

Patrick Honohan: Sketching a broad economic picture including employment prospects

Address by Mr Patrick Honohan, Governor of the Central Bank & Financial Services Authority of Ireland, to the Trinity Alumni Career Network, Trinity College, Dublin, 9 February 2010.

* * *

What can I say to graduates seeking employment in this, the deepest of recessions in living memory? There is much to talk about. In these opening remarks of your sessions, I will confine myself to sketching the broad economic picture in which your employment prospects will be determined.

First let me confirm that, in my view, the overall thrust of macroeconomic policy and the pace and scale of budgetary adjustment seems about right to me as a basis for building a sustained recovery. Few are now tempted here to suggest a Keynesian demand expansion fuelled by a larger budget deficit. Of course it would be nice to have the additional demand injected into the economy, but this cannot come from the budget in our present circumstances.

If we needed any reminder of how impossible such an approach would be, we need look no further than the recent movements in interest yields on the government debt of some other euro-area countries. Whether we like it or not, governments need to keep convincing the markets that their budgetary and borrowing plans are viable and will be delivered.

Interest rates on Irish government bonds, much lower than they were only a few months ago, have remained relatively unscathed during these past weeks of heightened tensions in the international markets for sovereign debt. This is clearly because of the degree to which foreign confidence has been building in Ireland's ability and determination to restore the public finances along a clearly defined strategy, as exemplified by the relatively tough measures already taken.

Continued adherence to this disciplined path will result in lower borrowing rates for the government – and will help accelerate the budgetary correction and reduce the long-term drag of debt servicing as we come out of the recession. The broad consensus on this need is one of Ireland's great strengths in tackling the recovery.

One of the factors keeping borrowing rates higher than they might be is the financial market's concern about the future costs to the Government of recapitalising the banking system. This cost will become clearer over the coming weeks, as the NAMA purchases clear the way for capital-raising exercises by the banks. It will of course be a sizable sum, though some of what is needed may be raised by the banks themselves through such steps as asset sales, new issues of equity, and discounted debt buybacks. Still, it is pretty clear that the government will be acquiring additional equity stakes. While I'm not yet in a position to put a number on it, I can say that the overall net cost to the State of recapitalisation will be manageable.

Indeed, the recapitalisation will ensure that the banks are clearly seen as strong, financially self-reliant entities able to fund themselves in the market into the future. By the same token, the overhang of the banking situation on the state's finances will be removed. These transactions are thus a key ingredient in moving both the banking and the budgetary situation forward. As the market digests and acknowledges these new realities, we can expect a further tightening of borrowing spreads.

This may all seem a little removed from your immediate preoccupation, which is the job market. But I think you will agree that an overall economic pick-up in Ireland offers the best

route to improved job prospects here for yourselves, and that pick-up will depend on a speedy resolution of the budgetary and banking problems.

Those of you who have the ambition and capacity to start on a career of entrepreneurship have an even more direct interest in ensuring that the banks are functioning providers of credit. I think it's fair to say – and what data we have seems to bear this out – that banks in Ireland have reacted to their own difficulties and to the downturn by greatly reducing their risk appetite. Some of this was a necessary adjustment, but the result has been limited availability of credit for start-up firms and SMEs. Indeed, I have the impression that, during the years of property-based lending, the banks have lost their edge in small business lending. This is something that they need to pay more attention to, not just for the sake of the economy, but for their own business performance in the years ahead when property-based lending will be on a much more limited scale. A number of new initiatives have been floated in this regard. It is important that the banks get going now on improving their techniques for making sound small business loans.

At the aggregate level, the pace of economic activity and the trend in unemployment still remain weak. The decline in aggregate income is bottoming out, but (in the second quarter of 2010) at a level perhaps 16 per cent lower than at the peak. (That's GNP: economic activity, measured by GDP it is about 11 per cent down). Unemployment we think will continue to rise somewhat during 2010, though a reversal of net migration flows will serve to limit this.

The current recession has resulted in a significant deterioration in the labour market position of the young in the worst affected countries. In Germany, the unemployment rate has hardly moved during the recession, whether at the aggregate level or among the under-25s. In the USA, which has seen its aggregate unemployment rate double from about 5 to about 10 per cent, youth unemployment went up only slightly faster from 12 to 19 per cent. But in Ireland youth unemployment has jumped from less than 10 per cent to over 31 per cent in the past two years – much faster than the aggregate rate which has gone from 4.7 to 13.3 per cent. (Spain has had an even worse experience). This has to be turned around: and that will require determination.

Some lessons can be learnt from past experience here.

This is the fourth major recession I have lived through, though I was only in Primary School for the dip of the mid-1950s which prompted the sea-change in economic policy and gave us the outward-looking globalised society we live in today. Globalisation has allowed us to converge in average living standards to the European frontier, but globalisation also does seem to be associated with heightened volatility, and the depth of the current downturn reflects the over-heated expansion that preceded it, which in turn was fuelled by credit sucked-in to Ireland all too readily from the globalised financial system. In short, we did not manage our engagement with the global economy in a manner consistent with stable growth.

But if globalised economies can fall far, their recovery can also be vigorous.

The spectacular recovery of employment and fall in unemployment after the deep recession of the mid-1980s has rightly been attributed among other things to the wage restraint that characterized the social partnership from 1987 on. Wage restraint is all the more important now, when price levels have been falling, with the result that nominal wage rates that might have been viable a couple of years ago, no longer make commercial sense. The problem is even worse because of the unsustainable upward drift in wages that occurred in the mid 2000s. I am sorry to bang on about this, but Central Banks aim at overall price stability to help ensure that wage and price planning can be carried out in a manner that ensures stable growth. When, as in Ireland today, inflation undershoots the target and goes negative, it is incumbent on me as a central banker to alert workers and unions to the consequences. I interpret the recent reductions in the net pay of public servants not only as a significant contribution to correcting the budget deficit, but also as a signal of the realignment of overall wage rates in the economy that is needed to restore employment growth.

The employment boom of the 1980s and 1990s also owed a lot, I think, to an emergent can-do attitude and a new willingness of the younger members of the Irish labour force (who are now, of course, in their 40s and 50s) to exploit an innate flexibility and turn their hand to any likely type or location of employment, without standing on ceremony, and without adopting an attitude of entitlement. It helped too that already third level education had become so widespread. For me, third level education at its best conveys much more than specific discipline-related skills. It enables the consolidation of generalised job-market relevant capabilities and understanding. These are what, perhaps unknowingly, you have to offer to the economy today. The openings may not be obvious, but seize them when they come, regardless of how ephemeral they may seem likely to be, how poorly remunerated at first, or that they do not yet fully exploit your hard-earned degree-specific qualifications. The speed and solidity of the economic recovery will in fact depend to a considerable extent on the enthusiasm and application of people like you in finding and working on the opportunities that do exist.

If you do go abroad for better immediate prospects, I hope you will not turn your back on Ireland. I have worked abroad for a few years at a time on more than one occasion. I found returning after one or two years easy; after a third year the new roots were harder to pull up. Some authoritative analysts are forecasting quite strong growth in output and employment already in 2012. Should this materialise, it will be good news both for those who stay and those who, like so many Irish over the years, leave to explore possibilities abroad.

Meanwhile, it is for us in the older generations to re-establish the conditions for this stable growth. That is a task to which, both in its monetary policy role, and in relation to financial regulation and supervision, the Central Bank is renewing its efforts.