John Hurley: Economic developments in Ireland and other issues

Opening statement by Mr John Hurley, Governor of the Central Bank of Ireland, at the presentation of the Annual Report 2001, Dublin, 10 June 2002.

* * *

You are all very welcome.

As you know, this is my first press conference as Governor of the Central Bank. Today, we are publishing the Bank’s Annual Report for 2001.

I want to focus briefly on seven issues - economic growth, inflation, fiscal policy, monetary policy, supervision, the Bank’s financial results and financial stability issues.

1. Economic growth

The Economic Overview in the Report reflects our concerns after a challenging year. We saw a marked slowdown in growth in the world economy and also here at home, for reasons that are well known. Export volumes were seriously affected, the IT and tourism sectors suffered particularly and the growth in capital formation was much reduced. However, a strong positive factor was the continuing growth in consumer demand.

Looking ahead, the Bank’s view of the economy remains positive but depends on the pace of international recovery. We expect growth of about 3 per cent this year. Our continuing potential is for growth of some 4½ to 5 per cent per year.

2. Inflation

Undoubtedly a key risk to growth is inflation, with its potential to seriously impact on the country’s competitiveness. Our consumer price inflation has been consistently higher than the euro area for two and half years - to the order of 2 percentage points above the average.

3. Fiscal policy

You will not be surprised therefore that we are advising prudent fiscal policy and attention to wage and other cost developments. Fiscal policy should aim to ensure a neutral stance in its impact on the economy. The Bank is also advising wage moderation, so as not to damage our competitive position. We will have more to say on these issues in our Summer Bulletin, which is due out later in the month.

4. Monetary policy

I would now like to comment briefly on the European scene, in the light of last week’s Governing Council Meeting.

As you know, at our meeting, the Governing Council decided to leave the key ECB interest rates unchanged. The economic outlook in the euro area is still subject to uncertainty. We decided that further evidence is needed before we can fully assess the risks to price stability over the medium term. However, the outlook remains less satisfactory than originally expected some months ago. The recent appreciation of the euro will contribute to containing inflationary pressures if it is sustained. However it is still too early to assess the impact of these developments on the outlook for prices.

The Governing Council’s expectations for a gradual recovery in growth in the euro area have been confirmed by recent Eurostat estimates. These show an improvement from negative growth in the last quarter of 2001 to moderately positive rates in the first quarter of this year. Forecasts all point to a continued strengthening in demand.

5. Supervision

The Bank's extensive regulatory tasks were further increased in 2001 when we took over responsibility for more than 2000 insurance intermediaries. In consultation with the industry, and with consumer interests, we developed an effective regulatory system and tackled the re-authorisation process - no small task.

Following the losses incurred at the AIB subsidiary, Allfirst, we requested an independent verification of all financial institutions' controls and risk management procedures. This is an important exercise, which involves a lot of work for the institutions concerned and indeed for the Bank; however, I think it will be a very worthwhile exercise. We expect the overall review process will be extended over a number of months. As you know, we have also entered into a Written Agreement with AIB and the Federal Reserve Bank in the US to address the specific issues that arose from the events in Allfirst. This was a first in international supervisory co-operation for both the Fed and the Central Bank.

A fundamental change arose from the publication in April this year of the Bill on the structure of financial regulation. We expect its passage to implementation will be given priority by the incoming government. We are already working closely with the Interim Board of the Irish Financial Services Regulatory Authority and its Chairman, Brian Patterson. We want to ensure a smooth transition to the re-structured organisation. I am very encouraged by the progress made in the short time that we have been working together.

6. Financial results

It was a good year for our financial results with profits of €563 million. This was despite the exceptionally high costs we faced with the euro changeover.

The successful management of our investment assets of €8.7 billion played a significant role in this performance. The return on these assets was 6.74%, or 16 basis points above the benchmark set by Merrill Lynch.

7. Financial stability

Responsibility for financial stability is a core Central Bank function. As was the case last year, the report contains a lengthy chapter on financial stability. The key messages from our report on financial stability are:

- The Irish banking system is stable, well capitalised and profitable.
- The main risks to global and, therefore, Irish financial stability are the well-known imbalances in the US. The overriding concern would be a very sudden and large depreciation of the US dollar, as distinct from an orderly exchange rate adjustment. However, we conclude that the US economy is sufficiently resilient to avoid such an eventuality.
- Here at home, risks to financial stability from excessive credit growth and property prices have eased but these have not been eliminated.

The central lesson is that there is a need for caution, but there is no major concern. This translates into a need for continuing prudence by the banking sector and, at the national level, for careful management of wages, other costs and the public finances.

That concludes my opening remarks. My colleagues and myself are now available to answer your questions.