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Quarterly Economic Commentary – Autumn 2020

DATE

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Overview

- Irish economy continuing to struggle with the impact of Covid-19
    - Unemployment rate 14.7% in September
- Significant variation in impact of pandemic on different sectors of the economy in Q2
    - Manufacturing: +16.5 %
    - Distribution and Transport: -32.0%
    - Arts & Entertainment: -67.8%
- Overall impact on GDP less than expected
    - Exports robust over Q2 (+0.1% y-on-y)
    - Consumption and modified investment fall significantly (-22.3% and -24.4%)
- Real GDP growth forecast to decline by 1.8% in 2020
- Two scenarios for 2021
    - Free trade agreement: 6.3% growth
    - No deal Brexit: 3.3% growth

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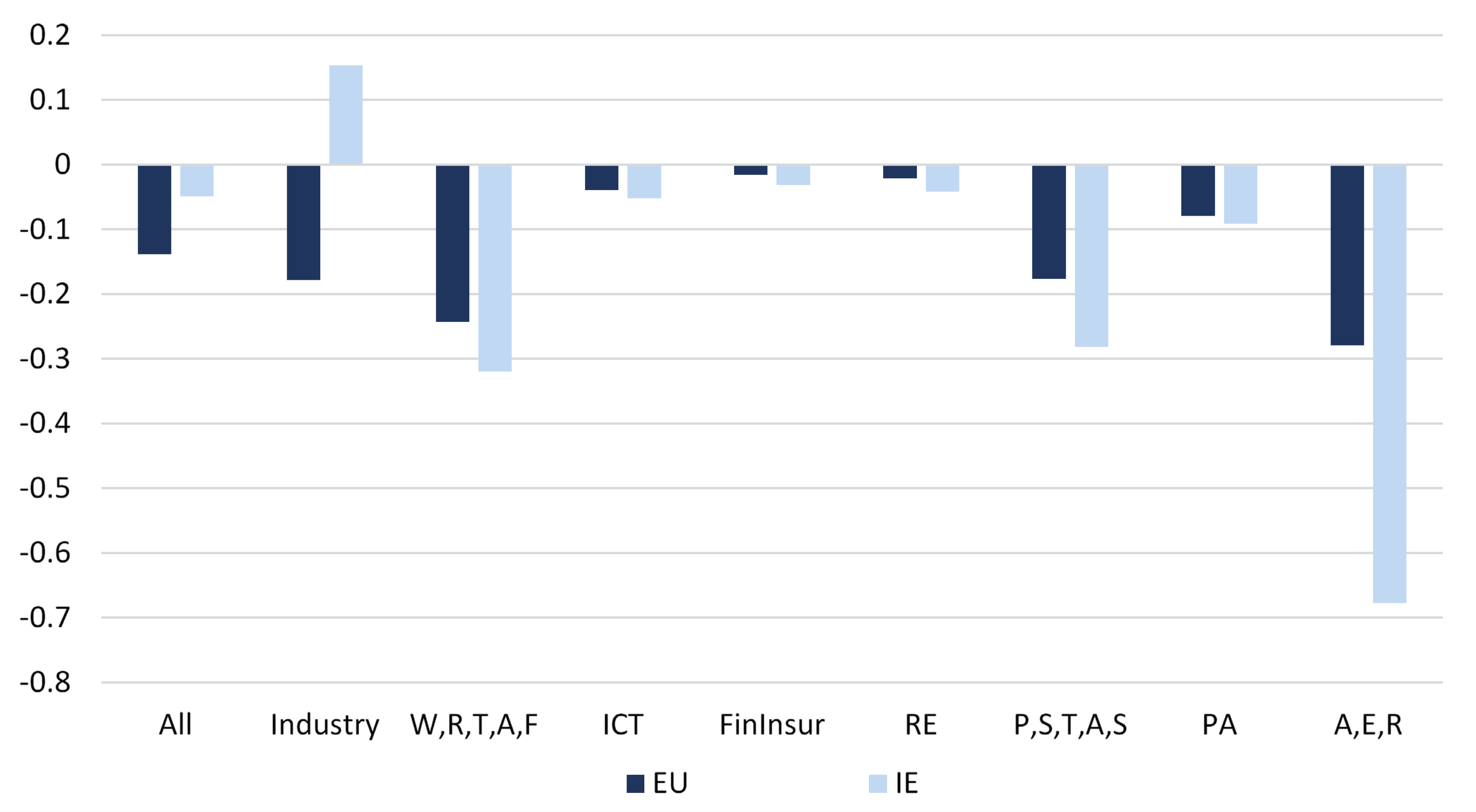
Summary

	2019	2020	2021
Output (Real Annual Growth %)			
Private Consumer Expenditure	3.2	-9.2	5.0
Public Net Current Expenditure	6.3	10.0	2.5
Investment	74.8	-17	8.0
Exports	10.5	1.7	6.1
Imports	32.4	-6.1	6.5
Gross Domestic Product (GDP)	5.6	-1.8	6.3
Gross National Product (GNP)	3.4	-2.3	5.2
Labour Market			
Employment Levels (‘000)	2,322	2,013	2,239
Unemployment Levels (‘000)	121	405	246
Unemployment Rate (as % of Labour Force)	5.0	16.8	9.9
Public Finances			
General Government Balance (€bn)	1.3	-25.4	-15.0
General Government Balance (% of GDP)	0.4	-7.3	-3.9

Sectoral Impact on Irish economy very different

FIGURE 2 ANNUAL CHANGES (%) IN SECTORAL OUTPUT VOLUMES: Q2 2019-Q2 2020: IRELAND VS EU27

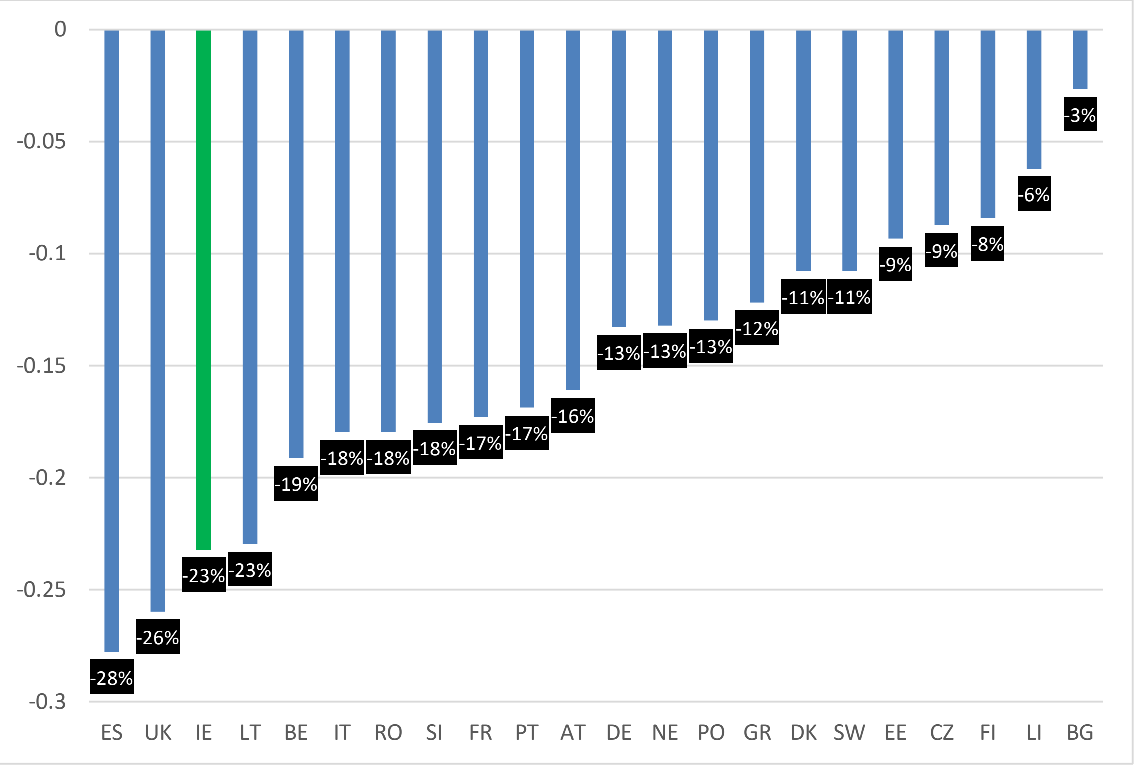


Source: Eurostat.
Note: W,R,T,A,F is Wholesale, retail, transport, accommodation and food services; RE is Real estate; P,S,T,A,S is Professional, scientific, technical, administration and support services; PA is Public administration; A,E,R, is Arts entertainment and recreation.

Consumption

- 2020: -9.2% 2021: 5.0%
- Consumption expenditure fell by 19.6 per cent between Q1 and Q2
- Third largest amongst 23 European countries
- Real time indicators of expenditure such as retail sales data point to a sustained and strong recovery as the economy was reopened
- Bottom up approach to forecast consumption over second half of the year
    - Following a similar approach to that developed in Coffey et al. (2020)
    - Utilising microdata from Household Budget Survey 2015/2016
- Consumption expected to drop back in Q4 as result of lockdown restrictions

Cumulative Change in Consumption for selected European Economies



Source: ESRI Analysis of Eurostat data. Consumption is the cumulative quarter on quarter changes for Q1 2020 and Q2 2020.
Series: Final consumption expenditure of households, chain linked volumes (2010), seasonally and calendar adjusted data.

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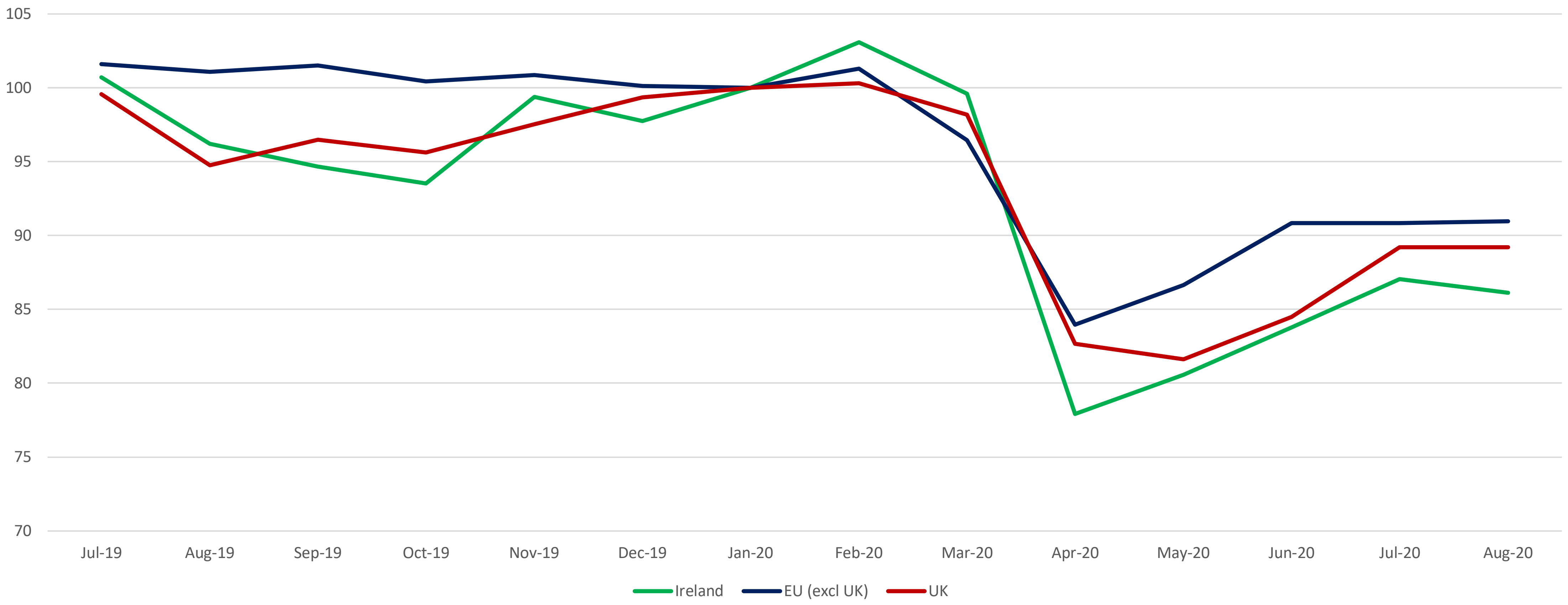
CONSUMER SENTIMENT INDICATORS – IRELAND, UK AND REST OF EU (JANUARY 2020 = 100)



*Source: European Commission data and ESRI calculation. Note: the positive/negative balances from the EU COF series are transformed by adding 100. We then set the base to 100 in January 2020 with growth relative to this point i.e ((Yt/YJan2010) -1)*100.*

Investment

- 2020: -17.0% 2021: 8.0%
- Modified GDFCF formation decreased by 24.4% y-on-y in Q2

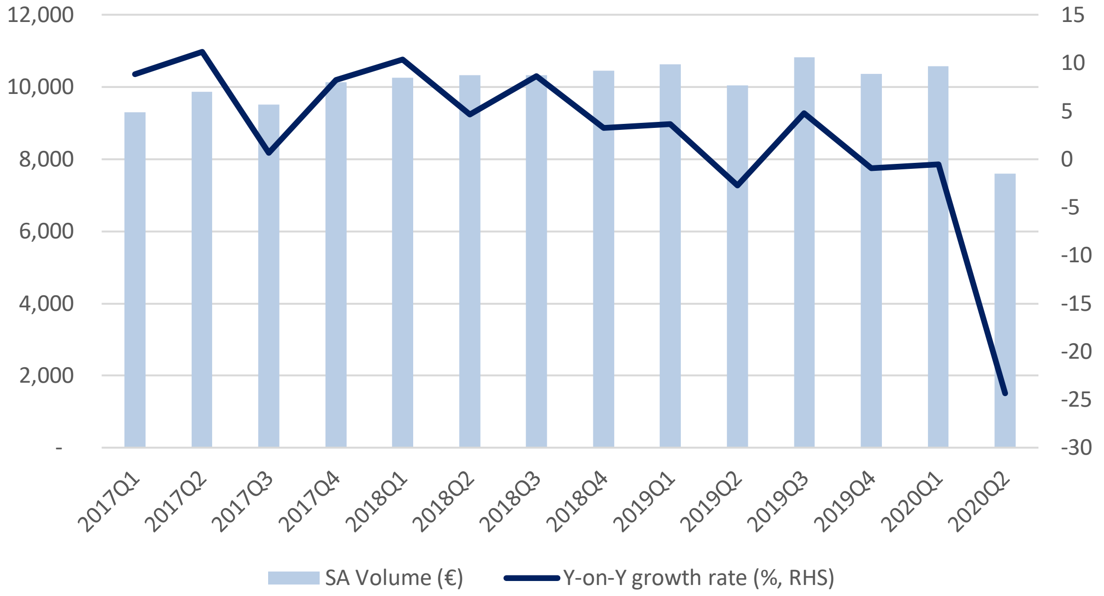
- Buildings & Construction investment decreased by 35 %
- 17,000 housing completions forecast for 2020

- Historical data shows a strong contemporaneous relationship between investment in Machinery and Equipment and business sentiment
  - O'Toole (2019)

- Weak investor sentiment implies significant decline in Machinery & Equipment in Q2

- Some positive news with latest CSO 'Business Impact of Covid Survey' in August showing 96% of firms currently trading
- Up from around 75% in April

MODIFIED GROSS DOMESTIC FIXED CAPITAL FORMATION



Source: Central Statistics Office

Trade

Exports

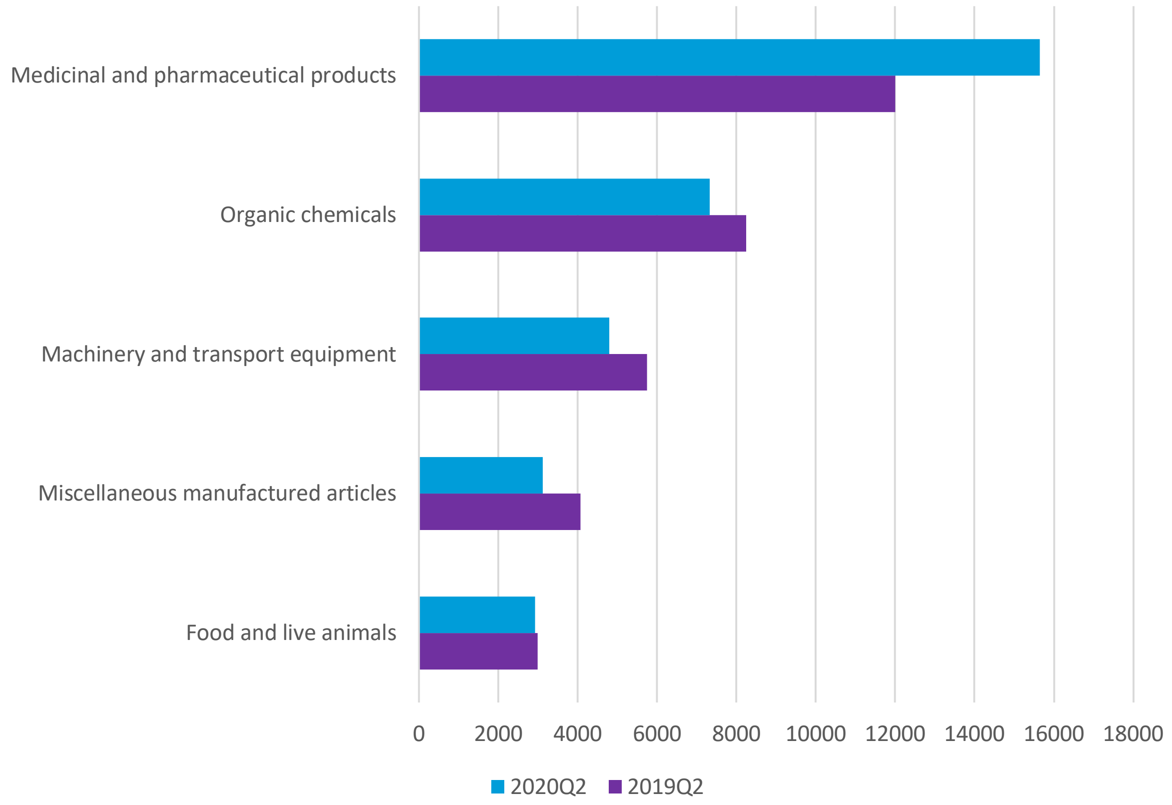
- 2020: 1.7% 2021: 6.1%
- Robust performance of Exports significantly dampened decline in GDP in Q2
- Largest components of goods and services performed very strongly
  - Medicinal and pharmaceutical products (+30.5%)
  - Computer services (+4.3%)
- Most other components declined over the same period
  - Organic Chemicals (-11.2%)
  - Machinery and Equipment (-16.8%)
  - Business Services (-13.2%)
  - Tourism and Travel (-89.6%)

Imports

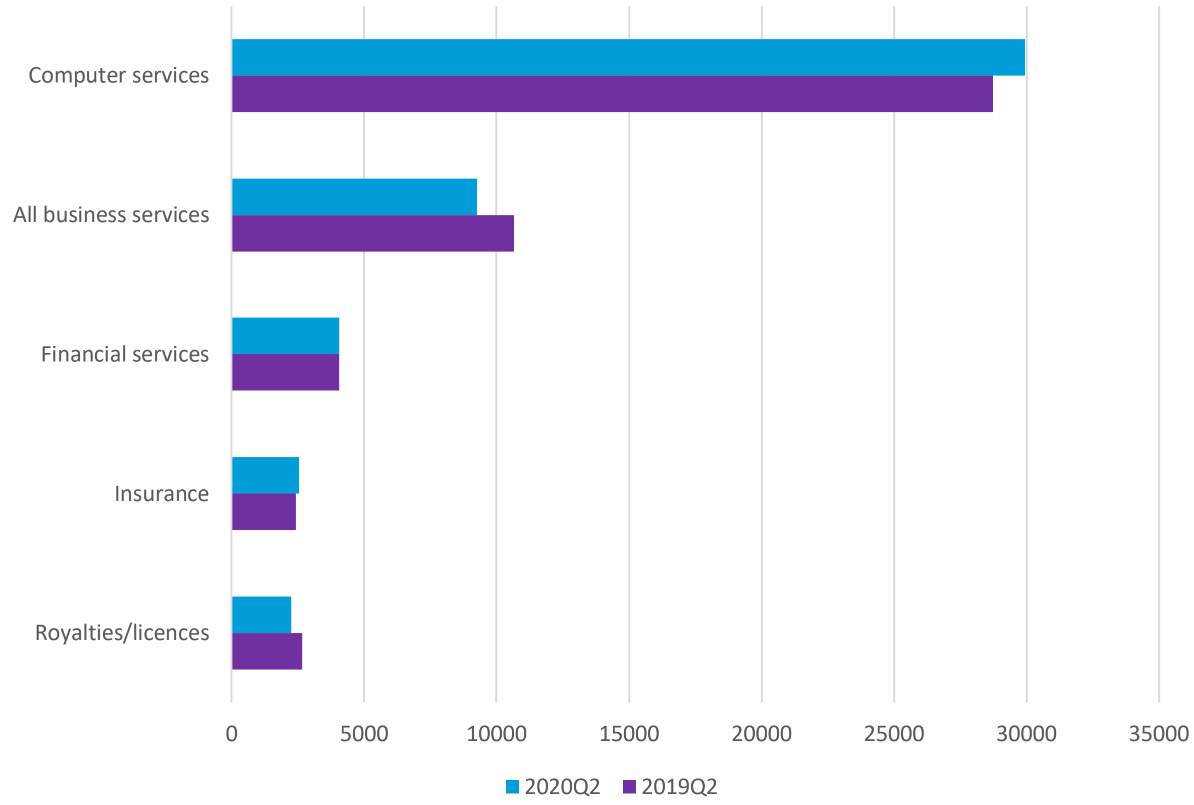
- 2020: -6.1% 2021: 6.5%
- Related to decline in consumption and investment
- Strong performance of some export groups should boost the imports of goods and services used in the production process

Exports by Component/Commodity Group

SERVICE EXPORTS BY COMPONENT (VALUE, €000,000)



MERCHANDISE EXPORTS BY COMMODITY GROUP (VALUE, €000,000)



Source: Central Statistics Office

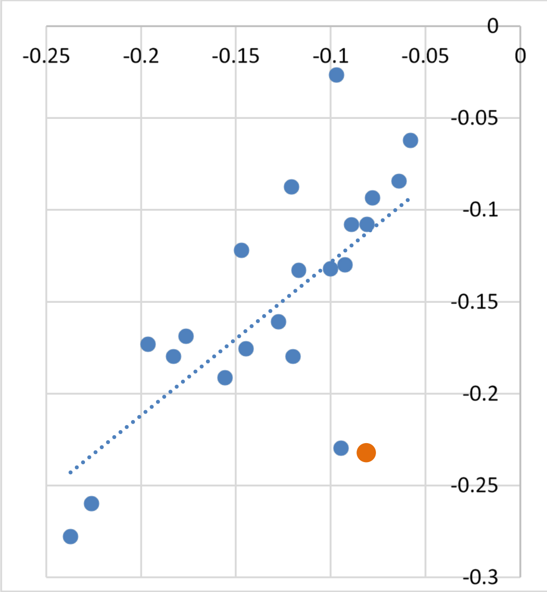
Research Note: Lockdown Tale of Two Economies

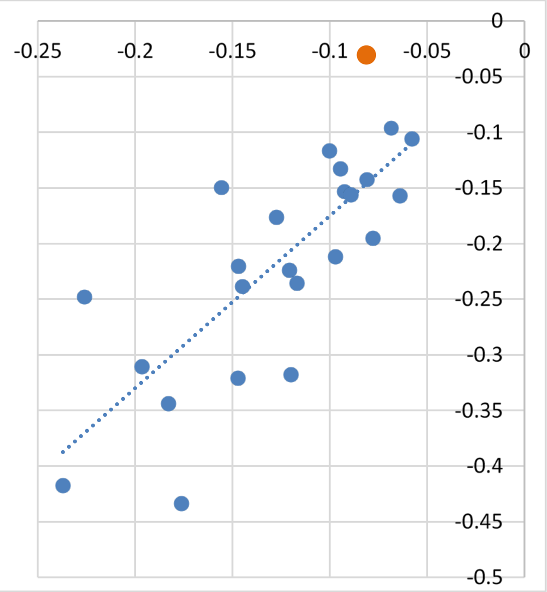
- Note aims to explain why GDP fall was relatively benign, given extremely large economic shock to domestic economy
- Demonstrates the impact of lockdown resistant sectors (computer services, pharmaceuticals)
- Shows exports are more important for Ireland than other countries and our main export sectors bucked the international trend of slower activity
- Increase in exports (y-on-y) in pharma for example outweighed fall in tourism, travel, transport related export service revenues.

FIGURE 4 SCATTER PLOT OF GDP FALL AND CHANGE IN CONSUMPTION AND EXPORTS

Cumulative Change in GDP Q1 + Q2 2020 Versus Change in Consumption (Y Axis)

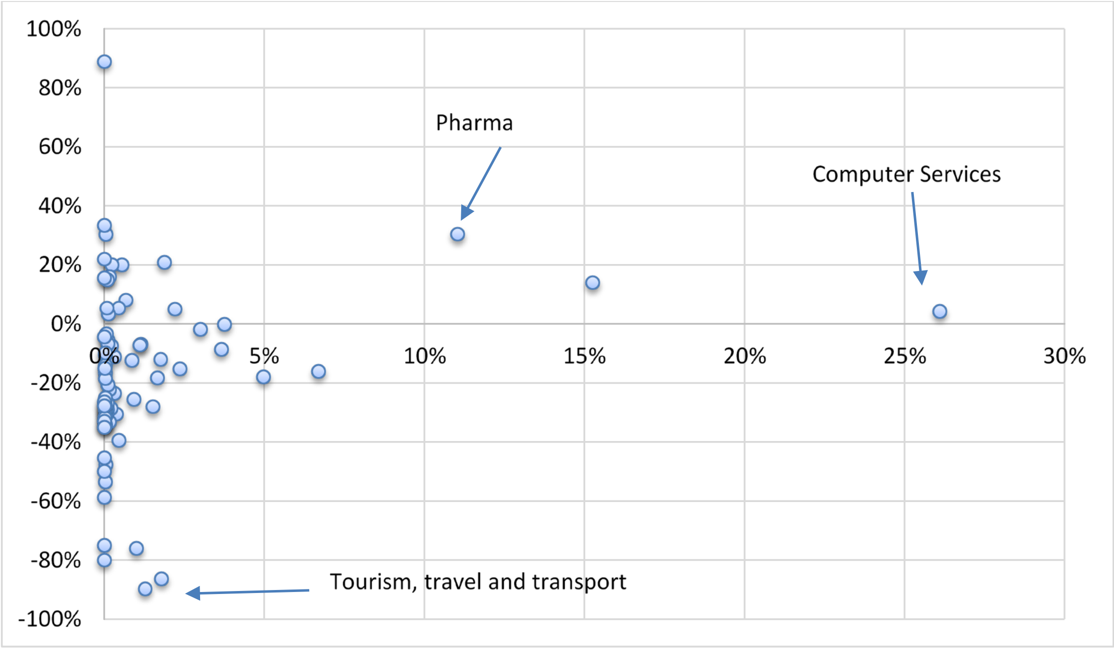
Cumulative Change in GDP Q1 + Q2 2020 Versus Change in Exports (Y Axis)





Source: ESRI Analysis of Eurostat data.
Note: Orange dot indicates Ireland.

FIGURE 15 SCATTERPLOT OF EXPORT SHARE (2019) (X-AXIS) AGAINST Q2 2020 YEAR-ON-YEAR CHANGE (Y-AXIS)



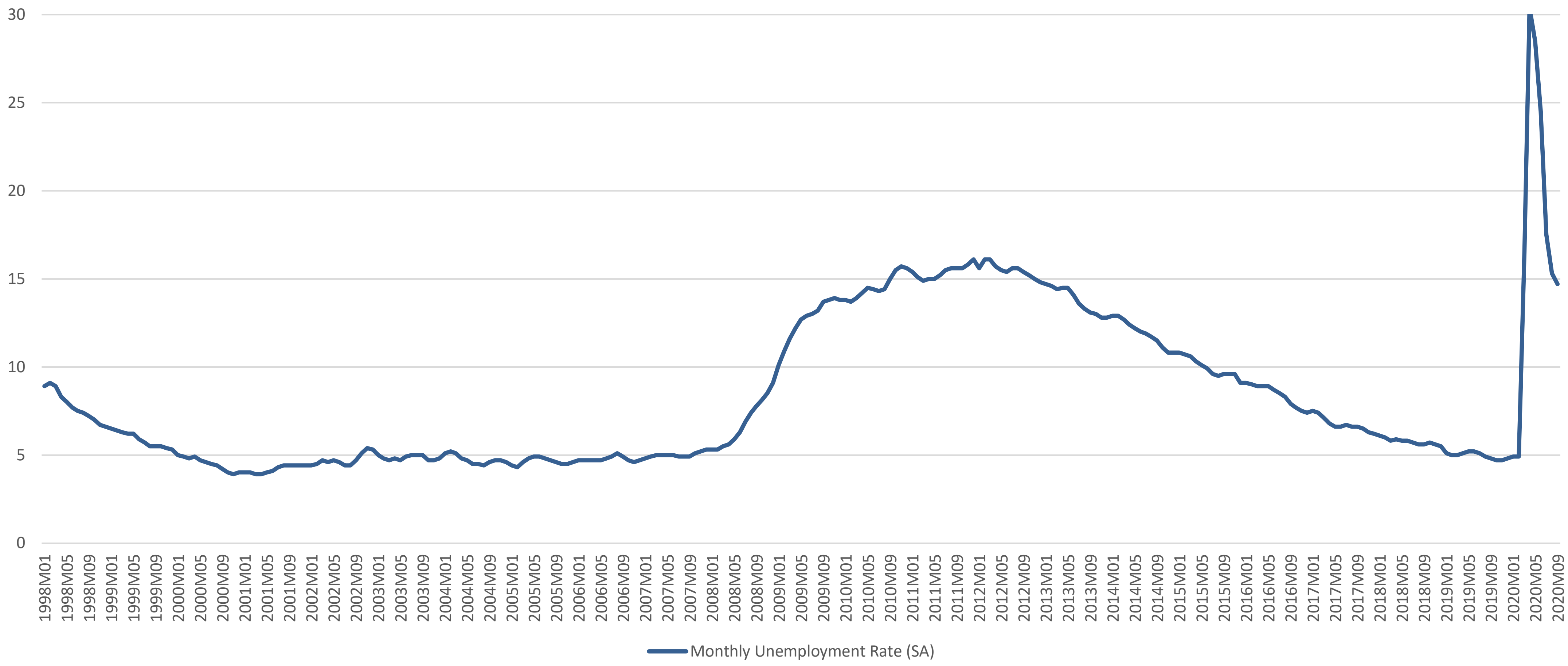
Source: ESRI Analysis of CSO data.

Labour Market

Unemployment

- 2020: 16.8% 2021: 9.9%
- Adjusted unemployment rate decreased to 14.7% in September
  - Down from over 30% in April
  - Over 340k people now receiving unemployment benefits
- Significant variation in impact of pandemic across sectors
- Percentage of employees on PUP or TWSS by end of July
  - Accommodation and food service activities (84%)
  - Construction (36%)
  - ICT (15%)
- Despite positive GDP growth forecast for 2021 unemployment will remain elevated

Unemployment rate



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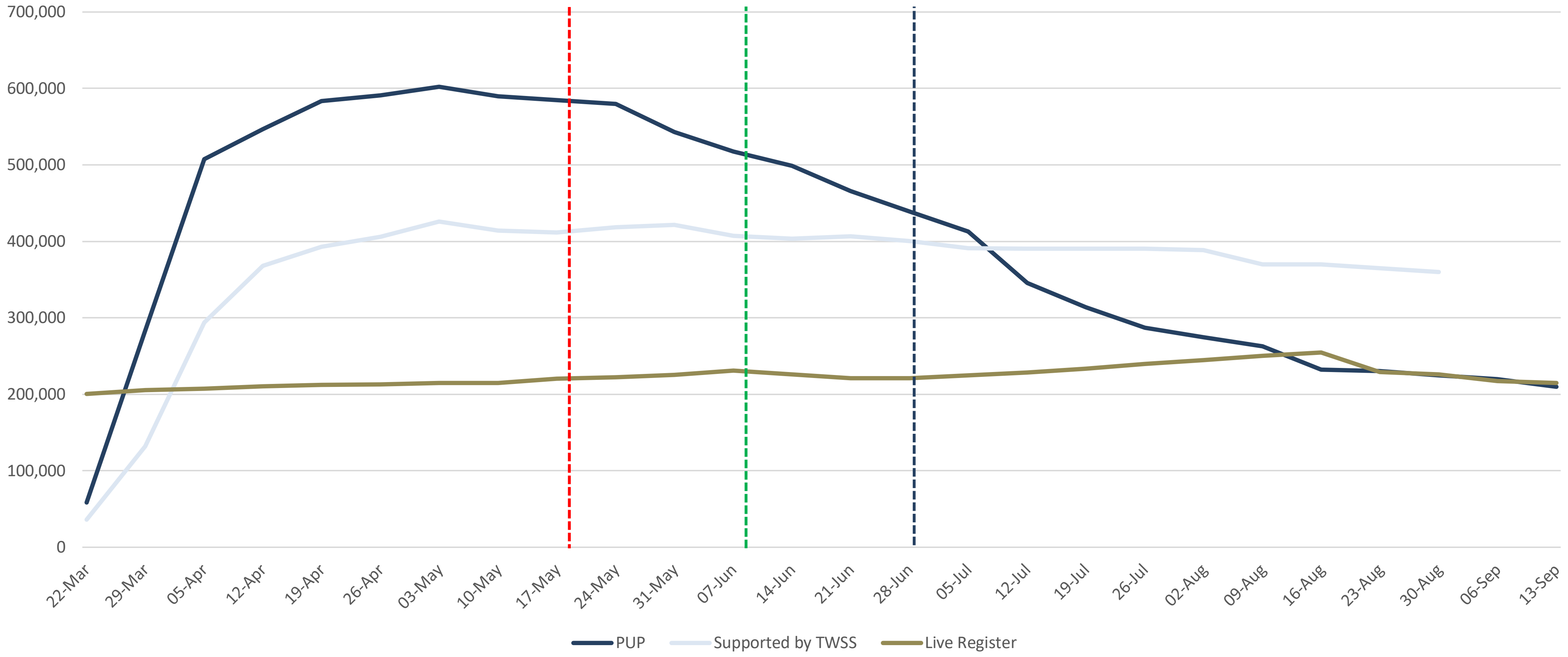
NUMBER OF PEOPLE CLAIMING THE PUP AND BEING SUPPORTED BY THE TWSS BY WEEK



Source: Central Statistics Office and Revenue Commissioners

Note: The 18th of May (red line) was the beginning of Phase 1 of 'The Roadmap for Reopening Society and Business', while Phase 2 and Phase 3 began on the 8th of June (green line) and 29th of June (blue line) respectively.

Public Finances - Baseline

- GGB (% of GDP) 2020: -7.3%   GGB (% of GDP) 2021: -3.9%
  Debt to GDP 2020: 63.5%   Debt to GDP 2021: 61.0%

- Significant decline in revenue expected for 2020 but less severe than originally anticipated
  - Decline in income tax (-2.1%) muted as result of low tax liability of those who have lost their jobs
  - Corporation taxes (+25%) increased significantly above expectation

- Most tax headings to register positive growth in 2021 as they recover from the declines in 2020
- Corporation tax is the exception
  - Windfall nature of returns in recent years
  - Ending of 'Double Irish'

- Expenditure to remain elevated through 2021
  - Health Expenditure
  - Social supports

- Revenue to decline by 14%, Expenditure to increase by 16%
- Debt to GDP will decline in 2021 as recovery in output exceeds the increase in national debt

Box 1: Exploring the Impacts of Covid-19, a Hard Brexit and Recovery Paths for the Economy

- Range of alternative scenarios for the Irish economy using structural macro-econometric model COSMO
  - Recovery (- 7.0 % deviation from baseline)
  - Delayed Recovery (- 9.5 % deviation from baseline)
  - 2nd Wave (- 8.0 % deviation from baseline)

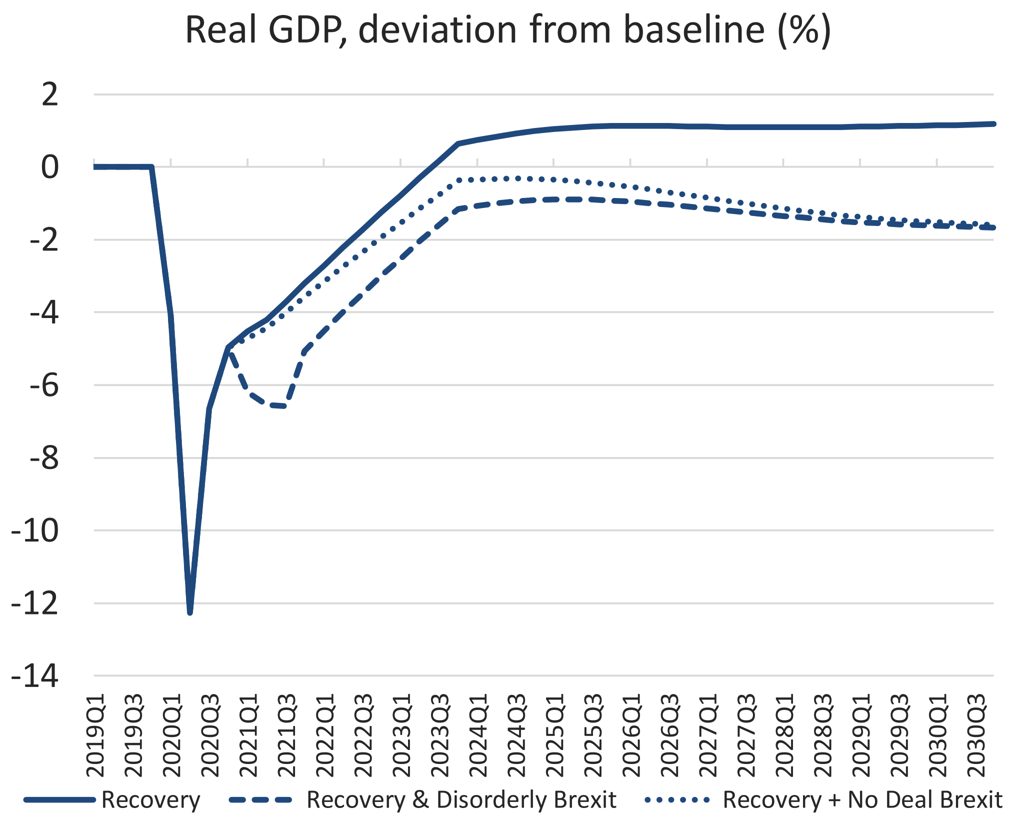
- Recovery scenario coupled with a range of alternative scenarios for Brexit
  - Recovery
  - Recovery & No Deal Brexit
  - Recovery & Disorderly Brexit

- Limited overlap in the sectors exposed to Brexit and Covid-19
  - Daly and Lawless (2020)

- No-deal Brexit will cause long term economic loss close to 2% after 10 years relative to the no-pandemic baseline

- Disorderly exit would also lead to significant short term losses

COVID-19 & NO-DEAL BREXIT: IMPACT ON GDP

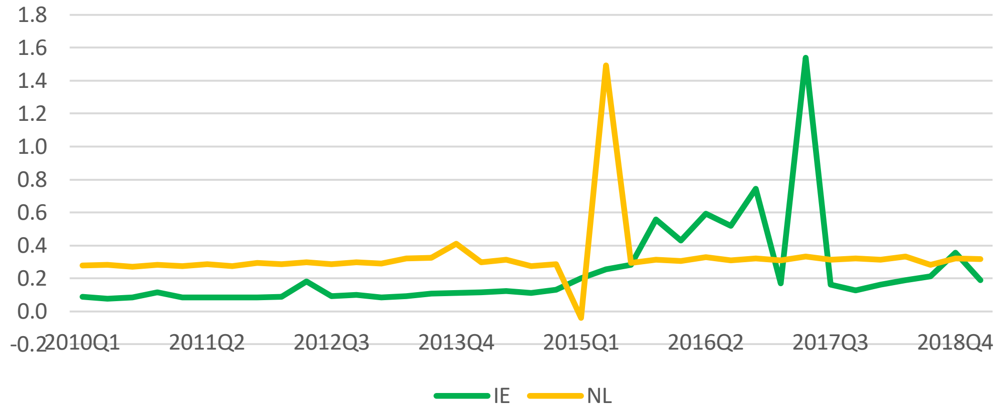


Source: Authors Calculations.

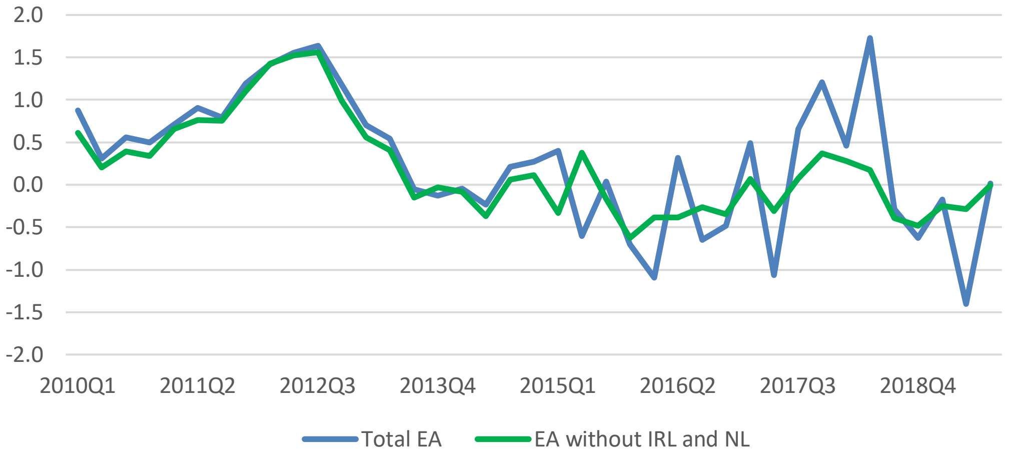
Box 2: The Treatment of Intellectual Property (IP): How Euro Area Data is Now Being Distorted

- Recent analysis from Setser (2020) suggests that the treatment of investment in intellectual property (IP) by certain large firms operating in the Irish and Dutch jurisdictions have non-trivial implications for Euro area data
- Certain large transactions in the Dutch economy in 2015 and in Ireland in 2017 caused the ratio of investment in IP to Euro Area GDP to increase substantially.
- These transactions are to do with certain subsidiaries of multinationals based in these countries acquiring the intellectual property of a non-resident company.
- Euro area data looks very different with Irish and Dutch net trade data excluded
- Implications
    - May be necessary for new macroeconomic indicators to be provided by Eurostat
    - Information revealed in national accounts reveals evidence of profit-shifting by multi-national firms.
    - In a post Brexit European Union, it is important that Irish authorities avoid any tax arrangements that multinationals can use to significantly reduce their global tax liabilities.

IRISH AND DUTCH INVESTMENT IN IP AS A % OF EURO AREA GDP



YEAR ON YEAR CONTRIBUTION OF NET TRADE TO EURO AREA GDP WITH IRISH AND DUTCH NET TRADE EXCLUDED (%) GDP



Impact of Second Lockdown in Q4

Based on previous analysis:

	Baseline	Second Lockdown (April Style)
Consumption	-9%	-16%
Investment	-17%	-28%
Government Spending	10%	14%

- Consumption and Investment decline significantly
- Likely to result in an increase in government supports

- Impact on trade less clear
- Again will largely depend on international demand and the performance of a small number of sectors

Assessment

- While the decline in GDP is much less severe than we previously expected, the economic shock has been substantial for particular sectors and for many households
- Certain characteristics of the Irish economy have been brought to the fore by the pandemic
  - Strong performance of export sector
  - High levels of corporation tax receipts
  - Muted decline in income taxes

- Support measures should be kept in place into 2021
- There will come a point where the tapering of policy measures will be necessary especially for firms
- Given the underlying strength of the Irish economy, should grow robustly when uncertainty around the virus passes