Seeds of opportunity: cultivating growth in the all-island economy

Economic Eye

Winter 2024 Forecast

EY

Building a better working world

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Growing the ROI and NI economies now and into the future

2024 is barely underway and it has already acquired numerous labels. The year of rate cuts. The year of war. The year of elections. For the all-island economy, it is expected to be a year of growth.

Our winter Economic Eye forecast is for reasonably solid growth in the Republic of Ireland (ROI) and a modest expansion in Northern Ireland (NI) in 2024. While international activity is relatively subdued and tighter monetary policy is biting, disinflation is helping to restore households' purchasing power. Economic momentum is expected to build as the European Central Bank and the Bank of England begin to loosen monetary policy and financing conditions for investment become more favourable, and as trading partner demand improves.

So, there are reasons for cheer, recent political developments in NI among them. But there are headwinds too and fostering growth over a longer time horizon requires doubling down on efforts to bolster the capital stock, boost the labour force, and enhance productivity.

Adding to the capital stock means upping investment. As the cost of borrowing is a key driver of firms' spending, the turning interest rate cycle is a positive. Conversely, geopolitical uncertainty is high amid the ongoing war in Ukraine and the Middle East conflict, and electoral uncertainty can interfere with the business cycle; there is a tendency to pause plans until there is clarity on the make-up of new governments and the direction of policy. The UK general election – which could happen in the second half of this year - may introduce some volatility into sterling as well. Structural factors are supportive of investment though, with businesses in ROI and NI undertaking digital and sustainable transformation programmes and starting to explore artificial intelligence (AI) technology. Harnessing the potential of new technologies like this will be crucial in the coming era.

Population gains and inward migration have a role to play in boosting the workforce, along with raising participation rates especially in NI and tapping untapped labour. Such steps would also help alleviate current labour market tightness. Firms need employees with the right skill sets as well, and as the twin transitions progress and skill requirements evolve, enterprise and education policies should further promote training and life-long learning.

As for enhancing productivity, policy measures that support research, development and innovation and public investment in infrastructure create an enabling environment, lowering business costs and increasing competitiveness. Delivering on ROI's National Development Plan is key in this respect, and from the perspective of achieving energy and climate targets and improving the quality of life.

Growth in 2024 is a welcome prospect and if the opportunity to cultivate the seeds - capital, labour, and productivity – is also taken, the ROI and NI economies will be well placed to keep pace with developments in global markets and grow into the future too, ensuring prosperity for all of society.

Economic Growth Outlook

	2023e	2024f	2025f
ROI	-1.9%	2.2%	3.8%
ROI MDD	1.2%	2.2%	2.5%
NI	-0.2%	0.7%	1.6%

(Annual change, constant prices)

Modified Domestic Demand excludes globalisation effects

Source: EY Economic Eye, EY ITEM Club

“Growth is in store for the two economies on the island of Ireland in 2024. Inflation is on the retreat, interest rate cuts are in prospect, and labour markets remain warm.

Dr. Loretta O'Sullivan
Partner and Chief Economist, EY Ireland

“As we look to the future, now is the time to invest in the drivers of tomorrow's economic growth as we know such investment will pay dividends many times over.

Graham Reid
Partner and Head of Tax & Law and Head of Markets, EY Ireland

Global Perspective

Pivotal times for the global economy

2024 to bring a turn in interest rates and elections in the US and Europe.

Dr. Loretta O'Sullivan
Partner and Chief Economist,
EY Ireland

In one of the most iconic scenes from the eternally popular sitcom Friends, Ross repeatedly shouts "pivot" at an increasingly frustrated Rachel and Chandler as they try to manoeuvre a couch up a staircase. Although the link between the '90s sitcom and present-day monetary policy is not immediately apparent, this is very similar to the situation that has been playing out in financial markets in recent months; put upon central bankers pushing back against traders' expectations of a change in the direction of monetary policy. A "pivot" in the lexicon of markets.

Faced with decades-high inflation, the US Federal Reserve spent much of 2022 and 2023 increasing interest rates. But as last year came to an end, Chairman Jay Powell gave traders the Christmas gift they wanted; a signal that rate cuts could begin in 2024. The European Central Bank has also been in tightening mode and while President Christine Lagarde has been more circumspect, a loosening of monetary policy in the Eurozone is in prospect this year as well.

Powell's pivot and the sense that Lagarde is merely lingering owe much to recent inflation data. This has been encouraging; a sharp decline in global energy prices and aggressive central bank hiking have gone a long way to restoring price stability. Headline inflation remains shy of the 2% target however, and both the Fed and the ECB are likely to proceed with caution. Europe is in for a bumpy couple of months as governments across the continent start phasing out cost-of-living supports, relatively tight labour markets in the two regions mean underlying inflation may be sticky, and geopolitical tensions, including the conflict in the Middle East, pose ongoing risks.

Something else to bear in mind is that monetary policy operates with a lag. The tightening that has already taken place is still passing through to households and businesses around the globe. This is dampening demand for goods and services and the IMF is forecasting growth below its historical average for the world economy in 2024.

What about the Republic of Ireland? Higher borrowing costs are generating headwinds here too. And the nature of our economy makes it sensitive to the international outlook. Inflation has moderated markedly though, and strong tax receipts are indicative of domestic strengths, especially the labour market. Further wage and employment gains are expected and bode well for consumer spending this year. Infrastructure, digitalisation, and decarbonisation agendas

should also lend support to the economy into the medium term; when it comes to financing such investments, any cut in interest rates will be welcome.

As well as bringing a turning point in interest rates, 2024 is a big election year. Countries around the world are going to the polls; Taiwan, India and Indonesia in the East, the US in the West, and Member States in the European Union will be voting in a new parliament. The results could be pivotal for geopolitical relations, trade flows, and the EU project. And for Ireland.

Economic populism and protectionism have been on the ascent globally for some time now. Trade and investment policies have become more inward-orientated, and this could intensify into the future. The potential costs to economies are far from insignificant; reduced competition, higher prices, lower productivity, and less scope to use new technologies among them. The reshaping of global supply chains in the wake of the pandemic, Russia's invasion of Ukraine and the attacks in the Red Sea is also a challenge. How can resilience and economic security be enhanced while retaining efficiency benefits?

Balancing acts are something that the European Union is well used to of course. Maintaining the integrity of the Single Market and respecting national interests is one long-standing example. But it is one that may be increasingly tested in a world of rising trade tensions and barriers.

As industrial policy at EU level evolves, it will be important that economic inefficiencies and distortions are minimised and that free-trade agreements are further developed. For small Member States, the fair and proper functioning of the internal market matters. Its completion does too, particularly in services. For open Member States, expanding and diversifying external trade is an imperative. Ireland is both small and open. In addition, we are a key part of global supply chains in many sectors.

So, it is incumbent on us to continue to use our voice and our soft power whenever we can, in discussions and debates in European and international fora, in support of rules-based trade and investment that promotes openness, competitiveness and multilateralism.

Many of the issues the world will be dealing with in 2024 and beyond will require joint action, not least the green transition. Achieving better economic growth outcomes for all is more likely if countries cooperate and work together, even if they are not always the best of friends.

World growth projections

Global GDP expanded moderately in 2023, and the IMF is projecting much the same for the period ahead. While the likelihood of a hard landing for the world economy has receded, and the more open path to a soft landing should help rebuild confidence, there are still plenty of headwinds. These range from geopolitical tensions to property market woes in China to extreme weather shocks.

Against this backdrop, the latest **EY CEO Outlook Pulse** finds that transformation is top of mind for businesses globally in 2024, with 95% of CEOs planning to maintain or accelerate transformational change. Some other insights from the research are:

- 45% of organisations have high capability to manage geopolitical risks through defined and active processes.
- 34% of CEOs are prioritising supply chain reconfiguration.
- 41% of organisations are adopting AI technologies to drive efficiencies and improve business performance.

Global Growth Outlook

	2023e	2024f	2025f
World	3.1%	3.1%	3.2%
US	2.5%	2.1%	1.7%
Japan	1.9%	0.9%	0.8%
China	5.2%	4.6%	4.1%
India	6.7%	6.5%	6.5%
Euro area	0.5%	0.9%	1.7%
Germany	-0.3%	0.5%	1.6%
France	0.8%	1.0%	1.7%
Italy	0.7%	0.7%	1.1%
Spain	2.4%	1.5%	2.1%
UK	0.3%	0.9%	1.8%

(Gross Domestic Product, annual change, constant prices)

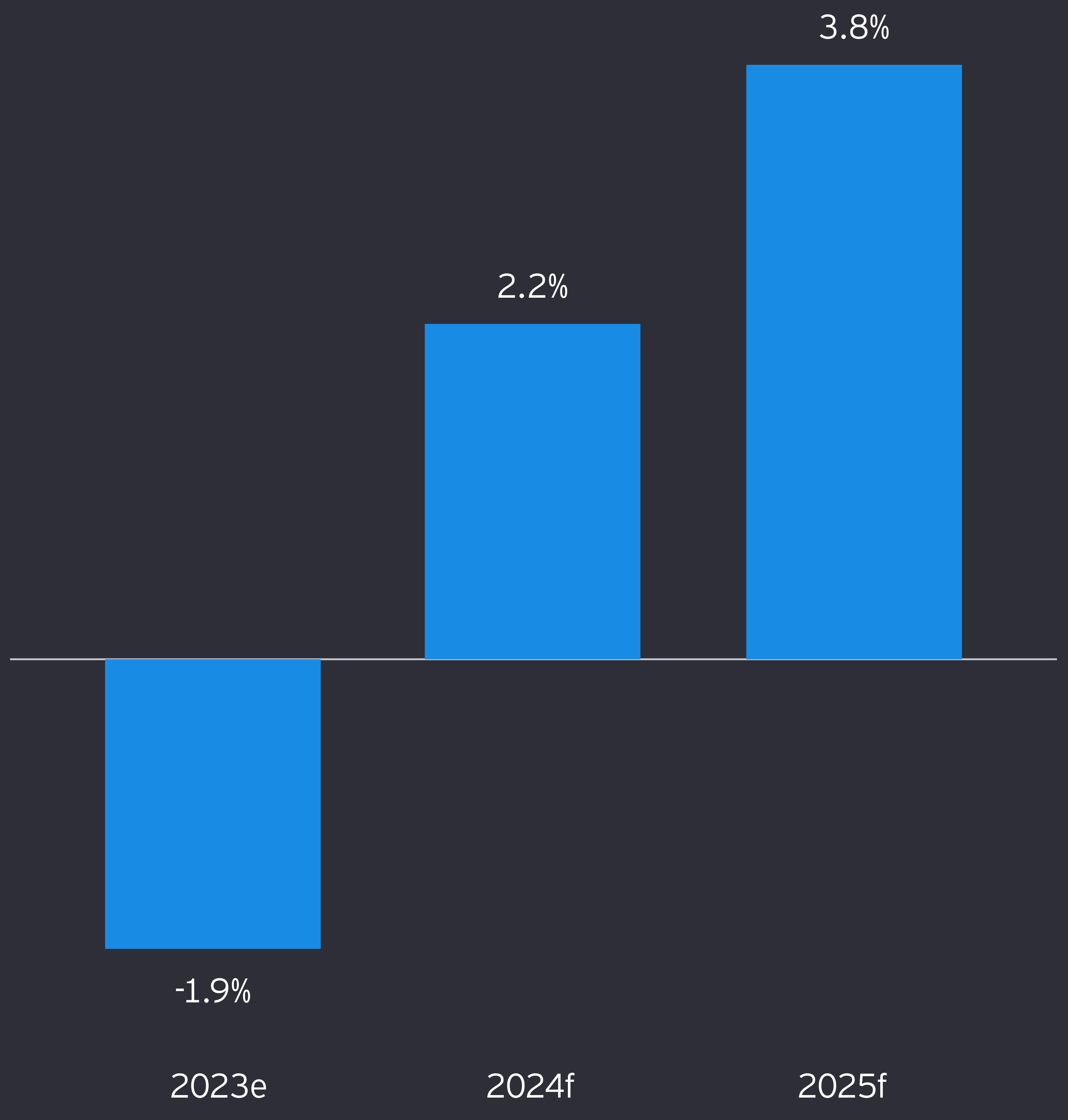
Fiscal year for India

Source: IMF, EY ITEM Club

All-Island Outlook

All-Island economy

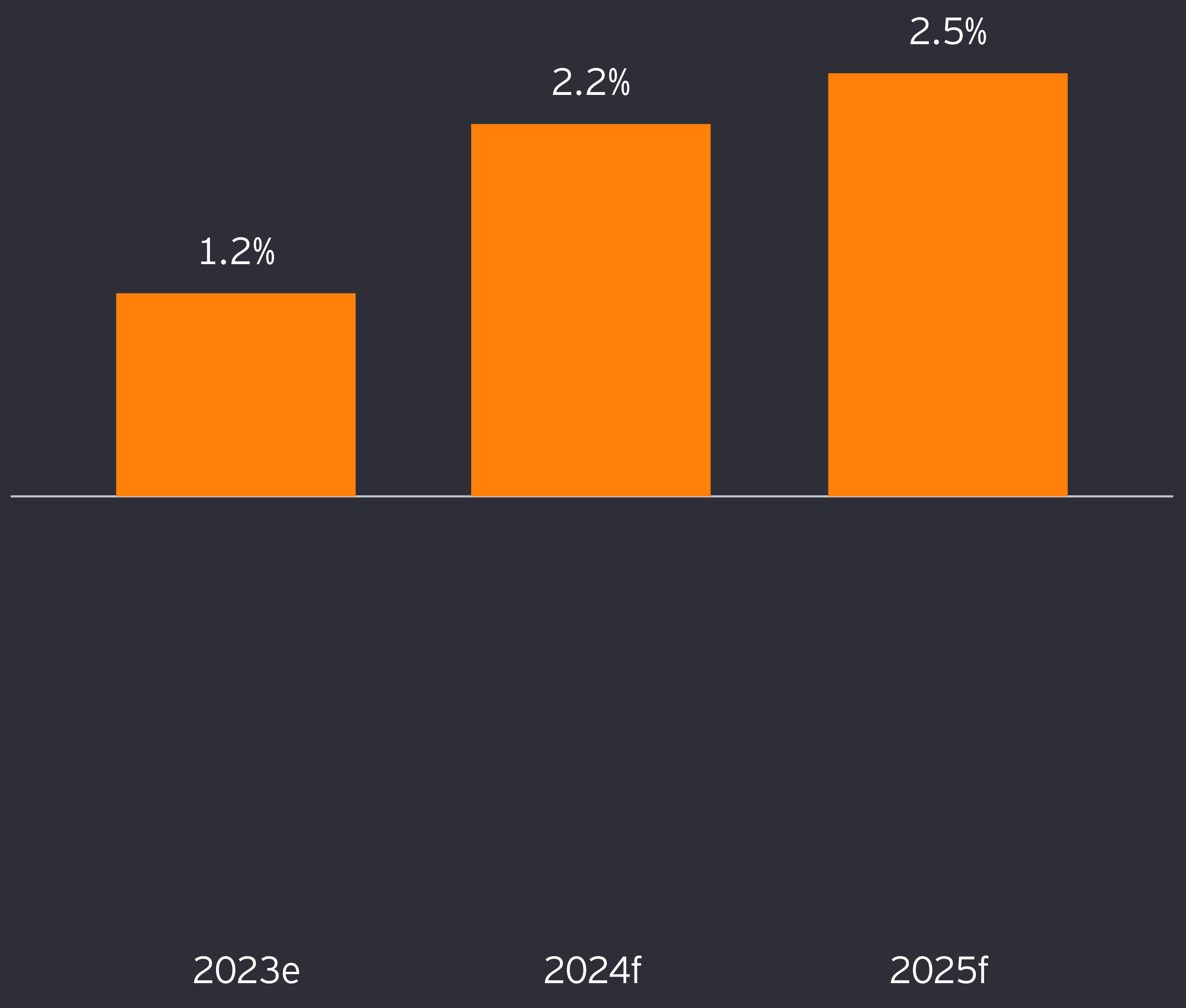
Republic of Ireland, GDP



(Gross Domestic Product, annual change, constant prices)

Source: EY Economic Eye

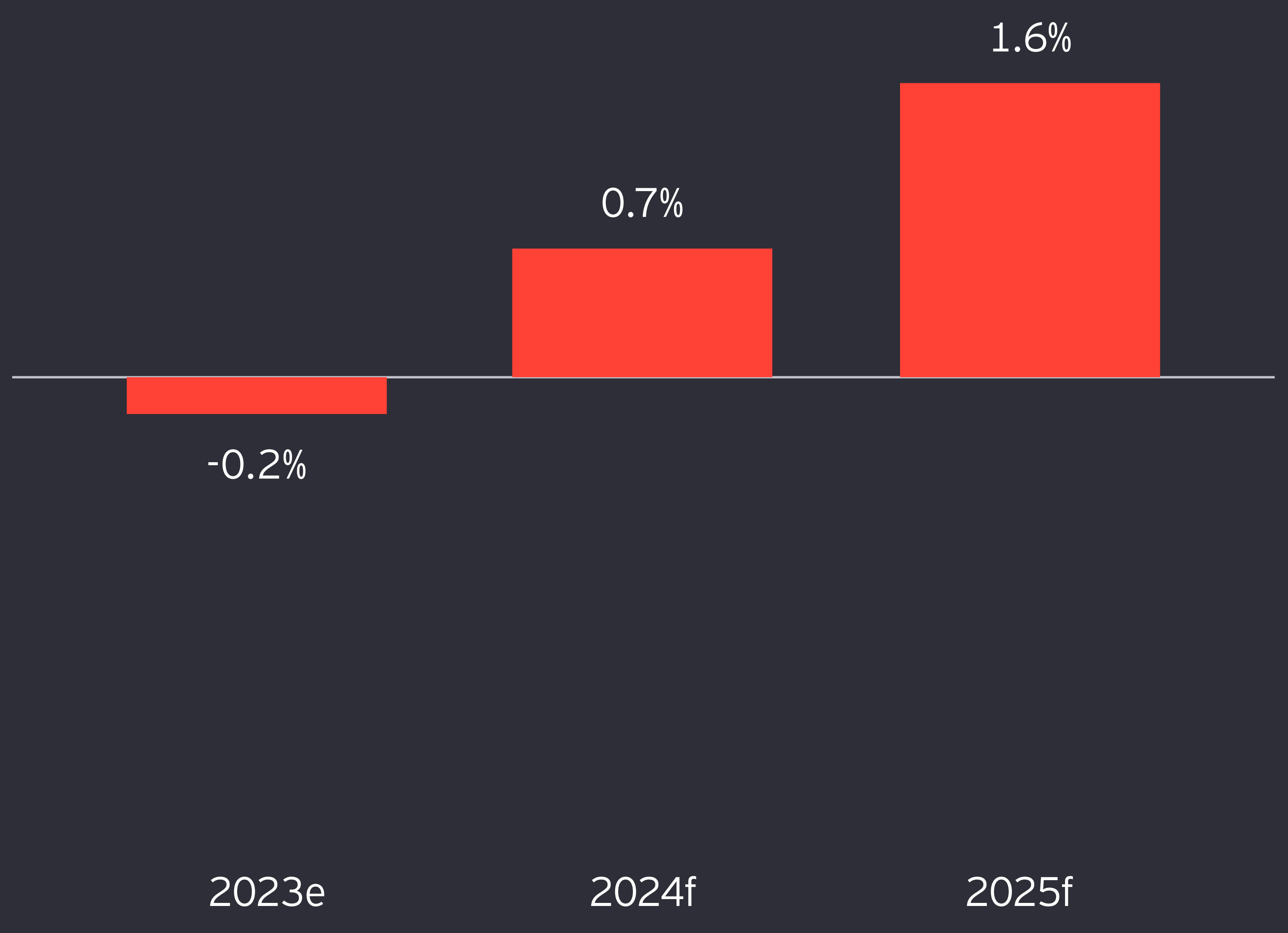
Republic of Ireland, MDD



(Modified Domestic Demand, annual change, constant prices)

Source: EY Economic Eye

Northern Ireland, GVA



(Gross Value Added, annual change, constant prices)

Source: EY ITEM Club

Republic of Ireland

Summarising the state of play in the ROI economy in one word is never an easy task. For 2023, contraction is a candidate as the flash full-year GDP estimate shows a decline in activity. The detailed National Accounts breakdown for the first three quarters indicate that the weakness related to exports and investment. This mainly stemmed from adjustments in the pharma-chemicals sector after an exceptional performance during COVID-19, and base effects from large-scale spending by multinationals on machinery and equipment in 2022. So "normalising" seems more apt. Indeed, available data point to an expansion in Modified Domestic Demand last year; and record high employment and strong tax receipts don't tally with an economy going backwards.

That's not to say that subdued global conditions, tighter monetary policy and higher living costs did not weigh on economic activity in 2023. They did and will do this year too. But a rebound in exports and an improvement in real incomes is expected, thus our winter forecast has GDP and Modified Domestic Demand increasing by 2.2% in 2024. In a word, "growth".

As always, forecasts are subject to risks. Externally, demand in important trading partners could be weaker than assumed, Russia's war in Ukraine or the Middle East conflict could intensify, and geoeconomic fragmentation could deepen. At the same time, labour shortages and domestic bottlenecks could adversely impact cost competitiveness, and constrain the economy's growth potential. Whereas the activities of multinationals might beat or underperform expectations.

On the fiscal front, Budget 2024 took steps to enhance the resilience of the public finances. Two new funds - the Future Ireland Fund and an Infrastructure, Climate and Nature Fund - are being established. Given the volatility of corporation tax revenues and future age and climate related spending pressures, these are welcome.

"After a stellar performance in recent years, economic activity in ROI is normalising, with growth projected to be more moderate over the coming period, albeit remaining reasonably solid. As a foreign direct investment hub with talented indigenous entrepreneurs and a highly educated workforce, the economy continues to operate from a position of strength.

Dr. Loretta O'Sullivan
Partner and Chief Economist, EY Ireland

Consumers

2024 Consumption Forecast, ROI: 2.9%

Many of the factors that underpinned consumption growth in ROI last year will provide support again in 2024. The economy is continuing to create jobs, wages are rising, and households' balance sheets are in good health in aggregate. The taxation and welfare packages (including three universal energy credits) set out in Budget 2024 will also improve households' circumstances. Moreover, retreating inflation means the squeeze on purchasing power is lessening and helping to lift consumer confidence; this rose for a fourth month running in January.

On the other hand, the cost of the representative shopping basket is higher than before the war in Ukraine, as are interest rates. The prevalence of fixed-rate mortgages has insulated around half of borrowers from the immediate impact of tighter monetary policy according to Central Bank of Ireland research. But as these contracts are typically short term, increased repayment burdens are probable for some over the coming years. Conversely, those with tracker mortgages will be looking ahead to European Central Bank rate cuts.

Government

Budget surplus projected for ROI in 2024

A general government surplus is estimated for last year and the outlook for ROI's public finances is positive. Tax receipts performed very well in 2023, rising by 6% on an annual basis – driven by growth in income tax, VAT, and corporation tax – and got off to a good start this year too.

Budget 2024 was sizeable, comprising temporary and permanent measures amounting to approximately €14 billion. The cost-of-living aspects will support households and firms in the near term, with spending on infrastructure and initiatives to spur innovation and boost the productive capacity of the economy helping to address supply constraints over the medium term.

The concentrated nature of corporation tax receipts is a risk to the public finances, however, and international tax changes are now taking effect; Pillar Two of the OECD agreement imposes a minimum 15% corporation tax rate on companies with over €750 million in global turnover. Hence, building fiscal buffers was also a focus of the recent budget.

“

Infrastructure bolsters productivity, supports economic growth, contributes to our climate objectives, and improves lives. The new Infrastructure, Climate, and Nature Fund underscores Ireland’s robust and future-focused commitment to this critical investment area.

Shane Mac Sweeney
Partner and Head of Government & Infrastructure, EY Ireland

Investment

2024 Modified Investment Forecast, ROI: 1.8%

While unfavourable financing conditions and global uncertainty are likely to temper spending decisions somewhat, investment growth is projected for 2024. The property sector is typically sensitive to higher interest rates and commercial construction activity has slowed. Residential building has held up however; 32,695 new dwellings were completed last year and the Housing for All target of 33,450 units in 2024 may well be exceeded. In addition, the Irish government is undertaking a major capital spending programme to improve public infrastructure and underpin the economy's digital and green transformation.

The twin transition is a priority for business investment too. Many firms are operating in constrained environments though, and are mindful of borrowing, staffing, regulatory and other costs (including transportation charges and delivery delays arising from the attacks in the Red Sea). Budget 2024 provided for an increase in the R&D tax credit from 25% to 30% which should also encourage investment, as should any loosening of monetary policy.

Exports

2024 Exports Forecast, ROI: 3.5%

For export-orientated countries, the external environment matters. The outlook for ROI’s main trading partners is mixed; after greater-than-expected resilience last year, growth is set to slow in the US, whereas a pick-up is envisaged in both the Euro area and the UK in 2024.

At the sectoral level, agri-food and other ROI businesses that sell goods to Great Britain (and to the rest of Europe via the Landbridge) are facing new Brexit customs and regulatory checks, while pharma-chemical and information communication technology (ICT) firms are repositioning themselves in the post-pandemic world.

The reopening of the Chinese market is good news for the beef industry, however, and general prospects for key multinational sectors remain positive. These have undertaken significant investment in the past few years and as this comes on stream, and global economic conditions improve over the forecast horizon, export growth is expected to strengthen.

Northern Ireland

After flatlining in 2023, the NI economy is projected to expand in 2024. The Purchasing Managers' Index (PMI) was back in positive territory in December, signalling an expansion in private sector activity, and decelerating inflation will provide some respite for households over the coming months. Bank of England interest rate cuts are in prospect too, albeit the lagged transmission of monetary policy means the tightening that has already taken place in the UK and elsewhere will keep a lid on local and trading partner demand. Overall, the economy is forecast to grow by 0.7% this year.

As we write, the restoration of power sharing and a Stormont Executive has just taken place; an encouraging development for future investment. A package of measures designed to ease potential concerns over NI's post-Brexit status and ensure the smooth flow of goods moving within the UK's internal market has been published by the UK government, with a financial package, including pay increases for public sector workers, also on the table.

Northern Ireland strengths

Growing population	5.1% population change Census 2011 - 2021
Educated workforce	Highest Level of degree completion in the UK
Trading opportunities	Unique access to both Great Britain and EU markets for goods
Business friendly	1,200+ International companies already invest in NI

Source: Invest Northern Ireland, NISRA

> "The strength of talent in NI was a significant factor in EY's decision to generate 1,000 new jobs in the region over the next five years. Whether you are a school leaver, a recent graduate, contemplating a career move or indeed reengaging with the workforce, these positions are available to everyone, supported further by our plans to open a new hub in the Northwest.

Rob Heron
Managing Partner,
EY Northern Ireland

Inflation Prospects

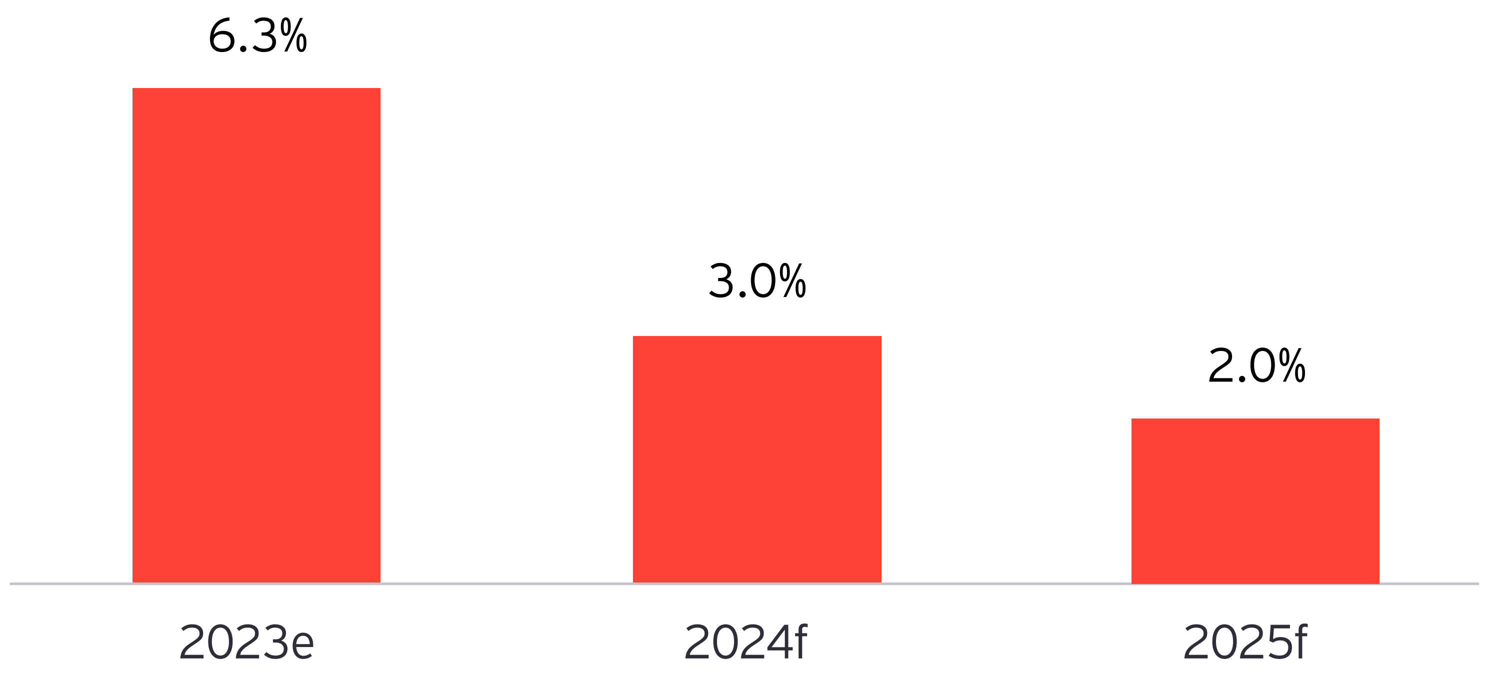
Inflation on the retreat

Headline inflation has eased significantly in ROI as the energy price shock triggered by Russia's invasion of Ukraine and other external pressures have waned. Underlying inflation which excludes food and energy was sticky through 2023 however, and services inflation which reflects domestic price pressures remained elevated as the year ended. The pass through of lower wholesale energy prices to retail prices is continuing – several providers have announced a fresh round of reductions – and with tighter monetary policy increasingly working its way through the economy, 2024 should see more broad-based disinflation.

Inflation has also come down in the UK, faster than initially anticipated. The EY ITEM Club has projected it will reach the Bank of England's 2% target in May, at which point interest rate cuts are expected to begin. The US Federal Reserve has already pivoted and a loosening of monetary policy by the European Central Bank is on the cards too, possibly come the summer. Currently Oxford Economics is pencilling in the second quarter for rate cuts in both.

Among the risks that could impact central banks' inflation forecasts, and our own, is a further escalation of the conflict in the Middle East leading to renewed energy market and prolonged shipping disruption.

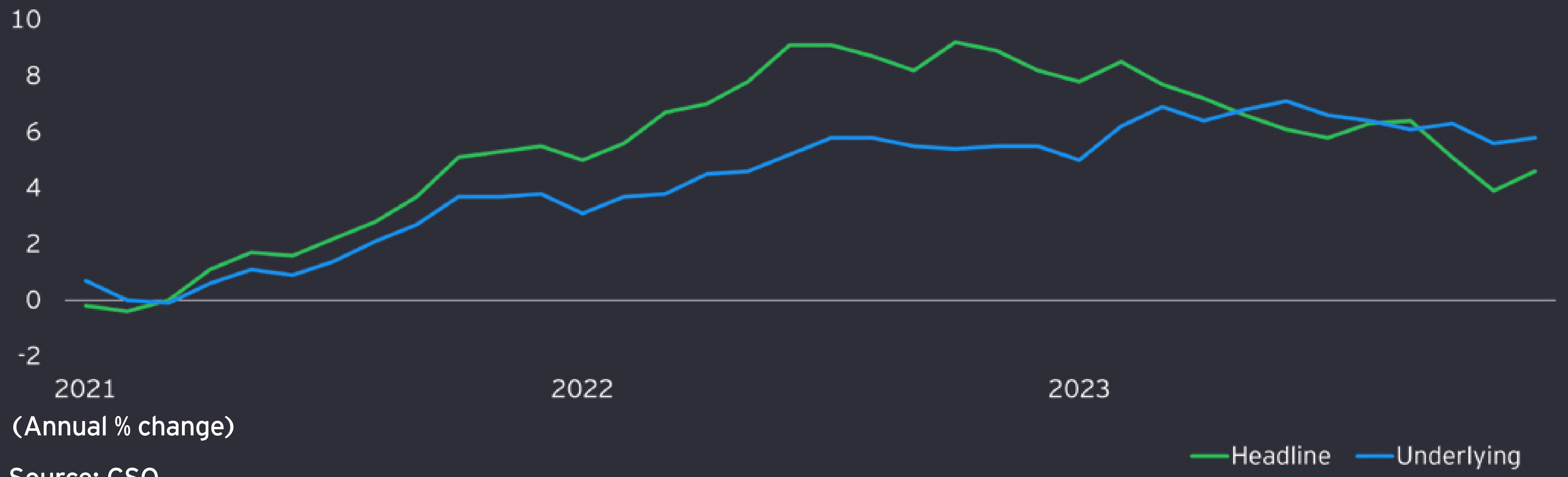
ROI Inflation Outlook



(CPI, annual change)

Source: EY Economic Eye

ROI Consumer Price Index



(Annual % change)

Source: CSO

Interest Rate Outlook

	2023	2024f	2025f
ECB	4.5%	3.0%	2.0%
BoE	5.25%	4.0%	3.25%
Fed	5.25% - 5.5%	4.5% - 4.75%	3.5% - 3.75%

(End year, ECB Refi, BoE Bank Rate, Fed Funds)

Source: Oxford Economics, EY ITEM Club

Labour Matters

Warm labour markets

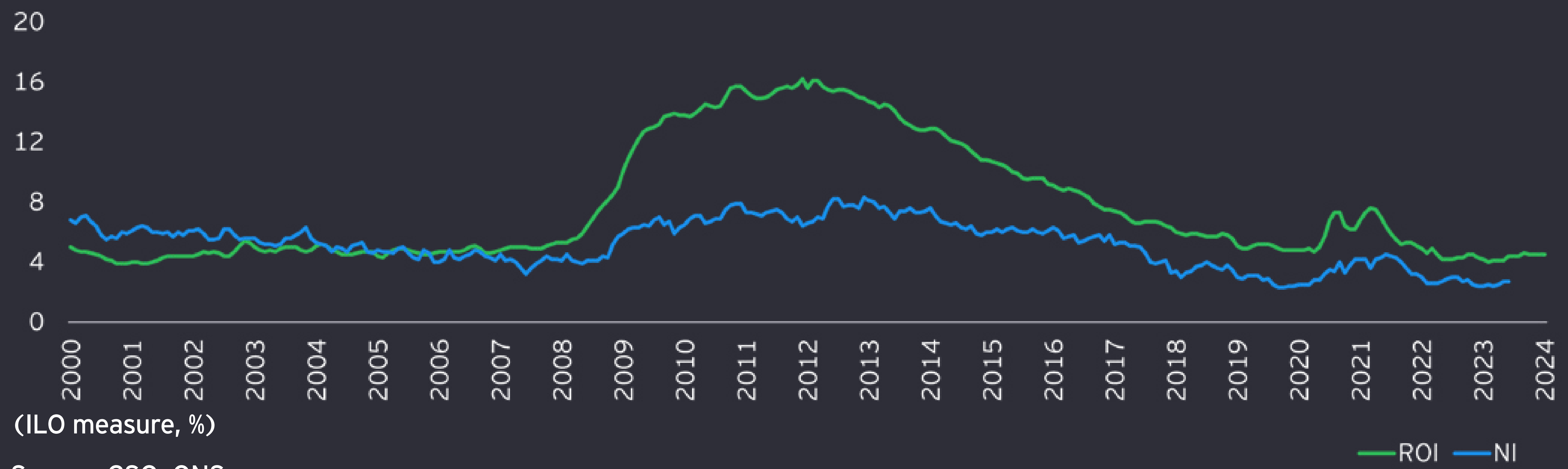
The two labour markets on the island put in a strong performance in 2023. The number of people in employment in ROI rose to a new high of 2.66 million, with all regions and most sectors registering gains in the year to Q3. Despite layoffs in some high-profile tech companies in recent times, ICT jobs were up over 10%. Foreign Direct Investment is continuing to provide support; more than 300,000 were employed by IDA client companies for the second year in a row. Workforce jobs in NI also posted a series high in the third quarter.

Signs of softening are beginning to emerge, however. The vacancy rate is tracking lower in ROI and the unemployment rate has ticked up, while the December PMI shows an easing in the pace of private sector job creation in NI.

As developments in the labour market typically lag those in the economy, some cooling is not surprising. But even though jobs growth is forecast to moderate in ROI and stall in NI in 2024, unemployment rates are projected to remain low by historical standards. So, recruitment and retention difficulties will be an issue for many businesses again this year.

The still tight labour market, along with some compensation for past inflation, also points to further wage increases. Agreement has lately been reached between the Irish government and public sector unions on a two-and-a-half-year pay deal, and the European Central Bank will be closely monitoring negotiated wage settlements in the wider Euro area over the coming months as part of its inflation risk assessment.

Unemployment Rate



(ILO measure, %)

Source: CSO, ONS

Employment Growth Outlook

	2023e	2024f	2025f
ROI	3.8%	1.6%	1.8%
NI	1.5%	-0.3%	0.9%

(Annual change, ROI Labour Force Survey, NI workforce jobs)

Source: EY Economic Eye, EY ITEM Club

Forecasts

Republic of Ireland

	2022	2023e	2024f	2025f
Consumption	9.4%	3.4%	2.9%	3.2%
Government Spending	3.5%	0.8%	0.8%	0.2%
Investment	5.1%	-10.5%	1.7%	2.2%
Modified Investment	15.9%	-3.8%	1.8%	3.0%
Exports	13.9%	-3.0%	3.5%	5.0%
Imports	15.9%	-3.2%	3.6%	4.5%
GDP	9.4%	-1.9%	2.2%	3.8%
Modified Domestic Demand	9.5%	1.2%	2.2%	2.5%
Jobs	6.6%	3.8%	1.6%	1.8%

(Annual change, GDP, MDD and components in constant prices)

Modified investment excludes R&D-related intellectual property imports and aircraft leasing

Source: EY Economic Eye, CSO

Northern Ireland

	2022	2023e	2024f	2025f
GVA	3.8%	-0.2%	0.7%	1.6%
Jobs	3.1%	1.5%	-0.3%	0.9%

(Annual change, GVA in constant prices)

Source: EY ITEM Club

Contact us

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