Banc Ceannais na hÉireann
Central Bank of Ireland
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Box B: QB 4 – October 2019

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The International Economic Outlook

By Monetary Policy Division

The outlook for global economic activity continued to worsen over the last months. Escalating trade tensions increasingly weigh on investment and confidence, adding to policy uncertainty and aggravating risks in financial markets. The OECD revised its projections in September further downward, foreseeing global GDP growth of 2.9 per cent in 2019 and 3.0 per cent in 2020. The OECD's assessment of the outlook is materially less favourable than the one provided by the IMF in July, which forecast global GDP growth of 3.2 per cent in 2019 and 3.5 per cent in 2020.

In the euro area, real GDP increased by 0.2 per cent on a quarterly basis and by 1.2 per cent on a yearly basis during the second quarter of 2019. The growth slowdown mainly reflects the weakness of trade in an environment of prolonged global uncertainties, which is particularly affecting the euro area manufacturing sector. On the other hand, the unemployment rate is close to historical lows for the euro area, remaining constant at 7.5 per cent in July – which is the lowest rate recorded since July 2008.

The ECB macroeconomic projections released in September foresee euro area GDP increasing by 1.1 per cent in 2019, 1.2 per cent in 2020 and 1.4 per cent in 2021 (revised down for 2019 and 2020). The balance of risks remains tilted to the downside, reflecting the prolonged persistence of uncertainty related to geopolitical factors and Brexit, as well as the risk of rising protectionism and vulnerabilities in emerging markets.

Sentiment indicators continue to signal a worsening outlook. The flash reading of the Markit Eurozone composite PMI posted 50.4 in September (down from 51.9 in August). The headline index continues to mask notable differences in sector performance; but the deepening manufacturing downturn (down to 46.0 from 47.9 in August) shows signs of spreading to the services sector (down to 52.0 from 53.5 in August). In August, the European Commission's business climate indicator for the euro area returned positive (up by 0.22 points to +0.11) and the economic sentiment indicator moved slightly up (by 0.4 points to 103.1, respectively), while the consumer confidence indicator decreased (by 0.5 points to -7.1).

Euro area annual HICP was 1.0 per cent in August, stable compared to July. Energy inflation displayed the largest decline, down to -0.6 per cent from 0.5 per cent in July. Measures of underlying inflation remained stable but subdued, with HICP inflation excluding energy and unprocessed food at 1.1 per cent, unchanged from July. The ECB revised down the outlook for inflation for the whole projection horizon: September projections forecast annual HICP inflation to be 1.2 per cent in 2019, 1.0 per cent in 2020 and 1.5 per cent in 2021.

In light of the weakening outlook for euro area inflation and growth, the ECB Governing Council (GC) announced a broad package of measures at its September meeting. The GC lowered the deposit facility rate (DFR) by 10 basis points to -0.50% and announced a two-tier system for reserve remuneration, in which part of banks' holdings of excess liquidity will be exempt from the negative DFR. State-contingent forward guidance was reinforced, with the key ECB interest rates being now 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 (APP) will restart in November at a monthly pace of €20 billion and are expected to run for as long as necessary to reinforce the accommodative impact of policy rates, and to end shortly before policy rates will be increased. The new series of targeted longer-term refinancing operations (TLTRO III) will be more accommodative than previously announced, with their rates reduced by 10 basis points and their maturity extended from two to three years.

Turning to the United States, business investment and exports have weakened, while labour market conditions and the growth rate of economic activity remain robust. Headline and underlying inflation are running below 2 per cent and market-based measures of inflation expectations remain low. Following the rate cut implemented in July, the US Federal Open Market Committee (FOMC) lowered the policy rate by an additional 25 basis points at its September meeting, setting the target range for the federal funds rate at 1.75 to 2 per cent. Looking forward, the FOMC estimates that sustained economic growth, strong labour market conditions and inflation near 2 percent are the most likely outcomes, but uncertainties about this outlook remain.

In the United Kingdom, data continue to be volatile: quarterly GDP declined by 0.2 per cent in the second quarter of 2019 but is expected to rise by 0.2 per cent in the third quarter. Shifting expectations about the potential timing and nature of Brexit have continued to heighten volatility in asset prices and in the exchange rate. The Bank of England's Monetary Policy Committee maintained the Bank Rate and the stock of bond purchases unchanged in September, at 0.75 per cent and at 445 billion GBP respectively. Looking ahead, the MPC assesses that the appropriate monetary policy response continues to depend on the effects of Brexit on demand, supply, and the exchange rate; as such, it will not be automatic and could be in either direction.