



An Roinn Airgeadais
Department of Finance

Budget 2021: Macroeconomic outlook

Presentation to Irish Fiscal Advisory Council
Economics Division, Department of Finance
25th September 2020



Birds-eye view

- Recent developments
- Post-lockdown macro-economic developments
- Forecast framework and methodological approach
- DoF short-term forecasts
- Overview of supply-side developments
- Conclusion

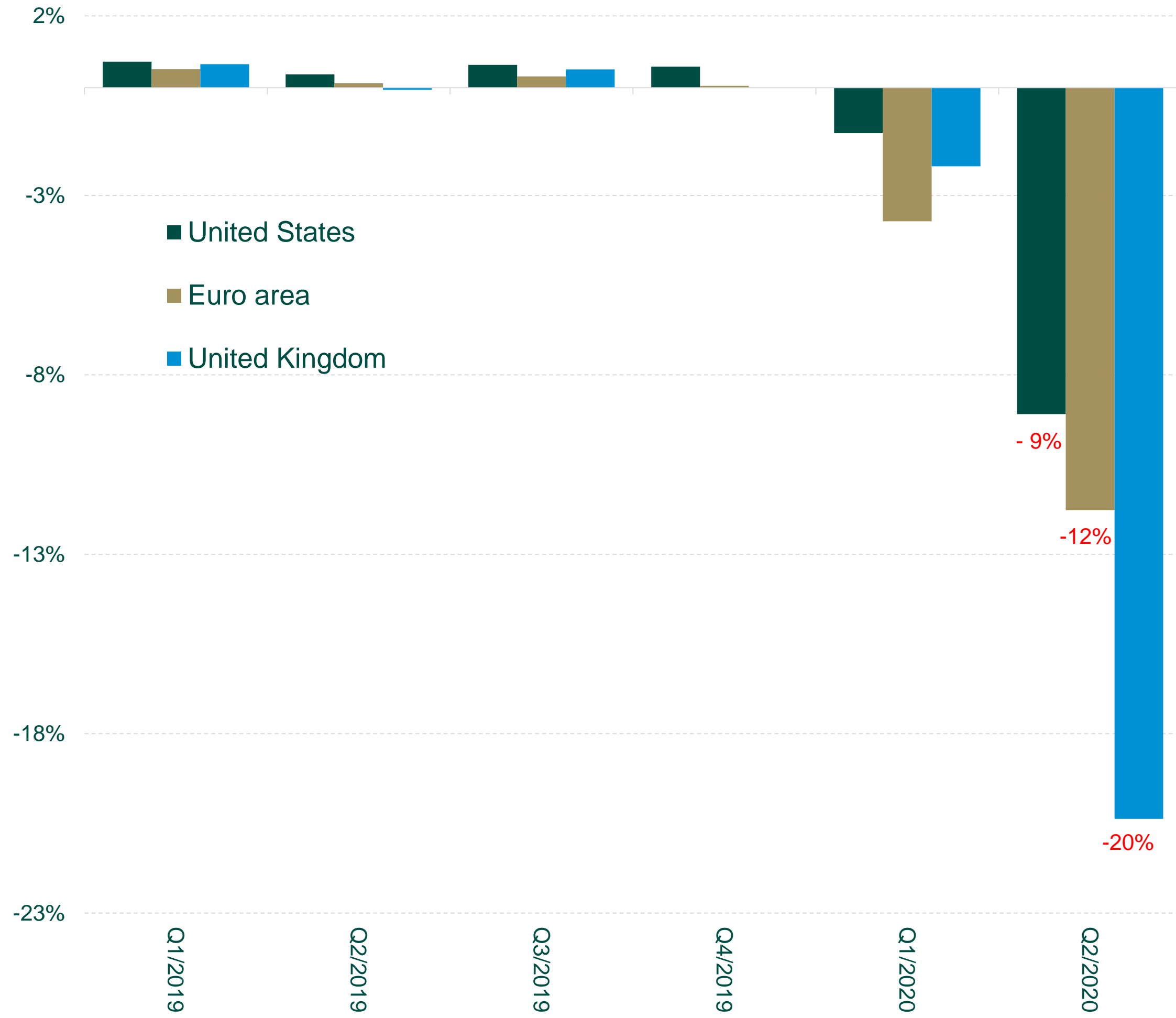


Recent developments

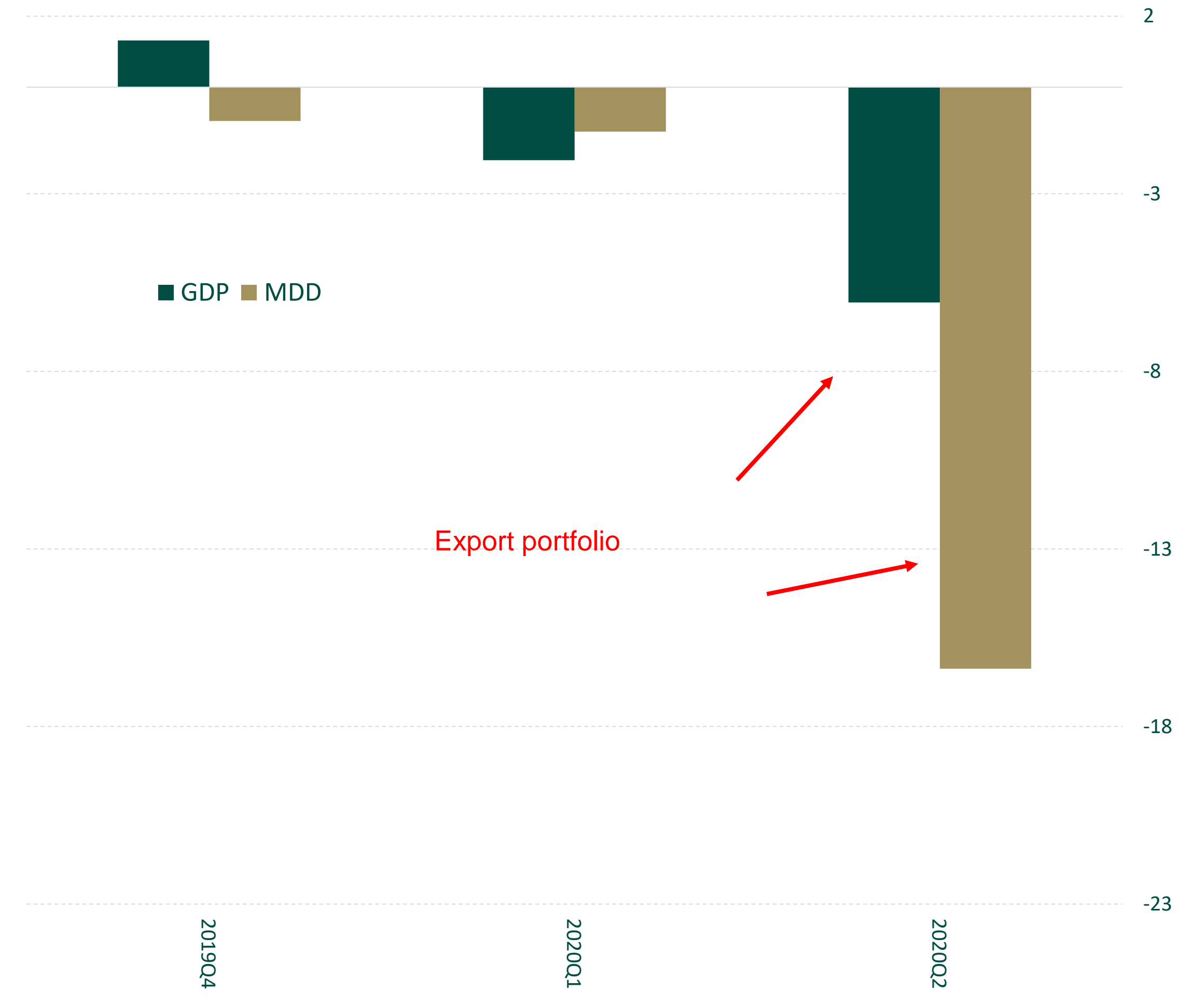
Truly global symmetric shock



Record GDP fall in key trading partners, q/q per cent change



“Two-speed” economic impact, q/q per cent change

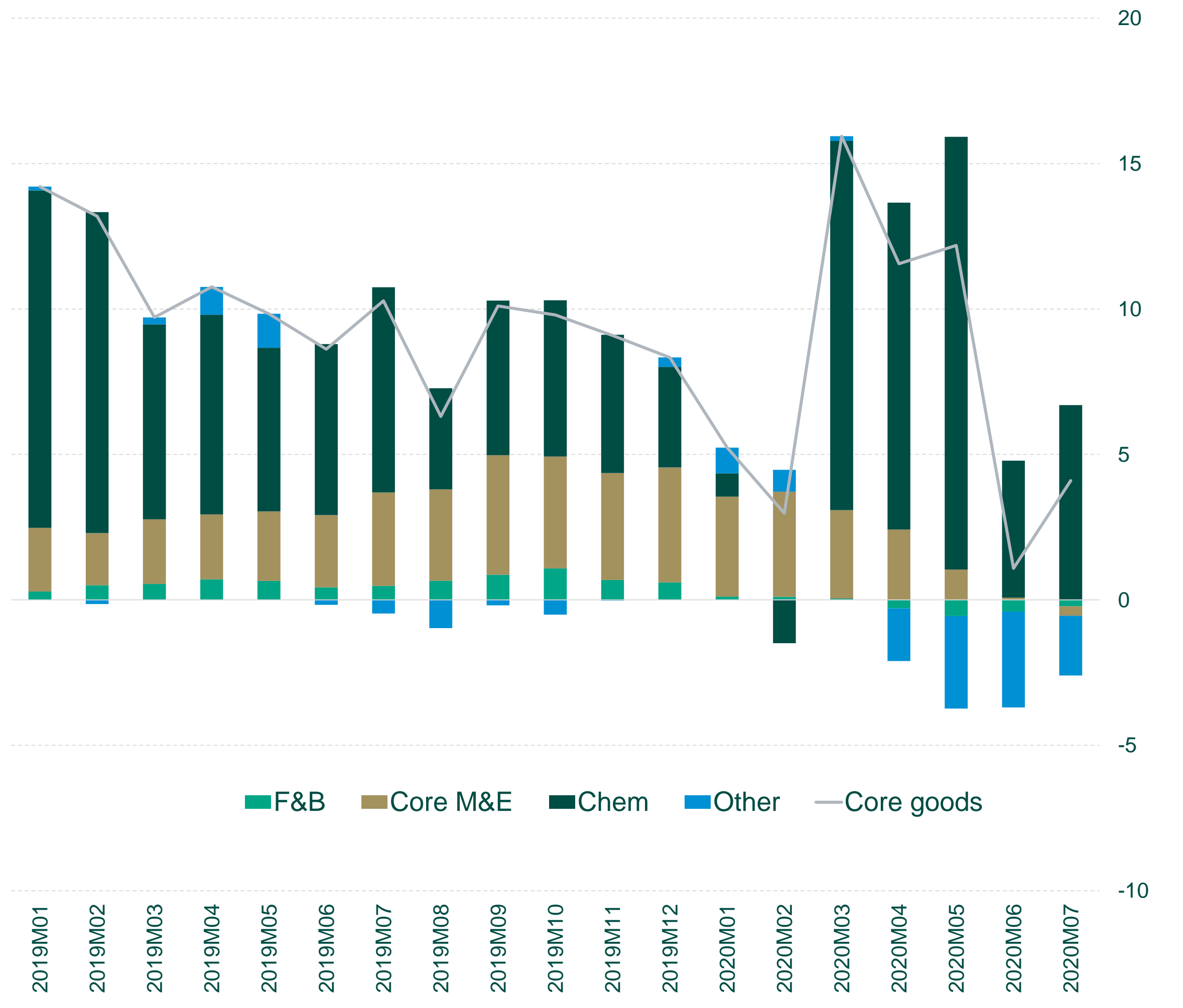
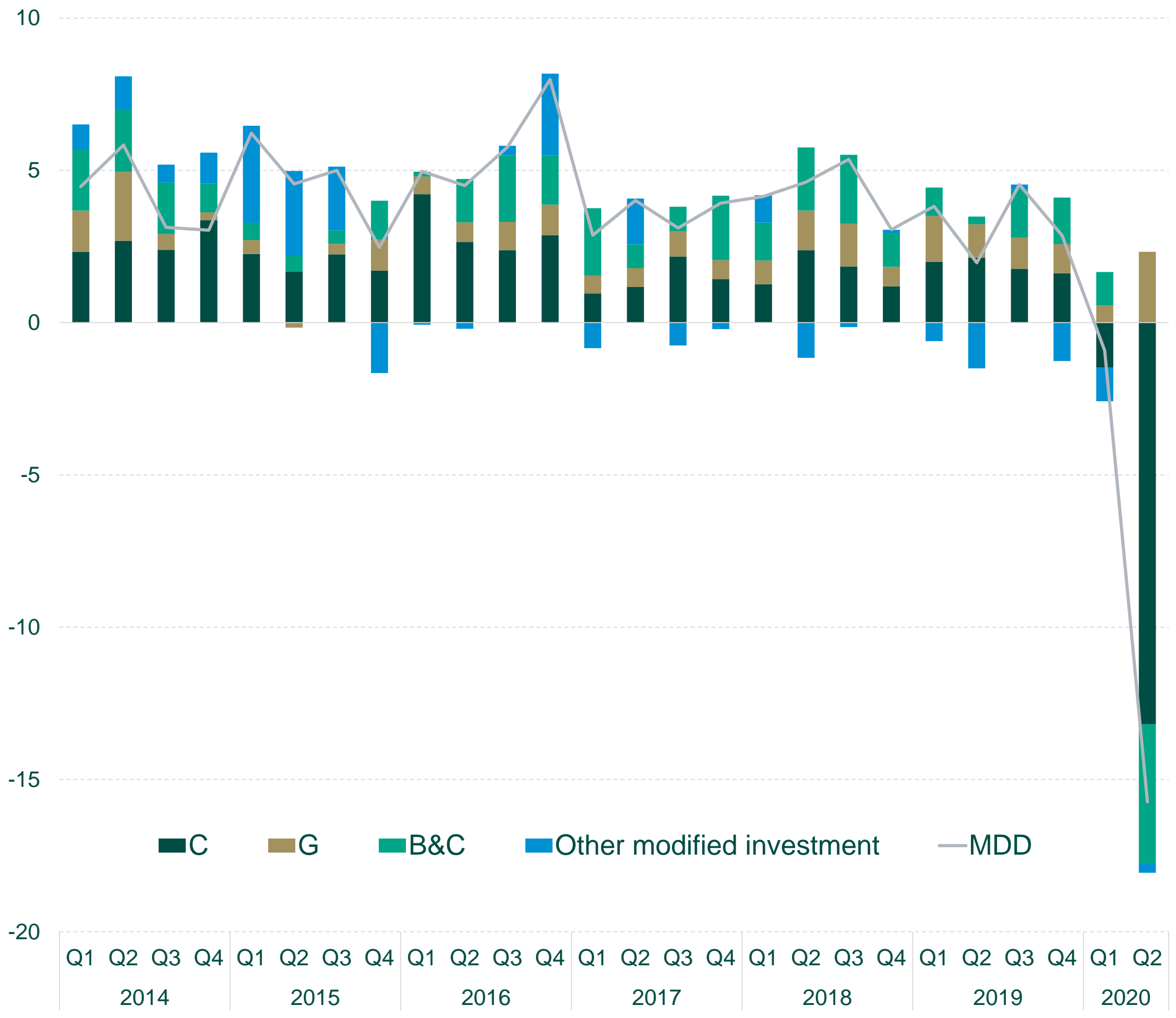


Domestic demand vs. external demand



Q2: modified domestic demand = -16 per cent

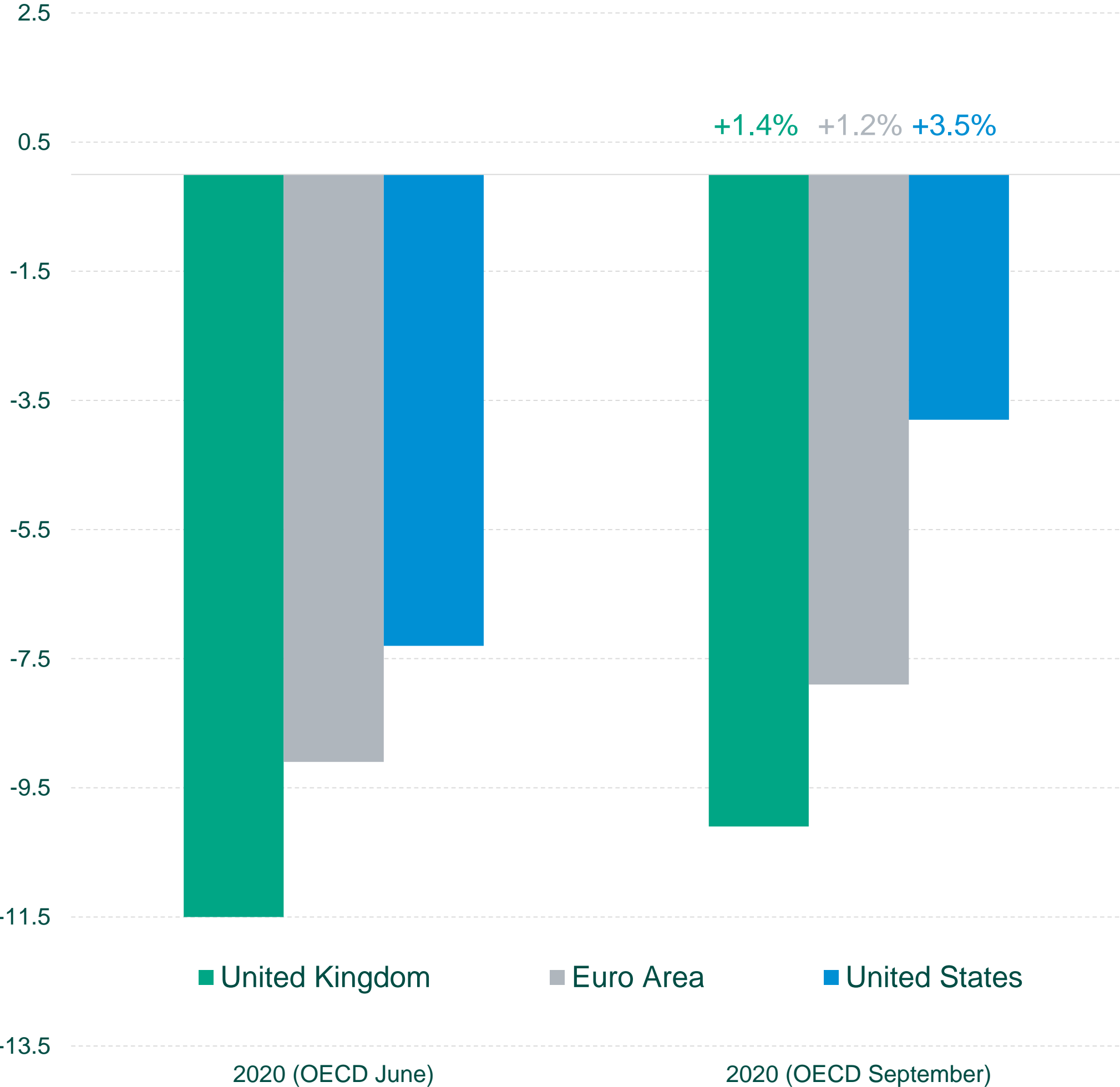
Contributions to 'core goods' export growth (y-on-y, 3MMA)



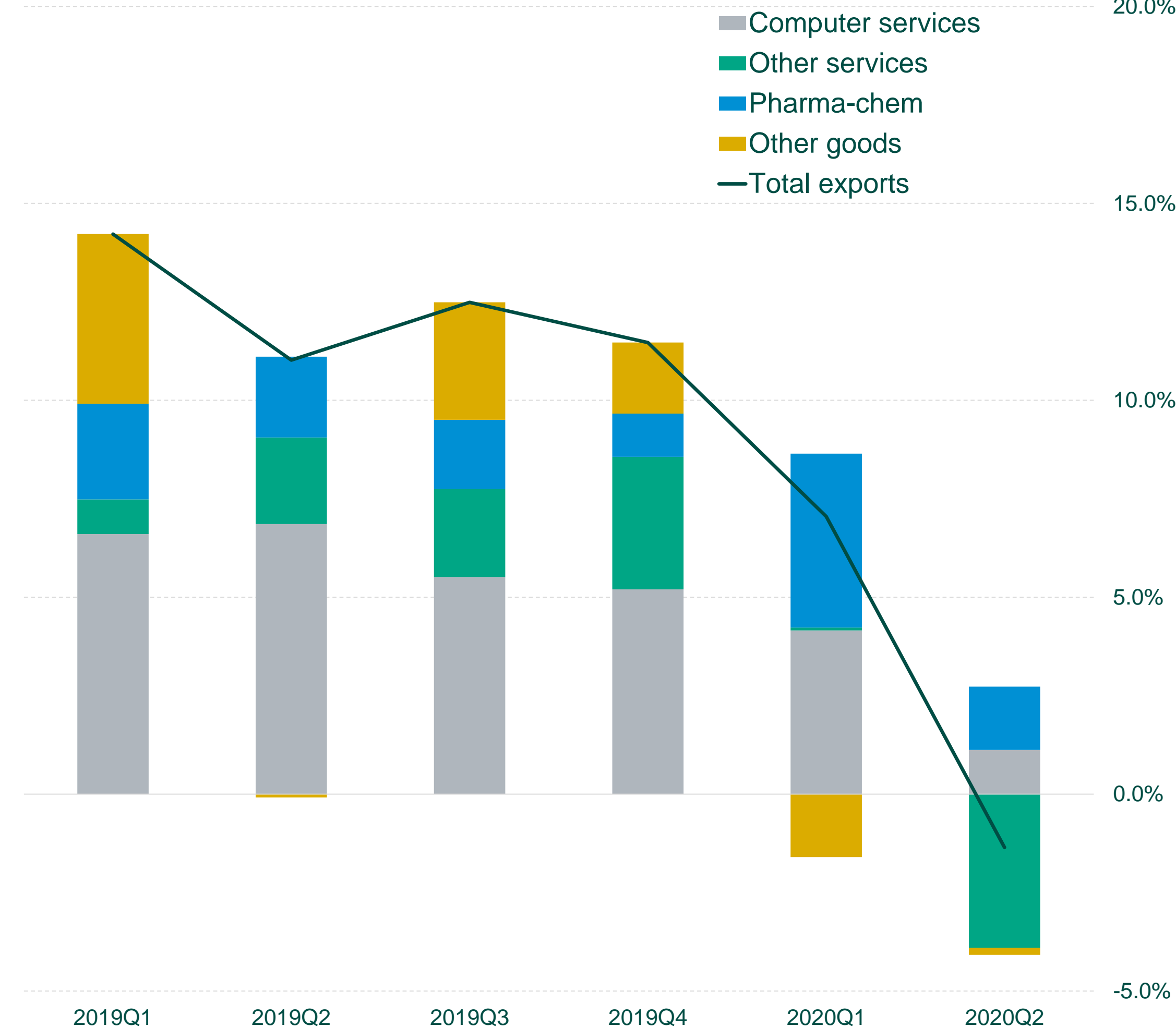
Exports proving resilient (so far) to fall in external demand



GDP – modest revisions in key trading partners



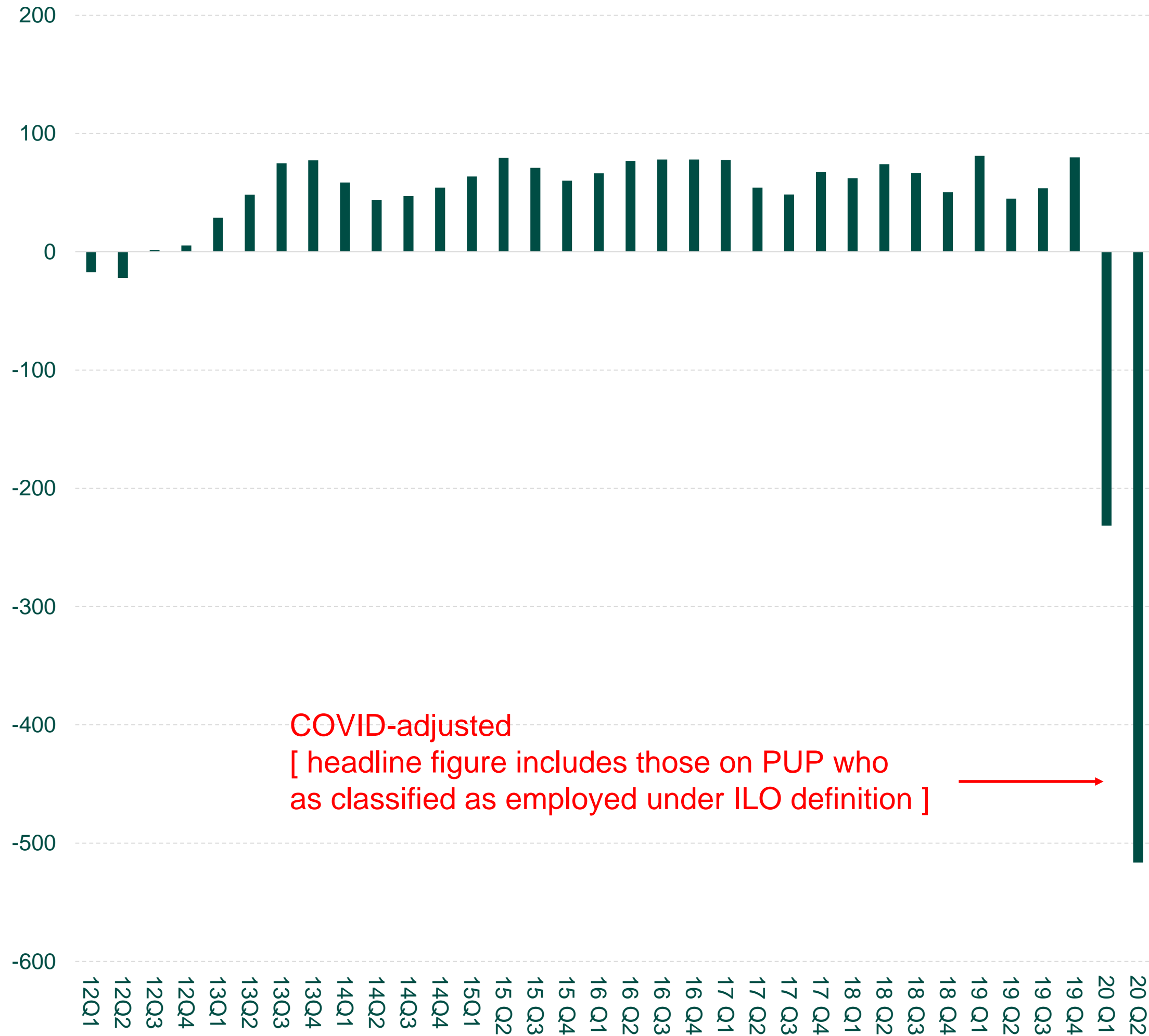
Contributions to Irish exports



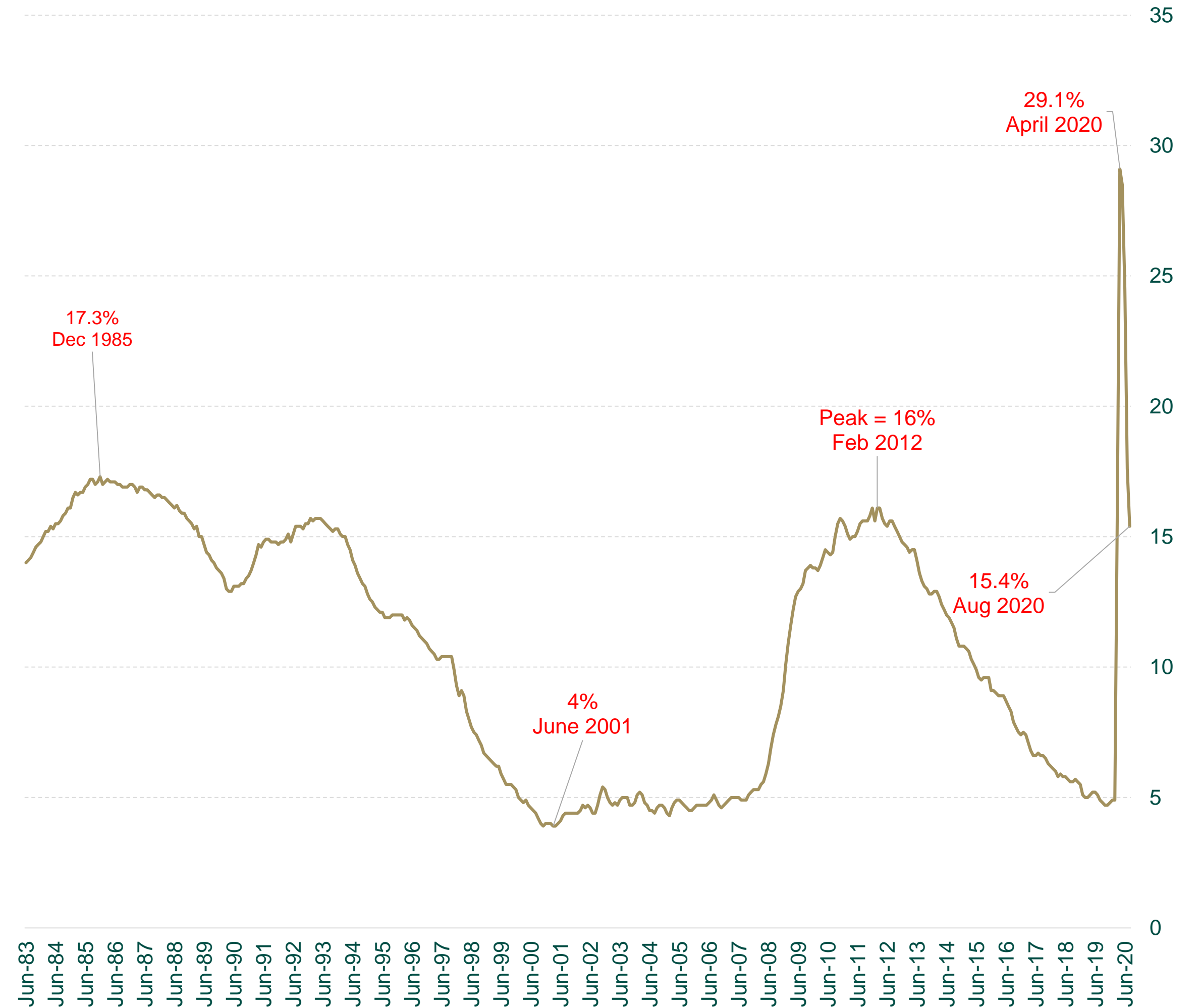
Fall-out in the labour market unprecedented



Change in employment levels (000's, y/y)



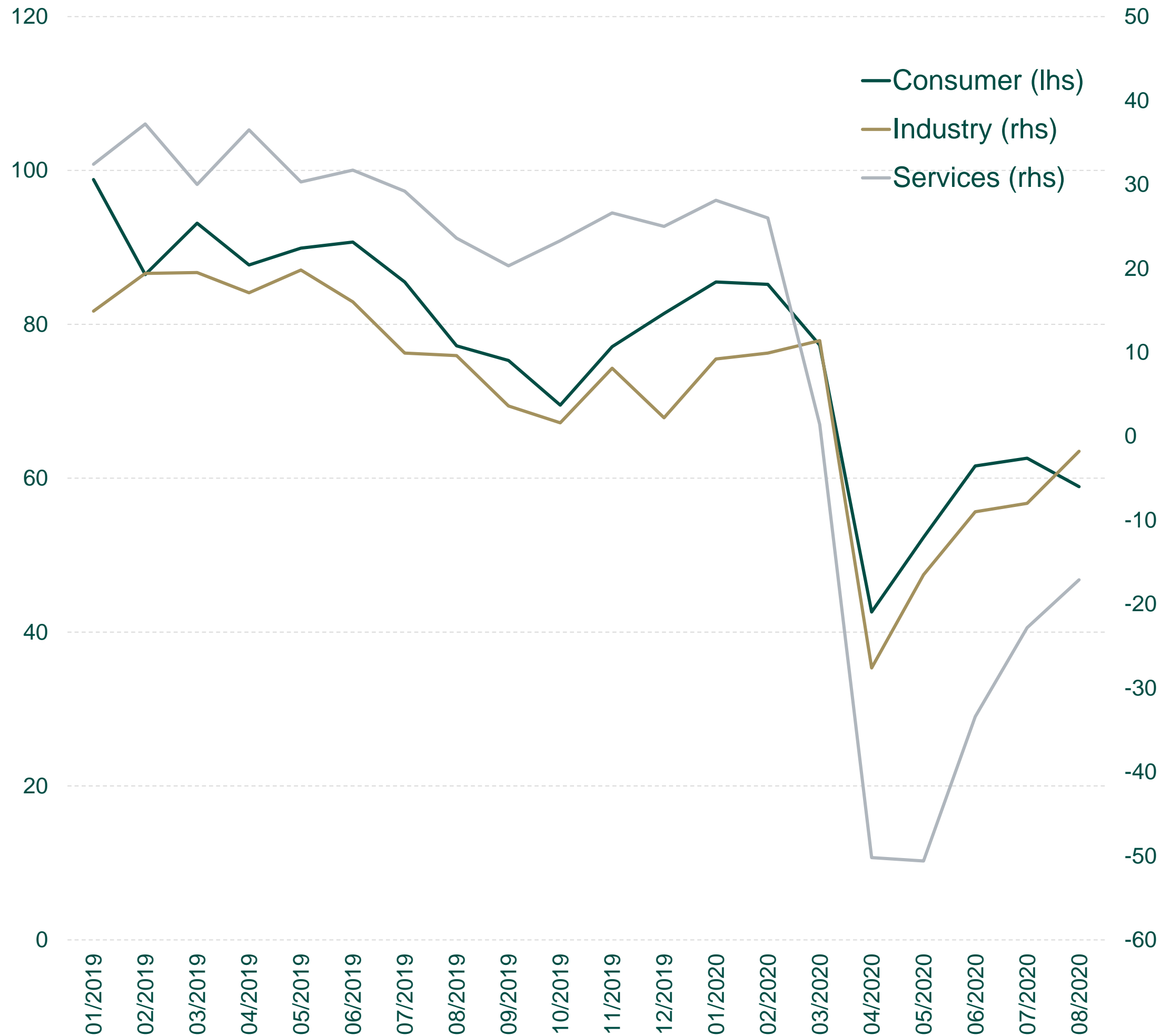
Unemployment rate, per cent = highest level ever [c. twice GFC rate]



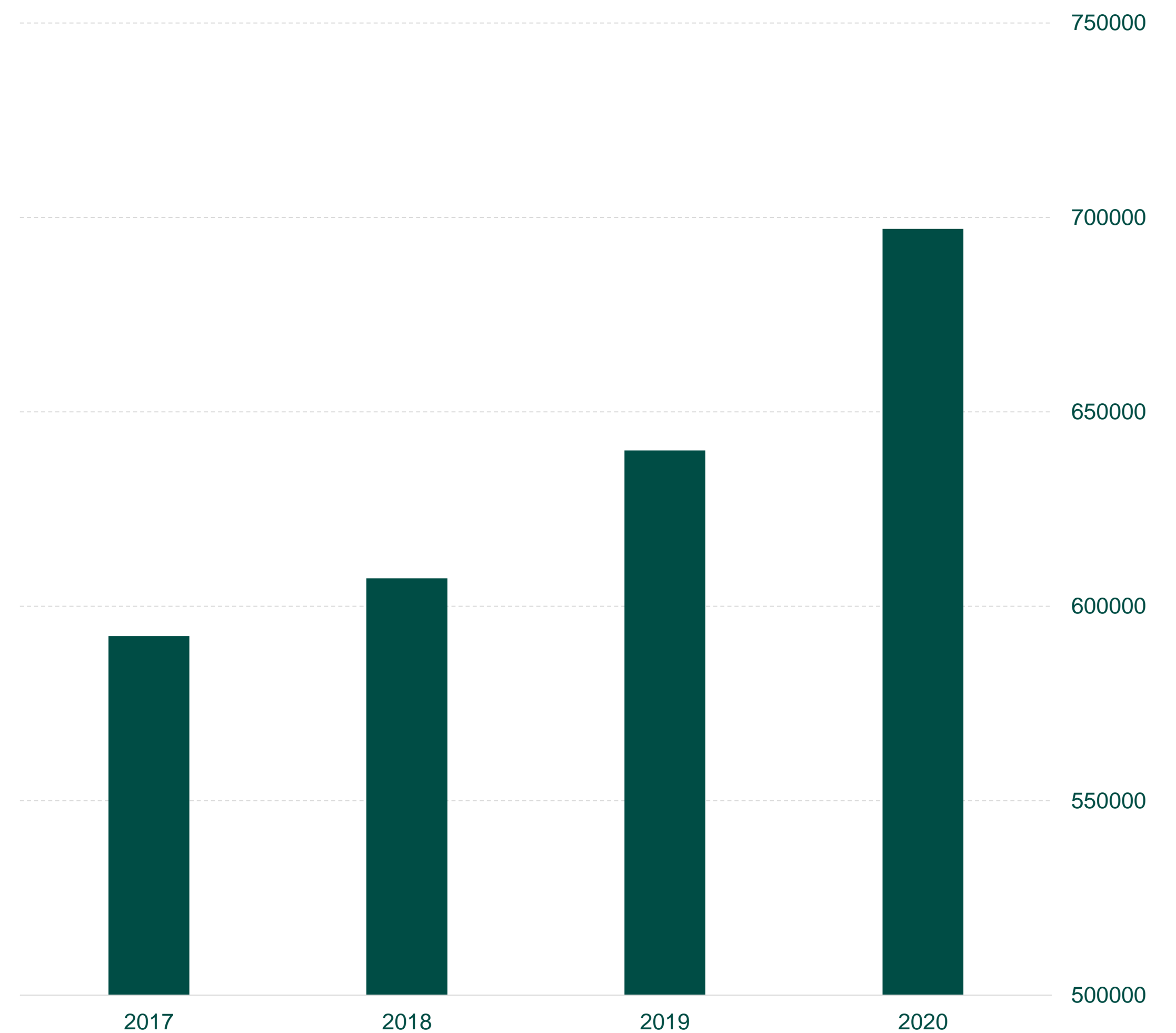
Weak sentiment = precautionary saving



Consumer & business sentiment



Cumulative change in household deposits, February to July, € million



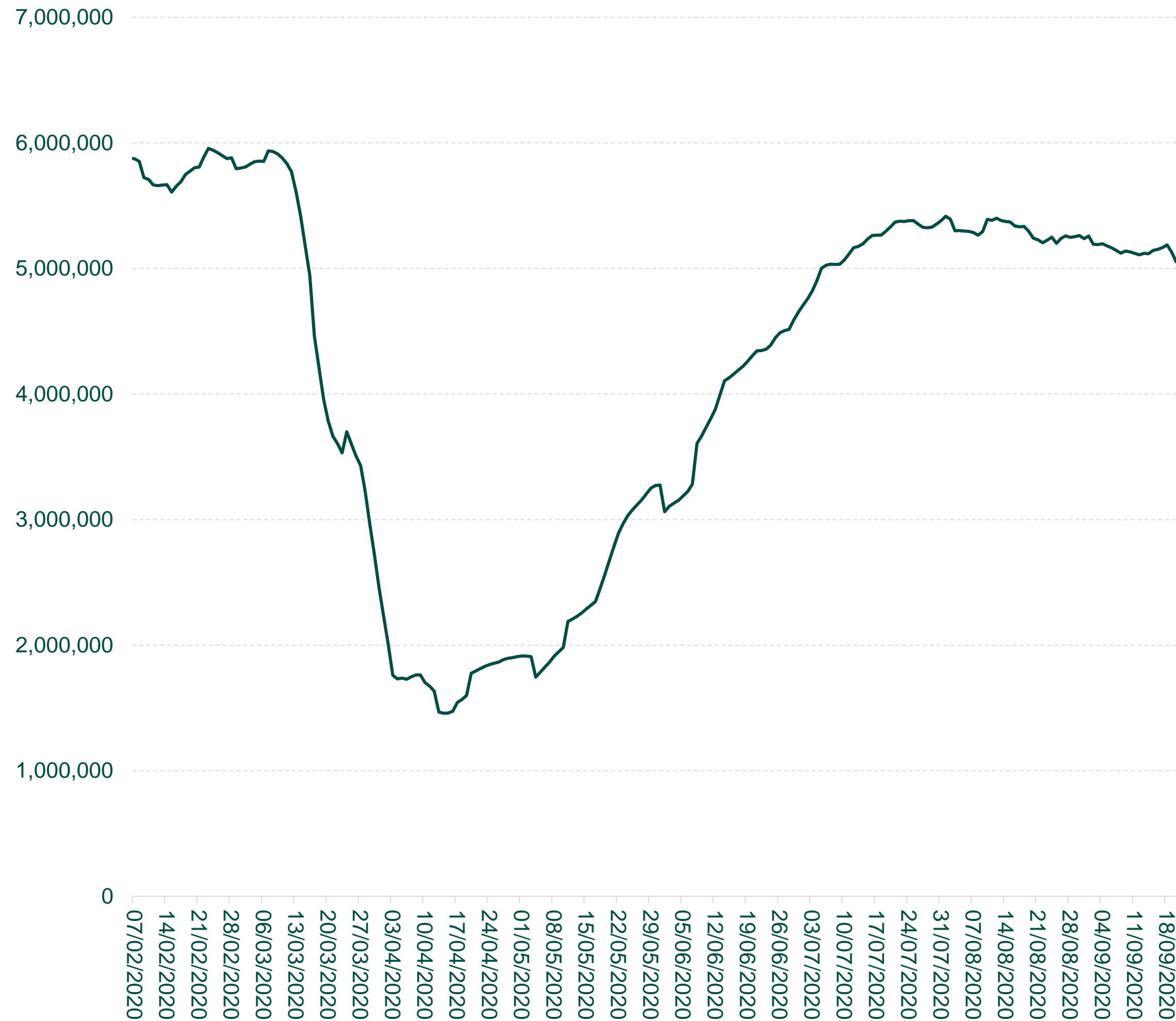


Post-lockdown macro-economic developments

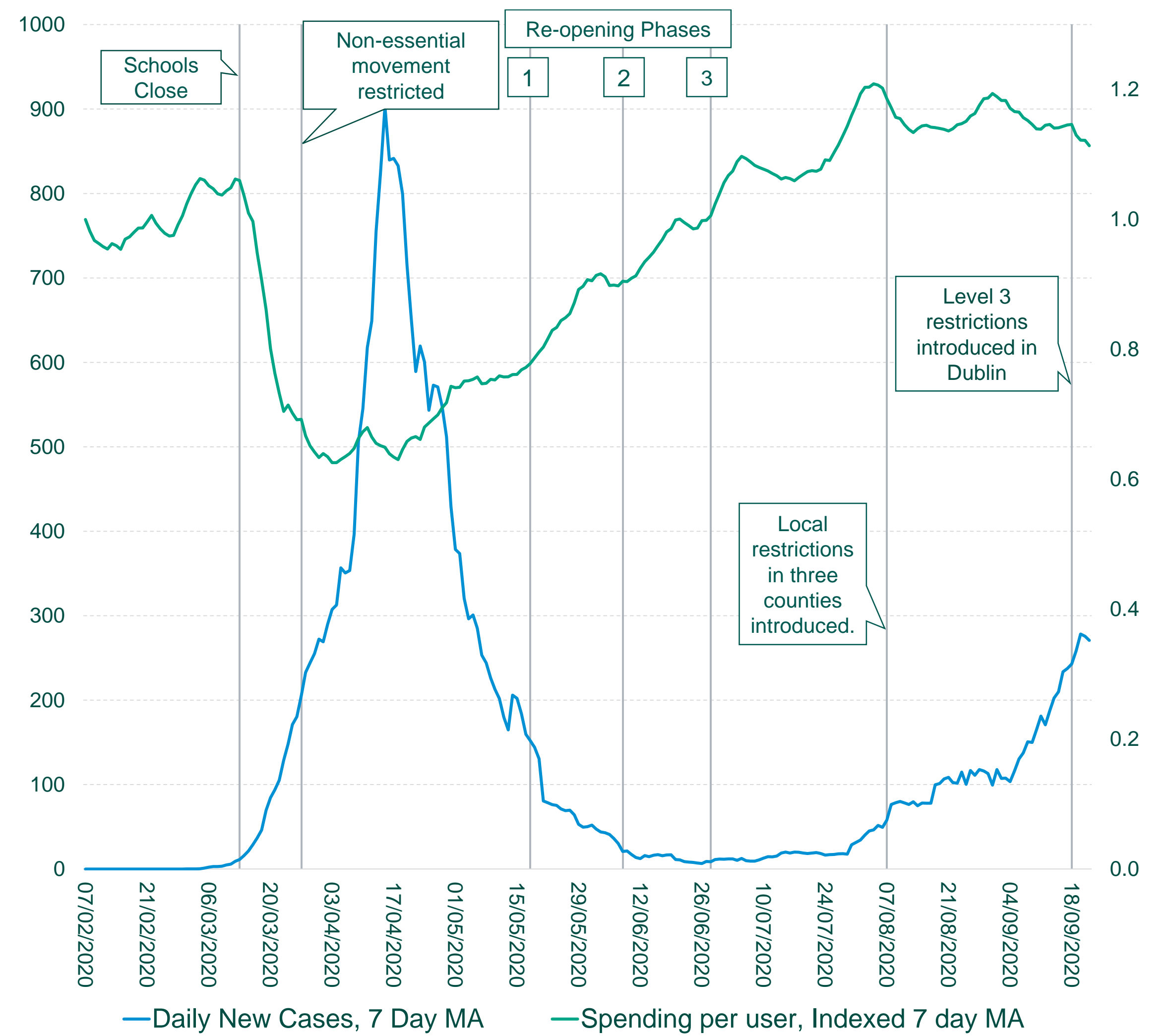
Ultra-high frequency / real-time data confirm rebound in q3



Number of cars on Irish roads



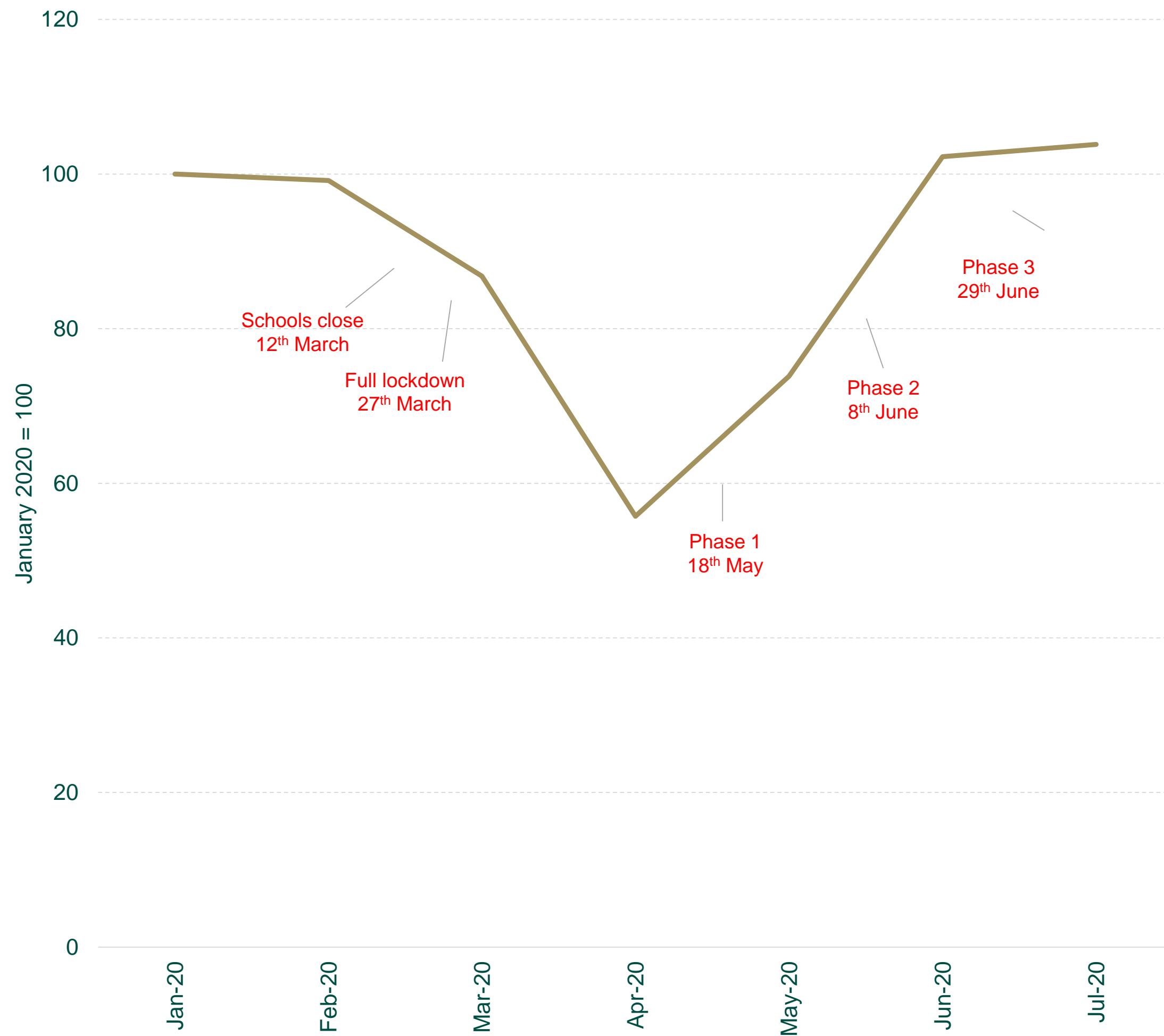
Daily *Revolut* transactions vs daily new infections (7 day ma)



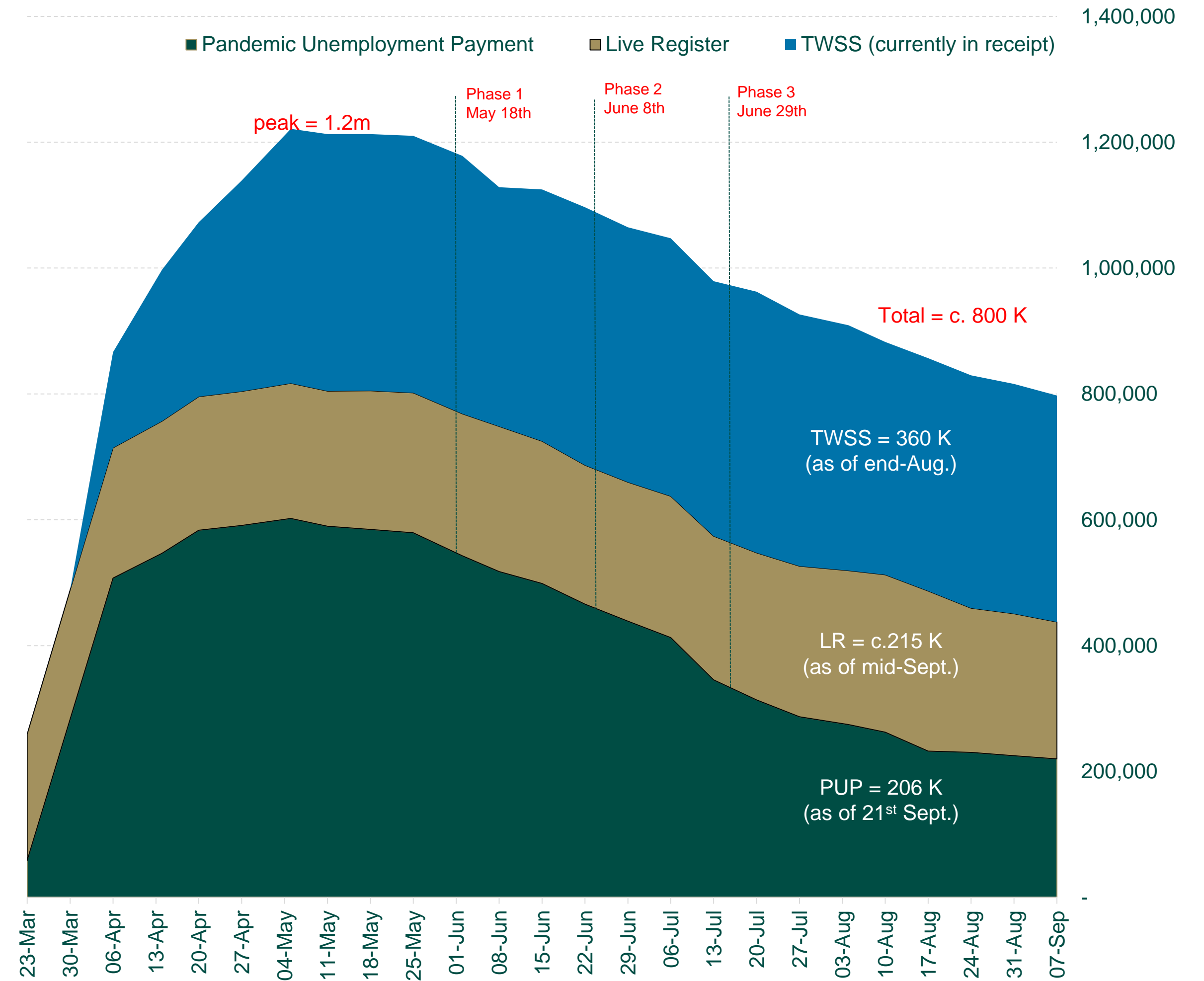
'Unofficial data' broadly confirmed by 'official data'



Retail sales [=goods] suggest release of pent-up demand



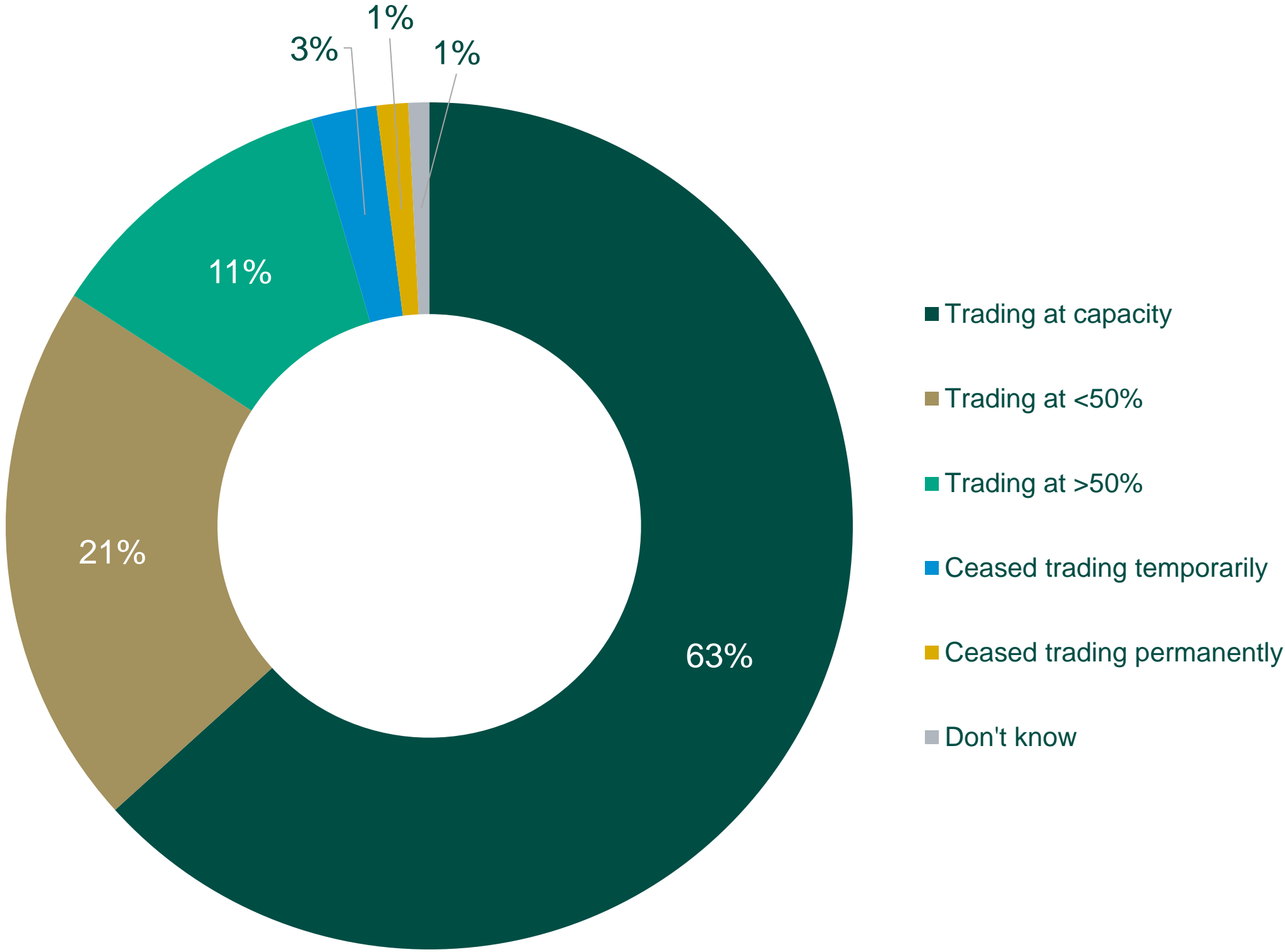
Unemployment / under-employment falling but v. high



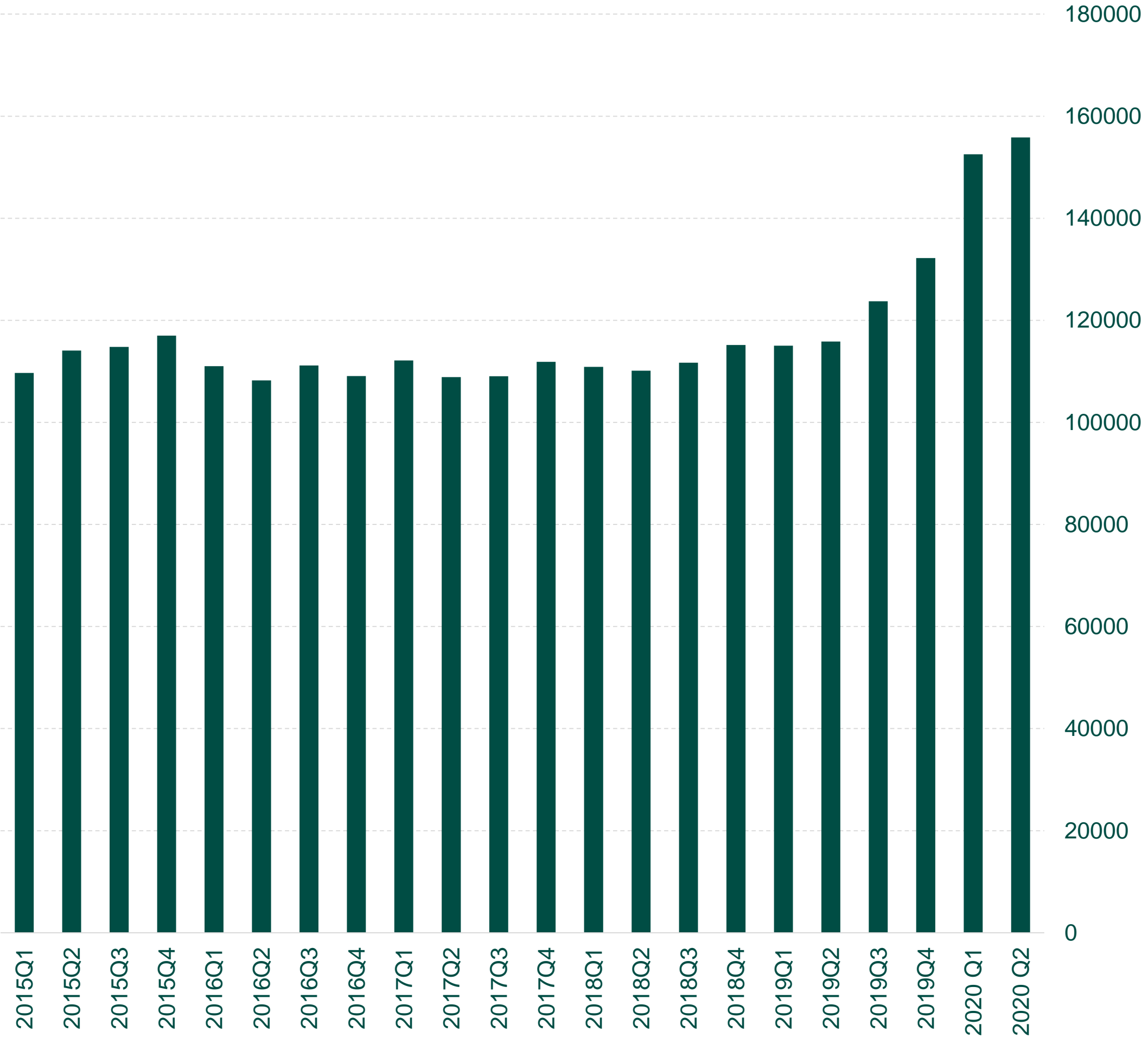
Majority of firms trading normally but uncertainty remains high



CSO Covid-19 Business Impact Survey Results, 27 July - 23 August



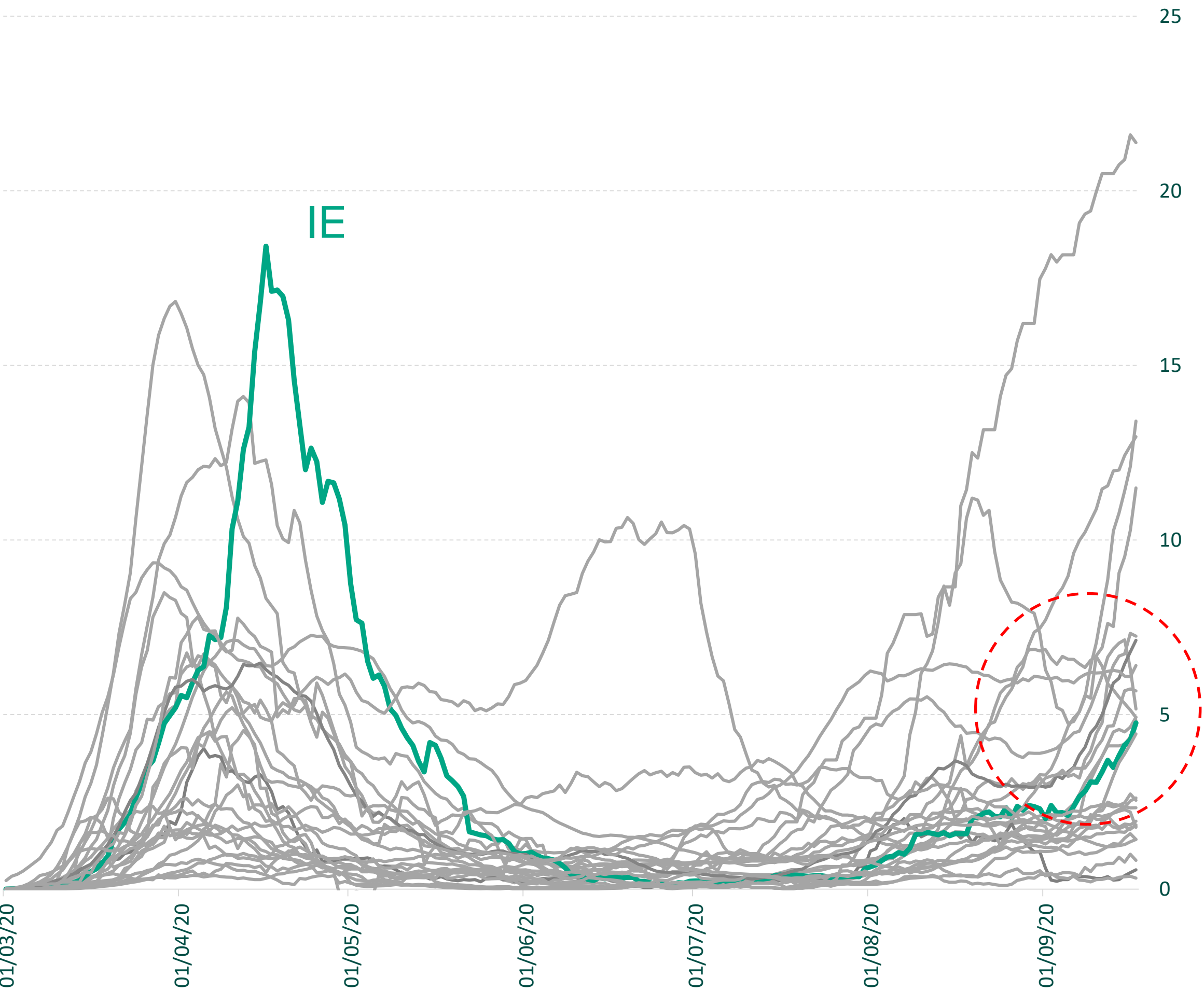
Corporate deposits by quarter, € million



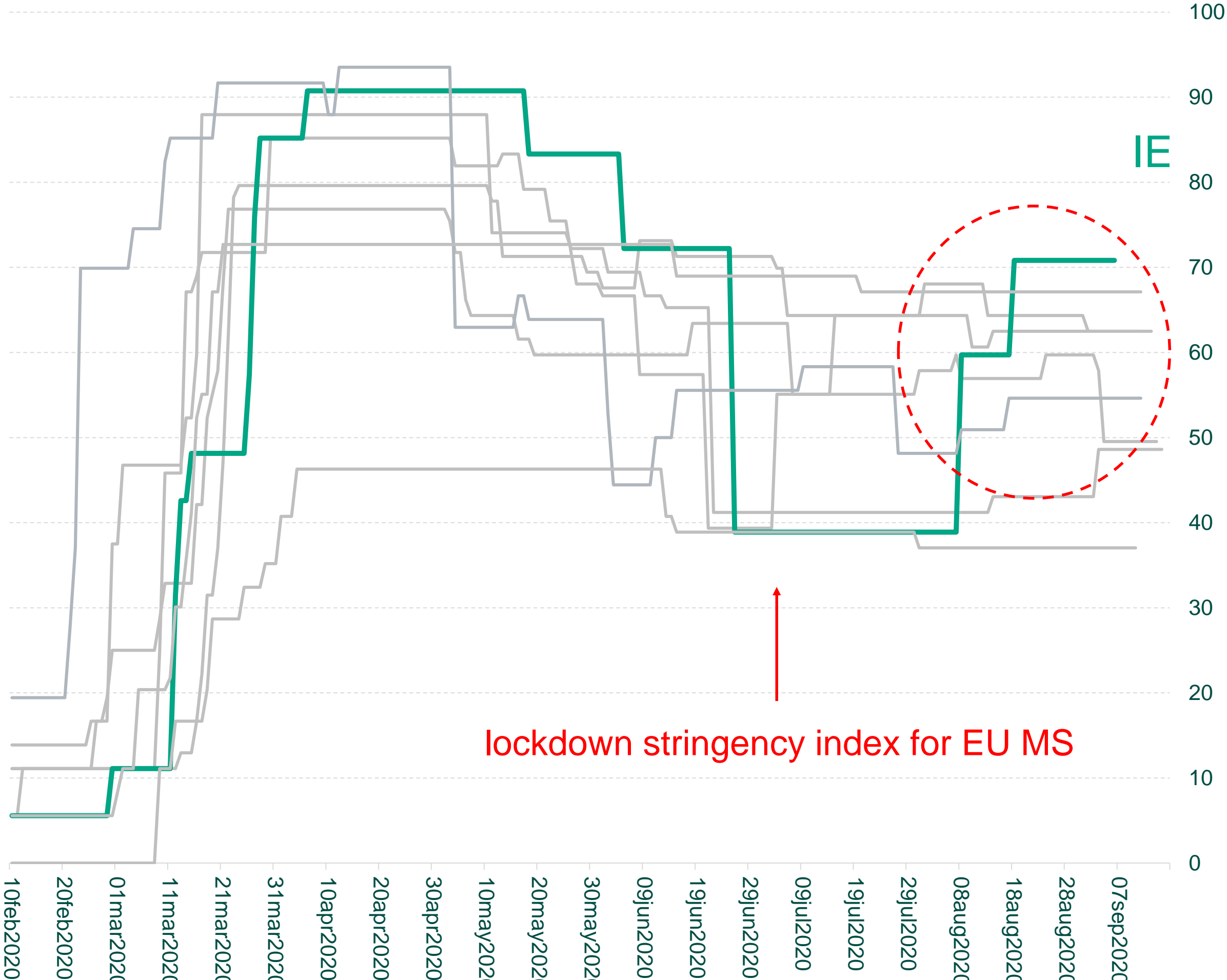
Virus-resilience: Ireland and elsewhere



Up-tick in infection rate in EU (no. infections per 100k, 7 day m.a.)



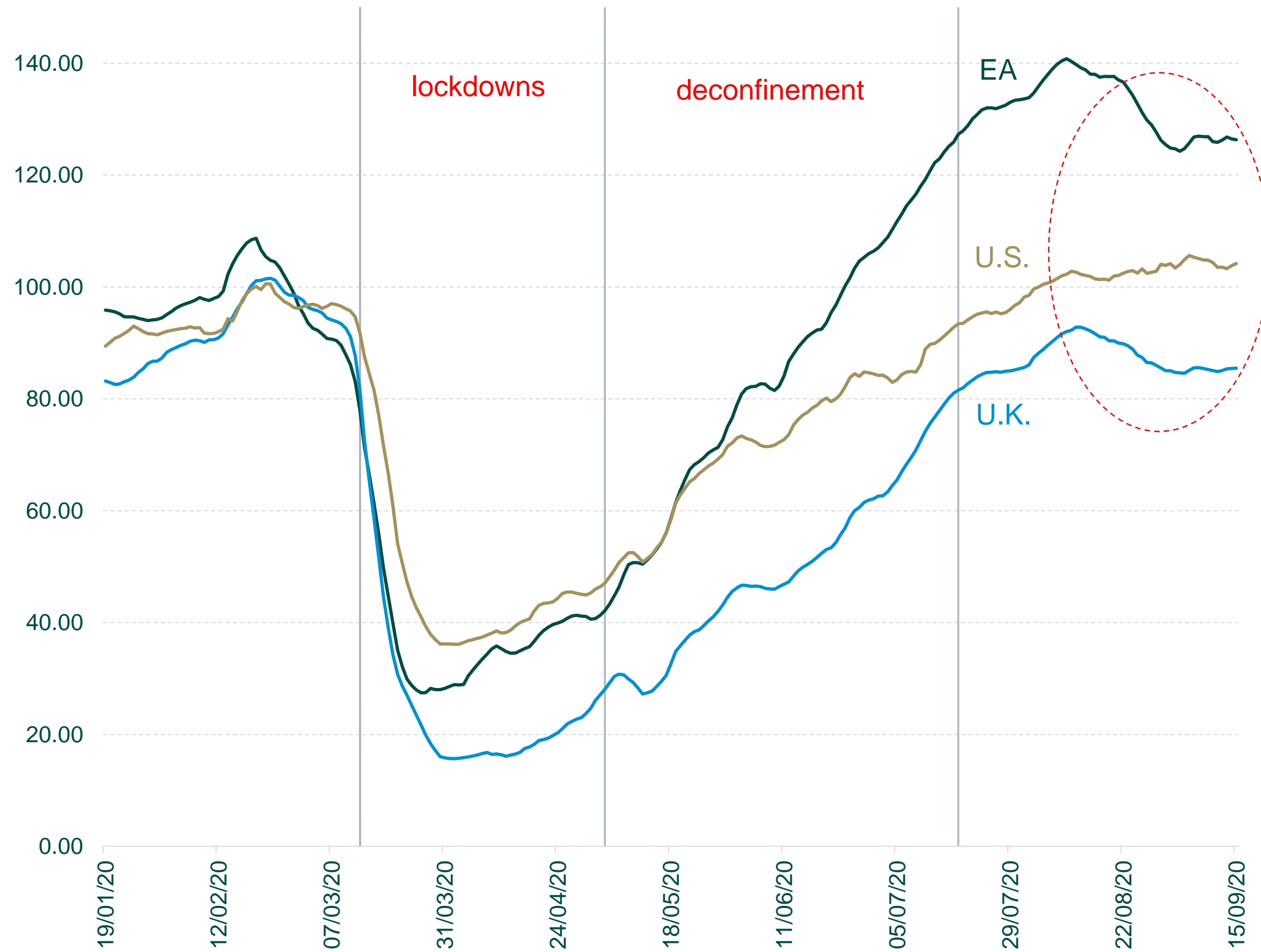
Re-introduction of restrictions in several EU MS



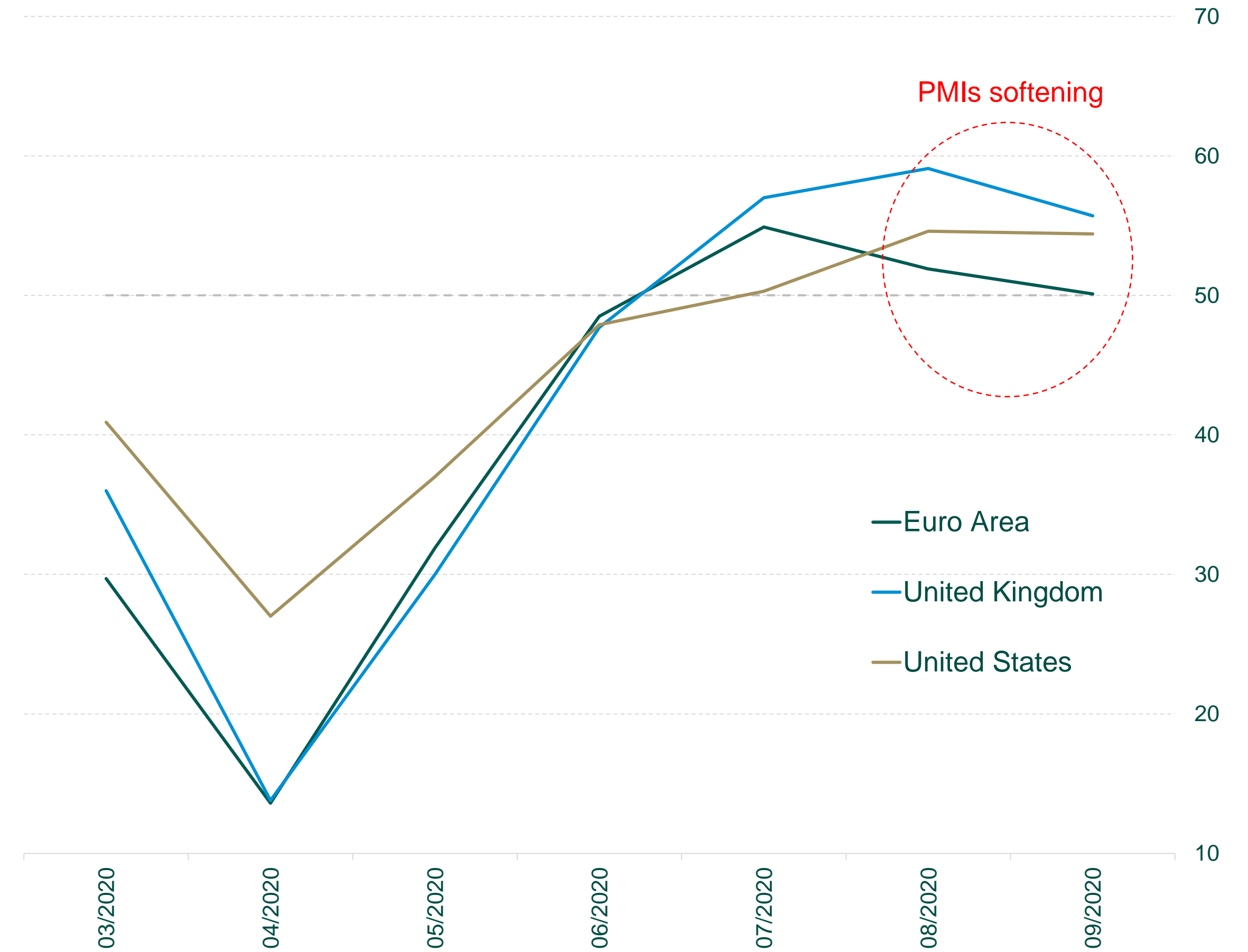
Spilling over into real-time data



Apple mobility indices for Ireland's MTPs



Composite PMI, 50 = no change





Forecast framework and methodological approach

Budget 2021: key building blocks of forecast



- Forecast horizon
 - : 2020 and 2021
 - : exceptional uncertainty
 - : medium-term projections in spring
- Key assumptions
 - : no vaccination
 - continued demand / supply constraints
 - : disorderly end to transition period
 - tariffs
 - NTBs
 - supply chains

Methodological approach

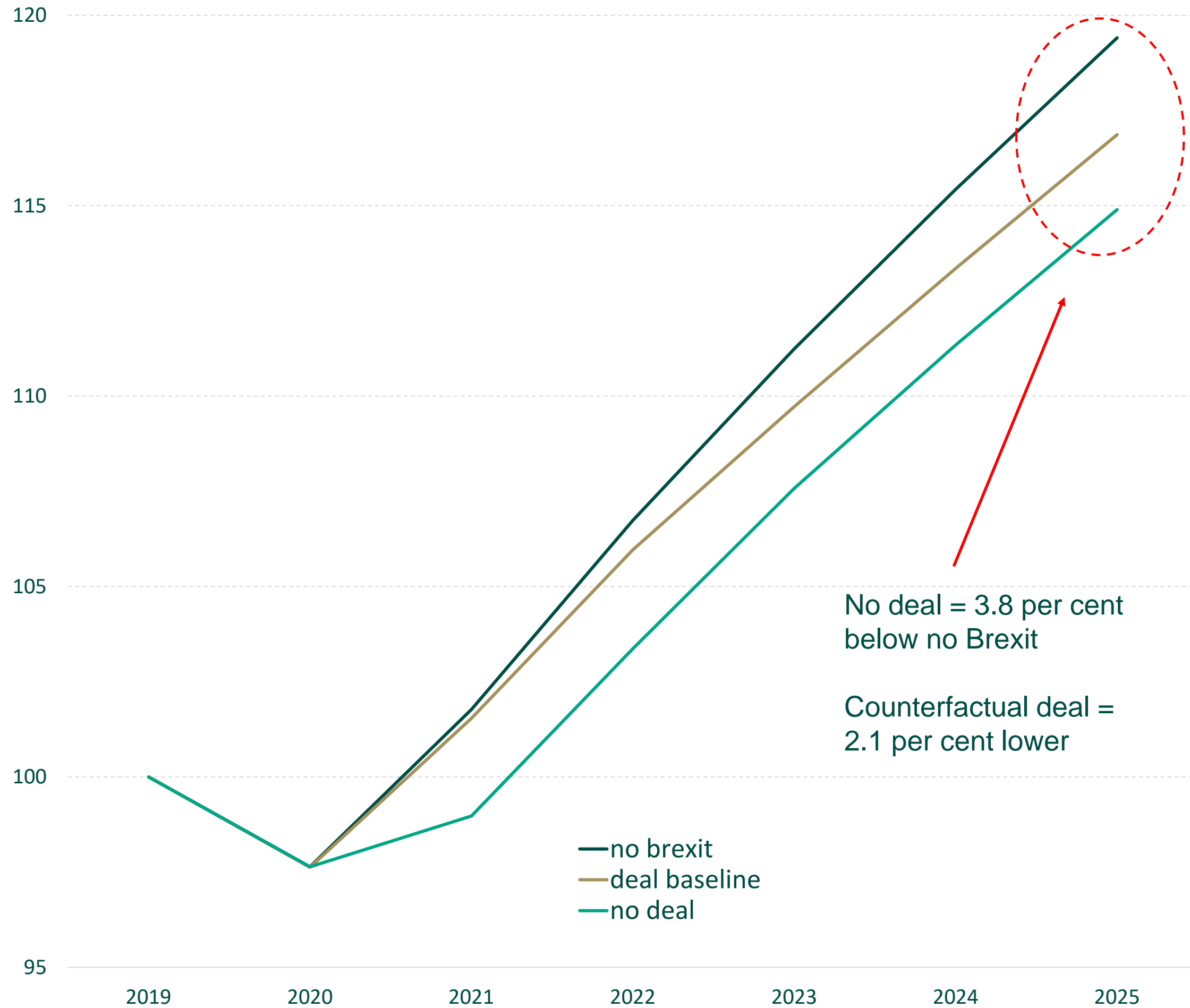


- **Calibration = challenging**
 - : no historical precedent for (1) pandemic or (2) IE-UK bilateral trade on WTO terms
- **Construct initial ‘baseline’ forecast = no vaccine in 2021**
 - : social distancing [supply and demand effects]
 - : heightened risk aversion / uncertainty [impacting on savings and investment decisions]
 - : take account of sector-specific [+ve. and –ve.]
 - : Brexit = **limited** FTA [less benign than previous assumptions]
- **Layer-in disruption to EU-UK trade**
 - : “no-deal shock” treated as additive [evidence base = DoF/ESRI]
 - : First year impact mostly on traded side
- **Consultation with third parties**
 - : Central Bank, IMF, ESRI on forecast approach and methodological issues

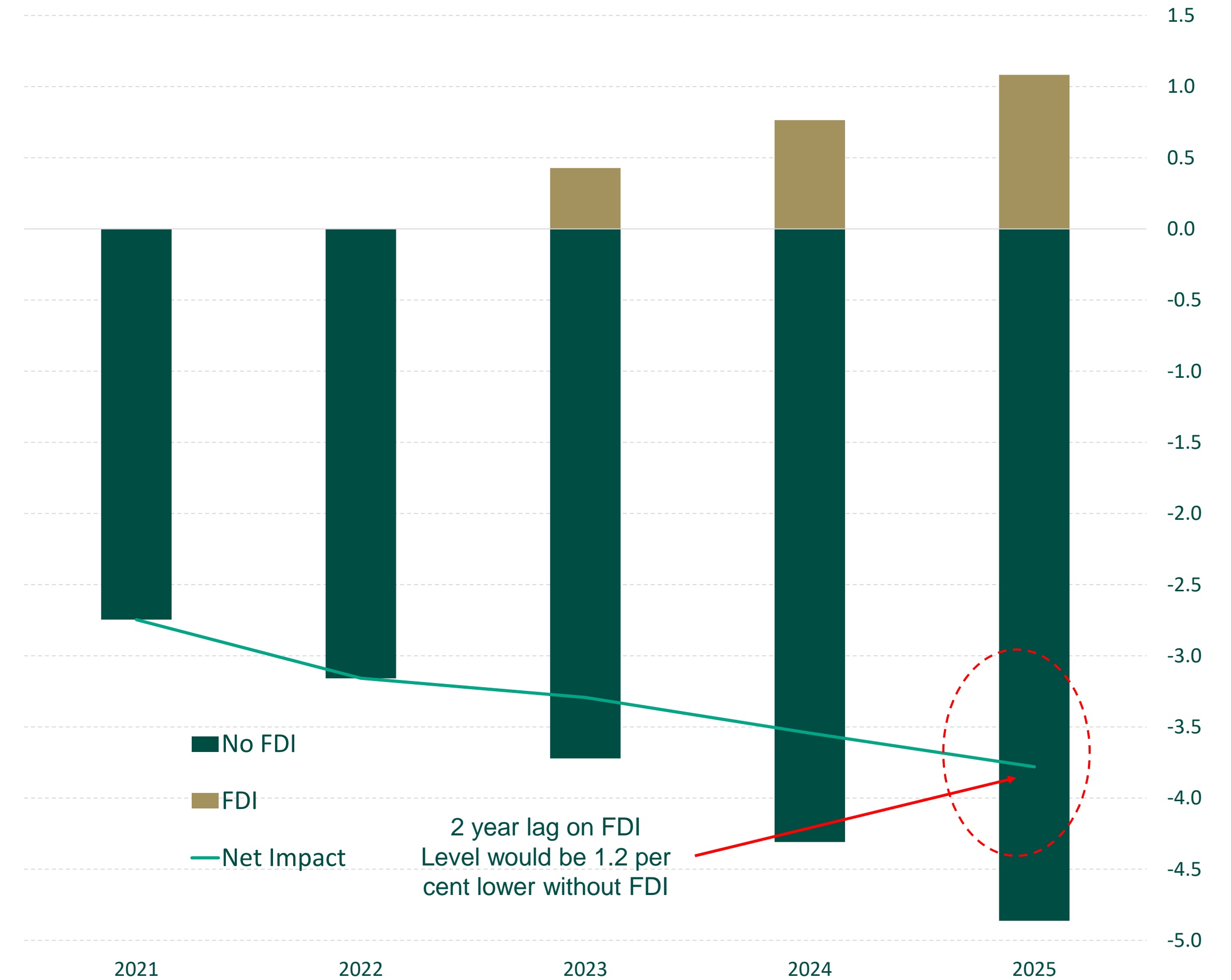
Impact of no trade deal UK exit – medium term



GDP levels – 2019 = 100



GDP - pp difference to hypothetical no UK exit baseline



Dual shocks: Covid and disorderly 'Brexit'



Evidence base:

Examination of the sectoral overlap of COVID-19 and Brexit Shocks (Daly & Lawless, 2020)

Approach:

- Sectoral impact of both shocks
- Sectoral overlap
- Domestic supply chain interactions

Main Findings:

- Limited overlap in the sectors exposed to both Covid-19 and Brexit shocks
- Adding shocks together
 - broader range of at risk
 - but sectors do not appear to be impacted by interaction effects
- Important: impacts likely to vary at firm level.
- SME revenue shortfall of €8-15bn by end-year
 - reduced capacity to absorb an additional shock?

Sectoral impact of dual shock: evidence base



		BREXIT			Sum Covid-19 Sectors
		Green	Amber	Red	
COVID-19	Green	7	10	6	23
	Amber	2	11	5	18
	Red	12	4	0	16
	Sum Brexit Sectors	21	25	11	57

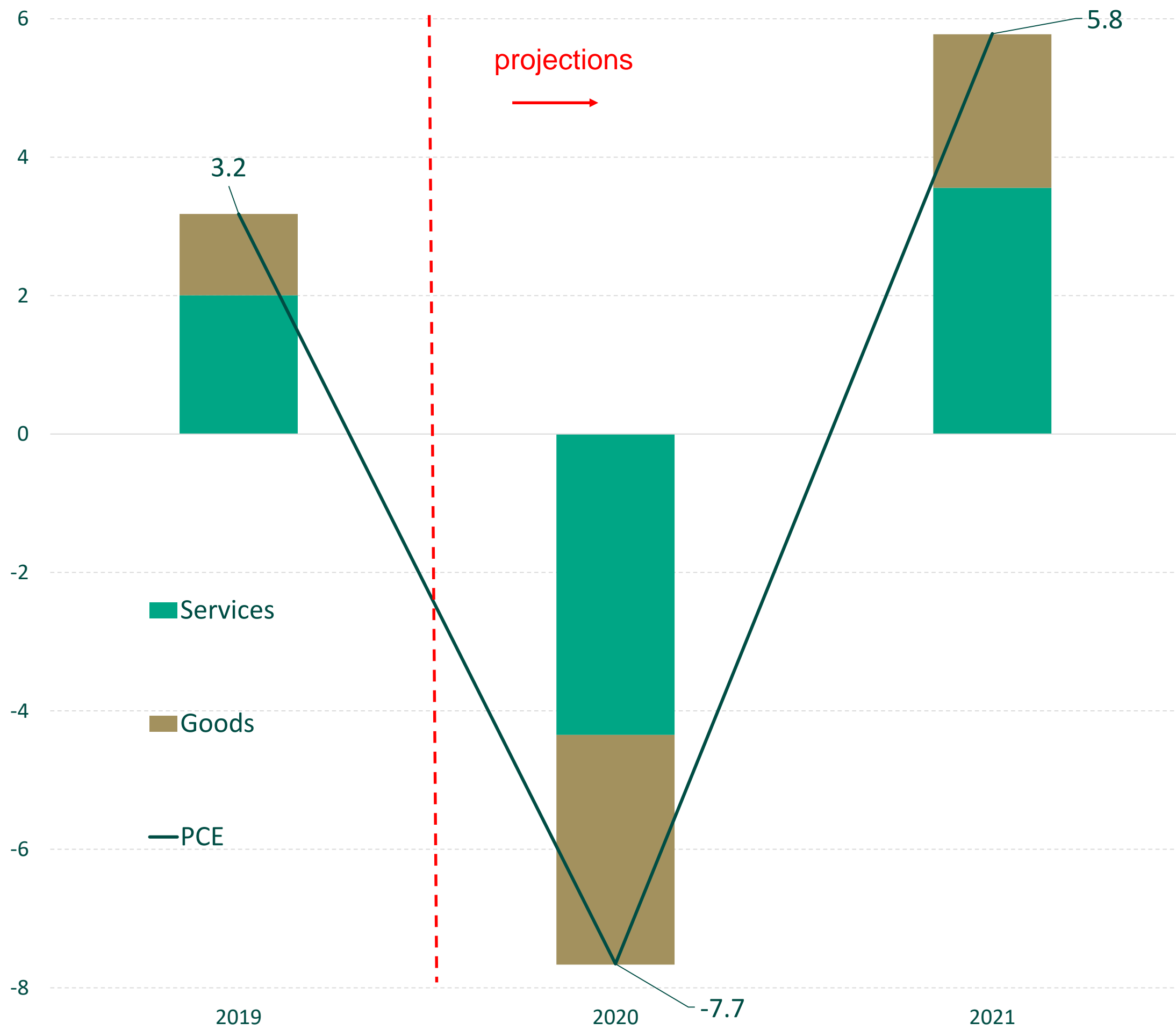


DoF short-term forecasts

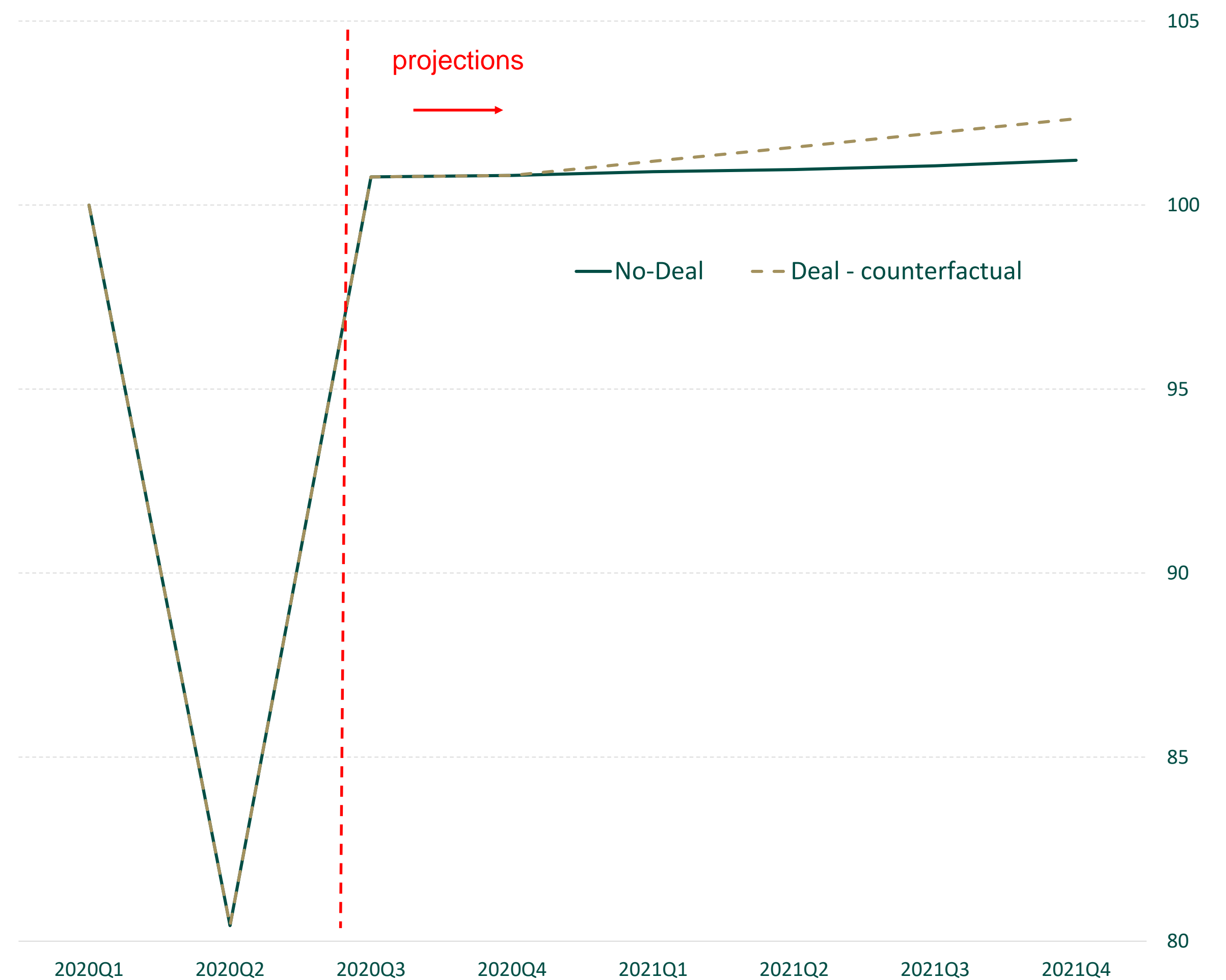
Consumer spending: precautionary savings to remain high



Personal consumer spending, contribution to y/y % change



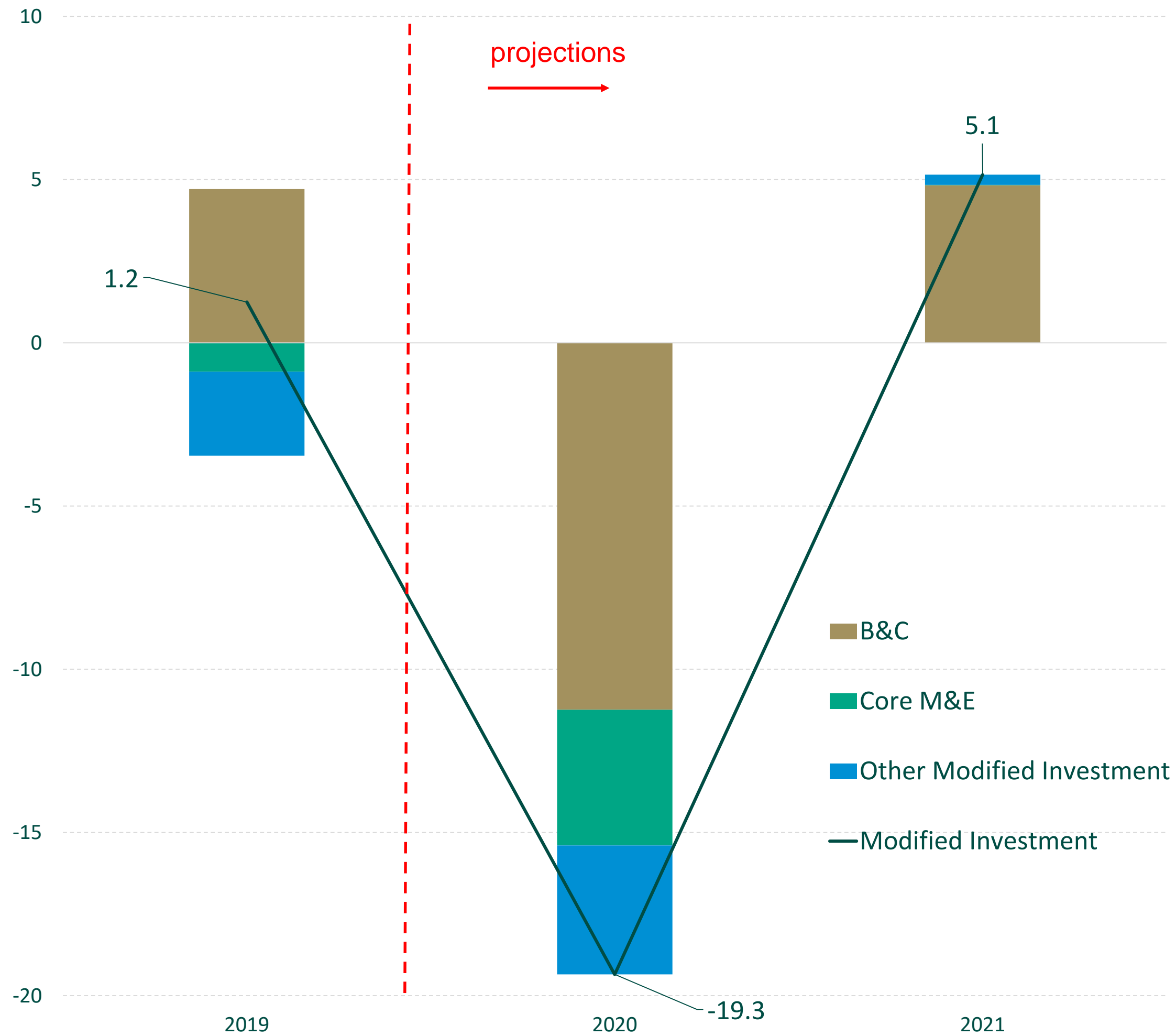
Quarterly profile for consumption, 2020q1=100



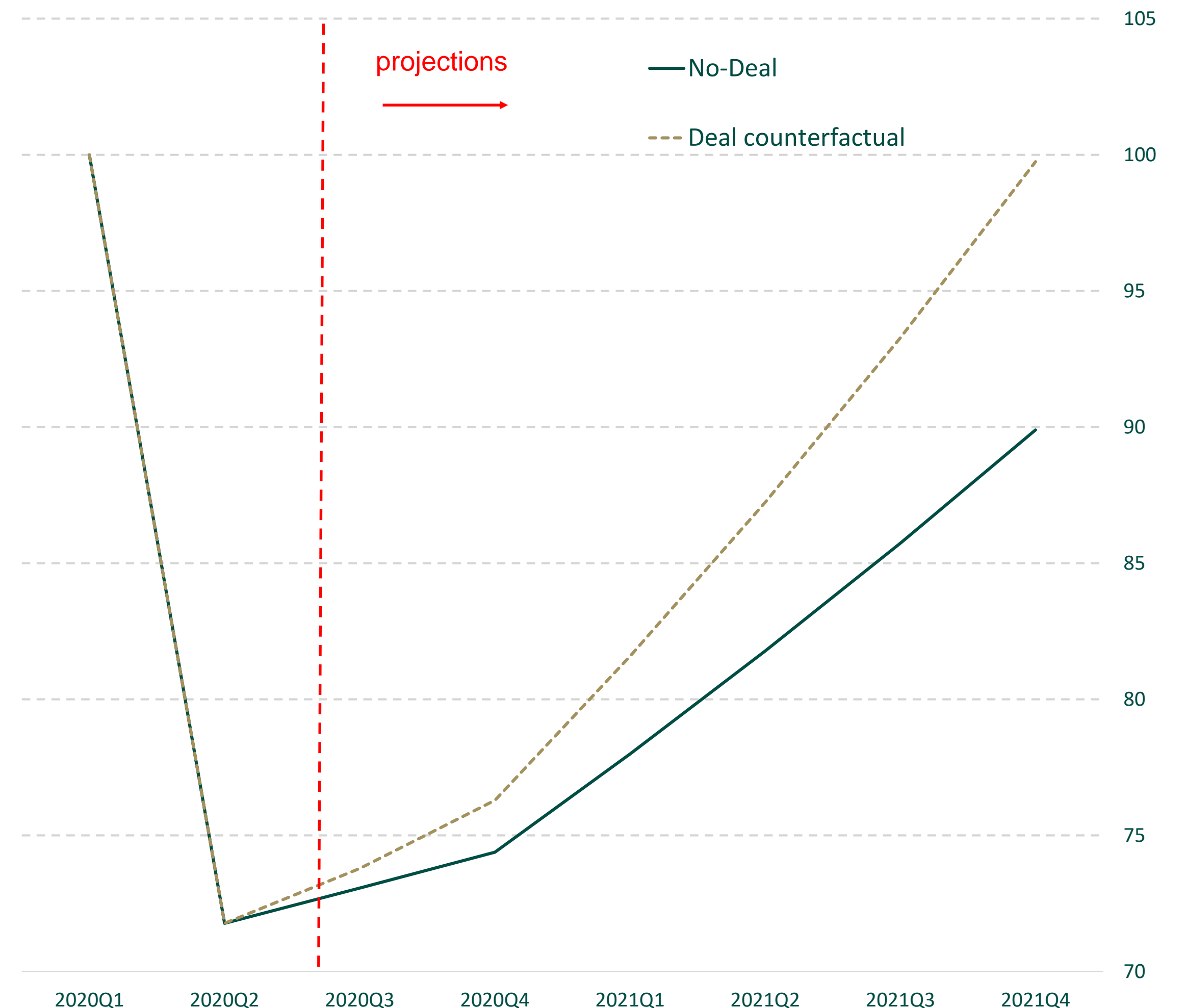
Uncertainty to curtail investment



Modified investment, contribution to y/y % change



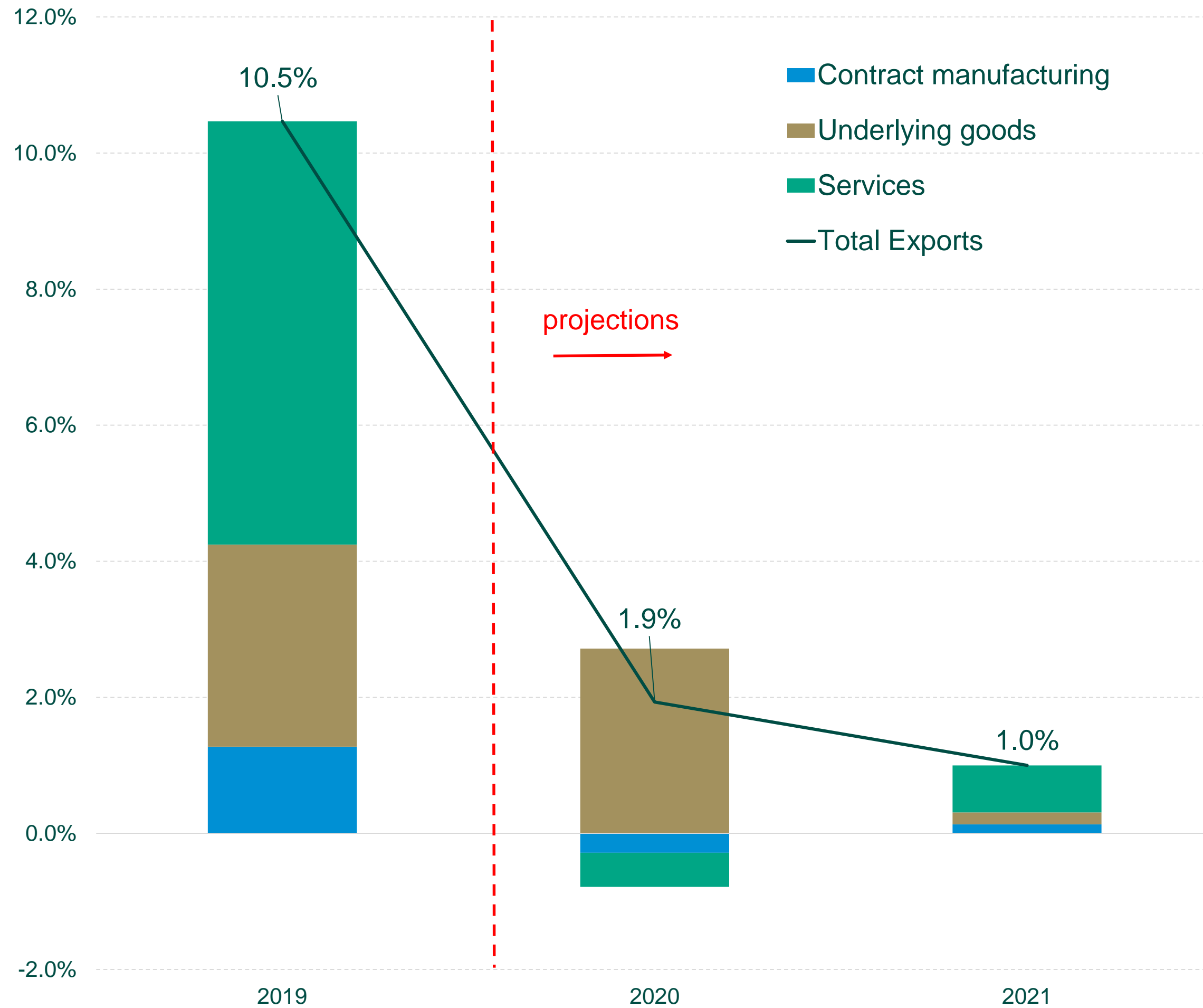
Quarterly profile for modified investment, 2020q1 = 100



Exports to outperform in 2020; WTO tariffs a headwind for 2021



Contributions to export growth, pp



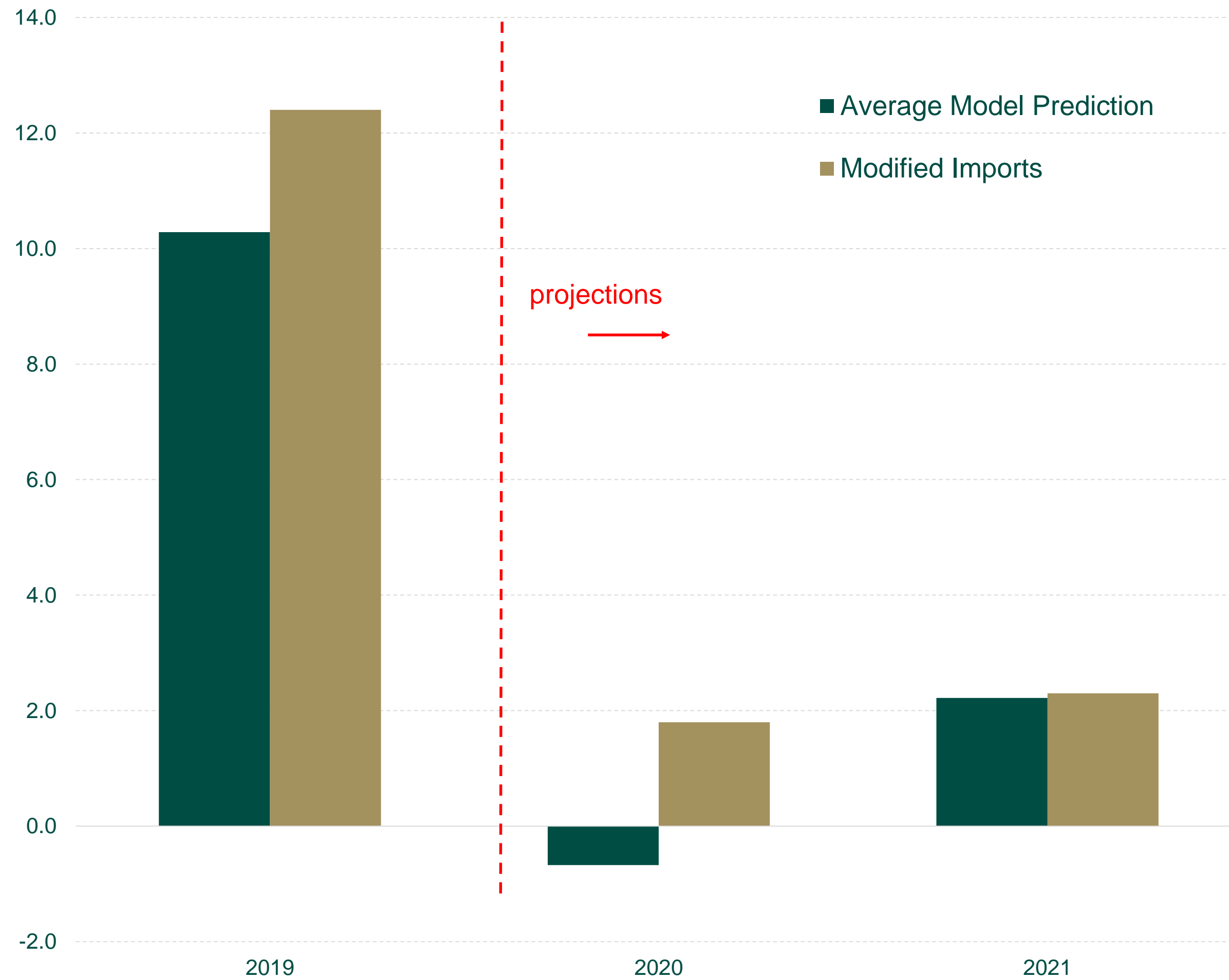
Quarterly Profile for exports, 2020q1 = 100



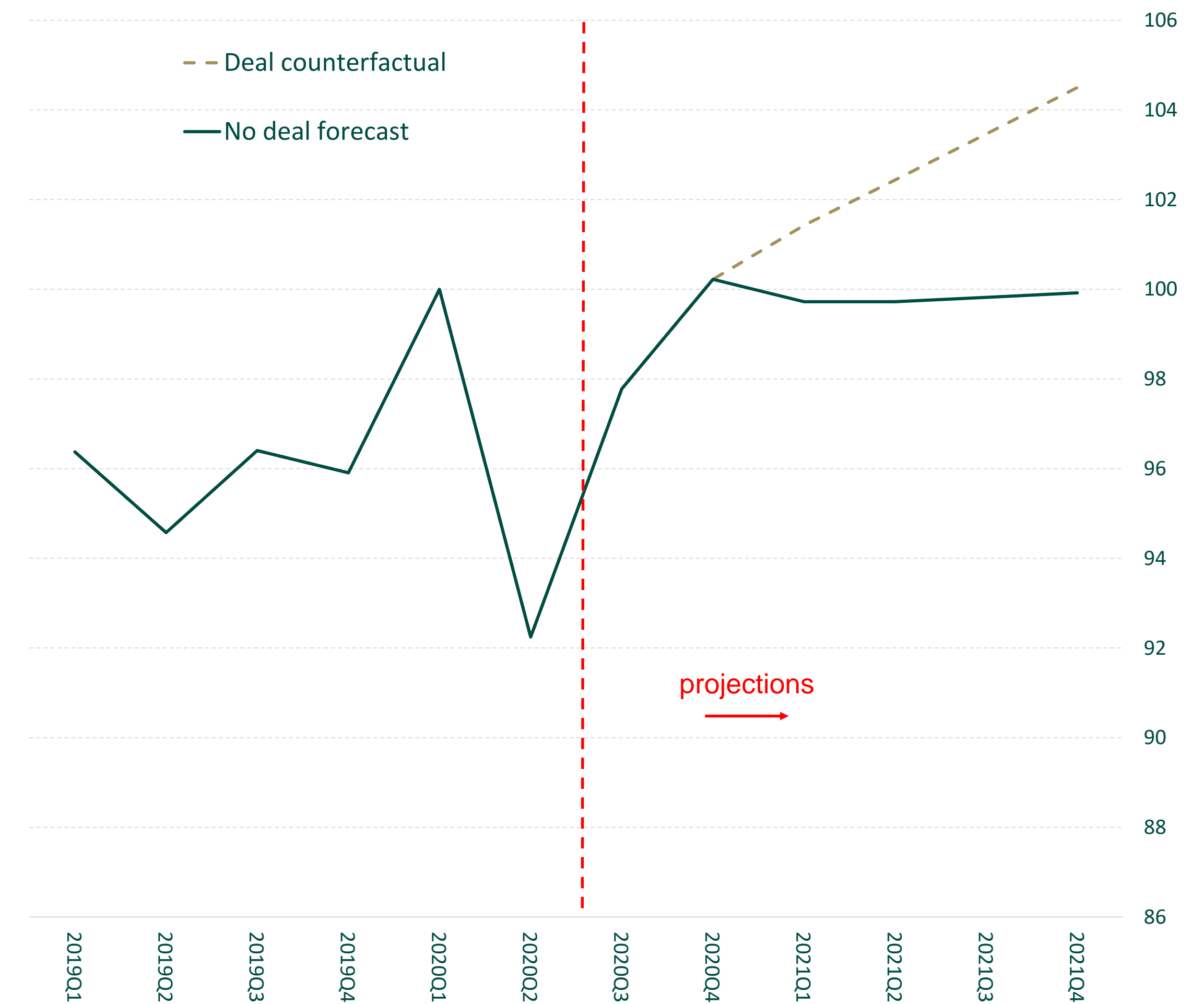
Imports broadly in line with final demand



Import growth y/y %



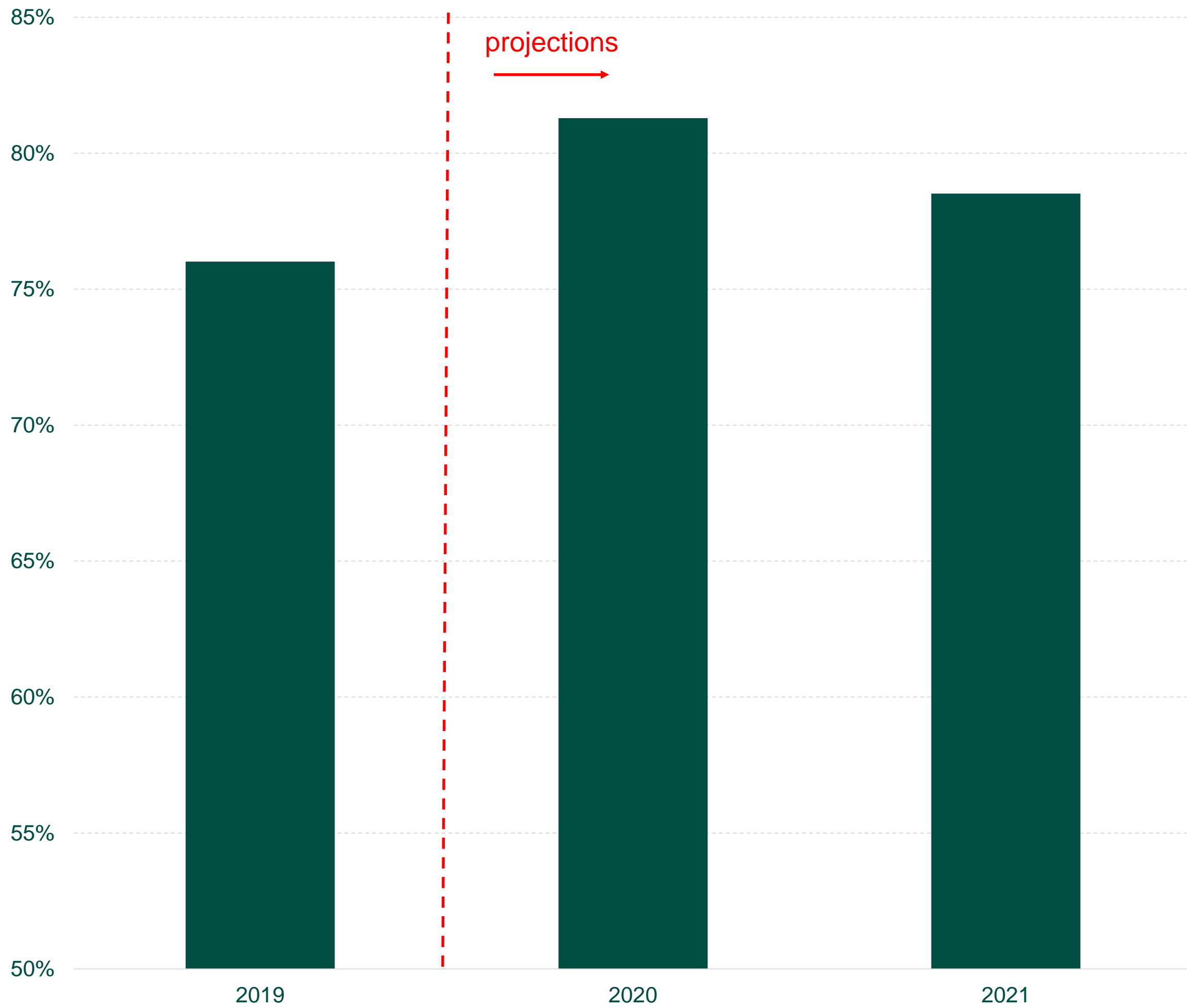
Quarterly Profile – Modified Imports, 2020q1 = 100



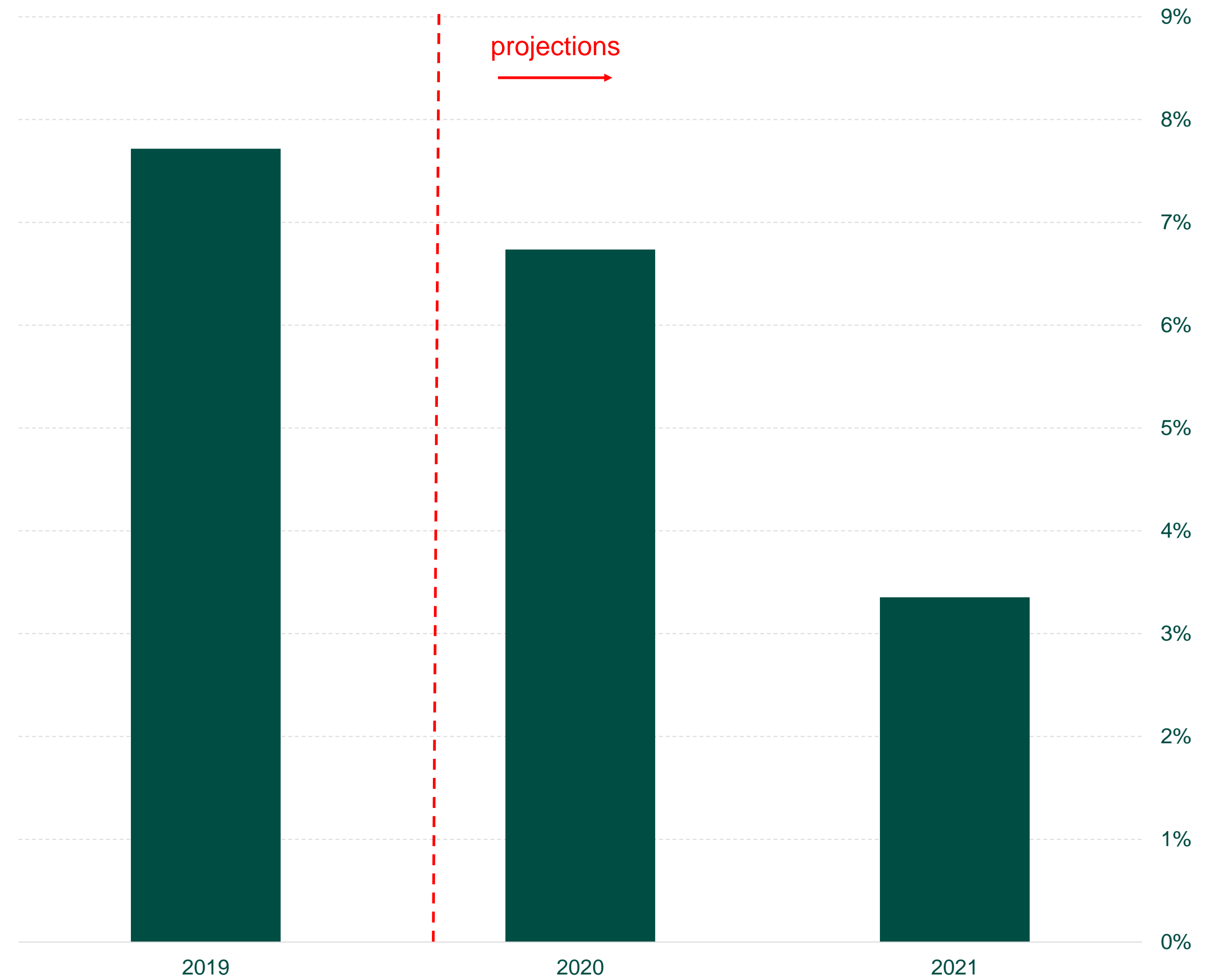
External accounts: surplus reduced by assumed tariffs / NTBs / etc



Modified Trade Balance, % of GNI*



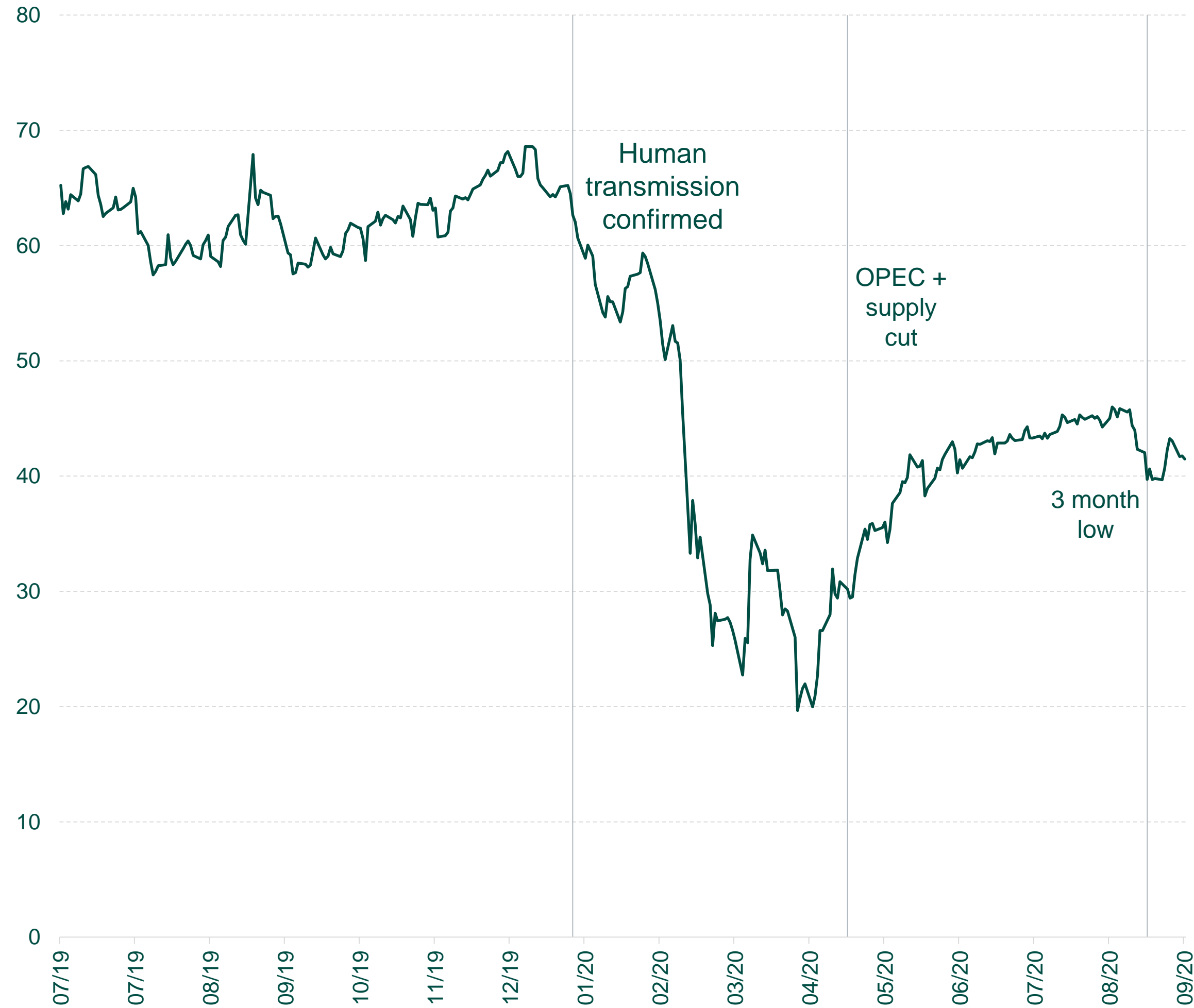
Modified Current Account, % of GNI*



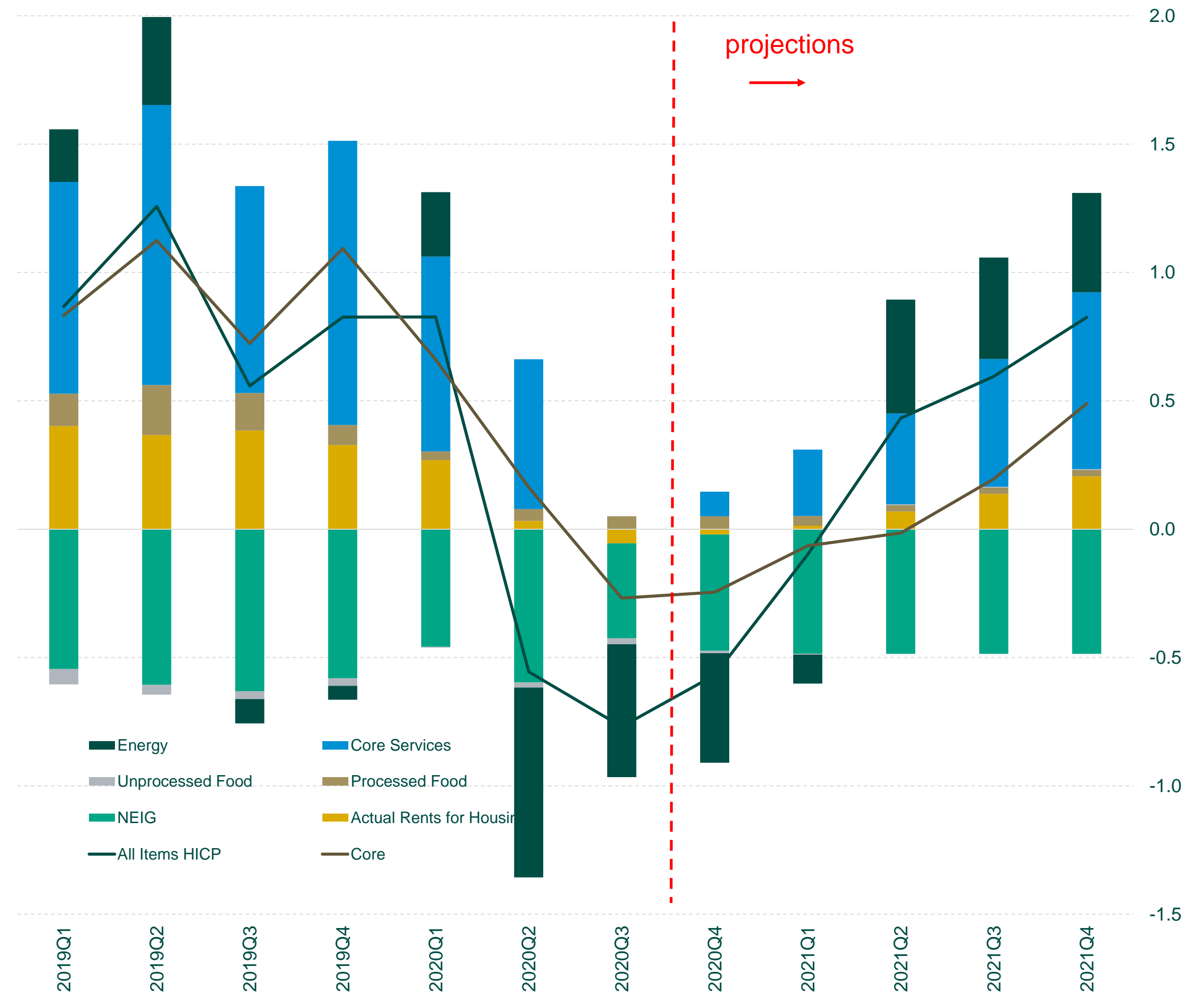
Inflationary pressures non-existent



Brent spot price, close USD



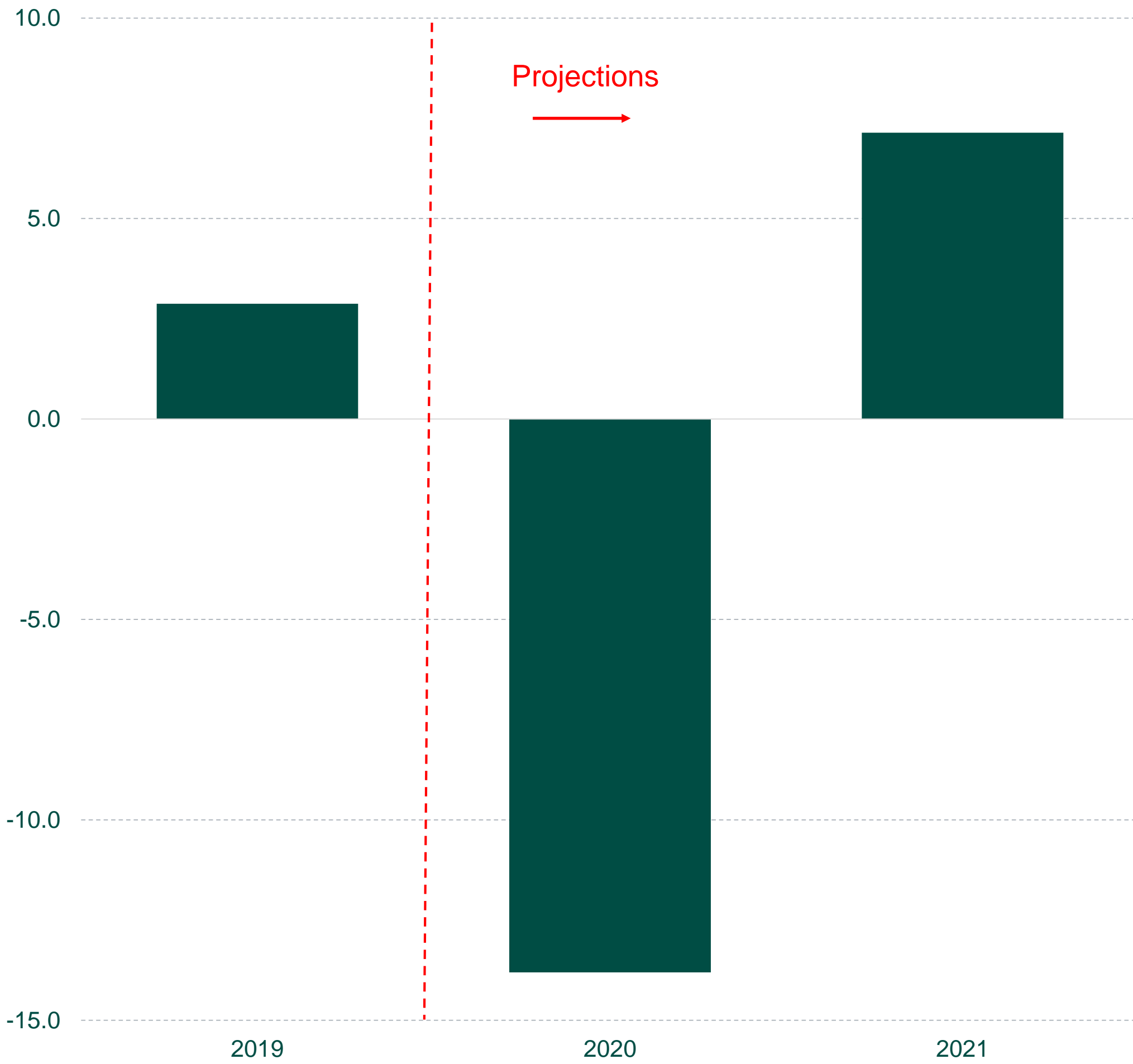
Core inflation remains muted, y/y % change



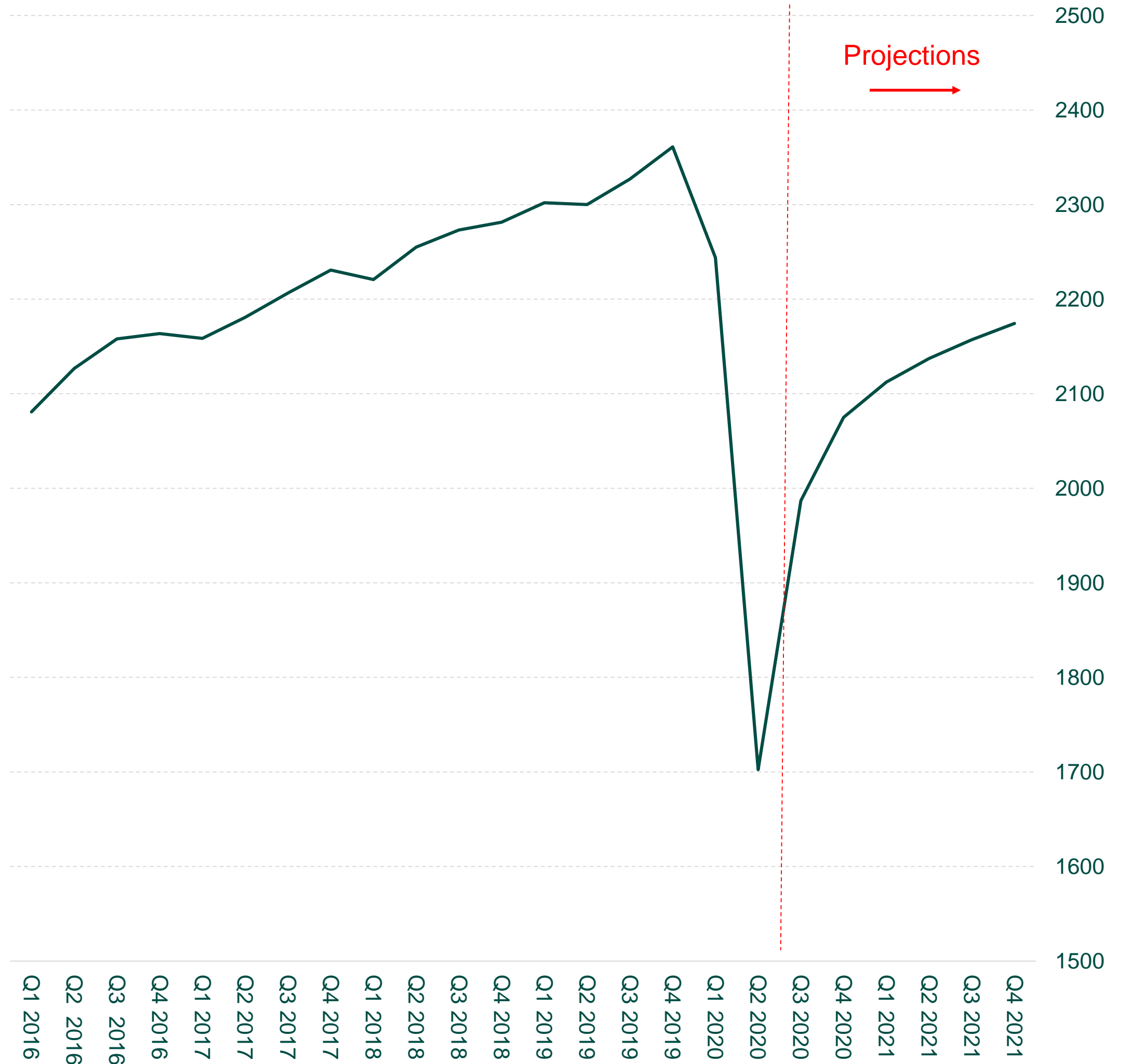
Labour market has borne the brunt



Employment growth



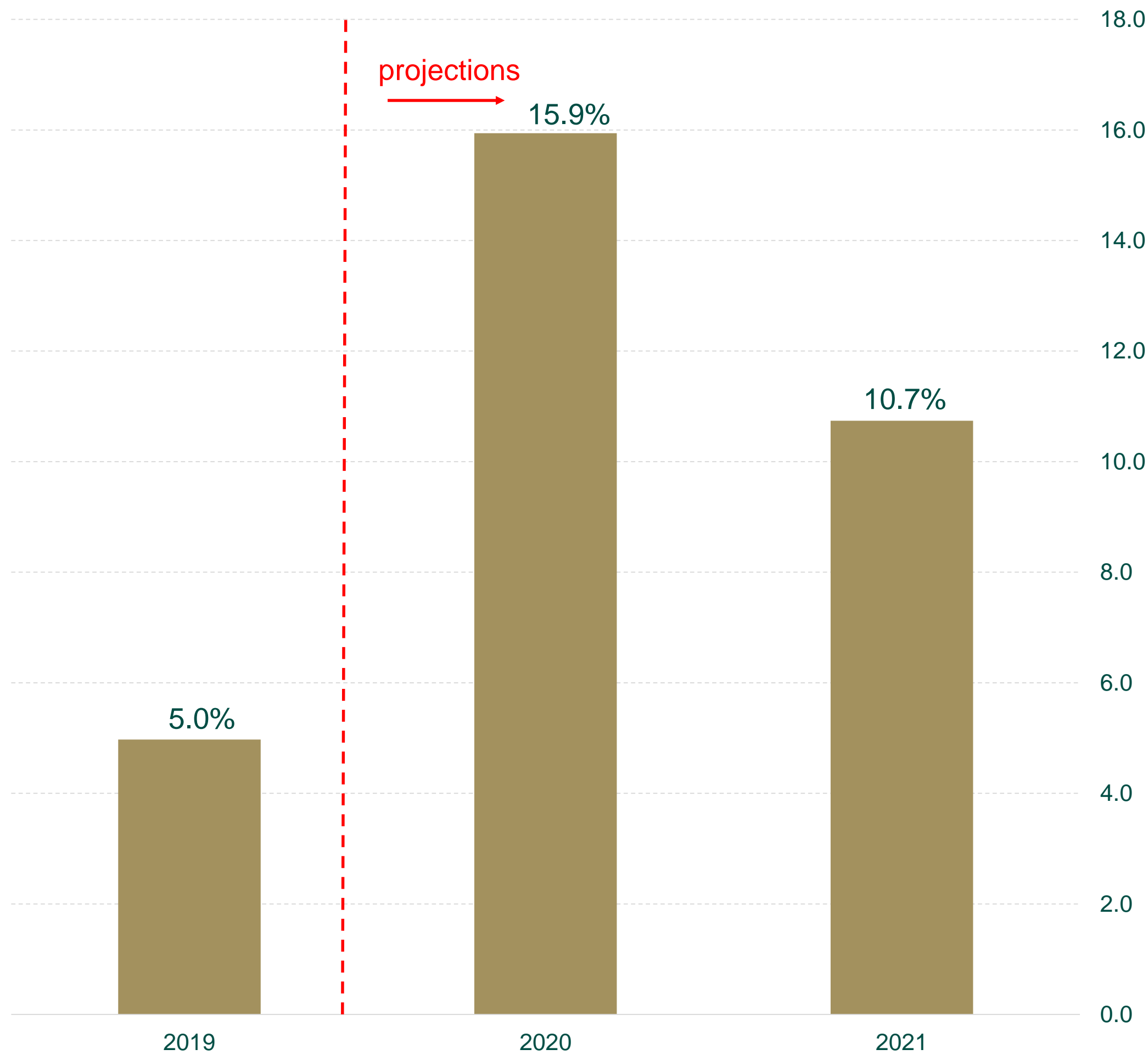
Employment levels ('000)



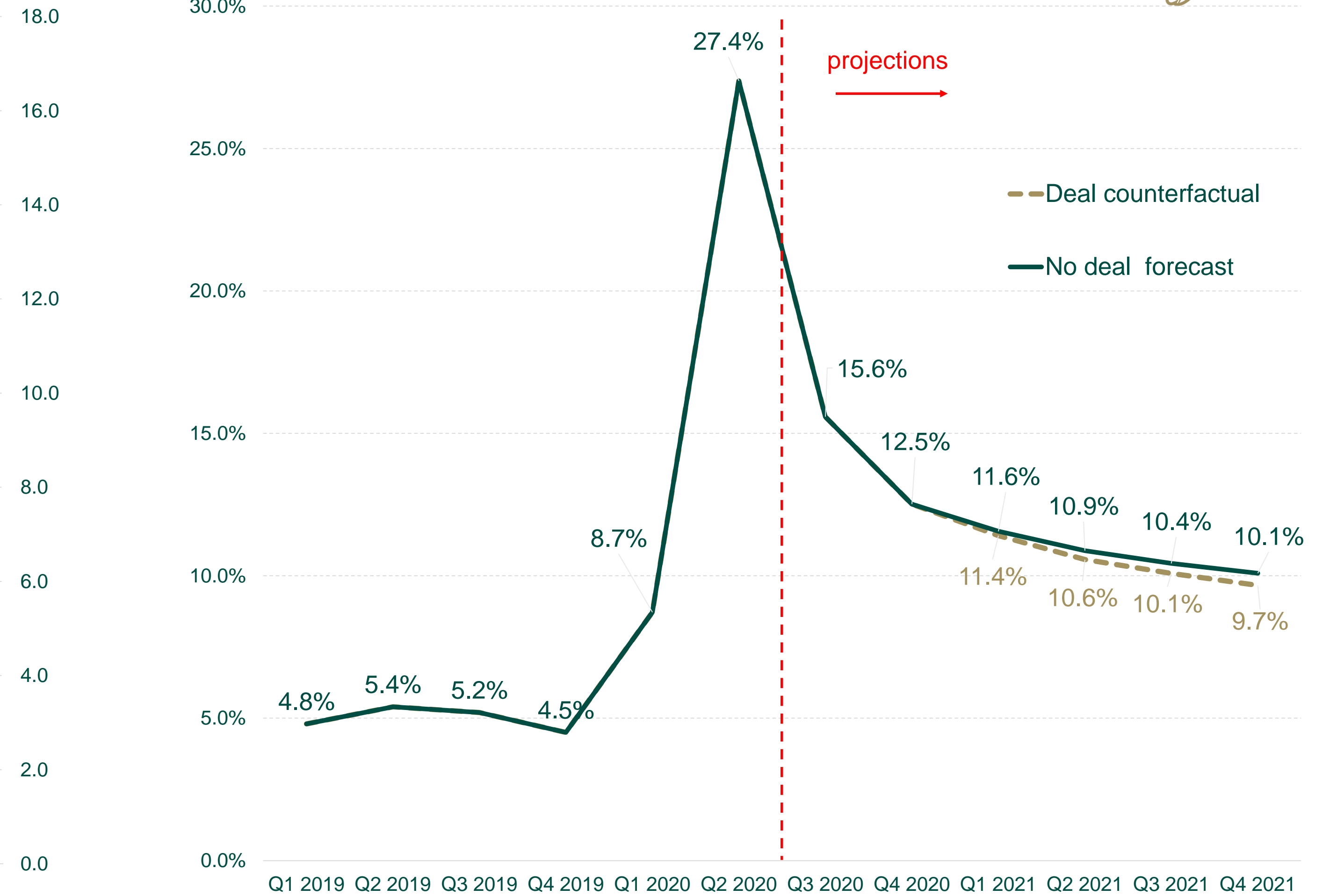
Unemployment shock lingers in the near-term: L-intensive sectors



Unemployment rate (% of labour force)



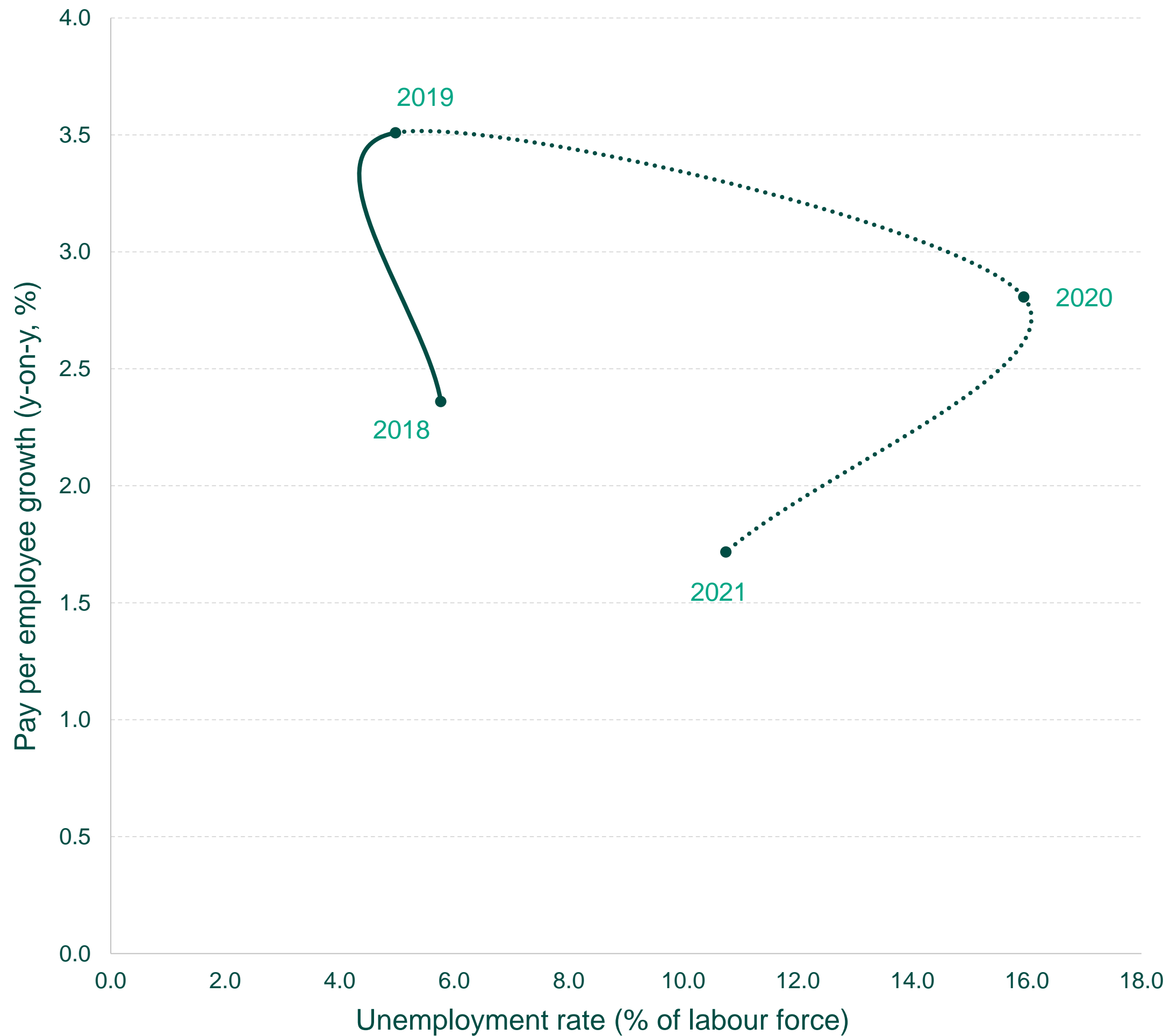
Quarterly profile for unemployment rate (% of labour force)



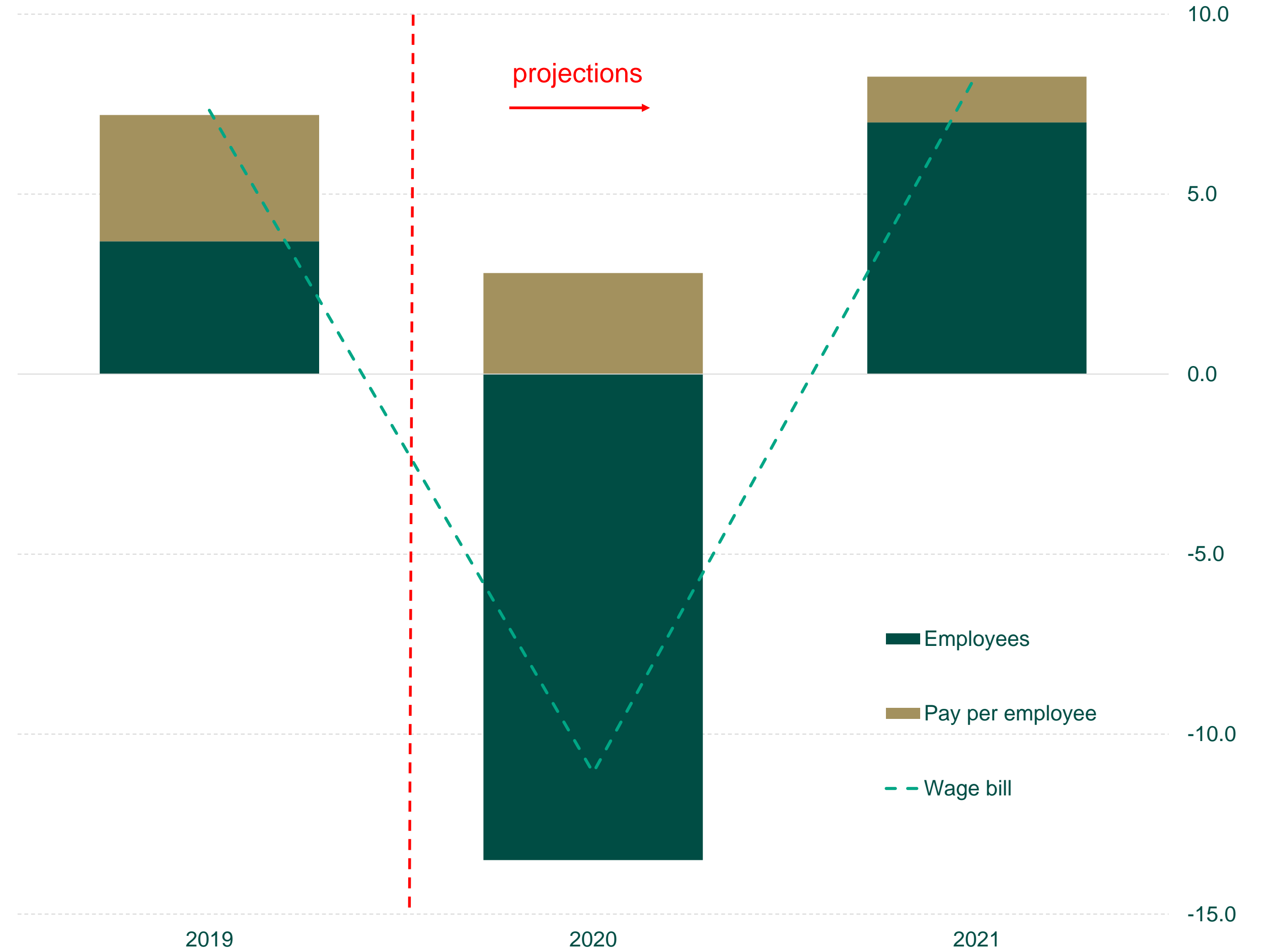
Evolution of 'wage bill'



Wage "Philips Curve"



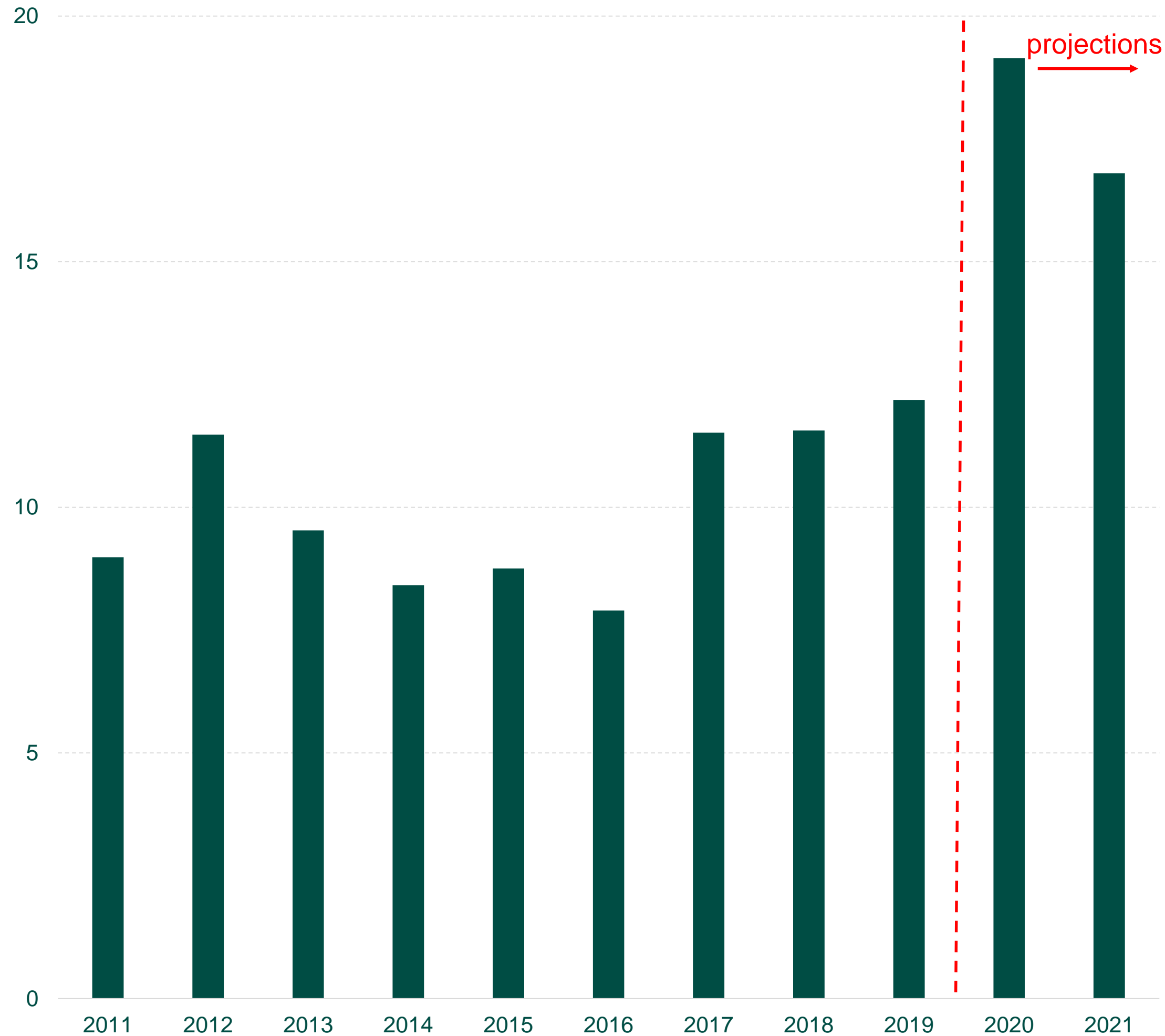
Recovery in labour income driven by employment recovery



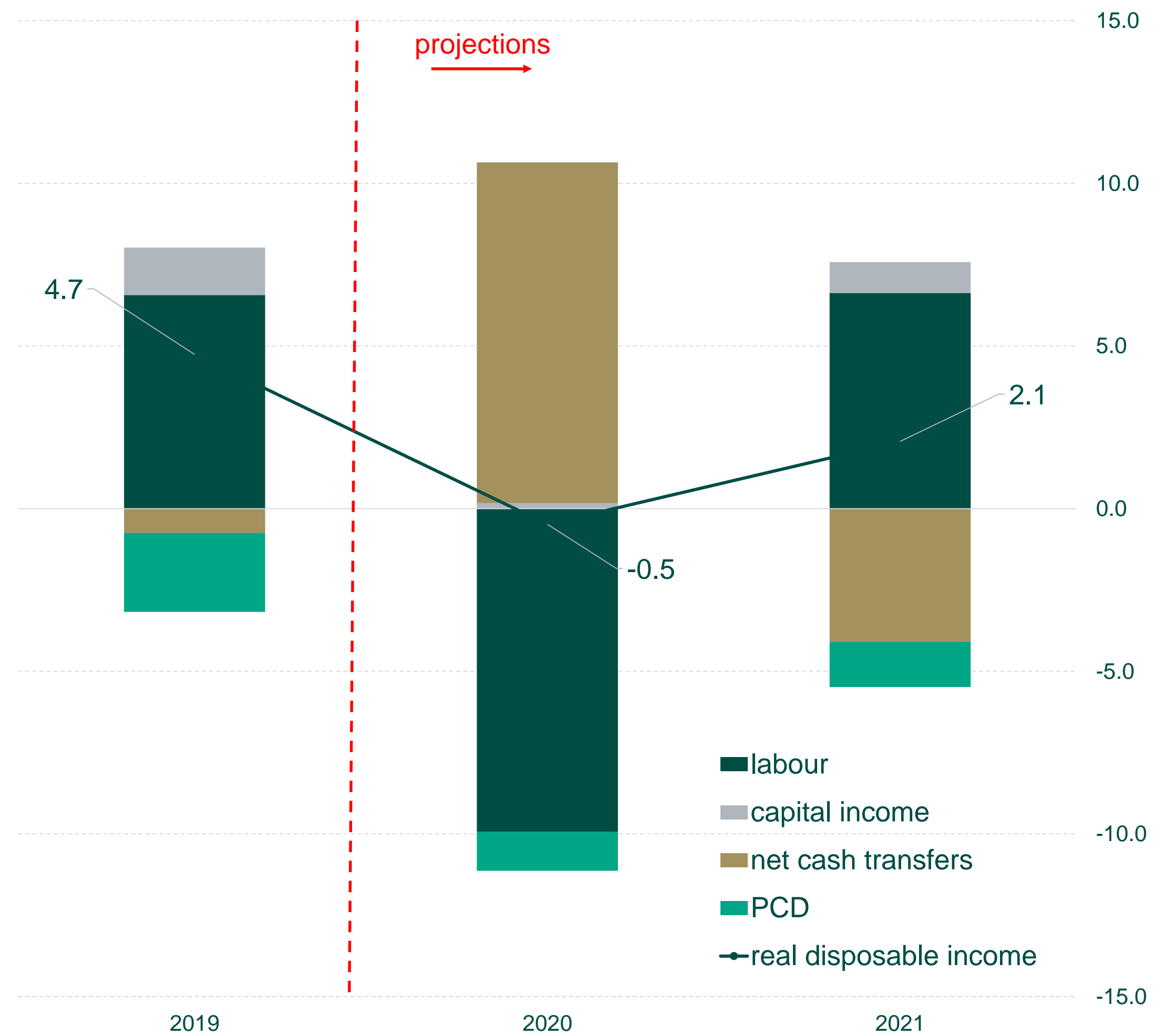
Household savings = precautionary motive



Household savings rate, per cent of disposable income



Contribution to real disposable income growth



Contributions to growth in GDP and MDD



Contribution to change in GDP – y/y%



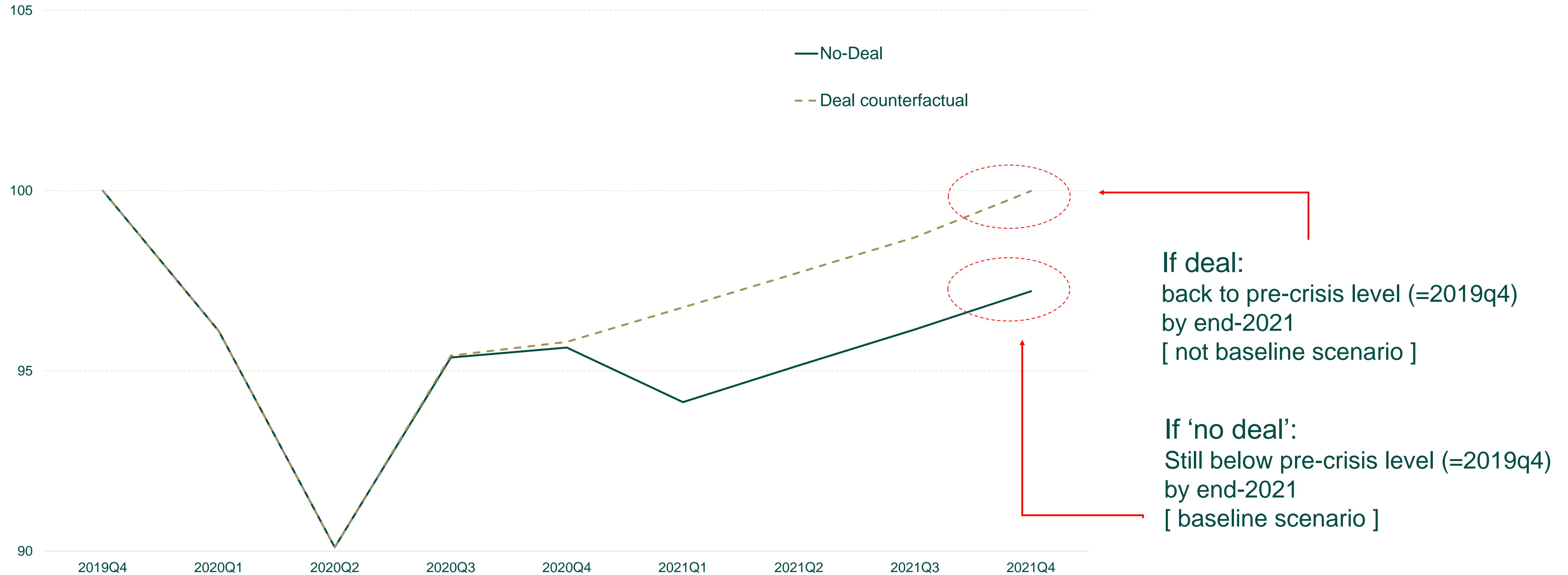
Contribution to change in MDD – y/y%



Assumed quarterly profile for economic activity



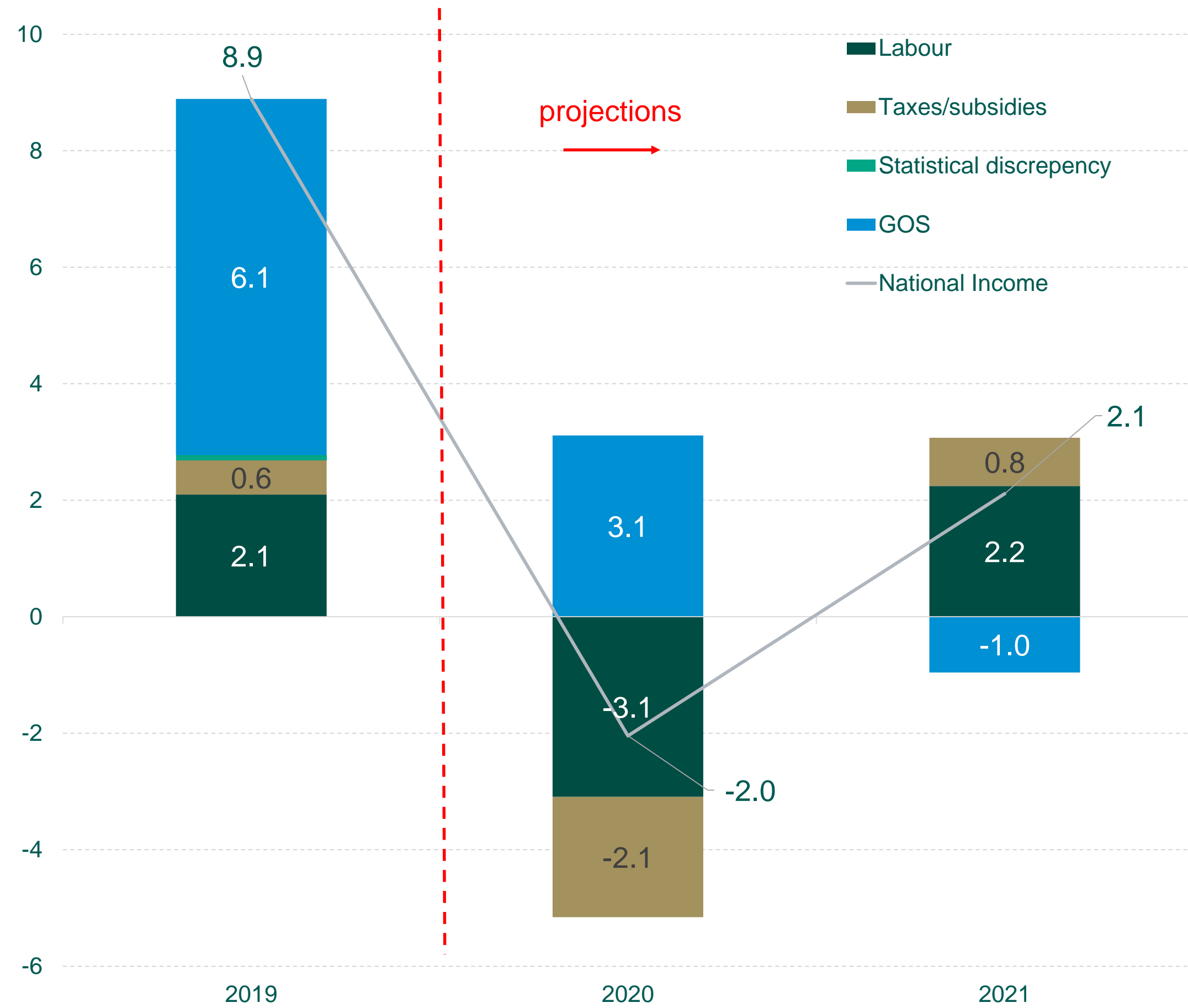
GDP, 2019q4=100



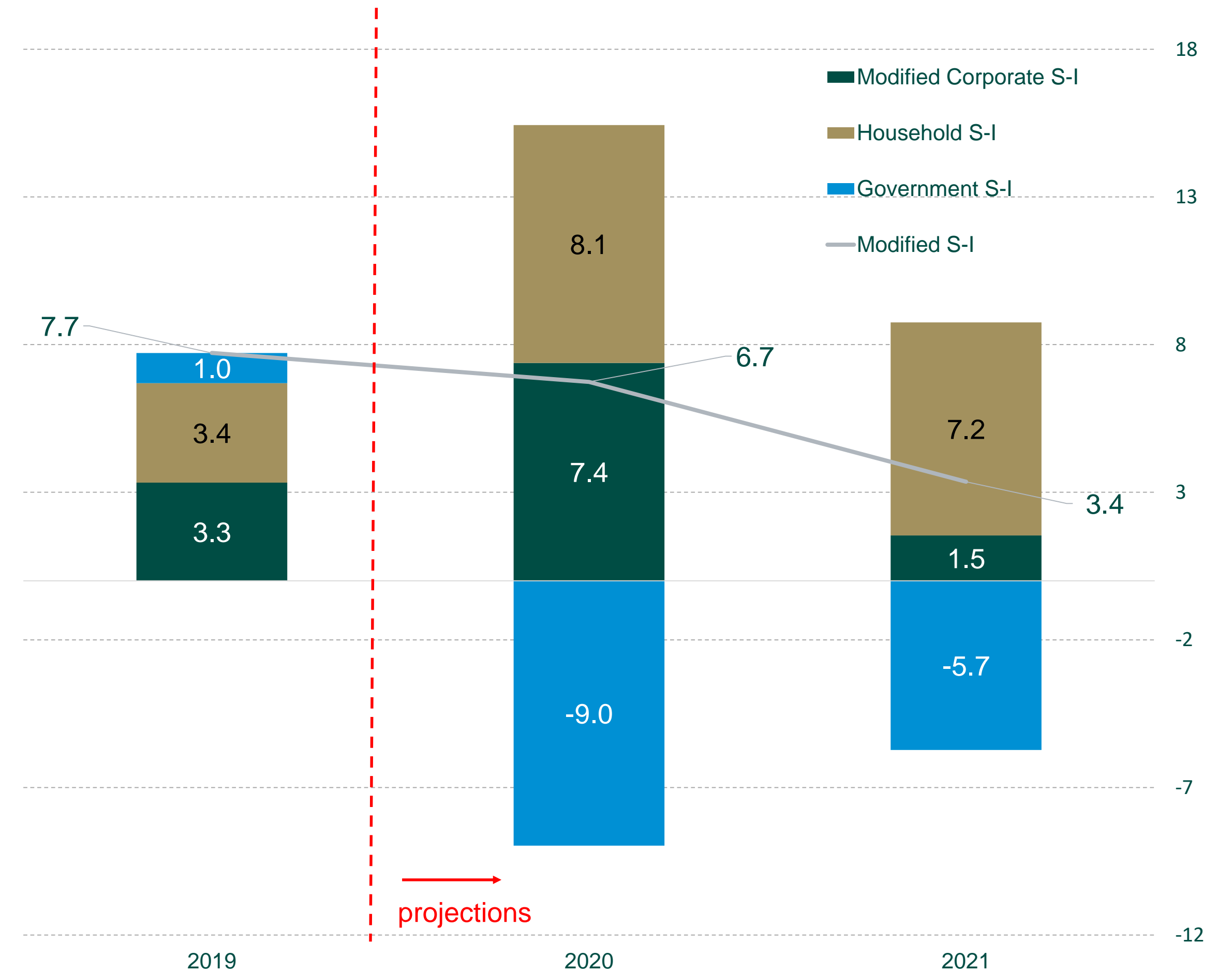
National income and flow-of-funds



Contribution to change in national income – y/y%



Modified S-I (% of GNI*)



Budget 2021 forecasts, annual per cent change unless stated

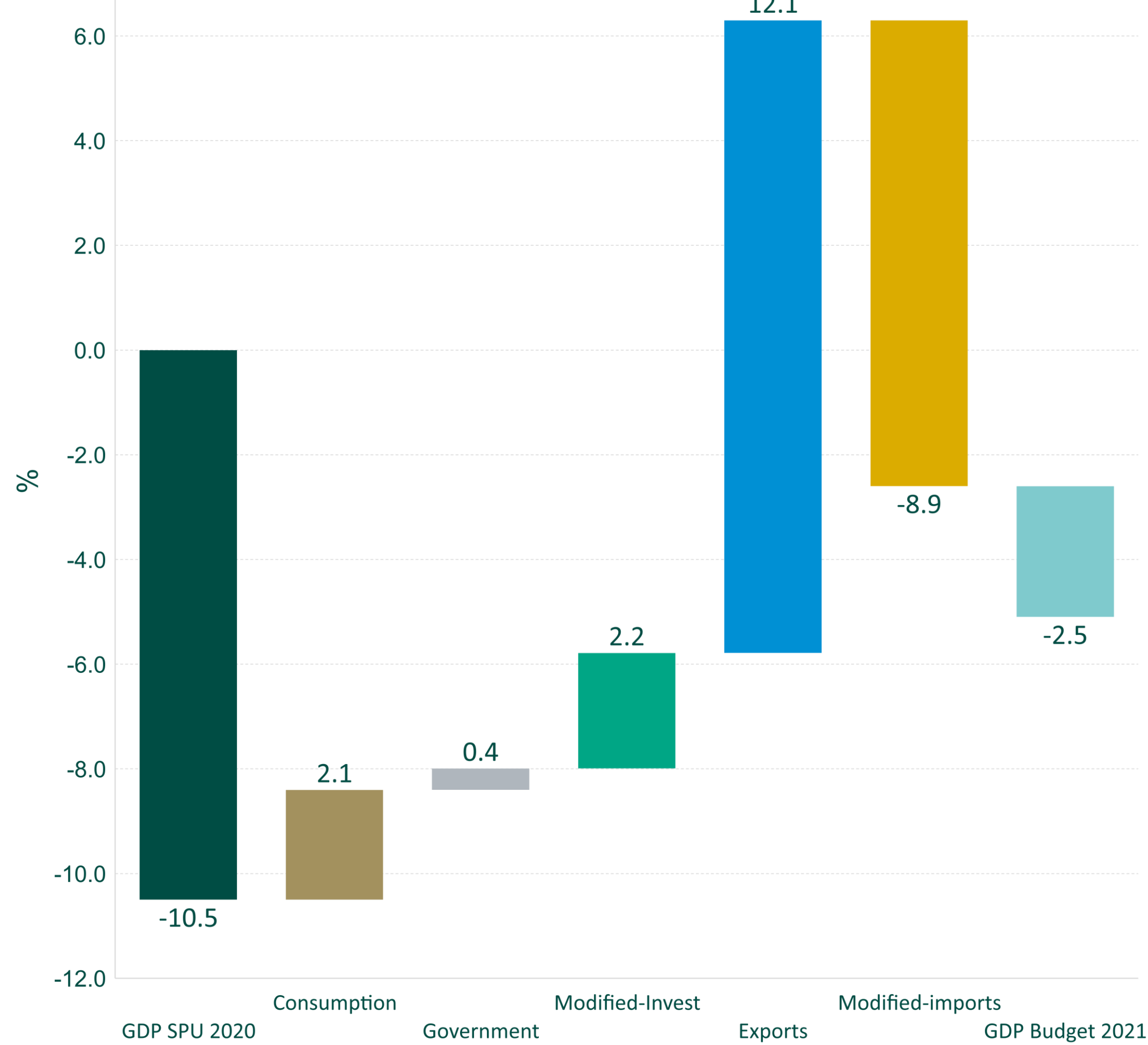


	2019	2020	2021
GDP	5.6	-2.5	1.4
Modified Domestic Demand	3.3	-6.5	3.9
Modified gross national income (current prices)	7.6	-5.6	1.8
Personal consumption	3.2	-7.7	5.8
Government consumption	6.3	13.3	-1.8
Modified investment	1.2	-19.3	5.1
Exports	10.5	1.9	1.0
Modified imports	12.4	1.8	2.3
Modified current account	7.7	6.7	3.4
Employment	2.9	-13.8	7.1
Unemployment (rate)	5.0	15.9	10.7

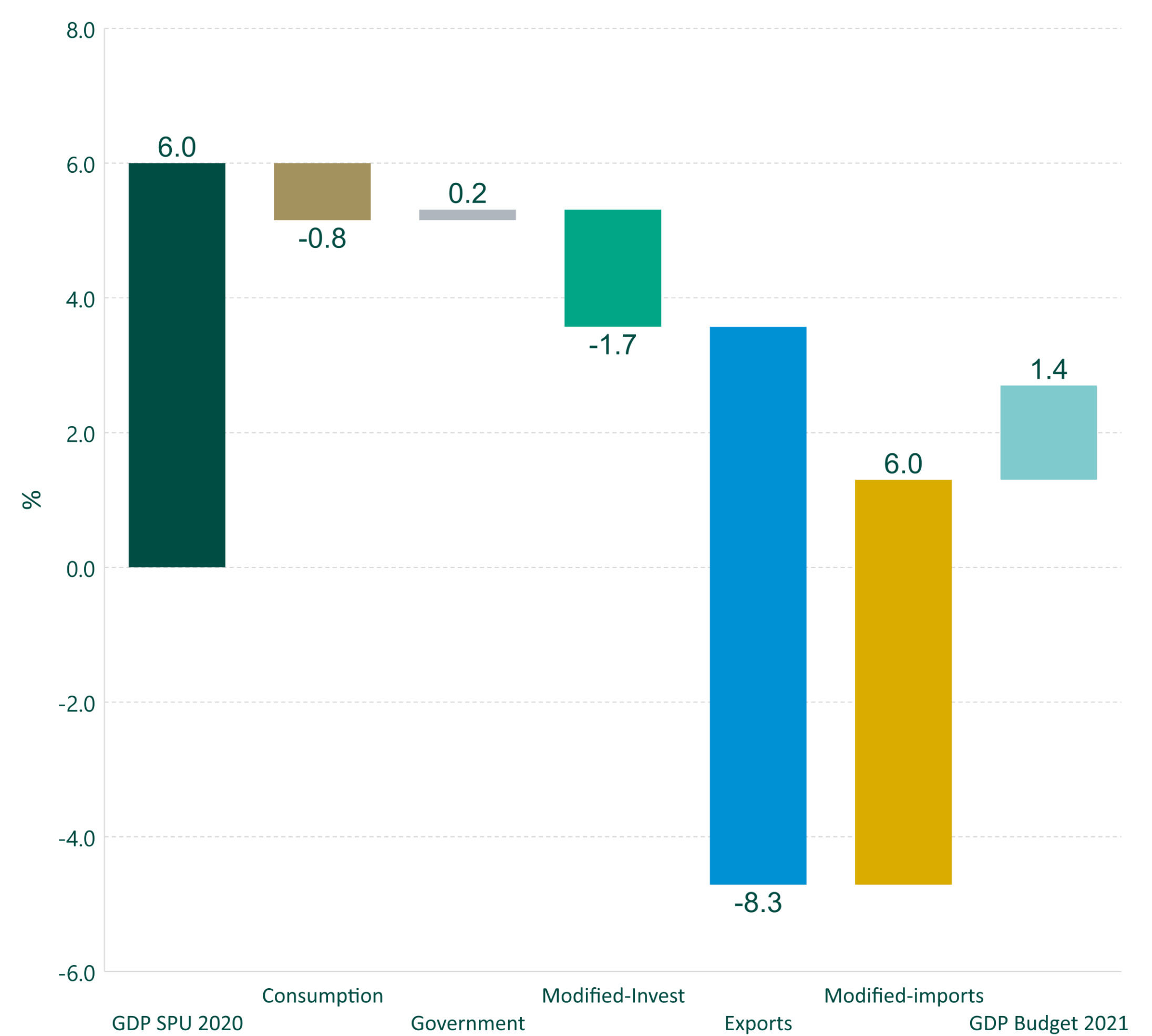
Forecast Changes vs SPU (2020): 2020 & 2021



Contributions to revision – 2020, pp



Contributions to revision – 2021, pp



Risk matrix – balance = tilted to downside



Downside
Second national lock-down
National lockdowns in main trading partners
Premature fiscal tightening in main trading partners
Financial sector becomes “amplifier”
Brexit impact leads to non-linearities
Beyond short-term:
“Scarring” effects [labour market mismatch / productivity]
Legacy effects [debt (public & private) / re-shoring / de-globalisation

Upside
Widespread deployment of vaccine earlier than expected
Significant progress on effective treatments limit mortality rates
Brexit trade agreement concluded (this year or next)
Faster-than-expected recovery in trading partners



Overview of supply-side developments

Possible recovery scenarios [publication (evidence base) = forthcoming]



Baseline:

- No Covid, Brexit 'deal' scenario

Recovery:

- rapid rebound to pre-pandemic level output

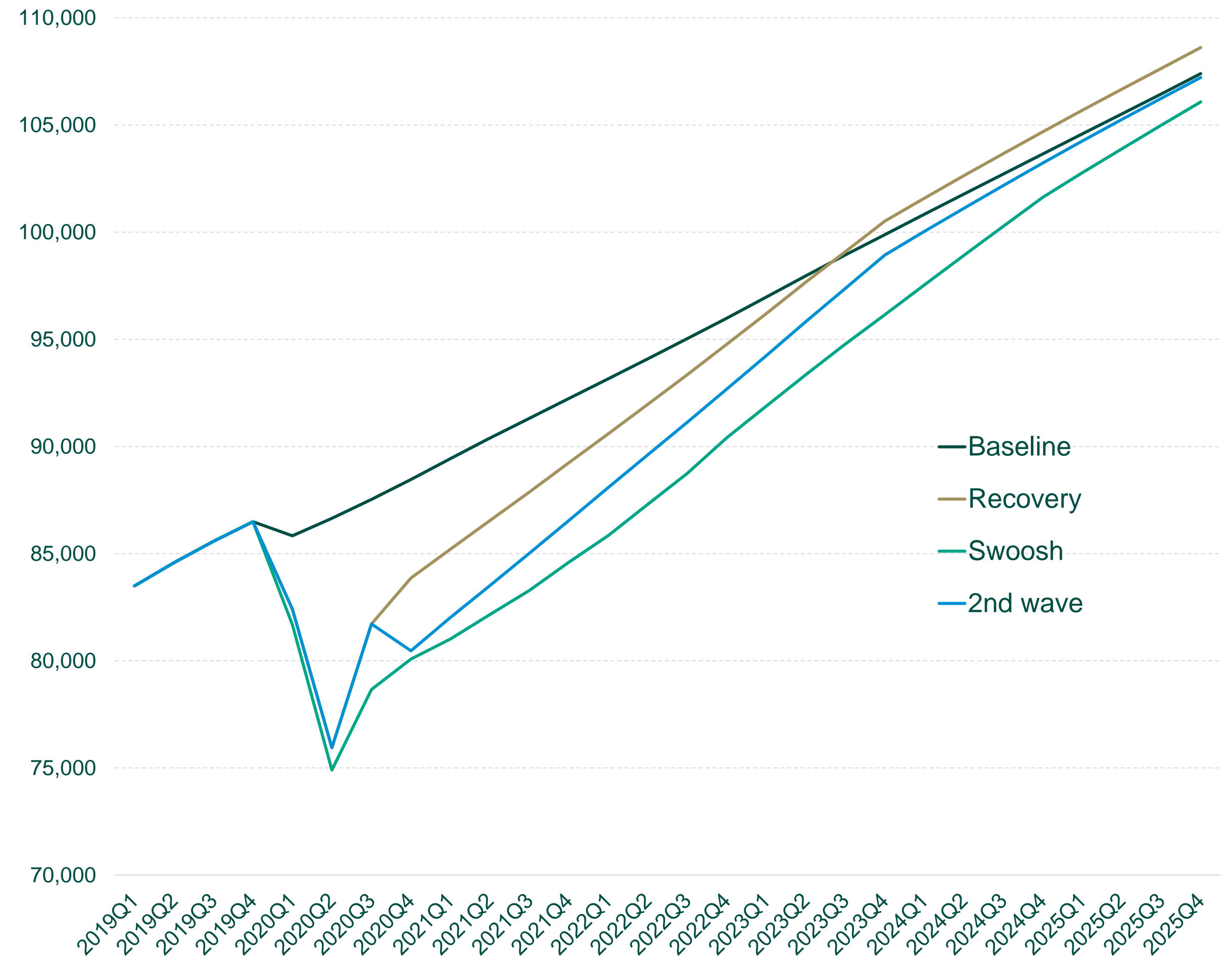
Swoosh:

- slow recovery due to scarring
- more likely the longer it lasts

2nd wave:

- 2nd lockdown
- slow recovery due to precautionary saving etc.

Medium term scenarios for real GDP (€mn)



'Trend' growth post COVID-19 ?



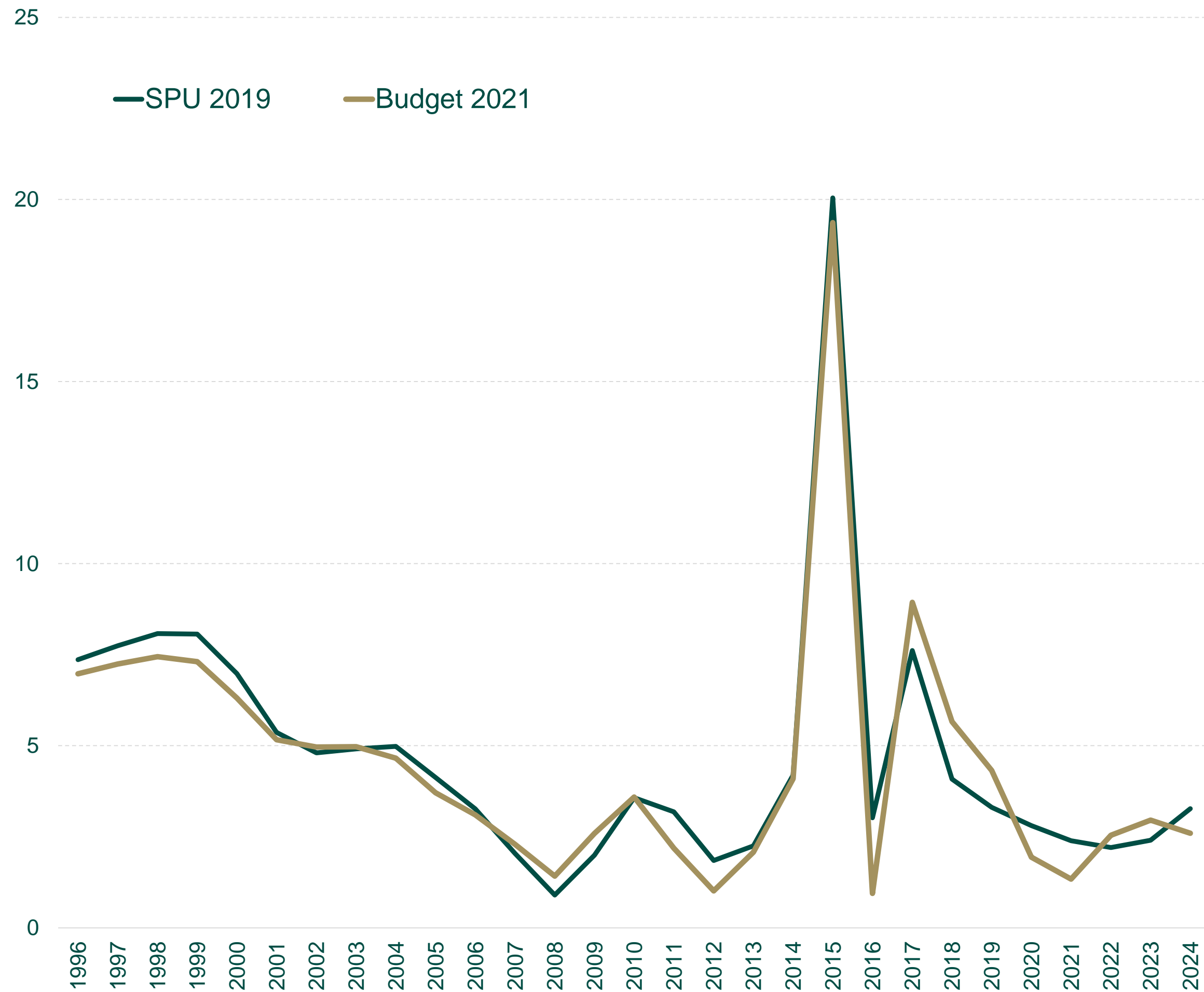
	Transmission channel	Impact on potential output growth
Labour	Migration	-
	Labour Supply	- / +
	Education/Training	- / +
Capital Stock	Investment	- / +
	Social distancing	-
Total Factor Productivity	Within firms	- / +
	Between firms	- / +
	Reallocation of activity	- / +

See also: Mauro, Filippo di, and Chad Syverson. "The COVID Crisis and Productivity Growth." VoxEU.Org (blog), April 16, 2020. <https://voxeu.org/article/covid-crisis-and-productivity-growth>
 Young, Garry. "Covid-19: Deficits, Debt and Fiscal Strategy." Presented at the Institute for Fiscal Studies (IFS) and the National Institute of Economic and Social Research (NIESR) (Webinar), July 1, 2020. <https://www.ifs.org.uk/uploads/Presentations/Covid-19-Deficits-debt-and-fiscal-strategy.pdf>

Alternative output gap measure: GDP, Extended HP



Potential Output



Average of K and L model estimates





Conclusion

Summary



- Economy in finely balanced position
 - shock = disproportionate impact on labour-intensive service sectors
- Labour market has borne the brunt
 - some firms / sectors potentially not viable with social distancing
 - Unemployment rate likely to be 'higher for longer'
- Outlook is for very modest growth
 - Drag on exports from no-deal Brexit
 - MDD recovering slowly
- Risks heavily tilted to downside
 - Vaccine a key unknown
 - Significant discontinuities on downside



Disclaimer and other information:

The forecasts in this presentation are those of the Department of Finance.

Outturn data are sourced from a variety of sources including the Department of Finance, Central Statistics Office, European Commission (AMECO) and Central Bank of Ireland.

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