

**Oireachtas Budgetary Oversight Committee**

**18 September 2024**

**Central Bank of Ireland Opening Statement**

***Robert Kelly, Director of Economics & Statistics***

Chair and committee members, thank you for the opportunity to address you today. Martin O'Brien, head of our Irish Economic Analysis Division, joins me.

Our Quarterly Bulletin, published today, paints a picture of a resilient domestic economy poised to grow in the region of 2.5 per cent annually through 2026<sup>i</sup>.

The labour market remains robust, and inflation has fallen below 2 per cent for the last six months.

However, revisions to national accounts data for 2023 and evidence on wage developments highlight the risk of persistent domestically generated inflation. Service inflation, in particular, has been stubbornly high, hovering between 4 and 5 per cent for over a year.

These factors necessitate a measured and targeted approach to budgetary policy that balances the need for economic stability with the imperative to address structural deficiencies.

The Summer Economic Statement (SES) outlines a fiscal package of €8.3 billion for Budget 2025. Nearly half of this increase directly supports maintaining the current level of services, doubling the allocation from Budget 2024. Over one-third of the package targets additional current spending and tax reductions, while the remaining 17 per cent is reserved for capital spending under the National Development Plan.

This represents a net spending increase of 7 per cent in 2025. This procyclical budget stance will add further to domestic price pressures. As outlined in the last Bulletin, spending increases of this magnitude above the 5 per cent rule since 2022 has added half a percentage point to inflation annually<sup>ii</sup>.

I want to draw out the vital interaction between fiscal and monetary policy.

Last week's Governing Council meeting saw the second 25 basis point cut in interest rates. This follows a sharp increase of 450 basis points in response to rising inflation from the strength of the pandemic recovery and, more prominently, Russia's invasion of Ukraine.

The ECB Governing Council has communicated that the future path for interest rates will be data-dependent and calibrated to economic developments across the euro area as a whole.

Fiscal policy is the key instrument available to national governments to manage the economy. However, a prolonged period of expansionary fiscal policy during an upturn in the economic cycle risks generating persistently higher domestic inflation, allowing wage growth to outstrip productivity gains and erode competitiveness.

Ireland's fiscal stance this year stands in contrast to the contractionary stance of the aggregate euro area.

## **Addressing the imbalance in the housing market**

Let me turn to the pressing issue of addressing housing market imbalances. Housing supply has not kept pace with the rapid growth in job creation - with a ratio of one home for every four new workers and now acting as a constraint on job growth.

Housing demand pressures are not unique to Ireland, and we have seen a rapid increase in delivery over the last couple of years. Demographic pressures and pent-up demand will likely require an upward shift to more than 50,000 new builds annually<sup>iii</sup>.

An increase of this magnitude fundamentally hinges upon making construction both financially and practically viable. Such viability is linked to three interconnected pillars: Preparation of zoned and serviced land, an efficient planning processes, and construction productivity.

Preparing serviced land ensures that land becomes available and is equipped with essential infrastructure. Without the requisite services, land cannot be developed efficiently, stifling the ability to meet housing demand.

Protracted approval times and complexity in the planning process can significantly delay housing developments and exacerbate costs.

A range of indicators point to labour capacity constraints in the construction sector. Policy can support productivity, reducing the amount of labour needed per unit by promoting and incentivising more expanded use of modern construction methods.

Addressing the viability of housing requires a multifaceted approach encompassing fiscal and non-fiscal policy interventions, with some measures exerting minimal direct pressure on public finances. Nevertheless, given the social and economic implications of the housing challenge, there is a justification for increased capital expenditure, particularly in infrastructure development and serviced land provision.

Such spending, however, must be carefully calibrated to ensure it does not jeopardise fiscal sustainability or contribute to overheating the economy.

The final component is financing - an upward shift to more than 50,000 units will require an estimated additional seven billion euro.

Additional financing alone cannot rectify housing imbalances; trying to do so would exacerbate overheating risks. Addressing viability concerns and lowering risk will strengthen the construction sector's ability to attract equity capital, which will, in turn, improve its capacity to raise debt and maintain an essential diversity of financing.

The State will continue to have an important role to play by providing social, affordable and cost-rental housing. However, the State's role has to co-exist alongside a sustainable, privately financed and developed market to ensure a diversity of housing and tenure types.

International investment will remain an important source of financing, as will the domestic banking system's balance sheet capacity for lending that can play a role in scaling up housing delivery.

## **Sustainability of public finances**

While addressing housing demands is warranted, additional capital spending must be funded in a manner that does not increase vulnerability in public finances.

The SES captures the known risks on both the revenue and expenditure sides well.

Corporation tax receipts continue to outperform expectations, yet these revenues remain highly concentrated across a small number of firms. Almost half of the funds collected are delinked from domestic economic activity.

This concentration poses a significant 'sudden stop' risk, immediately turning the current headline surplus into a deficit.

On the expenditure side, challenges loom large. An ageing population will place increasing pressure on public services, particularly in healthcare and pensions. At the same time Ireland's commitment to reducing emissions will require substantial investment.

Sustainability is also at the heart of the European Union's revised economic governance framework<sup>iv</sup>.

However, the effectiveness of EU rules is limited for Ireland. GDP is used as the measure of economic activity, which is distorted by the global activities of large multinationals with a presence in Ireland. In addition, the rules do not account for excess or windfall corporation tax revenues.

Therefore, the Government's Net Spending Rule is crucial in ensuring macroeconomic and fiscal sustainability<sup>v</sup>.

The Net Spending Rule is not mentioned in this year's SES, and the projections show noncompliance in 2025 and 2026.

The rule is designed to prevent overheating during periods of strong demand and high inflation while enabling supportive fiscal policy during downturns.

Adherence to the rule should facilitate difficult decisions necessary to ensure fiscal sustainability and avoid the boom-bust cycles that have damaged the Irish economy in the past.

## **Conclusion**

In conclusion, our economy is set for moderate but steady growth but is operating at capacity across several sectors.

The health of our public finances presents a unique opportunity to address the infrastructural and housing deficits built up over the past decade.

By maintaining an overall budgetary stance that is prudent and prioritising capital investment, we can safeguard Ireland's economic future and deliver long-term prosperity for all.

I thank the committee members for their attention, and we are happy to answer the members' questions.

---

<sup>i</sup> See [Quarterly Bulletin 3, 2024](#)

<sup>ii</sup> See Quarterly Bulletin Signed Article [Fiscal Priorities for the Short and Medium Term](#)

<sup>iii</sup> See [Economic policy issues in the Irish housing market](#)

<sup>iv</sup> See [European Commission Revised Economic Governance Framework](#)

<sup>v</sup> The Government Net Spending Rule was announced in the [2021 Summer Economic Statement](#). This rule, designed to stabilise expenditure based on trend growth (currently estimated at 3%) and the price stability target for inflation (2%), supports counter-cyclical fiscal policy.