# ESRI sees danger of wage-price spiral, suggests targeted measures

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**The ESRI has warned of the heightened dangers of a wage-price spiral, a risk added to by the impact of Russia's invasion of Ukraine. Further escalation of hostilities could impact on growth, adding to inflation and burden the public finances, it cautions.**

With the latest ESRI quarterly commentary expecting incomes to rise by around 4.7% this year, the Institute says this will mean a decline in incomes of between 2-3% in real terms, as inflation is expected to average 6.7% for 2022 as a whole – peaking at 8.5% or higher in mid-summer.

However, while there is pressure on the value of incomes today, it was also pointed out at separate briefing, that pay has exceeded inflation in recent years.

*Wage-price spiral risk if inflation expectations are "bid into wages demands"*

Russia's invasion of Ukraine is impacting negatively on global economic activity, as well as adding to existing inflationary pressures. "There is a considerable risk that, should tensions increase, further disruptions to gas and oil supplies might occur, and in a worst case, end-user rationing might be required in Europe," ESRI warns.

The conflict means that the now tentative forecasted growth in the Irish economy has been revised down to 6.2% in 2022 and 4.3% in 2023 next year. The ESRI's previous forecast, in December, was for growth of 13.6% this year and 7% for 2023, based on an easing of pandemic restrictions but without any real indication of a major war.

## CONTINGENT FACTORS

Understandably, the ESRI's forecasts in all of these areas, including incomes and inflation, are contingent on external factors to an even greater extent than usual. An illustration of this caution is starkly evident in relation to the humanitarian impact of the invasion of Ukraine by the Russian Federation.

The ESRI is well aware of the arrival of a large number of refugees here in the coming period. But given that estimates vary greatly and the events are so recent, it does not estimate what the cost to the Exchequer might be. However, Kieran McQuinn (ESRI Research Professor) noted that the Government's contingency fund of up to €4 billion, would be availed of – as referenced by Taoiseach Micheál Martin last week.

The risk to the public finances is due largely to the potential impact of the war on the Irish economy.

## CAST ASIDE

What can be said is that the more sanguine picture in relation to inflation, arrived at late last year, has been well and truly cast aside because of the war, with marked increases in energy costs and food market disruption, leading to the projected shortages in some agriculture-related products.

The result will mean a slowdown in the economies of the euro area and in Ireland, with a pick-up in inflation, and a consequent – and as yet uncertain - impact on the Exchequer. While the labour market situation still looks positive, inflation looks set to push up wage pressures, increasing the risk of a wage-price spiral.

Asked if the policy tools are available to help manage wage inflation, Professor McQuinn said that it would be unwise to lower taxation, but increased expenditure on housing would have to happen. He advised targeted measures on those most in need - and said there is the unknown cost of meeting the new humanitarian challenge.

Professor McQuinn said that targeted measures such as assisting pensioners with fuel allowances make sense, but he suggested that the Government avoid more general measures. Asked about recent broadly-based moves, like reducing excise duties on fuel, he said this was understandable in the context of a government needing to act speedily.

Professor McQuinn said that going forward, “the emphasis will have to be on more targeted measures to ensure the inflationary pressures aren’t compounded by Government measures.”

## INFLATION & PAY

The projected inflation rate has grabbed all the headlines this week. Expected by the ESRI to surge to 8.5% or more, with an average of 6.7% for the year as a whole, these figures haven’t been seen since the first half of the 1980s. At that time, the country did experience a wage-price spiral, but this eased off as locally negotiated wage deals in the private sector gradually moved back, but they never quite matched inflation.

The policy response by 1987, with wages still short of inflation, falling living standards, rampant unemployment, high emigration, high interest rates and low business confidence, was the Programme for National Recovery (PNR). This was underpinned by modest wage rises in return for modest income tax adjustments for PAYE workers.

Rather than acting as a floor for further wage increases, as national deals had tended to in the past, the PNR was adhered to - as were most of the subsequent social partnership deals in the private sector and in the commercial semi-states. This pay discipline was also assisted by the state’s dispute resolution bodies.

There is no suggestion of any return to this previously successful model at this time; the make-up of the economy has changed, there is a much lower level of collective bargaining coverage nationally and the crisis – with employment still at record levels – not nearly as drastic as it was at that time.

## DISCIPLINE?

But the situation could change given the highly volatile nature of the conflict, its various impacts on Europe and the EU – and the prospect of fuel or commodity rationing later in the year. Certainly, the social dialogue system, such as it is, proved especially useful during the recent Covid crisis (i.e. LEEF's work on pandemic supports, safety protocols and the pandemic recognition payment).

From a macroeconomic perspective, meanwhile, the ESRI says that given the potential for overheating in the domestic economy, greater capital investment by the State "does mean that significant discipline will have to be exercised in terms of increases in current Government expenditure".

It also means that the potential for reduction in taxation rates over the coming years is "very limited", the report says.

Given the uncertainty around the current geopolitical and economic environment, the Institute says its forecasts do come with considerable downside risks. "Further escalation of the hostilities in Ukraine could lead to a lower growth outlook, further increases in domestic inflation and a significant additional burden on the public finances," it concludes.