

Managing domestic risks in an uncertain world

EVENT

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Headline risks to outlook

Inflation & interest rates

- Continuing presence of inflation
- Increased cost of borrowing
 - Implications for investment

Global outlook & international trade

- Trembles in the Chinese economy
- Irish economy particularly small & open

Concentration risk

- Contraction in the ICT or pharma sector
 - Big impact on domestic employment, exports activities and corporation tax receipts

More subtle (upside) risks?

Lack of investment?

- Ireland is a rapidly growing country
- Both in terms of demographics and economic activity
- IBEC (2023)
 - Calls for spending to increase productive capacity of the economy
- At a European level
 - Panetta (2022) and Staehr and Urke (2022) argue
- Public investment is low and has declined in many EU countries since the GFC

Take housing as a case study

- Substantial impact of the great financial crisis (GFC)
 - Scarred medium-term prospects of the construction sector
 - Changes in the availability of credit
 - Domestic and international regulatory changes
 - Supply-side of the housing market struggles to recover
- Overall, housing supply lags demand significantly
- Ireland not alone in this regard
- OECD (2021) notes on average across OECD:
 - Public investment in housing development has shrunk from 0.17% of GDP in 2001 to 0.06% of GDP in 2018

Figure 1: Irish actual housing supply and structural demand (units).
2011 – 2023.

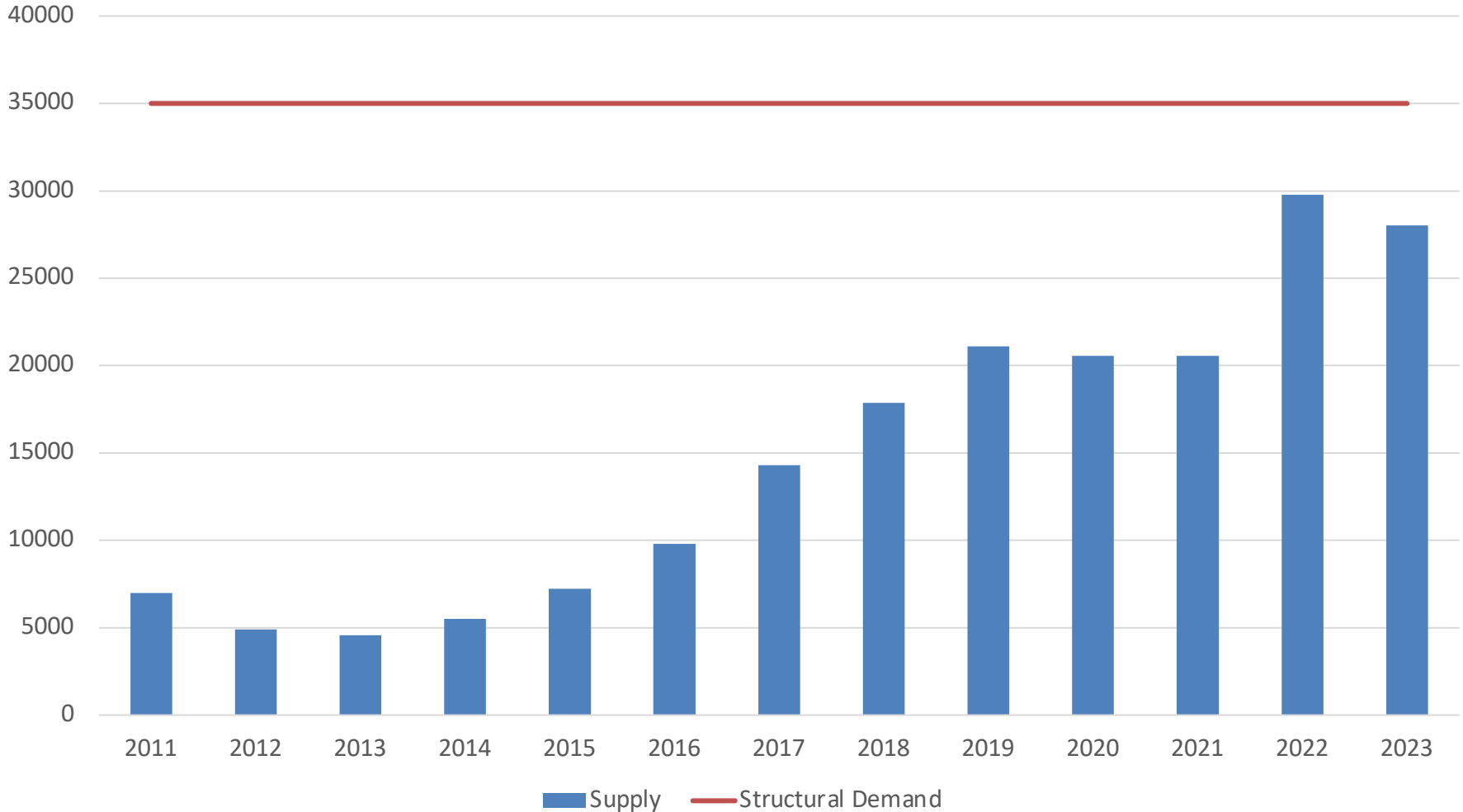
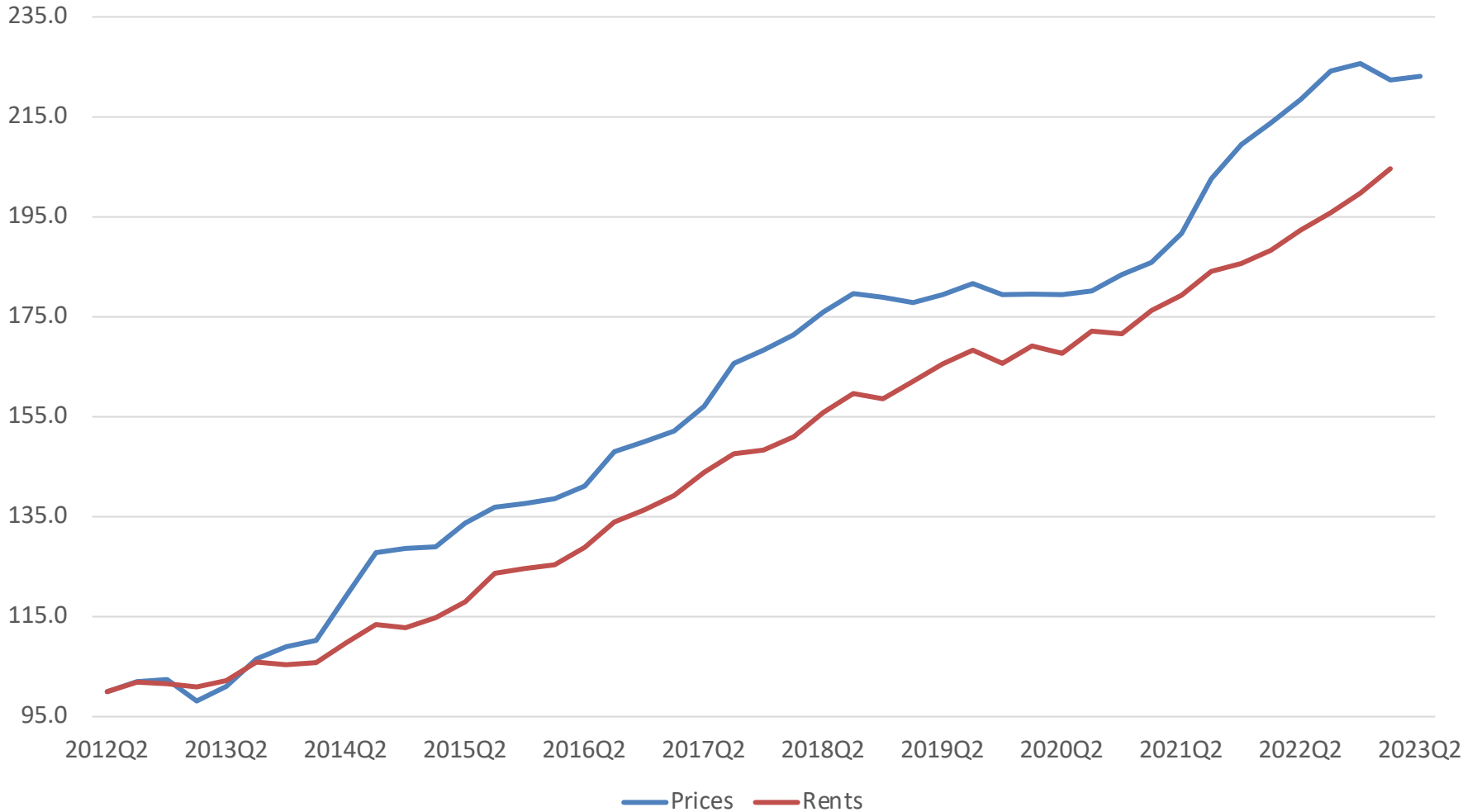


Figure 2: Irish house prices and rent levels: 2012 - 2023 (index 2012 = 100)



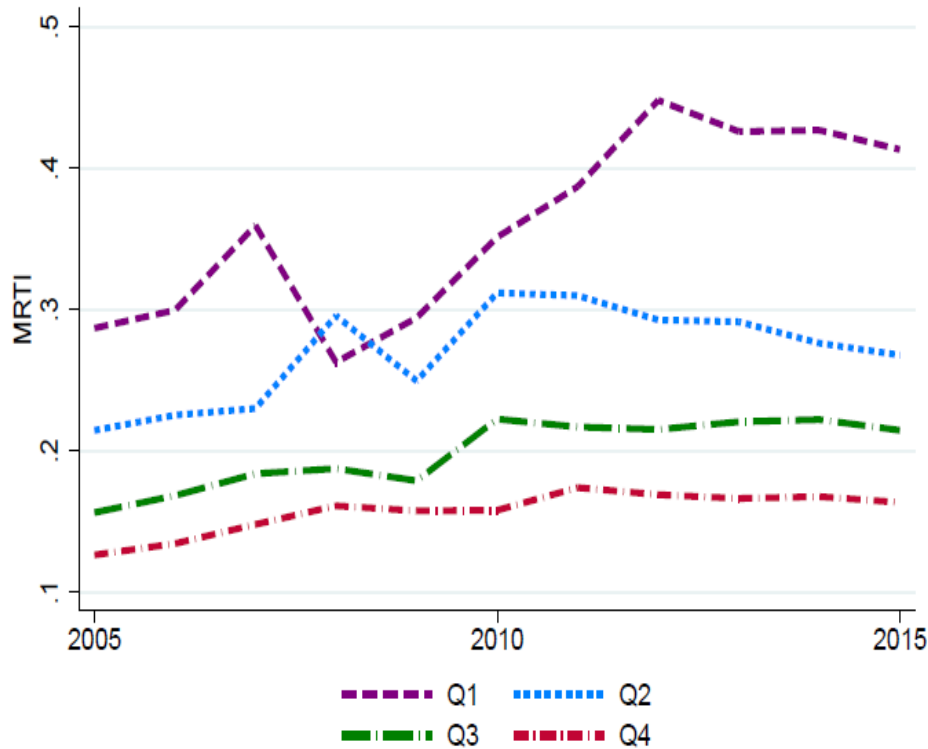
$$HPTI = \frac{\textit{Housing Payment}}{\textit{Net Income}}$$

$$MRTI = \frac{\textit{Mortgage Payment}}{\textit{Net Income}}$$

$$RTI = \frac{\textit{Rent Payment}}{\textit{Net Income}}$$

Figure 3: Housing payment costs by income quartile

Figure: Housing Payment to Income Ratios by Income Quartile



a) Mortgaged Households



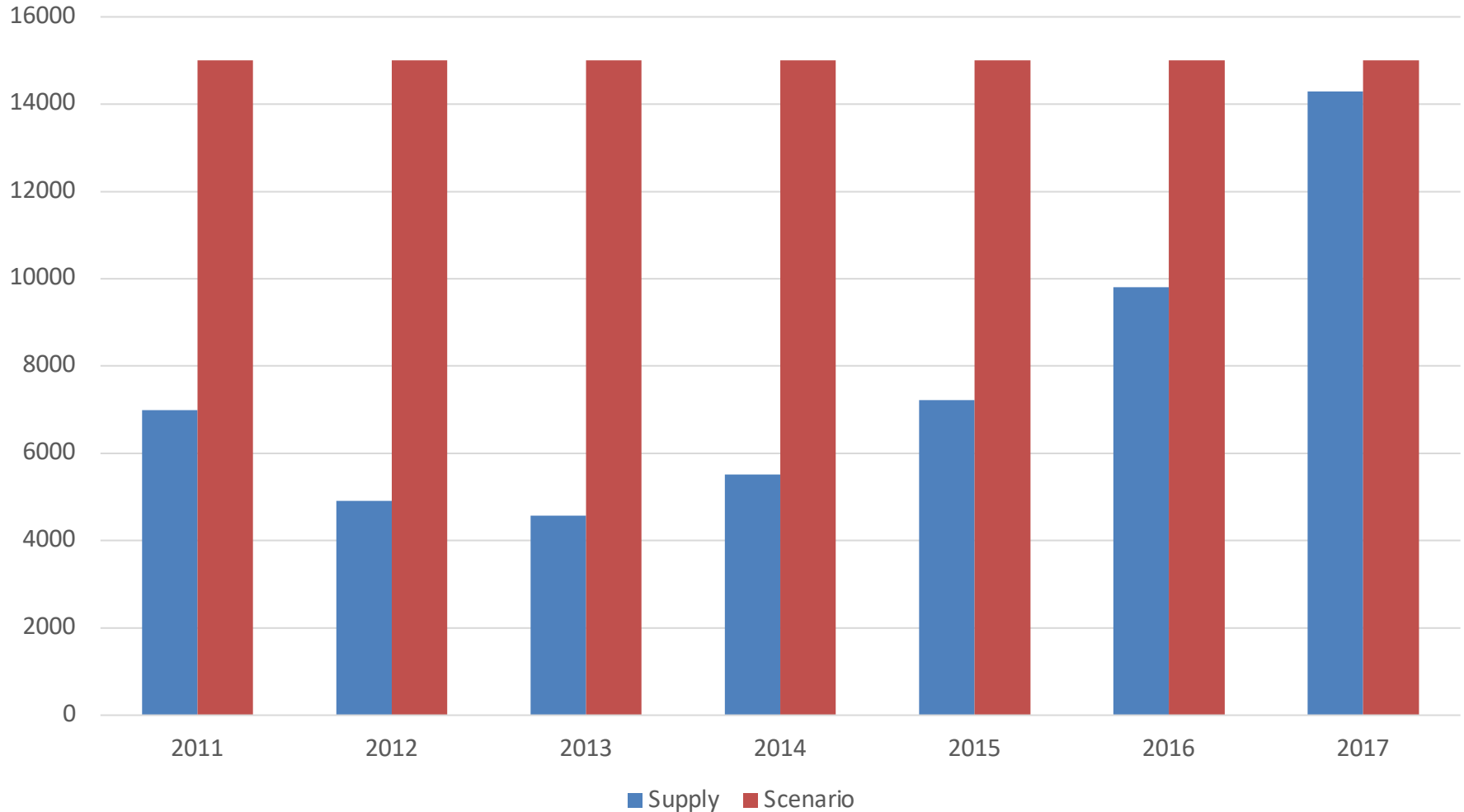
b) Private Renter Households

What might have been?

Alternative universe

- Policy-makers recognise in 2010
- Housing demand set to recover strongly after the GFC
- However, housing supply unlikely to reciprocate
- Therefore substantial increase in Government investment
- Government commits to substantial increase in output
- Crucially, fiscal means are in place to accommodate this

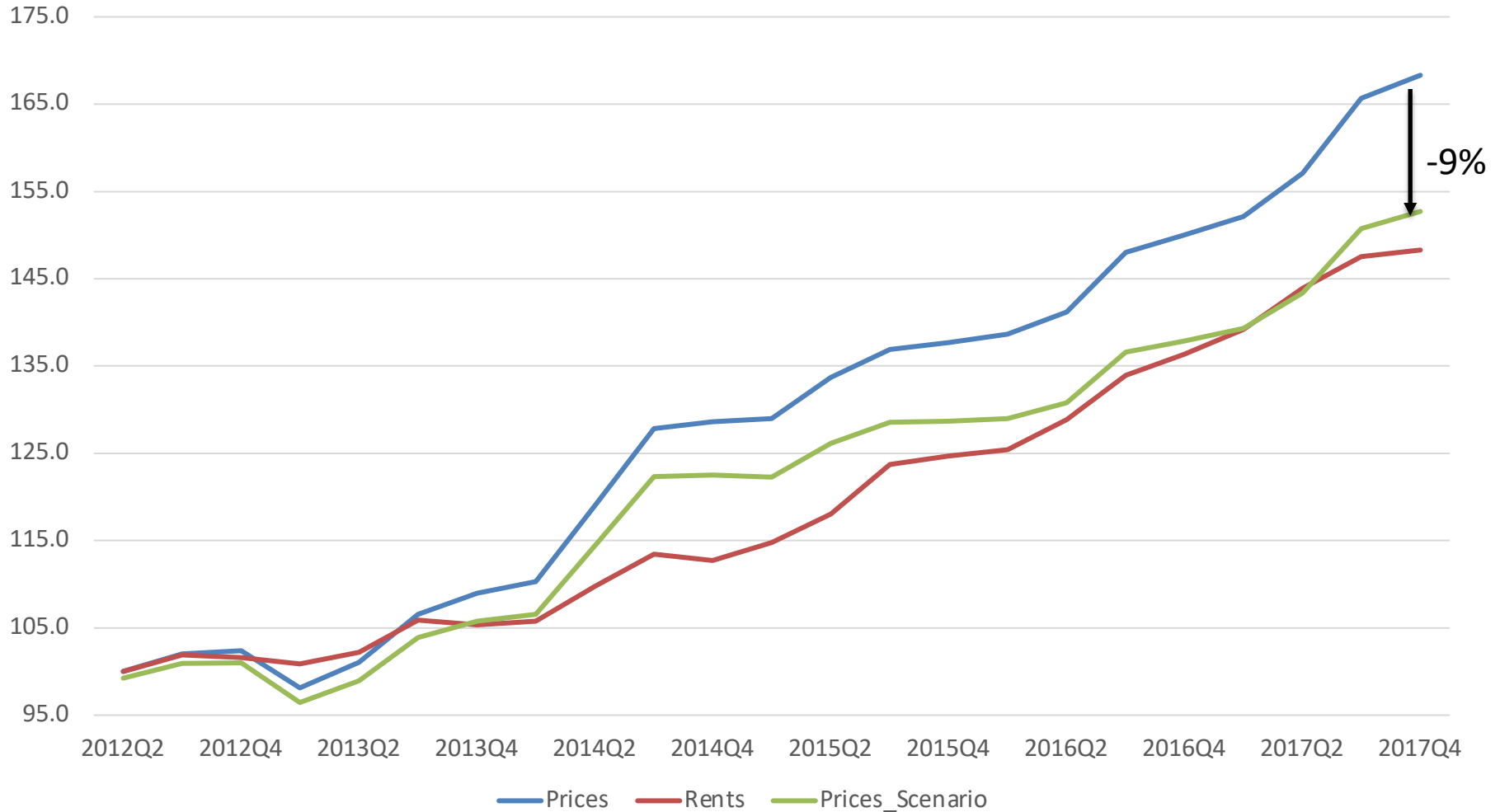
Figure 4: Irish actual housing supply and scenario level (units). 2011 – 2017.



COSMO scenario

- Using the new housing bloc in COSMO
 - <https://www.esri.ie/publications/adding-a-construction-sector-to-cosmo-structure-and-policy-analysis>
- Assume the Government has the fiscal space
- To launch a significant housing investment programme
- Results in 15,000 units
- Between 2011 and 2017
- We simulate the impact of this on house prices and find

Figure 5: Actual and scenario Irish house prices and rent levels: 2012 - 2017 (index 2012 = 100)



A review of Irish expenditure levels

Figure 6: Total Irish Government expenditure per head of working age population: 1995 – 2022 (€'s per head)

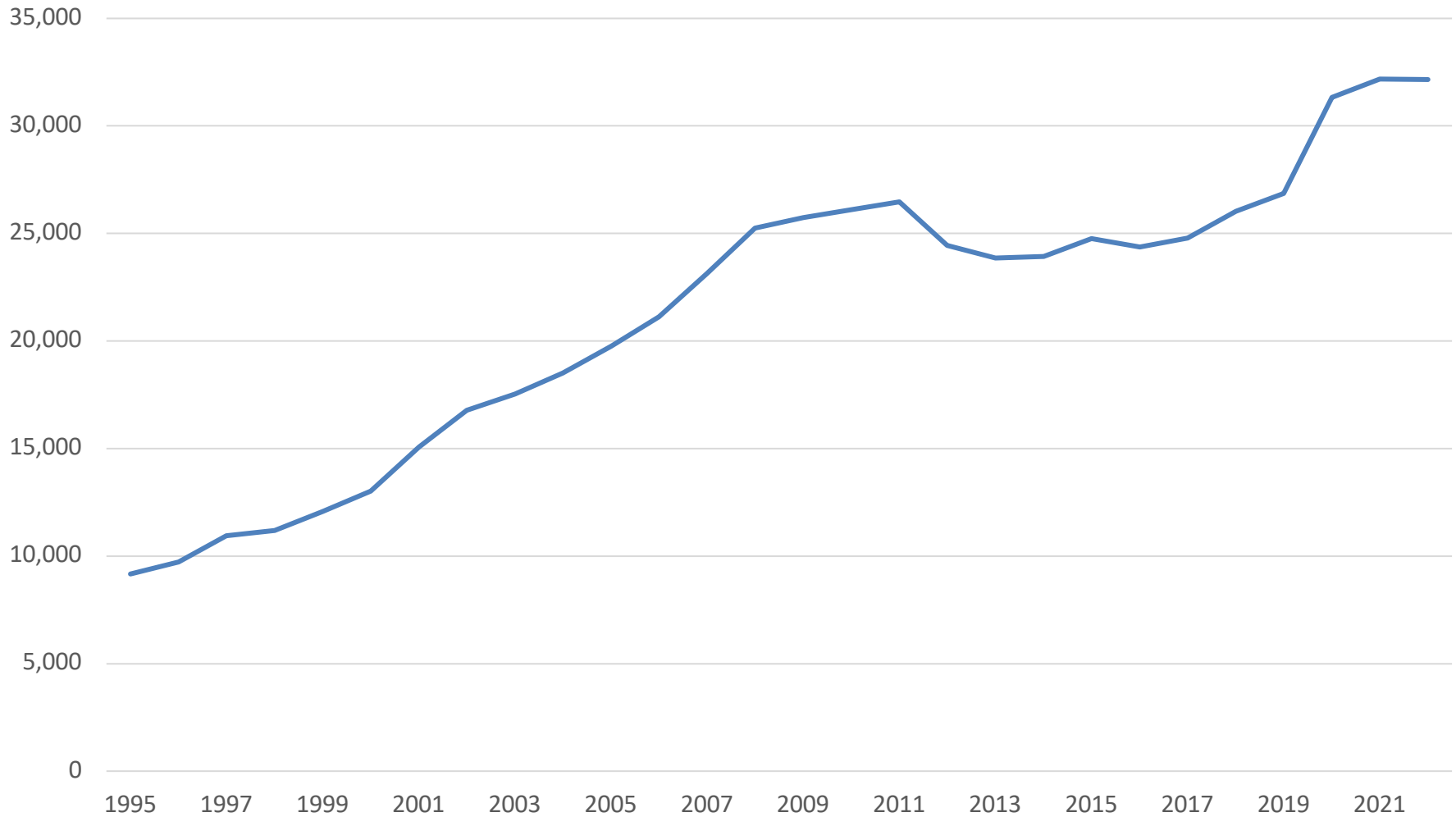


Figure 7: Irish current and capital expenditure per head of working age population: 1995 – 2022 (€'s per head)

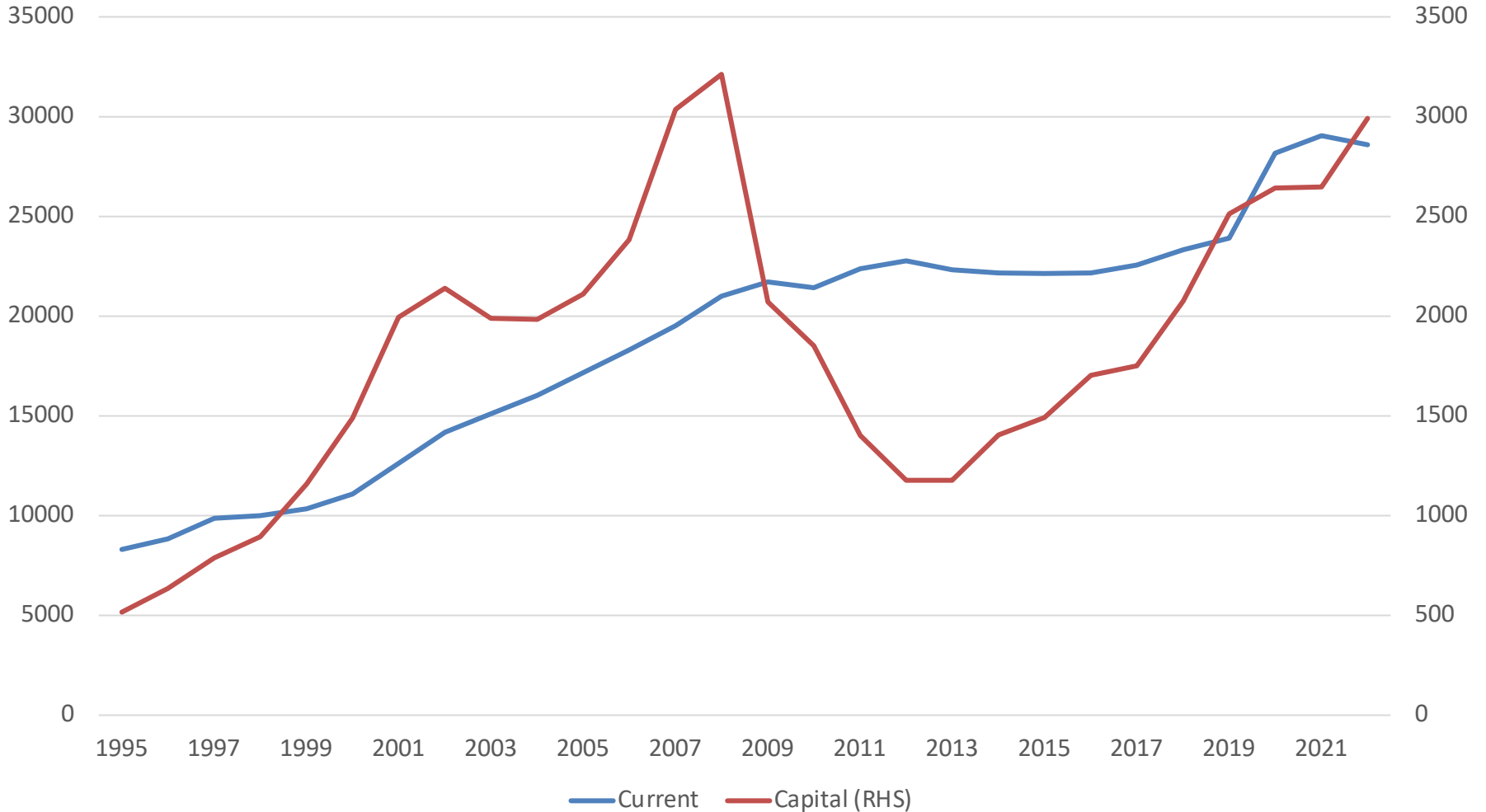


Figure 8: Ireland's ranking in current and capital expenditure. 2001 – 2022

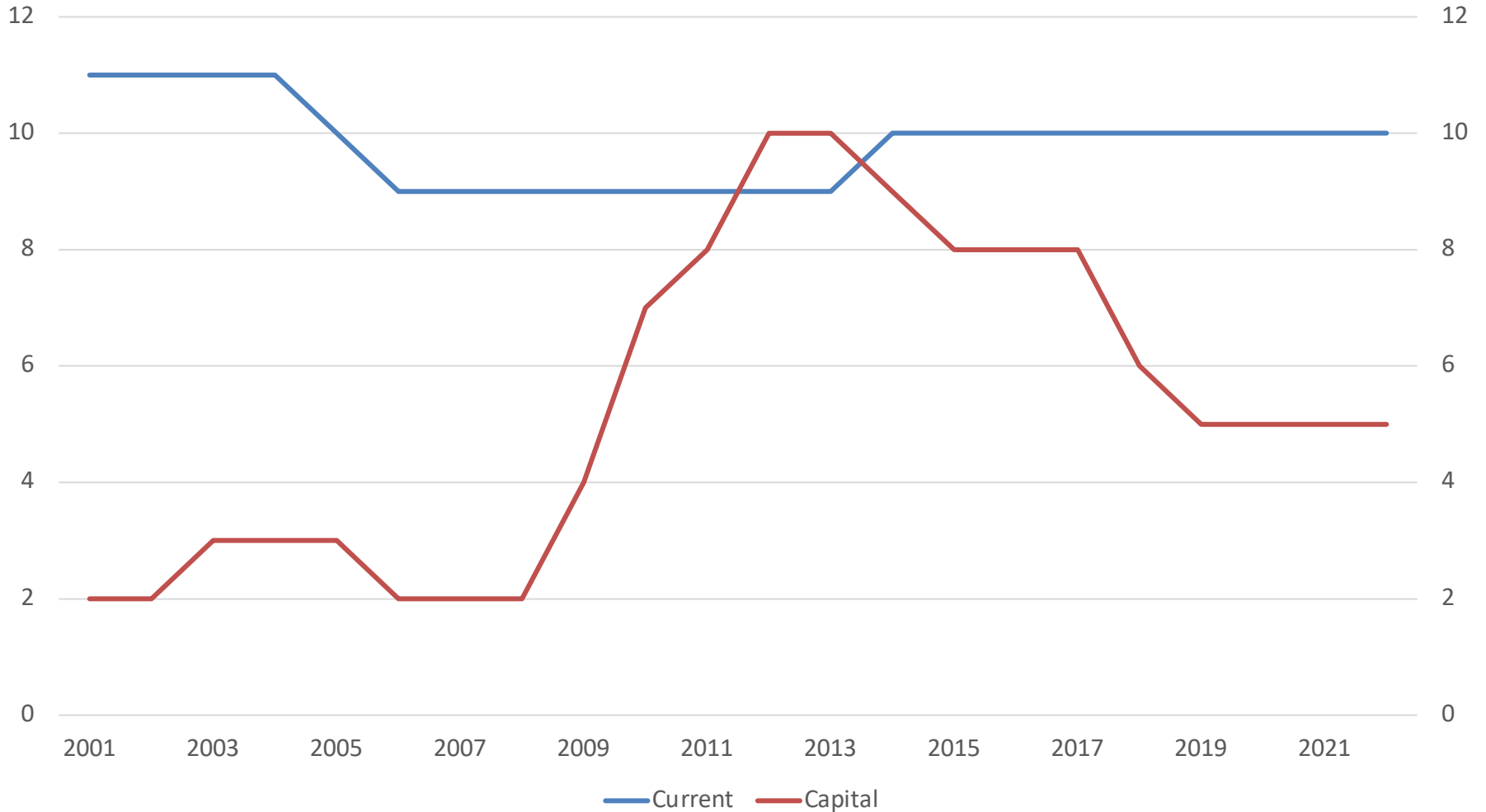
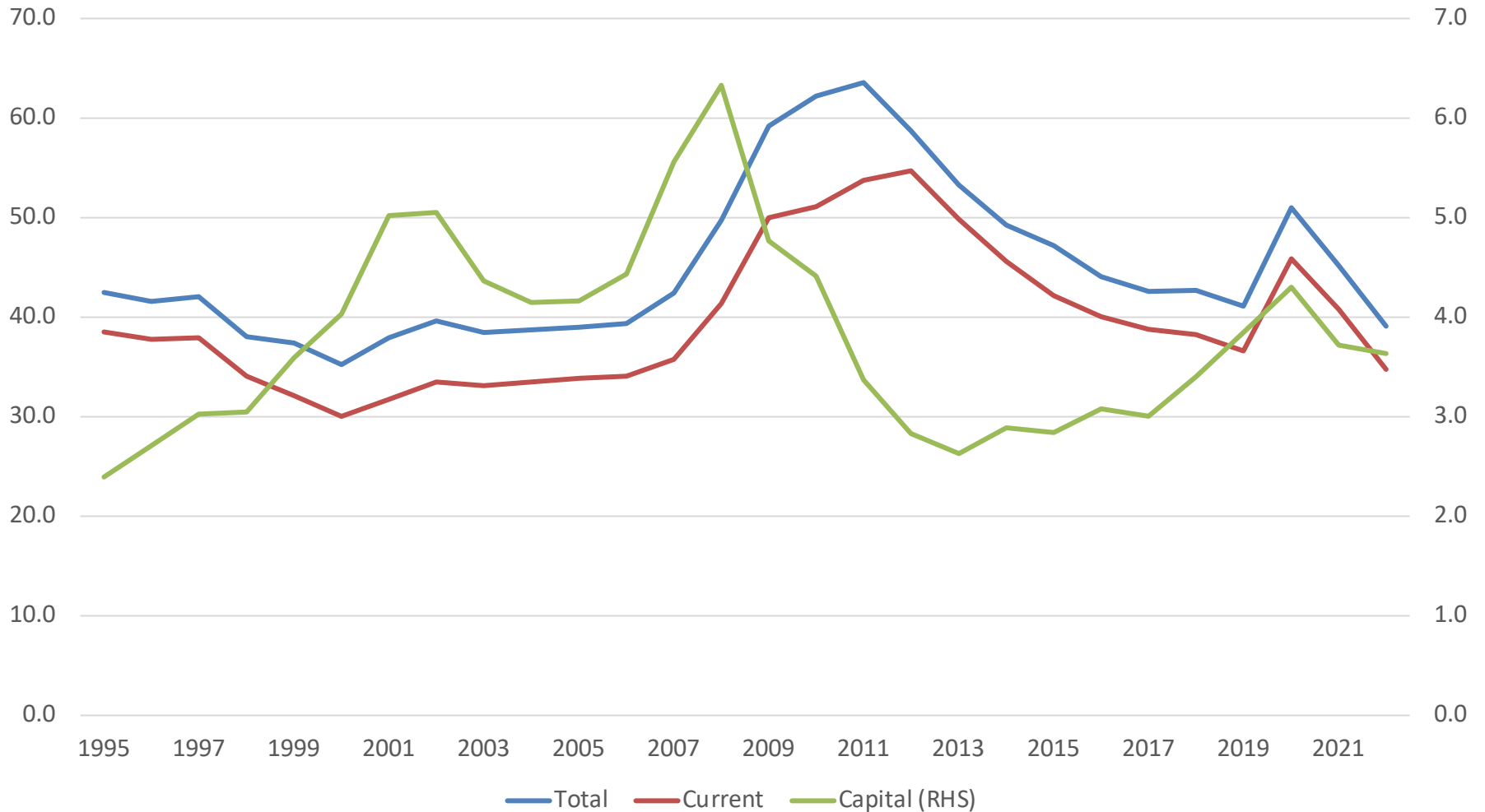


Figure 9: Ireland's total, current and capital expenditure as a percentage of GNI* 1995 – 2022.



Review of expenditure levels

- Volatile over the period 1995 – 2022
- Particularly capital expenditure
 - In absolute and
 - In relative terms
- Low capital expenditure vis-à-vis other EU countries
 - Government investment levels low generally
- After GFC - capital expenditure playing catch-up?

External challenges

- Era of low cost of finance at an end?
- Higher interest rate environment due to inflationary pressures
- Poses challenges for future investment
 - Ma and Zimmermann (2023)
 - Hysteresis and monetary policy
- Greater levels of investment going forward
- Requires greater role for fiscal policy?

Many fiscal/expenditure challenges ahead

- Housing supply
- Meeting climate change targets
- Health care reform
- Pension requirements

Domestic challenge

- Become better at spending money!
- Particularly focussing on large investment projects
- Unique opportunity in the context of present largesse!
- Concept of special reserve fund (SRF)
- Prudent to differentiate between sustainable and unsustainable revenue
- Windfall gains to be deployed for capital investment

Thank You