Irish Economic Update

AIB Treasury Economic Research Unit

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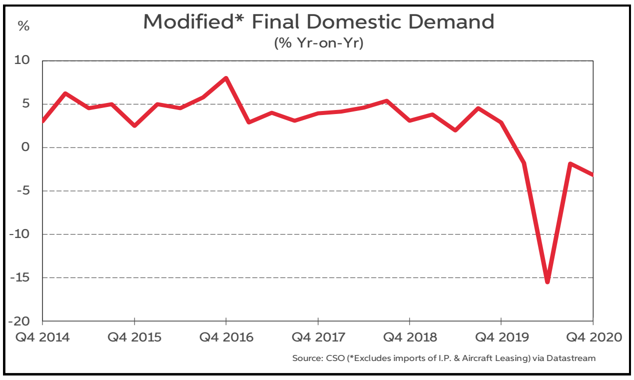
Irish economy more resilient to lockdown in 2021

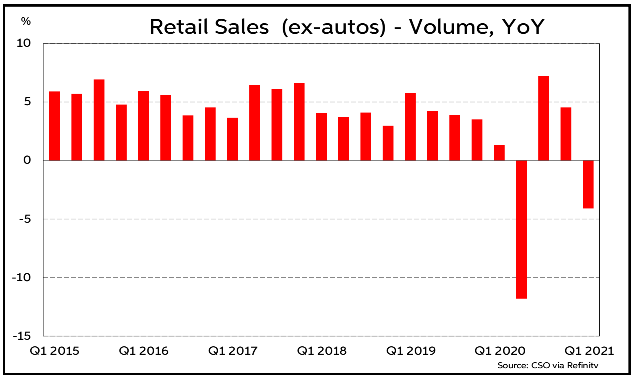
Irish GDP grew by 3.4% in 2020, with GNP up 0.6% as exports increased by 6.2%. The rise in exports was fuelled by a favourable product mix - with goods exports rising by 11.8%, due to a large jump in activity in the pharmaceutical sector. Services exports were flat for the year. However, these figures mask the effect that the pandemic and the accompanying restrictions had on the domestic economy. Modified final domestic demand contracted by 5.4%, with consumer spending down 9% and fixed investment falling by 8.5%. This was partially offset though, by a 9.8% rise in government expenditure. The impact was also uneven across sectors, with services much more impacted by social distancing restrictions than manufacturing and construction.



Data coming in on the Irish economy for the opening months of 2021 show that the current restrictions are not having as big a negative impact on activity as the shutdown in the spring of 2020. All of manufacturing remained open on this occasion, with the PMI for the sector rising strongly in March, before hitting a record level in April, as firms here participate in a global rebound in industrial activity. Meanwhile, part of the construction sector has remained open, meaning that although the PMI for the sector has fallen sharply, it has not been as severe as the collapse seen last year. Indeed, housing completions holding up much better than expected in Q1

More generally, the decline in the services PMI in the first two months of this year was nowhere on the scale of the contraction seen last spring. Firms have become better able to adapt to lockdowns, through remote working, online sales and home deliveries. The index has picked up in March and April also, printing at 54.6 and 57.7 respectively, reflecting an improvement in business conditions. Firm's outlook for the next 12 months is highly optimistic also. The future activity sub-component of the services PMI hit a three year high in April, with firms expecting a strong rebound in activity as restrictions are removed over the summer months.

Core retail sales declined in Q1, but again, not by as much as in the first lockdown. Sales fell by 8% in the quarter and were down by 4% on a year ago, but were 24% above the nadir reached last spring. Meanwhile, the cut in VAT helped support new car sales in early 2021. These were down by just 3.5% in the first quarter on year earlier levels. Retail sales are set to rebound strongly in Q2, with a full re-opening of the sector from mid-May onwards. More broadly, similar to last summer, households savings, which grew by €16bn last year are expected to be unwound somewhat as the economy re-opens due to the release of pent-up demand, leading to a sharp rise in consumption.



The latest lockdown has seen the unemployment rate, including those on the PUP (Pandemic Unemployment Payment), rise to 25% in the first quarter of 2021, compared to the high of 30% in the first lockdown last year. More recently, the Covid-19 adjusted rate has been moving lower, and was at 22.4% in April. It is set to fall sharply over the course of the summer. The expectation is that the rate will have fallen to 10% or below by end year, and continue to decline markedly over 2022-23.

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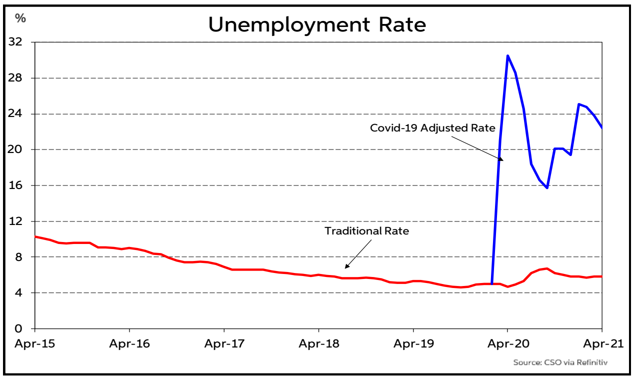
Forecasters expect strong recovery by Irish economy

Overall, recent growth forecasts for the Irish economy in 2021 have been quite upbeat. The rollout of highly effective vaccines has already allowed for some restrictions to be eased. The vaccine rollout is gathering momentum with most restrictions on activity due to be lifted over May and June as set out in the Government's recently announced re-opening plan. This will see activity pick up pace over the course of this quarter. Expectations are for a strong rebound in the second half of the year, when it is anticipated that lockdown restrictions will be fully lifted. The latest ESRI Quarterly Bulletin projects GDP growth of 4.4% for this year, up from 3.4% in 2020, based on a further rise in exports and a rebound in domestic spending.



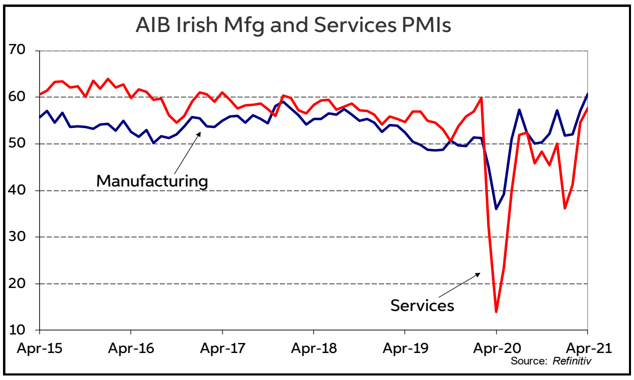
The IMF is forecasting GDP growth of 4.2% for Ireland in 2021. The Central Bank is even more bullish, forecasting GDP growth of 5.9%, with GNP up an astonishing 10.9%. This, though, is largely driven by international trade flows, with underlying domestic spending forecast to rise by a much more modest 2.8%. **The ESRI sees GDP growth at 5.2% next year, with the IMF and Central Bank are at 4.8% and 4.7%, respectively.**

Thus, the near-term prospects for the Irish economy look quite favourable. The key to the economic recovery remains the vaccine rollout. Furthermore, accommodative monetary and fiscal policy are likely to be kept in place as the economic recovery begins to take hold. Interest rates are set to remain very low, while the Government has indicated that there will be continuing supports to help businesses and workers.

There are other factors as well that suggest the economy is primed for a strong recovery. Between the Global Financial Crisis and the 2020 Coronavirus pandemic the economy has deleveraged, meaning there is a much lower amount of private sector debt. Furthermore, as restrictions are eased throughout this year, the release of the previously mentioned build-up in household savings should support a strong rebound in domestic spending. A strong global economic recover is also expected to take place, which augurs well for export orientated countries such as Ireland.

Meanwhile, the threat of a "no-deal" Brexit has now been removed following the trade deal agreed between the EU and the UK at the end of last year, another positive for the Irish economy. The Trade and Co-operation Agreement (TCA) though, is much inferior to the EU Single Market and involves extra administrative costs. The TCA does not extend to services either, creating a further hindrance to trade between Ireland and the UK. Elsewhere, a close eye, needs to be kept on likely changes to the global corporate tax regime. Ireland's relatively low and stable 12.5% corporate tax rate has been a key cornerstone in attracting FDI.

Ireland though, is likely to remain an attractive place for FDI. Big multinationals will still need to retain large global operations whatever happens in terms of taxation. Ireland's strong talent pool of internationally mobile and well educated workers, as well as our common law system remains a key attraction for US companies. Importantly also, the UK, our main competitor for FDI historically, is now outside of the EU Single Market & Customs Union.



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