderating) real wage growth and waning effects of past monetary policy tightening. The revisions compared to the June forecast were mostly due to revisions to private consumption projections.

Euro area labour productivity growth, cyclically low at the current juncture, is expected to rise to about 1 per cent by 2026.The outlook for the global economy (excluding the euro area) has slightly improved, with world ex-EA GDP projected to grow by 3.4, 3.4 and 3.3 per cent respectively in 2024 to 2026. Forecasts for global trade growth have been significantly revised upward for 2024 and are now very close to GDP growth rates across the forecast horizon. Trade remains a major source of uncertainty for the global economy. Global CPI inflation is projected to continue reducing gradually, from 5.0 per cent in 2023 to 4.2, 3.3 and 2.8 per cent, respectively, in 2024-2026.

The euro area economy continued to grow at a slow pace in the second quarter of 2024 with euro area GDP growing by 0.2 per cent on a quarterly basis (0.6 per cent higher compared to Q2 2023), down from 0.3 per cent in Q1. The main contribution to growth in GDP in Q2 2024 came from net exports and partly from Government consumption, while investment had a large negative contribution and households' consumption's contribution was negligible.

Labour market dynamics remained relatively strong, with employment growing by 0.1 per cent quarterly (0.8 per cent annually) in Q2 2024. The unemployment rate was 6.4 per cent in July – again, its lowest ever level. Euro area inflation remains close to, but above, the ECB target of 2 per cent. HICP Inflation fell to 2.2 per cent in August after ticking up to 2.6 per cent in July from 2.5 per cent the previous month. This decline was largely due to energy and industrial goods inflation. Core inflation (i.e. excluding food and energy) also fell to 2.8 per cent after three straight months at 2.9 per cent. Services inflation however increased to 4.2 per cent from 4.0 in July. The persistence of services inflation continues to keep the core and headline rates of inflation above target.

In March 2024, the Governing Council (GC) of the ECB agreed to changes to the operational framework for the implementation of monetary policy, which will take effect from 18th September 2024. Under this new framework, the GC confirmed that the monetary policy stance would be steered by adjusting the deposit facility rate (DFR, which is the lowest of the three policy rates); i.e., the ECB will operate monetary policy under a floor system. The spread between the DFR and the main refinancing operations (MRO) rate will be reduced to 15 basis points, with the main lending facility (MLF) rate remaining at a spread of 25 basis points from the MRO. Once the balance sheet of the Eurosystem returns to growth, structural longer-term refinancing operations and a structural portfolio of

securities will be established to provide structural liquidity levels to the banking sector and ensure a smooth functioning of the floor system.[1]

The GC decided in September to reduce the three key ECB interest rates by 25 basis points, with the DFR standing at 3.5 per cent. The key ECB rates had been kept unchanged at the previous meeting in July, and had been lowered by another 25 basis points in June 2024; that had been the first reduction in ECB policy rates since 2019. 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. The GC noted that recent inflation data was broadly within expectations; domestic inflation remained high although it is expected to moderate. The Council reiterated that it will keep policy rates at a sufficiently restrictive level for as long as necessary to ensure the return of inflation to its 2 per cent target in the medium term. The GC decision-making will remain data dependent and therefore the GC 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, are being 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.

The US economy continues to grow at a strong pace, despite tight monetary policy, and posted annualised growth of 3.0 per cent in Q2 2024, significantly up from 1.4 per cent in the previous quarter. The labour market has given mixed signals in the past weeks but overall continues to remain resilient; despite recent increases in the number of people filing jobless claims the unemployment rate in August stood at 4.2 per cent, just below 4.3 per cent in July, while it had been 3.8 per cent in the same month of 2023. In August, inflation dropped sharply to 2.5 per cent, from 2.9 in July and 3.0 in June; it had been above 3 per cent since April 2021. PCE inflation, the Federal Reserve's preferred metric, was 2.5 per cent in July, unchanged from June. Core inflation has been on a steady decline from the heights of over 6 per cent reached in 2022; it fell to 3.2 per cent in July and remained unchanged in August.

[1] See this ECB explainer for further background on the operational framework review, and forthcoming changes.

In July, the Federal Open Market Committee of the Federal Reserve decided to maintain the federal funds rate at a level between 5.25 and 5.50 per cent, noting that, in the US, economic activity has continued to expand at a solid pace, but employment growth has moderated and unemployment has picked up in recent months. Inflation, which has been on a downward trend towards the 2 per cent target, remained somewhat elevated. Uncertainty as to the interpretation of recent US employment and activity data, and the potential response of the Federal Reserve's monetary policy in the next months have led to significant financial market volatility between August and September.

The UK economy continued its strong rebound from the technical recession in the second half of 2023 with 2024 second-quarter growth of 0.6 per cent, which was only marginally below the 0.7 per cent growth the economy saw the quarter prior to that. The unemployment rate stood at 4.2 per cent in June, this follows four months of rising unemployment rates albeit from a historical low of 3.8 per cent in December 2023. The UK CPI inflation rate remained at 2 per cent in the month of June, a level consistent with the Bank of England's target. In August, the Monetary Policy Committee of the Bank of England decided with a majority of 5-4 to reduce the Bank Rate by 0.25 percentage points to 5 per cent. The Committee indicated that it continues to monitor inflationary pressures and expects an increase in CPI inflation in the second half of this year due to second-round effects capturing persistent inflationary pressures.

In July 2024, the Bank of Japan increased its policy rate by 0.15 per cent to 0.25 per cent, after raising it for the first time in March 2024 from the level of -0.1 per cent it had maintained since 2016. This move contributed to a quick appreciation of the yen in early August, which contributed to high but temporary volatility in financial markets. The BOJ expects to further increase the policy rate and continue towards a path of policy normalisation if its projected outlook is realised. It also outlined plans for a gradual reduction in its purchases of Japanese Government bonds to 3tn JPY per month by Jan-Apr 2026, from the current 6tn. Inflation in July was 2.8 per cent, for the third consecutive month, with core inflation increasing to 2.7 per cent from 2.6 per cent in June, the highest level since February. 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 decelerated to an annual growth rate of 4.7 per cent in Q2 2024, from 5.3 per cent the previous quarter, missing expectations. The country is facing weakness in domestic demand, tensions with trading partners, and a property downturn. The property

sector continues to weigh down on the economy, with new house prices falling by 4.9 per cent annually in July, an acceleration in the decline from previous months. Amidst the slowdown in demand, fiscal stimulus remains strong, while the People's Bank of China has in July lowered the 1 and 5-year loan prime rates by 10 basis points each to 3.35 and 3.85 per cent, respectively. Despite monetary and fiscal stimulus, inflation remains below target, recording 0.5 per cent in July 2024; core inflation is also weak, having fallen to 0.4 per cent in July.