Ireland Outlook

July 2023

Economic Update

GDP masking true picture

The latest data illustrates, once again, that GDP is an unreliable barometer for the health of the Irish economy. It shows strong growth in the first three quarters of last year but the brakes coming on in Q4 and then the economy contracting by 2.8% quarter-on-quarter in Q1 of this year. However, the latter was largely due to globalisation effects in the multinational (MNC) sector, reflected in a decline in industrial output, while the underlying domestic economy continues to grow – notwithstanding numerous headwinds not least falling real incomes and higher interest rates. Modified domestic demand grew by 4.5% year-on-year in Q1, helped by rising consumer spending over the course of the year and ongoing domestic investment (up 10% annually in Q1).

Another indicator that suggests the economy is performing robustly is the labour market with continued employment gains, 4.1% year-on-year in Q1, and a very low unemployment rate that stood at 3.8% in June. This signals a very tight labour market with employers struggling to fill openings. Notwithstanding this, employment growth should slow from its rapid post-Covid pace and we see it averaging 3.3% this year and 1.7% next year with unemployment to remain low throughout. Taking into account the out-turn for headline GDP in Q1, we are revising down our growth forecast for this year to 4% (from 6% in May) and leaving it unchanged at 5% in 2024. However, the underlying picture is a little better so modified domestic demand is being revised up this year to 3.0% (from 2.5%) and is unchanged at 3.5% next year. Inflation - which has dominated public and private discourse over the past year - is finally on the wane, with the CPI rate forecast to fall to 3.5% next year, but risks remain on this front, especially with a hot labour market.

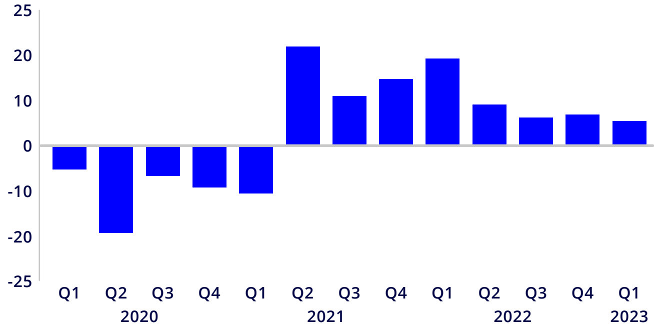
	2022	2023(f)	2024(f)
GDP	9.4%	4.0%	5.0%
Modified Domestic Demand	9.5%	3.0%	3.5%
Employment	6.6%	3.3%	1.7%
Unemployment	4.5%	4.0%	4.0%
CPI	7.8%	6.5%	3.5%

Bank of Ireland

Consumer

Consumer spending better than expected

Despite the cost of living issues over the past year, consumer spending has actually held up quite well, increasing by 9.4% in 2022. Not surprisingly however, spending slowed as the year went on and the pace of increase edged down to 5.1% year-on-year in Q1 2023. What consumers are spending on is changing as well, as a post-Covid surge in services spending appears to be easing back while goods spending, which had been weak, has picked up somewhat. Sentiment has improved from its lows, up to 64.5 in July, though this remains well off what might be considered a healthy level.



Personal Consumption (annual % change)

Source: CSO

Modest increases in the offing

The headwinds are easing for spending as we move through this year. Most notably, headline inflation is falling back and real incomes should improve while the labour market continues to be very tight. Against that, interest rates are making credit more expensive for households and savings levels have dipped from Covid-era highs with rainy day funds likely been used to support spending over the course of 2022. With that in mind, we are forecasting modest increases in household spending this year and next.

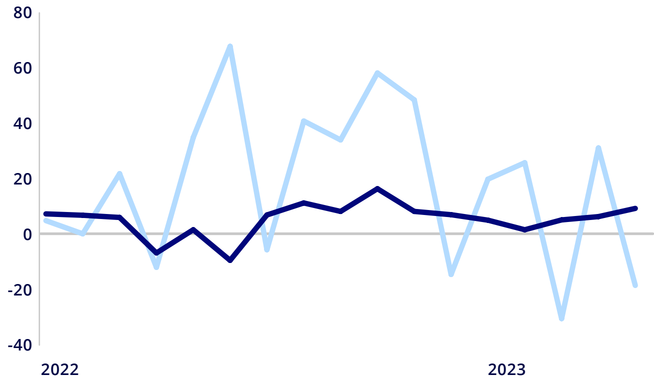
Consumer Sentiment (index)

Source: Credit Union

Business

Industry struggling

The main factor behind the slump in GDP in Q1 was weakness in the industrial sector, which declined by over 13% quarter-on-quarter. This slowdown appears to have extended into Q2 with production data up to May showing declines on both the month and the year. However, this is largely restricted to the MNC sector as traditional sector output – mostly domestic firms – was up by 9% annually in the same month. Meanwhile, the composite PMI in Q2 dipped slightly from Q1 and indicates just shallow growth in activity amongst businesses.



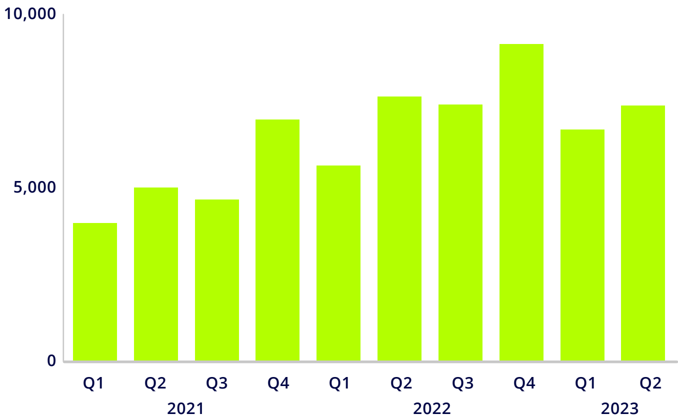
Traditional Sector Modern Sector (MNC dominated)

Industrial Production (annual % change, volume)

Source: CSO

Subdued investment

On the construction front, residential completions came in at just over 14,000 units in the first half of the year. While this is up in year-on-year terms, it's down about 2,500 homes compared to output in the second half of last year. This is in line with our expectations and, with building commencements data signalling only a small improvement, total completions are set to be broadly unchanged at around 30,000 in 2023. The construction sector as a whole is in flux dealing with higher interest rates, and past input price increases, which are affecting profitability for builders and affordability for buyers, and changing work practices which are impacting commercial demand. All of this means construction will not add much to investment growth this year. In addition, the current environment means business investment is likely to be fairly subdued as well but, in a nod to the better performance of the domestic economy, we are revising up modified investment growth to low but positive single digits this year with a further improvement to 3.5% next year.



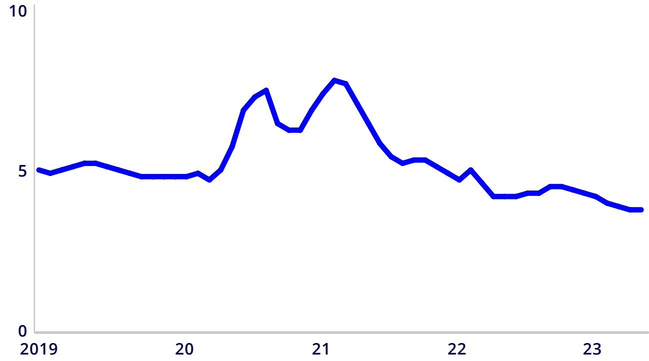
New Dwelling Completions (number of units)

Source: CSO

Labour Market & Inflation

Full employment

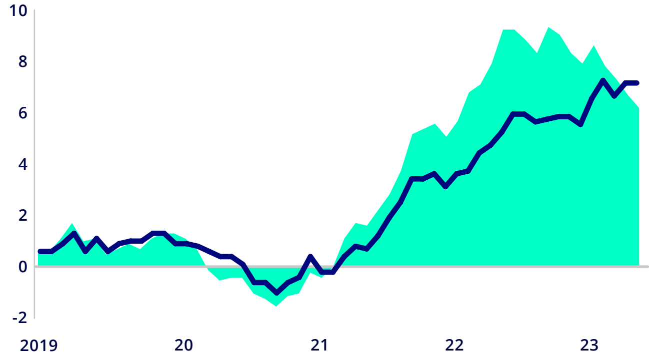
The labour market remains very tight with a record number in employment and an unemployment rate at 3.8% in June, which suggests full employment. Jobs growth has been strong and the labour force has been supported by higher inward migration. Earnings growth has been restrained in the face of high inflation with hourly earnings up by just 4.1% year-on-year in Q1. However, should the market remain tight – as we are projecting - then we may see upward pressure on wages particularly if inflation does not slow quickly from this point.



Unemployment Rate
Source: CSO

Headling inflation easing

Headline CPI inflation is falling, bringing relief to consumers and businesses alike, with the annual rate down to 6.1% in June from a recent high of 9.2% last October. This has been helped by a decline in wholesale energy prices, which is evidenced by a drop in transport and home heating fuel but has yet to pass through to retail electricity prices, though that may come in the second half of the year. Core inflation excluding energy is stubbornly sticky, coming in at 7.1% in June, just marginally off its high of 7.2% in March. The stubbornness of core inflation, not just in Ireland but across Europe, is a concern for policy makers and behind the ECB's aggressive interest rate increases. These will continue to impact over the next year or more and should help to push inflation down further with an average CPI rate of 6.5% expected this year and 3.5% next year.

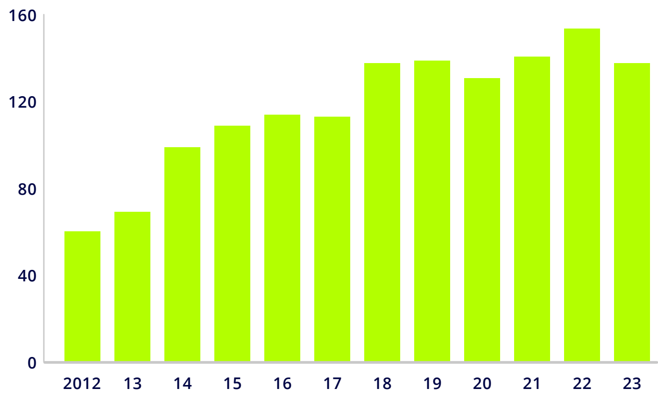


Consumer Price Index – Excluding Energy (annual % change)
Source: CSO

External Environment & Markets

More modest export growth

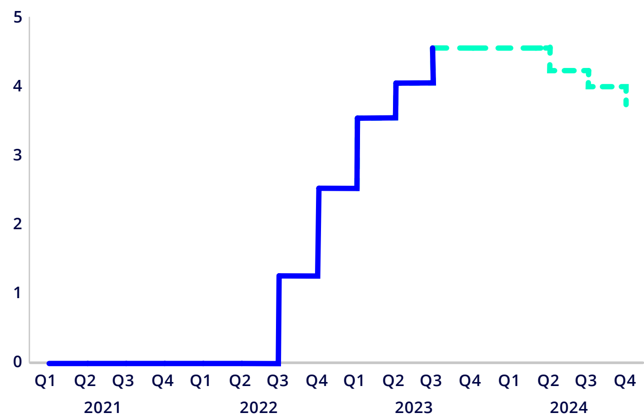
Activity in Ireland's key trading partners is weak but the outlook has improved a little as world economies navigate the higher interest rate environment. Revised data shows goods exports were healthy in Q1, up 12.3% year-on-year (though this is a slower pace than in recent quarters) while services exports were down 1.4%. This is largely due to idiosyncratic developments in the MNC sector and does not represent fundamental shifts in demand for Irish exports, evidenced by FDI continuing to flow in at a good clip. We expect exports will post solid growth of 4.5% this year and 6.0% in 2024, down from the unsustainable rates seen in the past number of years.



Number of Investments (first half of year)
Source: IDA

ECB close to the end

The ECB has acted aggressively to tackle inflation with the main refinancing rate now at 4.25%, a level not seen since 2008. Nevertheless, we can say with confidence that we are at or very close to the end of this hiking cycling, though the full impact on demand will be felt over the coming year and households and business will have to adjust to this 'higher for longer' rate environment. The next debate will be when the ECB will reverse course and cut rates, with the current expectation that this will not begin until closer to the summer of next year. For exporters, the euro's moves have been a headwind, having been on a relatively upward trend against the dollar since late '22 (when it fell below parity) and now trading at c.$1.11.



ECB Refi Rate (end of quarter, %)
Source: European Central Bank, Bloomberg

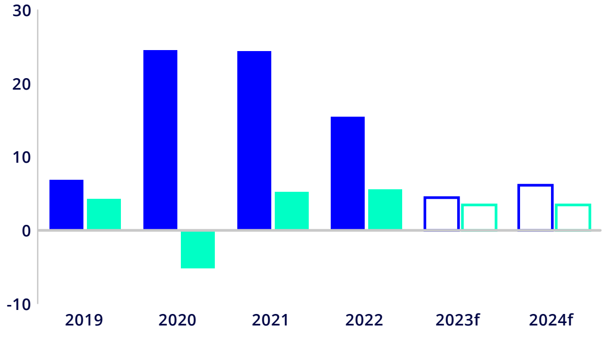
GDP

MNC's to contribute more modestly

Irish headline GDP is always impacted by activity in the multinational sector, usually with the result of boosting it beyond the underlying growth rate of the domestic economy. This will continue to be the case over the long-term, but, at the moment, volatility in the sector has pushed down on headline GDP while, in reality, the domestic economy is doing well and in line with our expectations. This is perhaps some payback for the supersized MNC's numbers we have gotten in recent years. All of this is somewhat moot, as we have not seen any evidence either in employment nor in FDI investment that there is any significant downward shift in the MNC sector and all of this may wash out in the coming quarters. We expect that MNC activity will contribute to growth in the years ahead and have pencilled in increases of 4.5% in 2023 and 6.2% in 2024.

Solid growth forecast

With domestic demand last year being revised up, this gives us a higher base going into 2023. Consumers and businesses are tackling the headwinds from cost of living issues, weak global growth and higher interest rates and activity is continuing to expand. We are revising up our expectations slightly for domestic sectors but this upward revision is outweighed by the negative impact of slower MNC activity with the overall result that GDP is now expected to come at 4% this year and 5% next year. Compared to our European peers, this is still very solid growth, particularly against the current sluggish global backdrop.



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

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

Forecasts	2022	2023(f)	2024(f)
Personal Consumption	9.4%	3.5%	3.5%
Government Consumption	3.5%	2.0%	3.0%
Total Investment	5.1%	0.0%	3.5%
Modified Investment	15.9%	2.0%	3.5%
Modified Domestic Demand	9.5%	3.0%	3.5%
Exports	13.9%	4.5%	6.0%
Imports	15.9%	2.2%	5.3%
GDP	9.4%	4.0%	5.0%
GNP	3.9%	3.0%	4.0%
Domestic Sector GVA	5.6%	3.5%	3.5%
Multinational Sector GVA	15.6%	4.5%	6.2%
Employment	6.6%	3.3%	1.7%
Unemployment Rate (Average)	4.5%	4.0%	4.0%
CPI	7.8%	6.5%	3.5%

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