Banking & Payments Federation Ireland

Continued economic growth with highest ever employment

Inflationary pressures to continue in the short term

Long term energy efficiency measures needed

SME Monitor

OCTOBER 2022

Structural measures for energy efficiency needed to address higher costs

Commentary

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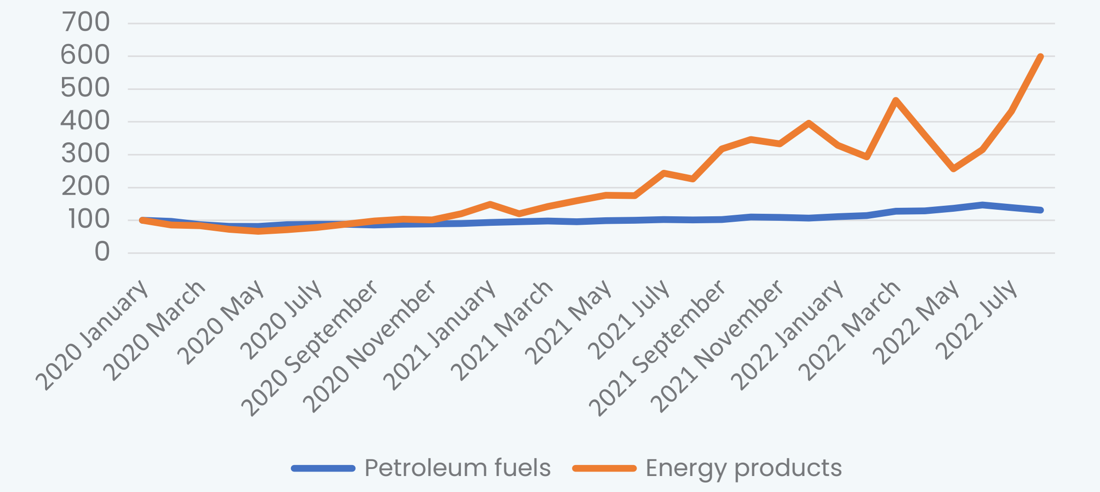
Structural measures around energy efficiency will be needed to address businesses' higher cost bases

Economic activity continued to increase during 2022, with modified domestic demand rising by 4.3% in the second quarter of 2022 compared to the previous quarter. Domestic economic activity in the second quarter of 2022 was 10% higher than the levels observed before the pandemic. Along with increased economic activity, employment reached its highest ever level, almost 2.6 million people were employed in the second quarter of 2022, while unemployment rate fell to 4.3% in August 2022.
Overall employment is now 8.7% higher than in Q4 2019 prior to the pandemic. However, the labour market recovery has not been evenly distributed across different sectors. The two sectors worst affected by the pandemic restrictions, accommodation and food services and administrative and support services, lost a combined 21,000 jobs between Q4 2019 and Q2 2022. Small and medium-sized enterprises (SMEs) account for around seven out of ten jobs across different business sectors in the Irish economy; however, this share ranges from 50% in industry to 69% in distribution and services and 92% in construction.

Energy fuelling inflation

Notwithstanding this strong performance, the economic outlook in the short term has deteriorated relative to earlier expectations mainly due to inflationary pressures affecting household incomes.
Many businesses, particularly those operating in sectors which rely heavily on energy such as transport and manufacturing, are exposed to further cost pressures in addition to potential reduced demand from households given their focus on essential expenditure in the short term, particularly due to higher energy bills over the winter.
Many analysts have revised their Irish economic growth estimates downward for 2023, despite the expected strong contribution from the exporting multinational sectors supporting growth.

Wholesale Price Index-Energy and Petroleum, 2020 Jan=100



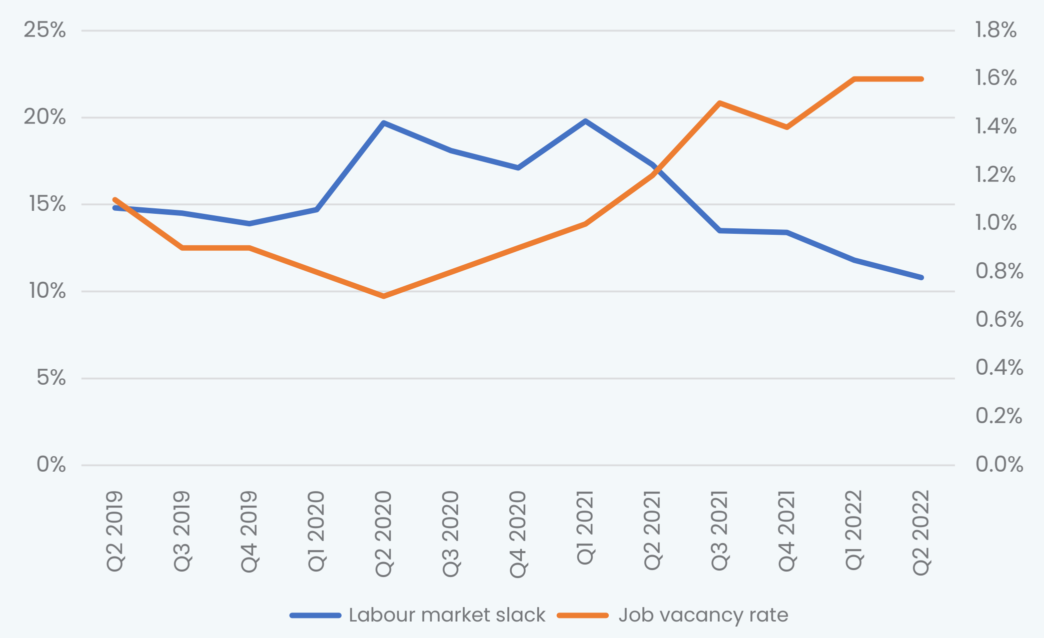
Source: Central Statistics Office (CSO).

Consumer prices have been rising on an annual basis since April 2021 and increased by 8.7% in August 2022 on an annual basis, which is the eleventh straight month where the annual increase in consumer prices has been at least 5%. Nearly 38% of annual increase in consumer prices in August was due to energy inflation. Between the beginning of 2020 and August 2022, average wholesale price inflation for petroleum products was 30%. However, wholesale energy prices increased nearly five folds during the same period, mainly driven by increases in electricity prices. The wholesale price of electricity is now 195% higher than in August 2021. Recent Central Bank of Ireland research shows that the lag between price changes in the wholesale gas and electricity markets and consumer prices can be around one year and it is likely that recent increases in wholesale prices will feed into increased energy costs in 2023 both for businesses and consumers.

Tightening labour market

In addition to significant cost inflation through energy prices, businesses are increasingly reporting challenges in hiring suitably trained and skilled staff. Labour market slack, which Eurostat suggests reflects the unmet need for employment, fell to 10.8% of the extended labour force (which includes underemployed part-time workers and those either not available for or not seeking work) in Q2 2022, down from 14.8% in Q2 2019. In addition, the job vacancy rate increased from 1.1% in 2019 to 1.6% at the end of Q2 2022.

Job Vacancies and Labour Market Slack



Source: CSO, Eurostat.

Substantial government supports, especially the employment wage subsidy scheme (EWSS), helped to absorb some of the impact of the reduced business activity on workers' incomes in the sectors worst affected by the restrictions. However, EWSS supports ended in May 2022. The latest available data shows that the EWSS payments directly supported 10.4% of overall employment. This proportion varied across the sectors ranging from 53.5% in the Accommodation and Food Services to 0.2% in the Public Administration, with EWSS payments accounting for one third of all earnings in the Accommodation and Food Services during the second quarter of 2022. In terms of insolvencies, the latest PWC Restructuring Update shows that as of Q3 2022, business failure rates remain at historically low levels. Business insolvency rates are at approximately one third of the average failure rates over the past 17 years and nearly one fifth of the rates observed at its peak in 2012. For comparison, the same report shows that UK failure rates were three times higher than the Irish rates in the year to Q2 2022.

The Irish economy has recovered from the initial negative effects of the pandemic and is operating close to full employment. However, both consumer and business sentiment in the short term have deteriorated mainly due to significant inflationary pressure that is likely to increase costs further for businesses and reduce real disposable incomes of households. Budget 2023 announced significant measures to help households and businesses with increasing energy costs in the form of a €4.1 billion once-off measures out of the total €11 billion. This includes the Temporary Business Energy Support Scheme (TBESS), a €1.25 billion fund that aims to help mainly small businesses, covering up to 40% of the increase in energy bills up to €10,000 per month until February 2023. The Ukraine Credit Guarantee Scheme, which was also announced as part of Budget 2023, will provide low cost working capital especially in energy saving measures to SMEs where loans will be available from finance providers including banks, non-banks and credit unions.

It is likely that current inflationary pressures through energy price increases will continue in the short term. Even if the rate of inflation declines, price levels will still be higher in the future; hence one-off measures may need to be replaced in the future with structural measures around energy efficiency both for households and businesses, such as the Ukraine Credit Guarantee Scheme, so that the economy does not face similar challenges in the years to come given the continued geopolitical uncertainty.

Market Analysis

Anthony O'Brien,
Head of Sector Research & Analysis, BPFI

SMEs and the wider economy

Economic activity continued to increase in 2022, fuelling record levels of employment and household earnings. However, disruptions and uncertainty caused by Covid-19 and Brexit as well as the war in Ukraine, drove sharp rises in business costs and consumer prices alike.[1]

Gross domestic product grew by an 1.8% quarter on quarter in volume terms in Q2 2022 (according to preliminary seasonally adjusted figures from the Central Statistics Office), driven by growth in sectors dominated by multinationals such as manufacturing and information and communication.

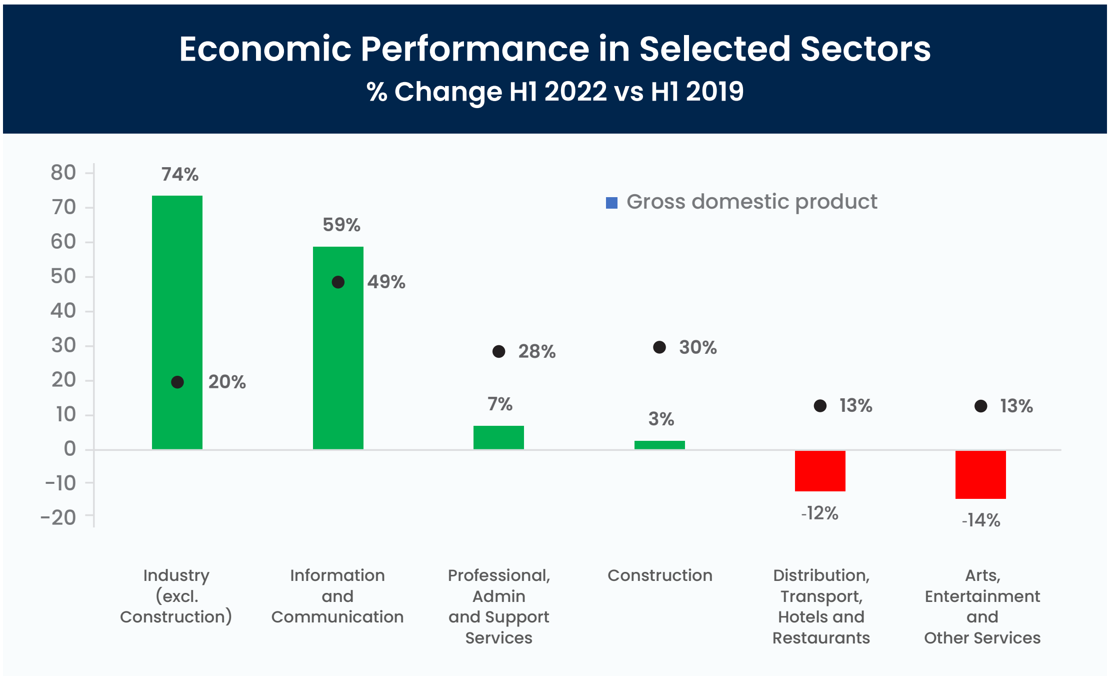
Modified final domestic demand, which excludes globalisation effects such as trade in intellectual property and aircraft leasing, rose by 4.3% quarter on quarter in Q2 2022, boosted by 11.4% growth in investment. While consumer spending rose by 1.8% quarter on quarter, it was 1.7% lower than in Q2 2019.

Services still lag in recovery

Sectors providing services that rely on face-to-face contact were still below their 2019 output levels, especially the hospitality sectors (hotels, restaurants, bars and cafes), personal services (such as hairdressers or beauticians), and arts and entertainment sectors.

These, with construction, include business sectors with some of the highest concentration of small and medium-sized enterprises (SMEs) – those businesses employing fewer than 250 persons.

[1] Data in this report is correct to 28 September 2022.



Source: CSO.

Substantial government supports, especially the employment wage subsidy scheme (EWSS), helped to absorb some of the impact of the reduced business activity on workers' incomes in the sectors worst affected by the restrictions. However, EWSS supports ended in May 2022.

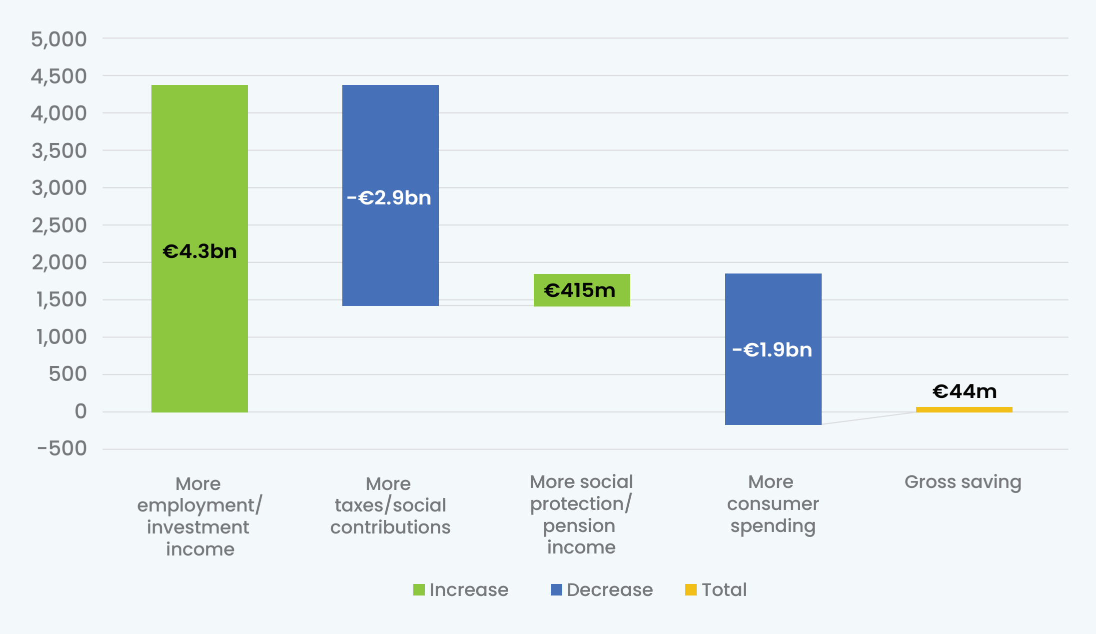
The total tax take in in the first eight months of 2022 was almost €49.8 billion, 26.3% more than in the same period of 2021, according to the Department of Finance. Income tax and corporation tax increased by 16% and 68.5%, respectively, compared with the year to date at the end of August 2021. Valued added tax receipts grew by 23.9%.

Gross voted current expenditure in the first eight months of 2022 was 4.3% lower than in the same period of 2021. Social protection spending fell from almost €12.7 billion to less than €8.1 billion.

Gross household saving barely changed between Q1 2020 and Q1 2022 as substantial increases in taxes and social contributions as well as consumer spending offset large increases in employment and investment income.

Unemployment levels fell in in the early months of 2022 with the seasonally adjusted unemployment at 4.3% in August 2022, down from 5.5% a year earlier, according to the CSO.

Change in Household Accounts (Q1 2022 vs Q1 2020)



Source: BPFI estimates based on CSO data.

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Cost and labour pressures intensify

Business activity in the manufacturing and services sectors, as measured by the AIB services and manufacturing purchasing managers' indices (PMIs) continued to increase in August but the rate of increase slowed. Both sectors again reported sharp increases in input cost and output prices, with Irish manufacturers raising their prices for the 23rd month running, as well as increases in employment. While new services business continued to increase, manufacturing output fell for the third month in a row. The contraction was more pronounced in construction, as measured by the BNP Paribas Real Estate Ireland construction PMI, which fell for the third successive month in August on the back of substantial reductions in new orders, possibly related to price increases.

Cost and price pressures have increased. Services prices for business rose by 4% year on year in Q2 2022, which almost half of the increase due to increased costs for air transport, while domestic producer prices for manufactured goods rose by 10.5% year on year to August 2022 partly due to large increased in food products, especially dairy. The CSO reported that the price of electricity in manufacturing almost trebled year on year (up 194.9%).

The KBC Bank Ireland consumer sentiment index fell to its lowest level since 2008 as consumers reacted negatively to the rising cost of living, including sharp increases in energy prices, as well as the European Central Bank's decision to increase its key interest rates in July with further increases signalled.

“Cost and price pressures have increased.”

Finding Customers

The European Central Bank (ECB) Survey on Access to Finance for SMEs (SAFE) has traditionally identified finding customers as the most pressing problem for SMEs in Ireland, followed by the availability of skilled staff or experienced managers. Availability of skilled staff or experienced managers was the main concern for 25.2% of respondents in the latest survey (H2 2021), followed by finding customers (17.6%) and costs of production or labour (17%). The survey was conducted up to March 2022, before the full impact of rising costs emerged.

The Department of Finance's Credit Demand Survey indicates that the net percentage of such SMEs reporting an increase in turnover in the previous six months was 27% in March 2022, rebounding from sharp declines in 2020 and 2021. While micro businesses (those with fewer than ten employees) reported a modest recovery and hotels and restaurants reported the bounced back strongly.

The CSO's seasonally adjusted value of services output was 24.1% higher in July 2022 than in February 2020, with information and communication output increasing by 48.9%. However, output in the sectors worst affected by the Covid-19 restrictions were still below their levels two years earlier: accommodation and food service activities were down by 2.9%, administrative and support service activities were 12.5% lower and other services were 1.3% lower.

Business Turnover Past Six Months
Net Percentage of Respondents

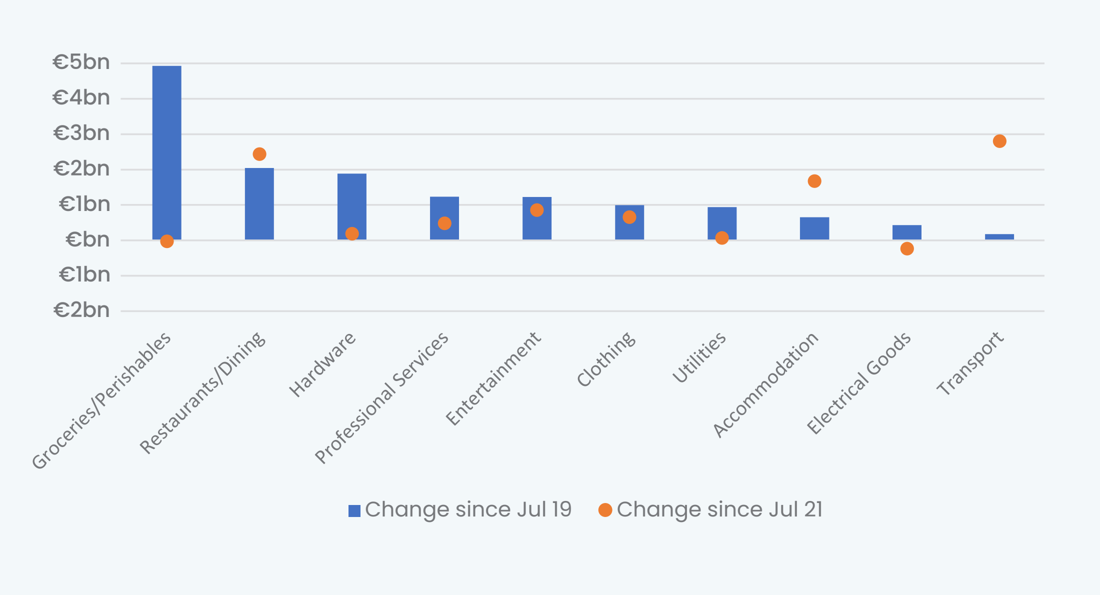
Source: Department of Finance Credit Demand Survey.
Note: The survey was not conducted for March 2020.

Retail sales rise and dining out rebounds

The CBI's monthly card payments data and the CSO's retail sales index both show turnover recovered to pre-pandemic levels by early 2022, though the evidence suggest that consumers may be cutting back in some areas in the face of rising living costs.

Annualised personal card spending (based on a twelve-month rolling sum) grew by 49% or €25.4 billion between the twelve months ending July 2019 and the twelve months ending July 2022. The CBI shows that personal card spend on groceries/perishables increased sharply in that time, with an additional €4.9 billion, while spending on hardware was almost €1.9 billion higher.

Change in 12-month Rolling Personal Card Spend to July 2022 (Selected Sectors)



Source: BPFI analysis of CBI monthly credit and debit card data up to July 2022.

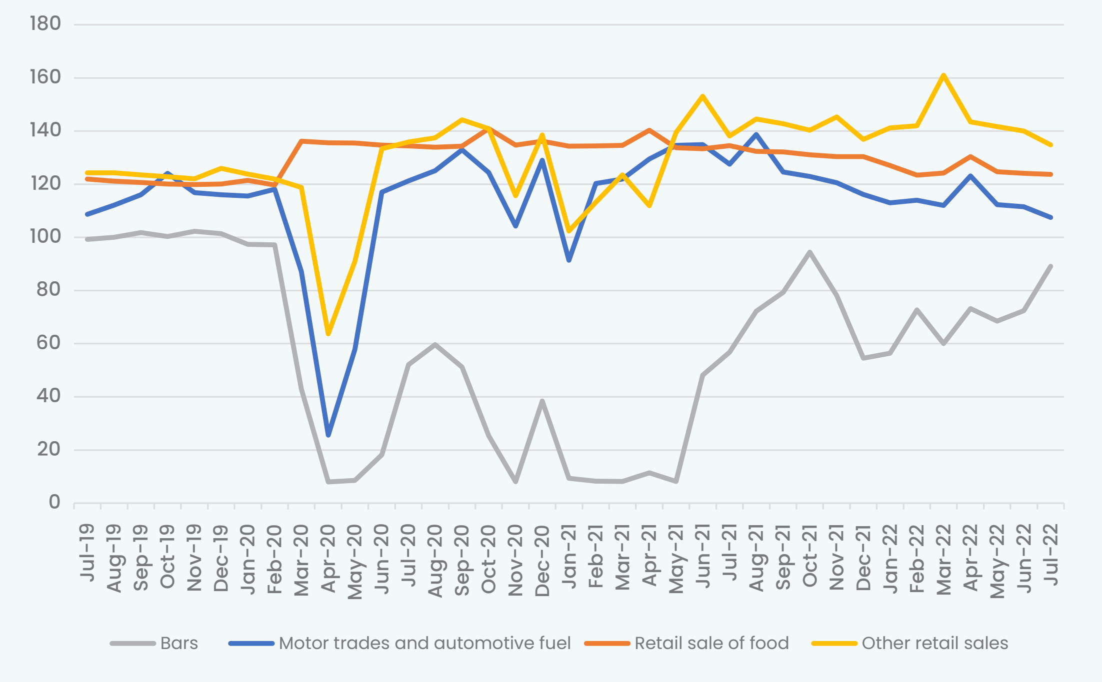
Personal card spending rebounded in the hospitality and leisure sectors, with card spend on restaurants/dining and entertainment some €2 billion and €1.2 billion higher in the twelve months ending July 2022 than three years earlier. Some of this increase reflects the replacement of cash payments with card: the value of cash withdrawn at ATMs fell by almost €6.6 billion over the same period.

The recovery in transport spend has been more modest reflecting the fact that the resurgence in international travel is incomplete: in July 2022, overseas arrivals by sea and air were 12% lower than in July 2019, according to the CSO.

The volume of retail sales in July 2022 was unchanged from February 2020, on a seasonally adjusted basis, but 1.6% lower than in July 2022. Performance varied markedly by retail sectors. The largest increases compared with February 2020 were in clothing, footwear and textiles (up 21.5%) and pharmaceuticals, medical and cosmetic articles (19.7%). Sales in books, newspapers and stationery segments were 42.2% lower while sales in bars, motor trades and fuel were 8.4%, 7.5% and 10.2% lower, respectively.

With most retail outlets open again, online sales have become less important than during the peaks of Covid restrictions, dropping to 4.4% of retail sales by July 2022, the lowest level since February 2020.

Retail Sales Indices



Source: CSO.

Availability of skilled labour

Employment grew strongly and reached historical highs in 2022 after the public health measures to control Covid-19 were lifted. The number of people in employment reached a new high of almost 2.6 million in Q2 2022, on a seasonally adjusted basis, with employment some 8.7% higher than in Q4 2019, according to the CSO. Industry (including manufacturing), information and communication, professional, scientific and technical activities, education and human health and social work all added more than 25,000 jobs between Q4 2019 and Q2 2022).

By contrast, two sectors worst affected by Covid restrictions (accommodation and food services activities and administrative and support service activities) lost a combined 21,000 jobs over that period.

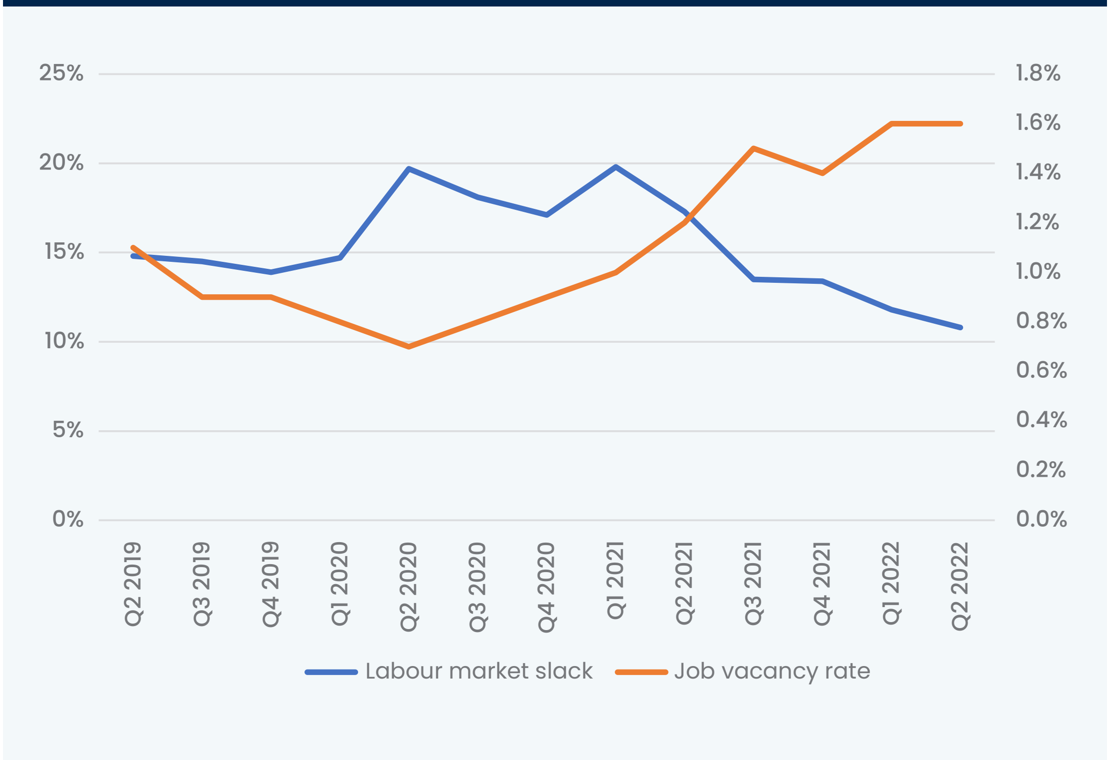
The standard seasonally adjusted unemployment ranged between 4.2% and 4.3% from May to August 2022, compared with 5.5% in August 2021 and at 5% in August 2019 September 2021 and February 2002.

Record employment and rising vacancies

With unemployment falling and employment at historically high levels, businesses are increasingly reporting challenges in hiring suitably trained and skilled staff. The job vacancy rate increased to 1.6% at the end of Q2 2022, compared with 1.1% three years earlier, according to the CSO. Labour market slack, which Eurostat suggests reflects the unmet need for employment, fell to 10.8% of the extended labour force (which includes underemployed part-time workers and those either not available for or not seeking work) in Q2 2022, down from 14.8% in Q2 2019.

The Covid-19 pandemic unemployment payment (PUP) closed to new applicants on 22 January 2022 and the final payments were made at the end of March.

Job Vacancies and Labour Market Slack



Source: CSO/Eurostat

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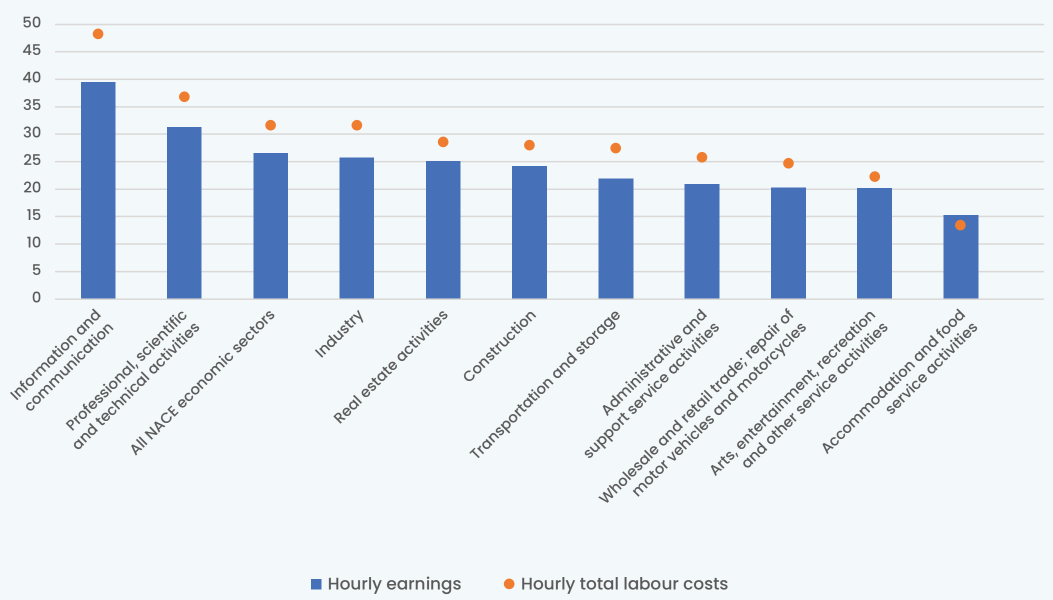
Hourly Earnings and Labour Costs by Sector (€)
Q2 2022)



Source: CSO

The Employment Wage Subsidy Scheme (EWSS), which provided an income subsidy for eligible employees to registered employers, closed at the end of May. An analysis by the Revenue Commissioners indicated that the number of employees supported by the EWSS had fallen to 261,200 by April 2022 and 97,700 by May. The accommodation and food services sector accounted for 46% of employees supported in April and 89% of those supported in May.

Without EWSS supports, the lowest-paid workers could be hardest hit, especially as the cost of living increases. These subsidies were important in supporting the incomes of workers in services sectors. In accommodation and food service activities hourly earnings (€15.05), which include supports such as the EWSS, were higher than the hourly total labour costs to employers (€14.72) even up to Q2 2022.

Preliminary CSO earnings data suggest that worker incomes have risen significantly in recent years, with average weekly earnings increasing by 21% between Q2 2017 and Q2 2022 to €871.62.

Accessing finance

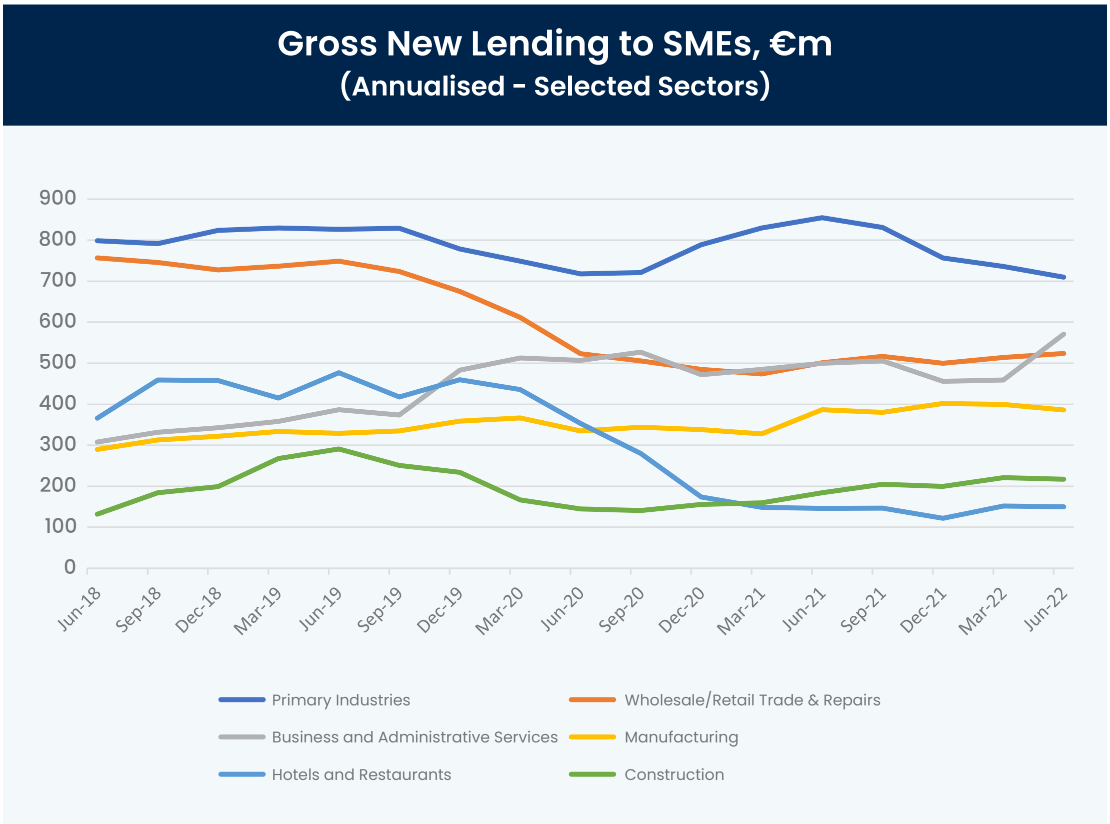
Demand for bank credit weakened further in the first half of 2022 with only 16% of SMEs responding to the March 2022 Department of Finance Credit Demand Survey reporting that they had requested bank finance in the previous six months, while only 12% expected to seek bank finance in the following six months.

Among those seeking finance, the focus was firmly on new business venture/acquisition of assets/expansion or investment in machinery/equipment with 42% and 20% of respondents, respectively, citing them as the main reason for finance requests in March 2022. However, 43% of micro business cited working capital requirements as the main reason. The importance of investment was also reflected in the lending products requested with 34% requesting leasing or hire purchase compared with 38% seeking new loans.

Some 76% of SMEs that had not requested finance said they did not need additional finance, while 14% said credit lines were sufficient.

Gross new lending to SMEs (excluding financial intermediation) fell by 4% year on year to €4.1 billion in the twelve months ending June 2022, according to the CBI. Real estate activities (mainly property investment/development) and primary industries (mainly agriculture) accounted for €890 million and €710 million, respectively, of gross new lending in the twelve months ending June 2022.

Drawdowns in the wholesale/retail trade and repairs sector rose to €524 million, their highest level since the twelve months ending March 2020, while SMEs in business and administrative services drew down €571 million, the most since the data series began in 2010.

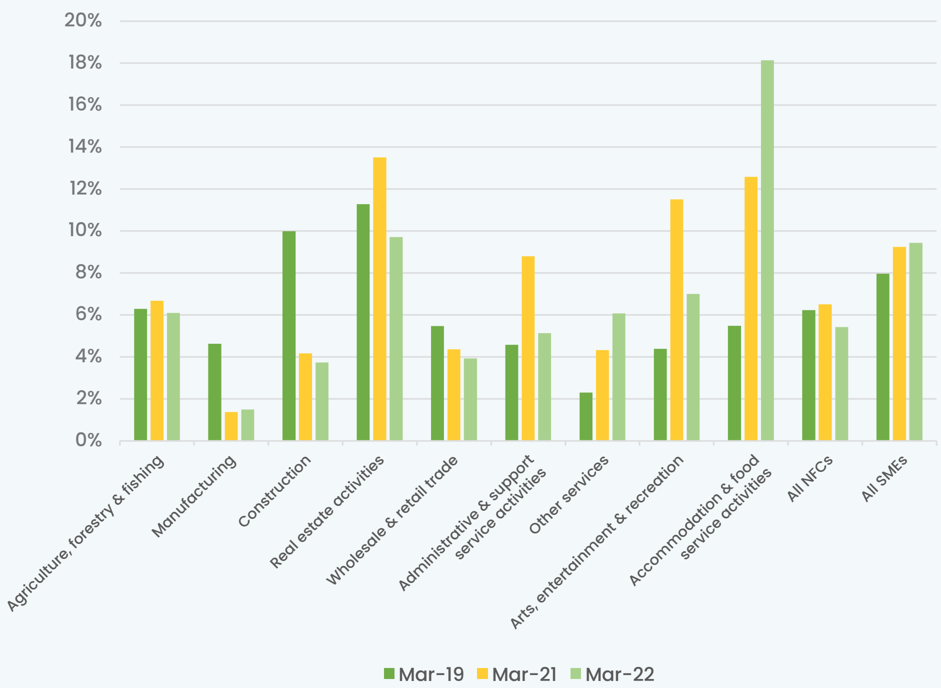


Source: Central Bank of Ireland

The value of outstanding credit to core SMEs (excluding property-related sectors) grew for the third quarter in a row in Q2 2022 to €12.8 billion. Three sectors (primary industries including agriculture, wholesale/retail trade and repairs and hotels and restaurants) accounted 57.4% of outstanding credit to core SMEs (excluding property-related sectors) in June 2022, with 24.5%, 19.1% and 13.7% of outstanding credit, respectively.

Non-performing loan (NPL) ratios on business loans have risen since the onset of Covid, after years of decline, according to the European Banking Authority (EBA). The NPL ratio for all SME loans was 9.4% at March 2022, down from 10.5% in December 2021 but up from 9.2% in March 2021. The real estate activities and administrative and support service activities sectors both saw spikes in NPL ratios in 2020/21, before returning to 2019 levels. NPL ratios rose sharply in other services sectors, especially accommodation and food service activities, in which the NPL ratio was 18.1% at March 2022, up from 12.6% a year earlier and 5.5% in March 2019.

NPL Ratios for Selected NACE Sectors



Source: European Banking Authority

Financial supports

Government financial supports for businesses affected by Covid-19 included grants provided by local authorities, local enterprises offices and State enterprise agencies, loans provided by bank and non-bank lenders with the support of the Strategic Banking Corporation of Ireland (SBCI) and subsidies or debt warehousing provided through the Revenue Commissioners. Most supports had closed to new applicants by September 2022.

Two SBCI medium-term loan schemes were still active: the Brexit Impact Loan Scheme and the Covid-19 Loan Scheme. In July 2022, the SBCI launched in €150 million Energy Efficiency Loan Scheme to support eligible SMEs and farmers investing in the energy efficiency of their businesses.

Over 90,000 entities were availing of Revenue's debt warehousing scheme by the end of May 2022. Some 2.9 billion in tax liabilities had been warehoused, of which VAT and employers' PAYE and PRSI each accounted for about €1.4 billion.

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