Ireland Outlook

February 2023

Economic Update

Bank of Ireland

Strong growth but domestic economy slowing

On the face of it, the Irish economy cleared all obstacles during 2022 with the CSO estimating that GDP increased by 12.2%, helped by a 3.5% quarter-on-quarter gain in the final quarter of the year. However, the multinational sector continues to have an out-sized impact on growth, with the domestic sector less resilient. The post-Covid surge in consumer spending and investment has stalled as the economy contends with higher inflation and rising interest rates. While the labour market remains healthy, with sustained jobs growth and unemployment at low levels, consumers are cautious as they see their real incomes slide, hitting spending, and businesses appear to be easing back on investment amid greater uncertainty about the outlook for demand. This has led to slower activity in the domestically dominated sectors of the economy, while the multinational sector – fuelled by exports– continues to grow apace.

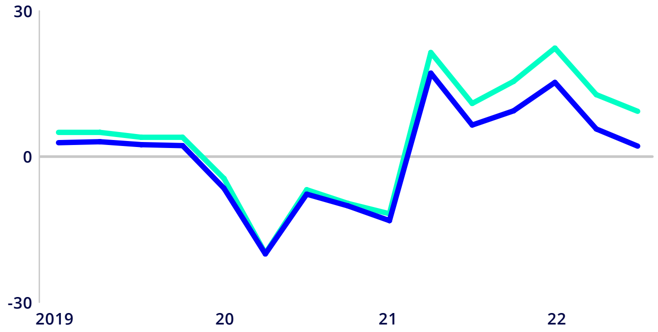
Looking ahead, the two-speed nature of the economy will be evident again in 2023. The outlook for the multinational sector remains relatively positive – notwithstanding the recent wobbles in the tech sector – and that will provide a strong base to growth this year. However, the domestic side is likely to be much weaker, with a pickup in activity unlikely to come until the second half of the year as inflation falls and eases some of the pressure on households. Against this backdrop, modified domestic demand is forecast to grow by just 1.5% in 2023 before a 3.0% gain in 2024, while GDP growth is expected to moderate to 7.0% this year and to 6.0% in 2024. There are, of course, risks to this outlook. The ongoing war in Ukraine and its potential impact on markets and global activity is a concern. Related to this, the cost of living, which dominated 2022, remains a key risk. While inflation is forecast to fall to 5.7% this year and 3.3% next year, this is not a certainty - were the economy to see continued high rates of inflation, it would eat into real incomes and cause household spending to retrench rather than recover.

	2022(e)	2023(f)	2024(f)
Personal Consumption	6.3%	2.5%	3.5%
Modified Investment	23.0%	-1.5%	3.0%
Modified Domestic Demand	8.8%	1.5%	3.0%
Exports	14.5%	9.0%	7.0%
GDP	12.2%	7.0%	6.0%
Employment	6.6%	1.5%	2.0%
Unemployment Rate (Average)	4.5%	4.7%	4.5%
CPI	7.8%	5.7%	3.3%

Consumer

Confidence and spending ebb in 2022

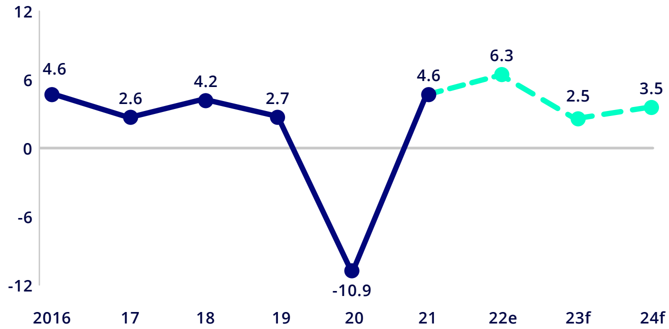
Consumer sentiment fell sharply over the course of 2022 as households were beset by cost of living issues and worries about the outlook for the economy. Growth in consumer spending was held up by services spending in the first quarter of the year but drifted down over subsequent quarters, with the annual increase slowing to 2.2% in Q3 from over 15% in Q1.



Consumer Spending Real Nominal (annual % change)
Source: CSO

Spending to pick up as inflation falls back

There are some positive signs of late with retail sales showing some improvement - the volume of sales was up 3.0% year-on-year in January - and consumer confidence picking up, though it remains at a relatively low ebb. However, inflation will continue to outpace income gains leaving households worse off, at least in the opening quarters of the year. The high rate of household savings – which is approximately double its long run average – may lend support to spending, especially in the second half of the year as inflation rates fall back. We expect spending growth of 2.5% this year, rising to 3.5% in 2024.

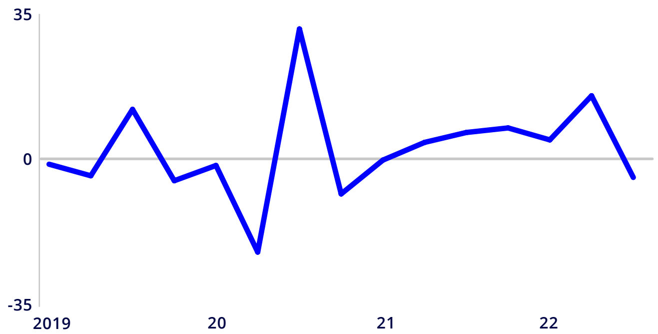


Consumer Spending (annual % change, constant prices)
Source: CSO & Bank of Ireland

Investment

Domestic investment under pressure

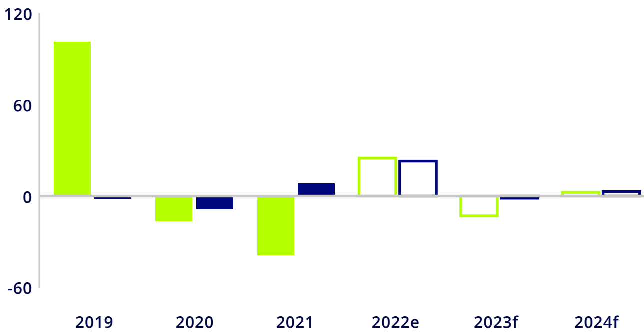
As multnational activity makes headline investment extremely volatile, a better indicator is modified investment which excludes intangibles and aircraft leasing. Having rebounded strongly post-Covid, modified investment turned around in Q3 2022, falling by 4.6% quarter-on-quarter. This softness is likely to continue in 2023 in an environment of higher costs and rising interest rates and a fall of 1.5% is projected for this year. However, with continued investment in housing and infrastructure, modified investment growth should return to positive territory in 2024, rising by 3.0%.



Modified investment (quarterly % change, constant prices)
Source: CSO

Demand underpinning housing

New house completions picked up to close to 30,000 last year though this is still some way off estimated requirements. Despite this, completions may fall back a couple of thousand this year, as housing starts have edged down as builders deal with worries over costs, affordability and labour and material shortages. Rising interest rates may dampen housing demand, but given the underlying demographic drivers - such as population growth and migration - completions should increase again in 2024.

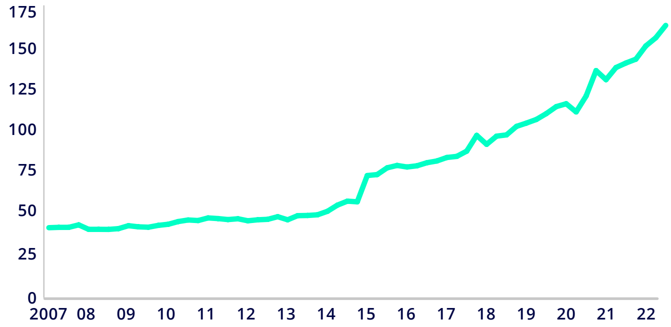


Total Investment Modified Investment (annual % change, constant prices)
Source: CSO & Bank of Ireland

Exports

Growth boosted by contract manufacturing

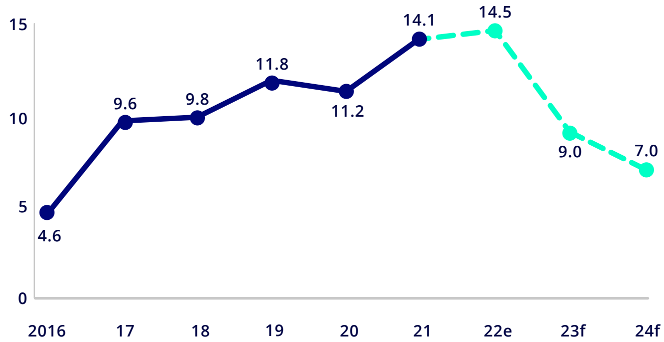
Exports continue to perform strongly, and are adding significantly to GDP growth. The growth in exports is being boosted by 'contract-manufacturing'. This is where goods are produced in another country and exported to a third country but are counted as Irish exports due to patents and royalties accruing to MNC's located here. This practice has added to an already very strong export picture over the past number of years.



Exports of Goods and Services (€bns, constant prices)
Source: CSO

Underlying position still positive

The exporting sector will have to contend with slower growth in our trading partners in the year ahead with relatively weak demand likely in the Euro area, US and UK economies. However, recent experience suggests that exports from Ireland are not particularly strongly correlated with overall growth in our key markets, and while export growth is expected to moderate, it is forecast to remain relatively strong at 9.0% this year and 7.0% next year.

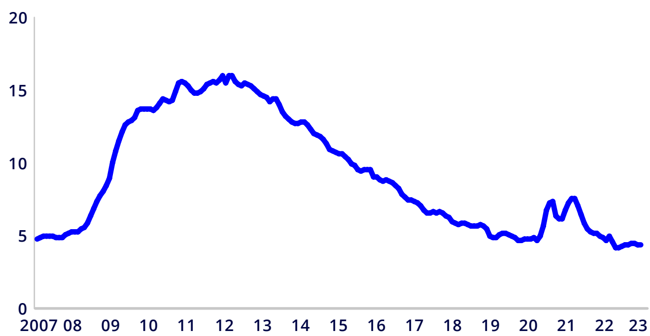


Exports (annual % change, constant prices)
Source: CSO & Bank of Ireland

Labour Market

Continued jobs growth

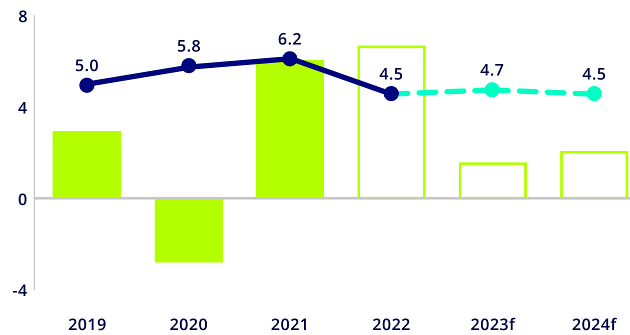
The labour market has outperformed expectations with healthy job growth across sectors during the year to Q4 2022, leading to a record 2.57 million people in employment – about 700,000 more than the post financial crisis low of 1.85 million in 2012. Unemployment has also fallen to low levels, averaging 4.5% last year down from 6.2% in 2021. While there have been jobs losses in the tech sector, the impact appears to be fairly limited with employment in the information and communication sector down just 1.3% year-on-year in Q4 2022, and still up close to 30% from its pre-Covid levels.



Unemployment Rate
Source: CSO

Unemployment rate to tick up slightly

While further jobs growth is in the offing, it's likely to be at a slower pace than seen recently, with an uptick in job losses from slowing activity in the domestic economy and the correction in the tech sector. We expect employment growth to ease to between 1.5% to 2.0% per annum over this year and next year, with a slight rise this year in the average unemployment rate to 4.7% before dropping back to 4.5% in 2024.

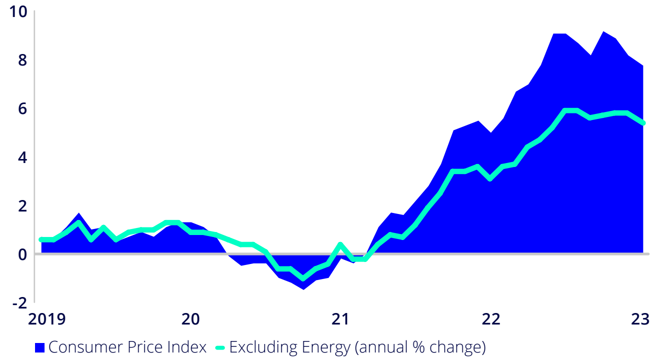


Employment (annual % change) Unemployment Rate (annual average)
Source: CSO & Bank of Ireland

Inflation

Inflation rise driven by energy costs

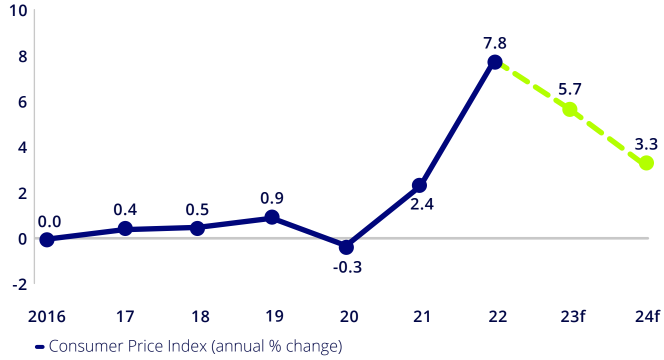
The rise in inflation and consequent increase in the cost of living dominated 2022. While the initial rise in inflation during 2021 was in part due to global supply chain issues, the conflict in the Ukraine was a catalyst for a surge in world energy prices that pushed inflation in Ireland to ever higher levels. Inflation appears to have peaked late last year though, and the average rate for 2022 as a whole came in at 7.8%. Underlying inflation excluding energy has also risen but there are signs it's stabilising now and should start to taper off.



Source: CSO

Price pressures to ease

With oil and gas prices waning of late, the headline rate of CPI inflation is edging lower and fell to 7.8% in January 2023 (from a peak of 9.2% in October 2022). It will take time for the decline in energy prices to fully pass-through to households, and while inflation should come down as we move through the year, the annual average rate for this year is forecast to be a still elevated 5.7% before easing further to a somewhat more palatable 3.3% in 2024.

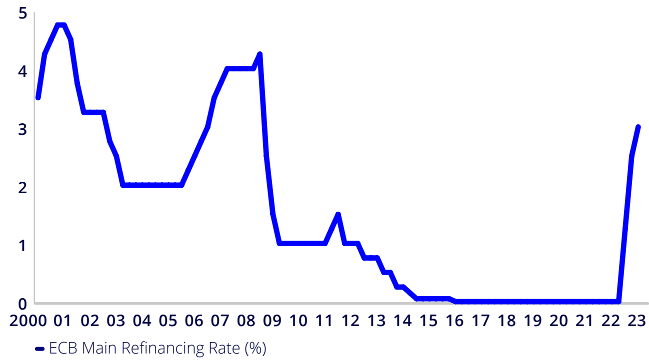


Source: CSO and Bank of Ireland

Markets

Rising interest rate environment

The decade post the financial crisis saw the ECB and other central banks keep policy ultra-accommodative in order to spur inflation back towards target rates. The situation in 2022 saw this stance flip as price rises shot past the target rate of 2%. The ECB responded by starting the first sustained hiking cycle in more than 10 years which took the refi rate to 3% from 0% in 6 months. Further rate rises are in offing this year, with the ECB clear that more will be needed to tame inflation in the Euro Area. The market is pricing in at least another 100 basis points in hikes by mid year and, with the latest data suggesting Europe will avoid recession, the ECB could be unmoved to ease policy excessively if and when inflation is tamed.



Source: CSO

Euro gains against dollar

With the Fed and Bank of England potentially closer to the end of their hiking cycle than the ECB, recent months have seen the euro make some gains. The single currency is now back to $1.06 against the dollar, having dropped below parity in the latter part of last year, and 88p to sterling. We may also see further gains, which would be bad news for Irish exporters to the UK.

Source: Bloomberg

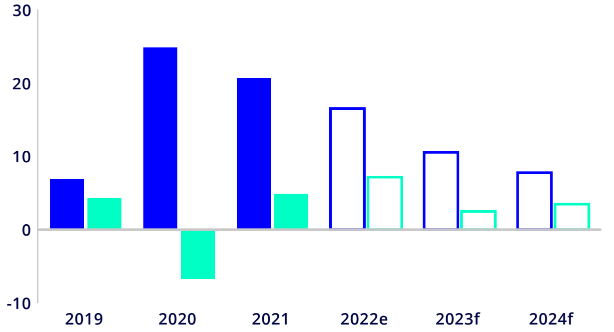
GDP

Multinationals boost output

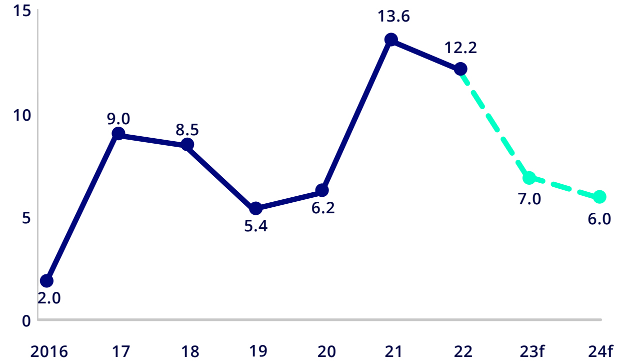
Headline GDP is strongly influenced by activity in multinational sectors and the outlook for the latter is still healthy, with more foreign direct investment in the pipeline adding to output capacity. Though there is a well-documented pull-back in the ICT sector - having expanded too rapidly during the pandemic - this retreat is likely to be moderate in nature, while the other side of Ireland's FDI story – chemicals and pharmaceuticals – is still powering on. Weaker global growth is probably more of a speed bump than a hurdle for the international companies located here and we forecast that output in the MNC sector will grow by 10.6% this year and 7.8% next year.

Domestic side to slow but GDP to hold up

In contrast, domestic output growth is forecast to be significantly more modest in 2022 at 2.5%, with slower consumer spending and investment penciled in for the first half of this year, before picking up to 3.5% in 2024. Slower domestic output growth will be masked in headline GDP by the outsized performance of multinationals, with growth of 7.0% in 2024 and 6.0% in 2023 set to make Ireland (again) the fastest growing economy among our European peers.



(annual % change, constant prices)
Source: CSO and Bank of Ireland



GDP (annual % change, constant prices)
Source: CSO and Bank of Ireland

Forecasts	2022(e)	2023(f)	2024(f)
Personal Consumption	6.3%	2.5%	3.5%
Government Consumption	1.0%	2.0%	2.0%
Total Investment	25.0%	-13.0%	2.5%
Modified Investment	23.0%	-1.5%	3.0%
Modified Domestic Demand	8.8%	1.5%	3.0%
Exports	14.5%	9.0%	7.0%
Imports	16.0%	2.0%	5.5%
GDP	12.2%	7.0%	6.0%
GNP	9.0%	6.0%	5.0%
Domestic Sector GVA	7.2%	2.5%	3.5%
Multinational Sector GVA	16.6%	10.6%	7.8%
Employment	6.6%	1.5%	2.0%
Unemployment Rate (Average)	4.5%	4.7%	4.5%
CPI	7.8%	5.7%	3.3%

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