



Ríaltas na hÉireann
Government of Ireland

Economic recovery in Ireland – real or illusion?

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Presentation to Cologne Institute for Economic Research
25th January 2019



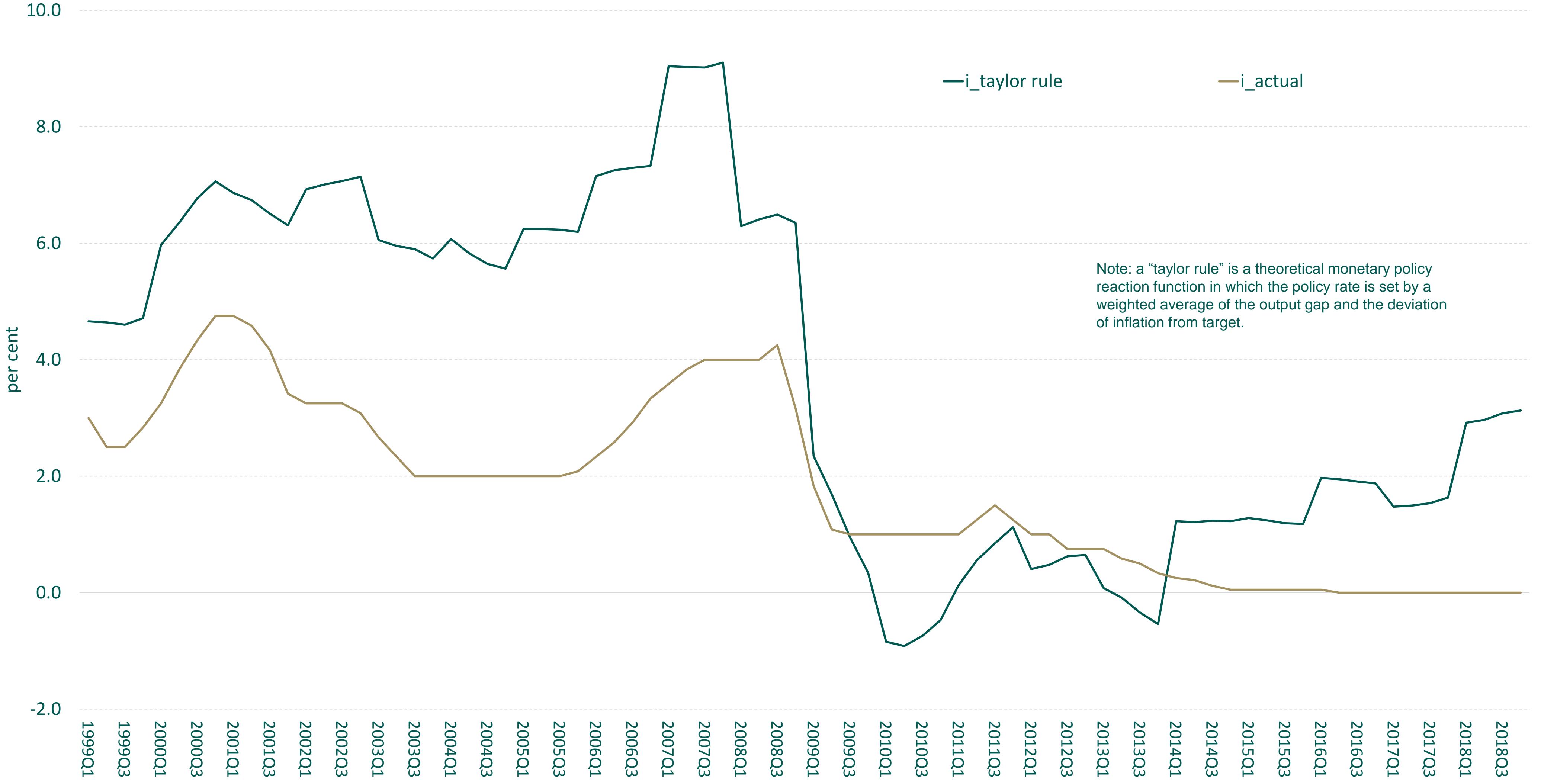
Birds eye view

- Accumulation of macroeconomic imbalances
 - failure to internalise implications of stage three of EMU
- Bank-sovereign “doom-loop”
- Breaking the “doom-loop”: three-pronged approach
 - addressing fiscal imbalances
 - restoring financial sector stability
 - microeconomic reforms
- Economic recovery
- Real or illusion: national accounting considerations
- Statistical response
- Conclusions

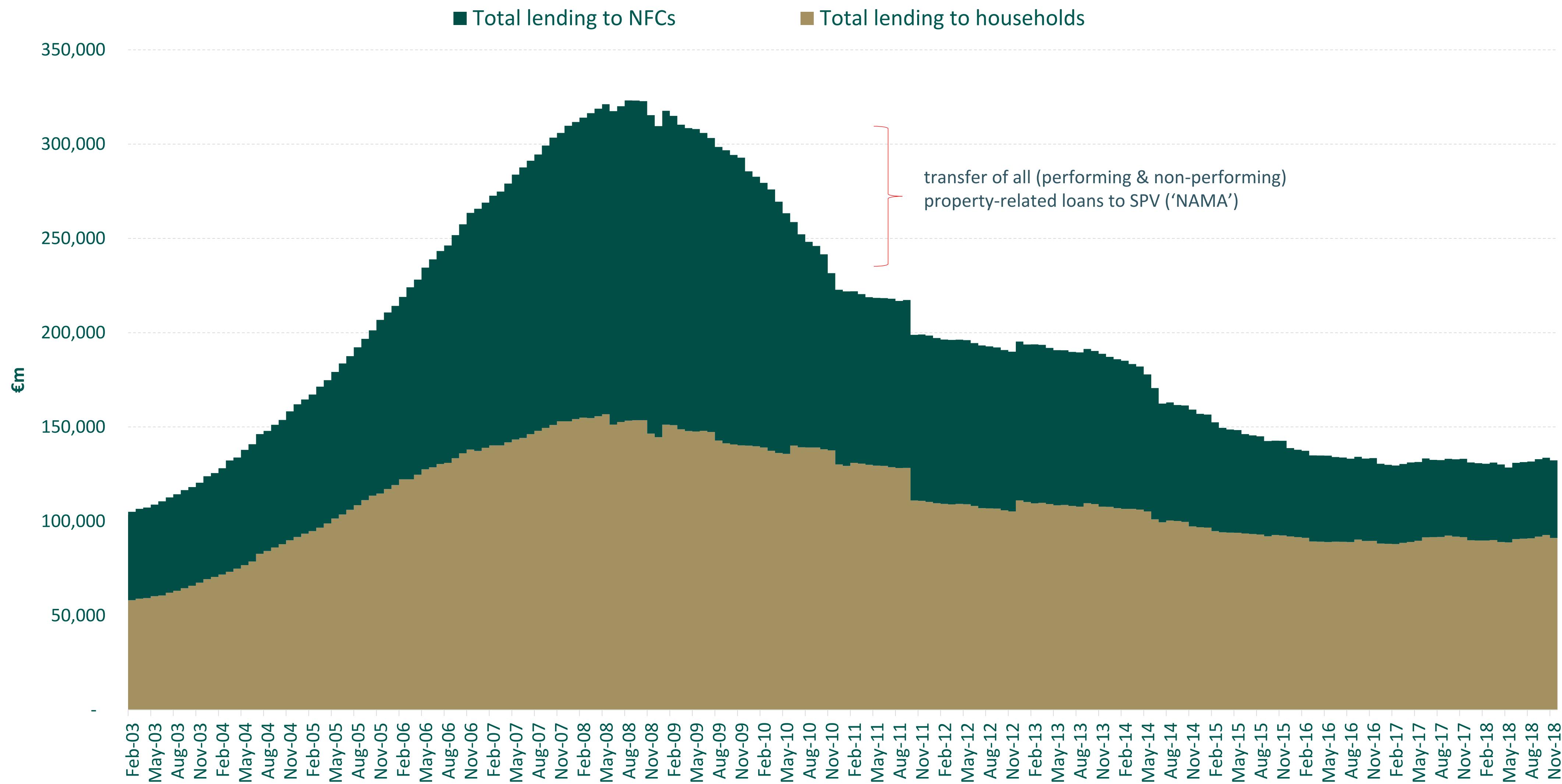


Accumulation of macroeconomic imbalances

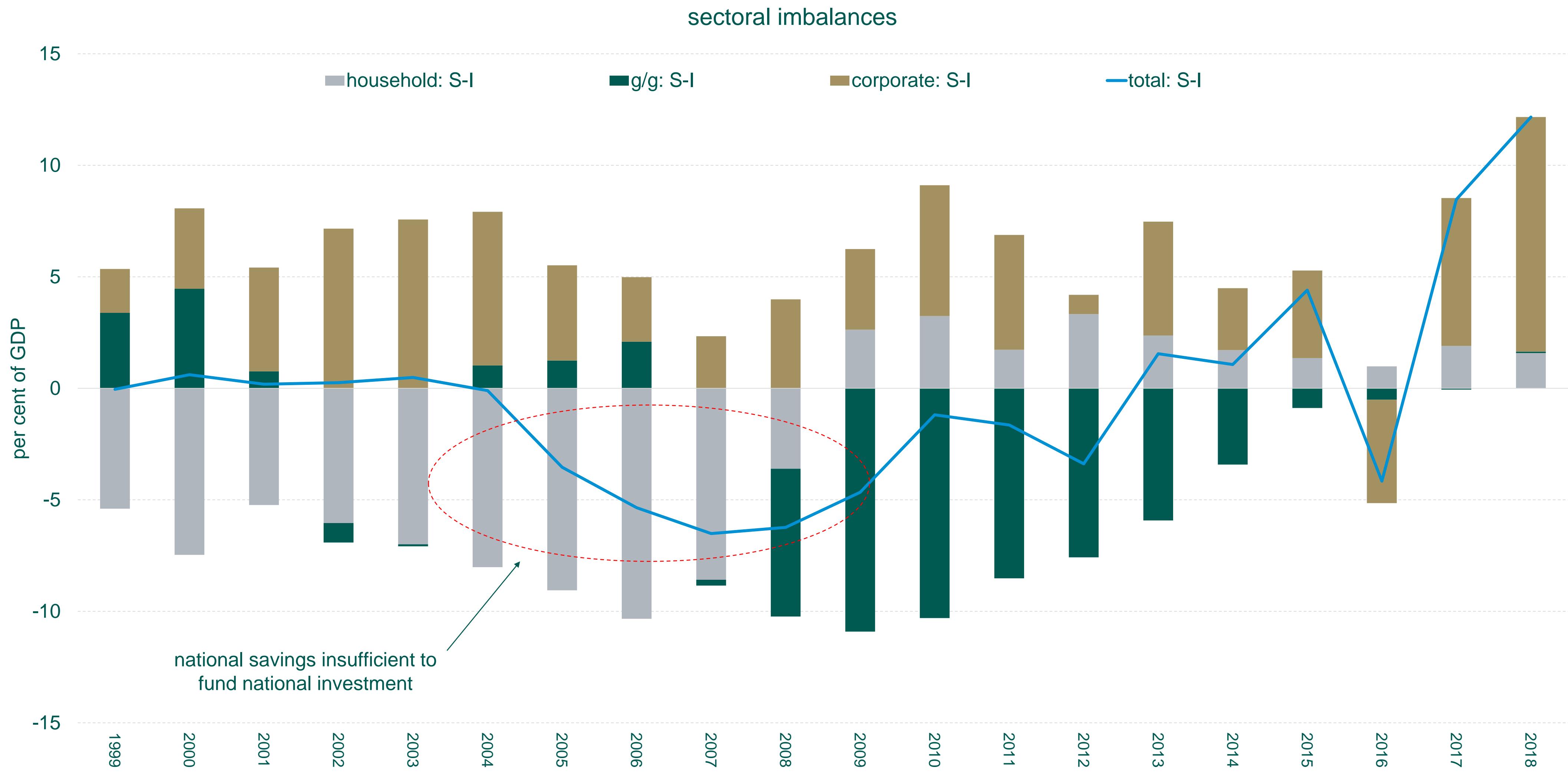
Monetary policy – Irish business cycle out-of-sync with euro area



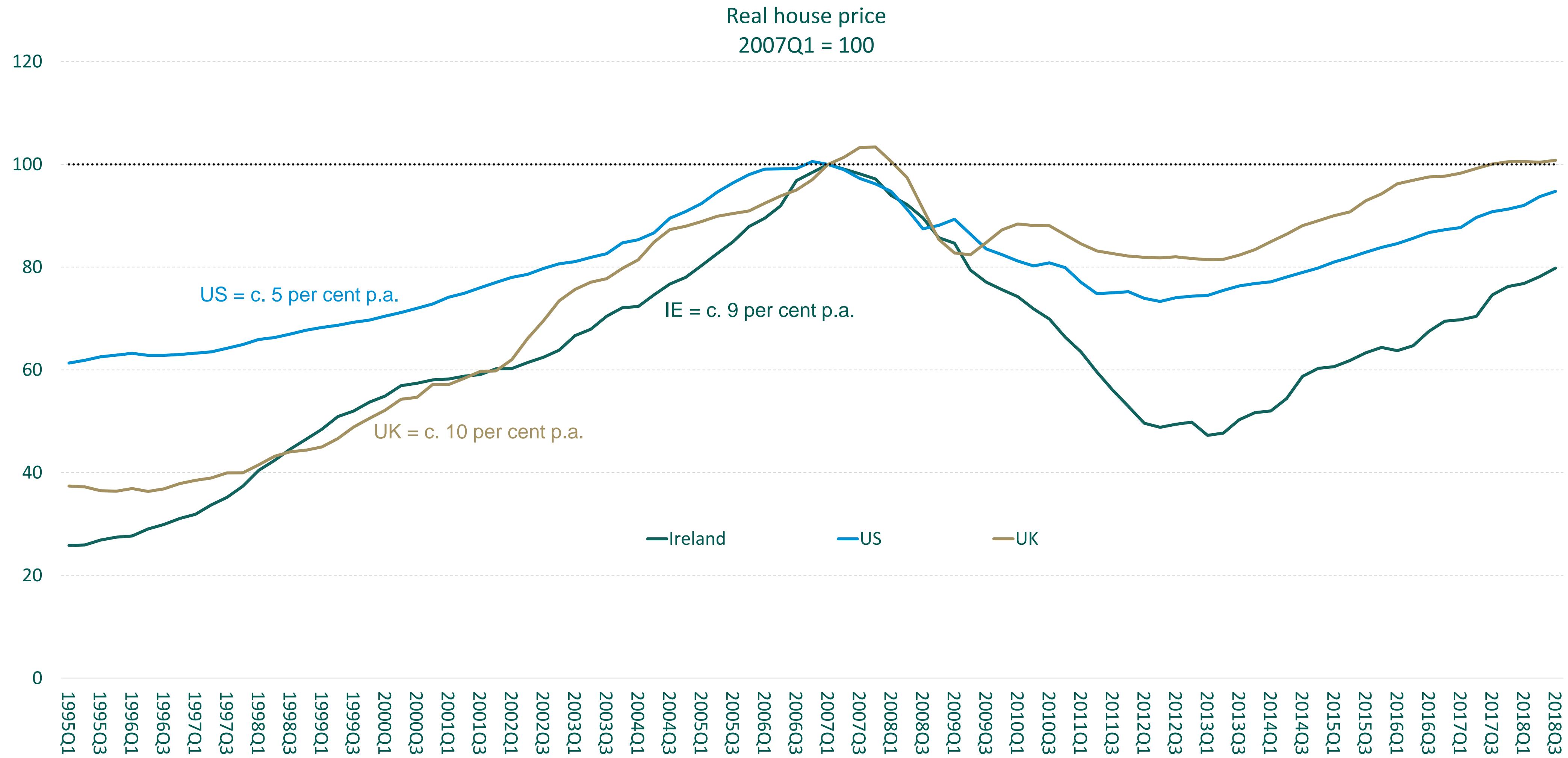
Accumulation of private indebtedness – mainly property-related



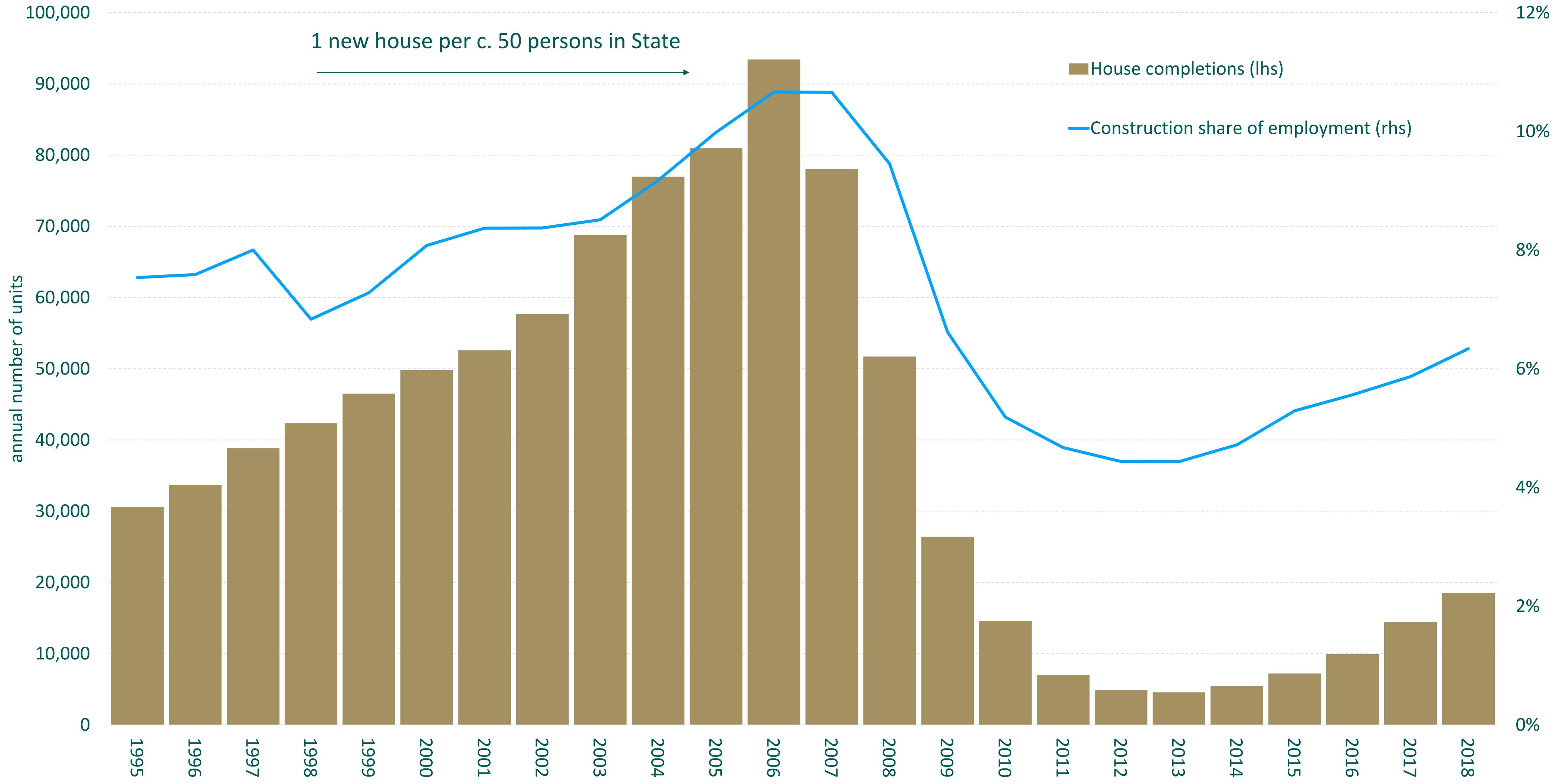
Drawing on foreign savings pool



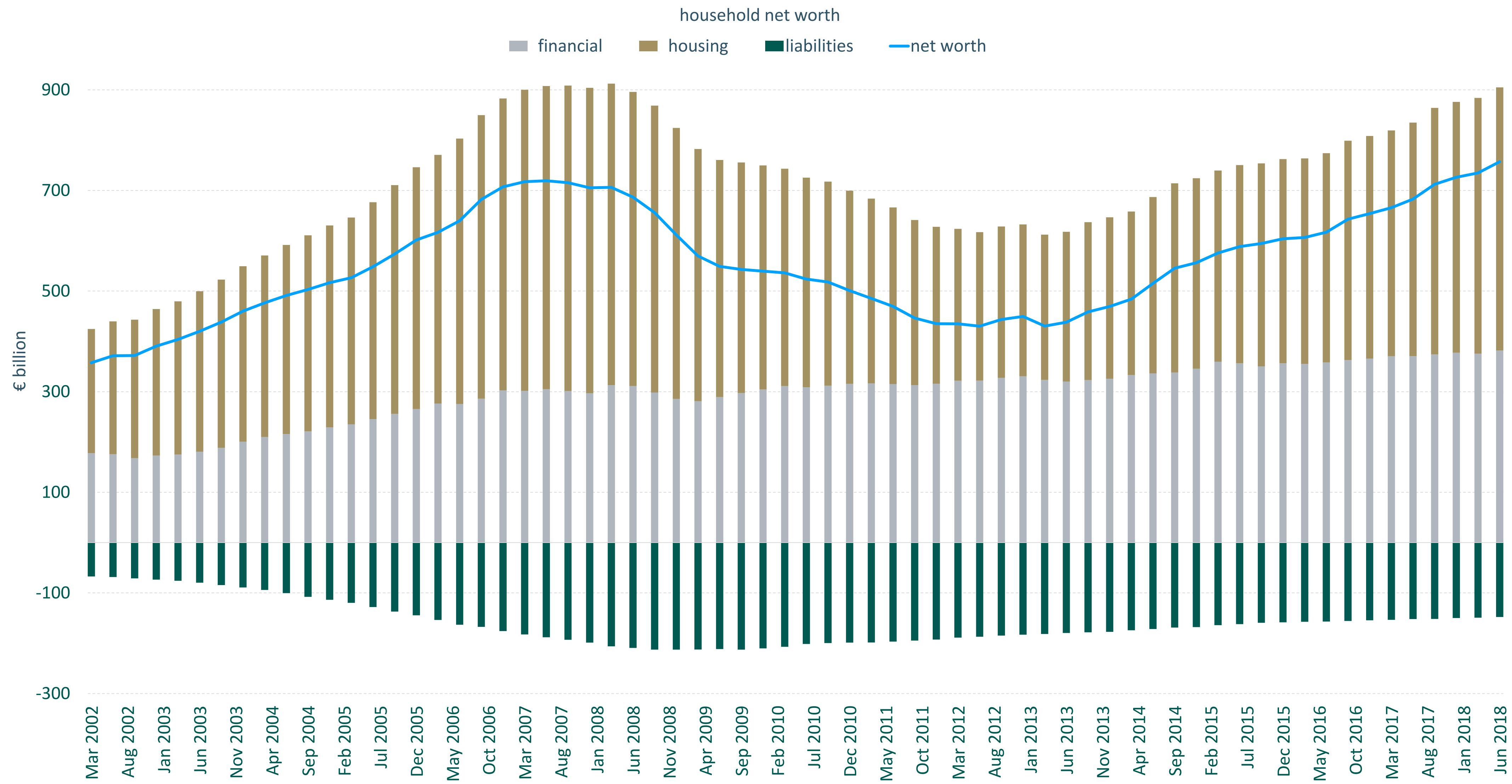
Dis-equilibrium in the housing market...



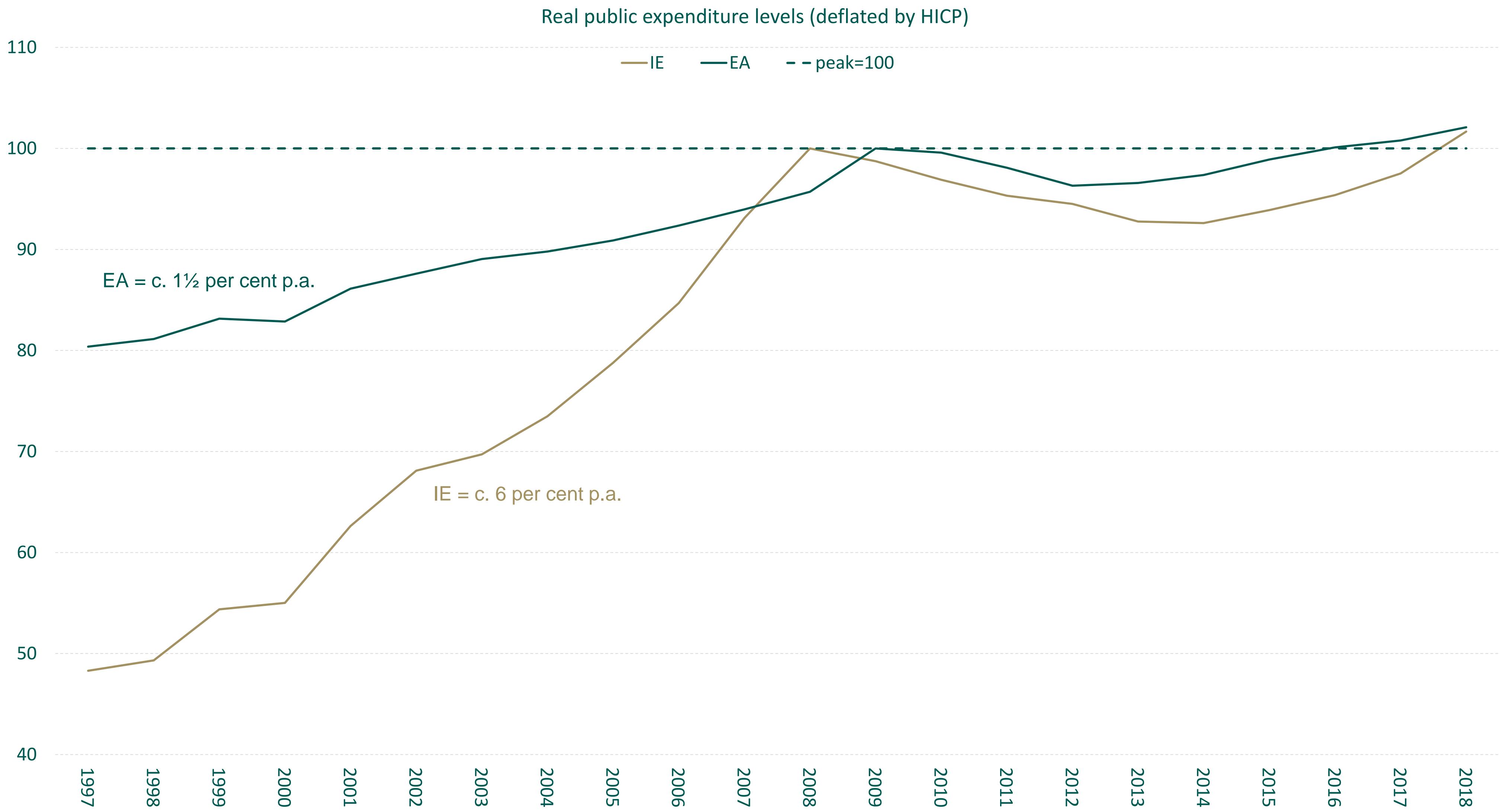
...with price signals leading to resource (K,L) mis-allocation



Household balance sheets: housing assets and financial liabilities



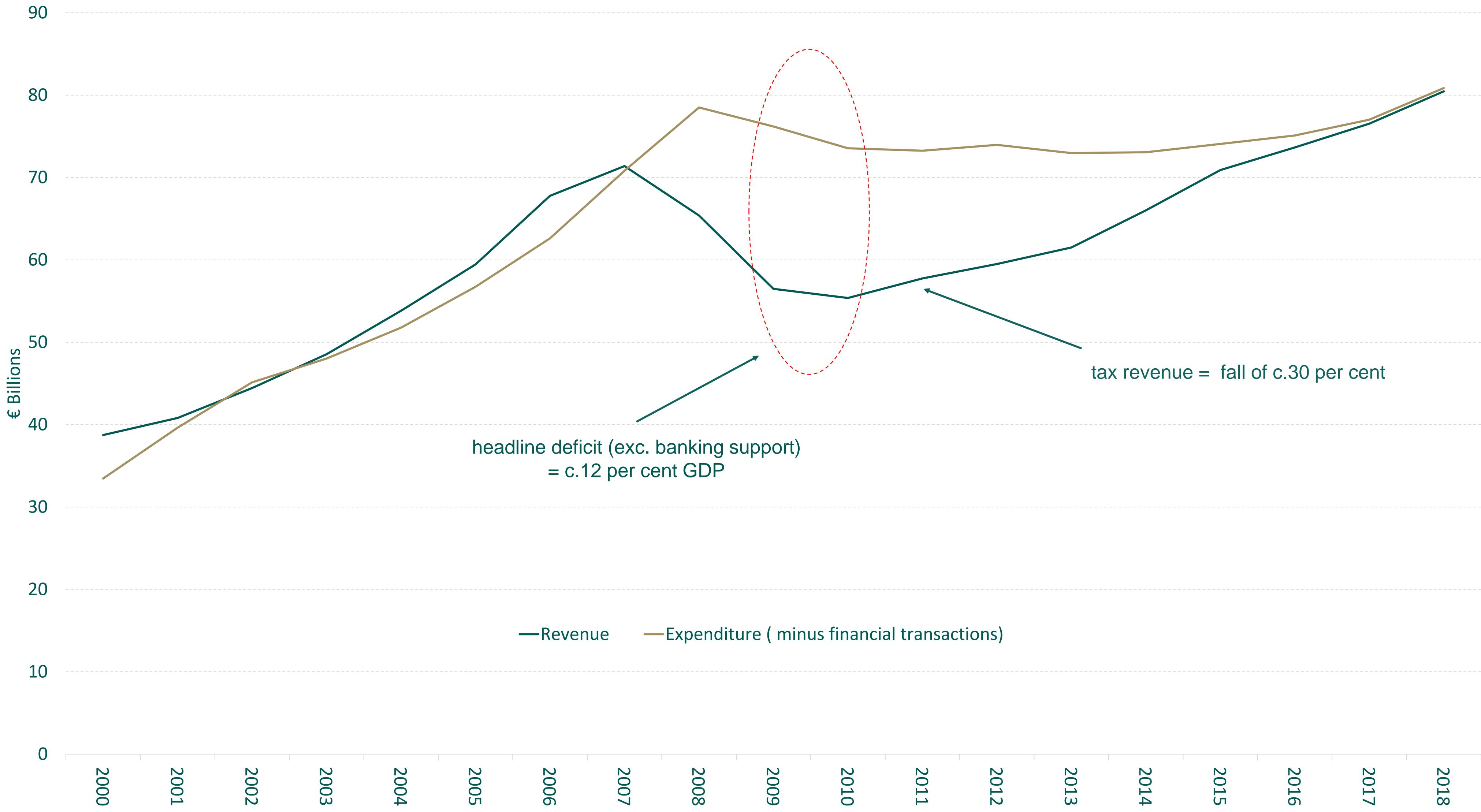
Pro-cyclical budgetary policy: financed by transient revenue streams



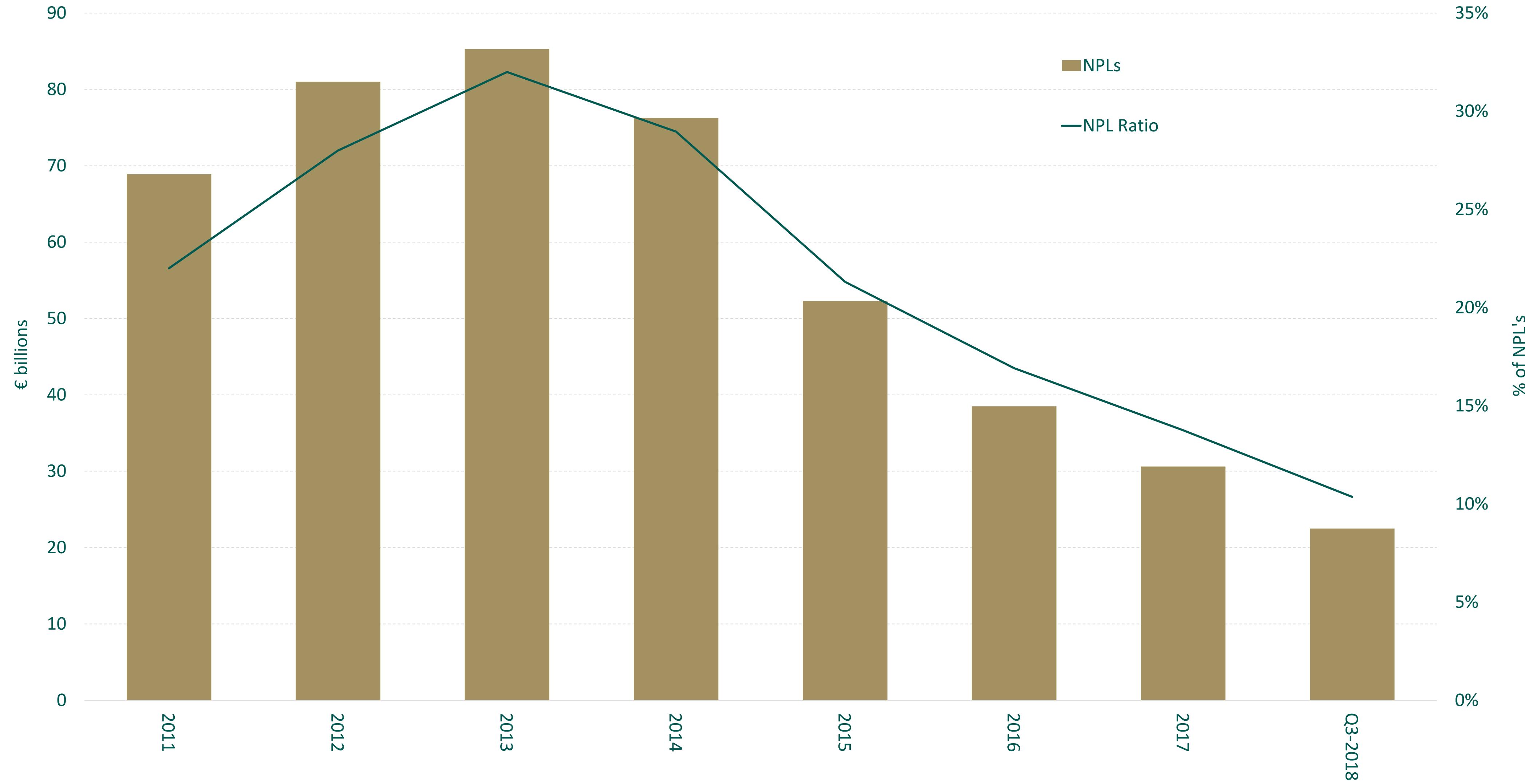


Bank-sovereign “doom-loop”

Bursting property bubble exposed narrow tax base



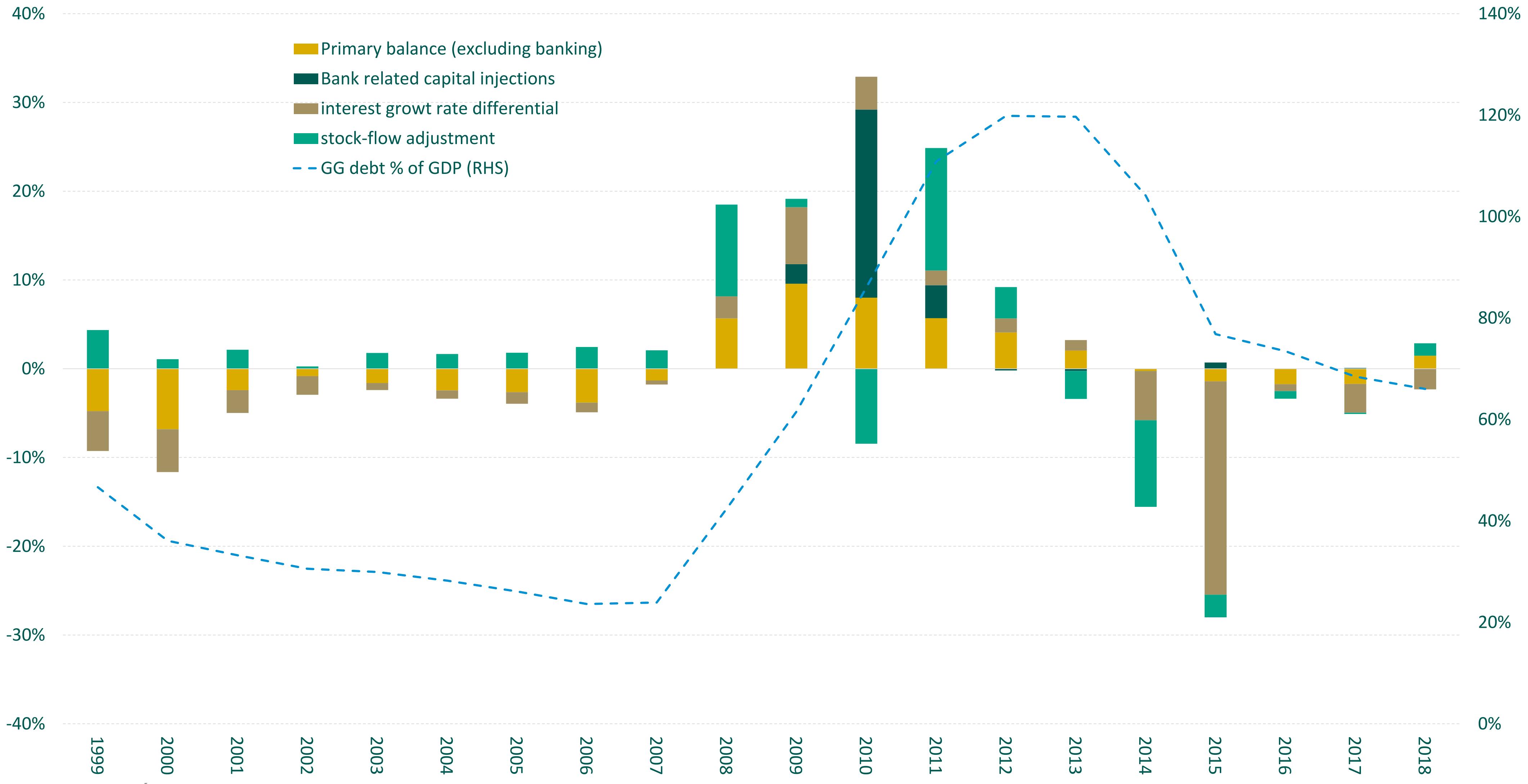
Depletion of bank capital due to surge in NPLs (peak = 2013)



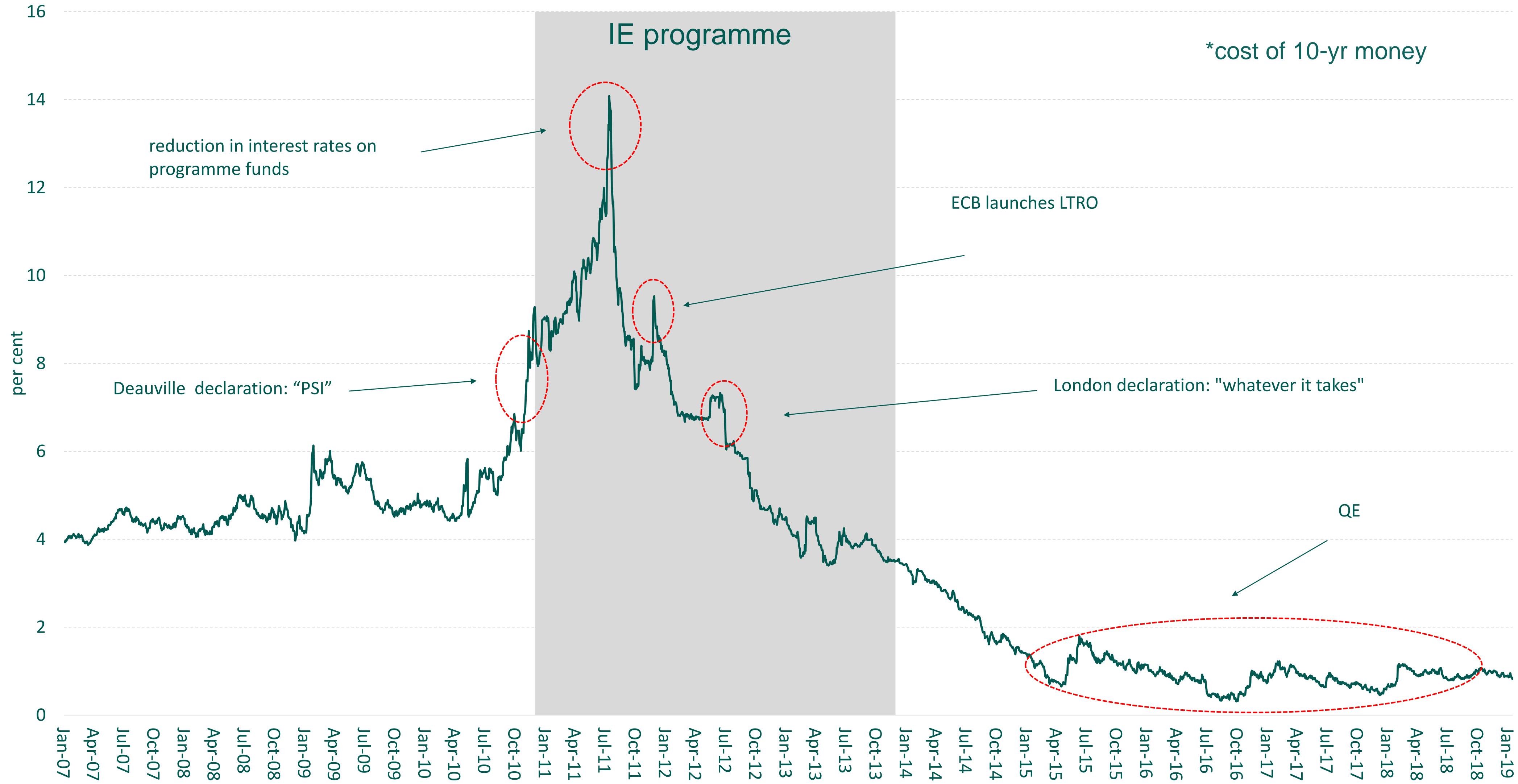
Public indebtedness increased by 100 pp in 2007-2012



Contributions to debt accumulation (pp of GDP)



Increase in Irish sovereign risk premium: loss of market access*





Breaking the “doom-loop”: three-pronged approach

Reform #1: addressing fiscal imbalances



- ***Ex ante consolidation of c. 18 per cent of GDP (2008-2014)***
 - frontloaded
 - unavoidably pro-cyclical
- **Objective = restore credibility:**

(1) Quality of consolidation generally good (minimise the ‘multiplier’)

- bias towards expenditure reductions (“best practice”)
- no ‘sacred cow’ on expenditure side
- revenue increases geared towards base-broadening (supply-side)

(2) Time consistency of adjustment

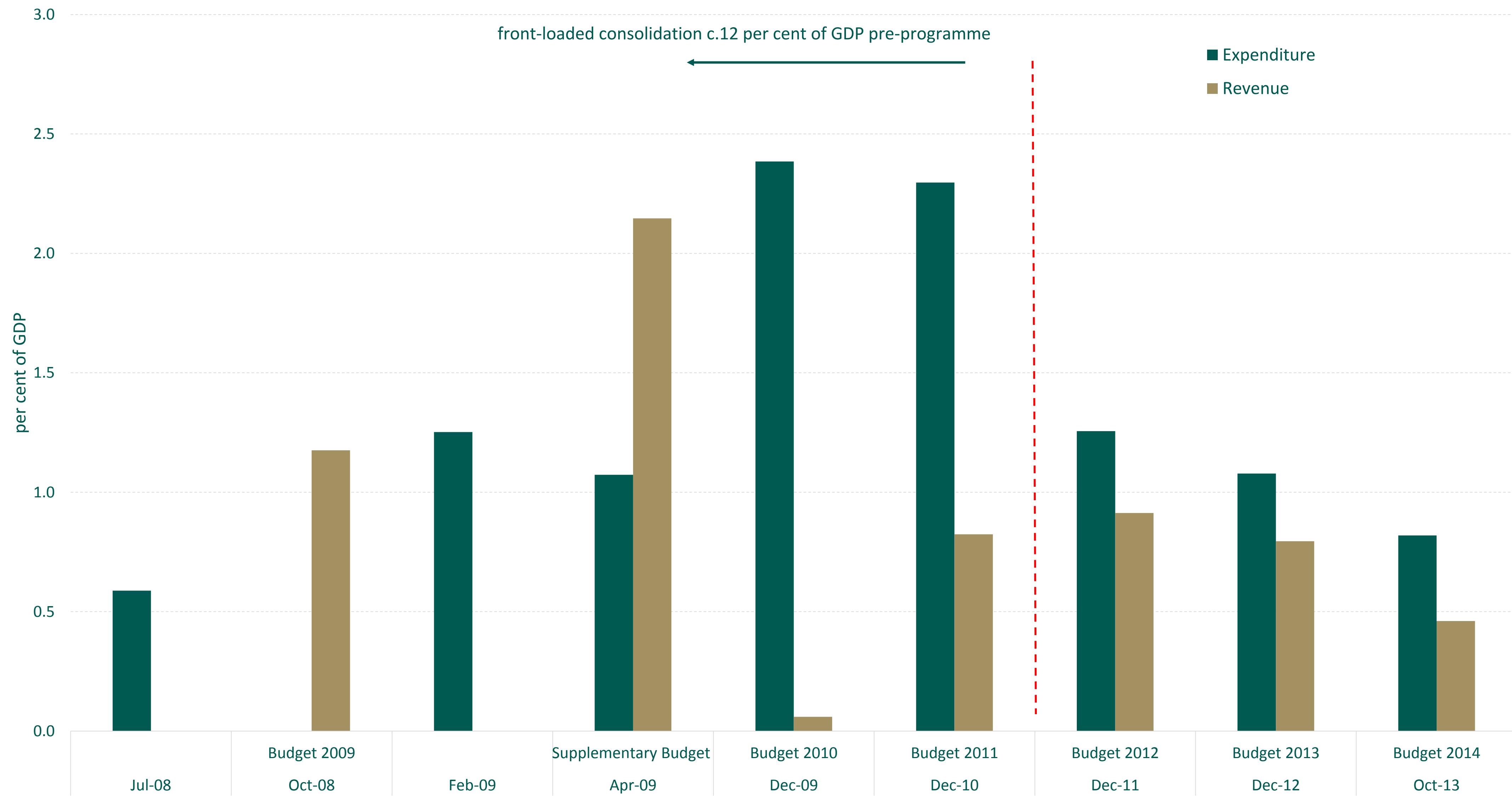
- “under-promise and over-deliver”

(3) Communication of medium-term anchor for multi-annual consolidation

- Treaty reference value = visible nominal anchor
- end-point and interim staging posts

(4) Strengthened fiscal architecture

Fiscal reaction function



Reform #2: addressing financial sector imbalances



- Back-stopping the banking sector = to address solvency concerns
 - PCAR (stress test) March 2011
 - : credibility
 - recapitalisation (€24 bn) of “going-concern” banks
 - : enhanced loss absorption capacity
- ‘Right-sizing’ the banking sector = to address liquidity concerns
 - reduce LDR closer to unity (from 1.8 in 2010)
 - unwind non-core assets (while avoiding fire-sales)
- Restructuring the sector
 - centred around two ‘pillar’ banks (and smaller consumer bank)
 - resolution of “gone-concern” banks
 - address institutional weaknesses
 - : enhanced regulation
 - : bank resolution framework (pre-BRRD)

Reform #3: microeconomic reforms

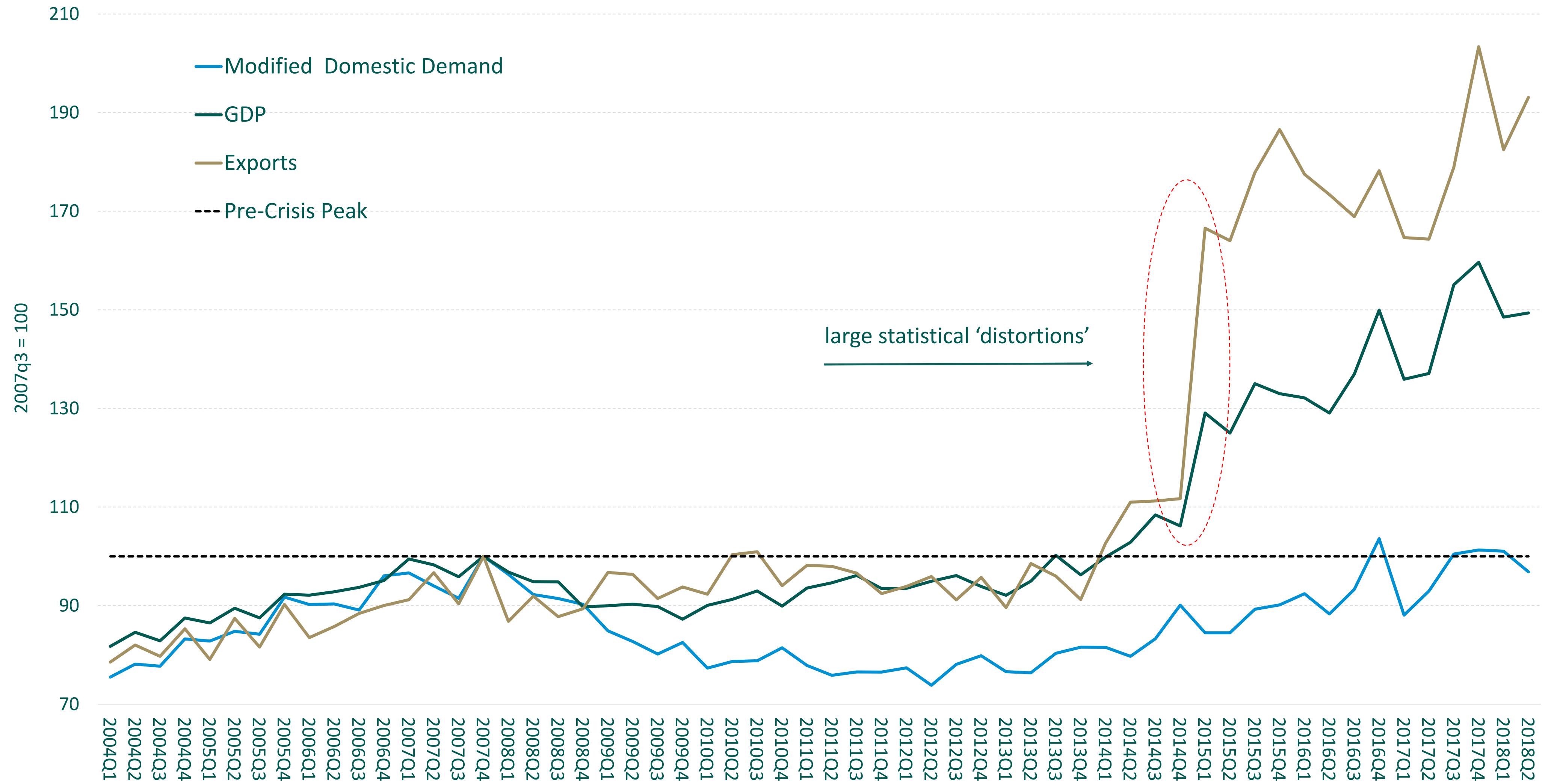


- Objective = boost growth potential
 - enhancing competition and increasing flexibility
 - though economy already fairly flexible
- Scope = product and factor markets
 - product market reforms
 - : legislation for greater competition
 - : reforms of public sector (inc. health sector)
 - factor markets reforms
 - : sectoral wage reforms and labour market activation
- Key reform = personal insolvency framework
 - high level of private indebtedness
 - need for “fresh start”
 - creation of non-judicial, out-of-court debt resolution mechanisms
 - design considerations
 - : avoid moral hazard,
 - : creditor buy-in
 - overhaul of bankruptcy legislation
 - : discharge term reduced



Economic recovery

Rebalancing economic activity – exports leading way



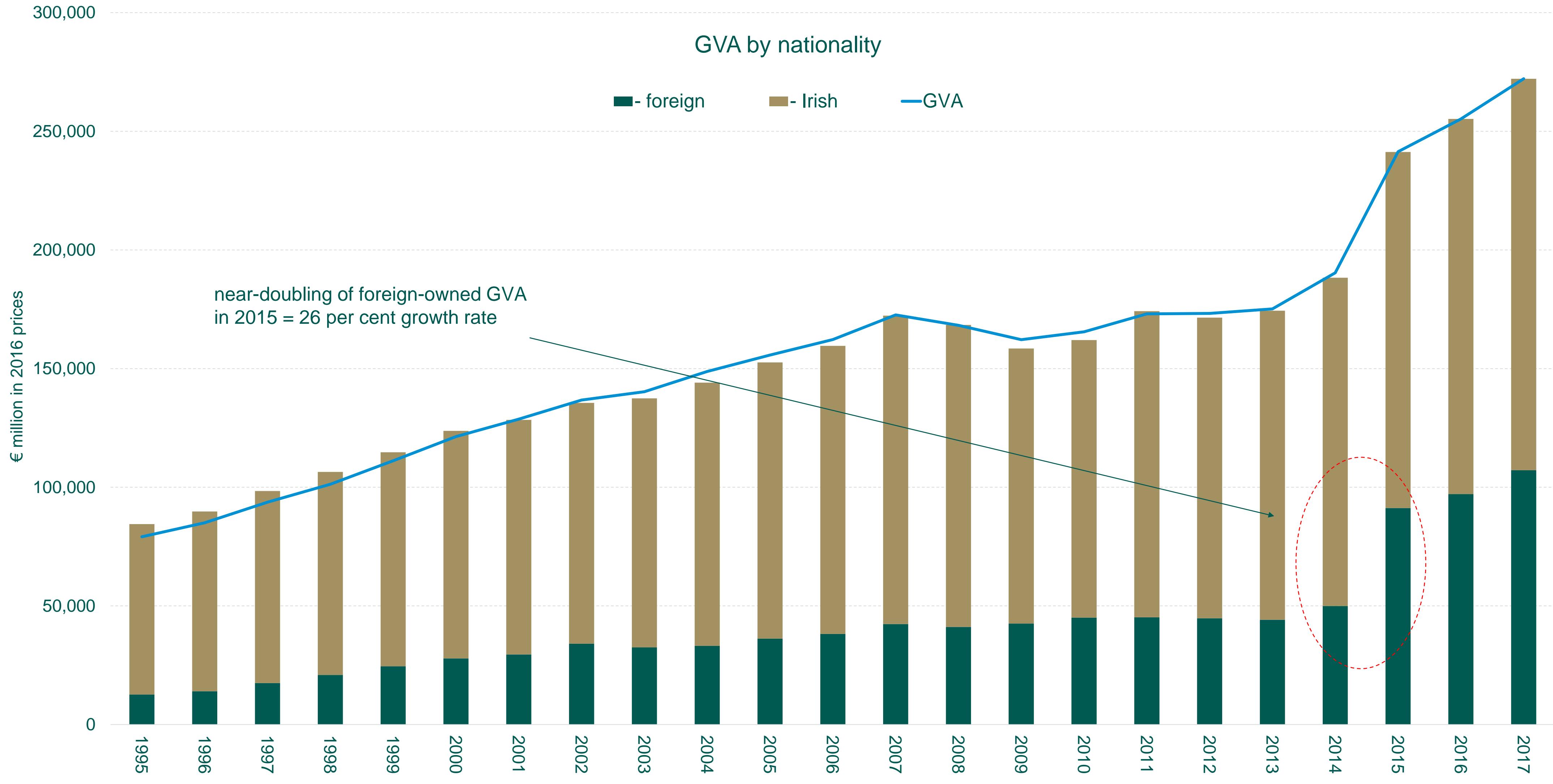
Labour market confirms recovery is ‘real’



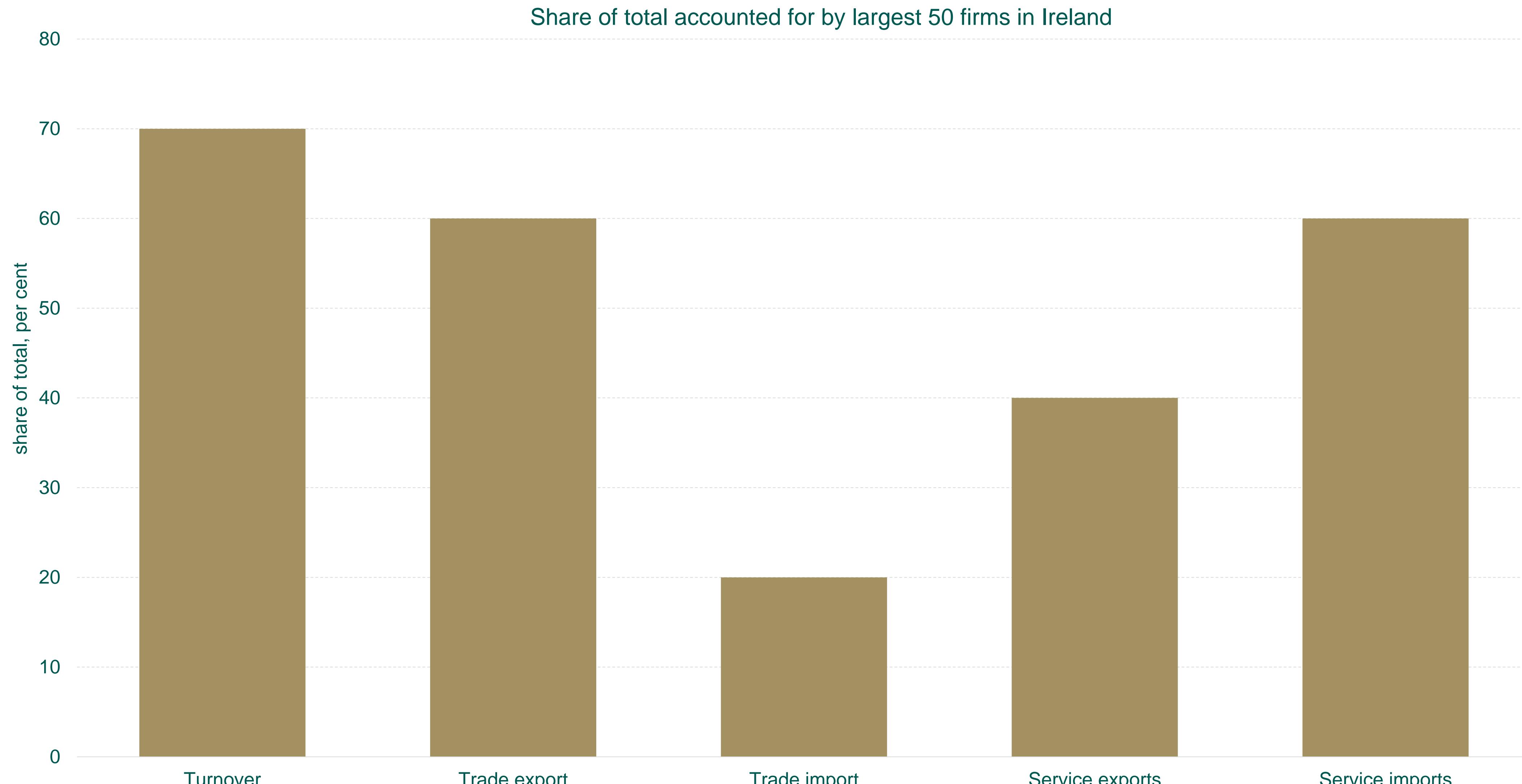


Real or illusionary: national accounting considerations

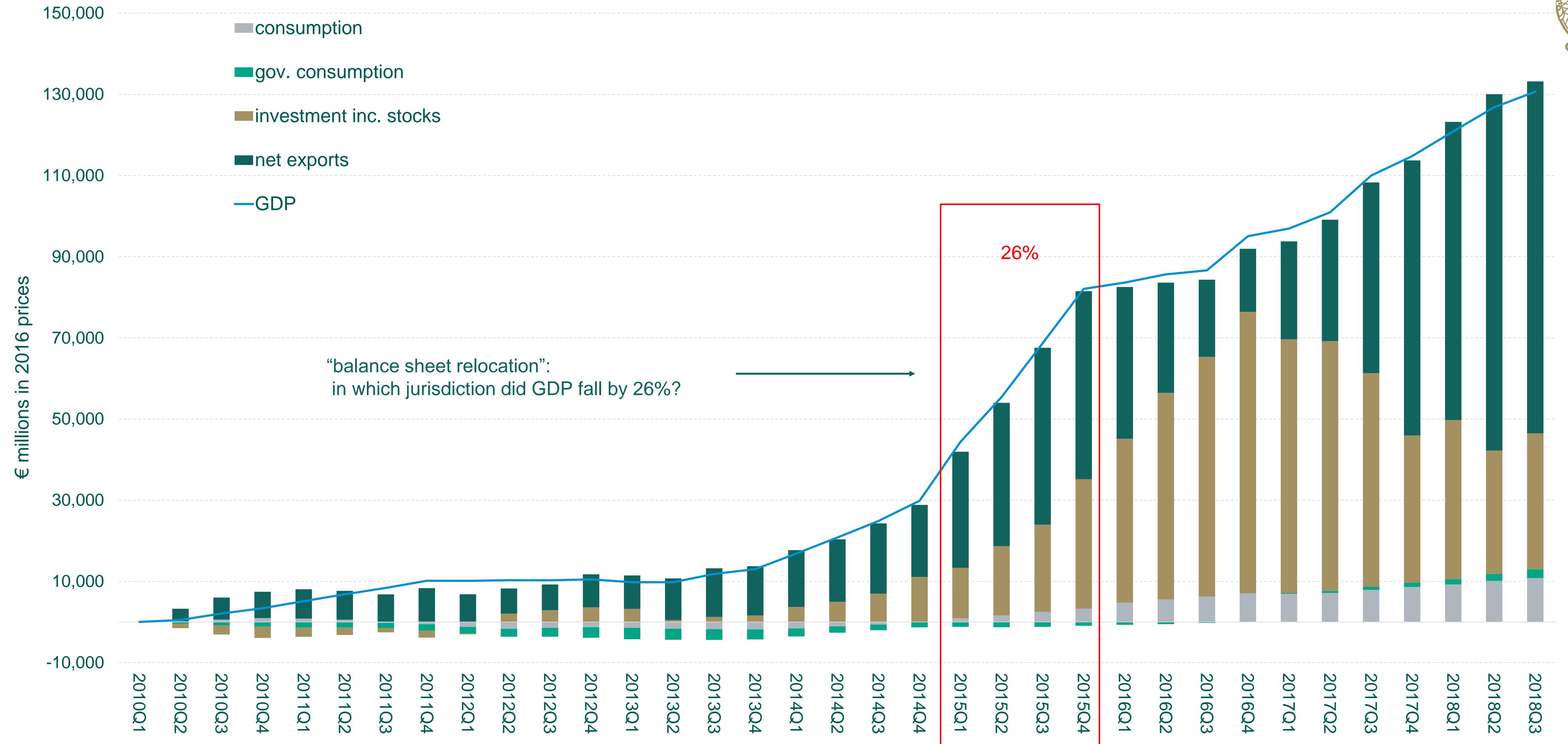
GDP: foreign owned and indigenous



Irish economy – deeply embedded in global supply chains



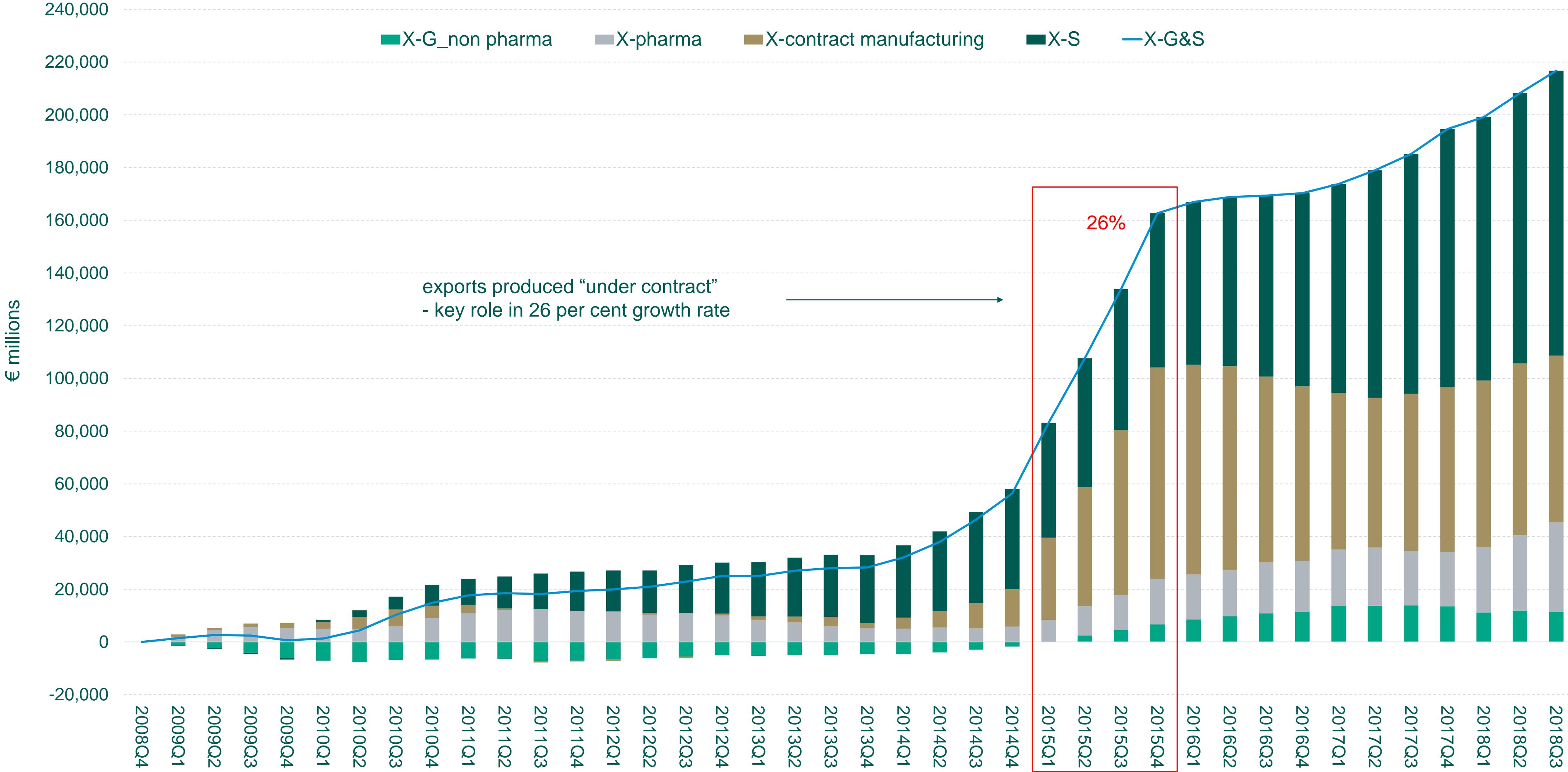
Near-doubling of GDP



Exports: “change of ownership” vs. “free on board”



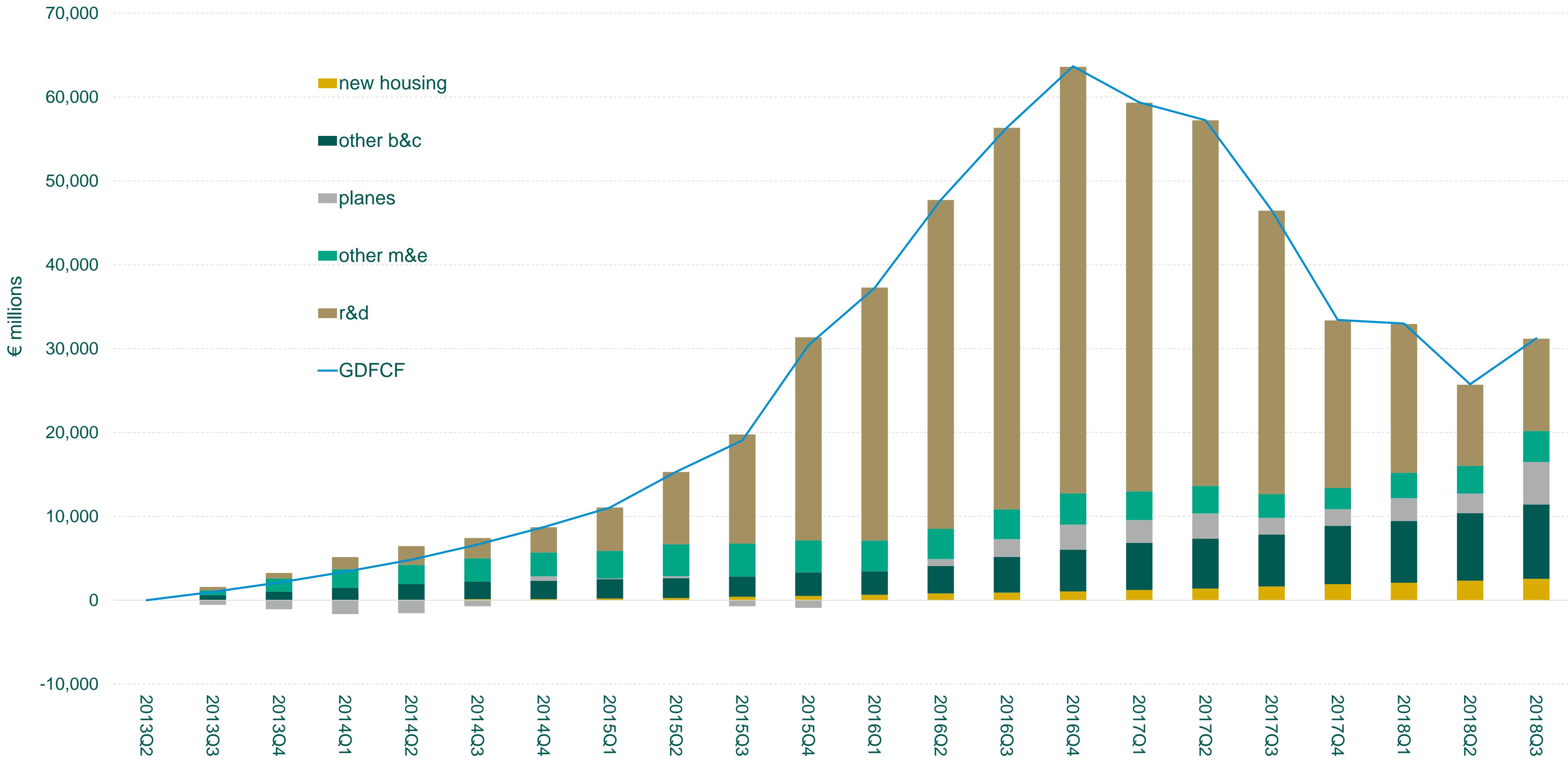
cumulative change in exports since end-2008 [annualised data]



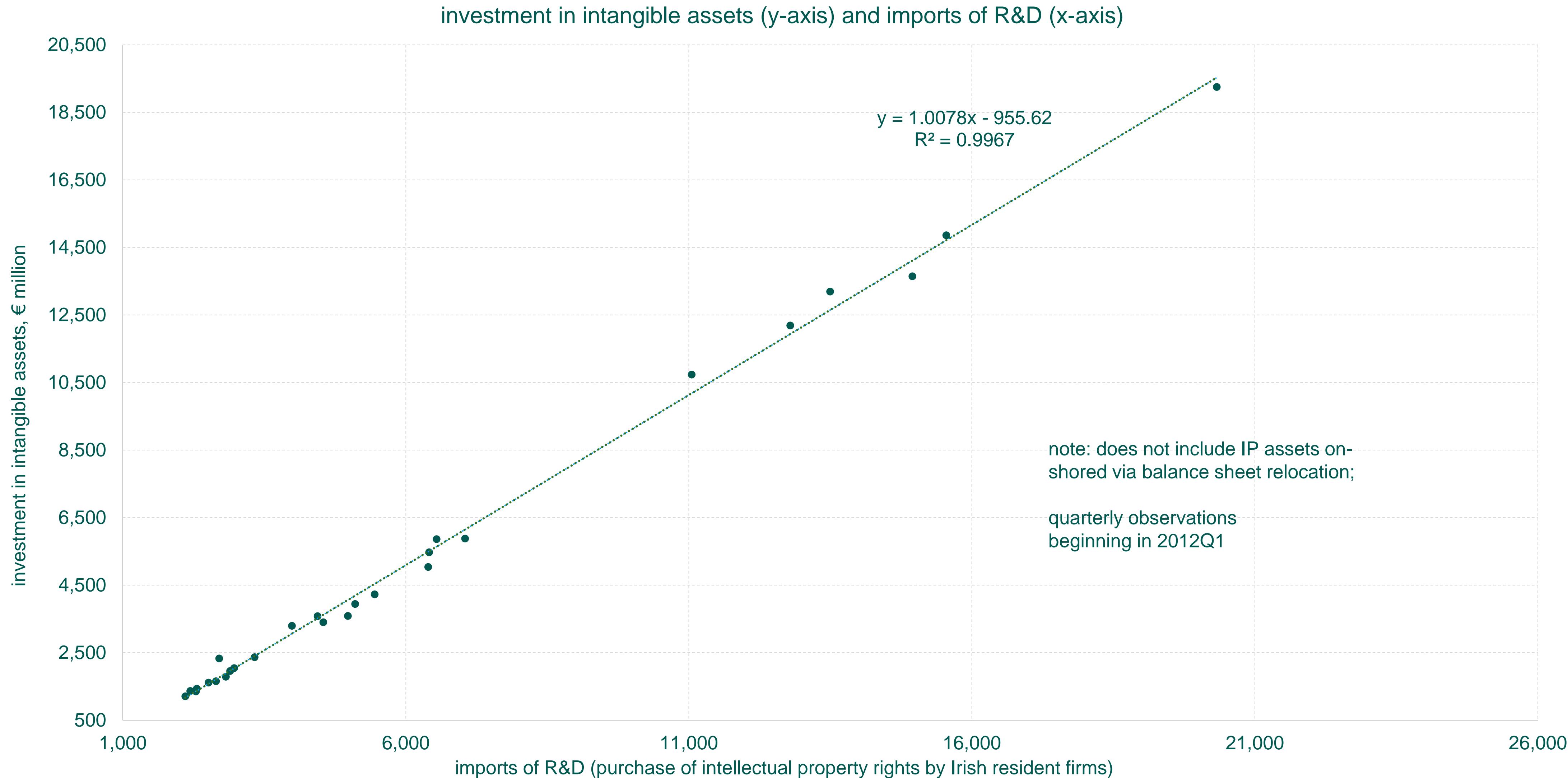
ESA2010: capitalisation of R&D



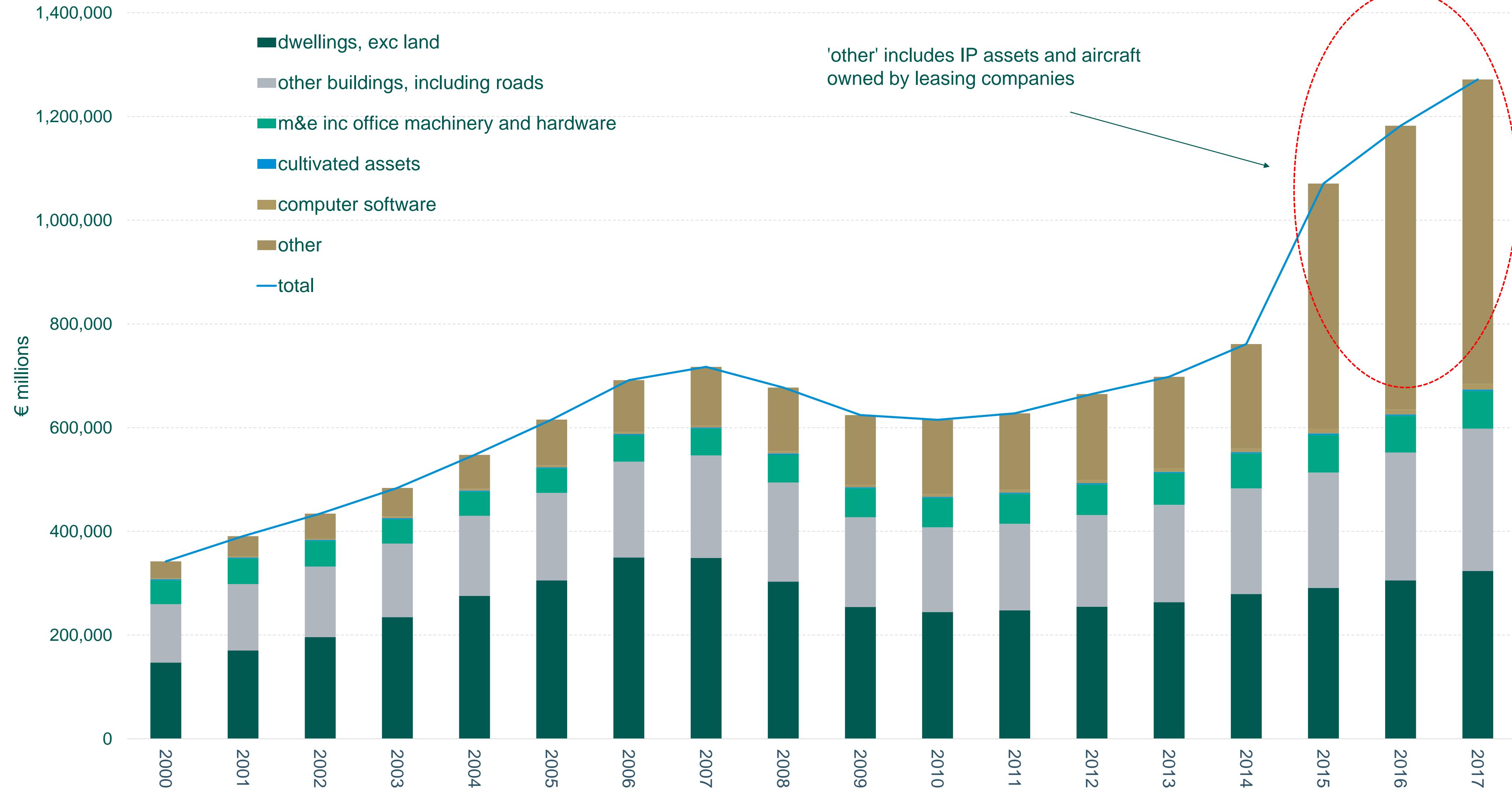
cumulative increase in capital formation since its lowpoint, 4q rolling sum



Actual investment = GDP-neutral (imports)



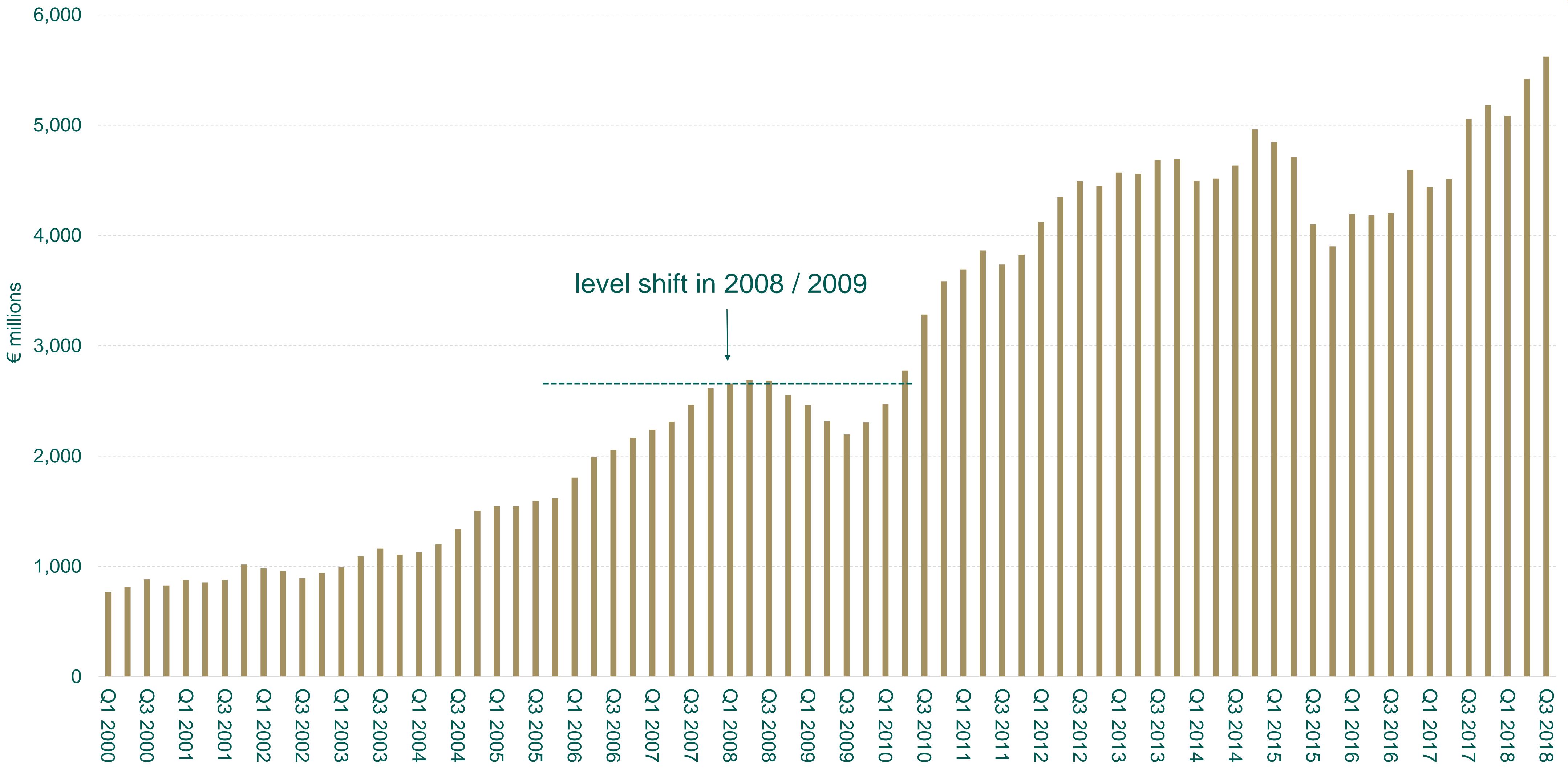
Globally mobile assets have expanded Irish capital stock



Re-domiciliation since 2008 / 09



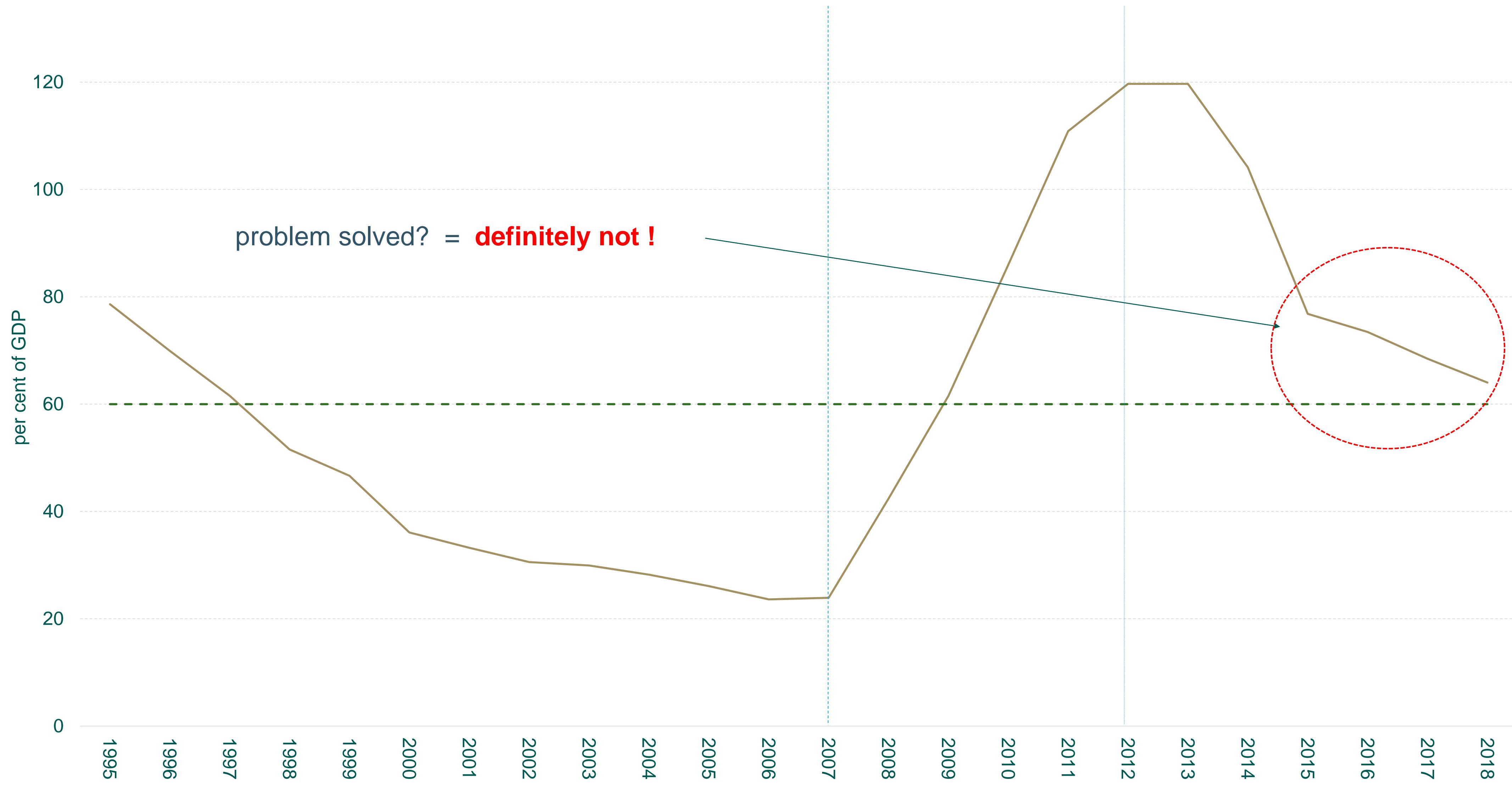
NFI: direct investment inflows, 4qma



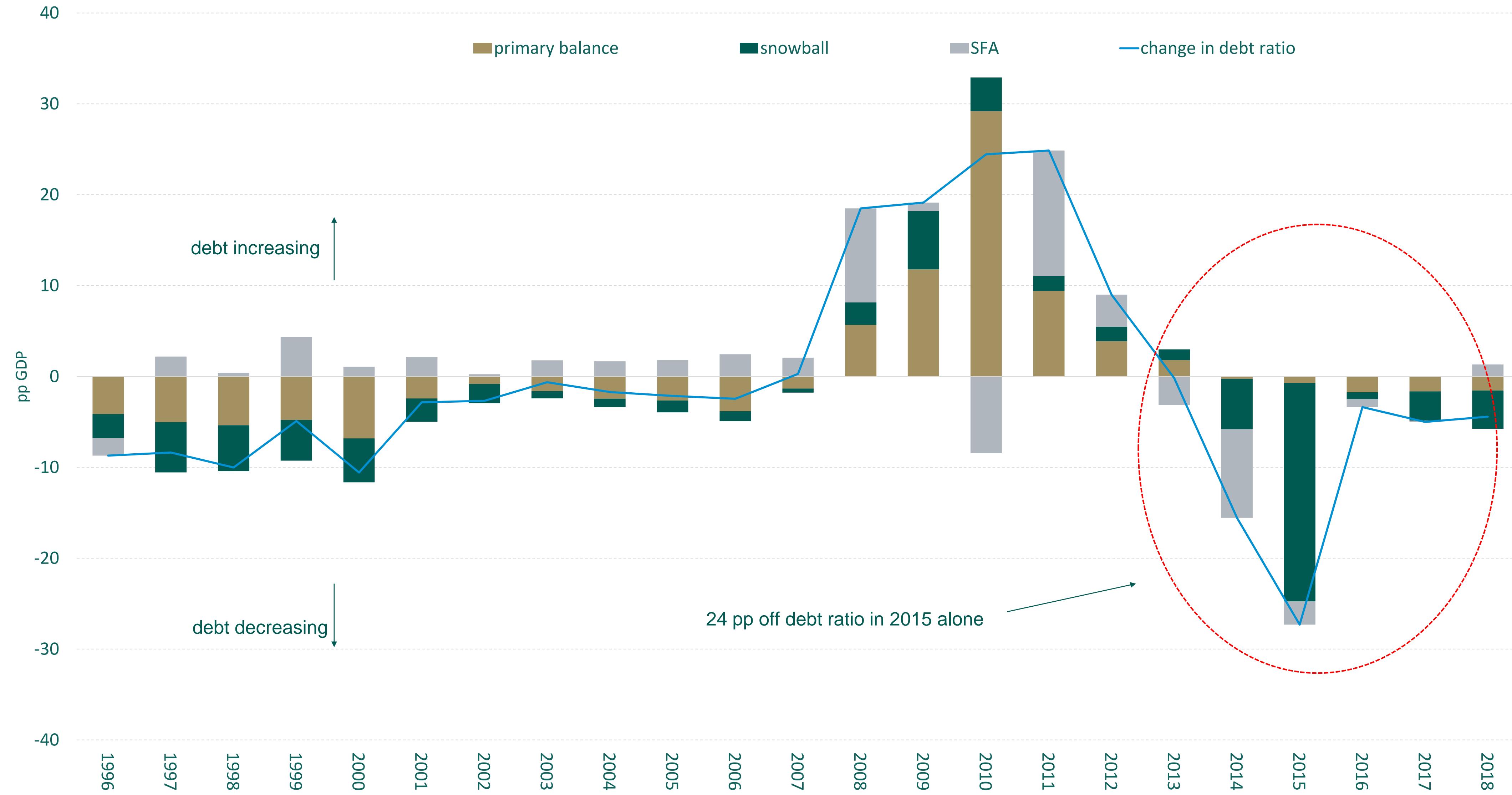


Policy Implications

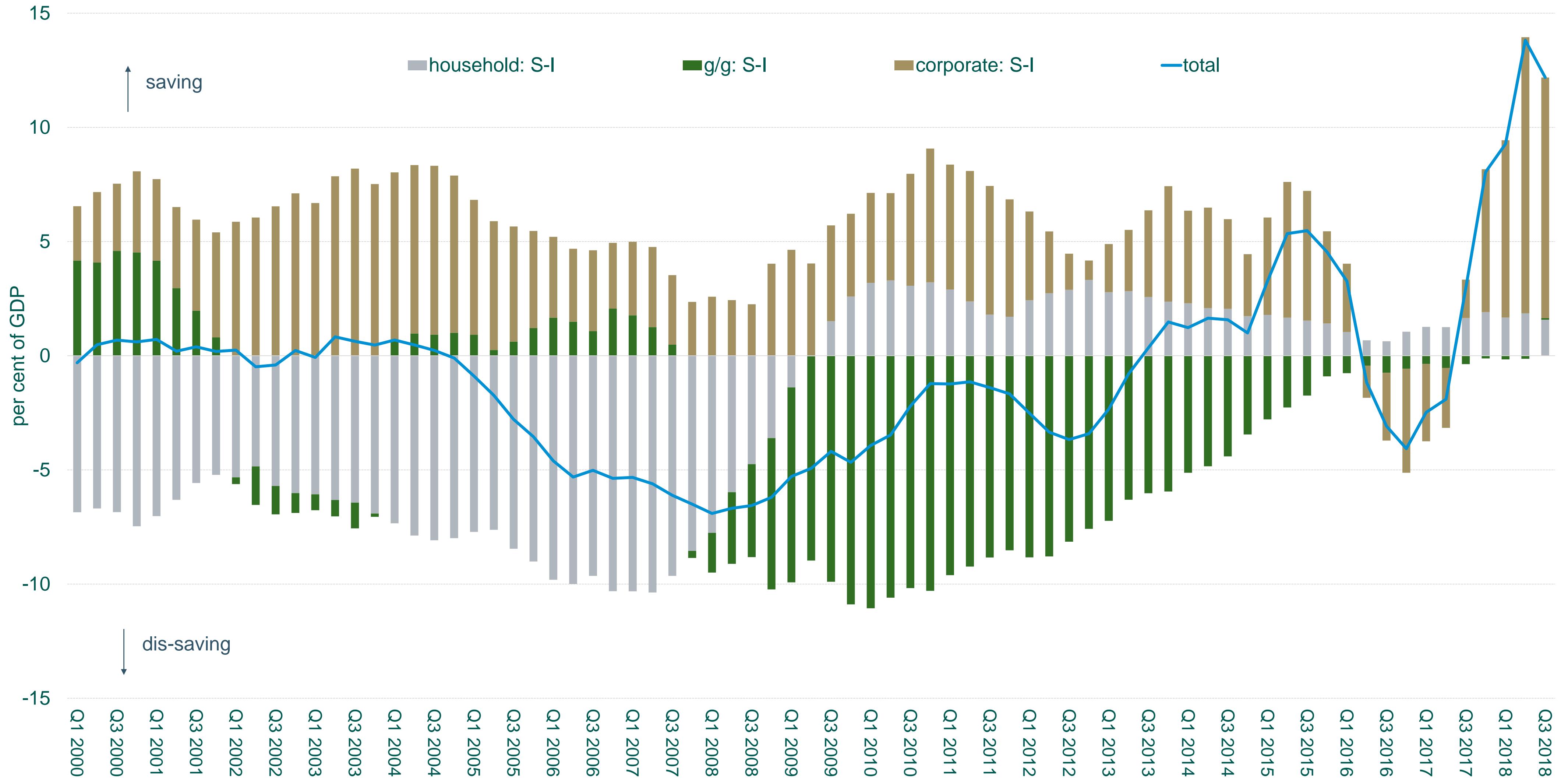
Ratio analysis – public debt/GDP ratio fallen substantially



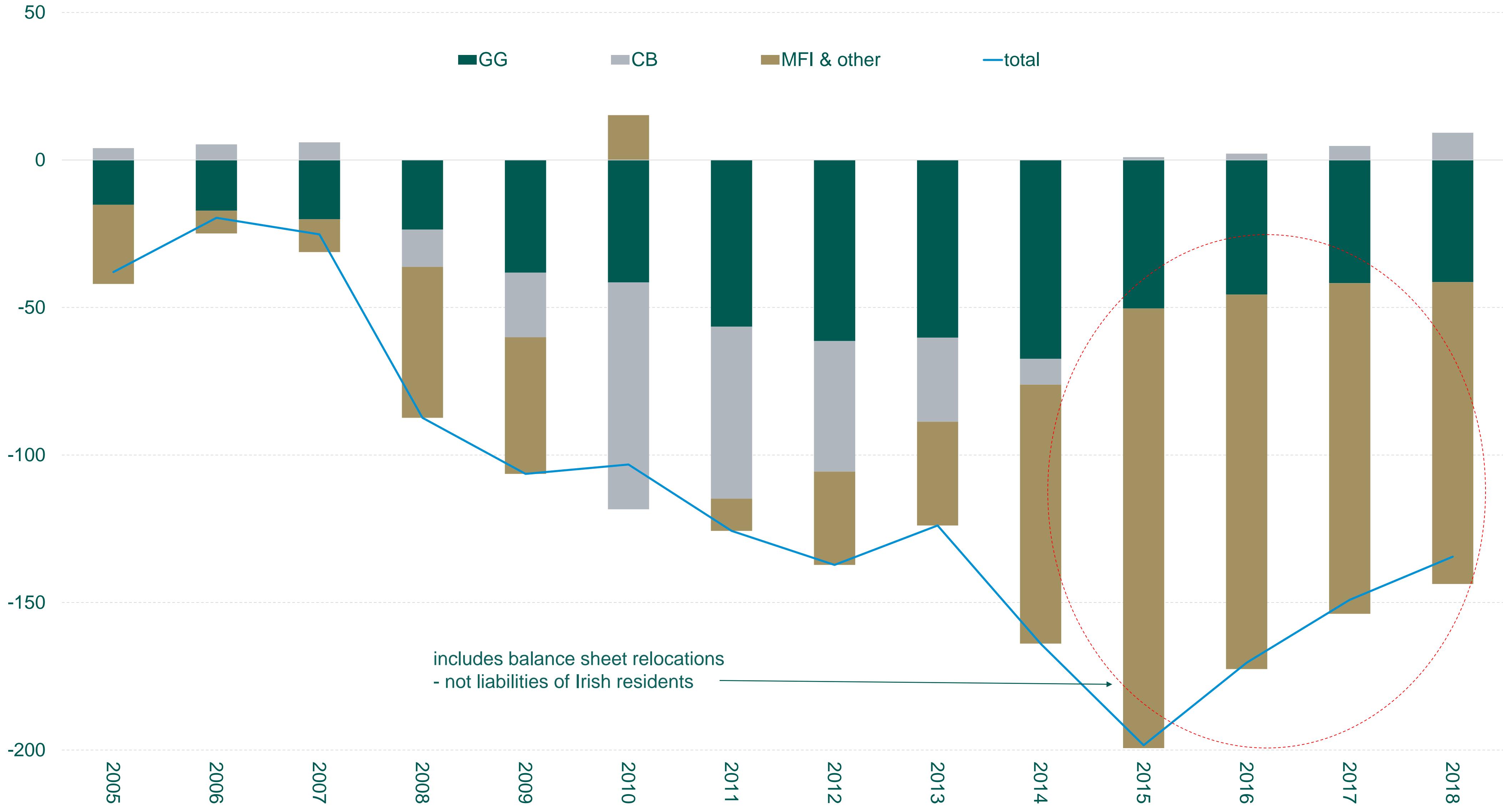
'Snowball' ($= r - g$) is doing the heavy lifting (esp. in 2015)



External sustainability – interpreting S-I imbalances



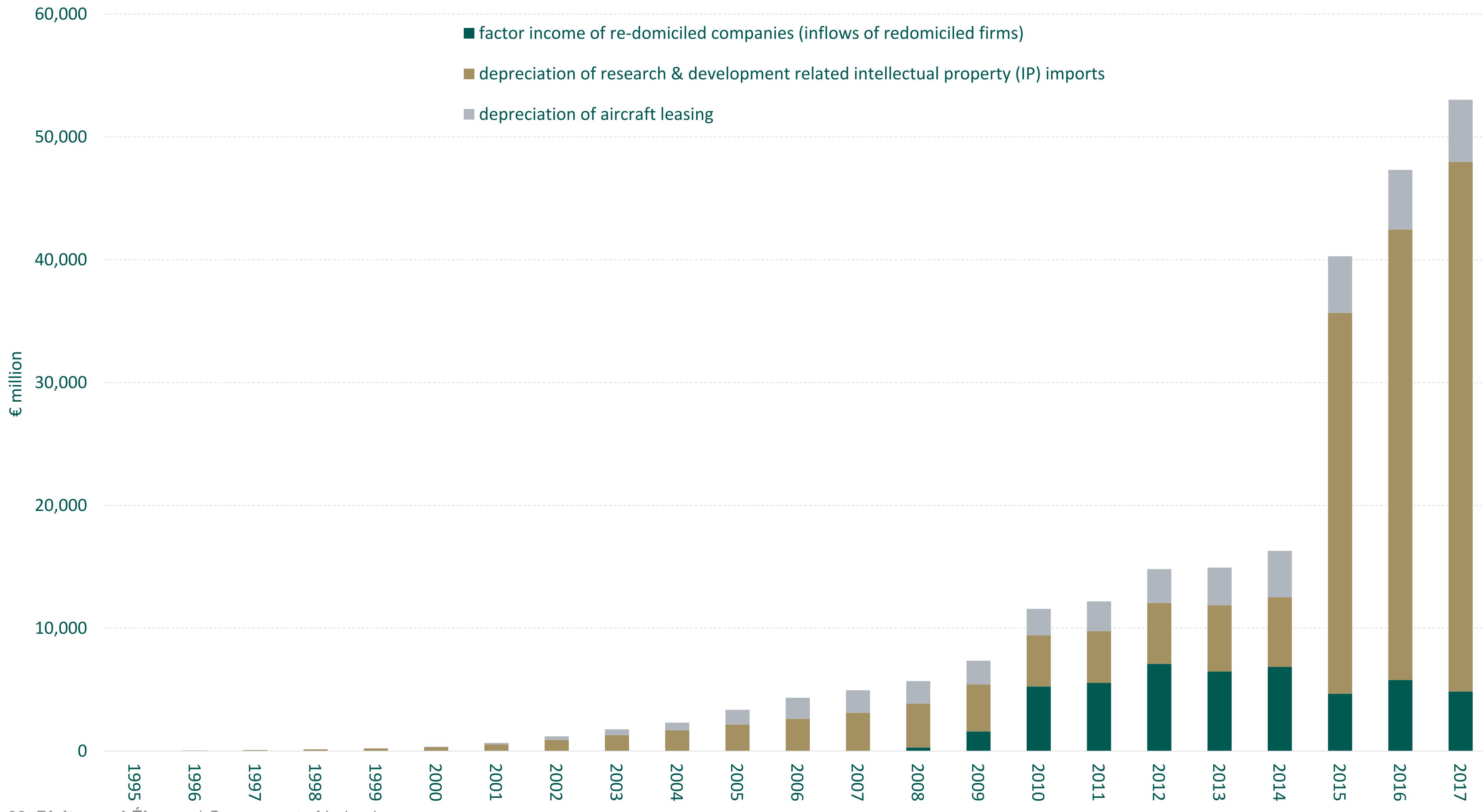
A net external debtor?...interpret NIIP with caution!





Statistical responses to meet user needs

Remove distortions to GDP and GNI



Modified GNI (=GNI*) better indicator of ‘size of pie’





Conclusions

Key lessons



Macroeconomic...

- For small, open economies
 - competitiveness matters
 - ‘turnaround times’ lower at both extremes of business cycle
 - flexible product and factor markets crucial
 - tail-risks can materialise → premium on policy caution
- Balance of Payments even more important in EMU
 - warning signal in EMU re. emerging imbalances
 - highlights exposure to ‘sudden stops’

Fiscal consolidation...

- Credibility is vital
 - frontloading
 - avoid overpromising
- Speed and quality of consolidation are important considerations

Financial sector...

- In EMU role for macro-prudential tools
 - stabilise housing / credit cycles

Real or illusionary?



- Recovery is real but...
- Macroeconomic diagnostics: greater complexity in Ireland
 - Ireland at 'coal-face' of globalisation
 - statistical methodologies lag pace of globalisation
 - side-effects of ESA2010 / SNA2008 substantial for IE
- Challenge for calibration of policy in real-time
 - accurate trend-cycle decomposition difficult (impossible?)
 - fiscal rules set in GDP terms
- Additional metrics welcome (modified BoP, GNI*, etc.)
 - no silver bullet
 - suite of indicators



Disclaimer and other information:

The views expressed in this presentation are those of the presenter and do not necessarily reflect the views held by the Department of Finance, the Minister for Finance or the Government of Ireland.

Some of the figures contained in this presentation are estimates based on the latest available forecasts as published by the Department of Finance in its autumn forecasts (October 2018).

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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