Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Box A: QB 1 – January 2022

This Box content is extracted from the Quarterly Bulletin – Q1 2022

The International Economic Outlook

By the Monetary Policy Division

The global economic outlook is expected to remain positive, owing to a strong recovery in 2021, with both monetary and fiscal policies set to remain generally supportive in 2022. However, with the future of the pandemic remaining uncertain and the continuing potential for new Covid-19 variants to emerge, the pace and distribution of growth across countries will depend on the global rollout and uptake of vaccines and boosters. The latest forecasts from the OECD shows while lower-income countries are highly unlikely to see output reaching pre-pandemic expectations, the output of advanced economies is expected to converge to pre-pandemic trajectories.[1] The OECD highlights that differences in vaccination rates are contributing to the imbalance in economic recovery. Higher income countries are more advanced along their respective vaccination programmes and this should help to spur the normalisation of demand patterns in those economies. An imbalanced labour market has also led to an uneven recovery not just among lower-income countries, but also across advanced economies as certain sectors are experiencing labour shortages despite employment and hours worked having not yet fully recovered in many instances. Common to all economies are higher energy prices and inflationary pressure stemming from a rising demand for goods struggling to be fulfilled against constricted production chains. Such bottlenecks are expected to fade over time. The latest OECD projections, released in December 2021, forecast global growth to moderate from 5.6 per cent in 2021 to 4.5 per cent in 2022 and 3.2 per cent in 2023.

Euro area seasonally-adjusted Gross Domestic Product (GDP) grew by 2.2 per cent in the third quarter of 2021, when compared with the previous quarter. This follows the same growth of 2.2 per cent in the second quarter of 2021. Forecasts for the euro area published by the ECB in December 2021 revised short-term growth downward compared with September

[1] It should be noted that these predictions were estimated prior to the emergence of the Omicron variant.

2021 projections, due largely to more restrictive public health measures and global supply bottlenecks. However, these headwinds are expected to dissipate in the second quarter of 2022, facilitating a bounce-back that should see real GDP by the end of 2022 surpassing the level foreseen at the time of the September 2021 ECB projections. The December projections include euro area real GDP growth of 5.1 per cent in 2021 (up from the September forecast of 5.0 per cent), by 4.2 per cent in 2022 (down from 4.6 per cent) and by 2.9 per cent in 2023 (up from 2.1 per cent). In December, the euro area Purchasing Managers Index (PMI) Composite Output Index, compiled by Markit, decreased to 53.3, from 55.4 in November. This indicates a nine-month low in economic growth, as the euro area experienced a resurgence in Covid-19 infections and the spread of the Omicron variant. Similarly, the Services PMI decreased from 55.9 in November, to 53.1 in December. Manufacturing growth fell to 58.0 during December, down from 58.4 in November and its lowest reading in ten months.

Euro area headline inflation, as measured by the year-on-year increase in the Harmonised Index of Consumer Prices, is estimated to be 5.0 per cent in December, up from 4.9 per cent in November. Looking at the main components of euro area inflation, energy is estimated to have the highest annual rate in December (26.0 per cent, compared with 27.5 per cent in November), followed by food, alcohol and tobacco (3.2 per cent, compared with 2.2 per cent in November). Euro area core inflation is estimated to be 2.6 per cent in December, unchanged from November. Eurosystem staff projections expect inflation to be higher for longer than previously estimated but anticipate a sharp decline in 2022, as higher energy price inflation subsides and supply catches up with demand. Consequently, the annual HICP inflation for the euro area is forecast to average 3.2 per cent in 2022 (up from 1.7 per cent in September) and 1.8 per cent in 2023 (up from 1.5 per cent).

In November 2021, the euro area seasonally-adjusted unemployment rate was 7.2 per cent, down from 7.3 per cent in October 2021 and from 8.1 per cent in November 2020. While continuing to show improvement, current unemployment estimates should continue to be read with caution given that, at least for some market segments, they still may not fully capture the unprecedented labour market situation and resulting supports triggered by the pandemic.

In December, the Governing Council (GC) of the ECB announced a step-by-step reduction in the pace of its asset purchases over the coming quarters. The GC expects to reduce the pace of net asset purchases under the Pandemic Emergency Purchasing Programme (PEPP) in the first quarter of 2022, and net purchases will cease at the end of March 2022. The GC intends

to reinvest the principal payments from maturing securities under the PEPP until at least the end of 2024. To maintain flexibility, the GC's mandate facilitates PEPP reinvestments to be adjusted across time, asset classes and jurisdictions in the event of renewed market fragmentation related to the pandemic. Furthermore, net purchases under the PEPP can restart, if warranted, to counter negative shocks related to the pandemic. With respect to the Asset Purchase Programme (APP), the GC decided on a monthly net purchase pace of €40 billion in the second quarter and €30 billion in the third quarter of 2022. From October 2022 onwards, the GC will maintain net asset purchases under the APP at a monthly pace of €20 billion for as long as necessary to reinforce the accommodative impact of its policy rates. The GC expects net purchases to end shortly before it starts raising the key ECB interest rates. The GC also intends to continue reinvesting, in full, the principal payments from maturing securities purchased under the APP for an extended period of time past the date when it starts raising the key ECB interest rates and, in any case, for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation.

In the United States, real GDP increased by 0.5 per cent quarter-on-quarter in the third quarter of 2021, after a 1.6 per cent increase in the second quarter of 2021. This decrease in growth in the third quarter reflects a resurgence of Covid-19 cases that resulted in new restrictions and delays in the reopening of establishments in some parts of the country. According to the latest OECD projections, released in December 2021, real GDP growth for the US is expected to increase by 5.6 per cent in 2021, with growth falling to 3.7 per cent in 2022 and 2.4 per cent in 2023. Headline inflation in the US rose by 0.5 per cent in December 2021 compared with November 2021 and by 7 per cent compared with December 2020. This represents the largest 12-month increase since the period ending June 1982. Core inflation rose by 0.6 per cent in December 2021 compared with November 2021 and by 5.5 per cent compared with December 2020. According to the latest OECD projections, US headline inflation is expected to rise to 4.8 per cent in 2022 and to fall to 2.5 per cent in 2023. In November, the unemployment rate fell by 0.4 percentage points to 4.2 per cent. While unemployment levels have declined notably over the past year, they remain above the pre-pandemic level of 3.5 per cent in February 2020.

In November 2021, the Federal Reserve's Federal Open Market Committee (FOMC) decided to begin reducing the monthly pace of its net asset purchases by $10 billion for Treasury securities and $5 billion for agency mortgage-backed securities. In December 2021, in light of inflation developments and the further improvement in the labour market, the FOMC

decided to reduce the monthly pace of its net asset purchases further, by $20 billion for Treasury securities and $10 billion for agency mortgage-backed securities. Beginning in January 2022, it will increase its holdings of Treasury securities by at least $40 billion per month and of agency mortgage-backed securities by at least $20 billion per month. The Committee held interest rates in a range of 0 to 0.25 per cent.

In the United Kingdom, GDP is estimated to have increased by 1.1 per cent in the third quarter of 2021. The level of GDP in the UK is now 1.5 per cent below where it was prior to the coronavirus pandemic at the end of 2019. According to the latest OECD projections, released in December 2021, real GDP growth for the UK is projected to rise by 6.9 per cent in 2021, with growth moderating to 4.7 per cent in 2022 and 2.1 per cent in 2023. Headline inflation in the UK increased by 0.7 per cent in November 2021, compared with October 2021 and by 5.1 per cent compared with November 2020. OECD projections estimate UK headline inflation is expected to rise to 4.4 per cent in 2022 and to fall to 2.4 per cent in 2023. At its December meeting, the Bank of England's Monetary Policy Committee (MPC) voted by a majority of 8-1 to increase the Bank Rate by 0.15 percentage points to 0.25 per cent. The MPC voted to maintain the target for the stock of UK government bond purchases at £875 billion and so the total target stock of asset purchases at £895 billion.

Table 1: Growth and inflation forecasts

	Real GDP Growth			Headline Inflation		
	2021	2022	2023	2021	2022	2023
Euro area	5.1	4.2	2.9	2.6	3.2	1.8
United States	5.6	3.7	2.4	4.6	4.8	2.5
United Kingdom	6.9	4.7	2.1	2.4	4.4	2.4

Source: ECB and OECD