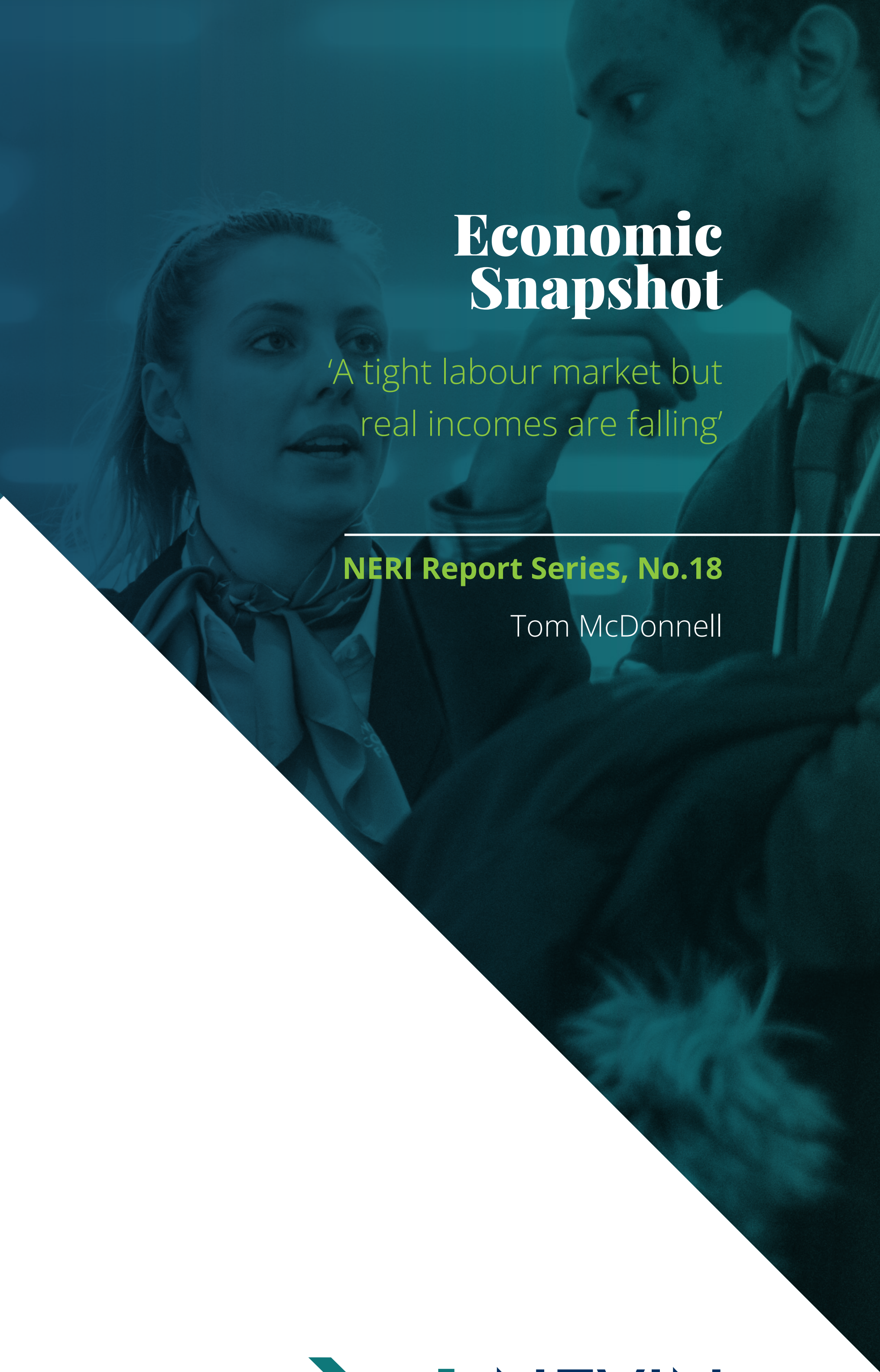

Economic Snapshot

'A tight labour market but real incomes are falling'

NERI Report Series, No.18

Tom McDonnell

NEVIN ECONOMIC RESEARCH INSTITUTE

The economy has made a sharp recovery from the pandemic – but the odds of a slowdown or even a recession have increased markedly in recent months

Cover: Photo by Evangeline Shaw
Photo by Mathias Reding on Unsplash

Introduction

The recovery from the shock of the Covid-19 pandemic has been much faster and more robust than that of previous recessions. Thanks to a strongly countercyclical stance, household incomes largely held up, the economy's productive capacity was broadly protected, and private sector debt remained low. Output already exceeds pre-pandemic levels in the majority of economic sectors. The labour market is now close to full employment with labour shortages in some sectors and good prospects for nominal wage growth.

However, the invasion of Ukraine has created an unfolding humanitarian disaster. The war has also led to a surge in global energy and food prices and triggered a cost of living crisis in many countries.

Inflationary pressures will lead to a decline in real disposable incomes this year and consequently a slowdown in household consumption. Central banks will increasingly tighten monetary policy as a response to high inflation and rising interest rates will further depress demand. Even so, our baseline assumption is that the Republic of Ireland's (henceforth Ireland) economy will avoid a technical recession, but that a number of Ireland's trading partners may well experience a short recession within the next 12 months. Inflation is likely to average close to 8% this year and to only decline gradually to around 4% by the middle of next year.

Budgetary policy should avoid exacerbating inflationary pressures and concentrate on targeted measures to protect low income households as well as measures to enhance the social wage via reductions in the cost of childcare and public services such as education, health and public transport. The many medium-term fiscal challenges and costs (e.g. ageing, net zero transition), fragility of corporation tax receipts, and the risk of further stoking inflation suggests there is no scope for cutting taxes on a net basis.

The World Economy

The humanitarian and social costs of the war are of paramount importance. However, the war is also causing significant economic hardship including disruption to global supply chains and spikes in energy and food prices. The OECD and the IMF have downgraded their forecasts for global economic growth. The OECD is projecting subdued real GDP growth of 3% and 2.8% in 2022 and 2023 respectively.

Table 1 Real economic growth rates (annual change, %), GDP unless stated

	20' Q2	20' Q3	20' Q4	21' Q1	21' Q2	21' Q3	21' Q4	22' Q1
Euro area	-14.7	-3.9	-4.2	-0.9	14.7	4.0	4.7	5.4
UK	-21.1	-7.7	-6.3	-5.0	24.5	6.9	6.6	8.7
US	-9.1	-2.9	-2.3	0.5	12.2	4.9	5.5	3.5
China	3.2	4.9	6.5	18.3	7.9	4.9	4.0	4.8
Ireland								
GDP	1.4	10.8	4.5	12.8	21.0	11.3	9.6	11.0
MDD	-12.2	-2.8	-2.2	-4.9	15.9	5.9	9.8	11.1

Notes: Irish GDP data is distorted by the outsize activities of a small number of multinationals.. Modified Final Domestic Demand gives us a better understanding of the performance of the domestic facing economy.

Sources: Eurostat: GDP main aggregates, CSO: Quarterly National Accounts, Trading Economics: GDP data.

Most advanced economies were in the midst of a post-pandemic economic resurgence prior to the invasion (Table 1). While the economic data is flattered by Covid base effects it also reflects the genuine strength of the rebound enabled by successful deployment of countercyclical labour market and income supports along with loose fiscal and monetary policy. This policy mix, along with the successful rollout of vaccines enabled a swift and increasingly broad recovery based primarily on the release of pent-up demand. The United States economy grew 5.5% on an annual basis in the 4th quarter of 2021 and 3.5% in the 1st quarter of this year. Similarly, the Euro area and the UK respectively grew by a robust 5.4% and 8.7% annually in the 1st quarter of this year.Both the US and in the Euro area are now characterised by tight labour markets. The Euro area's unemployment rate was at a record low of 6.6% in May, while US unemployment was at 3.6% in June. US employment at 158.1 million is close to its pre-pandemic record of 158.9 million, albeit with a decline in employment in June and some evidence of labour market scarring with labour force participation 1.2 percentage points below its February 2020 reading. Average hourly earnings in the US rose by 5.1% annually in June.

The post-pandemic bounce back was swift with labour markets now close to full employment in most advanced economies

Inflation is at 40-year highs in most of the advanced economies – there is an unfolding cost of living crisis

Seasonally adjusted unemployment rates in the Euro area range from below 3% in Czechia and Germany to over 12% in Greece and Spain (Ireland is 10th lowest at 4.7%). The Euro area's youth unemployment rate is well below its pre-pandemic levels at 13.1% while the job vacancy rate (3.1%) is well in excess of pre-pandemic levels. Hourly wages grew 3.3% annually in the first quarter while persons employed increased 2.9% year-on-year, and hours worked increased 6.9%. UK unemployment was 3.8% in the three months to April with average weekly earnings increasing by 6.8%. The number of pay-rolled employees in the UK was at a record level in May, although this conceals a substantial drop in self-employment since the pandemic.

However, significant inflationary pressures have been building in most OECD countries over recent months (see Table 2). This follows a decade of very low inflation in the Euro area and in many other advanced economies. The current inflationary pressures will cause a decline in real incomes in most if not all major Western economies this year. Fiscal and monetary policies are generally set to tighten over the next eighteen months and savings rates will therefore need to decline if consumption growth is to be attained and recessions averted. The Euro area household savings rate was at an elevated 15% in the first quarter of 2022 compared to a pre-pandemic 5-year average of just over 12%. This suggests scope for a lower savings rate to offset the impact of the decline in real incomes.

Table 2 Consumer Prices (Annual Change, %), HICP Unless Stated

	Jun '21	Dec '21	Jan '22	Feb '22	Mar '22	Apr '22	May '22	Jun '22
Euro area	1.9	5.0	5.1	5.9	7.4	7.4	8.1	8.6
UK	2.5	5.4	5.5	6.2	7.0	9.0	9.1	-
US	5.4	7.0	7.5	7.9	8.5	8.3	8.6	9.1
China	1.1	1.5	0.9	0.9	1.5	2.1	2.1	-
Ireland	1.6	5.7	5.0	5.7	6.9	7.3	8.3	9.6

Notes: US (PCE), UK and China (CPI)

Sources: Eurostat: Inflation – Flash Estimate, Trading Economics, US Federal Reserve, Bank of England

Inflation pressures began to meaningfully take hold in the Euro area in the second half of 2021, with the process having begun in earnest in the second quarter of 2021 in the US. Inflationary pressures were initially related to a mismatch between pent-up consumer and business demand on one side, and ongoing supply chain issues caused by transport bottlenecks, stop-start production and shortages of various inputs on the other side. The unwinding of Covid related base effects in energy and in various other commodities, alongside labour shortages and ongoing loose fiscal and monetary policy were also contributing to upward price pressure. The zero Covid strategy in China continues to disrupt global supply chains.

The invasion of Ukraine in February subsequently pushed energy and food prices higher and the subsequent input price shock is now broadening into higher core inflation across the OECD. Annual energy price inflation was up 35.4% in the OECD in May, food price inflation was up 12.6%, and core inflation (excluding food and energy) was at 6.4%. Upward price pressures have been significantly less pronounced in China (2.1% in May) and in Japan (2.5% in May).

US inflation at 9.1% in June was at its highest level since November of 1981. However, core inflation eased for the third month running to 5.9%. Similarly, UK inflation of 9.1% in May was the highest reading since 1982. Euro area inflation was at a record high of 8.6% in June with energy prices up 41.9% reflecting the disproportionate reliance on Russian supplies. Core inflation was 3.8% in the Euro area. The nature of the price shock, concentrated as it is on energy and food, means that low income households are on average experiencing higher rates of price inflation.

The high levels of inflation coupled with the tight labour markets means increasingly restrictive monetary policies including significant rate hikes over the next twelve to eighteen months. Policy rates are likely to be in the order of 2 to 3 percentage points higher in the US in 2023 than they were in 2021 and 1.5 to 2 percentage points higher in the Euro area. This will have a significant dampening effect on both personal consumption and private investment. If badly managed. this tightening could unintentionally precipitate a period of stagflation in certain countries.

Government bond yields have increased in most countries since the start of the year, albeit from historically low levels, and the upward trend in bond yields seems likely to continue over the short-to-medium term. This could create particular policy challenges for the ECB to the extent that bond yields in Southern Europe become decoupled from bond yields in the Euro area core countries such as Germany. The tightening monetary policies in advanced economies (especially the US) could also create debt sustainability problems for non-energy exporting countries in the global south. These countries will come under increasing pressure to increase interest rates and this in turn will slow down their growth rates.

The OECD projects Euro area inflation of 7% in 2022 and 4.6% in 2023. Consumer inflation in the Euro area is unlikely to fall to the 2% target prior to mid-2024 at the earliest, although an early resolution to the Ukraine conflict could precipitate an accelerated unwinding of inflationary pressures.

Economic Trends in the Republic of Ireland

Ireland's real GDP growth remained strongly positive throughout the pandemic and grew 13.6% in 2021 due primarily to robust export performances by the Industry and the Information and Communication sectors. As always, headline GDP should be treated with caution given the outsize activities of a small number of multinationals. The real GNI* indicator, which is a more meaningful indicator of activity in Ireland, declined by 4.6% in 2020 before sharply increasing 15.4% in 2021, an average increase of 5% per annum over the two years (see Table 3). Employee compensation increased 9.8% in 2021 following a rise of just 0.3% in 2020.

Table 3 Dashboard of Macroeconomic Indicators, Republic of Ireland

	2018	2019	2020	2021	22'Q1	Latest
Percentage volume change over previous year						
Gross Domestic Product	8.5	5.4	6.2	13.6	10.7	10.7 *(Q1'22)*
Modified Domestic Demand	5.0	2.4	-6.1	5.8	12.6	12.6 *(Q1'22)*
Personal Consumption	4.2	2.7	-10.9	4.6	15.3	15.3 *(Q1'22)*
Retail Sales	3.8	2.1	-2.3	8.7	7.2	0.3 *(M5'22)*
GNI*	4.4	2.8	-4.6	15.4	-	15.4 *(2021)*
Percentage annual average rate of change						
Employment	2.8	2.9	-2.8	6.0	12.3	12.3 *(Q1'22)*
Labour Productivity	5.6	3.1	14.1	-	-	14.1 (2020)
Average Hourly Earnings	2.9	3.5	4.8	4.8	1.9	1.9 *(Q1'22)*
Average Weekly Earnings	3.3	3.6	5.2	4.7	2.2	2.2 *(Q1'22)*
Inflation (CPI)	0.5	0.9	-0.3	2.4	5.8	9.1 *(M6'22)*
Percentage of annual GDP or quarterly GDP						
Government Balance (GGB)	0.1	0.5	-5.1	-1.9	-	3.3 *(Q4'21)*
Gov. Gross Debt (end year)	63.1	57.2	58.4	56.0	-	56.0 *(Q4'21)*
Percentage of labour force						
Unemployment *(Covid Adjusted)*	5.8	5.0	19.4	16.1	5.0	4.8 *(M6'22)*
Long-term Unemployment	2.1	1.6	1.3	1.8	1.7	1.7 *(Q1'22)*

Notes: Half-year, ('H'), Quarterly ('Q'), monthly ('M') and other data is compared to same period of the previous year. *Modified domestic demand* (MDD) is non-seasonally adjusted '*Total domestic demand less the effects of the trade in aircraft by aircraft leasing companies and the imports of IP*'. *Modified GNI* is GNI adjusted for factor income of redomicilied companies, and depreciation of aircraft leasing, R&D service imports and trade in IP. *GGB* is end-year figure as a % of annualised GDP or latest six-month figure as % of six-month GDP. *Unemployment* is Covid-adjusted.

Sources: CSO: *Labour Productivity, National Income and Expenditure, Quarterly National Accounts, Retail Sales Index, Labour Force Survey, Earnings and Labour Cost, Consumer Price Index, Balance of International Payments, Government Finance Statistics, Monthly Unemployment.*

Real modified domestic demand (MDD) grew 5.8% in 2021 and then 12.6% year-on-year in the 1st quarter of 2022, although it was down 1% on a quarterly basis. However, seasonally adjusted MDD was up just 3.7% on the 4th quarter of 2019 (i.e. the last pre-pandemic quarter) with quarterly personal consumption still below its pre-pandemic level. Consumption of close contact services was curtailed somewhat by the lockdown in January. The volume of retail sales has increased 7.2% between February 2020 and May 2022.

Seasonally adjusted Construction activity remained weak in the first quarter of 2022 and below its pre-pandemic level on an output basis and on a volume of production basis. Overall, four of ten economics sectors remained below their seasonally adjusted pre-pandemic levels in real terms.

The bounce-back in energy costs from a low base was the main contributor to the pre-invasion phase of inflation. Recent months have seen a further jump in energy prices and the inflationary pressures extending to food and to wider core inflation. Consumer prices for CPI and HICP rose by 1.3% between May and June.

Annual CPI inflation was 9.1% in June representing a 38-year high (Q2 1984), while HICP inflation was 9.6%. The largest increase was in Housing, water, electricity, gas and other fuels (22.5%) which mainly reflects higher costs for home heating oil (115.4%), electricity (40.9%) and gas (57.2%). This was followed by Transport costs (20.4%), which mainly reflects higher prices for diesel (50.7%), petrol (43.8%), purchase of motor cars (13%), and airfares (38.4%). Food prices rose 6.8% annually in June with price rises for staples like cereals, bread, pasta, oils and milk in double digit territory.

Analysis from the CSO estimates that annual inflation (up to March) was highest for the lowest income households, with renters, lone parents, and rural dwellers also disproportionately affected by the price increases over the last year.

Residential property prices rose 14.4% in the year to May while private rents increased by 11.9% in the year to June. Both figures continue to significantly outstrip wage growth as housing supply remains well short of demand. The pandemic-related work stoppages and rise in discretionary household savings have further added to property price pressures. The housing market has now been dysfunctional in one form or another for close to two decades.

The seasonally adjusted unemployment rate in June was 4.8%, or 134,000 persons. This compares to 120,000 persons (also 4.8%) just prior to the pandemic in February 2020 and the Covid-adjusted rate of 18.3% in June 2021 (408,000 persons). Youth unemployment reached a record low of 4.9% in May although it has since increased to 5.4% in June (21,800 persons). The youth unemployment rate was 11.6% prior to the pandemic and peaked at 32% in 2012. The high job vacancy rate (Table 4) is suggestive of a tight labour market, with the economy-wide and private sector rates higher than both their pre-pandemic levels and historical norms in almost every sector.

Inflation is hitting the poorest households the hardest

Table 4 Job vacancy rate by economic sector, 1st quarter

All Q1	2015	2017	2019	2022
Construction	1.3	0.4	0.5	1.5
Industry	0.6	0.6	0.7	1.1
Wholesale, retail, vehicle repair	0.8	0.5	0.6	1.2
Transport & storage	0.6	0.5	0.5	0.7
Accommodation, food services	0.8	0.8	0.8	1.4
Information & communication	2.6	1.7	1.5	2.7
Financial, insurance, real estate	2.3	2.1	1.8	3.2
Professional, scientific & tech	1.6	2.6	3.3	3.2
Administration & support	1.1	0.8	1.0	1.3
Public admin & defence	1.2	1.5	1.7	2.5
Education	0.5	0.6	0.4	1.2
Human health & social work	0.7	1.2	0.6	0.8
Arts, entertainment & other	1.1	0.8	1.0	2.0
All sectors	1.0	1.0	1.0	1.6

Note: JVR = number of job vacancies/ (number of occupied posts + number of job vacancies) *100

Sources: CSO: Labour Force Survey

Total employment passed 2.5 million for the first time in the fourth quarter of 2021 and was almost unchanged in the first quarter of 2022 (Table 5), albeit employment was up 12.3% year-on-year. Actual hours worked in the economy reached a peak of 80.8 million hours per week compared to 68.7 million in the first quarter of 2021. This represents an increase of 17.6% year-on-year. It is unclear as yet the extent to which the ending of the EWSS scheme will lead to job losses.

The CSO has started producing monthly estimates of payroll employees using administrative data. The seasonally adjusted employee index increased 0.8% in the month to April (an annual change of 15.6%) but declined 0.6% in the month to May. This decline may reflect the phase-out of pandemic support schemes. Even so, the employee index for May was 8.3% higher than in 2019 and marked the first decline in the index since February 2021.

Employment growth over the last five years has in relative terms been strongest in Information and Communication and in Public Administration and strongest in absolute terms in Education (53,600), Health (49,500) and Information and Communication (49,200). Employment declined over the period in agriculture, forestry and fishing and in ‘other activities’ a category that includes arts and entertainment. Employment growth has generally been stronger in higher value added and therefore higher wage sectors.

Table 5 Employment by sector, thousands or % change, 1st quarter

All Q1	2017	2019	2022	17-22	Share
				%Δ	%
Agriculture, forestry, fishing	107.3	103.4	103.5	-3.5	4.1
Construction	124.8	144.4	159.3	27.6	6.4
Industry	282.0	287.4	315.2	11.8	12.6
Wholesale, retail, vehicle repair	297.8	304.1	301.9	4.4	12.0
Transport & storage	91.4	105.8	113.2	23.9	4.5
Accommodation, food services	160.6	174.9	162.6	1.2	6.5
Information & communication	114.4	117.9	163.6	43.0	6.5
Financial, insurance, real estate	106.5	110.9	135.3	27.0	5.4
Professional, scientific & tech	130.1	139.2	162.3	24.8	6.5
Administration & support	90.6	110.4	102.3	12.9	4.1
Public admin & defence	93.5	110.4	133.7	43.0	5.3
Education	157.4	179.0	211.0	34.1	8.4
Human health & social work	275.7	286.1	325.2	18.0	13.0
Other activities	115.5	117.8	109.3	-5.4	4.3
Not stated	9.5	6.7	7.5	-21.1	0.3
All sectors	**2157.1**	**2298.3**	**2505.8**	**16.2**	**100**

Sources: CSO: Labour Force Survey

Average weekly earnings increased 2.3% overall, (Table 6) and by 4.1% in the private sector in the year-to first quarter 2022, with average hourly earnings up 1.9% and 2.7% respectively over the same time period. These figures are skewed compositionally due to the timing of the reopening of certain sectors as well as the composition of jobs lost during the Covid crisis. Weekly earnings grew by 14.1% across the economy between the first quarter of 2019 and the first quarter of 2022. This is an average of 4.7% per annum in nominal terms and 2.5% per annum in real terms. However, nominal wage growth in the vast majority of sectors will not keep pace with inflation this year.

Table 6 Weekly earnings by sector, % change, 1st quarter

All Q1	2019	2021	2022	19-22	21-22
HICP	100.8	101.5	107.5	6.6	5.9
CPI	101.2	102.0	107.9	6.6	5.8
	€	€	€	%Δ	%Δ
Industry	927.20	989.17	1031.78	11.3	4.3
Construction	768.44	808.61	881.29	14.7	9.0
Wholesale, retail, vehicle repair	591.30	622.72	649.43	9.8	4.3
Transport & storage	810.25	756.57	795.55	-1.8	5.2
Accommodation, food services	351.07	388.92	400.00	13.9	2.8
Information & communication	1269.95	1428.60	1506.04	18.6	5.4
Financial, insurance, real estate	1280.99	1345.87	1358.72	6.1	1.0
Professional, scientific & tech	913.89	1006.31	1097.03	20.0	9.0
Administration & support	618.82	698.16	712.95	15.2	2.1
Public admin & defence	958.84	1006.33	1005.69	4.9	-0.1
Education	840.67	932.40	937.94	11.6	0.6
Human health & social work	725.28	781.29	793.71	9.4	1.6
Arts, entertainment & other	509.26	603.40	615.11	20.8	1.9
All sectors	**771.60**	**860.19**	**880.37**	**14.1**	**2.3**
Private sector	717.20	803.15	836.30	16.6	4.1

Notes: CPI index is December 2016 = 100; HICP index is 2015 = 100

Sources: CSO: Earnings and Labour Cost Quarterly, Consumer Price Index

The public finances are performing well given the difficult economic context of the last two years. Income tax, corporation tax and VAT receipts have all been growing strongly. The Summer Economic Statement outlined a growth in core spending of 6.5% alongside over €1 billion in tax cuts. The Government is projecting that the deficit of 1.9% of GDP in 2021 will be followed by modest surpluses of between 0% and 1% of GDP in 2022 and 2023.

However, the headline public finance data is flattered by the ongoing surge in corporation tax receipts and it is unclear to what extent these receipts are sustainable over the medium-term. Ireland's public debt is also very high at close to €47,000 per person. While the per capita debt level is high the economy's growth potential remains strong and such growth, if realised, will gradually erode the debt burden over time. Bond yields have increased by close to 180 basis points in the last six months and are likely to continue to trend higher over the next 12 to 18 months.

Economic Outlook for the Republic of Ireland

Growth

The Irish economy is on track to grow in 2022 due to strong export growth from multinational enterprises (pharmaceuticals, ICT services), from lingering pent-up demand, and from base effect related to the pandemic lockdowns. The services (55.6) and manufacturing PMIs (53.1) were both in positive territory in June, albeit on a downward trajectory. However, the outlook has deteriorated in recent months because of the supply-side and cost-of-living challenges arising from the Ukraine war, alongside the likelihood of a slower than previously expected decline in household saving and significant and ongoing monetary tightening by the ECB. Recessionary concerns in each of the major trading partners (US, UK, Euro area) are increasing and if realised would weaken export growth.

The unwinding of savings and release of pent-up demand will be tempered in the second half of 2022 by the uncertain prospects for the global economy and the decline in real disposable household income caused by high inflation. In particular, low income households with limited savings will reduce their spending on non-essential goods and services. The consumer confidence index was just 57.7 in June indicating broadly negative perceptions of future economic activity and concerns over the cost of living and the possibility of stagnation or recession. This suggests that the savings rate is likely to remain elevated throughout 2022 as households build up precautionary savings. It also suggests that any release from savings built up over the last two years is likely to be channelled toward maintaining consumption of imported energy products and services.

The externally driven cost shock is increasing business input costs and fuelling uncertainty. This will weigh on private investment. The construction PMI was negative (i.e. below 50 – the reading was 46.4) in June suggesting pessimism about business conditions and activity in that sector. The lack of resolution of the Brexit issue means potential for trade disruption Additional sources of business uncertainty include ongoing supply chain problems including lack of availability of key components, rising interest rates, and the evolving impacts of sanctions policy.

Even so, real disposable household income and consumption should begin to pick-up again in 2023 as a tight labour market drives real wage growth in a context of gradually declining headline inflation rates and reduced uncertainty. Our projection is that real modified domestic demand will increase by close to 5% in 2022 given the strong start to the year and then by 4% in 2023.

Labour market

An important difference between the great financial crash of 2009-09 and the Covid pandemic is that there appears to be only very limited evidence of labour market scarring in Ireland in the wake of the pandemic. Enhanced income protection (PUP), wage subsidies (the TWSS and EWSS schemes), and loose macroeconomic policies combined to mitigate the shock to demand and preserve the productive capacity of the economy.

The labour market is recovering strongly, hours worked are at record levels, and the economy is close to albeit not at full employment. Analysis from the Central Bank points to a large annual increase of 9.6% in the labour force as a result of expanded female and youth labour force participation. The impact of inward migration from Ukraine is unclear but will increase the working age population and the potential labour supply.

The seasonally adjusted employment index was up 11.3% annually in May with an increase in every sector. However, we project that the pace of employment growth will slow-down significantly in the second half of 2022 as pent-up demand for services starts to taper and business conditions weaken somewhat. The Central Bank notes that the growth of job postings has started to show signs of levelling out. Even so, the unemployment rate will continue to fall over the next eighteen months. We project that the economy will be at full employment by mid-2023 with an unemployment rate at or near 4%.

The general outlook for nominal wage growth is very positive, albeit with the usual variation from sector to sector. Job vacancy rates are high and there is evidence of a labour supply shortfall in a number of sectors. The combination of high inflation and a tight labour market will put significant upward pressure on wages. We expect strong real wage growth in 2023 assuming wage growth lags inflation and that inflation declines gradually over the next 12-to-18 months. On the other hand, real wages will decline in 2022. We project nominal wage growth of close to 4.5% in 2022 and 5.5% in 2023.

Inflation

There is immense uncertainty about the future path of price inflation in the months ahead, particularly given the unknown duration of the Ukraine war and its fallout in terms of energy prices and supply chain disruptions. Global supply chain pressure remains elevated. The main central banks will continue to increase interest rates in the coming months in order to control prices and this will begin to temper demand and reduce the mismatch with supply.

There is tentative evidence that inflation may have already peaked in the US with core inflation now declining for three consecutive months. Sustained inflationary pressures may be more prolonged in Europe and will fuel higher wage demands across the Euro area and in the UK in order for workers to meet the cost of living. Increased business costs will also be passed on to some extent. The price shocks will take some time to work through the system. House prices and rents will continue to experience upward

Tax cuts should be avoided in Budget 2023

pressure given the ongoing supply and demand mismatch. Our baseline view is that inflation will average close to 8% this year and will peak in the third quarter of 2022 before declining to around 4% by the third quarter of 2023.

Fiscal policy – Budget 2023 and beyond

The public finances are expected to be modestly in surplus in 2022 and again in 2023. Budgetary policy will need to thread a careful line. It is not feasible or desirable to fully compensate all households for the cost of inflation and care will be needed to ensure that policy does not further add to inflation. Policy should focus on targeted supports for low income households, including significant increases to all welfare payments. A second appropriate cost of living focus would be on enhancing the social wage via cutting the costs involved in the use of public services such as public transport, healthcare and education, as well as other costs such as childcare services.

On the other hand, tax cuts should be avoided in Budget 2023 given the formidable fiscal pressures coming over the next 15 years and the uncertainty around the sustainability of corporation tax receipts. Demographic pressures will increasingly add to pension and healthcare costs as a percentage of national output. In addition, fixing the housing crisis will require massive and direct state intervention amounting to billions of euro in annual investment. Finally, the digital and especially the green transitions will require significant annual investment over the next two decades, while sustainable productivity-based growth will depend on a reversal of Ireland's chronic annual underinvestment in childcare, in public R&D and in per pupil spending on education.


zappi

NEVIN ECONOMIC RESEARCH INSTITUTE

31/32 Parnell Square, Dublin 1, Ireland
Phone: +353 1 8897722

45-47 Donegall Street, Belfast BT1 2FG, Northern Ireland
Phone: +44 (0)28 9024 6214

info@NERInstitute.net

www.NERInstitute.net

@NERI_research