Ireland Economic Commentary

Irish Budget Economic Commentary

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The Irish economy has emerged from the pandemic era in a relatively strong position, performing well in both absolute and relative terms. Growth in 2022 proved to be much stronger than initially anticipated, benefiting from a reopening surge with GDP growing 9.4% while Modified Domestic Demand (MDD), which is seen as a better measure of underlying growth, rose 9.5%. However, growth in 2023 and coming years is expected to moderate, settling back to more normal levels after the recovery evident last year.

The economy remains supported by several features. Firstly, household balance sheets are healthy, underpinned by a strong labour market with employment numbers at record levels and up over 12% compared to pre Covid. Household net worth is at an all-time high, boosted by rising house prices and assets accumulated in recent years, including supports and excess savings built through the pandemic. The government fiscal position is also relatively strong and provides a buffer to alleviate cost of living issues and any unforeseen risks and challenges to growth. Over the medium term, Ireland’s National Development Plan which is investing €165bn in vital infrastructure by 2030 should be supportive. Key advantages of a still competitive tax system, pro-business environment, young well educated labour force and the only English speaking country in the EU should continue to make Ireland an attractive destination for Foreign Direct Investment (FDI) and help Ireland’s growth exceed that of the Eurozone and other developed markets over the medium to long term.

Growth is expected to slow in 2023 as last year’s reopening surge fades. At the same time, the mix within the economy is shifting with domestic sectors now contributing more to growth, in contrast to recent years when multinational corporates (MNC’s) were the dominant drivers of the economy. This was evident in the first half of the year when MDD grew 1.8% y/y while GDP, which includes contributions from MNC’s and trade, rose only 0.2%. Consumption grew 3.7% versus the equivalent period in 2022 with domestic focused sectors such as Distribution/Transport/Health & Restaurants and Agriculture/Forestry/Fishing both growing 7.6% while the industrial sector, in which MNC’s account for a large share, fell -1.2%. The trade sector also suffered in the first six months of the year with exports down -1.7% q/q in Q1 and -4.1% q/q in Q2 as the pharmaceutical sector was impacted by lower demand post Covid while the technology sector was affected by the fallout from increasing restrictions on trade with China amid growing tensions with the West.

The higher interest rate environment following 450bps of interest rate rises by the ECB over the last fifteen months has also contributed to lower investment with capital investment in Q2 down -0.5% compared to the same quarter in 2022 although it remained positive in the first half, growing

3.7% compared to the first six months of 2022. The residential property market has held up reasonably well despite the higher interest rate backdrop as the ongoing supply/demand imbalance has supported prices. While national residential property prices declined modestly earlier this year, they have risen again over the last two months and are up 1.5% y/y with mortgage demand and approvals remaining strong.

As elsewhere, Irish inflation remains high although has fallen from last year's peak of 9.1% y/y, easing the squeeze on real incomes with the most recent CPI reading at 6.3% y/y. Even as the Irish economy faces some capacity constraints, further declines in inflation are expected as global supply chain pressures continue to subside. European gas prices are also significantly down from last year's highs and are expected to contribute to lower electricity prices in coming months. With Irish wages growing 4.5/5.0%, real wages could soon be back in positive territory as inflation is expected to fall below 3% in 2024.

Despite the slowdown in growth this year, Irish business sentiment remains strong. Purchasing Managers Indices are well above levels across the Eurozone and other developed markets. The services reading at 54.5 compares to the threshold level of 50 which represents the demarcation between growth and contraction. The overall composite reading of 52.1 is consistent with firm growth although the manufacturing reading of 49.6 does reflect some of the recent difficulties being experienced among multinationals in the pharmaceutical and technology sectors.

Overall, while the economy is set to slow this year, growth should remain relatively strong with MDD growth of 2.4% expected, supported by consumption growth of around 3% as a strong labour market and healthy consumer balance sheets boost spending. GDP growth is likely to lag MDD as headwinds in trade and the multinational sector mean domestic sectors outperform. While challenges exist in relation to inflation, domestic capacity constraints and global uncertainties, the underlying strengths of the economy including a healthy consumer, a strong fiscal position and Ireland's continued attractiveness as an FDI base should mean the short and medium-term economic outlook remains favourable with Ireland continuing to outperform Eurozone and developed market peers in coming years.

In terms of the budget details, the government announced a budget of €14bn which included a core expenditure package of just under €5.3bn, a once off cost-of-living adjustment of €2.7bn, a tax package of €1.3bn and non-core expenditure of €4.7bn. Some of the main measures announced are highlighted below.

The standard rate of income tax cut off point is being increased by €2,000 bringing the entry to the highest rate of income tax to €42,000. The 4.5% rate of USC is being reduced to 4.0%. The entry threshold to the 4% USC rate is being raised to €25,760. Personal/Employee PAYE and earned income tax credits are increasing by €100 each. The minimum wage is being increased by €1.40 to €12.70 per hour.

To address continued high energy prices, three energy credits of €150 will be provided to all households between the end of this year and April. The reduced 9% VAT rate for gas and electricity is being extended for another twelve months.

Mortgage interest relief will be given for one year to homeowners with an outstanding mortgage on their primary dwelling of between €80,000 to €500,000 as of 31st December 2022. The relief will be on any increase in interest paid in 2023 compared to 2022 at the standard rate of income tax of 20% and will be capped at €1,250 per property. The Rent Tax Credit is being increased from €500 to €750 per year. Parents who pay for their student children with tenancies in 'Rent a Room' or 'digs' accommodation will also be able to claim this credit.

Payments for Qualified Child Increase will be raised by €4 to €46 per week for under 12's and to €54 per week for over 12's. Child Benefit payments are being extended to 18-year-olds in full time education and a double payment of benefits will be made before Christmas.

Social protection payments will increase by €12 per week.

Free school books will be provided to students in the first three years of secondary school. Families with an income of less than €100,000 will have college fees for undergraduate students reduced by €1,500 while other families will have fees cut by €1,000.

An additional excise duty of 75c will be levied on 20 cigarettes while there are plans to introduce tax on e-cigarettes and vaping products.

There will be a revised bank levy next year which is planned to raise €200m.

A new savings fund, the Future Ireland Fund is being established. It will use some of the windfall corporate tax receipts and will receive funding of 0.8% of GDP annually from 2024 to 2035. The fund could rise to €100bn by 2035 and will be used to help protect living standards and public services for current and future generations.

Another new fund, the Infrastructure, Climate and Nature Fund was announced which will receive €2bn funding p.a. for seven years. The climate and nature component of the fund will be worth over €3bn and will aim to achieve carbon budgets thorough capital projects where targets are not being met. The fund is intended to operate in a counter cyclical manner in times of fiscal and economic stress.

Finally, VRT relief for battery electric vehicles is being extended to the end of 2025 while the accelerated capital allowances scheme for energy efficient equipment is being extended for two years.

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