Ireland's economic recovery is not as strong as data suggests

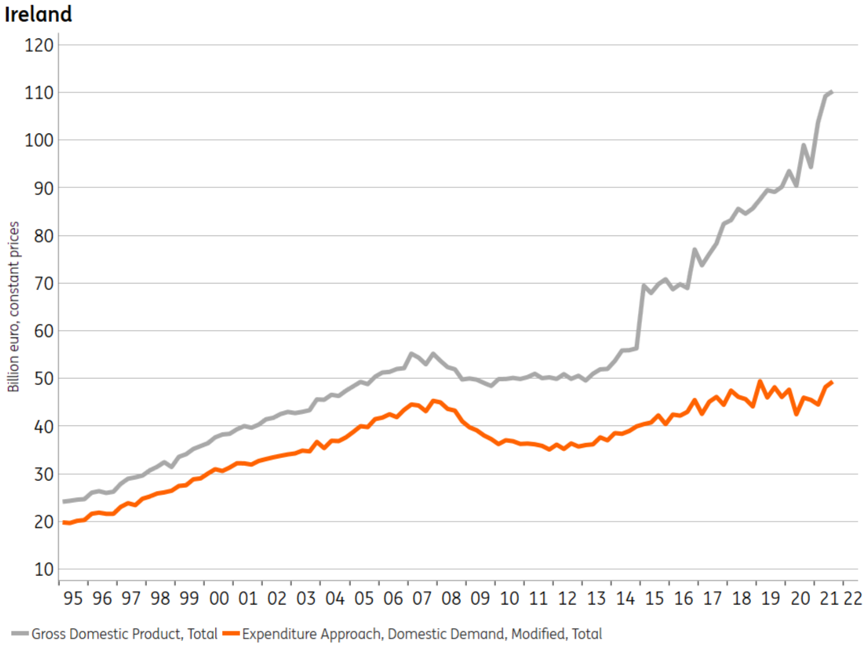
Ireland's GDP figure inflates its economic performance, but underlying data reveals a healthy recovery that shouldn't be by a reduction in asset purchases by the European Central Bank

How is the Irish economy doing? Well, not as great as GDP suggests, but not bad either

Ireland leads the eurozone on economic growth... or does it?

It's an all too familiar sight at this point, Ireland leading the eurozone in terms of economic growth. Extreme growth rates have been dominated by multinational activity for some time now, resulting in overstated activity compared to actual economic performance of the country, which is why the Irish Central Statistics Office looks at an alternative measure of economic activity: modified domestic demand. As Ireland is a competitive market for exports, there is more omitted from this activity figure than an economist would like to see, but it is a start to get a better sense of what is actually happening in the Irish economy.

As chart one shows, modified domestic demand and gross domestic product (GDP) have become increasingly out of whack. GDP growth has seen more extreme swings in recent years, which has increasingly impaired the view on the Irish economy, but the swings have become so large that it also increasingly muddies the statistics on the entire eurozone. In some quarters, it now has a sizable impact on quarterly GDP numbers and especially on investment figures. Given that the international organisations reporting activity in Ireland often operate well beyond the eurozone, this means that eurozone figures are increasingly distorted as well and numbers should be interpreted with more care than a few years ago.



Source: CSO, ING Research

Ireland's economy is also facing the impact of Brexit

So how is the Irish economy doing then? Well, not as great as the GDP suggests of course, but not bad either. Modified domestic demand is almost back to pre-pandemic levels and the labour market has been recovering quickly. The alternative measure of unemployment including people furloughed has been coming down rapidly and stands just marginally above the regular unemployment rate. Both have recovered quickly to close to pre-pandemic levels. Consumption is also almost there, although the economy has lost momentum due to the new restrictions combating the latest wave of the coronavirus.

Besides new restrictions, Ireland is also facing the impact of Brexit on trade. The impact is hard to judge given all of the pandemic effects playing a role here, but it does look like exports to the UK have been recovering after a rough start to the UK's formal EU exit. Overall, the Irish economy is set to recover swiftly once restrictions are lifted again as the economy still shows strong underlying performance.

Public finances are also doing better than expected and the deficit is shrinking rapidly. The budget balance is expected to drop below -2% this year, well within the European Commission’s target of -3% even though the emergency clause on the stability and growth pact is still active. With government debt set to drop below 60% again as well this year, Ireland has little to fear from the ECB tapering asset purchases at the moment. Yields have been on the rise, but are still below 70 basis points at the moment, a confirmation that markets do not see Ireland as a country among the first at risk of problems as the ECB winds down quantitative easing.

Irish economy in a nutshell

IRELAND	2020	2021F	2022F	2023F
GDP (%)	5.8	15.2	4.7	2.1
Private consumption (%)	-10.4	7.2	6.8	3.1
Investment (%)	-23.5	-31.2	14.1	5.1
Government consumption (%)	9.4	4.4	0.1	0
Net trade contribution (%)	21.4	25.6	2.5	-0.5
Headline CPI (%)	-0.5	2.5	3.6	1.9

Source: Macrobond, ING estimates

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