Banc Ceannais na hÉireann
Central Bank of Ireland
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Box A: QB 4 – December 2023

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The International Economic Outlook

By Monetary Policy Division

The post-pandemic rise in inflation, which affected economies throughout the globe, and the subsequent monetary policy tightening by most of the world's central banks, have shaped developments in the global economy in the last couple of years. Global inflation rates are now declining. Monetary policy tightening and its effects on economic activity is now limiting demand and slowing down economic growth. Against this background, global geopolitical tensions continue to remain elevated, with repercussions for global uncertainty, trade and financial markets.

The latest Eurosystem Broad Macroeconomic Projection Exercise foresees global GDP growth (excluding the euro area) averaging just above 3 per cent out to 2026. These rates of growth for the global economy are below the historical average throughout the period, with the relative weakness in large part due to the impact of monetary policy tightening especially in advanced economies. A significant slowdown in China's growth due to structural factors, despite stimulus, also contributes to this weaker outlook. Global trade, which was weak in 2023 due to further normalisation of global consumption patterns post-pandemic, is projected to gradually recover through the projection horizon, although worsening geopolitical tensions represent a significant downward risk.

The euro area economy weakened in the second half of 2023 and the short-term outlook points to stagnation in the face of tighter financing conditions, weak business and consumer confidence and low foreign demand. Over the medium term the economy should gradually return to moderate growth as both domestic and foreign demand recover. Overall, annual

GDP growth is expected to slow to 0.6% in 2023, before recovering slightly to 0.8% in 2024, and then stabilising at 1.5% in 2025 and 2026.

Inflation has continued to decline, and more recently fallen more than expected, due to falling energy inflation, ongoing easing pipeline pressures and supply bottlenecks and the impact of monetary policy tightening. All main components have been contributing to this decline, which reflects the broad based disinflationary process unfolding. It is expected to pick up temporarily in the coming months due to a rebound in energy inflation, but the ongoing disinflationary process is expected to continue as the effects of past energy price shock and other pipeline pressures fade. The strength in labour costs will then be the dominant driver of core inflation. Overall, headline HICP inflation is expected to decrease from 5.4% in 2023 to an average of 2.7% in 2024, 2.1% in 2025 and 1.9% in 2026.

Employment has been relatively resilient to the weakening in economic activity but there is some evidence that the labour market is cooling. employment levels growing by a further 0.2 per cent in Q3 2023 compared to the previous quarter (+1.3 per cent compared to Q3 2022). The seasonally-adjusted unemployment rate remained at its record low of 6.5 per cent in October. Labour demand (as reflected in job vacancy rates and Indeed data, is declining from high levels and employment is expected to soften in the last quarter of this year. Wage pressures are expected to remain high in the near term as forward-looking wage trackers signal high wages pressures, while unit profits are expected to weaken as they mitigate the inflationary effects of wage increases.

After increasing the three key ECB interest rates by a cumulative 450 basis points since July 2022 in an effort to return inflation to the 2 per cent target, the Governing Council of the ECB decided in December to maintain the deposit facility, main refinancing operations, and marginal lending facility rates at 4.0, 4.5 and 4.75 per cent, respectively. The Governing Council considered the key ECB interest rates to be at levels that, maintained for a sufficiently long duration, will make a substantial contribution to returning inflation towards the 2 per cent target; however it will maintain a data-dependent approach to determine the level and duration of monetary restriction. The holdings within the Asset Purchase Programme continue to be gradually reduced by not reinvesting maturing securities, while holdings within the Pandemic Emerging Purchase Programme continue to be reinvested flexibly. Over the second half of 2024, the Governing Council intends to reduce the PEPP portfolio by €7.5 billion per month on average, with reinvestments under the PEPP being discontinued at the end of 2024.

In the United States, the economy continued to show resilience despite the restrictive monetary policy stance, with household and government consumption growth remaining particularly strong. GDP increased by 5.2 per cent on an annualised quarterly basis in Q3 2023 (equivalent to +1.3 per cent quarter-on-quarter), after another 0.5 per cent QoQ increase in the previous quarter. The labour market also remains strong, with the unemployment rate standing at 3.9 per cent in October. US headline inflation marginally declined to 3.1 per cent in November, from 3.2 per cent in October. However, core inflation remained unchanged at 4.0 per cent, twice the Federal Reserve's target rate of inflation. In December, the Federal Open Market Committee (FOMC) of the US Federal Reserve decided to maintain the target range for the Federal Funds Rate at a level between 5.25 and 5.5 per cent. The median view of members of the FOMC, in their projections, was for the federal funds rate to fall to 4.6 per cent from the current levels in 2024 (3.6 in 2025), and to reach the inflation target by 2026. The FOMC will continue to monitor incoming data and is ready to adjust the stance of monetary policy as appropriate.

In the United Kingdom, GDP remained flat in Q3 2023 (+0.6 per cent YoY), following quarterly growth of 0.2 per cent in the previous quarter. The unemployment rate was 4.2 per cent in September, unchanged from the previous quarter. UK CPI inflation fell sharply in October to 4.6 per cent (its lowest level since October 2021), from 6.7 per cent in September mainly due to a fall in energy prices. At its November meeting, the Bank of England's Monetary Policy Committee maintained the Bank Rate at its current cyclical peak of 5.25 per cent, a rate that was reached in August 2023. In its Monetary Policy Report, the Bank sees inflation falling further and to reach its target by end 2025 if interest rates are kept high enough for a sufficient period of time.

Faced with deflation in China as a result of sluggish domestic demand, particularly from consumers (headline inflation in China reached a low of -0.5 per cent in November, although core inflation remained positive albeit at a low 0.6 per cent), and continued weakness of the property sector, the People's Bank of China maintained the loan prime rate at its record low of 3.45 per cent in November.

In November, the Policy Board of the Bank of Japan decided to maintain its policy of yield curve control, while adjusting its terms. The Board maintained the target level of 10-year Japanese government bond yields at around zero per cent, conducting yield curve control with the upper bound of 1.0 per cent for these yields as a reference and controlling the yields mainly through large-scale JGB purchases and nimble market operations. This could

potentially pave the way for the eventual abandonment of yield curve control, which could have large implications for global financial markets. While headline and core inflation in Japan have recently been above the 2 per cent target, the BOJ believes further accommodation is necessary to maintain inflation sustainably at this target.