DÁIL ÉIREANN

AN ROGHCHOISTE UM FHORMHAOIRSIÚ BUISÉID

COMMITTEE ON BUDGETARY OVERSIGHT

Dé Máirt, 23 Márta 2021

Tuesday, 23 March 2021

Tháinig an Roghchoiste le chéile ag 12.30 p.m.

The Select Committee met at 12.30 p.m.

Comhaltaí a bhí i láthair / Members present:

Teachtaí Dála / Deputies	
Richard Boyd Barrett,	
Ciarán Cannon,	
Pearse Doherty,	
Bernard J. Durkan,	
Mairéad Farrell,	
Michael Healy-Rae,	
John Lahart,	
Aindrias Moynihan,	
Ged Nash,	
Patricia Ryan.	

Teachta / Deputy Neasa Hourigan sa Chathaoir / in the Chair.

Pre-Stability Programme Update: Discussion

Chairman: Apologies have been received from Deputies Canney and Leddin. Today, the committee will engage in its ongoing scrutiny of the stability programme update report with representatives of the Central Bank of Ireland to discuss the current economic and fiscal situation and key issues that the medium-term fiscal strategy could consider and address. I welcome Dr. Mark Cassidy, director of economics and statistics, and Mr. Rónán Hickey, senior economist from the Irish economic analysis division.

Before we begin, I wish to explain to the witnesses some limitations to parliamentary privilege and the practice of the Houses as regards reference they may make to other persons in their evidence. Pursuant to both the Constitution and statute, the evidence of witnesses physically present or who give evidence from within the parliamentary precincts is protected by absolute privilege. However, the witnesses are giving evidence remotely from a place outside of the parliamentary precincts, and as such they may not benefit from the same level of immunity from legal proceedings as a witness who is physically present. Witnesses are reminded of the long-standing parliamentary practice to the effect that they should not comment on, criticise or make charges against a person or entity by name or in such a way as to make him, her or it identifiable, or otherwise engage in speech that might be regarded as damaging to the good name of the person or entity. Therefore, if statements are potentially defamatory in regard to an identifiable person or entity, witnesses will be directed to discontinue their remarks. It is imperative they comply with any such direction.

Members are reminded of the long-standing parliamentary practice to the effect that they should not comment on, criticise or make charges against a person outside of the Houses or an official either by name or in such a way as to make him, her or it identifiable. I remind Members of the constitutional requirements that they must be physically present within the confines of the places in which Parliament has chosen to sit, namely, Leinster House and-or the Convention Centre Dublin, to participate in public meetings. I will not permit a Member to participate where he or she is not adhering to this constitutional requirement. Therefore, any Member who attempts to participate from outside the precincts will be asked to leave the meeting.

I invite Dr. Cassidy to give his opening statement.

Dr. Mark Cassidy: I welcome the opportunity to appear before the committee. 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 economy, drawing on the macroeconomic forecasts set out in our latest quarterly bulletin, but I will also take account of the developments and available indicators since then. We will be publishing updated forecasts 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 past year, are likely to remain the dominant determinant of the path of the economy this year and in 2022. The near-term prospects 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 does offer 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% last year, indicate remarkable resilience in headline growth given the exceptional scale of the 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% compared with the previous year, with modified domestic demand down by 5.4%.

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 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%. When we also include the employment wage subsidy scheme, EWSS, approximately 960,000 people, or 39.3% of the labour force, are currently in receipt of one form or other of income support. 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 or earnings. That this has not been reflected in a decline in disposable incomes – disposable incomes actually increased last year by about 4% – 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 more than 11% of modified gross national income, GNI*. The general government balance has moved from a small surplus of 0.9% to a deficit of just under 9% of GNI* in 2020 and is likely to remain close to that level again this year. This has resulted also in an increase in public sector debt and the debt-to-national income ratio.

The resurgence in infections since December and the reimposition 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% in 2021, while GDP is projected to grow by 3.8%, 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% and GDP projected to grow by 4.6%. 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 co-operation agreement, TCA, has averted the threat of a no-deal

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.

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, macroprudential and microprudential 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 that 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 that 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 increase 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 to stabilise the economy. When health risks diminish, however, any continued support via current expenditure should be targeted and temporary, while any permanent increases in current expenditure will need to be funded in a sustainable manner. Ultimately, more favourable growth dynamics in coming years should support a decline in the public debt ratio. Even if action does not need to be taken now, however, 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.

I look forward to the discussion with members.

Chairman: I thank Dr. Cassidy.

Deputy Mairéad Farrell: Gabhaim buíochas, a Chathaoirligh, agus as an gcur i láthair sin.

How many bonds have been issued by the National Treasury Management Agency, NTMA, since the start of the pandemic and what proportion is held by the ECB?

Dr. Mark Cassidy: There have been two issuances this year, amounting to €7 billion. The first, in January, comprised ten-year bonds at a slightly negative yield, while the second, earlier this month, was at very slightly positive yields. That €7 billion accounts for approximately 40% of the overall planned issuance for this year, which is in the range of €16 billion to €20 billion. We do not have a figure for the amount of that issuance held by the ECB, although a significant proportion - perhaps of the order of one third, but I will seek to provide an exact figure - of the overall debt stock is held by the euro system. It is a significant proportion, although we do not have a figure for the most recent issuance. I can provide that precise figure in follow-up.

Deputy Mairéad Farrell: That would be great. I had heard that the figure was one third, so the ECB has, essentially, monetised that debt.

Following on from that, many have pointed out that a clean distinction between monetary and fiscal policy was one of the first casualties of the global financial crisis of 2008. In the current crisis, it is sometimes difficult to distinguish where one policy ends and the other begins, which is only natural given where we are today. This interplay of monetary and fiscal policy has brought a co-ordinated crisis response, one of mutual benefit. The ECB backstop - the bond markets of member states - is allowing them to engage in countercyclical spending and I very much welcome that.

Closer to home, however, there is a crisis in our highly domestic banking sector, which Mario Draghi described as a "quasi-monopoly", and the concentration of the banks' internal risk-weighted models means we have the highest mortgage rates in the EU. A further crisis is that if Ulster Bank's deposit book is distributed among the other banks, they could move to impose negative rates on retail customers. Moreover, there is the possibility that the Government, through its significant shareholdings, could urge the banks to offset potential negative rates by accessing funding through, perhaps, the ECB's targeted longer-term refinancing operations, TLTRO, which offers the bank funding at negative rates and is unofficially seen as a way to mitigate negative interest rates for banks.

Given that a future of banking in Ireland commission could be in train and considering everything I have mentioned, the case for the Central Bank playing an active role in the commission seems fairly indisputable. What are Dr. Cassidy's thoughts on that? Does he agree?

Dr. Mark Cassidy: I fully agree with the Deputy's assessment regarding the interaction of fiscal and monetary policy. They are much more complementary this time than at the time of the previous crisis. Important lessons have been learned and they are having a favourable impact.

With regard to the banking system, there is only so much I can say, given the side of the Central Bank from which I am coming. It is clear we have a heavily concentrated banking system compared with those of some other European countries, with somewhat less competition. Legacy and other issues, too, contribute to making our retail interest rates higher than those of other countries. As the Deputy will probably be aware, they are the second highest in the EU. That relates partly to previous losses from the crisis and partly to issues with banks being able to access collateral. This leads to a requirement for more capital in banks, which can pass through to their ability to pass on lower rates to consumers.

The TLTRO, which the Deputy mentioned, are a potential option of which banks can avail if they wish to access that type of funding. Certain conditions are attached and some of the Irish banks access that type of funding. While I acknowledge there has been some commentary recently on the Central Bank's participation in the banking commission, I would rather not comment beyond what has been said in the past because of my area of responsibility.

Deputy Mairéad Farrell: My next question relates to the Central Bank's concern for price stability. I was not surprised that it joined in the chorus of those who have criticised the shared equity scheme as being inflationary and further pushing home ownership out of the hands of many people. The Land Development Agency is also of great concern. Has the Central Bank carried out an estimate of the price impact of these two Government initiatives? What is its view on the recently announced move by the New Zealand Government to require its central bank to consider house prices when making decisions about monetary policy alongside other factors such as inflation and unemployment?

Dr. Mark Cassidy: On the shared equity scheme, I would not describe what we have provided as a critique. We provided an assessment to the Joint Committee on Housing, Local Government and Heritage in which we examined the shared equity scheme under a number of headings relating to our mandate for financial stability, our mandate for consumer protection and broader dynamics in the market. As for the third heading, which related to pricing and affordability, our assessment was that the main problem in the market relates to a lack of supply, about which I think there is a general consensus. We think the main effect of the shared equity scheme may be on demand and that while that may have some effect on supply, the effect may not be too great because there seems to be some sluggishness in how supply responds to demand.

We cannot yet provide an assessment regarding how great any impact on prices might be because we do not yet have enough information regarding the design of these measures. We would need information on who the measures could apply to, whether there would be particular thresholds or caps on the measures and whether they would apply to certain cohorts. Until we have more details, we will not be able to provide any quantification on supply.

Whether house prices should be taken into consideration in the assessment of price stability is a very topical, important and relevant issue. The Central Bank of Ireland, of course, is part of the euro system and we contribute to its monetary policy. The ECB is currently undertaking a fundamental review of its monetary policy strategy. It will be a very comprehensive review of many different areas. One key element will examine whether owner-occupied housing should be included in the measurement of the price basket when ECB takes decisions regarding price stability. It is too early to say what the outcome will be in that respect - the findings are expected to be announced during the second half of this year - but the issue is under active consideration as part of that stability review.

Deputy Mairéad Farrell: I have one more question in the brief time that remains in my slot. It relates to climate change. In previous years, the ECB and the central banks it co-ordinates have often had too great a focus on price stability, unlike the US Federal Reserve, which also has a focus on creating full employment. The president of the ECB, Christine Lagarde, recently stated that climate change affects all the bank's policy areas and that a new climate change unit has been established. This decision, an ECB press release stated, "reflects the growing importance of climate change for the economy". It seems to tie in with the EU's efforts to initiate a green new deal with a just transition, which is necessary if Europe is to reach its targets. It is clear that in order to do this, massive investment is required in green technology. Economists working in the climate area argue that spending of 2.5% of GDP on green investment and just transition is required but our Minister for Finance is arguing that we must start to reduce our spending and reduce our rate of borrowing. At the same time, the Tánaiste has been warning that inflation is about to take off, despite the fact that the EU has spent the past decade fighting deflation. Does the Central Bank accept that EU states must have access to the kind of funding required for large-scale green investment projects and that it is necessary to increase investment in these technologies if the EU is to come anywhere close to reaching its targets?

Dr. Mark Cassidy: I thank the Deputy for her questions, the response to which I will break down into a couple of different elements. Deputy Farrell mentioned that a new climate change unit has been set up at the ECB. I can confirm that we have done the same within the Central Bank in Dublin. That reflects the importance of climate change, including for central banks; this is not just something that we are looking out at in the rest of the economy. Climate change has a significant impact on the mandate of central banks, including through potential risks or impacts on price stability through its effects on the real economy, as well as its potential effects on financial stability, perhaps through the exposure of banks or insurance companies. We are directly interested and are taking our responsibilities in that regard very seriously. There is also the extent to which the central banking community in the euro system should be commenting on more general economic issues around central banking or taking that into consideration in our monetary policy decisions. I am sorry to be giving a similar answer to the previous one but this is under active consideration in the current ECB strategy review. What I can say is that the mandate of the ECB is very clear, namely that the primary concern is price stability. The secondary objective, without prejudice to price stability, is to take action to support the general economic policies of the EU which would include climate change. There is an indirect opportunity there, as long as it does not conflict with the primary objective of price stability which remains paramount.

In terms of the politics, I will not comment on the political dimension apart from agreeing with the fundamental importance of capital expenditure to mitigate risks relating to climate change. This is very clearly present in both our domestic national development plan, much of which relates to climate activities and also in the plans for the EU recovery and resilience facility, over one third of which must involve climate change measures. I hope that answers the Deputy's questions.

Deputy Bernard J. Durkan: I welcome our guests. To what extent does the Central Bank intend to influence the recovery period in our economy, after the restrictions are lifted, particularly with regard to the lessons learned from the previous economic crash?

Dr. Mark Cassidy: Our main responsibility in this areas relates to our active contribution to the monetary policy of the euro system. It is clear that the accommodative monetary policy reflected in low, zero and, in some instances, negative interest rates, as well as very significant asset purchases, has had a significant downward impact on Government borrowing costs, which are at around zero at the moment. That largely reflects ECB monetary policy actions to which we can contribute. In addition to the direct effect on sovereign borrowing costs, there is the effect on lending costs of financial institutions, which depend more than anything on those sovereign yields. The third effect is that the ECB's monetary policy is having a positive impact on the economic performance of the euro area as a whole and we benefit, in a secondary way, through spillovers from that positive growth. That is currently having a very significant effect and we published some analysis of that yesterday. The analysis shows that for both Ireland and the euro area, the results are roughly similar. Output this year is around 1.5% higher than it would be in the absence of this monetary policy.

I have just outlined the actions that have already been taken. What I would say about the recovery period is that the ECB is committed to ensuring that this accommodative monetary policy remains in place. The asset purchases will continue until at least March 2022 and longer, if necessary. Similarly, the guidance is that the interest rate environment will remain low until the recovery is established. It is very clear, through the monetary policy to which we contribute, that we are having and will continue to have a significant effect.

Our other responsibility is in the area of providing economic analysis and comment. Our public comments with regard to the public finances are very supportive of the idea that additional policy measures are required and that there is a role for fiscal policy in supporting the recovery, enhancing the productive capacity and reducing the scarring effects. We are very supportive of Government actions in that regard. I hope that answers the Deputy's question.

Deputy Bernard J. Durkan: In the aftermath of the shut down, there is likely to be a rapid recovery for the countries that are first to lift restrictions. It is also likely - and I have read newspaper reports recently to this effect - that there may be some poaching of skilled labour by adjoining jurisdictions if they emerge from lockdown before we do. To what extent has the Central Bank factored in that issue in the context of its potential impact on our economy?

Dr. Mark Cassidy: First, the recovery here and elsewhere will indeed depend on the duration and stringency of the restrictions, both of which depend on how quickly the vaccines are rolled out in an effective way. It is very clear that this is not happening at the same pace everywhere but the expectation is that there will be some convergence in the roll out of vaccines in the longer term. That said, some countries may recover somewhat quicker than others. In terms of our assumptions regarding the recovery of the economy, we see it beginning quite strongly during the second half of the year, which is not out of line with estimates for the rest of the EU. The scope for what the Deputy is describing is limited enough, although we have not done any assessment beyond that.

Deputy Bernard J. Durkan: I presume the Central Bank will be keeping it under review

Dr. Mark Cassidy: Yes. In terms of our economic analysis, we look at all factors. Labour market developments in this country, including not just the numbers in employment but also the skill levels and the human capital of the economy, are absolutely critical in determining our future path. As a result, monitoring those issues and publishing our analysis is a critical part of our mandate in the context of economic analysis and advice.

Deputy Bernard J. Durkan: When we move into better times, the private and public sectors will have to recover. Hopefully, this recovery will come about in a somewhat different fashion to the recovery following the last economic crash. It has been indicated to various committees in recent weeks that the banking sector will develop the means to assess the viability of small and medium enterprises, SMEs. I am not sure this is necessarily the best approach because it puts the assessment in the hands of the banks instead of the customer. It is necessary to take into account the views of those who have set up and maintained businesses and kept people in employment in both good times and bad in recent years. To what extent will the Central Bank be in a position to encourage the lenders to take account of the expertise in the SME sector, as opposed to what happened in the aftermath of the economic crash?

Dr. Mark Cassidy: We were in a very different situation with the recovery the last time. We have a much stronger banking system now, much healthier public finances, lower indebtedness and the structure of the economy is much better placed to recover. We are also in a situation where the Government can put money into the economy during a downturn as opposed to the need to take it out of the economy during the downturn, which was the situation last year because our borrowing costs had risen to levels which, frankly, nobody was willing to lend us money at, and which compares with a situation now where we are borrowing for ten years at effectively 0%.

The viability of small and medium-sized enterprises, SMEs, will be a critical issue on the path to recovery of this economy. It is clear that there are a lot of SMEs that are experiencing considerable losses at the same time that they would be structurally fundamentally sound when the economy begins. That, of course, is the rationale for the Government supports to the SME sector which are extremely important. Much of the distress will not become evident until after those supports are removed and that is when public policy reaches a critical juncture. Certainly, public policy will have to make decisions with regard to the balance between ongoing support for the sector versus trying to assess viability and trying to support new emerging sectors.

With regard to the Central Bank's role in this, I suppose we engage at a supervisory level with the banks. It is important for them to make quality risk assessments so as not to be putting their own funds in jeopardy. At the same time, we also discuss with banks the bigger picture. The economy as a whole does not benefit if there is to be undue closing of small and medium-sized enterprises. It is in nobody's interest for the economy as a whole to be affected negatively as a result. Therefore, it is important that banks also take into consideration the larger picture in making decisions. I am not involved in the supervisory area. Personally, I cannot say anything more about that engagement, except to agree with what Deputy Durkan says. As a general comment, there are many small and medium-sized enterprises that are a significant part of society and community and they need to be considered as such rather than in the narrow financial contribution.

Deputy Bernard J. Durkan: I thank Dr. Cassidy.

Deputy John Lahart: Have I ten minutes?

Chairman: Nine.

Deputy John Lahart: I thank the witnesses for coming.

This is a genuine question. I am just wondering is there a reason the Governor is not with us today. Was he not issued an invitation?

Dr. Mark Cassidy: The invitation was issued to me. I think that was the case previously. The Governor appears in other committees or other discussions, including possibly at this committee.

Deputy John Lahart: Many of us are not members of other related committees. The next time an invitation issues, it would be nice to see the Governor here. That is merely a personal perspective.

In relation to Davy, is this the end of the Central Bank's involvement or can Dr. Cassidy give us an update?

Dr. Mark Cassidy: I am reluctant to get into that because it is outside my area of responsibility. I am reluctant to add anything beyond what has been said. It is clear that the matter is under ongoing review. Our director of financial conduct, Ms Derville Rowland, provided the bank's position on this at different committees and I cannot comment any further on that.

Deputy John Lahart: There has been a little bit of talk because of the changes that are taking place in the banks and the withdrawal of a major bank from the banking environment in Ireland. What is the position of the Central Bank on a State bank?

Dr. Mark Cassidy: There are different potential models of banking in Ireland. This is something that is on the financial regulation side of our house. I am not aware of our position in my own role on economics and statistics.

Deputy John Lahart: Coming back to a previous question on the position going forward, what is the greatest fear that the public should have, say, from an economic outlook point of view, in terms of policy instruments?

Dr. Mark Cassidy: There are greatest concerns in terms of the economy generally and then from a policy perspective. For the economy generally, clearly we are hoping for the scenario, that I think people now expect, whereby the vaccines get successfully rolled out during the second half of the year and are effective in combatting the virus. Anything where that does not materialise is the greatest short-term risk for the economy.

Over the longer term, and this is getting also into the policy dimension, there are a number of challenges for Government policy. First of all, one will see additional financial pressures for the Exchequer from ageing, particularly as and from 2040, and also in relation to climate change. There is a draft Bill today which will include intermediate or secondary targets for before 2050. There are many medium-term pressures in the public finances that need to be considered now. They would be difficult to deal with if they are not addressed now.

In addition, Ireland is a small, open economy. We are always more vulnerable to shocks to the external environment than other countries and that remains the case. I would note maybe two of those in particular. First, we have a high degree of reliance on corporation taxes paid by foreign multinationals. It is welcome that we receive these corporation taxes but there are risks to those because there is quite a high degree of concentration in a small number of sectors and small number of firms. There is also an international process under the OECD in terms of changes to international taxation arrangements and it is acknowledged that Ireland could lose some of its current tax revenues as a result of that process. Risks relating to the external environment, multinationals and SMEs are important.

I suppose a third concern is that while the public finances remain in a generally favourable position and they can absorb the additional expenditures that will be required this year and perhaps after to alleviate the current costs of the restrictions because of Covid but also to help the economy recover, we still have a high level of public sector debt and a high level of public sector debt leaves an economy more vulnerable to unforeseen shocks that might come down the line. For that reason more than any, a key element of our policy advice is when conditions allow - I emphasise that part because we are not currently in that state - it will be essential to return the public sector debt ratio to a lower, more sustainable level than the current level which is approximately 100% of national income. Economic growth will do most of the heavy lifting in that regard but at the same time there is a need to think about a path to return the Government balance to a more sustainable situation that is compatible with a lower debt ratio. Those are just some of the concerns that come to mind.

Deputy John Lahart: Have I time left?

Chairman: The Deputy has almost three minutes.

Deputy John Lahart: This is a general question and I do not need a particularly long answer. Obviously, in a particular focused area of strategy we are trying to convert people to the use of hybrids, non-traditional diesel cars, etc. There are some incentives to encourage people to switch. Obviously, because transportation related taxes account for a significant amount of revenue for the State, when should these incentives cease and how will they be replaced?

Dr. Mark Cassidy: I am afraid, as important as that is, it is not appropriate for the Central Bank.

Deputy John Lahart: Okay, that is fine.

Dr. Mark Cassidy: Those are issues of specific policy.

Deputy John Lahart: Coming back to a question that was asked earlier in relation to the shared equity scheme, we had the ESRI's suggestions on this. In terms of policy instruments, how could a Government go about activating the thousands of idle planning permissions that are there? This was a modest scheme, but what positions would the Central Bank have on that?

Dr. Mark Cassidy: We cannot comment on specific policies apart from to fully agree with the importance of that issue. Addressing the supply side of the housing market is required in order to alleviate the problems that exist and issues relating to planning are important in that regard. With regard to specific projects, I would leave that to-----

Deputy John Lahart: Okay. In a general sense, what kind of things can be done to address the supply side without incentivising?

Dr. Mark Cassidy: Planning procedures and the cost of building are the two issues that come to mind.

Deputy John Lahart: The Economic and Social Research Institute, ESRI, mentioned the cost of building and the lack of available data. We have, apparently, among the highest building costs in the European Union. How can we address those issues, first the data piece?

Dr. Mark Cassidy: Getting into specific Government policies-----

Deputy John Lahart: I am not asking Dr. Cassidy to address Government policies. Why is there a dearth of data?

Dr. Mark Cassidy: I do not know the answer to that. Housing markets are different from most markets that exist because they are so different across countries. It is very difficult to get any type of harmonised or standardised data on housing markets because they differ. I suspect that is one factor but whether there are areas where things can be improved and data may become available, I am not aware. It is not an area in which I have worked.

Deputy John Lahart: Dr. Cassidy and the ESRI have mentioned the costs element. He must see some space or room for manoeuvre there, even if he cannot specify what that is. I do not want to misinterpret Dr. Cassidy, but it seems that he seed room for manoeuvre in terms of the cost of construction.

Dr. Mark Cassidy: I would find it hard to think that there is not room for improvement. I factor this in because the price of a house is such a high multiple of incomes that one must think there is something wrong in the market there. That is why availability of land, planning processes and costs are the most obvious issues. Do not get me wrong, I agree that these are the critical factors to consider, but it needs a depth of analysis.

Deputy John Lahart: Who is responsible for the depth of analysis?

Dr. Mark Cassidy: It is, ultimately, the responsibility of the Government but, of course, it can utilise institutions such as the ESRI because-----

Deputy John Lahart: Does the Central Bank have a role?

Dr. Mark Cassidy: The Central Bank has a role to an extent. We have significant responsibility for the mortgage market and publish a deep analysis of it every year in our review of mortgage market measures. To the extent that the supply of housing is a key factor affecting current mortgages, we have some responsibility but whether we are best placed to do the depth of analysis, I am not sure.

Deputy John Lahart: I thank Dr. Cassidy for his responses. I know my questions were shot at him at rapid pace and I thank him for his flexibility and willingness to answer them. That was very useful.

Deputy Richard Boyd Barrett: One of the big fears among ordinary people is that they are going to pay for the Covid-19 crisis, as was the situation during the most recent crisis, which was not of the people's making but of the making of bankers and developers. Their actions caused an unprecedented economic crash and ordinary people paid the bill through income losses, job losses and crushing cuts to areas such as housing, health and education. The people want to know that austerity is off the table and they are not going to be asked to pay the bill this time because it would be grossly unfair and counterproductive, as clearly was the case in previous cuts to areas such as healthcare, housing and education. In the context of Covid, one thinks about the price that we are paying for the cuts and lack of investment in areas such as those. Am I hearing our guests right that the advice of the Central Bank is to the effect that austerity of the sort where ordinary people pay the bill for the Covid crisis should be off the agenda?

Dr. Mark Cassidy: There are elements of that question that I cannot get into but I can say a few things. Current Government policies are considerably reducing the costs and hardships of the crisis. We saw that in some data we published recently where average wages would have declined and, in fact, average incomes in the economy increased last year due to the impact of Government supports. That contribution was greater for lower-income groups. Government policies have already had a positive effect.

The Deputy is asking about the forward-looking situation, once the temporary supports that are now in place are removed and a recovery is under way. The Deputy mentioned public sector investment. Experience shows that it is extremely unwise for an economy to cut back on capital investment following an economic crisis because that has negative effects on the productive capacity of an economy in the long run. That is a key lesson and a mistake was made in the past in that respect. In Ireland, we did not have too much choice because we could not afford to borrow money at the time but investment certainly fell significantly here and elsewhere after the most recent crisis. That has had significant negative effects.

Our advice and recommendation is that, first of all, current temporary policies remain necessary and they need not be removed prematurely. When they are removed, attention needs to be focused on the recovery of the economy. What will be most important there will be measures that reduce scarring effects, particularly long-term unemployment. There will be structural changes. In many ways, the economy will go back to where it was before but not fully. There will be changes in consumer preferences, tastes and habits that have been picked up during the crisis that will be permanent. We will have changes in commuting patterns because of working from home and that will have structural effects on the economy. What policy can do there is to try to gear the economy towards the new reality, including the retraining and upskilling of people. That is a significant way in which policy can have a positive effect.

I earlier mentioned enhancing the productive capacity of the economy. In terms of paying the bill for Covid, I also mentioned the fact that we think the current situation is sustainable. We do not think there is any need for what is commonly called austerity, albeit that can mean different things to different people. Austerity is certainly not required to a degree whereby demand is removed from the economy at a time when the recovery is not established. We firmly believe that when the time is right, public sector debt will need to return. We think that economic growth will do much of the heavy lifting in that respect and that is another reason to emphasise the importance of capital investment. We also think that the general situation in terms of Government balance, including the mix between current expenditure and taxation, will need to move to a more sustainable position, closer to balance or even surplus. With regard to how that is done, I would be getting into a political decision with regard to the distributional effects.

Deputy Richard Boyd Barrett: Dr. Cassidy appears to be saying that there will be no austerity for now but the level of the debt we have taken on means the potential of some hard choices coming at a certain point. Perhaps Dr. Cassidy will think this is getting into the political area, or whatever, but does he want to comment on the Oxfam report? I know that the Central Bank produces reports on wealth and its distribution. The Oxfam report, The Inequality Virus, states that, in Ireland and globally, huge numbers of ordinary people have lost jobs and incomes and have really suffered while a significant cohort of billionaires, the super wealthy and certain industries with which they are associated have done extraordinarily well and have seen their wealth increase significantly. That is true in Ireland. The report states that the wealth of Ireland's billionaires has increased by €3.3 billion. Has Dr. Cassidy any comment on that? Do the Central Bank figures on wealth accumulation bear that out? If Dr. Cassidy is not going to comment on what we should do in the areas of wealth and redistribution, would he agree that taxing such individuals is certainly something that should be considered as an option? It is being considered as an option and, in some cases, acted on in some countries. Countries like Chile and some others have introduced Covid-related wealth taxes. Rather than debt-financing Covid expenditure, they have at least opened up the option of taxes on those who have done well from Covid, and the very wealthy, to pay for the cost of the Covid crisis.

Dr. Mark Cassidy: I cannot comment on the policy element. I can comment that there are distributional effects of Covid which are common across countries. Lower income, part-time and younger workers are more negatively affected because of the nature of the crisis. It will be important to take that into consideration in the recovery period, particularly to ensure that temporary changes and inequality are not sustained over time because short-run effects become longer-run effects.

We publish material on wealth. It shows that for Irish households wealth depends upon the housing crisis, far more than anything. Housing remains the dominant form of wealth to a greater extent in Ireland than elsewhere. Certainly, a small number of the population is highly wealthy, but for the vast majority wealth has recovered having fallen dramatically after the last crisis. House prices are the main factor in that. However, I cannot comment on the policy issue.

Deputy Richard Boyd Barrett: How much time have I left?

Chairman: The Deputy has about one minute.

Deputy Richard Boyd Barrett: I have asked most of my questions. On wealth distribution, I take Dr. Cassidy's point about property values and so on but has he any further comment on it? The figure I am aware of is that the wealthiest 10% has approximately 58% of all the wealth. Therefore, if there is a concentration of wealth in property and other areas as a result of Covid, does it follow that there has been a growth in inequality as a result of the distribution of wealth from Covid? Is this an issue that needs to be looked at?

Dr. Mark Cassidy: Our data predate Covid. I imagine that Covid would have a very limited effect, but one could also look at the environment in which Covid is taking place and the fact that financial assets have increased quite significantly because of the low-interest rate environment. The motivation for low interest rates is to try to improve overall economic activity to benefit everybody in the economy. The evidence also shows that while there may have been some increase in wealth and financial assets, there has also been a significant effect on employment across the real economy. There are two effects there and I certainly support the monetary policy environment and the policies that are in place. Covid is having temporary income shocks that, hopefully, will not be sustained but I am not aware of Covid having particular effects, by itself, on wealth.

Deputy Ged Nash: I will first ask Mr. Cassidy about the EU fiscal framework and the fiscal rules. He referenced the incapacity, a decade ago, of the State to finance infrastructure projects that in the specific circumstances we have at the moment we could finance. We know the best thing is to invest in transport, housing and so on to stimulate the economy and get people back to work and do so in a sustainable fashion. There is a very lively debate going on at the moment around how the EU fiscal rules may be at least modified to allow that kind of positive investment. Has Dr. Cassidy a view on how that should happen?

Dr. Mark Cassidy: I thank the Deputy. This is very important. The European Commission issued an initial review of the framework in February. Progress on that has understandably stalled since the pandemic has taken up attention, but it pointed to certain weaknesses in the fiscal framework from a backward-looking perspective. Fiscal policies were often pro-cyclical and the composition of public finances was not as growth enhancing or encouraging of investment, including sustainable investment, as it might be. The complexity of the fiscal framework, particularly in relation to matters such as structural balances which are very difficult to calculate and are largely outside Government control, is another issue. The Government can decide how much it will spend but not necessarily how much it will take in. These are all potential areas, flagged by the European Commission, where there will be some changes to the framework in future.

I cannot be too definitive because these are inherently political matters, but the simplicity versus the complexity of the framework should be considered. Simpler rules on expenditure would be one option, rather than a focus on balances. There is a certain degree of one size fits all when it comes to assessment of debt which focuses on a single figure - the debt ratio. A broader understanding of an individual country's debt situation, the sustainability of its finances, and a distinction between good debt and bad debt is necessary. Good debt is accrued for capital and environmental investment versus bad debt which is not productive. Looking at what is underlying the debt and the sentiment of financial markets to further increases in debt are other issues.

There are a number of issues and an appetite for change in certain areas. However, there are political issues and some countries will be more resistant to changes than others, so I do not know what the reality will be. Certainly, the recent Commission report provides a basis for looking at these issues in the coming years once the current problems are out of the way.

Deputy Ged Nash: I will ask a question on potential inflation, price rises and interest rate rises. I do not necessarily expect Dr. Cassidy to comment on political remarks, but the Tánaiste expressed a view, in an interview with *The Irish Times*, that we should be preparing for rises in interest rates and price inflation. I do not agree with him and do not agree it is something we should be concerned about at this stage. Frankly, I agree that inflation may not be a bad thing over a period of time. What is Dr. Cassidy's view on the potential for price rises and interest rate rises and their impact?

Dr. Mark Cassidy: It is something that will be on our minds. Regarding the short term, we published projections for inflation and the outlook is for it to remain modest in the coming years. The announcements of the European Central Bank, ECB, on how long it expects to support monetary policy, both interest rates and asset purchases which put further downward pressure on Government borrowing costs, have clearly noted that support of an accommodative policy will remain in place for a while. The asset purchases and interest rate will remain until at least March 2022 and possibly longer, depending on Covid. The ECB projections are for inflation to be still below the global target of close to 2% by the end of its forecast horizon of 2023.

We do not expect to see the trends of higher inflation and higher interest rates in the short term. Some of the risks of higher interest rates have been mitigated by the bond issuance of the National Treasury Management Agency, NTMA, which leaves our maturities and need to roll over debt in a very favourable position. However, it is also the case that inflation and interest rates will increase at some stage. The resilience of the economy will depend on how well placed it will be to withstand that. I point particularly to the increase in interest rates. If public sector debt is high, and the Irish Fiscal Advisory Council published a useful document on this recently, there is significantly more vulnerability to higher interest rates when they occur. At some stage, they will occur although I certainly will not put a time frame on it. It is important that the economy is well placed. This means that public sector debt should be lower than it is now when interest rates increase.

Deputy Ged Nash: I have two further points. From what I am hearing from Dr. Cassidy, it seems he would not necessarily agree with the Tánaiste's remarks. I do not believe there is any evidence basis for them, frankly, and that seems to be what Dr. Cassidy is saying. One of the policy interventions that was made last year was an intervention that my party and I have been calling for in the context of how we might deal with a potential no-deal Brexit. I refer to the introduction of the initial temporary wage subsidy scheme, which has since evolved into the employment wage subsidy scheme. Would Dr. Cassidy be of the view, given the exposure of the locally traded sector to the decline we have experienced and the clear challenges that certain economic sectors will face in re-establishing themselves, that we should, as a feature of the labour market, have embedded into our system a formal short-time working scheme equivalent, for example, to the that which operates very successfully in Germany and which supported jobs and businesses through the financial crash in the late 2000s and early 2010s? Is this something he thinks we should consider, perhaps with a condition attached around training and upskilling? We have a serious issue on our hands in terms of productivity and competitiveness for SMEs and an ongoing challenge in the context of upskilling and retraining. I ask Dr. Cassidy to comment on that broad policy issue.

Dr. Mark Cassidy: There is a lot of merit in what the Deputy is suggesting. However, I will first go back to his initial comment because I cannot let it go by. I am not saying that I do not agree with the Tánaiste. Let me be very specific on that. The Tánaiste, as far as I am aware, did not put a timeframe on this. If the view is that, at some time, the next moves in regard to inflation and interest rates is that they are likely to be up, that is the case. I think what is uncertain is when that will happen. I must just make that point.

What the Deputy is suggesting in terms of the wage subsidy scheme evolving into something more permanent is worth consideration. He is talking about something that can reduce the risk that arises when a crisis happens and workers become disengaged from a firm for a period. It may only be temporary but such a disengagement leads to longer-lasting effects. There are potential schemes that could be used. The EWSS was introduced, obviously, for temporary purposes, but the rationale behind it could potentially be considered as something more permanent. I would not want to get into it any further than that except to agree with the Deputy that there is a lot of merit in what he is saying for reasons that relate to maintaining skills, motivation and engagement. If a worker leaves a firm, even only temporarily, it becomes much more difficult to re-engage that individual. I think what the Deputy is suggesting is worth consideration.

Deputy Patricia Ryan: I thank our guests for attending. At the end of his opening statement, Dr. Cassidy said that "policy must remain focused on supporting household incomes and firm liquidity in order to provide the most solid basis for recovery". In his view, is the taxing of the pandemic unemployment payment and the temporary wage subsidy scheme counterproductive?

Dr. Mark Cassidy: I cannot speak to the taxation element. At a higher level, I think both types of income support have been absolutely critical. We have evidence on how they have supported the incomes of many in the economy such that incomes generally have been maintained. However, in terms of taxation versus non-taxation, I would rather not comment.

Deputy Patricia Ryan: Dr. Cassidy mentioned that policy supports should facilitate structural transformations in order to assist economically sustainable activities. He referred to upskilling, retraining and all of that. What else would he recommend in this regard?

Dr. Mark Cassidy: There are two areas in particular. The first is about reducing the scarring effects that could occur through long-term unemployment. There are issues in terms of upskilling, retraining and even other active labour market policies. That is one area referred to by the Deputy. The other is enhancing the productive capacity of the economy. This would involve investment in infrastructure and human capital and also measures that could smooth the adjustment. We will have a reallocation of resources after this crisis. Much will go back to normal but not everything will. Some sectors will be permanently smaller after the crisis. As always, however, there will be new, emerging sectors. We must, first of all, try to ensure that the skills exist for those to develop, whether in the areas of data, IT, management and so on. That type of upskilling is needed. In essence, it is about ensuring there is a supportive environment for the development and growth of new industries and sectors. That is what we have in mind when we talk about those policies.

Deputy Patricia Ryan: We can all see the difference between GDP and GNI. Dr. Cassidy spoke earlier about multinationals. Are we over-reliant on those companies and, if so, what particular measures should we be taking to protect ourselves from that overexposure?

Dr. Mark Cassidy: I will make a couple of points on that question. First, it certainly is the case that multinational contribute significantly. Their contribution is extremely welcome. There are some issues in regard to the measurement of their output, but they contribute in a very real and meaningful way to export, employment and the public finances and also in terms of positive spillovers, including technology spillovers that help to upskill workers. The multinationals make an extremely positive contribution but our output figures show quite a degree of reliance. When that is the case, we need to look at whether the economy would be resilient in the event of either a firm-specific shock - we should keep in mind that a small number of firms dominate output in many of these sectors - or a sector-specific shock in a context where, for example, the pharmaceutical sector and the IT services sector dominate. We need to ensure that we would be resilient in such an event. We are not anticipating any reduction in the size of the multinational enterprise, MNE, sector but we want to be resilient because there is always a risk.

There are three things that need to be taken into consideration from a policy perspective. First, policies need to remain supportive of the multinational sector. We must remain a good place for multinationals to do business. Most of these sectors have been embedded in the economy for a long time. They are here for the long run and we need to make sure we remain a favourable location for business. Second, we need to make sure that, complementary to the MNE sector, there is a successful Irish-owned sector. It is indigenous SMEs that provide most of the employment - up to 1 million people - in this economy. There are issues in this regard. There is significantly weaker productivity among Irish-owned firms than there is among multinational firms. Policy needs to ensure that we also have a productive, innovative and expanding indigenous sector.

The third point relates to corporation taxes. We have developed a very high degree of reliance on those taxes. I understand that 20% of our overall tax revenues now relate to corporation taxes, which is extremely high by historical standards. That revenue source is dominated by multinationals and it means that if there were to be any shock to the overall balance between revenues and expenditure, it could be a shock akin to what happened when we had a degree of reliance on the construction sector back in the 2000s. We need to ensure that our public finances are not overly reliant on the tax revenues from multinationals and that we do not make decisions about permanent spending increases based upon revenues from corporation taxes that could turn out not to be sustainable over the long term. Again, I am not making a prediction in that regard. It is just about being prudent in terms of management. I would point to those policy areas in response to the Deputy's question.

Deputy Patricia Ryan: I thank Dr. Cassidy.

Deputy Aindrias Moynihan: I thank Dr. Cassidy for his presentation and for his informative responses to members' questions. There are two or three areas I would like to tease out further. Dr. Cassidy highlights the amount of savings of some people, which they would be spending around 2022. He also made reference to other sectors that have been hit much harder. Has he a measure of those harder hit sectors and the difficulty those people are experiencing, in particular in meeting their mortgages? Is the Central Bank monitoring the level of distress in that sector? I am not sure there was any reference to it in the earlier discussion but I am particularly interested in whether the Central Bank has been monitoring, or has a measure or a view of, the distress those people are experiencing.

Second, in regard to the EU budget rules, much of which is set aside for the moment, it is only a matter of time before some shape is reintroduced in that regard. Does the Central Bank have a view on those budgetary rules and what shape does it consider is best suited as we emerge into a post-Covid environment?

Third, does Dr. Cassidy have a view on the possibility of inflation or interest rate increases?

Dr. Mark Cassidy: I thank the Deputy. Let me deal with those three issues in turn. The first question highlights a clear gap in terms of people's experience during the crisis. For those people who have not been directly affected by any income losses, what they have generally experienced is a significant increase in their savings, largely because they have not had the opportunities to spend because outlets have been closed down and, in fact, in the past year savings have increased by around €15 billion. We think there is now a significant stock of savings that will be important in terms of supporting the recovery when it happens. On the other hand, there are many sectors of the economy very negatively affected, particularly those reliant on face-to-face contact, such as hospitality, large parts of retail and arts and entertainment.

The Deputy asked about the analysis of this. We have done something on this and we published it last year. First, the losses have been significantly mitigated by the effect of the Government supports, such as the employment wage subsidy scheme, EWSS. Given that, for most of these small enterprises, wages represent a very large amount of their costs, this has reduced the potential cost. At the same time, they also have significant non-wage costs and many SMEs have experienced losses on those. Our estimates are that SMEs last year would have experienced overall losses of roughly between €10 billion and €12 billion, which is very significant. We think the Government measures had a significant effect but the other estimate that we have published is that, even allowing for the supports, close to 15%, or just over one sixth of SMEs, are unlikely to have the financial capacity to meet their liabilities during 2021.

Essentially, bringing all of that together, while the Government supports have had a significant effect, significant losses have been incurred by many SMEs, including many viable SMEs and many SMEs which came into this crisis in a good financial position. However, if they are closed for 12 months of the year, of course, they are going to incur losses. Those are the estimates that we have.

Deputy Aindrias Moynihan: I take the point on the SMEs. Can Dr. Cassidy switch the focus to the distress on households and people?

Dr. Mark Cassidy: Apologies, I misunderstood. The distress on households has been mitigated even more than the supports. We published something on this in recent weeks and it shows that average household incomes actually increased last year. There were two reasons for that. First, a large part of the population are not affected directly by the crisis and, in fact, average incomes for that part of the population generally increased. More remarkable has been the effect of the Government income supports. Particularly for lower income workers and younger workers, the supports received from the wage subsidy scheme and the pandemic unemployment payment have significantly reduced the financial hardship, although not in all cases and there have still been some income cuts among some parts.

I have some figures to hand. Generally, if there had not been income supports, average incomes last year across the board would have declined by about 6% but, in fact, average incomes increased by about 4%. Among younger workers, the effect was even greater.

Deputy Aindrias Moynihan: Does that suggest households are not going to fall into mortgage arrears? That is what I am taking out of it but it does not sound like what one would hear from many people around Cork.

Dr. Mark Cassidy: I would emphasise that, first, this is not uniform and there have been some income cuts. However, in the same paper where we look at income, we also look at debt sustainability. It shows that debt ratios have increased in many cases but, in fact, they have increased much less than they would have in the absence of supports. I would emphasise that a lot of the issues will only become visible and evident once the supports are removed. Once the supports are removed and the recovery starts, if there are people who do not return to work, and there will be people who do not return to work, for that cohort, that is when we may see the pressures on debt sustainability and mortgage arrears. For that reason, we would expect to see some adverse impact on mortgage arrears arising from this pandemic, even if the figures are not yet visible because of the effect of income supports. I would in no way want to sound complacent about what the lasting effects will be.

In terms of EU budgetary rules, I would not comment on what is appropriate but there is much to be considered. There have been issues raised, first, that the current framework is overly complex; second, that it is not sufficiently supportive of growth and capital investment; and, third, that it is a little bit one-size-fits-all and does not take into account that a country's debt ratio is not the only metric one needs to look at. There is also what that debt represents, whether it is debt that has been accrued because of capital; what does the market think regarding the sustainability of that debt; and, more important than anything else, what is the financing cost of that debt. A 100% debt ratio at 0% interest is a lot better situation than a 100% debt ratio at 3% or 4% interest.

Those are the issues. The process was paused last February when the European Commission first reported on the budgetary rules and, of course, the Stability and Growth Pact escape clause has been triggered and that will be extended for a while. After the recovery starts, I think there is an opportunity to look again at the fiscal framework. There is scope there but it is a political issue as to what changes will actually materialise.

In terms of interest rates and inflation, all I would say is that we do not see them increasing markedly in the near term, and I think there are reasons for that. With regard to interest rates, the ECB is on the record as saying it expects its current asset purchases and its low interest rate environment to be in place for a while. However, I would say that interest rates and inflation are at historically low levels and, at some stage - I would not put a timeframe on it - there is likely to be an upward trend in those.

Deputy Pearse Doherty: Fáilte chuig an gcoiste. I have a couple of questions. Some of the issues I want to raise have already been touched on. I want to explore the supports and how long the Central Bank believes they will last. Looking at the economic letter that Mr. Hickey was part of drafting, page 3 states that the spending on temporary Covid supports, such as the EWSS, is likely to reduce in the coming years. Can I take that as an indication that the Central Bank believes this type of support should be continued not only post June, when it is expected to cease, or at least planned at this time to cease, but potentially into 2022?

Dr. Mark Cassidy: I would not put a time on it. It depends not on the time but on the economic circumstances. In the economic circumstances we are in at the moment it would clearly be extremely unwise to think of reducing these supports. I think a time will come when the economy will start recovering towards normal, and then we need to consider how best to start gradually removing these supports. I think that will be State dependent rather than time dependent. I think it will depend on the economic data not only on how quickly the economy is reopening and what parts of the economy are reopening but also on how consumers are reacting. The economy may reopen but some parts of it may still lag the recovery. I think the data on consumer spending and employment trends as well as other economic indicators, rather than putting a specific time and, ultimately-----

Deputy Pearse Doherty: Given where we see we are, and we know where we are likely to be with the vaccines, the job in respect of this programme update and the first interactions regarding the budget is to try to project ahead. Does the Central Bank see that the latter end of this year would be the right time to start to phase out or indeed to stop some of these supports in their entirety? I take from Dr. Cassidy's economic letter that there might be a tapering out, depending on the circumstances, but some of these supports are going out to 2022.

Dr. Mark Cassidy: We have a central assumption underlying our economic forecast. We are not forecasting the public health situation. We are making an assumption that during the second half of the year the vaccine will not become a one-stop shop but will gradually become effective such that by the end of the year the virus will be effectively contained. If that assumption materialises, the advice will be for a tapering during the second half of the year. As for the exact design of that tapering and this kind of cliff-edge effect, the economy will not return on day one to exactly where it was. Therefore, the idea that one would suddenly stop all supports does not make economic sense, and I think that is generally acknowledged. Previously, yes, I think a form of tapering was planned. It is not for me to make Government policy, but under that assumption what one might expect to see would be a tapering during the second half of the year. I would not, however, want to go further than that-----

Deputy Pearse Doherty: No. That is okay.

Dr. Mark Cassidy: I would be veering into political-----

Deputy Pearse Doherty: That is what I expected or interpreted from the letter. Dr. Cassidy points out, as I in fact pointed out to him, that there was, at the lower end, €5.4 billion of core, non-Covid-related expenditure in last year's budget and that could be in excess of €8 billion. He argues in his letter that that needs to be funded by sustainable financing through tax increases, yet we have a programme for Government which basically rules out all those types of measures bar plastic bag levies or carbon taxes. How credible does Dr. Cassidy think that is?

Dr. Mark Cassidy: We know about what was introduced in the budget. It was, as the Deputy said, a minimum of €5.4 billion. We use that as an illustration of our more general point, which is that, looking forward, the economics suggest that if permanent spending increases are to be introduced, and we are certainly not advocating permanent current spending increases, then in some way they need to be funded. We use our economic modelling techniques to show the extent of that. Our results show that an increase of that order, approximately €5 billion or €5.5 billion, would, if not funded, lead to a permanent increase in the general government deficit of approximately 1.5 percentage points. What that means is that if one is thinking of returning to a balanced situation over a certain time, those 1.5 percentage points would need to be raised elsewhere. That is just pointing out the choice that exists. If one wants to increase permanent expenditure, which is a purely political decision, then over the more medium term that needs to be financed in one way or the other. There were some permanent increases, as the Deputy mentioned, and as the Fiscal Advisory Council has highlighted, in the previous budget.

Deputy Pearse Doherty: What is the Central Bank's view on the idea that we could grow ourselves out of the situation we are in? We are talking about some permanent increases. Most of them - not the majority of them but the larger proportion of them - related to health and staff within our healthcare system, which many would argue we needed and should have made a long time ago. However, we also have the one-off expenditure, which has run into €32 billion or so over the course of two years and will probably increase given that last year's assumptions are not materialising in terms of the supports that are needed this year. Is it the Central Bank's view that the State can grow itself out of this without imposing restrictions or additional tax increases or cutting back on the type of expenditure we made in health, education and transport, which were probably the three key areas where core expenditure came? There are two questions there. I am looking at the one-off expenditure on Covid and the core expenditure. Is there an opportunity to grow our way out of this?

Dr. Mark Cassidy: The Deputy makes a very important distinction. The one-off expenditure has very different and more benign effects on the budgetary position. Essentially, it will lead to a one-off level shift up in the deficit but will not lead to permanent pressures which are repeated year after year. That is very important and we see that when we expect the budget deficit to reduce to 4% next year. That is because of an assumption that these temporary measures will not be in place and it shows how they are removed. That is why we feel very confident in supporting the temporary measures that have been introduced. They are affordable. We think we will need to see a reduction in the public sector debt ratio at the right time. We think economic growth will bear the brunt of that. We think any policies that would restrict growth in the future, therefore, would be counterproductive. We think, in addition to the impact of economic growth, that that budget balance will need to get down to balance and, if the economy gets back to full employment, ideally something of a small surplus. The public finance position, the general government balance position, in addition to debt, will be important for that. The balance, that is, what government expenditure goes on, is also critically important in that regard. Capital spending is much more conducive to economic growth than current spending. The multipliers, that is, the amount by which an additional €1 million of government spending leads to longer term growth, are much higher - about 2.5 times higher - when spent on capital investment.

Deputy Pearse Doherty: Yes, and obviously there is a huge hunger for that type of capital expenditure in the State. There is no doubt about it. Therefore, my question to Dr. Cassidy is this: what level, in his view, of public capital expenditure could the State absorb? We have been here before, where there were capacity issues and so on, but we are in a new year and new dynamics, with high levels of unemployment and, unfortunately, some of these jobs not coming back in the short term. Is capital expenditure one of the ways in which we can deal with a number of problems at the same time in respect of not only employment but also the type of investment we need and then the return in terms of growth?

Dr. Mark Cassidy: First, I fully agree with the Deputy on the importance of capital expenditure. Second, of course, he will be fully aware of the national development plan. We have seen capital investment. Over 2018 and 2019, the average increase was 20% per year. Even last year capital expenditure here continued to increase by approximately 15%. That contrasts significantly with other European countries, which saw roughly zero or even a fall in capital investment, so the evidence of the lessons having been learned here is quite apparent. What we will have over the next ten years, I think, will be really a guideline that public capital investment would average approximately 4% of national income every year, which is a substantial share, probably currently about €10 billion a year. I think that would be conducive to growth. Certainly, it represents an avoidance of the mistakes of the past where one cut back on capital because of pressures on the public finances.

The Deputy alluded to a very important point, that we have, unfortunately, moved away from the kind of overheating, full employment position we were in only 12 months ago. That does also mean that capital investment now would be more productive than in a situation in which we are at full employment and-----

Deputy Pearse Doherty: But-----

Chairman: The Deputy is out of time. I will open a second round for members of three minutes each. While people are gathering their thoughts, perhaps members will indicate using the hands-up button on their Teams screens if they want to come in for a second round. In the meantime, I will ask a couple of questions.

I want to return to the issue of SMEs and the recovery. We heard a little bit this week, although maybe not as much as I would like, about the EU recovery funds to which Ireland may have access. With regard to those grants and loans, what will the financial packages involved look like and what is the role of the Central Bank in this regard? Does it Bank have any role in regulation? In what way will the funds make their way to SMEs?

Dr. Mark Cassidy: We do not have a role ourselves but, with regard to what is expected, the Government is in the process of preparing its proposals for how the money will be used. The current estimate is that we might receive approximately €1 billion in total from the EU recovery and resilience fund, of which in the region of €900 million will come this year. There will be requirements regarding how that money will be disbursed when we receive it. There will be a need to take into consideration expenditure on climate-related matters. Approximately 35% or 40% may need to go on climate. There will also be a need to take into consideration productive investment, fairness and macro-stabilisation. Essentially, the funding is for investment recovery and enhancing long-term potential, which is extremely appropriate. In terms of the economic framework of the EU, measures that can enhance investment and improve environmental sustainability will be very appropriate. I am not sure to what extent that would make its way to SMEs. The €1 billion I was talking about will be in the form of grants. There is the potential for the same amount again within the overall EU envelope as loans, but it is not at all clear whether Ireland or many other countries would avail of those because borrowing costs in the private market are so low at the moment.

Chairman: Does Dr. Cassidy believe there would be a differential in the rate between the private and the EU loans?

Dr. Mark Cassidy: I do not know what the public rate might be. At the moment, we are able to borrow for approximately 0% over ten years so I am not sure what the incentive would be. I do not have the details available as to what those rates would be and what terms and conditions might apply. I certainly believe that for most countries, given the low interest rate environment, the grants are the most interesting.

Chairman: As Dr. Cassidy describes them, I would obviously be very supportive of the constraints and the principles on the basis of which grants would be offered. The building back better aspect and the green recovery in particular are really positive principles. There is, however, a very specific profile to those grants. We heard this week that because of Ireland's GDP and our measurement of the economy in that way, we are going to receive fewer of those grants than we might otherwise be able to draw down. During this session Dr. Cassidy outlined the three points relating to corporation tax - they are very good points - namely, that Ireland should remain a good place to do business, that we should have a successful indigenous sector and that we should not rely too much on corporation tax. It seems, however, that while Ireland is losing out on those grants, the argument is that we are getting it back in corporation tax. There is a qualitative difference between receiving corporation tax and being part of that recovery fund and those grants. The first point about Ireland remaining a good place to do business is now working against the second, namely, to foster a successful indigenous sector. Is that fair to say?

Dr. Mark Cassidy: There is a lot to what the Chairman has said. As a result of the presence of multinationals, it is well recognised that our headline GDP is overstated as a measure of the incomes of the economy. GDP is probably in the region of 40% higher than GNI, which is what we get when we adjust for some of the practices of multinationals that relate to depreciation of intellectual property, depreciation of aircraft leasing and what is called contract manufacturing. These are activities that do not really contribute to the Irish economy, but they do add to the headline GDP. One impact of that is exactly what the Chairman mentioned, which is that it sometimes means our contributions or receipts to and from the EU are affected because the denominator is GDP rather than GNI*. I have heard what the Chairman is describing in terms of what we receive but consider, for example, something rather simple. If a country's contribution to the European Union is a percentage of its national income, and if GDP is used for Ireland, we are paying a much higher share than if GNI* was used. It is the case that our contributions to, and in some cases returns from, the EU can be affected because of this measurement issue of national income. I would not deny to that extent but in considering the contribution of multinationals, while corporation tax is important, it is only one element. It is not just exports. The overall multinational sector employs more than 350,000 people. These are high-skilled jobs with above average wages. They create a demand for skilled work and they have other spillovers in the environment and in local communities and also in terms of productivity and innovation technology. The benefits from the multinational sector are much greater and more intrinsic than just corporation tax. It is very important that the sector remains healthy and is encouraged in the State.

Chairman: I will stay with the issues relating to SMEs. Earlier we talked about how we will determine what is a viable business. Many businesses will be quite worried about what those determinants are. Obviously, we are in a very febrile atmosphere and there is a great deal of flux in many industries. I presume that some of the factors to be considered are levels of indebtedness and levels of production. Would issues around labour force and capacity be considered? This is a particular question for the construction sector where companies might be losing skilled people due to the shutdowns. It might also apply to the aviation sector, where, for example, people in a certain cohort may be retiring. Will Dr. Cassidy outline the factors that he believes will impact on whether or not an SME is considered viable?

Dr. Mark Cassidy: This is a difficult issue. I am not sure what that assessment of viability will be. It will not be the Central Bank that will make a viability assessment. I am not sure what it will entail. In a way it is too early. I am aware that this is not a very satisfactory answer because, ideally, we would be able to design and consider future policies now, but we do not know how we will come out of the crisis. For example, we do not know how spending patterns will change, which would mean that some of the temporary effects from the crisis may be sustained over time. Some businesses that may have been viable going into the crisis may not be viable over the longer term. Getting the balance right between, on the one hand, ensuring viable business, which is certainly for the economic benefit of the State, versus, on the other, keeping alive businesses that will not be viable over the longer term by allocating resources to those businesses that could be allocated elsewhere. That is an extremely difficult balance to achieve.

In the first instance, there is a widespread recognition that many of the firms which have suffered significant losses and increases in debt during the crisis are viable and that the latter is just down to their businesses has been locked down temporarily, albeit for more than a year in many cases. They came into the crisis viable; they will potentially be viable in the future and Government supports can help them in that regard. At the same time, we have seen some firm closures and, undoubtedly, there will be firms that will not be viable after this pandemic. Policy also needs to examine the most efficient, effective and least costly ways of restructuring those firms that will allow for the business to try to trade itself out of trouble during a restructuring process or to prevent it from entering liquidation prematurely premature liquidation. There are measures under consideration such as lighter, more flexible examinership procedures that could help in that regard. Policies will look, first, at continuing supports and how they might need to be adjusted and, second, in terms of potential restructuring procedures in the economy. There are a couple of difficulties in that regard. It is very difficult in practice in terms of that viability assessment.

Chairman: I thank Dr. Cassidy. I am going to abide by my own rule. I have more questions but we are on to the second round, I am afraid. I call Deputy Durkan.

Deputy Bernard J. Durkan: I have two or three brief questions and only one answer will be required. The components used in determining the level of wealth in a particular country are, presumably, all goods and services, all property and all salaries and wages. Could I have confirmation on that and also the extent to which that may misdirect economic policy? For example, we could say that all property is inflated in terms of price and that all property is market related and, as we know from the economic crash, its value suddenly disappear. I presume the GNP and the GNI* figures are used to measure wealth. Are they used separately in these measurements or independently of each other?

Dr. Mark Cassidy: I thank the Deputy. There is a couple of different elements to that. The first would be a distinction I would make between national income and national wealth in the same way that a household will have its annual income and also its annual wealth. When we talk about GNI, GDP and all of these measures they relate to income so they relate to how much an economy is producing or, alternatively, how much an economy is spending or earning within a year. They do not include factors of wealth such as assets, housing or the like. We have very good cross-country comparisons on income. We have very poor cross-country comparisons on wealth because it is very difficult to compare many of the assets an economy might have in order to put a figure on those. I might restrict the answer to income, which is what these measures relate to, and say two things about them. We published something on this recently by our previous Governor, Professor Patrick Honohan, which looks at different measures of income that are used and how each may not be appropriate and can give very misleading results.

To summarise, if we look at GDP, which is what most economists around the world use, Ireland comes out as the richest country, in income terms, in the European Union and the fifth richest in the world. That is entirely misleading and it is because GDP is inflated by some factors relating to the multinational sectors that in no way benefit the incomes of the Irish economy. If we look at alternative measures just for those, we are probably around eighth highest in the European Union. That is probably a reasonably meaningful comparison.

Professor Honohan also looked at what happens if we adjust that for the prices people pay. Two countries may have the same incomes but one may be paying twice as much for its goods and services, and even for housing costs within a year, than another. Ireland has an extremely high price level compared with other European countries, so if we adjust for the price level, again, we are down around eighth to 12th in the European Union, which is more meaningful.

I would make one other point on that. National income is purely a financial and monetary concept. There are also broader measures of welfare which are extremely important to take into consideration. They may also reflect health, education and measures of well-being and happiness within an economy. These are more difficult to measure. They may be more representative of welfare in one country compared with another. There is one such measure that Professor Honohan's publication mentioned, which is a United Nations human development indicator. It includes all of these and when that is properly measured for Ireland, again, we are somewhere around the middle of the pack in terms of measurement compared with other European countries. My apologies for going back and forth with a couple of different concepts in respect of measurement but I hope what I said goes towards answering the Deputy's question.

Deputy Bernard J. Durkan: It gives me an idea. I thank Dr. Cassidy. The final question is whether the Central Bank would have a concern if house prices were increasing at a rate that might otherwise be alarming.

Dr. Mark Cassidy: Yes, and let me clarify what I would say about the term "might otherwise be alarming”. If prices are increasing fuelled by a lending boom - a credit boom - and people are purchasing houses not out of the income they are earning in work but are borrowing to do so and we get the same dynamic that we saw in the 2000s, and if there is a fixed supply of housing or housing that is increasing somewhat, people are borrowing more, which puts upward pressure on prices and means that other people coming after them have to borrow more again. I suppose that price credit dynamic is what we would be most concerned with and we have very clear evidence from the past about what that can lead to.

The second comment I would make is that there is clearly an issue with regard to affordability of housing at the moment. House prices are extremely high. Many individuals and families cannot afford appropriate suitable accommodation, whether to rent or buy. The issue very clearly for us is a shortage in the supply of housing. That is a factor that needs to be addressed if that problem is to be overcome.

Deputy Bernard J. Durkan: On the issue of the shortage of supply, I have heard rumours to suggest that blocks of apartments throughout the country have been closed down. They are completed and ready for occupation but are not being occupied. It would appear to me that such activity will impact in a positive way from the point of view of the owners but in a negative way from the point of view of the borrowers who would hope to buy and occupy those apartments. What, if anything, can be done about that? Should the Central Bank take an interest in that possibility and deal with it?

Dr. Mark Cassidy: I am not sure whether the Deputy is referring to something temporary because of disruption as a result of Covid-19 or something which predates that and some form of speculation. Anything that reduces the supply of accommodation, both apartments and houses, coming into the market is a negative in terms of dynamics in the housing market. What we need is more supply coming on stream as best as possible. Beyond that is getting more into housing policy. We are clear in our advice on housing policy. There is a need to increase supply but in terms of how best to do that, we might not be as close to the complexities as the Government in that regard.

Deputy Bernard J. Durkan: I thank Dr. Cassidy.

Chairman: As no other members are offering, I will take the opportunity to ask questions. I want to return to the banking sector. A number of weeks ago we had a debate in the Dáil about current events in the banking sector and the Minister for Finance stated that he considered it very unlikely that another pillar bank would enter the market in Ireland. Would Dr. Cassidy agree with that?

Dr. Mark Cassidy: It is a little outside of my mandate. We do have a highly concentrated banking system.

Chairman: Let me put it another way. Would Dr. Cassidy consider that consumers have a meaningful choice in the banking services that are available to them here?

Dr. Mark Cassidy: I apologise. I do not mean to evade the question. I would say there is less competition in the Irish retail banking sector than there is in most other European countries. That has implications and banking is seen as an inherently national activity. It would be useful if the completion of a banking union allowed for a more European financial sector development. Currently we have a highly concentrated banking system with implications for choice.

Chairman: What would that financial sector development look like? What would more choice look like?

Dr. Mark Cassidy: If the European Union is to be a complete economic, monetary and financial union, the one area that must be further developed relates to capital markets and the banking union. That would allow the same sort of cross-border choices with the provision of financial services that exist in more regular services. There is still a way to go. Banking, for whatever reason, is still a national activity. We are certainly not the only country in Europe with long-term issues relating to the banking system across Europe. For many countries there is "over-banking" and there is a need for consolidation of the banking system. For many countries, including Ireland, the profitability environment has been very challenging.

Chairman: To be clear, you are suggesting there might be a future whereby banking or financial institutions work across national boundaries and are regulated by a central European source.

Dr. Mark Cassidy: If we are talking about bank regulation, large banks right across Europe are already regulated and supervised at a European level. The European Central Bank and Single Supervisory Mechanism supervises the large banks in Ireland, including the Bank of Ireland and AIB. That already exists. There is not the same level of provision of services at a European level that exists for other services. To have a complete economic, monetary and financial union, there is further room to remove barriers across the EU in a way that would be prudent. A framework exists with the Single Supervisory Mechanism and the European Central Bank but there are other parts of the banking union that will be developed in the coming years.

Chairman: Credit unions are very keen to increase their services. What is the capacity of credit unions to do this? What particular considerations would have to be taken into account before that happens?

Dr. Mark Cassidy: I am not in a position to answer that and the Registrar of Credit Unions would be much better placed to do it. I do not want to say anything outside my area of expertise because it is such an important matter. It is not an area in which I work directly, although I am aware of the importance of credit unions of course. Our Registrar of Credit Unions would be better placed to answer that question.

Chairman: Okay. Dr. Cassidy spoke to another Deputy about the cost of housing, house prices in general and the role of the Central Bank. He stated the role of the Central Bank would be to look at the cost of mortgages and he referenced the fact that house prices are such an extraordinary multiple of the average income of most households. Would the cost of land, transactions, hoarding or speculation also be the business of the Central Bank? Has the Central Bank reviewed the economic mechanisms that would or might impact land transactions or speculation?

Dr. Mark Cassidy: With the role of mortgages, our mandate relates to the functioning of the financial system, and mortgage provision is a key element of that. We are interested from both a financial stability perspective to ensure the overall system remains stable and from a consumer protection aspect in ensuring consumers have full information and transparency about mortgages they are receiving. It is those areas rather than the cost of mortgages that we deal with. We provide information on the cost of mortgages but we do not involve ourselves in those pricing decisions.

With regard to the housing market, our role is consistent with the financial stability mandate in ensuring the dynamics in the mortgage market are not inconsistent with stability. That is why we think our mortgage measures are critical first in ensuring the resilience of borrowers and lenders and in preventing the type of unstable price-credit dynamic I spoke of earlier that can arise in the housing and mortgage market. That is our main responsibility with the mortgage market. We also have a mandate in the provision of economic analysis and commentary and in that regard we are interested in broader housing market dynamics.

Chairman: We are almost finished the session. I am speaking specifically about land transactions. The witnesses have indicated they have a mandate to consider the financial stability of the finance sector in general. After the past decade and a half we can all say that land speculation has given rise to financial instability for this nation. It has had a considerable impact, and it affects borrowers, lenders and the price-credit dynamic. Does the Central Bank have a particular role in that?

Dr. Mark Cassidy: Not in terms of policies. There is Government policy in how to improve supply. We will contribute by providing analysis and assessment. Our key assessment is that there is a shortage of supply that must be addressed. With regard to specific measures and the design of these, taking in complexities and trade-offs that must be considered, there is data that may be available to other Government authorities that we do not have. It would not be for us to design or recommend particular policies. It would come at a higher level.

Chairman: The role would be pointing out the danger of particular instability.

Dr. Mark Cassidy: We would provide analysis on the broader housing market dynamics. Our assessment in that regard-----

Chairman: Sorry but I have to cut across.

Dr. Mark Cassidy: We would not go deeper than that to recommend particular policies that could address the supply. We might point to matters relating to planning or cost but considering how to address those would steer into Government policy.

Chairman: I do not see anybody else indicating and we are nearly at the end of the session. It remains for me to thank Dr. Cassidy and Mr. Hickey for attending today. I thank them for their engagement and assistance to the committee.

The select committee adjourned at 2.30 p.m. until 12 noon on Tuesday, 30 March 2021.