Reasons for concern or a soft landing?

Growing at a more normal PACE

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The labour market and economy are stronger now in many respects than they were before the onset of the pandemic

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1. Introduction

The economy has successfully overcome the series of recent and profound exogenous shocks (Covid crisis, energy and cost of living crisis) with surprisingly little damage to its productive capacity. The labour market and economy are stronger now in many respects than they were before the onset of the pandemic.

However, the post-pandemic bounce in the Republic of Ireland's economy has ended. There is retrenchment in a number of foreign dominated sectors reflecting the ending of sector specific booms in investment and in exports, notably in the pharmaceuticals and ICT sectors. At the same time, cost of living pressure has eroded consumer confidence and is constraining demand. The rate of employment growth seen in recent years was unsustainable and reflected very specific dynamics. In particular, the post-Covid period of realised pent-up demand has now concluded with household savings having returned to the historical average.

A relatively weak external environment will dampen export potential in 2024 while the unwinding of the savings rate restricts the scope for household consumption to rise. High interest rates will create a drag on investment and creates concerns about higher than normal levels of business failure, although this pressure will hopefully recede over the course of the year as monetary policy loosens. A related concern is the potential impact of high interest rates on housing supply and on the market's ability to address capacity constraints in infrastructure.

Our baseline view is that the economy will continue to grow in 2024 but will do so at a more 'normal' pace compared to the volatile 2020 to 2023 period. Modified domestic demand is set to grow by close to 2%. Price inflation should continue to fall over the course of 2024 and this will boost consumer and business confidence and lead to a gradual loosening of the ECB's monetary policy over the course of the year.

The restoration of real wage growth as a tight labour market interacts with price growth deceleration will improve household finances and consumer confidence and ultimately support domestic demand. Employment growth and Budget 2024 will also add to demand and the public finances are well placed to respond to recessionary concerns if required. Budget 2025 is likely to be a 'political' and therefore expansionary budget coming as it does just before a scheduled election.

The economy is moving into a more normal phase of growth.

The post-pandemic boom is over - but the economy should continue to grow

2. The World Economy

The Republic of Ireland's economy is small and extremely open. Therefore, the performance of its major trading partners and indeed the global economy as a whole has an enormous impact on Irish economic performance through the export channel. The global economy is likely to grow somewhat below potential in 2024, in main due to the impact of restrictive monetary policy.

The US economy has thus far been very resilient in the face of a range of recent shocks including Covid disruption, high inflation and tightening monetary policy. Extremely loose fiscal policy and a low savings rate have contributed to growth which does raise questions about longer-run sustainability and resilience. The economy grew 3% year-on-year in the third quarter with the composite PMI at a marginally positive 51.0 in December. Retail sales increased 4.1% year-on-year in November which was the strongest growth since February.

The November unemployment rate was 3.7%. This is very low by historical standards with long-term unemployment standing at 0.7%. However, job vacancies are declining in absolute terms. The employment rate has yet to fully recover from the Covid shock, suggesting a degree of scarring or exiting, but it is nevertheless at its highest point since early 2020. Average hourly earnings increased 4% year-on-year in November.

The CPI measure of inflation decelerated to 3.1% year-on-year in November marking the sixth consecutive sub 4% reading. Core inflation was 4% as was the CPI trimmed-mean. PCE inflation fell to 3% in October. Inflation is now clearly coming under control. The fall in inflation and inflation expectations is contributing to an improvement in consumer sentiment. Falling inflation raises the possibility that the Federal Reserve might start to loosen monetary policy in the next few months although the combination of very low unemployment and above target inflation suggests interest cuts are not yet imminent.

The outlook for the US economy is for relatively modest growth over the next year. The lagged effect of tight monetary policy and weak confidence will likely slow demand in the first half of the year. However, both of those pressures should start to reverse in the second half of the year with interest rates and inflation both falling and with real wages rising. The composite PMI implies very modest growth in private sector activity though there is realistically no scope for further loosening of fiscal policy in the event of a recession.

While the Euro Area economy has similarly proven resilient in the face of the recent shocks, it has stalled in the third quarter (0.0% GDP growth year-on-year) and PMIs suggest it may now have fallen into recession. The lagged effects of higher interest rates and tight financing conditions are subduing demand with investment growth likely to underperform in the short-run. Annual retail sales contracted for the third consecutive month in October. More positively, interest rates should start to fall in mid-2024 now that inflation is gradually but decisively coming under control. HICP inflation fell to 2.4% in November (it had been 10.1% in November 2022) which is close to the ECB's long-run target of 2%. It may be close to the end of 2024 before price inflation decelerates fully to the ECB target. Core HICP inflation is 4.2%.

The Euro area's labour market remains strong by historical standards. Employment expanded 0.2% in the three months leading to September and the unemployment rate was 6.5% in October, just marginally above its record low. The long-term unemployment rate (2.3%) is also just marginally above its record low while the labour force participation rate is at a record high. However, the number of unemployed and the youth unemployment rate are on an upward trend suggesting some recent weakening in the labour market. The combination of a tight labour market and the lagged impact of high price inflation are translating into strong wage growth. Annual wage growth was 5.3% in the third quarter.

The Euro area's short-run growth outlook is mixed. The full impact of tightening monetary policy on prices and on demand has not yet been felt but will ultimately further dampen demand. A pause in interest rates would be appropriate in order to assess the full consequences of the recent rises on aggregate demand and investment. Fiscal policy will be a drag on growth in many Euro area countries with the withdrawal of temporary supports. The composite PMI of 47.0 in December suggests a modest decline in private sector output in the months ahead. Consumer confidence remains negative and below the long-run average.

The UK economy expanded 0.6% year-on-year in the third quarter. However, retail sales fell 2.7% year-on year in October marking the 19th consecutive month of decline. The unemployment rate remains low, at 4.2% in October. Similarly, the employment rate, while lower than the pre-pandemic level, is very high by historical standards.

The inflation rate fell to 4.6% in October – a marked decline from 6.7% in August and in September – and was mainly due to declining energy costs. Core inflation was 5.7%. The tight labour market combined with high inflation is generating reasonably strong real wage growth. Nominal wage growth was 7.2% in the three months to September.

Similar to the Euro area, the UK economy's short-term outlook is for very modest growth or even a short recession. It faces similar challenges in terms of restrictive fiscal policy and tight monetary policy. Even so, the composite PMI was 51.7 in December implying some positive, albeit modest, growth momentum. This was the 3rd consecutive monthly improvement. Consumer confidence remains weak but has improved in each of the last three months. The savings rate has moved slightly above its long-run average suggesting some additional scope for growth in consumption. The UK economy shrank in October.

Overall, global growth should be relatively anaemic in 2024 due to tight financing conditions, tighter fiscal policy, and low business and consumer confidence. More positively, while growth is slowing so too is price inflation. This suggests that monetary policy will start to loosen around mid-2024. In addition, labour markets have proven remarkably resilient in the face of recent crises suggesting there will be minimal scarring from a period of stagnant growth. While the baseline position is for weak but positive growth there is a meaningful risk of recession in each of the Republic's main trading partners.

The longer-term growth outlook for advanced economies is much more challenging. This is due to ageing demographics and decarbonisation but also, potentially, de-globalisation, structurally higher interest rates, and lower productivity growth. Policymakers will need to consider how best to prepare for these transitions and shocks.

3. Economic Trends in the Republic of Ireland

3.1 Output growth is slowing

Irish output growth is slowing (see Table 3.1) as the robust post-pandemic bounce-back in the economy fades away. The recent retrenchment in GDP is emanating from the foreign-dominated sectors and reflects the ending of sector specific booms in investment and exports in the pharmaceuticals and ICT sectors. These sectors had been growing at unsustainably high rates and had benefited from Covid-era specific factors. Real GDP contracted by 1.9% in the third quarter and by 5.8% year-on-year. GVA in the foreign dominated sectors was down 8.7% year-on-year in the third quarter while goods exports declined by 9.8%. The decline in goods exports is driving the decline in overall exports with service exports growing.

Table 3.1 Dashboard of Macroeconomic Indicators, Republic of Ireland

	2019	2020	2021	2022	23'Q3	Latest
Percentage volume change over previous year						
Gross Domestic Product	5.3	6.6	15.1	9.4	-5.8	-5.8 *(Q3'23)*
Modified Domestic Demand	2.2	-5.9	7.3	9.5	-0.4	-0.4 *(Q3'23)*
Personal Consumption	2.6	-9.9	8.4	9.4	2.6	2.6 *(Q2'23)*
Retail Sales	2.1	-2.3	8.7	-0.6	3.9	-0.2 *(M10'23)*
GNI*	2.5	-3.6	13.9	6.7	-	6.7 *(2022)*
Percentage annual average rate of change						
Employment	2.9	-2.8	6.0	6.6	4.0	4.0 *(Q3'23)*
Average Hourly Earnings	3.5	4.8	4.4	3.6	6.2	6.2 *(Q3'23)*
Average Weekly Earnings	3.6	5.2	4.7	3.4	4.6	4.6 *(Q3'23)*
Compensation of Employees	7.6	0.3	9.8	9.6	6.0	6.0 (Q3'23)
Actual Hours Worked (week)	2.9	-9.7	6.6	8.5	2.1	2.1 (Q3'23)
Inflation (CPI)	0.9	-0.3	2.4	7.8	6.2	3.9 *(M11'23)*
Percentage of annual GDP or quarterly GDP						
Government Balance (GGB)	0.5	-5.0	-1.5	1.7	-	1.7 (Q2'23)
Gov. Gross Debt (end year)	57.1	58.1	54.4	44.4	-	43.1 (Q2'23)
Percentage of labour force						
Unemployment *(Covid Adjusted)*	5.0	19.4	16.1	4.5	4.5	4.8 *(M11'23)*
Long-term Unemployment	1.6	1.3	1.8	1.3	1.1	1.1 *(Q3'23)*
Percentage						
Participation Rate (15+)	62.3	60.2	63.3	64.9	65.8	65.8 (Q3'23)
Savings Rate	10.8	25.6	24.6	20.6	-	9.6 (Q3'23)
Deprivation Rate	17.8	14.3	13.8	17.7	-	17.7 (2022)

Notes: Half-year, ('H'), Quarterly ('Q'), monthly ('M') and other data is compared to same period of the previous year. *Modified domestic demand* (MDD) is non-seasonally adjusted. *Unemployment* is Covid-adjusted for 2020 and 2021. *'Productivity'* refers to labour productivity in the domestic-dominated sectors.

Sources: CSO: *Labour Productivity, National Income and Expenditure, Quarterly National Accounts, Retail Sales Index, Labour Force Survey, Earnings and Labour Cost, Consumer Price Index, Government Finance Statistics, Monthly Unemployment, Household Saving, Survey on Income and Living Conditions.*

Irish GDP can be very volatile from quarter to quarter and indeed from year to year due to the outsize impact of a small number of firms and to the timing of multinational profit outflows. The recent decline should be considered in the context of recent outperformance with third quarter GDP increasing by 29% in real terms over the previous four years.

While GDP is set to decline in 2023 the perhaps more relevant Modified Domestic Demand (MDD) indicator will be positive for the year as a whole. Its growth is being driven by consumption which has held up in part at the expense of a falling savings rate. Personal consumption was up 2.6% annually in the third quarter although retail sales have slackened in recent months and declined 0.2% annually in October. Retail sales have declined month-on-month for six consecutive months and the volume index is at its lowest level since February. However, the picture is more positive once motor cars are excluded with retail sales increasing 0.3% year-on-year in October.

Seasonally adjusted MDD was flat in the third quarter with increases in consumption and government spending offset by a decline in modified investment. MDD was down marginally on an annual basis in the third quarter (-0.4%) although it is still on track to grow overall this year. We anticipate final MDD of less than 1% in 2023 but then rising to almost 2% next year. The construction sector remains a particular concern with output still below pre-pandemic levels. The volume of production declined year-on-year in the third quarter. However, there has been a strong increase in housing commencements and housing completions in 2023. Third quarter completions are up 14.4% annually and the fourth quarter is on track for an even faster rate of expansion.

3.2 Price pressures are receding

The Consumer Price Index (CPI) rose 3.9% annually in November with the alternative HICP measure at +2.5%. Both measures declined on a monthly basis. This was the first decline in the month-on-month CPI since January. The lower rate for the HICP is mainly explained by the fast rising cost of mortgages which is counted within the CPI but not the HICP. Mortgage interest is accounting for 30.3% (1.18 percentage points) of the rise in the CPI. The CPI is now at its lowest level since September 2021 with the downward trend evident when considered over the last year (see Table 3.2). Cumulative multi-year price changes up to November 2023 are shown in Table 3.3. The CPI has increased 19.2% over the last three years and by 13.1% over the last two years.

Table 3.2 Annual price inflation, CPI, % change

	2019	2020	2021	2022	2023
January	0.7	1.3	-0.2	5.0	7.8
February	0.5	1.1	-0.4	5.6	8.5
March	1.1	0.7	0.0	6.7	7.7
April	1.7	-0.1	1.1	7.0	7.2
May	1.0	-0.5	1.7	7.8	6.6
June	1.1	-0.4	1.6	9.1	6.1
July	0.5	-0.4	2.2	9.1	5.8
August	0.7	-1.0	2.8	8.7	6.3
September	0.9	-1.2	3.7	8.2	6.4
October	0.7	-1.5	5.1	9.2	5.1
November	1.1	-1.1	5.3	8.9	3.9
December	1.3	-1.0	5.5	8.2	

Note: 2016=100
Source: CSO: Consumer Price Index

Energy prices peaked in October 2022 so energy price base effects are now pushing the CPI downwards. Electricity prices were down 14.5% annually in November with diesel down 10.5%. Beyond mortgage interest there is notable upward pressure from food and non-alcoholic beverages, from recreation and culture (package holidays), from restaurants and from rents. Overall, services now account for almost 82% of inflation with energy price pressures now replaced by more second order price pressures.

Inflation is now on a clear downward trend

Core inflation which excludes volatile energy and unprocessed foods was 5.6% in November. Core inflation tends to be 'stickier' than headline inflation and is often more predictive of future inflation. Even so, we expect CPI inflation to fall to 3% next year with energy prices continuing to fall. The rise in the cost of living and the failure of incomes (particularly from social transfers and wages) to match the price increases is manifest in the jump in the deprivation rate from 13.8% in 2021 to 17.7% in 2022 (see Table 3.1). The deprivation rate is likely to increase further in 2023 given that full year inflation of circa 6.3% will once again outweigh average wage growth.

Table 3.3 Price inflation in 2023 by time period, CPI, % change

	1 month	3 months	1 year	2 years	3 years
January (114.9)	-0.8	-0.6	7.8	13.2	13.0
February (116.7)	1.6	0.6	8.5	14.5	14.1
March (118.0)	1.1	1.9	7.7	14.9	14.9
April (118.6)	0.5	3.2	7.2	14.7	15.9
May (119.0)	0.3	2.0	6.6	15.0	16.9
June (120.0)	0.8	1.7	6.1	15.7	17.5
July (120.2)	0.2	1.3	5.8	15.5	18.0
August (121.0)	0.7	1.7	6.3	15.6	18.9
September (121.1)	0.1	0.9	6.4	15.1	19.4
October (121.5)	0.3	1.1	5.1	14.7	20.5
November (120.5)	-0.8	-0.4	3.9	13.1	19.2

Note: 2016=100
Source: CSO: Consumer Price Index

3.3 The labour market remains strong

The labour market is still performing robustly, albeit with some evidence that the boom in employment is slowing down. The number of people employed was up by 4% or 101,600 year-on-year in the third quarter to a record 2.66 million at work (Table 3.4). This is a spectacular rate of growth by any standard. The participation rate is at its highest level since 2008 and increased 1 percentage point year-on-year to reach a rate of 65.8% (the labour force itself increased 4.2%). The participation rate ranges from 67.7% in Dublin to 62.4% in the Mid-West (Table 3.5).

All of the service sectors have seen employment growth with the exception of a modest decline in *Administration*. However, total *industry* has seen a decline with falls in employment in *Industry* and in *Construction*. *ICT* has seen particularly exceptional growth at 10.8% (17,100).

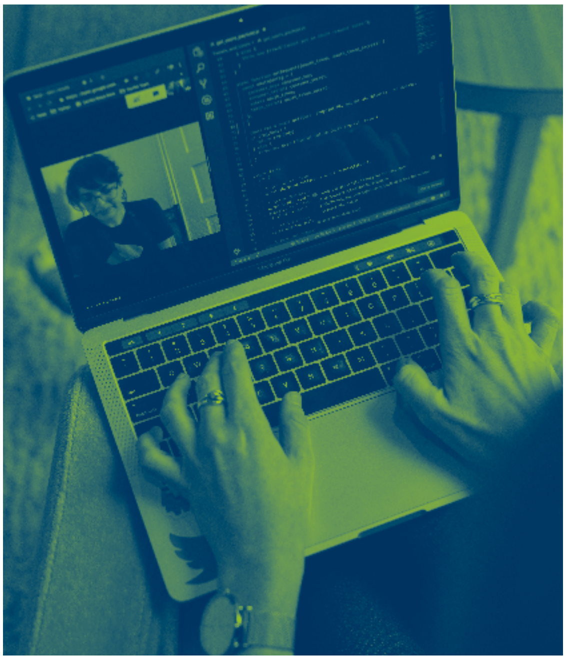

Table 3.4 Persons aged 15-89 in Employment, by sector, thousands, 3rd quarter

	2022	2023	Growth	Female
	000's	000s	%	000's (% of total)
Agriculture, forestry, fishing	94.6	111.7	18.1	17.2 (15.4)
Construction	171.0	167.4	-2.1	13.0 (7.8)
Industry	330.4	321.6	-2.7	109.8 (34.1)
Wholesale and retail, vehicle repair	315.3	322.2	2.2	164.3 (51.0)
Transportation and storage	108.5	114.5	5.5	21.1 (18.4)
Accommodation and food services	170.0	181.4	6.7	100.1 (55.2)
Information and communication	159.5	176.8	10.8	54.7 (30.9)
Financial, insurance and real estate	127.4	132.4	3.9	64.3 (48.6)
Professional, scientific and technical	165.7	177.9	7.4	80.2 (45.1)
Administration and support services	110.9	110.7	-0.2	46.9 (42.4)
Public administration and defence	132.2	134.0	1.4	67.3 (50.2)
Education	206.3	219.1	6.2	161.4 (73.7)
Human health and social work	336.6	353.6	5.1	276.8 (78.3)
Other or not stated	126.0	132.6	5.2	72.5 (54.7)
All sectors	2,554.3	2,655.9	4.0	1252.5 (47.2)

Note:
Sources: CSO: Labour Force Survey

Female employment is largest in *Health and Social Work* with *Industry* the largest employer of males. *Health and Social* also has the highest female portion of employment (78.3%), with *Education* a close second at 73.7%. *Construction* has the highest male percentage of employment with females comprising just 7.8% of *Construction* employment, 15.4% of *Agriculture, Forestry and Fishing* employment and 18.4% of *Transportation and Storage* employment (18.4%). Policy options for eliminating potential barriers to female employment in these sectors should be explored, particularly given the undersupply of workers in the construction sector.

Actual hours worked in the economy reached a third quarter record of 82 million hours per week up from 80.3 million hours in 2022 (+2.1%). The largest sectors by hours worked are *Industry* (11.1 million), *Health and Social Work* (10 million), and *Wholesale and Retail* and *Vehicle Repair* (9.4 million).

There is tentative evidence that the labour market boom is ending. The job vacancy rate fell to 1.2% in the third quarter, and while the employee index was at +2.3% year on year in September, the index also registered no net growth in employment (seasonally adjusted) between August and September.

Table 3.5 Economic status by region, thousands or %, 3rd quarter 2003

	Participation	Unemployment	Employed	Employment share
	% Rate	% Rate	000's	(% of total)
Border	63.0	4.3	210.2	7.9
West	66.4	3.4	257.7	9.7
Mid-west	62.4	5.2	247.6	9.3
South-east	64.0	4.9	227.5	8.6
South-west	66.0	4.8	384.2	14.5
Dublin	67.7	5.1	783.2	29.5
Mid-east	67.2	3.9	391.1	14.7
Midland	64.5	4.9	154.3	5.8
State	65.8	4.6	2655.9	100

Note: Participation rate is or persons aged 15+, Unemployment rate is for persons aged 15-74, Employment is persons aged 15-89. Rounding affects totals.

Sources: CSO: Labour Force Survey

The seasonally adjusted unemployment rate was 4.8% in November, or 132,700 persons. The rate has increased from being just 4.1% as recently as March. The CSO explains that some of this increase relates to an increase in Ukrainians (primarily females) receiving temporary working age income supports and therefore an increase in the numbers considered unemployed. The moderation in economic growth and the increase in labour force participation are additional relevant factors in the increasing rate. The male unemployment rate has risen from 4.3% in March to 4.9% in November while the youth unemployment rate has risen from 10.2% in January to 12.4% in November. Even so, the long-term unemployment rate of 1.1% in the third quarter represents a record low. Overall, the labour market remains very tight. Regional performance is shown in Table 3.5 with unemployment ranging from 3.4% in the West to 5.2% in the Mid-West. Our view is that net employment will increase by close to 1.5% in 2024.

Employee compensation was flat in the third quarter relative to quarter two. However, compensation was up 6% in nominal terms relative to the previous year (Table 3.6). Average weekly earnings increased 4.6% annually, (Table 3.7) with average hourly earnings up 6.2%. Average weekly wage growth was weaker in the private sector at just 3.9% (Table 3.8). Weekly earnings increased in 12 of 13 sectors with the largest increase in Arts and Entertainment at 10.6%. Weekly earnings were flat in *Transportation and Storage*.

Unemployment is on the rise

Table 3.6 Compensation of employees, 3rd quarter 2023, % annual change

	2023
Agriculture, forestry and fishing	3.7
Industry	4.6
Construction	2.4
Distribution, transport, hotels and restaurants	4.1
Information and communication	7.2
Financial and insurance	4.2
Real estate	4.1
Professional, administration and support	4.5
Public administration, education and health	9.6
Arts, entertainment and other	4.0
All sectors	6.0

Source: CSO: National Accounts

With the CPI increasing an average of 6.2% in quarter three, average weekly earnings fell in real terms across the economy while average hourly earnings were flat. Growth in hourly earnings exceeded CPI growth in a number of sectors in quarter three (Table 3.9). Nominal hourly earnings increased in all sectors with average increases ranging from 0.7% in *Transportation and Storage* to 11.7% in *Arts and Entertainment*. The Indeed wage tracker indicates posted wage growth of 4.2% in November (the CPI was +3.9%) suggesting a modest return to real wage growth for the first time since 2021. We anticipate that nominal average wages will rise by close to 4.5% in 2024.

Real wage growth is likely to have turned positive in November

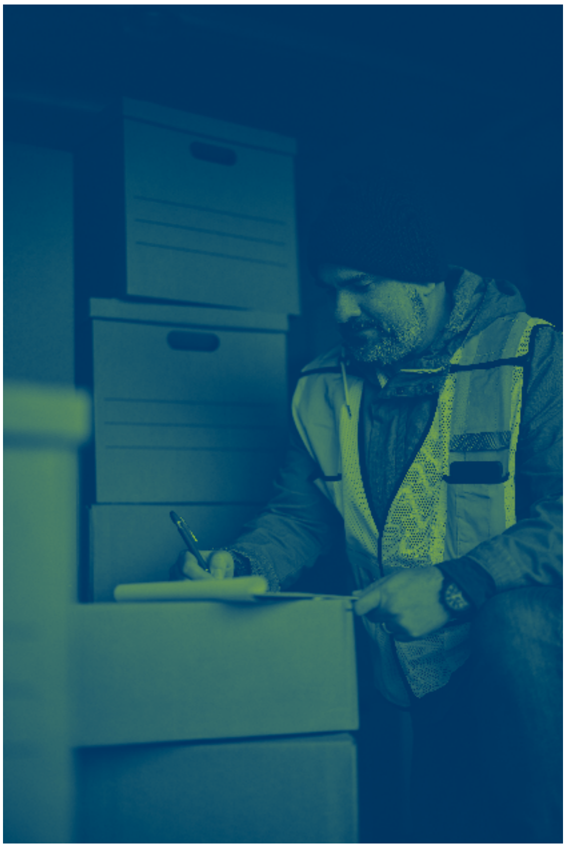

Table 3.7 Weekly earnings by sector and type, % change, 3rd quarter

	2018	2022	2023	18-23	22-23
HICP	101.5	113.5	119.0	17.2	4.8
CPI	101.9	113.7	120.8	18.5	6.2
	€	€	€	%Δ	%Δ
Industry	876	971	1,025	17.0	5.6
Construction	796	921	928	16.6	0.8
Wholesale and retail, vehicle repair	567	645	677	19.4	4.8
Transport and storage	818	851	851	4.0	0.0
Accommodation, food service	368	422	440	19.6	4.3
Information and communication	1,176	1,494	1,525	29.7	2.1
Financial/insurance/real estate	1,057	1,212	1,244	17.7	2.7
Professional, scientific/tech	901	1,034	1,107	22.9	7.0
Administration and support	575	685	702	22.1	2.4
Public administration and defence	945	1,020	1,099	16.3	7.7
Education	858	947	987	15.0	4.2
Human health and social work	715	826	885	23.8	7.1
Arts, entertainment and recreation	493	563	623	26.4	10.6
All sectors	743	868	908	22.2	4.6

Notes: CPI index is December 2016 = 100; HICP index is 2015 = 100;
Sources: CSO: Earnings and Labour Cost Quarterly, Consumer Price Index; Author calculations.

Table 3.8 Average weekly earnings by sector, % change, yearly averages, Q3

	2018	2022	2023	18-23	22-23
	€	€	€	%Δ	%Δ
Private	681.70	811.49	843.40	23.7	3.9
Public	960.14	1058.98	1125.92	17.3	6.3
All	742.75	867.63	907.72	22.2	4.6
HICP	101.5	113.5	119.0	17.2	4.8
CPI	101.9	113.7	120.8	18.5	6.2

Notes: CPI index is December 2016 = 100; HICP index is 2015 = 100
Sources: CSO: Earnings and Labour Cost Quarterly, Consumer Price Index

Table 3.9 Growth in hourly earnings by sector and type, % change, 3rd quarter

All Q2	22-23
HICP	4.8
CPI	6.2
	%Δ
Industry	5.7
Construction	4.6
Wholesale and retail, vehicle repair	6.4
Transport and storage	0.7
Accommodation, food service	8.8
Information and communication	1.9
Financial/insurance/real estate	4.5
Professional, scientific/tech	7.9
Administration and support	5.3
Public administration and defence	6.7
Education	7.1
Human health and social work	7.9
Arts, entertainment and recreation	11.7
All sectors	6.2

Notes: CPI index is December 2016 = 100; HICP index is 2015 = 100;
Sources: CSO: Earnings and Labour Cost Quarterly, Consumer Price Index; Author calculations.

3.4 The public finances remain strong despite pro-cyclical budgetary policies

Despite evident flaws, budget 2024 will end up going down as one of the most consequential budgets of recent years. The budget itself was modestly stimulatory and pro-cyclical. It will add to growth and to inflation in 2024. This stance was hardly ideal given that the economy was already running close to or at full employment and that it runs counter to monetary policy.

The cost of living supports were generally untargeted with significant deadweight in terms of averting poverty. Once-off supports make little sense given the permanent nature of the price increases. The cost of living crisis has highlighted the need for an ongoing 'cost of living' benchmarking of welfare payments. The Fiscal Council estimate the Budget 2024 tax cuts will raise consumer prices by 0.5 to 1.8% after eight quarters relative to a no-change baseline.

The tax cuts and indeed the regressive nature of the tax cuts were expected but still unwelcome from equality and fiscal sustainability perspectives. The tax cuts also run counter to the key recommendation of the Commission on Taxation and Welfare that government revenues need to meaningfully rise as a share of national output. Cutting taxes now means larger tax increases in the future and pushes the burden on to younger workers. The main beneficiaries of the tax cuts are those earning over €71,000 or so (single persons) and usually older, whereas the big losers are those earning in the range €20,000 to €40,000 and usually younger.

The most consequential budgetary announcements were in relation to the two new investment funds – the Future Island Fund (FIF), a de facto sovereign wealth fund, and the countercyclical Infrastructure, Climate and Nature Fund (ICNF). The FIF will eventually produce a new revenue source from the middle of the next decade and reduce the fiscal pressures caused by an ageing population. The ICNF could usefully end up insulating the capital budget from the economic cycle.

The creation of these funds has been enabled by the extremely strong and transitory surge in corporate income tax (CIT) receipts over recent years. CIT receipts are inherently volatile and pro-cyclical and Ireland's revenue base is very highly concentrated in a small number of firms. The scale of CIT receipts are also well above what might be expected given economic fundamentals and reflect the nexus of IP assets located in Ireland and actual activity occurring in other countries. While large fiscal surpluses are expected over the coming years it makes sense not to base current spending commitments or tax cuts on vulnerable receipts that are prone to future tax games or corporate downturns.

Overall, the public finances continue to perform well assisted by the healthy state of the labour market and the ongoing profit shifting into Ireland. There was a 12-month rolling deficit of €1.7 billion in November but this was in part due to a €4 billion transfer to the National Reserve Fund. Very substantial surpluses are projected for each of the next few years. However, the medium-to-long term fiscal position is much more challenging with significant and increasing age related expenditure pressure, the fiscal costs of climate action and diminishing revenues from green taxes.

3.5 Sentiment remains mixed

Sentiment indicators are consistent with only modest growth (see Table 3.10). The *Consumer Sentiment Index* increased to 61.9 in November, a third consecutive increase, though it still remains well below the historical average implying modest growth in consumption. The *Construction PMI* decreased to 44.5 in November marking the fifth consecutive negative reading. The weak outlook for the sector reflects a slowdown in the economy and in the completion of projects. Input costs remain high and the sector is particularly sensitive to the higher interest rates.

More positively, the *Manufacturing PMI* exited negative territory in November suggesting a stabilisation of conditions. New orders are up slightly following declines over most of the past year although sentiment about the broader economic outlook remains weak. Finally, the *Services PMI* increased to 54.2 in November signalling an increase in the pace of growth with rebounds in the transport and tourism and leisure sectors. Notably, all of the PMIs are below their long-run averages. The muted PMIs should temper expectations for 2024.

Table 3.10 Sentiment Indicators

PMI	Sep	Oct	Nov	13-year range	Long-run average
Services	54.5	52.6	54.2	13.9 - 66.9	57.0
Manufacturing	49.6	48.2	50.0	36.0 - 64.1	54.0
Construction	48.6	47.3	44.5	4.5 - 68.8	54.0
				27-year range	
Consumer Confidence	58.8	60.4	61.9	39.6 - 130.9	82.0

Note: A PMI in excess of 50 represents activity expansion compared to the previous month (growth), whereas a PMI below 50 represents contraction. The consumer sentiment index was 77.0 before the invasion of Ukraine in February 2022. Range is 11 years (2013 to 2023) for construction PMI.
Sources: AIB: Manufacturing and Services PMIs; BNP Paribas: Construction PMI; KBC/ILCU: Consumer Sentiment

3.6 The outlook is for weak but positive growth

Our analysis is that the economy will continue to grow in 2024 but will do so at a more 'normal' pace relative to recent years and perhaps slightly below potential given the range of headwinds from tight monetary policy and a weak external environment for Irish exports. Clearly the recent rate of employment growth was unsustainable and reflected very specific dynamics. Specifically, the post-Covid period of realised pent-up demand has now ended with household savings at close to the historical average. The restoration of real wage growth and, therefore, real disposable household income as price inflation declines in a tight labour market will be the main driver of consumption alongside employment growth. Budget 2024 will also add to demand.

The high interest environment does remain a concern and will put pressure on business viability and on investment levels. Of particular concern is the potential impact on housing supply and on the market's ability to address capacity constraints in infrastructure. The hope is that interest rates will start to fall as early as the second quarter of 2024 as price growth falls to the ECB target. The strong budgetary position offers scope for a countercyclical fiscal response if the economy does start to stagnate or go into reverse.

Overall, we expect the economy to grow by almost 2% with employment growth of close to 1.5%, CPI inflation of 3% and average nominal wage growth of 4.5%

We have entered a more modest phase of growth

Growing at a more normal pace

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