Banc Ceannais na hÉireann
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Box C: QB3 – July 2020

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The International Outlook

By Monetary Policy Division

The COVID-19 pandemic has triggered the most severe economic recession in nearly a century and is causing enormous damage to people's health, employment and well-being. In April, the IMF projected that the global economy would contract by 4.9 percent in 2020 and – assuming that the pandemic fades in the second half of 2020 – grow by 5.4 percent in 2021 as economic activity normalises, aided by policy support. Risks of more severe outcomes, however, were considered substantial. In June, the OECD released projections based on two equally probable scenarios – a double-hit scenario in which a second wave of infections, with renewed lock-downs, hits before the end of 2020, and a single-hit scenario in which another major outbreak is avoided. While the latter projects global economic activity to fall by 6 percent in 2020, in the double-hit scenario world economic output could plummet by 7.6 percent this year, before climbing back by only 2.8 percent in 2021.

In the euro area, seasonally adjusted GDP decreased by 3.6 percent on a quarterly basis (down from a 0.1 percent increase in the previous quarter) and by 3.1 percent on a yearly basis during the first quarter of 2019. The number of persons employed decreased by 0.2 percent compared with the previous quarter, displaying the first decline in the time series since the second quarter of 2013. In June, the ECB revised downward its projections for euro area economic activity. Euro area GDP is now expected to decrease by 8.7 percent in 2020, before increasing by 5.2 percent in 2021 and 3.3 percent in 2022. However, if a more adverse scenario of the pandemic materialises,[1] the ECB estimates that

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[1] In the severe scenario, a longer-term strict lockdown period (ending in the course of June 2020) has only limited success in containing the spread of the virus, thus requiring ongoing tough containment measures to remain in place even after some loosening of the very strict lockdowns. This scenario envisages significant and permanent output losses.

GDP could decrease by 12.6 percent in 2020, before increasing by 3.3 percent in 2021 and 3.8 percent in 2022.

Sentiment indicators continue to signal a sharp fall in economic activity in the euro area. Following April's survey historical low (13.6), the Markit Eurozone Composite PMI noticeably bounced in May, posting 31.9. Nonetheless, by remaining well below the 50.0 no-change mark, the index was again consistent with sharply falling activity as Covid-19 continued to have a severe impact on economic performance in both manufacturing and services. After the record slumps of March and April, the European commission business and consumer surveys showed first signs of a recovery in economic sentiments in May, while remaining historically low.

Euro area annual HICP was 0.1 percent in May, down from 0.3 percent in April. Low headline inflation was mainly due to sharply falling energy prices, which decreased by 11.9 percent in May on an annual basis. Measures of underlying inflation remained broadly stable but subdued, with HICP inflation excluding energy and unprocessed food at 1.2 percent (up from 1.1 per cent in April). ECB macroeconomic projections released in June include substantial downward revisions compared with March projections for the whole projection horizon, and foresee annual HICP inflation of 0.3 percent in 2020, 0.8 percent in 2021 and 1.3 percent in 2022. However, if a more adverse scenario of the Covid-19 pandemic materialises, the ECB estimates that HICP inflation could be even lower – namely, 0.2 percent in 2020, 0.4 percent in 2021 and 0.9 percent in 2021.

In June, in response to the pandemic-related downward revision to inflation over the projection horizon, the Governing Council (GC) of the ECB decided to increase the envelope for the pandemic emergency purchase programme (PEPP) by an additional €600 billion, bringing it to a total of €1,350 billion. The horizon for net purchases under the PEPP was extended to at least the end of June 2021, and the maturing principal payments from securities purchased under the PEPP will be reinvested until at least the end of 2022. The GC reiterated its commitment to adjust all of its instruments as appropriate to ensure that inflation moves towards its aim in a sustained manner.

Since the outbreak of Covid-19, the US Federal Reserve has intervened to provide monetary accommodation. The target range of the federal funds rate has been reduced by a total of 150 basis points and is now at 0 to 0.25 per cent. To support the smooth functioning of the monetary transmission mechanism, the Fed has moreover steadily increased its holdings of Treasury securities and agency residential and commercial mortgage-backed securities, offering at the same time large-scale overnight and term repurchase agreement operations.

Over the last monetary policy meetings, the Bank of England has also reduced its Bank Rate by 65 basis points to 0.1 per cent. In addition, it has increased its holdings of UK government bonds and sterling non-financial corporate bonds. This takes the total stock of asset purchases to £645 billion, and has introduced a new term funding scheme with additional incentives for small and medium-sized enterprises. This will be financed by the issuance of central bank reserves.