Opening Statement – Budget Oversight Committee

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Introduction

I would like to first thank the Chair for the invitation to appear before the Committee. I am Dr. Conor O'Toole from the Economic and Social Research Institute, and I am joined by my colleagues Dr. Claire Keane, Dr. Paul Egan and Dr. Muireann Lynch.

Domestic economy faces international headwinds

A range of indicators show that Ireland's economic performance remains strong. Employment has almost reached 2.8 million people and unemployment remains low, at just 4 per cent in June. The Consumer Price Index in May showed annual inflation of 1.7 per cent. Nominal wage growth is substantially higher than price inflation and so real wages are rising. The headline public finances remain strong with general government surpluses expected this year and next, thereby contributing to a falling debt to output ratio.

Despite this apparent strength, we have revised our growth forecast downwards due to international developments. The Irish economy is vulnerable to any deterioration in global trading conditions arising from either the imposition of trade barriers or prevailing uncertainty around trade policy and geopolitical developments. Our forecast for growth in Modified Domestic Demand was 3 per cent in our Spring Quarterly Economic Commentary – this is now 2.3 per cent. For 2026, we have adopted a technical assumption that tariffs settle at moderate levels, in line with the IMF forecasts; this would lead to a possible growth rate of MDD of 2.8 per cent.

As well as monitoring international forecasts, we have published a detailed paper assessing the impact of rising protectionism on the Irish economy. Using the ESRI's COSMO model in conjunction with the global NiGEM model, the paper examined a range of tariff and non-tariff scenarios involving the US, EU, and global economies. The paper considers a range of scenarios including a 10 per cent reciprocal tariff scenario and a 25 per cent reciprocal tariff scenario. Under the 10 per cent tariff scenario, the results show a negative impact on Irish GDP of up to 2 per cent and on Modified Domestic Demand of 1.5 per cent over a period of 5-7 years. Under the more severe 25 per cent tariff scenario, the negative impact on GDP is 3.5 per cent, while MDD is projected to decline by 3 per cent.

The traded sector, which includes high-value industries like ICT and pharmaceuticals, is particularly exposed—with production in the sector falling by up to 4%, double the impact on the domestic sector. This is especially concerning given the sector's outsized role in driving wages, tax revenue, and aggregate demand. This highlights the importance of the current carve out for pharmaceuticals in terms of US tariff policy.

While Ireland has limited direct influence over EU-US trade policy, the results of the paper highlight the need for strong domestic policy responses. Investment in infrastructure and productivity-enhancing measures will be essential to preserve competitiveness and support resilience in the medium-to-long term. The analysis also flags additional unquantified risks: heightened uncertainty, potential targeting of key sectors, negative effects on innovation, foreign direct investment, and economies of scale. Overall, the findings underscore the importance of open trade relationships, and the potential vulnerabilities Ireland faces as a small, export-oriented economy amid a shift toward global protectionism.

Domestic economic risks focus on housing and the public finances

The continued under-provision of housing relative to the needs of the population is both an economic and a societal concern. Increases in income, employment and population have seen housing demand outstrip supply, giving rise to rapid inflation in house prices and rents. Despite a rise in housing supply from 2015 onwards[1], evidence from 2024 and early 2025 suggests that the recovery has slowed due to a number of factors. Typical drivers of housing production include land costs and availability, labour costs, materials and inputs costs, the cost of financing, and price developments. The policy environment also has a major impact on production by targeting both the demand- and supply-sides.

A major challenge in an Irish context in delivering both housing and infrastructure is the issue of capacity constraints in the labour market. An ESRI review of the National Development Plan in 2024 found that an extra 40,000 workers in the construction sector would be required to produce an extra 20,000 housing units (Barrett and Curtis, 2024). However, increased productivity in the construction sector could make up for some of this shortfall. Recent research

[1] In 2015, a total of 7,219 units were completed and this rose to just over 32,515 in 2023. The largest increase came in apartments with over 11,534 units completed in 2023, well above 2015 levels.

has pointed towards lower productivity for small and domestic-owned construction firms relative to foreign-owned construction firms in Ireland (Lawless, 2025). This lack of productivity is likely to be inhibiting activity in the sector. Productivity could be enhanced through economies of scale with larger firms or by moving towards modern methods of construction (pre-fabrication etc) which can help standardise production, lower costs and increase timeframes (Egan et al., 2022).

Considering these factors in the round, allied with the outturn for 2024 and the first quarter of 2025, we do not foresee any major uptick in 2025 and 2026 in housing supply. We are currently forecasting 33,000 units in 2025 and 37,000 units in 2026. However, most of the risks weigh on the downside.

Current state of the public finances

While the headline public finances appear in a robust state with ongoing surpluses, there are underlying weaknesses and risks. The outsized contribution of corporate tax revenues is well known and well understood, but it is still important to highlight that this is a source of considerable vulnerability. Recent government surpluses would have been substantial deficits without windfall corporation tax revenues that are concentrated in a small number of taxpayers. Almost by definition the windfall revenues could evaporate quickly in response to factors such as international legislative changes or corporate events. History – in particular the economic collapse – provides a stark reminder that a vulnerability in the tax base can become a major problem if something arises to test the vulnerability. While the establishment of the investment funds[2] is extremely welcome, increasing the level of throughput from windfall payments to the funds would be advisable.

A second reason for voicing concern on the public finances relates to the fiscal stance. As pointed out over many years by the ESRI and others such as IFAC and the Central Bank, running underlying deficits is generally inadvisable when the economy is performing so well. A fundamental principle of fiscal management is that the fiscal stance should be counter-cyclical. Ireland's fiscal policy looks pro-cyclical right now, in the sense that expenditure is increasing during a period of growth for the domestic economy. While some degree of spending increases could be justified if targeted towards addressing infrastructure bottlenecks, broad

[2] This relates to the Future Ireland Fund and the Infrastructure, Climate, and Nature Fund.

based spending increases create risks such as overheating, as well as the longer term risk that it will be necessary to continue with a pro-cyclical fiscal stance in any downturn.

While inflation has been slowing down, prices remain at an elevated level. ESRI research[3] has shown that from 2020 to 2025 permanent changes to the tax and welfare system have resulted in small average income losses (-0.3% of disposable income) compared to policy changes pegged to wage growth. While temporary measures have been successful in helping households deal with rising prices, their inevitable phasing out will cause affordability issues. This is likely to lead to knock-on effects on poverty and inequality, if headline welfare payments fail to keep pace with income growth.

Energy developments

Irish energy prices have declined since the heights of the energy crisis in the wake of the war in Ukraine, but remain at high levels. However, prices for electricity in particular have not yet declined to the same extent as other EU countries. It is challenging to confidently identify the reasons for this, but prices are still largely driven by gas prices, and Ireland has not diversified away from using gas to generate electricity to the same extent as other EU countries.

Large investments in the electricity grid are required in order to meet growing demand, diversified supply, and to improve efficiency in the network, and the cost of subsidising renewable energy is also likely to increase. These costs are fixed, but will result in a reduction in the variable component of energy costs, i.e., fossil fuels and carbon permits. This means the cost base of electricity is projected to shift away from variable costs and towards fixed costs. This is good for consumers, as it reduces exposure to high price spikes, but may be regressive, depending on how these fixed costs are recovered by energy companies. Network tariffs should be designed taking these contributions to costs into account.

Concluding remarks

The picture we paint in our recent Commentary is one of a robust domestic economy facing international headwinds and significant challenges in housing, infrastructure and the public finances. Our Summer Quarterly Economic Commentary showed that current government expenditure relative to the size of the domestic economy[4] has increased notably in recent years.

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[3] See Doorley et al. (2024)

[4] As measured by Modified Domestic Demand, current expenditure as a share of MDD has increased from 27.4 per cent in 2018 to 35.8 per cent in 2024.

While the balance across expenditure and taxation is a choice for the Government, managing the net contribution to the economy is important. Our analysis, however, suggests that current expenditure in the coming years should be targeted and restrained, while capital investment projects should be carefully sequenced.

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