Economic Report, Presentation to FSU

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Recalling the pre-crisis labour market

The labour market was tightening on the back of almost eight years of sustained economic growth

The rate of expansion of employment growth was slowing but still well above long-term norms. The non-SA unemployment rate had fallen to 4.5% by Q4’19

However, the employment rate and unemployment rates were well off the best performing countries in the EU and it was clear we had not achieved full employment or potential output.

Even so, the long-term unemployment rate had almost halved between Q3’17 and the onset of the Covid crisis

- The South-East was the weakest region at the end of 2019 with an unemployment rate of 6.8% (all other regions were under 5% and the South-West was at 3.7%)
  - The labour force (+2.6% nationally) was increasing in all regions
- Weekly earnings in the private sector grew by 4% in the year to Q4’19
- Hourly earnings in the private sector also grew by 4% in the year to Q4’19

Macro statistics (2019-20)

	2019	2020
GDP	5.6%	5.9%
GNI*	2.6%	-3.5%
Modified Domestic Demand	1.7%	-4.9%
Consumption	3.3%	-10.4%
Retail sales (volume)	2.1%	-2.3%
Employment levels (Covid-Adjusted)	2.32 million	1.97 million
Unemployment Rate (Covid-Adjusted from March'20)	5.0%	18.7%
Average Weekly Earnings	3.6%	5.1%
Compensation of Employees	7.3%	-0.1%
Inflation (CPI, annual average)	0.9%	-0.3%
General Government Balance (€bn)	1.8	-18.4
General Government Balance (% GDP)	0.5%	-5.0%

The UR peaked at 30.5% in April 2020 but had declined to 15.7% by September 2020. It was 22.4% in August 2021.

Labour force trends (CSO, 000’s or %)

	2007 (Q4)	2009 (Q4)	2011 (Q4)	2013 (Q4)	2015 (Q4)	2017 (Q4)	2019 (Q4)	2020 (Q4)	2020 (Q4, Covid Adj)	2021 (Q2)	2021 (Q2, Covid Adj)	2022 (Dfin)
Labour Force (15+)	2347.6	2271.3	2228.3	2247.8	2292.2	2374.8	2471.7	2445.1	-	2533.2	-	
Particip Rate (15+)	66.2	63.1	61.9	61.8	61.8	62.2	62.7	61.3	-	63.1		
Employ (15+)	2232.9	1970.4	1888.2	1971.0	2085.4	2230.8	2361.2	2306.2	1970.6	2349.1	2120.8	2,357
Employ Rate (15-64)	71.3	62.3	60.1	62.7	65.5	68.3	70.2	67.8	57.5		64.3	

Participation rate fell to 56.9% in Q2 2020,
Labour force increased 12.1% year-on-year, Employment expected to grow 13.2% in 2022

Unemployment trends (Q4)

	2007	2009	2011	2013	2015	2017	2019	2020	2020 (Covid Adj)	2021 (Dfin)	2022 (Dfin)
Unem (15+)	114.7	300.9	340.1	276.8	206.8	144.0	110.6	138.9	468.7		
U Rate (15+)	4.9	13.3	15.3	12.4	9.1	6.1	4.5	5.7	19.4	9.3	6.5
Long-term unemp	33.2	113.4	206.5	164.6	107.1	60.0	38.7	36.8	36.8+		

September 2021

Non-SA Covid-19 Adjusted Unemployment Rate = 10% or 273,400 – down from 413,700 in June

Peak was 713,000 in April'20

Non-SA Covid-19 Adjusted Unemployment Rate , 15-24 year olds = 19.6%

Full employment UR rate is circa 4% or approximately 105,000 people based on a labour force of 2.6 million – so we are about 170,000 persons short of full employment – structural damage may mean that UR settles closer to 5-6%

Hours worked and Employment

Hours worked was up 14.9 million hours in the year to Q2 2021 (61 million to 75.9 million) – a 24.4% increase

- But was still down 2.6 million hours per week from Q2 2019 (78.5 million to 75.9 million) – a decline of 3.4%. 2019 represents the historical peak
  - Total hours worked is now higher than Q2 2017
  - Hours worked reached a modern low of 60.4 million in Q2 2012

Employment increased in all sectors in the year to Q2 2021. Strong growth in ICT, Industry, Health, Education

- - Financial, Insurance & RE (FIRE) grew by a modest 0.6% in employment terms. 131,600 working of which 48.7% are female
- However, some sectors remain below 2019 levels:
  - Accommodation & Food Services (-33.1% or -60,000, Q2’19 to Q2’21), ‘Other’ sector e.g. Arts/Entertainment/Hairdressing (-18.3% or -22,000), Construction (-12.9% or -18,900), Administration (-11.2% or -12,300), Transportation (-5.1% or -5,400)
  - FIRE was up 16.7% compared to Q2’19 (+18,800)
- No strong regional dimension

Differential impacts (Q2’19-Q2’21),

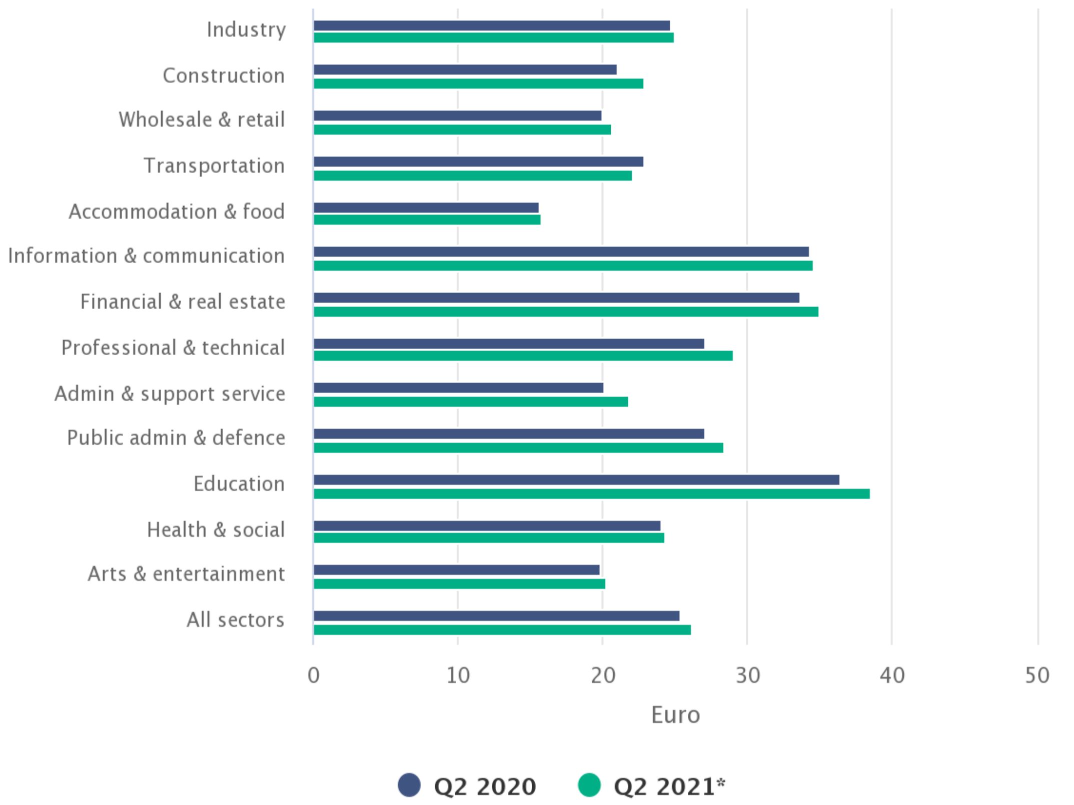
- Non-Covid adjusted employment (i.e. excl. PUP) declined in 5 of 14 sectors:
  - *E*mployment losses (non-Covid adjusted) were in *accommodation and food services*, *admin & support services*, *transport & storage*, *construction* and ‘other’ e.g. *arts/entertainment*
- Actual Hours Worked (AHW) is down in 7 sectors and is down overall
  - But Industry and ICT are performing very strongly, as are Education, FIRE, and Public admin
  - AHW in FIRE: Q2’19 = 4 million, Q2’20 = 4.5 million, Q2’21 = 4.7 million
- Job losses are concentrated amongst lower skilled workers, young workers (aged 15-24) and part-time workers
- **Gender**: Absolute unemployment increased more for males but the relative increase was higher for females

PUP Supports

- PUP recipients were at 97,100 as of 12 October 2021
  - Accommodation and food services (16,400), Wholesale & retail (15,500), Admin & supports (11,400), construction (9,100), other – e.g. Hairdressing/beauty (5,400)
    - FIRE = 2,840
  - Relatively even age spread. Largest group is the 35-44 group (26,700)
  - About half of recipients are on the lowest of the three rates, and there are more males (53.4k) than females (43.7k)
  - PUP recipients peaked at 600,000 in April/May 2020
    - Fiscal cost was about €5 billion in 2020
  - The second wave peak was 352,000 in late November
  - The third wave peak was 486,000 in January 2021
- ESRI analysis suggests that PUP/EWSS cost just €49 million extra per month (gross) per 100,000 workers relative to pre-existing income supports
  - 31,400 employers were availing of EWSS in July (341,500 employees)

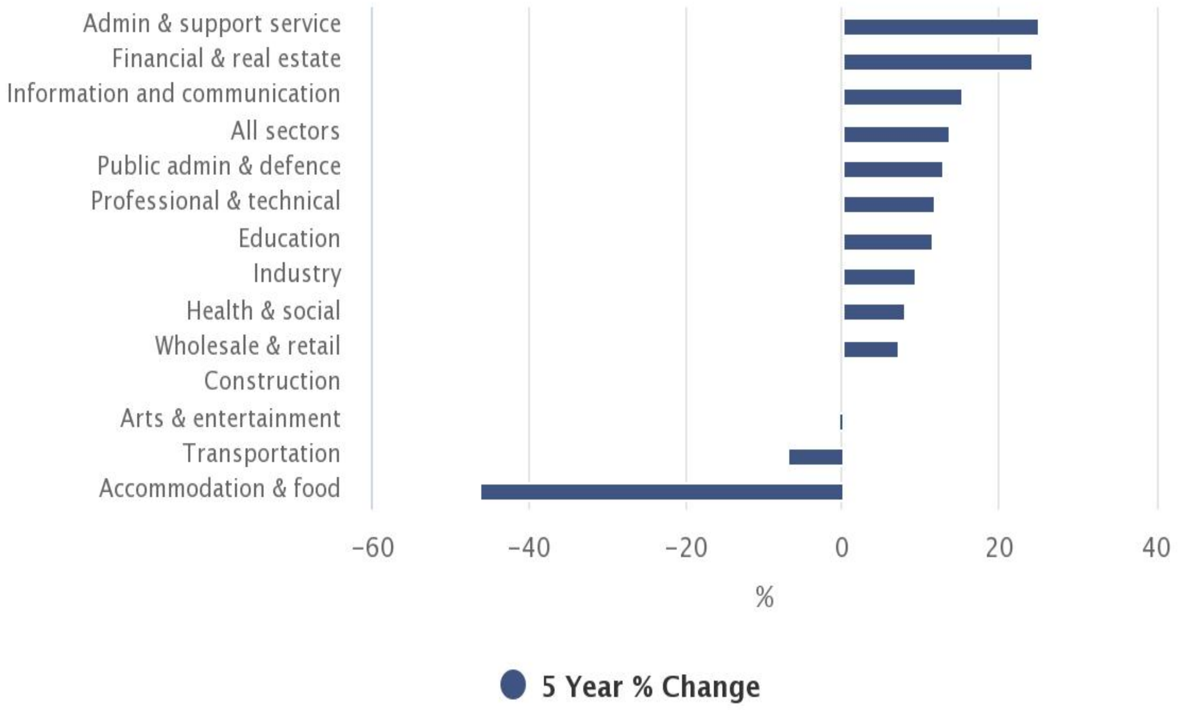
Recent wage developments (Pandemic distortions)

Figure 4: Average hourly earnings by economic sector



Source: CSO Ireland

Figure 6: Percentage change in average hourly total labour costs by sector Q2 2016 to Q2 2021



Source: CSO Ireland

Private Sector Wages, Q2 2021

- Pandemic is distorting averages due to composition of employment effects
- Weekly earnings (year-on-year)
  - Private sector +4.6%, Wholesale/retail +6.0%, Construction +8.2%, FIRE is +4.4%
  - Arts/entertainment –5.7%, Accommodation/food -7.1%, Transport/storage -3.7%
  - Private sector = €788.26 per week, €1,213.79 in FIRE
- Hourly earnings (year-on-year)
  - Private sector +3.5%, Wholesale/retail +3.3%, Construction +8.6%, FIRE is +3.9%
  - Transport/storage is the only sectors with falling wages (-3.3%)
  - Private sector = €24.29 per hour (32.5 hours), €35.06 in FIRE (34.6 hours)
- Private sector paid hours are up 1.2% year-on-year, 0.6% in FIRE
- Job vacancy rate (private sector) is 1.1%, Job vacancy rate in FIRE is 1.9%

Wider labour supply bottlenecks?

- Central Bank analysis of ‘Indeed’ data (growth in posted wages) indicates upward pressure on wages in:
  - Driving (9%),
  - Software (7%)
  - Construction (5%)
  - Hospitality and Tourism
  - Loading & Stocking
  - Food
- Analysis is restricted to new hires – but these trends often lead to incumbent wage increases. Wage growth in other sectors is weak – but job churn effects could spread the wage growth.
- Labour supply issues in skilled IT, construction and driving – demand for these skills across Europe
  - Implications for education policy?
- Will there be a strong rebound in labour supply in food and hospitality?

Projecting wage rates – the base equation

Wage Determination

Log(WAGE) = a_1 + $a_2$log(OUTPUTPR) + $a_3$log(CONSPR) + $a_4$log(TAX) + $a_5$log(LABPROD) + a_6UNEMP + $a_7$log(OTHER)

WAGE represents the wage rate;

- OUTPUTPR is the price of internationally traded goods (output);
- CONSPR is the consumption price deflator;
- TAX is the tax 'wedge';
- LABPROD is labour productivity;
- UNEMP is the rate of unemployment (this is really a proxy for the tightness of the labour market – more accurately we use sectoral/regional Job Vacancy Rates);
  - Crucially, to what extent is the economy growing? Is there overheating or recession?
- OTHER is everything else and includes things like trade union density

Wage rates are assumed to be determined as the outcome of a bargaining process - explanatory variables: output prices (+); consumer prices (+); tax wedge (+); unemployment rate (-); labour productivity (+); Other (+ and -)

Institutional forecasts, 2021-22

2021	CBI (Oct)	D Fin (Oct)	ESRI (Oct)	NERI (Oct)	2022	CBI	D Fin	ESRI	NERI
GDP	15.3%	15.6%	10.5%		GDP	7.2%	5.0%	6.1%	
Modified Domestic Demand	5.5%	5.2%	7.1%	6%	Modified Domestic Demand	7.1%	6.5%	-	6%
Consumption	6.2%	6.8%	7.5%	7%	Consumption	8.3%	9.6%	8.0%	8.5%
Gov Balance (% GDP)	-7.5%	-5.9%	-3.4%	-4%	Gov Balance (% GDP)	-4.2%	-3.4%	-1.7%	-3%
Un Rate (UR)	16.9%	16.8%	16.3%	16.5%	Un Rate (UR)	7.3%	7.2%	7.1%	7.2%
Inflation (HICP)	2.1%	2.3%	2.3% (CPI)	2.3%	Inflation (HICP)	2.9%	2.2%	2.5% (CPI)	2.5%
Comp per employee	5.1%	6.9%			Comp per employee	4.8%	6.0%		

Employment should approach 2019 levels by mid 2022

Inflation

- Price inflation
  - Central Bank (Oct) : 2021 (2.1%), 2022 (2.9%)
  - ESRI (Oct): 2021 (2.3%), 2022 (2.5%)
  - Dfin (Oct): 2021 (2.3%), 2022 (2.2%), 2023-25 average (2.1%)
- Dept. Finance
  - Personal consumption deflator: 2020 (0.7%), 2021 (3.4%), 2022 (3.3%)
  - Labour productivity: 2020 (27.1%), 2021 (7.3%), 2022 (-7.2)............composition effects.....average of 1.3% for 2003 to 2025

HICP (annual) was 3.8% in September (3.4% in the Euro area, 5.4% in the US) and 3.2% in the UK in August.

It had been negative for the first 11 months of the pandemic, turned positive in March, and has exceeded 2% in the last three months.

Likely to stay high until Q2 next year before eventually settling somewhere close to 2% in the second half of 2022

Dfin projects 4.5% in Q4’21 but falling below 2% in Q3’22

- Higher inflation relates to demand pressures, fiscal policy, labour shortages, base effects (energy & commodities) and supply chain problems (availability of inputs, transport bottlenecks)
- Likely to be temporary in nature

Short-run outlook (1) (2021-22)

- We project **GDP growth of close to 5.5% in 2022** fuelled by a robust increase in consumer spending (6% and 10% respectively). MDD should grow by 6-7% next year
- The projected expansion is based on:
  - The realisation of an unprecedented level of pent-up demand for activities constrained by the lockdown (primarily services), along with increased public investment from fiscal policy, and increased private investment as economic uncertainty fades (SME saving rose significantly in 2020) and the lockdown on construction ends
  - The normalisation of the household savings rate from its current excessive and historically high level
  - An increased demand for exports as trading partners experience strong demand based recoveries (e.g. Biden stimulus, EU NRRP)
- Important not to use previous recessions as baselines for the pace of recovery.
  - The Covid recession was a policy induced freeze on supply
  - The dynamics are qualitatively different from previous demand-side balance sheet recessions.
    - Productive capacity has broadly been protected (minimal scarring effect?)
    - In addition, policy response (monetary, fiscal, labour market) has learned from previous crises and will mainly be expansionary. Household incomes have largely held up.

Short-run outlook (risks) (2021-22)

- The unwinding of government supports remains a risk
  - The scale of business insolvency is difficult to predict and could be severe. A badly managed debt crystallisation process (e.g. back-taxes, rent arrears) could push firms over the edge. Early indications are positive.
- Scarring/hysteresis
  - Should not be as severe as during great financial crisis as there is no equivalent sectoral collapse akin to the structural collapse in construction post-2008
- Savings may be concentrated in higher income households – the commensurately lower propensity to consume may lead to a slower rebound in spending
- Fiscal/monetary policy support will not be indefinite (notwithstanding low interest environment) but likely to persist until 2023 and potentially longer
- New variants and further lockdowns
- Further Brexit effects (customs checks etc)

Short-run outlook (3) (2021-22)

- Labour market conditions should quickly improve once the restrictions are lifted. Even so, **unemployment** levels will still be elevated, **at around 7.5%** of the labour force, by Q2 of 2022. We expect it will be end-2023 before the labour market is fully or almost fully recovered.
- The extent of structural damage to the labour market remains unclear but scarring (recession induced structural unemployment) will be much less than during previous crises.
- Wage and employment growth will vary from sector to sector but average headline wage growth in 2022 will be low and perhaps negative as many of the new or restored jobs will be in low paid sectors. **Wage increases** for existing jobs should be in excess of **3% in 2022** (excess of 0.5% in real terms).
  - Wage projection could surprise to the upside
- Positive price inflation will resume in the next few months. However, NERI's baseline view is that higher inflation will prove temporary. We project **inflation** at **around 2.3% in 2021, 2.5% in 2022 and 2% in 2023**.
- Strong employment growth and the removal of once-off Covid supports will see the deficit fall significantly as of 2022, in both nominal as well as per cent of GDP terms. The key to fixing the public finances is to restore employment levels.

Conclusion

- Recent 2022 Inflation forecasts (and minimum needed to maintain living standards) range from 2.2% to 2.9%
  - A temporary spike? Inflation projected at circa 2% in 2023
- Labour productivity is difficult to estimate but pace of technological change (e.g. digital revolution) suggests it should be at least 1% per annum over the medium-term
- Labour supply issues and strong economic rebound potential suggest leverage for workers in at least some sectors – this could be a relatively short window
  - Ireland’s labour share is low.
  - Living wage increased from €12.30 to €12.90 (4.9%), national minimum wage will rise by just 2.9%