Banking & Payments Federation Ireland

Solid output growth in key SME sectors

Incomes have risen steadily as employment has grown

Inflation is likely to ease but prices will stay high

SME Monitor

APRIL 2023

SMEs should benefit from easing inflation as real incomes recover

Commentary

Dr Ali Uğur,
Chief Economist, BPFI

SMEs should benefit from easing inflation as real incomes recover

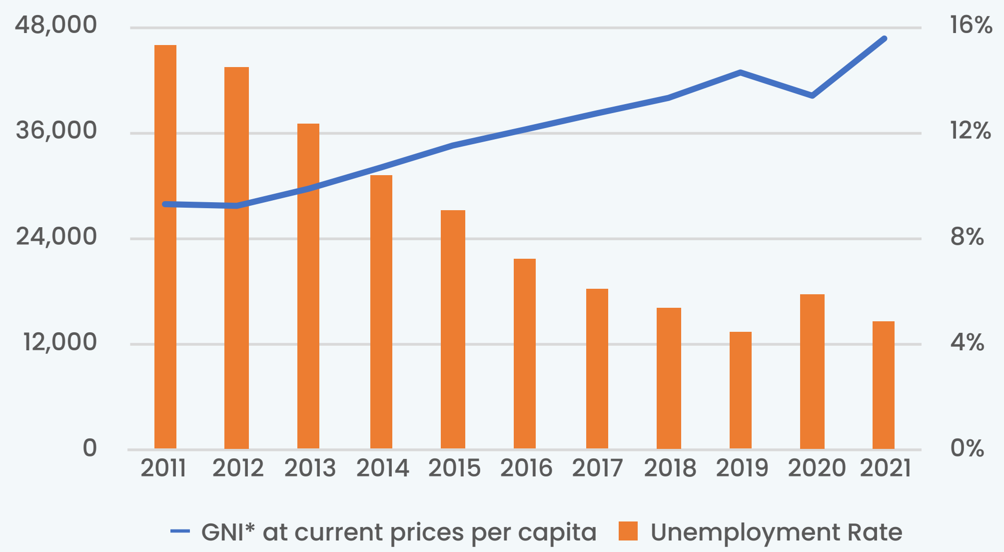
The Irish economy grew by 12% in 2022, according to the latest preliminary figures from the Central Statistics Office (CSO), driven mainly by growth in sectors dominated by multinational companies. At the same time, modified domestic demand, a narrower measure of underlying domestic activity, grew by 8.2% in 2022. Significantly, a number of sectors focussed on the domestic market, such as construction and distribution and hotels and restaurants, grew by more than 10% in 2022. Notwithstanding this significant overall increase in output, we see, for example in the hospitality sector, that accommodation output was almost 38% lower in the last quarter of 2022 compared to the same period in 2019, whereas food service activity output increased by over 21% over the same period. These sectors along with construction are mainly made up of small and medium-sized enterprises (SMEs).

The output growth in the Irish economy is also reflected in growth in employment numbers. The number of people in employment rose by 2.7% in the year to Q4 2022, reaching almost 2.6 million, the highest employment since the data series began in 1998. Employment rose by 9.2% or more than 217,000 people between Q4 2019 and Q4 2022. While most sectors saw employment growth over that period employment fell by 5.6% in agriculture, forestry and fishing, by 4.8% in accommodation and food service activities and by 1.7% in administrative & support service activities.

Incomes have risen steadily as employment has grown

A measure of income per person, Modified Gross National Income (GNI*) is an indicator that is designed

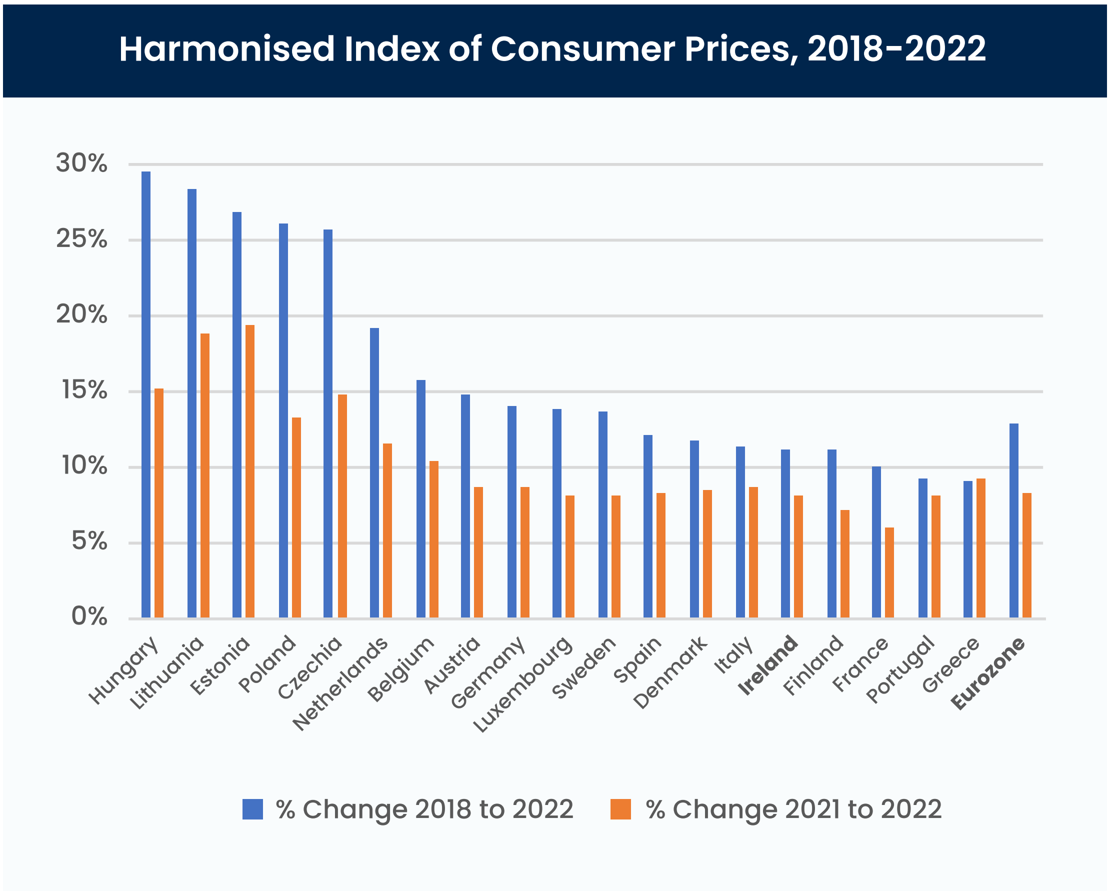
Income Per Capita and Unemployment Rate, 2011-2021



Source: Central Statistics Office (CSO).

to exclude globalisation effects that have a disproportionate impact on the measurement of the size of the Irish economy. In Ireland, GNI* per person rose from €27,890 in 2011 to €46,668 in 2021, a 67% increase during the period. In the same period, the unemployment rate has declined from over 15.3% in 2011 to 4.9% in 2021. This significant decline in unemployment happened during a period where there was significant growth in population. The population in Ireland has risen by over half a million since 2012, the third highest percentage increase in population in the EU.

Average inflation hit a 38-year high in 2022 mostly driven by rising energy costs and food prices, peaking at 9.2% in October 2022. The latest data from the CSO shows that annual inflation, measured by the consumer price index, declined to 7.7% as of March 2023. Average inflation seems to be mainly driven by the services sectors, with inflation at 9% compared to 4% annual inflation in goods-related sectors. This is similar to the trend observed in other eurozone countries where services sector inflation nearly doubled in the past year and now accounts for almost 30% of annual inflation. Initial increases in energy prices seen in 2022 seem to have spilled over to the wider economy.



Note: Base 2015=100
Source: Eurostat

Inflation is likely to ease but prices will stay high

When we look at the inflationary trend between 2018 and 2022 for Ireland and other EU countries, we see that Ireland and Finland had the sixth smallest percentage increase in consumer prices in the EU27 between 2018 and 2022, at 11.1%. At the eurozone level nearly two thirds of the increase in average inflation took place between 2021 and 2022.

In Ireland, almost 73% of the inflation in the past five years is accounted for price changes between 2021 and 2022. Even though average inflation is likely to gradually decline over this year, price levels are likely to stay high unless we see significant declines in average prices across the economy. In fact, for example, Ireland had the highest price levels for consumer goods and services in the EU27 in 2021 at 43.8% above the EU27 average, according to Eurostat.

The Irish government has provided significant fiscal support to both individuals and businesses since 2020 to absorb the impact of the pandemic-related restrictions as well as the rising energy prices. Most of these supports have expired but the Temporary Business Energy Support Scheme (TBESS), which will cost an estimated €1.3 billion, opened in November 2022. Under the scheme, eligible businesses can obtain grants where the cost of electricity and gas has risen by more than 30%. By mid-April 2023, almost 28,000 businesses had registered with the Revenue Commissioners for the scheme and almost €75 million in claims had been approved. Businesses with up to nine employees accounted for more than 16,000 registrations and €13.8 million in approved claims. At a sectoral level, the retail trade accounted for 21% of registrations while bars, cafes and restaurants combined accounted for 21.2%. In addition, in January 2023, the SBCI also launched the Ukraine Credit Guarantee Scheme to facilitate the provision of working capital and medium-term investment finance for businesses adversely affected by the war in Ukraine.

While costs have increased due to high inflation, average household incomes seem to have kept pace and on average, while households slowly increased their post-pandemic spending, they also maintained high level of savings. The most recent data from the CSO shows that in the last quarter of 2022, before adjusting for seasonality or inflation, Irish households saved €3.9 billion with a saving rate of around 20% which has been at this level in the last two years. Before the pandemic, the savings ratio fluctuated around 10% but increased to as much as 33% during the initial stages of the pandemic. As government supports to businesses due to the pandemic expire, the services sector, which is mainly made up of SMEs, is likely to need private consumption to increase. Household consumption is likely to increase gradually once uncertainty around energy prices as well as the general inflationary trend eases. Real disposable incomes should recover with declining inflation, however higher interest rates are likely to create further uncertainty for households and may act to further strengthen the savings ratio.

Market Analysis

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

SMEs and the wider economy

Economic activity increased strongly in 2022 with positive indicators in especially in tax revenues and employment in early 2023 even as the economy coped with sharp rises in business costs and consumer prices and the European Central Bank's efforts to ensure price stability through interest rate increases.[1]

Gross domestic product grew by 12% in volume terms in 2022 (according to preliminary seasonally adjusted figures from the Central Statistics Office), driven by growth in sectors dominated by multinationals such as manufacturing and information and communication.

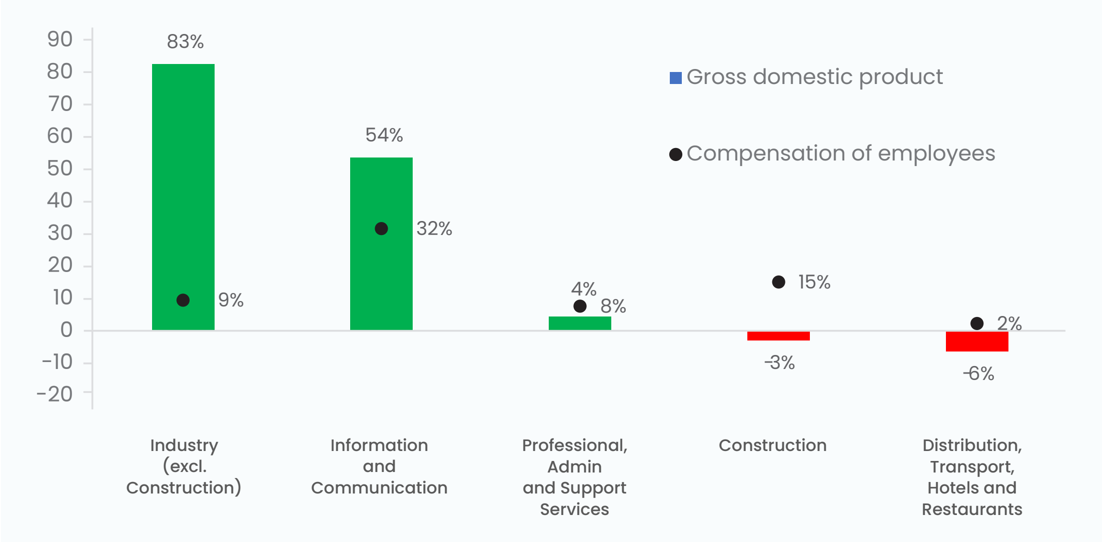
Modified final domestic demand, which excludes globalisation effects such as trade in intellectual property and aircraft leasing, rose by 8.2% in 2022, driven by a 19.8% jump in investment. While consumer spending rose by 6.6% in 2022, it was almost €700 million less than in 2019.

Strong recovery in services

Sectors providing services that rely on face-to-face contact such as the hospitality sectors (hotels, restaurants, bars and cafes), personal services (such as hairdressers or beauticians), and arts and entertainment sectors were worst affected by Covid-related restrictions. These sectors grew strongly in 2022 yet, in overall terms, they lagged pre-Covid activity levels. Within hospitality, the seasonally adjusted volume of accommodation output was almost 38% lower in Q4 2022 than it had been in Q4 2019. By contrast food service activity output had increased by 21% over the same period.

[1] Data in this report is correct to 11 April 2023.

Economic Performance in Selected Sectors
% Change 2022 vs 2019



Source: CSO.

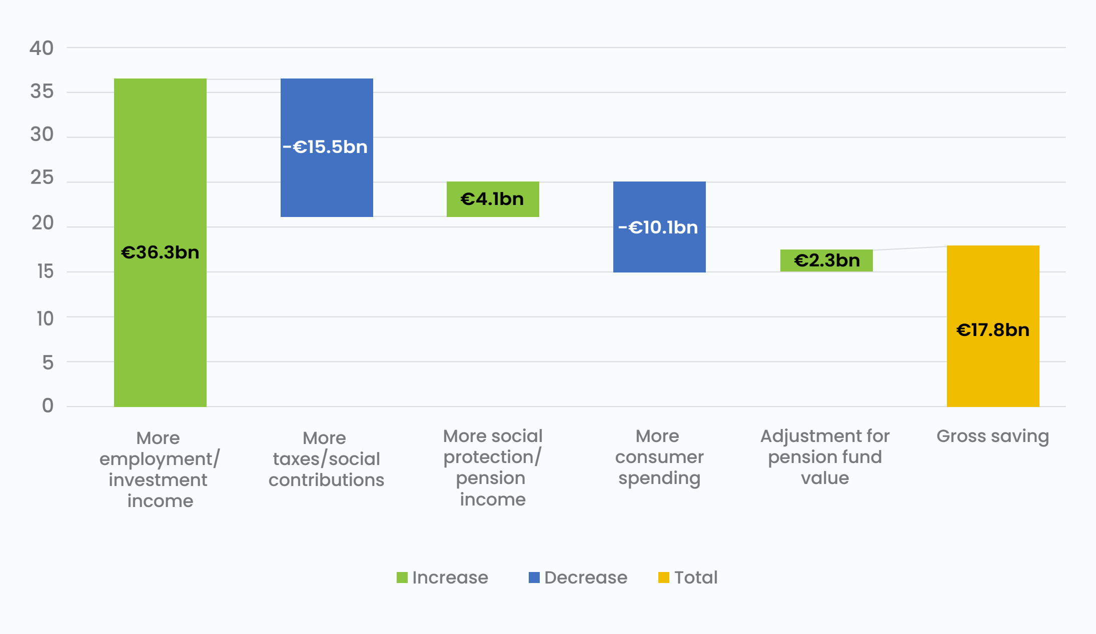
These, with construction, include business sectors with some of the highest concentration of small and medium-sized enterprises (SMEs) – those businesses employing fewer than 250 persons.

Substantial government supports have been introduced since early 2020 to absorb the impact of the Covid health restrictions and the rising energy prices on consumers and businesses. These included almost €10 billion through the employment wage subsidy scheme (EWSS), over €9 billion in pandemic unemployment payments, €1.2 billion in electricity credits to households and the €1.3 billion temporary business energy support scheme.

The total tax take in 2022 jumped to €83.1 billion, almost €24 billion more than in 2019 more than in the same period of 2021. Corporation tax accounted for about half of the increase, reaching almost €23 billion in 2022. However, income and value added tax (VAT) receipts also grew, increasing by 15.2% and 20.5%, respectively, in 2022. Those positive trends continued into Q1 2023, with tax receipts up by 14.6% to €19.7 billion. About half of the increase came from higher corporation tax receipts but these may have been boosted by earlier payment of receipts.

The increased income tax take was driven a combination of higher employment and increased earnings. Unemployment levels were relatively stable from May 2022 with the seasonally adjusted unemployment rate at 4.3% in March 2023, down from 5.0% a year earlier.

Change in Household Accounts (Q1 2022 vs Q1 2020)



Source: BPFI estimates based on CSO data.

Employment and investment income jumped by more than €36 billion between 2019 and 2022, continuing the long-term trend in income growth. In Q4 2022, income from paid employment rose by 23.6% higher than in Q4 2019 and 54% higher than in Q4 2007.

While consumer spending was some €10.1 billion higher than in 2019, gross saving jumped by €17.8 billion. Separate analysis by the Central Bank of Ireland (CBI) suggests that while about €11 billion of savings went into current and deposits in the twelve months ending September 2022, new investments in housing exceeded €8 billion.

Cost and labour pressures intensify

Business activity in the services sector continued to increase in March 2023, while manufacturing weakened, according to the AIB services and manufacturing purchasing managers' indices (PMIs) data.

The services sector reported a sharp rise in new business volumes and employment but firms reported difficulties in sourcing and retaining staff. The Transport/Tourism/Leisure sector increased activity for the first time since August 2022. Service firms continued to report upward pressure on input prices, particularly in wages and energy. Those higher costs continue to be passed on to customers.

Declines in manufacturing orders and output reflected subdued demand but there was modest growth in employment, supplier delivery times shortened as supply chain issues ease and input cost increases slowed.

CSO analysis suggest that producer prices rose by 3.6% in February 2023, although food product and construction material prices rose by 6.2% and 14.7%, respectively. Wholesale electricity prices were 9.2% lower.

Construction activity contracted for a sixth successive month in March 2023, according to the BNP Paribas Real Estate Ireland Construction PMI. However, new orders and employment increased and input price inflation fell to a 26-month low.

The Credit Union consumer sentiment index fell in March 2023 as rising costs and concerns about the general economic and financial environment weighed on consumers. For its part, the European Central Bank sought to reduce inflation by raising its key interest rates six times between July 2022 and March 2023. By the end of March, the main refinancing rate was 3.5%.

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Finding Customers

The ECB Survey on Access to Finance for SMEs (SAFE) has traditionally identified finding customers as the most pressing problem for SMEs in Ireland. However, only 15.8% of respondents in the latest survey (conducted in September/October 2022), cited finding customers as the most pressing problem, down from 30% three years earlier. Availability of skilled staff or experienced managers was the main concern for 25.6% of respondents in the followed by costs of production or labour (18%).
The Department of Finance's Credit Demand Survey indicates that the net percentage of SMEs reporting an increase in turnover in the previous six months was 20% in March 2022 (44% reported an increase in turnover). While 35% of micro businesses (those with fewer than ten employees) reported an increase in turnover, 30% reported a decrease. Hotels and restaurants bounced back strongly with 78% reporting an increase in turnover and only 12% reporting a decline.

The survey results indicated that rising prices reflecting higher input costs. Some 61% of SMEs increased the price on their main product/ service in the six month period April-September 2022. Some 96% of those said the price increase was due to increased input costs.

Business Turnover Past Six Months
Net Percentage of Respondents

Source: Department of Finance Credit Demand Survey.

Travel spending rebounds

The CBI's monthly card payments data and the CSO's retail sales index both show that, with the exception of bars, turnover exceeded pre-pandemic levels by early 2023, though the rate of growth eased in 2022 as consumers faced rising living costs.

Annualised card spending (based on a twelve-month rolling sum) grew by 46% or €27 billion between the twelve months ending February 2020 and the twelve months ending February 2023. Some of this increase reflects the replacement of cash payments with card: the value of cash withdrawn at ATMs fell by €6 billion over the same period.

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

Source: BPFI analysis of CBI monthly credit and debit card data up to February 2023

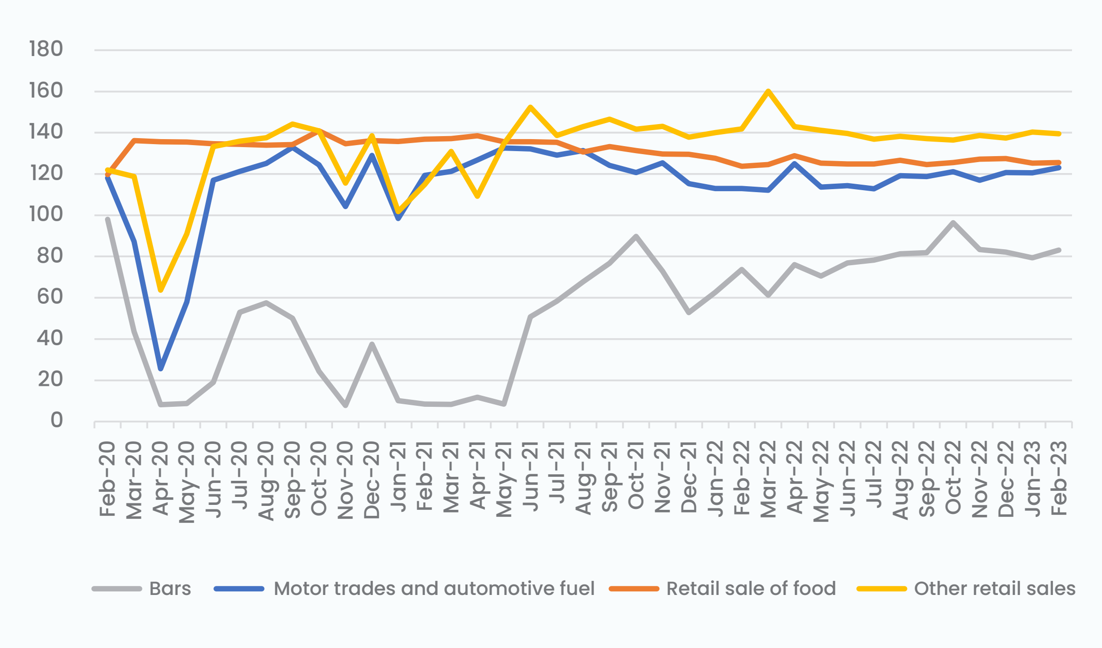
The CBI shows that card spend on groceries/perishables increased sharply in that time, with an additional €5.8 billion, while spending on hardware and clothing were almost €2.1 billion and €1.2 billion higher, respectively.

Card spending rebounded in the hospitality and leisure sectors in 2022, with card spend on restaurants/dining and entertainment some €2.9 billion and €1.4 billion higher in the twelve months ending February 2023 than three years earlier. The recovery in transport spend has been more modest (up by €1.2 billion since February 2019) and more recent (up €2.6 billion on February 2022). CSO data indicates that Irish residents spent €1.1 billion on domestic travel and €3.4 billion on international travel in Q3 2022 alone. Both figures were the highest values recorded since the date series began in 2000. On an annualised basis, residents spent almost €2.7 billion on domestic travel in the four quarters ending Q3 2022, the highest spend recorded, while international spend reached nearly €7.5 billion, the most since the four quarters ending Q1 2020.

The volume of retail sales in February 2023 was 3.6% higher than in February 2022, on a seasonally adjusted basis, and 4.1% higher than in February 2020. While bar sales grew by 12.8% year on year, they were 15.2% lower than their February 20202 level.

Performance varied significantly by sector. The largest increases compared with February 2020 were in clothing, footwear and textiles (up 51.5%), hardware, paints and glass (16.3%) and pharmaceuticals, medical & cosmetic articles (15.5%). Sales in department stores and in books, newspapers & stationery segments were 12.3% and 11.3% lower, respectively.

Retail Sales Indices



Source: CSO.

Availability of skilled labour

Employment grew strongly and reached historical highs in 2022. The number of people in employment reached rose by 2.7% in the year to Q4 2022, reaching almost 2.6 million the highest employment since the data series began in 1998.

Employment rose by 9.2% or more than 217,000 people between Q4 2019 and Q4 2022. While most sectors saw employment growth over that period employment fell by 5.6% in agriculture, forestry and fishing, by 4.8% in accommodation and food service activities and by 1.7% in administrative & support service activities.

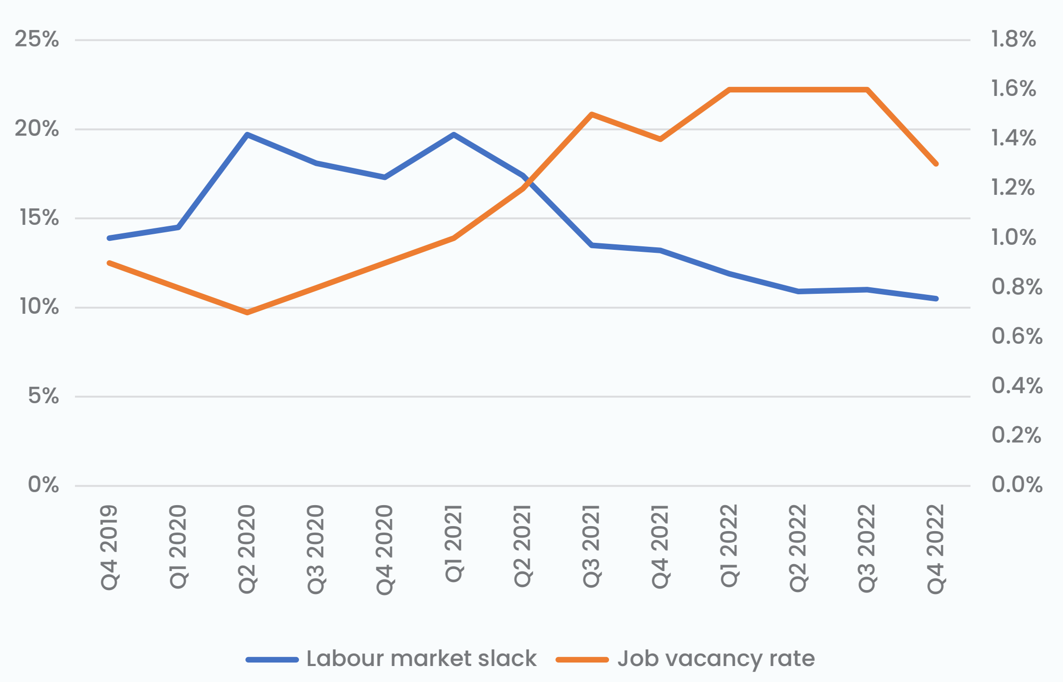
The standard seasonally adjusted unemployment ranged between 4.2% and 4.5% from May 2022 to March 2023.

Record employment

With employment at historically high levels and the employment rate at 73.2% in Q4 2022, businesses were reporting challenges in hiring suitably trained and skilled staff. The job vacancy rate increased to 1.6% in Q2 and Q3 2022, before falling to 1.3% in Q4 2022, according to the CSO. Labour market slack, which Eurostat suggests reflects the unmet need for employment, fell to 10.5% of the extended labour force (which includes underemployed part-time workers and those either not available for or not seeking work) in Q4 2022, down from 13.9% in Q4 2019.

The Employment Wage Subsidy Scheme (EWSS), which provided an income subsidy for eligible employees to registered employers, closed at the end of May 2022. This likely played a significant role in the 38.4% increase in average hourly other labour costs (excluding wages and salaries) between Q4 2021 and Q4 2022.

Job Vacancies and Labour Market Slack



Source: CSO/Eurostat

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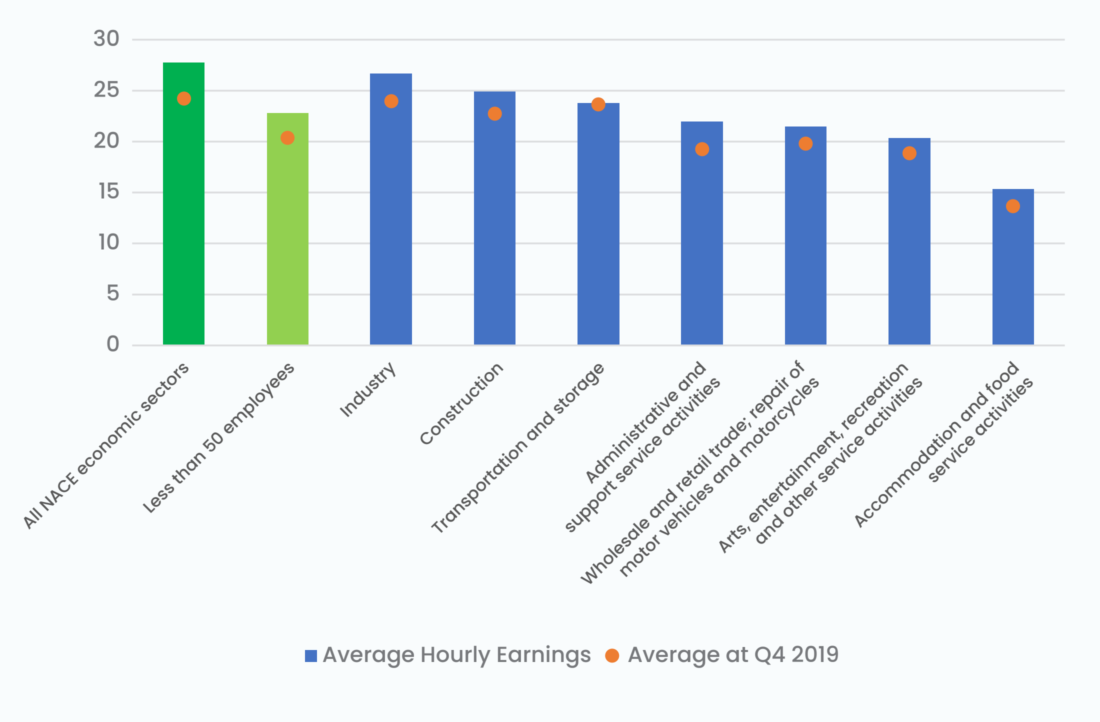
Average Hourly Earnings (€)
(Q4 2022)



Source: CSO

Average weekly earnings rose by 4.2% year on year to €900.26 while average hourly earnings increased by 5.5% to €27.72. Enterprises with fewer than 50 employees reported lower average weekly and hourly earnings at €700.69 and €22.78, respectively.

Average weekly earnings in the accommodation and food services were less than half the all-sector average at €408.63. This was partly related to the low average weekly paid hours (26.7 compared with 32.5 for all sectors combined) and the relatively low hourly earnings of €15.33.

Average hourly and weekly earnings rose by 13.7% and 14%, respectively, between Q4 2019 and Q4 2022. Most sectors with lower average hourly earnings saw more modest increases over that period including accommodation and food service up 12.1%, construction up 9.5% and wholesale and retail trade and auto repair up 8.4%.

The consumer price index rose by 13.1% between December 2019 and December 2022 but the annual rate of inflation has been at least 7% since April 2022. By contrast, hourly earnings in accommodation and food service rose by only 2.6%, while wholesale and retail trade and auto repair rose by 1.3%.

Accessing finance

Demand for bank credit remained weak in the second half of 2022 with only 17% of SMEs responding to the September 2022 Department of Finance Credit Demand Survey reporting that they had requested bank finance in the previous six months, while 17% expected to seek bank finance in the following six months.

Among those seeking finance, 41% cited working capital/cash flow as the main reason for finance requests while 35% cited new business venture/acquisition of assets/ expansion and 17% investment in machinery/equipment. The importance of investment was also reflected in the lending products requested with 34% requesting leasing or hire purchase compared with 38% seeking new loans.

Some 79% of SMEs that had not requested finance said they did not need additional finance, while 14% said credit lines were sufficient.

Gross new lending to SMEs (excluding financial intermediation) rose by 4.4% year on year to €4.2 billion in 2022. Real estate activities (mainly property investment/ development) and primary industries (mainly agriculture accounted for €997 million and €700 million, respectively, of gross new lending in 2022.

Drawdowns in the hotels and restaurants sector doubled to €244 million and this was the most in a twelve-month period since the twelve months ending September 2020. SMEs in business and administrative services drew down €611 million, 34% more than in 2021 and the most since the data series began in 2010.

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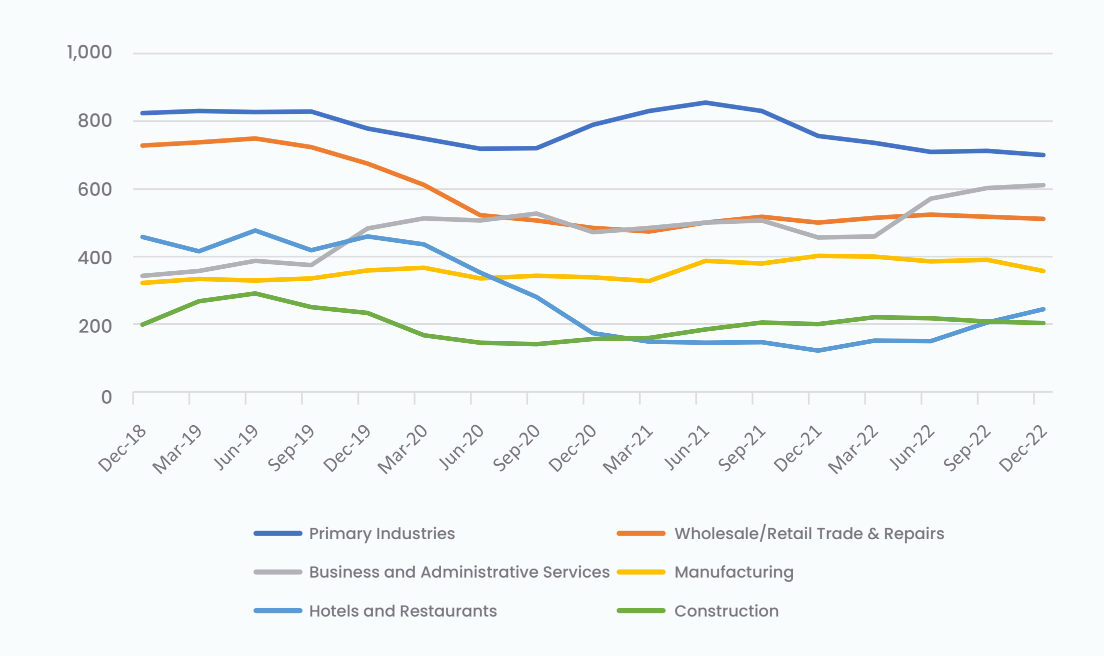
Gross New Lending to SMEs, €m
(Annualised - Selected Sectors)

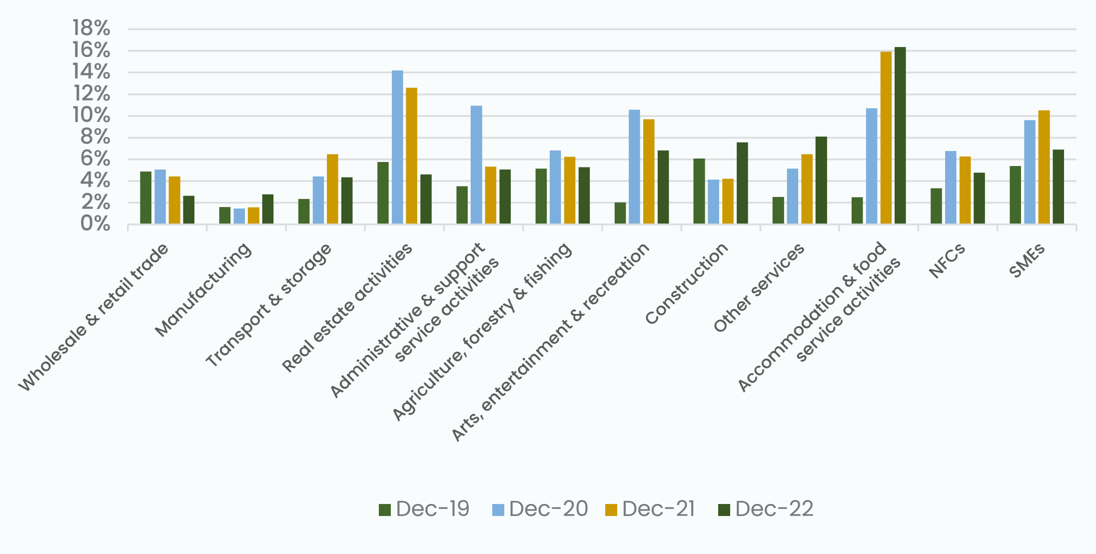


Source: Central Bank of Ireland

The value of outstanding credit to core SMEs (excluding property-related sectors and financial intermediation) fell from €12.7 billion at the end of 2021 to €12.5 billion a year later. Three sectors (primary industries including agriculture, wholesale/retail trade and repairs and hotels and restaurants) accounted 56.4% of outstanding credit to core SMEs (excluding property-related sectors) at the end of December 2022, with 24%, 19.1% and 13.2% of outstanding credit, respectively.

Non-performing loan (NPL) ratios on business loans rose during the pandemic but in most sectors they had declined significantly in 2022, according to the European Banking Authority (EBA). The NPL ratio for all SME loans was 6.9% at December 2022, down from 10.5% in December 2021 but up from 5.4% in December 2019. NPL ratios rose sharply in the arts, entertainment and recreation sector but have been declining since 2020. In the accommodation and food service activities sector, which was badly affected by health restrictions, the NPL ratio finally peaked at 18.3% in June 2022 and had fallen back to 16.4% by December 2022. This was well above the December 2019 level of 2.5%.

NPL Ratios for Selected NACE Sectors



Source: European Banking Authority

Financial supports

Most government financial supports for businesses affected by Covid-19 had effectively wound down by the end of December 2022. There were no loans in that month under the Covid Credit Guarantee Scheme, under which almost 9,900 businesses had drawn down nearly €709 billion in credit backed by a State guarantee. In July 2022, the Strategic Banking Corporation of Ireland (SBCI) launched the €150 million Energy Efficiency Loan Scheme to support eligible SMEs and farmers investing in the energy efficiency of their businesses.

About 74,000 businesses were availing of Revenue's debt warehousing scheme by the end of September 2022. Some €2.6 billion in tax liabilities had been warehoused, of which VAT and employers' PAYE and PRSI each accounted for about €1.2 billion. The wholesale and retail trade and the accommodation and foods service sector accounted for 20% and 17%, respectively of the warehoused debt. These liabilities can be repaid without interest until the end of April 2023.

More recent initiatives have focussed on rising energy costs and other consequences of the war in Ukraine. In January 2023, the SBCI also launched the Ukraine Credit

Guarantee Scheme to facilitate the provision of working capital and medium-term investment finance for businesses adversely affected by the war in Ukraine.

The Temporary Business Energy Support Scheme (TBESS), which will cost an estimated €1.3 billion, opened in November 2022. Under the TBESS, eligible businesses can obtain grants where the cost of electricity and gas has risen by more than 30%. By mid-April 2023, almost 28,000 businesses had registered with the Revenue Commissioners for the scheme and almost €75 million in claims had been approved. Businesses with up to nine employees accounted for more than 16,000 registrations and €13.8 million in approved claims. At a sectoral level, the retail trade accounted for 21% of registrations while bars, cafes and restaurants combined accounted for 21.2%.

Banking & Payments Federation Ireland

Banking & Payments Federation Ireland,
Floor 3, One Molesworth Street,
Dublin 2 D02 RF29, Ireland.

+353 1 671 53 11
info@bpfi.ie
www.bpfi.ie

Dublin • Brussels • Frankfurt