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Issues in the Irish economy: measurement, risks and conundrums

Economics Round Table, September 5th 2018

Outline: Issues in the Irish Economy

The Outlook in summary

- Positive contribution for external demand but domestic demand is the main driver

Issues behind the headline numbers:

Tracking developments in the domestic economy

- Underlying domestic demand tracks labour market developments well but is volatile
- A new domestic business cycle indicator

Labour market

- Approaching full employment so why are wages pressures so well contained?
- Sources of labour supply.

Prices: Why is inflation so low while output growth is so robust ?

- Brexit effects?
- Measurement issues?

Issues for discussion

- Domestic challenges
- External Risks



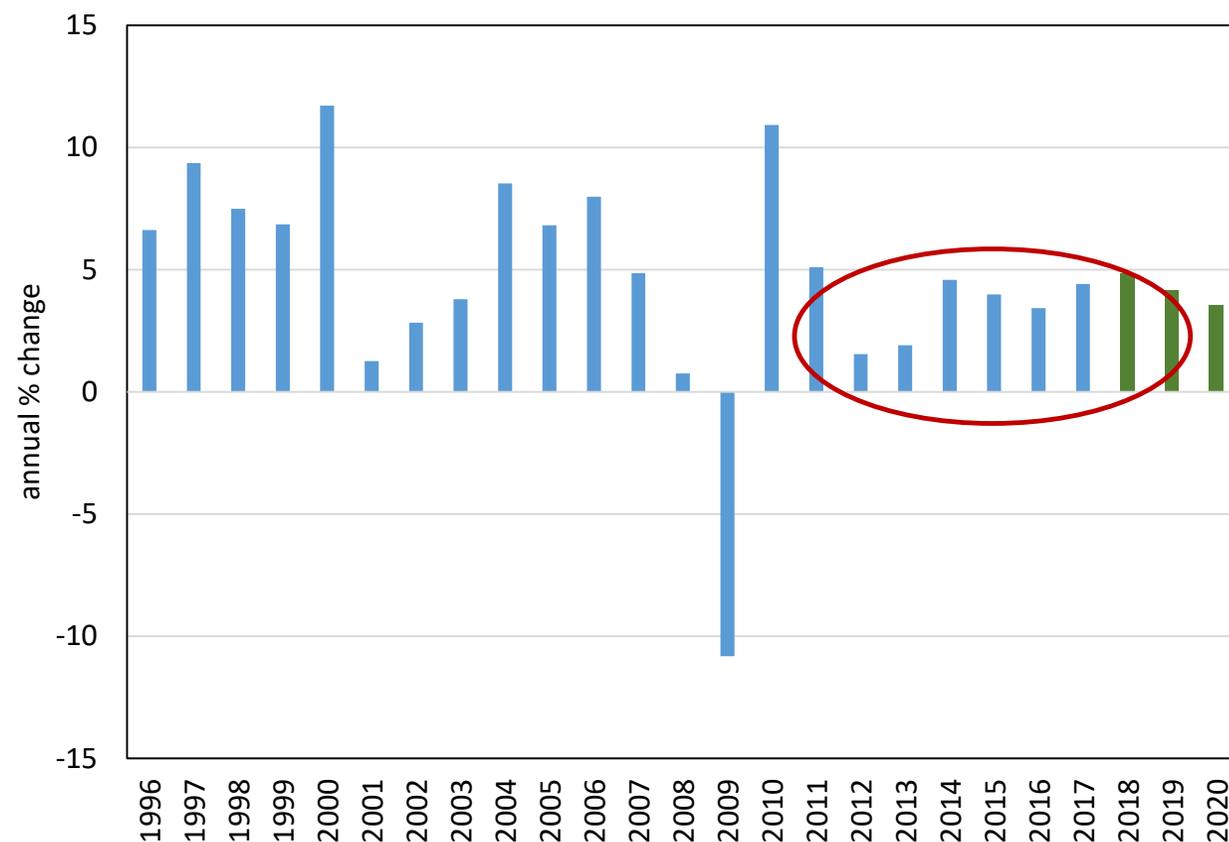
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Forecast Summary – robust outlook driven by domestic spending with modest net export contribution

Outlook	2016	2017	2018f	2019f
GDP	5.0	7.2	4.7	4.2
Consumption	4.0	1.6	2.6	2.5
Government	3.5	3.9	3.2	2.0
Investment	51.7	-31.0	9.2	9.0
Exports	4.4	7.8	5.0	4.3
Imports	18.5	-9.4	5.2	4.6
Underlying Domestic Demand	5.1	2.9	4.4	4.1
UDD Indicator	5.2	4.1		
Employment	3.6	2.9	2.6	1.9
Unemployment	8.4	6.7	5.4	4.8
Inflation (HICP)	-0.2	0.3	0.7	0.8

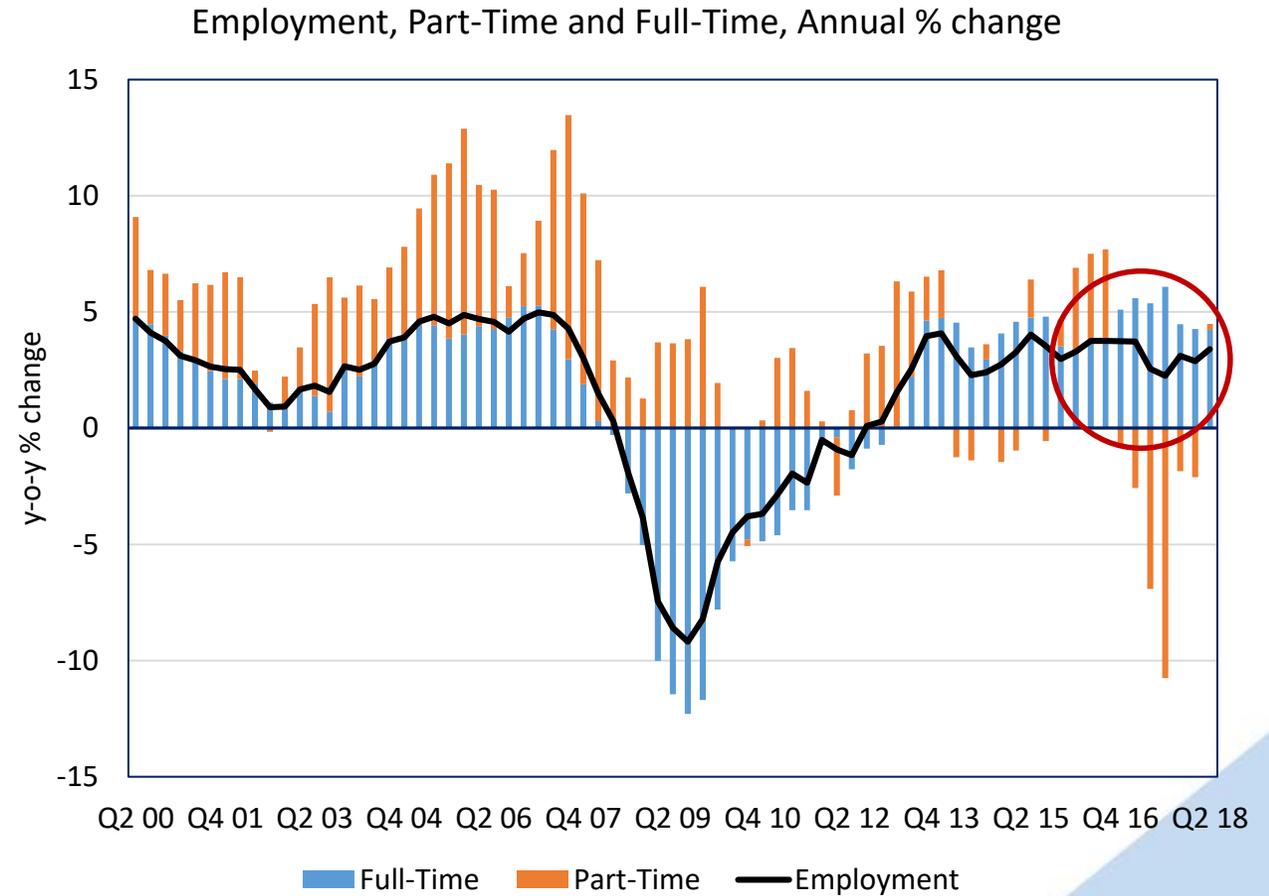
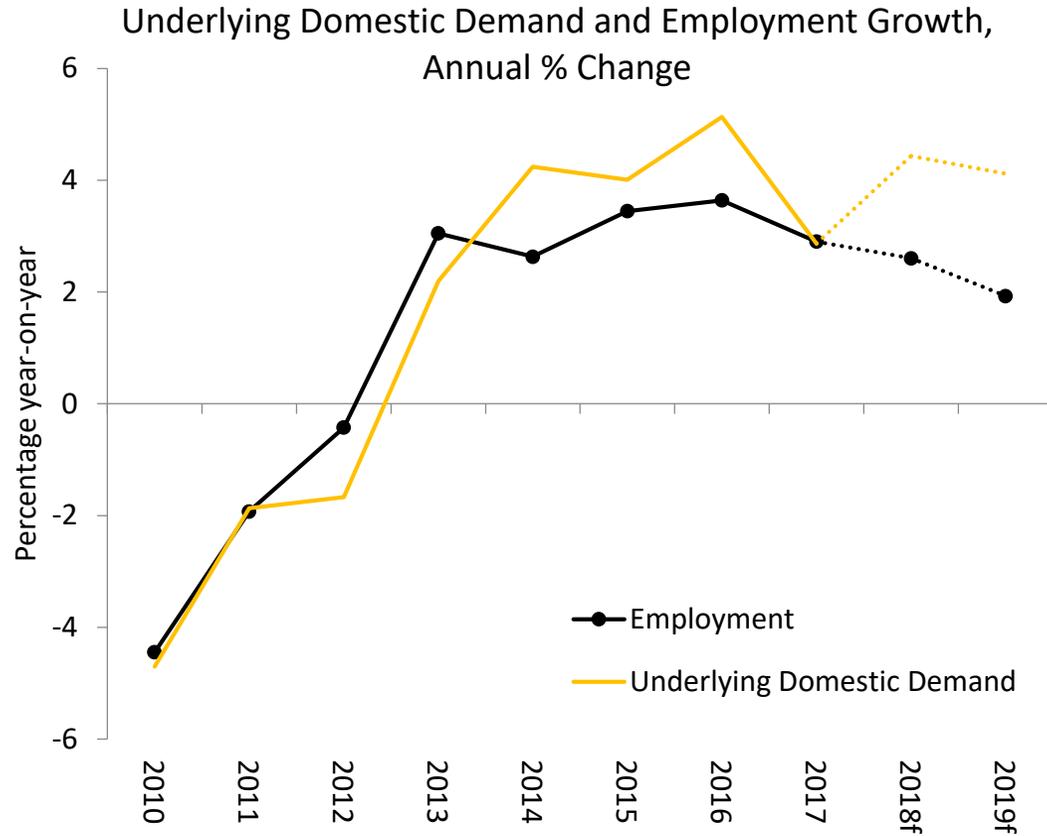
Weighted External Demand for Irish Exports, Annual % Change



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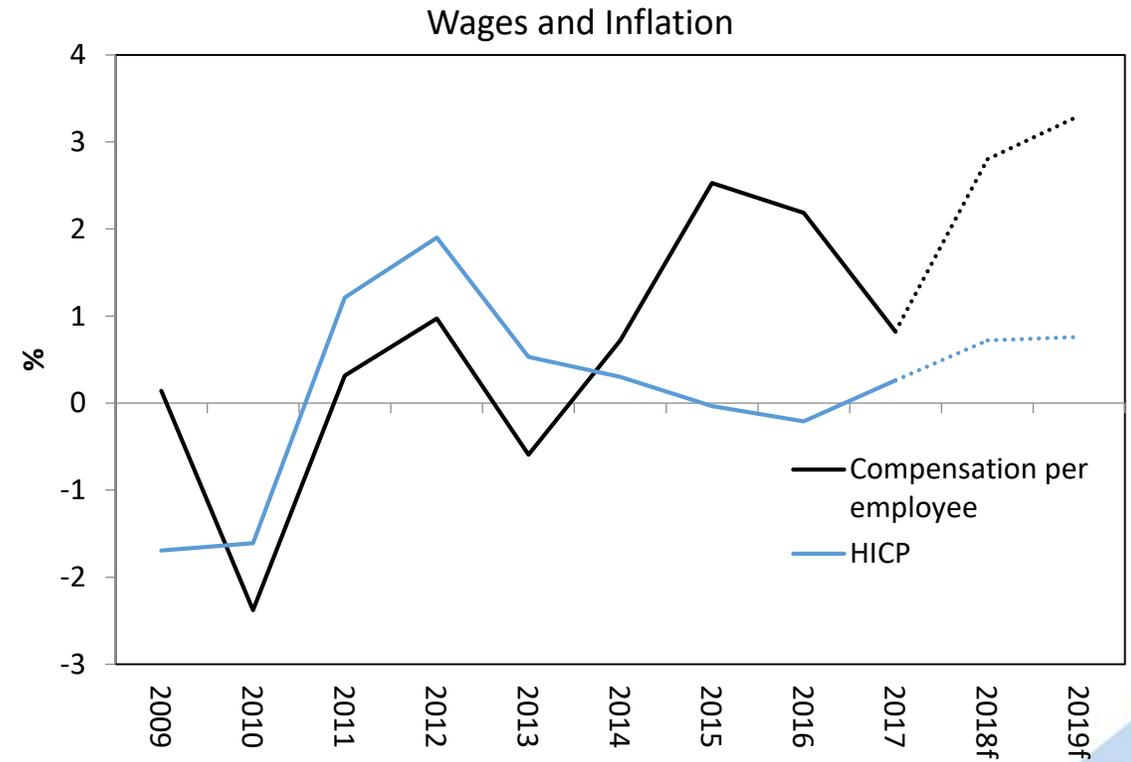
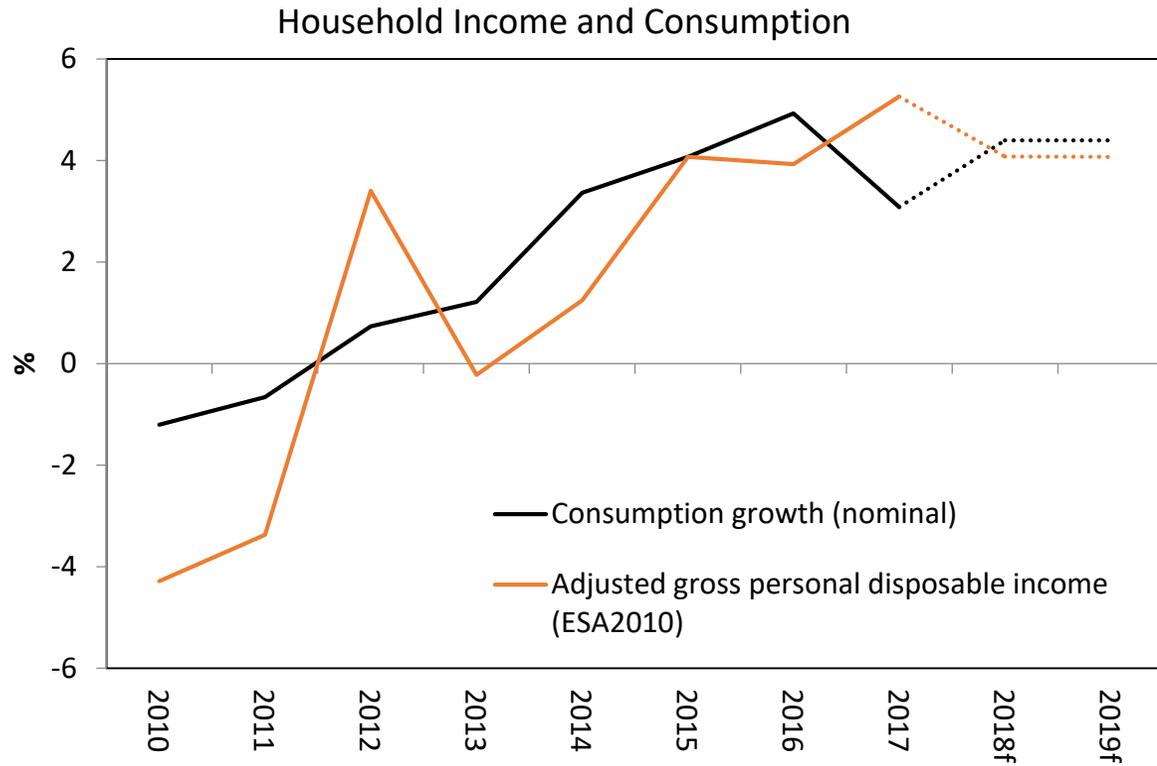
- Growth driven by domestic spending – labour market strength**



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- Wages and incomes recovering following the crisis...consumer price inflation remains subdued....surprisingly muted consumer demand last year



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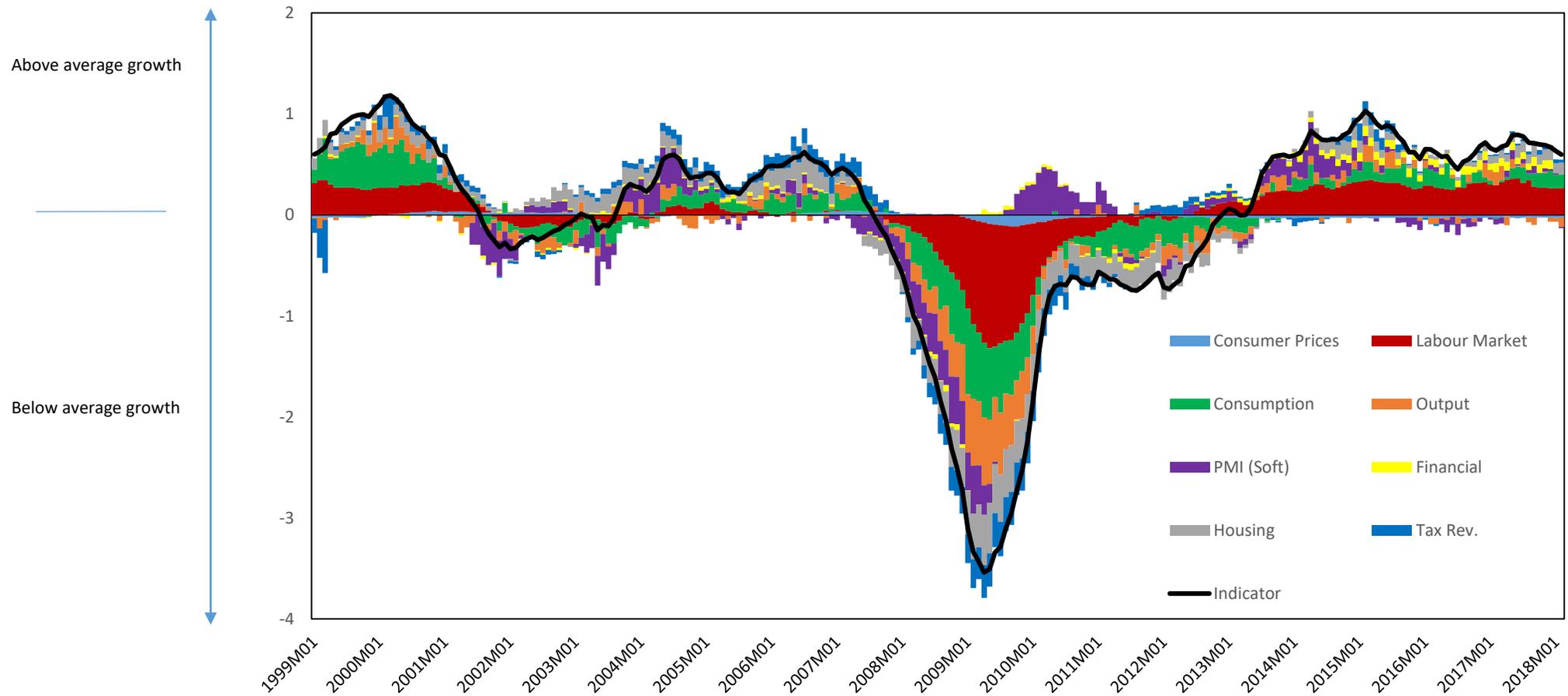
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Tracking developments in the domestic economy – limited information content in traditional measures

- Labour market developments are used as a key barometer
- We have developed a new Indicator of Economic Activity (Box C, July 2018 QB)
- Can we make sense of monthly data to decipher trends in underlying economic activity?
- We construct a single monthly indicator of economic activity using a panel of carefully selected high-frequency data.
 - Retail sales, unemployment, industrial production (domestic), Exchequer tax receipts, consumer prices, housing market.
- Indicator points to strong growth in economic activity since 2014 and tracks movements in employment and underlying domestic demand closely (correlation= ~ 0.85).
- Indicator can be used to provide a nowcast of underlying domestic demand.



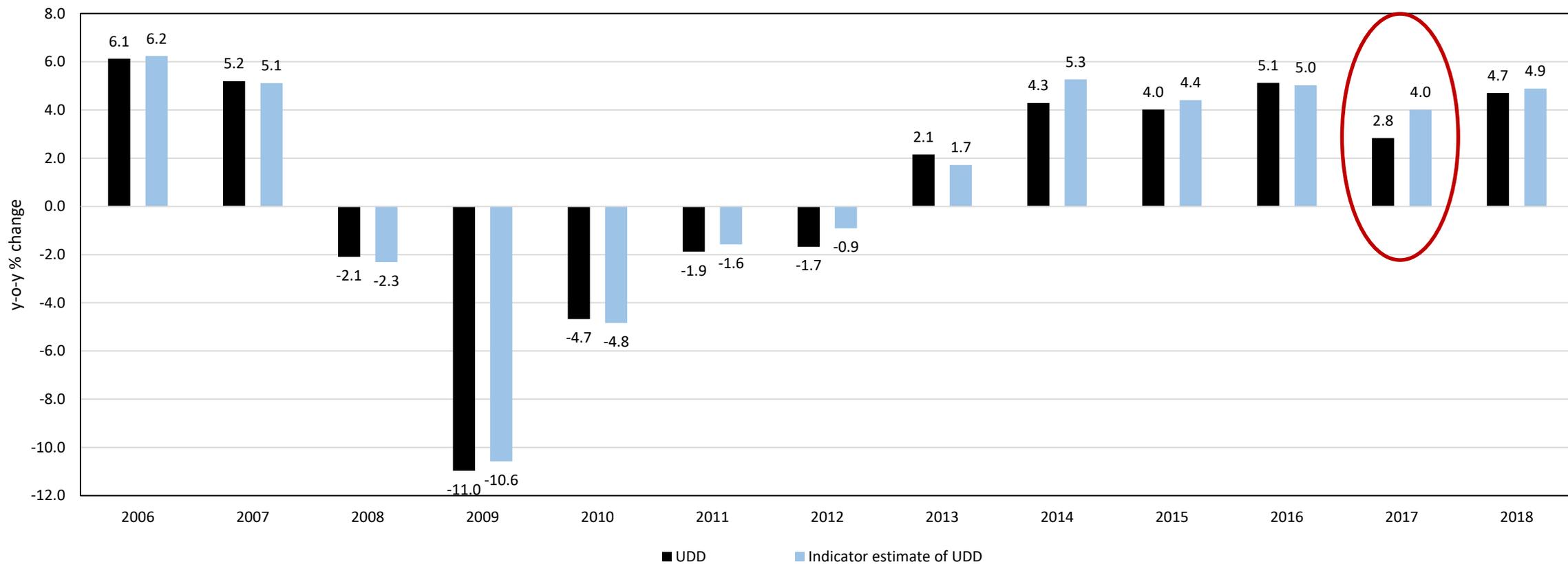
Business Cycle Indicator: Components



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BCI and Underlying Domestic Demand (UDD)

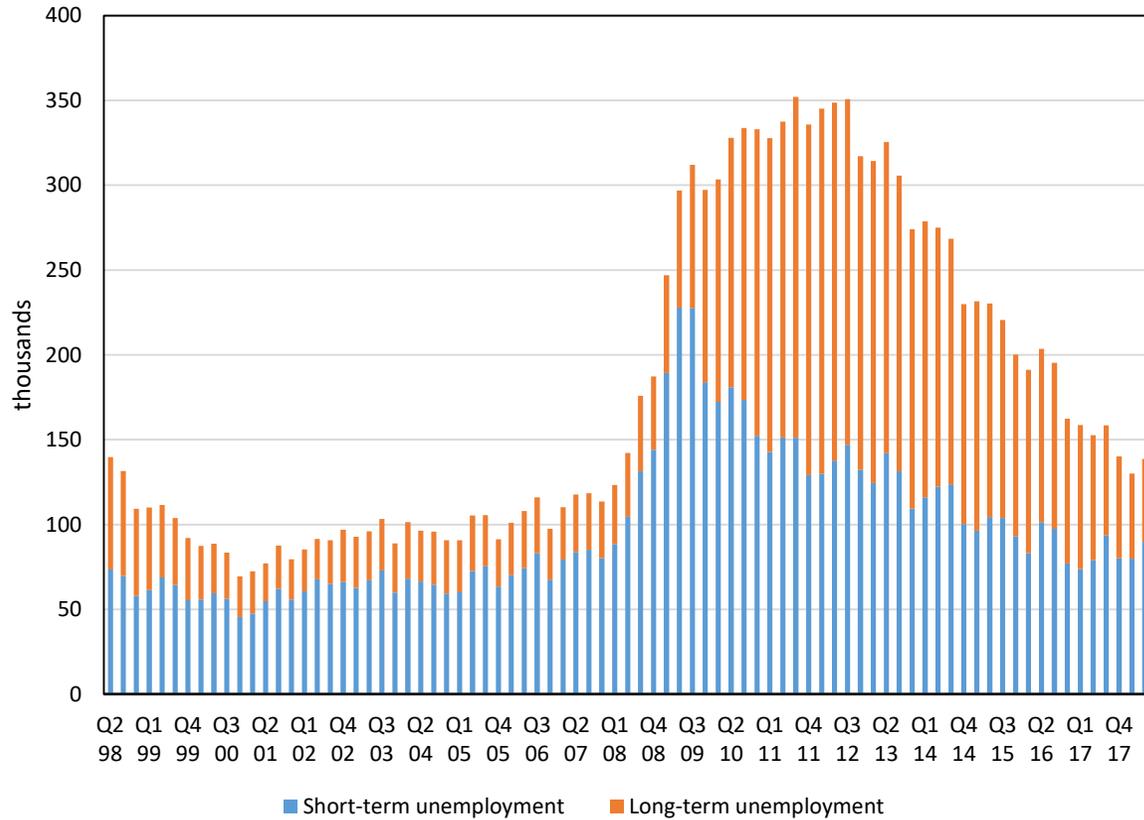


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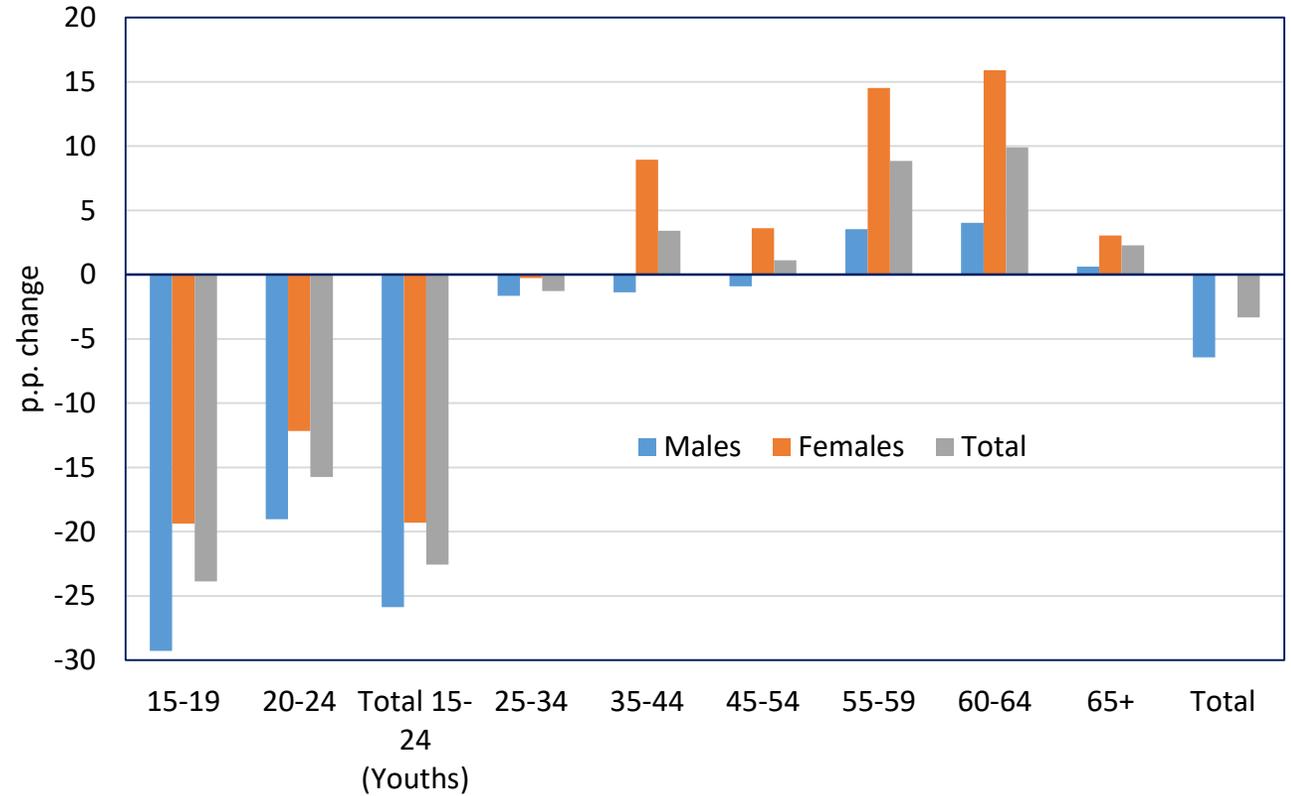
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- Labour market – approaching capacity across a range of measures – sources of supply?

Labour Supply: Stock of Unemployed Workers



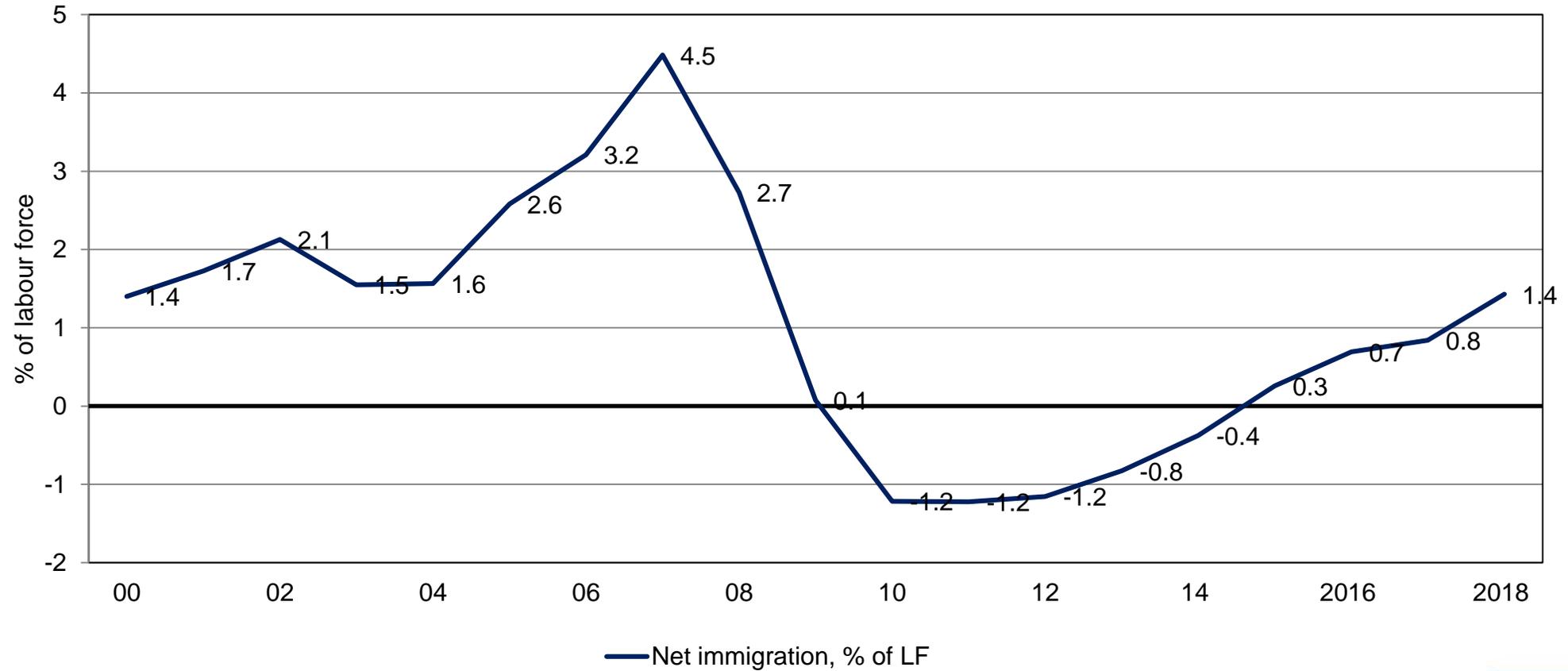
Change in Labour Force Participation Rate by Gender and Age, 2007Q2-2018Q2, Percentage Points



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Net Immigration, % of LF

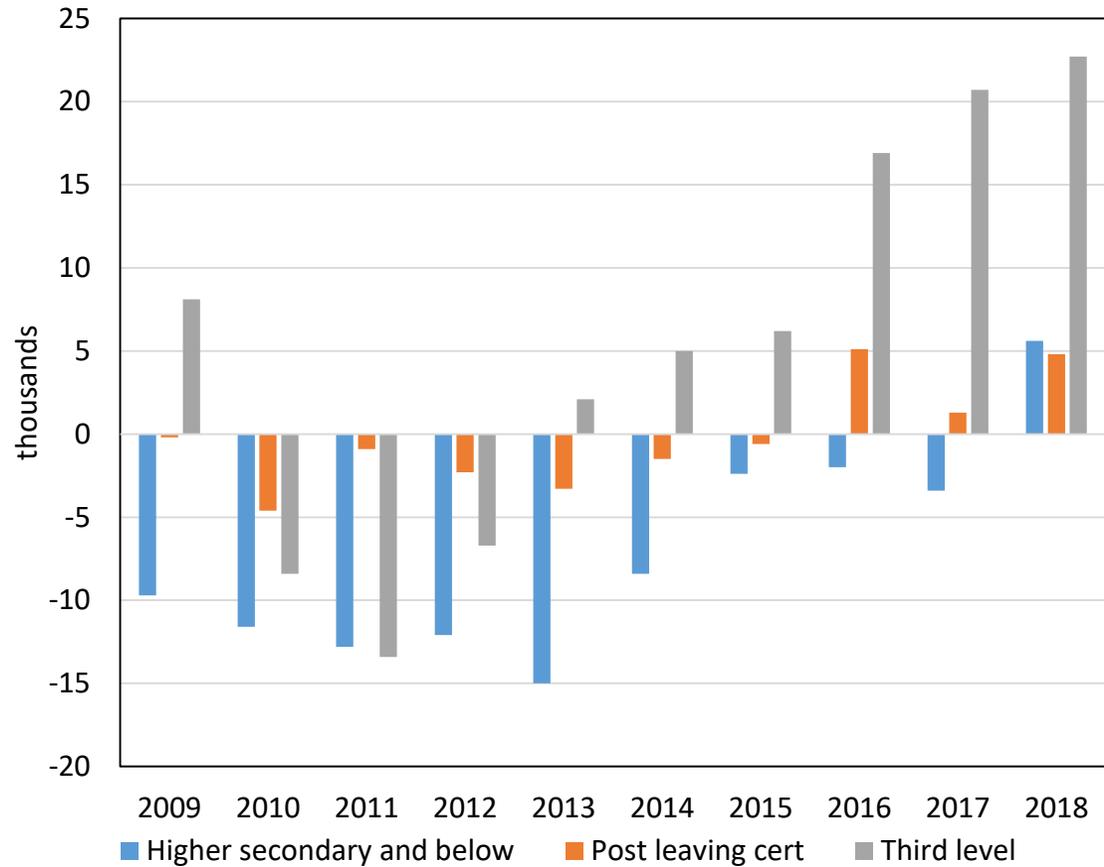


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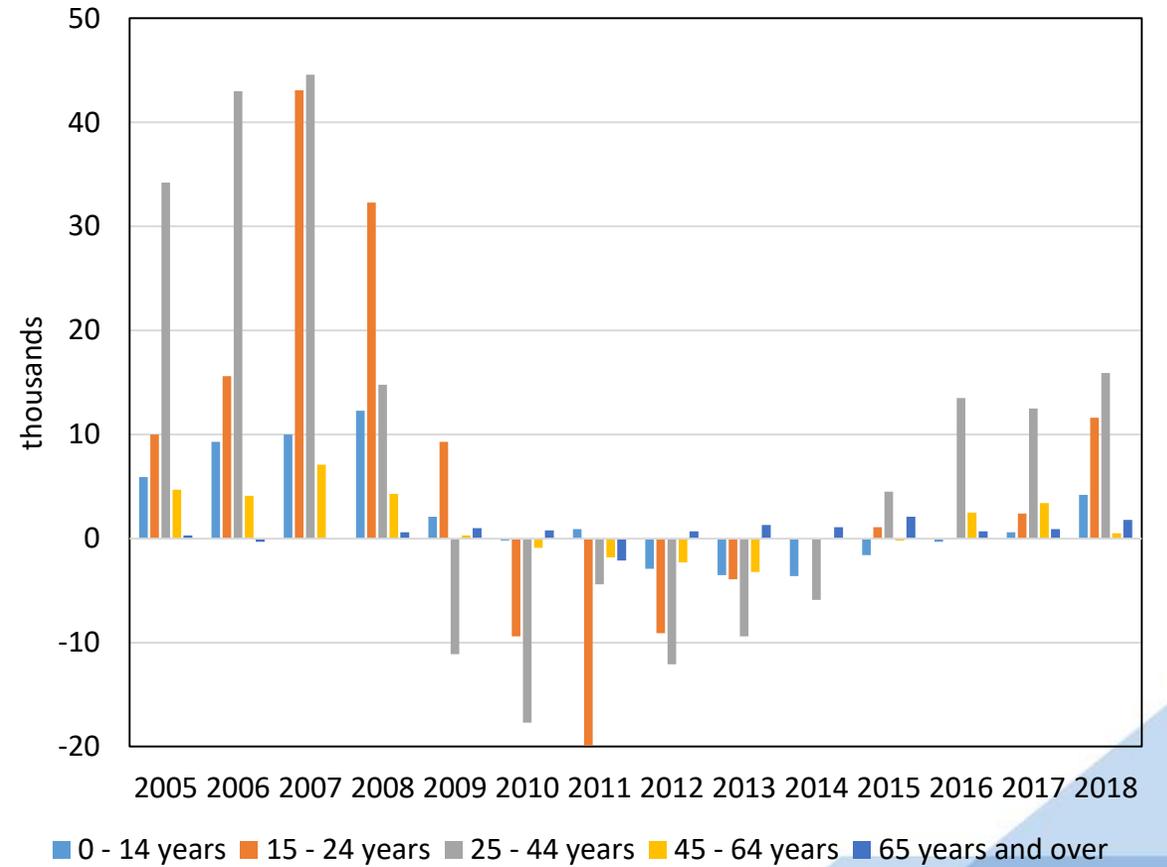
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Net Migration by Age and Education

Net Migration by Level of Education



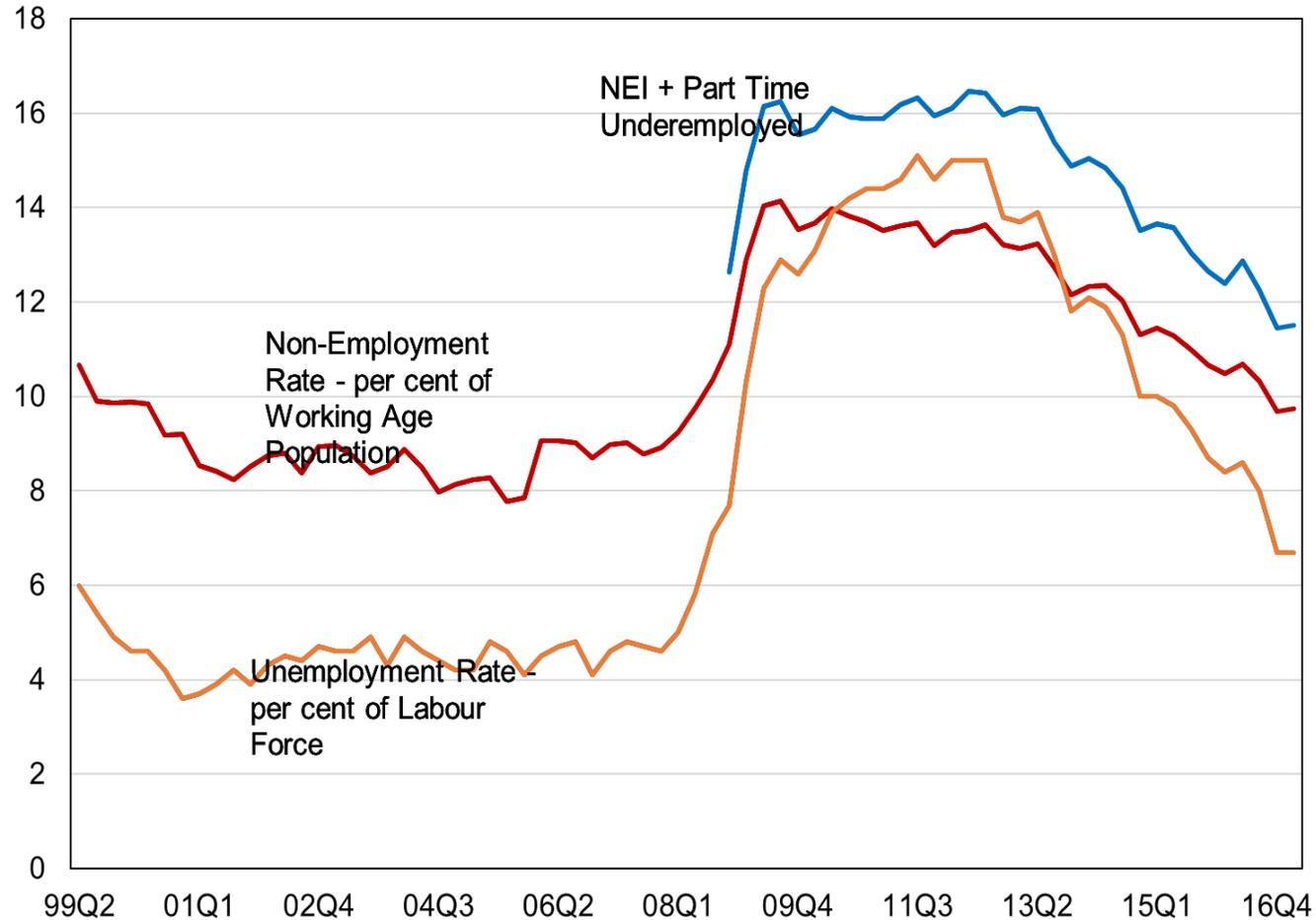
Net Migration by Age, Thousands



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Unemployment rate may not be adequately capturing labour market slack



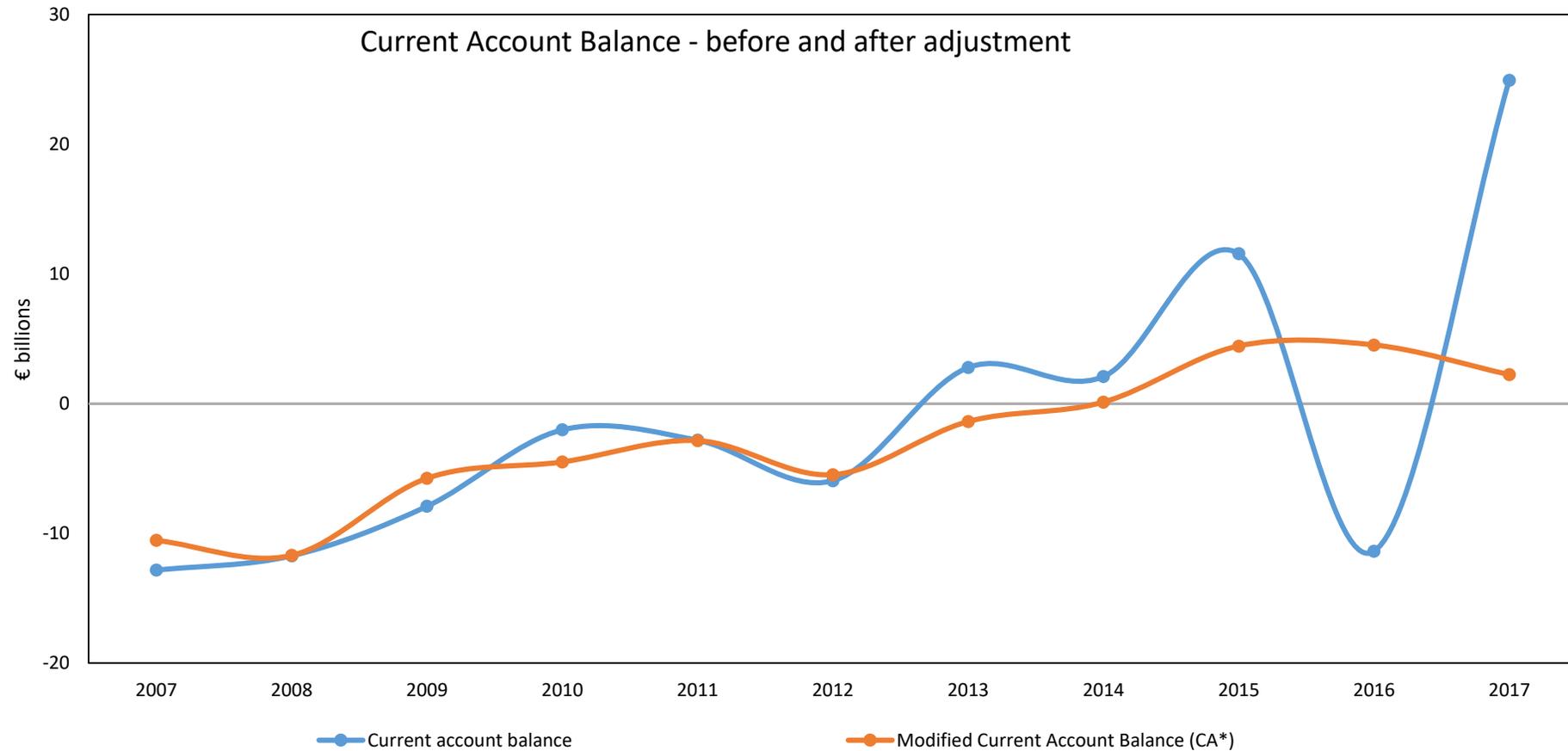
- Non-Employment Index (NEI) (Byrne & Conefrey, 2017).
- Includes cohorts outside of the labour force, weighted by their average transition probability over the QNHS sample period. (Proxy for their relative labour force attachment).
- Hints at greater degree of slack in the labour market than suggested by unemployment rate.
- Non-employment rate performs better than other measures of activity such as the unemployment rate in conditional forecasts of hourly earnings (Byrne, Conefrey & Zakipour-Saber (2018, forthcoming)).



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Wage developments and Current Account* not indicating cyclical pressures yet. Current Account* broadly in balance.



Inflation Developments: Brexit effect through the exchange rate (Reddan and Rice, 2017)

Inflation Contributions

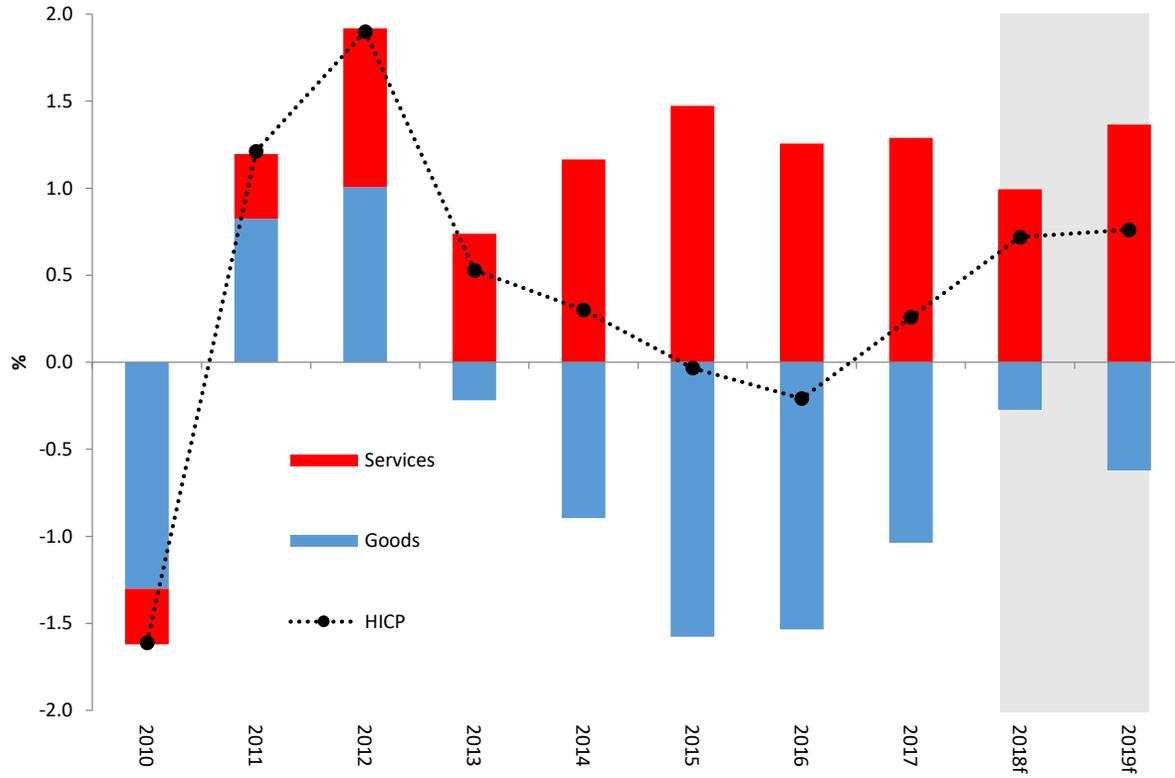
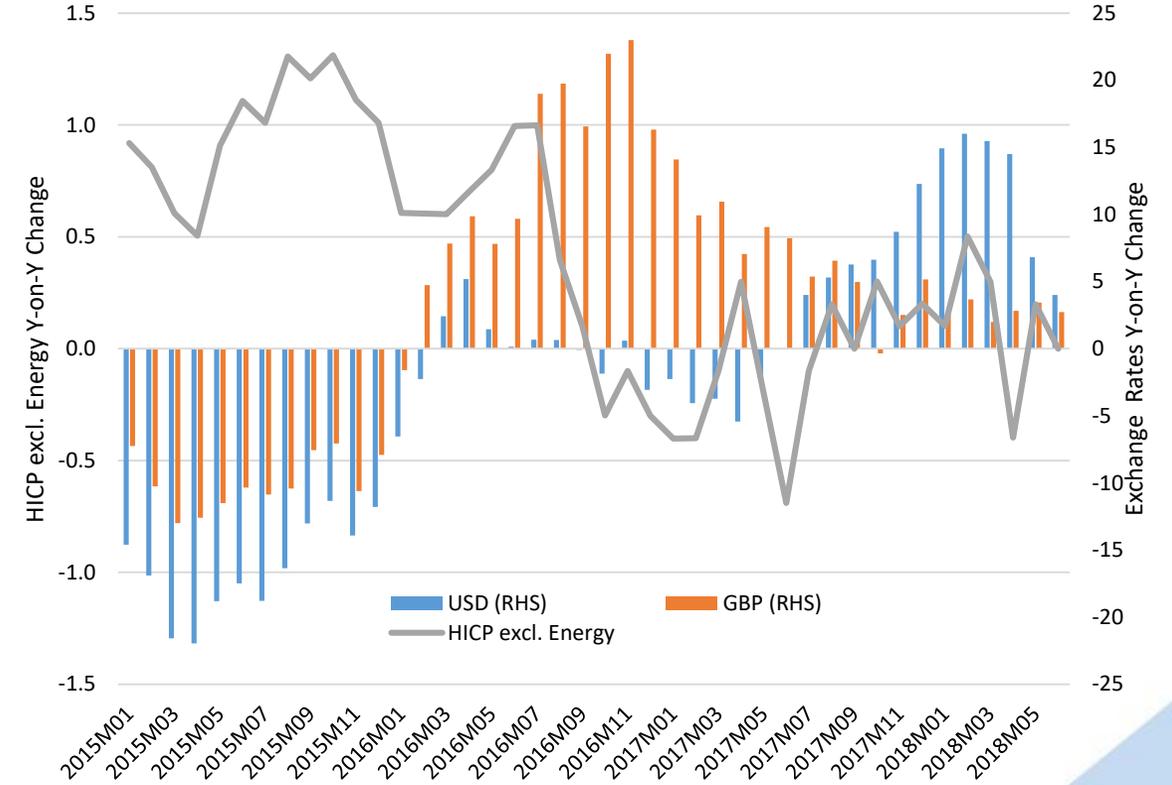


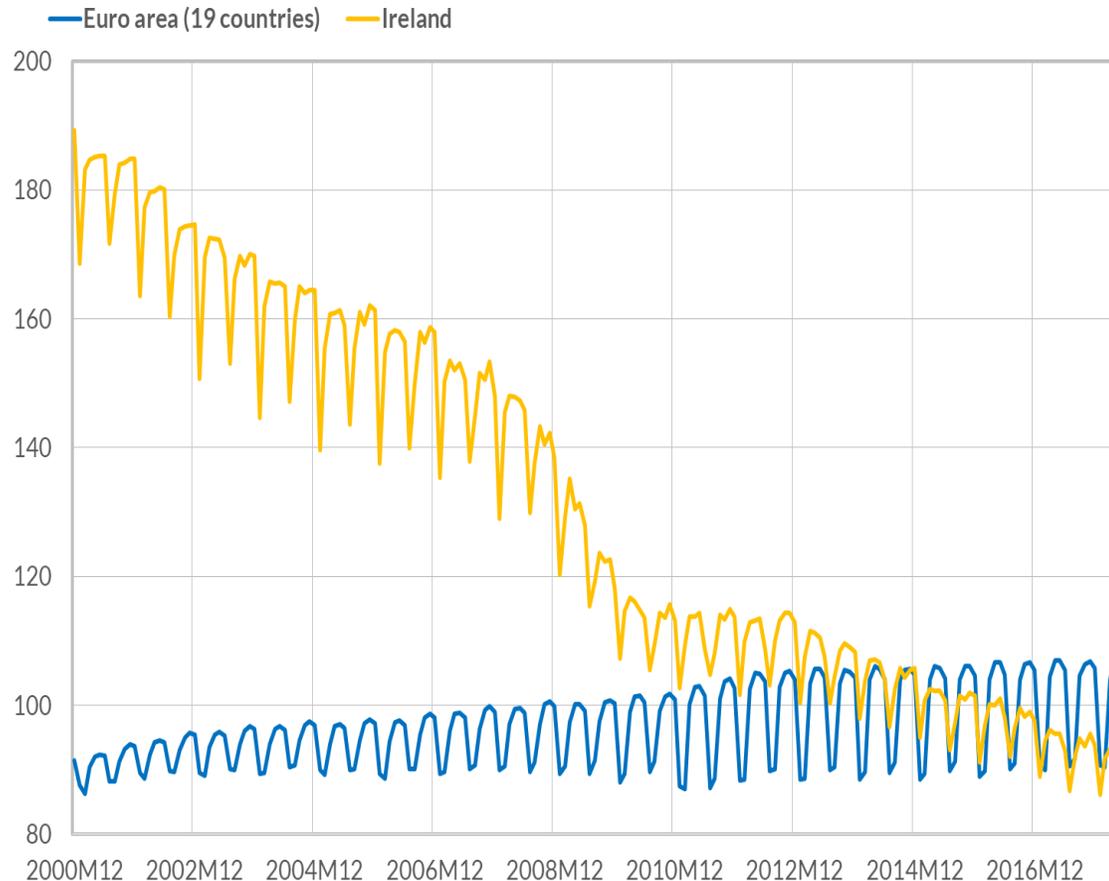
Chart: Irish Inflation and Exchange Rate Changes



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Clothing and Footwear Sales



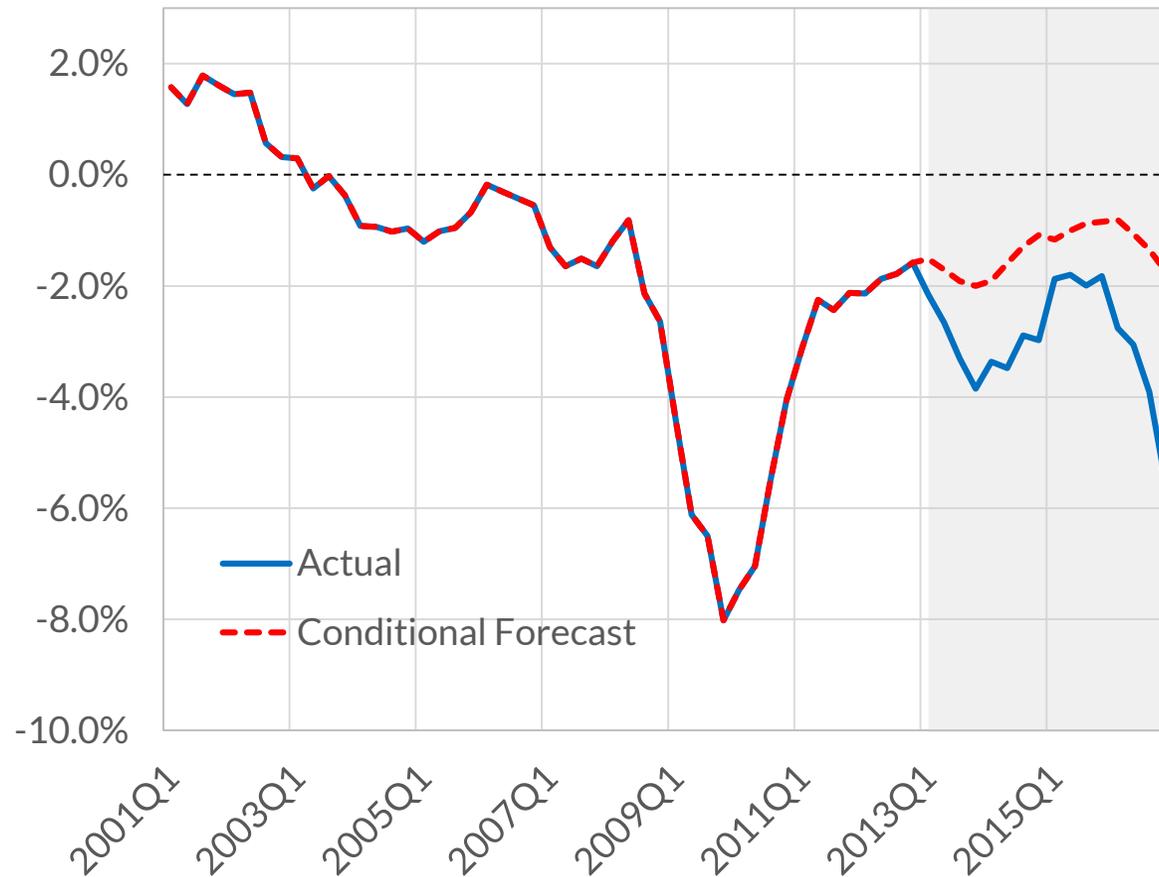
- The seasonality in Clothing and Footwear stems from the summer and winter sales.
- Interesting phenomenon in the Irish data that is not present in other euro area countries.
- After summer and winter discounting, clothing and footwear prices do not quite return to their former levels.
- This results in a persistent downward trend.



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- Goods inflation weaker than can be explained by drivers



- Recent Box (QB 2018.3) examined the case of Non Energy Industrial Goods.
- Clothing, appliances, furniture etc.
- Lower than expected given developments in main drivers (GBP, oil prices, domestic demand)
- Possible measurement issues related to quality adjustment, particularly in IT products and clothing.



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Issues for discussion

- Economy currently growing strongly in an environment of benign domestic and external conditions
- External and domestic challenges
 - Ireland is vulnerable given its openness and extensive trade, technology and financial linkages

Domestic challenges:

- How much spare capacity is there in the domestic economy?
- How hard is the production frontier in a SOE such as Ireland?
- Avoiding pro-cyclicality in policy

External risks:

- Brexit
- Protectionism
- Impact of international tax regimes on FDI decisions

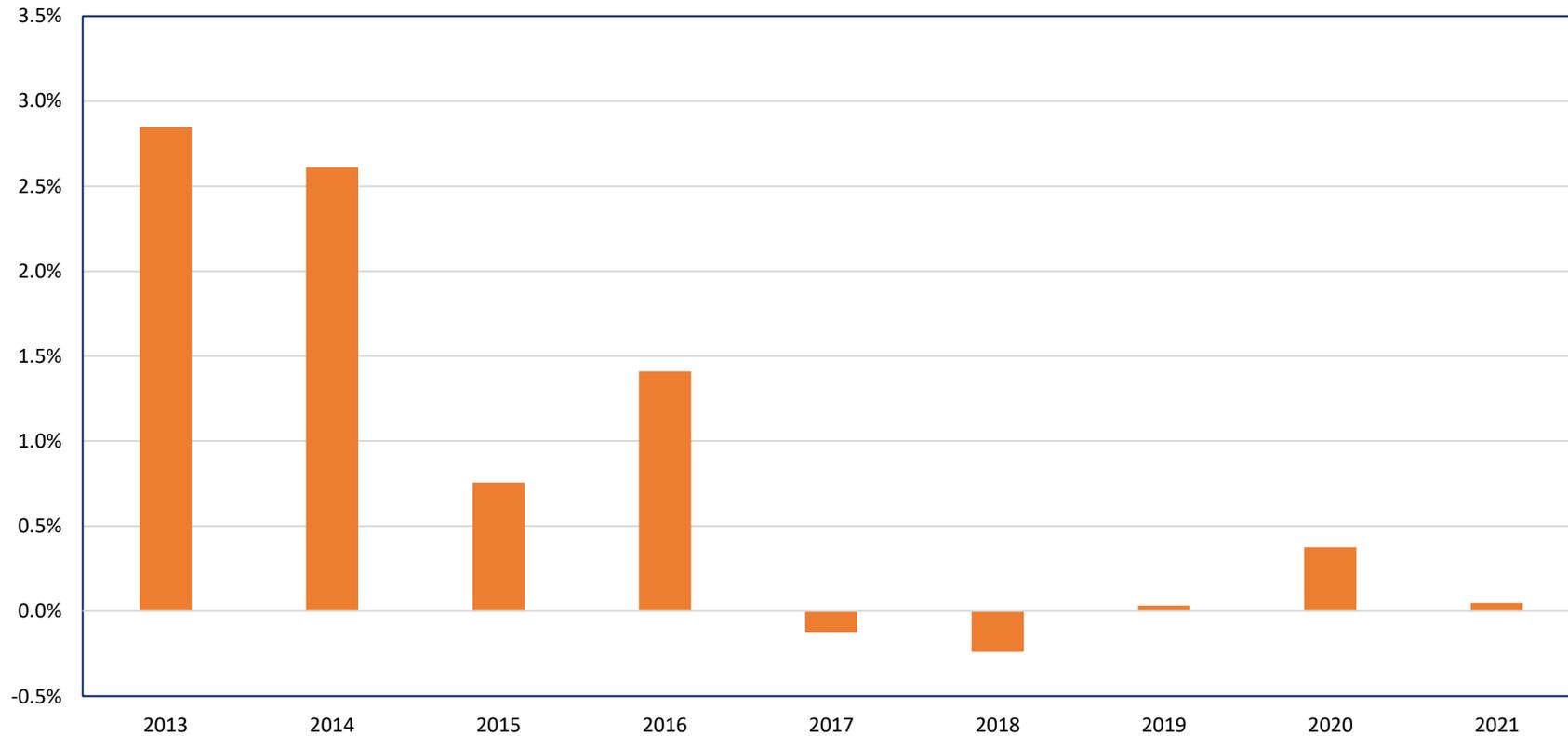


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Annex Slide

Change in the General Government Primary Balance (% GNI*)



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