

# Lunch Bites @ the IoD with Professor Alan Barrett

## Chief Executive Officer, Economic and Social Research Institute (ESRI)

Lunch Bites @ the IoD: Sponsored by IQ-EQ



@IoDIreland @IQEQ\_Group #IoDEvents

# Economic Commentary and Budget Analysis– Autumn 2022

DATE

October 13 2022

Presentation by  
Alan Barrett based on  
research conducted by my  
colleagues in the ESRI's  
Macroeconomics and Tax,  
Welfare and Pensions  
programmes



# Overview

- Despite significant global challenges, Irish economy set to register positive growth in 2022 and 2023.
- However, we revised down the outlook for 2023.
- Factors contributing on the positive side:
  - Rapid recovery in the labour market;
  - Export activity amongst ICT and pharmaceuticals largely unaffected by global conditions;
  - Strong investment activity on non-construction activity;
  - Continued increase in taxation receipts
- But challenges

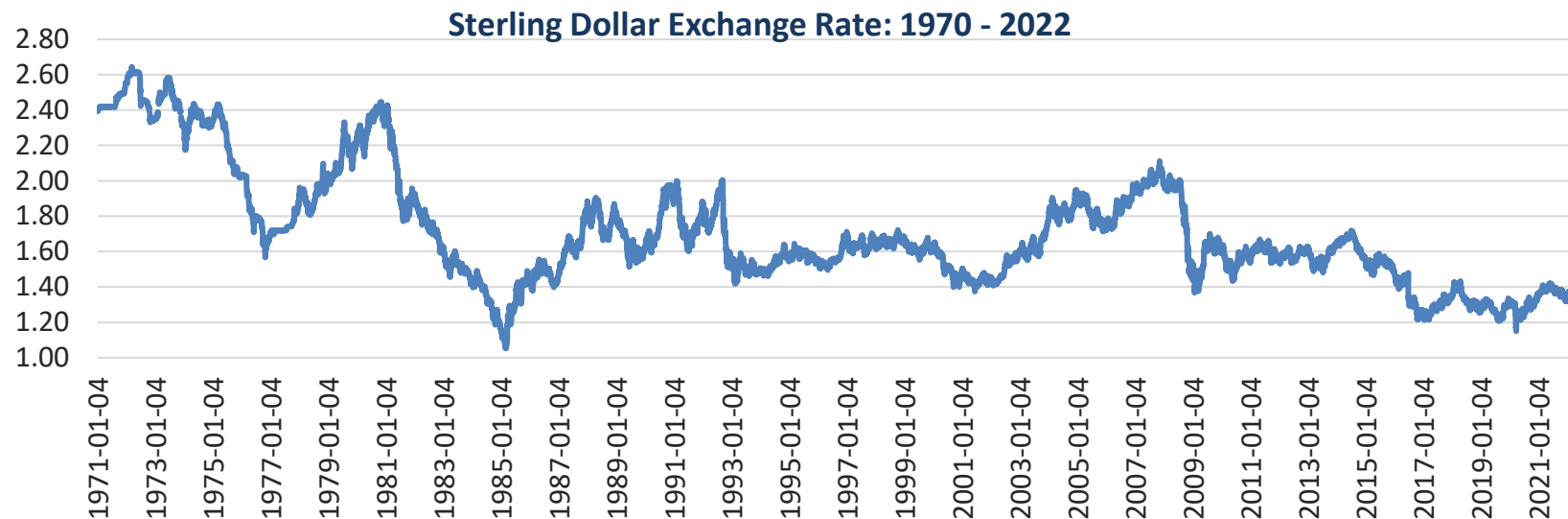
| Forecast    |      |     |
|-------------|------|-----|
|             | GDP  | MDD |
| <b>2021</b> | 13.6 | 5.8 |
| <b>2022</b> | 8.1  | 7.5 |
| <b>2023</b> | 4.4  | 2.5 |

# Risks to Growth

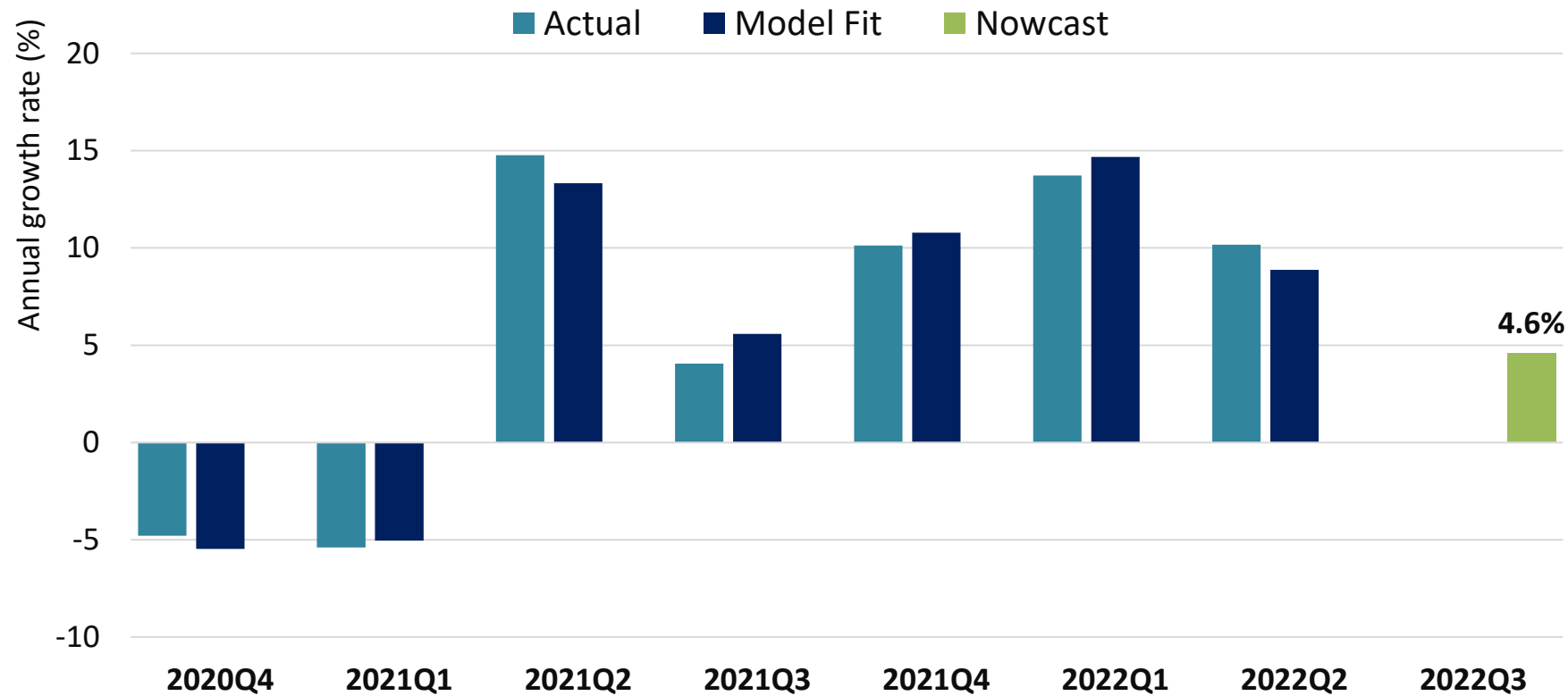
- Inflationary pressures and supply chain bottlenecks continue
  - Prior to the Russian invasion of Ukraine, inflation was related to a demand surge and constrained supply, supply chain bottle-necks; inflation then viewed then as a temporary problem but not now
- Energy markets severely strained
  - Price and availability concerns
- Slowdowns in global economic activity
  - Inflation would be expected to lead to consumption and investment curtailment
- Monetary response to inflation
  - If economies didn't slow themselves, central banks will do this anyway, in an effort to curb inflation

# Risks: Deteriorating outlook in the UK

- Market reaction to the “fiscal event” on 23<sup>rd</sup> September very adverse:
  - Significant increase in borrowing
  - Impact of tax cuts on inflation
  - Debt sustainability over the medium-term?
  - Side-lining the OBR
  - Capacity of UK economy to grow
  - Markets bidding in increases in UK interest rate

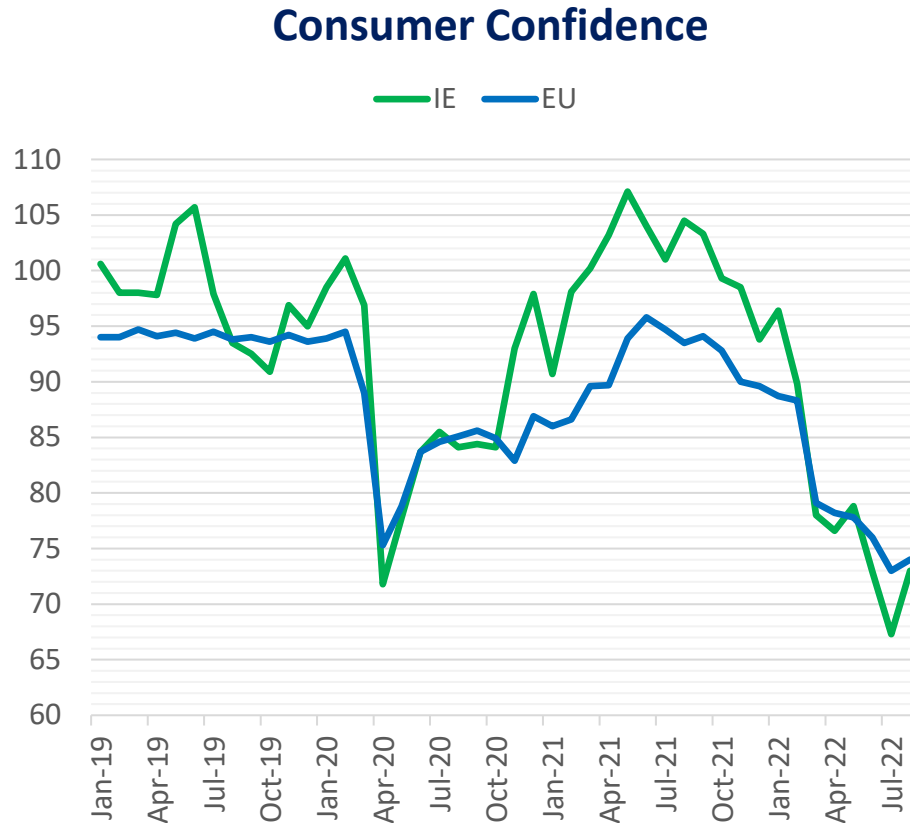


# Nowcast of Modified Domestic Demand



- Modified domestic demand rebounded significantly in Q1 2022 and is expected to continue growing at a moderate pace.
- The significant growth in modified investment is driving much of the growth in MDD.

# Global uncertainty and rising costs impact consumption activity

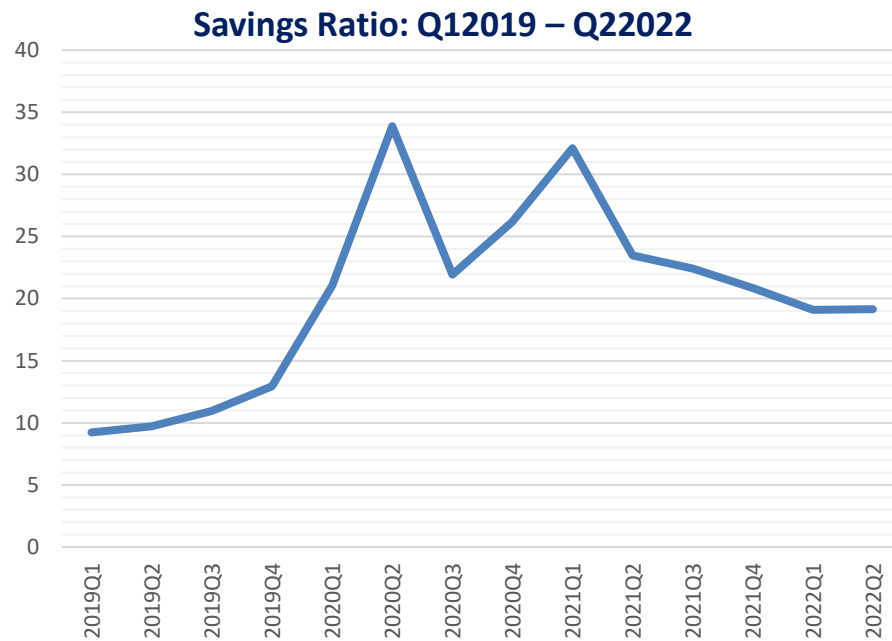


Source: European Commission

- Global uncertainty and inflationary pressures are impacting consumer confidence in both the EU and Ireland
- Consumer confidence has fallen significantly since the start of the year
- Retail sales and expenditure on credit and debit cards has declined in recent months, indicating that depressed sentiment is being reflected in consumption patterns.

# Savings and consumption expectations in Ireland

| Forecast |      |      |
|----------|------|------|
| 2021     | 2022 | 2023 |
| 4.6      | 3.2  | 2.5  |



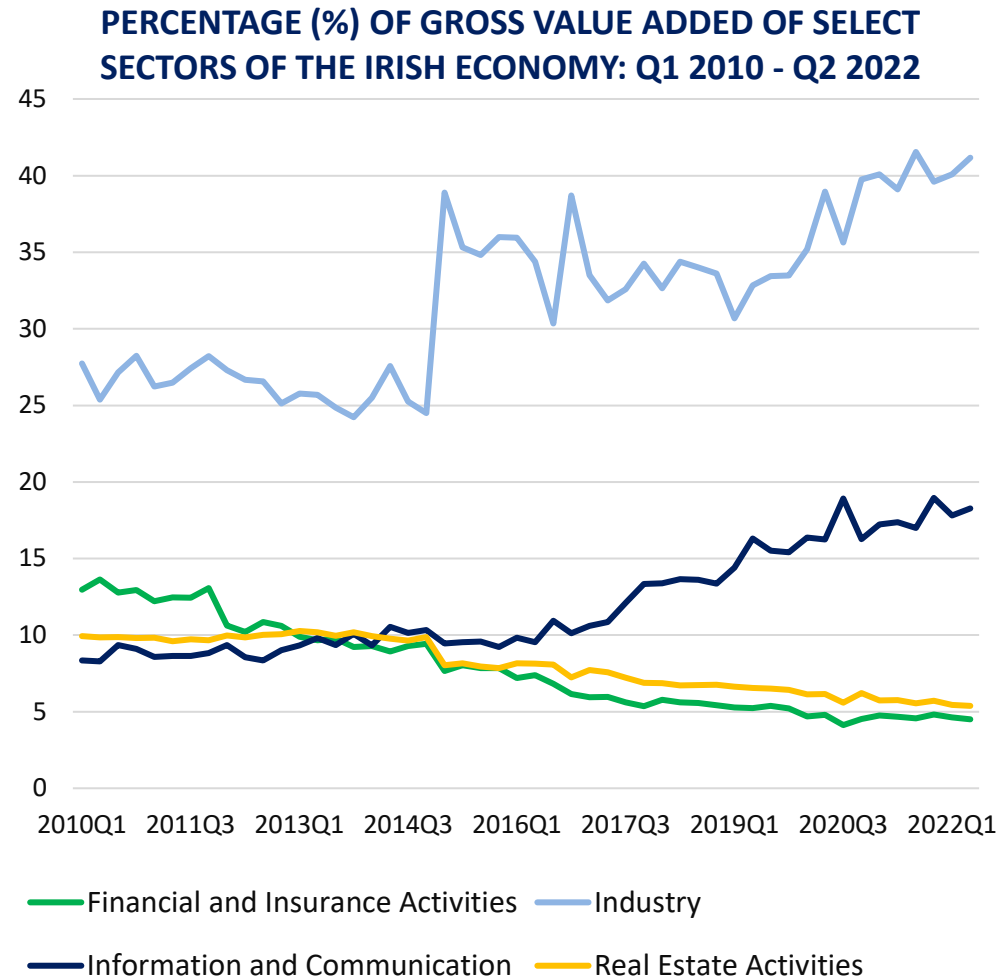
- Developments in the savings ratio will be a key determinant of consumption in 2022 and 2023.
- The savings ratio in Ireland remains high on a historical and cross-country basis.
- High earners might increase precautionary savings due to higher living costs but other households facing financial strain will likely use savings (or borrowing) to withstand higher costs.

Source: Central Statistics Office.



# The growing role of ICT and Industry

- Industry and ICT now account for over 40 and 18 per cent of total value added in the Irish economy.
- The significant increase in the Industry category since 2015 relates to the large movement of IP into the Irish economy.
- **Both sectors have also experienced significant increases in employment since 2019.**
- These sectors are main drivers of recent export growth in the Irish economy and therefore will have a strong effect should a significant correction in either sector occur.



# Trade: export activity

- Strong export activity continues to drive economic growth.
- ICT and pharmaceutical-related sectors of the economy have accounted for an increasingly large share of value added in the Irish economy and of export activity.
- ICT and pharmaceutical-related exports are dominating much of the growth in the value of exports. In Q2 2022:
  - medicinal/pharmaceutical products **↑40.9%** y-on-y
  - organic chemicals **↑31.4%** y-on-y
  - computer services **↑16.1%** y-on-y

## Trade: slowing global activity

- The expectation for sluggish global activity, ongoing supply chain disruptions, and uncertainty related to the trajectory of the war in Ukraine and the impact on energy markets will likely lead to a moderation in trade activity in 2023.

| Forecast |         |         |
|----------|---------|---------|
|          | Exports | Imports |
| 2021     | 14.1    | -8.3    |
| 2022     | 10.5    | 9.0     |
| 2023     | 6.2     | 6.4     |

# Labour Market: a rapid recovery

- The labour market has recovered rapidly from the pandemic; the unemployment rate in August 2022 was 4.3 per cent, below its pre-pandemic rate in February 2020.
- In Q2 2022, participation rates increased across all age groups compared to their pre-pandemic equivalent.
- By 2023, we expect the Irish economy to be operating at full employment with the unemployment rate set to be 4.1 per cent
- Upward pressure on wages likely as demand outstrips supply in the labour market.

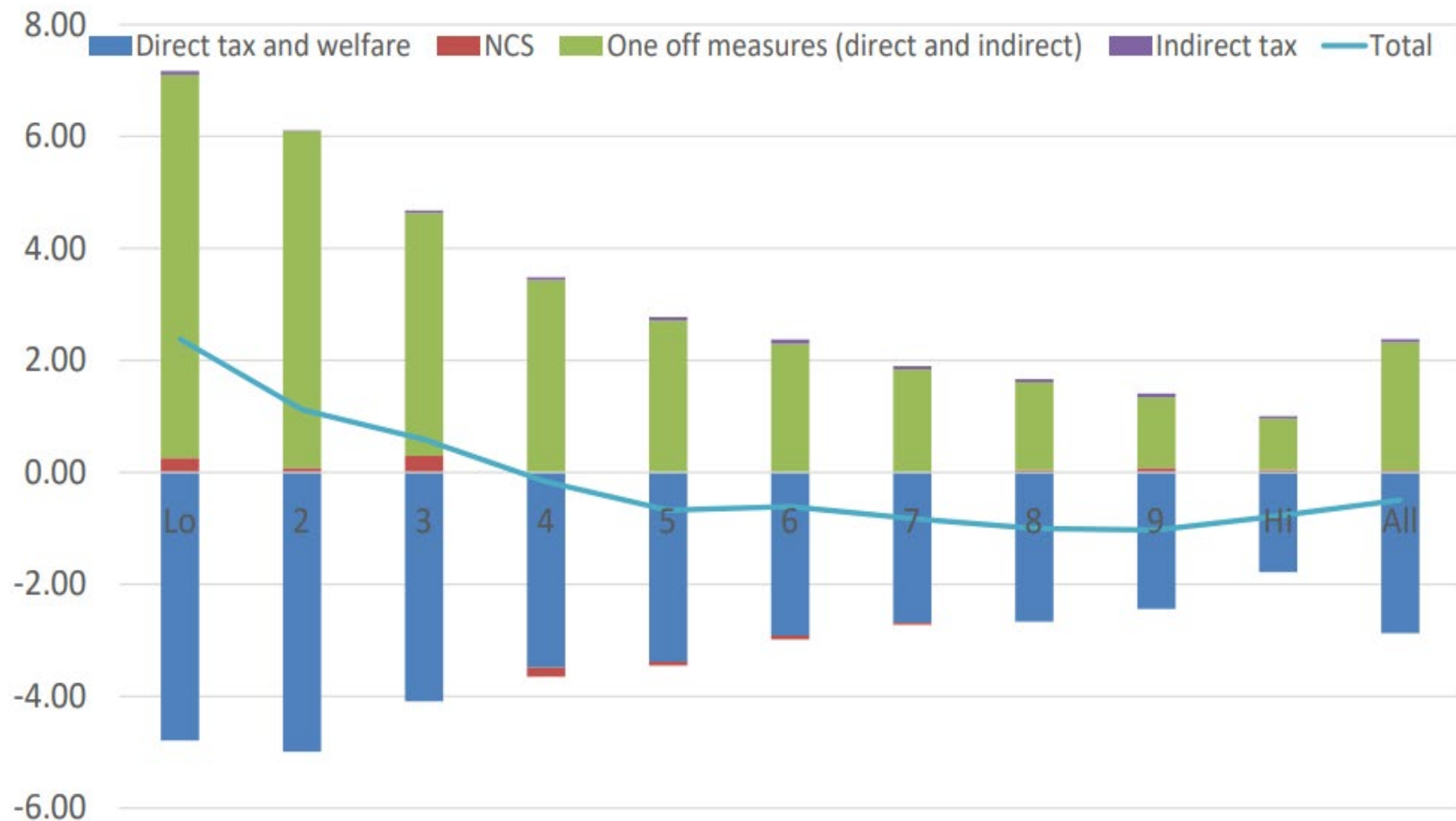
| Unemployment Rate |      |
|-------------------|------|
| 2021              | 16.1 |
| 2022              | 4.8  |
| 2023              | 4.1  |

*Note:* The unemployment rate through February 2022 is based on the COVID-adjusted monthly unemployment series published by the CSO.

# Budget 2023

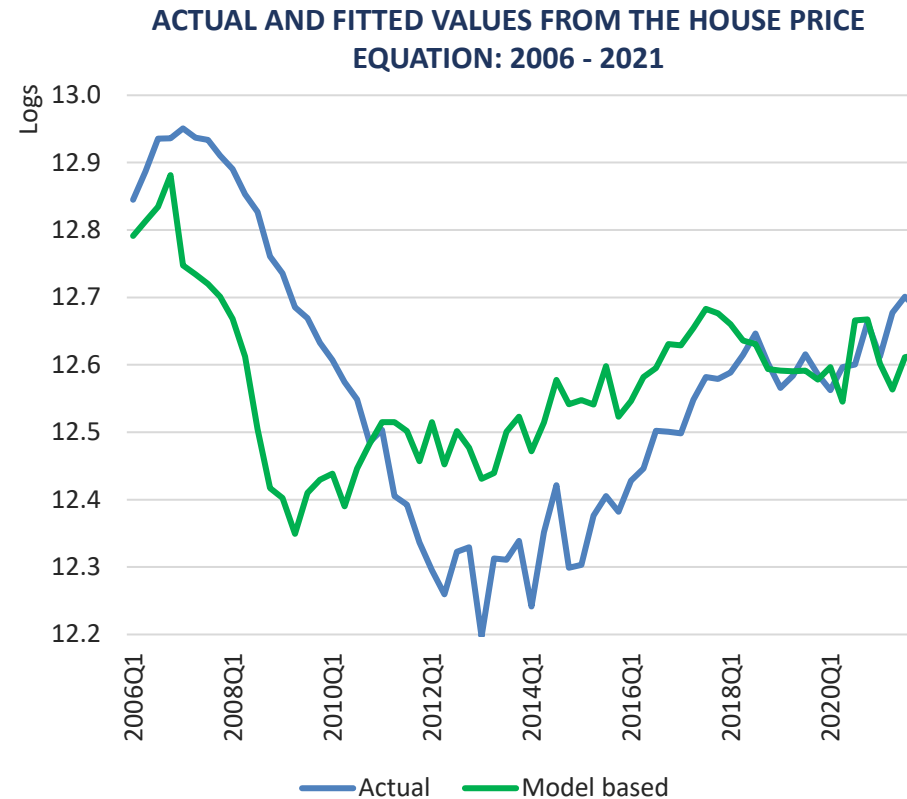
- The overall context:
  - Huge challenges, in terms of the need to offset the effects of the cost-of-living crisis
  - Very strong tax revenue, but with a big health warning (corporation profits tax revenue)
- A very clever balance achieved, albeit in the short term
- A picture to explain

# But one-off policies have provided substantial income support



# Dis-Equilibrium in the Irish housing market?

- Using a long-run economic model of house prices, we find a significant under-valuation of the Irish housing market between 2011 and 2018; however, evidence of over-valuation is present since the pandemic.
- The model suggests Irish house prices have recently been over valued by 7 per cent.



# Assessment

- The deteriorating geo-political situation has exacerbated pre-existing **inflationary pressures**, it has also given rise to concerns about **energy security** with the prospect of energy rationing across the European Union
- As inflationary pressures have become more broadly based, we now expect inflation to be higher than previously forecast, averaging **8.1 per cent in 2022** and decreasing to **6.8 per cent in 2023**.
- There will likely be scope in 2023 for the **Government to assist those most affected by increases in the cost of living**. However, these policies must be targeted in order to avoid generating inflationary pressures themselves.
- Despite downward revisions of global output, the domestic economy is still expected to grow, particularly as the **ICT and pharmaceutical** sectors remain largely unaffected by global slowdowns.
- For 2023, we expect global slowdowns to moderate growth in Ireland; we now forecast GDP and MDD to increase **4.4 per cent and 2.5 per cent**, respectively.



# Lunch Bites @ the IoD with Professor Alan Barrett

## Chief Executive Officer, Economic and Social Research Institute (ESRI)

Lunch Bites @ the IoD: Sponsored by IQ-EQ



@IoDIreland @IQEQ\_Group #IoDEvents