The Leadership Exchange

PwC Quarterly Economic Digest - Q1 2025

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Contents

1. The Rundown

Ireland faces the possibility of a technical recession due to a slight decline in GDP forecast for 2024. However, this does not fully capture the underlying economic dynamics, as modified domestic demand (MDD) is projected to have grown by approximately 3% in 2024. This growth is underpinned by supportive monetary and fiscal policies, rising incomes, and strong export performance, particularly from the technology and pharmaceutical sectors. Ireland's GDP is expected to recover robustly in 2025, with growth forecasts ranging from 4.2% to 4.5%. MDD is expected to hover around 3% per annum. Nonetheless, Ireland's economy remains vulnerable to global developments, including geopolitical tensions and shifts in the foreign direct investment (FDI) landscape, which could threaten economic stability.

Inflation in Ireland has decreased more rapidly than expected, with projections indicating it will have fallen below the 2% target in 2024 and will fall further to around 1.7% in 2025. However, inflation in the services sector, particularly hospitality, remains high. Globally, inflation is proving sticky, with slight increases in some major economies. Analysts predict cautious adjustments to policy rates by central banks to balance risks and achieve price stability. Domestically, a tight labour market and fiscal stimulus could contribute to inflationary pressures, while global trade changes and geopolitical tensions may also influence inflation outcomes.

Ireland's labour market is performing well, with an unemployment rate of 4.1% observed in November, indicating full employment. Female unemployment has improved significantly, although youth unemployment remains elevated at 10.9%. The public sector is experiencing increasing vacancy rates, especially in Public Administration, which could affect the performance of public agencies that are essential to the delivery of infrastructure.

The Economy at a Glance

Economic Output

Ireland appears likely to have experienced a technical recession in 2024, but Ireland's economic performance is understated by GDP currently. Modified domestic demand appears to have increased by around 3% in 2024.

Inflation

Headline inflation has continued to ease and is projected to have landed below the 2% target in 2024, and to dip further to around 1.7% in 2025. Services inflation remains elevated, driven mostly by price rises in the hospitality sector.

Labour Market

The economy is essentially at full employment with an unemployment rate of just 4.1% in November. Vacancy rates have been trending upward in the public sector.

Fiscal Outlook

Ireland's corporation tax receipts are becoming more concentrated with the top 100 companies accounting for around 80% of the total. Public spending has continued to increase, with significant additional fiscal stimulus in Budget 2025.

The shortage of planners and its impact on capital project delivery underscores the need for increased emphasis on public sector staffing.

Ireland's fiscal outlook is marked by significant growth in both corporation tax revenues and government spending. Corporation tax receipts have become more concentrated among the top 100 companies. This concentration poses risks, as changes in US policy could affect foreign direct investment and tax receipts. The Irish Fiscal Advisory Council advises treating exceptional corporation tax receipts as a finite resource, similar to Norway's approach to oil revenues. Government spending has increased, supported by these tax receipts, but the economy's capacity constraints and vulnerability to revenue reversals necessitate caution. Diversifying the economy, broadening the tax base, and investing in infrastructure are essential to mitigate these risks.

Our Topic in Focus in this Digest is FDI, which is a cornerstone of Ireland's economy, but growing geopolitical uncertainty and infrastructure deficits pose challenges. Ireland's globalised economy, heavily reliant on US investment, faces headwinds as globalisation appears to slow. Domestic issues, such as housing and infrastructure, further complicate the FDI landscape. To maintain competitiveness and economic stability, Ireland must address these challenges and focus on enhancing infrastructure and diversifying its economic base. The country's ability to navigate these complexities will be crucial in sustaining its economic growth and resilience in the face of global uncertainties.

Ciarán Nevin
Senior Economist

2. Economic Output

Ireland's economy is performing well with GDP expected to rebound strongly in 2025.

Ireland's GDP appears likely to have declined slightly in 2024 when compared to 2023, with annual growth forecast to be in the range of -1.1% to 0.3% (see Figure 1). Significant outflows associated with intellectual property have weighed on GDP in 2024. However, GDP growth is expected to recover strongly in 2025, with the Central Bank and the ESRI forecasting growth of 4.2% and 4.5% respectively. Growth of a similar magnitude is forecast for 2026.

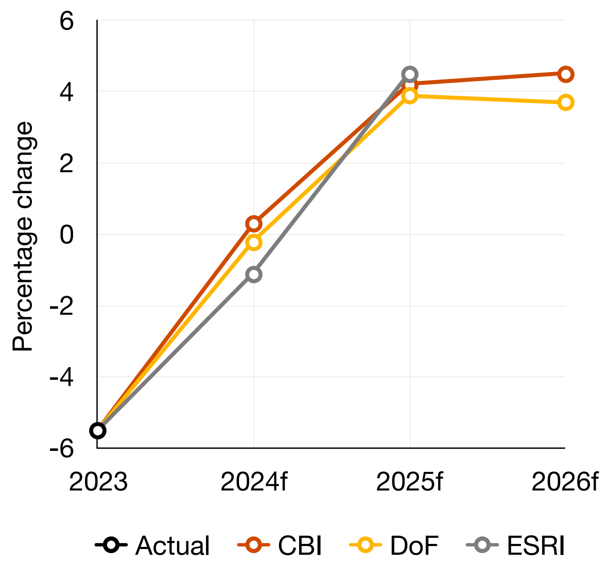
Domestic demand, driven by accommodative policy and increased incomes, continues to grow.

GDP has understated the performance of Ireland's real economy in recent years. Modified domestic demand (MDD), which strips out distortionary activity such as aircraft leasing, is a more appropriate measure of Ireland's economic output. MDD is forecast to have grown by around 2.5% to 3.2% in 2024 (see Figure 2), despite the relatively poor performance in GDP terms. MDD growth of 3% to 4% is forecast in 2025, with long run forecasts indicating growth of close to 3% per annum out to the end of the decade. The Central Bank of Ireland notes that the government's budgetary stance continues to add demand to the economy. This, combined with loosening monetary policy and increases in disposable income are major drivers of MDD growth. Exports from the FDI-dominated sectors of tech and pharma are also contributing to economic growth.

A mixed economic outlook for Ireland's main trading partners, may influence external demand for Irish exports.

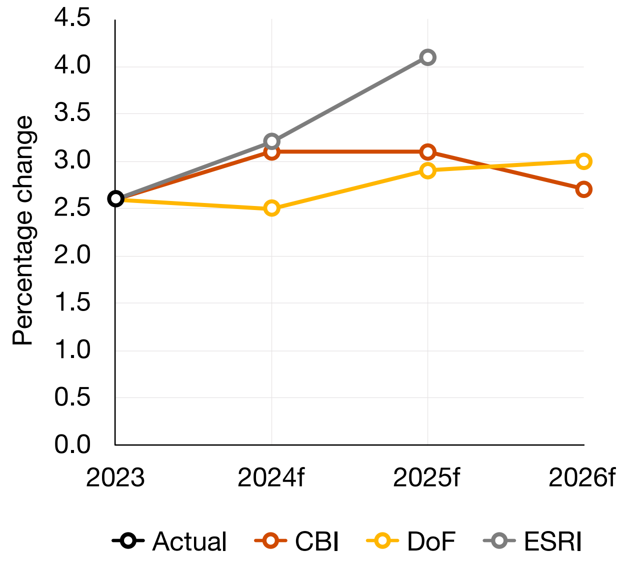
The euro area economy appears to have made a modest recovery in 2024, with GDP growth projected to have been around 0.8% (see Figure 3). This growth was driven by rising household incomes, a resilient labour market, and easing financing conditions. However, significant geopolitical and policy uncertainties continue to pose risks. The euro area economy is anticipated to strengthen further in 2025 with growth of 1.2% forecast, followed by growth of 1.3% in 2026. In the US, the economy is projected to grow by 2.7% in 2024. This growth is supported by a solid labour market, rising household wealth, and resilient consumer spending. Despite some headwinds, such as higher costs of capital and policy uncertainty, the US economy is expected

Figure 1. GDP growth forecasts



Source: CBI, CSO, DoF, ESRI

Figure 2. MDD growth forecasts



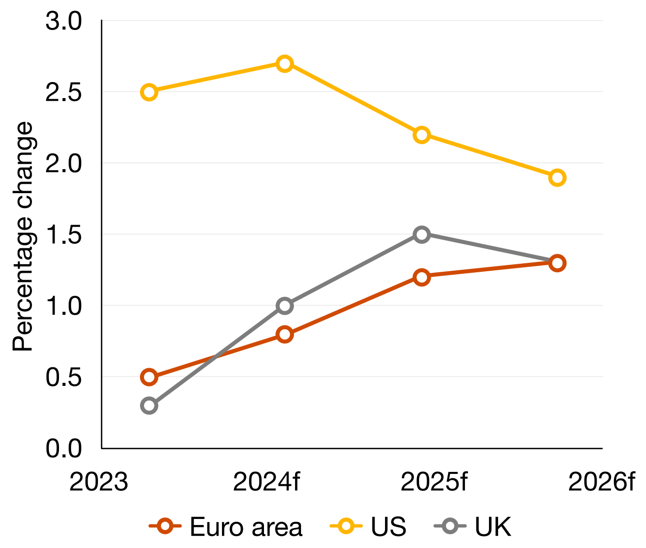
Source: CBI, CSO, DoF, ESRI

to maintain its momentum into 2025, albeit at a slower pace of 2.2% growth, with a 1.9% growth rate projected for 2026. The United Kingdom's economic recovery was relatively subdued in 2024, with GDP growth expected to be around 1%. The UK economy has shown resilience, benefiting from a stronger-than-expected start to the year. However, tight fiscal policies and ongoing uncertainties may limit future growth. Looking ahead, the UK economy is forecast to grow at a faster rate of 1.5% in 2025, driven by improved consumer spending and business investment. A growth rate of 1.3% if forecast for 2026.

External and domestic risks to the fore of policy makers' minds.

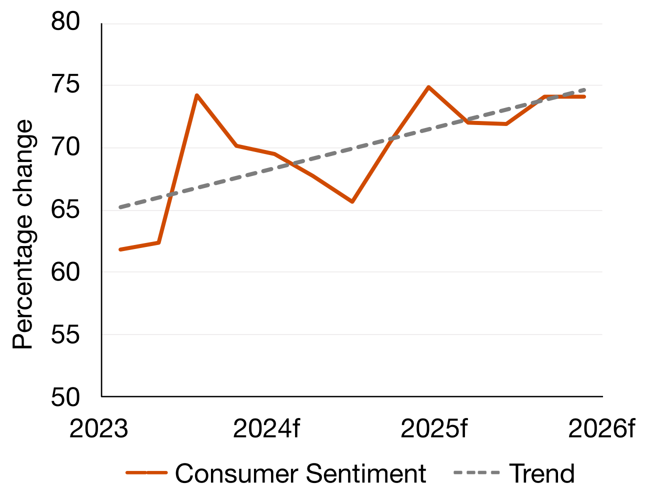
As discussed above, Ireland's economy is performing well and the economies of our main trading partners are growing, albeit at significantly different rates. However, as a small, open economy, Ireland is sensitive to global developments. Heightened geopolitical tensions, supply chain disruptions, and increased tariffs could disrupt trade flows. Additionally, a global economic slowdown, particularly in key trading partners such as the US and the euro area, could dampen demand for Irish exports, impacting economic growth. Policies affecting the FDI-dominated sectors, which significantly contribute to Ireland's economic output, adds another layer of uncertainty to the economic outlook. Our Topic in Focus (see Section 6) analyses Ireland's exposure to changes in the FDI landscape. Domestic demand appears to be robust and consumer sentiment (see Figure 4) has followed an upward trend over the past year. Higher disposable income combined with lower interest rates are likely to support greater domestic demand.

Figure 3. Global GDP growth forecasts



Source: PwC

Figure 4. Irish consumer sentiment



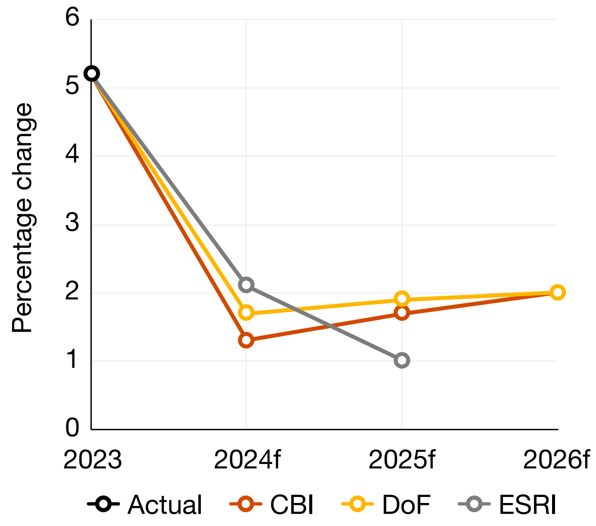
Source: Irish League of Credit Unions

3. Inflation

Headline inflation in Ireland has fallen more quickly than expected but the hospitality sector is bucking the trend.

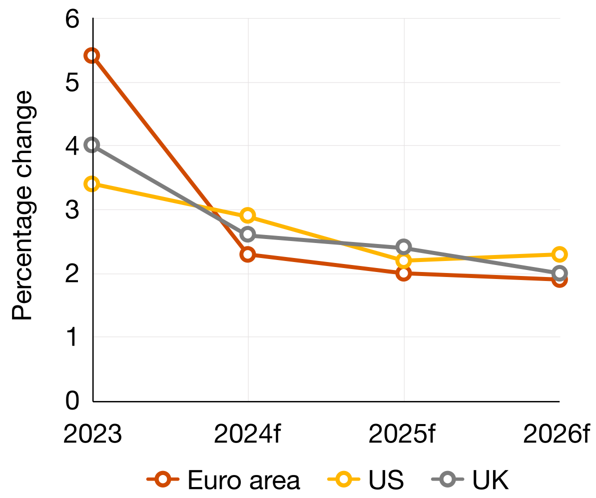
Inflation has fallen at a faster rate than expected. A number of forecasts show the headline inflation rate in Ireland tracking close to or under the 2% target rate, as shown in Figure 5. Both the Central Bank and the ESRI revised their inflation forecasts downward in December, as inflationary pressures continued to ease. Inflation expectations, which influence consumers' decisions and wage demands, have also decreased. Ireland's inflation rate is now lower than the EU average and this could have implications for the effectiveness and appropriateness of monetary policy. Low inflation combined with relatively high nominal wage increases is resulting in real wage growth. While headline inflation is broadly on target, inflation in the services sector has remained stubbornly high and this is driven primarily by price increases in the hospitality sector.

Figure 5. Inflation forecasts for Ireland



Source: CBI, CSO, DoF, ESRI

Figure 6. Global inflation forecasts

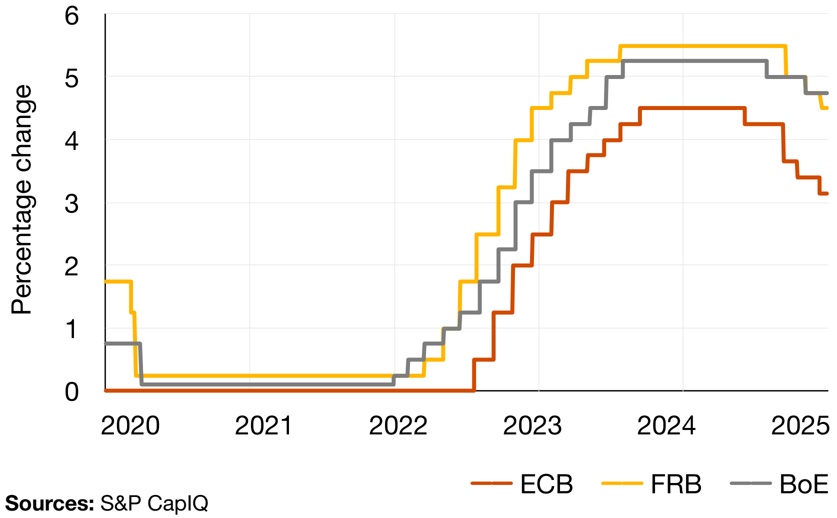


Source: PwC

Inflation remains sticky across the major developed economies.

The most recent statistics for the major developed economies indicate increases in inflation. The euro area's inflation rate increased slightly to 2.2% in November while the US also experienced a slight uptick to 2.7%. At 2.6%, the UK's inflation rate was also elevated. Forecasts suggest that while inflation will continue to decline, it may remain above 2% beyond 2026, with euro area inflation expected to land closest to the target rate over the period (see Figure 6). The policy rate paths of the ECB, the Federal Reserve and the Bank of England are shown in Figure 7. Policy makers are likely to act more cautiously in reducing policy rates to their neutral level throughout 2025, as they try to balance risks. The focus will be on achieving price stability while fostering sustainable growth and rebuilding fiscal buffers to handle future economic shocks.

Figure 7. Major central bank policy rates over time



Sources: S&P CapIQ

Changes to global trade patterns and a tight labour market may influence inflation in the year ahead.

Ireland's inflation risk is shaped by a mix of global and domestic factors. Looking to the year ahead, changes in global trade policy, including heightened geopolitical tensions, supply chain disruptions, and increased tariffs, could exert upward pressure on inflation. Conversely, a global economic slowdown might place downward pressure on prices by reducing demand. Domestically, a tight labour market is likely to push labour costs higher, contributing to inflation. Additionally, further fiscal stimulus in an already capacity-constrained economy could exacerbate inflationary pressures.

4. Labour Market

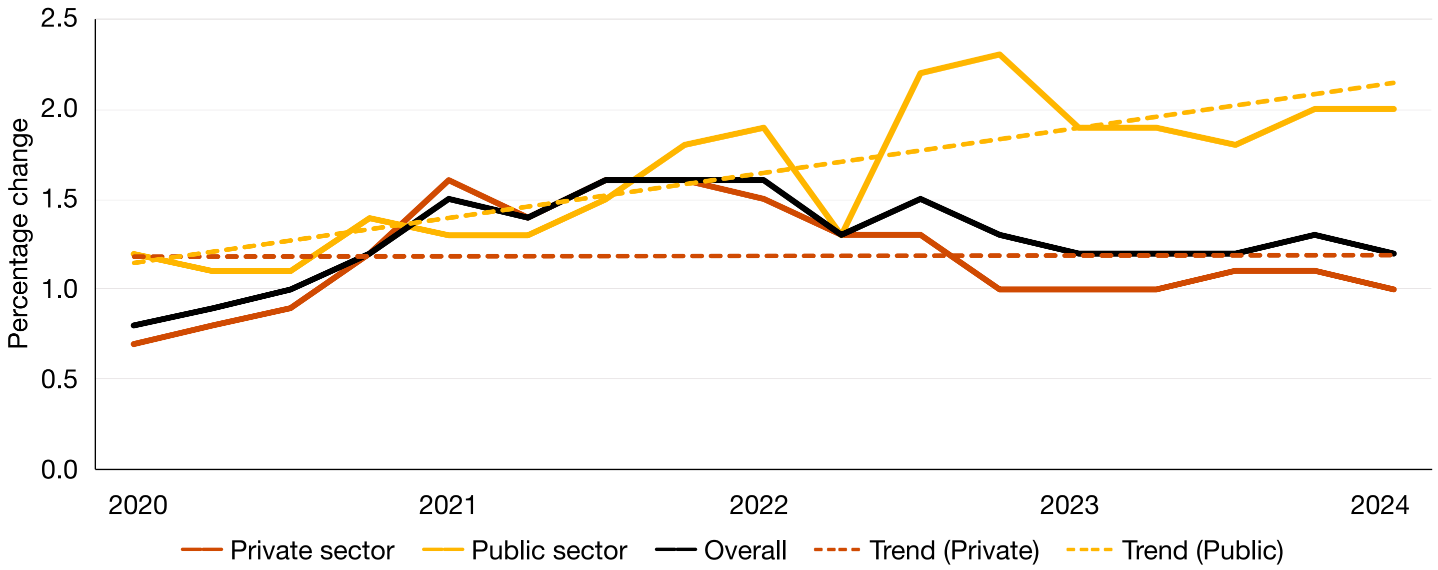
Ireland's labour market continues to perform well, with unemployment at 4.1% in November.

The seasonally adjusted unemployment rate returned to just 4.1% in November, having slightly increased in October. This compares favourably with a rate of 4.4% in November 2023 and essentially equates to full employment. Female unemployment has seen the greatest improvement in the 12 months to November, falling from 4.6% to 4.1%. Youth unemployment is persistently higher than the headline rate and stood at 10.9% in November.

Job vacancy rates across the public and private sector are diverging in a tight labour market.

The job vacancy rate considers the total share of job posts that are vacant as a share of all job posts (occupied and vacant). As such, a high vacancy rate can suggest that employers are having difficulty in filling posts. Ireland's overall job vacancy rate has been quite stable over the past five years. However, it is clear from Figure 8 that the vacancy rate in the public sector has been trending upward over the same period.

Figure 8. Job vacancy rates across the private and public sectors



Source: CSO

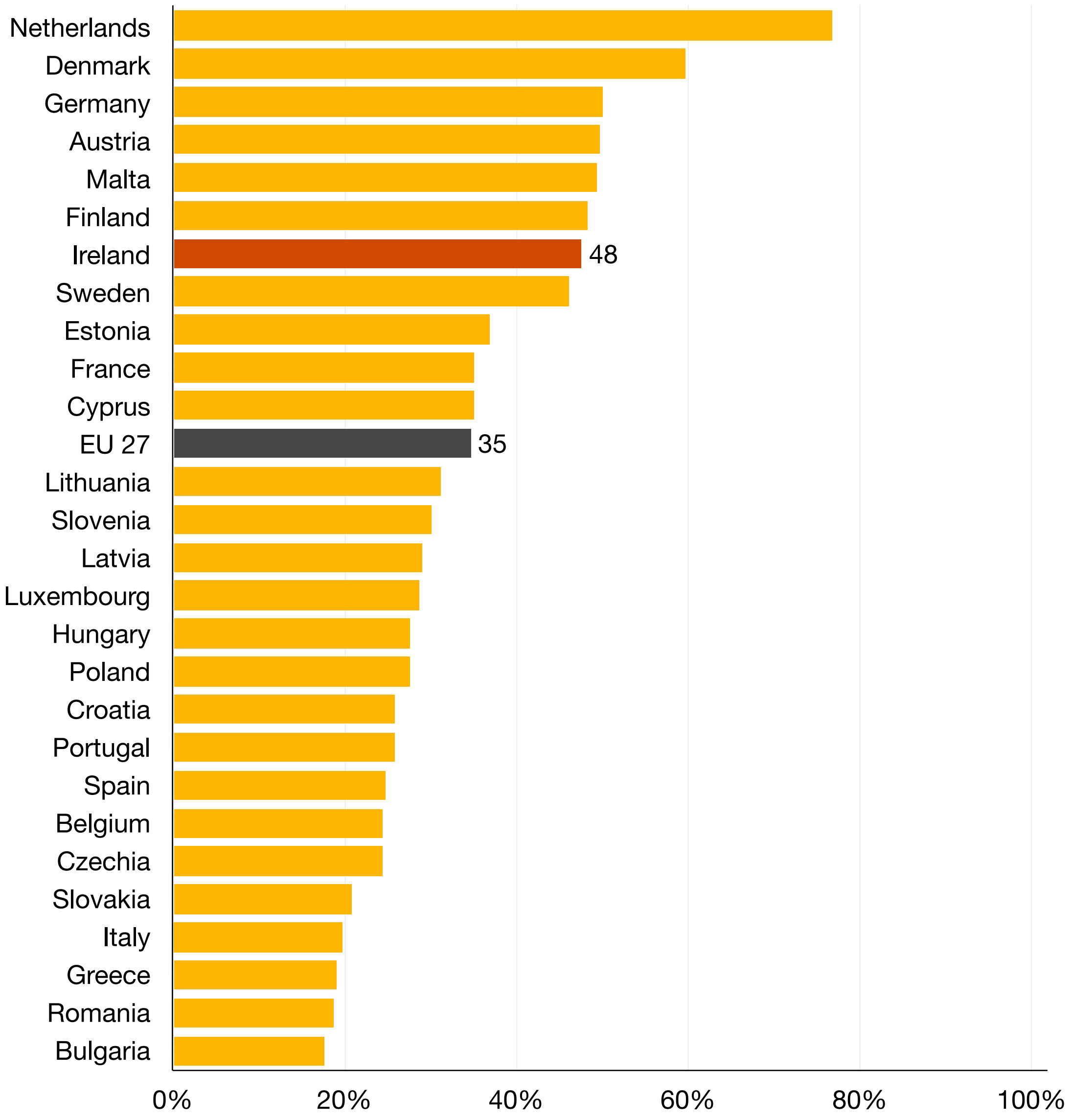
An increasing trend in the public sector vacancy rate may be cause for concern.

It appears from the data that the increasing public sector vacancy rate is primarily driven by vacancies in the *Public Administration* sector, which accounted for 22% of all vacancies (public and private sector) in Q3 2024. Ongoing vacancies will affect the ability of various public agencies to perform their functions. The shortage of planners, and its implications for the timely processing of planning applications has been well publicised, as an example. A large pipeline of essential capital projects, from offshore wind to housing, requires processing through numerous public agencies at various stages. The call for a significant increase in public sector headcount in critical areas has been heard from various quarters of society. Persistently higher vacancy rates in the public sector may point to difficulties in attracting the right talent to these critical roles.

While Ireland's youth unemployment rate remains higher than that of the general population, youth employment is higher than the European average.

At 48%, the youth employment rate in Ireland at the end of Q2 2024 was 13 percentage points above the EU average of 35% (see Figure 9). Other countries with similar overall total employment and unemployment figures such as Slovenia demonstrate a much lower youth employment rate to the EU average and Ireland. Ireland's youth employment is currently driven by retail trade and food and beverage service activities. Ireland's active labour market policies alleviate some employment barriers faced by youth, which could be a contributing factor to Ireland's relatively high youth employment rate.

Figure 9. Youth employment rate by country (Q2 2024)



Source: Eurostat

With an ageing population and growing dependency ratios, tackling youth unemployment is an imperative.

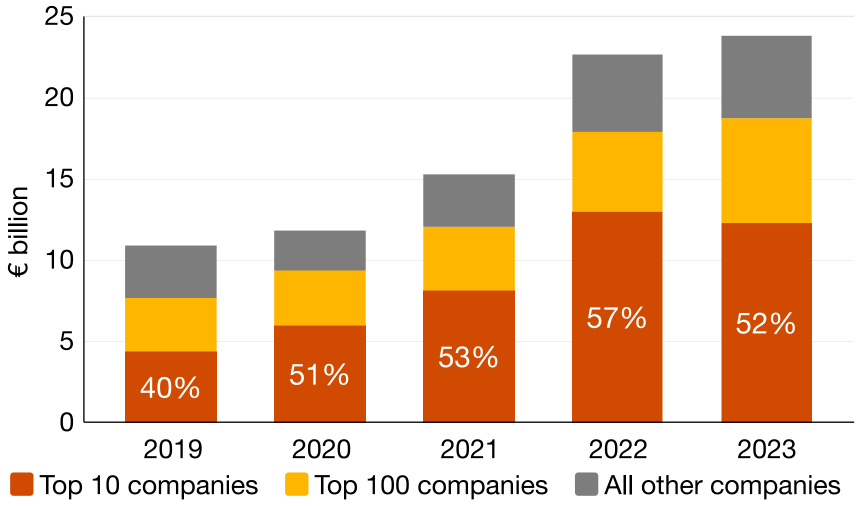
One long-term risk for the labour market is the growth in population of those aged 65+. Ireland has one of the highest life expectancies across EU countries and is projected to have one of the EU's highest old-age dependency ratios by the end of the century. The dependency ratio is the number of those aged 65+ per 100 people aged 15-64. It is projected to increase from 23.2 in 2023 to 60.9 by the end of the century. High life expectancy coupled with an increasing and ageing population will mean more people will spend longer in retirement, putting pressure on the existing labour force to fund pension payments. Ireland's growth in youth employment will help alleviate pressures put on the labour market by an ageing population, as will behavioural nudges to save for retirement such as the auto-enrolment pension scheme (see Section 7).

5. Fiscal Outlook

Ireland's corporation tax revenues have grown dramatically in recent years, while also becoming more concentrated.

Corporation tax revenues increased substantially in the past few years, from €11 billion in 2019 to €23 billion in 2023, but this has been characterised by higher concentration. As Figure 10 shows, the top 10 companies accounted for more than half of all corporation tax revenues in each of the past four years. These receipts, which make up a significant proportion of Ireland's budget surplus are subject to risks outside of government control.

Figure 10. Concentration of Irish corporation tax receipts



Source: Revenue

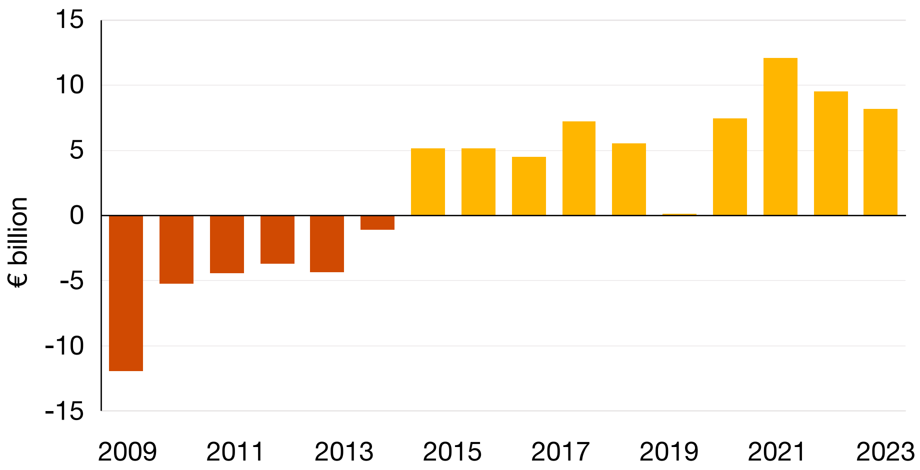
Changes in US policy could greatly impact the State's fiscal position.

Changes in foreign policy, especially in the US could have knock on effects for foreign direct investment (FDI) and for Ireland's corporation tax receipts. For example, were the US to pursue a policy to reshore the profits of US firms arising from intellectual property held in Ireland, this would impact future tax receipts. Increased tariffs could influence the investment decisions of multinational enterprises. To safeguard against risks associated with overreliance on corporation taxes, it is important to put a substantial share of revenues aside, broaden the tax base, invest in essential infrastructure, diversify the economy, and enhance competitiveness.

Spending is increasing while the economy is running at capacity and vulnerable to a reversal in tax revenues.

The Irish Fiscal Advisory Council (IFAC) has stated that government should treat its exceptional corporation tax receipts more like how Norway treats oil – as a high risk, finite resource. Government spending has increased in each of the last ten years, made possible while also reducing debt ratios, by the large increase in corporation tax receipts. Analysis by IFAC shows the changes in net policy spending i.e. how much the government is spending less the impact of tax policy changes (see Figure 11). Spending has increased in each of the last 10 years, with an average increase of over 9% in each of the last four years.

Figure 11. Government spending changes less the impact of tax policy



Source: IFAC

6. Topic in Focus: Foreign Direct Investment (FDI)

Growing geopolitical uncertainty and an infrastructure deficit leave no room for complacency on FDI.

Ireland has a long history of FDI, but recent decades have seen Ireland's economy become hyper globalised and heavily dependent on FDI, and in particular investment from the US. This has transformed Ireland's economy, creating high-tech jobs, driving high value exports, and delivering significant corporation tax revenues. However, concerns are growing that globalisation is slowing down and this leaves no room for complacency. This, combined with domestic issues related to housing and infrastructure create headwinds for Ireland. A renewed focus on seizing opportunities for investment that brings positive spillovers for the indigenous sector is key. Green technology offers one such opportunity.

FDI relates to the controlling ownership of a business or asset by an entity based abroad.

FDI describes the *controlling* ownership of a business, productive asset (e.g. factories), or real estate in one country by an entity based in another country. The term includes mergers and acquisitions, construction of new facilities, reinvesting overseas profits, and intracompany loans. FDI has the potential to transform economies, creating jobs and boosting economic output. It has also been found to increase local productivity growth.

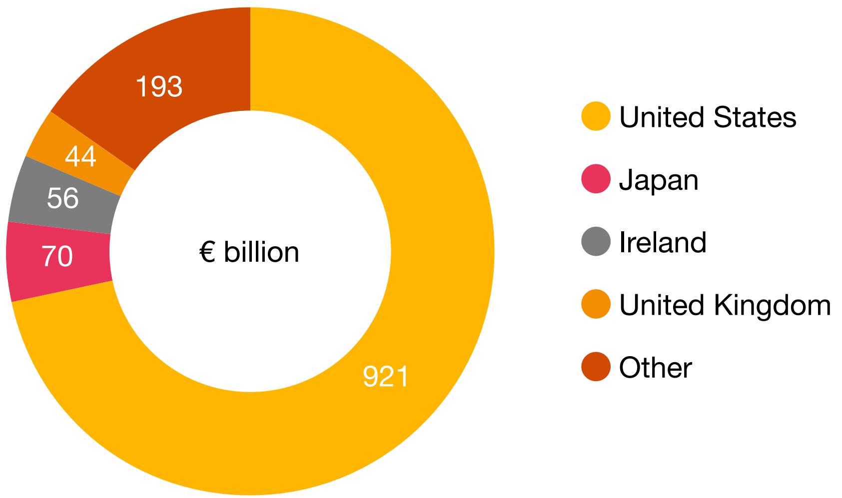
FDI has long been a feature of Ireland's economy, but its character has changed.

FDI is typically associated with trade openness but Ireland's earliest examples of inward FDI were the result of new trade barriers (Barry, 2019). Seeking to minimise the impact of tariffs on British manufactured goods imported into a newly independent Ireland, many British companies invested in production facilities in Ireland. This practice, known as "tariff-jumping", was used by a range of manufacturers including automotive firms, who completed the final stages of production in Ireland to avoid tariffs. Ireland's FDI sector has been utterly transformed since those early years, owing to changes in our business policies, and investment in education and skills.

Ireland's FDI sector today is large and is dominated by investment from the United States.

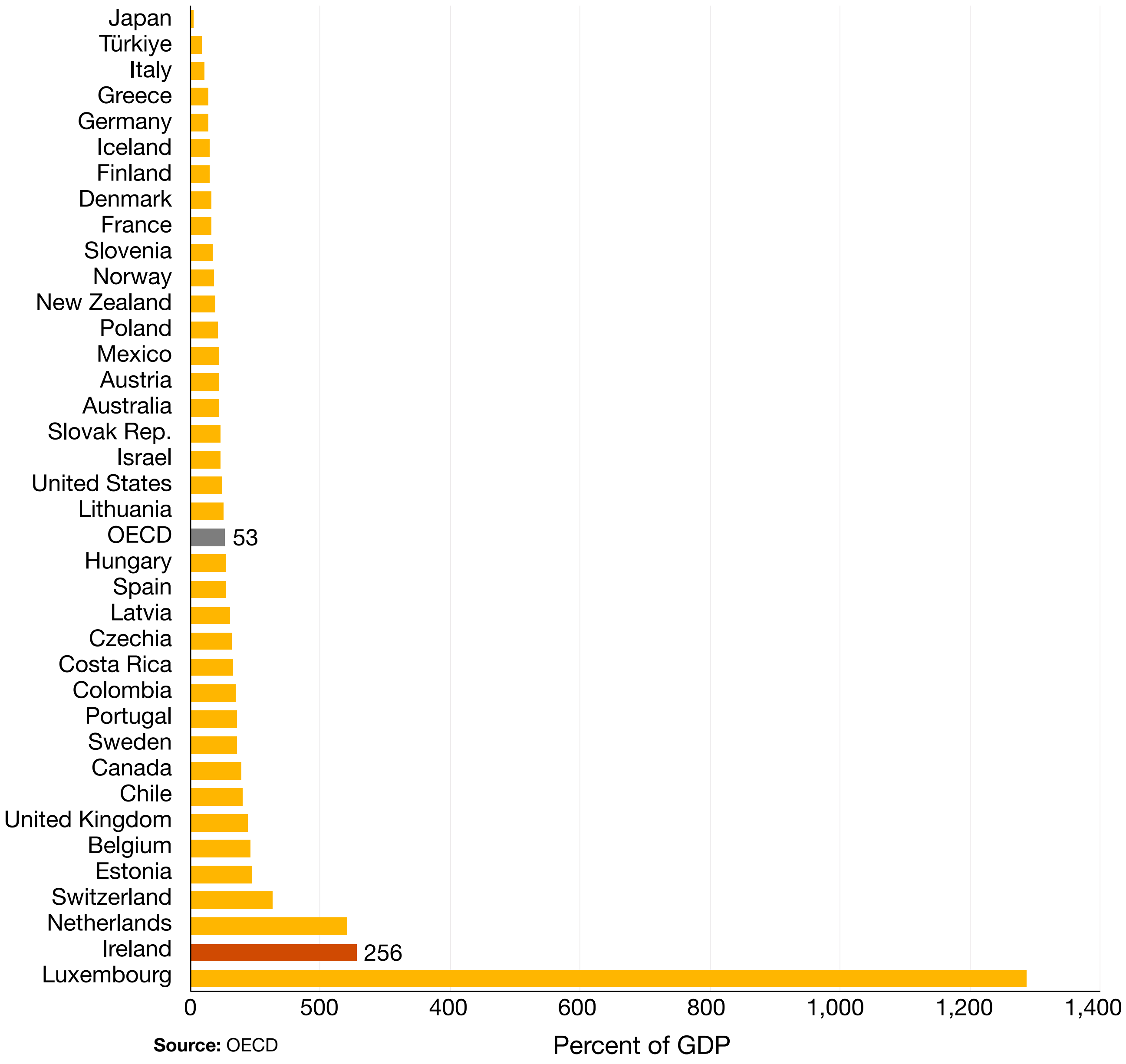
In 2022, the total stock of all FDI into Ireland amounted to some €1,284 billion. Ireland's FDI sector is dominated by investment from the US, which accounted for 72% of the stock of inward FDI in 2022 (see Figure 12 and accompanying note). Ireland's success is the result of a concerted effort by the State to attract investment, beginning in the 1950s and spearheaded by the Industrial Development Agency (IDA) Ireland. EU membership in 1973 gave businesses investing in Ireland access to the entire trading bloc, cementing Ireland's place as an FDI superpower.

Figure 12: Inward FDI positions by country of ultimate investment (2022)



Source: CSO

Figure 13: Foreign direct investment (FDI) stocks as a percentage share of GDP (2023)



Source: OECD

FDI is a major source of jobs, exports, and corporation tax revenues for Ireland.

IDA Ireland now has more than 1,800 client operations – multinational corporations who have chosen to invest in Ireland. The development authority reports that direct employment in its client companies stood at 300,583 in 2023, with more than half of these jobs spread across Ireland's regions. FDI creates even more jobs throughout the economy, indirectly. IDA Ireland estimates that for every 10 jobs created by an IDA Ireland client, 8 jobs are supported in the wider economy. IDA Ireland reports that the FDI sector accounts for approximately 70% of Irish exports. The Revenue Commissioners estimate that foreign owned multinationals accounted for 84% of all corporation tax revenues in 2023. Ireland's economy is highly dependent on FDI.

Ireland is particularly dependent on FDI compared to much of the OECD.

Given the central role of FDI in Ireland's economy, it is useful compare Ireland's FDI intensity with other developed countries. Ireland's stock of inward FDI, as a percentage share of GDP, amounted to 256% in 2023 (see Figure 13). This places Ireland second only to Luxembourg in terms of FDI intensity within the OECD, with an intensity five times greater than the OECD average of 53%. Ireland's success in attracting FDI is built on decades of stability and policy certainty, competitive tax policy, openness to trade, and widespread access to higher education. Ireland's longstanding membership of the EU, combined with its historic and cultural ties to the US, connects a single market of some 450 million consumers to the world's largest economy.

Doing more of the same is not enough to secure Ireland's fortunes.

The world that enabled Ireland's FDI success is changing. International tax regulations, such as the OECD's Base Erosion and Profit Shifting (BEPS) initiative is changing the global corporation tax landscape. Barriers to trade are increasing, as countries look to onshore and/or nearshore their supply chains. The new US administration may hasten this process. In such an environment, Ireland must act with agility to secure its future. Factors that are directly within domestic control, such as the provision of housing and critical infrastructure, can help keep costs down and maintain Ireland's global competitiveness. EU membership will help ensure that Ireland remains a popular location for US firms seeking to trade with the Union. But Ireland must also look to new opportunities to attract investment in the industries of the future, playing to our comparative advantages including our experience of facilitating FDI and our deep talent pool.

The future of Ireland's FDI may lie in the green transition.

One opportunity that can be seized is the green transition. The green transition will require large scale investment across a range of areas from electrification of road transport to the expansion of public transport, and from offshore wind energy to green finance. With offshore wind energy potential that vastly outstrips domestic demand, even after accounting for widespread electronification, Ireland has the potential to become an industrial hub for high energy users and/or an energy exporter. Successfully attracting industry to Ireland, close to our vast wind energy resources would help to rebalance Ireland's economy, creating high value jobs along Ireland's western seaboard. Correctly implemented, a green FDI initiative can drive local productivity growth, create local value chains, and benefit wider society. To do this, Ireland must put in place the appropriate incentives to attract investment, while removing barriers that exist. The good news is that Ireland has done this before, beginning in the 1950s.

Green FDI is growing force globally, tripling as a share of global GDP in the eight years to 2022

Analysis by the IMF has found that green FDI has surged in recent years, driven primarily by the emergence of investments in electric vehicles and green hydrogen, with flows into renewables remaining stable (IMF, 2024). The Fund has noted that a critical factor in the interplay between climate policy and green FDI is the potential that a country has to produce renewable energy. Specifically, the IMF's analysis finds that good geographic conditions, such as wind potential encourage FDI in renewable energy and amplify the impact of climate policies. Differences in the policy mix that each country pursues—e.g. incentives, taxes, sectors targeted, and complementary policies—affects green FDI flows. With Ireland's strong track record in attracting FDI and its ideal conditions for offshore wind, it is well placed to attract green FDI, provided it can put in place the supporting regulatory environment and deliver the required supporting infrastructure. As mentioned in Section 4, this will require capacity building across the public sector.

7. Behavioural Issues

Each quarter we take the opportunity to keep our biases in check

Cognitive biases are systematic errors in the way individuals reason with the world around them due to subjective perceptions of reality. In this section we explore the what, where, when and why of a different bias each quarter.

As 2025 begins and you set your New Year's goals, beware of present bias

Present bias refers to the tendency to overvalue immediate rewards or benefits at the expense of future rewards or benefits. As the new year rolls around and people make their New Year's resolution, Forbes notes less than 10% will be successful in maintaining those resolutions. People take out gym membership with great enthusiasm at the beginning of the new year, but attendance dwindles as the year goes on. This is a classic case of people valuing their present time more to do something else, at the expense of the longer-term health benefits associated with keeping fit.

Present bias can lead people and organisations to make irrational decisions about all manner of things from their finances to climate action to health and well-being. As the new year begins, many individuals and businesses will set goals for the coming year. Achieving those goals, however, is a much harder task. Some practices to help counter our inherent present bias in the new year include:

1. Framing your goals effectively

To overcome present bias, individuals and companies should consider the context in which their goals are to be achieved. For example, where a company's goal for the year ahead is to reduce costs by 10%, rather than focusing on the end result, consider the immediate framework in which employees will operate to achieve this goal. Enhancing the workplace to harbour a collective attitude where the companies end goals are framed in a way that each employee contributes can make it easier to achieve longer term goals. To reduce costs by reducing waste in the workplace, companies can encourage employees to use documents online rather than printing them out and employ clean desk policies.

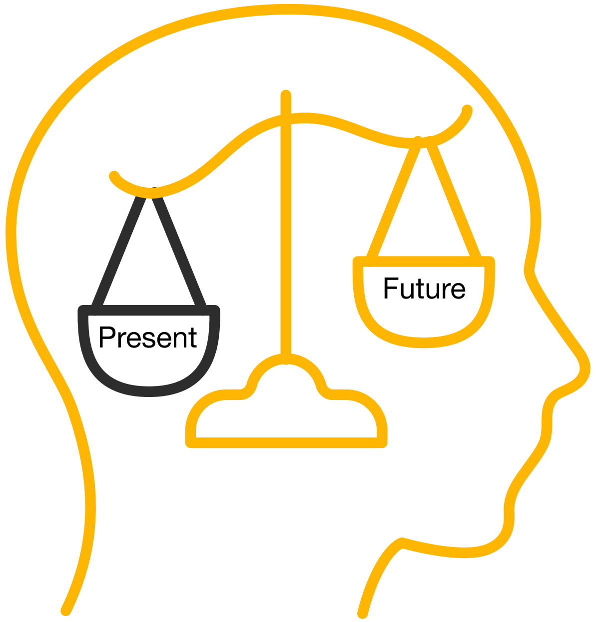
2. Incremental goals and progress

While having a long-term goal for the new year is all well and good, to achieve that goal, smaller, more well targeted and incremental tasks should be implemented. This ensures that employees can work towards and achieve tasks on an ongoing basis, bringing gratification forward as progress towards the long-term goal is made.

3. Change the default position

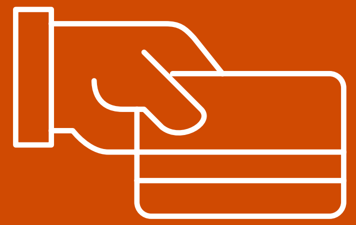
Present bias can be evident in individual's financial decisions, often prioritising present expenditures over long term savings. One example of an initiative to combat individual present bias is the auto-enrolment pension scheme. This scheme will reframe the financial decision to auto enrol individuals, where individuals can choose to opt-out if they wish, alleviating present bias and prioritising the populations financial future. By changing the default, more optimal outcomes can be achieved without compromising people's right to choose.

Figure 14. Present Bias



A culture of consumerism

Companies can often leverage consumer present bias to their benefit. Sales events such as Black Friday provide immediate financial gratification to consumers who feel they have gotten a bargain, without considering the potential long term financial implications of purchases. The use of credit allows customers to "buy now" and "pay later", which gives immediate gratification but can lead to unsustainable debt.



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Appendix

Sources

Bank of England
Central Bank of Ireland
Central Statistics Office
Department of Finance
Economic and Social Research Institute
European Central Bank
Eurostat
Federal Reserve Bank
Forbes
Frank Barry (2019) - Institute of International and European Affairs (IIEA)
IDA Ireland
International Monetary Fund
Irish Fiscal Advisory Council
Irish League of Credit Unions
National Treasury Management Agency
S&P Global

Glossary

BoE	Bank of England
CBI	Central Bank of Ireland
CSO	Central Statistics Office
DoF	Department of Finance
ECB	European Central Bank
ESRI	Economic and Social Research Institute
FRB	Federal Reserve Bank
GDP	Gross domestic product
GVA	Gross value added
HICP	Harmonized Index of Consumer Prices
IDA	Industrial Development Agency
IFAC	Irish Fiscal Advisory Council
ILCU	Irish League of Credit Unions
IPP	Intellectual property products
MDD	Modified domestic demand
NTMA	National Treasury Management Agency
RTB	Residential Tenancies Board

Notes

The data cut-off is 19 December 2024. The most recently available forecasts have been used in all cases. DoF forecasts are published twice per year – the most recently available are from September 2024.