IRELAND MARKET VIEW

After a number of challenges in 2023, conditions should improve through this year

H1 2024

Foreword

The prospects for the economy this year look fairly healthy. Households will benefit from cooling inflation, while the low unemployment rate and growing size of the workforce will further support consumption. For construction, housebuilding, which is set to be a key battleground in the upcoming general election, should expand. However, the tight labour market, alongside challenges with planning and water shortages, is likely to prevent it from developing as fast as politicians would like.

Meanwhile, the infrastructure sector should continue to perform well, with Project Ireland 2040 driving growth. By contrast, the non-residential building sector, which had a particularly difficult 2023, may struggle again. High interest rates and a weak global economy are likely to deter speculative developments, and its issues last year were one of the main reasons behind the recent drop in construction employment.

Frank Randles
Country Director for Ireland,
Mace Consult

Modified Domestic Demand grew at a modest...

0.6% ↑

last year, but growth is expected to pick-up in 2024.

Last year's weakness in production has led to a tightening in the labour market, and there were...

2.6% ↓

fewer people in construction employment in Q4 2023 than a year earlier.

Inflation continues to ease and the Harmonized Index of Consumer Prices now stands at...

1.7% ↓

its lowest level in almost two years.

Overall, construction production declined almost

5.25% ↓

last year, with large drops in both the residential and non-residential sectors.

The unemployment rate fell slightly in the first quarter of the year and, at...

4.3% ↓

suggests the labour market is at full capacity.

The residential sector finished the year growing...

3.0% ↑

in the final quarter and should continue to strengthen in the coming years.

Overview

While GDP declined last year, it is a poor metric for Ireland and other indicators suggest the domestic economy is not faring as badly as the headline figure shows. Overall, GDP shrank 3.2% in 2023, with there being a 3.4% reduction in the economy's size in the final quarter of the year. Dragging GDP down was a large fall in exports, with a striking decline in pharmaceutical products. In addition to specific sectors dragging down growth last year, GDP has grown drastically in recent years, and the weakness is a reversion of this. A better indicator for the economy is Modified Domestic Demand (MDD). Here, growth has slowed, and in 2023 was just 0.6%. Nevertheless, this also follows several years of substantial expansion. Within MDD, personal expenditure on consumer goods and services saw robust growth in the second and third quarters of last year, but flatlined in Q4. The economy is performing less well in investment, with falls in each of last year's quarters, and declining 7.1% for the year as a whole.

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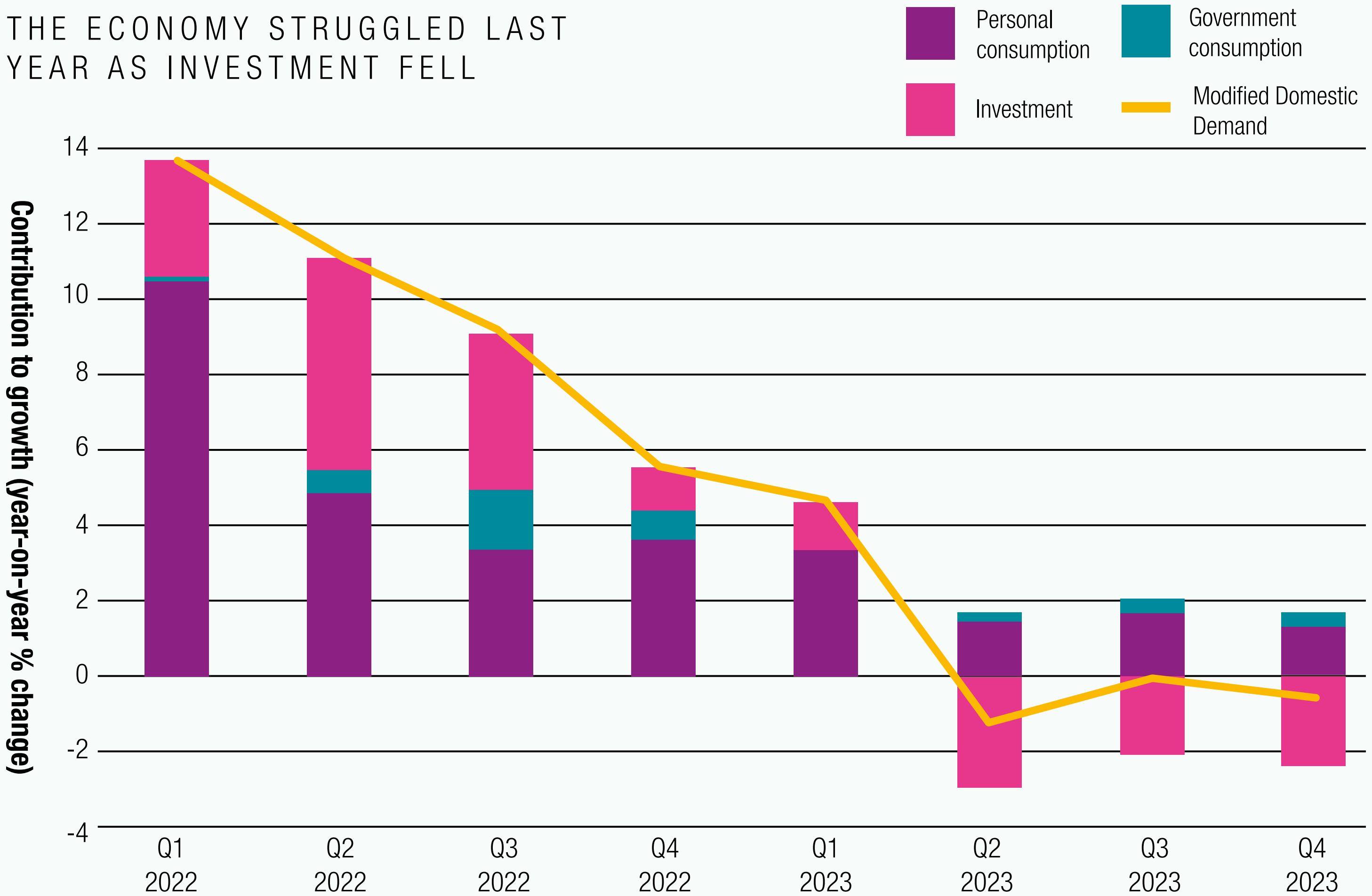
THE ECONOMY STRUGGLED LAST YEAR AS INVESTMENT FELL



Source: Central Statistics Office

Higher interest rates pose a risk

As with weakening in other sectors, much of last year's drop in investment was due to machinery and equipment and, in particular, intangibles moderating, having previously grown substantially. In addition, high interest rates are also likely to have deterred firms from investing. The European Central Bank raised rates on six occasions last year and the main refinancing rate is now 4.5%. Having started increasing the interest rate from 0% in the middle of July, this has been a sharp shift. In pushing up the cost of borrowing, real estate activities and construction saw a large decline in lending last year. More difficult credit conditions are likely to put some types of new projects at risk, as well as pose challenges to indebted contractors.

Inflation continues to ease

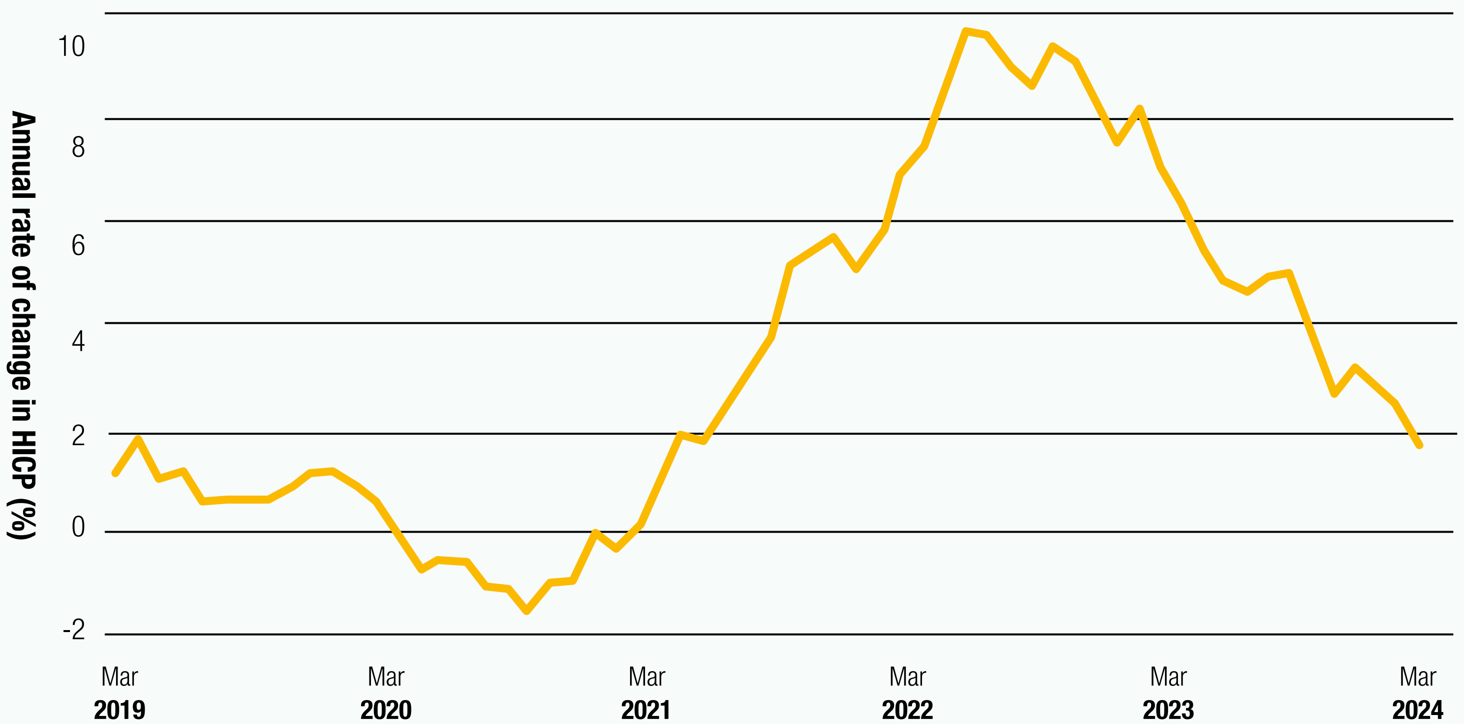
High interest rates have also contributed to inflation easing. In March, the Harmonised Index of Consumer Prices (HICP) had eased to 1.7%, the lowest it has been in almost three years. This slowdown is broad based, and pressures are likely to weaken further. Providing particular help are weaker energy prices; a mild winter and European gas storages reaching record levels for the time of year have led to a substantial reduction in natural gas prices. While there is a soft outlook for goods inflation, services inflation is set to be slightly stronger, and it is now domestic factors that are driving inflation. While the Central Bank of Ireland expects HICP to rise 2% this year, and 1.8% in 2025, its forecasts for services inflation are 3.7% and 3.1%, respectively. This fall in Irish inflation is faster than has happened in many European countries.

Tight labour market operating at full capacity

One reason for services inflation's relative strength is the tight labour market, with the Central Bank of Ireland believing it is operating at full capacity. The unemployment rate is very low and private sector earnings were 3.6% higher in Q4 2023 than a year earlier. Nonetheless, this wage growth is lower than it was and, with the vacancies rate dropping, there appears to be some weakening in labour demand. One factor helping dampen wage growth is inward migration, with well over half of the increase in the labour force over the past year coming from non-Irish nationals. Looking ahead, there is likely to be a marginal pick-up in the unemployment rate from its current levels. However, the move will be small, and with wages set to outpace inflation, the strong labour market should support household consumption.

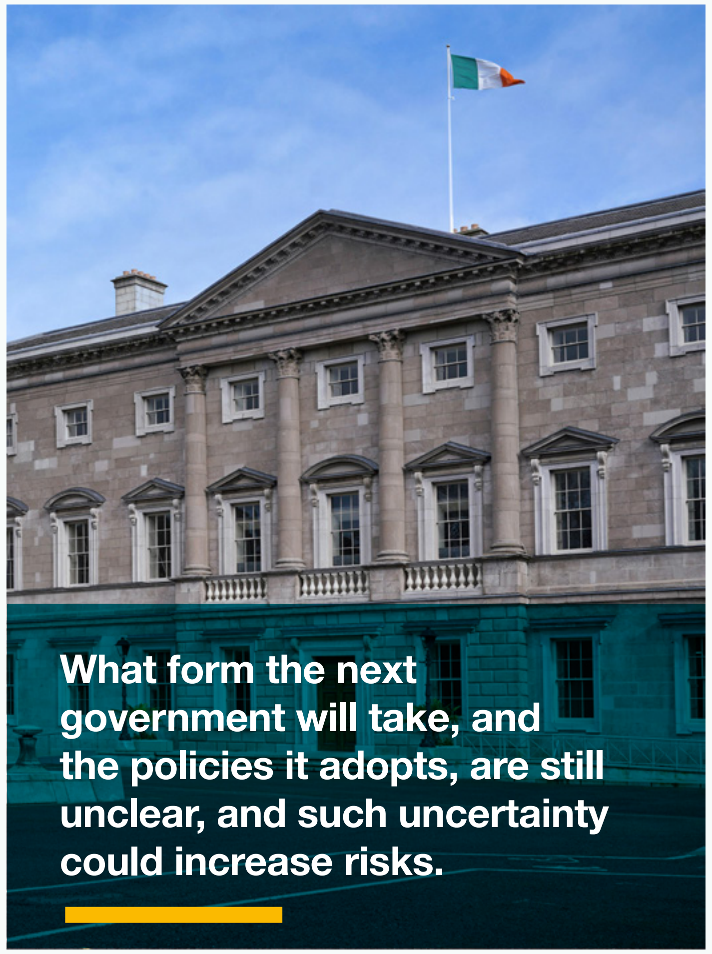
INFLATION RETURNS TO MORE NORMAL LEVEL

Source: Central Statistics Office

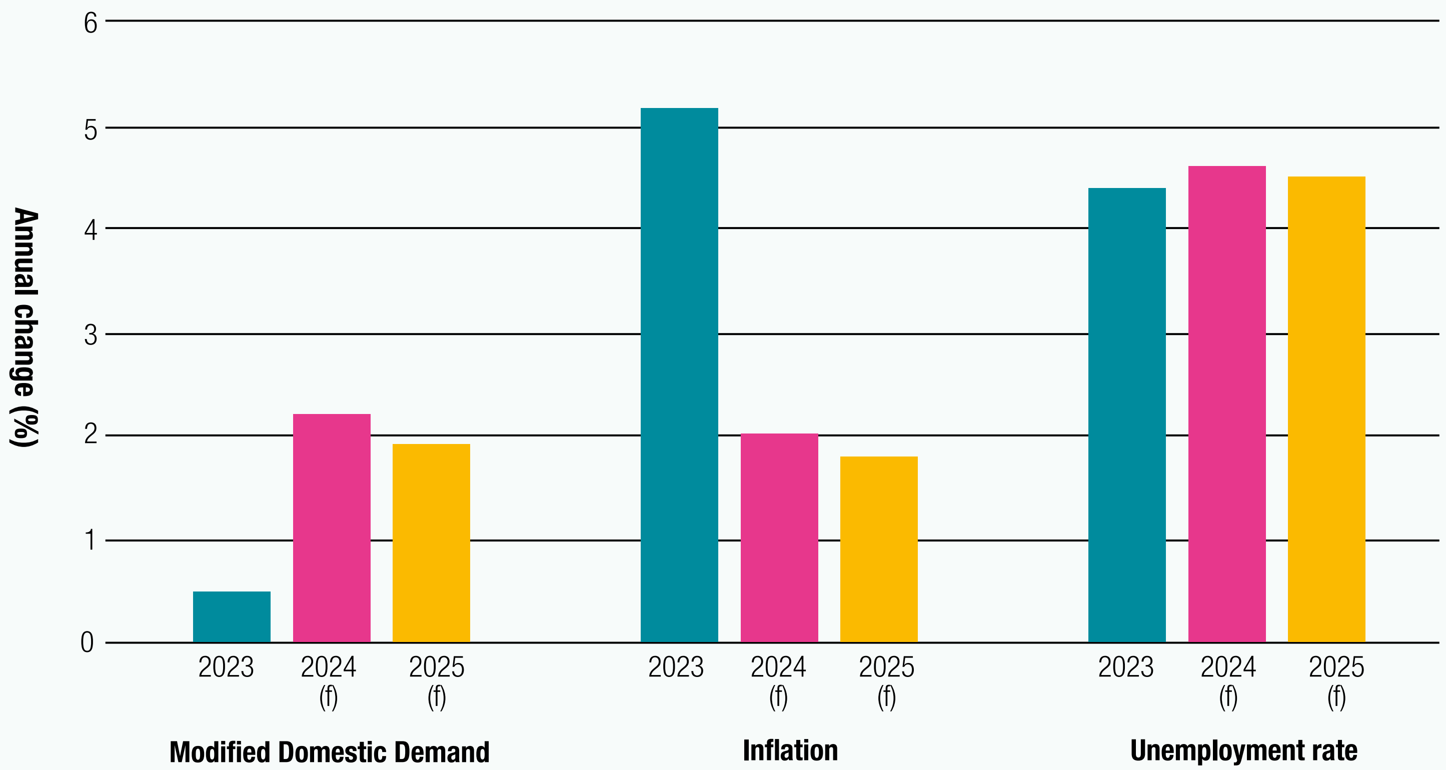


Outlook: Growth to increase this year

With much of Ireland's economic performance dependent on the global economy, there are likely to be further challenges in 2024. In particular, a lack of growth in the eurozone and the UK will hinder exporters. Nonetheless, domestic conditions appear much healthier. Easing inflation should help consumers, while low unemployment and a growing labour force will also support spending. Government expenditure is also likely to rise robustly this year, with last year's budget providing stimulus. Linked to this, and a consideration that will only grow as we move through the year, is the upcoming general election. Currently there is not a date for the vote, but it has to take place by March 2025. Albeit with a degree of uncertainty, polls suggest, there is a possibility of a new government being elected. What form the next government will take, and the policies it adopts, are still unclear, and such uncertainty could increase risks.



FORECASTS POINT TO HEALTHY ECONOMY



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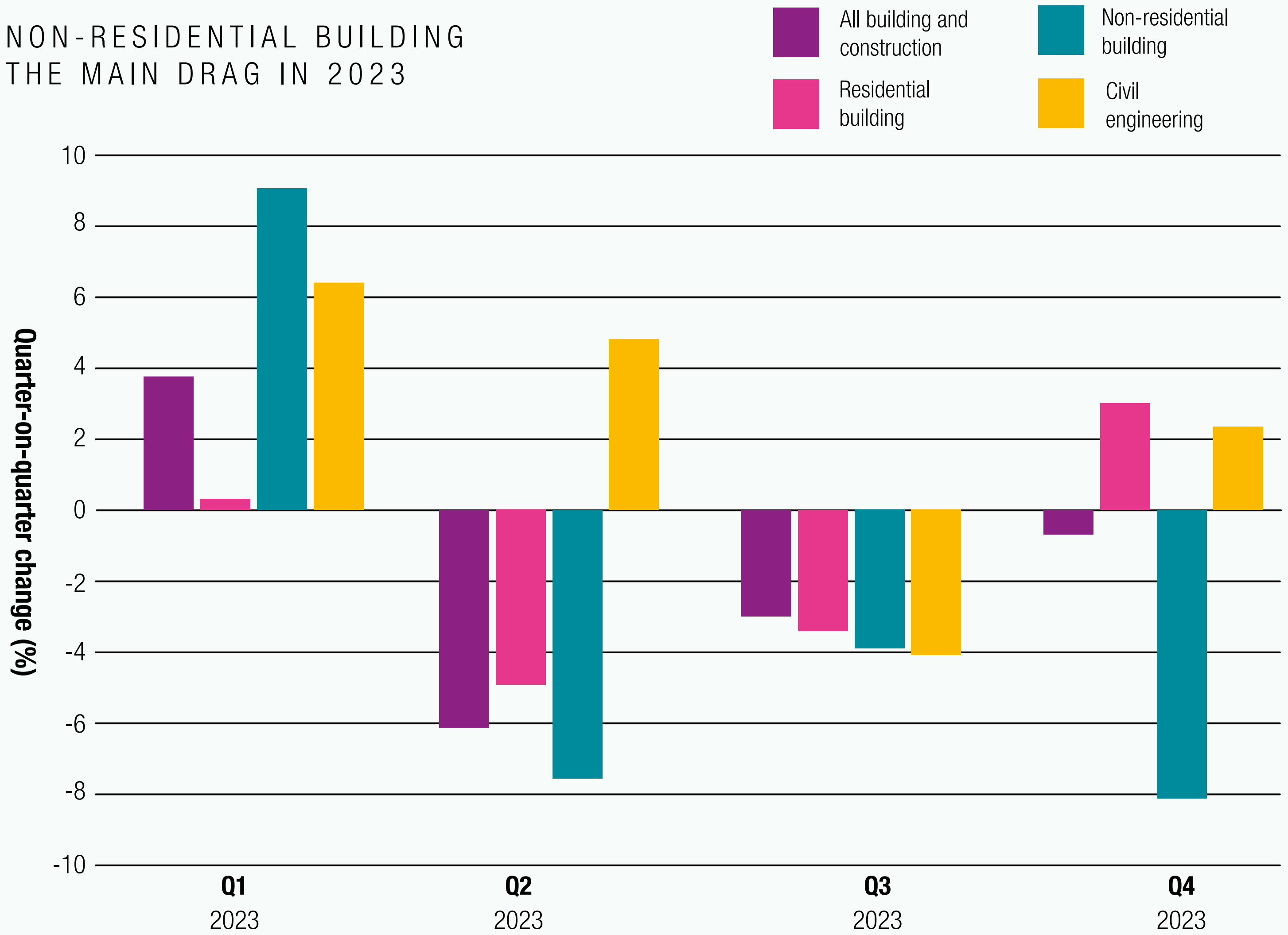
Construction market

2023 was not an easy year for construction. Overall, the volume of production in the sector declined 4.8%, with both the residential and non-residential sectors declining substantially. While both sectors have been negatively affected by higher interest rates, residential production had started to climb back-up by the end of the year. Growing by 3% in Q4, this was the largest increase since coming out of the pandemic, and there are other signs that conditions are improving. Notably, housing commencements have risen in each of the past five months and, in February 2024, there were almost twice as many as 12 months earlier. Further encouragement for new developments will come from house price growth starting to accelerate, along with cuts to interest rates on the horizon.

This turnaround in housing is timely given the problems facing the non-residential building sector. With a difficult global environment for multinationals, the sector shrunk 10.2% in 2023, including an 8.1% quarter-on-quarter reduction in Q4. Against this backdrop, and given high financing costs, developers are unlikely to be interested in speculative commercial projects. Workers being able to move to the residential sector is helpful, not least because the Q1 Outlook Survey by the Construction Industry Federation found 76% of respondents reporting access to skilled labour as the number one concern. In contrast to the 'building' components of construction (resi and non-resi), civil engineering grew strongly last year. Expanding by 12.3%, and with a strong pipeline in place, it should continue to support the construction industry.

NON-RESIDENTIAL BUILDING THE MAIN DRAG IN 2023



Weakening labour market

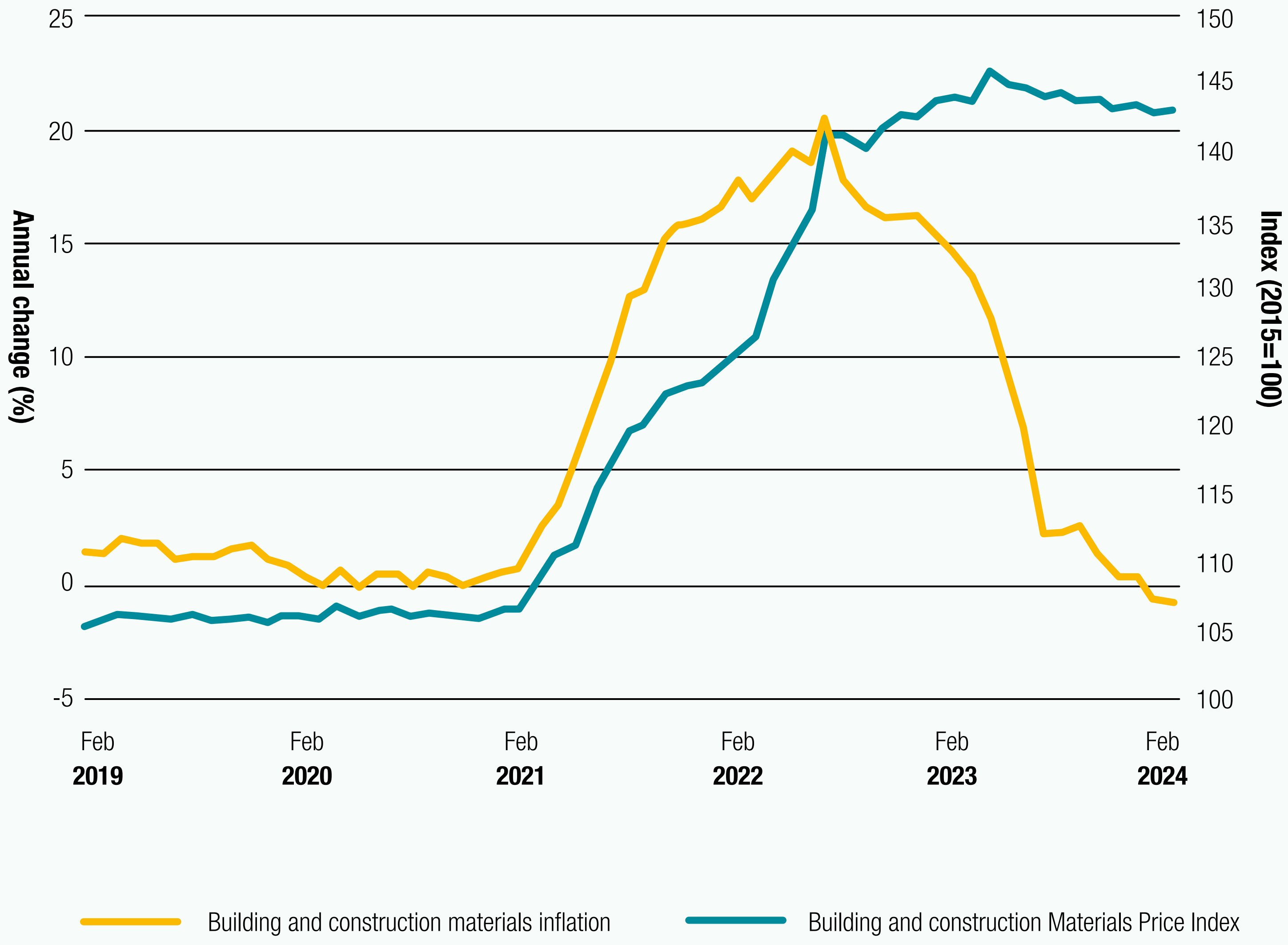
Compared to the whole economy, the construction sector appears weak. Whereas overall employment has grown strongly over the past 12 months, for construction it was lower in Q4 2023 than it was at the end of 2022. Similarly, pay growth in construction is not as pronounced. In particular, while average weekly earnings did grow last year, they declined between the third and fourth quarters. The drop in employment is likely to be strongly correlated with lower construction production and, while the growing residential sector will help, challenges in the labour market are likely to persist in the short-term. This ongoing weakness is backed-up by vacancy data, which show a sharp fall since the start of 2023.

Material prices dropping slowly

While the annual wholesale construction material price index is now negative, prices are only coming down slowly, and the decline is doing little to soften the surge that followed Covid and the start of the Ukraine crisis. However, the relative stability of prices for over half a year now should be boosting contractors' confidence when it comes to tendering. February, when the material index rose 0.1%, was the first rise in prices since last April and included a substantial jump in the 'other' structural steel index. Despite this recent rise, in general, falling prices over the past year seem widespread, and of the 37 materials that the CSO covers, 21 are lower than they were 12 months ago. Of these products, treated timber has seen the largest decline, although this again follows previous considerable rises.

STABILISING MATERIAL PRICES SHOULD PROVIDE CONFIDENCE

Source: Central Statistics Office



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Housing commencements on the rise

While parts of the construction market appear to be slowing, the residential sector is set for further growth this year. Housing commencements have been rising rapidly over the past few months and there were almost twice as many commencements in February 2024 than February 2023. The Dublin area is particularly hot and, with demand for housing so strong, the outlook for the sector looks upbeat. This is backed-up by the March BNP Paribas Real Estate Ireland Construction PMI which, for the first time since June 2023, pointed to an increase in overall construction activity. Within the index, housing also moved into positive territory, having had almost two years of declining activity. Despite the survey also reporting that the commercial sector is improving for the first time in four months, the outlook is likely less promising than for housing due to issues around speculative developments.

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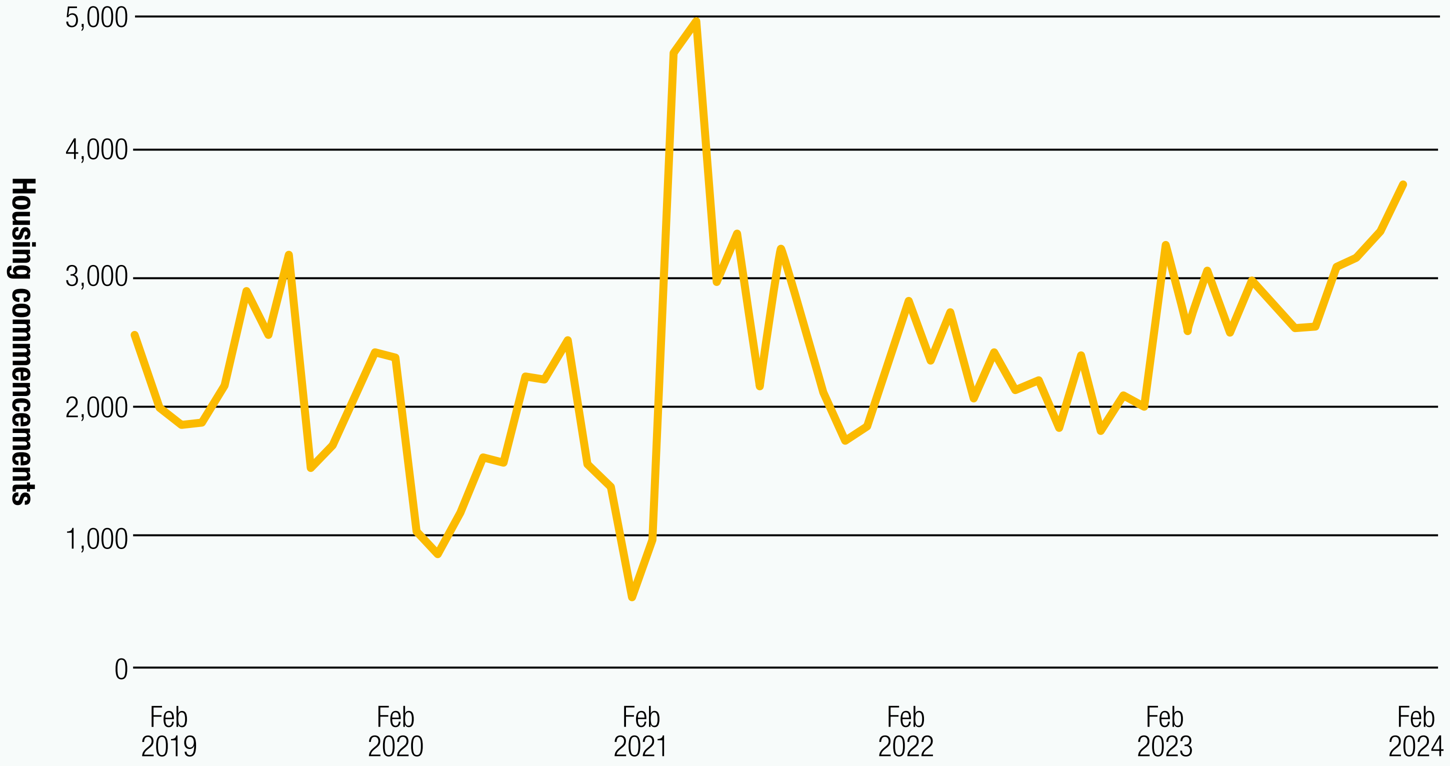
HOUSING MARKET WILL HELP DRIVE CONSTRUCTION

Source: Department of Housing, Local Government & Heritage



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Opportunities

There are a number of opportunities and considerations for clients in the near future and we summarise a couple of them below.

New Taoiseach and forthcoming election

In April, following Leo Varadkar's resignation, Simon Harris became the new Taoiseach. With an election having to take place within a year and his party Fine Gael behind in the polls, he is likely to want to implement policies which will turn those around. One such policy relates to housing. In his speech at his party conference, he said he would build 250,000 new homes in the next five years. This recognises that housing is one of voters' top concerns and a likely key battleground at the next election. Sinn Féin has responded to the challenge too, making an increase in housebuilding its number one priority. However, given the current target is 33,000 homes a year – a target just missed in 2023 – the chances of ramping up building so quickly seems highly optimistic. Nonetheless, housing and the associated infrastructure is definitely likely to increase in the coming years, with the opportunity (and challenges) discussed below.

Another more general growth opportunity is simply increasing government spending. This was something we discussed in our H2 2023 Ireland report, highlighting it as both an opportunity and a risk. According to April's Stability Programme Update, the general government balance is very strong, albeit not as healthy as it looked at the time of last autumn's budget. Politicians behind in polls will always have an incentive to increase spending but, in this case, overheating an already tight labour market has the potential to drive up inflation and, so far, there is no indication from the newly led government that it will pursue such a policy.

A final area that will concern both the new Taoiseach and be an area of debate in the election is how to advance Ireland's net zero policy goals. Here, Sinn Féin has set out its plans to increase spending on retrofitting for houses, suggesting the current government is not doing enough. Similarly, there will be questions around the appropriate amount of funding for projects, including wind and solar farms. A poll from February pointed to climate change and sustainability being the third most important issue for voters, behind housing and immigration. As such, when the manifestos are published before the election, they may promise greater spending for such policies over the next government.

Housing and the sector's enablers

As mentioned, one sector that should be growing over the next few years is residential. There is a rising population, huge demand for houses, not enough supply, and house prices are accelerating again. With this growth comes increased demand for products such as bricks, kitchen units and tiles, as well as associated labourers and workers. However, the market is highly unlikely to have the capacity to deliver a 50% increase in new homes as desired by Simon Harris. Without this capacity, attempting to increase property development so rapidly could come with undesirable consequences. Not only would it be inflationary, but without enough skilled workers, there could be many poor-quality properties built.

There are also well-documented existing challenges in meeting the current 33,000 a year target for new homes, with barriers to delivering the many different types of supporting infrastructure a recognised problem. In particular, there are issues with water supply. The Irish Home Builders Association has indicated that Dublin is facing especially severe challenges and Uisce Éireann (Ireland's national water utility) has highlighted that it may not be possible to connect new homes due to water infrastructure capacity. To address the issue requires a coordinated approach, both in terms of setting sustainable targets that can be met by all necessary parties and in terms of long-term available funding. Major capital investment in utilities (not just water), transport infrastructure and essential facilities, such as GP surgeries, is needed to enable the sustainable development of new, high-quality homes. This needs a 'team effort', with central and local government playing a key role, but also industry and the supply chain committing to closer and more collaborative working.

Challenges

As well as opportunities, there are a number of challenges, and here we present a couple in more detail as well as looking at mitigations.

The government's ability to deliver

In the coming years, irrespective of the leading political establishment, Ireland plans on considerably increasing its expenditure on infrastructure, as well as building many more homes. However, delivering such schemes on budget and to time is a complex task. As well as problems with the number of skilled workers, and whether the construction market is capable of carrying-out so many sizeable projects, one of the biggest challenges in achieving such goals is with the government itself. With historical projects, most notably the New Children's Hospital, where there were large cost overruns, there are questions about just how well equipped the civil service is.

There are signs this could change, however. In recognising past failures, one way in which the government is hoping to improve delivery is through its recently released 'Infrastructure Guidelines' document. The main aim of the report is to ensure that large infrastructure projects will provide value for money at the same time as being delivered in a timely fashion. To help accomplish this, the document provides direction during key stages of a programme lifecycle, calling for preparation of a comprehensive business case before going out to tender, and emphasising the need for regular monitoring of progress once up and running.

Nonetheless, simply ensuring that projects require a strong business case and are well thought through is no guarantee of success. Money is also key, and in April the government distributed an additional €2.25 billion to various departments for public capital projects. Before doing so, the government worked with the Economic and Social Research Institute to understand the likely impact of the spending. The aim of this is to avoid overheating a market with limited capacity. One of the main ways in which projects can go over budget is through inflation, and simply increasing budgets with no thought about the wider consequences is a good way to stimulate it. Such a step is, therefore, very positive, but also means that not all projects are going to get the necessary funding.

'Infrastructure Guidelines' outlines several ways to produce better results. One is through a programmatic approach, with the paper arguing that combining similar, smaller projects into a programme can lead to efficiencies of scale, with increased purchasing power. Additionally, it can help increase skills and avoid repeating the same mistakes through using lessons learned. A second is the need for a procurement strategy. Given the tightness of the market, making sure that contractors have the appetite for such projects is essential; early engagement with contractors can help. Similarly, having preferred suppliers can mean larger orders and the advantages of bulk buying and economies of scale.

Having said all of this, and while acknowledging that the government has many of the right ideas, this is very different to the successful implementation of policies. The proof is in the pudding and, during a time of political uncertainty, when departmental budgets might soon be changing hands, following best practice and focusing on long-term, positive outcomes can be a challenge. And all of this sits underneath a big question mark – can these new ideas be resourced?

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Planning

One of Ireland's biggest challenges in delivering new housing projects is planning. The government is currently going through a process of developing a new planning framework, but is only due to publish this in September 2024. Currently, the report is going through a consultation process, but there are several issues with the current system. Highlighting this challenge, there are approximately 80,000 units with planning permission that are un-commenced, and there is clearly a problem getting many schemes started. That this accounts for several years' worth of new house completions, upping the pace from granting permission to starting on site has the potential to transform the market. Furthermore, around half of these hold-ups are in Dublin, where demand for new homes is highest.

One reason for these delays is waiting for decisions from An Bord Pleanála. Not only does the planning department's pace of decision-making affect the rate of housebuilding, it also increases costs. One recent report indicated that over 20,000 homes were with An Bord Pleanála, noting that applications on average now wait for over 16 months to pass through the process. The paper estimates that these delays will add €125m to the cost and, somewhat inevitably, developers will pass this on to those who end up buying the properties.

There are several ways in which to speed things up. The government moving away from the Strategic Housing Development system to a new Large Residential Development process seems to have helped. Yet, there is still a backlog of those going through the SHD route. It is possible that additional staff in An Bord Pleanála would help. Government funding may also be necessary to support the infrastructure required to make new projects viable. Alongside this, there are also things developers can do to help expedite and the planning process and avoid appeals. In particular, following the correct consultation process with the local community and preparing the necessary documentation is invaluable. Importantly, large-residential developments are likely to require environmental impact assessments and strategic environmental assessments. These can be complex pieces of work, and if not done properly, with the right specialists involved, can give opponents to new developments an opportunity to appeal.

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