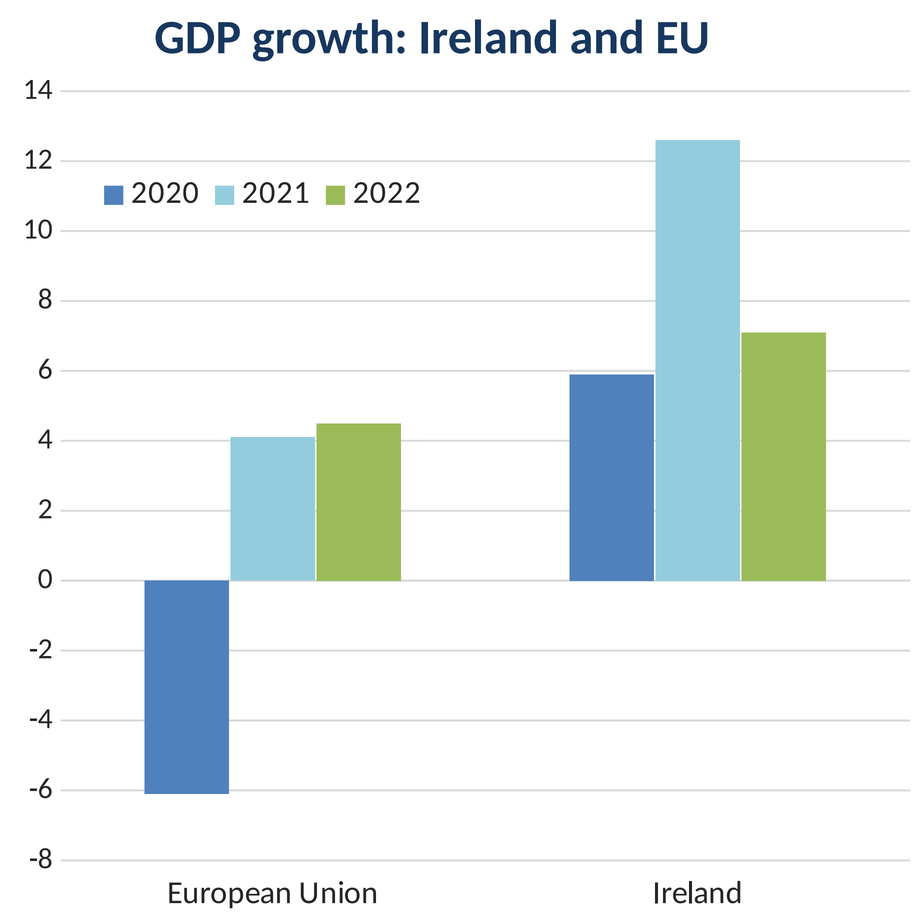
Quarterly Economic Commentary – Autumn 2021

DATE
October 6th 2021

AUTHORs
Kieran McQuinn, Conor, O'Toole, Cathal Coffey, and Wendy Disch.

Overview

- Despite unprecedented economic shutdowns during the COVID-19 pandemic, Ireland alone in the EU experienced economic growth in 2020 and is expected to have a strong recovery in 2021, with GDP forecast to increase 12.6 per cent in 2021 and 7.1 per cent in 2022.
- The easing of all public health restrictions will allow the economy to return to near normal activity by the end of the year. Consequently, we anticipate unemployment to fall to 9 per cent by the end of the year.
- The robust performance and reduction in unemployment will ease the pressure on public finances. Prudent management of the public finances will allow for investment in critical areas over the medium-term.
- Modified domestic demand, which excludes data on aircraft leasing, R&D service imports and trade in intellectual property is set to grow over 7 per cent in 2021.



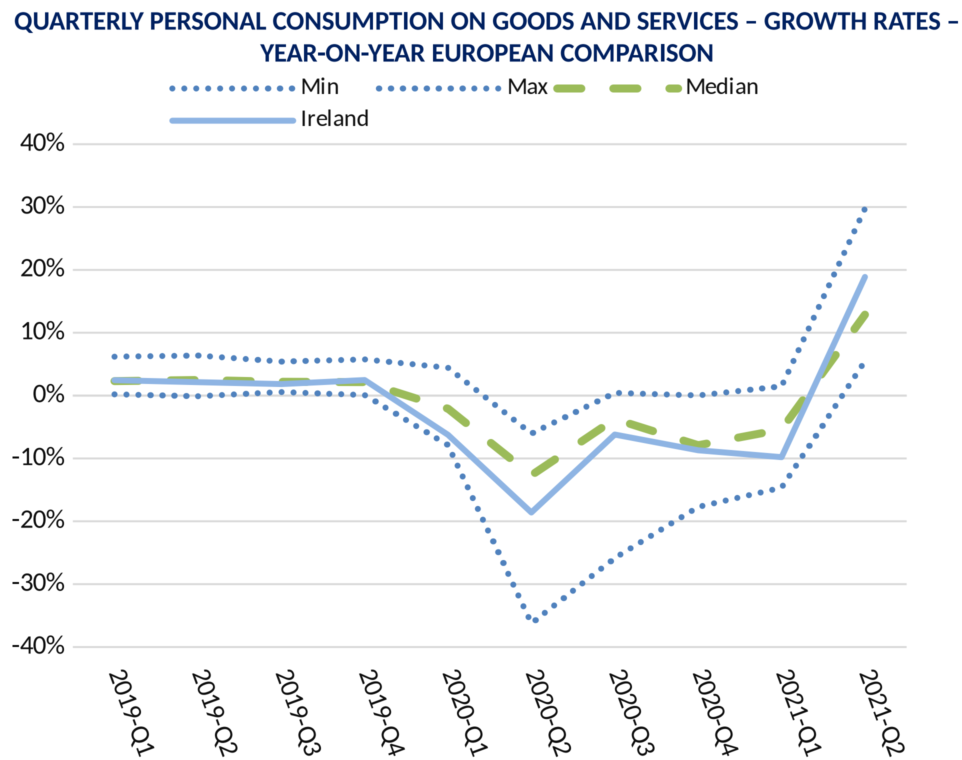
Source: ESRI calculations and EU Commission

Summary

	2020	2021	2022
Output (Real Annual Growth %)			
Private Consumer Expenditure	-10.4	7.5	8.0
Public Net Current Expenditure	10.9	4.1	3.0
Investment	-23.0	-45.0	8.3
Exports	9.5	14.3	9.0
Imports	-7.4	-7.9	10.0
Gross Domestic Product (GDP)	5.9	12.6	7.1
Gross National Product (GNP)	3.4	10.5	6.1
Domestic Demand (excl. Stocks)	-15.3	-20.0	7.2
Of which: Modified Domestic Demand	*-4.2*	*7.1*	-
Labour Market			
Employment Levels ('000)	1,976	2,039	2,307
Unemployment Levels ('000)	455	395	176
Unemployment Rate (as % of Labour Force)	19.4	16.3	7.1
Public Finances			
General Government Balance (€bn)	-18.4	-14.7	-8.0
General Government Balance (% of GDP)	-4.9	-3.4	-1.7
Inflation (Annual Growth %)			
Inflation (CPI)	-0.3	2.3	2.5

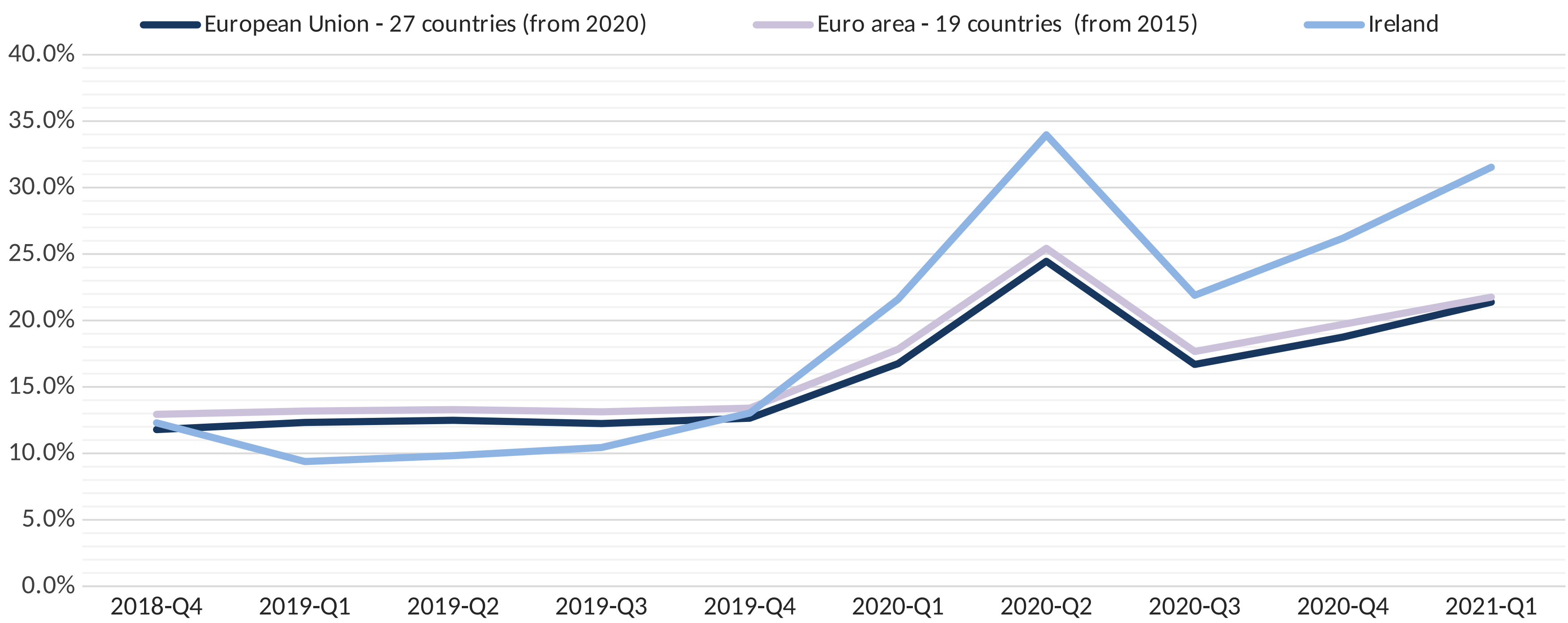
Consumption

- 2020: -10.4% 2021: 7.5% 2022: 8.0%
- The high savings ratio in Ireland and sustained economic reopening are likely to lead to a rebound in consumption.
- In 2020, the drop in consumption was larger in Ireland than the median of other European countries. Consequently, the recovery in consumption in Ireland in Q2 2021 was also much larger than the European median.
- The dramatic increase in the savings ratio in Ireland suggests that a large tranche of resources are available to households to spend as the economy reopens.
- One likely usage for built-up savings will be house purchases and home improvements.



Source: Author's calculations using Eurostat data.

SAVINGS RATIO – IRELAND AND EUROPEAN ECONOMIES – % OF DISPOSABLE INCOME



Source: Central Statistics Office

Investment

- 2020: -23.0%2021: -45.0%2022: 8.3%

- Headline investment levels are likely to drop dramatically in 2021 due to multinational activities.

- Modified investment declined annually by 7 per cent in Q1 2021 and then showed signs of rebounding in Q2 2021, with a growth of 20 per cent per annum.

- Construction output varied considerably over the course of the pandemic, as operations were limited during public health restrictions.
  - We expect completion of 21,000 units in 2021 and just over 26,000 units in 2022.

- Marked increase in business confidence indicators since April 2021 suggests we will see a rebound in investment by many businesses as the economy recovers.

MODIFIED GROSS DOMESTIC FIXED CAPITAL FORMATION

YEAR-ON-YEAR GROWTH

Source: Central Statistics Office and QEC analysis

Trends in Borrowing

- Both households and SMEs have experienced a sharp fall in lending throughout the pandemic.
    - Total lending to SMEs in 2020 decreased 23.2 per cent compared to 2019.
    - Average household debt levels were 2.8 per cent lower in 2020 than 2019, largely due to the drop in the demand for credit during the pandemic.
    - Total deposits have far surpassed household lending.

- Uncertainty surrounding the COVID-19 pandemic is a large contributor to the drop off in lending. However, the cost of finance is also an important factor.
    - The average annual interest rate on new home loans in Ireland was 2.7 per cent in Q2 2021 compared to just 1.5 per cent in the Euro Area.
    - Interest rates on loans to corporations in Ireland have also remained higher than the Euro Area average.
    - In 2020, the average interest rate paid by Irish corporations in need of small loans was 5.0 per cent, compared to just 1.9 per cent for Euro Area businesses.
    - Monitoring the cost of credit will be important as Irish households and SMEs strive to recover from the effects of COVID-19.

Trade

Trade

- Performance of Irish GDP linked to performance of Exports and Imports.
- Irish net exports were €55.4bn in Q2 2021. The strong year-on-year recovery is a signal of the significant declines in trade that occurred in Q2 2020.

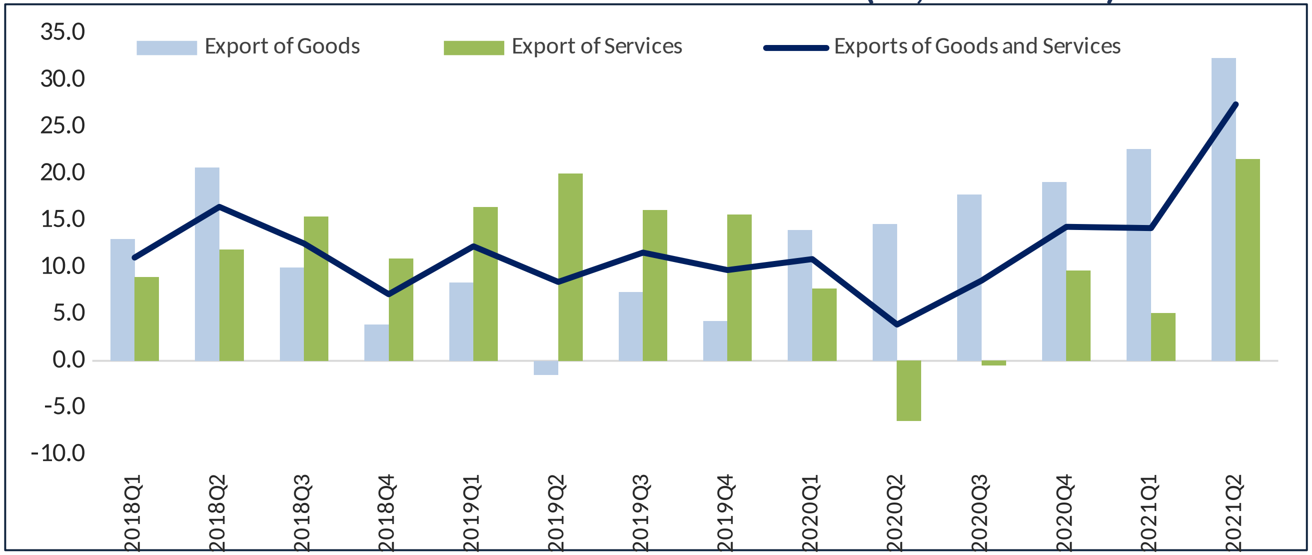
Exports

- 2020: 9.5% 2021: 14.3% 2022: 9.0%
- While exports of medicinal and pharmaceutical products declined slightly, growth occurred across a variety of other export groups, signalling that the recovery is being experienced across the economy:
  - Machinery and transport equipment (+23.7% y-on-y)
  - Computer services (+35.1% y-on-y)
- Further growth expected in 2021 and 2022 as Ireland's main trading partners recover.

Imports

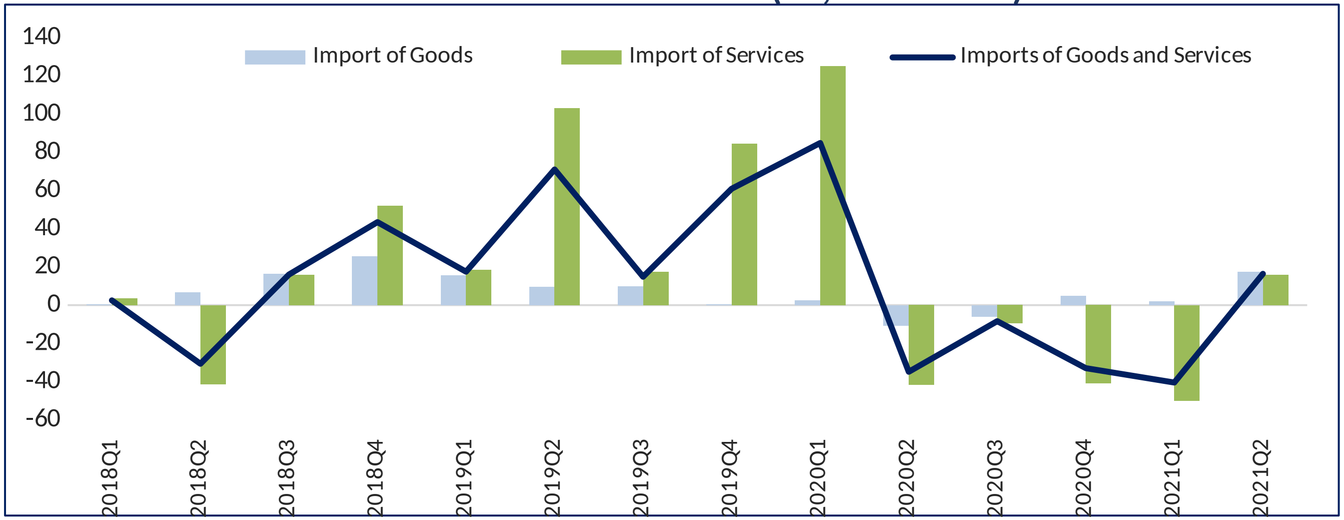
- 2020: -7.4% 2021: -7.9% 2022: 10.0%
- Q2 2021 registered positive annual import growth for the first time in five quarters.
- Significant increases in imports, particularly in transport equipment and manufactured articles, is likely related to declining uncertainty in market conditions as plans to reopen the economy materialised in Q2 2021.

EXPORTS: YEAR-ON-YEAR GROWTH (SA, VOLUME %)



In Q2 2021, goods and services exports increased 32.4 and 21.6 per cent per annum respectively.

IMPORTS: YEAR-ON-YEAR GROWTH (SA, VOLUME %)



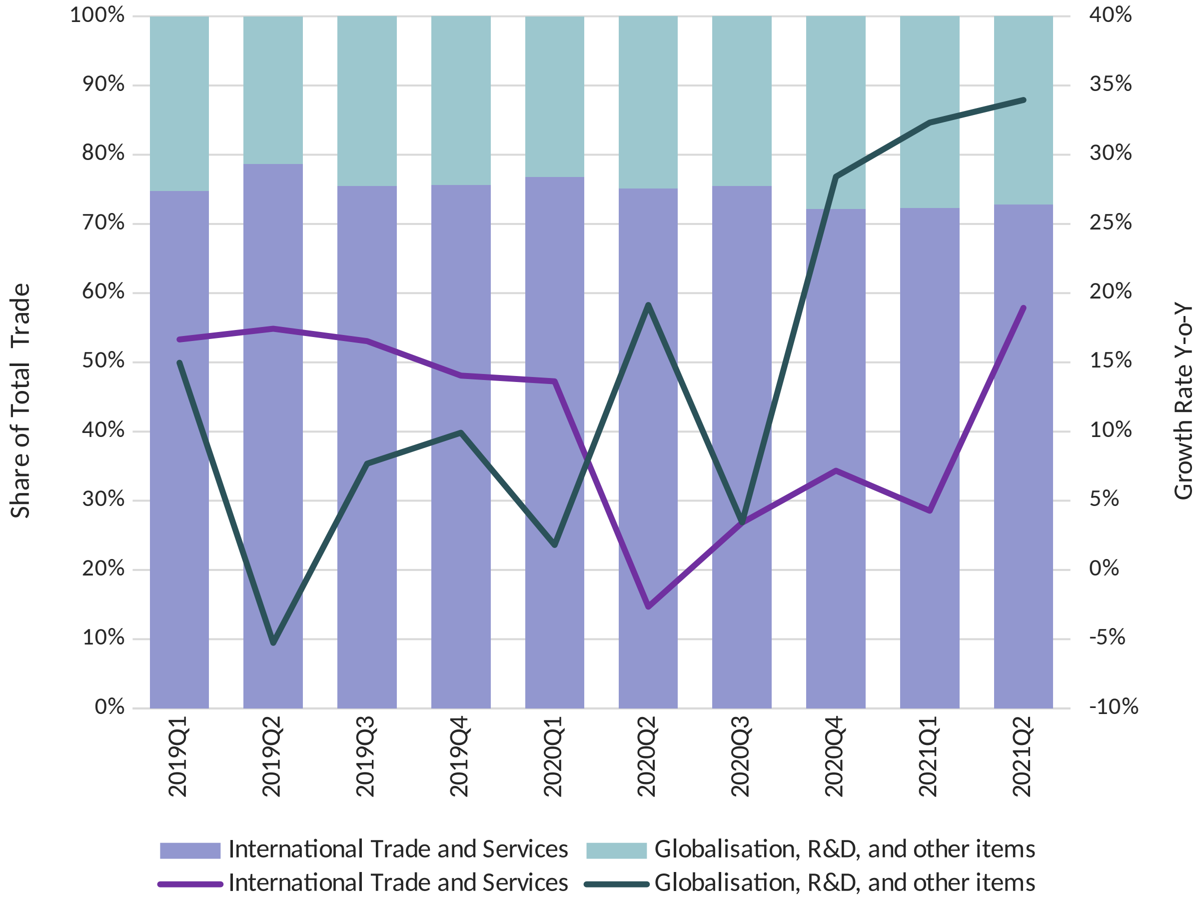
In Q2 2021, goods and services imports increased 17.5 and 15.9 per cent per annum respectively.

Source: Central Statistics Office

EXPORT GROWTH BY COMPONENT

(SHARE OF EXPORTS (LHS) AND YEAR-ON-YEAR GROWTH (RHS))

- While trade related to multinational activity has been robust throughout the pandemic, exports from domestic activities are performing strongly.
- Multinational activity includes globalization activities and adjustments; R&D and leasing; and royalties and licensing.



Source: QEC calculations using data from the Central Statistics Office, Current Account Trade Data.

Trade with the UK

- Since January 2021, goods from the UK to the EU must comply with new procedures and import requirements of EU Member States. Meanwhile, imports from the EU to the UK have not been met with the same stringency, resulting in an asymmetry in customs checks.

- The imbalance in customs checks:
  - In Q2 2021, Ireland's trade surplus with the UK was €4.26 billion.
  - Imports from the UK to Ireland have declined across all major commodity groups between 2019 and 2021.
  - Meanwhile, growth in many export categories from Ireland to the UK have occurred in this period. The only exceptions are Beverages & Tobacco and Food & Live Animals.

- Trade shows signs of recovery:
  - After the value of imports from Great Britain dropped 60 per cent from Q4 2020 to Q1 2021, the value of imports increased in Q2 2021 by 18.6 per cent compared to Q1 2021.
  - Exports to GB also grew (19.0% quarter-on-quarter) in Q2 2021.
  - After the close of the transition period, trade between Ireland and N. Ireland has also increased: the value of imports grew by 32 per cent between Q1 2021 and Q2 2021 while exports grew by 26.4 per cent in the same period.

Labour Market

Unemployment

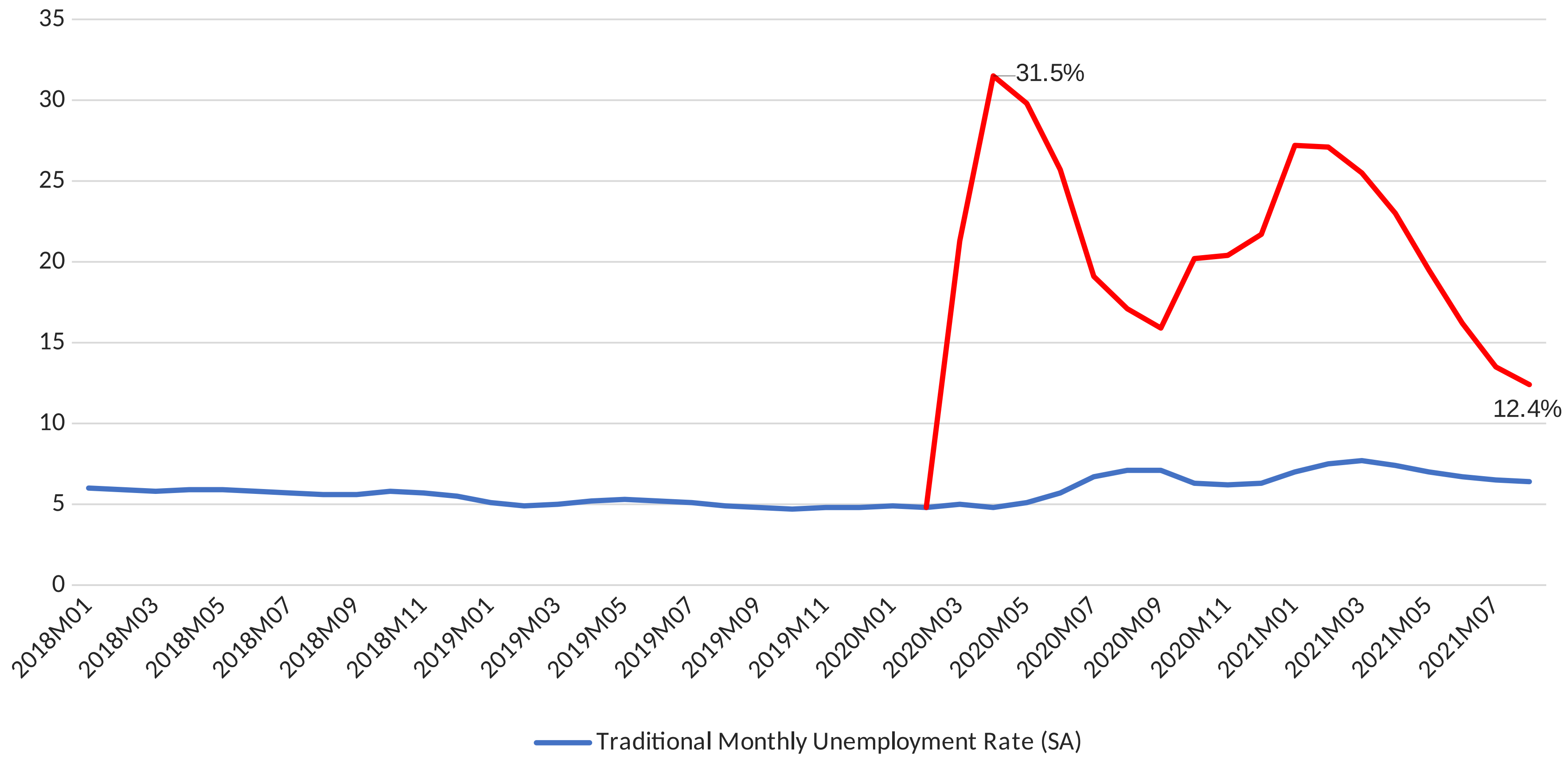
- 2020: 19.4%2021: 16.3%2022: 7.1%

- Wage subsidies and PUP have helped to uphold incomes during the pandemic.
  - The PUP closed to new applicants from 8th July 2021 and the weekly payment will be tapered down by €50 in September 2021, November 2021, and February 2022.
  - Those receiving a payment of €203 will move to Jobseeker's Benefit if eligible from 26th October 2021.
  - Employers received Employment Wage Subsidy Scheme (EWSS) payments for approximately 319,400 qualifying employees in August 2021.
    - EWSS is due to expire on 31st December 2021.

- As the economy continues reopening, we expect the unemployment rate to continue to lower swiftly.
  - From its peak of 31.5% in April 2020, the Covid-adjusted unemployment rate has since declined to 12.4% in August 2021.
  - Since May 2020, the number of PUP claimants in the accommodation and food sector has fallen by 103,000.
  - We anticipate unemployment to fall to 9 per cent by Q4 2021.

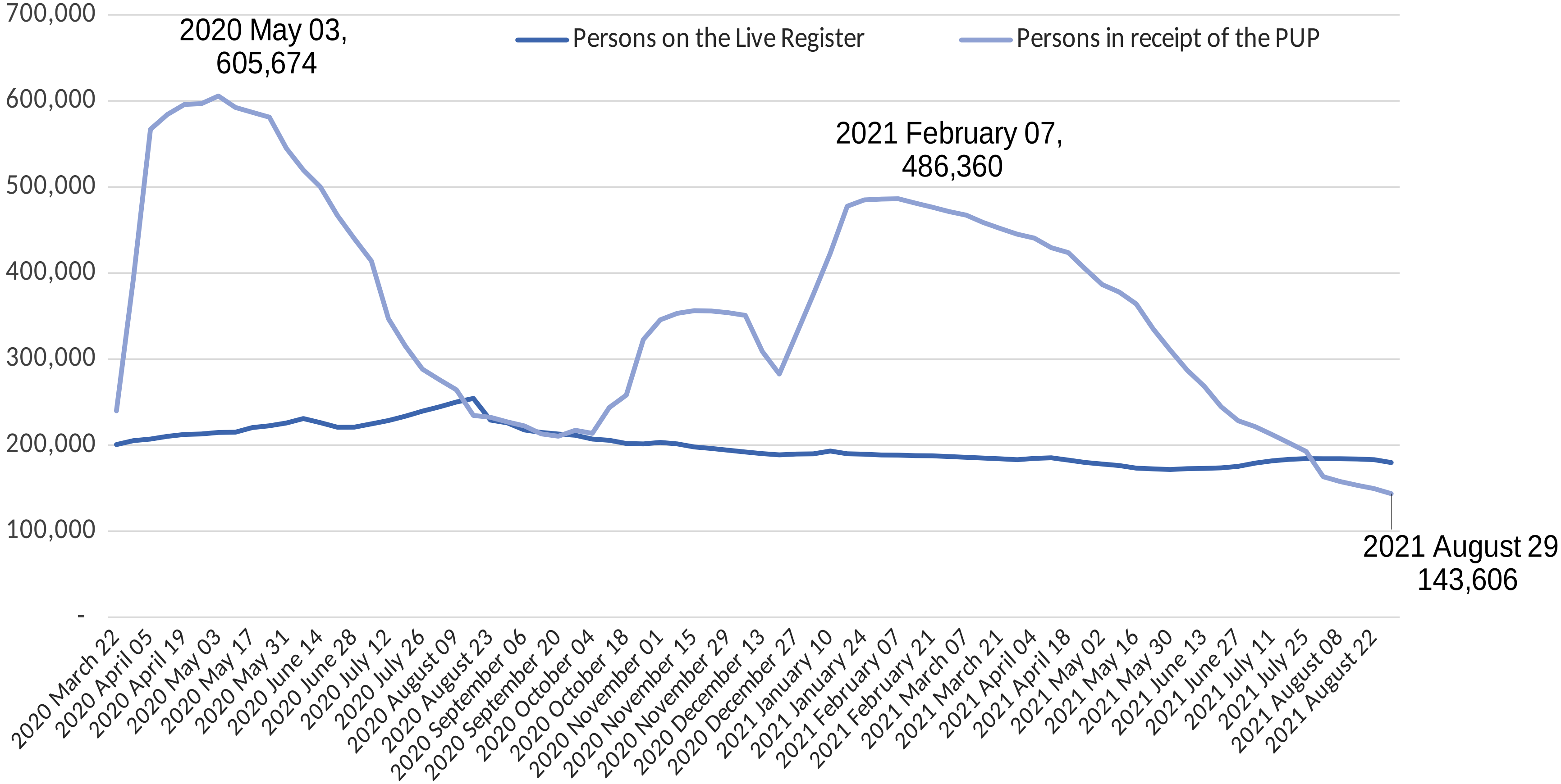
  - Forecast to decline to approximately 7.1 per cent in 2022.

Unemployment rate (%)



Source: Seasonally-Adjusted Monthly Unemployment Rate Series and the COVID-19 Adjusted Monthly Unemployment Rate Series. Central Statistics Office

NUMBER OF PEOPLE ON WAGE SUBSIDY SCHEMES BY WEEK



Source: Central Statistics Office .

Public Finances

- GGB 2020: -€18.4bn GGB 2021: -€14.7bn GGB 2022: -€8.0bn
- (% of GDP) 2020: -4.9% (% of GDP) 2021: -3.4% (% of GDP) 2022: -1.7%
- Debt to GDP 2020: 59.5% Debt to GDP 2021: 54.6% Debt to GDP 2022: 51.8%

- Overall taxation receipts increased substantially in 2021.
  - Overall tax receipts increased **16.6 per cent** between 2020 and 2021. All tax items have registered strong growth.

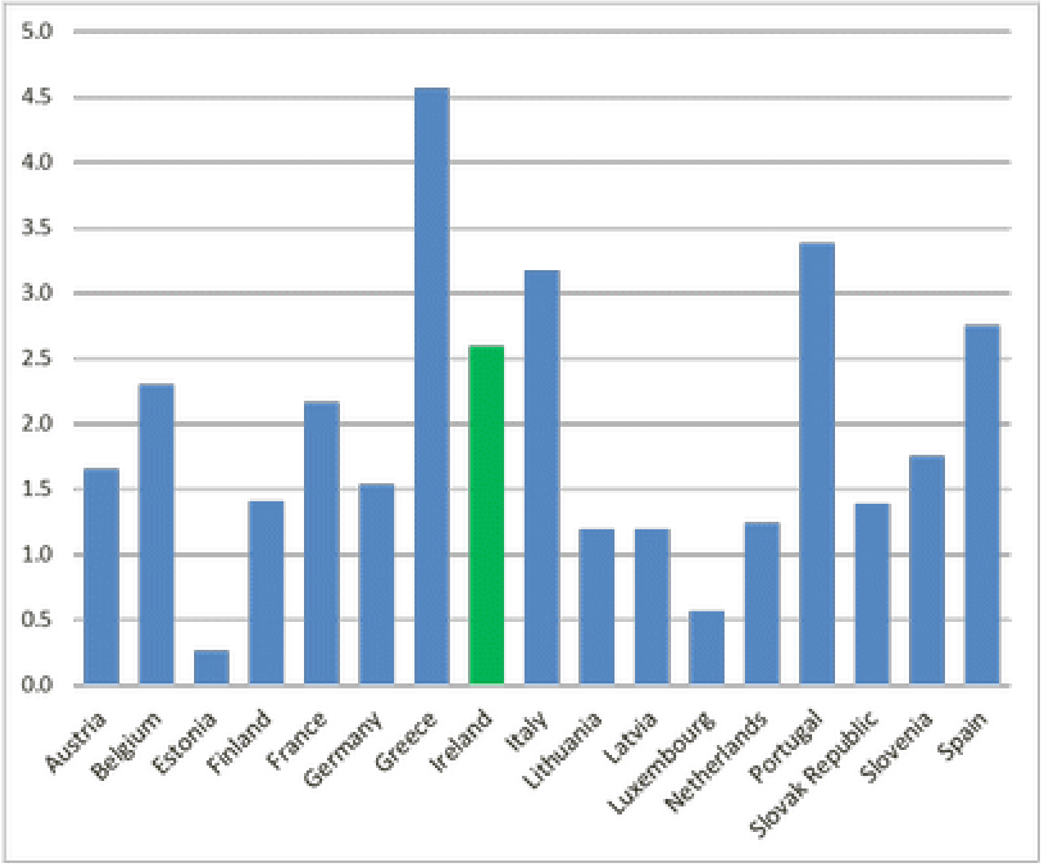
- Tax receipts have increased beyond their projected growth had the pandemic not occurred.
  - Using the average growth rates from 2016-2019, we estimate total tax receipts in 2020 had the pandemic not occurred.
  - Using this counterfactual figure, we find that tax receipts still registered an increase of **6.4 per cent** in 2021. This indicates that the increase is due not only to a low base in 2020, but rather to strong overall activity in 2021.

- The pace of Ireland's recovery coupled with the boost in taxation receipts has led to improvements in the debt to GDP and debt to GNI* ratios.
- We anticipate further reductions in these ratios throughout 2022, signaling Ireland's improvements in the general government balance.

Box B: Is Ireland a High Debt Country?

- The ratio of gross government debt to taxation revenue can be used across the EU to measure improvements in debt sustainability.
- While by no means the highest ratio, data from 2019 suggest that, at a ratio of 2.6, Ireland experiences higher indebtedness than the EU median. However, this is a marked improvement from Ireland's position in 2011, when the ratio was 3.9.

Ratio of Gross Public Debt to Total Government Taxation Revenues in 2019

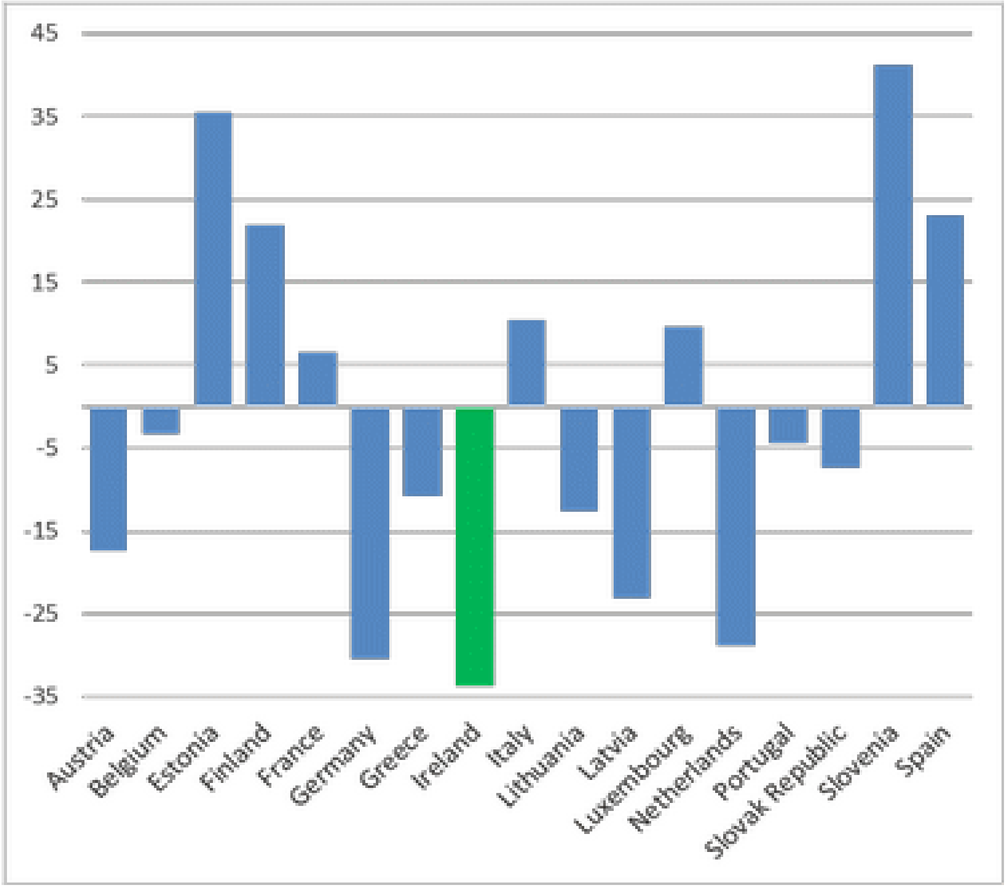


Source: OECD, Eurostat, and author's calculations

Box B: Is Ireland a High Debt Country? (Cont.)

- Over the past 10 years Ireland has registered the largest decline in the debt ratio and is anticipated to continue to perform well.
- By 2022, Irish debt levels are set to be just above the EU average.
- The improvements in Ireland's debt position suggest that sustainable borrowing may be feasible over the medium-term in order to address pressing post-Covid challenges.

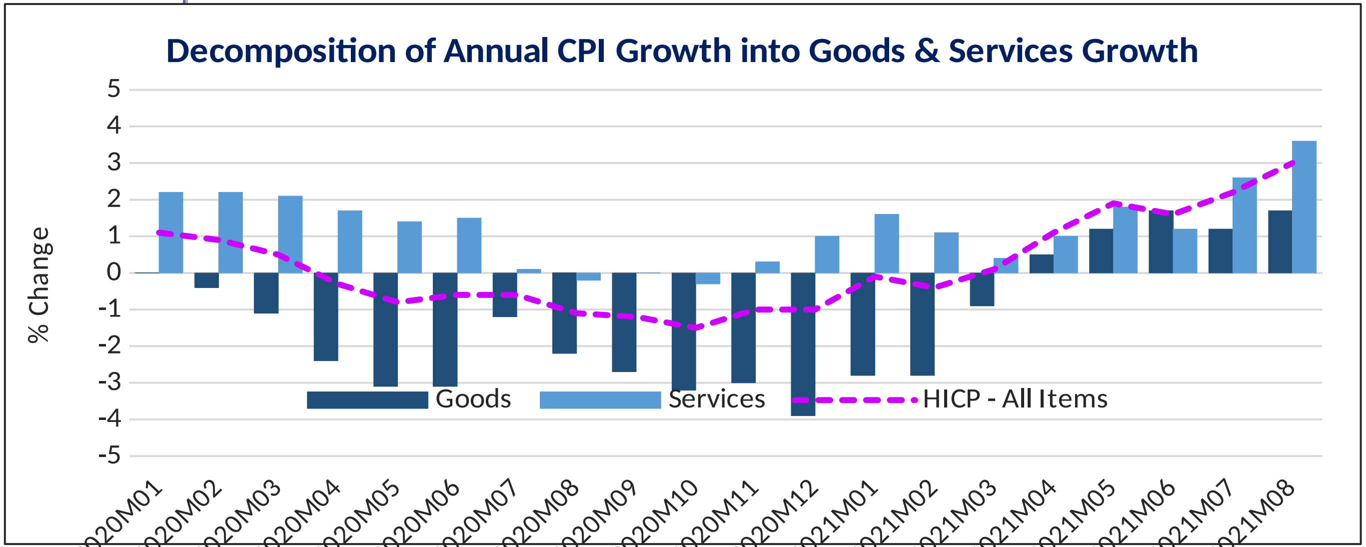
Change (%) in the Ratio of Gross Public Debt to Total Government Taxation Revenues (2011-2019)



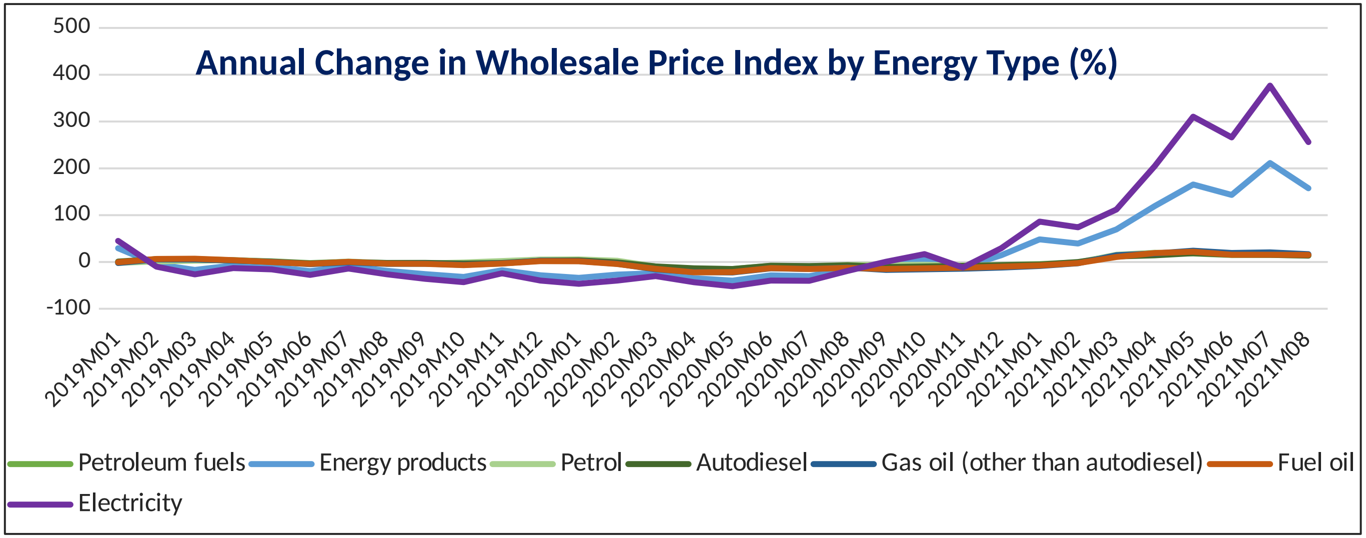
Source: OECD, Eurostat, and author's calculations.

Inflation Forecast

- As economies have resumed most normal activities in the second half of 2021, consumption and unemployment levels have rebounded slightly faster than anticipated.
    - The deflationary period that occurred in 2020 is a large contributor to the recent increases in inflation.
    - The easing of public health restrictions are also causing a surge in demand; prices for transport and restaurants and hotels increased in Q3 2021.
- Several countries experienced increases in the Harmonised Index of Consumer Prices (HICP) of over 2 per cent in Q3 2021.
    - By August of 2021, prices had increased 2.7 per cent in Ireland and 2.6 per cent in the Euro Area compared to the same period last year.
- However, global trends are also large contributors to inflationary pressures. 2021 has been accompanied by substantial changes in the energy market.
    - Energy products have increased over 100 percent annually from April to August 2021.
    - The Euro Area experienced an increase in energy prices of 3.4 per cent in Q3 2021 compared to Q2 2021.
    - Ireland experienced an increase of 5.3 per cent in the same period.
- We forecast inflation to reach 2.3 per cent in 2021 and to weaken considerably throughout 2022.



Prices of services increased 3.6 per cent per annum in August 2021, as consumers are enjoying services that were not available during lockdown.



While some declines in energy prices occurred in 2020, the latest increases in electricity and energy products have far surpassed pre-pandemic price levels.

Source: Central Statistics Office

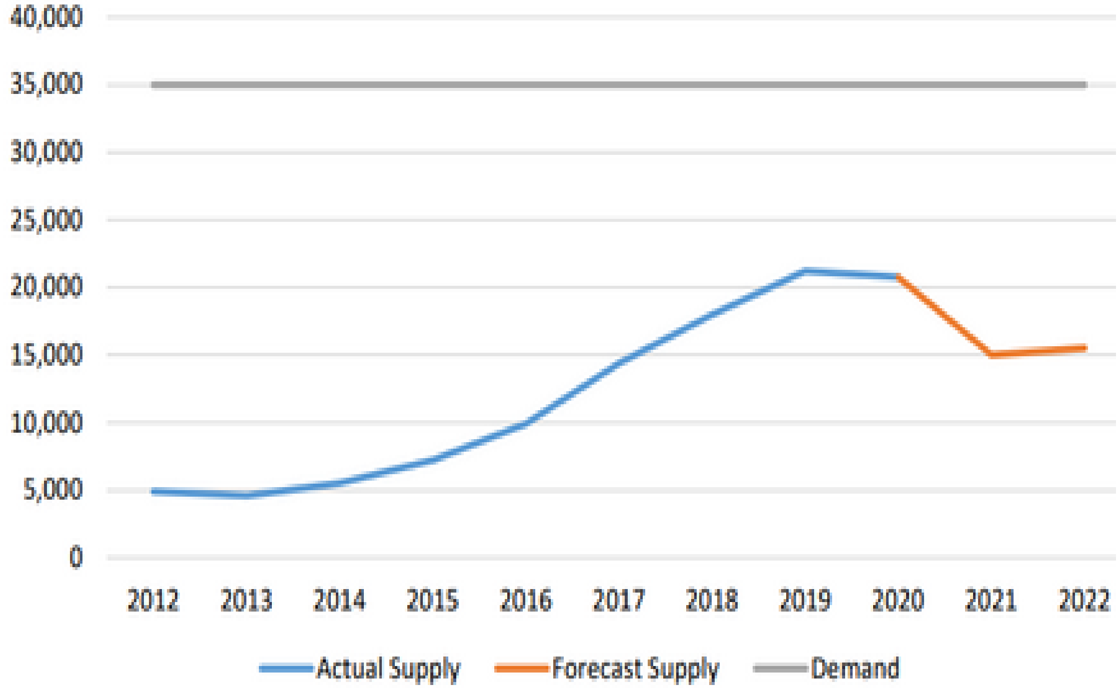
Assessment

- With both domestic and foreign economic activity performing strongly, GDP is set to increase 12.6 per cent in 2021.
- Modified domestic demand, which is a more accurate measure of how domestic sectors of the economy are performing, is set to increase by over 7 per cent in 2021.
- Reopening of the economy will see unemployment decline to 9 per cent by the end of the present year.
- The high savings ratio of households should decline moderately, providing a boost to consumption expenditure throughout the rest of the year and into 2022.
- Overall, the strength of certain aspects of the export sector and the robust performance of the Irish economy before the pandemic have contributed to its resilience over the past year and a half.
- Challenges await the post-pandemic economy; the resilience of the demand-side of the Irish economy has contributed to inflationary pressures as the supply-side adjusts. The residential property market in particular has experienced increases in house prices and rents since the start of 2021.
    - While we expect inflationary pressures to abate through 2022, inflation must be monitored. Inflation above the ECB target rate for a prolonged period may increase the pressure to unwind accommodative monetary policy.
- Due to greater than expected increases in taxation receipts and less than expected increases in expenditure, we expect the GGB to fall in 2021 and 2022.
- Future investment needed on housing, climate change and health care.
- Given the increased capital expenditure, restraint vis-à-vis current expenditure will be required to prevent overheating in the domestic economy

Thank You

Challenges ahead: addressing the imbalance between housing supply and demand

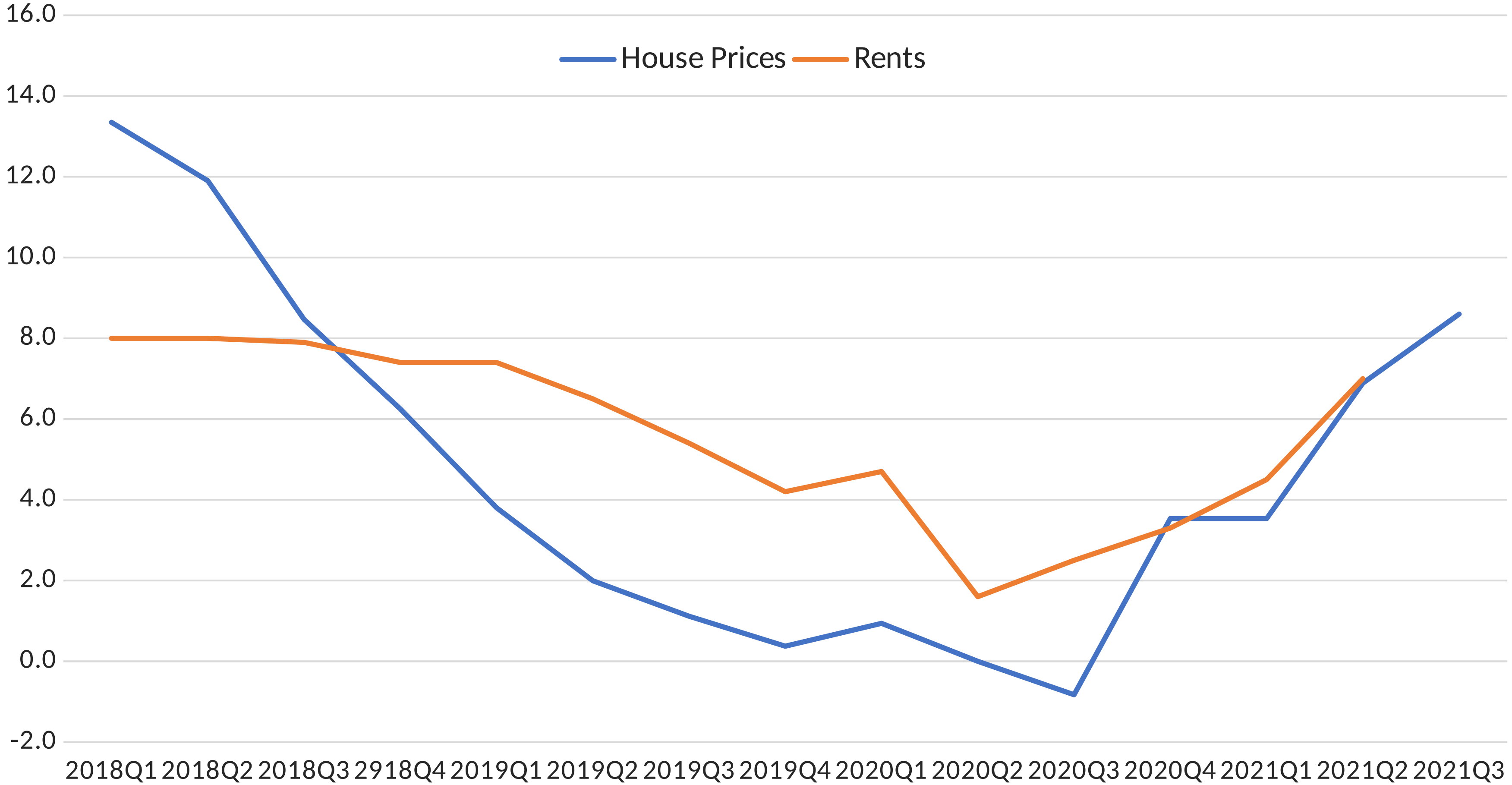
Actual and Forecast Housing Completions and Estimate of Structural Demand*



*Sources: CSO, *QEC* calculations and Bergin and Garcia-Rodriguez (2020)

- The pandemic has had negative effects on housing, with construction experiencing significant volatility as a result of public health measures. Considerable investment in housing is needed to increase housing supply and deal with considerable bottlenecks.
- Gaps between housing supply and structural demand have been a challenge in Ireland long before COVID-19; yet the pandemic has exacerbated the gap.

Recent annual house price and rental inflation (%)



COVID-19: Exacerbating the Gap

- Housing demand has not been diminished by the pandemic, as is evident from the annual increases in house prices so far in 2021. Meanwhile, forecasts for housing supply in 2021 and 2022 reflect slowdowns in housing completions due to the effect of public health restrictions on the construction sector.
- The private sector has particularly struggled to meet current housing demand – it is expected to complete just 10,000 housing units this year and next.
- The lack of adequate housing in Ireland and its subsequent effect on high costs of living is one of the biggest challenges to our competitiveness as an economy.
- While there are many pressing demands for additional State capital investment, we risk experiencing another decade of inadequate housing supply and higher housing costs without significant investment in this area.

Consumption: an outlet for savings

- Following the first set of public health measures announced in Q2 2020, new mortgage lending fell by 35 and 40 per cent per annum for first time buyers and movers, respectively.
- Yet the increase in savings for many households and the halt to house purchases has increased demand in the housing market.
- Mortgage lending grew in Q2 2021 over 49 and 44 per cent per annum for first time buyers and movers, respectively.