Ireland Outlook

October 2023

Economic Update

More moderate growth ahead

GDP surprised to the downside in Q2, increasing by just 0.5% quarter-on-quarter, meaning the economy barely grew in the first half of the year. Drilling down into the data shows that much of the weakness is due to developments in the multinational sector, with poor export performance holding back growth. The domestic side of the economy appears to be doing better, with modified domestic demand expanding by 1.0% quarter-on-quarter in Q2 and by 1.8% year-on-year in the first half. This was broadly in line with our expectations, albeit a touch lower on foot of somewhat weaker investment. Volatility in the multinational sector of the economy is not uncommon and in recent years, GDP has benefited from upside surprises. Our view is that the current slowdown is not structural or reflective of more serious problems, and given that employment (and FDI) continue to do well, exports should bounce back but the timing is not certain. Given the weak first half outturn, we have revised down our GDP forecast to 1% for this year (from 4% in our July Outlook) and to 4% next year (from 5%). We have also revised down our forecast for the domestic economy a touch, with modified domestic demand expected to grow by about 2% in 2023 and around 3% in 2024, from 3.0% and 3.5% respectively. Inflation is on a downward trajectory, as expected, and we are leaving our forecasts for CPI unchanged at 6.5% for this year and 3.5% next year, though the path of energy prices is an upside risk given the increase in oil prices since the start of the summer. Heightened geopolitical tensions, amid the ongoing war in Ukraine and the conflict in the Middle East, pose a downside risk to global growth, while higher for longer interest rates could dampen demand by more than expected.

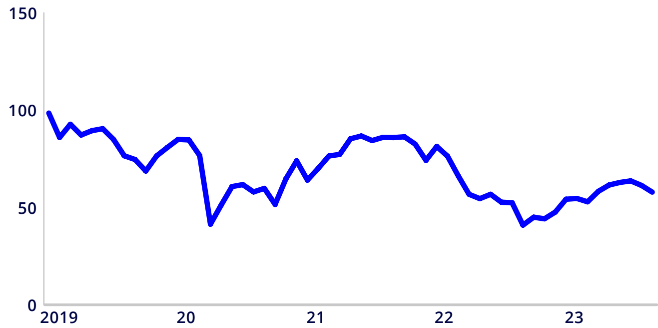
	2022	2023(f)	2024(f)
GDP	9.4%	1.0%	4.0%
Modified Domestic Demand	9.5%	2.0%	3.0%
Employment	6.6%	3.5%	1.5%
Unemployment	4.5%	4.3%	4.3%
CPI	7.8%	6.5%	3.5%

Bank of Ireland

Consumer

Spending held up

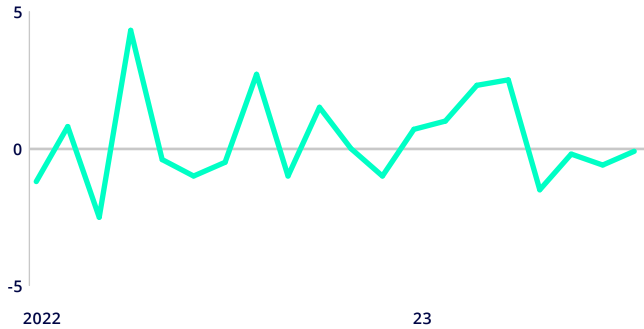
Despite the headwinds caused by higher inflation over the past couple of years, consumer spending has held up relatively well. Some drawdown of savings, a robust labour market and wage growth – though not enough to fully offset price rises – as well Government cost of living measures have supported spending which grew by 3.7% year-on-year in H1. However, the latest data suggest some softness is incoming, as retail sales up to August have fallen in month-on-month terms for four consecutive months while consumer confidence has also dipped recently albeit it is still off its late 2022 lows.



Consumer Sentiment (index)
Source: Credit Union

Slower spending ahead

With that in mind, we are tempering our expectations for household spending growth over the rest of the year. Following an unsustainable post-Covid surge with growth of over 9% in 2022, we expect a more modest increase of 3.3% for this year. Looking to next year, there remains headwinds for spending. Inflation, while easing, is cutting into real incomes and the higher interest rate environment will dampen demand. There will continue to be support from employment and earnings growth but we are pencilling in another modest increase in the region of 3 ¼ % next year also.

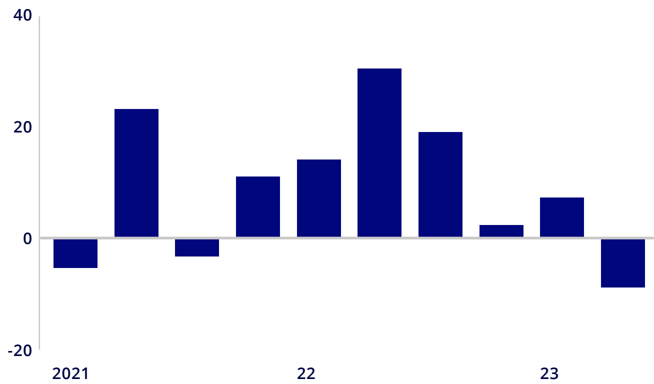


Retail Sales (monthly % change, volume)
Source: CSO

Business

Investment disappoints

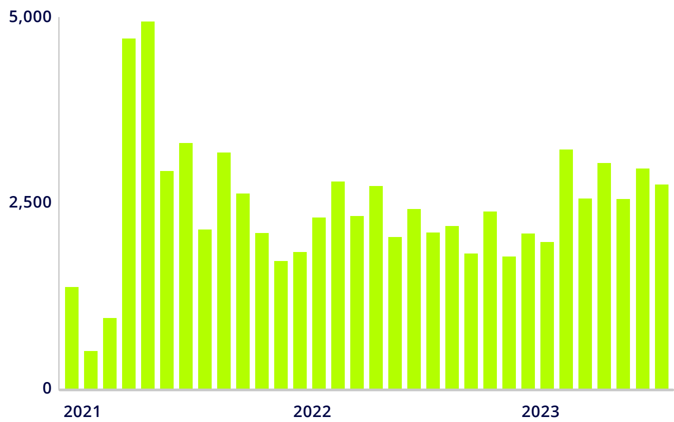
Investment disappointed in the first half of 2023, falling by 1.3% year-on-year. While volatility in the multinational sector does account for some of this, modified investment – which aims to exclude a lot of multinational activity – was also weak, dipping by 1.5% year-on-year. On the face of it, it appears that some 'other building' activity, such as in the commercial sector, might be easing while business investment is also weaker as firms adjust to the reality of not just the post-Covid economy but also increased prices and the 'new normal' of higher financing costs. Feeding that in, modified investment is likely not to do much better than a little above flat growth this year, but the expanding domestic economy should spur on modified investment next year, back to 1.0% growth.



Modified Investment (annual % change, constant prices)
Source: CSO

Completions to rise

On the residential construction front, completions have held up quite well in H1, coming in at just over 14,000 units. This was down on the second half of last year but, in context, given that building commencements data had indicated a slowdown it was a little better than expected. We think that completions are going to come in around 30,000 this year, about the same as 2022. The market is adjusting to higher building costs and a higher interest rate environment with affordability becoming more of a issue, particularly in larger urban areas. The mismatch between supply and demand remains a feature. Demand is driven by fundamentals – as evidenced by the recent 2023 population estimate which showed a near 2% (or almost 100,000 persons) increase – and with strong capital support from Government investment, our view is that completions will rise, to 32,000 near year. Housing commencements data seems to support this, and is up c.14% year-on-year for the first 8 months of the year.

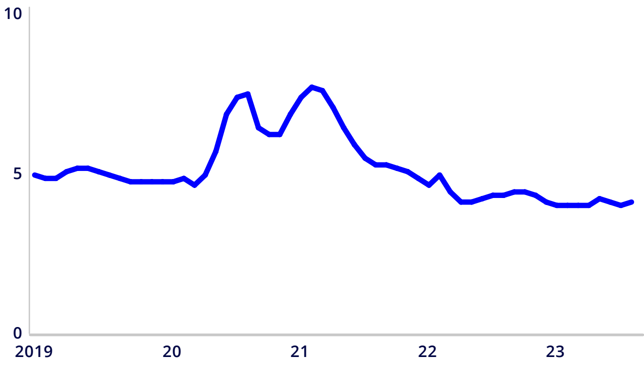


Housing Commencements (number of units)
Source: Department of Housing, Local Government and Heritage

Labour Market & Inflation

Tight labour market

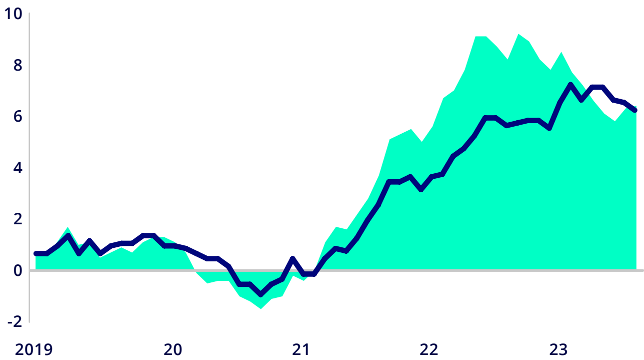
The strong performance of the labour market continued in Q2 with employment increasing by 3.5% year-on-year. A record 2.64 million people are now in work and the unemployment rate remains low, at just 4.2% in September. The pace of job gains is unsustainable and while we continue to expect the labour market to do well, we expect employment growth to moderate over the forecast horizon. It's not surprising that there are labour shortages in some sectors given how tight the market is, and despite high inward migration supporting labour force growth, we see this largely remaining the case with the unemployment rate averaging 4.3% this year and next. Wages growth remains modest, in the face of inflation pressures, with hourly earnings up by 5.1% year-on-year in Q2.



Source: CSO

Inflation to fall back

Inflation remains on a downward trend but recent data saw the headline CPI rate tick up to 6.3% in August (from 5.8% in July) and to 6.4% in September. The driver of this is largely liquid fuels – on the forecourt and for home heating – due to the increase in oil prices over the summer. While the future path of energy prices is a concern, the headline rate should fall back again as energy companies pass on reductions – from falls in wholesale gas prices - in the coming quarters. Core inflation is easing with CPI excluding energy falling to 6.2% in September from 6.5% in August. As drivers of inflation have been broad-based for some time, it's encouraging to see core inflation start to come back and with higher interest rates cutting into demand we are forecasting that inflation will slow further next year, averaging 3.5% down from an average of 6.5% this year.

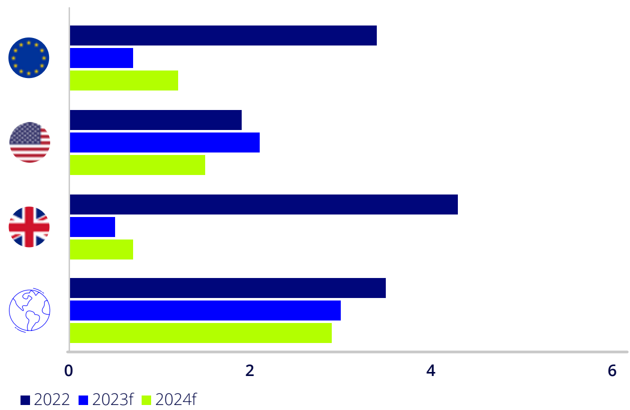


Source: CSO

External Environment & Markets

Rising global risks

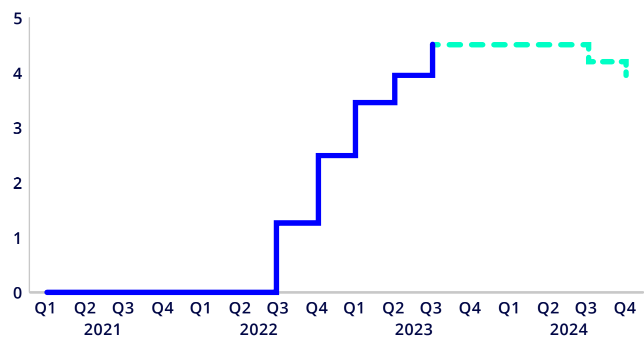
Downside risks to the outlook for the global economy having been rising of late. The ongoing war in the Ukraine and major escalation of conflict in the Middle East all threaten global prosperity. Added to that, the OPEC+ decision to continue to restrict oil production has sent fuel prices higher and is a threat to already elevated inflation around the world. For a small open economy like Ireland, this should all spell bad news for exports, which have been weak in the first half of the year. However, as our export mix of, amongst other things, high tech services and manufacturing, pharmaceuticals and medical and also food products, is resistant to lower demand in the global economy, this points to the poor performance of exports recently being down to one-off and multinational specific factors. This might be related to adjustment to the post-Covid landscape and exports should bounce back next year to somewhere like 5% growth after a subdued 1.5% increase this year.



Source: Eurostat, BEA, ONS
Forecasts: IMF October 2023 (UK: Bank of Ireland October 2023)

ECB in 'higher for longer' mode

The ECB raised rates again, by 25 basis points, in September taking the main refinancing rate to a 20-year high of 4.5%. The ECB may be done for the time being as the language post the meeting that rates "have reached levels that, maintained for a sufficiently long duration, will make a substantial contribution to the timely return of inflation to our target" suggests, at the very least, a pause in rate hikes or even an outright cessation. The ECB will be closely watching the path of core inflation in the Euro Area which fell to 4.5% in September from a high of 5.7% last March, but has some way to go still before it is at a level consistent with ECB inflation targets. For households and businesses, there will still be some further passthrough of previous hikes in the coming quarters which will dampen demand.



Source: European Central Bank, Bloomberg

Forecasts	2022	2023(f)	2024(f)
Personal Consumption	9.4%	3.3%	3.3%
Government Consumption	3.5%	1.5%	3.0%
Total Investment	5.1%	-8.0%	0.0%
Modified Investment	15.9%	0.5%	1.0%
Modified Domestic Demand	9.5%	2.0%	3.0%
Exports	13.9%	1.5%	5.0%
Imports	15.9%	0.5%	3.6%
GDP	9.4%	1.0%	4.0%
GNP	3.9%	0.0%	3.0%
Domestic Sector GVA	5.6%	4.0%	3.3%
Multinational Sector GVA	15.6%	-1.5%	4.6%
Employment	6.6%	3.5%	1.5%
Unemployment Rate (Average)	4.5%	4.3%	4.3%
CPI	7.8%	6.5%	3.5%

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