



Banc Ceannais na hÉireann
Central Bank of Ireland
Eurosystem

Gabriel Makhoul
Gobharnóir/ Governor

Mr Paschal Donohoe TD
Minister for Finance
Department for Finance
Government Buildings
Merrion Street
Dublin D02 R583

2nd July 2020

Dear Minister,

Re: The Economic Outlook

I attach a copy of the Quarterly Bulletin (QB) that we published today. In view of the scale of uncertainty surrounding the outlook, the QB sets out our projections for the economy on the basis of a scenario analysis (consistent with the Eurosystem staff projections that were published last month).

As the publication of the QB coincides with the formation of the new government, I thought I would set out my views on the economic outlook and challenges facing the country at this difficult time.

Covid-19 is a major economic shock. We have seen a very sudden and severe contraction in economic activity across the world, one that continues to pose challenges to governments and policymakers. Actions taken both domestically and globally have helped to contain the extent of the downturn and provide support to households and firms. But the outlook for the economy is clouded by significant uncertainty, in particular with regard to the future path of the virus, the effects on behaviour and economic activity and the damage to the economy's productive capacity.

The QB confirms that economic activity in Ireland remains significantly below pre-Covid-19 levels, although it is now higher than it was in April, as the economy begins to reopen. Under our baseline scenario, GDP is projected to fall by 9 per cent – and the unemployment rate to be around 12.4 per cent – by the end of 2020. We are projecting a recovery next year but economic output is estimated to only return to its pre-crisis level by 2022 at the earliest. Our projections also assume that the EU and the UK negotiate a free trade agreement that comes into effect after the transition period ends in December. If such an agreement is not reached, it is likely that growth in the Irish economy would be weaker than outlined in our scenario.

Looking to future policy, there are three areas that I suggest deserve careful consideration:

- Policy should continue to focus on supporting the productive capacity of the economy and avoiding scarring effects such as long-term unemployment. A key element of this is Government support measures to reduce the risk that firms that would otherwise be viable become insolvent. There is likely to be a need to transition from the support

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measures currently in place to ones that address structural challenges and support a quicker, stronger and more sustainable recovery. While these measures will be costly in the near-term, if they are effective in reducing the degree of damage to the economy's productive capacity, they will benefit the Government's fiscal position over the medium term. There also continues to be a need for co-ordinated and forceful action at a European level, proportionate to the magnitude of the shock throughout the EU.

- The rise in the government deficit and debt ratios is both warranted and necessary and is, currently, affordable. But the high level of debt will leave government finances vulnerable to future shocks, whether to interest rates, changes to the tax base or to growth. It will be important for the Government to provide a clear, credible and time-bound return to much lower and sustainable deficit and debt positions.
- The country's ability to withstand the immediate impacts of the Covid-19 shock is partly a result of policy actions over the last decade. There needs to be a continued focus on building economic resilience to future shocks, including a more sustainable debt position but also the longer term structural changes that would help to manage the challenges of international tax reform, the longer-term implications of the UK's withdrawal from the EU and climate change (among others).

Finally, congratulations on your (re) appointment as Minister for Finance. The Central Bank will continue to focus on supporting the recovery through the effective delivery of our mandate, including providing timely and relevant economic analysis and insights.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'Gabriel Makhlouf', with a horizontal line underneath the name.

Gabriel Makhlouf