Ireland in 2021: The lock of the Irish

Ireland is facing the challenge of bouncing back from its huge economic decline at the end of 2020 while experiencing all the uncertainty and possible trade problems that Brexit may bring

Brexit and Covid-19 collide

Like the rest of the eurozone, the Irish economy has been dominated by coronavirus developments this year. Compared to other countries though, GDP appeared to contract much less in the second quarter – just -6.1% QoQ. This suggests that the impact of the first lockdown was fairly mild but the well-known distortions to GDP due to multinational profit flows actually mask a much worse domestic performance. Modified domestic demand, which strips out the multinational accounting effects, actually contracted by -16.4%, indicating that the economic contraction from the first lockdown has been among the worst in the eurozone.

Against that backdrop, the strict second wave response is currently dealing another heavy blow to the Irish economy. While third quarter GDP figures are not yet known, modified domestic demand figures are likely to place Ireland's economic performance during the Covid-19 crisis at the lower end of the eurozone spectrum so far. The second lockdown came quicker than in other countries as cases rose above the threshold for significant new measures to be taken. Ireland has closed non-essential businesses and has curbed non-essential travel. As such, Google mobility data suggests that Ireland is experiencing a worse fourth quarter in terms of economic activity than other eurozone economies.

Life after Covid and Brexit

The fiscal response to the pandemic is key to a swift recovery in 2021. As income support has been extended by the new government, this should mitigate some of the second-round effects of the virus and help the economy recover. This has resulted in a very expansionary budget proposal for next year, causing debt-to-GDP to increase significantly. After Ireland had managed to bring down debt levels to below 60% in the years after the euro crisis, it is now set to increase to 66% in 2021, according to the 2021 budget proposal. That, however, is still pretty modest when compared with other countries.

> *The outcome of Brexit negotiations is key to the Irish economy's recovery*

A very dominant factor for the Irish recovery in 2021 will obviously be Brexit. Even if a deal is reached between the EU and UK, any initial disruption would still dampen the recovery path of the economy moving out of the second lockdown. The worst-case scenario would involve tariffs introduced between the UK and the EU, which would have a significant negative impact on the Irish economy as it involves its closest trading partner and the tariffs that the UK would introduce would disproportionately hit products that Ireland exports to the UK. This means that the outcome of ongoing negotiations is key for the Irish economy, but the result will be a negative impact on the economic recovery regardless.

The Irish economy is therefore set for a tumultuous year. Brexit certainty will not necessarily be helpful as it’s difficult to see how any outcome would not harm economic recovery in 2021. Still, the impact from Brexit won't be as severe as that seen following Covid-19, and as the lockdown is lifted, the economy will start another mechanical economic recovery.

The Irish economy in a nutshell

	2019	2020F	2021F	2022F
GDP (%)	5.6	-2.3	2.5	2.8
Private consumption (%)	3.2	-8.3	10.3	6.9
Investment (%)	74.9	-42.5	14.9	14.4
Government consumption (%)	5.8	13.5	-0.4	-1.1
Net trade contribution (%)	-17.5	17.1	-4.1	-4.0
Headline CPI (%)	0.9	-0.5	0.4	1.6

Source: Eurostat and ING Research forecasts

Author

Bert Colijn
Chief Economist, Netherlands
bert.colijn@ing.com

Disclaimer