4. IRELAND

Ireland's domestic economy was hit severely by the pandemic control measures in the first half of the year but strong exports by multinationals cushioned the fall in real GDP. Employment has been shielded by state income support schemes. The economic contraction and the substantive fiscal stimulus are expected to significantly widen the budget deficit. Risks to the outlook remain exceptionally high.

Multinationals cushion the fall in GDP

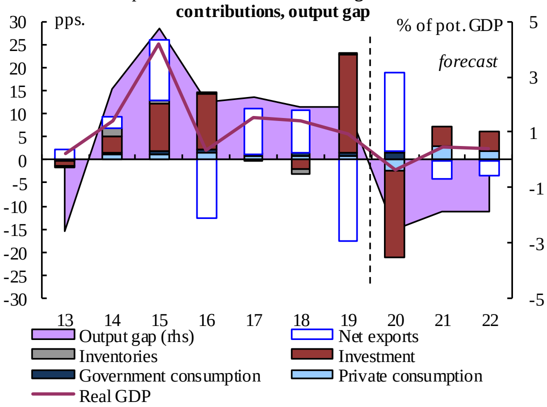
Ireland's real GDP contracted by 2.1% quarter-on-quarter in the first quarter and by 6.1% in the second, less than many of its European peers, as exports by multinational corporations, particularly the pharmaceutical and business services sectors, performed well. The domestic economy scored worse, with modified domestic demand falling by nearly one fifth in the first half of the year.

Private consumption compressed dramatically, by one fifth in the second quarter compared to the first, as a stringent lockdown curtailed in-person shopping. Household incomes, however, were relatively unaffected, as the government stepped in to support them. Pent-up demand was to some degree satisfied over the summer when consumers became more optimistic. A virus resurgence led to the reintroduction of restrictive measures and the imposition of a six-week national lockdown on 21 October, slashing prospects for a swifter recovery. The extension of income support schemes together with accumulated savings provide scope for consumption smoothing in 2021. Accordingly, private consumption is projected to shrink by 8% in 2020, but to rebound by 11% in 2021 and by 6½% in 2022. Public expenditure contributed positively to growth in 2020.

Investment collapsed by some 70% q-o-q in the second quarter. Construction faced a temporary ban, aircraft leasing saw a sharp fall in demand, and other projects were delayed or cancelled amid extreme uncertainty. Investment is set to remain weak in the near term amid heightened uncertainty, but is expected to recover during 2021 and further in 2022 with the assumed easing of lockdown measures. Support by the Recovery and Resilience Facility (RRF) could be an upside investment risk.

The fall in private consumption and investment triggered a decline in imports. Meanwhile, exports by multinationals held up and even increased in the second quarter compared to the first, resulting in a substantial current account surplus. The move to the new, significantly less beneficial EU-UK trading relations at the end of the transition period is expected to reduce trade and GDP growth in particular in 2021. It should be noted that according to the Protocol on Ireland and Northern Ireland Union rules relating to goods and the Union Customs Code will continue to apply to and in Northern Ireland, ensuring free circulation of goods between Northern Ireland and the EU.

Graph II.4.1: **Ireland - Real GDP growth and contributions, output gap**



Ireland's economy is projected to contract by 2¼% in 2020, before growing by 3% in 2021 (recovering 2019 levels) and by 2½% in 2022. Modified domestic demand, which better reflects the underlying domestic economy, is expected to fall by 6½% in 2020 and grow by 7¼% in 2021 and 4½% in 2022.

HICP inflation remains subdued amid low oil prices, weak demand and a recent VAT cut in effect as from September 2020. Inflation is projected to average –0.5% in 2020 before increasing to 0.3% in 2021 and to 1.6% in 2022.

The labour market is tested by the crisis

The labour market entered 2020 in a healthy condition. However, at the height of the lockdown, around one fifth of the workforce could not work and a large share had still not resumed work in October. Nonetheless, the wide take-up of government's income support schemes is set to cushion the labour market shock amid a drop in hours worked. Higher unemployment may accompany the economic recovery in 2021 as the Pandemic Unemployment Payment scheme ends in April. In 2022, a second year of recovery is set to support the start of a labour market rebound.

The government is set to continue prioritising temporary and targeted measures

The economic slump is expected to have a strongly negative impact on the government balance, due to the operations of automatic stabilisers and government discretionary fiscal measures.

The general government deficit is projected at 6¾% of GDP in 2020. In the first nine months of 2020, tax revenues were only slightly lower compared to last year. This reflects the resilience of corporate income tax receipts – supported by the ICT and pharmaceutical sectors – and of personal income taxes – largely due to the progressivity of the income tax system. The public support, with an estimated direct budgetary cost of around 5.2% of GDP, played a crucial role in mitigating the economic and social fallout from the pandemic, and led to a deficit in the government balance.

The deficit is forecast to decrease to 5¾% of GDP in 2021. The government is set to prioritise temporary measures to fight the effects of the pandemic next year. According to the 2021 Draft Budgetary Plan, the support largely comprises an extension of the measures already in place. It includes, among others, wage subsidies to protect jobs, welfare payments, healthcare support, and a contingency reserve to address further costs that may arise next year, with an overall direct budgetary cost of around 2.5% of GDP. In addition, it includes a recovery fund, of 0.9% of GDP, for additional expenditure to address evolving challenges from both the pandemic and the change in EU-UK trading relations. This forecast does not include any measures funded by RRF grants. Revenues are expected to grow in tandem with GDP. The deficit is forecast to shrink to around 2½% of GDP in 2022 under a no-policy-change assumption and the largely temporary nature, mostly limited to 2021, of the measures adopted to fight the pandemic.

The gross general government debt-to-GDP ratio is projected to reach 63% in 2020, 66% in 2021 and to stabilise in 2022. Risks to the fiscal outlook, specific to Ireland, reflect potential changes in the international taxation environment.

Table II.4.1:

Main features of country forecast - IRELAND

	2019		Annual percentage change						
bn EUR	Curr. prices	% GDP	01-16	2017	2018	2019	2020	2021	2022
GDP	356.1	100.0	4.0	9.1	8.5	5.6	**-2.3**	**2.9**	**2.6**
Private Consumption	104.2	29.3	2.4	2.2	2.6	3.2	**-8.1**	**11.1**	**6.6**
Public Consumption	42.3	11.9	2.3	3.9	5.7	5.8	**13.3**	**-0.4**	**-1.3**
Gross fixed capital formation	162.4	45.6	7.3	0.0	-6.3	74.9	**-41.3**	**15.3**	**13.5**
of which: equipment	25.5	7.2	6.3	11.5	15.5	-1.2	**-67.6**	**0.7**	**10.7**
Exports (goods and services)	448.9	126.1	6.9	9.2	11.1	10.5	**0.7**	**1.7**	**3.5**
Imports (goods and services)	405.1	113.8	6.7	1.1	4.0	32.4	**-14.1**	**6.6**	**7.6**
GNI (GDP deflator)	275.5	77.4	3.6	6.6	7.3	3.7	**-3.1**	**3.8**	**4.1**
Contribution to GDP growth: Domestic demand			3.3	1.3	-0.6	22.9	**-19.6**	**7.2**	**5.9**
Inventories			0.1	-0.2	-0.9	0.1	**0.4**	**0.0**	**0.0**
Net exports			1.2	10.0	9.4	-17.5	**16.9**	**-4.3**	**-3.3**
Employment			1.3	3.0	3.2	2.9	**-0.4**	**-3.6**	**1.1**
Unemployment rate (a)			8.9	6.7	5.8	5.0	**5.3**	**8.9**	**8.7**
Compensation of employees / head			2.8	2.9	2.6	3.5	**2.3**	**3.7**	**2.4**
Unit labour costs whole economy			0.1	-2.8	-2.4	0.9	**4.3**	**-2.9**	**0.9**
Real unit labour cost			-1.6	-4.4	-2.8	-2.2	**3.8**	**-4.5**	**-0.3**
Saving rate of households (b)			9.7	11.5	11.6	12.2	**27.8**	**17.6**	**13.3**
GDP deflator			1.8	1.6	0.3	3.1	**0.5**	**1.7**	**1.3**
Harmonised index of consumer prices			1.6	0.3	0.7	0.9	**-0.5**	**0.3**	**1.6**
Terms of trade goods			0.3	-4.1	-6.3	2.2	**1.2**	**0.4**	**-0.4**
Trade balance (goods) (c)			23.6	36.3	33.4	33.5	**41.8**	**39.7**	**39.1**
Current-account balance (c)			-1.8	0.5	6.0	-11.3	**5.7**	**0.2**	**-1.1**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)			-2.0	-8.1	-9.9	-21.2	**3.1**	**-1.2**	**-1.4**
General government balance (c)			-5.0	-0.3	0.1	0.5	**-6.8**	**-5.8**	**-2.5**
Cyclically-adjusted budget balance (d)			-5.0	-1.5	-0.9	-0.5	**-5.5**	**-4.8**	**-1.5**
Structural budget balance (d)			-	-1.5	-0.8	-0.5	**-5.5**	**-4.8**	**-1.5**
General government gross debt (c)			62.0	67.0	63.0	57.4	**63.1**	**66.0**	**66.0**

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.