Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Box B: **QB 1 – February 2020**

This Box content is extracted from the Quarterly Bulletin – Q1 2020

The International Economic Outlook

By Monetary Policy Division

The outlook for global economic activity remains weak, with only a slow and gradual recovery projected. Persistent political uncertainty, trade tensions and subdued business investment continue to weigh on the world economy and increase the risk of stagnation. Moreover, the coronavirus outbreak in China and its further spreading could cause increasing disruption to the Chinese economy and spill over to the rest of the world. The IMF downgraded its forecasts in January, expecting global GDP growth of 2.9 per cent in 2019, 3.3 per cent in 2020 and 3.4 per cent in 2021. In November, the OECD provided an even less favourable outlook, forecasting a global GDP growth rate of 2.9-3.0 per cent in 2020 and 2021.

In the euro area, seasonally adjusted GDP rose by 0.1 per cent on a quarterly basis and by 1.0 per cent on a yearly basis during the fourth quarter of 2019. Slow growth dynamics mainly reflect the ongoing weakness of international trade in an environment of prolonged global uncertainties and weigh particularly on manufacturing and investment. On the other hand, data point to some stabilisation in the slowdown of economic growth, and the unemployment rate, down to 7.4 per cent in December, is close to historical lows for the euro area.

The ECB macroeconomic projections released in December foresee euro area GDP increasing by 1.2 per cent in 2019, 1.1 per cent in 2020 and 1.4 per cent in both 2021 and 2022 (revised down slightly for 2020). Risks surrounding the outlook remain tilted to the downside, but are assessed to be somewhat less pronounced than in previous quarters.

Sentiment indicators continue to signal a weak outlook for euro area economic activity. The Markit Eurozone composite PMI is expected to remain unchanged at 50.9 in January, signalling that the economy remains close to stagnation at the start of 2020. The headline index continues to mask notable divergence between the performance of the manufacturing and services sectors. In January, the European Commission's consumer confidence indicator for the euro area remained unchanged (at -8.1), while the economic sentiment and business climate indicators increased (by 1.5 points to 102.8, and by 0.09 points to -0.23, respectively).

Euro area annual HICP is expected to be 1.4 per cent in January, up from 1.3 per cent in December. Energy inflation is expected to display the largest increase, at 1.8 per cent up from 0.2% in December. Measures of underlying inflation are expected to remain broadly constant but subdued, with HICP inflation excluding energy and unprocessed food at 1.3 per cent (down from 1.4 per cent in December). ECB projections released in December foresee annual HICP inflation of 1.1 per cent in 2020, 1.4 per cent in 2021 and 1.6 per cent in 2022 (revised up slightly for 2020 and down slightly for 2021).

In light of the subdued outlook for euro area inflation and growth, the ECB Governing Council (GC) at its January meeting reiterated the need for monetary policy to remain highly accommodative for an extended period, and thus confirmed the comprehensive policy package announced in September. The key ECB interest rates are expected to remain at their present or lower levels until the inflation outlook robustly converges to a level sufficiently close to, but below, 2% within the projection horizon, and such convergence has been consistently reflected in underlying inflation dynamics. Net purchases under the asset purchase programme are expected to run at a monthly pace of €20 billion for as long as necessary to reinforce the accommodative impact of policy rates, and to end shortly before policy rates will be increased.

Moreover, the GC launched a review of the ECB monetary policy strategy, which will span the quantitative formulation of price stability, monetary policy toolkit and communication, as well as monetary policy interaction with financial stability, employment and environmental sustainability. During the process, which is expected to be concluded by the end of the year, the Eurosystem will engage with all stakeholders.

Turning to the United States, business investment and exports remain weak, while labour market conditions remain strong and economic activity has been rising at a moderate rate. Headline and underlying inflation are running below 2 per cent and market-based measures of inflation expectations remain low. Having cut the interest rate three times in 2019, the US Federal Open Market Committee (FOMC) decided at its January meeting to maintain the target range for the federal funds rate at 1.5 to 1.75 per cent. Looking forward, the current stance of monetary policy is judged to be appropriate for the near future, with the latest dot plots showing that FOMC members forecast no action on the federal funds rate in 2020.

In the United Kingdom, the growth rate of economic activity is expected to pick up gradually from current low levels, supported by the reduction in Brexit-related uncertainty, fiscal policy easing and a modest recovery in global growth. Inflationary pressures are expected to build gradually, with CPI inflation being projected to slightly exceed the 2 per cent target towards the end of the forecast period. In light of these developments, the Bank of England’s Monetary Policy Committee maintained the Bank Rate and the stock of bond purchases unchanged in January, at 0.75 per cent and at 445 billion GBP respectively.