Opening remarks

by Mark Cassidy, Director of Economics and Statistics, Central Bank of Ireland

at the Seanad Special Committee on the Withdrawal of the United Kingdom from the European Union

19th June 2019

Chairman, Committee members, good afternoon. We welcome the opportunity to appear before you today. I am joined by Gina Fitzgerald, Head of the Financial Risks and Governance Division in the Central Bank. In my opening remarks I will briefly set out the work undertaken in the Central Bank in relation to Brexit as well as potential implications for the financial system and the wider economy.

The Central Bank has been focused on Brexit risks since before the 2016 UK referendum. Following the UK referendum, a Brexit Task Force was established on a permanent basis at the request of the Central Bank's Financial Stability Committee (FSC). It meets and reports quarterly to the FSC and the Central Bank Commission regarding related political, economic and financial market developments, risks arising for firms supervised by the Central Bank, and issues arising for the Central Bank itself, in particular with respect to authorisations. In September 2018, the Central Bank established a Brexit Steering Committee to oversee the further stages of the Central Bank's preparations for the UK's departure from the EU, focusing on cliff-edge risks and the adoption of mitigation actions where possible and appropriate.

The Central Bank's work has focused, *inter alia,* on ensuring that:

- the risks to the Irish economy are understood;
- financial stability and consumer protection risks are identified and mitigated to the greatest extent possible, particularly in relation to the 'cliff-edge' risks associated with a hard or no-deal Brexit;
- regulated firms deliver on their responsibilities of appropriately preparing their businesses for these risks; and

- we deliver our gatekeeper role in a robust, transparent and efficient way, consistent with our aspiration to operate to and influence with European norms of supervision; and ensuring that Irish and European financial stability, investor protection and consumer protection risks are mitigated.

We have taken a transparent approach to this work, recognising the importance of and interest in it. We publish the work of our Brexit Task Force, answers to frequently asked questions, have held several stakeholder roundtables, and have published numerous reports and speeches.

Let me now discuss our assessment of potential implications of Brexit for the Irish economy.

The Central Bank's central forecast is that is that underlying economic activity is set to continue to grow at a relatively solid pace in 2019 and 2020, though some moderation in growth is in prospect, reflecting both the impact of a less favourable and more uncertain international environment and also the limits imposed by domestic capacity constraints and tightening labour market conditions. If a disorderly no-deal Brexit scenario can be avoided, the outlook for the economy over the next two years remains broadly favourable. Economic growth is set to be supported by a still solid pace of expansion in domestic economic activity, underpinned by continued growth in employment and real incomes, the ongoing recovery of the construction sector and growth in domestic government spending.

As is now well understood, any type of Brexit would be negative for Ireland, with a disorderly, hard Brexit especially so. In previous analysis the Bank has published work examining the potential medium-term impact on the Irish economy of an orderly WTO scenario, a Free Trade Area-like agreement and, most recently, a disorderly, no deal Brexit. Even if a deal can be agreed, there will still be additional trade frictions, which will have disruptive effects for businesses and consumers, and for the agriculture and food sectors in particular. However, the effects would be relatively contained and spread over the medium term.

A disorderly, no deal scenario, on the other hand, would have very severe and immediate disruptive effects, with consequences for almost all areas of economic activity. Compared to a situation where the UK remained an EU member, our estimates suggest that a disorderly Brexit would result in a substantial and permanent loss of output. The disruption and related decline in economic activity would be front-loaded and would give rise to a significantly more adverse outlook for the Irish economy in the first few years. Certain sectors and regions would be disproportionately affected, especially those which are more reliant on trade with the UK or which are more vulnerable to the imposition of tariff and non-tariff barriers, particularly sectors such as agriculture, food and smaller scale manufacturing and rural regions and those near the Border.

Brexit is not the only risk to the Irish economic outlook. On the external side, there continue to be other downside risks facing the Irish economy. Given the position of Ireland as a small, highly open economy and the important role of multinational firms within the economy, the evolution of global economic and trading conditions, taxation regimes and movements in major exchange rates will have an important bearing on Irish economic performance. On the domestic side, while overall price inflation remains very subdued, wage growth has continued to pick up against a background where the remaining slack in the labour market is diminishing and there is a need to continue to guard against the risk that strong cyclical conditions give rise to overheating dynamics.

Let me now discuss implications of Brexit for the financial system.

On the basis of the specific Brexit work that we and others have undertaken, and, crucially, the work of the last decade to drive a significantly more resilient financial system, the immediate cliff-edge financial stability risks of a no deal Brexit are considered to be broadly manageable, albeit this eventuality would be challenging for all firms operating in Ireland.

There are some remaining risks of consumer detriment. The Irish and UK financial systems are closely connected, with UK firms and firms from Gibraltar providing financial services to

Irish consumers. The Central Bank has worked with the European and UK authorities to seek to ensure that those firms wishing to continue to provide services to Irish consumers are able to continue to do so in the event of a hard Brexit. The majority of UK based firms have taken appropriate action, but not all have to date. In this context, I am pleased to note that the Central Bank has worked with the Department of Finance to support the drafting of legislation to protect insurance customers in event of no deal Brexit, through the creation of a temporary run-off regime.

The nature, scale and complexity of the Irish financial system is changing as a result of Brexit. New authorisations and expansions of existing operations are increasing the size of many sectors. Our gatekeeping role is hugely important in mitigating financial stability risks and protecting market integrity and customers in Ireland and across Europe. It is imperative that any new business authorised here as a result of Brexit meets the high standards that are expected of any such firm authorised in the EU.

We also continue to be active internationally to ensure that the risk of divergence between EU jurisdictions in how they handle relocations from the UK is mitigated. In order to address the concern of regulatory divergences and the risk of regulatory arbitrage between EU member States, we have long been engaging closely with the European Central Bank, across the Single Supervisory Mechanism (SSM) and the European Supervisory Authorities to agree European-wide approaches to the key policy and supervisory issues, stances and decisions that have arisen from Brexit.

Following the UK's departure from the EU there will be a loss of experience and expertise when UK regulators are no longer sitting at the table. The UK's departure will require increased engagement on our part in the relevant EU and international fora. We have consistently and successfully been making a substantial effort in this regard since the crisis. We will continue to prioritise our work in this regard.

London is a truly global financial services centre operating within, and serving a very material amount of the financial services needs of the EU. Undoubtedly, the role of London and its interconnections with the EU will change post Brexit. It is critically important for the EU economy and all its citizens that it continues to have a financial services system that delivers within the EU, but also has deep global connectivity beyond it, including with London.