Q2

2022

Ibec Quarterly Economic Outlook

Turning Point

The Irish economy is at a turning point. Changes in the global environment – in commodity, energy and financial markets – are reshaping the global economy from the one we have recognised over the past decade. The era of record low interest rates, low inflation, and spare capacity we have lived through since the global financial crisis is being overturned. For Ireland, as a small open economy, shifts in the flow of capital through the global economy can have an outsized impact on our growth model. Our members are already experiencing this through tighter capital markets and a greater focus on costs. The outlook for Irish business is marked by growing concern at rapid shifts in our competitive position. This underlines the importance of controlling what we can here at home. As a society, we must plan for the long-term investments needed to grow our capacity and resilience in housing, energy, infrastructure and skills. There is a need to support those exposed to the downside of inflation. This support, however, must be targeted at those most in need. Attempts to wholly offset the impact of inflation on real incomes through fiscal measures, wages or prices risk adding to inflationary pressure and undermining our ability to meet these long-term goals.

Key indicators

Annual % change	2021	2022	2023
Consumer spending	4.5	6.6	4.0
Domestic investment	7.7	8.6	3.7
Exports	14.0	6.4	3.8
Imports	-8.3	8.2	5.0
GDP	13.4	7.0	3.6
Inflation (annual average %)	2.4	7.5	3.9
Unemployment rate (annual average %)	16.2	5.0	4.5

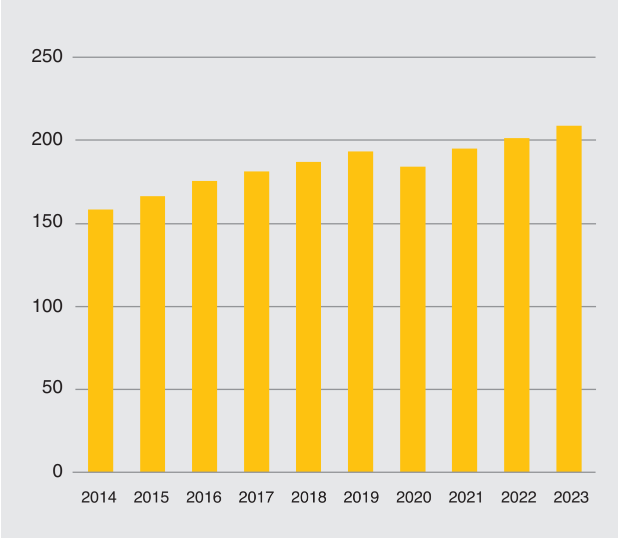
Ibec
For Irish Business

Economic overview

Economic overview

The European and Irish economies are both suffering from a 'terms of trade' shock. This is where the price of a country's imports rises quickly relative to the price of its exports. With the well-documented increase in the price of commodities, energy and transport being imported this translates to an overall loss of income for the Irish economy and a transfer of resources to economies which operate as commodity exporters. As higher prices – particularly of energy imports – are now expected to last for some time, there may be an ongoing adjustment in Irish living standards. We expect the strong recovery momentum, which was evident in the first half of the year, will fade as the year progresses. This will happen as the loss of income for businesses and households becomes manifest through higher heating bills and interest rates rising. This will reduce the growth rate of the two drivers of the domestic economy, consumer spending and investment, in the second half of the year and into 2023. We expect consumer spending growth to fall from 6.6% to 4% in 2023 and domestic investment to fall from 8.6% to just under 4%.

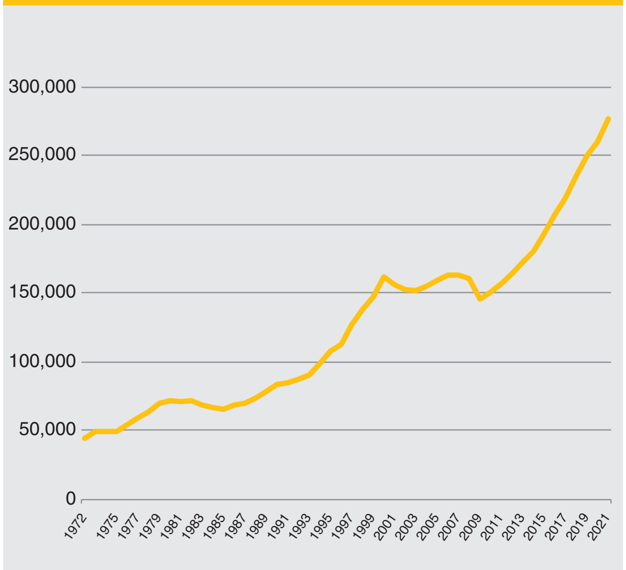
Figure 1: Total Domestic Demand, inflation adjusted (€ billion)



Investment

Investment in Ireland continued to be robust coming into 2022, most recently evidenced by another record year for IDA investments in 2021. However, the global environment is changing. Central Banks are raising interest rates globally. The market-implied path for the ECB Bank Rate (1.3%), the Bank of England (2.9%) and the US Federal Reserve (3.6%) are all expected to rise materially by the end of 2022. These shifts in global interest rates have already had material impacts on financial markets with rising Government bond yields and falling equity prices. Whilst interest rates are still exceptionally low by historical standards, these interest rate increases will have implications for investment in the private sector. Generally, projects need their return to clear the hurdle rate - the cost of capital plus a risk premium. Reported hurdle rates have generally sat between 10% and 15% globally over recent decades. As such, the rising cost of capital will be a particular issue for more risky investments and investments where returns might be comparable to 'safe' assets like treasuries. From an Irish economic perspective, investment levels will face a greater challenge from rising risk premiums and uncertainty around growth in major markets. In addition to changes in the funding environment, investment in Ireland is also facing headwinds from capacity pressures in the labour market and rising costs. Overall, we expect investment to continue strongly in 2022 on the back of an existing pipeline of projects, but to slow next year.

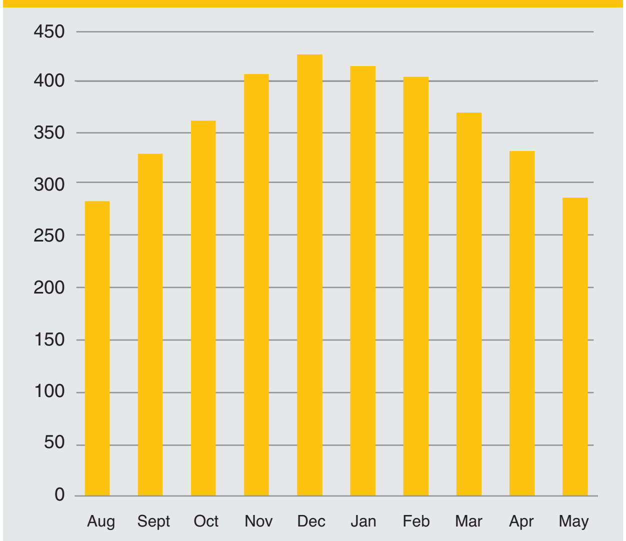
Figure 2: Total number of IDA supported jobs



Inflation

Price inflation in Ireland rose to 9.1% annually in June, its fastest increase since 1984. This was on the back of a continued rise in European gas prices as Russian pipeline exports to Europe fell by over 41% in June relative to May, the temporary planned closure of the Nord-Stream pipeline and strikes in Norway leading to concerns about supply to the UK market. Winter 2022 prices had been expected to fall coming in around 200 pence per therm as recently as early June. However, this has risen in recent weeks to over 400 pence per therm. This is compared to pre-crisis prices of 40 to 60 pence. Whilst there is significant volatility, it is now likely that higher energy prices will become a structural feature of the European economy in the coming years. On the other hand, we have begun to see some early signs of softening of global commodity prices and shipping costs over recent weeks. This has been driven by two trends which are likely to accelerate in the second half of the year, market supply adjustments following significant disruption during Covid and slowing demand for goods globally due to fears of a recession in some major markets. We expect inflation over the full year of 2022 to average 7.5%, falling below 4% in 2023.

Figure 3: UK natural gas price futures curve 2022-2023, pence per therm



Consumption

Consumer spending

Consumer spending in the first half of 2022 was strong with total spending on Irish credit and debit cards (including online and ATM withdrawals) in the year from January to the end of June running at €8.7 billion or 25% higher than the same period in 2021. This was well ahead of price inflation and around 25% ahead of 2019 in turnover terms. There were significantly differing trends between categories within the retail sector, however. When compared to the first five months of 2019 total retail (excluding cars, bars and fuel) rose by 11%. Within the different categories, some such as clothing, electrical goods, DIY and homeware were well above the average. On the other hand, department stores and bookstores are still well below their pre-Covid levels. There will likely be some softening of consumer trends in the second half of the year as heating usage increases along with unit prices and consumers begin to feel some squeeze from rising interest rates. We expect that consumer spending growth for the full year will run at over 6% in 2022 and 4% in 2023.

Disposable income

In normal times, a tight labour market, record and rapidly rising employment and wages which had been running at around 3% annually in the early part of the year, would spell a significant rise in real disposable incomes. Total disposable household income, in nominal terms, was up 18% in Q1 2022 relative to Q1 2019 and by 4.7% relative to the same period in 2021. However, we expect that inflation of around 7.5% for the full year of 2022 will offset this positive momentum when it comes to the spending power of households this year. For 2022 we expect inflation will add about €7 billion to total consumer spending in nominal terms. However, given the context of disposable income growing strongly, existing 'excess' household savings of over €22 billion, Government supports in 2022 of around €2 billion in 2022 and a rate of new saving which in Q1 2022 alone ran to almost 23% of disposable income (€6.5 billion) many Irish households have the resources to sustain spending levels despite inflation. The significant challenge from both a consumer marketing and policy perspective is that these savings are highly unequal.

Wealth effects

The rising interest rates outlined in previous sections are likely to have some impact on spending by households. There will be significant variability between different households, however. Over 69% of Irish households own their own home, rather than rent or live in social housing. Of those around half (34.5% of households) own their home with a mortgage or loan and are thus potentially exposed to rising mortgage interest rates. Of the total value of mortgages in the country 45% is on mortgages fixed for over a year, with the remainder split between either tracker or variable mortgages. The share of longer-term fixed products has risen from a level of only 6% as recently as 2014 and has been the dominant product in new mortgages in recent years. On the other hand, some Irish households will benefit from rising interest rates. In 2009 as we entered the financial crisis, Irish households held €80 billion on deposit in Irish banks and had €150 billion in debt to the system – including mortgages. Today those numbers have almost reversed with €139 billion on deposit in Irish banks from Irish households and only €80 billion owed in debt. As such, the rising interest rates will have a quite different effect than they would have in the past. Those savings are much higher amongst older households, households with high incomes and those who own their homes outright.

Figure 4: Change in retail sales, % versus 2019

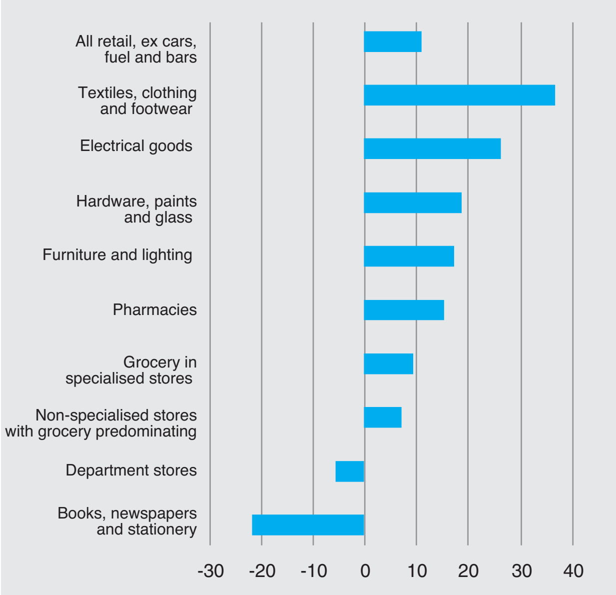


Figure 5: Irish household saving, % of after tax income

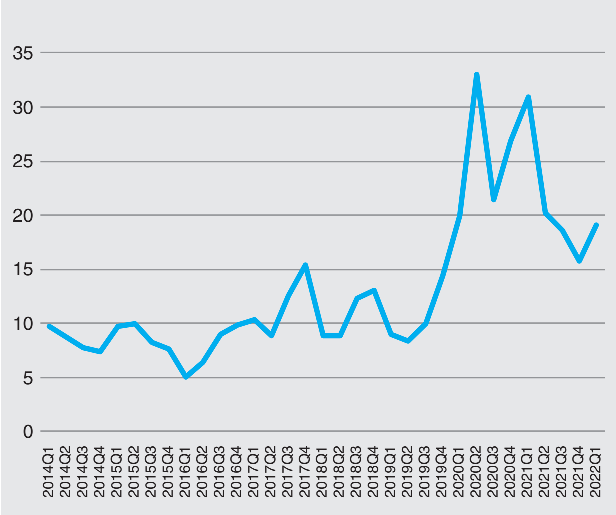
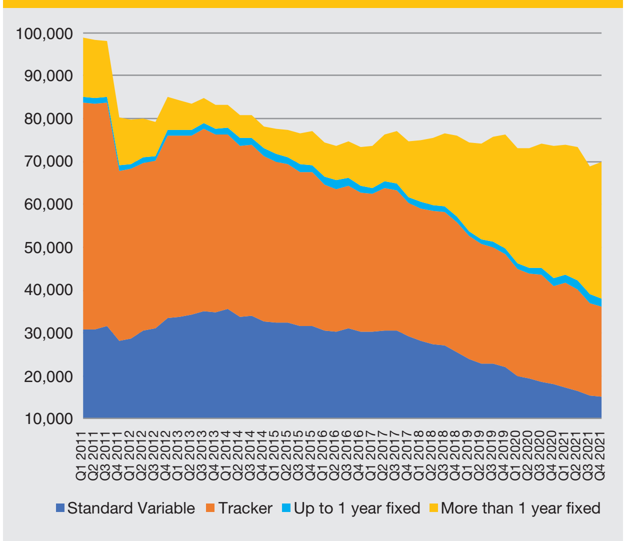


Figure 6: Value of mortgage debt by product, € million



Labour market

Labour market overview

Strong job growth in the first half of the year has resulted in a persistently tight labour market. The rate of unemployment has fallen to 4.8% as of June, a low last seen in the early Celtic Tiger period. As a result, there are currently 2.5 million people in employment. With a population of just over 5 million, this means almost every second person in the country is currently employed. While the recovery in employment in the first half of the year has been very strong and demand for additional workers remains high in many sectors, there have been some signs of a marginal fall back in demand for labour amid rising cost pressures for businesses. High-frequency payroll data indicates that in May there was a 0.6% decrease in the total number of payroll employees, mostly among the retail and construction sectors. We expect high employment levels to continue over the remainder of the year, resulting in an annual average unemployment rate of 5% for 2022.

Available labour and skills

High employment and strong growth across the Irish economy has left many key skills in demand. The large majority of those who were unemployed or furloughed as a result of the various Covid restrictions have returned to employment. This leaves 186,800 people remaining on the Live Register, a figure which also includes about 7,000 refugees from Ukraine as well as part-time workers who qualify for jobseeker's payments. Of those on the Live Register, only 11% formerly held roles in professional, technical or managerial positions, all areas of high demand in the current labour market. An additional 34% have no recently held occupation, while about 10% formerly worked as plant and machine operatives, and 18% worked in clerical or personal services. Of those currently unemployed just under two-thirds have been unemployed for under a year and are considered short-term unemployed, leaving just over a third as long-term unemployed, having been on the Live Register for more than a year.

Figure 7: Seasonally adjusted monthly unemployment, %

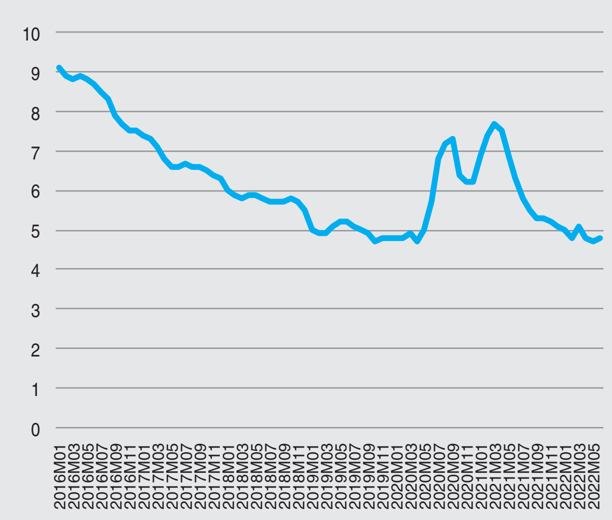


Figure 8: Persons on live register by last held occupation %

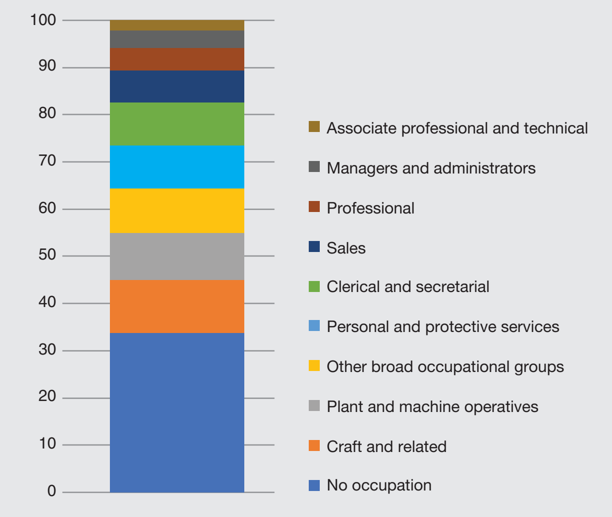


Table 1: Employment, 000s annual average

	2021	2022	2023
Agriculture	**106**	**108**	**108**
Industry & Construction	**419**	**472**	**473**
Services	**1,703**	**1,935**	**1,956**
Total	**2,229**	**2,515**	**2,538**
Unemployment rate (annual average %)	**16.2%**	**5%**	**4.5%**

Source: Ibec forecasts

Vacancies and recruitment

Recruitment and retention issues are ongoing amid a very tight labour market. Total job postings on the recruitment website Indeed.ie, an indication of labour market demand, remain elevated at a high level, with 60% more jobs advertised in June of this year than compared to pre-pandemic levels. While new job postings have fallen back marginally over recent weeks, they are still running 50% above the rates of new job postings seen in February 2020. Despite this, the sustained high number of total job postings indicates both strong demand for labour and that vacancies are remaining unfilled for longer in a difficult hiring environment. The number of postings seeking to recruit in the fields of therapy, social science and healthcare are all significantly higher than their pre-pandemic trends while job postings in construction, legal services and real estate remain near or marginally below their pre-pandemic levels, reflecting that demand for these skills was already high before the pandemic.

Wages and labour costs

Both a tight labour market and the new inflationary environment continue to place pressure on wages. According to the CSO, €111.2bn in total compensation of employees was paid out to workers last year - €10.1bn more than in 2019, representing a 10% increase. This was driven both by an increase in numbers employed and by the impact of rising wages on the total wage bill. While true wage growth in Ireland has been difficult to estimate over the pandemic due to large and rapid changes in the composition of the labour market, the EU's labour cost index estimates that wages and salaries in the EU were seeing annual growth of 3.7% in the early part of the year. In comparison, the US Bureau of Labour Statistics estimates average hourly earnings have grown by 5% annually while average weekly earnings in the UK are up 6.2% annually.

Jobs churn

A feature of the incredibly high growth in employment in the first half of the year has been a growing rate of employee turnover, as businesses compete for key skills. Analysis of transitions into employment from the pandemic unemployment payment conducted by the Department of Social Protection indicated that 55% of people returned to work for their former employer, while 45% came off the payment to work for a new employer. Of those that changed employers, 69% took up work in an entirely new sector, marking a large shift in where workers and skills are located precipitated by the pandemic. Across the sectors, ICT saw the lowest rates of return to working with a former employer, at just 34%. This is a reflection of the high level of competition particularly evident for those with information technology skills. In contrast, manufacturing and construction saw significantly higher rates of returning to a former employer, up at 68% and 64% respectively.

Figure 9: Total job postings on indeed.ie, % above pre-covid level

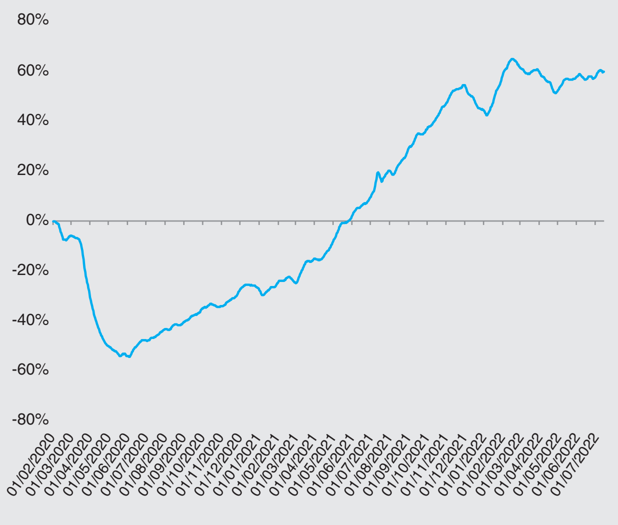


Figure 10: Total compensation paid to employees, € million

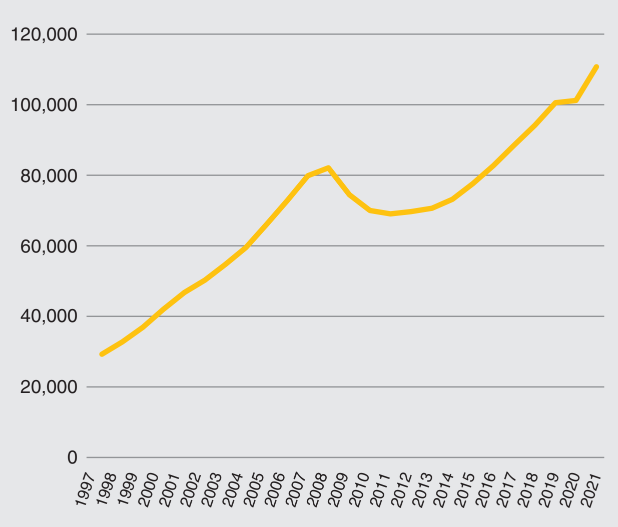
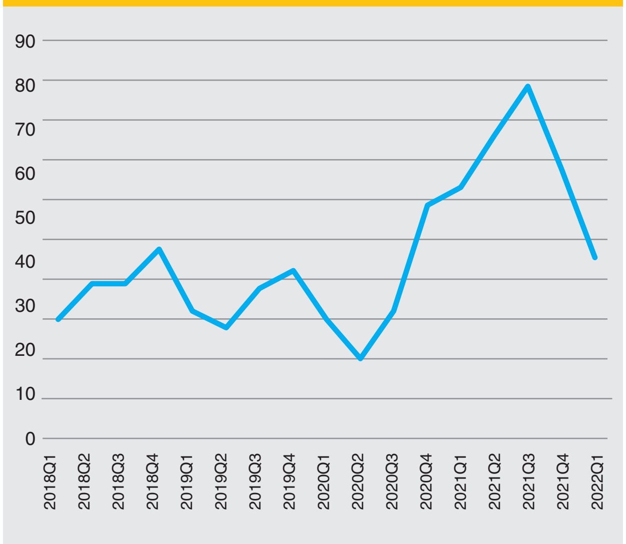


Figure 11: People transitioning from unemployment to employment, thousand



Global economy

Growth downgrades
Growth forecasts have been cut sharply across the global economy in recent months. The latest OECD forecasts from June now expect global GDP growth of 3% in 2022, a fall of 1.4 percentage points (pp) in expected growth from their December 2021 forecasts. Revisions have been particularly steep in several large European countries, particularly Germany (-2.2pp), Italy (-2.1pp) and France (-1.8pp). The OECD expects eurozone growth to average 2.6% in 2022, down 1.7 percentage points. On the other hand, other major trading partners are expected to slow somewhat less with the US losing 1.3 points of growth (to 2.5%) and the UK falling 1.1 points (to 3.6%). As we enter the winter period the impact of any potential fall in flows of Russian gas to Europe will have significant impacts on growth, with the OECD predicting a cessation in the flow of Russian gas to Europe would reduce global GDP by 0.5 points and European OECD nations by 1.3 points.

Euro weakness
The Euro has fallen to its weakest level, relative to the dollar, in almost twenty years in recent weeks. Euro/Dollar parity has been driven by several factors, not least the outsized effect that the economic fallout from the Russian invasion of Ukraine is having on the eurozone economy. On top of this broader economic picture, the slower pace of rate hikes by the ECB relative to the US Federal Reserve means that the US dollar is likely to strengthen for some time and at a faster pace than the Euro. From an Irish perspective, as we export more to the US than any other country in Europe, there may be some upside to our trade balance. Investments in Ireland may also become relatively cheaper, giving some buffer against global conditions for intra-company competition with non-eurozone locations. However, it is important to bear in mind that competitiveness gains from weakness in the eurozone are double-edged in that they reflect the weakness of our single biggest market. There is a significant risk, given the reliance on the growth model of large EU countries – particularly Germany – that rising energy costs may represent a structural weakness for some time. On the other hand, competitiveness buffers from currency movements, over which we have no control, are just as likely to be fleeting and cannot be an excuse to avoid focusing on fundamental competitiveness drivers here at home.

Figure 12: OECD downward growth revision since December 2021, percentage points

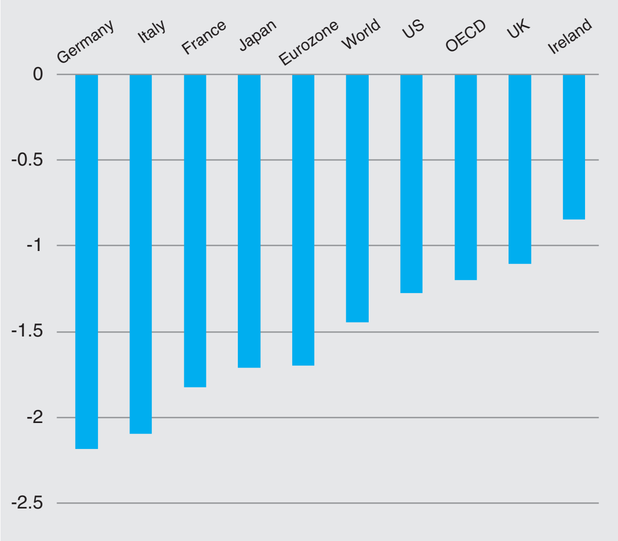


Figure 13: Euro/Dollar exchange rate

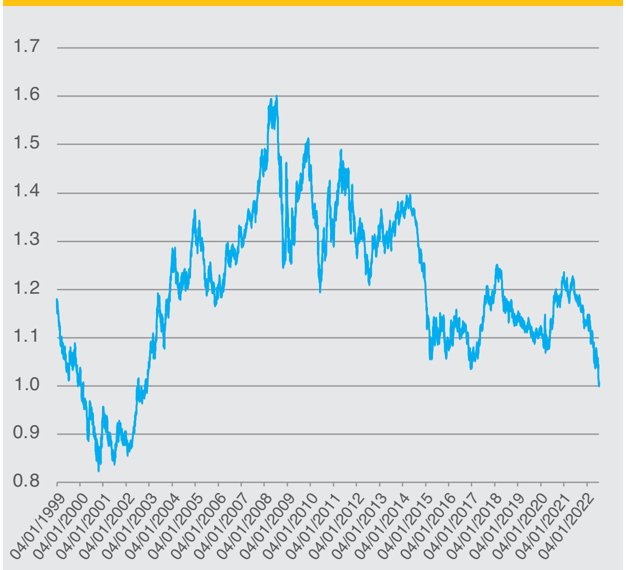


Table 2: Real GDP growth by country

Real GDP growth	Average 2013 to 2019	2022	2023
World	3.3	3.0	2.8
United States	2.4	2.5	1.2
Eurozone	1.9	2.6	1.6
Non-OECD	4.3	3.3	3.8
China	6.8	4.4	4.9

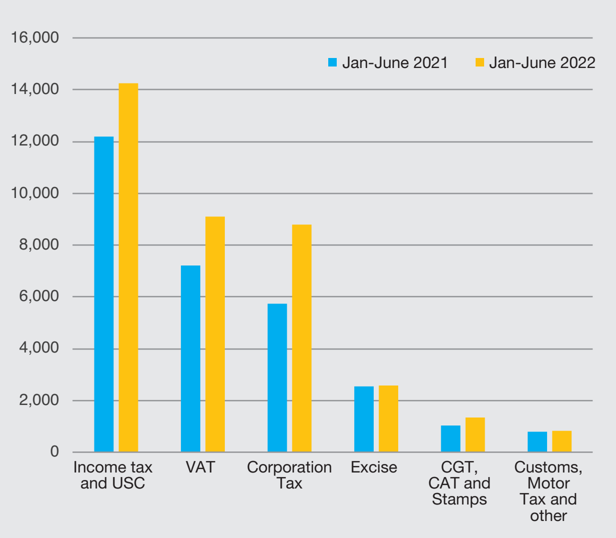
Source: OECD

Fiscal outlook

Tax revenue

The State's tax take at €36.8 billion in the months between January and June was up 25% or €7.3 billion on the same period in 2021. This was driven by a mix of a strong recovery in some of the main activity-driven tax heads such as income tax (up 17% or €2 billion) and VAT (up 26% or €1.9 billion). However, the major driver of rising taxes continues to be the unprecedented rise in corporate tax receipts. The total corporate tax take in the first half of the year was up 53% (up over €3 billion on 2021). These receipts - which have become increasingly concentrated in a small number of companies - are on track to reach close to €20 billion in the full year of 2022. Relative to comparator FDI-driven economies in Europe, Ireland's corporate tax receipts are trending above normal to the tune of over €4,000 per household annually. Ibec's view is that the outsized element of these receipts is best equated to a subvention to Irish households which help pays for the running of the State. They should be used solely for one-off expenditures which are focused on expanding capacity in the economy rather than on day-to-day expenditure.

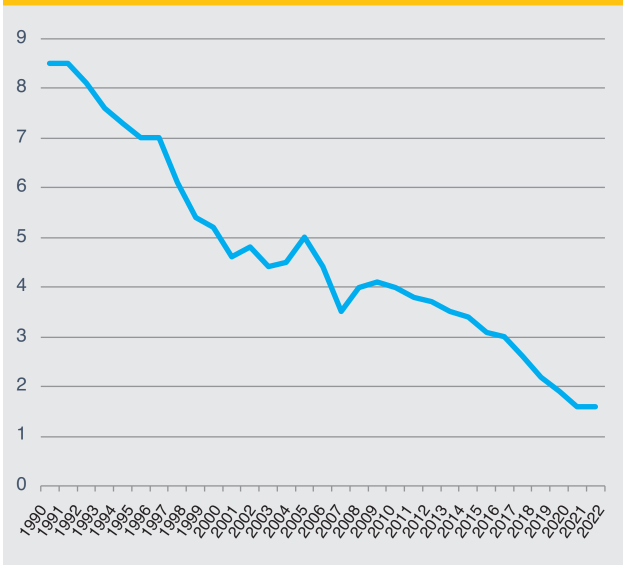
Figure 14: Tax take, January to June 2022 versus 2021



Debt sustainability

Rising inflation means the fiscal dynamic facing the economy is also likely to change relative to recent years. Even if inflation does prove somewhat transitory, the era of negative interest rates on Government debt is now over. Central Banks will normalise their purchasing in 2022, with net asset purchases under the ECB's Pandemic Emergency Purchase Programme (PEPP) ending in March and interest rate hikes of at least a further 250 basis points expected between now and September. Our existing debt is sustainable, however, with a low average interest rate on the existing stock of debt and roll-overs in the coming decade focused on higher-yield bonds. This means that interest rates would have to rise into the range of 3% to 4% for several years before we would see any material changes to the Government's interest rate bill – from existing debt. It also means, however, that returning to a balanced budget over the business cycle will be necessary and significant new day-to-day spending commitments will have to be matched by new tax revenues.

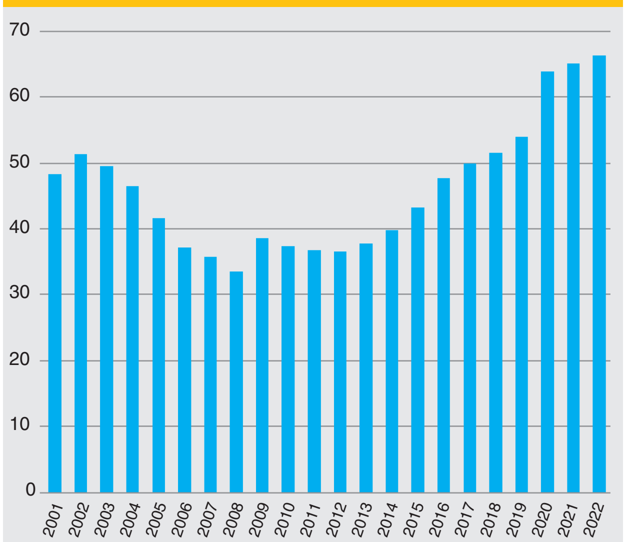
Figure 15: Average Interest Rate on the national debt



Emerging market debt

Along with the rising cost of commodities and energy emerging markets now face significant fiscal difficulties. Emerging and Developing Countries have seen an increase in their total debt to GDP ratios from about 100% a decade ago to 205% today. Within this, Government debt ratios are at their highest in three decades - at 66% of GDP. As Central Banks in advanced economies increase interest rates the knock-on impact on global capital flows will draw capital and liquidity out of emerging economies, increase the cost of servicing debt held in dollars and raise interest rates on re-financing existing debt. Previous periods of prolonged fiscal tightening in the 1980s lead to a sharp increase in the level of debt crises. The IMF estimate that already 30% of Emerging and Developing Markets and over 60% of very low-income countries are at high risk of debt distress. The knock-on social and economic impacts have already been witnessed quite publicly in Sri Lanka with multiple other countries facing similar challenges over the coming months. While some countries with low external borrowing requirements are well set to ride out the wave, others which are reliant on foreign capital flows, foreign denominated or short-term borrowing are most exposed.

Figure 16: Emerging and Developing Countries Government Debt to GDP, %



Housing and construction

Housing stock

Recent data from the 2022 Census has shown that the total housing stock has increased over the past six years by 6%. Despite this increase, housing shortages continue to impact sharply across the country. This is driven primarily by increases in the number of individual households requiring housing outpacing growth in the housing stock, with the total number of households increasing by 9%, or 151,000 households over the same period, compared to 120,000 additional dwellings in the housing stock. Net inward migration and additional demographic pressures from population growth are both contributing to the total number of households requiring housing, along with the average household size falling over recent decades. The number of vacant homes has similarly fallen since 2016, down by 9%, leaving 166,752 homes currently vacant, which account for around 7.9% of the total housing stock. Among the reasons most commonly given for a property being vacant, 20% were rental properties between lets, 16% had deceased owners and 25% were either for sale or being renovated.

Construction and housing costs

High construction costs and disruptions in the supply of key materials continue to act as a drag on the completion of new homes as well as contributing to rising house and construction tender prices. While price growth among certain materials, such as plumbing materials, plaster, and PVC, has slowed or stopped in recent months, prices remain elevated at a high level after sharp increases in costs over the last year. Material costs overall continue to increase, up by 19% annually, with core inputs such as timber and steel at least 50% more expensive than a year ago. Driven by both undersupply and rising costs of delivering new homes, house and apartment prices continue to rise across the country, up 14.4% over the previous year. Within Dublin, residential properties saw an annual 11.7% increase in prices, while prices continued to rise faster outside of Dublin, up 16.6%. New-build dwellings have seen a slower increase in prices than existing dwellings, up 6.2% and 17.8% respectively. This is likely reflecting that existing dwellings are more likely to be located in central locations, on higher value sites and where demand is stronger.

Future supply

Although housing delivery has rebounded over the year so far in the wake of Covid disruptions, there is some doubt as to whether the State's ambitious home-building targets will be met this year and next. The construction industry is facing the simultaneous challenges of very high material costs, the global spike in energy prices and a tight labour market. These constraints on the construction industry's ability to scale capacity make it difficult to meet the quick rebound in demand from households, businesses and the state. Employment in construction, although recovered strongly after Covid disruptions, is still below pre-2006 levels and recruitment into the sector has slowed on the back of an especially tight labour market and rising costs. Completions of new homes recovered strongly with the loosening of Covid restrictions on the sector, with 15% more completions in Q1 this year than before the pandemic. However, an early sign of potential difficulties over the coming months is a slowing in both commencements and planning permissions, despite strong demand, reflecting capacity constraints within the construction sector, the impact of rising building costs in deferring developments and concerns about the future financing of low yield investments.

Figure 17: % of vacant properties by reason for vacancy

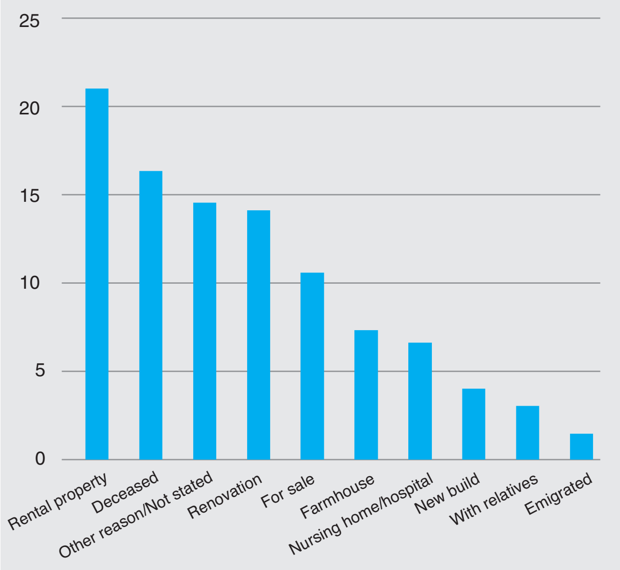


Figure 18: Wholesale Price Index for Building and Construction Materials

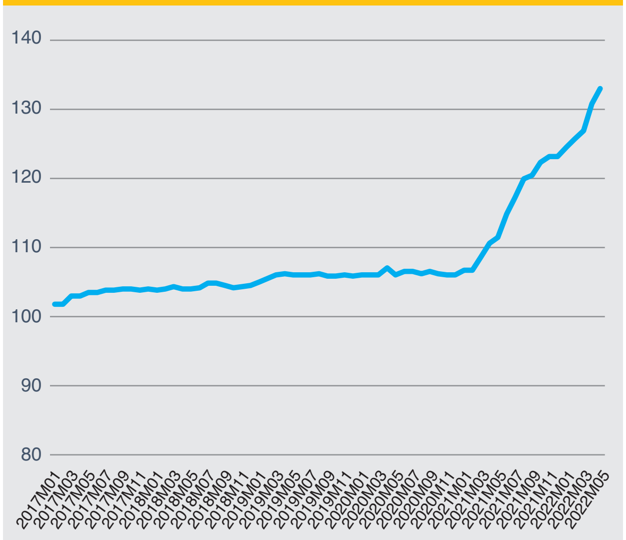
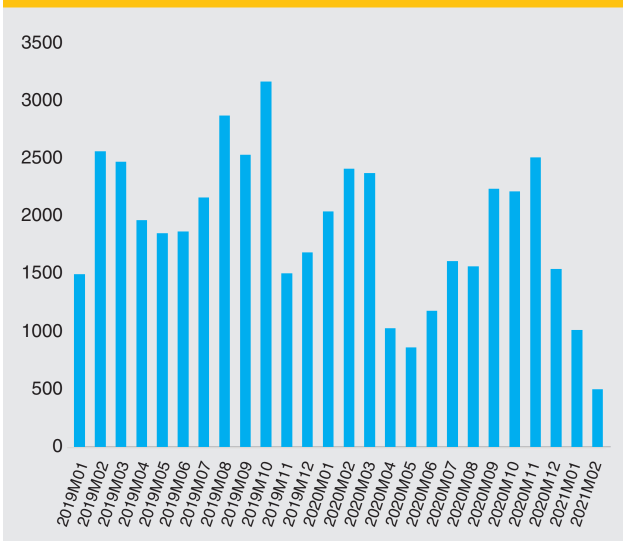


Figure 19: Monthly building commencements, number of residential units



Further information

Fergal O'Brien
Director of Policy and Public Affairs
T: 01 605 1544
E: fergal.obrien@ibec.ie

Gerard Brady
Chief Economist
T: 01 605 1515
E: gerard.brady@ibec.ie

Hazel Ahern-Flynn
Economist
T: 01 605 1603
E: hazel.ahern-flynn@ibec.ie

Web: www.ibec.ie
Twitter: Join the conversation @ibec_irl

Ibec Head Office
84/86 Lower Baggot Street
Dublin 2
T: + 353 1 605 1500
E: membership@ibec.ie
W: www.ibec.ie/membership

Galway
Ross House
Victoria Place
Galway
T: + 353 91 561109
E: galway@ibec.ie
W: www.ibec.ie/west

Cork
Knockrea House
Douglas Road
Cork
T: + 353 21 4295511
E: cork@ibec.ie
W: www.ibec.ie/cork

Brussels
Avenue de Cortenbergh
100, 1000 Brussels
Belgium
T: + 32 (0)2 740 14 30
E: europe@ibec.ie
W: www.ibec.ie/europe

Limerick
Gardner House Bank Place
Charlotte Quay Limerick
T: + 353 61 410411
E: midwest@ibec.ie
W: www.ibec.ie/midwest

Donegal
3rd Floor, Pier One Quay Street
Donegal Town Donegal
T: + 353 74 9722474
E: northwest@ibec.ie
W: www.ibec.ie/northwest

Waterford
Waterford Business Park
Cork Road Waterford
T: + 353 51 331260
E: southeast@ibec.ie
W: www.ibec.ie/southeast