Banc Ceannais na hÉireann
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Contents

Notes

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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:

e	**estimated**
n.a.	**not available**
p	**provisional**
. .	**no figure to be expected**
r	**revised**
–	**nil or negligible**
q	**quarter**
f	**forecast**

7. Data on euro exchange rates are available on our website at www.centralbank.ie and by telephone at +353 (0)1 224 6380.

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Comment

The economy overall was in a good position in the opening months of 2022. However, the Russian invasion of Ukraine has sparked a chain of events that presents significant challenges to the outlook for inflation and growth. Although the economy is still projected to grow, the central outlook is for a slower pace of expansion with markedly higher inflation over the short term than previously expected. Uncertainty around the outlook has also increased as a result of the conflict, compared with the situation at the time of the last *Bulletin* in January. While the economic recovery from the most acute effects of the COVID-19 pandemic has been robust, the path to a permanently less disruptive existence with the virus has been complicated by recent developments.

While the Russian invasion of Ukraine is first and foremost a humanitarian tragedy for the Ukrainian people, the economic consequences of the war are being felt across Europe. Direct trade links between Ireland and Russia, and Ireland and Ukraine are very low overall, but exposure on the import side is relatively important for coal, fertiliser and some cereals. However the implications of what is essentially a global supply-side shock, occur through the wider importance of both countries for energy, food and metal commodity markets. Coming during a period already characterised by pandemic-related supply-chain constraints, the European growth and inflation outlook has worsened as a result of the war. As a small, open economy, dependant on imported energy and fuel products, Ireland is not immune to these developments. The prospect of weaker foreign demand and more challenging conditions for domestic consumption and investment activity clouds what would otherwise be a favourable outlook for the Irish economy.

Both the sharp increase and volatility of commodity prices since the outbreak of the war is being reflected in current and prospective price developments for Irish households and businesses to varying degrees. While rising energy prices were already a driver of headline inflation since mid-2021, recent developments mean that consumer price inflation in Ireland will peak at a higher level than previously anticipated in 2022, and may mean that prices stay at higher levels for longer. Alongside energy, food prices are also likely to rise more substantially over the coming months. The experience of the currently high rates of inflation is not uniform across the economy. Cost of living increases from higher food and energy prices tend to be larger for lower income, older and rural households, who typically spend more of their weekly outgoings on these products.[1] More domestically determined inflation has in the past year been driven mainly by rents. As price increases are concentrated in goods and services that are more difficult to substitute or to avoid consuming, the reduction in real incomes expected for the Irish household sector this year will likely lead to lower consumption growth than previously expected.

Given that energy is an input to all aspects of economic activity, a key challenge for businesses will be the ability to absorb higher input costs without either increasing prices for their customers, or cutting back on production. This may be particularly difficult for businesses and sectors that have yet to fully recover from the restricted trading conditions that arose during the pandemic. However, the extended supply-side shock now occurring is driving up input costs for raw materials in key sectors such as construction. The existing challenges in terms of housing supply are further highlighted given the additional demand that will necessarily and appropriately have to be met to accommodate refugees displaced by the war in Ukraine. Combined with labour supply gaps in the construction sector, the increasing costs of production raise obstacles to the delivery of housing and other infrastructure investment over the short-to-medium term.

The adjustment of the labour market through the pandemic has been testament to the strength of the recovery. With numbers employed now exceeding 2019 levels and the standard ILO unemployment rate already at circa 5 per cent, attention turns to the full unwinding of Covid-19 employment supports in a more challenging non-pandemic-related environment than previously envisaged. Approximately 10 per cent of workers are in jobs supported by the EWSS, most notably in the Accommodation and Food services sector. Enabling continued employment in viable firms, while at the same time supporting a sustainable flow of labour into sectors with high demand, will be important in achieving sustainable growth. Despite the challenging conditions, a tightening labour market is expected over the forecast horizon, and in that context broader-based wage growth consistent with economic fundamentals is welcome, especially as real incomes will likely fall this year. However, where growth in wages or profits

[1] Lydon (2022).

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respond entirely to the currently high rates of inflation, or are detached from underlying productivity growth, the likelihood increases that harmful higher inflation becomes embedded.

The war in Ukraine raises many issues for the outlook and conduct of domestic economic policy, spanning the immediate humanitarian response for those displaced by the war, mitigating the economic impact on the most vulnerable Irish households, and addressing medium-to-longer term implications. This has to be achieved alongside addressing already existing priorities that raise demands on government resources, such as housing, climate action and the long-term costs of an ageing population. With the economy and labour market performing well over recent months, the public finances are well positioned to address the most immediate needs. It is appropriate for fiscal policy to reduce the impact of higher inflation on those households less able to cope with current circumstances through targeted and temporary measures. With the public finances in a deficit position following COVID-19, this additional expenditure will be funded by borrowing. If, for any reason, these measures became quasi-permanent, appropriate funding through current resources would have to be considered to avoid introducing a structural vulnerability in the public finances. To ensure that the economy and public finances remain on a sustainable path over the medium term, the composition of fiscal policy may have to be adjusted to avoid excessive inflationary pressures domestically, while simultaneously addressing the known priorities in housing and climate action for the community as a whole during a period of higher than expected inflation globally. Tax and expenditure measures that more explicitly support supply-side conditions and builds resilience to future shocks across the economy and public finances, are a more immediate priority the longer energy and other commodity prices are expected to remain high.

An Timpeallacht Gheilleagrach

Bhí ag éirí go maith leis an ngeilleagar tríd is tríd sna míonna ag tús na bliana 2022. Ach spreag ionradh na Rúise ar an Úcráin sraith teagmhas a chruthaíonn dúshláin shuntasacha don ionchas maidir le boilsciú agus fás. Cé go dtuartar go fóill go dtiocfaidh fás ar an ngeilleagar, meastar san ionchas príomha go mbeidh luas an leathnaithe níos moille ná mar a measadh roimhe seo agus go mbeidh boilsciú i bhfad níos airde ann sa ghearrthéarma. Tá an éiginnteacht faoin ionchas méadaithe go mór freisin mar gheall ar an gcoimhlint, i gcomparáid leis an staid a bhí ann nuair a foilsíodh an *Fhaisnéis Ráithiúil* deiridh i mí Eanáir. Cé go raibh téarnamh eacnamaíoch láidir ó na héifeachtaí ba ghéire a bhí ag paindéim COVID-19, tá an chonair i dtreo staid níos socra ó thaobh an víris de éirithe níos casta mar gheall ar na forbairtí le déanaí.

Thar gach ní eile is tragóid dhaonnúil do mhuintir na hÚcráine é ionradh na Rúise ar an Úcráin, ach tá iarmhairtí eacnamaíocha an chogaidh le brath ar fud na hEorpa freisin. Is beag nasc díreach trádála atá ann ar an iomlán idir Éire agus an Rúis, agus idir Éire agus an Úcráin, ach tá neamhchosaint ó thaobh allmhairí de tábhachtach maidir le gual, leasachán agus gránaigh áirithe. Cé gur turraing don soláthar domhanda í dáiríre, éiríonn iarmhairtí na turrainge sin as an tábhacht níos leithne a bhaineann leis an dá thír sin do na margaí fuinnimh, bia agus tráchtearraí miotail. Ó tharla go bhfuil sé seo ag tarlú i ndiaidh tréimhse ina raibh constaicí ar shlabhraí soláthair de bharr na paindéime, tá an t-ionchas don fhás agus don bhoilsciú Eorpach imithe in olcas de thoradh an chogaidh. Mar gheilleagar beag oscailte a bhíonn ag brath ar tháirgí allmhairithe fuinnimh agus breosla, níl Éire slán ó na forbairtí seo. Leis an ionchas d'éileamh eachtrach níos laige, mar aon le dálaí níos dúshlánaí do thomhaltas intíre agus do ghníomhaíocht infheistíochta, fágtar smál ar an ionchas do gheilleagar na hÉireann a bheadh fabhrach murach sin.

Tá an méadú géar ar phraghsanna tráchtearraí agus luaineacht na bpraghsanna sin ó thús an chogaidh á léiriú sna forbairtí ar phraghsanna

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reatha agus ar phraghsanna ionchasacha do theaghlaigh agus do ghnóthaí na hÉireann. Cé go raibh an boilsciú príomha á spreagadh ag praghsanna ardaitheacha fuinnimh cheana féin ó lár 2021 i leith, ciallaíonn na forbairtí atá feicthe le déanaí go mbainfidh boilsciú ar phraghsanna do thomhaltóirí in Éirinn buaicphointe níos airde amach in 2022 ná mar a tuaradh roimhe seo, rud a chiallaíonn go bhfanfaidh praghsanna ag leibhéil níos airde go ceann tréimhse níos faide. Mar aon le fuinneamh, is dócha go mbeidh méadú suntasach ar phraghsanna bia sna míonna atá le teacht. Ní hionann an taithí ar rátaí arda reatha an bhoilscithe ar fud an gheilleagair. Go hiondúil, bíonn na méaduithe ar chostas maireachtála ó phraghsanna níos airde bia agus fuinnimh níos measa do theaghlaigh ísealioncaim, do theaghlaigh níos sine agus do theaghlaigh tuaithe, toisc go gcaitheann na teaghlaigh sin cion níos mó dá n-eisíocaíochtaí ar na táirgí sin.[2] Le bliain anuas, bhí boilsciú ón taobh intíre á spreagadh don chuid is mó ag cíosanna. Ó tharla go bhfuil méaduithe praghsanna dírithe ar earraí agus ar sheirbhísí a bhfuil sé deacair earraí nó seirbhísí eile a chur ina n-ionad nó a bhfuil sé deacair a dtomhaltas a sheachaint, is dócha go mbeidh fás níos ísle ar thomhaltas ná mar a measadh roimhe seo mar gheall ar an laghdú ar fhíorioncam atá á thuar d'earnáil na dteaghlach in Éirinn i mbliana.

Ó tharla go bhfuil fuinneamh ina ionchur do gach gníomhaíocht eacnamaíoch, príomhdhúshlán a bheidh ann do ghnóthaí a gcumas costais níos airde ionchuir a iompar gan praghsanna a ardú dá gcustaiméirí nó gan gearradh siar ar tháirgeadh. D'fhéadfadh go mbeadh sé seo fíordheacair ar ghnóthaí agus earnálacha nach bhfuil tagtha chucu féin go fóill ó na dálaí srianta trádála a tháinig chun cinn le linn na paindéime. Ar a shon sin, tá méadú ar chostais ionchuir le haghaidh amhábhar i bpríomhearnálacha amhail foirgníocht á spreagadh ag an turraing atá ann faoi láthair ar thaobh an tsoláthair. Leagtar béim bhreise ar na dúshláin reatha atá ann maidir le soláthar tithíochta i bhfianaise an éilimh bhreise nach mór freastal air go cuí chun cóiríocht a chur ar fáil do theifigh a easáitíodh de bharr an chogaidh san Úcráin. I dteannta bearnaí i soláthar saothair san earnáil foirgníochta, cruthaíonn costais mhéadaitheacha táirgthe constaicí ar sholáthar infheistíochta i dtithíocht agus i mbonneagar eile sa ghearrthéarma agus sa mheántéarma.

Léiriú ar neart an téarnaimh is ea an coigeartú ar an margadh saothair le linn na paindéime. Ó tharla gur mó líon na ndaoine atá i bhfostaíocht anois ná leibhéil 2019, agus ó tharla gurb ionann agus 5 faoin gcéad ráta

[2] Lydon (2022).

caighdeánach dífhostaíochta ILO, is féidir aird a dhíriú anois ar thacaíochtaí fostaíochta COVID-19 a scaoileadh go hiomlán i dtimpeallacht neamhphaindéime atá níos dúshlánaí ná mar a ceapadh roimhe seo. Tá tuairim is 10 faoin gcéad d'oibrithe i bpoist a bhfuil SFPF mar thacaíocht leo, go mór mór in earnáil na seirbhísí Cóiríochta agus Bia. D'fhonn fás inbhuanaithe a bhaint amach, beidh sé tábhachtach fostaíocht leanúnach i ngnólachtaí inmharthana a chumasú, agus tacú ag an am céanna le sreabhadh inbhuanaithe saothair chuig earnálacha ina bhfuil éileamh ard. D'ainneoin na ndálaí dúshlánacha, meastar go mbeidh teannadh ar an margadh saothair thar thréimhse na réamhaisnéise, agus sa chomhthéacs sin, fáiltítear roimh fhás pá a mbeidh bonn níos leithne faoi i gcomhréir le bunphrionsabail eacnamaíocha, go háirithe toisc gur dócha go laghdóidh ioncam réadach i mbliana. Mar sin féin, i gcás ina mbeidh fás ar phánna nó ar bhrabúis ag freagairt go hiomlán do rátaí arda reatha an bhoilscithe, nó i gcás ina mbeidh siad scartha ó bhunfhás táirgiúlachta, méadaítear an dóchúlacht go leabófar boilsciú dochrach níos airde.

Tarraingníonn an cogadh san Úcráin ceisteanna maidir le hionchas agus seoladh an bheartais eacnamaíoch intíre, ina gcuimsítear an fhreagairt láithreach daoncharadais le haghaidh na ndaoine sin a easáitíodh de bharr an chogaidh, an tionchar eacnamaíoch ar na teaghlaigh is leochailí in Éirinn a mhaolú, agus dul i ngleic leis na himpleachtaí meántéarmacha agus fadtéarmacha. Ní mór é seo a dhéanamh agus aghaidh á tabhairt ag an am céanna ar thosaíochtaí reatha a chuireann éilimh ar acmhainní rialtais, amhail tithíocht, gníomhú ar son na haeráide agus na costais fhadtéarmacha a bhaineann le daonra atá ag dul in aois. Ó tharla go bhfuil an geilleagar agus an margadh saothair ag feidhmiú go maith le míonna beaga anuas, tá an t-airgeadas poiblí in áit mhaith chun dul i ngleic leis na riachtanais is géire. Le beartas fioscach, is iomchuí go laghdófar an tionchar a bhíonn ag boilsciú níos airde ar na teaghlaigh sin ar lú a gcumas déileáil leis na dálaí reatha trí bhíthin bearta spriocdhírithe sealadacha. Toisc go bhfuil an t-airgeadas poiblí i staid easnaimh i ndiaidh COVID-19, maoineofar an caiteachas breise seo trí iasachtú. Más rud é, ar aon chúis, go dtiocfaidh na bearta seo chun a bheith gar-bhuan, níor mhór maoiniú iomchuí trí acmhainní reatha a bhreithniú d'fhonn leochaileacht struchtúrach san airgeadas poiblí a sheachaint. Chun a chinntiú go bhfanfaidh an geilleagar agus an t-airgeadas poiblí ar chonair inbhuanaithe sa mheántéarma, b'fhéidir go mbeidh gá le coigeartú ar chomhdhéanamh an bheartais fhioscaigh d'fhonn brúnna boilscitheacha iomarcacha intíre a sheachaint, fad a rachfar i ngleic leis na tosaíochtaí aitheanta ó thaobh

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tithíochta agus gníomhú ar son na haeráide don phobal i gcoitinne le linn tréimhse ina bhfuil boilsciú domhanda níos airde ann ná mar a bhíothas ag súil leis. Dá fhaide a bheidh praghsanna arda fuinnimh agus tráchtearraí ann, is ea is géire an tosaíocht go nglacfar bearta cánach agus caiteachais a thacóidh go soiléir le dálaí soláthair agus a chothóidh athléimneacht in aghaidh turraingí amach anseo ar fud an gheilleagair agus an airgeadais phoiblí.

The Irish Economy

Overview

The Irish economy has continued to recover strongly from the effects of the pandemic, but the economic impacts of the Russian invasion of Ukraine will weigh on growth. The economy began 2022 with strong growth momentum from the lifting of pandemic restrictions. However, higher inflation, the result of sharply rising energy and higher food prices, as well as greater uncertainty and negative consumer confidence effects, all imply headwinds to growth. Accordingly, modified domestic demand growth has been revised down to 4.8 per cent in 2022, 4.3 per cent in 2023 and 3.9 per cent in 2024 (Figure 1).

The conflict will also reduce growth in Ireland's trading partners. Estimates suggest that the conflict will reduce euro-area GDP by 1.5 per cent by the end of 2023. While Ireland's direct trade links with Ukraine and Russia are small, there will be an impact on demand in our main trading partners and an increase in transport costs. Exports are forecast to grow by 8 per cent in 2022, 6.2 per cent in 2023 and 6 per cent in 2024.

Consumer price inflation is expected to average 6.5 per cent this year, the result of strong energy price inflation that is also passing through to increases in core HICP (excluding energy). Wholesale energy prices are the primary factor driving inflation at present, with financial markets expecting them to decline in the second half of the year but remain above 2021 levels over the course of our forecast horizon. Conditional on these assumptions, inflation is forecast to slow to 2.8 per cent in 2023 and 2.1 per cent in 2024 (Figure 2).

Personal consumption will continue to grow as household spending patterns normalise in the absence of public health restrictions, but the reduction in real incomes from higher inflation will be a drag on spending in the coming quarters. High frequency indicators show that the first quarter saw a strong rebound in spending and activity as restrictions eased. Over the forecast horizon, consumption is forecast to grow by 7.4 per cent this year, slowing to 4.7 per cent and 3.9 per cent in 2023 and 2024, respectively.

The increase in uncertainty and disruption to supply chains will constrain investment growth this year and next. While planning permissions and commencements indicate a strong pickup in construction this year, higher

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materials costs and labour shortages are forecast to constrain growth in the sector over the forecast horizon. The conflict in Ukraine, as well as lockdowns in China in the first quarter, will act to exacerbate strains on global supply chains. Modified investment is forecast to grow by 4 per cent this year, slowing to 6.9 per cent and 7 per cent in 2023 and 2024.

Both the deficit and debt position of the Government started 2022 in a better position than previously anticipated, with further improvement expected over the forecast horizon. A General Government surplus is expected to emerge next year, rising to 1.9 per cent of GNI* in 2024. Meanwhile General Government Debt is forecast to be 84.7 per cent of GNI* in 2024.

The risks to the growth outlook are tilted to the downside. The baseline forecast is conditional on market expectations of the future price of energy and other commodities. A larger or a more protracted energy shock would result in lower growth and higher inflation than outlined in the baseline forecast (see Box A).

Table 1: Macroeconomic Projections for the Irish Economy

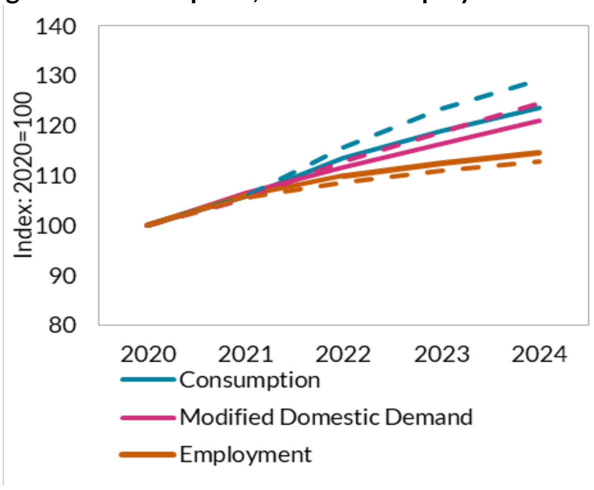
(annual percentage changes – constant prices)

	2021e	2022f	2023f	2024f
Modified Domestic Demand	6.5	4.8	4.3	3.9
Gross Domestic Product	13.5	6.1	5.5	5.9
Personal Consumer Expenditure	5.7	7.4	4.7	3.9
Public Consumption	5.3	-0.9	0.3	0.7
Gross Fixed Capital Formation	-37.6	3.5	5.9	6.1
Modified Gross Fixed Capital Formation	9.7	4.0	6.9	7.0
Exports of Goods and Services	16.6	8.0	6.2	6.0
Imports of Goods and Services	-3.7	7.8	5.9	5.1
Total Employment (% change)	6.1	3.7	2.2	2.0
Unemployment Rate	6.3	6.0	5.4	5.0
Harmonised Index of Consumer Prices (HICP)	2.4	6.5	2.8	2.1
HICP Excluding Energy	1.5	4.3	3.3	2.4
Compensation per Employee	1.7	2.3	4.7	5.1
General Government Balance (% GNI*)	-3.5	-0.8	1.0	1.9
General Government Gross Debt (%GNI*)	101.4	91.8	88.7	84.7

1 . GDP is reported here, as it is the standard measure used in international comparison and forms Ireland's contribution to the Eurosystem staff projections. Caution should be used in interpreting GDP developments for Ireland, as it is heavily influenced by globalisation and the activities of multinational enterprises.
2. A more detailed set of forecasts are available on our website.

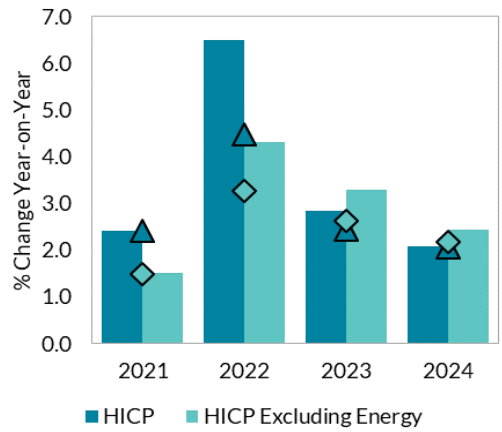
The economy will continue to grow strongly, and inflation will begin to moderate this year

Figure 1: Consumption, MDD and Employment



Source: CSO and Central Bank of Ireland
Note: Dashed lines indicate forecast from QB1 (Jan 2022)

Figure 2: HICP Inflation



Source: CSO and Central Bank of Ireland
Note: Markers indicate forecast from QB1 (Jan 2022)

Assessing the Implications of the War in Ukraine for the Irish Economy

The war in Ukraine is resulting in severe hardship and loss of life along with damage to Ukraine's physical infrastructure. With the situation changing rapidly, the implications for the economic outlook are extremely uncertain. Nevertheless, the economic consequences of the war are already serious, with energy and other commodity prices surging. This section provides an initial assessment of the implications of the war for Ireland's short-term economic outlook.

Exposures and Key Transmission Channels

The economic effect of the Russian invasion of Ukraine can be primarily characterised as a supply-side shock, leading to higher prices and lower availability of energy and other key commodities. A direct effect of higher international energy and other commodity prices on Irish inflation, real incomes and business costs, along with knock-on effects of higher inflation and slower growth in key trading partners, represent the main transmission channels of the Russia-Ukraine conflict to domestic economic growth.

In terms of direct trade links, the exposure of the Irish economy to both Russia and Ukraine is low. Russia accounts for around 0.3 per cent of all merchandise exports (€630 million in 2021) and 0.6 per cent of imports (€600 million).[3] Ireland also has a very small amount of direct trade with Ukraine with the country accounting for just 0.06 per cent of exports (€92 million) and 0.07 per cent of imports (€70 million). While this overall direct trade exposure is low, Russia and Ukraine account for a large share of Ireland's trade in a number of specific products. Ireland has a high exposure to Russian imports of coal (65 per cent of all Irish imports of coal, coke and briquettes come from Russia in 2021), fertiliser (25 per cent) and some wood products. Ireland has obtained 4-7 per cent of its fuel needs from Russia since 2017 (Figure 3). While direct imports are not substantial, wider supply and price effects will transmit through the international markets for energy and fuel.

For Ukraine, the main imports are cereals, with around 13 per cent of Ireland's maize imports coming from Ukraine. Ireland's services trade

[3] The Russian export ban, implemented in response to trade sanctions over the invasion of Ukraine, is unlikely to materially affect the Irish economy as it currently applies to only a very limited number of products imported to Ireland from Russia.

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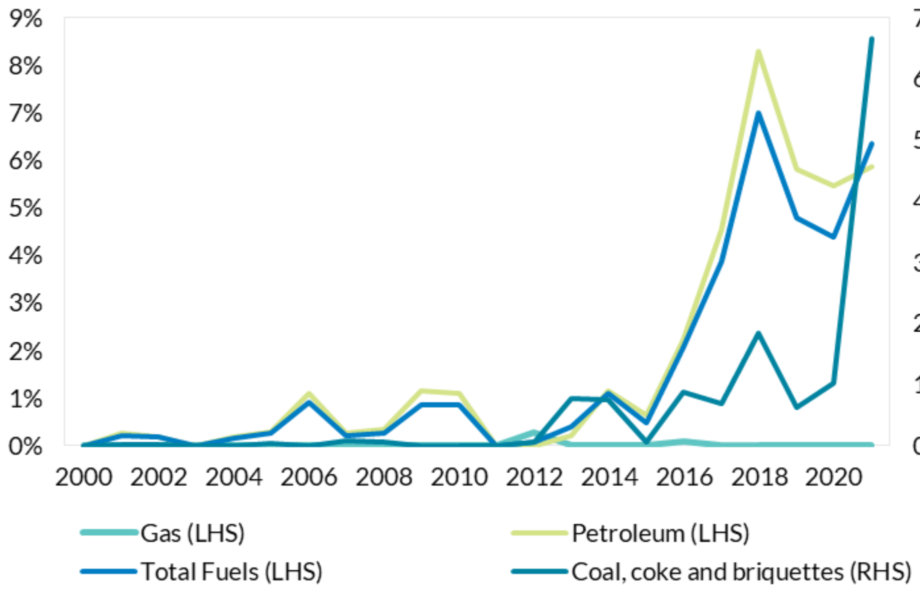
exposure to both Russia and Ukraine is very low. In 2020, 1.3 per cent of Ireland's services exports went to Russia with 0.3 per cent to Ukraine. Ireland's services imports from Russia and Ukraine are extremely small, less than 0.2 per cent of total services imports combined (see *Exports, Imports and Balance of Payments*).[4]

Irish reliance on Russia for most fuels is limited, but import dependence generally will cause prices to rise further in 2022 due to global market effects.

Figure 3: Irish imports of Russian fuels as a share of total fuel imports.



Source: Central Bank of Ireland calculations, using Eurostat IGTS data

The high share of Ireland's total imports of particular products that come from Russia and Ukraine could cause disruption in sectors that rely on these products as intermediate inputs. Shortages of fertiliser and maize, or the large increases in the price of these products over recent weeks, will have knock-on implications for the agriculture sector and, ultimately, food prices. The price and availability of some materials used in the construction sector is also likely to be affected by the war.

[4] While Russia accounts for a small proportion of services trade in overall terms, the aircraft leasing sector based in Ireland has more significant exposure to Russia. In 2018, the CSO reported that Russia accounted for 5.8 per cent of the operational leasing income generated by the sector in Ireland over a 10 year period. The aircraft leasing sector employed just under 2,000 people in Ireland in 2018. See: https://www.cso.ie/en/releasesandpublications/ep/p-ali/aircraftleasinginireland2018/

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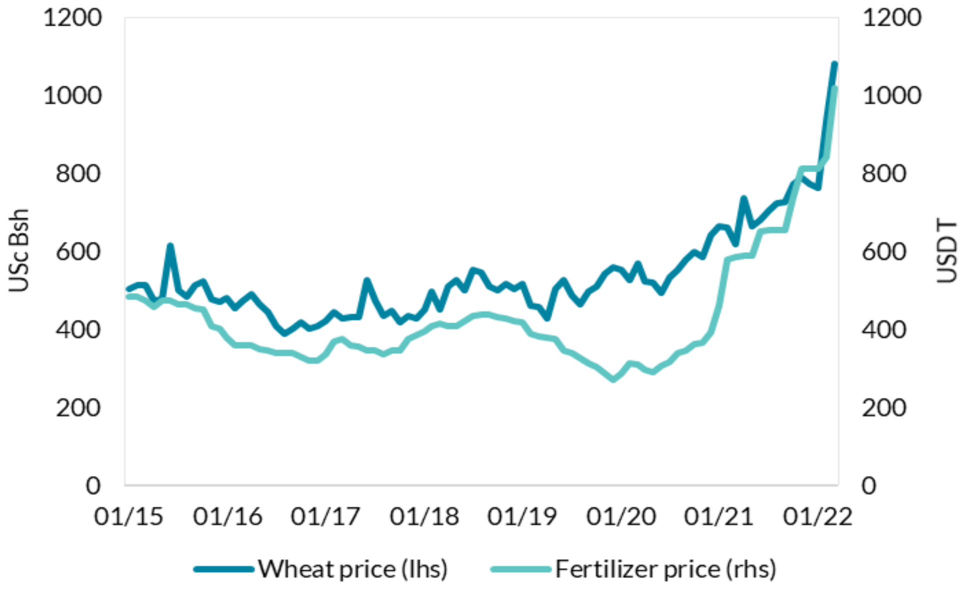
International Wheat and Fertiliser Prices have Soared since the Invasion

Figure 4: Wheat and Fertilizer Prices



Source: Refinitiv; Wv1 - CBoT Wheat Composite Commodity Future Continuation Month 1, DAP TAMPA-INDEX – Diammonium Phosphate Commodity Spot. USc Bsh is US Cent per bushel. USD T is US dollar per tonne.

Outside these direct trade effects on Ireland, Russia is the dominant energy provider to the EU, accounting for around one quarter of its oil and just under 45 per cent of its gas supplies in 2020.[5] As discussed below, energy prices have surged since the invasion from already high levels in early 2022, with the average benchmark prices of oil and gas in the first half of March increasing by 33 and 113 per cent respectively compared with their average levels in January. The increases in energy prices since the invasion comes on top of price rises already recorded in previous months and during 2021. These increases saw petrol, diesel and electricity prices in Ireland all rise by around 30 per cent on year-on-year basis in February 2022, before the impact of the war had been reflected.

Along with oil and gas, Russia and Ukraine account for a significant share of overall EU-28 and world trade in a number of other products such as fertiliser, cereals and certain metals. As shown in Figure 4, the international price of wheat and fertiliser increased by around 20 per cent and 100 per cent in 2021, respectively. This set a high base level for the

[5] See https://ec.europa.eu/eurostat/statistics-explained/index.php?title=EU_imports_of_energy_products_-_recent_developments#Main_suppliers_of_natural_gas_and_petroleum_oils_to_the_EU

further 40 and 50 per cent respective prices increase since the invasion. Given the importance of Russia and Ukraine as suppliers of these goods to the rest of the world and difficulty sourcing substitutes in the short run, disruption to the price and availability of these products will lower world trade and reduce demand for Irish exports. Along with the effect of higher energy prices, domestic production will also be negatively affected by increases in the cost and availability of these other imported inputs.

International growth forecasts have already been revised downwards and forecasts for inflation increased in response to the war (see Box B). In its staff macroeconomic projections published on 10 March, the ECB revised up HICP inflation for 2022 by 1.9 percentage points and revised down GDP growth for the euro area by 0.5p.p. Analysis by the National Institute for Economic and Social Research (NIESR) in the UK estimates that the war could increase euro area inflation in 2022 by around 2.5 p.p. and reduce GDP growth by almost 1 p.p.[6] These estimates were based on information available and judgements at a very early stage of the conflict. Weaker growth in Ireland's key trading partners (US, euro area and UK) along with higher energy and other commodity prices will spill over to the Irish economy in the form of a slower pace of economic activity and higher inflation relative to projections from before the outbreak of war.

In addition to its impact on trade and inflation, the war has also triggered other adverse effects in the wider economy and in financial markets. Since the invasion, economic uncertainty has increased and consumer and business sentiment has deteriorated.[7] These developments are likely to weigh on consumer spending and investment. Financial markets have also been negatively affected with declines in equity prices following the invasion in Europe, UK and US. Sovereign borrowing costs in the euro area and for Ireland have also increased.[8] There have also been significant movements in exchange rates, with the euro depreciating against the dollar. With oil priced in dollars, the fall in the value of the euro compounds the effect of the increase in oil prices on inflation.

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[6] https://www.niesr.ac.uk/wp-content/uploads/2022/03/PP32-Economic-Costs-Russia-Ukraine.pdf (published 2 March, 2022).
[7] In March 2022, consumer sentiment In Ireland fell from 77 to 67, the largest monthly drop in two years. https://www.kbc.ie/w/ukraine-and-inflation-fears-hit-irish-consumer-confidence-hard-in-march?redirect=%2Fblog%2Fconsumer-sentiment-surveys
[8] 10-year sovereign bond spreads (versus Germany) for Ireland, Spain and Portugal had increased by 14 basis points by end March 2022 compared to end December 2021.

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Changes in Commodity Futures Prices relevant for the Current Forecast

The invasion of Ukraine came at a time when energy markets were already tight. Oil prices increased steadily from COVID-related low of $15 a barrel in April 2020, having averaged $64 in 2019, to approximately $90 a barrel before the conflict began. These increases reflected developments in supply and demand as supply constraints and recovering global demand increased prices globally. The start of the war in Ukraine resulted in a period of extreme volatility in oil prices, with prices for Brent crude fluctuating between $105 per barrel on March 1st to almost $130 per barrel on March 8th.

Futures prices for oil are markedly different from the time of the previous Quarterly *Bulletin*. The oil price assumptions used at the time of the Bank's January projections compared to the assumptions for this *Bulletin* (Figure 5). The assumption uses the latest available 10-day average of the Brent crude oil price futures out to t+2 years.[9] As illustrated in the chart, the baseline assumptions for oil prices are now significantly higher than in January. In Quarterly Bulletin 1 2022, an average oil price of $80 per barrel in 2022 was assumed based on futures prices at that time. The current assumption used in this Quarterly Bulletin is an average price in 2022 of $99 per barrel, followed by $88 and $81 in 2023 and 2024, respectively.

Similarly, gas prices, which were at an elevated level coming into 2022, have been volatile since the invasion of Ukraine. Gas price futures in March are up 62 per cent for 2022 when compared to January futures (Figure 6). The uncertain future path for gas prices creates additional uncertainty around the external price assumptions and macroeconomic outlook.

Futures prices for certain non-energy commodities have also increased over recent weeks, following evidence of rising international prices prior to the Russia-Ukraine war. In February 2022, the UN Food and Agriculture Organisation (UN FAO) Food Price Index increased to an all-time high and was almost 21 per cent above its level in February 2021. The increase in the overall index in February – which reflects developments before the Russian invasion – was driven by rises in vegetable oil and dairy price sub-indices along with higher cereals and meat prices.[10] Reflecting

[9] Futures prices can vary substantially and rapidly depending on a myriad of complex developments on international energy markets, socio-economic developments and speculative activity.
[10] See https://www.fao.org/worldfoodsituation/foodpricesindex/en/

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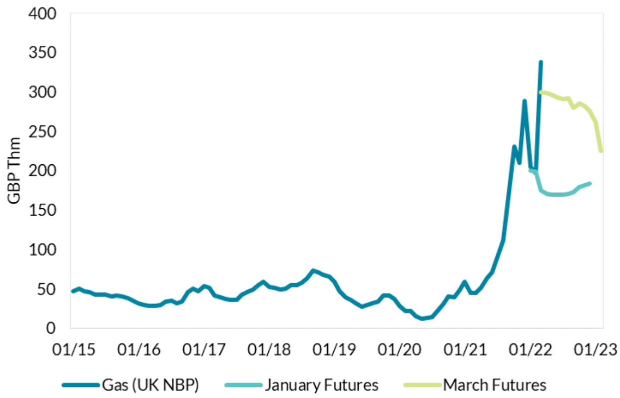
these developments and the implications of the Russia-Ukraine war, futures prices for food commodities have increased significantly over recent weeks. The futures prices of wheat and corn for 2022 were 21 per cent and 15 per cent higher respectively as of March relative to the equivalent prices in January.

Oil and gas futures prices have jumped in levels relative to QB1 2022

Figure 5: Oil Price Assumptions, QB1 2022 versus QB2 2022

Source: Refinitiv.

Figure 6: Gas Price Futures, Jan 2022 vs March 2022



Source: Refinitiv.

Revisions to Irish Inflation and Growth Projections

Energy price increases have both direct and indirect effects on the outlook for the Irish economy and these have been incorporated into the revised projections in this *Bulletin*. The direct effect is to increase the price of energy products in the consumption basket, that is the prices of electricity, gas, home heating oil, petrol and diesel, etc. The increase in inflation also directly reduces real incomes, that is, incomes adjusted for inflation. This reduction in real incomes coinciding with the price increases in goods and services that are hard to substitute for such as energy, fuel and food, leads to second round effects as households spend less on other goods and services. The increase in energy costs is also forecast to spill over into the price of other goods and services for which energy or transport costs are an important input in their production, thereby increasing non-energy inflation.

Recent increases in the price of other commodities will also feed through to higher consumer prices this year. In particular, increases in the price of

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wheat and corn (see Figure 1) are forecast to lead to rises in food prices, while increases in the price of certain metals will pass through to non-energy industrial goods. In addition, reflecting downward revisions to the growth outlook in Ireland's key trading partners, external demand is expected to be weaker than assumed at the time of our January projections, resulting in a downward revision to the export forecasts.

Overall, these factors have resulted in a significant upward revision to the inflation projection in this *Bulletin* and an associated downward revision to domestic demand and overall economic growth forecasts for the Irish economy. For 2022, inflation has been revised up by 2 percentage points, with MDD growth cut from 7.1 per cent to 4.8 per cent, compared with expectations in the January *Bulletin* (Table 2).

Table 2: Growth and Inflation Outlook (QB2 2022 vs QB1 2022)

	QB2			QB1			Revision		
	2022	2023	2024	2022	2023	2024	2022	2023	2024
MDD	4.8	4.3	3.9	7.1	5.2	4.8	-2.3	-0.9	-0.9
HICP	6.5	2.8	2.1	4.5	2.4	2.1	2.0	0.4	0.0
HICP Ex Energy	4.3	3.3	2.4	3.3	2.6	2.2	1.0	0.7	0.2

Box A: Benchmarking the Uncertainty Around the Central Forecast

By Stephen Byrne, Thomas Conefrey, John Scally and Graeme Walsh[11]

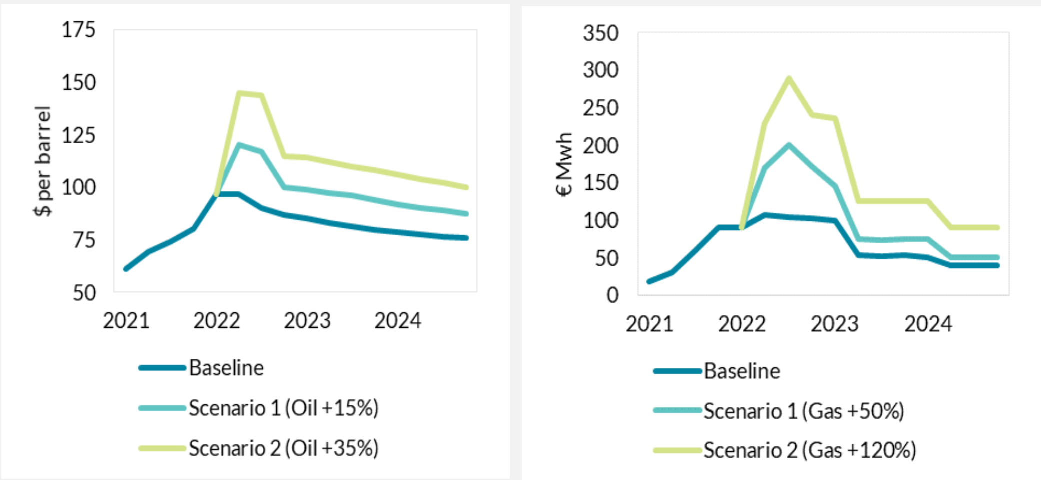
While the central forecasts take into account the latest available information on energy and other key assumptions, the situation is highly uncertain and, in particular, energy prices have been extremely volatile in recent weeks. Depending on the path of the conflict, there is a risk that energy prices could be higher than assumed in our central forecasts. Given this uncertainty, in this Box we consider two stylised scenarios where energy prices are higher than the baseline. We assess the potential impact of these scenarios on the global economy and on Ireland using the NiGEM and COSMO models.[12] The

[11] Irish Economic Analysis Division
[12] NiGEM is a global economic model developed by the National Institute of Economic and Social Research in the UK. The model documentation can be found at:

modelling exercise accounts for the different transmission channels of an energy-related supply-side shock discussed above. [13]

Figure 1: Oil and Gas Price Scenarios

(a) Oil prices **(b) Gas prices**



Source: Own calculations

Figure 1 shows the baseline forecasts for energy prices, which are based on the latest futures curves, and two stylised scenarios. In scenario 1, the price of oil and gas is assumed to be 15 and 50 per cent higher than in the baseline in 2022. In scenario 2, oil and gas in 2022 are assumed to increase by 35 per cent and 120 per cent above the baseline. These scenarios reflect purely technical assumptions on possible future energy prices designed to illustrate the sensitivity of the central forecasts to alternative energy assumptions.

Figure 2 shows the estimated effect of the energy price scenarios on inflation and domestic demand in Ireland relative to the Quarterly Bulletin baseline forecasts. In scenario 1, inflation would increase by just under 1 percentage point and MDD growth would be 0.2 percentage points lower in 2022 than in the baseline. In the second scenario involving more significant increases in energy prices, inflation would rise by 1.5 percentage points in 2022 and MDD growth would be 0.5 percentage points lower than in the baseline projections. Consistent with the expected channels through which these type of shocks transmit, higher energy prices in excess of the baseline assumptions would

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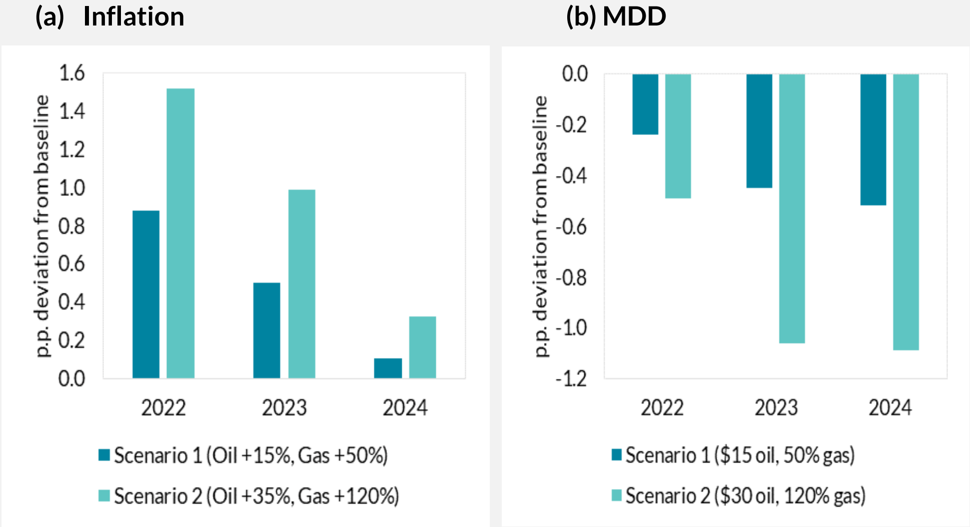
https://nimodel.niesr.ac.uk/ COSMO is a model of the Irish economy used by the Central Bank (see Bergin et al (2017) and Conefrey, O'Reilly and Walsh (2018)).

[13] The scenarios assume that monetary authorities view the shock as temporary in nature and do not respond by raising interest rates in response to higher inflation. Moreover, we do not include other potential policy responses such as stockpile releases and fuel subsidy payments to households.

increase inflation and reduce growth in Ireland relative to our central forecast.[14,15]

Figure 2: Impact of Energy Scenarios on Irish Inflation and Growth



Source: Own calculations.

These scenarios provide estimates of the sensitivity of baseline inflation and growth forecasts to a change in assumptions on energy prices. There are some caveats that should be considered in interpreting the results. First, the scenarios consider the impact of increases in energy prices in isolation. No additional shocks to consumer prices such as from increases in non-energy food or other commodities are included. If further energy price rises were accompanied by increases in other non-commodity prices or other changes in the wider economic environment, then the impact on inflation and growth could be larger than reported here. Relatedly, increases in energy prices such as those considered in both scenarios could be accompanied by a rise in uncertainty. If uncertainty effects were included in the modelling scenarios, they would amplify the negative effect on aggregate demand.

As well as further increases in prices, another more damaging outcome is the potential for the rationing of energy supplies in Europe, in particular gas, depending on the path of the war over the coming months. While Ireland does

[14] There is some literature to suggest that there may be asymmetries and nonlinearities in the transmission of oil price shocks. Our modelling scenarios use linear models, so nonlinear relationships would have the potential to amplify some of our results. However, there is no consensus on the existence or size of these possible non-linear effects and Kilian (2008) concludes that there is no compelling evidence of nonlinear effects at the macroeconomic level.

[15] The impact of the high energy price scenarios on inflation and demand would be influenced by the prevailing cyclical position of the economy and conditions in the labour market.

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not have direct reliance on Russian gas, a shortage of gas at EU level is still likely to have an impact if some of Ireland's currently imported gas supply was diverted to other EU Member States. Gas provided 34 per cent of Ireland's primary energy supply in 2020, with around 64 per cent imported via gas interconnectors from Scotland.[16] Gas accounted for just over half (51 per cent) of the electricity generated for end users in Ireland in 2020. Given the importance of gas for electricity generation in Ireland, rationing of supply would have significant negative implications for the output and exports of energy-intensive manufacturing sectors.

Lastly, an important consideration is the elasticity of substitution for different factors of production, particularly intermediate inputs.[17] It is challenging to estimate the degree of substitutability between different intermediate inputs reliably and this measurement problem would be compounded if there were large changes to the input mix across Europe. It is plausible to assume that the elasticity of substitution is larger in the medium to long run and smaller in the very short run. Thus, the macroeconomic effects of the Russian invasion of Ukraine depends crucially on the duration of the war and how production processes and inputs may adjust in response to price changes over time.

Box B: The International Economic Outlook

By the Monetary Policy Division

Since the Russian invasion of Ukraine in late February, the outlook for the global economy has deteriorated, particularly so in Europe. The war, and economic sanctions that followed, have generated disruptions to energy markets, international trade, and financial markets. Added to this has been considerable economic and geopolitical uncertainty that has hit business and consumer confidence. The economic impact of the war is widely seen as inflationary and damaging for growth prospects. Prior to it however, specifically between the last months of 2021 and the beginning of 2022, the impact of the omicron variant of COVID-19 on the global economy was proving milder than initially expected, and advanced economies were seen as

[16] See https://www.seai.ie/publications/Energy-in-Ireland-2021_Final.pdf and https://www.gasnetworks.ie/docs/corporate/company/Irelands-Gas-Network_Delivering-for-Ireland_FINAL-file-as-published-11-11-2021.pdf
[17] https://www.ifo.de/publikationen/2022/working-paper/what-if-economic-effects-germany-stop-energy-imports-russia (published 7 March, 2022).

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growing strongly despite ongoing supply chain issues and inflationary pressures arising from rising energy prices.

In January 2022, the IMF forecast that the global economy would grow by 4.4 per cent this year, slowing from 5.9 per cent in 2021, with the slowdown attributed partly to the spread of the omicron variant, remaining supply chain issues, and inflationary pressures, particularly from energy prices, as well as a slowdown in China. These projections however do not take into account the effects of the war in Ukraine on the global economy. Subsequently, the IMF has announced that it expects to revise projections downwards as a result of the war, while still seeing global growth as positive in 2022.

Using information available up to 2nd March, the ECB Staff Macroeconomic Projections are the first to estimate the effect of the war in Ukraine on the economic outlook, in a context of high uncertainty about how it will evolve. With an assumption of only a temporary effect of the war on global energy supplies, the forecast for GDP growth in the euro area in 2022 is 0.5 per cent lower than in the December 2021 projections. However, thanks to a strong general economic recovery and labour market, GDP growth is still seen as robust, at 3.7 per cent this year. GDP growth rates in 2023 and 2024 are forecast, respectively, at 2.8 and 1.6 per cent. This revised outlook follows growth in euro area GDP of 5.3 per cent.

The war and its effect on energy markets are expected to put further and longer-lasting pressures on energy prices, and also on food prices. Because of this, euro area inflation is projected to average 5.1 per cent in 2022 (up 1.9 percentage points compared to the December 2021 projections). These pressures on food and energy prices are forecasted to dissipate over the course of 2022, with euro area inflation in 2023 and 2024 respectively projected at 2.1 and 1.9 per cent (both also revised upwards), broadly in line with the ECB's target.

Euro area annual HICP inflation was 5.9 per cent in February 2022, significantly up from 5.1 per cent in January. Monthly inflation stood at 0.9 per cent, up from 0.3 per cent. Energy remains the most significant contributor to euro area inflation, and stood at 31.7 per cent in February 2022, when compared with the same period a year earlier. Underlying inflation also increased strongly however, with HICP excluding energy and unprocessed food showing a reading of 2.9 per cent for February, and a month-on-month inflation rate of 0.6 per cent.

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The euro area seasonally-adjusted unemployment rate stood at 6.8 per cent in January 2022, down from 7.0 per cent in December 2021 and 8.3 per cent in January 2021. It represented the lowest value for unemployment in the historical series for the euro area. In Q4 2021, the annual growth rate of employment in persons for the euro area was 2.2 per cent, up from 2.1 per cent in Q3. ECB projections for the euro area unemployment rate in 2022 remain unchanged since the December forecast, at 7.3 per cent, while it was revised up in both 2023 and 2024 to 7.2 and 7.0 per cent.

Prior to the war in Ukraine, the Markit Eurozone Composite PMI indicators were pointing to both an increased pace of growth in economic activity and in business input and output prices through February.

In its March 2022 meeting, the ECB Governing Council (GC) revised the schedule for its asset purchase programme (APP), with purchases amounting to €40bn in April, €30bn in May and €20bn in June. The GC will end net purchases in the third quarter if the data will support the expectation that the medium-term inflation outlook will not weaken afterwards. Should the medium-term inflation outlook change and financing conditions become inconsistent with progress towards the two per cent target, the ECB stands ready to revise this schedule. Any adjustments to the key ECB interest rates will take place some time after the end of net purchases and will be gradual and determined by the GC's forward guidance and by its commitment to stabilise inflation at two per cent over the medium term.

In the United States, quarterly GDP increased by 1.7 per cent in the fourth quarter of 2021, after a 0.6 per cent increase in the third quarter. Overall, US GDP in 2021 was 5.7 per cent higher than in 2020. In February 2022, the unemployment rate stood at 3.8 per cent, down from 4.0 per cent in January and 6.2 per cent in February 2021. At its January meeting, the Federal Open Market Committee (FOMC) of the US Federal Reserve maintained the target range for the Federal Funds Rate at 0 to 0.25 per cent. However, with inflation well above 2 per cent and a strong labour market, the FOMC expects it will soon be appropriate to raise the target range for the federal funds rate. The FOMC decided to continue to reduce the monthly pace of its net asset purchases.

In the United Kingdom, quarterly GDP increased by 1.0 per cent in the fourth quarter of 2021 (+6.5 per cent relative to Q4 2020), unchanged compared to the third quarter. Across 2021, GDP increased by 7.5 per cent following a 9.4 per cent fall in 2020. At its February meeting, the Bank of England's Monetary

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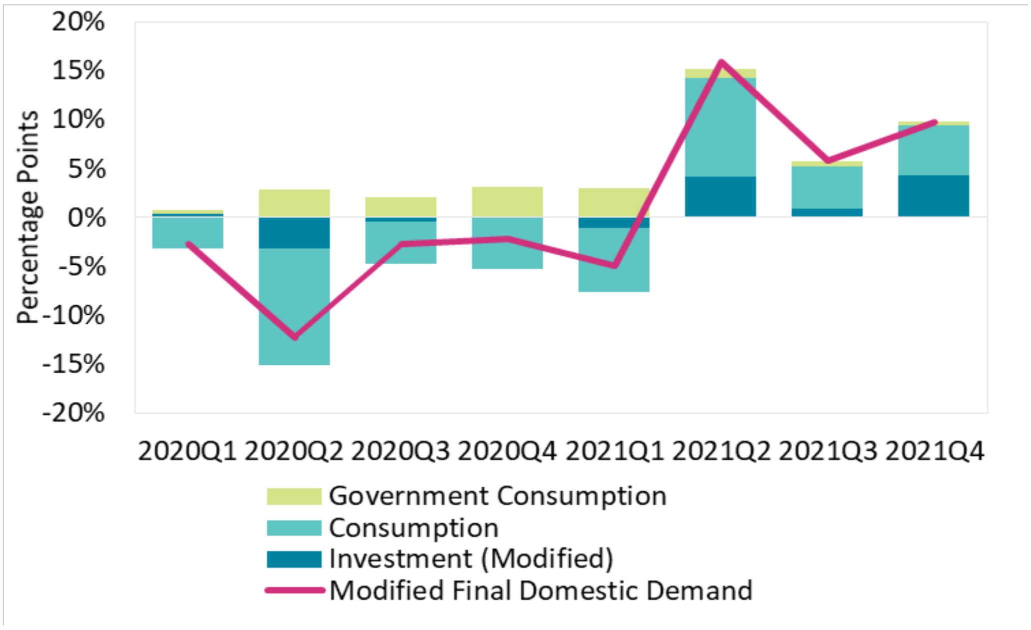
Policy Committee voted to increase the Bank Rate by 0.25 percentage points, to 0.50 per cent, after a 0.15 per cent increase in December. The Committee decided to begin reducing the Bank of England's stock of UK government bonds by ceasing to reinvest maturing assets. A similar approach will be taken for sterling non-financial investment-grade corporate bond holdings, in conjunction with a programme of corporate bond sales to be completed no earlier than late 2023 that should unwind fully the stock of corporate bond purchases of recent years.

Recent Developments

The domestic economy rebounded strongly in 2021, despite new coronavirus variants and higher inflation. Modified domestic demand rebounded strongly from Q1, with the momentum continuing in Q4, with a year-on-year growth rate of 9.8 per cent. Demand grew by 7.5 per cent on a quarterly basis, driven by increased personal consumption and investment. Overall modified domestic demand grew by 6.5 per cent in 2021 (Figure 7).

Consumption continues to be the main driver of demand

Figure 7: Contributions to Growth in Modified Final Domestic Demand



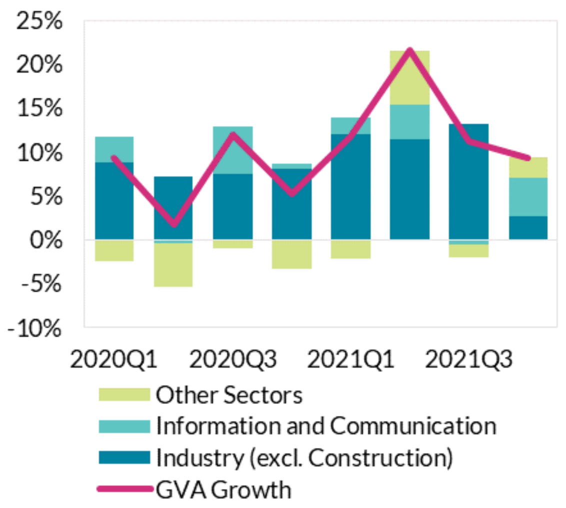
Source: CSO.
Note: percentage change compared to the same period of the previous year

National Accounts figures for 2021 Q4 indicated that economic activity, as measured by GDP, increased by 13.5 per cent in 2021 compared to 2020. The increase was driven mainly by exports and was amongst the highest growth rates in the European Union. Quarter-on-quarter, GDP declined by 5.4 per cent in seasonally adjusted terms between Q3 and Q4 of 2021 (with the decrease resulting from rising imports). A Current Account surplus of €58.8bn was recorded in 2021, reflecting lower levels of *Intellectual Property Products* imports among other factors. Strong export growth, especially in the pharmaceutical and ICT sectors, were the main drivers of GDP growth in 2021. Imports fell sharply in

Q1 and rose throughout the remainder of the year. Government expenditure growth eased as recourse to pandemic supports fell.

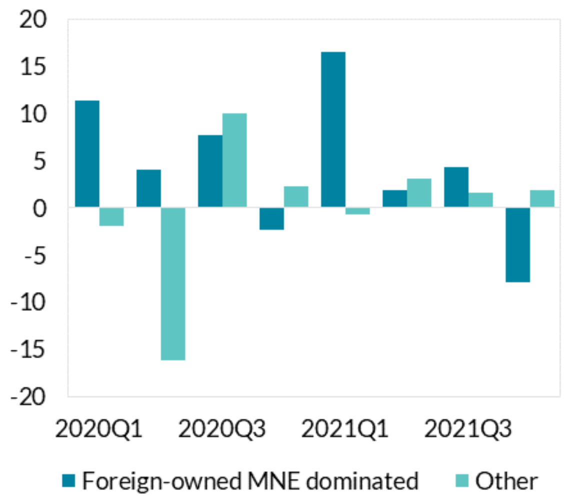
The foreign-owned MNE sector did not see a decline during the pandemic, and continued to grow strongly throughout the year up until Q4 2021.

Figure 8: Contributions to GVA Growth



Source: CSO

Figure 9: GVA Growth in MNEs and Domestic Sectors



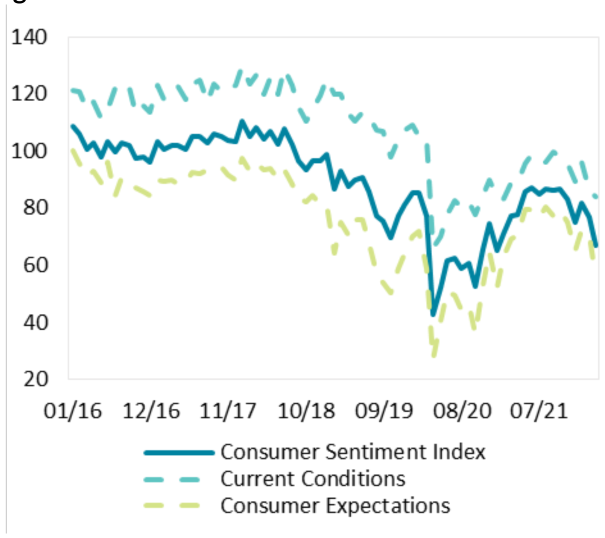
Source: CSO

All sectors of the economy excluding agriculture, forestry and fishing expanded over the year to Q4 2021. The Arts and Entertainment sector continued to see high growth rates of 34 per cent year on year, despite the reintroduction of restrictions in December, while the Distribution, Transport, Hotels and Restaurants sector increased by 9 per cent on an annual basis. Information and communication, and industry excluding construction, which are dominated by non-Irish owned corporations and when combined represent over half of GDP, grew at a stronger rate than the overall economy in 2021. Unlike previous quarters however, in Q4 2021 all other sectors grew at a similar rate as industry excluding construction, while domestically dominated firms maintained a positive growth rate and foreign dominated firms experienced negative growth (Figure 8 and Figure 9).

Consumer sentiment fell as the economic fallout of Russia's invasion of Ukraine and cost of living concerns increased. The KBC consumer sentiment index registered a level of 67.0 in March, down 10 percentage points on February's figure of 77, and is the lowest figure recorded since January 2021. March's drop was the largest month-on-month decline since April 2020 and reflects higher inflation and expected economic pressures arising from Russia's invasion of Ukraine (Figure 10).

Consumer and business sentiment recovered throughout 2021 but fell with the onset of war in Ukraine.

Figure 10: Consumer Sentiment Index



Source: KBC Bank Ireland

Figure 11: Purchasing Managers Indices

Source: Allied Irish Banks

Purchasing Managers' Indices, while at somewhat lower levels than recent months, show continuing signs of growth in manufacturing and, in particular, in services activity. The manufacturing PMI for February stood at 57.8, down from January's figure of 59.4, indicating expansion overall but at a slower pace. A higher pace of growth is noted in the services index, which stood at 61.8 in January, compared to 56.2 in January and 55.4 in December (Figure 11). Service input price pressures are evident as input prices grew at their fastest rate in over 21 years. While there has been some marginal improvement in delivery times, supply chain bottlenecks and pressures are remaining persistent as delivery times of goods remain uncertain (see *Investment*).

As a result of higher energy costs and supply bottlenecks and strong underlying demand, inflation has surged in recent months, reaching 5.6 per cent (HICP) in the year to February. The invasion of the Ukraine by Russia has exacerbated energy prices and supply concerns, with early flash estimates for March pointing to annual inflation of 6.9 per cent. Housing, Energy, and Transport and food prices have been the main drivers of rising inflation. An increase in inflation has, nevertheless, been registered across most parts of the consumption basket (Figure 13). The current high rates of consumer price

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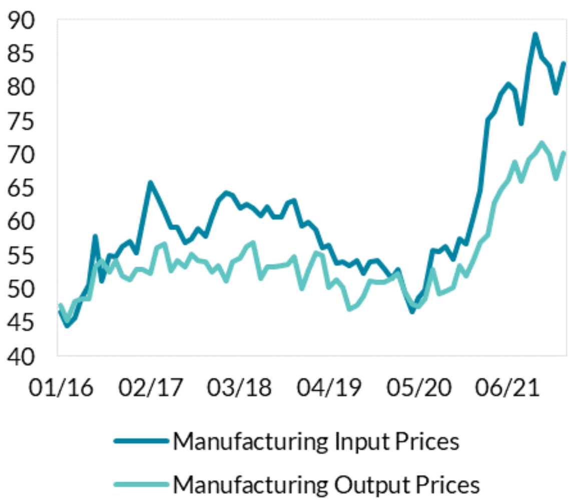
inflation had been expected to ease substantially in the latter half of 2022, as supply chain issues unwound and energy prices stabilised. Russia's invasion of Ukraine and the resulting commodity price pressures have changed this expectation.

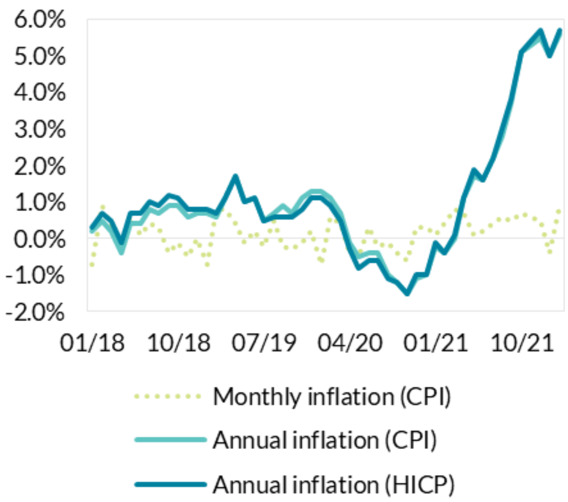
Supply chain disruption and energy price shocks led to increased input prices for firms during 2021, which led to the strong acceleration seen in inflation during the year.

Figure 12: PMI Input and Output Prices



Source: Allied Irish Banks

Figure 13: Consumer Price Inflation



Source: CSO

The Central Bank's Business Cycle Indicator continues to show strong growth in economic activity. After showing above average growth in 2021 H2, the BCI fell in December when new public health measures were announced to help curb the spread of the Omicron variant. In January, the BCI rebounded strongly as pandemic-linked restrictions were phased out in Ireland (Figure 14). The improvement in the BCI in January and February has been broad based with positive contributions from consumer spending (despite weak consumer sentiment data), the labour market and industrial production in the indigenous sector.

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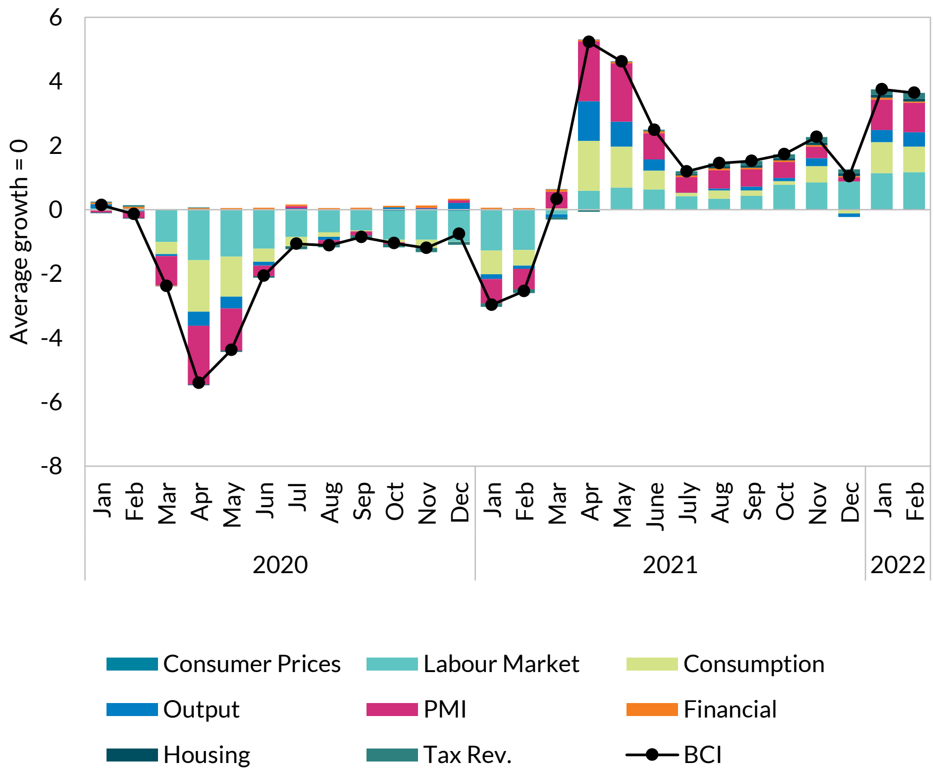
The BCI grew strongly at the start of 2022 after easing in December

Figure 14: Business Cycle Indicator (BCI)



Source: authors' calculations.
Note: Feb estimate is preliminary due to missing industrial production data.
Updated: 28/03/2022

The Pandemic Unemployment Payment closed on 29 March following two years of operation as all remaining pandemic-related restrictions have been lifted. The scheme was closed with 44,747 people still registered, with the Accommodation and Retail sectors accounting for a combined 34 per cent of final payments. These remaining recipients will move to standard jobseeker's terms, if eligible, with figures for the Live Register expected to increase in the coming weeks. Recent estimates for the Employment Wage Subsidy Scheme (EWSS) suggest 256,000 persons were registered as of end-February. The scheme is scheduled to close at end-April for the majority of sectors, with hospitality firms affected by health restrictions in December allowed one additional month of supports. The seasonally-adjusted monthly unemployment rate for February remained flat at 5.2 per cent relative to the previous month.

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Box C: Spending, Credit, and Deposits: An Update on Irish Household and Business Activity

By Statistics Division

This Box provides an update, based on the latest data, on some of the key trends relating to the spending, savings and borrowing activities of Irish households and businesses.

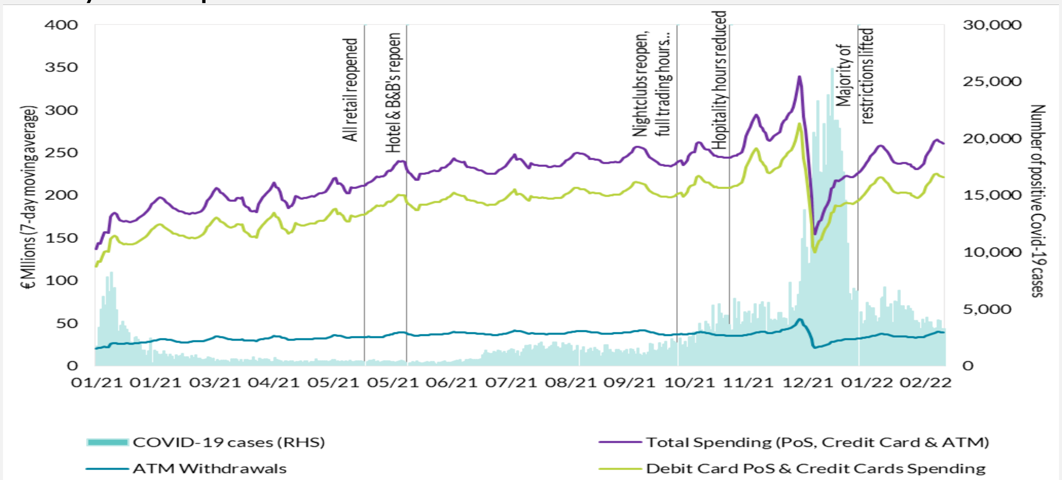
The economic and financial market effects of the Russian invasion of Ukraine are not yet evident in the statistical data referenced in this Box. However, there is a potential for the increased geopolitical and economic volatility to impact financing conditions and decisions over the coming months, which may in turn influence future developments in these data.

Household Spending

Card spending data show that total card spending (including ATM withdrawals) remained strong in the early part of 2022. This followed robust spending during the final quarter of 2021, and despite January typically being associated with lower consumer activity, Supported by increased consumer confidence in January, spending exceeded levels in the corresponding period last year and, more relevantly, immediately prior to the pandemic (Figure 1).

Changes in daily card spending and cash withdrawals

Figure 1: Change in daily card spending and cash withdrawals (7-day moving average) from January 2021 to present



Source: Central Bank of Ireland

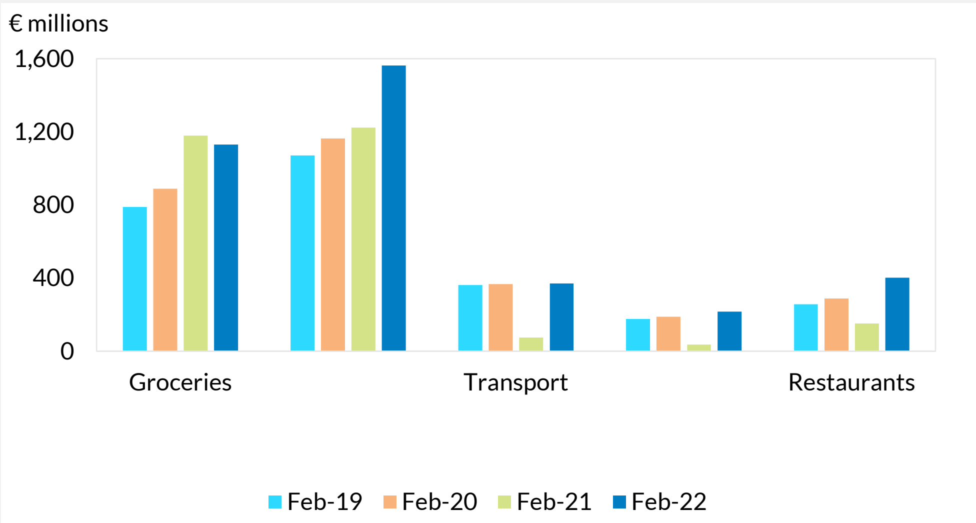
The more granular, but less timely, monthly card data for January shows that spending increased by 36 per cent compared to the same month the previous year, when public health restrictions limited in-person expenditure. Growth was broad-based across sectors, but was particularly strong in the services and social sectors which rose by 76 per cent and 100 per cent, respectively.

Following the cessation of the majority of public health restrictions in late January, the daily data shows that spending in the transport and hospitality sectors (i.e. accommodation and restaurants) saw an immediate uplift in spending before plateauing in February. According to the daily data, total spending contracted marginally in February compared with the previous month. This was driven in part by seasonal trends and reduced spending in the groceries and other retail sectors, however, these declines were in part offset by strong growth in the accommodation and restaurants sectors.

Despite the marginal month-on-month contraction in February, spending was considerably higher in year-on-year terms, and in comparison with pre-pandemic corresponding periods (Figure 2). The magnitude of growth experienced in the transportation and accommodation sectors over the year reveals the impact public health restrictions had on trading activity in these sectors last year. While in contrast, the comparatively moderate increase in the other (non-groceries) retail sector, which was also impacted by restrictions, indicates that some of the worst effects were limited by modifying business models and by shifting the availability of goods online.

Spending in hospitality sectors increased as restrictions were eased

Figure 2: Monthly sectoral totals (monthly and daily data)



Source: Central Bank of Ireland

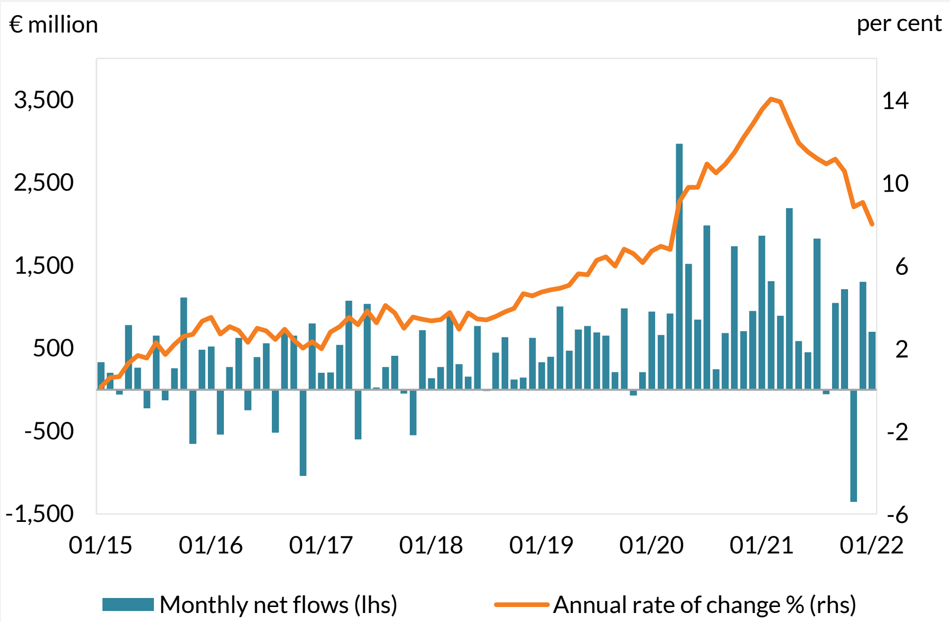
Household deposits and lending

Aggregate household deposits have risen sharply since the beginning of the pandemic as the introduction of the associated public health measures limited the opportunity for consumption in general, while increased precautionary savings also contributed to the headline rise, especially in the early months of the pandemic. The latest Credit and Banking Statistics show a continued moderation in the accumulation of household deposits in recent months. Despite the sharp decline in deposits in November last year, the first month since the start of the pandemic where withdrawals significantly exceeded lodgements by households, aggregate household deposits rose in both December and January. The annual rate of growth stood at 8 per cent in January, down from a peak of 14 per cent in February last year (Figure 3).

The outstanding stock of household deposits stood at €143 billion in January 2022, significantly higher than prior to the pandemic. It must be noted that the latest figure for January is boosted compared to the previous month due to a methodological change required for the purposes of statistical reporting.[18] In the nearly two years since the beginning of the pandemic, accumulated net savings for the period amounted to just over €24.5 billion.

Annual rate of deposit growth has moderated, but remains high

Figure 3: Deposits from Households; net flows, and annual rate of change



Source: Central Bank of Ireland

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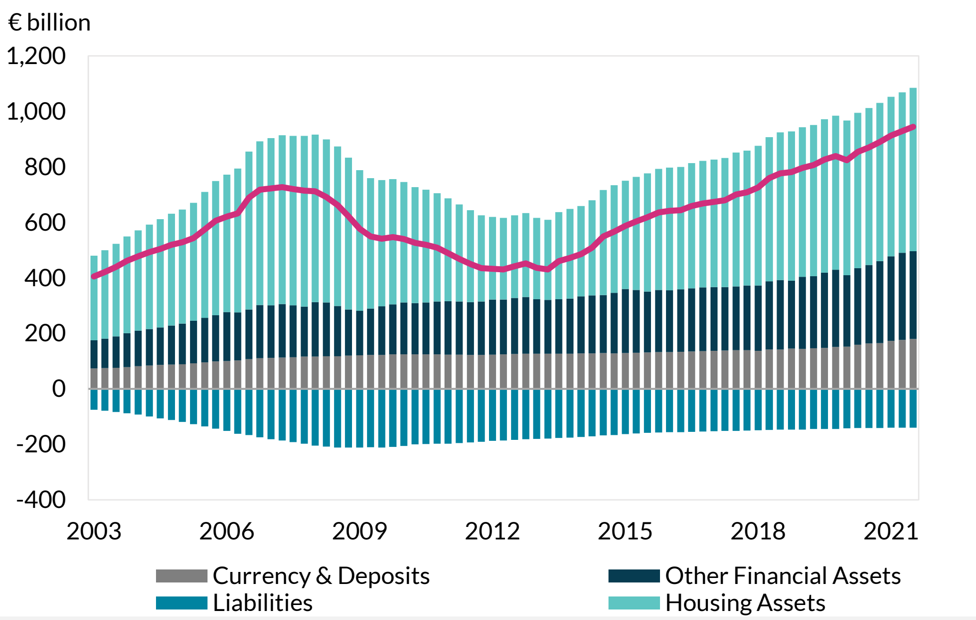
The latest Quarterly Financial Accounts data for Q3 2021 shows household net worth at a new series high of €944 billion (Figure 4), an increase of €105 billion, or 13 per cent, compared to end-2019. The marked rise in household deposits has translated into higher household financial assets, which along with rising housing assets, were the primary drivers, of an increase in overall household net worth.

Household net worth has risen to a new high

Figure 4: Household Net Worth



Source: Central Bank of Ireland

The value of new mortgage agreements in recent months is in-line with seasonal pre-pandemic levels (Figure 5). For 2021 as a whole, the value of new mortgage agreements stood at €11.5 billion, while this equates to an increase of 12 per cent compared with the previous year, it remains short of the recent high of €13.2 billion recorded in 2018.

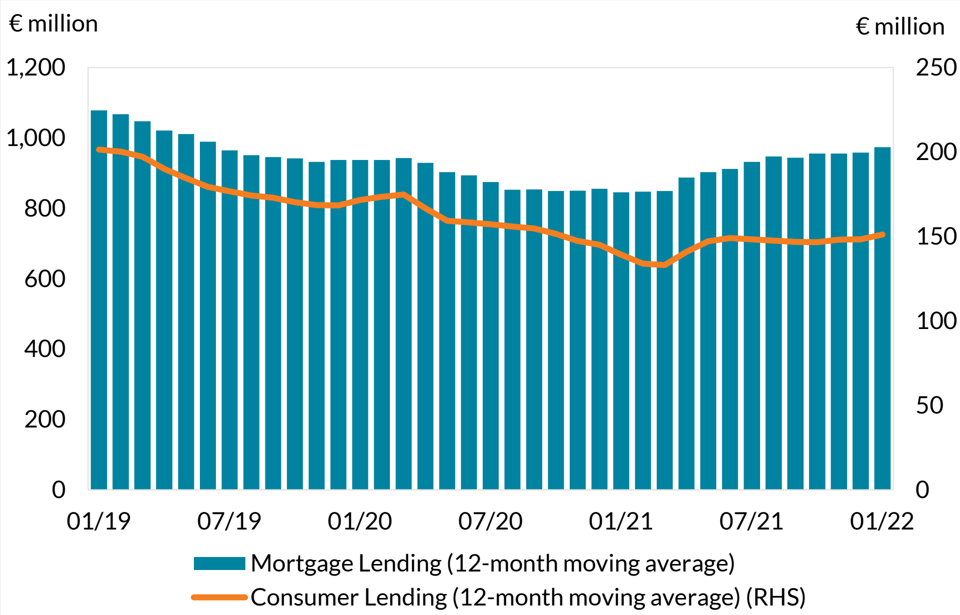
Consumer lending remained somewhat muted in 2021 and was largely unchanged compared with 2020. The latest available data show that consumer lending of €191 million occurred in January, up from €104 million in December, a seasonal increase boosted by financing for new car sales at the beginning of a calendar year. While this equated to an increase of 22 per cent compared with January 2021, it remained somewhat lower than the corresponding periods prior to the pandemic, potentially impacted by supply constraints that continue

[18] See January's Money & Banking release for more information.

to limit new car sales and/or financing of purchases through accumulated savings.

Mortgage lending is recovering to pre-pandemic norms but consumer lending lags

Figure 5: New Lending to Households by Purpose (12-month moving average)



Source: Central Bank of Ireland

According to the latest data from the BPFI, mortgage approvals for first-time buyers' remains strong and have continued to increase through December and January in comparison with the corresponding period immediately prior to the pandemic. Mover purchasers also increased in January following a number of months of strong growth (Figure 6). Mortgage top-ups, often used to fund consumption or home improvements, remains weak by comparison.

New mortgage lending (excluding renegotiations) data show a strong second half of the year in 2021, up 14 per cent compared with the same period in 2020 and in-line with the corresponding period in 2019. The latest data for January show that despite the significant decline compared with the previous month, which is in-line with seasonal trends, the value of new mortgage agreements remains robust.

The latest Bank Lending Survey published in January, noted that credit standards on loans to households for house purchase were unchanged in the final quarter of 2021. In the case of consumer credit and other lending, it noted that increased consumer confidence had a positive impact on loan demand

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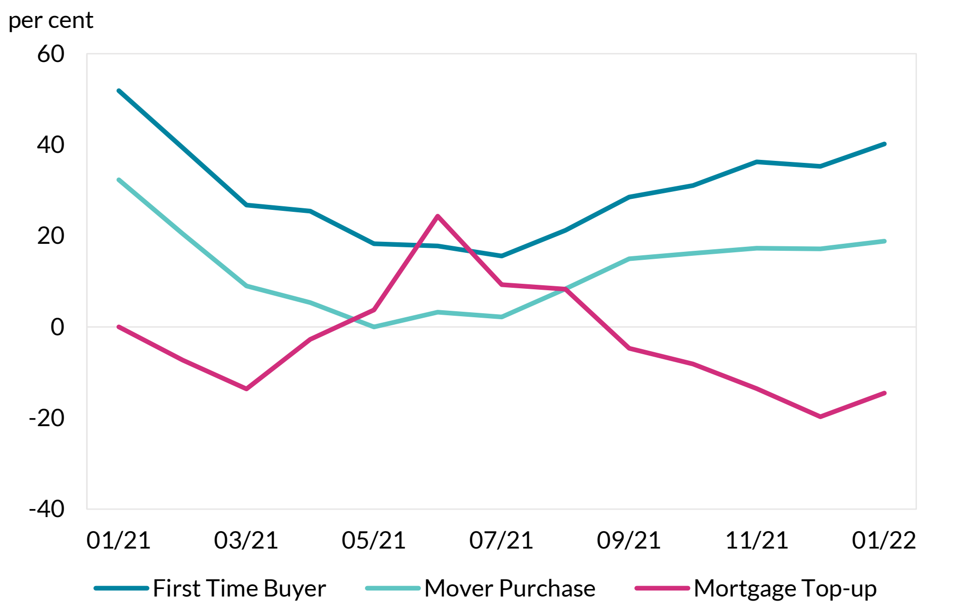
while internal financing, out of savings, had a negative impact on consumer loan demand.

Mortgage approvals very strong relative to pre-pandemic period

Figure 6: Mortgage approvals change on same period immediately prior to the pandemic



Source: BPFI

Business Credit and Deposits

Net new lending to businesses was volatile throughout 2021 and finished marginally negative for the year as a whole, at negative €36 million. By comparison, in 2020 business repayments exceeded loan drawdowns by €1.8 billion. As a result, the latest data shows that the annual rate of change recovered into positive territory in January 2022, at 0.6 per cent (Figure 7). This was first positive reading since the early months of the pandemic, when companies sought to strengthen their balance sheets.

The relatively muted credit picture can also be seen in new lending to small and medium sized enterprises (SMEs). The latest data for the final quarter of 2021 show new loans to SMEs were down 17 per cent compared to the same period in 2020. For 2021 as a whole, new lending to SMEs equated to €4.1 billion, largely unchanged from 2020, but was significantly lower, by 25 per cent, compared to 2019. Government supports and forbearance measures likely suppressed demand for SME borrowing in 2020 and 2021. New lending remains very volatile across economic sectors. The manufacturing and

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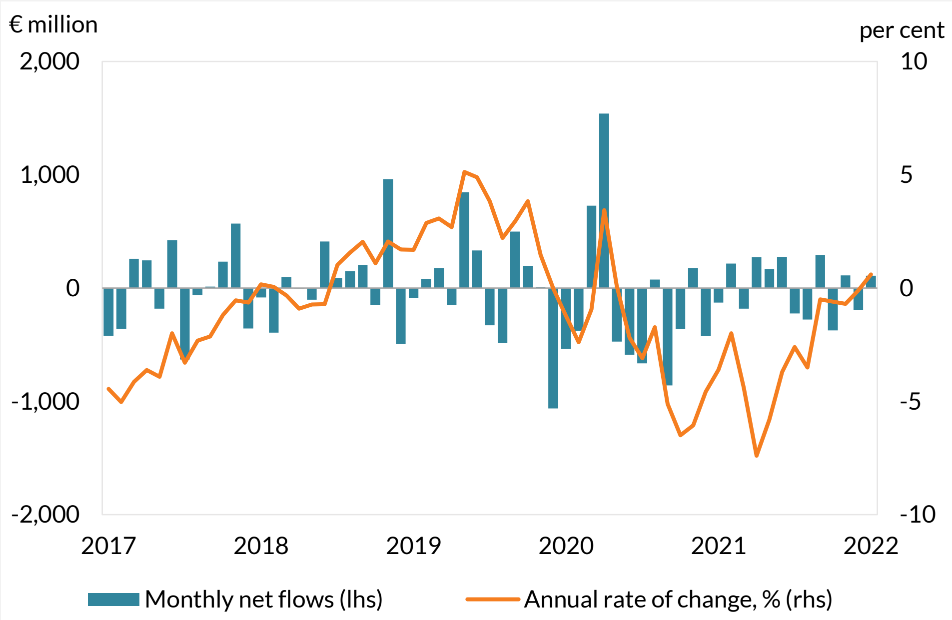
construction sectors recorded some of the largest year-on-year increases for 2021 as whole, rising by 19 per cent and 28 per cent respectively. Meanwhile the hospitality sectors such as hotels and bars continue to be among the most affected and continued to see very low new loans reflecting the uncertain operating environment and outlook at the time.

Annual rate of change for NFC loan drawdowns exceed repayments in January

Figure 7: Net flows of loans to Non-Financial Corporations



Source: Central Bank of Ireland

Similar to households, the accumulation of deposits from businesses had slowed through most of 2021. However, business deposits have deviated from this trend in recent months. The annual accumulation of deposits increasing to 13.2 per cent in December before slowing marginally to 12.8 per cent in January. Cumulative net inflows of deposits for 2021 as a whole amounted to €9.6 billion, a slight reduction from €11.4 billion in 2020.

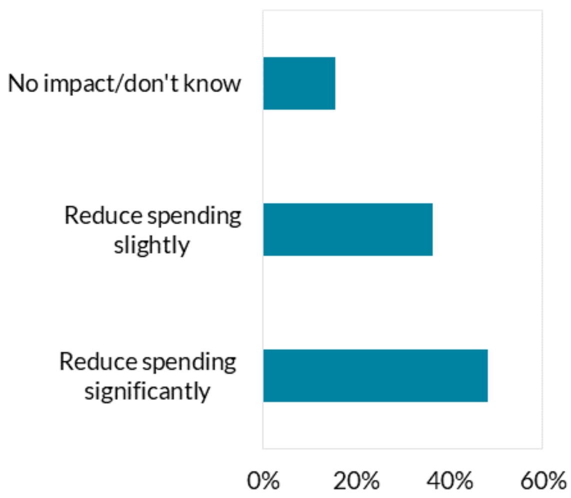
Domestic Demand

Overview

The Irish economy continues to recover strongly from the effects of the pandemic, but the economic impacts of the Russian invasion of Ukraine will weigh on growth. The outlook has become highly uncertain and depends on how the war unfolds, the effect of current economic sanctions on Russia on the European economy and on any possible further measures that may be taken. Since the invasion began, consumer sentiment has declined and economic policy uncertainty has increased markedly (Figure 16). Households have, in turn, indicated that they expect to reduce their spending because of higher prices and uncertainty (Figure 15). These factors will act as a headwind to domestic demand growth in the near term.

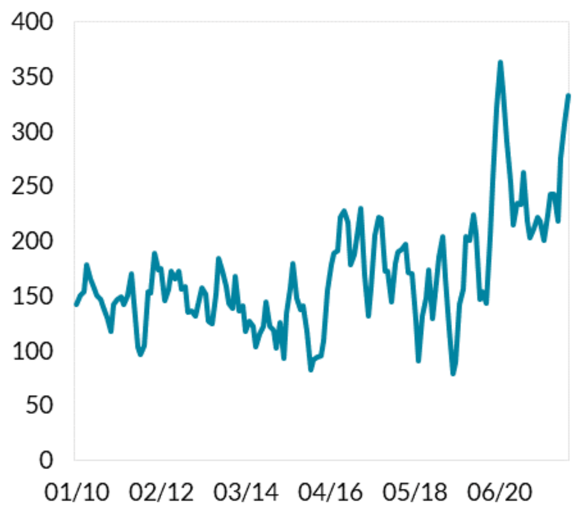
Households have indicated they will reduce their spending as a result of higher energy costs and uncertainty

Figure 15: Impact of higher energy costs and uncertainty on spending intentions



Source: KBC Consumer Sentiment Survey, Special Module (March 2022)

Figure 16: Economic Policy Uncertainty



Source: policyuncertainty.com

The series of energy price increases and associated higher inflation rates expected this year will reduce household incomes in real terms, with knock-on effects for domestic demand growth. While wage growth is forecast to pick up in nominal terms, it is projected to be outpaced by overall HICP inflation – meaning that wages are projected to decline this year in real terms. These effects will be felt most acutely by those in the lower deciles of the income distribution.

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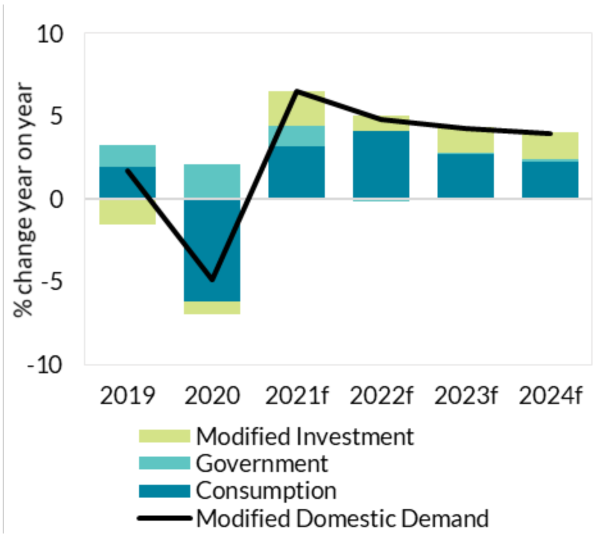
As well as consuming more of their income, energy and food are typically a higher share of expenditure of lower income households compared to the average household.[19]

Overall, modified domestic demand is forecast to grow by 4.8 per cent in 2022, 4.3 per cent in 2023 and 3.9 per cent in 2024 (Figure 17). Compared with Quarterly Bulletin 1, released in January, the outlook for growth has been revised down by over 2 percentage points in 2022, owing mainly to the impact of the war on energy prices, confidence and global trade (Figure 18).

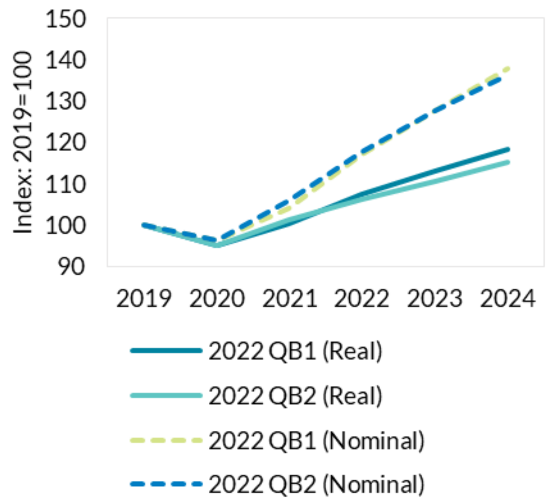
While revised down in real terms, consumption will continue to be the main driver of domestic demand growth

Figure 17: Contributions to Modified Domestic Demand



Source: CSO and Central Bank of Ireland

Figure 18: Revisions to real and nominal MDD



Source: CSO and Central Bank of Ireland

Consumption

Private consumption will remain the key driver of growth in domestic economic activity between 2022 and 2024. Despite the headwinds from the reduction in real incomes, the strong momentum from the lifting of pandemic related restrictions and strong growth in the labour market imply continued growth in consumption over the forecast horizon.

Over the remainder of this year, consumption will continue to grow towards its pre-COVID trend – albeit at a slower pace than expected at the time of the last *Bulletin*. Card payment transactions were 28 percent higher in the first quarter

[19] Household characteristics, Irish inflation and the cost of living. Lydon (2022).

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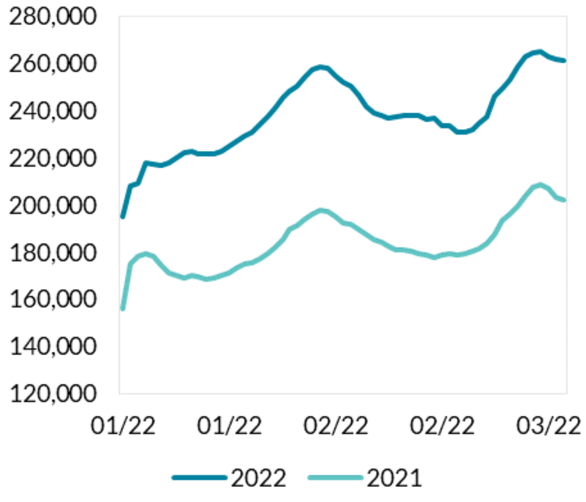
than in the same period in 2021 (Figure 19). Similarly, retail sales point to strong growth in consumption in the first quarter (Figure 20). This follows a slower pace of growth in the final months of 2021 as the Omicron variant emerged. As the impact of the reopening wanes and the effect of higher inflation takes hold, the rebound growth in early 2022 is expected to moderate over the year. For the year as a whole, consumption is forecast to grow by 7.4 per cent.

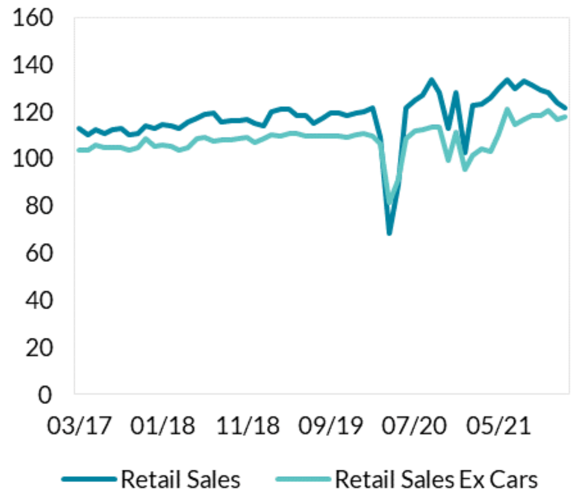
Card payment and retail sales data point to a strong growth in Consumption in the first quarter

Figure 19: Daily card payments (7 Day Moving Average)



Source: Central Bank of Ireland

Figure 20: Retail Sales



Source: CSO

Despite the headwinds of higher inflation, restoration of real income growth amid a tighter labour market and the normalisation of the savings rate sees consumption growth being maintained through 2023 and 2024 (Figures 21 and 22). Consumption growth of 4.7 per cent in 2023 and 3.9 per cent in 2024 is now expected. Although at a lower rate than the previous *Bulletin*, this pace of growth still envisages consumption patterns being above pre-pandemic trend over the course of the forecast horizon.

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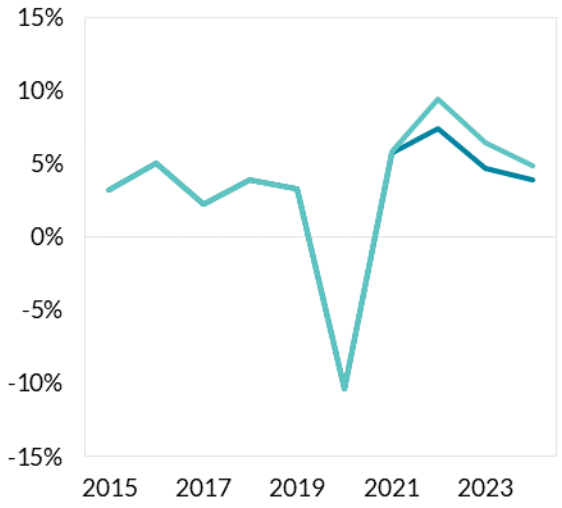
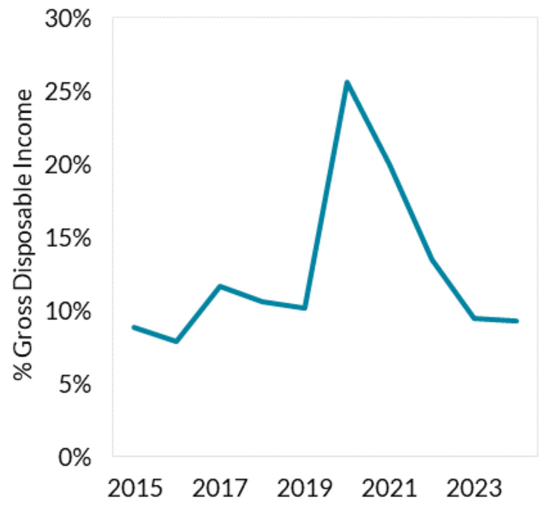
Consumption will be lower than previously forecast, but savings accumulated during the pandemic will provide a buffer to some higher income households

Figure 21: Consumption forecast



Source: Central Bank of Ireland

Figure 22: Savings ratio



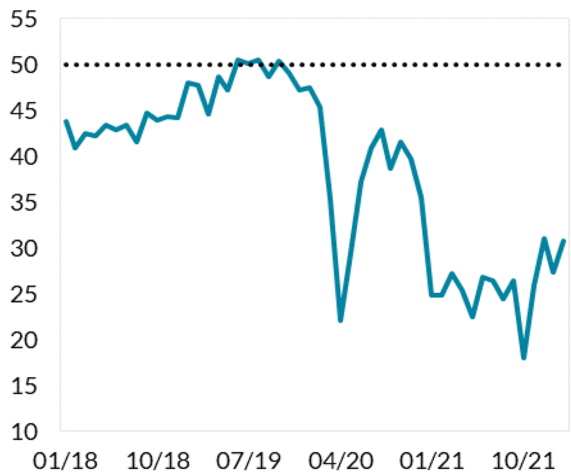
Source: CSO

Firms are facing shortages for materials and equipment, and delivery delays are significant

Figure 23: Factors affecting manufacturers production

Source: European Commission Business Climate Survey

Figure 24: PMI Manufacturing Delivery Times Index



Source: Refinitiv/Markit
Note: Values below 50 indicate increased delivery times

Investment

The outlook for modified investment growth is less favourable than that in the previous *Bulletin*. The Russian invasion of Ukraine led to an increase in uncertainty in global equity markets. Market-based measures of uncertainty

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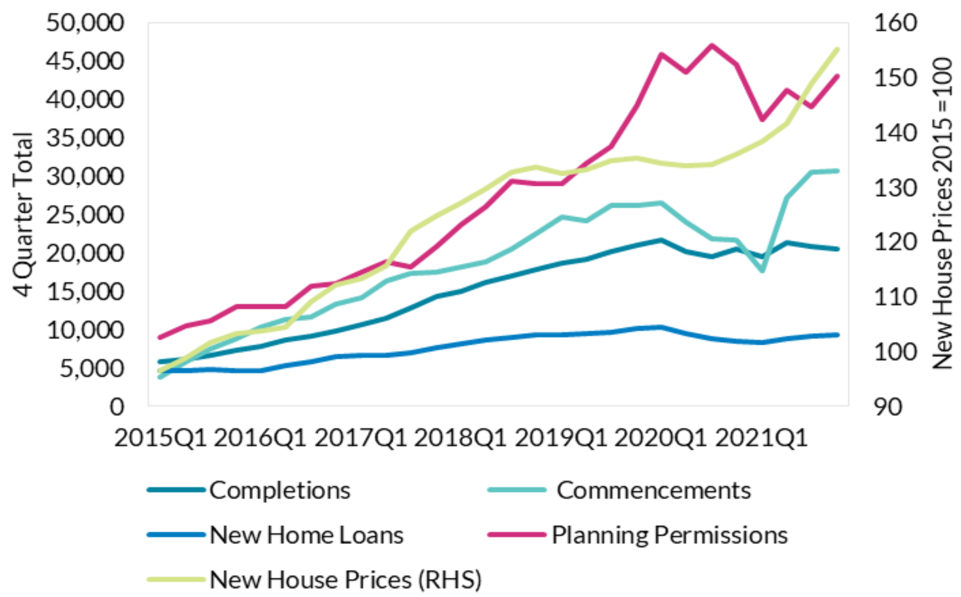
have increased significantly in recent weeks. This is occurring alongside concerns about inflationary pressures, a resurgence of COVID-19 in parts of the world and on-going global supply chains issues (Figures 23 and 24).

Commencements have increased in recent months

Figure 25: Housing Supply Indicators



Source: CSO and BPFI

On the housing front, shortage or delayed delivery of raw materials, along with substantial rises in construction inputs costs, mean that new house completion forecasts are slightly lower than previously expected. While commencement figures are running at approximately 31,000 on an annual basis (Figure 25), planning and procurement delays, material and labour supply constraints and delays in connecting to public infrastructure mean that it is unlikely all of these will be converted into completions in 2022. House completions are forecast to number approximately 24,500 this year, increasing to 29,000 and 33,000 in 2023 and 2024, respectively. This is a reduction of approximately 3,500 housing units over the forecast horizon compared with the previous forecast. Nominal expenditure on housing, however, will be broadly the same or higher than the previous *Bulletin* as higher costs absorb more of the spending. Despite the introduction of Home Renovation Incentives, home improvements are projected to increase at a more moderate rate than the previous *Bulletin*, as inflation constrains disposable incomes and labour supply challenges in the construction sector remain.

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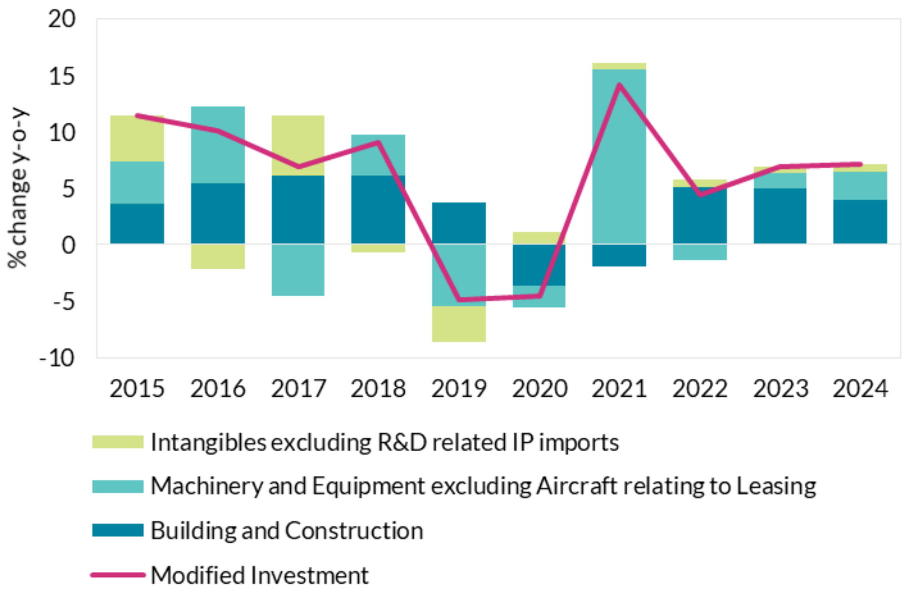
On the non-residential side, the pipeline for commercial real estate is relatively positive despite the uncertainty surrounding the need for office space and the resilience of the work-from-home model. Strong demand in the industrial and logistics sectors has been maintained. Non-residential investment is expected to record substantial gains with increases in government capital expenditure outlined in the National Development Plan, forecast to increase by almost 15 per cent in real terms in 2022. The Construction PMIs for February point to expansion in the commercial sector and, to a lesser extent, civil engineering components. The forecast is for an increase in non-residential spending of 7 per cent in 2022.

Building and construction growth will be the primary driver of investment growth over the forecast horizon

Figure 26: Contributions to Modified Investment Growth



Source: Central Bank of Ireland.

The implications of the Russian invasion of Ukraine for raw materials generally is expected to weigh on machinery and equipment investment. Russia is an important supplier of certain metals. Ukraine is also part of the value chain in the production of certain capital goods. The war is likely to pose challenges in terms of the price and availability of such goods, which in turn dampens the extent of machinery and equipment investment. Overall, modified investment is forecast to grow by approximately 4 per cent this year and 6.9 per cent next year, and increasing slightly to 7 per cent in 2024 (Figure 26).

Exports, Imports and Balance of Payments

Export growth remained resilient to the more negative effects of the COVID-19 pandemic in 2021, with continued growth occurring across key sectors of the economy. Aggregate exports increased by 16.6 per cent in 2021, their highest rate of growth since 2015. In contrast, total imports continued the decline observed in 2020, falling by 3.6 per cent over the year. With export volumes more than 25 per cent larger than the volume of imports, international trade remains a core driver of Irish output.

Disaggregating the headline export figures, goods exports were the strongest driver of growth in 2021, increasing by 20.6 per cent over 2020 values. Merchandise trade continued to be dominated by a small number of key sectors, with Medical and Pharmaceutical products (37.9 per cent), Organic Chemicals (15.6 per cent), and Electrical Machinery (7.2 per cent) accounting for over 60 per cent of total merchandise exports in 2021. Services exports also performed strongly, recording a double-digit growth rate of 12.2 per cent (compared with just 2.6 per cent in 2020). At the sectoral level, Computer Services (21.4 per cent), Insurance (12.4 per cent) and Financial Services (9.9 per cent) were the core drivers of services export growth. Contract manufacturing also grew substantially (9.6 per cent), as COVID-based restrictions, suppliers' delivery times, and capacity constraints at a number of major ports all eased in the second-half of 2021.[20]

On the import side of international trade in goods and services, goods imports to the Irish economy recovered strongly from 2020 values, with growth of 6.5 per cent in 2021. Against this, services imports continued to decline due to a combination of Brexit and pandemic-related effects. While most services sectors recorded positive import growth in 2021, large declines in business services imports (-28.9 per cent) were the overriding reason for aggregate negative growth in services imports for 2021.

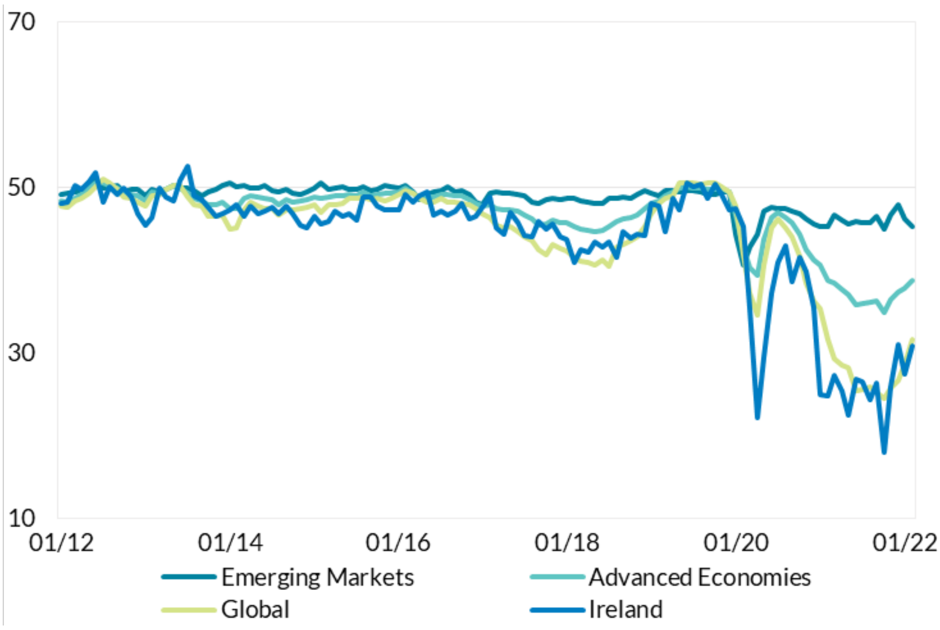
While conditions have improved towards the end of 2021, global production networks are still subject to supply-side bottlenecks, with uncertainty over their development. Global shipping costs have fallen from their Q3 2021 peak, but remain substantially above pre-pandemic levels and could rise if excess demand pressures return. Similarly, global

[20] Contract manufacturing refers to a practice whereby a firm resident in Ireland (typically a multinational enterprise) contracts a firm abroad to manufacture goods on its behalf. The products are included in the Irish National Accounts as imports and exports, even though the goods are not physically produced in Ireland, and no domestic labour is used in the production of these products.

PMI supplier delivery times (SDTs), which proxy for delivery bottlenecks, began 2022 at peak levels, indicating that considerable supply chain delays persist in the global economy (Figure 27). Additional COVID-19 outbreaks in manufacturing hubs (including those in several Chinese provinces), could cause a fresh wave of closures of firms and ports. Finally, the effect of the Russian conflict in Ukraine on shipping logistics, fuel prices and access to shipping containers will likely push transportation costs above 2021 levels. Combined, these factors have the potential to significantly impact global supply chains, further increasing shipping delays and prices, and raising the cost of production.

Supplier delivery times, elevated since 2020q2, are indicative of the widespread strains in global production networks.

Figure 27: PMI Supplier Delivery Times across regions Jan-2012 - Jan-2022



Source: Central Bank of Ireland calculations, using Markit PMI SDT data.
Note: Lower values of the SDT index represent longer delivery times.

Given the considerable uncertainty surrounding the Russian invasion of Ukraine, the conflict will contribute to a range of economic headwinds in 2022. These headwinds have the potential to cause a contraction in global trade flows, in both the short run and in the medium term. Supply chain problems resulting from pandemic related lockdowns continue to spill over into 2022, with business experiencing continued delays to international shipping times. Inflationary pressures and turbulent commodities markets will dampen global trade sentiment, while declining output will likely affect export and import markets more than domestic business activities.

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Based on estimates of the effects of the Russia-Ukraine conflict on global output by leading international organisations (including the OECD and the ECB), global import demand is projected to decline relative to previous forecasts, but remain positive over the 2022-2024 horizon period. Growth rates of 4.2 per cent in 2022, 2.8 per cent in 2023 and 1.9 per cent in 2024 are all lower relative to those in the Q1 *Bulletin*, reflecting reduced projections of global economic growth and commodity price volatility. These estimates are subject to considerable uncertainty, given changing conditions in global supply chains (including "reshoring" and the movement away from "just-in-time" logistical models) and risks to additional Omicron-related lockdowns in key contract manufacturing locations.

Despite a range of headwinds, the Irish exports outlook remains broadly favourable, both in headline terms and for indigenous exporters. The primary drivers of Irish exports over recent years are expected to continue over the forecast horizon, with headline export growth of 8.0 per cent projected for 2022, 6.2 per cent in 2023, and 6.0 per cent in 2024 (Figure 28). In particular, the pharmaceutical and computer services exports sectors should remain relatively resistant to negative demand effects from the headwinds reflected in the baseline forecast. These sectors should provide a stable base for Irish exports series to grow over the forecast horizon, acting as a positive contributory factor to growth in Irish GDP. However, more extreme supply constraints on key inputs than assumed in the baseline could lead to somewhat lower production in even these sectors.

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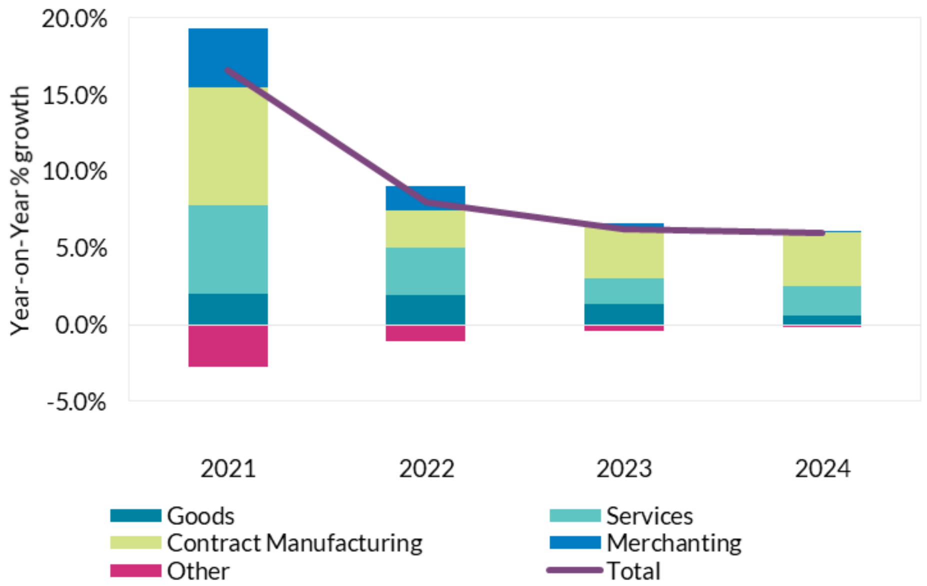
Services and contract manufacturing will anchor export growth during global trade turbulence.

Figure 28: Contributions to Growth in Total Gross Exports



Source: Central Bank of Ireland forecasts, using CSO Balance of Payments and ECB Trade Consistency Exercise data

Cross-border trade growth, typically more responsive to global conditions, should see larger declines over the forecast period, but should remain positive throughout. While some components of domestic goods and services exports are likely to remain unaffected by the anticipated deterioration in global trade conditions, this is not true for all products and sectors. Consequently, somewhat lower growth rates for these sectors are projected, relative to aggregate exports. Combined, cross-border exports are projected to grow by 6.6 per cent in 2022, 4.0 per cent in 2023 and 3.4 per cent in 2024 (Figure 29). Again, commodities market volatility, the duration of the Russia-Ukraine conflict and price increases in intermediate products impose substantial uncertainty on these estimates.

Similar to cross-border exports, imports are also forecast to respond to adverse trade conditions, as well as slower growth in domestic demand. The anticipated global trade headwinds are expected to transmit through to Irish imports, through a combination of reduced import demand (related to export reductions), constraints on energy and agricultural products available for import, and possible supply chain issues. Overall, Irish import growth rates are forecast at 7.8 per cent for 2022, before declining to 5.9 per cent in 2023 and 5.1 per cent in 2024.

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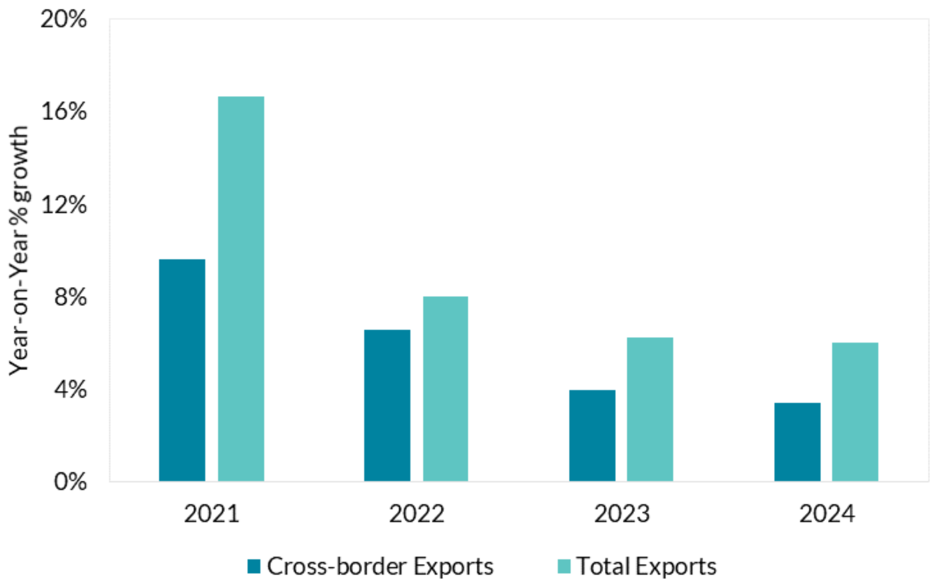
Export growth will remain positive over the forecast horizon, despite global trade headwinds.

Figure 29: Export Growth Forecasts, 2022-2024



Source: Central Bank of Ireland forecasts, using CSO Balance of Payments and ECB Trade Consistency Exercise data

A small surplus of €1.5bn in the headline current account was recorded in Q4 2021. Combined with record surpluses in the first three quarters of 2021, the overall surplus for the year was €58.8bn, equivalent to 14 per cent of GDP and the largest on record. The CSO will publish an estimate of the modified current account (CA*) for 2021 in the summer.

Prices and Costs

Consumer price inflation is forecast to remain higher for longer compared to the previous *Bulletin*. Price increases are being driven by rising energy and commodity prices and continued supply bottlenecks in the presence of growing demand. The Russian invasion of Ukraine has led to further increases in global energy and commodity prices at a time when their prices were already high. The war has also led to elevated volatility in commodity markets and uncertainty about its outcome has added considerable uncertainty to forecasts, with significant upside risks (see Box A). The inflationary period is a global phenomenon, with consumer prices rising across the US, UK and euro area. Prices continued their upward

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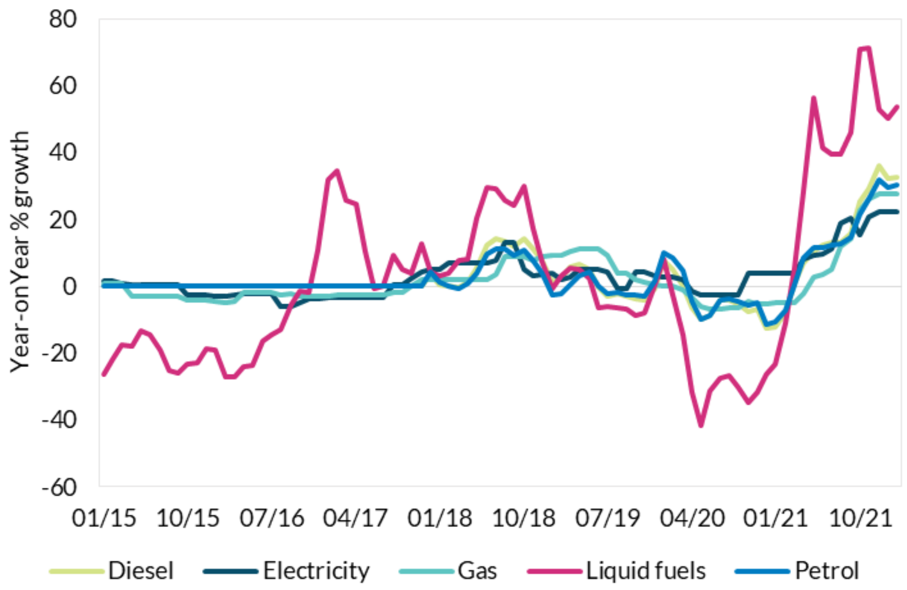
trend in Ireland, increasing by 6.9 per cent over the year to March according to the HICP.[21]

Driven by increases in international oil and natural gas prices, energy prices for consumers increased by 30 per cent year-on-year in February 2022. Oil and natural gas prices increased rapidly over the year to February 2022 as the global economy experienced pandemic and weather-related imbalances between global energy demand and supply. These increases in wholesale international energy prices (Figure 30) were passed through to consumers in the form of higher prices for petrol, diesel, home heating oil, gas and electricity bills. Forecasts for inflation are conditional on the path of wholesale oil and gas futures, which are projected to decline gradually over the forecast horizon. Current consumer prices, therefore, may not yet reflect developments in the current spot price as there is a lag passing through the wholesale prices. Further increases in consumer energy prices could be expected for some months even if oil and gas prices decline on international markets.

Increases in wholesale international energy prices passed through to consumers in the form of higher electricity and energy prices.

Figure 30: Energy price inflation



Source: Eurostat

[21] This is a flash estimate by Eurostat for inflation in Ireland in March 2022.

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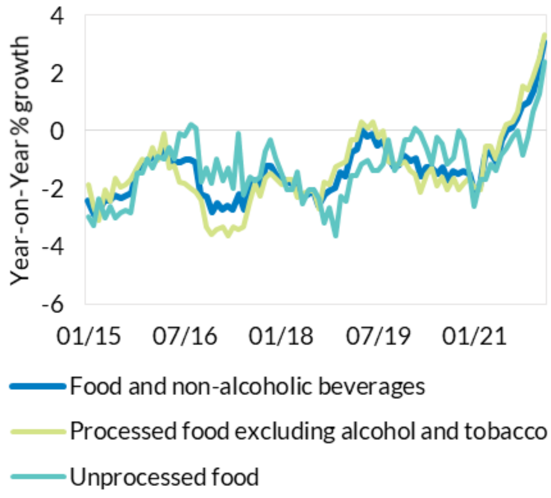
Increases in energy prices have spread to broader consumer prices including food and durable goods. Energy is a vital component in the production of all goods and services, but some have a heavier energy input than others and may experience a faster pass-through to consumer prices. Globally, fertiliser prices have increased in recent months, as gas is a vital component in fertiliser manufacturing. In turn, food prices are expected to rise given the use of fertiliser as an input to food production. Following a five year period of price declines, food prices increased by 3 per cent year-on year in February (Figure 31). While some increase may relate to declines in the pandemic and increases in the minimum unit price of alcohol, many staple foods are increasing relative to 2019; bread, pasta, lamb, chicken and milk increased by 7.9 per cent, 8 per cent, 16.5 per cent 4 per cent and 6 per cent relative to 2019. Further increases in food prices are forecast as energy prices continue to pass through to consumer goods. Food prices are forecast to increase by 5 per cent in 2022. Non-energy Industrial Goods (NEIG) prices have also reversed a longstanding downward trend. NEIG prices increased by 3.8 per cent in February, with durable good prices increasing by 7.5 per cent (Figure 32).

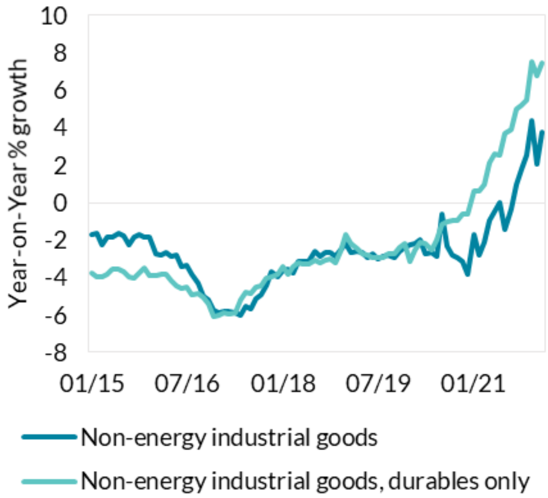
Increases are evident also in non-energy components of inflation.

Figure 31: Increases in food prices



Source: Eurostat

Figure 32: Increases in non-energy goods



Source: Eurostat

Supply bottlenecks continue to drive up input prices in a number of sectors and these prices will continue to feed through to consumer prices. In addition to energy supply concerns, the war in Ukraine and associated sanctions are likely to exacerbate supply chain concerns in a

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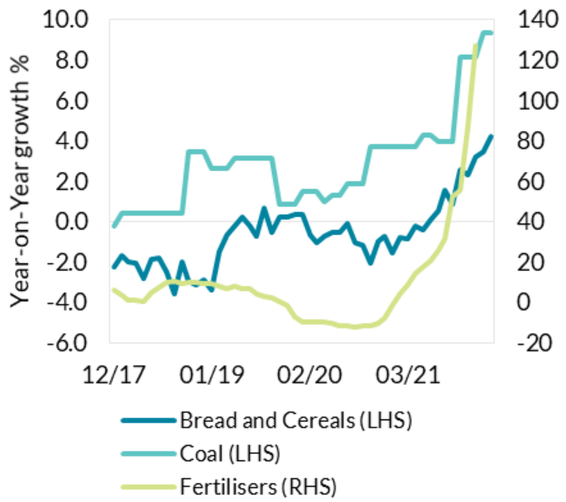
number of areas. Increases in the price of, and shortages of, inputs, or intermediate goods, like coal, maize, wheat, fertilisers, wood and certain metals are likely and already evident (Figure 33 & 34). Disruption of trade routes, freight costs, inaccessibility of critical raw materials will likely cause further inflationary pressures both internationally and domestically. Continued shortages of semi-conductors and some metals are leading to further disruptions for automobile manufacturers, with implications for the price of both new and second had cars domestically. Relatedly, the prices of household appliances have also been notably rising. Supply chain issues around COVID-19 remain elevated with recent outbreaks resulting in the closure of important manufacturing facilities in Shenzhen, China. Depending on the length of the war in Ukraine, supply chain issues are likely to be more prolonged than initially projected, increasing the probability of supply side inflationary pressures continuing into 2023.

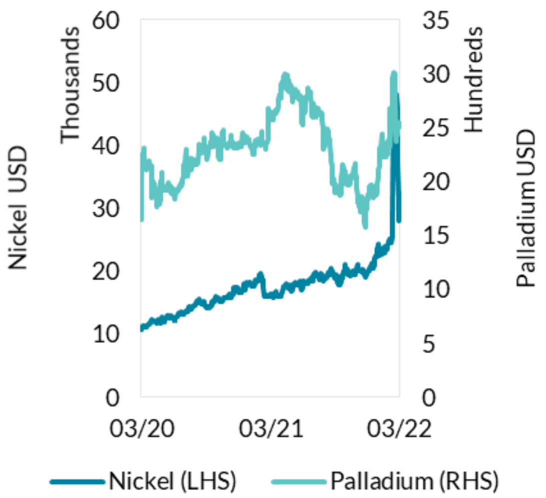
Supply bottlenecks continue to drive up input prices

Figure 33: Selected food and energy inputs



Source: CSO, Eurostat

Figure 34: Surge in metals prices



Source: Refinitiv

The inflation rate is forecast to peak in the second quarter of 2022 at approximately 7.7 per cent, remaining above 7 per cent for the third quarter and declining to 5.1 per cent in the fourth quarter of 2022. The average rate for 2022 is forecast to be 6.5 per cent (Figure 35). Inflation prospects this year reflect the atypical, asymmetric demand/supply imbalance of the pandemic and the impact of war in Ukraine. The underlying situation is also an Irish economy that is approaching its productive capacity. Headline HICP inflation is expected moderate to 2.8

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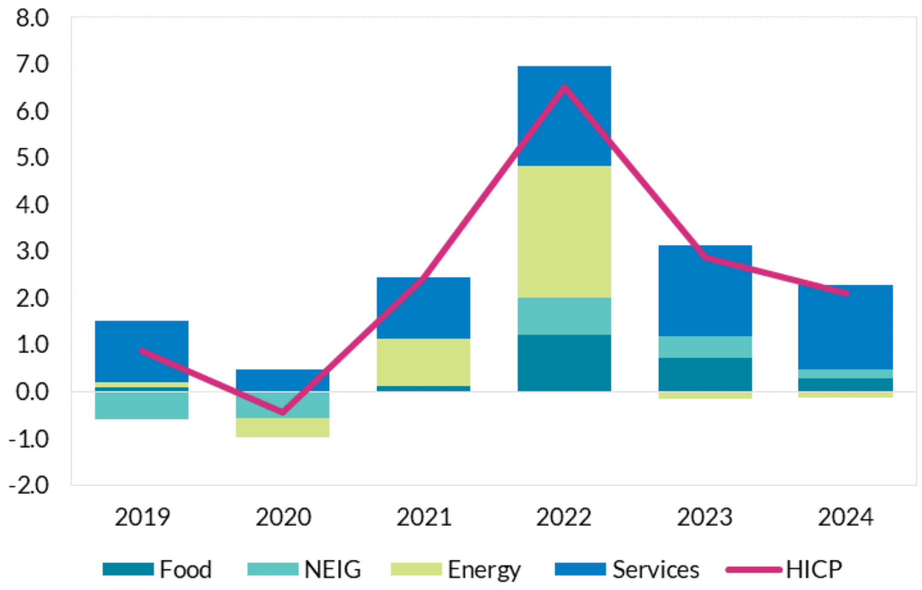
per cent in 2023 before easing to 2.1 per cent in 2024. Core inflation, excluding food and energy prices, is forecast to increase by 4.1 per cent in 2022, 3.4 per cent and 2.8 per cent in 2023 and 2024, respectively.

Energy market futures are predicting a negative contribution to inflation going forward

Figure 35: Contributions to inflation



Source: Central Bank of Ireland and CSO

Risks to the inflation forecasts remain tilted to the upside. The war in Ukraine and the potential for further COVID-related disruption increase the risk that global supply bottlenecks persist longer than anticipated, adding to the costs of consumer goods and services. The market expectations of a decline in energy prices over the forecast horizon also present an upside risk if geo-political tensions do no ease. The exchange rate channel also presents an upside risk to inflation if the euro falls further against its main trading partners. The dynamics between wages and prices will be an important determinant of future inflation developments, with expectations for future inflation showing some upward movement for next year. On the other hand, a more prolonged surge in inflation could dampen consumption and investment prospects, with negative demand consequences and second round knock-on effects for inflation.

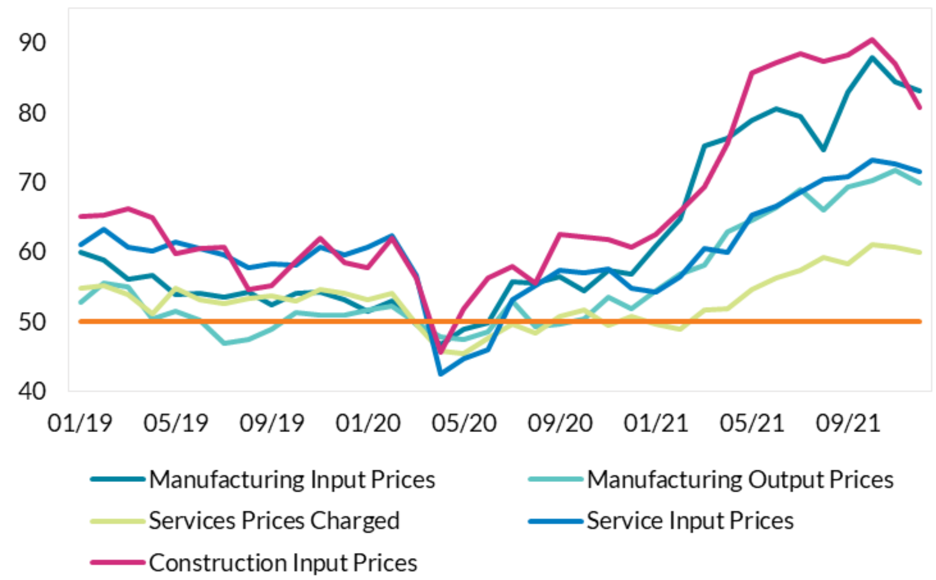
Table 3: Inflation Projections

	2021	2022	2023	2024
HICP	2.4	6.5	2.8	2.1
Goods	2.0	8.7	1.8	0.6
Energy	12.3	30.9	-2.1	-1.5
Food	0.5	5.7	3.3	1.3
Non-Energy Industrial Goods	0	3.5	2.0	0.8
Services	2.4	4.3	3.9	3.6
HICP ex Energy	1.5	4.3	3.3	2.4
HICP ex Food & Energy (Core)	1.7	4.1	3.4	2.8
Modified Domestic Demand Deflator	3.3	6.1	3.8	2.9
Private Consumption Deflator	3.3	6.5	3.7	2.5
Modified Investment Deflator	4.6	8.5	4.8	3.6

Source: Central Bank of Ireland

Broader measures of costs in the economy picked up during 2021

Figure 36: PMI Input and Output Prices



Source: AIB

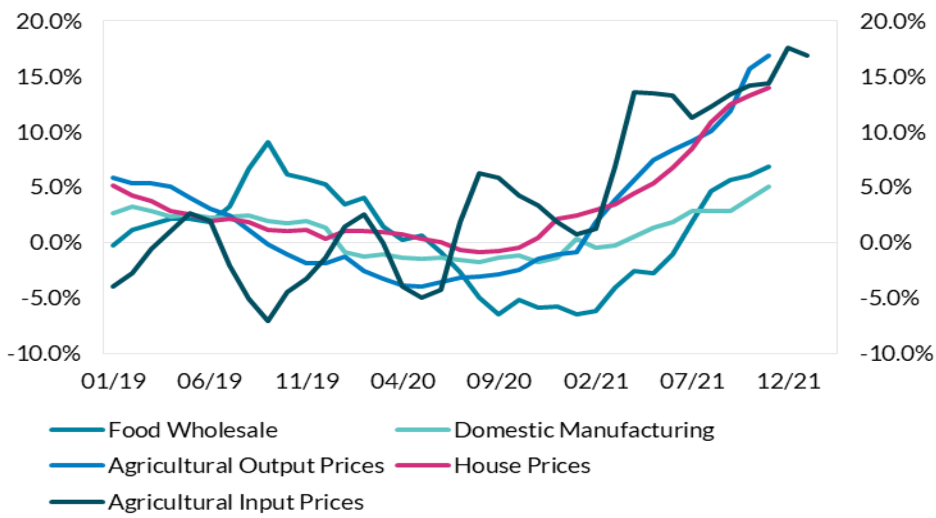
Broader Costs in the Economy

Input and output prices in the manufacturing, services and construction sectors continue to point towards supply constraints and significant price pressures in the months ahead. While the indices for input costs and prices look to have peaked, they remain at historical highs (Figure 36).

Inflation is also evident in other price measures, including agricultural prices, domestic wholesale prices, property prices and asset prices (Figure 37). The rise in these measures reflects the broadly-based nature of price increases across the economy expected over the forecast horizon.

Broad based price increases evident throughout 2021

Figure 37: Wholesale, Asset, Agricultural and Manufacturing prices



Source: CSO

Labour Market

Employment forecasts have been revised upwards relative to the previous *Bulletin* due to the scale of the increase observed in the latter half of 2021, which is in part offset by the expected impact of the Russian invasion of Ukraine on the real economy. Based on the latest data for Q4 2021, employment continues to grow strongly driven by the increased participation of younger age cohorts and females in 2021. Employment increased by 10.1 per cent annually in the year to Q4 2021 to reach a new peak level of over 2.5 million persons. This follows similar growth rates observed in the two preceding quarters as year-end employment levels are 149,000 higher than Q4 2019 figures. The outlook for employment is buoyed by increased labour demand

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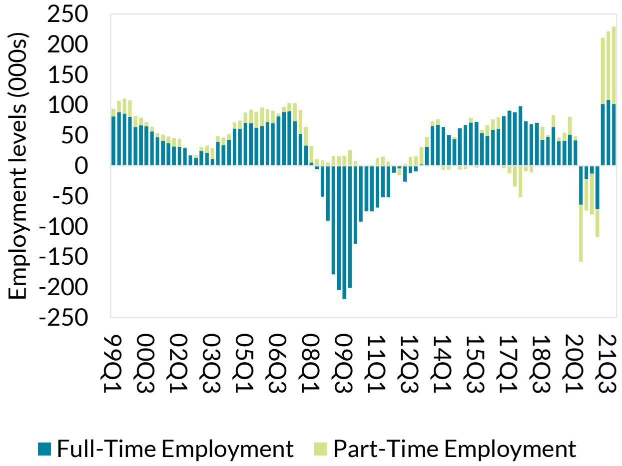
across all economic sectors to absorb additional spare capacity as pandemic support schemes are wound down and public health measures are lifted. Ongoing inflationary developments and rising business costs pose downside risks to employment growth. Employment is projected to increase by 3.7 per cent this year due to strong base effects before moderating to 2.2 per cent in 2023.

Part-time employment has driven a large share of the employment recovery

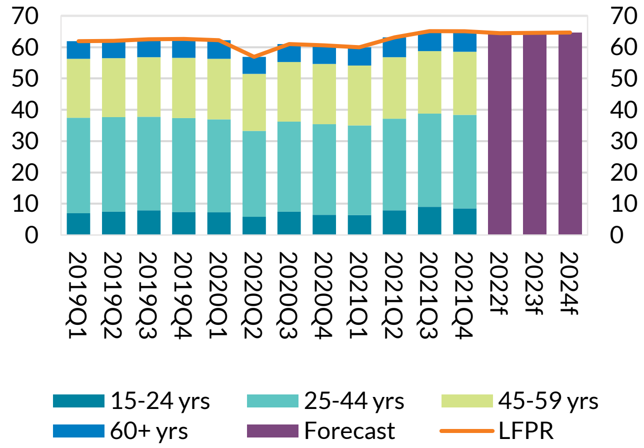
Figure 38: Annual change in full-time and part-time employment levels



Source: CSO: LFS

Strongest contribution to labour force participation growth has come from younger age cohorts

Figure 39: Decomposition of Labour Force Participation Rate by age cohort



Source: CSO: LFS

Employment growth has been diverse across sectors, with an increased role of part-time employment. There is continued heterogeneity in the recovery of NACE-sector employment levels as the contact-intensive sectors such as Administrative services and Accommodation services remain 14.6 per cent and 9.7 per cent below their pre-pandemic levels in Q4 2019, respectively. Non-contact intensive or essential services have shown a sustained expansion over the same period as seen in ICT (30.9 per cent) and Professional services (22.8 per cent). Part-time employment growth has contributed significantly to the recent overall expansion, which is often observed following an economic shock, although the contribution is much more pronounced in the pandemic recovery period (Figure 38). There is now a greater share of part-time employment in the contact-intensive sectors relative to Q4 2019 due to the inflow of younger workers. This change plays a major role in the slower recovery of total actual hours worked (0.2 per cent) compared to employment (6.3 per cent) over the

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same period. Additionally, COVID-related absences from work continue to impact total hours worked, as the number of those away from work in the Q4 2021 was 65,200 persons higher than the equivalent period in 2019. As economic sectors continue to recover and figures for those away from work begin to normalise, a share of this part-time employment is expected to move to full-time work, bringing about a moderation in the overall growth rate.

The labour force increased by 8.9 per cent in the year to Q4 2021 with participation effects continuing to drive these developments, with the demographic effect remaining curtailed by lower net inward migration throughout the pandemic. The labour force participation rate remains unchanged from the previous quarter at 65.1 per cent, but there has been a further increase in the female rate to a new peak of 60.1 per cent to offset a slight reduction in the male rate. The increase in the aggregate participation rate relative to the pre-pandemic period is driven by a combination of a higher number of younger persons (aged under 25 years) and females (aged over 25 years) in the labour force (Figure 39). Looking ahead, the demographic effect is expected to contribute to a lesser extent to labour force growth as net inward migration levels begin to normalise following the removal of public health measures both domestically and internationally. Additionally, with the war in Ukraine influencing migration patterns, there will be a stronger increase in the working age population over the forecast horizon than previously expected. Labour force growth rates of 3.5 and 1.6 per cent are projected for 2022 and 2023, respectively.

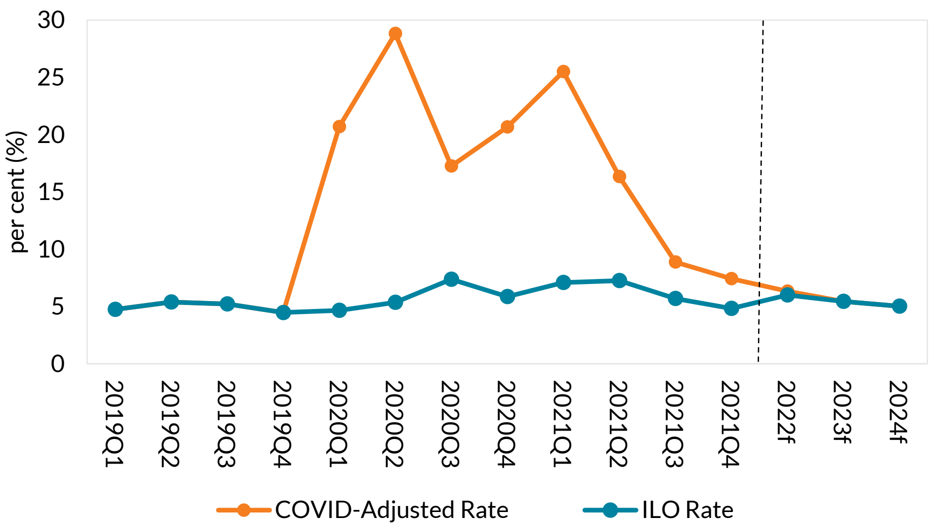
The outlook for unemployment is likely to be determined by the phasing out of pandemic support schemes early in the year and the impact of inflationary developments and supply chain issues on the real economy. The seasonally-adjusted monthly ILO unemployment rate for February 2022 measured 5.2 per cent, with the COVID-adjusted rate continuing its downward trajectory to 7 per cent (Figure 40). Income support schemes are gradually being phased out in Q1 and Q2, respectively, with the PUP scheme closing at end-March and the EWSS at end-April.[22] A change in the labour status of persons coming off these supports can have a significant impact on labour market figures. A move to ILO unemployment status would result in an upward movement of the unemployment rate as it converges with the COVID-adjusted rate in Q2 2022. Similarly, a transition to outside of the labour force would generate a downward effect on the labour force participation rate. The EWSS scheme currently supports an estimated 256,000 workers, 52 per cent of whom are employed in

[22] COVID-19 Income Support Schemes 10 March 2022

Accommodation and Retail sectors.[23] The scheme remains weighted towards relatively low-income workers. While it accounted for 4 per cent of total earnings in Q4 2021, the share is higher for firms in the Accommodation (45.6 per cent) and Arts sectors (19.9 per cent). Firms with tighter business margins may face greater difficulties with increasing input prices at the same time as they begin to realise full wage costs. This could contribute to a dampening effect on the viability of the recent expansion in part-time employment, much of which has been younger workers, and could lead to reductions in hours worked or employment levels in certain sectors. Unemployment rate projections have been revised marginally upwards over the forecast horizon to 6 per cent, 5.4 per cent and 5 per cent in 2022, 2023, and 2024 respectively.

Unemployment rates begin to converge as PUP scheme is gradually Closed

Figure 40: Actual and Forecast Unemployment Rates



Source: CSO

[23] Businesses availing of EWSS that were directly impacted by the public health restrictions in operation from 20 December 2021 to 22 January 2022 will receive additional support under the scheme to assist them as they fully reopen. These businesses will continue to receive support under the EWSS until 31 May 2022 with a delayed step-down in subsidy rates.

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Table 4: Labour Market Developments

	2021	2022f	2023f	2024f
Employment (000s)	2,389	2,477	2,532	2,583
% change	6.0	3.7	2.2	2.0
Labour Force (000s)	2,547	2,635	2,678	2,720
% change	6.5	3.5	1.6	1.6
Participation Rate (% of Working Age Population)	63.3	64.5	64.6	64.7
Unemployment (000s)	158	158	146	136
Unemployment Rate (% of Labour Force)	6.3	6.0	5.4	5.0
COVID-adjusted Unemployment Rate (% of Labour Force)	14.5	6.3	5.4	5.0

Earnings and Incomes

Average hourly earnings from CSO EHECS data increased by 2.5 per cent in the year to Q4 2021, down from a 3.8 per cent annual growth rate in the previous period. This moderation in growth may be indicative of more part-time workers returning to employment although there remains considerable compositional issues in the various underlying NACE sectors. Observing growth in average hourly earnings over a two-year period from 2019 to 2021, the largest increases are evident in the Administration and Accommodation sectors (Figure 41), however, employment and total actual hours worked figures are yet to return to pre-pandemic levels in the contact-intensive sectors. The relatively higher growth in hourly earnings may be reflective of a greater compositional share of higher-earning workers that did not exit the sector over the course of the pandemic and the exit of relatively lower-earning workers that have not yet returned to the sector, which negatively influences total actual hours worked levels. Conversely, strong earnings and employment growth have been observed in the remote working sectors such as ICT, Professional and Finance that were less likely to exhibit these compositional effects. These sectors recorded the next highest increases in average hourly earnings over the two-year period, in addition to exhibiting the highest sectoral vacancy rates. CSO Frontier Analysis finds that workers who did not receive PUP or WSS supports (accounting for 67 per cent of employees) tended to have the highest weekly income levels, in addition to exhibiting a 7 per cent annual increase in weekly earnings in Q3

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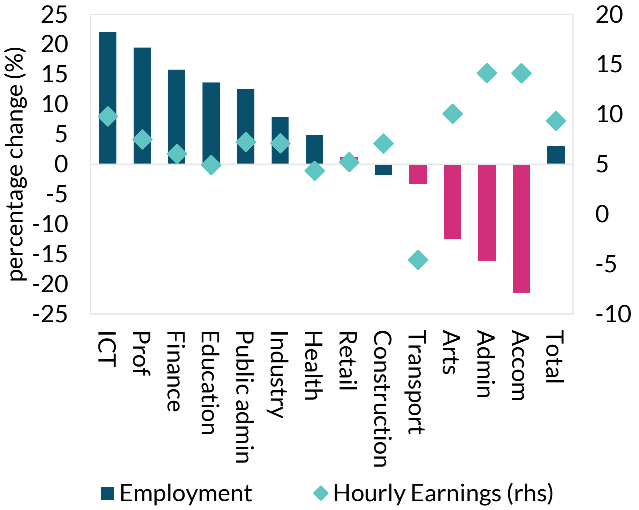
2021.[24] The change in earnings is even greater for non-recipients who changed to a different employer over the same period (12.7 per cent).

Compositional effects remain evident in pandemic-affected sectors but continued earnings expansion in remote-working sectors

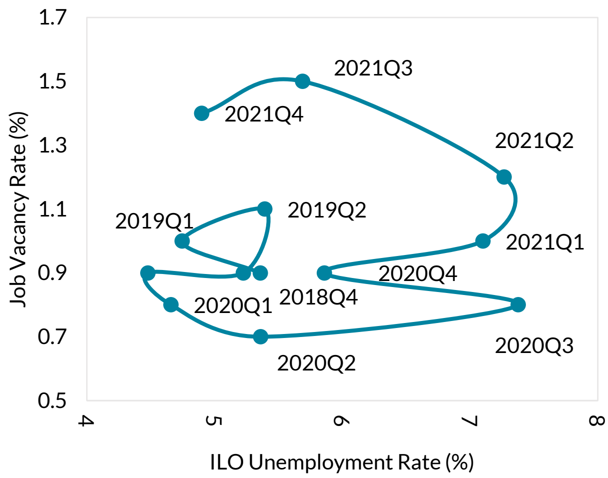
Figure 41: Percentage change in average hourly earnings and employment (2019-2021)



Source: CSO: EHECS and LFS
Note: the dark blue bars represent sectors in which total actual hours worked are above Q4 2019 levels, while the pink bars represent sectors in which total actual hours worked figures are lower with respect to Q4 2019 levels

Beveridge Curve indicates remaining labour market tightness

Figure 42: Beveridge Curve



Source: CSO: LFS and EHECS

The job vacancy rate remains high following significant increases through 2021. Despite easing somewhat in Q4 2021 as a result of the transmission of the Omicron variant, higher-frequency data based on Indeed job-postings show that the most recent levels have rebounded to 59 per cent above the pre-pandemic comparison period of February 2020.[25] Rising uncertainty related to the war in Ukraine and associated energy costs do not yet appear to have influenced labour demand greatly. The highest job vacancy rates continue to be in the Professional (2.7 per cent), Finance (2.5 per cent) and ICT (2.2 per cent) sectors, which also rank among those with the highest hourly earnings levels. The relationship between vacancies and unemployment as reflected by the Beveridge Curve (Figure 42) provides an indication of current labour market tightness. While there has been a sharp recovery since the onset of the pandemic, the unwinding

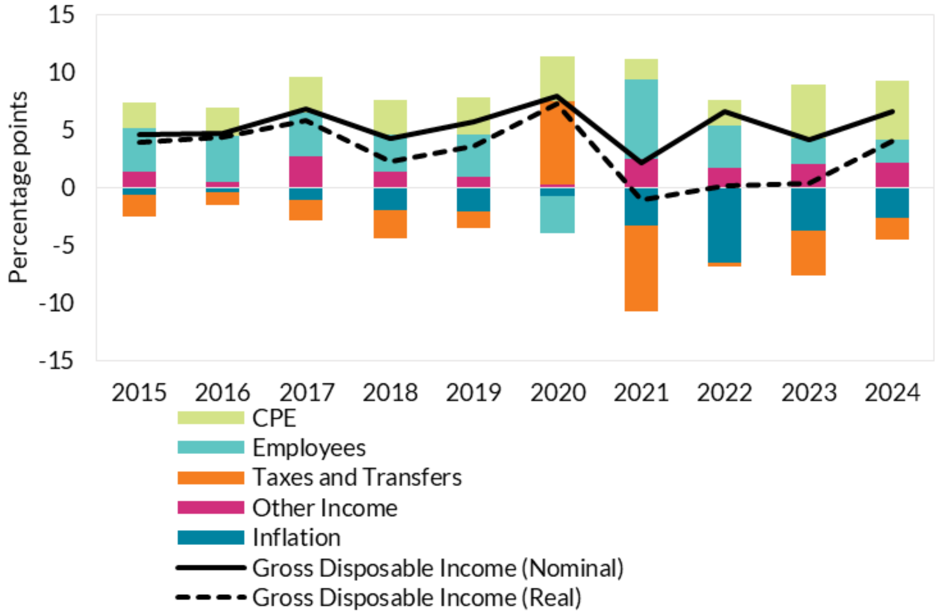
[24] CSO: Impact of COVID-19 Income Supports on Employees, - Insights from Real Time Administrative Sources, Series 3
[25] Indeed (2022) Irish Job Postings Through 18 March: Postings Retreat From Peak

of EWSS and PUP supports in the first half of 2022 will further reveal the extent to which labour demand levels on the whole can be met and can serve to ease potentially broader wage pressures.

The effect of current inflationary developments could result in a decline in aggregate earnings this year in real terms for the first time since 2013. A nominal compensation per employee projection of 2.3 per cent in 2022 corresponds to a real decline of 4.2 per cent before then moving into positive figures in 2023 and 2024 (Figure 43). This growth in real earnings of 1.8 per cent and 3 per cent, spurred by tighter labour market conditions and a moderation in the inflation outlook, is expected to support increased consumption activity above the pre-pandemic trend.

While compensation is forecast to pick up over the forecast horizon, higher inflation will act as a drag on real incomes

Figure 43: Decomposition of Compensation Per Employee



Source: CSO, Central Bank of Ireland.

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The Public Finances

Overview

The general government balance is estimated to have improved significantly last year. The deficit is estimated to have fallen by over 5 percentage points to 3.5 per cent of GNI* (Table 5) compared with 2020, with the improvement primarily driven by a rapid recovery in tax revenue. Expenditure also appears to have come in below expectations, with gross voted spending below profile across all of the Ministerial Vote Groups. A further improvement in the public finances is expected this year, while the general government balance is projected to return to surplus in 2023, as the withdrawal of temporary pandemic supports and the impact of strong activity levels on tax receipts outweigh robust core expenditure growth. The budget surplus is projected to be 1.9 per cent of GNI* at the end of the projection horizon in 2024.

Despite the general government balance running a large deficit last year, the general government debt ratio is estimated to have declined. This reflected the large, negative interest – growth rate differential. Favourable debt dynamics are expected to lead to further improvements over the medium term, with the ratio projected to be 84.7 per cent of GNI* in 2024. Irish sovereign borrowing rates have continued to trend upwards in recent months but remain low relative to historical borrowing costs. The medium term maturity profile is favourable and the National Treasury Management Agency (NTMA) continues to hold very large cash balances. These factors should increase sovereign funding flexibility in a more uncertain environment going forward.

As noted in previous Quarterly Bulletins, there is a much higher level of uncertainty surrounding the fiscal outlook than would normally be the case. This reflects not only uncertainties linked to the COVID-19 pandemic, such as the final cost of support measures, but also those linked to the Russian invasion of Ukraine. The latter includes both expenditure on providing humanitarian support for refugees and measures introduced to mitigate the impact of high energy prices. There are also broader, more general structural uncertainties such as those related to government spending pressures and the potential impact of international tax reforms on corporation tax receipts.

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Table 5: Fiscal outlook

	2020	2021f	2022f	2023f	2024f
GG Balance (€bn)	-18.4	-8.1	-2.1	2.6	5.3
GG Balance (% GNI*)	-8.8	-3.5	-0.8	1.0	1.9
GG Balance (% GDP)	-4.9	-1.9	-0.4	0.5	1.0
GG Debt (€bn)	217.9	231.6	227.4	231.0	229.5
GG Debt (% GNI*)	104.7	101.4	91.8	88.7	84.7
GG Debt (% GDP)	58.4	54.9	49.4	46.6	43.0

Source: CSO and Central Bank of Ireland projections

Box D: Fiscal Policy in a High Inflation Environment

By Rónán Hickey and David Staunton

Introduction

Inflation in Ireland is currently well above its pre-pandemic level. High inflation has implications for the public finances by affecting government revenue, spending decisions and debt. This Box discusses how the rise in inflation can affect the public finances, outlines the government measures to mitigate the effect of higher inflation announced to date, and looks at considerations for possible future policy actions.

Transmission channels of high inflation to the public finances

The most immediate effect of the rise in inflation is on Government revenue, as higher prices translate into higher income from indirect taxes like VAT and excise duty. Together, these two tax headings accounted for around one quarter of Exchequer revenue last year. It is likely that the Exchequer has already benefited from the rise in prices, but any secondary effects of higher inflation such as potential reductions in household consumption could eventually reduce indirect tax receipts. Moreover, the Government recently announced a temporary cut to excise on fuels that will directly reduce revenue from this source by €320 million. Direct taxes and social contributions, by comparison, are not automatically affected by higher inflation. If wage growth accelerates, PAYE and USC may also come in ahead of expectations. This is due to the increase in total wages, as well as the fact that unless the tax bands are adjusted, a greater share of income will be taxed at the higher income tax rate (this is known as fiscal drag). Against this, it is possible

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that lower non-energy consumption could lead to weaker employment growth, placing downward pressure on the base for income taxes.

On the expenditure side, the direct effects are limited. Unlike many other euro area countries, Ireland's pension and social welfare system does not use automatic indexation.[26] This means that any increases to the state pension and unemployment benefits will be at policymakers' discretion. However, higher prices may still lead to spending pressures. Government could choose to compensate certain groups for higher prices by increasing social benefits, and long-term capital projects will be more vulnerable to cost overruns. More generally, a given level of real expenditure could now cost more in nominal terms. Since headline inflation is an average figure, it does not capture the varying impact that price increases can have on different household types. Low-income households, for example, spend a greater share of their income on energy goods.[27] This makes these households more exposed to the recent rise in prices and various measures have been put in place by Government to help alleviate the higher cost of living, some of which are targeted towards lower income groups (discussed below). Any extension or expansion of these programmes could increase expenditure above what was included in Budget 2022. More persistent inflationary pressures could over time also lead to higher debt interest payments as interest rates would generally rise. In the Irish case, however, there are limited bonds maturing (€12bn between now and end-2023) over the coming 18 months and the National Treasury Management Agency (NTMA) has significant cash reserves on hand (€34.4bn at end-February 2022), providing it with funding flexibility. The NTMA currently plans to issue €10 - €14bn of bonds this year, €4.5bn of which has already been raised in the first quarter.

Higher inflation can impact the ratio of debt-to-national income through both the numerator and denominator channels. In the case of the former, this can occur through changes in the interest-growth differential (either through higher nominal growth rates, higher effective interest rates, or a combination of the two) or changes in the primary balance. The overall direction of the impact will depend on which of these factors dominates. In the case of the denominator, one would expect nominal GNI* to be

[26] Checherita-Westphal, Public Wage and Pension Indexation in the Euro Area, 2022.
[27] Lydon, Household characteristics, Irish inflation and the cost of living, 2022.

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higher for a given real level of output, putting downward pressure on the debt ratio.

Irish Government response to date

The Irish government has announced a number of measures in recent months to mitigate the impact of higher energy costs on households and businesses. These include a temporary reduction in excise duty on fuels, an energy credit of €200 per household, an exceptional payment of €125 to households in receipt of the fuel allowance and subsidies for hauliers. As Table 1 outlines, it is estimated that these measures will cost €855m or 0.3 per cent of GNI* in 2022. These measures are in addition to an increase in the weekly rate of the fuel allowance announced in Budget 2022. The better than expected performance of the public finances last year, coupled with the large COVID-19 contingency reserve, has provided the Government with some additional space to fund this expenditure.[28] Nevertheless, with the public finances in a deficit position following COVID-19, this expenditure will be funded by borrowing.

Table 1 : Fiscal measures announced since Budget 2022 in response to increase in Inflation

Date of Announcement	Measure	Estimated Cost in 2022
Feb-22	Fuel allowance lump sum payment	€49m
February	Energy credit payment of €200	€378m
February	Reduction in public transport fares	€54m
February	Reduction in Drug Payment Scheme threshold	€17m
February	Increased income threshold for Working Family Payment	€4m
February	Reduced cost of school transport fees	€3m
Mar-22	Temporary reduction in excise duty on fuels	€320m
March	Subsidy for hauliers	€18m
March	Targeted intervention for tillage sector	€12m
	Total	**€855m**

Source: Department of Finance, Department of Transport

In terms of the overall impact of higher energy prices on the fiscal position, our latest estimates show that the negative impact on real

[28] As recently as Budget 2022 a General Government deficit of €13.3bn (-5.9 per cent of GNI*) was expected for 2021, but this is now estimated to have been closer to €9bn (-3.8 per cent of GNI*) reflecting higher than expected tax receipts and lower than projected spending. The Government's projected €8.3bn deficit for this year includes a €2.8bn (1.1 per cent of GNI*) unallocated COVID-19 contingency.

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activity more than offsets the positive impact of higher prices this year. Accordingly, when coupled with the direct costs of the measures outlined above, it appears that higher energy prices will have a negative effect on the public finances in 2022.

As set out in the scenario analysis in *Box A* of this *Bulletin*, further increases in energy prices could lead to higher inflation and lower than expected growth than in the central forecast. The scenario results indicate that, while higher inflation would directly increase government revenue from some tax headings, this would be offset by the impact of slower overall economic activity. The net impact on the public finances would be negative. In scenario 1 (oil prices +15 per cent, gas +50 per cent), the General Government deficit would be higher by 0.2 percentage points in 2023 while in scenario 2 (oil +35 per cent, gas +120 per cent), the deficit would be 0.5 percentage points larger than in the central forecast. The scenarios assume that no additional government support measures are introduced.

Options for the future

In the event that further government supports are deemed necessary to help offset higher inflation, it is important that any such measures are temporary in nature and targeted to those most affected by the price increases. Were the need to arise for the measures already introduced to remain in place for an extended period beyond 2022, options for the sustainable funding of these supports would need to be considered.

Measures also need to limit the risks of second round effects emerging, generating the need for additional supports. The European Commission published a toolbox of short and medium-term measures last October that could be taken to support consumers and industry in response to a spike in inflation.[29] These include targeted social payments to those most at risk, deferrals of bill payments, reduced tax rates for vulnerable households and aid to companies in line with EU state aid rules.

Permanent and across the board spending increases - which are not offset by additional revenue raising measures - would weaken the structural budgetary position, at a time when the government debt ratio remains at an elevated level and spending pressures over the medium to longer term are set to increase due to factors such as demographics and

[29] European Commission, Tackling rising energy prices: a toolbox for action and support, October 2021.

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climate change. The full year cost of the measures already announced is estimated to be around 0.5 per cent of GNI*. Were these measures not to be rolled back in due course they would therefore lead to a permanent increase in spending of this magnitude that would need to be financed. It is notable that the projected improvement in the budget balance in the coming years is expected to be driven by a strengthening of the cyclical position and an unwinding of temporary measures rather than structural developments.[30]

Subject to protecting those households with greater difficulty in absorbing the higher commodity-based inflation, it is also important that additional support measures introduced do not unnecessarily add further stimulus to the economy. While there has been a sharp increase in the level of uncertainty surrounding the economic outlook since the last Quarterly Bulletin, the economy and labour market are still expected to be running at close to its potential level before the end of the projection horizon. While the expectation is for somewhat lower real growth as a result of the Russian invasion of Ukraine, the geopolitical situation poses a more fundamental supply-side shock to the economy. Against this backdrop, and with inflationary pressures already high, the fiscal stance should not add further demand in the economy over and above existing plans. Expenditure which supports supply-side conditions, builds resilience to future shocks and over the longer-term enhances the structural budgetary position becomes a more immediate priority the longer energy and other commodity prices are expected to remain high.

Summary

Overall, there is a strong rationale for using fiscal policy to compensate those most affected by the recent increase in energy prices. As the pandemic response has shown, a temporary and targeted fiscal response can mitigate the negative impact of an exogenous shock on households and firms, while at the same time limiting the exposure of the broader economy and the public finances.[31] Any additional measures introduced should limit the potential for second round effects, while the overall fiscal stance should remain unchanged from the plans in Budget 2022 to

[30] See Government of Ireland, 'Budget 2022 Economic and Fiscal Outlook', Table 11 Page 32.
[31] For example see Conefrey et al, 'COVID-19 and the public finances in Ireland', Central Bank of Ireland Economic Letter 2021-3.

ensure fiscal policy does not add further to demand in the economy given existing supply constraints.

Fiscal Outlook, 2022 to 2024

The general government balance is expected to record a further improvement this year, although there is significant uncertainty surrounding the outlook. The deficit is projected to fall to -€2.1bn or -0.8 per cent of GNI*. Revenue growth of 8 per cent is expected, a moderation from the exceptional level recorded in 2021, but greater than its average growth rate in the three years prior to the pandemic. In nominal terms private consumption growth remains very strong, supporting indirect tax receipts, while employment and compensation are expected to continue to recover. Tax receipts grew by 20.4 per cent in annual terms in the first two months of the year, although as noted by the Department of Finance this figure was distorted by a number of factors, flattering the year-on-year comparison.[32] Total expenditure is projected to grow by 1.6 per cent this year, but there are considerable uncertainties over spending to provide humanitarian support for refugees from the Ukraine war and the level of COVID-19 spending required. In the case of the former we incorporate expenditure of €1bn (0.4 per cent of GNI*) for 2022, but the final figure could be higher. We assume that this expenditure – and the cost of measures introduced to mitigate higher energy prices (see Box D) - are fully financed by resources previously allocated to the COVID-19 contingency reserve, so they have no net impact on the general government balance this year. In the case of the latter, while it is anticipated that COVID-19 related spending will drop by more than half - as the major income support programmes are wound down – this assumes that the remainder of the €4bn (1.5 per cent of GNI*) COVID-19 reserve outlined in Budget 2022 is utilised.[33] Outside of these factors, core spending continues to grow strongly. Government investment is expected to increase at a particularly robust pace, supported by the National Development Plan and Next Generation EU (NGEU) funding.

[32] See Department of Finance, 'Fiscal Monitor 2022'.
[33] This includes the €2.8bn COVID-19 Contingency Reserve, the €296m COVID Reserve earmarked for Education and Health and the €936m COVID-19 Reserve earmarked for the Labour Market. Fully including these reserves in expenditure is consistent with the approach undertaken by the Department of Finance when preparing the fiscal projections that underpinned Budget 2022.

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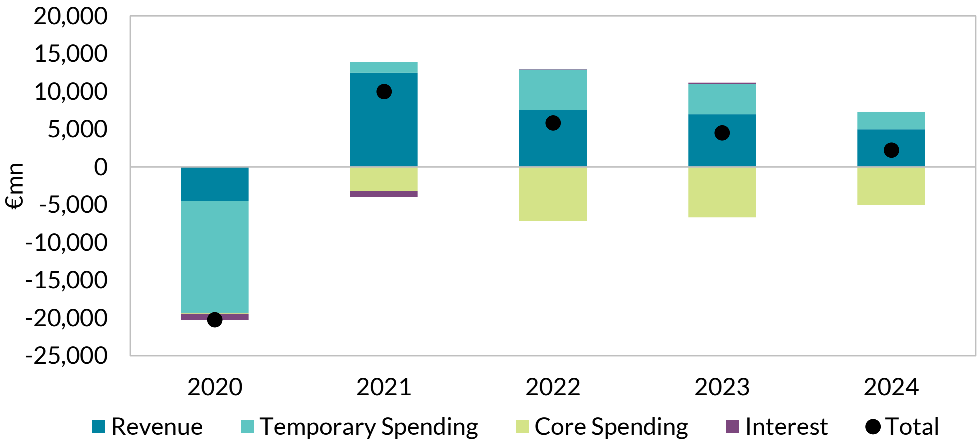
Deficit improves over medium term as pandemic related spending declines

Figure 44: Decomposition of General Government Balance



Sources: CSO, Department of Finance, Central Bank of Ireland Projections

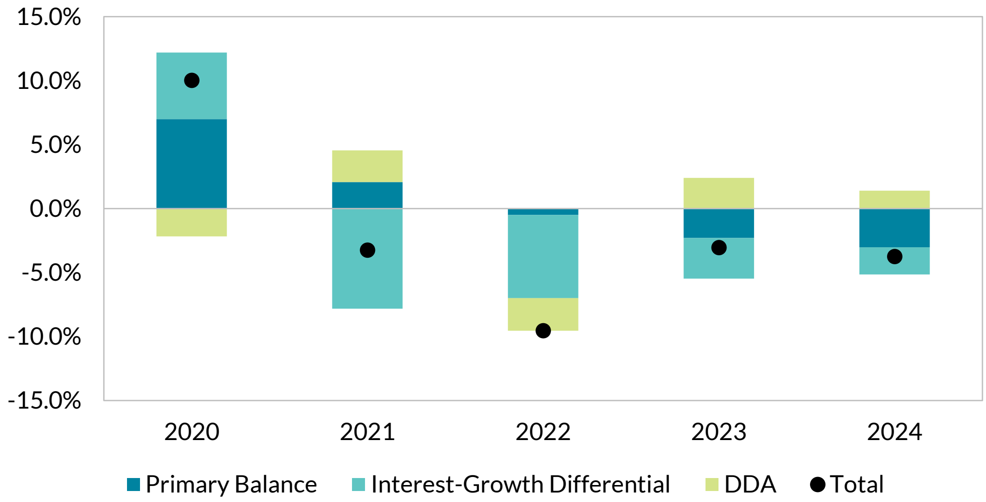
The improvement in the public finances is projected to continue in the coming years, underpinned by robust economic growth and the withdrawal of most of the remaining pandemic related supports. The general government balance is projected to return to surplus next year (€2.6bn or 1 per cent of GNI*), a considerable achievement given the scale of the deterioration that occurred in the public finances following the emergence of the pandemic (Figure 45). The withdrawal of temporary supports – linked primarily to COVID-19 but also those in response to high energy prices - reduces spending by around €4bn (1.5 per cent of GNI*) next year. Total government spending still increases by 2.3 per cent, however. Core spending remains robust - supported by the Government's Medium Term Expenditure Strategy – while expenditure on providing humanitarian support for refugees from the Ukraine war is assumed to increase to €2.5bn in 2023 before falling back to €1bn in 2024 (1 per cent and 0.4 per cent of GNI* respectively). [34] As a result, despite the withdrawal of almost all COVID-19 related supports, total spending remains substantially higher at the end of the projection horizon than it was prior to the pandemic (30 per cent above the 2019 level in 2024). Revenue growth moderates to 4.8 per cent by 2024, with the anticipated negative impact of international tax reforms on corporation tax receipts

[34] The Government's Medium Term Expenditure Strategy permanent core Exchequer expenditure increases of 5 per cent per annum. For more information on this see Government of Ireland, 'Summer Economic Statement July 2021', page 9.

weighing on total receipts. Consistent with Government expectations we assume this results in a €2bn loss of revenue over the medium term, although as noted by the Irish Fiscal Advisory Council there is upside risk to this outlook. [35] Despite this, both direct and indirect tax receipts perform strongly against the backdrop of robust consumption and employment growth. A surplus of €5.3bn (1.9 per cent of GNI*) is projected for 2024.

Debt ratio declines over medium term but remains at elevated level

Figure 45: Decomposition of General Government Debt



Sources: CSO, Department of Finance, Central Bank of Ireland Projections

Against the backdrop of very favourable debt dynamics, the gross debt ratio is expected to decline to 84.7 per cent of GNI* by the end of the projection horizon. While below its pre-pandemic level this would still represent an elevated ratio, with the nominal stock of debt around €30bn above its 2019 level. The main driver of the improvement in the ratio over the medium term is the large, negative interest growth differential (Figure 46). The effective interest rate on the debt stock is expected to average around 1.5 per cent between the years 2022 and 2024, considerably lower than an average forecast GNI* growth rate of 5.9 per cent. The return to

[35] Consistent with the latest Government assumptions we assume that international tax reforms result in a €2bn decline in corporation tax receipts over the medium term. As noted by IFAC in its December Fiscal Assessment Report, however, Budgetary forecasts do not incorporate any assumed positive impact to corporation tax receipts as a result of the increase in the rate from 12.5 to 15 per cent. Accordingly there is some upside risk to this outlook.

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primary surplus also means the primary balance has a favourable impact on the debt ratio from 2023 onwards. The deficit debt adjustment (DDA) is also expected to support the fall in the ratio this year – as the Government uses some of its significant cash balances to part finance deficit spending – but to have a less favourable impact in subsequent years. [36] The National Treasury Management Agency (NTMA) plans to issue €10bn to €14bn of bonds this year, of which €4.5bn was already raised in the first quarter. Interest rates on Government borrowing have continued to trend upwards but remain low relative to historical borrowing costs, supported by the ECB's pandemic emergency purchase programme. [37] Planned issuance is down from the €18.5bn raised last year, reflecting the lower Exchequer Borrowing Requirement and substantial NTMA holdings of cash balances and other liquid assets (€34.4bn or 14 per cent of GNI* at end February 2022). Coupled with Ireland's relatively long maturity profile – only €12bn of government bonds are set to mature between now and end-2023 – these factors should provide funding flexibility over a less certain medium term environment. [38]

[36] This is consistent with the deficit-debt adjustment outlined by the Government in documentation supporting Budget 2022.
[37] In March 2022 the NTMA issued 10-year debt at a yield of 0.778 per cent. This compares to a yield of 0.013 per cent on 10-year debt issued in March 2021.
[38] A €5bn bond is set to mature in October 2022, followed by a €7bn bond maturing in March 2023. These have yields of 0.0 and 3.9 per cent respectively suggesting that, in net terms, rolling them over could actually reduce the effective interest rate.

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