A person is rock climbing on the underside of a large, overhanging rock formation. The climber is wearing a red and orange outfit and is secured by ropes. Below the climber, a person stands on a rocky ledge, managing the ropes. The background shows a vast, blue sea with distant islands and mountains under a clear sky. The scene is illuminated by warm, golden light, suggesting late afternoon or early morning. A large yellow banner is overlaid on the left side of the image, containing text.

How people, prices, and planet will shape the all-island outlook

Economic Eye

Winter 2021 forecast

The EY logo, consisting of the letters 'EY' in a bold, white, sans-serif font, with a yellow triangle pointing upwards to the right of the 'Y'.

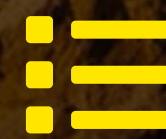
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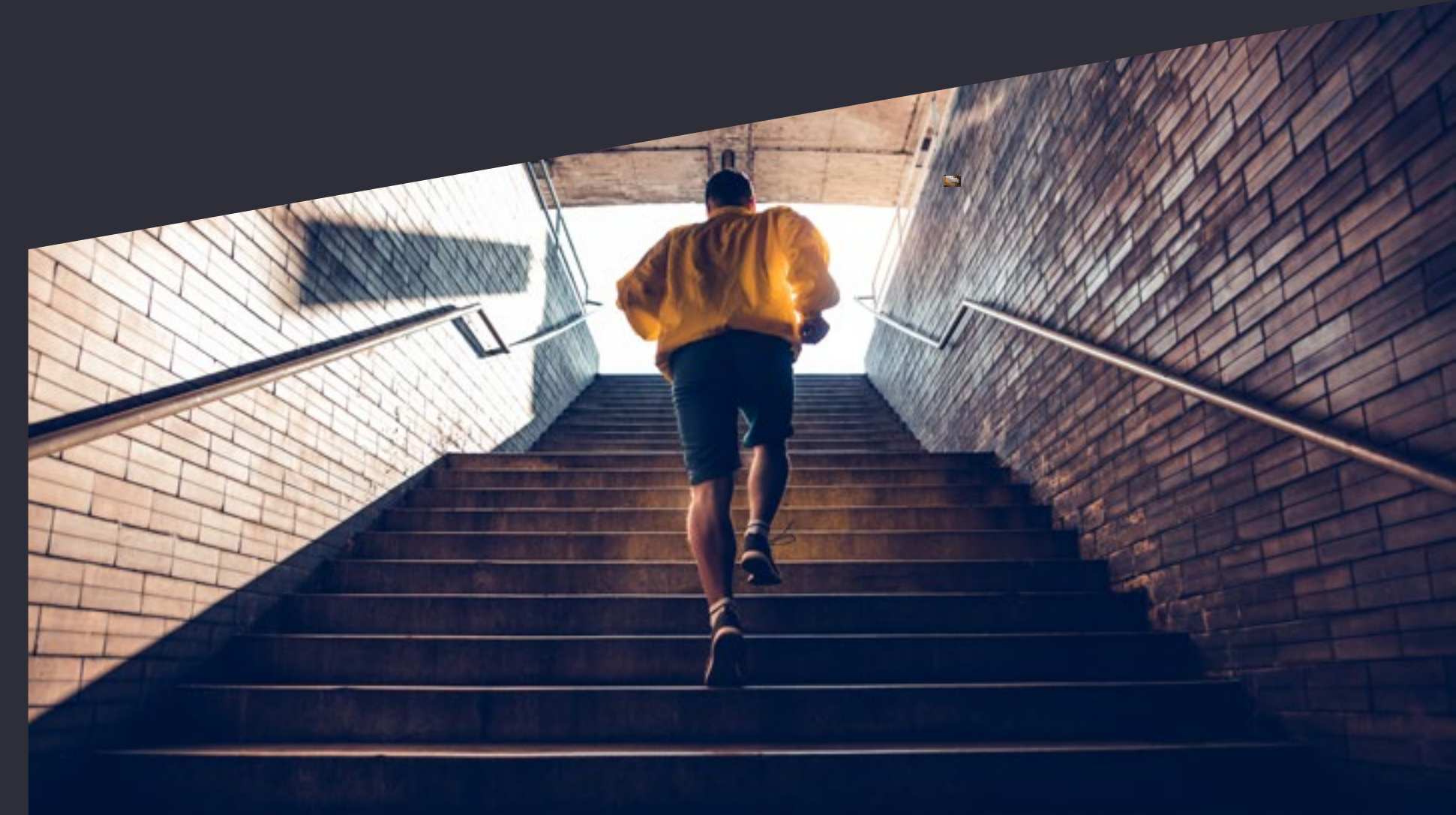
Executive summary

How people, prices, and planet will shape the all-island forecast

Resilience and adaptability allow all-island economy to surpass expectations

It is encouraging to report that the all-island economy is in much better health than expected as 2021 draws to a close despite the economic and societal headwinds of the past 21 months. The economic rebound has been quick and substantive to date, driven by a combination of well-timed policy responses and the ingenuity and flexibility of the business base. The economy is dealing with labour shortages and price increases exacerbated by high levels of demand. These problems can be viewed as consequences of success, but it does not make them any easier for businesses or policymakers to navigate.

The emergence of the latest COVID-19 “variant of concern” adds renewed uncertainty to the outlook as many unknowns remain about its severity and impact at the time of writing. The 2022 outlook for both the Republic of Ireland (ROI) and Northern Ireland (NI) have been revised upwards since our Spring report, with the labour market outperforming expectations. The pandemic has hastened a trend that has been gathering momentum – not all growth is equal. Purposeful growth that brings together economic, societal, and environmental development has become the goal for policymakers, citizens, and business leaders alike. The resilience and adaptability of the all-island economy will be tested further as the challenges of the “three Ps” – people, planet, and prices – move into sharper focus in 2022.



EY growth forecasts

	2020	2021	2022	2023	2024
ROI	5.9%	15.4%	5.9%	4.2%	3.8%
ROI MDD*	-4.9%	4.8%	5.4%	4.0%	3.0%
NI	-9.0%	6.0%	5.3%	2.1%	1.4%
UK	-9.7%	6.9%	5.6%	2.3%	1.8%

Source: EY Economic Eye, UK ITEM Club

*Modified domestic demand removes the impacts of IP relocation and aircraft leasing, giving a more accurate picture of the domestic economy.

Can the headwinds become tailwinds?

The headline economic performance may be better than expected, but not all businesses are booming. The ever-changing nature of the virus, supply chain disruptions, and rapidly increasing prices all present significant headwinds for many businesses. A strong labour market recovery amid a slowdown in migration also means that many businesses are struggling to attract and retain talent.

The economic outlook appears much more daunting when these short-term challenges are coupled with the necessity to transform towards a more sustainable future. The evidence of the past 21 months has shown that the organisations that can turn these challenges into opportunities will achieve unparalleled success. Finding talent in new places, deploying technology to mitigate price increases, achieving sustainability goals through innovation, clear leadership and targeted investment are all traits of businesses that have thrived in these uncertain conditions.

The key question for the wider economic outlook is whether a sufficiently broad cohort of businesses can be a part of this transformation.

Policy plan remains ‘grow faster’

Both the UK and ROI budgets emphasised the need to keep public spending levels high to tackle ongoing pandemic issues and to accelerate efforts to address major societal, environmental, and economic challenges. Climate change and housing were the two most prominent issues set out in the ROI and UK budget speeches. It was evident that the key policy choice is to raise taxation to meet spending rather than curb spending to match income. There were no widespread austerity measures put in place across either economy despite the levels of borrowing incurred due to the pandemic.

However, the UK did introduce two major tax increases to begin to rebalance public finances and facilitate sustained elevated levels of public spending, increasing both national insurance and the headline corporation tax rate. In ROI, strong levels of growth and tax receipts have safeguarded against any immediate tax rises for the time being. However, the OECD global tax agreement will modestly increase the corporation tax rate.

Reassessing risks is an imperative

Given the outperformance of the all-island economy, it may seem pessimistic to warn of complacency as a risk to economic growth, but as the emergence of the new variant demonstrates, it is important not to take the strong recovery for granted in 2022. The availability of a seemingly endless supply of public money to deal with the pandemic, the assumption by most economists that inflation will be temporary, and the availability of low-cost finance are all open to challenge.

The public finances will need to be repaired, particularly if interest rates rise sooner rather than later. Traditionally, technology, global competition, and labour supply would keep prices muted. However, these assumptions are now being challenged as wages are rising and consumers are becoming more conscious of the ethical and environmental standards suppliers are following. Growth is always hard earned. The ingenuity and adaptability that has been evident across the island economy will be required again. As scientific evidence shows, there is very little calm to be found after the storm, but at least the economy faces the challenges from a stronger platform than was predicted.

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Businesses, governments, and citizens across the island have shown remarkable adaptability and resilience that has put the two economies on a stronger platform from which to build. However, the continuously evolving pandemic, and new challenges relating to talent and rising prices mean that these traits will be required again in 2022.



Graham Reid
Head of Markets
EY Ireland

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Perhaps it is time to ask whether many long-held macro assumptions are still valid. Will inflation and interest rates be forever low, will labour always be readily available, and will governments always be able to borrow what they need to support the economy?



Professor Neil Gibson
Chief Economist
EY Ireland

Economic outlook

Global outlook

Are rising prices impacting the recovery?

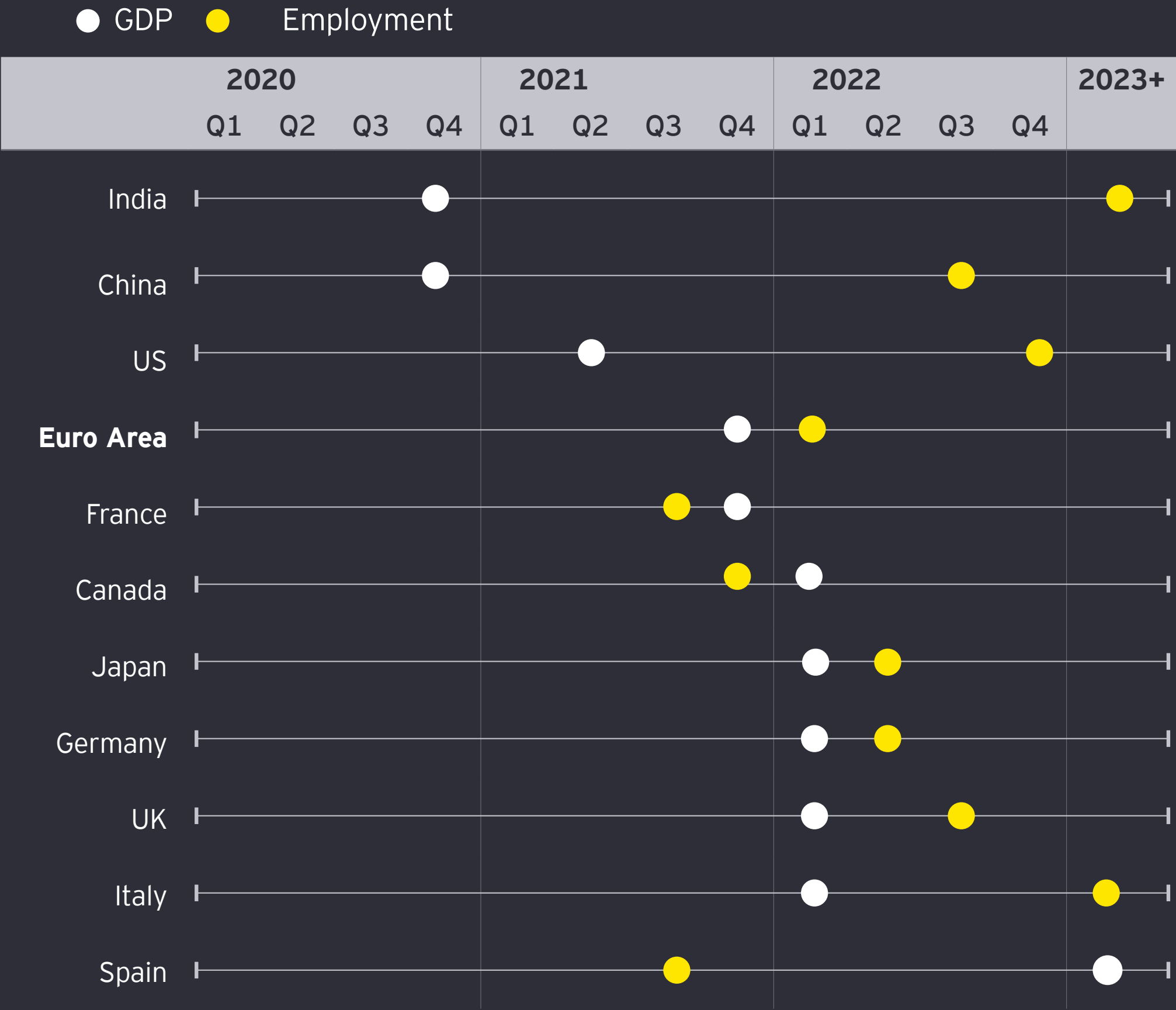
Global forecasts have followed an unsettled trajectory throughout 2021 and although widespread growth is anticipated, it can be largely attributed to the major global contraction in 2020, which created a “bounce-back” effect thereafter. Recovery has taken longer than initially expected, hampered by a wide range of factors such as surges in COVID-19 cases, re-imposition of public health restrictions, rising prices, and global supply chain disruptions. This has resulted in a reduction in overall global output and a recent downward revision of forecasts for most major economies. The news of the latest COVID-19 variant may lead to further downward revisions to the outlook for next year. Labour market disruption, particularly in the services sectors, means that employment recoveries will be more sluggish than headline growth, although the strength and resilience of labour markets is one of the defining features of this period.

GDP forecasts – key markets

	2020	2021	2022
World	-3.4%	5.6%	4.5%
China	2.3%	8.1%	5.1%
India	-7.3%	9.4%	8.1%
US	-3.4%	5.6%	3.7%
Canada	-5.3%	4.8%	3.9%
Japan	-4.6%	1.8%	3.4%
OECD average	-4.7%	5.3%	3.9%
France	-8.0%	6.8%	4.2%
Germany	-4.9%	2.9%	4.1%
Italy	-9.0%	6.3%	4.6%
UK	-9.7%	6.9%	4.7%
Spain	-10.8%	4.5%	5.5%

Source: OECD Economic Outlook, December 2021

When will economic activity return to pre-pandemic levels?



Source: Oxford Economics, EY analysis
Note: Quarter in which GDP and employment are expected to return to Q4 2019 levels

In the second half of 2021, the future path of inflation and interest rates has dominated global economic debate. The Eurozone is experiencing its highest inflation rate in a decade and the US recently recorded its highest rate in over 30 years. There is no longer a consensus about price increases being transitory and, consequently, the expected timelines for interest rate hikes have been brought forward in most major economies.

The pandemic has been the primary driver of the spike in inflation levels. Base effects from the fall in prices at the peak of the first wave in 2020 are the largest factor that led to the recorded increases. The synchronised rebound across the globe has driven up energy prices and the significant disruptions in supply chains following the outbreak of the pandemic have also impacted prices. However, not all price increases in global markets can be attributed to COVID-19. Antiquated infrastructure and labour shortages have also played a role in many of the world’s largest markets, resulting in longer delivery times and higher costs.

The period of price fluctuation, supply chain weaknesses, and an increased focus on environmental and ethical issues are leading to significant transformations of supply chains and investment strategies, which could further drive prices up for consumer goods.

Opinions diverge on whether this period of price increases will be temporary or become more persistent. The new variant of the virus presents downside risks to employment and growth and increases uncertainty over inflation, according to US Federal Reserve Chair Jerome Powell. Oil prices fell initially on the news of the new variant, but it is difficult to say what impact it will have on energy prices in the medium term until there is more data on its severity, transmissibility, and ability to evade vaccines. If the pace of growth slows, interest rate rises may be delayed in the US and the UK. A fall in consumer confidence and, consequently, spending, may also quell short-term inflationary pressures. However, pandemic-related supply chain disruptions may be exacerbated, leading to price increases.

Long tail of the pandemic slows recovery

As we enter the final month of 2021, uncertainty and volatility levels have increased. There is renewed pressure on policymakers to act decisively in the best interest of citizens, but there is no consensus yet on the best approach. Government support and fiscal packages may be required once again should activities be curtailed to minimise permanent business closures and unemployment but will serve to further increase national debts. Further interventions are likely to be focused on individuals and businesses that have been most impacted.

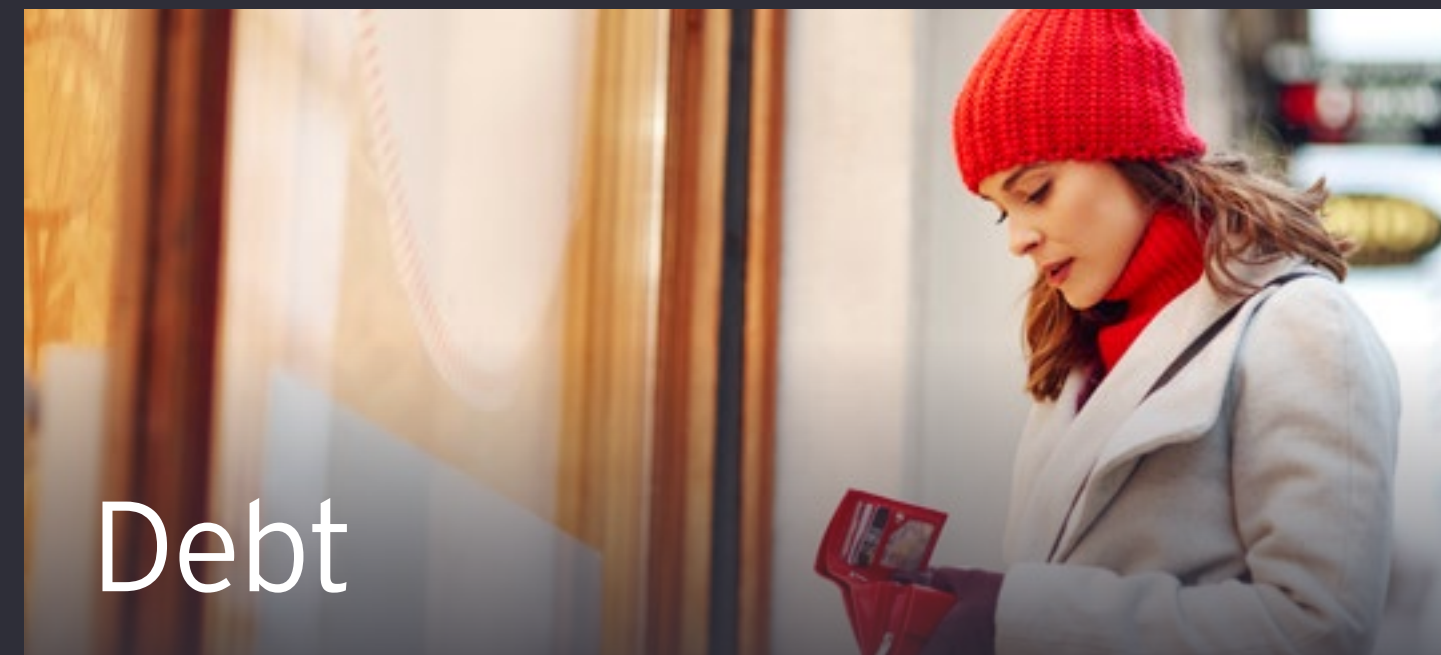
Booster campaigns are being rolled out in advanced economies, but low-income economies face a worsening outlook as poor access to vaccines leaves the vast majority of populations vulnerable and there is little or no policy support to mitigate the economic effects of the pandemic. COVID-19 remains the most significant downside risk to the short-term forecast for most markets.



Risk overview for key markets



The outlook is always uncertain, but the scale of variance in the growth scenarios for most major economies is much greater than normal. An impossible to predict virus and continued reliance on consumer spending means that businesses need to prepare for a much wider range of possible outcomes. Differing interest rate policies, shifting attitudes to debt, and COVID-19 impacts are likely to lead to greater divergence in economic performance in 2022.



Debt levels have risen sharply, driven by a sustained need for government spending and a recovering tax base, but are not gathering the attention that might be expected given how much they have expanded. Pandemic spending was necessary and seen as temporary. However, if further policy supports are required, combined with potential interest rate rises, government debts may become more difficult to service and attract more scrutiny over plans to address the problem.



The timing and pace of interest rate rises are likely to be the dominant economic story heading into 2022. The evolving nature of the virus and the impact of rising prices are already beginning to impact forecasts, which are being revised down modestly in most markets. This may cool the pressure for rate rises, but central bankers will try to balance hard evidence of higher prices today with uncertain projections over future prices.



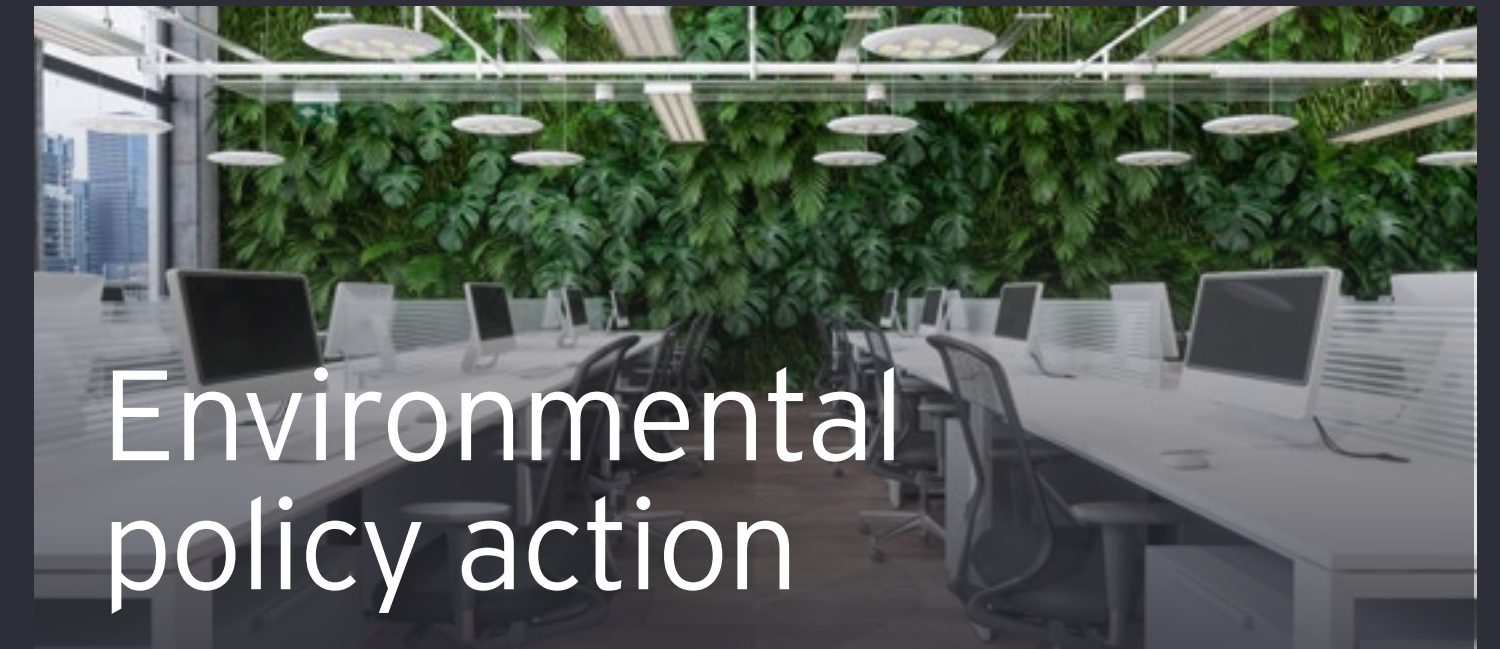
Exchange rate risk

There is an increasing possibility of greater exchange rate movements due to pandemic-related uncertainties and divergent interest rate policy trajectories. Higher rates can be expected to lead to appreciation in the dollar and sterling, but a range of other factors make it likely that currency volatility will be higher in 2022 than in either of the previous two years. This would have a disproportionate impact on emerging markets which rely largely on the dollar for their borrowing, making debt repayments more expensive.



Risk to consumer confidence

Despite a very difficult time globally, consumers appear remarkably resilient and willing to spend in alternate ways which has helped accelerate the pace of economic recovery in many markets. The recent trajectories in house prices, second-hand cars, and demand for entertainment and travel, point to a lower level of scarring or fear than might have been expected. Although prices have been driven by demand and supply imbalances, the queue of willing customers could not have been predicted. Looking into 2022, there is a risk that consumers could lose this sense of confidence if the resurgence of COVID-19 suggests a more challenging future than they had anticipated. This presents a material risk to the pace of the global outlook.



Environmental policy action

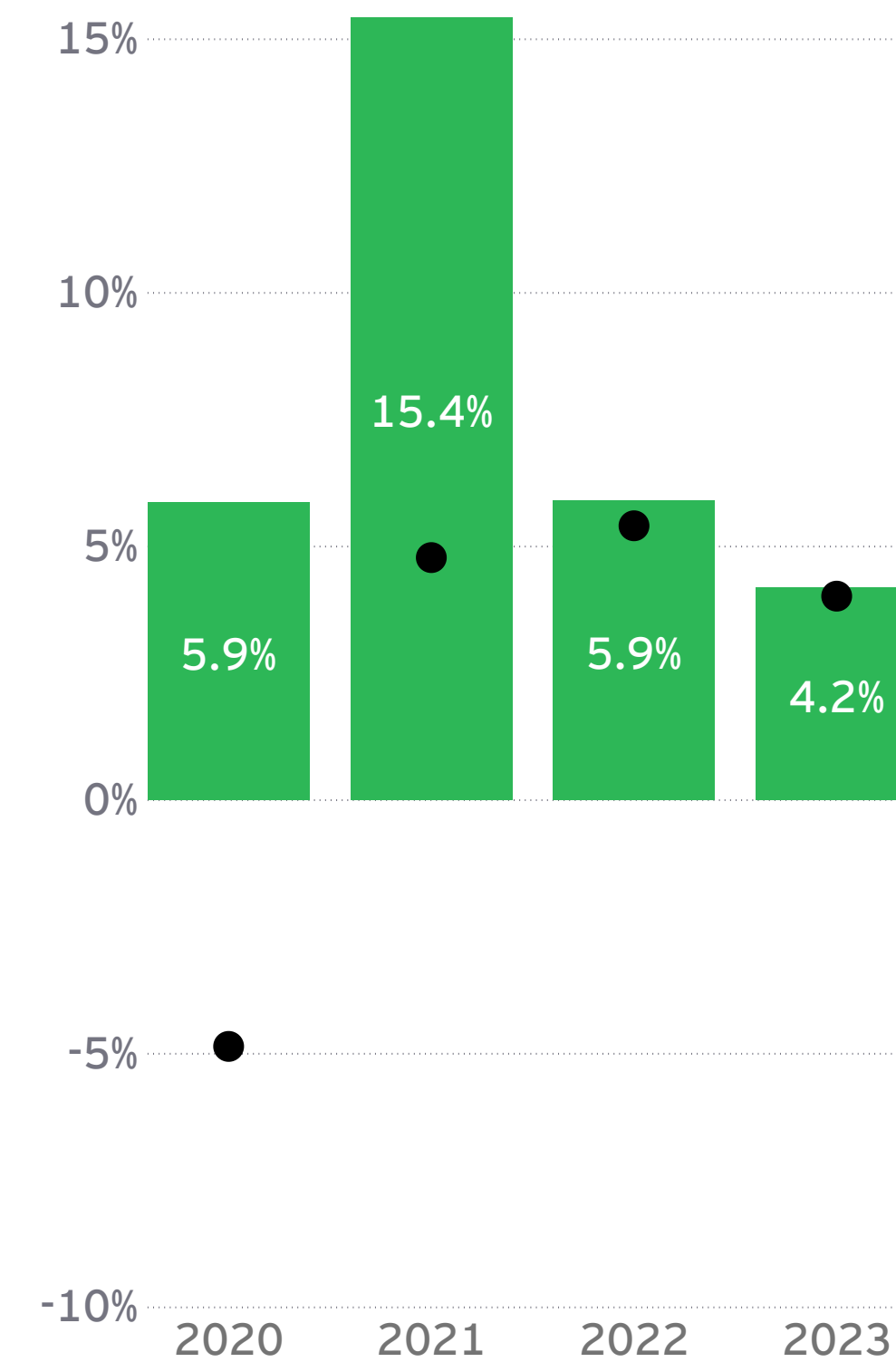
The economic impact of climate change is coming into sharper focus. Once viewed as a longer-term risk, climate action has become more immediate as scientific evidence weighs heavily on policymakers. There has been little sign of a weakening economy derailing plans to accelerate environmental progress, but the greatest test to this resolve may come in 2022. Sustained high energy prices and a slowdown in growth will pose social and economic challenges that may make many of the recent global pledges more difficult to honour. Most developed markets have locked in many of their policy plans, but the lengthy debate over the approach to burning coal that occurred at COP26 is a reminder that change is harder in practice.

Macro outlook

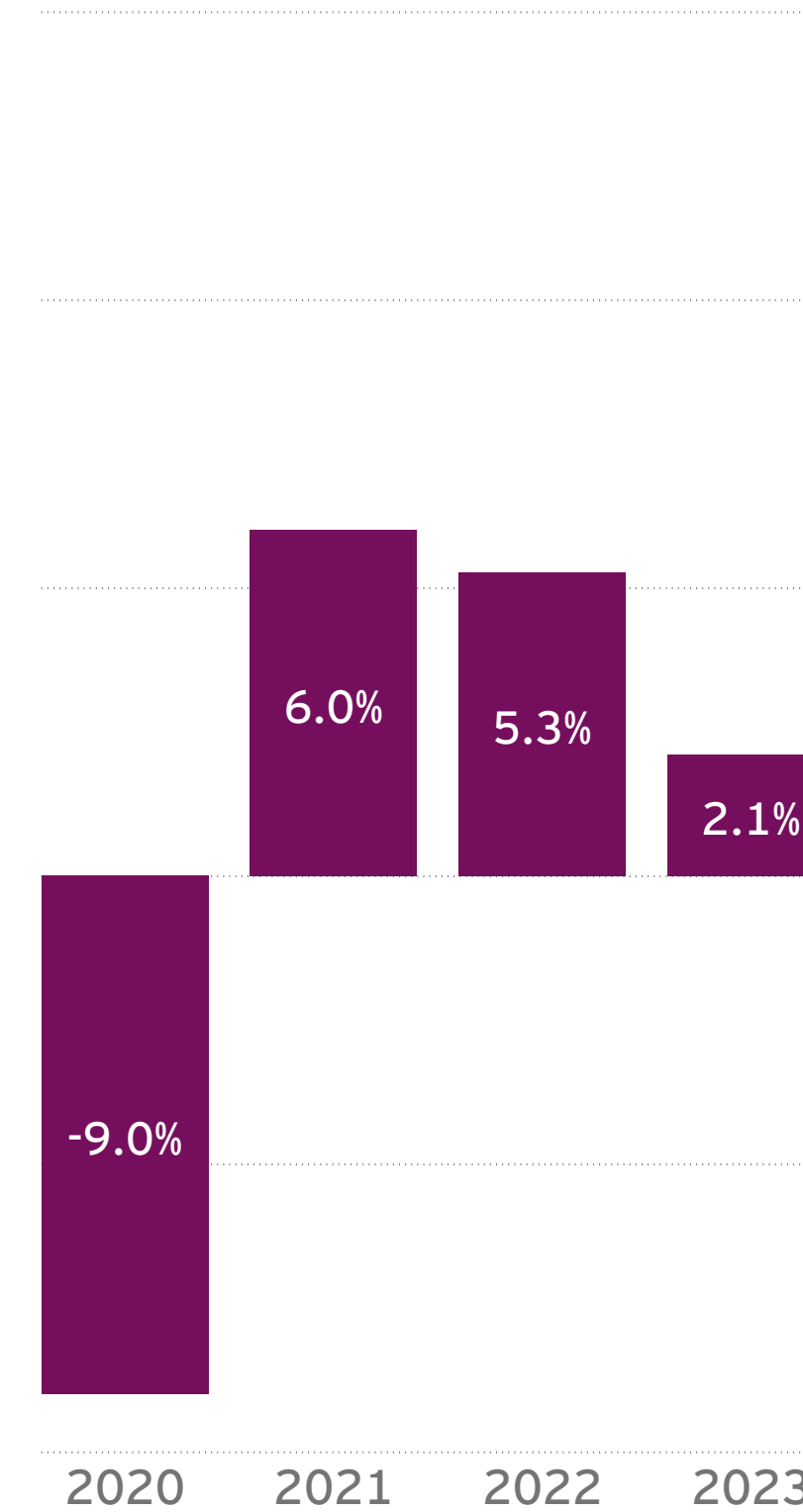
EY growth forecasts for ROI, NI and UK (2020-2023)

Republic of Ireland

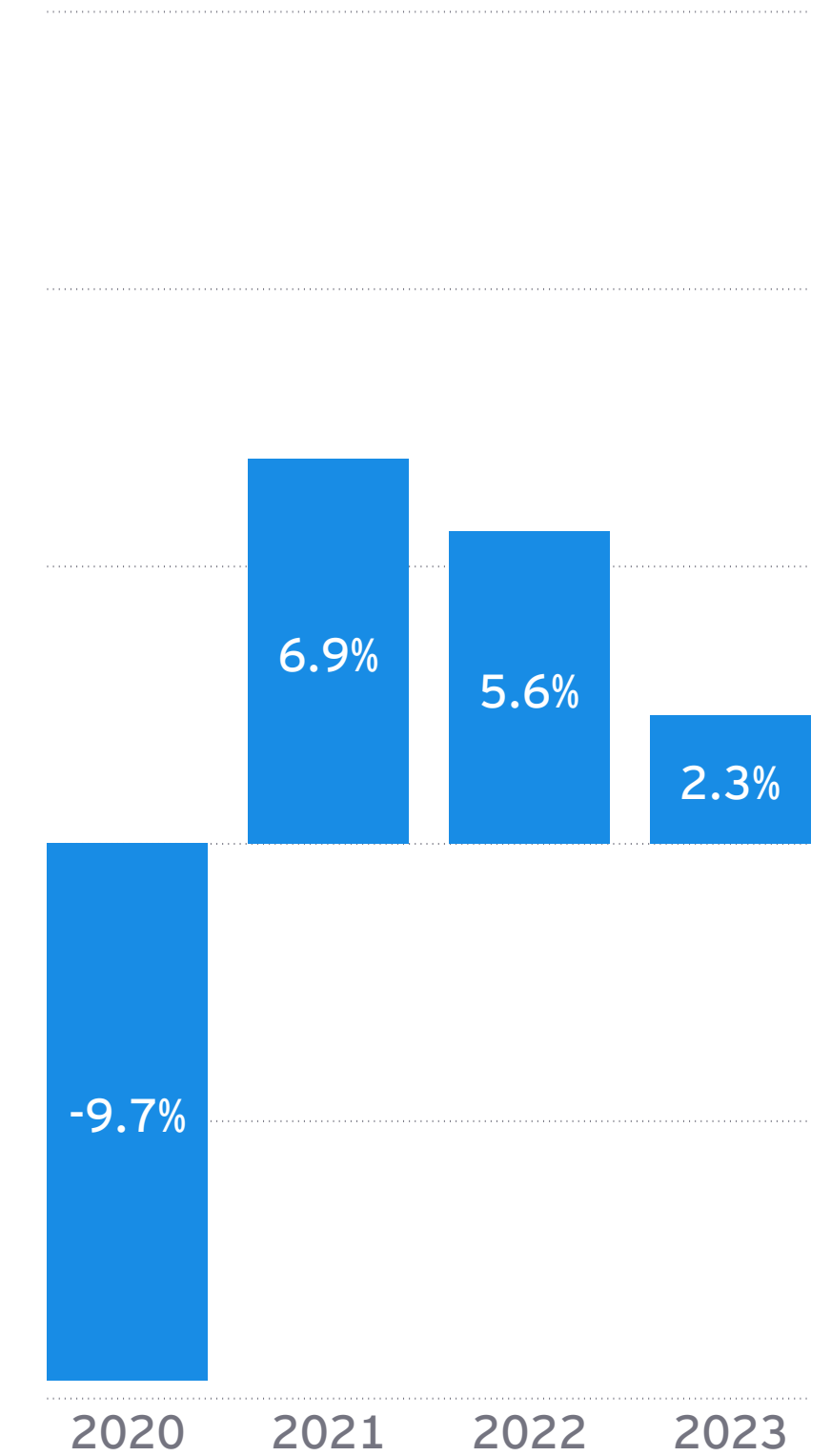
● ROI ● ROI MDD*



Northern Ireland



United Kingdom



Source: EY Economic Eye, UK ITEM Club

*Modified domestic demand removes the impacts of IP relocation and aircraft leasing, giving a more accurate picture of the domestic economy.

Republic of Ireland

The headline GDP figure for ROI continues to be an unreliable measure of performance. The 15.4% projected for 2021 will comfortably top the global charts again but remains heavily distorted by international flows of intellectual property (IP) and contract manufacturing. Modified domestic demand, which is a better reflection of the internal economy, is projected to grow at 4.8% this year and 5.4% in 2022 - a robust recovery and a slight upward revision from our Spring forecast. Debate over the validity of GDP as an economic growth measure can detract from the assessment of the overall macroeconomic situation, which is evidently significantly more favourable than it was in the aftermath of the last major global financial crisis. Tax receipts are comfortably ahead of projections and, consequently, government borrowing, though amongst the highest in the world on a per capita basis, has not risen at a rate that would alarm the markets.

The sharp rise in general inflation and a worrying acceleration in house prices present fresh challenges for the ROI economy. The accumulation of savings and a continued demand-supply mismatch means that property prices are likely to keep rising. Inflation rose above 5% during Q4 and is not projected to peak until early 2022. The inflation trend will act as an intensifying headwind for consumer spending. It may also add to existing social tensions and a growing disconnect with headline economic performance, particularly for those on lower incomes. The refreshed National Development Plan 2021-2030 (NDP) and the need to address challenges in housing, health, and climate change suggest that public spending, which rose sharply during the pandemic, will not recede over the forecast. Strong growth will be required to avoid tax increases to keep the public finances on track. Unlike in the UK, there is little prospect of any immediate increase in the cost of borrowing, although that may change if inflation does not promptly settle back to a lower level across the EU.

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The ROI economy is ending 2021 in a strong position, but faces challenges resulting from this positive performance. Increasing prices, wages and housing costs are each at least partially a function of strong demand. This may make them problems of success, but they still present significant risks to the forecast.



Professor Neil Gibson
Chief Economist
EY Ireland

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The potential for NI to offer a ‘best of both worlds’ proposition to investors is an intriguing prospect. There is still too much uncertainty to confidently project such a future, but the level of investor curiosity indicates that developments are being monitored carefully.



Simon MacAllister

Partner and Brexit Lead
EY Ireland

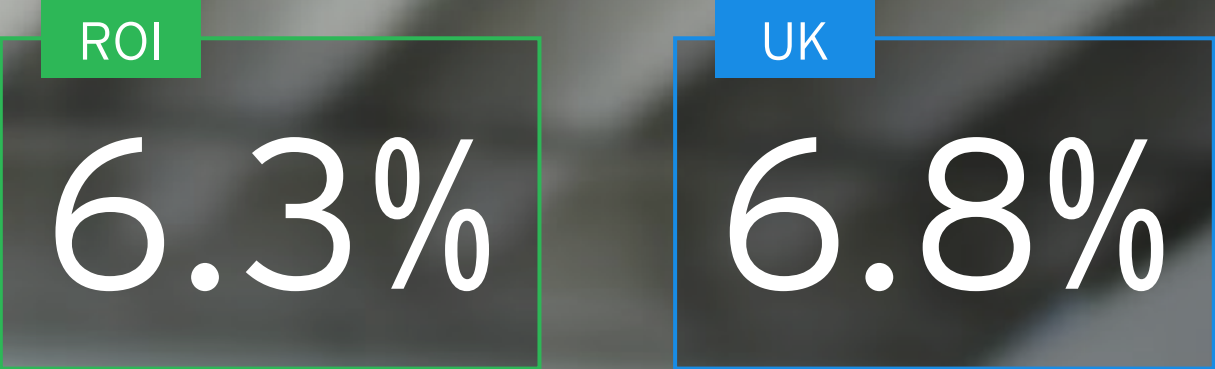
Northern Ireland/UK

NI does not have the same headline grabbing GDP figure for 2021. However, like ROI, its economic situation is better than projected heading into 2022. Unemployment has remained relatively low and strong headline economic growth is expected. There are further downside risks from geopolitical factors and interest rate increases. Tensions surrounding the Northern Ireland Protocol and its impact on NI trading patterns and availability of products remain extremely high at the time of writing. There is a strong desire amongst the business community to find a solution that does not escalate tensions further.

NI is heavily dependent on government and consumer spending, and although both are set to increase, there are risks from the escalation of prices. The extension of government supports, and the long tail of the pandemic means that headline growth is projected to stay above trend in 2022 before reverting closer to its long-term path by 2023.

Consumers

2022 Consumption forecast



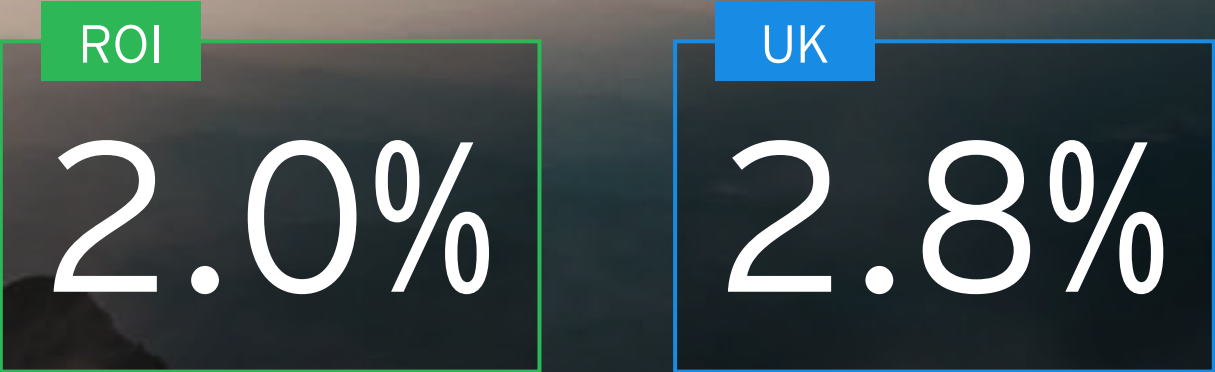
Price increases may dampen consumer spending

Consumers play a more significant role in NI's overall growth than in ROI, but their experience is crucial in both economies. The ability to win elections is partly impacted by how voters experience the economy. Employment and wage levels that drive consumer spending power are much more impactful than GDP growth figures in this regard. Consumer spending trajectories across the island have been much more similar than headline growth figures indicate. Labour market data is complicated by the various pandemic support schemes, but the combination of the relatively high level of Pandemic Unemployment Payment (PUP) in ROI and the success of furlough in NI appears to have protected employment and incomes well.

Both economies have recorded significant increases in domestic savings, although there is evidence from the UK that the profile of this increase is heavily concentrated on retirees and high earners. These elevated savings should sustain a strong period of consumer spending growth. However, money will not be spent as quickly as it was saved. With sharply rising prices and the partial reimposition of restrictions on travel and hospitality, there is likely to be a deceleration in spending. Data from recently reopened activities suggest a strong desire for citizens across the island to get out and spend. This may be relatively insensitive to price increases initially but is likely to be short lived. The cost of fuel will be a major topic of debate this winter and policy focus will narrow to the societal implications of a rising price environment. In NI, the potential for interest rate increases, albeit modest ones, may also dampen spending and property price growth.

Government

2022 Government spending forecast



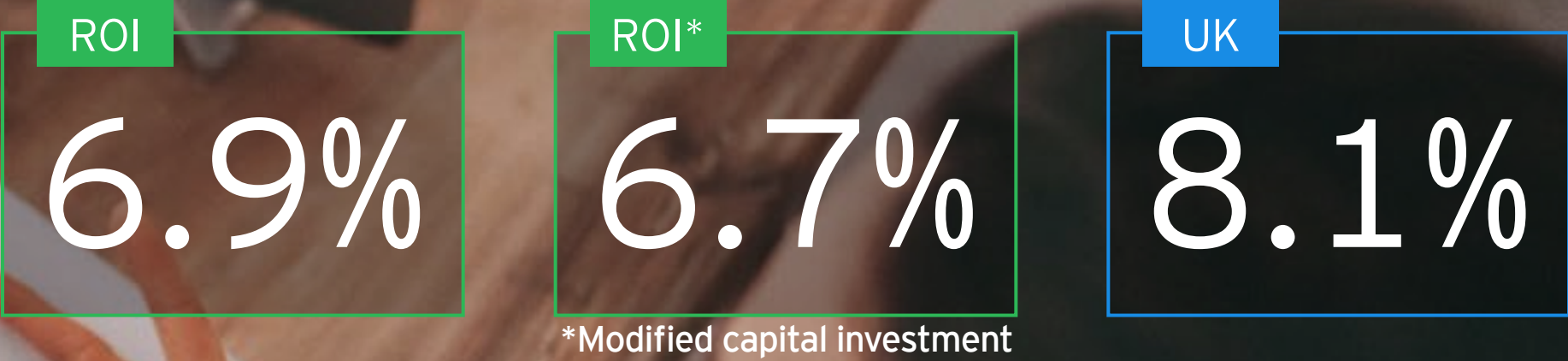
Government spending set to stay high

Governments in the UK and ROI show no signs of moving into counter-cyclical mode or tapering spending as the economy grows rapidly. This has been gently pointed out by the Fiscal Council in ROI and the Office for Budget Responsibility (OBR) in the UK. Economic theory suggests that easing government spending at a time of fast growth avoids inflationary pressures and facilitates the accumulation of resources for tougher times ahead. However, government spending has both a political and societal dimension – it is not purely an economic exercise. As the pandemic continues to disrupt and the need to tackle climate change, transform healthcare, modernise infrastructure and recover lost education has become increasingly clear, it is easy to see why government policy does not feature counter-cyclical restraint. In ROI, a record level of tax receipts in November will add confidence that the current spending policy is both working and affordable.

Rising costs of servicing government debt due to the increase in inflation will draw greater attention to spending levels in 2022. Corporation tax rises are coming for UK and NI businesses, and there have been UK tax increases for workers through the upward move in national insurance rates. The OECD global minimum corporation tax rate is not expected to raise more government revenue in ROI due to the partial movement of taxation to the market in which services or goods are consumed. The forecast for government spending across the island is modest in 2022, but it is important to note that this indicates sustained elevated spending levels that are not being unwound.

Investment

2022 Investment forecast



A clear need for investment but costs a concern

Investment data in ROI is heavily distorted by IP flows and, as such, underlying modified capital investment is a more helpful indicator and a closer comparator to investment data in other economies. The forecast for modified capital investment in ROI and investment in the UK suggests 2022 should be a strong year for both economies. Housing demand is robust despite a slowdown in migration, bolstered by the retrofitting of properties to meet new ways of working and environmental standards. Long-term prospects for the island are positive when considered from the perspective of need, but the escalating cost of materials and labour presents a significant challenge to the investment outlook.

The potential increase in borrowing costs in the UK in 2022 is a further slight headwind for NI. The volume of investment may be lower than expected even if spending levels increase due to rising prices. Consequently, the investment forecast may fall short of projections. Business investment in the UK has been very low for a protracted period and even lower in NI, albeit according to very dated information. Therefore, the need for a considerable level of necessary or essential investment should underpin a relatively robust outlook.

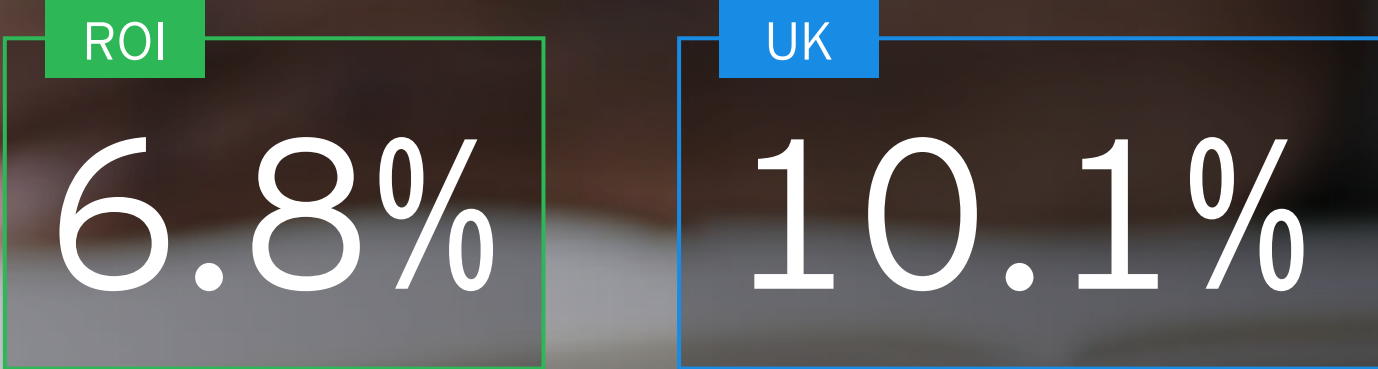
Trade

Trade disruption set to extend into 2022

Trade flows have been hugely impacted by the pandemic. Supply chain disruptions continue to influence trade performance globally, but their eventual resolution should provide a boost to trade later in 2022 and into 2023. Export and import forecasts are above the long-term trend in both the UK and ROI, reflecting the period of normalisation that will extend well into next year. ROI’s strengths in pharma, ICT and agri-food have provided a much more robust demand profile during the pandemic than in the UK, which has a higher concentration of transport equipment and materials.

Brexit has been a further disruptive factor in ROI and NI trade, although it is difficult to unpick this impact from the pandemic. Evidence points to significantly higher cross-border trade levels on the island post Brexit, while trade between ROI and GB has been less affected. However, there are issues with country classifications that may amplify the cross-border effects. The material changes to trading patterns are a major point of focus in the ongoing Protocol discussions, the outcome of which will impact trade forecasts for the island. ROI growth in exports should moderate slightly from the heights partly driven by the pandemic, but the outlook remains robust, particularly as global growth is projected at over 4% in 2022.

2022 Exports forecast



2022 Imports forecast



Labour market outlook

Policy support, resilience, and strong demand aid labour market recovery

The resilience and swift recovery of the ROI and NI labour markets are arguably the most striking features in the available economic data. The latest data indicates that the labour markets in both economies are almost back to their pre-pandemic levels, albeit there needs to be some caution when relying on any single data source. However, recent restrictions on hospitality in ROI would be expected to slow the overall rate of employment growth in the short term. The reintroduction of Government support in ROI should provide a level of income protection and labour market security as it did previously.

The latest NI data suggests that the unemployment rate rose marginally from 3.8% to 4.0% in Q3, but it is still too early to confirm if the furlough scheme, which concluded in September 2021, has served its intended purpose, although the signs are very encouraging. The final NI furlough recipient figure was 26,000 from an estimated peak of 200,000, indicating a significant decrease in reliance on the scheme by its close.

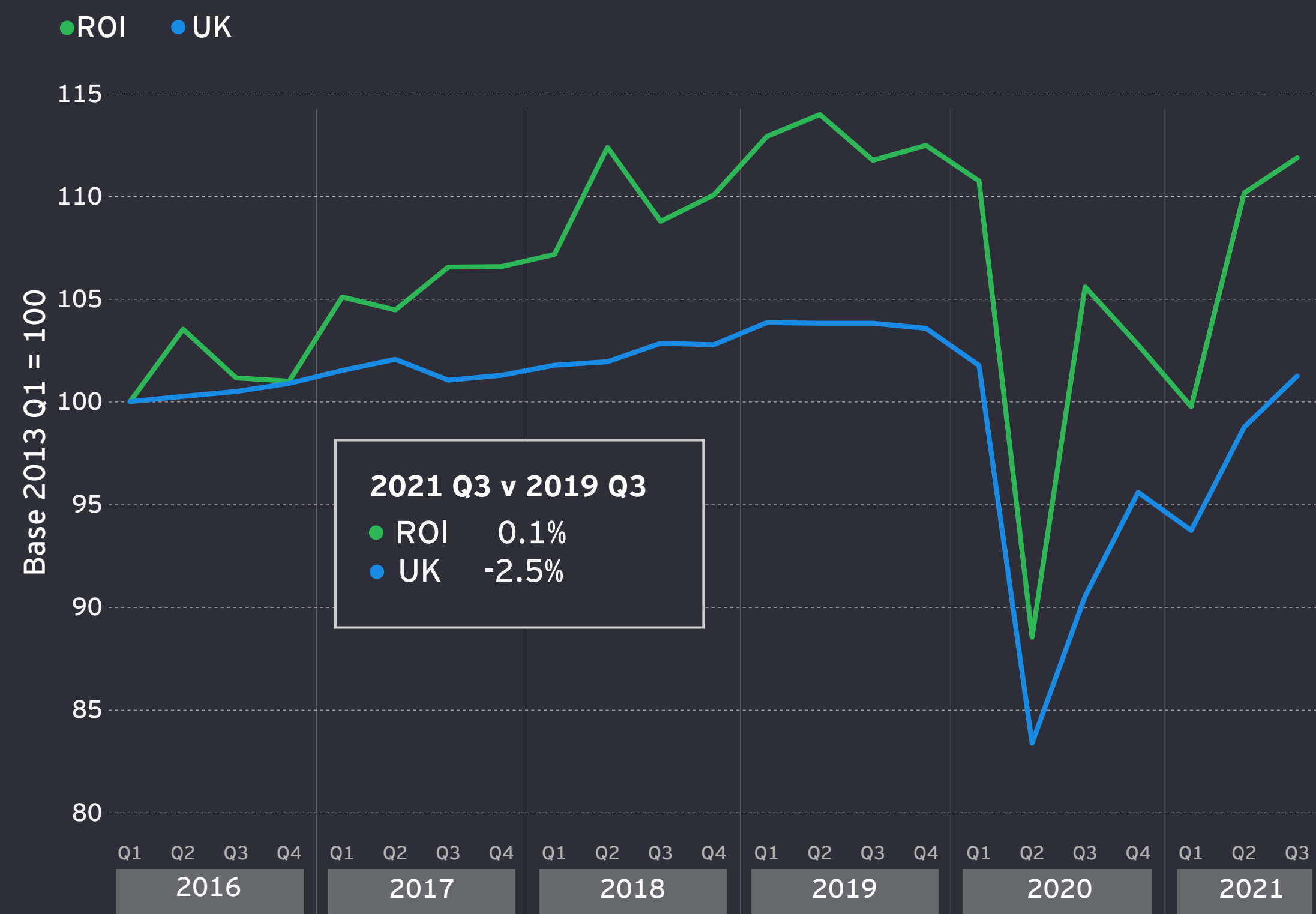
Despite overall employment levels being relatively flat over the last year, the Labour Force Survey (LFS) data for NI indicates that the composition of the labour market has changed markedly. There was a sharp 20% fall in the number of self-employed people over the last year, in contrast to a 3% increase in employee jobs, which may partly indicate that self-employed people are moving into employee jobs.

EY employment forecast

	2020	2021	2022	2023	2024
ROI	-2.8%	6.1%	4.2%	1.6%	1.5%
NI	-0.9%	-3.1%	2.1%	1.0%	0.6%
UK	-1.8%	-0.2%	1.7%	1.1%	0.7%

Source: EY Economic Eye, UK ITEM Club
ROI Labour Force Survey, UK, and NI workforce jobs

Total actual weekly hours worked ROI and NI



Source: CSO, ONS
Note: Total hours worked for those in employment measured by the LFS

ROI’s labour market added 122,100 jobs in Q3 2021 (unadjusted), surpassing expectations, and leaving overall employment at record highs. Notably, Accommodation and Food added 56,000 jobs, or 46.2%, in the quarter in which hospitality fully reopened. All sectors are at or nearly at their pre-pandemic employment levels with the exception of Arts and Recreation and Administrative services. Despite the overwhelmingly positive aggregate job growth, the pandemic-induced disruption has caused labour market measurement issues and there is need for caution when interpreting the figures. For example, there are currently over 300,000 people, or 12.3% of total employment, counted as employed but absent from work. This figure likely includes those temporarily laid off due to the pandemic and is about 86,000 above pre-pandemic levels, suggesting a slower recovery in the labour market than the headline figure indicates.

The complexity in the data arises due to measurement issues in official employment surveys across the island. People may still be counted as employed even if they are on PUP in ROI, while in NI some of those counted in the workforce jobs figure may not be working any hours. For example, in ROI, LFS employment fell by 2.8% in 2020, COVID-19 adjusted employment fell by 18.2%, and hours worked fell by 9.6%. Estimates of the true fall in employment during 2020 is likely to lie somewhere in the middle of the official rate and the hours worked. Overall weekly hours worked for ROI are back to their corresponding 2019 levels and in the UK, they are almost back to peak - another positive indication of a recovering labour market that points to a stronger job forecast in the year ahead. However, the latest restrictions on hospitality, a worsening disease trajectory, and further business disruption during the winter present significant downside risks to the forecast.

Tighter labour market and rising prices may drive wage inflation

EY wage forecasts (% change)

	2014-19 average	2020	2021	2022
ROI	2.3%	5.2%	4.3%	4.5%
NI	3.1%	-0.2%	7.1%	2.4%

Source: EY Economic Eye

EY Economic Eye forecasts a 4.2% rise in ROI employment in 2022, largely driven by the exceptionally strong 2021 rebound. The rate of job growth will slow through 2022 as those absent from work return, consumer spending growth moderates early next year, and there are less people available for organisations to hire. Encouragingly, there will continue to be diversity in employment success across the island, with job growth expected in a broad range of sectors, including Industry, Public and Professional services.

Ascertaining a clear picture of earnings is also challenging for similar data measurement issues. Wages were steadily increasing by 2% to 3% on average per year across the island up to 2019, but that changed in 2020 with strong growth in ROI and a much more muted increase in NI. This difference is partly due to the impact of the furlough scheme in place in NI, keeping employees subsidised on the payroll. ROI’s PUP scheme meant that fewer lower paid workers remained in official employment throughout 2020 and overall average pay increased due to higher paid workers making up a larger share of the overall employment base. ROI average earnings increased by 5.4% in the year to Q3, while the UK increased by 5.8%. Monthly PAYE data shows that NI median earnings rose by 4.2% in the year to October 2021 and by 4.9% in the UK. The consensus on earnings is far from established as data from a range of recruitment agencies shows more muted wage increases than the published figures, indicating that higher wage inflation may be limited to specific skills and sectors. In pre-pandemic times, the prospect of wage increases of 3% to 4% would be welcome, but current inflation rates of 4% to 5% means that this translates into real wage decreases for workers and a decline in purchasing power, at least in the short term.

Job vacancy data supports a picture of a tighter labour market than predicted. In NI, just under half of the 31 sectors experienced their highest-ever vacancies in Q3, according to NIjobs.com. The latest monthly data available from the Department for the Economy states that the highest number of vacancies in October were in Health and Social Work and Manufacturing. In ROI, job postings were nearly 50% above their pre-COVID-19 peak in early November, according to Indeed Ireland, which points to a widening mismatch between labour demand and supply. An Indeed Ireland survey also found that more than half of unemployed respondents were not currently looking for a job, citing care responsibilities, partner income, financial cushions, and health concerns related to COVID-19 as the main deterrents. Evidence from employers mirror these findings as businesses increasingly report difficulties recruiting the skills they need. Anecdotal evidence of the “Great Resignation” among younger workers, as constrained migration flows continue to curtail the talent pool for employers, may further add to confidence and bargaining power when negotiating pay and working conditions. Labour mobility may, however, remain constrained in the short term as pandemic-related uncertainty persists.

Although there are complexities with each data source, combining data on employment, unemployment, vacancies and wages points to a tighter labour market and inflationary wage environment in the year ahead. The combined effect of the pandemic, housing crisis, and rising prices will attract fewer overseas workers, thereby adding to the workforce challenges businesses are facing. Organisations will increasingly have to either look to technology, new talent pools or creative new ways to better align to changing employee expectations to attract the talent they need.

Feature - Will prices continue to rise?

ROI inflation hits 20-year high

A period of price increases was to be expected given the sharp falls experienced a year ago, but the critical question is whether the increase is transitory or the start of a new, more worrying trend. In our last Economic Eye report, we presented scenarios suggesting a much higher level of general price inflation was possible towards the end of the year and that is what has come to pass. Inflation has exceeded 5% in ROI for two consecutive months and is currently at its highest rate in two decades. The UK, at 4.1%, is at its highest level since December 2011. The recent higher inflation rate in ROI compared to the UK is largely due to the deflation experienced in ROI during the first phase of the pandemic.

The rapid rise in inflation has been largely due to a combination of four factors:

Fast global growth

Surge in oil prices, partly resulting from fast growth

A rebound from last year's price decreases, notably oil prices

Ongoing global supply chain disruption

The conventional wisdom is that these are all temporary and the period of inflation will quickly pass. A closer look at the data suggests that this is an assumption open to debate.

Monthly CPI inflation ROI and UK



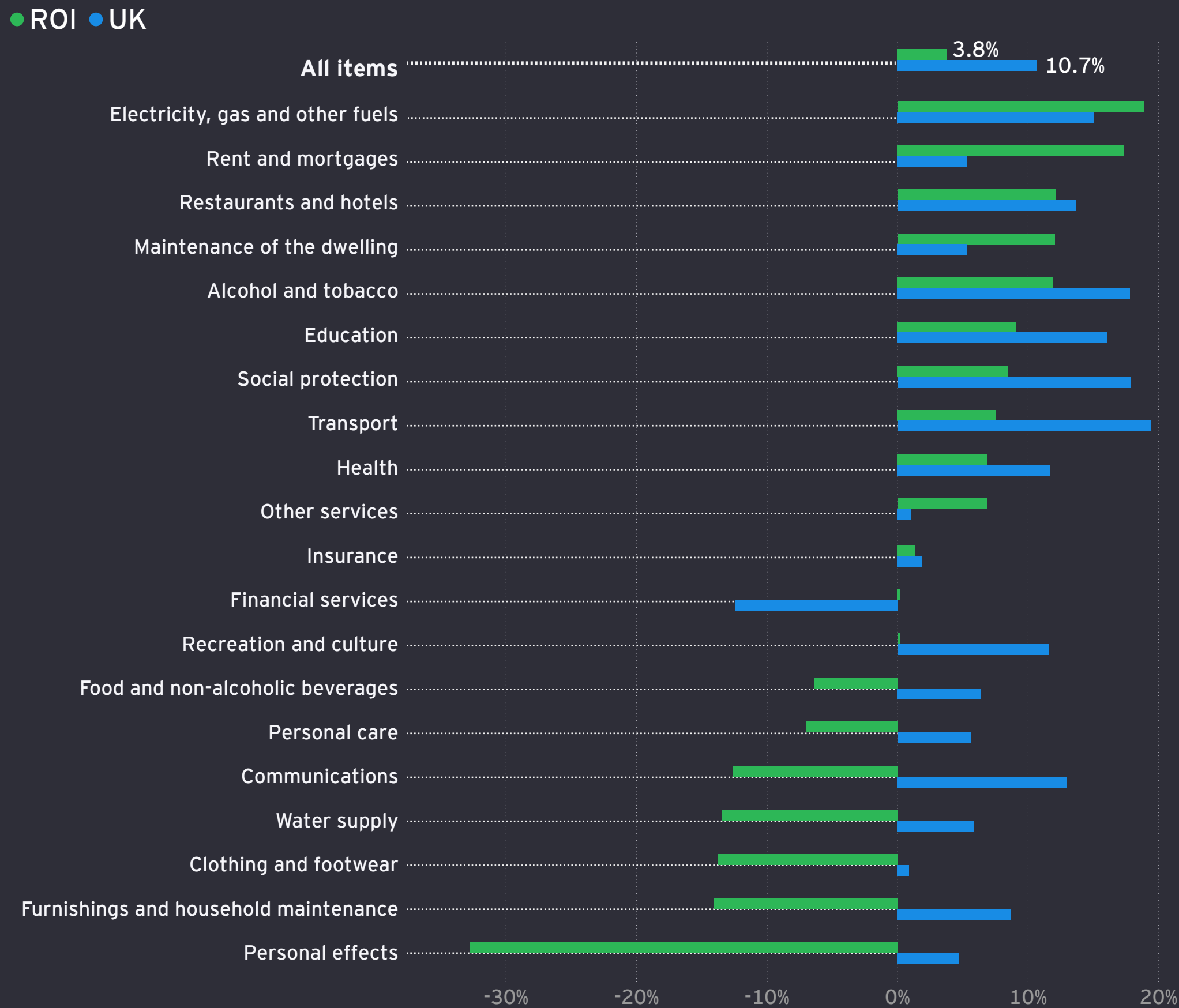
Source: CSO, ONS, EY Economic Eye forecasts

Looking back on a divergent price story

Comparing price levels to five years ago for the UK and ROI show a remarkably divergent story. There is no separate inflation data for NI but given the importance of exchange rates and the structure of NI's trading relationships over the period, the expectation is that prices would be closer to the UK than ROI. In the UK, all prices have increased over the last five years except for Financial Services. In ROI, there has been a significant decline in prices in many categories, notably Clothing and Footwear, and Furnishings. This partly reflects the depreciation in sterling immediately following the Brexit vote in June 2016, which led to higher inflation in the UK driven by higher costs of imports.

However, Brexit does not offer an explanation for the deflation that ROI experienced in 2020 that the UK did not. It is unlikely inflation in ROI will revert to the record lows of 2018-19, with further sustained price falls unlikely in any category unless currency depreciation occurs.

CPI price change ROI and UK (2016 - 2021*)



Source: CSO, ONS
*Data for the final two months of 2021 are EY estimates

Transitory or a new trend?

The argument for inflation returning to a very low, below 2% long-term level, is largely based on three factors which have been dominant over the last two decades:

Competition

In a globally competitive world, businesses have been “price takers” rather than “price makers.” Any attempt to raise prices would see businesses outcompeted by rivals, locally or internationally.

Availability and cost of labour

Workers have historically been price takers as an almost infinite supply of labour before the pandemic allowed firms to meet their staffing needs without raising pay. The erosion of collective bargaining power, coupled with extended periods of public sector spending restraint or austerity, has also contributed to muted pay growth.

Technology

New technology has been driving down global prices for almost every service and commodity, offering the ability to replace labour with capital in a broadening range of sectors.

It is possible to imagine a world in which these three forces return as before and inflation settles quickly back to a very low level. This is the prevailing assumption in most published forecasts, including in our central inflation scenario. However, there are reasons to suggest that there are challenges to at least two of these long-term norms that may give rise to a new, more elevated, medium-term outlook for prices.

Changes to labour supply and bargaining power

Rising living costs and the disruption to migration due to the pandemic may make it more challenging to attract labour from overseas. In NI, the added complexity of post-Brexit migration laws may further limit labour supply. This provides more bargaining power for workers to drive up wages, especially in sectors that are not mobile, which, in turn, creates an environment in which prices may rise. The public sector is a significant, domestically based employer in both ROI and NI that has endured a long period of subdued pay growth. The importance of high-quality public services has been brought into sharper focus by the pandemic and there is an understandable desire to increase pay rates and improve relative attractiveness to support recruitment. Many businesses are increasingly recognising just how precious talented people are. For an increasingly large number of roles across the economy, the concept of an infinite pool of labour is no longer valid.

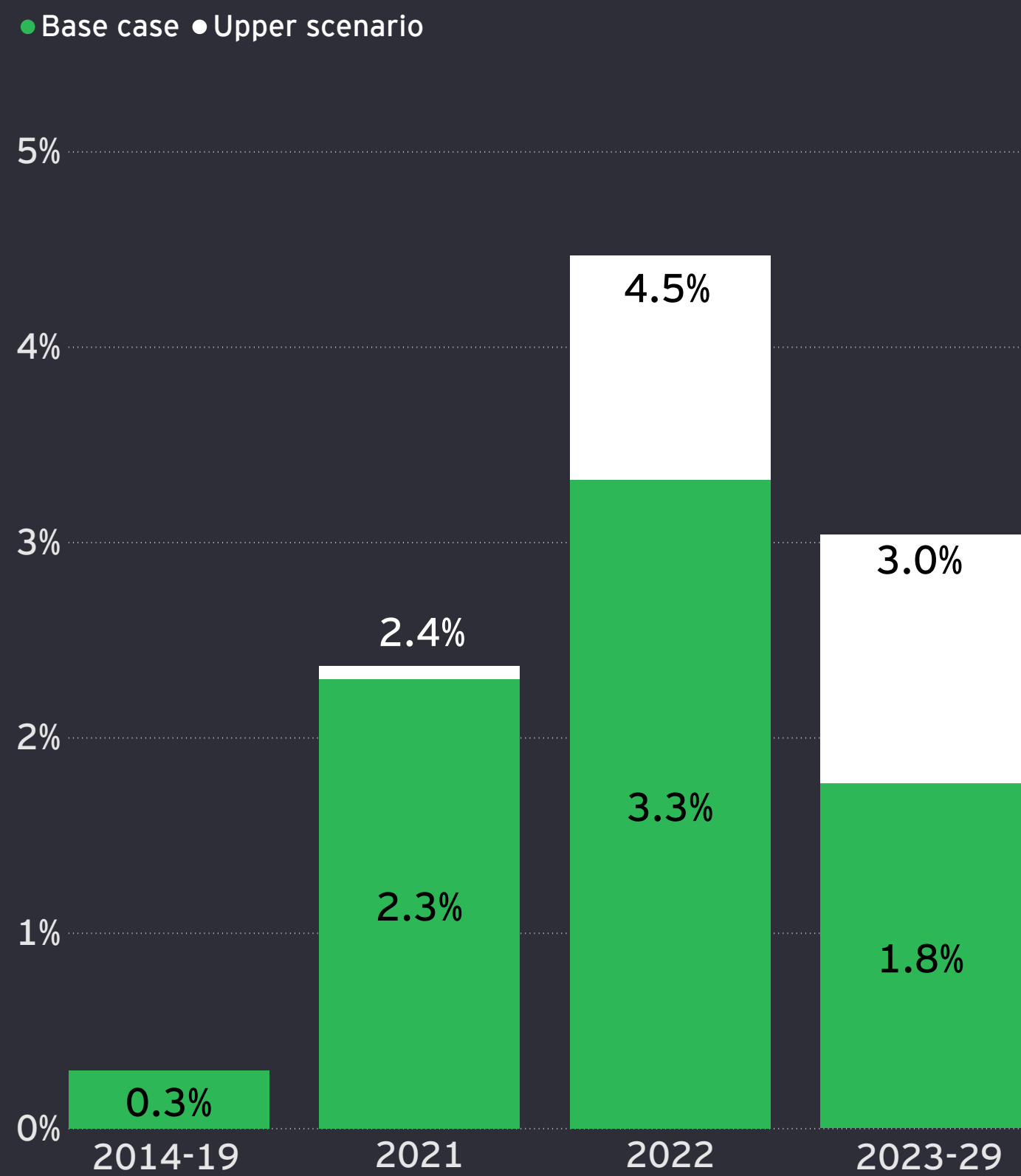
New costs

Efforts to better protect the environment present many opportunities, but there are extra costs being incurred by businesses as they make the necessary investments and changes to their ways of working. This, together with additional regulatory and compliance costs, some of which relate to Brexit, provide further upward pressure on prices.

Changes in consumer attitudes

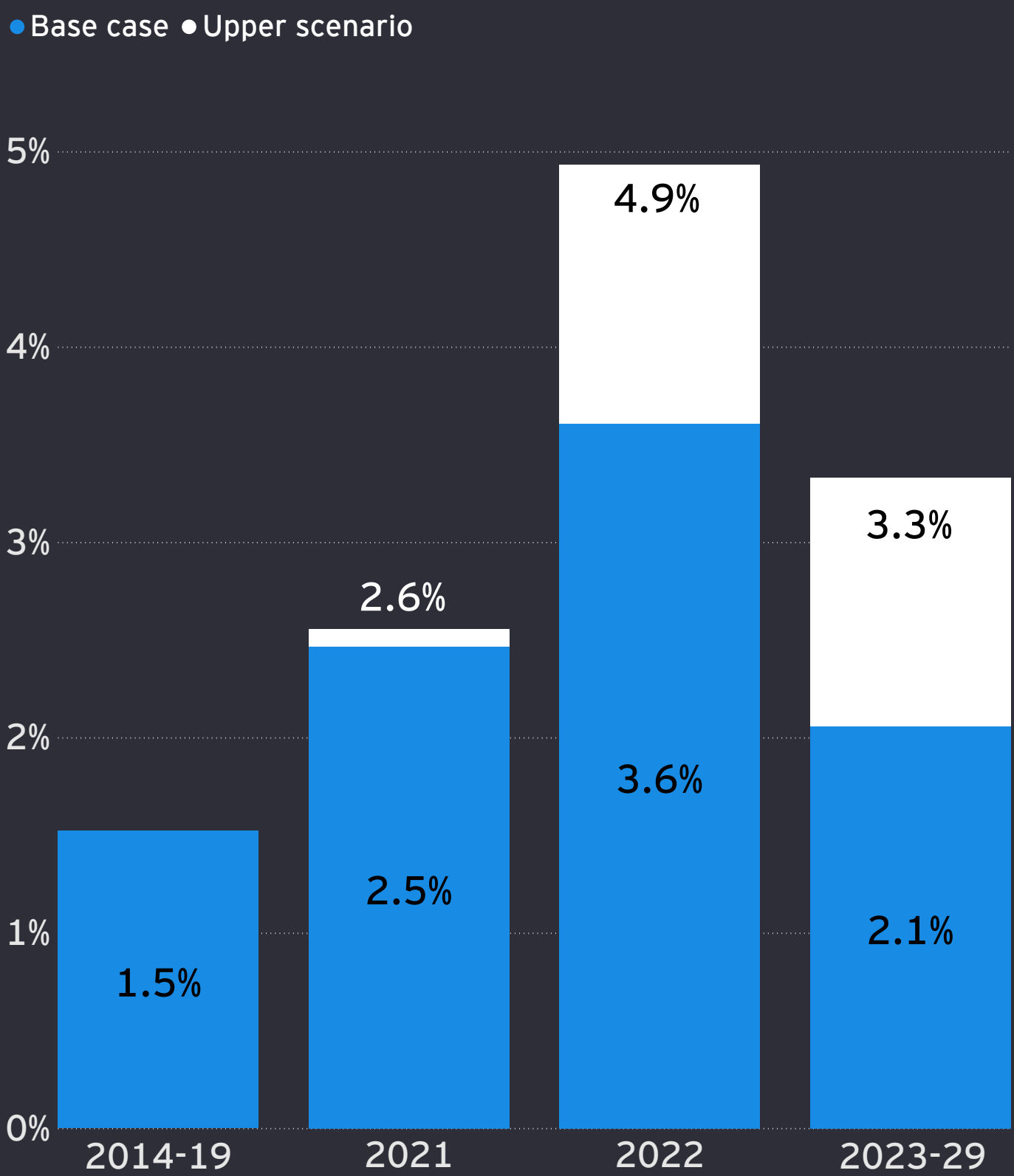
As consumers become more environmentally and ethically engaged, this may alter purchasing patterns, slowing the long-term trend of ever cheaper imports from low-cost markets.

ROI inflation forecast



Source: EY Economic Eye

UK inflation forecast



Our scenario analysis suggests that a longer-term inflation rate of 2.5% to 3% across the island is both plausible and, arguably, more likely than returning to pre-pandemic levels. In the higher scenario, we have assumed that the recent trend of elevated prices will continue in the first six months of 2022, which would be consistent with oil prices reaching \$100 per barrel and a further 5% increase in house prices/rental costs. Renewed concerns relating to the pandemic at the time of writing indicate that the rate of global growth may be slightly more muted than expected and this may ease energy price inflation, although it may also increase supply chain disruptions. The longer-term forecast assumes an increased cost for consumer goods and energy prices, reflecting new standards and policies to accelerate sustainability efforts. It is important to bear in mind how integral a role both exchange rates and oil prices play in driving price levels. Oil is currently the single best predictor of overall inflation despite the progress on renewables.

When will interest rates rise?

An upward move in interest rates in both the UK and the US appeared imminent before news of the latest COVID-19 variant emerged. This is consistent with our commentary that rate rises may be earlier than markets had been expecting, although small rises in early 2022 are now priced in. Interest rates are not projected to rise in the EU until 2025, according to Oxford Economics. However, the relative differential in interest rates is an important driver of money flows and, consequently, exchange rates. If the UK and the US move on rates, there is a strong likelihood that the EU's stance could change, bringing forward rate rises, particularly if inflation remains elevated. Sluggish economic performance in several EU markets is a major factor delaying any rate increases, but the shift in the UK and the US plans reflects how quickly things can change. Nevertheless, the longer-term trajectory for interest rates is only for modest increases with current expectations of below 3% across the EU, the US, and the UK even by the end of 2025. Scenario planning for a higher price environment, including the price of money, is advised given the evidence of recent months.



Key takeaways





1

Demand levels are strong. Plan for growth despite challenges.

The all-island economy is entering 2022 in better health than expected. In particular, the labour market appears to have performed remarkably and has returned to peak in aggregate terms. Headline unemployment rates are relatively low, vaccination levels are high, and wage inflation reflects a competitive labour market with more choice for employees. This positive outcome is due to swift and substantive policy responses, and impressive level of adaptability from businesses. The public finances are also performing better than projected even though headline growth in NI and modified domestic demand in ROI are largely in line with forecasts made at the start of 2021. However, there are still many jobs supported either directly or indirectly by Government. It would be misleading to say that the outcome is better than expected for all, but the key message is that we are heading into 2022 on a more solid footing than anticipated.

2

Build your scenario plan for a longer period of elevated prices.

One of the impacts of the stronger global economic conditions is that prices are being driven sharply upwards. The accelerated inflation is a result of the collective impact of rising oil prices, strong demand, and pandemic-induced supply chain disruptions. Set against the unique backdrop in which consumers, businesses and governments are all spending, it is reasonable to question just how temporary the price increases will be. They are perhaps not simply a mathematical anomaly driven by the decline last year, but a trend that could be more sustained. Our scenario analysis points to the very real prospect of a further increase in the headline inflation rate in early 2022 and no return to previous ultra-low levels that prevailed on the island.

Key takeaways



3

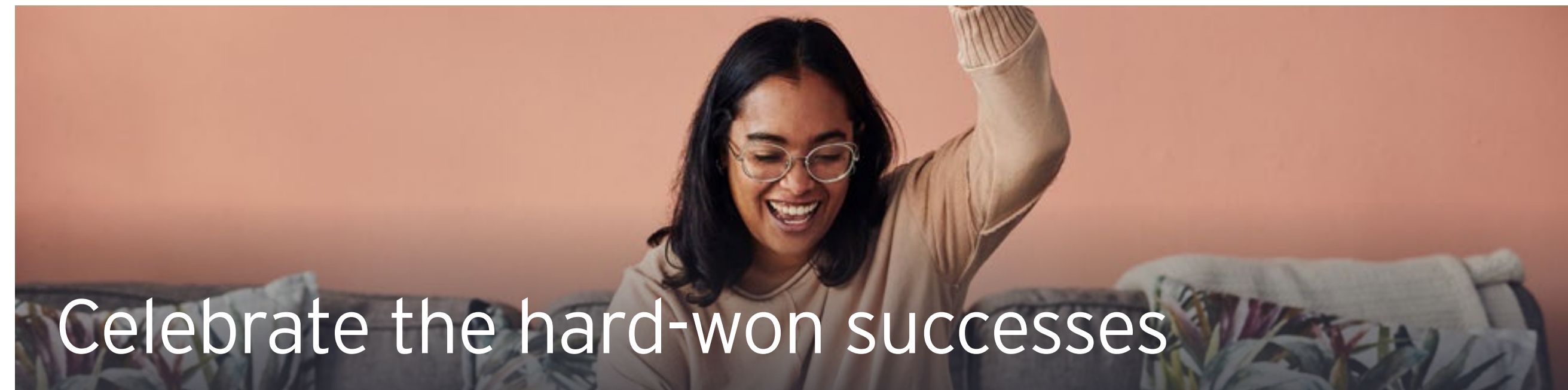
No austerity on the horizon, but imminent tax cuts unlikely.

Public finances have reflected the stronger than expected economic performance, which has allowed the UK and ROI Governments to continue to increase spending and borrow money needed to fund further support and reward public servants. In the UK, tax increases have come in the form of corporation tax which is due to rise from 19% to 25% from April 2023 and the introduction of a 1.25% health and social care levy from April 2022. In ROI, the major tax change is the increase in corporation tax from 12.5% to 15% having signed up to the OECD global minimum rate. Neither government has embarked on any immediate rebalancing of the public finances or eased back spending as might be expected when the economy is recovering strongly. This reflects the importance of maintaining public service quality for citizens. Taxes will likely rise to support spending if needed and austerity is unlikely to be the chosen strategy. The hope in both economies is that growth can be fast enough to generate the revenue needed, although both in the UK and in ROI warnings have been sounded that tougher decisions may eventually need to be taken.

4

Keep your talent strategies under constant review.

The unexpectedly resilient labour markets in both NI and ROI, coupled with a shift in attitudes and priorities of many potential employees, suggests that attracting and retaining talent will remain the number one challenge across the island for the foreseeable future. Migration flows are lower than in pre-pandemic times, and perhaps forever altered in NI post Brexit, causing the labour shortage issue to broaden across sectors and occupations. Wage data, though complex to unpick, suggests more bargaining power for workers. High inflation levels will also change the dynamic of pay discussions as will the current worrying escalation in house prices. Businesses will need to work harder to hire and retain top talent as the labour market tightens and employees expect more in terms of work-life balance, employer values, places of work, pay and recognition.



5

Test all your business assumptions and celebrate success when it comes.

The impressive performance of many businesses during the pandemic and after Brexit should be celebrated. Organisations that have turned headwinds into tailwinds have thrived in the toughest conditions. Those businesses that have found innovative ways to find talent, suppressed price increases by adopting new technologies and ways of working, or turned the climate challenge into an opportunity are the ones that have outperformed their competitors. It is, however, important not to be overconfident and believe the economies are prepared for everything. There are long-held assumptions, some of which may be under severe challenge, that we must not rely upon in our business planning. The future will not look like the past. Governments may not always have the money to fund supports, low interest rates may not always prevail, inflation may not revert to its pre-pandemic levels, and the talent supply taps may not be turned back on in the same way. However broad and deep the risk register, we will always need the flexibility, agility and resourcefulness to pivot and deal with the unforeseen. There is now a greater urgency to protect the planet and pursue the sustainability agenda with public policy, corporate strategies, and citizen behaviour all rapidly evolving. Within this evolution there is potential for not just environmental and societal progress, but also economic opportunity.

“

The lessons learnt over the past 21 months should give businesses confidence as they look ahead to 2022 and beyond. Meeting the challenges presented by rising prices, talent shortages, and climate action urgency will be important drivers of economic growth and societal progress.



Graham Reid
Head of Markets
EY Ireland



Summary forecast

Republic of Ireland

	2019	2020	2021	2022	2023	2024
Consumption	3.3%	-10.4%	5.3%	6.3%	4.7%	3.1%
Government spending	7.1%	10.9%	4.5%	2.0%	0.2%	0.7%
Investment	99.5%	-23.0%	-49.8%	6.9%	6.2%	5.2%
Modified Capital Investment*	-6.9%	-3.6%	3.8%	6.7%	6.1%	5.1%
Exports	10.4%	9.5%	15.7%	6.8%	5.6%	5.1%
Imports	41.7%	-7.4%	-11.1%	5.8%	6.0%	5.9%
GDP	4.9%	5.9%	15.4%	5.9%	4.2%	3.8%
Modified domestic demand	1.7%	-4.9%	4.8%	5.4%	4.0%	3.0%
Jobs	3.0%	-2.8%	6.1%	4.2%	1.6%	1.5%

Source: EY Economic Eye
*Modified capital investment excludes multinational R&D related IP and aircraft leasing flows. It is mainly investment in building and machinery



United Kingdom

	2019	2020	2021	2022	2023	2024
Consumption	1.3%	-10.8%	3.9%	6.8%	2.3%	2.0%
Government spending	4.2%	-6.3%	15.8%	2.8%	1.2%	1.9%
Investment	0.5%	-9.1%	4.9%	8.1%	3.4%	1.3%
Exports	3.4%	-14.7%	-2.3%	10.1%	4.0%	2.2%
Imports	2.9%	-16.8%	1.5%	9.4%	3.7%	2.4%
GDP	1.7%	-9.7%	6.9%	5.6%	2.3%	1.8%
Jobs	1.5%	-1.8%	-0.2%	1.7%	1.1%	0.7%

Source: EY Economic Eye, UK ITEM Club



Northern Ireland

	2019	2020	2021	2022	2023	2024
GVA	0.3%	-9.0%	6.0%	5.3%	2.1%	1.4%
Jobs	2.7%	-0.9%	-3.1%	2.1%	1.0%	0.6%

Source: EY Economic Eye

All data updated as on 9 December 2021



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Join in the conversation
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