Banc Ceannais na hÉireann
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Box A: QB 4 – October 2021

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The International Outlook

By Monetary Policy Division

Global economic prospects have diverged along vaccine access and policy support lines. While almost all advanced economies are anticipating a normalization of economic activity toward the end of this year, many emerging markets and developing economies continue to face resurgent infections and rising Covid death tolls. In July, the IMF forecast global growth of 6 per cent in 2021 and 4.9 per cent in 2022, with prospects for developing economies being marked down for 2021 and those for advanced economies being revised up. Beyond the impact of varying vaccine rollouts rates and policy support, a patchy recovery is expected to be further shaped by new variants, aftershocks and supply-demand mismatches. Despite this uncertainty, financial conditions remain supportive and market sentiment is positive, given the expected global recovery.

Euro area seasonally-adjusted Gross Domestic Product (GDP) grew by 2.2 percent in the second quarter of 2021, when compared with the previous quarter. The follows a decline of 0.3 percent in the first quarter. The euro area economy is expected to grow rapidly in the second half of 2021 and to then gradually normalise. This reflects the assumptions that containment measures will continue to ease at an increased rate, supply bottlenecks will be alleviated from the start of 2022, substantial policy support will be ongoing and a continued global recovery. ECB projections expect euro area real GDP to grow by 5 per cent in 2021, and by 4.6 per cent and 2.1 per cent in 2022 and 2023 respectively.

In July 2021, the euro area seasonally-adjusted unemployment rate was 7.6 per cent, down from 7.8 per cent in June 2021 and from 8.4 per cent in July 2020. While showing improvement, current unemployment estimates should continue to be read with caution, as they do not fully capture the unprecedented labour market situation triggered by the pandemic. Euro area Purchasing Managers Indices (PMIs), compiled by Markit, continue to show strong levels of relative expansion, albeit at a

more moderate pace in the most recent months for both services and manufacturing. Manufacturing growth in the euro area slowed to a six-month low in August, with the final PMI at 61.4, down from 62.8 in July. Supply issues, stemming from input prices, a lack of components and shipping capacity, have been the primary cause of this shortfall in manufacturing production relative to orders.

Euro area headline inflation, as measured by the year-on-year increase in the Harmonised Index of Consumer Prices, stood at 3.0 per cent in August, up from 2.2 percent in July, according to Eurostat. Looking at the main components of euro area inflation, energy had the highest annual rate in August (15.4 per cent, compared with 14.3 per cent in July), followed by non-energy industrial goods (2.7 per cent, compared with 0.7 per cent in July). ECB projections for the euro area inflation have been revised upward for this year and next, and now expect HICP inflation to average 2.2 per cent in 2021 (up from the June forecast of 1.9 per cent), 1.7 per cent in 2022 (up from 1.5 per cent) and 1.5 per cent in 2023 (up from 1.4 per cent).

In July, the Governing Council of the ECB adjusted its forward guidance, in line with its new monetary policy strategy, which was approved and announced on 8 July.[1] The key ECB interest rates are now expected to remain at their present, or lower, levels until the Governing Council sees inflation reaching 2 per cent well ahead of the end of its projection horizon and durably for the rest of the projection horizon, and it judges that realised progress in underlying inflation is sufficiently advanced to be consistent with inflation stabilising at 2 per cent over the medium term. This may imply a transitory period in which inflation is moderately above target. In September, the Governing Council confirmed the monetary policy package in place, including continuing net asset purchases under the pandemic emergency purchase programme (PEPP) with a total envelope of €1,850 billion until at least the end of March 2022. It decided, however, that favourable financing conditions can be maintained with a moderately lower pace of net asset purchases under the PEPP than in the previous two quarters.

In the United States, real GDP increased by 1.6 per cent quarter-on-quarter in the second quarter of 2021, after a 1.5 percent increase in the first quarter. The increase in second quarter GDP reflected the continued economic recovery, reopening of establishments, and continued government response related to the Covid-19 pandemic. In August, the unemployment rate declined to 5.2 per cent. While unemployment levels have declined notably over the past year, they remain well above the pre-pandemic level of 3.5 per cent in February 2020. In July, the Federal Reserve's Federal Open Market Committee (FOMC) held interest rates in a range of 0 to 0.25 per cent, in a unanimous decision. The FOMC committed to maintaining an accommodative stance, and reiterated that it would continue its asset purchase programme at a rate of $120 billion per month until "substantial further progress" was

[1] A Signed Article included in this *Bulletin* discusses the outcomes of the ECB monetary policy strategy review in more detail.

made towards its goals of maximum employment and inflation at a rate of 2 per cent over the longer run. The FOMC expects higher inflation in the coming months, but largely due to transitory factors.

In the United Kingdom, GDP is estimated to have increased by 4.8 per cent in the second quarter of 2021. The level of GDP in the UK is now 4.4 per cent below where it was prior to the coronavirus pandemic at the end of 2019. At its August meeting, the Bank of England’s Monetary Policy Committee (MPC) voted unanimously to maintain the Bank Rate at 0.1 per cent. The MPC also voted to maintain the target for the stock of UK government bond purchases at £875 billion and so the total target stock of asset purchases at £895 billion.