An Roinn Airgeadais
Department of Finance

SPU 2022: Macroeconomic outlook

Presentation to *Irish Fiscal Advisory Council*
Economics Division,
Department of Finance
1st April 2022

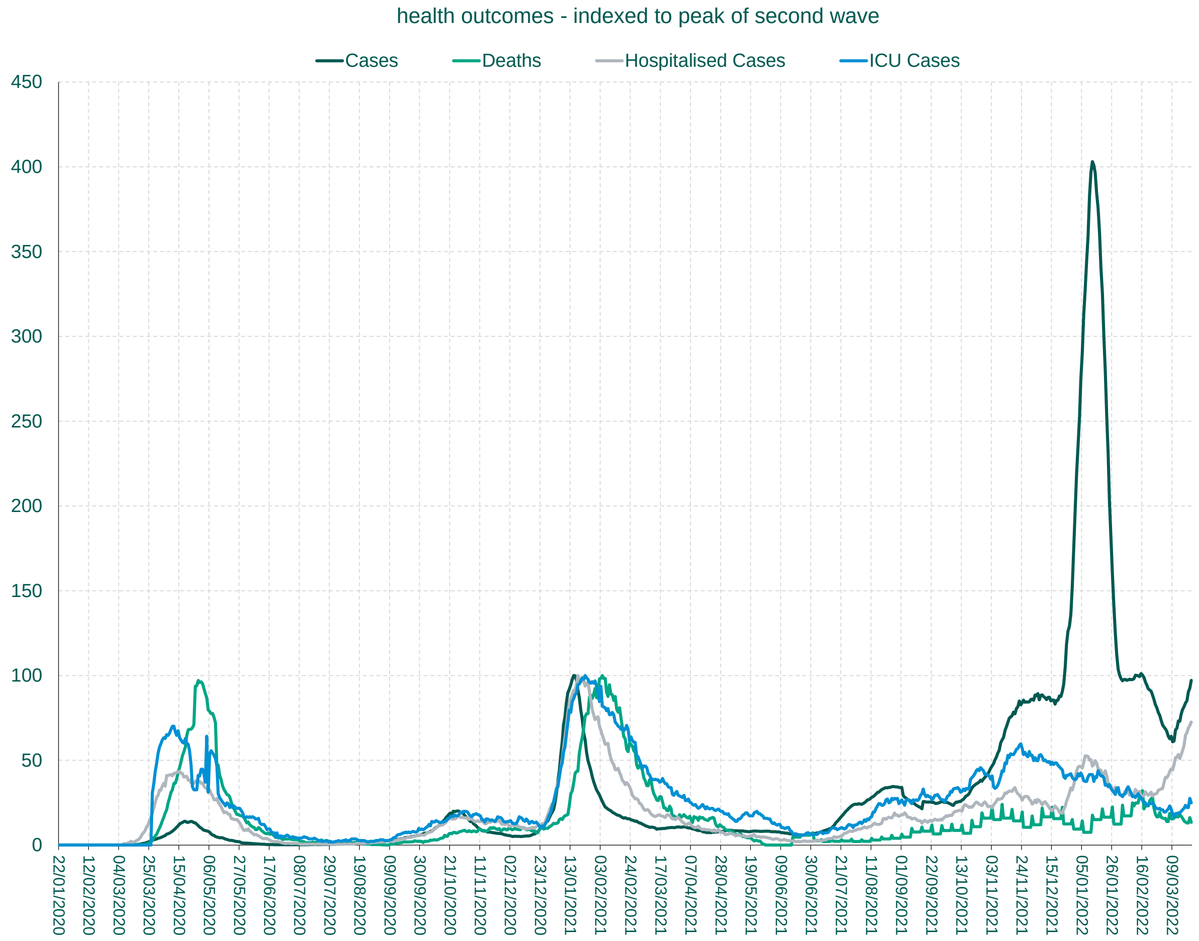
Bird’s eye view

- Key building blocks of the forecast
- Transmission channels: from war to economic variables
- Focus on inflation
- Implications for ‘real’ domestic economy
- External developments and implications for trade
- Summary and conclusion

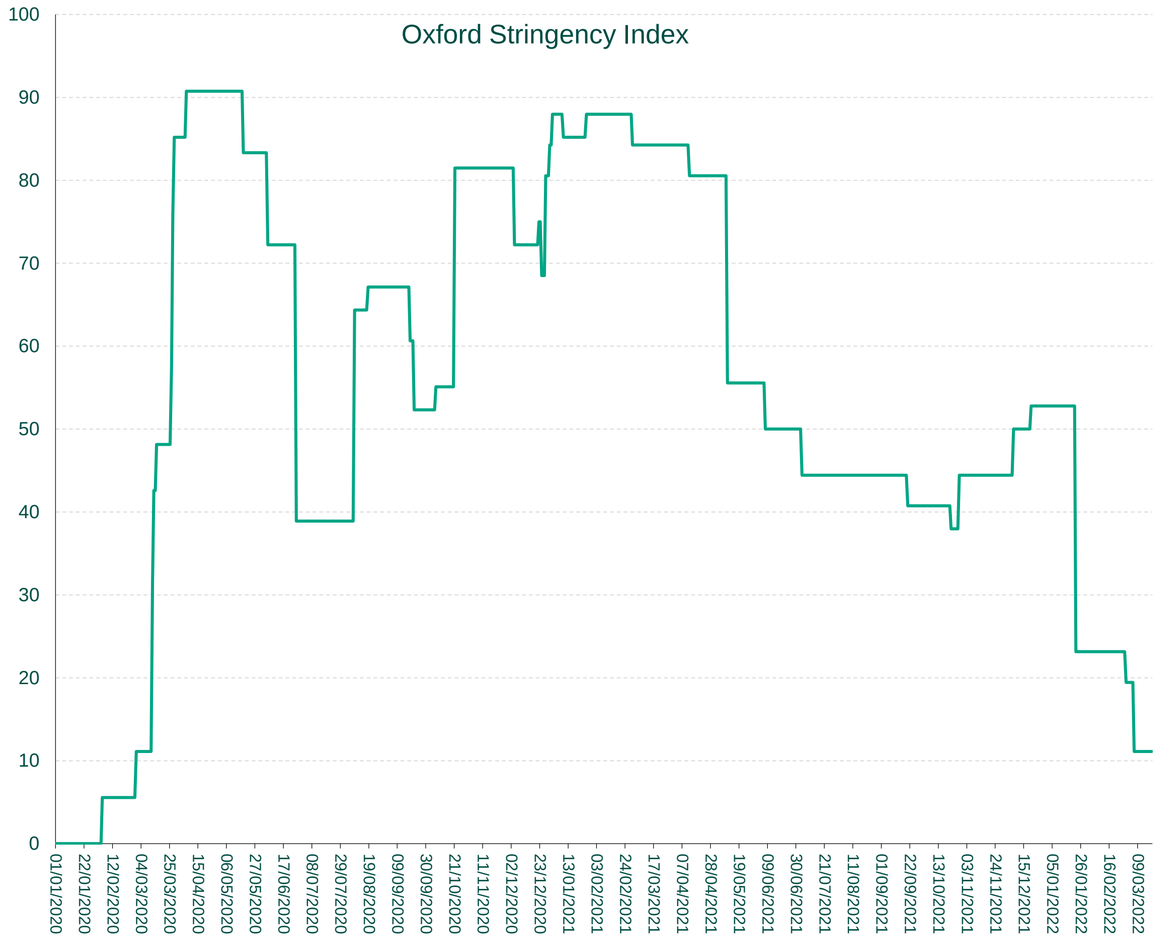
Key building blocks of the forecast

Economic fallout from pandemic is waning

Notwithstanding transmissibility of Omicron sub-variant…



…restrictions remain non-stringent



Building blocks of the forecast: ‘one step up and two steps back’

1. Epidemiology [=economic tailwind]

- Further waves do not result in re-imposition of restrictions
- Economic recovery – domestically and in MTPs

  : ‘base effects’ result in strong (mechanical) growth
- “Zero-Covid” strategy in parts of China – disruption to supply chains

2. War in Ukraine [=economic headwind]

- Scope: remains a bilateral conflict
- Duration: sanctions remain in place over forecast horizon
- EU carve-out for energy sanctions remains in place
- Demand in MTPs = c. -1 pp in 2022
- Migration boost labour supply – modest impact initially

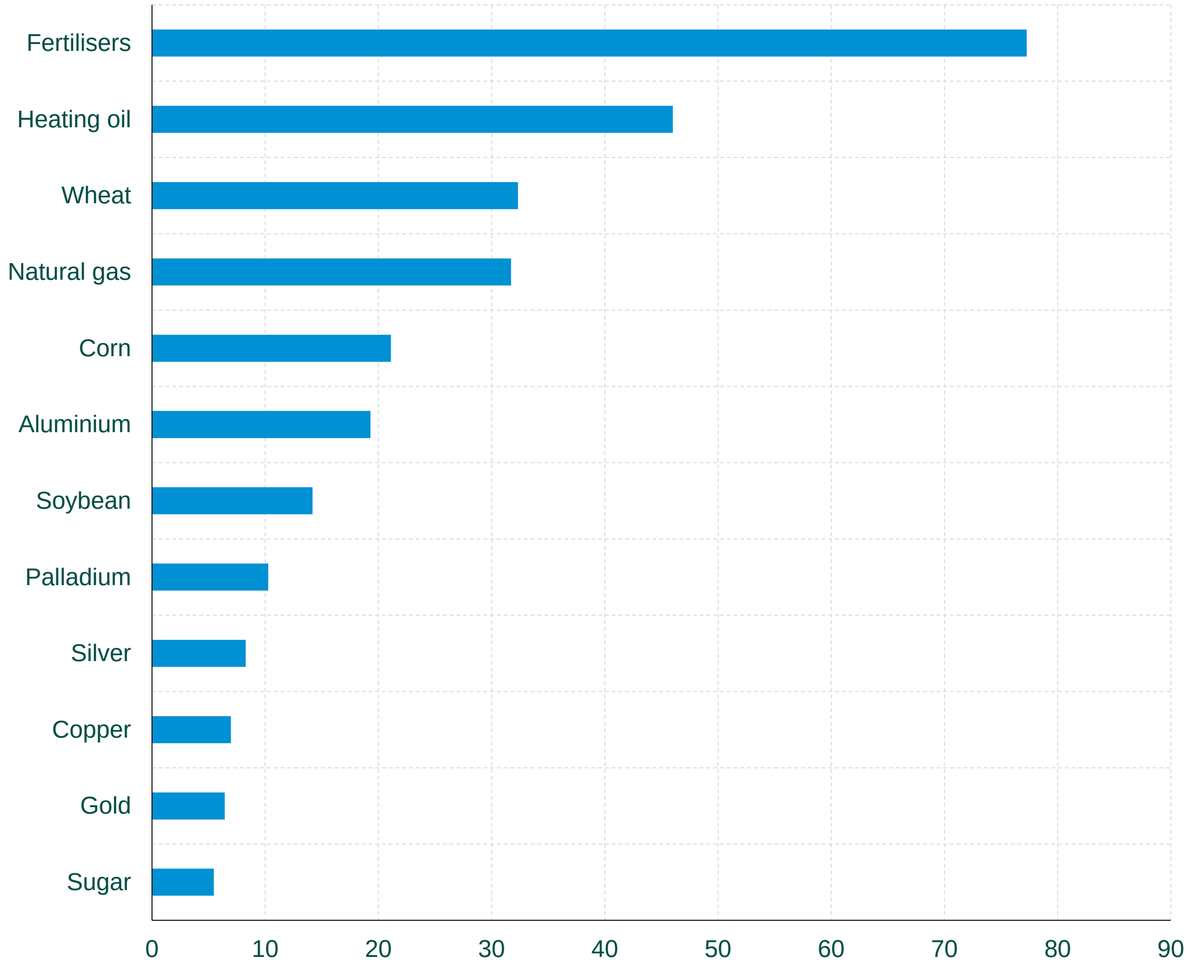
3. Inflation [=economic headwind]

- Commodity price *levels* remain high in T, T+1 (but contribution to *change* diminishes over time)
- Higher input costs feed into ‘core’ inflation

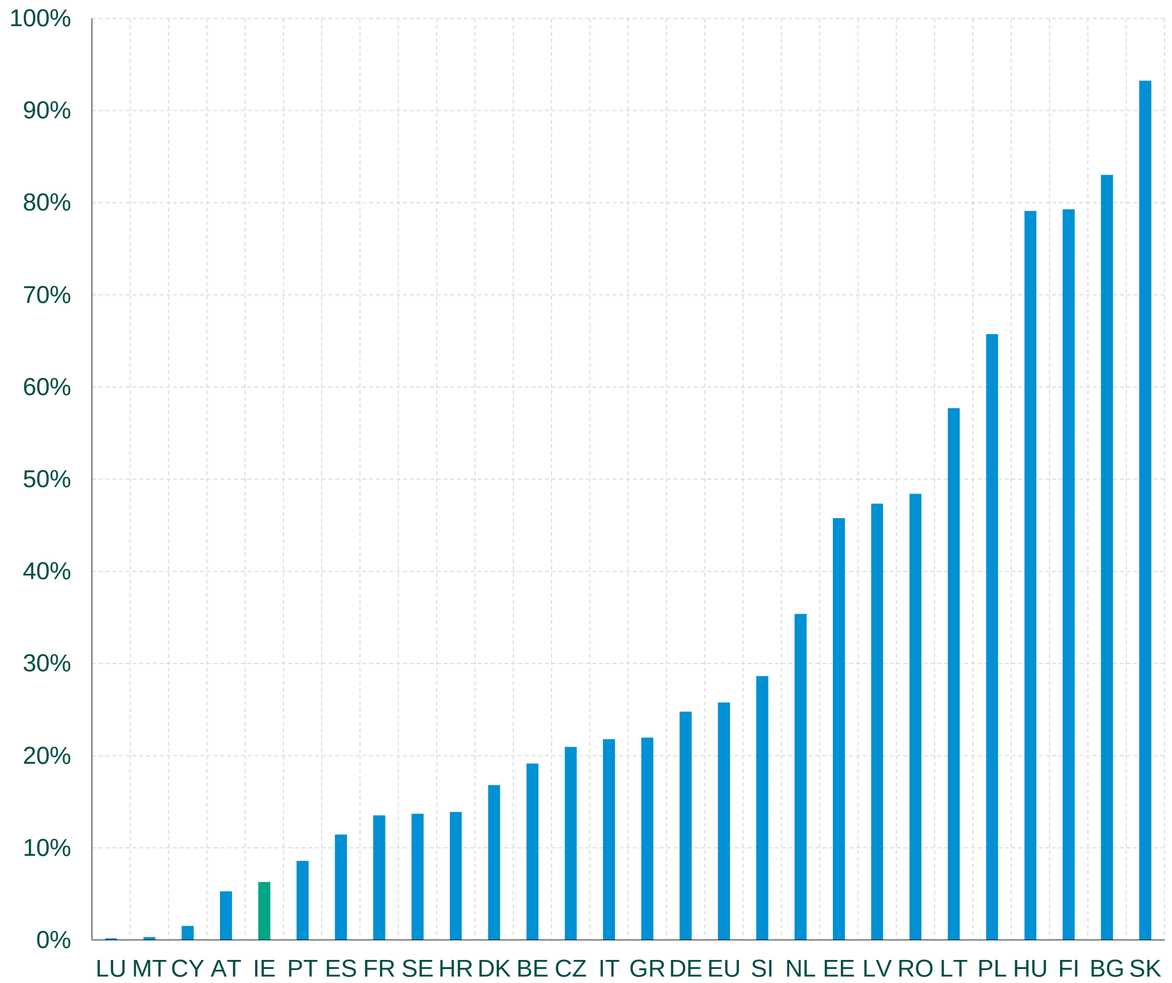
Transmission channels: from war to economic variables

War in Ukraine: main transmission channel = commodity prices

Commodity price, per cent change from January average to March 28th



Energy sourced from Russia, share of total energy imports

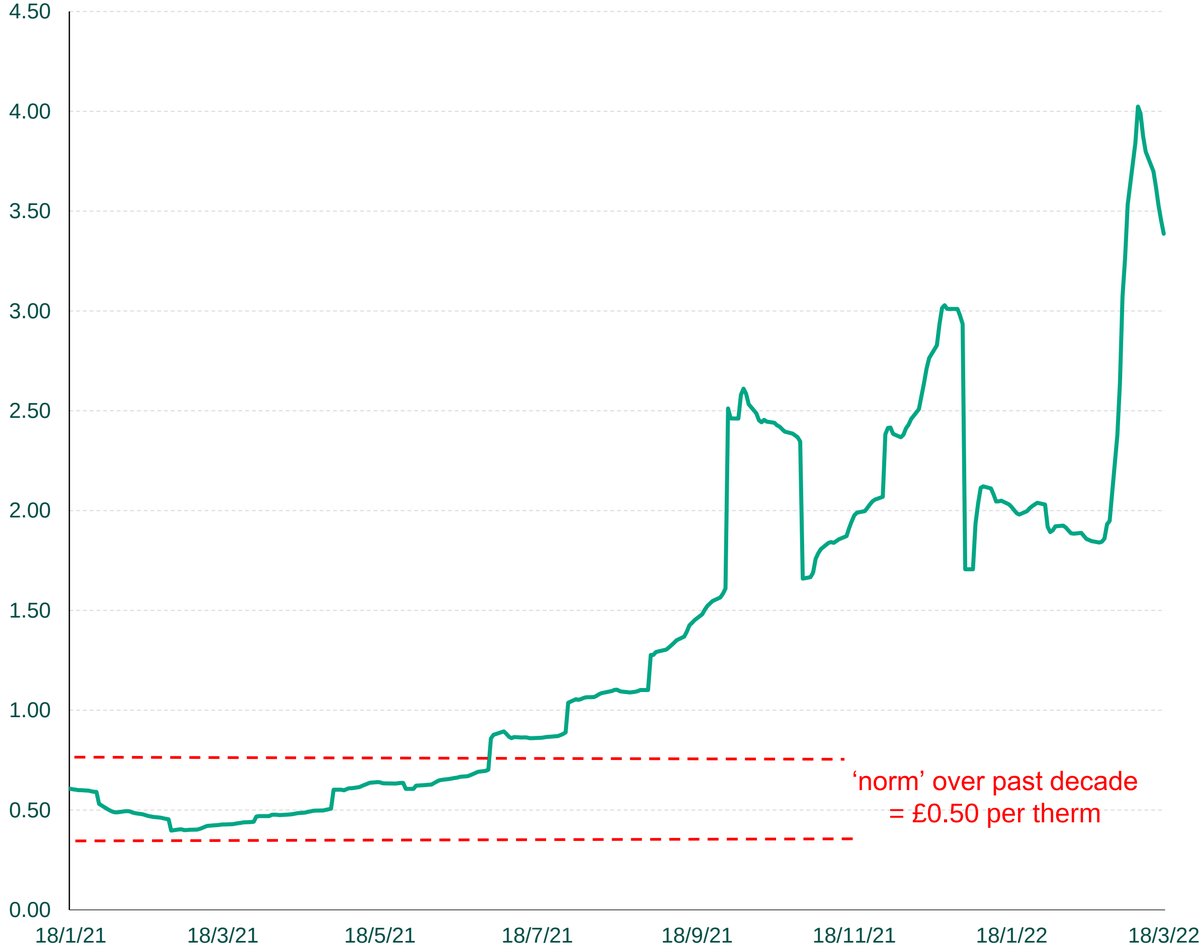


Note: Fertilisers = Potassium Chloride. The fertiliser price increase refers to the per cent change between the monthly price for January and the monthly price for February.

Energy prices in particular …

Oil spot prices – US$ per barrel

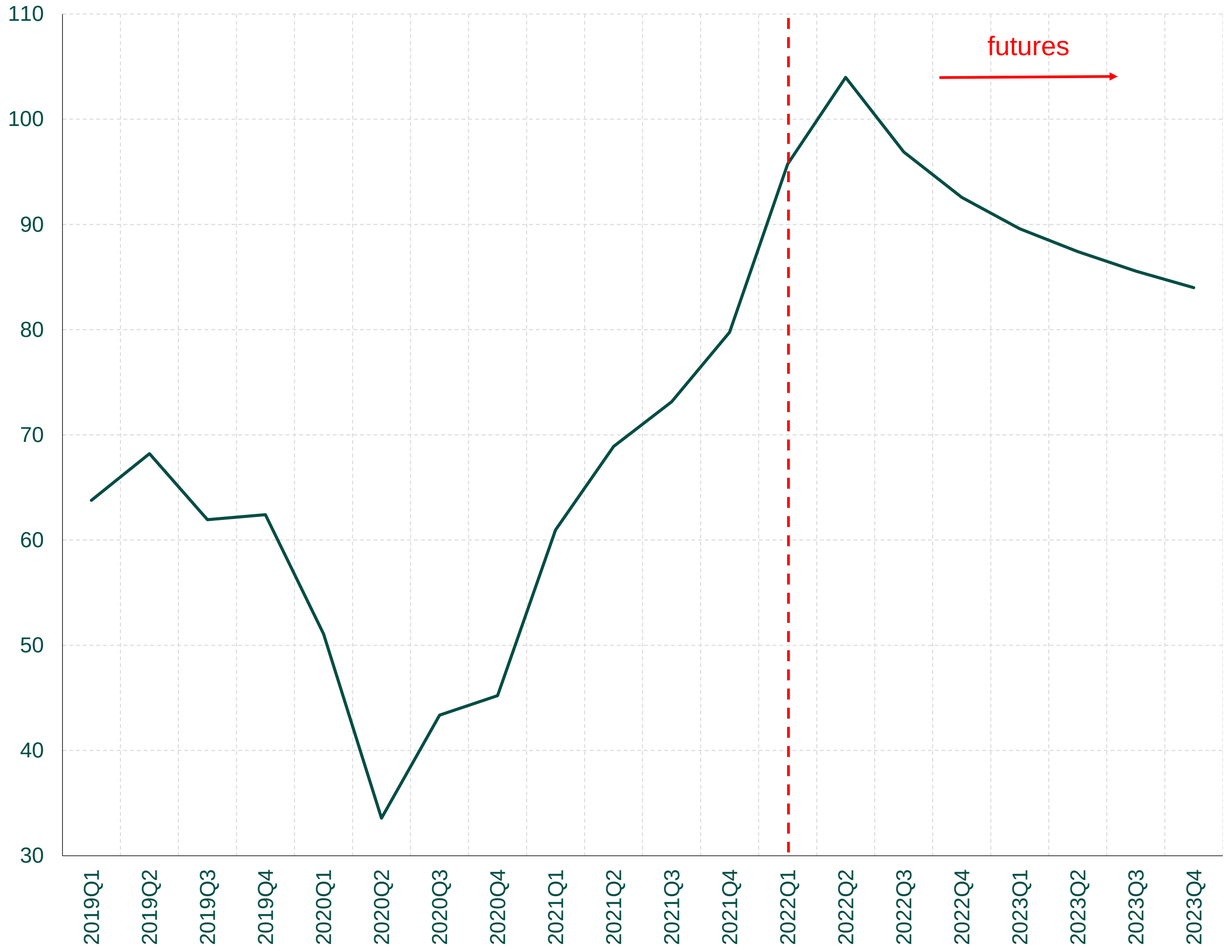
Gas spot prices – stg£ per therm



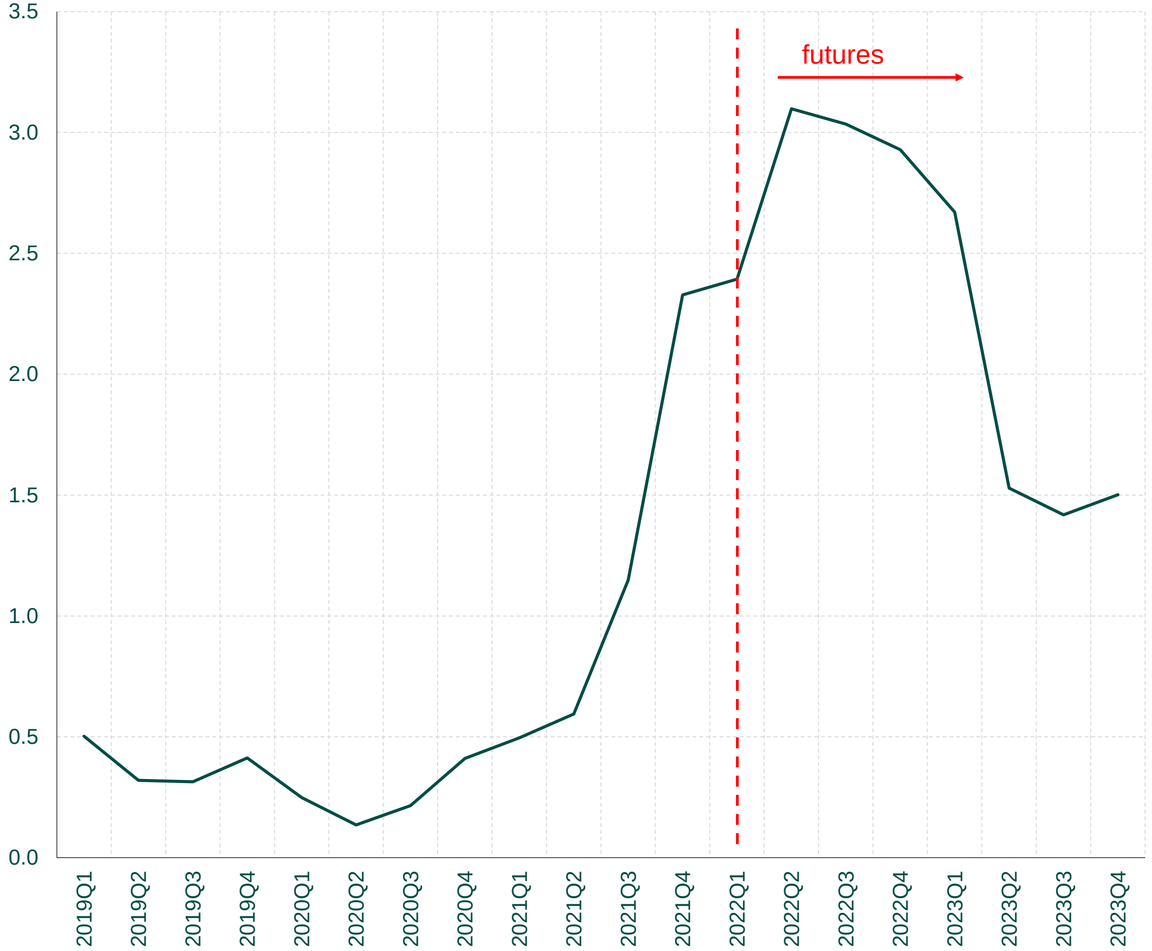
Focus on inflation

Futures curves: market participants building in modest declines in energy prices

Oil futures ($/barrel)

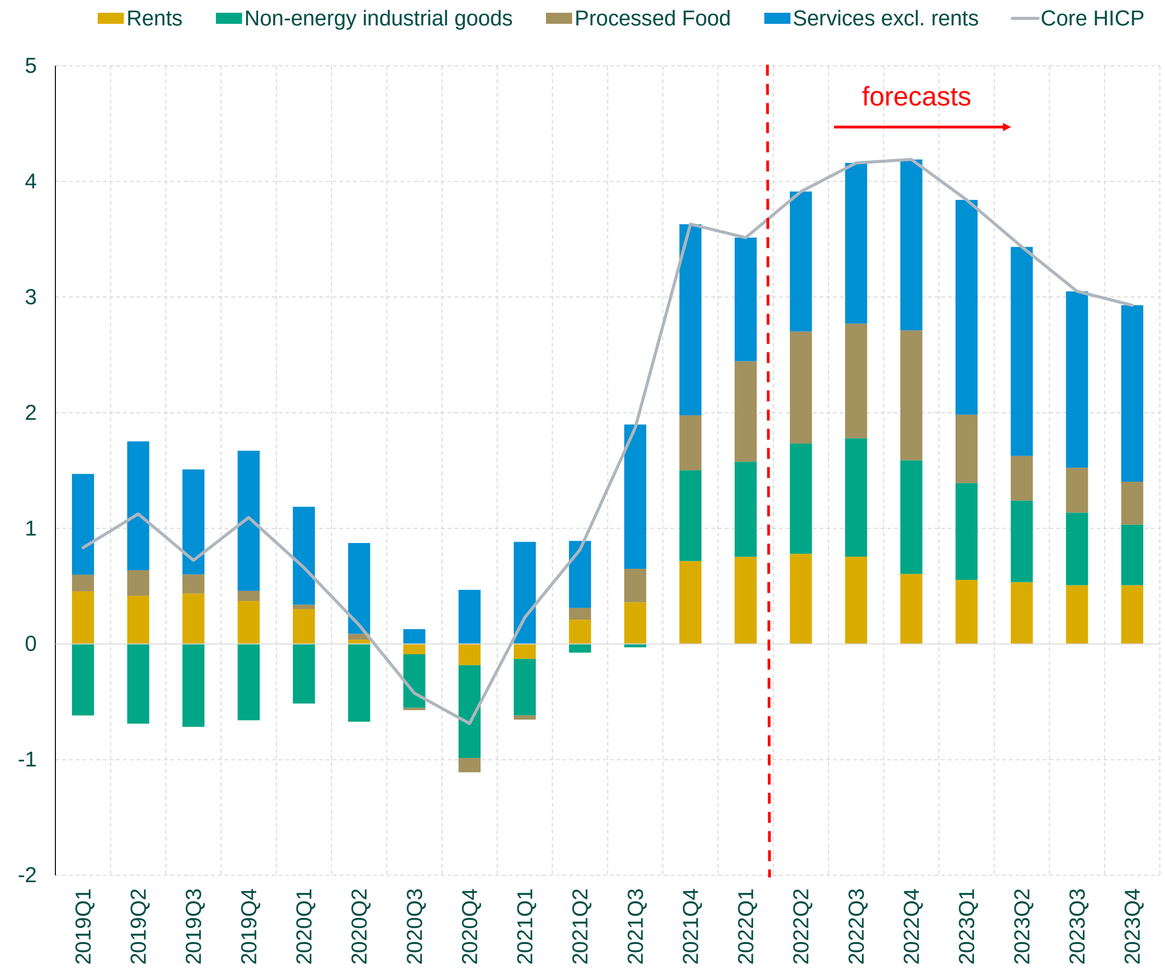


Gas futures (£/therm)

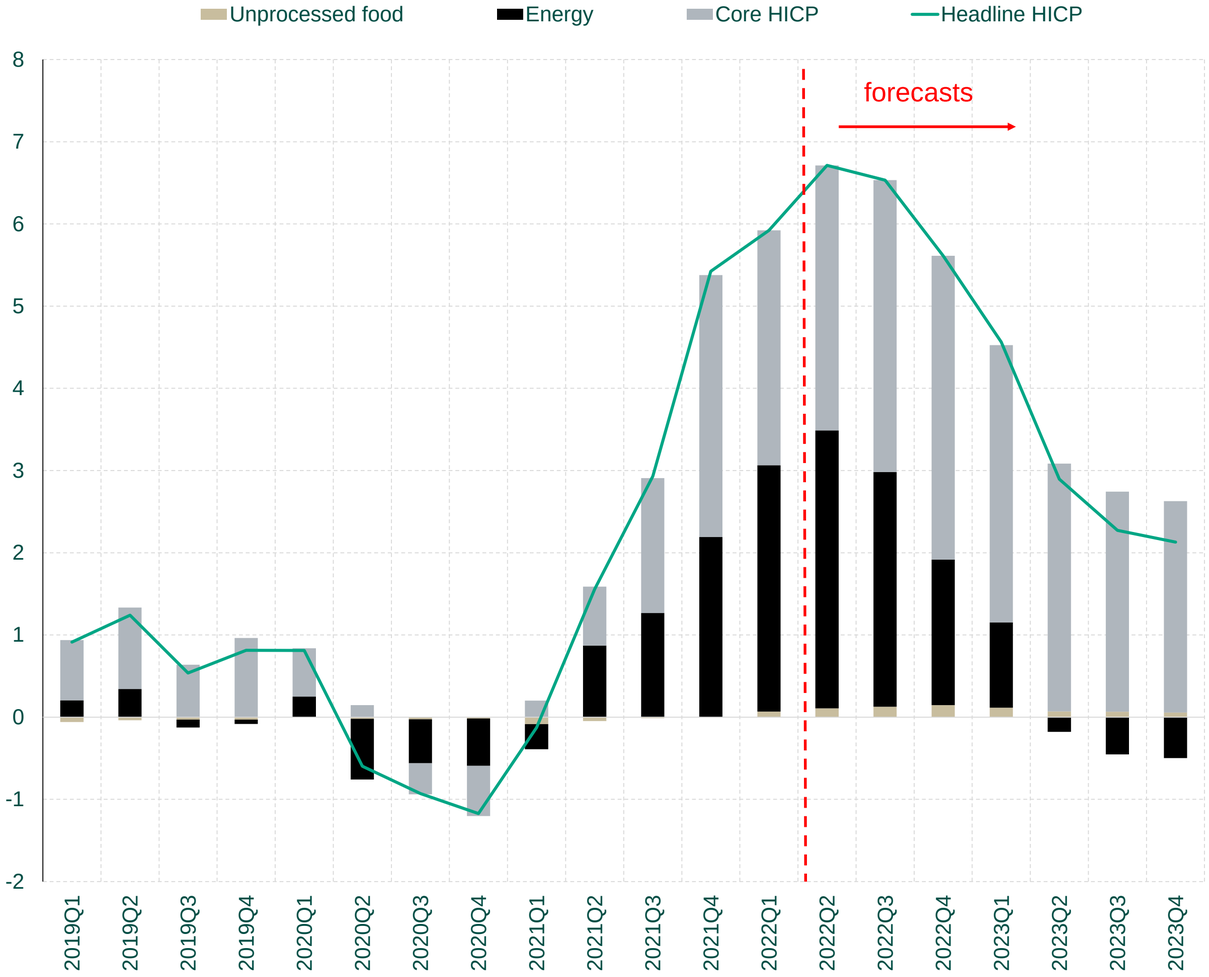


Passing through to energy costs, but also core inflation

Contribution to y-o-y % change in core HICP, pp



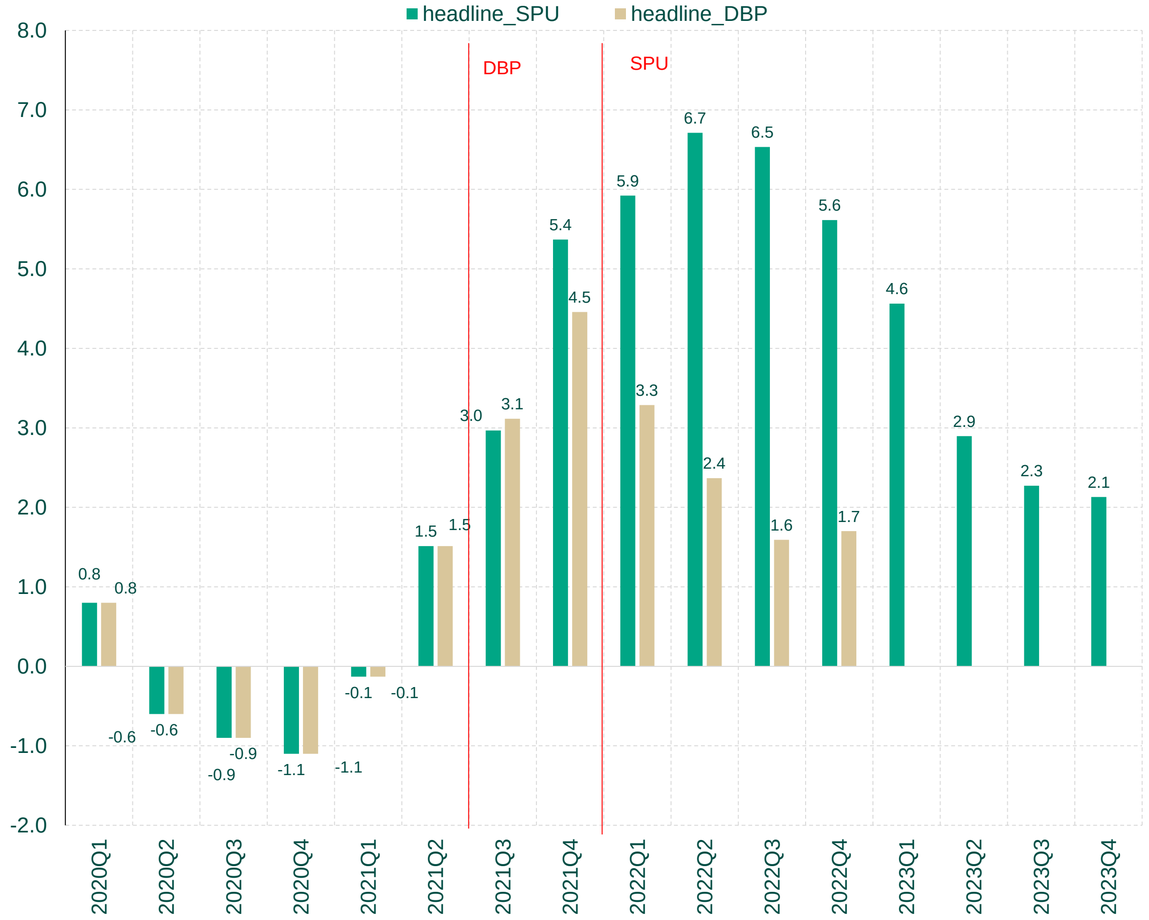
Energy inflation driving headline HICP in 2022



Forecast incorporates upward revision to inflation

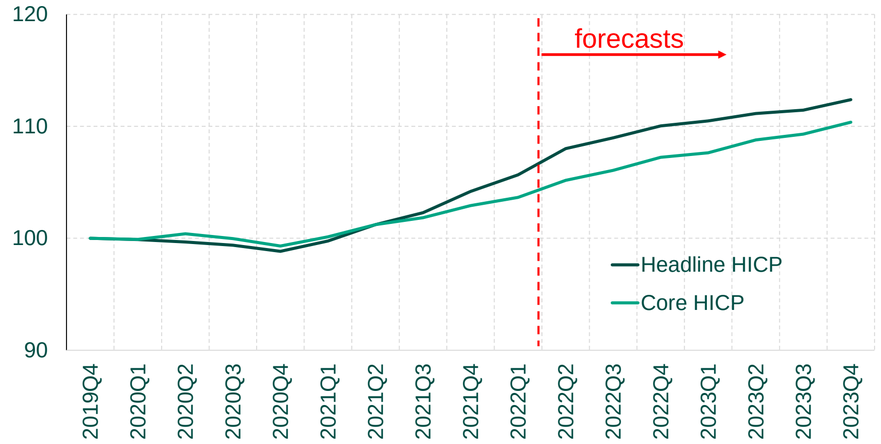
Then and now: quarterly forecast for core inflation, per cent y/y change

Then and now: quarterly forecast for headline inflation, per cent y/y change

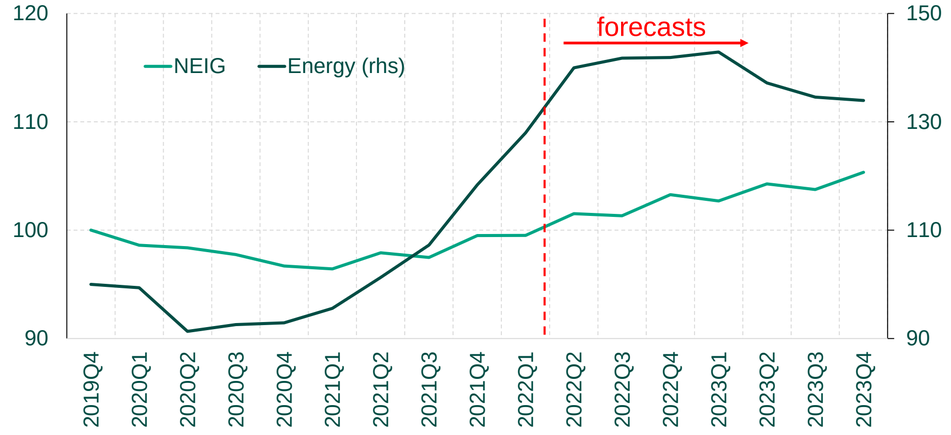


Inflation quarterly profiles

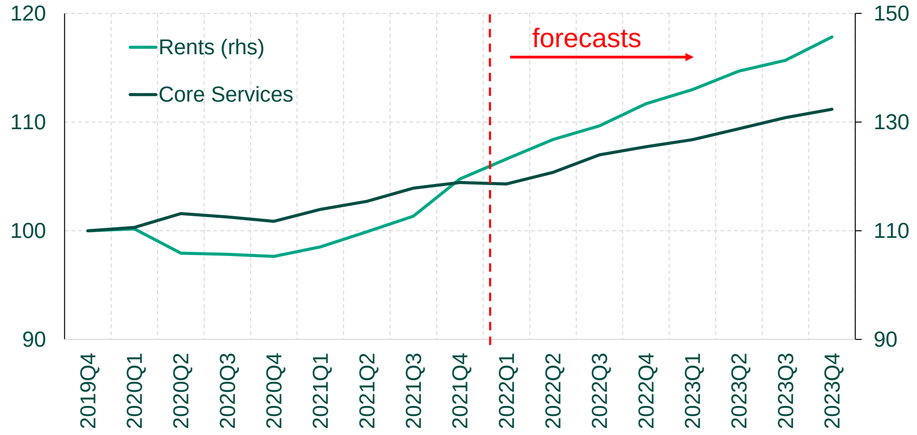
Headline and core HICP, 2019 Q4 = 100



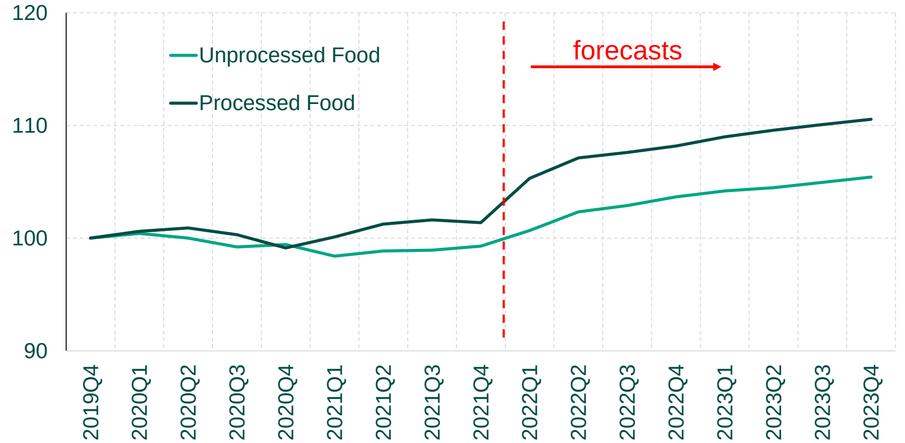
Energy and non-energy industrial goods, 2019 Q4 = 100



Core services and rents, 2019 Q4 = 100



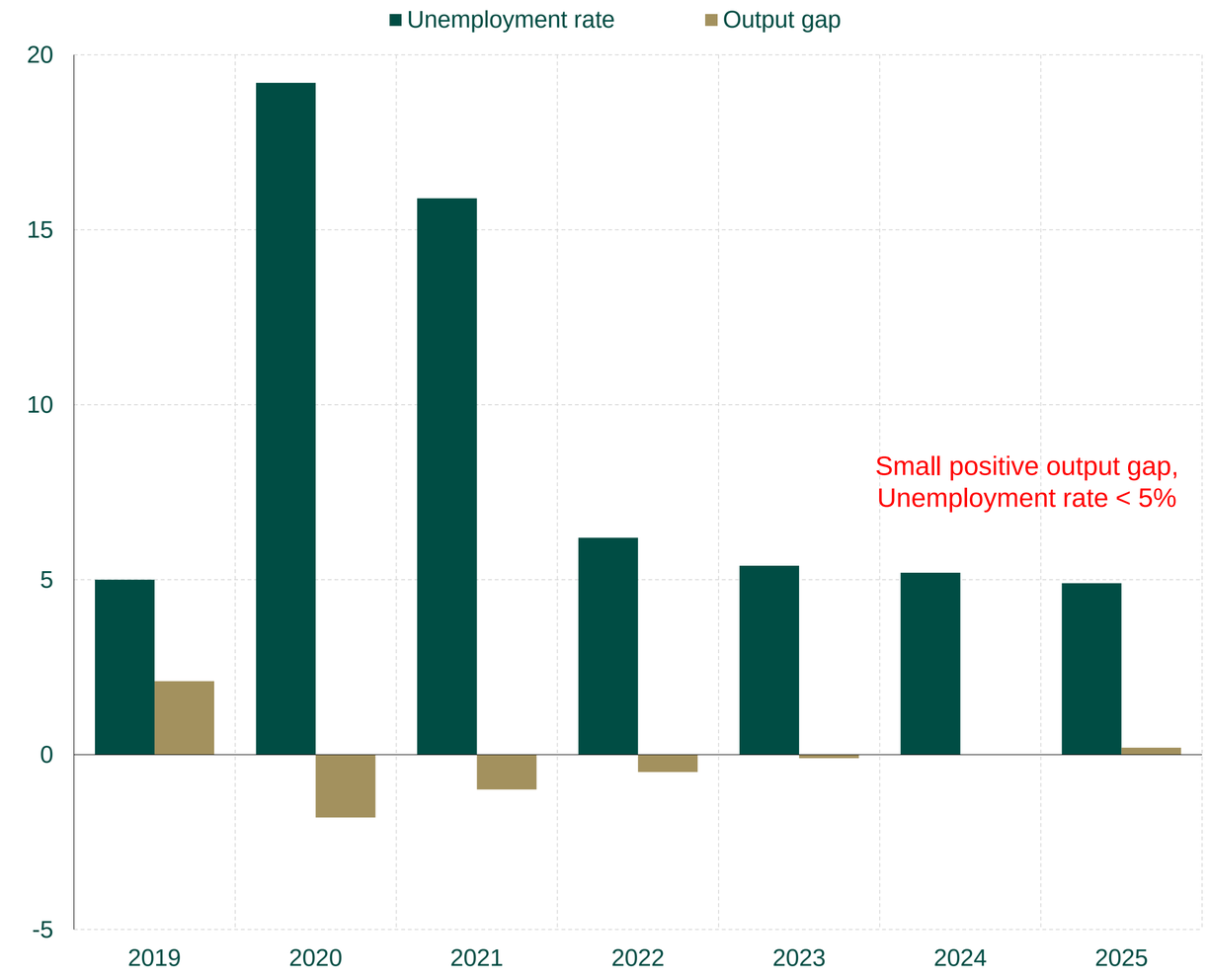
Processed and unprocessed food, 2019 Q4 = 100



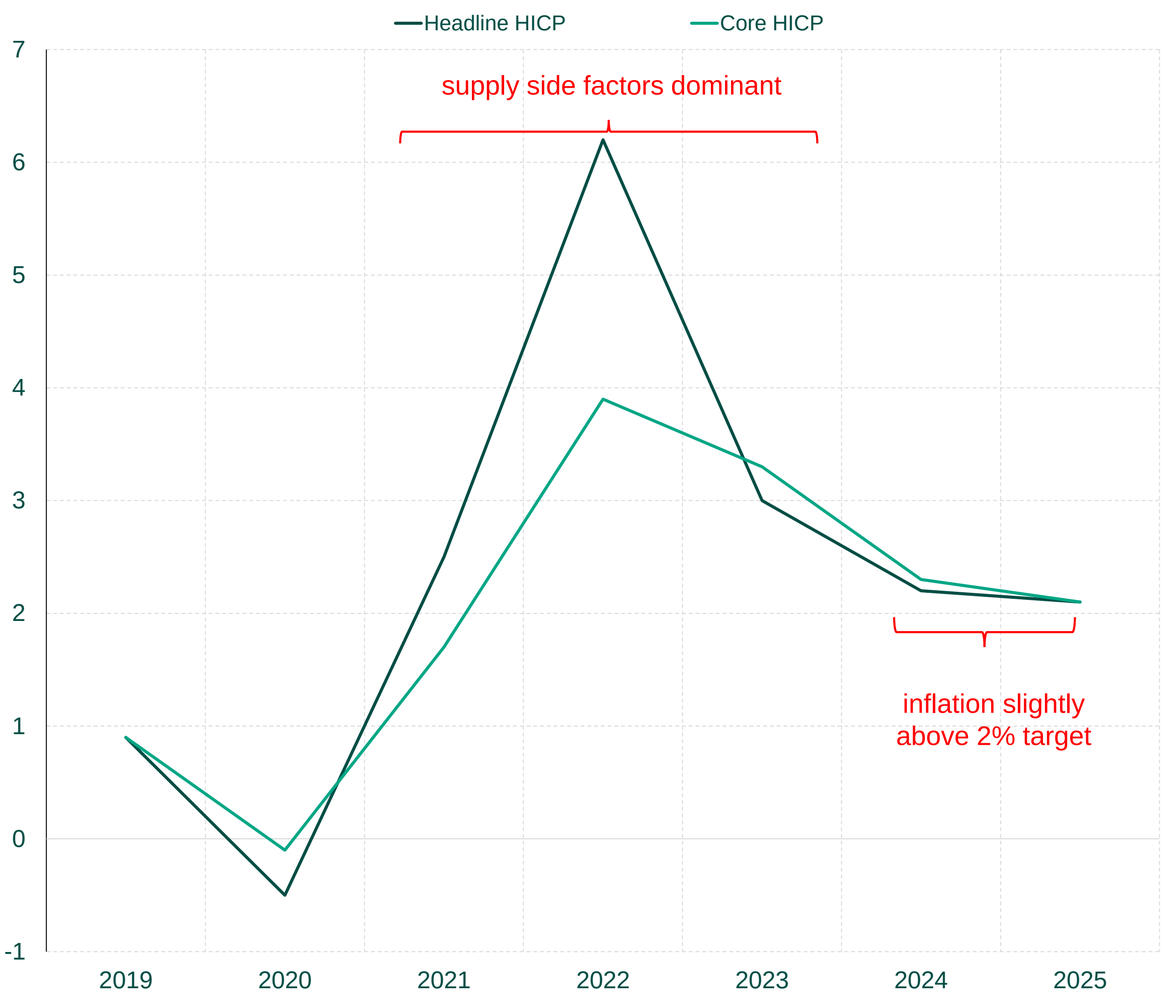
Note: Data are not seasonally adjusted.

Medium term inflation outlook: anchored in price stability

Unemployment rate and output gap, per cent



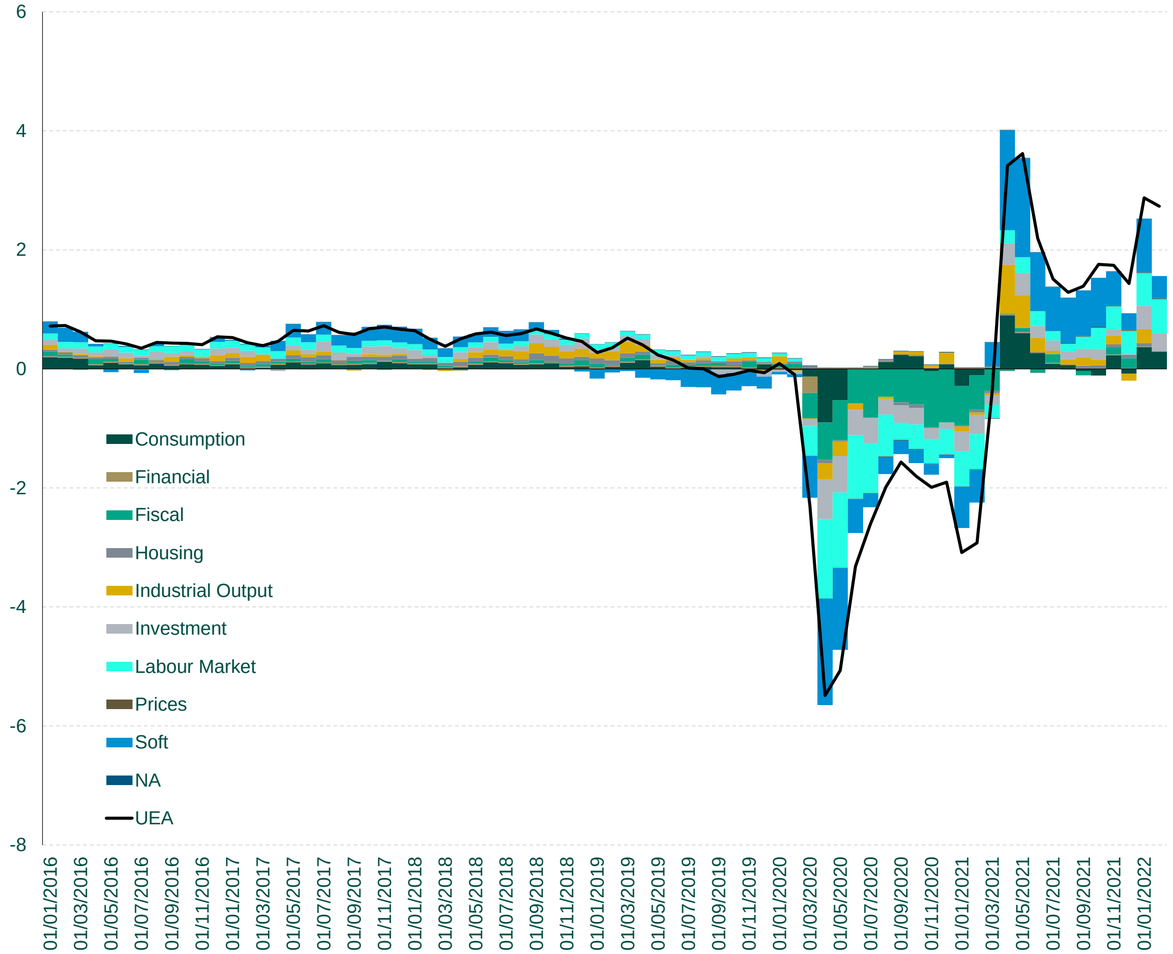
Headline and core HICP, y/y per cent change



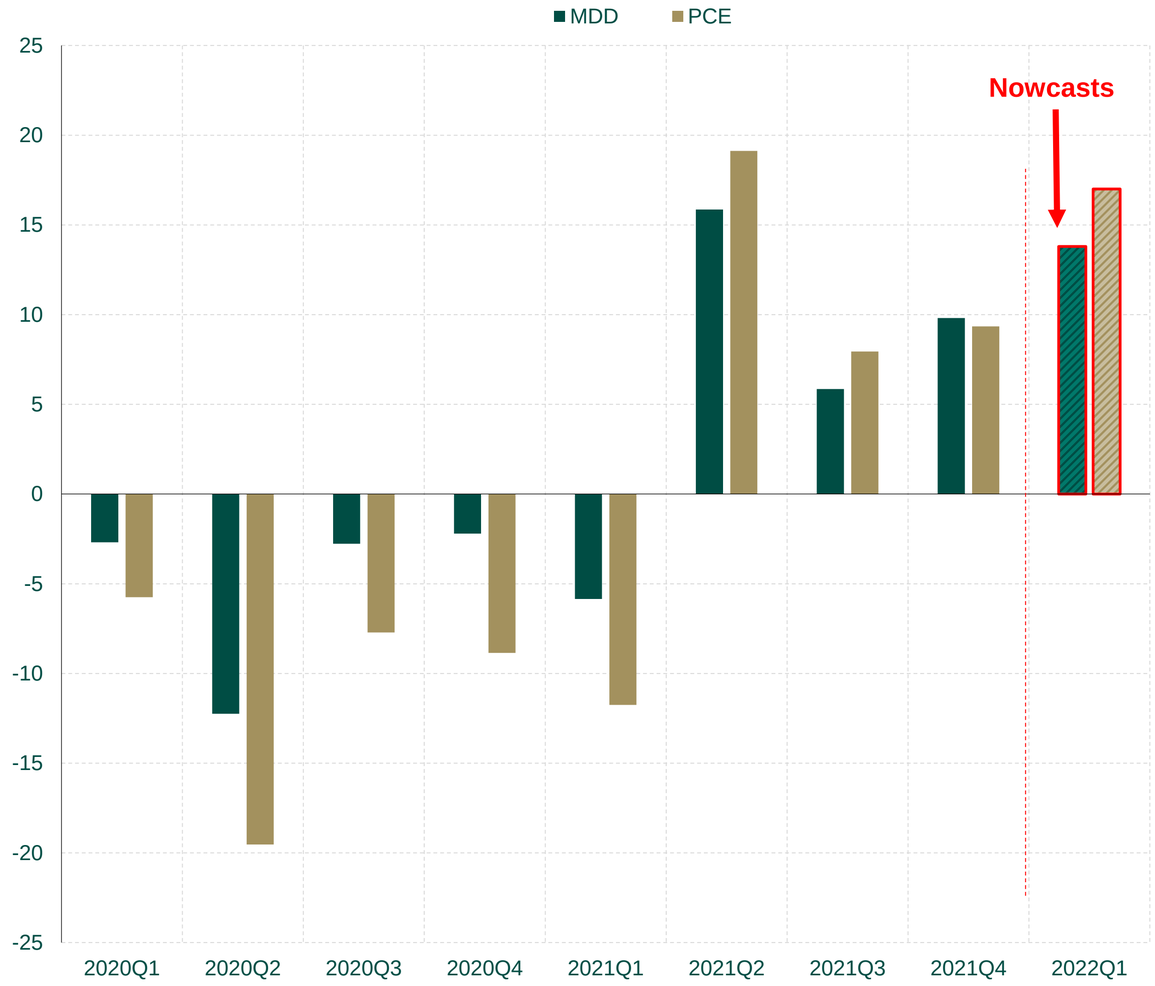
Implications for ‘real’ domestic activity

War impact not yet reflected in Q1 Nowcasts

Underlying Economic Activity (UEA)

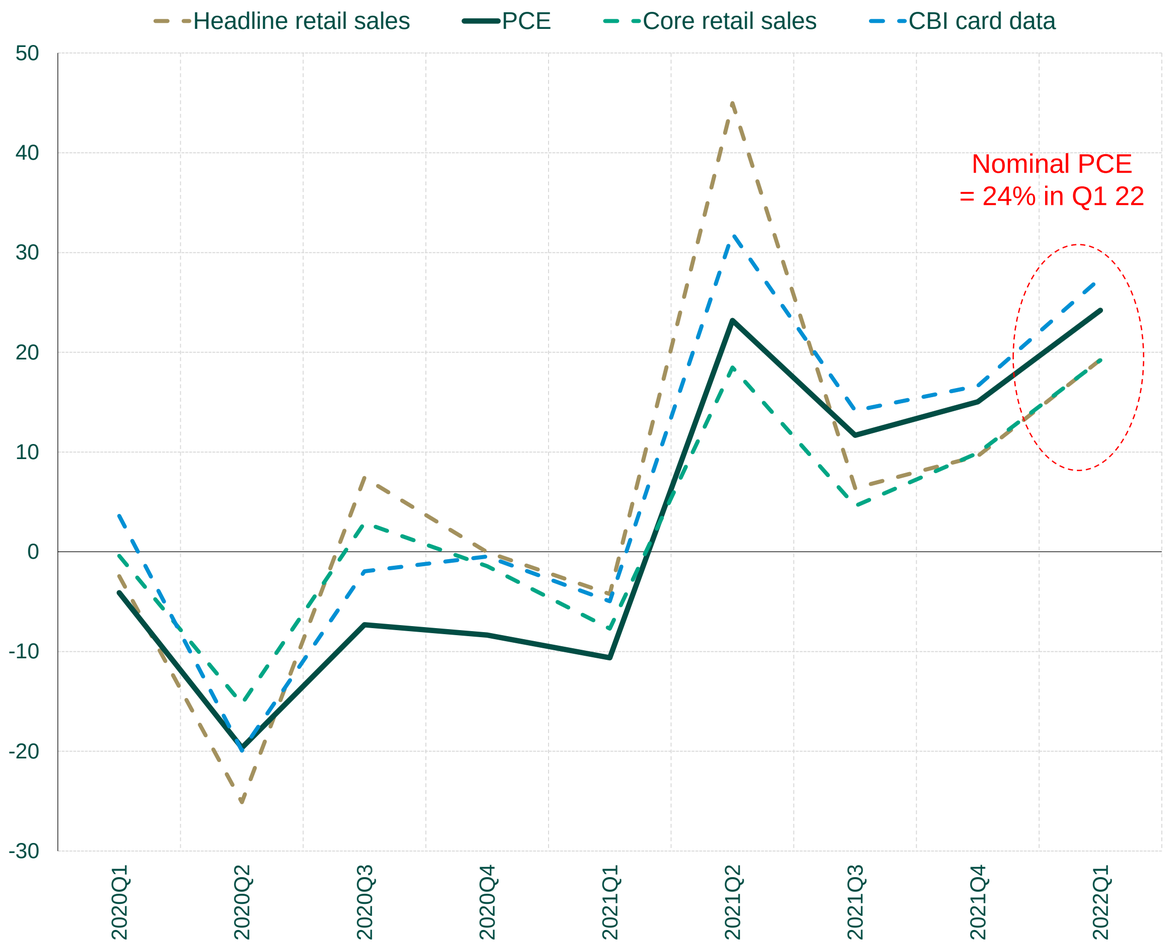


Q1 ‘nowcasts’ for MDD and PCE, y/y per cent change

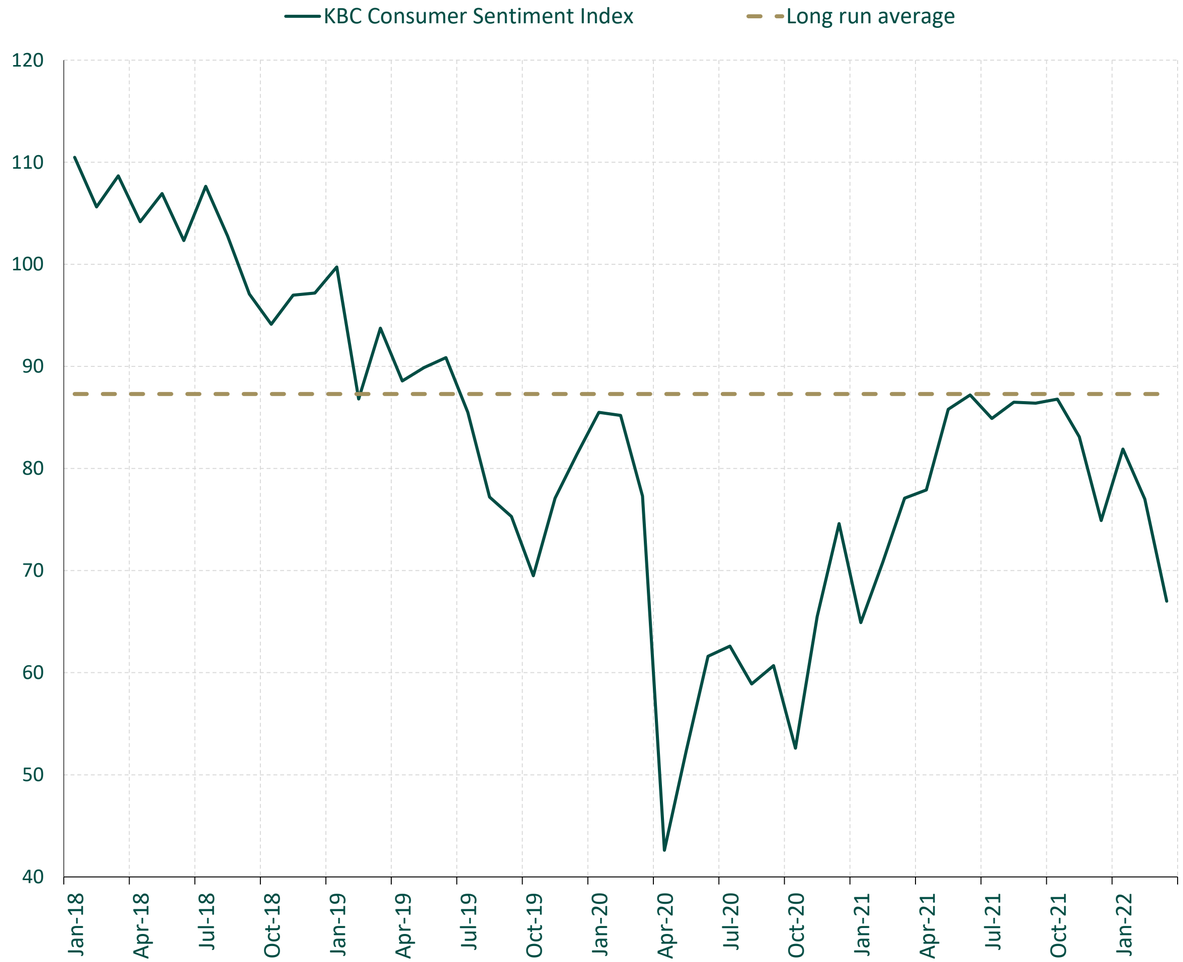


Consumer spending: high frequency data for Q1 2022

High frequency indicators, y/y per cent change

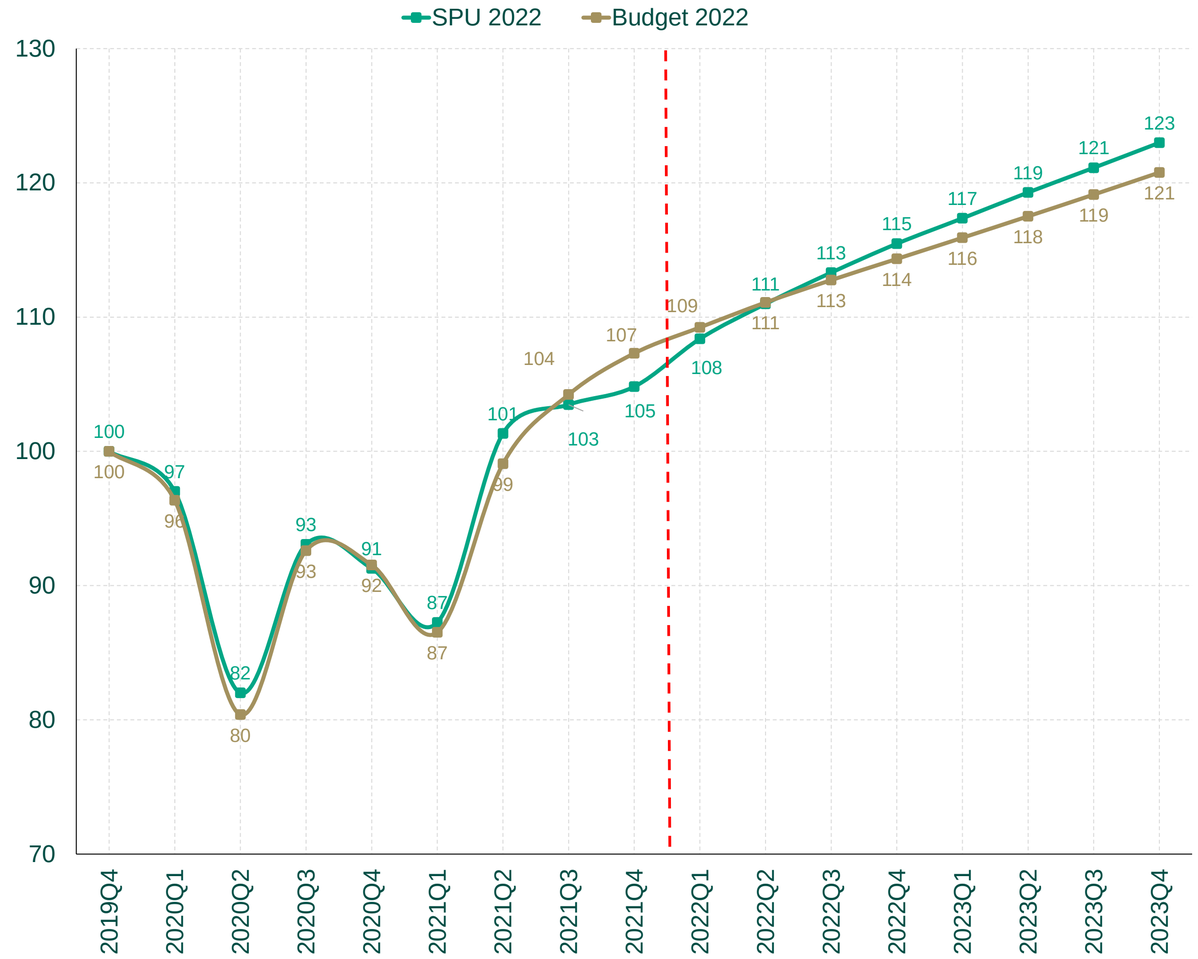


KBC Consumer Sentiment Index

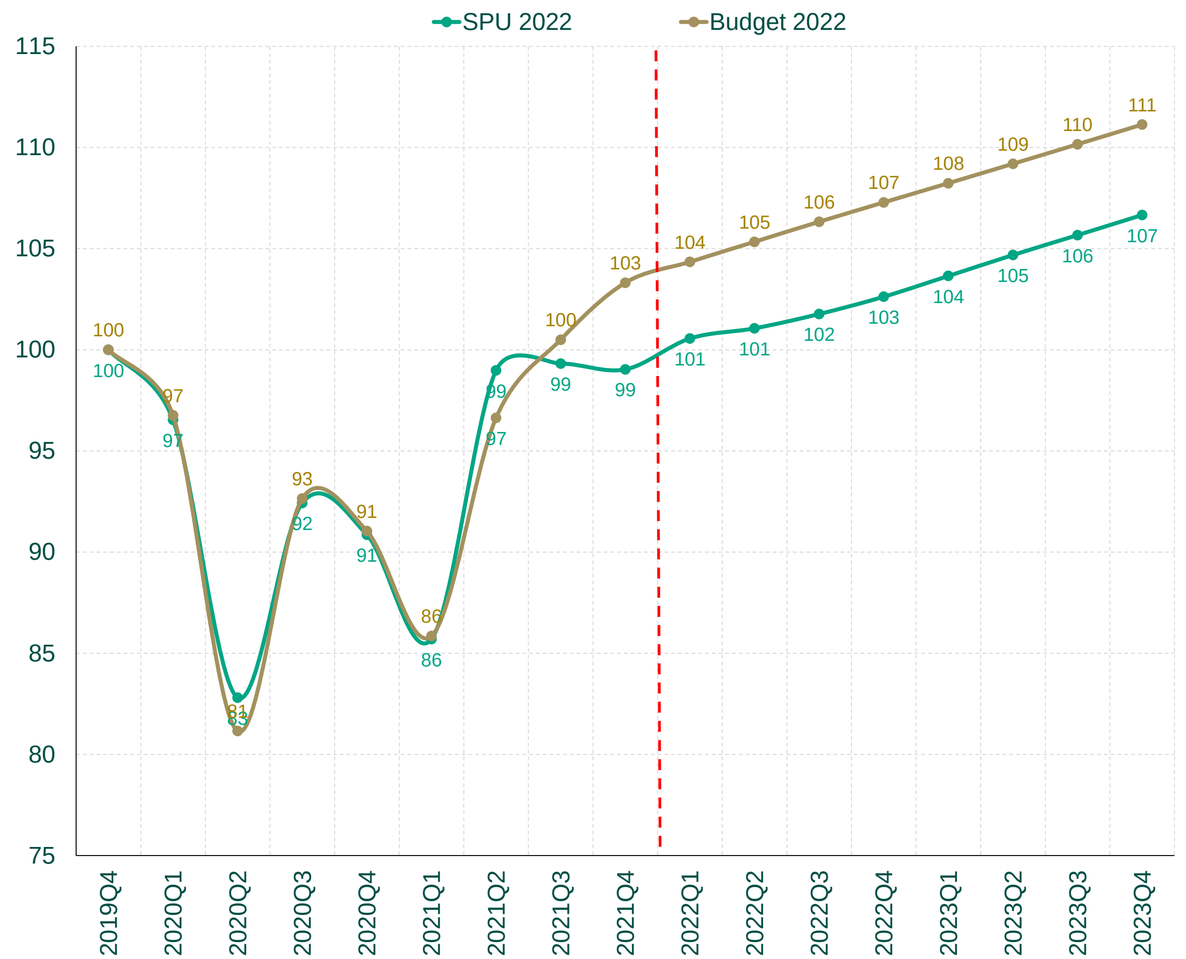


Consumer spending: higher inflation weighs on real spending

Nominal consumer spending, 2019Q4 = 100

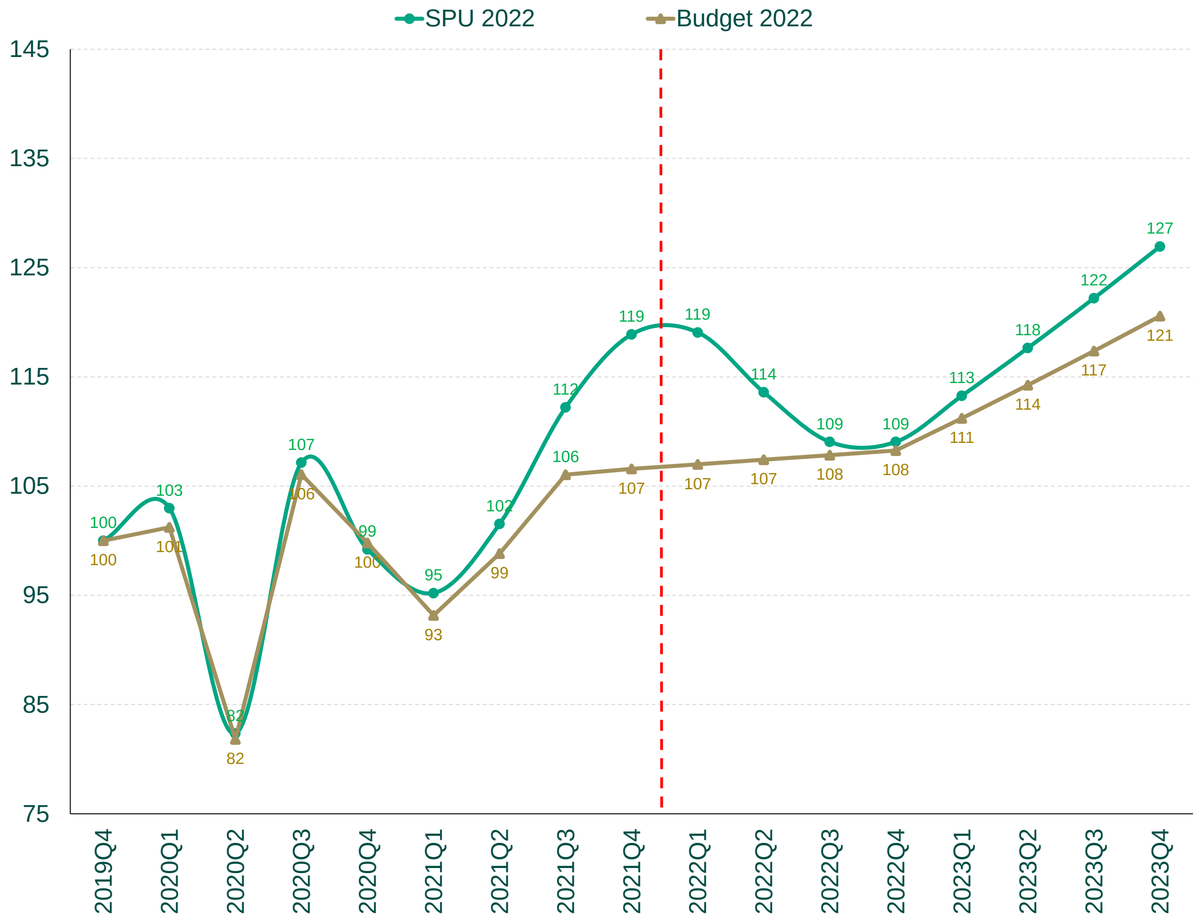


Real consumer spending, 2019Q4 = 100

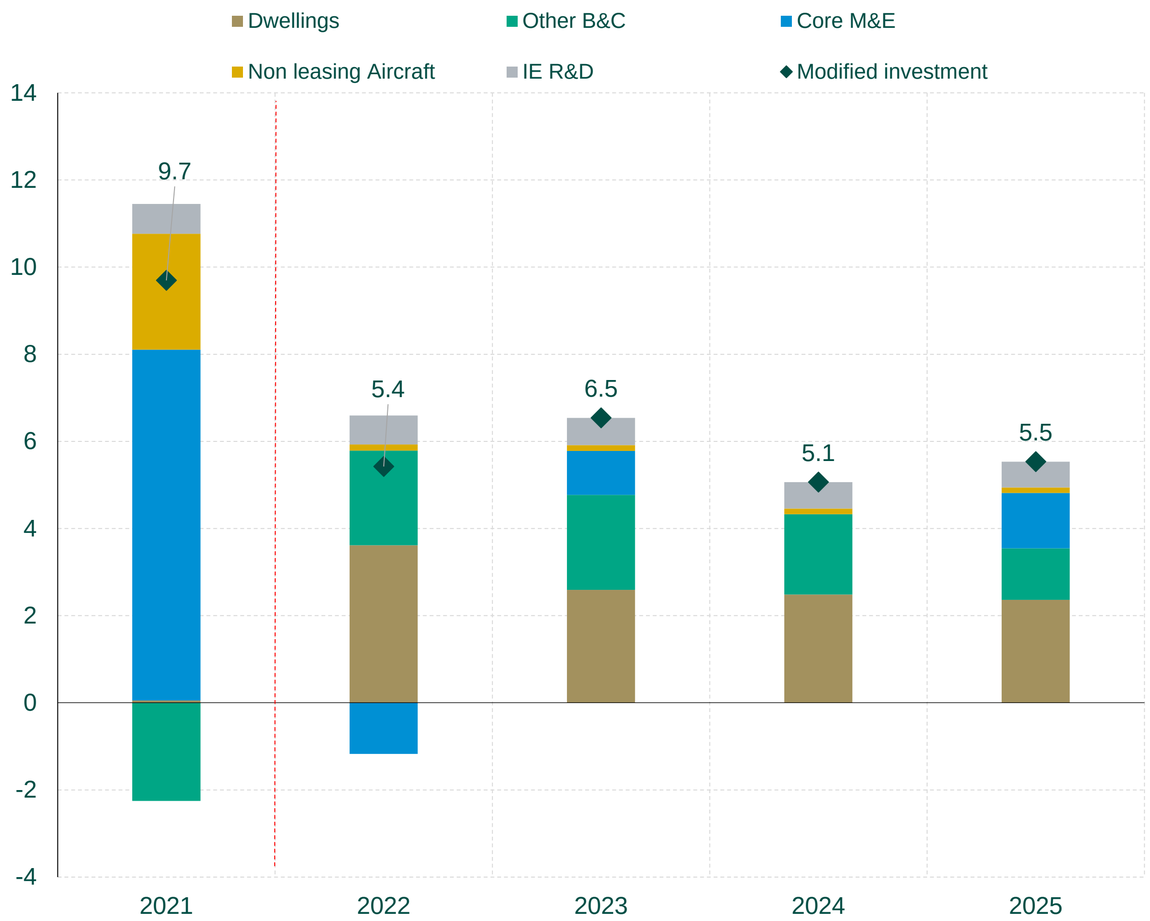


Uncertainty to weigh on (modified) investment

Real modified investment, 2019Q4 = 100

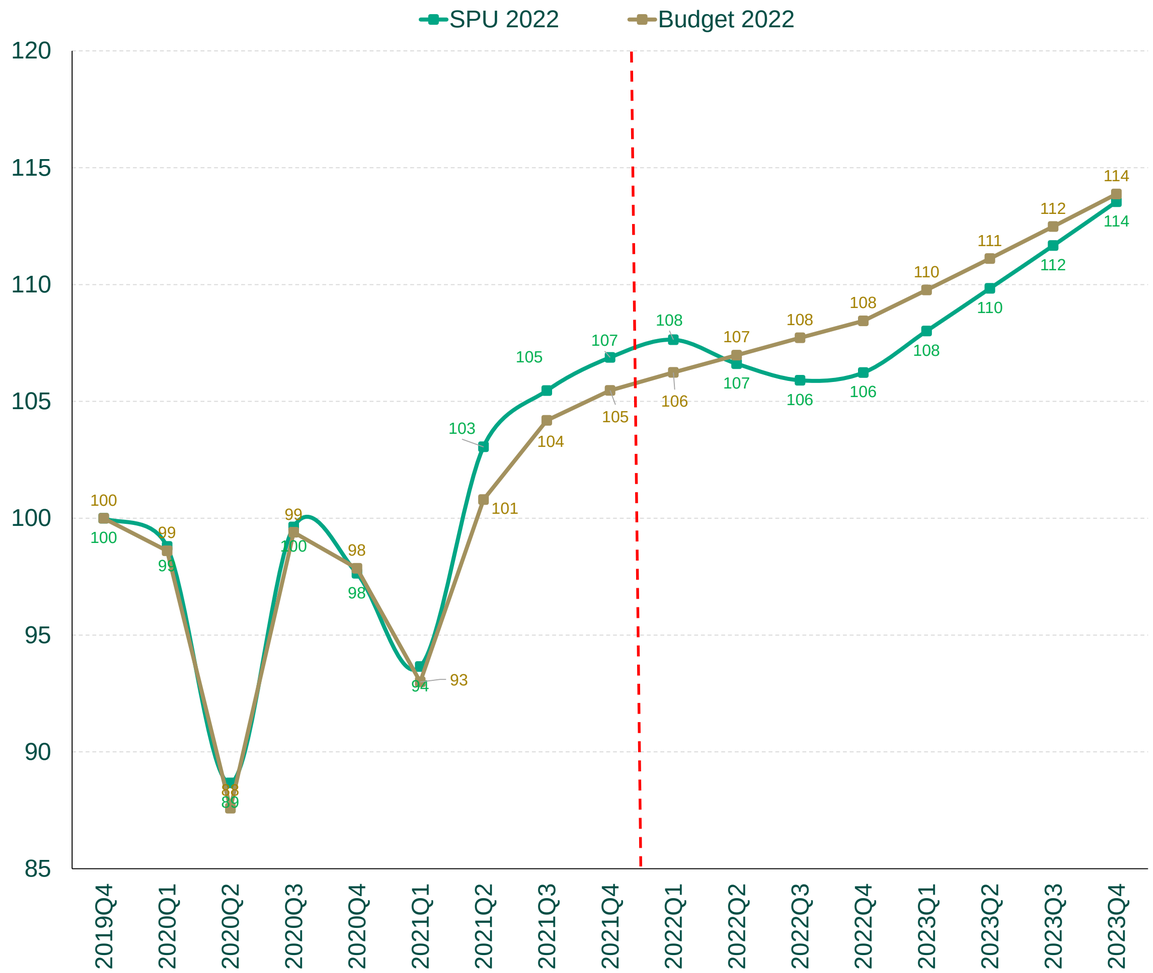


Modified investment: contribution, pp

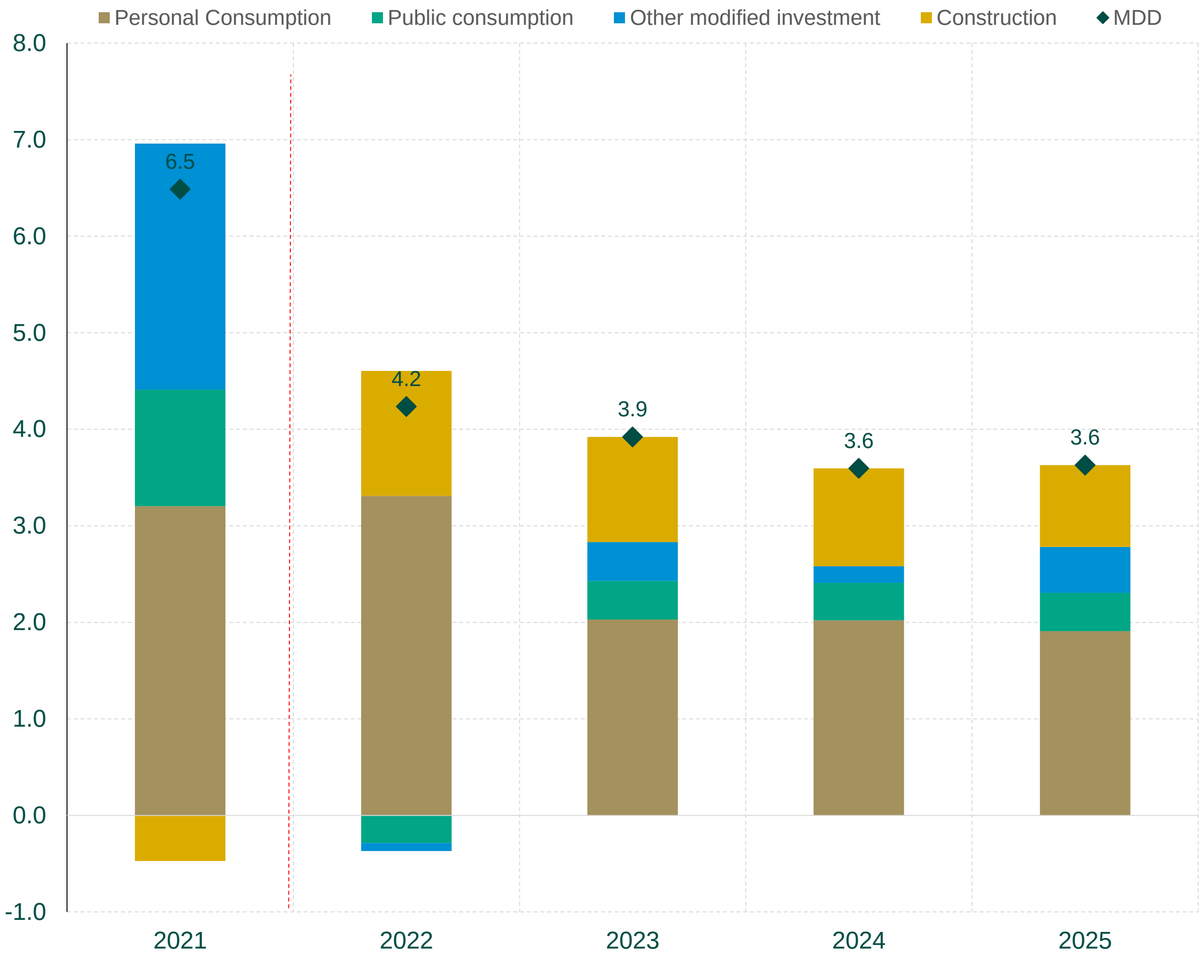


Modified Domestic Demand

Real MDD growth, 2019Q4 = 100

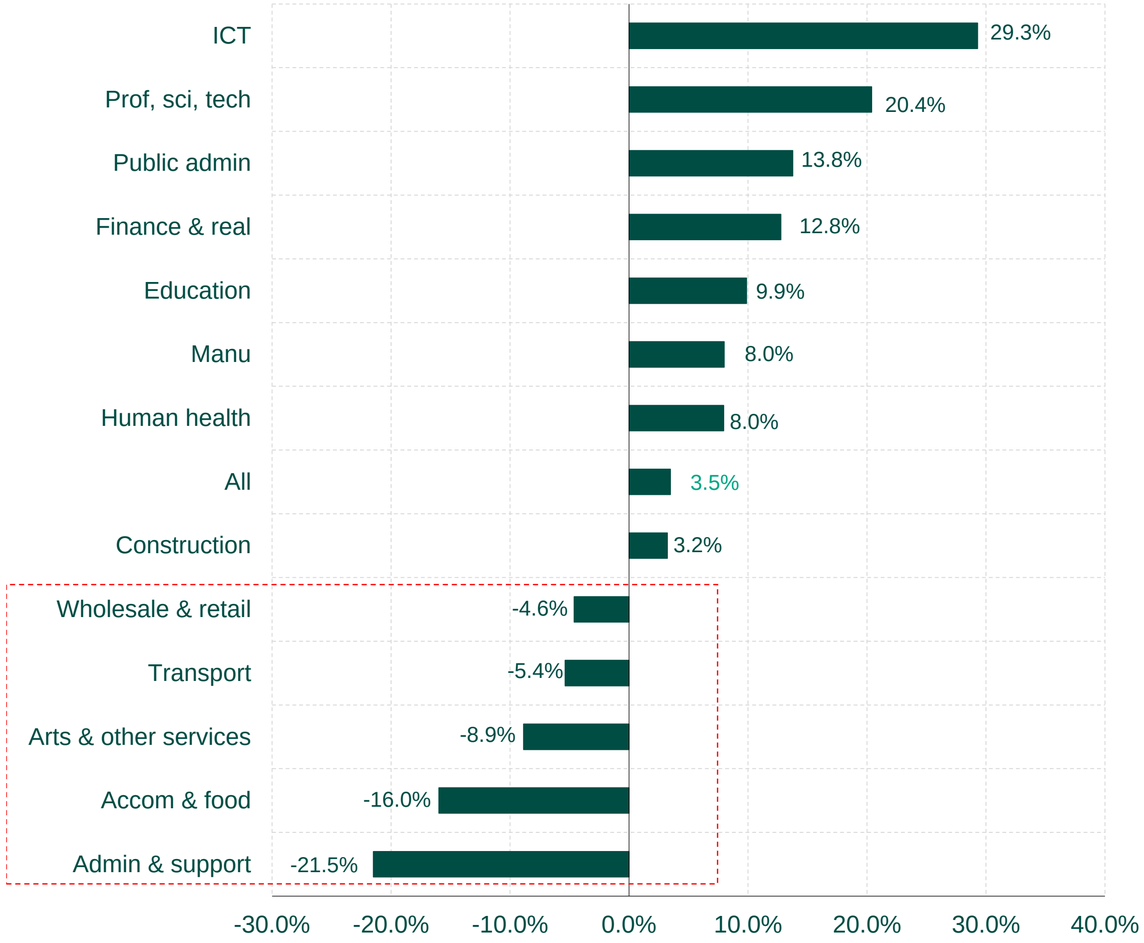


MDD Contribution Chart

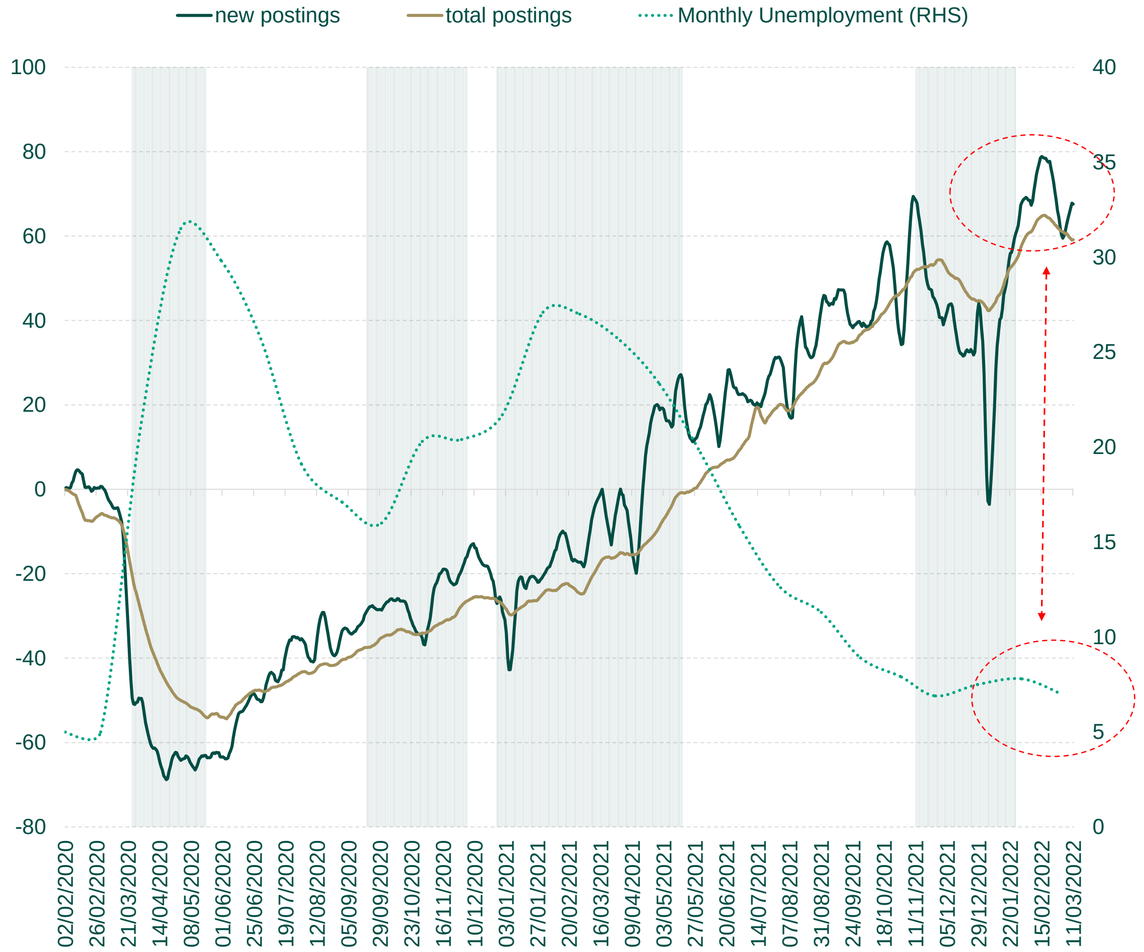


Pandemic impact on labour market beginning to unwind

COVID-adjusted employment, per cent change Q421/Q419



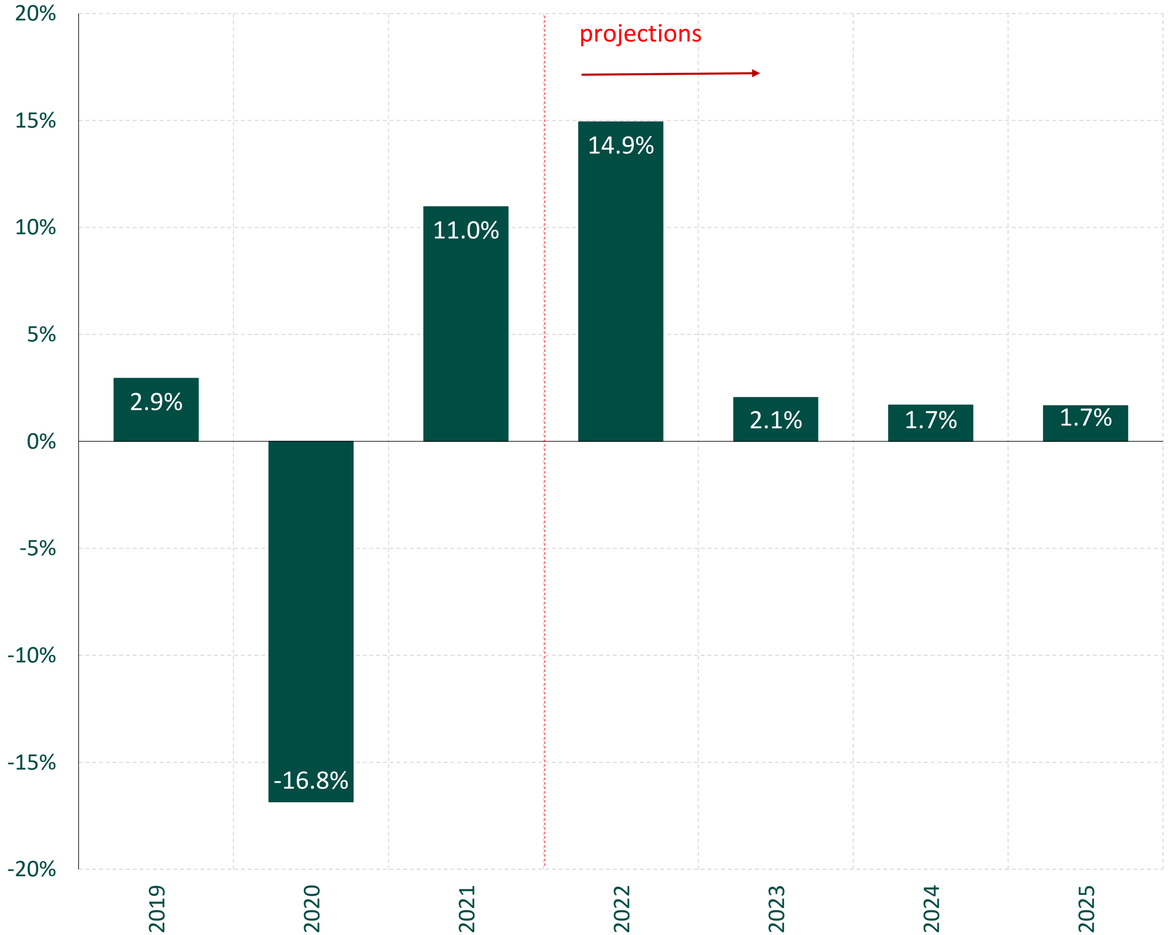
Indeed job postings, 7-day trailing avg. relative to February 2020



Labour market dynamics: employment now above pre-pandemic levels

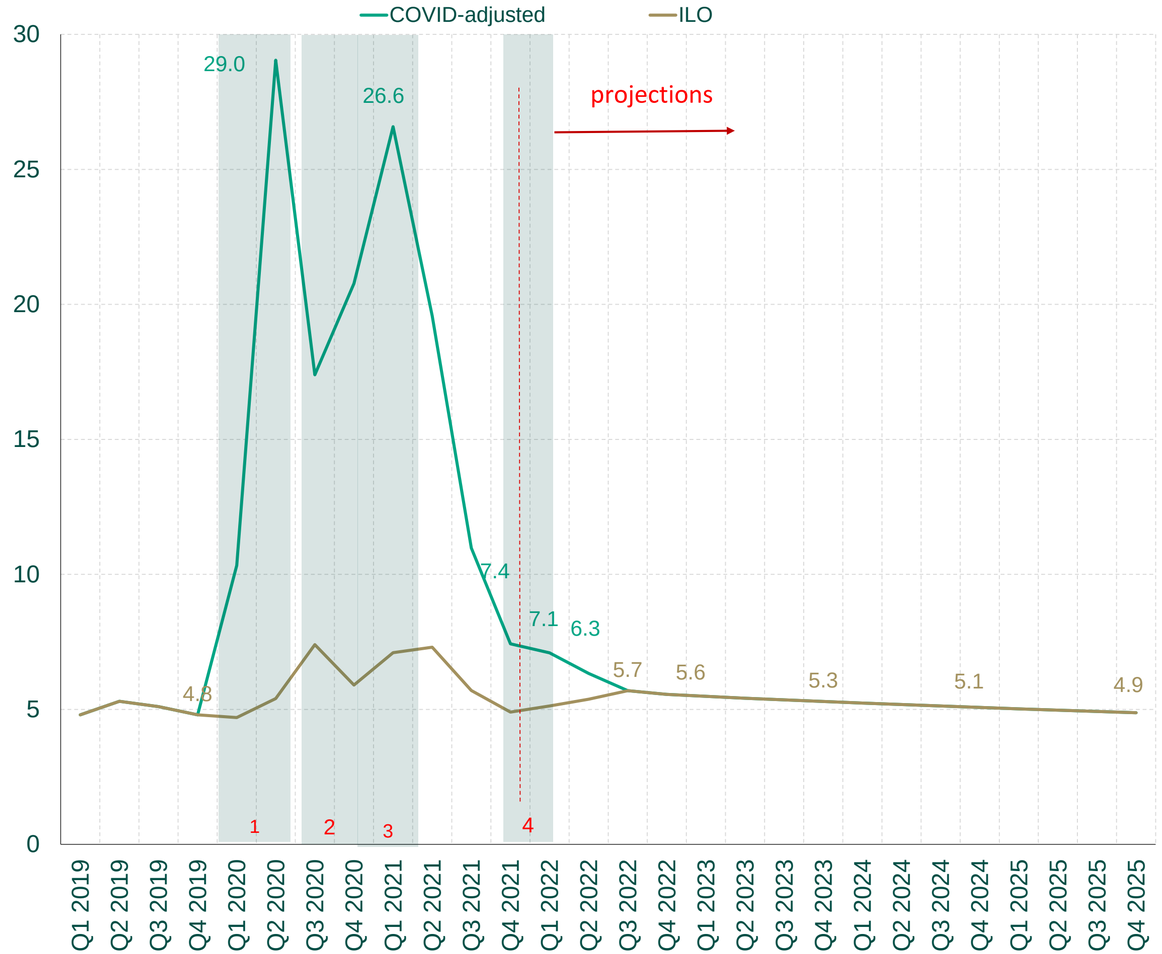
Employment – quarterly, 000, s.a.

Employment – annual growth rate, per cent

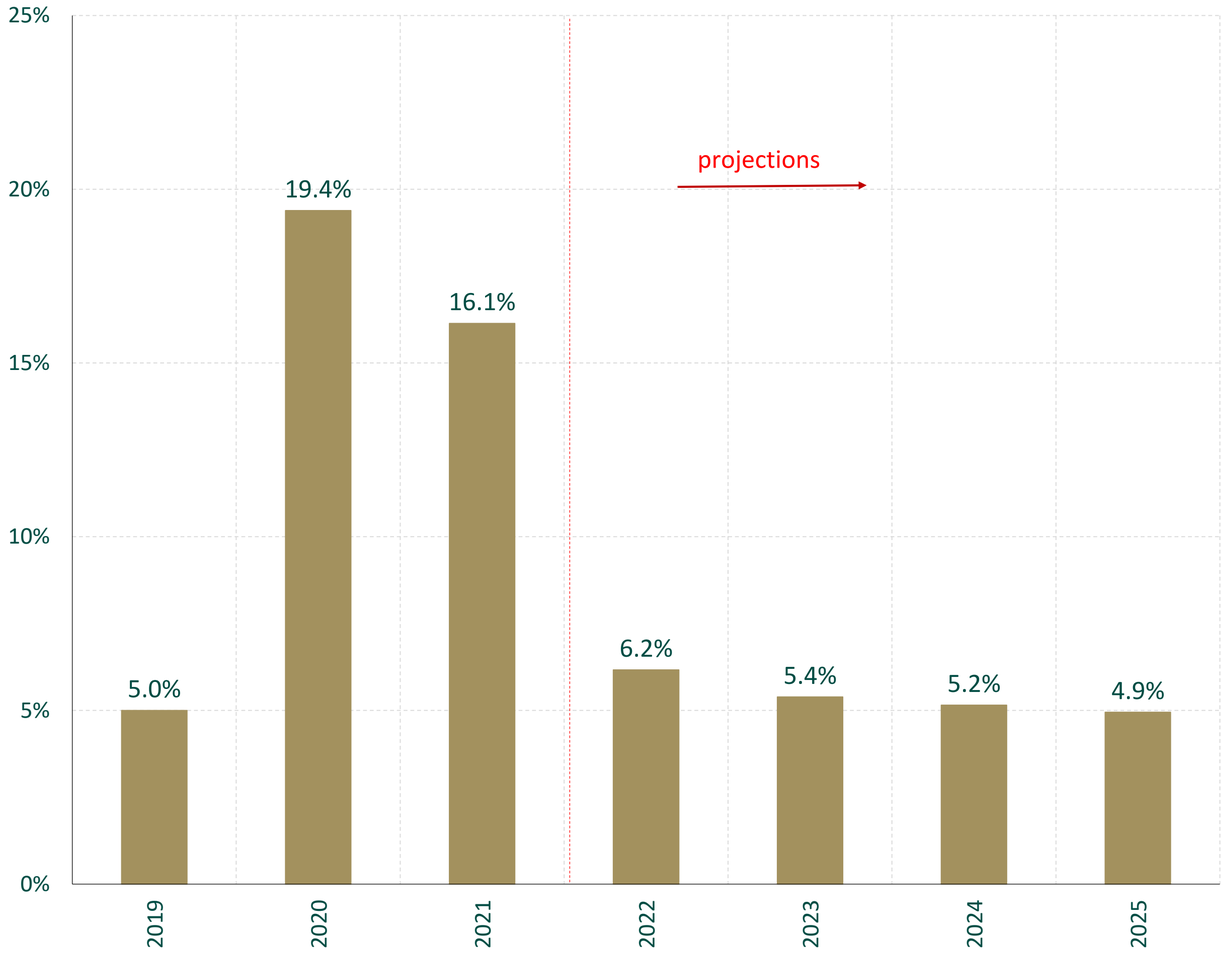


Unemployment projections assume slower recovery

Unemployment - quarterly, per cent s.a.

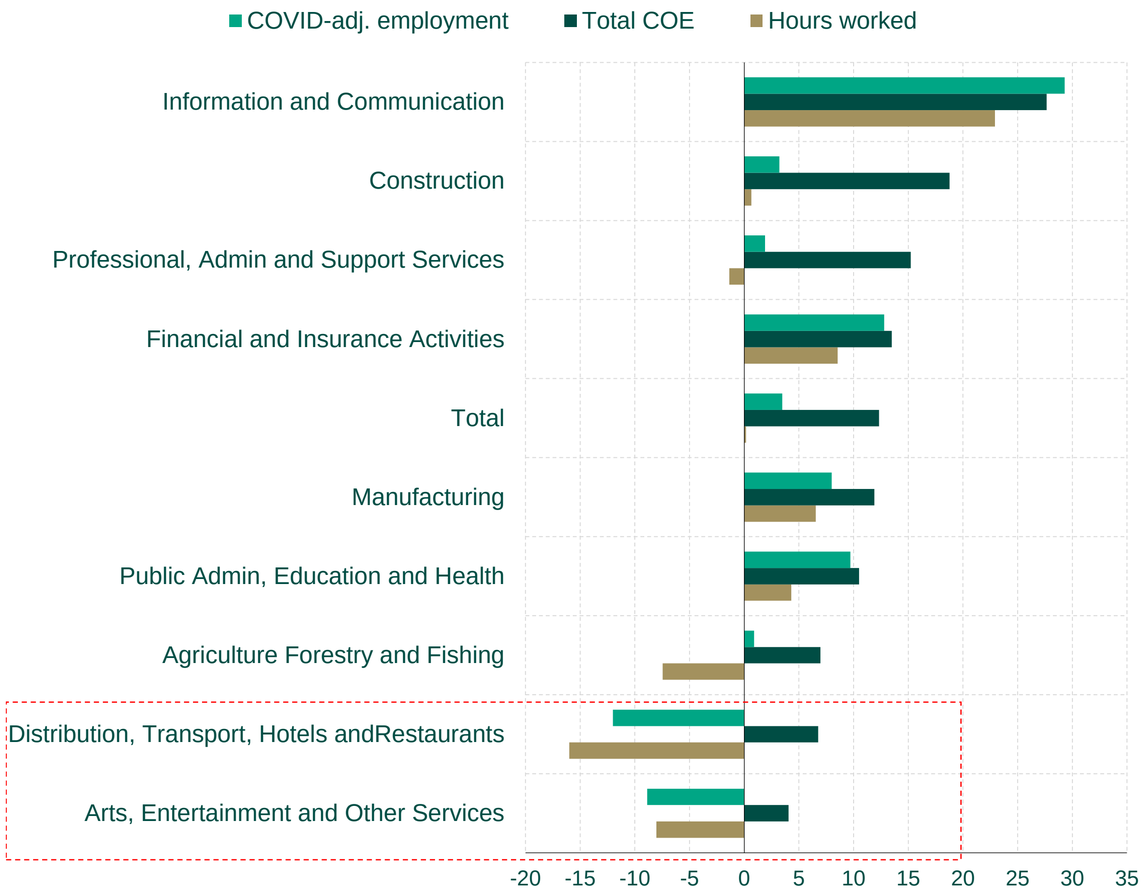


Unemployment – annual rate, per cent

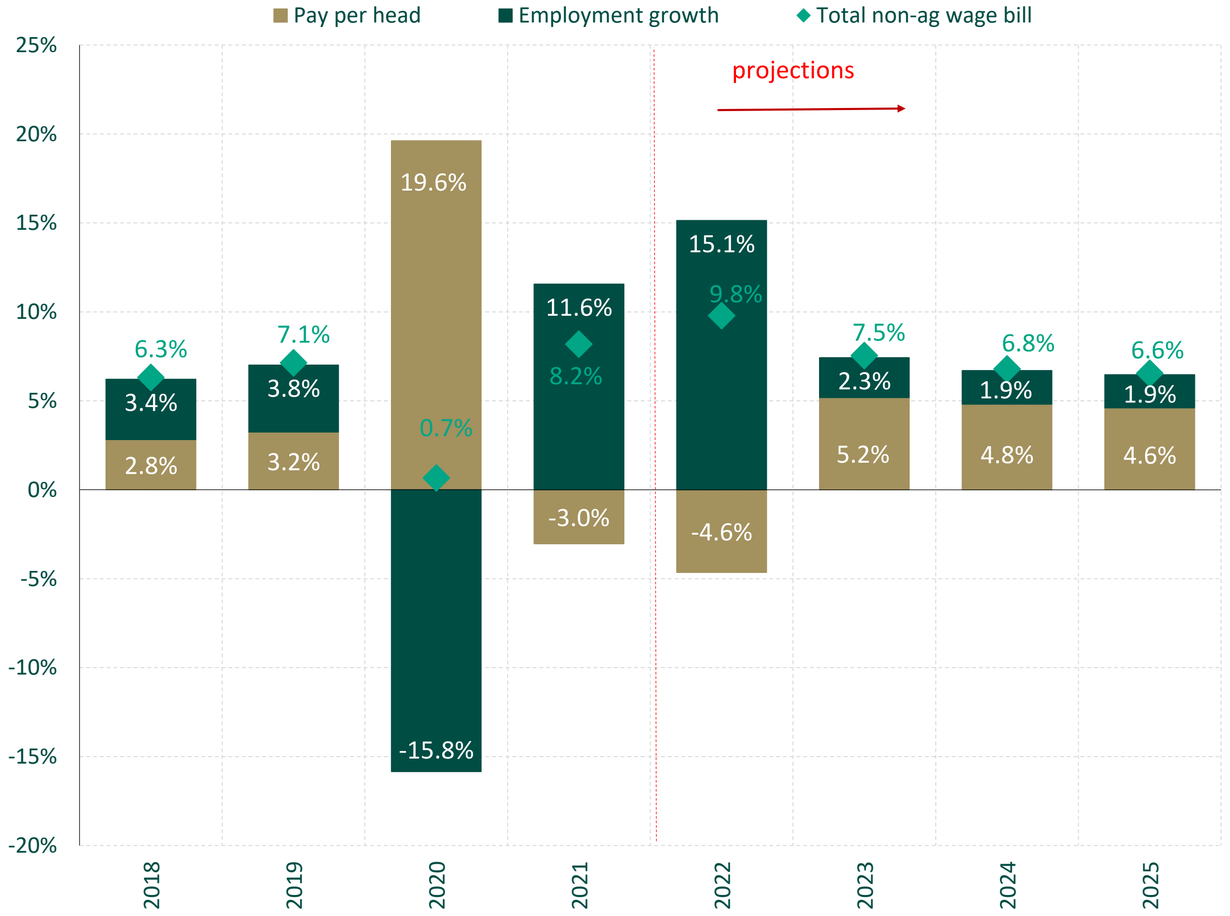


Evolution of national wage bill

Evolution of pay versus pre-pandemic, per cent change Q421/Q419

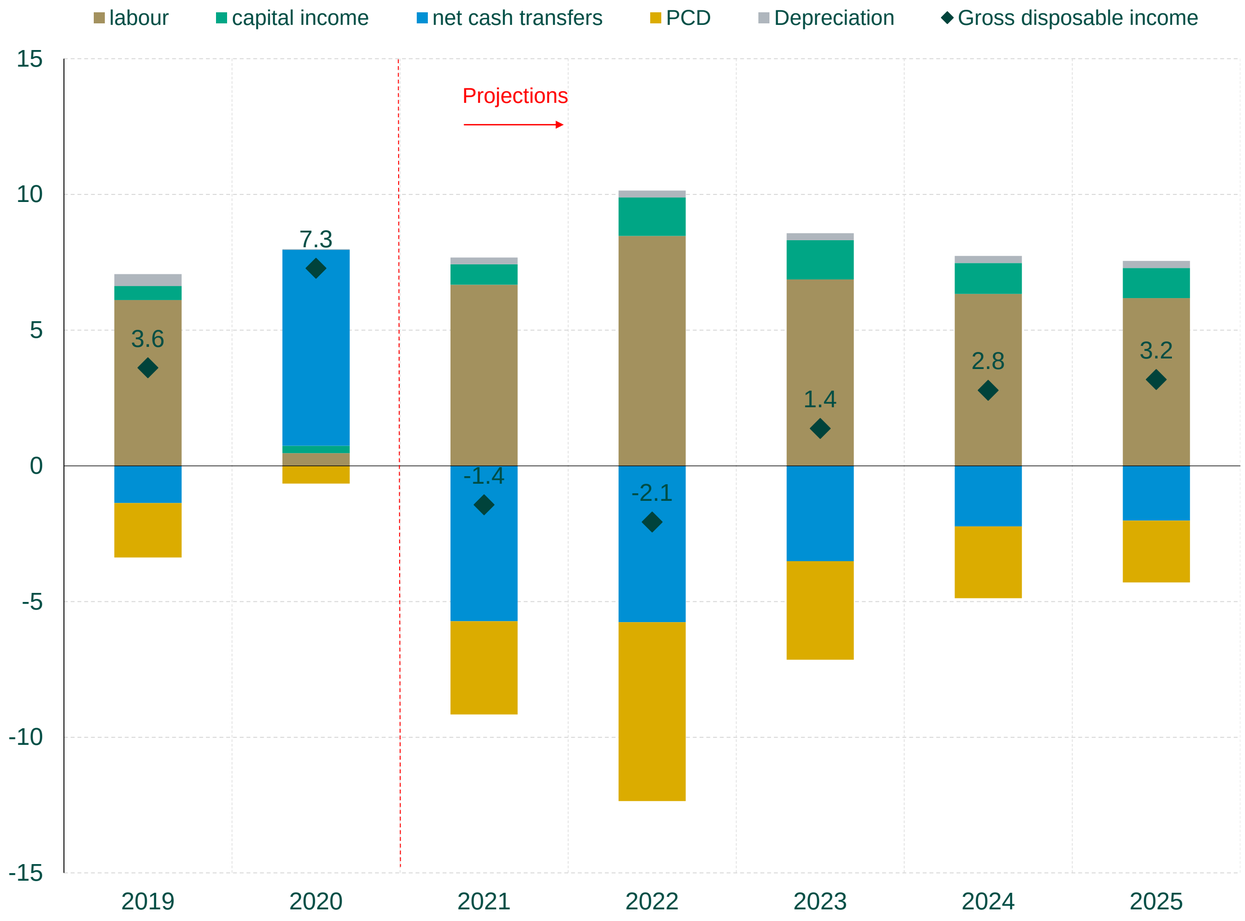


Decomposition of total wage bill, per cent

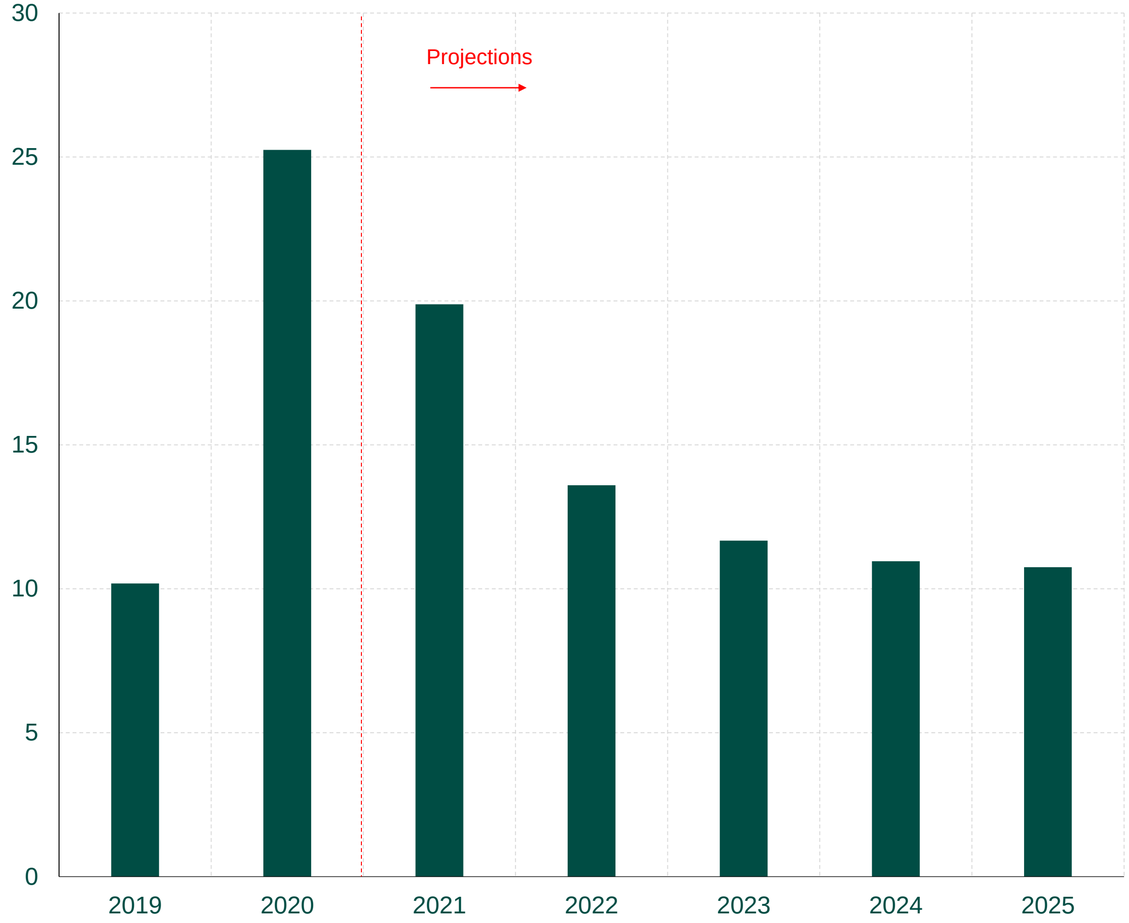


Household disposable income and its allocation

Gross Disposable Income – contributions, pp



Household Savings rate, per cent Y_d

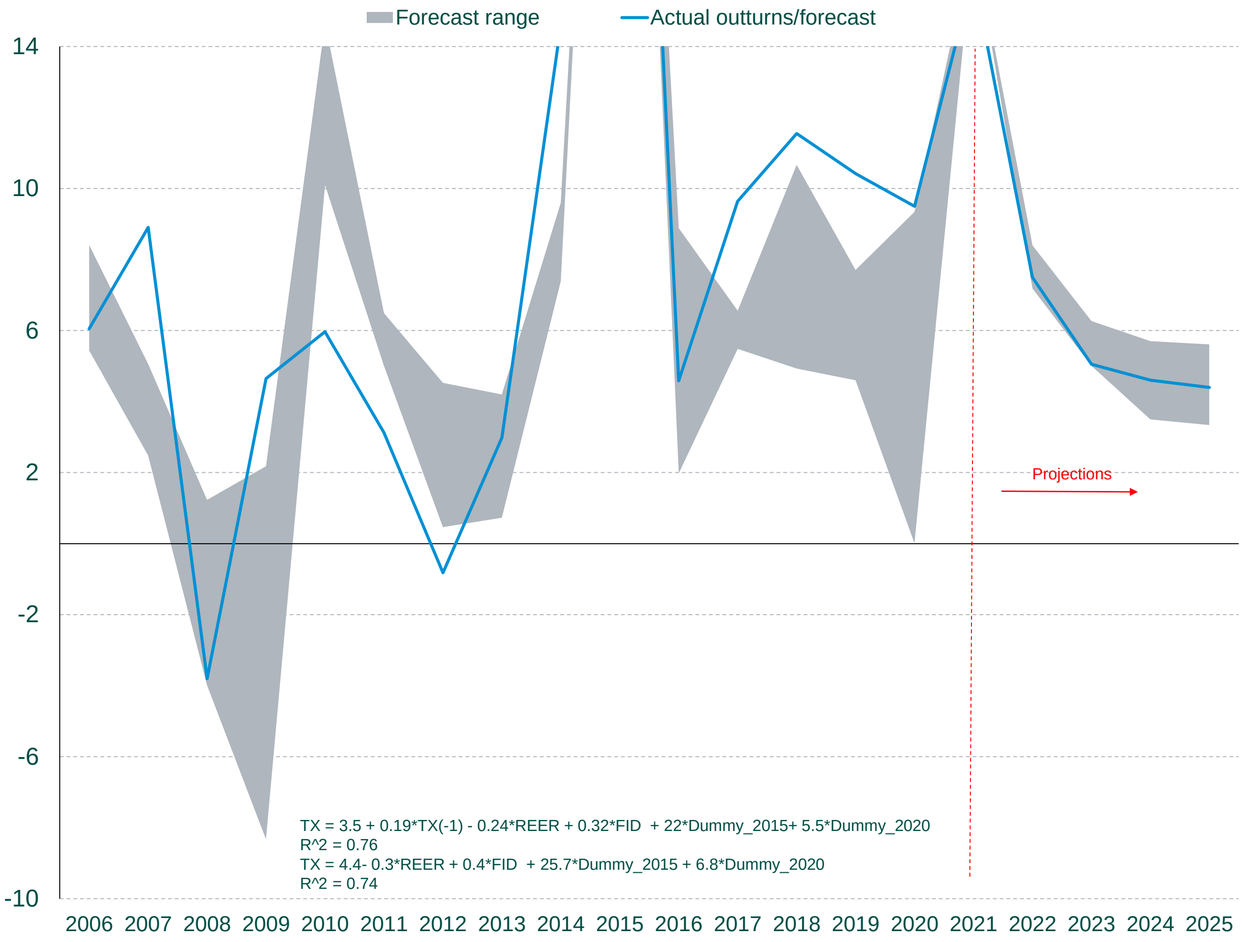


External developments and implications for trade

Export portfolio a source of resilience

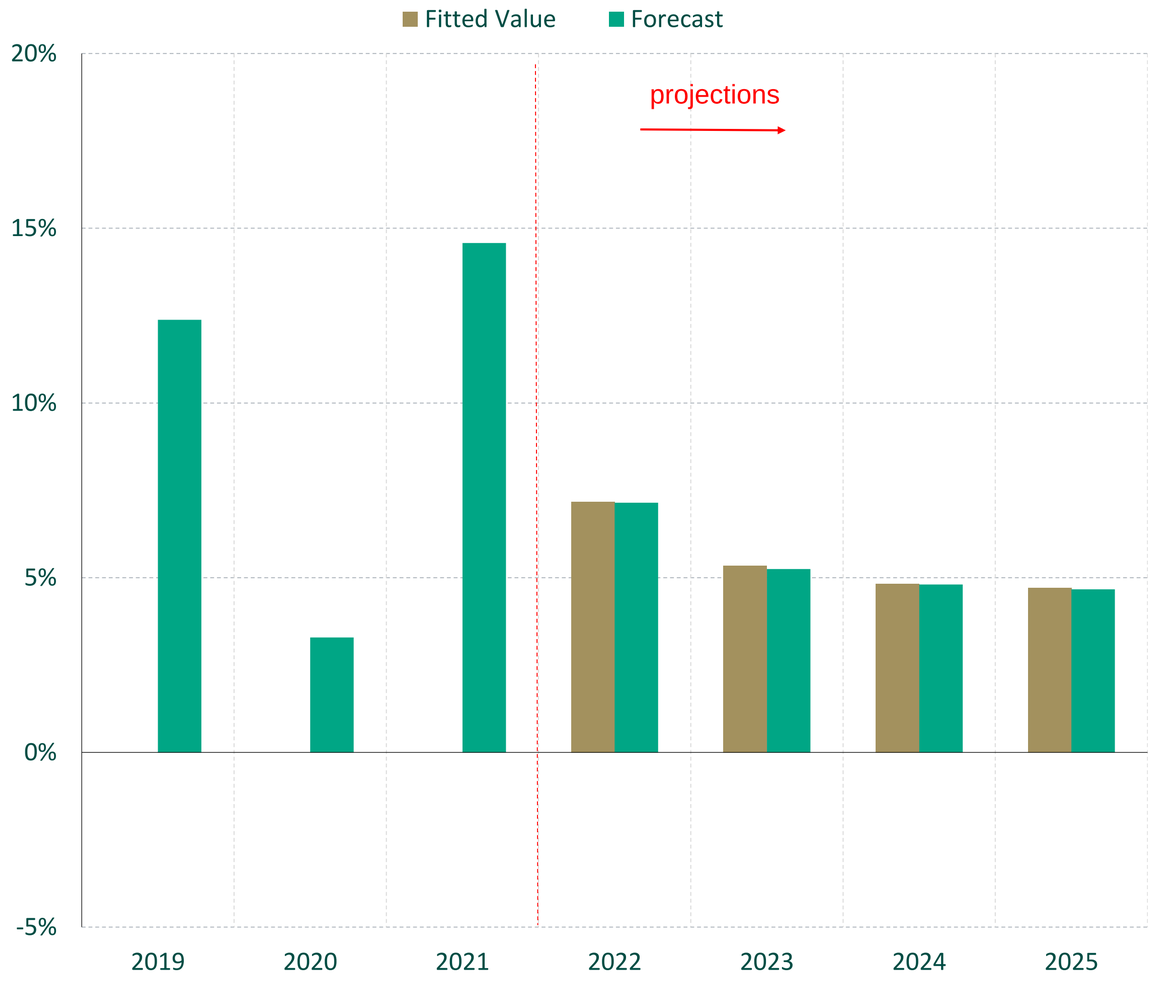
Export growth – services becoming dominant, pp contribution to change

Export models, per cent change

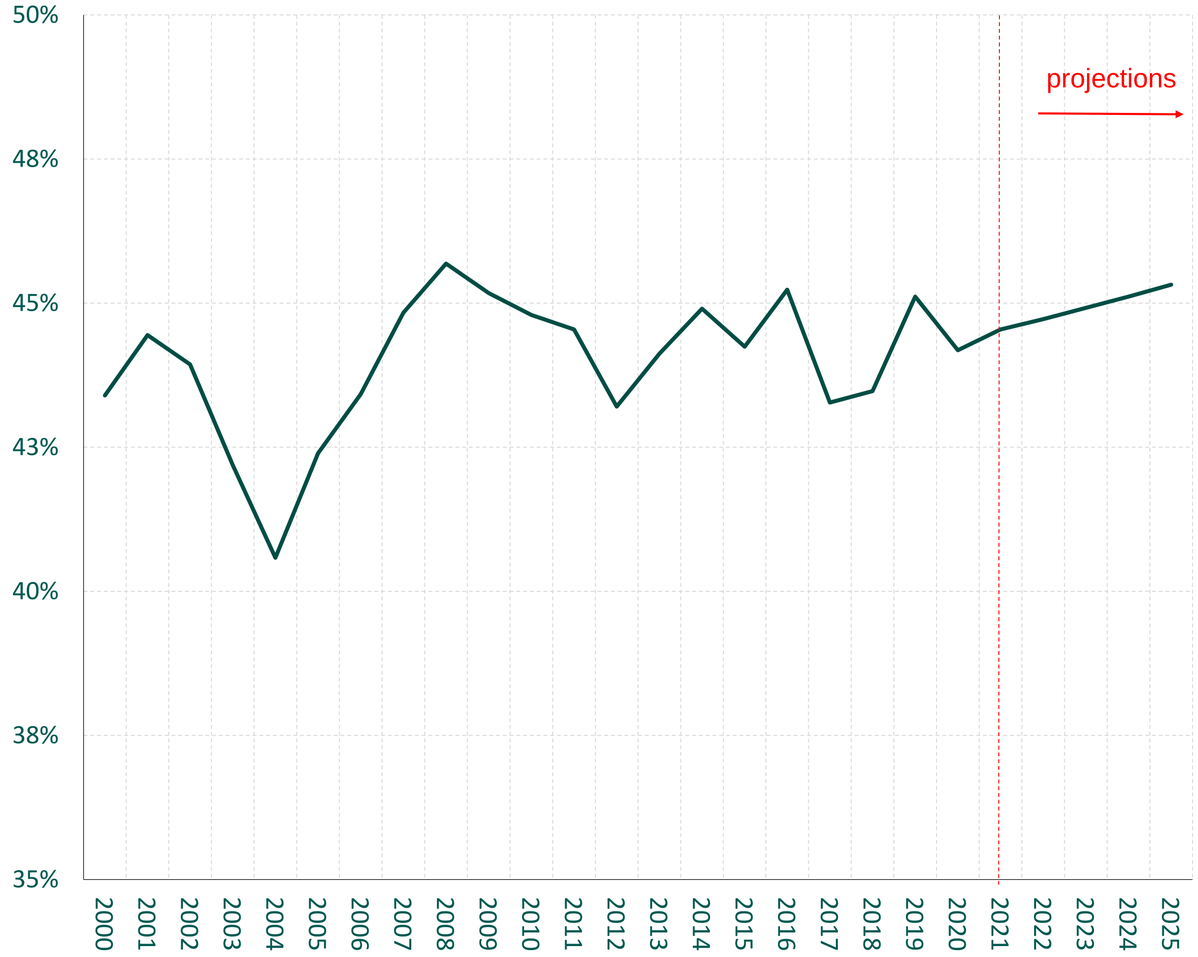


Modified import growth driven by MDD and Exports

Modified imports, y/y % change

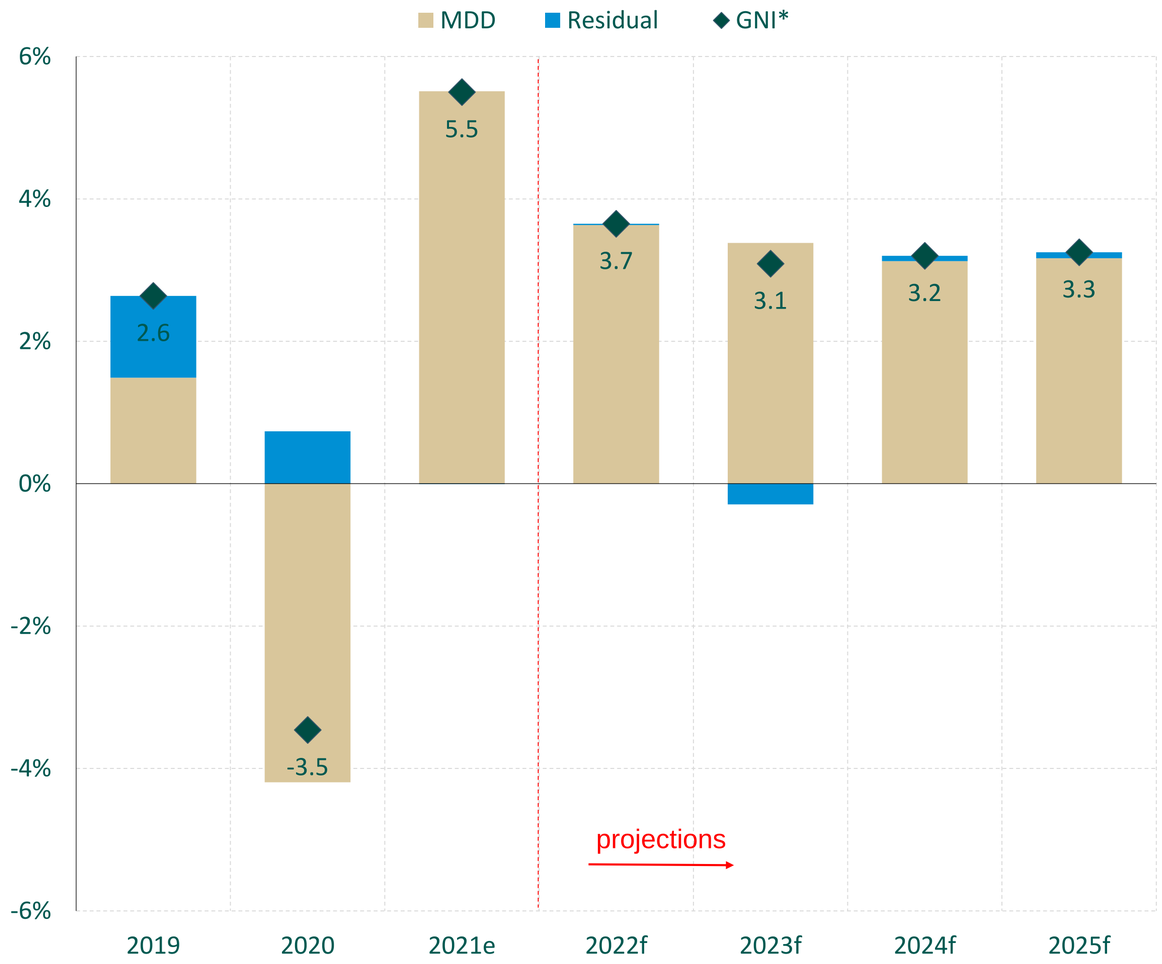


Modified import share of modified final demand, per cent

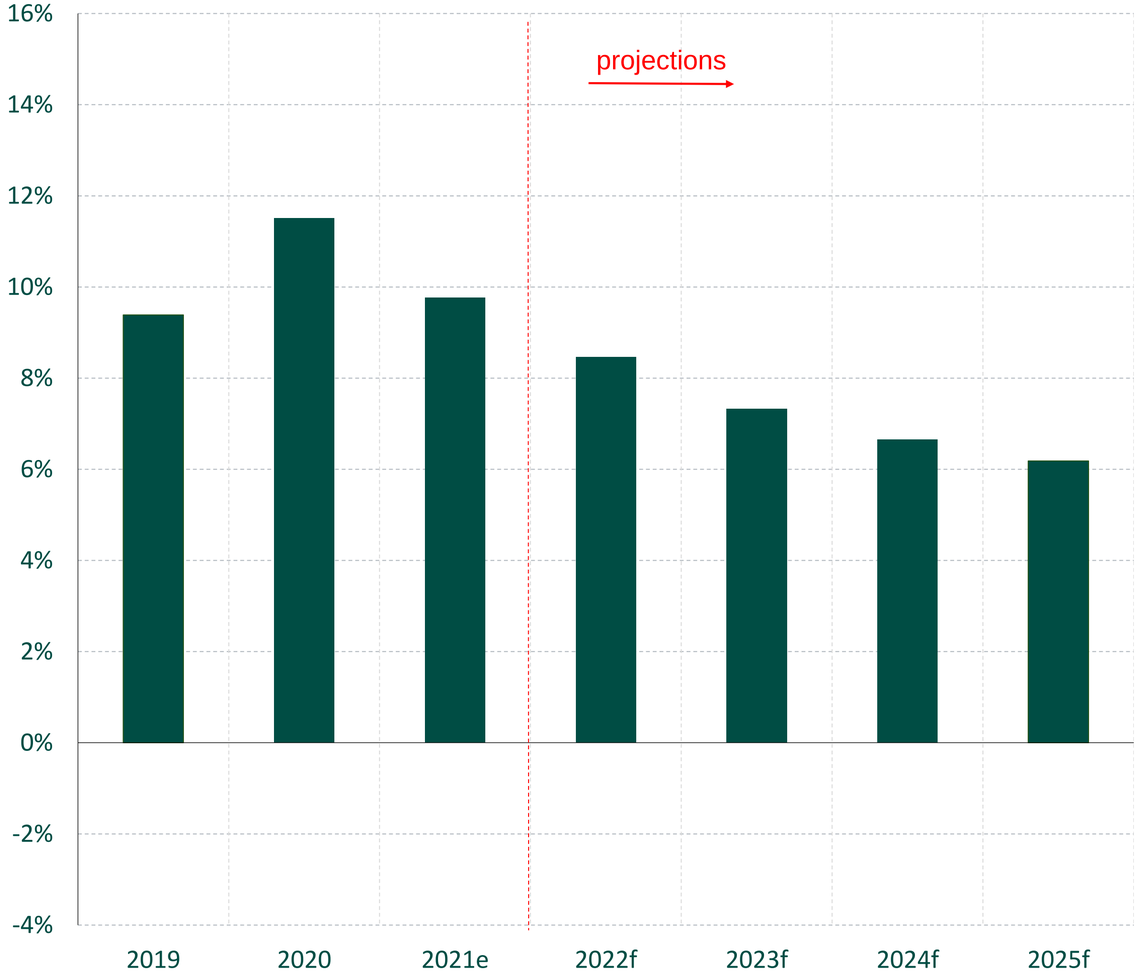


Modified GNI driven by growth in MDD

Real GNI* growth, contribution to y/y % change

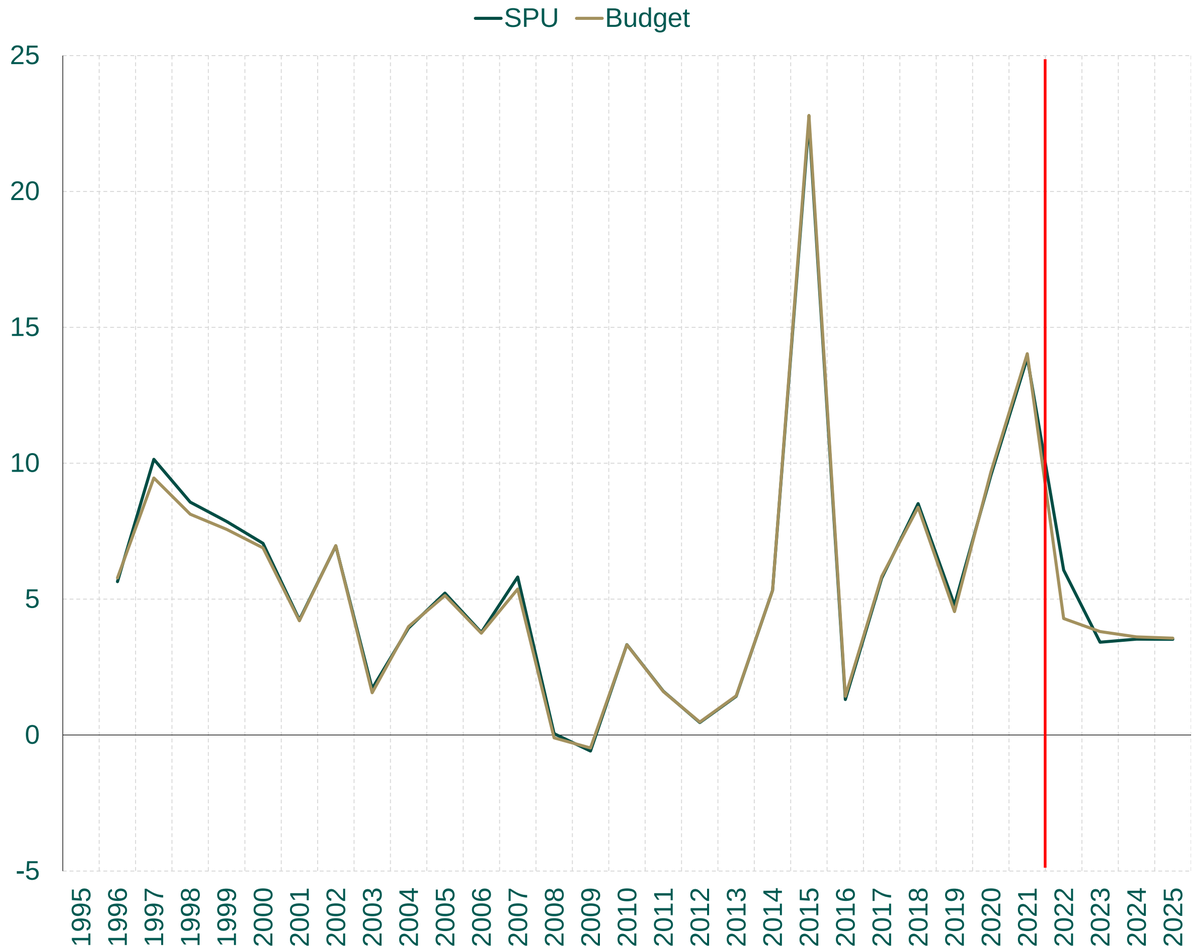


Modified current account, per cent GNI*

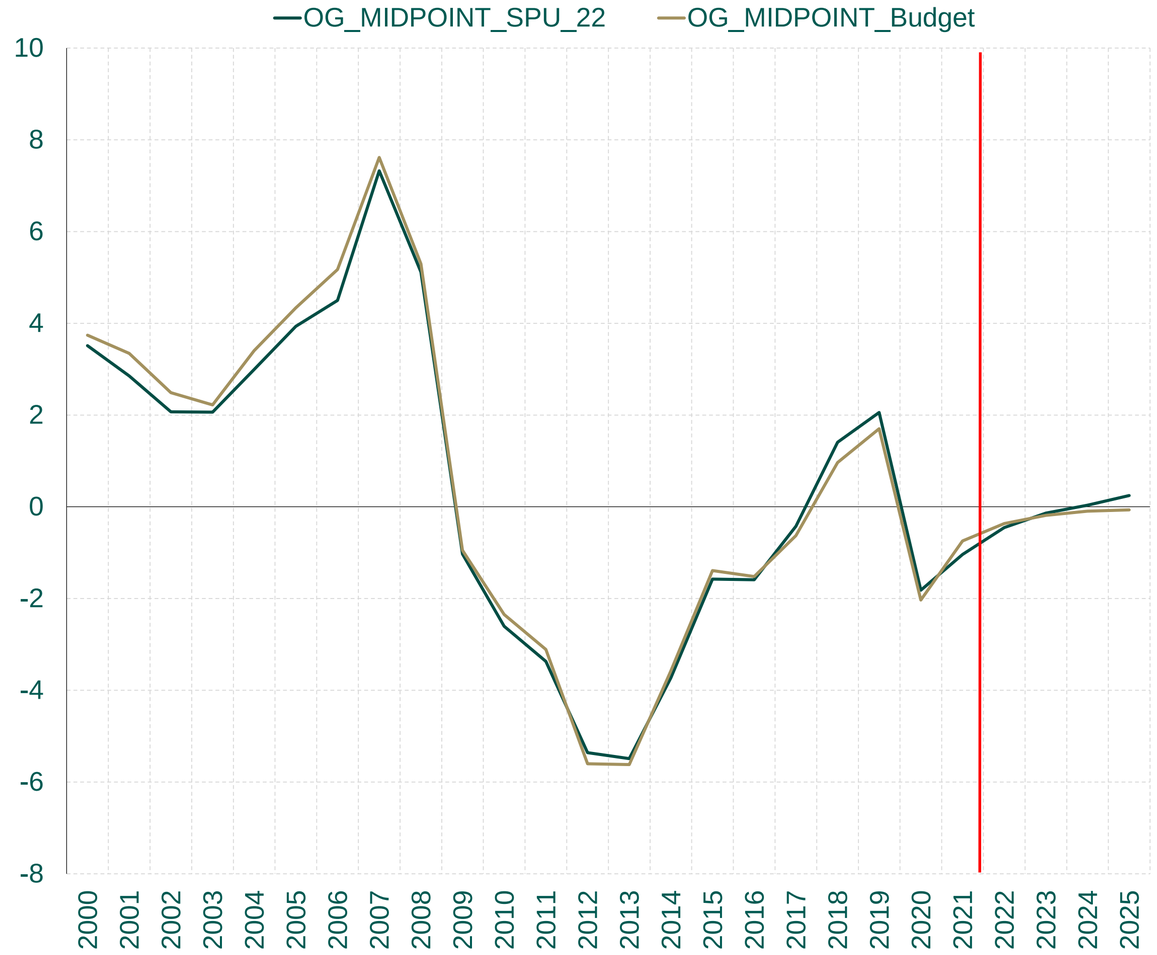


Supply side and balance with aggregate demand (Domestic GVA, Kalman filter)

Annual change in potential output, per cent

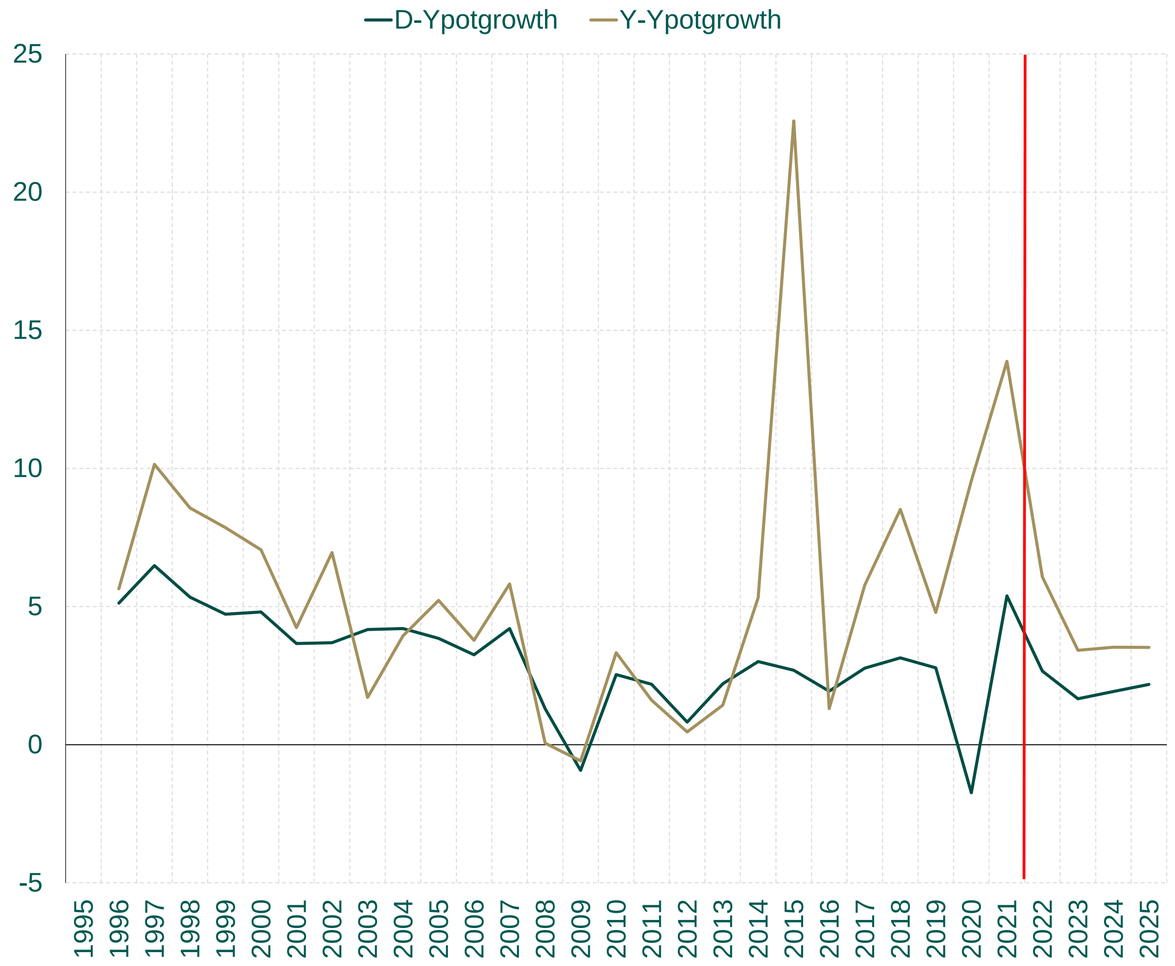


Output gap, per cent



Alternative output gap measure: Domestic GVA, Kalman filter

Potential Output Growth



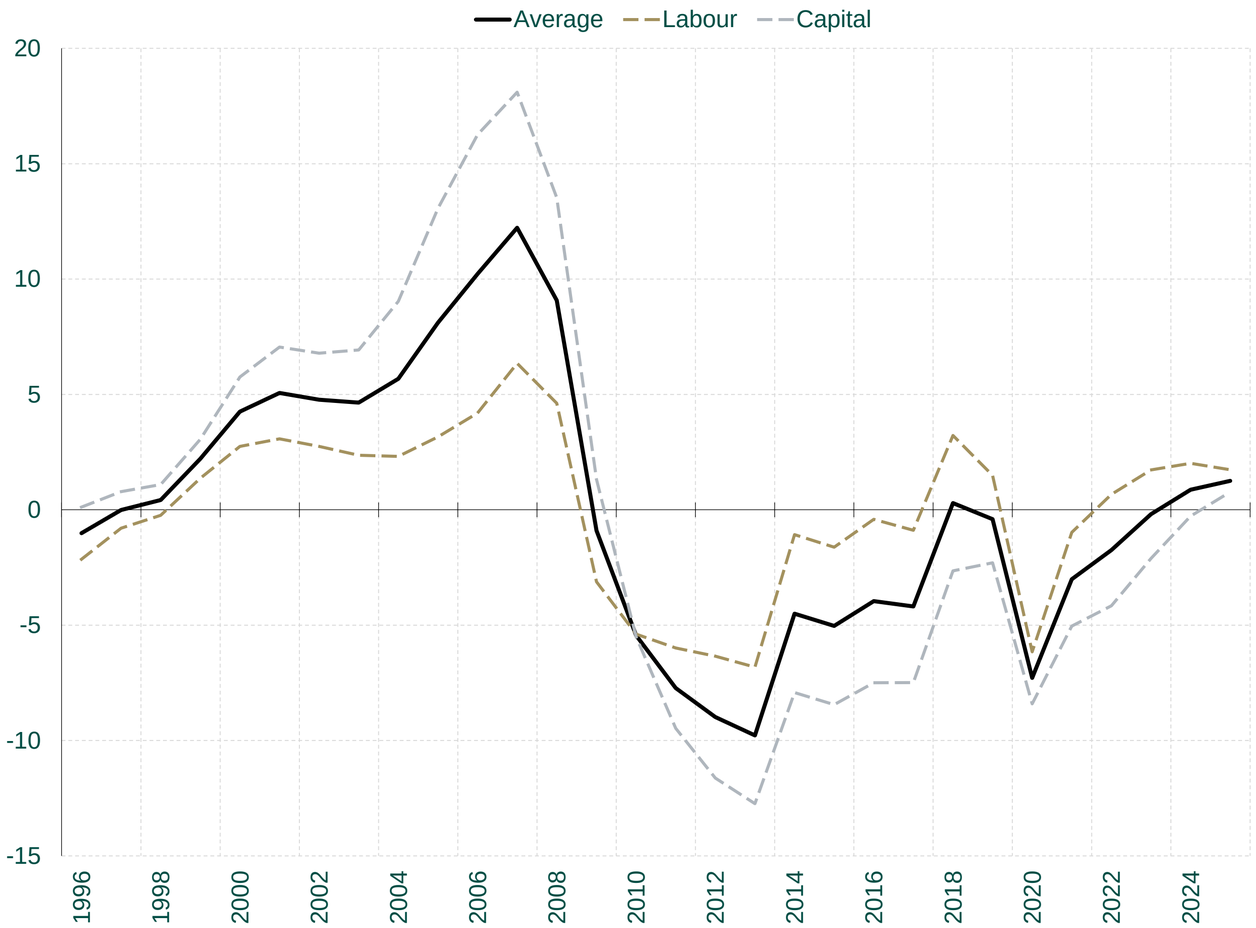
Output Gap

Experimental Work: Borio GNI* Output Gap

Ongoing exploratory work

- Pseudo-GNI*:
  - Input based on relationship between GNI* and MDD
- Based on Borio Models
  - previously used by the Department with GDP
- Labour model:
  - Unemployment
  - Net Migration
- Capital Model:
  - Core CPI
  - Private Sector Credit
  - Construction Employment
- Experimental at this point

‘Pseudo-GNI*’ Output Gap



Risks

Risks = firmly tilted to the downside

Downside
External Risks:
War in Ukraine [wider geopolitical / more prolonged]
Covid [prolonged supply chain disruption]
Further energy shocks [price and / or volume], inc. related to ‘weather events’
More rapid-than-assumed ‘normalisation’ of monetary policy
Spill-overs from any disorderly adjustment of Chinese economy
Domestic Risks:
Public health restrictions [new variant]
Rise in corporate insolvency rate
Brexit [non-tariff barriers]
Lost competitiveness [wage-price spiral]

Upside
Excess savings
MNC’s [export and GDP impacts]
Net inward migration [including from Ukraine, but more medium term]

Work in Progress: Ukraine Impact from NiGEM and COSMO

Work-in-progress

- Extracted outputs from NiGEM model (Liadze *et al,* 2022)
- Applied in COSMO
- Export demand shock:

  - calibrated on GDP impact of main trading partners

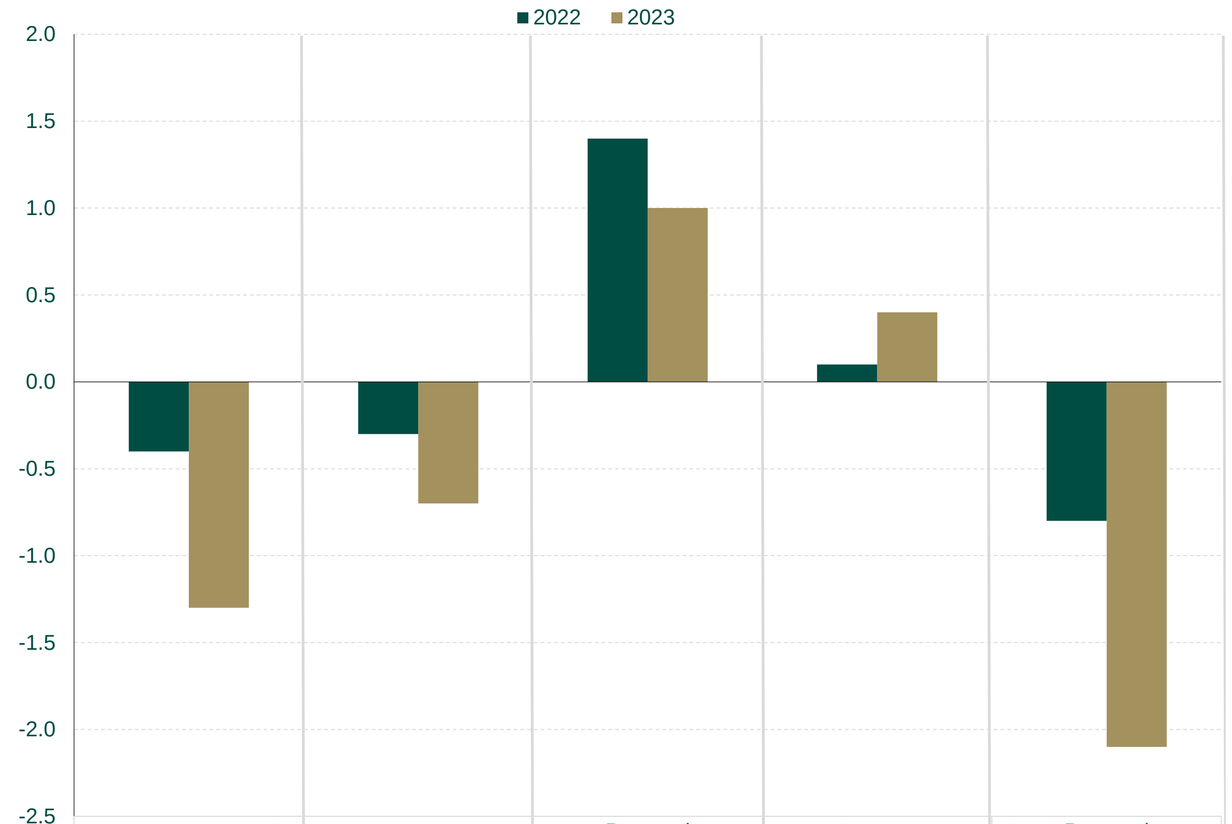
- NIESR Assumptions:

  - c. 50 per cent oil price shock
  - 70 per cent fall in value of RUB vs USD.

- GDP & inflation impact in IE < EA

See: Liadze, I., Macchiarelli, C., Mortimer-Lee, P. and Juanino, P.S., 2022. The Economic Costs of the Russia Ukraine Conflict. *National Institute for Economic and Social Research*

COSMO Outputs



	Non-Traded Output	GDP	Personal Consumption Deflator	Unemployment (pp)	Personal Consumption
2022	-0.4	-0.3	1.4	0.1	-0.8
2023	-1.3	-0.7	1	0.4	-2.1

Department of Finance calculations

Summary and conclusion

Summary: spring forecasts

per cent change (unless stated)	2021	2022	2023	2024	2025
GDP	13.5	6.4	4.5	4.0	3.8
Modified Domestic Demand	6.5	4.2	3.9	3.6	3.6
Modified gross national income	5.5	3.7	3.1	3.2	3.3
Personal consumption	5.7	6.0	3.6	3.5	3.4
Government consumption	5.3	-1.3	2.0	2.0	2.1
Modified investment	9.7	5.4	6.5	5.1	5.5
Exports	16.6	7.5	5.1	4.6	4.4
Modified imports	13.7	7.1	5.2	4.8	4.7
Modified current account (per cent GNI*)	9.8	8.5	7.3	6.7	6.2
Employment	11.0	14.9	2.1	1.7	1.7
Unemployment (per cent)	15.9	6.2	5.4	5.2	4.9
Inflation (headline, HICP)	2.5	6.2	3.0	2.2	2.1
‘Core’ inflation	1.7	3.9	3.3	2.3	2.1

Summary: spring forecasts, change vs autumn forecasts

percentage points (unless stated)	2021	2022	2023	2024	2025
GDP	-2.1	1.4	0.4	0.3	0.2
Modified Domestic Demand	1.3	-2.3	-0.3	-0.4	-0.2
Modified gross national income	0.8	-1.6	-0.4	-0.1	0.1
Personal consumption	-1.1	-3.7	-0.1	0.1	0.1
Government consumption	3.1	0.5	0.0	0.0	0.0
Modified investment	5.7	-1.0	-1.1	-2.0	-1.1
Exports	0.6	1.9	-0.1	0.0	0.0
Modified imports	2.4	0.2	-0.7	-0.4	-0.3
Modified current account (per cent GNI*)	-0.8	-0.8	-1.1	-1.0	-0.7
Employment	3.2	1.7	-0.6	-0.9	-0.5
Unemployment (per cent)	-0.9	-1.0	-0.6	-0.1	0.0
Inflation (headline, HICP)	0.2	4.0	1.1	0.1	-0.1
‘Core’ inflation	0.0	1.8	1.4	0.2	-0.1

Disclaimer and other information:

The forecasts in this presentation are those of the Department of Finance.

Outturn data are sourced from a variety of official sources, including the Department of Finance, Central Statistics Office, European Commission (AMECO), Oxford University School of Government, and Central Bank of Ireland. Data sourced from the private sector is also used, including *Indeed.com.*

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