Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Box A: QB 3 – September 2023

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The International Economic Outlook

By the Monetary Policy Division

According to the IMF World Economic Outlook (July 2023), global growth is projected to be higher than previous estimates, but it still remains weak by historical standards. Global growth is projected to fall from 3.5 per cent in 2022 to 3.0 per cent in both 2023 and 2024. Advanced economies have played a large part in the decline in global growth in 2022 and will continue to do so through 2023, with weaker manufacturing counteracting stronger services activity. For emerging economies, the growth outlook is holding relatively stable for 2023 and 2024, although with notable regional differences. Global headline inflation is expected to fall from 8.7 per cent in 2022 to 6.8 per cent in 2023 and 5.2 per cent in 2024. Heightened uncertainties surrounding weather related events and geopolitical tensions continue to pose potential risks to global economic landscape.

Euro area GDP is estimated to have risen in Q2 2023 by 0.3 per cent, after a decline of 0.1 per cent in Q1 2023. For the whole of 2022, euro area GDP increased by 3.5 per cent. Economic activity has proven to be stronger than expected in the beginning of 2023, which was in part driven by a boom in the tourism and services sector. However, consumer demand has, in the round, weighed on GDP growth in both Q1 and Q2 2023. ECB staff projections see growth remaining muted and picking up in 2024, as foreign demand approaches its pre-pandemic trend and real incomes grow. Growth in the euro area is projected to be 0.7 per cent in 2023, before rising to 1.0 per cent in 2024 and 1.5 per cent in 2025.

The labour market continues to remain historically strong in the euro area, with seasonally adjusted unemployment remaining stable at a record low level of 6.4% in July 2023. Employment continued to grow, albeit at a slightly slower pace, increasing by 0.2 per cent on a quarterly basis and 1.5 percent annually, in the flash estimate for Q2 2023. While leading indicators of wage dynamics suggest the

recent acceleration in wage growth has plateaued, the rate of growth, in the range of 4-5 per cent, remains high, and if not accompanied by sufficient increases in productivity, poses upside pressure on inflation.

Euro area annual HICP inflation was 5.3 per cent in August, unchanged from July and down from 5.5 per cent in June. On a monthly basis, prices increased by 0.6 per cent in August. Between July and August, energy inflation increased (while remaining negative in annual terms), while services and non-energy industrial goods inflation both decelerated, to 5.5 and 4.8 per cent, respectively. Core inflation (i.e. HICP excluding energy, food, alcohol and tobacco, a key indicator of domestic inflationary pressures) remained elevated, but it declined from 5.5 per cent in July to 5.3 per cent in August. ECB staff projections see inflation averaging 5.6 per cent in 2023, 3.2 per cent in 2024 and 2.1 per cent in 2025.

In order to reinforce progress in bringing euro area inflation toward its 2 per cent target in a timely manner, the ECB governing council at its latest meeting in September decided to raise the three key interest rates by 25 basis points. Cumulatively, the key ECB interest rates have been raised by 450 basis points since the start of the hiking cycle last year; bringing the deposit facility rate, the main refinancing operations rate and the rate on the marginal lending facility to a level of 4.0 per cent, 4. 5 per cent and 4.75 per cent, respectively. Based on its current assessment, the Governing Council considers that policy rates are now at levels that, if maintained for a sufficiently long duration, will make a substantial contribution to bringing euro area inflation back to target. In order to determine the appropriate level and duration of restriction, the Governing Council will continue to take a data-dependant approach going forward, taking regard of the inflation outlook given incoming data, the path of underlying inflation, and the strength of monetary policy transmission.

In the United States, quarterly GDP rose at an annual rate of 2.1 per cent in the second quarter of 2023, after increasing at an annual rate of 2 per cent in the first quarter. The labour market remains strong, with the unemployment rate being 3.5 per cent in July. US inflation rose further by 0.2 per cent monthly in July, reaching an annual rate of 3.2 per cent, slightly higher than 3.0 percent in June; it had reached a peak of 9.1 percent in June 2022. Core inflation also rose by 0.2 per cent in July, reaching an annual rate of 4.7 per cent. In July, the Federal Open Market Committee (FOMC) of the U.S. Federal Reserve decided to raise the target range for the federal funds rate to 5.25 to 5.50 per cent. The FOMC stated that while inflation has somewhat moderated since the middle of last year, the process of getting inflation back down to the 2 per cent target still has a long way to go. The July rate hike came after the FOMC decided to maintain the target range in June in order to properly assess the state of the economy and the appropriate monetary policy stance. Recent resumptions of rate increases after a period of pause have also been made by both the Bank of Canada and the Reserve Bank of Australia.

In the United Kingdom, quarterly GDP increased by 0.2 per cent in the second quarter of 2023. The unemployment rate rose to 4.2 per cent in June from 4.0 per cent in May. UK CPI inflation was 6.8 per cent in July, down from 7.9 per cent in June, largely due to falling gas and electricity prices. Core inflation was 6.9 per cent in July, unchanged from June. At its August meeting, the Bank of England's Monetary Policy Committee (MPC) increased Bank Rate by 0.25 percentage points, to 5.25 per cent, to ensure inflation returns to the 2 per cent target.

In China, following an initial reopening boost, the post-pandemic recovery is losing momentum. The People's Bank of China (PBOC) recently cut policy rates as it is dealing with inflation rates well below target, and potentially facing deflationary risks, with the one-year medium-term lending facility rate cut to 2.5 percent and the seven-day reverse repo rate cut to 1.8 percent in an effort to speed up monetary easing and to boost economic recovery. In Japan, inflation has recently been exceeding the Bank of Japan's (BOJ) target of 2 per cent, after several decades of the economy being in a deflationary environment. In July, the BOJ announced that, while the central target for the 10-year Japanese government bonds would remain 0 per cent (or within a range of -0.5 to 0.5 per cent), it will offer to purchase 10-year JGBs at a rate of 1 per cent, if necessary.