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Department of Finance

Stability Programme, April 2023 Update: Macroeconomic outlook

Presentation to Irish Fiscal Advisory Council

Economics Division

31st March 2023

Birds-eye view



1. Key changes since Autumn forecasts [= easing of economic headwinds]

- Domestic economy better than expected in H2 [carryover effect]
- Energy prices have come in significantly
- External environment somewhat more positive [IMF, OECD]
- Further monetary policy tightening
- Most severe risks have moderated [though new risks in tech / financial sectors]

2. Short-term outlook [= improved outlook]

- Lower headline inflation reduces headwind to consumer spending [interest rates a new headwind]
- Upward revision to MDD this year
- Labour market to remain very tight (at or below 'natural' rate) – pay per head to increase
- Labour supply (migration) the driver of employment growth

3. Medium-term outlook [= slower growth]

- Transition to era of slower growth (ageing, productivity, auto-enrolment)
- Demand-side in 2030 locked-in to supply-side



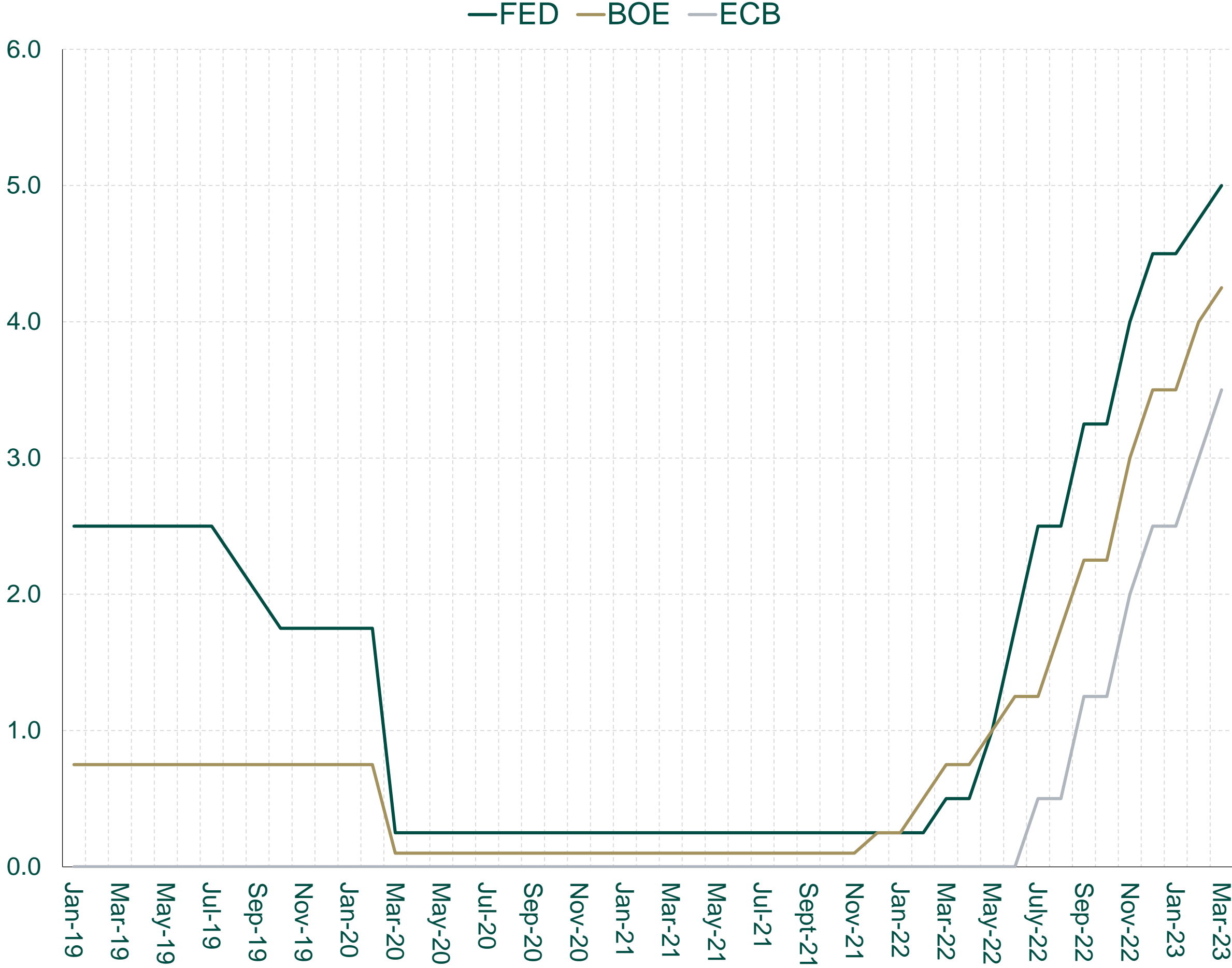
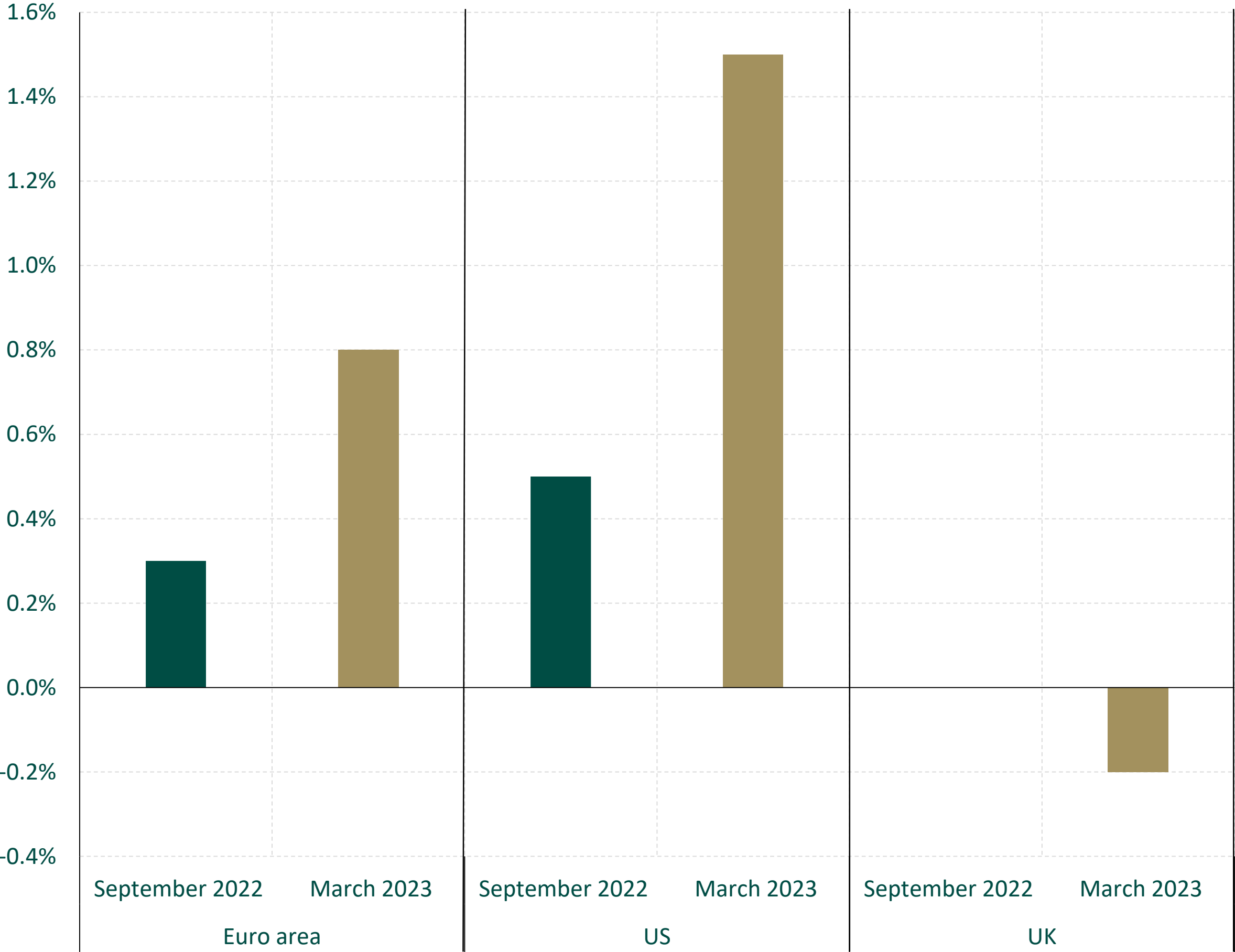
Global backdrop

Global outlook: slightly more optimistic than in autumn but new risks have materialised



GDP growth: current assumptions vs assumptions in autumn

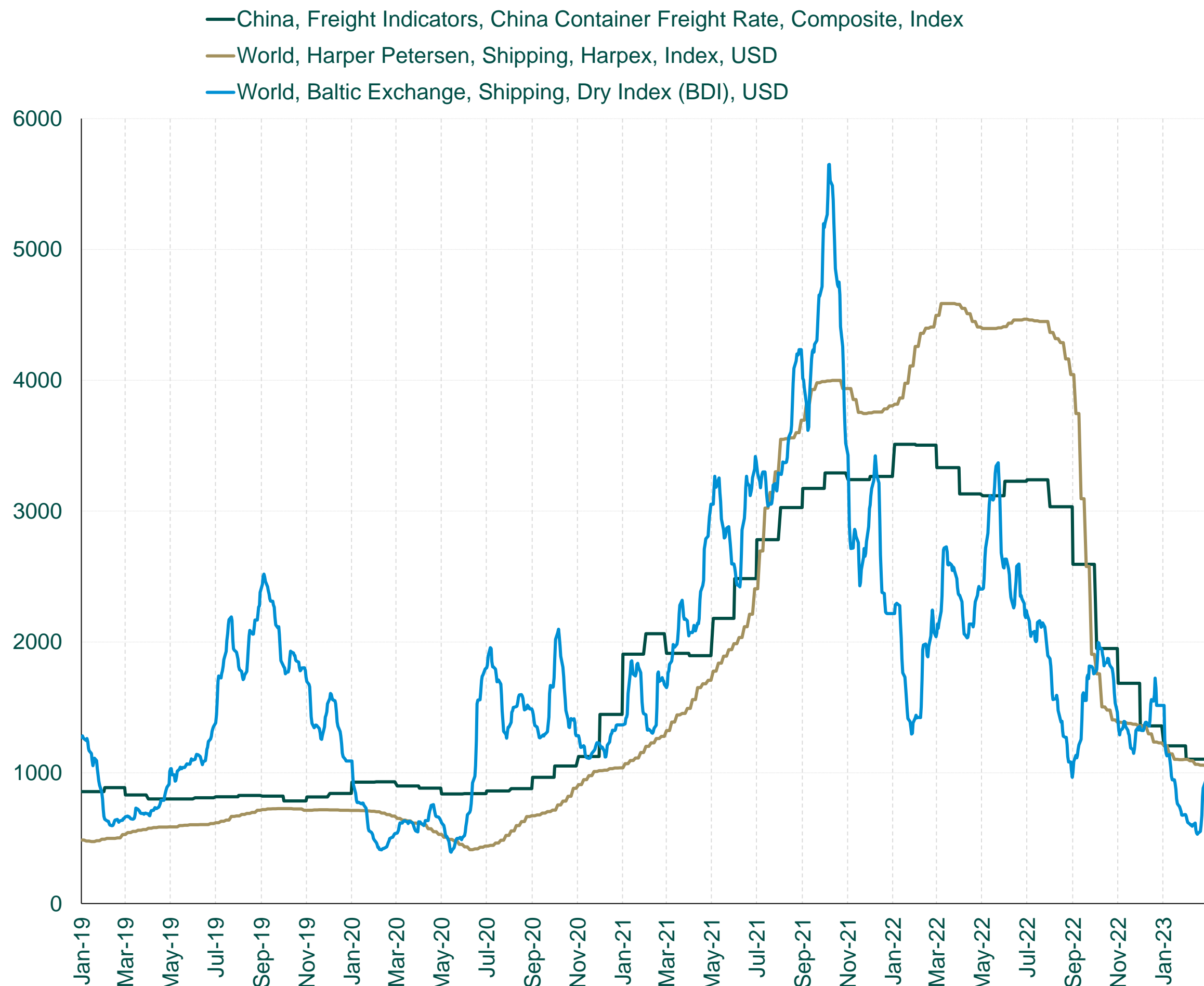
Monetary policy = headwind



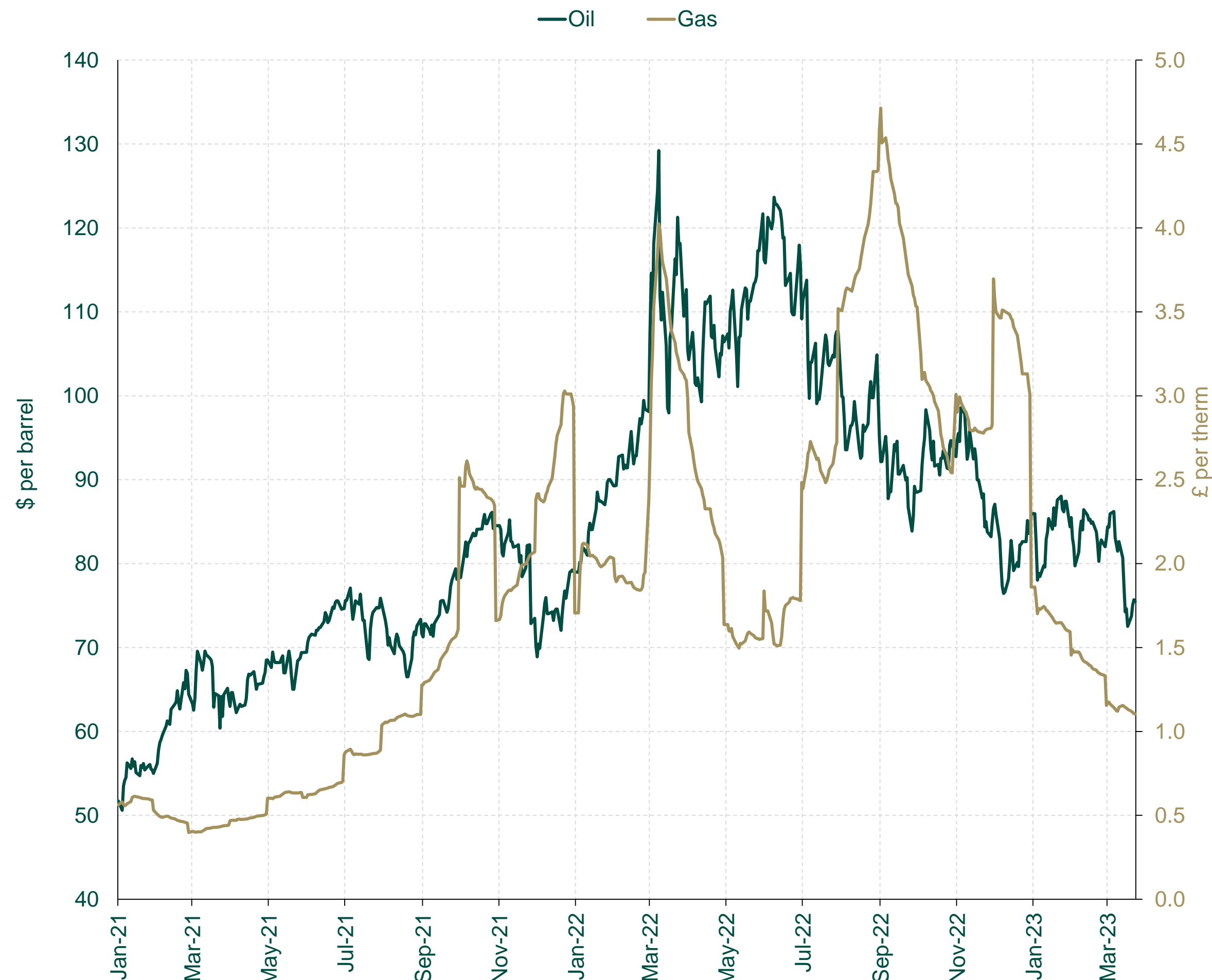
Supply-side bottlenecks have eased significantly



Shipping costs = 'mean reversion'



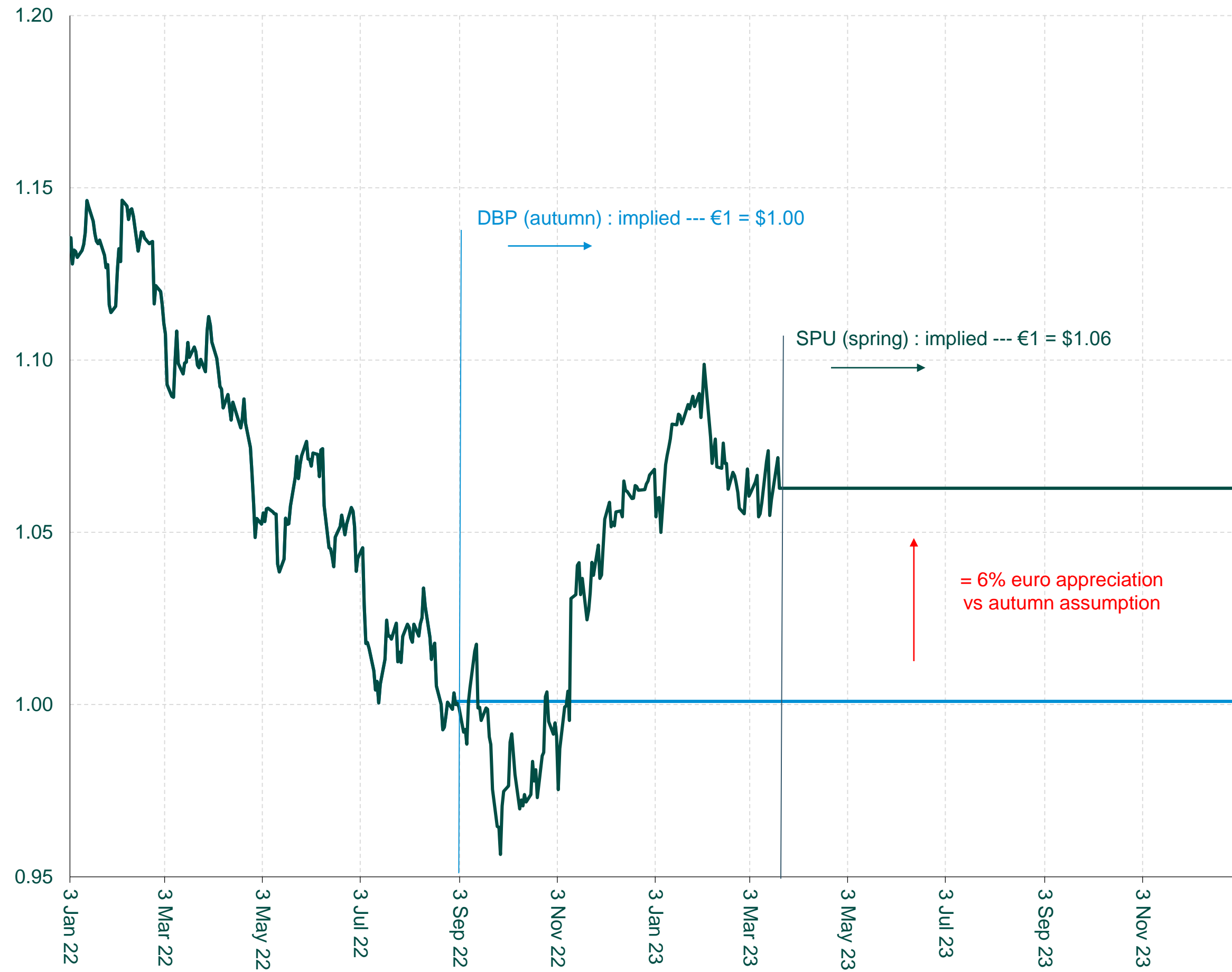
Lower demand has helped rebalance energy market



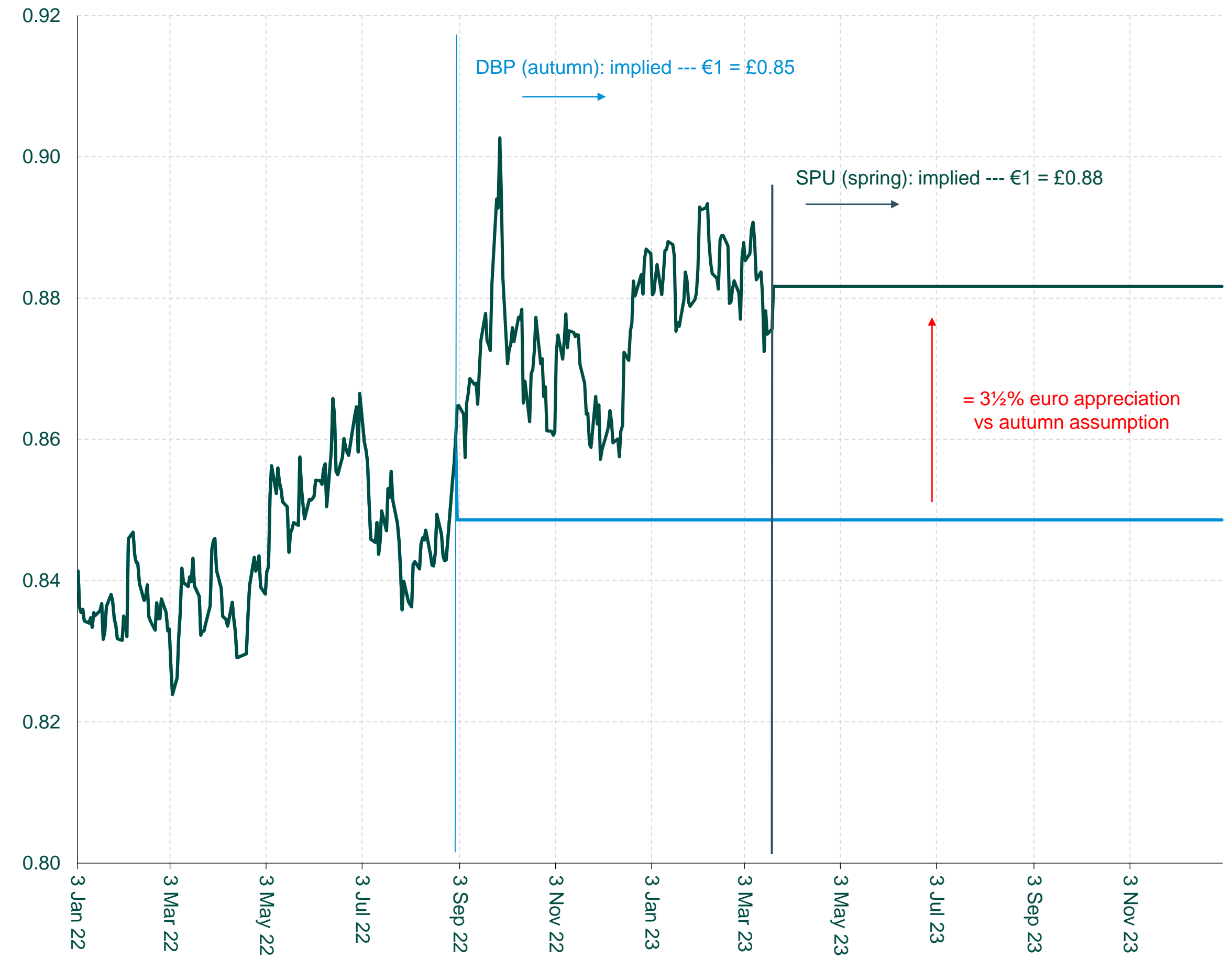
Exchange rate re-alignment: some reversal in relative attractiveness of US assets



Euro-dollar bilateral rate



Euro-sterling bilateral rate



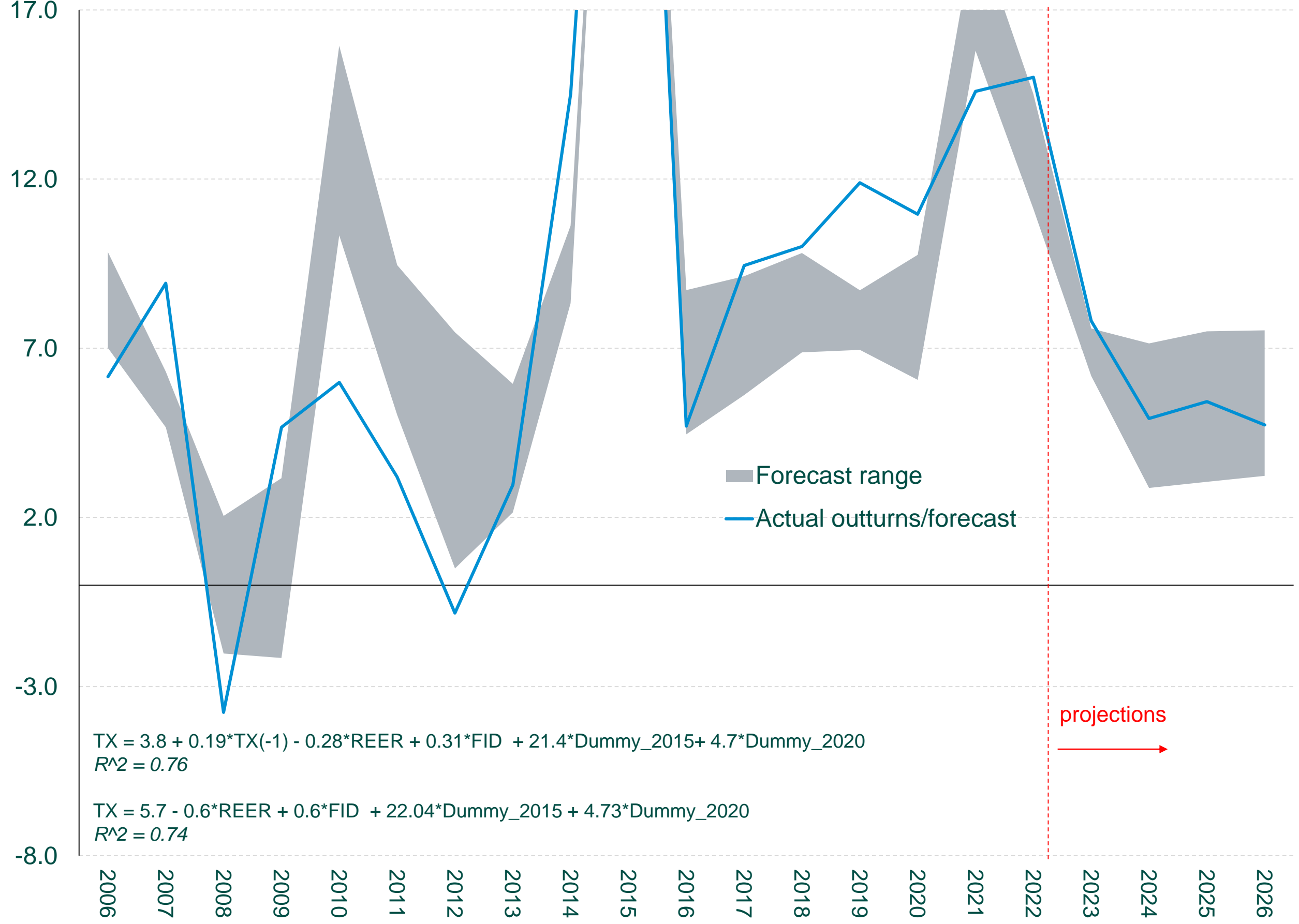
External demand a key driver of exports – sectoral issues also



Export growth set to moderate



Results informed by standard export model



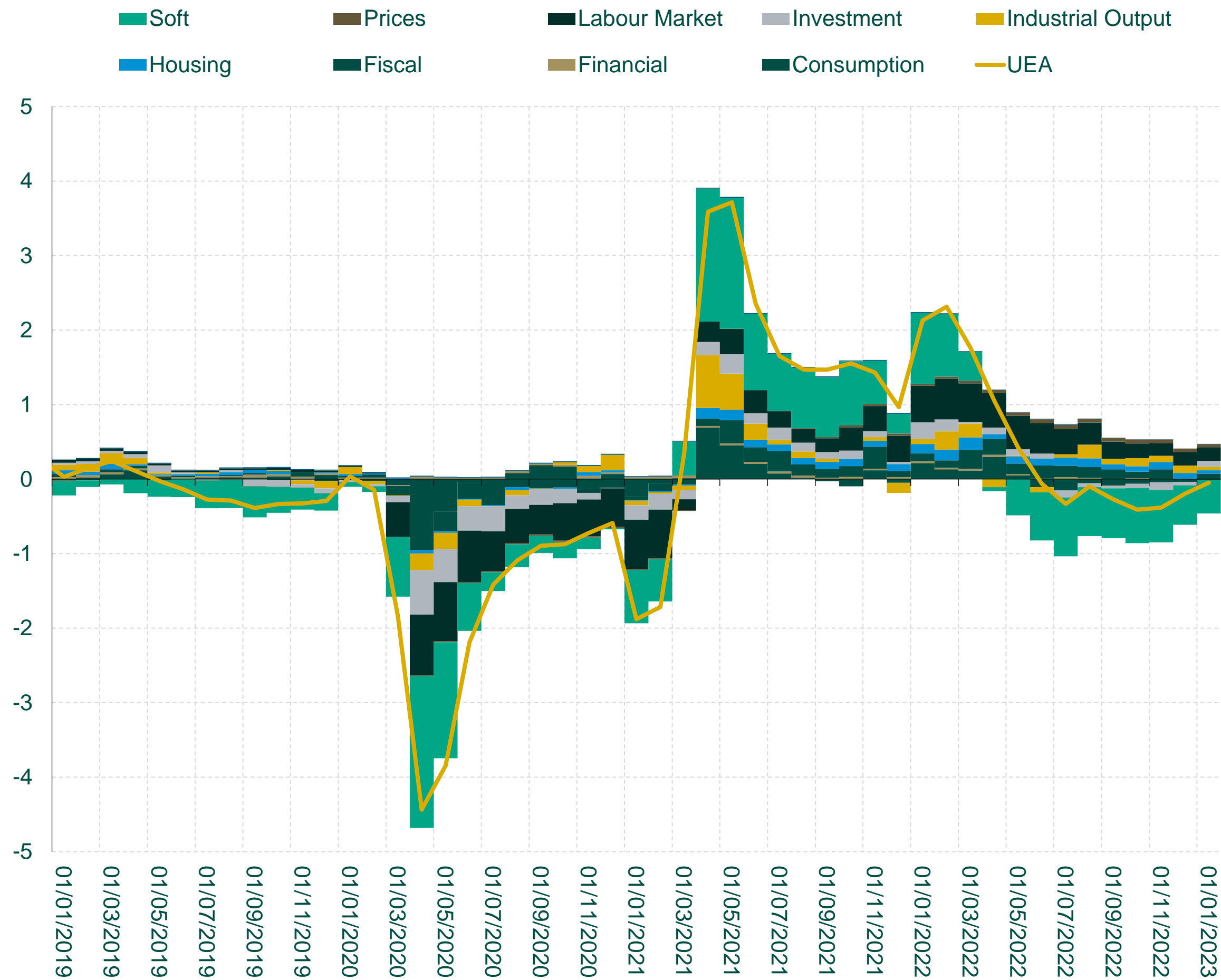


Short-run demand side

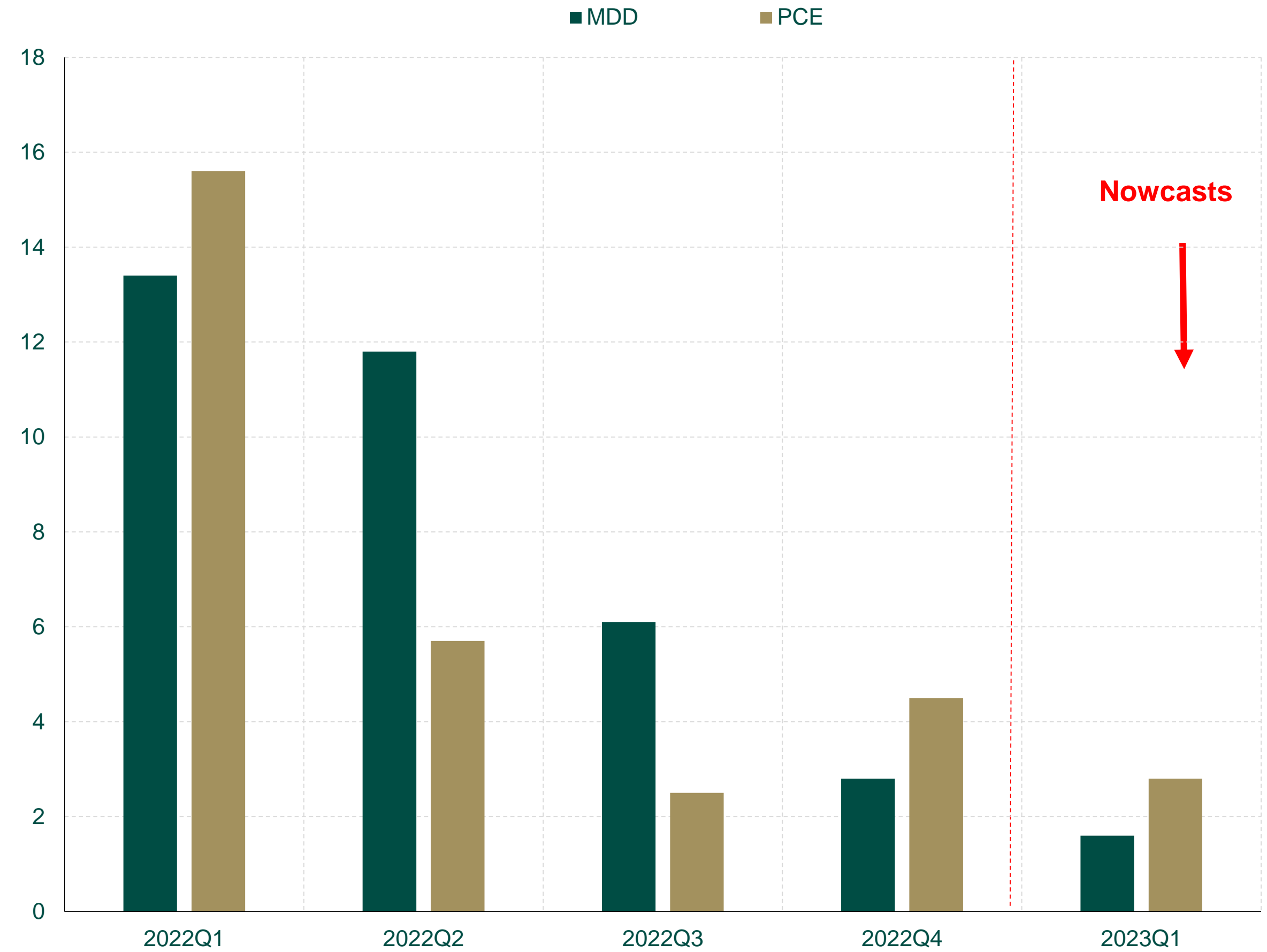
Bridge models [DoF] consistent with modest improvement



DOF Underlying Economic Activity Indicator (UEA)



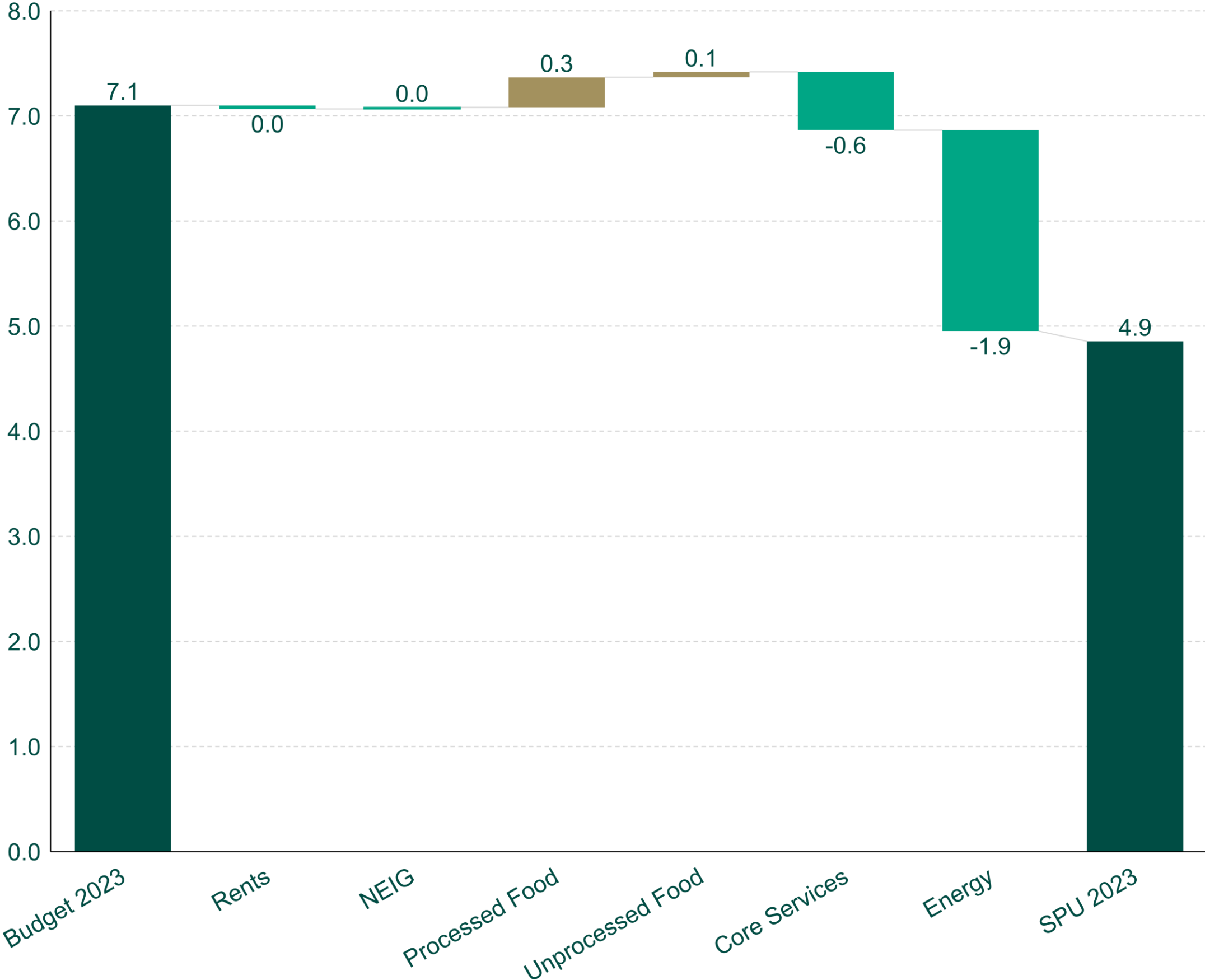
DOF Q1 2023 Nowcasts (Y/Y)



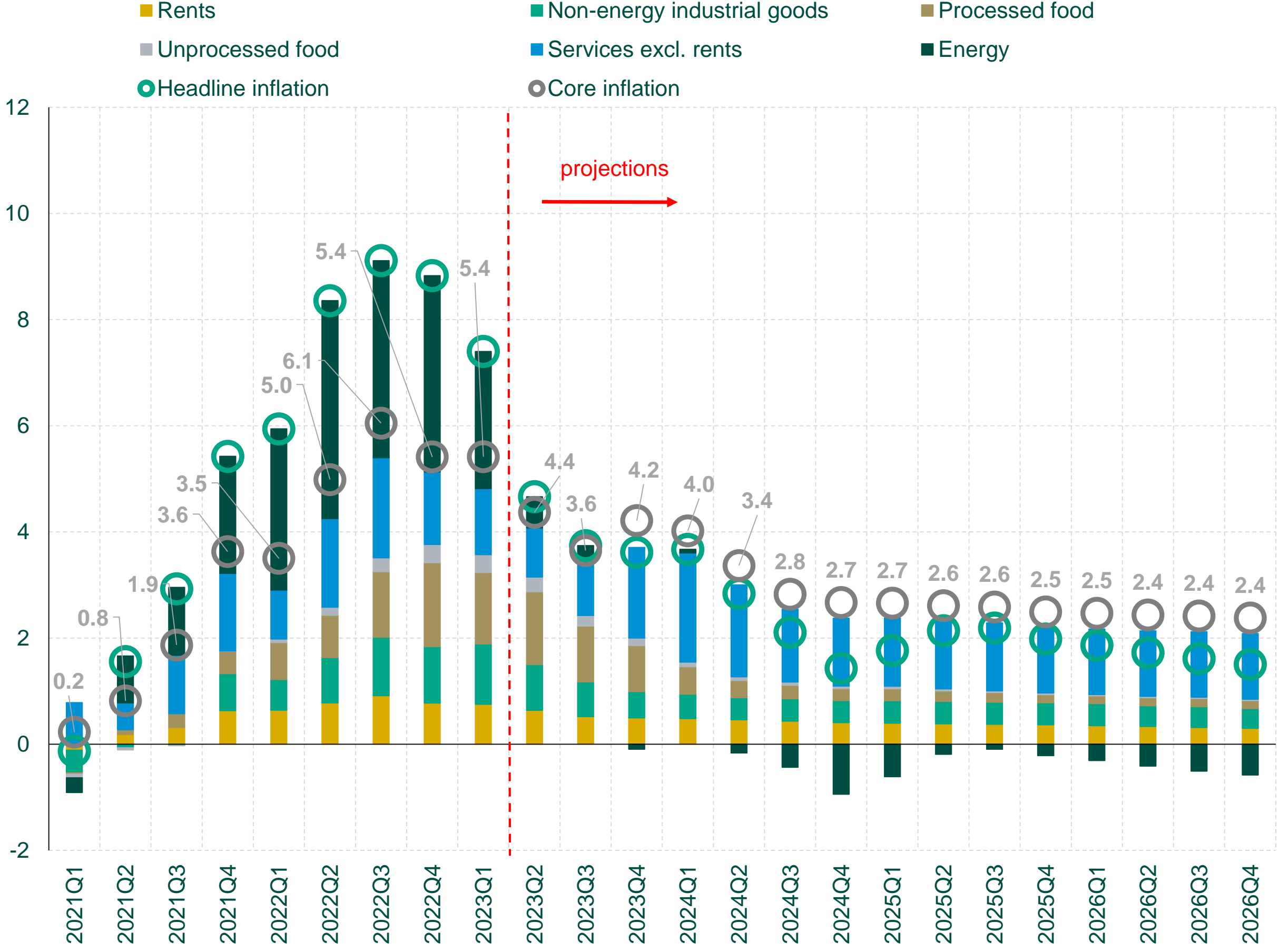
More moderate inflation this year due to lower energy prices



Contribution to change in 2023 HICP inflation forecast



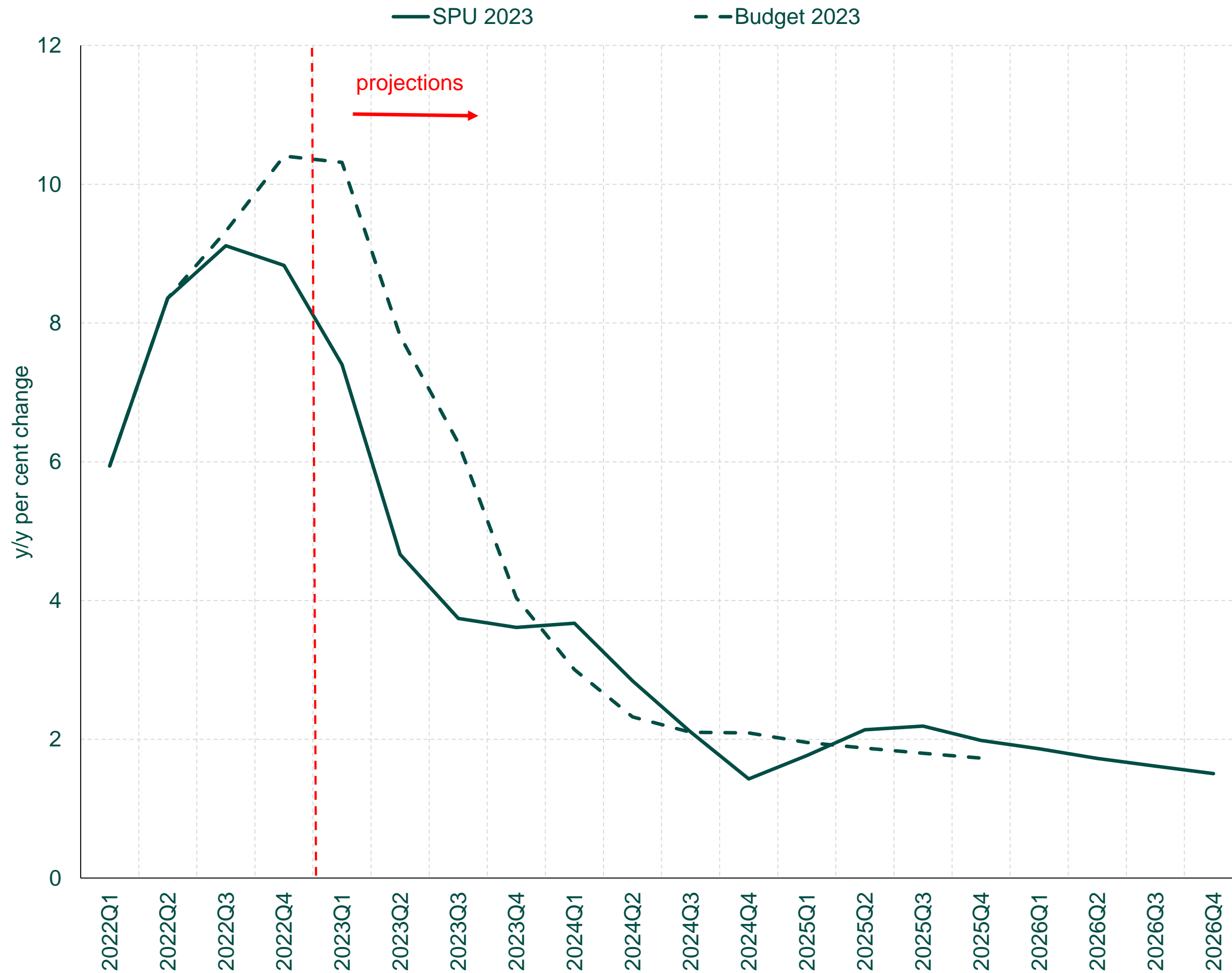
Contribution to y/y growth in headline inflation, pp



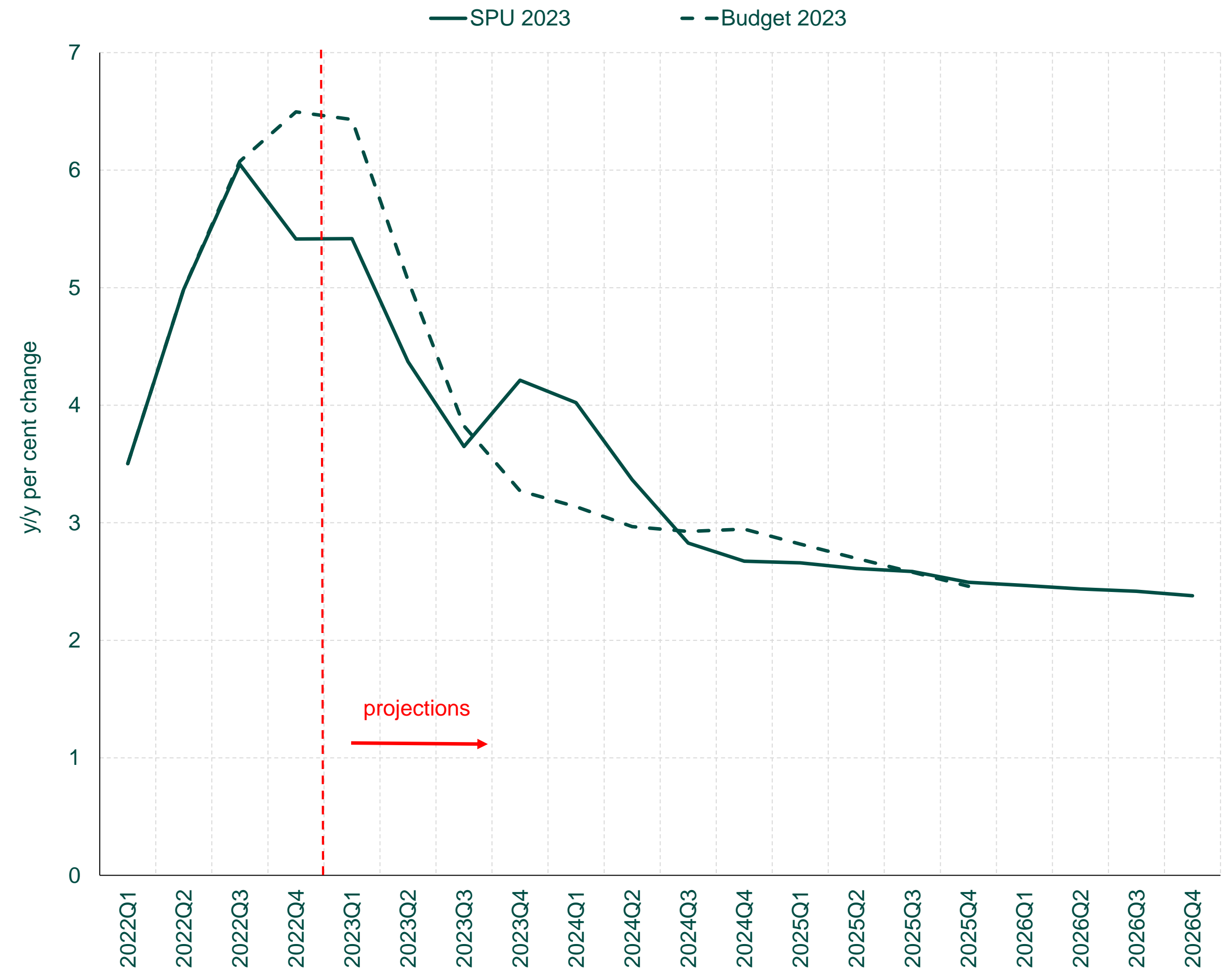
Inflation: morphing from supply- to demand-side shock ?



Headline inflation set to ease sharply from second quarter



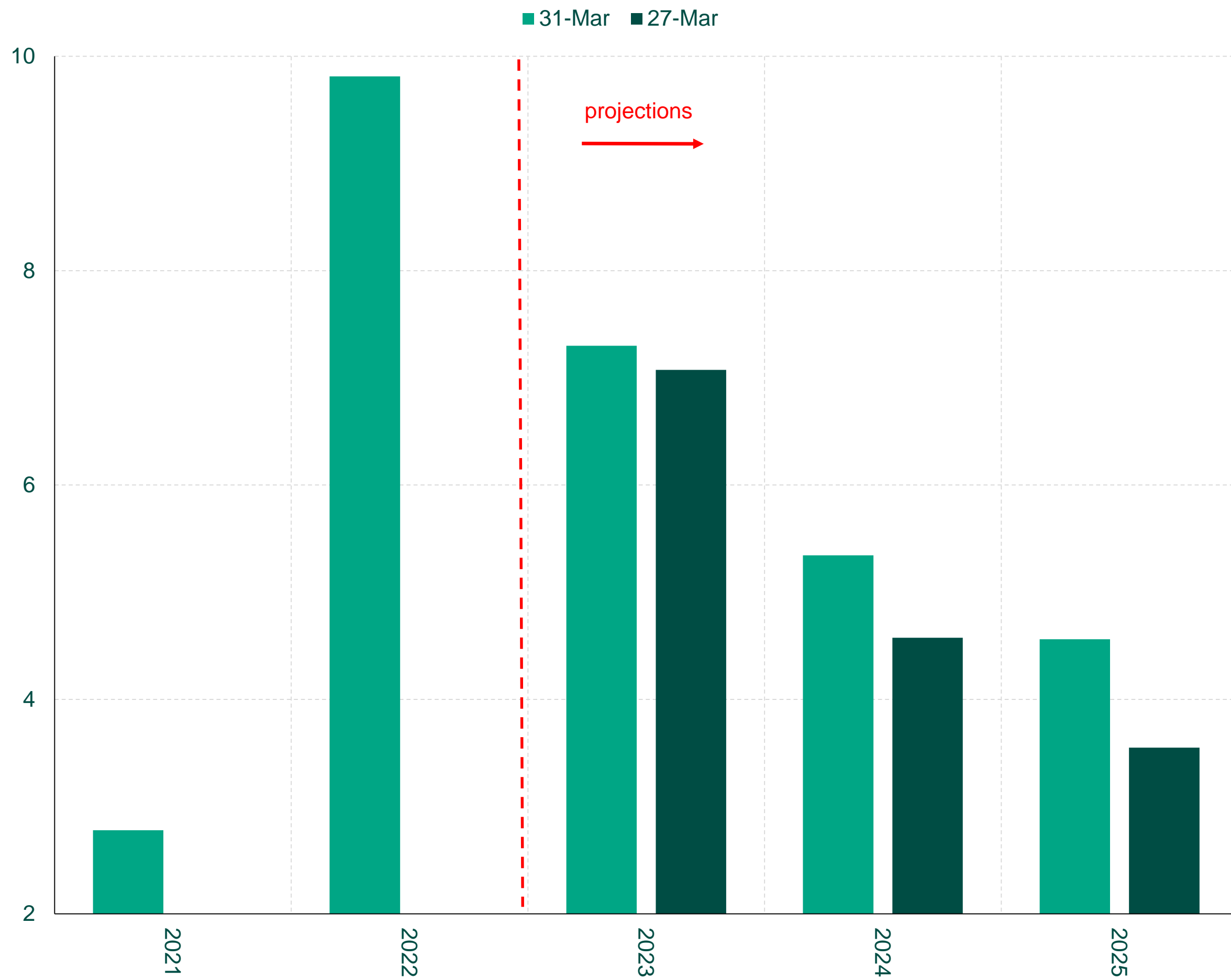
Core inflation is more 'sticky'



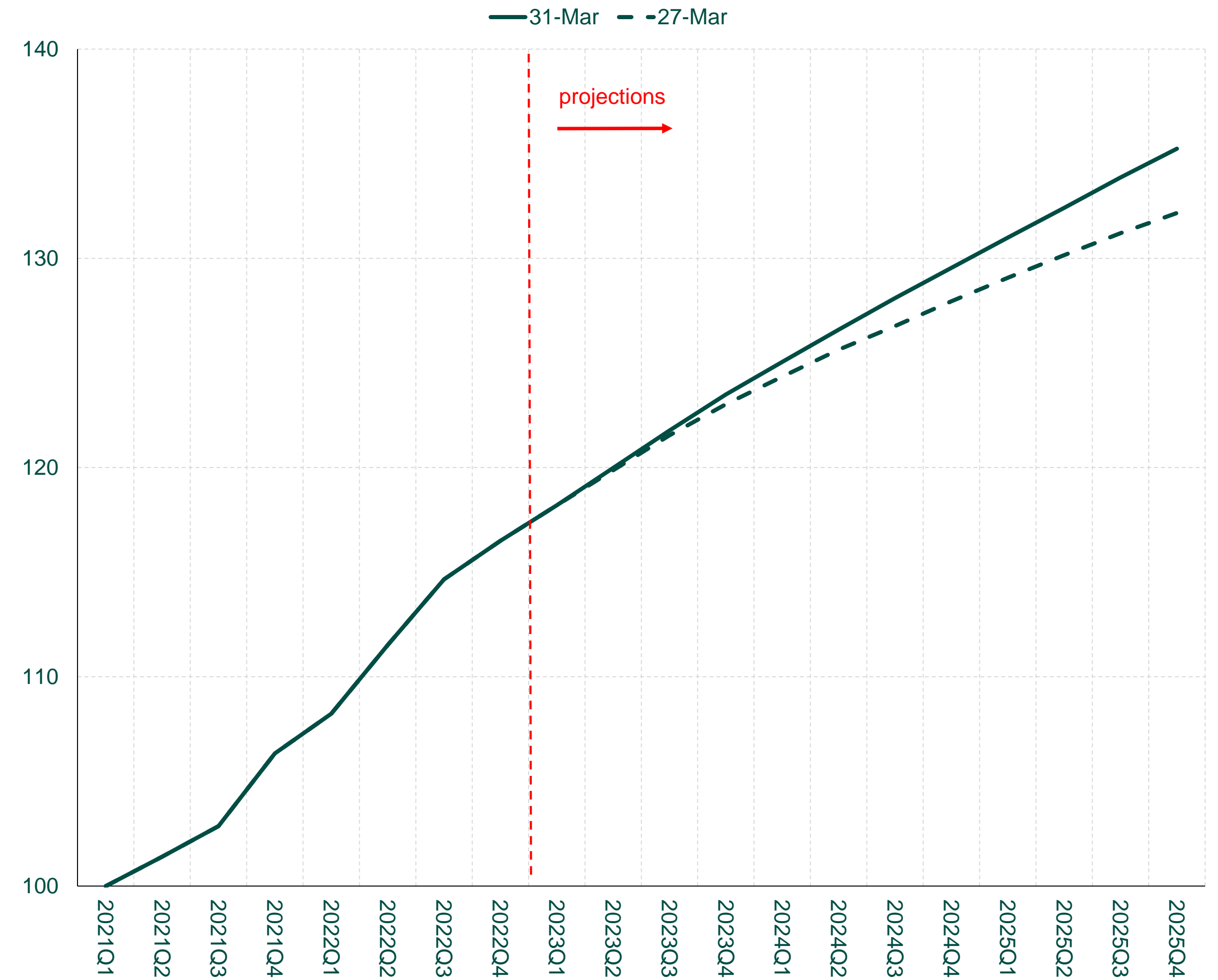
Rents to continue to rise strongly despite easing of annual inflation rate



Annual rate of rental price inflation



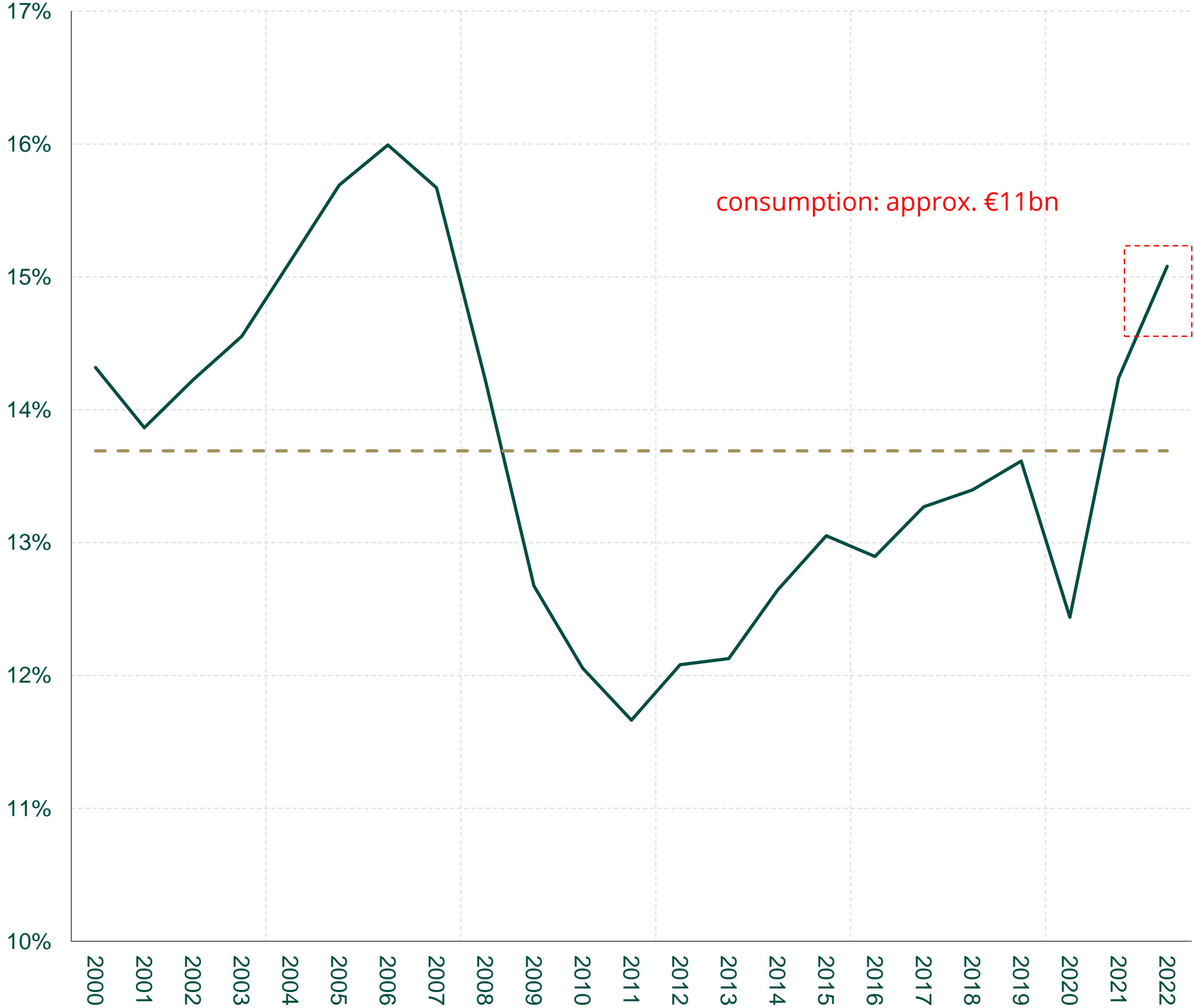
Rents price level, 2021 Q1 = 100



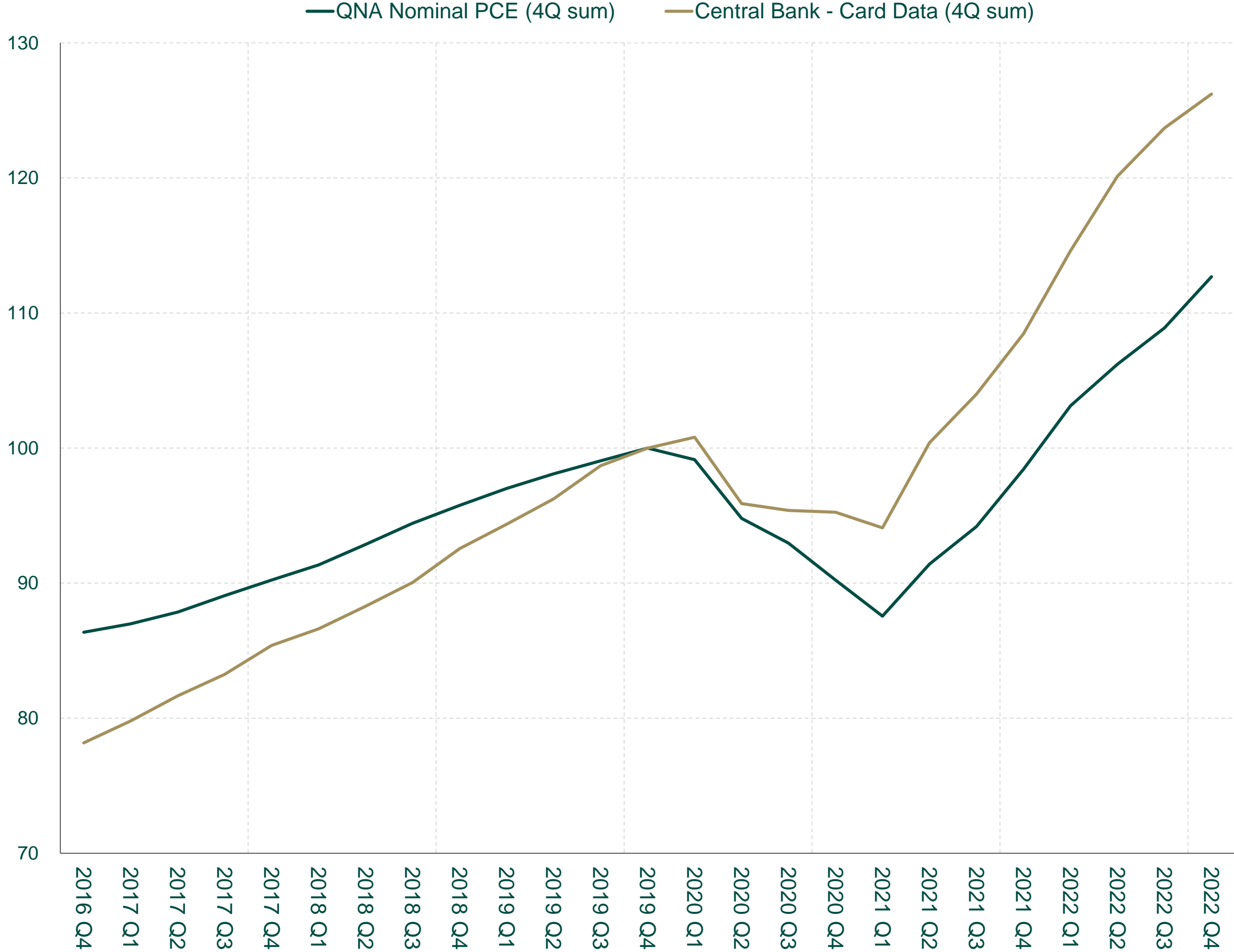
Under-estimate of consumer spending ?



Effective rate of VAT (VAT receipts / nominal PCE)



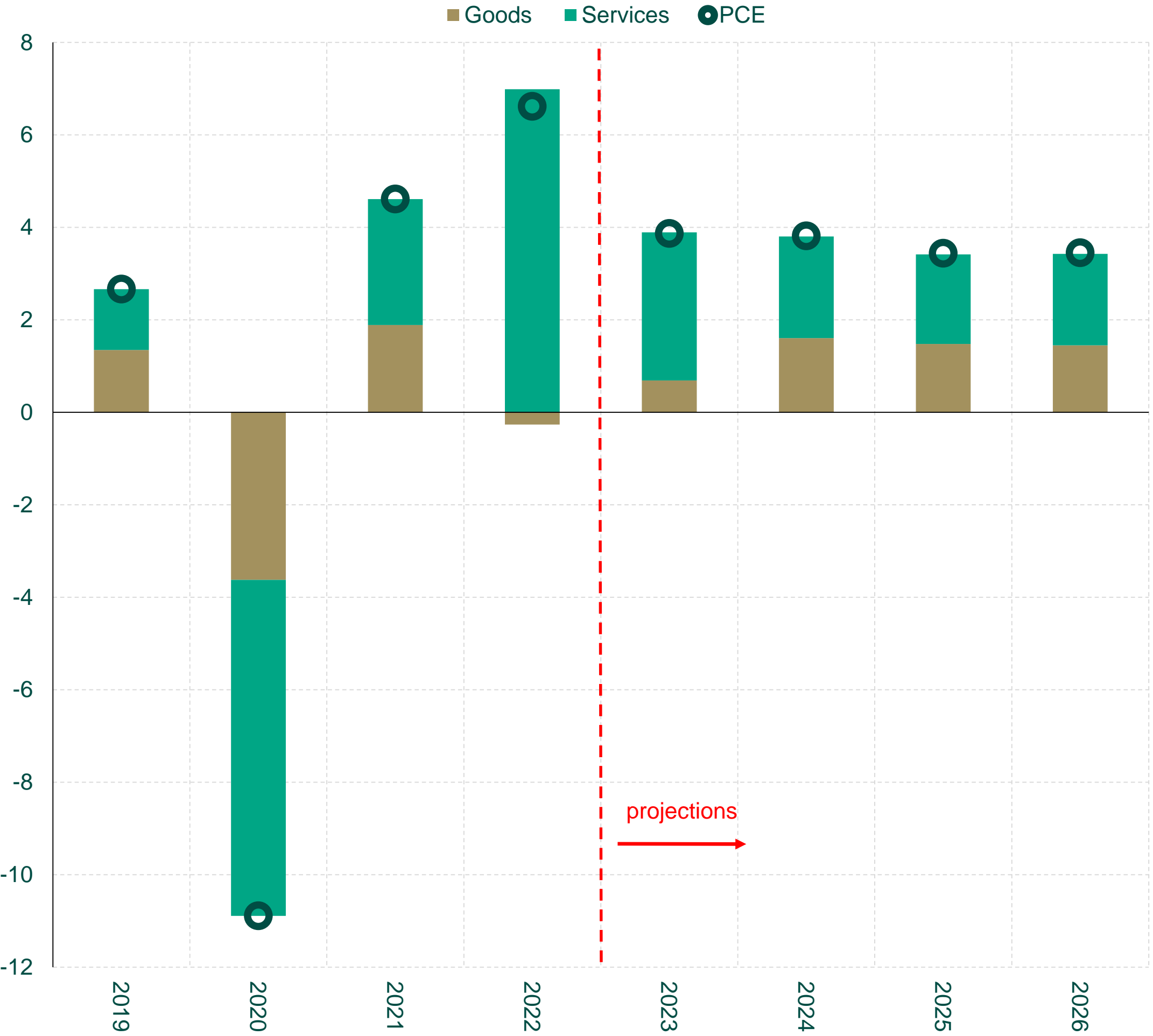
Nominal PCE vs Central Bank card spending, 2019q4=100



Goods and services consumption



Contribution to real PCE growth, pp



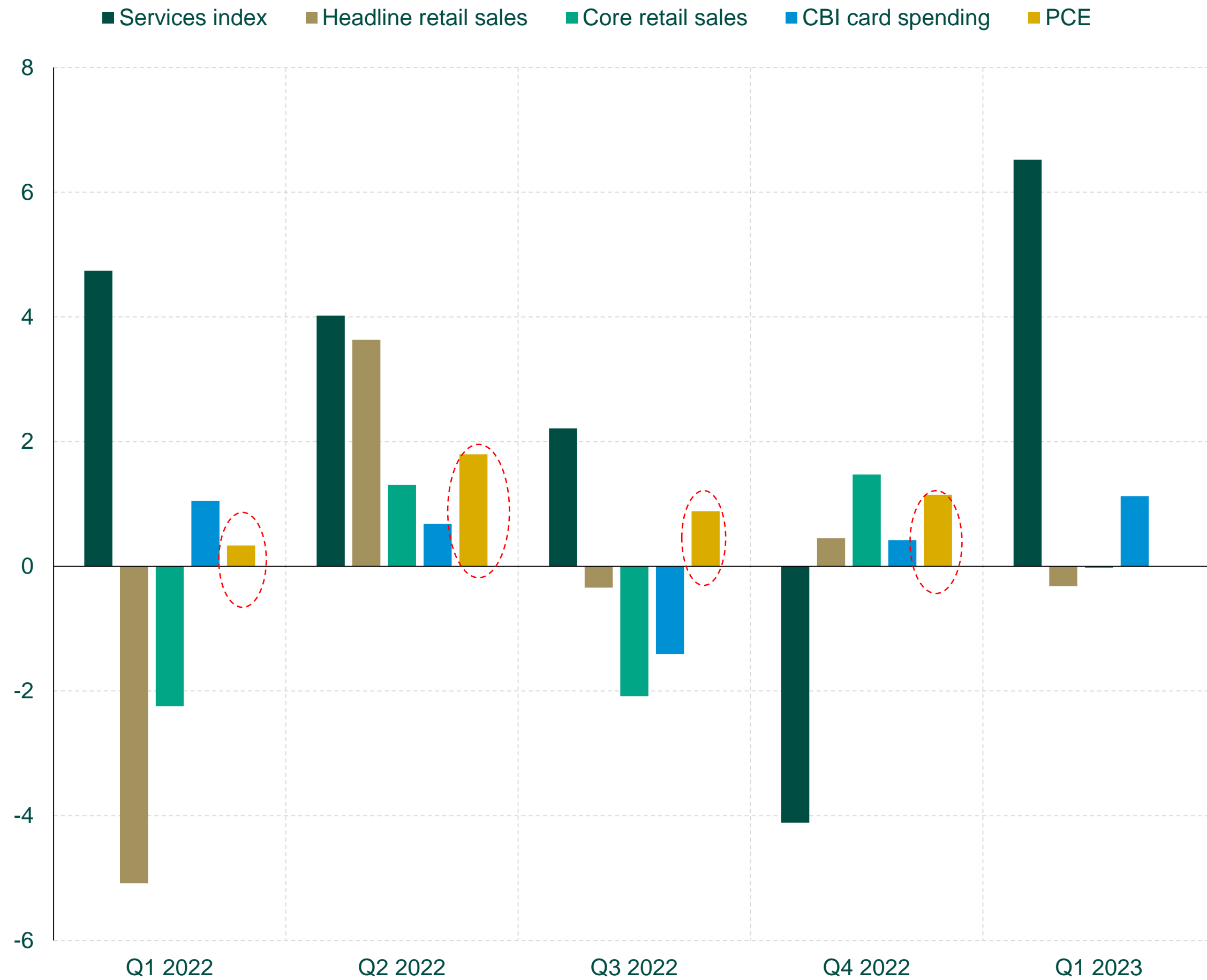
Real consumption, 2019 = 100



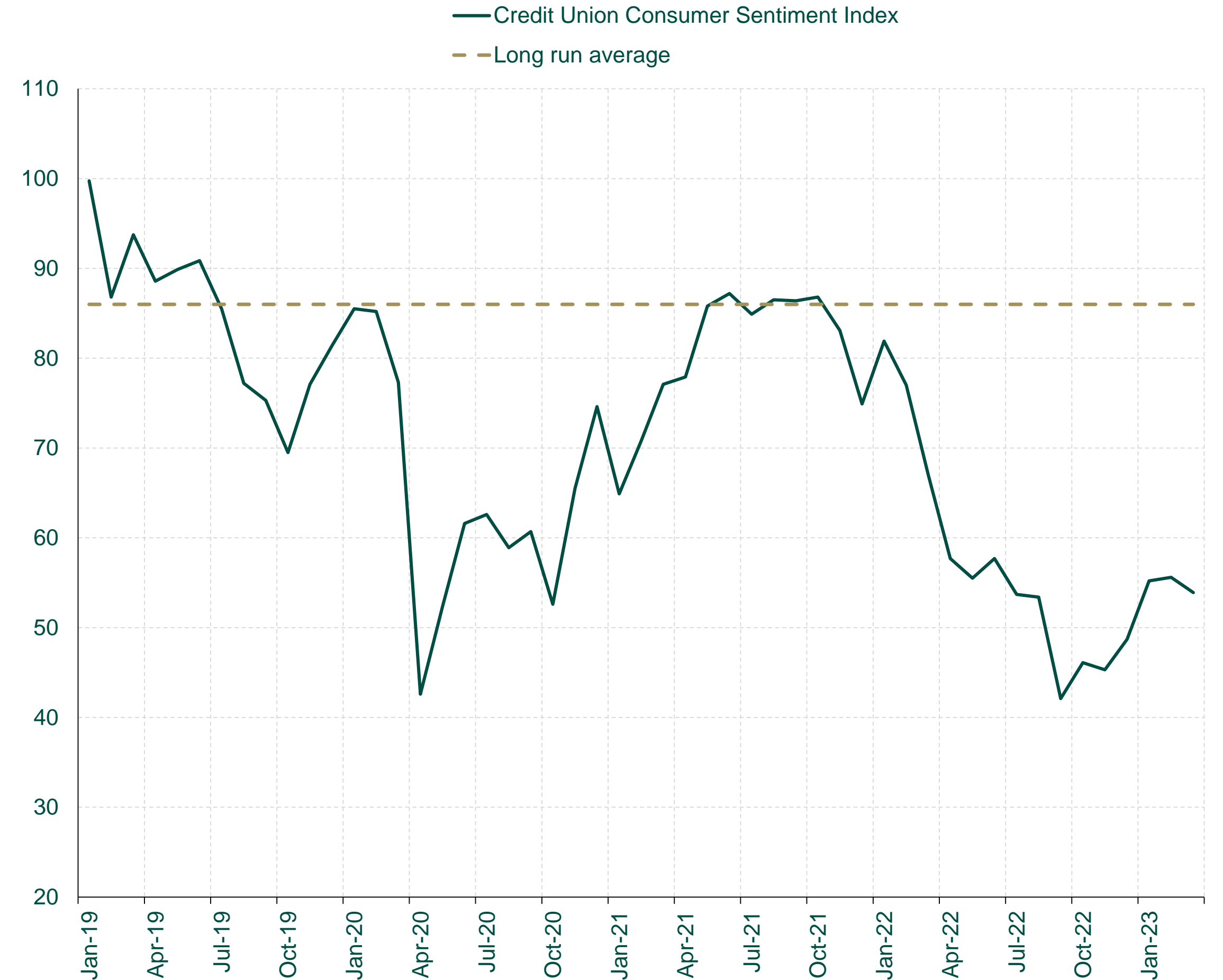
Erosion of real income has weighed on consumer spending



Most data show modest household spending growth in q1



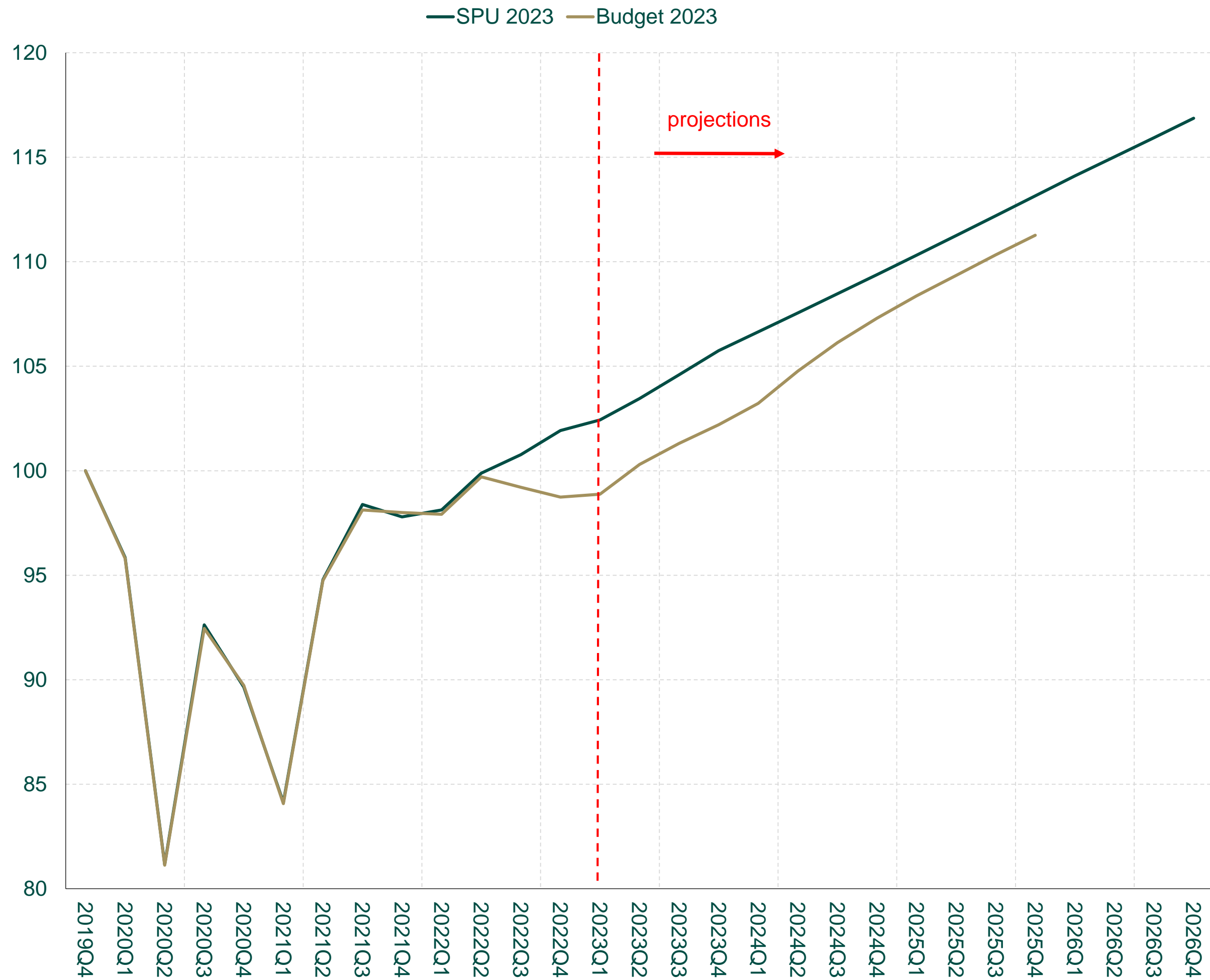
Weak consumer sentiment : precautionary savings?



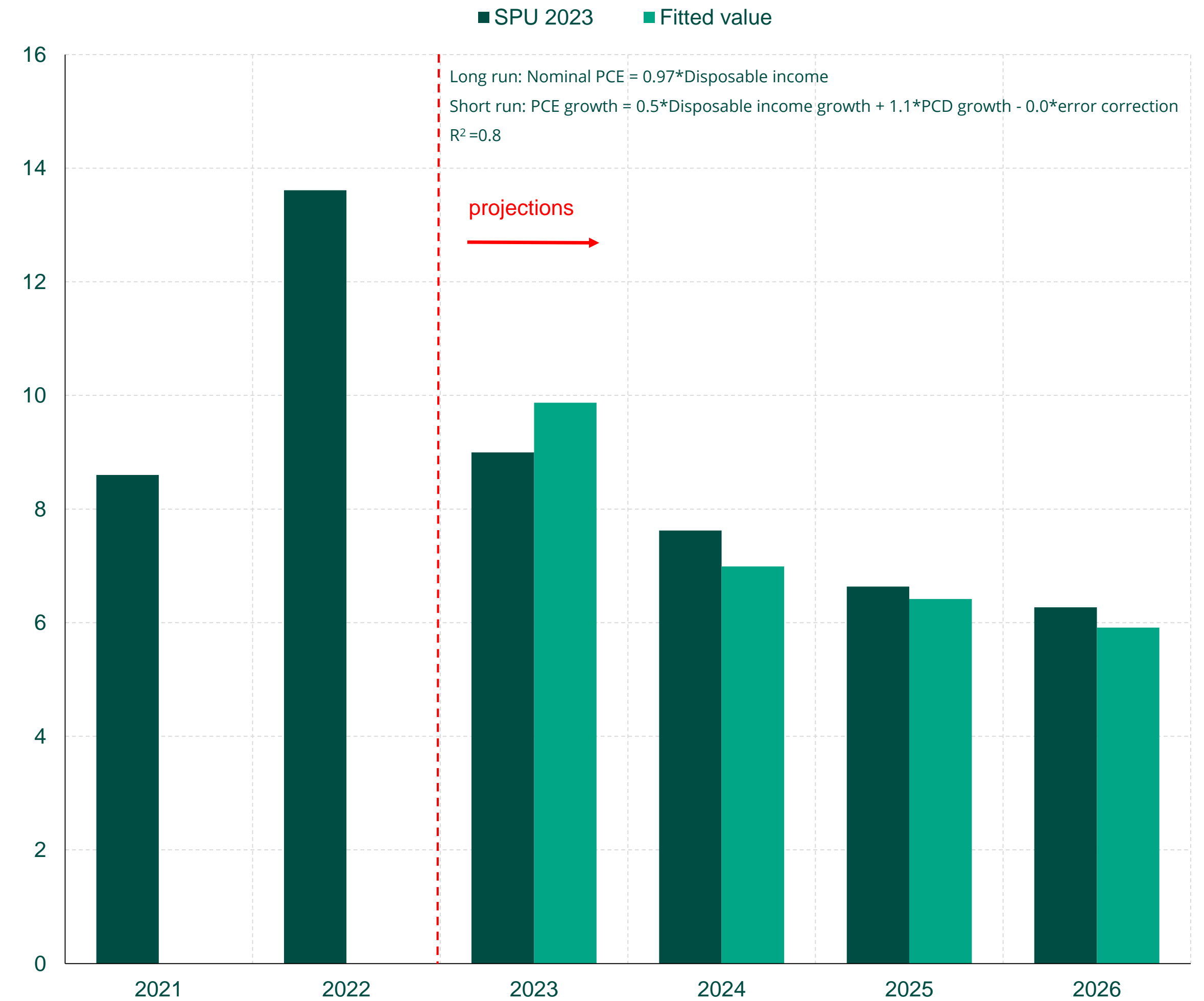
Easing in inflation pick-up in consumer spending



Consumer spending: spring 2023 vs autumn 2022 forecasts



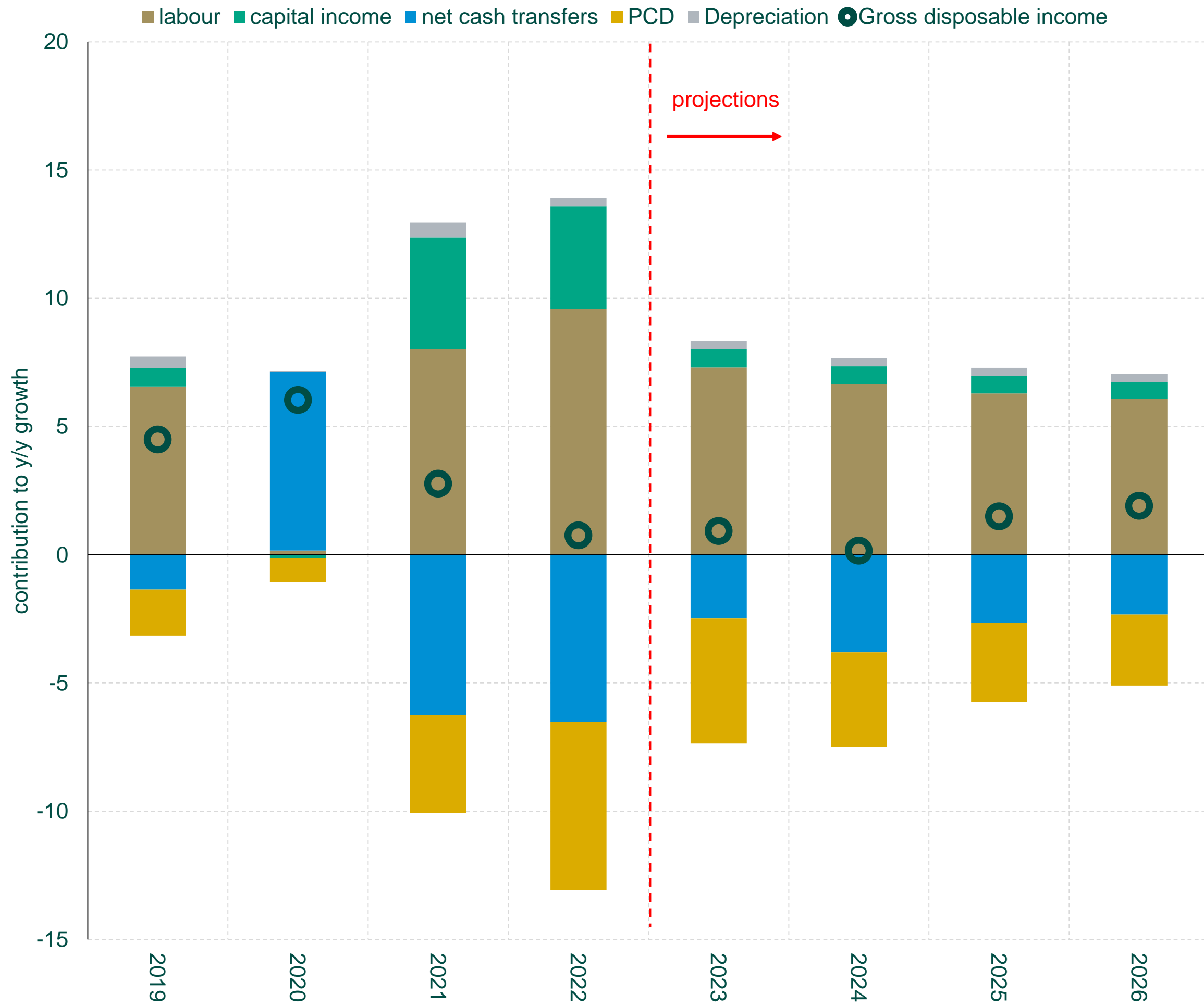
Nominal consumption model, annual % growth



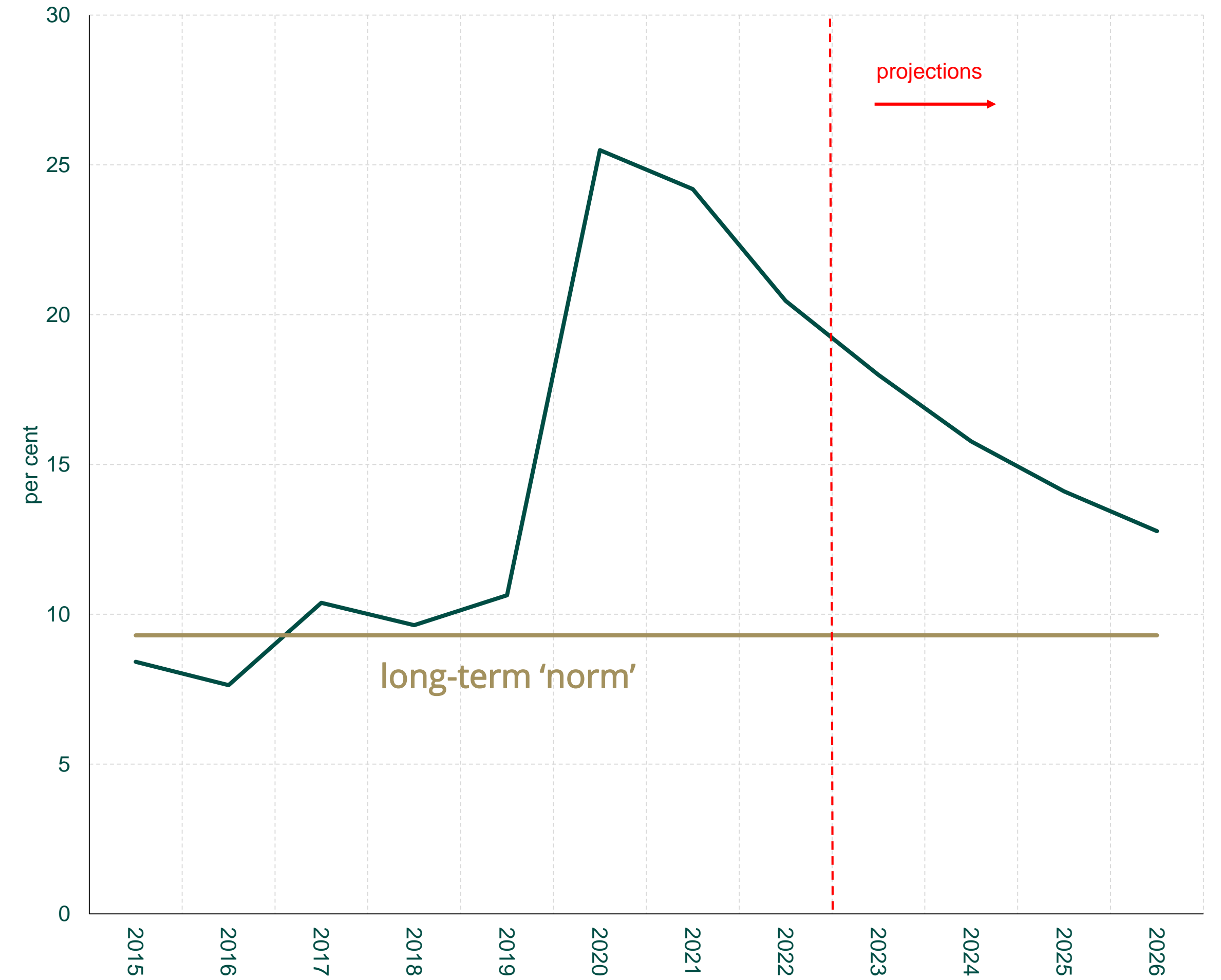
Household income and savings



Change in Real Gross Disposable Income



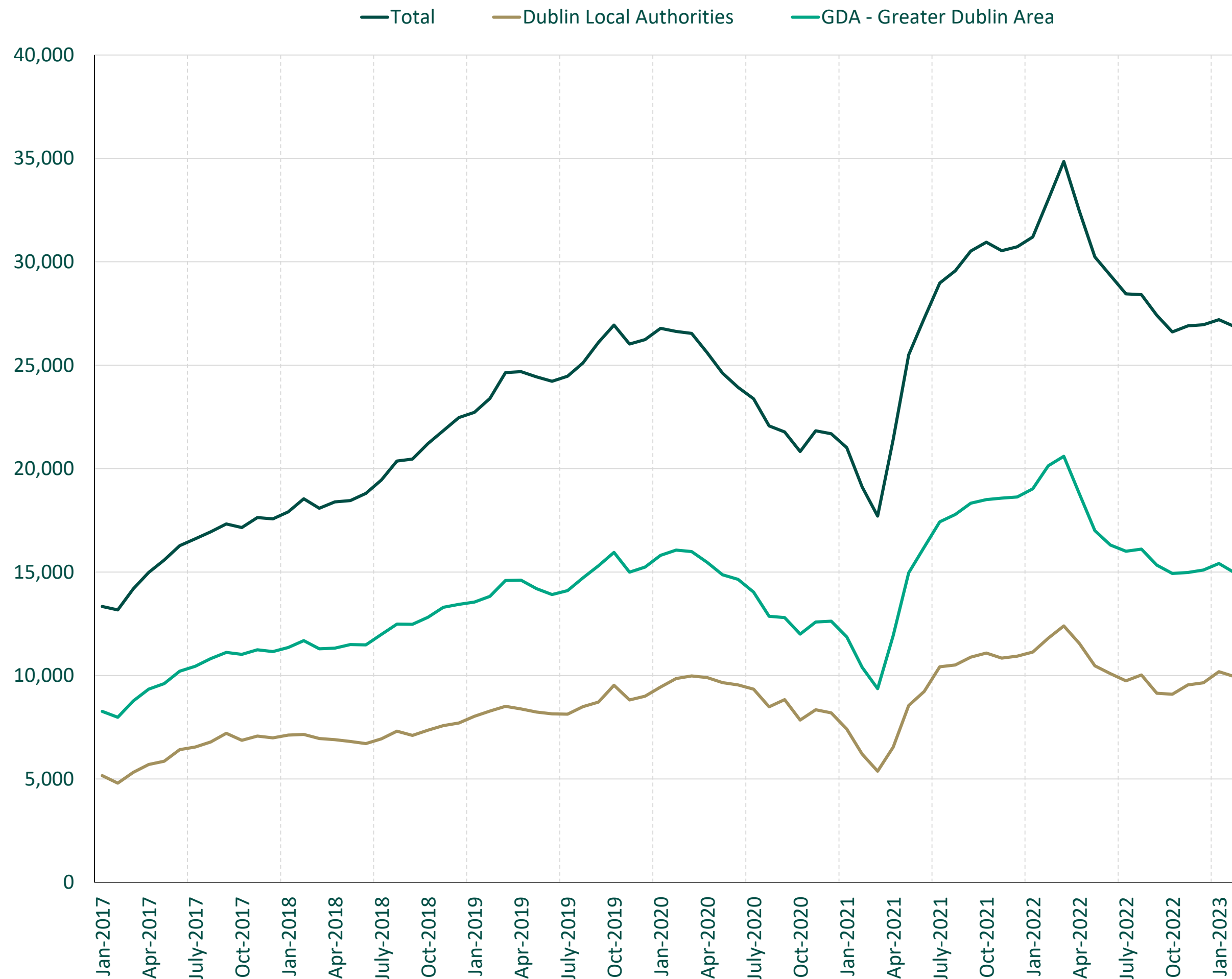
Household saving behaviour to 're-normalise'



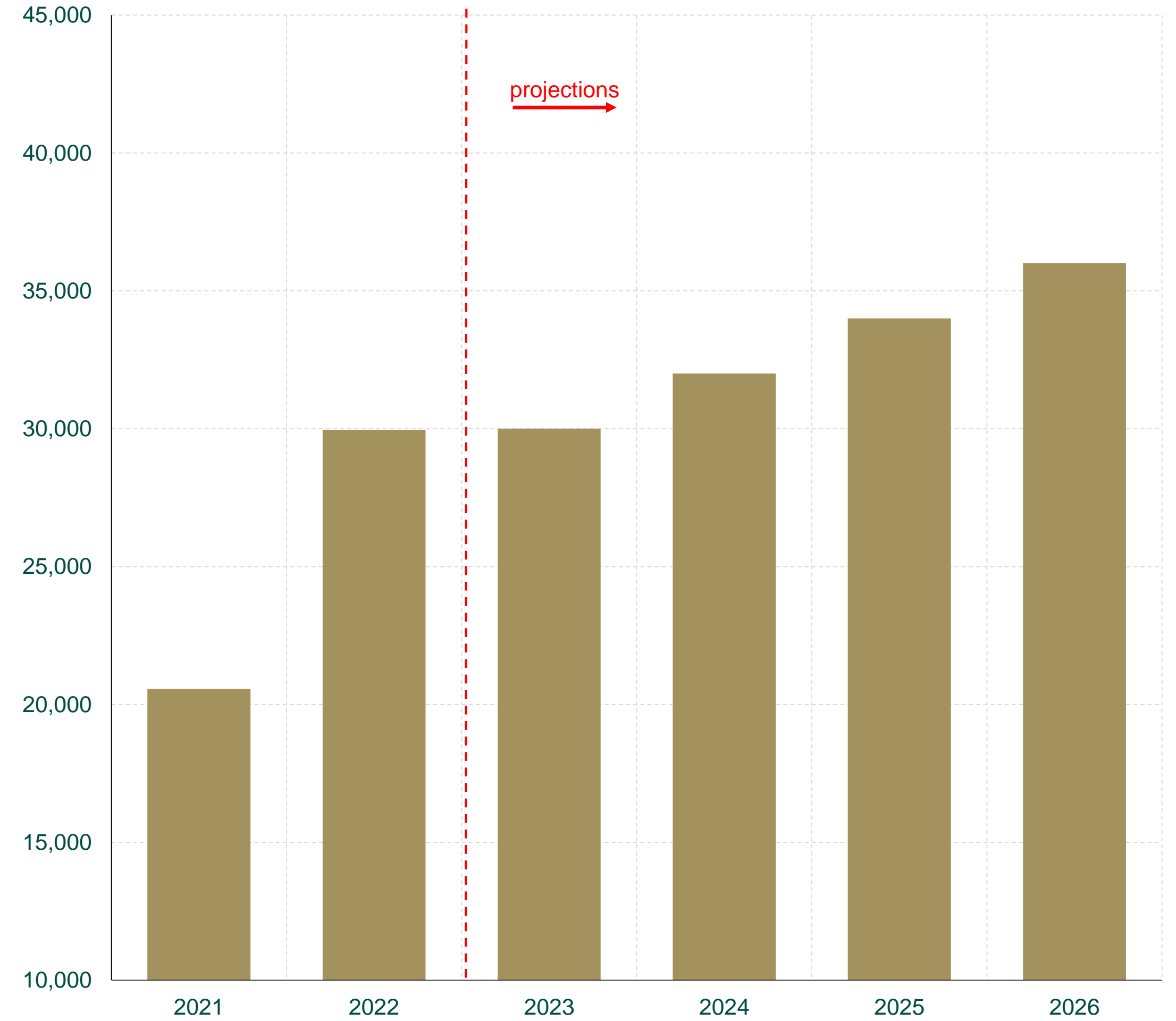
Building and construction investment: housing



Housing commencements, 12-mth rolling sum



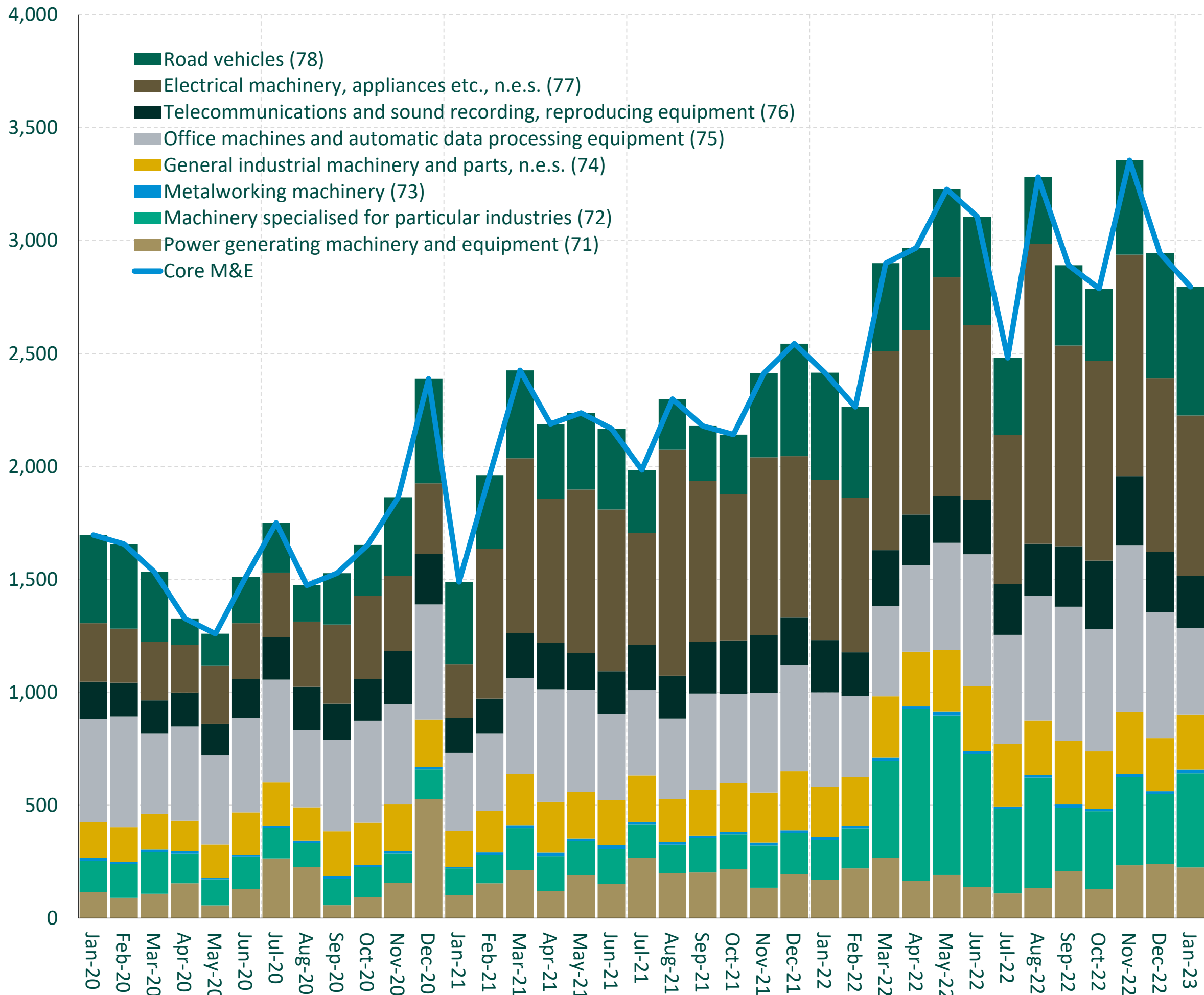
Housing completions forecast



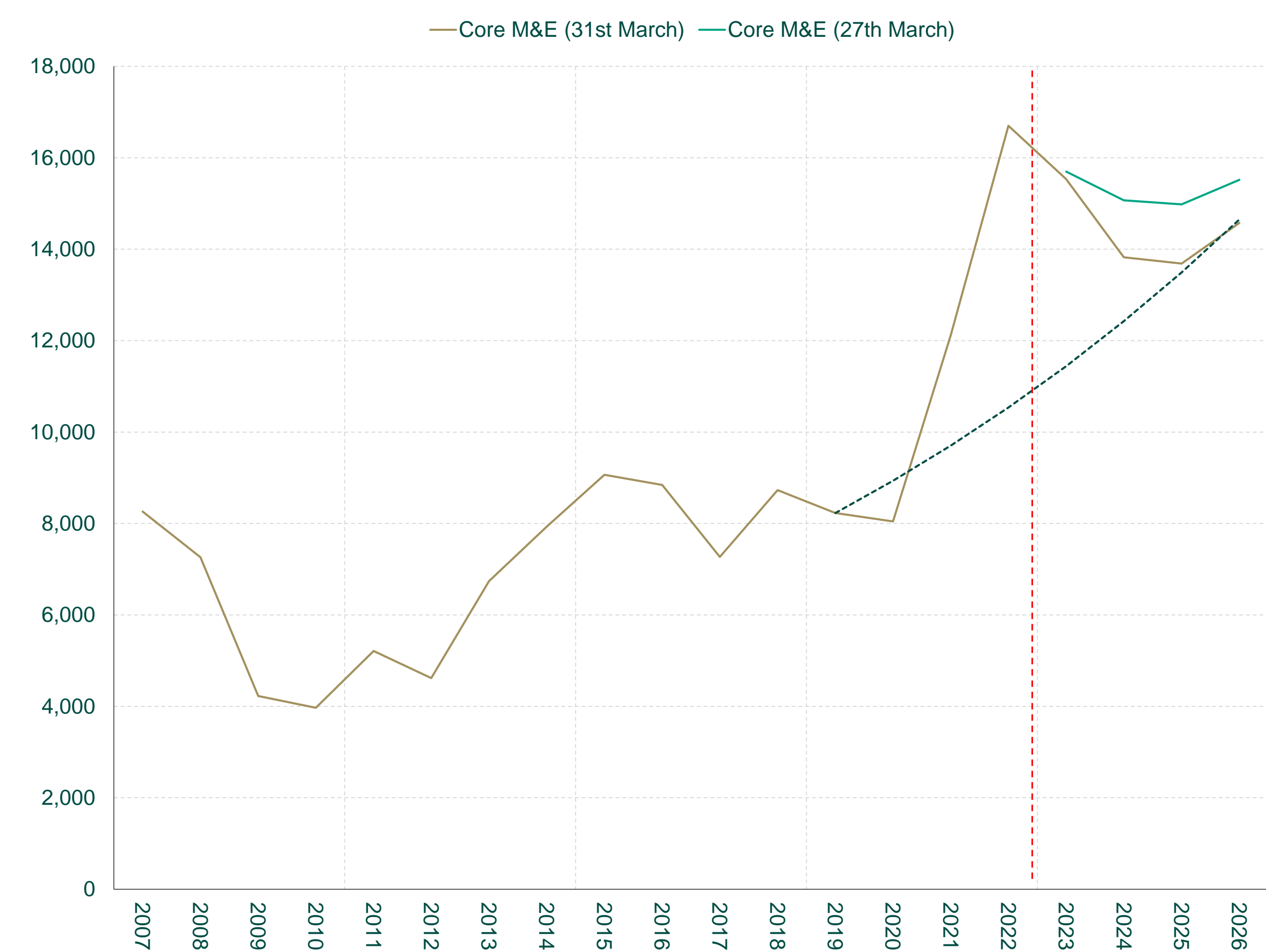
Surge in modified investment over recent years



Core M&E Imports, € millions



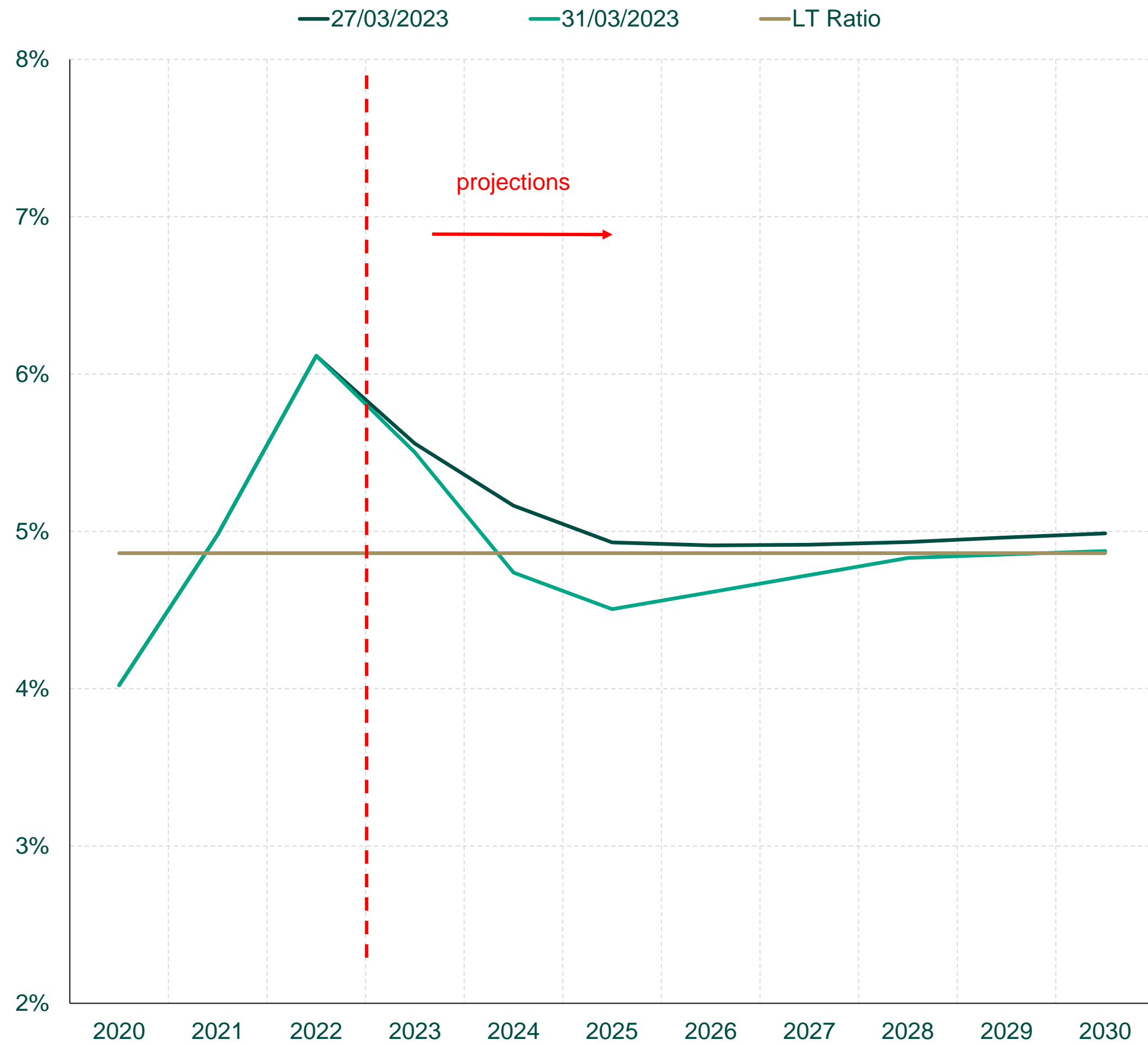
Core M&E Forecast Level, € millions



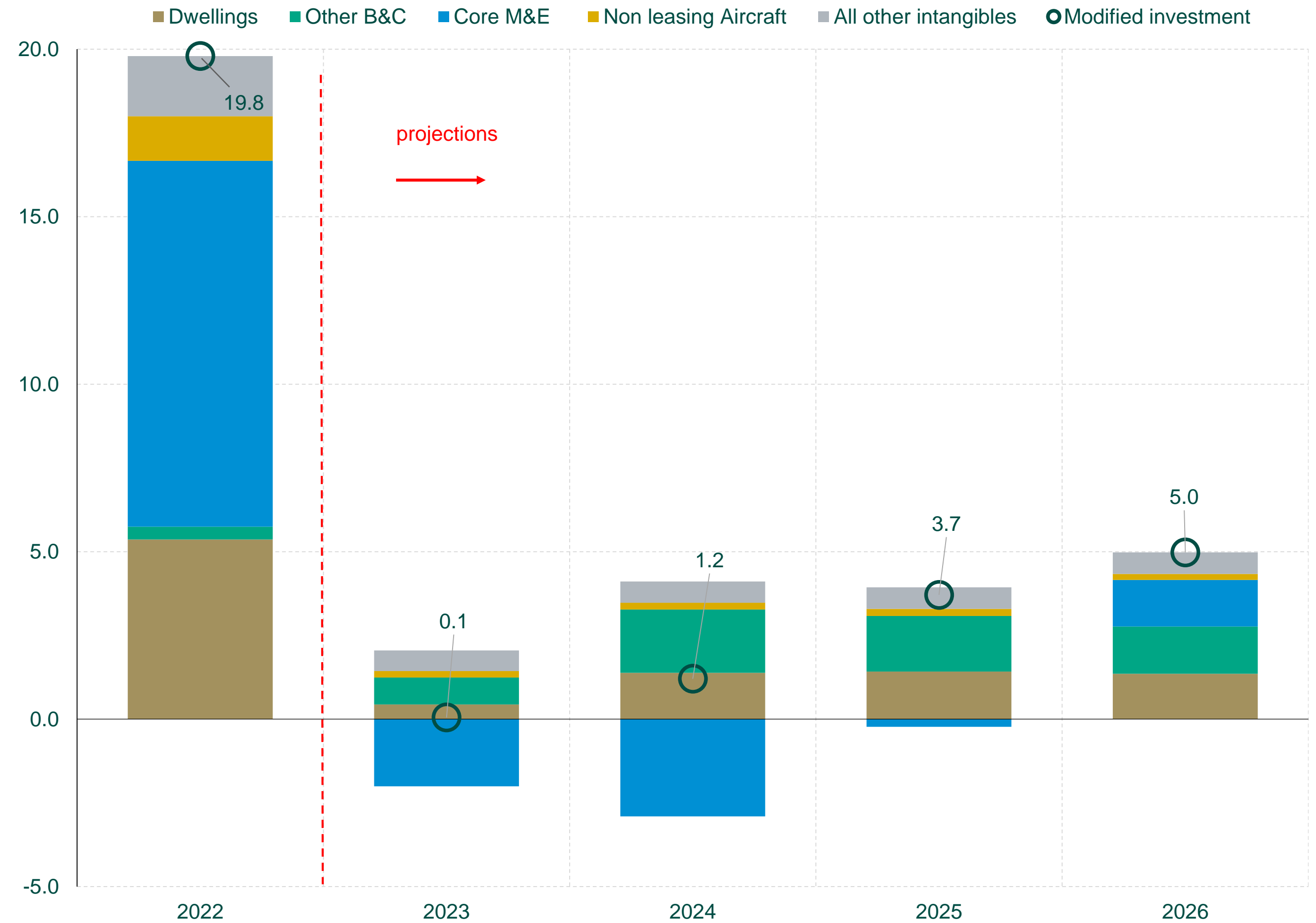
Modified M&E investment: normalisation from exceptionally high level



Core M&E investment % GNI*



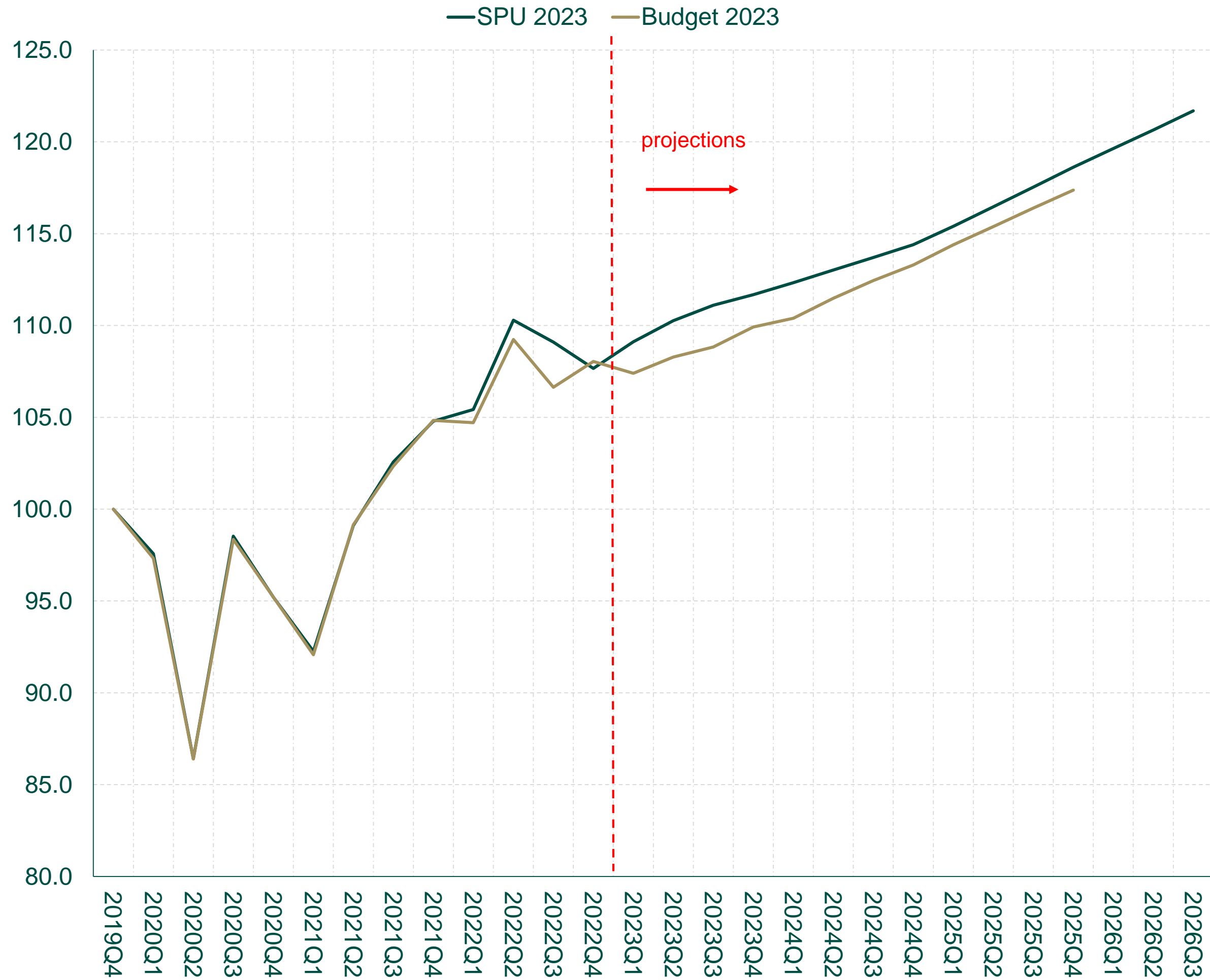
Modified Investment: contribution to y/y



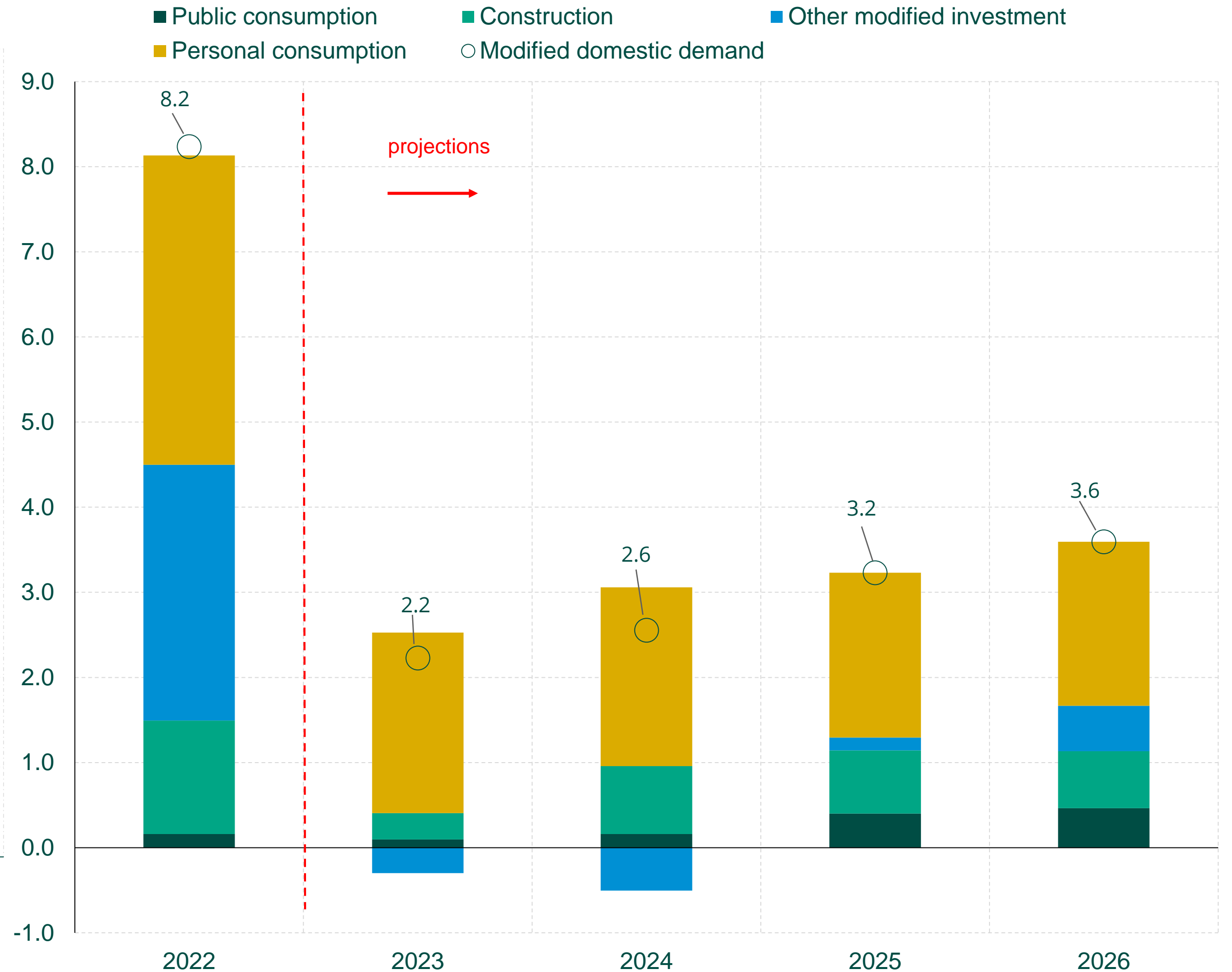
MDD: near-term forecasts incorporate modest upward revision



MDD: spring 2023 vs autumn 2022 forecasts



MDD contribution to y/y per cent change



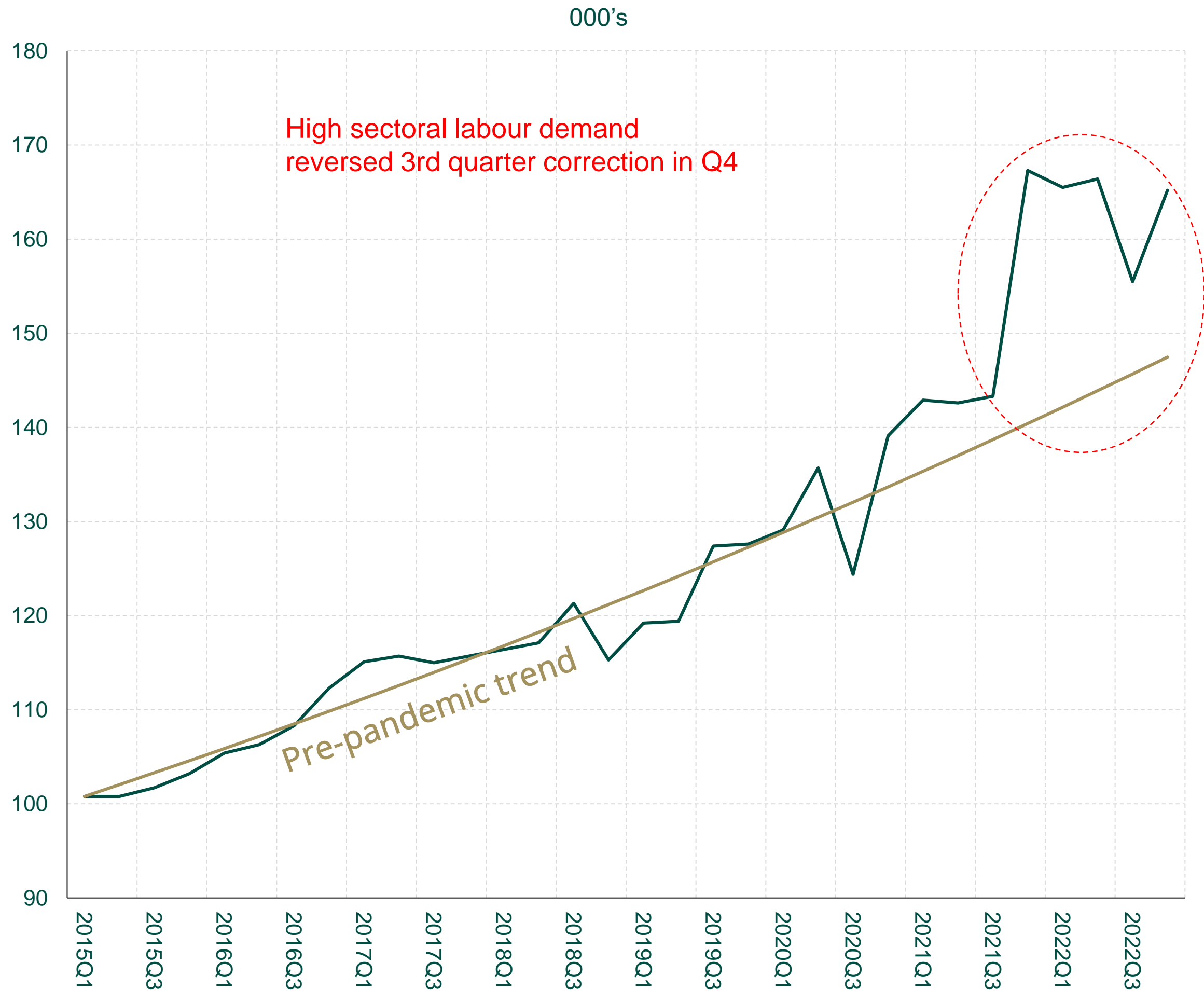


Labour Market

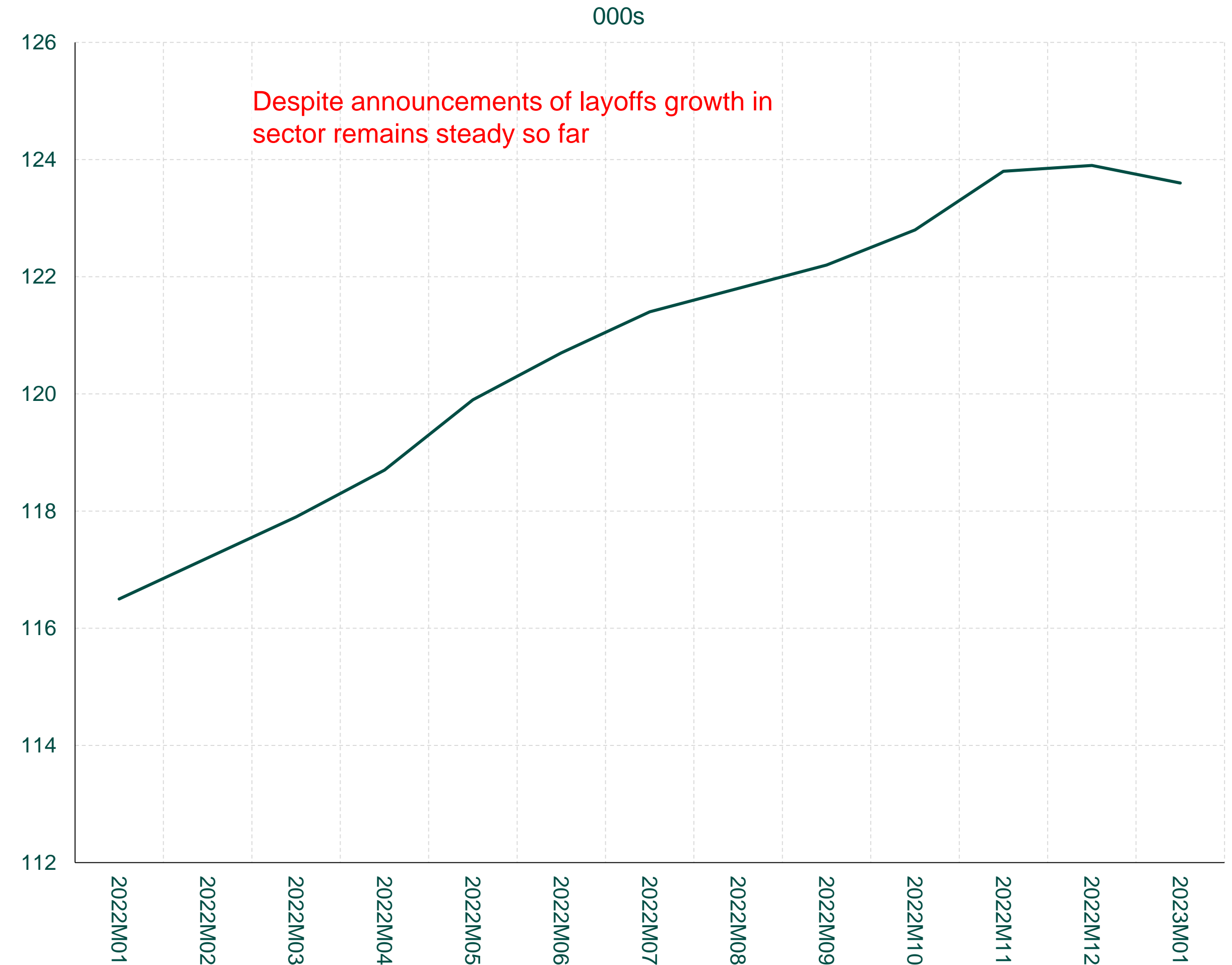
ICT Sector – correction or inflection?



Survey data: Employment in ICT sector above trend, level



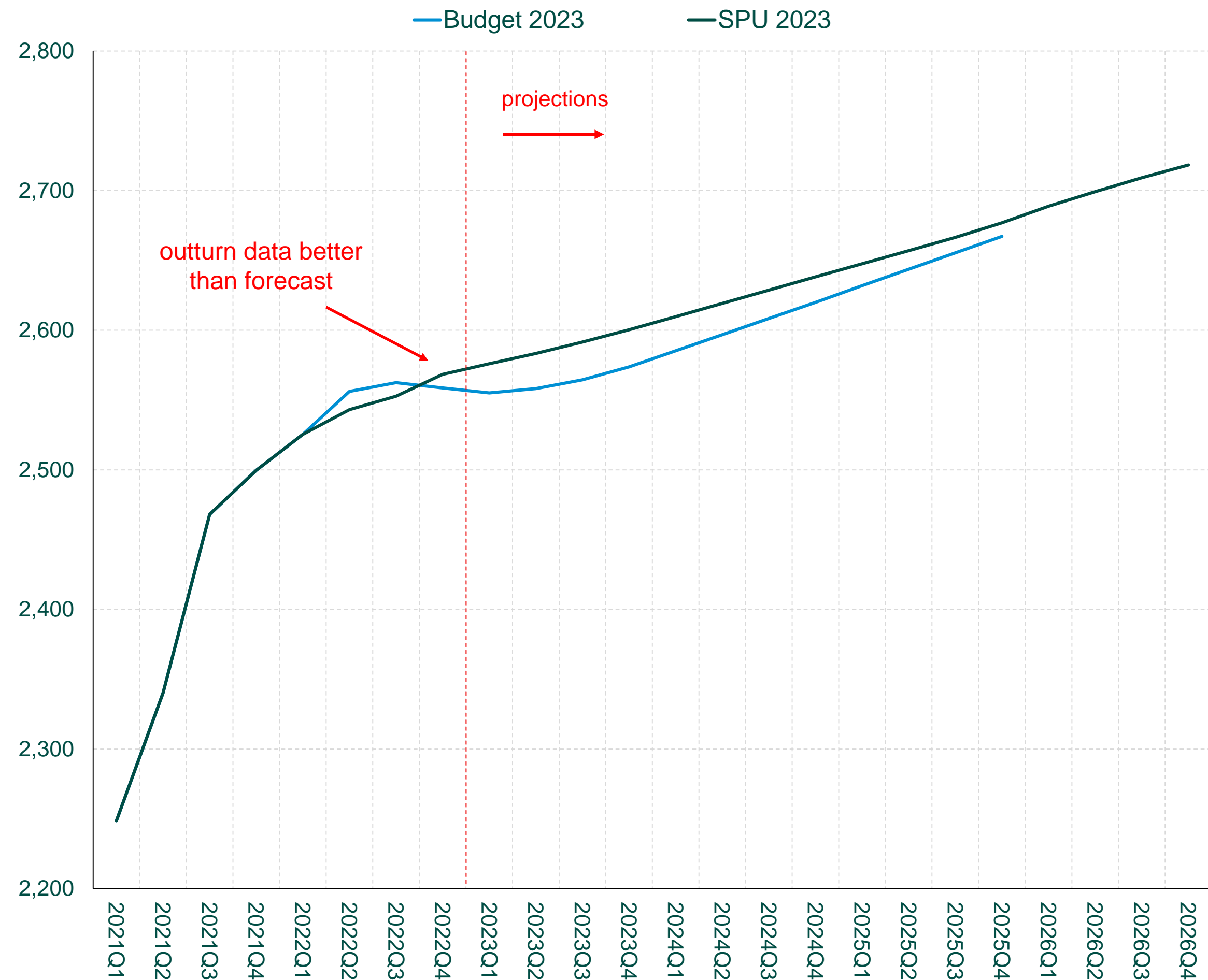
Administrative data: steady employment in ICT sector



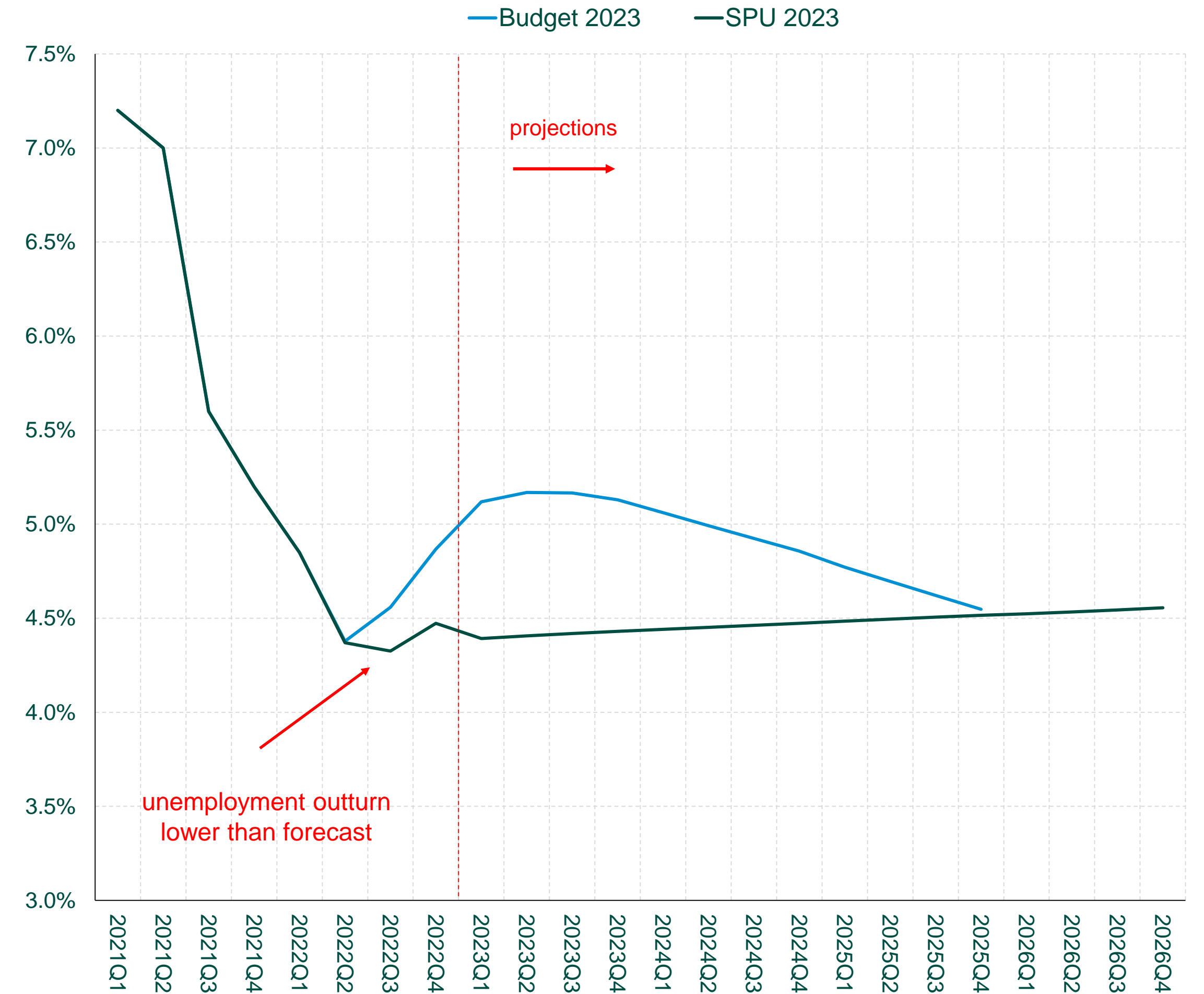
Labour market resilience = improved outlook



Employment, 000s



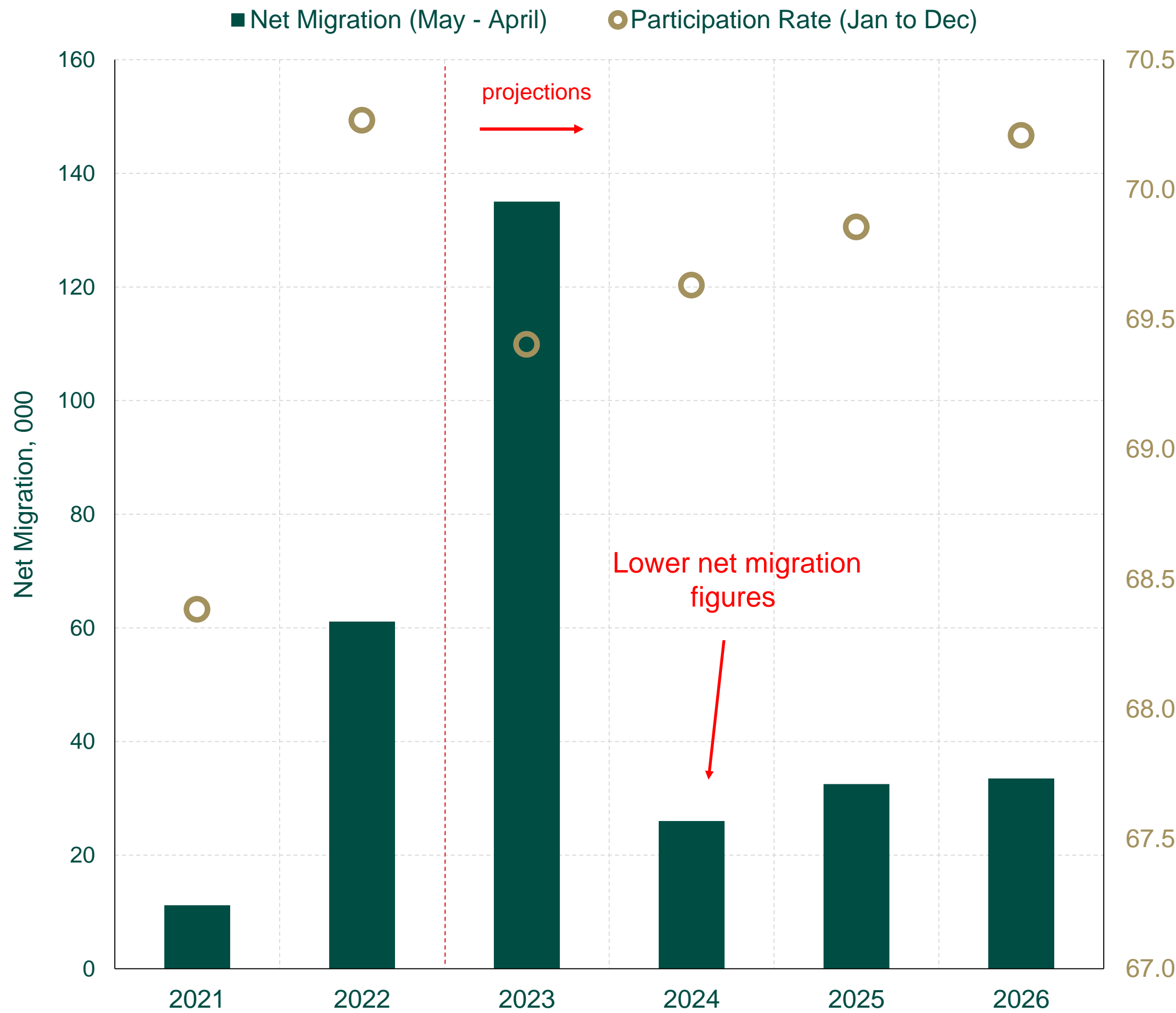
Unemployment rate, per cent



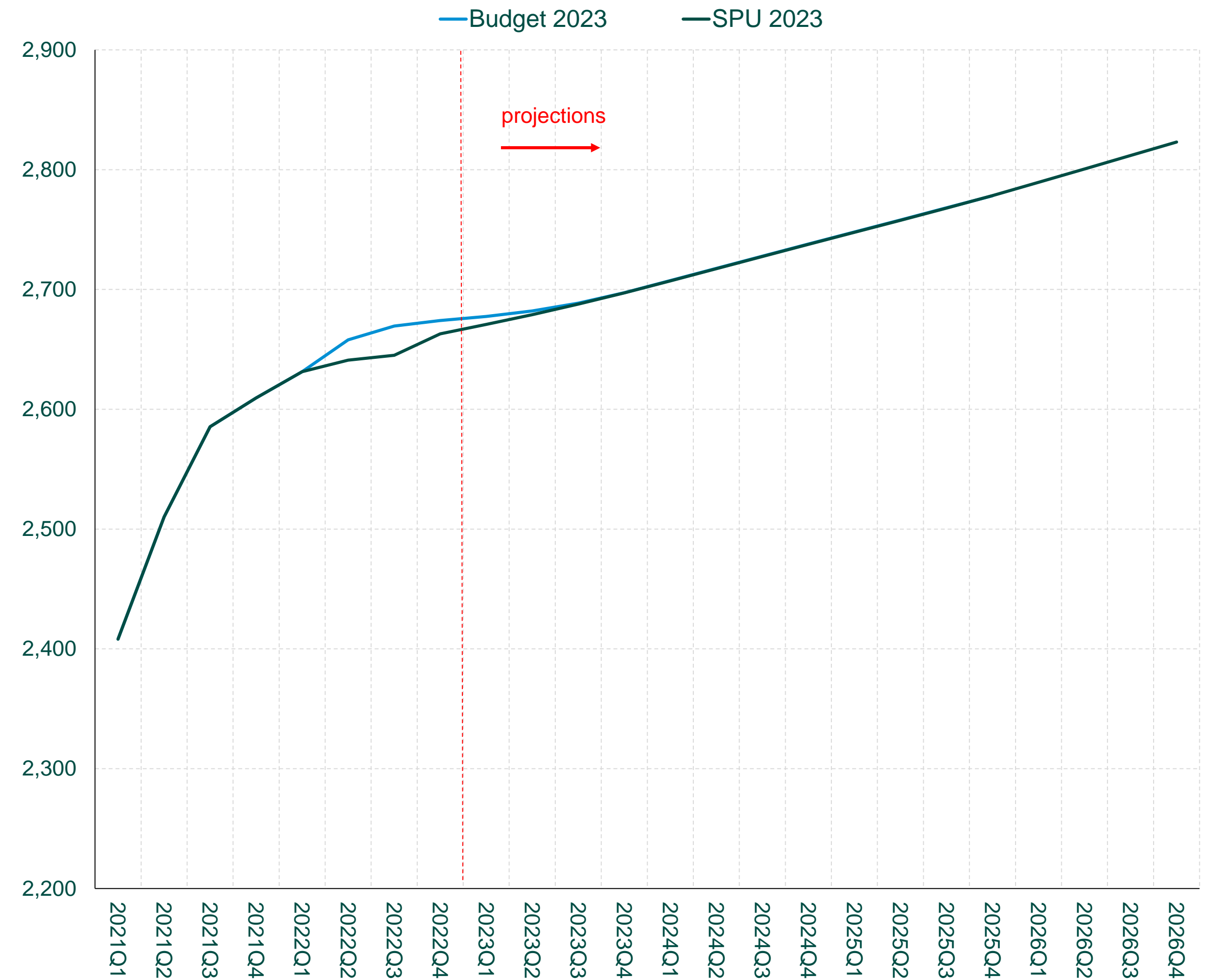
Labour force growth to slow due to lower net migration and participation rates



Net migration and participation set to slow



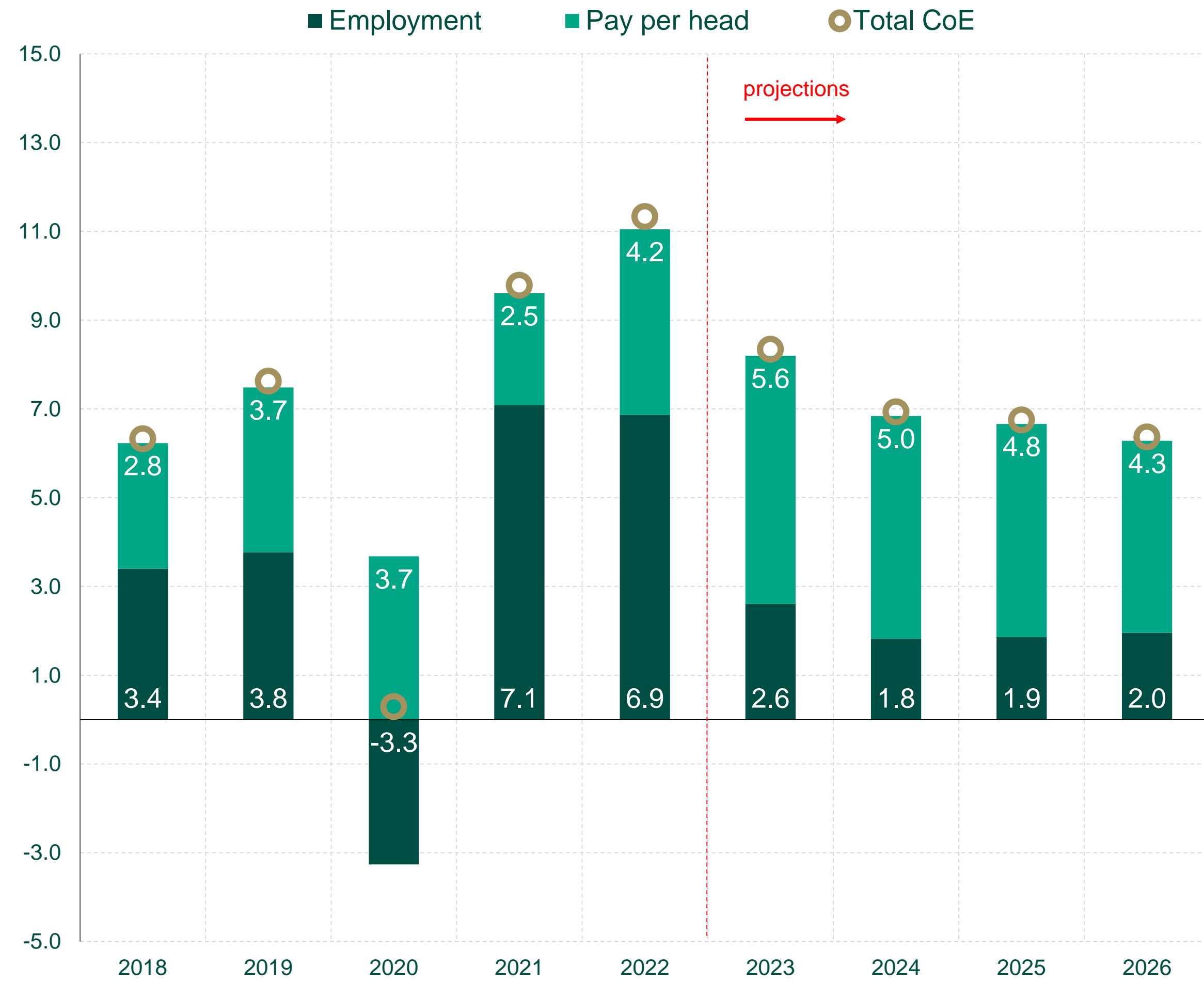
Labour force, 000s



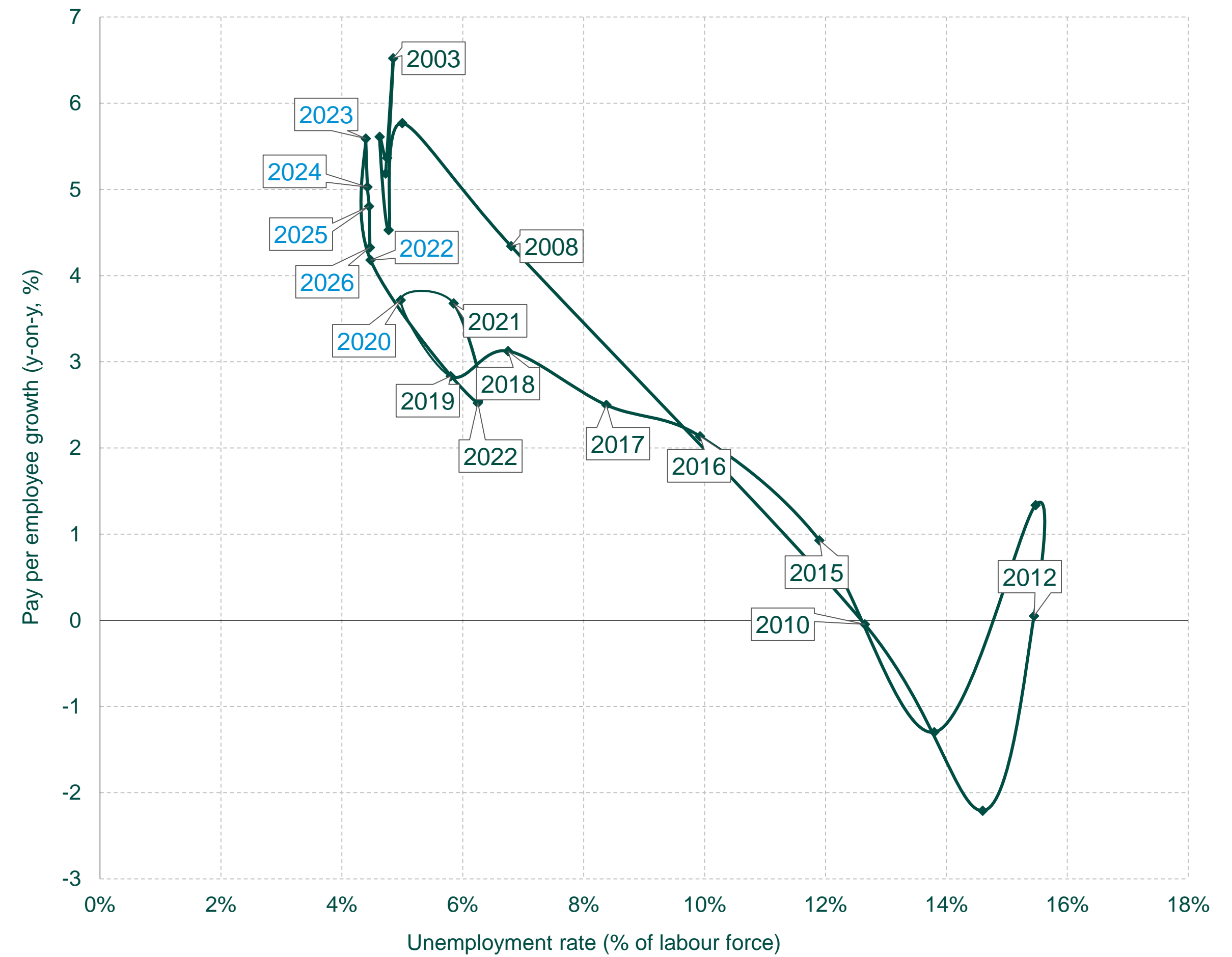
Tight labour market to drive increased pay pressures



Decomposition of total wage bill, per cent change



Phillips curve, per cent



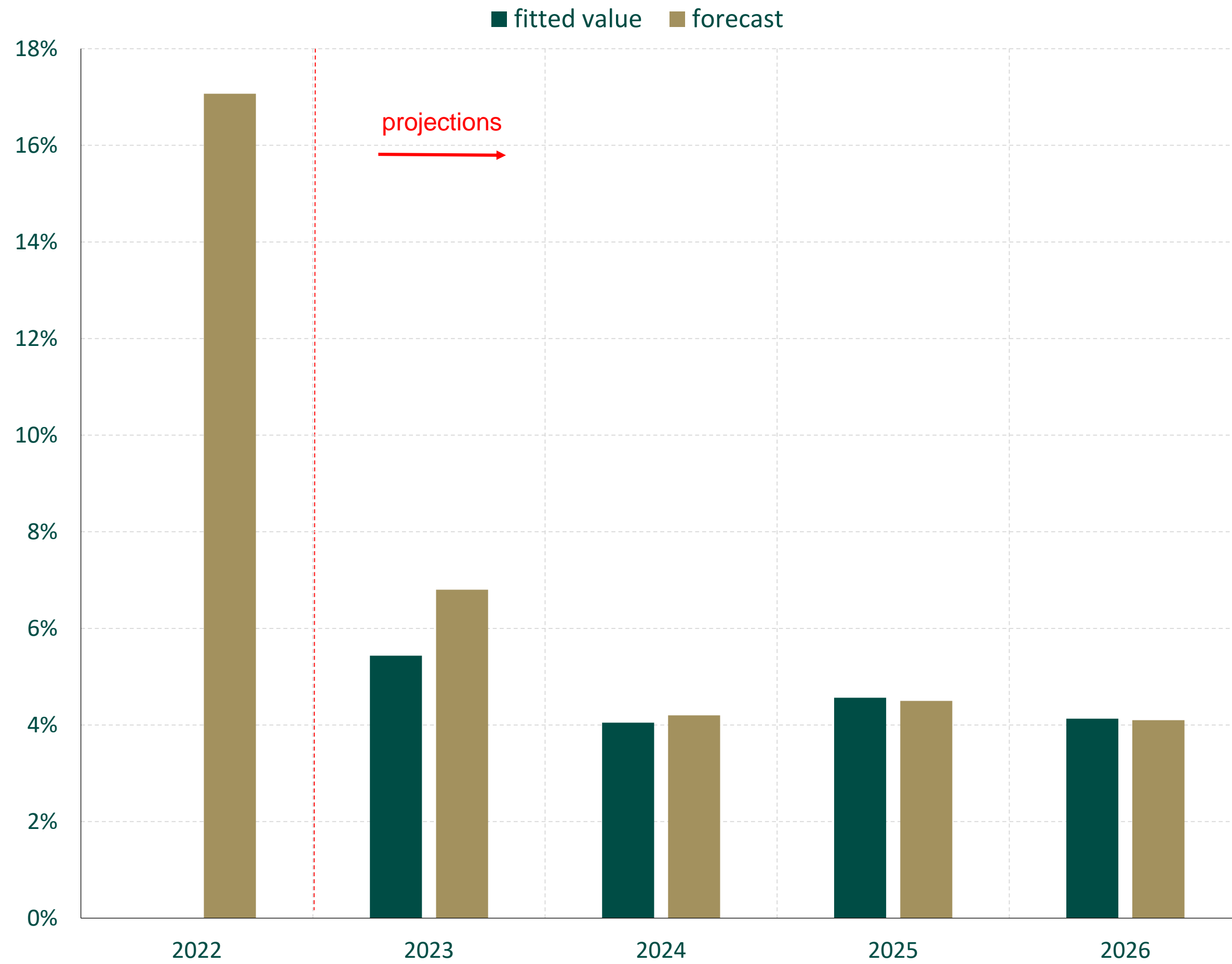


Imports and the external accounts

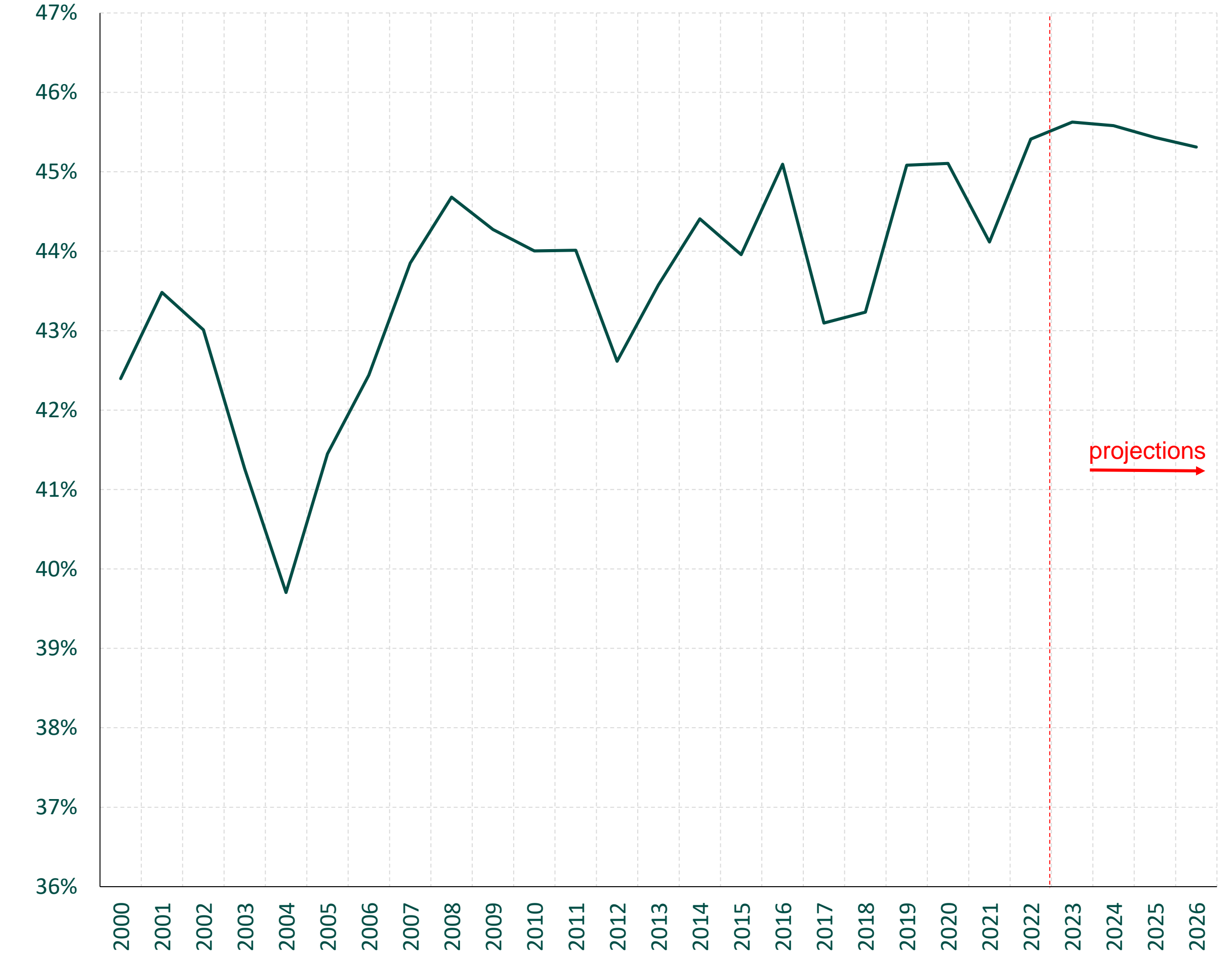
Modified import growth driven by MDD and Exports



Modified imports growth, y/y per cent change



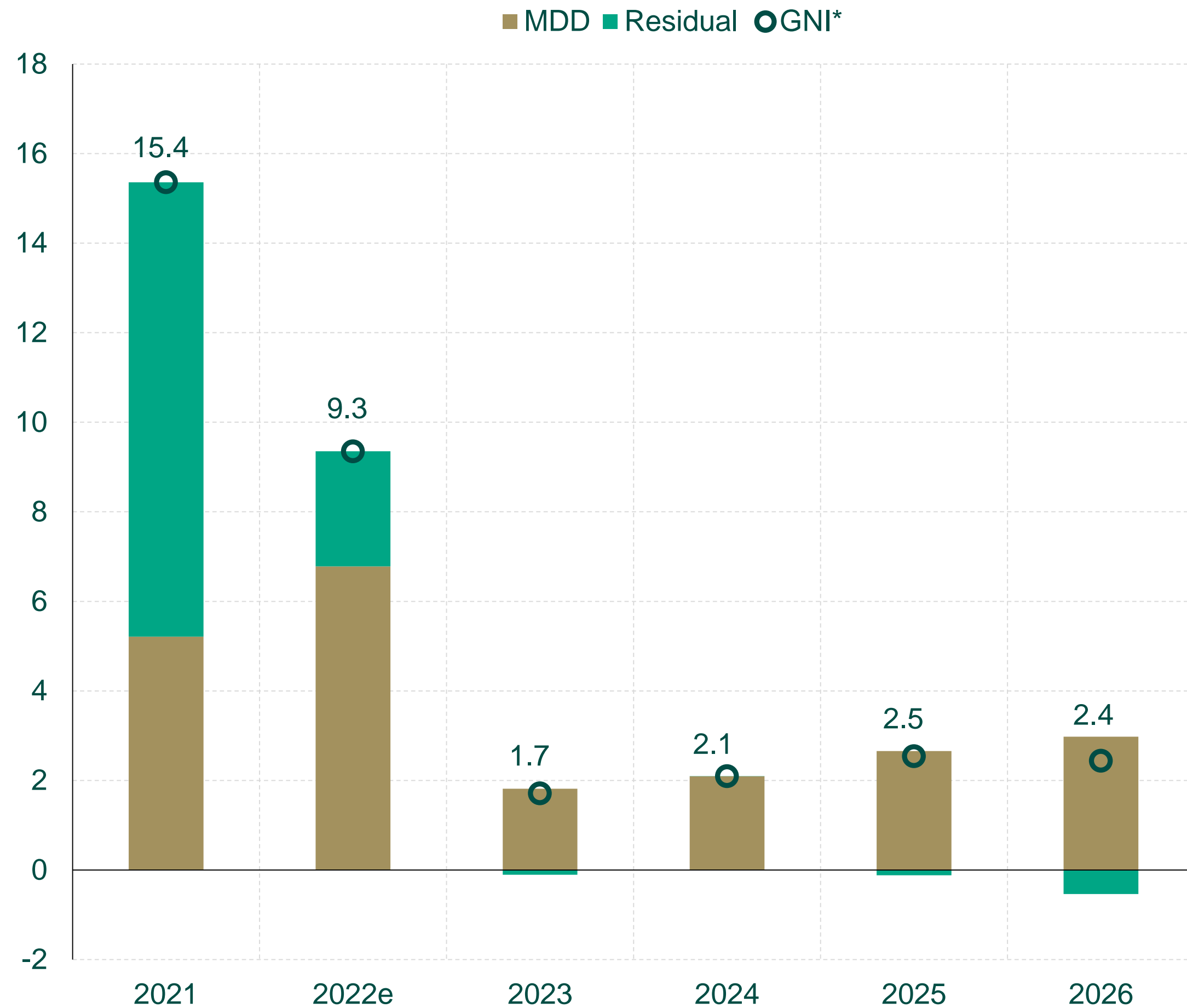
Modified import share of modified final demand, per cent



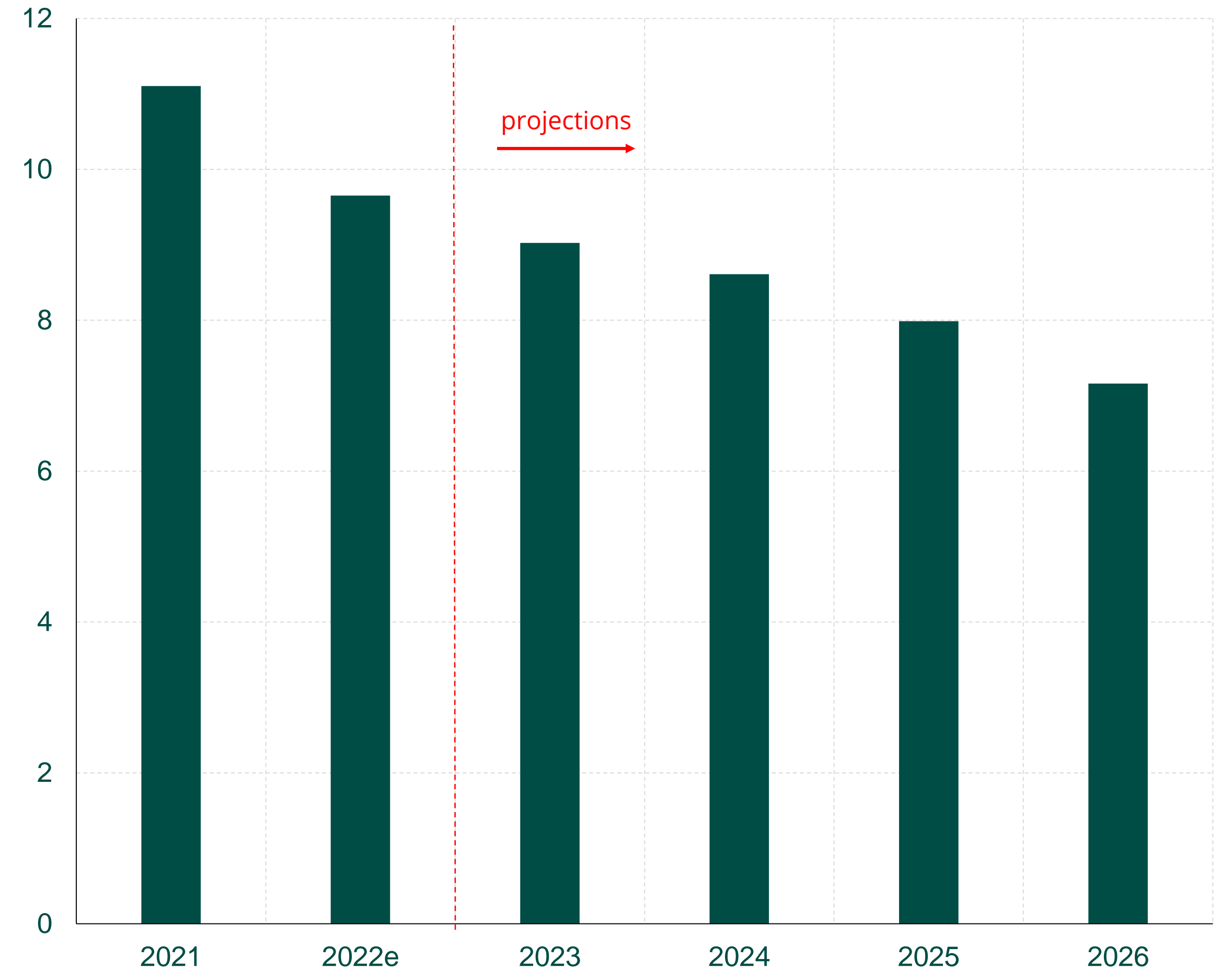
Modified GNI driven by growth in MDD



Real GNI* growth, contribution to y/y per cent change



Lower hh net financial surplus will reduce CA* surplus, per cent GNI*





Supply side

Determination of: labour input

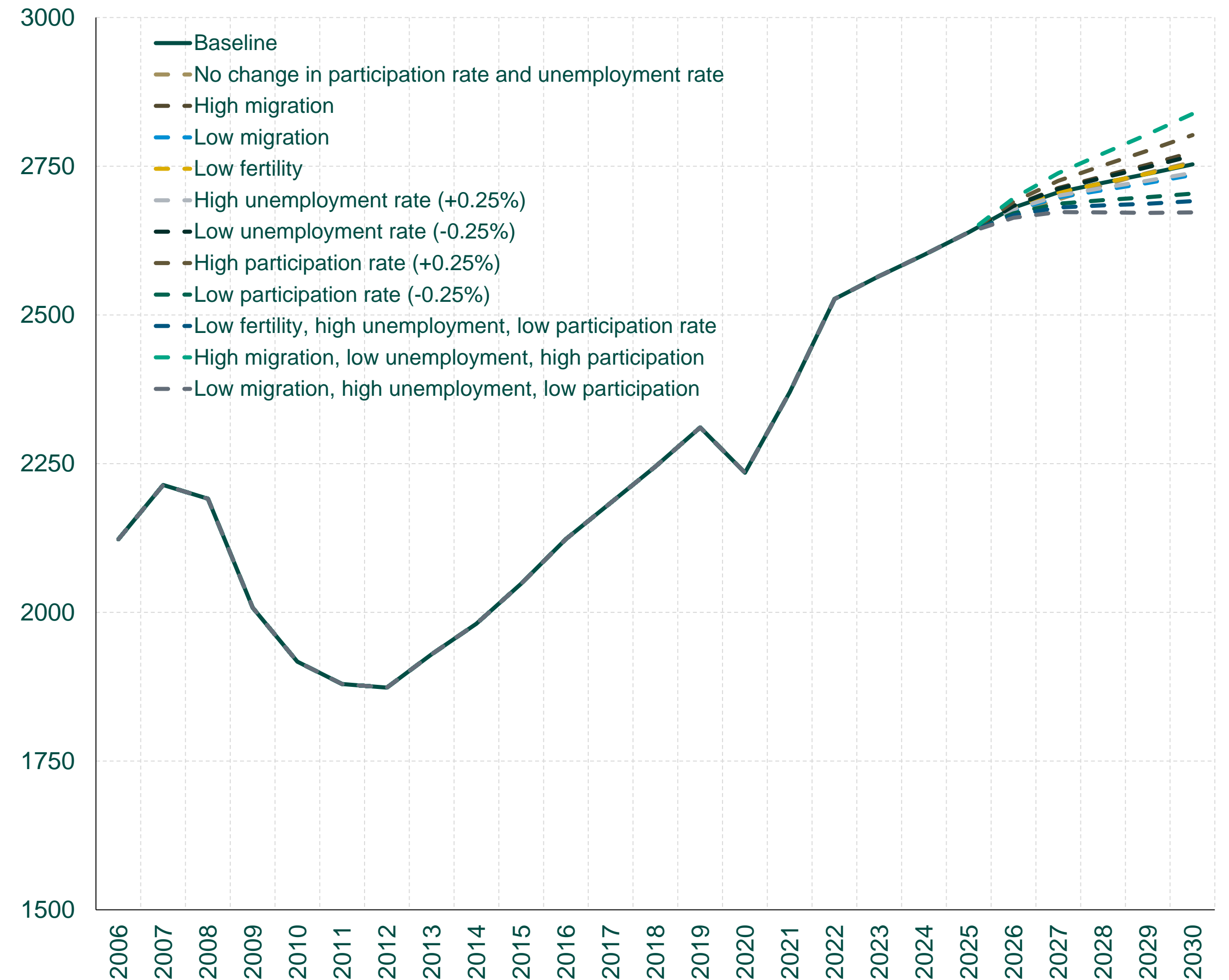


General approach: KEY ASSUMPTIONS

- Consistent with demand-side forecasts up to 2030
 - Weakening demographics drag on participation rate
 - Hours worked growing in line with employment
 - Unemployment at 'natural rate'

- Alternative scenarios applied from 2025

Level of employment, 000



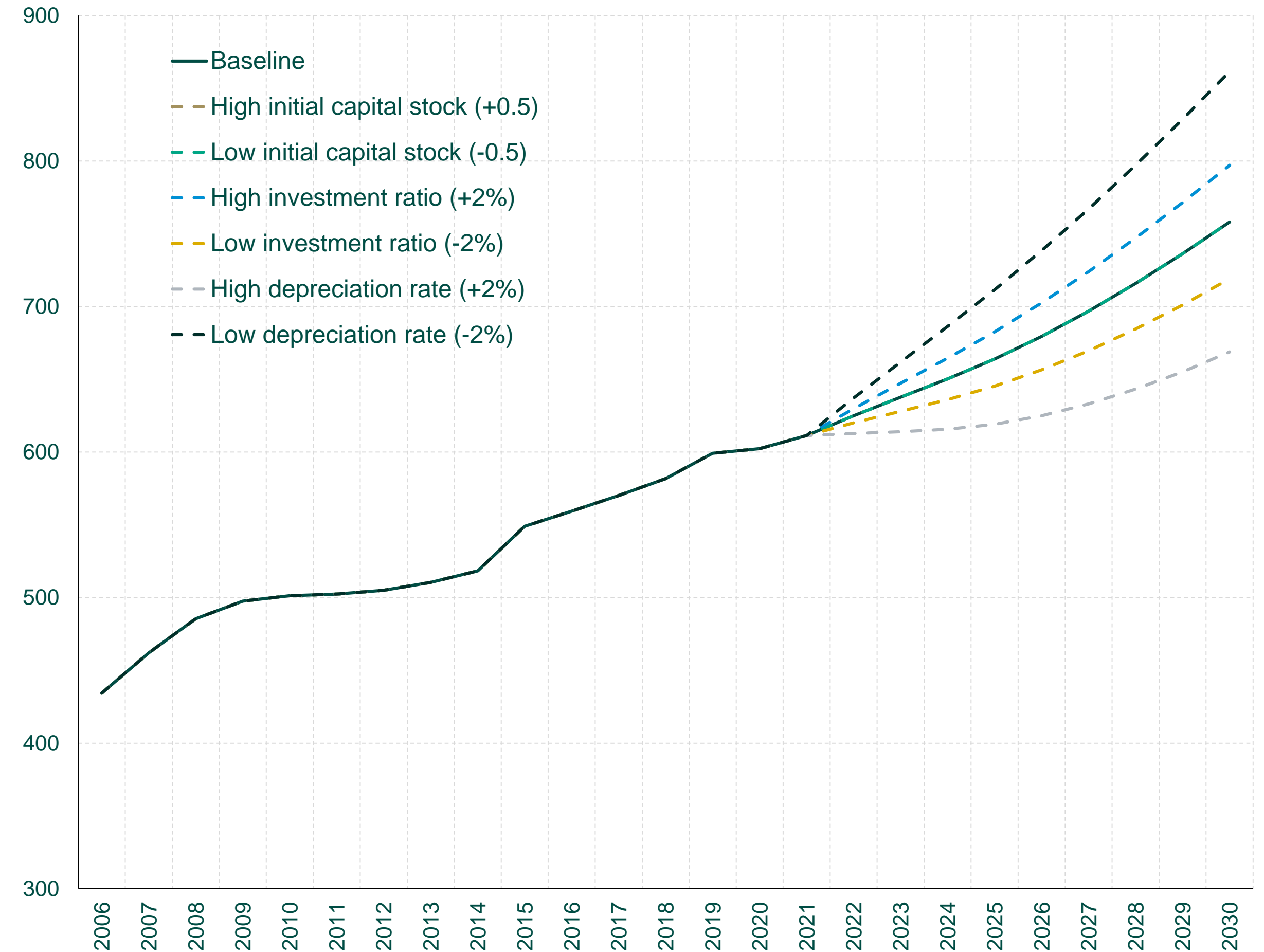
Determination of: **capital input**



General approach: KEY ASSUMPTIONS

- ‘Adjusted’ net capital stock
 - CSO net capital 2000-2021
 - Remove intangibles and transport equipment of IT, manufacturing and admin sectors
- Aligned with modified real investment from demand-side
 - Ratio = 20-22% over forecast horizon
- Assume annual depreciation = 6%
 - Fiscal Council, 2020

Level of capital stock, €bn



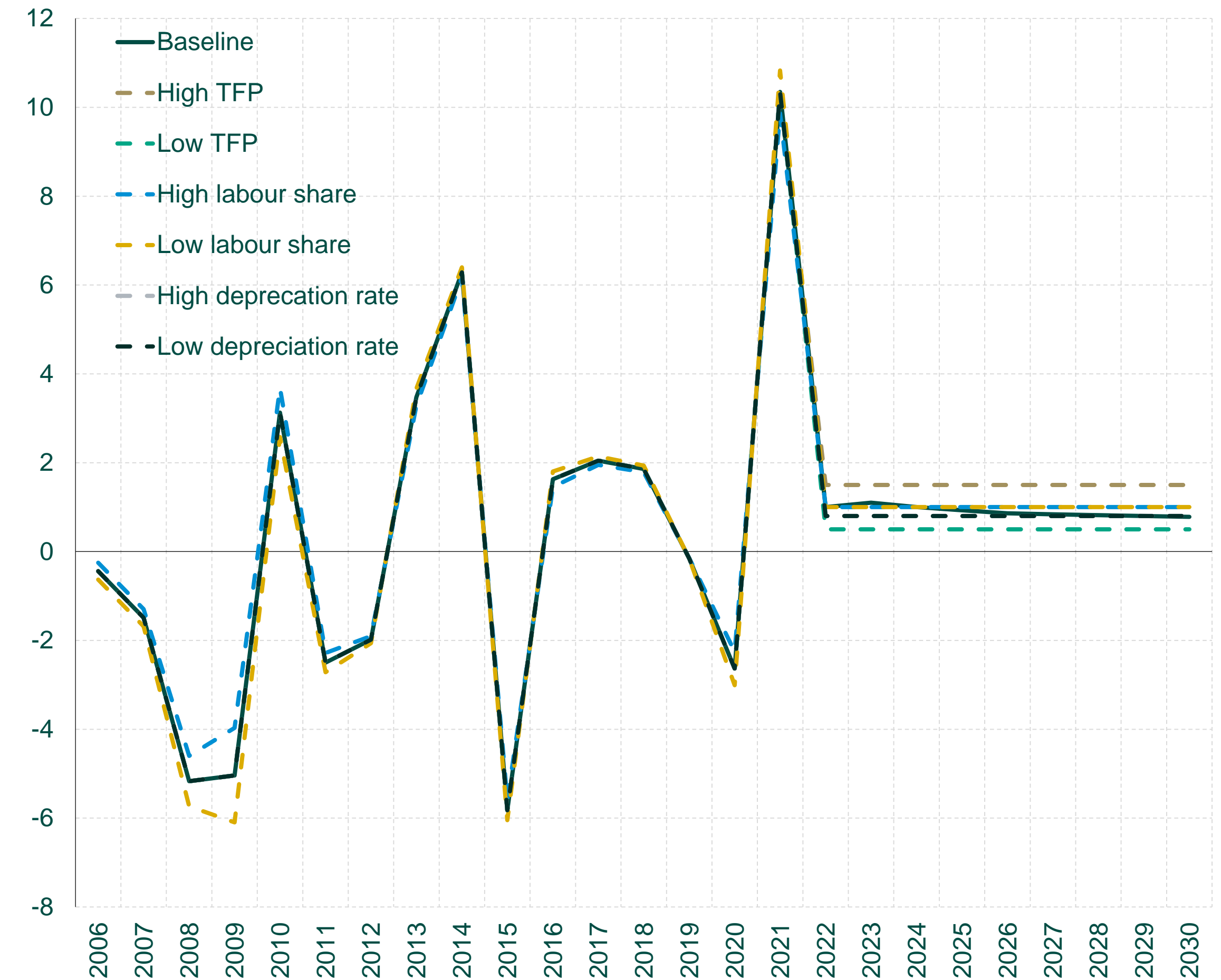
Determination of: Total Factor Productivity



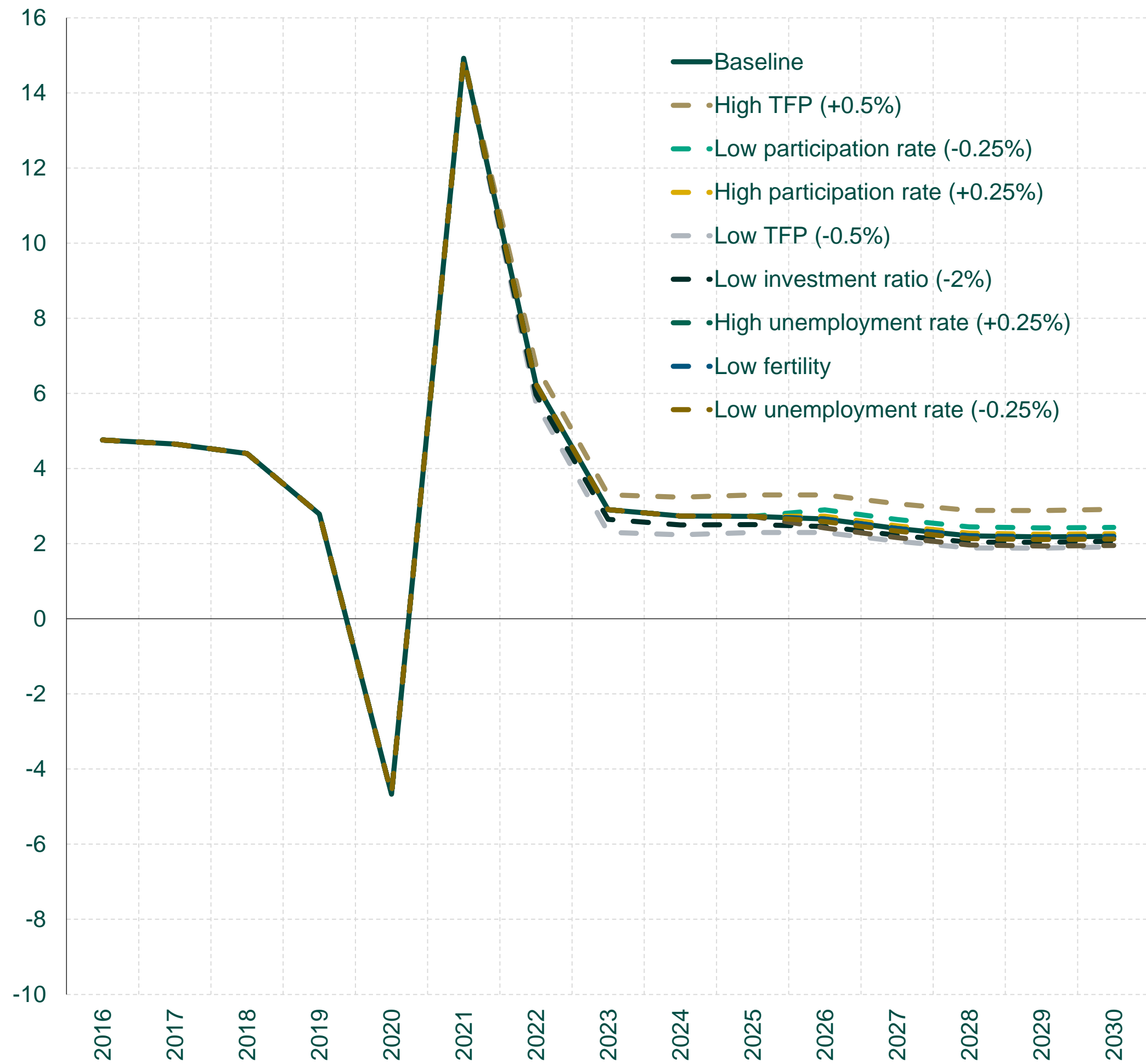
General approach: KEY ASSUMPTIONS

- Calculated as residual in historical data
- Fixed parameter for 2022
 - 1% growth 2023-25
 - 0.8% 2026-30 (Fiscal Council, 2020; AWG, 2023)
 - = *Historical average 2010-2019*
- Reallocation of sectors in short-medium run
- Impact from:
 - digitalisation (+),
 - deglobalisation (-),
 - decarbonisation (-/+),
 - demographics (-) and
 - global productivity slowdown (-)

TFP growth, %



Putting it all together = medium-term GNI* growth



Contribution to growth, baseline, pp

	2000-2019	2010-2019	2022-2025	2026-2030
Modified GNI* Growth	2.0	2.4	3.6	2.3
TFP	-0.2	0.8	1.0	0.8
Capital stock	1.2	0.6	0.7	0.9
Employment	1.0	1.0	1.8	0.6
Labour (hrs)	0.9	1.2	1.0	0.6
Labour Productivity	0.5	1.0	0.8	1.4

Range of scenarios for medium-term GNI* growth



High growth vs low growth

- Low growth scenario
 - *Weaker TFP*
 - *Weaker investment*
 - *Lower migration, lower participation, higher 'natural rate'*

- High growth scenario
 - *Stronger TFP*
 - *Higher investment*
 - *Higher migration, higher participation, lower 'natural rate'*

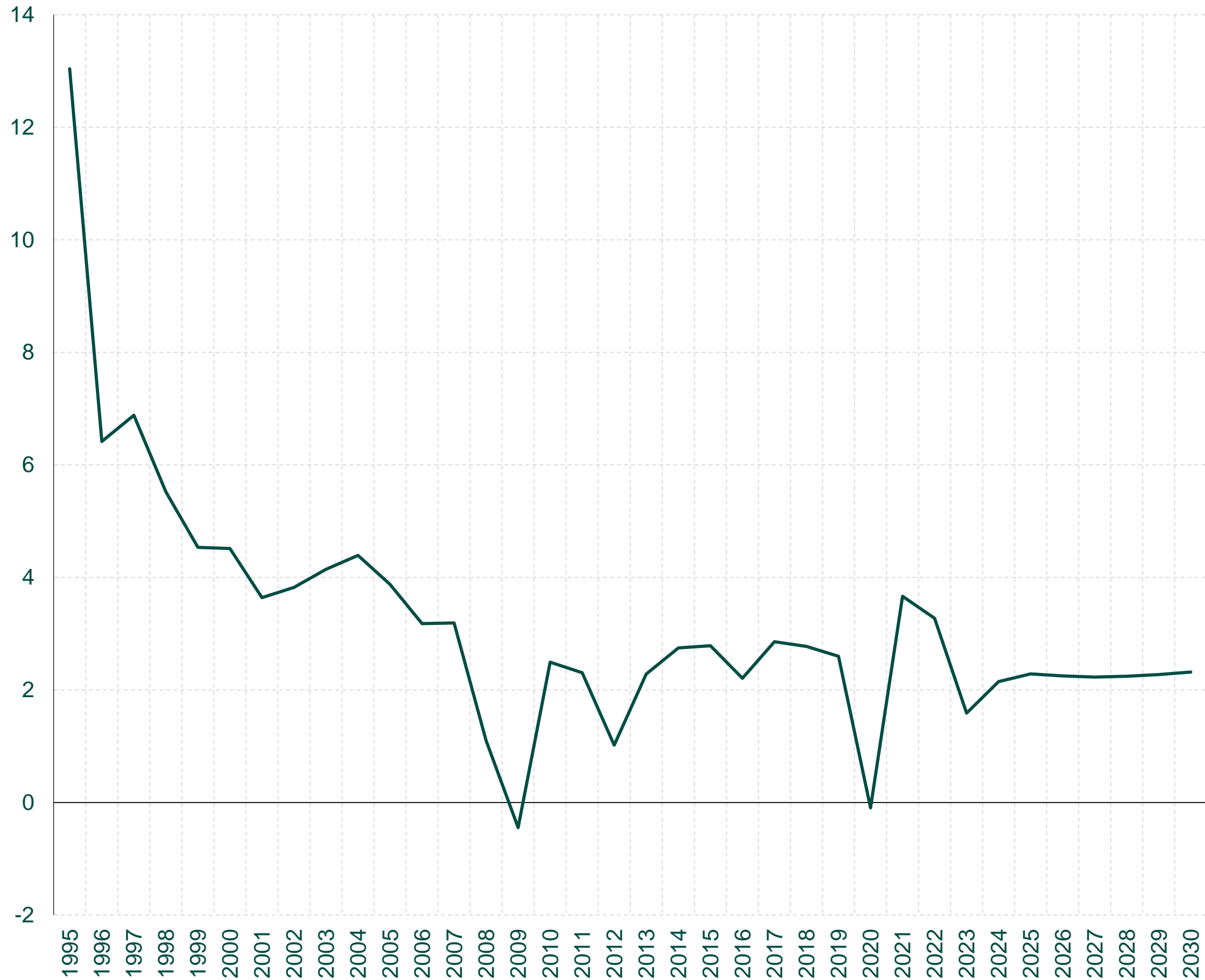
Contribution to growth 2026-2030, baseline, pp

	Baseline	Low growth	High growth
GNI*	2.3	1.3	3.3
TFP	0.8	0.3	1.3
Capital stock	0.9	0.7	1.0
Employment	0.6	0.3	1.0

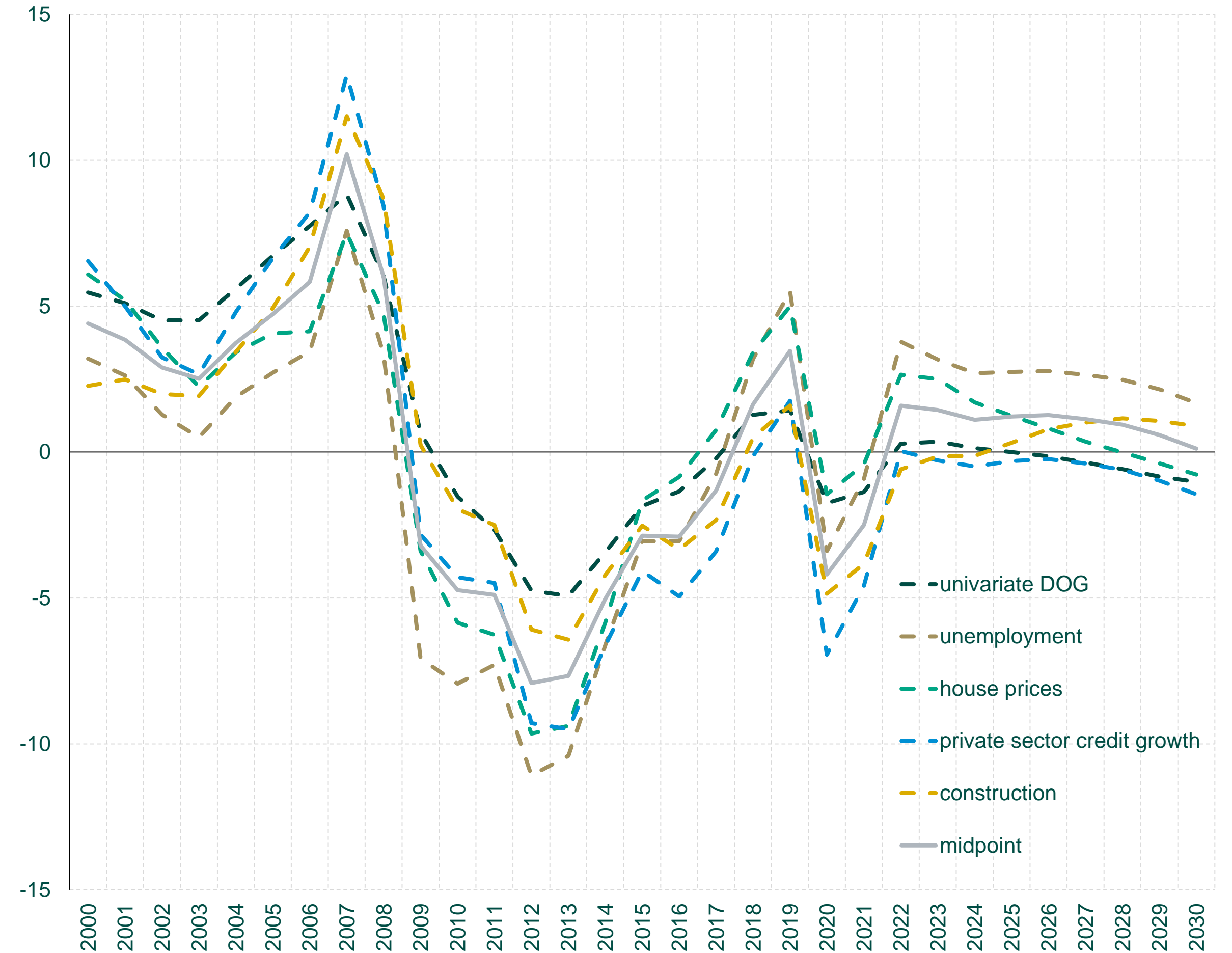
Alternative output gap: Kalman filtering domestic GVA



Domestic potential output growth, per cent



Domestic output gap, per cent



Risks



- Some tail-risks have dissipated
- New tail-risks now on horizon
- Scenario analysis in SPU
- Distribution of risk around central scenario = tilted to the downside

Upside	Downside
Quicker than anticipated easing of inflation	Financial sector - credit disruption/feedback loops
Unwinding of 'excess' savings	Stickier inflation – sharper monetary policy response
Net inward migration	Escalation of war/Geo-economic fragmentation

Summary



- Broadly positive in short-term
 - particularly w.r.t. the labour market
- Sectoral issues = downside risks
 - ICT / global banking sector
- Transition to lower growth in medium-term
 - ageing, population



Disclaimer and other information:

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Outturn data are sourced from a variety of sources including the Department of Finance, Central Statistics Office, European Commission (AMECO) and Central Bank of Ireland.

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