Banking & Payments Federation Ireland

Demand rises but cost pressures intensify

Labour constraints emerge amid jobs growth

Credit demand weakens further

SME Monitor

APRIL 2022

Growth Outlook Positive but Inflationary Pressures to Continue

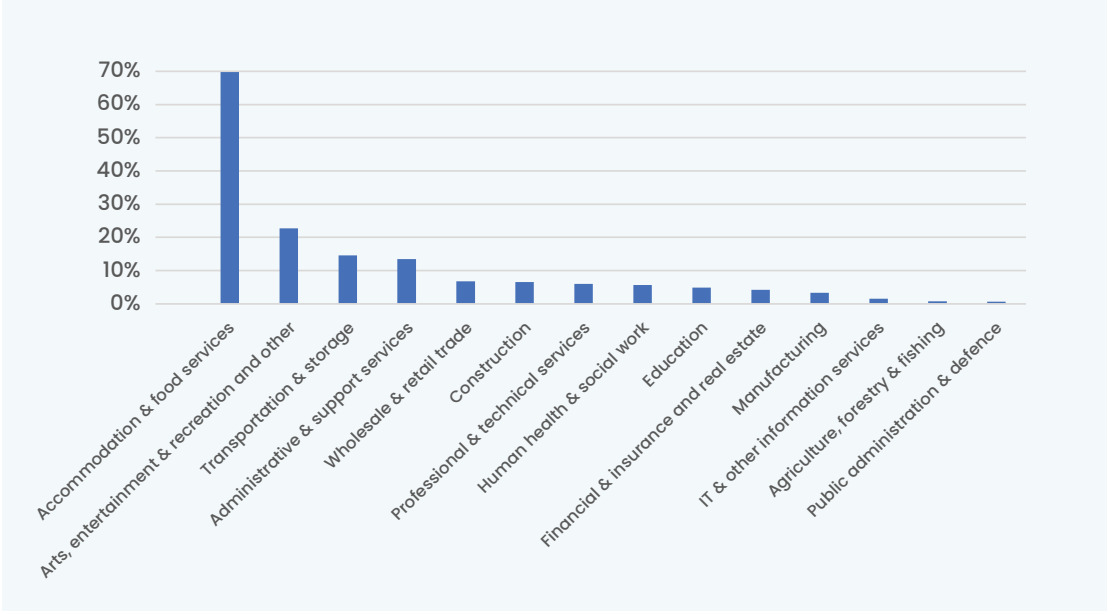
Commentary

Dr Ali Uğur,
Chief Economist, BPFI

Cost pressures and expiring supports pave a rocky road to recover for many SMEs

The Irish people, as well as the Irish economy are trying to learn to live with Covid-19 as much as possible with the full removal of restrictions since the end of February. The recovery in the Irish economy was already evident in the second half of 2021 and full year data for the year shows that in terms of GDP, the Irish economy grew by 13.5% in 2021. However, GDP figures are heavily affected by the presence of multinational companies in the Irish economy, hence a more relevant measure is the Modified Domestic Demand (MDD) which grew by 6.5% in 2021 and is 1.3% above the pre-pandemic levels. This wider growth

Share of Employees on EWSS as % of Total in Each Sector



Source: BPFI analysis based on CSO and Revenue Commissioners data.

in the economy is also reflected in employment numbers where we have a record level of more than 2.5 million people in employment.

However, this wider economic growth is not fully reflected on all sectors of the Irish economy. For example, in terms of gross value-added, the distribution, transport, hotels and restaurants sector as well as the arts, entertainment and other services sector are still below their 2019 contribution levels to the economy. At the end of 2021, accommodation and food service activities were down by around 15% in terms of value and 20% in terms of volume compared to the first quarter of 2020[1]. The latest available Central Statistics Office (CSO) data show that 99.8% of enterprises in the Distribution and Services sectors were small and medium sized enterprises (SMEs).

The Irish government has provided significant support to both employees and employers during the pandemic. One of the schemes designed to help employers is the Employment Wage Subsidy Scheme (EWSS) whereby qualifying businesses impacted by public health restrictions receive a flat rate subsidy towards the gross pay of eligible employees. The scheme is due to end at the end of April 2022[2] and overall support provided up to 24th March was over €7.68 billion, comprising €6.65 billion in direct subsidy payments and PRSI forgone of €1.03 billion to 51,900 employers in respect of over 725,000 employees. Businesses in the accommodation and food services received around €1.9 billion under the scheme in total followed by wholesale and retail trade sector which received over €800 million in total subsidy payments.

There were still 258,000 employees on the scheme at the end of February 2022, which was around 10% of the total employment in the Irish economy. However, the share of employees receiving EWSS varies between sectors and ranges from 1% in agriculture to around 70% in the accommodation and food sector.

In addition to direct supports from the government, around 95,000 individual businesses were availing of tax debt warehousing with a total of €3.1 billion of tax liabilities by the end of February. The businesses availing of this support will have until April 2023 to pay back tax liabilities before interest is being charged. Out of the 95,000 businesses availing of the tax debt warehousing, around 92,000 are SMEs according to the latest data from the Revenue Commissioners. Revenue sectoral data shows that the wholesale and retail trade sector accounted for around 20% of total warehoused tax debt followed by the accommodation and food services sector with 13%.

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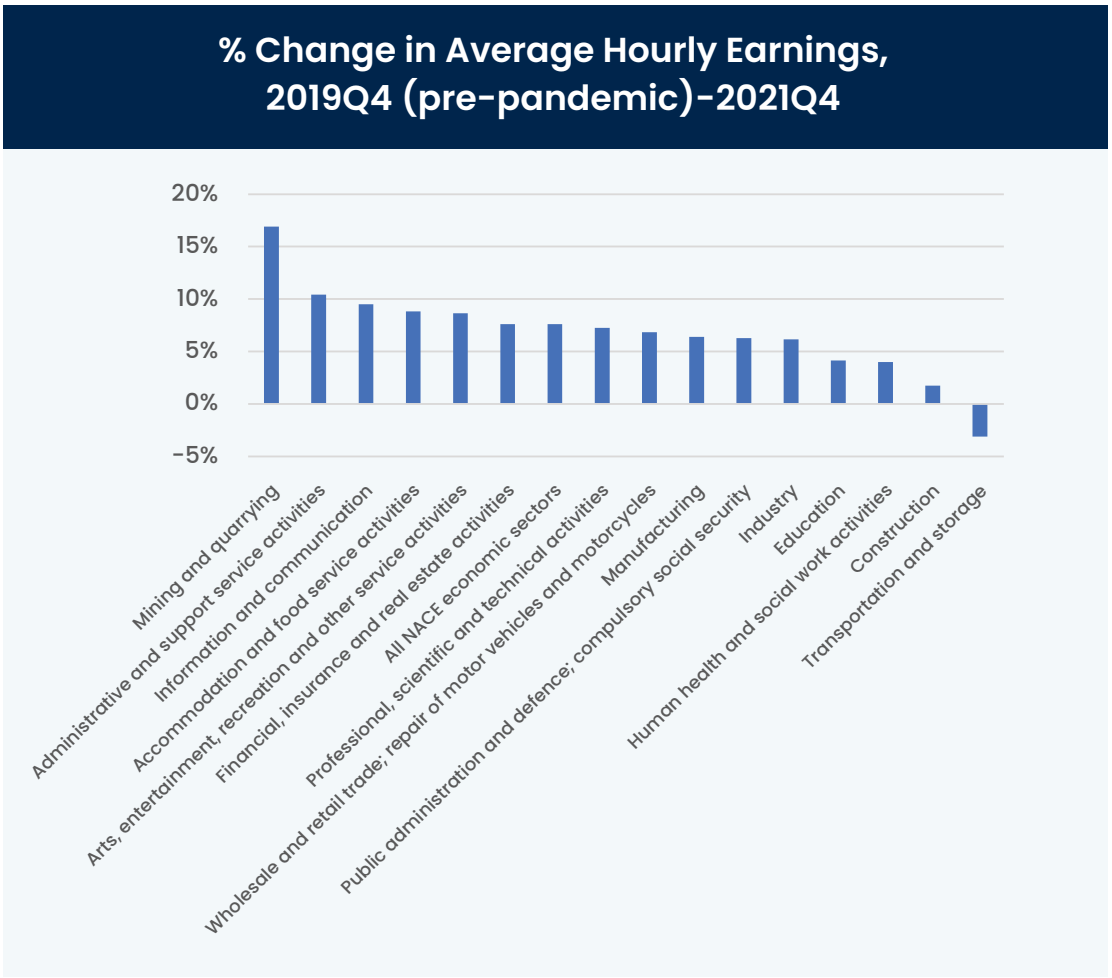
[1] CSO Monthly Services Index, January 2022.

[2] Although the scheme was extended until the end of May 2022 for businesses that were affected during restrictions introduced in December 2021.



Source: CSO

Nearly a third of eligible companies in the accommodation and food services sector have warehoused their tax liabilities, the highest share across the different sectors.

Average hourly earnings have increased by around 8% across the Irish economy between the last quarter of 2019, prior to the pandemic, and the last quarter of 2021. Most sectors have experienced increases in average earnings around the average except for education, human health and social work and construction which has seen average earnings increasing between 2% to 4% during the same period. However, the CSO's latest Labour Force Survey shows that average hourly labour costs declined by 81% and 13% for the accommodation and food services and arts and entertainment sectors, respectively which perhaps shows the extent of wage subsidies and forgone PRSI in these sectors. In other words, while average earnings have increased from the employee's perspective, total labour costs to the average employer in this sector have declined due to significant State supports.

As with other economies globally, the Irish economy is facing higher inflation mainly from higher energy, commodity and food prices since the summer of 2021. Inflation was already running high before the war in Ukraine started, mainly due to supply shocks from the pandemic. Annual inflation, measured by the Consumer Price Index (CPI), was 5.5% at the end of 2021. The latest data from the CSO shows that in February 2022, annual inflation was 5.6%, mainly driven by goods inflation at 7.1% annually compared with services inflation at 4.4%. A breakdown of CPI components shows that annual inflation was around 30% for energy products. While supply chain problems due to the pandemic have been easing since November last year, they have recently resurfaced due to the war in Ukraine and new lockdowns in China which are likely to put further pressure on consumer goods prices.

Another indicator of annual inflation in the economy is the Wholesale Price Index (WPI) which measures the average change in the price of goods at a wholesale level. The annual inflation at the wholesale level was 2.8% in February 2022 however when broken down between export sales and sales in Ireland, we see that wholesale prices increased by around 6.2% for sales in Ireland in the year whereas export prices increased by 2.6% during the same period. For example, at the wholesale level, average annual inflation was at around 5% for food products whereas at the consumer level this translated into an average annual increase of 3%. In addition to accounting for most of the current inflation rate, increases in energy prices adds to higher producer prices for goods and services. Annual wholesale energy inflation in February 2022 was 145% in Ireland.

While the service price inflation in some sectors should be settling with the re-opening of these sectors after the removal of public health restrictions, there are likely to be cost inflation factors in all sectors of the economy due to second round effects from high energy prices in the coming months. Added to this is the fact that some of the sectors which were in receipt of EWSS from the Irish government will not be able to avail of these supports after the end of April 2022. This is likely to feed into higher average labour costs for businesses in these sectors, mainly made up of SMEs, as well as wage growth expectations by employees due to higher consumer inflation. There are different views in the markets as to how long the inflationary pressures will exist, however the European Central Bank's most recent assessment shows that most of the current inflation will decline towards the end of this year and will be a lot lower in 2023, given that it is a supply shock, however as an economy we will have to live with higher price levels even if prices rise more slowly in the future.

Market Analysis

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

SMEs and the wider economy

Economic activity generally increased in late 2021 and early 2022, despite volatility stemming from the Omicron variant of Covid-19, disruptions and uncertainty from Brexit and the conflict in Ukraine. While the impacts of global events vary, all seem to be driving inflation higher, increasing business costs and consumer prices across the economy.[3]

Domestic demand recovers

Gross domestic product grew by 13.5% in volume terms in 2021 (according to preliminary 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 6.5% in 2021, compared with 2020, but by only 1.3% compared with 2019. While consumer spending rose by 5.7% year on year in 2021, it was 5.3% lower than in 2019.

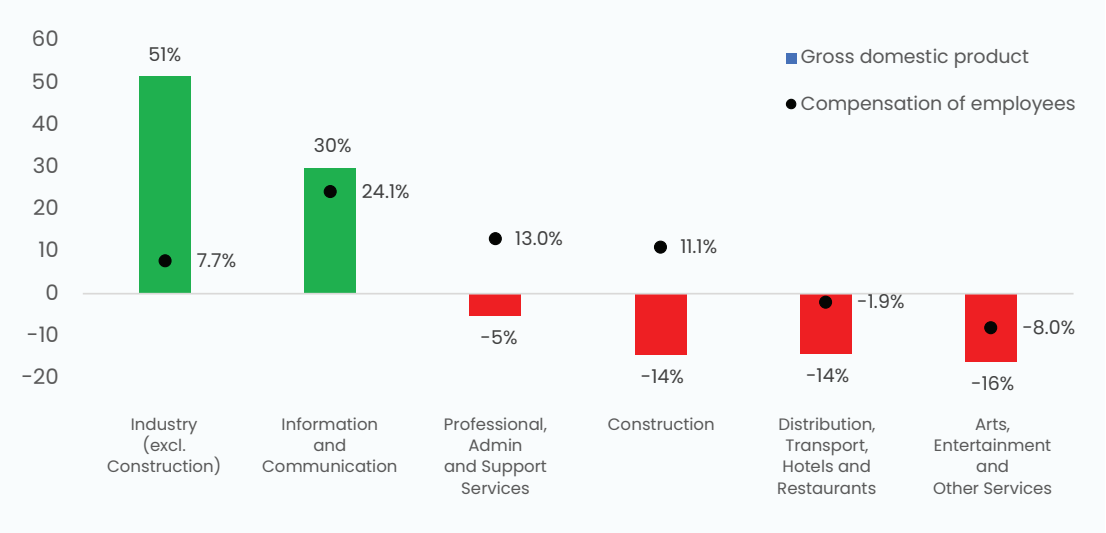
Sectors providing services that rely on face-to-face contact were hard hit, especially the hospitality sectors (hotels, restaurants, bars and cafes), personal services (such as hairdressers or beauticians) and arts and entertainment sectors.

These, with construction where gross value added fell by 14.4% between 2019 and 2021, include business sectors with some of the highest concentration of small and medium-sized enterprises (SMEs) – those businesses employing fewer than 250 persons.

[3] Data in this report is correct to 28 March 2022.

Economic Performance in Selected Sectors

% Change 2021 vs 2019



Source: CSO.

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. Compensation of employees increased in the construction and professional, administration and support services sectors.

The total tax take in 2021 was almost €68.4 billion, 19.7% more than in 2020 and 15.3% higher than in 2019. Income tax and corporation tax increased by 16.3% and 40.8%, respectively, compared with 2019. In 2021, corporation tax represented 22.4% of the tax revenues, almost matching valued added tax receipts (22.6%).

Gross voted current expenditure was 2.6% higher than in 2020. Social protection spending fell by 0.7% but it accounted for almost 30% of total expenditure.

The combination of increased social protection support and increased income resulted in a large increase of €2.3 billion in household gross savings in Q3 2021 compared with Q3 2019.

Unemployment levels stabilised from Q4 2021 with the seasonally adjusted unemployment at 5.2% from September 2021, the lowest level since May 2020. The CSO estimated the adjusted unemployment rate was 7% when all claimants for the pandemic unemployment payment (PUP) were included, down from 27% a year earlier.

Change in Household Accounts (Q3 2021 vs Q3 2019)

Source: BPFI estimates based on CSO data.

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Cost and labour pressures intensify

Business activity, as measured by the Bank of Ireland (BoI) economic pulse, the AIB services and manufacturing purchasing managers' indices (PMIs) and the BNP Paribas Real Estate Ireland construction PMI, continued to increase up to February 2022 driven by strong demand, boosted by the removal of Covid restrictions, although general business sentiment measured by BoI fell slightly in March on lower short-term expectations.

Cost and price pressures have increased as have labour constraints. Input price inflation in services jumped to its highest level in over 21 years, driven mainly by salaries and energy, while in manufacturing and construction, supply chain disruption, Brexit as well as higher raw material and transportation costs exacerbated cost pressures. CSO data suggests that the cost of electricity in manufacturing trebled between February 2019 and February 2022, while the industrial producer price of basic metals and wood and wood products increased by 29.3% and 23.2% year on year, respectively, in February 2022.

Businesses' efforts to increase employment were partially undone by difficulty filling vacancies and staff absences due to Covid.

The KBC Bank Ireland consumer sentiment index recorded its sharpest monthly drop in two years in March 2022 as the conflict in Ukraine and rising cost of living, including accelerating rent and house price inflation, negatively affected consumers' perceptions of the general economic outlook and their personal financial circumstances. Some 85% of consumers said they planned to reduce spending in 2022 because of higher energy and other costs and/or greater uncertainty/caution, with 49% saying they would reduce spending significantly.

"Businesses' efforts to increase employment were partially undone by difficulty filling vacancies and staff absences due to Covid."

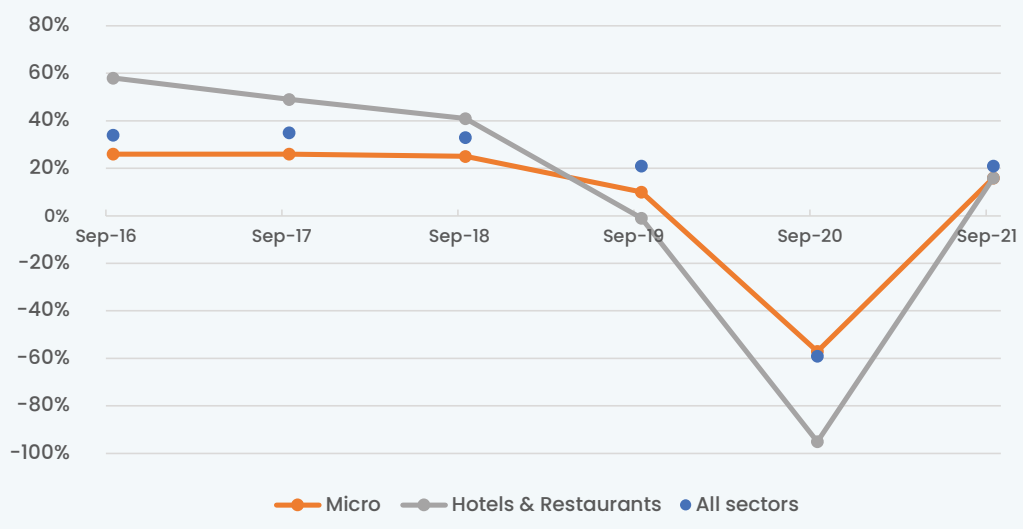
Finding Customers

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. While finding customers was the main concern for 22.4% of respondents in the latest survey (H1 2021), for the first time since the survey was first conducted in 2009, more respondents (24.6%) selected availability of skilled staff or experienced managers.

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 21% in September 2021, rebounding from a sharp contraction in September 2020. Micro businesses (those with fewer than ten employees) and hotels and restaurants reported the strongest recoveries.

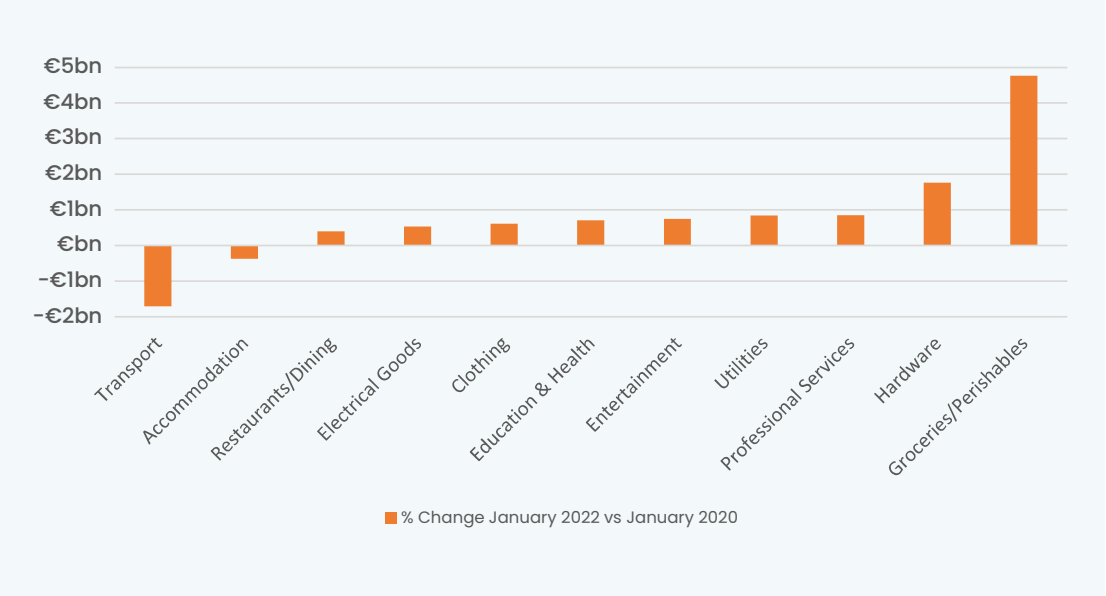
The seasonally adjusted value of services output was 10.4% higher in January 2022 than in January 2020. However, output in the sectors worst affected by the Covid-19 restrictions were below their levels two years earlier: accommodation and food service activities were down by 35.2%, administrative and support service activities were 16.7% lower and transportation and storage was 11% lower.

Business Turnover Past Six Months
Net Increase/Decrease



Source: Department of Finance Credit Demand Survey.

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



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

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. Annualised personal card spending (based on a twelve-month rolling sum) grew by 10.2% or €7.9 billion between the twelve months ending January 2020 and the twelve months ending January 2022. The CBI data shows that personal card spend on groceries/ perishables increased sharply in that time, with an additional €4.7 billion, while spending on hardware was almost €1.8 billion higher.[4]

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 €1.7 billion or 41.4%. Accommodation spending was some 15.7% lower in the twelve months ending January 2022 than two years earlier. Some of this decline reflects the 63% drop in card spend outside Ireland over the same period.

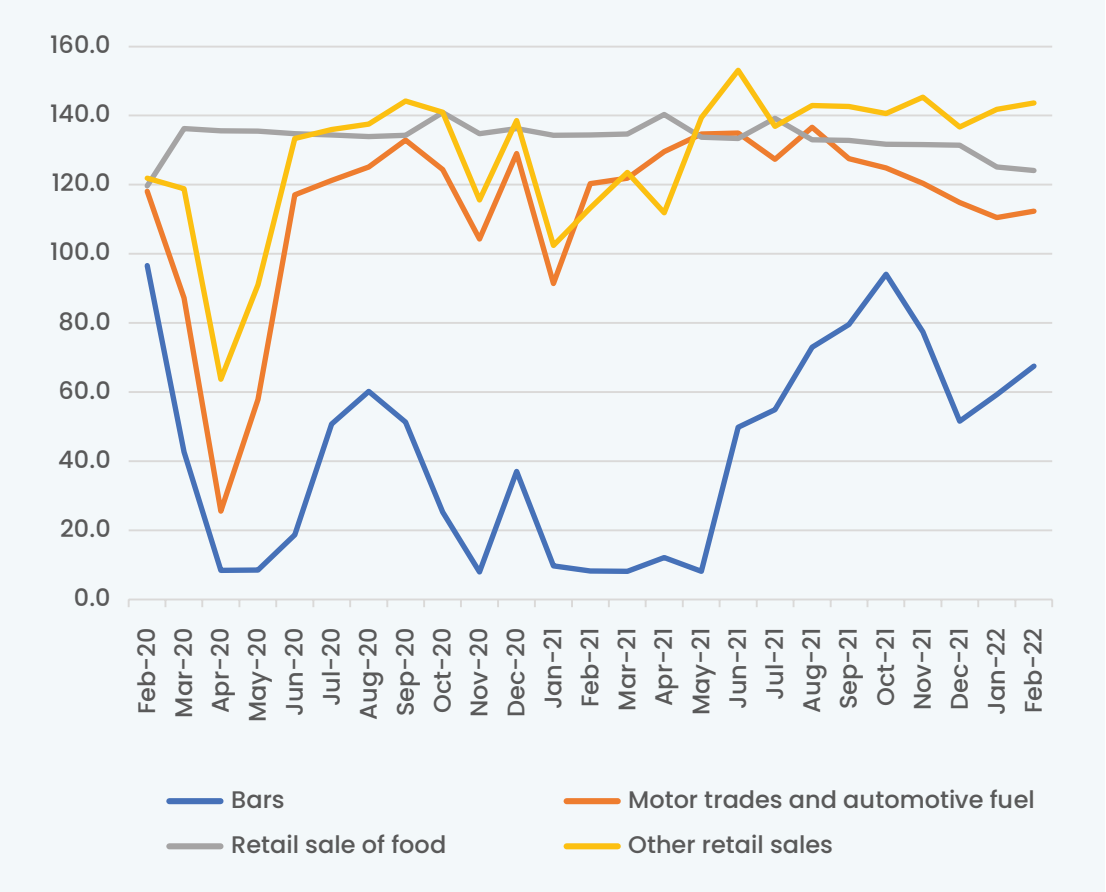
The volume of retail sales in February 2022 was 4.2% higher than in February 2020, on a seasonally adjusted basis. Sales of food, household equipment and clothing and footwear all grew. While sales of food had held up well due to many stores remaining open as essential services, the volume of food sales was

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

only 3.7% higher in February 2022 than two years earlier. The biggest increases were in clothing, footwear and textiles (up 49%), electrical goods (up 16.7%) and hardware paints and glass (up 12%).

The sharpest decline was in bars (down 30.2%), with sales of books, newspapers and stationery down 10.1% and motor trades and automotive fuel 4.9% below their February 2020 level.

Retail Sales Indices



Source: CSO.

With most retail outlets open again, online sales have become less important than during the peaks of Covid restrictions. However, online channels account for a growing share of retail sales. Online sales accounted for 6.5% of the value retail sales, excluding motor trades, automotive fuel and bars, in February 2022, up from 4.8% two years earlier.

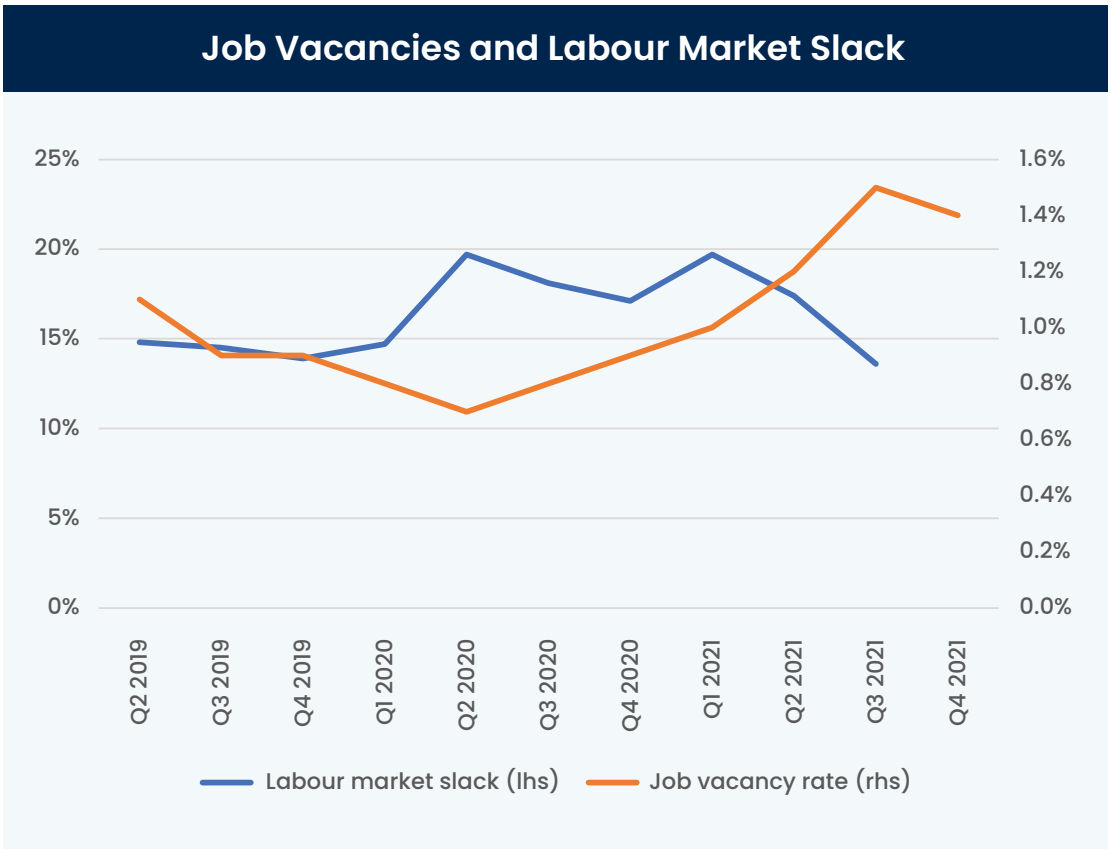
Availability of skilled labour

Employment grew strongly and reached historical highs in Q4 2021 as the public health measures to control Covid-19 were lifted. The number of people in employment exceeded 2.5 million for the first time in Q4 2021, with employment some 6.3% higher than in Q4 2019. However, the number of people absent from work was 34.9% higher at more than 250,000. Industry (including manufacturing), information and communication, professional, scientific and technical activities and human health and social work all added more than 25,000 jobs between Q4 2019 and Q4 2021).

More than 445,000 employees or self-employed people had been medically certified for receipt of a Covid-19 related illness benefit payment by 22 March, according to the Department of Social Protection, equivalent to about 18% of all persons in employment.

The standard seasonally adjusted unemployment remained unchanged at 5.2% between September 2021 and February 2002, although the female unemployment rate rose from 5.1% to 5.4 % over that time. The CSO's Covid-19 adjusted unemployment rate - which includes all recipients of the pandemic unemployment payment (PUP) – fell to 7% in February 2022, from 27% a year earlier.

> With unemployment falling and employment at historically high levels, businesses are increasingly reporting challenges in hiring suitably trained and skilled staff.

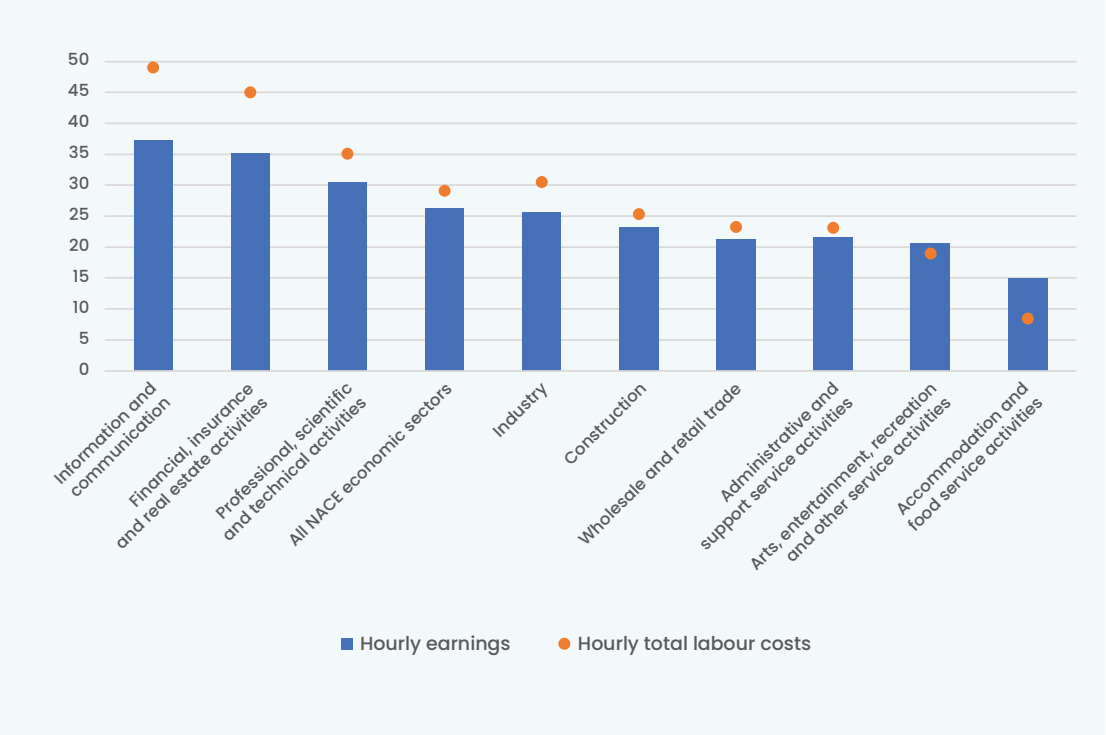


Source: CSO/Eurostat

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 1.4% at the end of Q4 2021, compared with 0.9% two years earlier, according to the CSO. Labour market slack, which Eurostat suggests reflects the unmet need for employment, fell to 13.6% of the extended labour force (which includes underemployed part-time workers and those either not available for or not seeking work) in Q3 2021, down from 18.1% a year earlier and 14.5% in Q3 2019.

The Covid-19 pandemic unemployment payment (PUP) closed to new applicants on 22 January 2022. Two months later, only 46,000 people were receiving PUP payments, the lowest level since the PUP was introduced. Some 46% of PUP recipients had previously worked in the accommodation and food services, wholesale and retail (plus motor) trades or administrative and support services.

Hourly Earnings and Labour Costs by Sector (€)
(Q4 2021)



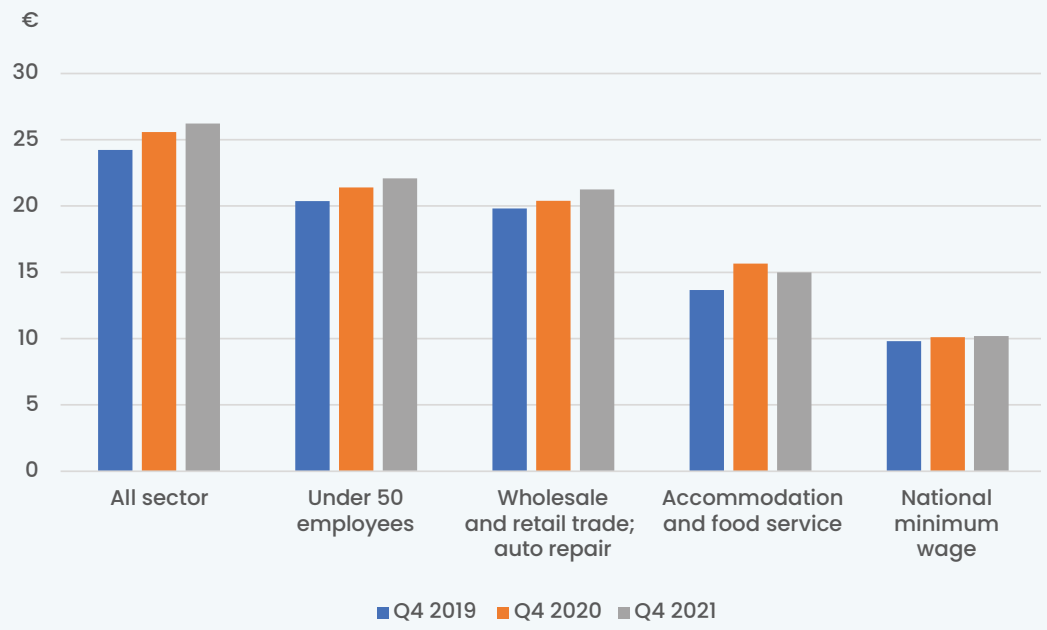
Source: CSO

The Employment Wage Subsidy Scheme (EWSS), which provides an income subsidy for eligible employees to registered employers, is due to close at the end of April[5]. An analysis by the Revenue Commissioners in late March indicated that the accommodation and food services sector accounted for €1.9 billion of the €6.7 billion in scheme payments up to March 2022, with the wholesale and retail trade receiving some €800 million.

When EWSS supports expire, the lowest-paid workers could be hardest hit, especially as the cost of living increases. These subsidies have been important in supporting the incomes of workers in accommodation and food service and the arts, entertainment and recreation sectors. In both sectors hourly earnings, which include supports such as the EWSS, were higher than the hourly total labour costs to employers. The data suggest that in accommodation and food services, on average, some 44% of hourly earnings were subsidised.

[5] The scheme was extended until the end of May 2022 for businesses that were affected during restrictions introduced in December 2021.

Hourly earnings and the minimum wage



Sources: CSO, Workplace Relations Commission

Preliminary CSO earnings data suggest that worker incomes have risen significantly in recent years, with average weekly earnings increasing by 20.5% between Q4 2016 and Q4 2021 to €864.51.

Despite the support from the EWSS, average weekly earnings in accommodation and food services were less than half the all-sector average at €397.42.

This was also the only sector reporting a yearon- year fall in average hourly earnings in Q4 2021, down 4.3% to €14.99, which compared with the national minimum wage in 2021 of €10.20.

Accessing finance

Demand for bank credit weakened further in the second half of 2021 with only 17% of SMEs responding to the September 2021 Department of Finance Credit Demand Survey reporting that they had requested bank finance in the previous six months, while only 7% expected to seek bank finance in the following six months. Among those seeking finance, the focus has shifted from working capital/cashflow to investment. Some 46% cited new business venture/acquisition of assets/expansion or investment in machinery/equipment as the main reason for finance requests in September 2021, up from 26% in October 2020. The proportion citing working capital/cashflow fell to 37% from 59% over the same period.

Some 63% of SMEs that had not requested finance said they did not need additional finance, while 15% said credit lines were sufficient.

Gross new lending to SMEs (excluding financial intermediation) in 2021 rose by €47 million or 1.2% year-on-year to €4.0 billion. Real estate activities and primary industries accounted for €927 million and €757 million, respectively, of gross new lending in 2021.

Drawdowns in the manufacturing sector increased by 18.9% to €402 million in 2021, while lending to construction rose by 28.2% to €200 million. By contrast, gross new lending to hotels and restaurants continued the decline, dropping to €122 million in 2021. That compared with €460 million in 2019.

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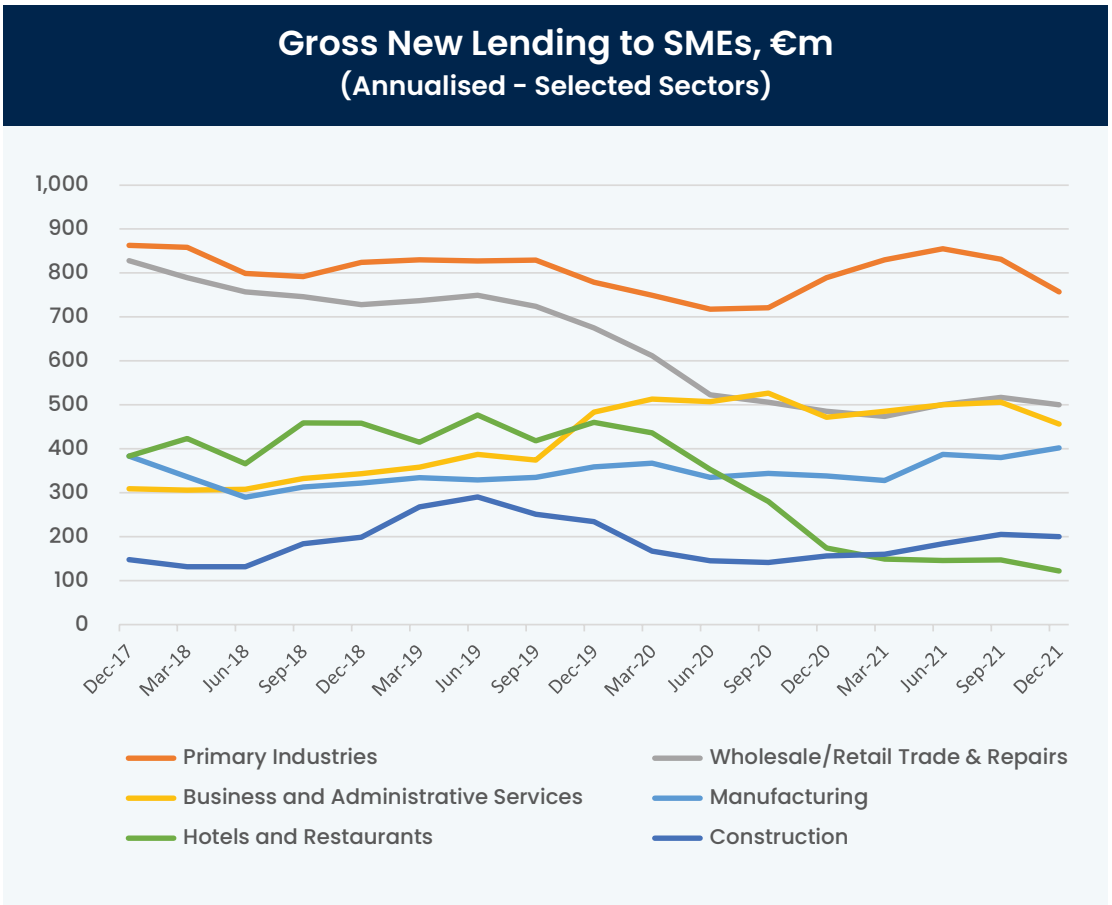


Source: Central Bank of Ireland

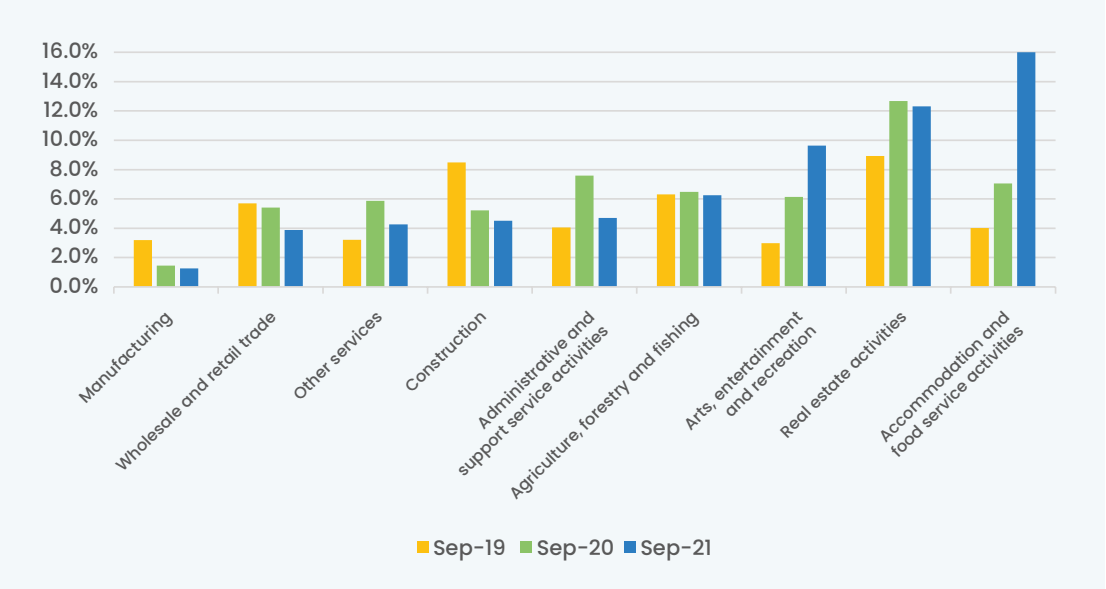
Three sectors (primary industries including agriculture, wholesale/retail trade and repairs and hotels and restaurants) accounted 57.2% of outstanding credit to core SMEs (excluding property-related sectors) in December 2021, with 23.8%, 19% and 14.4% of outstanding credit, respectively. The value of outstanding core SME credit contracted as businesses continued to deleverage falling from €12.8 billion at the end of 2020 to €12.7 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 65% of the €0.3 billion in payment breaks still active by the end of September 2021.

Non-performing loan (NPL) ratios rose during the pandemic in a number of key sectors, according to the EBA, including accommodation and food service activities (where the NPL ratio rose to 16% in September 2021 from 4% in September 2019).

The average NPL ratio in the arts, entertainment and recreation and real estate activities sectors rose sharply during 2020 but declined in 2021, with the former peaking at 14.2% in December 2020 then dropping to 12.3% in September 2021. In the real estate activities sector, the average NPL ratio peaked at 11.5% in March 2021 but fell to 9.6% six months later.

NPL Ratios for Selected NACE Sectors



Source: European Banking Authority

Financial supports

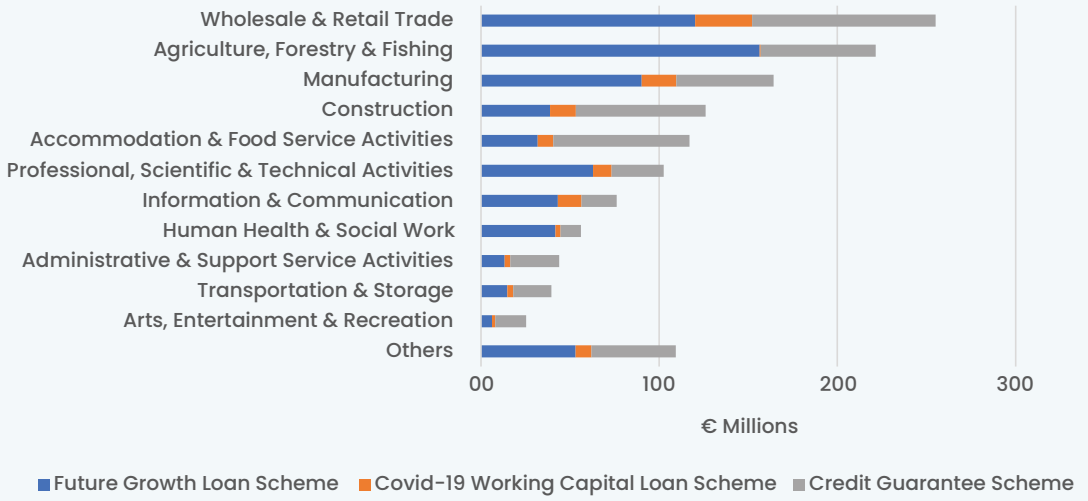
Government financial supports for businesses affected by Covid-19 have included grant provided by local authorities, local enterprises offices and State enterprise agencies, loans provided by bank and non-bank lenders with the support of the Strategic Banking Corporation of Ireland (SBCI) and subsidies or debt warehousing 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 lenders had fully subscribed their FGLS capacity by October 2021.

More than €1.3 billion in loans were drawn down up to the end of 2021 under the three schemes, with the FGLS accounting for about €670 million of the total and the CGS some €545 million.

Three sectors of the sectors worst affected by Covid-19 (wholesale and retail trade, construction and accommodation and food service activities) accounted for €498 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 19% of total drawdowns in the three schemes. Primary industries (agriculture, forestry and fishing) and manufacturing accounted for 17% and 12% of total drawdowns under the three schemes. Primary industries accounted for 23% of FGLS drawdowns.

Drawdowns for SBCI-Supported Schemes
(December 2021)



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

Note: All data relates to drawdowns to 31 December 2021.

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