Q3 2022 Ibec Quarterly Economic Outlook

An economic reset

Overview
Page 2

Households and consumption
Page 3

Trade and investment
Page 4

Labour market
Page 5 and 6

Global Economy
Page 7

Macro trends
Page 8

Housing and construction
Page 9

The international economy is in a place of significant challenge. High rates of inflation, rising interest rates and volatile energy markets have all driven deep downward revisions for international growth rates in 2022. In Europe, the Russian invasion of Ukraine means geopolitical risk has now been built into energy prices for the coming years. The last decade has seen the lowest interest rates globally since the start of the modern industrialised economy in the 18th century. The prospect of an economic reset through accelerated monetary tightening by the world's major Central Banks, is one which will lead to some further instability in financial markets globally. Ireland's strong economic momentum – exemplified by rising employment and tax revenues - which had defied the backdrop for much of 2022 will be challenged over the winter. As a small open economy, we are exposed to the prospect of a global economic slowdown and recessions in some major trading partners. The Global economy is experiencing a period of reset to normalised monetary policy and higher energy costs. The key question facing businesses planning for the year ahead is no longer whether that reset will be challenging, but rather how long those challenges will last.

Key indicators

Annual % change	2021	2022	2023
Consumer spending	4.6	5.8	3.0
Domestic Investment	8.1	14.0	3.7
Domestic Demand	5.8	6.6	3.0
Exports	14.1	8.1	3.5
Imports	-8.4	12.4	6.3
GDP	13.6	5.6	2.0
Inflation (annual average %)	2.4	8.1	5.0
Unemployment rate (annual average %)	16.2	4.7	4.3

Ibec
For Irish Business

Overview

Economic overview

Whilst economic momentum in the first half of 2022 was extraordinarily strong, there are now several leading indicators which suggest the volume of activity in the consumer economy and labour market may be beginning to slow. Both retail sales volumes and leading indicators of employment activity have been weaker in recent months, along with significant weakening of both business and consumer sentiment. Our expectations for 2023 have been revised downward since our previous forecasts in July, on the back of rising costs and a weaker outlook for the global economy. Our forecast for total domestic demand (both consumption and investment) in 2023 has fallen from 3.7% in our July Economic Outlook to 3% in our current forecasts. The weakness of the global growth outlook remains the most significant risk factor for the internationally traded sectors of our economy in 2023. By extension it remains a risk to the whole economy. Further monetary tightening by Central Banks carries risks for both financial stability and the broader economy throughout next year. The success of that adjustment will determine the amount of economic retrenchment ahead in 2023 and beyond.

Monetary tightening

The past decade has seen the lowest consistent period of interest rates at any time since the emergence of the modern industrial economy in the 18th century. Across the developed world, 2023 will see a normalisation of interest rates and a withdrawal of other emergency monetary supports. Central Bankers have emphasised their role in restoring price stability and reducing inflation over and above other economic outcomes, such as growth or employment. In the eurozone, market expectations for ECB interest rates are that they will rise from a level which stands at 1.25% today, to between 2.5% and 3% by the middle of 2023. This monetary normalisation will drive reallocation of capital away from the phenomenon of 'reach for yield' – whereby investors bought riskier assets to achieve higher yields. We have already seen the impact of this in adjustments to risky assets like cryptocurrencies and in the realignment of equities with earnings. The impact of this will be a particular challenge for companies with high levels of leverage, startups and other firms with long 'runways' to sustainable profitability and for those (such as parts of the property industry) where returns might be comparable to 'safe' assets like treasuries.

Fiscal backdrop

Ireland is in a unique position in Europe with tax revenues growing rapidly, allowing the Government to engage in both higher spending and to run a significant budget surplus. Total tax revenues at €58 billion in the first nine months of 2022 were up by 68% (from €41 billion) on the same period in 2019. Most other EU countries have seen their tax take rise by between 8% and 18% over the same period. Total tax revenue is now expected to rise to €82 billion for the full year of 2022 and €87 billion in 2023, relative to a level of €59 billion in 2019. This has been driven by rising corporate tax and income tax receipts. As a result, the Government have been able to do three things – provide a budget day package worth over 4% of national income (€11 billion), run a significant surplus, and put a similar amount of funds away in a state savings vehicle. The State expects to run a surplus of €1 billion in 2022 and €6.2 billion in 2023. This is after accounting for the €6 billion which is due to be added to the National Reserve Fund by the end of next year. Having a combined surplus and saving of over €12 billion will also allow for ongoing flexibility should further support for the economy be needed into 2023 and beyond.

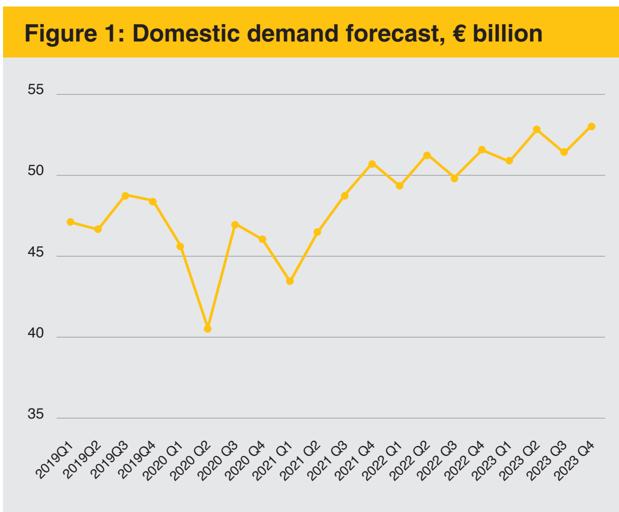


Figure 1: Domestic demand forecast, € billion

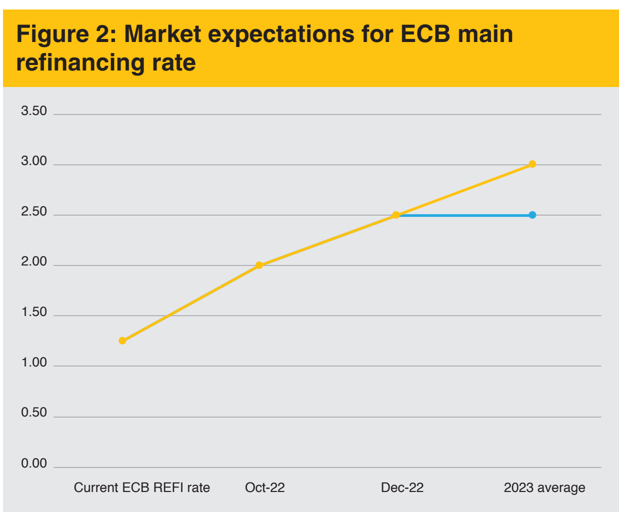


Figure 2: Market expectations for ECB main refinancing rate

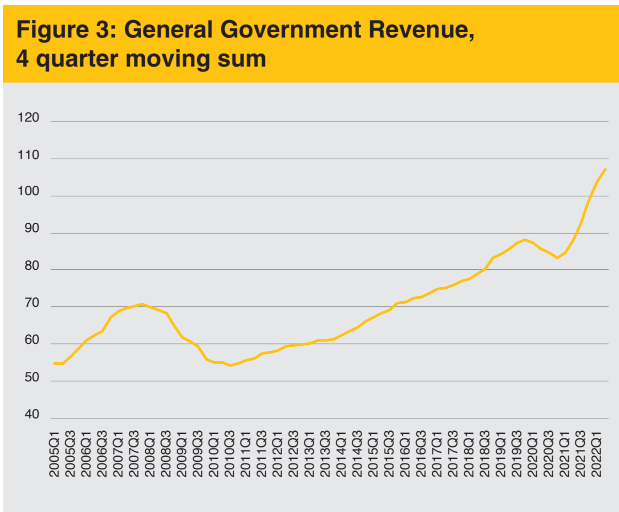


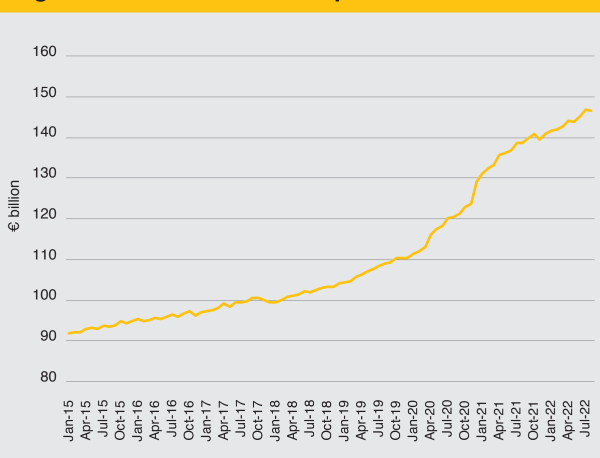
Figure 3: General Government Revenue, 4 quarter moving sum

Households and consumption

Household finances

The Irish economy is still seeing exceptional rates of household saving in the post-pandemic era. Household deposits with Irish banks reached a level of €147 billion in August. This is up from €139 billion in August 2021 and a pre-pandemic level of €109 billion. This level is now €27 billion ahead of its pre-pandemic trend. Whilst the growth in savings has slowed in 2022 it is now up €4.5 billion since March, relative to €6 billion of net deposits in the same period in 2021 and €8.4 billion in 2020. Given the scale of these savings (over €70,000 per household in the country) and their concentration in middle and higher income households, it is clear that a significant share of households have material buffers against inflationary pressures. In a European context, the 20% savings rate of Irish households in Q2 2022 was similar to German or Dutch levels, putting Irish households at the very upper end of European savers. Given other major investment challenges in the Irish economy, it is possible the current rate of savings is above what is optimal.

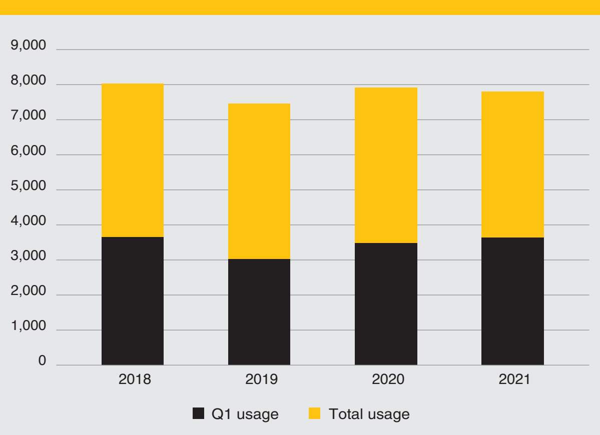
Figure 4: Irish household deposits



Consumption

Over the coming months, the bite of energy, interest rate and other costs will begin to be felt by households, despite the supportive stance of Government in the recent Budget. Irish households use about 45% of their annual heating in the first quarter of any given year as temperatures drop. As a result, seasonality in spending decisions may be pronounced next year. Meanwhile a cohort of households (in the region of one-fifth of all households) with variable rate or tracker mortgages remain vulnerable to rising interest rates into 2023. As a result of more rapid tightening of monetary policy, we are likely to see a further weakening of sentiment and outcomes over the winter period and into early 2023. For these reasons, we have downgraded our forecasts for growth in the volume of consumer spending in 2023 from 4% in our July Economic Outlook to 3% today. This will leave total consumer spending in 2023 marginally ahead of its pre-pandemic level.

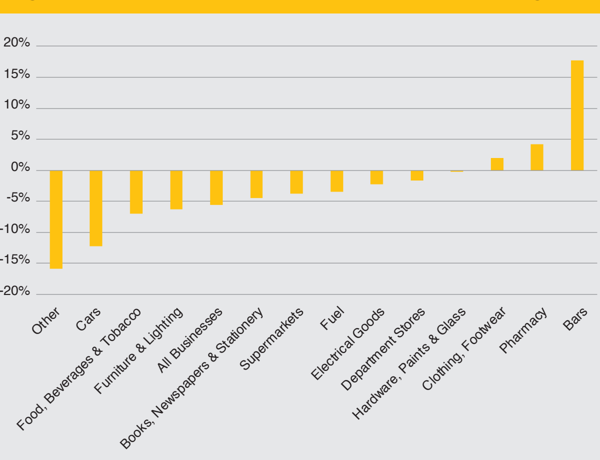
Figure 5: Residential metered gas consumption, GwH



Retail

The dampening effects of rising prices and higher energy costs are already hitting consumers, with a annual decline in total retail sale volumes excluding cars and bars of -3.1% in August. This is in contrast with retail sales turnover growth of 4.3% over the same period, reflecting the impact of rising prices, even as the volume of sales falls. Despite the decline in retail volumes over the summer, sales volumes across most categories excluding cars, bars and books are still well above their pre-pandemic levels. Many goods that saw a significant fall in sales volumes over the summer have also seen somewhat of a bounce back in early autumn, reflecting high volatility and uncertainty in consumer markets. The expectation is, with energy costs impacting most strongly in the winter months, the most significant impact on retail sales will be felt in Q4 2022 and Q1 2023. This is borne out in consumer sentiment, which is showing a large decline in households' expectations of the economy over the next twelve months, despite feeling relatively positive about their current financial position.

Figure 6: Retail sales volumes, annual % change

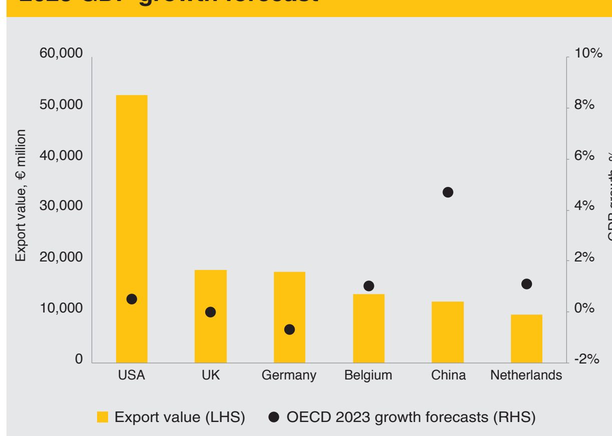


Trade and investment

Exports

Despite a significantly weakened outlook in the world economy, Irish exports are continuing to grow strongly this year, with the total value of goods exports 30% above the same period last year. Biopharma, medical technology and food and drink products continue to be the largest goods export categories, with Biopharma exports in August 64% higher than the same month last year. Amid rising inflation and a slowing in the global economy, Ireland's major trading partners have seen significant downward revisions in their growth forecasts. The US, UK and Germany accounted for just over half of Ireland's goods export value last year and have seen significant downward revisions in recent forecasts to either verging on recession (Germany, UK) or growth below 1% (US). Despite the incredible momentum of Ireland's exporting industries over recent years, these slowdowns in our export markets will impact on trade. As a result, it's expected that exports will continue to grow next year, but at a slower pace, coming in at around 3.5% growth for 2023.

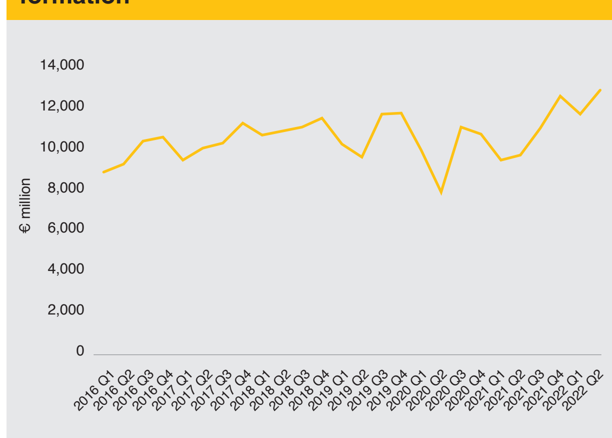
Figure 7: 2021 Irish goods export value vs OECD 2023 GDP growth forecast



Investment

Inflation, bottlenecks in construction and rapidly rising global interest rates are all acting as a drag on investment both globally and domestically. Despite these headwinds, both domestic investment and inward FDI performed strongly in the first half of the year. The second quarter national accounts highlighted the significant contribution of investment to Ireland's ongoing growth, with a nearly 30% quarterly increase in investment in machinery and equipment (excluding aircraft) by firms, reflecting Irish business' drive to scale operations to meet the rapid post-Covid recovery in demand. In addition to record FDI related jobs growth, there is also evidence of increased investment among Irish SMEs in the first half of the year. The Department of Finance's credit demand survey recorded credit demand growth among SME's primarily for business expansion and new machinery and equipment. Despite this strong bounce-back in investment this year, we expect growth in domestic investment to fall to 3.7% in 2023, as rising cost of finance, declining global demand and surging energy costs bite.

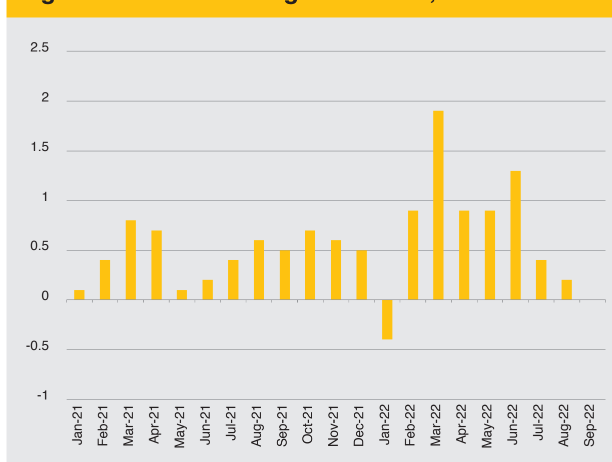
Figure 8: Modified gross domestic fixed capital formation



Inflation

Consumer prices were 8.2% higher in September than a year earlier. Energy products added around 3% to the total. Core inflation, which strips out commodity driven sectors like unprocessed food and energy, is running at 5.5%. This rebalancing of inflationary pressures from energy alone, to items and services indirectly using energy is a signal of the passing on of rising costs. At the same time, the month-on-month pace of price changes overall has shown some signs of easing. The 1-month pace of inflation (August 2022 to September 2022) was close to zero. This is a significant change relative to the earlier summer months when inflation was running at over 1% per month, as energy costs rose rapidly. There may, however, be a resurgence in price growth in the coming months as further pressure is put on energy and mortgage costs. However, in the medium run both shocks dent purchasing power for households and thus create deflationary pressures. The most important aspect of the inflationary environment is the level shift in prices we have witnessed over the course of the past year. We expect prices will be up just over 8% in the full year of 2022. Although price growth will slow to 5% next year, the price level will still be up over 12% between 2021 and 2023. Given much of the spend on energy driving this inflation will flow out of the economy, this will result in a significant loss of real income for households and businesses.

Figure 9: 1 month change in the CPI, %



Labour market

Overview

The Irish labour market remains tight on the back of high employment, despite difficulties in the wider macroeconomy and rising costs for businesses and consumers. The monthly unemployment rate has fallen to 4.3%, a low not seen since the Celtic-tiger era. When youth unemployment is stripped out, the unemployment rate for adults aged 25-75 is 2.9%. While there have been some marginal declines in employment across certain sectors, widespread difficulties in attracting and retaining key skills remain. Given the difficult headwinds confronting businesses this winter, the expectation is that there won't be a significant reduction in employment, but rather a slow-down in new hiring, as businesses face both higher costs and a tight labour market in which it is difficult to recruit. As a result, we expect unemployment to average 4.7% for 2022, and to come in at 4.3% on average in 2023 on the back of ongoing employment growth.

Monthly Payroll index

Monthly payroll data from Revenue, a leading employment indicator, has seen three months of moderate decreases in the total number of Irish payroll employees since early summer, down by 2% since May. This is mostly driven by declines in the estimated number of payroll employees in the hospitality, entertainment, and education sectors, which declined by 5.9%, 1.9% and 3.3% respectively between July and August. Sectors which had seen high employment growth during Covid such as finance, ICT and professional services have all seen either no growth or a marginal decrease in total payroll employees. This suggests both a slowdown in new hiring and ongoing difficulty in sourcing skills to fill roles in a difficult hiring market. Likewise, the total number of employees in manufacturing is holding steady, with a marginal reduction in construction. While these results may be early indicators of a slowdown of hiring in some sectors, the labour market as a whole continues to be extremely tight, with continued employment growth expected over the coming year.

Figure 10: Monthly unemployment rate, %

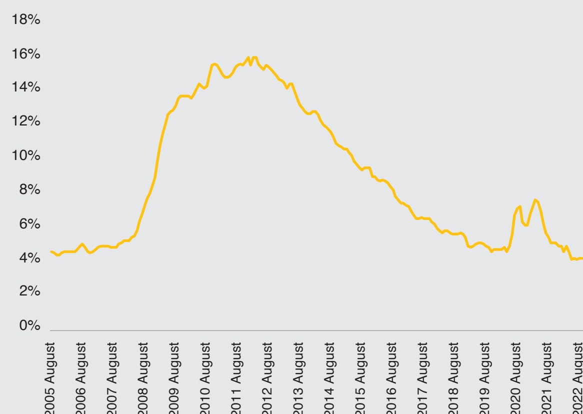


Figure 11: Payroll employees, monthly % change

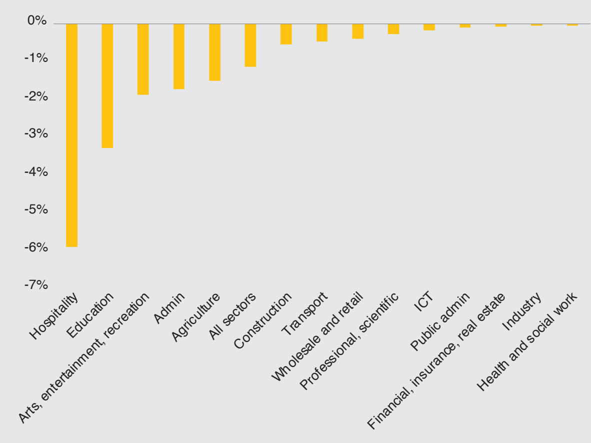


Table 1: Employment, 000s annual average

	2021	2022	2023
Agriculture	106	106	106
Industry & Construction	419	486	498
Services	1,703	1,946	1,957
Total	2,229	2,539	2,561
Unemployment rate (annual average %)	16.2%	4.7%	4.3%

Source: Ibec forecasts

Global economy

Vacancies and recruitment

Vacancy rates across all sectors over the last four years had averaged about 1%, but currently stand at 1.6%. Unsurprisingly, given ongoing skills shortages, the sectors with the highest job vacancy rates are currently in the Professional, Scientific & Technical sectors with a rate of 4.4%, followed by the financial sector with a rate of 3.1%. Consequently, these are also the sectors which have seen the fastest growth in hourly pay. Vacancy rates above 3%, indicating the percentage of roles in an area being advertised but remaining unfilled, are unusual and a sign of real difficulty in hiring. The biggest downward adjustment over the past year has been in the hospitality sector, which saw a peak in vacancies in Q3 of 2021, of 1.9%. That has since fallen back to 1.1%. Given the similar trends in payroll numbers this seems to reflect a slowdown in hiring in the broader experience economy.

Wages and employment growth

The rising cost of living, combined with competition for labour and skills, continues to place pressure on wages. Ibec's HR update report shows that 80% of responding employers intend to increase pay next year, with an average increase in basic pay of 3.8%. For 2022, average pay increases have been in the range of 3.4%-5.2%, depending on the sector. Unsurprisingly, given sustained skills shortages in the sector, ICT saw the highest wage growth in the year so far. Despite rising energy and labour costs posing a challenge for business, just over half of all employers surveyed indicated they intend to increase total number of employees next year, this is significantly higher than any point in recent years. On the other hand, only 3% of companies expect a decrease in headcount in 2023. Given sustained hiring intentions and that significant further growth of available labour is unlikely in the short to medium term, the labour market will remain tight over the coming months.

Characteristics of unemployment

Amidst strong employment growth, there are currently 184,100 people on the Live Register. This is 4,700 fewer than the same period in 2019. Of those currently on the register, 13,505 are refugees. If these were discounted, the reduction in numbers on the Live Register is even more significant in terms of flows into employment. Two welcome outcomes of the rapid recovery in employment over the past year are the continued reduction in long-term and youth unemployment, two forms of unemployment which tend to have persistent scarring affects and can be intractable for policymakers. The number of long-term unemployed who have been on the register for a year or more has fallen by 12% since September 2019. Currently, a little over two-thirds of those on the live register have been on it for less than a year, with about a third on it for under three months. Around 20%, or 36,000 people, have been on the live register for more than three years, with men making up 58% of those in long-term unemployment. The rapid fall in numbers of long-term unemployed reflects the sustained labour market tightening of recent years.

Figure 12: Job vacancy rate across all sectors

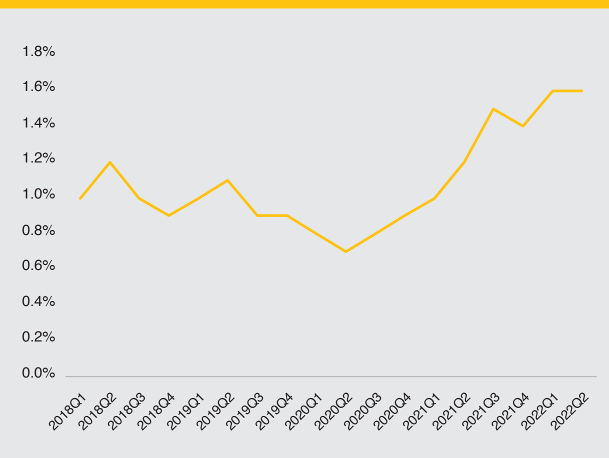


Figure 13: Employers' hiring intentions 2023

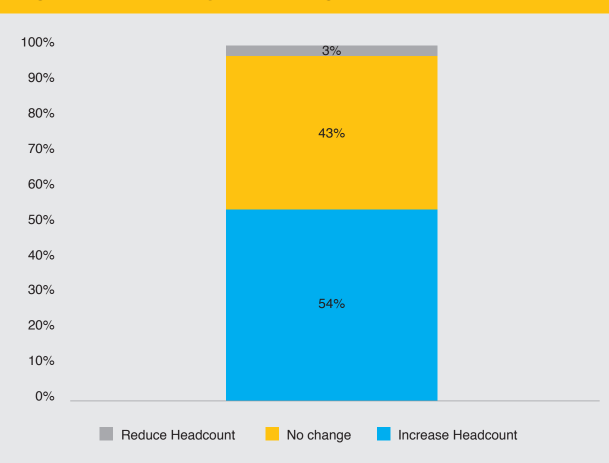
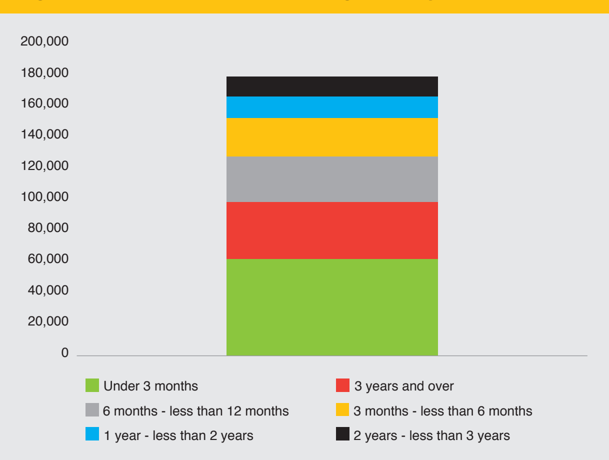


Figure 14: Persons on live register by duration



Business costs

UK credibility woes

The 'mini' Budget of the British Government provoked a significant market backlash, focused on both UK Government bonds and the value of sterling. The Government set out a programme of significant tax cuts and energy subsidies. These unfunded measures would have required significant Government borrowing. Given the UK's persistent current account deficit and low productivity growth, financial markets didn't regard the fiscal plan as credible. The market reaction, in turn, precipitated a political crisis which has consolidated the reputational damage. The result will be a financial premium on UK borrowing for both Government, households and corporates. This in turn will mean that the British Government will face significant market focus on its fiscal credibility which, allied with a higher interest rate bill on borrowing, will result in fiscal retrenchment once again. From an Irish economic perspective, the immediate spillover from recent events will be limited. The long-term prospect of a weaker UK economy will, however, impact on Irish SMEs for whom the UK remains an important export market.

EU close to recession

The high cost of energy and greater geo-political risk has resulted in most forecasters increasing their odds of a recession in the EU in 2023. In the eurozone's largest economy, Germany, business sentiment has fallen precipitously in recent months. The IFO Business Climate Index fell in September to a balance (positive minus negative responses) of -15.7. This compares to a series low of -25 in March 2009, during the onset of the global financial crisis. Business expectations of the future, however, fell to a score of -43. This is the most pessimistic response on future expectations, in the past two decades, bar April 2020 and the onset of Covid. Recent forecasts from the IMF put eurozone growth next year at 0.5%, down from 3.1% in 2022. Of the major eurozone economies, both Germany and Italy are expected to experience recessions next year, with GDP falling marginally. Whilst sentiment is bound to remain volatile over the winter period, it will be linked closely to the energy crisis, security of supply and cost.

Figure 15: UK balance of payments, % of GDP

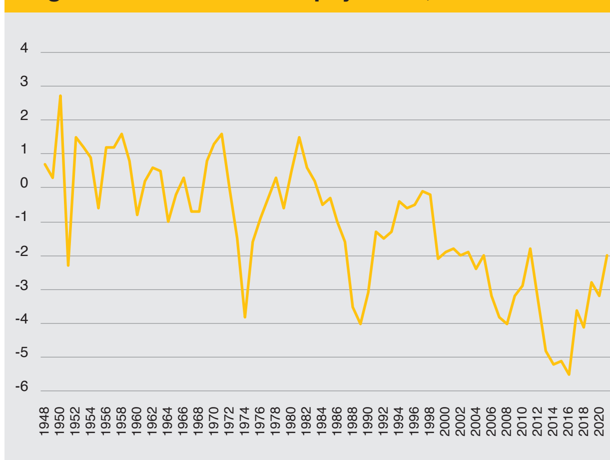


Figure 16: ifo Business Climate index, Germany

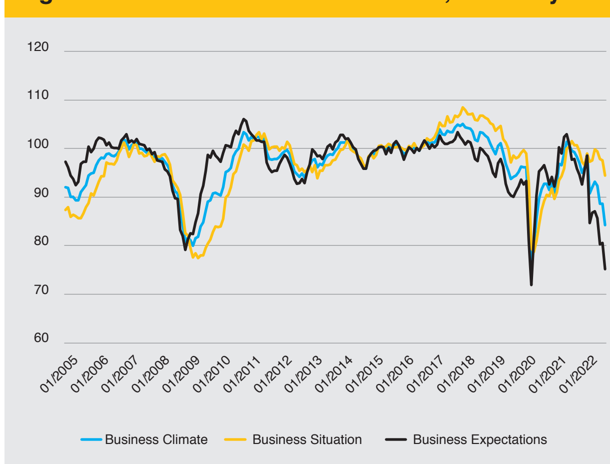


Table 2: IMF GDP forecasts by major global economy

	2021	2022	2023
US	5.7	1.6	1.0
Eurozone	5.2	3.1	0.5
Germany	2.6	1.5	-0.3
China	8.1	3.2	4.4
UK	7.4	3.6	0.3

Source: IMF Outlook

Business Recovery

Bond yields

There has been significant market volatility in fixed income assets over recent months. Over 12-months, the average yield on AAA rated 10-year eurozone government bonds has increased from negative rates (-0.16%) to 2.4% this month. US treasury yields have also increased to 4% from 1.6% a year ago. On the corporate front, eurozone corporates are also seeing higher borrowing costs. The S&P Eurozone Investment Grade Corporate Bond Index has shown an increase in yields to 4.1% in recent weeks, from less than 0.2% a year earlier. This increase in bond yields overturns a decade since the global financial crisis, where government and corporate borrowing costs have been compressed by Central Bank interventions. Rising borrowing costs and risk-free-rates will impact on financing, capital costs and balance sheets for companies over the coming years.

Dollar dominance

The US dollar has strengthened by over 15% against the value of other advanced economy currencies since the start of the year. This is on the back of both higher US interest rates and a rush toward 'safe' dollar denominated assets. Given the importance of the dollar in the global economy this has significant implications for growth and financial stability. 40% of total global exports are dollar denominated. ECB research also shows that the dollar also accounts for two-thirds of the world's foreign exchange reserves and international debt liabilities. Even in the EU, in 2021, almost half of all goods imported into the EU market were invoiced in dollars. US dominance in financial markets means that US monetary policy plays a significant role in the global financial cycle. As a result, the US Federal Reserve and its current campaign of monetary tightening will have a major impact on global currencies, trade, investment and financial stability. The ECB recently noted that US monetary policy spillovers have had "at least as much of an impact on euro area asset prices and the euro-dollar exchange rate over the last 12 months as ECB monetary policy actions". For countries, such as Ireland, with strong links to dollar denominated trade and investment the impact of US monetary contractions can be exacerbated by lowering of the risk appetite of US companies and slowing cross-border financial flows.

Global supply chain pressures

Pressures in global supply chains, which dominated the economic outlook globally, have shown signs of easing in recent weeks. For example, the cost of shipping a 40-foot non-refrigerated container from East Asia to Northern Europe has fallen to $5,500 in October, from a level of between $10,000 and $15,000 between July 2021 and the end of August 2022. This is relative to pre-Covid norms of around $2,000. The Federal Reserve Bank of New York's Global Supply Chain Pressure Index, which captures several real time indicators of international freight costs and business delivery times, backlogs and stock levels has also seen a broad-based fall in the past 5 months, having peaked in December 2021. Some continued normalisation of supply chains is likely over the coming 12-months, not least because of a slowdown in demand from some major economies.

Figure 17: Eurozone government bond yield curve

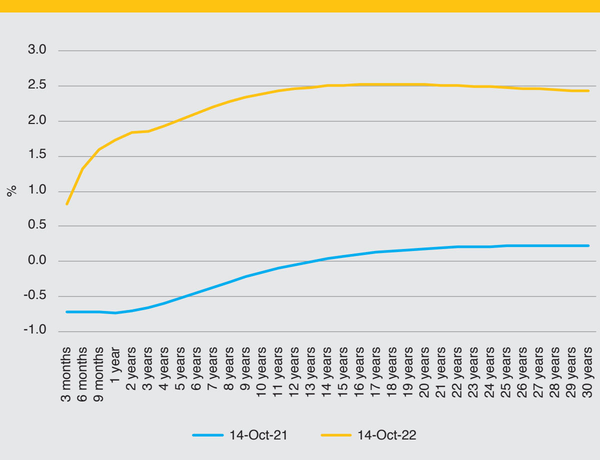


Figure 18: Nominal Advanced Foreign Economies U.S. Dollar Index

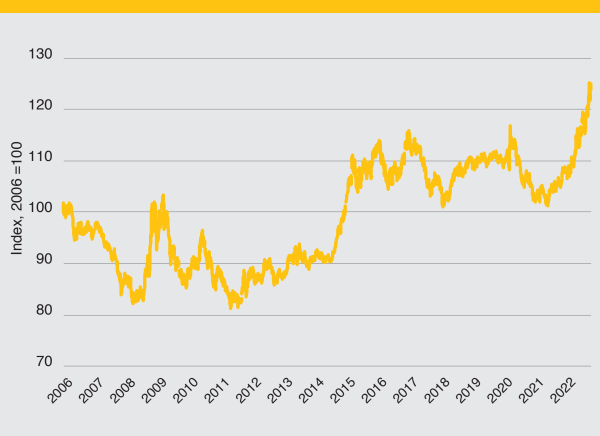
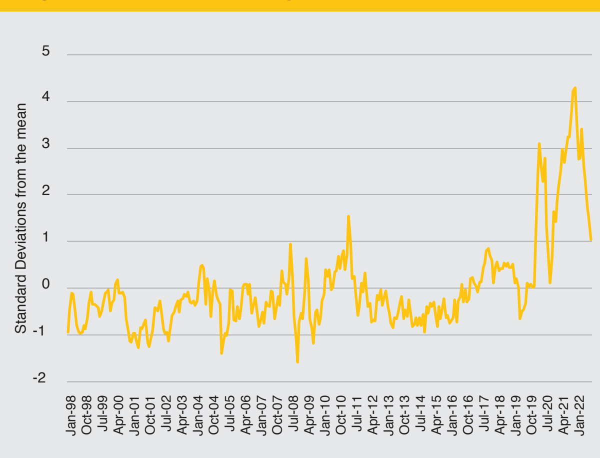


Figure 19: Global Supply Chain Pressure Index



Housing and construction

Housing supply

13,315 new dwellings were completed in the first half of the year, up significantly above the same period in 2021. Although this is a welcome reflection of the quick recovery in construction activity, housing supply is unlikely to meet demand in the medium term. On the supply side, construction costs are rising rapidly as inflation and rising interest rates affect both materials and the cost of financing. While the number of planning permissions granted have begun to increase back toward their pre-pandemic levels in recent months, given rising costs, challenges with financing, and bottlenecks in the construction sector, these are unlikely to fully translate to new homes over the coming years. The end of the build-to-rent regulations are also likely to negatively impact total housing delivery. Under the Government's 'Housing for all' plan there is a target of an average of 35,000 new homes a year over the next nine years to meet demand. Trends in terms of the rising population and smaller average household size suggest that the real demand for housing may be significantly above this figure.

Mortgage lending

A long-term upward shift in savings rates among Irish households, along with the consistent paying down of debts has left households in aggregate with a significantly improved financial position compared to 2015, when mortgage lending rules were introduced. On the back of improved stability of Irish household finances, the Central Bank is easing its loan-to-income restrictions for first-time buyers to allow mortgage borrowing of up to four times income, increasing from the previous multiple of 3.5 times income. This brings the loan-to-income restrictions more in line with countries with similar regulations such as the UK and much of the EU. The total value of housing assets held by households is at a record high of €649bn, driven by rising house values. While reduced limits on borrowing may bring home ownership in reach of some people, it also comes at a time when rising interest rates will increase the cost of mortgage payments for both new and existing homeowners. In response, banks are increasing rates and tightening their credit standards for mortgage applicants, reflecting higher risk of non-performing loans in the current environment.

Home ownership

Of the 67,915 total dwelling sales in the past year, a quarter were bought by first-time buyers, 45% were bought by non-first-time household buyers intending to occupy the dwelling, 18% by companies, state institutions or NGOs and 12% by non-first-time buyer households not intending to occupy the property. Over the last year, the median price of properties bought across Ireland, which includes both houses and apartments, was €308,000 for first-time buyers and €315,000 for non-first-time owner occupiers. The divide is more significant in Dublin, where the median price of properties bought by first-time buyers over the past year was €390,000 compared to €475,000 for non-first-time buyers. Houses act as the most significant store of wealth for Irish households, with median net wealth of home-owning households at €303,000 compared to just €5,300 for renters.

Figure 20: Quarterly planning permissions granted by unit type

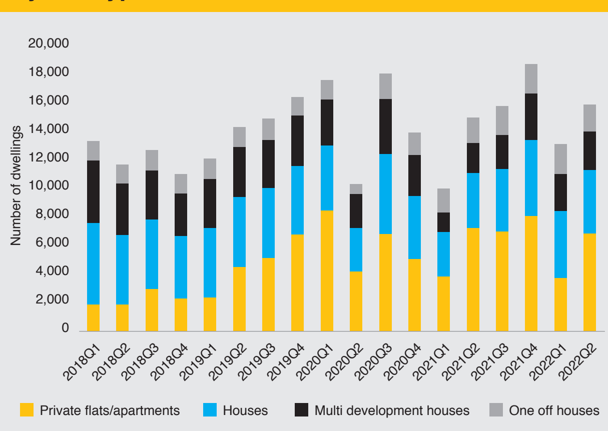


Figure 21: Total outstanding loans to households for house purchase

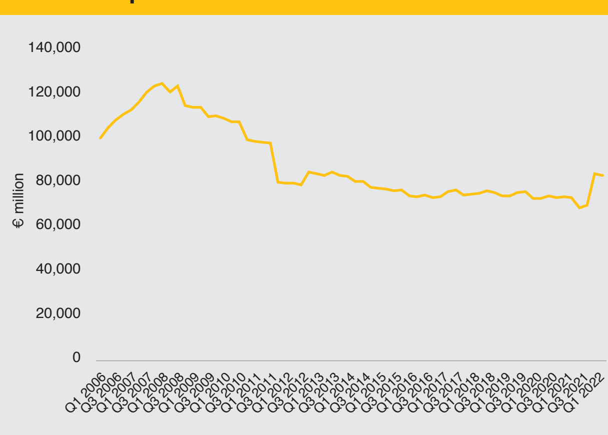
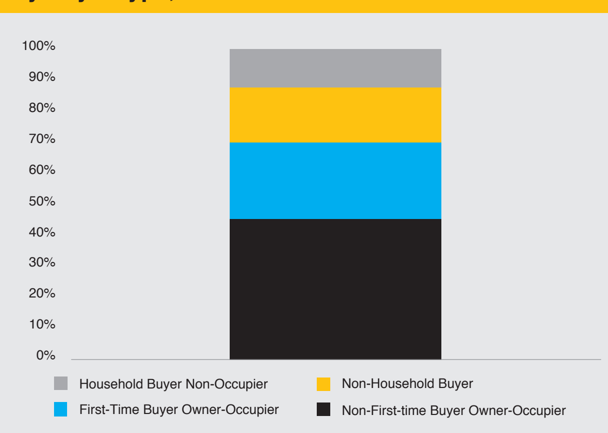


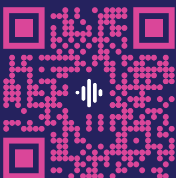
Figure 22: Dwelling sales over previous 12 months by buyer type, %



There's a lot to talk about

Are you listening?

Ibec's podcast series now has more voices, more stories and more expert analyses on the issues facing Irish businesses today.



Scan the QR code or visit
www.ibec.ie/podcasts
to start listening

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