

7. IRELAND

Strong budgetary deterioration hampers adjustment

The economy entered recession in 2008

After having enjoyed well over a decade of strong growth, Ireland has been particularly hard hit by the current crisis and faces significant adjustment challenges. The sharp adjustment in the housing market from its 2006 peak spread to the wider economy and has been amplified by the financial crisis (the weight of the financial services sector is high) and by the recession in Ireland's main trading partners (euro area, US and UK). The Irish economy entered into recession in the first half of 2008 and with a sharp fall in the fourth quarter, when seasonally-adjusted GDP contracted by 7.1% q-o-q, the loss in output for the year as a whole amounted to 2.3% according to preliminary estimates. Domestic demand is estimated to have contracted by 5½% in 2008, mainly driven by a substantial broad-based reduction in investment. The 27% decline in housing investment was accompanied by a slightly smaller cut in equipment investment as capacity utilisation diminished and business sentiment deteriorated. Decelerating disposable income growth, also reflecting job losses, and an increase in precautionary saving led to a decline in private consumption. On the back of declining imports, the external sector is estimated to have made a significant positive contribution to growth despite slightly declining exports of goods and services.

Recession to deepen in 2009-2010

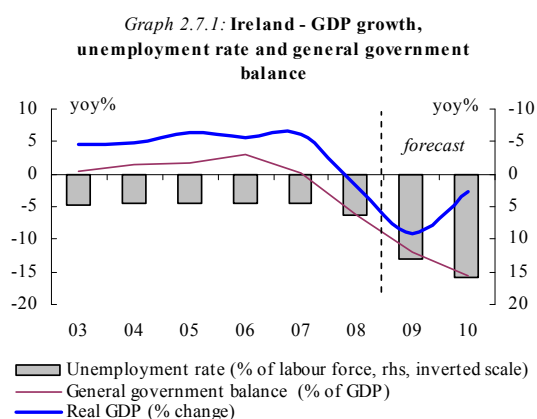
Ireland is facing a protracted and deep recession, with GDP projected to contract further, by around 9% in 2009 and 2½% in 2010. Some stabilisation could set in towards the end of the forecast

horizon. Domestic demand should continue to be the main driver of the recessionary developments. In particular, an even stronger fall than in 2008 is projected for all investment components in 2009, with annual housing output almost halving. A further, albeit less pronounced, reduction in investment is expected in 2010 as market confidence stabilises. At the same time, despite the projected decrease in the price level, private consumption is expected to fall significantly and continue to decline in 2010, in the face of reduced disposable income and higher savings devoted to improving balance sheets. In 2009, general government consumption is also expected to decline as a result of consolidation measures.

The projected marked decrease in real exports in 2009 should - in conjunction with reduced domestic demand - translate into even weaker import developments, implying a positive contribution of the external sector to growth. In 2010, when exports stabilise at a marginally negative growth rate, with imports slightly weaker, a positive contribution is also expected.

Unemployment to more than double, downward pressure on prices

While the pace of job losses was still moderate in 2008 in almost all sectors except construction, all segments of the labour market are expected to be increasingly affected in 2009, with a projected overall decline in employment of around 9%. The effect of these job losses on unemployment is expected to be somewhat mitigated by a decline in the labour force, especially with prospects of outward migration and economic immigrants leaving Ireland. Nevertheless, a steep rise in the unemployment rate, to over 13% in 2009 and close to 16% in 2010, is expected. Pay-related savings measures in the public sector, as well as downward wage flexibility in the private sector in the current circumstances, suggest a broad-based decline in wages in 2009. Together with the projected slight increase in productivity, this should lead to a decrease in unit labour costs thus starting to reverse the deterioration in Ireland's competitive position since the beginning of the decade. Low economic activity and further employment losses should imply a further decline in average wages in 2010. The ongoing adjustment would also contribute to an improvement in Ireland's external



balance, which deteriorated over the last years as growth became increasingly driven by domestic demand.

Inflation is set to fall strongly compared with last year. In 2008, substantial increases in energy and food prices, as well as high services inflation, contributed to an HICP inflation rate of just above 3%, despite a marked deceleration in the second half of the year. This year, a strong dampening effect of the recession, as well as negative base effects regarding energy prices in particular, is expected to produce negative inflation for the year as a whole despite indirect tax increases in the budget for 2009. Inflation should return to a low positive rate in 2010.

Double-digit deficits and steep increase in the debt ratio

The general government deficit is estimated to have reached 7.1% of GDP in 2008, after a slight surplus of 0.2% in 2007. This was mainly due to the massive impact on revenues of the ongoing housing market correction and the wider recession. Spending was also somewhat higher than targeted although some savings were made in mid-year.

In 2009, the deficit is projected to widen further to

12% of GDP (target: 10¼%), the highest in the euro area, despite successive consolidation efforts since mid-2008, including the supplementary budget in early April 2009. In spite of tax-raising measures, current revenue is expected to decrease by over 12%, reflecting the further adjustment in the housing market and the continued fall in economic activity. The projected rise in current expenditure of almost 6% is largely driven by a steep increase in social spending in response to the rapid rise in unemployment, and by sharply rising debt service costs. In 2010, the deficit should widen to 15½% of GDP on a no-policy-change basis.

From only 25% of GDP in 2007, the debt ratio should triple over the forecast horizon. This is due to the large primary deficits as well as increasing interest expenditure and falling nominal GDP. No impact on the public finances of the September 2008 bank guarantees (none called on to date) is included, while the February 2009 bank recapitalisations are assumed to be fully financed from existing resources. Nor do the projections reflect any impact of the National Asset Management Agency, which is to be set up shortly to deal with banks' impaired assets.

Table 2.7.1:

Main features of country forecast - IRELAND

	2007		Annual percentage change							
	bn Euro	Curr. prices	% GDP	92-04	2005	2006	2007	2008	2009	2010
GDP at previous year prices	190.6	100.0	7.0	6.4	5.7	6.0	-2.3	-9.0	-2.6	
Private consumption	88.1	46.2	5.3	7.2	7.0	6.0	-0.8	-7.9	-4.0	
Public consumption	30.5	16.0	4.9	3.1	5.3	6.8	2.1	-0.6	2.0	
Gross fixed capital formation	50.1	26.3	8.1	14.1	4.0	1.3	-19.9	-29.2	-15.6	
of which : equipment	10.1	5.3	8.2	21.7	-4.5	14.1	-20.0	-20.0	-5.0	
Exports (goods and services)	151.4	79.4	12.8	5.2	5.7	6.8	-0.4	-8.9	-0.2	
Imports (goods and services)	131.0	68.7	11.7	8.2	6.3	4.1	-4.4	-12.5	-2.5	
GNI at previous year prices (GDP deflator)	162.1	85.1	6.4	6.5	6.9	4.0	-2.6	-10.0	-3.1	
Contribution to GDP growth :										
Domestic demand			4.9	7.2	5.0	4.1	-5.3	-10.1	-4.1	
Stockbuilding			0.0	0.2	0.4	-0.8	0.3	-0.3	0.0	
Foreign balance			2.2	-1.2	0.3	2.6	2.7	1.4	1.5	
Employment			3.6	4.7	4.3	3.6	-0.9	-9.0	-4.0	
Unemployment rate (a)			8.8	4.4	4.5	4.6	6.3	13.3	16.0	
Compensation of employees/head			5.3	6.4	4.6	6.0	5.5	-4.1	-2.4	
Unit labour costs whole economy			1.9	4.7	3.2	3.6	7.0	-4.0	-3.9	
Real unit labour costs			-1.8	2.3	-0.2	2.2	7.3	-2.9	-3.6	
Savings rate of households (b)			-	-	10.3	11.5	14.8	17.9	18.2	
GDP deflator			3.8	2.3	3.4	1.4	-0.3	-1.2	-0.3	
Harmonised index of consumer prices			-	2.2	2.7	2.9	3.1	-1.3	0.4	
Terms of trade of goods			-0.5	0.0	-3.7	-4.9	-5.2	3.8	-1.9	
Trade balance (c)			20.9	17.4	14.1	11.8	14.1	17.9	18.8	
Current account balance (c)			1.3	-3.1	-3.5	-5.4	-4.6	-1.8	-0.4	
Net lending(+) or borrowing(-) vis-à-vis ROW (c)			2.2	-2.9	-3.4	-5.3	-4.5	-1.8	-0.4	
General government balance (c)			0.4	1.7	3.0	0.2	-7.1	-12.0	-15.6	
Cyclically-adjusted budget balance (c)			0.4	0.9	1.9	-1.8	-7.5	-9.2	-12.2	
Structural budget balance (c)			-	1.2	1.9	-1.8	-7.5	-9.8	-12.2	
General government gross debt (c)			58.4	27.5	24.9	25.0	43.2	61.2	79.7	

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