Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Box A: **QB 1 – March 2024**

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The International Economic Outlook

By the Monetary Policy Division

With the notable exception of the United States, the global economy in 2023 witnessed a weakening in demand and growth momentum. In many cases, this arose in through the effects of high inflation and the associated monetary policy response, and a significant slowdown in international trade partly due to geopolitical tensions. Global inflation rates are now on a steady downward path. Monetary policy tightening has reached its peak in a number of large economies, limiting demand and slowing economic growth. With headline inflation falling towards target in many jurisdictions, market expectations are for policy rates to ease from the current restrictive levels in a number of major economies over the course of 2024. Against this background, global geopolitical tensions continue to remain elevated, with repercussions on global uncertainty, trade and financial markets.

Within this global environment, the March ECB staff macroeconomic projection exercise forecasts 0.6, 1.5 and 1.6 per cent for GDP growth in 2024-2026 and 2.3, 2.0 and 1.9 per cent respectively for inflation. Despite representing a slowdown from +3.5 per cent in 2023, economic growth for the world excluding the euro area has been revised upwards to 3.4, 3.2 and 3.2 per cent in 2024 to 2026 (compared with 3.1, 3.2 and 3.2 respectively); this is for the most part attributable to stronger than expected performance of the US economy, against subdued consumer spending in China. Global (excl. euro area) trade growth is expected to pick up after a weak 2023, to 2.8, 3.1 and 3.2 per cent respectively in 2024-2026. Global CPI inflation is projected to continue reducing gradually, from 4.9 per cent in 2023 to 4.1, 3.2 and 2.8 per cent respectively in the following years.

The euro area economy stagnated in the last quarter of 2023, with GDP unchanged on a quarterly basis compared to Q3 2023, and only 0.1 above the same quarter of 2022. The slowdown in economic activity is the result of a combination of factors, including weak household consumption, fiscal consolidation, weak dynamics for global trade, as well as the delayed effects of unprecedented

monetary tightening on aggregate demand in the economy. The euro area economy is expected to have grown by 0.5 per cent in the whole year of 2023 compared to 2022.

Despite stalled growth and restrictive monetary policy, the labour market remained relatively strong in the euro area, with employment levels growing by a further 0.3 per cent in Q4 2023 compared to the previous quarter (+1.3 per cent compared to Q4 2022). However, as average hours worked per person employed has declined, the total number of hours worked in the economy did not increase as much. The euro area seasonally-adjusted unemployment rate reached a record low of 6.4 per cent in January 2024, down from a level 6.5 it had remained at since March 2023.

After falling steadily throughout the year to a low of 2.4 per cent in November 2023, annual HICP inflation rose to 2.9 per cent in December and later declined to 2.8 per cent in January and 2.6 per cent in February 2024 (0.6 per cent on a monthly basis). The increase since November was in large part due to base effects, especially related to energy prices, dropping out of the calculation (energy inflation rose to -3.7 per cent in February from a low of -11.5 in November). At the same time, annual price growth for most of the main sub-components of HICP continued to fall. In particular, core inflation in February declined from 3.3 per cent to 3.1 per cent, non-energy industrial goods inflation fell from 2.0 per cent to 1.6 per cent, while services inflation (the largest component of the HICP basket and mostly reflecting domestic developments) declined to 3.9 after remaining flat at 4.0 per cent for the previous three months.

The Governing Council of the ECB decided in February to maintain unchanged the deposit facility, main refinancing operations, and marginal lending facility rates at 4.0, 4.5 and 4.75 per cent, respectively. The ECB had previously increased the three key ECB interest rates by a cumulative 450 basis points over 10 consecutive meetings from July 2022 up to September 2023 in an effort to return inflation towards its 2 per cent target. The Governing Council considers the key ECB interest rates to be at levels that, if maintained for a sufficiently long duration, will make a substantial contribution to returning inflation towards the 2 per cent target; however, it will maintain a data-dependent approach to determine the level and duration of monetary restriction. The holdings within the Asset Purchase Programme continue to be gradually reduced by not reinvesting maturing securities. Holdings within the Pandemic Emerging Purchase Programme continue to be reinvested flexibly, but a reduction in the portfolio by €7.5bn per month (done by only partial reinvestments) will start in the second half of the year, while all reinvestments will be discontinued at the end of 2024.

In the United States, the resilience of the economy continued to surprise despite restrictive monetary policy, with household and government consumption remaining particularly strong. GDP increased by 0.8 per cent on a quarterly basis in Q4 2023 (3.1 per cent higher than the same quarter of the previous year). The labour market also remains strong, with the unemployment rate standing at 3.7 per cent in January, unchanged from the previous two months. US CPI inflation has fallen to 3.1 per cent in

January 2024, down from 3.4 in December; it had reached a low of 3.0 per cent in June 2023 and has fluctuated around that level since then. The core inflation rate, although on a slowly declining trend, remained unchanged at 3.9 per cent in January. In January, the Federal Open Market Committee (FOMC) of the US Federal Reserve decided to maintain the target range for the Federal Funds Rate at a level of 5.25 per cent to 5.5 per cent; further decisions will be based on the Committee's assessment of the appropriate monetary policy stance. The FOMC is continuing to reduce the size of the Federal Reserve balance sheet.

In the United Kingdom, GDP fell by 0.3 per cent in Q4 2023, following a contraction of 0.1 per cent in the previous quarter. Trade, household spending and government consumption all declined. Overall, the economy is expected to have grown by 0.1 per cent in 2023 compared to the previous year. The unemployment rate was 3.8 per cent in December, after falling by 0.1 per cent each month since July 2023. UK CPI inflation remained unchanged at 4.0 per cent in January 2024, after declining steadily until November (3.9 per cent). At its February meeting, the Bank of England's Monetary Policy Committee maintained the Bank Rate at 5.25 per cent, a level that was set in August 2023. The MPC judged that monetary policy would need to remain restrictive for sufficiently long so as to return inflation to the 2 per cent target sustainably in the medium term.

The inflation rate in China turned negative in October 2023 amid weak domestic consumption and continuing weakness in the property sector, and by January 2024 it has reached a value of -0.8 per cent. Core inflation remains positive (0.4 per cent) but producer prices are falling. GDP for the full year of 2023 was 5.3 per cent higher than in 2022. While this growth rate compares to a rate of 3.0 in 2022, it represents a significant slowdown in growth compared with the pre-pandemic years. In this context of deflation and weak demand, the People's Bank of China in February reduced the 5-year loan prime rate to 3.95 per cent, from 4.2 per cent previously. GDP in Japan unexpectedly contracted by 0.1 per cent in Q4 2023, after a decline of -0.8 per cent in Q3 due to weak consumer demand. The full year 2023 growth in GDP was 1.9 per cent owing to relatively strong growth in the first half of the year. Inflation declined to 2.6 per cent in December, from 2.8 per cent in November. The Policy board of the Bank of Japan decided to maintain unchanged its current policy of yield curve control, and main policy rate at -0.1 per cent. While headline and core inflation in Japan have recently been above the 2 per cent target, the BOJ believes further accommodation is necessary to sustainably maintain inflation at this target. However, the BOJ notes that the probability of these conditions being reached has recently increased, with tentative signs of a cycle of pass-through of price increases to wages, and vice-versa, having started to take hold.