Central Bank Quarterly Bulletin 1 2017 Media Briefing

Attendees

Central Bank of Ireland:	Gabriel Fagan (GF) Gillian Phelan GP) John Flynn (JF) Jill Forde (JillF)
Journalists:	Sean Whelan, RTE (SW) Eamon Quinn, Irish Examiner (EQ) Vincent Wall, Newstalk (VW) Colm Kelpie, Irish Independent (CK) Peter O'Dwyer, Times Ireland (PO'D) Eoin Burke Kennedy, The Irish Times (EBK) Padraic Halpin, Reuters (PH) Peter Flanagan, Bloomberg (PF)

Jill Forde: …trying to make the presentation somewhat shorter to allow time for more questions as well. So, a similar line-up to the last one now but with Gillian. So Gabriel Fagan, our chief economics, John Flynn, our head of economic analysis and Gillian who has returned after a period of leave, the head of monetary policy.

GP: So, as usual I'll start with a brief overview of the developments in the euro area. So looking at the chart on the left hand side the euro area recovery remains moderate with GDP expanding by about 1.6% in 2016. So growth is now becoming more broad based across sectors as well across countries. Consumption and residential investment continued to grow and it's supported by labour income and low interest rates. Business investment continues its cyclical recovery. It's supported by favourable demand and financing conditions but its level really remains low in a longer term perspective. Foreign demand also remains weak with the global environment constituting an important source of uncertainty. So, looking the chart on the right hand side HICP inflation increased through 2016 and it reached 1.1% year on year in December 2016 according to Eurostat's flash estimate and that's its highest level since 2013. This increase was stronger than expected but it was mainly driven by higher energy inflation. So, higher oil prices push up the outlook for headline inflation in the short term while the possible implications for the speed of normalisation in underlying inflation are not as clear. At the same time, underlying price pressures remain fairly contained. The annual growth rate of wages continues to hover around 1.3% and has failed to gain any real momentum after the large drop in unemployment in the euro area since 2013. So, looking forward, the ECB project growth to be 1.7% in 2017 and 1.6% in 2018. In terms of inflation projections are 1.3% in 2017 and 1.5% in 2018. So, they see the overall risk to these projections to the downside and they include increased political uncertainty, banking and sovereign fragilities and potentially stronger adverse economic effects of the UK, of the exit of the UK from the euro area and also the new administration in the US. In this context, at its December meeting the ECB governing council decided to extend the asset purchase programme out to December 2017 with the volume of asset purchases per month decreasing from €80 billion to €60 billion.

Communication from the ECB was clear that if in the meantime the outlook looks less favourable or if financial conditions become inconsistent with further progress towards a sustained adjustment in the path of inflation, the governing council intends to increase the size of the programme and/or its duration. The governing council also reiterated its previous guidance in relation to both the reinvestment of principle payments from securities already purchased and the expectations that the policy rate will remain at or below current levels for an extended period of time and well past the horizon of the net asset purchases. So, just to summarise very briefly the key developments in the euro area, the euro area recovery remains moderate but it is broadening further. Headline inflation has increased more strongly than expected in December and that's mainly driven by higher energy inflation while core inflation remains more subdued. The euro area's recovery still faces considerable headwinds. Risk include political uncertainty, faster than expected rebound in energy prices and a persistent weakness in global trade. In response to this outlook the ECB have made some changes to the asset purchase programme in December and they reiterated their commitment to substantial monetary accommodation as necessary. So I'll pass it over to John to take you through the developments in the Irish economy.

JF: That's great. Thanks very much Gillian. So, thanks. And turning to the Irish economy and the main message is that the economy continues to grow at a healthy pace, though there are signs that momentum has slowed a little. Looking ahead, the overall outlook remains relatively positive so following GDP growth of 4.5% last year, our forecast is for GDP to grow by 3.3% this year in 2017 and by 3% next year in 2018. However, it has been the case since around the middle of last year, kind of following the outcome of the Brexit referendum, the outlook is characterised by a lot of uncertainty about the external environment and risks to these forecasts are clearly weighted to the downside and we'll talk more about the risks as we move on, later. The highly globalised nature of the Irish economy and the impact of activities of foreign multinational firms has had an impact on headline measures of the national accounts, in particular on measures of imports, exports and investment. And that leads to problems of interpretation with some of the headline measures in the national accounts, we saw that in the 2015 data and there are some issues which I will come to about 2016 as well. So, given that background it's necessary to look beyond the headline GDP and GMP numbers and to look at other more reliable spending and activity indicators to get a more accurate measure of what's happening in the Irish economy and in the domestic economy and what's happening to domestic incomes and production. Now, when you do this the underlying picture is that the recovery continues to be led by domestic demand though after a period of robust growth, there's some signs of moderation in domestic demand but that appears to be gradual. A measure that we look at and have been looking at for the last year or more has been a measure which we call underlying domestic demand which looks, which is the combined sum of consumption, government spending and the more stable components of investment if you like or the less volatile components and the ones which are relevant for the domestic economy. So, we exclude from that investment in aircraft and investment in tangibles. So we have a measure which links to better, we feel, to activity in the domestic economy. And if you look at that, underlying domestic demand has been growing fairly strongly in recent years. The stronger performance of activity on the domestic side of the economy has been supported by a number of factors. So we've seen strong, broad based employment growth. Employment grew by 2.8% last year which was its fastest rate in almost a decade. We've seen, while modest growth, we've seen growth in incomes but the impact of that on the economy has been boosted if you like by the fact that inflation is low so the real impact has been greater. And then we also have favourable financing conditions. So if we look at the components of demand, well, employment growth was very strong in 2016, there is evidence that consumption spending has slowed a little over the second half of the year and that's consistent with the evidence that we have from tax data and also from some softening in the indicators, some of the indicators of consumer sentiment. With regard to investment if we focus on the domestic components, growth remains pretty solid but the important point that I want to emphasis is that growth is occurring from a low base. So while there may have been some moderation in domestic demand it seems to be gradual according to the evidence that we have. Now, the next slide sets out the numbers in the forecasts along with our latest projection for the outturn for 2016 because we only have data so far for the first three quarters of 2016. And I'll start with the outturn for 2016 and I'll kind of talk about the forecasts, the 2017, 2018 numbers. So, starting with the outturn for 2016 the headline data here is once again affected by the impact of the activities of multinational firms and the national accounts and in particular our measures of exports, imports and investment. And we've seen that in the data for the first three quarters of last year. The sluggish performance of exports that we've seen is largely driven by a decrease in contract manufacturing activity and that has also had some impact on services imports, related to that. And the other factor at work has been a volatility in the imports of intangible assets and intellectual property. There has been weakness there and that's being reflected in corresponding volatility in imports and investment. So, as a result the national accounts measures of imports, exports and investment in 2016, as you can see from the table, are weaker than previously projected. But if we, but they tend to offset each other, so we still reckon that we're looking at GDP growth of 4.5% for last year, but obviously we'll have to await publication of the Q4 GDP numbers in March before we know that, we know exactly what the outcome is there. Now, abstracting from the volatility and the headline trade and investment data in the national accounts, however, domestic spending or activity indicators remain strong. So, as I said, we saw employment growing by 2.8% last year which is a very strong rate and we see a fairly healthy consumption growth as well. So, as a result underlying domestic demand grew by almost 4% last year, by 3.9% in 2016 and it was this which largely supported the growth of domestic incomes and production last year. Now looking ahead, assessing the outlook for the economy is complicated by the potential adverse effects of Brexit on Ireland. Given the close relationship between the Irish and the UK economies any significant weakening in the UK economy or weakening in the sterling exchange rate would adversely affect those sectors with a high dependency on exports to the UK. Now, we're six, seven months on from the Brexit referendum. So if we look a little bit at what evidence we've seen, what data we have since then, what does it tend to tell us, well, because the big challenge for forecasting really kind of for the last while, and still currently, has been assessing the impact of Brexit. So, if we look at what has happened since the Brexit referendum to date, in the absence of any weakening in the UK economy, because the UK economy has done reasonably well in the second half of 2016, the impact of Brexit has mainly been felt through the volatility in the euro/sterling exchange rate, so that's kind of what we've seen so far. We saw uncertainty in the period following the Brexit referendum and we saw that reflected in a sharp weakening in business sentiment indicators, both manufacturing and services indicators but they have subsequently rebounded strongly and they have recovered most of the lost ground. So, what that tends to suggest is that overall for the manufacturing and services sectors that the impact from Brexit related factors for the second half of 2016 has been contained or has been muted. Now, if we look at the sectoral data that we have to drill down a bit more and if we look at the industrial production data that points to some softening in the output of the traditional manufacturing sector, so we've seen that ease off. But the problem in interpreting that is that that trend was in place since the start of last year, since early last year. So it's difficult to isolate a Brexit affect in there of itself. So there's been a weakening in that but the weakening has been going on for about a year or so now. Looking ahead, however, it's mainly this sector, it's mainly this, you know, this mainly indigenous sector which would be vulnerable, well along with other sectors as well. Now, reflecting concerns about the impact of Brexit on the forecasts you might recall that we adjusted our forecasts for Brexit impacts in July last year. So, when we published the July bulletin we made a downward provision to report forecasts for the economy for 2016 and 2017. Now, since then the initial fears in relation to Brexit have been countered by some better UK data and we haven't seen any weakening in the UK economy so far. So, at this point in terms of compiling our forecasts, we're happy enough to continue with that negative adjustment and not to add to it at this point. But I'd say obviously there are risks and potential for those risks to re-emerge remains and we'll talk a little bit about those later. Now, subject to those downside risks, our latest forecast is for GDP to grow by 3.3% this year following the projected growth of 4.5% last year. Our growth forecast for 2017 is 0.3% lower than we published in the last bulletin and that essentially reflects a somewhat weaker output for net export growth. And we also published our first forecast for 2018 today where we project growth of 3% of GDP. Now, looking ahead we see the same pattern so we see that the main influence to growth for this year and next year will come from domestic demand and the outlook for the growth of consumption and investment is broadly favourable. But growth rates are projected, as you can see from the table, to moderate over the forecast horizon. The main driver of growth we see has been continuing gains in employment and incomes although in a less benign environment, we expect employment growth to moderate somewhat over the forecast horizon. But notwithstanding this gradual moderation we still see underlying domestic demand growth being fairly solid so being of the order of over 3% this year and around 3% next year. On the external side the outlook for exports obviously is subject to considerable uncertainty. We've seen a lot of volatility in the trade data for what's been reported so far for 2016 and then obviously there's potential Brexit affects. But separate from these uncertainties the outlook is for some moderation in export growth. Inflation we don't see much change really. We see inflation as being very subdued and has been essentially flat and slightly negative. We see inflation very gradually rising but still remaining under 1% this year and rising a little bit further into 2018. So, those would be, that's the forecast as we see them and I'll hand over to Gabriel.

GF: OK thank you very much John and thank you very much for coming here. The forecast that John has presented is our main scenario. It's the scenario that we deem to be most likely. Now it's a fairly benign forecast, it's a healthy growth in the economy. There's robust employment growth, unemployment coming down to nearly 6% by the end of the forecast horizon and it's happened in a context where you can see notable improvements in the economy still ongoing. The public finances are still improving. On the private financial sector, we see ongoing falls in personal sector debt down to about 150% of disposable income, falling mortgage arrears and restoration of bank profitability. So, overall a rather favourable scenario, healthy growth in the economy continuing. But of course this is a scenario, this is what we think is the most likely to happen given the information that we have at the moment. However, like all forecasts, but particularly at this moment in time, the forecast is subject to considerable risks. First, and most prominent, of these risks is the impact of Brexit on the Irish economy which could prove to be quite substantial. We've already incorporated an estimate of a Brexit affect into the central forecast but there is a lot of uncertainty, likely to be a lot of turbulence over the next two years as the negotiations proceed which will potentially pose downside risks and likely that maybe our estimates are not fully incorporating the downside factors. Then on the broader international environment we have two key elements that are a source of risk. One of course is the new US administration which has, in some sense it's a sort of mixed bag in terms of risk. On the one hand it's likely to have an expansionary fiscal policy which will boost growth in the United States and in the rest of the world including Ireland. But on the other hand policies in regard to international trade could prove disruptive to Ireland and to the global economy more generally. And then we have of course in Europe itself, in particular in the euro area, we have a year of potential political turbulence with elections in a number of countries which could give rise to a substantial volatility and uncertainty which could have adverse effects on the economy. So overall, looking at the picture of risk that we're seeing at the moment, our assessment is that the risks to the forecast are weighted to the downside. So what that means technically, is it's more likely that our forecast will prove to be too optimistic than too pessimistic in those terms. So that raises the obvious question, given the forecast, given the risk, what sort of policy message can we extract or is probably relevant here. And we summarise our message, it's not a new message, it's the same message more or less that we had in previous rounds and that is that policy should remain focused on underpinning stability and reducing uncertainty. So these are the key elements in this environment given the vulnerabilities of the economy. We have already listed out risks to Brexit related vulnerabilities, the risk coming from the broader international environment, the fact that we have an open economy, a small open economy which by itself is very sensitive to international shocks and then of course we still are carrying, although there have been substantial improvements in the public and private finances, there still is a high legacy debt burdening both the personal sector of the banks and the public sector. So, all of this calls for prudence in terms of fiscal policy in particular, in terms of wage policy, so that we make the economy in a position where it's robust and resilient and able to withstand shocks without major disruption. Thank you.

Jill F: Thanks very much. And we're now open to questions. Sean?

SW: Just picking up on that very last point Gabriel, emerging trends in wage policy, opening positions and direction of travel…

GF: You're talking about public sector or private?

SW: Public.

GF: Yeah, well I mean I think the important point we should stress is that public sector wages are an important component of government spending. So I think, as far as I recall, something like €19 billion is the public sector, the exchequer pay and pensions bill, about 15% of government spending. So, any discussions in regard to wage formation in the public sector has to take that into account. Now, it's not for us as the Central Bank to say, you know, what should the rate of increase be in public sector pay or who should get increases or not but we would highlight, you know, the importance of this component of expenditure for the overall fiscal position and the wage increases that are conceded need to be financed in such a way as they don't undermine the achievement of the government's budgetary targets.

EQ: Again, are you looking for much higher fiscal offers?

GF: Well our position, as was articulated, was as a minimum one needs to adhere to the fiscal rules, the European fiscal rules, that's the first point. Then there is an additional point that happens, what happens after we manage to achieve our medium term objectives, where do we go from there? And there the position has been that I think the aim should be to have a medium term debt target which is below 60% level and that has been accepted by the government as well so it's incorporated in policy. So, it's broadly speaking a consensus because with a high level of debt the economy is extremely, the public finances are extremely vulnerable to adverse shocks. We've seen that already and we see what we had with an even low level of debt initially at 20% of GDP, when you had adverse shocks on the economy. So prudence would require that we build up these buffers. So, to be able to better withstand those shocks. The worst thing that could happen is that the economy could, you know, be faced with a very adverse shock and at the same time, because the public finances are in a perilous state, there is a need for fiscal contraction, so that would exacerbate the shock and destabilise the economy. Whereas when you build up buffers you're in a position to allow some increase in deficits in the face of adverse shock so it's a more stabilising fiscal policy.

EQ: And no step up of that target or medium term target given the…?

GF: No, we're not arguing for any changes in the numbers that have been put in the public domain.

PH: Gabriel, when you look at the scenarios you put out last July for various Brexit risks to growth. I think there was, the most pessimistic, WTO rose which was about a 3% hit over 10 years using the Norwegian model and a more benign one, given what we've heard in the last couple of weeks what kind of hard Brexit do you see happening and where does that fit into those scenarios?

GF: Well I think now given the statements by the UK government the sort of soft Brexit options that we have in mind like a European economic area or a Norwegian or Swiss model, that's really off the table now so we're basically looking at what looks like some form of hard Brexit. So, the UK government said they will not be in the single market and they will not be in the customs union, so that's pushing for a hard Brexit. Now, the estimates that we put in, into our forecasts, were very much based on this hard Brexit because we thought it would be wise and prudent to do that rather than make an optimistic assumption about the nature of the Brexit. So this is the first part, it's related to the, sort of the next two years that are incorporated in the forecast. Then you have the longer term Brexit effects on the economy. There was a recent statement I think by the colleagues in the Department of Finance regarding these effects. So there were quite substantial adverse effects on the Irish economy, I think something like job loss relative to baseline at 40,000, impacted to what, 2% of employment, 4% of GDP. These are broadly, these are quite large impacts but they're broadly in line with the sort of numbers that we have regarding a hard Brexit scenario. So, the bottom line is I think we're really heading very much towards the hard Brexit scenario but we've already incorporated into our forecast.

JF: Yeah, the revisions we made in July, the end of July bulletin, were based on basically the WTO rules applying. So we, and that box is there. Again the effects on GDP and the effects on employment are probably similar to the numbers that the department were talking about.

VW: Just on that point, just a little bit of extra clarity for me anyway, you're not changing the Brexit effect adjustment yet, and I know the 0.3% downward forecast is broadly technical issues, but does it reflect a slowing economy generally if the Brexit adjustment factor is constant?

JF: Yeah, where it comes from, I suppose there's a couple of parts to that, where it comes from specifically, the 0.3%, is essentially from a weaker, a slightly weaker external outlook. And so…

VW: Net of Brexit though?

JF: Net of Brexit if you like, so that's net of Brexit yeah, is the important point there. So we haven't done, we made a Brexit adjustment in July and on the basis of the sort of things that it was talking about, and based on what we've seen since, we're saying well it's not that we wouldn't rule out ever doing something but based on what we've seen, we don't think it would be appropriate to do something now sort of in addition on Brexit. So, the slow down we've seen is net of that.

VW: So, sorry to cut across you John, but net of Brexit that slightly less favourable external environment is basically what, the new situation in the States?

JF: It'll be, it'll be, basically that say between sort of July and now, the broad external environment has changes a little in a downward direction, kind of. So, not that it would be, there is a little bit of that in it. There would be a little bit of the kind of broader influence of Brexit on the international environment so it's got to do with those factors. So, we would, each time we forecast we take the latest outlook for the international economy and factor that in. So basically that outlook has changed in six months so kind of that's what…

VW: It's kind of a double Brexit effect effectively. The risk analysis last summer, which you haven't have changed, is I suppose a specific direct impact it might have on us.

JF: Yeah.

VW: But there's a broader Brexit impact on world…

JF: Well, Brexit is not the only thing that would be affecting the world. So basically the world economy has evolved, has slowed a little is kind of what we're factoring in. And we've seen, you know, then we're looking at our export performance as well and factoring that in. So basically we have more data so we're looking at that. What we're seeing on the domestic side is that we've had a period of pretty robust growth on domestic demands, and that's slowing a little, it doesn't seem to be slowing a lot, but then there are these risks then as well.

GF: And just maybe not to overplay this downward revision which relates to GDP. If you look at other indicators, if you look at underlying domestic demand, if you look at employment, if you look at consumption, they have actually been revised a little bit up for 2017. So, it's a mixed picture - not to overplay the GDP a little.

CK: There's a 3% projection for next year, and I know it's quite far out, but does that take account of these factors that you're talking about that, are you assuming that there will be a continued slowdown in the world economy and Brexit and Trump, is that all factored into that?

JF: What we've done basically, so when we forecast we take, we look at forecasts from the international institutions kind of for the broader global economy, for the global economy, and we factor those in. So what we've done is, we've taken the latest forecasts and put those in and to the extent that the people kind of putting those forecasts together, so say the IMF, OECD and people like that are factoring in a bit of that, then there's a little, there's a little bit there.

POD: What are the greatest domestic effects of the economic growth at the moment?

JF: Well the risks to, I mean the risks essentially are largely on the outside. So it's from the outside in. So like the risks that are forecast essentially are external and it would be then how would they, how they would, if they were to materialise the channels through which they would materialise. So if they were to materialise, if there was to be some sort of adverse external development it would be the channel through which it would come in, so it would be trade essentially in some way or other.

EBK: We've heard a lot of talk about, you know, Dublin picking up a slice of the post Brexit cake, if I can put it like that. But is the bank seeing a pick up in firms seeking authorisations to trade from here under passporting rules or…?

GF: Yes. What we have, at this stage what we observe, our colleagues on the regulatory side, is a lot of, a number of enquiries from financial firms in the UK about the possibility of locating some of their activities in Ireland. My understanding is that we've had about 100 such enquiries so far and of course there may be more to come. But these enquiries, it has to be stressed, they're very much at a tentative stage. So the institutions are exploring their options. So, some of those institutions are also looking at other jurisdictions within the euro area. So, at this stage we definitely are seeing interest in authorisations but it's far too early to say what the impact of that would be on the economy, how much more, how many firms will come to Ireland to locate here, how much employment will that involve. But there are signs that there was an interest and the firms are exploring this.

EBK: About 100 since the referendum, is that what you're…?

GF: Yes, yeah and before that I mean, yes exactly, that's right.

CK: It's probably a question for your colleagues on that side but when they come and they make these tentative enquiries what are they asking? Is it what the authorisation process is or how long it takes or what are the sort of…?

JF: I think it varies and we would get into the detail really on the other side of the house as well. You're talking about funds as well, different types of firms across the financial services sector. And I suppose a key point we're making as well is that the same authorisation requirements apply within the EU area so they are really no different here than anywhere else. But we can take that offline and I think maybe you've spoken to Gerry Cross before, reading his work in this area and maybe go through it in more detail then.

CK: Sorry, I know it's probably…

JF: Yeah.

PH: Just on the long term Brexit impact, the most pessimistic scenario you had in July, the 3.2% hit to GDP over that 10 year period, is that what you see as being the most likely scenario now and when will that, will we sort of see that coming off growth figures, is it sort of up past that two year period or would it be five years down the line?

GF: OK one needs to distinguish two things, sort of the political question, what is the likely arrangement of the UK with the rest of the EU after the Brexit takes place? And of course there you have also the additional complication of possible transitional reviews which may make it a longer time. So, that's the actual, what do you think the actual scenario in terms of the political arrangement will be. And then we have the question of what will be the effect on the economy of those, the particular arrangement. Now, I think it's pretty clear in terms of the first question, we're pretty much heading towards a hard Brexit. I mean I think that's, there's no way really around that. So then the question is what's the effect of the economy? I don't, John you may want to take the details, but basically I mean the main channels are first of all there's an effect on the UK economy which has a direct effect on the Irish economy because of trade linkages. There's the exchange rate related matter that will affect it. Then then finally the important element is the disruption of trade patterns. I mean if you have something like tariffs, the return of customs posts which increase trade gaps, this will lead to a fall in trade, both imports and exports. So, all of these elements together are… Now, it has to be stressed that any estimate of Brexit, even if we knew for certain what the relationship will be with the UK and the rest of the EU, there would still be an uncertainty about the economic effects, I mean that's clear. Do you want to add anything?

JF: No, no I mean I think that's, that's…

GF: OK fine.

JF: Thanks.

EBK: Do you give any credence to the kind of theory that we could be a bigger victim of Brexit than Britain?

GF: No. I think that's very implausible, I mean in terms of the magnitudes involved. I mean the main impact of Brexit will be on the UK economy itself because I mean if you look at the extent of trade I mean it's important but it's 15%, what is it, 15% of goods and services?

JF: Yeah.

GF: Going to the UK, the rest not going to the UK, going elsewhere. Whereas of course the UK exports on the percent of UK exports, so they're going to be much more affected by that. And we add on the other factors in terms of the financial sector and all of these other industries so I never, we never, I had seen some people who had made these claims but they are I think economically implausible.

PF: Given, you know, Trump's comments about international trade and bringing companies home and everything else, is there anything suggesting that, you know, Trump's effect on the Irish economy could be greater than Brexit in the long term or is that…?

GF: Well I think it would be very hard to quantify the magnitudes of the relative effects but I mean you're right in highlighting the key sort of downside from the possible Trump administration policies, relating to essentially global trade and the relocation of industry and business maybe back towards the US. In Ireland we have something like 150,000 people who are employed in US owned firms so there's an obvious vulnerability there. There is the question of corporation tax; again reforms of the US corporate tax system are almost likely, certain to take place. We don't know exactly what they will be and they would have implications potentially for corporation tax revenue. So those factors are there but I don't think we can weigh them up against, you know, Brexit and whatever. And also then when we talk about the US administration we should also bear in mind that there are positive factors at work as well, the fiscal stimulus in the US will boost global growth and Irish growth as well.

EQ: OK, just on the same point, is there any possible analysis of where, what the effect on Ireland from US corporation tax at different levels, 20% and 15%?

GF: I'm not aware of any. Are you?

JF: No I'm not. I'm not aware of, I'm not aware of any.

GF: There has, sorry, now my memory catches up with me, as a consequence of old age it takes a while! I think there was an interesting piece by the ESRI, by Martina Lawless, on the effects of this, of corporate tax on, corporate tax rates on FDI, there has been some work. And also maybe Conor, Conor had a…

JF: Yeah, Martina looked at the common consolidated tax base I think yeah so…

PH: Can I just ask on the house price inflation and I think in the report you say it's unlikely to moderate significantly in the short term, given the acceleration that began in recent months. Does that, does that begin to, begin to impact affordability for some people in the economy and what are the long terms impacts of that potentially on demand for those people?

GF: Well I would say it's that, I mean we have to look at the fundamental issue in the housing market which is the issue of supply. I mean we have our forecasts and other forecasts clearly see a substantial increase in housing. We've already observed it in the data and it's expected to continue over the next few years. However, the level of house building is below most estimates of what the demographic needs of the economy are so there is a shortage of housing. That is the case and then the forecasts take that into account. There are lots of factors that come into play then that may push it one way or the other. Maybe some of the housing strategies will prove to be effective in increasing supply which will help to diminish the prices. We may have effects on the economy, for example, related to Brexit if we were to have a sudden inflow of, I suppose say foreigners into work in our financial sector that would obviously put additional impact on the housing market, especially in Dublin.

PH: And when do you think that Ireland will get to the 25,000 houses, 30,000 houses a year that is needed?

JF: Our forecast for 2018 is 20,000 so we're getting, kind of we're getting closer. So we're putting on, say we're putting on say in terms of numbers about 2,500, 3,000 a year anyway so, you know, we're not that far off it at that point, you know.

GF: But just a point to make here is that these estimates are for flows, you know, flows. So even if you managed to have the new demand, you match, if the new demand is 25,000 a year, you're building new houses at 25,000 a year, there's still that big stock if you like of unfilled demands. It may be that you'd need to go beyond the longer term demographic need in order to get the market back into balance.

EQ: I get a, I still can't get my head around, you know, domestic demand, house prices rising say 8% up to 10% and domestic demand much lower… I do apologise, the increase in, well wages basically are not increasing by 8% or 10% so something has to give doesn't it?

GF: Well, I mean just to explain that…

EQ: I know about shortages and mortgages.

GF: Yeah, shortages. Also we have, I mean we've published in the context of the review of the macro credential measures a number of background studies which look at the German house prices and rents and so forth. I mean a key factor it that, within technical terms, the income elasticity, the income elasticity of housing in Ireland is greater than one. So if you might, if income rises by 5% then demand for housing may rise by 10%, just an illustration so that adds to the thing. So, even if you have a lower, so there's no reason given that to expect house prices to rise at the same rate as domestic demand or income. There has actually been a trend upwards over time in houses prices relative to income.

EQ: Yeah, but it's the same result isn't it, I mean you could get Irish people spending an increasing amount of their income on housing?

GF: Yeah, that's the implication of that - that is the implication.

EQ: Does something not have to give eventually?

GF: Well you'll have to spend less on other things, less foreign holidays, less eating out in restaurants, all of these sorts of things. These are, I mean it's the implication; you're increasing your share of expenditure on housing, so other shares have to go down.

EQ: That's what's going to happen isn't it, that's what, that's what is what is happening and is going to happen?

GF: Yeah.

EQ: And there's no sign of that supply given the other pressures you say, say well paid foreign workers possibly coming in?

GF: Yeah I mean the forecast for house prices have house prices rising faster than income.

EQ: Is there a possibility though to reach a greater portion of income than it was in 2006?

GF: I don't, we'd have to do as assessment.

JF: You would have to have a look at that yeah.

GF: Yeah, we haven't actually asked that question ourselves but…

EQ: So, it is inevitable that Irish people will be, have to spend more of their household income on housing...

GF: I think so, unless there is major change to supply patterns. Now, the third pattern we've observed in Ireland of rising house prices relative to income is a pattern observed in many countries but not all. If you have a situation, and in some cases, you know, some countries it's even worse, I think the UK has even worse than Ireland in terms of this NIMBY problem on supply. But if you can manage to change the supply pattern as in another country, like Germany, for example, house prices had been relatively stable compared to income for a long period, recently they've picked up, but that's because the supply is very elastic in Germany. When there's an increase in demand building starts off and they build new houses, that's less the case, it is the case in Ireland as well but it's less the case in Ireland. So that's really, if you want to tackle, if you see this as a problem and you want to tackle it the solution is to address the supply side.

SW: In Germany they've been arguing that because of rising house prices, they've been driven by ultra low Central Bank interest rates. The solution is to put up interest rates and that will put a stop to the gallop of the house prices, any argument for putting up interest rates across the board here as well?

GF: Well, I think your interpretation of what has been said is correct, that they have made this point, people have made this point. I'm not sure that this problem we're addressing is a structural problem, in the case in hand, so putting up interest rates, for example, will increase the cost of mortgages and so forth so the affordability will not improve. But in terms of the euro area as a whole the president of ECB have been very clear, the communication in terms of interest rates and nonstandard measures has been very clear, that the present levels will continue, until such time as we see a sustained adjustment in the path of inflation, until inflation starts rising back towards the level of the ECB targets. And it's also been said that the measures will continue to the end of this year, so the purchases, so I don't think increases in interest rates in the euro area are on the agenda for the reasonable horizon that we can look at.

SW: And in a fairly theoretic view then has there been, are you aware of anybody looking at any relationship between interest rates and the point at which it becomes more attractive to build according to supply in the market…

GF: In the case of Ireland?

SW: Is there any kind of relationship between the higher rates, interest rates, and making construction more attractive than it currently is or is that all spoof from the builders?

GF: No I think, no there's different issues. I mean I don't think builders are arguing for higher interest rates. But I mean I think their argument is that lower interest rates and low interest rates make it easier for builders to finance their projects and they will therefore increase supply because of the saleable supply effect. But of course lower interest rates make it cheaper to buy houses and that pushed us the demand. So I think most people would imagine, and certainly not imagine, I think the evidence supports the view, that reductions in interest rates would push up house prices, not push them down.

SW: But not the opposite?

GF: No, no I mean I think that's a very interesting theory. If the guy who developed that theory manages to persuade other people he could be a candidate for a Nobel prize.

JillF: On that note, I think we have probably exhausted all the questions, we've come to time. So, thank you very much everybody. See you for the next quarterly bulletin in April, is that right? Thank you very much.

ENDS