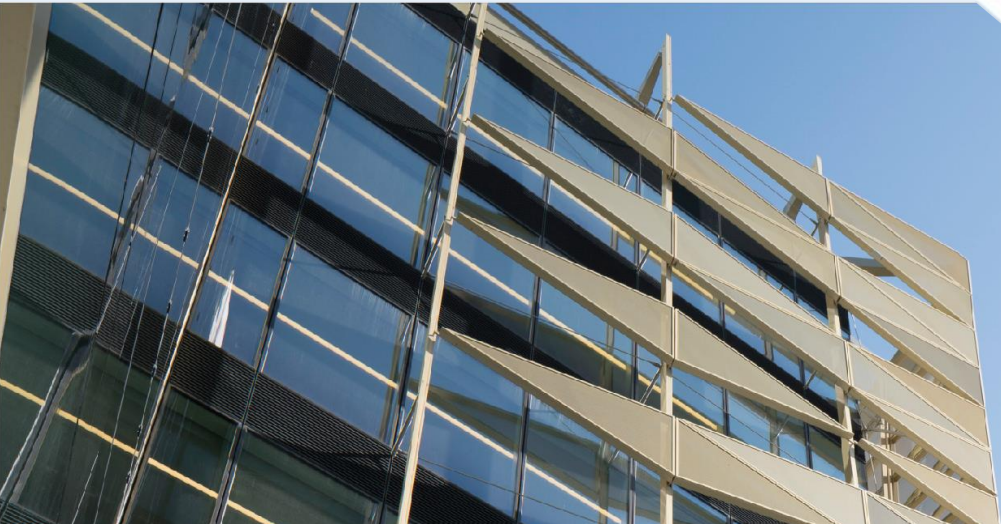




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PDST Economics Webinar

Enda Keenan
Irish Economic Analysis Division
Central Bank of Ireland

Main Topics

- Role of the Central Bank of Ireland
- Functions and Implementation of Monetary Policy
- Financial Regulation
- Economic Analysis



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Role of the CB

- Learning Outcome 4.4 Monetary policy and the price level
 - Examine the role of central banks in implementing monetary policy
 - Evaluate how being a member of the Eurozone shapes and influences monetary policy in the Irish Economy



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What Do Central Banks Do?

The Central Bank of Ireland serves the public interest by safeguarding monetary and financial stability and by working to ensure that the financial system operates in the best interests of consumers and the wider economy

'The primary objective of the ESCB shall be to maintain price stability. Without prejudice to the objective of price stability, it shall support the general economic policies in the Community'

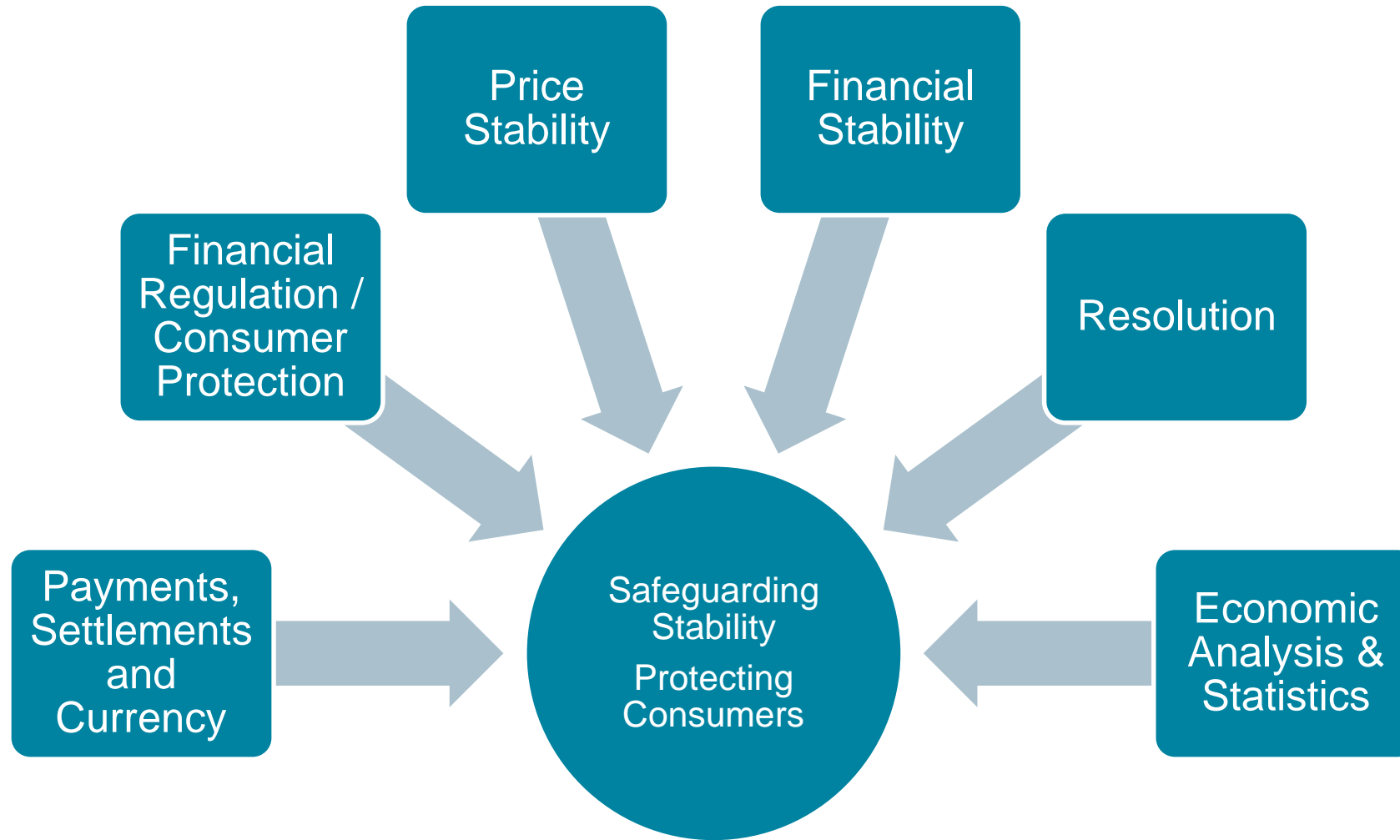
Maastricht Treaty, Article 2 (1992)



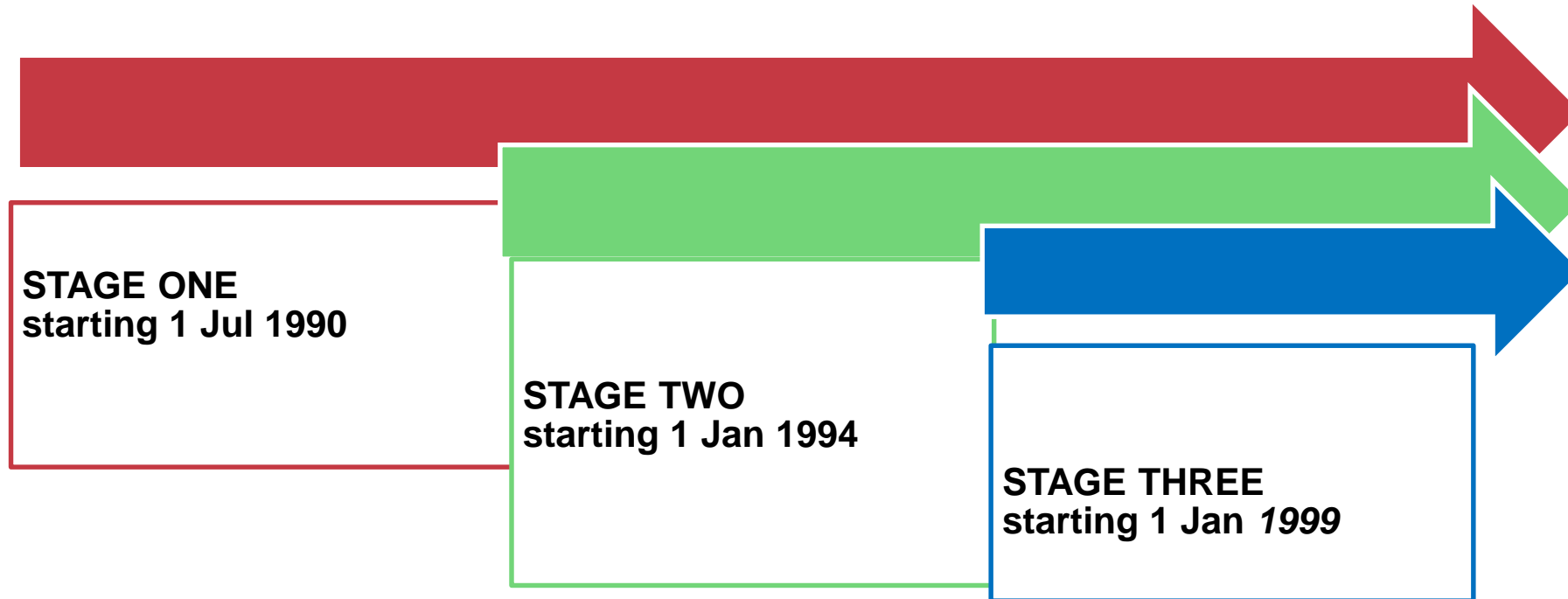
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Role of the Central Bank



Economic and Monetary Union



**Euro currency first
issued on 1 January
2002**



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Function and implementation of Monetary Policy

- Learning Outcome 4.4 Monetary policy and the price level
 - Explain inflation and deflation and describe how they are measured using the CPI
 - Evaluate the causes of inflation and consequences of changes in the price level for consumers, firms and the economy as a whole
 - Examine the role of central banks in implementing monetary policy
 - Evaluate how being a member of the Eurozone shapes and influences monetary policy in the Irish Economy



What is Monetary Policy

Monetary policy concerns the decisions taken by central banks to influence the cost and availability of money in an economy through interest rates

Any change it makes to these rates affects the interest rates commercial banks charge their customers for borrowing money and ultimately influences consumer spending and business investment.

Price stability is the best contribution that monetary policy can make to economic growth

- This ensures confidence that your money will be worth the same tomorrow as it is today
- Stable prices help people make well-informed decisions on spending, saving, borrowing and investing

Every six weeks, the ECB Governing Council meets to determine what should be done to keep inflation below, but close to, 2%



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Why is 2% chosen as the optimal level of inflation?

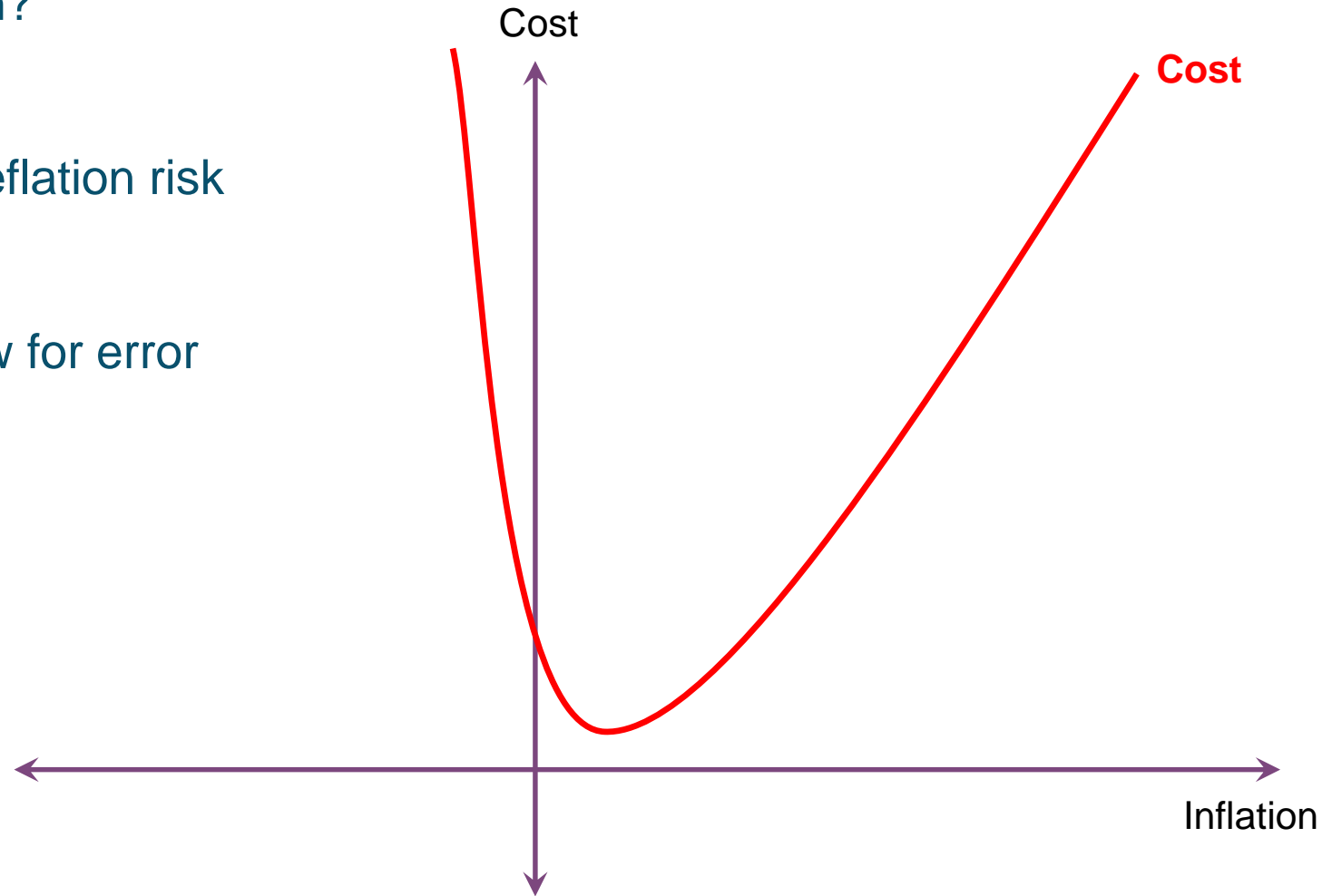
Why not target zero inflation?

Safety margin away from deflation risk

Measurement buffer to allow for error

Country differences

Substitution Bias



Why price stability as a primary objective?

Costs of high inflation:

- Inflation erodes purchasing power and devalues savings.
- Inflation distorts price signals, which provide key information on supply and demand. Therefore, inflation disrupts the price mechanism which is at the centre of a market economy.
- Inflation increases uncertainty and, hence, the inflation premium → higher interest rates and cost of credit.
- Risk of wage-price spiral (in extreme cases)

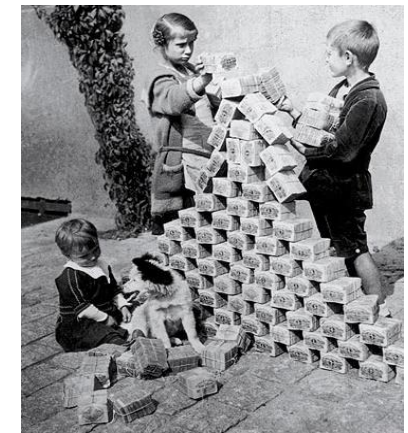
Losers	Winners
Creditors/Savers	Debtors
Owners of financial assets	Holders of real assets
Those earning a fixed income/in receipt of social benefits	Holders of external assets

Danger of Hyperinflation

Definition: more than 50% inflation per month

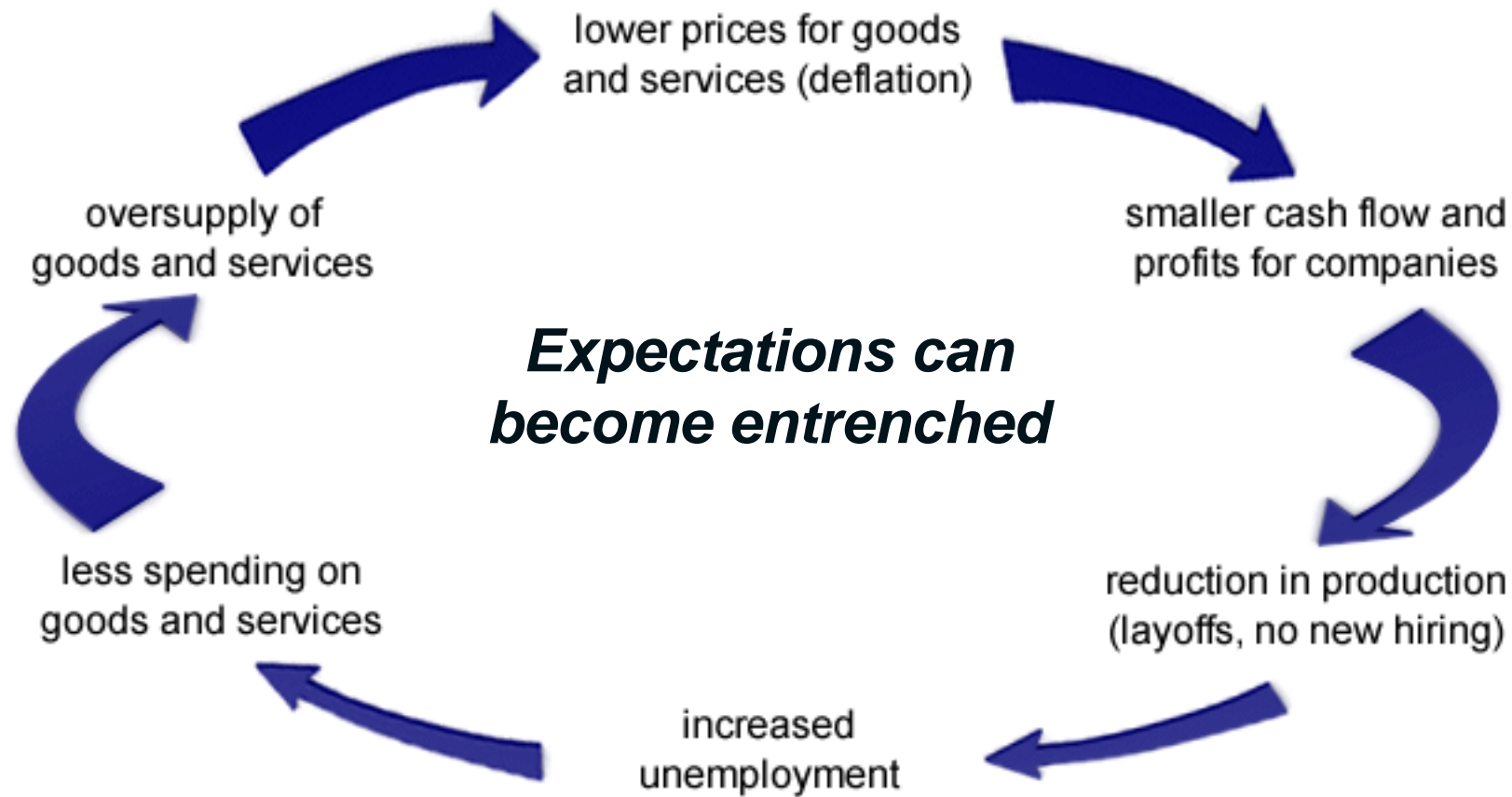
Examples:

- Germany, Austria (1920s)
- Zimbabwe (2007/08)
- Venezuela (since 2016)



Why deflation may be harmful?

What is the problem with falling prices?

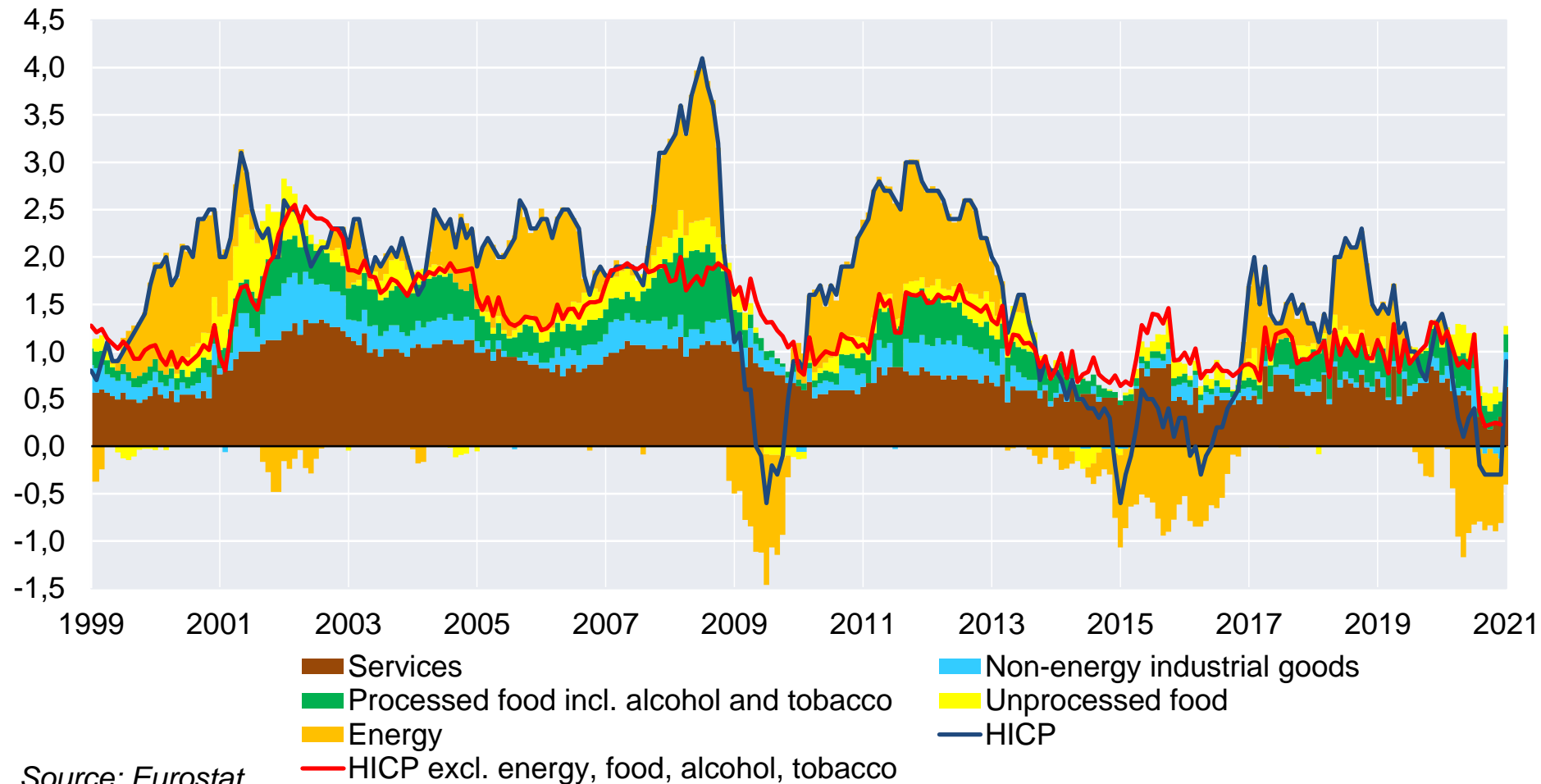


!!! deflation \neq disinflation \neq (temporarily) negative inflation !!!

Inflation Development

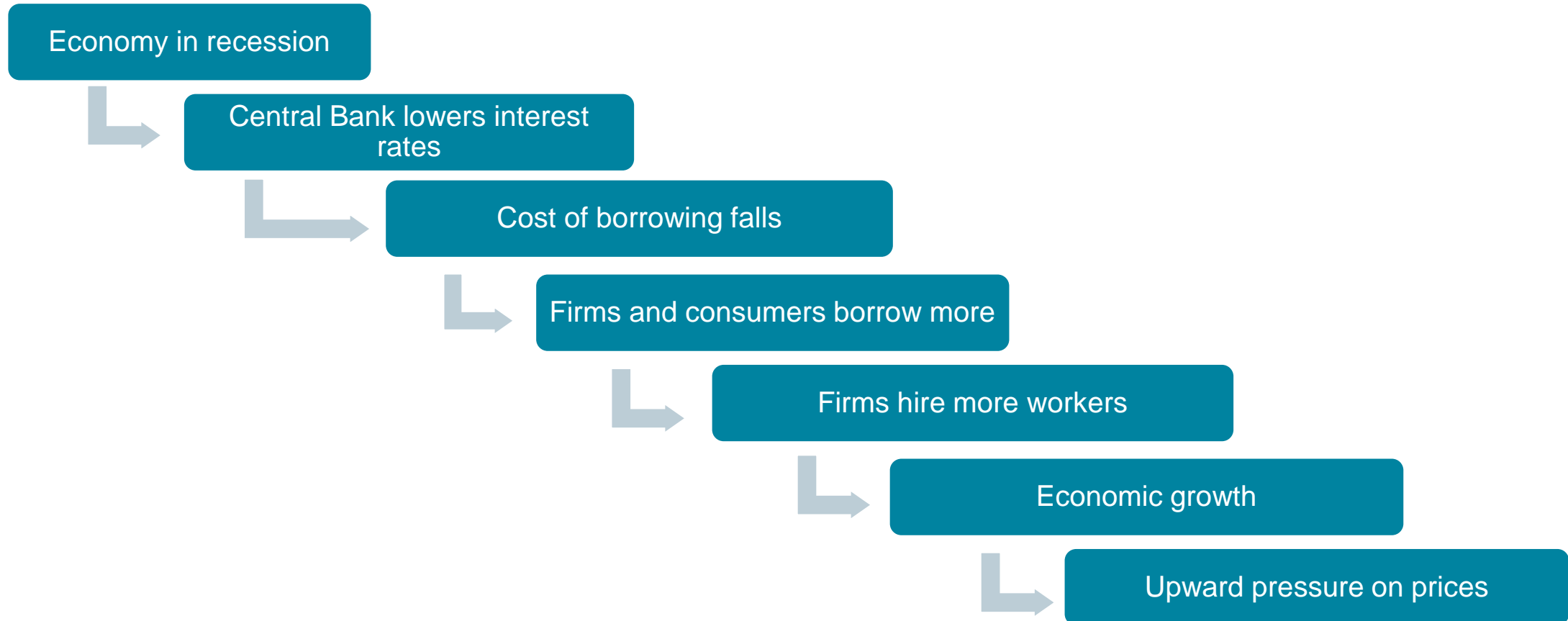
Components of the HICP: Contributions to annual inflation

in percentage points (lines: in %)

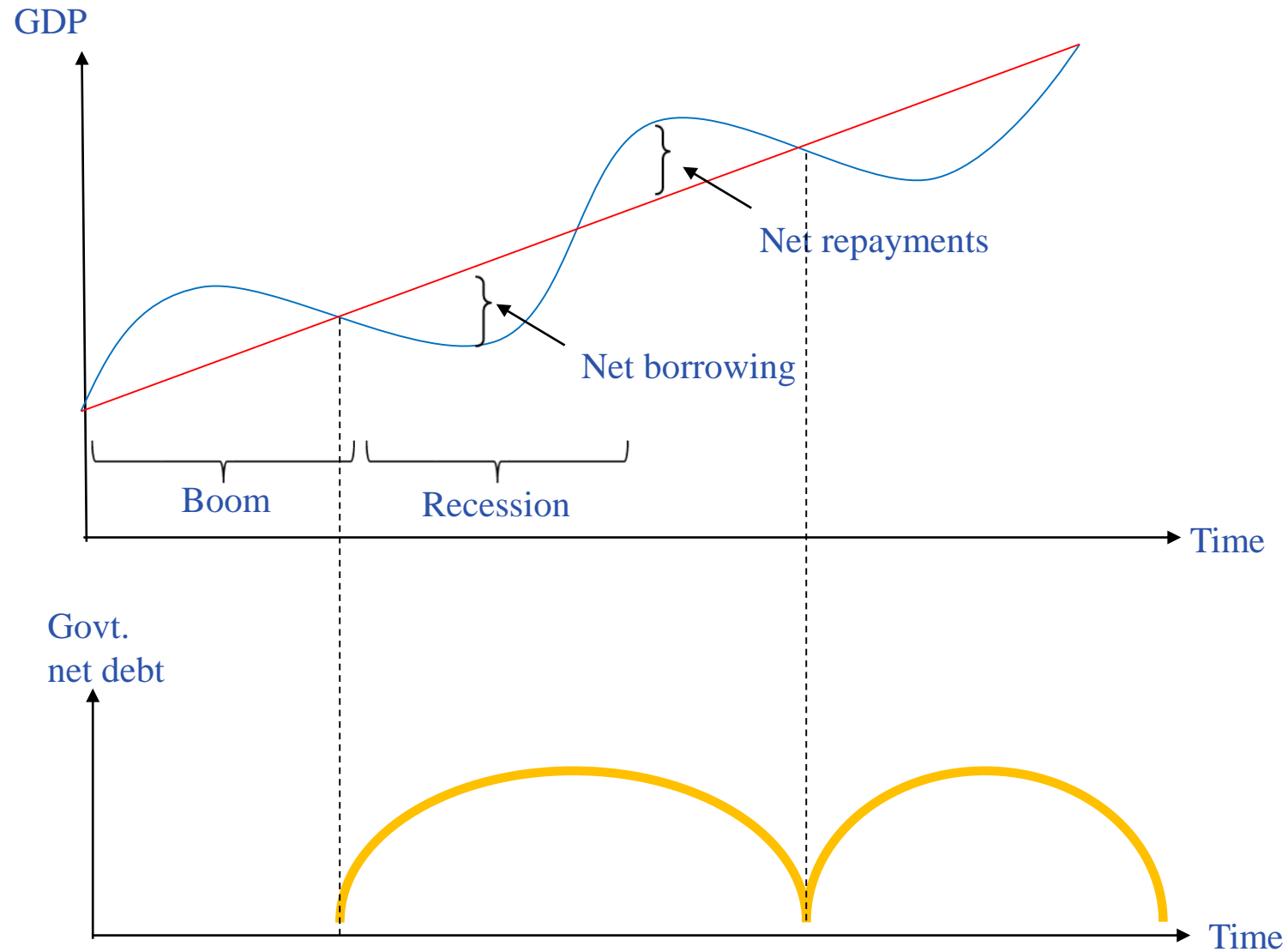


Source: Eurostat.

How does a Central Bank affect the economy?

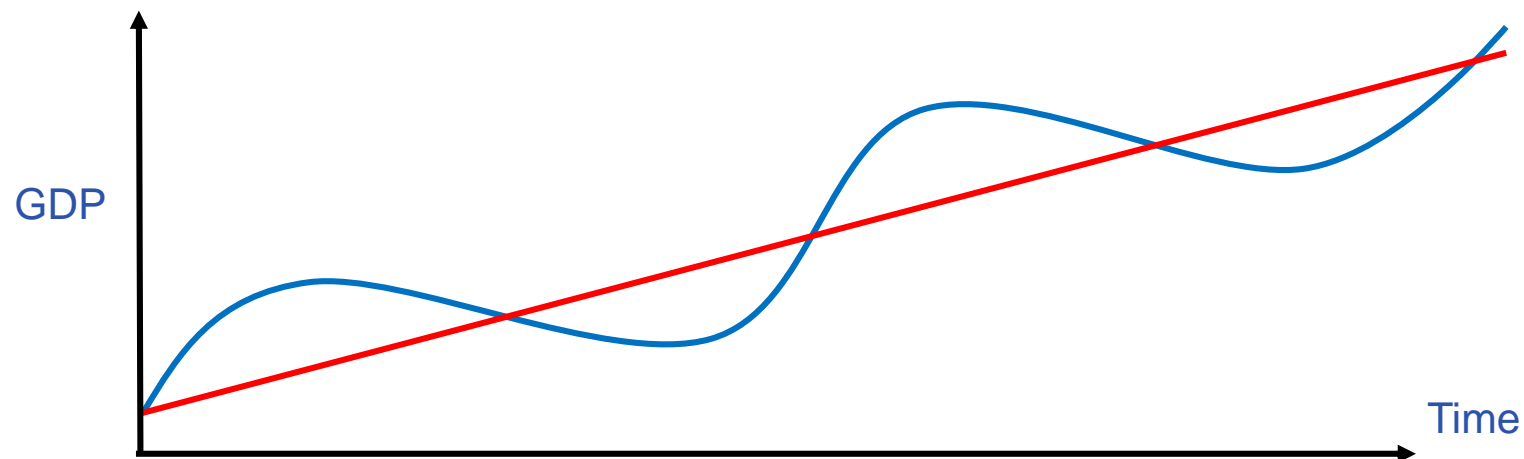


Business cycle and fiscal cycle



Business cycle, potential growth, distribution

Policy	Fiscal policy	Monetary policy
Target	<ul style="list-style-type: none">• Business cycle stability• Distribution	<ul style="list-style-type: none">• Price stability• Business cycle stability
Instrument	<ul style="list-style-type: none">• Taxation• Government spending• Automatic stabilizers	<ul style="list-style-type: none">• Key interest rates• Unconventional measures



Financial Regulation

■ Learning Outcome 4.5 Financial Sector

- Examine the main factors affecting the demand for and supply of cash and credit funds in the money market
- Explain how commercial banks create credit and outline the consequences for an economy
- Analyse the factors that influence the level of interest rates, evaluating the impact of changes on economic activity
- Examine the role and effectiveness of current financial institutions and regulators in the operation of financial markets



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Supply and Demand for Money in the Market

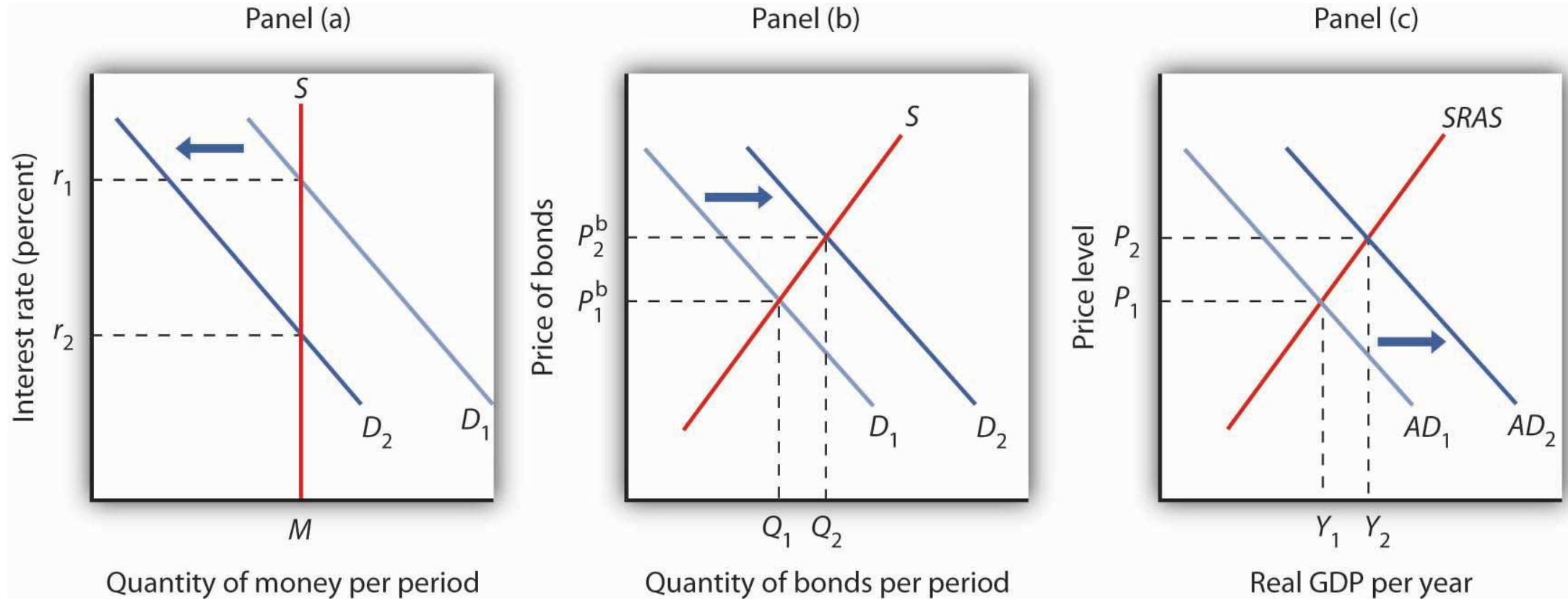
Supply is affected by:

- Open market operations - The Central Bank buys government bonds, effectively creating money (Form of Quantitative Easing through the APP since 2009 or now the PEPP)
- The reserve requirement imposed on banks –the % of customer deposits that the bank must keep hold of rather than lending it out
- The policy interest rate set by the central bank – the rate of interest will influence how many households and businesses are willing and able to borrow

■ Demand is affected by:

- Interest rate on loans
- The amount of monetary transactions that we expect to carry out
- Speculative motive - desire to hold other financial assets, e.g. bonds, property, savings
- Economic growth developments and the anticipated rate of inflation
- Pace of financial innovation - extent to which it is possible to use debit cards / credit cards
- Precautionary motives - the extent to which we might have to pay out large unexpected payments

Supply and Demand for Money



Financial Innovation

- As monetary is forward-looking, it is important to implement policy reflective of technological advancement
- Increased technological progress can drive productivity which affects the rate of return on investment and the level of real equilibrium interest rates.
- Advancement can also create opportunities and challenges for monetary policy:
 - High-frequency card-spending data shows consumption in real time using Revolut/N26
 - Greater international effect from global value chains and exchange rate pass-through to inflation
 - E-commerce can provide lower costs to consumers but difficulty in measuring and pricing can affect national accounts

Impact of digital currency on financial markets

- Commonly seen as an intangible currency that is created outside the ubiquitous central bank currency-based banking and payment system (a decentralised alternative). Intended as with conventional currency to provide a medium of exchange (MOE) and store of value to its users.
- Bitcoin is the best known example and covers of some of its main features: decentralised, supply governed and limited by a number of computer algorithms, transferred and protected by Blockchain technology. It is not in common use as an MOE and has seen its value fluctuate, often within a short period
- Digital currencies are in their infancy and so it is difficult to quantify their likely effects on financial markets. Issues raised include:
 - Their value (in US dollar terms) fluctuates considerably. Affected by confidence, supply, investor endorsement, regulatory response, new entrants (competition) , speculative attack. Value is usually determined on cryptographic exchanges
 - Scope for Ponzi schemes and delusory value
 - Have had little effect on broader financial markets but that could change if digital currencies garner broader appeal and are adopted more by financial entities. How do the public assess their worth?

Impact of digital currency on financial markets

- Central bank digital currencies (CBDCs) are now being considered in part due to these issues.
- These CBDCs would see the CB providing a new retail payment instrument directly to the public (as occurs with physical notes and coins) using electronic means .
- Potential advantages: secure, government-backed payment mechanism, maintain trust in the payments system, promote social inclusion,
- Potential downsides: privacy concerns among the public, would the public ‘run’ from their retail bank deposits to CBDCs during a financial crisis?
- The ECB is considering starting a formal investigation into a digital euro in mid-2021

Financial Regulation - Why we do this

Well functioning banking system acts as a fulcrum around which the real economy turns

- Allocates resources efficiently
- Acts as a repository of national saving

Economic and financial systems, when left on their own, are prone to episodes of extreme volatility.

Financial crises can have large and expensive economic consequences

- Bank runs, failures & contagion
- Asset markets collapse and government debt rises
- Declines in output and employment

Regulation is an important policy tool in the struggle to limit the probability of crises occurring



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Financial Regulation - How we do this

What instruments are available to reduce the risk of financial crises occurring?

■ Capital requirements

- Imposition of higher requirements → banks have more to lose if they fail & so they pursue less risky activities
- Capital also acts as a cushion in case of a shock

■ Effective bank supervision

- Monitor how and by whom banks are operated
- Examine various risks institutions are exposed to (market, credit, operational etc.)
- Ensure compliance with capital requirements and any restrictions

■ Greater disclosure & transparency requirements

- Financial institutions must provide additional details regarding their activities, positions held, portfolio values

■ Restrictions on the assets banks can hold

- Prevent banks from holding assets which are deemed too risky

■ Greater use of macro-prudential tools



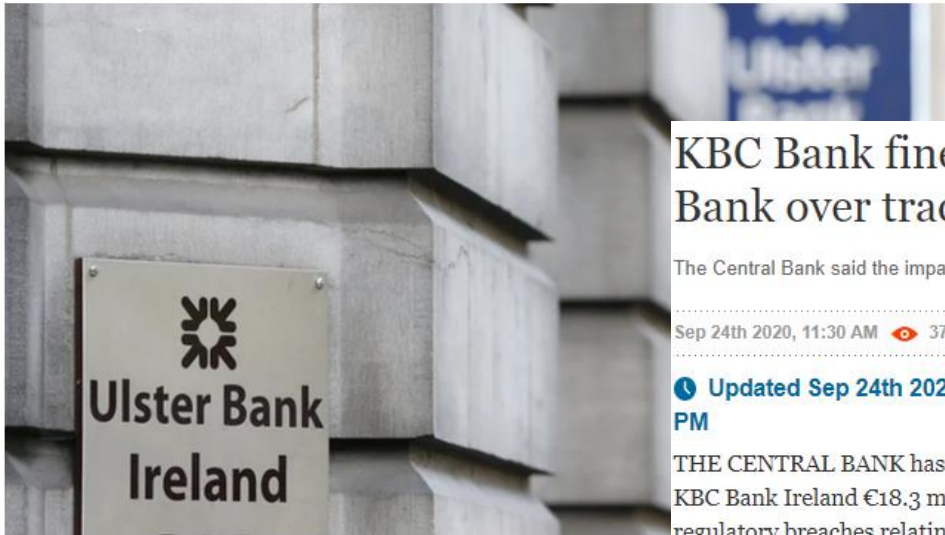
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Role of CBI in Regulation

Ulster Bank hit with record €38m Central Bank fine for tracker mortgage failings

Updated / Thursday, 25 Mar 2021 20:20



KBC Bank fined €18.3 million by the Central Bank over tracker mortgage scandal

The Central Bank said the impact on customers was 'devastating'.

Sep 24th 2020, 11:30 AM 37,065 Views 42 Comments Share 69 Tweet Email 1

Updated Sep 24th 2020, 12:35 PM

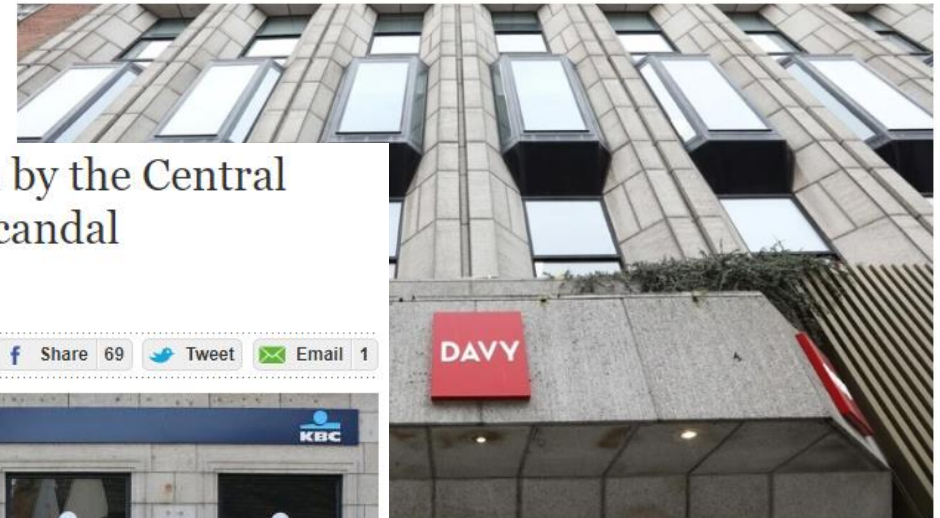
THE CENTRAL BANK has fined KBC Bank Ireland €18.3 million for regulatory breaches relating to the tracker mortgage scandal.

This fine comes on top of the €153,524,363 that the Belgian-owned bank has been required to pay to date in redress and compensation.



Central Bank fines Davy €4.1m for breaching market rules

Updated / Tuesday, 2 Mar 2021 16:28



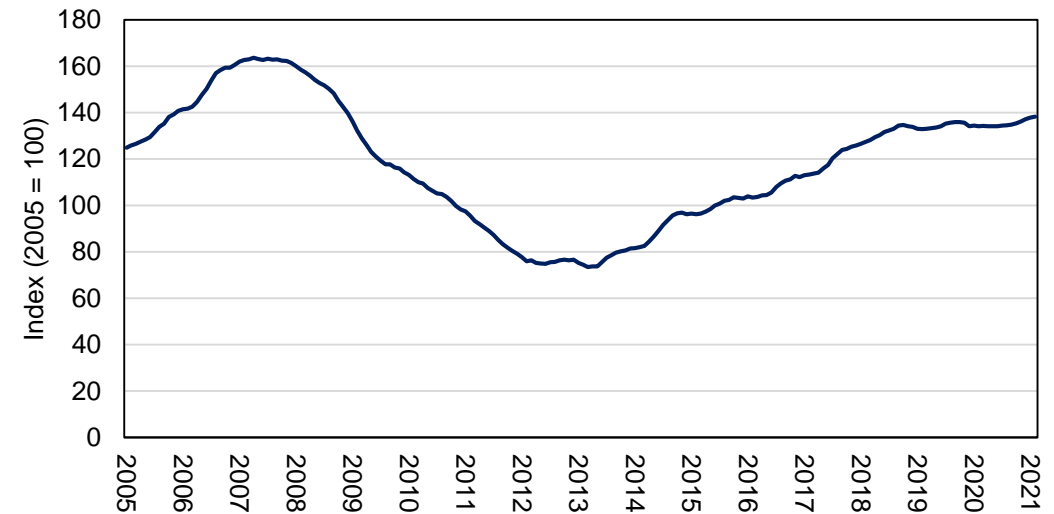
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Macroprudential mortgage measures

- Aims to mitigate the systemic risk that could have serious negative consequences for the real economy.
- Designed to ensure that banks lend money prudently and to limit the extent to which house buyers can borrow more than they can afford
- They increase the resilience of both borrowers and the banking system so that they can better withstand any future economic shocks.

Residential House Price Index



First Time Buyers

For most people,
MORTGAGE CAPPED at:

**3.5
TIMES
INCOME**

← 20% of
mortgages can
be above cap

**DEPOSIT
REQUIRED:
10%**

5% of
mortgages
can have a
lower deposit



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Economic Analysis

■ Learning Outcome 4.1 National Income

- Investigate data patterns in Ireland's national income, price level, unemployment rate, government expenditure and national debt over a period of time; identify the different phases of business cycles and critically examine the main factors that led to fluctuations in output

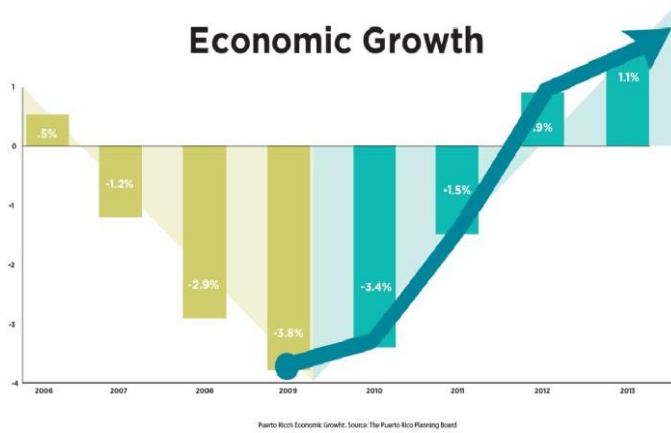


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Macroeconomic Concerns

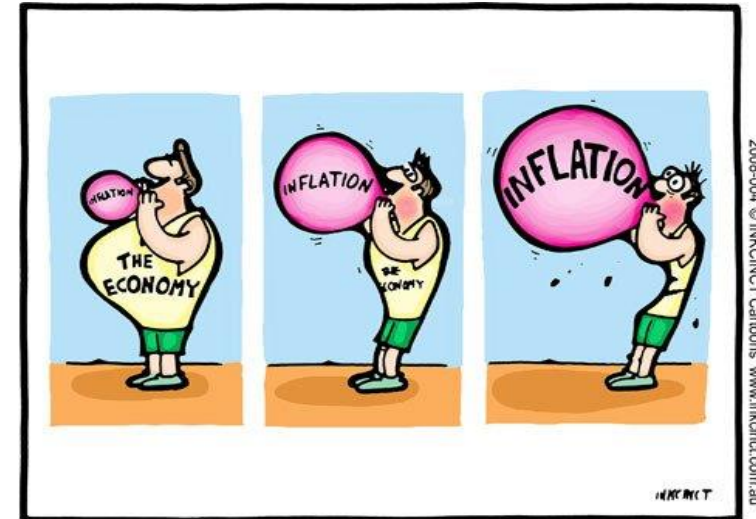
Economic Growth



Unemployment



Inflation



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Key Economic Indicators and Analysis

- There are a wide range of economic indicators to track, understand and analyse.
 - Developments in output
 - Demand and labour conditions
 - Broad range of price and cost indicators
 - Fiscal policy
 - Balance of Payments

- Each year, we publish 4 sets of economic forecasts in the Quarterly Bulletin
 - January, April, July and October
 - Supplementary boxes on issues of national interest e.g. Brexit, Household Savings etc

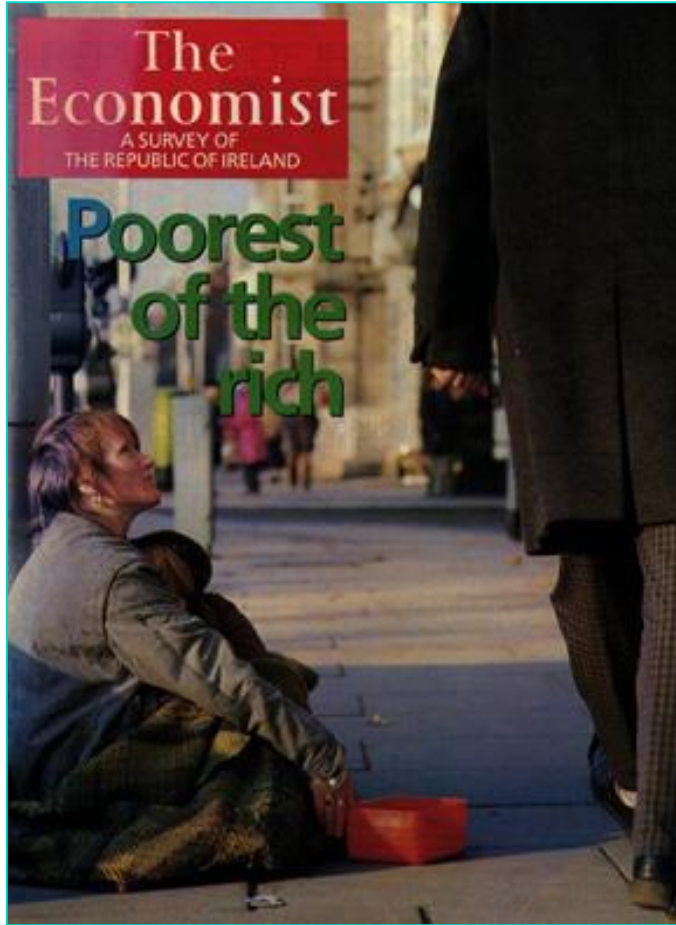
- The Irish economy can be difficult to analyse at times for a number of reasons
 - Large degree of data distortions e.g. multinational firms
 - Small open economies are highly susceptible to external shocks e.g. US policy or COVID-19



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From Poverty to Shining Light in a decade



1988



1997



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Then back to bust...

ireland's crash

After the race

Once among the richest people in Europe, the Irish have been laid low by a banking collapse and the euro zone's debt crisis. What now?

Feb 17th 2011 | DUBLIN AND TRALEEE | From the print edition



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And recovery...

The Economist | World politics | Business & finance | Economics | Science & technology | Culture

PageFair hack - [update for visitors to econom](#)

Charlemagne

The emerald shines again

Ireland is a good news story, but not quite in the way the EU would like

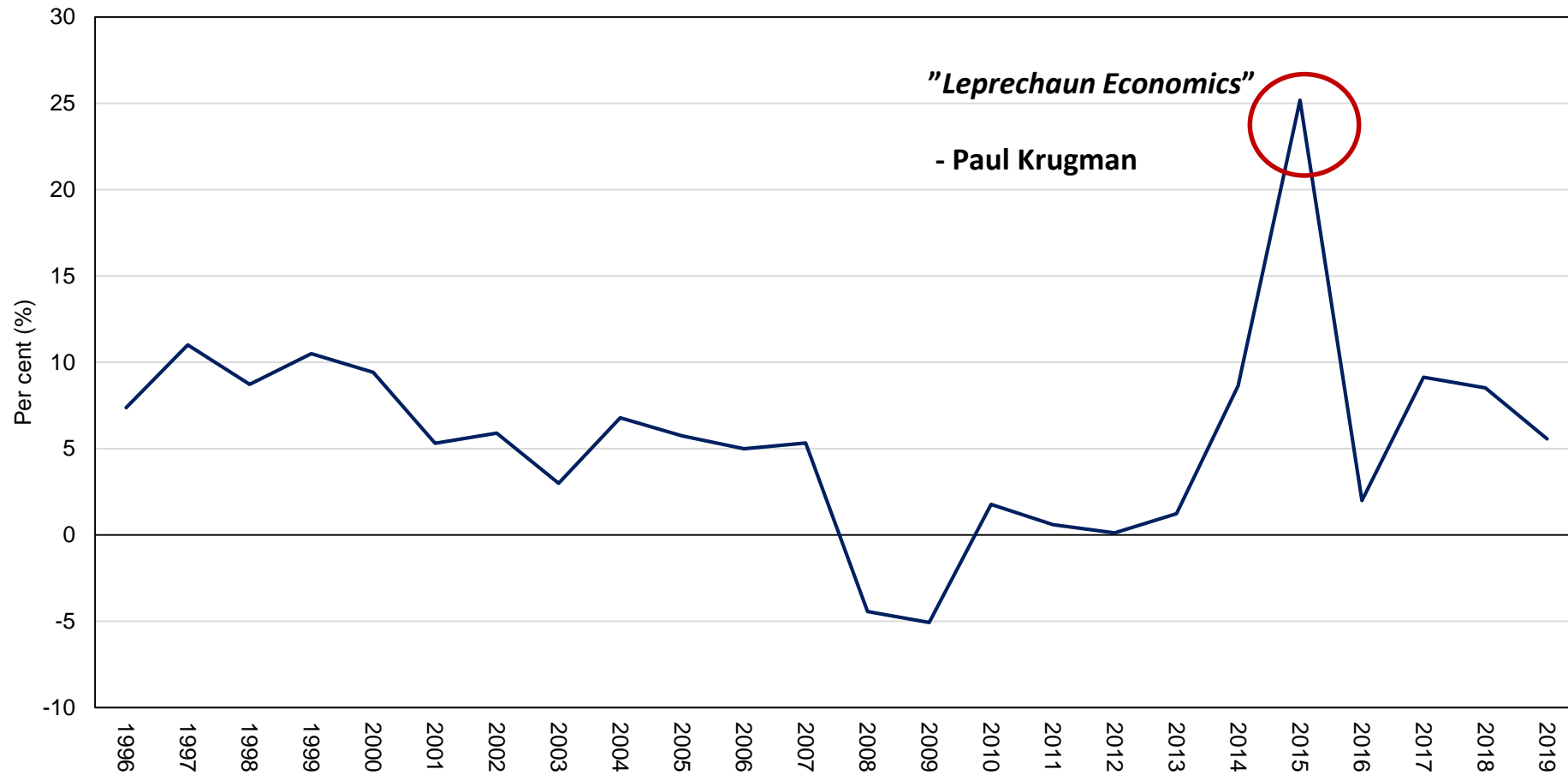
Nov 8th 2014 | From the print edition |  Timekeeper



Peter Schrank



Annual GDP Growth.....can often be misleading

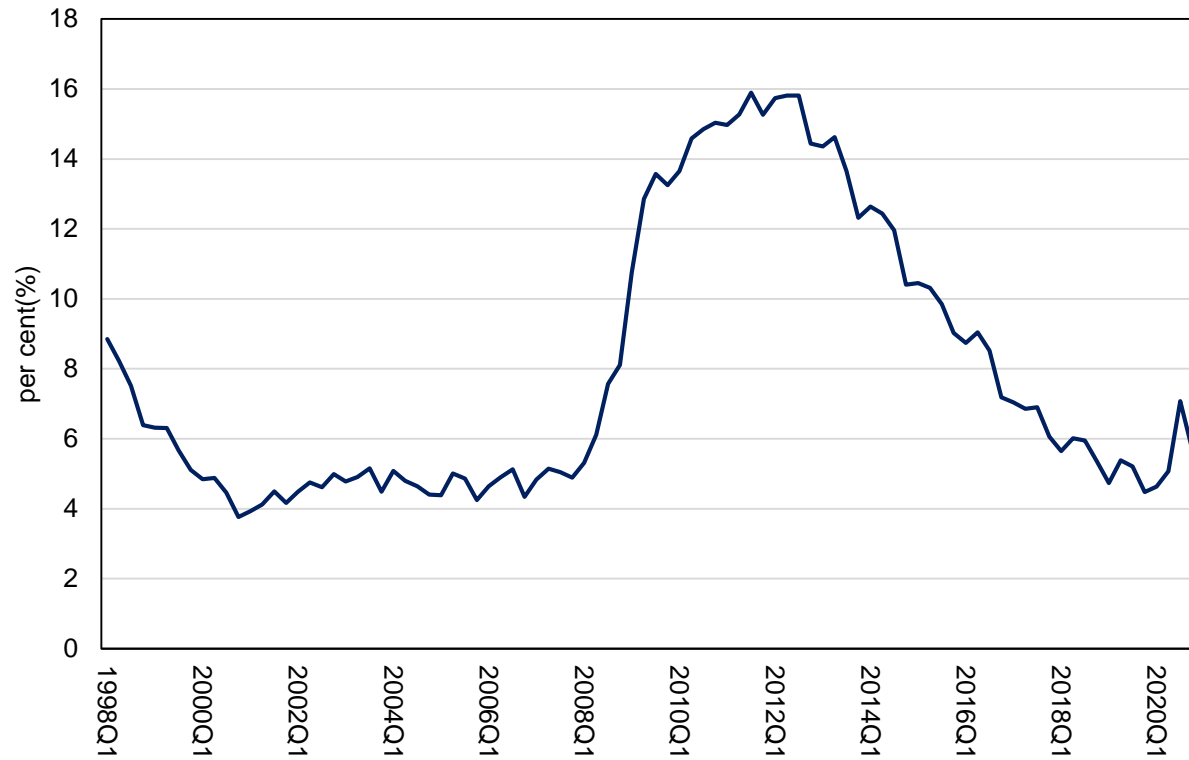


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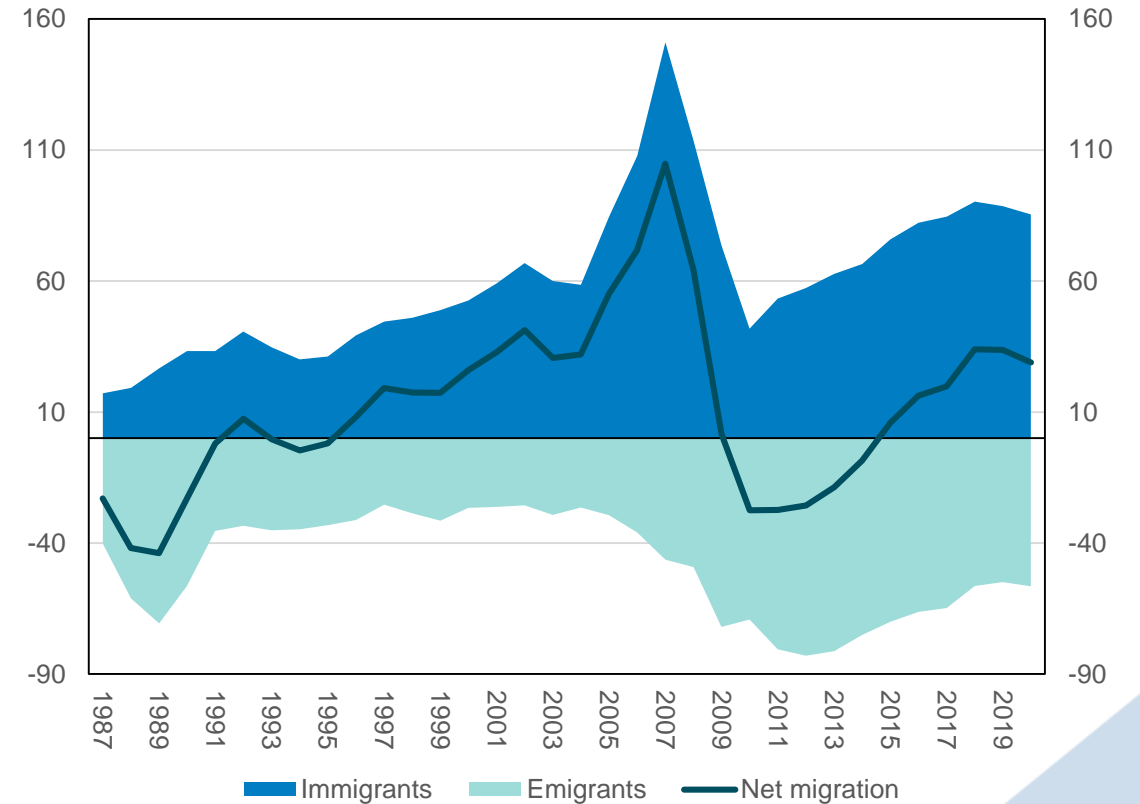
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Unemployment and Migration

Unemployment Rate



Migration

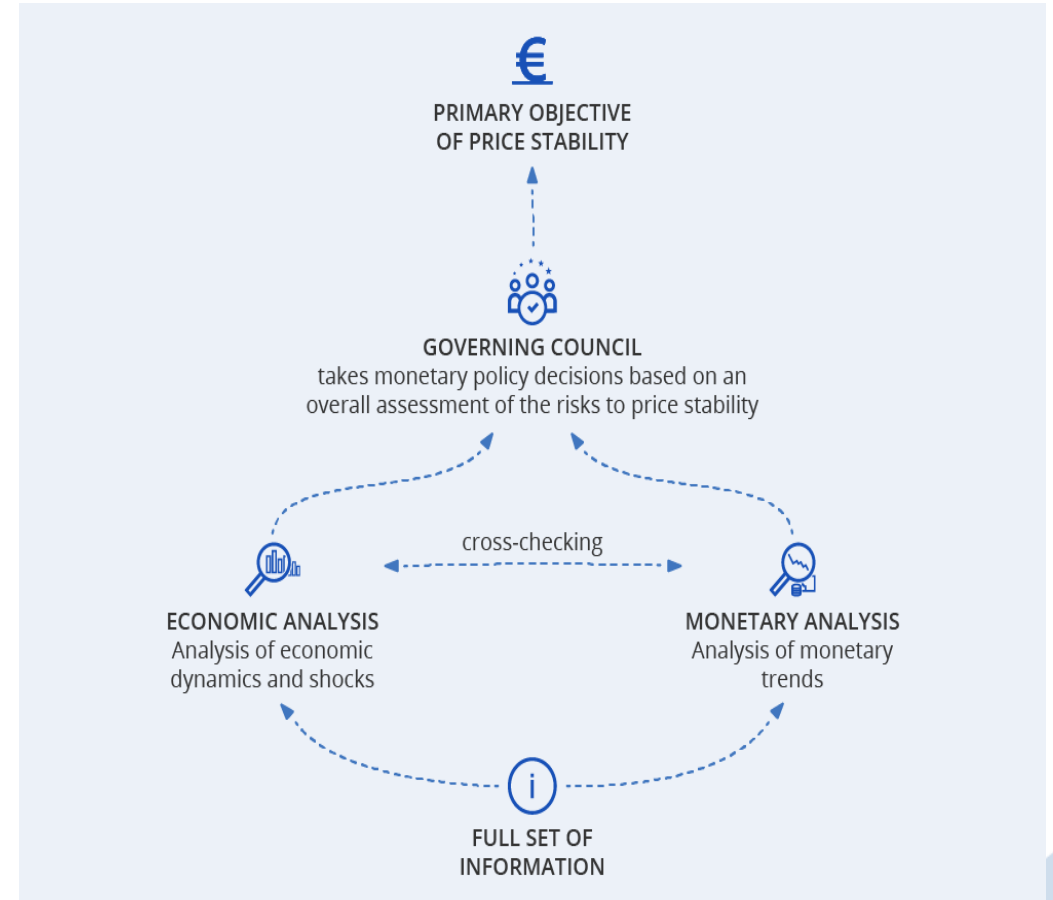


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Approach to Forecasting

- We produce forecasts to assist in monetary policy decision-making
- Individuals are assigned to various “forecasting blocks”
- Main inputs are CSO data releases, Eurostat, surveys, external assumptions, etc.
- Series of equations/models/data intensive process/judgement
- One main forecast table – brings all of the aspects together to tell a story
- Process is always evolving in line with latest challenges and developments



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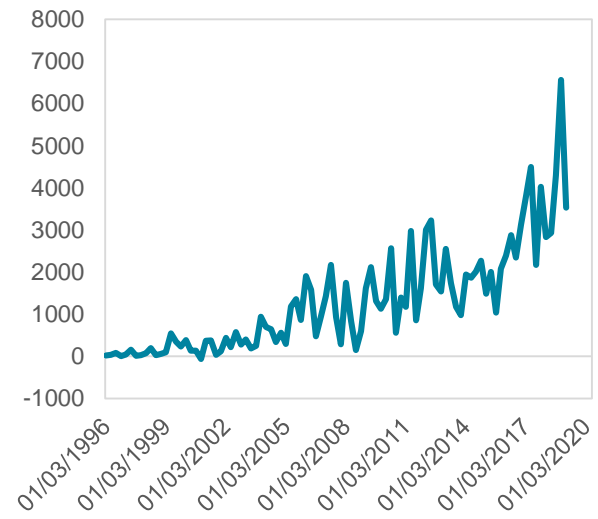
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A refresher on measurement issues in the Irish National Accounts

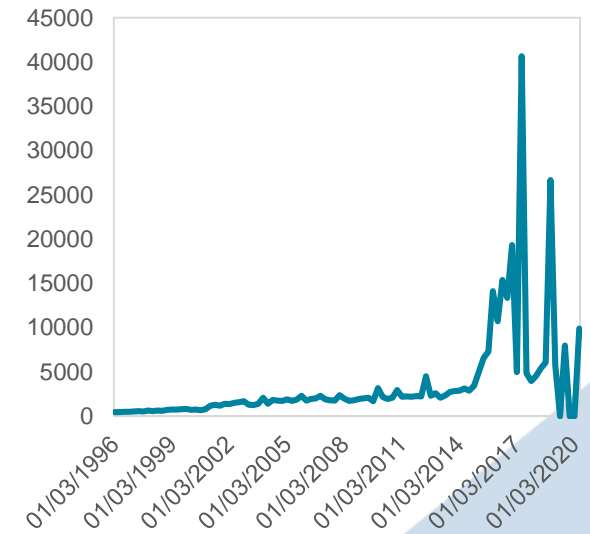


Building and Construction ;
 Machinery & Equipment ;
 Intangible assets

$C + I + G$	Domestic Demand
$C + (I - I^*) + G$	Modified Domestic Demand

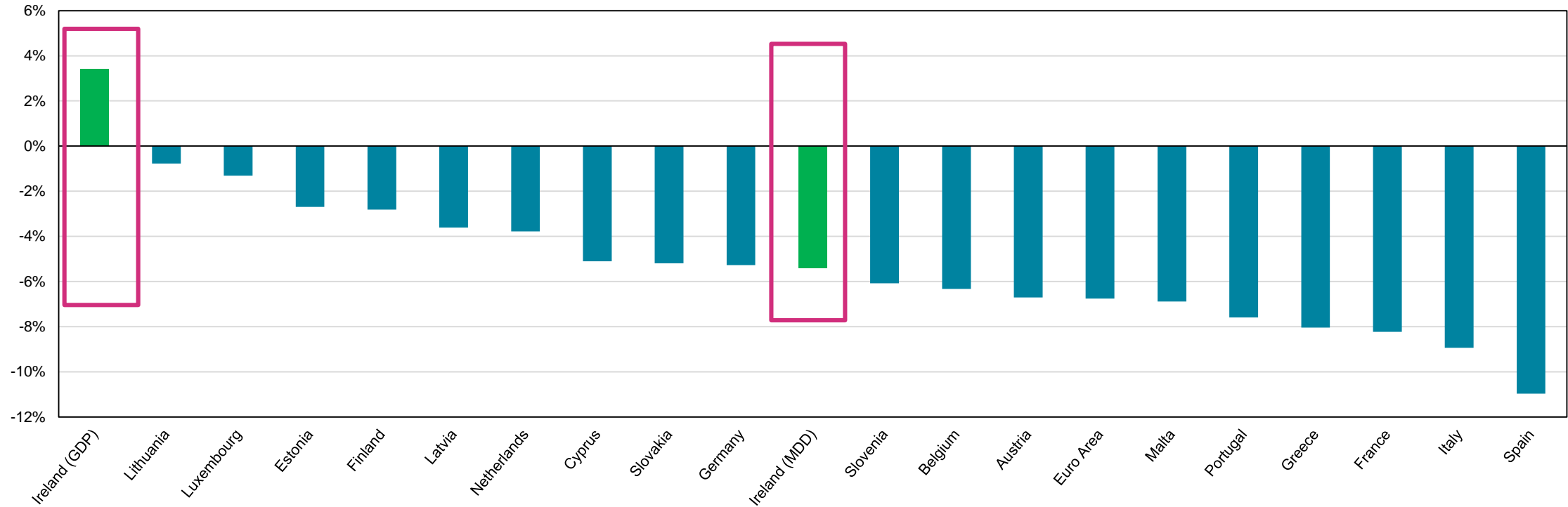


Investment: of which – other transport equipment
Source: CSO



Investment: of which – Intangible assets
Source: CSO

Annual GDP growth across the Euro Area, 2019-2020



Source: Eurostat, CSO

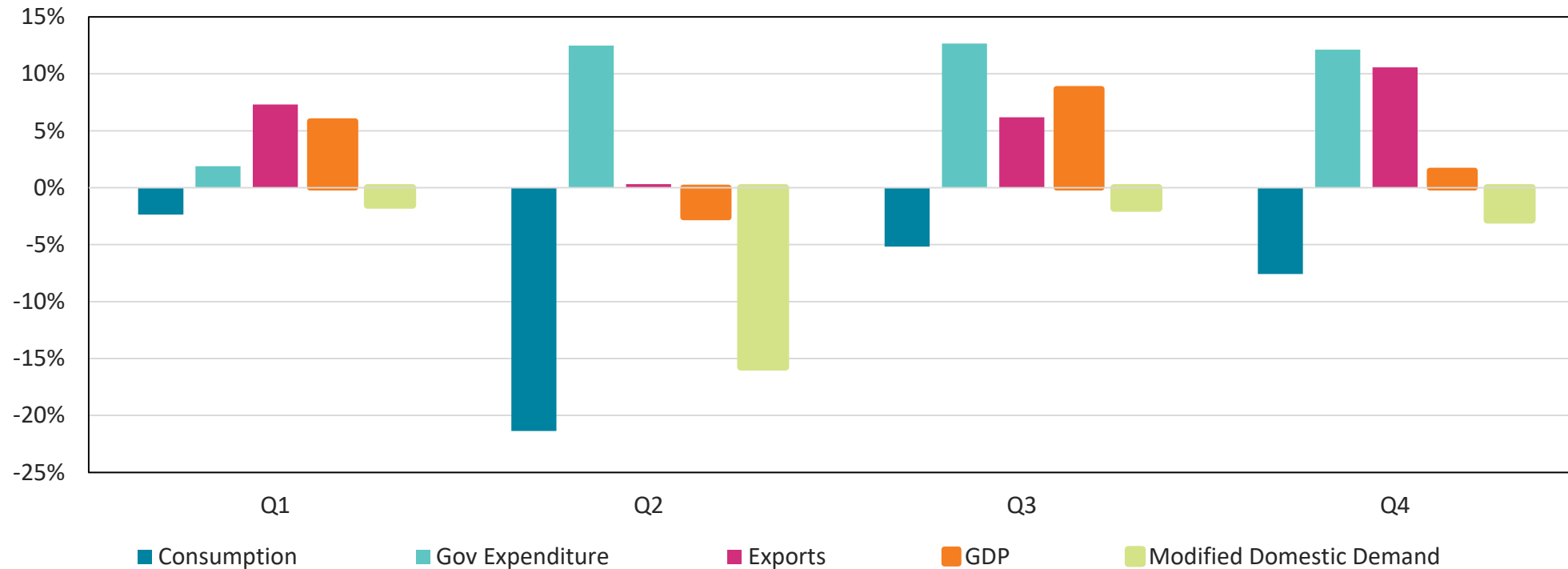
Notes: Chart shows the annual growth rate of GDP for 2020. Data are seasonally and calendar adjusted. Chart is sorted in order from highest to lowest growth in 2020. Irish data for modified domestic demand are also included.



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National Accounts Aggregates 2020 (Annual Change)



Source: CSO.

Note: percentage change compared to the same period of the previous year

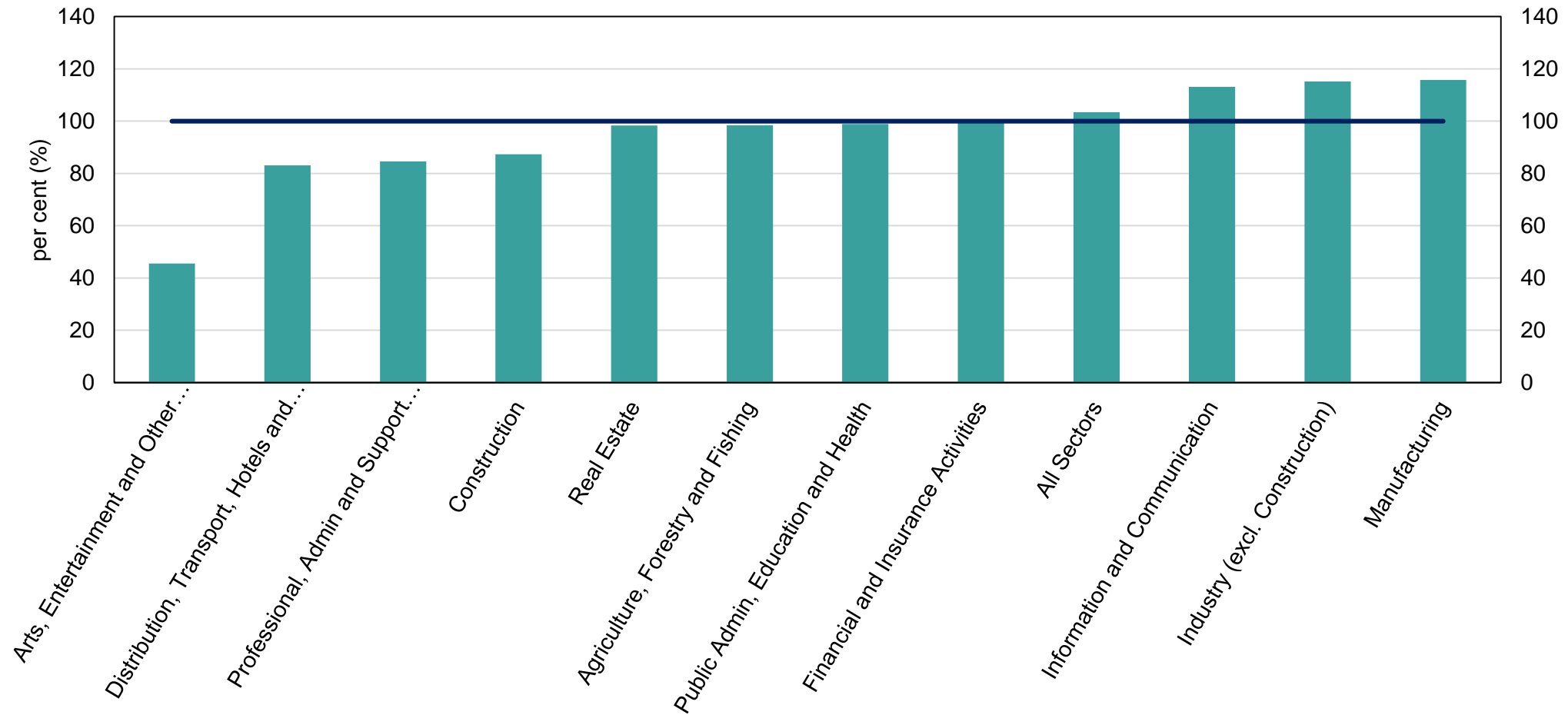


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2020 Output as a % of 2019 by Sector

Level of output in 2020 as a % of 2019 level

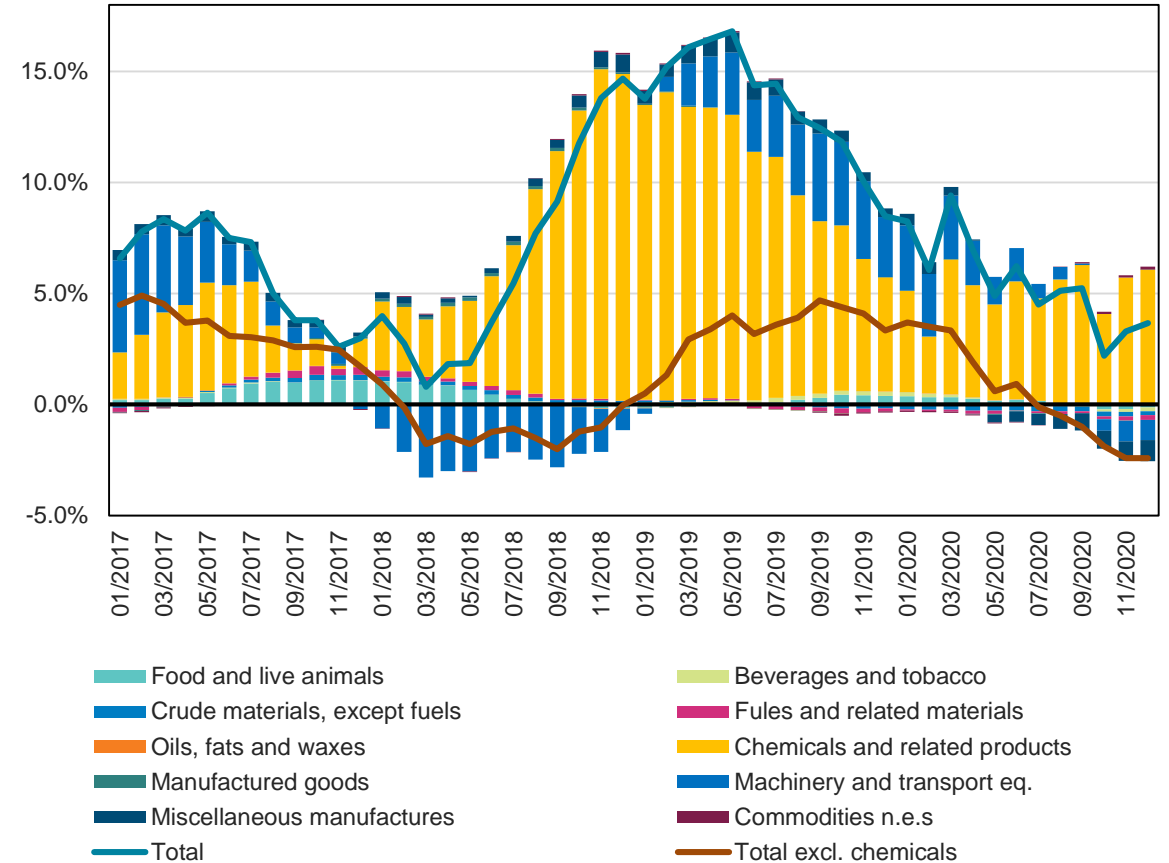


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Export Performance

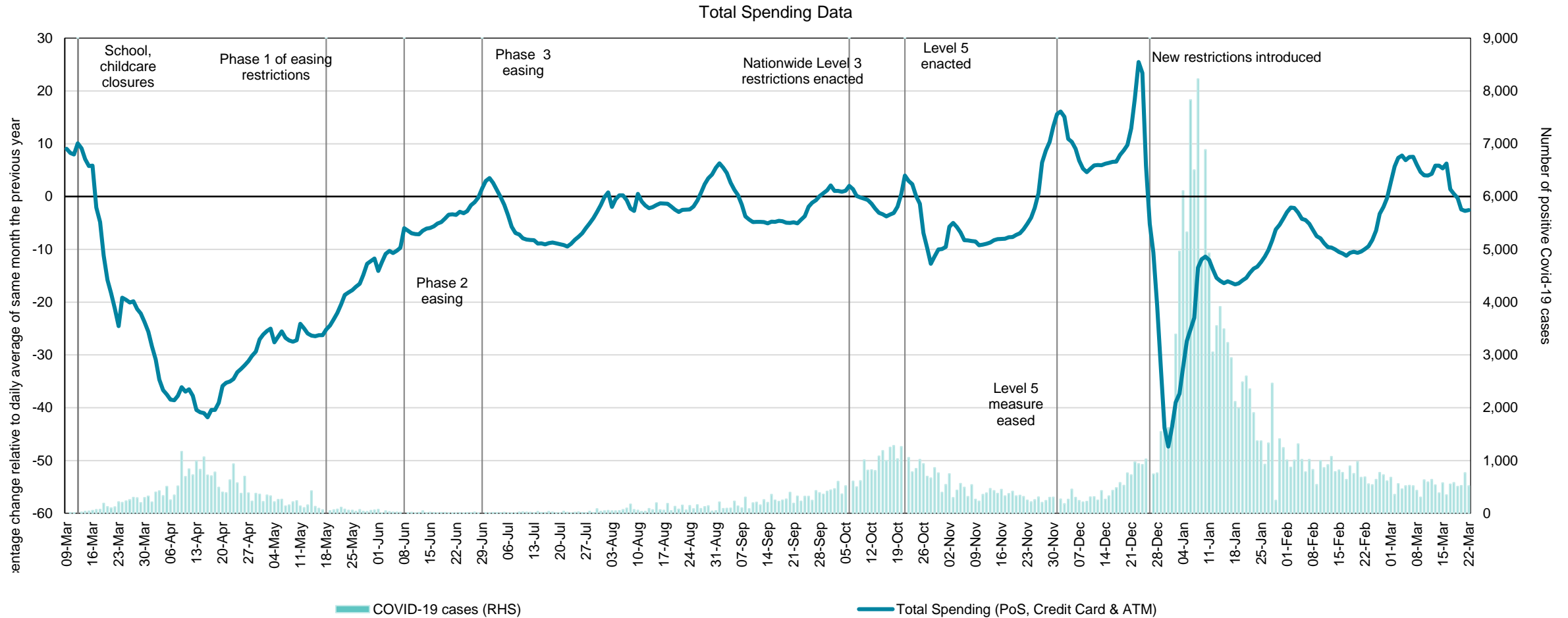
- Irish exports grew by 6.2% in 2020 despite a contraction in global trade
- Concentrated sectors such as chemicals and ICT have been gaining market share in recent years
- MNE performance masks severe declines in indigenous sectors such as transport and tourism
- Recovery in machinery and equipment and other investment goods is expected to increase as firm and economic recovery occurs



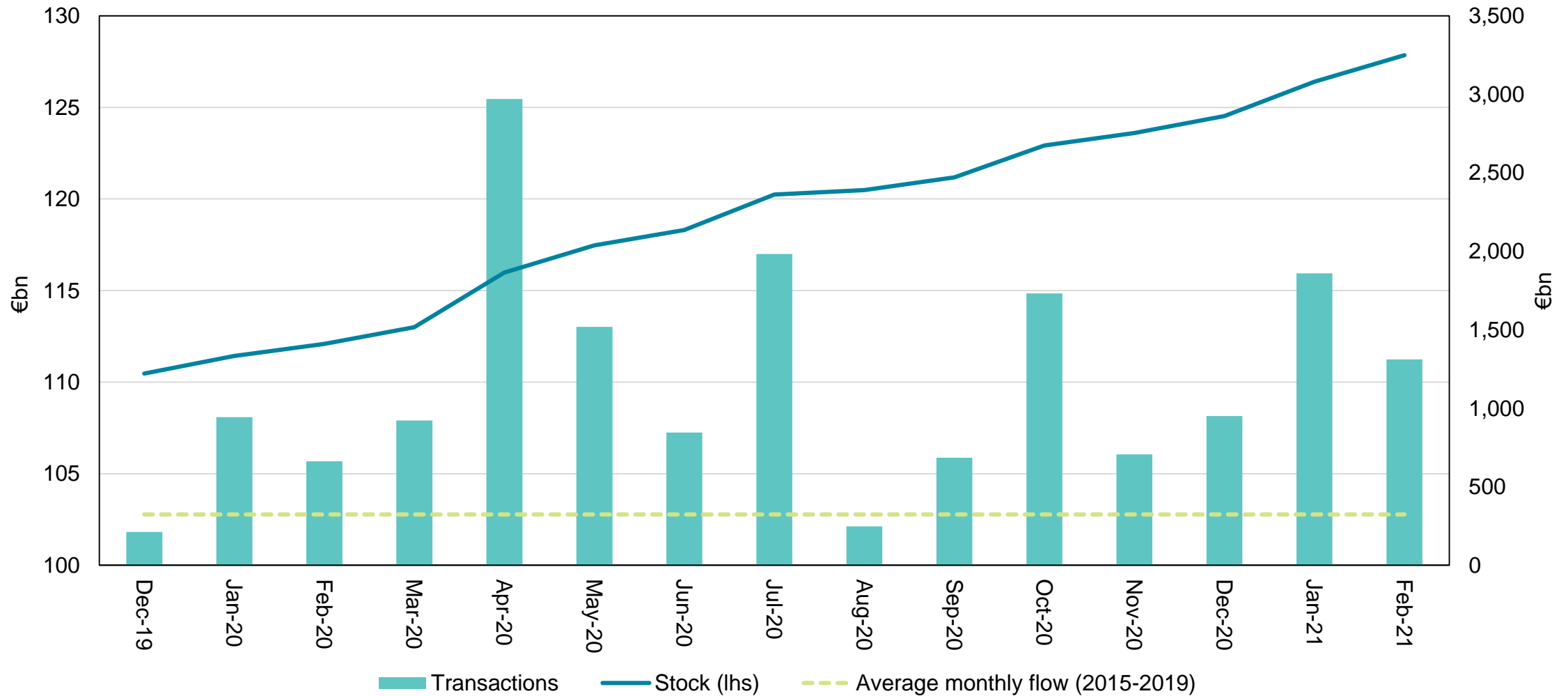
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Spending now closer to last year levels despite restrictions



Household Deposits

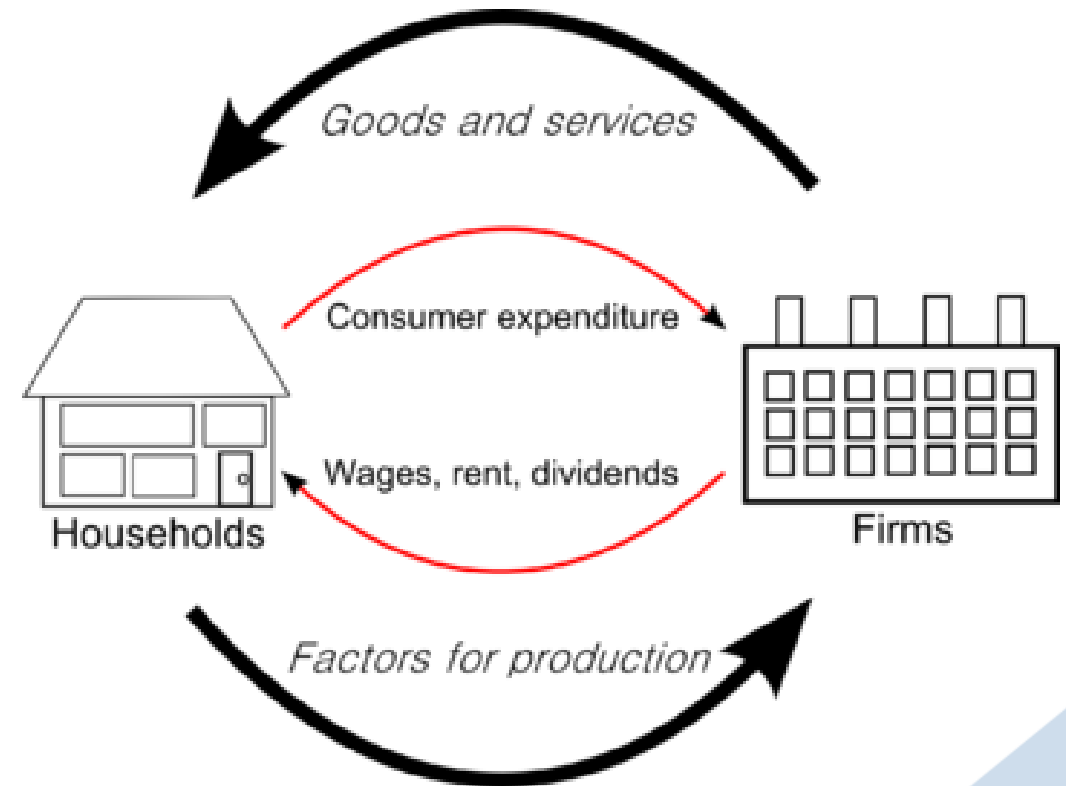


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Circular flow of money and how savings have been affected by COVID

- Large build up of savings during the pandemic
- Not evenly spread across households with higher concentration in higher income households
 - Typically lower MPC
- Big implications for future consumption and economic recovery
- Could savings contribute to higher house prices in the short-run

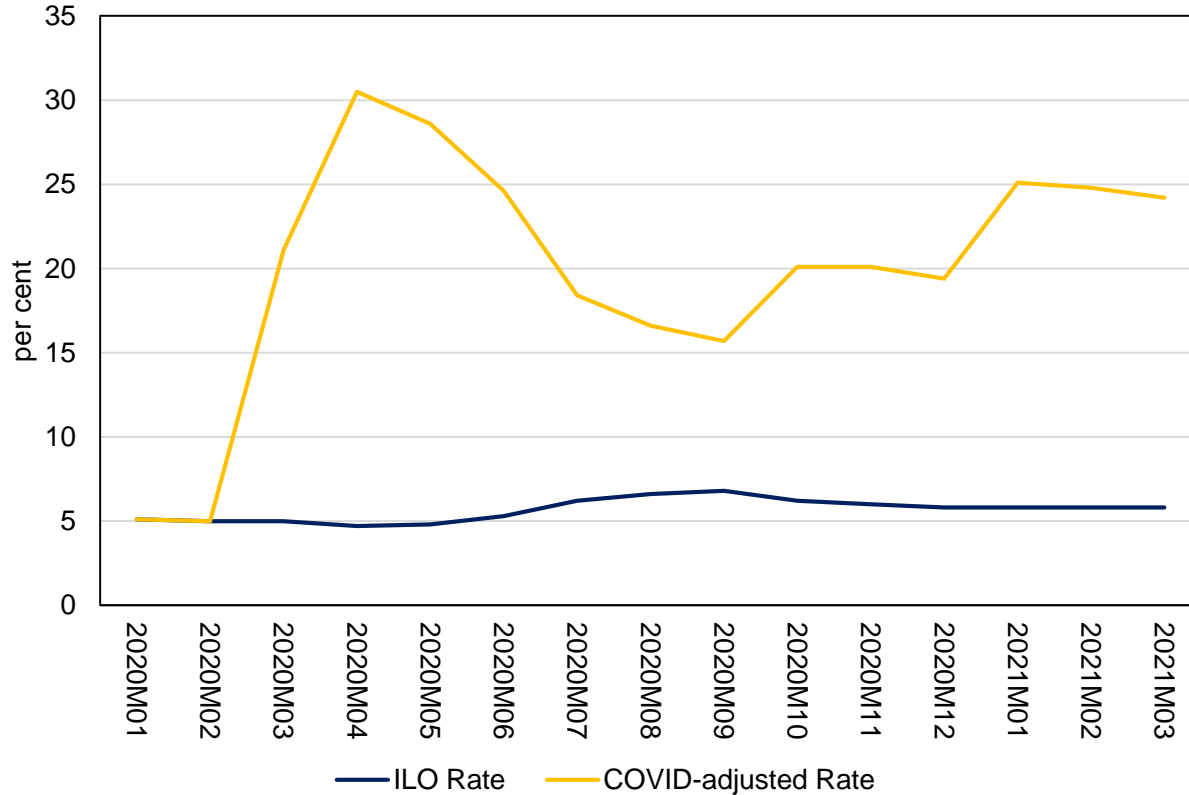


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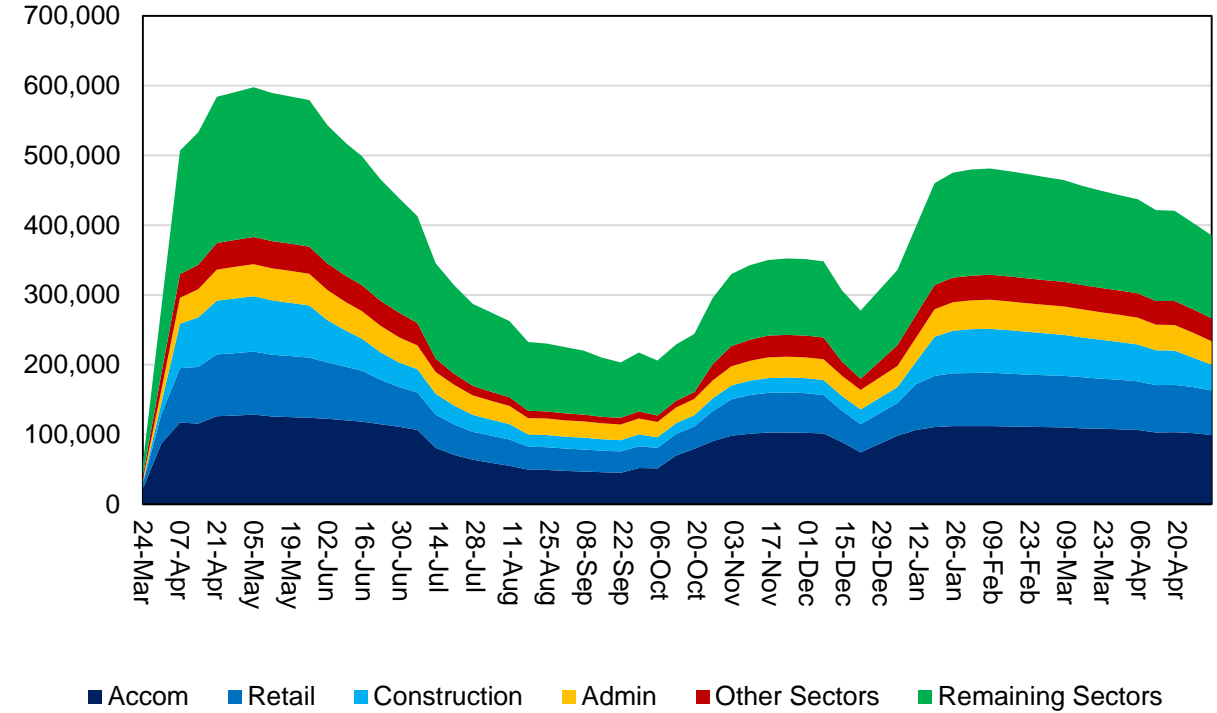
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Labour Market

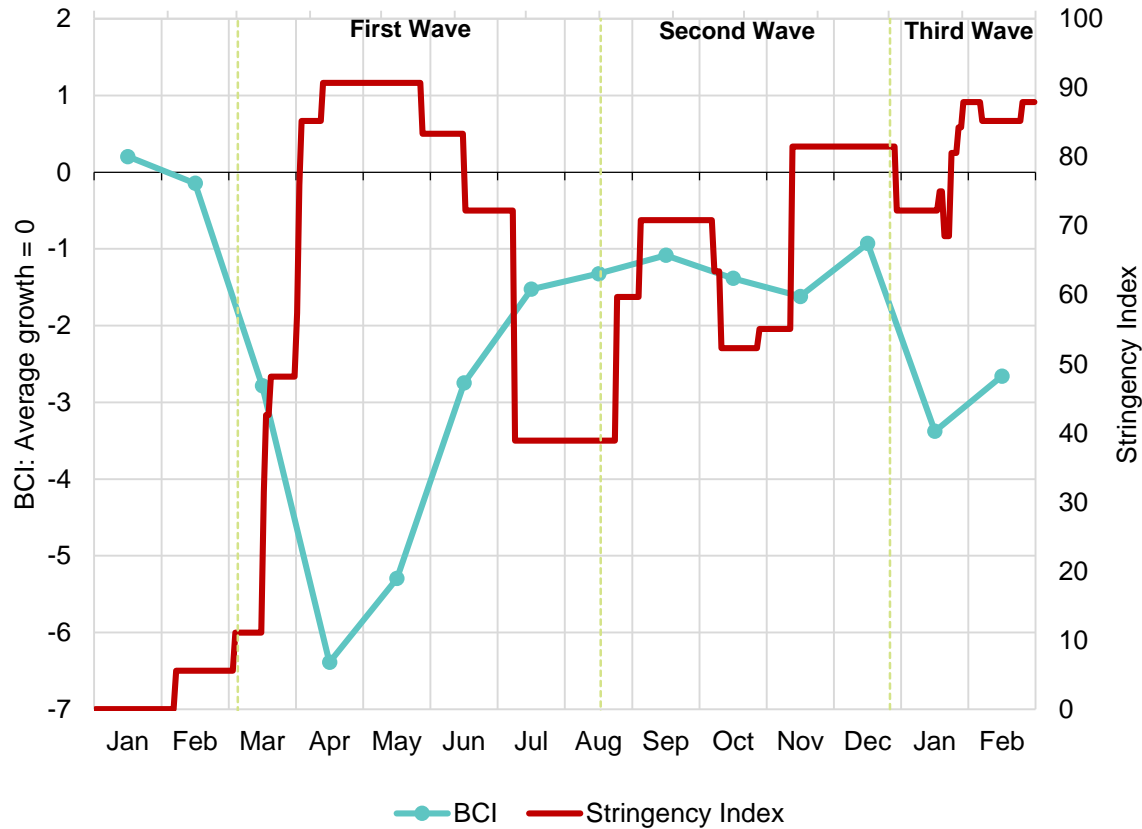
Monthly Unemployment Rate



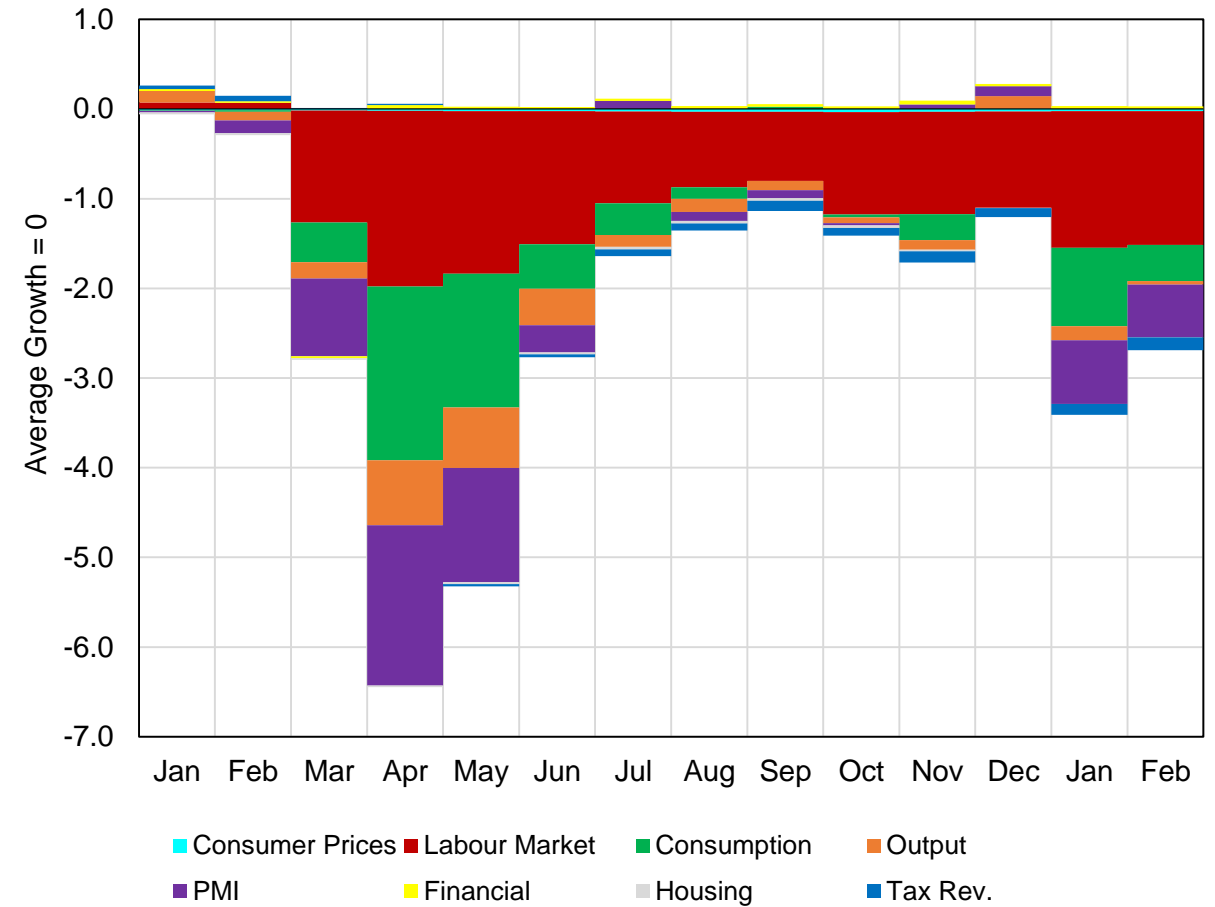
Pandemic Unemployment Payment



Business Cycle Indicator – A Year in Review



Source: Central Bank BCI, University of Oxford (Stringency Index), authors' calculations.



Quarterly Bulletin Q2 2021 Projections

	2019	2020e	2021f	2022f
Real Economic Activity				
Personal Consumer Expenditure	3.2	-9.1	3.7	7.1
Public Consumption	6.3	9.9	3.4	-7.5
Gross Fixed Capital Formation	74.8	-32.3	-15.2	6.0
Exports of Goods and Services	10.6	6.2	5.5	5.0
Imports of Goods and Services	32.4	-11.3	-1.9	4.8
Gross Domestic Product	5.6	3.4	5.9	4.7
Modified Final Domestic Demand	3.3	-5.4	2.8	3.9
HICP Inflation	0.9	-0.5	0.8	0.8
Unemployment Rate	5.0	5.7	6.6	8.1

Additional Resources

- Central Bank of Ireland
 - Governor's Blog
 - Behind the Data series
 - Animated Explainer Series

- Other
 - ECB Explainer Series
 - Gov.ie Emerging Developments
 - Federal Reserve Economic Database (FRED)
 - Voxeu.org
 - Irish PMI Statistics



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