Estimation of Costs of Doing Business in the Hospitality Sector in 2022 and 2023

Anthony Foley

Associate Professor Emeritus of Economics

Commissioned by the Drinks Industry Group of Ireland

September 2022

Executive Summary

- This report examines the costs of doing business in the hospitality sector of restaurants, hotels and public houses and other bars, and examines the overall impact of the current inflation surge on the hospitality business cost model.
- This report makes for dismal reading by large elements of the hospitality sector. The dismal reading is worst for restaurants.
- The analysis takes 2019 as a starting point as the last "normal" year of business. The new higher costs and higher hospitality prices are then applied to the 2019 situation to assess their overall impact on operating margins in terms of a normal year at the new costs and prices.
- The high costs increases have greatly reduced operating margins in the three sectors of restaurants, hotels and public houses and higher hospitality prices have been insufficient to restore margins to the normal 2019 levels. This is particularly so for restaurants and public houses and to a much lesser extent for hotels.
- Comparing a normal year, including the higher costs and prices, with 2019, the restaurants' margin for profits, depreciation and interest dropped from 7.2% to 3.5%; the hotels' margin dropped from 12.7% to 12.4%; and the margin for public houses dropped from 12.5% in 2019 to 9.5% in a normal year.
- The bad news does not stop at the above comments. The cost situation for hospitality will deteriorate further in the remainder of 2022 and into 2023. Interest rates will continue to increase and in 2023 the average interest rate will be 2% points, or more, higher. Water charges for many hospitality enterprises will continue to increase in the rest of the transition period and especially at the end of the transition period of three years from October 2021. Energy prices, especially gas and electricity, will continue to increase in the rest of 2022 and through much of 2023. Regulatory changes including the introduction of the living wage and possible increases in employer PRSI will add to the cost pressure facing the sector. General inflation will continue into 2023 but at a lower rate and this will increase the cost of a range of business operating costs.
- Energy is a particular worry. In addition to already suffering a doubling of energy costs, the sector faces an additional possible doubling between now and late 2023.
- The cost structures of the three hospitality sub-sectors illustrate how vulnerable the sector is to labour and food cost increases. The labour cost relative to turnover is between 28.9% and 33.3%. Food and beverages inputs amount for between 30% and 36.9%. Other purchases, which includes energy, is between 22.2% and 25.8% of turnover.

- The key cost elements in hospitality are food and beverages inputs (the cost of sales), labour cost, and other (non-labour) operating expenses including energy for operations, light and heat, insurance, water charges, advertising, kitchen and bar supplies, legal and professional fees, bank charges, rates, entertainment and audit fees.
- The current high inflation rate is very different to the experience of the past several years. The past decade had very small inflation rates The annual inflation rates for the past five years were 2017, 0.4%; 2018, 0.5%; 2019, 0.9%; 2020, -0.3% and 2021, 2.4%.
- The current Central Bank inflation forecasts (forecast published on 7 July 2022) for 2022 and 2023, based on the Harmonised Index of Consumer Prices are 2022, 7.8% and 2023, 4.2%. The ESRI is forecasting an inflation rate of 7.1% in 2022 and 4% in 2023 in its June 2022 forecast.
- The June 2021 12 months' consumer price increase was 1.6%. From July 2021 the annual rate of inflation started to increase. The figures were 2.2% in July 2021, 2.8% in August and 3.7% in September. The annual rate increased to 5% or over in each of the months between October 2021 and February 2022. Thereafter the inflation rate increased again from 6.7% in March, 7.0% in April, 7.8% in May, 9.1% in June and 9.1%, the same, in July.
- Several factors are responsible for the high inflation rate. There were several years of low inflation which would eventually come to an end. There were several years of expansionary monetary policy, which was always capable of eventually generating inflationary pressures. As economies emerged from the Covid restrictions there was substantial pent-up demand and large accumulated savings available for spending. This increase in demand was not matched by an equivalent increase in aggregate supply due to Covid-related disruptions and problems in global and national supply chains. Challenges were already emerging in the energy markets.
- The Russian invasion of Ukraine in February 2022 significantly worsened the inflation performance and outlook mainly through the energy and food sectors, especially in energy, but also through more disruptions to supply chains. Russia and Ukraine are significant producers in certain sectors such as wheat, corn, fertilisers, natural gas, oil, sugar beet and sunflower oil. Ireland also had the price increasing effects of Brexit from increased administrative costs of trade and transport costs. In addition, the Irish economy rebounded very well from Covid and the labour market was very strong. It should be noted that Irish inflation was increasing substantially throughout 2021 and early 2022, before the start of the Ukraine war.

- Illustrations of recent price and cost increases are: the overall rate of inflation was 9.1 % in July 2022 compared with July 2021
- The consumer price of food increased by 8.1% in July 2022 compared with July 2021
- The consumer price of beef and veal increased by 11.3% in July 2022 compared with July 2021
- The consumer price of poultry increased by 13.4% in July 2022 compared with July 2021
- Fresh milk increased in price by 21.2%%
- Electricity price increased by 40.0% in July 2022 compared to July 2021 which followed a substantial increase of 11.3% in July 2021.
- Gas increased by 60.2% in July 2022 compared with a year earlier and a lower 4.9% in July 2021.
- Home heating oil increased by 91.9% in July 2022 which followed an additional large increase of 39.6% in July 2021.
- In addition to the above suppliers have announced substantial new increases in electricity and gas from August and October.
- The consumer price increases between July (the current prices) and the average price level in 2019 are food 6.9%, beef and veal 4.1%, poultry 12.7%, electricity 52.6% and natural gas 57.4%. This compares to the overall index price increase of 11.3%.
- In the year June 2022 relative to June 2021 based on producer prices, food products increased in price by 10.2%. Meat and meat products increased by 14.5%. Dairy products increased by 49.1%. Fish increased by 7.9% Vegetable and animal oils and fats grew by 4%.
- If the average 2019 producer price level is compared with June 2022 the food increase is 7.3%, dairy increased by 56.3% and the meat increase is 25.2%.
- Food price increases from the interviews were, beef brisket 45%, beef in loin 7%, beef filet 17%, chicken fillets 21% for Irish product and 40% for Dutch, chicken wings 36%, fish 13% and flour 39%.
- The business energy price increases exceeded the household increases in the period July to December 2020 and July to December 2021. In the lower volume band of business energy users, the business electricity price increase of 13.9% slightly exceeds the household increase of 13.2%. There is a large difference in gas. Households' gas price increased by 12.1% while the lowest band of business gas users had a price increase of 23.8%, more than double the household increase.
- The wholesale price of electricity increased by 91.3% in the year to June 2022 compared to the consumer electricity price increase over the same period of 40.9%.

- The size of energy cost increases reported in the interviews exceed the picture presented by the official statistics. Separate references were made to a doubling of energy costs, a threefold increase in electricity costs, a 150% increase in electricity, more than a doubling of heat and light costs, approximately a 150% increase in electricity costs, a 180% increase in gas costs. Some enterprises had recently come out of a long term fixed energy price and now faced substantially more than a doubling.
- The hospitality sector is facing significant cost increases and further increases, especially in energy, will continue well into 2023. Thereafter there is no expectation of a return to 2021 energy costs. The recent cost increases, despite hospitality price increases, have reduced margins, especially in restaurants. This pressure on margins will continue into 2023.
- The UK energy price cap for domestic households is an indication of energy price developments and future prospects. The cap was increased by 54% with effect from April 2022. In October 2022 the cap was increased by 80% and the forecast for January 2023 is an increase of 52% with a further increase of 23% for the second quarter of 2023. The cap is expected to drop by about 11% in the third quarter of 2023. The UK cap in the third quarter of 2023 could be 4.6 times the level of the cap before April 2022.

1. Objective

The objective of this report is to examine and estimate the costs of doing business in the hospitality sector which we define to include restaurants, hotels and public houses and other bars, and, in particular, to identify the overall scale of the current inflation surge and its impact on the hospitality business cost model. In addition to the recent growth in operating costs, the report examines elements of the level of operating costs.

The key cost elements in hospitality are food and beverages inputs (the cost of sales), labour cost, and other (non-labour) operating expenses including energy for operations, light and heat, insurance, water charges, advertising, legal and professional fees, bank charges, rates, entertainment and audit fees. Based on CSO data for 2019, the cost of sales on a sectoral basis ranges from 30% of turnover to 36.4% for hotels, restaurants and public houses. Labour cost on a sectoral basis ranges between 28.9% and 33.3%. Other operating expenses range between 22.2% and 25.8%.

Since 2019 and more recently, there have been substantial increases in hospitality labour costs due to broad economic factors and the specific features of the hospitality sector. Energy costs have increased very substantially, mainly due to the Ukraine war. Food costs have substantially increased. Water charges have increased for most hospitality enterprises by very substantial amounts in the new tariff structure but the ongoing impact of this is masked by the interim three year caps on water charge increases.

Several assumptions and estimates are used in the analysis due to the unavailability of certain data. These assumptions are identified in the report to facilitate scrutiny and transparency. Apart from these assumptions, the analysis is primarily based on CSO statistics.

2. Data and definitions

Hospitality in this report is defined as the Central Statistics Office NACE classification Section I divisions 55 and 56. NACE 55 refers to accommodation and NACE 56 refers to food and beverage service activities. This group is referred to as Section I, accommodation and food services (AFS) and for purposes of the report is treated as equivalent to hospitality and is used to refer to restaurants, hotels and public houses. This is done because of data limitations but is not fully correct because works canteens (56.29, other food service activities) are included in the NACE 56 classification as well as restaurants (included in NACE 56.10). Beverage service activities include a range of activities such as coffee shops and juice bars as well as licensed premises. Accommodation includes activities other than hotels and guesthouses such as camping grounds and caravan parks.

The composition of NACE 55 and 56 is shown below.

Composition of NACE 55 and 56

NACE code: description

55 Accommodation

55.1 Hotels and similar accommodation

55.2 Holiday and other short stay accommodation

55.3 Camping grounds, caravan parks

55.9 Other accommodation

56 Food and beverage service activities

56.1 Restaurants and mobile food service activities

56.2 Event catering and other food service activities

56.3 Beverage serving activities (includes pubs, other bars, fruit juice bars, coffee shops)

The lowest level of disaggregation for which statistics are available in the Labour Force Survey is the two-digit level of the NACE classification. This means that public houses/licensed premises which are in NACE 56.3 are not separately identified and, instead, are included with restaurants and other food service activities. Beverage services are separately identified in the Annual Services Inquiry (ASI) but the separate classification of public houses is not identified. Accommodation in the ASI is classified into a number of sub categories.

The use of some official data is limited by the "age" of the data relative to current inflationary pressures. In effect, the impact of current changes may not be captured by official data which is published with a time lag. This is compounded by the recent and accelerating nature of cost increases and general inflation. Labour costs illustrate this issue. Labour is a very large element of hospitality costs. The most recent CSO labour earnings data for the hospitality sector was published on 31 May 2022 and refers to Quarter 1 2022. At time of writing this report, it is the start of August. Substantial increases in labour cost could have occurred between Quarter 1 2022 and August 2022.

Price data from official sources is relatively up-to-date. At time of writing the latest CSO consumer prices data refer to July 2022 and were published on 11 August 2022. The wholesale price index for June 2022 is available from 22 July 2022. The latest services producers' prices index is available for Quarter 1 2022 and was published on 15 June 2022. Agricultural input and output price indices are available for Quarter 2 2022. However, while the prices data is relatively up to date it does not take into account already announced price increases for the future. For example, some additional energy price increases have already been announced for August. Electric Ireland announced in July increases of 10.9% in residential electricity and 29.2% in gas to take effect from August 1st. Flogas Energy announced that from August 19th residential electricity unit rates will increase by 9.8%, while residential natural gas unit rates will increase by 24.1%. It should also be noted that consumer energy prices are not necessarily a guide to business energy prices and price increases. Electric Ireland said its electricity bills will increase by 26.7% and residential gas bills by 37.5% from October 1. Electric Ireland has announced further increases to its residential electricity and gas bills from 1 October after increasing them in August. SSE Airtricity is increasing its electricity prices by more than 35% and its gas costs by 39% from October.

Interviews by phone were held with operators of restaurants, hotels and public houses to obtain a picture of business cost levels and movements. These were supplemented by discussions with relevant business associations and practitioners servicing the hospitality sector. The absence of official up to date detailed information on business input costs, apart from labour cost, is unfortunate in the context of this project and is in contrast to the detailed and timely data on consumer prices. The absence of such data dictates that the analysis in this report involves a substantial degree of estimation which was informed by the interviews. Most of the analysis was undertaken in the second half of August.

Covid causes difficulties in identifying a reference period with which to compare current costs. Comparing current (August) or recent costs with the same period one year ago is inappropriate because most of the sector was closed or restricted due to Covid regulations and was not operating normally. Wage costs were not “normal” twelve months ago and recorded wage costs and changes in earnings would not have reflected normal operations throughout the Covid restricted period. The same reservation applies when comparing other current costs with any period during the Covid period. The most recent annual normal period before Covid relates to 2019 for a full year and February 2020 for a reference month.

For most businesses, the Covid-related Employment Wage Subsidy Scheme ceased on 30 April 2022 but those businesses that were subject to the public health restrictions of late December 2021 were given an extension of one month to the termination and these were mainly hospitality businesses. For these enterprises, the labour subsidy scheme was ended on 31 May 2022. The period from February to May 2022 is therefore not indicative of “normal” labour costs. Commercial rates were waived for the first quarter of 2022, avoiding part of normal costs for 2022.

In addition, for some hospitality sub-sectors, the volumes of business since the ending of Covid restrictions is above the expected level for this period. This is partly due to pent-up demand from the Covid restrictions. However, this is not the case for all sub-sectors. In June 2022 bar sales as measured by the CSO were only 82.1% of the June 2019 value and 74% of the June 2019 volume.

Two indicators are generally referred to in the measurement of price changes, the average change between two periods and the change at a date compared to the equivalent date one, three or twelve months previously. The latest CSO data show a 9.1% increase in prices in July 2022 compared with July 2021. This was the same for June but the annual changes for earlier months were less, 7.8% in May, 7.0% in April, 6.7% in March, 5.6% in February and 5.0% in January. If we compare average prices throughout January to July, the 2022 figure is 7.2% above the 2021 figure. Of course, the higher July 2022 price continues into the future in the absence of additional increases or decreases.

The approach adopted in this report in examining the impact of the current cost increases is to start with the most recent "normal" year which is 2019, identify the cost elements for 2019 and then apply the recent increases to these cost elements. Of course, hospitality enterprises have also increased the prices of their products over the same period. The impact of the combined cost and revenue increases is identified. The end result is to identify the current operating position of a normal year as illustrated by the 2019 level of business taking account of cost and revenue increases since 2019. In effect, this involves examining the impact of delivering the 2019 level of business at the current costs of business and product prices. This, plus inclusion of additional future price and cost increases in the coming months, illustrates the cost impact coming into 2023.

3. Inflation, cost and economic environment

3.1 Inflation and cost; consumer and producer prices

We examine the overall inflation position for two time periods, the current position relative to the pre-Covid period and the more recent annual and shorter period. The current high inflation rate is very different to the experience of the past several years. The past decade had very small inflation rates. Between 2013 and 2019 the average annual inflation rate was less than 1%. In 2015 and 2020 prices declined slightly and in 2016 there was no change. The inflation rate increased to 2.4% in 2021. This recent medium-term experience contrasts greatly with the very high inflation rates of 13.2% in 1979, 18.2% in 1980, 20.4% in 1981 and 17.1% in 1982. The annual inflation rates for the past five years were 2017, 0.4%; 2018, 0.5%; 2019, 0.9%; 2020, -0.3% and 2021, 2.4%. The current Central Bank inflation forecasts (forecast published on 7 July 2022) for 2022 and 2023, based on the Harmonised Index of Consumer Prices are 2022, 7.8% and 2023, 4.2%. The ESRI is forecasting an inflation rate of 7.1% in 2022 and 4% in 2023 in its June 2022 forecast. Overall prices are expected to continue to increase in 2023.

The rapid acceleration in inflation was unexpected as shown by Budget 22's expectation of an inflation rate of 2.2% in 2022 and 1.9% in 2023. One of the Budget assumptions was a Brent crude oil price of $67.2 per barrel in 2022. The actual price in end July was €110.01 after a peak of €127.98 on 8 March 2022. The sustained and rapid increase in the inflation rate over 2021 and 2022 is shown in Table 3.1. The monthly increase in prices relative to the same month in the previous year is shown. The twelve months' inflation rate (comparing a month with the same month one year ago) remained below 2% up to June 2021. The February 2021 twelve months change in prices was a decline of 0.4%, in March 2021 prices stayed the same compared with March 2020. There was an increase of 1.1% in April and 1.7% in May 2021. The June 2021 12 months' increase was 1.6%. From July 2021 the annual rate of inflation started to increase. The figures were 2.2% in July 2021, 2.8% in August and 3.7% in September. The annual rate increased to 5% or over in each of the months between October 2021 and February 2022. Thereafter the inflation rate increased again from 6.7% in March, 7.0% in April, 7.8% in May, 9.1% in June and 9.1%, the same, in July.

The current Eurostat flash estimate for Ireland for July compared with July 2021 is 9.6% on the HICP basis. The previous monthly annual changes on the HICP basis were 9.6% June, 8.3% May and 7.3% April.

Table 3.1 Annual Irish inflation rate, specific month compared with same month one year ago, % change February 2021 to July 2022

Month	% change over 12 months for Consumer Price Index (%)
2021 February	-0.4
2021 March	0
2021 April	1.1
2021 May	1.7
2021 June	1.6
2021 July	2.2
2021 August	2.8
2021 September	3.7
2021 October	5.1
2021 November	5.3
2021 December	5.5
2022 January	5.0
2022 February	5.6
2022 March	6.7
2022 April	7.0
2022 May	7.8
2022 June	9.1
2022 July	9.1

Source. CSO Consumer Price Index

Several factors are responsible for the high inflation rate. There were several years of low inflation which would eventually come to an end. There were several years of expansionary monetary policy, which many economists would argue, was always capable of eventually generating inflationary pressures. As economies emerged from the Covid restrictions there was substantial pent-up demand and large accumulated savings available for spending. This increase in demand was not matched by an equivalent increase in aggregate supply due to Covid-related disruptions and problems in global and national supply chains. Challenges were already emerging in the energy markets.

The Russian invasion of Ukraine in February 2022 significantly worsened the inflation performance and outlook mainly through the energy and food sectors, especially in energy, but also through more disruptions to supply chains. Russia and Ukraine are significant producers in certain sectors such as wheat, corn, fertilisers, natural gas, oil, sugar beet and sunflower oil. Ireland also had the price increasing effects of Brexit from increased administrative costs of trade and transport costs. In addition, the Irish economy rebounded very well from Covid and the labour market was very strong. It should be noted that Irish inflation was increasing substantially throughout 2021 and early 2022, before the start of the Ukraine war.

The different inflation rates for various products and sectors are outline below. In the wider Eurozone based on the Eurostat July flash estimates the various rates were (for July 2022 compared with July 2021):

- All items HICP 8.9%
- All items excluding energy 5.4%
- All items excluding energy and unprocessed food 5.0%
- All items excluding energy, food, alcohol and tobacco 4.0%
- Food, alcohol and tobacco 9.8%
- Processed food, alcohol and tobacco 9.4%
- Unprocessed food 11.0%
- Energy 39.7%
- Non-energy industrial goods 4.5%
- Services 3.7%

While the annual inflation rate was 8.9%, services inflation was only 3.7% and non-energy industrial goods had an annual price increase of 4.5%. While the latter two price increases are large relative to the experience of the previous decade, they are much lower than the aggregate inflation rate. The main drivers of the high inflation rate are energy and food. Energy prices increased by 39.7% in July compared to one year ago. The food price increase was also high with 11% for unprocessed food and 9.4% for processed food, alcohol and tobacco. The HICP excluding energy, food, alcohol and tobacco increased by only 4% compared to the total HICP increase of 8.9%.

The above discussion considers only the past year. Energy prices were increasing before then. The 39.7% energy price increase reported above is in addition to a euro area energy price increase of 14.3% in the year to July 2021 compared to an overall inflation rate of 2.2% and an unprocessed food price increase of 1.9%.

The Irish annual price increases to July are shown in Table 3.2 for a sample of products. While the hospitality enterprises use a wide range of products as inputs and are therefore exposed both directly and indirectly to much of the general inflationary pressure, they are particularly exposed to energy and food prices.

Table 3.2 Annual inflation rate July relative to July of previous year 2020, 2021 and 2022, food and energy products. % change

Detailed Sub Indices	2020 July	2021 July	2022 July
All items	-0.4	2.2	9.1
Food and non-alcoholic beverages	-1.2	0	7.7
Electricity	-2.7	11.3	40
Natural gas	-7.2	4.9	60.2
Liquid fuels (home heating oil)	-27.3	39.6	91.9

Source. CSO

The all-items inflation was 9.1% in July 2022 compared with July 2021. This is a large increase on the July 2021 to July 2020 rate of 2.2%. Food and non-alcoholic beverages increased by 7.7% in July 2022 compared to a small decrease and no change in July 2020 and July 2021. Electricity price increased by 40.0% in July 2022 which followed a substantial increase of 11.3% in July 2021. Gas increased by 60.2% in July 2022 and a lower 4.9% in July 2021. Home heating oil increased by 91.9% in July 2022 which followed an additional large increase of 39.6% in July 2021.

The above prices are consumer prices. As noted earlier, consumer prices changes are not necessarily an exact equivalent of business prices changes. However, they should broadly indicate the actual or eventual pattern of business prices over a reasonable time period. For example, If the consumer market generates a meat price increase of 11%, why would meat suppliers not attempt to seek similar prices from business customers subject to competitive and other market conditions. However, there are also reasons why the consumer and business prices trends might not coincide. The multiples who dominate the retail grocery sector may not immediately pass on input price increases but suppliers of the hospitality sector would have less scope to delay or avoid passing on input cost increases.

Business often have short-term or annual price contracts with suppliers, sometimes with fixed prices. Consequently, some of the consumer price increases would not be immediately reflective of prices paid by some business for inputs. Of course, one would expect that the renegotiation of supply contracts would reflect the market increase in prices with a time lag. In addition, the two market segments may have different demand conditions which could allow different pricing strategies for business and residential customers. Business, wholesale and producer prices are examined later in this section.

Table 3.3 shows the price increase for the period February 2020 (just before the Covid restrictions) and July 2022 for the same products in Table 3.2

Table 3.3 % price increases February 2020 to July 2022, food and energy products

Detailed Sub Indices	UNIT	2020 February	2022 July	% Change
All items	Base Dec 2016=100	102.3	113.6	11.0
Food and non-alcoholic beverages	Base Dec 2016=100	96	103.2	7.5
Food	Base Dec 2016=100	95.8	103.3	7.8
Electricity	Base Dec 2016=100	112	170.2	52.0
Natural gas	Base Dec 2016=100	111.8	177.7	58.9
Liquid fuels (home heating oil)	Base Dec 2016=100	105.7	215.1	103.5

Source. CSO

Over the period from just before Covid to July 2022, overall prices increased by 11.0%. The price of food and non-alcoholic beverages increased by 7.5%. Electricity price increased by 52.7%, natural gas increased by 58.9% and heating oil increased by 103.5%.

Price increases for the twelve months to July 2022 and the February 2020 to July 2022 period for certain specific foods of particular relevance to the hospitality sector are shown in Table 3.4.

Table 3.4 % Price increases for 12 months to July 2022 and increases February 2020 to July 2022 for certain food products.

Detailed Sub Indices	% increase July 2022 to July 2021	% increase Feb 2020 to July 2022
Food and non-alcoholic beverages	7.7	7.5
Food	8.1	7.8
Beef and veal	11.3	6.0
Poultry	13.4	13.1
Fish	5.4	7.0
Oils and fats	17	16.8

Source. CSO

The price of food increased by 8.1% in the year to July 2022. Beef and veal increased by 11.3%, poultry price grew by 13.4% and fish increased by 5.4%. The price of oils and fats grew by 17.0%. The price of beef and veal together grew by 11.3% in the 12 months to July 2022 but by only 6.0% in the February 2020 to July 2022 period. This apparent contradiction is explained by a reduction in beef prices between February 2020 and July 2021 of 4.7% and an increase of 11.3% between July 2021 and July 2022. This gives a February 2020 to July 2022 increase of 6.0%. (See table 3.5)

Table 3.5 Changes in beef and veal prices within February 2020 and July 2022 period

Month	UNIT	VALUE
2020 February	Base Dec 2016=100	95.1
2020 July	Base Dec 2016=100	92.5
2021 July	Base Dec 2016=100	90.6
2022 July	Base Dec 2016=100	100.8

Source. CSO

The price changes between July (the current prices) and the average price level in 2019 are shown in Table 3.6. Food increased by 6.9%, beef and veal increased by 4.1%, electricity increased by 52.6% and natural gas increased by 57.4%. This compares to the overall index price increase of 11.3%.

Table 3.6 Price change between average 2019 level and July 2022

	Average index 2019	July 2022 index	% change
Food and beverages	96.9	103.2	6.5
Food	96.6	103.3	6.9
Beef and veal	96.8	100.8	4.1
Poultry	94.4	106.4	12.7
Electricity	111.5	170.2	52.6
Gas	112.9	177.7	57.4
All items	102.1	113.6	11.3

Source. CSO

The following table identifies the annual price changes for a range of food products. Food prices started to accelerate in December 2021. In that month food prices were 1.3% higher than December 2020. This increase to 2% in January, 2.9% in February, 3% in March and 3.5% in April. Food prices in May 2022 were 4.5% higher than a year ago, 6.8% in June and 8.1% in July. Beef and veal prices declined in 2021. By May 2022 beef and veal process were 4.7% higher than a year ago. The June and July figures were 7.3% and 8.2% respectively. Poultry prices increased more rapidly. The February annual price increase was 4.7%. This increased to 6.9% in March,7% in April, 10.2% in May, 13.6% in June and 13.4% in July.

Table 3.7 Annual % consumer price changes in certain food products for months July 2021 to July 2022

Statistic	Month	UNIT	All items	Food	Beef and veal	Poultry
Percentage Change over 12 months for Consumer Price Index	2021 July	%	2.2	-0.1	-2.1	0
Percentage Change over 12 months for Consumer Price Index	2021 August	%	2.8	0.1	-2.9	0.5
Percentage Change over 12 months for Consumer Price Index	2021 September	%	3.7	0.3	-1.8	1.1
Percentage Change over 12 months for Consumer Price Index	2021 October	%	5.1	0.6	-1.7	0
Percentage Change over 12 months for Consumer Price Index	2021 November	%	5.3	0.6	-3.6	2.3
Percentage Change over 12 months for Consumer Price Index	2021 December	%	5.5	1.3	-0.5	3.5
Percentage Change over 12 months for Consumer Price Index	2022 January	%	5	2	0.2	3.6
Percentage Change over 12 months for Consumer Price Index	2022 February	%	5.6	2.9	2.2	4.7
Percentage Change over 12 months for Consumer Price Index	2022 March	%	6.7	3	2.9	6.9
Percentage Change over 12 months for Consumer Price Index	2022 April	%	7	3.5	4.7	7
Percentage Change over 12 months for Consumer Price Index	2022 May	%	7.8	4.5	7.3	10.2
Percentage Change over 12 months for Consumer Price Index	2022 June	%	9.1	6.8	8.2	13.6
Percentage Change over 12 months for Consumer Price Index	2022 July	%	9.1	8.1	11.3	13.4

Source. CSO

The recent performance of producer or industrial prices is identified below. The figures which are presented refer to the June 2022 relative to June 2021 increase and refer to products of relevance to the hospitality sector. Food products increased in price by 10.2%. Meat and meat products increased by 14.5%. Dairy products increased by a very large 49.1%. Fish increased by 7.9% Vegetable and animal oils and fats grew by 4%. The overall price of goods manufactured for the home market increased by 8%. The broad implication of the data is that prices of inputs for hospitality firms increased significantly in the year to June 2022 alongside the increase in consumer prices. The producer/industrial food price increases for the year to June 2022 is larger than the consumer price increase.

Table 3.8 Producer/industrial % price changes June 2022 relative to June 2021, various products

Industry Sector NACE Rev 2	VALUE %
Food products (10)	10.2
Meat and meat products (101)	14.5
Fish, crustaceans and molluscs (102)	7.9
Vegetable, animal oils and fats (104)	4
Dairy products	49.1
Manufacture of beverages (11)	5
Manufacturing industries (home sales)	8

Source. CSO

In the period February 2020 to June 2022 the producer/industrial price of food increased by only 2.8% which is lower than the consumer price increase. The difference between the two periods is explained by the decrease in producer food prices between February 2020 and December 2020 of 9.9% followed by an increase between December 2020 and June 2022 of 14.1%. However, meat prices increased greatly in the February 2020 to June 2022 period by 24%. Dairy products increased by an even larger 56.0%

Table 3.9 % Increase in producer prices food and meat February 2020 to June 2022

Industry Sector NACE Rev 2	UNIT	2020M02	2022M06	% increase
Food products (10)	Base 2015=100	105.5	108.5	2.8
Meat and meat products (101)	Base 2015=100	96.6	119.8	24.0
Dairy products	Base 2015=100	109.6	171.0	56.0

Source. CSO

If the average 2019 producer price level is compared with June 2022 the producer/wholesale food increase is 7.3% and the meat increase is 25.2%. Over the same period dairy products producer price increased by 56.3%.

The recent monthly progression in annual producer prices inflation is shown in Table 3.10. For food as a whole, the largest monthly annual change was May 2022 with an increase of 11.4% compared to one year ago. Price increases were large from August 2021. The meat producer price increase was high for each of the months in the table. The July 2021 yearly change was 13.7%. The November 2021 annual increase was 19.25. The January 2022 annual increase was 21.9%. In the more recent months the annual change was 16.9% in May 2022 and 14.5% in June 2022.

Table 3.10 Annual % producer price changes in food and meat products for months July 2021 to June 2022

Month	Food products (10)	Meat and meat products (101)	
2021M07	1.8	13.7	
2021M08	4.7	13.7	
2021M09	5.6	15.1	
2021M10	6.1	15.3	
2021M11	6.8	19.2	
2021M12	3.2	16.1	
2022M01	6.5	21.9	
2022M02	4.8	18.4	
2022M03	6	17.6	
2022M04	8.8	17	
2022M05	11.4	16.9	
2022M06	10.2	14.5	

Source. CSO

The wholesale price of electricity increased by 91.3% in the year to June 2022 compared to the consumer electricity price increase over the same period of 40.9%.

The Sustainable Energy Authority of Ireland publishes average residential and business energy prices which are examined below. Unfortunately, the latest data refer to the second half of 2021. The data relating to the first half of 2022 will not be available until later in the year.

Table 3.11 SEAI Weighted average residential and business energy price increases July-December 2021 compared to July to December 2020, % change

Energy	Residential	All business, excluding the highest band users	Lowest band business users (e.g. less than 20 MWh electricity)
Electricity	13.2	40.6	13.9
Gas	12.1	77.2	23.8

Source. SEAI, Electricity and gas prices in Ireland

The business energy price increases exceed the household increases in the period covered in the table. However, almost all hospitality businesses would be in the lower band of business energy users. For this category, the business electricity price increase of 13.9% slightly exceeds the household increase of 13.2%. There is a large difference in gas. Households' gas price increased by 12.1% while the lowest band of business gas users had a price increase of 23.8%, more than double the household increase.

3.2 Summary of consumer and producer price changes

The overall prices information for food and energy is summarised below.

- The overall rate of inflation was 9.1 % in July 2022 compared with July 2021
- The consumer price of food increased by 8.1% in July 2022 compared with July 2021
- The consumer price of beef and veal increased by 11.3% in July 2022 compared with July 2021
- The consumer price of poultry increased by 13.4% in July 2022 compared with July 2021
- Electricity price increased by 40.0% in July 2022 compared to July 2021 which followed a substantial increase of 11.3% in July 2021.
- Gas increased by 60.2% in July 2022 and a lower 4.9% in July 2021.
- Home heating oil increased by 91.9% in July 2022 which followed an additional large increase of 39.6% in July 2021.
- The consumer price increases between July (the current prices) and the average price level in 2019 are food 6.9%, beef and veal 4.1%, poultry 12.7%, electricity 52.6% and natural gas 57.4%. This compares to the overall index price increase of 11.3%.
- Additional increases were announced for gas and electricity to take effect in August
- In the period February 2020 to June 2022 the producer/industrial price of food increased by only 2.8% and this is explained by the decrease in producer food prices between February 2020 and December 2020 of 9.9% followed by an increase between December 2020 and June 2022 of 14.1%. However, meat prices increased greatly in the February 2020 to June 2022 period by 24%.
- In the year June 2022 relative to June 2021 based on producer prices, food products increased in price by 10.2%. Meat and meat products increased by 14.5%. Dairy products increased by 49.1%. Fish increased by 7.9% Vegetable and animal oils and fats grew by 4%.
- If the average 2019 producer price level is compared with June 2022 the food increase is 7.3%, dairy increased by 56.3% and the meat increase is 25.2%.
- The business energy price increases exceed the household increases in the period July to December 2021 and 2020. In the lower volume band of business energy users, the business electricity price increase of 13.9% slightly exceeds the household increase of 13.2%. There is

a large difference in gas. Households' gas price increased by 12.1% while the lowest band of business gas users had a price increase of 23.8%, more than double the household increase.

3.3 Labour market and the economy

Along with most other sectors of the economy the hospitality sector faces challenges in recruiting staff. This has already put pressure on payroll costs which disproportionately affects hospitality because it is a labour intensive sector. This will continue to be the case at present and will continue for some time in the absence of a significant deterioration of the labour market. The Grant Thornton International Business Report research carried out in the second half of 2021 found almost two-thirds (63%) of Irish businesses report access to a skilled workforce as a significant constraint to the growth and development of their business compared to the 37% of businesses who reported the same in the first half of 2021.

Due to the tight labour market the survey reported that 56% of businesses regard labour costs as a constraint to growth, compared to 27% who reported the same in the first half of 2021. The shortage of labour in hospitality is not due solely to wage levels. As shown above, it is an economy wide issue. Shortages exist for higher paid manager positions as well as lower skill jobs in hospitality. Reasons include the long closures experienced by hospitality relative to other sectors and the fear that this may arise again, the return to their home countries or move to other countries of some overseas hospitality workers, job opportunities with better conditions such as daytime work in other sectors, the cost and limited availability of housing in Ireland relative to other locations.

The overall labour market is tight with the economy at or close to full employment. The most recent CSO estimate of monthly unemployment reports an unemployment rate of 4.2% for July 2022.

The economy has performed very well in job creation since Covid. In Quarter 1 2019 total employment was 2.320 million and in Quarter 1 2022 this had increased to 2.5322 million, an increase of 9.1% or over 200k jobs. Hospitality employment, defined by the CSO accommodation and food services activities sector, employed 178.3k people in Quarter1 2019 and this compares with 166.4k jobs in Quarter 1 2022, a decrease of almost 12k. Labour shortages are reported throughout the hospitality sector. The Kroll's Business Sentiment Survey of the restaurant sector (in September 2021) reported that 94% of respondents had difficulty recruiting staff and 65% reported that staff shortages were the reason for reduced opening hours and lower volumes of actual business compared to potential business. Dublin publicans report that the main trading change post-Covid is in reduced hours of service and, in some cases, closure in the early part of the week, due to a shortage of staff. Outside of Dublin reduced hours of opening due to staff shortages is also a feature of the post-Covid situation.

In its Spring 2022 review of the hotel sector Failte Ireland noted that the challenge as demand returns in 2022 will be the recruitment and retention of staff and coping with higher wage costs in certain areas, due to increased expectations around pay and conditions. Failte Ireland reports in its February 2022 labour market research that there are 40k job vacancies in hospitality and tourism of which 24% are at senior level. 88% of hospitality enterprises have considerable difficulty in hiring chefs and culinary staff. The equivalent figure is 70% for bar service, 62% for waiters and waitresses and accommodation services 59%. The retention of hospitality staff is also a problem. In terms of per cent of enterprises which report considerable difficulty in retaining staff the figures are chefs/culinary 51%, accommodation services 55%, waiters and waitresses 42% and bar service 41%.

The 2022 second quarter earnings data were published by the CSO on August 30 just as this report was being completed. There are substantial and unexpected differences between the Quarter 1 and Quarter 2 hospitality earnings data. Private sector average hourly earnings were €25.91 in Quarter 1 2022 which was an increase of 15.5% since Quarter 1 2019. Covid period earnings data are imprecise and subject to interpretation. Hospitality earnings growth kept pace with the overall private sector in the year to Quarter 1. Hospitality hourly earnings were €15.45 in Quarter 1 2022 which is an increase of 15.9% since Quarter 1 2019's level of €13.33. The average hospitality hourly earnings in 2019 (the average of the four quarters) was €13.42. The Quarter 1 2022 €15.45 is 15.1% greater than the 2019 average. This led us to expect that the earnings increase between July/August 2022 and 2019 would be substantially greater than 15% and could be about 20%.

However, according to Quarter 2 CSO earnings data there was a drop in hospitality hourly earnings between Quarter 1 (€15.45) and Quarter 2 (€15.05) but this is probably due to the Covid-related data issues. It was also unexpected relative to the general public discussion on hospitality staffing and labour earnings. Between Quarter 2 2022 and Quarter 2 2019 hospitality earnings increased by 13.2% and the increase between Quarter 2 2022 and the average of 2019 was 12.1%. The latest Quarter 2 data on hospitality earnings has led to a downward revision of our estimate of the increase from 2019 to date. The Quarter 2 data are an average of that period and increases have probably also continued after Quarter 2. Consequently, the estimates of costs increases presented in Section 7 up to August are prepared on the basis of a 15% increase in labour costs between 2019 and currently.

The hospitality sector will face higher labour costs in the future beyond 2022 because of labour market pressures and regulatory/public policy factors.

4. Economic characteristics of the hospitality sector

The pre-Covid 2019 economic characteristics of the hospitality sector (accommodation and food service activities) are outlined in this section. The main source is the Annual Services Inquiry undertaken by the CSO. The economic characteristics also provide insights into the business model and cost structure of the sector. Table 4.1 contains data on the number of enterprises, turnover, production value (which is an approximation of gross margin which is turnover less cost of sales), personnel costs (which includes all labour cost including employer PRSI), gross value added and persons engaged.

There are 19,418 enterprises and a total of 222,716 persons engaged in the sector. This gives an average size of 11.5 persons. The more usually referenced source for hospitality employment is the Labour Force Survey which recorded an employment level of 179k persons in Quarter 4 2019. This is much lower than the Annual Services Inquiry total. Payroll cost is 31.8% of turnover and 78% of gross value added. Gross margin is 65.4% of turnover.

According to the CSO purchases include both the value of goods and services acquired for resale and operating expenses. Production value is an equivalent of Gross Profit (Margin) and Gross Value Added is an equivalent of Value Added at Factor. Personnel costs include wages and salaries, superannuation and employer PRSI.

Operating expenses include all expenses of the enterprise during the year including commercial rent, if any, except for, purchases for resale, personnel costs/wages, capital items and expenditure classified as financial and banking interest and depreciation/amortisation. Clearly, labour cost is a large component of the business model in hospitality.

Table 4.1 Economic characteristics of the hospitality (accommodation and food service activities) sector 2019

Year	Distribution and Service Enterprises (Number)	Turnover (Euro Thousand)	Production Value (Euro Thousand)	Personnel Costs (Euro Thousand)	Gross value added at factor cost (Euro Thousand)	Persons Engaged (Number)	Gross margin/ Production value as % of turnover	Labour cost as % of turnover
2019	19418	12597151	8242768	4009361	5142140	222716	65.4	31.8

Source. CSO

The breakdown of the hospitality sector into its components of accommodation, restaurants, beverage serving and others is done in Table 4.2. Restaurants and mobile food services account for 86,694 persons or 38.9% of total employment in the sector. Hotels and similar accommodation have 67,306 persons engaged or 30.2% of the sector’s employment. Beverage serving activities have 47.868

jobs or 21.5% of the sector. Event catering and other food service activities employ 16,613 persons, other accommodation has 1,644 persons and the two smaller accommodation components are 1,422 (holiday and other short- stay) and 1,169 (camping grounds, recreational vehicle parks and trailer parks.

Table 4.2 Component activities of the hospitality sector, employment and turnover, 2019

NACE Rev 2 Sector	Turnover (Euro Thousand)	Persons Engaged (Number)
Accommodation (55)	4551820	71541
Hotels and similar accommodation (551)	4230944	67306
Holiday and other short-stay accommodation (552)	100269.9	1422
Camping grounds, recreational vehicle parks and trailer parks (553)	96414.84	1169
Other accommodation (559)	124191.1	1644
Food and beverage service activities (56)	8045330	151175
Restaurants and mobile food service activities (561)	4409451	86694
Event catering and other food service activities (562)	925437.1	16613
Beverage serving activities (563)	2710442	47868

Source. CSO

The small enterprise nature of the sector is illustrated by Table 4.3. 76.8% of hospitality enterprises have less than ten persons engaged. 19.3% have between 10 and 49 persons engaged. 4% have between 50 and 249 persons engaged and 0.4% of enterprises have 250 or more persons engaged. The average size of enterprise in the category below ten persons engaged is three persons. The average size in the 10-49 persons' category is 19.7 persons.

Table 4.3 Size structure of the hospitality sector by persons engaged 2019

Persons Engaged	Number of enterprises	% of total	Persons engaged	Average size in size class
0 - 9	14905	76.8	44814	3.0
10-49	3746	19.3	73965	19.7
50 - 249	697	4.0	68683	98.5
250 and over	70	0.4	35254	593.6
Total	19418	100	222716	11.5

Source. CSO

Revenue Commissioners' data is available on the size distribution of public houses measured by revenue. It reinforces the information on the small size of the hospitality enterprises.

The vast majority of public houses are small operations. The number and percentage of pubs and bars in each of the six licensing net turnover bands classified by Revenue are shown below for 2018. The very notable features are the small number with high levels of sales and the very large number and proportion with low levels of sales. Only 8.6% of publican licences have average annual sales of €952.5k or higher. On the other hand, 49.5% of public houses (treating the publican licences as equivalent to public houses) or 3923 enterprises have annual sales of under €190.5k. 73% of publican licences were in the less than €381k category in 2018.

Table 4.4 Pubs and bars in each turnover band for licensing 2018 (net sales)

Turnover band €k	Number of licences	% of licences
Under 190.5	3,923	49.5
190.5-380.999	1,862	23.5
381.0-634.999	881	11.1
635.0-952.499	499	6.3
952.5-1,269.999	291	3.7
1,270.0 or more	466	5.9
Total	7,922	100

Source. Answer to parliamentary question

From the costs perspective very small enterprises may have more difficulty coping with cost increases than larger enterprises. Small enterprises would have less market power versus inputs suppliers and may face scale-related difficulties, such as knowledge, finance and pay-back period, in investing in, or availing of, cost reducing new technologies.

Table 4.5 examines the differences in gross margin in the four size categories of hospitality enterprises. The sector average is 65.4%. The largest size group, 250 persons and over has a gross margin of 65.7% which is close to the sector average. The highest gross margin is in the 50-249 persons' size classification. The two smallest size categories each have lower gross margins than the other two categories, 62.6% and 62.5%.

Table 4.5 Gross margin in different hospitality size categories, 2019

Size, persons engaged	Turnover	Production value	Gross Margin %
0 - 9	2343125	1466720	62.6
10-49	4166868	2603730	62.5
50 - 249	4011204	2808108	70.0
250 and over	2075953	1364210	65.7
All	12597151	8242768	65.4

Source. CSO and derived from CSO Annual Services Inquiry data.

5. Competitiveness features of the Irish economy

The National Competitiveness Council in its press release on its May 2022 Bulletin on "Inflation and the Competitiveness of Irish Enterprises" stated that a

"*significant competitiveness challenge facing businesses today is the high inflation environment and rising input prices. This is damaging to the enterprise sector if the sudden rise in the costs of doing business cannot be absorbed by some firms, resulting in the closure of otherwise viable enterprises. Many businesses, including SMEs, around the country are seeing their margins squeezed by the rising costs of doing business, and in particular the significant increase in energy costs.*"

This challenge is significantly felt by the hospitality sector. In addition to the current high and unexpected inflation rate and increase in input costs, there are several longstanding negative issues relating to overall and hospitality sector competitiveness. Economy wide competitiveness issues have an impact on the hospitality sector through the prices of inputs and other specific competitiveness issues directly affect the hospitality sector. These have been recently reviewed by Failte Ireland and ITIC and are summarised below.

Overall price level is high in Ireland

Ireland is a high-cost high price economy, with a high general the cost of doing business. Using the Eurostat measure of price level for final household consumption in 2021 with the EU measured as 100, Ireland, along with Denmark, were the most expensive countries in the EU in which to live. Consumer costs in Ireland and Denmark were 40% above the EU average. Luxembourg was next at 132, followed by Sweden at 128 and Finland at 126. The Netherlands was on an index of 116 which was 83% of the Irish cost of living. France was 113 and Germany was 108. Spain was at 97, 69% of the Irish cost of living.

Hospitality price level is high in Ireland

Following on from the high overall Irish price level, certain hospitality related products are also priced highly. Hotel and restaurant prices in Ireland were 30% above the European average, alcoholic beverages and tobacco prices almost double, and transport services 39% higher than the EU average.

Labour costs are relatively high in Ireland

Ireland, in 2021, had the 4th highest labour costs in the EU at €30.10 per hour on average which is 37% above the EU27 average of €21.90. Higher cost EU economies are Denmark, Luxembourg and Belgium. Ireland, in July 2022, had the third highest minimum wage in the EU after Luxembourg and Belgium. At €17.60 per hour, Ireland's accommodation and food services sector labour cost is 33% above the EU average for the sector of €13.20.

Electricity

Historically, electricity prices in Ireland have been relatively high compared to the EU average. In the second half of 2021 non-household electricity prices in Ireland were 60% above the EU average.

Indirect taxes; VAT and alcohol excise

Alcohol is a substantial part of tourists' expenditure. Ireland's alcohol excise is very high compared to other EU economies and the UK. Ireland has the highest wine excise in the EU27 and UK.

Ireland has the second highest beer excise in the EU 27 and UK behind Finland.

Ireland has the third highest spirits excise in the EU 27 and UK behind Sweden and Finland. Fifteen EU economies do not impose any excise on wine. In addition, France and Malta have very low wine excise tax. On an overall composite alcohol excise level (measured by the unweighted average of the different beer, spirits and wine excise rates), Ireland is the second highest behind Finland. The magnitude of the differences in alcohol excise between Ireland and other EU economies is large. For example, Ireland's beer excise is 11.4 times that of Germany. Irish spirits excise is 4.4 times that of Spain. There is a substantial difference between the alcohol excise levels of the four highest alcohol taxed economies, Finland, Ireland, Sweden and the UK, and the remaining 24 countries. Finland's composite rate per HLPA is 22.1% higher than Ireland's, €4222 compared to Ireland's €3458. Sweden's composite rate is 13.0% below the Irish rate and the UK rate is 15.8% below the Irish rate.

Lithuania has the fifth highest composite excise rate of €1530 and is 55.8% below the Irish rate. Germany's composite alcohol excise per HLPA is €500 or 14.5% of the Irish level of €3458. France's composite level of €871 is 25.2% of the Irish level. Spain's composite rate is €386 or 11.2% of the Irish level. Application of the German beer excise rate to Ireland would reduce the price of a pint of stout in a public house by 11.7%, the price of a glass of wine in a restaurant by 14.0% and the off- licence price of a bottle of whiskey by 37.3%. In Spain, the excise on a bottle of whiskey is €2.69 which is €9.23 lower than in Ireland.

If German alcohol excise rates were applied to Ireland, Irish annual excise revenue would total €178.7m instead of €1,232.6m. (Based on 2019 pre-Covid receipts). Ireland pays an estimated €1,053.9m more annually in alcohol excise tax than German rates would produce.

The standard VAT rate of 23% is relatively high by EU standards. Only six of the other 27 countries (EU and UK) have higher rates than this and range between 24% (Greece and Finland) to 27% (Hungary). Denmark, Sweden and Croatia are each on 25%. Portugal and Poland each have VAT rates of 23%, the same as Ireland. The other nineteen countries have lower standard VAT rates Ireland. The current 9% VAT rate for hospitality is competitive compared to other EU economies but a return to the 13.5% reduced rate would leave Ireland with the sixth highest rate for meals and the fourth highest for accommodation.

Interest rates

Irish mortgage rates are high by EU standards. The average interest rate on new mortgages in the Irish market was 2.77 per cent in April 2022 compared to the euro zone average of 1.59 per cent.

It should also be noted that Ireland has a relatively low rate of corporation profits tax and a low rate of employer PRSI which contribute to the competitiveness of enterprises.

6. Revenue developments

This section examines the revenue developments in the hospitality and drinks sector over the period from 2019 to currently. Revenue is determined by price and quantity of product sold. The CSO CPI is used, with some adjustments, to identify changes in hospitality consumer prices. The price increase in accommodation is notable with an annual increase of 21.7% in July 2022. Between February 2020 and July 2022 the increase was 48.1%.

Table 6.1 Recent consumer price increases, hospitality products

	2020 February	2022 February	2022 July	% change Feb 20 to July 22	% change Feb 22 to July 22	% change July 2021 to July 2022
All items	102.3	107.6	113.6	11.0	5.6	9.1
Alcoholic beverages - off licences	99	106.3	107.9	9.0	1.5	9.0
Restaurants, cafes and the like	107.8	113.3	117.9	9.4	4.1	5.6
Licensed premises	106.7	110.7	114.9	7.7	3.8	5.0
Spirits - licensed premises	107.6	113.2	117.3	9.0	3.6	5.0
Wine - licensed premises	106.2	109.3	113.4	6.8	3.8	5.3
Beer - licensed premises	106.5	110.7	115.1	8.1	4.0	4.7
Soft drinks and mineral water	108.2	112.3	116	7.2	3.3	6.2
Accommodation services	108.5	118.2	160.7	48.1	36.0	21.7

Source. CSO

Hotel room prices are subject to strong seasonal pressures and summer prices tend to be higher than much of the rest of the year. In 2019, based on the December 2016=100 index, the accommodation prices ranged from an index of 101.1 in January to 128 in August with July being the third highest month at 125.8. The index dropped from 128 in August to 108.6 in December. Consequently, it is inappropriate to use the Feb 2020 to July 2022 accommodation price change or the average 2019 to July 2022 price change, as an indicator of revenue and price growth. The 2019 monthly pattern is shown in Table 6.2. The index values for July for 2018 were 124.3, 2019 125.8, 2020 116.9, 2021 132.1 and 2022 160.7. If the July 2019 to July 2022 index values are used the per cent increase is 27.7%. The seasonal pattern in restaurants is mainly a December increase relative to the rest of the year. The seasonal pattern in on-licence alcohol prices is not an issue for the analysis.

The 2019 average licensed premises index was 106.1 and July 2022 is 8.3% higher than this. The restaurant's increase relative to the average of 2019 is 10.2%. The accommodation increase is 37.8% but this is subject to the seasonal issue.

The accommodation services price change refers to various kinds of accommodation but we assume the price change can be applied to hotels. However, hotels revenue comes from food and beverages in addition to accommodation. The CSO states that "Accommodation services excludes catering services except for breakfast or other meals included in the price of the accommodation. So meals are only included if they are included in the original price the consumer books". In estimating the recent revenue changes on the hospitality model allowance should be made for this.

The estimates refer to the specific three sectors as opposed to particular products of the sector.

The Crowe hotel survey mentioned in section 7 reports that in hotels, rooms accounted for 44.2% of revenue, food accounted for 31.4%, beverages accounted for 16.5% and other sources of revenue were 7.8% of the total.

The overall accommodation sector is probably more dependent on rooms revenue than the Crowe survey participants and we assume the following breakdown in estimating the average price increase rooms 60%, food 27%, beverages 11% and other 2%. Based on price changes for each product of 27.7%, 10.2%, 8.3% and 10% we get the following average price increase for the hotel and similar accommodation sector of 20.5%. However, there should be a major doubt about the likelihood of the current high room rates continuing into 2023 when the pent up demand arising from Covid is reduced and when the refugee determined spike in demand for hotel accommodation is reduced. On an assumption of room rates continuing at 20% higher than the 2019 level, the aggregate hotel price or average revenue increase is 15.9% relative to 2019. A room rate increase of 18% relative to 2019 gives an overall hotel price increase of 14.7% for the period.

We can compare the CSO data on accommodation price increases with Failte Ireland and industry data for the first half of 2022. The Failte Ireland June Hotel Survey reported an increase of 24% in the average June room rate compared with June 2019. The CSO figure for the same period was an increase of 18.4%.

The Dalata Hotel Group half yearly results report an average room rate increase of 15% between HI 2019 and H1 2022. This compares with much the same increase of 14.9% over the same period from the CSO.

Based on the above considerations of seasonal pattern and the role of products in addition to accommodation we assume an ongoing price increase of 15% for the hotel sector compared with 2019 when calculating revenue in section 7.

The equivalent price increases for revenue calculation purposes for restaurants and public houses are based on the different food and beverages shares of sales and are, for restaurants 9.6%, and 8.6% for public houses and bars.

Table 6.2 Monthly seasonal pattern of accommodation prices 2019

Month	Consumer Price Index (Base Dec 2016=100)
2019 January	101.1
2019 February	106
2019 March	113.2
2019 April	116.3
2019 May	120.3
2019 June	126.5
2019 July	125.8
2019 August	128
2019 September	124.2
2019 October	118.1
2019 November	111.2
2019 December	108.6

Source. CSO

The objective is to assess the impact on the hospitality cost/business model of the recent cost increases in labour, beverages and food inputs and operating expenses. Consequently, the performance of the volume of business is not an issue. We use 2019 as a base against which to assess the cost increases on that performance. Business volume changes affect individual and overall costs but do not have to be included in the exercise but the price of the given volume is of relevance.

7. The hospitality business model and recent cost increases

7.1 Overview from Annual Services Inquiry (ASI)

Our focus is on the three activities of hotels and similar accommodation, restaurants and mobile food service activities and beverage serving activities. Table 7.1.1 presents the main elements of the business models for the three sectors. As with all large aggregates, the figures are totals and averages. Actual values for individual enterprises are dispersed around the average. For example, the gross margin of 63.1% for restaurants is an average of individual values which are higher and lower than the average. There is a wide variety of enterprises with different cost models within the overall hospitality cost model. Some hotels have swimming pools with larger water costs and some do not. Hotels have higher water costs than pubs and restaurants because of the accommodation element of the business. Some public houses are drink only operations with lower gross margins than public houses with a food element. Some enterprises have mortgages and some do not. As was evident from the survey, some enterprises have invested substantially in equipment and systems which improve the efficiency of water and energy usage. For example, the IHF has published information on a hotel which reduced its annual water consumption by 4,800 m^3 per year (28 %), reducing its water bill by €10,914 per year. Measures which were implemented included:

- *all taps were fitted with aerators which reduced water flow from 8.5 litres per minute to 5.5 litres per minute*
- *Toilet cisterns were adjusted from a flush of 6.5 litres to 5 litres*
- *All taps in public toilets were replaced with automatic push taps*
- *Urinal flushes were adjusted from 1 every hour to 1 every 2.5 hours*
- *A carbon filter and flocculent dosing system was installed in the plant room for chemical dosing of the pool water, reducing the number of times required to back wash the pool*
- *A harvesting tank was installed to service the public toilets, collecting 250,000 litres of rainwater per year*

More modern equipment such as dishwashers, fridges and cookers are more energy efficient than older equipment. But, of course, many small hospitality businesses are not in the financial position to engage in this level of investment.

Some hospitality enterprises are, or were recently, in fixed price energy contracts which would delay the imposition of the recent energy price increases. However, the impact of the new higher prices is felt when the contract ends. Other enterprises had to bear the energy price increases as they arose.

The gross margins reported in the ASI for 2019 are 63.1% in restaurants, 63.6% in beverage services and 70.0% in hotels. Our interviewee enterprises had gross margins which ranged from 53% (very small public house to 78% (hotel). Purchases, excluding labour, which include operating expenses purchases and cost of sales purchases as a per cent of turnover are 59.5% in restaurants, 58.6% in beverage serving and 55.7% in hotels. Personnel costs are 33.3% of turnover in restaurants, 31.6% in hotels and 28.9% in beverage serving. The combination of personnel costs and purchases is a measure of the cost of doing business except for depreciation and interest payments. Consequently, turnover less this measure results in the financial resources available for profits, interest payments and depreciation and this ranges from 12.7% for hotels and 12.5% for beverage serving to 7.2% in restaurants.

Table 7.1.1 Main elements of hospitality cost model 2019

Statistic	UNIT	Hotels and similar accommodation (551)	Restaurants and mobile food service activities (561)	Beverage serving activities (563)
Turnover	Euro Thousand	4230944	4409451	2710442
Gross margin % of turnover	%	70.0	63.1	63.6
Personnel costs relative to turnover %	%	31.6	33.3	28.9
Purchases relative to turnover %	%	55.7	59.5	58.6
Cost of sales relative to turnover	%	30.0	36.9	36.4
Purchases included in gross margin (purchases –cost of sales) relative to turnover	%	25.8	22.6	22.2
Personnel costs plus purchases relative to turnover %	%	87.3	92.8	87.5
Margin available for profit, depreciation and interest as % of turnover	%	12.7	7.2	12.5

Source. CSO, Annual Services Inquiry and derived from CSO data

7.2 Hotels business model profile from Hotel Industry Survey

According to the Crowe Annual Hotel Industry Survey for 2020 (with data for 2019) rooms accounted for 44.2% of revenue, food accounted for 31.4% and beverages accounted for 16.5%. Other sources of revenue were 7.8% of the total. Payroll accounted for 36.1% of revenue. The ASI figure was 31.6%. However, the Crowe survey is more representative of larger enterprises and the ASI category is hotels and similar accommodation. Utility costs (energy, water and waste) accounted for 4.0% of revenue. Hotels in the survey averaged just under 4% for energy.

7.3 Cost model information from interviews with hospitality enterprises, services professionals and industry associations

Some of the main points from the telephone interviews with hospitality entrepreneurs and managers are identified below. The phone interviews with hospitality enterprises reported substantial increases in labour salary and wage rates, substantial increases in the cost of light and heat, increases in food inputs prices and increases in the price of beverage inputs. Hotels reported very large price increases for linen services. There was a mixed response to insurance costs with some experiencing large increases, others had price decreases ((because of specific circumstances) and others had small price increases.

The wages increase is of particular relevance because of the large role of wages in the hospitality cost model and the large increase in rates of pay. The pay increases which were reported relative to 2019 were larger than expected and larger than indicated by official data, Particular issues in the recruitment of chefs and other kitchen staff were mentioned. Individual responses (some referred to specific occupations and some referred to general labour cost) included: increase of 28.6%, increase of 19%, increase of between 25% and 30%, increase of 26.7%, increase of 20%, increase of 25%, increase of 33% and increase of 15%. As discussed earlier, the labour cost estimate used in the analysis is 15% which is largely based on CSO data.

Substantially higher price increases for meat were reported in some of the interviews compared to the consumer price index. Increases which were identified were, beef brisket 45%, beef in loin 7%, beef filet 17%, chicken fillets 21% for Irish product and 40% for Dutch, chicken wings 36%, fish 13% and flour 39%. However, some of these prices are comparable to some of the producer price increases. For example, the June 2022 annual CSO wholesale food price changes were 10.2% for all food, 14.5% for meat and 49.1% for dairy. The CSO consumer price increases for the year to July 2022 were food 8.1%, meat 11.1 of which poultry was 13.4%. Fresh milk increased in price by 21.2%%. Some of the cost information from the interviews referred to the most recent performance, other information referred to the most recent annual increase and some referred to the full 2019 to 2022 period.

The size of energy cost increases reported in the interviews exceed the picture presented by the official statistics. References were made to a doubling of energy costs, a threefold increase in electricity costs, a 150% increase in electricity, more than a doubling of heat and light costs, approximately a 150% increase in electricity costs, a 180% increase in gas costs. Some enterprises had recently come out of a long term fixed energy price and now faced more than a doubling. Most non-electricity energy was natural gas as opposed to oil.

IHF has reported that three quarters of hotels are significantly impacted by escalating costs. IHF members reported year-on-year (to March 2022) increases of 88% in energy, 22% in water and 18% in food and beverage, as well as significant insurance increases.

7.4 Summary of cost increases used in estimates

The cost increases which are used to estimate the overall costs impact on the hospitality business model are outlined here. Within the constraints of the available data the exercise takes into account the differences between the three sub-sectors. In the cost of sales public houses beverages share is much higher than hotels and restaurants. Food constitutes a smaller share of purchased food inputs in public houses than in hotels and restaurants. Wine is a larger share of beverages purchases in restaurants than in public houses. Energy costs and water costs play a greater role in hotels than in public houses.

Within the sub-sectors there are substantial differences between enterprises on the role of interest payments in operating expenses depending on the debt and mortgage characteristics of the specific enterprise.

Reference is also made to future cost increases. While the full future of the cost inflationary situation is unclear there are some definite expectations. Some energy price increases beyond those included in the official prices data have already been announced, interest rates are on an upward trend and after the three-year transition period water charges will increase substantially for many hospitality enterprises. Other possible cost pressures beyond 2022 relate to higher employer PRSI and a statutory living wage.

The assumptions on purchases price increases and labour costs are detailed below. This is the current position relative to 2019 which is the latest “normal” year. We assume the same unit price increases apply to all three sub-sectors. We assume the same labour cost increase applies to the three sub-sectors.

The cost of sales situation is as follows. We ignore the small element of cost of sales which is not food or beverages. Beverages are assumed to be 80% for public houses and food is 20%. For hotels and restaurants, the breakdown is 70% food and 30% beverages. Based on the available survey information that wine price has increased by more than beer and spirits and that public houses sell less wine than the other two sub-sectors the following beverage input price increases are used in the exercise, 8% for hotels and restaurants and 6% for public houses. The estimated price increase for aggregate food inputs over 2019 to 2022 for the hospitality sector is 10% but, of course, the annual and more recent price increases for particular products are larger. This based on the 2019 to June 2022 wholesale increase of 7.3% for food and the meat and dairy increases of 25.2% and 56.3% respectively, adjusted for possible additional price increases in July and August and the larger role of meat in meals out than in overall food consumption. The cost increases in other purchases reflects the higher energy usage and share of turnover in hotels compared to the other two sub-sectors. For hotels, non –cost of sales purchases increased by 22% which includes an 100% energy increase (this is lower than indicated by some of the survey responses and higher than indicated by the price statistics) and a 10% water increase. The equivalent increase for the other two sub-sectors are restaurants 20% and public houses 18%.

As already noted, the CSO reports that Hotels and similar accommodation have a labour costs to turnover share of 31.6%. However, the Crowe Hotels Survey reports a payroll share of 36.1%. We use the CSO data in this analysis but a higher labour cost share would result in a worse cost situation for hotels.

7.5 Assessment of impact of cost increases

The analysis takes 2019 as a starting point as the last “normal” year of business. The new higher costs and higher hospitality prices are then applied to the 2019 situation to assess their overall impact on operating margins.

Costs are estimated to have increased as identified in the previous section. The exercise is intended to show the sensitivity of the cost model to these increases while including the impact of hospitality price increases. The revenue increase is based on the 9.6% price/average revenue change in restaurants between 2019 and July 2022, and the 8.6% increase for public houses as estimated in Section 6 except for hotels/accommodation services where the July 2019 to July 2022 change adjusted for the specific circumstances of 2022 as outlined in Section 6 is used to account for the large degree of seasonality in the accommodation prices before adjusting for non-accommodation revenues. This gives a price increase of 15% for the hotel sector. The implication of the prices application is that the three figures for price increases relative to 2019 mentioned above would apply for the full year of normal trading. The changes in revenue, cost and margin relate to the 2019 actual situation compared to that level of business adjusted for the price and cost increases.

Table7.5.1 Implications of cost increases: restaurants, € thousand

	Cost and revenue increase estimates %	2019	Costs up revenue increases by 9.6%
Turnover/revenue	9.6	4409451	4832758
Labour	15	1468041	1688247
Purchases		2624744	2977198
Cost of sales		1627314	1780282
Cost of sales-food	10	1139120	1253032
Cost of sales- beverages	8	488194	527250
Other purchases	20	997430	1196916
Total costs (labour+purchases)	14.0	4092785	4665445
Margin for profit/depreciation/interest (turnover-costs)	-42.2	316666	167313
Margin as % of turnover		7.2	3.5

Source. Derived from CSO data and authors estimates

Based on the assumptions and analysis identified above, we can see that compared with 2019 the "new" normal situation is substantially worse for restaurants. Despite the revenue increase, the cost increases have halved the margin. The margin decreases from 7.2% of turnover to 3.5%. Turnover increased by 9.6%, costs increased by 14.0% and margin decreased by 42.2%.

Table 7.5.2 examines the same scenario for hotels. The revenue increase is the 15% increase which was discussed in Section 6. Despite the large price increase, the combination of cost increases and the revenue increase just about maintains the margin for hotels. The 2019 margin was 12.7% of turnover and the combination of cost increases and price increases lowers this to 12.4%. Costs increased by 15.4% compared to the turnover increase of 15%. The monetary level of the margin increased by 12.4% resulting in the margin% rate declining slightly.

Table 7.5.2 Implications of cost increases: hotels, € thousand

	Cost and revenue increase estimates %	2019	Costs up revenue increases by 15.0%
Turnover/revenue	15	4230944	4865586
Labour	15	1336344	1536796
Purchases		2357946	2725933
Cost of sales		1267944	1396131
Cost of sales-food	10	887561	976317
Cost of sales-beverages	8	380383	419814
Other purchases	22	1090002	1329802
Total costs (labour+purchases)	15.4	3694290	4262729
Margin for profit/depreciation/interest (turnover-costs)	12.4	536654	602857
Margin as % of turnover		12.7	12.4

Source. Derived from CSO data

There are some unusual features of the 2019 CSO hotel data compared to previous years. The CSO data record a significant reduction in the hotel gross margin per cent in 2019 compared to previous years. From 2016 to 2018 it was above 80%. It dropped to 70.0% in 2019. The details are in Table 7.5.3. There was a large turnover increase reported in 2019 with a decline in production value. Purchases increased substantially in 2019 but personnel costs were much the same in 2019. The number of persons engaged also increased surprisingly in 2019 to 67,306 compared to 57,861 in 2018. The same is true for the number of enterprises which was 2,590 in 2019 and 1,580 in 2018. For purposes of this report the latest 2019 ASI data is used.

Similar unusual data movements in 2019 do not occur in the other two hospitality sectors except for the production value and turnover in 2017 being much lower than in 2016 and 2018 in beverage serving.

Table 7.5.3 Gross margin % and other aggregates hotels and similar accommodation 2016 to 2019

Year	Turnover (Euro Thousand)	Purchases (Euro Thousand)	Production Value (Euro Thousand)	Gross margin %	Personnel Costs (Euro Thousand)
2016	3487679	1606052	2836080	81.3	1277449
2017	3491554	1698072	2798670	80.2	1363528
2018	3744596	1782115	3016389	80.6	1322646
2019	4230944	2357946	2963000	70.0	1336344

Source. CSO

Even if the 2018 gross margin and turnover profile was more representative of the hotel sector than the 2019 profile the cost increases would still result in a substantial decrease in the surplus or margin but from a higher level.

The exercise for beverage serving enterprises is shown in Table 7.5.5

Table 7.5.5 Implications of cost increases: beverage serving, € thousand

	Cost and revenue increase estimates %	2019	Costs up revenue increases by 8.6%
Turnover /revenue	8.6	2710442	2943540
Labour	15	784296	901940
Purchases		1587932	1763229
Cost of sales		986880	1053988
Cost of sales-food	10	197376	217114
Cost of sales-beverages	6	789504	836874
Other purchases	18	601052	709241
Total costs (labour+purchases)	12.4	2372228	2665269
Margin for profit/depreciation/interest (turnover –costs)	-17.7	338214	278371
Margin as % of turnover		12.5	9.5

Source. Derived from CSO data

The beverage serving activities sector started in 2019 with a margin before interest, depreciation and profit of 12.5%. The combination of cost increases and revenue increase reduced that to 9.5%. Costs increased by 12.4% compared to a turnover increase of 8.6%. The monetary value of the margin decreased by 17.7%.

The results of the analysis are worrying for the hospitality sector. The conclusions are based on CSO data and on estimates developed in this report. There is scope for disagreement about the estimates and assumptions. For example, the estimates for the energy and food price increases and the labour cost growth may be too high. Some hospitality stakeholders may believe they are too low. However, the margin for debate is relatively small and alternative estimates would have limited effect on the conclusions. An assumption of an 80% energy price increase instead of 100% would, of course, improve the margin position for restaurants. Equally, an estimate of a labour cost increase of 17% instead of 15% would be equivalent to a worsening of the restaurants' position of about 0.6% of turnover.

7.6 Anticipating the remainder of 2022 and 2023 for hospitality business costs and economic performance

The report shows that hospitality enterprises face very substantial business cost increases. This arises as the sector is recovering from the adverse financial impact of Covid. Despite very welcome Government support the financial reserves of many hospitality enterprises were drained by Covid and their overall business capability was reduced. This makes it more difficult to effectively absorb the post Covid cost increases. As shown in the report, despite price increases, the operating margins of public houses and restaurants are reduced compared with the last normal year of 2019. The same is true for hotels but to a much lower extent. Unfortunately, in addition to the cost issues already referred to, there are more negative cost issues facing the hospitality sector over the remainder of 2022 and in 2023 and beyond in interest rates, water charges and regulatory changes. In addition, while the overall inflation rate will decline in 2023 compared with 2022, there will still be substantial price and cost pressures.

The analysis in the report covered the period up to July/August. It is likely that additional cost pressures will arise in the remainder of 2022. Pressure on wage and salary rates will continue throughout 2022. It is very likely that energy prices will rise in the remainder of 2022 and the follow-through effect of earlier inflation on food input costs is not completed yet. Energy prices are unlikely to decrease until well into 2023. Any optimism on energy is very dependent on an easing of the Ukraine/Russia hostilities. Hospitality enterprises will enter 2023 with higher business costs than currently even after the very large increases of recent years and months.

The energy situation is particularly concerning for the hospitality sector. For example, a hotel which had an energy- to- turnover figure of 4% before the current energy price surge now (August) operates on an energy cost to turnover figure of 8% (without any change in turnover). A further doubling of energy prices over the coming months would push the energy- to- turnover figure to 16%. It can be readily seen that this level of energy cost would have substantial adverse effects on the sector, including, most likely, substantial closures. Given the recent changes in retail and wholesale energy prices and projections it is not excessive to expect a further doubling between now and the end of the year.

The UK energy price cap for domestic households is an indication of energy price developments and future prospects. The cap was increased by 54% with effect from April 2022. In October the cap was increased by 80% and the forecast for January 2023 is an increase of 52% with a further increase of 23% for the second quarter of 2023. The cap is expected to drop by about 11% in the third quarter of 2023. The UK cap in the third quarter of 2023 could be 4.6 times the level of the cap before April 2022.

Business energy prices in the UK will follow a similar pattern of significant increases over most of the next year but as there is no cap on prices for commercial users and commercial energy costs could increase by more.

The potential additional increase in Irish and EU energy costs for enterprises may be reduced by changes in the electricity market being considered by the EU and by possible Government support measures.

The August Conference Board Global Economic Outlook indicates a weakening macroeconomic environment. The USA and Europe are expected to experience a mild recession. The 2023 GDP forecast growth rates are USA 0.2%, Euro area 0.4%, Germany –0.2%, UK -0.6% and France 0.6%. In the Irish economy, discretionary expenditure will be much reduced with adverse effects on the hospitality sector. Wage increases will not keep pace with inflation which will reduce real incomes. This will reduce the ability of the hospitality sector to pass on the higher costs in higher prices. Current 2023 forecasts for the Irish economy expect reasonable growth in output but forecasts are likely to be downgraded as the year progresses.

The EU economy is in a period of increasing interest rates and higher interest rates will persist for the medium-term future. This results in higher interest charges for hospitality business and imposes an additional cost burden on enterprises. The ECB Survey of Professional Forecasters (third Quarter of 2022) expected the interest rate on the Eurosystem's main refinancing operations to increase steadily from 0.5% in the third quarter 2022 to 1.3% the first quarter of 2023. Interest rates are expected to stand at an average level of 1.5% in 2023 and reach 1.8% by 2024. However, recent indications by the European Central Bank are that interest rates will climb higher than previously expected.

In quarter 2 2022 there was €4.937 billion in outstanding bank credit to Irish and non-Irish hospitality enterprises. Each 1% increase in interest rates is an additional cost burden of €49.37 million on the sector. An average 2023 increase of 2% would add a cost burden of €98.76 million, a 3% increase would add €148.11 million to the sectors costs

Water charges are a substantial additional cost increase in the next few years. A new tariff structure is currently being introduced. 46.4% of enterprises will have a reduction in charges and 53.7% will have an increase. Transition arrangements for three years are in place in moving to the new tariff structure. Decreases and increases of €250 will be charged the new tariff immediately. For connections facing an annual bill increase of €750 or greater, a 10% cap will automatically apply to their annual bill increase in each of the three transition years before moving to the full new higher charge. The new scheme was initially intended to operate from May 2020 but this was delayed to

October 2021 because of Covid. The rate of increase will vary between counties because the new uniform national tariff replaces a system of different county council charges.

Some policy/regulatory changes have implications for business costs. The introduction of a ”living wage” measure will increase labour costs. This is intended to be introduced over a four-year period from 2023 or quicker if the Low Pay Commission decides. At present, the recent increases in hospitality labour costs have brought most hospitality workers to near or above the estimated 2022 hourly figure of €12.17 compared to the National Minimum Wage of €10.50 per hour. However, the living wage is set at 60% of the national median wage which will increase over time and increase the absolute level of the living wage. Ireland’s current employer PRSI is low by EU standards and there have been various suggestions to increase it over the coming years.

8. Assessment and conclusions

This report makes for dismal reading by substantial parts of the hospitality sector, a sector which is still recovering from the economic and business difficulties of the Covid restrictions period. The dismal reading is worst for restaurants.

As well as suffering very large cost increases, the products of all three sectors have had price increases between 2019 and July/August 2022. When both of these are taken into account the margins for restaurants and public houses are significantly below the 2019 margins. Including both price and cost increases the restaurants’ operating margin is reduced to 3.5% in a normal year compared with 7.2% in 2019. The new restaurant operating margin is very low and well below the 2019 level. Based on reasonable expectations these low margins are not sustainable.

Public houses perform a little better. When the higher price of public house services and increased costs are taken into account, the “normal” year margin is 9.5% which is substantially below the 2019 level of 12.5%.

The hotel sector has a better performance. Including both higher costs and higher prices, the new operating margin is 12.4% compared with 12.7% in 2019. Obviously, this is because the revenue increase was close to the overall costs increase. In effect, even with what are perceived to be large price increases the hotel operating margin has declined a little.

The bad news does not stop at the above comments. The cost situation for hospitality will deteriorate further in the remainder of 2022 and into 2023. Interest rates will continue to increase and in 2023 the average interest rate will be 2% points or more, higher. Water charges for many hospitality enterprises will continue to increase in the rest of the transition period and especially at the end of the transition period of three years from October 2021. Energy prices will continue to increase in the rest of 2022 and through much of 2023, especially for gas and electricity. An additional doubling of energy costs is possible.

Regulatory changes including the introduction of the living wage and possible increases in employer PRSI will add to the cost pressure facing the sector. General inflation will continue into 2023 but at a lower rate than 2022 and this will increase the cost of a range of business operating costs. Labour market pressures for the hospitality sector will continue into 2023 in the absence of a significant deterioration of the economic and employment situation. In addition, the sector will have to cope with the easing of the Covid-related pent-up demand and an overall weaker market environment due to reduced consumer confidence and lower discretionary income.

The sector may seek to compensate for the current higher costs (and future cost increases) and lower margins by additional price increases but there are competitive and market limits to this leading to trade-offs between prices and volumes of business.

There are different behavioural responses by enterprises to increases in input costs. Less of the more expensive input could be used but this is difficult for hospitality businesses. Customers want to be warm and comfortable in hospitality buildings. Hotel residents expect warm water and warm swimming pools. Restaurants have to have food inputs to operate their business. An enterprise could substitute other less costly inputs for the more expensive input but there are limited possibilities of this in the hospitality sector. An enterprise could source cheaper suppliers and thereby avoid part of the cost increase or achieve lower prices from existing suppliers. This is possible only to the extent that cheaper suppliers exist. The vast majority of hospitality enterprises are small operations which have very limited market power. New menus with less dependence on the more expensive products could be developed subject to market and customer acceptance. Hospitality enterprises could engage in productivity enhancement and innovation. These could include new energy, food and water management systems which reduce the amount of the input needed to service the enterprise. The latter could require significant investment resources and would not be capable of immediate implementation. To the extent that hospitality enterprises do respond to the higher input costs with the measures referred to above which reduce the unit cost of the input or reduce the number of units, the full cost increase would not be borne by the enterprise. It is reasonable to assume that some of the above behaviour has occurred and will occur which means that the actual deterioration in margins would be a little better than indicated in the analysis.

The cost structure of the three hospitality sub-sectors is outlined in Table 8.1. It illustrates how vulnerable the sector is to labour and food cost increases. The labour cost relative to turnover is between 28.9% and 33.3%. Food and beverages inputs amount for between 30% and 36.9%. Other purchases, which includes energy, is between 22.2% and 25.8% of turnover.

Table 8.1 Cost elements as% of turnover 2019 (last normal full year), three sub-sectors of hospitality

	Restaurants	Hotels	Beverage serving
Labour	33.3	31.6	28.9
Food and beverage inputs	36.9	30.0	36.4
Other purchases, including energy	22.6	25.8	22.2
Total costs excluding interest and depreciation	92.8	87.4	87.5

Source. CSO and author's estimates

Illustrations of the cost increases faced by the hospitality sector are shown below. Reference is made to the Consumer Price Index, producer or wholesale prices and interviews undertaken for this report.

- The overall rate of inflation was 9.1 % in July 2022 compared with July 2021
- The consumer price of food increased by 8.1% in July 2022 compared with July 2021
- The consumer price of beef and veal increased by 11.3% in July 2022 compared with July 2021
- The consumer price of poultry increased by 13.4% in July 2022 compared with July 2021
- Fresh milk increased in price by 21.2%%
- Electricity price increased by 40.0% in July 2022 compared to July 2021 which followed a substantial increase of 11.3% in July 2021.
- Gas increased by 60.2% in July 2022 compared with a year earlier and a lower 4.9% in July 2021.
- Home heating oil increased by 91.9% in July 2022 which followed an additional large increase of 39.6% in July 2021.
- The consumer price increases between July (the current prices) and the average price level in 2019 are food 6.9%, beef and veal 4.1%, poultry 12.7%, electricity 52.6% and natural gas 57.4%. This compares to the overall index price increase of 11.3%.

- Additional increases were announced by various suppliers for gas and electricity to take effect in August and October 2022.
- In the year June 2022 relative to June 2021 based on producer prices, food products increased in price by 10.2%. Meat and meat products increased by 14.5%. Dairy products increased by 49.1%. Fish increased by 7.9% Vegetable and animal oils and fats grew by 4%.
- If the average 2019 producer price level is compared with June 2022 the food increase is 7.3%, dairy increased by 56.3% and the meat increase is 25.2%.
- Food price increases from the interviews were, beef brisket 45%, beef in loin 7%, beef filet 17%, chicken fillets 21% for Irish product and 40% for Dutch, chicken wings 36%, fish 13% and flour 39%.
- The business energy price increases exceeded the household increases in the period July to December between 2021 and 2020. In the lower volume band of business energy users, the business electricity price increase of 13.9% slightly exceeds the household increase of 13.2%. There is a large difference in gas. Households' gas price increased by 12.1% while the lowest band of business gas users had a price increase of 23.8%, more than double the household increase.
- The wholesale price of electricity increased by 91.3% in the year to June 2022 compared to the consumer electricity price increase over the same period of 40.9%.
- The UK energy price cap for domestic households is an indication of energy price developments and future prospects. The cap was increased by 54% with effect from April 2022. In October the cap was increased by 80% and the forecast for January 2023 is an increase of 52% with a further increase of 23% for the second quarter of 2023. The cap is expected to drop by about 11% in the third quarter of 2023. The UK cap in the third quarter of 2023 could be 4.6 times the level of the cap before April 2022.
- The size of energy cost increases reported in the interviews exceed the picture presented by the official statistics. Separate references were made to a doubling of energy costs, a threefold increase in electricity costs, a 150% increase in electricity, more than a doubling of heat and light costs, approximately a 150% increase in electricity costs, a 180% increase in gas costs. Some enterprises had recently come out of a long term fixed energy price and now faced substantially more than a doubling.