Q3 2021 Ibec Quarterly Economic Outlook

Opening up is hard to do

As we emerge from the pandemic the Irish economy is seeing a rapid recovery in domestic demand across almost every sector. The resilience of our business model has again shone through. Both locally and globally, however, this welcome bounce back from the pandemic has been tempered by significant cost increases in key inputs, energy prices and the cost of transport. In addition, the Irish labour market is experiencing capacity pressures linked to our significant supply shortages in our housing market. Ireland as a small open regional economy and an island nation is more reliant on global supply chains in areas from energy and material inputs to transport and skills. As such our continued prosperity remains more vulnerable to competitiveness shocks than most. As we have drawn attention to in the past – Ireland is also likely to suffer a greater competitiveness challenge from Brexit, from international tax reform and due to our laggard status in completing the low carbon transition. The key to weathering an exceptionally volatile external environment and reaping the long-term opportunities economic re-opening can bring is ensuring we protect our competitiveness. This can only be done by controlling costs where we can and prioritising strategic investments in innovation, digitalisation and skills.

Key indicators

Annual % change	2020	2021	2022
Consumer spending	-10.4	9.6	6.2
Domestic investment	-3.7	9.4	11.7
Exports	9.5	14.0	5.0
Imports	-7.5	-8.9	8.2
GDP	5.8	15.5	5.9
Inflation	-0.3	2.1	3.1
Unemployment rate (annual average %)	16.7	17.4	8.1
Unemployment rate, Q4	20.7	10.6	6.8

Ibec
For Irish Business

Overview

Economic overview

High-frequency economic data now suggests that Ireland's consumer economy is returning to levels of activity last seen in the pre-Covid era. These trends will become increasingly durable as we see sustained re-opening across the economy in the coming months. The export side of the private sector continues to grow strongly with exports of both goods and services rising by 30% relative to the first half of 2019 (albeit flattered by exports manufactured for Irish firms under contract abroad). There is no doubt the Irish economy is recovering its momentum quite rapidly. On the other hand, there is significant uncertainty in the global business environment. Rising costs in areas such as transport, energy and raw materials are reflective of major pressures on supply chains as the global economy re-opens from Covid related restrictions. Whilst the pace of some of these cost pressures may ease as supply dynamics adjust, many are set to be with us for some time. What is more, whilst cost increases may normalise over time, Ireland may still be left with a permanently higher cost base. For businesses, this means a challenging and deeply uncertain environment ahead when it comes to operating margins. For a small island economy, which is heavily reliant on an open labour market, strong transport links and energy imports, the competitiveness challenges of these trends will be multiplied.

Merchandise exports

Merchandise goods exports increased by 5% in the first seven months of 2021 relative to the same period in 2019. Relative to the same period in 2016, exports are up by 39% or around €3.7 billion per month. This growth has been amongst the fastest in the developed world over that period. It is worth noting, however, that about 85% of this growth has been driven by the spectacular growth in BioPharma exports. This has been driven by major investments in a new generation of plants in the biologics or large molecule space. Excluding the BioPharma sector, Irish exports are up 14% over five years and are only marginally (0.6%) higher than they were in the first seven months of 2019. This underpins the need to take a sectoral view of Irish exports when understanding their final impact on the broader economy. Looking forward to the rest of 2021 and into 2022, we expect that export growth will continue to drive a strong recovery in the economy at large. Improvements in global demand along with secular demand for products and services in the food and drink, life sciences and ICT sectors will all underpin strong growth in Irish exports. We expect export growth of over 5% again in 2022.

Investment

Total physical investment in Ireland has seen a much bigger fall than most of the eurozone over the past two years. Total capital investment (excluding purchases of intellectual property) fell by 10.3% in the first half of 2021. This is relative to a 2.4% rise in investment over the same period in the eurozone. Most of this investment gap has been driven by two factors – falling investment in aeroplanes and longer lockdowns in construction. The first aspect is driven by an outsized (19%) share of transport investment in Ireland's overall capital investment relative to the eurozone (9%) due to the size of our air travel sector. On the other hand longer lockdowns in construction have seen Irish construction investment fall by 8.2% in H1 2021 relative to 2019, whilst construction investment in the eurozone has grown by 5.8% over the same period. All of this means that, as lockdowns ease and some normality returns to investment activity, Ireland is likely to see a bigger bounce-back in investment than most of our eurozone partners.

Figure 1: Key indicators change H1 2021 versus H1 2019

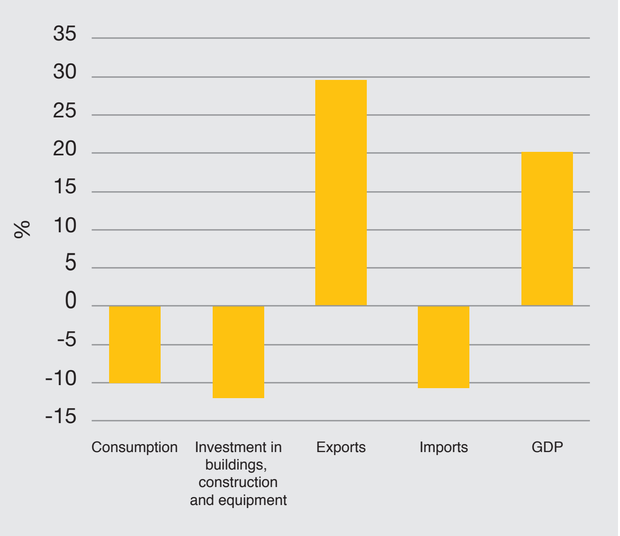


Figure 2: Goods exports by month, cumulative

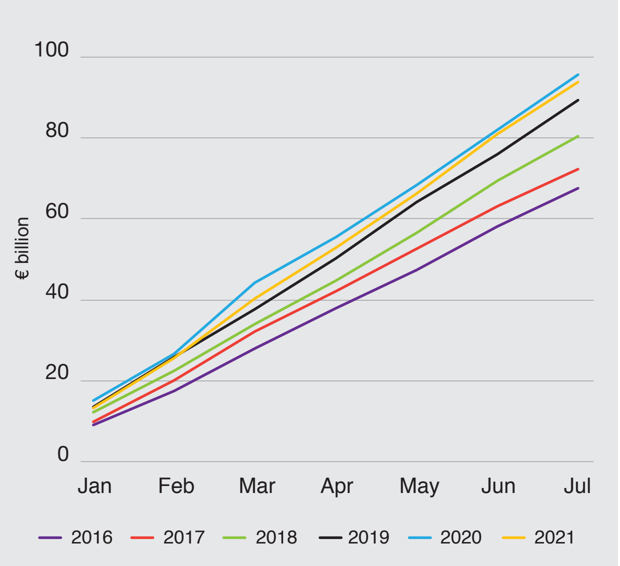
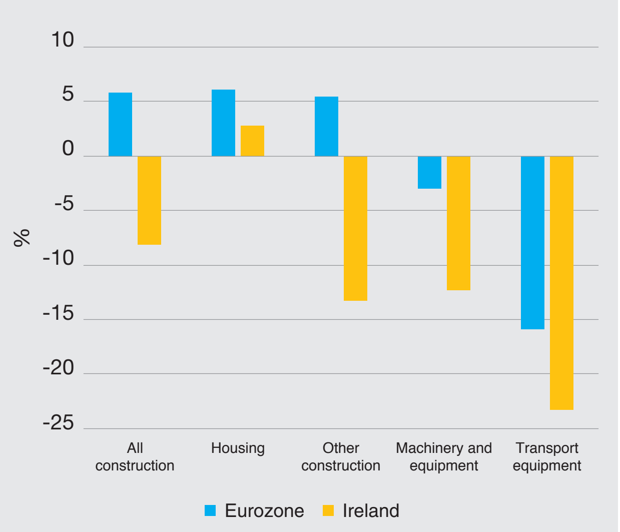


Figure 3: Investment growth in Ireland and the eurozone



Consumption

Consumer spending

Data on all credit card, debit card and ATM transactions from the Central Bank shows that the months from July until September saw the first consistent readings of household consumer spending over and above their March 2020 levels. In the seven days to the 12th of September total card spending rose to €1.7 billion. This represents an increase of €250 million per week (17%) on the first week in May and €360 million (27%) on the first week in February. The underlying fundamentals of re-opening, a tight labour market, recovering consumer sentiment and elevated, but falling, rates of saving will underpin strong consumer demand over the coming months. Indeed, Christmas 2021 may be an extremely busy season for Irish consumer businesses. On the other hand, the impact of rising energy and housing costs for many cohorts of consumers may counterbalance some of the positive factors as we head into the winter season. We expect strong growth in consumer spending over the coming two years on the back of these positive fundamentals despite global challenges.

Savings

Total deposits from Irish households in Irish banks rose to €124 billion in Q2 2021. This is an increase of just under €20 billion (19%) relative to the final quarter of 2019. Deposits from Irish households now outstrip outstanding lending to Irish households by almost €39 billion, the highest level of record. Relative to other eurozone countries Ireland has gone from having a savings rate (as a share of after-tax income) which was (10.5%) well below average (13.3%) in 2019 to one which was the highest in the eurozone in 2020. Ireland was, at 25.7%, marginally ahead of other countries with high saving rates such as the Netherlands (25.4%), Slovenia (25.3%), Germany (24%) and Belgium (22.2%). In part, these savings have been driven by the fact that Irish households spend significantly more – as a percentage of their after-tax income – on eating and drinking out, travel, entertainment and other areas of the Experience Economy. A return even toward normal rates of saving on new income could, regardless of the use of existing pandemic savings, significantly increase consumer spending. Every five percentage points drop in the rate of savings in 2021 and 2022 relative to 2020 would release a little over €6 billion for household consumption.

Inflation

Inflation over the first eight months of the year has been relatively benign when taken as a whole at only 1.1%. However, recent months have seen annual price increases of nearly 3%. Globally there are significant price pressures facing producers with a range of key inputs to manufacturing, construction and consumer goods showing record global price spikes as the economy re-opens. For example, global transport costs have also seen post-pandemic spikes with shipping costs on routes from East Asia to Europe seven times higher than this time last year. In addition, the wholesale price of natural gas in Europe is 250% higher than in January. Increasing prices for consumers were, until recent months, driven solely by the impact of rising oil prices globally on transport and energy costs. However, rising cost pressures are now more broad-based with increases in a range of producer and consumer prices. For example, there have been significant increases in the cost of vehicles (7.3%) and household appliances (6.9%) annually in August on the back of unmet demand and a global shortage of microchips. Similar increases can be seen in areas of DIY and other household goods. The interaction of global cost pressures and consumer prices in Ireland will be determined by both the duration of these cost conditions facing business, the impact on consumer demand and labour market bottlenecks and the level of price pass-through. What is clear is that the outlook for the remainder of 2021 and into 2022 is marked by significant uncertainty. We expect inflation of 2.1% in 2021 and 3.1% in 2022.

Figure 4: Spending on credit and debit cards, 7 day moving sum

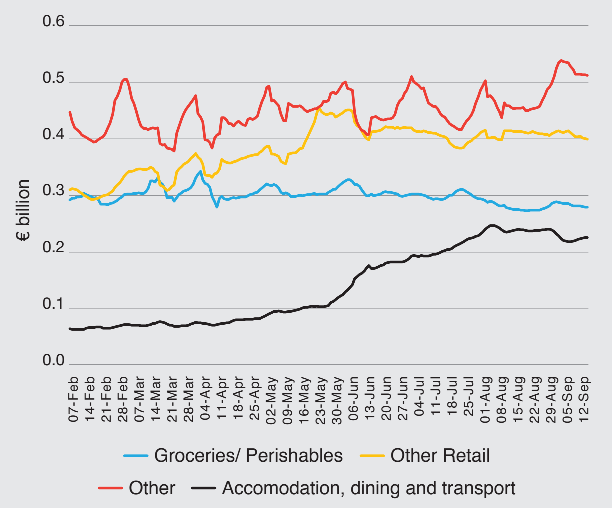


Figure 5: Total lending and deposits from Irish households

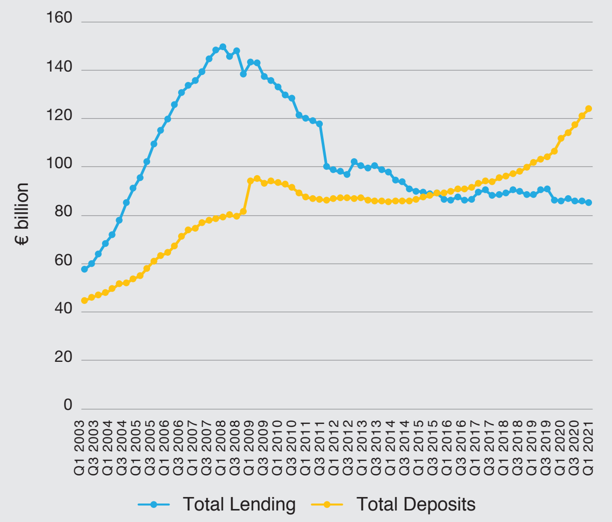
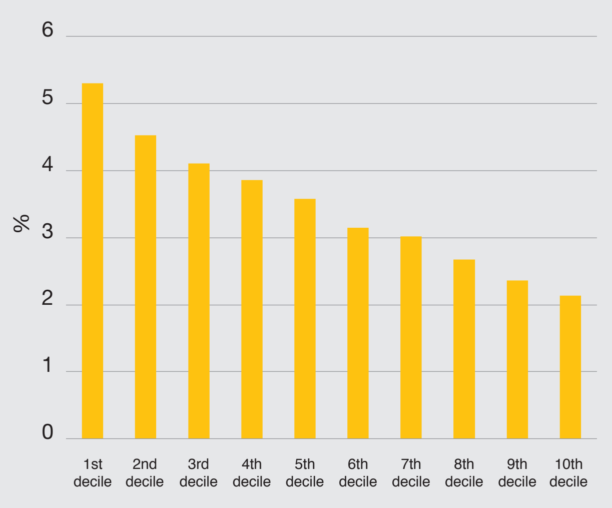


Figure 6: Electricity and Gas consumption by income decile (% of household expenditure)



Labour market

Labour market overview

The reopening of many sectors has brought about a rapid improvement in employment over the summer, with numbers on the Pandemic Unemployment Payment (PUP) down to just under 110,000 people, the lowest since the payment was introduced. There is a combined total of 290,461 people on either the PUP or Live Register, compared to just under 500,000 on the PUP alone at its February peak. The monthly COVID-adjusted unemployment rate, which considers both people on the PUP and the Live Register, is 12.4%. This remains significantly above the 5% unemployment rate just before COVID. However, given the adjusted unemployment rate peaked at 27% in the lockdown of the first quarter, this effectively means that unemployment has more than halved on the back of the reopening. That figure will continue to improve over the remainder of the year, albeit at a slower pace.

Regional employment recovery

The recovery in employment has been strong regionally, with all counties excluding Dublin and some commuter counties seeing a decrease of numbers on the PUP of between 77% to 83% since peak unemployment in February. Mayo has seen the most rapid improvement, with PUP recipients falling by 82%, with just over 2,000 people currently on the payment. Counties Kerry, Wexford, Kilkenny have all seen similar levels of improvement in terms of employment. In contrast, the relative employment recovery in Dublin and surrounding counties has been slower, with numbers claiming the PUP in Dublin down by 72% over the same period, leaving a total of 41,617 people still reliant on the payment in the capital. This is likely due to the higher number of hospitality and retail workers in the county and the slower re-opening of the city centre economy. The cities of Cork, Limerick and Galway are faring comparatively better, with PUP claimants falling by 77-80%.

Figure 7: Numbers on the PUP

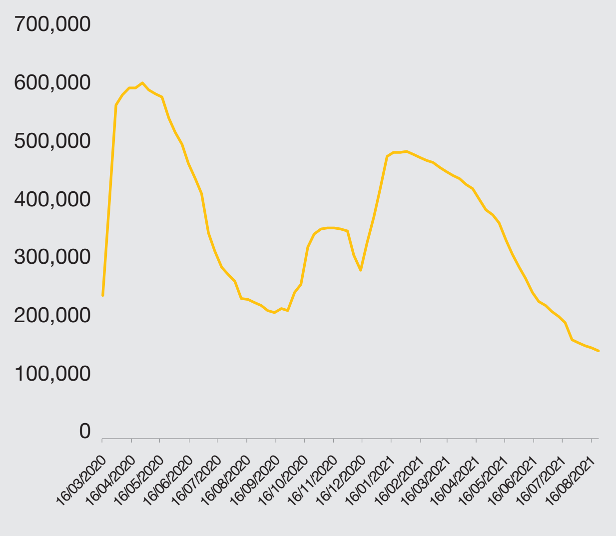


Figure 8: Current PUP recipients vs February peak unemployment

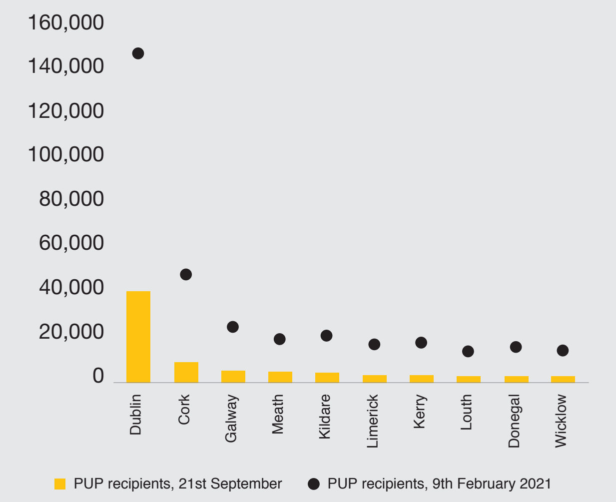


Table 1: Employment, 000s annual average (including PUP as unemployed)

	2020	2021 (f)	2022 (f)
Agriculture	100	104	105
Industry & Construction	397	402	434
Services	1,567	1,602	1,707
Total	2,064	2,108	2,247
Employment growth (%)	-10.9%	2.1%	6.6%
Unemployment rate (annual average %)	16.7%	17.4%	8.1%
Unemployment rate, Q4	20.7%	10.6%	6.8%

Source: Ibec forecasts

Employee wage subsidy scheme
There are currently just over 300,000 employees receiving the Employee Wage Subsidy (EWSS), making up 14% of all employees in the state. A total of 28,500 employers are availing of the scheme, with €388m in wage subsidy payments paid out in August. The EWSS is continuing to play a strong role in supporting Ireland's employment recovery, effectively acting as a pipeline for workers from the PUP into employment. Just under 65,000 people moved off the PUP into employment in July and of these 64,200, or 99%, moved into EWSS supported employment. The scheme is to be extended until the end of 2021, with the Government committing to no cliff-edge withdrawal of the support. The decision as to whether the scheme will be extended into 2022 and in what form will be taken later in the year.

Sectoral Reopening
The staggered re-opening of activity across the economy has reduced unemployment among workers across all sectors, albeit at varying rates. Construction, hospitality and personal services such as hairdressing have all seen the largest drop in workers on the PUP since peak unemployment this year, falling by around 83%. Despite the rapid improvement in those sectors, as one of the largest sectors in terms of employment, hospitality workers still account for 17.6% of all PUP claimants. Together, hospitality, retail and administrative workers make up just under half of all those remaining on the PUP, or 50,000 people. Amid ongoing disruption in the labour market, several sectors are reporting hiring difficulties. This is likely due to a number of factors, including the sharp reduction in immigration of foreign workers throughout COVID, the relocation of some workers out of urban centres and frictions within the labour market as workers seek new employment or to reskill.

Skills needs
Widespread disruption in the labour market has resulted in the unusual position of both relatively high numbers seeking work and simultaneous skills and labour shortages in certain sectors. As the economy kicks back into high gear, with both consumer demand and construction taking off, the hospitality and construction sectors are reporting difficulty filling vacancies, while pre-existing pinch points within ICT and Finance are persisting. To accommodate strong economic growth over the coming years and Ireland's ambitious plans in terms of housing and carbon reduction, there will be an urgent need for new skilled labour. To this end, Government forecasts expect that we will need a minimum of 17,500 additional construction workers annually over the next four years. In addition, the action plan on apprenticeship commits to doubling annual apprenticeship registrations, up to 10,000 a year to address skills shortages in a wide range of areas. With the inward migration of workers declining even before COVID, there will be an increasing need to train for in-demand skills domestically.

Figure 9: Share of employees receiving Employment Wage Subsidy Scheme

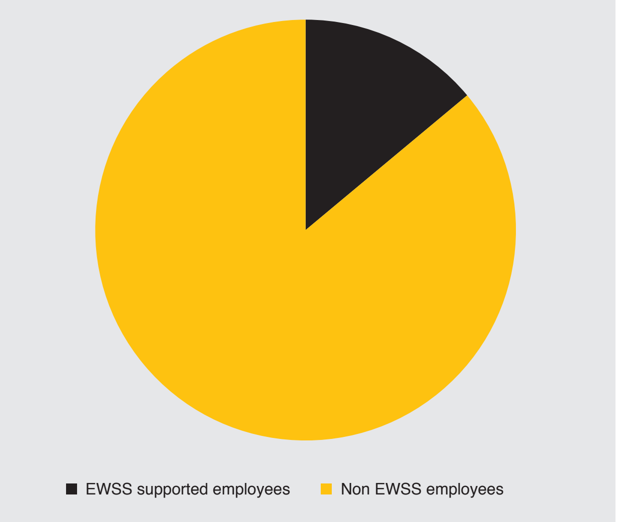


Figure 10: Sectoral share of PUP claimants, ten largest contributors

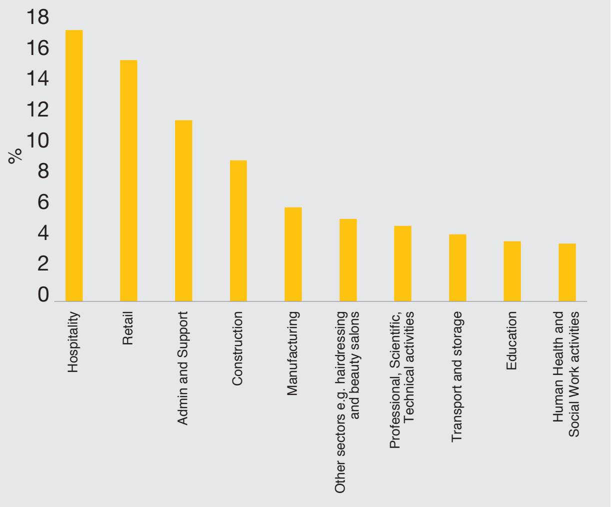
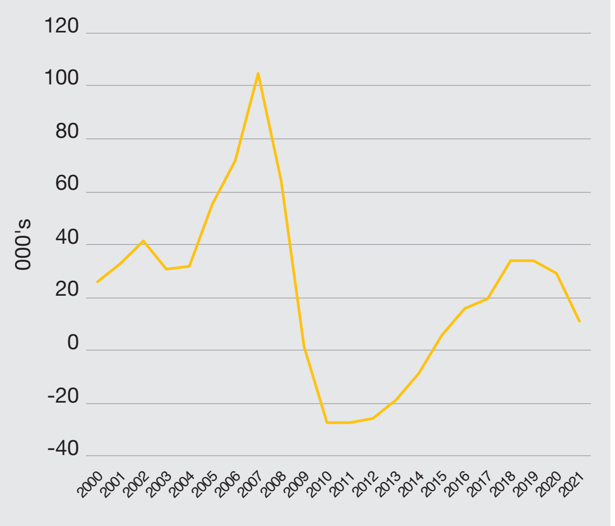


Figure 11: Net migration



Global Economy

EU recovery

The widespread rollout of vaccines across EU member states along with the parallel easing of restrictions has led to a return to growth over the summer. While comparisons with an especially difficult year in 2020 will lead to volatility and unusually high growth figures this year, the broad recovery across EU member states is a positive sign that the wider EU economy has turned a corner. GDP growth for the EU as a whole was 13.8% in Q2 compared with the same period in 2020, with all EU members returning to annual growth after a difficult winter. As economic activity picks up, there has also been a bounce-back in employment across many Member States, with numbers employed across the EU up 1.8% annually. While broadly positive, the recovery in employment has been more uneven than that of overall growth, with several states including Romania, Slovakia, Bulgaria and Germany seeing negative or stagnant employment growth in contrast with Spain, Hungary, Austria and Portugal which have all seen employment growth of more than 4%.

US employment and labour shortage

On the back of a strong jobs recovery, there has been an annual increase of 6 million in total nonfarm employment in the US in 2021. Within that figure, the areas of employment growth have been similar to that seen in other developed economies, with leisure and hospitality and business services growing strongly as COVID related restrictions are eased, with an additional 2.2 million and 1.8 million jobs respectively. So far this year, an average of 586,000 new jobs have been created in the US each month, bringing the US unemployment rate down to 5.2%. This strong employment growth brings its own challenges, as employers now compete to attract workers in the face of labour shortages. Retail vacancies hit 1.2 million roles this Summer, 36% more than the same period before Covid. Total private sector vacancies have risen even more dramatically, with almost 10 million unfilled roles in July, a more than 50% rise over usual pre-pandemic levels.

Global trade

Global goods trade bounced back early this year as several major world economies saw an uptick in demand both for manufacturing and construction inputs and consumer durables. The first quarter of the year saw global trade in goods grow 10% year on year, with trade in goods rising above pre-pandemic levels, while services have been slower to recover. However, over recent months rising COVID cases in East Asia, which is home to many of the worlds' manufacturing and shipping hubs, have slowed growth. In particular, several port closures in China have both added to the dramatic growth in shipping costs globally, as well as placing further strain on supply chains. The closures are having a widespread impact on shipping further afield, with ports in the US now facing their own backlogs as the global movement of containers slows and congestion spreading to the major European ports of Rotterdam and Antwerp.

Figure 12: Annual GDP growth EU14

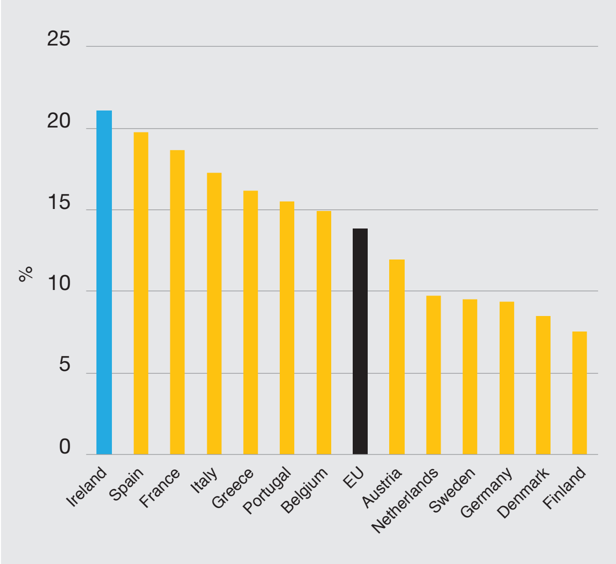


Figure 13: US total private sector job openings

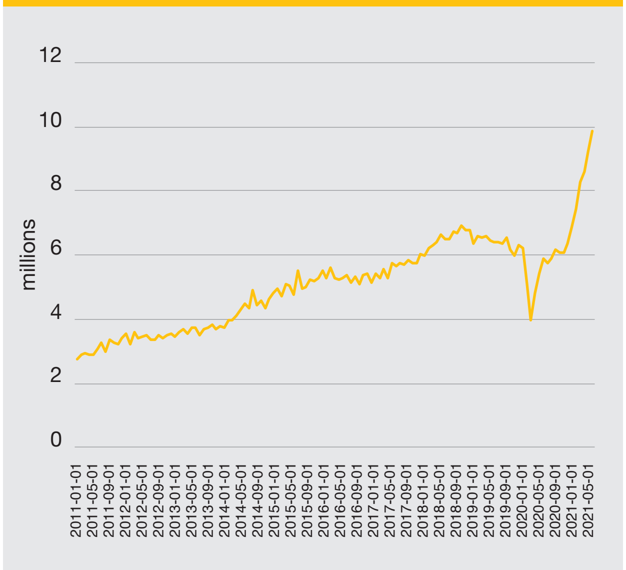
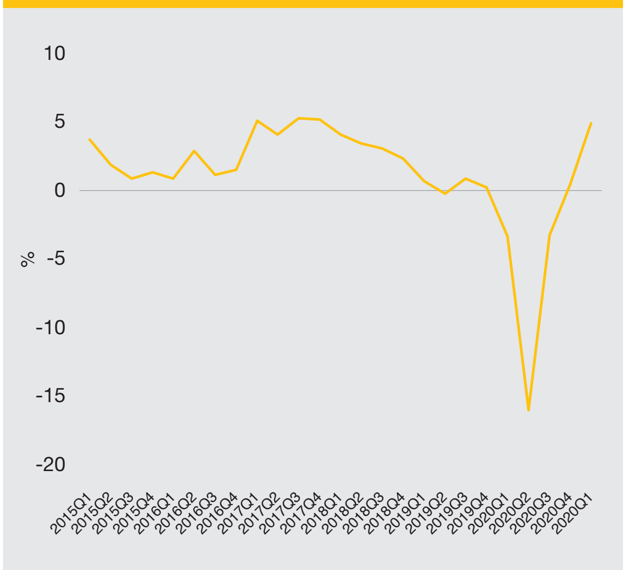


Chart 14: World export growth, % y-o-y



Brexit and All-island trade

All-island

Much focus has been given in recent months to the increasing share of Irish imports coming from Northern Ireland. In total this share has risen from 1.8% in 2019 to 3.8% in the first seven months of 2021. By way of comparison, the share of Irish imports coming from Great Britain has fallen from 21% to 11% over the same period. This level of import share from Northern Ireland is a change relative to recent years but would not have been unusual before the mid-1990s when Irish trade data was not as dominated by multinational supply chains. Much of this change has come about due to growing demand for Northern Irish products in the face of a significant change in trade structures and costs post-Brexit. In addition, the CSO has drawn attention to revisions to previously existing data whereby an inability (before Brexit) to separately identify Northern Irish VAT numbers led to an underestimate of over 27%, or €1 billion, in cross-border goods trade. Significant gaps still exist in our understanding of the All-Island economy - particularly when it comes to other points of integration such as services trade, transport and labour flows. In this context, and the context of significant change in the All-island economy, the recent strategy of the National Statistics Board outlined the need for further data collaboration projects between agencies, taking a shared-island view.

Industrial production

Industrial production in Northern Ireland has significantly outperformed that in Britain since January 2020. Total production across all industries is up 4.2% by Q2 2021 relative to a fall of 1.3% in the UK as a whole. Growth has been particularly strong in the food and drinks sector with production rising 8.5% over the same period (relative to only 0.5% in the UK as a whole) and the BioPharma sector, which has seen an increase in production of 20% (relative to 4.1% in the UK). Of the total increase in manufacturing output the main driver has been in intermediate goods (electronics components, ingredients, chemicals) rather than consumer or capital goods such as plant and equipment.

EU imports

The share of imports in major EU economies coming from the UK plummeted in the first half of 2021. Of the countries for which we have full H1 data the share of imports coming from the UK fell by between 22% in France and 55% in Portugal. This can be seen as Brexit accelerating a long-term trend where greater global interlinkages led to the UK share of EU countries imports falling significantly over several decades. For example, through the 1990s the UK accounted for over 7.7% of German imports. This had fallen to4.3% in the past decade but fell to 2.4% in the first half of 2021. With supply chains re-opening and global economies on the mend, it is now likely that these import trends represent a real and sustained re-alignment of the structure of trade within Europe.

Figure 15: % of imports cross-border

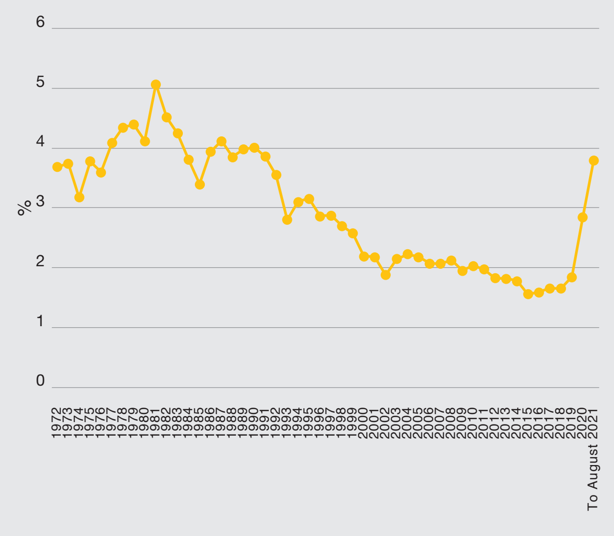


Figure 16: Index of food, beverage and tobacco production

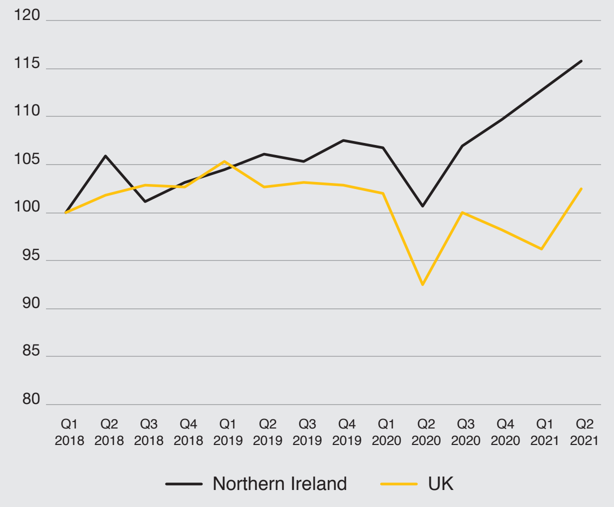
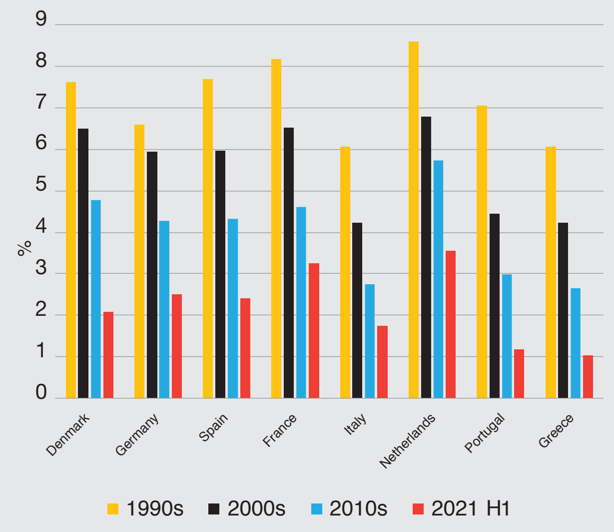


Figure 17: Share of imports from the UK



Budget 2022

Next week's Budget will be a crucial one for business. The focus on this and coming budgets is going to be on the big infrastructural deficits – housing, climate, transport. That means funding will be relatively tight for day-to-day tax and spending at around €1.6 billion annually. At the same time, we are also facing significant competitiveness threats to our business model. Without a continued focus on competitiveness, the tax receipts to underpin the investments society needs will not exist. As a result, Ibec recommends that next week's Budget address three key areas:

1. Underpin competitiveness, digitalisation and innovation
Continued support to induce additional business investment, digitalisation and innovation, tackling key labour market challenges, and helping companies deal with the permanent increase in trade costs represented by Brexit are all key to facilitating the tax returns needed to underpin ambitious public investment.

Keys asks:

- Radically improve the tax treatment of SMEs including significant improvements to investment supports such as capital gains tax entrepreneurs' relief.
- Scale public investment in research and innovation by €112 million or 20% per annum every year to 2025.
- Stand ready to use the Government's €2.8 billion contingency reserve in the case that additional support is needed for sectors worst impacted by Covid.
- Use €540 million of the €1 billion Brexit Adjustment reserve to help Brexit impacted firms innovate, find new markets, and improve their competitiveness through direct grant support and an export credit insurance scheme.

2. Prepare our business model for change
We must address the competitiveness challenge of global tax changes by investing in other growth levers, such as improving our tax offering in areas we control and investing in education, digital transformation, research and development and critical infrastructure.

Keys asks:

- Work with stakeholders to prepare our corporate tax offering for significant change through regime simplification from 2022 onward.
- Significantly improve the attractiveness of the R&D tax credit, expanding limits on outsourcing to third parties like universities and research specialists.
- Introduce accelerated capital allowances for advanced manufacturing in areas like computer-aided machinery and robotic machines.
- Make sure we continue to produce highly skilled workers by investing over €130 million in education and skills in 2022.
- Invest €50 million in our digital capacity including investments in digital regulatory and cybersecurity capacity, digital skills and an updated National Digital Strategy.

3. Build back better
Revitalising our labour market and building for a new world of work, give companies the support necessary to meet ambitious low-carbon targets and make targeted interventions in areas like childcare can help us drive a new economic model which builds back better.

Keys asks in the submission are for the Government to:

- Urgently prioritise the commitments outlined in the 'First 5' childcare strategy in a much shorter timeframe by investing €110 million in 2022.
- Provide an additional €220m to drive low carbon investment in business by scaling up and expanding industry supports in areas like renewable heat, pursuing VAT reform at an EU level and introducing further incentives for commercial fleets to adopt lower emission vehicles.
- Improve access to the labour market by providing €28 million of additional support to carers and persons with a disability.

Housing and construction

Housing for All plan

Under the recently announced Housing for All plan, the Government has committed to delivering 300,000 new homes by 2030. Just over half of these new units are intended to be provided by the private sector, while the balance will be delivered as a mix of social and affordable housing. Since 2019 there have been around 20,000 total new dwellings completed in Ireland each year. Achieving the plan's targets would mean delivering an average of 33,000 dwellings a year, requiring a rapid scaling of housing output that is likely to be backloaded towards the end of the decade. Under the Housing for All plan, 90,000 additional social housing units are targeted for 2030. Before COVID, social housing output had seen between 4,000 and 6,000 new builds delivered by local authorities and approved housing bodies each year. This would need to rapidly increase towards 9,500 annually. While the additional €4 billion in spending on housing under the plan should go some way towards providing urgently needed additional supply, the timing of this investment means that rising labour and construction input costs will likely impact both project timelines and the total cost of delivery.

Homeownership

Recent data from the CSO highlights the impact of the housing crisis on homeownership and tenancies in the country. Both first time home purchases and trading-up are happening later in life amid undersupply of housing and higher barriers to mortgage approval. In 2010 the median age of home purchase, including apartments, was 35. By 2019 this had risen to 38. The change was even more marked for sole purchasers, including single-parents, for whom the median age of home purchasers rose from 34 to 42 over the same period. The effect of mortgage lending restrictions is also coming through in the demographics of who is buying residential property, with joint purchasers making up two-thirds of all purchases in 2019 compared to just under half of all purchases a decade ago, as single buyers find it harder to meet the deposit and loan-to-income restrictions amid rising property prices.

Construction inputs squeeze

Sharp increases in both the global demand for building materials as construction resumes around the world and rising transport costs are driving ongoing cost pressures on construction activity. Overall building materials wholesale prices have risen by 9.9% annually. Timber prices in Ireland have risen between 58% to 65% annually, while structural steel and reinforcing metal wholesale prices have risen by a fifth over the same period. Similarly, electrical fittings, plaster and PVC have all seen an increase in the range of 15% to 20%. The resumption of construction projects delayed due to COVID in many developed countries, as well as an uptick in new projects, have placed pressure on supply chains globally, as materials suppliers struggle to keep up with a sudden bounce-back in demand. Adding to difficulties in the sector, international shipping costs continue to rise, further increasing costs and worsening lead times. Sea and land freight costs have been rising globally, with the average cost of shipping a 40ft container from East Asia to Northern Europe at a record high of $14,000, an increase of 570% over the previous year.

Figure 18: Projected housing stock under Housing for All plan, thousands

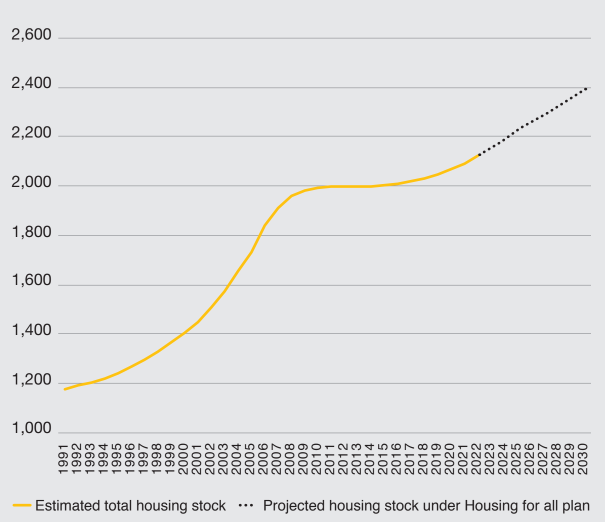


Figure 19: Housing completions by type

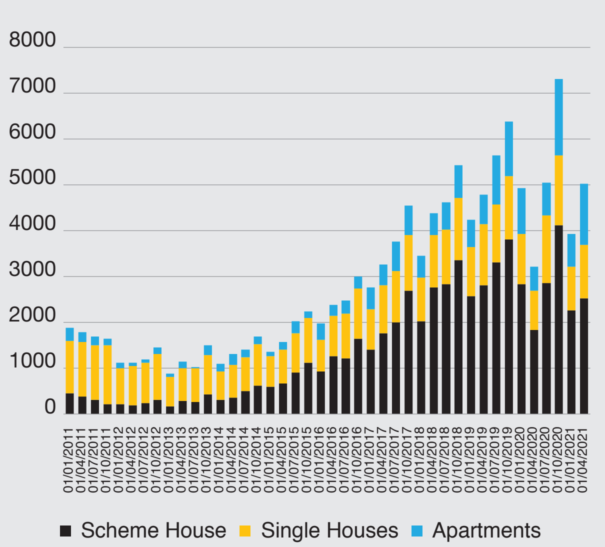
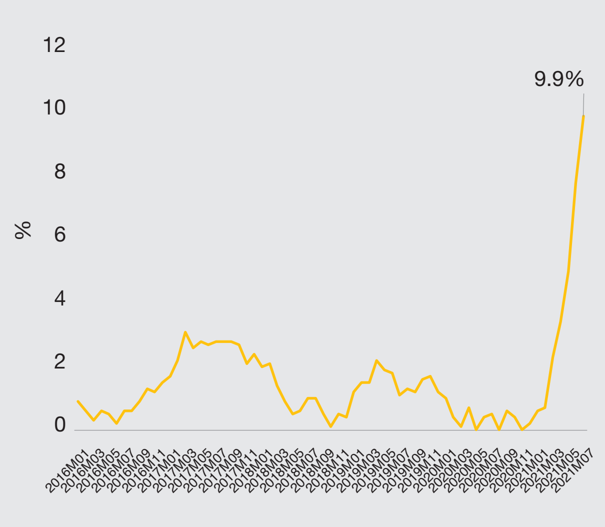


Figure 20: Construction materials wholesale price, annual % change.



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