7. IRELAND

Completing the two-thirds of its adjustment programme with encouraging economic performance

2012 GDP growth slightly above expectations

Real GDP grew by 0.9% in 2012, somewhat higher than the 2013 winter forecast of 0.7%. The positive performance resulted from expected developments in domestic demand. Private consumption fell by 0.9% in annual terms, almost a full percentage point less than expected, on the back of modest but positive annual growth in the second half of 2012. Gross fixed capital formation expanded by 1.1% after contracting by double-digit figures for four consecutive years. While it was mainly driven by investment in aircrafts, other investment categories also appeared to have bottomed out. Nominal GDP grew by 2.9% in 2012, supported by favourable terms of trade developments, while inflation pressures have continued to abate.

Industrial production grew steadily during the three months to February 2013 compared to a year earlier, driven by partial reversals of the weak performance of high-tech and chemical companies seen during the second half of 2012. At the same time, the most recent survey indicators such as manufacturing and services PMIs suggest that a more subdued performance can be expected going forward. Retail sales, services indices and housing market indicators have also been relatively weak with small but negative annual growth rates in the beginning of 2013. While unemployment fell to 14.0% in February according to the monthly Live Register, the trend continues to be driven more by a shrinking labour force than by major employment creation.

External performance strong in 2012

The current-account surplus surged to 4.9% of GDP in 2012, reflecting not only the contraction in domestic demand, but also the competitiveness gains achieved through increased productivity, inflation below the euro-area average, and cost-cutting measures including on wages. Persistent weakness in trading partner demand is nevertheless affecting demand for merchandise exports, which contracted on a quarterly basis in the last two quarters of 2012, also on account of the anticipated expiration of pharmaceutical patents. The rise in services exports, which have expanded by around 10% in annual terms every quarter since the second half of 2010, has however substituted for weak goods export developments.

Positive financial market sentiment

Strong investor interest has resulted in declining yields on Irish sovereign bonds, both in primary and secondary markets, as especially evident from the widely oversubscribed mid-March issuance of a new 10-year benchmark bond, the first since the start of the economic adjustment programme. Banks have continued to access market funding on attractive terms, which together with continued deposit inflows and progress with deleveraging, has led to the lowest level of Eurosystem funding since the beginning of the programme. Despite these improvements in banks' funding, extension of credit to the domestic economy remains weak, implying continuously weak demand for credit.

Growth outlook stable but more broad-based

The forecasts for real GDP growth in 2013-14 are left unchanged compared to the 2013 winter forecast, albeit with slightly different compositions. Given the more favourable outturns in 2012, the negative contribution of domestic demand in 2013 is expected to be smaller, with nearly flat growth in private consumption and positive investment growth. Downgrades of trading partner demand compared to the time of the winter forecast is projected to constitute a drag on goods exports in particular and result in a somewhat smaller external surplus throughout the forecast horizon. Unemployment is set to be lower than in earlier projections, but mainly on account of stronger-than-expected emigration flows. Risks around the baseline scenario are broadly balanced, with faster-than-expected financial sector repair posing an upside risk to private consumption through working off the debt overhang, while more-adverse-than-projected trading partner demand developments or spillovers from vulnerable euro-area countries could subtract from growth.

Tight 2013 fiscal position set to improve in 2014

The fiscal deficit stood at 7.6% of GDP in 2012 and is projected at 7.5% in 2013.[19] The significant fiscal adjustment effort of 2.5% of GDP budgeted in 2013 is projected to deliver only a

[19] The deficit forecast is net of one-off financial sector support measures, as such measures are excluded from the EDP deficit ceilings for Ireland.

muted improvement in the EDP deficit due to increasing debt-servicing costs and the effects of some one-off operations. A step increase in the interest expenditure by 1.3 pps. of GDP reflects the end of the grace period for interest payments on the promissory notes and continued accumulation of debt. The primary balance is expected to improve at a more moderate pace on the back of one-off revenues in 2012 from the sale of mobile phone licenses (0.4% of GDP), a drop in revenues from Eligible Liabilities Guarantee (ELG) after the discontinuation of the scheme in March 2013 (0.4%) and one-off ELG claim payments to the covered creditors of Irish Bank Resolution Corporation (IBRC) (0.6%).[20] The upward revision in the 2013 deficit by 0.2% of GDP as compared to the 2013 winter forecast reflects lower base-effect from the December 2012 tax revenue surprise and higher one-off costs linked to the IBRC liquidation than previously estimated. The fiscal performance in the first quarter of 2013was broadly in line with plans and the same is expected for the year as a whole. However, risks to the 2013 budget includes (i) possibly higher one-off cost of IBRC liquidation, (ii) the payment of Allied Irish Banks (AIB) dividends on preference shares held by the government via the issuance of ordinary shares may be reclassified as deficit-increasing transfers as was the case in 2012 (0.2% of GDP) and (iii) the planned wage bill savings of 0.2% of GDP still need to be effectively implemented after the rejection of the initial agreement by the public service unions. In 2014, the EDP deficit is projected to decline to 4.3% of GDP, driven by (i) the fiscal adjustment measures of 1.4% of GDP to be detailed in the 2014 budget in October and (ii) an ongoing expenditure freeze. Moreover, the full positive effect of the promissory note exchange will be realised once the IBRC-liquidation-related transaction costs are settled later in 2013. The government debt-to-GDP ratio increased from 106% in 2011 to 118% in 2012. The increase in debt is driven by a still high fiscal deficit, sizeable financial transfers and an accumulation of precautionary cash balances, which stood at around 12% of GDP at end-2012. The debt is projected to peak at 123% of GDP in 2013 and to decline thereafter as primary surpluses are achieved and economic growth picks up.

[20] Eurostat is examining the statistical treatment of the liquidation of IBRC and the restructuring of the promissory notes and their impact on the government deficit and debt.

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	**0.9**	**1.1**	**2.2**
Private consumption		77.5	48.7	5.3	-5.7	0.5	-2.3	**-0.9**	**-0.1**	**1.2**
Public consumption		29.2	18.4	4.6	-3.7	-4.6	-4.3	**-3.4**	**-2.5**	**-2.8**
Gross fixed capital formation		16.1	10.1	6.7	-27.7	-22.7	-12.2	**0.9**	**0.9**	**2.8**
of which : equipment		5.9	3.7	7.6	-18.8	-10.6	-10.5	**7.6**	**4.8**	**5.0**
Exports (goods and services)		166.8	104.9	10.8	-3.8	6.2	5.1	**2.9**	**2.7**	**3.7**
Imports (goods and services)		131.9	82.9	10.1	-9.7	3.6	-0.3	**0.3**	**1.8**	**2.7**
GNI (GDP deflator)		128.3	80.7	5.8	-9.1	0.0	-2.4	**2.9**	**-3.0**	**2.1**
Contribution to GDP growth :		Domestic demand		4.8	-9.7	-4.3	-3.4	**-1.0**	**-0.4**	**0.4**
		Inventories		0.0	-0.7	0.6	0.4	**-0.2**	**0.0**	**0.0**
		Net exports		1.7	4.1	2.9	5.4	**2.8**	**1.5**	**1.8**
Employment				3.6	-7.8	-4.1	-1.8	**-0.6**	**0.1**	**0.9**
Unemployment rate (a)				7.9	12.0	13.9	14.7	**14.7**	**14.2**	**13.7**
Compensation of employees/head				5.2	-1.3	-3.2	-0.2	**1.8**	**0.3**	**0.2**
Unit labour costs whole economy				2.6	-3.8	-6.4	-3.3	**0.2**	**-0.6**	**-1.0**
Real unit labour costs				-0.5	0.9	-4.3	-3.5	**-1.7**	**-1.8**	**-2.4**
Saving rate of households (b)				-	14.9	12.0	10.7	**16.6**	**10.2**	**9.7**
GDP deflator				3.0	-4.6	-2.2	0.2	**1.9**	**1.2**	**1.4**
Harmonised index of consumer prices				-	-1.7	-1.6	1.2	**1.9**	**1.3**	**1.3**
Terms of trade of goods				-0.2	6.3	-3.6	-5.1	**-1.6**	**-0.1**	**-0.1**
Merchandise trade balance (c)				19.3	20.1	22.8	23.0	**22.2**	**22.9**	**23.4**
Current-account balance (c)				-0.1	-2.3	1.1	1.1	**5.0**	**3.1**	**4.0**
Net lending(+) or borrowing(-) vis-à-vis ROW (c)				0.5	-3.1	0.7	1.0	**3.7**	**1.8**	**3.5**
General government balance (c)				0.0	-13.9	-30.8	-13.4	**-7.6**	**-7.5**	**-4.3**
Cyclically-adjusted budget balance (c)				-0.4	-11.8	-28.6	-11.9	**-7.0**	**-7.3**	**-4.8**
Structural budget balance (c)				-	-9.8	-9.1	-7.7	**-7.4**	**-6.9**	**-4.8**
General government gross debt (c)				51.2	64.8	92.1	106.4	**117.6**	**123.3**	**119.5**

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