Watch Out for Speed Bumps

Last week's Quarterly Bulletin from the Central Bank saw upgrades to its forecasts for the Irish economy. This was largely due to a better than expected global economic backdrop as well as downward revisions to projections for the path of inflation in 2023. Irish HICP inflation is now forecast to fall to 5% this year from 8.1% last year, and moderate further to 3.2% in 2024, and 2.2% in 2025. The Central Bank sees Irish GDP expanding at a 5.0-5.5% rate over the period 2023-2025. Meanwhile, modified domestic demand is forecast to grow by around 3% in both 2023 and 2024 and circa 2.5% in 2025.

These growth rates represent a marked deceleration from the exceptional pace of expansion registered in 2022, when GDP rose by 12% and modified domestic demand grew by 8.2%. Nonetheless, they are still strong growth rates. Meantime, the unemployment rate is projected to remain stable at 20-year lows of 4.3-4.4% out to 2025. The Central Bank's growth forecasts are somewhat more upbeat than the recently published projections from the European Commission. It sees the Irish economy expanding by 5% this year and 4% in 2024.

Irish data published for the opening two months of 2023 show an economy continuing to perform well. The PMIs for the manufacturing and services sectors have picked up, with a particularly sharp rise in the latter in February, helped by a strong rise in new business activity. New car sales were up by 9.5% in January/February on year earlier levels, while the unemployment rate has been stable in a 4.3-4.4% range. Tax receipts remain strong, rising by 13.5% year-on-year in the first two months of the year, with broad based strength in the main tax headings. Consumer confidence also continues to improve, having fallen sharply between last spring and autumn.

Overall, the data indicate that the Irish economy is showing considerable resilience in the face of the sharp jump in inflation, marked increases in interest rates, and more subdued growth in its main export markets. Another headwind facing the Irish economy is more binding capacity constraints. This is particularly evident in the labour market, with the economy at virtually full employment.

Labour force growth last year was almost entirely driven by an influx of workers from outside the EU. The indigenous labour force actually contracted reflecting a decline in the participation rate and outward migration by Irish citizens. Surveys indicate that labour shortages are now the main factor inhibiting growth across the economy. The problem is being made more acute by the marked decline in average hours worked per person in employment seen since 2019.

There are also concerns about the severe shortage of housing becoming a constraint on economic growth, with the scarcity of stock and high levels of rents and house prices reducing Ireland's attractiveness as a place to work. Capacity constraints are also increasingly evident in terms of the growing pressures on public infrastructure and services, in particular the electricity grid. Addressing capacity constraints needs to remain a key focal point of public policy if Ireland is to remain a strong growth economy.

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