Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Box A: QB 2 – June 2023

This Box content is extracted from the Quarterly Bulletin – Q2 2023

The International Economic Outlook

By the Monetary Policy Division

After peaking at elevated levels towards the end of 2022, inflation in major advanced economies has been on a declining path. This occurred as global prices of energy and commodities moderated after the extremely elevated levels they reached as a result of a strong post-pandemic surge in demand meeting supply shortages, combined with the effects of the Russian war in Ukraine. Generally faced with strong domestic inflationary pressures and high core inflation, central banks across the world have continued raising interest rates.

According to the OECD June 2023 economic outlook, after growing by 3.2 per cent in 2022, which is more than 1 percentage point less than expected at end 2021, GDP growth for the world economy in 2023 and 2024 is forecasted to reach 2.7 per cent and 2.9 per cent, respectively. This would represent the slowest rate of growth for the world economy since the global financial crisis. Inflation in the OECD is predicted to fall from 9.4 per cent in 2022 to 6.6 per cent in 2023 and 4.3 per cent in 2024, with core inflation remaining particularly persistent. The IMF world Economic Outlook (April 2023) paints a similar picture, with global growth forecasted to be 2.8 per cent in 2023 and 3.0 per cent in 2024. The slowdown in growth in advanced economies is predicted to be significantly more pronounced than for developing economies, with growth in these economies falling from 2.7 per cent in 2022 to 1.3 per cent in 2023. The IMF also sees inflation to be elevated but declining throughout the forecast horizon.

Due to the energy price shock and declining post-pandemic momentum, euro area growth slowed down considerably throughout 2022, with GDP contracting marginally, by 0.1 per cent, in both Q4 2022 and Q1 2023. In annual terms, GDP was 1.0per cent higher in Q1 2023 compared to the same quarter a year before (as opposed to a 1.8per cent year-on-year growth rate in Q4 2022). Improvements in the trade balance as energy prices continued falling from their 2022 peaks contributed positively to growth, while domestic activity, weighed down by inflation, had a negative contribution to GDP. ECB staff projections published in June 2023 see GDP growth slowing

significantly in 2023, to 0.9 per cent, recovering somewhat to 1.5 and 1.6 per cent in 2024 and 2026 respectively. The ECB further predicts inflation to decline gradually through the projection horizon, falling from 8.4 per cent in 2022 to 5.4, 3.0 and 2.2 per cent in 2023, 2024 and 2025.

The labour market remained exceptionally strong in the euro area, with the seasonally-adjusted unemployment rate declining to 6.5per cent in April 2023, a new record low.. In terms of the number of persons employed, this continued to grow at a strong pace in the first quarter of 2023, increasing by 0.6 per cent on a quarterly basis, and 1.6 per cent annually, accelerating from 1.5per cent growth year on year in Q4 2022. The strong labour market continues to put upward pressure on wages and thus medium-term inflation.

Euro area annual HICP inflation continued to steadily decline from the two-digit rates reached at the end of last year, due in great part to a sharp drop in energy inflation. HICP inflation fell to 6.1 per cent in May according to a Eurostat flash estimate, down from 7.0 per cent in April and below forecasters' expectations. The month-on-month rate of inflation was zero. All the major sub-components of the index saw a decline in their growth, with energy inflation turning negative (-1.7 per cent year-on-year and -2.2 per cent month-on-month). Food inflation decelerated to 12.5 per cent from 13.5 per cent in April and 15.5 per cent in March, but remains the largest contributor to overall euro area HICP inflation. Core inflation (i.e. HICP excluding energy, food, alcohol and tobacco) declined to 5.3 per cent from 5.6 per cent in April. Services inflation, the largest component of the HICP basket, declined from 5.2 per cent to 5.0 per cent.

As euro area inflation remains well above the European Central Bank's target of 2 per cent, and noting in particular the strength of underlying inflationary pressures, the ECB Governing Council has continued to bring interest rates into sufficiently restrictive territory to ensure inflation returns to target in the medium term. At its latest meeting in June, the Governing Council decided to raise the three key interest rates by 25 basis points, while maintaining a data-dependent and meeting-by-meeting approach for future decisions. Cumulatively, the key ECB interest rates have been raised by 400 basis points since the start of the hiking cycle last year; this brought the deposit facility rate, the main refinancing operations rate and the rate on the marginal lending facility at a level of, respectively, 3.50, 4.00 and 4.25 per cent after the June Governing Council meeting. As previously announced, reductions in the ESCB's holdings of assets under the APP programme will amount to €15 billion per month until the end of June 2023; these reductions will be done by only partially reinvesting maturing securities under the APP. At the June meeting, the Governing Council confirmed it will then discontinue all reinvestments under the APP starting from July, implying a faster reduction in asset holdings.

In the United States, quarterly GDP increased by 0.3 per cent in the first quarter of 2022, after another 0.6 per cent increase in the previous quarter. In annual terms, GDP growth rebounded to 1.6

per cent in Q1 2023 from 0.9 per cent in Q4 2022. The labour market remains particularly strong, although the unemployment rate unexpectedly increased to 3.7 per cent in May, from 3.4 in April. US inflation further declined to 4.0 per cent in May 2023 from 4.9 the previous month; it had reached a peak of 9.1 per cent in June 2022 and had been falling since. Core inflation in the US, at 5.3 per cent in May, is now higher than headline inflation. In June, the Federal Open Market Committee (FOMC) of the US Federal Reserve decided to maintain the target range for the Federal Funds Rate at its current level of 5.00 to 5.25 per cent. The FOMC stated that this pause will allow the Federal Reserve to properly assess the state of the economy and the appropriate monetary policy stance, maintaining the options open for further increases in the federal funds rate at later meetings. Recent resumptions of rate increases after a period of pause have been made by both the Bank of Canada and the Reserve Bank of Australia.

In the United Kingdom, quarterly GDP increased by 0.1 per cent in the first quarter of the year, following the same growth in the previous quarter. The unemployment rate slightly increased to 3.9 per cent in March from 3.8 per cent in February. UK inflation in April declined to 8.7 per cent from 10.1 per cent in March 2022 partly due to a fall in energy inflation; meanwhile, core inflation accelerated to 6.8 per cent. At its May meeting, the Bank of England's Monetary Policy Committee voted to increase the Bank Rate by a further 25 basis points, to 4.5 per cent, to ensure inflation returns to the 2 per cent target.

The People's Bank of China, on the other hand, was one of the few outliers in terms of monetary policy stance over the past year. Inflation in China has fallen well below 2 per cent since the beginning of 2023 and the country is even potentially facing deflationary risks. In June, the PBOC lowered its seven-day reverse repo rate by 10 basis points to 1.90 per cent.