Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Box B: QB 2 – April 2022

This Box content is extracted from the Quarterly Bulletin – Q2 2022

The International Economic Outlook

By The Monetary Policy Division

Since the Russian invasion of Ukraine in late February, the outlook for the global economy has deteriorated, particularly so in Europe. The war, and economic sanctions that followed, have generated disruptions to energy markets, international trade, and financial markets. Added to this has been considerable economic and geopolitical uncertainty that has hit business and consumer confidence. The economic impact of the war is widely seen as inflationary and damaging for growth prospects. Prior to it however, specifically between the last months of 2021 and the beginning of 2022, the impact of the omicron variant of COVID-19 on the global economy was proving milder than initially expected, and advanced economies were seen as growing strongly despite ongoing supply chain issues and inflationary pressures arising from rising energy prices.

In January 2022, the IMF forecast that the global economy would grow by 4.4 per cent this year, slowing from 5.9 per cent in 2021, with the slowdown attributed partly to the spread of the omicron variant, remaining supply chain issues, and inflationary pressures, particularly from energy prices, as well as a slowdown in China. These projections however do not take into account the effects of the war in Ukraine on the global economy. Subsequently, the IMF has announced that it expects to revise projections downwards as a result of the war, while still seeing global growth as positive in 2022.

Using information available up to 2nd March, the ECB Staff Macroeconomic Projections are the first to estimate the effect of the war in Ukraine on the economic outlook, in a context of high uncertainty about how it will evolve. With an assumption of only a temporary effect of the war on global energy supplies, the forecast for GDP growth in the euro area in 2022 is 0.5 per cent lower than in the December 2021 projections. However, thanks to a strong general economic recovery and labour market, GDP growth is still seen as robust, at 3.7 per cent this year. GDP growth rates in 2023 and

2024 are forecast, respectively, at 2.8 and 1.6 per cent. This revised outlook follows growth in euro area GDP of 5.3 per cent.

The war and its effect on energy markets are expected to put further and longer-lasting pressures on energy prices, and also on food prices. Because of this, euro area inflation is projected to average 5.1 per cent in 2022 (up 1.9 percentage points compared to the December 2021 projections). These pressures on food and energy prices are forecasted to dissipate over the course of 2022, with euro area inflation in 2023 and 2024 respectively projected at 2.1 and 1.9 per cent (both also revised upwards), broadly in line with the ECB's target.

Euro area annual HICP inflation was 5.9 per cent in February 2022, significantly up from 5.1 per cent in January. Monthly inflation stood at 0.9 per cent, up from 0.3 per cent. Energy remains the most significant contributor to euro area inflation, and stood at 31.7 per cent in February 2022, when compared with the same period a year earlier. Underlying inflation also increased strongly however, with HICP excluding energy and unprocessed food showing a reading of 2.9 per cent for February, and a month-on-month inflation rate of 0.6 per cent.

The euro area seasonally-adjusted unemployment rate stood at 6.8 per cent in January 2022, down from 7.0 per cent in December 2021 and 8.3 per cent in January 2021. It represented the lowest value for unemployment in the historical series for the euro area. In Q4 2021, the annual growth rate of employment in persons for the euro area was 2.2 per cent, up from 2.1 per cent in Q3. ECB projections for the euro area unemployment rate in 2022 remain unchanged since the December forecast, at 7.3 per cent, while it was revised up in both 2023 and 2024 to 7.2 and 7.0 per cent.

Prior to the war in Ukraine, the Markit Eurozone Composite PMI indicators were pointing to both an increased pace of growth in economic activity and in business input and output prices through February.

In its March 2022 meeting, the ECB Governing Council (GC) revised the schedule for its asset purchase programme (APP), with purchases amounting to €40bn in April, €30bn in May and €20bn in June. The GC will end net purchases in the third quarter if the data will support the expectation that the medium-term inflation outlook will not weaken afterwards. Should the medium-term inflation outlook change and financing conditions become inconsistent with progress towards the two per cent target, the ECB stands ready to revise this schedule. Any adjustments to the key ECB interest rates will take place some time after the end of net purchases and will be gradual and determined by the GC's forward guidance and by its commitment to stabilise inflation at two per cent over the medium term.

In the United States, quarterly GDP increased by 1.7 per cent in the fourth quarter of 2021, after a 0.6 per cent increase in the third quarter. Overall, US GDP in 2021 was 5.7 per cent higher than in 2020.

In February 2022, the unemployment rate stood at 3.8 per cent, down from 4.0 per cent in January and 6.2 per cent in February 2021. At its January meeting, the Federal Open Market Committee (FOMC) of the US Federal Reserve maintained the target range for the Federal Funds Rate at 0 to 0.25 per cent. However, with inflation well above 2 per cent and a strong labour market, the FOMC expects it will soon be appropriate to raise the target range for the federal funds rate. The FOMC decided to continue to reduce the monthly pace of its net asset purchases.

In the United Kingdom, quarterly GDP increased by 1.0 per cent in the fourth quarter of 2021 (+6.5 per cent relative to Q4 2020), unchanged compared to the third quarter. Across 2021, GDP increased by 7.5 per cent following a 9.4 per cent fall in 2020. At its February meeting, the Bank of England's Monetary Policy Committee voted to increase the Bank Rate by 0.25 percentage points, to 0.50 per cent, after a 0.15 per cent increase in December. The Committee decided to begin reducing the Bank of England's stock of UK government bonds by ceasing to reinvest maturing assets. A similar approach will be taken for sterling non-financial investment-grade corporate bond holdings, in conjunction with a programme of corporate bond sales to be completed no earlier than late 2023 that should unwind fully the stock of corporate bond purchases of recent years.