7. IRELAND

The road to recovery is still challenging

Global slowdown hits nascent export-led recovery

The expansion of the Irish economy moderated in the first half of 2012 to 0.5% compared to the same period in 2011, following real GDP growth of 1.4% in 2011. Net exports continued to be the sole growth engine, as all subcategories of domestic demand shrunk on the back of sustained household and public sector deleveraging and weak labour markets. More positively, the orderly adjustment of the Irish economy was recently rewarded with improved market sentiment in the form of declining sovereign-bond yields, which enabled the sovereign to resume debt issuances. On balance, 2012 real GDP growth has thus been marked down only marginally to 0.4%. Weakening trading partner demand is expected to weigh more heavily on the external sector during 2013, which together with lack of support from the domestic economy is forecast to result in a more moderate expansion in 2013, with growth at 1.1%.

Domestic demand remains subdued due to deleveraging and fiscal consolidation

A further contraction across all domestic demand components is envisioned for the rest of 2012. Private consumption and investment are expected to decline at moderating rates in 2013-14, as the debt overhang is being addressed and the outlook for the construction sector remains bleak. While fiscal multipliers are low in the very open Irish economy, the planned continued fiscal consolidation will subtract from GDP growth during the forecast period. Domestic demand is expected to return to positive growth in 2014 after six years, led by the private sector.

External imbalances are falling, though the backdrop has deteriorated

Export growth moderated in the second quarter of 2012 after a relatively strong expansion in the first quarter. Expected surpluses in both the services and goods trade balances by end-2012 are projected to outweigh a likely increase in net factor income outflows, and push up the current-account surplus further to 2.3% of GDP. Competiveness indicators are expected to improve in 2012 and throughout the forecast period, albeit at a more gradual pace than during the first years of the crisis. Export demand is anticipated to be hurt by the worsening euro area and UK outlook in 2013-14 but helped somewhat by the relative resilience of the US economy. The current-account surpluses are therefore forecast to continue growing during the period.

Labour markets remain weak, moderating inflation

The labour market deteriorated further during the first half of 2012, with employment falling by 1.8%, mainly reflecting public sector layoffs and retirements. Due to migration-driven falls in the labour force, the fall in employment did not fully translate into increased unemployment, which increased somewhat compared to the 2011 average to 14.8%. Only small increases in employment are expected in 2013-14 as growth will be driven by the relatively capital-intensive export sector. Unemployment is expected to decrease very gradually and hence be increasingly long-term in nature. HICP inflation surprised on the upside during the first half of 2012 due to relatively strong increases in energy, administered and services prices, and the end-year inflation forecast has been revised upwards to 2%. These effects are expected to peter out and inflation to decline gradually to 1.4% in 2014.

Broadly balanced macroeconomic risks

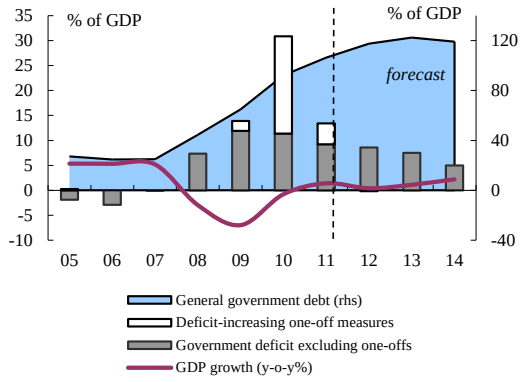
Downside risks stem from the uncertain external outlook, especially trading partner demand, although the Irish export sector decoupled successfully during the first years of the crisis. Expiring patents could however reduce growth in chemical exports. There are downside risks to private consumption from further falls in real estate prices, but also upside ones given substantial pent-up demand if precautionary savings decline and financing conditions ease, facilitating balance sheet repair and credit flows.

Fiscal pressures increase

The general government deficit-to-GDP ratio stood at 13.4% in 2011 (including 4.3% of GDP of one-off banking support measures). The 2012 fiscal deficit is now estimated at 8.4% of GDP. Central government cash data through September shows strong tax revenue performance offsetting some

expenditure overruns, mainly in social and health services. While renewed effort and additional measures should contain the slippages in the health sector, some overruns in unemployment benefits and social contributions would persist.

Graph II.7.1: **Ireland - General government debt and deficit, one-offs and GDP growth**



The general government deficit is projected to be 7.5% of GDP in 2013 and 5% in 2014. This forecast includes the planned fiscal adjustment of 3.9% of GDP over the two years, of which one-third is on revenue side and two-thirds on expenditure. Moreover, the 2012 expenditure overruns in health sector (0.3% of GDP) will be fully corrected by structural measures. The structural balance adjustment is lower than the nominal adjustment, due to low potential growth as the economy undergoes structural changes. Lower real economic growth weakens the fiscal position, though this is somewhat offset by more favourable price developments.

The government debt-to-GDP ratio increased from 25% in 2007 to 106% in 2011, and is seen peaking at around 122% in 2013 before declining. The still high deficit and changes to the level of government cash balances are key inputs to the gross debt trajectory and its eventual peak. [24] Under the baseline, the currently high precautionary cash balances of 11% of GDP at end-2012 and end-2013 are projected to decline to 6% at end-2014.

[24] In 2012, one-off financial investments in the financial sector contribute to increase in the debt (1% of GDP).

Table II.7.1:

Main features of country forecast - IRELAND

	2011			Annual percentage change						
	bn EUR	Curr. prices	% GDP	92-08	2009	2010	2011	2012	2013	2014
GDP		159.0	100.0	6.2	-5.5	-0.8	1.4	**0.4**	**1.1**	**2.2**
Private consumption		77.5	48.7	5.4	-5.7	0.5	-2.3	**-2.1**	**-0.5**	**1.2**
Public consumption		29.2	18.4	4.6	-3.7	-4.6	-4.3	**-4.0**	**-1.7**	**-3.0**
Gross fixed capital formation		16.1	10.1	6.7	-27.7	-22.7	-12.2	**-4.0**	**-1.5**	**3.0**
of which : equipment		5.9	3.7	7.6	-18.8	-10.6	-10.5	**2.8**	**4.8**	**5.0**
Exports (goods and services)		166.8	104.9	10.8	-3.8	6.2	5.1	**2.8**	**3.2**	**4.2**
Imports (goods and services)		131.9	82.9	10.1	-9.7	3.6	-0.3	**0.3**	**2.0**	**3.2**
GNI (GDP deflator)		128.3	80.7	5.8	-9.1	0.0	-2.4	**-2.4**	**0.3**	**2.1**
Contribution to GDP growth :		Domestic demand		4.8	-9.7	-4.3	-3.4	**-2.2**	**-0.7**	**0.3**
		Inventories		0.0	-0.6	0.6	0.4	**0.0**	**0.0**	**0.0**
		Net exports		1.7	4.1	2.9	5.4	**2.6**	**1.8**	**1.9**
Employment				3.5	-8.1	-4.2	-2.1	**-1.2**	**0.0**	**0.9**
Unemployment rate (a)				7.9	11.9	13.7	14.4	**14.8**	**14.7**	**14.2**
Compensation of employees/head				5.3	-0.9	-3.1	0.2	**0.7**	**0.0**	**0.1**
Unit labour costs whole economy				2.6	-3.7	-6.5	-3.2	**-0.9**	**-1.0**	**-1.1**
Real unit labour costs				-0.4	1.0	-4.3	-3.4	**-2.5**	**-2.3**	**-2.5**
Saving rate of households (b)				-	14.7	13.4	14.1	**17.2**	**16.7**	**16.0**
GDP deflator				3.0	-4.6	-2.2	0.2	**1.7**	**1.3**	**1.4**
Harmonised index of consumer prices				-	-1.7	-1.6	1.2	**2.0**	**1.3**	**1.4**
Terms of trade of goods				-0.2	6.3	-3.6	-5.1	**0.0**	**0.0**	**-0.1**
Merchandise trade balance (c)				19.3	20.1	22.8	23.0	**23.8**	**24.7**	**25.3**
Current-account balance (c)				-0.1	-2.3	1.1	1.1	**2.3**	**3.4**	**4.4**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				0.5	-3.1	0.7	1.0	**2.1**	**3.3**	**4.3**
General government balance (c)				0.1	-13.9	-30.9	-13.4	**-8.4**	**-7.5**	**-5.0**
Cyclically-adjusted budget balance (c)				-0.3	-12.1	-28.9	-12.1	**-7.7**	**-7.3**	**-5.3**
Structural budget balance (c)				-	-10.1	-9.4	-7.9	**-7.9**	**-7.5**	**-5.3**
General government gross debt (c)				51.2	64.9	92.2	106.4	**117.6**	**122.5**	**119.2**

(a) Eurostat definition. (b) gross saving divided by gross disposable income. (c) as a percentage of GDP.