Banking & Payments Federation Ireland

Employment growing despite weaker demand

Earnings and prices increasing

SME deleveraging accelerates

SME Monitor

NOVEMBER 2023

Labour shortages will have to be addressed to maintain growth in key SME sectors

Commentary

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Labour shortages will have to be addressed to maintain growth in key SME sectors

The Irish economy has demonstrated significant resilience since the end of 2019 against external shocks such as the Covid-19 pandemic, the war in Ukraine and the interest rate increases by the European Central Bank to ensure price stability in the eurozone economy in the past year.

At the end of Q2 2023, more than 2.6 million people were in employment, the highest level since the data series began in 1998. The number people of employed in the economy increased by almost 350,000 in the four-year period between Q2 2019 and Q2 2023. Most of the gains in employment during this period were in the services sector, which accounted for 84% of the total employment increase. Three services sectors, namely information and communication, education and human health and social work accounted around 45% of the total employment increase during the period.

In terms of output, gross domestic product (GDP) increased by about 35% and almost 26% in gross national product (GNP) terms in the first half of 2023 compared with the first half of 2019, prior to the pandemic, according to the Central Statistics Office (CSO). On a year-on-year basis though, growth in output has been much slower. GDP only increased by 0.2% in the first half of 2023 compared with the equivalent period of 2022. Modified final domestic demand, which excludes globalisation effects such as trade in intellectual property and aircraft leasing, rose by 1% in Q2 2023, driven by a 19.8% jump in investment. While consumer spending rose by 0.9% quarter on quarter to €32 billion.

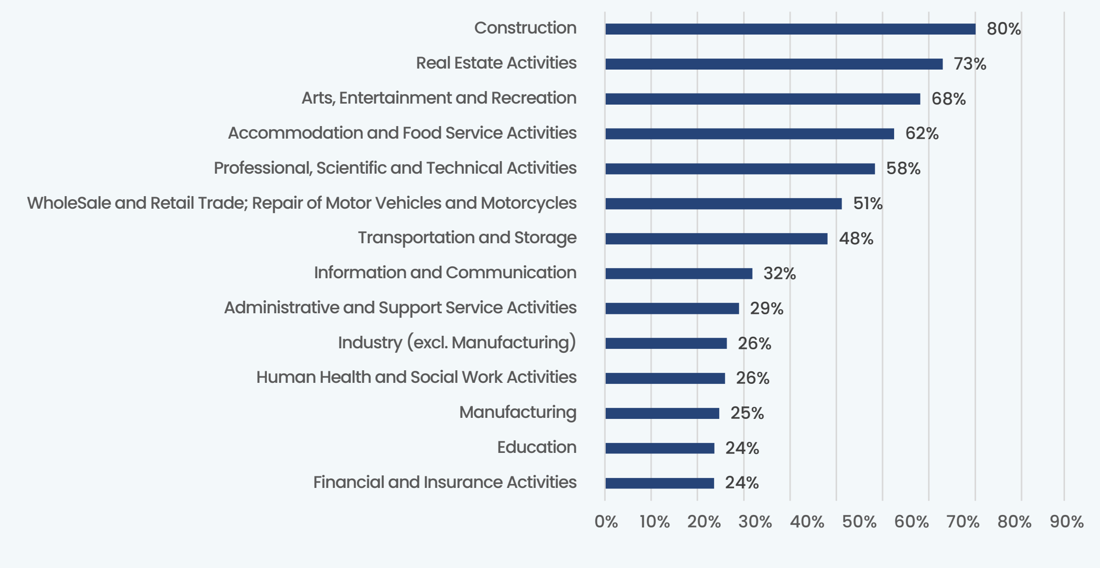
Growth in services activity continued in September 2023, albeit at its lowest level since January 2023, as growth in technology/media/telecoms offset further contraction in transport/tourism/leisure. In terms of the short-term outlook, most economic forecasts for the Irish economy, such as GDP and GNP growth, have been revised down, as have forecasts as the labour market in terms of employment levels for 2023 and 2024.

SMEs account for most employment

A well-documented feature of the Irish economy is its dual nature; an export-oriented multinational sector and a domestically oriented sector which is mostly made up of by small and medium-sized enterprises (SMEs). The number of small and medium-sized enterprises (SMEs) reached a new high of about 365,000 at employing almost 1.4 million people in 2021, according to the CSO. However, most of these businesses, over 92%, are accounted for by micro enterprises, those employing less than 10 people. SMEs account for around 60% of all employment in the economy. Interestingly, the share of number of businesses as well as employment levels accounted for by SMEs and particularly micro businesses in Ireland are very similar to the shares observed on average in the European Union (EU). Share of employment accounted for by SMEs in Ireland varies considerably across different sectors, ranging from 24% in financial and insurance activities to 62% in accommodation and food service and 80% in the construction sector. The share of employment accounted for by SMEs across the EU also varies, but in the construction sector it accounts for 87% of employment and around 86% in food and accommodation sector. Measured by the consumer price index, inflation 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.

Consumer expenditure plays an important role for SMEs in Ireland. The latest CSO data shows that personal consumption of goods and services reached €32 billion in Q2 2023, an increase of 0.9% from the previous quarter and 2.3% increase from the same quarter in 2022. The level of personal consumption of goods and services has now surpassed levels observed prior to the pandemic, which is perhaps mainly due to the significant savings accumulated by Irish households.

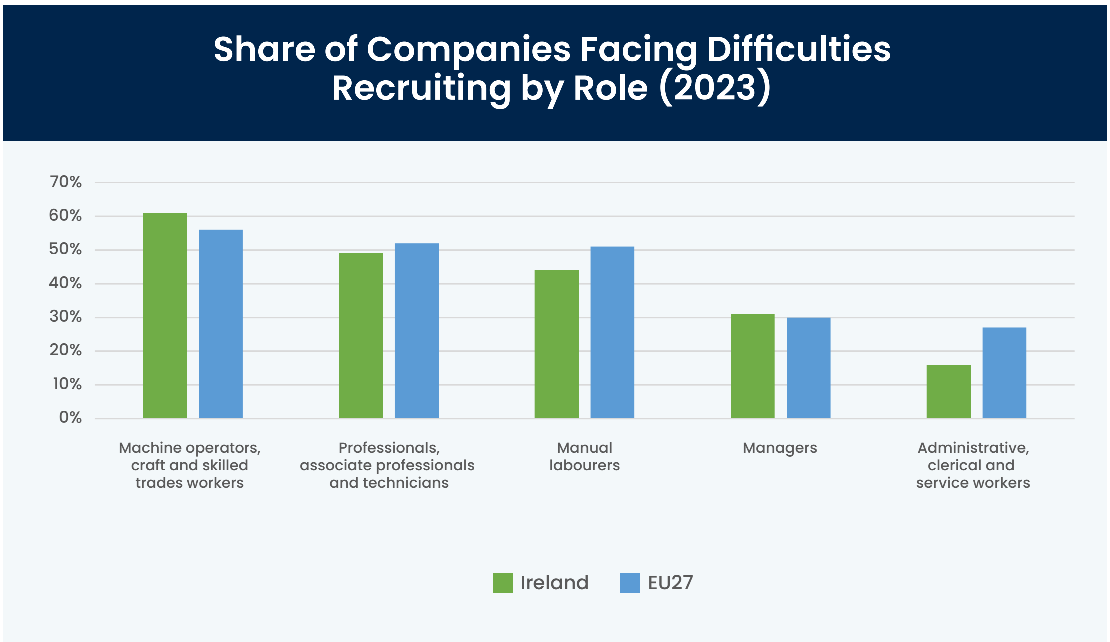
Share of Employment Accounted for by SMEs (2021)



Source: Central Statistics Office (CSO).

However, after peaking at over 30% during the pandemic, household savings rate has declined to around 12% in Q2 2023, which is along the long-term trend for the savings rate in the Irish economy.

Most government financial supports for businesses affected by Covid-19 have effectively wound down. Almost 60,000 businesses were availing of Revenue's debt warehousing scheme by the end of August 2023. Majority of these businesses are classified as micro and small businesses. Some €1.9 billion in tax liabilities had been warehoused, of which VAT and employers' PAYE and PRSI accounted for about €950 million and €800 million, respectively. The wholesale and retail trade and the accommodation and food service sectors accounted for 21% and 16%, respectively, of the warehoused debt. The extension to the scheme announced in October 2022 means that there is no obligation on some businesses to commence repaying their warehoused debt until 1 May 2024. Around 6,000 businesses have a tax debt higher than €50,000 and 45% of these businesses are in the construction, wholesale and retail trade and accommodation and food service sectors, sectors in which SMEs account for a significant share of employment.



Source: Eurobarometer

Note: % of SMEs with the relevant role

Skills mismatches and shortages emerging as key challenges

Along with increases in input prices, skill mismatches and shortages are identified as one of the main challenges that the SMEs in Ireland, as well as in the EU, are currently facing. Results from the 2022 Survey on Access to Finance of Enterprises (SAFE) show that the "availability of skilled staff" was the most important issue faced by SMEs in the EU. With employment at historically high levels and the employment rate at 74.2% in Q2 2023 in Ireland, businesses were reporting challenges in hiring suitably trained and skilled staff.

A recent report published by Chambers Ireland shows that over 95% of micro-businesses in Ireland were experiencing skill gaps. Skill deficits across different roles vary between micro, small and medium firms. However, one common area where there are significant skill deficits reported across the SMEs is around technically qualified professions and trades. An EU survey published in September 2023 provides a comparison of the areas where SMEs face difficulties in recruiting staff across the EU.

Results show that 61% of SMEs in Ireland find it difficult to recruit staff in machine operators and craft and skilled trades workers. In addition, 49% of SMEs in Ireland, the highest ratio across the 27 EU member states, indicated that educational qualifications in the form of degrees, diplomas or certificates are very important when recruiting workers.

A channel commonly used for training potential employees especially for a trade or skill is apprenticeship, which provides on-the-job learning as well as a certificate at the end of the process. Data published by the National Apprentice Office show that there were 8,286 apprentices registered at the end of 2022, with projections for over 9,000 registrations in 2023. Apprenticeships in the construction and electrical sectors accounted for nearly 60% of all registrations in 2022. Monthly registrations in 2023 to July have exceeded registrations of the same month in 2022 and 2021, according to a recent report by the National Competitiveness and Productivity Council.

However, it will take time for these new entrants to complete their apprenticeships and the completion rate rarely exceeds 75%. Financial obstacles could also limit uptake as workers face relatively low rates of pay and employers face limited grants for apprentices and potential wage demands driven by the increase in the national minimum wage.

A second channel to fill some of the skill gaps, particularly in the construction sector, is the use of work permits. Almost all roles in the construction sector are now eligible for employment permits. The number of permits issued to the construction sector has increased significantly over the past five years. In 2022, the Department of Trade, Enterprise and Employment issued 1,474 employment permits for roles in the construction sector, up from 608 in 2021, and there have been almost 1,000 work permits issued in the first nine months of 2023. Earlier this year, the department sought evidence-based submissions from sectoral representatives and employers on changes to be made to the critical skills occupational list. This should help to ensure that employment permits can be granted for highly skilled occupations in key sectors which are experiencing labour or skill shortages.

It will be important to leverage every available source for new skills and new workers for key sectors such as construction to maintain the positive recent momentum.

Market Analysis

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

SMEs and the wider economy

Economic activity continued to grow in 2023 with positive indicators especially in tax revenues and employment 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]

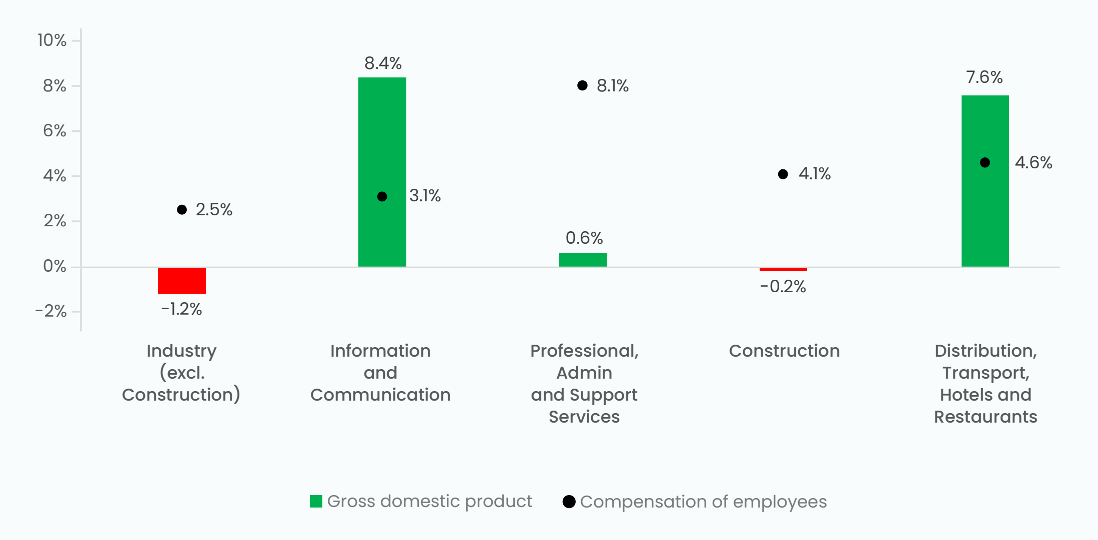
Gross domestic product grew by 0.5% quarter on quarter in volume terms in Q2 2023 (according to preliminary seasonally adjusted figures from the Central Statistics Office). Modified final domestic demand, which excludes globalisation effects such as trade in intellectual property and aircraft leasing, rose by 1% in Q2 2023, driven by a 19.8% jump in investment. Consumer spending rose by 0.9% quarter on quarter to €32 billion.

Strong recovery in services

The number of small and medium-sized enterprises (SMEs) – those businesses employing fewer than 250 persons – reached a new high of about 365,000 at the end of 2021. They employed almost 1.4 million people (including business owners). Key SME sectors include the service sectors construction, accommodation and food service activities, arts, entertainment and recreation and wholesale and retail trade as well as the repair of motor vehicles. SMEs accounted for at least 70% of employment in each of these sectors.

[1] Data in this report is correct to 13 October 2023.

Economic Performance in Selected Sectors
% Change H1 2023 vs H1 2022



Source: CSO.

Both industry and construction recorded annual contractions in gross domestic product in H1 2023, as did arts and entertainment, while both information and communication and distribution, transport, hotels and restaurants expanded by more than 7%. All sectors saw growth in incomes through compensation of employees except real estate activities.

Substantial government supports have been introduced since early 2020 to absorb the impact of firstly, the Covid health restrictions and, more recently, rising energy prices on consumers and businesses, including the Increased Cost of Business Scheme announced in Budget 2024.

The total tax take in the first nine months of 2023 was €76 billion, according to the Department of Finance, 0.1% more than the same period of 2022. Income tax receipts were up 8.2% year on year to €23.1 billion in the year to date, on the back of strong employment figures. Corporation tax also grew, by about 4.4%, to €14.4 billion.

On the expenditure side, value added tax (VAT) receipts increased by 9.7% year on year to €16.8 billion in the nine months ending September 2023, likely reflecting higher personal spending as well higher consumer prices. Prices for consumer goods and services rose by 6.3% on average in August 2023 compared with August 2022, according to the Central Statistics Offices (CSO's) consumer price index. Annual inflation of 5% or more has been recorded each month since October 2021.

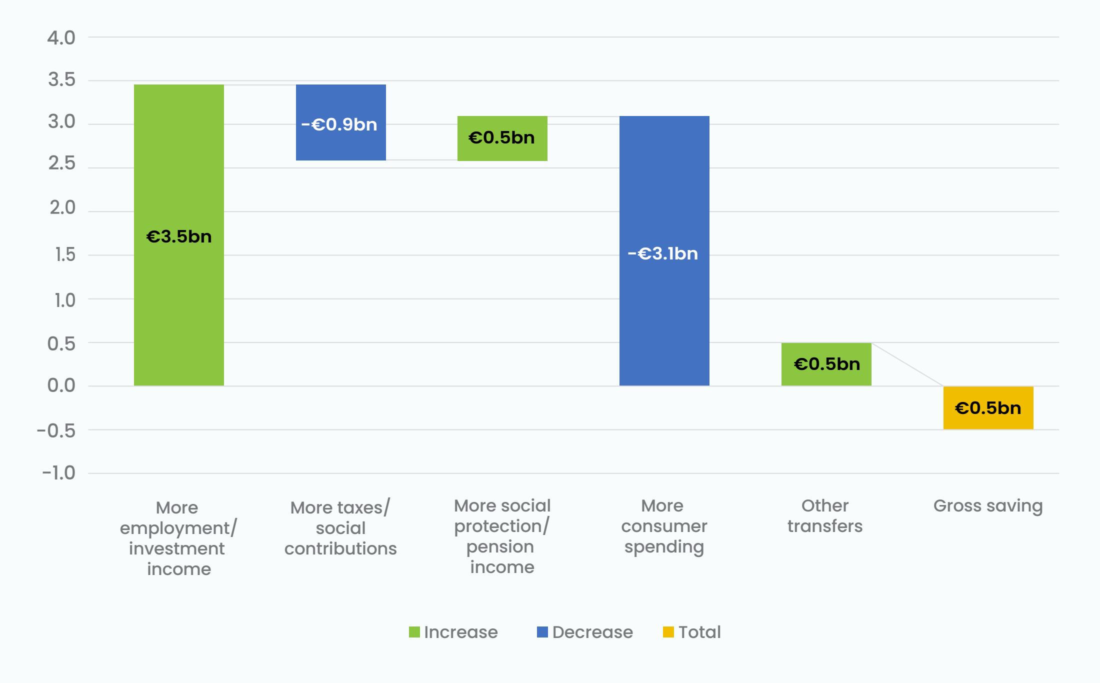
The increased income tax take was driven a combination of higher employment and increased earnings. Unemployment levels were relatively stable from in the first nine months of 2023 with the CSO's seasonally adjusted unemployment rate ranging between 4.1% and 4.3% during the period. By the end of Q2 2023, more than 2.6 million people were in employment, the highest level since the data series began in 1998.

Employment and investment income increased by more than €4.2 billion between Q2 2022 and Q2 2023, continuing the long-term trend in income growth. In Q2 2023, income from paid employment rose by 8.6% year on year and was 30.4% higher than in Q2 2019.

CSO analysis suggests that wages and salaries outpaced inflation resulting in an increase in gross disposable household income in Q2 2023.

Consumer spending was some €3.1 billion higher than in Q2 2022 but saving remained strong with the seasonally adjusted household saving rate at 11.99% in Q2 2023, making it the 14th quarter in a row with a gross saving rate of at least 10%. The CSO estimates that €2.5 billion was invested in dwellings and improvements, while the Central Bank of Ireland (CBI) indicates that households added €1.1 billion to their deposits in banks.

Economic Performance in Selected Sectors
% Change H1 2023 vs H1 2022



Source: BPFI estimates based on CSO data.

Weaker demand amid continued employment growth

Growth in services activity continued in September 2023, albeit at its lowest level since January 2023, as growth in technology/media/telecoms offset further contraction in transport/tourism/leisure. Employment continued to increase, reflecting confidence in future business lines.

Inflationary pressures in the services sector eased but remained elevated. CSO analysis suggests that producer prices were 0.3% lower when compared with a year earlier in August 2023, as food products and wholesale electricity prices fell by 7.6% and 72.5%, respectively. Construction material prices rose by 2.3%.

A significant decline in new orders has led to the weakening in Irish manufacturing conditions in September as the PMI index fell from 50.8 to 49.6 in September 2023.

Declines in manufacturing orders and output reflected subdued demand but there was modest growth in employment with supplier delivery times shortening as supply chain issues ease and input cost increases slowed. Employment continued to increase for the third consecutive month during September.

Just over a half of PMI survey respondents (51%) forecast an increase in business activity during the year ahead, while only 8% predict a reduction. Positive expectations can be attributed to long-term expansion plans, investment in new products and hopes of a recovery in export sales.

The construction sector remained in contraction at the end of September 2023 according to the BNP Paribas Real Estate Ireland construction PMI. Activity in residential, commercial, and civil engineering sectors of construction covered by the survey saw the pace of decline ease in September as rate of cost inflation softened. Companies expressed optimism that demand conditions will improve with more than 37% of respondents predicting a rise in output outlook.

The Credit Union consumer sentiment index fell in September 2023 to its lowest level in six months as rising costs, rising interest rates and concerns about the general economic and financial environment weighed on consumers. The European Central Bank sought to reduce inflation by raising its key interest rates ten times between July 2022 and September 2023. By the end of September, the main refinancing rate was 4.5%.

The credit union consumer sentiment index shows that one in nine see preventing the Irish economy from overheating as a key priority while two out of three consumers see cost-of-living supports as a key priority.

Finding Customers

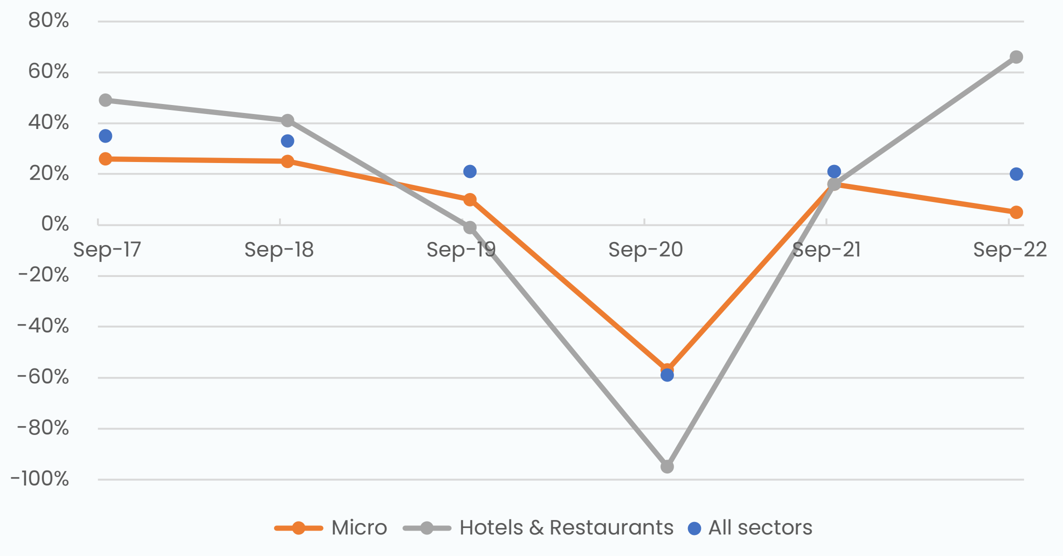
The ECB Survey on Access to Finance for SMEs (SAFE) has traditionally identified finding customers as the most pressing problem for SMEs in Ireland. However, only 14.2% of respondents in the latest survey (conducted in September/October 2022), cited finding customers as the most pressing problem, down from26.6% three years earlier.

Availability of skilled staff or experienced managers was the main concern for 28.7% of respondents in the followed by costs of production or labour (20.6%).

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



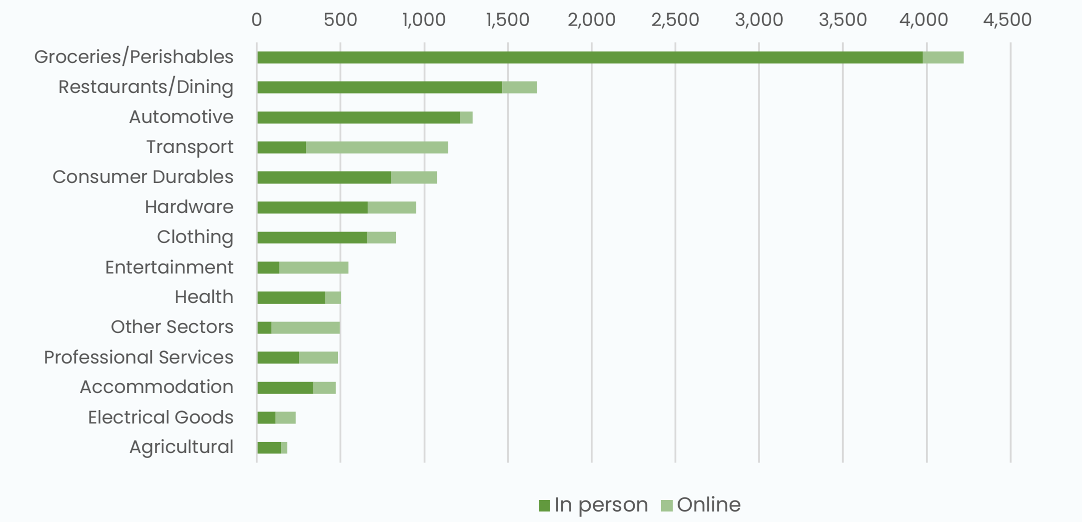
Source: Department of Finance Credit Demand Survey.

Travel spending rebounds

The CSO's retail sales index indicates the volume of retail sales increased in the first eight months of 2023 but the rate of increase slowed from May onwards. Indeed, seasonally adjusted retail sales fell for the fourth month in a row in August 2023.

Domestic spend on credit and debit cards reached €18.5 billion in Q2 2023, of which €10.9 billion was in stores and other physical points of sale such as cafes, restaurants and cinemas. The clothing, hardware and consumer durable sectors each saw in-store spend of over €500 million.

Domestic Card Spend by Sector (€m)
Q2 2023



Source: BPFI analysis of CBI monthly payment cards data

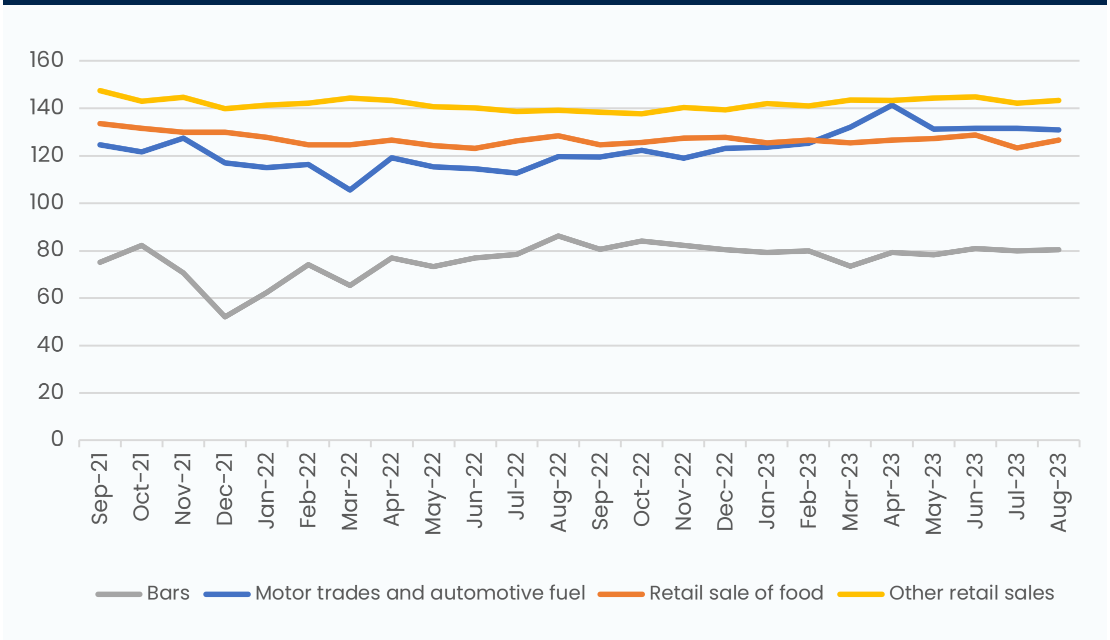
The volume of retail sales in August 2023 was 3.6% higher than in August 2022, on a seasonally adjusted basis, but 1.2% lower than in August 2021. The value of retail sales rose by 7.0% in the 12 months from August 2022.

Performance varied significantly by sector. The largest increases compared with August 2022 were motor trades and pharmaceuticals, medical and cosmetic articles growing by 10.9 and 7.6% respectively.

Sales in bars and food, beverages and tobacco (specialised stores) saw the biggest declines of all sectors compared to August 2022 at 6.7% and 6.2% respectively.

When compared to pre-Covid levels in 2019, bar sales have fallen by 19.2%. In contrast to this, electrical goods sales increased by 20.8% over the same period. The value of automotive fuel sales has increased by 24.3% since 2019 while the volume of sales has increased by just 1.8% over the same period.

Retail Sales Indices



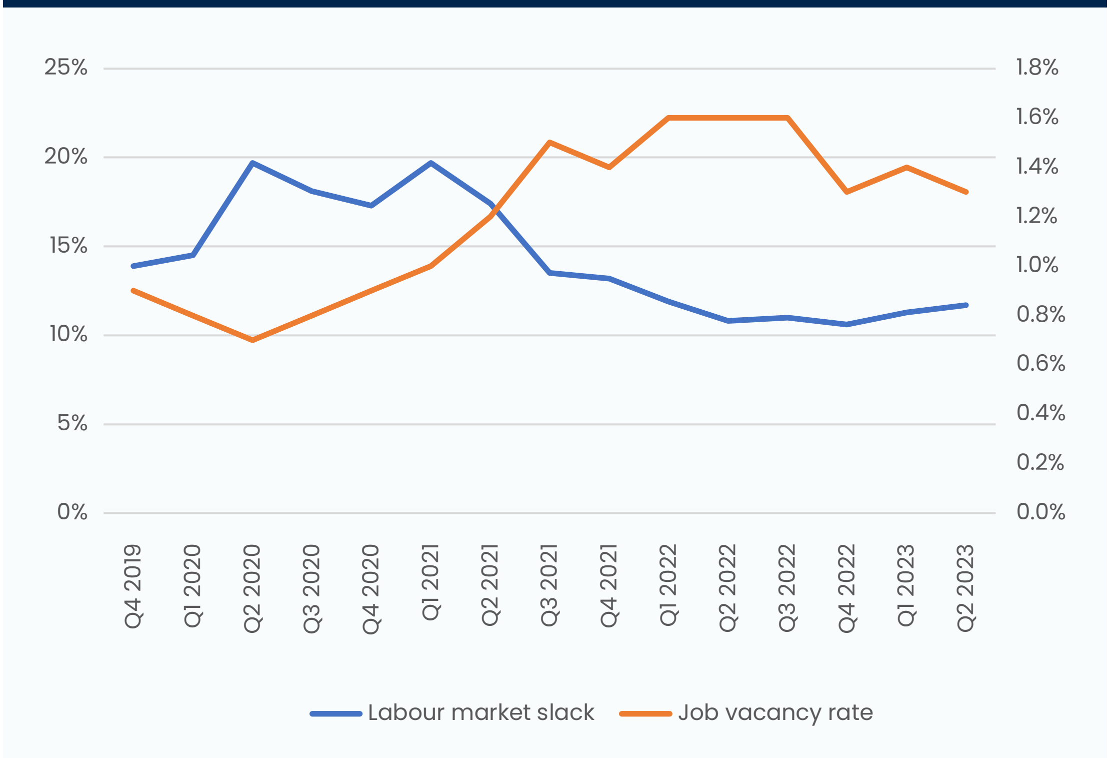
Source: CSO.

Availability of skilled labour

Employment grew strongly and reached historical highs in 2023. The number of people in employment reached rose by 3.5% in the year to Q2 2023, reaching more than 2.6 million the highest employment since the data series began in 1998. Employment rose by 15.1% or more than 346,800 people between Q2 2019 and Q2 2023. While most sectors saw employment growth over that period employment fell by 1.4% in agriculture, forestry and fishing and by 4.3% in accommodation and food service activities.

The standard seasonally adjusted unemployment remained unchanged between Q1 and Q2 of 2023 at 4.2%.

Job Vacancies and Labour Market Slack



Source: CSO/Eurostat

Record employment

With employment at historically high levels and the employment rate at 74.2% in Q2 2023, businesses were reporting challenges in hiring suitably trained and skilled staff.

The job vacancy rate fell by 0.1% quarter on quarter to 1.3% in Q2 2023, 0.3% higher than the corresponding quarter in 2022 according to CSO. The number of vacancies fell to 28,200, the lowest level since Q2 2021.

Labour market slack, which Eurostat suggests reflects the unmet need for employment, increased to 11.7% of the extended labour force (which includes underemployed part-time workers and those either not available for or not seeking work) in Q2 2023, up from 10.8% in Q2 2022.

Average Hourly Earnings (€)
(Q2 2023)

Source: CSO

Average weekly earnings rose by 4.3% year on year to €909.77 while average hourly earnings increased by 5.1% to €28.07. Enterprises with fewer than 50 employees reported lower average weekly and hourly earnings at €724.76 and €23.50, respectively.

Average weekly earnings in the accommodation and food services were less than half the all-sector average at €431.85. This was partly related to the low average weekly paid hours (27.2 compared with 32.4 for all sectors combined) and the relatively low hourly earnings of €15.89. The national minimum wage is due to increase by €1.40 per hour to €12.70 per hour in January 2024.

Earnings have increased significantly since 2019. Average hourly and weekly earnings rose by 18.6% and 17.9%, respectively, between Q2 2019 and Q2 2023. All sectors saw increases of over 11% in weekly earnings over the same period except for Transportation and Storage which increased by 4.9%. Information and communication saw the largest increase at 27.8%.

The consumer price index rose by 6.3% between August 2022 and August 2023 while the annual rate of inflation has not been below 5% since September 2021. By contrast, hourly earnings in construction rose by only 0.16%, while wholesale and retail trade and auto repair rose by 0.41%.

“With employment at historically high levels and the employment rate at 74.2% in Q2 2023, businesses were reporting challenges in hiring suitably trained and skilled staff.”

Accessing finance

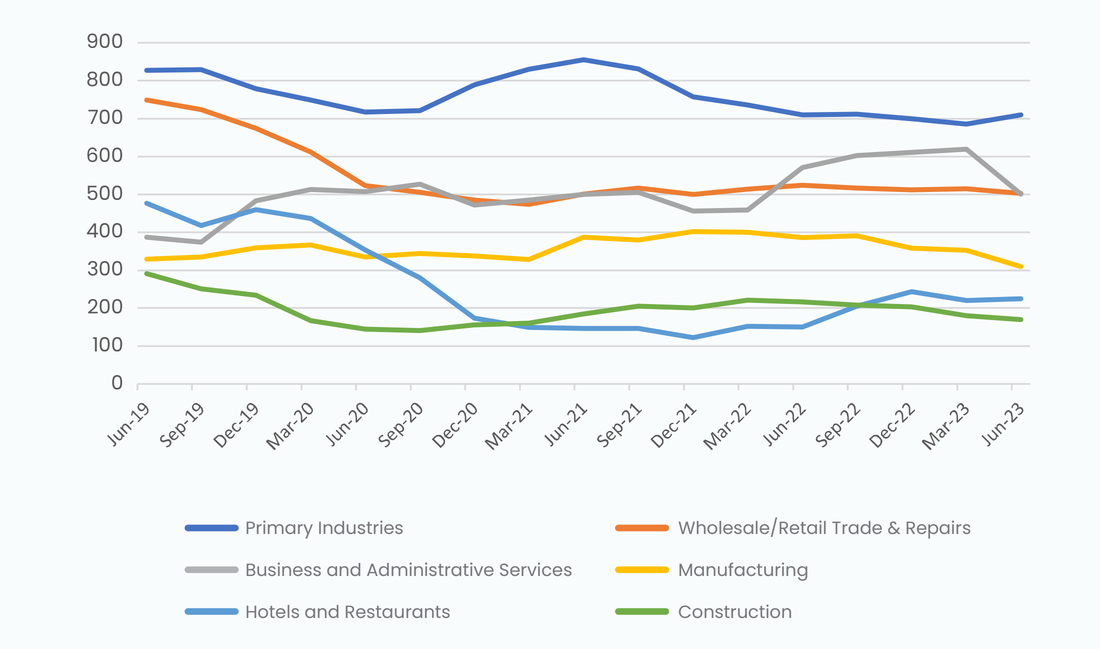
SME demand for bank credit was unchanged in the first half of 2023 according to the Central Bank of Ireland (CBI) bank lending survey, although demand among large enterprise increased marginally.

Gross new lending to SMEs (excluding financial intermediation) totalled €3.9 billion in the twelve months ending June 2023, 5% less than in the twelve months ending June 2022. SMEs continued to deleverage with estimated repayments by SMEs increasing by 7.3% to €4.6 billion in the twelve months ending June 2023.

Real estate activities (mainly property investment/development) and primary industries (mainly agriculture) accounted for €1,090 million and €712 million, respectively, of gross new lending in the twelve months ending June 2023.

Drawdowns in the hotels and restaurants sector increased by 49% to €224 million in the twelve months ending June 2023. Annualised gross new lending in the construction and manufacturing sectors fell to their lowest levels since the twelve months ending March 2021 and June 2018, respectively.

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

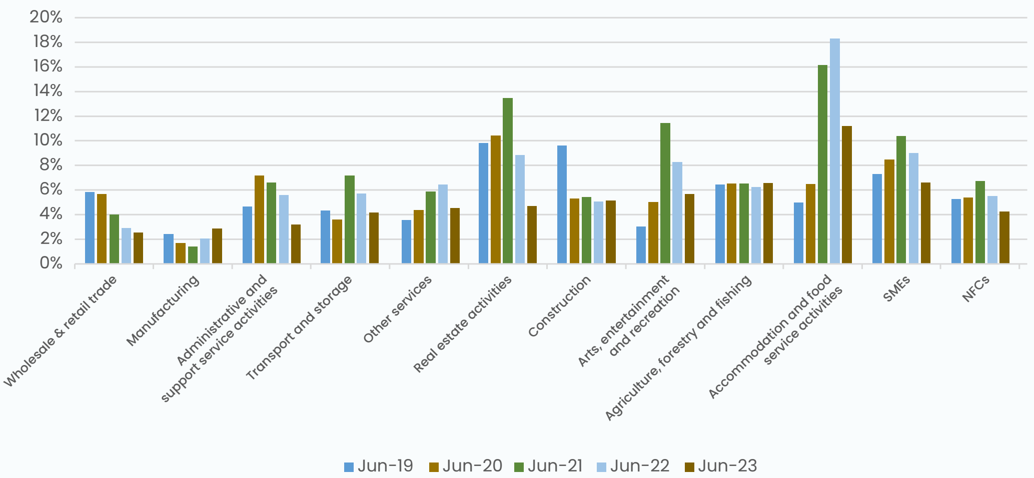


Source: Central Bank of Ireland

The value of outstanding credit to core SMEs (excluding property-related sectors and financial intermediation) fell by €770 million in the twelve months ending June 2023 to about €12 billion. Three sectors (primary industries including agriculture, wholesale/retail trade and repairs and hotels and restaurants) accounted for 56.8% of outstanding credit to core SMEs (excluding property-related sectors) at the end of June 2023, with 25.8%, 18.5% and 12.6% of outstanding credit, respectively. The outstanding stock of lending to SMEs involved in real estate activities (mainly property investment or development) increased by 8.5% year on year to almost €5.5 billion.

Non-performing loan (NPL) ratios on business loans rose during the Covid-19 pandemic but they declined significantly in the twelve months ending June 2023, according to the European Banking Authority (EBA). The NPL ratio for all SME loans was 6.6% at June 2023, down from 9% in June 2022 7.3% at June 2019. The NPL ratios in the accommodation and food service activities and arts, entertainment and recreation were still significantly above their June 2019 levels, at 11.2% and 5.7%, respectively.

NPL Ratios for Selected NACE Sectors



Source: European Banking Authority

Financial supports

The Temporary Business Energy Support Scheme (TBESS), which aimed to support businesses with increases in their electricity or natural gas energy costs, expired at the end of September 2023. By 20 July, 50,513 claims had been approved and more than €107 million in claims had been paid.

The government announced additional support to businesses through Budget 2024 including the Increased Cost of Business Scheme, a once-off grant to benefit up to 130,000 rate-paying SMEs at a cost of €250 million. The rates grant is expected to be paid through local authorities.

Among the tax measures announced were an increase in R&D Tax credit from 25% to 30%. A new targeted Capital Gains Tax relief for angel investors has been announced which will provide for a lower rate of 16% (18% for partnerships) for disposals of qualifying investments for gains up to a value of two times the initial investment. The Employment Investment Incentive scheme which provides tax relief for risk capital investments in qualifying SMEs has been enhanced to allow investors to claim relief of €500,000, up from €250,000.

A number of loan schemes are managed by the Strategic Banking Corporation of Ireland (SBCI). The Energy Efficiency Loan Scheme aims to support eligible SMEs and farmers investing in the energy efficiency of their businesses, while the Ukraine Credit Guarantee Scheme which facilitates the provision of working capital and medium-term investment finance for businesses adversely affected by the war in Ukraine.
The first phase of the Growth and Sustainability Loan Scheme opened earlier this year for climate action and environmentally sustainable investment loan applications. The scend phase, loans for general long-term investment, is expected to start in December 2023.

Most government financial supports for businesses affected by Covid-19 have effectively wound down. Almost 60,000 businesses were availing of Revenue's debt warehousing scheme by the end of August 2023. Some €1.9 billion in tax liabilities had been warehoused, of which VAT and employers' PAYE and PRSI accounted for about €950 million and €800 million respectively. The wholesale and retail trade and the accommodation and foods service sector accounted for 21% and 16%, respectively, of the warehoused debt. The extension to the scheme announced in October 2022 means that there is no obligation on some businesses to commence repaying their warehoused debt until 1 May 2024.

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