Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Box A: QB 3 – July 2019

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The International Economic Outlook

By Monetary Policy Division

Global economic activity has continued to slow during recent months. Over the past year, trade and investment have moderated sharply, business and consumer confidence have declined, while global trade tensions persist and policy uncertainty remains high. At the same time, financing conditions have eased somewhat, as the US Federal Reserve signalled a more accommodative monetary policy stance looking forward. The IMF revised down its projections in July, forecasting global GDP to grow by 3.2 per cent in 2019 and 3.5 per cent in 2020, 0.1 percentage point lower than in the April projections for both years.

In the euro area, real GDP increased by 0.4 per cent on a quarterly basis and by 1.2 per cent on a yearly basis during the first quarter of 2019, exceeding expectations but largely reflecting temporary factors. A number of persistent adverse factors, mainly related to weak confidence, rising protectionism, and Brexit uncertainties, continue to weigh on the growth outlook. On the other hand, unemployment continued to decrease and reached 7.5 per cent in May, down from 7.6 per cent in April. This is the lowest rate seen since July 2008. Monetary policy remains accommodative, thereby stimulating domestic demand and supporting favourable financing conditions. This, coupled with rising wages, is expected to support consumption and economic activity over the medium term.

The Eurosystem staff macroeconomic projections released in June are broadly in line with those released in March. Euro area GDP is projected to increase by 1.2 per cent in 2019 (slightly revised up compared with the March 2019 projections) and by 1.4 per cent in 2020 and in 2021 (revised down both for 2020 and 2021). The balance of risks is still tilted to the downside, mainly reflecting external geopolitical factors, as well as uncertainties stemming from the risk of rising protectionism and vulnerabilities in emerging markets.

Turning to sentiment indicators, the Markit Eurozone composite PMI was 52.2 in June (up from 51.8 in May). The headline index masked notable divergences in sector performance, with services enjoying a solid rise in activity (at the highest reading in eight months) but manufacturing continued to slow. The European Commission's indicators of business climate, consumer confidence and economic sentiment decreased in June (by 0.13 points to +0.17, by 0.7 points to -7.2 and by 1.9 points to 103.3, respectively).

Euro area annual HICP was 1.3 per cent in June, up 0.1 percentage points compared to May. While the services component picked up somewhat over recent months, prices of non-energy industrial goods have remained at very low levels. Looking forward, energy inflation is expected to decline over the forecast horizon, partly offset by a gradual rise in underlying inflation. The March projections forecast annual HICP inflation at 1.3 per cent in 2019 (revised slightly up compared to the March 2019 projections), 1.4 per cent in 2020 (revised slightly down) and 1.6 per cent in 2021 (unchanged).

At its July meeting, the Governing Council (GC) of the ECB enhanced its forward guidance on interest rates. The key ECB interest rates are now expected to remain at their present levels or lower levels at least through the first half of 2020 and in any case for as long as necessary to ensure the continued sustained convergence of inflation to its aim over the medium term. It confirmed the full reinvestment of the principal payments from maturing securities purchased under the asset purchase programme for an extended period of time past the date when the key ECB interest rates will start rising, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation. In June, he GC also communicated the modalities of the new series of quarterly targeted longer-term refinancing operations (TLTRO-III), announced in March and starting in September 2019. The interest rate will be set at 10 basis points above the average MRO rate over the life of each operation and, for counterparties exceeding their lending benchmark a lower interest rate will apply, which can be as low as the average deposit facility rate plus 10 basis points.

Turning to the United States, the labour market remains robust, with strong job gains and low unemployment, and GDP growth displayed a solid 0.8 per cent increase on a quarterly basis during the first quarter of 2019. However, sentiment indicators have signalled a loss of momentum in business activity since February; the composite PMI reached a three-year low of 50.9 in May, before slightly increasing to 51.5 in June. Headline and underlying inflation are running below 2 per cent; market-based measures of inflation expectations have declined.

The US Federal Open Market Committee (FOMC) maintained the target range for the federal funds rate unchanged at 2.25 to 2.5 per cent. at its June meeting; but looking forward, it signalled a more accommodative monetary policy stance than previously expected. According to the dot plot, eight FOMC participants expect at least one rate cut this year, while nine FOMC participants, a slight majority, expect at least one rate cut by end 2020. In March, no FOMC participant was expecting a rate cut to happen over the forecast horizon.

In the United Kingdom, data have been volatile recently, mainly due to Brexit-related effects on financial markets and business, as, for instance, companies build stocks ahead of recent Brexit deadlines. GDP growth exceeded expectations in the first quarter of 2019, rising by 0.5 per cent on a quarterly basis, but is expected to be flat in the second quarter. The underlying pattern of relatively strong household consumption growth but weak business investment has persisted. Headline inflation is running at levels around the 2 per cent target, but is expected to decline later this year reflecting falling energy prices.

The Bank of England's Monetary Policy Committee (MPC) maintained the Bank Rate and the stock of bond purchases unchanged in June, at 0.75 per cent and at 445 billion GBP respectively. Looking forward, the economic outlook continues to depend significantly on the nature and the timing of the United Kingdom withdrawal from the European Union. The MPC confirmed that it is committed to achieve the 2 per cent inflation target, and that the monetary policy response to Brexit will not be automatic and could be in either direction.