Goodbody

Irish Economy

Health Check - Embarrassment of Riches

July 2023

Robust growth in domestic demand continues

Large budget surpluses expected out to 2026

Higher capital spending can improve medium-term growth potential

Economists

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Irish Economy

Health Check Q3 2023

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Embarrassment of riches

Solid growth in domestic spending continues

The Irish economy continues to perform ahead of expectations, fuelled by robust growth in consumer spending, a strong FDI sector and healthy government finances. We are upping our forecast for modified domestic demand (MDD) to 2.6% in 2023 (from 0.7%), reflecting a better-than-expected performance in H1. Solid growth (2.4%) is expected to continue in 2024, despite international risks.

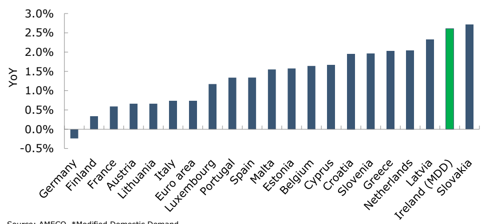
Budget surpluses should be used to stabilise capital spending plans

Helped by a boom in corporation tax revenue, the Irish government has an "embarrassment of riches" at its disposal and thus has important choices to make. An estimated budget surplus of 4% of GNI* is the best in the euro area, but there are vulnerabilities. Reflecting this and the acute infrastructural needs of the country, a proposed new "capital spending stabilisation fund" is to be welcomed and should target spending of 5% of GNI* over the medium term.

Housing output holding up despite interest rate hikes

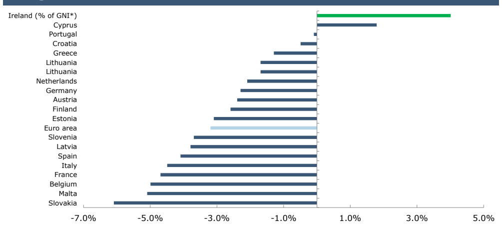
Housing output is holding up better than feared despite viability constraints due to costs and higher interest rates. We forecast housing completions of 30K units in 2023, in line with last year's levels. Increased state involvement has been key here and will remain a feature of the Irish housing market. Rate rises should not pose a threat to household financial stability given prudent lending rules of recent years.

2023 domestic demand growth by country



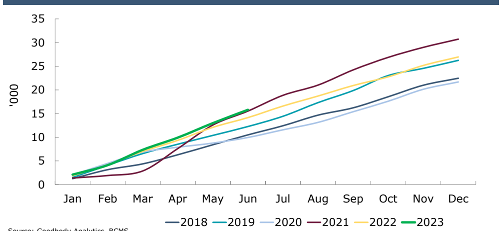
Source: AMECO, *Modified Domestic Demand

Budget balances in the euro area 2023



Source: CSO, AMECO, Goodbody

Housing commencements holding up despite rate risks



Source: Goodbody Analytics, BCMS

Economic Indicators	2021	2022f	2023f	2024f
Growth Components				
Consumption	8.4%	9.4%	4.2%	3.2%
Government	6.3%	3.5%	0.8%	2.0%
Investment	-40.4%	5.1%	1.3%	1.4%
- Modified Investment	0.5%	15.9%	0.3%	0.7%
Domestic Demand (DD)	-17.5%	6.7%	2.5%	2.3%
- Modified DD	6.2%	9.5%	2.6%	2.4%
Exports	15.1%	13.9%	5.2%	4.5%
Imports	-7.5%	15.9%	6.2%	4.7%
GDP	15.1%	9.4%	3.0%	2.9%
GNP	13.9%	3.9%	2.1%	2.4%
Prices				
Consumer Price Inflation	2.4%	7.8%	6.1%	2.8%
House Price Inflation (end-year)	14.2%	7.7%	0.5%	3.8%
Wage Inflation (GBS)	4.8%	3.3%	4.2%	3.7%
Fiscal				
GGB / GDP	-2.0%	1.6%	2.1%	2.2%
Debt/GDP	55%	47%	44%	41%
Consumer Profile				
Employment Growth (end year)	10.2%	2.8%	3.0%	1.3%
Unemployment Rate (end-year)	5.2%	4.4%	4.2%	4.6%
Exchange Rates (Avg for the year)				
€/$	1.18	1.06	1.09	1.18
€/£	0.86	0.85	0.88	0.90

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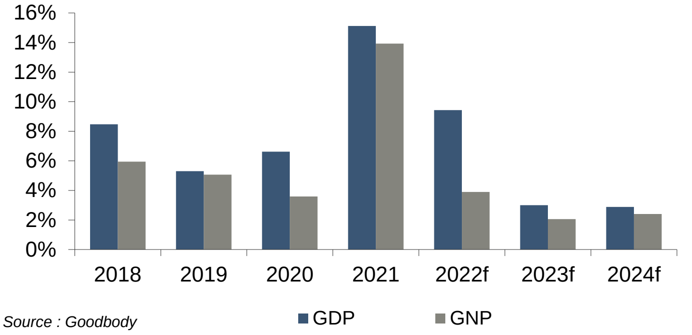
DOMESTIC MACRO DATA	2020a	2021a	2022f	2023f	2024f
Growth Components					
Consumption	-9.9%	8.4%	9.4%	4.2%	3.2%
Government	11.6%	6.3%	3.5%	0.8%	2.0%
Investment	-16.5%	-40.4%	5.1%	1.3%	1.4%
- Modified Investment	-10.6%	0.5%	15.9%	0.3%	0.7%
Domestic Demand (DD)	-11.3%	-17.5%	6.7%	2.5%	2.3%
- Modified DD	-6.1%	6.2%	9.5%	2.6%	2.4%
Exports	11.5%	15.1%	13.9%	5.2%	4.5%
Imports	-1.7%	-7.5%	15.9%	6.2%	4.7%
GDP	6.6%	15.1%	9.4%	3.0%	2.9%
GNP	3.6%	13.9%	3.9%	2.1%	2.4%
Housing Statistics					
Completions	20,574	20,553	29,822	30,034	30,351
Average House Price (€k)	280,267	320,101	344,818	346,464	359,779
House Price Inflation (end-year)	2.2%	14.2%	7.7%	0.5%	3.8%
Mortgage Credit Growth (end-year)	0.9%	1.2%	-0.9%	1.5%	2.5%
Prices					
Consumer Price Inflation	-0.3%	2.4%	7.8%	6.1%	2.8%
Wage Inflation (GBS)	5.0%	4.8%	3.3%	4.2%	3.7%
Fiscal					
Exchequer Balance	-12,315	-7,372	4,884	5,877	9,100
Exchequer Balance / GNP	-4.4%	-2.3%	1.3%	1.5%	2.2%
General Government Balance	-18,415	-8,522	7,934	11,352	12,390
GGB/GDP	-4.9%	-2.0%	1.6%	2.1%	2.2%
GGB/GDP - ex banking costs	-4.9%	-2.0%	1.6%	2.1%	2.2%
Debt/GDP	58%	55%	47%	44%	41%
Consumer Profile					
Employment Growth (end year)	-3.3%	10.2%	2.8%	3.0%	1.3%
Employment Growth (Full-year avera	-2.8%	6.0%	6.6%	3.4%	1.6%
Unemployment Rate (end-year)	6.2%	5.2%	4.4%	4.2%	4.6%
Debt/Disp. Income	107%	98%	90%	85%	82%
Interest Rates (At year end)					
ECB	-	-	2.50%	4.00%	3.75%
BoE	0.10%	0.25%	3.50%	5.75%	5.25%
Fed	0.25%	0.25%	4.50%	5.50%	5.00%
Trade					
Current Account (€m)	-100,248	60,573	49,659	58,404	65,024
CA as a % of GDP	-26.7%	14.0%	9.8%	10.9%	11.5%
Exchange Rates (Average for the year)					
€/$	1.14	1.18	1.06	1.09	1.18
€/£	0.89	0.86	0.85	0.88	0.90

SOVEREIGN ANALYSIS	2020a	2021a	2022f	2023f	2024f
Debt/GDP					
Austria	83%	82%	78%	75%	73%
Belgium	112%	109%	105%	106%	107%
Cyprus	114%	101%	87%	80%	73%
Finland	75%	73%	73%	74%	76%
France	115%	113%	112%	110%	110%
Germany	69%	69%	66%	65%	64%
Greece	206%	195%	171%	160%	154%
Ireland	58%	55%	47%	44%	41%
Italy	155%	150%	144%	140%	140%
Luxembourg	25%	25%	25%	26%	27%
Malta	53%	55%	53%	55%	56%
Netherlands	55%	53%	51%	49%	49%
Portugal	135%	125%	114%	106%	103%
Slovakia	59%	61%	58%	58%	59%
Slovenia	80%	75%	70%	69%	67%
Spain	120%	118%	113%	111%	109%
Eurozone avg.	99%	97%	93%	91%	90%
GGB/GDP					
Austria	-8.0%	-5.8%	-3.2%	-2.4%	-1.3%
Belgium	-9.0%	-5.5%	-3.9%	-5.0%	-4.7%
Cyprus	-5.8%	-2.0%	2.1%	1.8%	2.1%
Finland	-5.6%	-2.8%	-0.9%	-2.6%	-2.6%
France	-9.0%	-6.5%	-4.7%	-4.7%	-4.3%
Germany	-4.3%	-3.7%	-2.6%	-2.3%	-1.2%
Greece	-9.7%	-7.1%	-2.3%	-1.3%	-0.6%
Ireland	-4.9%	-2.0%	1.6%	2.1%	2.2%
Italy	-9.7%	-9.0%	-8.0%	-4.5%	-3.7%
Luxembourg	-3.4%	0.7%	0.2%	-1.7%	-1.5%
Malta	-9.7%	-7.8%	-5.8%	-5.1%	-4.5%
Netherlands	-3.7%	-2.4%	-	-2.1%	-1.7%
Portugal	-5.8%	-2.9%	-0.4%	-0.1%	-0.1%
Slovakia	-5.4%	-5.4%	-2.0%	-6.1%	-4.8%
Slovenia	-7.7%	-4.6%	-3.0%	-3.7%	-2.9%
Spain	-10.1%	-6.9%	-4.8%	-4.1%	-3.3%
Eurozone avg.	-7.1%	-5.3%	-3.6%	-3.2%	-2.4%

10Y Spread to Germany	2019a	2020a	2021a	2022a	Current
Austria	0.19	0.14	0.25	0.63	0.60
Finland	0.21	0.15	0.26	0.56	0.57
France	0.31	0.23	0.38	0.54	0.53
Netherlands	0.13	0.08	0.15	0.32	0.34
Belgium	0.27	0.19	0.36	0.64	0.66
Spain	0.65	0.61	0.75	1.08	1.04
Italy	1.61	1.12	1.35	2.10	1.69
Portugal	0.61	0.60	0.64	1.04	0.72
Greece	1.64	1.19	1.50	2.05	1.45
Ireland	0.30	0.26	0.43	0.53	0.40

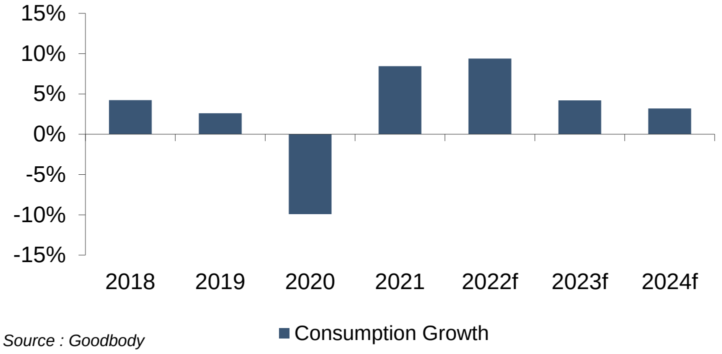
Source: FactSet & European Commission

Irish economic growth



Source : Goodbody

Consumption Growth



Source : Goodbody

Key Themes – Embarrassment of Riches

Growth upgrades after a strong H1

- The Irish economy has performed ahead of expectations in H1 and is on track to be one of the fastest growing economies in the euro area once again in 2023 and 2024. We are upgrading our forecast for modified domestic demand (MDD) in 2023 to 2.6% (0.7% previously), with solid growth expected to continue in 2024 (2.4%).
- The expansion continues to be driven by a robust services sector, despite recent weakness in manufacturing. The "war chests" of robust government and household balance sheets remain an important attribute of the Irish economy, positioning it well in the face of ongoing risks in the international economy and higher interest rates.

Embarrassment of riches provides government with options

- The most notable aspect of Irish economic developments in 2023 thus far has been in the public finances. Tax revenues grew by 11% in the first half of the year, taking the gain since 2019 to c.50%. Despite voted spending being up by 30% since 2019, Ireland is on track to achieve a budget surplus of over €11bn in 2023, equivalent to 4% of GNI*. This compares to an expected deficit of 3.2% in the euro area overall.
- Cumulative surpluses to 2026 are now expected to amount to c.€65bn, providing the government with options. Recognising the vulnerability and unpredictability of corporation tax revenues, Ireland has been wise in separating the estimated "windfall" element of these receipts. The idea of a new sovereign wealth fund has been floated recently to house these windfall gains. We welcome this policy move but believe that a certain proportion can be earmarked to ensure a stable and consistent flow of capital spending over the medium-term. This has historically been an 'Achilles heel' for Ireland over the economic cycle.

Resilient labour market supporting growth in household income

- Consumer spending continues to be the biggest driver of the growth in modified domestic demand. In Q1, real consumer spending grew by 6.4% yoy, with nominal spending growing by 13% yoy. There is some evidence of a normalisation of savings behaviour, but the savings ratio remains above long-term averages and a stock of savings equivalent to 18% of disposable income remains.
- The labour market is as tight as it has ever been. Employment growth is close to 4%, while the unemployment rate stands at an all-time low of 3.8%. Growth in employment is being facilitated by very large flows of non-Irish nationals into the labour market. In the absence of these migrants, wage inflation is likely to have been higher than the current c.4% rate.

Data centres & ICT behind business investment boom

- A 'credit-less' rebound in business investment appears to be driven by a boom in ICT investment in data centres and microchips. Ireland is a recognised hub for this fast-growing sector and the pipeline of activity remains strong. The recent concerns about the extent of energy use by the sector highlights the priority to focus on improving the country's energy infrastructure, taking account of sustainability objectives.

Housing output holding up well despite interest rate concerns

- At the beginning of the year, we feared that rising rates would negatively impact on housing supply, particularly in the apartment sector. Our analysis of the commencements data highlights that new apartment supply is holding up quite well, suggesting that completions this year and next may be close to the 2022 output of 30K units. An increased role for government is contributing here, and this will remain a feature in the coming years. Higher rates are impacting affordability, but prudent lending standards in recent years suggests that Irish household financial stability is not threatened.

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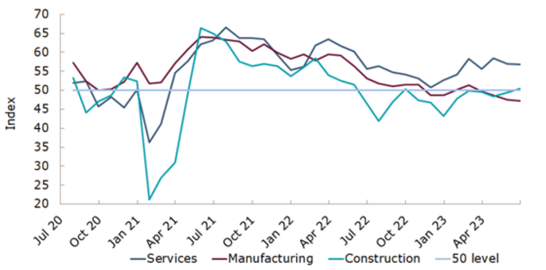
Forecast update – Upgrades after a strong H1

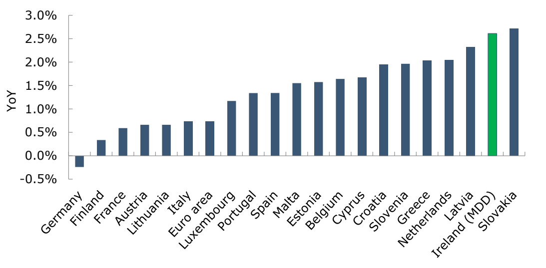
A range of indicators confirm that the Irish economy performed better than initial expectations in the first half of 2023. While there was an expectation that weaker global developments, including possible recession in some of Ireland's most important trading partners would act as a headwind, growth has proved to be more robust than feared to date. The ongoing expansion is most visible in the services sector of the economy, with the latest reading pointing to growth well in excess of that seen in the euro area as a whole. Expected domestic spending growth of 2.6% in Ireland compares to 0.7% for the euro area overall in 2023.

Services sector leading the growth charge



Source: Factset

Domestic demand* growth 2023 compared



Source: AMECO, Goodbody *Modified Domestic Demand for Ireland

The domestic "war chests" of a robust government position and healthy household balance sheets have contributed to the resilience. While headwinds still exist (weaker international economy in H2, higher interest rates), there has also been progress on some fronts (energy crisis, inflation). We are upgrading our expectations for growth in modified domestic demand in the Irish economy in 2023 to 2.6% (up from 0.7%). Growth of 2.4% is expected in 2024.

Irish growth forecasts

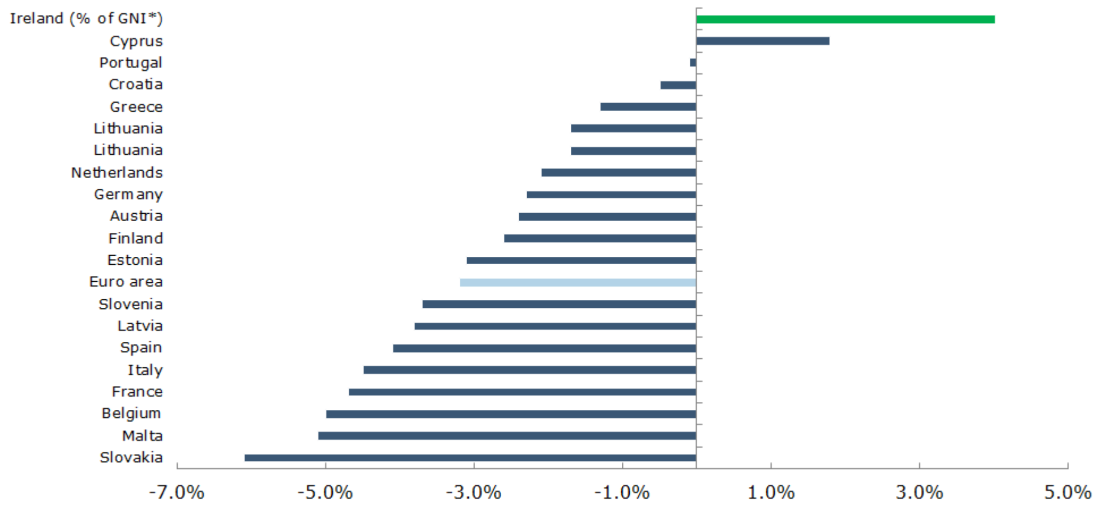
	2020	2021	2022e	2023f	2024f
Consumption	-9.9%	8.4%	9.4%	4.2%	3.2%
Investment	-16.5%	-40.4%	5.1%	1.3%	1.4%
Core investment	-10.0%	0.0%	14.4%	2.8%	0.4%
Government	11.6%	6.3%	3.5%	0.8%	2.0%
Domestic Demand	-11.3%	-17.5%	6.7%	2.5%	2.3%
Modified domestic demand	**-6.1%**	**6.2%**	**9.5%**	**2.6%**	**2.4%**
Exports	11.5%	15.1%	13.9%	5.2%	4.5%
Imports	-1.7%	-7.5%	15.9%	6.2%	4.7%
GDP	**6.6%**	**15.1%**	**9.4%**	**3.0%**	**2.9%**
GNP	**3.6%**	**13.9%**	**3.9%**	**2.1%**	**2.4%**

Source: Goodbody, CSO

An embarrassment of riches in the public finances

The most notable aspect of Irish economic developments in 2023 thus far has been in the public finances. Tax revenues grew by 11% in the first half of the year, taking the gain since 2019 to 53%. Despite voted spending being up by 30% since 2019, Ireland is on track to achieve a budget surplus of over €11bn in 2023, equivalent to 4% of GNI*. This compares to an expected deficit of 3.2% in the euro area overall, with Ireland among only two countries in the euro area that is expected to be in surplus.

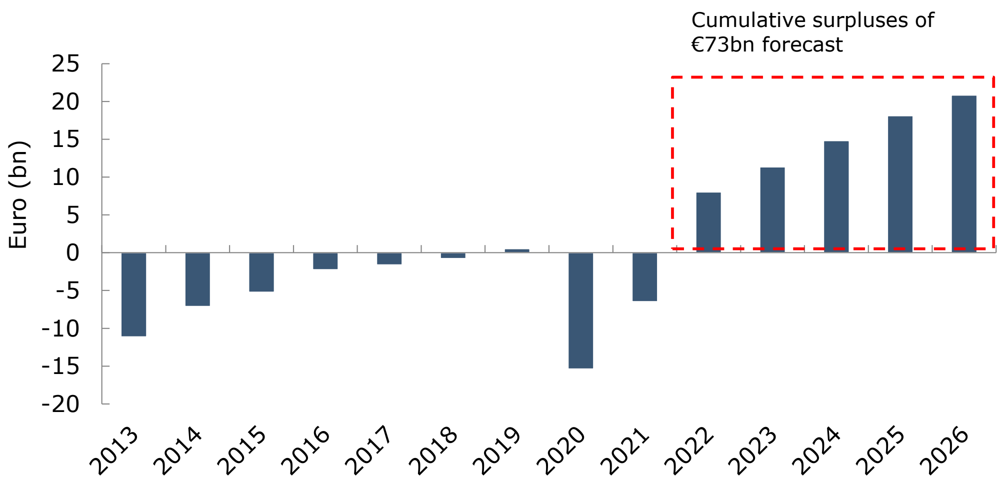
Budget balances in the euro area 2023



Source: AMECO, Goodbody

New forecasts published by the Department of Finance in the latest *Stability Programme Update* point to a series of large surpluses through to 2026. In monetary terms, these amount to a cumulative €65bn over the period from 2023-2026 and follows a surplus of €8bn in 2022.

Large budget surpluses are forecast under current government projections



Source: CSO, DoF, Goodbody

Higher tax revenues explain most of the improvement in the past year

The rebound in the public finances since 2020 can be explained by three factors:

- A doubling of corporation tax receipts from €12bn to an expected €24bn this year.
- A strong rebound in domestically generated tax headings (income & VAT) of €17bn
- A fall in "non-core" spending from €14.7bn to an expected €7.2bn in 2023. Non-core spending is expected to fall to €4bn in 2024, boosted by an expected €2.5bn to fund ongoing humanitarian relief for Ukrainian refugees.

The table below highlights the scale of change in estimates for the public finances over the past twelve months in monetary terms, comparing forecasts in the Stability Programme Updates (SPU) in 2022 and 2023. The improvement in the general government balance is €9bn and €10bn in 2023 and 2024, respectively. In 2023, this is due to a €12.5bn increase in the estimate for revenue, combined with a €3.7bn increase in spending.

Main budgetary aggregates of DoF forecasts (Eur bn)

	SPU 2022		SPU 2023		Change	
	2023	2024	2023	2024	2023	2024
Exchequer balance	1.5	5.6	4.5	12.9	3.0	7.3
GG Balance	**1.2**	**6.5**	**10.0**	**16.2**	**8.8**	**9.8**
GG Revenue	**110.9**	**116.0**	**123.4**	**129.2**	**12.5**	**13.2**
Tax revenue	80.4	84.8	88.9	94.4	8.5	9.6
Income	31.7	33.6	32.8	34.9	1.2	1.3
VAT	19.3	20.4	20.4	22.4	1.1	1.9
Corporation tax	16.9	17.7	24.3	25.1	7.4	7.4
Other tax	12.5	13.1	11.3	12.1	-1.1	-1.0
Other revenue	30.6	31.2	34.6	34.8	4.0	3.6
GG expenditure	**109.7**	**109.5**	**113.4**	**113.0**	**3.7**	**3.4**
Compensation of employees	28.3	29.5	29.8	30.9	1.5	1.4
Intermediate consumption	16.9	17.3	18.3	18.2	1.4	0.9
Social	36.8	37.1	38.6	38.4	1.8	1.3
GFCF	11.8	12.7	11.0	12.1	-0.9	-0.6
Other	15.9	12.9	15.8	13.4	-0.1	0.5

Source: DoF GG: General Government

Within government revenue, corporation tax outperformance accounts for c.60% of the change over the past twelve months. As we and others have noted previously, this is the most vulnerable component of government revenue due to the concentrated nature of these receipts. 87% of corporation tax receipts were paid by multinationals in 2022, with the top ten groups accounting for 60% of the total. As shown in the table below, this dependence goes beyond just corporation tax, with over half of income tax being paid by those working for multinationals in 2022 for instance. Of the five revenue categories below (corporation, income, USC, PRSI and VAT), multinationals account for 64% of total taxes.

Importance of multinational sector to taxes and employment in Ireland

	Corp	Income & USC	PRSI	VAT	Total	Wages	Employment
Foreign MNE	19,579	8,787	4,452	5,571	38,389	33,135	850,896
Irish MNE	928	2,151	1,149	584	4,812	9,120	265,123
Non-MNE	2,135	5,627	3,416	5,154	16,332	28,837	1,452,935
Total	22,642	16,565	9,017	11,309	59,533	71,092	2,568,954
% of Total							
Foreign MNE	86%	53%	49%	49%	64%	47%	33%
Irish MNE	4%	13%	13%	5%	8%	13%	10%
Non-MNE	9%	34%	38%	46%	27%	41%	57%
Total	100%	100%	100%	100%	100%	100%	100%

Source: Revenue statistics

Concentration of employment & taxes among largest multinationals (% of total)

	CT	Payroll taxes	Employments	Earnings
Top 100 groups	77.4	10.5	7.7	9.2
Top 10 groups	60.1	3.8	1.6	3.1

Source: Revenue

While this highlights Ireland's success in attracting the most successful companies in fast-growing, structural growth industries, there are risks associated with its concentration that necessitates certain policy choices to be made.

To its credit, the Department of Finance has provided significantly more transparency around this issue over recent years. It now includes an estimate of the budget deficit excluding "windfall" corporation tax. In 2023, this windfall is estimated at €11bn.

There are important choices to make given the expected surpluses, including:

(a) Allow the large surpluses to happen, with monies going to debt reduction;
(b) Allow the large surpluses to happen, with monies going towards a new sovereign wealth fund;
(c) Implement targeted tax cuts;
(d) Increase current expenditure;
(e) Increase capital expenditure

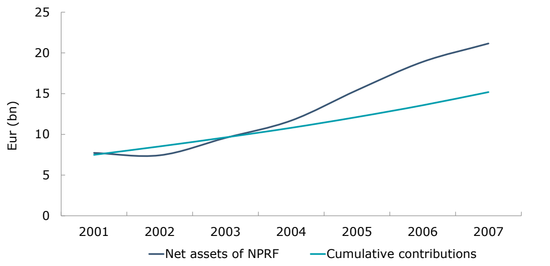
A new sovereign wealth fund for Ireland

Given the size and projected duration of the surpluses, the Irish government has floated the idea of a new sovereign wealth fund for Ireland. A number of options are on the table here in terms; (i) the scale of monies to be put into the fund on an annual basis over the coming years; (ii) where it may be invested, and; (iii) what it may be used for in the future.

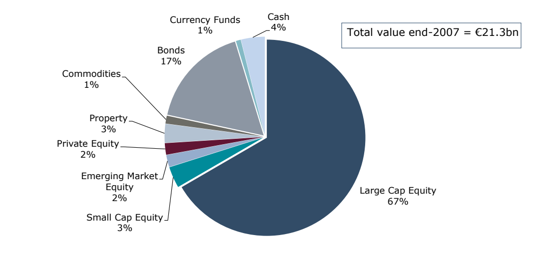
Our preference is for an amount equivalent to the estimated "windfall" corporation tax receipts (c.€12bn) to be put into a fund/funds over the coming years. This "rainy-day" fund should then be used to both partly finance future liabilities associated with the aging of the population and to finance important infrastructure investment needs in the economy over the coming years. IBEC has recently suggested setting up a "national infrastructure fund" that can be drawn upon to smooth out capital spending over the medium term. We believe that this can be incorporated into the design of the new fund, with a proportion of the fund being invested in liquid assets that can be used for capital spending purposes if required.

A sovereign wealth fund is not a new construct for Ireland. The table below illustrates where the assets within the National Pensions Reserve Fund (NPRF) were invested prior to its liquidation for the purposes of investing in the banking system after the Global Financial Crisis (GFC).

Development of the NPRF in the 2000s



Allocation of NPRF Assets - 2007

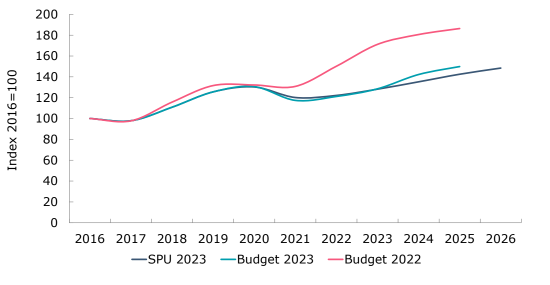


Source: NPRF Annual Reports

A strong case for increased capital spending

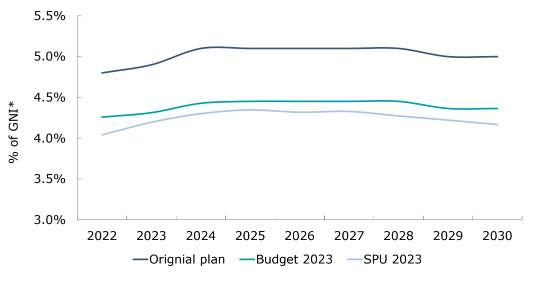
Under the original plans for the National Development Plan (NDP), the Irish government set out a plan to spend an amount equivalent to 5% of GNI* on capital spending over the period to 2030. Due to a combination of higher inflation, underspend and downward revisions to estimates, the real level of investment was expected to be significantly lower in the coming years, albeit high in an international context. IFAC recently estimated that the real level of investment in 2025 would be 24% lower than estimated at the time of Budget 2022. Although real capital spending is expected to grow by c.5% over the coming years, to return Exchequer spending to its originally planned level, IFAC estimates that spending would need to be €2.7bn higher per annum over the period to 2030. The government went some way to addressing this with the announcement of larger capital spending in the Summer Economic Statement (SES).

Real capital spending estimates revised down significantly…



Source: IFAC

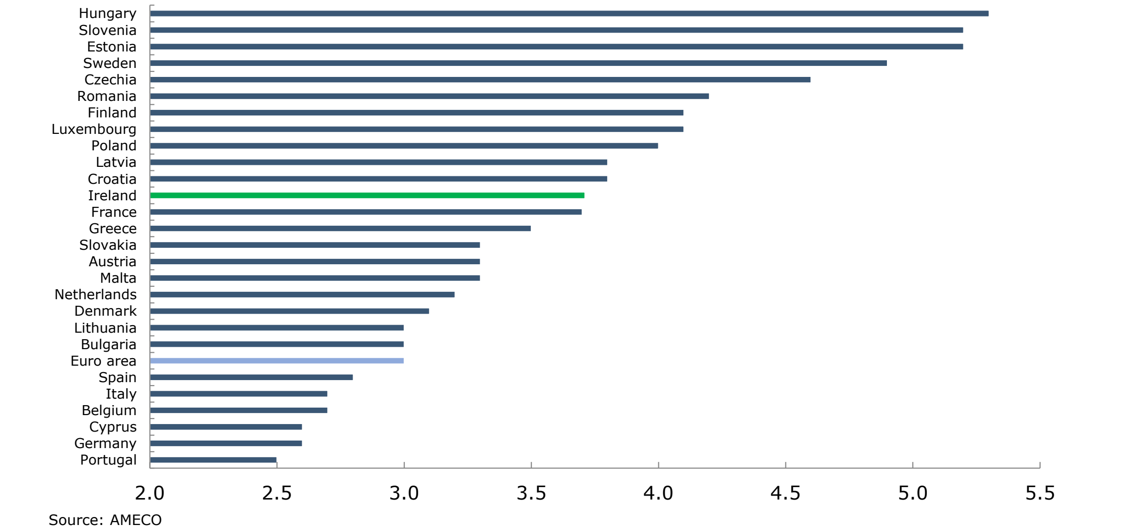
…with spending relative to GNI* to average 4.2% to 2030



Source: IFAC

In 2022, capital investment amounted to 3.7% of GNI*, only slightly above its average level since 1995. While this is above the euro area average of 3%, the level of capital spending is higher in several countries in the EU. It might be legitimately argued that with the economy at full capacity increased spending will lead to further inflationary pressures in the construction sector. However, there is clear evidence that the office construction cycle is passed its peak, thus creating some slack. In addition, increased capital spending increases the supply capacity of the economy, with positive impacts on output in the medium-term

Capital spending levels in the EU 2022 – Scope for Ireland to increase



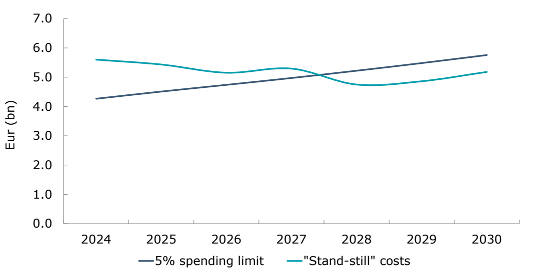
Source: AMECO *data relates to 2022

Any breaches of spending rule should be due to higher capital spending

In 2021, the Irish government introduced a spending growth rule of 5% to limit cyclicality in the public finances. In Budget 2023, it planned for a breach of this rule, with core spending expected to grow by 7.4% this year. At that time, the government pledged to return to adherence to the rule from Budget 2024, but the recent Summer Economic Statement confirmed that core expenditure will grow in excess of that limit in 2024, with a spending increase of €6.4bn pencilled in for next year. Part of the reasons cited for the increased spending is the higher inflationary environment. IFAC estimated in its *Fiscal Assessment Report* that an increase of €5.6bn would be required in 2024 to keep pace with demographic developments, indexation of pensions and other social welfare benefits and increased capital spending. Indeed, the average annual increase in spending required for a "stand-still" situation amounts to €5.2bn over the period to 2030, compared to a €5.0bn annual increase using the 5% spending limit.

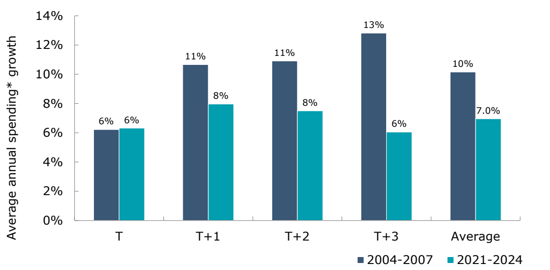
The scope for additional spending increases/tax cuts beyond is limited, especially in the context of an economy at full capacity currently. The breaching of the 5% limit is small in our view and certainly does not- threaten fiscal sustainability. Ireland has a history of damaging pro-cyclical policy, but this "breach" is significantly smaller than the mistakes made in the 2000s for instance. Moreover, it is welcome that more funds have been provided for capital infrastructure out of the "windfall" gains from corporation tax. By addressing of the large infrastructural deficits in housing and energy, this will help boost the medium-term growth potential of the economy.

"Stand-still" cost increases exceed spending limit in the short-term



Source: IFAC

Spending growth substantially below rates seen in the mid-2000s



Source: DoF, Goodbody *refers to core spending in 2021-2024

Goodbody fiscal forecasts

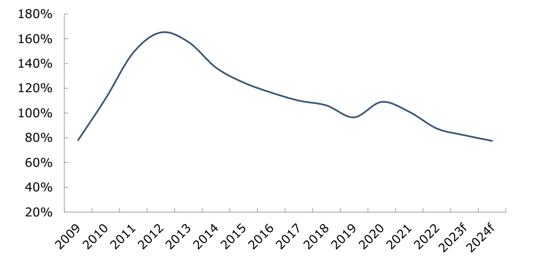
	2019	2020	2021	2022	2023f	2024f
Budget balance (Eur m)	533	-15,379	-6,455	8,032	11,352	12,390
Budget Balance (% of GDP)	0.1%	-4.1%	-1.5%	1.8%	2.1%	2.2%
Budget Balance (% of GNI*)	**0.2%**	**-5.4%**	**-2.1%**	**2.4%**	**4.0%**	**4.2%**
Underlying* balance (% of GNI*)	**0.9%**	**-9.1%**	**-5.8%**	**-0.4%**	**0.3%**	**0.5%**
GG Debt (Euro bn)	203	218	236	235	232	230
GG Debt (% of GDP)	57%	58%	55%	47%	44%	41%
Debt/GNI*	97%	109%	101%	87%	82%	78%
Interest/GDP	1.2%	1.0%	0.8%	0.7%	0.7%	0.6%
Primary balance	1.4%	-3.1%	-0.8%	2.4%	2.9%	2.8%
Average interest rate	2.2%	1.8%	1.4%	1.4%	1.7%	1.5%

Source: Goodbody, CSO, NTMA, DoF *excludes estimate of "windfall" corporation tax

Further positive ratings actions likely if debt levels fall further

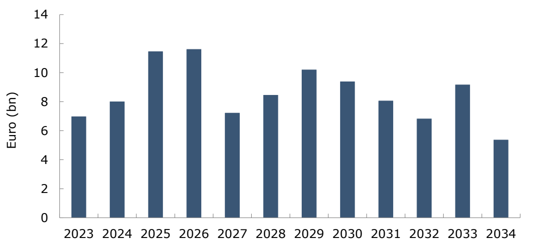
Given these positive fiscal developments, debt sustainability for the Irish sovereign has continued to improve and this has been reflected in ratings actions over recent months. Debt/GDP is expected to fall to 41% next year, while debt/GNI* is expected to fall to 78%. This is down from a peak of 165% in 2012 and a recent high in 2019 of 109%. If this further reduction is realised, there is scope for further ratings upgrades in our view. The NTMA continues to run large cash balances, amounting to €27bn at the end of June 2023. Given this and the large, expected budget surpluses, funding requirements in the market will be less than initially expected. However, it is important that Ireland keeps a presence in the market, learning the lessons from the 2000s period when lack of market proved an issue when economic conditions deteriorated.

Debt/GNI* set to fall below 80%



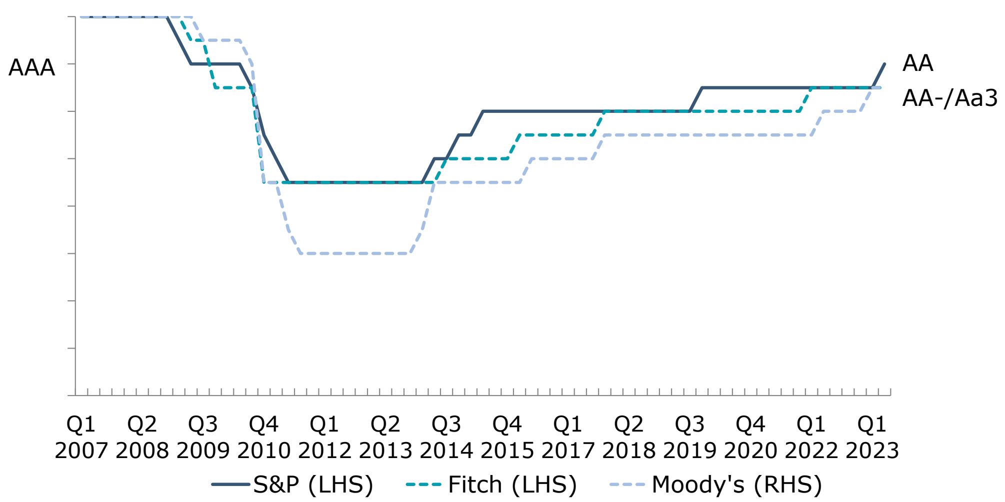
Source: CSO, NTMA, Goodbody

Modest sovereign redemptions in short-term



Source: NTMA

Ireland has had two positive ratings moves in 2023 to date



Source: Bloomberg

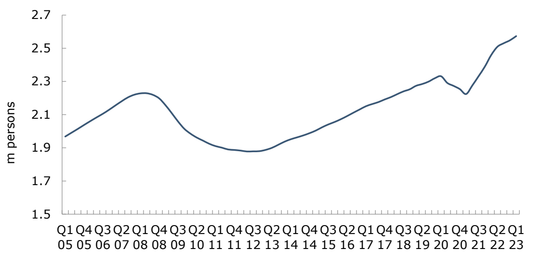
Irish household spending resilient in the face of high inflation

Consumer spending continues to be the biggest driver of the growth in modified domestic demand. In Q1, real consumer spending grew by 6.4% yoy, with nominal spending growing by 13% yoy. Real spending is now 4% above pre-Covid levels, with goods spending 8% higher and services spending 2% below Q4 2019 levels. This gap is, however, starting to close as consumer spending patterns continue to normalise. More recent data show that retail sales continued to grow in Q2, but the growth is dominated by an increase in car sales (+19% yoy in three months to May 2023). This is partly due to a loosening in supply chains in this sector. Excluding cars, retail sales volumes grew by just 1% yoy in the latest three-month period.

This spending growth is underpinned by four features of the Irish household sector:

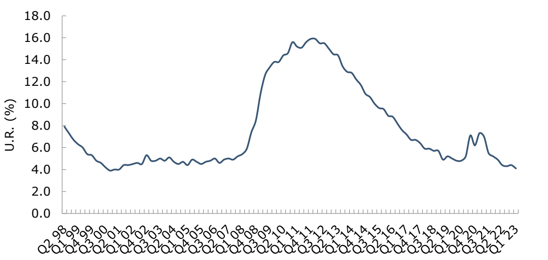
1. **Ongoing employment growth** – Employment grew by 4.0% yoy in Q1 to a record level of 2.6m. The unemployment rate has fallen to a record low of 3.8%.

Employment at record highs…



Source: CSO

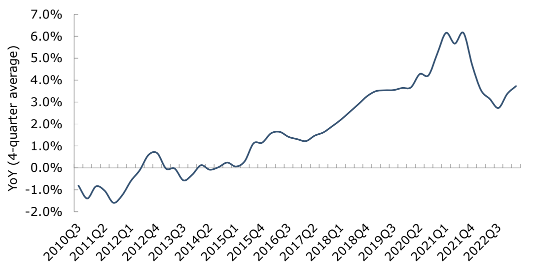
…& unemployment at record lows



Source: CSO

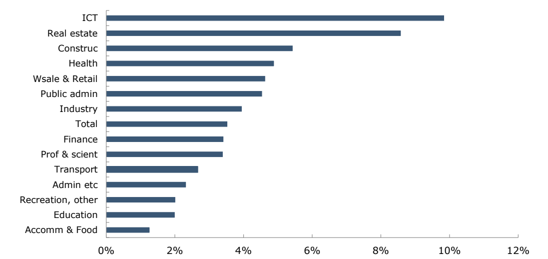
2. **Earnings growth continues** – Earnings growth has continued to grow at a steady if not spectacular pace. Weekly earnings increased by c.4% in Q1, with hourly earnings growing at a similar pace. All sectors of the labour market are experiencing underlying hourly earnings growth, with the ICT sector continuing the lead the way, followed by real estate activities. We expect growth in earnings to continue close to the current pace over the forecast horizon.

Annual growth in weekly earnings at c.4%



Source: CSO

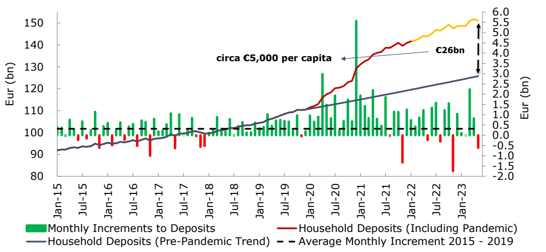
Strongest earnings growth is in ICT



Source: CSO

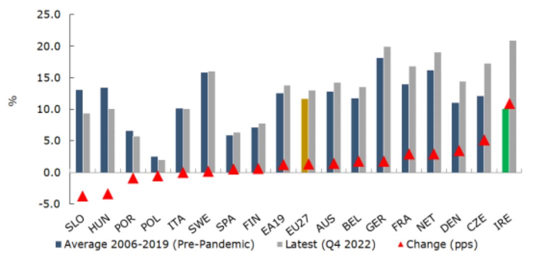
3. **Normalisation of savings** – Ireland experienced the largest increase in household savings during the pandemic, but there is some evidence of normalisation now in train. In Q1, the household savings ratio fell to 14%, returning to close to pre-pandemic levels for the first time. Ireland had maintained a much higher level of saving throughout the 2020-2022 period, resulting in a very large stock of household deposits.

"Excess" savings stand at 18% of disp. income



Source: Central Bank

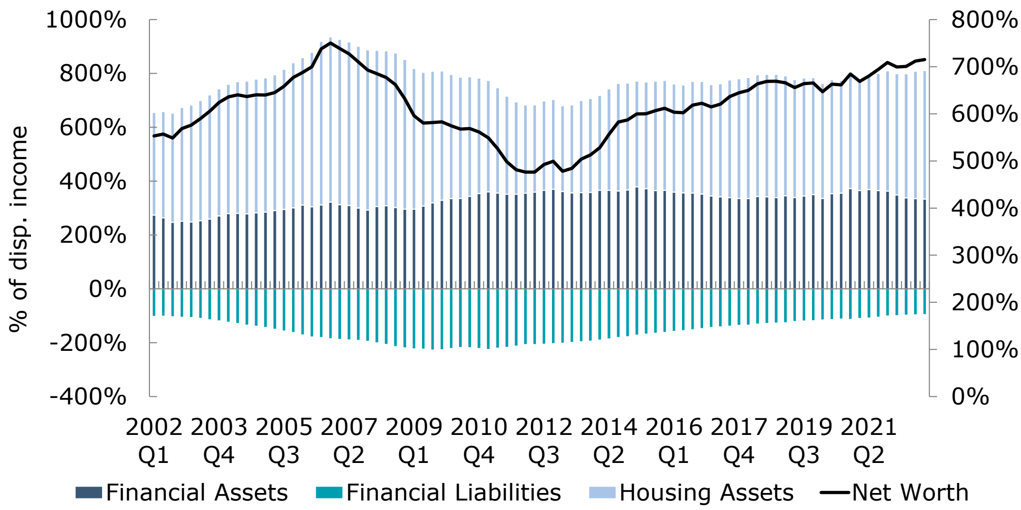
Ireland experienced biggest increase in savings in the euro area



Source: AMECO

4. **Record level of net wealth** – Boosted by ongoing growth in household assets and growth and further falls in liabilities, Irish household net wealth now stands at record levels.

Household net worth close to all-time highs



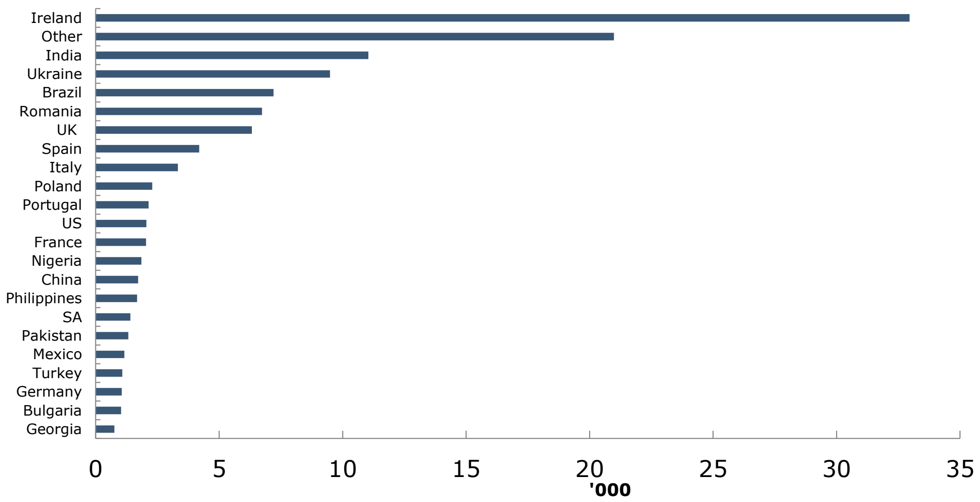
Source: Central Bank

Migration propelling labour force growth

With limited spare capacity in the labour market, employers are increasingly relying on international sources of labour to fill their workforces. In Q1, employment among Irish nationals grew by 1.7%, while non-Irish national employment grew by 15% yoy. This has contributed to population growth amongst the fastest in the euro area over recent years. In Q1, the population (aged over 15) rose by 2.9% yoy, compared to a euro area average of 0.6% yoy.

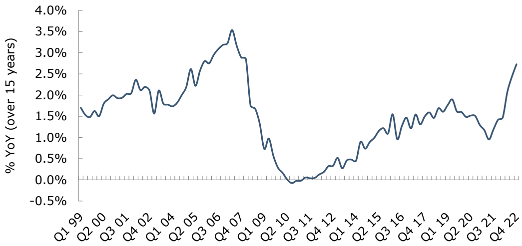
The influx of Ukrainian migrants has played a big role in the growth in migration, but is far from the only source. The chart on the next page shows the nationality of the top 20 countries (including "other") which received PPS numbers in the first half of 2023. India was the biggest single source of migrants to Ireland in H1, followed by Ukraine and Brazil.

Nationality of PPS numbers issued – H1 2023



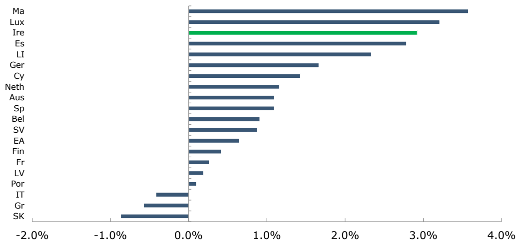
Source: DSP

Population surge due to migration...



Source: CSO

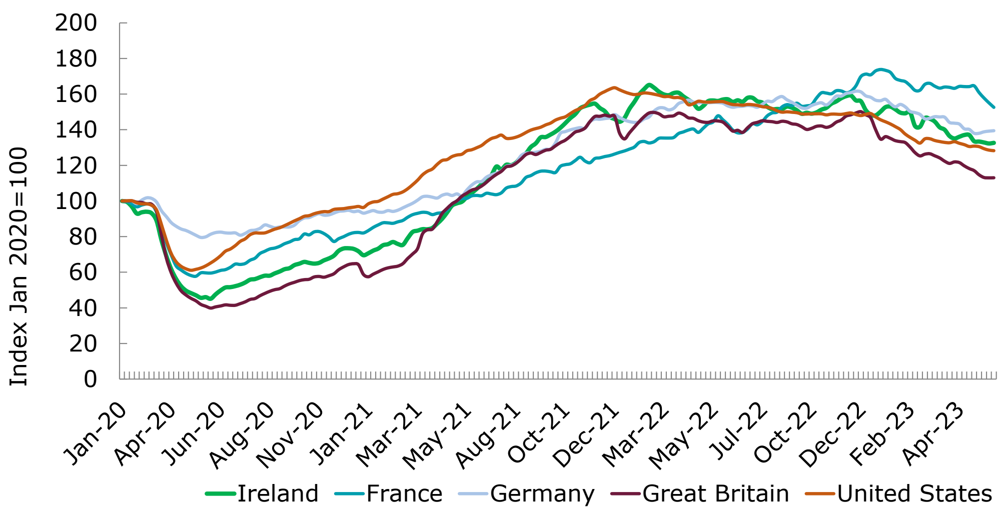
...is amongst the fastest in the EU



Source: Eurostat

Like other developed economies, there is some evidence of loosening in the labour market, but the level of vacancies remains c.30% above pre-pandemic levels.

Some loosening, but vacancies remain well above pre-pandemic levels



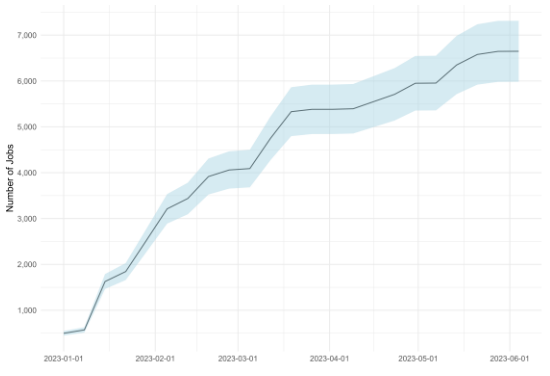
Source: HiringLab

High levels of inward migration have likely had a dampening effect on the rate of wage growth over recent quarters. Earnings growth has been running at c.4%, albeit with significant differences across the segments of the labour market. The ICT sector continues to see the fastest growth in core earnings (i.e. hourly earnings less bonuses), increasing by c.10% yoy in Q1 2023).

No evidence of widespread layoffs in the ICT sector

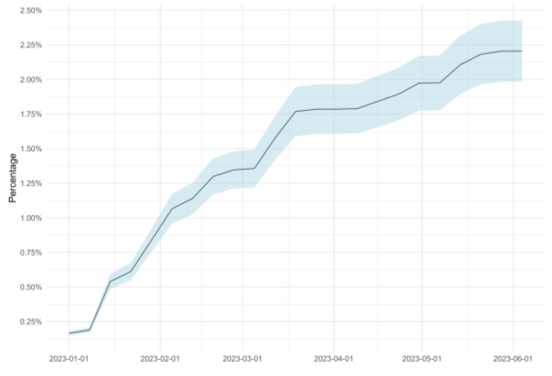
There was some concern around the turn of the year that mass layoffs in the ICT sector would cause problems for the Irish economy. Goodbody Analytics work shows that there has been a slowing in job cut announcements associated with IDA supported companies in recent months. In gross terms, the cumulative job cut announcements amount to c.7K or c2.5% of the IDA workforce.

Cumulative layoffs estimated at c.7k...



Source: Goodbody

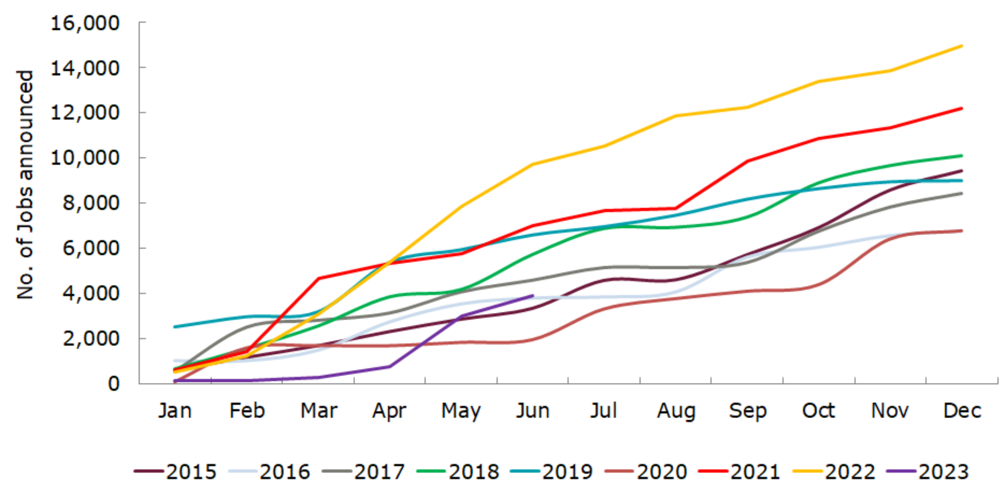
...or 2% of IDA-supported employment



Source: Goodbody

Similar trends have occurred with regard to new job announcements per our analysis of IDA press releases. As the chart below shows, it was exceptionally weak at the start of the year for new job announcements from the IDA, but there was an improvement in the second quarter of the year.

Cumulative IDA job announcements by year – Pick up evident after a slow start

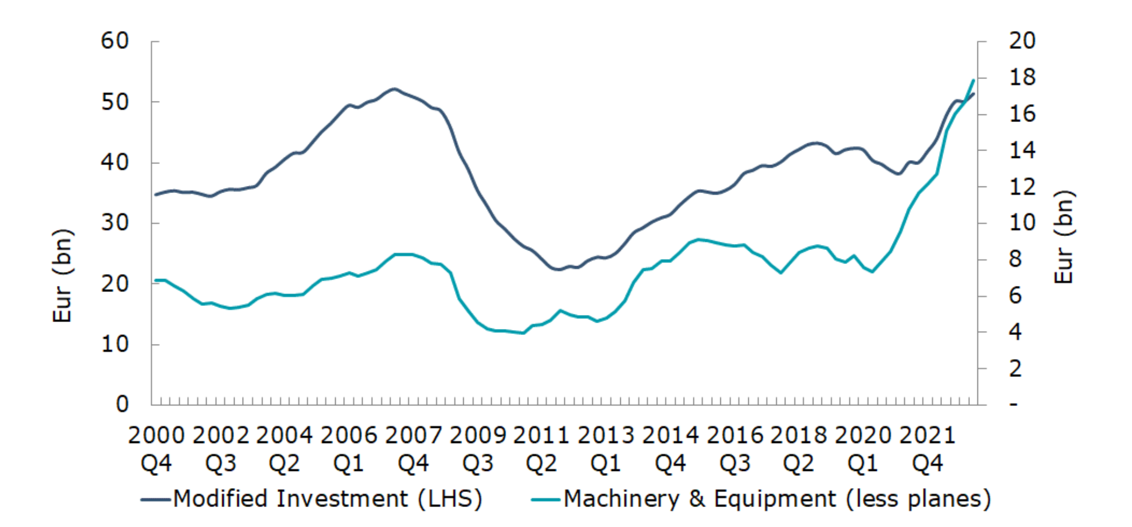


Source: IDA, Goodbody

What is behind the boom in business investment?

Beyond consumption, the other major contributor to the strong growth in modified domestic demand is from investment. Excluding aircraft leasing and IP imports, investment grew 11% in 2021 and by 20% in 2022. The bounceback in construction activity following COVID lockdowns was an important driver in 2022 (detailed later) but business and equipment investment has been a standout performer over the recent past. After growing by 51% in 2021, core machinery and equipment investment increased by a further 38% in 2022. This is almost double the pre-COVID level.

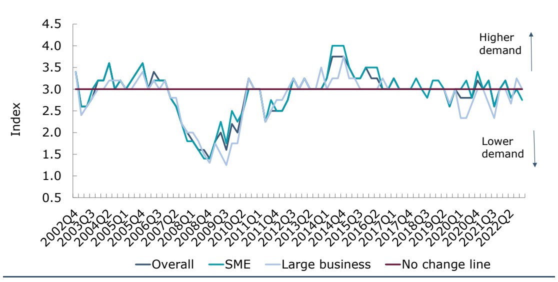
Machinery & equipment propelling investment expansion



Source: CSO

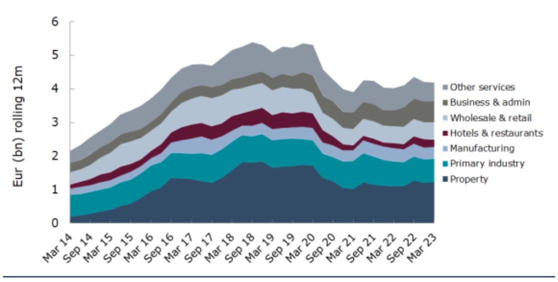
While there has been an improvement in domestic business investment after the full reopening of the economy after COVID, it does not explain the full extent of the rebound in this component of investment. For instance, net lending to SMEs was flat in the year, while new lending has been relatively stable since early 2020 at an annual rate of c.€4bn. The most recent bank lending survey suggests loan demand from SMEs and large businesses has remained largely unchanged over recent quarters. It appears, therefore, that a credit-less rebound in business investment is in train.

Loan demand has been muted…



Source: Central Bank

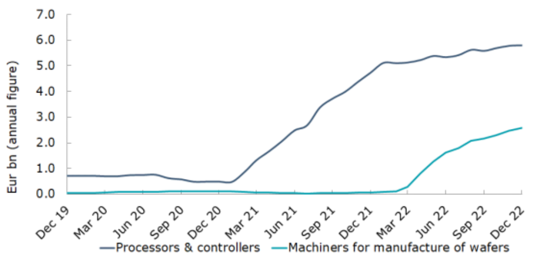
…while new SME lending remains at €4bn pa



Source: Central Bank

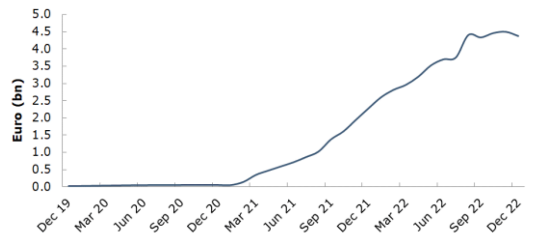
Delving deeper into the data suggests that the multinational sector may once again be playing a role. Annual investment in machinery and equipment rose from c.€8bn in 2019 to c.€18bn in the latest period. Over that same period, imports of machinery and equipment rose by 26% to €52bn. Two sub-categories saw a trebling of imports over the period, namely "Machinery specialised for particular industries" and "Electrical Machinery, apparatus and appliances". Detailed trade statistics show that this growth has been driven by high tech imports into the ICT sector, namely processors and wafers. As shown below, Israel appears to be the source of a large percentage of these imports. Both Ireland and Israel are recognised hubs for the ICT industry. These trends are due to the large increase in both data centre and microchip facilities being built in Ireland currently.

Data centres & chip production the reason for increase in certain manufactured imports



Source: CSO, Goodbody

Imports of data processing machinery from Israel to Ireland has surged



Source: CSO, Goodbody

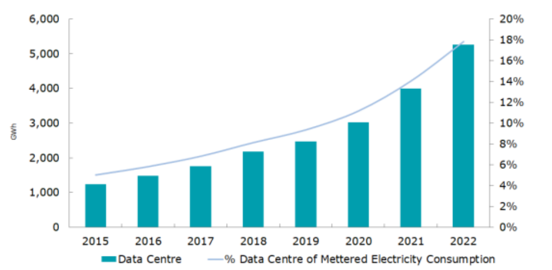
The share of electricity being used for data centres has become a big political topic in Ireland recently. CSO data recently showed that data centres now account for 18% of Ireland's total electricity, up from 5% in 2015. This is expected to grow to 28% by 2028. There have been some concerns about the granting of further planning permissions, leading to a recent tightening of the assessment criteria for new data centre permissions. Despite this, significant growth is expected over the short to medium term. It is estimated (by bitpower) that there are currently 82 data centres in operation in Ireland, with a further 66 under construction, have had planning approved or are going through planning. Notably though, the data centres that have recently been approved are much larger in size, potentially increasing energy usage in the sector by 160%. Given the structural growth in this sector, this may continue to be a feature and highlights the importance once again for the government's focus to be on resolving infrastructural shortages.

Data centres in Ireland...

	No. in use	Energy use (MW)	Average per data centre
Operational Data centres	82	1,261	15
Under Construction	14	356	25
Planning Approved	40	1,268	32
Planning Application	12	390	33

Source: Bitpower.ie

...now account for 18% of electricity usage



Source: CSO

New housing supply holding up better than feared

Given the important role that apartments had played in the ramp up in new housing supply since 2021, we feared that the rise in yields would exacerbate viability issues in this space and lead to a stalling of new projects. Our analysis of the commencements data suggest that new apartment supply is holding up quite well, suggesting that completions this year and next may be close to the 2022 output of 30K units. Our wider housing forecasts are in the table below.

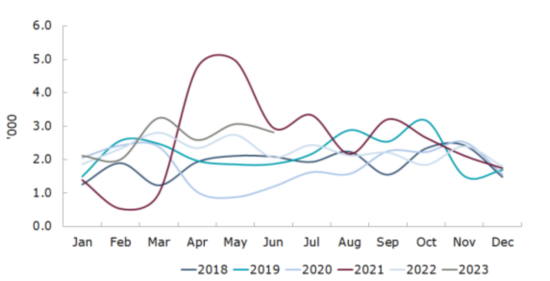
Key housing metrics

	2019	2020	2021	2022e	2023f	2024f
New dwellings	21,107	20,574	20,553	29,822	30,034	30,351
Average house price (€, end-year)	274,139	280,267	320,101	344,818	346,464	359,779
Price inflation (% YoY, end-year)	0.3%	2.2%	14.2%	7.7%	0.5%	3.8%
- Dublin (% YoY, end-year)	-1.7%	1.5%	12.8%	5.9%	-0.9%	4.2%
- Non-Dublin (% YoY, end-year)	2.5%	2.9%	15.2%	9.1%	1.7%	3.7%
Gross mortgage lending (€m)	9,542	8,367	10,467	14,056	14,067	13,988
Growth in gross lending	9.4%	-12.3%	25.1%	34.3%	0.1%	-0.6%
Net mortgage lending growth (end -year)	1.9%	0.9%	1.2%	-0.9%	1.5%	2.5%
Rental growth	4.5%	-3.2%	8.1%	11.0%	4.5%	2.7%
Gross rental yield (end-year)	5.7%	5.4%	5.1%	5.2%	5.4%	5.4%

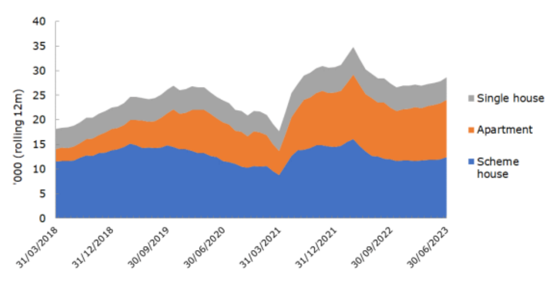
Source: CSO, BPFI, DoH, Goodbody

One of the important reasons for the relative stability in housing commencements is the mobilisation of state resources to take up some of the slack from the retreating private rental sector (PRS). This can occur through local authorities, Approved Housing Bodies (AHBs) or the Land Development Agency (LDA). We believe that this will remain an important feature of the picture for housing supply in Ireland over the coming years. This level of supply is clearly insufficient to keep pace with the combination of the growing population and the pent-up demand built up over the past decade. Therefore, the market remains in an acute undersupply situation.

Housing commencements in Ireland…



…holding up relatively well

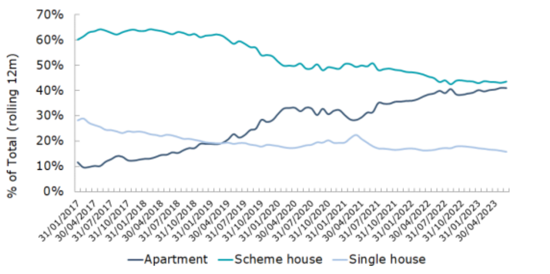


Source: Goodbody Analytics, BCMS

Apartments overtake scheme houses in importance to output

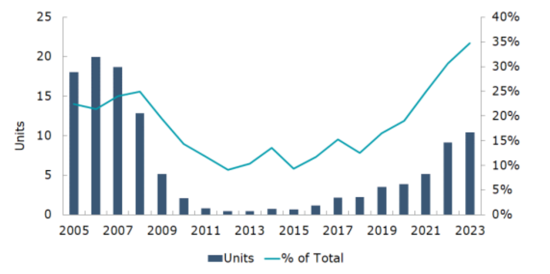
Apartments continue to make a vitally important contribution to new housing output, particularly in Dublin. This is both due to the shortage of smaller accommodation space in the country and the policy efforts to ensure higher density housing development. In the first half of 2023, we estimate that there were more apartments commenced that scheme homes for the first time. In 2022, apartments accounted for 31% of the total, while we expect this to grow to a record 35% in 2023.

Commencements by type (% of total)



Source: Goodbody Analytics, BCMS

Record share of apartment completions



Source: CSO, Goodbody

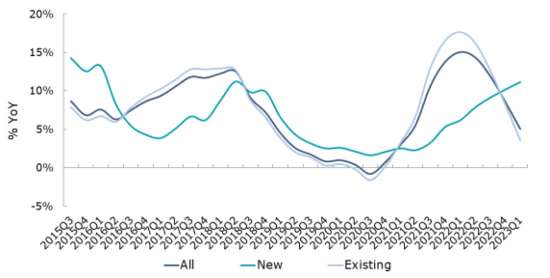
House prices expected to be flat in 2023

Price inflation has cooled since the heady period in 2022, led by higher priced homes in the capital. The latest official data shows annual price inflation fell to just 3.6%, with prices down by 1.5% in the year to date. The largest declines have been in Dublin, where prices have fallen by 3% in the year to date. Second-hand prices are traditionally more volatile than new home prices and this appears to be the case on this occasion also. The latest data for Q1 shows new home prices up by 11%, relative to just 4% for the second-hand market. We expect a flat outturn for prices in 2023, followed by modest growth in 2024.

Prices stable after reaching prior peak…

Source: CSO

…with new homes outperforming

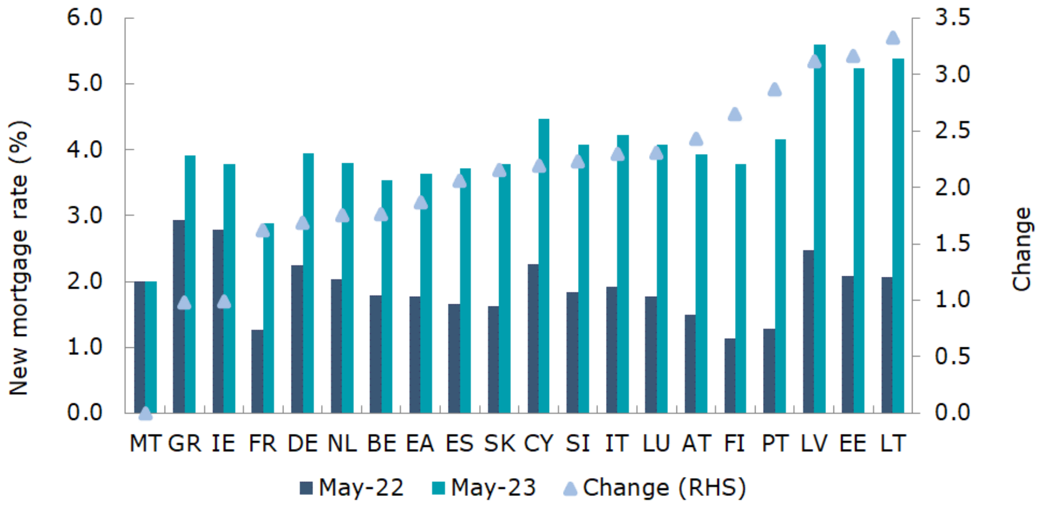


Source: CSO

What is the impact of higher rates on mortgage affordability?

Given the sharp rise in borrowing costs by the ECB, the housing market has proved to be relatively resilient. This is partly because the banks have not passed on the full extent of the increases in ECB rates to customers. Over the period from May 2022 to May 2023, the ECB increased interest rates by 3.75%, yet the average new mortgage rate in Ireland rose by only 1%. This compares to a median increase across the euro area of 2.15%. The mortgage rate stood at 3.78% in May, in line with the euro area median of 3.79%.

Mortgage interest rates in the euro – relatively small changes in Ireland



Source: ECB

Given the latest rate hike in June, recent announcements from some of the major banks and the likelihood of another hike in July, the average rate is likely to soon rise to c.4.5%, with upside risks. The table below illustrates the impact this rate change would have on the "average" first time buyer. The H1 2022 data is taken from actual data from the Central Bank. We have then updated the numbers for H1 2023 based upon property price movements and an assumption for the mortgage interest rate. This analysis shows that the monthly servicing cost in this scenario has gone from 22.5% of disposable income to 28% currently. This remains at a relatively prudent level, suggesting that the rise in rates should not cause great financial distress at this point.

Affordability analysis for an average* First-time buyer in Ireland

	H1 22	Jun-23
Property value (€)	331,065	338,529
LTV (%)	80.1	80.1
Loan size (€)	261,443	271,162
Income (€)	82,633	85,714
Loan-to-income	3.2	3.2
Monthly net income (€)	4,757	4,956
Loan term (years)	28.9	28.9
Interest rate (%)	2.61	4.50
Monthly repayment (€)	1,072	1,397
% of net income	22.5%	28.2%
With additional 2% interest rate rise:		
Monthly repayment (€)		1,733
% of net income		35.0%

Source: Goodbody, Central Bank, ECB, CSO *uses actual data for H1 22 and updates for price, income, interest rate & tax changes

The second table attempts to gauge the affordability impacts for a First-time buyer (FTB) of a new home at the margin, that is a FTB borrowing the maximum amount allowed under the Central Bank's macro-prudential rules assuming a 30-year mortgage. This shows that the percentage of income on mortgage payments due to the change in rates, the increase in the median new home price and the increased leverage allowed due to the higher Loan-to-Income ratio (4x). In this scenario, the proportion of income being used to service the mortgage rises from 25% to 35%. If a stress test was done by the financial institution for an additional 2% rise in rates, this would increase to 44%. This is likely to be above the threshold that would be allowed by the financial institution. Therefore, it is our view that the interest rate, rather than the loan-to-income ratio, is becoming the binding constraint on the marginal buyer.

Affordability analysis for the marginal FTB of a new home in Ireland**

	H1 22	Jan-Apr 23
Property value (€)	352,202	390,622
LTV (%)	90	90
Loan size (€)	316,982	351,560
Income at max. LTI (€)	90,566	87,890
Loan-to-income	3.5	4.0
Monthly net income (€)	5,075	5,043
Loan term (years)	30	30
Interest rate (%)	2.61	4.50
Monthly repayment (€)	1,271	1,781
% of net income	25%	35%
With additional 2% interest rate hike:		
Monthly repayment (€)		2,222
% of net income		44%

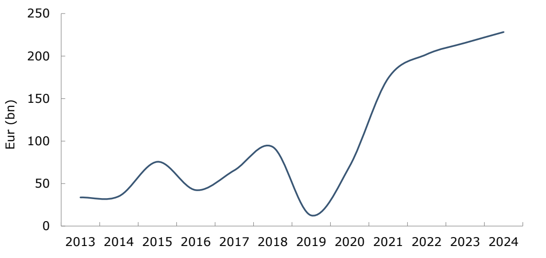
Source: Goodbody, Central Bank, ECB, CSO **uses median price of new home nationally for 90% LTV and maximum LTI

Trade flows heavily influenced by multinational activity

At a headline level, Irish exports continued to grow strongly at the start of 2023, maintaining the trade surplus at close to record levels. The details point to the ongoing distortions caused by multinational activity and Ireland's place in the global value chain for some of the largest companies in the world.

Irish exports grew by 6% yoy in Q1 2023 on the back of a 12% increase in goods exports. Balance of Payments data reveal that this growth was totally driven by "contract manufacturing", which refers to when an Irish resident company which gets its products manufactured abroad ships these goods to a third country, without them ever encountering Ireland. This category of export (termed "Goods for processing") grew by 88% yoy in Q1 and accounted for 39% of total merchandise exports in the quarter.

Trade balance has ballooned since the pandemic



Source: CSO, Goodbody

...partly due to a rise in the prevalence of "contract manufacturing"

Source: CSO

As a result, the higher frequency trade data have not been a good gauge of the performance of trade as they only illustrate the performance goods that cross Irish borders. This component of trade continued its weak trend in Q2, with the value of exports down 6% yoy in the first five months of 2023. The driver of this fall is a 28% yoy reduction in exports of chemicals and related products to the US. In contrast, this same category experienced a 10% yoy increase in exports to the EU.

The success of Ireland in attracting and retaining a large stock of FDI has been key in achieving the record surplus over recent years. With this success comes difficulties in managing the volatility.

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