Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Economics Roundtable Discussion Summary

5 September 2018

Governor's Remarks – Points raised by attendees

A discussion was had on fiscal policy and in particular recent public commentary on the potential role for an SSIA style scheme in Ireland. Participants stressed the need for counter cyclical fiscal policies, but also said that while private individuals may be willing to save, there is pressure on public spending in Health, Education etc. The level of private affluence in the economy was discussed. It was noted that only certain parts of society would be in a position to avail of an SSIA style scheme. Household consumption throughout the country is not exceedingly high, although pockets of affluence do exist. Also discussed was the timing within any such saving scheme. The previous SSIA scheme was paid out in 2006/2007, at possibly the worst point in the business cycle for consumers to be getting a windfall of cash. A future savings scheme could have a macroeconomic trigger so that the money is paid out when the economy is growing slowly or there is a weak labour market. Separately, corporation tax currently makes up a large part of total tax revenue for the government. This can be pro-cyclical, so some proportion of it could be put away for future periods when the tax take is lower.

Public spending will increase aggregate demand in the economy, so could be offset by increased taxation. Another alternative is shifting money from current expenditure to capital expenditure. The pro-cyclical impact of Government spending should be considered - we must be careful about adding to demand when the economy is near capacity.

The participants considered what fiscal policy is ideal for Ireland at this point in the business cycle. It was noted that many countries that are less wealthy than Ireland have already moved their budget into surplus, whereas Ireland may still run a small deficit in the next budget. Moving into surplus as early as possible can reduce the need for large fiscal consolidation during the next downturn.

Participants discussed the role that new financial technologies would play in the Irish economy. It was generally agreed that major banks were incorporating a lot of the new technology and we will not see them lose much market share to Fintech startups. This makes sense given the economies of scale in banking, like the ability to pool regulation and risk management costs. Participants also supported a greater role for pan-European banking so that banks would not be geographically undiversified.

Issues in the Irish Economy – Points raised by attendees

A discussion was had on the level of labour supply. Discussants suggested that migration would not be sufficient to keep up with the level of jobs being created. Support for this point was offered by describing how strong Eastern European economies are – once the key source of immigration. With a tight labour market in Poland and Lithuania, workers there have less incentive to relocate to Ireland. The composition of workers moving to Ireland may be different in the future – more likely to be higher skilled.

The effect of labour supply on competitiveness was mentioned – if firms cannot find staff at reasonable wage rates then Ireland's competitiveness will be eroded. As Ireland is part of a monetary union, there can of course be no currency devaluation to counteract this. There was some debate over when and to what extent wage growth would take off. Research on the wages of new hires was mentioned, and supported the belief that wages will continue to grow. Some workers are concerned about their employers relocating so are less demanding when negotiating wages. In addition, there were concerns voiced about the trend of 'fake self-employment' in industries such as construction. The size of this problem and its potential impact on average wages were discussed. It was mentioned that wage levels are a macroeconomic question as there are macro externalities to growing wages.

The role of unions was discussed. Union workers command a pay premium over similarly skilled non-union workers in the US. However, it was suggested that Ireland's labour market is structured differently – less reliance on large scale manufacturing for example.

The role of the GBP/EUR exchange rate in dampening Irish inflation was discussed. It was noted that in the long run the effect of the weak sterling could drop out of goods inflation. Services have 2% inflation in Ireland. Some participants suggested that inflation may increase quickly if the sterling effect begins to attenuate.

Monetary Policy – Points raised by attendees

The size of the European Central Bank's (ECB) balance sheet, and the speed at which it might be reduced, were discussed. It was said that yields are being kept low not just by the active purchasing of assets, but also by keeping those assets on the balance sheet. The Federal Reserve (Fed) is normalising its balance sheet and it will be important to learn from their experience. Another question that attendees discussed was 'what is normal monetary policy now?' It is plausibly beneficial for central banks to have a large stock of assets. This could help private banks borrow from central banks, rather than relying on the shadow banking sector.

Attendees described how they thought ECB policy would evolve over the next 6 – 12 months. The importance of signalling was emphasised – how can the ECB signal their intention to normalise without worrying the markets? In contrast to the Fed, the ECB has not provided detailed guidance on its normalisation plans. Participants were in favour of the ECB beginning a practice of communicating its intentions more explicitly. It was argued that the ECB must not decide its course of action too far ahead of time. It must maintain some level of flexibility to respond to different economic environments as they arise.

In terms of the eurozone economy's connectedness with the US economy, it was said that the primary linkage is financial rather than trade based. Banks in Europe often rely on dollar funding. In addition, emerging markets that trade with eurozone countries are dollar funded. A rising dollar can make their debts more difficult to repay and could weaken eurozone trade with them.

Lending – Points raised by attendees

Attendees discussed timing in the allocation of mortgage rule exemptions. It was suggested that there is a seasonal effect in mortgage lending now that banks are having difficulties spreading the exemptions out evenly throughout the year. The discussion turned to whether it is up to the banks to remove the seasonality, or if the rules should be changed. It was argued that banks are aware of the rules and should be capable of spreading the exemptions throughout the year – they could do this by improving internal procedures.

The impact of the help-to-buy scheme was discussed. Attendees deliberated on the size of the effect it is having on house prices, and whether this effect varies depending on the value of the house.

The growing number of commuters was mentioned as a possible reason for wage growth being lower than expected. Usually, rising residential property prices in urban areas have to be compensated by employers via higher wages. If people decide to commute, this wage pressure is not there. Concerns were still raised about rising house prices and the impact on competitiveness.

Commercial property was discussed. It was suggested that the market is being driven by fundamentals – low building during the recession means there is a lot of pent up demand. Supply is catching up however, so the level of construction in the commercial sector is not expected to expand indefinitely.

The counter cyclical capital buffer (CCyB) was discussed by participants. It was said that the CCyB varies in importance across the eurozone. Given that Ireland has a high level of debt it is of more significance here than in France, for example. The CCyB rate in Ireland can be moved depending on the macroeconomic environment – in a downturn, it could be reduced or even suspended to give banks more capital. New accounting rules surrounding provisions are also relevant, it was added, and the Eurosystem must look at the cyclical element of provisioning.

This led into a discussion of how the financial system can fund the necessary scale of house building. If housing targets are met, some argued, the financial system might become under strain. Cyclical risks still exist, so lending pressures must be monitored carefully.