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# Irish Economic Forecast:6.5%growth in 2021


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Irish economic growth has consistently exceeded consensus forecasts in recent years, in large part due to the performance of the external sector. Exports account for over 130% of GDP so forecast errors in GDP reflect a persistent underestimation of Irish export growth. This was again the case in 2020; GDP was generally expected to fall, reflecting the impact of Lockdowns on both domestic demand and exports, but in the event, exports actually rose by over 6%, driven by strong growth in medicinal and pharmaceutical products and organic chemicals. This dwarfed the negative impact of a 9% fall in personal consumption, a similar fall in construction and a 32% plunge in overall capital formation, with the weakness in domestic demand feeding into an 11% decline in imports. The upshot was a 3.4% rise in real GDP, outpacing China, and leaving Ireland as the only EU country that avoided an economic contraction.

The quarterly pattern was in line with the Euro norm, nonetheless, in that GDP fell in q1 (-3.9%) and q2 (-2.1%) before rebounding strongly in the third quarter (11.8%) and declining again in q4. The latter fall, at -5.1%, was much larger than we expected, leaving annual growth in q4 at only 1.5%, a much weaker carry over effect in 2021 than we anticipated. Indeed, that figure may well be revised up in our view, as exports grew by over 4% while the import figure looks too high relative to the data on domestic demand, but as it stands we have revised our 2021 forecast downward given the q4 outturn.

The outlook for 2021 year has also been impacted by a prolonged Lockdown in Ireland, yet to be materially lifted, which alongside a slow roll-out of the Covid vaccines has continued to impact the domestic economy. In addition, the picture on exports is clouded by delays in Northern Ireland on trade with and through GB. There has been a supply response- a significant increase in new direct sea routes between the Republic and continental Europe- which will help relieve some of the congestion, but it remains to be seen how much of the weak trade figures to date, particularly with the UK, are Lockdown related or the impact of short-term teething problems with the new system.

The speed of the vaccine roll-out in Ireland and the pace at which the remaining restrictions are lifted will clearly have a big influence on domestic demand as the year unfolds, and a big fall in both consumption and construction appears likely for q1. Residential construction has now fully re-opened, however, and the unusually large reservoir of household savings built up last year may well support consumer spending as the service sector fully re-opens; the savings ratio jumped to 33% in the second quarter of 2020 and averaged 23% for the full year, which is double the ratio seen in recent years. We have assumed a modest decline in the ratio in 2021, rather than a plunge back to previous levels, and this alongside strong base effects gives a 6.5% rise in personal consumption over the year.

Building and Construction is unlikely to recover all the ground lost due to the q1 Lockdown and we forecast a 10% fall, although spending on machinery and equipment plus transfers is expected to rebound, with the caveat that the latter is extraordinarily volatile, albeit not normally recording two successive large annual declines. So we anticipate a rebound in total capital formation (15% growth) which alongside another year of supportive government consumption (6.5%) results in a 9% rise in domestic demand. This will boost imports, which we forecast to grow by over 9% which is expected to outpace export growth of 7.0%. The latter, as noted, is the key determinant of overall GDP growth and the industrial production figures are currently indicating a much stronger export performance than the early trade data-production rose an annual 40% in February. The global recovery is also likely to boost Ireland's offshore contract manufacturing and hence the overall export figure that feeds into the national accounts.

Employment in Ireland fell by less than 30,000 last year, or 1.2%, but this is based on the standard Labour Force survey methodology and does not include all the recipients of the Pandemic Unemployment Payment, on the basis they are still technically in work. This also explains why the latest official Irish unemployment rate, for March, was only 5.8% while the Covid adjusted figure was 24%. The latter is likely to fall significantly as the economy opens but the official unemployment figure may well rise as some firms stay closed and others reduce staffing levels; we expect the unemployment rate to average 6.8% this year from 5.6% in 2020.

Inflation in Ireland remains weak; the CPI fell by 0.3% last year while the HICP index declined by 0.5%. The mid-year collapse in oil prices was a big factor but goods prices in Ireland have fallen in every year since 2012, reflecting both global disinflationary forces and structural changes in the Irish retail market. Base effects and the recovery in energy prices should result in a pick-up in inflation this year and we expect an average of 0.9%, albeit with a 2% figure likely be end-year.

On the fiscal side the General Government deficit came in below Government expectations last year, at €18.4bn (5% of GDP) despite a 24% increase in day-to-day current spending as tax receipts proved resilient, notably income tax and corporation tax. The 2021 Budget had projected a €20.5bn deficit for this year, predicated on GDP growth of 1.7% but the Government now expects the economy to grow by 4.5% and the deficit forecast has been reduced to €18bn or 4.7% of GDP. The Debt ratio is projected to rise to 62% from 59.5% last year. The Irish Central bank and the ECB owns €60bn of the €142bn bonds currently at issue, yet this rarely seems to be mentioned by those arguing that Ireland's debt is too high, although who owns the debt is often crucial.

Ireland does have a credit problem, though, in that household debt has been falling for twelve years and household cash and deposits exceed loans outstanding by €33bn. The deposit build up in Irish banks has also been huge which alongside mortgage controls and limited new housing supply has left banks with over €50bn in excess deposits relative to loans.

*Table 1 Irish GDP Forecast*

| Real GDP (% change) | 2019 | 2020 | 2021(f) |
|---|---|---|---|
| Personal Consumption | 3.2 | -9.0 | 6.5 |
| Government Consumption | 6.3 | 9.8 | 6.5 |
| Investment | 74.8 | -32.3 | 15.0 |
| Construction | 8.0 | -9.1 | -9.5 |
| M+E+I | 98.7 | -36.9 | 22.0 |
| Stocks (% of GDP) | 0.5 | 1.5 | 0.8 |
| Exports | 10.5 | 6.2 | 7.0 |
| Imports | 32.4 | -11.3 | 9.3 |
| **GDP** | 5.6 | 3.4 | 6.5 |
| **GNP** | 3.4 | 0.6 | 7.7 |

Economic sentiment has risen across the developed economies and growth forecasts generally have been revised up in recent months, in large part due to optimism on the impact of the vaccine roll-outs on Covid. Yet severe Lockdowns are a still a feature across many European economies and the course of the virus remains the main risk factor in any outlook. If the Irish economy opens as hoped we may well see a strong recovery in domestic demand from q2 onwards, which alongside robust exports delivers our 6.5% growth forecast. GNP, which adjusts for external flows of net profit and interest, may grow at a faster pace, of 7.5%, as the outflows were unusually large last year and may return to more normal levels.