Banc Ceannais na hÉireann
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Opening remarks

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Chair, Committee members, good afternoon.

I welcome the opportunity to appear before you today. I am joined by Rónán Hickey from the Irish Economic Analysis Division of the Central Bank. I will give a brief summary of the outlook for the Irish economy, drawing on the macroeconomic forecasts set out in our most recently published Central Bank Quarterly Bulletin but also taking account of the developments and available indicators since then. We will be publishing updated projections in our forthcoming Quarterly bulletin at the beginning of April.

The COVID-19 pandemic and the measures to contain the spread of the virus, which has caused an unprecedented contraction in the Irish and world economies over the last year, is likely to remain the dominant determinant of the path of the economy this year and in 2022. The near-term prospects for the economy have deteriorated following a resurgence in COVID-19 cases early in 2021. However, the prospect of a successful deployment of vaccines from an increasing range of choices offers the prospect of recovery from the second half of the year, underpinned by continued support from accommodative monetary and fiscal policy.

Preliminary National Accounts statistics, which show GDP growth of 3.4 per cent last year, indicate remarkable resilience in headline growth given the exceptional scale of the COVID-19 shock to domestic and world demand. However, the headline GDP figure was boosted by strong export growth that was in turn largely accounted for by a surge in pharmaceutical exports and continued strength in the IT sector. This masked a decline in domestic demand which was among the most severe in the EU. Output declined in all other sectors with the largest declines in sectors with a high dependence on face-to-face contact with customers including the arts, hotels, bars and restaurants and high-street retailers. Private consumption last year was down by 9 per cent compared with the previous year, with modified domestic demand down by 5.4 per cent.

The impact of the pandemic is particularly evident in the labour market. While the headline unemployment rate has not changed significantly, reflecting standard international statistical conventions regarding the its measurement, the COVID-adjusted rate which includes those workers who are availing of the pandemic unemployment payment (PUP) increased rapidly - it currently stands at a rate of 24.8% (February 2021). Including the employment wage subsidy scheme (EWSS), around 960,000 people, or 39.3 per cent of the labour force, are currently in receipt of one form of income support or other. The figures also show that younger and lower paid workers have been most affected.

The concentration of the pandemic labour market shock among workers in the bottom half of the income distribution is reflected in a corresponding decline in compensation per worker (earnings). That this has not been reflected in a decline in disposable incomes – disposable incomes actually increased last year by about 4 per cent – is testament to the effectiveness of government income support measures. Similarly, at firm level, government support measures have provided significant mitigation to the financial distress to SMEs most affected by pandemic related business disruption. These supports, while proportionate and appropriate to the size of the shock to households and firms, have been unprecedented in scale, amounting to over 11 per cent of Modified Gross National Income (GNI*). The General Government Balance has moved from a small surplus of 0.9 per cent to a deficit of just under 9 per cent of GNI* in 2020 and is likely to remain close to that level this year. This has resulted also in an increase in public sector debt and the debt to national income ratio.

The resurgence in COVID-19 infections since December and the re-imposition of strict containment measures weakens the near-term outlook and makes it more uncertain. The containment measures have dampened economic activity significantly in the first quarter of this year and, beyond that, some public health measures are likely to continue to be required, until the successful deployment of effective vaccines reaches a significant proportion of the population. Assuming successful deployment of vaccines by the second half of the year, domestic economic activity should begin to rebound. On this basis, modified domestic demand is forecast to grow by 2.9 per cent in 2021, while GDP is projected to grow by 3.8 per cent, although the recovery in the labour market is likely to lag somewhat until the broader economic recovery becomes more established. The outlook is considerably uncertain, however, and contingent on key assumptions on COVID-19 developments.

Looking ahead, a further pick-up is projected in 2022, with modified domestic demand forecast to grow by 3.6 per cent and GDP projected to grow by 4.6 per cent. While uncertainty and a subdued labour market are likely to keep precautionary savings elevated in 2021, these restraints should ease next year. The unwinding of the large stock of savings accumulated during the pandemic should support a strong recovery in consumption in 2022. Similarly, the reduction in uncertainty should allow investment to begin to recover next year.

The new EU-UK Trade and Cooperation Agreement (TCA) has averted the threat of a no-deal WTO Brexit and means that the significant disruption to economic activity that would have accompanied such an outcome has been avoided. The new agreement allows for the continuation of a basic economic relationship between the EU and UK. Nevertheless, the EU-UK TCA makes trade in both goods and services more cumbersome and costly relative to EU membership. In the short run, this is likely to be associated with continued supply-chain disruption. In the long run, the negative impact of the UK's EU exit on trade flows, migration and productivity will reduce output in the Irish economy.

Chair, committee members, I will conclude my remarks with some views on the policy response to the pandemic and in particular how the available policy instruments can best support a sustainable recovery. The impact of the pandemic has been mitigated by a range of fiscal, monetary, macro-prudential and micro-prudential policy actions to support vulnerable households and businesses. In the near term, policy must remain focused on supporting household incomes and firm liquidity to provide the most solid basis for recovery. However, the size and nature of support should be ready to adapt to changing circumstances. Policy support should continue to counter the threat to viable economic activities and employment from the pandemic and, in time, facilitate structural transformations which support economically sustainable activities. This would help to enhance resilience, support the productive capacity of the economy and mitigate scarring effects, such as long-term unemployment.

On the fiscal side, the rise in deficit and debt ratios that has occurred has been both warranted and necessary. Policy support will need to be maintained over the short-term in order to stabilise the economy, however when health risks diminish, any continued support via current expenditure should be targeted and temporary. Outside Covid-19, permanent increases in current expenditure could only be sustainably accommodated if accompanied by offsetting revenue-raising measures. Ultimately, more favorable growth dynamics in coming years should support a decline in the public debt ratio. However, even if action does not need to be taken now, it is important to plan to reduce the level of the debt ratio in time to a more sustainable level, to ensure that the economy can face future shocks with sufficient headroom such that all available policy instruments can be deployed.