Banc Ceannais na hÉireann
Central Bank of Ireland

Eurosystem

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Contents

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4. The method of seasonal adjustment used in the Bank is that of the US Bureau of the Census X-11 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 5800.

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Comment

Having displayed resilience throughout the overlapping shocks of COVID-19 and the onset of the war in Ukraine, the Irish economy has slowed into a phase of growth over our forecast horizon in-line with its current medium-term potential. Inflation has declined significantly over the course of 2023. The effects of the initial commodity price shock have faded and the secondary impacts remain relatively contained, despite supply pressures in parts of the labour market still being evident. As the momentum of domestic economic activity ebbs, and the effects of tighter monetary policy both at home and abroad continue to emerge, the process of disinflation is expected to proceed at a more gradual pace over the next two years.

The multi-faceted nature of the economy frequently makes it difficult to decipher how economic conditions in Ireland are changing. This has rarely been more so the case than in 2023. In headline terms, economic activity as measured by GDP will likely contract for the year as a whole. At the same time, the domestic economy as measured by modified domestic demand (MDD) will likely grow, albeit with a more pronounced slowdown through the course of the year than was previously expected. However, there are a series of general and sector-specific issues that, to varying degrees, underlie recent developments and can in part explain the near-to-medium term outlook in this *Bulletin* (Box C).

First, base effects and post-pandemic normalisation. These mostly relate to the unwinding of the exceptional level of physical investment in the State by multi-national enterprises in 2022 that are affecting MDD, as well as in the normalisation of export activity in the pharmaceutical sector post-Covid, which primarily affects GDP. Both MNE investment and pharmaceutical exports grew by double digits in 2022, in part boosted by pandemic-related factors. Although investment and pharmaceutical exports have normalised in 2023 contributing to weaker MDD and GDP, their drag on growth is expected to ultimately pass when the exceptional year of 2022 falls out of year-on-year comparisons.

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Second, structural factors. On this front there is the potential role of geopolitics and fragmentation in goods and services trade that may in the near-term negatively affect semi-conductor trade with China, primarily weighing on GDP, and the domestic capacity constraints in the labour market and in housing, limiting the scope for higher sustainable growth in the domestic economy. Given the potential for these factors to be more persistent, they may contribute to a lower trend growth profile for economic activity than could otherwise be the case over the forecast horizon, presenting further downside risks to growth.

Third, the general slowdown of activity globally and domestically, as demand is damped by tighter monetary policy necessary to bring inflation back to sustainable levels. This is already affecting both external and domestic demand developments for Ireland, and is contributing to slower growth than would otherwise be the case over the forecast horizon.

As well as affecting real economic activity, all three factors are also contributing to the recent developments in inflation and its expected future path, especially the strength and timing of transmission of higher monetary policy rates. The related reaction of the labour market and the interplay between wages, productivity growth and the capacity of businesses to absorb higher labour costs shape the outlook for inflation over the forecast horizon. That said, the profile for inflation over the forecast horizon is now lower than the projections in the previous *Bulletin*, reflecting realised data, favourable changes in commodity price assumptions and the revised real economic outlook.

Against this background, the labour market in Ireland has been remarkably resilient. While more moderate rates of employment creation and lower vacancy rates are emerging, unemployment remains relatively low. This is expected to remain the case over the forecast horizon. Wage growth is picking up in response to the tight labour market conditions, and in part to reverse real wage declines experienced since 2021. Growth in real hourly wage rates has turned positive in the latter half of 2023. However, when combined with higher levels of employment and lower levels of average working hours, the net result on growth in average take-home pay per person employed is not as pronounced as that of hourly wage rates. Examining the different experience of inflation and disposable income growth across households, the evidence suggests that while overall real household income has returned to pre-Covid levels, that of lower income households has not (Box E). For a given fiscal cost, this may have been mitigated further by a more targeted and progressive use

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of taxes and transfers during the emergence of the cost-of-living pressures in recent years. Looking ahead, despite some softening in labour constraints, nominal wage growth in excess of contemporaneous inflation is expected throughout the forecast horizon. For these higher labour costs to be consistent with the next phase of more gradual disinflation they will have to be accompanied by sufficient productivity growth and other means for businesses to absorb those costs without passing them on again to consumer prices.

With respect to monetary policy, following its latest meeting on 14 December, the ECB Governing Council have maintained the key ECB policy rates at levels reached in September 2023, following a cumulative rise of 450 basis points over the preceeding 14 months. In continuing to follow a data-dependent approach, the Governing Council assesses that rates are currently at levels that, if maintained for a sufficiently long period, will make a substantial contribution to a timely return of euro area inflation to the 2 per cent target. Domestically, the pass-through of higher policy rates to retail rates on loans and deposits held by Irish consumers and businesses has become more pronounced. There are some indications that this is influencing credit demand and relative preferences for liquidity, with a small shift out of low/no-interest bearing overnight deposits to term and notice deposits with higher rates of return. Alongside the effect of the broad-based monetary policy tightening in advanced economies over the past 18 months or so, the pass-through to retail interest rates is weighing on demand conditions both in Ireland and in its major trading partners as part of the necessary containment of demand to restore inflation to target.

In Ireland, the use of mortgage interest payments as a proxy for the costs of owner occupied housing in the domestic Consumer Price Index (CPI) has led to a divergence between it and the Harmonised Index of Consumer Prices (HICP) measure of inflation (Box D). The HICP is used for consistent cross-country comparison and monetary policy purposes. The current episode of CPI inflation exceeding HICP inflation is likely to persist for the forthcoming months, as financial institutions may continue to increase their mortgage interest rates.

It is important that domestic policy is focussed on the need to maintain macro-financial stability over the near-to-medium term. Policy actions by domestic authorities should not unnecessarily aggrevate any remaining imbalances between domestic demand and supply conditions, and thereby disrupt the gradual disinflation foreseen for the coming years. The opportunity arises for achieving this aim while at the same time delivering the necessary scale of

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investment to address critical needs in housing and related infrastructure, alongside that required to decarbonise the economy and mitigate the implications of climate change. The relative stance of fiscal policy in comparison to that of the euro area, and in the context of what monetary policy is aiming to achieve for the euro area, is important to keep in mind. Domestically, fiscal policy is set to continue to be expansionary in 2024, as it was this year, at a time when the economy is operating at its medium-term potential. A clear focus in public policy towards enhancing the supply side of the economy in order to promote sustainable growth in living standards is warranted. At the same time, it is necessary to build resilience in the economy and public finances in light of the emerging reality of an ageing population. The creation of the Future Ireland Fund (FIF) and the Infrastructure, Climate and Nature Fund (ICNF), with the use of excess corporation tax receipts, is welcome in this respect. However, vigilance is required both in the building up and the use of those funds. Their existence should not be seen as a panacea for the challenges and opportunities arising from the demographic and climate transitions, nor the critical housing and related infrastructure gap that exists. The ultimate size of the funds is uncertain, given the relatively higher volatility and uncertainty of excess corporation tax receipts. In addition, based on estimates from the Department of Finance, the extra age-related demands on the public finances expected from 2035 are larger than the estimated future drawdowns from the FIF.[1] With the economy operating in-line with its current medium-term potential, achieving the necessary scale of investment in housing and climate-related priorities, in addition to others, will require careful management and trade-offs to avoid unnecessary inflationary pressures over the medium term.

[1] See Table 4: https://assets.gov.ie/256707/ae2b2fc8-1411-4a64-9425-b3a42e1b6423.pdf

An Timpeallacht Gheilleagrach

Cé go raibh geilleagar na hÉireann athléimneach le linn thurraing COVID-19 agus an chogaidh san Úcráin, turraingí a tháinig sna sála ar a chéile, tá an fás ar an ngeilleagar ag moilliú thar thréimhse na réamhaisnéise i gcomhréir lena acmhainn reatha mheántéarmach. Tá laghdú suntasach tagtha ar bhoilsciú le linn 2023. Tá éifeachtaí shuaitheadh tosaigh na bpraghsanna tráchtearraí imithe i léig agus tá iarmhairtí tánaisteacha sách srianta i gcónaí, d'ainneoin go bhfuil brúnna soláthair fós le feiceáil i gcodanna den mhargadh saothair. De réir mar atá fuinneamh na gníomhaíochta eacnamaíche intíre ag meath, agus éifeachtaí beartais airgeadaíochta níos géire ag teacht chun cinn sa chríoch baile agus thar lear, meastar go mbeidh próiseas an fhrithbhoilscithe ag tarlú ar luas níos céimsí sa dhá bhliain atá romhainn.

I bhfianaise chineál ilghnéitheach an gheilleagair, is doiligh a oibriú amach go minic cén chaoi a mbíonn dálaí eacnamaíocha in Éirinn ag athrú. Is amhlaidh atá an cás in 2023 thar aon am eile. Ó thaobh cúrsaí príomha de, is dócha go maolóidh gníomhaíocht eacnamaíoch arna tomhas le OTI don bhliain ina hiomláine. Ag an am céanna, is dócha go méadóidh an geilleagar intíre, arna thomhas le héileamh modhnaithe intíre, ach go mbeidh moilliú níos suntasaí air le linn na bliana ná mar a bhíothas ag súil leis roimhe seo. É sin ráite, tá sraith saincheisteanna ginearálta agus earnáilsonracha ann atá mar bhunús, faoi réir leibhéil éagsúla, leis na forbairtí le déanaí agus míníonn siad go pointe an t-ionchas meántéarmach a chuirtear in iúl san *Fhaisnéis Ráithiúil* seo (Bosca C).

Ar an gcéad dul síos, bunéifeachtaí agus normalú i ndiaidh na paindéime. Baineann siad seo don chuid is mó le scaoileadh leibhéal eisceachtúil na hinfheistíochta fisiciúla sa Stát ag fiontair ilnáisiúnta in 2022 a dhéanann difear don éileamh modhnaithe intíre (MDD), mar aon le normalú na gníomhaíochta onnmhairíochta san earnáil cógaisíochta i ndiaidh Covid, rud a dhéanann difear go mór mór don OTI. Tháinig méadú i bhfigiúirí dúbailte ar infheistíocht ag fiontair ilnáisiúnta agus ar onnmhairí cógaisíochta in 2022, rud a bhí á spreagadh go páirteach ag tosca a bhain leis an bpaindéim. Cé go bhfuil

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normalú tagtha ar infheistíocht agus ar onnmhairiú cógaisíochta in 2023, rud a chuireann le MDD agus OTI níos laige, meastar go dtiocfaidh an sracadh a bhíonn acu ar fhás chun deiridh nuair nach mbeidh bliain eisceachtúil 2022 ag teacht faoi chomparáid bliain ar bhliain a thuilleadh.

Ar an dara dul síos, tosca struchtúracha. Ina thaobh seo, tá seans ann go ndéanfaidh an gheopholaitíocht agus ilroinnt trádála earraí agus seirbhísí difear diúltach sa ghearrthéarma do thrádáil leathsheoltóirí leis an tSín, ag cur isteach ar OTI go príomha, agus srianta acmhainneachta intíre sa mhargadh saothair agus ó thaobh tithíochta de, rud a theorannóidh an scóip maidir le fás inbhuanaithe níos airde sa gheilleagar intíre. Toisc go bhfuil an fhéidearthacht ann go leanfaidh na tosca sin, féadfaidh go gcuirfidh siad le treocht níos ísle maidir le próifíl fáis na gníomhaíochta eacnamaíche thar thréimhse na réamhaisnéise ná mar a bheadh i gceist murach sin, agus is riosca eile ar an taobh thíos é don fhás.

Ar an tríú dul síos, an moilliú ginearálta ar an ngníomhaíocht ar fud an domhain agus sa chríoch baile, de réir mar a mhaolaítear an t-éileamh le beartas airgeadaíochta níos doichte, rud atá riachtanach chun boilsciú a thabhairt ar ais chuig leibhéil inbhuanaithe. Tá sé seo ag dul i gcion cheana féin ar fhorbairtí maidir le héileamh seachtrach agus intíre, agus tá sé ag cur le fás níos moille thar thréimhse na réamhaisnéise ná mar a bheadh i gceist murach sin.

Ní hamháin go ndéanann na trí thoisc sin difear do ghníomhaíocht an fhíorgheilleagair, ach chomh maith leis sin, cuireann siad leis na forbairtí le déanaí i ndáil le boilsciú agus le conair mheasta an chéanna amach anseo, go háirithe neart agus tráth tharchur rátaí beartais airgeadaíochta níos airde. Tá freagairt ghaolmhar an mhargaidh saothair agus an t-idirghníomhú idir pánna, fás táirgiúlachta agus cumas gnóthaí costais saothair níos airde a iompar ag dul i bhfeidhm ar an ionchas maidir le boilsciú thar thréimhse na réamhaisnéise. É sin ráite, tá próifíl an bhoilscithe níos ísle anois ná mar a bhí sna réamh-mheastacháin a cuireadh i láthair san *Fhaisnéis Ráithiúil* deiridh, rud a léiríonn sonraí réadaithe, athruithe fabhracha i dtoimhdí maidir le praghsanna tráchtearraí agus an t-ionchas athbhreithnithe don fhíorgheilleagar.

I bhfianaise an chúlra seo, tá margadh saothair na hÉireann iontach athléimneach. Cé go bhfuil rátaí níos measartha ó thaobh cruthú fostaíochta de agus rátaí folúntas níos ísle ag teacht chun cinn, tá an dífhostaíocht sách íseal i gcónaí. Meastar go mbeidh an scéal amhlaidh thar thréimhse na réamhaisnéise. Tá méadú ag teacht ar an bhfás ar phánna mar fhreagra ar dhálaí teanna an mhargaidh saothair agus, go páirteach, chun na laghduithe ar fhíorioncam ó 2021 i leith a fhreaschur. Tá an fás ar rátaí pá in aghaidh na

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huaire dearfach arís sa dara leath de 2023. Ach, má chuirtear é san áireamh i dteannta leibhéil fostaíochta níos airde agus leibhéil meánuaireanta oibre níos ísle, níl an glantoradh ar fhás ar mheánphá glan in aghaidh an duine chomh suntasach leis an nglantoradh ar rátaí pá in aghaidh na huaire. Ag féachaint ar an taithí éagsúil a bhí ag teaghlaigh éagsúla ar bhoilsciú agus ar fhás ioncaim, tugann an fhianaise le tuiscint go bhfuil fíorioncam iomlán na dteaghlach tar éis filleadh ar na leibhéil a bhí ann roimh Covid ach nach amhlaidh atá i gceist i gcás teaghlaigh ísealioncaim (Bosca E). Ar chostas fioscach ar leith, d'fhéadfadh sé seo a bheith maolaithe trí chánacha a úsáid ar mhodh ní ba spriocdhírithe agus ní b'fhorásaí nuair a tháinig brúnna maidir le costas maireachtála chun cinn le blianta beaga anuas. Ag féachaint romhainn, meastar go mbeidh an fás ainimniúil ar phá os cionn boilsciú comhaimseartha thar thréimhse na réamhaisnéise. Chun go mbeidh na costais saothair níos airde seo ag teacht leis an gcéad chéim eile den fhrithbhoilsciú níos céimsí, beidh fás táirgiúlachta leordhóthanach de dhíth freisin, mar aon le bealaí eile ag gnóthaí chun na costais sin a iompar gan iad a chur ar aghaidh chuig praghsanna do thomhaltóirí.

Ó thaobh beartas airgeadaíochta de, chinn Comhairle Rialaithe BCE go gcoinneofaí príomhrátaí beartais BCE ag na leibhéil a bhí ann i mí Mheán Fómhair 2023 i ndiaidh ardú carnach de 450 bonnphointe le linn na tréimhse 14 mhí roimhe sin. Agus cur chuige ag brath ar shonraí á leanúint aici, measann an Chomhairle Rialaithe, má choinnítear rátaí ag na leibhéil ag a bhfuil siad faoi láthair, go bhféadfaí boilsciú an limistéir euro a thabhairt ar ais chuig sprioc 2 faoin gcéad. Sa chríoch baile, tá tarchur rátaí beartais níos airde chuig rátaí miondíola ar iasachtaí agus ar thaiscí arna sealbhú ag tomhaltóirí agus gnóthaí Éireannacha ag éirí níos suntasaí. Tá roinnt comharthaí ann go bhfuil sé seo ag dul i gcion ar an éileamh ar chreidmheas agus ar roghanna coibhneasta maidir le leachtacht, sa mhéid go bhfuil aistriú beag le feiceáil ó thaiscí thar oíche ar ús íseal nó gan ús ar bith chuig taiscí go deireadh téarma agus taiscí ar fhógra a ngabhann rátaí níos airde leo. I dteannta éifeacht an daingnithe leathain ar bheartas airgeadaíochta i ngeilleagair fhorbartha le 18 mí anuas, tá an tarchur chuig rátaí úis miondíola ag cur isteach ar dhálaí éilimh in Éirinn agus ina príomhpháirtithe trádála mar chuid den srianadh riachtanach ar éileamh chun boilsciú a thabhairt ar ais chuig an sprioc.

Toisc go n-úsáidtear íocaíochtaí úis morgáiste mar sheach-chostais i gcás tithíocht úinéir-áitithe san Innéacs intíre ar Phraghsanna do Thomhaltóirí (IPT) in Éirinn, tá éagsúlacht tagtha chun cinn idir an tInnéacs intíre ar Phraghsanna do Thomhaltóirí (IPT) agus an tInnéacs Comhchuibhithe ar Phraghsanna do Thomhaltóirí (ICPT) mar thomhas ar bhoilsciú. Úsáidtear ICPT chun comparáid

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a dhéanamh idir thíortha agus chun críocha beartais airgeadaíochta. Is dócha go mbeidh IPT os cionn ICPT ar feadh roinnt míonna eile de réir mar a leanfaidh institiúidí airgeadais dá rátaí úis morgáiste a ardú.

Tá sé tábhachtach go ndíreofar le beartas intíre ar an ngá le cobhsaíocht macra-airgeadais a choimeád ar bun sa ghearrthéarma agus sa mheántéarma. Le gníomhaíochtaí beartais ag údaráis intíre, níor cheart go ngéarófaí gan ghá aon mhíchothromaíochtaí idir an t-éileamh intíre agus dálaí soláthair, rud a chuirfeadh isteach ar an bhfrithbhoilsciú céimseach atá tuartha sna blianta atá romhainn. Tá deis ann an aidhm seo a bhaint amach agus, ag an am céanna, scála riachtanach infheistíochta a dhéanamh chun freastal ar riachtanais chriticiúla i ndail le tithíocht agus bonneagar gaolmhar, mar aon le deis an geilleagar a dhícharbónú agus iarmhairtí an athraithe aeráide a mhaolú. Ní mór staid choibhneasta an bheartais fhioscaigh i gcomparáid le beartas fioscach an limistéir euro a chur san áireamh, i gcomhthéacs a bhfuil de chuspóir ag an mbeartas airgeadaíochta a bhaint amach don limistéar euro. Sa chríoch baile, beidh beartas fioscach forleathnaitheach ann in 2024, mar a bhí i mbliana, tráth atá an geilleagar ag feidhmiú ar a acmhainn mheántéarmach. Tá gá le béim shoiléir i mbeartas poiblí ar fheabhsú cúrsaí soláthair sa gheilleagar d'fhonn fás inbhuanaithe ar chaighdeáin mhaireachtála a chur chun cinn. Ag an am céanna, is gá cur le hathléimneacht sa gheilleagar agus san airgeadas poiblí i bhfianaise go bhfuil an daonra ag dul in aois. Sa chomhthéacs seo, fáiltítear roimh an gCiste do Thodhchaí na hÉireann (FIF) agus roimh an gCiste Bonneagair, Aeráide agus Nádúir (ICNF), trí fháltais bharrachais ó cháin chorparáide a úsáid. Ar a shon sin, ní mór a bheith cúramach nuair a bheifear ag cur leis na cistí sin agus ag úsáid na gcistí sin. Níor cheart breathnú orthu mar réiteach ar na dúshláin nó deiseanna a bhaineann le haistrithe déimeagrafacha nó aeráide, nó ar an mbearna atá ann idir an tithíocht ríthábhachtach agus bonneagar gaolmhar. Baineann éiginnteacht le méid iarbhír na gcistí i bhfianaise na luaineachta agus na héiginnteachta níos airde a bhaineann le fáltais bharrachais ó cháin chorparáide. Anuas air sin, meastar go mbeidh na héilimh bhreise de bharr aoise ar an airgeadas poiblí ó 2035 ar aghaidh níos mó ná na tarraingtí anuas measta ón FIF, ar bhonn meastachán ón Roinn Airgeadais.[2] D'fhonn scála riachtanach infheistíochta a dhéanamh i dtosaíochtaí tithíochta agus aeráide, beidh gá le bainistíocht chúramach agus comhréitigh chun brúnna boilscitheacha gan ghá a sheachaint, ó tharla go bhfuil an geilleagar ag feidhmiú ar a acmhainn reatha mheántéarmach.

[2] Féach Tábla 4: https://assets.gov.ie/256707/ae2b2fc8-1411-4a64-9425-b3a42e1b6423.pdf

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The Irish Economy

Overview

Economic activity has slowed noticeably in 2023 but the economy is still expected to grow over the forecast horizon. Recent data confirm a retrenchment in the MNE-dominated part of the economy, with signs that domestic activity has also slowed. Improvements in real income are projected to support modest increases in Modified Domestic Demand (MDD) in 2024 and 2025. After the unusual weakness in 2023, net exports are expected to recover in 2024. Nevertheless, external demand conditions remain weak relative to previous historical patterns. The ongoing transmission of tighter monetary policy to the economy will weigh on growth, which is already being limited by capacity constraints. As a result, the economy has shifted onto a slower growth path following the strong post-pandemic recovery.

Headline inflation has fallen sharply in 2023 as externally-driven price pressures have eased. Falling energy prices have contributed most to the drop in headline inflation to date and recent data show a marked easing in price rises for other non-energy industrial goods. A more generalised reduction of externally-driven price pressures is expected to continue, bringing headline inflation back to 2.1 per cent in 2025. Domestic price pressures – as reflected in services inflation – are expected to be more persistent, with the latter projected to stay above 3 per cent in 2025.

Labour market conditions are forecast to remain tight out to 2026. The pace of employment growth has slowed in 2023 but rising labour force participation and continued net inward migration point to ongoing strength in labour market activity. The unemployment rate is expected to average 4.6 per cent out to 2026 – close to its historical low. This supports further increases in nominal incomes, which, in combination with falling inflation, implies annual average real income growth of 1.7 per cent per annum from 2023-2026.

The growth outlook is uncertain and downside risks have increased. The forecasts are contingent on a rebound in the pharma and ICT manufacturing sectors in 2024. A more prolonged downturn would weaken exports, domestic investment and economic activity more broadly relative to the central forecasts. The inflation outlook assumes energy prices continue on a downward path and excessive domestic inflationary pressures are avoided. Near-term inflation risks are to the upside and are more balanced thereafter.

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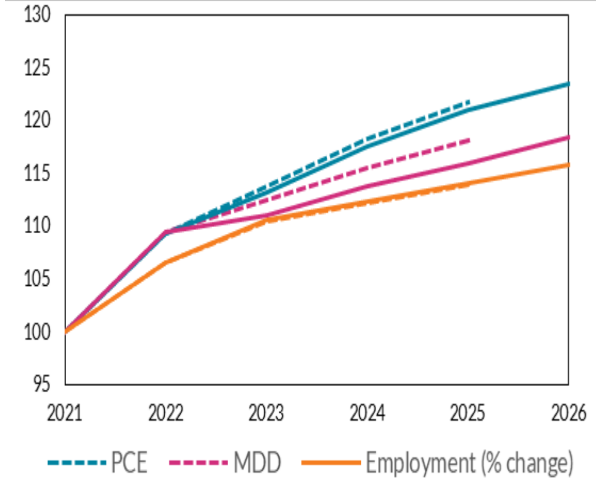
Table 1: Macroeconomic Projections for the Irish Economy
(annual percentage changes unless stated)

		2022	2023f	2024f	2025f	2026f
Constant prices	Modified Domestic Demand	9.5	1.5	2.5	1.9	2.0
	Gross Domestic Product	9.4	-1.3	2.5	4.5	4.2
	Personal Consumer Expenditure	9.4	3.5	3.8	3.0	2.0
	Public Consumption	3.5	1.5	0.8	-0.2	2.1
	Gross Fixed Capital Formation	5.1	-10.1	2.2	1.9	2.7
	Modified Gross Fixed Capital Formation	15.9	-3.8	0.8	0.8	1.7
	Exports of Goods and Services	13.9	-2.6	3.0	5.3	5.6
	Imports of Goods and Services	15.9	-2.0	3.3	4.0	4.9
Total Employment (% change)		6.6	3.7	1.6	1.5	1.5
Unemployment Rate		4.5	4.5	4.8	4.7	4.6
Harmonised Index of Consumer Prices (HICP)		8.1	5.2	2.3	2.1	1.4
HICP Excluding Food and Energy (Core HICP)		4.6	4.4	2.9	1.9	1.7
Compensation per Employee		2.7	3.5	5.0	5.1	4.5
General Government Balance (% GNI*)		3.1	3.0	2.7	4.3	3.8
'Underlying' General Government Balance (% GNI*)[3]		-1.0	-0.9	-0.9	0.7	0.4
General Government Gross Debt (%GNI*)		82.3	77.3	72.0	67.8	64.1

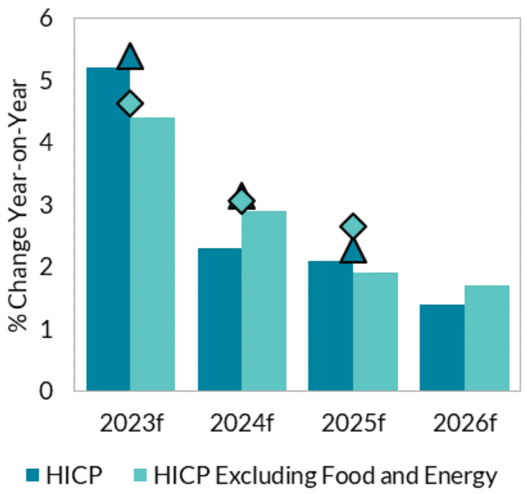
Revisions to the growth profile for modified domestic demand and inflation

Figure 1: MDD, Consumption and Employment



Source: CSO and Central Bank of Ireland
Note: Dashed lines indicate forecast from QB3. PCE refers to Personal Consumer Expenditure.

Figure 2: HICP Inflation



Source: CSO and Central Bank of Ireland
Note: Markers indicate forecast from QB3

[3] 'Underlying' General Government Balance excludes estimates of excess corporation tax receipts.

Box A: The International Economic Outlook

By Monetary Policy Division

The post-pandemic rise in inflation, which affected economies throughout the globe, and the subsequent monetary policy tightening by most of the world's central banks, have shaped developments in the global economy in the last couple of years. Global inflation rates are now declining. Monetary policy tightening and its effects on economic activity is now limiting demand and slowing down economic growth. Against this background, global geopolitical tensions continue to remain elevated, with repercussions for global uncertainty, trade and financial markets.

The latest Eurosystem Broad Macroeconomic Projection Exercise foresees global GDP growth (excluding the euro area) averaging just above 3 per cent out to 2026. These rates of growth for the global economy are below the historical average throughout the period, with the relative weakness in large part due to the impact of monetary policy tightening especially in advanced economies. A significant slowdown in China's growth due to structural factors, despite stimulus, also contributes to this weaker outlook. Global trade, which was weak in 2023 due to further normalisation of global consumption patterns post-pandemic, is projected to gradually recover through the projection horizon, although worsening geopolitical tensions represent a significant downward risk.

The euro area economy weakened in the second half of 2023 and the short-term outlook points to stagnation in the face of tighter financing conditions, weak business and consumer confidence and low foreign demand. Over the medium term the economy should gradually return to moderate growth as both domestic and foreign demand recover. Overall, annual GDP growth is expected to slow to 0.6% in 2023, before recovering slightly to 0.8% in 2024, and then stabilising at 1.5% in 2025 and 2026.

Inflation has continued to decline, and more recently fallen more than expected, due to falling energy inflation, ongoing easing pipeline pressures and supply bottlenecks and the impact of monetary policy tightening. All main components have been contributing to this decline, which reflects the broad based disinflationary process unfolding. It is expected to pick up temporarily in the coming months due to a rebound in energy inflation, but the ongoing disinflationary process is expected to continue as the effects of past energy price shock and other pipeline pressures fade. The strength in labour costs will then be the dominant driver of core inflation. Overall, headline HICP inflation is expected to decrease from 5.4% in 2023 to an average of 2.7% in 2024, 2.1% in 2025 and 1.9% in 2026.

Employment has been relatively resilient to the weakening in economic activity but there is some evidence that the labour market is cooling. employment levels growing by a further 0.2 per cent in Q3 2023 compared to the previous quarter (+1.3 per cent compared to Q3 2022). The seasonally-adjusted unemployment rate remained at its record low of 6.5 per cent in October. Labour demand (as reflected in job vacancy rates and Indeed data, is declining from high levels and employment is expected to soften in the last quarter of this year. Wage pressures are expected to remain high in the near term as forward-looking wage trackers signal high wages pressures, while unit profits are expected to weaken as they mitigate the inflationary effects of wage increases.

After increasing the three key ECB interest rates by a cumulative 450 basis points since July 2022 in an effort to return inflation to the 2 per cent target, the Governing Council of the ECB decided in December to maintain the deposit facility, main refinancing operations, and marginal lending facility rates at 4.0, 4.5 and 4.75 per cent, respectively. The Governing Council considered the key ECB interest rates to be at levels that, maintained for a sufficiently long duration, will make a substantial contribution to returning inflation towards the 2 per cent target; however it will maintain a data-dependent approach to determine the level and duration of monetary restriction. The holdings within the Asset Purchase Programme continue to be gradually reduced by not reinvesting maturing securities, while holdings within the Pandemic Emerging Purchase Programme continue to be reinvested flexibly. Over the second half of 2024, the Governing Council intends to reduce the PEPP portfolio by €7.5 billion per month on average, with reinvestments under the PEPP being discontinued at the end of 2024.

In the United States, the economy continued to show resilience despite the restrictive monetary policy stance, with household and government consumption growth remaining particularly strong. GDP increased by 5.2 per cent on an annualised quarterly basis in Q3 2023 (equivalent to +1.3 per cent quarter-on-quarter), after another 0.5 per cent QoQ increase in the previous quarter. The labour market also remains strong, with the unemployment rate standing at 3.9 per cent in October. US headline inflation marginally declined to 3.1 per cent in November, from 3.2 per cent in October. However, core inflation remained unchanged at 4.0 per cent, twice the Federal Reserve's target rate of inflation. In December, the Federal Open Market Committee (FOMC) of the US Federal Reserve decided to maintain the target range for the Federal Funds Rate at a level between 5.25 and 5.5 per cent. The median view of members of the FOMC, in their projections, was for the federal funds rate to fall to 4.6 per cent from the current levels in 2024 (3.6 in 2025), and to reach the inflation target by 2026. The FOMC will continue to monitor incoming data and is ready to adjust the stance of monetary policy as appropriate.

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In the United Kingdom, GDP remained flat in Q3 2023 (+0.6 per cent YoY), following quarterly growth of 0.2 per cent in the previous quarter. The unemployment rate was 4.2 per cent in September, unchanged from the previous quarter. UK CPI inflation fell sharply in October to 4.6 per cent (its lowest level since October 2021), from 6.7 per cent in September mainly due to a fall in energy prices. At its November meeting, the Bank of England's Monetary Policy Committee maintained the Bank Rate at its current cyclical peak of 5.25 per cent, a rate that was reached in August 2023. In its Monetary Policy Report, the Bank sees inflation falling further and to reach its target by end 2025 if interest rates are kept high enough for a sufficient period of time.

Faced with deflation in China as a result of sluggish domestic demand, particularly from consumers (headline inflation in China reached a low of -0.5 per cent in November, although core inflation remained positive albeit at a low 0.6 per cent), and continued weakness of the property sector, the People's Bank of China maintained the loan prime rate at its record low of 3.45 per cent in November.

In November, the Policy Board of the Bank of Japan decided to maintain its policy of yield curve control, while adjusting its terms. The Board maintained the target level of 10-year Japanese government bond yields at around zero per cent, conducting yield curve control with the upper bound of 1.0 per cent for these yields as a reference and controlling the yields mainly through large-scale JGB purchases and nimble market operations. This could potentially pave the way for the eventual abandonment of yield curve control, which could have large implications for global financial markets. While headline and core inflation in Japan have recently been above the 2 per cent target, the BOJ believes further accommodation is necessary to maintain inflation sustainably at this target.

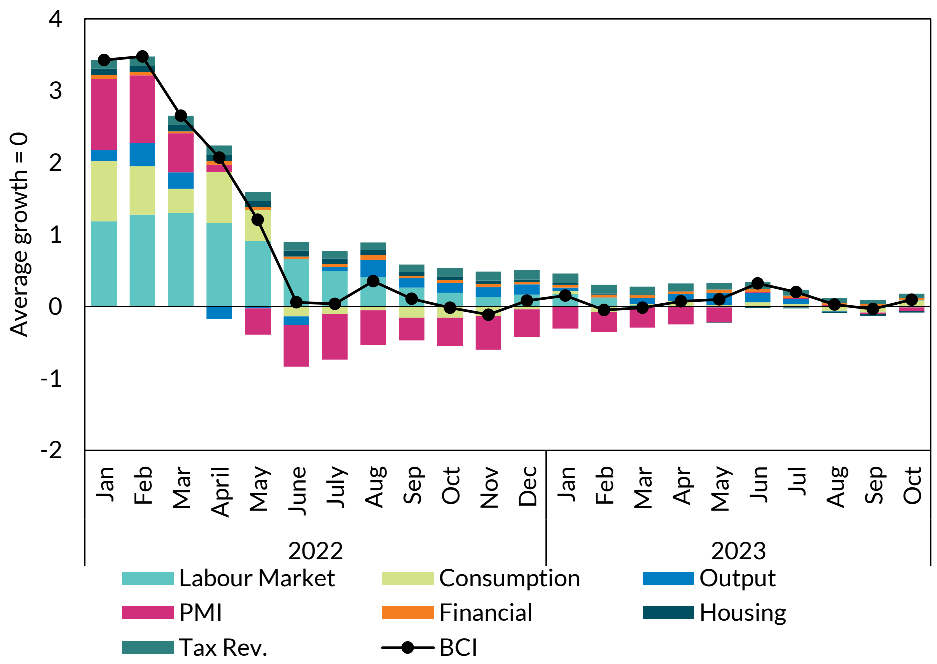
Recent Developments

Modified Domestic Demand (MDD) contracted marginally by 0.4 per cent on a year-on-year basis in Q3 2023 as lower modified investment offset continued growth in consumption. Comparing the first three quarters of the year to the same period in 2022, MDD is up by just under 1 per cent, signifying a significant slowdown in the pace of growth compared to 2022. Modified investment remains at a high level compared to its 2015-2019 average but growth has declined from the exceptional rates recorded in 2022. The pace of growth in consumption remains positive but has also slowed as 2023 has progressed.

GDP has contracted in the first three quarters of 2023 driven by weaker cross-border exports along with a sharp drop in exports that are produced abroad, but counted in Irish National Accounts statistics. Physical exports produced in Ireland have declined in 2023, due mainly to lower activity in the pharmaceutical and ICT manufacturing sectors. GDP has been further reduced by a sharp decline in offshore exports (known as contract manufacturing). GDP does not provide a good indicator of economic conditions in Ireland, which are better measured by MDD and employment (see Box B).

The underlying domestic economy is likely to be growing in line with its medium-term capacity

Figure 3: Central Bank's Business Cycle Indicator (BCI), (Jan 2022 – October 2023)



Source: Central Bank of Ireland

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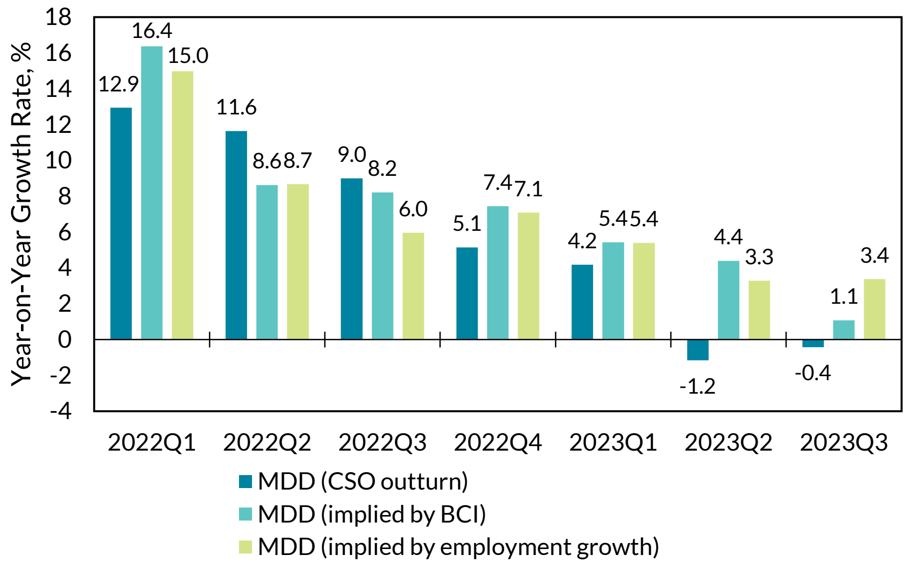
The Central Bank's Business Cycle Indicator (BCI) shows that the pace of growth in domestic economic activity has continued to moderate gradually during 2023 following the strong post-pandemic recovery. The BCI provides a summary of a range of recent developments in both hard data (e.g. retail sales, unemployment, and industrial production) and soft data (e.g. consumer sentiment, purchasing managers' indices). Overall, the BCI remained positive but close to zero in October, consistent with domestic activity growing in line with its long-run average (Figure 3). Tax revenue, retail sales and indigenous sector output contributed positively to the BCI in October while the PMIs exerted a small negative impact.

Despite two negative quarters of MDD growth, alternative indicators are more positive about the current state of the economy

Figure 4: MDD and implied estimates from BCI and Employment Growth



Source: authors' calculations.
Note: this chart shows the outturn for MDD growth (year-on-year) and the implied estimate of MDD growth using a nowcast regression with the BCI, or employment growth, plus lags.

The BCI paints a more positive picture of domestic economic activity when compared to modified final domestic demand from the latest Quarterly National Accounts. The BCI and employment growth can be used as a guide to estimate the pace of growth in the domestic economy. While the BCI and employment growth remain broadly positive, the year-on-year change in MDD was negative in Q2 and Q3 2023 (-1.2 and -0.4 per cent, respectively). Given their historical relationship, it is possible to use the BCI or monthly employment, respectively, as indicators to nowcast MDD. On both fronts, the implied MDD growth estimates using the two other indicators of underlying domestic activity have been stronger in both Q2 and Q3 2023 than the official

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estimates of MDD published by the CSO. (Figure 4). This suggests that other factors, most notably the outsized role of physical investment in the State by MNEs in 2022 and the fall in investment growth from this high level in 2023, is leading to lower growth in MDD through 2023 than would be implied by the majority of other economic indicators.

Looking in more detail at individual components of the BCI, the Credit Union Consumer Sentiment Index rebounded in October while the volume of core retail sales remains positive over the year. Consumer sentiment increased to 60.4 in October, up from 58.8 in the previous month, and remains above its 2022 average (Figure 5). Hard data shows that consumer spending continues to grow in year-on-year terms albeit with some signs of slowing down; the volume of core retail sales is up 0.3 per cent in October compared to 0.9 per cent in Q2 (Figure 6).

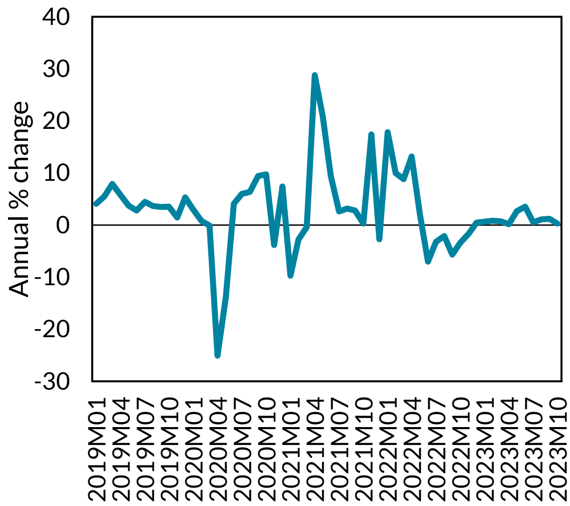
Consumer sentiment rebounded in October

Figure 5: Consumer sentiment index

Source: Credit Union.

Core retail sales continue to grow in year-on-year terms

Figure 6: Volume of core retail sales



Source: CSO.

The AIB PMI shows signs of stabilisation in the manufacturing sector and continued expansion in the services sector in October while the BNP Paribas PMI shows a weak but improving construction sector. The outlook for the manufacturing sector stabilised over recent months with the AIB Manufacturing PMI hovering around the 50 level (Figure 7). In contrast, the AIB Services PMI has been above 50 for 33 consecutive months, indicating continuing improvements in the sector. The BNP Paribas Construction PMI has been below 50 for the past quarter, but is showing signs of improvement. In terms of hard data, the volume of traditional sector output growth was 6.2 per

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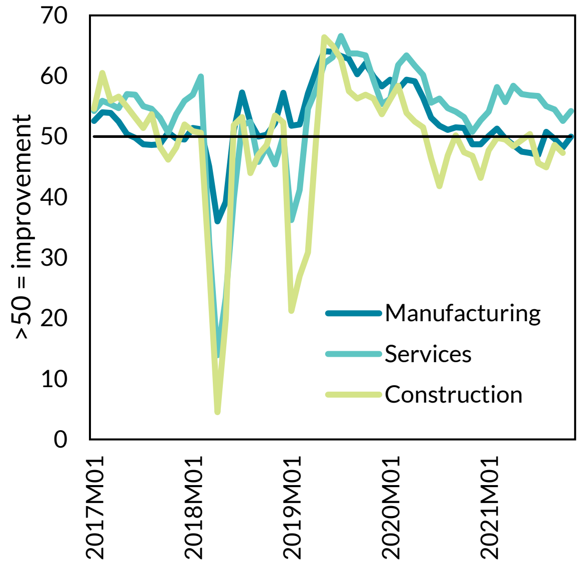
cent over the year in Q3 down from a rate of 8.5 per cent in the previous quarter (Figure 8).

Manufacturing has stabilised while services activity accelerates

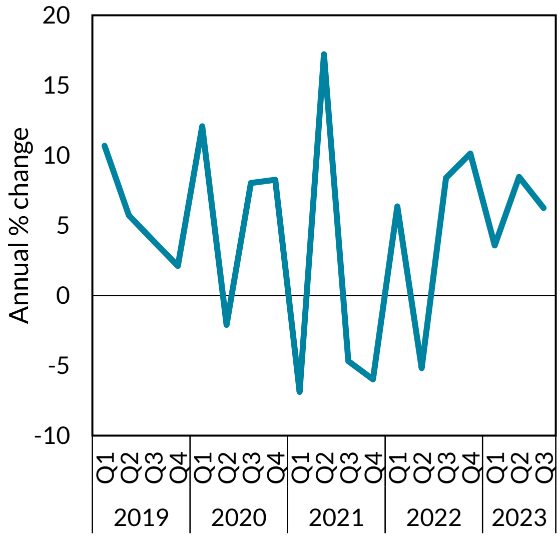
Figure 7: Purchasing Managers' Indices (PMIs)



Source: AIB and BNP Paribas.

Traditional sector output growth remains positive

Figure 8: Volume of traditional sector output



Source: CSO.

Headline inflation continues to decelerate, with tentative signs of a return to normal seasonal patterns. Inflation excluding energy and food (core) has been more sticky and is supported by strong services inflation. Headline HICP inflation in year-on-year terms resumed its decline in October falling to 3.6 per cent and declined further to 2.5 per cent in November. Inflation excluding energy and food components ticked-up to 4.3 per cent in October but fell in November and stood at 3.6 per cent. The most notable changes in the year to November were increases in *Recreation and Culture* (+7.8 per cent), *Restaurants and Hotels* (+7.1 per cent), *Food and Non-Alcoholic Beverages* (+6.7 per cent) and *Alcoholic Beverages and Tobacco* (+4.7 per cent). The most notable decrease was recorded in *Housing, Water, Electricity, Gas and Other Fuels* (-2.6 per cent).

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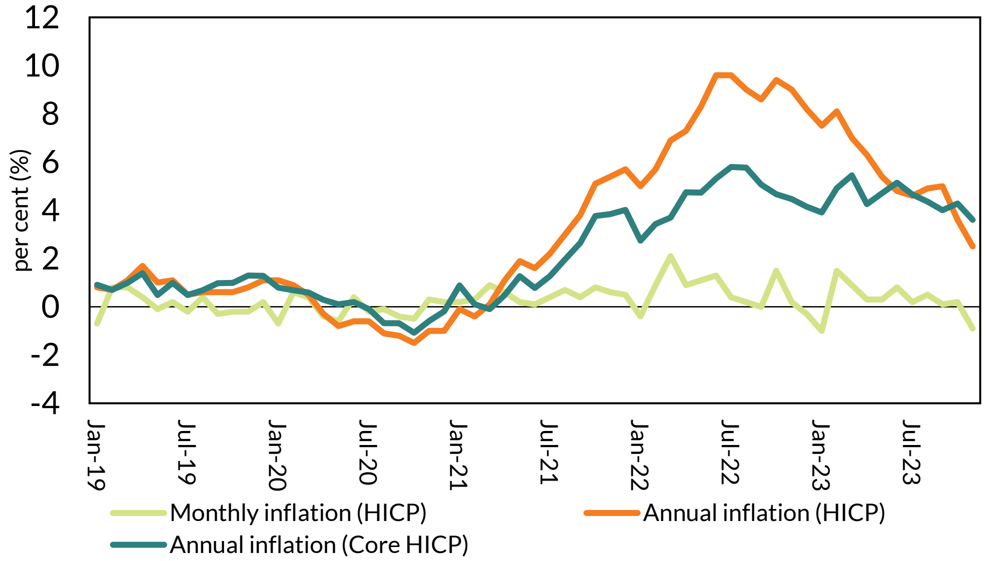
Headline inflation has been falling in recent months, but core inflation remains sticky

Figure 9: Consumer Price Inflation



Source: CSO.

The labour market remains tight despite a slight increase in monthly unemployment to 4.8 per cent in October on a seasonally-adjusted basis. The unemployment rate increased from 4.4 per cent to 4.6 per cent throughout Q3 and currently stands at 4.8 per cent in October 2023 – its highest level in 18 months. Meanwhile, employment continues to grow at a moderating pace. Over the course of the year, employment growth has fallen steadily from 5.1 per cent on a year-on-year basis in January to 2.1 per cent in September, as measured by the CSO's monthly payroll employee index.

Exchequer data showed increases in both tax revenue and government expenditure in the year to November. Total tax receipts grew by 5.8 per cent, with income tax and VAT receipts remaining robust. Corporation tax receipts also increased, albeit at a significantly weaker pace than in preceding years, reflecting a volatile monthly pattern in the second half of the year. Gross voted government expenditure was 9.9 per cent higher on an annual basis, as both current and capital spending grew strongly. Current spending was €2.1bn above profile, led by overspends in the Health vote group. This was partly offset by capital spending coming in €714m below expectations.

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Box B: Developments in Irish Deposit and Lending Activity

By Nicholas Kaiser (Statistics Division)

This *Box* provides an overview of recent developments in credit and deposit activity in Ireland, as well as a more detailed examination of the responsiveness of retail deposit rates and business volumes to the increase in euro area monetary policy rates since June 2022.

Table 1: Changes in Interest Rates, June 2022 - October 2023

	Rate June 2022	Cumulative change (bps)	Rate October 2023 (%)	Cumulative change since Q3 Quarterly Bulletin (bps)[4]	Change in Volume of New Business (%)[5]
Deposit Facility[6]	-0.5	450	4.0	50	-
Deposits					
Household overnight	0.02	10	0.12	8	-
Household new term	0.02	257	2.59	47	749.37
NFC overnight	-0.11	22	0.11	4	-
NFC new term	-0.22	392	3.7	32	250.0
Lending					
New Mortgage	2.68	159	4.27	23	1.93
New Consumer	7.72	-8	7.64	-55	20.12
New NFC	3.22	262	5.84	34	-29.15

Source: Central Bank of Ireland

Summary

The unprecedented rise of 450 basis points in monetary policy rates has had a varying impact on retail lending and deposit rates and business volumes (Table 1). The average interest rate on household overnight deposits has been particularly slow to respond, increasing by only 10 basis points since June 2022. In contrast, the weighted average interest rate on new household term deposits rose by 257 basis points, and the volume of new business has rebounded significantly in recent months.

Interest rates on new mortgage lending agreements by banks (excluding renegotiations)[7] have continued increasing, rising to 4.27 per cent at end-October, a 159 basis point increase since June 2022, just before the ECB began raising policy rates, and a 158 basis point increase in 2023 alone. The effect of rising mortgage interest rates differs by borrower, largely determined by the type of mortgage product they hold (Byrne, McCann, & Gaffney, 2023). In addition, borrowers on tracker mortgages, especially those

[4] Q3 Quarterly Bulletin used equivalent data from June 2023
[5] Volume of new business in October 2023 compared to June 2022
[6] Cumulative change in other monetary policy rates same as for Deposit Facility
[7] Unless specified otherwise, new mortgage lending refers to bank lending agreements excluding renegotiations

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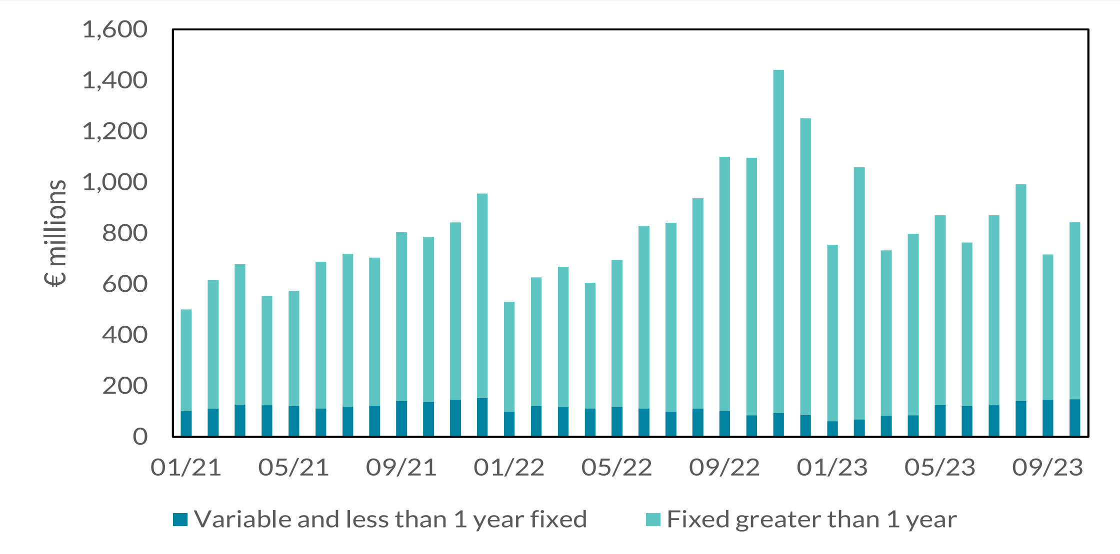
with previous repayment challenges, have been those most likely to enter early arrears since the current cycle of monetary tightening began (Shaikh, Kilgarriff, & Gaffney, 2023). The volume of new mortgage agreements (excluding renegotiations) has remained resilient despite higher interest rates. The volume of outstanding mortgage lending was mostly unchanged over the previous year, while the volume of new mortgage agreements in October, at €843 million, was in line with what has been typical over the past 2-3 years (Figure 1).

New mortgage lending still strong despite rising interest rates

Figure 1: Volume of new mortgage agreements excluding renegotiations



Source: Central Bank of Ireland

Shortly after the ECB began raising policy rates last year, the average interest rate on new lending to NFCs began increasing quickly, but since March 2023, the rate has begun to plateau, peaking in May of this year at 6.05 per cent, before falling back to 5.84 per cent by October. This is in contrast to new mortgage lending, for which the average interest rate increase began later, and persists into the most recent data. NFC lending activity has slowed, with the annual growth rate negative for four consecutive months as of October. The volume of new NFC lending has been declining slowly since May, but rebounded slightly in October. New SME lending (excluding financial intermediation and property related sectors) in Q3 2023 was €696 million, 3.7 per cent higher than in Q2 2023, but down 5.2 per cent from Q3 2022.

Deposits

Since June 2022, the weighted average interest rate on household overnight deposits has increased by only 10 basis points, to 0.12 per cent, over half of which occurred between August and October 2023. The stability of interest rates on overnight deposits, even during a monetary policy tightening cycle, is not always typical. In contrast, over the first

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16 months of the tightening cycle beginning in November 2005, the weighted average interest rate on household overnight deposits rose by 64 basis points in response to changes in the ECB policy rate of 175 basis points over that period (Figure 2).

Interest rates on outstanding deposits have responded more weakly to changes in ECB policy rates over this tightening cycle

Figure 2: Overnight deposits

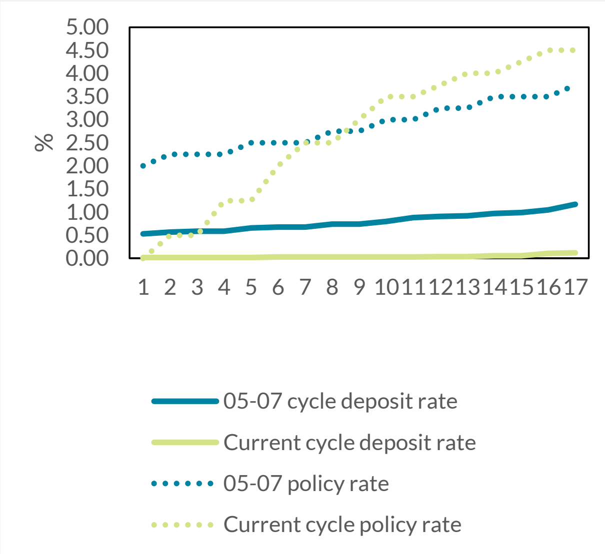
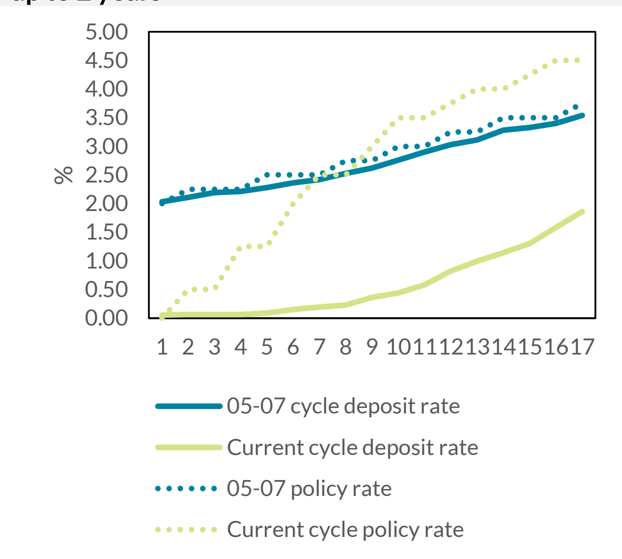


Figure 3: Outstanding deposits with maturity up to 2 years



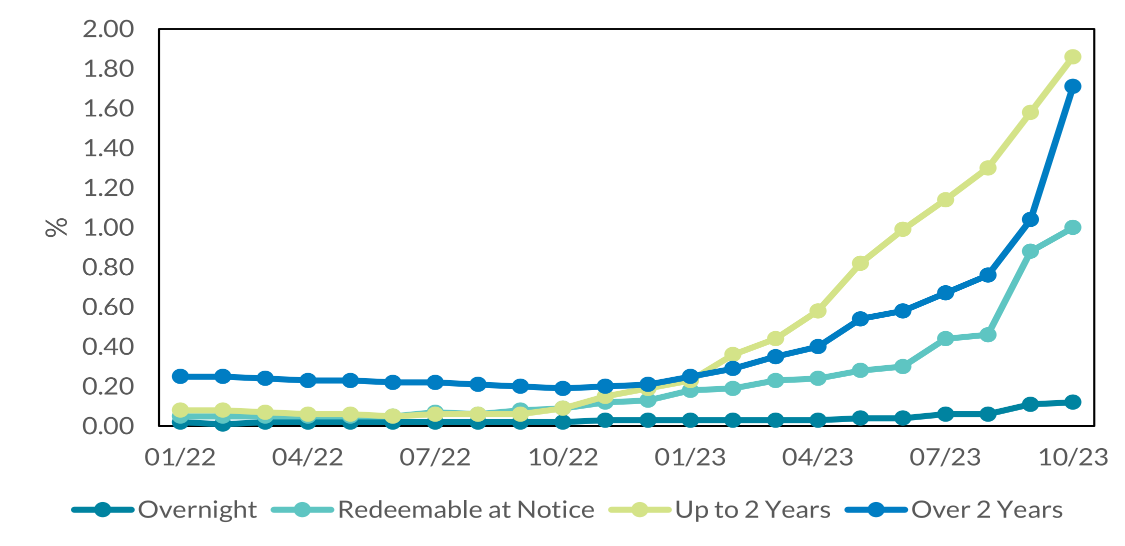
Source: Central Bank of Ireland
Note: Note: horizontal axis shows months since tightening cycle began, month zero is November 2005 and June 2022; policy rate is Main Refinancing Operations[8]

However, interest rates on deposits with agreed maturity, both for NFCs and households, have responded much more strongly to ECB rate increases. The strongest response from outstanding household deposits has been from those with agreed maturity of up to two years (Figure 3). The weighted average interest rate on these deposits has increased from 0.05 per cent to 1.86 percent since June of last year (Figure 4), while the weighted average interest rate on new household deposits with agreed maturity rose to 2.59 per cent in October.

[8] For further discussion of pass-through, see Byrne & Foster, 2023

Interest rates on outstanding household term deposits have increased more than on overnight deposits in Ireland

Figure 4: Weighted average interest rates on outstanding household deposits

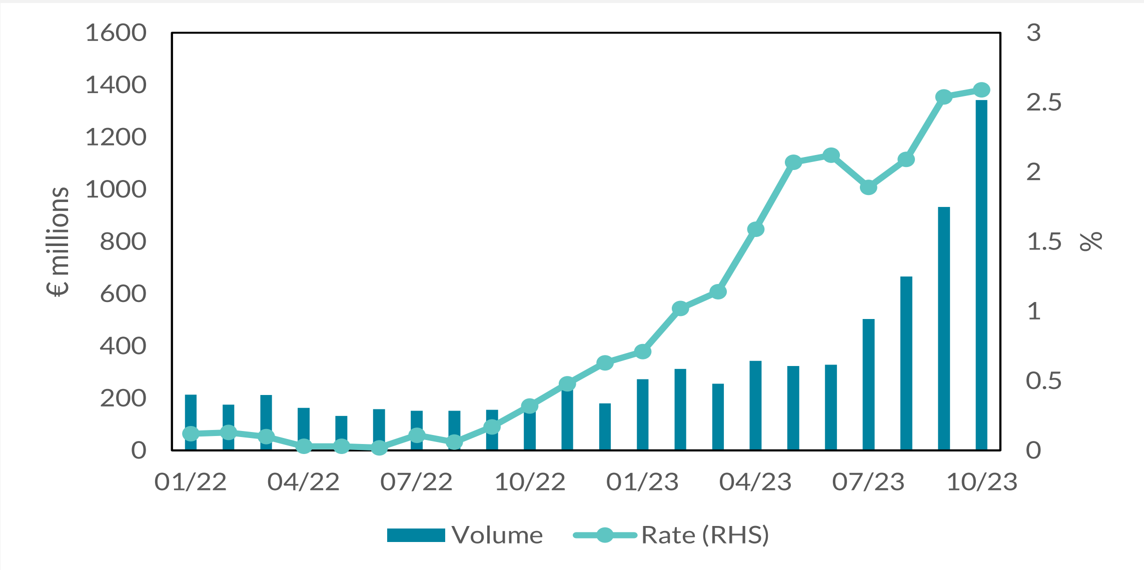


Source: Central Bank of Ireland

There is now evidence that households have begun to move deposits from overnight to term deposits in order to avail of higher interest rates. In October, new deposits with agreed maturity were at the highest level since January 2021, at €1.34 billion (Figure 5).

Interest rates on new household term deposits responded quickly to increases in the ECB's policy rates

Figure 5: Volume and weighted average interest rate on new household term deposits

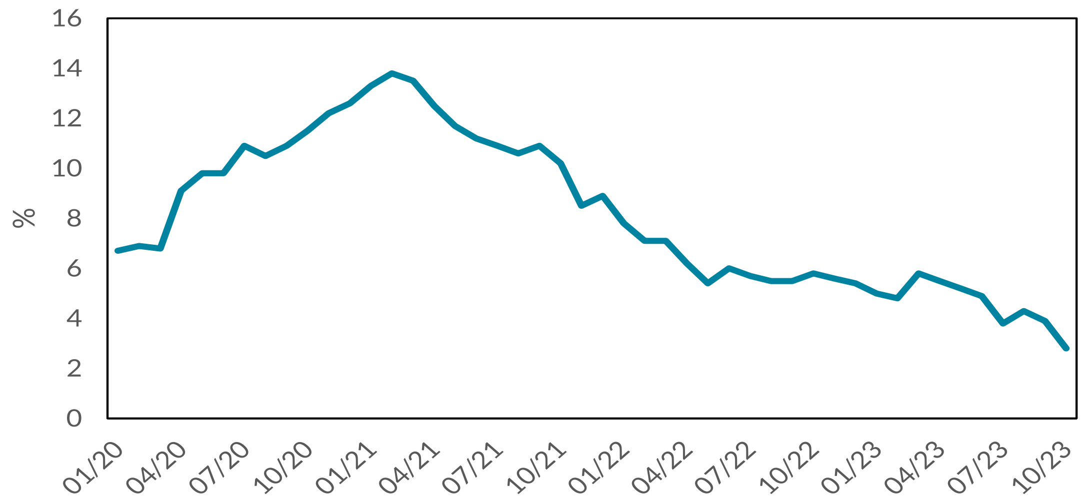


Source: Central Bank of Ireland

Additionally, there were net withdrawals of €993 million from household overnight deposits from August to October, while there were €1.06 billion of net inflows to total household deposits over the same period. During the pandemic, household deposits were elevated, primarily driven by higher income households (Lydon & McIndoe-Calder, 2021), but the annual growth rate of household deposits is now falling toward the pre-pandemic level (Figure 6).

The annual growth rate of household deposits has been falling since the pandemic

Figure 6: Annual growth rate of total household deposits



Source: Central Bank of Ireland

As of end-October, 92 per cent of all household deposits were overnight deposits. This was not the case during the pre-financial crisis hiking cycle. At the same point during that cycle (March 2007), only 48.3 per cent of household deposits were overnight, suggesting the potential for a weaker transmission of policy rates to the real economy overall According to data from the ECB, the proportion of the volume of household overnight deposits to total household deposits was higher in Ireland than in any other euro area country in October (Figure 7). [9]

[9] Figure 5 uses a different but similar data collection than is used when referencing Irish deposit interest rates

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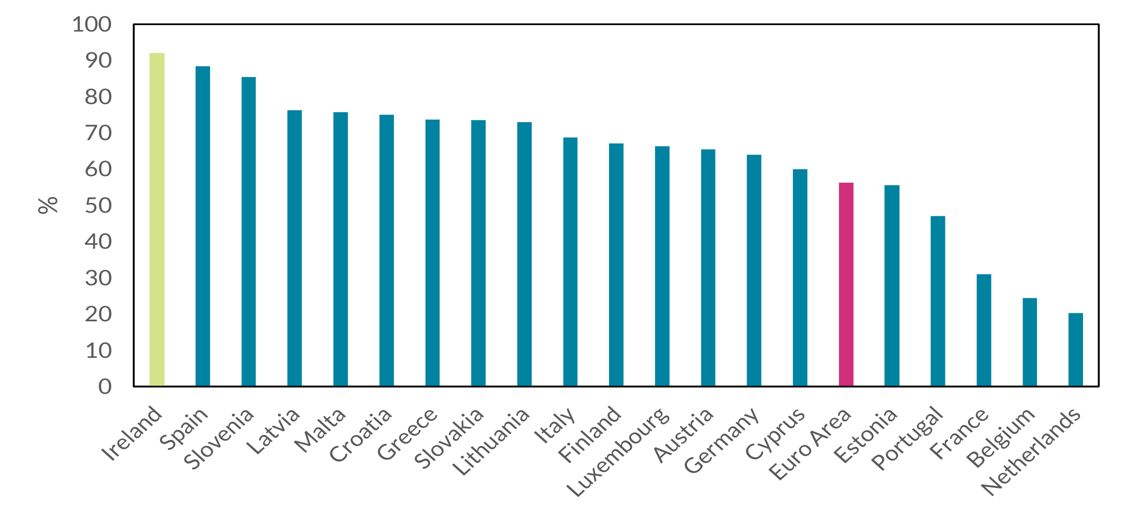
Irish household deposits are held proportionally more in overnight accounts relative to euro area peers

Figure 7: Volume of overnight household deposits as a percent of total household deposits, October 2023

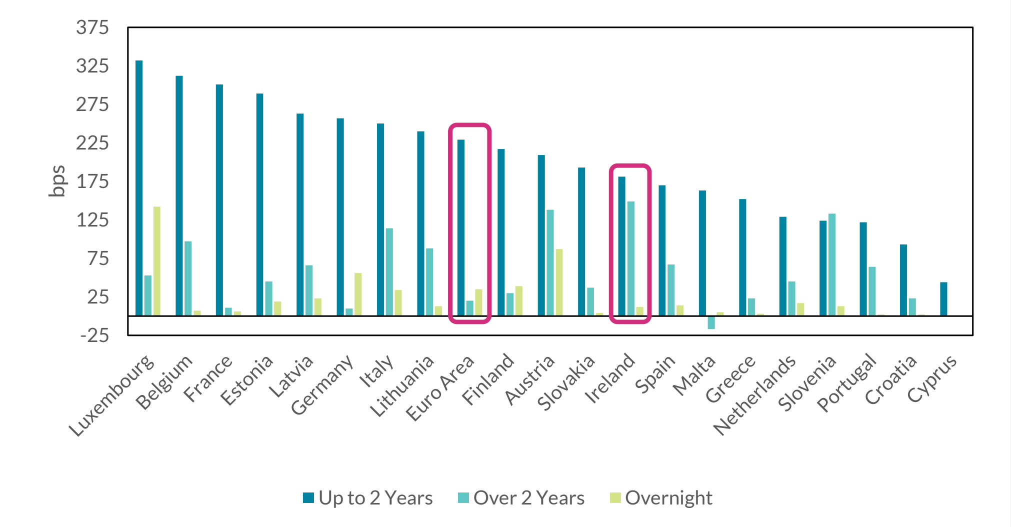


Source: ECB

It is typical in the euro area for weighted average interest rates on outstanding deposits with agreed maturity to have increased more over the length of the current hiking cycle than the weighted average rate on overnight deposits. As shown in Figure 8, the cumulative increase in the weighted average interest rate on both term and overnight deposits has been relatively small in Ireland.

Cumulative change in interest rates largest for household deposits with maturity up to 2 years across euro area

Figure 8: Cumulative changes in weighted average interest rates on outstanding household deposits, June 2022 – October 2023



Source: Central Bank of Ireland

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On household overnight deposits, the euro area weighted average interest rate at end-October was 0.35 per cent, nearly three times that of Ireland. At the beginning of the current tightening cycle, all euro area countries had near-zero weighted average interest rates on household overnight deposits, and most rates remain very low. The higher euro area average is driven primarily by a few outlier countries that have seen larger increases in these interest rates than has been typical.

Consumption

Consumption growth has remained resilient in recent quarters despite the headwinds of still high (but decreasing) inflation and rising interest rates. Growth in services consumption has offset a slowdown in the growth rate of goods, as visible in retail sales data in recent months. Consumption grew by 0.7 per cent in the third quarter, slightly lower than forecast at the time of the last Bulletin. Indeed, this is reflected in weaker card spending and retail sales in Q3 (Figures 10 and 11). The weaker outturn in Q3 reflects still high inflation, particularly for essentials like energy and food, which divert household spending away from other consumption (Figure 12). Taking the outturn up to Q3 and an expectation that consumption will grow in Q4 on a quarter-on-quarter basis, consumer spending is forecast to rise by 3.5 per cent for 2023 as a whole.

Looking ahead to 2024, a projected pickup in consumption will be an important driver of growth in domestic demand, albeit at a slightly slower pace than projected in the last Bulletin. The small downward revision to consumption growth in 2024 is consistent with a weaker projection for wage growth in 2023 and 2024. However, fiscal measures announced in Budget 2024 have mitigated the size of the revision. Overall, consumption is projected to grow relative to 2023 as a result of decelerating inflation and an expected pickup in real wages.

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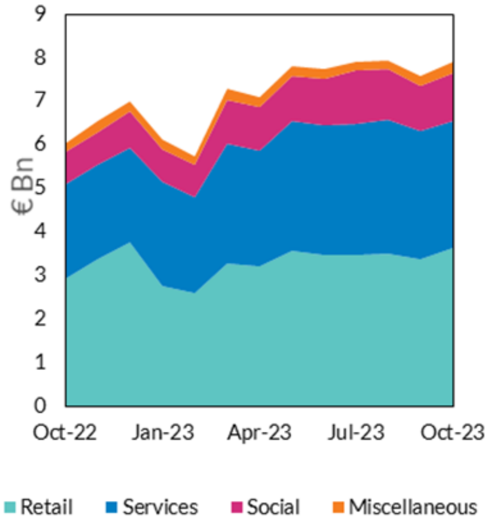
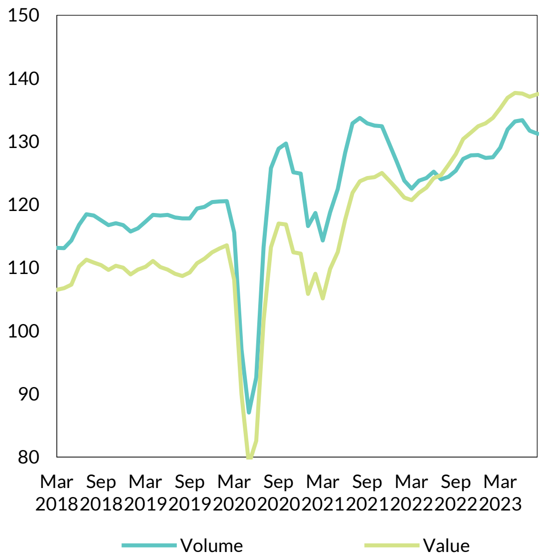
High frequency indicators suggest consumption has weakened in the second half of the year

Figure 10: Card Payments by Sector



Source: Central Bank

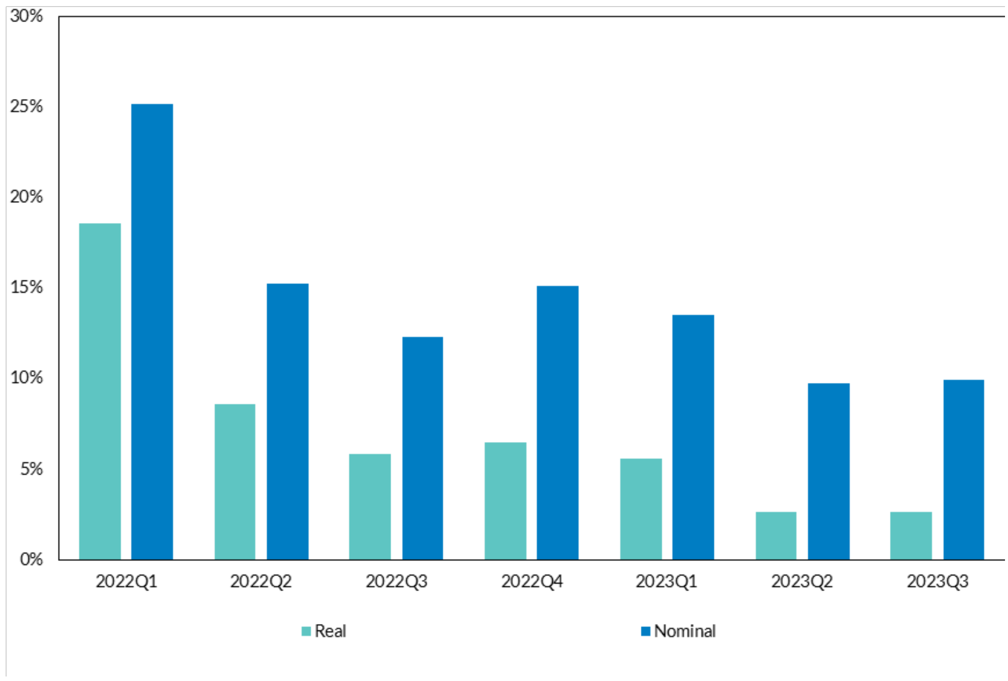
Figure 11: Retail sales



Source: Central Bank of Ireland

High inflation has reduced the real value of consumption

Figure 12: Real and Nominal Consumption

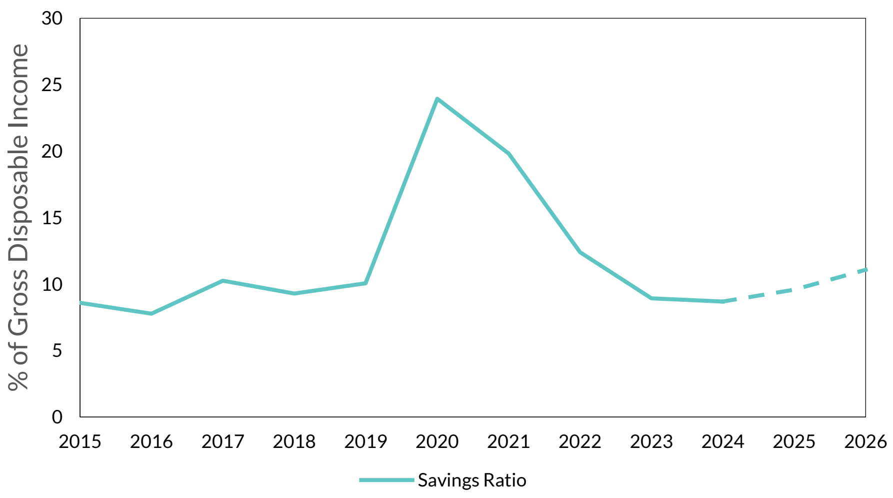


Source: CSO

Relatively slow growth in incomes and weakening employment growth implies that consumption growth will be lower than its historical average in 2025 and 2026. While inflation is forecast to slow sharply in the latter years of the forecast horizon, relatively modest gains in income will slow consumption growth in 2025 and 2026. These developments mask significant heterogeneity across the income distribution (see Box E), while the households sector in aggregate is expected to continue to build savings during the forecast period (Figure 13). Household spending is projected to rise by 3 per cent in 2025 and 2 per cent in 2026.

The savings ratio is expected to rise moderately over the forecast horizon

Figure 13: Gross Household Savings Ratio



Source: CSO

Investment

Modified investment growth has slowed in 2023 relative to 2022, after being boosted strongly last year by once off investments. The level of modified investment remains high compared with 2021 (Figure 14). Developments in modified investment over the last two years have been primarily driven by capital investment in machinery and equipment and investments in the MNE sector. The slowdown in modified investment in 2023 most likely relates to a return to lower levels of investment in these sectors following the large increases in 2022, although a decline in commercial real estate investment is evident in the data for Q2 and Q3 2023. For confidentiality reasons, the breakdown of modified investment has been mostly redacted by the CSO during the last two years, indicative of the small number of firms that were responsible for a significant portion of the growth and subsequent slowdown in

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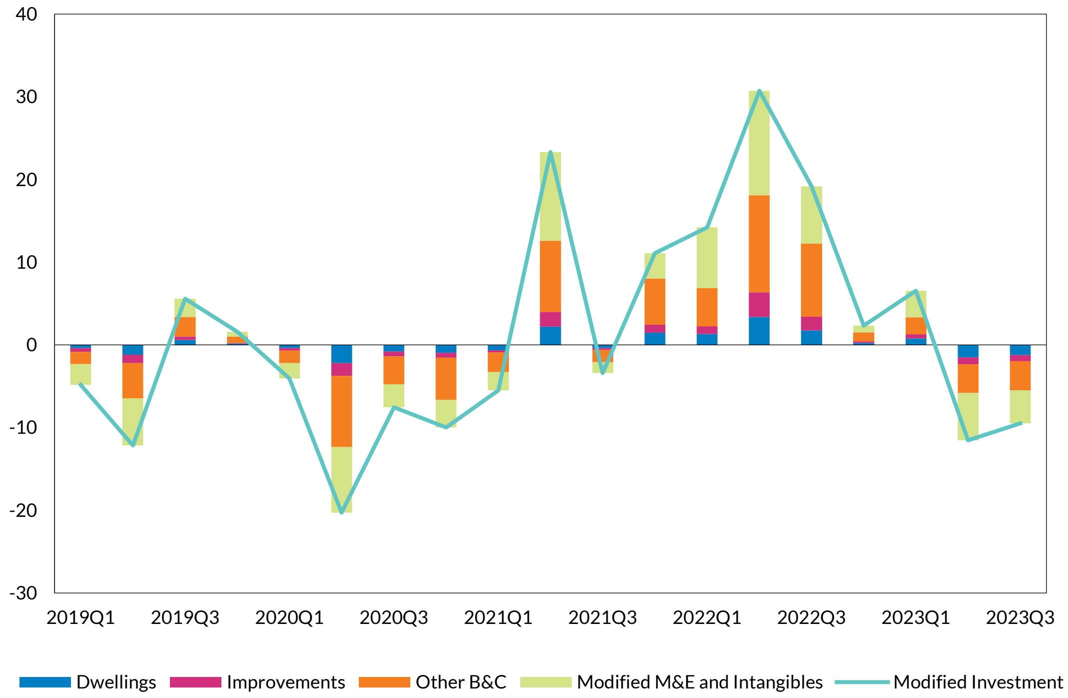
modified investment. These data redactions make it more difficult to forecast modified investment. Incorporating new data for Q3, we have revised down our estimate of Modified investment for 2023 to -3.8 per cent.

Modified investment growth was boosted by once-offs in 2022. Growth has moderated but the level of investment remains high compared to 2021

Figure 14: Contributions to Modified investment



Source: CSO

Looking ahead, higher financing costs as a result of tighter monetary policy are expected to constrain private investment over the forecast horizon. The largest effect on modified investment will likely come through the impact of higher interest rates on MNE investment decisions, while domestically that tightening will have a small effect on housing completions. Although higher interest rates are damping construction sector activity somewhat, around 30,000 completions are expected in 2023 and we have revised our forecast for housing completions up slightly from our September *Bulletin* to approximately 31,000 units in 2024, 31,500 in 2025 and 32,500 in 2026. In the near term, this is informed by the developments in planning permissions (Figure 15) and commencements (Figure 16). The declining impact of higher interest rates will bring about a further strengthening in housing output in 2025 and 2026.

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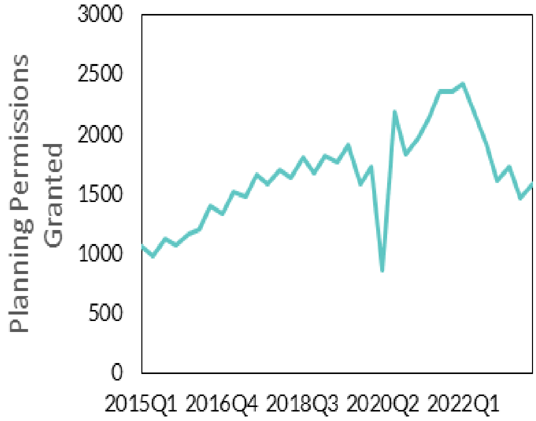
Planning permissions for dwellings have declined since early 2022. Commencements dipped in early 2023, but have recovered in the second half of the year

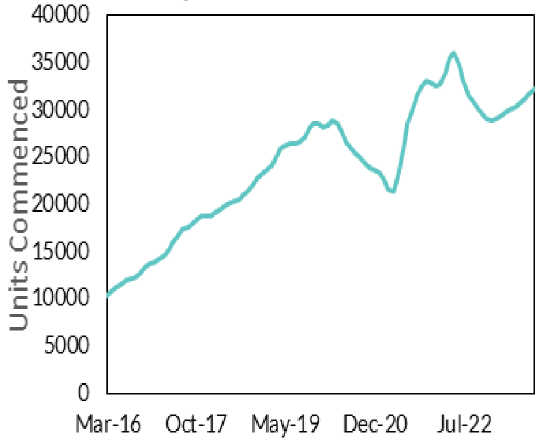
Figure 15: Planning permissions granted (dwellings)



Source: CSO

Note: Last Data point is 2023Q2

Figure 16: Residential Commencements (12 Month Rolling Sum)



Source: CSO

Box C: Interpreting Mixed Signals on the Recent Performance of the Irish Economy and the Revised Short-Term Outlook

By Thomas Conefrey (Irish Economic Analysis Division)

The Irish economy is characterised by the presence of large foreign-owned multinational enterprises (MNEs) alongside other firms whose activity is domestically oriented. As a result, headline macroeconomic statistics in Ireland sometimes present diverging signals as to the condition of the economy. This arises because the global factors that affect output in the MNE-dominated parts of the economy often differ from the drivers of activity in the domestic-facing economy. Such effects have been evident during 2023.

For the first three quarters of the year – the most recent period for which a full set of macroeconomic and labour market statistics are available – CSO data indicate that GDP contracted by 1.3 per cent compared to the same period in 2022. This was driven by a pronounced fall in net exports in the MNE-dominated sector of the economy. Over the same period, modified domestic demand (MDD) increased by 0.9 per cent. Meanwhile, labour market data – which are probably the most salient indicators of domestic economic conditions – also point to continued economic expansion in Q3 with employment increasing by 4.1 per cent. These differences in the realised data for the economy up to the third quarter of 2023 are also reflected in the projections published in

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this *Bulletin*. Against this background, this Box (1) explains the reasons for the negative GDP (and related net export) outturn for the economy in 2023 compared to the performance of domestic demand and employment and (2) describes the main drivers of the revised short-term outlook for economic activity contained in this *Bulletin*.

The somewhat divergent performance of the MNE-dominated and domestic-facing sectors of the economy is evident in a number of indicators. Figure 1 shows the year-on-year change in industrial production (3-month moving average) for the *modern* and *traditional* sectors as defined by the CSO.[10] The *modern* sector consists of the MNE-dominated parts of the economy including chemicals and pharmaceuticals, medical devices and computer, electronic and optical equipment. The *traditional* sector covers all other industries including the more domestically-oriented parts of the economy. Growth in industrial production in the *traditional* sector has remained steady and positive during 2023. The average volume of industrial production in the three months to September 2023 compared to the same period in 2022 is up by 5.9 per cent. In contrast, production in the *modern* sector declined by 24.3 per cent over the same period, resulting in overall production being 20.4 per cent lower in the three months to September 2023 compared to the same period in 2022. Figure 2 shows the contribution of the different headline expenditure components to the year-on-year change in GDP. Following an exceptionally large positive contribution to GDP in 2022, net exports have declined over the last two quarters, pushing overall annual GDP growth into negative territory.

The extent of decline in activity in the MNE-dominated sectors compared to domestic activity is further illustrated in Figure 3. The contribution of the domestic sectors to overall output (gross value added) growth has moderated but remained positive up to Q3 2023, whereas output in the foreign-dominated sector turned negative in the quarter – mirroring the decline in exports.

[10] See: https://www.cso.ie/en/releasesandpublications/ep/p-ipt/industrialproductionandturnoverseptember2023/

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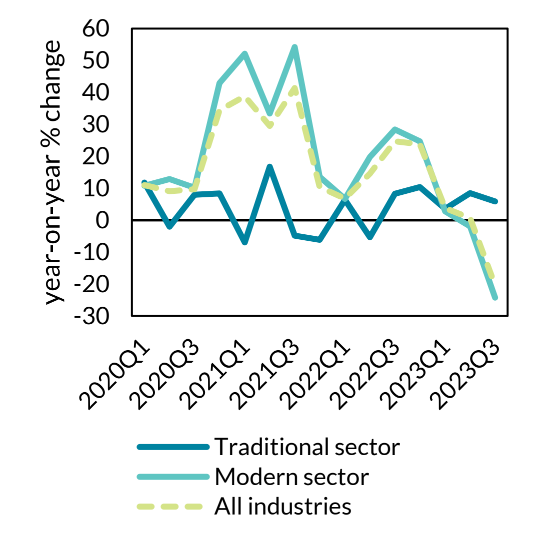
Output in MNE-dominated sectors falls sharply while activity in domestic sectors continues to grow

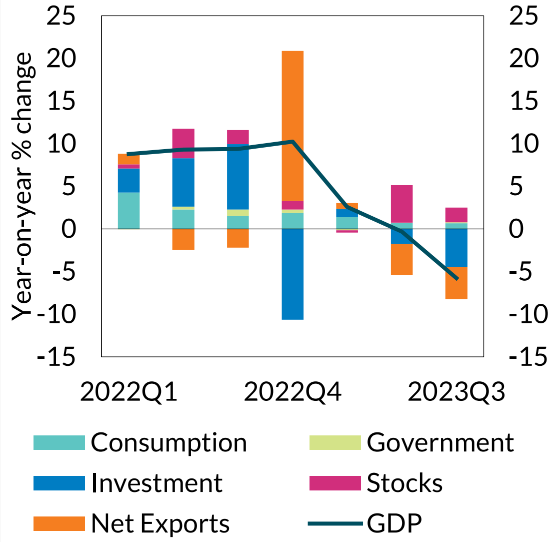
Figure 1: Industrial production, modern and traditional sectors, 3-m rolling average, year-on-year change



Source: CSO.

Following a large increase in 2022, net exports turn negative in 2023, lowering overall GDP

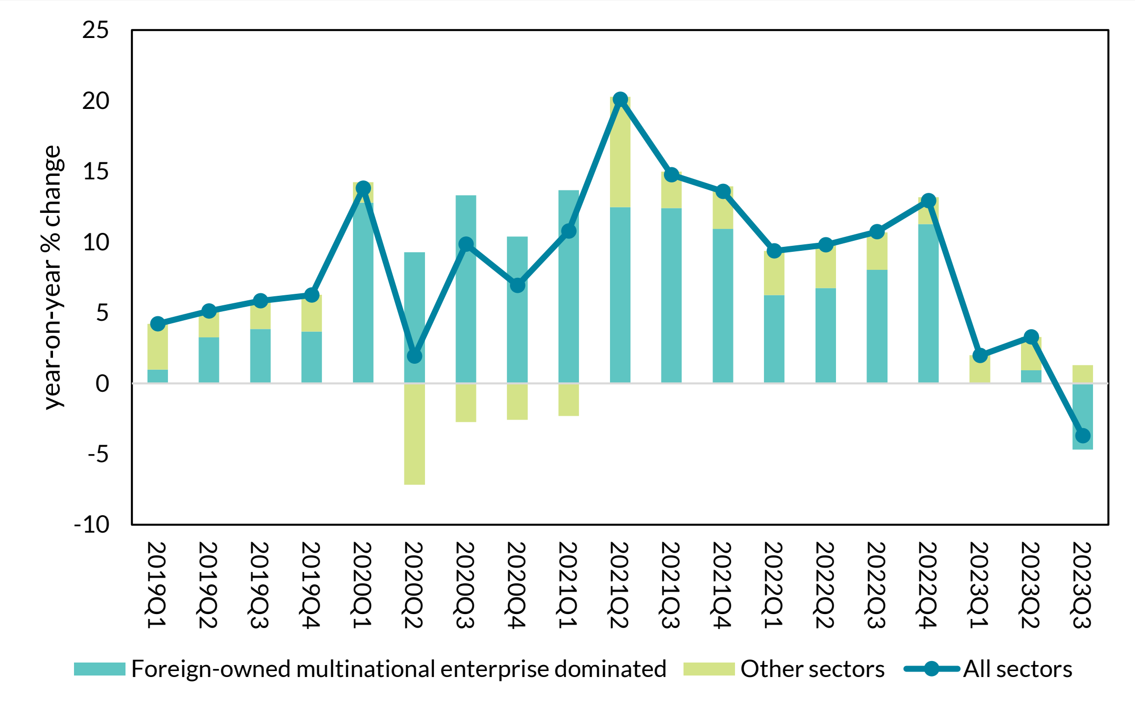
Figure 2: Contribution to year-on-year change in GDP



Source: CSO.

Pronounced slowdown in MNE-dominated sectors during 2023. Domestic sector output increases in first three quarters, but at a slower pace than in 2022

Figure 3: Contributions to y-on-y change in GVA, foreign-dominated and other sectors



Source: CSO.

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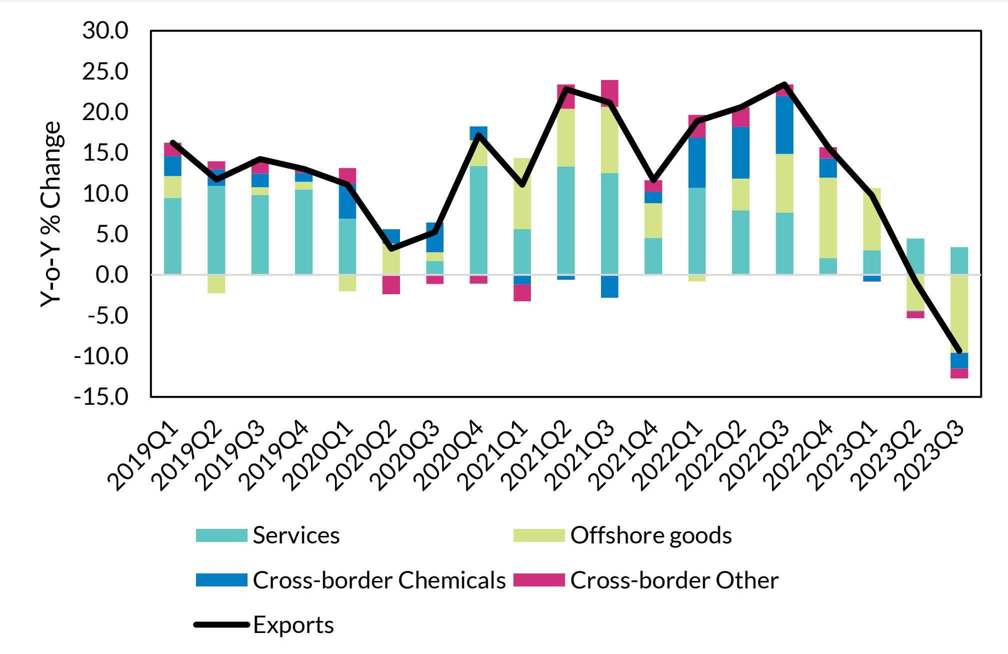
The reduction in net exports in 2023 is in turn concentrated in goods trade while services exports have continued to grow in 2023. The figure for overall goods exports published in the National Accounts includes goods physically produced in Ireland and goods produced abroad on behalf of Irish-resident MNEs, also known as contract manufacturing (CM).[11] The latter do not directly affect the employment or incomes of Irish residents. In 2023, the value of both components of overall goods exports has declined relative to 2022 with a particularly sharp drop in contract manufacturing or offshore exports. Figure 4 shows the contribution to the change in the value of overall exports of each of its components up to Q3 2023. On a year-on-year basis in Q3 2023, contract manufacturing (offshore goods) exports declined by almost 50 per cent, making by far the largest contribution to the overall decline in goods exports in the quarter.

Sharp reduction in exports produced abroad while cross-border goods exports manufactured in Ireland also decline in 2023

Figure 4: Contributions to year-on-year change in the value of overall exports



Source: CSO.

The decline in cross-border physical exports produced in Ireland is concentrated in two sectors: pharmaceuticals and ICT manufacturing. The decline in pharmaceutical exports follows a very large increase in 2022, boosted by the manufacture of Covid-related vaccines and treatments in Ireland. While the value of pharmaceutical exports over the first nine months of 2023 are 5.5 per cent lower than in 2022, exports are 29 per cent above the level for the same period in 2021. Consequently, and with the general prospects for the pharmaceutical sector remaining positive, once the exceptional

[11] See https://www.cso.ie/en/interactivezone/statisticsexplained/nationalaccountsexplained/contractmanufacturing/

pandemic-related export performance during 2022 drops out of annual comparisons, the outlook for growth in 2024 and beyond is favourable.

Exports of ICT goods, in particular semiconductors, are sharply down over the first three quarters of 2023 compared to 2022. China accounts for almost 70 per cent of all exports of semiconductors from Ireland. The drop in exports in 2023 is due mainly to a reduction in exports to that market, as well as lower exports of semiconductors to the US. The reduction in semiconductor exports to China and the US could be the result of a deterioration in the performance of individual firms in the sector, a cyclical weakening in demand for these goods globally or structural changes. In relation to firm performance, the semiconductor manufacturing sector in Ireland is highly concentrated with a small number of firms accounting for the majority of exports. A deterioration in the performance of an individual firm or firms, for example as reflected in a loss of market share, could negatively affect aggregate exports. In terms of potential structural factors and as noted in our September 2023 *Quarterly Bulletin*, the Biden Administration announced in October 2022 new restrictions on exports to China of certain ICT manufacturing goods.[12] The restrictions cover exports from US-based firms but they also apply to any company worldwide that uses US semiconductor technology in its production processes. Since US-owned multinational enterprises account for a significant share of exports from this sector in Ireland, it is possible that the restrictions are one factor behind the weakness in Ireland-China ICT goods exports to date in 2023.

Looking ahead, our projections assume a recovery in cross-border physical exports from 2024. Following the correction in 2023 after the exceptional growth in 2022, pharma exports are projected to grow again over the forecast horizon reflecting the generally favourable medium-term prospects for this sector globally. The outlook for ICT manufacturing is more uncertain and a repeat of the weakness observed in 2023 would pose a risk to our overall export projections. Our forecast for overall exports, both goods and services, is weaker than at the time of our last *Bulletin* in September due to downward revisions to economic growth for Ireland's key trading partners over recent months.

[12] These goods include advanced integrated circuits (ICs), computers and components containing advanced ICs, semiconductor manufacturing equipment and related software and technology.

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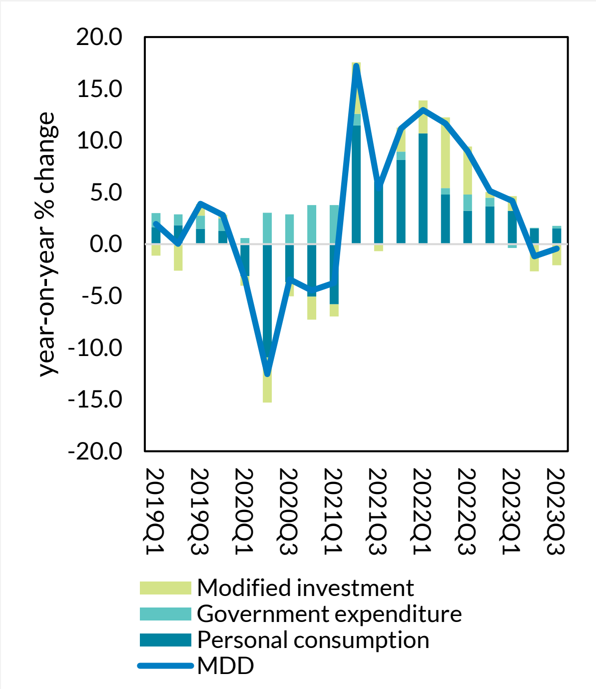
Consumption growth still positive in 2023 but weaker modified investment lowers MDD

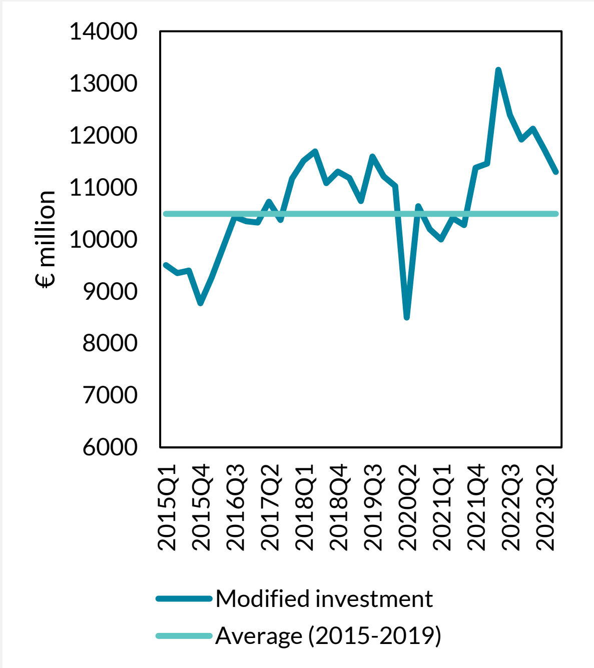
Figure 5: Modified investment, constant prices, seasonally adjusted



Source: CSO.

Modified investment increased sharply in 2022. Levels remain high in 2023 but have reduced

Figure 6: Contribution to year-on-year change in MDD



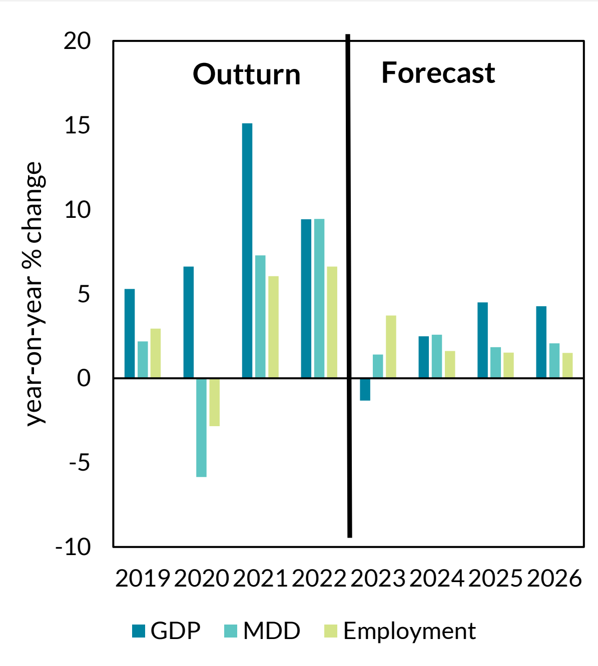
Source: CSO.

Turning to domestic demand, there are signs that activity has also slowed in this part of the economy during 2023 but the evidence is somewhat mixed and the extent of the slowdown is significantly less than observed in MNE-dominated activity. Growth in MDD was negative year-on-year in Q2 and Q3 2023. Personal consumption has continued to grow up to Q3 but was offset by a decline in modified investment (Figure 5). Part of the weakness in the latter can be attributed to a slowdown in investment activity from very high levels recorded in 2022. Modified investment in 2022 increased to its highest level since before the 2008 financial crisis, in part driven a number of large-scale firm specific investments in the MNE sector. As shown in Figure 6, the level of modified investment remains high in 2023 but has declined from the levels recorded in 2022. While the reduction in modified investment has acted as a drag on overall MDD in 2023, other indicators point to continued growth in domestic activity, but at a reduced pace (see *Recent Developments* section).

Putting these elements together, Figure 7 show the overall forecasts for GDP, MDD and employment in this *Quarterly Bulletin* and Figure 8 shows the revisions to these forecasts compared to our September projections. Reflecting the weak outturn for the first three quarters of the year, 2023 GDP has been revised down substantially from QB3 and is projected to contract for the year as a whole by -1.3 per cent. GDP growth is forecast to resume in 2024 and 2025 but the pace of growth has been revised down slightly based on the weaker external demand assumptions in this *Bulletin* compared to our September forecasts. These assumptions incorporate the ongoing impact of the transmission of tighter monetary policy to Ireland's key trading partners.[13]

Pace of growth in economic activity forecast to slow from 2023 following strong post-pandemic recovery

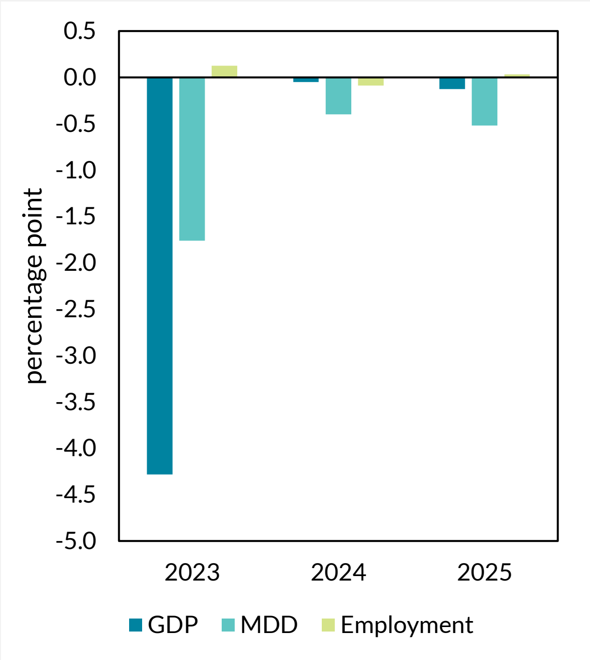
Figure 7: Outturn (2019-2022) and forecasts (2023-2026) for GDP, MDD and Employment, annual % change



Source: CSO (outturn data) and Central Bank of Ireland (forecasts)

MDD revised down in 2023 but by less than revision to GDP as domestic activity is still expected to grow this year

Figure 8: Revisions to GDP, MDD and employment, QB 4 versus QB 3



Source: CSO.

Note: The first projections for 2026 are published in this *Bulletin* (QB4 2023), hence no revision is shown for this year in Figure 8.

Turning to MDD, this has also been revised down for 2023 as a result of the weakness in modified investment but the revision is significantly smaller than for GDP and MDD is still expected to grow this year, in contrast to the projected decline in GDP. A slowdown in MDD growth is to be expected given the pace of the post-pandemic recovery observed in 2021 and 2022 (Figure 7). As the savings rate in the household sector and the investment rate in the company sector have returned to more normal levels, this is being reflected in a moderation in the pace of overall MDD in 2023 and for the remainder of our forecast horizon. Consistent with the projection for domestic demand, the pace of employment

[13] See Box C of QB 2 2023 (June 2023) for analysis of the transmission channels and estimated impact on the Irish economy of the monetary policy tightening implemented by the ECB between July 2022 and June 2023.

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growth is expected to moderate. With the economy already at full employment in 2023, domestic capacity constraints – particularly in the housing market – are expected to place a limiting constraint on economic growth out to 2026.

Summing up, data for the first three quarters of 2023 point to a complex and mixed pattern of growth in the Irish economy. Activity in the MNE-dominated sector of the economy has contracted sharply, partly reflecting a reduction in pharmaceutical trade after exceptional levels of activity in 2022. Given the favourable prospects for this sector globally, exports should recover from 2024 onwards. Exports of semiconductors have fallen in 2023 and if this is driven by longer-term structural factors rather than a temporary cyclical downturn, the outturn for overall exports could be weaker than outlined in the *Bulletin*. In addition to these sector specific issues in pharma and ICT manufacturing sectors, the outlook for exports is somewhat weaker than in previous projections as tighter monetary policy reduces global growth prospects.

For the domestic economy, developments in 2023 have been more favourable than implied by the negative outturn for GDP. Growth in MDD has moderated but this largely reflects a return to a reduced pace of growth following the strong post-pandemic recovery. The reversion to a lower growth path for MDD in 2024 and 2025 is influenced by the transmission of higher interest rates as well as the impact of capacity constraints, in particular in the labour market and in housing, which are expected to limit the pace of expansion in activity over the coming years.

Exports, Imports and Balance of Payments

Overall exports fell by 2.8 per cent in the first three quarters of 2023 compared to the same period last year. The decline was driven by goods exports, while services exports increased. In assessing the performance of Irish trade, it is important to distinguish between physical cross border exports produced in Ireland and exports produced abroad but included in headline National Accounts statistics. Goods exports as measured in the National Accounts fell by 7.5 per cent in the first three quarters of the year, driven by a slowdown in cross-border pharmaceuticals and ICT manufacturing as well as a sharp drop in offshore exports (contract manufacturing). Pharmaceutical and Chemical exports from Ireland were boosted in recent years by Covid-19 vaccines and this activity has declined this year as expected. In addition, ICT manufacturing exports, in particular exports of semi conductors, have reduced

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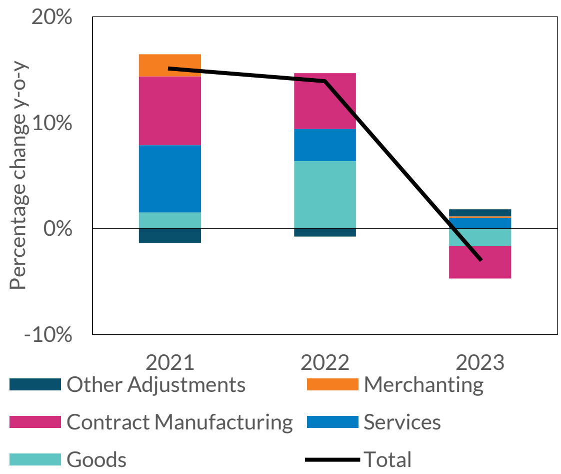
by 51 per cent in 2023 compared to 2022. Along with these declines in cross-border physical exports produced in Ireland, contract manufacturing activity, where Irish firms "contract" a company in another country to manufacture goods for export on their behalf, has fallen sharply in 2023. The decline in CM in 2023 may reflect restructuring by some large MNEs (Figure 17).

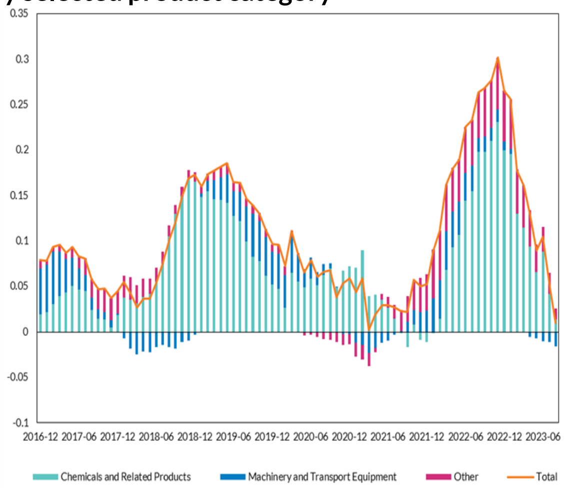
The fall in exports in 2023 can be attributed to a decline in contract manufacturing and pharmaceutical exports

Figure 17 : Estimated contribution to year over year changes in export growth



Source: Central Bank Calculations

Figure 18: Contributions to 12 Month Moving Aver Merchandise export growth by selected product category



Source: CSO and Central Bank of Ireland
Note: Figures are calculated as contributions to the 12 mo average of the growth rate of Merchandise exports.

Services exports grew strongly in the third quarter, offsetting the decline on the goods side. Service exports grew by €6.2 billion compared to Q3 2022. The majority of the increase in services exports was in computer services exports – which account for approximately 58 per cent of total services exports (Figure 19). Looking ahead, we expect strong growth in services to continue over the forecast horizon.

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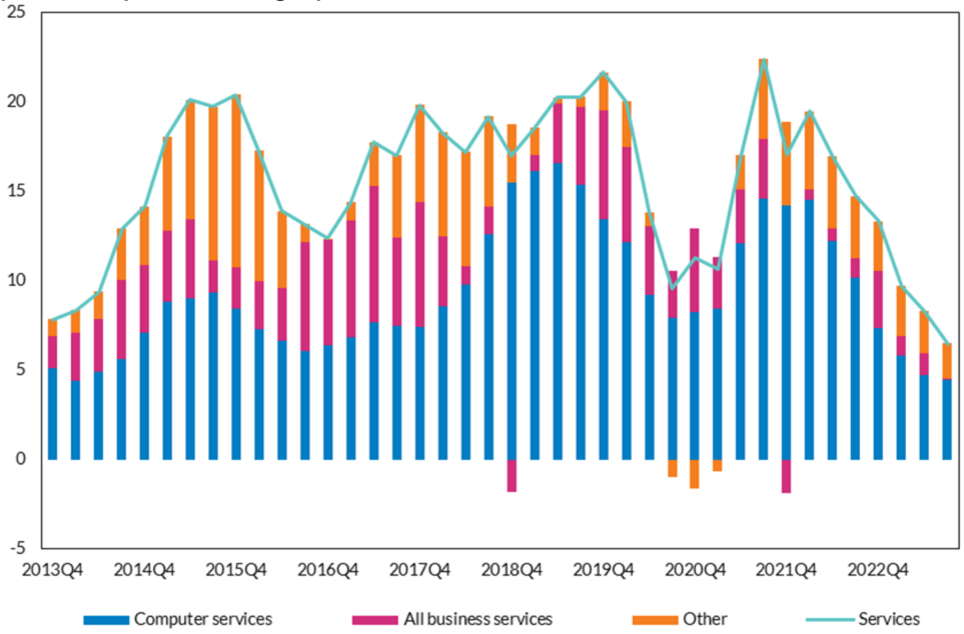
Exports of computer services have continued to grow strongly

Figure 19: Contributions to 4 quarter moving average of services export growth by selected product category



Source: CSO and Central Bank of Ireland
Note: Figures are calculated as contributions to the four quarter moving average of the growth rate of Merchandise exports.

Overall exports are forecast to decline this year by 2.6 per cent, before picking up during 2024 as pharmaceutical exports rebound. Our expectation of a pickup is predicated on two key assumptions. First, we expect demand for Irish exports to grow, albeit at a slower pace than previously expected. Global GDP is forecast to grow by 3 per cent in 2024, and prospects in Ireland's major trading partners are also positive (Figures 20 and 21). Second, investments in recent years by large firms in the pharmaceutical and ICT sector are expected to begin to generate export growth next year and thereafter. However, the average growth rate for exports in our projection for 2024 to 2026 will be around half the historical average (1995-2019). This reflects the assumption that, as globalisation activity slows and with the ongoing transmission of tighter monetary policy weighing on global growth, Irish exports will expand less quickly than before. Our projection assumes that contract manufacturing activity returns to its average level from 2015 to 2019. This assumption presents a moderate upside risk to the forecast.

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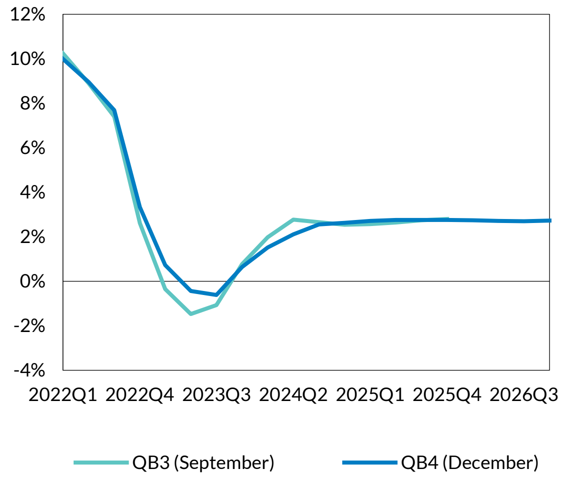
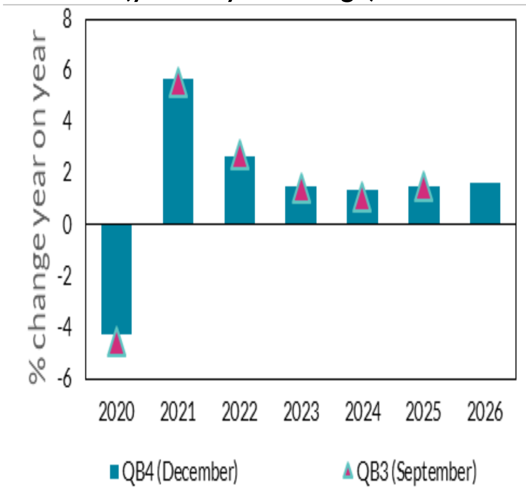
The forecasted pickup in exports is predicated on a recovery in demand in Ireland's main trading partners

Figure 20 : World Demand for Irish Exports (year on year change)



Source: ECB calculations

Figure 21: GDP growth forecast for advanced Economies (year on year change)



Source: ECB calculations

Imports have also declined in line with the fall in exports in the first three quarters of the year. A significant portion of goods exports contain imported intermediates, and, consequently, the decline in exports has been matched by a fall in imports. Looking ahead, we forecast that imports will grow in line with growth in our forecast for final demand, returning to its long run average (Figure 22).

Despite the slowdown in trade in 2023 thus far, the headline balance of payments remains in a strong surplus. In the third quarter of 2023, the headline current account recorded a surplus of €20.8 billion. While the decline in merchandise exports was larger than the decline in imports, the overall level of exports remains substantially above the level of imports in the economy.

The stock of Foreign Direct Investment (FDI) assets held in Ireland by foreign investors has continued to grow strongly in 2023. The stock of FDI in Ireland increased €40.8 billion in Q3 2023. Additionally, Irish investors expanded their FDI assets abroad by €26.7 billion during the quarter, reaching a total of €1,166.9 billion.

Looking ahead, based on our forecasts for goods and services trade, we expect the current account to remain in surplus, both in terms of headline and modified measures. As the economy, and particularly net exports recover, we forecast the modified current account surplus to average 7 per cent over the forecast horizon.

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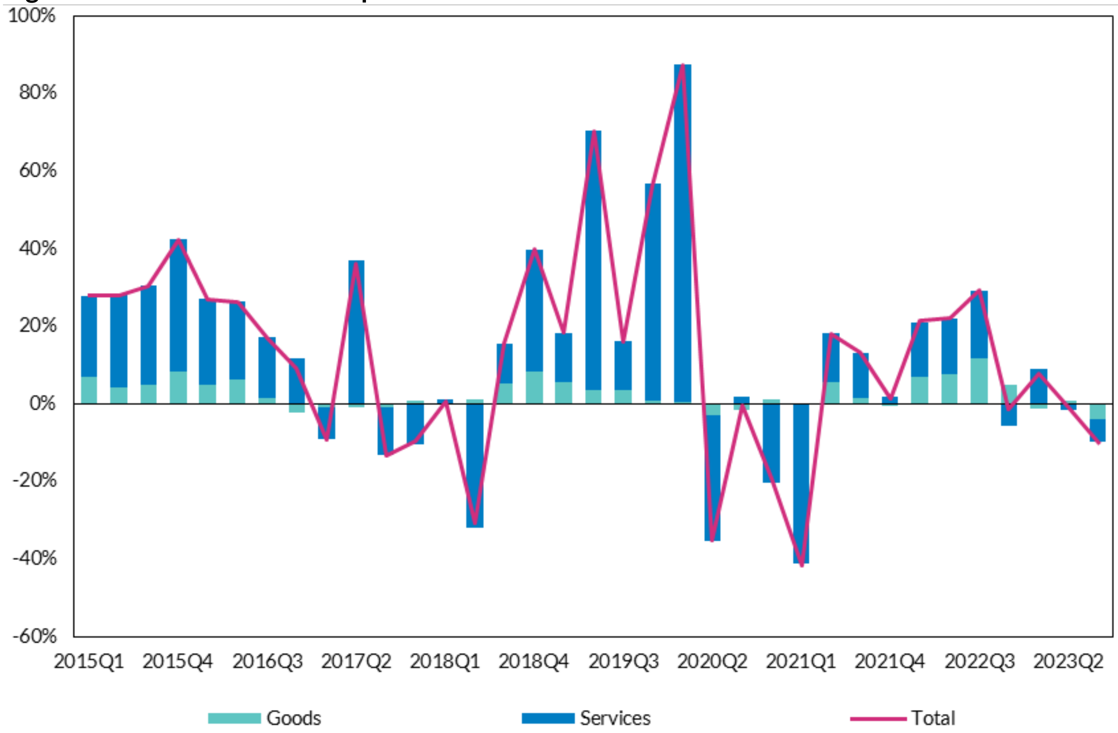
Imports have slowed in line with the falloff in exports

Figure 22: Contributions to Import Growth Year on Year



Source: CSO and Central Bank of Ireland

Prices and costs

Consumer Prices

Consumer price inflation has declined sharply since the start of 2023. Headline HICP inflation in year-on-year terms resumed its decline in October, falling to 3.6 per cent, after picking up slightly in August and September. It fell further to 2.5 per cent in November. The sharp deceleration observed in the last couple of months may not continue, but there are encouraging signs that price growth is returning to more normal rates. Over the course of 2023, CPI inflation has also declined notably, however it remains above HICP inflation (at 3.9 per cent in November). Box D explains the key differences between the two inflation measures. In line with falling inflation rate, consumer inflation expectations declined from 7.2 per cent in February to 5.9 per cent in September.[14]

Recent data provide tentative signs of a renewed disinflationary momentum. When inflation changes rapidly, as has been the case recently, annual rates

[14] Central Bank of Ireland Expectations Survey.

may not reflect well most recent dynamics in prices. At the same time, monthly inflation provides a noisy signal of what happens to prices over time. Following Eeckhout (2023), we construct an "instantaneous" inflation measure for Ireland, where developments in current and most recent months have the largest weights assigned to them.[15] At the start of the pandemic, instantaneous inflation fell more sharply before picking up much faster and by more compared to year-on-year HICP inflation in 2021-22 (Figure 23). After peaking in the middle of 2022, instantaneous inflation declined in advance of a sustained but slower decline in headline inflation. Between January and October, the instantaneous inflation measure indicated price pressures somewhat stabilising above the pre-pandemic level (averaging at 4.1 per cent). However, it fell sharply and turned slightly negative in November, influenced by the fall in energy prices.[16] Similarly, monthly inflation (light green dashed line) have decelerated in recent months. Data also suggest a return to more normal seasonal patterns in headline inflation. During the pandemic period month-on-month HICP inflation rates deviated significantly from their pre-pandemic averages for each month in a year, mostly upwards (Figure 24). In 2023, monthly growth rates in prices have come down closer to their seasonal averages from 2015-2019.

Disinflation in headline HICP has been driven mostly by lower energy inflation. Energy inflation declined sharply and turned negative in the first half of 2023, reflecting a drop in inflation in all its major components. This decline was interrupted by a pick-up in year-on-year inflation rates for liquid fuels, petrol and diesel towards the end of summer and early autumn, with energy inflation increasing in August and September. Energy prices resumed a decline in October falling by -4.3 per cent compared to a year ago, driven by electricity, gas and solid fuels prices. Electricity and gas prices for consumers in Ireland declined in annual terms in October for the first time since September 2020 and April 2021, respectively. Gas prices also fell on a monthly basis for the first time since November 2020, while electricity prices continued to decline each month since May 2023 (Figure 26). However, energy prices still remain much higher compared to the euro area and have continued to decline at a slower pace. November's data showed a further fall in energy prices (-10.2 per cent annually and -6.1 per cent monthly).

[15] In the conventional year-on-year inflation rate, month-on-month inflation rate twelve months ago is given the same weight as month-on-month inflation rate in the current month. In the instantaneous inflation measure, the weight declines rapidly with less weight assigned to months further back. The weights decline from 34 per cent for the current to nearly 0 per cent for the monthly rate eleven months ago.
[16] It registered the first fall in prices since October 2020.

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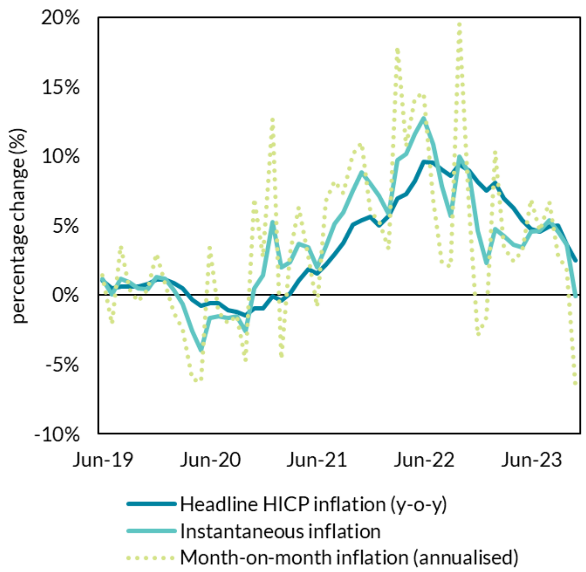
Tentative signs of a loss in momentum and a return to more normal seasonal patterns

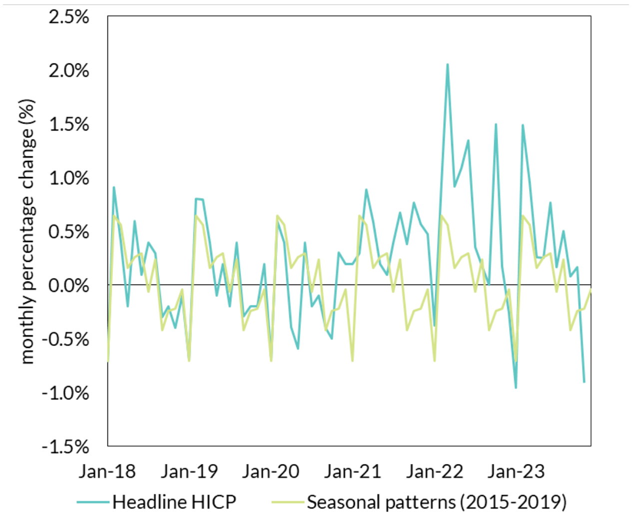
Figure 23: Annual and instantaneous inflation



Source: Eurostat, CBI calculations.

Note: instantaneous and month-on-month inflation are based seasonally adjusted HICP.

Figure 24: Seasonal patterns in headline inflation

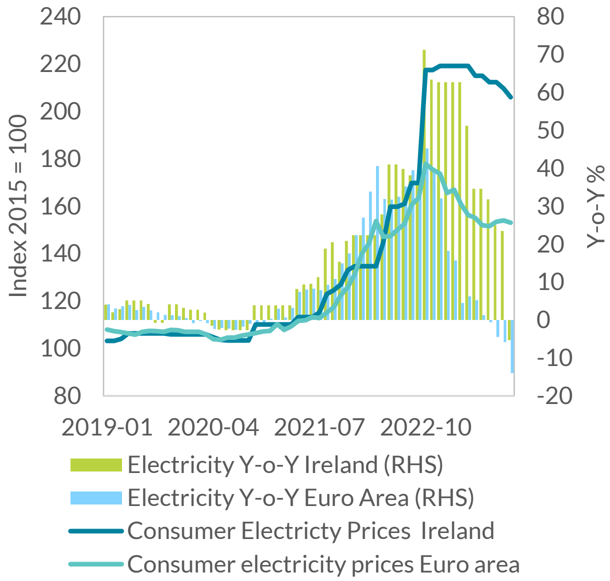


Source: Eurostat, CBI calculations.

Note: seasonal patterns calculated averaging monthly inflation rate (non-seasonally adjusted) rates for each of twelve months across years.

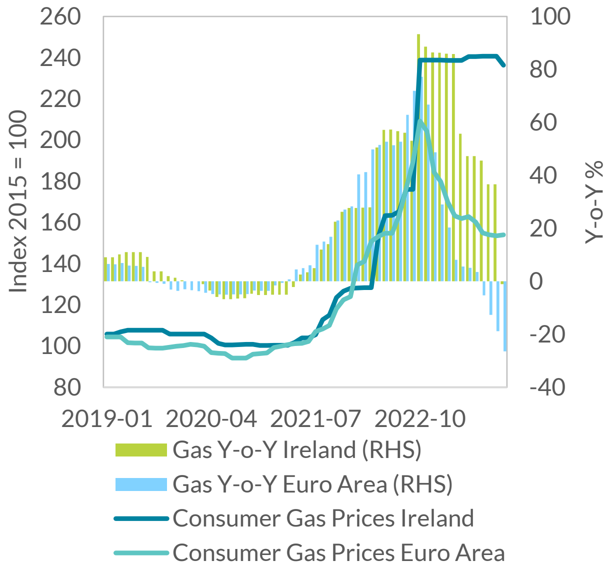
Consumer electricity prices in Ireland continue to decline, gas prices declined in October for the first time since November 2020

Figure 25: Consumer Electricity Prices



Source: Eurostat

Figure 26: Consumer Gas Prices

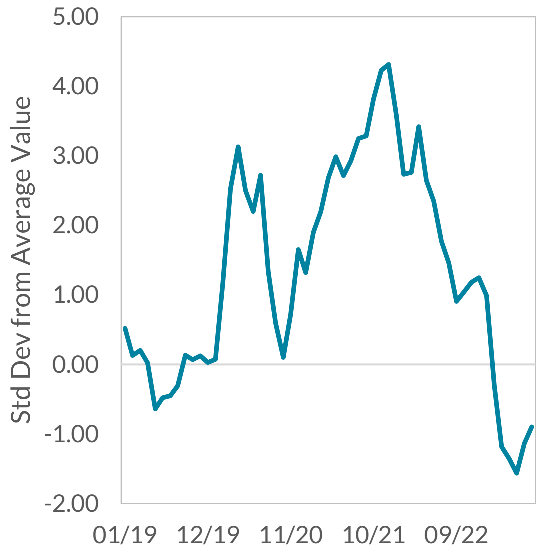


Source: Eurostat

Declining inflation for non-energy industrial goods and food (including alcohol and tobacco) has also contributed to a slowdown in headline inflation in 2023. Supply chain pressures have eased considerably from the peak in late 2021. The Global Supply Chain Pressure Index (Figure 27), which combines data on global transportation costs with delivery times, backlogs and purchased stock data in global PMIs, suggest global supply chain pressures remain below the historical average in 2023. Euro area manufacturing suppliers' delivery times have improved substantially since 2022, with the index close to its pre-pandemic level (Figure 28). Lower energy prices pass through to production costs reducing inflationary pressures. Year-on-year non-energy industrial goods (NEIG) inflation declined from 5.1 per cent in January to 1.2 per cent in November. Food inflation was at a still high level of 6 per cent in November, but down from 9.4 per cent at the start of the year.

Supply chains pressures below average

Figure 27: Global Supply Chain Pressure Index



Source: NY Fed.

Suppliers' delivery times recovered

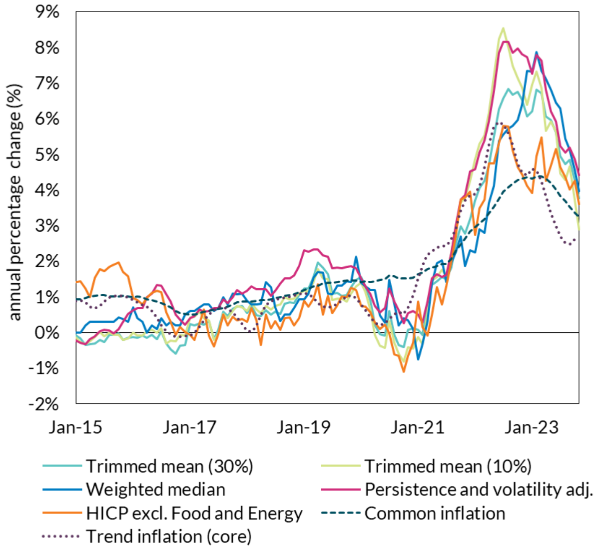
Figure 28: Manufacturing Delivery Times

Source: IR AIB PMI Manufacturing

HICP inflation excluding food and energy components (core HICP) is more persistent and remains high, driven by services inflation. In October, HICP inflation excluding food and energy stood at 4.3 per cent, up from 4 per cent in September. It has been fluctuating between 4 per cent and 5 per cent throughout 2023. In November, core HICP inflation fell to 3.6 per cent. As NEIG inflation has declined significantly, services inflation has shown little easing so far this year and stood at 4.8 per cent in November. This is in line with still strong demand for services, the pass through from past increases in energy prices, persisting tightness in the labour market and higher wages contributing to input costs and higher output prices. Although input costs growth has normalised and is now at its long-term average, prices charged continue to increase and PMI data point to growth in output prices above historical averages (see the section on Broader Costs in the Economy).

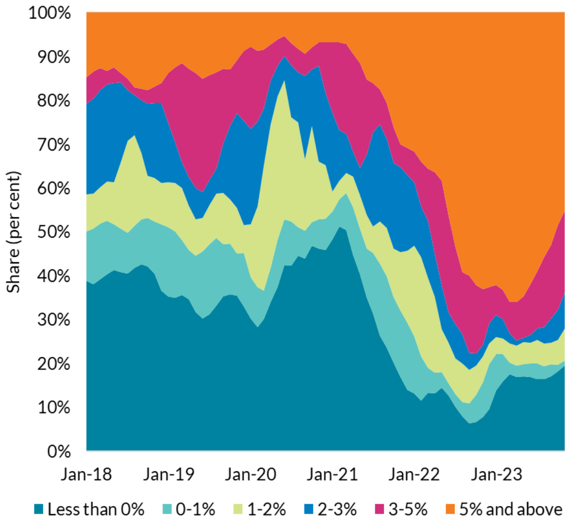
Price increases are still broad-based but the share of basket with high inflation rates continues to decrease

Figure 29: Underlying inflation measures



Source: Eurostat, CBI calculations.

Figure 30: Weighted shares of price changes



Source: Eurostat, CBI calculations

Note: each data point is a three-month moving average.

Underlying inflationary pressures continue to decline from the peak but remain elevated. Measures of underlying inflation aim to remove temporary fluctuations and product-specific shocks often unrelated to underlying economic conditions from headline inflation rates (Figure 29).[17] Underlying inflation measures show that inflationary pressures have already peaked and have started to decline. Nearly all underlying measures have been on a steady decline over the course of 2023. The range across the various measures has also recently narrowed, after widening considerably in 2022. Nevertheless, underlying inflation rates are still at much higher levels than in years preceding the pandemic. The proportion of goods and services experiencing price rises of 5 per cent or more has been declining steadily in recent months but remains

[17] These measures are: 'Trimmed Mean', which removes the top and bottom 5 per cent (15 per cent) of the weighted price change distribution; 'Weighted Median', which is the inflation rate of the basket item at the middle of all weighted price changes; 'Persistence and Volatility Adjusted', which assigns higher weight to basket items with higher persistence and lower volatility of price changes as in da Silva Filho (2015); 'Trend core inflation', which is a filtered measure of core HICP as in Aydin-Yakut (2023); and 'Common inflation', which uses a dynamic factor model to extract common trend into price developments across components of the basket, such as described in Box E, QB2 2022.

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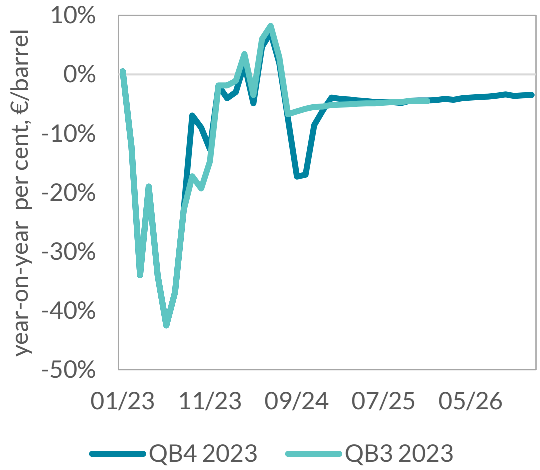
elevated at 45 per cent in November on a three-month moving average basis (Figure 30).

Oil prices were higher in September and October 2023 than expected in the last *Bulletin*, but a larger year-on-year decline in oil prices is expected over the course of 2024 (Figure 31). The Israel-Hamas war that broke out in October contributed to the spike in oil prices, which were already rising due to supply concerns in light of announced and expected OPEC+ output cuts. More recently, oil prices have eased back amid concerns over slowing global demand as well as higher than expected US oil output. Nevertheless, prices have been supported by recently-announced voluntary cuts to oil output for 2024.

Gas futures prices are lower throughout the projection horizon than assumed at the time of the last *Bulletin* in September (Figure 32). In year-on-year terms, gas futures as of late November indicate lower growth in gas prices over 2024 and a smaller decline in 2025 than previously assumed. Based on futures data, a further fall in gas prices is expected in 2026.

Oil prices increased in the third quarter but are expected to decline more sharply in 2024

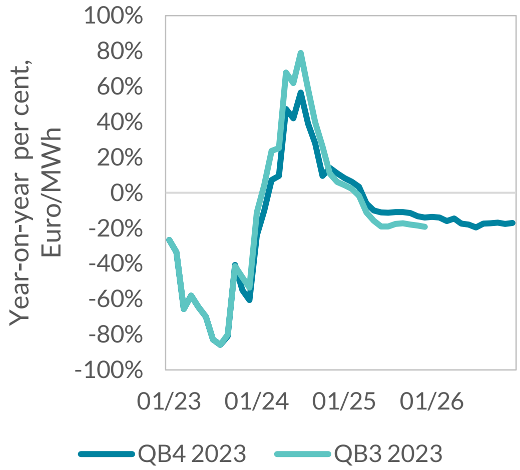
Figure 31: Brent Crude Futures



Source: ECB internal assumptions, Refinitiv

Gas futures indicate lower gas price inflation in 2024 and smaller decline thereafter

Figure 32: TTR Gas Futures



Source: ECB internal assumptions, Refinitiv

HICP energy prices are expected to fall by 3.7 per cent in 2024. In 2025, energy inflation is projected to increase and stand at 4 per cent before declining to -1.3 per cent in 2026. Consumer energy prices are expected to continue to gradually decline for the remainder of this year and next as the effects of the hedging strategies of energy companies expire. However, the extent of the lag between wholesale and retail energy prices is the subject of

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some uncertainty. The postponement of the reversal of VAT and excise reductions to next year also imply a slowdown in energy inflation between now and late 2024 and a pickup in energy inflation towards the end of 2024 and into 2025, relative to our QB3 projections.[18] While energy inflation is higher in 2025, it is below its level in 2023, and declines to negative figures subsequently in 2026. Compared to the last *Bulletin*, the forecast for energy price inflation has been revised down except for 2025 (Table 2).

Food commodities price growth higher

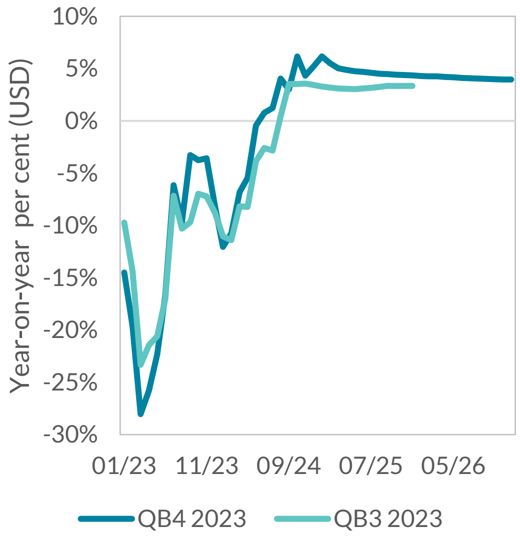
Figures 33: Aggregate Food Futures

Source: ECB internal calculations

Note: total food commodity index was used in Q3, for QB4 use-weighted index is used.

Industrial goods futures price growth also up

Figures 34: Aggregate Industrial Futures



Source: ECB, internal calculations

Note: total industrial goods commodity prices used in QB3, for QB4 hard industrial goods commodity index is used.

Food price inflation is expected to be higher than forecast in the previous projections reflecting higher food price commodity assumptions (Figure 33). The projection is for a significant moderation in food inflation from 8 per cent in 2023 to 3.5 per cent in 2024 and 1.9 per cent in 2025-26. The food inflation forecast has been revised upwards in each year of the forecast horizon compared to the previous forecast (Table 2). Despite a substantial decline expected, the food inflation forecast for 2026 is higher than prior to the pandemic and slightly above its historical average.

[18] The reduced 9 per cent VAT rate on gas and electricity was due to be restored to 13.5 per cent in November 2023. This has been delayed to November 2024. Similarly, the reversal of cuts in excise duties on petrol, diesel and gas oil have been postponed from November 2023 to April 2024 and August 2024 (will be restored in two phases).

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Inflation in non-energy industrial goods (NEIG) is expected to moderate from 3.4 per cent this year to 1.4 per cent next year, followed by further declines to -0.7 per cent and -1.2 per cent in 2025 and 2026, respectively. The non-energy industrial goods prices are largely imported and depend on assumptions for international goods (Figure 34) and energy futures as well as exchange rates.

Conditional on international commodity price assumptions, headline HICP inflation is expected to decline gradually over the forecast horizon, but core HICP inflation is expected to remain above headline out to 2026. Headline HICP inflation is expected to fall to 2.3 per cent, 2.1 per cent and 1.4 per cent in 2024, 2025 and 2026. Declining HICP inflation mostly reflects lower energy, food and NEIG inflation (Figure 35). Core HICP is forecast to measure 4.4 per cent, 2.9 per cent and 1.9 per cent in 2023, 2024 and 2025 respectively. In 2026, core HICP is expected to be 1.7 per cent. These forecasts represent downward revisions compared with our September projections. The revisions are driven by weaker projections for NEIG inflation in 2025 as well as a downward revision to services inflation. Changes to the NEIG outlook in this *Bulletin* stems from changes in key external assumptions for energy futures prices, industrial goods futures prices and exchange rates since the last *Bulletin*. In addition, the outturn for NEIG inflation in recent months was somewhat weaker than expected. The downward revision to services is driven by lower projected MDD growth for 2023 to 2025 along with lower wage growth for 2023 compared with QB3, as well as recent outturns for services inflation being lower than previously expected. The downward revision to MDD and wage growth is largest for 2023 but the impact carries through to 2024 and 2025 given both the contemporaneous and lagged impact of these drivers on services inflation. Services inflation is forecast to decline gradually over the projection horizon from 4.9 per cent this year to 3.1 per cent in 2026 but is expected to be the key driver of overall inflation from 2024-2026. This reflects relatively strong projected growth in domestic economic activity, albeit more moderate than previously expected, with real incomes recovering and a tight labour market.

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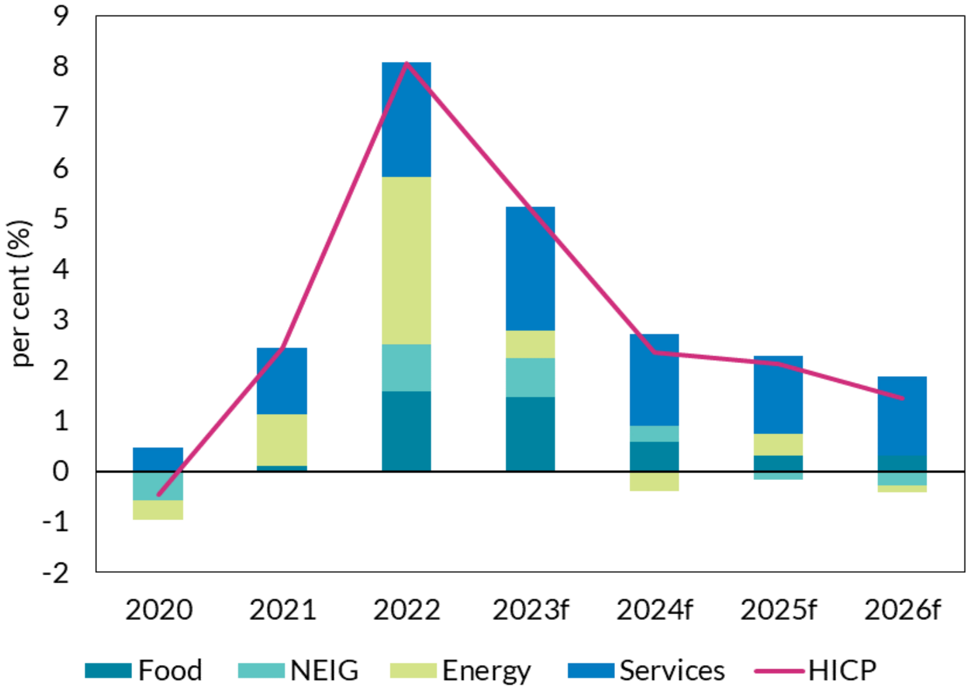
Services is a key driving force of headline inflation looking ahead

Figure 35: HICP Forecast



Source: CSO and Central Bank of Ireland

Table 2: Inflation Projections

	2022	2023	2024	2025	2026
HICP	8.1	5.2	2.3	2.1	1.4
Goods	11.4	5.4	1	1.1	-0.2
Energy	41.2	5.2	-3.7	4	-1.3
Food	7.3	8	3.5	1.9	1.9
Non-Energy Industrial Goods	4.2	3.4	1.4	-0.7	-1.2
Services	4.7	4.9	3.7	3.1	3.1
HICP ex Energy	5	5.1	3	1.9	1.8
HICP ex Food & Energy (Core)	4.6	4.4	2.9	1.9	1.7
Private Consumption Deflator	6.5	6.5	3.5	1.5	1.5

Source: CSO, Central Bank of Ireland

The inflation forecasts contained in this *Bulletin* are subject to both upside and downside risks, but upside risks are dominating in the near term while in the medium term risks are more balanced. European energy markets are still vulnerable to continued geopolitical tensions and ongoing wars. It is not yet clear how quickly the decline in wholesale commodity prices will pass-through to consumer products. Food prices are also subject to changing weather conditions and Russia-Ukraine war effects on grains supply. Climate change-

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related transition may put upward pressure on inflation in the medium-term due to mismatches in supply and demand for brown and green fuels as well as further increases in carbon taxes or new taxes to that effect. However, the global slowdown may also prove to be more protracted, having ripple effects on the Irish economy, damping demand and reducing inflationary pressures. The domestic economy could also slow down by more than expected in light of larger than anticipated monetary policy effects via higher interest rates. This could lead to more slack in the labour market than currently projected and somewhat slower or only partial catch-up in real wages, which would negatively affect domestic demand and reduce inflation more than anticipated. Nevertheless, an upside risk could also emerge if financial conditions loosen over the projection horizon by more than currently assumed. Remaining measurement issues in NEIG prices which has been manifested in a persistent downward trend in this price index pose some downside risks over the medium term if this trend persists.

Broader Costs in the Economy

Price pressures in the manufacturing sector eased considerably in 2023, but remain strong in the services sector. PMI survey data point to declining manufacturing input and output prices since the middle of 2023 with both series now below their long-term average (Figure 36). The services input prices and prices charged indices have been increasing at a slower pace in the recent period but still indicate rising prices. While the input prices indicator is at its long-term average, the prices charged indicator remains slightly above, indicating still relatively strong price pressures. Meanwhile, the decline in domestic manufacturing wholesale prices continues (Figure 37). Wholesale energy inflation remains negative, albeit to a lesser extent than earlier in 2023. Inflation in wholesale domestic building and construction costs averaged around 2.8 per cent between July and October and is much lower than in 2022.

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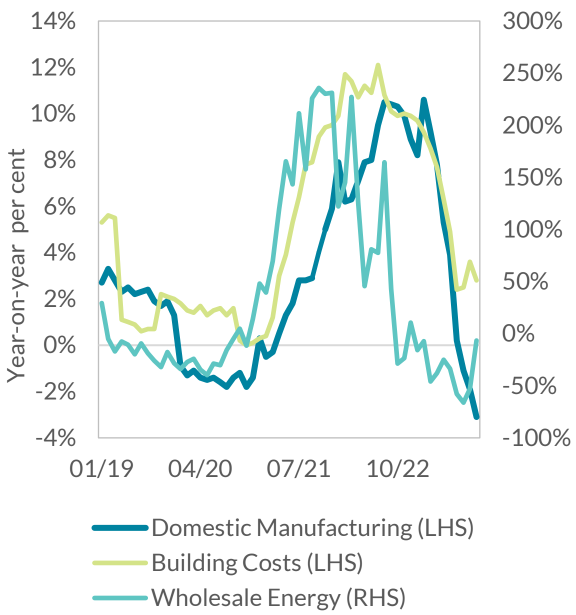
Wholesale prices declining led by energy

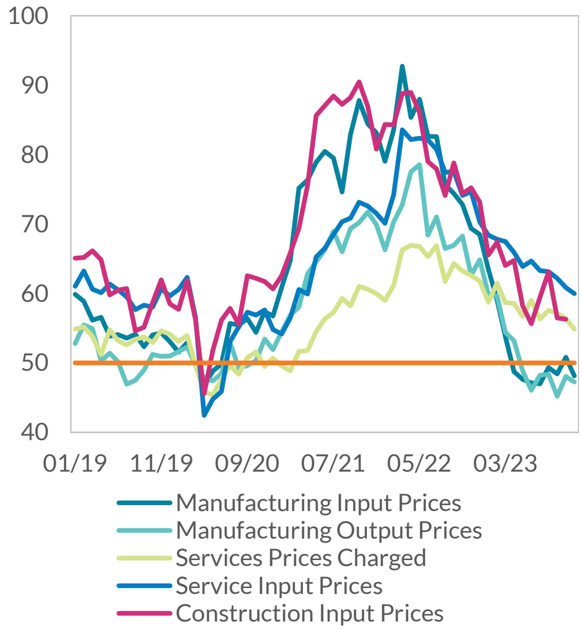
Figure 36: Wholesale Price Index



Source: CSO.

Input and output prices moderating

Figure 37: PMIs



Source: Refinitiv Eikon

Box D: Headline measures of inflation in Ireland: explaining the difference

By Zivile Zekaite (Irish Economic Analysis Division)

Two main inflation measures in Ireland

The official inflation measure in Ireland is based on the *Consumer Price Index* (CPI). [19] As Ireland is part of the euro area with common monetary policy set by the European Central Bank (ECB)[20], inflation is also measured using the *Harmonised Index of Consumer Prices* (HICP). Both CPI and HICP for Ireland are compiled by the Central Statistics Office (CSO), with the latter submitted to Eurostat and published along with the results for other euro area countries. In this way, inflation rates are comparable across the euro area. The ECB's inflation target of 2 per cent over the medium term is defined in terms of HICP inflation, thus, it is the relevant measure when deciding on euro area monetary policy.

In general, CPI and HICP inflation rates move together closely. CPI inflation has been higher than HICP by only 0.19 percentage points *on average* since January 2000.

[19] Inflation is defined as a percentage change in the price index over the 12-month period and reflects an overall change in prices of goods and services that people typically buy. See this video by the CSO for more information.

[20] National central banks contribute to the formation and implementation of monetary policy decisions.

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However, the difference in inflation rates can be much larger at specific points in time. In October 2023, CPI inflation stood at 5.1 per cent compared to the HICP inflation rate of 3.6 per cent.

The difference between the two measures arises because the HICP consumer basket is a subset of the CPI basket and excludes some items covered by the CPI. In total, items comprising a little over 6 per cent of the CPI basket are not included in the HICP. Most importantly, the CPI includes a measure of owner-occupied housing (OOH) costs, which are mostly excluded from the HICP.[21] In addition, motor tax, motor insurance, and union subscriptions are only covered by the CPI.[22]

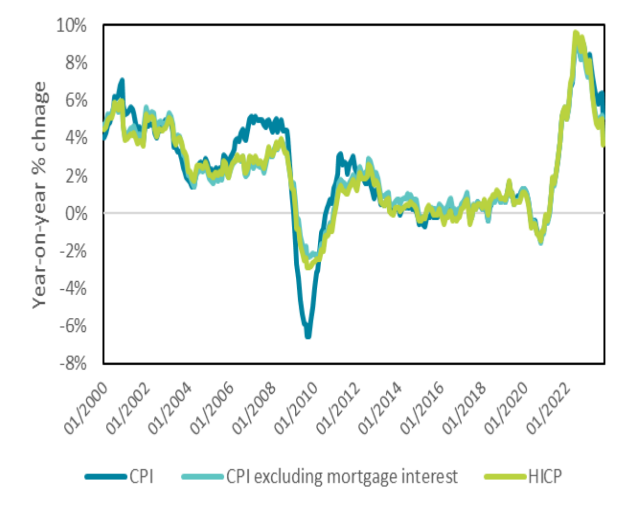
OOH costs are the costs associated with owning, maintaining and living in one's home. There exist several ways to measure such costs. The CPI includes OOH based on the *payments* approach, with the "price" of OOH consisting of mortgage interest, building materials, home insurance related to dwellings, and Local Property Tax.[23] Mortgage interest is the largest of these components.

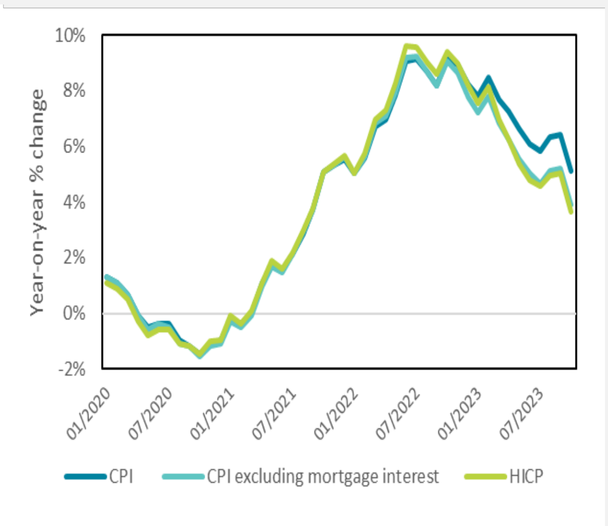
Once mortgage interest is excluded from the CPI, the measured inflation rate comes very close to the HICP rate for much of the period since 2000 (Figure 1). Developments in mortgage interest payments as estimated by the CSO largely reflect changes in average mortgage interest rates and only to a small extent changes in *estimated* outstanding mortgage debt, which is derived based on residential property prices.[24]

[21] Currently, the HICP covers the costs of maintenance and minor repairs and other running costs (e.g., water supply, refuse and sewage collection, utilities) for both tenants and owner-occupiers.
[22] The CPI also applies a different treatment to some insurance-related items. For more details see the relevant methodological manuals for the CPI here and HICP here.
[23] The payments approach measures actual cash flows of a household to cover costs associated with homeownership (see e.g., Allen et al., 2022).
[24] Mortgage interest is a product of 1) a weighted average interest rate on mortgages (fixed rate for different fixation periods, variable and tracker rates, new and existing loans) and 2) a measure of mortgage debt outstanding for a house bought in each month over the last 20 years. The house price for each month is taken from the Residential Property Price Index produced by the CSO and is adjusted to reflect loan repayments over time. For a given month, interest outstanding is the sum of adjusted house prices multiplied by average interest rate in each month over the preceding 20 years. Interest debt can then be compared to its value in the previous month to derive a price relative for mortgage interest payments between two months. We thank Anthony Dawson from the CSO for providing this information. See also here for methodological information.

The difference between CPI and HICP inflation rates is driven by mortgage interest

Figures 1a: CPI; Figure 1b: HICP inflation



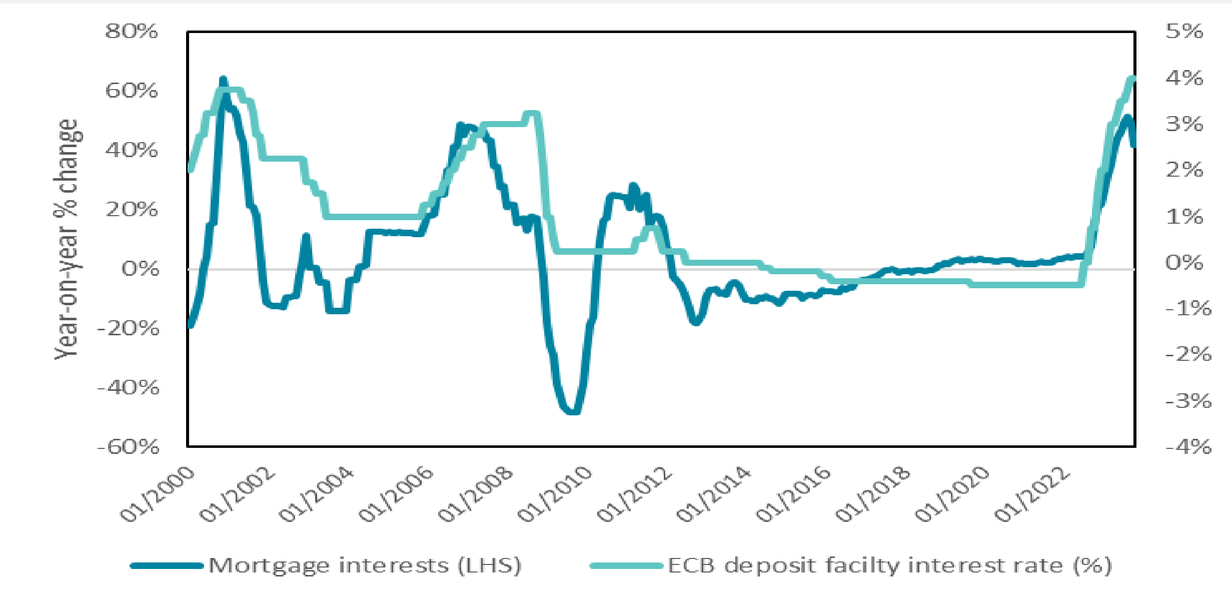


Source: CSO

Since the start of 2023, the gap between the two inflation measures has been increasing, reflecting the current monetary policy tightening cycle and the resultant higher lending interest rates as a result. The annual percentage change in mortgage interest payments tends to move closely with the key ECB policy interest rates (Figure 2).

Mortgage interests payments tend to rise (fall) with increasing (decreasing) ECB policy interest rate

Figure 2: Mortgage interest and ECB deposit interest rate



Source: CSO and Central Bank of Ireland

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Mortgage interest reflects both interest rates paid on existing mortgages and interest rates offered on new mortgages. Thus, the variation of the gap depends on how quickly changes in the ECB policy interest rate feed through to new and outstanding mortgage rates. Around two thirds of mortgage holders in Ireland have their mortgage interest rate fixed, thus, the pass-through also depends on how long is the remaining period on a fixed rate (Byrne et al., 2023; Byrne and Foster, 2023).

ECB strategy review and OOH treatment in the HICP

The inclusion of OOH costs in the HICP index helps to better reflect inflation experiences of households and would enhance the comparability of overall inflation across countries.[25] Following the monetary policy strategy review in 2020-2021, the ECB has recommended the inclusion of OOH within the HICP measured using the *net acquisition* approach.[26] Due to some practical and conceptual challenges, the implementation may take time.[27] Currently, the HICP remains the main inflation measure for monetary policy purposes, while OOH inflation plays a supplementary role in monitoring inflationary pressures (Eiglsperger et al., 2022).

The measure of OOH costs based on the ECB's preferred net acquisition approach already exists for nearly all European Union countries. Eurostat has developed *experimental* OOH price indices (OOHPI) and is regularly publishing this data for Ireland and other euro area countries.[28] The OOHPI measures the changes in the price of acquisition of new dwellings for own-use (including self-built dwellings and major renovations) as well as other costs related to the acquisition and ownership of dwellings (e.g. major repairs and maintenance, insurance, etc.). Nevertheless, there are several issues to be addressed before integrating this index into the HICP. As it contains house prices, the asset component would be introduced into the consumer price index, which measure the costs of consumption, not investment. This drawback is also true for the CPI. Furthermore, the OOHPI is only available on a quarterly basis and with a long publication lag, which would affect timeliness and quality of the HICP.

Despite these challenges, the proposed *net acquisition* approach is preferred for the HICP over the *payments* approached used for the CPI. The inclusion of mortgage interest

[25] OOH costs comprise a big part of households' total expenditure. In many European countries the homeownership rate is high at around 70 per cent or above and it varies substantially from country to country (from around 50 per cent to just over 90 per cent).
[26] The net acquisition approach treats a dwelling as a durable good that is part asset (land) and part consumable (structure) and the costs are measured using a market price at the point of a purchase. Only dwellings that are *new* to the household sector are covered, including self-built housing, while transactions between households are excluded. In addition, the costs associated with the acquisition or construction (e.g., fees and taxes), dwelling insurance, major renovations and repairs are also covered (Eiglsperger et al., 2022).
[27] Before the OOH price index can be included to the HICP, several adjustments need to be made as outlined in the roadmap proposed by the ECB (ECB, 2021).
[28] The data only begins in 2010Q1. For more information on the index see here.

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payments in the CPI makes the index unsuitable for monetary policy purposes and can complicate communication with the public. A central bank increases (decreases) its policy interest rate to reduce (increase) inflation by dampening (boosting) demand relative to supply in the economy. Thus, a higher policy rate would directly add to measured inflationary pressures through higher mortgage interest payments. Furthermore, interest payments reflect the cost of borrowing rather than consumption, which is conceptually not in line with the CPI or HICP.

OOH inflation in Ireland

OOHPI inflation as measured by Eurostat using the net acquisitions approach moves in line with inflation in residential property prices, however, it is typically not as large in terms of magnitude and is much less volatile (Figure 3). On average since 2011, OOHPI inflation in Ireland has been 2.8 per cent. More recently, it measured 7.6 per cent in 2023Q2 from the all-time peak of 9.4 per cent recorded in the first quarter of the year.

While house price inflation has been on a decline since the first quarter of 2022, OOHPI inflation has been gradually increasing until the second quarter of this year when it fell for the first time since late 2020. This can be explained by a different coverage of the indices and different price dynamics of new and existing dwellings. The house price index includes both new dwellings as well as secondary market purchases, i.e., acquisitions between households. OOH price index does not include house prices in the secondary market. The sharp decline in house price inflation has been predominantly driven by prices of existing houses stagnating and then starting to fall.[29] At the same time, prices of new houses continued to rise, with annual inflation of 10.4 per cent in 2023Q3.

Figure 4 shows main sub-components of the OOHPI for Ireland. The inflation rate of new dwellings prices has remained stable at a high level and inflation in costs of ownership (major repairs and maintenance, insurance, etc.) has only started to decline most recently. Developments in self-build and renovation costs as well as costs of services related to acquisitions have also kept OOH inflation more persistent than house price inflation.

[29] Existing house prices have been falling since 2022Q4 and fell also in annual terms in 2023Q3.

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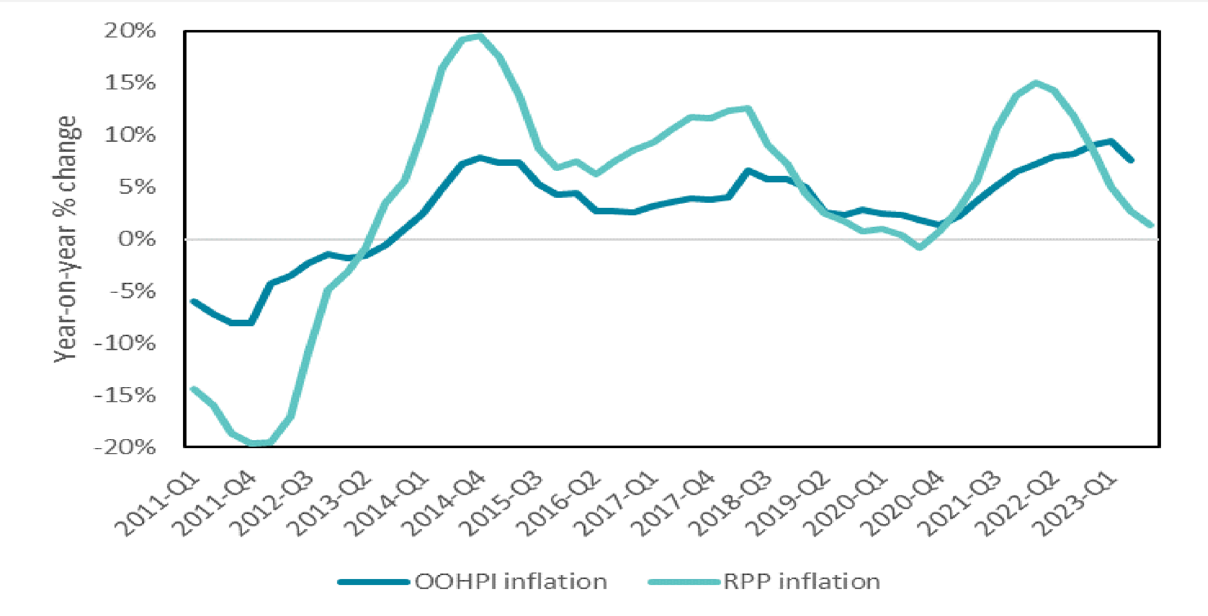
OOHPI inflation moves broadly in line with house price inflation but is less volatile

Figure 3: OOHPI and RPP inflation



Source: CSO and Eurostat

Figure 5 compares OOHPI inflation and mortgage interest inflation.[30] It is notable that the series often move in the opposite direction. In the aftermath of the global financial and sov debt crises, mortgage interest inflation declined sharply, turned negative and remained neg indicating falling mortgage interest costs until the end of 2018. At the same time OOHPI in increased, turned positive and then fluctuated well above zero. More recently, the two me of OOH costs have behaved more similarly and have risen sharply since 2021. In addition, t magnitude of percentage changes in OOHPI are greatly different from percentage changes mortgage interest. While the mortgage interest item has a weight of only 3.2 per cent in the basket, it can make a large contribution to overall CPI inflation when mortgage interest infl either very high or very low. If OOHPI were to be included in the HICP, its weight in the HICP+OOH basket would approximately be 9 per cent (see ESS (2023) for more detail), thu contributions to overall HICP inflation when OOHPI inflation is very high or very low woul not be as significant.

[30] We focus here on the mortgage interest component only, however the CPI, as noted in the first section, also includes some other items of OOH (with a smaller weight) based on the payments approach.

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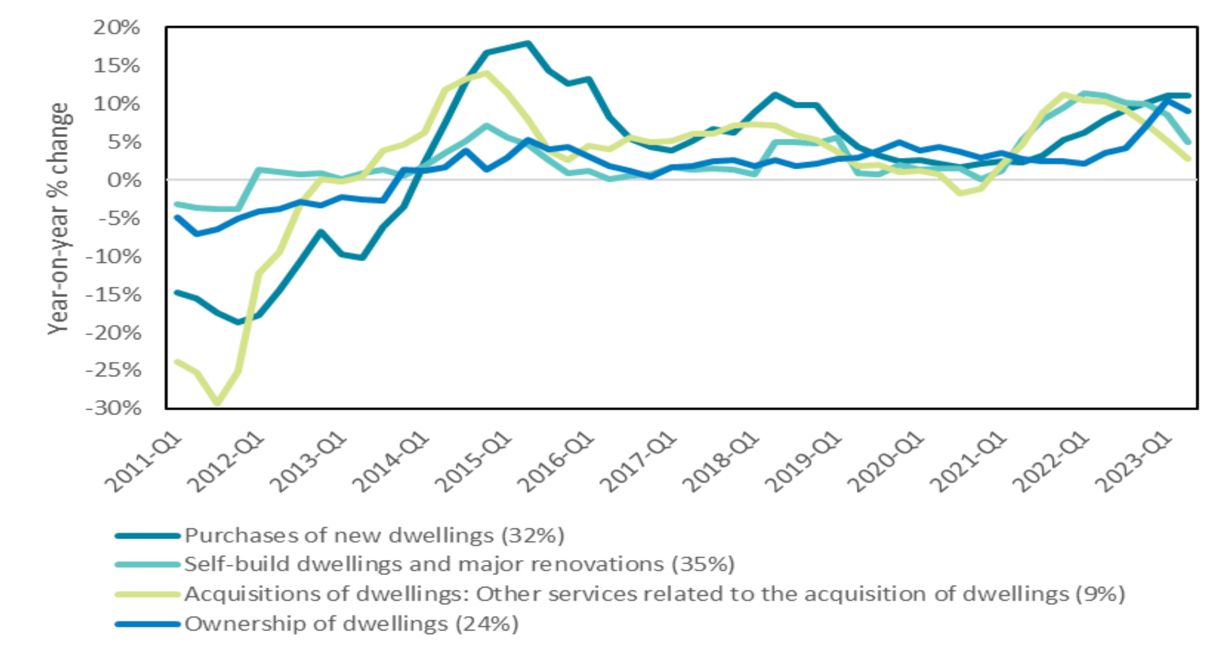
Increases in new dwellings prices and costs of ownership keeps OOHPI inflation elevated

Figure 4: OOHPI components



Source: CSO, Eurostat

Note: figures in brackets reflect the weights of the components in the total OOHPI.

Conclusion

The two main inflation measures for Ireland can at times provide different signals about inflationary pressures. This *Box* has shown that the gap between CPI and HICP inflation rates can be largely explained by dynamics in the mortgage interest payments included in the CPI. Following the Monetary Policy Strategy Review, the European Central Bank recommended including a measure of OOH costs into the HICP, although based on an alternative measurement approach. Different approaches, however, lead to very different outcomes for OOH inflation. Thus, the inclusion of OOH in the HICP may not help close the gap between CPI and HICP.

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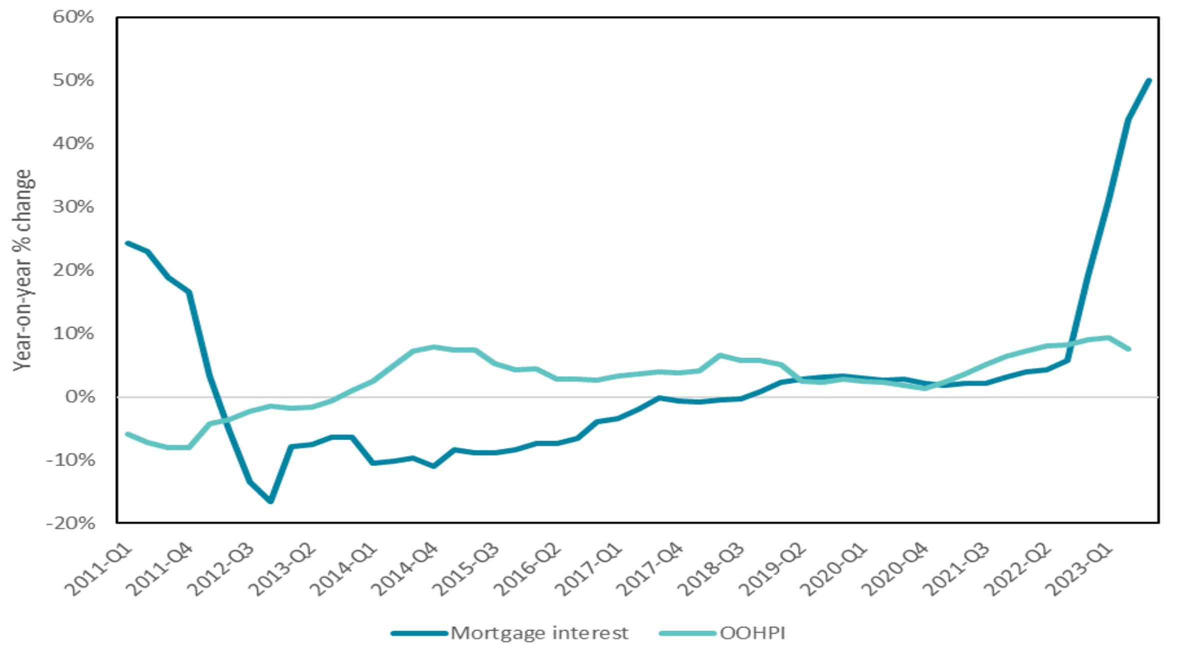
Different measures of OOH costs often send conflicting signals

Figure 5: Mortgage interest and OOHPI inflation



Source: CSO and Eurostat

Labour Market

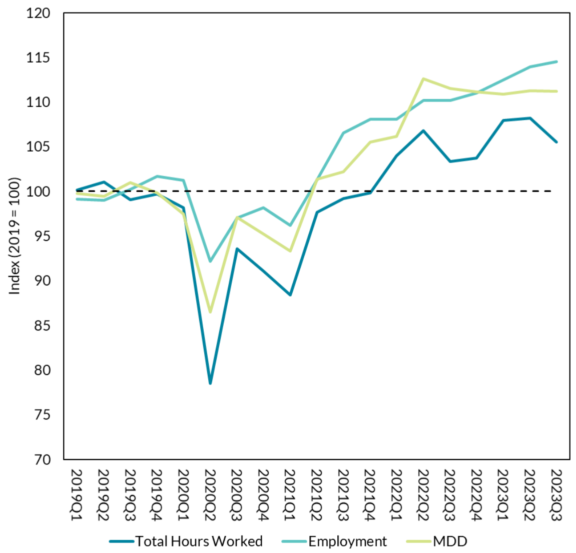
Labour market conditions have remained resilient in 2023 against economic headwinds but employment growth is expected to moderate over the forecast horizon. Employment levels in the Q3 2023 Labour Force Survey increased annually by 4 per cent (101,600 persons) accompanied by strong net inward migration. Employment growth is likely to persist into the final quarter of the year, buoyed by seasonal factors. These factors have contributed to an upward revision in employment growth projections to 3.7 per cent for this year. As the labour market is frequently a lagging indicator of changes in the business cycle, employment growth is projected to slow to 1.6 per cent and 1.5 per cent in 2024 and 2025, respectively, to reflect both domestic labour capacity constraints and a more subdued pace of growth in economic activity.[31]

[31] LFS figures are due to be revised upon the release of Q4 2023 data early next year to align to Census 2022 data. Given the higher population levels in the Census relative to LFS, this revision may result in an upward shift in levels with resulting base effects for annual growth rates. Representative rates such as the unemployment rate and labour force participation rate are expected to remain broadly similar.

The deviation between the growth in employment and total actual hours worked has continued into Q3. *Total* actual hours worked increased by 2.1 per cent annually in Q3 2023. Combined with the growth in employment, average hours worked was down 1.8 per cent over the same period. Employment growth remains broadly in line with developments in modified domestic demand (Figure 38), which contrasts somewhat with the weakness in average hours worked. On a sectoral basis, Agriculture and ICT recorded the largest employment growth rates in the year to Q3 2023, though there were declines in Industry and Construction. Employment in the Accommodation and Food services sector has returned to its pre-pandemic level for the first time, though average hours worked within the sector declined by 8.2 per cent annually (Figure 39). Average hours within the sector are down 15 per cent relative to pre-pandemic levels. This may be due to an increase in the share of part-time employment in the sector, which rose from 40 per cent to 50 per cent over the same period. [32]

Hours worked continues to detach from employment and economic activity

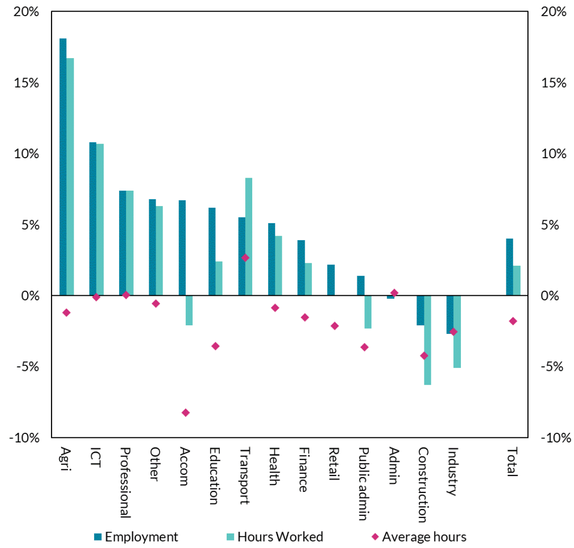
Figure 38: Indexed growth of employment, total hours worked and modified domestic demand



Source: CSO
Note: MFDD refers to seasonally-adjusted constant market prices

Decline in average hours evident across majority of sectors

Figure 39: Annual change in employment, total hours worked and average hours by economic sector (Q3 2023)



Source: CSO

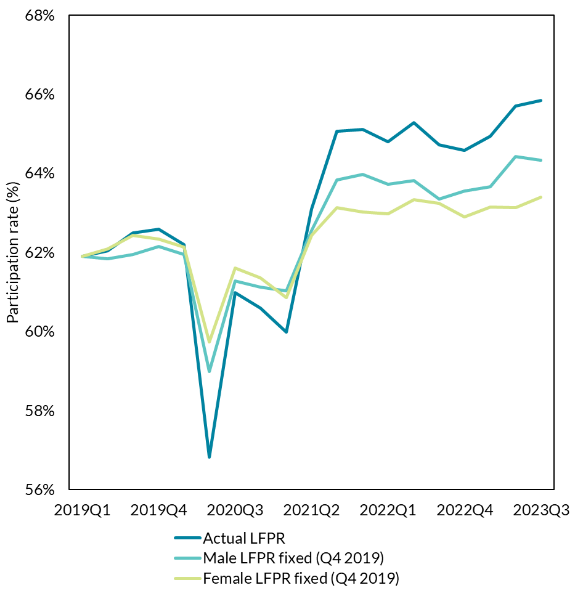
Increased female labour force participation and high levels of net inward migration continue to drive overall labour force growth. The labour force

[32] The share of part-time employment of the total workforce has remained relatively stable over time. The 2019 average was 20.4 per cent and there has been a marginal increase to 21.6 per cent in Q3 2023 though this has been largely driven by the Agriculture and Accommodation sectors with comparably minimal and offsetting changes in other sectors.

increased by 111,000 persons (4.2 per cent) annually in Q3 2022 with females accounting for 70,400 of the increase. The effect of higher female activity in the labour force has seen the labour force participation rate (LFPR) increase to 65.8 per cent, the highest level since Q3 2008. Figure 40 shows the relative contribution of female participation in recent years as the LFPR would be 2.5 percentage points lower if the rate for females was held constant at its 2019 level. Meanwhile, non-Irish nationals accounted for 50 per cent of the annual increase in the labour force to Q3 2023. This represents the fifth consecutive quarter in which the demographic effect of non-Irish has been the dominant driver of labour force growth. Net inward migration is concentrated in workers outside of the UK and EU.[33] Looking ahead, the LFPR is projected to increase at a slower pace and net migration will likely continue as the primary driver of labour force growth. The future path of net inward migration is uncertain and will be influenced by domestic infrastructural constraints, particularly in housing, as well as external geopolitical developments (Figure 41). Labour force growth of 3.7 per cent is forecast for 2023, before moderating to 2 per cent in 2024.

Increased female participation has been the dominant driver of overall labour force growth

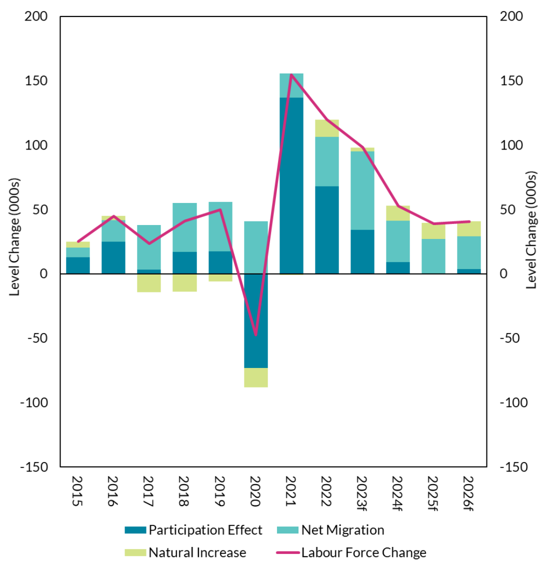
Figure 40: Actual LFPR and counterfactual LFPR by gender



Source: CSO

Net migration continues to play a major role in driving labour force growth

Figure 41: Components of labour force growth



Source: CSO

The Q3 2023 ILO unemployment rate increased to 4.6 per cent from 4.4 per cent in the previous quarter. While the unemployment rate remains relatively

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[33] The demographic effect is defined as the change in the number of people in the labour force as influenced by the size of the working age population.

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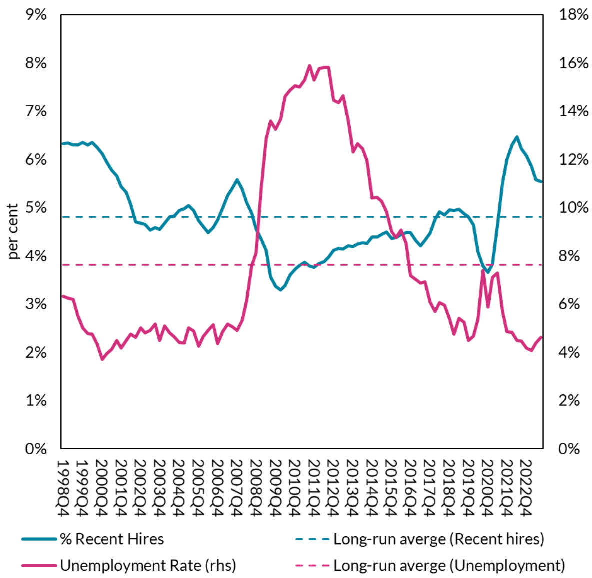
low reflecting the current tightness of the labour market, this marginal increase may indicate some cooling following the strong post-pandemic performance. The share of persons in a job less than three months (or recent hires), which exhibits an inverse relationship with unemployment, has begun to moderate closer to its long-run average in recent months (Figure 42). When discerning any potential slowdown in the labour market, it is important to consider wider measures of labour slack such as the labour underutilisation rate, which suggests that the level of available capacity in the labour market has increased to 11.6 per cent in Q3 2023 relative to the 10.5 per cent in the previous year (Figure 43).[34] The increase in part-time under-employment might suggest potential labour hoarding by employers in a bid to retain workers amidst elevated labour demand and low unemployment.[35] Unemployment is projected to remain close to historical lows over the medium-term with a slight increase to 4.8 per cent in 2024 projected, due to downward revisions to the economic growth before moderating to 4.6 per cent in 2025.

Share of recent hires has begun to normalise following elevated levels of job switching in pandemic recovery period

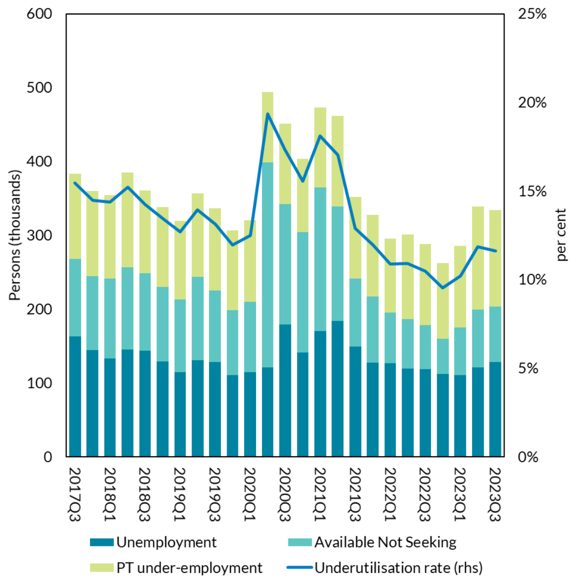
Figure 42: Share of recent hires and unemployment



Source: CSO
Note: Recent hires refers to persons in their current employment for a period of less than three months

Increase in underutilised labour resources led by rise in part-time employed who wish to work more hours

Figure 43: Labour underutilisation rate



Source: CSO

[34] The Labour Underutilisation Rate refers to the number of persons classified as unemployed, plus those part-time under employed who wish to work additional hours and are available to do so, plus those outside the labour force who are available for work but not seeking work as a percentage share of the extended labour force. See U6 definition.

[35] Arce et al (2023) suggest that hoarding labour may become less attractive for firms faced by rising labour and financial costs, leading to a normalisation of average hours worked.

Earnings and Income

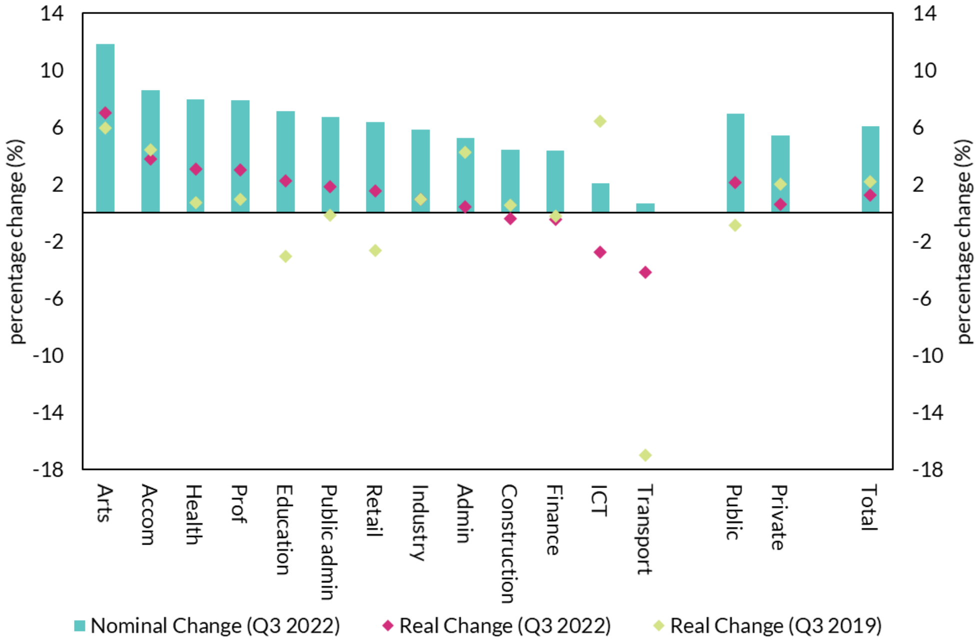
Average hourly earnings showed positive annual growth in real terms in Q3 2023 for the first time since 2021. CSO EHECS data for Q3 2023 shows that average hourly earnings increased annually by 6.1 per cent in nominal terms or 1.2 per cent in real terms following seven quarters of negative real growth. This increase also represents the highest nominal growth rate observed since the pandemic period, during which earnings data were distorted, and indeed was the highest since before the Global Financial Crisis.[36] Nominal growth was recorded across all sectors with the largest increases in Arts and entertainment (11.9 per cent) and Accommodation (8.6 per cent) (Figure 44). Consumer price inflation (HICP) was higher than nominal average hourly earnings growth in certain sectors resulting in real earnings declines for Transport (-4.2 per cent) and ICT (-2.8 per cent). The public sector continues to register higher growth than the private sector owing to the base effects of negotiated wage increases over a staggered period. Overall, this catch-up in average hourly earnings is consistent with findings from Boyd et al (2023) that ongoing labour market tightness can be expected to place upward pressures on labour costs. Increases in hourly wage rates in excess of hourly productivity growth would contribute to higher unit labour costs, which in turn could add to inflationary pressures.

Indicators of labour demand have shown signs of moderating in recent months, consistent with higher unemployment and still high core inflation. The latest Indeed job postings index for November showed levels at 26 per cent above the pre-pandemic period. While pre-pandemic comparisons may be troublesome due to potential structural changes in the labour market, it is important to note that the index is down 25 per cent from the start of the year as the unemployment rate has marginally ticked upwards (Figure 45).[37] Posted wage growth for new hires has slowed as the reading for October (4.6 per cent) is down from a peak 6.2 per cent recorded in March, which is in-keeping with similar developments in the US and euro area (Figure 46).

[36] See Box A of Boyd et al (2023) for discussion of distortionary effects of the pandemic on average hourly earnings
[37] Indeed (2023) Irish Job Postings Continue to Show Resilience

Widespread nominal earnings growth though real declines evident in some sectors

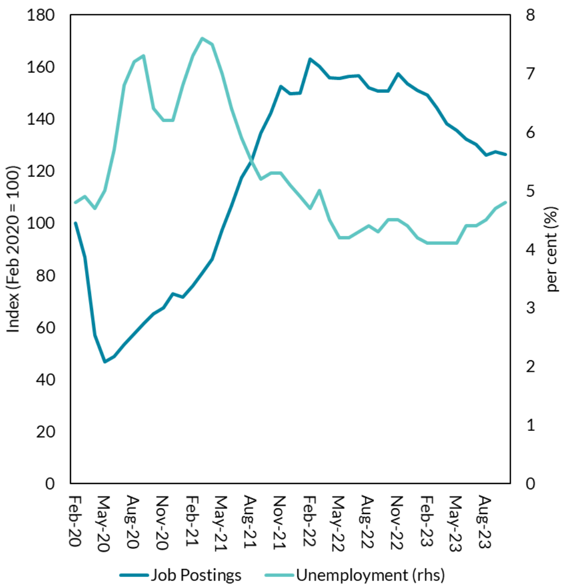
Figure 44: Change in nominal and real average hourly earnings by sector (Q3 2023)



Source: CSO; EHECS

Job postings have fallen relative to early 2023 as the unemployment rate has ticked upwards

Figure 45:Indeed job postings index and ILO unemployment



Source: Indeed and CSO

Posted wages closely track core inflation developments with tentative signs of moderating growth

Figure 46: Indeed posted wages and core HICP inflation

Source: Indeed and CSO

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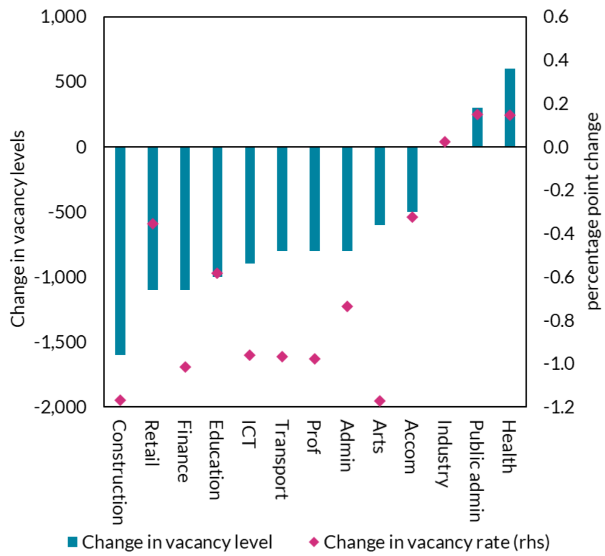
The job vacancy rate declined for a second consecutive quarter, to 1.2 per cent. The level of job vacancies as published in EHECS fell annually in Q3 2023 by 24 per cent (8,100 openings) though it remains above its long-run average. The largest falls in vacancy levels were recorded in the Construction (1,600) and Retail (1,100) sectors, while the only level increases were observed in the public-facing sectors of Health and Public Admin (Figure 47). These developments have resulted in a further downward shift in the Beveridge curve as the labour market shows signs of slowing (Figure 48).[38]

Declines across all private sector job vacancies marginally offset by increase in public sector labour demand

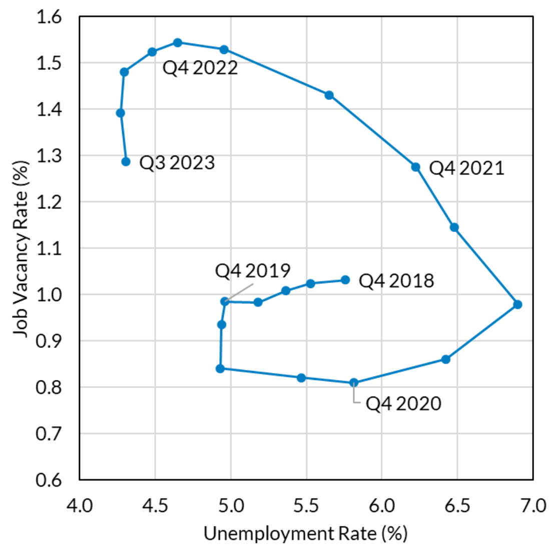
Figure 47: Annual change in job vacancy levels by sector (Q3 2022)



Source: CSO

Beveridge curve continues to slope downwards as vacancy fall in relation to rising unemployment

Figure 48: Beveridge curve (Q4 2018 – Q3 2022)



Source: LFS and EHECS
Note: Data are presented using a four-quarter moving average

Average real compensation per employee (CPE) growth for 2023 is projected to be negative as a result of the continued fall in hours worked and the impact of inflation in the first half of the year. Nominal compensation of employees increased by 6 per cent annually in Q3 2023, with a number of factors contributing to weak CPE growth. Firstly, total hourly labour costs increased annually by 7.2 per cent but a drop in the average number of hours worked has damped aggregate earnings growth (Figure 49). Secondly, robust growth in employee numbers (4.1 per cent) has resulted in a more moderate

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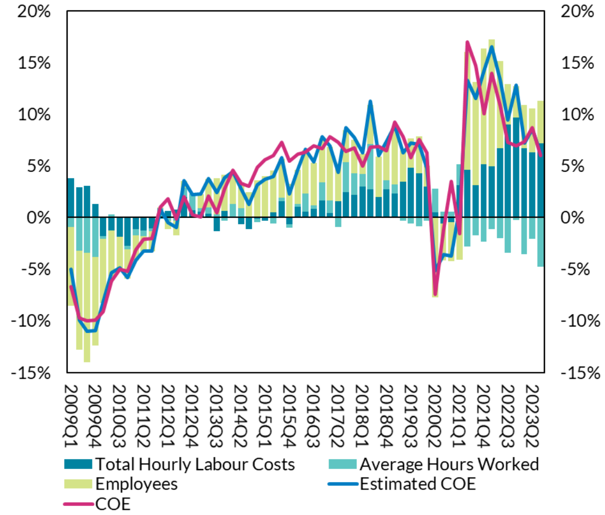
[38] The Beveridge Cure is a graphical representation of the inverse relationship between the unemployment rate and the job vacancy rate

increase in per worker compensation (1.9 per cent in nominal terms)[39]. Overall, real CPE growth for 2023 is projected to decline by 1.6 per cent, however. Real wages are forecast to increase over the medium-term horizon by 2.6 per cent and 2.8 per cent respectively in 2024 and 2025. Real gross disposable income (GDI) is projected to grow by 0.4 per cent in 2023 in aggregate terms, boosted by taxes and transfers (See Figure 50). On a per household basis, real GDI is expected to decline by 0.8 per cent in 2023 before averaging 2.7 per cent annual growth across 2024-2026. Analysis of real gross disposable income across the household distribution suggests that lower-income households have experienced the largest declines in real income since 2021 due to the relatively larger effect of energy and food price developments on these households (See Box E).

Weaker growth in aggregate earnings as a decline in average hours worked partially offsets higher hourly earnings

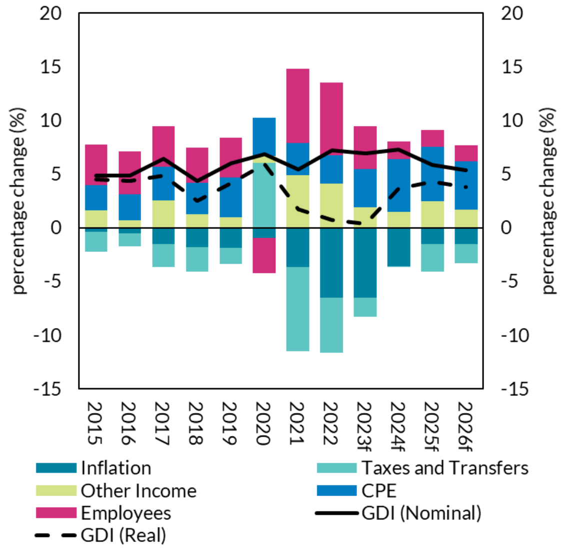
Figure 49: Decomposition of Compensation of Employees



Source: CSO and internal calculations
Note: Estimated COE is a bottom-up measure derived using total labour costs from EHECS data in addition to employee and hours worked LFS data in order to match aggregate COE developments

Real CPE declines in 2023 to be offset by taxes and transfers to generate positive gross disposable income

Figure 50: Decomposition of Gross Disposable Income



Source: CSO and internal calculations

[39] While CPE growth remains negative, it is important to consider wider cost-push pressures that can lead to firms increasing prices. Nominal unit labour costs, which measures how much a firm pays workers to produce one unit of output, has increased annually by 5.2 per cent in Q2 2023 (-0.3 per cent real decline). This is up from 4.8 per cent in Q2 2022 in CSO data. For economic sectors dominated by domestic enterprises, the growth rate in 2023 is 3.1 per cent compared to 7.3 per cent in MNE-dominated sectors.

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Table 3: Labour Market Projections

	2022	2023f	2024f	2025f	2026f
Employment (000s)	2,547	2,642	2,685	2,726	2,767
% change	6.60%	3.70%	1.60%	1.50%	1.50%
Labour Force (000s)	2667	2765	2820	2858	2900
% change	4.70%	3.70%	2.00%	1.40%	1.40%
Participation Rate (% of Working Age Population)	64.80%	65.60%	65.80%	65.80%	65.90%
Unemployment (000s)	119	123	135	133	132
Unemployment Rate (% of Labour Force)	4.50%	4.50%	4.80%	4.60%	4.60%

Box E: Changes in real income across the distribution of Irish households

By Laura Boyd, Enda Keenan and Tara McIndoe-Calder (Irish Economic Analysis Division)

Inflation can affect Irish households differently depending on the spending patterns observed across the income distribution. Previous analysis highlighted that lower-income households experienced relatively larger cost of living increases in 2021 and 2022. This is because energy and food account for a larger share of the overall expenditure of these households compared to higher-income households and these items experienced the largest increases in prices (Lydon, 2022; Boyd et al., 2022). Just as households' experiences of inflation differ across the income distribution, there can be considerable variation in the growth rate of household income at different points on the distribution. For example, lower-income households typically rely on transfers as their main source of income, while wage earnings account for the bulk of income for households higher in the distribution. As a result, real disposable income growth can vary across the income distribution.

This Box explores price and nominal income developments by combining price and nominal income data since 2002 in order to generate real income profiles. Realised data at the household level are available for incomes, annually to 2021; and for prices, every 5 years to 2015. Data are simulated for periods without observed household level data using a combination of National Accounts, Eurostat and Quarterly Bulletin forecast data. The results show that over the period 2002 to 2021, for which realised data at the household level are available, real income growth was progressive, with lower-income households experiencing larger percentage gains than the highest income households. Preliminary analysis using data simulated at the household level for 2022 and 2023

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indicates that the position may have reversed in the last two years with a regressive pattern evident in real income changes.

Estimating Price Changes across the Distribution

To calculate price changes experienced by households at different points of the income distribution, we use Household Budget Survey (HBS) microdata to calculate expenditure weights across four main spending categories: food, goods, energy and services. These weights reflect the share of spending by households across the four categories and are calculated for five quintiles of annual household income. As the HBS is collected every five years, we extrapolate between HBS waves by applying changes in annual spending weights from Eurostat.[40] For example, with the most recent HBS data being for 2015, we extrapolate these 2015 expenditure weights forward to 2023 using Eurostat spending weights from 2015-2023.[41] We repeat this for each income quintile. Finally, we merge these income quintile-expenditure category weights with the equivalent sub-component of the HICP to calculate the price changes experienced by households across the quintiles of the income distribution. The results highlight that households in the first quintile experienced an annual HICP inflation rate of 5.1 per cent in September 2023 compared to 5 per cent at the aggregate level (Figure 1). For higher-income households in the fifth quintile, a comparatively lower inflation rate of 4.7 per cent is estimated. Changes in expenditure shares and price developments over time can lead to heterogeneous inflation rates across the distribution. Between 2002 and 2023, households in the first quintile experienced 2.7 percentage point higher growth in the price level they face compared to aggregate HICP, the highest amongst the five quintiles (Figure 2).[42]

[40]Eurostat annual spending weights are calculated using HBS data and derive annual changes based on expenditure data from the National Accounts. See Eurostat reference metadata Section 18 for further details. This approach is consistent with that used by Lydon (2022) and CSO inflation analysis by characteristic (CSO, 2022 and 2023). It assumes a uniform growth in expenditure weights across all households and does not allow for changes in household spending behaviour.

[41] HBS data is available for 2000, 2005, 2010, 2015, see CSO, HBS.

[42] Between 2002 and 2019, households in the lowest quintile experienced 2.2 percentage point higher growth in the price level to aggregate HICP. Between 2019 and 2023, this was 1.2 percentage points.

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Lower income households have experienced higher rates of inflation, especially since 2021, primarily due to energy and food price developments

Figure 1: Relative HICP inflation rate across household income distribution, 2002-2023

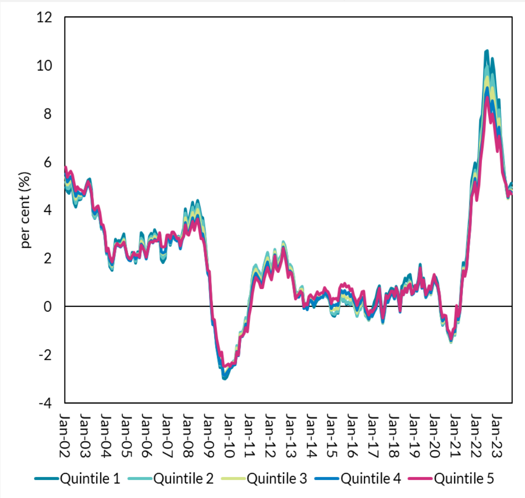
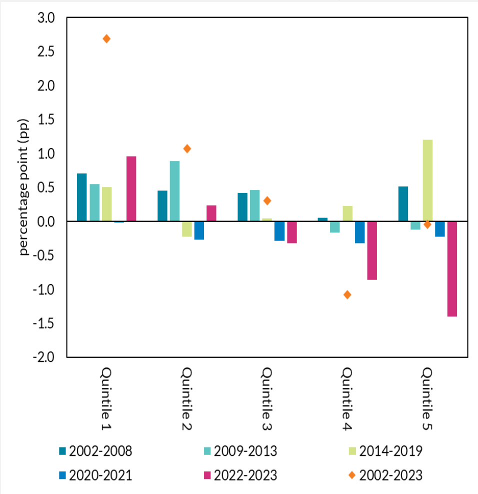


Figure 2: Deviation from headline HICP across household income distribution, 2002-2023



Source: CSO, Eurostat and author's calculations
Note: Last observation is September 2023

Estimating Income Changes across the Distribution

To estimate nominal income changes at different points of the distribution, we use microdata from the Survey of Income and Living Conditions (SILC). It includes data on market income, taxes, and transfers, which is particularly beneficial as not only do lower-income households receive a higher share of their net disposable income as transfers, the pandemic and subsequent impact on economic sectors saw households across the distribution avail of pandemic income-support measures.[43] The most recent SILC relates to income received by households in 2021. In order to assess how changes in incomes across households may have evolved during the period of high inflation in 2022 and 2023, we extrapolate the data forward. In the case of 2022, we use the observed changes in market income, transfers and taxes in aggregate from the National Accounts while for 2023, we use Quarterly Bulletin forecasts.[44] This is a relatively crude approach as it applies the same aggregate growth rates for these components to all income quintiles. At the same time, the approach generates heterogeneity across the net disposable income distribution as transfers are a larger share of income for lower-income households.[45] The resulting nominal income profiles are presented in Figure 3.

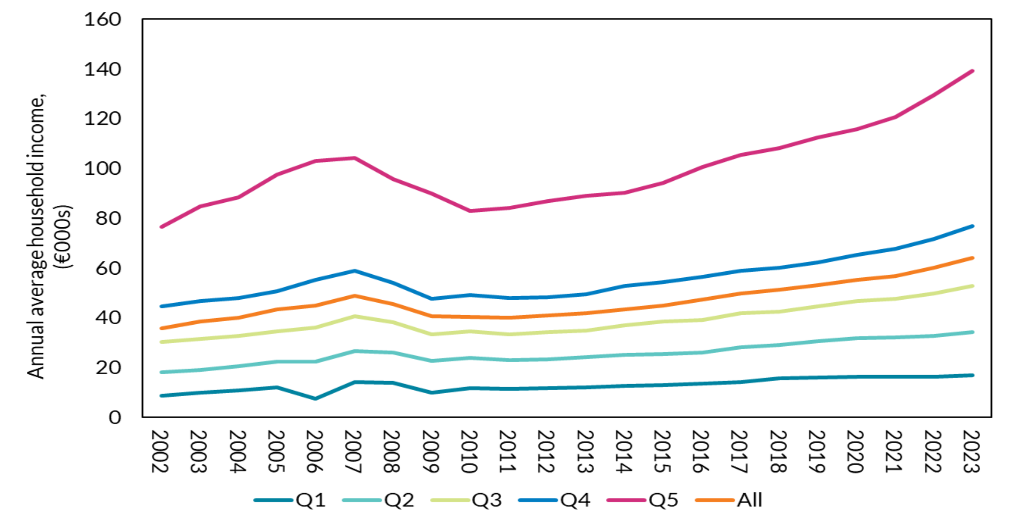
[43] The impact of the pandemic on measures of income and earnings is discussed in detail by Boyd et al (2023) in Box A.
44 For full year 2023 the extrapolations are consistent with the macroeconomic forecast in the *Quarterly Bulletin*. Comparative distribution analysis with other datasets such as CSO EAADS and LFS+ shows complementary income trends across the household distribution in since 2021.
[45] The share of transfers (market) in net household disposable income is 84.6 (18.3) per cent and 13.8 (131.7) per cent on average over 2002-2019 for Q1 and Q5 households, respectively.

Estimated Real Income Changes across the Distribution

Combining our price indices and nominal income profiles, we generate real household disposable income profiles for each quintile of the income distribution. Figure 4 shows that over the 2002-2021 period (for which realised data are available) both real and nominal income growth has been strongly progressive, with the first quintile experiencing an average 2.6 per cent real income growth each year, compared to an average of 1.4 per cent in the fifth quintile. This progressive pattern is typically strongest during economic expansions (namely 2002-2007 and 2013-2019), whereas real income changes were regressive during the financial crisis and the immediate aftermath (2008-2013).[46] The progressive role of taxes and transfers was particularly beneficial to lower income quintiles. Over the 2002-2021 period, taxes and transfers contributed 2.1 percentage points to the 2.6 per cent annual real income growth experienced by these households. This compares to a contribution of 0.1 percentage point to the 1.5 per cent real income growth observed at the aggregate level.

Higher-income households have experienced faster growth in nominal disposable income, particularly since 2019, due to their larger share of market income

Figure 3: Household nominal disposable income across the household income distribution



Source: SILC and author's calculations
Note: Data from 2001 to 2021 are observed data in published SILC releases. Data for 2022 and 2023 are extrapolated using aggregate changes in wage earnings, taxes and transfers from the National Accounts

Using the extrapolated data for 2022 and 2023, our estimates suggest that households in the upper-end of the income distribution experienced the strongest real income growth (Figure 5). This finding is consistent with earnings data trends showing larger growth rates in the higher-earning economic sectors during the pandemic recovery, after accounting for distortionary issues in measured employment levels (Boyd, Keenan, McIndoe-Calder (2023). Social transfers remain the largest contributor to income growth for the lowest quintile in 2022-2023, contributing 4.7 percentage points to growth, though this is strongly outweighed by the relative inflation rate resulting in -3.7 per cent

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decline in real incomes. While market income growth is lower the further down the distribution, targeted social transfers can be highly beneficial in addressing regressive income trends. Furthermore, indications that the distribution of income growth is likely to have been regressive over 2021-2023 is consistent with previous periods during which the economy has experienced negative shocks. For example, from 2009-2013, household income declined across the distribution but households in the top quintile experienced a smaller decline (-1.4 per cent per year) than households in the first (-2.1 per cent per year). Doorley and Roantree (2023) find similar results for Ireland focussing on real equivalised household income over the 1987-2021 period.

Over 2002-2021, disposable income growth was progressive with higher growth for lower-income households; however, the purchasing power of lower-income households is likely to have been most adversely impacted by the recent inflationary period

Figure 4: Disposable income components' contribution to real income growth across the household income distribution, 2002-2021 (%)

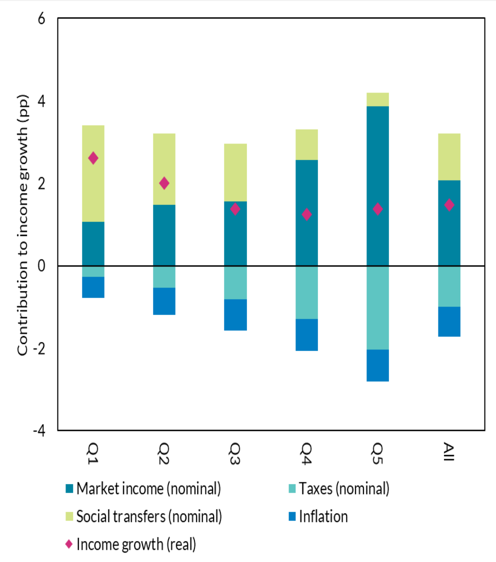
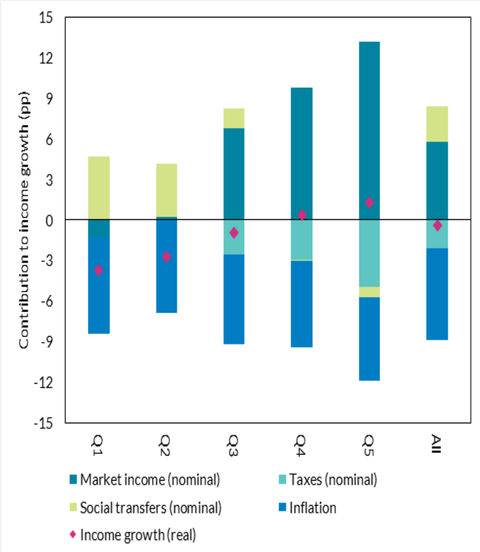


Figure 5: Disposable income components' contribution to real income growth across the household income distribution, 2022-2023 (%)



Source: SILC, HBS and authors' calculations

Comparing the real income profiles across years, the results suggest that the real disposable income of households in the first quintile in 2023 is similar to 2017 levels. The situation improves along the distribution. For instance, under our simulation analysis, households in the third quintile show a real income profile in 2023 that sits between its 2019 and 2020 profiles, while households in the top quintile have higher real incomes

[46] Similar findings are described by Roantree and Doorley (2023) whereby the bottom quintile experienced 5.1 per cent real disposable income growth between 2012 and 2021 relative to 2.7 per cent growth for the top quintile.

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than in all previous years. This analysis highlights the heterogeneous impact of the recent period of high inflation on households at different points in the income distribution.

In conclusion, this *Box* combines the different developments in income and inflation experienced by households across the income distribution. Over the period 2002-2023, real income growth has been broadly progressive. However, the simulation exercise suggests the pattern reversed somewhat during the period of high inflation since 2021. Looking ahead, projections in this QB indicate that aggregate real gross disposable income growth will increase by an average of 4 per cent over the forecast horizon following observed lower growth (1.2 per cent) in the 2021-2023 period. Improved targeting of fiscal measures would enhance the progressivity of income growth and restore real incomes of lower income households to pre-pandemic levels more quickly.

The Public Finances

Overview

The outlook for the public finances remains favourable, with the headline general government balance (GGB) expected to record large surpluses over the period 2023 to 2026. The GGB is projected to run a surplus of 3 per cent of GNI* this year – broadly in line with the 2022 outturn - as revenue growth remains strong and is expected to offset an acceleration in government spending. Tax receipts increased by 5.8 per cent in the year to November, with income tax, VAT and corporation taxes (CT) all higher than for the same period in 2022. The pace of increase in revenue from these sources has slowed as the year has progressed, however, consistent with the evidence of weaker domestic economic activity. CT receipts were notably volatile in the second half of the year. The acceleration in government expenditure growth reflects continued strong increases in core (or permanent) spending coupled with broadly stable non-core spending. The latter had recorded a large decline last year. Gross voted Exchequer expenditure was 9.9 per cent higher in the year to November, as both current and capital spending increased strongly, with the former €2.1bn ahead of profile. Current overspends in the Health vote group were particularly notable at €1.1bn. The GGB surplus is expected to weaken marginally in 2024, before recording a sharp improvement to 4.3 per cent of GNI* in 2025. This is contingent on the anticipated withdrawal of most of the remaining non-core expenditure measures that have been introduced in recent years.

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The favourable budgetary outlook is forecast to support further declines in the general government debt (GGD) ratio in the coming years. The public debt ratio recorded a very large decline last year, 19 percentage points of GNI*, against the backdrop of a return to a primary budget surplus and exceptionally strong nominal GNI* growth. The improvement over the medium term is expected to be more gradual, but still notable, with the ratio projected to fall to 64 per cent of GNI* by 2026. Despite the increase in sovereign borrowing rates over the past year, debt dynamics are expected to remain favourable reflecting robust nominal output growth, a low average interest rate on the debt stock and the expectation of large primary surpluses. From a funding perspective, the relatively low level of bonds maturing in the coming years, coupled with the large cash balances held by the National Treasury Management Agency (NTMA), provide the sovereign with some flexibility going forward.

While baseline Irish fiscal projections are favourable over the medium term, the outlook for the public finances faces a number of challenges and risks. Recent developments in CT receipts have highlighted the uncertainties surrounding such a narrow tax base. Excluding 'excess' CT revenue – which cannot be explained by underlying developments in the economy and may be vulnerable to a sudden reversal - reveals a much less favourable outlook for the 'underlying' budget balance (GGB). It would remain in deficit in 2023 and 2024 and record much smaller surpluses in subsequent years. Other risks for the public finances include spending overruns in the Health vote group and the potential need to provide additional, currently unbudgeted non-core support post 2024. Maintaining an appropriate fiscal stance at a time when the economy is already at full employment, while appropriately supporting necessary public capital expenditure, and ensuring sufficient resources are available to meet future ageing and climate transition costs represent additional challenges. Against this backdrop the creation of two new long-term public saving funds in Budget 2024, which aim to prepare for future challenges, reduce pro-cyclicality and increase the resilience of the public finances more generally, is a welcome development.

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Table 4: Fiscal outlook under a baseline scenario

	2022	2023	2024	2025	2026
GG Balance (€bn)	8.5	8.7	8.2	13.8	13.0
GG Balance (% GNI*)	3.1	3.0	2.7	4.3	3.8
GG Balance (% GDP)	1.7	1.7	1.6	2.5	2.2
GG Debt (€bn)	224.8	222.8	222.1	219.8	218.2
GG Debt (% GNI*)	82.3	77.3	72.0	67.8	64.1
GG Debt (% GDP)	44.4	43.9	42.3	39.7	37.0
Excess CT (€bn)	11.2	11.2	11.2	11.5	11.5
Underlying GGB (€bn)	-2.7	-2.6	-3.0	2.3	1.5
Underlying GGB (% GNI*)	-1.0	-0.9	-0.9	0.7	0.4

Source: CSO and Central Bank of Ireland Projections

Fiscal Outlook, 2023 to 2026

The latest data suggests that the GGB surplus will be broadly stable this year, as revenue growth is expected to offset an acceleration in government spending. The significant improvement in the budget balance in 2022 was driven by historically high revenue growth and the unwinding of a large part of the non-core spending, factors that have not persisted this year. As a result, the GGB surplus is forecast to stabilise – while remaining at 3 per cent of GNI* (€8.7bn). Following an increase of 17 per cent in 2022, government revenue growth is projected to moderate to 7.5 per cent this year. While slower than the exceptional performance over the period 2021-2022, this would still be stronger than the average revenue increase in the three years prior to Covid-19 (6.2 per cent). Income tax and VAT receipts have remained robust – increasing by 7.3 and 8.6 per cent respectively in the year to November – supported by the strong labour market and significant growth in nominal private consumption. The pace of growth in these tax heads has moderated as the year has progressed, however. CT receipts increased at a much weaker growth rate than in preceding years over this period, by 4.2 per cent, reflecting a volatile second half of the year. While they remain significantly above their level of just two years earlier (see Figure 50), CT's recent performance highlights once again the high levels of uncertainty surrounding such a narrow tax base.

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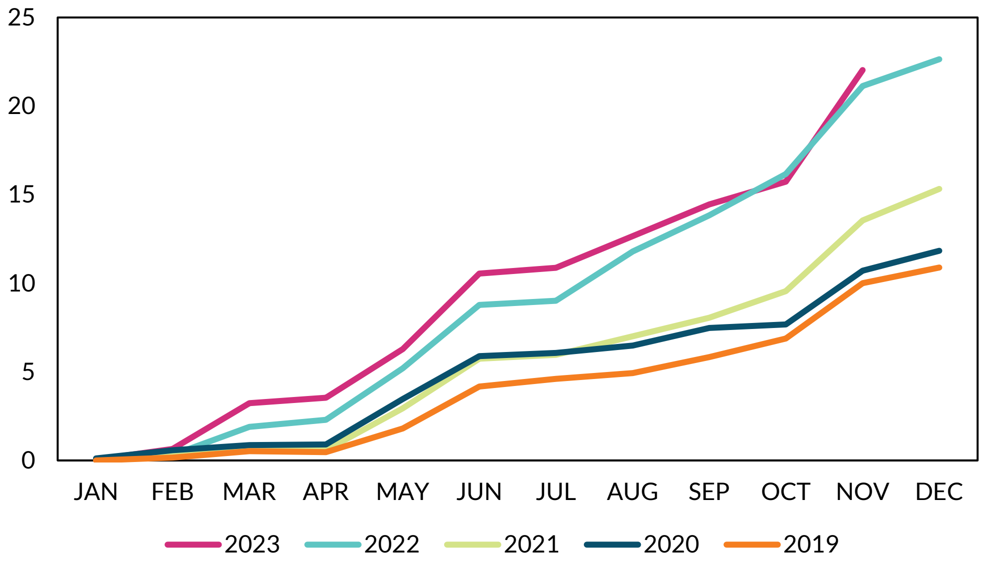
Corporation tax is expected to increase again this year

Figure 51: Rolling sum of corporation tax by year (€bn)



Source: Department of Finance

Government expenditure growth is projected to increase from 1.6 per cent last year to 8.0 per cent in 2023. This acceleration reflects continued strong growth in core or permanent spending, coupled with the persistence of non-core expenditure. The latter, which declined by 2.6 per cent of GNI* in 2022, is expected to be relatively stable in 2023, as the continued withdrawal of Covid-19 related spending is offset by other measures, most notably those related to cost of living and humanitarian supports (see Table 5). Exchequer data revealed gross voted expenditure was 9.9 per cent higher in the year to November, with large annual increases on both the current and capital side (8.1 and 29.1 per cent higher respectively). Gross Exchequer spending was 1.7 per cent ahead of profile as a €2.1bn overspend on the current side – driven by developments in the Health vote group and the introduction of additional cost of living measures – was partially offset by capital spending being €700m below expectations.

Table 5: Evolution of non-core expenditure (percentage of GNI*)

	2020	2021	2022	2023	2024	2025	2026
Covid-19	7.2	5.3	1.4	0.5	0.4	0.1	-
Cost of Living	-	-	0.9	1.0	0.4	-	-
Humanitarian	-	-	0.4	0.7	0.8	-	-
Other	-	-	0.1	0.2	0.2	0.0	0.1
Total	**7.2**	**5.3**	**2.7**	**2.5**	**1.8**	**0.1**	**0.1**

Source: CSO, Department of Finance and Central Bank of Ireland Estimates

The Government has provided significant cost of living supports since the beginning of 2022 and the majority of the measures have not been targeted. An additional €2.9bn of cost of living measures were introduced in Budget 2024, with the impact of these supports spread over the final months of 2023 and next year. These measures included additional social protection payments, household energy credits, extending the lower VAT rate for gas and electricity and the mineral oil tax reduction, and the temporary reintroduction of mortgage interest relief. Non-core cost of living supports introduced to date are estimated to cost around €9bn (3.3 per cent of GNI*), by the time they expire. Around one-quarter of total measures are estimated to be directly targeted to those most affected by the higher price environment (see Table 6), although this figure increases to 30 per cent when just focusing on the most recent supports announced in Budget 2024.

The GGB is expected to remain broadly stable in 2024, before recording a large improvement in 2025 as the majority of the remaining non-core spending measures are due to unwind (See Figure 51). The GGB is forecast to record a surplus of 2.7 per cent of GNI* in 2024, increasing to 4.3 per cent in 2025 (or €8.2bn and €13.8bn respectively). The 2024 outlook is less favourable relative to *Quarterly Bulletin 3*, reflecting the introduction of additional non-core spending measures in the recent Budget that had not previously been flagged in the Summer Economic Statement. These include the cost of living measures outlined in Table 5 above and an additional €500m for the health sector to deal with the legacy of Covid-19. The outlook for 2025 on the other hand, is broadly unchanged as these additional measures are due to be temporary in nature. If the measures ae not withdrawn as is currently envisaged in the Budget 2024 projections, or new measures are introduced, the projected general government surplus in 2025 would be lower than shown in our central forecasts.

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Table 6: Non-Core cost of living measures introduced by Government

Measures	€mn
CoL measures Jan-October 2022	**1,327**
Estimated percentage targeted	10%
CoL measures in Budget 2023	**3,434**
Estimated percentage targeted	32%
CoL measures announced in February 2023	**1,283**
Estimated percentage targeted	28%
CoL measures announced in Budget 2024	**2,917**
- Additional social protection payments	906
- Energy credit	900
- Education measures	250
- Business supports	250
- Tax measures	611
Estimated percentage targeted	30%
TOTAL	**8,961**
Estimated percentage targeted	27%

Sources: 'The fiscal response to the cost of living crisis', Department of Finance, April 2023; 'Budget 2024, Expenditure Report', Department of Public Expenditure, NDP Delivery and Reform, October 2023; 'Temporary Business Energy Support Scheme Preliminary Statistics', Revenue, October 2023; Central Bank of Ireland calculations for percentage targeted.
Note: Measures are defined as targeted if they are directed towards those most exposed to increases in the cost of energy. For individuals, this generally relates to having low income, while for firms, it relates to the extent to which the firm's energy costs increased.

Revenue growth is expected to moderate further over the medium term, averaging 4.6 per cent per annum, reflecting the impact of budgetary measures and underlying developments in the economy. The outlook for government expenditure reflects divergent developments in core and non-core spending. The former is forecast to continue to increase at a robust pace, as outlined by the Government's Medium Term Expenditure Framework and the National Development Plan. Non-core spending, by comparison, is expected to fall from an estimated cost of 2.5 per cent of GNI* in 2023 to just 0.1 per cent in 2025 (see Table 5). This leads to total spending growth moderating sharply that year, driving the significant improvement in the GGB. The surplus is expected to remain at an elevated level in 2026 at just below 4 per cent of GNI* (€13bn). There are downside risks to this outlook with the potential for additional, currently unbudgeted, non-core spending, while persistent overspends in the Health vote group also imply that government expenditure could be higher than currently budgeted for over the forecast horizon.

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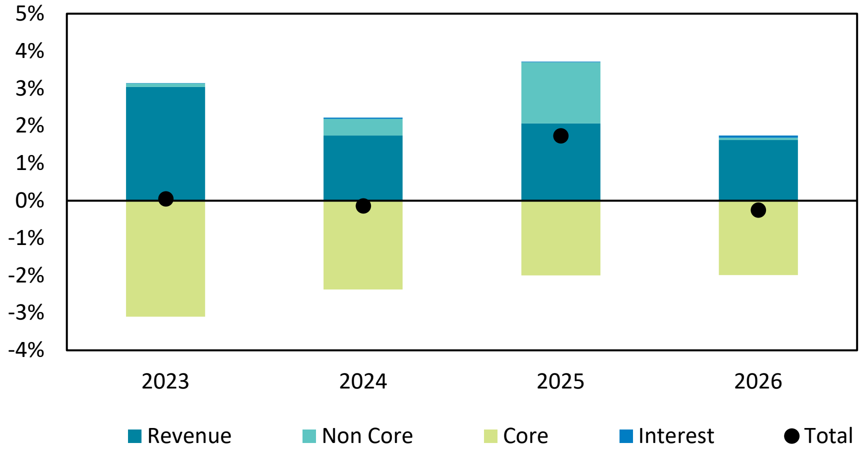
Improvement in GG surplus contingent on temporary fiscal measures being withdrawn

Figure 52: Factors driving the change in GGB Ratio (% GNI*)



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

While the headline budget balance is set to record large surpluses over the medium term, focusing on the 'underlying' balance – which excludes estimates of excess corporation tax (CT) - presents a less favourable outlook. Much of the recent improvement in the budgetary position has been driven by increases in CT, which was the State's second largest tax head last year. CT receipts have grown rapidly since 2015, and a large part of this increase cannot be explained by underlying developments in the Irish economy. Given the risk that these excess CT receipts could be subject to sharp reversals, it is prudent to adjust the GGB to exclude such inflows. Doing so reveals that the outlook for the 'underlying' fiscal position is not as strong as the 'headline' projections would suggest. The underlying GGB would remain in deficit this year and in 2024, and record much smaller surpluses in 2025 and 2026. The slowdown in the CT growth rate in the second half of the year – albeit after very strong growth a year earlier – provides a reminder of the volatility of these flows and the narrowness of the base that leaves the public finances exposed to the decisions of a very small number of firms.

Against the backdrop of large primary surpluses, the general government debt (GGD) ratio is projected to continue to decline over the medium term. The public debt ratio recorded an exceptionally large decline last year, 19 per cent of GNI*, as the primary balance returned to surplus and nominal GNI* recorded extremely strong growth. The improvement over the medium term is expected to be much more gradual, but still notable, with the ratio expected to fall from 82.3 per cent of GNI* in 2022 to 64.1 per cent in 2026. The interest-growth differential, which has been the key driver of the long term

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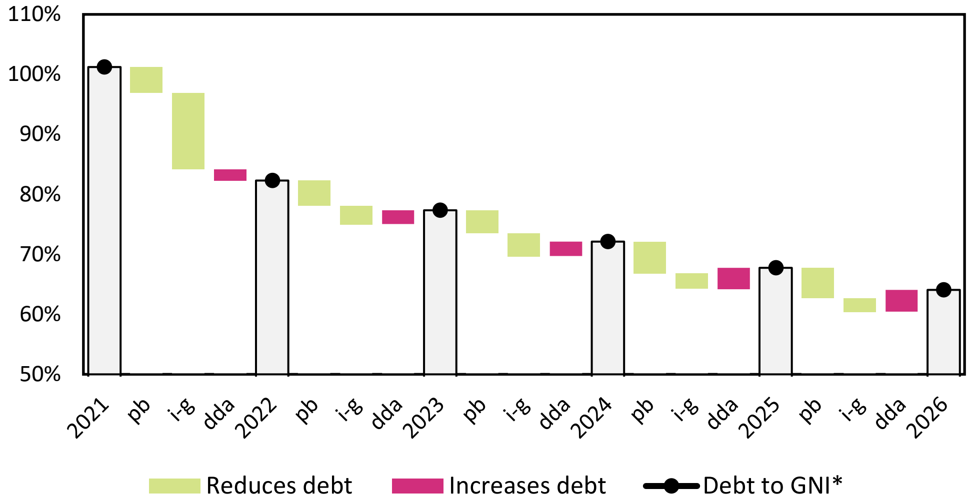
improvement in the debt ratio since the financial crisis, will continue to have a favourable impact. Nominal GNI* growth is projected to average 5.7 per cent per annum in the coming years, higher than the average effective interest rate of 1.6 per cent. It is the large projected primary surpluses – forecast to be around 5 per cent of GNI* in 2026 - which are expected to play the largest role in supporting the debt ratio's reduction, however (Figure 52). The deficit debt adjustment – which explains the difference between the GGB and the change in the stock of government debt in a given year – is forecast to partly offset these favourable developments, primarily reflecting the transfer of resources to the new savings funds introduced by the Government in Budget 2024.

GG debt projected to fall below 65 per cent of GNI* by 2026

Figure 53: Factors driving the change in GG Debt Ratio (% of GNI*)



Source: CSO, Department of Finance, Central Bank of Ireland Projections
Note: pb = primary balance, i-g = interest growth differential, dda = deficit debt adjustment

Budget 2024 saw the creation of two new long term public saving funds, which aim to build resilience in the public finances, reduce pro-cyclicality of fiscal policy and prepare for known future challenges. The larger of the two funds, the Future Ireland Fund (FIF), will partially pre-fund the major fiscal transition costs - ageing, digitalisation, and climate - that are expected to increase over the coming years. The second fund, the Infrastructure, Climate and Nature Fund (ICNF), aims to ensure that the Government can continue to finance capital spending even during an economic downturn. The objective of this fund is to avoid the pro-cyclicality that has typically characterised Irish public investment in the past. The Government plans to have a balance of €14bn in the ICNF by 2030 (transferring €2bn per year), and could potentially have up to €100bn in the FIF by 2035 (transferring 0.8 per cent of GDP per

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year, €4.8bn in 2024). The existing National Reserve Fund will be closed, with its €6bn in resources used to seed the two new funds next year.

Irish sovereign borrowing rates for new issuances have risen. The yield on 10-year Irish sovereign debt stood at 2.7 per cent in early December. This is down from 3 per cent at the time of the last *Bulletin* but higher than the yield in December 2022 (2.3 per cent). While higher borrowing costs makes refinancing debt (or financing budget deficits) more costly, the large projected surpluses combined with the favourable debt maturity profile reduce the risk of higher market interest rates passing through to the actual interest expense borne by the Exchequer. For example, there are no Government bonds maturing in the remainder of 2023, and the bonds maturing in 2024 (€8bn at 3.4 per cent) and 2025 (€11.5bn at 5.4 per cent) have interest rates above the current yield on Irish sovereign debt. This implies that refinancing them at current rates would actually reduce the effective interest rate. The period 2026 to 2030, however, will see €55bn of Government bonds maturing, all with interest rates below the current 10 year yield. The NTMA published its funding plan for 2024 last month and intends to raise between €6bn and €10bn in bond issuances next year. This is broadly in line with the €7bn raised in 2023. The relatively low funding range is based on the projected strength of the fiscal position over the coming years. Cash balances also remain substantial, standing at just below €25bn in November.

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