11 June 2021

2021 GDP Forecast raised to 9.5%

13-03
27-03
10-04
24-04
08-05

Dan McLaughlin Economics

Ireland's first quarter GDP release shattered the consensus forecast for the quarter and the full year, while again highlighting the dual nature of the economy. Domestic spending fell sharply, as expected given the Lockdown, but exports surprised to the upside, resulting in q1 GDP growth of 7.8% against a general expectation of contraction. That surge allied to a strong base effect left the annual change in GDP at 11.8%, which will no doubt lead to upward revisions to the consensus forecast for the full year, which had stood at 4%. That now looks far too low, as does our own 6.5% projection, which we are revising up to 9.5%.

The renewed Lockdown in the quarter led to a 5.1% fall in consumer spending and an 18% decline in building and construction, with domestic demand overall contracting by 10%. The weakness in domestic spending was also reflected in the 9% fall in imports. In contrast, the monthly industrial production data had shown a strong rise in q1, implying export growth, and the latter duly emerged, at 5.8%. The merchandise export figure includes contract manufacturing, production outsourced abroad from Irish based companies, and this component was unusually strong, perhaps reflecting the re-opening of the Chinese economy, as that is generally believed to be the home of most Irish contract production.

The monthly trade data in Ireland (which only measures production leaving these shores) has pointed to a big impact on both exports and imports, notably with the UK, from post-Brexit border delays in Northern Ireland, although there has been a substantial increase in direct sailings from the Republic to continental Europe, so avoiding using the UK land bridge. In the event the quarterly rise in exports on a national accounts basis left annual export growth at 18%. We doubt that will be maintained through the year given base effects and the likelihood of a weaker contract manufacturing effect in q2 and therefore project a 12% rise in exports over the year, albeit much stronger than our initial 7% forecast.

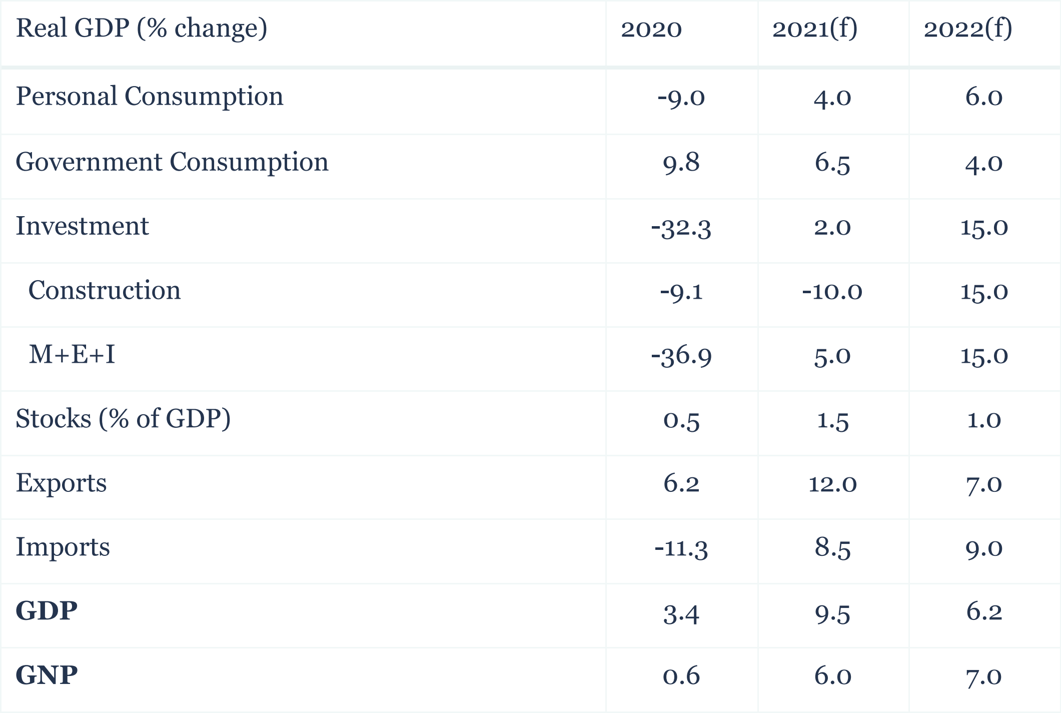
Exports have some import content, of course, which alongside a rebound in consumer spending and a pick-up in investment spending generates an 8.5% increase in forecast imports for the year. Personal consumption in the first quarter was 12% down on the previous year but the second quarter will see a very strong base effect, shifting the annual change into positive territory. Credit card data showed a 31% annual increase in May, supporting this view, while car sales have also risen strongly, but the retail sector has only recently fully re-opened, with the hospitality sector still partly closed. Consequently, we have revised down our forecast for consumption growth, and now expect a full year figure of 4%.

Building and construction has re-opened and the remaining months of the year will no doubt see a strong pick up in housebuilding in particular, although we still expect the annual construction figure to be down by 10%, a similar fall to that seen in 2020. Against that, spending on machinery and equipment may rise modestly, by 5%, after a big fall last year while we have pencilled in a flat reading for Intangibles- it is by far the most volatile component in the national accounts and appears to have fallen steeply on q1, but base effects should be supportive over the full year. The net effect is that overall investment spending is expected to rise by a few percentage points.

Our 9.5% GDP forecast is therefore largely driven by the export figure, and any significant setback to contract manufacturing or indeed to a relatively small number of multinationals based here could seriously impact the outcome. The G7 proposal on a 15% minimum corporation also represents a potential negative for the Irish economy but it is too early to say how that will play out. GNP, which adjusts for international profit and interest flows, arguably better reflects domestic income and we now expect a 6.0% rise this year.

Despite the expectation of strong GDP growth, the outlook for the labour market remains uncertain. This is in part captured by the unemployment data in recent months; the official figure, based on those deemed to be seeking work, was 135k in April, or 5.8% of the labour force, while if one adds in those receiving pandemic unemployment payments the figure rises to over 500k, implying an unemployment rate of over 22%. The latter figure is falling and is expected to decline further as the economy reopens but the former may start to rise if some firms close permanently, and others scale back. We expect the total employment fall to be modest, though, and as such forecast the unemployment rate to average 6.2% for the year.

Table 1 Irish GDP Forecast



Real GDP (% change)	2020	2021(f)	2022(f)
Personal Consumption	-9.0	4.0	6.0
Government Consumption	9.8	6.5	4.0
Investment	-32.3	2.0	15.0
Construction	-9.1	-10.0	15.0
M+E+I	-36.9	5.0	15.0
Stocks (% of GDP)	0.5	1.5	1.0
Exports	6.2	12.0	7.0
Imports	-11.3	8.5	9.0
GDP	3.4	9.5	6.2
GNP	0.6	6.0	7.0

Irish inflation, as measured by the Consumer price Index, has been remarkably low for years now, despite stellar economic growth, having been below 1% on an annual basis since 2012, reflecting disinflationary forces in the price of goods. The annual inflation figure has picked up in recent months though, to 1.7% in May, albeit largely due to energy prices and, excluding this, inflation is still under 1%. Nevertheless, the headline rate is likely to go above 2% in the coming months, and average around 1.5% for the year which will dampen real incomes. Data on the latter has been impacted by high Government transfers and the figures on average earnings distorted by wage subsidies but as it stands household disposable income rose by 4.9% last year, to over €124bn, and we expect a more modest increase this year as supports unwind.

That increase alongside a Lockdown induced fall in consumption propelled the Irish savings ratio to 23.8% last year, double the figure in 2019, and there is much speculation as to when and how much of this forced savings will be spent. Car sales have picked up strongly in recent months and house prices have started to rise again, albeit modestly relative to the EU and UK experience, but deposits in banks are still rising strongly. Indeed, Ireland can be said to have a credit problem in that lending to the household sector is falling, as is lending to corporates, leaving banks with a growing pool of excess deposits. Mortgage lending is still growing, but has slowed to an annual 0.7%, against a euro area figure in excess of 5%.

The economic impact of the pandemic on Government receipts and expenditure resulted in a General Government deficit of 5% of GDP last year and the 2021 Budget projected a deficit of 5.7%, albeit predicated on GDP growth of only 1.7%. The latter was subsequently revised to 4.5% in April, with a deficit now seen at €18bn or 4.7% of GDP. Our GDP forecast implies the latter is now too high anyway but tax receipts as at end-May are running well ahead of target so the outcome may be around €16bn or 4.1% of GDP. In which case the rise in the Debt ratio will be very modest, pitching it at just over 60% from 59.5% last year. Well over half the Government bonds at issue are held by the Irish central bank and the domestic banking sector so reducing the prospect of a sustained spike in borrowing costs.

Forecasts for global growth have risen of late and sentiment is certainly much more positive, buoyed by the vaccine roll-out and the implication for a return to a more 'normal' economic environment. The hard economic data is also now starting to benefit from the base effects of last year's Lockdown, but the international situation on Covid and vaccination is still very uneven and we suspect global growth may disappoint rather than surprise to the upside, which would mean that the current inflation upturn will not be sustained. As noted, our Irish forecast is also cautious in terms of domestic demand, and the GDP figure will again be dominated by exports, which as we have consistently pointed out, are of a composition that are best seen in terms of secular growth rather than seen through the usual cyclical model.