Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Managing domestic risks in an uncertain world

Dublin Economics Workshop

Macroeconomic context

- The pandemic and Russia's war against Ukraine and its people represent a constellation of extraordinary shocks hitting the global and Irish economies in recent years

- The Irish economy recovered quickly from the pandemic and has proved resilient, but these shocks have led to a sharp increase in inflation, reaching levels not seen in decades

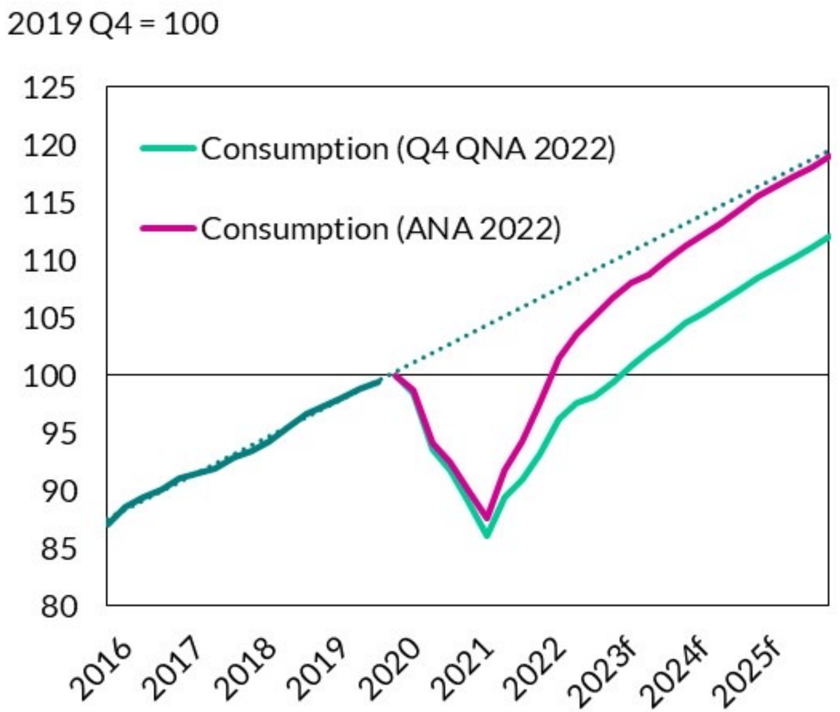
- The ECB – like other central banks globally – has responded to the inflationary shock with an exceptionally rapid increase in euro area interest rates

- Important that domestic policy choices do not pull in opposite direction to euro area monetary policy and take into account specificities of Irish experience during these shocks

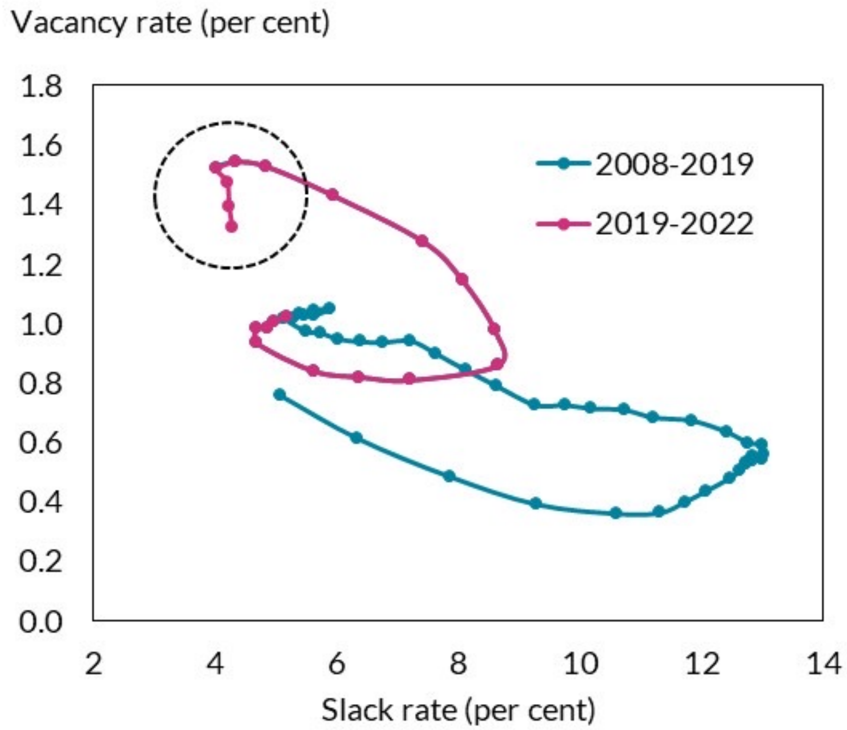
- These choices are critical to ensure macroeconomic resilience, in light of increasingly uncertain global environment (slowing activity, geoeconomic fragmentation, climate shocks)

The economy is operating at full capacity

Recent revisions to national accounts suggest post-pandemic recovery stronger than previously thought

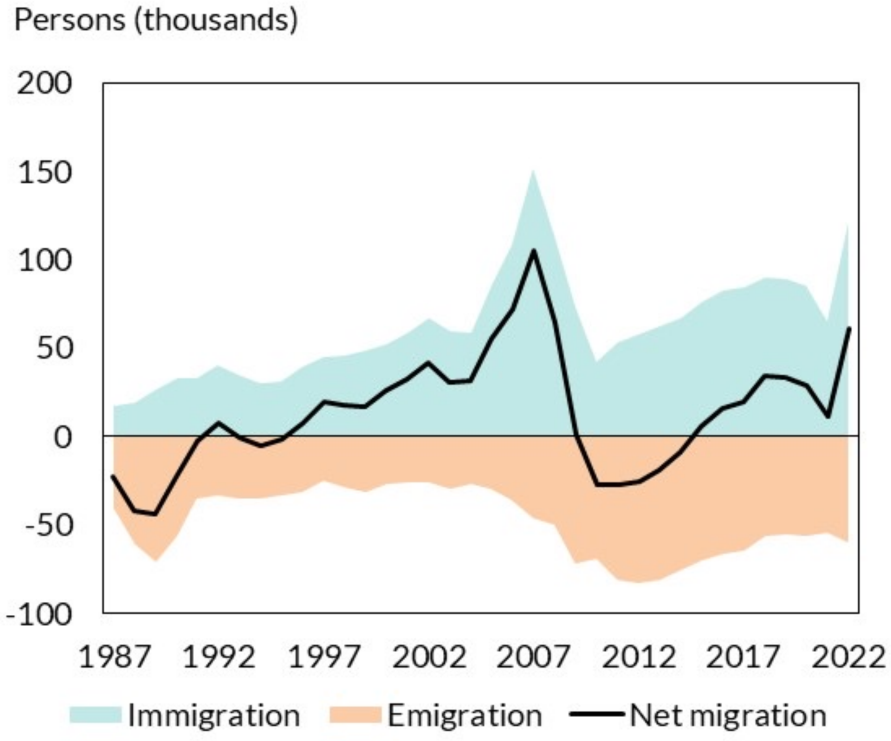


Despite some moderation in vacancies, the Beveridge curve points to a very tight labour market

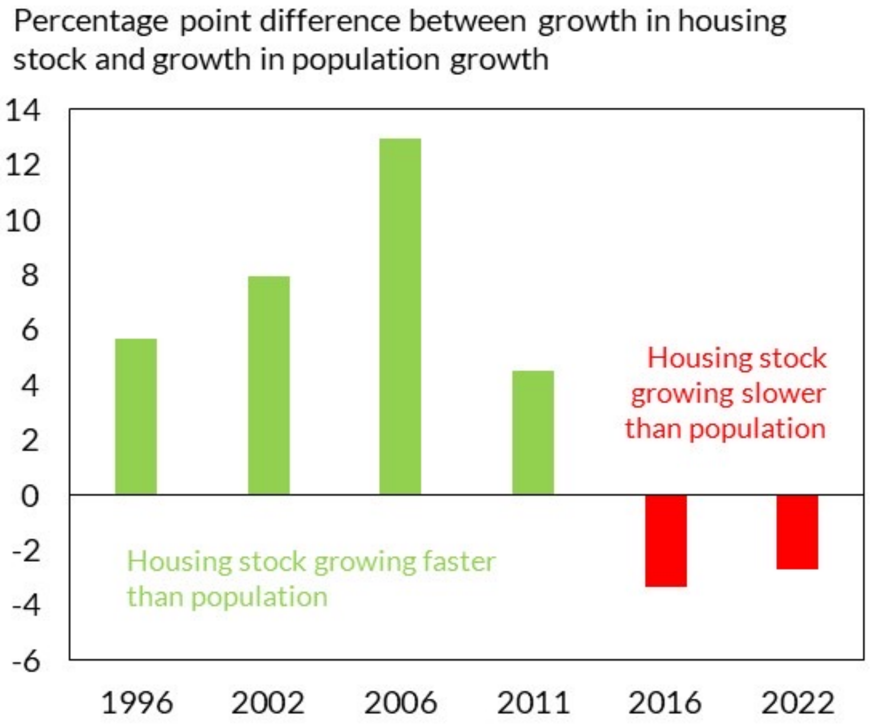


Interaction between capacity constraints in labour and housing markets

Net inward migration flows have acted as a pressure valve for capacity constraints in the labour market

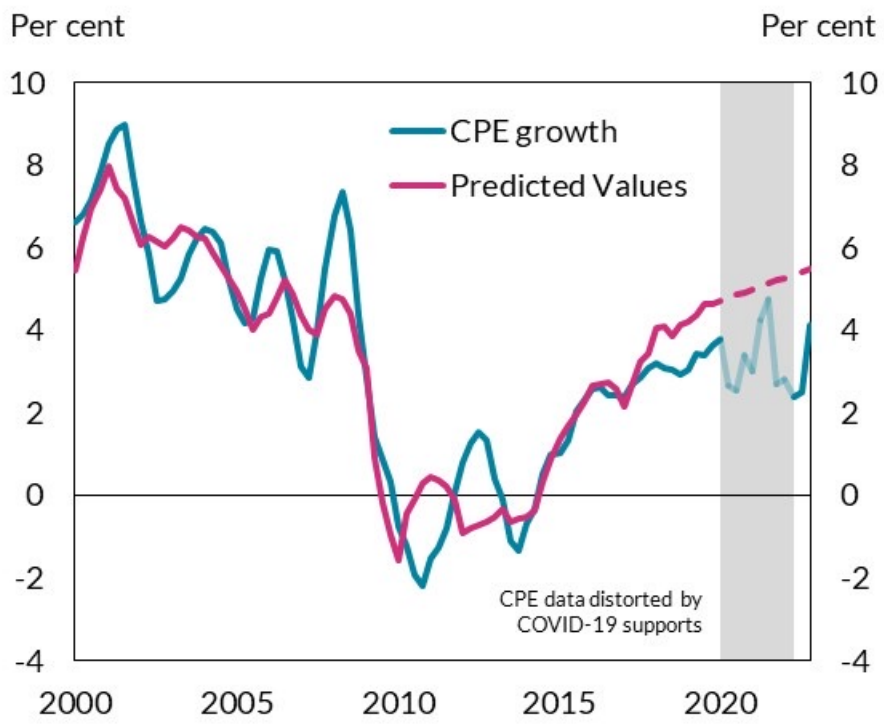


Over the past decade, growth in the housing stock has not kept up with population growth



Real wage catch-up is expected to continue in coming years

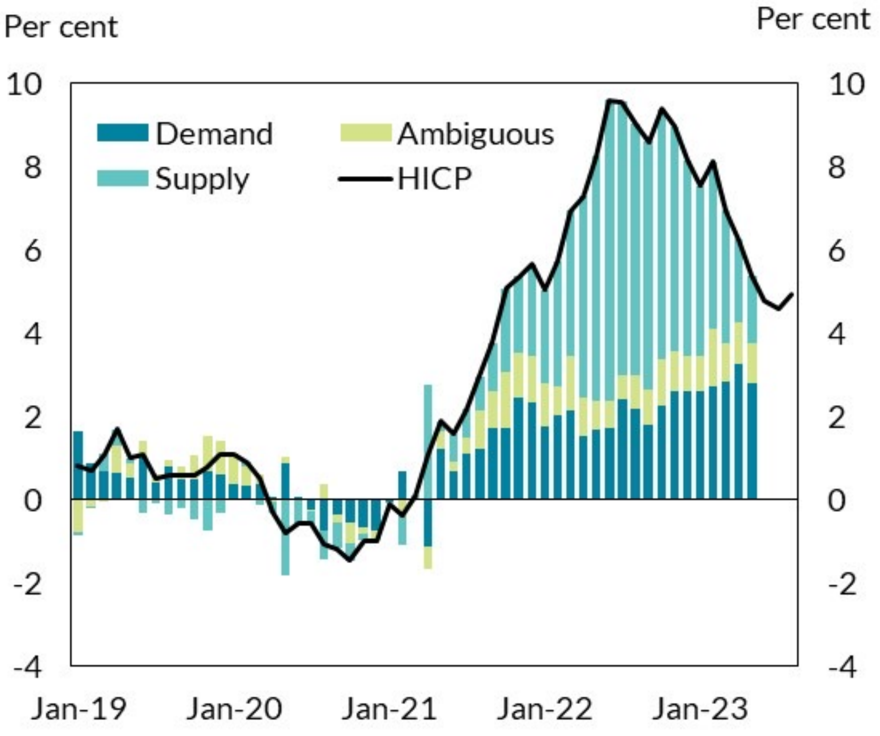
Wage growth has been somewhat lower than expected, given tightness of the labour market and inflation shock



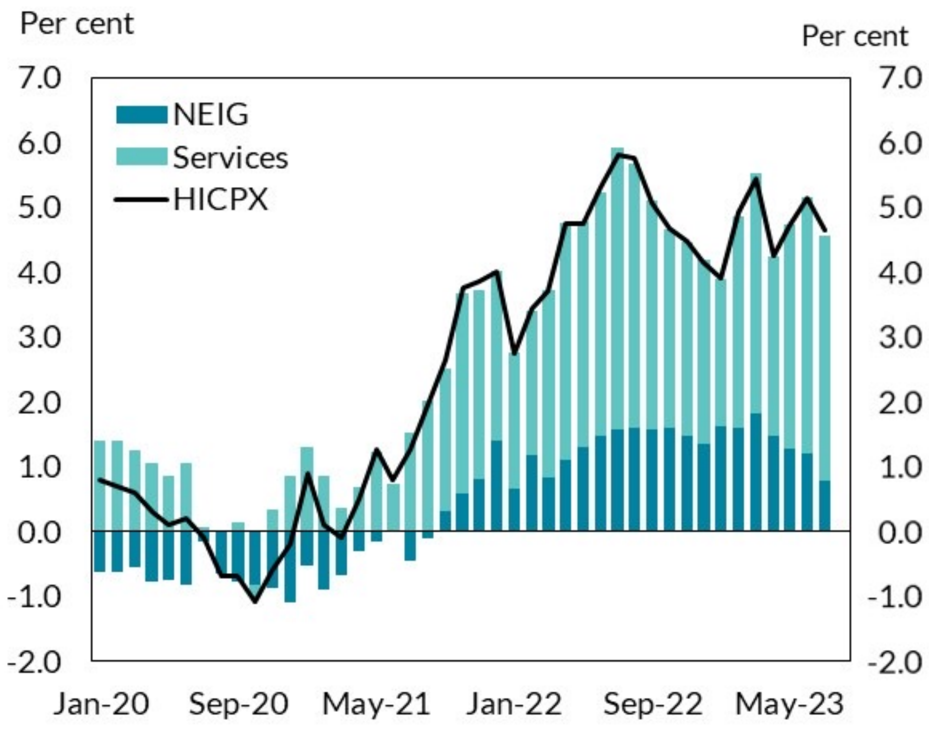
- Nominal wage growth has been somewhat lower than would have been expected under estimates of the Phillips curve.
- As inflation surge was unexpected, adjustment of wages to prices likely slower.
- Central Bank projections expect return to positive real wage growth in 2023 and return to trend by 2025.
- Other factors could also explain gap to Phillips curve predictions (eg WFH, fiscal supports, pandemic savings).
- Longer-lasting inflation could lead to higher wage pressures as labour slack is low.

Inflation is becoming increasingly domestically-generated

Headline inflation has eased as the interlocking shocks from COVID and the war in Ukraine are starting to unwind

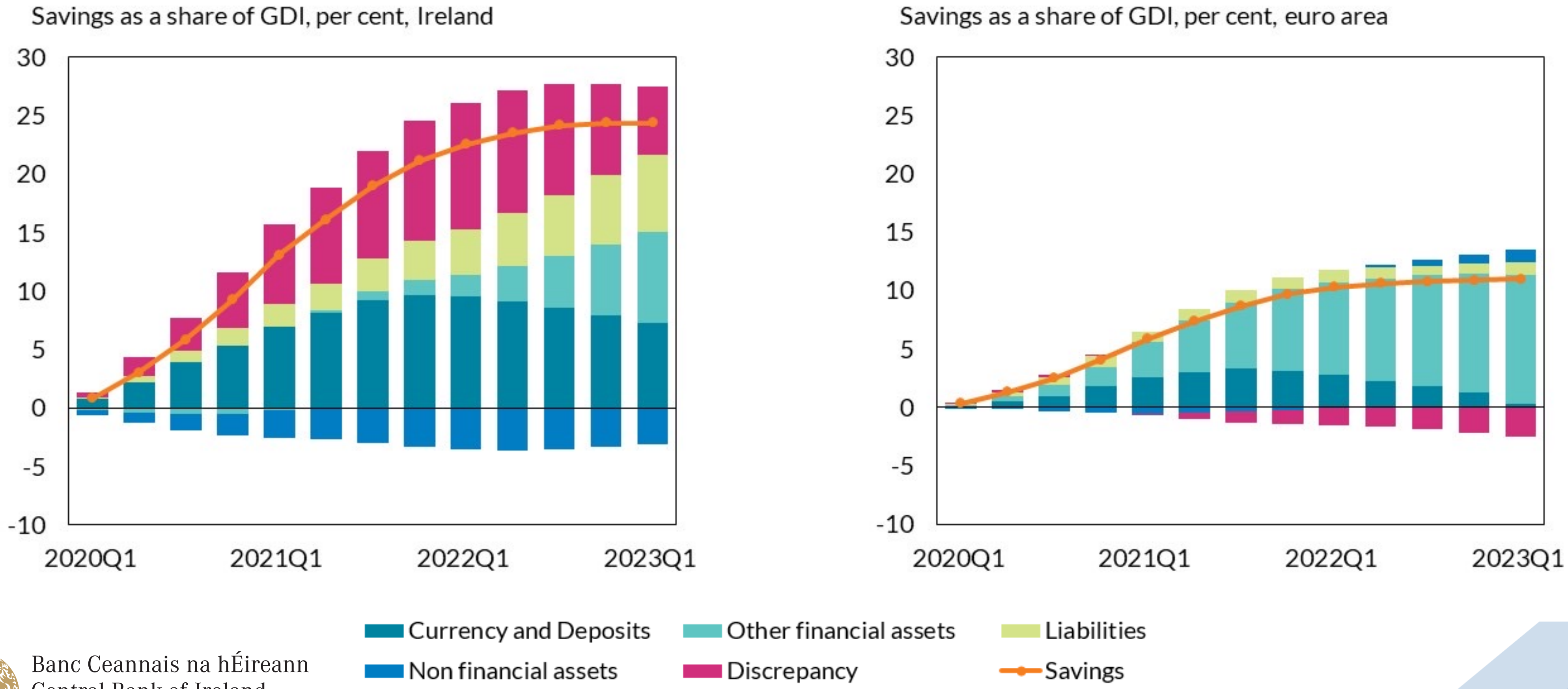


But core inflation has remained more persistent, driven by services, pointing to domestically-generated inflation



Excess pandemic savings have been particularly high in Ireland, posing greater upside risks to consumption than the EA

Ireland has seen a much greater accumulation of 'excess savings' during the pandemic than the euro area. And a greater proportion of these savings have been in liquid assets.



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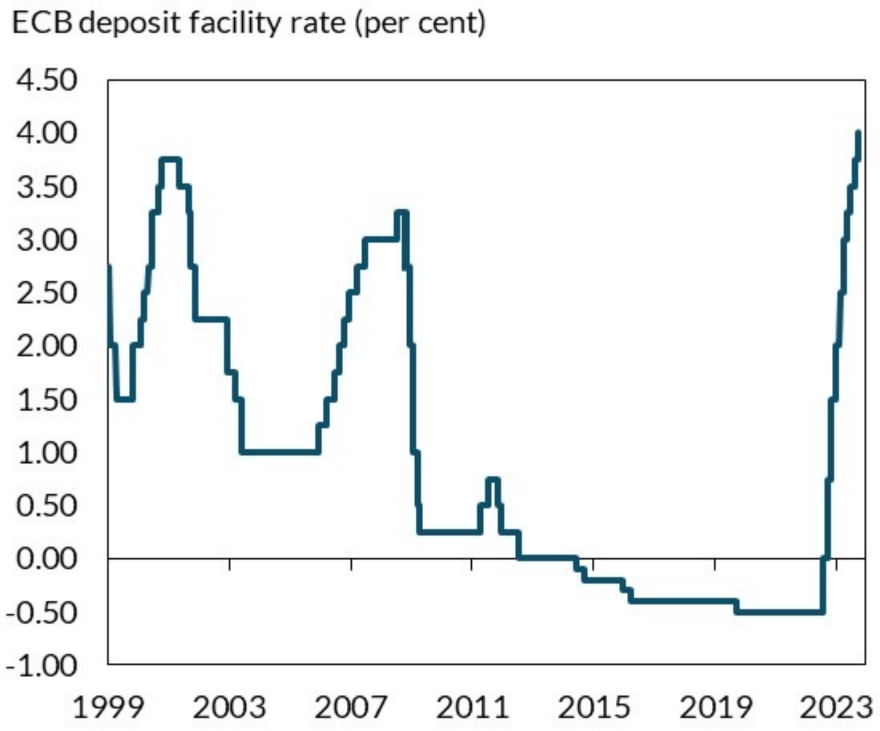
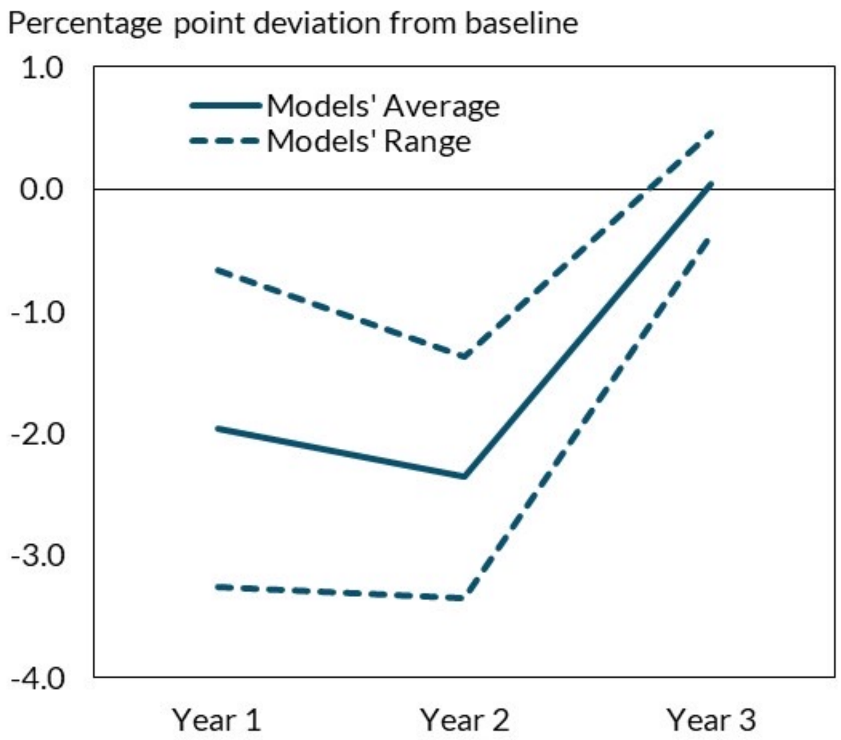
ECB monetary policy has responded to ensure a timely return of inflation to target across the EA

Interest rates have increased at unprecedented speed in the euro area



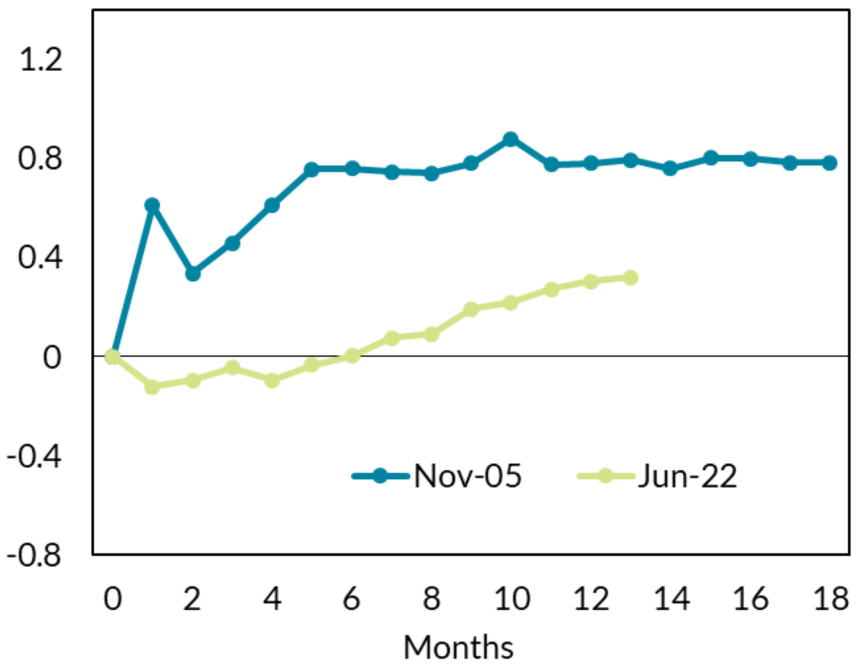
The inflation outlook in Ireland would have been significantly worse in the absence of monetary policy tightening



“Pass through” via the banking channel to households in Ireland has been more muted, both relative to EA peers and our own history

Pass-through to new mortgage rates has been less than the last major tightening cycle…

Pass-through multiplier - new mortgages

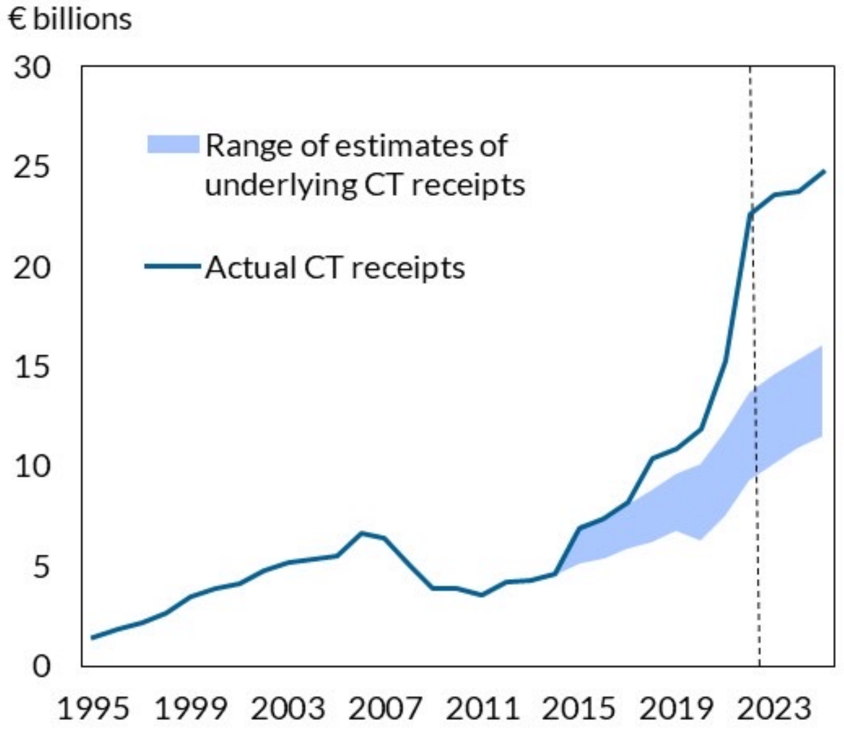


…with a similar picture emerging for pass-through to household deposit rates.

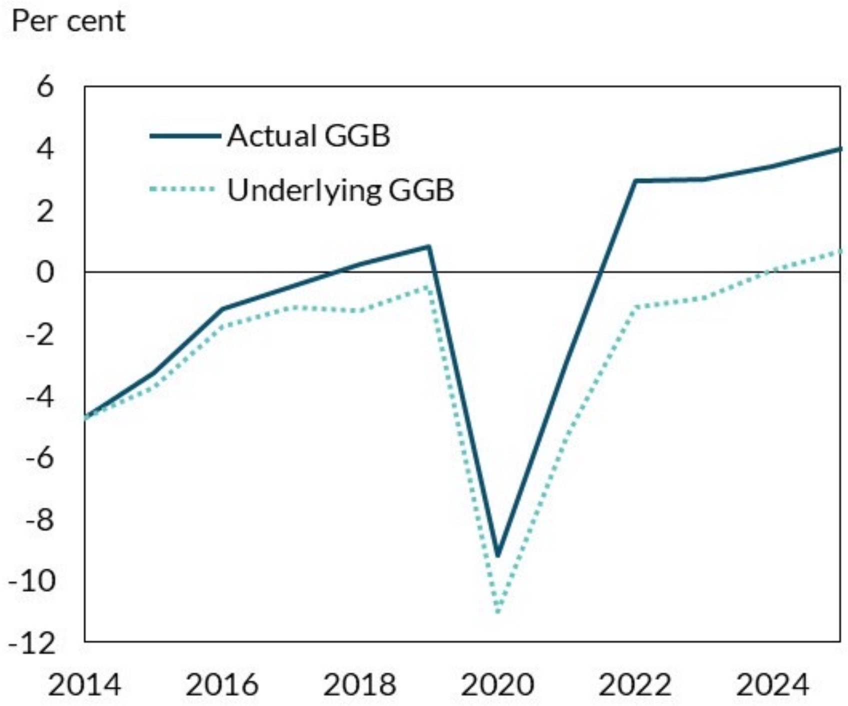
Pass-through multiplier - term household deposits

“Excess” corporation tax receipts have increased sharply in recent years and are inherently volatile

Further sharp increase in excess corporation tax receipts in recent years

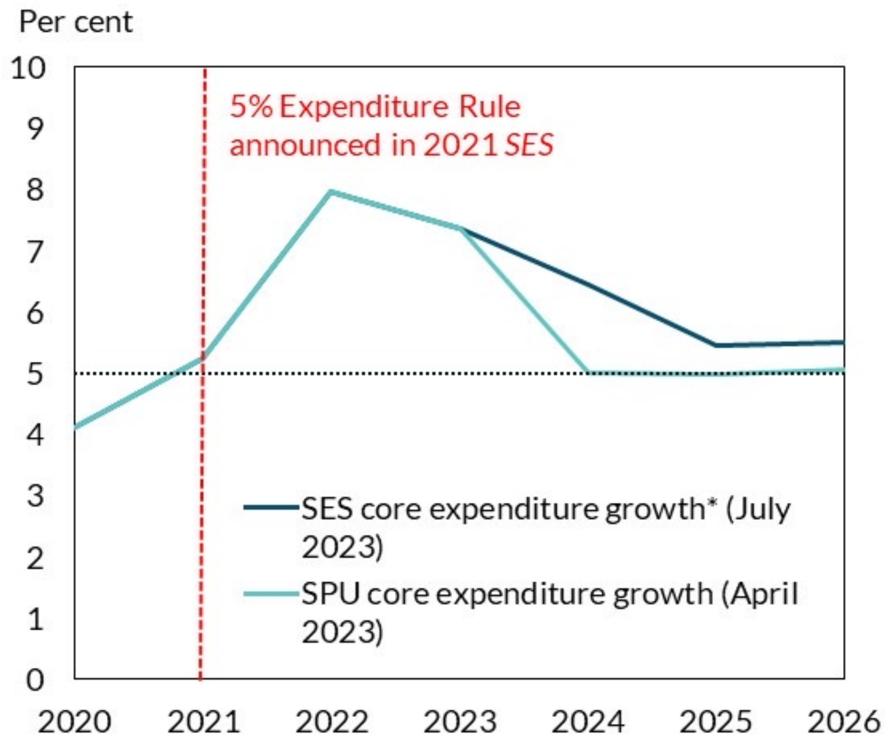


Excluding corporation tax receipts, the government’s underlying fiscal position is less strong



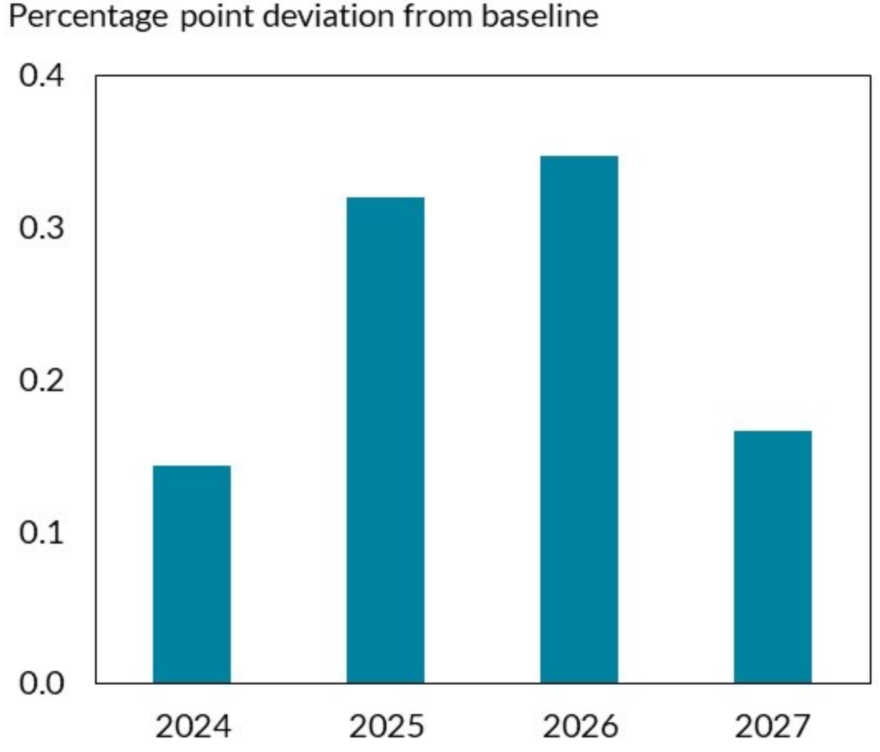
Budgetary package outlined in Summer Economic Statement more expansionary than previously expected

SES budgetary position more expansionary relative to Stability Programme Update (SPU) in April 2023



**SES* expenditure growth includes windfall capital spending.

Estimated marginal effects of additional stimulus from April SPU to Summer Economic Statement on inflation



Development of macroprudential policy framework has filled key gap in the toolkit for macroeconomic stabilisation

Central Bank's macroprudential framework entail three pillars

Banks

Safeguard resilience of the banking system to adverse shocks, so that it is better able to support households and business, both in good times and in bad.

Borrowers

Ensure sustainable mortgage lending standards and guard against the emergence of a damaging and unsustainable relationship between credit and house prices.

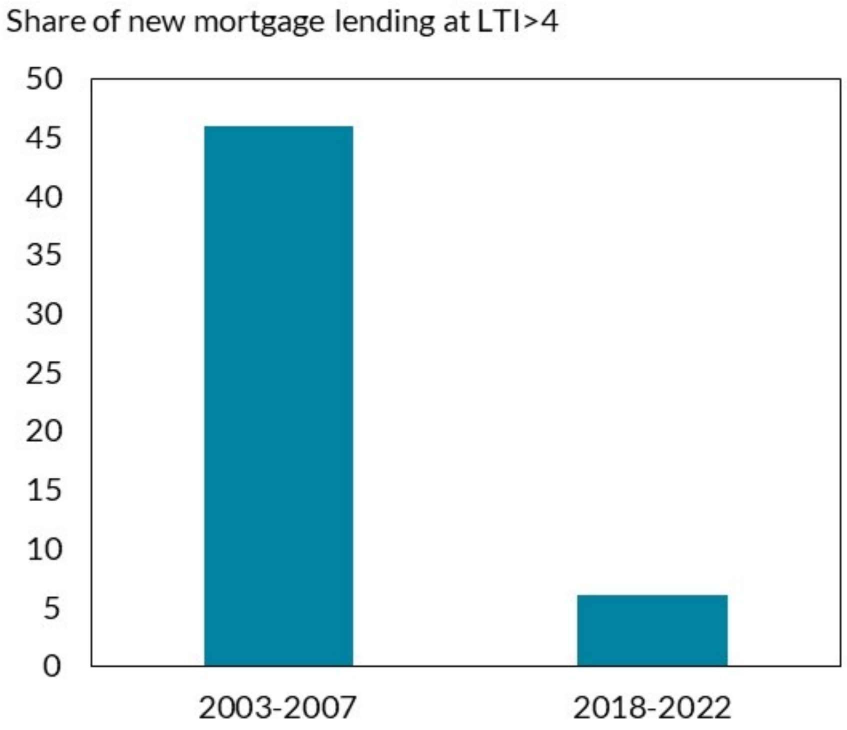
Non-Banks *(new)*

Safeguard resilience of this growing form of financial intermediation and reduce the risk that financial vulnerabilities amplify adverse shocks to broader economy.

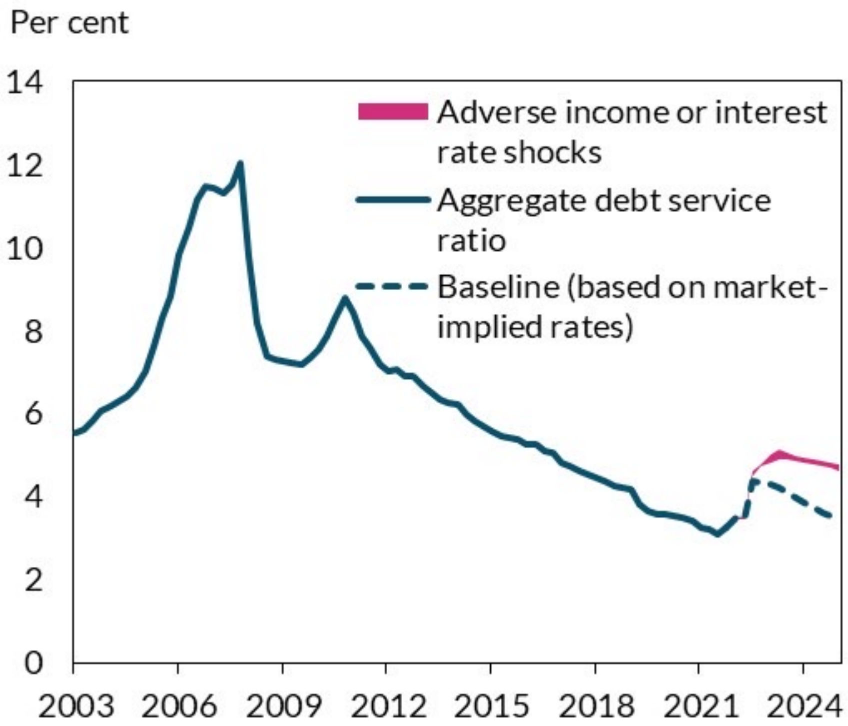
Ultimately, the objective of macroprudential policy is to ensure that the financial system does not act as an amplifier of adverse shocks to the rest of the economy.

Macroprudential policy actions have strengthened resilience to rising rates, better enabling monetary policy to do its job

New mortgage lending in recent years has been extended at much more sustainable levels of indebtedness

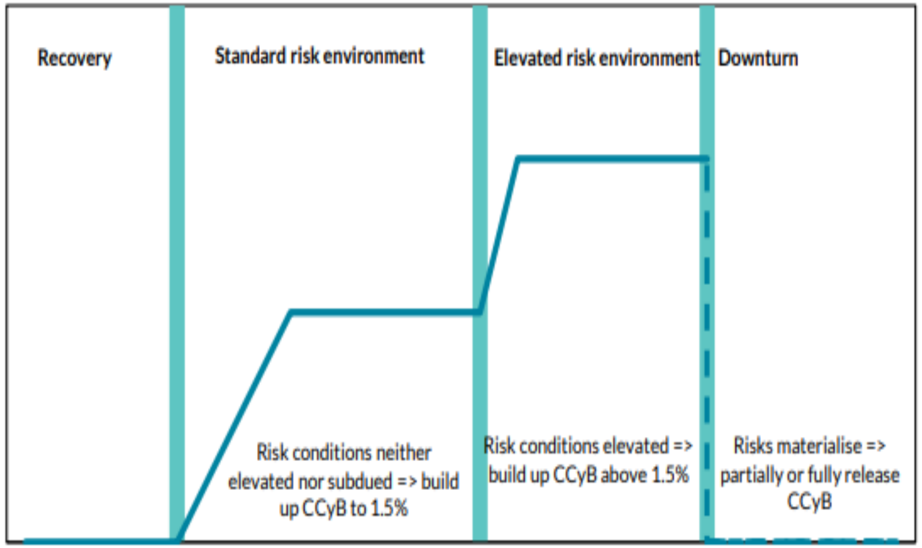


The fall in aggregate household indebtedness has reduced the vulnerability of households to interest rate shocks



Updated strategy for macroprudential bank capital measures and growing macroprudential focus on non-bank finance

The Bank's CCyB strategy aims to ensure loss-absorbing capacity of the banking system evolves in line with the risk environment (stylized representation below)



- Macroprudential framework, at a global level, still heavily focused on the bank sector.
- Significant growth in non-bank financial intermediation in recent years.
- Regulatory framework needs to keep up to speed with evolution of the financial system.
- Central Bank introduced macroprudential measures for property funds (phased implementation).
- Discussion Paper on developing a macroprudential perspective in the regulation of the investment fund sector.

Conclusion

- A stable macroeconomic environment is a key precondition for sustained prosperity of people across the country
- As a small, highly-globalized economy, Ireland is particularly exposed to shocks in the global environment, which remains highly uncertain
- While many of these global factors are beyond the control of policymakers on these shores, domestic economic policy choices matter
- In the current environment, important that monetary and fiscal policy levers do not pull in opposite directions, to ensure that inflation returns to 2%
- Domestic macro policy needs to account for specificities of Irish experience in recent years (large pandemic savings, growth in “excess” corporate tax receipts, pass-through dynamics)