Economic Research

Recession milder than consensus expectation 14/9/2020

Ireland has essentially two economies. One is driven by domestic demand and the other by the export sector which is in turn dominated by multinationals. The composition of the latter's output, fueled in value terms by organic chemicals, Pharma, medical devices and ICT, renders exports resilient in the face of the global pandemic, and as a result exports and hence GDP have held up much better than the consensus expected, with most forecasts expecting an average fall in 2020 iof 7-10% . Our previous forecast of –3.5% was well above consensus and we are now revising that figure up, to –1.5%, although we would be surprised if the consensus figure does not also move higher.

The economy did contract sharply in the second quarter, but the Irish fall , at 6.1%, was less severe than the EA average of 11.8%. A change to the seasonal adjustment methodology also led to a significant revision to the first quarter figure, with GDP now seen to have contracted by 2.1% instead of the initial 1.2% rise. However the annual growth rates benefitted from the strong carryover from the previous year, leaving annual growth in q1 at 5.7%, and the q2 figure at –3.0%. Consequently it is highly unlikely that the average for the full year can be as severely negative as many had feared, particularly given the apparent recovery in domestic spending since April. That said, the future course of the Covid virus remains a key unknown and cases have risen sharply in Ireland of late. The prospect of a no-deal Brexit has also re-emerged in recent weeks as another big risk factor.

Personal consumption bore the brunt of the shutdown in March and April and plunged by some 20% in q2, with the annual fall at 22%. Retail sales rebounded strongly in May and June , but are unlikely to maintain that momentum; we forecast an average fall of 12% for the year. Personal consumption accounts for less than a third of Irish GDP but such is the scale of the projected fall that it contributes –4 percentage points to the 2020 figure. As elsewhere, the Government brought in a series of income support measures following the Lockdown and although most are transfers, government consumption has risen sharply, and we expect the average increase for the year to be 10%, although that represents less than 1% in terms of the contribution to GDP. The construction sector effectively shut down for a number of months and output fell an annual 35% in the second quarter, although again we expect some recovery, with the decline over the full year put at 7%. The other components of investment, spending on machinery and equipment and intangibles, are largely driven by multinational flows and have proven extraordinarily volatile, with an estimated annual collapse of 75% in q2 following a 260% rise in q1. As a result overall capital formation fell by 71% in q2 but the q1 figure was so strong that we expect a full year rise of 30%.

That expected increase offsets the fall in construction to leave capital formation higher by 24% over the full year, Most of the capital spending and virtually all the intangibles are imported, however, so the impact on GDP is neutral, albeit still distorting the investment share of GDP. So imports fell precipitously in q2, by 37%, but that followed a 48% annual rise in q1, and for the full year we forecast a 10% rise.

As noted, exports have proven very resilient, rising by an annual 3.0% over the first half of the year, and we now expect a modest increase for the full year of 2%. That makes a 2.5% positive contribution to forecast GDP, which alongside a strong stock build (adding 1 %) offsets to a large degree the fall in personal consumption, leaving the annual change in GDP at –1.5%. As often stated here, exports are key and will largely determine the GDP outcome.

The consensus also appears to be wrong on the labour market. The official unemployment rate (based on the Labour Force survey) puts the average figure to August at around 5%, as those in receipt of the Pandemic Unemployment Payment are not deemed unemployed as they are not seeking work. Employment did fall sharply in q2, by an annual 53,000 (2.3%), and we expect further declines over this year and into 2021. For that reason we expect the unemployment rate to be higher next year, at 7.1%, from an expected 5.8% in 2020. Inflation, in contrast , has panned out broadly as expected, with substantial price falls in energy and most goods, with declines also seen in the hospitality sector. The annual inflation rate fell to –1.0% in August and we expect the average for the year to be –0.2%, as the figure was strongly positive in q1.

Government spending is running substantially above profile but the surprise has been on the revenue side, which at end-August was some €6bn or 21% above profile, with all headings above target, notably income tax and corporation tax. Tax receipts are down on the year but by only 2.5% which is not consistent with a huge fall in GDP. Nonetheless, this is unlikely to mean a big undershoot in the projected deficit given the trend in exchequer expenditure.

Detailed forecasts available on http://www.danmclaughlin.ie

Real GDP (% change)	**2019**	**2020 (e)**	**2021 (f)**
Personal Consumption	3.2	-12.0	8.0
Government Consumption	6.3	10.0	3.0
Fixed Capital Formation	74.8	24.0	-21.0
Stocks (% GDP)	0.5	1,2	0.9
Exports	10.5	2.0	4.0
Imports	32,4	10.0	-6.6
GDP	5.6	-1.5	3.8
GNP	3.4	-3.0	4.1