The Irish Economy: Resilient Amidst Shocks and Falling Incomes

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The economy and labour market have been resilient to a range of shocks but the cost of living crisis is putting pressure on low income households.

Introduction

The Republic of Ireland's economy and its labour market have been generally resilient to the variety of external shocks they have faced over the last few years. These shocks include Covid-19 and its associated lockdowns, Brexit disruption, the energy supply shock, the cost of living crisis and decline in real incomes, and the recent turbulence in international financial markets.

Irish real GDP grew at an extremely robust 12% in 2022 while modified domestic grew 8.2% in part due to the post-pandemic bounce back. The economy's productive capacity was largely preserved by the highly supportive and countercyclical fiscal and wider suite of economic policies that were aggressively and correctly pursued during the Covid crisis. This proactive intervention enabled the strong bounce back in 2022.

The labour market is performing strongly. Employment grew 2.7% and actual hours worked increased 3.9% year-on-year in the final quarter of 2022. Even so, real disposable household incomes declined in 2022. This was because the energy shock triggered very significant inflationary pressures that have outpaced weekly earnings growth. Low income households have been particularly badly affected by the cost of living crisis with a rise in the deprivation rate in 2022.

Central Banks have responded to the surge in the cost of living by increasing interest rates and otherwise tightening policy in order to reduce price inflation. Tightening monetary policy and weak consumer confidence will dampen consumption and investment this year. However, the Irish economy remains, on balance, likely to avoid a recession, with improving real incomes, employment growth, and a normalisation of the household savings rate all set to support underlying demand.

Our baseline view is that the unemployment rate will remain low with employment remaining close to full capacity. The rising cost of living, along with a very tight labour market characterised by capacity constraints in a number of areas, will combine to generate a high level of nominal wage growth over the course of 2023 as well as a return to real wage growth by the end of the year.

With the labour market close to capacity, fiscal policy should seek to avoid exacerbating inflationary pressures via unnecessary tax cuts. Instead, fiscal policy should focus on ensuring income adequacy for poorer households and on dealing with the Republic of Ireland's profound strategic economic and social challenges in areas such as housing supply and in the provision of the necessary infrastructure and other supports needed to manage a successful and a just green transition.

The windfall corporation tax receipts should not be used to finance a short-run fiscal expansion. Instead, net spending increases beyond the rate of medium-term potential growth should be funded via discretionary increases in taxes and/or social contributions.

The World Economy

The Republic's main trading partners avoided recession in 2022 despite the range of external economic disruptions and the energy supply shock. The Euro area grew by 3.5% in 2022 while the United States and the United Kingdom grew by 2.1% and 4% respectively (see Table 1). Such growth is somewhat flattered by post-pandemic base effects and primarily reflects the post-pandemic economic resurgence and pent-up demand, alongside supportive fiscal policies. There was evidence of a slowdown in late 2022 with the US (0.9%) and UK (0.6%) experiencing weak year-on-year growth rates in the final quarter of 2022.

The IMF is projecting a fairly weak growth performance in 2023 despite the stimuli of the Chinese economy reopening and supply chain and commodity market disruptions unwinding. This is mainly due to sticky inflation, to weak or negative real income growth and to weak lending and potentially financial instability arising from the rapid shift to higher interest rates. The Fund estimates that the United States (1.6%) and the overall Euro area (0.8%) will both grow modestly and that the UK (-0.3%) and German (-0.1%) economies will contract. As the US is energy independent its economy is less affected by the energy price shock. The OECD are similarly projecting a mild recession in the UK (-0.2%) as well as modest growth of 1.5% in the US and 0.8% in the Euro area.

Table 1 Real economic growth rates (annual change, %), GDP unless stated

	21' Q1	21' Q2	21' Q3	21' Q4	22' Q1	22' Q2	22' Q3	22' Q4
Euro area	-0.8	14.2	4.0	4.8	5.5	4.4	2.4	1.8
UK	-7.7	24.4	8.5	8.9	10.5	3.9	1.9	0.6
US	1.2	12.5	5.0	5.7	3.7	1.8	1.9	0.9
China	19.3	7.9	4.9	4.0	4.8	0.4	3.9	2.9
Ireland								
GDP	11.4	19.5	10.4	13.8	11.7	12.6	11.6	12.0
MDD	-5.1	14.7	3.9	10.4	13.4	11.8	6.1	2.8

Notes: Irish GDP data is distorted by the outsize activities of a small number of multinationals. Modified Final Domestic Demand (MDD) gives us a better understanding of the performance of the domestic facing economy.

Sources: Eurostat: GDP main aggregates, CSO: Quarterly National Accounts, Trading Economics: GDP data.

The IMF projects global growth at just 2.8% while the OECD projects growth of 2.6%. This would be weak by historical standards. Higher inflation and interest rates will strain the global financial system and potentially slowdown lending. The ongoing tightening of monetary policy will reduce the level of private investment and overall aggregate demand. In addition, rising interest rates in the United States and a strengthening US dollar could precipitate a sovereign debt crisis in a number of emerging markets.

Labour markets remain very tight in most major European and North American economies. The unemployment rate was at a close to full-employment 3.5% in the United States in March with the labour force participation (LFP) rate at its strongest (62.6%) since the beginning of the pandemic. However, LFP rates and employment rates remain well below pre-pandemic and historical levels, perhaps reflecting labour market scarring and/or older workers exiting the labour market. Average hourly earnings increased 4.2% year-on-year in March. This was the smallest increase in almost two years and below the rate of headline inflation.

The outlook for advanced economies is weak this year with a range of risks including rising interest rates, potential banking failures, and a slowdown in credit

The EU's seasonally adjusted unemployment rate was at a record low of 6% in February (6.6% in the Euro area and down from 6.8% twelve months previously). There was a range of performance: lows of 2.4% in Czechia and 2.9% in Germany to highs of 11.4% in Greece and 12.8% in Spain (Ireland ranked 9th best of the EU-27 at 4.3%). The Euro area's youth unemployment rate was below its pre-pandemic level at 14.4% while the labour force participation rate was 74.7% in the fourth quarter of 2022 and marginally down on the record level seen in the third quarter. Employment growth was 1.5% in the fourth quarter while wages grew by a robust 5.1% reflecting the tight labour market. Even so, this was just half the rate of inflation. UK unemployment was 3.8% in the three months to February with average weekly earnings increasing by 5.9% (6.9% private and 5.3% public).

Table 2 Headline Consumer Prices: Annual Change, %, HICP Unless Stated

	Aug '22	Sep '22	Oct '22	Nov '22	Dec '22	Jan '23	Feb '23	Mar '23
Euro	9.1	9.9	10.6	10.1	9.2	8.6	8.5	6.9
Core	4.3	4.8	5.0	5.0	5.2	5.3	5.6	5.7
UK	9.9	10.1	11.1	10.7	10.5	10.1	10.4	10.1
Core	6.3	6.5	6.5	6.3	6.3	5.8	6.2	6.2
US	8.3	8.2	7.7	7.1	6.5	6.4	6.0	5.0
Core	6.3	6.6	6.3	6.0	5.7	5.6	5.5	5.6
China	2.5	2.8	2.1	1.6	1.8	2.1	1.0	0.7
Core	0.8	0.6	0.6	0.6	0.7	1.0	0.6	0.7
Ireland	8.7	8.2	9.2	8.9	8.2	7.8	8.5	7.7
Core	5.8	5.5	5.4	5.5	5.5	5.0	6.2	6.9

Notes: US (PCE), UK, China and Ireland (CPI). Core inflation excludes energy, food, alcohol and tobacco. Core data for Ireland is CPI excluding Energy and Unprocessed Food.

Sources: Eurostat: Inflation – Flash Estimate, Trading Economics, US Federal Reserve, Bank of England

The combination of tight labour markets and high inflation means that fiscal and monetary policies will become increasingly restrictive in 2023. Temporary fiscal supports will be withdrawn and interest rates will continue to rise. Policymakers will therefore restrain growth as they seek to control inflation. The IMF projects consumer price inflation this year of 5.3% in the Euro area, 6.8% in the United Kingdom and 4.5% in the United States.

While headline inflation is falling (6.9% in the Euro area in March) the core rate of inflation reached a record of 5.7% in March (see Table 2). High core inflation suggests that inflation may be sticky and hard to bring down to central bank targets. If so, interest rates are likely to continue to increase with terminal rates not reached until the second half of 2023. Interest rates may not start to decline until 2024 at the earliest.

Nominal wage inflation still remains well below headline inflation in most advanced economies. In other words, real incomes are still declining for most households. This phenomenon of declining incomes will increase poverty rates and dampen short-run discretionary personal consumption. The implication of prices rising faster than wages is that corporate margins have increased, particularly in those sectors where prices have risen disproportionately such as energy. More positively, tight labour markets suggest that real average wage growth will turn positive later this year as price inflation starts to recede.

Sentiment indicators are mixed. The Euro area consumer confidence indicator was -19.2 in March of 2023 and below the historical average. On the other hand, business confidence is reasonably positive and the composite PMI of 53.7 is consistent with an expectation of modest expansion. The UK's composite PMI is also marginally positive.

Overall, the global outlook is fragile. Most economies will avoid recession but growth will be largely anaemic.

Economic Trends in the Republic of Ireland

The Irish economy grew very strongly in 2022. GDP growth was a robust 12%. While GDP is distorted by the outsize effect of a small number of multinationals and imperfectly measures the economic activity that is actually occurring in the Republic of Ireland we can see from more meaningful indicators such as Modified Domestic Demand (MDD) and personal consumption that the economy grew strongly last year. Real MDD grew by 8.2% in 2022 while personal consumption increased by 6.6% (see Table 3). Retail sales data gives a more mixed picture with the real index declining annually in each month from May to December. The index has recently moved back into positive territory with growth of 3.1% in January and 3.6% in February. The seasonally adjusted household savings rate in the final quarter of 2022 was, at 22%, around double its pre-pandemic rate.

Table 3 Dashboard of Macroeconomic Indicators, Republic of Ireland

	2019	2020	2021	2022	22'Q4	Latest
	Percentage volume change over previous year					
Gross Domestic Product	5.4	6.2	13.6	12.0	12.0	12.0 (Q4'22)
Modified Domestic Demand	2.4	-6.1	5.8	8.2	2.8	2.8 (Q4'22)
Personal Consumption	2.7	-10.9	4.6	6.6	4.5	4.5 (Q4'22)
Retail Sales	2.1	-2.3	8.7	-0.6	-1.6	3.6 (M2'23)
GNI*	2.8	-4.6	15.4	-	-	15.4 (2021)
	Percentage annual average rate of change					
Employment	2.9	-2.8	6.0	6.6	2.7	2.7 (Q4'22)
Labour Productivity	3.1	14.1	-	-	-	14.1 (2020)
Average Hourly Earnings	3.5	4.7	4.4	3.4	5.5	5.5 (Q4'22)
Average Weekly Earnings	3.6	5.2	4.7	3.3	4.2	4.2 (Q4'22)
Compensation of Employees	4.7	-3.9	6.6	7.8	3.9	3.9 (Q4'22)
Actual Hours Worked (week)	2.9	-9.7	6.6	8.5	3.9	3.9 (Q4'22)
Inflation (CPI)	0.9	-0.3	2.4	7.8	8.8	7.7 (M3'23)
	Percentage of annual GDP or quarterly GDP					
Government Balance (GGB)	0.5	-5.0	-1.6	1.6	-	1.6 (2022)
Gov. Gross Debt (end year)	57.0	58.4	55.4	44.7	-	44.7 (2022)
	Percentage of labour force					
Unemployment (Covid Adjusted)	5.0	19.4	16.1	4.5	4.2	4.3 (M3'23)
Long-term Unemployment	1.6	1.3	1.8	1.3	1.3	1.3 (Q4'22)
	Percentage					
Participation Rate (15+)	62.3	60.2	63.3	64.9	64.6	64.6 (Q4'22)
Savings Rate	10.8	25.6	24.6	20.6	22.0	22.0 (Q4'22)
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.

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.*

Each of the main economic sectors grew last year. However, while construction activity was up 14.4% year-on-year it was still below the 2019 level. Production in building and construction was down 11% year-on-year in the fourth quarter. The slow progress in increasing housing supply is now creating capacity constraints for the economy with demand significantly outstripping supply. Property prices have increased by an average of 8% annually since 2015 and increased 6.1% in the year to January 2023. The only other sector with output below its pre-pandemic level was distribution, transport, hotels and restaurants. Low value-added parts of this sector are experiencing labour supply constraints due to the overall labour market tightness across the economy.

The consumer price index (CPI) averaged 7.8% in 2022 with inflation during the middle of the year reaching levels not seen since the mid-1980s. Price rises initially reflected a post-pandemic bounce back in energy costs from a low base coupled with a mismatch between pent-up demand and significant supply constraints. The Russian invasion of Ukraine in February of 2022 precipitated a further spike in energy costs that gradually extended to food and to wider core inflation.

Analysis from the CSO estimates that annual inflation (up to September) was highest for the lowest income households (9% or higher for the poorest 3 deciles and below 8% for the 3 richest deciles), with renters and lone parents disproportionately affected by the price increases over the last year. Annual price inflation for private rents rose 10% year-on-year in March. The rise in the cost of living and the failure of incomes to match price increases can be seen in the jump in the deprivation rate from 13.8% in 2021 to 17.7% in 2022.

HICP inflation was 7% in March with energy prices up 11.7% over the previous year and HICP excluding energy up 6.3%. The CPI rose by 7.7% between March 2022 and March 2023. Base effects are starting to exert modest downward pressure on the headline rate. The headline rate was down from 8.5% in February. The largest increase was in Housing, water, electricity, gas and other fuels (20.8%) which mainly reflects higher costs for electricity (62.7%), natural gas (92.1%), mortgage interest (35.3%) and private rents (10%). Food prices rose 13.1% annually in March with double digit price rises for staples like bead and cereals, pasta, oils and fats, and milk and eggs. Even so, price pressures are now greatest on the services side (10.5%) with goods inflation at 4.1%.

While headline inflation is on a downward trajectory, core inflation is looking increasingly sticky and increased to 6.9% year-on-year in March. This has implications for the likely trajectory of monetary policy.

The seasonally adjusted unemployment rate was 4.3% in March, or 117,200 persons. This compares to 120,000 persons just prior to the pandemic in February 2020 and the Covid-adjusted rate of 18.3% in June 2021 (408,000 persons). Unemployment is down from 131,600 in March 2022. The long-term unemployment rate was 1.3% in the fourth quarter of 2022, and below its pre-pandemic level.

Youth unemployment was at 10% in March. This is higher than March 2022 but is the lowest reading since May of last year. The high job vacancy rate (JVRs) is suggestive of a tight labour market (see Table 4), with the economy-wide and private sector rates higher than both their pre-pandemic levels and historical norms. However, most sectoral JVRs declined between quarter three and quarter four reflecting a modest decline in labour demand.

Despite the tight labour market and strong job growth, real incomes fell in 2022 while deprivation increased.

Table 4 Job vacancy rate by economic sector, 4th quarter 2022

Construction	1.0	Professional, scientific & tech	3.1
Industry	0.9	Administration & support	1.3
Wholesale, retail, vehicle repair	1.0	Public admin & defence	1.9
Transport & storage	0.6	Education	1.5
Accommodation, food services	0.3	Human health & social work	1.0
Information & communication	1.1	Arts, entertainment & other	1.8
Financial, insurance, real estate	2.6	All sectors	1.3

Note: JVR = number of job vacancies/ (number of occupied posts + number of job vacancies) *100

Sources: CSO: Earnings and labour costs

Total employment passed 2.5 million for the first time in the fourth quarter of 2021 and rose to 2.57 million by fourth quarter 2022 (Table 5) with employment up 6.6% over the course of 2022 and 2.7% year-on-year in the fourth quarter. The employment rate for those aged 15 to 64 increased marginally from 73% to 73.2% between fourth quarter 2021 and fourth quarter 2022 although the participation rate declined from 65.1% to 64.6%.

Table 5 Employment by sector, thousands or % change, 4th quarter

All Q1	2017	2019	2022	19-22	Share
				%Δ	%
Agriculture, forestry, fishing	111.7	106.8	100.8	-5.6	3.9
Construction	133.3	147.1	163.2	10.9	6.3
Industry	282.4	286.3	323.0	12.8	12.5
Wholesale, retail, vehicle repair	307.7	309.3	320.3	3.6	12.4
Transport & storage	94.7	108.0	113.1	4.7	4.4
Accommodation, food services	168.4	179.0	170.4	-4.8	6.6
Information & communication	116.1	127.4	164.6	29.2	6.4
Financial, insurance, real estate	106.1	115.1	132.7	15.3	5.2
Professional, scientific & tech	135.2	141.1	170.7	21.0	6.6
Administration & support	94.6	111.8	110.0	-1.6	4.3
Public admin & defence	100.9	116.6	137.5	17.9	5.3
Education	166.7	190.5	204.9	7.6	8.0
Human health & social work	279.9	293.7	336.5	14.6	13.1
Other activities or not stated	128.3	124.5	126.9	1.9	4.9
All sectors	2,226.0	2,357.3	2,574.5	9.2	100

Sources: CSO: *Labour Force Survey*

Actual hours worked in the economy reached 80.6 million hours per week during the fourth quarter of 2022 compared to 70.8 million in the fourth quarter of 2020 and 77.6 million in the fourth quarter of 2021. Hours worked in 2022 were up 8.5% compared to 2021, with hours worked in the fourth quarter increasing 3.9% over the previous year. The sectors with the most hours worked are *Industry* (11 million) *Human Health & Social Work* (9.9 million) and *Construction* (5.9 million).

Employment grew in most sectors between fourth quarter 2021 and fourth quarter 2022. The exceptions were *agriculture, forestry & fishing, information and communication* (ICT), *financial insurance & real estate* (FIRE), *professional, scientific & technical* (PST), and *education*. However, ICT, FIRE and PST have all grown very strongly when looked at over a 3-year period with ICT (29.2%) and PST (21%) growing particularly robustly (see Table 5). Employment grew 9.2% in the three years to Q4 2022. In absolute terms, employment grew by 217,200 since Q4 2019 with *human health & social work* accounting for 42,800 net new employments, followed by ICT (37,200), and Industry (36,700).

Only three sectors have declined in net terms since the final pre-pandemic quarter. These are the low value-added sectors *agriculture, forestry & fishing*, *accommodation & food services* and *administration & support*. Overall, the composition of employment has been shifting towards higher value and higher wage activities which is exactly as we would expect given the tightness of the labour market and the greater choice available to workers. *Human health & social work* (13.1%), Industry (12.5%) and *Wholesale/retail & vehicle repair* (12.4%) are now the largest sources of employment.

The CSO's seasonally adjusted employee index increased 0.3% in the month to January (an annual change of 4.8% and a new record high). The *Accommodation and Food services* sector experienced the fastest annual growth at 12.1% with employment in FIRE activities up by 10.1%. Employment increased year-on-year for all sectors. The employee index for January was up 10.9% on the average for 2019.

Employee compensation increased 7.8% in 2022 and increased 3.9% year-on-year in the fourth quarter. However, compensation declined in Real estate activities, in *Professional, administration & support* and in *Arts, entertainment & other services*.

Average weekly earnings increased 4.2% overall, (Table 6) but by just 2% in the private sector in the twelve months to Q4 2022, with average hourly earnings up 5.5% and 3.7% respectively over the same time period. Notably, the economy-wide figures are skewed upwards due to the backdating in October of basic salaries for public servants to February 2022. Table 7 shows economy-wide weekly wage growth of 3.3% in 2022 with private sector wages up 3.8% and public sector wages up 2.9%. We can see that wages fell far short of inflation for the vast majority of workers with real wages declining across the economy by 4%. ICT was likely the only sector experiencing real wage growth in Q4 2022, once we strip out the impact of the public sector backdating of wages.

Employment growth has been very strong. The labour market is tight and may be close to overheating.

Table 6 Weekly earnings by sector, % change, 4th quarter

All Q1	2019	2021	2022	19-22	21-22
HICP	101.7	106.0	115.3	13.4	8.8
CPI	102.3	106.5	115.8	13.2	8.7
	€	€	€	%Δ	%Δ
Mining & quarrying (Ind)	905.96	1070.12	1235.83	36.4	15.5
Manufacturing (Ind)	902.16	968.83	982.94	9.0	1.5
Electricity, water, waste (Ind)	1094.33	1134.84	1215.74	11.1	7.1
Construction	841.01	916.08	939.74	11.7	2.6
Wholesale/retail, vehicle repair	602.86	659.06	652.08	8.2	-1.1
Transport & storage	827.71	808.07	862.62	4.2	6.8
Accommodation, food service	379.14	391.15	408.63	7.8	4.5
ICT	1240.01	1376.7	1512.16	21.9	9.8
Financial and insurance	1176.88	1279.61	1313.87	11.6	2.7
Real estate	739.60	797.82	865.14	17.0	8.4
Professional, scientific & tech	974.01	1087.9	1084.91	11.4	-0.3
Administration & support	625.61	686.2	703.99	12.5	2.6
Public admin & defence	976.49	1011.61	1117.40	14.4	10.5
Education	881.35	927.1	999.83	13.4	7.8
Human health & social work	750.94	806.35	868.34	15.6	7.7
Arts, entertainment & rec	548.61	632.84	621.93	13.4	9.8
Other	490.05	539.39	542.02	10.6	0.5
All sectors	786.33	863.70	900.26	14.5	4.2

Notes: CPI index is December 2016 = 100; HICP index is 2015 = 100

Sources: CSO: *Earnings and Labour Cost Quarterly, Consumer Price Index*

Table 7 Average weekly earnings by sector, % change, yearly averages

All Q1	2019	2020	2021	2022	19-22	21-22
	€	€	€	€	%Δ	%Δ
Private	715.97	755.79	795.57	825.84	15.3	3.8
Public	976.03	1004.30	1035.73	1065.33	9.1	2.9
All	774.68	814.99	853.08	881.29	13.8	3.3
HICP	101.8	101.2	103.6	112.0	10.0	8.1
CPI	102.1	101.8	104.2	112.3	10.0	7.8

Notes: CPI index is December 2016 = 100; HICP index is 2015 = 100

Sources: CSO: *Earnings and Labour Cost Quarterly, Consumer Price Index*

The public finances are performing well given the difficult economic context of the last two years. Income tax, VAT, and especially corporation tax receipts, have all been growing very strongly and there was a general government surplus of €8 billion in 2022 or 1.6% of GDP (3% of GNI*). The Department of Finance is projecting surpluses of €10 billion in 2024 and €16 billion in 2025.

However, the headline public finance data is greatly flattered by the enormous and difficult to explain surge in corporation tax receipts. It is unclear to what extent the level of corporation tax receipts we have seen is sustainable over the medium-term with official estimates of 'windfall' proportions likely to be somewhat speculative.

Most of the excess or windfall receipts should be saved[1] instead of using it to support ongoing increases in current expenditure. In addition, the economy may already be overheating and is currently characterised by a very tight labour market. If so, the structural fiscal position is less benign that the headline general government balance suggests, as the economy is benefiting from lower than average expenditure on unemployment benefits and from higher than average income tax and VAT receipts. Finally, Ireland's public debt remains very high at close to €44,000 per person with bond yields rising as 3.2% in March (2.89% as of 20 April).

1 One prudent option would be to place some or all of the windfall receipts into a countercyclical fund that would be triggered automatically as temporary household income supports once certain defined macroeconomic criteria are met. This would support aggregate demand during recessionary periods.

Economic Outlook for the Republic of Ireland

Sentiment

Sentiment indicators are mixed (Table 8). The consumer sentiment index was 53.9 in March. This is well below the historical average of 82 and indicates a broadly negative perception of future economic activity and prospects amidst high inflation and pressure on household finances. The Manufacturing PMI and the Construction PMI are both in marginally negative territory (49.7 and 49.5 respectively) and below their long-run averages. This implies a broadly stagnant outlook. However, the services PMI was in positive territory and close to its long-run average (55.7) suggesting some positive growth momentum.

Table 8 Sentiment Indicators

PMI	Nov	Dec	Jan	Feb	Mar	12-year range
Services	50.8	52.7	54.1	58.2	55.7	13.9 - 66.9
Manufacturing	48.7	48.7	50.1	51.3	49.7	36.0 - 64.1
Construction	46.8	43.2	47.7	49.8	49.5	4.5 - 68.8
						25-year range
Consumer Confidence	45.3	48.7	55.2	55.6	53.9	39.6 - 130.9

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 and has a 25-year average of close to 82. Range is 10 years (2013 to 2023) for construction PMI.

Sources: AIB: Manufacturing and Services PMIs; BNP Paribas: Construction PMI; KBC/ILCU: Consumer Sentiment

Institutional forecasts

Despite the immense uncertainty hanging over the global and domestic economies there is a remarkable degree of institutional consensus about the trajectory of growth, inflation and unemployment (see Table 9).

This consensus suggests GDP growth of close to 5.5% in 2023 with modified domestic demand increasing by close to 3%. The broad consensus also suggests that headline inflation will average 4.5% to 5% in 2023 and 2% to 3.5% in 2024. Official forecasters are projecting that the unemployment rate will remain stable at between 4% and 4.5% and that the public finances will continue to improve.

Table 9 Institutional Forecasts 2023, % growth or % (2024 in brackets)

	GDP	MDD	Inflation	GBB	UR
Dept Finance	5.6 (4.1)	2.1 (2.5)	4.9 (2.5)	1.8 (2.8)	4.4 (4.5)
Central Bank	5.6 (4.8)	3.1 (2.9)	5.0 (3.2)	1.4 (2.6)	4.4 (4.4)
ESRI	5.5 (6.0)	3.8 (3.9)	4.5 (3.5)	0.7 (1.7)	4.2 (4.0)
European Commission	4.9 (4.1)	-	4.4 (2.1)	-	-
IMF	5.6 (4.0)	-	5.0 (3.2)	1.3 (1.2)	4.5 (4.5)

Notes: MDD is Modified Domestic Demand; Inflation is the CPI or HICP as projected by the institute; GBB is the General Government Balance (% of GDP); UR is the Unemployment Rate

Sources: D Finance: Stability Programme Update (April); Central Bank: Quarterly Bulletin (March); ESRI: Quarterly Economic Commentary (March); European Commission: Winter Forecasts (February) – Inflation forecast is HICP; IMF: World Economic Outlook (April).

Output

The Republic's economy is small and extremely open. Recessionary prospects are fading amongst the Republic's trading partners notwithstanding concerns about the global financial sector. We anticipate that the trading sectors of the economy will benefit from the improving international conditions. Strong export growth from the multinational sector boosted growth in 2022 and this is likely to continue, albeit at a slower pace, into 2023. However, export performance is subject to significant uncertainty and volatility due to its high level of concentration in pharmaceuticals and ICT and the large impact of globalisation effects such as contract manufacturing. The uncertainty in the global financial sector may impact on the level of foreign direct investment into Ireland.

While headline inflation rates are trending down in the Euro area, core inflation may be becoming sticky and it remains on an upward trajectory. There, therefore, appears little prospect that the current phase of the ECB's monetary tightening has finished. We expect a further two 0.5 per cent increases this year. The ongoing monetary tightening will increasingly weigh on consumption (incentivises saving) and investment (higher cost of credit) over the short-term. Notably, the higher cost of credit may act as a brake on investment in housing supply. Housing commencement numbers suggest a decline in output in 2023. In addition, the temporary fiscal policy supports are unlikely to be renewed in Budget 2024 and a more countercyclical or at least neutral fiscal stance will also weigh on demand in late 2023 and into 2024.

Weak sentiment and higher interest rates will temper demand – but the economy should escape a recession

The muted PMIs and confidence indicators imply only modest growth this year. The still-high savings rate (double its pre-pandemic rate) and the unwinding of savings offers scope for consumption to remain relatively buoyant this year, although weak consumer confidence my temper this process. Full normalisation of the savings rate is unlikely in the short-run.

The supply-side and cost of living challenges of recent years will diminish in 2023 while the tight labour market will drive real wage growth. The increase in real disposable household income will support demand. Retail sales growth has held up well in the first two months of the year. Our projection is that modified domestic demand will grow by 2% to 2.5% in 2023 and then by a further 2.5% to 3% in 2024 buttressed by real wage growth, employment growth and a declining savings rate.

Risks are weighed to the downside and include weaker than expected trading partner growth, further shocks to energy prices, or prolonged and aggressive monetary tightening due to sticky core inflation. In addition, the ongoing housing supply crisis may weigh on employment growth via reduced investment into Ireland and via constraints on internal labour mobility during a tight labour market.

Inflation

The second and third order effects of the energy price shock continue to reverberate and to exacerbate cost of living pressures. We anticipate that the decline in price inflation in the United States is likely to be replicated in Ireland and in the Euro area over the coming months and quarters. The global economic outlook in terms of commodity prices suggests a downward trend in prices. While headline inflation is likely to continue its downward trajectory over the next year, the pace of that decline remains highly uncertain, with the transmission of monetary policy onto demand still unclear in terms of lag and size of effect. Supply and demand mismatches are becoming less pronounced although too loose fiscal policy could drive up inflation. Second order dynamics have yet to significantly manifest via wage growth though this may change given the tightness of the labour market.

Notably, core inflation has yet to decline. We envisage that the process of core inflation normalising will begin in the near future, albeit core inflation will decline at a slower pace than headline inflation. Core inflation becoming stuck is a significant downside risk to the macroeconomic outlook as it would precipitate additional monetary tightening.

Inflation will fall but will remain elevated this year and next. The cost of living crisis will worsen for low-income households in the absence of further intervention

Labour market

The labour market is performing very strongly and would be close to capacity in the absence of ongoing inward migration. There is little evidence of scarring from the Covid pandemic due to the successful economic response to that crisis, while the composition of employment has generally shifted to higher value-added activities. Labour supply issues are already evident in a number of areas including the broad construction sector.

While employment growth will not match the unsustainable levels seen in recent years and job vacancy rates have started to slow, we anticipate, assuming an ongoing expansion of economic activity, that net employment gains will be sufficient to keep the unemployment rate at close to 4%. The tight labour market and a lagged 'catch-up' with a high but falling inflation rate implies real wage growth this year and next. Wage growth is likely to exceed 6% this year and 5% in 2024, albeit with the usual variation between sectors.

The labour market Is close to capacity and future employment gains will be more subdued

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