

# Quarterly Economic Commentary – Spring 2022

## DATE

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# Overview

- The Irish economy experienced a robust recovery from the COVID-19 pandemic in 2021, with GDP growth of 13.5 per cent.
- Despite the increased uncertainty associated with the invasion of Ukraine by the Russian Federation, we anticipate continued growth in 2022 and 2023, with GDP forecast to increase 6.2 and 4.3 per cent, respectively.
- The double-digit growth in 2021 was driven largely by multinational activities in the export sector. However, the domestic economy also experienced growth, with modified domestic demand (MDD) increasing 6.5 per cent in 2021.
- We forecast MDD to grow by 5.0 per cent in 2022 and 4.5 per cent in 2023.

Forecast		
	GDP	MDD
2021	13.5	6.5
2022	6.2	5.0
2023	4.3	4.5

# Risks to Growth: Geopolitical tensions

## Difference between Winter 2021 and Spring 2022 forecasts for 2022 (%)

	Winter 2021	Spring 2022
Private Consumer Expenditure	7.8	5.6
Public Net Current Expenditure	3.0	4.5
Investment	8.4	6.8
Exports	9.0	7.8
Imports	10.0	8.0
GDP	7.0	6.2
Modified Domestic Demand	7.1	5.0
Unemployment Rate (as % of Labour Force)	5.8	6.3
Inflation (CPI)	4.0	6.7

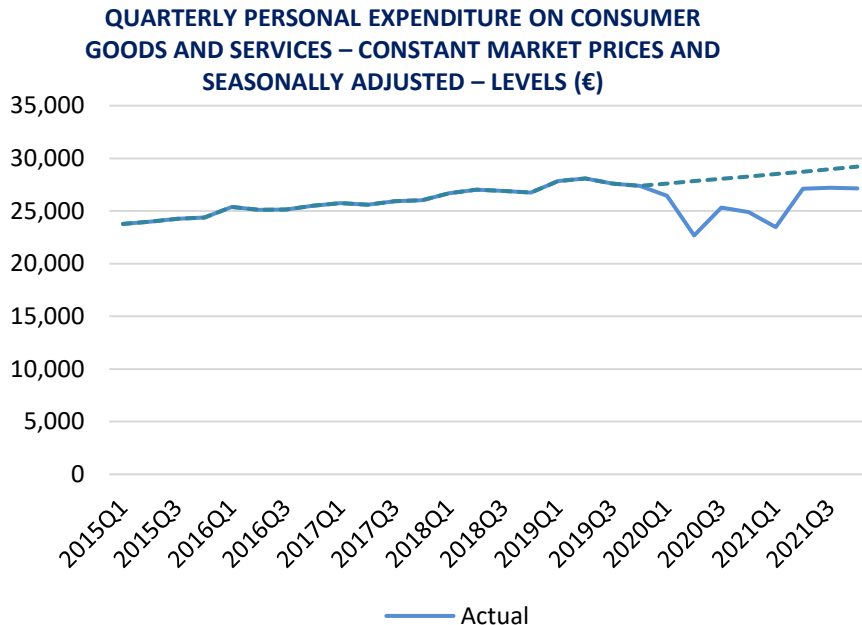
- Forecasts are revised downward from the Winter 2021 Commentary
- The Russian invasion of Ukraine will have a negative impact on global economic activity
- However, we still anticipate positive growth in 2022 and 2023, with GDP and MDD increasing 6.2 and 5.0 per cent in 2022.
- The conflict will further exacerbate inflationary pressures. We now expect average inflation for 2022 to be 6.7%

# Geopolitical tensions and the impact on the Irish Economy

- Direct trade between Ireland and Russia, Ukraine and Belarus is very limited- disruptions are unlikely to have major direct macroeconomic consequences for the Irish economy
- However, Russia is an important trading partner for specific items in energy and agricultural production. Sector-specific shocks may be likely in the result of a trade disruption.
- Greatest shock to the Irish economy will stem from reductions in international trade
  - OECD, NIESR both indicating global growth impact of approx. 1 percentage point
- Heightened uncertainty will likely drive growth lower in the general European economy through both investment and potentially precautionary savings channels.
- Rapid deterioration in the relationship between Western economies and Russia will be felt in the energy market. If Western authorities decide to reduce European consumption of Russian gas, higher energy bills over the short- to medium-term and a pick up in inflation can be expected.
  - OECD, NIESR indicating pickup in inflation of 2+ percentage points

# Consumption

Forecast		
2021	2022	2023
5.7	5.6	4.2



- Easing of public health restrictions led to a robust recovery in consumption throughout 2021
- The deteriorating geopolitical situation in Ukraine and increases in the cost of living due to elevated inflation will dampen consumption activity in 2022.
- The savings ratio in Ireland remains elevated compared to its pre-pandemic level as well as to the rest of the EU.
- We anticipate growth in consumption in 2022 despite uncertainties, as households use their elevated savings to smooth consumption patterns
- Expectations of financial situation already deteriorating which likely reflects rising cost of living challenges

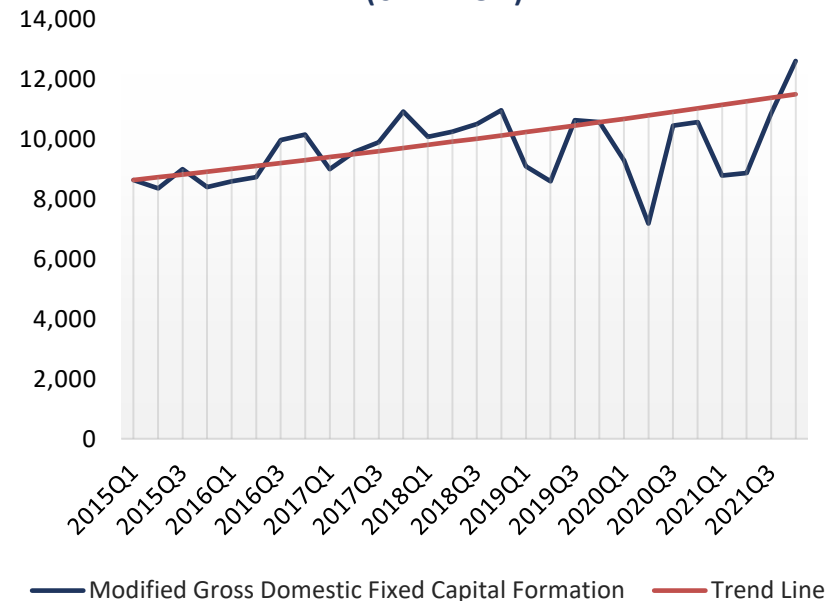
# Investment

- The dramatic drop in headline investment in 2021 was mainly driven by a sharp reversal in investment in intangibles.
- However, modified investment, a better indicator of trends in investment in the domestic economy, rebound considerably in 2021; investment surpassed the pre-pandemic trend in Q4 2021 for the first time since the COVID-19 shock
- The investment outlook is framed by the competing tensions of improved epidemiology and immunology but a deteriorating geopolitical outlook
- Housing the completions in 2021 remained below the pre-pandemic level of 21,000 in 2019; however, housing commencements increased substantially in 2021 (30,724).

## Forecast

	2021	2022	2023
Investment	-37.6	6.8	7.9
<i>Modified Investment</i>	9.7	6.3	7.4

**MODIFIED GROSS DOMESTIC FIXED CAPITAL FORMATION**  
(€ MILLION)



Source: Central Statistics Office; trend line calculated as quarterly annual compound growth rate between Q1 2015 and Q4 2019. Growth factor – 1.06 per cent per quarter.

## Trade Outlook

- The robust performance of the export sector was a major contributor to Ireland's economic growth in 2021; net exports increased €98.1bn compared to 2020
- Imports declined slightly in 2021, largely due to significant declines in the first quarter.
- Despite rising geopolitical tensions and likely global growth slowdown, we expect the traded sector to continue to perform well into 2022.
- However, considerable downside risks on international activity

### Exports

- While exports related to cross border international trade have grown, globalisation activities have had a significant influence on the export sector performance:
  - Merchanting, contract manufacturing and adjustments increased 42.4% in 2021
- In Q4 2021, goods and services exports increased 12.9% and 5.9% per annum, respectively

### Imports

- Services imports increased 20.2 per cent in Q4 2021 from Q4 2020.
- Goods imports declined slightly in Q4 2021 from Q4 2020 (-0.4% y-on-y).

Forecast			
	2021	2022	2023
Imports	-3.7	7.0	6.0
Exports	16.6	8.0	7.0

# Labour Market

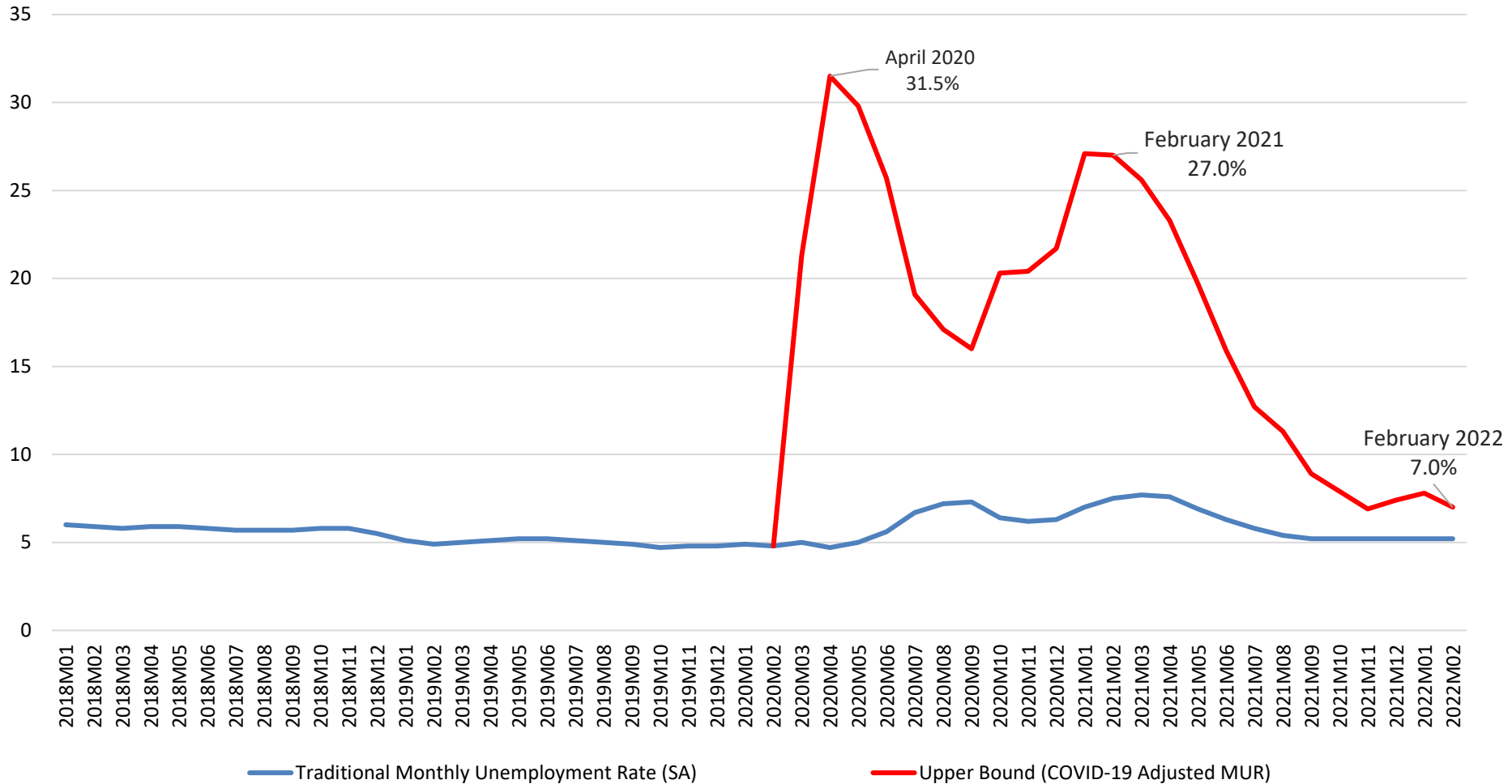
- Wage subsidies and PUP have helped to uphold incomes during the pandemic.
  - Approximately 53,700 people received the Pandemic Unemployment Payment (PUP) on 27 February 2022, a decline of 88.6 per cent from the same period in 2021
  - From 22 January 2022, the PUP closed to new applicants
  - Final payments to PUP recipients will be made through 29<sup>th</sup> March 2022.

Unemployment Rate	
2021	16.1
2022	6.3
2023	4.8

- With the reopening of the economy and the end of wage supports, we expect the unemployment rate to continue to fall.
- Increased growth in job vacancies has also resulted in upward pressure on wage growth.
- Increases in earnings, tightness in the labour market and rising inflation risk leading to a wage-price spiral if inflation expectations begin to be bid into wages demands.
- Risk that the traditional unemployment rate increases slightly if workers in the most affected sectors are vulnerable to long-term unemployment and shift to jobseekers' benefits.



# Unemployment rate (%)



Source: Seasonally-Adjusted Monthly Unemployment Rate Series and the COVID-19 Adjusted Monthly Unemployment Rate Series. Central Statistics Office

# Public Finances

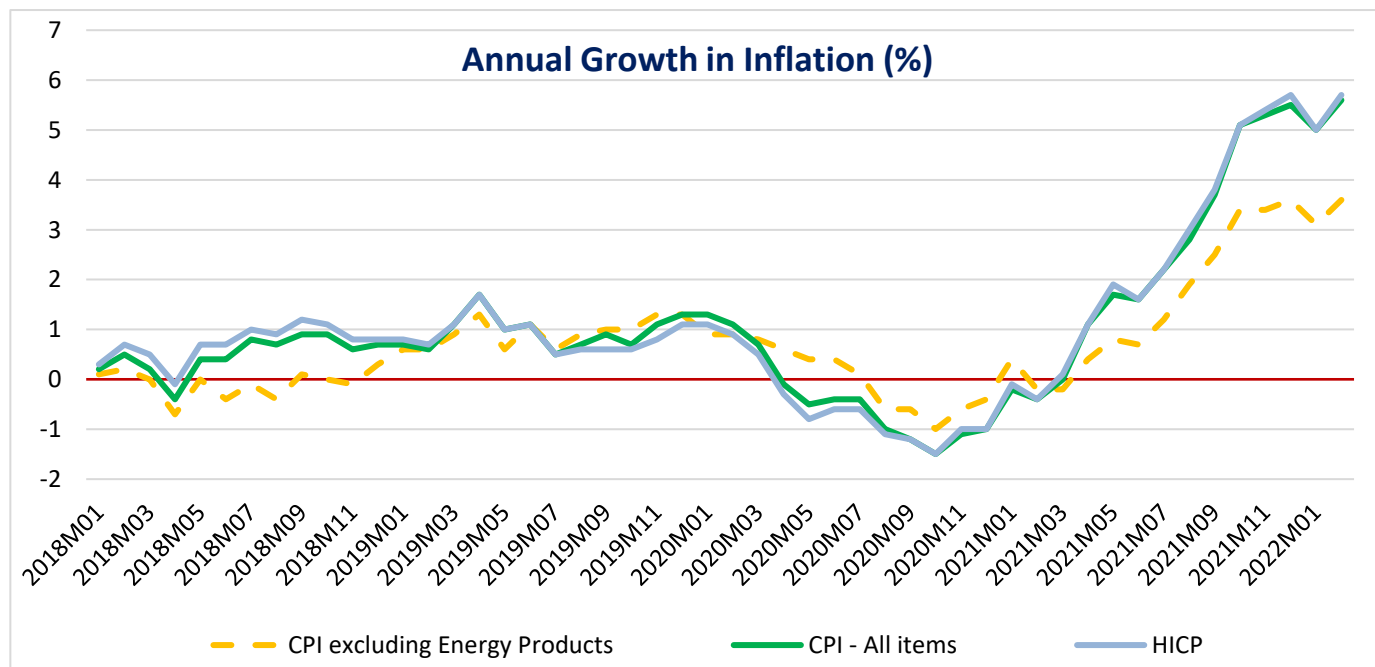
- Overall taxation receipts grew strongly in 2021 (+20.1 % y-on-y), driven largely by income tax receipts as the labour market largely recovered from COVID-19.
  - Income tax (+17.4% Y-on-Y)                      Corporation tax (+29.5% Y-on-Y)
  - VAT (+24.3% Y-on-Y)                              Excise Duties (+7.2% Y-on-Y)
- Government expenditure has been lower than initially expected.
  - Spending in 2021 was 1.5 per cent lower than what was allocated in Budget 2021
- This better-than-expected outcome for the public finances is due to both the significant recovery in domestic economic activity after the lifting of recent public health restrictions, and the underlying pace of growth in the Irish economy.
- Although the negative economic effects of the pandemic have abated, there are increasing concerns surrounding inflation and the impact of the conflict in Ukraine. Policy responses to these issues will have a significant impact on the trajectory of the public finances.

	2021	2022	2023
GGB	-7.1	1.1	3.2
% of GDP	-1.7	0.2	0.6
Debt to GDP	53.4	46.6	43.8

# Inflation

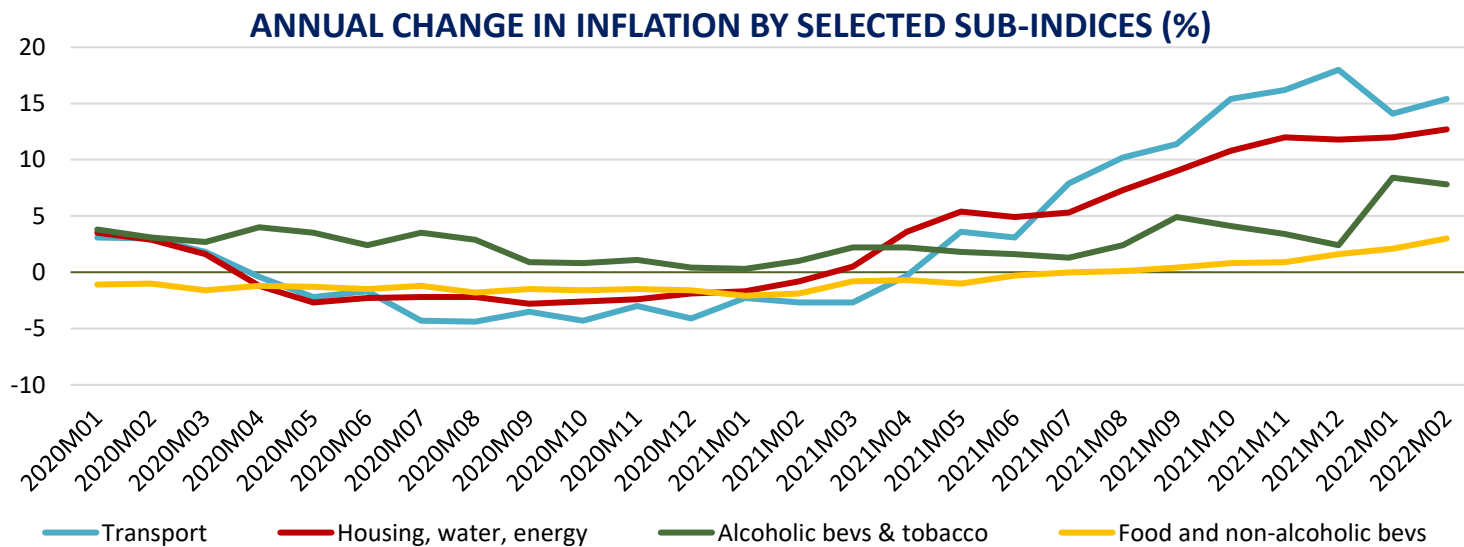
- Considerable inflation growth since summer 2021 has emerged as a result of a rebound in demand for goods and services, continued disruptions and bottlenecks in international supply chains, and ongoing challenges in the global energy market.
- As of February 2022, the Irish CPI increased 5.6% y-on-y

Inflation	
2021	2.4
2022	6.7
2023	5.0



# Factors of Inflation

- The two sub-indices experiencing the largest increases in inflation in February 2022 are Transport (+15.4% y-on-y) and Housing, water, and energy (+12.7 % y-on-y)
  - In Q4 2021, passenger transport by air had increased 60 per cent y-on-y
  - In February 2022 fuels and lubricants for personal transport increased 31.4% per annum while the price of liquid fuels increased 53.7% in the same period.
  - gas and electricity increased significantly in the same period, at 27.8 per cent and 22.4 per cent, respectively



Source: Central Statistics Office

# The Distributional Effects of Inflation and Prospects for Income Growth

- Using expenditure shares calculated using the Household Budget Survey, differential inflation rates are estimated by household income level, location and age
- Average inflation in January 2022 was 5.2%, yet:
  - Households in the lowest income decile experienced higher inflation than households in the highest income decile (1.1% higher)
  - Rural households experienced higher inflation than urban households (0.7% higher)
  - older households experienced higher inflation than younger households (1% higher)
- The Cost-of-Living package announced on February 10<sup>th</sup> 2022 is estimated to result in nominal income gains of 0.5%, with larger effects for households in low income deciles
- The temporary cut to excise duties announced on March 10<sup>th</sup> 2022 is estimated to result in a disposable income gain of 0.25%, benefiting lower-income and rural households most.
- As inflationary pressures continue to put a strain on many households, policymakers will need to consider greater targeting of any future measures to limit the cost of future supports and the risks of fuelling further inflation

# Risks to Growth

- The conflict in Ukraine has already impacted global output and poses further risks to our forecasts.
- Inflation may pick up further if impacts on global food production and energy markets intensifies, resulting in a reduction in consumption. Second round effects from wage bargaining also a risk if inflation is expected to be permanently higher
- Heightened uncertainty will likely reduce global trade and investment activity.
- The public finances are likely to be heavily impacted through a number of channels:
  - Assistance to displaced refugees
  - Transfers to households to aid with rising cost of living
  - Support to sectors affected by inflationary pressures and shortages (ie agriculture)

# Climate Change: Fossil Fuel Subsidies

- Many EU states, including Ireland, have committed to carbon taxation goals in order to disincentivise the use of fossil fuels.
- However, carbon taxation efforts can be quite small in comparison to savings which can be achieved through targeting fossil fuel subsidies (FFS)
  - total budgetary cost of Irish energy FFS was around €2.44 billion in 2014
  - government's total carbon tax revenue was €390.9 million in 2014
  - In 2018, FFS was 5.4 times as large as carbon tax revenues
- Removing all energy FFS in Ireland would result in a 16% reduction in CO<sub>2</sub> emissions by 2030 compared to keeping them in place.
- Ireland will be under increasing pressure to phase out the use of FFS in the coming years. Therefore, policies will need to address the distributional effects of removing these subsidies, as the impacts for specific sectors (mainly transportation, mining, and electricity generation) and households (particularly the rural poor) can be extremely high

# Assessment

- The invasion of Ukraine by the Russian Federation presents a number of significant difficulties for the international and domestic economy. The increased global uncertainty may lead to lower levels of investment and consumption.
- The impact of the crisis on energy prices will be the most significant factor influencing global output. Potential increases in grain prices and disruptions to supplies of food production inputs will likely disrupt global food markets.
- Given the inflationary pressures stemming from the conflict, we now expect inflation to be higher than previously forecast, averaging 6.7 per cent in 2022 and decreasing to 5.0 per cent in 2023.
- Additionally, financial stability risk across the euro area is heightened by the exposure of the financial sector to default risks in Ukraine and Russia.
- Despite the conflict, domestic output is still expected to increase, with GDP and MDD increased 6.2 and 5.0 per cent in the present year.
- The labour market continues to see an improvement in its fortunes; by the end of the year, we expect the unemployment rate to fall to 5.5 per cent. In 2023 the unemployment rate is set to fall below its long-run rate
- Improvements in the public finances provides the Government with some fiscal capacity to deal with the emerging crisis in Ukraine; our forecasts include the recent measures introduced by the Government dealing with the inflationary pressures as well as the reduction in excise rates. However, it is also clear that there are significant downside risks to the public finance if the geopolitical and humanitarian situation deteriorates further.



# Thank You