



Banc Ceannais na hÉireann  
Central Bank of Ireland

Eurosystem



# Quarterly Bulletin

QB4 – October 2019

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# Section 1



## Notes

1. The permission of the Government has been obtained for the use in this Bulletin of certain material compiled by the Central Statistics Office and Government Departments. The Bulletin also contains material which has been made available by the courtesy of licensed banks and other financial institutions.
2. Unless otherwise stated, statistics refer to the State, i.e., Ireland exclusive of Northern Ireland.
3. In some cases, owing to the rounding of figures, components do not add to the totals shown.
4. The method of seasonal adjustment used in the Bank is that of the US Bureau of the Census X-12 variant.
5. Annual rates of change are annual extrapolations of specific period-to-period percentage changes.
6. The following symbols are used:

<b>e</b>	<b>estimated</b>
<b>n.a.</b>	<b>not available</b>
<b>p</b>	<b>provisional</b>
<b>..</b>	<b>no figure to be expected</b>
<b>r</b>	<b>revised</b>
<b>-</b>	<b>nil or negligible</b>
<b>q</b>	<b>quarter</b>
<b>f</b>	<b>forecast</b>
7. Data on euro exchange rates are available on our website at [www.centralbank.ie](http://www.centralbank.ie).

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# Forecast Summary Table

The economic outlook is uncertain, depending on the outcome of Brexit negotiations.

Deal	2018	2019f	2020f	2021f
<b>Real Economic Activity</b>				
Personal consumer expenditure	3.4	2.5	2.7	2.4
Public consumption	4.4	5.7	3.1	2.5
Gross fixed capital formation	-21.1	42.5	5.9	6.0
Exports of goods and services	10.4	6.9	4.6	3.0
Imports of goods and services	-2.9	16.5	4.6	2.9
<b>Gross Domestic Product (GDP)</b>	<b>8.2</b>	<b>5.0</b>	<b>4.3</b>	<b>3.9</b>
<b>Underlying Domestic Demand</b>	<b>5.3</b>	<b>3.8</b>	<b>3.6</b>	<b>3.4</b>
<b>Prices, Costs and Competitiveness</b>				
Harmonised Index of Consumer Prices (HICP)	0.7	0.8	1.1	1.4
Compensation per Employee	2.7	3.6	4.2	4.3
<b>Labour Market</b>				
Total employment	3.1	2.4	1.5	1.4
Labour force	1.9	1.8	1.3	1.3
Unemployment rate (ILO)	5.6	5.0	4.8	4.8
<b>No-Deal</b>	<b>2018</b>	<b>2019f</b>	<b>2020f</b>	<b>2021f</b>
<b>Real Economic Activity</b>				
Personal consumer expenditure	3.4	2.1	-0.7	1.4
Public consumption	4.4	5.7	3.1	2.5
Gross fixed capital formation	-21.1	41.7	-4.0	1.5
Exports of goods and services	10.4	5.8	-2.5	3.2
Imports of goods and services	-2.9	15.1	-5.2	3.4
<b>Gross Domestic Product (GDP)</b>	<b>8.2</b>	<b>4.7</b>	<b>0.8</b>	<b>1.9</b>
<b>Underlying Domestic Demand</b>	<b>5.3</b>	<b>3.4</b>	<b>-0.4</b>	<b>1.8</b>
<b>Prices, Costs and Competitiveness</b>				
Harmonised Index of Consumer Prices (HICP)	0.7	0.8	0.9	1.2
Compensation per Employee	2.7	3.6	3.5	3.0
<b>Labour Market</b>				
Total employment	3.1	2.1	0.2	-0.2
Labour force	1.9	1.8	0.8	1.0
Unemployment rate (ILO)	5.6	5.3	5.8	6.9

## Comment

The Irish economy continued to grow at a strong pace in the first half of 2019, despite rising uncertainty about the economic outlook and a less favourable external economic environment. While the underlying outlook for growth in the economy remains positive, there are significant domestic and external risks and uncertainties which threaten that outlook. At present, the main uncertainty relates to Brexit and the path ahead for the economy in coming years is linked to the future path of the Brexit process. If a disorderly, no deal Brexit can be avoided, it is projected that underlying economic activity will grow at a relatively solid pace in coming years, though with some moderation in growth in prospect. In a no-deal scenario, however, significant disruption and the negative shock to economic activity would adversely affect output and employment and the path ahead for the next few years would be very different.

Looking at the recent performance of the economy, while headline measures of the National Accounts continue to be affected by the activities of globalised firms, underlying measures of economic activity pointed to continued resilience in domestic demand in the first-half of the year.

Continued gains in employment and incomes supported ongoing growth in domestic economic activity and consumption grew strongly in the first half of the year, despite a weakening of consumer sentiment over the same period. On the external side, despite the less favourable international economic environment, export growth was surprisingly strong, however, that growth continues to be concentrated in a small number of sectors, dominated by multinational firms.

Despite the strong performance of the economy in the first half of 2019, however, there are signs that rising uncertainty is dampening economic activity. Box A (page 16), which provides an update and assessment of the Central Bank's Business Cycle Indicator (BCI), shows that the BCI, which is an indicator of the current and prospective state of the economy, has fallen to its lowest level since 2013. While partly reflecting some moderation in

monthly economic data, the fall in the BCI primarily reflects a sharp weakening in consumer and business sentiment data since early 2019, with increasingly negative expectations for the forward-looking components outweighing moderating, but more positive, current conditions measures. While it is not possible to be definitive, concerns over the potential impact of Brexit are likely to have played a significant role in this weakening of forward-looking indicators.

Given the uncertainty around the prospective divergent paths for the economy, this Bulletin outlines forecasts for the main macroeconomic aggregates, prices and labour market variables under both a Brexit deal and no-deal scenario. This extends the analysis contained in the July Bulletin, which looked at the possible implications of no deal for growth and employment over the forecast horizon, which is now extended to 2021.

In the case that a deal can be agreed, the main impetus to growth over 2019 to 2021 is expected to continue to come from domestic demand driven by further growth in employment and incomes, though some moderation in employment growth is projected. In addition, some further support is likely to be provided by the positive impact of the removal of existing uncertainties in relation to a disorderly Brexit, which should also support some recovery in underlying investment. In this case, underlying domestic demand is projected to grow by 3.8 per cent in 2019, moderating gradually to 3.4 per cent by 2021 and unemployment is forecast to move lower, averaging 4.8 per cent in 2021. On the external side, export growth is forecast to moderate in line with slowing demand in trading partner countries. Combining all the elements, in the Brexit deal case, GDP is projected to grow by 5.0 per cent this year, easing to 4.3 per cent next year and 3.9 per cent in 2021. In this scenario, the continued strength of domestic demand and tightening labour market conditions highlight the need to guard against the risk of strong cyclical conditions giving rise to overheating dynamics.

Turning to a disorderly, no deal, the key channels through which the economy will be affected will be through shocks to the exchange rate, trade, consumption and investment, leading to a marked deterioration in economic conditions and a much more adverse outlook. In response, firms and households are likely to cut spending; the disruption to trade infrastructure will have adverse effects for both exports and imports, with the impact on exports reinforced by exchange rate movements and the impact on imports potentially having implications for production and consumption.

Assuming a no-deal Brexit from 31 October, most of the impact on growth and demand would be felt in 2020, with the impact on employment lagging



slightly in terms of timing. In this case, GDP growth is projected to slow to 0.8 per cent in 2020, before picking up to 1.9 per cent in 2021. This is 3.5 percentage points lower in 2020 and 2.0 percentage points lower in 2021 than in the case where there is a deal. Consumption, investment, exports and imports are all projected to contract in 2020 and resume growth in 2021 in this scenario. While overall GDP growth is forecast to remain positive in 2020, activity on the domestic side of the economy is projected to contract, with underlying domestic demand forecast to fall by 0.4 per cent in 2020 as a result of the severe impact of no deal on domestic activity. Compared to the deal scenario, employment is projected to be 73,000 lower in 2021 and unemployment is forecast to rise to 5.8 per cent in 2020 and 6.9 per cent in 2021, over 2 percentage points higher in 2021 than in the deal scenario. While considerable uncertainty necessarily attaches to estimates from an exercise of this type, a disorderly, no deal Brexit would present enormous challenges and result in a significant loss of output and employment compared to a no Brexit scenario.

However, Brexit is not the only external risk to the Irish economic outlook. As Box B (page 20) indicates, the outlook for global economic activity has continued to worsen in recent months. Given the position of Ireland as a small, highly open economy, the state of global economic conditions has an important bearing on Irish economic performance. Risks in relation to trade and taxation also persist. Given the important role of multinational firms both within the economy and in driving the strong growth of corporation tax revenues, in addition to the growing concentration of export growth, it is important to build the resilience of both the economy and the public finances to possible shocks to the sector.



# An Timpeallacht Gheilleagrach

Lean geilleagar na hÉireann de bheith ag fás ar ráta láidir sa chéad leath de 2019, in ainneoin tuilleadh éiginnteacha faoin ionchas eacnamaíoch agus in ainneoin timpeallacht eacnamaíoch sheachtrach nach bhfuil chomh fabhrach agus a bhí. Cé gur dearfach fós an t-ionchas fáis don gheilleagar, tá rioscaí agus ábhair shuntasacha éiginnteachta intíre agus seachtracha ann a chuireann isteach ar an ionchas sin. Faoi láthair, baineann an príomhábhar éiginnteachta le Brexit, agus tá slí an gheilleagair do na blianta atá romhainn nasctha le slí phróiseas Brexit amach anseo. Más féidir Brexit mí-ordúil, gan chomhaontú, a sheachaint, tuartar go dtiocfaidh fás réasúnta seasmhach ar bhunghníomhaíocht eacnamaíoch sna blianta atá romhainn, cé go bhféadfadh maolú áirithe a bheith ar fhás. I gcás Brexit gan chomhaontú, áfach, bheadh tionchar dochrach ag suaitheadh suntasach agus ag tuarraing dhiúltach do ghníomhaíocht eacnamaíoch ar aschur agus ar fhostaíocht agus bheadh an bealach do na blianta beaga atá amach romhainn an-difriúil.

De réir fheidhmíocht an gheilleagair le déanaí, tá tionchar fós ag gníomhaíochtaí gnólachtaí domhanda ar mhéideanna ceannlíne na gCuntas Náisiúnta, ach tugadh le tuiscint le bunmheasúnuithe gníomhaíochta eacnamaíche go bhfuil athléimneacht fós in éileamh intíre sa chéad leath den bhliain. Bhí méaduithe leanúnacha ar fhostaíocht agus ar ioncaim mar thacaíocht le fás leantach i ngníomhaíocht eacnamaíocht intíre agus tháinig fás láidir ar thomhaltas sa chéad leath den bhliain, in ainneoin lagú ar sheintimint tomhaltóirí sa tréimhse sin. Ar an taobh seachtrach, in ainneoin timpeallacht gheilleagrach idirnáisiúnta níos lú fabhraí, tá fás láidir ar onnmhairí, fás nach rabhtas ag súil leis, cé go bhfuil an fás sin fós cruinnithe i líon beag earnálacha, a bhfuil forlámhas ag gnólachtaí ilnáisiúnta iontu.

In ainneoin fheidhmíocht láidir an gheilleagair sa chéad leath de 2019, tá comharthaí ann go bhfuil éiginnteacht ardaithe ag maolú gníomhaíocht

eacnamaíoch. I mBosca A (leathanach 16), tugtar nuashonrú agus measúnú ar an Táscaire ar an Timthriall Gnó (BCI) ón mBanc Ceannais. Is táscaire é an BCI ar staid reatha agus ar staid fhéideartha an gheilleagair, agus léirítear sa Bhosca go bhfuil an táscaire ag an leibhéal is ísle ó bhí 2013 ann. Cé gur léiriú é, go pointe áirithe, ar mhaolú áirithe ar shonraí eacnamaíocha míosúla, go príomha is léiriú é an BCI ar lagú géarr ar sheintimint tomhaltóirí agus gnólachtaí ó thús 2019. Tá bearta dálaí reatha níos dearfaí sáraithe ag ionchais níos diúltaí do ghnéithe réamhbhreithnithe. Cé nach féidir a bheith go hiomlán cinnte faoi seo, is dócha go raibh ról suntasach ag inní maidir le tionchar féideartha Brexit ar lagú na dtáscairí réamhbhreithnithe seo.

I bhfianaise na héiginnteachta faoi na conairí éagsúla féideartha don gheilleagar, tugtar cur síos san Fhaisnéis seo ar na príomh-mhéideanna maicreacnamaíocha comhiomlána agus ar na hathróa praghais agus margaidh saothair faoi chomhaontú Brexit agus faoi Brexit gan chomhaontú. Is leathnú é seo ar an anailís a bhí i bhFaisnéis mhí Iúil, inar scrúdaíodh na himpleachtaí féideartha a bheadh ag Brexit gan chomhaontú ar fhás agus ar fhostaíocht le linn thréimhse na réamhaisnéise (a bhfuil síneadh uirthi anois go dtí 2021).

Sa chás gur féidir comhaontú a fháil, meastar go dtiocfaidh an príomhspreagadh d'fhás eacnamaíoch na hÉireann in 2019 agus in 2021 ón éileamh intíre, arna spreagadh ag fás breise ar fhostaíocht agus ar ioncaim, cé go dtuairtar go dtiocfaidh maolú éigin ar an bhfás fostaíochta. Sa bhreis air sin, is dócha go mbeidh tacaíocht bhreise ann ón tionchar dearfach a bheidh ag imeacht na n-éiginnteachtaí atá anois ann maidir le Brexit mí-ordúil, rud a thacóidh le téarnamh áirithe i mbun-infheistíocht. Sa chás sin, meastar go dtiocfaidh fás 3.8 faoin gcéad ar an mbunéileamh intíre i mbliana agus go maolóidh an fás sin go dtí 3.4 faoin gcéad faoi 2021 agus go dtí 4.8 faoin gcéad in 2020. Ar an taobh seachtrach, tuairtar go dtiocfaidh maolú ar fhás onnmhairí i gcomhréir le héileamh atá á laghdú i dtíortha comhpháirtithe trádála. I bhfianaise na ngnéithe sin ar fad, sa chás go mbeidh Brexit le comhaontú ann, meastar go dtiocfaidh fás 5.0 faoin gcéad ar an mbunéileamh intíre i mbliana agus go maolóidh an fás sin go dtí 4.3 faoin gcéad in 2020 agus go dtí 3.9 faoin gcéad in 2021.

Sa chás sin, léiríonn neart leantach an éilimh intíre agus géarú ar dhálaí an mhargaidh saothair a thábhachtaí atá sé a bheith san airdeall maidir leis an riosca go n-eascróidh dinimic an róbhortha as dálaí timthriallacha láidre.

I gcás Brexit mí-ordúil, gan chomhaontú, is iad na príomhchainéil trína mbeidh tionchar ar an ngeilleagar ná turraingí don ráta malairte, do thrádáil, do thomhaltas agus d'infheistíocht. As sin, d'eascródh meathlú suntasach ar dhálaí eacnamaíocha agus ionchas i bhfad níos dochraí. Ag

freagairt dó sin, is dócha go ndéanfadh gnólachtaí agus teaghlaigh gearradh siar ar chaiteachas agus beidh éifeachtaí dochracha ag an suaitheadh do bhonneagar trádála ar onnmhairí agus ar allmhairí. Déanfar géarradh ar an tionchar ar onnmhairí de bharr gluaiseachtaí rátaí malairte agus d'fhéadfadh impleachtaí a bheith ag an tionchar ar allmhairí do tháirgeadh agus do thomhaltas.

Má ghlactar leis go mbeidh Brexit gan chomhaontú ann ar an 31 Deireadh Fómhair, bheadh an tionchar ba mhó ar fhás agus ar éileamh le brath in 2020, agus bheadh moill bheag ann maidir leis an tionchar ar fhostaíocht. Sa chás sin, tuartar go dtiocfaidh moilliú ar fhás OTI go 0.8 faoin gcéad in 2020, sula dtiocfadh feabhas air go 1.9 faoin gcéad in 2021. Tá sé sin 3.5 pointe faoin gcéad níos lú in 2020 agus 2.0 pointe faoin gcéad níos lú in 2021 ná sa chás ina mbeadh comhaontú ann. Tuartar go dtiocfaidh laghdú ar thomhaltas, infheistíocht, onnmhairí agus allmhairí in 2020 agus go dtosóidh siad ag fás arís in 2021 sa chás sin. Cé go dtuartar go bhfanfaidh fás OTI dearfach in 2020, meastar go dtiocfaidh laghdú ar ghníomhaíocht ar an taobh intíre den gheilleagar. Tuartar go dtiocfaidh laghdú 0.4 faoin gcéad ar bhunéileamh intíre in 2020 de bharr an tionchair dhéin a bheadh ag Brexit gan chomhaontú ar ghníomhaíocht intíre. I gcomparáid leis an gcás ina mbeadh comhaontú ann, tuartar go mbeidh fostaíocht 73,000 níos lú in 2021 agus tuartar go dtiocfaidh ardú ar dhífhostaíocht go 5.8 faoin gcéad in 2020 agus go 6.9 faoin gcéad in 2021, níos mó ná 2 pointe faoin gcéad níos airde ná mar atá sa chás go mbeadh comhaontú ann. Cé go bhfuil éiginnteacht shuntasach ag baint leis na meastacháin ón gcineál ceachta seo, bheadh dúshlain ollmhóra ag baint le Brexit mí-ordúil, gan chomhaontú, agus bheadh cailleanas suntasach aschuir agus fostaíochta ann i gcomparáid le cás gan Brexit.

Ní hé Brexit an t-aon riosca seachtrach d'ionchas eacnamaíoch na hÉireann, áfach. Mar a léirítear i mBosca B (leathanach 20), bhí an t-ionchas do ghníomhaíocht eacnamaíoch domhanda ag éirí níos measa fós le cúpla mí anuas. Toisc gur geilleagar beag, rí-oscailte atá ag Éirinn, tá tionchar tábhachtach ag dálaí eacnamaíocha domhanda ar fheidhmíocht eacnamaíoch na hÉireann. Tá rioscaí ann fós maidir le trádáil agus cáin freisin. I bhfianaise ról tábhachtach na ngnólachtaí ilnáisiúnta sa gheilleagar, i bhfianaise an róil atá ag na gnólachtaí sin borradh láidir a chur faoi ioncaim cánach corparáidí, agus i ngeall ar an bhfás atá ag teacht ar chruinniú fáis onnmhairí, tá sé tábhachtach athléimneacht a thógáil sa gheilleagar agus sa státchiste in aghaidh turraingí féideartha don earnáil.

# The Irish Economy

## Overview

- The Irish economy grew strongly in the first half of 2019. Underlying measures of economic activity point to continued resilience in domestic demand in the first-half of the year. However, some headline measures of the National Accounts, specifically investment and imports, displayed considerable volatility, continuing to be affected by the impact of globalisation. On the domestic side, growth in the economy up to mid-year was supported by continued expansion in employment and incomes in a low inflation environment. On the external side, while overall export growth remained robust, the strength of pharmaceutical and computer services exports masked more modest growth in other sectors.
- Looking ahead, the outlook is subject to heightened levels of risk and uncertainty (see Box A, which looks at the latest signals from the Central Bank's Business Cycle Indicator) and there are both significant domestic and external risks to the outlook. If these risks do not materialise, or can be averted, the outlook remains positive. However, if these risks materialise then the path ahead may be very different, with a risk of overheating on one side or a sharp deceleration in activity on the other.
- At present, the most prominent risk, and the one with the largest potential effect, is that of the UK leaving the European Union on 31 October without either ratifying the Withdrawal Agreement or agreeing an alternative deal. The outlook for the economy over the forecast horizon, 2019 to 2021, is substantially different depending on whether or not a disorderly Brexit occurs. As noted in previous Bulletins, if a deal can be agreed, the outlook for the economy is positive, albeit with growth moderating in line with the deteriorating outlook in the international environment. In a no-deal scenario, however, the prospects for output and employment in coming years would be very different.

- Given the uncertainty around these divergent paths for the economy, this Bulletin sets out forecasts for the Irish economy under both a Brexit deal, involving a transition period during which the status quo is maintained, and a no-deal scenario. If a disorderly, no-deal Brexit can be avoided, it is projected that underlying economic activity will grow at a relatively solid pace in coming years, though with some moderation in growth in prospect. In this case, GDP is projected to grow by 5.0 per cent in 2019, 4.3 per cent in 2020 and 3.9 per cent in 2021 (see Table 1). The projected moderation in growth reflects both the dampening influence of the less favourable global growth outlook over the coming year and the gradually limiting impact of emerging domestic capacity constraints.
- If a no-deal outcome can be avoided, the main impetus to growth is expected to come from the continued expansion in underlying domestic demand, reflected in solid growth in consumer spending and underlying investment. In this case, underlying domestic demand is projected to grow by 3.8 per cent in 2019 and 3.6 per cent in 2020, moderating to 3.4 per cent in 2021. In addition to being supported by the positive impact of the removal of existing uncertainties in relation to a disorderly Brexit, the expansion in underlying activity over the forecast horizon is projected to be mainly driven by continuing gains in employment and incomes. However, a moderation in employment growth is projected over the forecast horizon. On the external side, exports are forecast to grow in line with slowing demand in Ireland's trading partners, though net exports are projected to continue to contribute positively to growth over the forecast horizon.
- The outlook for the main macro aggregates and underlying domestic demand in a disorderly, no-deal scenario, are shown in the bottom half of Table 1. Given the possible date of 31 October for a no-deal Brexit, most of the possible impact would occur in 2020. In this scenario, GDP growth is projected to slow to 0.8 per cent in 2020, before recovering to 1.9 per cent in 2021. This is 3.5 percentage points lower for 2020 and 2 percentage points lower for 2021, in comparison to the case

in which there is a deal. As can be seen from the Table, all the main private sector aggregates - consumption, investment, exports and imports - are projected to contract in 2020 and begin to grow again in 2021. GDP growth remains positive in 2020 because the combined effect of the growth in public consumption and a positive net export contribution, as a result of the impact on imports being greater than exports. However, domestic economic activity is projected to contract in 2020, with underlying domestic demand forecast to fall by 0.4 per cent, reflecting the impact of the decline in consumption and investment spending. This compares with projected growth of 3.6 per cent in underlying domestic demand in 2020 in a deal scenario. With the growth of consumption and investment beginning to recover in 2021, underlying domestic demand is projected to grow by 1.8 per cent in that year.

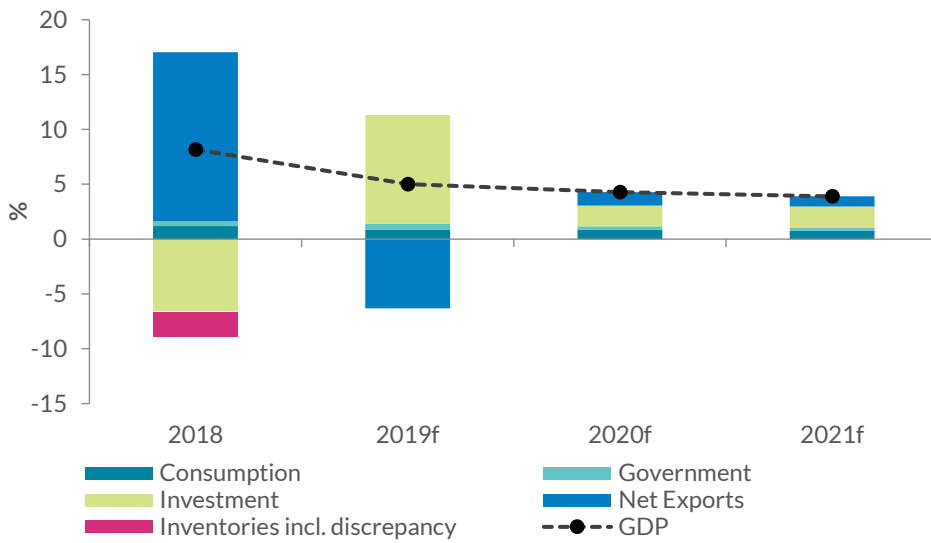
- It is important to emphasise that the degree of uncertainty around these estimates is large. This is due to the fact that Brexit is an event without historical precedent. There is substantial uncertainty around how the economy would adjust in a no-deal Brexit: by how much and how quickly would trade flows be affected by the imposition of WTO tariffs, what would be the scale of logistical and supply-chain disruption, how would financial markets and exchange rates react? The projections are based on assumptions on these key transmission channels, based on the best available evidence from academic research and other published studies. At the same time, there is an unavoidably high degree of uncertainty around the magnitude, and even the direction, of some of these effects. As a consequence, the impact on the Irish economy could turn out to be more or less severe than these estimates. Whatever the precise magnitude of the economic impact, a disorderly Brexit would present enormous challenges for the Irish economy and would result in a loss of output and employment compared to a scenario where the UK remained in the EU.

Table 1: Comparison of forecasts under a deal and a no-deal scenario

Deal	2018	2019f	2020f	2021f
<b>Real Economic Activity</b>				
Personal consumer expenditure	3.4	2.5	2.7	2.4
Public consumption	4.4	5.7	3.1	2.5
Gross fixed capital formation	-21.1	42.5	5.9	6.0
Exports of goods and services	10.4	6.9	4.6	3.0
Imports of goods and services	-2.9	16.5	4.6	2.9
<b>Gross Domestic Product (GDP)[1]</b>	<b>8.2</b>	<b>5.0</b>	<b>4.3</b>	<b>3.9</b>
<b>Underlying Domestic Demand</b>	<b>5.3</b>	<b>3.8</b>	<b>3.6</b>	<b>3.4</b>
<b>Prices, Costs and Competitiveness</b>				
Harmonised Index of Consumer Prices (HICP)	0.7	0.8	1.1	1.4
Compensation per Employee	2.7	3.6	4.2	4.3
<b>Labour Market</b>				
Total employment	3.1	2.4	1.5	1.4
Labour force	1.9	1.8	1.3	1.3
Unemployment rate (ILO)	5.6	5.0	4.8	4.8
<b>No Deal</b>	<b>2018</b>	<b>2019f</b>	<b>2020f</b>	<b>2021f</b>
<b>Real Economic Activity</b>				
Personal consumer expenditure	3.4	2.1	-0.7	1.4
Public consumption	4.4	5.7	3.1	2.5
Gross fixed capital formation	-21.1	41.7	-4.0	1.5
Exports of goods and services	10.4	5.8	-2.5	3.2
Imports of goods and services	-2.9	15.1	-5.2	3.4
<b>Gross Domestic Product (GDP)</b>	<b>8.2</b>	<b>4.7</b>	<b>0.8</b>	<b>1.9</b>
<b>Underlying Domestic Demand</b>	<b>5.3</b>	<b>3.4</b>	<b>-0.4</b>	<b>1.8</b>
<b>Prices, Costs and Competitiveness</b>				
Harmonised Index of Consumer Prices (HICP)	0.7	0.8	0.9	1.2
Compensation per Employee	2.7	3.6	3.5	3.0
<b>Labour Market</b>				
Total employment	3.1	2.1	0.2	-0.2
Labour force	1.9	1.8	0.8	1.0
Unemployment rate (ILO)	5.6	5.3	5.8	6.9



**Figure 1: GDP growth is forecast to remain strong in the event the UK ratifies Withdrawal Agreement**



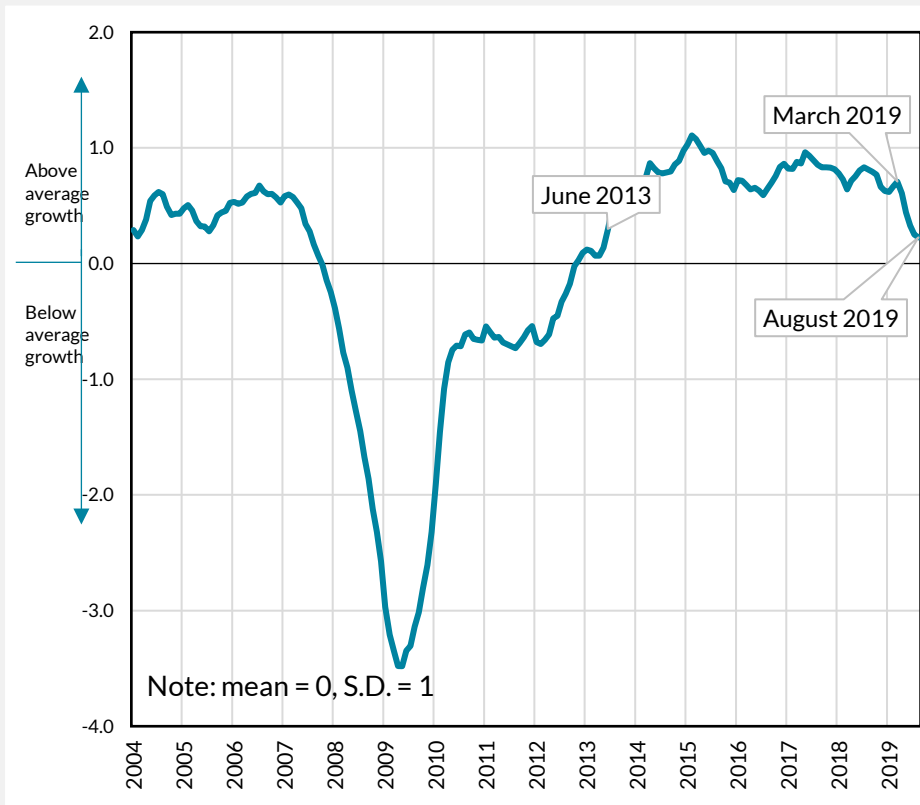
Source: CSO and Central Bank of Ireland.

**Box A: Business Cycle Indicator – An Update**  
 By *Graeme Walsh*<sup>1</sup>

The Central Bank’s Business Cycle Indicator (BCI) is a statistical measure of economic activity used to help provide a timely assessment of the current state of the economy. The indicator uses a large panel of relevant economic data from a variety of monthly data releases. For example, the dataset includes retail sales, Exchequer tax returns, and survey measures of both consumer and firm sentiment.<sup>2</sup> The combination of high-frequency data and a mix of hard and soft data allows the indicator to identify potential turning points in the economy. This Box presents the latest update of the BCI for the period up to August 2019.

<sup>1</sup> Irish Economic Analysis Division

<sup>2</sup> For a full description of the BCI and the underlying dataset, see: [Conefrey, Thomas and Graeme Walsh \(2018\), “A monthly indicator of economic activity for Ireland,” Economic Letters 14/EL/18, Central Bank of Ireland.](#)

**Figure 1: Business Cycle Indicator (2004M01-2019M08)**

Source: Author's Calculations

### Latest Estimates

The latest estimate of the BCI is shown in Figure 1.<sup>3</sup> The indicator shows that following the sharp downturn in 2008-2009, the economy eventually rebounded in 2013 and, for the past 5 years, has continued to grow at a steady, above average, pace. The most recent estimates show that the indicator has fallen for the past five consecutive months, signalling a marked slowdown in economic activity. In August 2019, the indicator fell to its lowest level in 6 years, comparable to its level in June 2013.

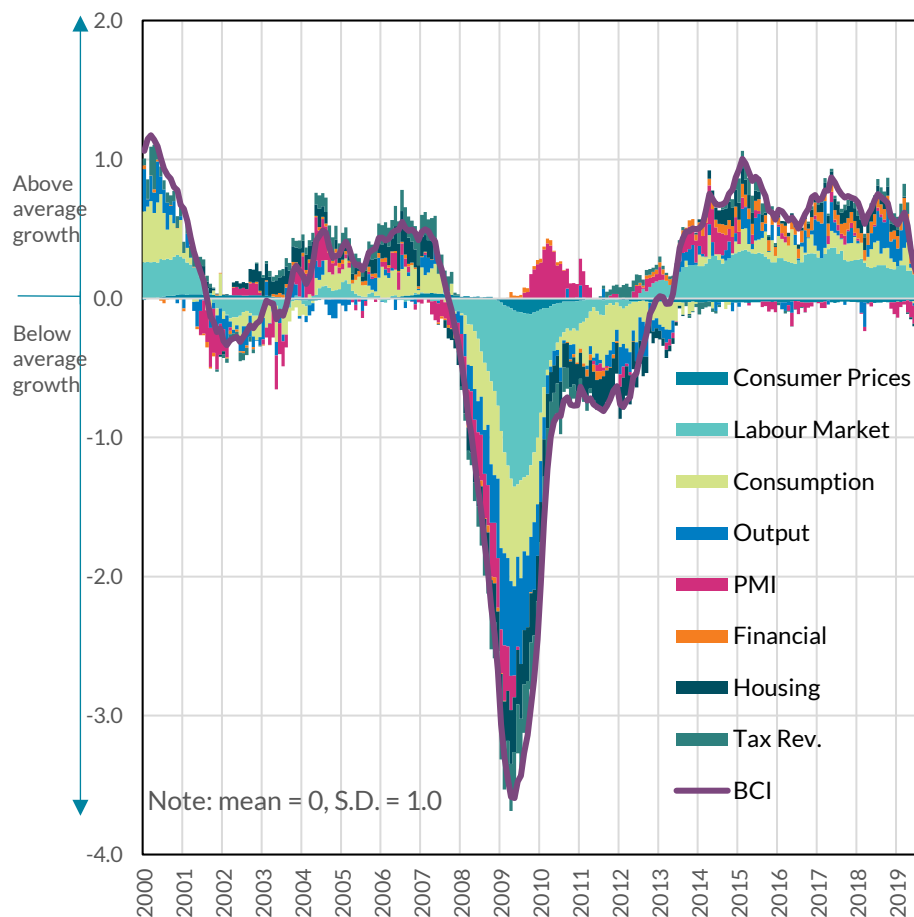
### Historical Decomposition

Figure 2 presents a historical decomposition of the indicator. This illustrates which variables in the dataset have caused the indicator to move up and down over time. For example, in the late 1990s, the main factors supporting economic activity were consumer spending and improvements to the labour market. Then, during the mid-2000s, the expansion in housing market activity and consumer spending explained most of the variation in the indicator. Throughout the 2008-2013 period, there was a broad-based contraction with the rapid rise in

<sup>3</sup> Values of the indicator above zero signal that economic activity is expanding at a rate above its long-run historic average; values below zero indicate slower than average growth.

unemployment and reduction in economic output resulting in lower spending by both consumers and firms. Since 2014, there have been significant improvements to the labour market. Output and consumer spending have also been important factors behind the recent above average levels of economic activity. The slowdown in the indicator in 2019 is explored more closely in the next section.

**Figure 2: Historical Decomposition (2000M01-2019M07)**

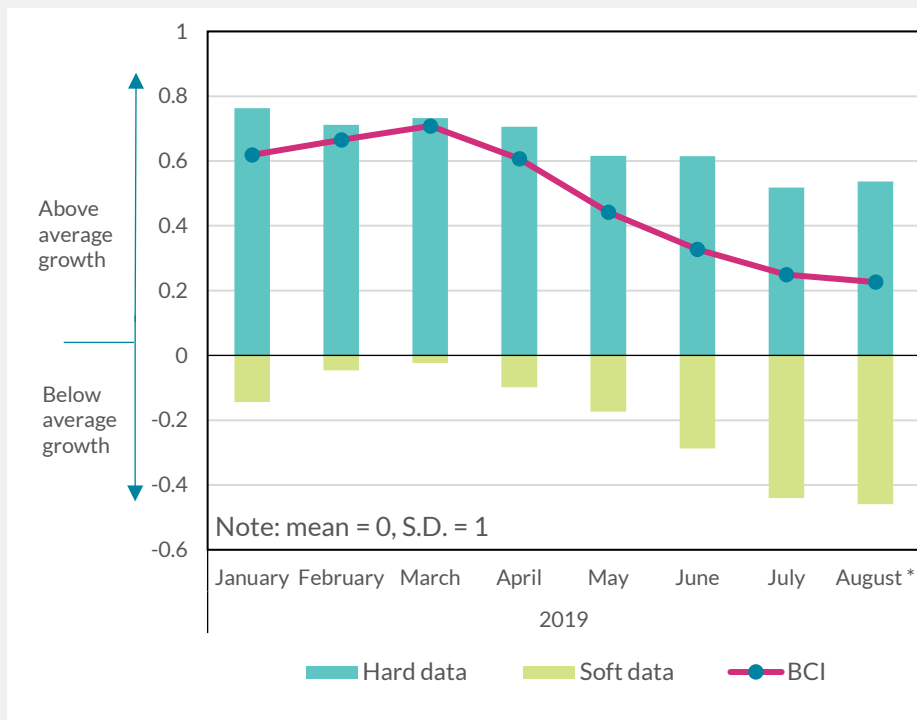


Source: Author's Calculations

### Slowdown in 2019

By decomposing the indicator and examining the underlying data, it is possible to identify the main drivers behind the sharp slowdown since early 2019. To see this more clearly, Figure 3 shows a decomposition of the indicator for the current year into the contributions from hard and soft data.<sup>4</sup>

<sup>4</sup> "Hard data" here refers to measured economic activity such as retail sales, production volumes, tax receipts, etc., while "soft data" refers to survey-based estimates of sentiment, uncertainty, and expectations.

**Figure 3: Hard and Soft Data Contributions (2019M01-2019M08)**

Source: Author's Calculations

\* excludes housing and production (data n.a.)

There are two features worth highlighting. First, throughout 2019, the **soft data** have acted as a drag on the BCI and its effects have become even more pronounced since July. The soft data includes survey estimates of both consumer and firm sentiment, such as the KBC Consumer Sentiment Index and the IHS Markit Purchasing Managers Index for Ireland. The manufacturing PMI stood at 53.9 in March 2019 and has since fallen below 50 to 48.6 signalling a contraction in August 2019.<sup>5</sup> Meanwhile, the services PMI continues to indicate an expansion with a value of 54.6 in August 2019; however, this is down compared to the average value of 58 in 2018. In terms of consumer sentiment, the survey-based measures fell to their lowest levels in six years in August 2019.<sup>6</sup>

Second, although the **hard data** have continued to signal an expansion in economic activity, its positive contribution to the BCI has weakened significantly since the second quarter. The unemployment rate currently stands at 5.2 per cent, and as the labour market has tightened, its positive contribution to the indicator has decreased.<sup>7</sup> Other hard data, such as

<sup>5</sup> In August 2019, the associated sub-indices for output and new orders stood at 47.0 and 47.8, respectively.

<sup>6</sup> See: <https://www.kbc.ie/blog/consumer-sentiment-surveys/consumer-sentiment-index-august-2019>.

<sup>7</sup> The monthly unemployment rate increased to 5.3 per cent in September 2019.

consumer spending, tax receipts, and traditional sector activity, have shown robust growth in 2019. For example, core retail sales grew by 4.4 per cent in August while traditional sector output grew by 7.9 per cent in July 2019. The strength of these and other hard data have ensured that the overall BCI remains in positive territory despite the weakness in the soft data.<sup>8</sup>

Historically, weak consumer confidence and firm sentiment have acted as a leading indicator of a slowdown in economic activity. While this relationship does not always hold, it will be important to closely monitor incoming data over the coming months for any signs that the recent weakness in the Bank's BCI is being reflected in slower economic activity and employment.

## Box B: The International Economic Outlook

*By Monetary Policy Division*

The outlook for global economic activity continued to worsen over the last months. Escalating trade tensions increasingly weigh on investment and confidence, adding to policy uncertainty and aggravating risks in financial markets. The OECD revised its projections in September further downward, foreseeing global GDP growth of 2.9 per cent in 2019 and 3.0 per cent in 2020. The OECD's assessment of the outlook is materially less favourable than the one provided by the IMF in July, which forecast global GDP growth of 3.2 per cent in 2019 and 3.5 per cent in 2020.

In the euro area, real GDP increased by 0.2 per cent on a quarterly basis and by 1.2 per cent on a yearly basis during the second quarter of 2019. The growth slowdown mainly reflects the weakness of trade in an environment of prolonged global uncertainties, which is particularly affecting the euro area manufacturing sector. On the other hand, the unemployment rate is close to historical lows for the euro area,

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<sup>8</sup> For quantitative estimates of uncertainty on consumption and investment in Ireland, see: [McQuinn, Kieran \(2019\), "Box 1: Modelling Irish consumer sentiment – the potential impact of Brexit," Economic and Social Research Institute Quarterly Economic Commentary June 2019](#). Also see: [McQuinn, K., O'Toole, M., Allen-Coghlan, M. and Economides, P. \(2019\) "Small open economies – vulnerabilities in a changing world," Economic and Social Research Institute presentation at Dublin Economics Workshop](#).

remaining constant at 7.5 per cent in July – which is the lowest rate recorded since July 2008.

The ECB macroeconomic projections released in September foresee euro area GDP increasing by 1.1 per cent in 2019, 1.2 per cent in 2020 and 1.4 per cent in 2021 (revised down for 2019 and 2020). The balance of risks remains tilted to the downside, reflecting the prolonged persistence of uncertainty related to geopolitical factors and Brexit, as well as the risk of rising protectionism and vulnerabilities in emerging markets.

Sentiment indicators continue to signal a worsening outlook. The flash reading of the Markit Eurozone composite PMI posted 50.4 in September (down from 51.9 in August). The headline index continues to mask notable differences in sector performance; but the deepening manufacturing downturn (down to 46.0 from 47.9 in August) shows signs of spreading to the services sector (down to 52.0 from 53.5 in August). In August, the European Commission's business climate indicator for the euro area returned positive (up by 0.22 points to +0.11) and the economic sentiment indicator moved slightly up (by 0.4 points to 103.1, respectively), while the consumer confidence indicator decreased (by 0.5 points to -7.1).

Euro area annual HICP was 1.0 per cent in August, stable compared to July. Energy inflation displayed the largest decline, down to -0.6 per cent from 0.5 per cent in July. Measures of underlying inflation remained stable but subdued, with HICP inflation excluding energy and unprocessed food at 1.1 per cent, unchanged from July. The ECB revised down the outlook for inflation for the whole projection horizon: September projections forecast annual HICP inflation to be 1.2 per cent in 2019, 1.0 per cent in 2020 and 1.5 per cent in 2021.

In light of the weakening outlook for euro area inflation and growth, the ECB Governing Council (GC) announced a broad package of measures at its September meeting. The GC lowered the deposit facility rate (DFR) by 10 basis points to -0.50% and announced a two-tier system for reserve remuneration, in which part of banks' holdings of excess liquidity will be exempt from the negative DFR. State-contingent forward guidance was reinforced, with the key ECB interest rates being now expected to remain at their present or lower levels until the inflation outlook robustly converges to a level sufficiently close to, but below, 2% within the projection horizon, and such convergence has been consistently reflected in underlying inflation dynamics. Net purchases under the asset purchase programme (APP) will restart in November at a monthly pace of €20 billion and are expected to run for as long as necessary to reinforce the accommodative impact of policy rates, and to end shortly before

policy rates will be increased. The new series of targeted longer-term refinancing operations (TLTRO III) will be more accommodative than previously announced, with their rates reduced by 10 basis points and their maturity extended from two to three years.

Turning to the United States, business investment and exports have weakened, while labour market conditions and the growth rate of economic activity remain robust. Headline and underlying inflation are running below 2 per cent and market-based measures of inflation expectations remain low. Following the rate cut implemented in July, the US Federal Open Market Committee (FOMC) lowered the policy rate by an additional 25 basis points at its September meeting, setting the target range for the federal funds rate at 1.75 to 2 per cent. Looking forward, the FOMC estimates that sustained economic growth, strong labour market conditions and inflation near 2 percent are the most likely outcomes, but uncertainties about this outlook remain.

In the United Kingdom, data continue to be volatile: quarterly GDP declined by 0.2 per cent in the second quarter of 2019 but is expected to rise by 0.2 per cent in the third quarter. Shifting expectations about the potential timing and nature of Brexit have continued to heighten volatility in asset prices and in the exchange rate. The Bank of England's Monetary Policy Committee maintained the Bank Rate and the stock of bond purchases unchanged in September, at 0.75 per cent and at 445 billion GBP respectively. Looking ahead, the MPC assesses that the appropriate monetary policy response continues to depend on the effects of Brexit on demand, supply, and the exchange rate; as such, it will not be automatic and could be in either direction.

## Demand

### Domestic Demand Overview

Underlying domestic demand is forecast to grow by 3.8 per cent this year and by 3.6 per cent in 2020 under a deal scenario. The projected moderation in the pace of growth in the domestic economy over this year and next reflects both the advanced stage of the business cycle and the negative impact of heightened uncertainty on consumer and business sentiment. Under a no-deal scenario, underlying domestic demand is likely to be significantly weaker. Underlying domestic demand would decline by 0.4 per cent in 2020, rebounding to 1.8 per cent in 2021.

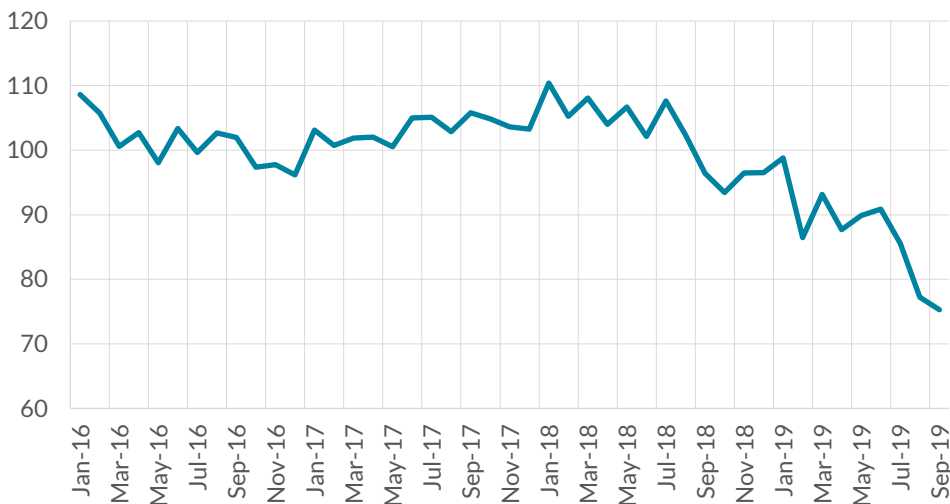
### Consumption

The recent National Accounts data indicate that consumption has continued to grow at a sustained pace. Personal consumption grew by 3.1 per cent year-on-year in the second quarter, up from the 2.5 per cent



growth recorded in the first quarter. Higher frequency data support this picture, with core retail sales (excluding cars) volumes growing by 3.6 per cent year on year in the second quarter. Developments in private consumption continue to be supported by growth in employment and real incomes.

**Figure 2: Despite rising real incomes, consumer sentiment continues to decline**

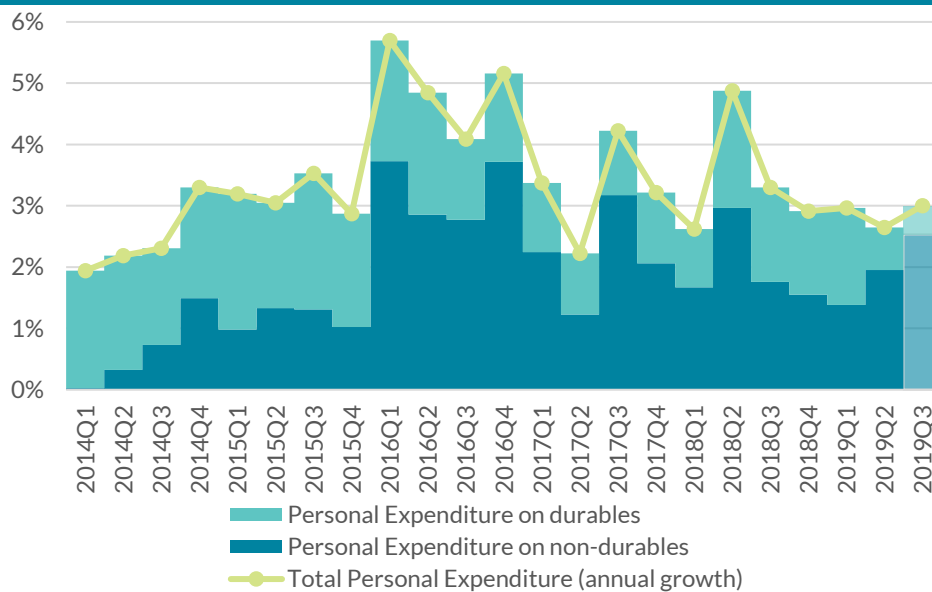


Source: KBC Consumer Sentiment

Note: KBC Consumer Sentiment Indices are based to 1994=100. The last observation for the sentiment indices is September 2019.

Solid growth in consumption continued in the first half of the year, with a weakening in consumer sentiment over the same period appearing to be reflected in a decline in the growth in spending on durables (Figure 3). More recently, the weakening of consumer sentiment has accelerated over the third quarter, falling to its lowest level since late 2013 in September, with the more forward-looking expectations components dipping sharply. Heightened uncertainty is likely to weigh on consumption growth until negotiations around the UK's exit from the EU have been resolved. Typically, large declines in consumer sentiment are associated with households delaying large purchases, such as consumer durables. The slowing of the pace of growth in residential property transactions is also likely to affect durables consumption over the forecast horizon.

**Figure 3: Growth in spending on durables has declined in recent quarters**



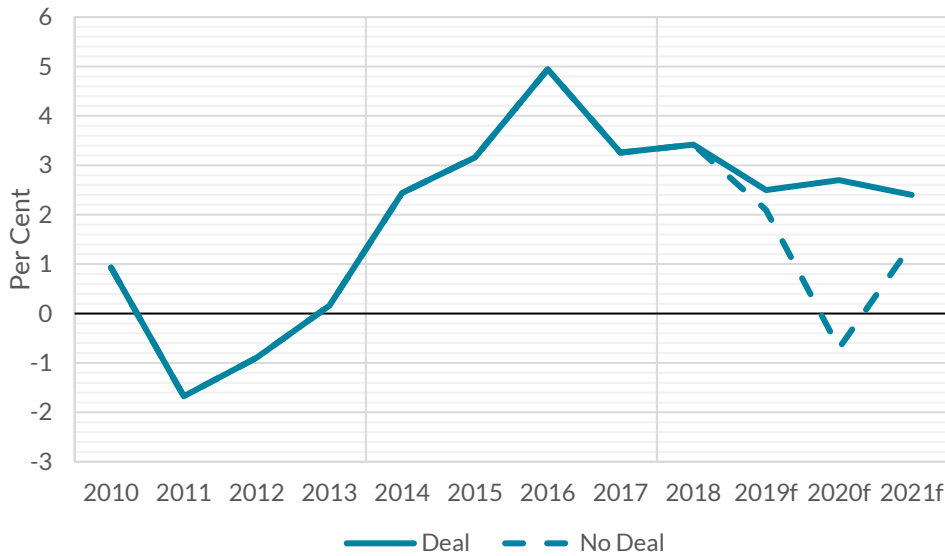
Source: CSO and Authors' calculations.

Given the strength of consumption in the first half of the year, the projection for consumption growth in 2019 is positive under both forecast scenarios. It is projected that consumption will grow by 2.5 per cent in 2019 if a deal is agreed and by 2.1 per cent in a disorderly scenario.

The outlook for 2020 and 2021 strongly diverges under a deal and a no-deal scenario, however. If a deal and subsequent transition arrangement is agreed, consumer confidence is likely to rebound as uncertainty dissipates. Under this scenario, we expect consumption to grow by 2.7 per cent and 2.4 per cent in 2020 and 2021 respectively.

In a no-deal scenario, however, consumption growth is likely to be significantly weaker (Figure 5). The effect of a disorderly Brexit on consumption comes through two primary channels. Firstly, the negative impact on the labour market means that income growth will be weaker (see Labour section). Secondly, the disruption and uncertainty generated by a disorderly Brexit and the full extent of its impact throughout the economy would result in an increase in precautionary savings. Considering these factors, consumption is projected to decline by 0.7 per cent in 2020, and to grow by 1.4 per cent in 2021 in no-deal scenario.

**Figure 4: Consumption growth would be weaker under a no-deal scenario**



Source: CSO and Bank Calculations

### Box C: Short-term disruption to trade infrastructure in a no-deal Brexit

By Stephen Byrne<sup>9</sup>

Much of the economic analysis conducted on the impacts of Brexit on the Irish economy has assessed the deviation from baseline GDP growth under various forms of the future trading relationship, i.e. a Free trade agreement; Customs Union, etc. In each of these scenarios, the status quo applies during a transition period lasting for one to two years<sup>10</sup>. This transition period means that firms, households and administrators are able to prepare for the move to a new trading arrangement between Ireland and the UK.

In a no-deal/disorderly Brexit however, a transition period would not apply. This means there is not only the substantial impact of tariffs and non-tariff barriers, but substantial adjustment costs incurred as firms and administrative bodies in Ireland, the UK and other European countries would be required to implement all of the infrastructure, both administrative and physical, for trading with a third country in a very

<sup>9</sup> Economist, Irish Economic Analysis Division

<sup>10</sup> The Bank has published a series of Quarterly Bulletin Boxes, for example (Conefrey, O'Reilly and Walsh, 2019). See also analysis by the [Department of Finance](#) and [ESRI](#).

short period of time. This box analyses two of primary channels through which short term disruption may arise, logistical delays and the imposition of sanitary and phyto-sanitary checks.

These effects mean that, in the case of no deal, the impact of Brexit on the forecasts is more severe in the short-term. This is primarily through their effect on trade, but also on domestic demand since a significant proportion of firms make use of intermediate inputs imported either from or through the United Kingdom.<sup>11</sup> Assessing the magnitude of this impact on output is difficult however. No country has ever left a free trade agreement with the level of integration that the UK has with EU member states. As such, we have used a significant element of judgement arising from economic theory and the best estimates available in the literature.

### Logistics

A disorderly Brexit would mean that ports and logistics operators in Ireland, the United Kingdom and on the European continent would need to adapt to a substantial number of new regulations in a short space of time. In the long run, evidence suggests that these increases in delays and administrative burdens would reduce UK-Ireland trade by 9.6 per cent.<sup>12</sup>

In the short run, however, the process of adapting to new regulations and implementing a new tariff regime will result in delays at ports/airports compared with the status quo. Furthermore, there would likely need to be upgrades to port infrastructure to allow any delayed consignments to be stored, for traffic management, as well as to allow trucks to comply with tachograph rules, etc.<sup>13</sup>

As well as delays to Irish imports and exports to and from the UK, there may also be delays to Irish consignments travelling through the UK to the European market. While Irish trucks will still be able to transit through the UK using the 1975 TIR convention,<sup>14</sup> they will still be affected by any delays at UK ports. Furthermore, transiting under the TIR convention requires obtaining and paying for a permit<sup>15</sup> and will also require further

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<sup>11</sup> See Martina Lawless (2018) "Intermediate Goods Inputs And The UK Content Of Irish Goods Exports". ESRI Working Papers

<sup>12</sup> Byrne, S., & Rice, J. (2018). [Non-tariff barriers and goods trade: a Brexit impact analysis](#) (No. 6/RT/18). Central Bank of Ireland.

<sup>13</sup> [Seanad Committee on the Withdrawal of the United Kingdom from the European Union. Submission of the Freight Transport Association. 25th September 2019](#)

<sup>14</sup> [https://ec.europa.eu/taxation\\_customs/business/customs-procedures/what-is-customs-transit/tir-transports-internationaux-routiers-international-road-transport\\_en](https://ec.europa.eu/taxation_customs/business/customs-procedures/what-is-customs-transit/tir-transports-internationaux-routiers-international-road-transport_en)

<sup>15</sup> Currently TIR permits cost between \$40 and \$220 depending on the issuing country and other factors. See [Morgenroth \(2018\)](#)

administrative and learning costs, which are likely to be most acute in the months immediately following a disorderly Brexit.

Evidence suggests that Irish and UK firms engaged in significant stockpiling in advance of the 31 March 2019 deadline in order to mitigate the impact of the first months of adjustment in the event of a no-deal.<sup>16</sup>

An aggravating factor with regard to the October deadline is that it comes at a time in the year when warehouses are typically at peak capacity, meaning that stockpiling is more difficult and more costly.

These factors will hinder trade, potentially significantly, in the very short run, adding to the increase in input costs for Irish firms already incurred from tariffs and non-tariff barriers in late 2019 and early 2020.

### **Sanitary and Phyto-sanitary (SPS) Checks**

At present, animal, plant and non-animal food imports are subject to no checks at ports when arriving from the UK. When the UK becomes a third country, authorities at Ireland's ports will be required to implement EU SPS checks. The degree of checking required differs significantly for different goods and for different source destinations. For example, imports of food of animal origin from third countries are prohibited unless a number of regulations and certifications are acquired by both the third country and the exporting firm.<sup>17</sup> In a no-deal, it is assumed that the UK will acquire the relevant certifications almost immediately, but there will likely be significant heterogeneity in the speed at which UK firms become compliant.

Importation of goods subject to SPS requirements may only occur through a designated first point of entry, currently Dublin port and Dublin airport. Each consignment undergoes documentary and identity checks, as well as physical checks at an "appropriate frequency". The frequency of physical checks is reduced on frequently traded items (more than 200 consignments per annum) according to a risk index maintained by the European Commission.<sup>18</sup>

Implementing these checks will require an increase in physical infrastructure at Ireland's ports (storage facilities, laboratory equipment for physical testing). Adapting to this new system in a short period of time in a no-deal scenario will be problematic, and will likely result in further

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<sup>16</sup> Bank of England (May 2019) [Inflation Report](#)

<sup>17</sup> See [European Commission: Notice To Stakeholders Withdrawal Of The United Kingdom And EU Food Law And EU Rules On Quality Schemes](#)

<sup>18</sup>

[https://ec.europa.eu/food/plant/plant\\_health\\_biosecurity/non\\_eu\\_trade/less\\_frequent\\_checks\\_en](https://ec.europa.eu/food/plant/plant_health_biosecurity/non_eu_trade/less_frequent_checks_en)

delays to trade significantly above what would be the case under a transition agreement scenario.

### **Mitigating factors**

While the unprecedented and uncertain nature of a disorderly Brexit make it difficult to plan for, certain contingency measures have already been put in place that will mitigate the short run impact. The Government announced in 2018 that it would hire extra customs officials including additional staff to carry out checks on agricultural products.<sup>19</sup>

Revenue have also published figures which shows that 96 per cent of merchandise export trade with the UK in 2018 was carried out by firms which now have an “Economic Operators Registration and Identification” (EORI) number, which is required by revenue for firms trading with a third country.<sup>20</sup> While having an EORI number does not reduce the impact of the factors discussed above, it implies that the majority of Irish firms who currently trade with the UK are aware of their requirements in the event of a no-deal.

### **Investment**

Headline investment growth was distorted by a sharp increase in intangible assets in the second quarter of 2019. Underlying investment, which excludes some of the activities of the multinational sector - namely aircraft and intangible investment - grew at a much more moderate pace, and has slowed as the year has progressed, reflecting uncertainties related to Brexit and global trade concerns. Building and construction growth is driving underlying investment, with weakness evident in the machinery and equipment component.<sup>21</sup>

Under a deal scenario, the outlook for investment is similar to that of consumption in that there should be some unwinding of uncertainty and an associated pick-up in activity in 2020. Building and construction investment is forecast to increase by 7.2 and 7.1 per cent in 2020 and 2021, following an increase of 6.3 per cent in 2019. New dwellings completions are expected to number approximately 22,000, 24,500 and 27,000 units in 2019, 2020 and 2021, respectively - a slight downward revision since the previous Bulletin but an increase of approximately 20 per cent in the year. Construction growth in non-residential investment is also expected to remain robust, with an increase of 7.0 and 7.5 per cent anticipated in 2020

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<sup>19</sup> [Parliamentary Question, 18th December 2018](#)

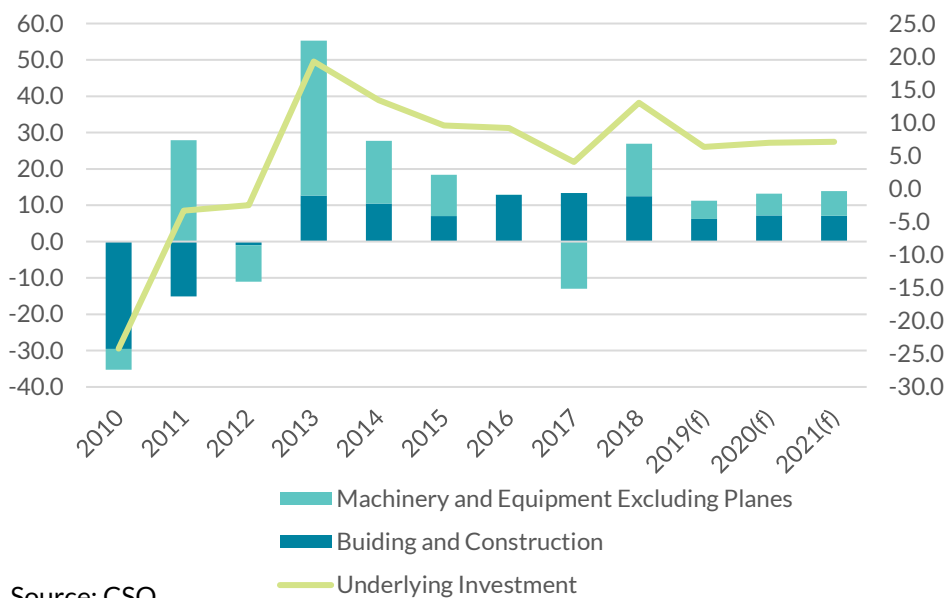
<sup>20</sup> [Revenue press statement on Brexit engagement](#)

<sup>21</sup> Machinery and equipment investment figures for Q2 2019 were redacted for confidentiality reasons.

and 2021. Machinery and equipment investment not related to the aircraft sector is forecast to increase by approximately 6 and 7 per cent in 2020 and 2021. Taken together, these estimates imply that underlying investment is forecast to increase by 7.0 and 7.1 per cent in 2020 and 2021, respectively, while headline investment is expected to increase by around 6 per cent in both years.

Under a disorderly no-deal scenario, the outlook for investment is significantly lower than the deal scenario outlined above. Headline investment is forecast to decline by 4 per cent in 2020, before recovering and growing by 1.5 per cent in 2021.

**Figure 5: Growth in Underlying Investment has been driven by Building and Construction**



Source: CSO

### Box D: Grocery Prices in Ireland after Brexit

By David Horan, Peter McQuade, and John Scally<sup>22</sup>

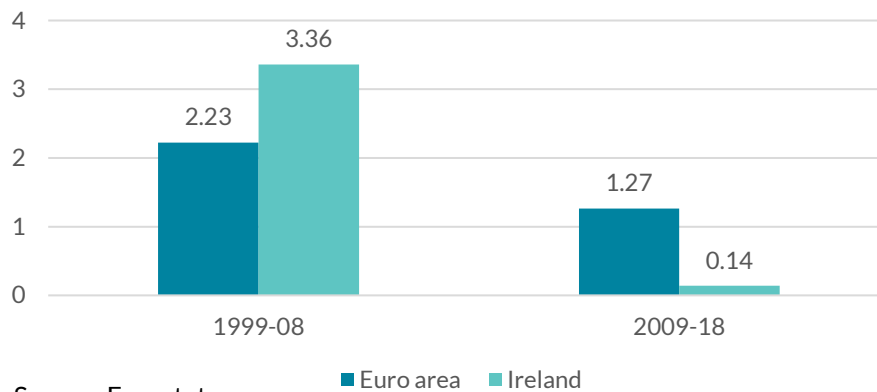
The evidence we examine suggests that Irish consumers have typically experienced relatively high grocery prices over time. This is likely the result of a number of structural features of Ireland and its groceries market. In addition to short-term inflationary effects, a hard Brexit could exacerbate a number of these structural issues with potentially adverse consequences for consumers.

<sup>22</sup> Irish Economic Analysis Division and International Relations Division.



At different times, Ireland has experienced inflation differentials vis-à-vis the euro area average during its 20 years as a member of the single currency.<sup>23</sup> In the first decade of the euro, Ireland had consistently higher inflation than the rest of the euro area, particularly during the early 2000s (Figure 1). The reverse occurred in the following decade, with Irish inflation averaging about 1 per cent lower than the euro area average.

**Figure 1: 20 Years of Inflation: Ireland and the Euro Area**



Despite fluctuations in relative inflation, the price level of groceries in Ireland, as proxied here by food and non-alcoholic beverage prices has remained persistently high. Ireland's food and non-alcoholic beverage prices were already above the euro area average when the currency was introduced in 1999. They then increased relatively rapidly during the first decade of the euro, and have declined somewhat in the crisis and post-crisis period (Figure 2). Yet, when one takes into account the level of expenditure per capita, food and non-alcoholic beverage prices appear to have been consistently high throughout the period relative to other Member States. There are a number of structural features of Ireland, and the grocery market in particular, which may help to account for this pattern and which could be exacerbated by a hard Brexit.<sup>24</sup>

<sup>23</sup> See for example: Honohan, P & Lane, P.R. (2003) "[Divergent inflation rates in EMU](#)," *Economic Policy, CEPR:CES:MSH*, vol. 18(37), pages 357-394, October.  
Honohan, P. & Lane P.R., (2004) "[Exchange Rates and Inflation Under EMU: An Update](#)," CEPR Discussion Papers 4583, C.E.P.R. Discussion Papers.

<sup>24</sup> See for example: ECB (2011) "[Structural Features of Distributive Trade and their Impact on Prices in the Euro Area](#)," Occasional Paper Series, No. 128.  
ECB (2015) "[Grocery Prices in the Euro Area: findings from the analysis of a disaggregated price dataset](#)," European Central Bank Economic Bulletin 2015, No. 1.

**Figure 2: Groceries price level and expenditure: 1999,2008, 2018<sup>25</sup>**

Source: Eurostat

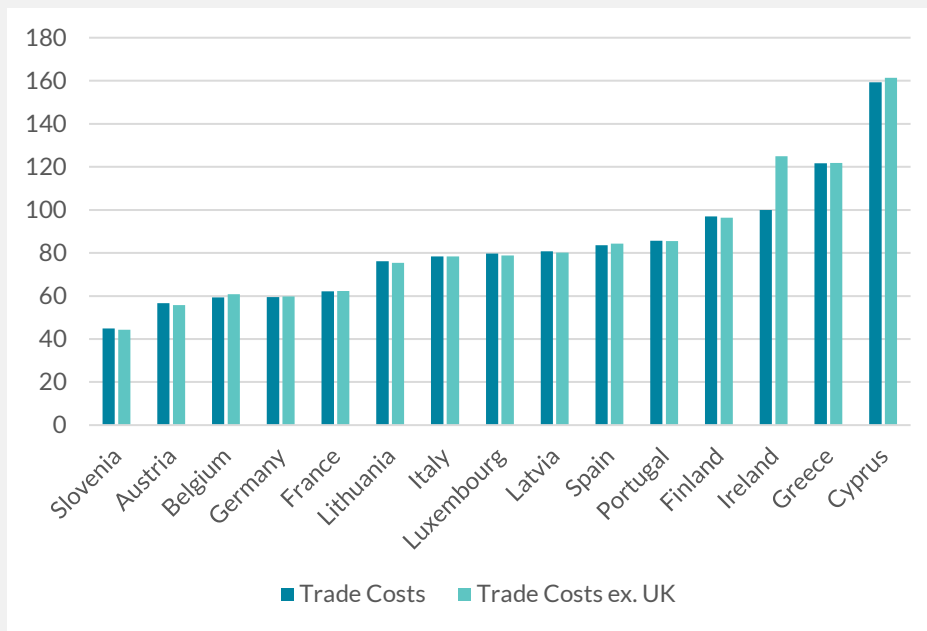
Note: 2015=100

As Ireland is a geographically remote country, Irish importers must pay relatively high transport costs compared to some other EU Member States. Figure 3 illustrates the average of trade costs estimated using a gravity model, and therefore reflect not only transport costs associated with distance, but also costs associated with linguistic, cultural or institutional barriers.<sup>26</sup> These data suggest that Ireland has relatively high trade costs, in common with other remote euro area Member States like Cyprus, Greece and Finland. A hard-Brexit may involve a change in the pattern of trade and transport to and from Ireland. The pink bars show the average estimated non-tariff shipping and trade costs, excluding goods imported from the UK, Ireland's closest trading partner. Having to import goods from more distant countries would lead to additional shipping costs for Ireland, while a diversion of trade via the UK would have a far more limited consequence for import costs in other Member States. However, trade costs are not the only potential factor contributing to Ireland's high grocery prices.

<sup>25</sup> X-axis shows nominal expenditure per inhabitant (in euro) on food and non-alcoholic beverages. Y-axis displays an index of the price level of food and non-alcoholic beverages, where the EU15=100 for each year.

<sup>26</sup> Novy, Dennis (2013) "[Gravity Redux: measuring international trade costs with panel data](#)" Economic Inquiry, Vol 51(1).

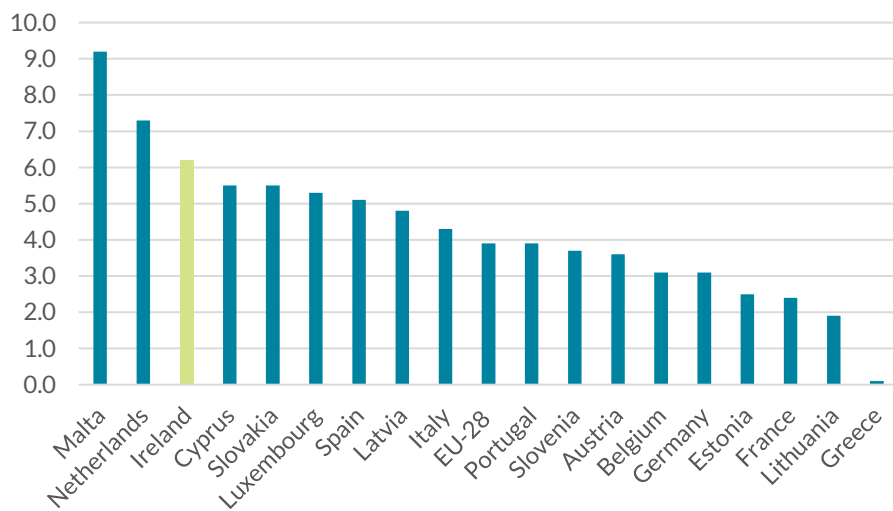
**Figure 3: Trade/Shipping Costs**



Source: Estimates based on ESCAP-World Bank Trade Cost Database, IMF direction of trade statistics and Central Bank of Ireland staff calculations.  
 Note: Index of trade costs where Ireland=100

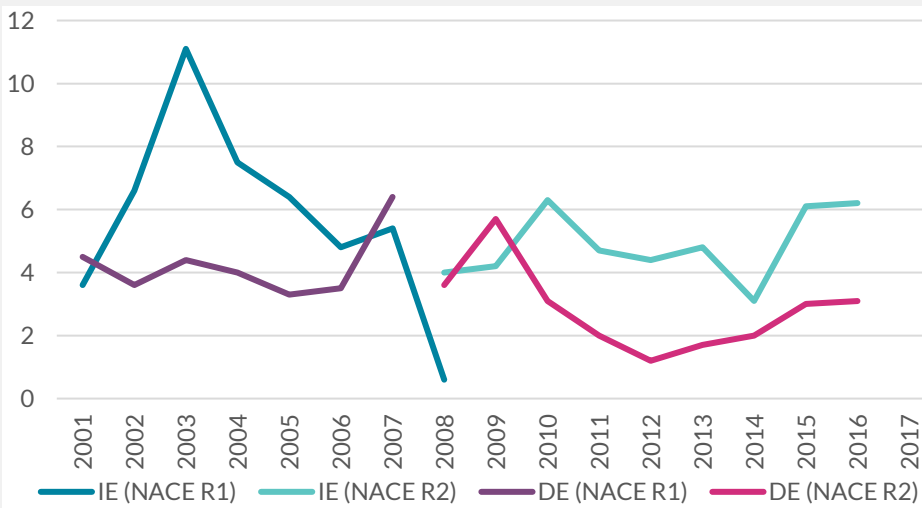
Proxy indicators suggest that grocery retail profits may be relatively high in Ireland. Of the countries for which data are available, only Malta and the Netherlands exhibit higher profitability in the groceries sector (Figure 4). Figure 5 suggests that this relatively high profitability compared to some other euro area Member States, such as Germany, has been a consistent feature for most of the past 20 years, with the exception of the period of the global financial crisis. While it is possible that this reflects higher mark-ups in Ireland, this indicator should be treated with caution as it could also be interpreted as showing a lack of efficiency in the German retail sector relative to Ireland.

**Figure 4: Profitability in Grocery Retail in the Euro Area (2016)<sup>27</sup>**



Source: Eurostat

**Figure 5: Profitability in Grocery Retail: Ireland vs. Germany 2001-2016<sup>28</sup>**



Source: Eurostat Structural Business Statistics

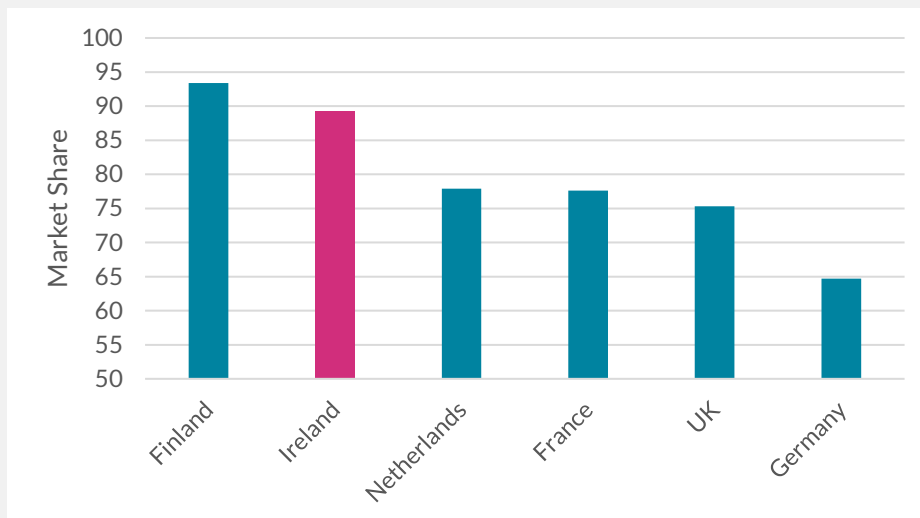
Note: Series report gross operating surplus/turnover in per cent for the category retail sale in non-specialised stores with food, beverages or tobacco predominating. Series discontinuity between NACE Revision 1 (R1), which ends in 2008, and NACE Revision 2 (R2) which begins in 2008.

<sup>27</sup> Chart displays gross operating surplus/turnover in per cent for the category of retail sale in non-specialised stores with food, beverages or tobacco predominating.

<sup>28</sup> Chart displays gross operating surplus/turnover in per cent for the category of retail sale in non-specialised stores with food, beverages or tobacco predominating. Series discontinuity between NACE Revision 1 (R1), which ends in 2008, and NACE Revision 2 (R2) beginning in 2008.

The top 5 grocery retailers in Ireland account for almost 90 per cent of the groceries market (Figure 6). In general, a higher degree of market concentration is expected to have a dampening effect on market competition, facilitating higher mark-ups and firm profitability. The concentration ratio in the Irish groceries market has increased since 2011, as a result of mergers in the sector.<sup>29</sup> For comparison, the equivalent concentration ratio is 75.3 per cent in the UK, 77.6 per cent in France, 77.9 per cent in the Netherlands. In contrast, at 93.4 per cent, the concentration ratio in Finland is even higher than in Ireland. It should also be noted that the distribution of market share among the top five retailers in Ireland is now more even compared to 2011, when the top two firms accounted for over half of the market. What is also notable is the increasing share of discount retailers, which rose from 9.1 per cent to 23.6 per cent over the period since 2011, and which may have contributed to competition and downward price pressures.

**Figure 6: Grocery Market concentration in selected EU countries<sup>30</sup>**



Source: Statistica, Kantar Worldpanel, Finnish Grocery Trade Association, Lebensmittelzeitung.

UK grocery retailers maintain a significant presence in Ireland. In the context of Brexit, it is notable that a UK retailer had the third highest market share in July 2019, while other UK-based grocery retailers also maintain a significant presence in the Irish market.<sup>31</sup> Research has shown that anti-dumping tariffs on imports can lead to higher prices being

<sup>29</sup> Forfas (2011) "[Review of the economic impact of the retail cap](#)," Report prepared for the Departments of Enterprise, Jobs and Innovation and Environment, Community and Local Government, April 2011.

<sup>30</sup> Market share of top five grocery stores

<sup>31</sup> Source: <https://www.statista.com/statistics/534106/grocery-market-share-ireland/>

charged by domestic firms, as reduced competition leads to greater market power for domestic firms.<sup>32,33</sup> However, the high profitability of the grocery retail sector may mitigate the likelihood of UK-based retailers leaving the Irish market, and thereby further increasing market concentration.

Increased tariffs and trade costs may be passed on to consumers. The market structure in the groceries market, if characterised as having low levels of competition and relatively high mark-ups, could imply that some of the increased trade costs associated with Brexit may be passed on to consumers, while the price of domestic substitute goods could also increase in the event of tariffs. Cole and Eckel (2018) demonstrate that traditional substitution effects – where consumers respond to higher prices on imports by substituting towards cheaper alternatives – can be dominated by retailers absorbing the additional costs of tariffs on imports through increasing their mark-ups on other more efficient, low cost products, where mark-ups tend to be highest.<sup>34</sup> Alternatively, high profitability could potentially allow retailers to absorb higher costs, lowering pass through to consumer prices. However, if retailers are forced to absorb Brexit related costs, they could respond by withdrawing less profitable products, leading to a reduction in variety with associated utility losses for consumers.<sup>35</sup> Overall, however, the relationship between UK and Irish producers, retailers and consumers is complex.

Imports from the UK are a substantial portion of the Irish groceries consumption basket. Figure 7 shows that agri-food products are the most exposed to high tariffs in a hard-Brexit scenario. Products in the milling industry, dairy products and meat products rely on imports from the UK, while the tariffs that would be applied to these goods, in the event of a no-deal scenario, are sizeable. Lawless and Morgenroth (2018) examine the contribution of UK imports to overall household expenditure in Ireland and estimate their exposure to tariffs and other non-tariff related cost increases from possible restrictions on trade.<sup>36</sup>

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<sup>32</sup> An anti-dumping tariff is a protectionist tariff that a domestic government imposes on foreign imports that it believes are priced below market value.

<sup>33</sup> Konings J. and Vandenbussche H. (2005) "[Antidumping protection and markups of domestic firms](#)", *Journal of International Economics*, Vol.65(1) p. 151-165.

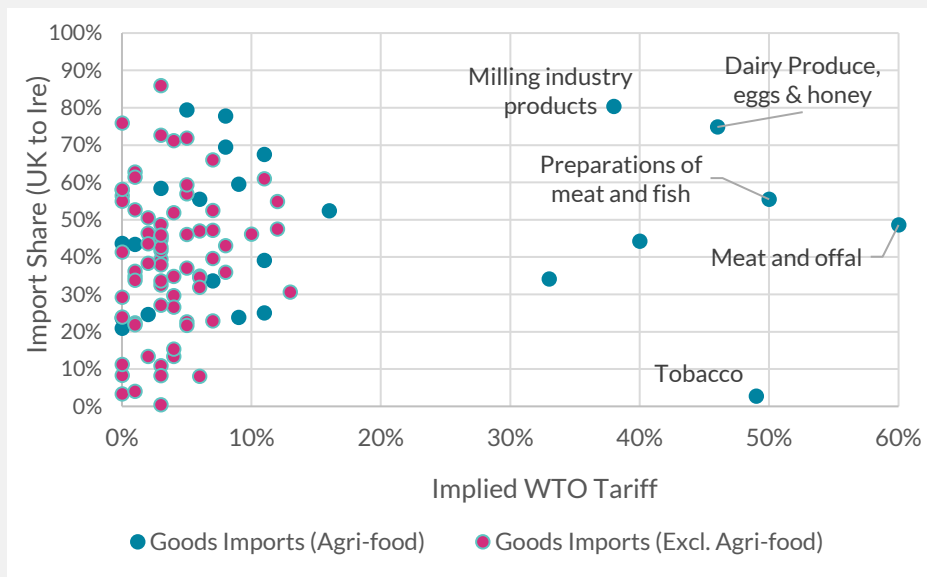
<sup>34</sup> Cole, M.T. & Eckel, C. (2018) "[Tariffs and markups in retailing](#)," *Journal of International Economics*, vol. 113(C), p. 139-153.

<sup>35</sup> Cole, M.T. & Davies, R.B. (2014) "[Royale with Cheese: Globalization, Tourism, and the Variety of Goods](#)," *Review of Development Economics*, Wiley Blackwell, vol. 18(2), pages 386-400, May.

<sup>36</sup> Lawless, M. & Morgenroth, E. (2018) "[Brexit and Irish Consumers](#)," Quarterly Economic Commentary: Special Articles, Economic and Social Research Institute (ESRI).

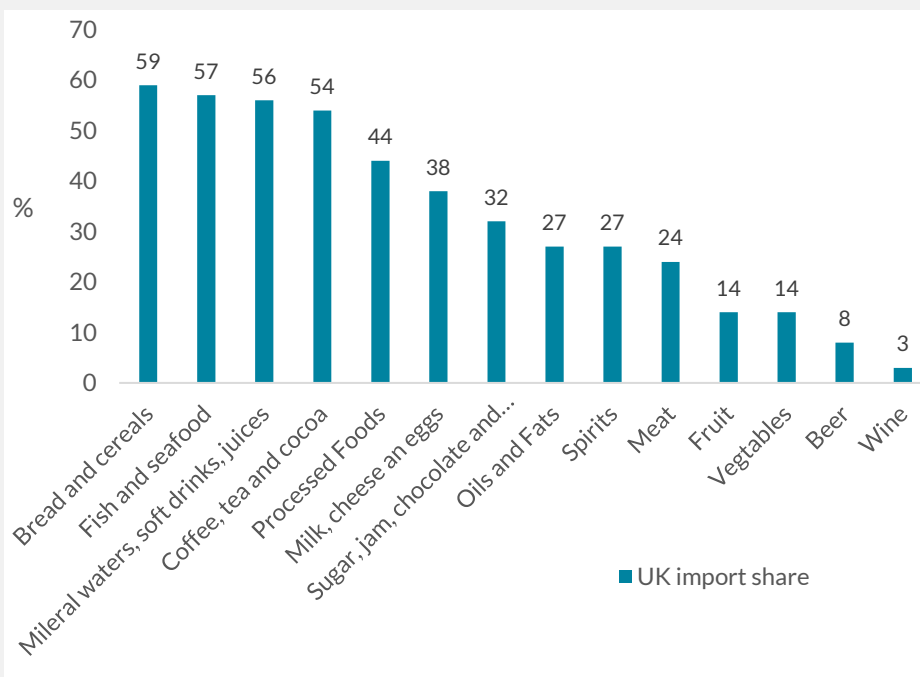
The authors note that these are upper bound estimates of the potential price effects of a no-deal Brexit as their study does not take account of possible exchange rate or substitution effects, and assumes full price pass through to consumers. Caveats aside, their estimates indicated that the sectors most exposed are bread and cereals, as 59 per cent of these products are imported from the UK. The dairy sector is found to have the highest potential sector-level price effect.

**Figure 7: Concentration of Irish Imports from the UK and Implied WTO Tariffs<sup>37</sup>**



Source: Lawless and Morgenroth (2018), Eurostat and authors' calculations.

<sup>37</sup> Indicative values of average ad valorem equivalent tariffs estimated on the basis of the minimum tariffs weighted using EU imports from the UK at the HS 6-digit product level.

**Figure 8: UK Food Imports as a Share of Total Food Imports**

Source: Lawless and Morgenroth (2018), Kee et al (2009)<sup>38</sup>

A hard-Brexit could lead to some temporary increases in grocery inflation. Assuming no change in the exchange rate, full pass through of the tariffs and non-tariff barrier effects, and that consumers do not substitute away from UK products, the food price increases assumed by Lawless and Morgenroth (2018) would lead to an overall increase in the average basket of consumer goods. The *Processed Foods* and *Milk, Cheese and Eggs* categories make the largest contribution to the increases. In reality, these price increases are unlikely to fully materialise as consumers are likely to switch products, while producers may withdraw less profitable products from the Irish market. Moreover, weakening domestic demand and a sterling depreciation would exert downward pressure on Irish grocery prices. Nevertheless, some hard-Brexit related increase in the price level of groceries relative to other euro area Member States could prove to be persistent because of the potential adverse structural consequences described above.

<sup>38</sup> Looi Kee, H., Nicita, A., & Olarreaga, M. (2008). [Estimating trade restrictiveness indices](#). *The Economic Journal*, 119(534), 172-199.



**Table 1. WTO and NTB Tariff Estimates**

	WTO tariff rate %	Non-Tariff Barrier tariff equivalent estimates %	UK import share %
Bread and cereals	16	36	59
Fish and seafood	10	20	57
Mineral waters, soft drinks, juices	13	27	56
Coffee, tea and cocoa	7	29	54
Processed Foods	8	27	44
Milk, cheese and eggs	43	79	38
Sugar, jam, chocolate and confectionery	29	55	32
Oils and Fats	23	46	27
Spirits	7	9	27
Meat	38	62	24
Fruit	9	25	14
Vegetables	9	27	14
Beer	0	6	8
Wine	8	14	3

Source: Lawless and Morgenroth (2018), Kee et al (2009)

## Government Consumption

Reflecting measures announced in Budget 2019, government consumption is projected to grow by 5.7 percent this year, moderating to growth of 3.1 per cent in 2020 and 2.5 per cent in 2021. This follows estimated growth in government consumption of 4.4 per cent in 2018.

## Box E: Sectoral Export and Employment Exposures to External Risks

By David Horan and Peter McQuade<sup>39</sup>

This box examines the sectoral export and employment exposures facing the Irish economy in light of the risks posed by a no-deal Brexit and the

<sup>39</sup> Irish Economic Analysis Division and International Relations Division

threat of heightened trade tensions between the EU and the US. Our analysis highlights the critical importance of the US for the pharmaceuticals sector, while the UK is a key market for services and agricultural exports. The agri-food sector employs over 153,000 workers, while a no-deal Brexit could result in disproportionate income or job losses in the sector, which would be unevenly distributed across Ireland.

### Trade Exposures

Trade exposures are a useful metric for assessing the likely impact of certain external risks to the Irish economy. For example, one of the key channels through which a hard Brexit would affect Ireland is through its effect on bilateral Irish-UK trade. Similarly, much of the current global economic policy uncertainty, and consequent global economic slowdown, arises from risks associated with international trade disputes. Moreover, many MNEs are primarily located in Ireland in order to have an “export platform” combining low taxation, access to the EU single market, and Ireland’s highly educated labour force, such that looking at exports can inform our view on which sectors are important and vulnerable to disruption. While this box does not focus on Irish goods imports, Lawless (2018) highlights the importance of the UK as a source of intermediate goods imports which significantly contribute to the export performance of Irish firms.<sup>40</sup>

Turning first to merchandise trade, the EU (excluding the UK) remained Ireland’s largest export destination in 2018, accounting for almost 39 per cent of all goods exports. Table 1 shows bilateral merchandise trade data disaggregated by both region/country and SITC commodity group. The bottom row shows the share of merchandise trade attributable to each country/region, while the right hand column displays each commodity group as a percentage of total merchandise exports. For example, *medicinal and pharmaceutical products* and *organic chemicals* are by far the largest categories. These two top-tier categories account for 33 per cent and 19 per cent of total merchandise exports, respectively. Exports of these products are quite concentrated in the US, which reflects the substantial activities of US MNEs in the chemicals and pharmaceuticals sector in Ireland. As such, any tariffs imposed on EU goods in the pharmaceuticals sector, destined for the US, would likely have negative

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<sup>40</sup> Lawless, M. (2018) “[Intermediate Goods Inputs and the UK Content of Irish Goods Exports](#)”, ESRI, July 2018.

consequences on Irish exports. However, this sector has yet to be the subject of tariff discussions.<sup>41</sup>

**Table 1: Irish Merchandise Exports by Sector and Region (2018)<sup>42</sup>**

	UK (%)	EU28 Excl. UK (%)	USA (%)	China (%)	ROW (%)	Value of exports (€bn)	% share of total merch. exports <sup>43</sup>
Medicinal and pharmaceutical products	5.43	40.98	36.71	1.78	15.10	45.85	32.6%
Organic chemicals	1.73	46.48	33.77	2.66	15.36	26.49	18.8%
Essential oils and perfumes	8.55	30.14	28.50	0.57	32.23	7.87	5.6%
Miscellaneous manufactured articles	8.90	37.72	38.89	3.56	10.93	7.42	5.3%
Professional, scientific and controlling apparatus	3.44	38.21	44.24	3.46	10.66	6.21	4.4%
Electrical machinery	9.06	16.01	30.96	36.84	7.13	5.43	3.9%
Other transport equipment	4.07	14.55	19.65	0.07	61.67	5.10	3.6%
Office machines and automatic data processing equipment	11.23	50.87	4.90	5.43	27.56	4.23	3.0%
Meat and meat preparations	49.95	36.96	0.69	3.68	8.73	4.04	2.9%
Chemical materials and products	8.32	67.96	6.95	0.82	15.95	4.02	2.9%
Dairy products and birds eggs	33.13	41.37	7.70	2.45	15.35	2.62	1.9%
Misc. edible products and preparations	14.37	25.00	0.82	24.40	35.41	1.98	1.4%
General industrial machinery	14.42	43.94	18.22	1.78	21.64	1.97	1.4%
Beverages	20.17	24.22	43.01	0.19	12.41	1.43	1.0%
Photographic apparatus, optical goods, watches and clocks	11.95	9.69	13.30	8.95	56.10	1.35	1.0%
Telecommunications and sound recording	12.71	61.57	8.07	2.92	14.74	1.31	0.9%
Metalliferous ores and metal scrap	16.34	64.51	0.86	0.41	17.88	1.13	0.8%
Power generating machinery and equipment	19.73	38.24	18.03	3.57	20.44	0.85	0.6%
Manufactures of metal	32.30	39.92	12.14	3.18	12.46	0.84	0.6%
Unclassified estimates	60.97	30.46	0.00	0.00	8.57	0.77	0.5%
Machinery specialised for particular industries	27.27	46.86	11.21	1.09	13.57	0.76	0.5%
Petroleum, petroleum products and related materials	48.51	15.58	14.77	7.29	13.84	0.70	0.5%
Fish, crustaceans, molluscs and preparations thereof	8.04	61.47	0.21	9.28	21.00	0.58	0.4%
Commodities and transactions	13.19	14.28	10.80	0.03	61.70	0.50	0.4%
Non-metallic mineral manufactures	80.48	11.85	4.46	0.06	3.16	0.48	0.3%
Plastics in non-primary forms	30.15	29.77	31.90	1.97	6.19	0.48	0.3%
Plastics in primary forms	43.69	29.27	7.00	1.22	18.83	0.46	0.3%
Live animals except fish	75.28	16.62	3.66	0.06	4.39	0.44	0.3%
Cereals and cereal preparations	93.24	3.86	1.66	0.10	1.15	0.43	0.3%
Coffee, tea, cocoa, spices and manufactures thereof	68.61	16.87	7.78	0.08	6.66	0.39	0.3%
Electric current	54.03	45.97	0.00	0.00	0.00	0.36	0.3%
Feeding stuffs for animals, excluding unmilled cereals	69.12	18.79	3.31	0.54	8.24	0.35	0.2%
<b>Total</b>	<b>11.5%</b>	<b>38.9%</b>	<b>27.9%</b>	<b>3.9%</b>	<b>17.9%</b>	<b>140.70</b>	

Source: CSO and authors own calculations

<sup>41</sup> McQuade, P. and Mehigan, C. (forthcoming) "Trade tensions and the composition of Ireland's exports".

<sup>42</sup> High trade exposures are recorded in red, lower values in blue.

<sup>43</sup> The total share of exports may not sum to 100%, as some (smaller) categories have been omitted for visual representation purposes. Also, the sum of export values, displayed in column 7, may not sum to €140.7bn for this same reason.

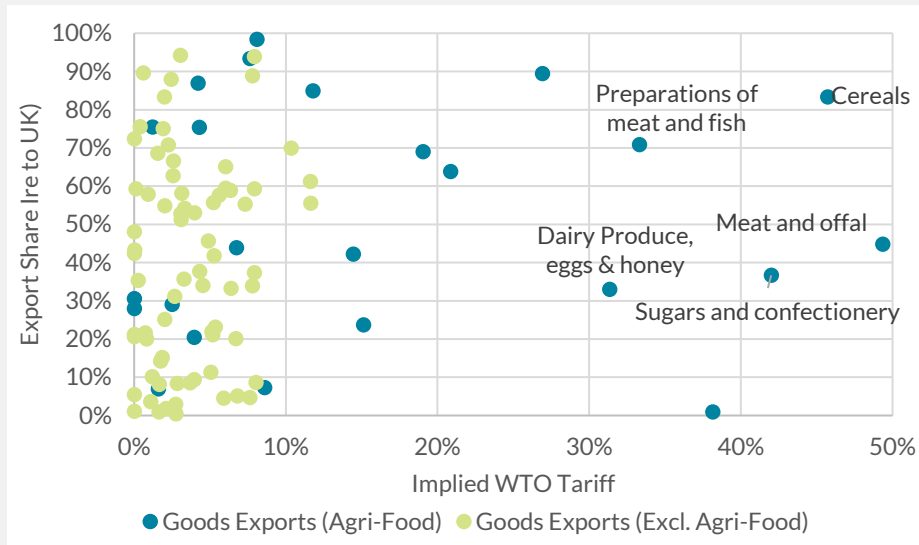
The UK remains an important destination for Irish exports, primarily for products relating to food and agriculture. Indeed, the UK is Ireland's third largest goods exports destination, but the sectoral composition of goods exports is quite different to that of the US. In addition to pharmaceutical exports, exports of agricultural and food products, including in the meat and dairy categories, are also substantial. As such, many second tier export categories are highly concentrated in the UK. This may reflect the high exposure of many domestic Irish firms and industries to the UK. It is worth noting that non-tariff barriers (NTBs), such as additional customs procedures and documentary compliance, also pose a sizeable risk to merchandise trade with the UK in a hard-Brexit scenario. Byrne and Rice (2018) show that a potential hard-Brexit related increase in NTBs is associated with a 9.6 per cent decline in bilateral trade between Ireland and the UK, with *agriculture* and *machinery and transportation*, most acutely affected.<sup>44</sup>

The agri-food sector relies heavily on the UK market as an export destination, while the introduction of tariffs in the event of no-deal Brexit would acutely affect many of these products. Figure 1 illustrates the sectoral concentration of Irish exports to the UK and the implied WTO tariff schedule that would be imposed on each product type in the event of a hard Brexit. Products found on the right-hand side of the chart would see the highest tariffs introduced in a no-deal scenario, while products found in the top half of the chart have a high reliance on the UK market as an export destination. As such, the goods found in the top right hand section of Figure 1 appear to be most exposed to a no-deal Brexit. However, the two dimensional nature of the chart means that it does not show the significance each product in terms of its share of total merchandise exports. For example, cereal products, while highly exposed as per Figure 1, contributed only 0.01 per cent of total goods exports in 2018, significantly lower than many other sectors. Given the fact that agri-food products face the highest tariffs under a no-deal scenario, we focus on meat and dairy products as they are the largest agri-food export sub categories (see Table 1). Both the meat and dairy sector exported a sizeable portion of their produce to the UK in 2018 (43 per cent and 35 per cent of total exports, respectively), while a no deal Brexit would see tariffs in excess of 30 per cent applied to these goods.

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<sup>44</sup> Byrne, S. and Rice J. (2018) "[Non-Tariff Barriers and Goods Trade: a Brexit Impact Analysis](#)", Central Bank of Ireland Research Technical Paper, Vol.2018, No.7.

**Figure 1: Concentration of Irish Goods Exports to the UK and Implied WTO Tariff Schedule<sup>45</sup>**



Source: Lawless and Morgenroth (2016), Eurostat and Authors' Calculations

Services now account for more than half of Irish exports. Irish services exports totalled €160 billion in 2017, some €37 billion more than merchandise exports.<sup>46</sup> The UK market was the largest destination for Irish services exports in 2017, accounting for over 16 per cent of all services exports. Available data suggest that the UK is particularly important for computer services and financial services exports.<sup>47</sup> We focus on the impact of NTBs on services trade, which may subsequently disrupt trade flows between Ireland and the UK, in the event of a no-deal Brexit. Lawless (2018) found that NTBs, such as limits on market access or specific requirements in terms of licencing and recognition of standards, are likely to significantly reduce services trade between Ireland and the UK.<sup>48</sup> These results suggest that EU membership has had a particularly strong effect on the levels of trade in financial and business services, particularly in insurance and telecommunications. Overall, their estimates suggest that removing the EU membership effect on Irish-UK trade in services would reduce services exports to the UK by 49 per cent,

<sup>45</sup> Data on implied WTO tariffs have been extracted from Lawless, M. and Morgenroth, E. (2016) "[The Product and Sector Level Impact of a Hard Brexit across the EU](#)", ESRI Working Paper, No.555.

<sup>46</sup> Byrne, S. and O'Brien, M. (2015) "[The Changing Nature of Irish Exports: Context Causes and Consequences](#)", Quarterly Bulletin

<sup>47</sup> Due to statistical disclosure requirements, some observations are redacted by the CSO.

<sup>48</sup> Lawless, M., (2018). [Irish-UK Services Trade and Brexit](#). ESRI Working Paper, Issue 595.

equivalent to a 10 per cent reduction on total services exports.<sup>49</sup> While Brexit may result in some pick up in Foreign Direct Investment, it is unlikely that any such increase would offset the adverse trade and employment effects that would materialise under a no-deal scenario. Having explored the key trade exposures facing the Irish economy, we next consider how external risks may affect the labour market by examining employment exposures.

## Employment Exposures

Trade risks also pose a threat to the labour market and employment. Understanding the sectoral composition of employment is important when analysing how external risks may materialise in the labour market. Indeed, employment data provides useful insight into developments in the real economy, and which employment intensive industries are likely to be important for income tax revenues. Table 2 shows the importance of domestically oriented sectors for overall employment, as the *wholesale and retail trade* and *health* sectors are the two largest employment sectors accounting for 13 per cent and 12.5 per cent of total employment, respectively. Of the more tradeable sectors, *industry* and *professional, scientific and technical activities* are the largest employers, accounting for 12.3 per cent and 6 per cent of total employment, respectively.

**Table 2: Sectoral decomposition of employment (Q2 2019)**

Sector	Employed (000's)	Percentage of total employment
Agriculture, forestry and fishing	100.9	4.4%
Industry	282.6	12.3%
Construction	146.3	6.4%
Wholesale and retail trade, repair of motor vehicles and motorcycles	297.9	13.0%
Transportation and storage	105.8	4.6%
Accommodation and food service activities	181.1	7.9%
Information and communication	117.9	5.1%
Financial, insurance and real estate activities	112.9	4.9%
Professional, scientific and technical activities	139.1	6.0%
Administrative and support service activities	109.7	4.8%
Public administration and defence, compulsory social security	111.8	4.9%
Education	179.7	7.8%
Human health and social work activities	288	12.5%
Other NACE activities	119.8	5.2%
Not stated	6.7	0.3%
<b>Total</b>	<b>2,300.2</b>	<b>100%</b>

Source: CSO

<sup>49</sup> The figures provided are based on subtracting the estimated 'EU membership effect', whereby services can be traded freely with no NTBs. As the final outcome of negotiations regarding services trade between the UK and EU remain unclear, these estimates should provide insight into the distribution of exposure across sectors, not a projection/forecast of the final outcome.

The pharmaceuticals and life sciences sectors employment share is not proportionate to their share of exports. Pharmaceuticals exports were a critical element of Ireland's recovery from the global financial crisis because Ireland's exports of pharmaceuticals continued to expand in this period, even as external demand and the value of exports in many other categories declined. On the one hand, this is positive as it suggests a relatively low elasticity of demand for these products and highlights Ireland's ability to gain export market share. As such, the exports may be less sensitive to any price/cost increases resulting from the imposition of tariffs. On the other hand, Irish merchandise exports, and export growth, are very heavily concentrated in one subcategory of pharmaceuticals, namely *Antiserum and Blood Factors*.<sup>50</sup> An examination of manufacturing employment levels shows that more than 44,000 people were employed in manufacturing basic pharmaceutical products and pharmaceutical preparations in 2018. While significant, employment in *pharmaceuticals* production comprises only 2 per cent of total employment, when pharma related exports contributing more than half of all merchandise exports. Indeed, pharmaceutical exports have grown markedly in recent years - driving the growth in overall merchandise exports - without any material increase in employment in the sector.

Employment in pharmaceuticals is likely to be relatively resilient in the event of a no-deal Brexit. Only 5 per cent of all medicinal and pharmaceutical exports go to the UK, while exports of pharmaceutical products from Ireland have typically exhibited relatively low elasticities of demand. It is not surprising, therefore, that estimated employment losses in the pharmaceuticals sector are modest when compared to some more exposed sectors (Vandenbussche 2019).

In contrast, a no-deal Brexit would have negative consequences for the agri-food sector. Primary agriculture and the food processing sectors (agri-food sector) employ around 153,000 people in Ireland, accounting for almost 7 per cent of all jobs. Lawless and Morgenroth (2016) estimate that the average implied tariff on meat and dairy exports to the UK, in the event of no-deal Brexit, would be close to 50 per cent and 30 per cent, respectively.<sup>51</sup> As outlined in Table 1, meat and dairy are significant Irish export categories, amounting to almost €7 billion, or 5% of all merchandise exports, combined, in 2018. Conefrey (2019) finds that the beef sector is particularly exposed to a no-deal Brexit due to the high

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<sup>50</sup> Byrne, S. (2019) "[Strong Pharmaceutical Exports Boost Overall Export Growth](#)", Central Bank of Ireland Quarterly Bulletin 1-2019, Box C

<sup>51</sup> Lawless, M. and Morgenroth, E. (2016) "[The Product and Sector Level impact of a Hard Brexit across the EU](#)", ESRI Working Paper No.550.



tariffs and NTBs that would be applied to exports, in conjunction with the sectors reliance on the UK market and the low profitability in beef farming.<sup>52</sup> Vandebussche (2019) show that a hard Brexit would have a disproportionately adverse effect on agricultural employment in Ireland, in comparison to other sectors.<sup>53</sup> Moreover, agricultural employment is not equally distributed across regions. For example, only 3 per cent of employment in Dublin is in the agri-food sector compared with one in seven in the Border region in 2016.<sup>54</sup> Regions that are heavily reliant on agricultural employment – such as the south west, midlands, mid-west, mid-east and border regions- are more acutely exposed to potential income or job losses under a no-deal Brexit.

## Exports and Imports

Exports have grown strongly despite the continued deterioration of the external environment. Ireland's total exports increased by 10.6 per cent in the second quarter of 2019 compared to the second quarter of 2018, while imports were also up, having grown by 61.4 per cent over the same period. While the contribution of net exports to GDP growth was strongly negative, standing at -38.7 per cent of GDP in the second quarter of 2019, this effect was more than offset by the associated increase in investment.

Import growth surged in the second quarter of 2019 but this reflects a sharp increase in intellectual property imports. The spike in imports of business services was likely due to research and development (R&D) imports by one or more MNEs in intellectual property intensive sectors such as computer services or pharmaceuticals. Business services imports stood at almost €54bn in the April-June period compared to less than €18bn in the previous quarter. Royalties and licenses imports also grew strongly and these imports may support future export growth in intellectual property intensive sectors. Merchandise imports also continued to grow strongly in the second quarter of this year, albeit partly driven by the 21 per cent year-on-year growth in the other transport equipment category, which includes aircraft purchased by the aircraft leasing industry.

Strong exports of pharmaceuticals and computer services continues to mask more modest growth in other sectors (Figure 6). The merchandise trade surplus increased further in the year to July, but this was again

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<sup>52</sup> Conefrey, T. (2019) "[New Risks and Old Problems: The Uncertain Outlook for Irish Agriculture](#)", Central Bank of Ireland, Economic Letter, Vol.2019, No.10.

<sup>53</sup> Vandebussche, H. (2019) "[Sector-Level Analysis of the Impact of Brexit on the EU-28](#)" Report prepared for Flanders Department of Foreign Affairs, Belgium.

<sup>54</sup> Conefrey, T. (2018) "[Irish Agriculture: Economic Impact and Current Challenges](#)", Central Bank of Ireland, Economic Letter Vol. 2018, No. 8.



heavily dominated by pharmaceuticals, with most of the remaining growth due to the machinery and transport equipment sector. The share of exports attributable to contract manufacturing declined somewhat, accounting for approximately 27 per cent of goods exports in the second quarter of this year, compared to nearly 31 per cent in the previous quarter.

Services exports have grown rapidly and now account for more than half of total exports. Total services exports grew by 16.5 per cent in the April-June period, compared to the second quarter of 2018, of which 13.7 percentage points was attributable to computer services. Most of the remaining growth in services exports was due to business services (other than research and development and operational leasing) while the contribution to services export growth of the remaining services sectors was modest or, in some categories, mildly negative.

In a deal scenario, medium-term exports are forecast to remain broadly unchanged relative to the projections in the last Quarterly Bulletin. The very strong growth observable in the latest data, combined with the positive effect on sentiment of a resolution of Brexit uncertainty, would only be partly offset by the deterioration in the global and European economy. While exports of pharmaceuticals and computer services continue to perform very strongly in 2019, the forecast assumes some tapering off of these exceptional growth rates in the coming years, while other export sectors may decelerate or even decline, import demand in our main trading partners diminishes. Exports are expected to grow by 6.9 per cent in 2019, slowing to 4.6 per cent in 2020. Related to the very strong first quarter data, imports are expected to grow by 16.5 per cent in 2019, driven by the spike in business services, with the resultant base effect leading to a fall in import growth to 4.6 per cent in 2020. In 2021, exports are expected to grow at just 3.0 per cent, while imports are forecast to increase by 2.9 per cent on the assumption that the expiry of the transition agreement between the EU and the UK will have some dampening effect on trade flows.

In a no-deal Brexit scenario, export growth would weaken significantly. In this scenario, trade barriers between the EU/Ireland and the UK would directly hinder trade between these economies, including goods using the land-bridge to transit through the UK on their way between Ireland and the EU (See Box C). Moreover, the adverse shock to the UK economy from a no deal Brexit would also result in reduced demand for products exported by Ireland. This would have asymmetric effects across sectors and regions, with agri-food exports particularly exposed to the UK and both tariff and non-tariff barriers. The pharmaceutical sector may prove to be more resilient to this shock as the UK is a less important export destination, although the UK is a critical destination for services exports and the

introduction of non-tariff barriers could have severe consequences. In a no deal Brexit scenario, export growth is projected at 5.8 per cent in 2019, due to the strong growth already observed in the year so far. However, exports are forecast to fall by 2.5 per cent in 2020, as continued growth in the exports of pharmaceuticals and computer services would be more than offset by very severe declines in more exposed sectors. Exports are projected to recover somewhat in 2021 in this scenario, growing by 3.2 per cent. Imports are forecast to grow by 15.1 per cent in 2019, before falling sharply by 5.2 per cent in 2020, reflecting the adverse effect of a no-deal Brexit on domestic demand for imports combined with the base effect arising from the surge in business services imports observed in 2019. The level of imports are then projected to recover somewhat in 2021, growing by 3.4 per cent.

Additional downside risks to the projections could emerge from an escalation of international trade tensions. Trade tensions between the US and either China, or the EU, could escalate. Ireland is particularly vulnerable to such disruptions because it is a highly open economy, dominated by the presence of a number of US MNEs that are deeply embedded in global value chains. Equally, a resolution of the disputes could lead to a recovery in global demand with positive implications for Irish exporters.

### **Net Trade, Factor Incomes and International Transfers**

Ireland recorded a large deficit on the current account balance of €26.5 bn in the second quarter of 2019, having consistently run substantial surpluses over the previous seven quarters. The marked deterioration of the current account balance in the second quarter reflects the activities of multinational enterprises (MNEs) and is not driven by developments in the domestic economy. As noted above, this decline was due to a spike in imports of business services, most likely associated with R&D imports by MNEs in intellectual property intensive sectors. Relatedly, total royalties and licenses imports exceeded €20 bn for the first time in the second quarter of this year, while CSO analysis shows that these imports continue to be dominated by the pharmaceuticals, and information and communications technology sectors. Net services trade recorded a deficit of €33.4 bn in the second quarter, while net goods trade delivered a surplus of €28.2 bn.

The substantial deficit in net income is due to the sizeable share of highly profitable MNEs in the Irish economy. Income paid to foreign investors stood at €47 bn in the second quarter, compared to income paid to Irish resident investors of €25 bn. As a consequence, the net income outflow was €21.3 bn in the quarter, compared to €19.9 bn in the previous quarter. As

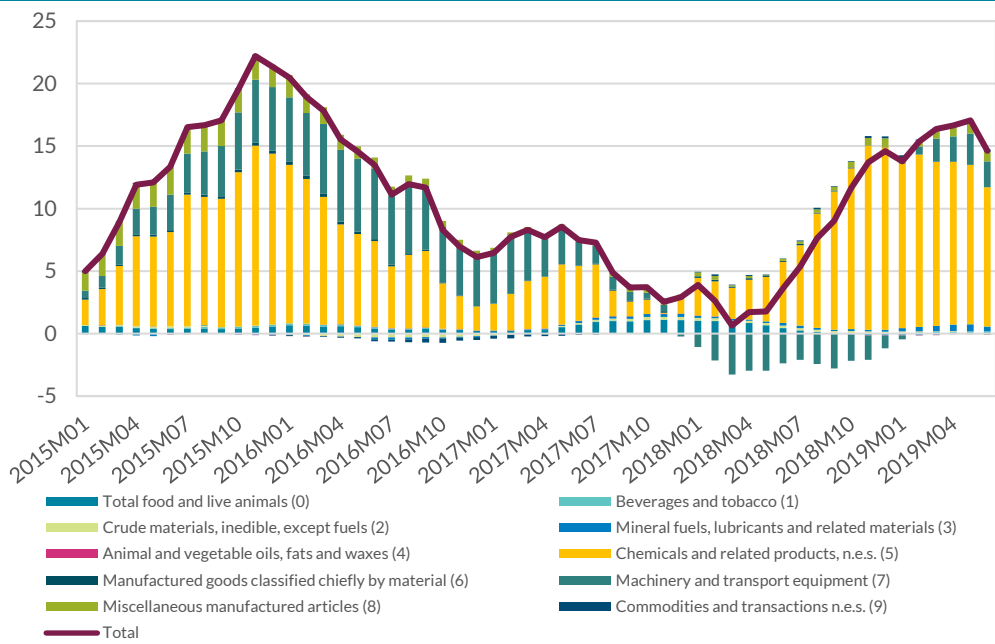
such, the small deterioration in the net income balance was not a key driver of the sudden emergence of a current account deficit.

There was a deficit on the financial account of €37.7 bn in the second quarter following a surplus of €11.7 bn in the previous quarter. Much of this deterioration was driven by a retrenchment by Irish investors from their external direct investment asset holdings of €61.7 bn in the second quarter of the year. At the same time, foreign investors reduced their direct investment in Ireland by €12.7 bn. Purchases of other investment assets by Irish investors remained strong, standing at €44.2 bn in the second quarter of 2019, albeit down from €55.2 bn in the previous quarter. At €44.8 bn portfolio investment inflows to Ireland also remained strong, compared to €40.6 bn in the first quarter.

Overall, while the headline external balance figures appear volatile, this reflects the highly globalised nature of the Irish economy and financial system. The headline trade balance is expected to be approximately 26 per cent of GDP in 2019, and approximately 25 per cent of GDP in 2020 and 2021. The forecast for 2019 is for the headline current account surplus to decline to 1 per cent of GDP in 2019, and -0.1 per cent in 2020 and -1.1 per cent of GDP in 2021.

A no-deal Brexit scenario would have a smaller effect on the net trade and current account balances as projected declines in both exports and imports would partly offset each other. Indeed, the current account balance is projected to improve somewhat in this scenario as Brexit is expected to have a more severe effect on domestic demand for imports than on external demand of Irish exports.

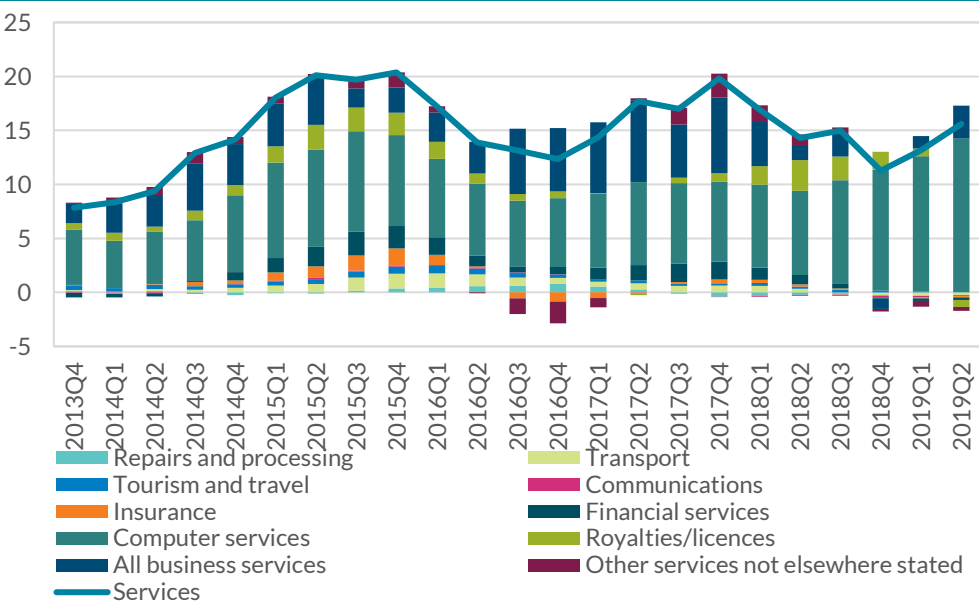
**Figure 6: Merchandise export growth has been dominated by Chemicals and Pharmaceuticals**



Source: Unit is annual change in percent. CSO Merchandise Trade Statistics

Note: Contribution to growth in total merchandise exports over a rolling 4-quarter period.

**Figure 7: Services exports have been dominated by ICT**



Source: CSO Balance of Payments Statistics

Note: Unit is annual change in percent. Contribution to growth in total services exports over a rolling 4-quarter period.

**Table 2: Trade in Goods and Services**

	2018		% change in		2019f		% change in		2020f		% change in		2021f		
	€millions	vol	price	€millions	vol	price	€millions	vol	price	€millions	vol	price	€millions	vol	price
Exports	396,383	6.9	1.5	430,179	4.6	1.2	455,448	3.0	1.1	474,483					
Goods	216,307	6.2	0.9	231,785	4.2	0.0	241,520	3.0	0.3	249,512					
Services	180,077	7.8	2.2	198,394	5.2	2.5	213,928	3.1	2.0	224,971					
Imports	288,993	16.5	1.2	340,849	4.6	1.3	361,278	2.9	1.5	377,400					
Goods	103,346	11.9	1.7	117,632	4.6	1.0	124,279	3.5	1.2	130,124					
Services	185,647	19.0	1.0	223,217	4.6	1.5	236,999	2.6	1.7	247,275					

**Table 3: Balance of Payments**

	2018	2019f	2020f	2021f
Trade Balance	107,391	89,331	94,172	97,085
Goods	112,961	115,089	117,687	119,616
Services	-5,570	-25,759	-23,516	-22,533
Net Factor Income from the Rest of The World	-69,736	-82,570	-91,156	-97,921
Current International Transfers	-3,365	-3,365	-3,365	-3,365
Balance on Current Account	34,290	3,396	-350	-4,201
(% of GDP)	10.6	1.0	-0.1	-1.1

## Supply

The latest Quarterly National Accounts for Q2 2019 show that GDP in the quarter was up 5.8 per cent from Q2 2018. All of the eleven economic sectors grew over this period, but there was significant variability in the rates of growth. *Information and Communication* continues to grow much more quickly than the rest of the economy, with output increasing by 32.4 per cent. Agriculture grew by 16.2 per cent, but this growth must be taken in the context of the adverse weather conditions that affected output in the first half of 2018. Construction and Financial and Insurance activities also grew robustly, expanding by 6 and 5.3 per cent respectively.

Production in the industrial sector of the economy grew by 1.2 per cent in July 2019, but remains 1.5 per cent lower than July 2018. Given the effect that large multinational enterprises have on these statistics, it is best to consider the Traditional and Modern sectors separately. The CSO report that the Modern Sector recorded an annual decrease of 6.4 per cent when compared with July 2018. Output in the Traditional Sector also declined,

and is now 8 per cent below its July 2018 level. On a 3 month moving average basis the Traditional sector grew by 4.8 per cent in the twelve months to July while the Modern sector still shows a decline, given the steep reduction in the index in June and July.

PMI data weakened in July and August, with the overall manufacturing index falling by 1.1 index points to 48.6.<sup>55</sup> This is 8.9 points below the same month last year, and is the third consecutive month in contractionary territory. The decline over the last 12 months has largely been driven by weakness in the Output and New Orders series, but all 13 components of the PMI have weakened, on a year-on-year basis, since last July. New Orders in particular may be impacted by Brexit related stockpiling in Q1, which has led to reduced demand later in the year as those stocks are unwound.

### **The Labour Market**

Employment growth has been strong in the first half of the year, growing by 3.7 per cent in the first quarter and by 2 per cent in the second quarter on an annual basis. Looking through the volatility in the quarterly data, the underlying trend in employment growth has been positive. The growth has also been broad based. Employment expanded in eleven of the fourteen sectors, with the largest increases evident in transportation and storage (8.6 per cent), education (7.8 per cent) and public administration (5.7 per cent). Agriculture employment was down 5 per cent annually.

The labour force grew by 1.3 per cent annually to 2019Q2. Recent annual population estimates have shown the strong contribution of net inward migration to population and labour force growth. In the year to April 2019, annual net migration declined to an estimated 33,700 persons. Given recent levels of net migration, the labour force is expected to increase by 1.8 per cent in 2019 and 1.3 per cent in 2020 and 2021.

If a Brexit deal is agreed, the continued expansion in the economy means that the labour market would be at full capacity within the forecast horizon. As such, continued growth in employment will be dependent on strong positive net inward migration. Employment levels under this scenario are estimated to grow by 2.4 per cent in 2019, 1.5 per cent in 2020 and 1.4 per cent in 2021. The effect on the unemployment rate would see a moderation from a projected annual average rate of 5.0 per cent in 2019 to 4.8 per cent in both 2020 and 2021.

In the event of a no-deal Brexit, there will be an adverse effect on the labour market, which, in terms of the timing of its impact, is likely to lag the fall in output. Under a no-deal scenario, employment growth is forecast to

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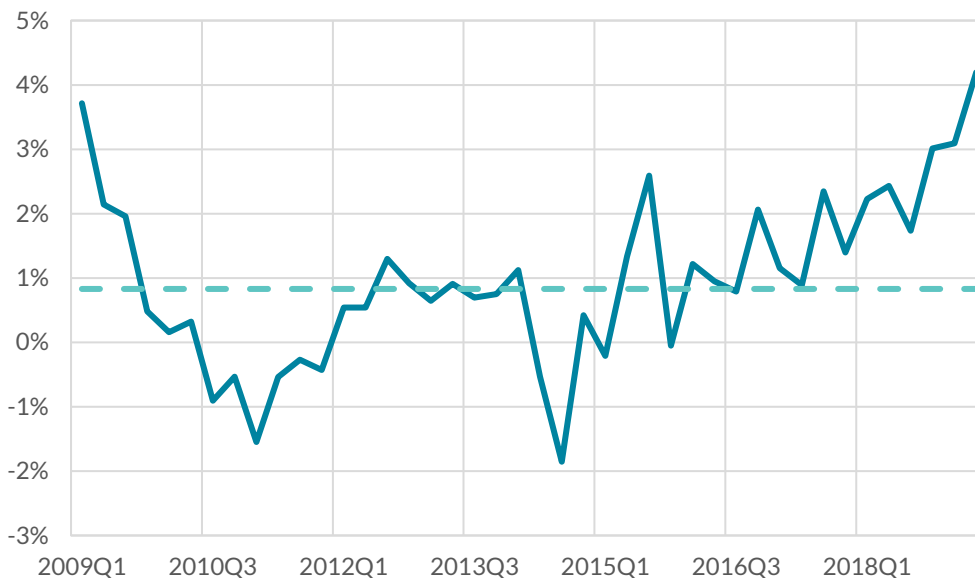
<sup>55</sup> A value below 50 indicates contraction.

slow to 2.1 per cent in 2019. 0.2 per cent in 2020, and decline by 0.2 per cent in 2021. While the unemployment rate is largely unaffected in 2019, it is projected to rise to 5.8 and 6.9 per cent in 2020 and 2021 respectively.

## Pay

Compared with the period from 2013 to 2018, compensation growth has picked up over the past four to six quarters (Figure 8). The CSO Earnings Hours and Employment Survey (EHECS) has reported an annual increase in average hourly earnings of 3.8 per cent in the second quarter of 2019. The largest increases were recorded in the transportation and storage and administrative and support service sectors. Wage growth continues to be driven by the private sector at 4.4 per cent annually compared to 1.7 per cent in the public sector.

**Figure 8: Compensation growth has picked up in recent quarters**



Source: CSO. Note: Growth in hourly earnings excluding irregular earnings. The dashed line represents the average growth between 2012 and 2017.

The overall job vacancy rate has remained relatively flat at 1 per cent in recent quarters, with a higher vacancy rate exhibited in key export-orientated sectors. The largest vacancy rates are evident in the multinational-dominated sectors. Recent Bank research has showed that in the ICT sector, more than half of the clicks on online job vacancy listings were by persons located outside of Ireland, highlighting the importance of migration to employment needs in key sectors.<sup>56</sup>

<sup>56</sup> Lydon, R. and Adrjan, P. (2019) "[Labour Market Tightness - Insights from online data on job postings and job search](#)" Dublin Economics Workshop

In a deal scenario, compensation per employee is projected to grow by 3.6 per cent in 2019 and by 4.2 per cent in 2020. In the event of a no-deal scenario, the adverse impact on employment would contribute to lower income growth, which would see anticipated compensation rates slow to 3.5 per cent in 2020 and 3 per cent in 2021.

**Table 4: Employment, Labour Force and Unemployment**

	2018	2019f	2020f	2021f
Agriculture	107	106	105	105
Industry (including construction)	425	437	443	452
Services	1,730	1,773	1,802	1,827
Total Employment	2,262	2,316	2,350	2,383
Employment growth (%)	3.1	2.4	1.5	1.4
Labour Force	2,395	2,438	2,470	2,502
Labour Force growth (%)	1.9	1.8	1.3	1.3
Unemployment	133	122	120	119
Unemployment Rate (%)	5.6	5.0	4.8	4.8

## Inflation

### Prices

HICP inflation averaged 0.9 per cent for the January to August 2019 period. The dualistic nature of negative goods price declines accompanied by positive services price increases continued throughout the year. Goods prices declined by 0.6 per cent year on year over that period, while services prices increased by 2.3 per cent year on year. Within goods prices, food price increases averaged 0.6 per cent and industrial goods prices declined by 2.7 per cent. These prices have a significant import content and can be influenced by exchange rate movements. Services price trends, on the other hand, are driven more by domestic economic developments. Rent prices increased by 5.5 per cent.

Inflation forecasts in a deal scenario are for a moderate increase in prices over the forecast horizon. Conditional on the assumptions for oil prices, exchange rates and real economic activity under the deal scenario, HICP inflation is forecast to increase by 0.8, 1.1 and 1.4 per cent in 2019, 2020 and 2021, respectively.

The forecasts for inflation in a no-deal Brexit are subject to significant uncertainty. The main channels through which prices would be affected are through tariffs, non-tariff barriers, exchange rates, aggregate demand and competitive effects. These channels affect the outlook for prices in different directions, with the forecast contingent on which factor



dominates in the short run. The below indicates the likely influence of each of these channels on inflation.

Modelling work suggests that the aggregate demand shock and the depreciation of the sterling will dominate aggregate price developments over the projection horizon. There is likely to be significant heterogeneity across the components of the price basket, however. For example, price increases are likely in imported groceries (see Box D). Services prices, which typically exhibit a greater co-movement with aggregate demand, are likely to moderate as the economy weakens.

The extent of the downward effect on aggregate inflation would be mitigated significantly by the imposition of tariff and non-tariff barriers associated with trading with a third country. Tariffs on imports from the UK, which account for approximately 24 per cent of Irish imports, would revert to WTO levels. These tariff rates vary considerably but are highest for meat, dairy and confectionery products. How much of this cost increase for retailers and producers is absorbed into profit margins is uncertain and sector dependent but some studies suggest that the pass through to consumer prices could be relatively high.

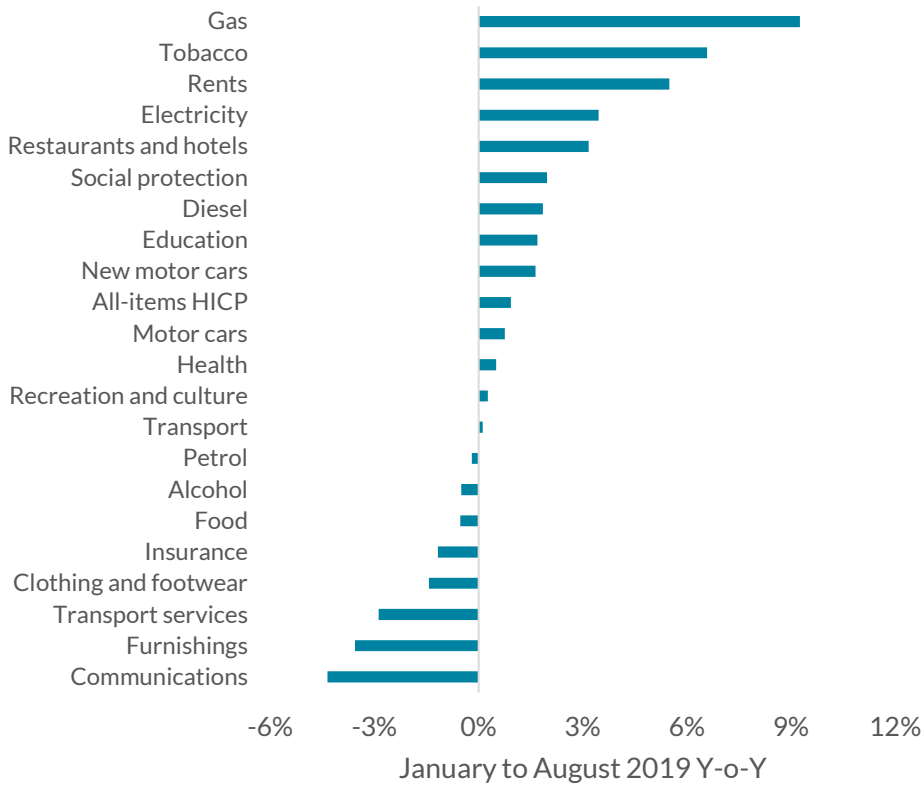
The inflationary effect of Non-Tariff Barriers could also be substantial and even outweigh the effect of tariffs. These costs are likely to occur even in the event of an agreement to reduce tariffs from their WTO levels. Non-tariff barriers include higher transport costs, administrative costs, quantity limits, barriers from licencing, labelling, standards, sanitary and phyto-sanitary rules. Moreover, since a significant proportion of our imports use the UK as a land bridge, a greater amount of consumer products could be affected by higher non-tariff barrier effects like higher administrative and transport costs.

A reduction in competition in certain sectors or product categories may also lead to price increases. Reduced competition as some firms potentially decide to exit the market rather than absorb cost increases, may mean remaining firms increase prices reflecting changes in the market.

Transmission Mechanism	Impact on prices
Tariffs	↑
Non-Tariff Barriers	↑
Exchange Rates	↓
Aggregate Demand	↓
Reduced Supply	↑

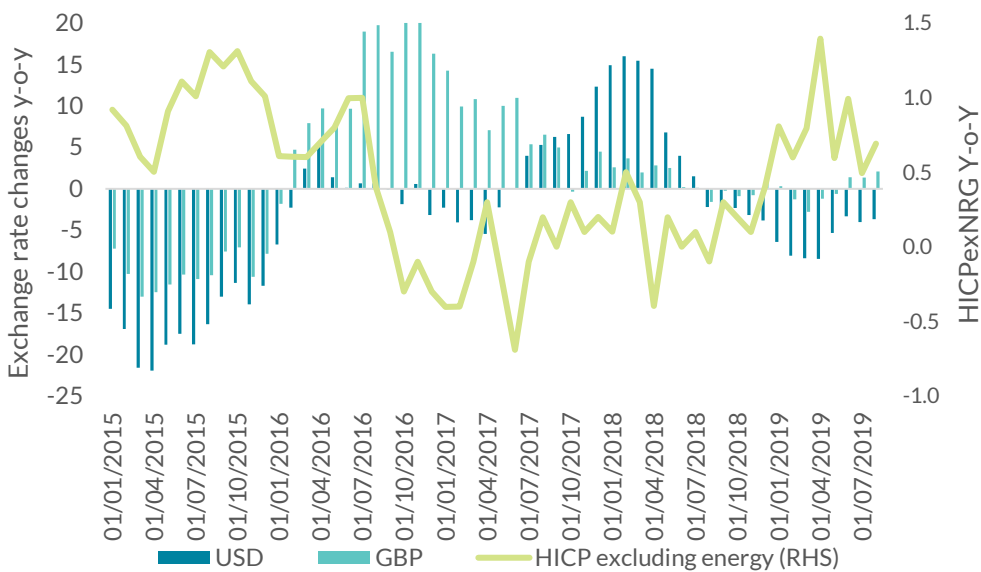
In the event of a no-deal scenario, inflation is forecast to increase by 0.8, 0.9 and 1.2 per cent in 2019, 2020 and 2021, respectively.

**Figure 9: Price developments have been characterised by strong growth in services, particularly energy and rents**



Source: Eurostat

**Figure 10: The appreciation of the euro vis a vis the Sterling has had a dampening effect on price increases since the referendum**



Source: Eurostat

**Table 4: Inflation Measures – Annual Averages**

Measure	HICP	HICP excluding Energy	Services	Goods	CPI
2018	0.7	0.1	1.7	-0.3	0.5
2019 <sup>f</sup>	0.8	0.8	2.3	-0.9	1.0
2020 <sup>f</sup>	1.1	1.3	3.3	-1.3	1.1
2021 <sup>f</sup>	0.8	1.6	3.5	-0.9	1.6

### Residential Property<sup>57</sup>

National residential property prices rose by 2.3 per cent in the twelve months to July 2019. Prices in Dublin declined by 0.2 per cent in July, the first annual decrease experienced in the capital in almost seven years. The disparity in price growth between Dublin and non-Dublin regions continued in July, with the latter growing by 4.8 per cent. The border region saw the largest rise in house price inflation for the fourth consecutive month, up 16.1 per cent since July 2018. Overall, the national index remains 17.3 per cent below its highest peak in 2007, while Dublin and the rest of Ireland are 21.8 per cent and 20.2 per cent, below their respective pre-crisis peaks.

In terms of supply, recent data show that housing completions totalled 4,920 units in Q2 2019, representing an annual increase of 12 per cent. Growth in overall completions was primarily driven by apartments, which grew by 56 per cent when compared to Q2 2018. Despite still seeing positive growth in the number of new dwelling completions in Q2 2019, these figures suggest a moderation in the growth rates which were evident between 2015 and 2018.

According to the Daft.ie rental report for Q2 2019, rents nationwide rose by 6.7 per cent on an annual basis. Over the last year, the rate of rental inflation almost halved, down from 12.4 per cent in Q2 2018. In Dublin, rents were 4.5 per cent higher in Q2 2019 when compared with the same period last year. Rental prices in Cork, Limerick, Waterford and Galway, continue to rise more rapidly than in the capital.

### Commercial Property

The latest data from the MSCI/IPD database show that the pace of growth in commercial property values grew by 2.2 per cent in the second quarter of 2019, marginally lower than the yearly rate of 2.9 per cent recorded in the

<sup>57</sup> The Bank's [Financial Stability Review](#) for H1 2019 provides a more detailed review of residential and commercial property prices.

previous quarter. Over the same period, industrial and office values increased by 4.8 and 2.6 per cent, respectively, while retail capital values fell by 0.3 per cent.

## The Public Finances

### Overview

The latest fiscal data suggest that there will be a modest improvement in the fiscal position this year. The general government deficit ratio in the first quarter of 2019 was broadly similar to the deficit recorded in the same quarter last year, while the Exchequer position was better than expected in the year to August. Government revenues, – in particular tax receipts – have been growing at a solid pace so far this year and are ahead of profile. Meanwhile, government expenditure, which has overrun in four of the past five years, was slightly below profile. Further uncertainty related to the UK's departure from the European Union, in whichever form it may eventually take, could potentially lead to lower than expected tax revenues from a slowing economy, and higher than planned expenditure as the Government provides supports to vulnerable sectors of the economy most exposed to Brexit risks. The level of general government debt remains elevated, highlighting the fiscal challenges that persist and the work that remains to be done to ensure the public finances remain on a sound footing.

### Exchequer Returns

Exchequer data for the year to August was broadly positive. Excluding transactions with no general government impact, the Exchequer deficit was almost €1 billion ahead of profile at €3.5 billion, as both revenue and expenditure outturns were better than expected (see Table 5).

**Table 5: Analytical exchequer statement, January to August 2019**  
(€ millions)

	Jan - Aug 2019 €m	Jan - Aug 2018 €m	Annual Change (%)	Outturn vs Profile (€m)
<b>Revenue</b>	<b>44,572</b>	<b>41,465</b>	<b>7.5</b>	<b>530</b>
Tax Revenue	35,050	32,421	8.1	233
Appropriations-in-Aid	8,275	7,869	5.2	103
Other Revenue	1,247	1,175	6.1	194
<b>Expenditure</b>	<b>48,096</b>	<b>45,620</b>	<b>5.4</b>	<b>-463</b>
Current Primary Expenditure	40,782	38,794	5.1	-239
Capital Expenditure	3,362	2,679	25.5	-130
Interest on National Debt	3,952	4,147	-4.7	-94
<b>Balance</b>	<b>-3,524</b>	<b>-4,155</b>	<b>15.2</b>	<b>993</b>

Source: Department of Finance

Note: The figures in the Table exclude transactions with no general government impact, giving a closer approximation to the General Government balance.

In the case of revenue, tax receipts continued to record robust growth, increasing by 8.1 per cent on an annual basis, driven by solid gains in corporation taxes and excise duties. Total taxes were slightly ahead of target in the year to August, reflecting the favourable economic climate. Corporation taxes came in 6.8 per cent (€314 million) ahead of profile, continuing the trend of recent years, while excise duties were 3.0 per cent (€113 million) above profile. Income tax and VAT were marginally below profile in the first eight months of this year, but still recorded solid annual growth of 7.9 per cent and 5.5 per cent, respectively. Better than expected receipts from other (non-tax) sources also helped support government revenues to date in 2019.

Government expenditure was 1.0 per cent below target so far this year, driven by developments in both current and capital spending. Investment spending was 25.5 per cent higher on an annual basis, but 3.7 per cent (€130 million) below what was initially budgeted. Current primary spending increased by 5.1 per cent compared to the same period last year, but was 0.6 per cent (€239 million) below profile. A lower than expected EU budget contribution combined with lower than anticipated spending across the majority of Government departments brought about these savings. Maintaining fiscal discipline over the final months of this year will be incredibly important given the uncertainty surrounding Brexit and every effort should be made to avoid the pattern of over spending in recent years that has tended to occur in the final months of the year.

## Funding and Other Developments

The National Treasury Management Agency (NTMA) raised an additional €2 billion in the third quarter of the year through Government bond sales. This brought the total raised to date in 2019 to €12.25 billion, just below the lower bound of the NTMA's target of €14 to €18 billion for the year. The State's funding requirements for 2019 are relatively modest, with €15 billion of bonds set to mature over the course of the year and an Exchequer deficit of just over €2 billion projected in June's Summer Economic Statement. Reflecting recent operations, the NTMA noted in August that the State is fully funded three to four quarters in advance. Recent months also saw the cancellation of a further €0.5 billion of the floating rate treasury bonds issued in connection with the liquidation of Irish Bank Resolution Corporation. As a result, more than half of these bonds - issued in 2013 - have now been cancelled, with a balance of €9.5 billion outstanding.

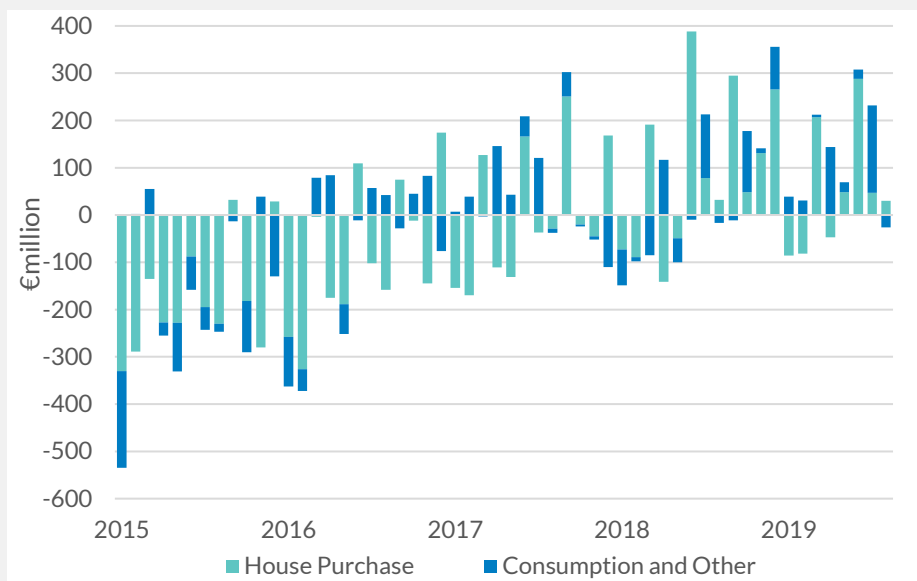
### Box F: Credit Developments in the Irish Economy

By *Statistics Division*<sup>58</sup>

The latest macroeconomic data suggest that the Irish economy continues to perform favourably but downside risks have increased largely due to external factors. Coinciding with higher uncertainty around the eventual terms of the United Kingdom's withdrawal from the European Union, Irish consumer and business sentiment indicators have deteriorated recently. While new bank lending to certain sectors continues to grow, credit developments remain modest. Households continue to increase deposits, suggesting the increase in uncertainty could be leading to precautionary savings alongside rising incomes. The deposit growth, however, is in line with the broader euro area trend.

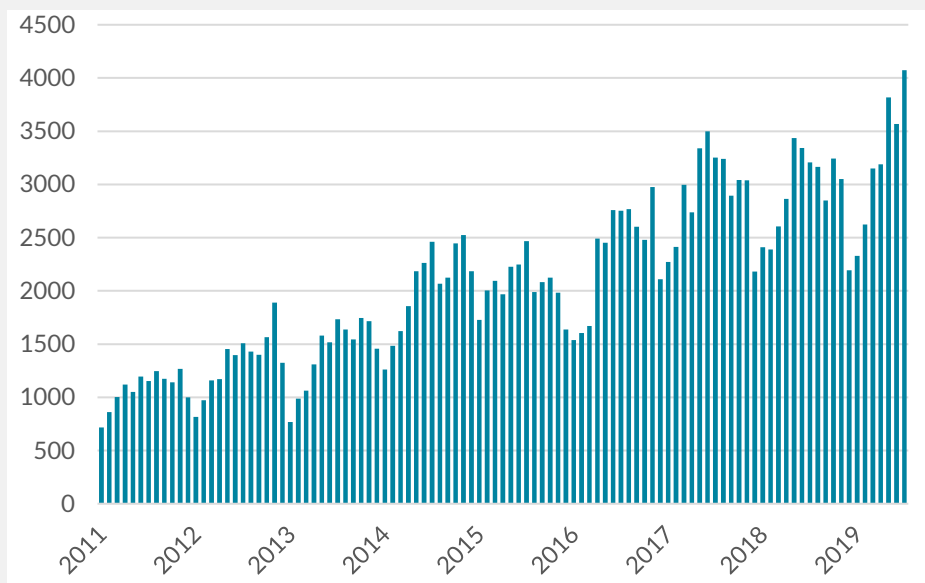
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<sup>58</sup> Prepared by Brian Kenny

**Figure 1: Flow of Loans to Households**

Source: Central Bank of Ireland

On an annual basis, bank lending to Irish resident non-financial corporations (NFC) and households continued to increase at a relatively modest pace in August 2019 at 2.3 and 2 per cent, respectively. Much of the increase in household lending came from lending for house purchase contributing 64 per cent of the growth. The growth in housing-related lending was driven by principal dwellings with lending for buy-to-let and holiday homes still declining (Figure 1). The pipeline of new lending appears to be strong with mortgage approvals at the highest level since 2011 (see Figure 2). This trend is mirrored in lending for consumption purposes, which in Q2 had the largest annual increase recorded since 2008. New loans for car purchase were also increasing throughout the first half of 2019, marking the largest volume of new lending for car finance recorded since the series began in 2012. Further, the latest results from the Irish Bank Lending Survey show that banks reported a marginal increase in loan demand from households for house purchase and for consumer credit in Q2. As noted earlier however, the materialisation of downside risks to domestic demand could lead to lower consumption with subsequent implications for future credit demand among Irish households.

**Figure 2: Developments in Mortgage Approvals<sup>59</sup>**

Source: BPF1

While annual growth in SME credit continued to remain negative, a strong flow of new lending is also evident for this sector. Gross new lending to SMEs continued to increase in the second quarter of 2019, up 11 per cent on the same period in 2018. SMEs in the property sector accounted for the majority of new drawdowns with increases also observed in the primary industries, retail and manufacturing sectors. The latest euro area SAFE data<sup>60</sup> notes that SME demand for bank loans, along with the reported availability of external sources of finance, increased in the six-month period to end March 2019. Moreover, it shows that the countries in which SMEs reported the most improvement in the availability of bank loans were Spain, Ireland and Portugal. While growth in SME lending remains robust despite Brexit related uncertainty facing the economy, the latest Department of Finance Credit Demand Survey<sup>61</sup> shows that although credit demand increased relative to the previous survey, it declined marginally in annual terms. A lack of credit requirements and availability of internal funding<sup>62</sup> may explain the decline. The survey also highlighted the deterioration in business sentiment among SMEs due to Brexit.

<sup>59</sup> Source: Banking and Payments Federation of Ireland [Mortgage Approvals Report](#)

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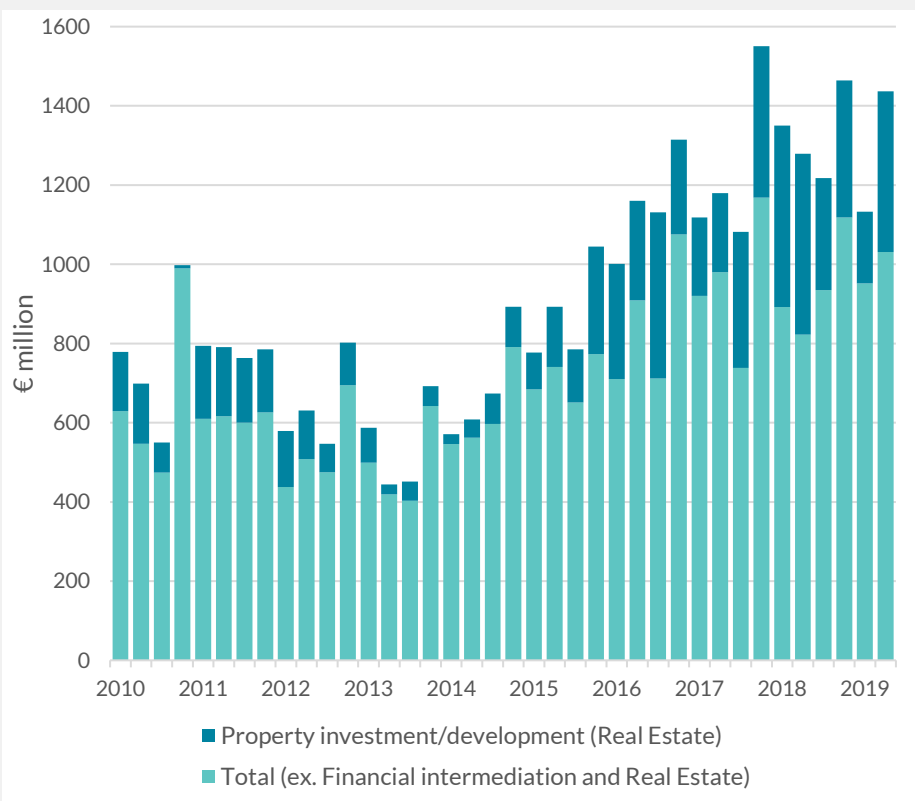
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<sup>61</sup> The [Department of Finance SME Credit Demand Survey](#) released in September 2019 covers the six-month period October 2018 – March 2019.

<sup>62</sup> See the Central Bank's [Financial Stability Review](#) and the [SME Market Report](#) for further information and analysis of the Irish SME sector.

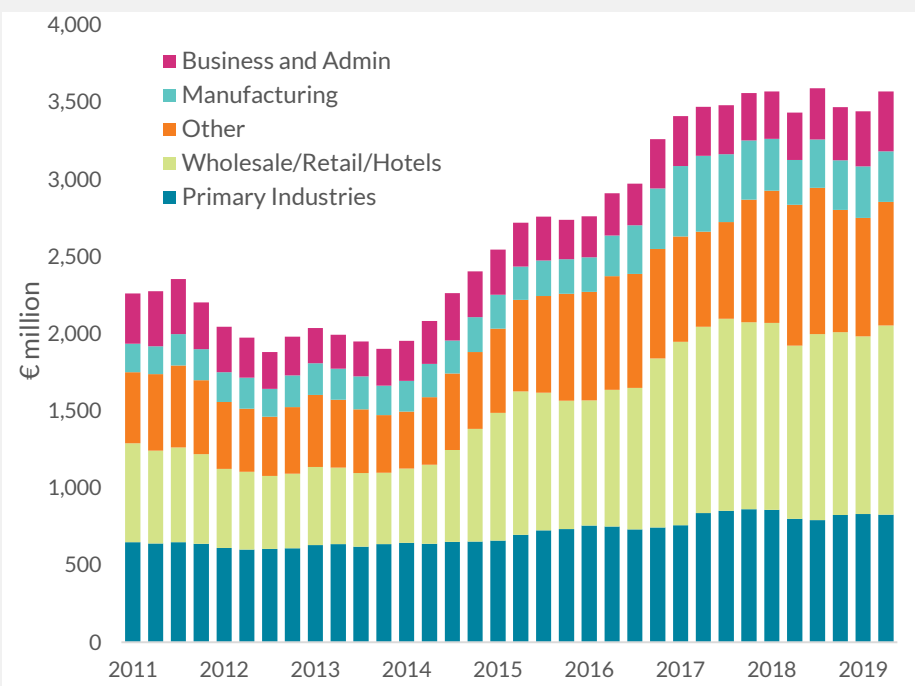


**Figure 3: Developments in New Lending to SMEs**



Source: Central Bank of Ireland

**Figure 4: New lending to core SMEs - 12 month sum**

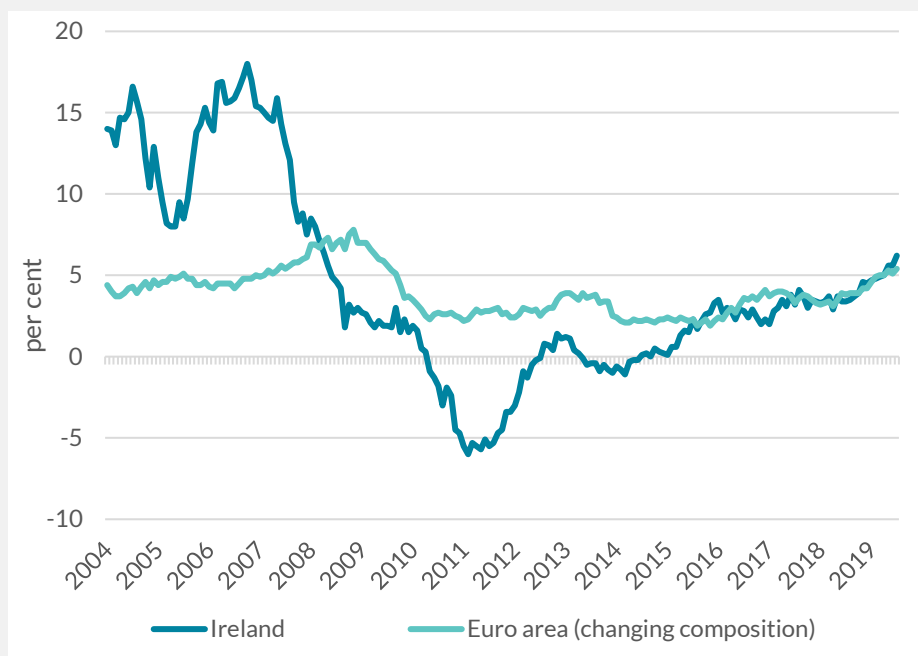


Source: Central Bank of Ireland

Household deposits have been increasing strongly and were up by 6.4 per cent on an annual basis in August, reaching a series high of over €109 billion. This could be due to overall economic uncertainty, with Irish

annual growth rates in deposits converging with EU levels in recent times, or potentially an increased desire for precautionary savings as mentioned in previous Central Bank Quarterly Bulletins<sup>63</sup>. The savings behaviour of households is also changing in terms of the maturity within the deposits. Previously, Irish households held roughly equal shares of term and overnight deposits. The recent trend has seen a strong rebalancing towards overnight deposits. This shift in preference could be due to the fact that the interest rate premium on term deposits have fallen significantly due to a flattening of the yield curve. Since late 2012, the premium on term deposits has steadily declined from 304 basis points to just 27 basis points in July 2019.

**Figure 5: Annual growth in Household deposits<sup>64</sup>**



Source: ECB Statistical Data Warehouse

Although indicators suggest consumer sentiment is slowing, credit continues to increase in certain sectors. There is uncertainty about the future path of consumption and in turn credit and deposit developments. In the event of a disorderly withdrawal of the United Kingdom from the European Union and a corresponding income shock, personal consumption could moderate with a reduction in credit demand and a decline in savings. If household income does not decrease significantly, there could be an uptake in precautionary deposits. However, given the scenario of an orderly withdrawal, the opposite effect may emerge with

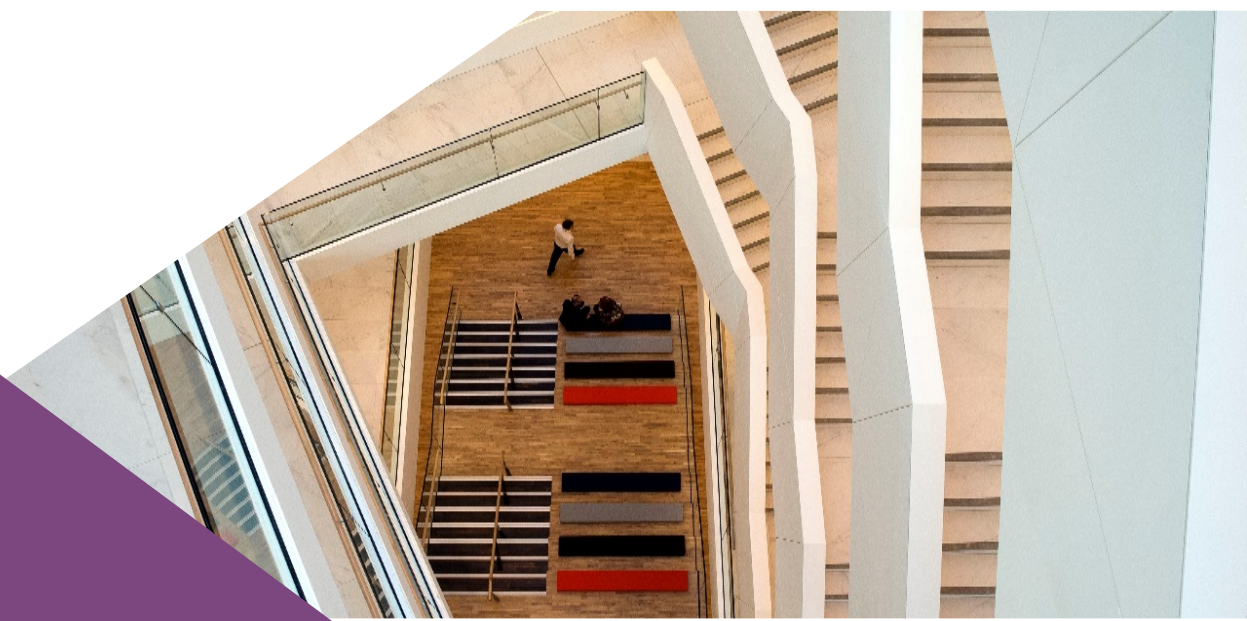
<sup>63</sup> See Central Bank of Ireland [Quarterly Bulletin No.3 2019](#)

<sup>64</sup> Source: Central Bank of Ireland and the European Central Bank [Statistical Data Warehouse](#)

continued growth in credit and drawdowns in deposits as consumer sentiment recovers.

# Overview of Financial Developments in the Irish Economy

The Overview of Financial Developments Chapter presents a summary of the latest financial trends in Ireland. The Financial Statistics Summary Table and accompanying graphs provide key insights for understanding important trends, utilising the latest data for the household sector, small and medium sized enterprises, the financial sector and the public finances. Links to the relevant source data are provided below each chart.



## Financial Statistics Summary Table

	2016	2017	2018	2019
<b>Lending - Outstanding, € billion</b>				
Irish Households for House purchase	73.5	74.8	76.1	74.6**
	-1.3%	0.0%	1.4%	1.5%**
Irish Households for Consumer and Other credit	14.7	15.1	15.3	15.5**
	0.4%	2.1%	1.5%	4.3%**
Irish Non-Financial Corporates	42.3	41.3	40.9	40.7**
	-3.3%	-0.6%	1.7%	3.8%**
Irish resident Small and Medium Sized Enterprises	28.3	26.4	23.5	22.6*
	-8.4%	-4.0%	-3.8%	-3.2%*
Irish Private Sector <sup>1</sup>	147.5	148.4	150.0	147.7**
	-2.5%	0.7%	1.1%	1.2%**
<b>Deposits - Outstanding, € billion</b>				
Irish Households	97.1	99.5	104.0	108.5**
	2.3%	3.4%	4.5%	6.3%**
Irish Non-Financial Corporates	45.6	50.6	52.3	57.8**
	9.0%	9.8%	3.4%	9.7%**
Irish Resident Private-Sector Enterprises	89.3	93.2	95.7	101.9*
	0.7%	6.3%	2.1%	6.9%
<b>New Business Interest Rates, %</b>				
Lending for House purchase <sup>2</sup>	3.4	3.2	2.98	2.98**
Non-Financial Corporate Lending	2.6	2.9	2.3	2.4*
Irish Small and Medium Sized Enterprises Lending	4.3	4.1	4.0	3.8*
Household Term Deposits	0.8	0.6	0.4	0.4*
<b>Households - € billion</b>				
Household Debt to Disposable Income	143%	130%	123%	120%***
Household Net Worth	655.0	727.4	760.7	772.2***
<b>Financial Sector Assets - Outstanding, € billion</b>				
Credit Institutions	590.3	552.1	599.8	669.0**
Investment Funds	1,938.4	2,241.8	2,327.8	2,661.5*
Money Market Funds	485.2	500.6	502.1	525.2**
Special Purpose Entities	740.1	731.8	731.2	789.0*
Insurance Corporations <sup>3</sup>	301.1	311.8	304.9	321.7*
<b>Securities - € billion</b>				
Securities Held by Irish Residents	2,484	2,736	2,786	3,055***
Government Bond Debt	121.6	127	131.2	134.2**
Debt Securities Issued by Irish Residents <sup>4</sup>	732	719.7	687.9	728.9**

<sup>1</sup> Includes lending to households, Non-Financial Corporates, Insurance Corporations and Pension Funds, and Other Financial Intermediaries

\*Ref. June 2019

<sup>2</sup>Ex. Renegotiations

\*\*Ref. July 2019

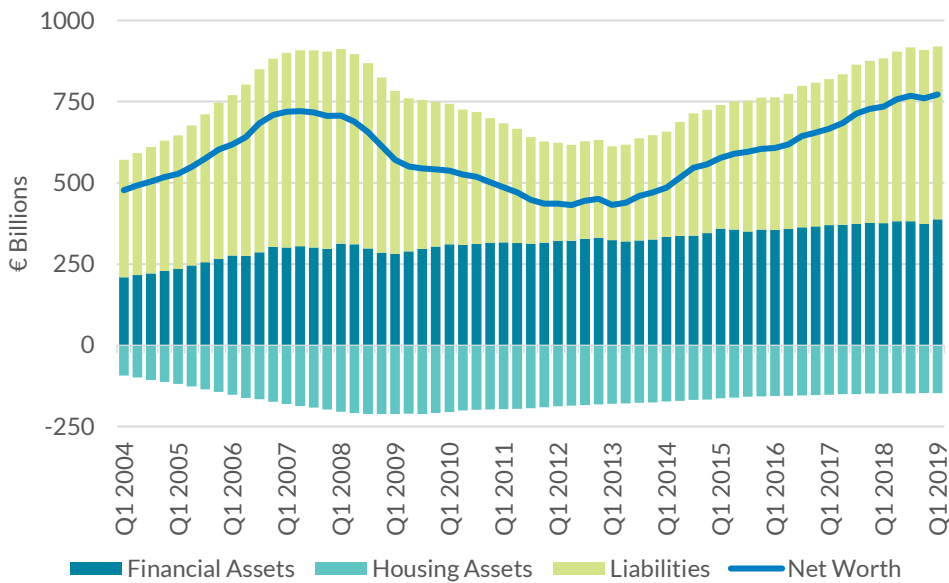
<sup>3</sup>First reporting commenced in 2016

\*\*\*Ref. Q1 2019

<sup>4</sup>Debt Securities: all currencies

## Household Sector

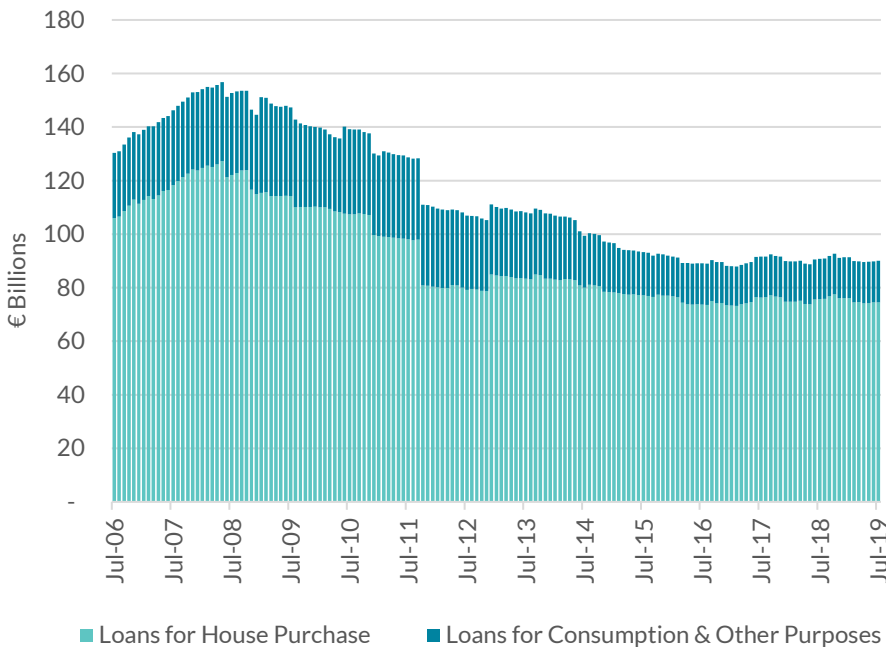
Chart 1: Household Net Worth



Household net worth reached a new high of €772bn in March 2019, while the value of housing assets declined for the second consecutive quarter.

Source: [Quarterly Financial Accounts](#), Central Bank of Ireland

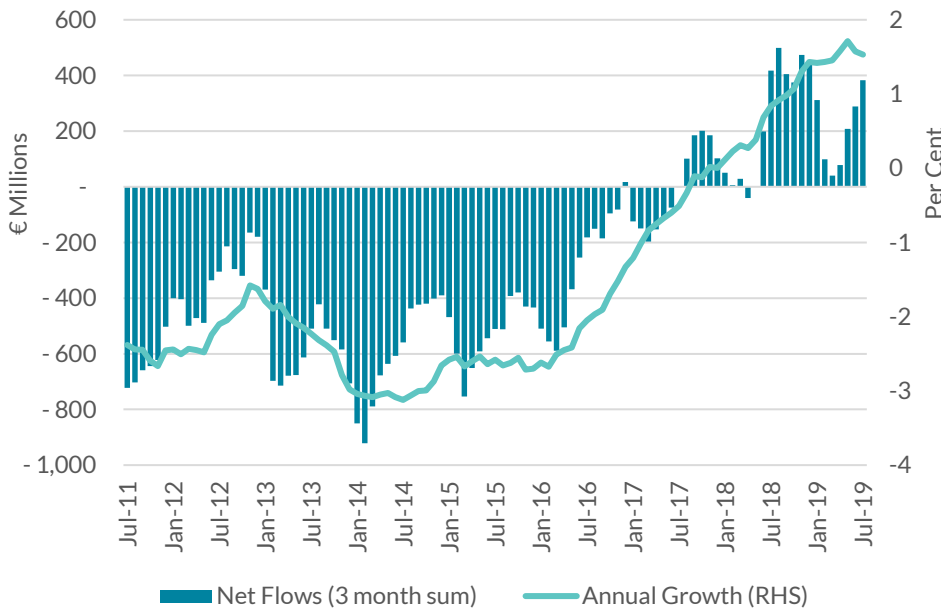
Chart 2: Outstanding Bank Loans to Irish Households



Irish bank loans to households remains at a subdued level relative to its historical highs.

Source: [Bank Balance Sheet Statistics](#), Central Bank of Ireland

**Chart 3: Net flows for Loans for House Purchase**

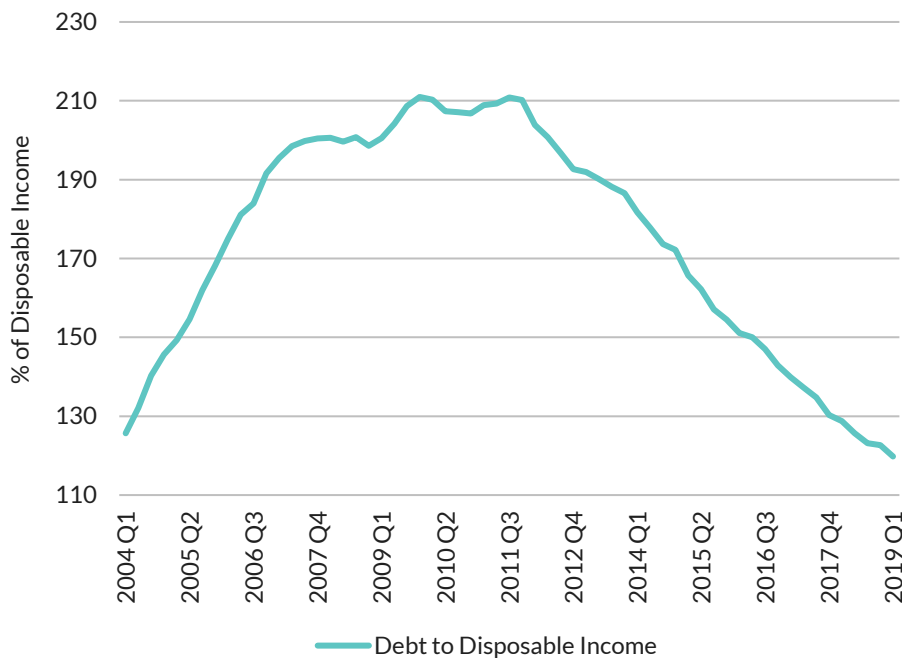


Growth in loans for house purchase stabilised in Q2.

Source: [Bank Balance Sheet Statistics](#), Central Bank of Ireland

Note: Data encompass Irish resident bank on balance sheet net lending for the purpose of house purchase.

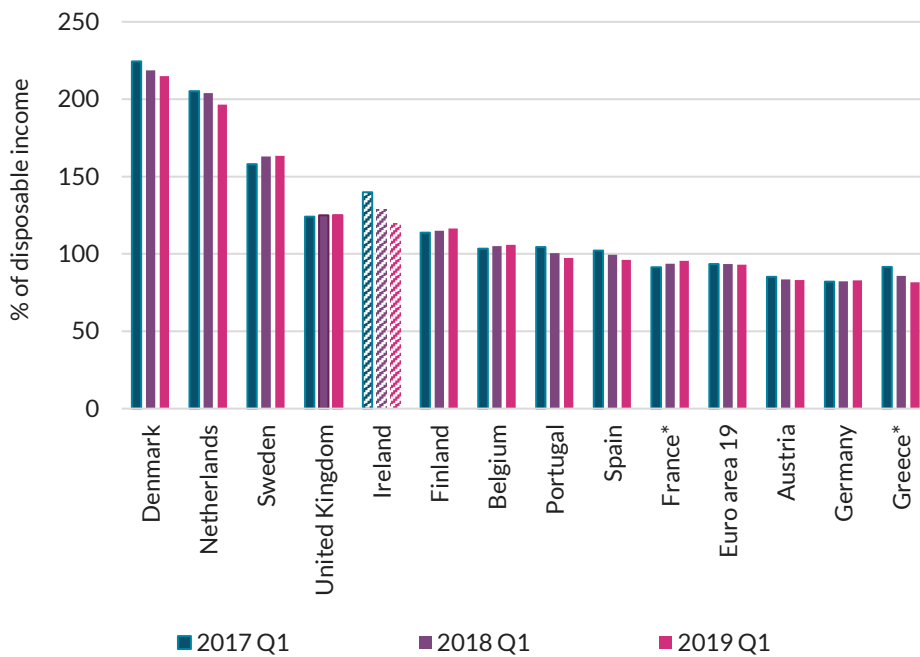
**Chart 4: Household Debt to Disposable Income**



Households are continuing to deleverage - debt to disposable income is at its lowest point since 2004.

Source: [Quarterly Financial Accounts](#), Central Bank of Ireland

**Chart 5: EU Cross Country Comparison of Household Indebtedness**

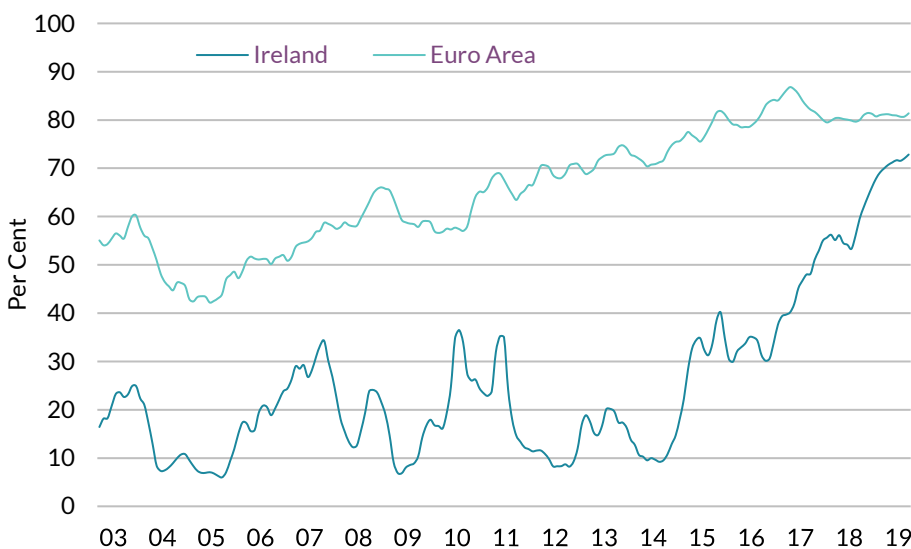


Ireland ranks fifth among European countries when comparing ratios of household debt to disposable income.

Source: [Quarterly Financial Accounts](#), Central Bank of Ireland

Note: \*Data are from Q4 2018.

**Chart 6: New Mortgage Agreements: Share of Fixed Rate Mortgages (3 Month Rolling Average)**

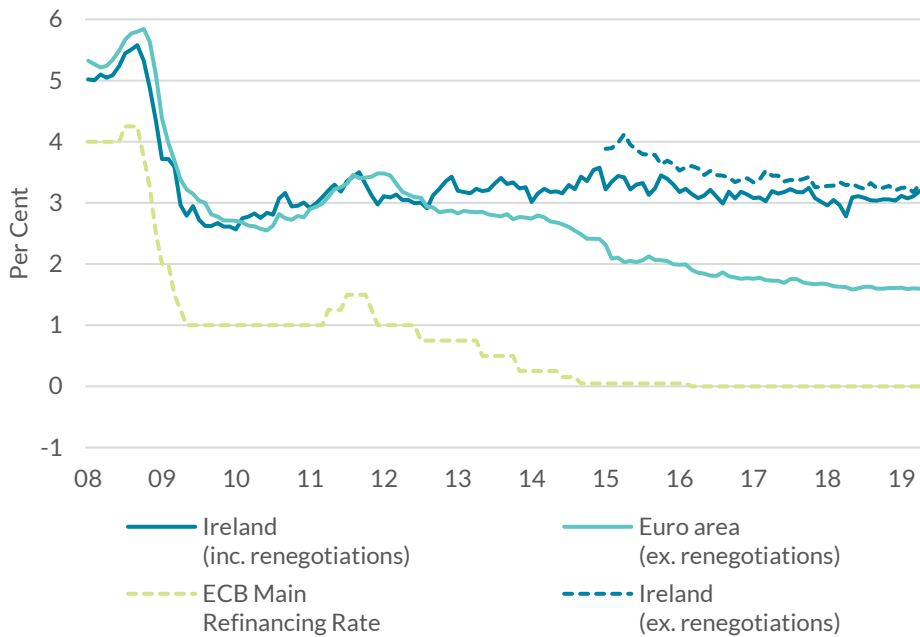


The share of fixed rate mortgages is converging with the Euro Area, although fixed rate terms remain shorter in Ireland.

Source: [Interest Rate Statistics](#), Central Bank of Ireland, [ECB Statistical Data Warehouse](#)



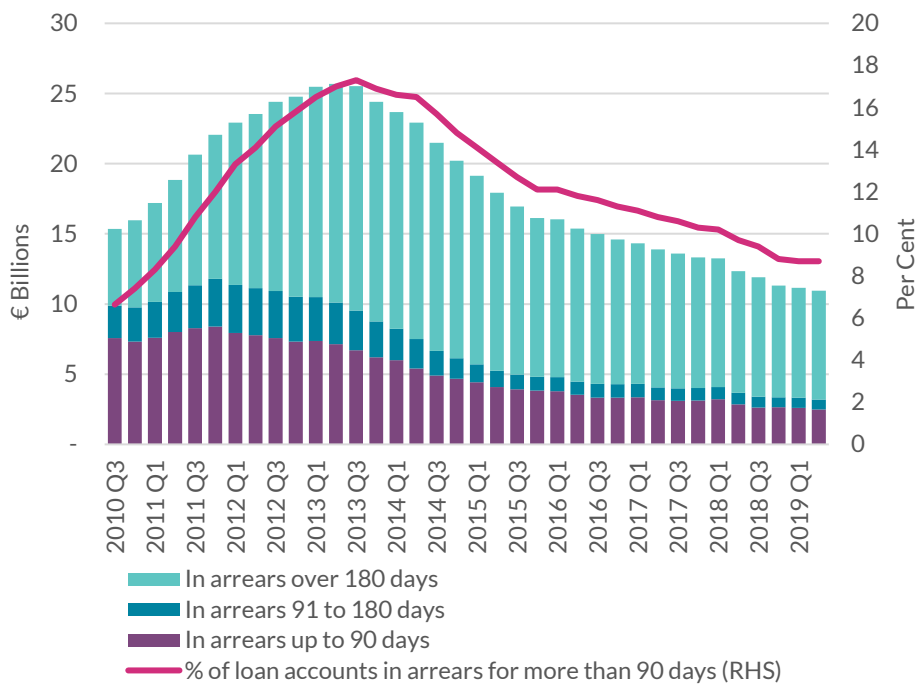
**Chart 7: Interest Rates on New Variable Rate Loan Agreements to Households for House Purchase**



New variable mortgage interest rates remain above the Euro Area rate.

Source: [Interest Rate Statistics](#), Central Bank of Ireland

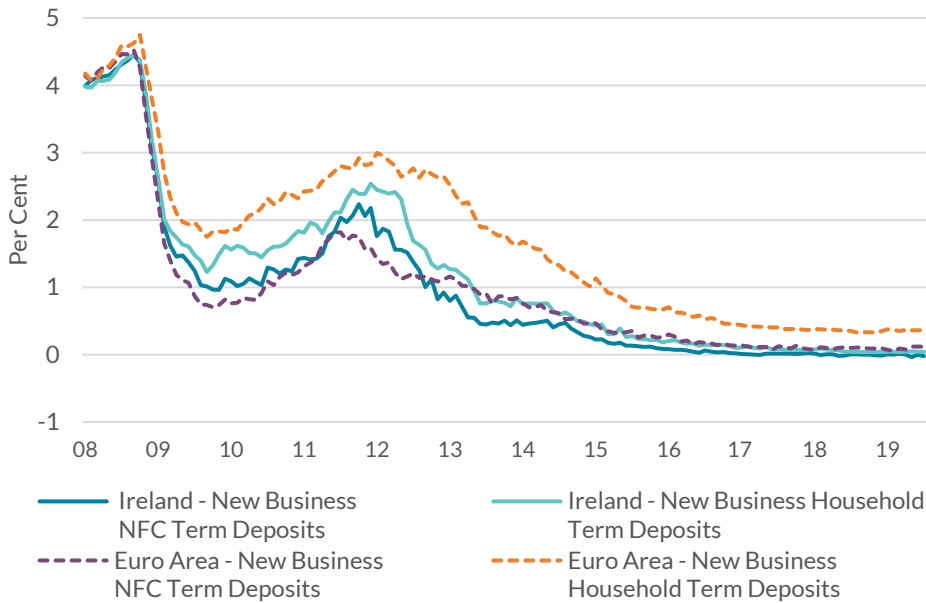
**Chart 8: Mortgage Arrears (Primary Dwelling House)**



The decline in the number of accounts in arrears has slowed in recent quarters.

Source: [Mortgage Arrears Statistics](#), Central Bank of Ireland

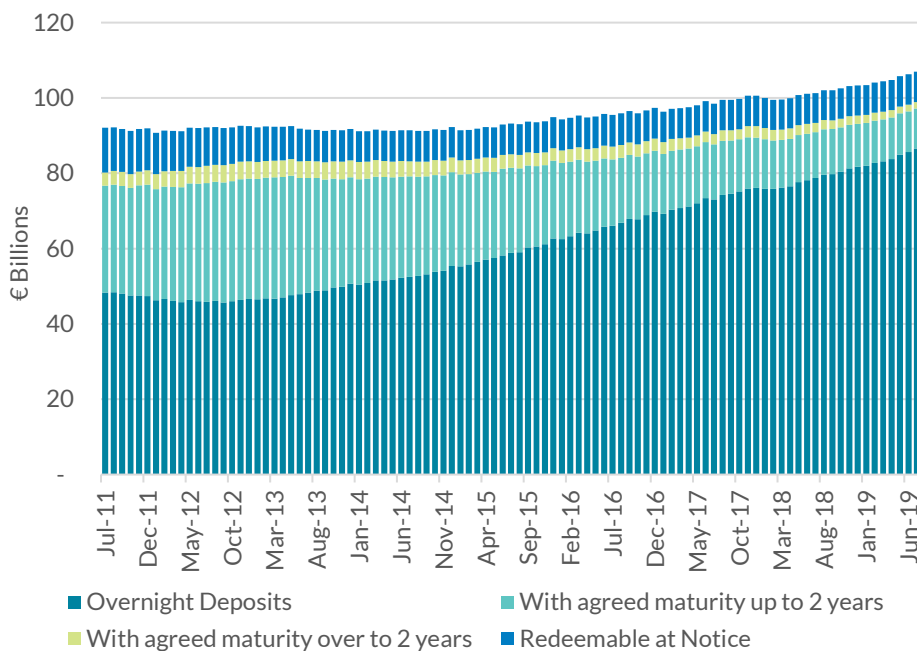
Chart 9: Interest Rates on Household & NFC Term Deposits



Interest rates on Irish new household term deposits were 0.04 per cent in July 2019.

Source: [Interest Rate Statistics](#), Central Bank of Ireland

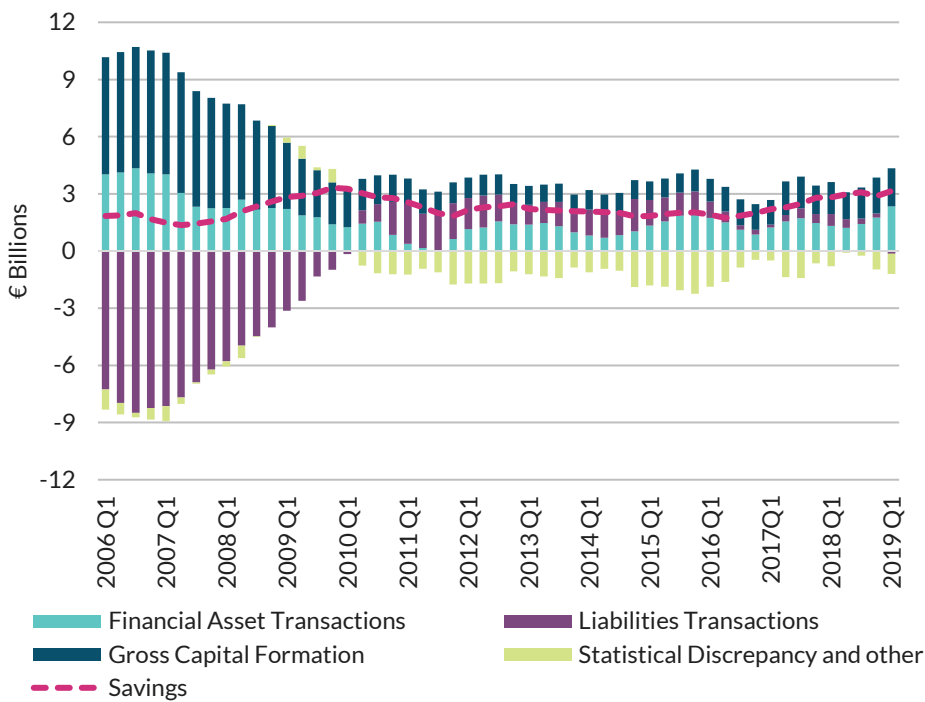
Chart 10: Deposits of Irish Households by Category of Deposit



Overnight deposits are driving the increase in total household deposits.

Source: [Bank Balance Sheet Statistics](#), Central Bank of Ireland

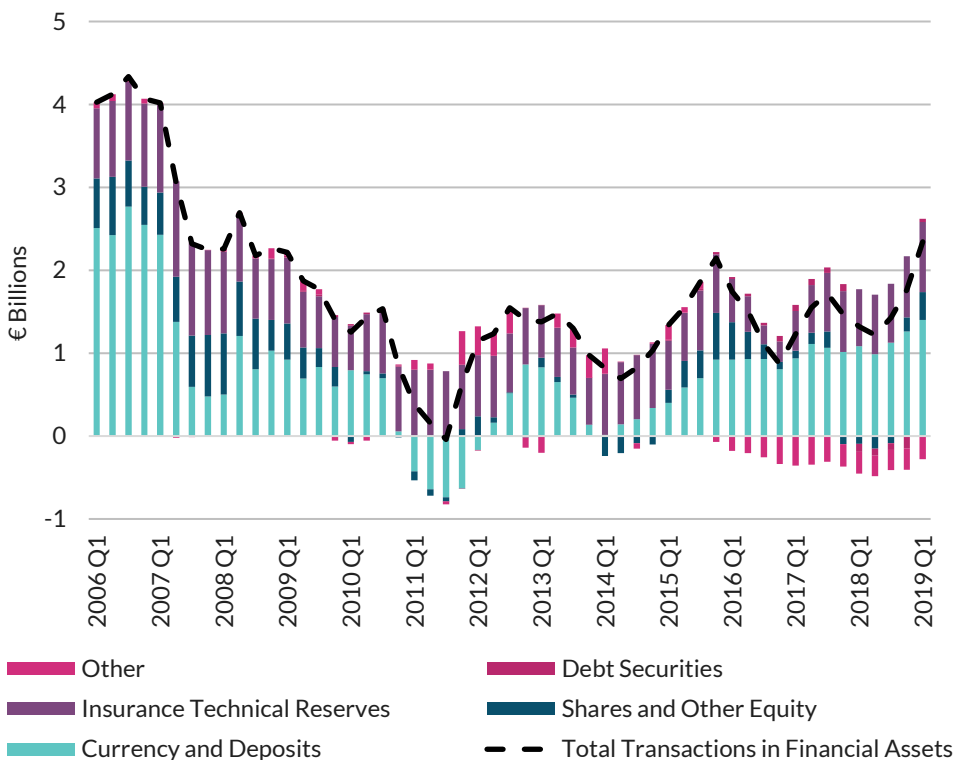
Chart 11: Household Savings by Use (4-Quarter Moving Average)



Households saved €3.1bn in Q1 2019. This saving consisted of €2.3bn of financial asset transactions and a €2bn investment in gross capital formation.

Source: [Quarterly Financial Accounts](#), Central Bank of Ireland

Chart 12: Household Transactions in Financial Assets (4-Quarter Moving Average)

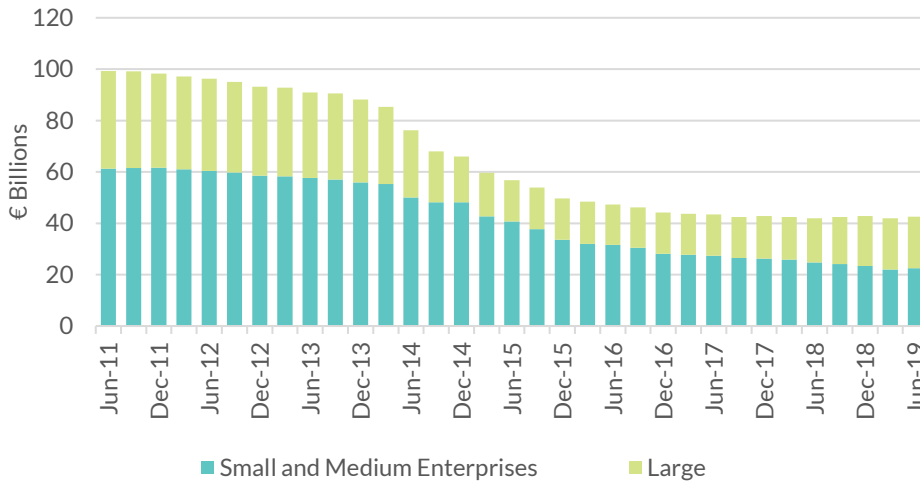


Households are investing primarily in currency and deposits and in insurance and pension policies.

Source: [Quarterly Financial Accounts](#), Central Bank of Ireland

## Non-Financial Corporate Sector

**Chart 13: Credit Extended to Small and Medium (SME) and Large Non-Financial Enterprises**

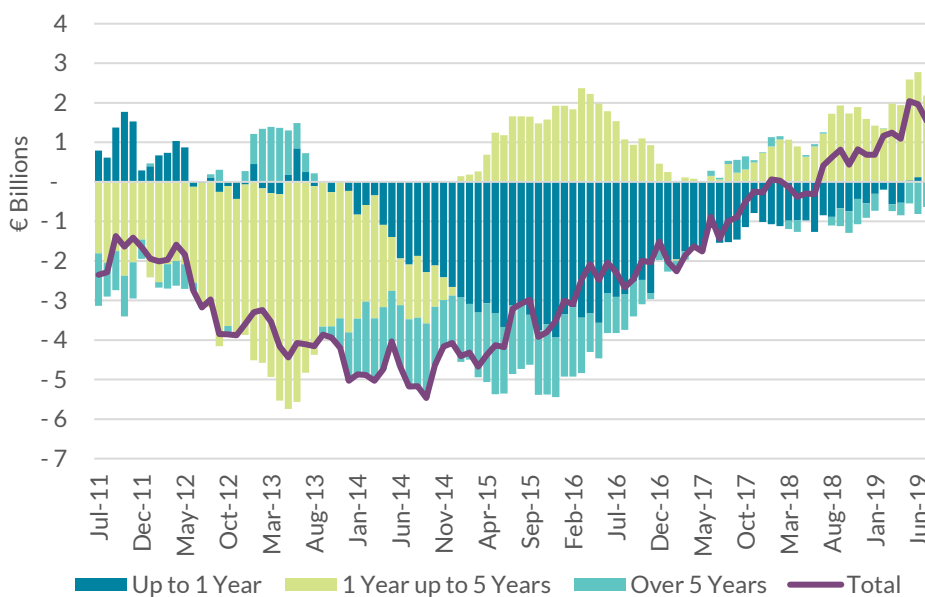


Bank lending to large enterprises continued its recovery in Q2, while lending to SMEs remained flat.

Source: [SME and Large Enterprise Credit and Deposits](#); Author's Calculations, Central Bank of Ireland

Note: SMEs are defined as enterprises with fewer than 250 employees and whose annual turnover does not exceed €50 million and/or whose annual balance sheet does not exceed €43 million. This is the standard EU definition of an SME.

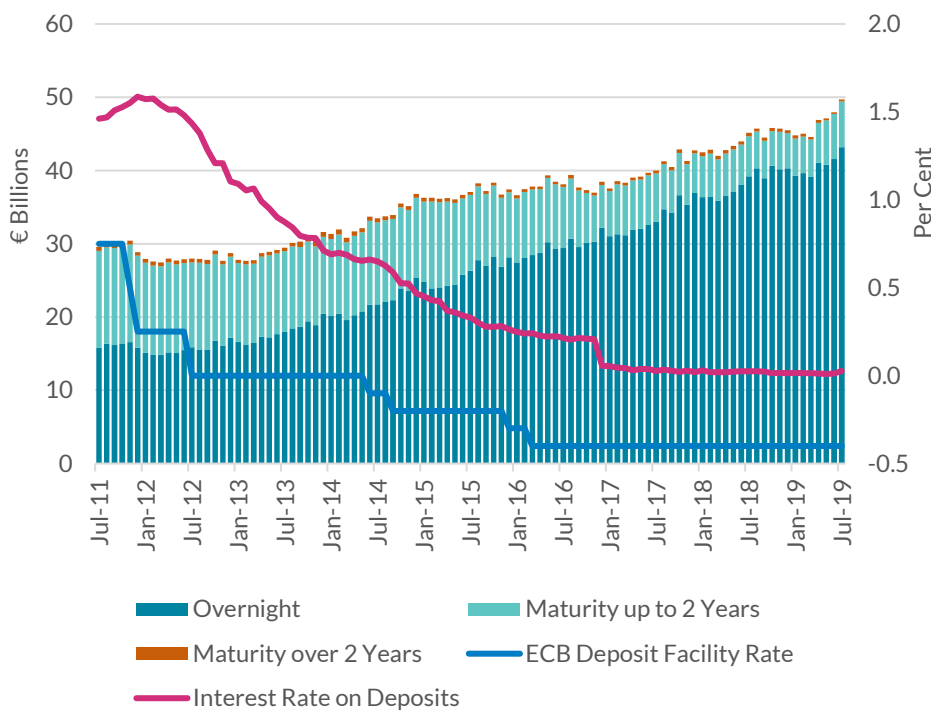
**Chart 14: Loans to NFCs; Net Flows (12-Month Sum) by Original Maturity Category**



Growth in annual net lending to NFCs slowed in July 2019.

Source: [Loans to Irish Private Sector Statistics](#), Central Bank of Ireland

**Chart 15: Deposits of Irish NFCs by Category of Deposits**

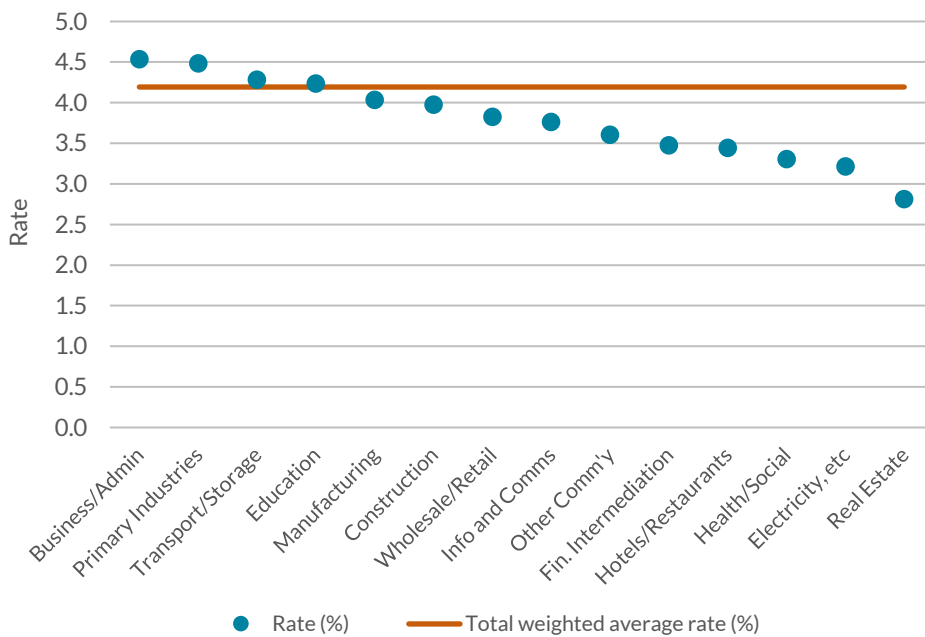


Deposits from NFCs continue to increase. This growth is driven by deposits of overnight maturity.

Source: [Bank Balance Sheet Statistics](#), Central Bank of Ireland

Note: Interest rate on deposits is a weighted average across maturity categories.

**Chart 16: SME New Lending Interest Rates by Business Sector, Q2 2019**



Business and Administration Services and Primary Industries SMEs saw the highest interest rates for new lending in Q2 2019.

Source: [SME and Large Enterprise Credit and Deposits](#), Central Bank of Ireland

Chart 17: Gross New Lending to SMEs, Q2 2019

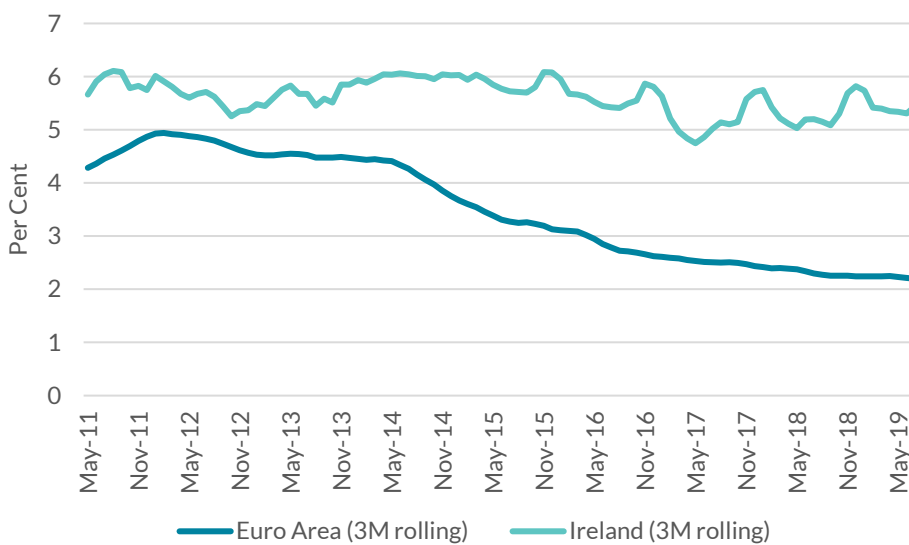


Real Estate Activities received the greatest amount of new lending in Q2 2019.

Source: [SME and Large Enterprise Credit and Deposits](#), Central Bank of Ireland

Note: Other includes Education, Information & Communications, Electricity, Gas, Steam and Air Conditioning Supply

Chart 18: Interest Rates on Small Loans to Non-financial Corporations



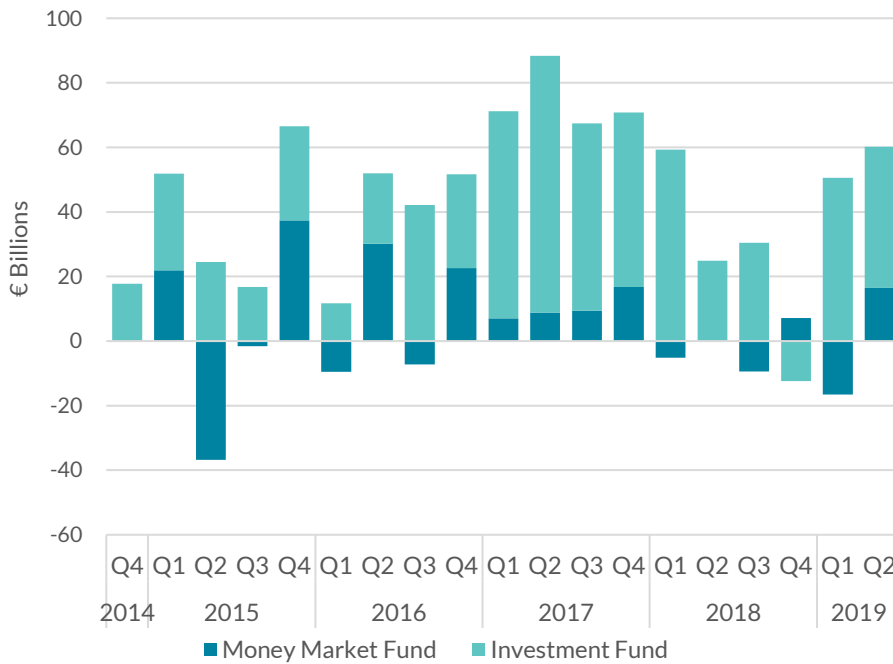
Irish NFCs face higher funding costs than the euro area average for bank loans.

Source: [Bank Interest Rate Statistics](#), ECB Statistical Data Warehouse

Note: Only includes interest rates charged on new bank lending to NFCs of amount <€250k

## Non-Bank Financial Sector

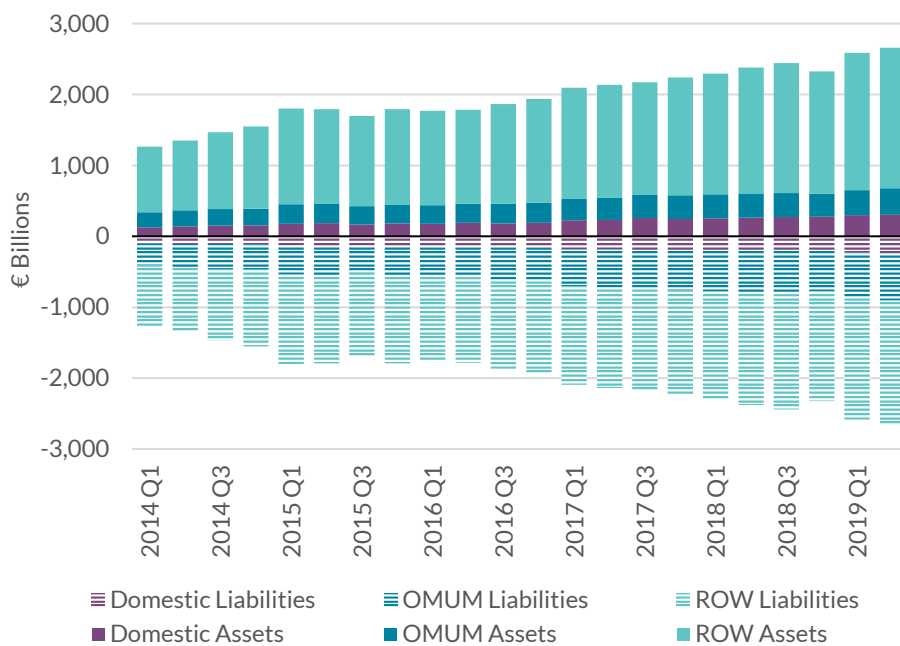
Chart 19: Net Subscriptions of Money Market and Investment Funds



Investment Funds continued to see strong inflows in the first half of 2019.

Source: [Investment Funds Dataset](#), Money Market Funds Dataset, Central Bank of Ireland

Chart 20: Total Assets and Liabilities of Investment Funds - by Region

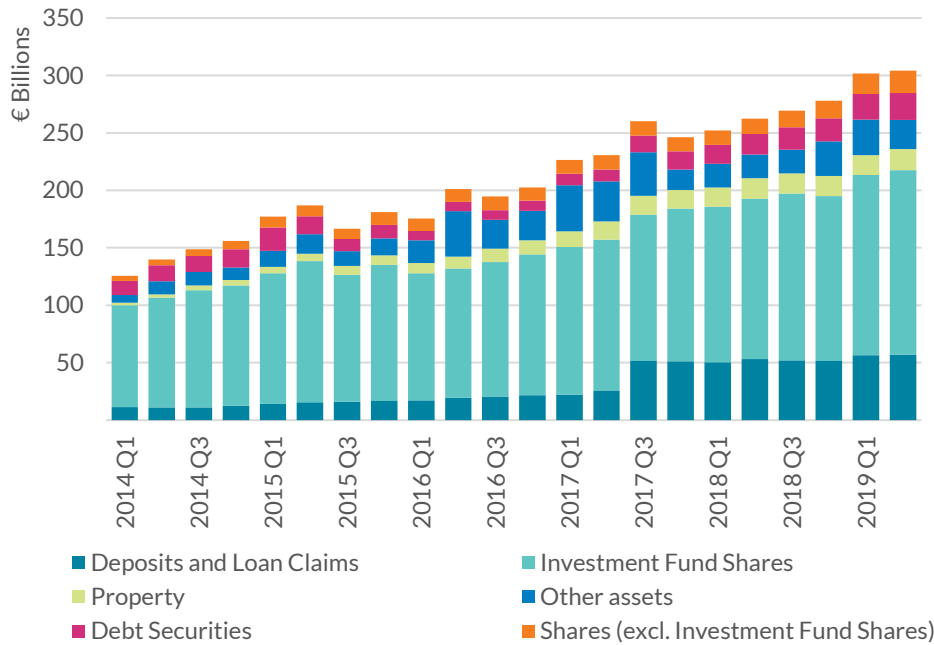


Investment funds are mainly used by foreign investors to invest in foreign assets.

Source: [Investment Funds Dataset](#), Central Bank of Ireland

Note: OMUM= Other Monetary Union Member, ROW=Rest of World.

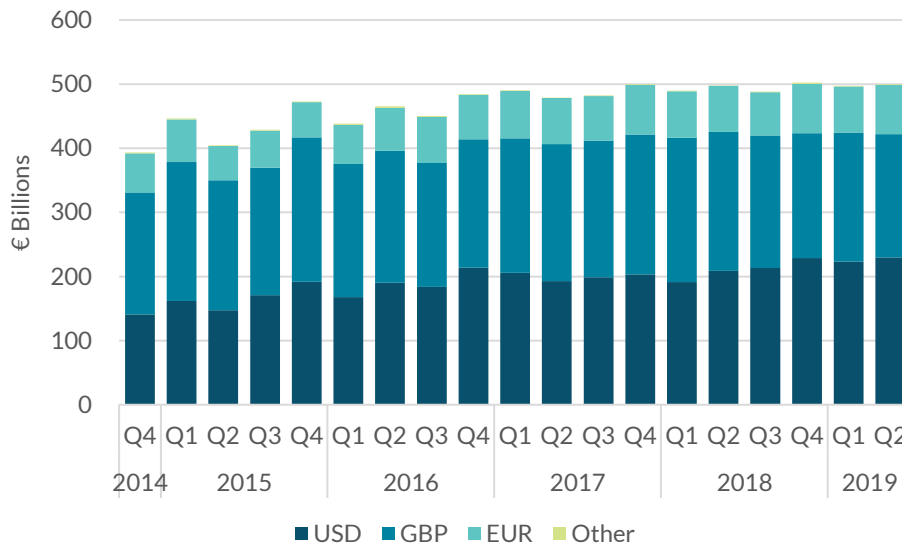
**Chart 21: Total Irish Assets of Irish Resident Investment Funds, by Asset Class**



Investment in other Irish funds constitutes the majority of Irish assets held by Irish resident investment funds.

Source: [Investment Funds Dataset](#), Central Bank of Ireland

**Chart 22: Total Assets of Money Market Funds, by Currency**



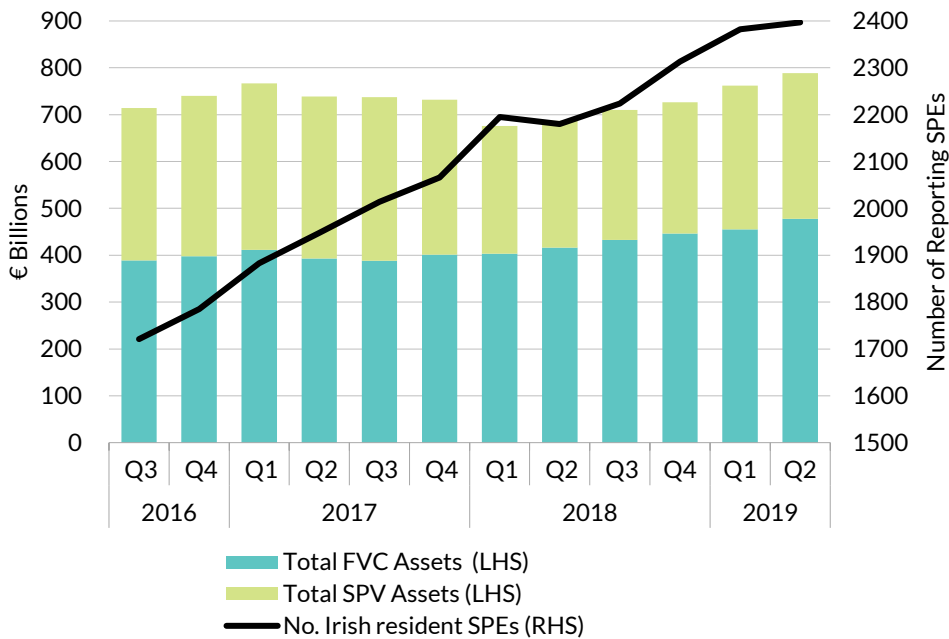
Money Market Funds mainly satisfy demand from GBP and USD investors.

Source: [Money Market Funds Dataset](#), Central Bank of Ireland

Note: Source excludes other assets and equity held by money market funds, and thus does not exactly match chart.



**Chart 23: Total Assets and Number of Irish Resident SPEs**

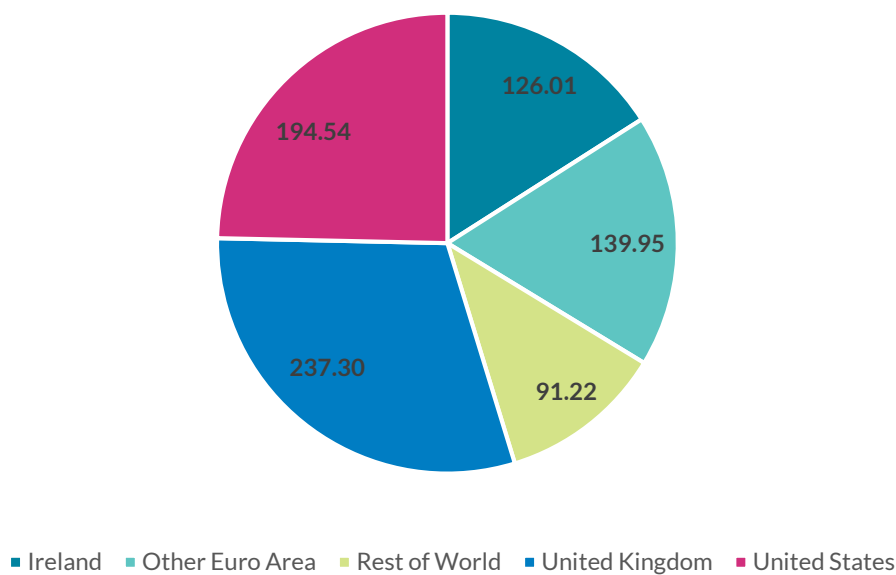


The growth in the total assets of special purpose entities outpaced the growth in the number of entities in Q2 2019.

Source: [Special Purpose Entities Dataset](#), Central Bank of Ireland

Note: A Special Purpose Entity (SPE) is a legal entity created to fulfil narrow, specific or temporary objectives. The population of SPEs consists of FVCs (Financial Vehicle Corporations) and SPVs (Special Purpose Vehicles).

**Chart 24: Total SPE assets by sponsor region in Q2 2019, € billions**

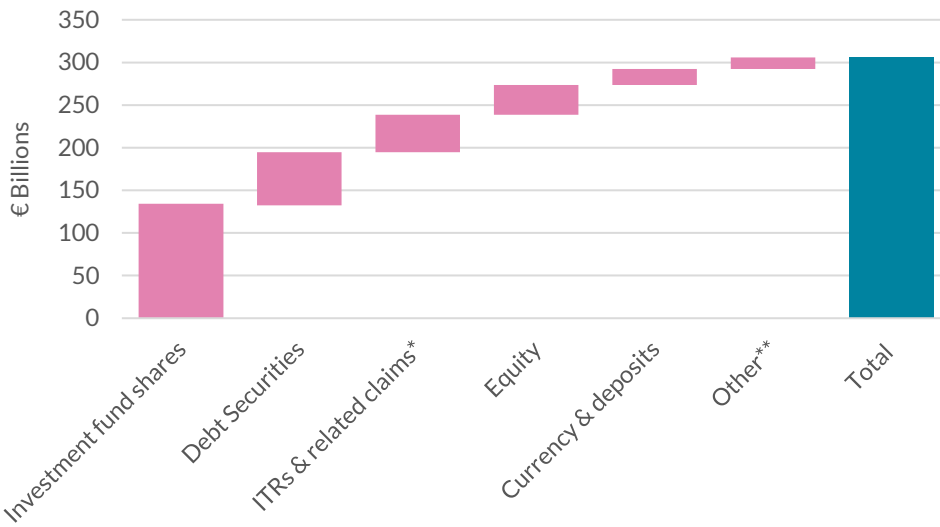


United Kingdom and United States sponsors have set up the majority of SPEs (by assets).

Source: [Special Purpose Entities Dataset](#), Central Bank of Ireland; Authors own calculations

Note: The sponsor of an SPE is the institution that has set it up.

**Chart 25: Irish Insurance Corporations (ICs) Financial Instrument breakdown, Q4 2018**



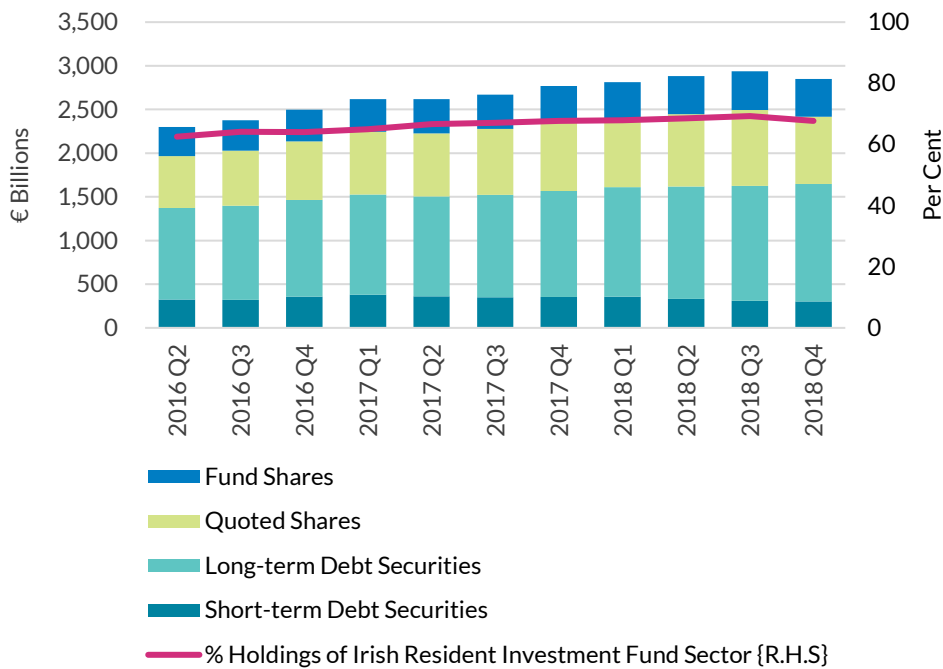
Insurance Corporations predominantly hold Investment Fund Shares.

Source: [Insurance Corporation Statistics](#), Central Bank of Ireland.

Note: \*Insurance Technical Reserves and Related Claims. \*\*Other includes Loans and Financial Derivatives.

## Other Statistics

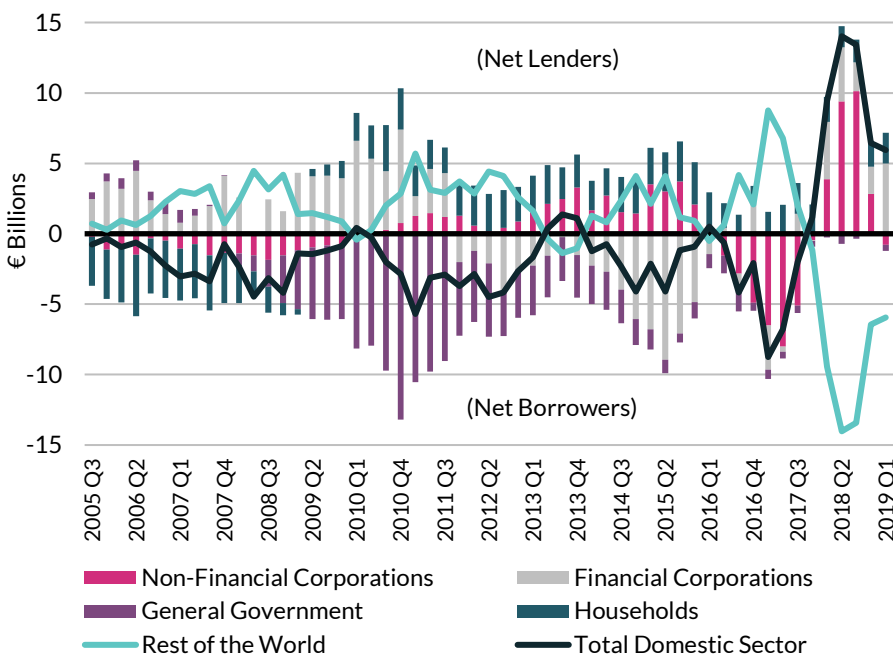
Chart 26: Total Securities Holdings of Irish Residents



Investment Funds hold the majority of debt and equity held by Irish residents.

Source: [Securities Holdings Statistics](#), Central Bank of Ireland, Author's calculations

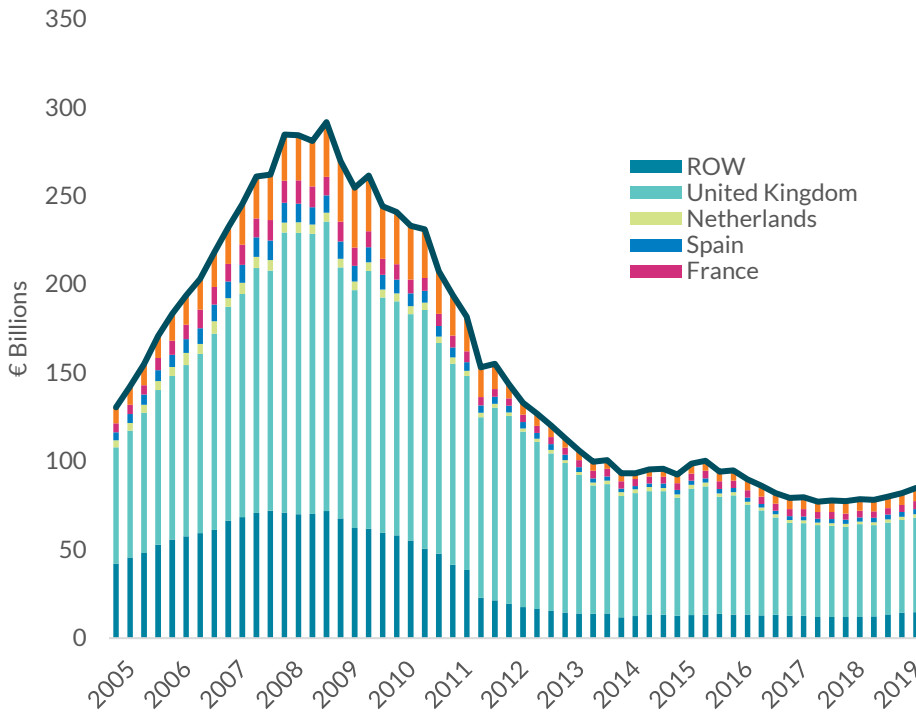
Chart 27: Net lending/borrowing of Irish residents (4 quarter moving average)



Net lending by the domestic economy decreased by €0.5bn Q1 2019.

Source: [Quarterly Financial Accounts](#), Central Bank of Ireland

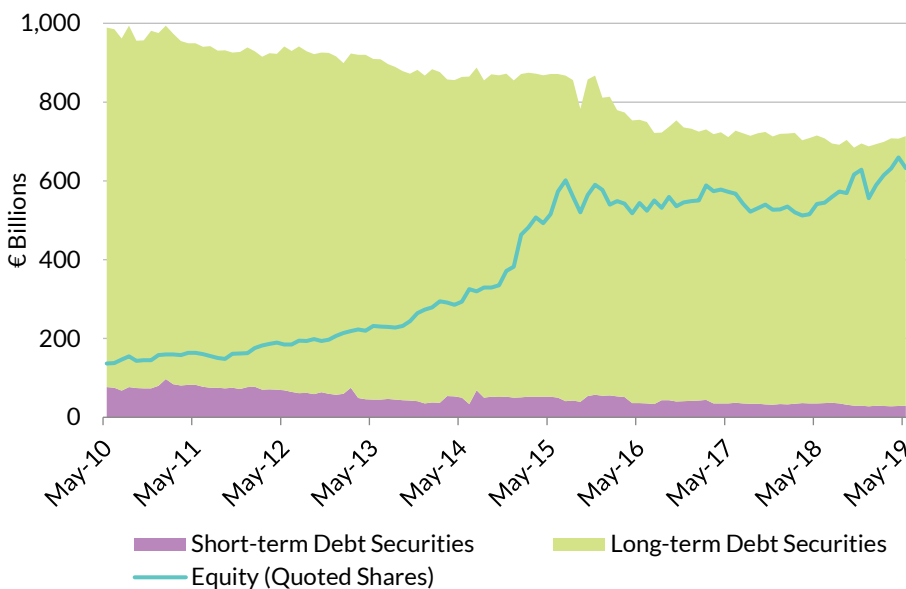
**Chart 28: Location of Irish Foreign Claims**



Domestic banks' largest foreign claims continue to be on the United Kingdom.

Source: [Consolidated Banking Statistics](#), Central Bank of Ireland

**Chart 29: Issuance of Debt and Equity by Irish Financial and Non-Financial Corporations**

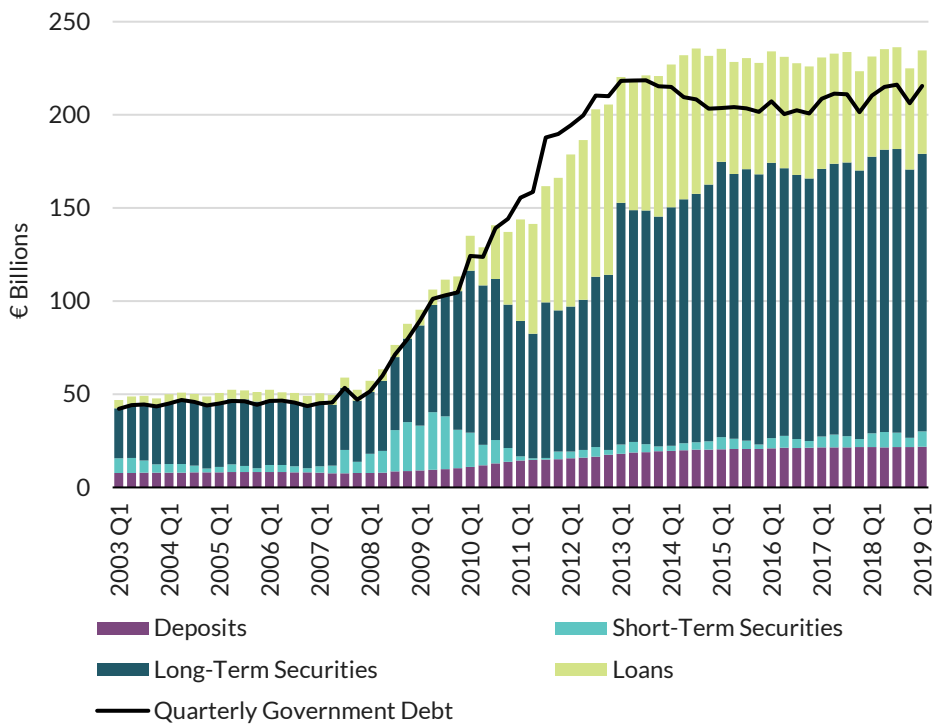


The gap between the total equity and total debt issued by Irish financial and non-financial corporations continues to narrow.

Source: [Securities Issue Statistics](#), Central bank of Ireland

## Government Sector

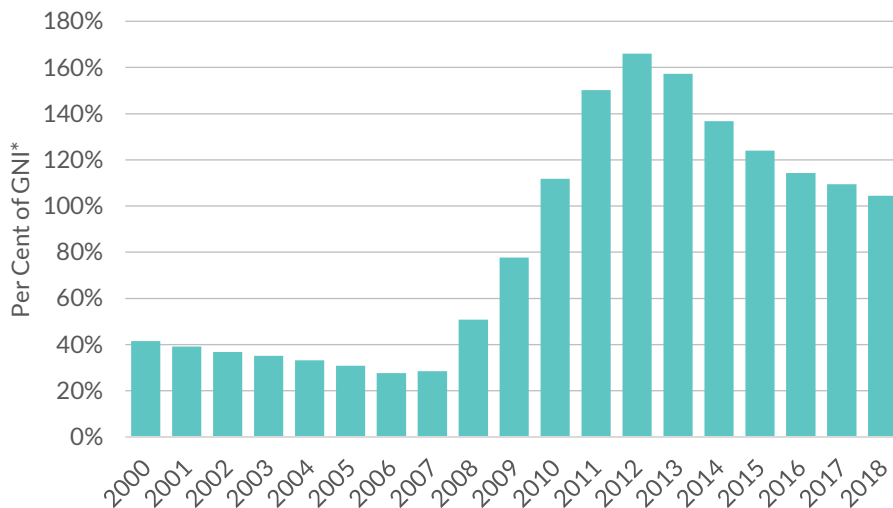
Chart 30: Irish Government Debt - by Category



Quarterly Government Debt rose by €9.3bn to €215.5bn in Q1 2019.

Source: [Quarterly Financial Accounts](#), Central Bank of Ireland

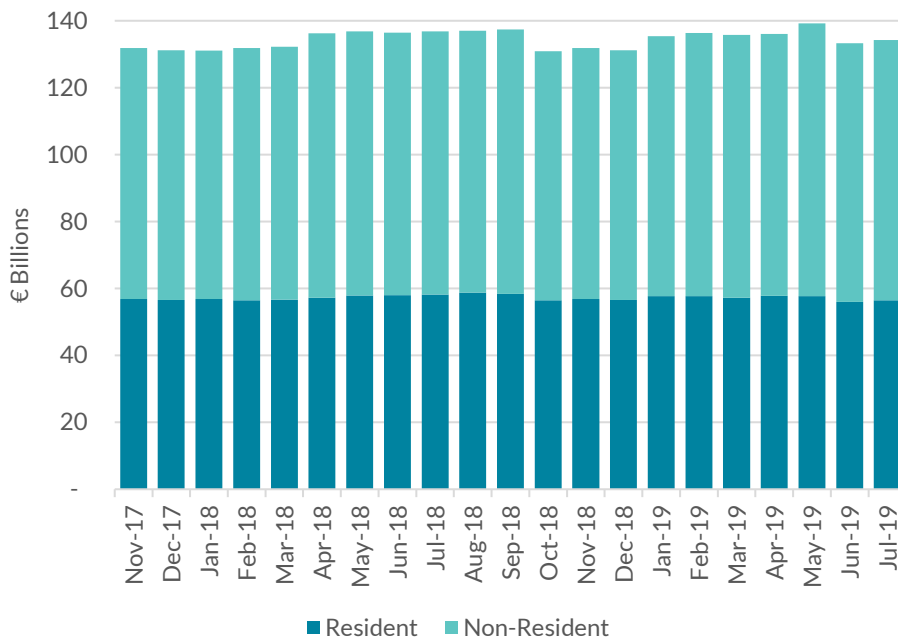
Chart 31: Irish Government Debt-to-GNI\*



The ratio of General Government Debt to GNI\* was 104 per cent in 2018.

Source: [Annual Government Financial Statistics](#) and [National Income and Expenditure Results](#), Central Statistics Office

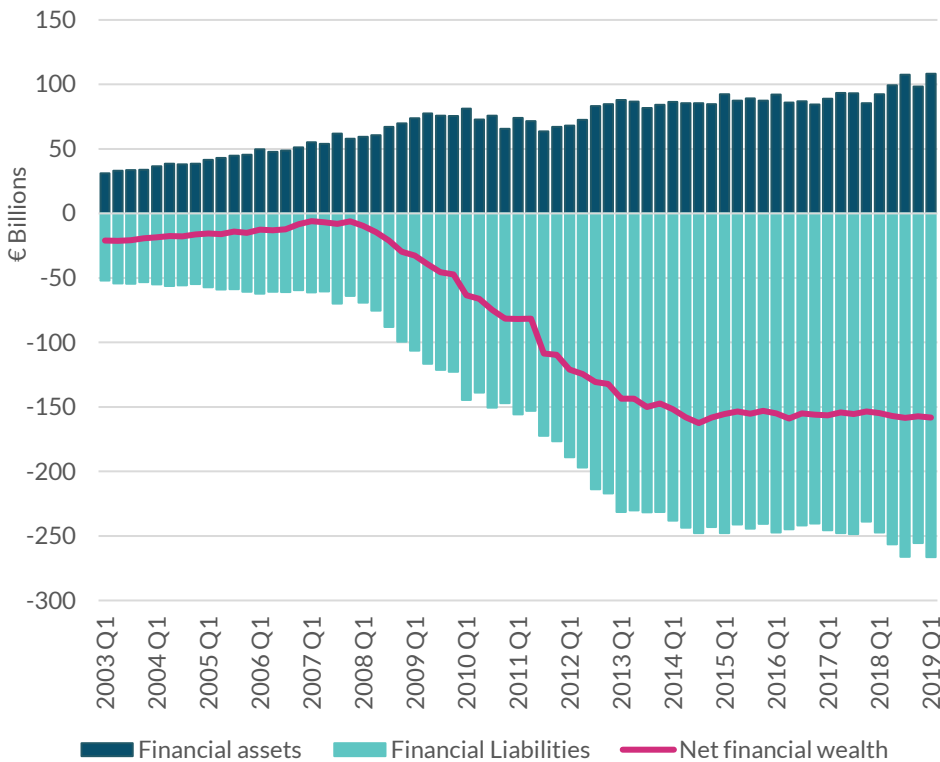
**Chart 32: Breakdown of Holders of Government Bonds**



Non-resident investors' holdings of Irish government bonds increased by €1bn to €78bn in July 2019.

Source: [Holdings of Long Term Government Bonds](#), Central Bank of Ireland

**Chart 33: Government Net Financial Wealth**



Government net financial wealth fell by €0.8bn during Q1 2019 as the increase in liabilities outstripped the increase in financial assets.

Source: [Quarterly Financial Accounts](#), Central Bank of Ireland

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