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Irish Economic Forecast: 16% growth in 2021

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Irish economic growth has consistently surprised to the upside in recent years, in large part due to the external sector as exports account for over 130% of GDP. Forecast errors in GDP reflect a persistent underestimation of Irish export growth, exacerbated by the fact that monthly trade data neither includes services (equal in value to merchandise exports) nor contract manufacturing (production outsourced abroad by Irish domiciled firms) which is now a substantial figure. The consensus growth forecast for 2021 was around 4% early in the year and then rose to 10% following a stellar q1 outturn, but that too now looks far too low in the wake of the q2 national accounts. GDP rose by a seasonally adjusted 6.3% with q1 at 8.7%, leaving the annual growth figure in the second quarter at 21.6%. Base effects will probably turn negative in q3, but the annual growth rate in 2021 is now forecast at 16%.

Domestic demand recovered strongly in q2 as the economy began to re-open and we expect a full year rise of 8% following a 15% fall last year. Consumer spending in q2 was flattered by a very positive base effect (up an annual 19%) but the q3 base impact will be very negative and we expect 4% average growth in that component over the year. There has been much debate in Ireland about the likely impact on demand from the spike in forced savings last year and the associated increased in household bank deposits but as yet there is not much evidence pointing to a surge in spending relative to income growth. Indeed, household deposits are still growing at a double-digit pace according to the latest available data, for July.

The pace of Government consumption is slowing following a surge last year and we expect a 4.5% increase this year. In contrast, construction spending has rebounded faster than many expected, notably on the residential side, and house completions may well reach 24,000 from under 21,000 last year. As a result, we now forecast 5% growth in construction instead of the previous fall, with overall investment set to rise by 17% supported by a 20% rise in spending on machinery and equipment and intangibles. The latter is notoriously volatile but is largely also captured as a service import, so is broadly GDP neutral.

The combination of a rebound in domestic demand and extremely strong export growth results in a substantial rise in imports, which we expect at 15% following a 7% fall last year. This is dwarfed in our forecast by the growth in exports which averaged a remarkable 21% in the first half of the year, dominated by multinationals, and reflected in stellar performances in service exports and in contract manufacturing. Base effects may lead to some slowing but we now forecast 19% export growth for 2021 and any risk to the forecast, up or down, stems from that component.

Government support for wages and a furlough scheme has been very effective in supporting household incomes, albeit also clouding the underlying picture on pay and employment. The official unemployment rate, for example, which was under 5% in early 2020, rose as one might expect but the increase was lower than many feared, hitting a high of 7.7% earlier this year before falling sharply to 6.5% in August. That implies that employment has held up well and is growing again,

although one gets a different picture if th0se receiving Pandemic Unemployment Payments are assumed unemployed, which resulted in a cycle high UR of 28%, albeit also falling sharply of late as the economy re-opened, down to 12.4% in August.

The average earnings data has also been impacted by the combination of wage subsidies (boosting the numerator) and the furlough scheme (impacting the denominator of those at work). Taken at face value, average earnings rose by 5.1% last year and in the second quarter of 2021 had slowed to 3.9%. It would seem that the pandemic did not materially impact those on higher incomes, which also explains why the housing market did not falter as much as some predicted, with house prices nationally rising by 8.6% in July.

Table 1 Irish GDP Forecast

Real GDP (% change)	2020	2021(e)	2022(f)
Personal Consumption	-10.4	4.0	5.0
Government Consumption	10.9	4.5	3.0
Investment	-23.0	17.0	14.0
Construction	-9.1	5.0	10.0
M+E+I	-36.9	20.0	15.0
Stocks (% of GDP)	1.4	1.2	0.8
Exports	9.5	19.0	12.0
Imports	-7.4	15.0	12.5
GDP	5.9	16.0	9.5
GNP	3.4	9.3	9.0

Real incomes have been squeezed this year, nonetheless, by a sharp rise in inflation, contrary to the Irish experience over the past decade. The headline CPI inflation rate was 2.8% in August (after -0.3% in 2020) and although the initial acceleration was largely due to higher energy prices the most recent data points to a broader increase in the core rate. This in part reflects base effects but a weaker euro/sterling exchange rate tends to be negative for Irish inflation. We expect a figure above 3.5% over the next few months with an average 2% for the year followed by a similar figure in 2022.

On the fiscal side the projected deficit this year of some €20bn may well be undershot by around €5bn given stronger than expected tax receipts year to date and lower than projected spending. That, allied to a much higher level of GDP than officially forecast may result in a deficit ratio of 0nly 3.5% of GDP, rather than the 5.1% projected a few months ago. Similarly, the debt ratio could fall to 56.5%. The low level of borrowing costs, helped by QE and the PEPP, has prompted a change in tack by the Government on the fiscal side, with the prospect of a budget balance now pushed out a few years, reflecting higher spending than previously announced, notably on the capital side. We are all socialists now.