



Banc Ceannais na hÉireann  
Central Bank of Ireland

Eurosystem



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# Notes

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6. The following symbols are used:

<b>e</b>	<b>estimated</b>
<b>n.a.</b>	<b>not available</b>
<b>p</b>	<b>provisional</b>
<b>..</b>	<b>no figure to be expected</b>
<b>r</b>	<b>revised</b>
<b>-</b>	<b>nil or negligible</b>
<b>q</b>	<b>quarter</b>
<b>f</b>	<b>forecast</b>
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# Comment

The Covid-19 pandemic will remain the main determinant of the economic outlook this year and in 2022. The near-term prospects for the economy have deteriorated following a resurgence in COVID-19 cases early in 2021. Activity in the domestic economy is likely to remain subdued in the first half of the year reflecting a more protracted duration and more gradual relaxation of level 5 restrictions than had been assumed in the last Bulletin. However, the prospect of a successful deployment of vaccines from an increasing range of choices offers the prospect of recovery from the second half of the year underpinned by continued support from accommodative monetary and fiscal policy.

Preliminary Irish National Accounts, which show GDP growth of 3.4 per cent last year, point to remarkable resilience in headline growth given the exceptional scale of the Covid-19 shock to domestic and world demand. However, the headline GDP figure, boosted by strong export growth that was in turn largely accounted for by a surge in pharmaceutical exports and continued strength in the IT sector, masked a severe decline in domestic demand. Output declined in all other sectors, with the largest declines in sectors with a high dependence on face-to-face contact with customers including the arts, hotels, bars and restaurants and high-street retailers. Private consumption last year was down by 9 per cent compared with the previous year, with modified domestic demand down by 5.4 per cent.

The impact of the pandemic is particularly evident in the labour market. While the headline unemployment rate has not changed significantly, reflecting standard international statistical conventions regarding its measurement, the COVID-adjusted rate which includes those workers who are availing of the pandemic unemployment payment (PUP) increased rapidly - it currently stands at a rate of 24.8% (February 2021). Including the employment wage subsidy scheme (EWSS), around 960,000 people, around 4 in 10 in the labour force, are currently in receipt of one form of income support or other. The figures also show that younger and lower paid workers have been most affected.

The concentration of the pandemic labour market shock among workers in the bottom half of the income distribution is reflected in a corresponding decline in compensation per worker (earnings). However, although

significant income losses have been sustained by workers in the most affected sectors, average disposable incomes have been protected reflecting significant government income supports. Similarly, at firm level, government support measures have provided significant mitigation to the financial distress of those SMEs most affected by pandemic-related business disruption. Notwithstanding Government supports, many SMEs face losses that will continue to accumulate. While indicators of financial distress such as firm liquidations have been limited to date due to government supports and exceptional levels of creditor forbearance, they are likely to become more evident as we emerge from the pandemic.

The resilience of household disposable incomes combined with sharply lower consumer spending has resulted in an exceptional increase in household savings. Household deposits increased by €15.7 billion between March 2020 and February 2021. Reflecting the relative resilience of incomes at the higher end of the income distribution, it is perhaps not surprising that higher income households account for the bulk of this increase. The timing and extent to which this exceptional building up in household savings is unwound will have significant impact on the pace and timing of the post-pandemic recovery in domestic demand.

A resurgence in Covid cases in the first quarter of 2021 saw infection rates spike to levels well above previous peaks. Although re-imposition of strict containment measures led initially to a rapid reduction in cases, the pace of decline has slowed in recent weeks pointing to a slower than hoped for reopening of the economy during the second quarter. The near term outlook for domestic demand is accordingly less positive and more uncertain than at the time of the previous Bulletin. Nevertheless, on the assumption of a successful deployment of vaccines by the second half of the year, domestic demand remains well placed for a strong recovery, albeit from a somewhat weaker mid-year base. The weaker prospects for domestic demand this year will be offset by better prospects for exports reflecting both a stronger outlook for world demand and continued strength in key exporting sectors such as pharmaceuticals and computer services. On this basis, modified domestic demand is forecast to grow by 2.8 per cent in 2021 and by 3.9 per cent in 2022. Supported by a strong export performance, GDP is projected to grow by 5.9 per cent in 2021 and by 4.7 per cent in 2022.

The new EU-UK Trade and Cooperation Agreement (TCA), which came into force on 1 January 2021, allows for the continuation of a basic economic relationship between the EU and UK averting the threat of a no-deal WTO Brexit. However, the new agreement makes trade in both goods and services more cumbersome and costly relative to EU membership. Early evidence from UK and Irish trade statistics of the impact of Brexit is

examined in Box D on page 34. These data point to a significant drop in EU-UK trade in January that was much larger than corresponding changes in trade between the UK and non-EU countries. While much of this drop in trade volumes may be related to pandemic effects and stock building in the last three months of 2020, it also provides some early albeit tentative evidence of a negative Brexit effect. In the long run, the negative impact of the UK's EU exit on trade flows, migration and productivity will reduce output in the Irish economy.

The Covid-19 pandemic has prompted an exceptional policy response that has been unprecedented both in scale and the rapid pace of its deployment. The impact of the pandemic has been mitigated by a range of fiscal, monetary, macro-prudential and micro-prudential policy actions to support vulnerable households and businesses.

Government support measures for firms and workers, while proportionate and appropriate to the size of the shock to households and firms, have been unprecedented in scale, amounting to over 11 per cent of Modified Gross National Income (GNI\*). The General Government Balance has moved from a small surplus of 0.9 per cent to a deficit of just under 9 per cent of GNI\* in 2020 and is expected to remain close to that level this year. This has resulted also in an increase in public sector debt and the debt to national income ratio.

Such a deterioration in the public finances might typically generate concerns regarding credit worthiness putting upward pressure on government financing costs. However, this was avoided by the swift and decisive monetary policy action by the ECB which contained government borrowing costs in the eurosystem at historically low levels. The ECB policy supports have been designed to preserve favourable financing conditions and to bring medium-term inflation back towards its aim of below, but close to, 2 per cent. In addition to the impact on government interest payments and the public finances, monetary policy also supported the economy directly by reducing borrowing rates for the private sector, and indirectly through spillovers from higher economic activity. Simulations using the Bank's Macro Economic Model find that ECB monetary policy actions will boost the level of output in Ireland by around 1.4 per cent in 2021, relative to a scenario in which the ECB had not intervened.

In the near term, policy should remain focused on supporting household incomes and firm liquidity in order to provide the most solid basis for recovery. However, the size and nature of support should be ready to adapt to changing circumstances. Policy support should continue to counter the threat to viable economic activities and employment from the pandemic and, in time, facilitate structural transformations which support economically sustainable activities. This would help to enhance resilience,

support the productive capacity of the economy and mitigate scarring effects, such as long-term unemployment.

On the fiscal side, the rise in deficit and debt ratios that has occurred has been both warranted and necessary. Policy support will need to be maintained over the short-term in order to stabilise the economy. However, when health risks diminish, any continued support via current expenditure should be targeted and temporary and any permanent increases in current expenditure would need to be funded in a sustainable manner. While favorable growth dynamics should support a decline in the public debt ratio, additional actions may also be required to close any structural imbalances between expenditure and revenue when the recovery is firmly established. Even if action does not need to be taken now, it is important to plan to reduce the level of the debt ratio in time to a more sustainable level, to ensure that the economy can face future shocks with sufficient headroom such that all available policy instruments can be deployed.

# An Timpeallacht Gheilleagrach

Beidh an tionchar is mó ag paindéim COVID-19 ar an ionchas eacnamaíoch i mbliana agus in 2022. Tá na hionchais ghearrthéarmacha imithe in olcas de bharr borradh nua ar chásanna COVID-19 go luath sa bhliain 2021. Is dócha go mbeidh gníomhaíocht sa gheilleagar intíre lag sa chéad leath den bhliain, rud atá ag freagairt do thréimhse níos faide shrianta leibhéal 5 agus do mhaolú níos céimsí orthu ná mar a bhíothas ag súil leis san Fhaisnéis Ráithiúil roimhe seo. Tá an fhéidearthacht ann, áfach, go bhfeicfear téarnamh sa dara leath den bhliain i gcás ina mbeidh leithdháileadh rathúil vacsaíní ann mar aon le rogha mhéadaitheach vacsaíní, agus beidh tacaíocht leanúnach ó bheartas in-chomhfhoirmeach airgeadaíochta agus fioscach mar bhonn faoin téarnamh sin.

Sna Réamhshonraí Cuntas Náisiúnta a thugann le fios gurb ionann fás OTI anuraidh agus 3.4 faoin gcéad, léirítear athléimneacht shuntasach san fhás príomha, go háirithe i bhfianaise scála neamhghnách thurraing Covid-19 don éileamh intíre agus domhanda. Ar a shon sin, bhí laghdú ar an éileamh intíre, a bhí ar cheann de na laghduithe ba mhó san AE, á cheilt ag figiúr príomha OTI a bhí á spreagadh ag fás láidir ar onnmhairí, fás a bhí inchurtha do bhorradh ar onnmhairí cógaisíochta agus neart leanúnach na hearnála TF. Tháinig laghdú ar an aschur sna hearnálacha eile go léir agus bhí na laghduithe ba mhó le feiceáil sna hearnálacha sin a bhíonn ag brath go mór ar theagmháil duine le duine, lena n-áirítear na healaíona, óstáin, beáir agus bialanna agus miondíoltóirí mórshráide. Tháinig laghdú 9 faoin gcéad ar thomhaltas príobháideach anuraidh i gcomparáid leis an mbliain roimhe sin, agus tháinig laghdú 5.4 faoin gcéad ar an éileamh modhnaithe intíre.

Tá tionchar na paindéime le feiceáil go mór mór sa mhargadh saothair. Cé nach bhfuil athrú suntasach tagtha ar an ráta dífhostaíochta príomha, rud a léiríonn coinbhinsiúin idirnáisiúnta staidrimh maidir lena thomhas, tháinig méadú mear ar an ráta arna choigeartú do COVID lena n-áirítear na hoibrithe sin a bhfuil an íocaíocht dífhostaíochta phaindéime (PUP) á fáil acu - ráta atá comhionann faoi láthair le 24.8% (Feabhra 2021). Agus an scéim fóirdheontais pá fostaíochta (SFPP) á cur san áireamh, tá liúntas tacaíochta ioncaim á fháil ag tuairim is 960,000 duine, is e sin le rá tuairim is 4 as gach 10 sa lucht saothair. Léiríonn na figiúirí freisin gurb iad oibrithe níos óige agus oibrithe ar thuarastal íseal is mó a ndéantar difear dóibh.

Ó tharla go gcuireann turraing na paindéime don mhargadh saothair isteach níos mó ar oibrithe ar thuarastal níos ísle, feictear laghdú comhréireach ar

an gcúiteamh in aghaidh an oibrí (tuilleamh). Cé gur bhain cailíteanais shuntasacha ioncaim d'oibríthe sna hearnálacha sin is mó atá thíos leis an bphaindéim, cosnaíodh meánioncam indiúscartha, rud a léiríonn tacaíochtaí suntasacha ioncaim ón rialtas. Ar an gcaoi chéanna, ar leibhéal gnólachta, tá anás airgeadais na FBManna sin is mó a gcuireann an phaindéim isteach ar a ngnó maolaithe go mór ag bearta tacaíochta rialtais. D'ainneoin tacaíochtaí ón Rialtas, tá go leor FBManna ag dul i ngleic le cailíteanais atá ag méadú. Cé go bhfuil comharthaí anáis airgeadais, ar nós leachtú gnólachta, teoranta go dtí seo mar gheall ar thacaíochtaí rialtais agus leibhéil shuntasacha staonta ag creidiúnaithe, is dócha go dtiocfaidh siad chun cinn de réir mar a chuirimid an phaindéim dinn.

Tá méadú as cuimse tagtha ar choigilteas teaghlach mar thoradh ar athléimneacht ioncam indiúscartha teaghlach agus ar chaiteachas níos ísle tomhaltóirí. Tháinig méadú €15.7 billiún ar thaiscí teaghlach idir Márta 2020 agus Feabhra 2021. I bhfianaise athléimneacht choibhneasta ioncaim ag ceann uachtair dháileadh an ioncaim, ní nach ionadh go mbaineann formhór an mhéadaithe sin le teaghlach a bhfuil ioncam níos airde acu. Cathain a dhéanfar, agus a mhéid a dhéanfar, an carnadh suntasach seo ar choigealtas teaghlach a scaoileadh - is ceist í sin a mbeidh tionchar suntasach aici ar luas agus ar uainiú an téarnaimh iar-phaindéime ar an éileamh intíre.

Leis an mborradh athuair ar chásanna Covid sa chéad ráithe de 2021, tháinig méadú tobann ar na rátaí ionfhabhtaithe. Cé gur tháinig laghdú mear ar chásanna nuair a cuireadh dianbhearta srianta i bhfeidhm, tá moilliú tagtha ar an laghdú sin le roinnt seachtainí anuas, rud a thugann le fios go mbeidh athoscailt an gheilleagair sa dara ráithe níos moille ná mar a bhíodhas ag súil leis. Dá réir sin, tá an t-ionchas gearrthéarmach don éileamh intíre níos diúltaí agus tá níos mó éiginnteachta ag baint leis ná mar a bhí tráth foilsithe na Faisnéise Ráithiúla roimhe seo. Dá ainneoin sin, tá dóigh mhaith ar an éileamh intíre ó thaobh téarnaimh de, cé gur ó bhonn níos ísle lár bliana a bheidh i gceist, ag glacadh leis go n-éireoidh go maith le leithdháileadh vacsaíní faoin dara leath den bhliain. Déanfar na hionchais níos laige don éileamh intíre i mbliana a fhritháireamh le hionchais níos fearr d'onnmhairí, rud a léiríonn ionchas níos láidre don éileamh domhanda agus neart leanúnach na bpríomhearnálacha onnmhairí amhail seirbhísí ríomhaireachta agus cógaisíocht. Ar an mbonn sin, meastar go dtiocfaidh méadú 2.8 faoin gcéad ar an mbunéileamh modhnaithe intíre in 2021 agus go dtiocfaidh méadú 3.9 faoin gcéad air in 2022. Agus feidhmíocht láidir onnmhairí mar bhonn taca faoi, meastar go dtiocfaidh fás 5.9 faoin gcéad ar OTI in 2021 mar aon le fás 4.7 faoin gcéad in 2022.

Leis an gComhaontú Trádála agus Comhair idir an tAontas Eorpach agus an Ríocht Aontaithe (TCA), leantar den bhunchaidreamh eacnamaíoch idir AE

agus RA agus seachnaítear an baol go mbeidh Brexit gan chomhaontú ar théarmaí WTO ann. Mar sin féin, tá trádáil earraí agus seirbhísí níos anásta agus níos costasaí faoin gcomhaontú nua ná mar a bhí i gceist le ballraíocht AE. I mBosca D ar leathanach 34, breathnaítear ar an luathfhianaise atá ann ó staidreamh RA agus ó staidreamh na hÉireann maidir le tionchar Brexit. Tugann na sonraí sin le tuiscint go raibh laghdú suntasach ar thrádáil AE-RA i mí Eanáir, laghdú a bhí i bhfad ní ba mhó ná na hathruithe comhréireacha ar thrádáil idir RA agus tíortha lasmuigh den AE. Cé go bhfuil seans ann go mbaineann cuid mhór den laghdú sin ar mhéid na trádála le héifeachtaí na paindéime agus le carnadh stoic sna trí mhí dheireanacha de 2020, cuireann sé luathfhianaise choinníollach ar fáil i dtaobh éifeacht dhiúltach Brexit. San fhadtéarma, beidh tionchar diúltach ag imeacht na Ríochta Aontaithe as an Aontas Eorpach ar shreafaí trádála, imirce agus ar tháirgeacht, rud a laghdóidh aschur gheilleagar na hÉireann.

Spreag paindéim Covid-19 freagairt eisceachtúil beartais a bhí gan fasach ó thaobh scála agus luas a leithdháilte de. Tá iarmhairt na paindéime maolaithe ag raon gníomhaíochtaí beartais fhioscaigh, airgeadaíochta, macrastuamachta agus micreastuamachta lena dtacaítear le teaghlaigh agus le gnóthaí leochaileacha.

Cé go bhfuil na bearta rialtais lena dtugtar tacaíocht do ghnóthaí agus d'oibrithe comhréireach agus oiriúnach i dtaca le méid na turrainge do theaghlaigh agus do ghnóthaí, tá siad gan fasach ó thaobh scála de, is é sin breis agus 11 faoin gcéad den Ollioncam Modhnaithe Náisiúnta (OIN\*). Ghluais an tIarmhéid Rialtais Ghinearálta ó bharrachas beag de 0.9 faoin gcéad go dtí easnamh a bhí díreach faoi bhun 9 faoin gcéad den OIN\* in 2020 agus meastar go bhfanfaidh sé gar don leibhéal sin i mbliana. Mar thoradh air seo, bhí méadú ar fhiachas na hearnála poiblí agus ar an gcóimheas fiachais le hioncam náisiúnta.

Go hiondúil i gcás meathlú ar airgeadas poiblí, bheadh imní ann go gcuirfeadh acmhainneacht creidmheasa brú aníos ar chostais maoiniúcháin rialtais. Ach seachnaíodh é seo trí ghníomh beartais airgeadaíochta BCE lenar coimeádadh costais iasachtaithe rialtais san eurochóras ag leibhéal atá níos ísle ná riamh. Tá tacaíochtaí beartais BCE ceaptha dálaí fabhracha maoiniúcháin a choimeád ar bun agus an boilsciú meántéarmach a thabhairt ar ais i dtreo a sprice, is é sin gar do 2 faoin gcéad ach faoina bhun. Chomh maith leis an éifeacht a bhí aige ar íocaíochtaí úis rialtais agus ar an airgeadas poiblí, thacaigh an beartas airgeadaíochta go díreach leis an ngeilleagar trí rátaí iasachtaithe a laghdú don earnáil phríobháideach agus go hindíreach trí bhíthin éifeachtaí iarmhartacha a d'éirigh as an ngníomhaíocht eacnamaíoch níos airde. Le hionsamhlúcháin a bhaineann úsáid as Samhail Mhaicreacnamaíoch an Bhainc, tugtar le fios go ndéanfar leibhéal an aschuir in Éirinn a mhéadú faoi 1.4 faoin gcéad in 2021 trí

bhíthin ghníomhartha beartais airgeadaíochta BCE, i gcomparáid le cás easpa gnímh BCE.

Sa ghearrthéarma, ba cheart go leanfaí den bheartas a dhíriú ar ioncam teaghlach agus leachtacht gnólachtaí a neartú chun go gcuirfear bonn daingean faoin téarnamh. Ba cheart go mbeifí réidh, áfach, chun cineál agus méid na tacaíochta sin a chur in oiriúint do dhálaí a bheidh ag athrú. Le tacaíocht beartais, ba cheart go gcuirfí in aghaidh na bagartha atá ann ón bpaindéim do ghníomhaíochtaí inmharthana eacnamaíochta agus don fhostaíocht agus, le himeacht aimsire, go n-éascófaí claochluithe struchtúracha a thacódh le gníomhaíochtaí inmharthana eacnamaíochta. Chuideodh sé seo le hathléimneacht a fheabhsú, le cumas táirgthe an gheilleagair a neartú, agus le héifeachtaí díobhálacha, ar nós dífhostaíocht fhadtéarmach, a mhaolú.

Ar an taobh fioscach, bhí an méadú ar chóimheasa easnaimh agus fiachais inchosanta. Is gá leanúint den tacaíocht beartais sa ghearrthéarma chun an geilleagar a chobhsú. Nuair a laghdóidh rioscaí sláinte, áfach, ba cheart gur tacaíocht spriocdhírthe shealadach a bheidh i gceist le haon tacaíocht leanúnach a chuirfear ar fáil trí chaiteachas reatha agus níor mhór aon mhéaduithe buana ar chaiteachas reatha a mhaoiniú ar mhodh inmharthana. Cé gur cheart go dtacódh dinimic fhabhrach fáis sna blianta atá romhainn le laghdú ar an gcóimheas fiachais phoiblí, tá seans ann go mbeidh gníomhartha breise ag teastáil chun aon mhíchothromaíochtaí struchtúracha idir caiteachas agus ioncam a scor nuair a bheidh bonn maith faoin téarnamh. Fiú mura gá dul i mbun gnímh anois, tá sé tábhachtach go ndéanfar pleanáil chun leibhéal an chóimheasa fiachais a laghdú go tráthúil chun go gcinnteofar go mbeidh an geilleagar ábalta dul i ngleic le turraingí amach anseo agus go mbeidh scóip aige úsáid a bhaint as na hionstraimí beartais go léir atá ar fáil.

# The Irish Economy

## Overview

- Covid-19 and the public health measures taken to contain its spread resulted in a significant downturn in domestic economic activity in 2020. In 2021, Level 5 restrictions mandating the closure of most consumer facing services, construction and non-essential retail have remained in place throughout the first quarter. With both the duration of Level 5 restrictions more prolonged and the relaxation of restrictions now likely to be more gradual than assumed in the last Bulletin, the outlook is for domestic economic activity to remain subdued in the first-half of this year. Beyond that, assuming successful deployment of vaccines in line with the Government's timeline, domestic economic activity should begin to rebound in the second half of this year, gaining momentum in 2022.
- While the economic outlook is highly uncertain, the baseline forecast assumes that Level 5 restrictions remain in place until at least end-April, and are unwound very gradually thereafter, starting with the unwinding of restrictions on construction. Continued fiscal policy support, particularly labour market interventions such as the Pandemic Unemployment Payment (PUP) and the Employers Wage Subsidy Scheme (EWSS), will continue to mitigate the impact of the restrictions on household incomes and the unemployment rate.
- The public health measures are likely to dampen domestic economic activity significantly in the first half of the year and some measures are likely to continue to be required until the deployment of effective vaccines reaches a large enough proportion of the population. In the forecasts set out in this Bulletin, vaccine roll-out is assumed to proceed as currently announced by the Government, with the majority of the adult population vaccinated by the beginning of the fourth quarter of 2021.
- Exports are projected to continue to grow at a strong pace in 2021, before returning to a more moderate pace of expansion in 2022. This strong growth is expected to be driven by continued gains in market share by multinational pharmaceutical and ICT firms and their subsidiaries located in Ireland. Certain indigenous exporting sectors however suffered from the effects of the pandemic and will recover more slowly, facing headwinds from Brexit, as well as the impact of the pandemic on economic activity in Ireland's main trading partners.

- Economic growth will rebound this year from the low base in 2020. Modified domestic demand, a measure of domestic activity (excluding exports and imports), is forecast to grow by 2.8 per cent in 2021 and 3.9 per cent in 2022. Total economic activity, as measured by GDP, is forecast to grow by 5.9 per cent in 2021 and 4.7 per cent in 2022. The recovery in activity this year will be mainly supported by exports, before broadening substantially next year. A return of the savings ratio from recent high values towards more normal levels will support a rebound in consumption in 2022 towards pre-pandemic levels.
- The unemployment rate is forecast to increase to 6.6 per cent this year and 8.1 per cent in 2022. The unwinding of Government supports such as the Pandemic Unemployment Payment later this year, which have kept workers classified as employed, will push the rate up. However, the Covid adjusted rate, which includes PUP recipients is forecast to decline sharply in line with the reopening of the economy in the second and third quarters.
- The public health crisis continues to have a significant impact on Ireland's public finances. Having run a surplus of €1.9bn (0.9 per cent of GNI\*) in 2019, the general government recorded a deficit of close to €20bn (just under 9 per cent of GNI\*) last year. With a small increase (as the primary deficit impact dominates) and decrease forecast for this year and next, the debt ratio is expected to still be close to 100 per cent of GNI\* at the end of the projection horizon.
- In a more severe Covid-19 scenario, assuming only limited success in containing the virus from ongoing health restrictions and a substantially longer timeline for the successful deployment of vaccines, high infection and hospitalisation rates could require public health measures to persist throughout the projection horizon. Under such a scenario, there would be further economic scarring and a permanent loss to potential output. Modified Domestic Demand would grow by 1.6 per cent this year and 1.8 per cent in 2022 while GDP would grow by 4.8 per cent in 2021 and by 2.4 per cent in 2022.

**Table 1: Forecast Summary Table**

<b>Real Economic Activity</b>	<b>2019</b>	<b>2020e</b>	<b>2021f</b>	<b>2022f</b>
Personal Consumer Expenditure	3.2	-9.1	3.7	7.1
<i>Public Consumption</i>	6.3	9.9	3.4	-7.5
Gross Fixed Capital Formation	74.8	-32.3	-15.2	6.0
Exports of Goods and Services	10.6	6.2	5.5	5.0
Imports of Goods and Services	32.4	-11.3	-1.9	4.8
<b>Gross Domestic Product</b>	5.6	3.4	5.9	4.7
Gross National Product	3.4	0.6	10.9	3.1
<b>Modified Domestic Demand</b>	3.3	-5.4	2.8	3.9
<b>External Trade and Payments</b>				
Balance of Payments Current Account (€m)	-40,406	16,927	19,124	19,950
Current Account (% of GDP)	-11.4	4.6	4.9	4.8
<b>Prices, Costs and Competitiveness</b>				
Harmonised Index of Consumer Prices (HICP)	0.9	-0.5	0.8	0.8
HICP of which: Goods	-0.8	-2.1	-0.5	-0.2
HICP of which: Services	2.4	0.9	1.8	1.9
HICP Excluding Energy	0.9	-0.1	0.4	0.8
Consumer Price Index (CPI)	0.9	-0.3	0.8	0.8
Compensation per Employee	3.5	-2.6	-1.8	4.4
<b>Labour Market</b>				
Total Employment (% change)	2.9	-1.2	-1.3	0.6
Labour Force (% change)	2	-0.5	-0.2	2.3
Unemployment Rate	5	5.7	6.6	8.1

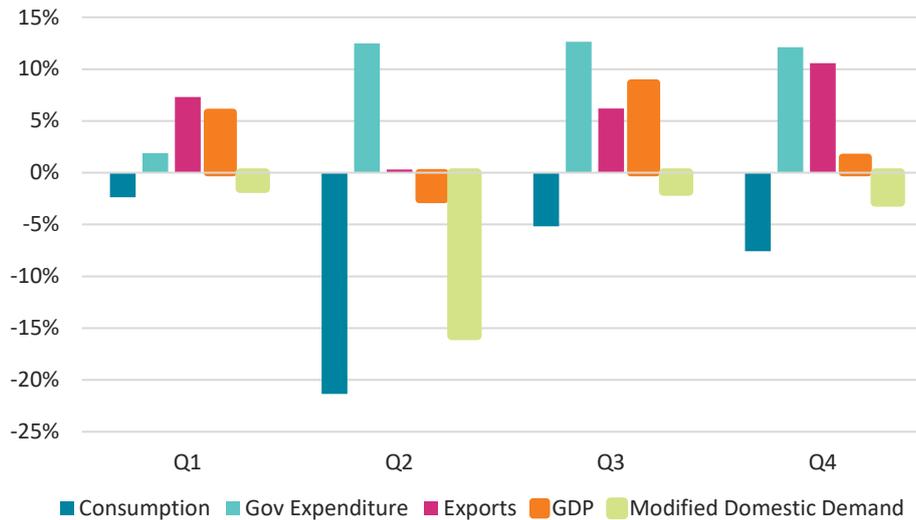
## Recent Developments

National Accounts figures for 2020 Q4 indicate that economic activity, as measured by GDP, increased in 2020 compared to 2019. Ireland and Luxembourg were the only countries in the European Union where this was the case. Annual GDP grew by 3.4 per cent compared with 2019. Quarter-on-quarter, GDP declined by 5.1 per cent in seasonally adjusted terms between Q3 and Q4 of 2020 (the decrease being mostly due to rising imports lowering the trade balance).

Strong export growth, especially in the pharmaceutical sector, was the main factor behind the expansion of output in 2020. Exports continued to grow strongly while imports fell sharply during Q2 and Q3 in line with falling domestic demand. On the output side of the economy, growth in value-

added was led by Industry (and within this mostly the Pharmaceutical sector), and Information and Communications. These were the only growing sectors of the economy, expanding by 15.2 per cent and 14.3 per cent respectively in the year to reach just over half of total Irish gross value added (GVA) in 2020 between them.

**Figure 1: Selected National Accounts Aggregates, 2020**



Source: CSO.

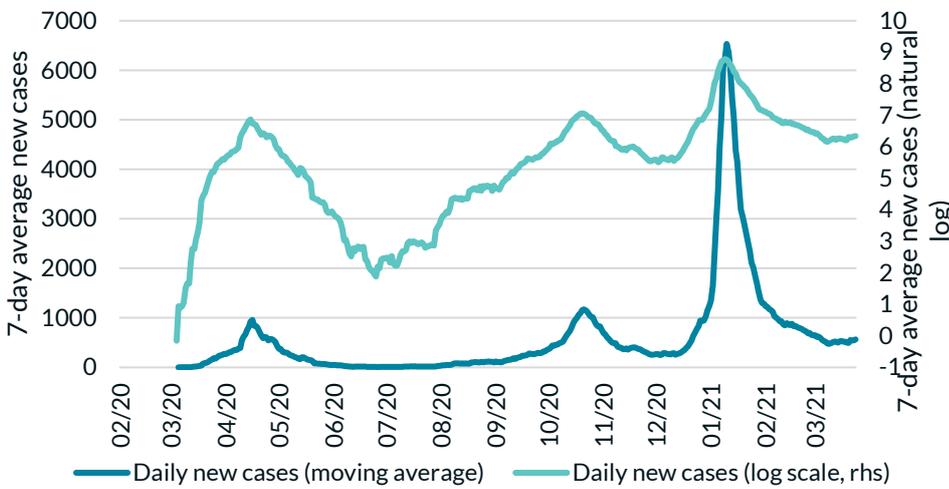
Note: percentage change compared to the same period of the previous year

More domestically focussed indicators of economic activity, which remove distortions arising from globalisation, paint a considerably less positive picture, with the domestic economy contracting substantially as a result of the pandemic. Figure 1 shows the growth of several National Accounts aggregates through 2020. Personal consumption fell by 9.0 per cent due to restrictions and reduced opportunities and willingness to spend, while Government spending increased by 9.8 per cent, and modified investment (mainly investment in building and machinery) declined by 8.5 per cent. These developments in Modified Domestic Demand (MDD) declining by 5.4 per cent compared with 2019 were broadly in line with other European economies. On the other hand, exports of pharmaceutical products and computer services kept rising, taking total exports 6.2 per cent higher, while imports declined by 11.3 per cent due to falling domestic demand and lower imports of aircraft. This led to a record trade balance of €109bn in 2020, and determined the rise in GDP despite the contraction in domestic demand.

During the first quarter of 2021, Irish economic activity has been curtailed by the Level 5 public health restrictions. While Covid-19 case numbers have declined significantly from their January peak, with cases having levelled off recently (see Figure 2), there is an expectation that any re-

opening of the economy in the coming months will proceed at a cautious pace.

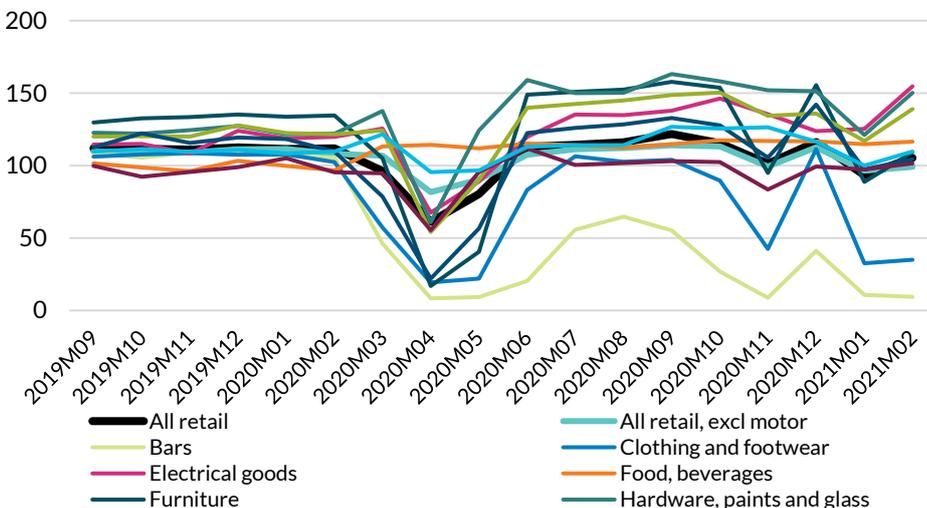
**Figure 2: COVID-19 Case Numbers**



Source: Ourworldindata.org

Since January of this year, consumer spending has remained lower compared to the same period of 2020, although relatively strong if seen against levels witnessed during the first lockdown. Continuing Level 5 restrictions have meant that the opportunity for in-store spending has been confined to only essential retail. The value of retail sales declined by 16.2 per cent in January when compared to the same month of last year, while in February the annual change was -5.9 per cent, after sales increased by 12.6 per cent monthly. Looking at the impact across different sectors, in terms of sales of goods, the hardest hit sectors remain bars and clothing, while supermarkets and hardware, furniture and electrical goods have generally seen an increase in sales compared to pre-pandemic levels (Figure 3).

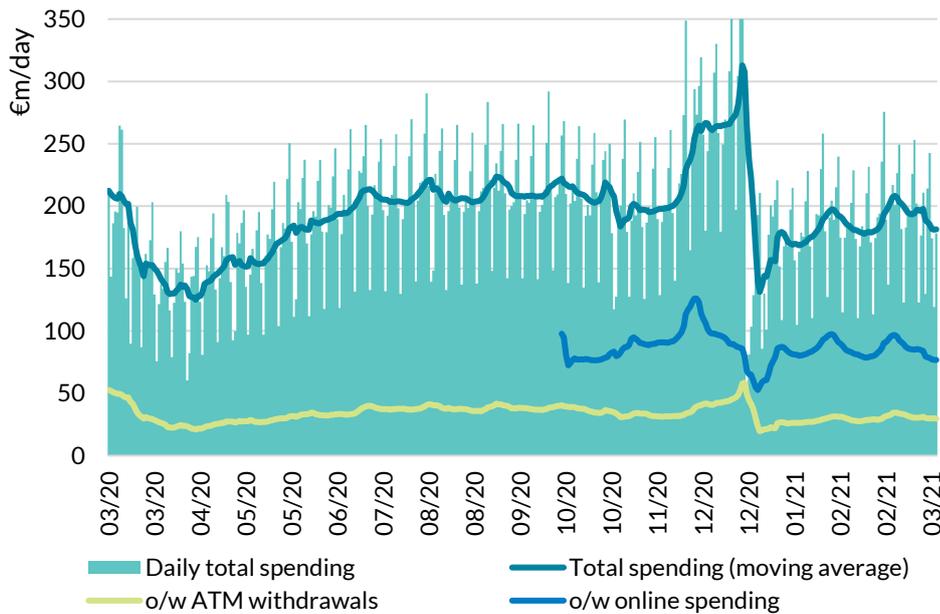
**Figure 3: Retail Sales Index and Selected Sub-Indices**



Source: CSO

Credit and debit card payment data (Figure 4) tell us that spending between January and February has been on average about 10 per cent lower than the corresponding period in 2020, just before the pandemic hit. While still relatively subdued, card payments in March remain significantly higher than spending levels during April and May 2020, when similar restrictions were in place, suggesting that consumers and firms have adapted somewhat to the restrictions.

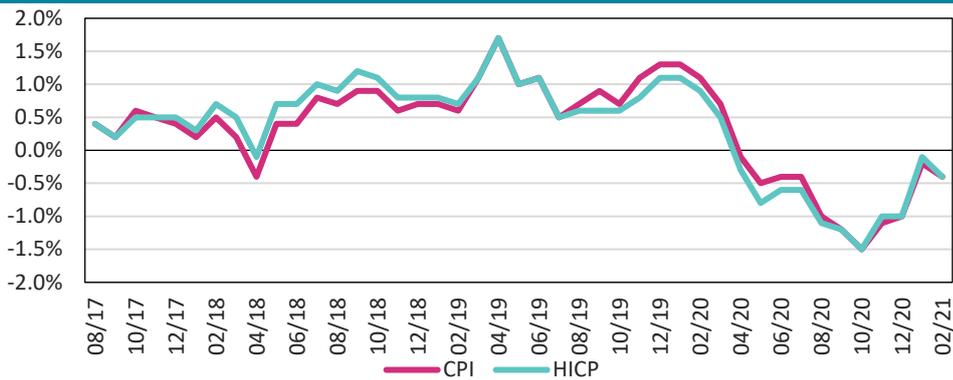
**Figure 4: Daily Spending on Credit and Debit Cards**



Source: Central Bank of Ireland Credit and Debit Card Statistics

Since reaching a low in October at -1.5 per cent, year-on-year Irish consumer price inflation has risen somewhat in the last few months – with prices increasing month-on-month since November – and stood at -0.4 per cent in February (Figure 5). Aside from developments in the official inflation rate, consumers are likely to experience a different level of inflation on what they do buy, compared to the Consumer Price Index measure, due to the changing consumption basket as a result of the pandemic. Box D illustrates how consumption weights are being changed to better reflect changes in households’ consumption basket.

**Figure 5: Inflation**

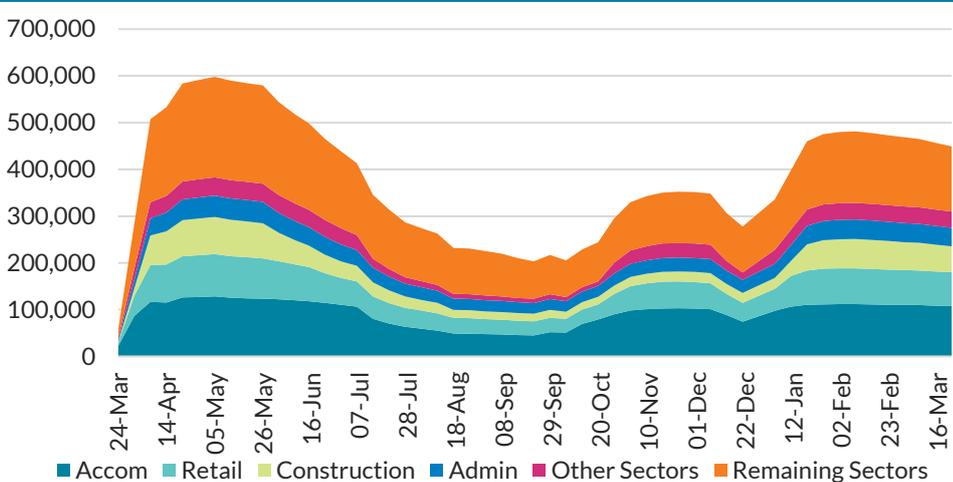


Source: CSO

COVID-19 adjusted unemployment remains high, with the number of PUP recipients still close to its highest level since last summer. COVID-19 adjusted unemployment was 24.8 per cent in February, marginally lower than the rate of 25.1 per cent in January, and reflects a total of just under 600,000 persons out of work (including PUP recipients). On the other hand, the traditional measure of unemployment, which does not take into account recipients of the PUP, remained constant since December at 5.8 per cent (140,800 persons), but is still higher than the 5.0 per cent seen in February 2020.

The number of PUP recipients declined marginally, by only a few thousand recipients a week, since February (Figure 6). Compared to the October and November lockdown, construction activity is now restricted as well, resulting in a higher number of PUP recipients, while the bulk of recipients remains in the accommodation, retail, and administration sectors. The Government has announced that the PUP scheme is currently expected to remain in place at least until the end of June 2021.

**Figure 5: PUP Recipients by Sector**



Source: Department of Employment Affairs and Social Protection

January 2021 was the first month after the end of the Brexit transition period. Compared to January of last year, imports from the UK declined by 65 per cent, decreasing by more than €900m to €500m. Imports of live animals and mineral fuels each declined by more than 70 per cent. This exceptional fall might be partly due to stockpiling before the end of 2020, as well as the public health restrictions in Ireland. More data in the upcoming months are needed to clarify how much of this is a direct effect of the new trade relationship with the UK. Exports to the UK, on the other hand, only declined by 14 per cent, in line with overall exports, which were 12 per cent lower than in January 2020.

## Box A: The International Economic Outlook

*By the Monetary Policy Division*

The outlook for the global economy has improved in recent months, but growth prospects vary widely between countries and sectors. While uneven across countries, vaccine rollout is gaining momentum and government stimulus, particularly in the United States, is likely to provide a major boost to economic activity. After a fall of 3.4 per cent last year, the OECD expects global GDP to rise by 5.6 per cent in 2021 and a further 4.0 per cent in 2022 (March 2021 forecasts). In January, the IMF projected global growth to rebound to 5.5 per cent in 2021, and then rise by 4.2 per cent in 2022. The growth outlook would markedly improve if production and distribution of vaccines accelerate and are better coordinated around the world, getting ahead of virus mutations.

Euro area quarterly GDP decreased by 0.7 per cent in the fourth quarter of 2020; this decline follows the strong rebound in the third quarter (+12.5 per cent) and the contraction in the second quarter (-11.6 per cent), the sharpest observed since the series started. March ECB projections assessed that the recent intensification of the pandemic has weakened the near-term outlook for euro area activity but not derailed the recovery.<sup>1</sup> Euro area GDP is expected to increase by 4.0 per cent in 2021 (slightly up from December 2020's forecast of 3.9 per cent), 4.1 per cent in 2022 (slightly down from 4.2 per cent), and 2.1 per cent in 2023 (unchanged).

In January 2021, the euro area unemployment rate was 8.1 per cent according to Eurostat, down from the August 2020 high of 8.7 per cent,

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<sup>1</sup> The ECB baseline projections rest on the assumptions of a swift relaxation of containment measures from the second quarter of 2021 and a resolution of the health crisis in early 2022.

but 0.8 percentage points higher than it was in February 2020. Current unemployment estimates should be read with caution, as they are based on the globally used International Labour Organisation standard definition of unemployment, which does not fully capture the unprecedented labour market situation triggered by the pandemic. The Markit Eurozone Composite PMI posted 48.8 in February (up from 47.8 in January), signalling that the euro area private sector economy experienced a further modest drop in that month. PMI data continue to indicate a two-speed economy, with manufacturing registering its strongest expansion of output in four months but services – especially business areas impacted the most by social-contact restrictions – recording another marked contraction of activity.

Euro area annual HICP inflation is expected to be 0.9 percent in February 2021 (Eurostat flash estimate), unchanged from January. Annual energy price inflation is expected to stabilise (-1.7 percent, up from -4.2 percent in January), while HICP inflation excluding energy and unprocessed food is expected to remain broadly stable, but subdued (1.2 percent, down from 1.4 percent in January). ECB projections for the euro area inflation have been revised upward for this year and next, with an annual HICP inflation rate of 1.5 percent in 2021 (up from the December 2020 forecast of 1.0 percent), 1.2 percent in 2022 (up from 1.1 percent), and 1.4 percent in 2023 (unchanged).

In March, the Governing Council (GC) of the ECB confirmed that it will continue to conduct net asset purchases under the pandemic emergency purchase programme (PEPP) with a total envelope of €1,850 billion until at least the end of March 2022 and, in any case, until it judges that the coronavirus crisis phase is over. Based on a joint assessment of financing conditions and the inflation outlook, the GC expects purchases under the PEPP to be conducted over the second quarter of 2021 at a significantly higher pace than during the first months of the year. The GC confirmed its commitments with respect to the key ECB interest rates, the asset purchase programme (APP), the expected PEPP reinvestment phase, and the third series of targeted longer-term refinancing operations (TLTRO III).

In the United States, quarterly GDP increased by 1.0 per cent in the fourth quarter of 2020, after a 7.5 per cent increase in the third quarter. In January, the unemployment rate edged down to 6.3 per cent, decreasing by 0.4 percentage points over the month, but remaining 2.8 points higher than it was in January 2020. At its January meeting, the Federal Open Market Committee (FOMC) of the US Federal Reserve maintained the target range for the federal funds rate at 0 to 0.25 per cent. The FOMC remains committed to an accommodative stance of

monetary policy until it achieves maximum employment and inflation moderately above 2 per cent for some time so that inflation averages 2 per cent over time.

In the United Kingdom, quarterly GDP increased by 1.0 per cent in the fourth quarter of 2020, following a revised 16.1 per cent growth rate in the third quarter. Despite two consecutive quarters of growth, over the year 2020 as a whole, GDP contracted by 9.9 per cent, marking the largest annual fall in UK GDP on record. Looking ahead, GDP is projected to recover rapidly towards pre-Covid levels over 2021, as the UK vaccination programme is assumed to lead to an easing of Covid-related restrictions. Projected activity is also supported by the substantial fiscal and monetary policy actions already announced. At its February meeting, the Bank of England maintained the Bank Rate at 0.1 per cent and confirmed the continuation of its quantitative easing programme, maintaining the total target stock of asset purchases at £895 billion.

## Macroeconomic Projections

### Domestic Demand

**The outlook for the economy remains highly uncertain, and is contingent on the evolution of the Covid-19 pandemic and related public health measures.** While the public health restrictions have remained in place for longer than expected, the vaccination programme is now expected to proceed according to the timetable set out by the Government. Combined with an expected stronger pickup in consumption in the latter half of 2021, the forecast for modified domestic demand has been revised down by only 0.1 percentage points in 2021. For the latter half of the year and 2022, the effective rollout of the vaccination program is the key factor affecting the economic outlook. The baseline projections contained in this Bulletin assume that Covid-19 restrictions weigh heavily on economic activity at least until end-May, and are unwound very gradually between June and October when it is planned that the majority of the adult population are planned to have been vaccinated. Fiscal support, particularly supports to the labour market, as well as the accommodative monetary policy stance, will mitigate the extent and duration of the downturn in the first half of the year and allow for a faster recovery throughout the remainder of the forecast horizon. Contingent on these assumptions, modified domestic demand is forecast to grow by 2.8 per cent in 2021, while GDP is expected to grow by 5.9 per cent.

**While most restrictions affecting economic activity are expected to be lifted by the end of the year, some restrictions affecting travel and**

**tourism, in particular, are assumed to remain in place for the duration of the forecast horizon.** The baseline scenario for our forecast is that Covid-19 cases will gradually decline to very low levels but that the virus will continue to circulate globally, with sporadic outbreaks in regions with lower vaccine coverage requiring careful monitoring. The impact of outbreaks in other regions on economic activity and trade is assumed to gradually diminish, and may even be offset by improvements to logistics and teleworking which have taken place.

**Looking ahead, the economy is forecast to rebound strongly in 2022, with modified domestic demand expected to grow by 3.9 per cent and GDP expected to grow by 4.7 per cent.** Consumption will grow more quickly than income, which was largely protected during the pandemic, leading to a steady decline in the savings ratio towards pre-pandemic levels (17.7 per cent in 2021 and 10.4 per cent in 2022). This decline, as well as a likely unwinding of a portion of savings accumulated during periods of restrictions, will support strong consumption growth during 2022. Business investment is also expected to recover strongly in the baseline scenario, benefitting from a reduction in uncertainty and more favourable financing conditions.

**Turning in more detail to the components of GDP, consumption is forecast to grow by 3.7 per cent this year.** In the first half of the year, elevated public health measures are projected to suppress services consumption, albeit to a lesser extent than in Q2 2020. As the restrictions on certain types of activity are gradually eased, spending in these sectors is projected to recover. Previously postponed purchases should support a surge in demand in some sectors, as was seen during the initial easing of restrictions in summer 2020. Precautionary behaviour with regard to contact-intensive activities, however, could mitigate some of this effect, until a significant proportion of the population are vaccinated. Continued fiscal support and a boost from the unwinding of accumulated savings is projected to support strong consumption growth of 7.1 per cent in 2022. This would bring consumption, on an inflation-adjusted basis, back to 2019 levels.

**Figure 6: Consumption will rebound sharply in 2022 towards its pre-crisis level**



**Headline investment shrank by approximately a third last year** as the uncertainty created by the twin shocks of COVID-19 and Brexit curtailed business investment. Modified investment<sup>2</sup> – a more relevant measure of domestic economic developments – declined by 8.5 per cent last year. The outlook for modified investment this year is less favourable than that contained in the previous *Bulletin*, as more prolonged COVID-19 containment measures, uncertainties around the future path of the virus and the vaccine roll-out and, also, the impact of Brexit weigh on business investment decisions.

**Construction sector activity has been hampered by the longer than anticipated closure of sites** under the latest lockdown phase. While house completions held up better than expected in 2020, with 20,676 new units recorded, completions this year are again likely to be hampered by the accumulating impact on construction activity of public health restrictions and site closures. House completions are forecast to number approximately 20,000 units this year and 23,000 in 2022, subject to the assumption that most residential sites reopen in April 2021 and are not restrained by further public health measures. These projected levels of new housing supply remain well below estimates of the medium-term demand for housing.

<sup>2</sup> Modified investment excludes multinational R&D related IP and aircraft leasing flows. The headline investment figures are often skewed by large MNC intra-company revenue transfers.

**Non-residential construction declined by 9.5 per cent in 2020.** However, most of this decline is projected to be recovered over the forecast horizon, with growth of 5 per cent expected for this year and next. Over the longer term, considerable uncertainty surrounds the outlook for non-residential investment, the level of which was at a historical high in 2019. The pandemic may induce longer-term structural changes in the demand for office and retail space depending on the durability of the work-from-home model and also the adverse effects of the pandemic on business restarts. The Ulster Bank Construction PMI business expectations index for February 2021, however, points to optimism within the industry that activity will rebound when sites reopen.

**Machinery and equipment investment excluding leasing and aircraft investment was broadly flat in 2020.** This a better performance than expected at the time of the last Bulletin. Overall, modified investment is forecast to decline by 0.3 per cent in 2021 and grow by 7 per cent in 2022.

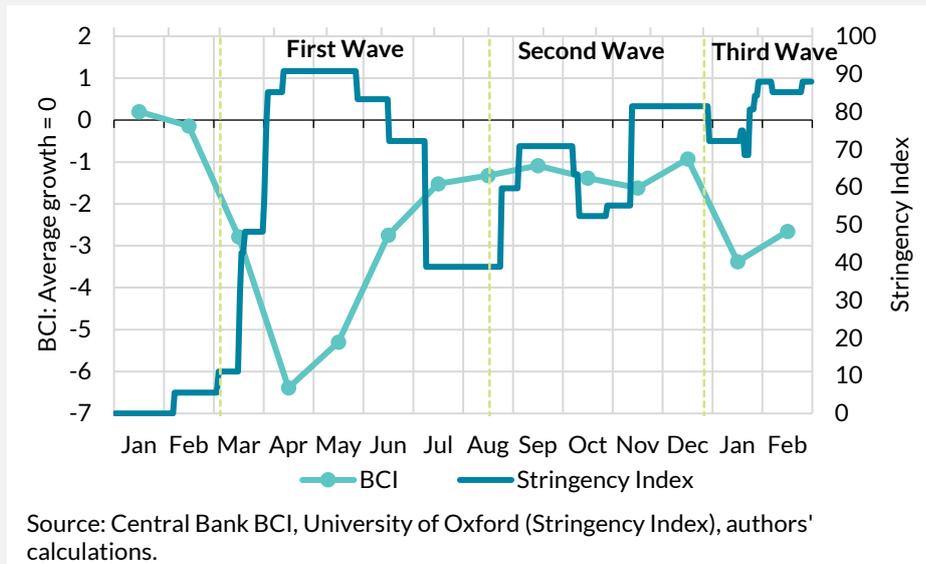
## Box B: A Year of the Pandemic: A View from the BCI

*By Thomas Conefrey and Graeme Walsh*

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).<sup>3</sup> 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.

<sup>3</sup> The BCI was estimated using data available on 29/03/2021.

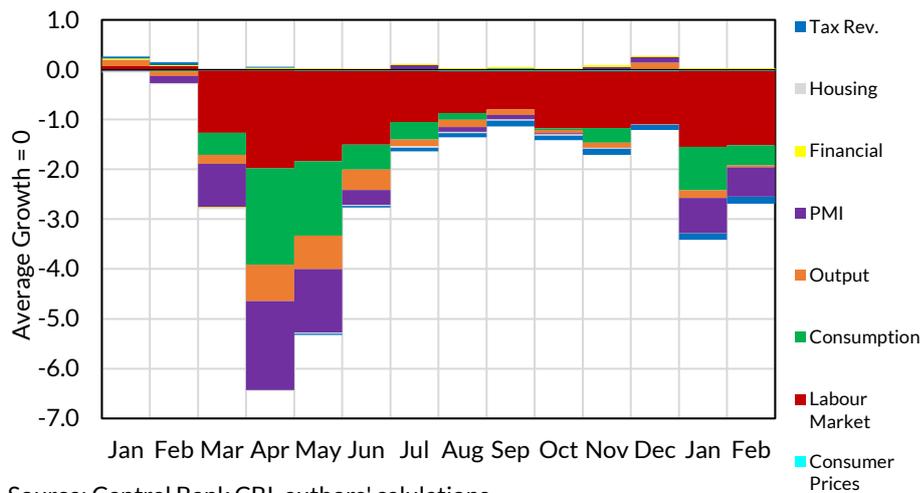
**Figure 1: BCI and Oxford Stringency Index from January 2020 to date**



**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.

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**

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 indicators, the BCI fell to a historic low surpassing the lowest level reached during the 2008/2009 economic and financial crisis.<sup>4</sup>

The level of restrictions in May were similar to those in 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

<sup>4</sup> It is worth noting that the Covid-19 pandemic and events from 2008/9 are significantly different economic shocks. This comparison is for illustrative purposes only.

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.<sup>5</sup> 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 by 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.

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 in January 2021, 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 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

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<sup>5</sup> On 21 October, Ireland became the first country in the EU to re-enter level 5 restrictions.

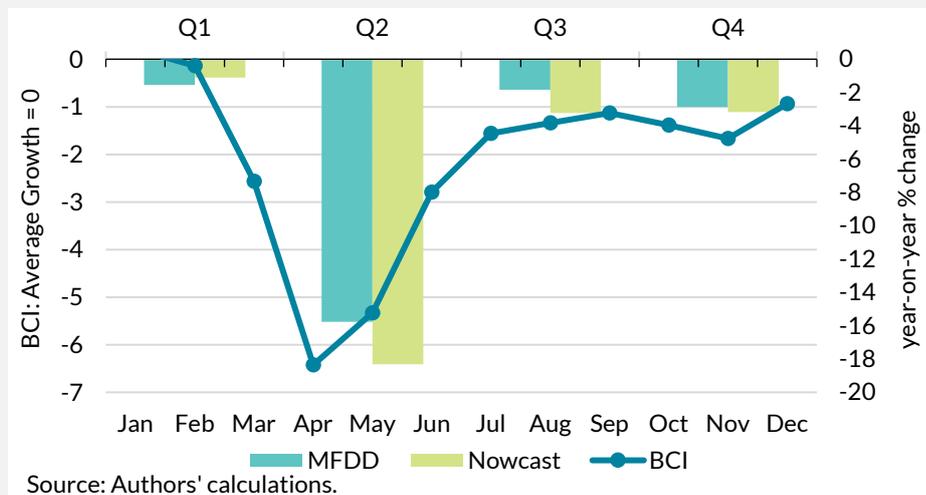
unemployment rate fell marginally from 25.1 per cent in January to 24.8 per cent in February.

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**



## Net Trade

**Headline export growth remained very strong in 2020 despite the collapse in global trade due to the coronavirus pandemic.** Total exports grew by 6.2 per cent in 2020 while imports fell by 11.3 per cent over the same period. With the volume of exports significantly higher than the volume of imports, net exports contributed strongly to Ireland being one of the few countries worldwide to see positive GDP growth in 2020. Trade continues to be highly concentrated in pharmaceutical and computer services. Movements in small number of very high value-added sectors dominated the headline growth figures for both exports and imports (see Box C).

**Looking ahead, headline exports are forecast to grow by 5.5 per cent in 2021 and 5 per cent in 2022 driven by a continued strong performance in the multinational sector.** These firms are gaining market share in sectors that are growing strongly worldwide. This growth in market share has led to export growth strongly outpacing growth in trading partner demand in recent years and forward-looking indicators suggest that this will continue over the projection horizon. Indigenous exporting firms are likely to see a slower recovery more in line with the recovery in import demand in our main trading partners.

**Headline imports fell sharply in 2020, primarily driven by a decline in research and development services imports.** Merchandise imports also declined somewhat, in line with the overall fall in global trade. Looking ahead, imports are projected to recover in line with the pickup in final domestic demand, albeit with some distortions relating to the import of intellectual property. Headline imports are projected to fall by 1.9 per cent in 2021 and grow by 4.8 per cent in 2022.

### Box C: Why did Irish Exports Grow by 6.2 per cent in 2020 when Global Trade Contracted?

By Stephen Byrne and Simone Cima<sup>6</sup>

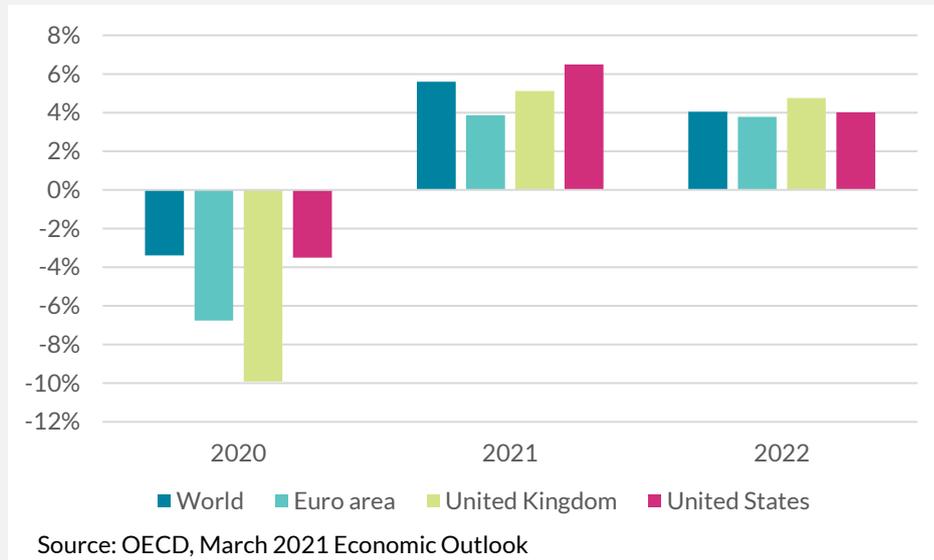
In spite of a large fall in world trade as a result of the COVID-19 pandemic, Irish exports – already over 120 per cent of GDP in 2019, grew by 6.2 per cent in 2020. World GDP is estimated to have declined by 3.5 per cent last year,<sup>7</sup> with the euro area and UK's economies contracting at an even sharper pace (Figure 1). Combined with a sharp decline in

<sup>6</sup> Irish Economic Analysis Division

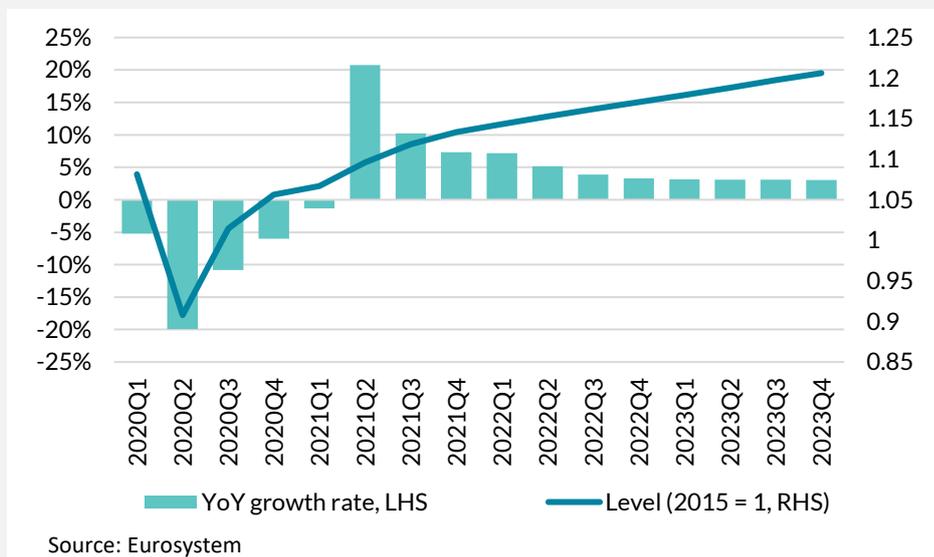
<sup>7</sup> March 2021 [OECD Economic Outlook](#)

imports (-11.3 per cent) this resulted in the highest annual trade surplus on record. This box highlights that this strong export performance was concentrated in a small number of sectors, and that most Irish exporting firms experienced a decline more in line with what was seen in the world economy and in world demand (Figure 2).

**Figure 1: Forecast Growth of Ireland’s Main Trade Partners**



**Figure 2: World Demand for Irish Output (Actual and Projection)**

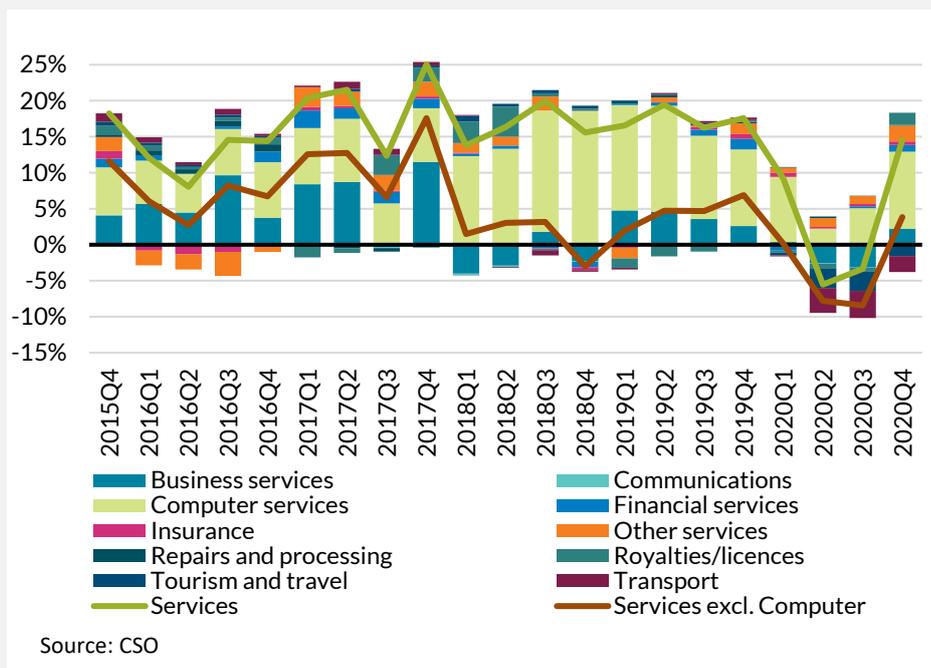


Looking at exports by sector, what stands out is the high level of concentration of export growth in just a few, key sectors. Indeed, the sectoral concentration of exports in Ireland is the second highest in the euro area and well above other countries of similar size. By far the largest export sectors for Ireland are *Chemicals and Related Products* for goods trade (representing 61 per cent of the total value of goods exports as of 2019 and made up primarily of pharmaceutical products and organic

chemicals), and computer services (around 53 per cent of services exports in 2019). As illustrated in Figures 3 and 4, not only do these sectors account for the largest share of exports, they have also been growing at a much faster pace than the remaining sectors in recent years, and have thus been the main driver of growth in aggregate export numbers.

To illustrate the extent to which these two sectors supported export growth during 2020, we hold the volume of exports of chemicals and related products and computer services fixed at 2019 levels (assuming a neutral contribution to growth). The result is shown in the red line in figures 3 and 4 for goods and services trade, respectively. The picture for the performance of the remaining export industries was far less positive during 2020.

**Figure 3: Contributions to Growth Rate in Services Exports, by Component**

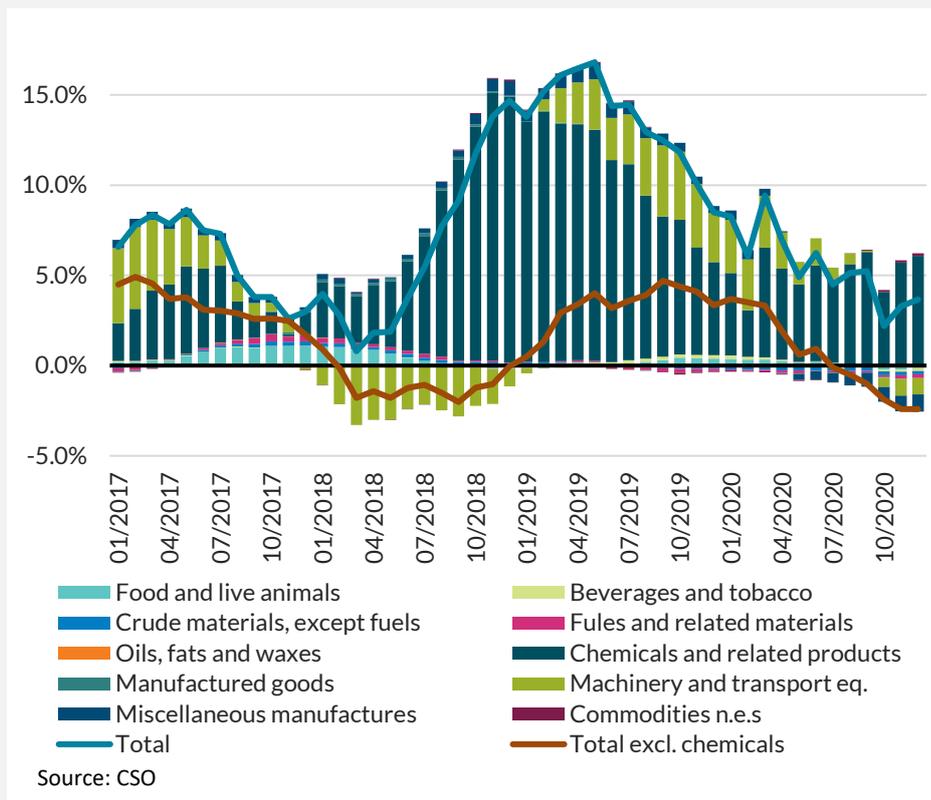


While exports of computer services grew by almost 13 per cent in 2020, exports of services excluding these actually declined by 6.2 per cent, brought down by a collapse in transport and tourism services, which both fell by around 70 per cent in the year. These two sectors were particularly adversely affected by the pandemic, as international travel declined substantially in 2020 due to the pandemic.

On the goods side, excluding pharmaceutical products, exports declined substantially in 2020. The largest declines in the value of Irish merchandise exports in 2020 were in machinery and equipment

(specifically other transport equipment incl. aircraft, industrial machinery and office machines – while there was strong growth in electrical machinery), and manufactured goods such as professional and scientific apparatus, and other miscellaneous manufactured articles. Exports in other smaller categories of goods also fell in most cases at a rate in line with the decline in trading partners’ economic activity, while exports of food were resilient.

**Figure 4: Contributions to Growth Rate in Merchandise Exports, by Component**



Most of the non-pharma exports of goods are likely to not be affected by the COVID-19 shock in the long term, as demand from trading partners recovers in the coming years. The goods items which saw the largest declines in exports, i.e. machinery and equipment and professional equipment, are largely investment goods, so that exports of these products are expected to recover together with firms’ investment, which will likely return to growth once COVID-19 is under control.

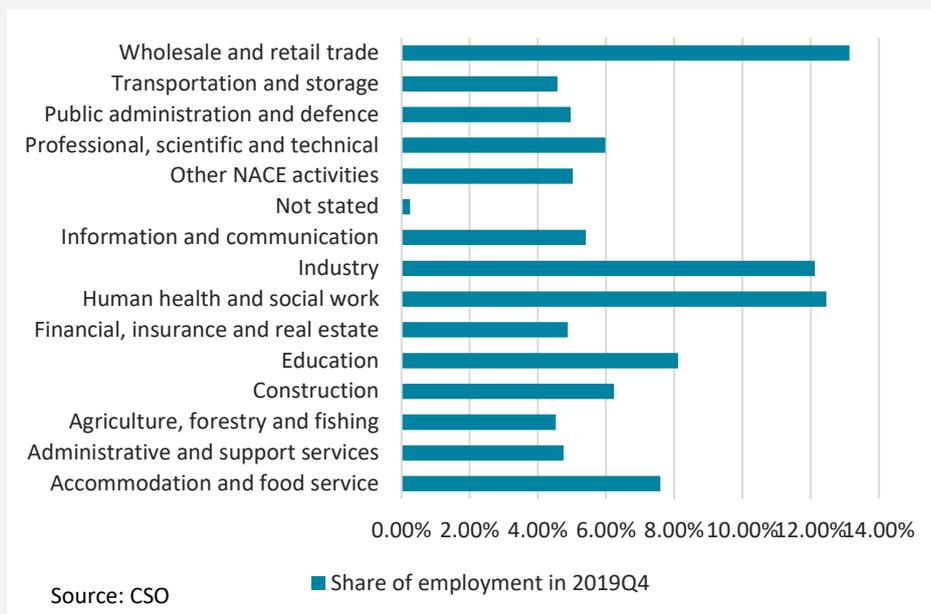
On the other hand, a large share of Irish-owned export-oriented businesses in other sectors mainly sell to the UK, with a large fraction of these actually selling exclusively to the UK.<sup>8</sup> Indeed, only 22 per cent of Irish exporters and 14 per cent of importers in 2017 had no trade with

<sup>8</sup> <https://www.cso.ie/en/releasesandpublications/ep/p-ituk/irishtradersandtheuk2017/>

the UK. With the end of the Brexit transition period in January, non-tariff trade barriers with the UK might make it more difficult and less profitable for some Irish businesses to sell to the UK competitively. These businesses might run into financial difficulties or lose market share as a result. Of particular concern in terms of their disproportional reliance on trade with the UK are exports of agricultural products, food and beverages, and several manufacturing products.

While the match with export sectors is imprecise, examining employment by NACE sector can give an idea of the importance of a category of exports for the domestic labour force, with the caveat that, for each sector, the share of employment that is supported by exports is different. Figure 5 shows the share of employment for each NACE activity at Q4 2019.

**Figure 5: Share of Employment, by NACE Sector**



While it is difficult to quantify how many jobs in each sector are supported by external rather than domestic demand, some sectors are more exposed than others to international trade. Retail, public administration, health, education, construction and administration are primarily domestic. Most of industry, representing about 12 per cent of the labour force, relies on exports, and is supported by manufacturing exports, primarily of pharmaceuticals and machinery. The information and communication sector (accounting for more than 5 per cent of workers) is largely linked to multinationals and the export of computer services. A large part of employment in financial services is also linked to exports and the IFSC. All of these jobs look set to remain largely unaffected by the pandemic.

On the other hand, many jobs in accommodation (which was the sector which was hardest-hit by the pandemic) are dependent on the tourism industry, which, as noted above, may face continued difficulties in the years ahead. Finally, while agricultural exports have not suffered during the pandemic, Brexit may be harmful to this sector, which employs 4.5 per cent of workers (see Box D).

## Box D: Trade Flows in the Early Aftermath of Brexit

*By Thomas Conefrey*

The end of the Brexit transition period on 31 December 2020 ushered in major changes in the arrangements governing trade between the EU and UK. The passage of time and further data will be required before the full economic impact of the new arrangements can be clearly identified. This Box reviews some of the early data on trade developments in the UK and Ireland since the EU-UK agreement took effect.

While the EU-UK Trade and Cooperation Agreement avoided the introduction of tariffs, the UK's exit from the single market and customs union introduced a range of new barriers to trade in goods and services. For trade in goods, these include rules of origin checks, customs procedures and additional Sanitary and Phytosanitary (SPS) checks on agri-food products.<sup>9</sup> These requirements came into full force on 1 January 2021 across the EU for imports from the UK. In contrast, the UK is implementing new customs and border procedures on its imports from the EU on a phased basis. On 11 March the UK extended the introduction of full checks on EU goods until 1 January 2022.<sup>10</sup>

### UK-EU Trade

With this phased introduction of the new procedures by the UK, as well as the period it takes for firms to adjust to the new arrangements, it will take some time before the effect of the new EU-UK trade agreement is clearly visible. The introduction of full customs and SPS procedures by the EU but not the UK (until January 2022) means that British exporters will continue to face greater barriers trading into the EU than their EU

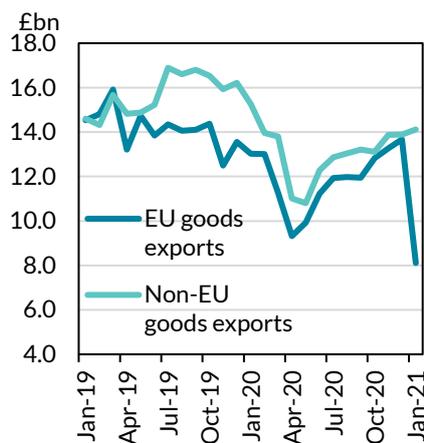
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<sup>9</sup> See <https://www.centralbank.ie/docs/default-source/publications/quarterly-bulletins/boxes/qb1-2021/box-c-the-eu-uk-trade-and-cooperation-agreement.pdf>

<sup>10</sup> The UK initially announced that the new customs and SPS checks would be introduced on a phased basis from 1 January until 1 July 2021, the date on which full border checks on EU goods entering Great Britain were to be operationalised.

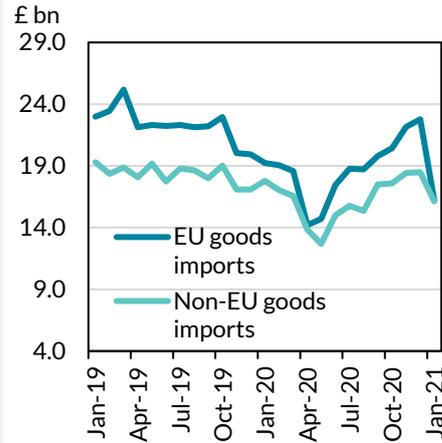
counterparts have exporting to Great Britain. UK trade data for January provides a first glimpse at the possible impact of the new trading arrangements. As shown in Figure 1 and Figure 2, the data indicate that imports to the UK from the EU fell by less than UK exports in the month. On a month-on-month basis, UK exports to the EU fell by 41 per cent while imports from the EU declined by 28 per cent. By way of comparison, these reductions in EU-UK trade are much larger than the corresponding changes in trade between the UK and non-EU countries (non-EU goods exports increased in January). Caution needs to be exercised in interpreting these monthly changes. In particular, the UK Office of National Statistics (ONS) has pointed out that November and December 2020 saw increasing imports and exports of goods, consistent with potential stockpiling of goods from the EU in preparation for the end of the EU exit transition period. The UK also went into another national lockdown at the beginning of January 2021 which is likely to have affected UK trade.

**Figure 1: UK Goods Exports, EU and Non-EU, Seasonally Adjusted, £ billion**



Source: ONS.

**Figure 2: UK Goods Imports, EU and Non-EU, Seasonally Adjusted, £ billion**



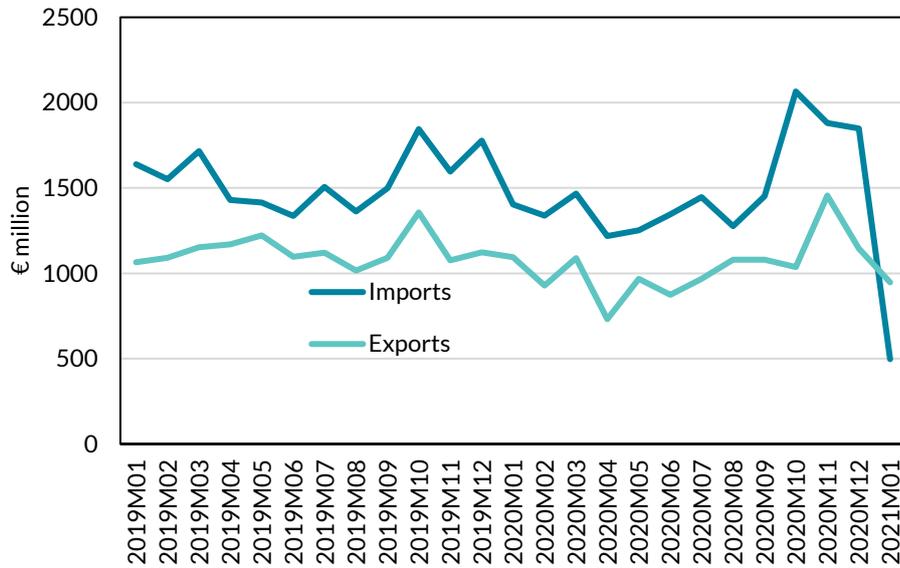
Source: ONS.

These considerations suggest that some of the declines in January may be temporary and could at least be partly recouped in the coming months. At the same time, even prior to the UK's formal exit from the EU there was evidence of a negative impact on UK trade arising from the vote to leave the EU.<sup>11</sup> Thus while the ultimate magnitude of the fall in EU-UK trade flows is still uncertain, the preliminary indications from the

<sup>11</sup> See Crowley, M, O. Exton and L. Han. 2019. "[Renegotiation of Trade Agreements and Firm Exporting Decisions: Evidence from the Impact of Brexit on UK Exports](#)," CEPR Discussion Paper 13446 and Graziano, A., K. Handley and L. Limão. 2021. "Brexit uncertainty and trade disintegration in Europe and beyond." Available at: <https://voxeu.org/article/brexit-uncertainty-and-trade-disintegration-europe-and-beyond>

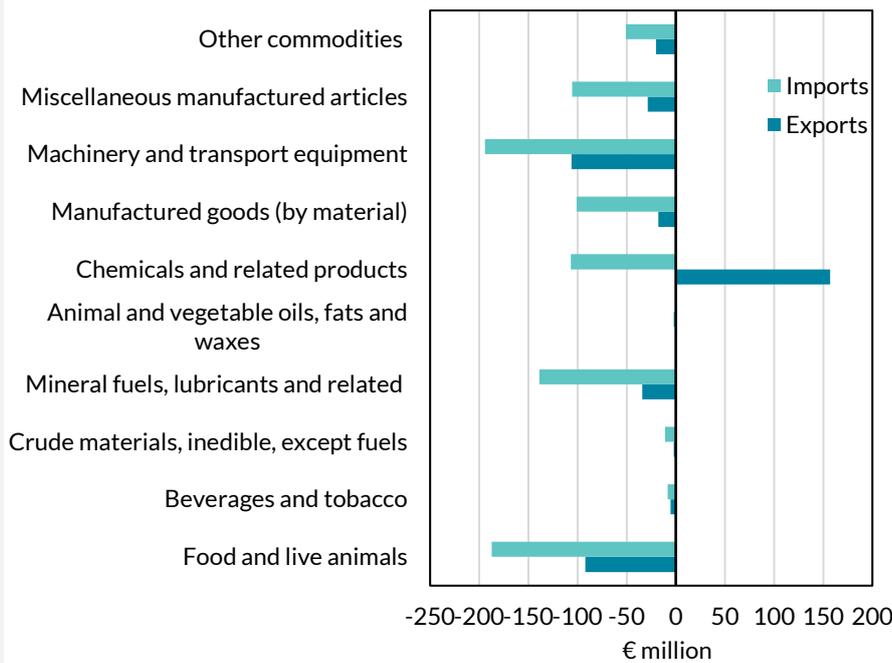
January data combined with existing evidence from research strongly points to a reduction in UK trade from moving to the less preferential terms of the post-Brexit trade deal. Lower UK GDP and imports will have negative knock-on consequence for the Irish economy.

**Figure 3: Ireland-UK Trade in Goods, Non-Seasonally Adjusted, € millions**



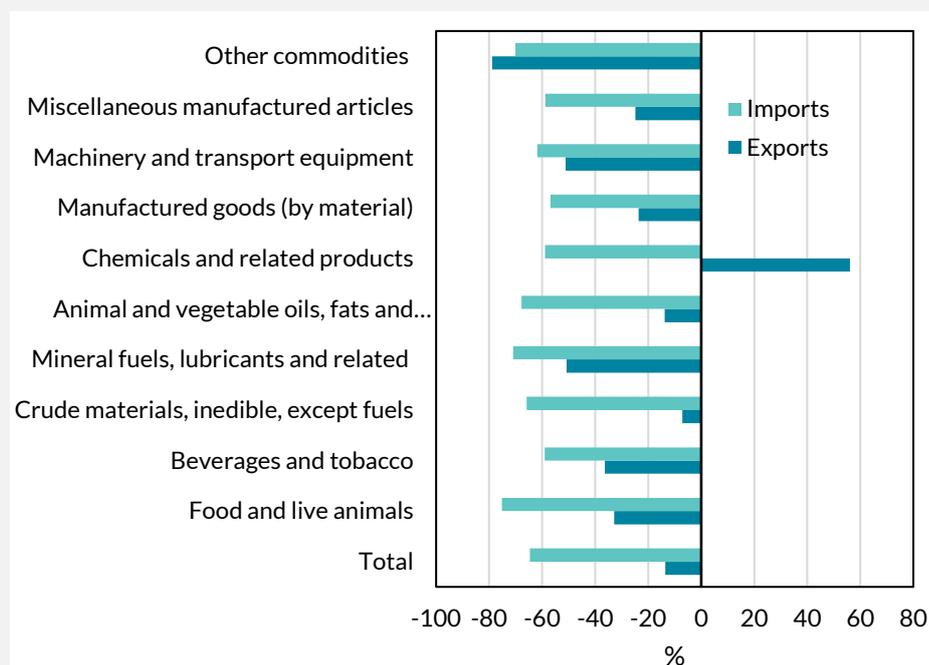
Source: CSO External Trade Statistics.

**Figure 4: Change in Ireland-UK Trade in Goods, January 2021 versus January 2020, Non-Seasonally Adjusted, € millions**



Source: CSO External Trade Statistics.

**Figure 5: Ireland-UK Trade in Goods, January 2021 versus January 2020, Non-Seasonally Adjusted, Year-on-Year Percentage Change**

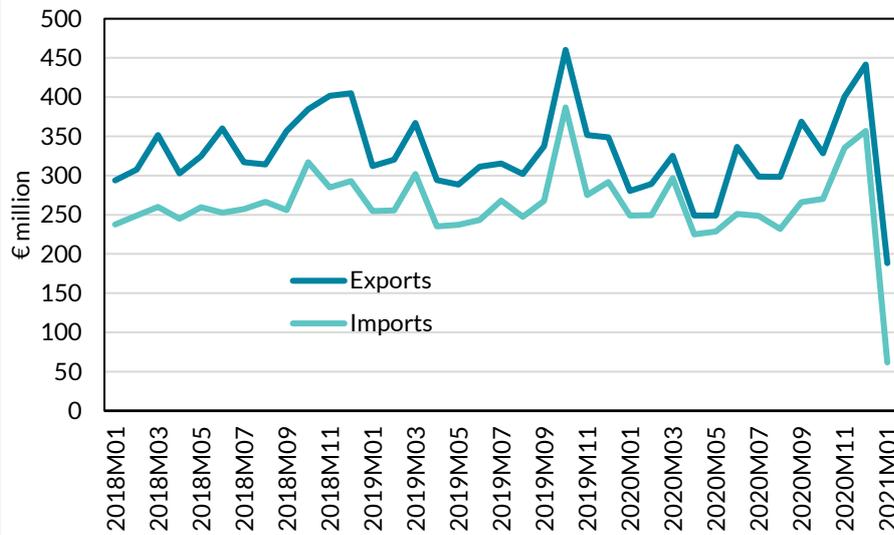


Source: CSO External Trade Statistics.

### Ireland-UK Trade

Further preliminary information on the early impact of the move to the new EU-UK trade arrangements can be gained from the monthly trade statistics for Ireland released on 18 March. As with the UK data, caution is required in interpreting trends from a single month's data in a context where several non-Brexit related developments are likely to be affecting trade flows. The monthly data show a 14 per cent (€149 million) drop in the value of exports to Great Britain and a 65 per cent (€906 million) fall in imports in January 2021 relative to January 2020. The fall in imports in January followed three previous months where the value of imports from the UK were significantly higher than in the corresponding months of the previous year (Figure 3). Figure 4 and Figure 5 show the decline in exports and imports by commodity group. The largest declines in imports from Great Britain in January were in machinery and transport equipment and food and live animals. The same sectors accounted for the biggest falls in exports.

**Figure 6: Ireland-UK Trade in Food and Live Animals, Non-Seasonally Adjusted, € millions**



Source: CSO Merchandise Trade Statistics.

Agri-food goods made up just under one-third of Ireland's merchandise exports to Great Britain and around one-fifth of imports in 2020. The sector has been highlighted as being particularly exposed to the effects of the UK's exit from the EU since new border formalities under the EU-UK agreement are most onerous on products of animal and plant origin. Figure 6 shows exports and imports of food and live animals between Ireland and the UK. Exports and import values both increased in the final three months of 2020, consistent with stockpiling of goods in the run-up to the end of the transition period (and in October 2019 – a previous Brexit deadline). In January 2021, exports and imports both fell sharply with Ireland's imports from the UK recording the larger decline. The reductions in imports and exports occurred across all commodities and were largest in meat and dairy products. This is consistent with the implementation of full customs and SPS checks by the EU on UK imports in contrast to the phased introduction of checks by the UK on imports from the EU.

The extent to which the fall in agri-food imports from the UK in January reflects the effect of the introduction of new checks from 1 January is not possible to determine from the data. The impact of these non-tariff barriers can be largest at the time of their introduction, before firms, customs and port authorities have fully adjusted to the new arrangements.<sup>12</sup> The CSO has noted other that factors which are likely to

<sup>12</sup> See Byrne, S. and J. Rice. 2018. "Non-Tariff Barriers and Goods Trade: A Brexit Impact Analysis." Available at: <https://www.centralbank.ie/docs/default->

have influenced the January data include the previous stockpiling of goods in Q4 2020, possible substitution with goods from other countries and a reduction in trade volumes due to the impact of COVID-19 related restrictions throughout January. Although the fall in exports to the UK was much smaller in January, it is notable that it occurred before the full range SPS checks on agri-food products have been implemented by the UK. It is possible that trade volumes will recover in the coming months but the data will need to be carefully monitored for signs of persistent weakness. This Box has focussed on developments in merchandise trade in January but services will also have been affected by the UK's exit from the Single Market. Similar monthly data for services trade are not published but quarterly data will be released by the CSO with the Q1 2021 National Accounts and Balance of Payments in June.

Around 90 per cent of Ireland's merchandise trade in volume terms is transported using sea borne freight. As well as changes in the value of trade, there have been significant changes in sea freight logistics since 1 January. In particular, there has been a large increase in direct freight sailings to the Continent. In February 2021, there were around 68 Roll-on Roll-off (RoRo) freight sailings between Ireland and the Continent in a typical week, an increase of 34 per week compared to February 2020. At the same time, weekly RoRo freight on Ireland-Great Britain routes has reduced.<sup>13</sup> The increase in direct Continental freight capacity has facilitated importers and exporters wishing to avoid new customs procedures at UK ports, but is likely to have implications for the cost of importing and exporting. Further data and analysis will be required to identify any passthrough to import and consumer prices in Ireland or for evidence of adverse effects on the competitiveness of Irish exporters.

## Labour Market

**Employment fell by 2.3 per cent in the fourth quarter, compared with a year previously.** The effect of the pandemic on the labour market continues to cause issues in interpreting traditional measures of activity due to the complexities brought about by the government income support schemes. In Q4 2020, the level of employment grew slightly compared to the previous quarter despite a substantial increase in the number of PUP recipients. The schemes have mitigated the rise in unemployment throughout the

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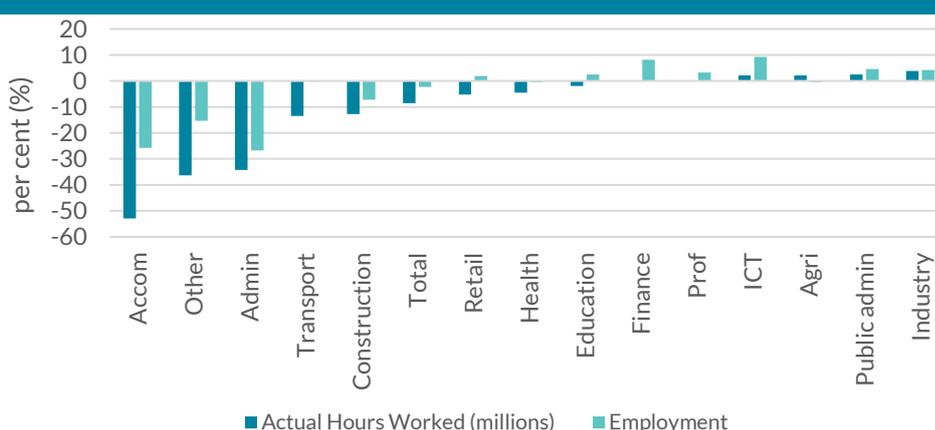
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<sup>13</sup> See <https://www.gov.ie/en/publication/b3b67-government-operational-update-two-months-post-brexit-transition/#freight-capacity>

pandemic, although some methodological issues pose difficulties in interpreting official data.<sup>14</sup> While yet to recover to pre-pandemic levels, employment figures are now at their highest point since Q1 2020 despite the re-introduction of health restrictions in late-October. The introduction of Level 5 restrictions from late 2020 onwards has not resulted in sharp increases in unemployment due to the treatment of PUP and EWSS recipients in the official ILO measure, with these effects only observed in the COVID-adjusted figures.

**The recovery in the labour market over the forecast horizon is contingent on the effective deployment of vaccines and the safe unwinding of health restrictions.** While government support schemes have enabled many firms to retain staff and remain operational, an eventual phasing out of these schemes may see a gradual rise in unemployment and an increased take-up of traditional supports such as the Live Register with few sectors in a position to absorb the excess labour supply if continued social distancing measures limit economic activity. While gradual employment recovery is expected to occur in 2022, a slower rate of job matching due to return to education, worker retraining programs and difficulties in finding work due to prolonged periods of inactivity may mean a delay in employment reaching pre-pandemic levels until beyond the projection horizon. Employment levels are projected to decline further in 2021 by 1.3 per cent followed by growth of 0.6 per cent in 2022.

**Figure 7: Annual Change in Hours Worked and Employment (Q4 19 – Q4 20)**



**The labour force declined by 1.1 per cent in the year to Q4 2020 due to greater flows from employment to inactivity, particularly amongst younger age groups.** The effects of this increased transition rate is evident in the labour participation rate, which has now declined to 2015 levels. In

<sup>14</sup> See [Box D "Measuring and Forecasting the Unemployment Rate during COVID-19" Central Bank of Ireland Quarterly Bulletin No.4 \(2020\)](#).

Q4 2020, the participation rate measured 61.3 per cent, notably below the 62.7 per cent level a year previously. Increased levels of worker discouragement from a lengthy period of inactivity, particularly amongst younger and female cohorts, may result in a structurally lower participation rate in the coming years relative to the pre-pandemic average until vaccination levels and economic recovery can support job growth across a wider range of sectors. The labour force is projected to decline by 0.2 per cent in 2021, before subsequently rising by 2.3 per cent in 2022.

**The ILO unemployment rate declined from 7.1 per cent in Q3 2020 to 5.6 per cent in Q4 2020 despite PUP levels rising above 350,000 persons during the quarter.**

The latest seasonally-adjusted ILO monthly unemployment rate for February measured 5.8 per cent with the COVID-adjusted measure rising to 24.8 per cent. The ILO rate has remained subdued because individuals in receipt of the PUP can be classed as employed if they consider themselves to be temporarily away from work and expect to return to work within a period of 3 months. The easing of restrictions will see a sharp decline in PUP figures similar to the previous summer months, particularly in the construction and retail sectors, although not all recipients will return to work due to potential firm closures, permanent layoffs and continued social distancing requirements affecting certain sectors. While improvements in the unemployment rate are expected in line with the recovery, figures are likely remained elevated relative to the pre-pandemic environment beyond the projection horizon. As the schemes are expected to be unwound later this year, the ILO and COVID-adjusted unemployment rates should converge, with the official rate (ILO) projected to rise from 6.6 per cent in 2021 to 8.1 per cent in 2022.

Average hourly earnings increased by 5.5 per cent in the year to Q4 2020 although there have been significant compositional shifts in the labour market relative to previous quarters. For instance, the 26 per cent decline in employment in the Accommodation sector between Q1 and Q4 2020 was accompanied by a corresponding 10 per cent increase in earnings. A number of relatively lower earnings sectors exhibited similar trends to suggest that average earnings in the sector rose due to a lower share of part-time workers reducing average earnings figures. As the labour market improves in line with easing restrictions and increased vaccinations, average hourly earnings may exhibit negative growth in the coming quarters to reflect a recovery in part-time employment, with higher levels of lower-earning workers acting to reduce the overall average.

Using job postings data as a real-time measure of labour market activity, data from Indeed show that levels for the first week of March were 24.3 per cent below seasonally-adjusted levels from a year previous. The

sectoral effects from COVID-19 have been very uneven, with only healthcare and manufacturing occupations levels exceeding pre-pandemic baselines.<sup>15</sup> The sectors affected most by social distancing measures such as hospitality and tourism remain far below those levels. Job vacancy data show that while the overall vacancy rate remains unchanged from previous quarters, vacancy levels have risen in the public sectors of public administration, education and health.

**Table 2: Labour Market**

	2019	2020f	2021f	2022f
Employment (000s)	2323	2294	2265	2279
per cent Change	2.9	-1.2	-1.3	0.6
Labour Force (000s)	2443	2431	2426	2480
per cent Change	2.0	-0.5	-0.2	2.3
Unemployment (000s)	121	137	160	201
Unemployment Rate (per cent)	5.0	5.6	6.6	8.1

## Inflation

**The outlook for inflation is marginally stronger than that of the last Bulletin.** While modified domestic demand is projected to grow modestly this year, other factors are adding to price pressures suggesting that the downward trend identified in recent Bulletins may be coming to an end.

**Supply chain pressures and cost increases associated with the UK's exit from the EU are likely filtering through to imported consumers prices,** although the extent and timing of the pass-through is uncertain. Many on-line consumers are experiencing a form of hidden inflation in the form of significant delays and reduced choice of products, particularly in sourcing goods that either come from or through the UK.

**Developments in energy prices and exchanges rates since the previous Bulletin are expected to add to prices pressures.** At the time of writing, Brent crude oil futures are on a higher path compared to the last Bulletin, which is likely to pass-through to higher consumer energy prices over the forecast horizon. Weakness in the euro relative to sterling and the dollar will likely add to price pressures in imported goods<sup>16</sup>.

<sup>15</sup> Indeed.ie "[Ireland Labour Market Review and Outlook: Hiring Recovery Continues, but Still Some Way to Go](#)"

<sup>16</sup> Exchange rate assumptions are based on the average of the latest available 10-day period at the time of writing. While rates are assumed constant at this rate

**Measured inflation is subject to more than the usual degree of uncertainty.** Methodological updates to the weights of goods and services included in the HICP and CPI - to reflect more recent consumption patterns - are also having an impact on measured inflation (see Box E). Moreover, limitations on price collecting and consumption due to COVID-19 restrictions mean that a portion (15 per cent in February 2021) of the goods and services in the HICP/CPI basket are imputed using seasonal patterns or price developments in similar products. The rate of inflation for imputed items was higher than that of the rest of the basket where consumption was actually possible. In addition, disruption continued in seasonal patterns for many goods where consumption was possible, for example, the usual sales patterns for clothing and footwear has not been evident.

**Headline HICP is expected to reach 0.8 per cent this year and next.** Core inflation, excluding food and energy prices, is forecast to average 0.7 per cent and 0.9 per cent in 2021 and 2022, respectively.

### Box E: The Impact of Pandemic Spending Patterns on HICP Weights and Inflation in Ireland

By Stephen Byrne<sup>9</sup>, John Scally<sup>17</sup> and Zivile Zekaite<sup>18</sup>

Consumer price inflation is measured as a percentage change in the price index between two periods. The price index, such as the Harmonised Consumer Price Index (HICP), tracks prices of a broad range of consumer goods and services (consumer basket) over time<sup>19</sup>. In order to calculate the overall consumer price index, different goods and services are assigned weights based on their share in the total household expenditure on goods and services covered by the index. Thus, the weights reflect the average expenditure by households on various categories of goods and services.<sup>20</sup>

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over the forecast horizon, a lower euro level relative to sterling and the dollar will add to price pressures in future months due to lags in pass-through to consumer prices.

<sup>17</sup> Irish Economic Analysis Division

<sup>18</sup> Monetary Policy Division

<sup>19</sup> There are around 600 items in the Irish HICP that are representative of goods and services in the average consumer's basket and around 51,000 prices are collected each month for this basket. These items are updated every five years using data from the Household Budget Survey.

<sup>20</sup> The HICP is a chain-linked Laspeyres-type price index, i.e. a 13-month series of Laspeyres-type indices for each year (December to December) are aligned into a

In the context of the Irish HICP, the weights used to construct the price index in the current year ( $t$ ) should be representative of the expenditure shares in the previous year ( $t-1$ ) and are fixed within a calendar year.<sup>21</sup> In order to keep the price index representative of consumers' spending patterns, the weights are updated annually at the beginning of the year, using the previous year's expenditure patterns. In normal times, these expenditure shares do not change much over short periods of time and minor intra-year fluctuations in expenditure shares do not bias the measurement of consumer price inflation.

The coronavirus pandemic has generated significant challenges to the measurement of consumer price inflation. We witnessed large changes in household expenditure last year due to various restrictions imposed on the economy to contain the spread of the virus as well as changes in consumers' preferences for goods and services. For example, restaurant spending has declined while grocery spending has increased. People staying home led to reduced expenditure on transport and increased spending on home heating<sup>22</sup>. The fixed-within-calendar-year weights of items in the consumer price basket mean that the price index for 2020 had become less representative of actual consumption habits. This implies a bias in measured inflation.

As of January 2021, these expenditure changes are now reflected in the HICP weights for 2021. Table 1 reports changes in weights for selected aggregate items. In general, the weight for *Goods* increased to 52.1% of the total consumer basket, while that of *Services* decreased to 47.9%. Looking at a more disaggregate level, the largest decline in the consumption basket's share is noted for *Restaurants and Hotels*, while *Food and Non-alcoholic Beverages* saw the largest increase in the weight. These changes are much greater than observed in the past.<sup>23</sup> Other notable changes in weights are observed for *Housing, water, electricity, gas and others fuels* and for *Alcoholic beverages and tobacco*, with higher shares in the basket for 2021. Also, the share of *Transport* in the basket declined

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single index in each December month (link month). More details are in the [HICP methodological manual](#) Chapter 8.

<sup>21</sup> In practice, these expenditure weights are based on full-year national accounts data for  $t-2$  year due to lags in data availability and then price updated to the previous year.

<sup>22</sup> As the expenditure shares are relative, even if euro spending on a specific good or a service did not change, the share of this expenditure in the overall spending may have changed due to higher or lower spending on other items.

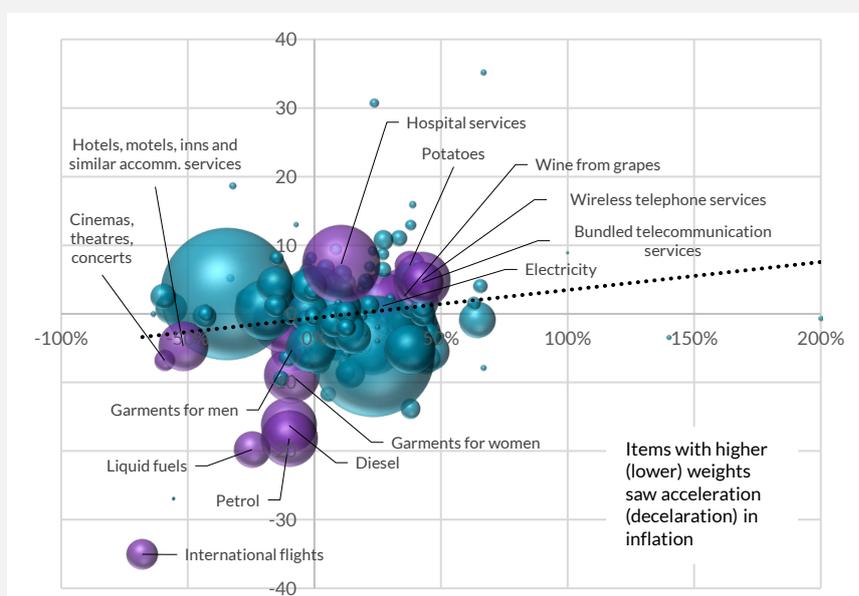
<sup>23</sup> Annual weight updating came into effect in 2012. The comparison is done with respect to 2012-2019 period.

by a relatively large amount. Similar patterns are also observed for the euro area HICP.<sup>24</sup>

**Table 1: Harmonised Consumer Price Index Weight Changes (% of total)**

HICP Item	2020	2021	Change
Goods	45.3	52.1	6.8
Services	54.7	47.9	-6.8
Restaurants and hotels	21.7	13.9	-7.8
Food and non-alcoholic beverages	10.8	14.9	4.1
Housing, water, electricity, gas and other fuels	11.5	13.5	2
Alcoholic beverages, tobacco	4.9	6.6	1.7
Transport	14.4	12.8	-1.6
Communications	2.8	3.9	1.1
Recreation and culture	8	7.1	-1
Furnishing, household equipment and routine house maintenance	5.3	6.2	0.9
Health	6.3	6.8	0.5
Miscellaneous goods and services	7.7	8.1	0.4
Clothing and footwear	4.8	4.5	-0.3
Education	1.9	1.9	0

**Figure 1: Consumers switched into some items with higher inflation and away from some items with lower inflation. (Average inflation Jan-Feb 2021-Average inflation Jan-Feb 2020)**



Source: Eurostat and Authors Calculations

Note: The x axis shows percentage changes in the HICP weights (at 5-digit level) between 2021 and 2020 (%). Values on the y axis represent the difference (in percentage points) between average annual inflation for each item in January - February 2021 and January - February 2020. The size of the bubbles represent

<sup>24</sup> See the ECB Economic Bulletin, Issue 2, 2021, Box 6.

the item's current weight in the HICP basket. Hire of garages, parking spaces and personal transport equipment is not shown due to its scale (14.3%, 69.6, size: 0.8).

At the most disaggregate level for which data is publicly available<sup>25</sup>, there appears to be (on average) a positive relationship between the change in an item's weight for 2021 and change in its inflation rates. Figure 1 highlights several items that saw an increase (decrease) in the weight and higher (lower) inflation rates in January and February compared to the same months last year. The upward sloping trend line in Figure 1 signals that new weights contributed to measured inflation being higher in the first months of 2021.<sup>26</sup>

### Weight effects on inflation rates

A counterfactual exercise to calculate the HICP index assuming no change in the weights for 2021 can help to quantify the effect of weights on recent Irish inflation figures. This requires using the most detailed data on the HICP price sub-indices (Figure 1).<sup>27</sup> We then compare the counterfactual annual inflation rates for January and February in 2021 with actual figures of -0.1% and -0.4% for January and February, respectively. Without a change in the weights, HICP inflation would have been lower by approximately 0.4 (0.3) percentage points in January (February). This shows that new weights led to higher measured consumer price inflation.

In more detail, services inflation is around 0.6 p.p. higher on average in the two months of this year due to the weights update. Across services, transport-related services inflation is affected the most and it is around 5.3 p.p. higher. For non-industrial goods excluding energy and food, this inflationary effect is smaller, while for energy inflation the effect is deflationary (approx. 0.5 p.p. on average). This is in line with the weight effects reported for the euro area HICP.<sup>28</sup>

### Future Implications

The HICP weights for 2021 may become less representative of actual consumption expenditure shares later this year and next year. We are likely to return to spending habits closer to normal over the course of this

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<sup>25</sup> COICOP-5 digit level.

<sup>26</sup> As the expenditure weights are updated every year, annual inflation rates calculated for a given month in a given year will also reflect changes in the weights between the two years.

<sup>27</sup> This exercise closely follows the analysis for the euro area provided in the ECB Economic Bulletin Issue 2, 2021, Box 6. For further details on the index aggregation, see also Chapter 8 of the [HICP methodological manual](#).

<sup>28</sup> See the ECB Economic Bulletin Issue 2, 2021, Box 6.

year and even more likely so in 2022<sup>29</sup>. Prices and total amount spent might increase in sectors for which there will be pent-up demand (e.g. restaurants) but the weights of these goods and services will continue to reflect the pandemic patterns.

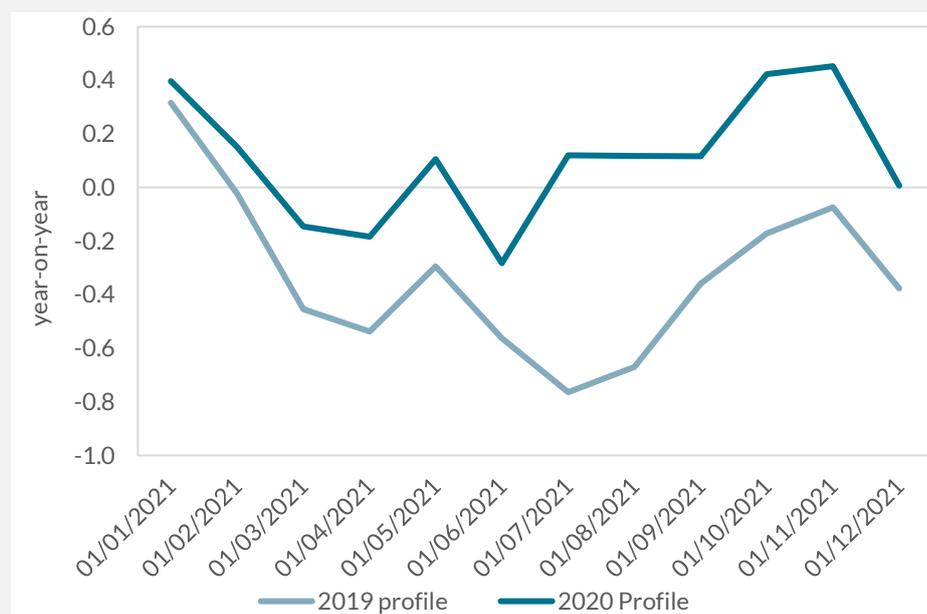
In addition, the weight changes introduce a degree of uncertainty into the Bank's HICP inflation forecasts since the forecasts assume fixed weights over the projection horizon. Importantly, the effects of changes in weights can be seen most precisely at the most disaggregate level. However, forecasting inflation occurs at a higher level of aggregation and therefore the impact of the weights on forecasts is somewhat uncertain. The ECB has run a counterfactual COICOP-5 level exercise for two hypothetical sets of forecasts and has shown that the effects of the weight changes depends crucially on the path of assumed future month-on-month changes<sup>30</sup>. The impact of the weight changes for Ireland was greater and more negative when a "normal" year-on-year profile was assumed. When the path for month-on-month inflation was assumed to take a similar path in 2021 as it did in 2020, the impact of the weight change was less negative. These results highlight the problematic nature of the shifts in consumption patterns given the current methodology in determining both current and future inflation. For available data this year, the expenditure weight change has resulted in higher measured inflation than in a no-change situation. This upward bias may change, however, if the inflation profile returns to a more normal profile in the latter stages of 2021.

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<sup>29</sup> According to the HICP methodological manual, the weights for 2022 should be representative of the consumption in the previous year, i.e. 2021. However, average actual consumption patterns in 2022 are likely to be quite different from those in 2021. Thus, some kind of adjustment in weights may be required.

<sup>30</sup> Using the old 2020 and new 2021 weights, as well as the assumed m-o-m paths for inflation, two implied paths for annual inflation in 2021 are calculated. The difference between the two implied inflation paths provides a proxy for the impact of the weight change.

**Figure 2: Impact of Weight Changes on 2021 Inflation Forecast Simulation**



Source: ECB Calculations

## Box F: Spending, credit, and deposits: An update on Irish household and business activity

By Statistics Division

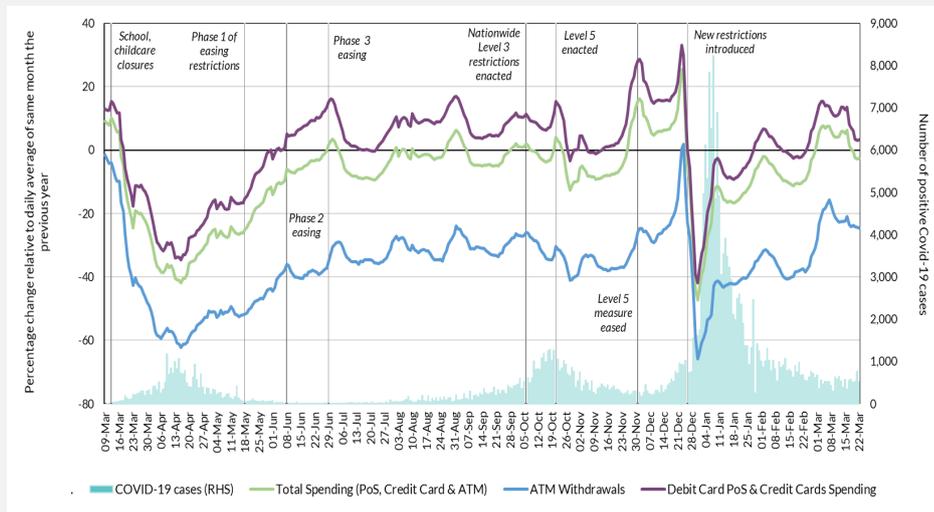
The impact of the COVID-19 and the associated public health measures continue to reverberate throughout all areas of economic activity, including the saving and borrowing decisions of households and businesses. This unprecedented shock brought about a disruption to consumption patterns, a rapid accumulation of savings, and a decrease in demand for external financing. This Box provides an update on the key trends relating to the payments, savings and borrowing activities of Irish households and businesses, relying on the latest available and most timely data.

The move to Level 5 restrictions at end-December coincided with a stark reduction in payment activity, while the growth of household deposits reached rates not seen since before the Global Financial Crisis. Borrowing activity has fallen for both households and businesses. This is particularly the case for short-term consumer lending, while lending for house purchases, continues to grow, but at a slower pace.

## Household Spending

Daily card payments data reveal the large impact of the COVID-19 pandemic on the spending patterns of Irish households (Figure 1). Spending, including both payments using cards and ATM withdrawals, decreased during the initial restrictions introduced in March and April. As restrictions were eased during the summer of 2020, spending started to rebound, and by late-June recovered to levels close to what was observed in 2019. Consumer behaviour switched towards greater use of cards to conduct payments rather than cash. ATM withdrawals remained below their 2019 levels for most of the year.

**Figure 1: Change in card spending and cash withdrawals compared to the daily average in the same month the previous year**



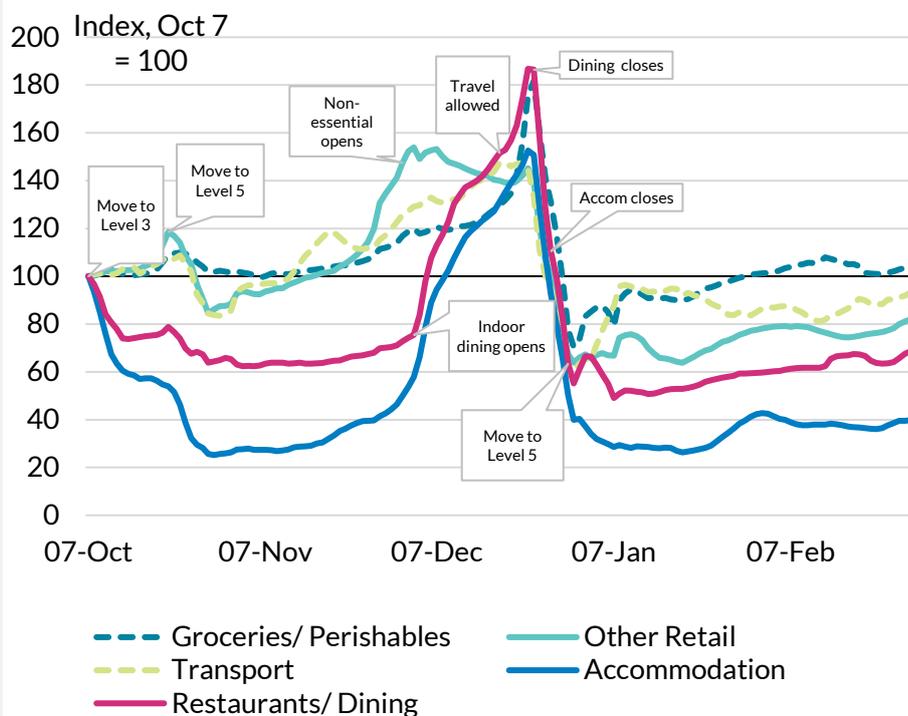
Source: Central Bank of Ireland

In late December, spending and payment activity again fell sharply. This coincided with the introduction of national Level 5 restrictions from Christmas Eve, initiated in response to the rapidly deteriorating situation regarding COVID-19 infections. It is worth noting that there were significant seasonal and other factors at play on this occasion, which contributed to the steep decline in payment activity, relative to the response during the March restrictions. Contributing factors such as the impact of public holidays, the impact of the weekend, and the relatively higher rate of infections, all likely exacerbated the decline relative to the previous imposition of restrictions. Both cash and card payments sharply declined, with the fall in card payments driven primarily by the reduction in the use of cards for in-store payments.

While the extent and pace of the initial decline in activity was even greater than that which was seen during the March 2020 restrictions, the subsequent recovery in payment activity has also been swifter. By late-

January, card payment activity had recovered to 2020 levels, while total payment activity would recover by early March, reflecting both the seasonal post-Christmas recovery and an improvement in consumer sentiment that accompanied the beginning of the vaccination programme<sup>31</sup>. Using the card data to monitor shifts in sectoral spending, payments for accommodation and restaurants/dining, which had surged during the December opening, have reverted to levels seen during the previous Level 5 period from late-October to early-December (Figure 2). Meanwhile, spending on groceries, has proven largely resilient to the recent changes regarding public health measures, and remains significantly higher than pre-pandemic levels<sup>32</sup>.

**Figure 2: Changes in Sectoral Spending**



Source: Central Bank of Ireland Table A.13.2, 7-day moving average, author's calculations

### Household Credit & Deposits

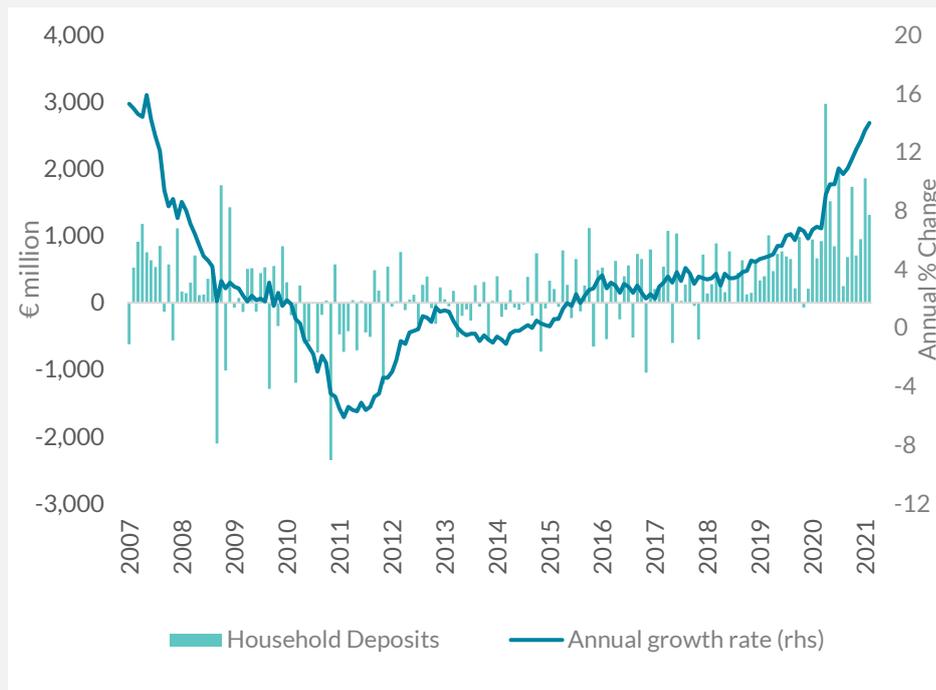
Household savings have increased sharply since the outbreak of the pandemic and the introduction of public health measures. These measures have reduced the opportunities for households to spend, while

<sup>31</sup> See <https://www.kbc.ie/w/confidence-recovers-in-march-as-irish-consumers-focus-on-post-pandemic-improvement-in-economy-and-jobs-but-household-savings-likely-to-remain-higher-in-future-1?redirect=%2Fblog%2Fconsumer-sentiment-surveys>

<sup>32</sup> For more information on changing consumer spending patterns, see [Hopkins, A. and Sherman, M. Shining a light on sectoral spending behaviours through the most recent phases of the pandemic. Central Bank of Ireland, Behind the Data](#)

government interventions have helped mitigate shocks to household income, resulting in a higher level of saving at an aggregate level. Additionally, precautionary motives may also be driving households to save more in response to uncertainty over future economic conditions.<sup>33</sup> The broadest view of what is occurring regarding household savings comes from the [Quarterly Financial Accounts](#). Although only available with a lag, these data clearly show the increase in saving activity during the first three quarters of 2020 was driven primarily by the accumulation of currency and deposits, rather than investing in housing or other financial assets such as stocks or bonds. The more timely [Credit and Banking Statistics](#) show that, in the period from March 2020 to February 2021, net inflows of deposits amounted to €15.7 billion. This compares to net inflows of €7.3 billion for the same period in the preceding 12 months. In February 2021, the annual growth rate of household deposits reached 14 per cent, the highest rate of growth since June 2007 (Figure 3).

**Figure 3: Household Deposits Net Transactions and Annual Rate of Change**



Source: Central Bank of Ireland

Annual growth in household debt, which has been positive since mid-2017, turned negative in the final months of 2020. The most recent data for February shows a small annual decline of 0.3 per cent, as dampened

<sup>33</sup> For a discussion on who is saving and why, see [Lydon, R. and McIndoe-Calder, T. Saving during the pandemic: Waiting out the storm? Central Bank of Ireland Economic Letters Vol. 2021 No. 4](#)

levels of new lending have been counterbalanced by decreased repayment activity since the onset of the pandemic.

Looking further into household debt by purpose of lending reveals different trends in lending for house purchases and shorter-term lending for consumption and other purposes. New mortgage lending, which had slumped during the initial phase of the pandemic, witnessed a recovery in activity late last year, as new mortgage agreements reached a multi-year peak in December (Figure 4). New mortgage lending has been somewhat slower so far in 2021, down to €500 million in January, compared to €535 million in January 2020. Forward-looking indicators such as approvals and Central Credit Register enquiries remain buoyant in recent weeks. New mortgage approvals, for example, were up 3.9 per cent annually in volume terms in February<sup>34</sup>. According to the latest Bank Lending Survey<sup>35</sup>, demand for household loans has continued to recover from the steep decline seen in Q2 2020, and lenders expected that demand for loans for house purchase would continue to rise in Q1 2021.

The average interest rate recorded for new mortgage lending in January was 2.79 per cent. While 13 basis points lower than the average rate in January 2020, the cost of mortgage credit in Ireland is higher than the average for any other euro area country<sup>36</sup>. In addition to the reduction in interest rates, credit standards on loans for house purchases loosened somewhat in the final quarter of 2020, as reported in the Bank Lending Survey. This follows the significant tightening of standards seen in the second quarter of last year.

New lending for consumption purposes is expected to remain subdued until consumer confidence and activity returns. New agreements for consumer credit and other household lending were down 33.9 per cent year-on-year in January. For consumer credit, repayments exceeded new lending by €817 million over the 12 months to end-February, reflecting the weakening of household consumption and increased deleveraging over the period. This represents an annual growth rate of minus 6.7 per cent in outstanding consumer debt, down from plus 3.2 per cent growth a year earlier. This is the strongest pace of decline in consumer debt since October 2014. Consumer credit is largely driven by car purchases, holidays and credit cards, on which the opportunity to spend has been substantially curtailed due to the public health restrictions. The quick

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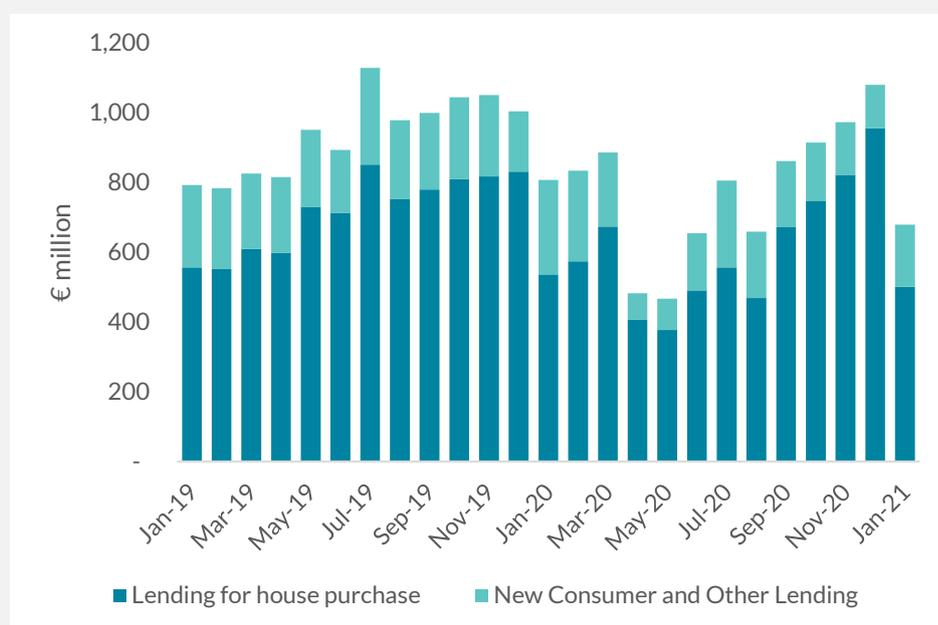
<sup>34</sup> Banking and Payment Federation Ireland Mortgage Approvals Report, February 2021 <https://bpfi.ie/publications/bpfi-mortgage-approvals-report-february-2021/>

<sup>35</sup> See: <https://www.centralbank.ie/statistics/data-and-analysis/credit-and-banking-statistics/bank-lending-survey>

<sup>36</sup> See Governor's Blog, 'Monetary policy and interest rates in Ireland' for a discussion on the factors effecting interest rates in Ireland <https://www.centralbank.ie/news/article/blog-monetary-policy-and-interest-rates-in-ireland>

rebound in consumer lending seen in summer 2020 highlights that the flow of consumer credit can pick up quickly and sharply to support the recovery when health restrictions ease.

**Figure 4: Volume of New Household Loan Agreements by Purpose of Loan**



Source: Central Bank of Ireland

### Business Credit & Deposits

Following a three-year period of relative stability, lending to non-financial corporations (NFCs) contracted over the course of 2020, with repayments exceeding drawdowns by €2.1 billion on a whole-year basis. This pattern has continued into 2021, with NFC loans contracting by 2.5 per cent year-on-year in February. The decrease in February mostly reflects strongly negative movements in short-term lending with maturity of one year or less, which was down 21 per cent compared to the previous year. Lending between one and five year's maturity was relatively stable, at minus 1.1 per cent, while longer-term lending with maturity of over five years increased by 4.8 per cent year-on-year.

New lending to SMEs has recovered from the very low levels seen after the initial health restrictions in Q2 2020 (Figure 5). New lending to SMEs in Q4 2020 was 90 per cent above that of Q2, albeit still 15 per cent below Q4 2019. The recovery in lending activity varies dramatically across sectors with very strong levels of lending to construction and primary industry sectors reflecting their continued operational activity in late 2020. The strong rebound in construction lending as construction sites reopened provides some evidence that credit is flowing and

available when demand returns. On the other hand, credit drawdowns in heavily impacted service orientated sectors are far below normal levels. This is most acute in the hotel sector where new drawdowns are 85 per cent down on Q4 2019.

**Figure 5: Gross New Lending to SMEs by Sector of Activity**



Source: Central Bank of Ireland

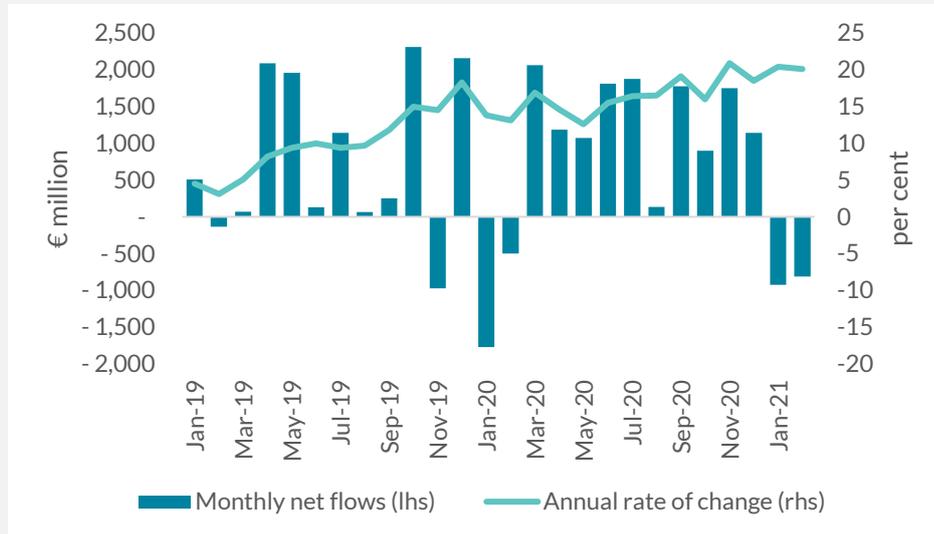
The continued weakness in bank lending corresponds with marginal tightening of credit standards reported in the Bank Lending Survey, due to broad economic and firm specific conditions<sup>37</sup>. The tightening in credit supply conditions observed so far does not appear to be driven by factors that relate to bank balance sheet constraints, such as capital, access to funding or liquidity. Lenders reported via the survey that conditions for lending to SMEs tightened in Q4, while they remained unchanged for larger businesses. Lenders also reported an increase in demand from SMEs, particularly for longer-term loans although additional health restrictions introduced in December may delay this demand materialising.

Similarly to households, businesses responded to the pandemic by increasing their aggregate holdings of deposits. Deposits from businesses have been growing since 2013, but the recent figures point to an acceleration of that trend. In the period between March 2020 and February 2021, businesses have accumulated deposits of €12 billion,

<sup>37</sup> See: <https://www.centralbank.ie/statistics/data-and-analysis/credit-and-banking-statistics/bank-lending-survey>

compared to €6.9 billion in the same period of the previous twelve months (Figure 6).

**Figure 6: Business Deposits: Net Transactions and Annual Rate of Change**



Source: Central Bank of Ireland

**Summary**

Irish households and businesses continue to adapt their financing activities in response to the evolving nature of the COVID-19 pandemic and the corresponding public health measures. Daily payments data highlight the rapid adjustment of spending activity that was prompted by the re-introduction of Level 5 restrictions late last year, and highlight the differing sectoral impacts of the ongoing restrictions. Household savings, meanwhile, are growing at rates not seen since before the Global Financial Crisis, reflecting the lack of opportunities to spend, the ongoing income supports provided by the government and precautionary motives.

In terms of observed credit outcomes, there was a material contraction in new lending volumes at the onset of the COVID-19 shock across most segments. New lending has started to recover, with trends diverging across segments. In the mortgage market, we have seen a strong recovery in activity but consumer lending remains at low levels, in line with general consumer spending patterns. In the SME segment, there has been a relatively strong headline recovery in bank lending activity, but trends vary widely across sectors, depending on the impact of COVID-19.

## The Public Finances

### Overview

The public health crisis continues to have a very significant impact on Ireland's public finances. Having run a surplus of €1.9bn (0.9 per cent of GNI\*) in 2019, we estimate that the general government recorded a deficit of close to €20bn (just under 9 per cent of GNI\*) last year. This deterioration would be amongst the largest in the Euro area. The latest Exchequer data point to a continuation of the trends that drove this deterioration in the first months of this year, that is reduced domestic activity weighing on tax receipts and significant income and business supports increasing expenditure. While the labour market and modified domestic demand are projected to experience some recovery in the second half of 2021, the deficit ratio is expected to stabilise at 9 per cent of GNI\* for the year as a whole. This reflects not only the impact of the pandemic on the government finances, but also the large 'core' expenditure increases announced in the Budget. This should represent the deficit's peak, however. Under the assumption that the fiscal measures introduced in response to the crisis are temporary in nature, and with the economic recovery strengthening, the budget balance is projected to improve considerably to -4 per cent of GNI\* in 2022. Even with temporary support measures dropping out of the base, government expenditure would remain well above its pre-pandemic level at the end of the projection horizon.

Against this backdrop, public debt is estimated to have increased by around 5 percentage points to 100 per cent of GNI\* last year. Such an increase in the debt ratio would be considerably smaller than that in the Euro area as a whole, reflecting the favourable impact of positive economic growth and the utilisation of existing resources to finance some of the budget deficit. A further small increase in the debt ratio is expected this year, driven by the large primary deficit, but over the medium term a gradual reduction is projected. Despite the adverse economic impact of the pandemic, Irish sovereign borrowing rates remain at very low levels - supported by the ECB's pandemic emergency purchase programme - while the medium term maturity profile is favourable, with no bonds maturing in 2021. The National Treasury Management Agency (NTMA) continues to hold large cash balances, increasing sovereign funding flexibility going forward.

As noted in previous Quarterly Bulletins, there is a much higher level of uncertainty surrounding the fiscal outlook than would normally be the case. This reflects uncertainty about the impact of both the pandemic and Brexit on the macro economy this year and over the final cost and duration of the support measures introduced by Government. In the case of the large 'unallocated' expenditure announced in Budget 2021, for example, it is

unclear whether the contingency expenditure will be sufficient and, more broadly, how these resources will be allocated. Potential changes to international tax systems could also affect the public finances over the medium term.

## Exchequer Returns

The Exchequer ran a deficit of €720 million in the first two months of the year, compared to a surplus of €1.0bn in the same period of 2020. The position would have been worse but for a number of factors that have no impact on the general government balance - primarily capital receipts - excluding which the deficit was €1.6bn (see Table 3)<sup>38</sup>. The trends that drove the sharp deterioration in the budget balance last year were evident once again. While total revenue increased by 5.3 per cent, this appears to have reflected timing factors that boosted non-tax receipts. Tax revenue, by comparison, recorded an annual decline of 9 per cent over the period, led by contractions in VAT and excise once again (see Table 4). Total gross expenditure was almost 20 per cent higher than a year earlier, with the increase driven by large income support payments against the backdrop of Level 5 restrictions. The Department of Social Protection saw gross voted spending increase by around 50 per cent or €1.8bn compared to a year earlier. In average terms, there were 615,000 weekly recipients of the Pandemic Unemployment Payment or live register in the first two months of the year. This compares to 165,000 recipients of the live register in the same period of 2020. A further 330,000 workers had their wages subsidised in January and February. Given the limited data for the year so far, it is informative to look at developments on a rolling 12-month basis – a period that takes account of the full impact of the pandemic. Over this period the deficit excluding transactions with no general government impact was €18.5bn, highlighting the sharp impact that the health crisis has had on the Exchequer.

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<sup>38</sup> It is more appropriate to focus on the Exchequer balance excluding transactions with no general government impact. This provides a better proxy for the main international budgetary measure and the one that is relevant for both domestic and European fiscal rules.

**Table 3: Analytical Exchequer Statement, February 2021 (€ millions)**

	2021 Jan to Feb €m	2020 Jan to Feb €m	Annual Change €m	Annual Change per cent y-on-y
<b>Exchequer Balance</b>	-721	1001	-1722	-172
Transactions with no General Government impact	927	984	-57	-5.8
<b>Exchequer Balance excluding transactions with no General Government impact</b>	-1648	17	-1665	-9703
of which Revenue	12072	11466	606	5.3
of which Expenditure	13720	11449	2271	19.8

Source: Department of Finance.

Notes: The figures in the Table exclude transactions with no general government impact, to give a closer approximation to the General Government balance.

**Table 4: Developments in Tax Heads, 2020<sup>39</sup>**

Year on Year - Cumulative			
	Jan to Feb 2021 (€m)	Jan to Feb 2020 (€m)	per cent Change
Income Tax	4034	3978	1.4
VAT	2657	3057	-13.1
Excise	750	881	-14.8
Corporation Tax	350	583	-39.9
Other	610	729	-16.3
<b>Total</b>	<b>8401</b>	<b>9228</b>	<b>-9.0</b>

Source: Department of Finance

## Fiscal Outlook, 2020 to 2022

Reflecting the latest data available, we now estimate that the general government recorded a deficit of just below 9 per cent of GNI\* or around €20bn last year (see Table 5). This deterioration, from a surplus of 0.9 per cent of GNI\* in 2019, would be one of the largest in the Euro area, although the deficit ratio itself would be broadly in line with the region's average<sup>40</sup>. It would also be considerably lower than was expected for much of last year. Revenue is estimated to have declined by 3½ per cent (compared to average growth of 6 per cent in the preceding three years), led by a sharp

<sup>39</sup> Given the very high level of uncertainty surrounding the outlook the Department of Finance has delayed publishing its usual tax profiles until later in the year.

<sup>40</sup> Source 'Autumn 2020 Economic Forecast', European Commission. The euro area deficit is projected to be 8.8 per cent of GDP in 2020 with improvements to 6.4 and 4.7 per cent projected for 2021 and 2022 respectively. On a national basis Ireland would run the eighth highest deficit ratio amongst the regions' 19 economies in 2020.

contraction in indirect taxes and to a lesser extent developments in social contributions and other non-tax revenues. Direct taxes, by comparison, remained broadly resilient reflecting the nature of the labour market shock experienced by the economy and the progressive nature of the income tax system here<sup>41</sup>. The revenue projection assumes higher than usual tax accruals due to the deferment of some receipts during the pandemic, which represents an element of downside risk<sup>42</sup>. Government expenditure is estimated to have increased by just over 20 per cent, compared to average growth of 4.5 per cent in the preceding three years. This sharp increase primarily reflected the necessary fiscal support measures that were introduced in response to the crisis. We estimate that direct expenditure measures amounted to €16.4bn (7.5x per cent of GNI\*) last year, with a further €5bn of indirect supports such as guarantees and loans<sup>43</sup>. The impact was particularly evident in Government Finance Statistics data, which showed exceptional growth in subsidies (reflecting wage subsidy schemes) and social payments (due to the pandemic unemployment payment and other income supports) in the first three quarters of last year.

**Table 5: Fiscal outlook under a baseline scenario (per cent of GNI\* unless otherwise stated)**

	2019	2020e	2021f	2022f
GG Balance (€bn)	1.9	-19.6	-21.0	-9.9
GG Balance (per cent GNI*)	0.9	-8.9	-9.0	-4.0
GG Balance (per cent GDP)	0.5	-5.4	-5.4	-2.4
GG Debt (€bn)	204.1	220.1	241.2	251.1
GG Debt (per cent GNI*)	95.5	100.1	102.7	101.1
GG Debt (per cent GDP)	57.3	60.0	61.6	60.7

Source: CSO and Central Bank of Ireland Projections

While some of these supports are due to expire this year, Covid-related expenditure is still expected to cost the State around €12bn (5.4 per cent of GNI\*) in 2021<sup>44</sup>. This figure includes €5.5bn of unallocated resources for

<sup>41</sup> For a more detailed look at why income taxes have remained resilient see 'Box F: The Resilience of Income Tax in 2020', Central Bank of Ireland Quarterly Bulletin, No 4 2020.

<sup>42</sup> As noted by the Department of Finance in the documentation accompanying Budget 2021, tax accruals are estimated to have increased from €525m in 2019 to €1815m last year (see 'Budget 2021: Economic and Fiscal Outlook', Page 53.

<sup>43</sup> When revenue measures are also included total fiscal supports increase to €24.6bn in 2020 and €12.6bn in 2021.

<sup>44</sup> When revenue measures are also included total fiscal supports would be €12.6bn (5.7 per cent of GNI\*) this year.

the Covid-19 Contingency Reserve and Recovery Fund<sup>45</sup>. Assuming that these resources are sufficient to deal with the fiscal cost of continued lockdown into the second quarter of the year, and possibly beyond, we project that government expenditure will increase by 3.5 per cent this year. This figure also reflects the notable increase in permanent of 'core' expenditure announced as part of Budget 2021 – €5.4bn in Exchequer terms and possibly as high as €8.5bn in general government terms<sup>46</sup> - that will need to be financed over the medium to longer term. On the revenue side, the gradual recovery in modified domestic demand and the labour market in the second half of the year is expected to support growth of around 3 per cent. These revenue and expenditure developments would see the general government deficit stabilise at 9 per cent of GNI\*.

This should represent the deficit's peak, with a significant improvement to 4 per cent of GNI\* projected in 2022. This improvement reflects the impact of a recovering economy on taxation receipts and, more crucially, the expiration of pandemic related measures. The economy is expected to enter 2022 with more momentum, supporting an acceleration in revenue growth closer to 5 per cent. With private consumption, employment and compensation growth all accelerating, the recovery in tax receipts should be relatively broad based. Under the assumption that the pandemic support measures – including the Recovery Fund - are fully temporary in nature and drop out of the base next year, meanwhile, government expenditure is projected to contract by just over 6 per cent in 2022. It would still be well above its pre-pandemic level at the end of the projection horizon, however.

In terms of general government debt, we estimate that the ratio increased by 5 percentage points to 100 per cent of GNI\* last year. Such a change would be smaller than that experienced by the Euro area as a whole<sup>47</sup>, but would still represent a very elevated ratio reflecting its high starting position prior to the pandemic. While the large primary deficit had a negative impact on the ratio, this effect was partially offset by the use of some existing resources to finance part of the budgetary decline; most

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<sup>45</sup> The breakdown of this 'unallocated' expenditure is €2.1bn for the Covid-19 Contingency Reserve and €3.4bn for the Recovery Fund. While the former is contingent on developments in the pandemic, our projection assumes that the full amount of these resources are utilised in 2021. This approach is consistent with that undertaken by the Department of Finance in Budget 2021 (see Table 11 in 'Budget 2021: Economic and Fiscal Outlook', Department of Finance). For forecasting purposes we have allocated the expenditure evenly between government consumption, government transfers and other spending; this does not represent judgement about how the resources should be utilised, but is rather a purely technical assumption.

<sup>46</sup> See 'Fiscal Assessment Report', Irish Fiscal Advisory Council, December 2020.

<sup>47</sup> The European Commission projected a 16 per cent increase in the region's debt ratio in its Autumn Forecast.

notably NAMA and Central Bank surplus incomes, and funds in the National Surplus Reserve Fund. The combination of low interest rates and continued economic growth – the snowball effect - also had a favourable impact on the ratio last year. With a small increase (as the primary deficit impact dominates) and decrease forecast for this year and next, the debt ratio is expected to still be close to 100 per cent of GNI\* at the end of the projection horizon. The large cash balances held by the National Treasury Management Agency - €23bn entering March – represent some upside risk to this outlook<sup>48</sup>.

## Funding and Other Developments

The NTMA raised €7bn of funding in the first quarter of 2020. Yields were marginally higher when compared to those recorded in the final months of last year, but the cost of Irish sovereign borrowing remains low, supported by the ECB's pandemic emergency purchase program<sup>49</sup>. The first quarter issuance represents 40 per cent of the planned total bond issuance for the year. The NTMA took advantage of favourable market conditions in recent years to improve Ireland's maturity profile by extending out borrowing and replacing expensive loans with cheaper ones. This activity, coupled with the high level of cash reserves on hand and strong issuance in the first quarter increases the Agency's flexibility in meeting borrowing requirements. Notably there are no long term government bonds now set to mature until 2022<sup>50</sup>.

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<sup>48</sup> A reduction in cash balances is no longer estimated to have occurred in 2020.

<sup>49</sup> In March 2021 the NTMA issued Treasury bonds maturing in 2031 and 2050 at yields of 0.0 and 0.7 per cent respectively.

<sup>50</sup> Around €500m of UK bilateral loans are due to be repaid in 2021 following a payment of €2bn this year.

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