Irish Economy Update

AIB Treasury Economic Research Unit

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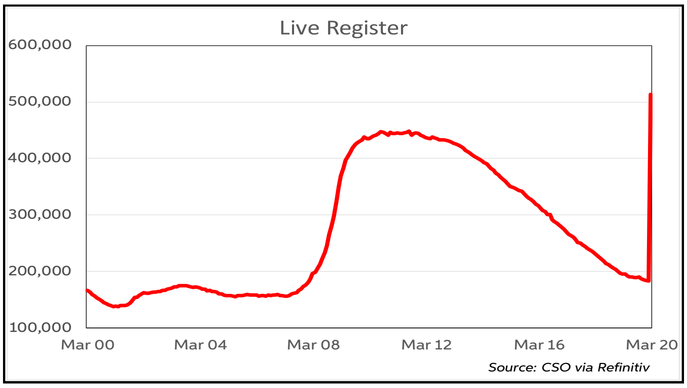
COVID-19 Pandemic to See Very Deep, but Short Recession

It is important at the outset to bear in mind that the Irish economy is facing into this recession from a very strong starting position. The unemployment rate had fallen to below 5%. Meanwhile, the economy had undergone a period of major deleveraging in the private sector, including households, over the past decade. The household debt to disposable income ratio had fallen from a peak of around 210% to below 120%. Meanwhile, from a government finances perspective, the budget deficit had been eliminated at a quicker than expected pace, returning to a surplus in 2018/19, while government debt levels have been brought down. The balance of payments had also returned to significant surplus.

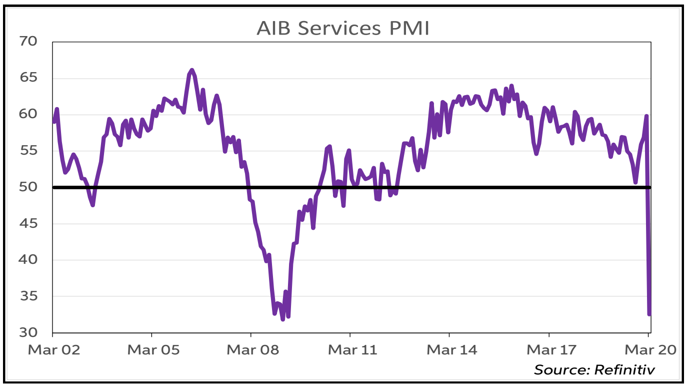
Incoming global macro data starting to show sharp hit to economies

The wave of negative data has started to come through on the drastic impact that the measures to contain the spread of the coronavirus are having on economic activity, both in Ireland and elsewhere. Labour market statistics are giving the clearest indication of the immediate and severe effects of the shutdown on large parts of the world economy. The US has seen jobless claims rise by 10 million in just two weeks.



Irish data also now showing the impact

Ireland saw an increase of 330,000 in jobless numbers to over 500,000 in March. It is estimated that the Irish unemployment rate may have risen from below 5% in February to 17% last month. The latest estimates are that the numbers in receipt of unemployment payments have risen to over 700,000 in early April. Meanwhile, PMIs for the services sector, including in Ireland, have fallen to the troughs seen during the 2008-09 recession in the space of just one month. Indicators such as car sales, which fell by over 60% in year-on-year terms in March, show the sharp fall-off in consumer spending. Other noteworthy data published in Ireland were the Exchequer Returns for March, which showed a big rise in government spending and a decline in tax revenues. As elsewhere, Ireland is heading for a blow-out budget deficit this year.



Unprecedented sharp recession in prospect for the global economy

The recession the world economy is now facing is expected to be the deepest since the Great Depression of the 1930s. Some jaw-dropping forecasts are being published of close to double digit declines in GDP in 2020 for many advanced economies, including Ireland.

This is largely due to a collapse in output levels in the second quarter as a result of the lockdowns to contain the coronavirus. The OECD has estimated that the containment measures could see falls of between 20% and 30% in GDP in the second quarter of the year in most economies. The OECD believes that the impact on the Irish economy may be less severe than elsewhere. Notably, of the almost 50 countries analysed, Ireland had the smallest projected decline in GDP in Q2 at 15%. This reflects the composition of Irish output and exports, which is dominated by large multi-national companies operating in sectors such as pharmaceuticals, ICT and financial services. These are less negatively impacted than other sectors by global downturns.

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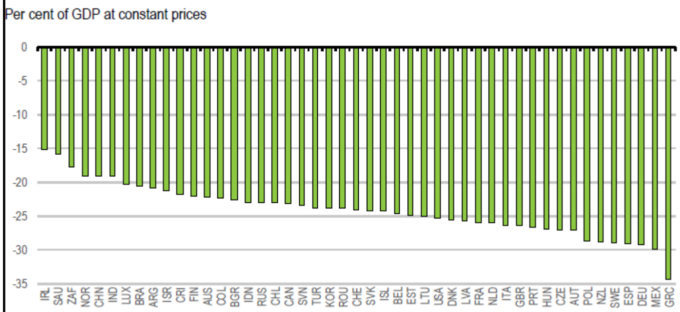
Recession will likely be short-lived

Naturally, there has been a lot of focus on the depth of the recession that economies are now entering. We have not seen this type of recession before. However, it will likely be short lived. The Bank of England at its March policy meeting noted that while the scale of the economic shock will be large and sharp, it should "ultimately prove temporary".

In this regard, there are some signs in a number of European countries that the coronavirus outbreak may be reaching a peak. If the number of cases falls back appreciably, then lockdown measures could start to be eased later this month. Austria and Denmark have already announced plans to start gradually easing restrictions post-Easter, but the process will take a month to six weeks.

The potential initial impact on activity of partial or complete shutdowns on activity in selected advanced and emerging market economies



Note: See notes to Figure 1. The sectoral data are on an ISIC rev. 4 basis in all countries apart from Korea and Brazil, where national data are used. Real estate services excluding imputed rent are assumed to be 40 per cent of total real estate services in countries in which separate data are not available.
Source: OECD Annual National Accounts; OECD Trade in Value-Added database; Statistics Korea; Brazilian Institute of Geography and Statistics; and OECD calculations.

Strong rebound should follow, but may be impediments

There are concerns, though, that once restrictions start to be eased, the pace of recovery could be impeded by scarring effects, such as lingering damage to confidence, lasting negative impacts on businesses, company failures, rising bad debt levels and tighter financial conditions. There is also the risk of a second smaller wave to the virus.

It is expected that supply will rebound quite quickly as restrictions are lifted, allowing business to re-open and people to go back to work. Some business failures are inevitable and it will take a long time to get back to normal in certain sectors such as aviation and tourism.

There is more uncertainty about how quickly and strongly demand will rebound. It certainly will pick up given it has fallen to such a low base at present. Consumers and businesses, though, may be cautious given the hit they are now suffering. It would not be a surprise to see governments come forward with fresh stimulus measures to boost demand once restrictions are lifted.

In a strong opinion piece in the Financial Times, the highly regarded former President of the ECB, Mario Draghi, argued that the challenge for public policy is to act with sufficient speed and strength to prevent the coronavirus recession morphing into a prolonged depression. This means greatly increasing public debt. Mr. Draghi argued the alternative to the state offsetting much of the hit to private demand would be much more damaging to the economy and eventually the public finances. He noted that with interest rates being kept very low, higher public debt levels will not add to servicing costs.

We saw clear evidence of this in Ireland's ability to raise substantial funding at a rate of just 0.25% this week. The NTMA sold €6bn in a new 2027 year bond, but the total order book was over €33bn. This is in marked contrast to the financial crisis over a decade ago, when Ireland was shut out of capital markets and unable to fund, thus requiring an IMF-led bailout. With central banks standing behind sovereign debt markets on this occasion, expansionary fiscal policies are likely to play a keep part in ensuring the recession is followed by a robust recovery in activity, as governments everywhere avail of the option to increase borrowing at low funding costs. Austerity has been confined to the history books.

Even if the recovery in activity in the second half of 2020 is not sufficiently strong to prevent a very sharp fall in GDP for the year as a whole, economies are still expected to grow at very strong rates in 2021. It is striking that those who are forecasting that GDP could decline by circa 8% in advanced economies in 2020 generally see it rebounding by around 8% in 2021. Indeed, most forecasters see growth next year roughly offsetting whatever decline in output they are expecting in 2020.