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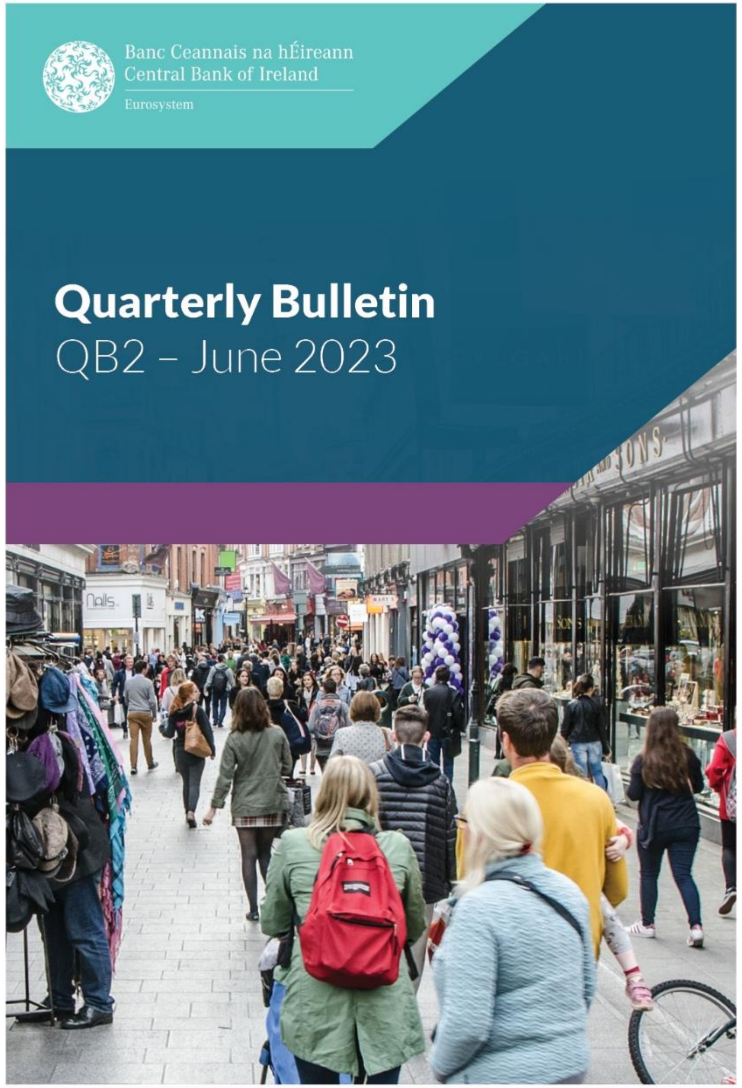
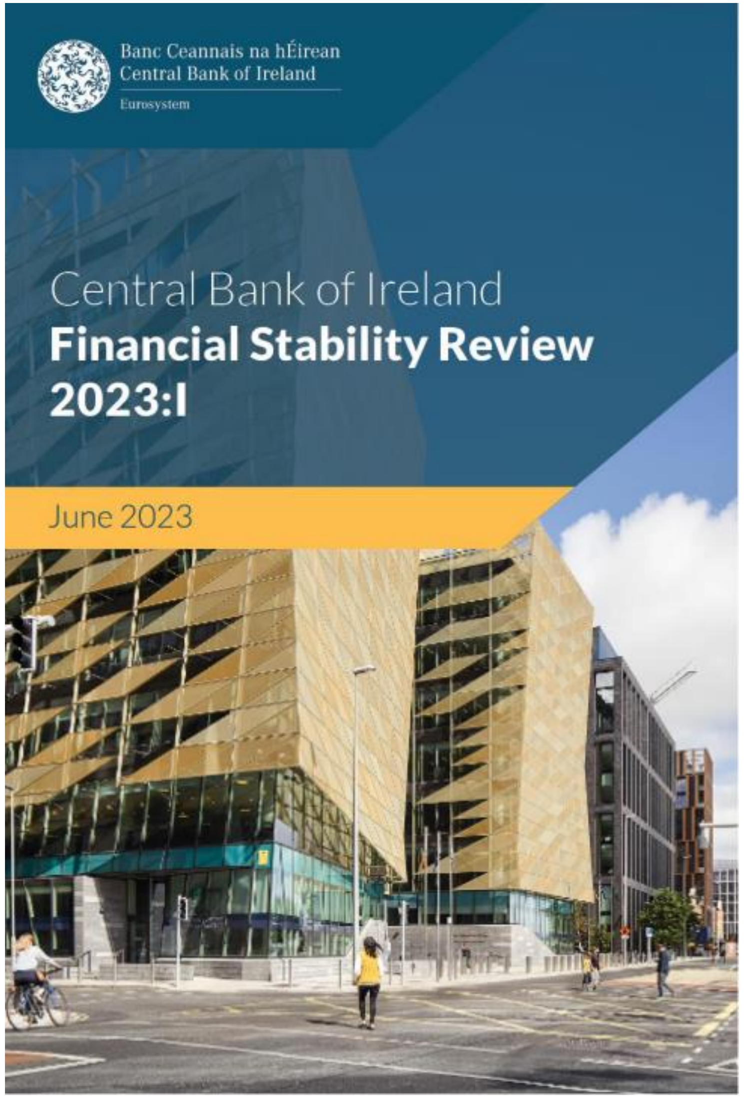
Central Bank of Ireland
Eurosystem

Civil Society Roundtable – 21 June 2023

Session One – Economic Discussion





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Comment

- **The economy overall has proven resilient** in the face of the COVID-19 pandemic and the war in Ukraine.

- The latest National Accounts data highlights the **difficulties of using GDP to gauge the temperature of the Irish economy**.
  – Two successive quarters of negative growth in GDP, while at the same time the labour market surprised on the upside and consumer spending and output of domestic-focused sectors was firmly expanding.
  – Volatility of GDP, and extent of activity outside the State that it captures, emphasises the need to look at more at other measures such as MDD, GNI* and labour market developments.

- **The economy is now operating at capacity**
  – Unemployment is at multi-decade lows of less than 4 per cent, and we expect it to remain at these low levels until the middle of the decade.
  – Although employment growth has been strong, job vacancies relative to available workers remains elevated, contributing to the anticipated increase in wage growth.

- **The determinants of the inflation outlook are evolving**.
  – In the short-run, the spill-over of higher energy prices to other parts of the consumer basket continues, but the impact of the sharp rise in input costs will continue to fade.
  – Domestic factors, in particular the ability of the labour market to sustainably meet the demand in the economy, will determine the persistence of inflation.

- Near-term macroeconomic stability **requires alignment between monetary and domestic policy**.

Forecast Summary

		2023	2024	2025
	MDD	3.7% ⇧ 0. 6pp	2.5% ⇩ 0.4 pp	2.5% ⇩ 0.1 pp
Inflation	Headline	5.3% ⇧ 0.3 pp	3.4% ⇧ 0.2 pp	2.5% ⇧ 0.3 pp
Inflation	Core	4.9% ⇧ 1.4 pp	3.4% ⇧ 0.6 pp	2.7% ⇩ 0.2 pp

Main Reasons for the Revision
(with respect to QB1 –March 2023 Projections)

The near-term growth outlook has improved compared with the last *Bulletin*.

- Reflects better-than-expected consumption growth in Q1 and a continued moderation in saving rates towards pre-pandemic levels.
- Modified investment momentum from last year is expected to continue into 2023, but later in the projection horizon is more uncertain with tighter financing conditions domestically and globally.

- Inflation revisions reflect the continued pass-through of input price shocks to the broader consumer basket, the wage pressures from a tighter labour market and strong aggregate demand.

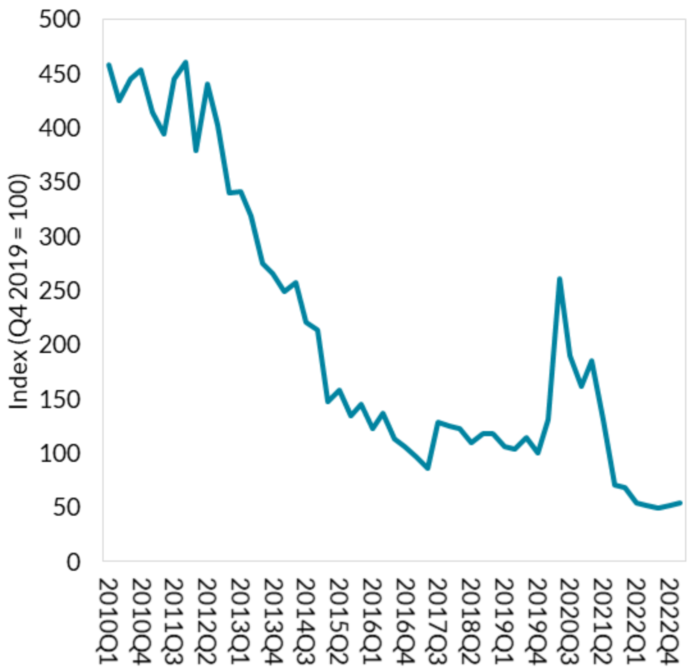
Main sources of projection uncertainty

- While uncertainty remains high, it has reduced since the last *Bulletin*.

	Growth	Inflation
Escalation of geopolitical tensions	⇩	⇧
Effect of monetary policy is different than anticipated	⇩⇧	⇩⇧
Domestic policy provides additional stimulus	⇧	⇧

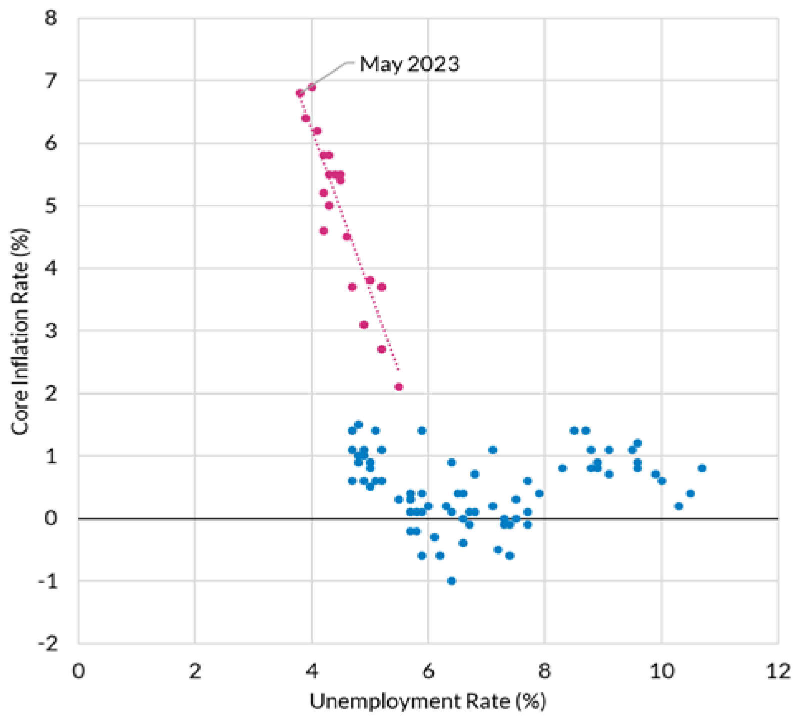
Overall conditions point to the economy at full employment

Job creation is significantly above pre-pandemic trend but labour market remains tight



Source: CSO
Note: Labour slack to job vacancy ratio. Labour Slack is defined as the sum of unemployed persons and the potential additional labour force

As unemployment declines the sensitivity of inflation to a tight labour market increases



Source: CSO and Central Bank of Ireland calculations
Note: Data refer to Core CPI inflation. Blue dots denote period Jan-2015 to Jul-2021. Pink dots denote period Aug-2021 to May-2023

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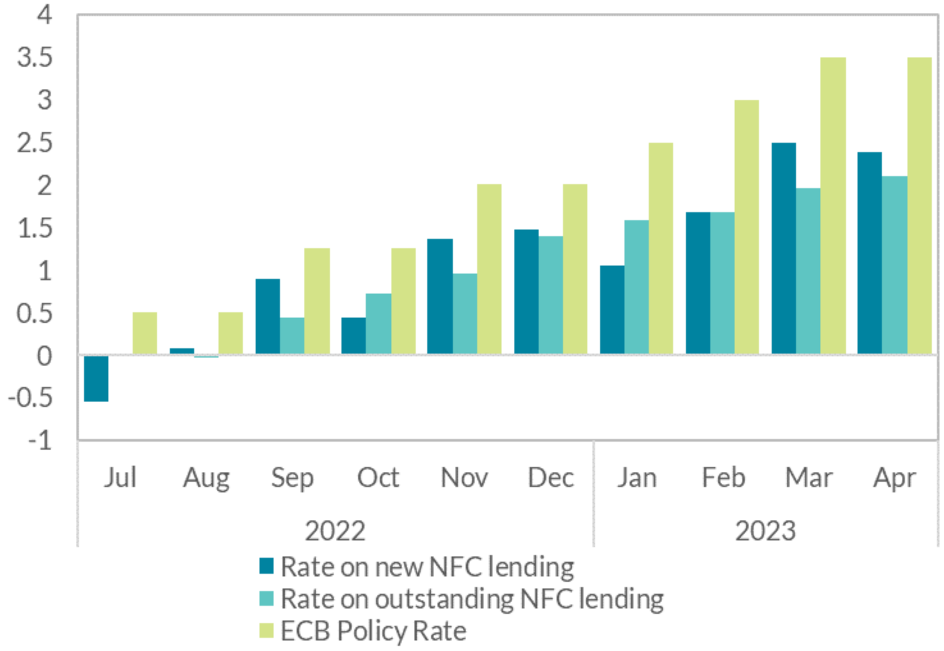
Pass-through of monetary policy to retail interest rates beginning

Interest rates on NFC lending have risen



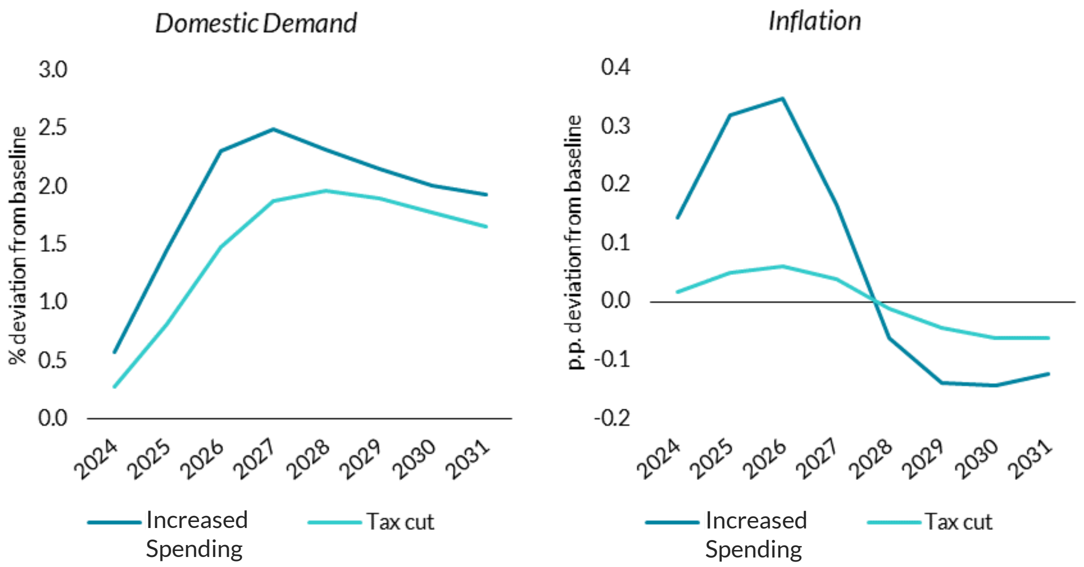
Source: Central Bank of Ireland

Mortgage interest rates have not risen as fast in part due to composition of the market

Source: Central Bank of Ireland

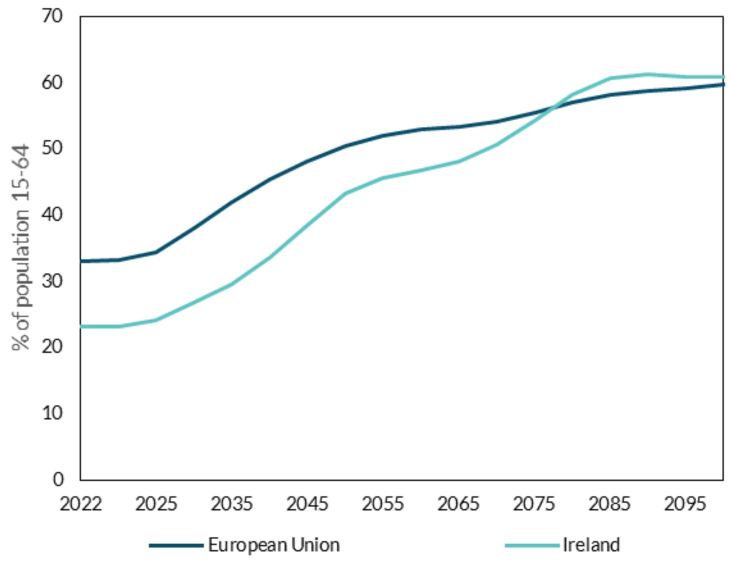
Domestic policy needs to contribute to macroeconomic stability and build resilience towards medium term challenges

Scenario analysis on the impact of additional government spending and cuts to income tax



Source: Central Bank of Ireland estimates
Note: Chart shows the impact on domestic demand (MDD) and inflation for (i) growth in government spending is increased from 5% to 6.5% annually for X to Y and (ii) income tax is reduced by the same notation values as (i).

Ireland's favourable demographic profile will change rapidly in the coming years

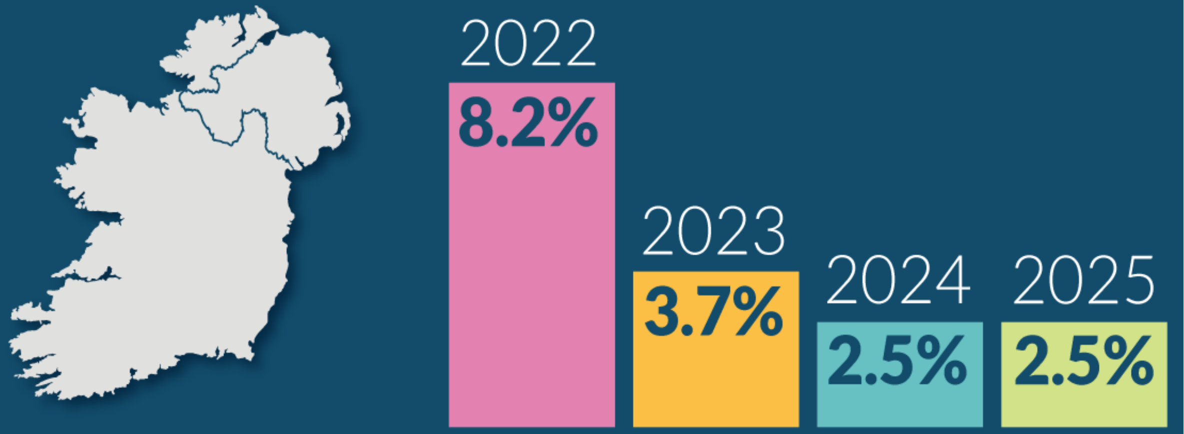


Source: Eurostat Population Projections 2023 (europop2023)
Note: Projected Old Age Dependency Ratio, EU and Ireland.

Quarterly Bulletin QB2 – June 2023

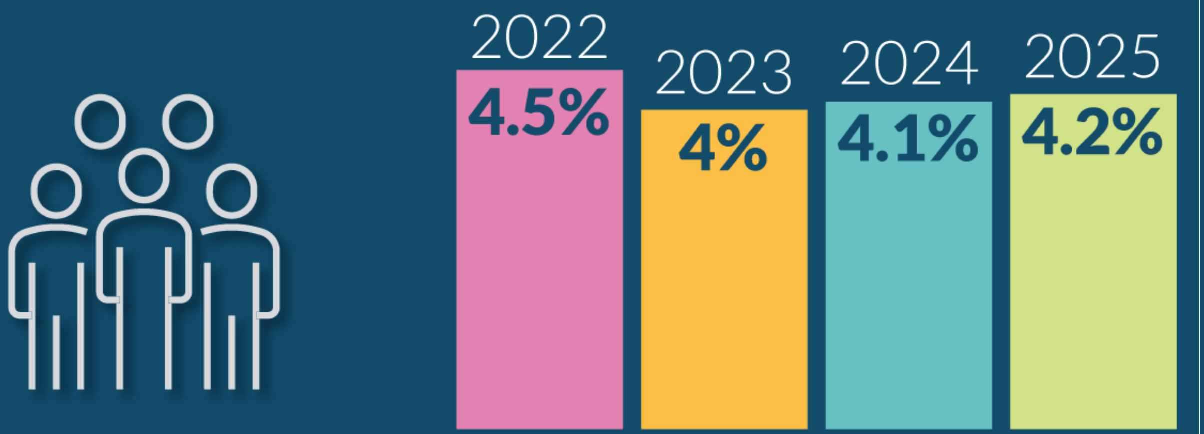
What is the outlook for the economy?

Forecast growth* in Irish economy



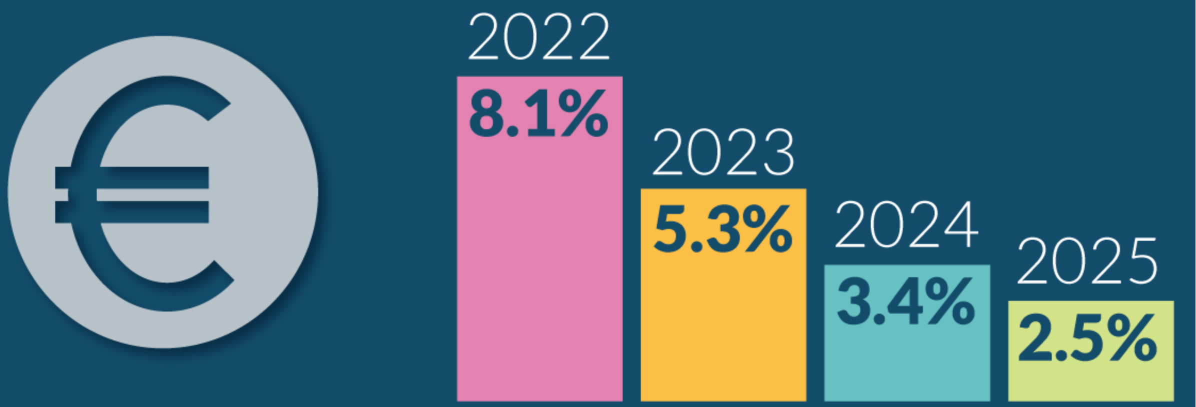
*Modified Domestic Demand.

Unemployment* forecast in Ireland



*International Labour Organisation Definition.

Inflation* rate forecast



*Harmonised Index of Consumer Prices.

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See our Quarterly Bulletin Research at: centralbank.ie/QB

Main messages of the *Financial Stability Review*

Risks facing the financial system

- Amid persistent inflation, the global economy is subject to downside risks related to the erosion of real incomes, financial sector stresses, credit supply tightening, and geopolitical fragmentation.
- The global financial system remains vulnerable to disorderly market adjustments after a decade of elevated risk-taking, as evidenced by recent turbulence in the banking system.
- Domestically, persistent inflation and higher interest rates could lead to slower growth and expose vulnerabilities, particularly in CRE markets.

Resilience of the financial system

- The balance sheets of household and business borrowers are proving resilient to the inflationary shock, but remain vulnerable to sharp increases in unemployment.
- While credit risk is likely to rise, retail banks are continuing to benefit from rising net interest income and have strong capital and liquidity buffers.
- Some non-bank lenders are retrenching credit supply, reflecting risks associated with their funding models, particularly in the mortgage and real estate markets.

Policies to safeguard financial stability

- CCyB to be increased to 1.5%, in line with gradual build-up announced last year, reflecting the importance of building resilience in the banking sector.
- Limited effects on credit supply expected given capital headroom and profitability outlook for the banking sector.

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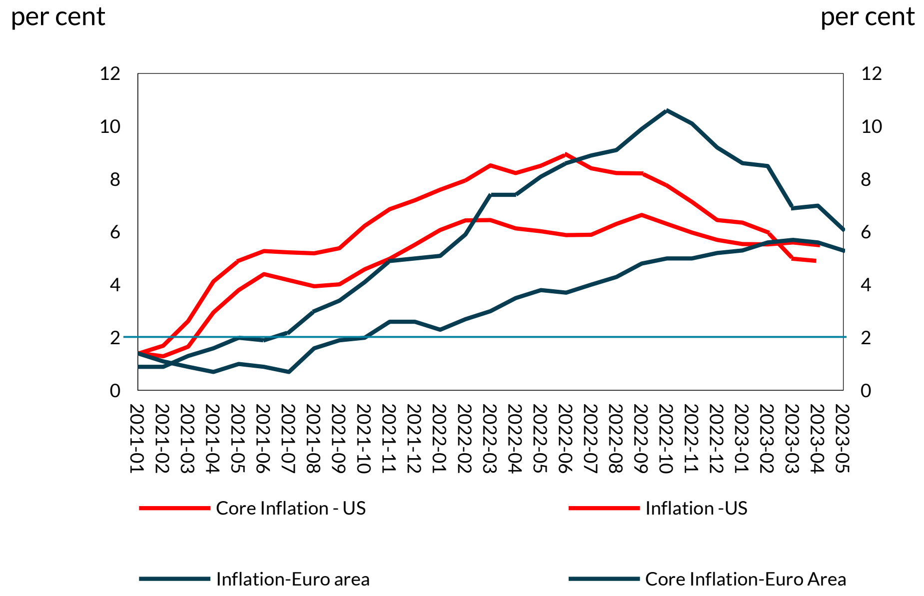
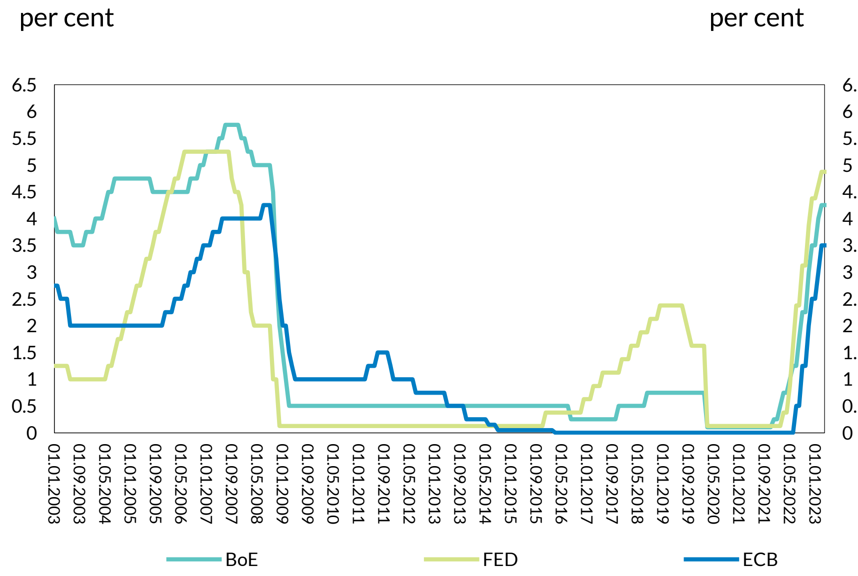
Underlying inflationary pressures are persisting globally, despite significant monetary tightening

Core inflation is proving persistent at levels well above target



Source: Eurostat and FRED

In response, central banks have been raising interest rates, with further increases expected in the near term



Source: BIS
Rates: DFR (ECB), Fed funds rate (FED), Bank of England Base rate (BoE)

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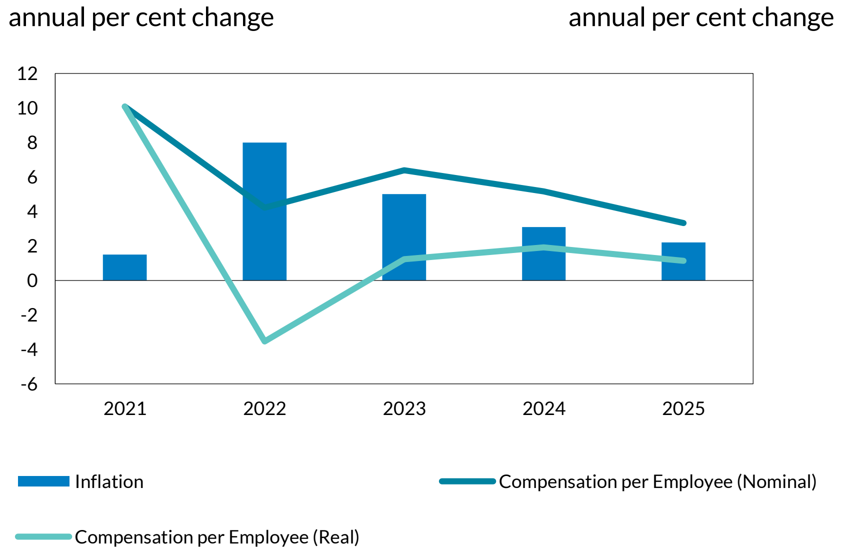
Domestically, economic activity is showing signs of resilience and labour markets remain tight

Unemployment at multi-decade lows, increasing signs that capacity constraints are more binding

Source: Central Statistics Office
Note: Vacancy rate is calculated as the number of job vacancies divided by the sum of the number of job vacancies and occupied posts.

Domestic demand growth will be supported by expected recovery in real disposable incomes



Source: CSO and Quarterly Bulletin Q1 2023

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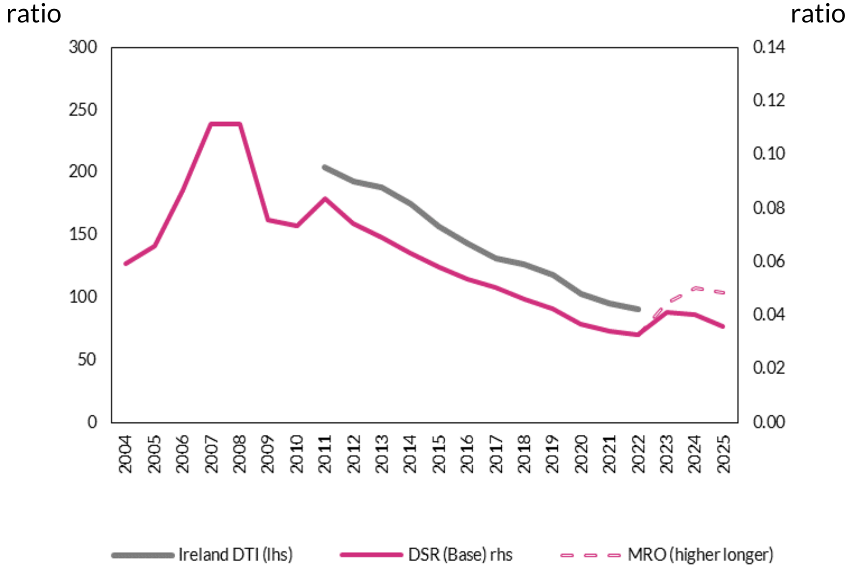
Irish households have proven resilient to the inflationary shock so far, although increased financial stresses will emerge among some cohorts.

Irish households have deleveraged substantially through the last decade

Households Debt service burden



Source: Central Bank of Ireland, Eurostat

Notes: Household mortgage interest payment to disposable income ratio. Solid pink line after 2023 provides baseline forecast. Dotted line provides a hypothetical adverse scenario where the MRO increases to 7%.

- **Build-up:** decade of deleveraging, nominal income growth, strong housing equity, prudent new lending, substantial aggregate savings.
- **Central outlook:** nominal income growth supports debt repayments; some increase in credit risk and arrears
- **Survey:** 2/5 of mortgagors have thin liquidity buffers to cover repayments, if income shocks do arise.
- **Simulation**: modest increases in financial stress (8 to 9%) in baseline; increase of one half (8 to 12 %) in severe adverse.

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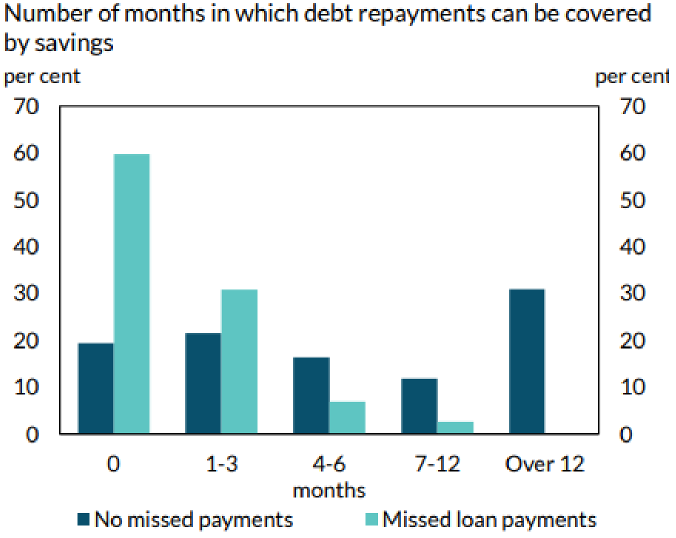
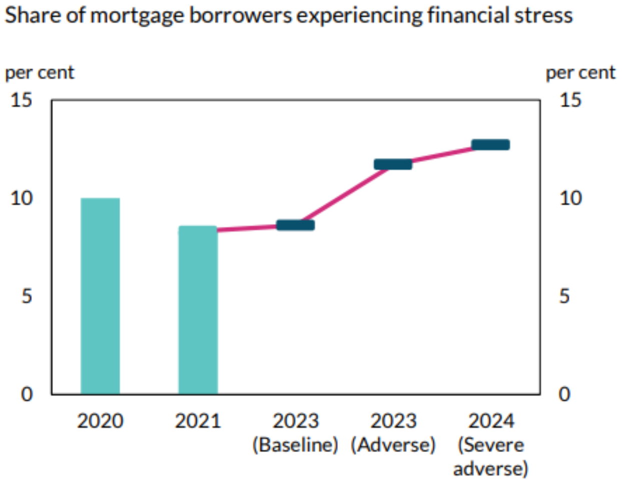
Although central projections show household financial stress to be contained, income and unemployment shocks continue to be the main risks to household resilience

Despite strong aggregate savings, many households report thin liquidity buffers available if income shocks do arise



Source: Central Bank of Ireland Expectations Survey (Yao, 2023). Notes: Sampling period: February 2023. 73 per cent of all households are in the "No missed payments" category, while 10.2 per cent are in the "Missed loan payments" category. Data source is a telephone survey, rather than official financial statistic.

Growth in financial stress is projected to be modest in the baseline scenario



Source: Adhikari and Yao (2023).

Notes: Households are classified as financially stressed in this modelling approach when income and liquid assets cannot cover essential expenditure, rent and debt payments. Baseline and adverse scenarios correspond to the EBA 2023 stress test scenarios

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The Central Bank is progressing with the increase in the CCyB to 1.5%, supporting resilience to future adverse shocks.

- In line with its strategy for the CCyB, **the Central Bank has been gradually building towards a 1.5 per cent rate** since June 2022.
- The buffer **provides resilience to the (potential) materialisation of risks** facing the financial system.
- The capital position and profitability outlook for the banking sector (in the central scenario) **limit the potential for adverse impacts**.
- The 1.5 per cent rate **will come into effect from June 2024**.

- The Central Bank would expect to
  - **maintain the 1.5 per cent rate** when (cyclical) risks are **neither elevated nor subdued**;
  - **release the CCyB** if **risks were to materialise**; and
  - **increase the CCyB** if **cyclical risks were becoming elevated**.
- An **addendum to the Central Bank's capital framework document** will be published alongside the FSR in June, providing further clarity on the CCyB framework and in particular how the Central Bank determines the risk environment.

What does this mean from a consumer perspective?

1. While prices wont be rising as fast as they did last year, consumer's purchasing power will only gradually improve, as the overall cost of living not expected to decline.
2. Households and businesses adapting to a higher price level, especially for fossil fuels, in a much shorter time period than would normally be the case.
3. Energy and food price inflation typically affects lower-income households more so.
4. Higher interest rates a necessary part of bringing inflation back down.
5. Fiscal policy plays a part too – choices can be made on use of public resources within the constraint of not adding to overall levels of demand in the economy.

Discussion questions

1. What are the biggest economic issues for the people you represent?

2. What are the biggest economic risks for the people you represent?

3. What role can the Central Bank play in addressing these issues?

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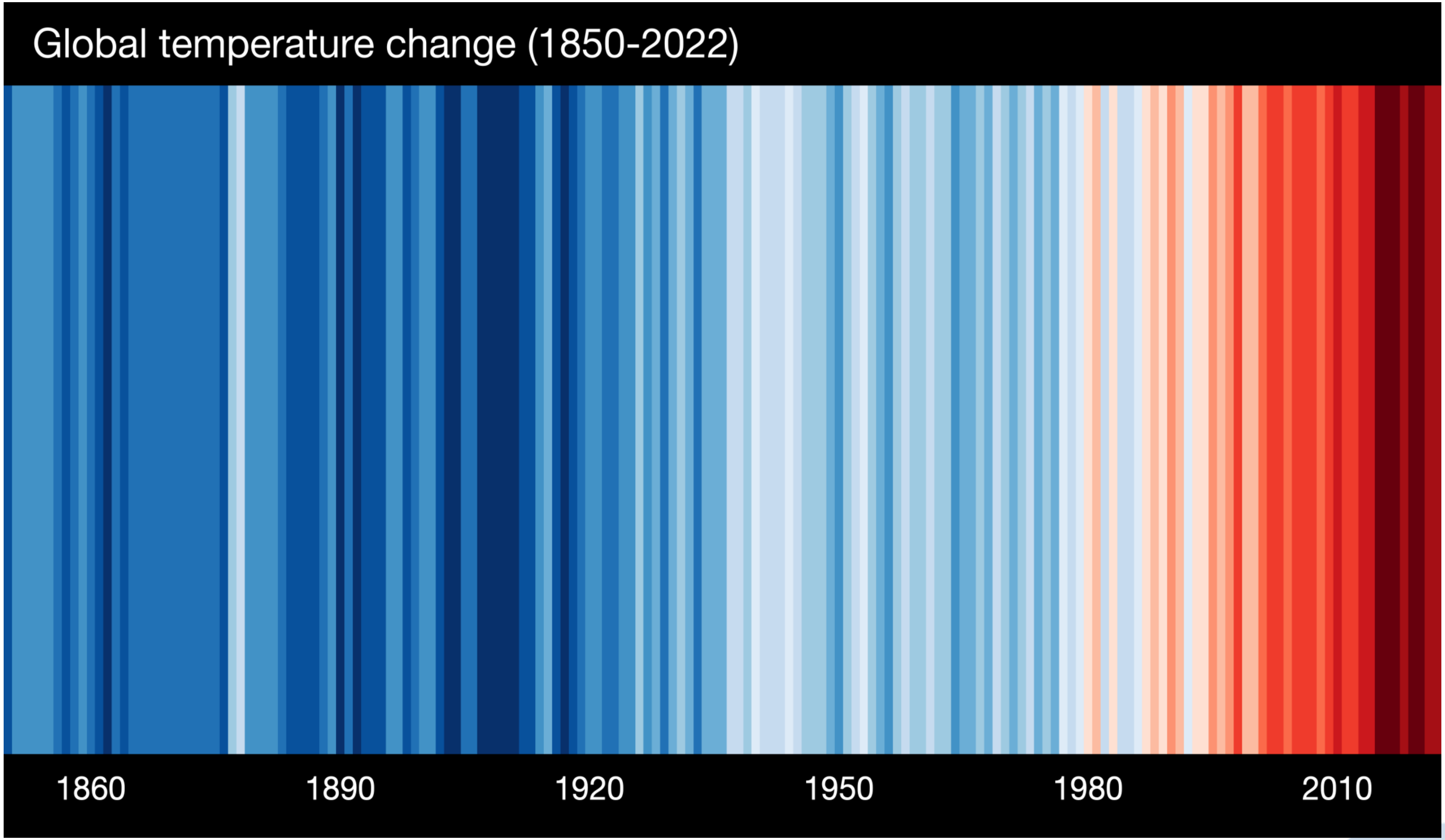
Session Two – Climate Change Discussion

1. The reality of climate change



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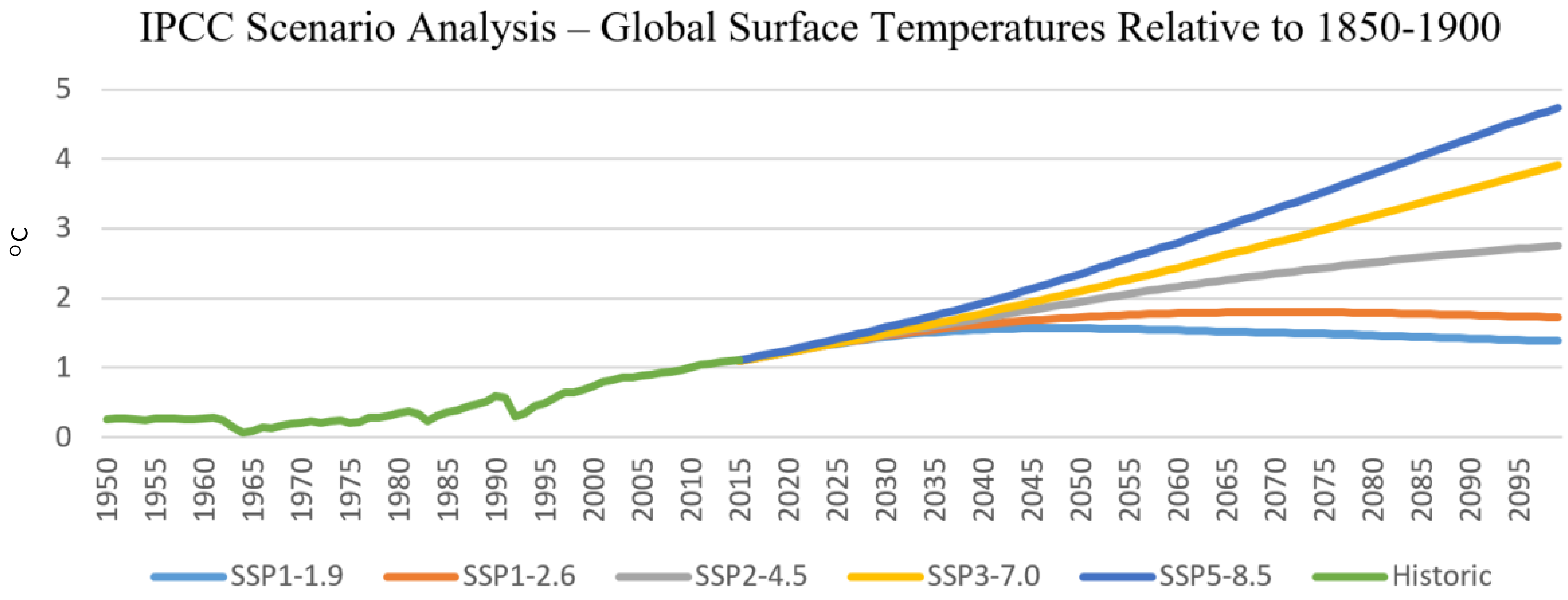
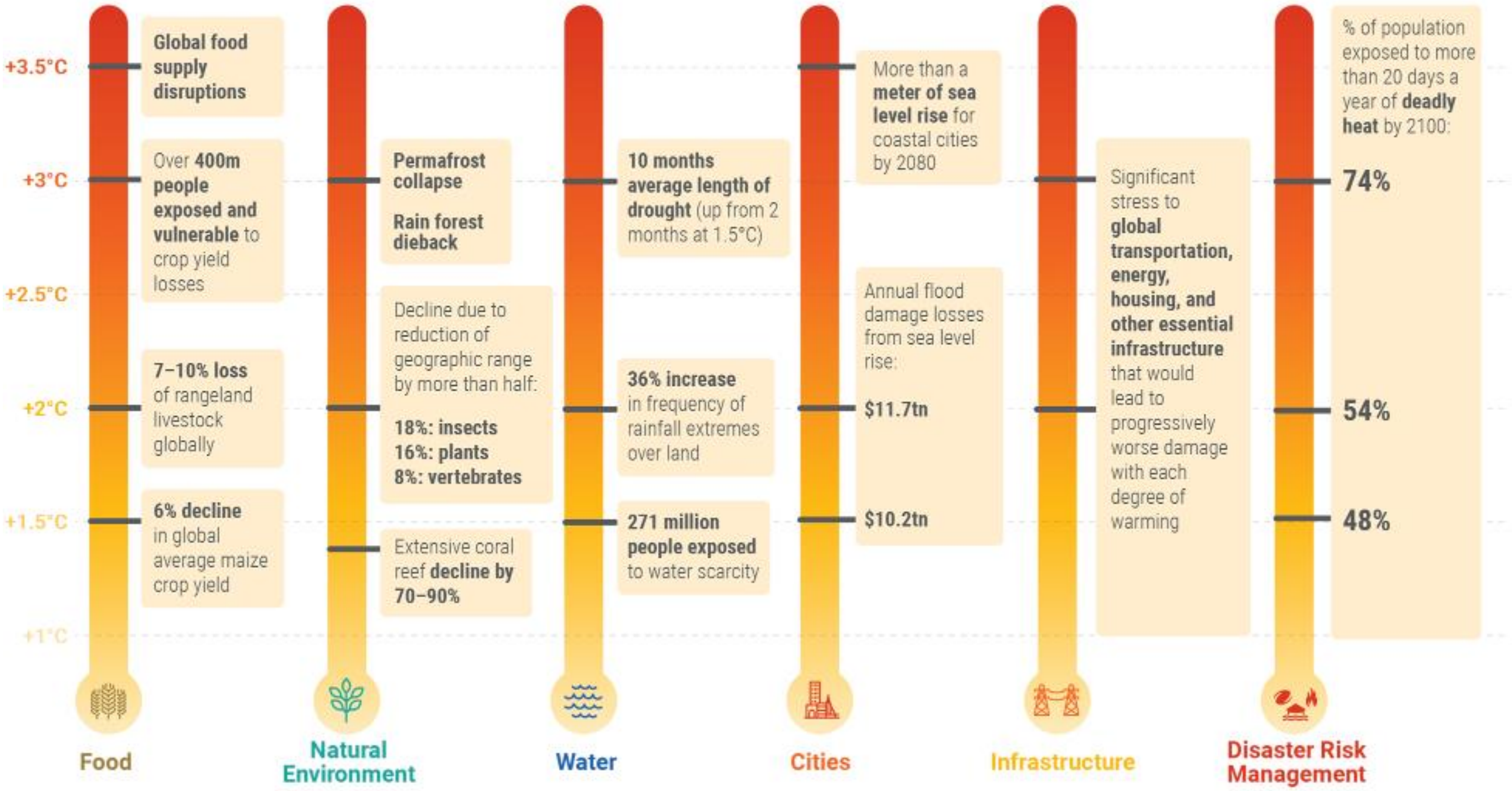
Climate change: future scenarios



Source: Climate Change 2021: The Physical Science Basis, Summary for Policymakers, IPCC.
Notes: The chart shows the temperature projections under alternative GHG emissions scenarios, ranging from very low emissions (SSP1-1.9) to very high emissions (SSP5-8.5). The scenario labels are taken from the IPCC, where 'SSP' refers to 'shared socio-economic pathway', reflecting alternative socio-economic trends underlying each of the 5 scenarios.

What could happen when temperatures increase?



Source: Global Commission on Adaptation

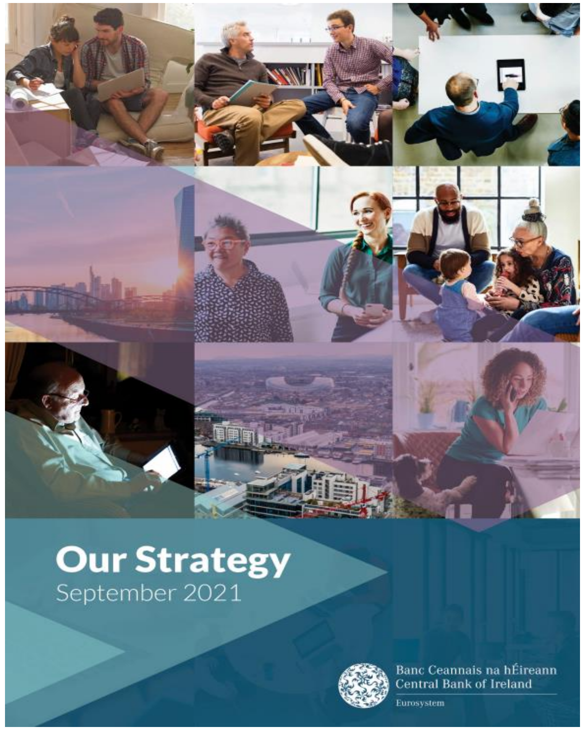
2. Implications and Central Bank role

Climate change has cross-sectoral implications across the Central Bank mandate

Including…….

- **Financial stability** – covering physical and transition risk impacts on the economy and financial system, associated risk transmission and policy mitigation, as well as resolution (*see Carroll, 2022*)
- **Price stability** – climate change could impact price volatility, the natural rate of interest or the transmission mechanism (*see McInerney (2022); Makhlouf (2021); Lane (2019)*)
- **Prudential resilience of firms** – assets and liabilities could be adversely affected (*see ECB (2023); ECB (2022)*)
- **Consumer and investor protection** – through the climate transition, ensure firms act in the best interests of consumers and investors (i.e. preventing greenwashing of products/services)
- **Market integrity –** our role as securities regulator on new securities issuance and on the ongoing regulation of trading activities to ensure market integrity, given financial markets will be central to sustainable finance provision and the broader funding of transition

→ Responding to climate change is a core part of the *Central Bank's Strategy 2022-2026*



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Ongoing domestic and international engagement and cooperation

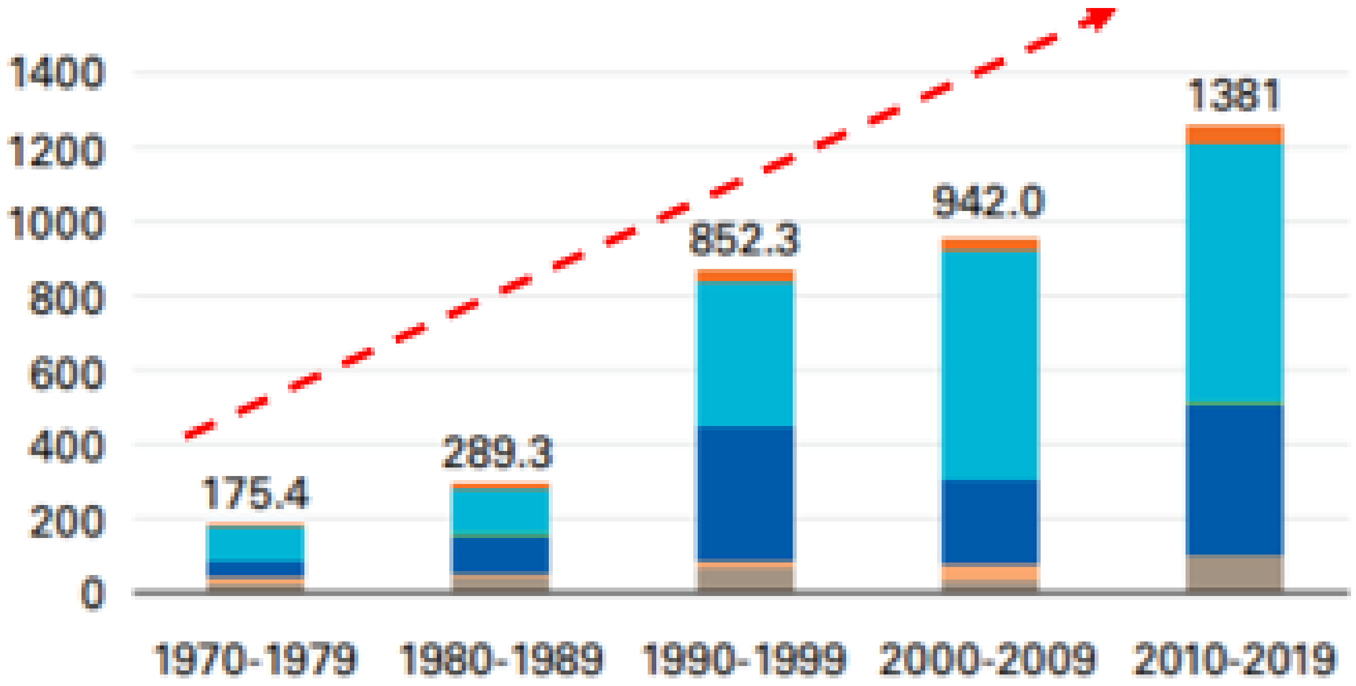
Climate change is associated with economic and financial risks

Physical risks

- **Physical risks arise from climate/weather events or progressive shifts in climate/weather patterns:**
    - Increased severity/frequency of extreme weather events (droughts, floods, etc.)
    - longer-term shifts in climate (e.g. ocean acidification, rising sea levels & temperatures)

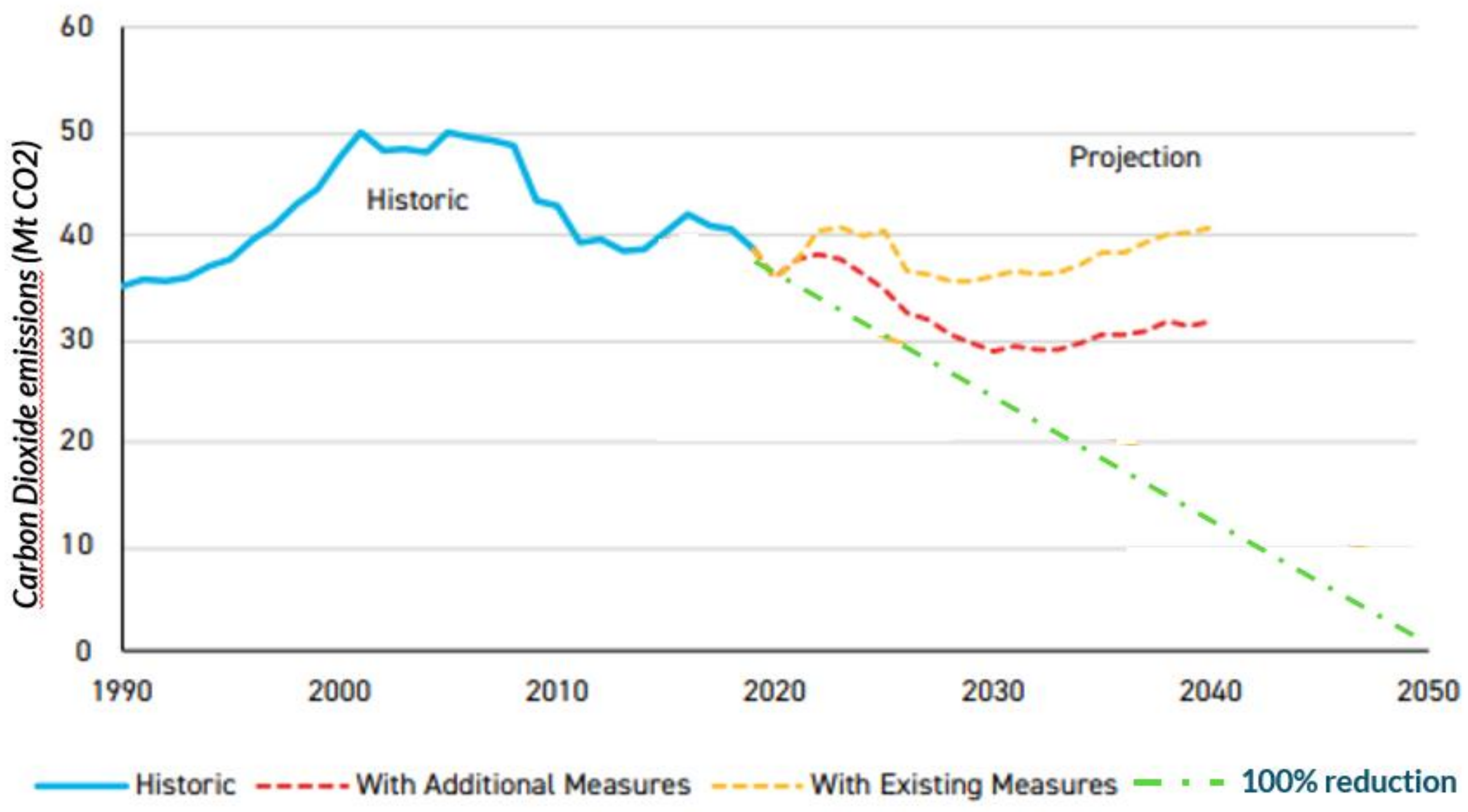
- **<u>Possible implications</u>:** adverse impact on productivity, labour migration, economic growth, asset/collateral values, borrowers capacity to repay debt

Reported economic losses, US$ bn



Source: World Meteorological Organization (WMO) (link)

Climate change is associated with economic and financial risks



Source: Adapted from Climate Advisory Council 2021 Annual Review

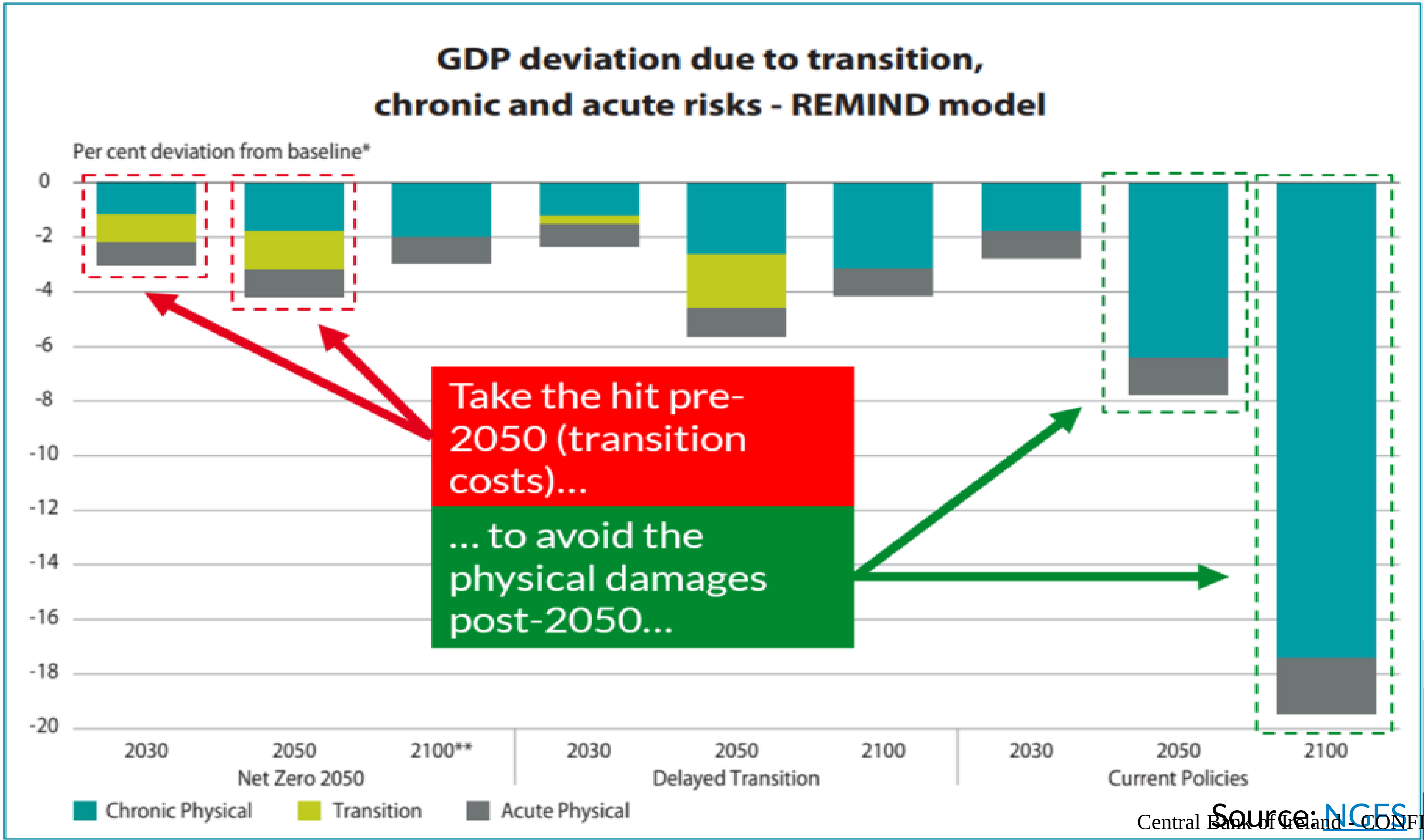
Transition risks

- **Financial risks arising from adjustment to a lower-carbon and more circular economy:** Risks from changes in Government policy, technology, market sentiment or consumer behaviour on foot of transition

- **Possible implications** : reducing emissions will have a significant impact on the wider economy, affecting asset/collateral values, the cost of doing business (particularly in carbon-intensive sectors) and consumer choices

__Note:__ Emissions of carbon dioxide in Ireland from 1990 to 2018 and projections to 2040 (excluding agriculture and land use):
- 'with additional measures' (WAM)
- 'with existing measures' (WEM)
An illustrative linear pathway for achievement of the transition to 2050 carbon neutrality also shown.

How might climate change affect global GDP?



Source: NGFS

3. Central Bank response (mandate focussed)

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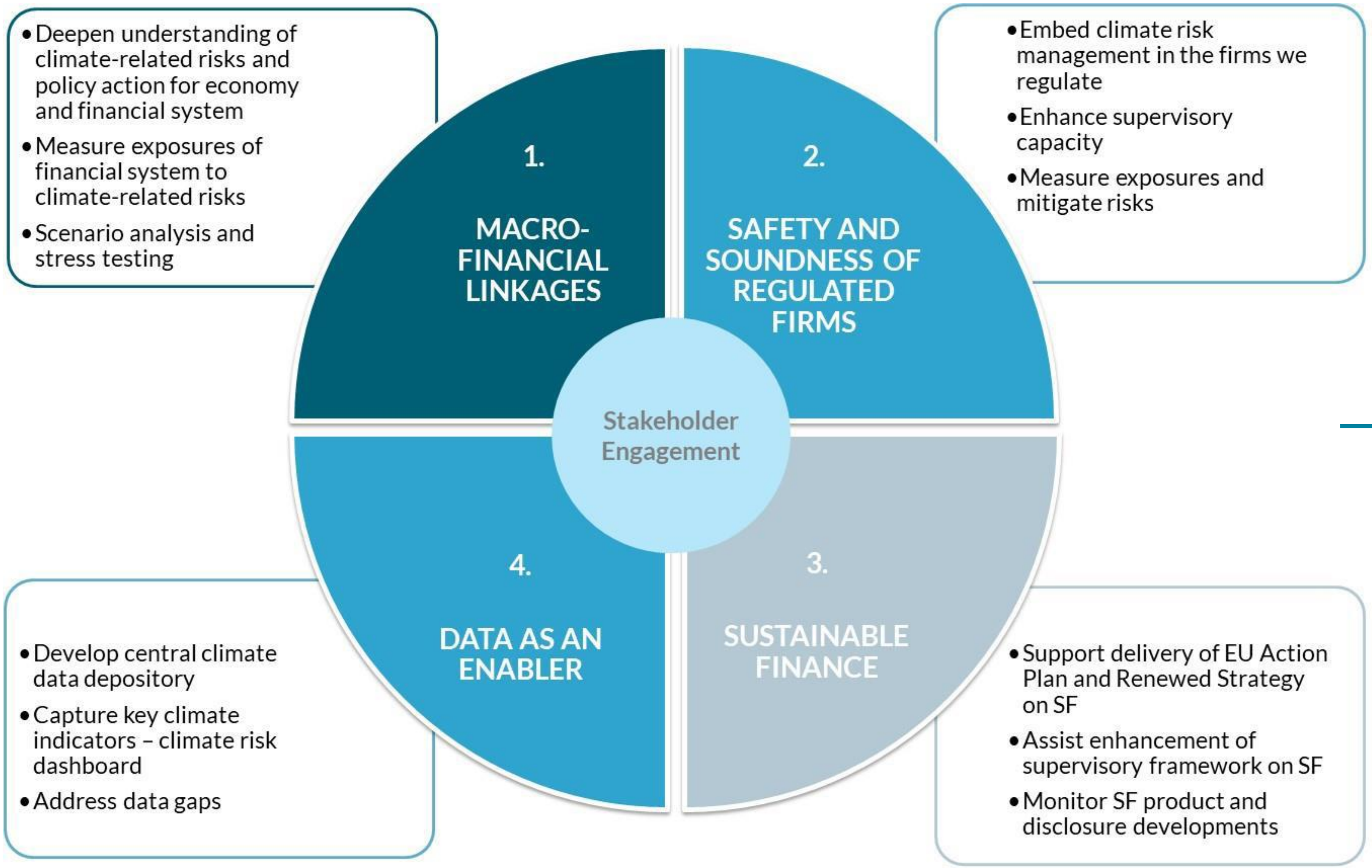
Climate change unit – broad workplan and implementation model



Hub and spokes model:

- Four dedicated **workstreams** in place to progress the work
- Brings together cross-Bank colleagues working on similar climate-related tasks in own divisions
- Provides clear sight of and opportunity for colleagues to leverage from experience and progress in other areas of the Central Bank
- Developed detailed Roadmaps to guide work

What we are working to achieve

1. The Central Bank will have an established (while still evolving) knowledge, technical expertise and toolkit to assess the **economic and financial** consequences from climate change and the transition to a low-carbon economy, enabling micro- and macro-prudential risks to be addressed

2. Timely insights will be communicated in Central Bank **publications** informing the broader public policy debate

3. Central Bank **staff will be equipped** to supervise regulated entities for climate-related risks and climate-considerations will have been embedded in supervisory tools and activities

4. **Regulated financial service providers** will have made progress in integrating climate-risk considerations to all aspects of their business management and will be compliant with climate-related disclosure obligations

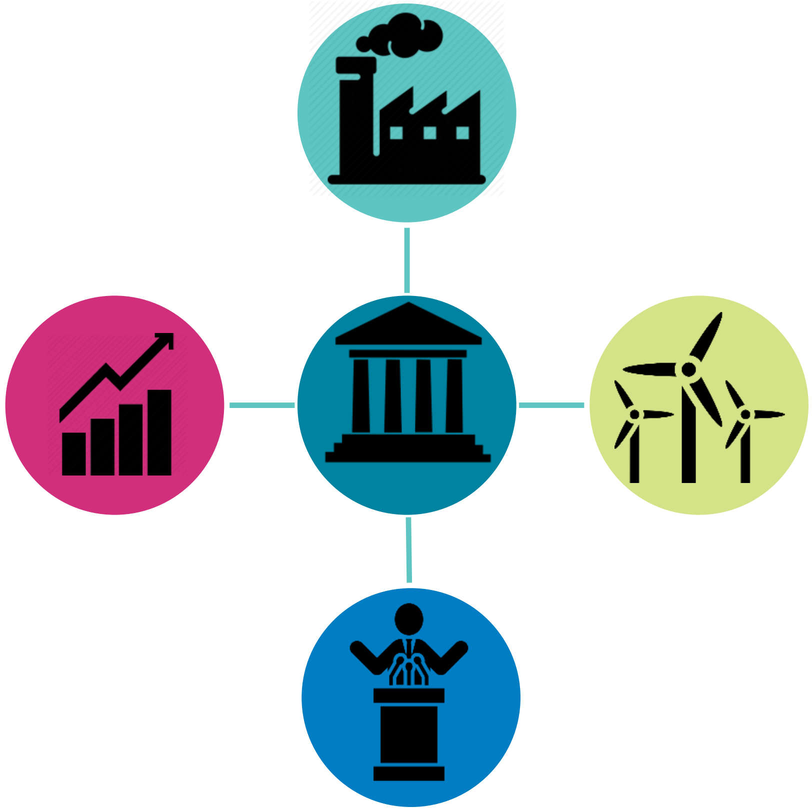
5. The market for sustainable finance will **support the transition** to a carbon neutral economy, while the interests of consumers / investors in this market will be protected

6. Identified **data gaps** will have been, or be in the process of being, filled, to support the development of further knowledge and policy positions

7. The Central Bank will have enhanced its **engagement with stakeholders** on climate-related issues, both domestically and internationally, and will be actively shaping and contributing to the development of policy insights and positions

Climate risk and sustainable finance forum

- **Main Objective:** build and accelerate a shared approach among industry and the Central Bank to the understanding (and mitigation) of the financial risks and opportunities posed by climate change
- Provides **a formal structure** for engagement by the Central Bank with industry on climate-related issues, supported by clear objectives and proposed outputs
- Provides a framework (**working groups)** within which industry is working together to produce own outputs/practitioner perspectives to relay examples of good practise, etc.
- **Membership** comprises representative bodies of banking, insurance, asset management and markets along with a cohort of climate experts / scientists
- Forum meets twice a year, chaired by Deputy Governor Donnery



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The Central Bank’s Sustainability Initiatives

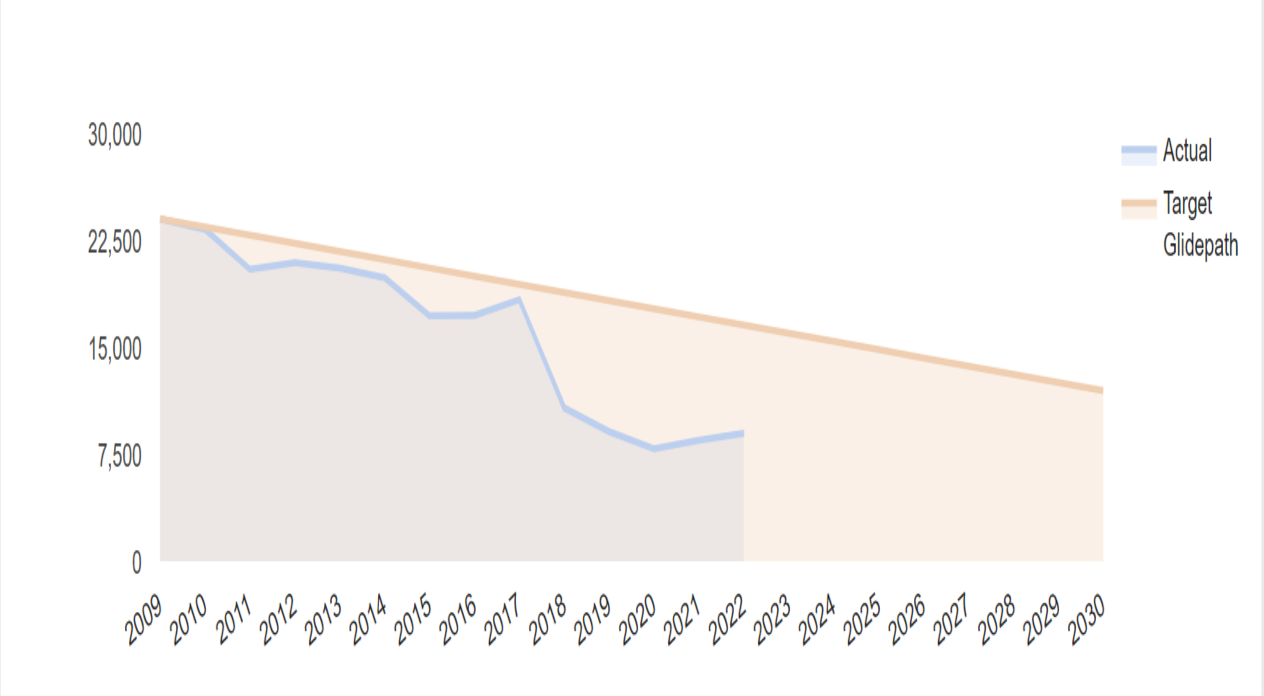
Journey to Date

2015	First building in Ireland to achieve BREEAM Outstanding at Design stage for North Wall Quay
2016	Environmental Officer recruited to deliver a greener Central Bank of Ireland
2017	ISO 14001 (Environmental), ISO 45001 (Health & Safety) and ISO 50001 (Energy) certification achieved for Dockland Campus
2018	ISO 50001 certification achieved in the Currency Centre
2019	Biodiversity Action Plan established for all sites
2020	First building in Ireland to achieve BREEAM Excellent in Use North Wall Quay
2021	Signed up to All-Ireland Pollinator Plan & two bee hives onto the roof in NWQ
2022	Established Sustainability Taskforce and operational subgroups

Energy Performance Indicators - 2022

2022 EnPI = 9,055 $\frac{\text{kWh}}{\text{FTE Employees}}$

Target EnPI = 12,040 $\frac{\text{kWh}}{\text{FTE Employees}}$



Central Bank Climate Action Roadmap (March 2023)

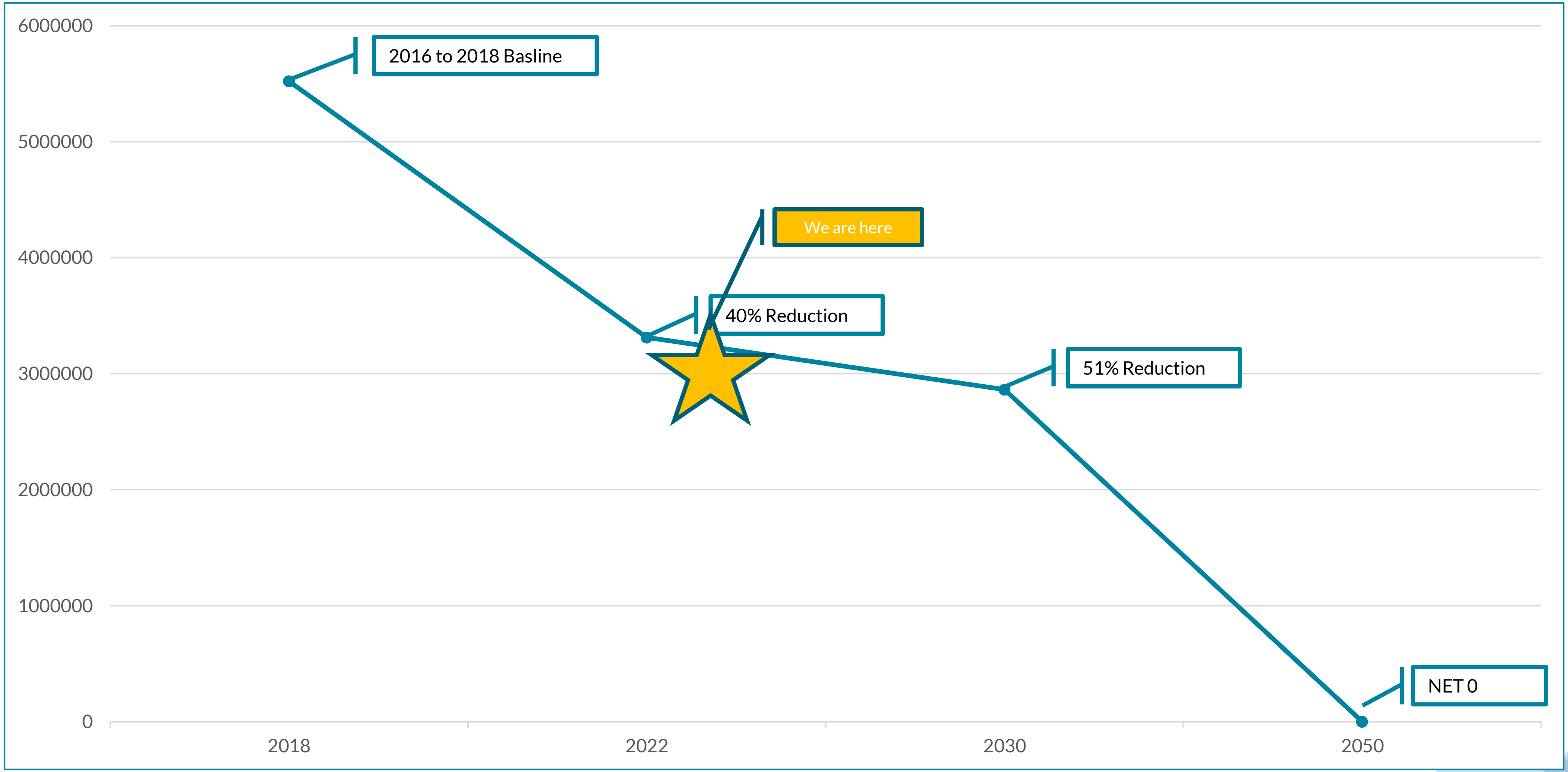
Central Bank acting as a socially responsible and sustainable organisation while playing our part in the transition to a carbon neutral economy.

What success looks like:
We progress our organisational sustainability objectives as set out in the Roadmap

How We Are Organised	Our Ways of Working (policies, practices, buildings)	**Playing Our Part** (Our People)
Social and Sustainability Oversight Group	Energy management and efficiency	Sustainability Champions and green teams
Sustainability Taskforce	Reduce GHG emissions	Leadership training
Climate and Sustainability Champion	Business travel & employee commuting	Annual workshops
Climate Action Roadmap with set objectives	Procurement –BUs embed green criteria	Climate and sustainability training
Annual Reporting including EH&S Report	Investments of CBI financial assets	
	Waste management plan and use of paper	
	Parking and use of bicycles	

Data Analysis, KPIs/Targets, Monitoring and Reporting
Public and Internal Reporting - Accreditation

GHG Emissions Glide path (Scope 1 & 2 only)



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Discussion questions

1. What are the biggest climate-related issues for the people you represent?
2. What are the biggest climate-related risks for the people you represent?
3. What role can the Central Bank play in addressing these issues?