Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Box B: QB 4 – October 2020

This Box content is extracted from the Quarterly Bulletin – Q4 2020

The International Outlook

By Monetary Policy Division

Global economic activity has shown signs of recovery following the easing of measures to contain the Covid-19 pandemic, after collapsing in the first half of the year. However, the pace of recovery has lost momentum over the summer, and the risk that a second wave of infections will force governments to re-impose containment measures is on the rise, negatively affecting confidence. In June, the IMF projected that the global economy will contract by 4.9 percent in 2020, 1.9 percent below April's projection, before expanding by 5.4 percent in 2021. At the same time, the IMF remarked that the degree of uncertainty surrounding baseline projections is much higher than usual.

During the second quarter of 2020, marked by Covid-19 containment measures in most member states, euro area GDP decreased by 11.8 percent on a quarterly basis (down from a 3.7 percent contraction in the previous quarter) and decreased by 14.7 percent on an annual basis. The number of employed persons in the euro area decreased by 2.9 percent compared with the previous quarter (following a 0.3 percent decrease in in the previous quarter). Both GDP and employment registered the sharpest declines observed since the time series started in 1995. In September, the ECB revised upward its projections for the euro area GDP growth in 2020, now expected to decrease by 8.0 percent, up from an 8.7 percent contraction projected in June. GDP is then expected to increase by 5.0 percent in 2021 and 3.2 percent in 2022. However, if a more adverse scenario of the pandemic materialises,[1] the ECB estimates that GDP could decrease by 10.0 percent in 2020, before increasing by only 0.5 percent in 2021 and 3.5 percent in 2022.

Sentiment indicators signal that the recovery of the euro area economic activity has lost momentum in September. After rebounding sharply in July and, to a lesser extent, in August, the Markit Eurozone

[1] The severe scenario is based on the assumption that a strong resurgence of the pandemic leads governments to restore stringent containment measures, which would significantly dampen activity across sectors of the economy until a medical solution becomes available.

Composite PMI fell to 50.1 in September (flash estimate, down from 51.9 in August). The reading indicated a near stalling of the economy at the end of the third quarter as rising infection rates and ongoing social distancing measures curbed demand, notably for consumer-facing services. A renewed downturn in the service sector offset faster growth in manufacturing.

Euro area annual HICP was –0.2 percent in August, down from 0.4 percent in July. While negative headline inflation was mainly due to decreasing energy prices (–7.8 percent on annual basis), underlying inflation was subdued, with HICP inflation excluding energy and unprocessed food increasing by only 0.6 percent (down from 1.3 percent in July). August figures, however, were affected by negative base effects due to sales periods falling in August instead of July in a number of member countries. ECB projections for the euro area inflation remained broadly unchanged in September. The ECB foresees annual HICP inflation of 0.3 percent in 2020, 1.0 percent in 2021 (up from a 0.8 percent forecast in June) 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 lower – namely, 0.3 percent in 2020, and 0.7 percent in 2021 and in 2022.

At its September meeting, the Governing Council (GC) of the ECB confirmed its forward guidance on the key ECB interest rates, as well as its commitments in terms of net purchases and reinvestment under the APP and the PEPP programmes. With respect to the latter, the GC confirmed that the PEPP will have a total envelope of €1,350 billion by end of June 2021, and maturing principal payments will be reinvested until at least the end of 2022. Purchases will continue to be conducted in a flexible manner over time, across asset classes and among jurisdictions, so as to stave off risks to the smooth transmission of monetary policy throughout the euro area.

Turning to the United States, GDP decreased by 9.1 on a quarterly basis during the second quarter of 2020 (after decreasing by 1.3 percent in the first quarter). In August, the unemployment rate declined by 1.8 percentage points to 8.4 percent. Unemployment has declined for four consecutive months, reflecting the continued resumption of economic activity that had been curtailed due to the pandemic and efforts to contain it, but is still 4.9 percentage points higher than in February.

On 27 August, the FOMC announced the completion of its strategy review, with the adoption of a strategy that seeks to achieve inflation that averages 2 percent over time. At its September 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%. As inflation is running persistently below the FOMC's longer-run goal, rates will remain unchanged until inflation will be moderately above 2 percent for some time so that inflation averages 2 percent over time, and longer-term inflation expectations remain well anchored at 2 percent.

In the United Kingdom, the impact on economic activity of the Covid-19 pandemic and related containment measures has been particularly severe in the second quarter of 2020, with GDP decreasing by 20.4 percent on a quarterly basis and by 21.7 percent on an annual basis. At its August

meeting, the Bank of England maintained the Bank Rate at 0.1 percent and confirmed the continuation of its quantitative easing

programme, with the target for the total stock of asset purchases unchanged at £745 billion. Looking forward, the path of economic activity will depend not only on the evolution of the pandemic and related containment measures, but also on the nature of, and transition to, the new trading arrangements between the European Union and the United Kingdom.