Media Briefing Transcript

Quarterly Bulletin 1 – January 2019

Journalist 1: Have your fears of overheating heightened since the last Bulletin and also would you include FDI (foreign direct investment) flow in to fears of a 'no deal' [Brexit], as one of the consequences?

Mark Cassidy, Central Bank Director of Economics and Statistics: I wouldn't say our concerns in relation to overheating have increased, but we would maintain those concerns. So I would say upfront that we do not currently see overheating present in the economy. The Bulletin shows that domestic price and wage pressures remain contained and, critically unlike in the 2000s, economic growth is not being driven by unsustainable increases in credit, nor by financial inflows from abroad. But the concern would be as the economy gets closer to full capacity – and I think we're seeing this now, the employment rate of course has fallen below 6% and is expected to fall below 5% this year – we've seen an increase to record highs in the job-switching rate, which can be an indicator of labour market tightness and we published some analysis of this just before Christmas. And we're seeing in the vacancy rate that firms, some firms, are finding it more difficult to find available labour. So, it appears that we're getting closer to full capacity. The evidence suggests that when that happens, then the risk of overheating does increase. The risk to prices and wages will increase out of line with real economic developments, which increases the risk of the return to boom-bust type cycles, so it certainly remains very much on our radar. We will be monitoring it without any increase in the risk since our last Bulletin. I think how the labour market and wages have evolved since the last Bulletin would have been in line with expectations. I might just … the latter question then, sorry, you might just remind me.

Journalist 1: Would you see FDI flow as an issue in a 'no-deal' Brexit scenario?

Mark Cassidy: We would actually see the potential for FDI flows being something of a mitigating factor over the medium term. The net effect is likely to be more inward FDI as a result of a diversion of FDI from the UK, with a view to serving the European market. This may take some time. In some sectors, such as financial services, where preparations have been underway for a longer period of time because of the nature of that sector, the need to get authorisation….you might get more immediate trade flows. But over the medium-term you might see inward migration, positive net inward migration in a broader range of sectors. That would be included in our analysis of the medium-term impact. Therefore the 6% negative impact on output over the medium-term includes some positive offsetting effect from FDI flows.

Journalist 2: Can I just ask you, in terms of, what probability would you put on a no-deal Brexit?

Mark Cassidy: I wouldn't put a probability on it. What I would say is, it is a material risk. I think the risks have come in to much more focus over recent weeks and months, which is understandable, I think, although ourselves and other commentators have been warning about this material risk since the time of the referendum. I would also say that the impact of this scenario increases the closer we get to 29 March without any clarity regarding what the new arrangements will be, because it leaves less time for firms to prepare. So, without giving a probability, I would say it's come into focus, particularly for those reasons.

Journalist 3: In the event of the hard Brexit scenario, will you still urge fiscal consolidation on the government? Would you still urge to build up buffers at a time when growth is going to fall to 1.5%?

Mark Cassidy: There would be clearly a change in circumstances in that case. So, a disorderly 'no-deal' Brexit would have a material, negative, immediate impact on the public finances that would in fact persist over a number of years. You would, in that case, need a reassessment regarding what the future expenditure and taxation policies would be. While the government has already considered that, it would need to do so when more information is available. So I think a reassessment by government, but it would be a changed situation because taxation and expenditures would automatically be hit in an adverse way.

Journalist 3: My point was, would you still urge the government to build fiscal buffers at a time when economic growth has fallen off a cliff, instead of spending money in a countercyclical manner?

Mark Cassidy: No, I'm not saying that. I'm saying that our policy advice in relation to the fiscal situation relates to our central scenario, whereby a 'no-deal' Brexit can be avoided and I'm saying a reassessment would be required in the event of the 'no-deal' scenario, because the fiscal situation would have deteriorated in those circumstances and I think it's too early to know what exactly that would entail, but that would be a different situation.

Journalist 3: Would you urge the government to spend, to increase spending?

Mark Cassidy: I think we'd need more information about the nature of the Brexit…and what impact…we'd need an assessment from the fiscal authorities as to what the impact on the various expenditure and taxation takes would be, but it would involve a different outlook for policy. I would maybe say, I suppose one of the reasons that in recent years, particularly, I suppose, since 2015-2016, we have been urging more fiscal prudence, was for the possibility of risks such as this or other risks materialising, such that the fiscal situation is in a good position and so if a Brexit deal is avoided – sorry if a 'no-deal' scenario is avoided – this is a good example of how you want your public finances to be a good situation if other shocks – and there are other medium-term shocks for the economy – do materialise.

Journalist 4: This Box B [Macroeconomic Implications of a Disorderly Brexit] suggests that there could price hikes in consumer goods and that the supply of certain goods imported from the UK could be jeopardised – those are your words – can you give us examples of what they are? The other thing is, is a hard Brexit likely to cost us jobs or slow the rate at which we're creating jobs and if you could give us a sense of what that might be? And finally what actual size was our GDP last year? I know that you haven't got a final figure, but you must have some kind of handle on it because there's lots and lots of estimates out there?

Mark Cassidy: Okay, so in terms of prices, I think you would, where you would see the main impact in terms of our imports, would be first of all consumers will be impacted. We import a large amount of our foodstuffs, for example, through the United Kingdom. The tariffs, if imposed, are particularly high in the importation of food products. In addition, non-tariff barriers, so customs and regulatory checks, they tend to be particularly significant also for the food imports. So I think you would see the possibility of delays and higher trade costs in the importation. Of course that may be offset to an extent if there is significantly weaker sterling that would put some downward pressure, but overall you would probably see a net effect of higher consumer prices.

Journalist 4: How high?

Mark Cassidy: I don't have an estimate of that. The other particular impact…so it's important to remember we import a lot more goods from the UK than we export. A lot of the goods imported are intermediate products, so products that are used by Irish firms in the production of further products. They're examples of the type of supply chains. So, Irish manufacturers, domestic enterprises which use intermediate products sourced from the UK would be affected regardless of whether they export to the UK. So, that's what, when we talk about the effects being spread across the economy beyond direct exports to the UK, that is what we have in mind. In terms of…so I think GDP is around 290 billion, 316 maybe…sorry, the question in relation to the GDP?

Journalist 4: Yeah, there were two things, I was saying do you have, can you give us a sense of what kind of goods might be affected on the supermarket shelves and that kind of thing? And is it likely to cost us jobs or will it slow the rate that those jobs are going to be created?

Mark Cassidy: Hopefully the first part I answered. So imports – foodstuffs and other consumer imports from the UK, but also firms that use intermediate products from the UK in terms of their production. In terms of employment, we would expect – so this will have a negative effect on employment – we still expect positive employment growth overall. The impact on employment will be somewhat less immediate than on output. So you tend to see that if output falls dramatically, the change in employment lags that somewhat. So maybe just to step back a little, maybe I would mention what we see as the path for economic growth, because that is somewhat relevant for the employment. So, if we see a very sharp immediate downturn in the first year, and maybe the first two years as in this scenario, then beyond that what you'll see are some positive effects also. We mentioned one already which is the FDI effect. But also firms in the economy will start to adjust to the new trading arrangements. The infrastructure at ports and the like, our ability to process the new regulatory checks, will improve over time. So, in fact the path for economic growth will be much more favourable after one to two years, so the overall employment effect will be mitigated somewhat by firms which may not need to leave off so many workers. So we expect the impact on employment to be somewhat negative over the medium-term. Maybe less immediately dramatic as in with the output figures. And most importantly, overall employment for the economy as a whole, given the other favourable factors in the economy, will still be positive including this year and next. But by a somewhat lesser amount than the current forecast, which I think is 2.2% this year.

Journalist 4: So, just to clarify, you seem to think that in terms of the consumer goods that are going to be hit, that it's mostly foodstuffs and then you have…so that's stuff we buy in the supermarket basically, that's manufactured or comes through the UK from locations in Europe? And the other stuff is…the other point then is intermediate products, that's components that go into manufacturing?

Mark Cassidy: Exactly. Exactly.

Journalist 5: I'm just wondering in both the forecast, I suppose, the non-hard-Brexit scenario, and the assumptions you're making for the hard-Brexit-scenario, what are the average sterling-euro exchange rates you're factoring in there?

Mark Cassidy: We assume for central forecast, we assume a constant exchange rate in the future years, so that's about 0.88 pence sterling per euro and then in the scenario, an additional 10% depreciation of sterling .

Journalist 5: That's what you're basing your assumptions on, for a disorderly Brexit? The additional 10%?

Mark Cassidy: That's correct.

Journalist 5: Okay. From 0.88?

Mark Cassidy: That's correct, yes.

Journalist 2: Have you broken it down for regional disparity in terms of, say the border regions will be the hardest hit, have you broken it down into that level, how much …?

Mark Cassidy: No, we wouldn't have figures. We don't really have the capacity to look at…to model on that basis. So, it's more really a qualitative assessment. And as you say those sectors…so the direct effects are primarily for the food and agriculture sectors…so those regions of the economy, particularly the border regions, are most affected. Also any sectors, the SME sector generally, most of our…we've a very large number of domestic Irish-owned small and medium enterprises that export to the UK. Many of them, I think around half of firms that export to the UK, that is their only market. So, I think regions where agriculture, food predominates, or where you have a lot of small and medium Irish-owned enterprises, are the most affected. That's based on what we know about the share of agriculture in those sectors. Our models don't look at regional.

Journalist 2: Can I just ask you one more question? In the UK, a lot of the very prominent Brexit supporters say this is all part of 'Project Fear' and that come 30 March there will be a seamless transition to WTO (World Trade Organisation) rules and the disruption will be absolutely minimal. But I mean even this would suggest the complete opposite would be the case?

Mark Cassidy: Well we can only…I can't speak regarding the discussions, debate in the UK. We would hopefully present in this Box a detailed analysis of where we see the various pressure points in the economy on 29 March and where we see disruptions in terms of….so, there would be, in WTO arrangements, you would automatically get tariffs imposed. Tariffs, for example, on meat exports to the UK are, I think, of the order of 59%. There's much research that shows that, in fact, non-tariff barriers can actually have a greater impact under normal circumstances than tariff barriers. So, regulatory checks, customs checks, all of these, again…particularly for the agriculture and food sector where the speed of moving goods…where you have phytosanitary checks which can be particularly time-consuming. So it's hard to see how any of these can be avoided. The decline in UK demand, I think, nearly all commentators in the UK point to significant decline in UK demand. That is actually the main factor impacting on our exports. So, we can only speak for our own circumstances and really all of these channels would seem to be realistic.

Thomas Conefrey, Senior Economist, Central Bank: Just to say as well that the studies which have been done for the UK by the Treasury, Bank of England, NIESR, (National Institute of Economic and Social Research) a range of bodies, all show a negative effect on the UK economy in a normal WTO scenario, even one after a transition period. So while, you know, there might be commentary to the contrary, the range of studies carried out in a similar way to ours and that we build on, all suggest a negative effect on the UK economy in moving from EU membership to trading on WTO terms.

Mark Cassidy: So, one of the views that's sometimes mentioned is that there was these doomsday predictions pre-referendum and then we have not seen the negative effects materialise. Now, we've not seen the negative effects materialise because we have not seen Brexit yet. So, the UK outcome…the UK economy has weakened more than was expected before the referendum, as we would expect, but the main effects will occur after the actual Brexit occurs, so you wouldn't have expected to see particularly significant effects during the period between the referendum and the actual departure of the UK.

Journalist 3: What are the margins of error around your forecast, from the point of the central forecast for the next couple of years, but also for the Brexit forecast, the 1.5%, what's the margin of error around that because you stress the forecasting is very difficult, so what's your…?

Mark Cassidy: Well, first I would say that the margin of error around the scenario for the disorderly hard Brexit is much higher than under normal circumstances. So, our models that we have previously presented to you in terms of estimates for the other scenarios, they can very well take into account the decline in the UK economy, the depreciation of sterling, the imposition of tariff barriers, regular effects of non-tariff barriers. But they cannot take into account…the departure of the UK from the EU is unprecedented, so our model cannot give us results for the immediate disruption that can be caused. So, we use a lot of other techniques and we look at a lot of other potential relationships that can give us information about what might happen in that case. But there is inevitably much greater uncertainty than there normally is. In terms of margins of error, I wouldn't have a number around the normal figures, but Irish economic growth is subject to much greater volatility than most other advanced economies, reflecting the nature of our economy and particularly the volatility of production, including the timing during which production is recorded for the multinational sector. Our forecast for this year and next assume that there are no distortions relating to the multinational sector, the like of which we have seen in recent years which has caused this divergence between GDP and GNI*. That's one reason why we have actually mentioned the GDP figures in our opening presentations, because they are not distorted by these, because we don't have any data yet for Q1. So we can make an assumption that these do not exist and therefore these are meaningful economic growth forecasts. As the year progresses, then we may see some of the activities of multinationals adding some volatility to those figures, but at the moment these would be our best estimators, based on – and we have this new indicator of underlying demand in the economy which we presented before, which is a very useful composite of all the available indicators and gives us a bit more accuracy regarding what we might expect.

Journalist 6: I think you might have mentioned this, about the summary forecast, exports of goods and services dropping from 7.3 to 4.3, is that entirely Brexit or is that partly the general softening?

John Flynn, Head of Irish Economic Analysis, Central Bank: The export numbers last year, the figures for last year, are affected by some distortions from multinational firms in some cases. So, the 7.3 has some of those effects in there. We saw very strong growth in some elements of those. It's probably more useful to compare them to our last forecast for 2019. So they've been lowered, we've taken about 0.2% off relative to what we were previously forecasting for 2019. So, on a like-for-like basis, I'd probably compare them that way.

Mark Cassidy: And I'd say that revision is less about Brexit and more about uncertainty in the international environment more generally. Because as I say, our central forecast assumes a deal and therefore a transition period up to the end of 2020. So, we do have some negative uncertainty effects in there relating to Brexit, but probably the weaker global outlook is more relevant.

John Flynn: Yes, the weaker global outlook is what's going on there.

Thomas Conefrey: There's a Box [Box C: Strong Pharmaceutical Exports Boost Overall Export Growth] on the goods exports last year and they were extremely strong, so the trade performance on the goods side last year made a positive contribution to growth.

Mark Cassidy: Yes, that's an interesting Box actually. It shows how much chemicals really drove economic growth last year, the export of chemicals. Sorry drove export growth, it's a Box in this Bulletin…

Journalist 4: This is probably a dumb question but you're saying it's four percentage points, so obviously that's not 4% of growth, it's each of those four percentage points of growth will be knocked off. So, just so I'm clear, if you were to apply that across the year, you would get 0.4% economic growth but because it's happening at the end of the first quarter, it's going to be 1.5% growth in this particular scenario?

Mark Cassidy: That's spot on yes.

Journalist 4: The other thing is, are you seeing any signs of the, kind of, reining in of consumer spending and investment that you're talking about in Box B, already? I mean people doing this in anticipation of a hard Brexit?

Mark Cassidy: I think we've seen some softening in sentiment, yes. I think we look at business investment sentiment, consumer sentiment – they're quite variable, you need to be careful how you interpret them – but yes, I think we have seen some softening in both. We have, as a result, we have revised down our forecast for consumption this year, from 2.5% in our previous Bulletin to 2.1% in this, and that reflects what we're seeing coming into the year with some modest evidence of softening. And of course we would expect that uncertainty in the event of a no deal to increase and be much weaker.

Thomas Conefrey: If you look at the UK there's definitely evidence in the UK, like in the Bank of England's report, they link some of the weakness in sentiment to uncertainty related to Brexit. They have agents who talk to big firms and they have been…they have said fairly directly that there has been a reining in of investment spending due to worries over Brexit.