Banc Ceannais na hÉireann
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Box B: QB 2 – April 2021

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A Year of the Pandemic – A view from the BCI

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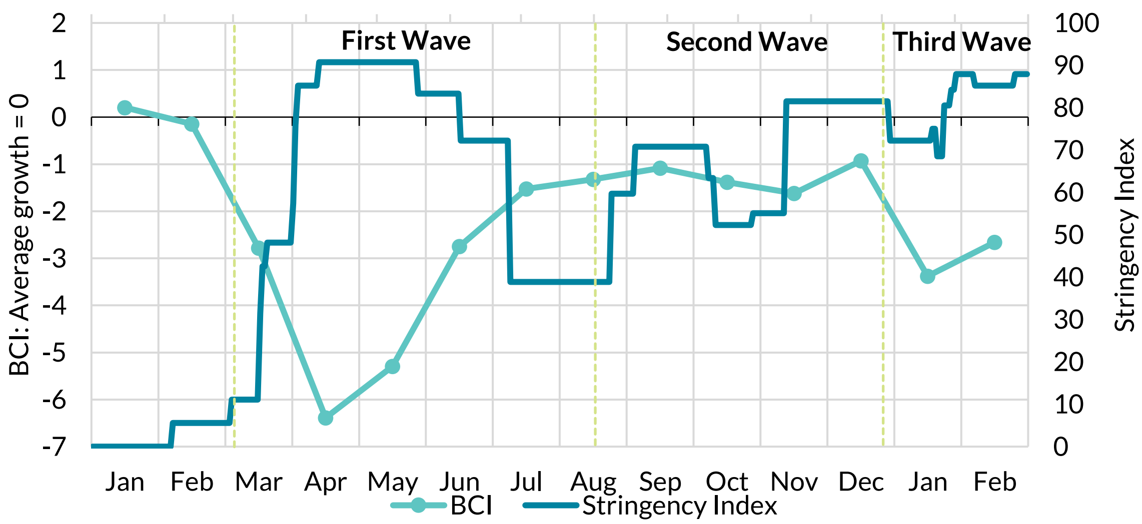
This box takes stock of the key developments in the economy a year after the start of the pandemic through the lens of the Central Bank's Business Cycle Indicator (BCI).[1] The BCI is a monthly indicator of economic activity in Ireland. It summarises into a single indicator the information from a broad range of high frequency data relating to the labour market, retail spending and consumer sentiment, industrial production and business expectations, the public finances, prices and financial markets. Values of the indicator above zero signal that economic activity is growing above its long-run historical rate while values of the BCI below zero indicate weaker than average growth. Figure 1 shows the BCI from January 2020 to date with reference to the Oxford Stringency Index – a measure of the level of COVID-19- related restrictions. The chart shows that there is an inverse relationship between the BCI and the severity of restrictions.

Figure 1: BCI and Oxford Stringency Index from January 2020 to date



Source: Central Bank BCI, University of Oxford (Stringency Index), authors' calculations.

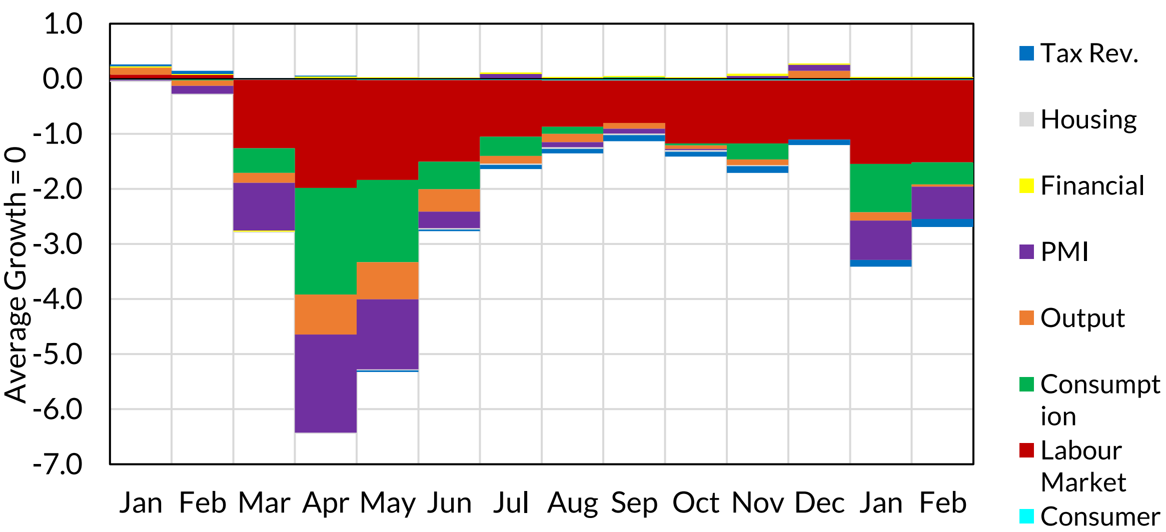
[1] The BCI was estimated using data available on 29/03/2021.

February – July 2020

In early February 2020, Covid-19 reached Europe and the number of confirmed cases began to rise across a range of countries. By the end of February, the first case of Covid-19 was detected in Ireland. The BCI began to fall in February and turned negative for the first time since April 2013. In March, Covid-19 infections increased rapidly in Ireland. The government responded by putting in place a range of restrictions and social distancing measures to limit and reduce the spread of the virus. Over this period, the stringency index rose from below 10 to over 90, reflecting the increase in the level of restrictions.[2]

The rise in confirmed cases and imposition of restrictions resulted in a decline of economic activity and the BCI fell sharply in March. The largest contribution to the fall in the BCI was due to the labour market component, with over 280,000 persons in receipt of the newly introduced pandemic unemployment payment (PUP) giving a Covid-adjusted unemployment rate of 20 per cent (Figure 2).

Figure 2: Contributions to the BCI from January 2020 to date



Source: Authors' calulations.

April represents the height of the first wave of Covid-19 in Ireland. Both the number of cases and severity of restrictions peaked in April and this combination of events led to an unprecedented negative impact on economic activity. The number of persons availing of the PUP climbed to 600,000 and the Covid-adjusted unemployment rate peaked at 30 per cent. Consumer sentiment dropped to its lowest level since 2008 and the services and construction PMIs fell to historic lows of 13.9 and 4.5, respectively. Industrial production fell in annual terms by 22 and core retail spending by 25 per cent. Credit and debit card transactions also fell sharply. As a result of the collapse in this wide range of

[2] The lockdown period began on 27 March and was extended until 18 May.

indicators, the BCI fell to a historic low surpassing the lowest level reached during the 2008/2009 economic and financial crisis.[3]

The level of restrictions in May were similar to those April, but restrictions began to ease towards the end of the month as the number of confirmed cases and deaths declined. A second month of tight restrictions meant that economic activity continued to operate at a very low level. Covid-19 restrictions were eased during June and July and the economy gradually reopened. The stringency index fell from a peak of over 90 in May to about 40 in June and July. By the end of the first wave, the BCI had bounced back from its low point in April making up about 75 per cent of the loss, but remained significantly below its pre-Covid level.

August – November 2020

In August, in response to a rise in the spread of the virus, the government re-imposed a series of restrictions, which led to an increase in the stringency index from about 35 to 70. The BCI continued to improve in August but at a slower rate compared to the gains made in the previous two months.

In September, the government announced a new 5-level plan for managing the virus. After a short period of easing restrictions, the country gradually moved back to level 5 restrictions by the end of October.[4] The stringency index increased from about 50 to 80. Over this period, the economic recovery stalled and the BCI began to show signs of levelling off below its pre-Covid level. In November, the BCI fell for a second month in a row, coinciding with a tightening of restrictions, which held the stringency index above 80.

December 2020 – to date

From 1 December, restrictions were eased on a phased basis to bring the country back to level 3. This lower level of restrictions lasted until a few days before Christmas and coincided with a reduction in the stringency index, which fell from around 80 to 70. The pickup in economic activity in the run up to Christmas brought the BCI to its highest level since the start of the pandemic, although it remained in negative territory.

Figure 2 shows a positive contribution in December from traditional sector output, which grew at an annual rate of 5.5 per cent – the first month of output growth since January 2020. The most significant negative contribution in this month was due to the labour market component, with the Covid-adjusted unemployment rate remaining at 19 per cent.

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[3] It is worth noting that the Covid-19 pandemic and events from 2008/9 are significantly different types of shocks. The comparison is for illustrative purposes only.
[4] On 21 October, Ireland became the first country in the EU to re-enter level 5 restrictions.

Following a steep rise in Covid-19 cases from mid-December, level 5 restrictions were introduced from 24 December. This brought the stringency index back up to about 90, a fraction below the level experienced during the first wave. As a result of the rapid spread of the virus and resumption of level 5 restrictions, the BCI dropped sharply, signalling a decline in economic activity and undoing the gains made over the summer months. As shown in Figure 2, the decline in the BCI in January was broad based with weaker labour market data, retail sales and industrial production.

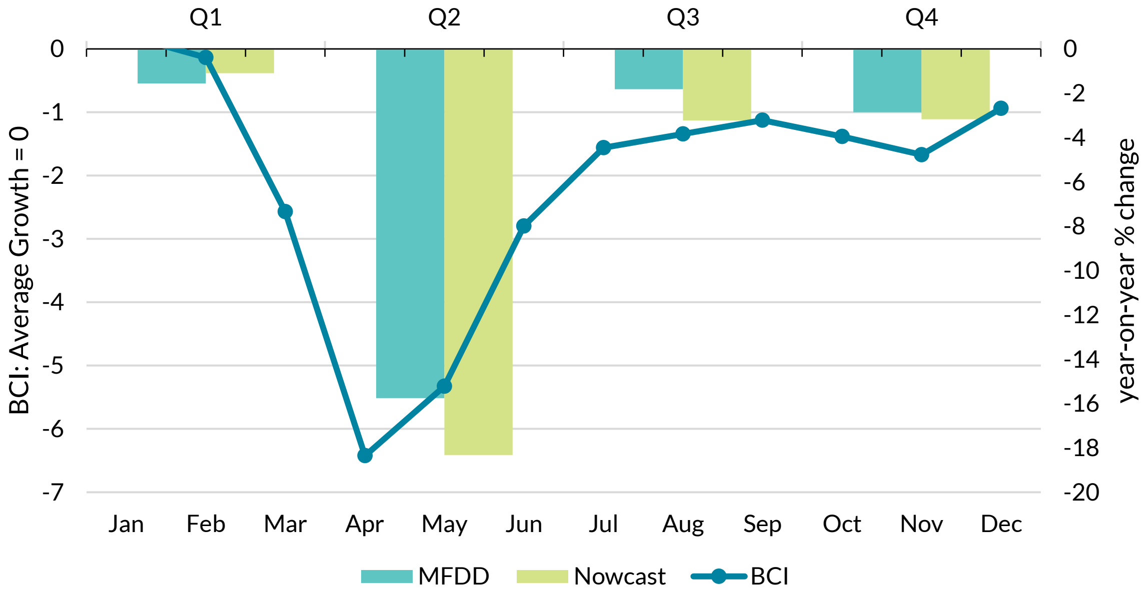
In February, the BCI showed signs of recovery on the back of more positive retail sales data and consumer sentiment; however, other indicators did not improve significantly compared to January as shown by the decomposition in Figure 2. For example, the Covid-adjusted unemployment rate fell marginally from 25.1 per cent in January to 24.8 per cent in February.

The fall in the BCI in January was only about half that recorded during the first wave in April 2020, despite the stringency of restrictions being similar. There are at least a few reasons why the initial effects of the lockdown in the third wave compare favourably to the first wave. Firstly, firms had more experience and had adapted their operations to continue trading despite the restrictions (for example by offering click and collect services etc.). Secondly, there were more fiscal supports in place, which put a floor under economic activity. Thirdly, a larger number of essential businesses were allowed to operate compared to the situation in April 2020. Despite suffering a smaller drop than during the first wave, the BCI currently remains well below its pre-Covid level and the recovery will depend on the path of the virus and vaccine rollout as discussed in the main text of this *Quarterly Bulletin*.

Nowcast

The BCI can be used as a nowcast tool to produce early estimates of modified domestic demand (MFDD) in advance of the release of official National Accounts data. Figure 3 shows the BCI and compares the corresponding nowcast estimates with the outturn for MFDD during 2020. Throughout the course of 2020, the nowcast estimates have captured the movements in MFDD relatively well, albeit with a tendency to provide estimates that are slightly more negative than the actual outturn. For 2020 as a whole, MFDD fell by 5.5 per cent while the BCI nowcast implied a 6.5 per cent decline. We continue to develop the BCI as a way of harnessing the information from high-frequency data in order to inform our assessment of current economic conditions.

Figure 3: BCI and nowcast compared to MFDD



Source: Authors' calculations.