Business Investment Trends in Ireland
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Key messages

- Business investment increased dramatically in recent years. In 2018 firms were investing four and a half times more than they were in 2010.

- Business investment in Ireland grew significantly faster than the EU average and is now 41% higher than 2006, while investment in the EU is only 18% higher.

- Business investment has also grown significantly faster than other sectors of the economy. From 2000-2008 the household and government sectors were investing two and a half times more than the business sector. However, from 2015 onwards the business sector has invested more than the government and household sectors combined.

- In 2018 for every €1 invested by households, business spent €2 and for every €1 invested by government business invested €3. While strong business investment is good for the economy (and is accompanied by higher employment), the scale at which it is outpacing government and household investment is causing pressures to build in the housing and transport sectors.

- While business investment continues to grow, it is likely that it will slow in the future. The COVID-19 pandemic will lead to a slowdown in 2020 which will cause business investment to fall. It might rebound in 2021 if the pandemic subsides quickly, however, if it doesn't and leads to a deeper more prolonged recession it will take longer for business investment to resume to existing levels.

What is Business Investment

Business investment is when a firm purchases assets such as buildings, machinery and equipment. By investing in these assets, a business can increase their production capacity and can produce more goods and services. Business investment can also include spending on intangible assets (e.g. databases and intellectual property), but this note will only focus on tangible investments (i.e. plant, machinery and equipment).

These investments have a direct impact on economic growth as they contribute to GDP. They also impact on long-term growth as these investments increase the capital stock. This means that the country will be able to produce more goods and services. This should lead to higher growth in the future and an improvement in living standards.

What influences Business Investment?

There are three main drivers of business investment which are as follows:

The Economy: When the economy is growing, demand for goods and services will rise as people spend more. Companies will invest so that they can produce more goods to meet this rising demand. The opposite is the case during a recession. Demand for goods and services will fall and firms will put investment decisions on hold. This happened in Ireland during the recession (see Figure 1).

Business Confidence: This is related to the economy, but it is primarily focused on future expectations. If companies expect weaker growth in the future, they might reduce investment and put certain projects on hold. This could happen if they feel growth will slow in the future or if there is significant policy or political uncertainty. This happened in the UK when there was a significant slowdown in business investment after the Brexit referendum.

1 Intangible investments include assets such as intellectual property and databases. Since 2015, companies have imported significant amounts of intangible assets which has caused overall investment (and imports) to increase significantly.
Credit: Firms often borrow to finance capital investments. If interest rates are high, the investment project will be more expensive. If interest rates fall, the cost of carrying out the investment also falls which will lead to higher investment. Firms often borrow to finance capital investments. If interest rates are high, the investment project will be more expensive. If interest rates fall, the cost of carrying out the investment also falls which will lead to higher investment.

Recent Changes in Business Investment

Business investment in Ireland has always been very volatile and sensitive to the economic cycle. During the last recession the collapse in residential construction was well documented. However, business investment (excluding intangible and aircraft leasing assets) also fell by a significant amount. From 2006-2010 business investment fell by 74%. This was likely driven by a combination of weak demand, uncertainty about the future and restrictive lending conditions.

Since 2010 however, business investment increased dramatically. Firms are now investing four and a half times more in plant machinery and equipment than they were in 2010. This strong growth is somewhat expected as business investment fell significantly during the recession and therefore experienced stronger growth as it returned to previous levels. However, business investment is now significantly higher than it was during the last “boom” period as it surpassed its previous 2006 peak in 2015. As a result, business investment in 2018 (2019 data will be available in Spring 2020) was 41% higher than 2006.

Figure 1: Business Investment (excluding intangible assets)

Source: Authors calculations based off Eurostat and CSO data. 2019 data will be available in Spring 2020.

Overall, from 2000-2007 Irish business investment grew broadly in line with EU investment. However, it collapsed during the recession while business investment for the EU remained broadly stable. Since then, Irish business investment accelerated at a significant pace and is now 41% higher than 2006, while investment for the EU28 is only 18% higher than 2006.

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2 Business Investment is characterised as gross fixed capital formation by the non-financial sector (firms producing goods and non-financial services). The data excludes intangibles for the EU and for Ireland it excludes both intangibles and investments relating to aircraft leasing activities.
Investment by Sector

Figure 2 compares Irish business investment with other types of investment in Ireland. Business investment fell to the same extent as the household sector (which consists mostly of residential housing and improvements) during the recession. However, business investment recovered much faster as it started growing in 2010 whereas the household sector only started improving modestly in 2015. Government investment reached peak levels in 2008 which was later than the business and household sectors.

Figure 2: Investment by Sector

Source: Authors calculations based off Eurostat and CSO data. 2019 data will be available in Spring 2020.

The dramatic growth of the business sector is clear when compared to these two sectors. In 2018, business investment was 40% higher than peak levels in 2006. However, household investment was still 70% lower than its 2006 peak while Government investment was 56% lower than its peak in 2008.

Figure 3: Investment by Sector

Source: Authors calculations based off Eurostat and CSO data. 2019 data will be available in Spring 2020.
Figure 3 shows the amount spent on investment by each sector. From 2000-2008 the household and government sectors were spending two and a half times as much as the business sector. This spending peaked in 2006 when both sectors combined were spending almost three times as much as the business sector. Business investment overtook combined investment by the government and household sectors in 2013. In 2018 businesses were investing 14% more than the government and household sectors combined. This meant that in 2018 for every €1 invested by households, business spent €2 and for every €1 invested by government business invested €3.

### Capacity Constraints

Strong business investment is a sign that firms are positive, investing in the future and are likely to stay located in a country. It is good for the economy as it also leads to higher employment. New firms investing for the first time will need workers to run operations. Existing firms that are expanding their operations will also need extra workers. So far, strong business investment has been accompanied by strong employment growth as there was almost half a million (463,500) extra people at work in Q3 2019 compared to the same period in 2010.

However, this strong growth does bring challenges, particularly when government and household investment is not keeping up with the business sector. Additional workers put pressure on the housing market as more people need homes. Extra commuters will cause congestion if the public transport and road network do not improve. Given the scale of business investment, it is not surprising that capacity constraints have emerged in the housing and transport sectors.

### Role of Multinational Companies

A significant component of business investment in Ireland is carried out by multinational companies. Domestic firms accounted for 17% of business investment (including intangibles) and 26% in 2018. The remainder was accounted for by multinational companies. This suggests that a significant proportion of business investment is driven by global as opposed to domestic conditions.

Global business investment has been strong in recent years, reflecting the positive momentum in the global business cycle. There are signs however that the global business cycle has peaked and growth is starting to slow. This may cause firms to cut back on investments as they expect weaker demand in the future. Several other countries already experienced a slowdown in business investment. For example, while the US economy continues to experience strong growth, business investment has fallen. In the second half of 2019 business investment fell by 1.7% compared to the same period in 2018. This could have knock on implications for Ireland as a significant proportion of business investment is undertaken by US multinationals located in Ireland. If the same companies start delaying investment decisions abroad, it is likely they would start putting off investments in other jurisdictions.

**Figure 4: US Business Investment (excluding intangibles)**

![Graph showing US Business Investment](source: BEA)
Business Investment and COVID-19

While economic data is yet to become available, Ireland and many of its key export markets will see a surge in unemployment and a reduction in economic activity due to the COVID-19 pandemic. This slowdown will lead to uncertainty and many companies will put investment decisions on hold until it becomes clear that economic activity will resume to previous levels. The fall in demand will also have an impact as firms will now have some spare capacity and wont need to undertake investments that enable them to produce more goods. While borrowing costs may fall (as a result of monetary policy measures to tackle the crisis), firms may find it harder to access these funds if banks impose stricter lending conditions due to the growing uncertainty.

These factors suggest that business investment is likely to fall in 2020. It might rebound in 2021 if the pandemic subsides quickly, however, if it doesn’t and leads to a deeper more prolonged recession it will take longer for business investment to resume to existing levels.