Ireland Outlook

February 2024

Economic Update

Bank of Ireland

Domestic economy growing despite headline GDP fall

We are revising down our forecast for Irish GDP growth to 1.5% this year following a very poor GDP performance in 2023 where the economy contracted by 1.9%. This contraction is down to specific issues in the multinational export sector which are likely to have largely played out and should not impact too much in 2024. These issues do not reflect a long term trend and don't tell us anything about Ireland's continuing attractiveness as a destination for FDI. We still expect solid activity in the indigenous sector where expansions in employment and domestic demand in 2023 should continue in 2024.

2023 was an unusual year for the Irish economy where, following years of outsized GDP growth driven by the multinational sector, we saw a reversal of fortune where distortionary factors caused falls in industrial production, investment, exports and headline GDP but the domestic economy continued to grow. This is some payback for rapid growth in previous years and reflects the significant impact of the multinational sector on the Irish economy. In reality, the economy continued a steady rebound last year. We think that consumer spending (+3.3%) employment (+3.8%) and modified domestic demand (+0.7%) all pushed on, and when we take out transport equipment, such as planes which are not produced here, we see machinery and equipment investment also improved last year.

Looking ahead, the impact of the fall in GDP last year will impact a little on 2024 but GDP growth will pick up, back to 1.5%. The issues in the multinational sector do not, in our view, reflect a change in direction for these companies and are short term and sector specific and exports should return to growth, albeit somewhat more modest than we have seen in past years. With inflation falling back and real incomes growing, employment (+1.6%) and consumer spending (+2.9%) should continue to expand while continued house building should underpin domestic investment growth contributing to a solid rise of 2.3% in modified demand. Risks to the outlook, as always, abound with the path of interest rates and increased geopolitical uncertainty – including an acrimonious US presidential election, flaring conflict in the Middle East and the ongoing situation in the Ukraine – key short term external risks. Over the longer term the risks are closer to home with Ireland pushing up against capacity constraints which will hold back growth and continued investment in areas just as housing, infrastructure and climate action are needed to futureproof the economy.

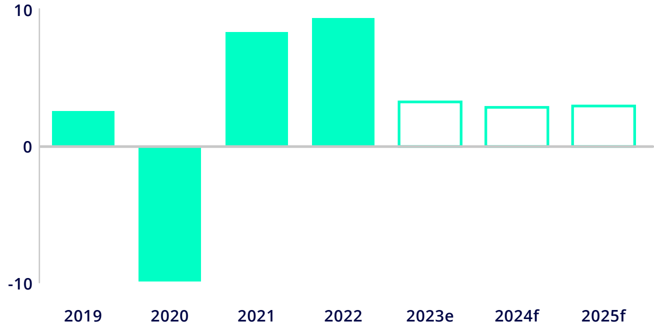
	2023(e)	2024(f)	2025(f)
Personal Consumption	3.3%	2.9%	3.0%
Government Consumption	0.5%	2.5%	2.2%
Total Investment	-12.5%	1.0%	2.0%
Modified Investment	-5.6%	0.3%	3.5%
Modified Domestic Demand	0.7%	2.3%	3.0%
Exports	-4.0%	3.0%	5.0%
Imports	-5.1%	2.8%	4.0%
GDP	-1.9%	1.5%	4.0%
GNP	5.0%	1.5%	3.0%
Employment	3.8%	1.6%	1.5%
Unemployment Rate (Average)	4.3%	4.5%	4.5%
CPI	6.3%	2.5%	2.0%

Resilient consumer spending

Despite being beset on all sides by cost of living issues during 2023, the consumer has been the relative bulwark of the economy with steady growth in the first three quarters of the year, expanding by 3.6% year-on-year. This is more modest then the outsized Covid related bounce back of a 9.4% increase in spending during 2022 but it reflects the squeeze that higher inflation and interest rates did put on households last year. Strong job creation and fiscal supports helped to offset those headwinds somewhat in 2023 while the tax cuts in Budget 2024 should lend support in the coming year. Spending on services remains the better performer with faster growth here than in the goods side of spending which lags behind.

With inflation easing back, consumer sentiment has moved up in the past few months, reaching a 23 month high of 74.2 in January. Spending this year should be assisted by higher real incomes - with wage increases likely outpacing a more modest rate of inflation – while continued employment growth should also help. However, there is a risk from the much higher interest rate environment that households now find themselves in, particularly those who are coming off fixed rates to refinance mortgages this year, and this will dampen spending somewhat. With consumer spending growth of around 3.3% pencilled in for last year, we see growth of around 3.0% both this year and next.

Consumer Confidence (index)
Source: Irish League of Credit Unions

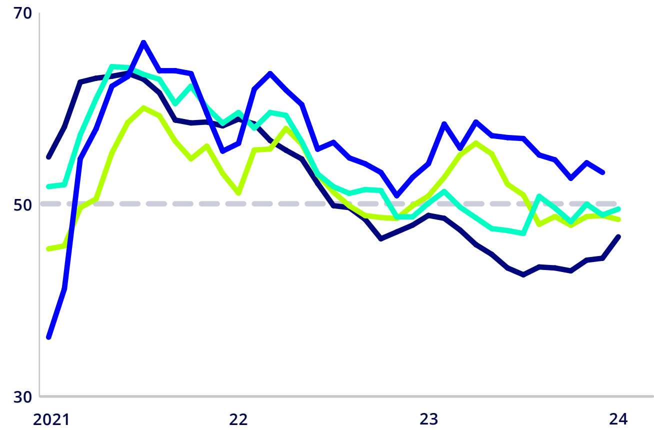


Consumer Spending (annual % change, constant prices)
Source: CSO & Bank of Ireland

Underlying investment position shows growth

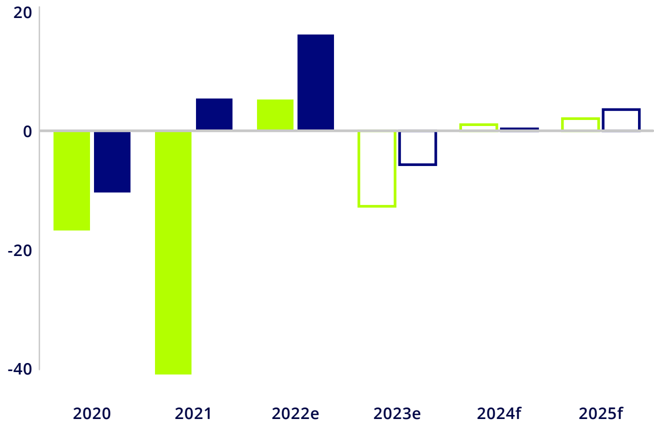
Headline investment can be extremely volatile, heavily influenced by intangibles spending by multinationals, and last year was no exception where lower intangibles investment led to a sharp contraction. Machinery and equipment spending was also weaker at a headline level but again this was largely down one-off factors such as plane investment - which is related to a small number of companies. If we take transport equipment out, we see that machinery and equipment spending rose by 1.2% in the first quarters of the year meaning businesses are keeping up quite robust levels of spending in this area. Irish businesses are more confident than some about the outlook as the PMIs have remained relatively robust, particularly compared to other countries in Europe. Services, is doing especially well and came in 53.2 in December 2023 and has averaged well above 50 all year while manufacturing, not surprisingly given the issues in goods exports, is weaker but is still up around, but just below, the 50 level. The fact that Irish PMIs are performing better than our European peers should not be surprising given the counter cyclical nature of our export mix (agri-food, ICT, medical and pharmaceuticals). The other good news for investment is that FDI continues to flow in and the IDA announced another 248 investments in 2023 with Ireland continuing to attract high value and high tech services and manufacturing names.

On the other side of investment, construction continues to improve. Housing supply has picked up further in the face of continued very strong demand with 32,695 completions in 2023, an increase of 10% from 2022. Starts data indicates that this number should improve again this year which bodes well for an economy desperate for more housing. There is also a host of public funding infrastructure projects to support building activity with the only real weak spot being commercial building which probably slowed again in 2023 as the sector adjusts to the post-Covid landscape. All in all, investment should bounce back this year and we are forecasting small gains in both headline investment and modified investment in 2024 which will strengthen to 2% and 3.5% increases respectively in 2025.



Ireland Services PMI · Ireland Manufacturing PMI · Euro Area Services PMI · Expansion/Contraction · Euro Area Manufacturing PMI

Source: Markit/Bloomberg

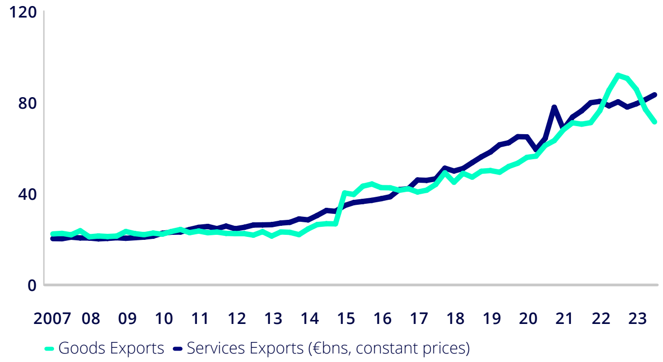


Investment · Modified Investment (annual % change, constant prices)
Source: CSO & Bank of Ireland

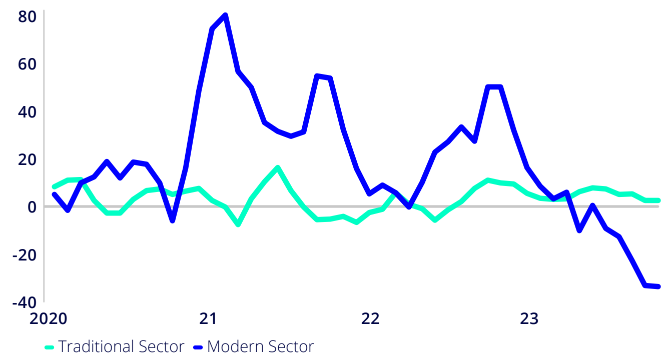
Exports turn negative

Exports have been the driver of the exceptional growth Ireland has seen over the past number of years, though a large chunk of this was down to contract manufacturing in a small number of companies rather then truly reflective of the strength of the export sector as a whole. The outsized influence has turned around this year and is negatively impacting with export growth falling from 13.9% in 2022 to average -2.9% in the first three quarters of 2023. While some of this weakness is down to some restructuring in pharmaceutical and ICT sectors in a post Covid landscape, the evidence is that the bulk of the change in circumstances is restricted to export of high tech goods, with goods exports down 7.4% in the first three quarters of the year while services exports are up 2.1%.

We are not particularly concerned about the sharp drop in exports this year as we think it's due to some sector specific and one off factors that will run their course. From industrial production data we can see that the downturn in modern (high tech) sector extended into the end of 2023 which indicates that goods exports activity could be poor into the start of 2024. However, on a brighter note, traditional manufacturing which includes many indigenous exporters was up nearly 5% in the first eleven months of the year. This reinforces the view the temporary factors impacting exports are restricted to potentially a small number of MNC's. Ireland has a diverse export mix that is somewhat resistant to fluctuations in the global economy and we see Ireland overcoming its struggles in the export sector as the year progresses with positive export growth penciled in for this year and next.



Source: CSO

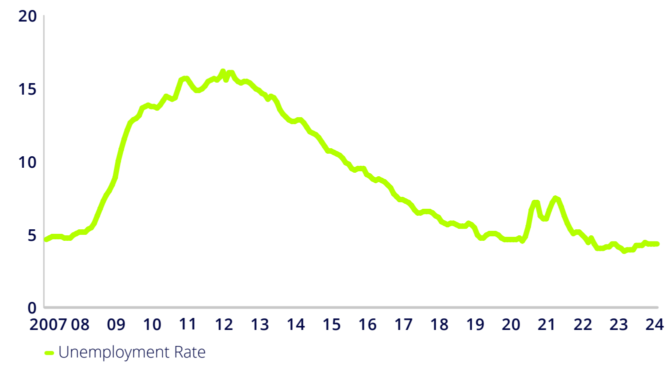


Industrial Production (annual % change, 3 month moving average)
Source: CSO

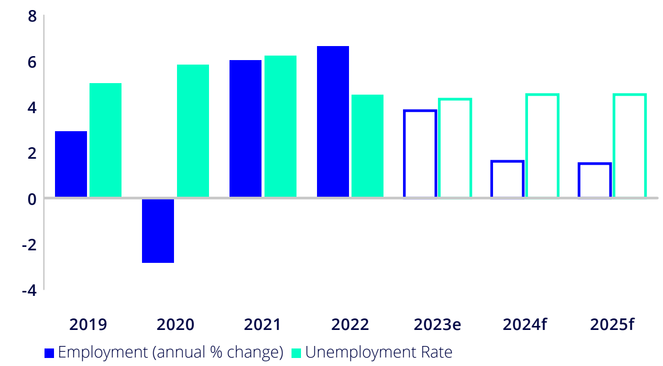
Exceptional job creation

Once again, the labour market has performed strongly over the past year with employment rising by 3.8% in the first three quarters of the year, or close to 100,000 new jobs. This means that Ireland is at record employment, some 2.66m, which is c.13% or close to 300,000 extra employment over pre-pandemic levels, a performance other countries would envy. This rapid pace of job creation that continued unabashed during 2023 is at odds with the fall in headline GDP and suggests there is continued increased activity in the real economy. These substantial employment gains have been facilitated by strong labour force growth in the period, supported by demographic factors - the participation rate is a 15-year high - and robust inward migration.

Unemployment remains at low levels though it has picked up of late. The seasonally adjusted rate stood at 4.5% in January 2024, up from a low of 4.0% in February of last year. This increase has been driven by growth in the labour force rather then weakness in employment growth. In fact, while further jobs growth is in the offing it's likely to be constrained by labour shortages as the current pace of increase in the labour force is probably unsustainable. We see employment growth slowing from 3.6% last year to around 1 ½ % in each of the next two years with labour force growth easing back to 1.8% this year and 1.5% next year with the labour market supported by participation staying around its current level of 65%. Risks to this outlook would be further corrections in the ICT and/or other multinational sectors, or a slowdown in the domestic economy but in the round, the outlook is for slower growth but more stability in the labour market and the unemployment rate remaining around 4.5% over the forecast horizon.



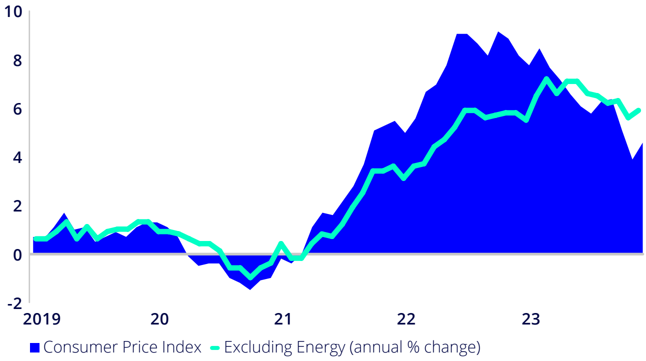
Source: CSO



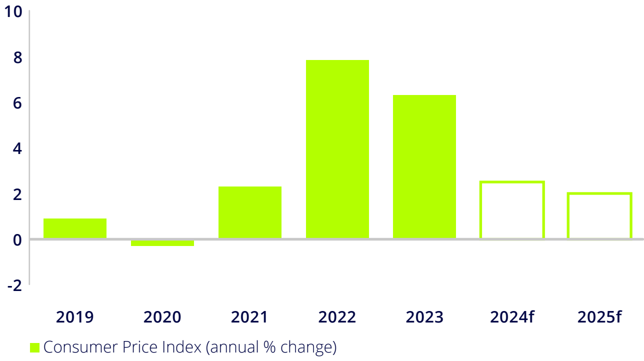
Source: CSO & Bank of Ireland

Inflation to further ease

The rate of inflation has finally eased back lifting some of the burden from consumers and businesses. As measured by the CPI, the annual rate of increase slowed to 4.6% in December 2023 from 8.2% in the same month of 2022. The composition of inflation has changed however as second round effects now mean core inflation (ex energy components) is now running higher (5.9%) in December than headline inflation with the changes in energy prices now helping to keep inflation down rather than up. Policy makers would like to see core inflation come back further over the next year as evidence that the monetary policy response has worked to dampen demand. As a small export oriented economy, Ireland has to keep a close eye on the competitiveness impact of sustained price level impacts particularly if inflation falls back faster elsewhere than compared to Ireland. While wage increases may compensate workers for previous inflation – nominal wages should grow faster than CPI this year – we need to remain mindful that such increases should be accompanied by productivity gains, particularly in the indigenous sector though less of an issue of the multinational sector, which has seen massive productivity boosts in recent years. We do see the path of inflation falling further, helped by domestic energy providers cutting prices and combined with the ongoing impact from an aggressive interest rate hiking cycle. CPI is forecast to average 2.5% this year, down from 6.3% last year, and to 2.0% next year.



Source: CSO

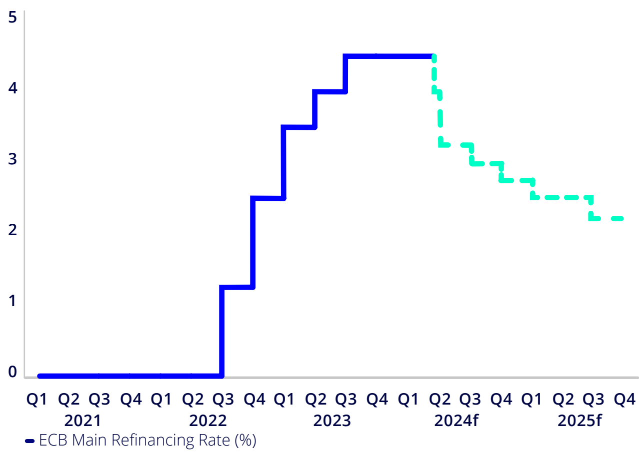


Source: CSO & Bank of Ireland

Rate cycle to turn with cuts incoming

There has been a significant change in market expectations for interest rates since our last outlook in October. Central banks globally had hiked rates dramatically in response to inflation over the past two years but these hikes appeared to have been paused by the end of the summer of 2023 as inflation rates fell back. At the same time, central banks were cautioning that we were in a 'higher for longer' period of rates until they could be sure that elevated inflation had been banished for good. However, the decline in inflation over the second half of last year was sharper than policy makers had anticipated and with forecasts also showing sluggish growth in the major economies - not least in the Euro area – that prompted the markets to price in rate cuts beginning in the second quarter of this year. For their part, the ECB remains on hold for now with President Lagarde urging caution on interest rate cuts in the near term while still acknowledging monetary easing is likely to happen this year, perhaps 'in the summer'. The current pricing has the ECB cutting by around 125-150bps during 2024, going someway to reversing the 450bps of increases seen since the hiking cycle began. This should help in some way to support spending and investment in Ireland and the rest of the Euro area at the back end of 2024 and during 2025. However, consumers and businesses alike will have to get used to paying for credit as the era of close to zero rates we experienced during the 2010's is surely consigned to history and we don't foresee a situation where the ECB has to cut rates to dramatically low levels.

For Irish exporters, the euro has been in a relatively stable trading range against both the dollar and sterling during much of 2023. We still hold the view that the dollar will gradually weaken against the euro this year with the single currency heading back towards the $1.15-$1.20 range during this year which would better reflect the purchasing power of the two currencies. This should help indigenous Irish exporters selling into the US and, as for those selling to the UK, we don't foresee too much change in the euro/sterling cross. A caveat to any market forecast this year is that we are heading into elections in many countries, including the UK and US, and that has the potential to bring increased market volatility during 2024 – particularly given the US presidential election looks set to be a divisive rematch between President Biden and Donald Trump.



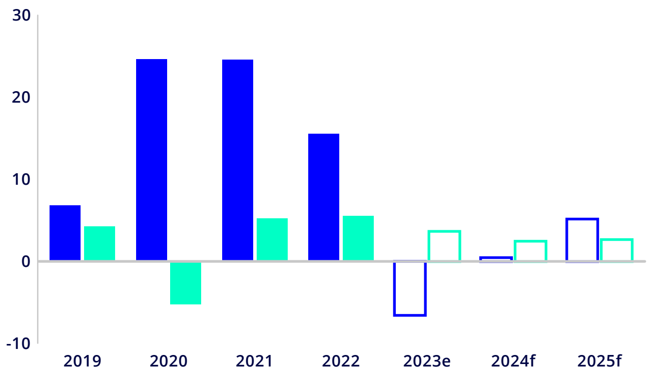
Source: ECB & Bloomberg

Source: Bloomberg

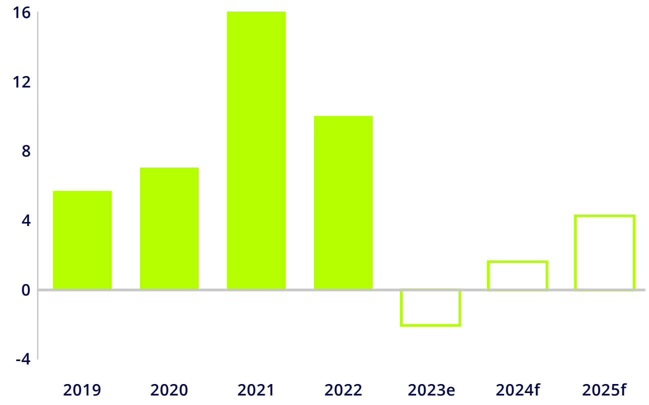
Positive GDP growth to return in 2024

Headline Irish GDP is often influenced, mostly positively, by activity in the multinational sector and despite the blip in fortunes last year, the outlook for the sector remains healthy with recovery likely during this year and into 2025, particularly as foreign direct investment in the pipeline does not appear to have slowed and that will further add to output capacity. The well discussed retraction in ICT appears only to have affected Ireland around the margins and we can see from services export growth and employment in the sector that it remains in a robust position, although issues on the high tech manufacturing side is hampering goods exports growth, at least for now. Pharmaceutical companies were also likely to have to reorganise and retool post COVID – and this also appears to have impacted exports this year – but any slowdown here is likely to be very temporary as Ireland remains a world leading destination for medical/chemical/pharmaceutical companies. Modest global growth is not a huge dampener given the Irish export mix and we are forecasting the MNC sector to bounce back from a contraction of 6.6% in 2023 to 0.5% growth in 2024 and 5.2% in 2025. In the domestic sectors, slower but steady growth is the forecast, with the consumer contributing and investment, supported by continued home building, also chipping in and we see the indigenous sector expanding by about 2 ½ % in 2024 and 2025.

As for risks to the outlook while the shorter term ones such as the path of interest rates and geopolitical instability are external in nature we also see considerable internal risks over the longer term. Bottlenecks in housing, infrastructure and in the labour market will act as a constraint on growth sooner rather than later unless they are addressed. However, this is easier said than done with a great many competing areas for investment. Demand continues to outstrip supply in areas like housing while public investment continues to play catchup where employment and population growth are beating forecasts leading to further pressure on existing infrastructure. Added to that is climate action which will require massive investment over the next generation to pivot the economy to a more sustainable future.



Foreign-Owned Multinational Dominated Sectors Other (annual % change, constant prices)
Source: CSO & Bank of Ireland



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

Forecasts	2023(e)	2024(f)	2025(f)
Personal Consumption	3.3%	2.9%	3.0%
Government Consumption	0.5%	2.5%	2.2%
Total Investment	-12.5%	1.0%	2.0%
Modified Investment	-5.6%	0.3%	3.5%
Modified Domestic Demand	0.7%	2.3%	3.0%
Exports	-4.0%	3.0%	5.0%
Imports	-5.1%	2.8%	4.0%
GDP	-1.9%	1.5%	4.0%
GNP	5.0%	1.5%	3.0%
Employment	3.8%	1.6%	1.5%
Unemployment Rate (Average)	4.3%	4.5%	4.5%
CPI	6.3%	2.5%	2.0%

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