The Dual Irish Economy

Irish GDP had been widely forecast to fall by between 7% and 10% this year, broadly in line with the Eurozone and UK. However, Irish national accounts data published last week for the second quarter of the year, when much of the economy was in lockdown, point to a much smaller decline. This is largely due to the continuing strength of exports, most notably in the pharma sector and computer services.

Irish GDP fell by 6.1% in quarter two following a decline of 2.1% in the first quarter. Thus, the economy entered recession. However, this 6.1% contraction is much smaller than the declines of 11.8% and 20.4% recorded in the Eurozone and UK for the same quarter. The smaller Irish fall is a surprise given the extent and duration of the lockdown in Ireland during the second quarter.

The domestic economy, though, as measured by modified final domestic demand, contracted by a sharp 16.4% in the second quarter, which included declines of 20% in consumer spending and 28% in domestic fixed investment. Another indication of the scale of contraction in activity in the quarter was the 22% fall in average hours worked compared to last year.

On the other hand, though, the value of pharma exports rose by 28% year-on-year in the January-June period, while exports of computer services were up by 10%. Exports in most other sectors held up relatively well, with the notable exception of tourism, travel and transport. Overall, the data highlight the dual nature of the Irish economy, with markedly different performances by the export and domestic sectors.

The fall in Irish GDP in 2020 as a whole is now likely to be quite moderate. Growth will rebound in the second half of the year. Indeed, the domestic economy started to recover over the summer months. Core retail sales in July had already rebounded to above their pre-Covid levels and were up by 20% on quarter two and 6% higher than a year earlier.

Meanwhile, exports seem likely to continue to perform relatively well in the second half of the year, given the favourable product mix. Lower royalty payments on intellectual property rights are also boosting net trade.

In terms of other indicators, tax receipts are holding up better than expected. They were down by just 2.3% to end August, helped by the strength of corporation taxes and to a lesser extent, income tax receipts.

Meantime, there has also been a sharp decline in the Covid-adjusted unemployment rate from a peak of 29% in April to 15.4% by August. The housing market also seems to be weathering the economic downturn, with output picking up again and prices holding firm.

Nonetheless, the economy has undergone a deep shock and will take quite some time to fully recover, especially on the domestic side. Sectors like hospitality and travel continue to be very badly impacted by social distancing measures. There also remains considerable uncertainty about the economic outlook, both here and abroad, given the persistence of the coronavirus.

The uncertainty and risks are reflected in continuing low levels of consumer confidence. It is also seen in an ongoing strong rise in private sector savings which has been evident since the crisis hit in March, including household savings. Finally, Brexit will pose a major challenge to the economy next year, especially if the EU and UK fail to agree a free trade deal.

Thus, it is important that both fiscal and monetary policy remain supportive of activity, with the focus now on next month's budget.

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