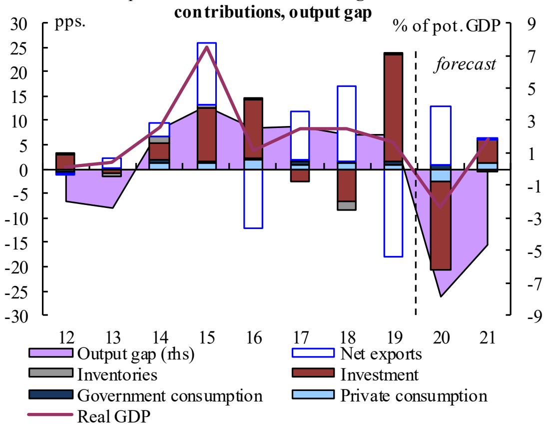
4. IRELAND

After years of strong growth, Ireland's economy is expected to contract in the second quarter of 2020, with a severely weakened external environment and lockdown measures hitting investment, private consumption, and external trade. Public spending is projected to expand sharply in order to mitigate these effects, contributing to a significant general government deficit. Negative risks to the macroeconomic and fiscal outlook remain exceptionally elevated.

Strong activity before the pandemic

Ireland's real GDP grew by 5.5% in 2019, partly driven by the activities of multinationals. Domestic economic activity, as reflected by the modified domestic demand indicator, grew by 3%. Ireland entered 2020 on a strong footing, with both domestic demand and net exports performing well.

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



The onset of the pandemic changed the situation dramatically. Initially, it disrupted global value chains and affected large information and telecommunication companies registered in Ireland. As the disease spread across Europe, containment measures enacted by the Irish authorities disrupted private consumption, as people were unable to access certain services and goods, while a number of households postponed purchases of durable goods amid uncertainty regarding income. Private consumption is expected to shrink by about 9% in 2020 and to partly recover by 4½% in 2021. Ireland has banned construction works since late March, while investment in equipment and other areas is likely to be postponed or even lost. As a result, gross fixed capital formation is forecast to drop by around 40% in 2020 from its very elevated level in 2019. The negative outlook is corroborated by confidence and other activity indicators, such as credit card use, which suggest a large contraction in economic activity since the lockdown.

In contrast, the contribution of net exports to economic growth in 2020 is expected to be positive, as a result of substantial import compression and some export resilience due to the large share of pharmaceuticals and medical products in Irish exports. In addition, exports of information and communication goods and services may also prove resilient. Overall, Ireland's economy is projected to contract by around 8% in 2020 and to expand by around 6% in 2021. The large uncertainty surrounding this outlook is compounded by factors specific to Ireland, such as changes in the international taxation environment. Moreover, Ireland is particularly affected by the future relationship between the EU and the UK. Operations of multinationals remain difficult to predict and can affect GDP figures in either direction.

Inflation expected to weaken…

Contagion mitigation measures may have changed consumption patterns, with purchases reportedly concentrating in food and necessities, where prices are likely to increase, and away from durables and non-essential services. The sharp fall in oil prices, which translates into lower energy prices and is gradually spilling into other categories, has reinforced the overall disinflationary pressures stemming from the fall in global demand. As a result, Ireland is expected to experience a period of negative inflation, with an average of -0.3% for the whole of 2020, followed by moderate inflation of 0.9% in 2021.

…and the labour market to weather the storm

The labour market performed strongly in 2019. In early 2020, the unemployment rate had stabilised at 4.8%. Since the end of March, the lockdown has prevented at least one fifth of the workforce from working, notably affecting the retail, accommodation, and recreation sectors. However, the increase in registered unemployment is expected to be relatively muted as many companies avail themselves of the government's income support schemes. In 2020, the unemployment rate is expected to rise to 7½ %, amid losses in consumption and exports. The rebound of the economy in 2021 is forecast to bring employment gradually back to pre-crisis levels by the last quarter of 2021, resulting in an average unemployment rate of 7.0% in that year.

Public finances to move into deficit and remain clouded by uncertainty

The general government balance reached a surplus of 0.4% of GDP in 2019, on the back of a booming economy, which brought about strong increases in tax revenues and social security contributions and a continued fall in the interest burden.

The economic slump is forecast to have a strong negative impact on the general government balance in 2020, due to the operations of automatic stabilisers and discretionary fiscal measures taken by the government. Revenues are expected to move in tandem with the decline in GDP. This reflects lower tax receipts, associated with weaker consumption and declining imports, lower income taxes, both personal and corporate, as well as lower social contributions, due to weaker personal income and company profits. The government response to the pandemic – wage subsidies to protect jobs, welfare payments and healthcare support – will raise current expenditure, with an overall direct budgetary cost of around 2% of GDP. Revenue and expenditure pressures are projected to lead to a general government deficit of 5½% of GDP in 2020. The government deficit is projected to shrink to around 3% of GDP in 2021 under the assumptions of no policy change and the temporary nature, limited to 2020, of the measures adopted to fight the pandemic.

Against this background, the gross government debt-to-GDP ratio is projected to reach 66½% in 2020 and 66¾% in 2021. Risks to the fiscal outlook are elevated and reflect various sources of uncertainty such as: the outlook for growth and jobs, the final cost of the fiscal expansion to counter the crisis and the changes in the international taxation environment.

Table II.4.1:

Main features of country forecast - IRELAND

		2018			Annual percentage change					
		bn EUR Curr. prices	% GDP	00-15	2016	2017	2018	2019	2020	2021
GDP		324.0	100.0	4.4	3.7	8.1	8.2	**5.5**	**-7.9**	**6.1**
Private Consumption		100.5	31.0	2.7	5.4	3.1	3.4	**2.8**	**-8.8**	**4.6**
Public Consumption		38.6	11.9	2.5	3.4	3.5	4.4	**5.1**	**7.7**	**-3.0**
Gross fixed capital formation		75.8	23.4	5.0	50.6	-6.7	-21.1	**94.2**	**-41.6**	**16.9**
of which: equipment		24.5	7.6	5.0	25.1	-11.2	39.4	**-12.3**	**-35.0**	**5.8**
Exports (goods and services)		396.4	122.3	7.9	4.1	9.2	10.4	**11.1**	**-15.2**	**6.7**
Imports (goods and services)		289.0	89.2	6.9	18.4	1.1	-2.9	**35.6**	**-27.7**	**8.4**
GNI (GDP deflator)		254.3	78.5	3.6	10.0	5.3	6.9	**3.7**	**-9.8**	**7.8**
Contribution to GDP growth:	Domestic demand			2.9	14.4	-0.9	-5.0	**23.4**	**-19.8**	**5.5**
	Inventories			0.2	0.3	0.4	-1.6	**0.2**	**0.0**	**0.0**
	Net exports			2.1	-12.1	10.0	15.4	**-18.2**	**11.9**	**0.6**
Employment				1.3	3.7	3.0	3.2	**2.9**	**-2.5**	**1.3**
Unemployment rate (a)				8.6	8.4	6.7	5.8	**5.0**	**7.4**	**7.0**
Compensation of employees / head				3.2	2.2	2.5	2.1	**4.0**	**-2.3**	**1.7**
Unit labour costs whole economy				0.1	2.2	-2.3	-2.6	**1.4**	**3.5**	**-3.0**
Real unit labour cost				-1.9	2.5	-3.4	-3.4	**-0.1**	**2.2**	**-4.1**
Saving rate of households (b)				8.5	8.0	10.5	10.2	**10.9**	**19.6**	**13.3**
GDP deflator				2.2	-0.3	1.1	0.8	**1.5**	**1.3**	**1.2**
Harmonised index of consumer prices				2.0	-0.2	0.3	0.7	**0.9**	**-0.3**	**0.9**
Terms of trade goods				0.0	2.7	-4.2	-6.1	**1.7**	**2.9**	**-0.1**
Trade balance (goods) (c)				22.8	39.0	36.7	34.9	**35.4**	**35.9**	**36.0**
Current-account balance (c)				-1.5	-4.2	0.5	10.6	**-9.4**	**4.6**	**4.4**
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-1.6	-5.8	-8.2	-5.8	**-19.3**	**-6.1**	**-5.6**
General government balance (c)				-4.6	-0.7	-0.3	0.1	**0.4**	**-5.6**	**-2.9**
Cyclically-adjusted budget balance (d)				-4.9	-2.0	-1.7	-1.0	**-0.7**	**-1.5**	**-0.5**
Structural budget balance (d)				-	-2.2	-1.7	-0.9	**-0.7**	**-1.5**	**-0.5**
General government gross debt (c)				59.6	73.8	67.7	63.5	**58.8**	**66.4**	**66.7**

(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.