Banking & Payments Federation Ireland

Consumer spending recovers as prices rise

Making work pay as income supports end

Business credit demand remains weak

SME Monitor

OCTOBER 2021

A digital, low-carbon recovery

Commentary

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A digital, low-carbon economic recovery

Economic activity in many sectors in the Irish economy has been restricted at stages since March 2020 due to the pandemic-related public health measures. Since the phased reopening in April 2021, the Irish economy has started to recover significantly. Recent forecasts by the Department of Finance in the context of Budget 2022 show that Modified Domestic Demand, which is the most useful indicator of domestic economic activity in the Irish economy, is estimated to grow by 5.2% in 2021 and 6.5% in 2022, after contracting by 4.9% in 2020.

We can also see the recovery in the labour market. Prior to the pandemic, the highest number of people in employment in Ireland was in the last quarter of 2019 when more than 2.36 million persons were in employment and unemployment rate was 4.5%. The Covid-19 adjusted rate of unemployment peaked at 31.5% in April 2020 before declining to 16% in September 2020. The latest data from the Central Statistics Office (CSO) shows that this rate has fallen further down to 10% in September 2021.

Fewer Workers on Government Supports

According to the latest analysis by the CSO, more than 1.36 million people had received one or more of the government Covid-19 income supports by mid-2021, which is nearly half the pre-pandemic labour force[1]. The number of people on the Pandemic Unemployment Payment (PUP) has declined to 97,130 as of 12 October from its peak of over 600,000 people in week commencing 4 May. However, the number of workers supported through the Revenue administered Employment Wage Subsidy Scheme (EWSS) has not declined at the same rate. The latest data shows that there were over 308,000 workers supported through the scheme in September 2021 compared with 344,000 workers in September 2020.

[1] The two main income support measures were Pandemic Unemployment Payment (PUP) administered by the Department of Social Protection and the Temporary Wage Subsidy Scheme (TWSS), which was later replaced by the Employment Wage Subsidy Scheme (EWSS) and administered by the Revenue Commissioners.

As the number of workers claiming PUP decline with the phased reopening of the economy, we see a shift towards the EWSS support scheme. Revenue data[2] shows that just over 28% of all employers received EWSS support during 2021, where in sectors like Accommodation and Food Services and Arts and Entertainment, this ratio was 65% and 53%, respectively. On average, 75% of average gross pay was supported through the scheme, but this ratio was as high as 88% in the Arts and Entertainment Sector and 81% in the Accommodation and Food Sector.

Small and medium enterprises (SMEs) in the Services sector account for more than 56% of all active enterprises and around 53% of employment within the SME sector[3]. Given that the labour-intensive services sectors such as retail, food and beverage, accommodation, tourism and travel are the most affected sectors due to the pandemic, this has created a disproportionate effect on SMEs. We know from various CSO surveys that 56% of SMEs reported closing at some point during the pandemic in 2020, while 67% reported less turnover than normal[4].

In this context, it was announced by the Minister for Finance during his Budget 2022 speech that the EWSS, which was due to expire at the end of 2021, is extended until April 2022 in order to support businesses availing of the scheme for a longer period given that the recovery in the labour market is likely to lag the recovery in economic activity. At the same time, as observed in other countries, in certain sectors such as accommodation and food, we see a mismatch between demand for labour and effective supply.

Transition to a Digital and Low-Carbon Economy

While the impact of the Covid-19 pandemic will continue to challenge businesses, particularly SMEs, in the short term, it is important to note that it also provides an opportunity to transform the Irish economy via digitalisation and transition to a low-carbon economy. The recently revised National Development Plan (NDP) 2021-2030 forms part of the Irish government's overall fiscal strategy where the objective is to boost the economy's stock of infrastructure in order to support private investment by businesses. The NDP rests on two main pillars of financing the transition to a carbon neutral and digitised economy, supported by other investment priorities such as housing, health and education.

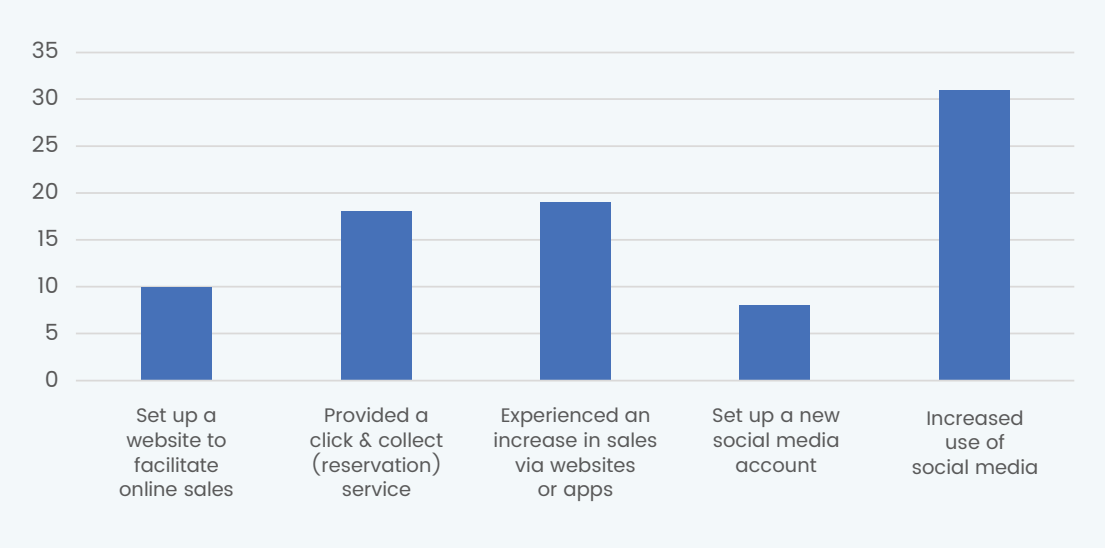
[2] Revenue PAYE Trends and Analysis, Q3 2021.
[3] CSO Structural Business Statistics 2019.
[4] CSO Press Statement, Impact of Covid-19 on our Society and Economy over 18 months.

The NDP sets out a total public investment of €165 billion over the period 2021-2030. Strategic investment priorities to achieve further digitalisation of the economy and transition to a low carbon economy includes a Green Transition Fund for the wider economy and a Digital Transition Fund focussed on SMEs. These two funds are also supported by the National Recovery and Resilience Plan (NRRP) which received formal approval from the European Commission where Ireland is set to receive almost €1 billion over the period 2022-2025.

In terms of digitalisation, Irish enterprises have made significant progress over the past number of years. Covid-19 has also accelerated the digital transformation as many businesses needed to adapt to changing consumer trends and behaviours during the pandemic. For many enterprises, this meant increasing their information technology (IT) usage or adapting new IT uses into the business. CSO's Information Society Statistics show that in 2021, one in five enterprises reported an increase in sales via websites or apps during the Covid-19 pandemic and one in ten set up a website to facilitate online sales.

However, many businesses encountered financial difficulties during the pandemic. This is evident from the increase in arrears on non-domestic energy accounts reported by the Commission for Regulation of Utilities (CRU). The proportion of non-domestic gas accounts in arrears jumped from 13% in February 2020 to 29% by January 2021, before falling

Enterprise responses to the Covid-19 Pandemic, 2021 (%)



Source: CSO

[5] Government of Ireland, National Development Plan 2021-2030

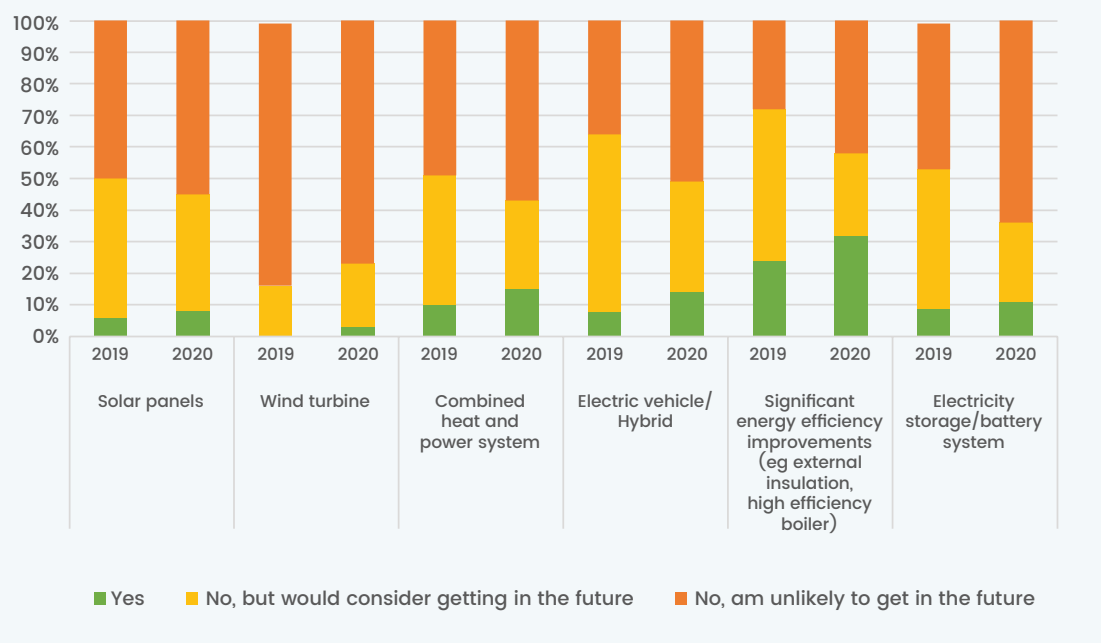
back to 25% by April 2021. Similarly, the proportion of non-domestic electricity accounts in arrears rose by 10% in February 2020 to 15% by June 2020. By April 2021, some 13% of non-domestic electricity accounts were in arrears.

More recently consumers and businesses have faced soaring energy costs. CSO data indicates that the cost of electricity in manufacturing jumped by 188% between August 2019 and August 2021. Rising energy costs are likely to focus businesses' attention on how to increase energy efficiency.

Research suggests that the energy performance of commercial premises lags that of dwellings. CSO data on Building Energy Rating (BER) shows that only 21% of non-domestic buildings constructed between 2015 and 2021 received an A rating compared with 97% of domestic dwellings constructed during the same period.

A recent survey carried out for the CRU in relation to electricity and gas markets in Ireland has a section on green products in the SMEs' business. The results show that some SMEs have made significant energy efficiency improvements in 2020 compared to 2019, however consideration of getting green power products in the future has declined across all different categories.

Green Electricity Products Used or Planned by Businesses



Source: CRU SME Electricity and Gas Markets Survey Results 2020

[6] CSO, Non-Domestic Building Energy Ratings

Given the importance of SMEs in the Irish economy, it is imperative that SMEs start planning for the green transition that will take place over the next decade. As outlined by the OECD[7], SMEs can do this either by reducing the environmental footprint of their products and services or by offering green product and services to other parts of the economy. However, while recovering from the pandemic, transition to a more digitalised and a low-carbon economy must be sustainable for SMEs in Ireland. In this regard, the funds that are available under the NRRP and through the Sustainable Energy Authority of Ireland will play a major role, however private investment will also be needed.

The International Monetary Fund (IMF) estimates[8] that envisaged emission reduction targets in Ireland will require investment close to €20 billion per annum over the next ten years of which about one-third would be public capital spending and the rest would have to come from private investment. Financial services and particularly the banking sector will play a significant role in providing funding for this required investment over the next number of years.

[7] OECD, SMEs: Key Drivers of Green and Inclusive Growth, 2018

[8] IMF, Considerations for Climate Change Mitigation in Ireland, June 2021

Market Analysis

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SMEs and the wider economy

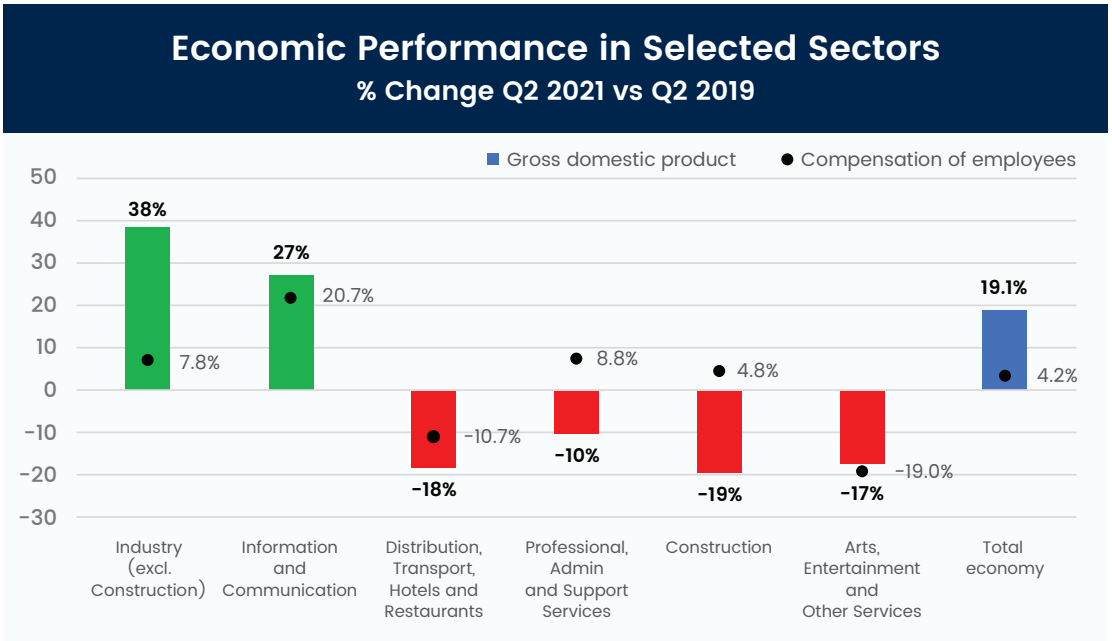
Irish economic activity seems have recovered well from the impact of Covid-19 pandemic and the health measures introduced to limit its spread. Most metrics show significant improvements since the government began to ease the most recent restrictions from mid-April.

Services suffer more

Traditional measures of economic output show that Covid-19 had a significant but uneven impact on the economy. Gross domestic product grew by 6.3% in real terms in Q2 2021 (compared with Q1 2021) boosted by 12.6% growth in personal consumption expenditure. Modified final domestic demand, which excludes globalisation effects such as trade in intellectual property and aircraft leasing, rose by 8.4% in Q2 2021, compared with Q1.

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

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



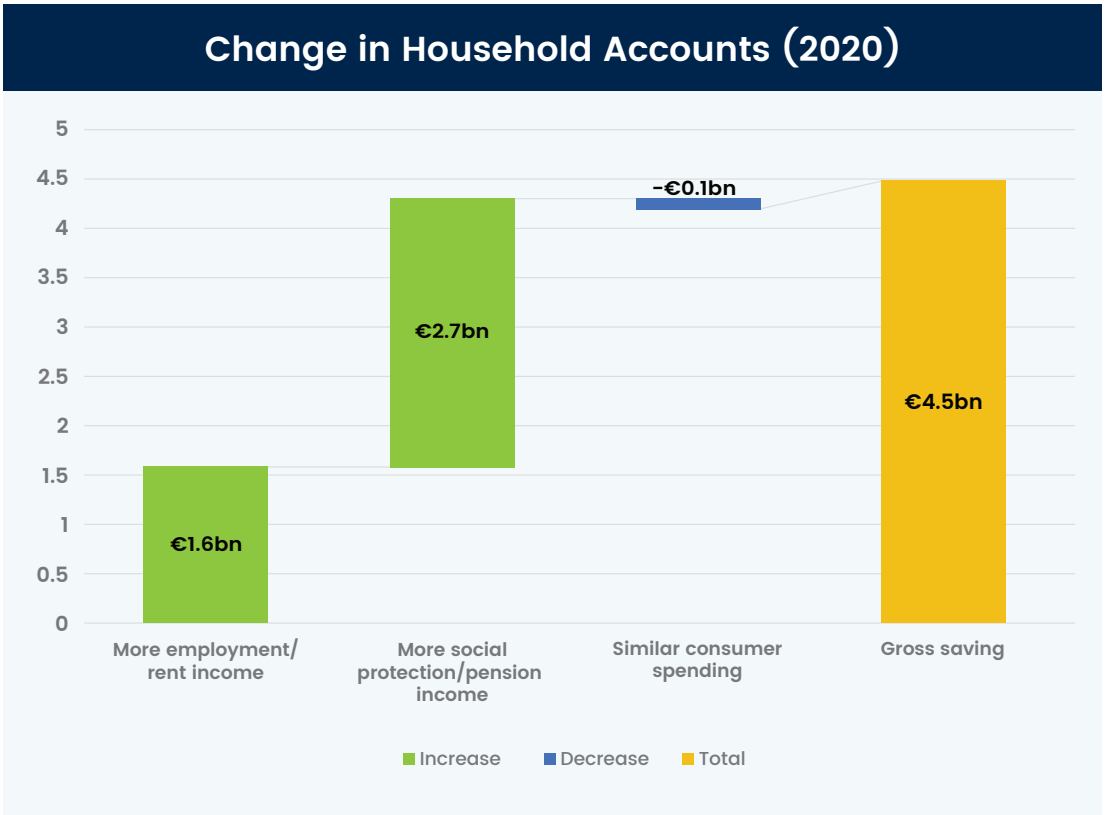
Source: CSO

Gross value added by the Distribution, Transport, Hotels and Restaurants sector fell by 18% in Q2 2021 compared with Q2 2019, while compensation of employees fell by 11.3%, according to the Central Statistics Office (CSO)[1]. Substantial government supports, especially the employment wage subsidy scheme, helped to absorb some of the impact of the reduced business activity on workers' incomes in the sectors worst affected by the restrictions.

The total tax take in the first nine months of 2021 was almost €45.9 billion, some 5.8% ahead of profile or forecast receipts and 15.9% more than in the same period of 2020. While income tax were only 0.8% ahead of profile, corporation tax receipts were 14.8% ahead of profile. At almost €8.1 billion, corporation tax accounted for almost 18% of total tax revenues. The strong growth in consumer spending meant that VAT receipts were 7.7% higher than forecast in the year to September at €12.4 billion.

Gross government expenditure was 1.8% below profile but social protection spending was 1.6% above profile and at €22.7 billion, accounted for almost 38% of total expenditure. The combination of increased social protection support and increased income resulted in a large increase of €4.5 billion in household gross savings in Q2 2021 compared with Q2 2019.

[1] To address the volatility resulting from Covid-19 and identify underlying trends, where possible, we will compare the most recent data with equivalent data from 2019.



Source: BPFI estimates based on CSO data

> Substantial government supports...helped to absorb some of the impact of the reduced business activity on workers' incomes.

Despite the economic recovery, unemployment remained high. The seasonally adjusted unemployment rate fell to 6.4% in September 2021 from the recent peak of 7.6% in March 2021. The CSO estimated the adjusted unemployment rate was 10% when all claimants for the Pandemic Unemployment Payment (PUP) were included, down from 15.9% a year earlier.

Recovery faces headwinds

Consumer sentiment and business conditions improved significantly between Q1 and Q3 2021 but cost and price pressures have increased. The KBC consumer sentiment index dropped slightly to 86.4 in September 2021 but held steady close to the two-year high of 87.2 seen in June. Consumer prices rose by 3.7% year on year in September, the fifth successive month in inflation rose by more than 1.5%. Fuel costs soared with home heating oil prices up 46% year on year in September 2021 (though only 2% higher than in September 2019), while electricity and natural gas prices rose by 20% and 15%, respectively, year on year. The AIB Services and Manufacturing purchasing managers' indices (PMIs) continued to show strong growth in those sectors in September.

However, cost pressures continued to increase with input price inflation in services at its highest level since December 2000, input and output prices increasing at record pace in manufacturing and input cost inflation in construction near the record levels. In construction and manufacturing, firms reported difficulty in sourcing materials and staff, with significant lengthening of suppliers' delivery times.

However, demand remained strong, and firms remained optimistic on the 12-month outlook for their businesses.

> Consumer sentiment and business conditions improved significantly between Q1 and Q3 2021 but cost and price pressures have increased.

Finding Customers

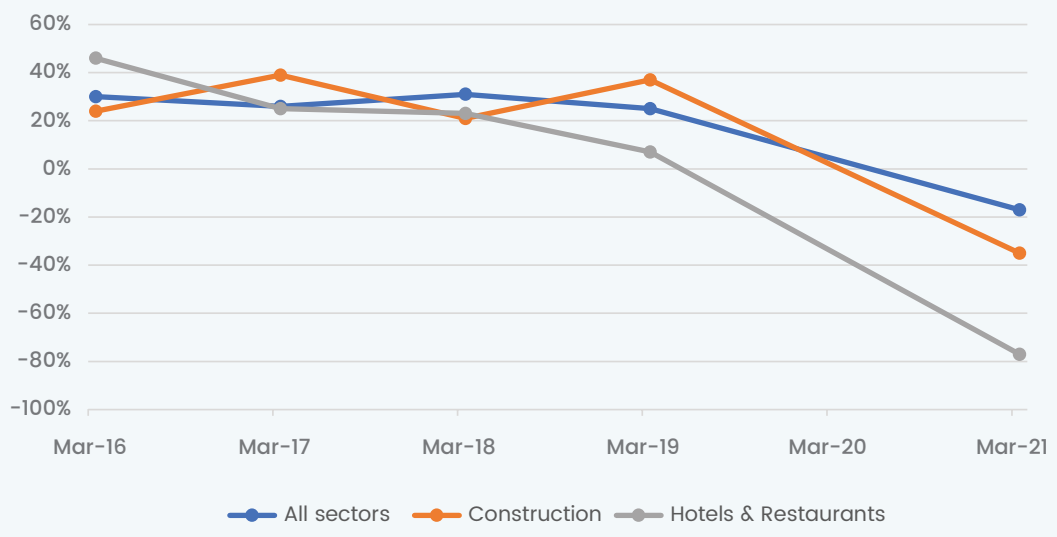
Small and medium-sized enterprises – those businesses employing fewer than 250 persons. Business sectors with the highest concentration of SMEs were among the worst affected by Covid-19; in particular, accommodation and food services, construction, wholesale and retail trade.

The European Central Bank (ECB) Survey on Access to Finance for SMEs (SAFE) highlights finding customers as the most pressing problem for SMEs in Ireland and elsewhere in the Euro area, following by the availability of skilled staff or experienced managers.

It also showed that SMEs across the euro area were reporting worsening turnover performances.

In the hotel and restaurant sector, survey data suggests that business turnover began to deteriorate as far back as 2016-17. The Department of Finance's Credit Demand Survey indicates that the net percentage of such SMEs reporting a decrease in turnover in the previous six months

Business Turnover Past Six Months
Net Percentage of Respondents



Source: Department of Finance Credit Demand Survey

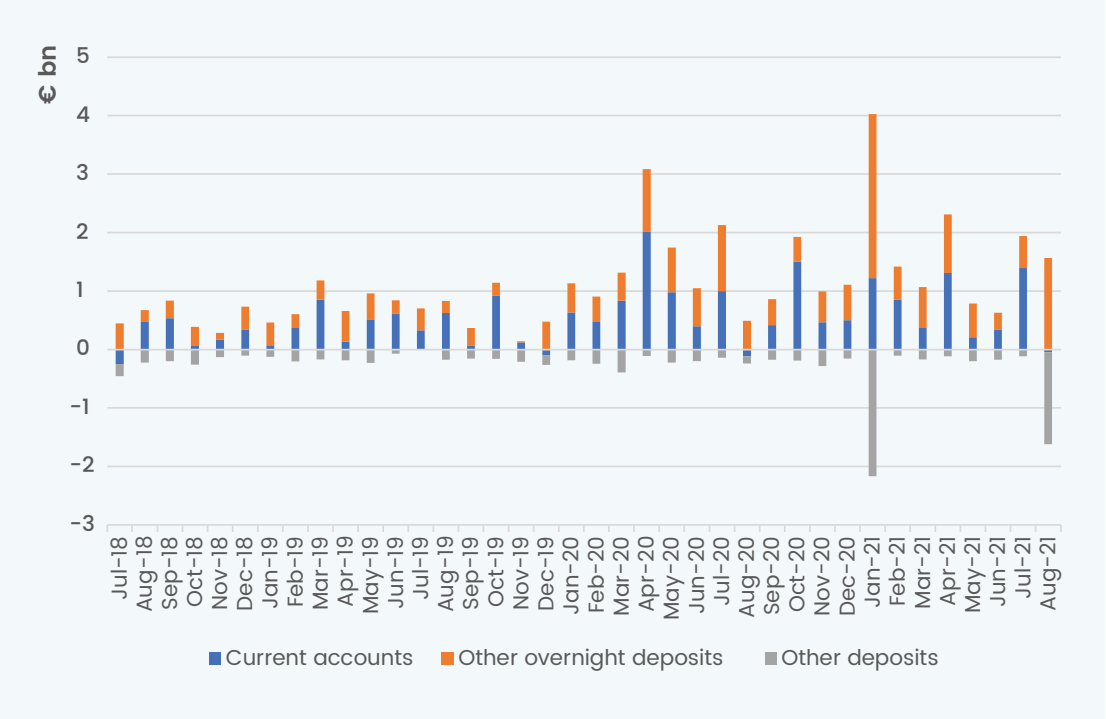
reached 77% in March 2021 (the survey was not conducted for March 2020). That compared with a net percentage of only 7% reporting an increase in turnover in March 2019. In August 2021, the seasonally adjusted value of monthly services increased to its highest value since the data series began in 2015 driven by a strong performance in information and communication services. While other sectors recovered from slumps during the lockdowns in Q2 2020 and Q1 2021, the index for accommodation and in administrative and support service activities were 63% and 76% of the base year 2015 levels.

More cash in the bank and beyond

CBI data indicates that household deposits in banks and credit unions have risen steadily in recent years. Household deposits reached almost €134 billion at the end of February 2021 from less than €103 billion three years earlier.

However, household deposit transactions were negative in August 2021, for the first time since November 2019, with a net outflow of some €1.6 billion from term and notice deposit accounts.

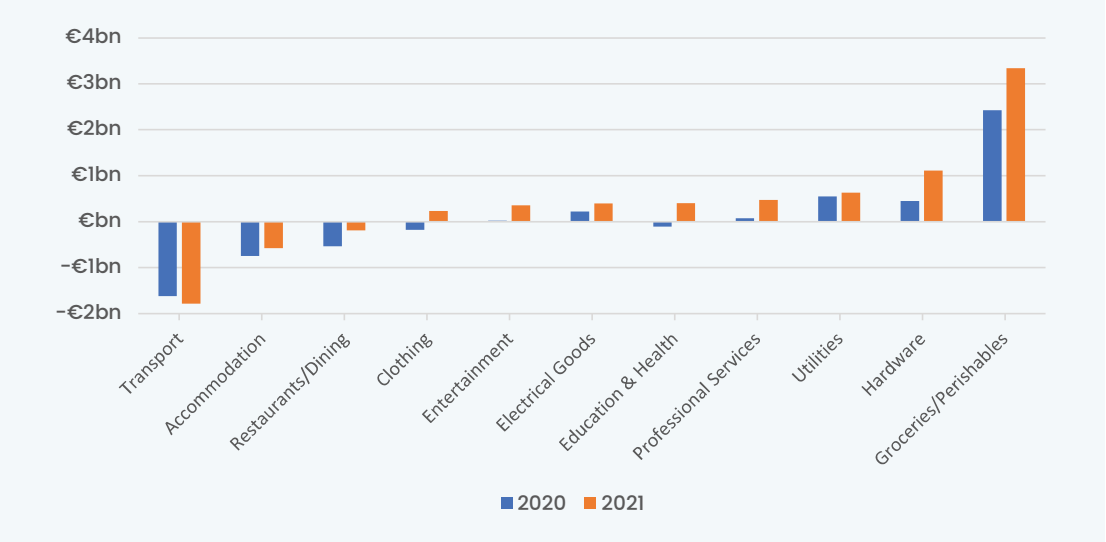
Household deposit transactions



Source: Central Bank of Ireland

State Savings products also enjoyed a strong performance in the first nine months of 2021 with total State Savings up by about €1.2 billion in the year to date to €23.9 billion, including €15.2 billion in fixed rate products and €4.4 billion in prize bonds. The large deposit base should provide substantial resources to fund consumer spending.

Change in YTD Card Spend By Merchant Type (vs 2019)



Source: CBI analysis of monthly credit and debit card data up to August 2021

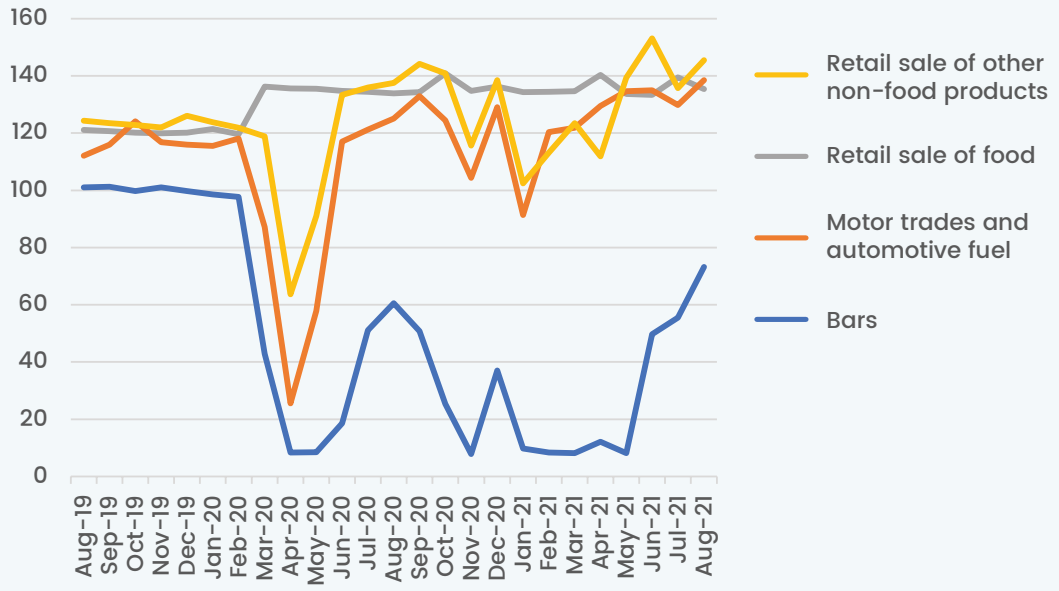
The CBI's monthly card payments data and the CSO's retail sales index both show turnover remained below pre-Covid levels in the worst affected sectors, while others are still benefitting from a boost. The CBI shows that personal card spend on groceries/perishables increased sharply for the second year in a row, with an additional €3.3 billion spent on groceries/perishables in the first eight months of 2021, compared with the same period of 2019, bringing total spend to more than €10.3 billion[2].

Hardware similarly saw more than €1.1 billion in additional card spending to almost €3.4 billion. Personal card spending plunged in the hospitality and leisure sectors, with card spend on transport (including commuter travel and holiday-related travel such as flights) down by €1.8 billion compared with 2019 to about €1.1 billion. Restaurants/dining and, to a lesser extent, accommodation, recovered in 2021, with card spend of about €2.1 billion and €1 billion, respectively, in the year to August 2021.

[2] The increase in card spending partially reflects a shift from payments by cash to payments by card.

The CSO's retail sales index shows that by August 2021, retail sale of food, especially supermarkets, remained well above the level before the pandemic. While retail sale of other non-food products and motor trades and automotive fuel recovered strongly from a deep dip in April 2020, bar sales increased substantially from June onwards but was some 28% below its August 2019 level.

Retail Sales Indices



Source: CSO

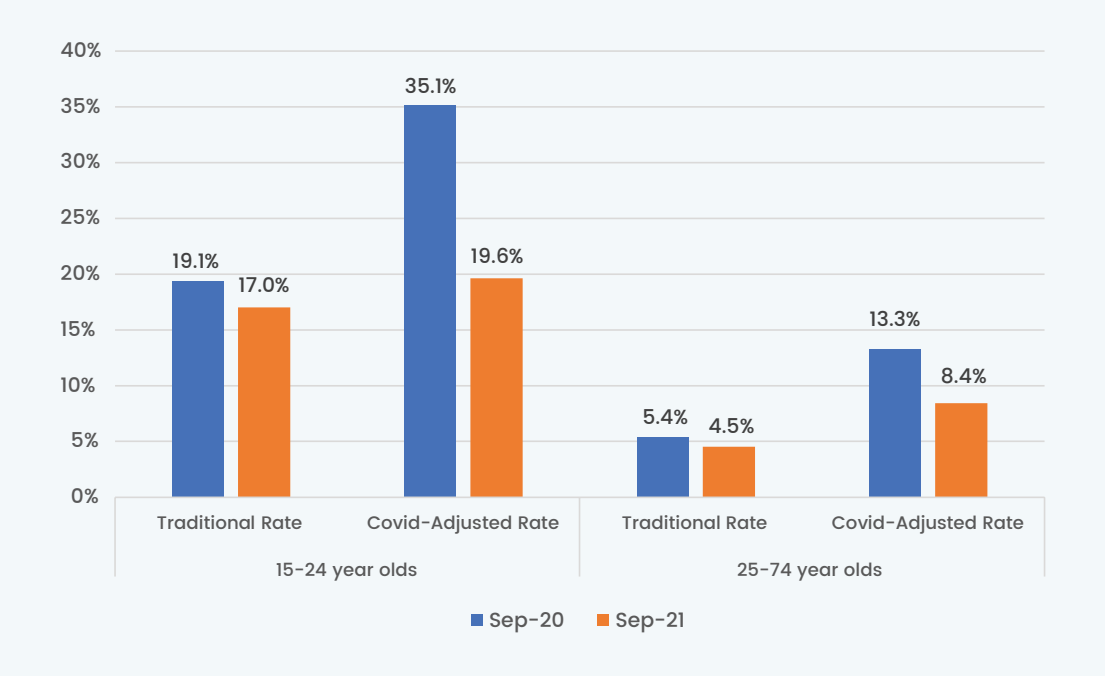
With most retail outlets open again, online sales have become less important. The proportion of retail turnover that was generated by online sales fell dropped to about 4.9% in the summer of 2021, similar to levels in 2020 when most physical retail outlets were open for business and slightly higher than the same period of 2019.

Availability of skilled labour

The pandemic and the public health measures to manage it have had a huge impact on the labour force, with many jobs lost or in a vulnerable position and many employees adapting to new ways of working.

The standard seasonally adjusted unemployment reached 6.6% in September 2021, down from 7.2% a year earlier and 7.6% in March 2021. The CSO's Covid-19 adjusted unemployment rate - which includes all recipients of the pandemic unemployment payment (PUP) – fell to 10% in September 2021, from 15.9% a year earlier.

Monthly Unemployment Rates



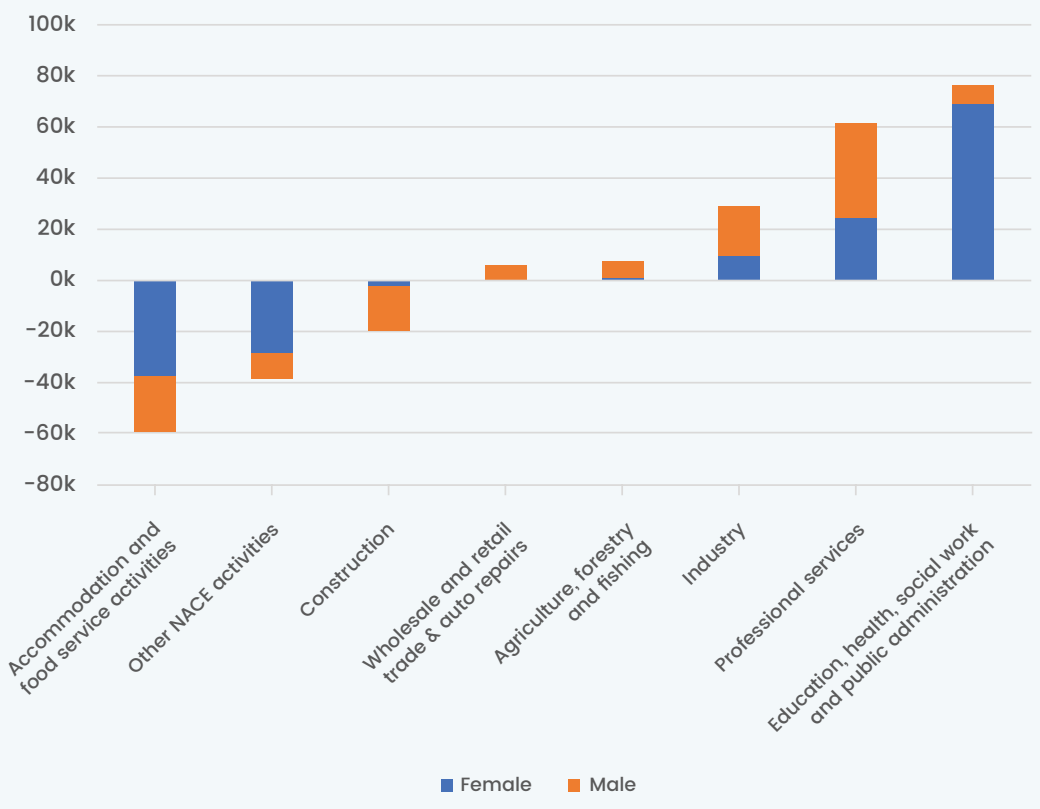
Source: CSO

With 19.6% of 15-24 year olds classified as unemployed using the adjusted measure (17% according to the standard measure), the pandemic has had a major impact on younger people's employment chances.

Labour-intensive sectors such as construction and hospitality have been hard hit by Covid-19, a fact illustrated by sharp drops in employment in those sectors between Q2 2019 and Q2 2021.

While females accounted for most of the 33% (60,000) drop in employment in accommodation and food services between Q2 2019 and Q2 2021, males accounted for most of the 12.9% drop in construction employment. By contrast, females accounted for nine-tenths of the additional 76,000 persons employed in education, health, social work and public administration.

Change in Seasonally Adjusted Persons Employed
Q2 19 vs Q2 21 (000s)



Source: CSO

The number of people receiving the PUP dropped below 100,000 for the first time on 12 October and eligible recipients will move onto a jobseeker's payment from 26 October.

An analysis by the Revenue Commissioners suggests that by mid-October some 204,000 employees and 18,300 employers were still supported by the Employment Wage Subsidy Scheme (EWSS). The government announced in Budget 2022 that the EWSS would be extended until April 2022, though the scheme will close to new employers from 1 January 2022.

The EWSS in particular has helped support the incomes of those still in employment and preliminary CSO earnings data suggest that incomes have risen substantially in recent years. Average weekly earnings increased by 10.1% between Q2 2019 and Q2 2021 to €849.69, with increases in all sectors, except transportation and storage.

However, the sectors most affected by the pandemic are all lower than the average for all sectors, with average weekly earnings in those sectors ranging from €377.73 in accommodation and food services to €685.10 in administrative and supports services. Construction was something of an outlier with average earnings only 2% lower than the all-sector average.

The all-sector vacancy rate rose to 1.1% in Q2 2021 – the same as Q2 2019. Information and communication and public administration and defence had the highest vacancy rates at 2.4% and 2.2% respectively while the accommodation and food services rate was 0.5%, its lowest Q2 level since 2016.

> Labour-intensive sectors such as construction and hospitality have been hard hit by Covid-19.

Accessing finance

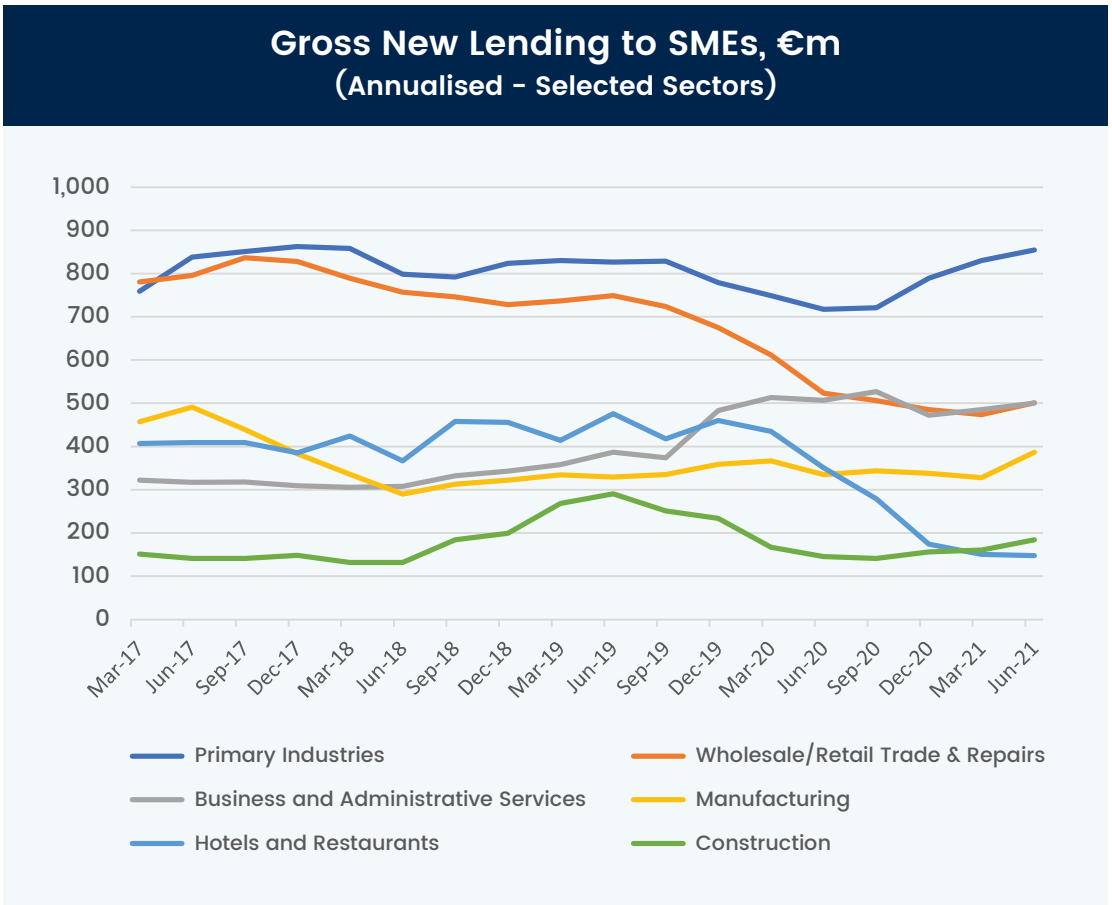
Access to cashflow and liquidity concerns have been the key drivers for credit demand during the pandemic, at least in its early stages.

Overall demand remained weak with only 20% of SMEs responding to the March 2021 Department of Finance Credit Demand Survey reporting that they had requested bank finance in the previous six months. That compared with 25% in March 2019 and 26% in March 2016. Some 86% of SMEs that had not requested finance said they had sufficient internal funds or current lines of credit, while 15% said their business generated sufficient revenue. Some 16% said they did not "like to be indebted". Debt aversion was strongest among micro SMEs (employing fewer than ten people), with 24% saying that they did not like to be indebted.

Gross new lending to SMEs (excluding financial intermediation) rose to €1.1 million in Q2 2021, up from €0.7 billion a year earlier but down from €1.4 billion in Q2 2019. Real estate activities and primary industries (including agriculture) accounted for almost half of new lending at €312 million and €189 million, respectively.

In annualised terms, gross new lending fell from almost €5.3 billion in the twelve months ending June 2019 to less than €4.3 billion in the twelve months ending June 2021. Real estate activities and primary industries accounted for more than €1,044 million and €855 million, respectively of gross new lending in the twelve months ending June 2021.

Lending to the wholesale and retail trade had peaked in the twelve months ending September 2017 at €837 million and was following a downward trend even before the pandemic broke out but the decline accelerated in early 2020. In the twelve months ending June 2021, gross new lending to SMEs in the sector had recovered slightly to €501 million. Lending to hotels and restaurants fell sharply from Q2 2020. Gross new lending to hotels fell to €37 million in the twelve months ending June 2021, the lowest level since the twelve months ending December 2013, while lending to bars dropped to €30 million, the least since the twelve months ending June 2013.



Source: Central Bank of Ireland

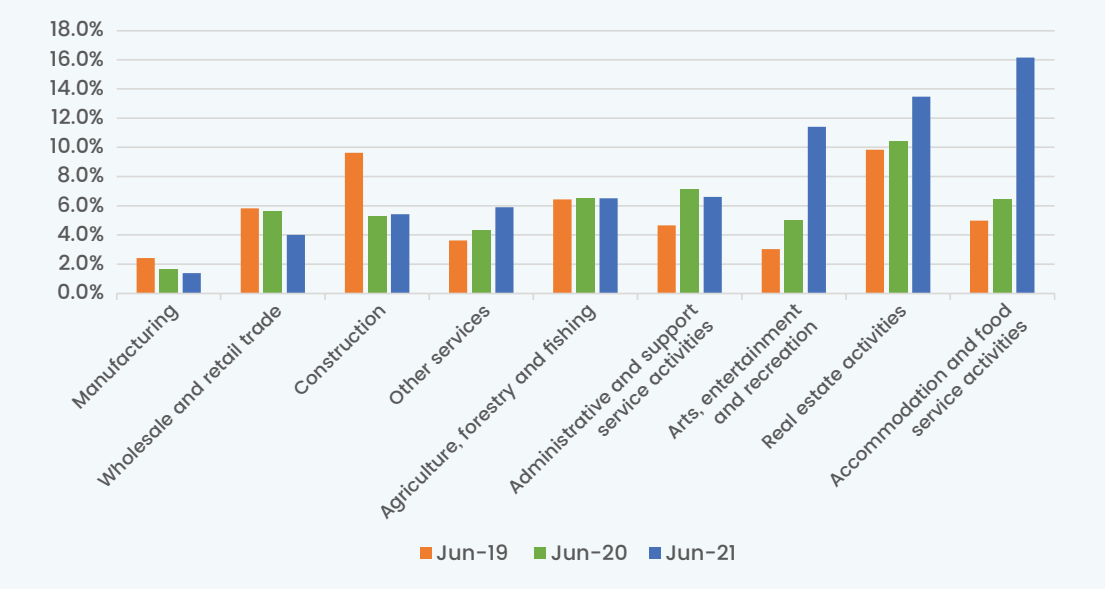
Three sectors (primary industries including agriculture, wholesale/retail trade and repairs and hotels and restaurants) accounted 61% of outstanding credit to core SMEs (excluding property-related sectors) in June 2021, with 26%, 20% and 15% of outstanding credit, respectively. The value of outstanding credit contracted as businesses continued to deleverage falling from €13.2 billion at the June 2020 to €12.8 billion a year later.

Deleveraging slowed somewhat as a significant proportion of SMEs availed of payment breaks offered by lenders during 2020. European Banking Authority (EBA) data indicates that non-financial corporations accounted for about 70% of the €0.5 billion in payment breaks still active by the end of June 2021.

Despite efforts to support businesses disrupted by the pandemic, non-performing loan (NPL) ratios rose in a number of key sectors, according to the EBA, including accommodation and food service activities (where the NPL ratio

rose to 16.1% in June 2021 from 5% in June 2019) and arts, entertainment and recreation (to 11.4% from 3%). The average NPL ratio in real estate activities rose sharply during 2020, reaching 14.2% in December 2020 before levelling off at 13.5% in March 2021. By contrast, NPL ratios fell in manufacturing and wholesale and retail trade from already low levels.

NPL Ratios for Selected NACE Sectors



Source: European Banking Authority

Financial supports

The government offers a range of financial supports for businesses affected by Covid-19.

These includes grant 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 provided through the Revenue Commissioners.

SBCI launched four major schemes from June 2019: the Future Growth Loan Scheme (FGLS) from June 2019, the Covid-19 Working Capital Loan Scheme (CWCLS) in March 2020 and the Credit Guarantee Scheme (CGS) from September 2020. The CWCLS closed to new applications for eligibility for mid-July 2021 and most participating banks had fully subscribed their FGLS capacity by October 2021.

Almost €1.2 billion in loans were drawn down up to the end of September under the three schemes

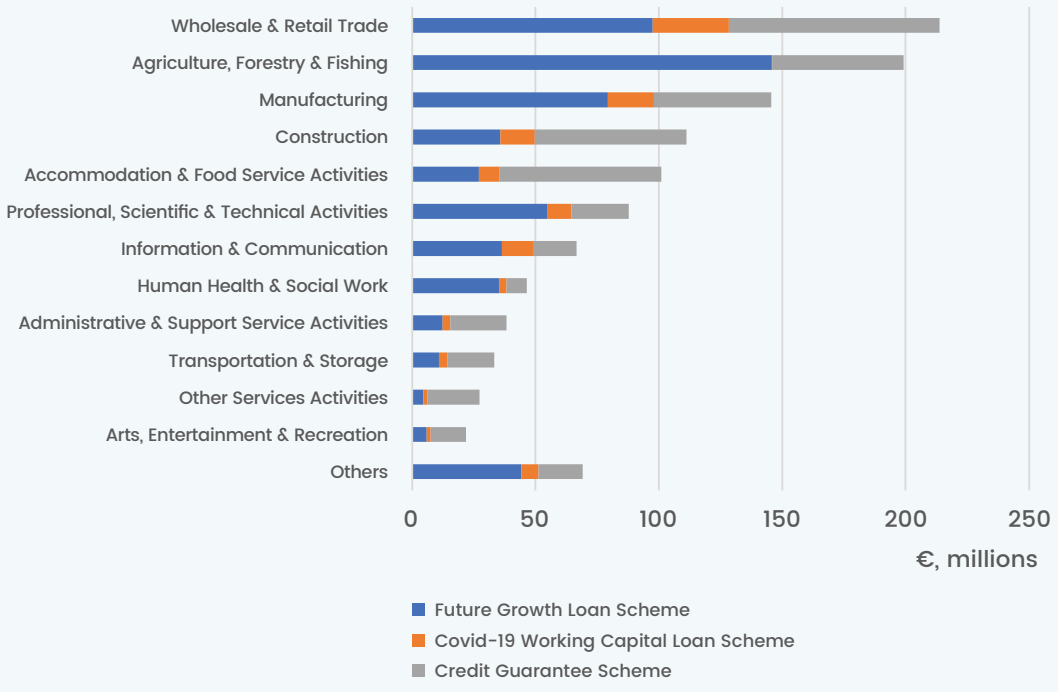
(drawdown data is only available up to the end of June is available for the FGLS and CSCLS), with the FGLS accounting for about €590 million of the total and the CGS some €457 million.

Three sectors of the sectors worst affected by Covid-19 (wholesale and retail trade, construction and accommodation and food service activities) accounted for €426 million in SBCI-supported loan drawdowns or 37% of the total. These sectors accounted for some 46% each of CWCLS and CGS drawdowns.

Wholesale and retail trade accounted for the biggest share at 18% of total drawdowns in the three schemes and 19% of CGS drawdowns.

Primary industries (agriculture, forestry and fishing) and manufacturing accounted for 17% and 13% of total drawdowns under the three schemes. Primary industries accounted for 25% of FGLS drawdowns, which was to be expected given its support by the Department of Agriculture, Food and the Marine.

Drawdowns for SBCI-Supported Schemes
(September 2021)



Source: BPFI calculations based on data from the Department of Enterprise, Trade and Employment.

Note: All data relates to drawdowns with CGS data to 30 September 2021 and other data to end June 2021.

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