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QUARTERLY ECONOMIC COMMENTARY

AUTUMN 2024

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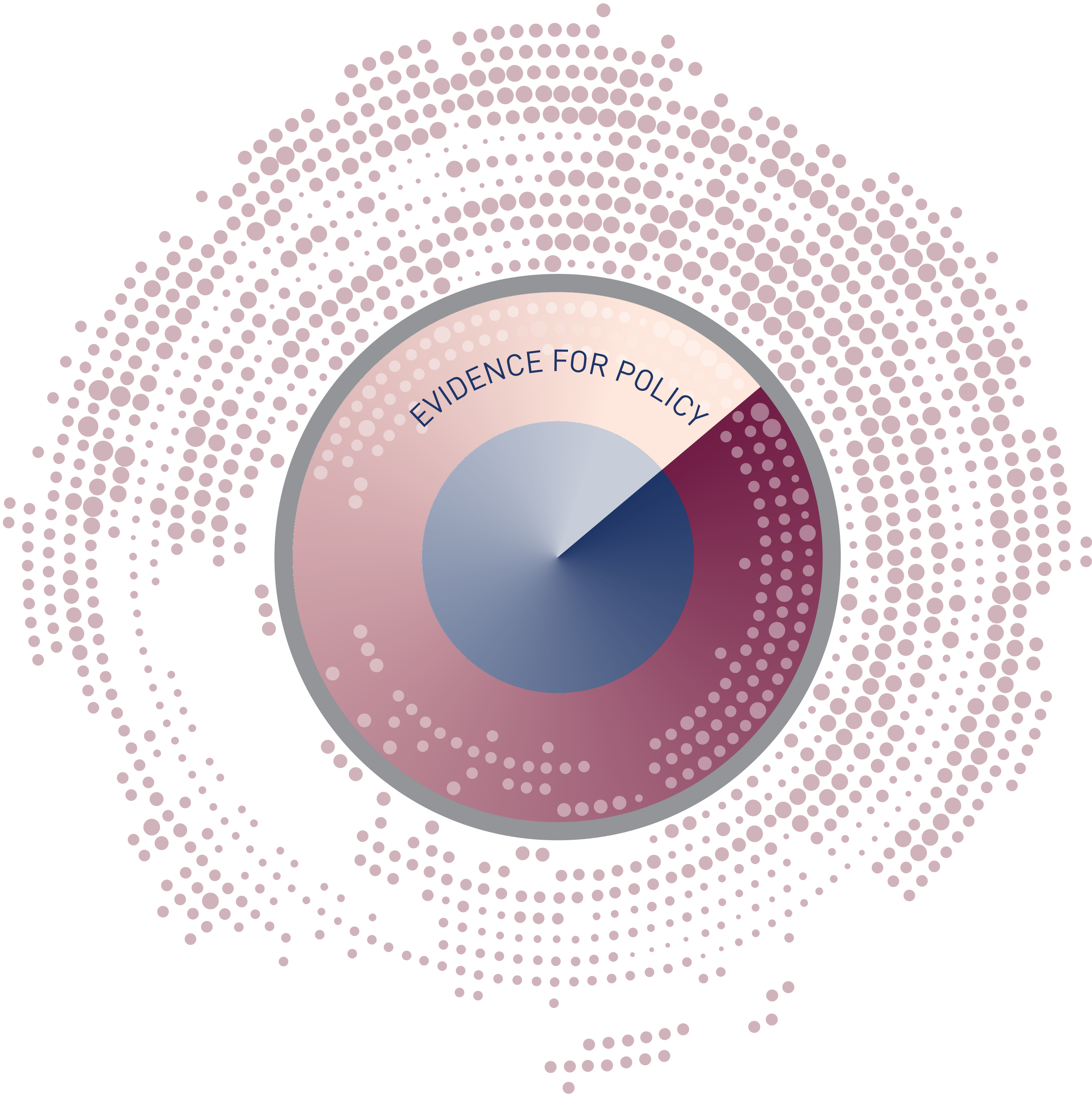
DÓNAL O'SHEA



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QUARTERLY ECONOMIC COMMENTARY

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September 2024

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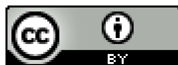

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The Quarterly Economic Commentary has been accepted for publication by the Institute, which does not itself take institutional policy positions. It has been peer reviewed by ESRI research colleagues prior to publication. The authors are solely responsible for the content and the views expressed.

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SUMMARY TABLE

Output (Real Annual Growth %)	2022	2023	2024	2025
Private Consumer Expenditure	10.9	4.9	2.3	2.7
Public Net Current Expenditure	3.0	4.2	3.8	3.0
Investment	4.1	2.8	-16.4	18.8
Modified Investment	10.4	-4.3	1.0	4.3
Exports	13.6	-6.0	6.8	3.0
Imports	16.4	1.3	5.9	5.9
Gross Domestic Product (GDP)	8.7	-5.7	-0.4	2.5
Gross National Product (GNP)	2.7	5.3	-1.0	2.7
Modified Domestic Demand	9.1	2.7	2.3	3.1
Domestic Demand (excl Stocks)	6.9	4.0	-4.4	8.0
Labour market				
Employment Levels (‘000)	2,595	2,685	2,742	2,794
Unemployment Levels (‘000)	120	120	125	123
Unemployment Rate (as % of Labour Force)	4.4%	4.3%	4.3%	4.2%
Public finances				
General Government Balance (€bn)	8.6	8.3	8.5	9.7
General Government Balance (% of GDP)	1.7	1.6	1.5	1.6
Prices				
Inflation (CPI)	7.8%	6.3%	2.3%	1.2%

The Irish Economy – Forecast Overview

- Despite a significant decline in headline investment levels in Q2 2024, the underlying pace of growth in the Irish economy is set to be robust this year and next.
- Modified domestic demand (MDD), which is the preferred indicator of output growth, is set to increase by 2.3 per cent in 2024 and by 3.1 per cent in 2025.
- The Irish labour market continues to perform in a very strong manner with the unemployment rate set to converge back to 4 per cent over the next year, which is quite remarkable given the significant increase in population which is currently being experienced.
- Much of this increase is coming about through increased net migration. Given recent political and social developments, the *Commentary* argues it is important that the contribution of immigration to Ireland's continued economic success is acknowledged.
- Given the proximity of the Budget, the *Commentary*, in a Box prepared by McQuinn and Walsh, examines the sustainability or otherwise of recent and future expected increases in Government expenditure.
- The Box concludes that future expenditure levels are still on a sustainable path once the scale of the economy is allowed for. However, the significant increase in Government spending necessitates the identification and monitoring of indicators which aim to track productivity and efficiency gains in key areas of public policy such as healthcare.
- The *Commentary* cautions against any delay in the adoption of the proposed residential zoned land tax (RZLT). This measure has been identified as one way of targeting land hoarding in the residential market. Reducing the cost of residential land is one practical way the Government can improve the efficiency and productivity with which housing is supplied to the market.

Domestic and International Outlook

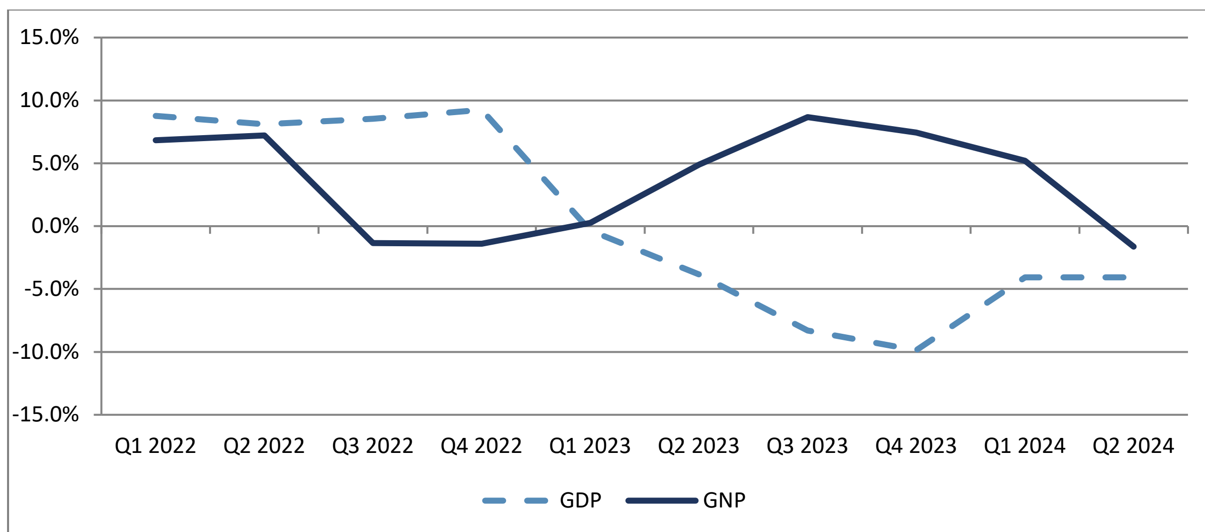
OVERALL OUTLOOK

Sector-specific developments continue to affect overall growth path

As documented in the previous *Commentary*, according to certain headline indicators, Ireland's economy declined in 2023 on the back of a fall in multinational export activity, which was driven by a combination of a slowdown in world trade and specific sectoral developments in key export product areas. Export activity has recovered in the first half of 2024 but negative growth in GDP and GNP has continued because of sector-specific developments in investment.

Figure 1 highlights the continuing drop in GDP during the first half of 2024. GDP continued to experience negative growth in 2024, albeit at a slower pace than in the final three quarters of 2023. During 2023, GNP had continued to grow due to changes in factor income flows from the multinational sector. This effect was smaller in 2024, causing GNP to begin to decline in Q2 2024.

FIGURE 1 GDP AND GNP GROWTH – YEAR-ON-YEAR – CONSTANT PRICES (SA)



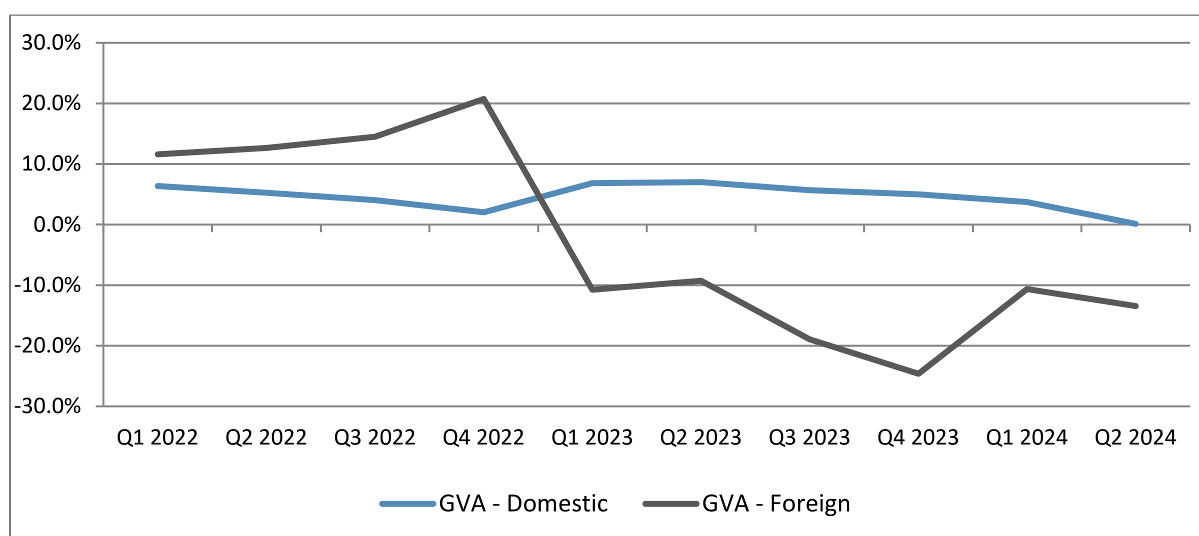
Source: Central Statistics Office.
Notes: SA refers to seasonally adjusted series.

Given the dual nature of activity in Ireland (between FDI-led exports and domestic activity), it is important to understand the factors contributing to the slowdown in growth. Figure 2 presents the breakdown of growth in gross value added (GVA) by two sectors defined by the CSO as foreign-dominated or domestic-oriented sectors. It can be clearly seen that the major downward pressure in the economy at present in GVA comes through the foreign-dominated sectors. These sectors grew at considerable double-digit levels in the period 2020 through 2022, before

experiencing a sharp downturn, which was documented in previous *Commentaries*. This downturn has continued throughout 2023 and the first half of 2024.

In the domestic-oriented sectors of the economy, previous *Commentaries* pointed to a stabilisation in growth following the volatility of the COVID-19 period. At 0.1 per cent for Q2 2024, growth is somewhat weaker than the recent trend.

FIGURE 2 GVA GROWTH – YEAR-ON-YEAR – DOMESTIC VS FOREIGN DOMINATED SECTORS – CONSTANT PRICES (SA)

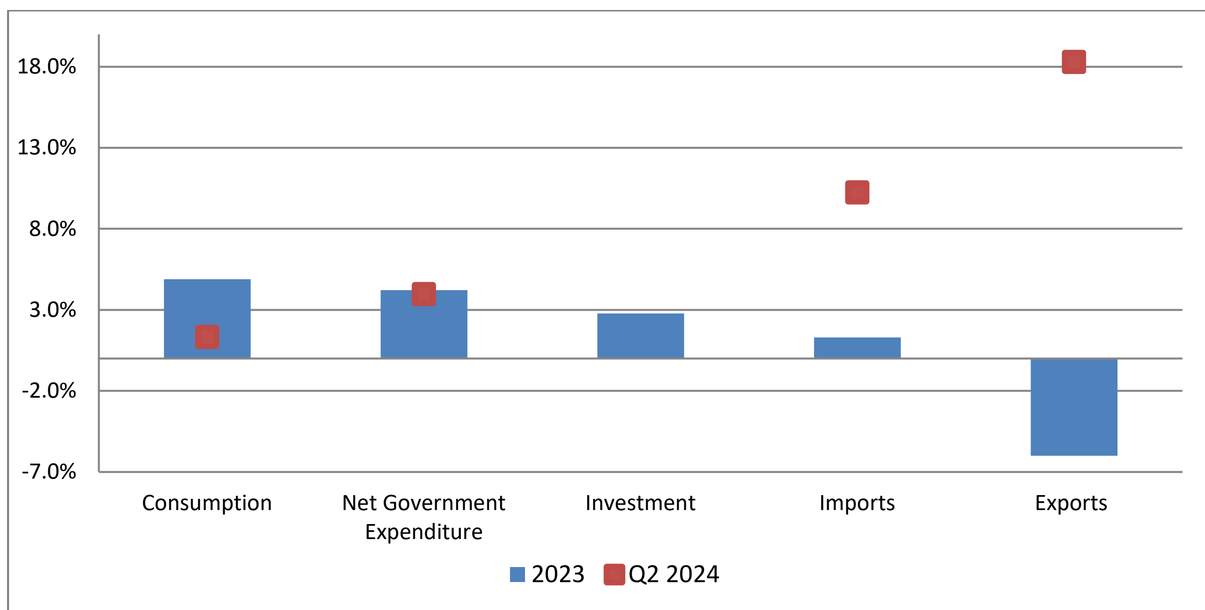


Source: Central Statistics Office.

This divergence between the foreign-dominated and domestic-oriented sectors which is inherent in the Irish economy can be seen more clearly in Figure 3 which presents data for the expenditure components of GDP: consumption, Government spending, investment, imports and exports. The data presented compare the year-on-year growth for 2023 compared to 2022 (in blue) with the year-on-year quarterly growth for Q2 2024 (red).

Household consumption has experienced a slowdown in growth since 2023, with the growth rate falling from almost 5 per cent to 1.3 per cent in Q2 2024. Growth in net Government expenditure is in line with the 2023 figure. While overall exports declined in 2023, this trend has reversed in the present year, with exports in the second quarter of 2024 showing growth of over 18 per cent. While investment expenditure was up slightly in 2023 from 2022 levels, overall investment fell sharply in the second quarter of 2024 with a growth rate of -66.4 per cent.

FIGURE 3 COMPONENTS OF GDP GROWTH – YEAR-ON-YEAR – CONSTANT PRICES (SA)



Source: Central Statistics Office.
Notes: This chart presents the year-on-year growth rate for 2023 compared to 2022 and Q2 2024 compared to Q2 2023. The Q2 2024 figure for Investment of -66.4 per cent is not presented on the chart.

Each of the components of GDP growth is discussed in more detail below. The overarching positive factors shaping the outlook for the Irish economy are the quicker than expected disinflation, the likelihood of further interest rate declines in the remainder of 2024, and the robust labour market in Ireland. Factors weighing on the outlook include the current high interest rate environment, uncertainty around the outcome of the US presidential election, geopolitical tensions in the Middle East and their impact on global trade, as well as the ongoing risk of second round inflationary effects from a domestic economy which is running close to capacity. In terms of headline GDP, we expect a decline of -0.4 per cent in 2024 and a positive growth rate of 2.5 per cent in 2025.

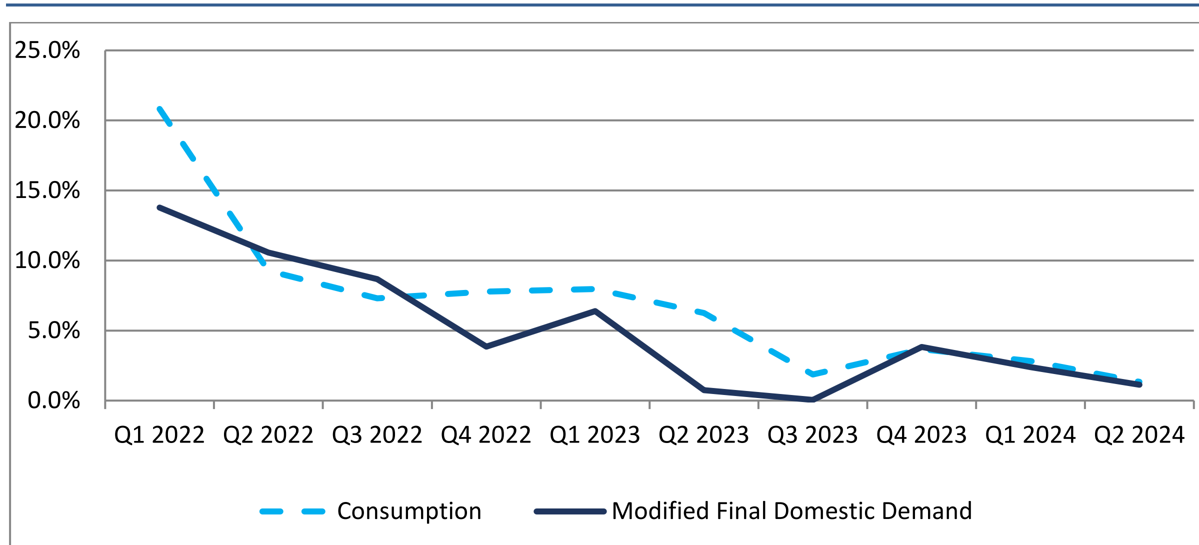
Household spending growth to recover with real income boost expected

As far as the underlying performance of the economy is concerned, the trend is a more positive one with growth continuing albeit at a reduced rate compared to recent years. Figure 4 presents the growth rate in personal household consumption and modified domestic demand (MDD).[1] Modified domestic demand growth had been lower than consumption growth because of subdued investment activities throughout 2023, although this gap has narrowed. The recent downward trend in the growth rate of these two indicators, evident since the beginning of 2023, has

1 Modified Domestic Demand is the adjusted Domestic Demand calculation which replaces overall investment, with the modified series removing aircraft leasing and R&D IP.

continued into Q2 2024. We expect the negative trend in consumption growth to be reversed as real incomes increase into 2025.

FIGURE 4 CONSUMPTION AND MODIFIED FINAL DOMESTIC DEMAND – YEAR-ON-YEAR – CONSTANT PRICES (SA)



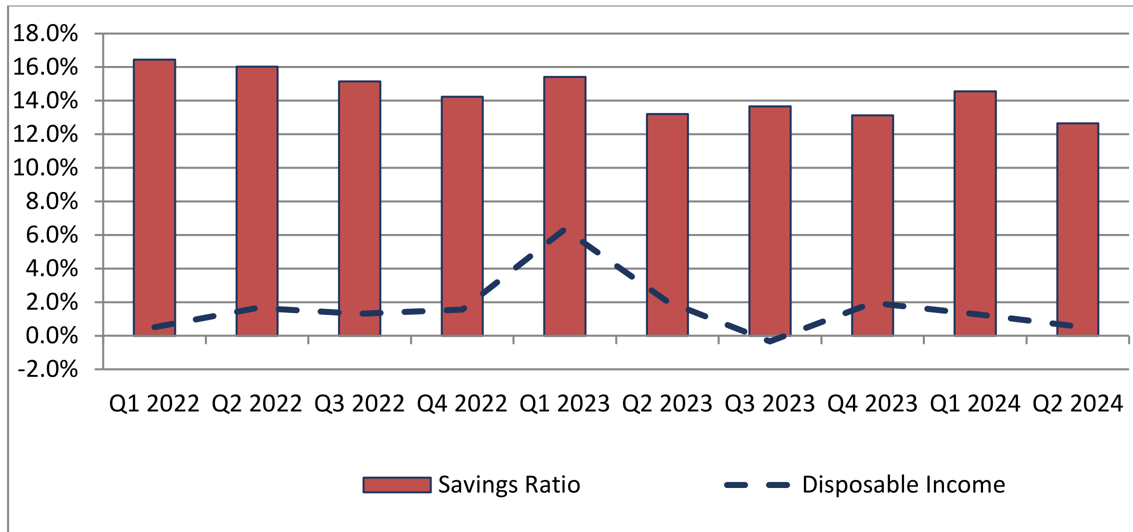
Source: Central Statistics Office.

The main drivers of consumption (both income growth and changes in the savings ratio) are presented in Figure 5. In terms of income developments, Figure 5 presents the year-on-year growth in total household disposable income (constant prices). Since the second half of 2023, real incomes have been on an increasing trajectory as inflationary effects have begun to abate.

Savings rates (red bars) which were elevated following the COVID-19 pandemic had fallen back to more normal rates throughout 2023. This was likely due to many households using savings buffers to maintain consumption in the face of rising prices. Over time the savings ratio is likely to stabilise at long-term rates leaving consumption growth to track income growth in a more significant manner than in the past two years. However, the most recent data indicate that the savings ratio has returned to just under 13 per cent which is a drop from the first quarter of the year.

Coupled together, this suggests that consumption is likely to continue to grow strongly into 2024 and 2025 as real incomes recover and the higher-than-expected savings ratio continues to provide a potential boost to expenditure. Given these developments, we expect consumption expenditure to increase by 2.3 per cent in 2024 and 2.7 per cent in 2025 on the back of rising real incomes.

FIGURE 5 HOUSEHOLD TOTAL DISPOSABLE INCOME (%) AND SAVINGS RATIO – CONSTANT PRICES (SA)

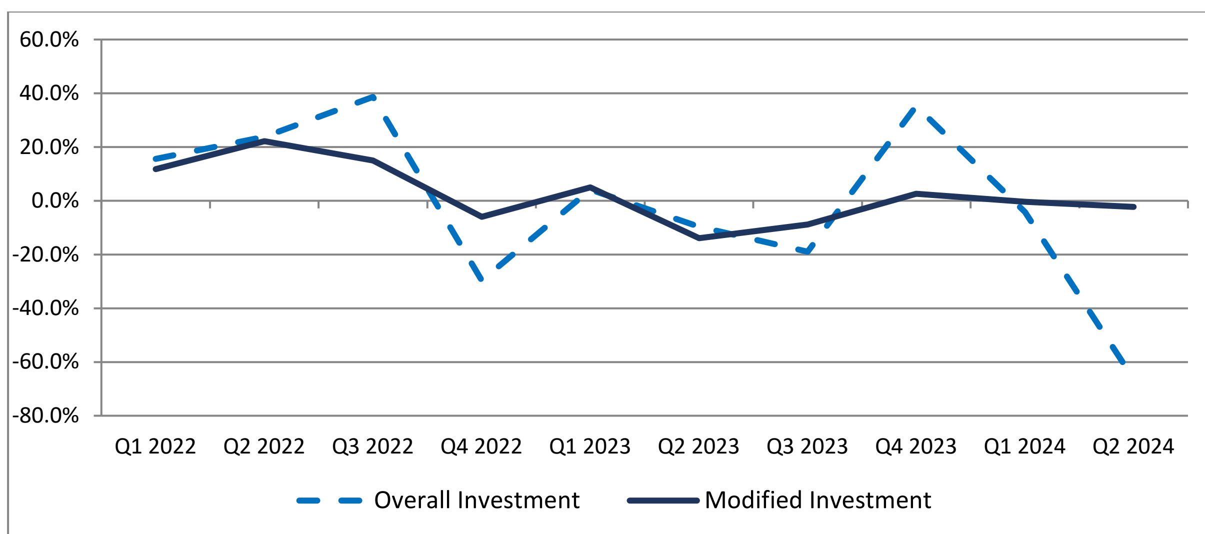


Source: Central Statistics Office.

Sharp decline in investment caused by multinational activity

Underlying investment in the Irish economy declined slightly in the first half of 2024, having faltered more significantly in 2023 as interest rates increased the cost of financing and global uncertainties weighed on the business outlook. Figure 6 presents the year-on-year growth rate on a quarterly basis in overall investment and in modified investment (which removes aircraft leasing and R&D intellectual property assets). Q2 2024 saw a sharp decline in overall investment, which can be attributed to a large fall in intangible assets as a result of multinational intellectual property activity.

FIGURE 6 OVERALL INVESTMENT AND MODIFIED INVESTMENT – CONSTANT PRICES (SA)

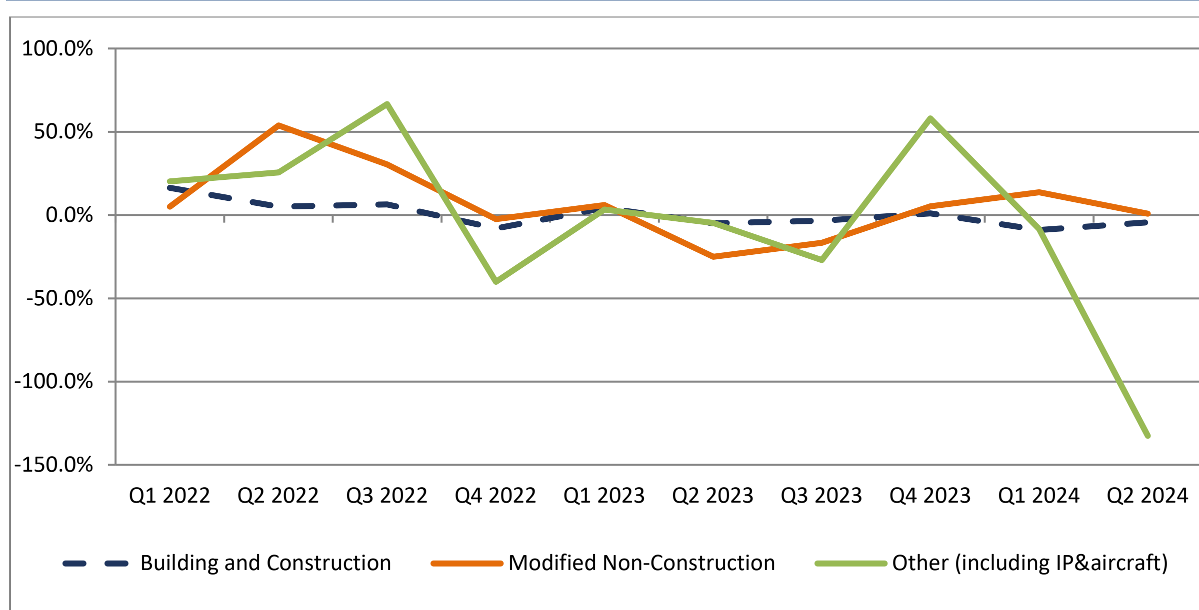


Source: Central Statistics Office.

To unpick the trends in the investment subcomponents and help explain the sharp decline in overall investment, Figure 7 presents the year-on-year growth rate on a quarterly basis for the following sub-series: ‘building and construction investment’, ‘modified investment excluding construction’ and ‘other investment’. ‘Other investment’ is a residual calculated as total investment minus modified investment to capture distortionary investments from IP and aircraft leasing.[2] It is clear that both ‘building and construction investment’ and ‘modified non-construction investment’ displayed notable weakness in 2023, likely due to the ongoing global uncertainties and higher interest rates. Investment in both sectors has not recovered from this period, with the exception of a temporary rebound in ‘modified non-construction investment’ in the first quarter of 2024.

Other investment saw a growth rate of -132.6 per cent in the second quarter of 2024. It is clear that this figure, attributable to the intellectual property activities of multinationals, is driving the fall in overall investment.

FIGURE 7 COMPONENTS OF INVESTMENT – CONSTANT PRICES (SA) – YEAR-ON-YEAR CHANGE (%)



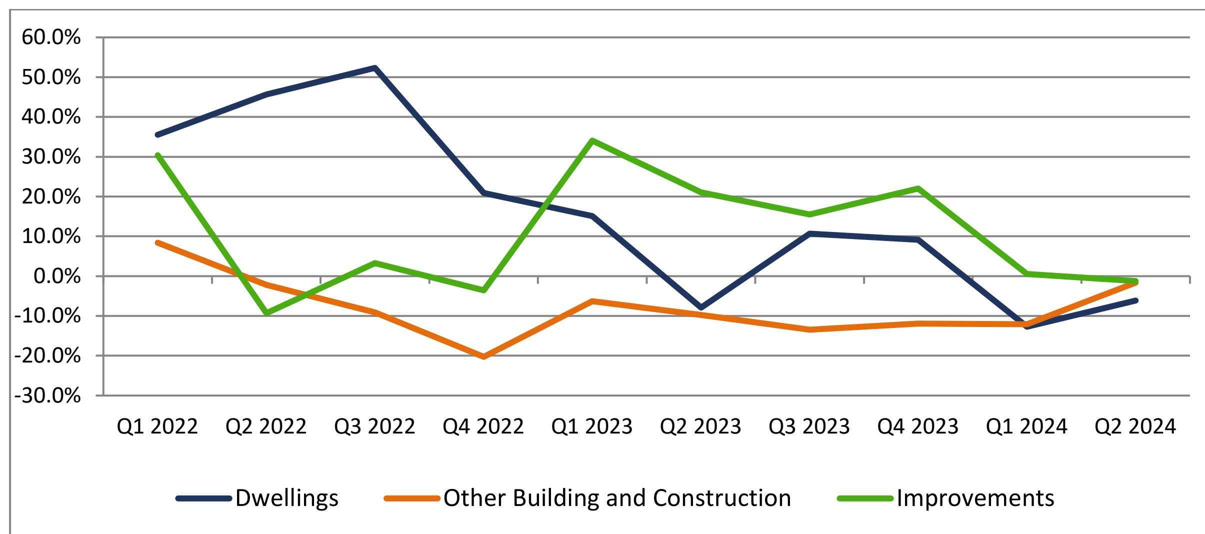
Source: Central Statistics Office.
Note: Modified non-construction series is calculated by subtracting building and construction for total modified. Other investment is calculated by removing modified investment from total investment.

Within construction, as shown in Figure 8, the notable downturn in 2023 was characterised by countervailing effects across the sub-sectors. Residential dwelling investment increased by over 9 per cent in 2023 while non-dwelling construction dropped by 4 per cent. This reflects the ongoing challenges faced by the commercial real estate sector which has suffered a notable downturn on the back of changing work practices and higher interest rates. However, the difference between the sub-sectors has narrowed in 2024. Growth in investment in

[2] These calculations are undertaken due to redactions in the underlying data.

improvements has faded since 2023 while two successive quarters with declining investment in dwellings is a worrying development, given the residential housing deficit that Ireland is experiencing at present.

FIGURE 8 COMPONENTS OF BUILDING AND CONSTRUCTION INVESTMENT – CONSTANT PRICES – YEAR-ON-YEAR CHANGE



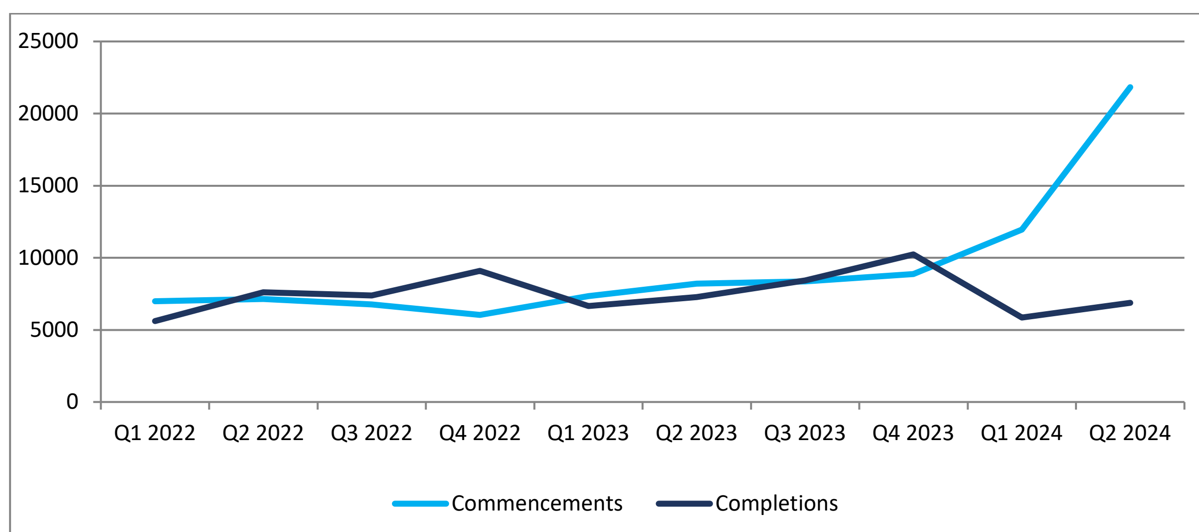
Source: Central Statistics Office.

The 2023 increase in housing investment documented above translated into a housing output of just under 33,000 units which is the highest level since the onset of the financial crisis in 2007. However, in the first half of 2024, housing completions dropped back to just over 12,700 units. This is presented in Figure 9. A figure of nearly 22,000 for commencements in Q2 2024 is more encouraging, with 18,000 commencements in April alone. However, some of this increase may be due to changes in policy (such as the development levy and water connection waiver).[3] While this may lead to higher housing output in 2025 if commencements follow a traditional 9-18 month transition period into completions, there is a risk that these starts are artificially high to benefit from the policy change and their time-to-completion may not follow typical patterns.

For the present year, there are a number of factors that are likely to be weighing on the outlook. Even though the ECB has begun the process of moderating interest rates, the present high rate is likely to continue to exert downward pressure on investments; the elevated cost of materials and other inputs as well as capacity constraints from the labour market are also factors which may weigh negatively on the outlook.

3 On 25 April 2023, the Government approved measures which introduced a temporary time-limited arrangement for the waiving of local authority ‘section 48’ development contributions and the refunding of Uisce Éireann water and wastewater connection charges. In April 2024, the changes were extended to the end of the year and to October respectively.

FIGURE 9 QUARTERLY LEVEL OF DWELLING COMPLETIONS AND COMMENCEMENTS



Source: Central Statistics Office.

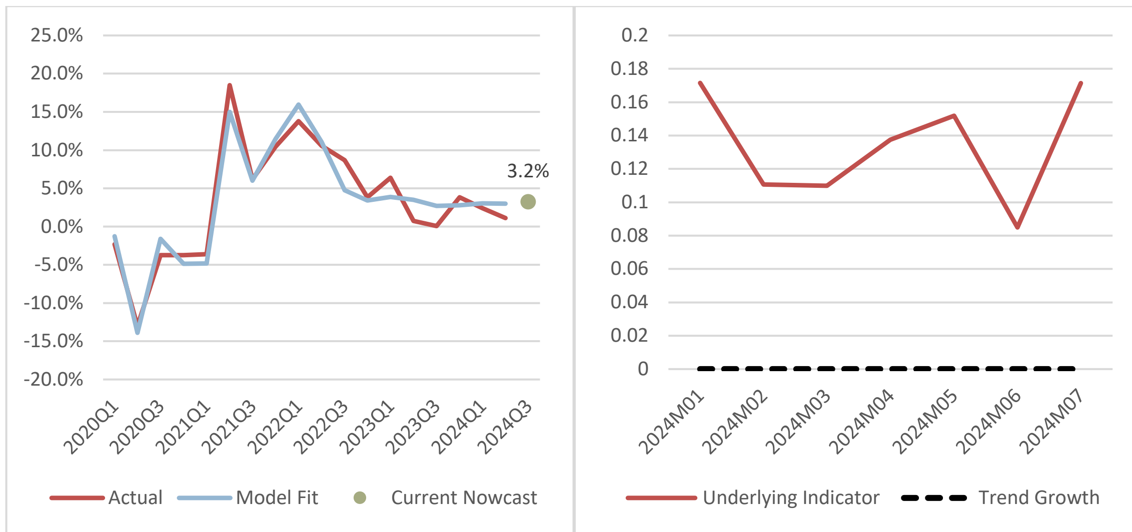
Overall, we expect investment to decline by 16.4 per cent in 2024 mainly because of the drop in intellectual property activity outlined above. We expect this sharp decline to reverse in 2025, with a growth rate of 18.8 per cent for the year.[4] For the more stable modified investment, we expect growth of 1 per cent in 2024 but a recovery to 4.3 per cent growth in 2025. This reflects the increase in construction investment for dwellings in 2024 and the lower interest rate environment. Given the expected changes in both consumption and modified investment we now believe that modified domestic demand (MDD), the preferred indicator of domestic economic activity, will grow by a robust 2.3 per cent in 2024 and at an enhanced rate of 3.1 per cent in 2025.

Figure 10 (on the left-hand side) presents the ESRI's Nowcast for MDD that is published on a monthly basis (see Egan and Kren, 2024, for details).[5] The figure shows the most recent nowcast estimate for Q3 2024. As of 18 September, the ESRI's Q3 2024 nowcast estimates that MDD is growing at 3.2 per cent year-on-year. This is based on all available data for July. Figure 10 (right-hand side) shows the underlying indicator used to produce the nowcast estimate. This indicator is based on the monthly indicators across a number of key headings related to the domestic economy including financial, labour, prices, housing, fiscal, consumer, output and sentiment indicators. The figure shows that while June's value was the lowest so far in 2024, the indicator has remained above zero, which represents a 'normal' or trend level of growth in the domestic economy throughout the year so far.

[4] Underlying these figures is the technical assumption that intellectual property investments return to their quarterly average levels seen in the period 2021–2023.

[5] https://www.esri.ie/news/esri-nowcast.

FIGURE 10 NOWCAST OF MODIFIED DOMESTIC DEMAND (MDD)



Source: Authors' calculation.
Note: For the graph on the right-hand side, value above and below 0 representing above and below average trend growth respectively.

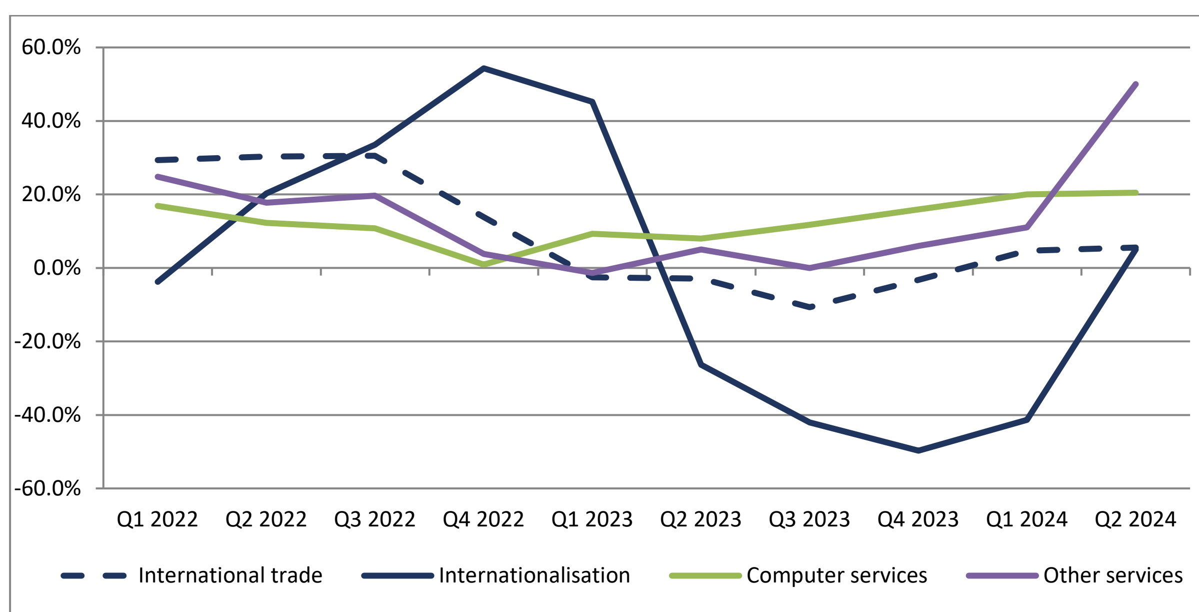
Exports recover following recent declines

Export growth from multinational activities has been the cornerstone of the extremely high headline growth rates seen in Ireland in recent years. The growth in exports has had two distinct strands. First, it has been driven by exceptional performances in key foreign-dominated sectors such as computer services and pharmaceuticals. Second, it has also come through increased exports accounted for in Ireland through the globalisation activities of multinationals (such as merchanting, contract manufacturing and other activities).

In 2023, overall export growth dropped notably by nearly 5 per cent, reversing previous trends. While the global economy, which demands Irish exports of goods and services, slowed in 2023, Figure 11 shows that the magnitude of the reversal in the performance of Irish exports is mainly driven by sector-specific effects and a reversal in globalisation activities.

Figure 11 presents the year-on-year change in exports (in value terms) on a quarterly basis. The grouping of the categories splits exports between 'international goods trade', 'internationalisation activities', 'computer services' and 'other services'. A very clear trend can be seen throughout 2023 with a reversal in the internationalisation exports and also a downturn in international trade. Both of these categories show a return to positive growth in Q2 2024. 'Computer services' have continued to grow strongly, and 'Other services' grew rapidly in Q2 2024. Given the challenges faced by some large firms in the IT sector, the continued and resilient strong growth in exports of 'Computer services' is an area of considerable strength for the Irish economy.

FIGURE 11 COMPONENTS OF EXPORTS – VALUE – YEAR-ON-YEAR CHANGE



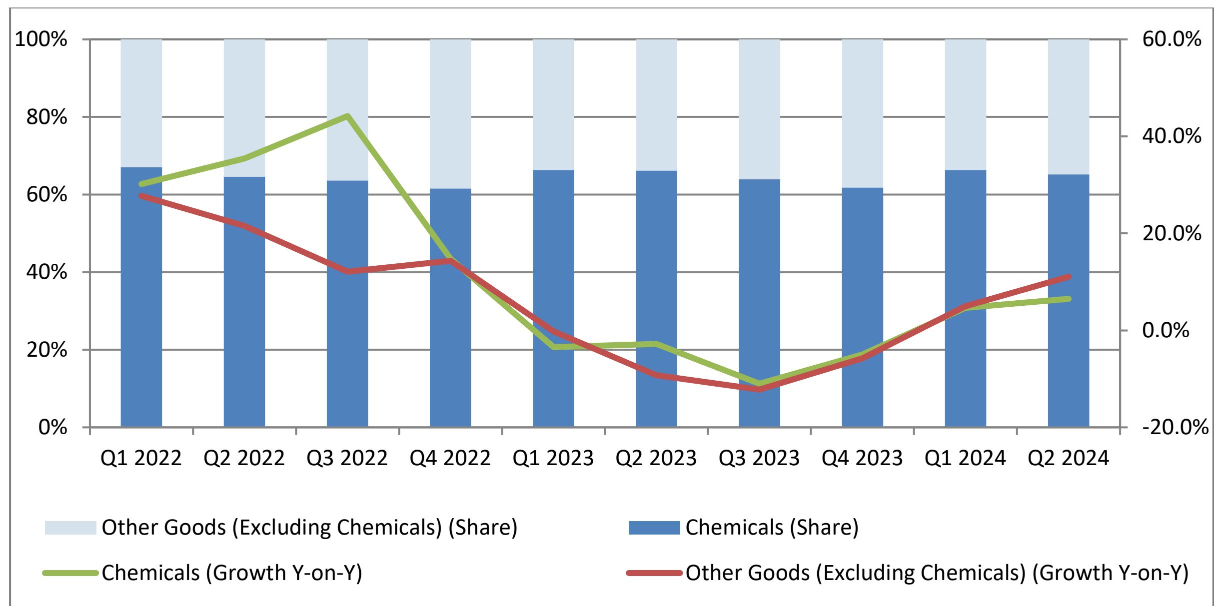
Source: Central Statistics Office.
Notes: International data series corresponds to the sub-series as presented in the quarterly Balance of Payments data.

Within the international goods trade activities, the main export product is 'pharmaceuticals and chemicals'. This can be seen in Figure 12. The bars (left axis) show the percentage of total goods that are represented by chemicals exports relative to all other exports. The proportion is consistently around two-thirds of total goods exports. The trends in the year-on-year growth rate for 'chemicals' and all 'other goods' exports are presented on the right axis. In 2023, both categories declined but a recovery in the first half of 2024 is clearly evident.

Alongside the sector-specific nature of the fall-off in Irish exports, international trade slowed in 2023 on the back of persistently high inflation, higher interest rates and geopolitical challenges. This is presented in Figure 13 which displays the IMF's latest world economic outlook forecasts for global growth and global trade. Global trade is expected to pick up in 2024 and continue to grow strongly in 2025. Given the small and highly globalised nature of the Irish economy, these projections signal an improvement in the international environment.

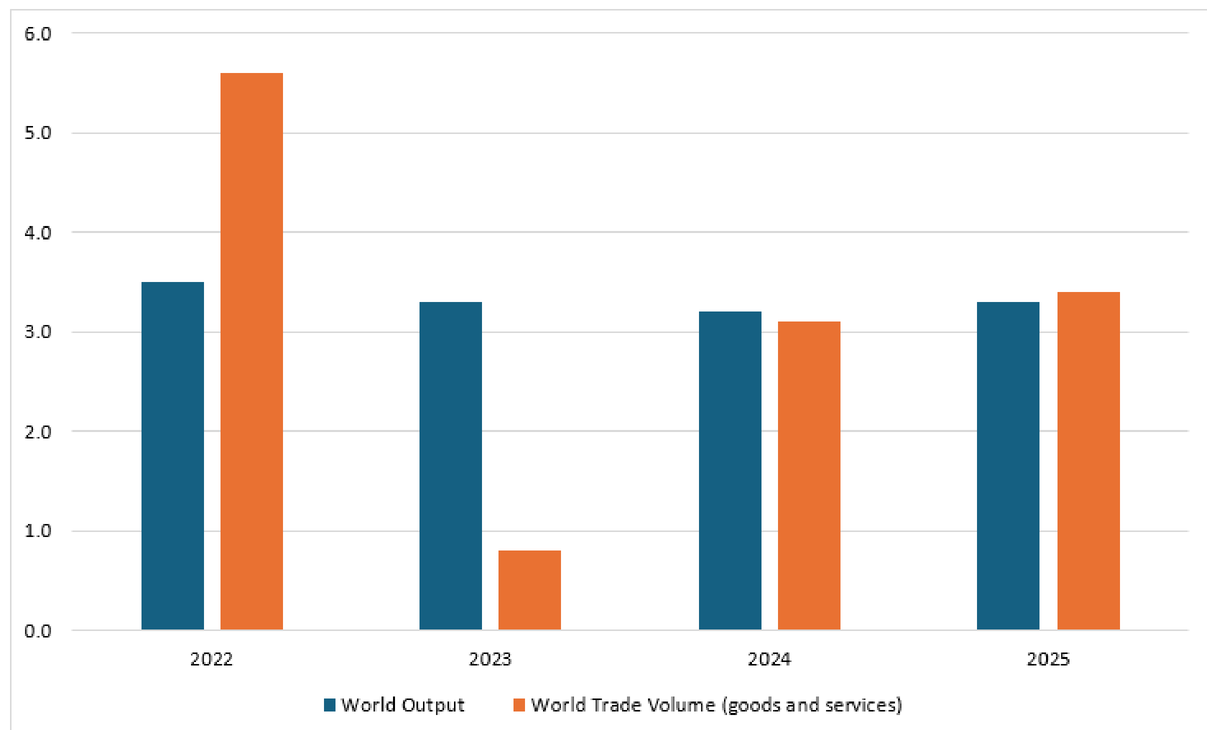
Given these considerations, we expect a return to export growth in 2024, in line with international trends as well as sector specific developments. We also expect a continued rate of growth into 2025. We forecast exports to grow by 6.8 per cent in 2024 and 3.0 per cent in 2025. The lower pace of growth in 2025 reflects a base effect in the 2024 levels because of the exceptionally high level of exports in the other services category in service exports.

FIGURE 12 GOODS EXPORTS – VALUE – BY COMPONENT – SHARE OF TOTAL AND YEAR-ON-YEAR % CHANGE



Source: Central Statistics Office.
Notes: 'Other Goods' is calculated by taking chemicals from the total value of goods exports.

FIGURE 13 WORLD AND ADVANCED ECONOMY OUTLOOK – % CHANGE YEAR-ON-YEAR

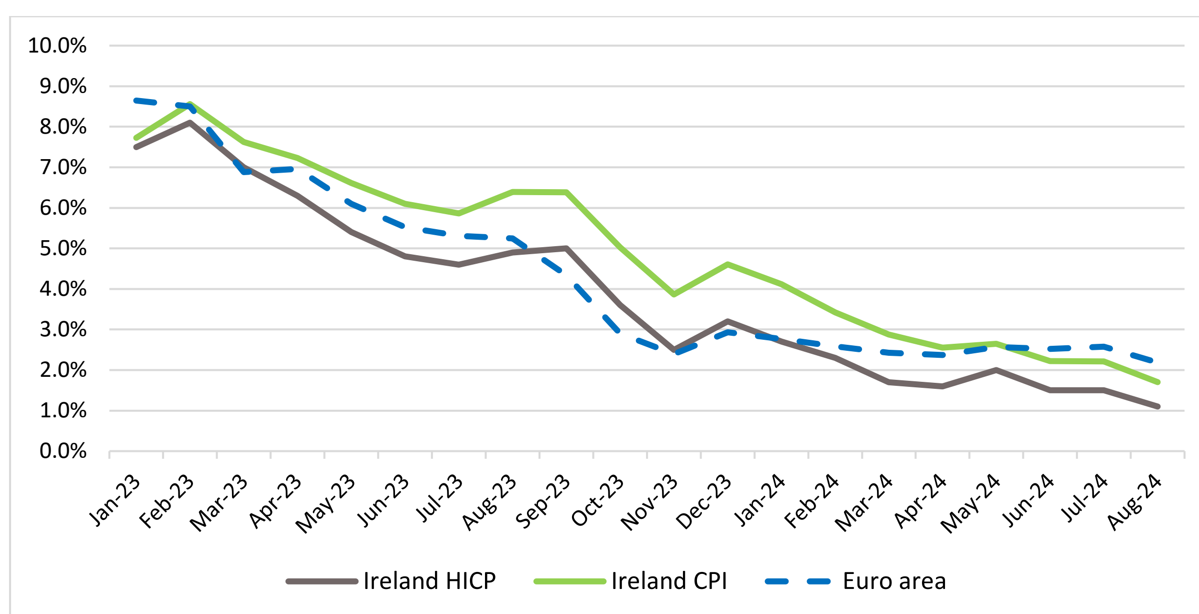


Source: IMF World Economic Outlook Update, July 2024.

INFLATION

Both the Consumer Price Index (CPI) and the Harmonised Index of Consumer Price (HICP) demonstrate that inflation in Ireland is continuing to decrease, as shown in Figure 14. CPI inflation is a bit higher, standing at 1.7 per cent in August 2024, the first time it has been below 2 per cent since June 2021, while the HICP stands at 1.1 per cent in August 2024. This is because the HICP measurement excludes mortgage rates. However, as will be shown below, mortgage interest payments are a part of the CPI that is still growing at a relatively high rate compared to the other the sub-indices.

FIGURE 14 IRISH CPI AND HICP COMPARED TO EURO AREA HICP

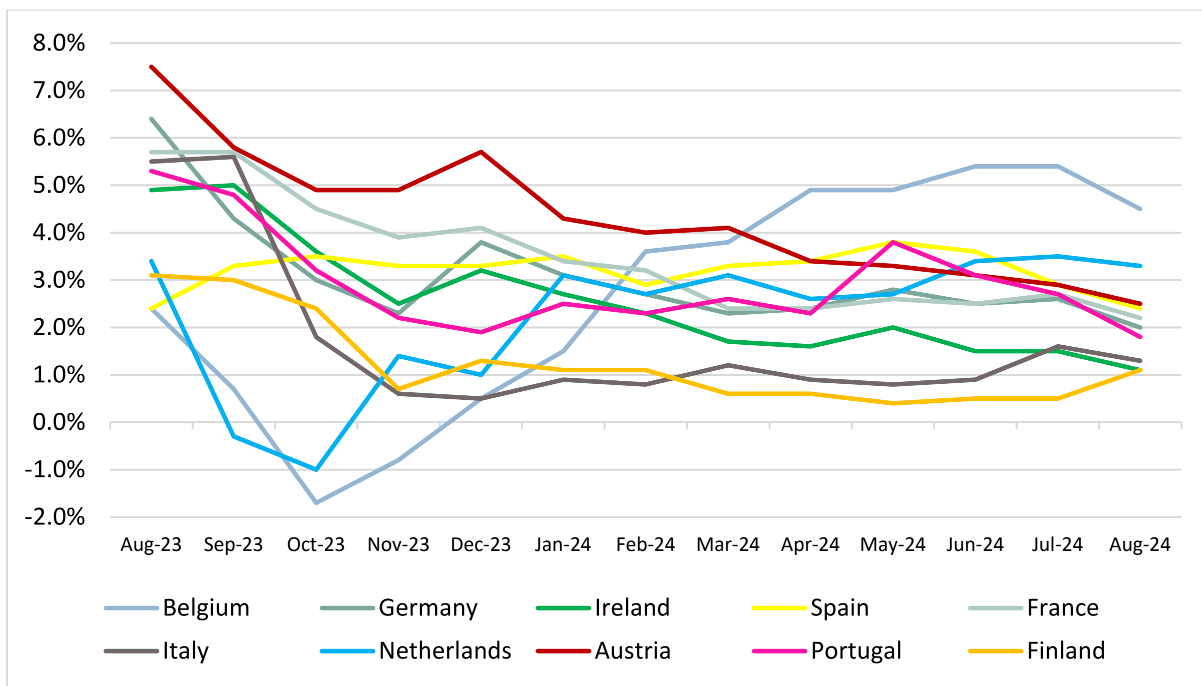


Source: Central Statistics Office and Eurostat.

Inflation across Europe

To provide a comparative view of Ireland's position among its European peers, Figure 15 illustrates the path of the HICP over the past 12 months across ten European countries. Ireland, alongside the Netherlands and Italy, is among the three countries with the lowest HICP inflation in August 2024, with these three countries reporting HICP rates below 1.5 per cent. The data also suggest that inflationary pressures are generally easing, as most countries are now reporting a decline in HICP inflation rates. These rates are approaching the European Central Bank's target of 2 per cent. Countries whose inflation rates have fluctuated more profoundly include Belgium, the Netherlands, Portugal and Austria.

FIGURE 15 HICP IN IRELAND AND SELECTED EUROPEAN COUNTRIES



Source: Eurostat.

Bernanke and Blanchard (2024)[6] provide an insightful analysis of pandemic-era inflation and its consequences. In developing a model which examines the roles of various shocks and transmission mechanisms driving inflation, Bernanke and Blanchard (2024) find that in most countries, initial price increases were primarily caused by adverse price shocks and sectoral shortages. These conditions led to tight labour markets, which initially had a minimal impact on inflation, compared to the price shocks. However, in some economies, the increasing tightness in labour markets eventually contributed to inflationary pressures, with the labour market playing a more significant role as the initial adverse price shocks began to subside.

However, as illustrated in Figure 15, not all economies are experiencing a strictly downward trajectory in inflation (e.g. Belgium, the Netherlands, and Portugal). This upward pressure on inflation in these countries could be attributable to the impact of tight labour markets.

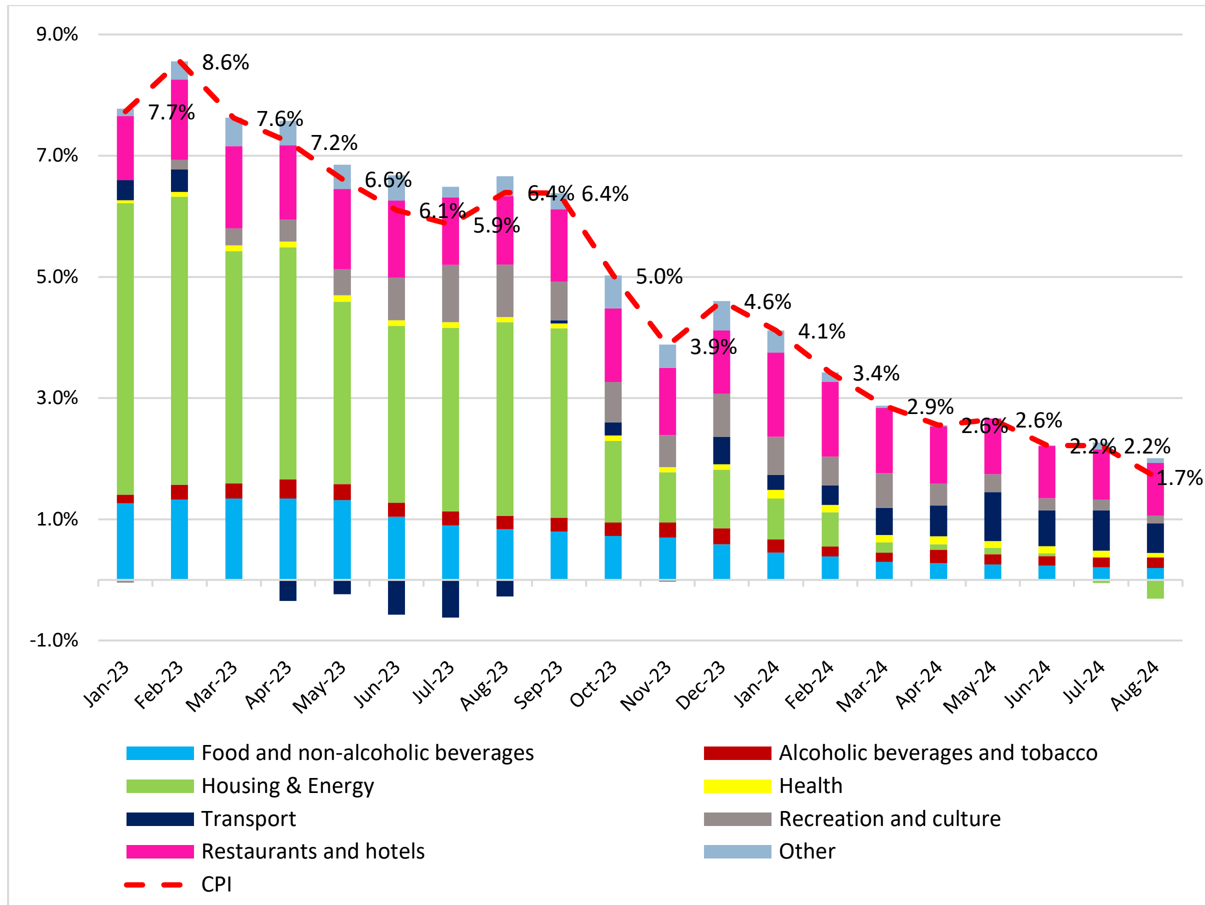
Drivers of CPI inflation in Ireland

In 2024, inflation appears to be following a downward path, standing at 1.7 per cent in August. Figure 16 depicts the development and drivers of CPI inflation throughout 2023 and 2024. It becomes clear that some of the sectors which contributed the most to the cost-of-living crisis – the 'Housing and energy' and

[6] Bernanke, B. and Blanchard, O. (2024). *An Analysis of Pandemic-Era Inflation in 11 Economies*. Peterson Institute for International Research.

'Food and non-alcoholic beverages' sectors – have experienced significantly slower rates of inflation in 2024. The 'Housing and energy' sector is even showing negative growth for the first time in July, and again in August 2024 (further discussed below).

FIGURE 16 WEIGHTED CPI DEVELOPMENT



Source: Central Statistics Office and authors' calculation.

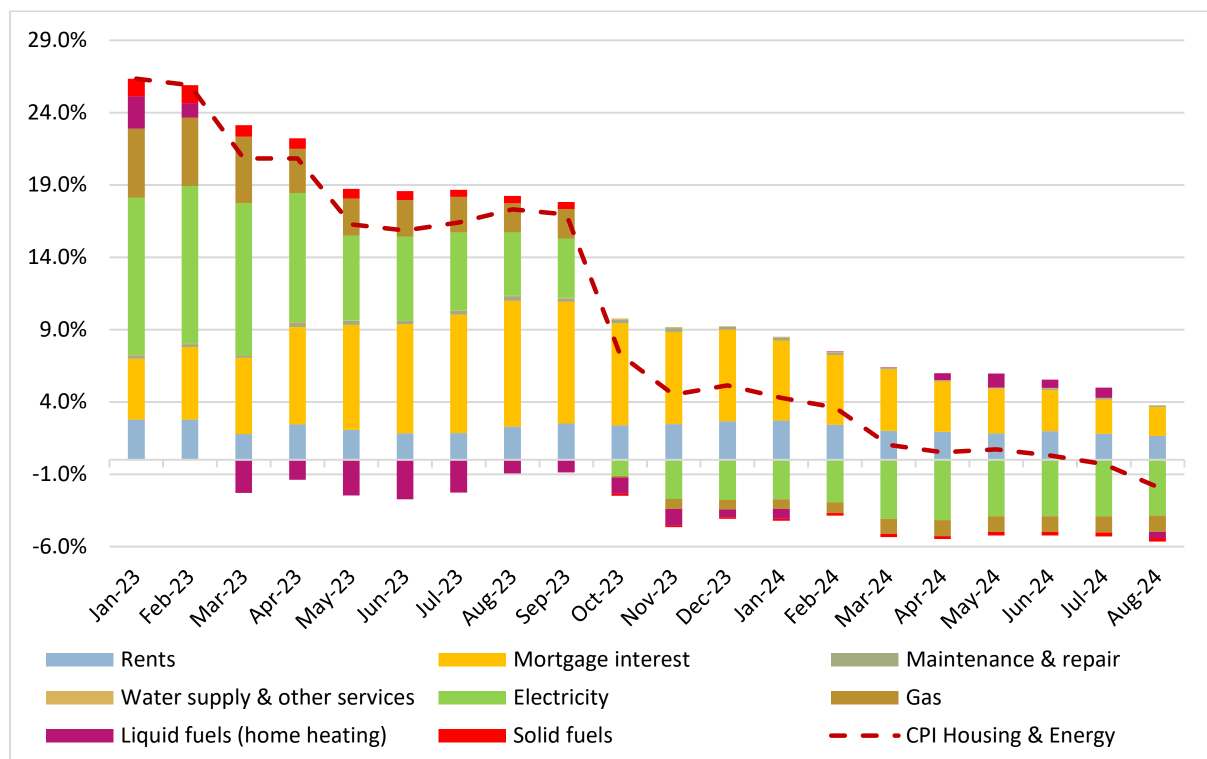
The main driver of inflation in July 2024 are 'Restaurants and hotels' and 'Transport', which together make up almost all of the current rate of inflation (i.e. 1.7 per cent). Within the transport sector, the sub-category that experienced the largest increase was 'Transport services'. While 'Diesel' prices were increasing by 10 per cent on a year-on-year basis throughout April to July, this has slowed down in August. The primary factor currently driving inflation appears to be the 'Restaurant and hotels' sector. Its contribution to inflation has only slightly decreased since the beginning of 2023, particularly when compared to other sectors. Among the subgroups[7] within the Restaurant sector, the ones that stand

[7] Being 'Restaurants and hotels', 'Catering services', 'Restaurants, cafes and the like', 'Licensed premises', 'Spirits – licensed premises', 'Wine – licensed premises', 'Beer – licensed premises', 'Soft drinks and mineral water', 'Restaurants, cafes, fast food and take-away food', 'Canteens', and 'Accommodation services'.

out in terms of price growth are 'Canteens' and 'Restaurants, cafes, fast food and take-away food'. All sub-categories within this category saw price increases ranging from 4 to 6 per cent in July 2024.

Among the CPI components, the 'Housing and energy' sector has garnered the most attention during periods of high inflation, as it was the primary driver of inflation and second-round effects, influencing sectors such as 'Restaurants and hotels'. However, as previously mentioned, this sector is now experiencing negative growth for the first time in a considerable period. Figure 17 illustrates that electricity and gas, which were previously the largest contributors to inflation, are now experiencing negative price growth. Components that have slowed in growth but remain positive include mortgage interest and rents.

FIGURE 17 WEIGHTED CPI COMPONENTS OF THE CATEGORIES 'HOUSING AND ENERGY'



Source: Central Statistics Office and authors' calculation.

Summary

Inflation developments in Ireland have been relatively stable. Both the Consumer Price Index (CPI) and the Harmonised Index of Consumer Prices (HICP) are decreasing gradually, standing at 1.7 per cent and 1.1 per cent, respectively, in August 2024. The sectors contributing most to CPI inflation in July 2024 are 'Restaurants and hotels' and 'Transport' while the 'Housing and energy' sector is contributing negatively to CPI inflation for the first time in some time.

Compared to other European countries, Ireland's inflation is continuously decreasing. The extent to which general inflation will continue to fall may at some

stage be influenced by the increasingly tight nature of the Irish labour market (as argued by Bernanke and Blanchard (2024). However, it is clear that the expected continued declines in crucial sub-indices of the overall inflation rate will result in lower inflation in the Irish economy in 2025 compared with that which prevailed in 2024.

Therefore, we expect CPI inflation in 2024 to average at 2.3 per cent and at 1.2 per cent in 2025.

LABOUR MARKET

The Irish labour market is currently operating very near to full capacity, with increasing employment levels and declining job vacancies – a trend typical of a market approaching full employment. The supply of labour is also expanding at a considerable rate, as indicated by recent increases in both the labour force participation and unemployment rates. This is likely driven by population growth due to high levels of inward migration. Consequently, while job vacancies are decreasing, the unemployment rate is increasing marginally, reaching 4.7 per cent in July 2024 – the highest rate recorded this year after a continuous rise. In August 2024 it reduced back to 4.3 per cent. Additionally, real wages have been increasing since the beginning of 2024 and are expected to continue rising.

Vacancies

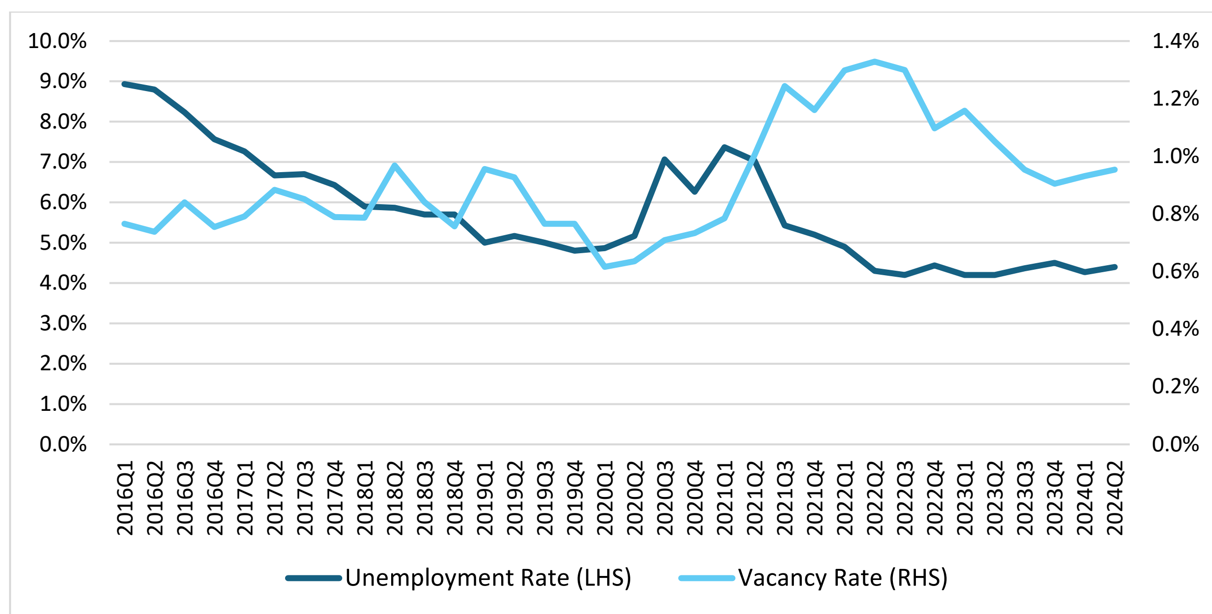
Although the year-on-year growth of overall vacancy numbers remains negative, the first two quarters of 2024 saw a renewed quarter-on-quarter increase in job vacancies following a two-year period of decline. Figure 18 displays the most recent data on the unemployment rate and the job vacancy rate. The job vacancy rate, which measures the proportion of job vacancies relative to the number of people employed, showed an upward trend in the second quarter of 2024. This increase is attributed to both a rising number of job vacancies and a continuously growing workforce (see below).

Sectors which showed significant year-on-year increase in vacancy rates are the Transport (260 per cent) and Construction (13 per cent) sectors. Furthermore, sectors that registered a considerable demand for labour in the second quarter of 2024 were the Industry (53 per cent), ICT (25 per cent), and Education (15 per cent) sectors. Most of the other sectors experienced a decrease in vacancies, indicating the general tightness of the labour market. Overall, the number of vacancies has decreased by 7 per cent.

Simultaneously, the unemployment rate has been gradually increasing. A recent adjustment by the CSO reveals that the unemployment rate has risen by approximately 0.1 percentage points each month throughout the year, reaching 4.7 per cent in July 2024. This increase is likely due to the expanding labour force and the growing number of individuals seeking employment. The recent performance of the labour market would suggest that this increase in

unemployment is a timing issue, where people who come into country and initially appear as unemployed quickly gain employment subsequently.

FIGURE 18 UNEMPLOYMENT AND VACANCY RATE



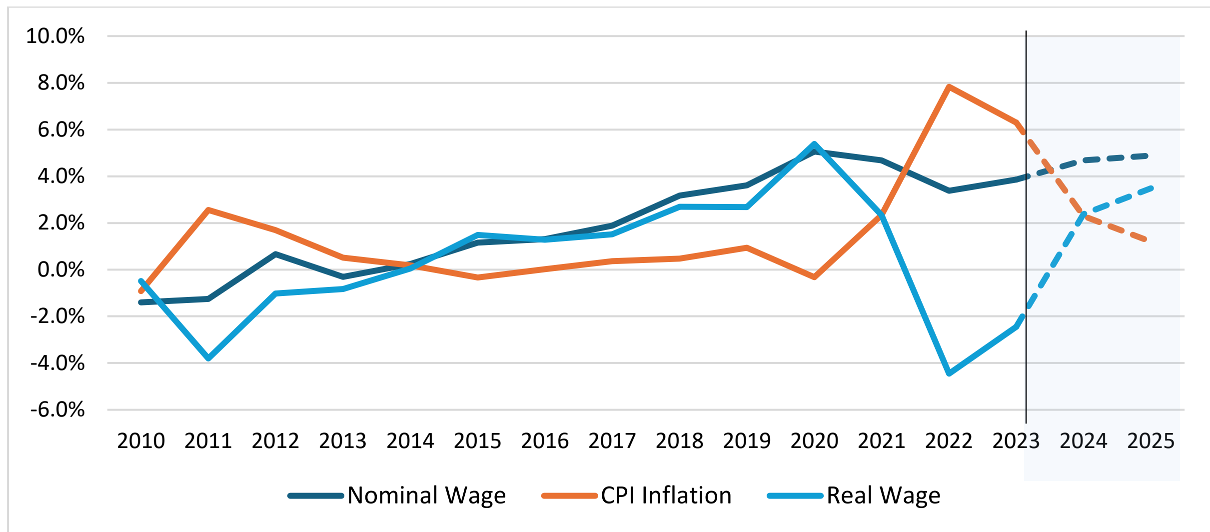
Source: Central Statistics Office and authors' calculation.

Real wages keep growing

Figure 19 illustrates the ongoing growth in both real and nominal wages including our forecasts for 2024 and 2025. As highlighted in the Summer 2024 *QEC*, the rise in real wages is attributed to both increasing nominal wage growth and declining CPI inflation, as previously discussed. In the second quarter of 2024, nominal wage growth is not as pronounced as the sharp increase in real wages, suggesting that a significant portion of the real wage growth is due to the ongoing decline in inflation. This becomes even more evident when looking at the forecasted area of the graph.

This increase in real wages signifies a recovery in household purchasing power. However, as noted in previous *Commentaries*, during periods of exceptionally high inflation households relied on savings accumulated during the post-COVID-19 period. Consequently, in the presence of ongoing higher price levels, it remains uncertain whether these higher real incomes will be directed toward savings or will be used to increase consumption.

FIGURE 19 NOMINAL AND REAL WAGE GROWTH FORECAST

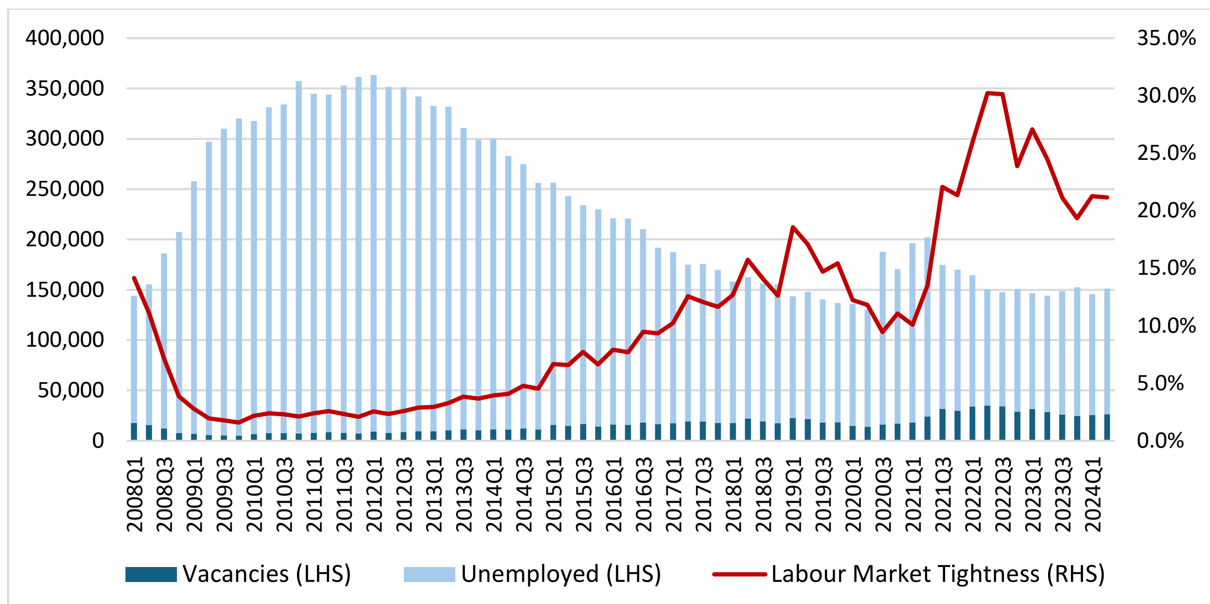


Source: Central Statistics Office and authors' calculations.

Tightness of the Irish labour market

An important assessment of any labour market, particularly one experiencing increased demand, is its tightness, which occurs when the demand for labour exceeds its supply. This tightness is characterised by low unemployment rates, high vacancy rates, and rising wages. Many countries measure labour market tightness using the ratio of job vacancies to unemployed individuals. In Ireland, Figure 20 illustrates this by displaying the number of vacancies, the number of unemployed individuals, and the resulting labour market tightness ratio. The higher this ratio, the tighter the labour market.

FIGURE 20 LABOUR MARKET TIGHTNESS IN IRELAND



Source: Central Statistics Office and authors' calculations.

As illustrated, during the financial crisis there was a significant slack in the labour market, as there was a low number of vacancies and a high number of unemployed individuals. As unemployment decreased, the labour market gradually tightened, reaching its first peak in 2019 at 18.5 per cent, before declining between 2019 and 2021, primarily due to a drop in vacancies. However, starting in early 2021, the Irish labour market tightened again very quickly as both the number of vacancies increased and unemployment decreased at the same time. In mid-2022, the labour market reached its peak tightness, with a tightness rate exceeding 30 per cent, before easing slightly due to a decline in vacancies. Despite this, the number of unemployed individuals has remained relatively stable since early 2022. In the second quarter of 2024, tightness in the Irish labour market stands at 21.1 per cent.

Employment numbers keep increasing

The latest population estimates reveal the highest increase in population since 2008. According to the CSO, this growth is primarily driven by immigration rather than due to natural increase.[8] Consequently, it is important to examine the employment patterns of non-Irish/EU/UK citizens in assessing their impact on Irish society and the labour market.

The latest labour market data indicate a consistent increase in employment over time. As of the second quarter of 2024, the number of employed individuals has reached its highest level on record. Since the latter half of 2022, the average quarterly increase in employment has been 3 to 4 per cent.

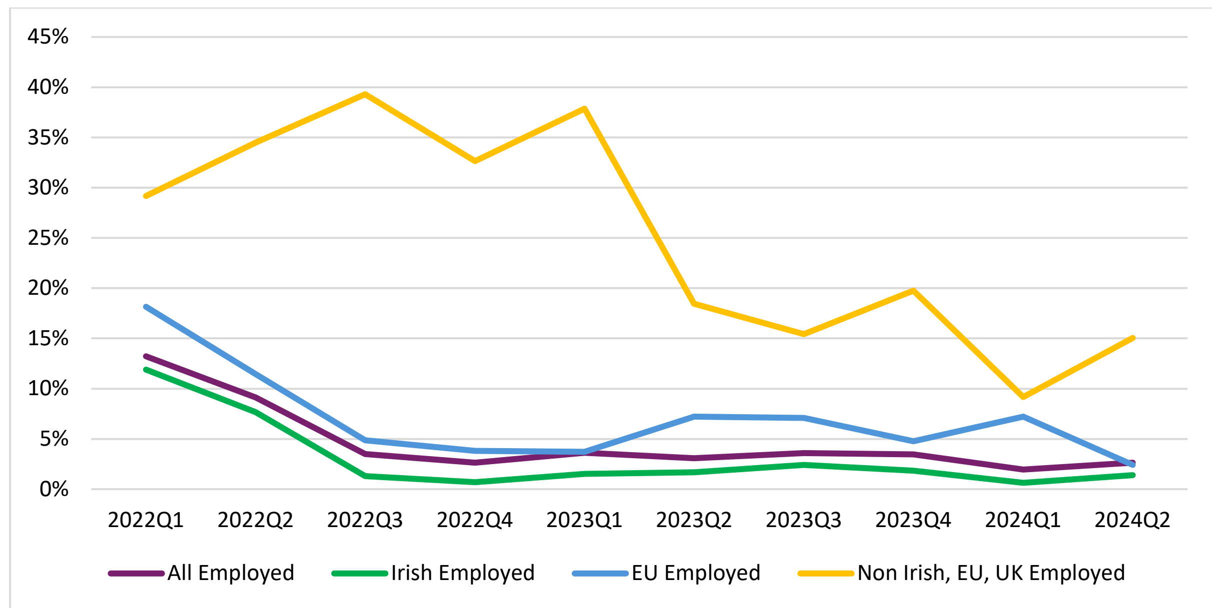
Figure 21 provides a breakdown of employment growth by nationality, revealing that among Irish citizens, EU citizens, and non-Irish/EU/UK citizens, the latter group has experienced the most significant growth in employment in the past two years. The year-on-year growth rate for this group has been more variable than for the others, ranging from 9 to 39 per cent per quarter. Notably, the highest increases were observed in 2022 and early 2023.

In the most recent quarter, employment for non-EU/UK citizens rose by 15 per cent, building on an already elevated level in 2023. This aligns with the findings presented in Figure 22, which shows the absolute number of non-Irish/EU/UK citizens over the past three years by employment status. The data reveal not only an increase in the number of people within this group but, more importantly, a significant rise in those who are employed. As discussed in the Summer *QEC* 2024, the relevance of non-Irish/EU/UK citizens in essential sectors such as the 'Human health and social work activities' is clear. In contrast, the same graph for individuals with EU or Irish citizenship would display a much more even pattern over the same period, with no significant changes in either the labour force population or the number of employed individuals (as indicated in Figure 21).

8 The natural increase is the number of births minus the number of deaths in Ireland.

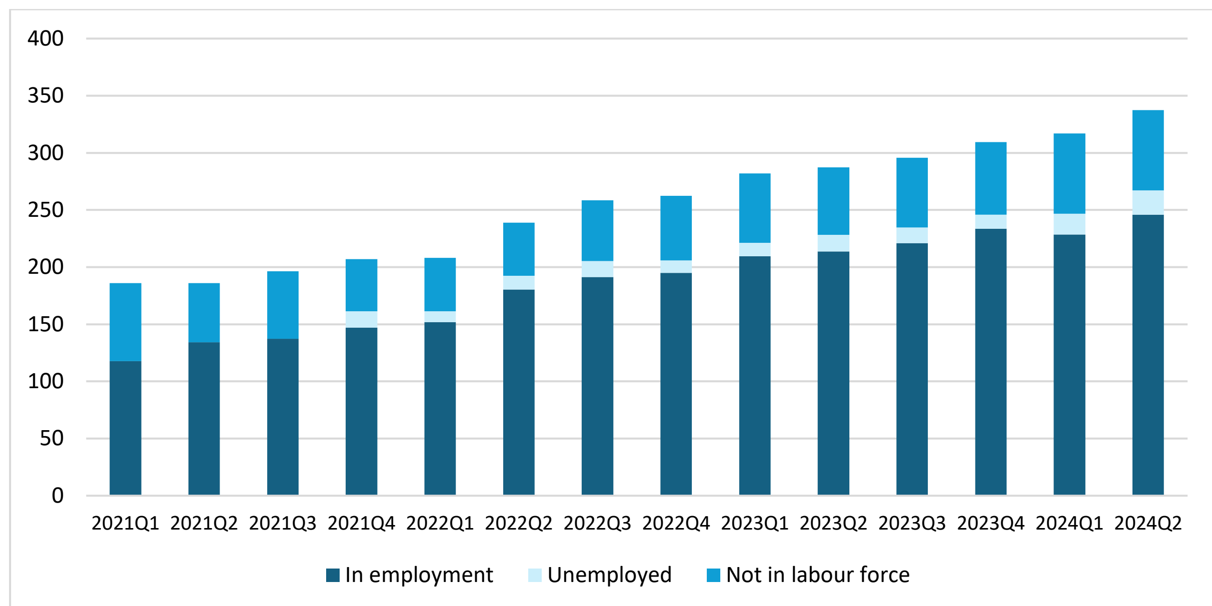
These findings highlight the significance of immigration for Ireland, as an increasing number of people in employment plays a crucial role in increasing the growth capacity of the domestic economy.

FIGURE 21 YEAR-ON-YEAR EMPLOYMENT GROWTH BY CITIZENSHIP (%)



Source: Central Statistics Office.

FIGURE 22 NUMBER OF CITIZENS FROM OUTSIDE IRELAND, THE EU, OR THE UK BY EMPLOYMENT STATUS ('000)



Source: Central Statistics Office.

Sectoral employment trends

Overall employment has increased 2.6 per cent compared to the second quarter in 2023. Examining sectoral disparities, it shows that nearly all sectors show an increase in the number of people employed compared to last year. However, the Construction and Wholesale sectors are exceptions, as both have experienced a decline in employment of approximately 7 per cent compared to the same period last year. In both sectors, employment decreased for both men and women. Notably, the decline in the Wholesale sector was relatively balanced between genders, while in the Construction sector, the reduction in employment was more pronounced among women. Although job vacancies in the Construction sector have increased, vacancies in the Wholesale sector have declined, suggesting a slight contraction in the latter.

The sectors with the most significant employment growth are 'Professional, scientific, and technical activities,' which increased by 12.6 per cent, and the 'ICT' sector, which grew by 6.4 per cent. Additionally, male employment in the 'Health and social' sector notably increased by 20.5 per cent. Despite this growth, the sector remains predominantly female, with women comprising 78 per cent of the workforce as of the second quarter of 2024.

Summary

As employment numbers are rising, and job vacancies are decreasing, there has been a mild increase in recent quarters in the unemployment rate. This seems to be due to the fact that both labour demand and supply are increasing at present in the Irish economy. Additionally, the expanding population initially contributes to a higher unemployment rate; however, as discussed throughout this section, this growth eventually leads to an increase in employment levels. We expect that the unemployment rate will stabilise at 4.3 per cent in 2024 and decrease slightly to 4.2 per cent in 2025.

We also present an alternative indicator of the labour market, specifically its tightness. During the financial crisis, the Irish labour market was characterised by low vacancy levels and high unemployment, indicating a loose labour market. However, over time, the market tightened considerably, reaching a peak tightness of over 30 per cent in mid-2022. By the second quarter of 2024, labour market tightness had decreased to 21.1 per cent, indicating a continuing downward trend.

Furthermore, as shown above, nominal and real wages have been increasing. Due to those trends and the continuous decrease in inflation, as discussed in the section above, we expect real wages to grow 2.4 per cent in 2024 and by 3.5 per cent in 2025.

Public Finances

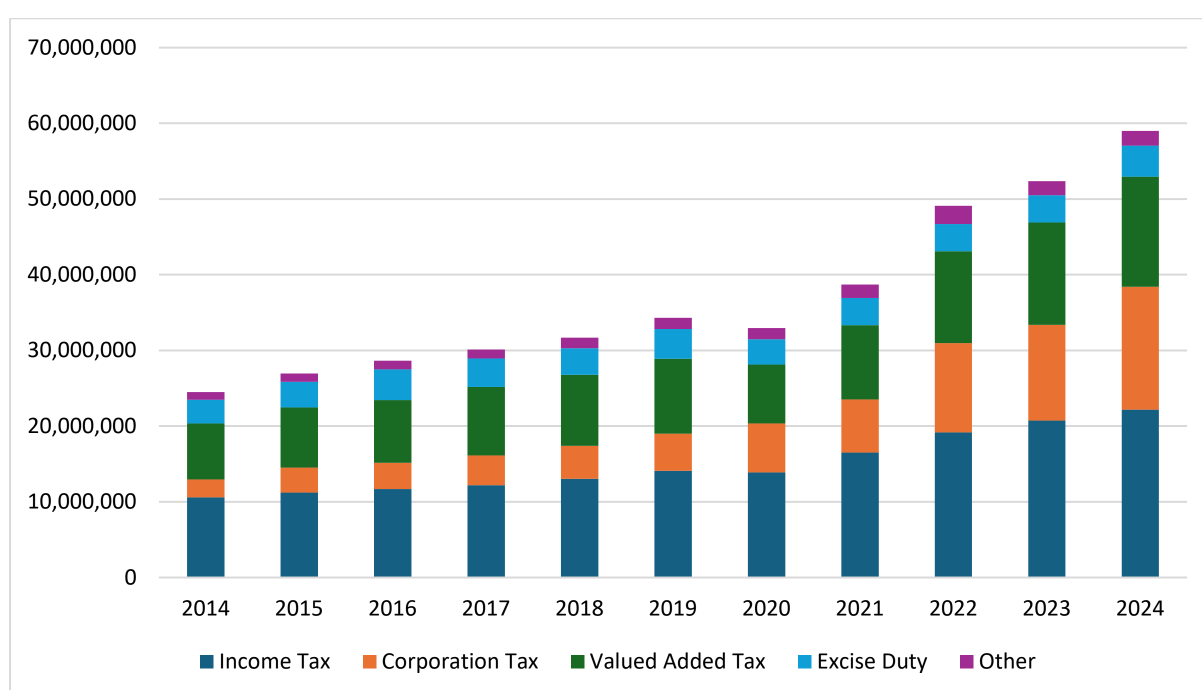
Overview and forecast of tax revenue

As of August 2024, tax receipts registered a substantial increase in overall revenue compared to the same period in 2023. This trend is apparent in Figure 23, which tracks the evolution of revenue across major tax categories over the past decade. Each block in the figure represents tax revenues collected from January to August of each respective year.

Corporation tax receipt growth

Notably, corporation tax receipts have shown a particularly sharp and consistent rise over this period. While income tax and VAT receipts have also experienced continuous growth, their increase is not as pronounced as that of corporation tax receipts. The 'Other' tax category includes Customs, capital gains tax, capital acquisitions tax and stamps, and has barely changed over time. The same can be said about excise duties.

FIGURE 23 GROWTH RATE OF MAIN TAXATION HEADINGS, JANUARY-AUGUST ('000)



Source: Department of Finance and authors' calculations.
Note: 'Other' includes Customs, capital gains tax, capital acquisitions tax and stamps. Calculations for all years are for the time of January to August in the year.

To illustrate the significance of Government revenue from corporation taxes, Figure 24 presents corporation tax receipts per capita over time. For the years 2013 to 2023, the per capita amounts were calculated by dividing the total corporation tax receipts for each year by the population. The data reveal a consistent upward trend. While Ireland's population has been steadily increasing, as discussed earlier, corporation tax receipts have been growing at an even faster rate. For 2024, the calculation is based on corporation tax receipts collected up to August of that year.

Despite it being for the year to August, the total corporation tax revenue already stands at €3,022 per capita, thereby surpassing all previous years except for 2022 and 2023. It is expected that the 2024 figure will also exceed even these years' totals. The Department of Finance estimates that a large component of the corporation tax receipts (approximately €11 billion in the present year) can be classed as windfall. If these windfall taxes are removed from the surplus calculations, the Government budget balance would be in a deficit situation.

Expenditure Issues

The latest stability programme update (SPU)[9] provides estimates of Government expenditure in both current and capital expenditure out to 2030. There has been some concern expressed about the scale of likely Government expenditure over this period. To that end, it is interesting to contrast both actual and planned expenditure with actual and likely Exchequer receipts as an indication of the potential sustainability or otherwise of Government fiscal policy. Box 1 by McQuinn and Walsh (2024) examines future expenditure levels in terms of the likely size of the economy.

Figure 25 plots the ratio of Government expenditure[10] to total Exchequer receipts over the period 1995–2030. To remove the issue of heightened corporation tax returns we exclude this category from overall taxation receipts. For the future period (2024–2030), we use the expected expenditure levels from the SPU, and we grow total Exchequer receipts (exclusive of corporation taxes) by 5 per cent per annum.[11]

From the graph it is clear there have been periods where expenditure levels grew quite substantially vis-à-vis the level of Exchequer receipts; in particular the period during the Global Financial Crisis (GFC) and more recently during the COVID epidemic. However, over the forecast period, it does not appear that expenditure levels are growing in an unsustainable manner given likely increases in Exchequer receipts over the period.

One other expenditure issue worth highlighting in the present context is the deviation this year between actual and profile expenditure where profile is the forecast of expenditure levels by the Department of Finance at the start of the year. Already, for the year to August, actual expenditure is ahead of profile by over €2 billion. This is a particularly large deviation and this significant overrun observed in 2024 is primarily attributable to rising healthcare costs. This issue is also explored in Box 1 by McQuinn and Walsh (2024).

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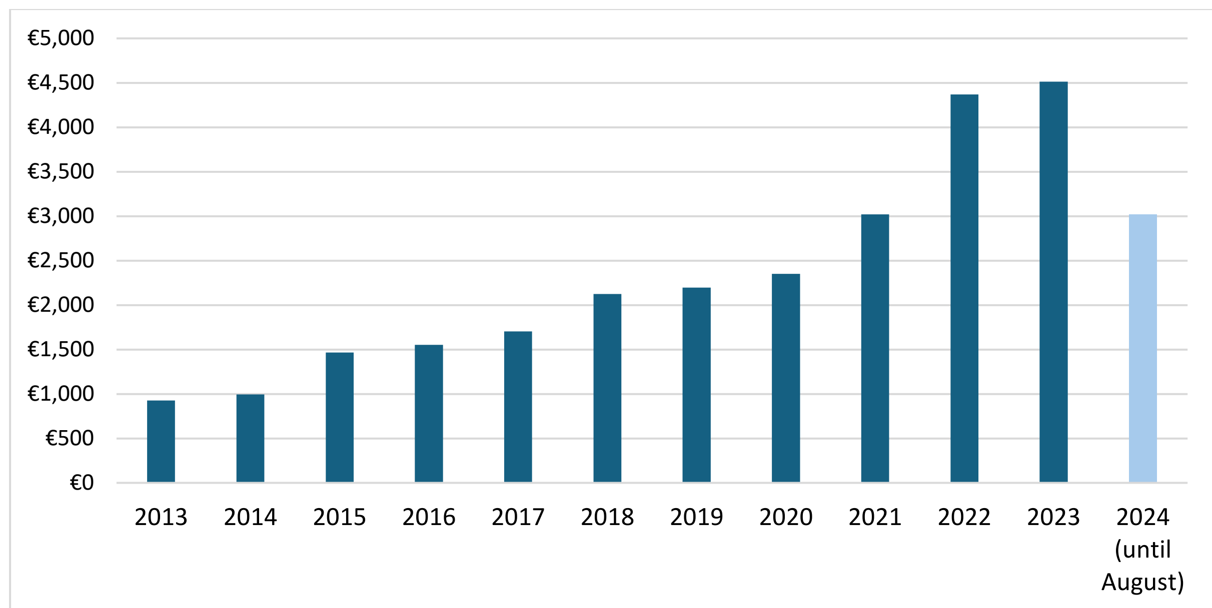
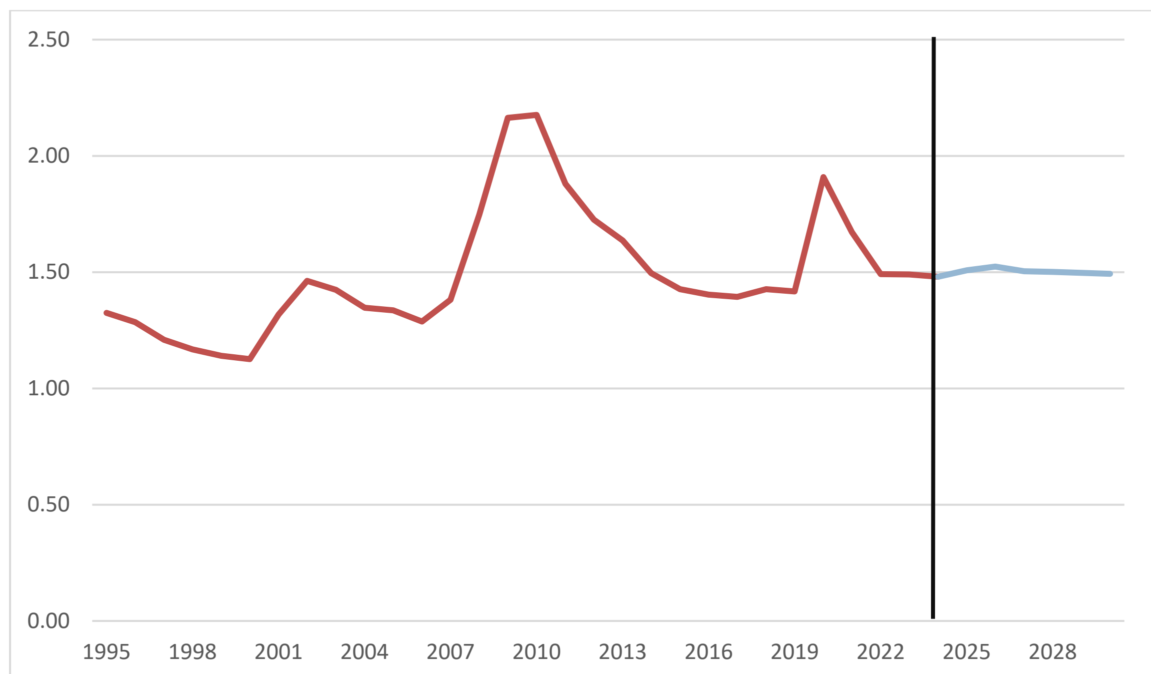
9 Details can be observed at: https://www.gov.ie/en/campaigns/e1e94-stability-programme-update-2024/.
10 Gross expenditure is used in this case.
11 This is a rather conservative forecast given recent increases in this taxation category.

FIGURE 24 CORPORATION TAX RECEIPTS PER CAPITA



Source: Exchequer Receipts, CSO, and authors' calculations.

FIGURE 25 RATIO OF TOTAL GOVERNMENT GROSS EXPENDITURE TO TOTAL EXCHEQUER RECEIPTS – EXCLUSIVE OF CORPORATION TAXES – 1995-2030



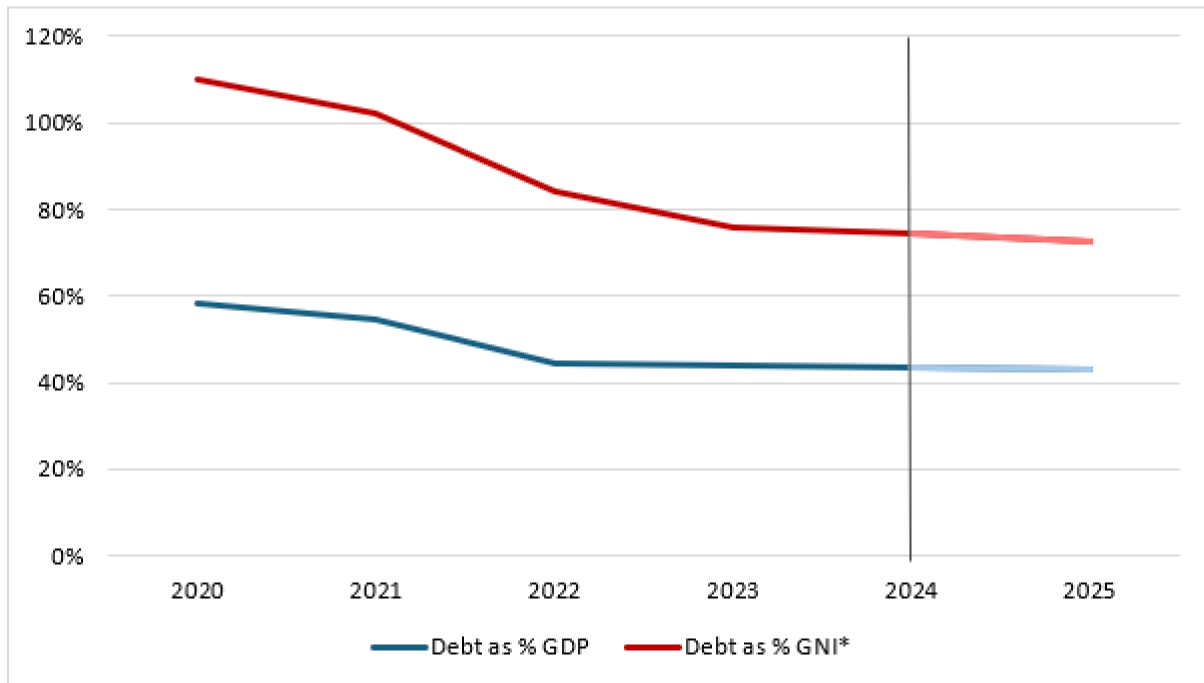
Source: Department of Finance and authors' calculations.

Debt-to-output ratios declining

As illustrated in Figure 26, the debt-to-output ratio has decreased when measured against both GDP and GNI*. This decline is attributable not only to the rise in both output indicators over recent years but also to a reduction in debt levels.

Additionally, the General Government Balance (GGB) has shown consistent improvement, with projections indicating a significant surplus in both 2024 and 2025. This would mark four consecutive years of surplus, the first occurrence of such a trend since 2007. The pattern is expected to persist into 2025, as further reflected in Figure 26.

FIGURE 26 DEBT-TO-OUTPUT RATIO TREND AND FORECAST



Source: Department of Finance and authors' calculations.

Summary

In summary, public finances are anticipated to improve further in 2024 and 2025. The General Government Balance is forecasted to exceed 1.5 and 1.6 per cent of GDP during these years, contributing to a reduction in the total debt-to-GDP ratio and the debt-to-GNI* ratio, which are expected to fall to 33 per cent and 56.2 per cent, respectively, by the end of 2025.

BOX 1 ASSESSING PUBLIC EXPENDITURE AND REFORM

Introduction

In this Box we update previous estimates of fiscal policy to assess the sustainability of current and projected Government expenditure over the medium term. Concerns have been raised about the large increase in Government expenditure in recent years as outlined in the recent Summer Economic Statement,[12] which details planned Government expenditure over the next six years. We also discuss how increased expenditure in key Government departments should be accompanied by the publication and monitoring of indicators to track the productivity and efficiency of these sectors. The focus will be particularly on the health sector, which has observed significant increases in funding over recent years.

We examine Government expenditure both historically and for the forecast period 2024–2030. In doing so we revisit the approach used in McQuinn (2023) where we divide expenditure levels by an indicator for national output as a way of evaluating the sustainability of such expenditure levels. Wren-Lewis (2024) recently advocates such an approach, arguing that it controls for inflation and real growth, which affect both the public as well as the private sector. He argues that examining spending relative to national output provides a better understanding as to whether public services are improving or deteriorating, compared to indicators that only control for inflation.

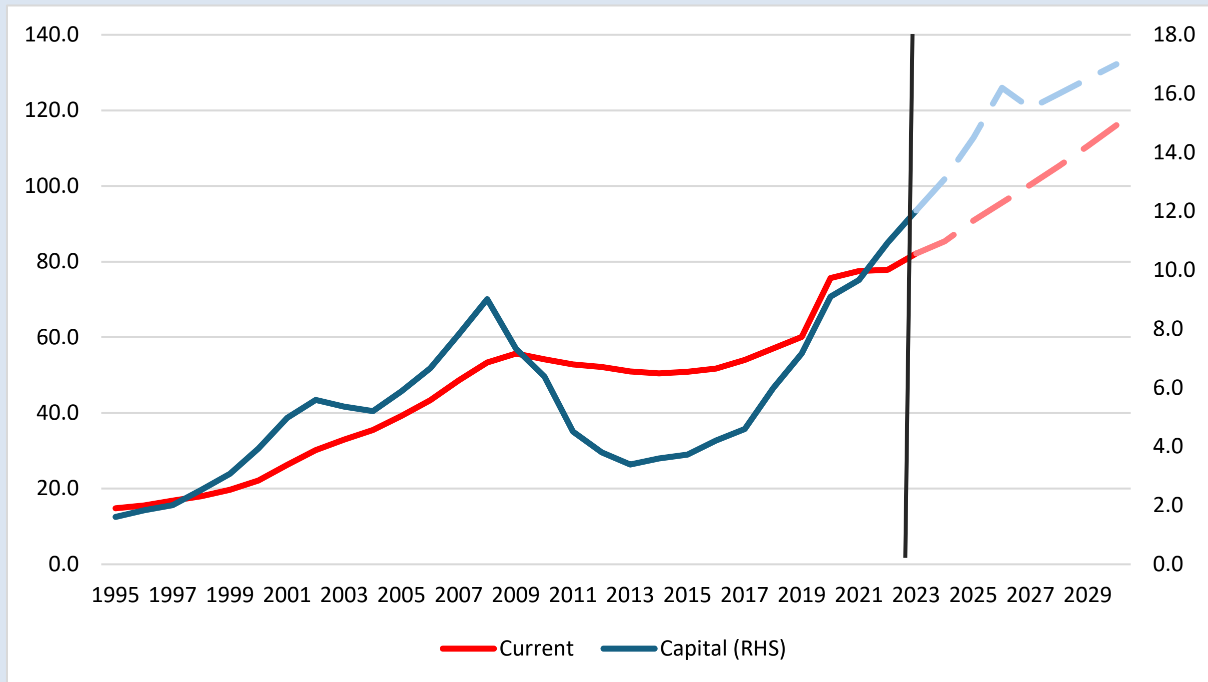
In an Irish context, difficulties with using GDP or GNP as an indicator of overall national output have been well documented (Lane, 2017; FitzGerald, 2018; FitzGerald, 2020; Honohan, 2021; FitzGerald, 2023; and Kostarakos et al., 2023). Therefore, following FitzGerald (2020) and FitzGerald (2023) we use net national product at factor cost (NNP) as our indicator of output for the Irish economy. Fitzgerald (2018) advocates using NNP as a measure of output over GNI* as separate contributions by individual sectors of the economy can be identified using NNP. Additionally, as an indicator of output, NNP is being increasingly published by other countries facilitating cross-country comparisons.

Figure B.1 displays actual and planned Government current and capital expenditure over the period 1995 to 2030.[13]

12 See https://www.gov.ie/en/publication/ee21b-summer-economic-statement-2024/ for details.

13 We use gross as opposed to net as agencies such as the Parliamentary Budget Office (PBO) tend to use the gross concept when discussing Government spending. See https://data.oireachtas.ie/ie/oireachtas/parliamentaryBudgetOffice/2023/2023-06-13_measuring-the-cost-of-public-service-provision-gross-and-net-spending-in-ireland_en.pdf for more details.

Figure B.1: Actual and planned Government gross current and capital expenditure 1995 – 2030 (€ billion)



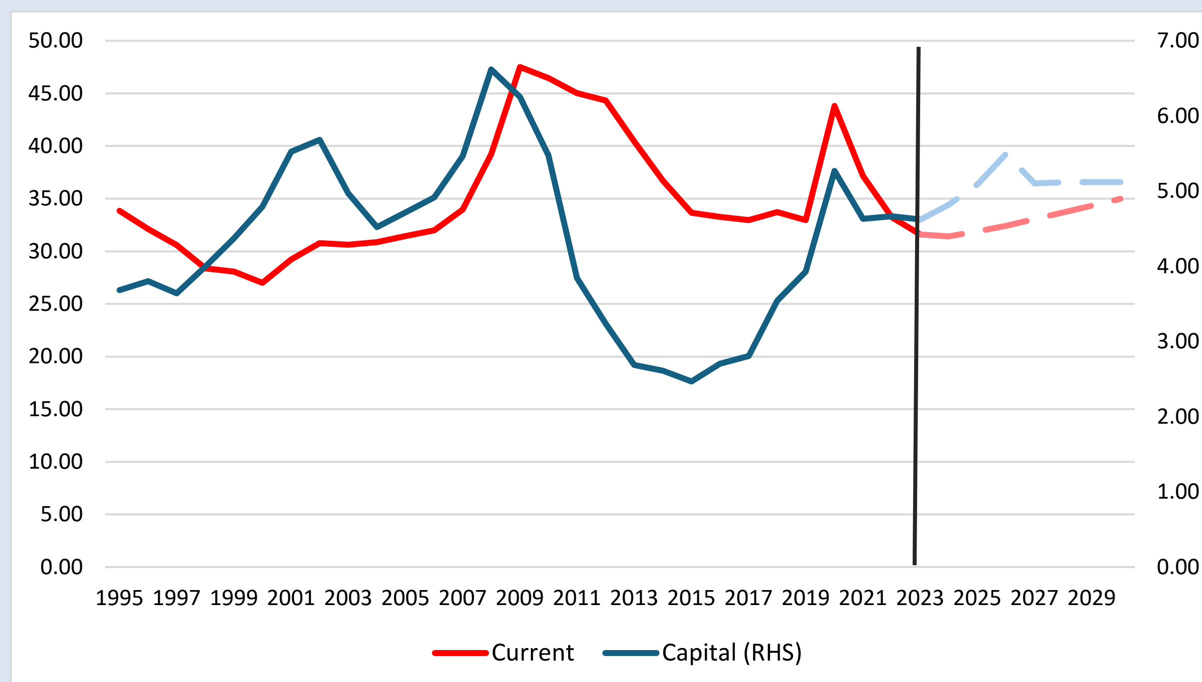
Source: QEC calculations.

Figure B.1 shows significant fluctuations in Government expenditure over time. During the pre-Global Financial Crisis (GFC) period, both current and capital expenditure increased significantly. The crisis saw both expenditure levels decline with capital expenditure particularly witnessing a sharp drop. From 2017 onwards, expenditure levels have begun to increase again. The dotted lines after the vertical black line in Figure B.1 display planned further expenditure over the period 2025 to 2030. Total expenditure between both current and capital expenditure is projected to increase by 35 per cent over this period to €133 billion in 2030.

On the face of it, this appears like a substantial increase, but what happens when we normalise it by national output over the same period? Figure B.2 presents actual and planned Government expenditure as a proportion of our indicator for national output.[14]

[14] We use actual output until 2023. For 2024 and 2025, *QEC* forecasts for real output growth and inflation are used to forecast the output level forward to 2025. From 2026 to 2030, we take real output growth at 2 per cent per annum and inflation at 1 per cent per annum resulting in total output increasing by 3 per cent over the period.

Figure B.2: Actual and planned Government gross current and capital expenditure compared to national output 1995-2030 (%)



Source: QEC calculations.

Figure B.2 shows that although both ratios of expenditure to output have increased from 2017 onwards and are expected to increase between 2024 and 2030, they remain somewhat lower than those observed at the height of the 'Celtic Tiger'. Capital expenditure peaked as a percentage of national output in 2008 at 6.6 per cent, while current expenditure peaked in 2009 at 47.5 per cent. However, by 2030, capital expenditure is expected to be just over 5 per cent of national output while current expenditure is set to reach 35 per cent. Accordingly, both are still somewhat less than their historical peaks.

Therefore, although expenditure levels have increased somewhat in recent years, overall spending is still recovering from the post-GFC period when fiscal policy was forced to contract sharply due to the budgetary pressures at that time. The swift and persistent recovery in the economy since that period has meant that overall economic activity outpaced the level of Government expenditure, particularly over the period 2010 to 2017. In 2024, for instance, capital expenditure was only at the same rate of national output as it was in 1999.

Quality of expenditure?

While the necessity for greater investment – and hence Government expenditure – in the Irish economy has been clearly outlined in Barret and Curtis (2024) amongst others, it is also essential that any significant increase in Government expenditure must be accompanied by improved productivity and efficiency in these sectors. The

risk is that expenditure levels will increase without a commensurate increase in performance in areas such as health, housing, and climate change.

To ensure greater productivity and efficiency, metrics that provide an accurate assessment of performance in the respective sectors must be established and measured. Changes in these metrics can then be gauged in light of the increased investment in the different areas.

One area which has been in receipt of significant increases in Government spending has been the health sector. It is generally acknowledged for example, that the Irish health service is quite poor at capturing health service productivity. A Productivity and Savings Taskforce[15] was set up in January 2024 with the intention of generating savings and productivity improvements across the HSE. This consisted of:

> *'a Productivity and Savings Taskforce Action Plan being published with a timeline to achieve savings and increase productivity such as through the reduction in expenditure on management consultants, reduce non-pay expenditure, and reduce waiting times for care.'* (Productivity and Savings Taskforce).

While this is a step in the right direction, the metrics used to measure productivity are generally recognised as being somewhat crude in nature. The Taskforce refers to the Acton Plan as a 'living document', and refinement of metrics will be required over time.

To date the taskforce has published a first Indicator Dashboard[16] which outlined new productivity metrics such as patient numbers per consultant working time equivalents (WTEs) or waiting numbers per hospital. Significant variations across time and regions were identified in the dashboard; however, little explanation for the variation was provided (e.g. patient complexity). Identifying and quantifying the appropriate metrics to track productivity developments, particularly in the health sector, is not a trivial exercise as shown by the Institute for Fiscal Studies (IFS) in the UK, for example. They outlined the problems of measuring productivity in the NHS,[17] and many of the problems experienced developing productivity metrics in the NHS can be applied to the Irish health system.

Concluding comments

While there has been a significant increase in public expenditure recently, this could be argued as a catch-up for a period following the GFC, when there was a substantial contraction in Government expenditure. Using metrics previously used proposed in McQuinn (2023), it is clear that expenditure is not on an unsustainable path, even

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15 https://www.gov.ie/pdf/?file=https://assets.gov.ie/295333/2777d1ad-d8f8-4070-ac7d-388e4066c61a.pdf#page=null.

16 https://app.powerbi.com/view?r=eyJrIjoiNDY0NDVlNjAtODdkNi00ODRhLThjY2MtMzNlNTMxMmNmNDEzIiwidCI6IjVmNjdkNGNjLTVjOTAtNDAyZC05ZDZmLWFhZjIzYTRhNWM4MSIsImMiOjh9.

17 https://ifs.org.uk/articles/there-really-nhs-productivity-crisis.

when one allows for the increase in spending outlined by the Government in its most recent Summer Economic Statement. This is because the Irish economy, as measured by NNP at factor cost, has been increasing substantially since 2013 with public expenditure only picking up since 2017. Furthermore, the economy is expected to grow at a slightly reduced but persistent rate over the period 2024 to 2030.

A significant challenge for policymakers over this period, however, is ensuring that any increase in expenditure results in improved outcomes in major areas such as housing, health and climate change, given that the current buoyancy in Irish public finances is unlikely to last indefinitely. This necessitates the development and monitoring of appropriate metrics which accurately track the key outcomes in different areas of public policy. It would help focus the debate on whether areas which have not demonstrated improvements in delivery should actually be in receipt of any additional public funding.

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This Box was prepared by Kieran McQuinn and Brendan Walsh.

General Assessment

Current expected outlook – real income set to increase

While headline economic data appear to show some countervailing trends in the Irish economy, indicators, which better capture the underlying performance of the economy, suggest that it is experiencing reduced but consistent growth. The substantial decline in intangible assets within the domestic economy has led to a significant reduction in headline investment levels for 2024. This ultimately impacts GDP with that indicator set to decline by just under 0.5 per cent in the present year before growing again in 2025.

However, modified domestic demand (MDD), which captures underlying investment and consumption levels in the economy, is set to increase by a healthy 2.3 per cent in 2024 and by a further 3.1 per cent in 2025. The latest Nowcast estimate in the *Commentary* (see Egan and Kren, 2024, for details),[18] shows that MDD is currently growing at 2.5 per cent.

One of the main reasons for the expected continued growth in the Irish economy is the increase in real wages forecast for 2024 and 2025; this will be the first increase in real incomes since 2021. Indeed, in this *Commentary*, we are now forecasting stronger growth in real wages in 2025 as we expect the inflation rate to be lower than was previously the case.

Further evidence of the robust domestic performance of the economy is the health of the labour market, with employment levels continuing to grow and the unemployment rate remaining near to 4 per cent over the forecast horizon. This is despite the strong increase population levels which have occurred recently. Another accurate indicator of the state of the Irish economy is the Exchequer receipts. While developments in corporation taxes have tended to dominate movements in taxation receipts, it is worth noting that these receipts excluding corporation revenues are up nearly 8 per cent in 2024 for the year to August.

Population movements and the importance of inward migration

The recent CSO population estimates reveal that the overall population of the State is now 5.4 million and that net inward migration for the year to April was nearly 80,000. This constitutes the highest population level in the country since 1850, while net immigration has not been as high since 2007. In the context of a growing population, the labour market section has demonstrated the significant contribution made to the domestic labour force by inward migration. In particular, the sizeable contribution of employees in the healthcare sector now accounted for

[18] https://www.esri.ie/news/esri-nowcast.

by non-EU citizens. This is also the case across a number of crucial sectors of the domestic economy.

This underscores a recent point made by Wren-Lewis (2024),[19] which is the importance of acknowledging the positive contribution made by immigration in society. If public debate refuses to cite the benefits of immigration, it enables others to make erroneous claims about problems associated with immigration. For example, some cite the pressure on public services due to recent population increases; however, as the labour force data clearly show, immigrants play an important role in the provision of key public services.

Political uncertainty in the United States

November 2024 sees the United States take to the polls for a presidential election. In many respects the stakes for the international economy could not be higher. Both candidates have articulated their economic policies, however the possible election of the Republican candidate could see major consequences for macroeconomic stability. First, the possibility of an escalation in geopolitical tensions under a second Trump presidency cannot be underestimated.

Secondly, the policy stance of a new Trump presidency would have a highly distortionary impact on global trade. Trump has argued for a 60 per cent tariff on all imports into the United States from China and a 10 per cent increase across the board tariff on imports from everywhere else. The Republican candidate has also suggested that he would scrap federal income tax and replace it with revenues from these tariffs on imports. As outlined by Clausing and Obstfeld (2024),[20] this would be a particularly distortionary form of consumption tax as it would shift production in the US economy away from things it does well (e.g. export goods such as airplanes and light trucks) and toward goods in which the United States has no comparative advantage (e.g. clothing and furniture).

Finally, because of the potential tariff policy, Posen (2024)[21] has noted that the threat of inflation would be substantially higher under a Trump presidency. For example, the large-scale deportation of migrant workers, another Trump proposal, would be stagflationary with higher prices resulting from the lack of workers at the same time as a contraction in output from key sectors of the US economy.

All of these factors, along with other policy proposals such as Trump's intention for the Presidency to assume some degree of control over monetary policy would have considerable implications for the global economic outlook and by association Ireland's likely trade prospects.

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19 https://mainlymacro.blogspot.com/2024/08/transforming-politics-of-immigration.html.
20 https://www.piie.com/blogs/realtime-economics/2024/can-trump-replace-income-taxes-tariffs.
21 https://www.ft.com/content/b2941304-c3cd-491b-8fad-94be7296f958.

It is one reason for policymakers to be somewhat prudent in the design of Budget 2025 as global economic conditions could deteriorate somewhat in 2025, depending on the outcome of the US election.

Sustainability of the public finances

According to standard fiscal metrics, the Irish public finances appear in a robust state. The General Government Balance (GGB) is set to register a significant surplus in both 2024 and 2025. That will be four consecutive years in a row that a surplus will have been achieved and the first time that has occurred since 2007. Indeed, one could say that but for the exceptional set of circumstances in 2020 and 2021, the public finances would have been in an even stronger position.

However, there are notable risks, in particular around the concentration of the corporation tax receipts and their increase in recent years. Recent estimates of the windfall element of the corporation tax amounted to approximately €11.2 billion in 2023, with similar levels for 2024 and 2025.[22] If these figures are excluded from the General Government Balance, the Exchequer would be in a deficit position.

Public expenditure has increased significantly since 2017 and the Summer Economic Statement outlines more increases in spending for 2024 through 2030. This has caused some commentators to be concerned about the sustainability or otherwise of this spending increase. In a Box within the *Commentary*, McQuinn and Walsh (2024), updating work from 2023, show that once overall national output is taken into account, spending levels are somewhat lower as a percentage of national output than rates witnessed at the height of the Celtic Tiger. It still appears to be the case that public expenditure levels are catching up with the pace of economic growth after the Global Financial Crisis (GFC).

The importance of increased public and private investment in EU countries is one of the main conclusions emerging from the recent report about growth in the European Union chaired by former ECB President Mario Draghi (European Commission, 2024).[23] To meet the objectives laid out in this report, a minimum annual additional investment of €750 billion to €800 billion would be needed across the European Union. This would correspond to 4.4 – 4.7 per cent of EU GDP in 2023. Delivering this increase would require the EU's investment share to jump from around 22 per cent of GDP today to around 27 per cent, reversing a significant trend in declining investment across most large EU economies.

Indeed, there are a number of longer-term challenges which will impact the potential growth rate of the Irish economy and likely require significant State resources. These include infrastructure bottlenecks in housing, the requirement to

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[22] Government of Ireland (2024). 'Stability Programme Update', available online at: https://www.gov.ie/en/publication/f9556-stability-programme-update-2024/.

[23] European Commission (2024). 'The future of European competitiveness – A competitiveness strategy for Europe'. Available online at https://commission.europa.eu/document/97e481fd-2dc3-412d-be4c-f152a8232961_en.

invest in climate-related actions, and population ageing. However, addressing these bottlenecks immediately at full employment with capacity constraints poses a risk to the recent progress on inflation. To create space in the economy for such investments, the targeting of investment priorities (be they in housing, health or climate action) should be shifted towards those with low domestic labour intensity or high import content in the investment phase as noted in Barrett and Curtis (2024).[24] Given that infrastructure bottlenecks need to be addressed, restraint is needed in other areas of fiscal policy in order to create the space for the investment that is necessary. In particular, taxation policy must be particularly prudent if the risk of increasing inflation is to be avoided.

The recent decision by the European Court of Justice to set aside the judgment of the lower General Court concerning the Apple case means that the Irish public finances have arguably been boosted by another €13 billion. This relates to the EU Commission's 2016 original finding that Apple had underpaid taxes totalling €13.1 billion due to Ireland between 2003 and 2014. If some of this revenue is now to materialise it should be added to the existing revenues which have been diverted to the two recent investment funds set up by the State. As argued previously in the *Commentary* these funds allow the possibility of future capital investment in the Irish economy to be more acyclical in nature.

In terms of a sustained increase in Government expenditure though, this does necessitate a renewed focus on value for money and whether increased expenditure is yielding improved services in the areas such as health, housing and climate change for the public at large. As outlined in McQuinn and Walsh (2024) this requires the identification and estimation of a series of metrics which accurately track productivity in crucial areas of the public service. Future spending increases should then be evaluated against the progress or otherwise of those metrics. Some work has commenced in the health sector; in this regard, however, much more is required. Given the current relatively buoyant nature of the public finances, it would be a missed opportunity if the quality of Irish public services were not improved over the medium term.

Housing market issues

Recently there has been some speculation about the implementation of the proposed residential zoned land tax (RZLT). This tax is set to be charged each year on land that is zoned for residential use and has access to necessary services such as water supply, roads and lighting. The purpose of the tax is to prevent the hoarding of land which could be used for residential purposes. Recently some public debate has focussed on the difficulties which some farmers may experience if the tax were to go ahead, as they would be liable for the tax on land used for agricultural purposes. The rate of the RZLT is 3 per cent of the market value of the land. The market value is self-assessed by the landowner.

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[24] Barrett, A. and Curtis, J. (2024). *The National Development Plan in 2023: priorities and capacity.* ESRI Survey and Statistical Report Series 123. Dublin: ESRI. https://doi.org/10.26504/sustat123.

It is crucially important that the implementation of this tax proceeds immediately. This *Commentary* has argued on a number of occasions that addressing land prices is arguably the only way policymakers can significantly reduce the cost of supplying a house. Most other cost elements such as labour and materials are broadly speaking outside the control of Government. However, by addressing possible land hoarding, the price of land can be targeted, thereby potentially reducing a cost of production which, typically, accounts for approximately 15 to 20 per cent of the cost of a residential unit (see McQuinn, 2024).[25] Given the significant expenditure by the State on providing housing at present, it is imperative, as discussed previously in the context of the health sector, that policymakers explore all means of improving productivity when substantial amounts of public spending are involved.

[25] McQuinn K. (2024). 'Residential land prices for the Irish property market: An initial examination'. Economic and Social Research Institute (ESRI) Working Paper 778.

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