Box A: Official forecasts of the domestic economy are not consistent with the Government's fiscal plans

The Government's update of its economic projections in the *Summer Economic Statement* (*SES*) published in July was not consistent with its new fiscal plans. Although forecasts of net exports and GDP were updated, the outlook for domestic demand was left unchanged relative to the *Stability Programme Update* forecasts set out in April. This partial update was despite a large budgetary expansion implied by the *SES* plans, and the implications this would have for scarring over the medium term.

Furthermore, a number of available indications of the strength and speed of the recovery in the domestic economy were not factored into the *SES* projections for domestic demand. As noted by the Council in the May 2021 *Fiscal Assessment Report* (Fiscal Council, 2021), upside risks to the domestic economy had already become evident in high-frequency indicators of consumer spending.

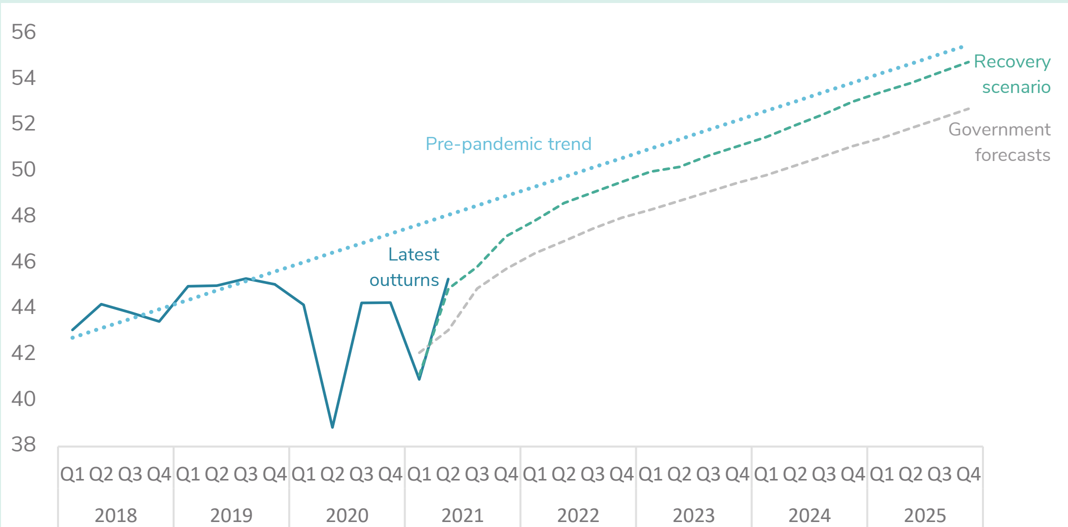
To carry out a meaningful analysis of the fiscal stance over the medium term, this box presents a "Recovery Scenario" for the domestic economy. This forms the basis for a more realistic set of fiscal projections, taking account of the plans for budgetary expansion (see section 3), and a more positive view of most likely path for the economy in the coming years.

Incorporating SES fiscal plans and indications of an ongoing rapid recovery

Figure A1 compares the most recently published official forecasts for the domestic economy with a Recovery Scenario. This scenario takes account of the positive impact on demand of the budgetary expansion set out in the *SES*, and a rapid rebound in activity in Q2 2021.

Figure A1: The domestic economy has rebounded rapidly in 2021

€ billions, underlying domestic demand (seasonally adjusted, 2019 prices)



Sources: CSO, Department of Finance, and Fiscal Council workings.
Notes: Government forecasts are based on the *SPU 2021* quarterly profiles for personal consumption, government consumption, and modified investment (which excludes aircraft for leasing and R&D intellectual property intangibles). The modified investment profile is used as a basis for an underlying investment projection (i.e., investment excluding all aircraft and all intangibles). The series above reflect downward revisions to historical data in *National Income and Expenditure 2020*.

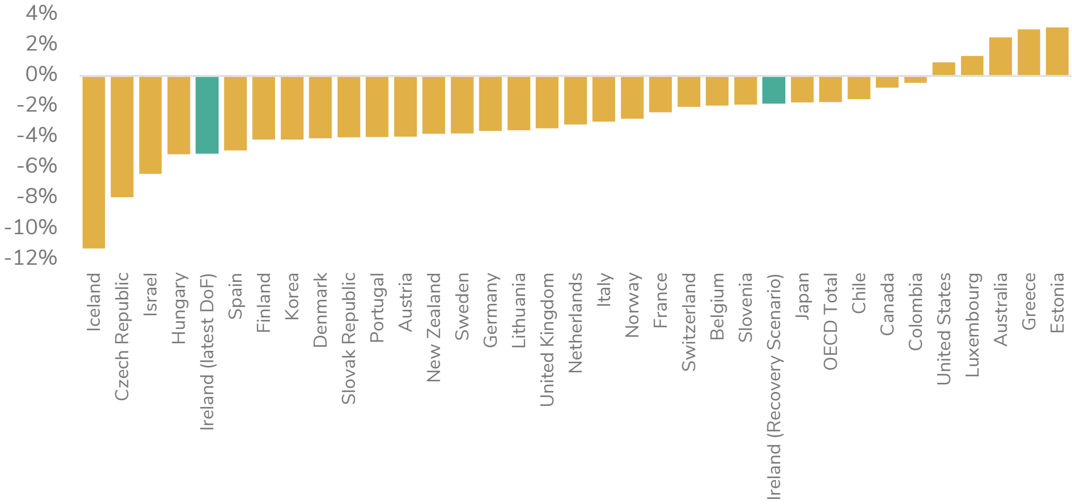
With Covid-related confinement measures easing over the summer period and vaccinations progressing, domestic economic activity has been rebounding quickly. Assuming that 90 per cent of the adult population (16+) are fully vaccinated by end-September, and no reintroduction of confinement measures, it is likely that the economy will continue to recover much of its lost output. Substantial savings have also been accrued by households, which, if spent, could boost the recovery further at least in the short term (as discussed in Box A of the May 2021 *Fiscal Assessment Report*). Furthermore, employee compensation has held up well despite repeat lockdowns, as sectors that were not directly affected by the pandemic have continued to grow.

The "Recovery Scenario" implies less scarring than in official forecasts

Figure A2 shows estimated effects of the pandemic on domestic economies across the OECD by Q4 2022, and compares these with the official and Recovery Scenario forecasts for Ireland's underlying domestic demand. The calculations compare OECD forecasts of final domestic expenditure with a pre-pandemic trend, where 2014–2019 is the sample period. The official forecasts include a demand shortfall of 5.1 per cent by end-2022, and as shown in Figure A1, this gap continues until 2025. For the Recovery Scenario, the implied shortfall by end-2022 is 1.8 per cent, and this reduces over time to 1.5 per cent by 2025.

Figure A2: The "Recovery Scenario" is close to the OECD's overall projection

% difference between volumes of forecast domestic demand and pre-pandemic trends in Q4 2022

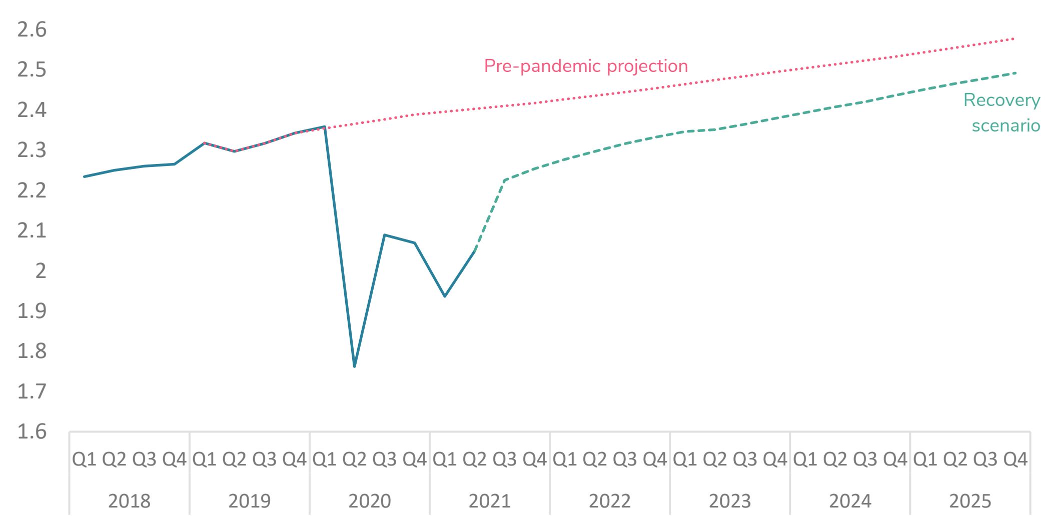


Sources: OECD Economic Outlook (May 2021), Department of Finance, and Fiscal Council workings.
Notes: The OECD forecasts for Q4 2022 are used for all countries except Ireland. The trend is based on a linear trend over Q1 2014 to Q4 2019.

Figure A3 shows seasonally adjusted levels of employment. Official labour market data are adjusted so that those in receipt of the Pandemic Unemployment Payment, but whose labour market status is technically designated as employed, are not included. The Recovery Scenario would point to a significant increase in employment in the second half of this year. Employment would be forecast to exceed its pre-pandemic highs by the middle of 2023, despite some sectors experiencing scarring. By 2025, employment would remain 3.5 per cent lower than a pre-pandemic projection.

Figure A3: Employment could surpass pre-pandemic levels in 2023

Millions, seasonally adjusted



Sources: CSO, and Fiscal Council workings.
Notes: Offical LFS employment figures are adjusted to account for Pandemic Unemployment Payment claimants whose ILO labour market status may be recorded as employed. The pre-pandemic projection is based on the Council's March 2020 "no-pandemic" baseline.