

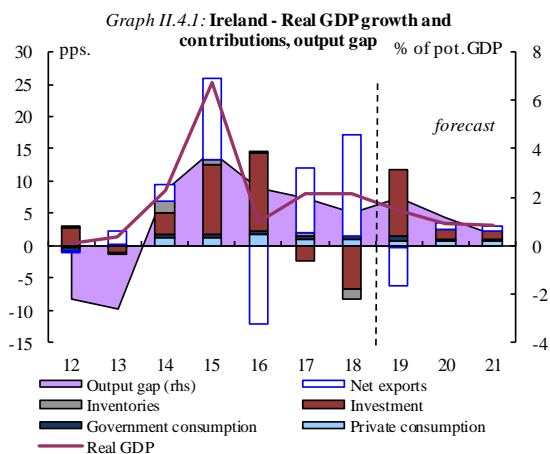
4. IRELAND

Solid growth subject to substantial uncertainty

GDP growth is set to moderate amid a weakening external environment, while underlying economic activity is expected to remain robust, driven by household consumption and investment in construction. Inflation is expected to remain moderate. The government balance is projected to further improve, but risks to the fiscal outlook remain.

Domestic activity is moderating but remains robust

Real GDP in Ireland grew by 6.6% year-on-year (y-o-y) in the first half of 2019, well above the euro area average. GDP growth is expected to reach 5.6% in 2019 and to moderate to 3.5% in 2020 and 3.2% in 2021, on the back of increasing capacity constraints and an expected slowdown in government expenditure.



Consumption and investment in construction support domestic activity

GDP figures remain distorted by the activities of multinational companies operating in Ireland. *Modified domestic demand*, a measure of domestic activity that strips out some of the effects of multinationals, grew by 2.3% y-o-y in the first half of 2019, supported by robust, albeit moderating, private consumption and construction investment. Modified domestic demand is projected to grow over 3% on average over the forecast horizon.

In the first half of 2019, employment grew by 2.8% y-o-y and the unemployment rate declined to 5.2%, a level last seen in 2007, suggesting a labour market close to full employment. Although skills and labour shortages are building up, high net inward migration should continue to alleviate Ireland's labour supply constraints. Employment is

expected to continue expanding over the forecast horizon, albeit at a moderating pace, in line with the projected slowdown in activity. Average hourly earnings grew by 3.4% y-o-y in the first half of 2019. Wage growth is expected to strengthen further, supporting household disposable income.

Ireland's trade and investment figures were heavily influenced by the activity of multinationals in the first half of 2019. Investment sharply increased, bolstered by investment in intellectual property. As this investment component is entirely imported, the surge in investment was matched by a rise in service imports. These two effects largely offset each other and have an overall neutral first-round impact on GDP. Domestic investment, by contrast, decreased by 0.6% y-o-y in the first half of 2019. While external uncertainty weighed on investment in machinery and equipment, investment in construction increased by 8.2% y-o-y. It is expected to moderate but remain robust, as housing supply is still catching up with demand.

Low inflation supports disposable income

Average HICP inflation hit 0.9% in the first three quarters of 2019 and is forecast to remain moderate. Rents and restaurant service prices are expected to sustain services price inflation, while the downward trend in industrial goods prices is expected to lower price pressures along the supply chain. In 2020 and 2021, inflation is projected to rise slightly, as wage pressures build up in a tight labour market.

Trade developments are less favourable

In the first half of 2019, exports increased by 12.5% y-o-y, supported by pharmaceuticals and computer services, while imports surged by 38.7%, bolstered by imports of R&D services. As the high share of pharmaceuticals and ICT services makes Ireland's exports particularly competitive and less sensitive to changes in overall global demand, export growth is projected to remain robust, though lower than in 2019.

The economic outlook remains clouded by uncertainty

Uncertainty mainly relates to the terms of the UK's withdrawal from the EU and to changes in the international taxation environment. More generally, the difficult-to-predict activities of multinationals could drive headline growth in either direction. On the domestic side, the tight labour market and diminishing spare capacity point to an economy possibly operating above its potential. Against this background, signs of overheating could become more apparent if adverse external shocks do not materialise.

Buoyant tax revenue continues to support public finances

The headline government balance is projected to increase to 0.2% of GDP in 2019. In the first three quarters of 2019, growth in total expenditure was broadly matched by a strong increase in revenue. This translated into a mild surplus of the cash balance, compared with a deficit in the same period of last year. Tax revenue increased by 8.7% y-o-y in the year to date, driven largely by buoyant corporate tax receipts.

Ireland's 2020 Draft Budgetary Plan includes new spending measures of around 0.3% of GDP.⁽¹⁰⁸⁾ They are partially financed by revenue raising measures of around 0.1% of GDP. Including the pre-committed expenditure increases, the balance is expected to improve in 2020 to 0.3% of GDP and, based on a no-policy-change assumption, register a surplus of 0.6% of GDP in 2021. Risks to the fiscal outlook remain skewed to the downside, mainly reflecting the uncertainty surrounding the economic outlook, the ongoing international discussions about reforms to the global tax system and the sustainability of corporate tax revenue.

The structural deficit is expected to deteriorate in 2019 to about ¾% of GDP before improving in 2020 and turning into a surplus in 2021. The general government debt ratio is projected to decline to 59.0% of GDP in 2019 and to fall further to 53.9% and 52.6% of GDP in 2020 and 2021, respectively. This is contingent on continued stable medium-term economic growth and positive primary balances.

⁽¹⁰⁸⁾ This amount excludes the contingency provisions (amounting to 0.35% of GDP) for measures that will be defined only if the UK leaves the EU without a deal.

Table II.4.1:

Main features of country forecast - IRELAND

	2018			Annual percentage change						
	bn EUR	Curr. prices	% GDP	00-15	2016	2017	2018	2019	2020	2021
GDP	324.0	100.0		4.4	3.7	8.1	8.2	5.6	3.5	3.2
Private Consumption	100.5	31.0		2.7	5.4	3.1	3.4	2.7	2.5	2.4
Public Consumption	38.6	11.9		2.5	3.4	3.5	4.4	6.2	3.0	2.2
Gross fixed capital formation	75.8	23.4		5.0	50.6	-6.7	-21.1	44.3	4.5	3.9
of which: equipment	24.5	7.6		5.0	25.1	-11.2	39.4	-0.1	3.7	3.2
Exports (goods and services)	396.4	122.3		7.9	4.1	9.2	10.4	11.4	4.1	4.1
Imports (goods and services)	289.0	89.2		6.9	18.4	1.1	-2.9	22.3	4.2	4.1
GNI (GDP deflator)	254.3	78.5		3.6	10.0	5.3	6.9	3.5	5.0	4.6
Contribution to GDP growth:										
Domestic demand				2.9	14.4	-0.9	-5.0	11.9	2.6	2.3
Inventories				0.2	0.3	0.4	-1.6	-0.4	0.0	0.0
Net exports				2.1	-12.1	10.0	15.4	-5.9	0.9	0.9
Employment				1.3	3.7	3.0	3.2	2.4	1.7	1.4
Unemployment rate (a)				8.6	8.4	6.7	5.8	5.2	5.0	5.0
Compensation of employees / head				3.2	2.2	2.5	2.1	3.5	3.7	3.8
Unit labour costs whole economy				0.1	2.2	-2.3	-2.6	0.4	1.8	2.0
Real unit labour cost				-1.9	2.5	-3.4	-3.4	-0.4	0.4	0.4
Saving rate of households (b)				8.5	8.2	10.8	9.0	9.4	9.2	9.2
GDP deflator				2.2	-0.3	1.1	0.8	0.8	1.5	1.5
Harmonised index of consumer prices				2.0	-0.2	0.3	0.7	0.8	1.1	1.4
Terms of trade goods				0.0	2.7	-4.2	-6.1	-3.4	-1.3	-1.3
Trade balance (goods) (c)				22.8	39.0	36.7	34.9	34.1	32.7	31.5
Current-account balance (c)				-1.5	-4.2	0.5	10.6	0.8	1.3	1.7
Net lending (+) or borrowing (-) vis-a-vis ROW (c)				-1.6	-5.8	-8.2	-5.8	-14.6	-13.4	-12.2
General government balance (c)				-4.6	-0.7	-0.3	0.1	0.2	0.3	0.6
Cyclically-adjusted budget balance (d)				-4.7	-2.0	-1.4	-0.6	-0.8	-0.3	0.3
Structural budget balance (d)				-	-2.1	-1.4	-0.6	-0.8	-0.3	0.3
General government gross debt (c)				59.6	73.9	67.8	63.6	59.0	53.9	52.6

(a) as % of total labour force. (b) gross saving divided by adjusted gross disposable income. (c) as a % of GDP. (d) as a % of potential GDP.