# 7. IRELAND

## Sustained growth amidst heightened risks

*Irish GDP growth surged to 26.3% in 2015, driven by the operations of some multinationals, with little impact on the domestic economy. Yet, discounting this factor, underlying economic activity grew strongly, at an estimated 4 to 5%. In 2016-2018, domestic demand is projected to continue expanding at robust rates, although risks have heightened, including since the UK referendum. Having dropped in 2015 with the GDP surge, deficit and debt indicators are expected to continue to improve gradually.*

### Multinationals drove 2015 GDP growth but the domestic economy also performed strongly

In 2015, gross value added (GVA) doubled in the production sectors where foreign multinationals dominate [74]. A few such companies restructured their operations, leading to a bigger share of GVA from global value chains being booked in Ireland. As a result, net exports contributed 18 pps. to GDP growth, driven by contract manufacturing. [75] This level-shift is assumed not to revert or reproduce over the forecast horizon. At the same time, the domestic economy also grew at robust rates, with GVA in the other sectors up by 4.4% and core domestic demand [76] up by 5.4% in 2015.

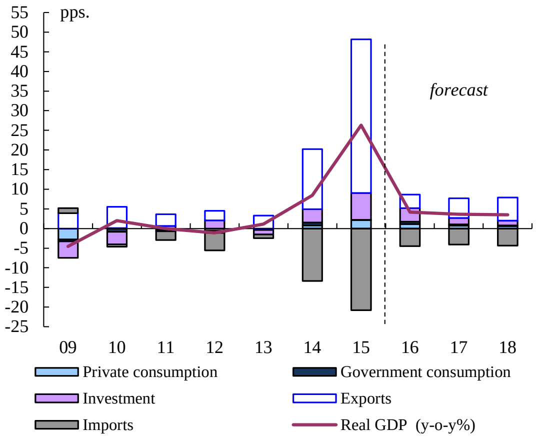
### Economic activity is expected to remain strong driven by domestic demand and jobs

Job creation and recovering wages are projected to support consumption in 2016-2018, with increased household formation and inward migration helping to drive demand particularly for durable goods. Housing completions are forecast to grow at close to 15% per year, albeit from a low base, supported by government policies and improvements to the infrastructure necessary for housing development. After years of contraction, public investment is forecast to grow gradually, reaching 2% of GDP in 2018, in line with government plans and helped by the Investment Plan for Europe. Equipment investment is due to decelerate in 2016, after the recent completion of a large project, but is expected to recover over the next two years as firms further replenish their capital stock to meet demand and construction picks-up. In the labour market, the unemployment rate is forecast to fall to 7.6% in 2018, thanks to continued job creation and despite sizeable natural population growth and net inward migration. Unit labour costs are expected to increase moderately but remain well below pre-2015 levels. Inflation is forecast to increase on account of the constant improvements in the labour market and the gradual growth in energy prices.

### However, risks have heightened considerably, including since the UK referendum

The contribution of net exports to GDP growth is forecast to be negative in 2016 but to recover thereafter, in line with global trade. The weak sterling affects mostly indigenous firms, including in the agri-food sector, but has limited impact on multinationals with exports denominated in other currencies. Short-run job losses in the sectors more exposed to the sterling depreciation are expected to be more than compensated by employment growth in services and construction. At the same time, the positive contribution of contract manufacturing to GVA is expected to remain, although its size is uncertain and further level-shifts could take place.

*Graph II.7.1:* **Ireland - Real GDP growth and contributions**




Risks to the outlook relate mostly to uncertainty following the UK 'leave' vote. Further falls in sterling or hits to consumer or business confidence could weigh on economic activity. Yet, stronger-than-anticipated investment in infrastructure and housing could push employment and household

(74) Such as pharmaceuticals, communications, reproduction of recorded media, electronics or medical devices.

(75) Contract manufacturing refers to the production of goods abroad on behalf of Irish-domiciled entities for exporting. Under ESA-2010, their sale abroad counts as Irish exports. Following the corporate restructurings in 2015, it started to have a large positive contribution to GVA in Ireland.

(76) A measure of domestic demand that excludes investment in intangible assets and transport equipment.

consumption beyond the central forecast scenario. While the increased share of corporate tax receipts in government revenue makes public finances more sensitive to shifts in corporate tax strategies, the growing interest of some multinationals in basing more manufacturing in Ireland could also lead to higher investment.

### Public finances are expected to improve on the back of resilient economic growth

The general government deficit is forecast to fall to 0.9% of GDP in 2016, a small improvement from last year's underlying deficit of 1.1% [77]. Relative to the spring forecast, the improvement (0.2 pps.) reflects the large revision to 2015 GDP as well as the additional expenditure allocated to healthcare in June 2016 to address emerging overruns.

Cash returns for the first three quarters of 2016 were slightly above government projections due to buoyant corporate tax and excise duties. For the second year in a row, corporate tax receipts are on course to exceed the government's own projections by a wide margin. Overall, cash returns increased by 5.7% over the twelve months to September, while expenditure remained below the target set in June, supported by lower interest expenditure.

Ireland's 2017 Draft Budgetary Plan includes new expansionary measures of around EUR 1.3 billion, at a ratio of three euros in spending increases for every euro in tax cuts. Due to the resilient outlook for GDP and domestic demand, the deficit is still expected to fall to 0.5% of GDP in 2017 and, based on a no-policy change assumption, to narrow further to 0.4% in 2018. Risks to the fiscal forecast mainly relate to the uncertainties surrounding the macroeconomic outlook and the volatility of some sources of government revenue. On the upside, November cash returns could exceed expectations.

The structural deficit is expected to remain broadly stable in 2016 at about 1¾% of GDP and to narrow gradually to about ⅔% of GDP in 2018. Gross general government debt is projected to continue to decline. The GDP surge in 2015 had a direct arithmetic effect on the debt-to-GDP ratio, which stood at 78.6%, around 15 pps. below the ratio in the spring forecast. It is projected to further decline to 75.4% in 2016 and to reach 71.9% in 2018, contingent on still robust GDP growth and the realisation of primary budget surpluses of more than 1½% of GDP per year in 2016 and 2017.

[77] Excluding a one-off transaction of 0.8% of GDP, related to the restructuring of a state-owned bank's capital base.

*Table II.7.1:*

**Main features of country forecast - IRELAND**

| | 2015 | | Annual percentage change | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| bn EUR | Curr. prices | % GDP | 97-12 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 |
| GDP | 255.8 | 100.0 | 4.2 | 1.1 | 8.5 | 26.3 | **4.1** | **3.6** | **3.5** |
| Private Consumption | 87.3 | 34.1 | 3.8 | -0.3 | 1.8 | 5.0 | **3.4** | **2.1** | **1.8** |
| Public Consumption | 32.1 | 12.5 | 3.5 | -1.3 | 4.5 | 0.3 | **4.7** | **2.1** | **1.5** |
| Gross fixed capital formation | 54.2 | 21.2 | 4.1 | -5.7 | 18.3 | 32.9 | **16.0** | **6.8** | **5.0** |
| of which: equipment | 16.4 | 6.4 | 7.4 | -6.3 | 24.2 | 3.0 | **1.0** | **6.0** | **5.0** |
| Exports (goods and services) | 317.2 | 124.0 | 8.2 | 3.1 | 14.4 | 34.4 | **2.8** | **4.2** | **4.8** |
| Imports (goods and services) | 236.0 | 92.2 | 7.9 | 1.1 | 15.3 | 21.7 | **4.9** | **4.4** | **4.7** |
| GNI (GDP deflator) | 203.9 | 79.7 | 3.4 | 5.1 | 8.7 | 18.2 | **5.4** | **3.5** | **2.3** |
| Contribution to GDP growth: Domestic demand | | | 3.3 | -1.5 | 4.9 | 8.9 | **5.1** | **2.6** | **2.1** |
| Inventories | | | 0.0 | -0.1 | 1.3 | -0.8 | **0.0** | **0.0** | **0.0** |
| Net exports | | | 1.2 | 2.3 | 1.9 | 18.3 | **-1.1** | **1.0** | **1.5** |
| Employment | | | 2.1 | 2.5 | 1.7 | 2.5 | **2.3** | **1.9** | **1.9** |
| Unemployment rate (a) | | | 7.5 | 13.1 | 11.3 | 9.4 | **8.3** | **7.8** | **7.6** |
| Compensation of employees / head | | | 3.9 | 1.4 | 1.8 | 2.8 | **2.7** | **2.5** | **2.1** |
| Unit labour costs whole economy | | | 1.8 | 2.8 | -4.5 | -16.5 | **0.9** | **0.9** | **0.5** |
| Real unit labour cost | | | -0.8 | 1.4 | -3.4 | -20.4 | **1.4** | **-0.3** | **-1.0** |
| Saving rate of households (b) | | | - | 10.3 | 10.9 | 10.7 | **10.7** | **10.8** | **10.8** |
| GDP deflator | | | 2.6 | 1.4 | -1.2 | 4.9 | **-0.5** | **1.2** | **1.5** |
| Harmonised index of consumer prices | | | 2.3 | 0.5 | 0.3 | 0.0 | **-0.2** | **1.2** | **1.4** |
| Terms of trade goods | | | 0.5 | 0.9 | -5.6 | 8.3 | **-0.2** | **-0.1** | **0.1** |
| Trade balance (goods) (c) | | | 21.7 | 19.1 | 21.1 | 43.2 | **41.8** | **42.0** | **43.1** |
| Current-account balance (c) | | | -1.7 | 2.1 | 1.7 | 10.2 | **7.9** | **7.7** | **7.4** |
| Net lending (+) or borrowing (-) vis-a-vis ROW (c) | | | -1.3 | 1.6 | -1.8 | 9.7 | **8.2** | **8.0** | **7.7** |
| General government balance (c) | | | -3.5 | -5.7 | -3.7 | -1.9 | **-0.9** | **-0.5** | **-0.4** |
| Cyclically-adjusted budget balance (d) | | | -3.7 | -3.2 | -3.7 | -2.6 | **-1.8** | **-1.0** | **-0.6** |
| Structural budget balance (d) | | | - | -3.6 | -3.6 | -1.8 | **-1.7** | **-1.0** | **-0.6** |
| General government gross debt (c) | | | 50.7 | 119.5 | 105.2 | 78.6 | **75.4** | **73.6** | **71.9** |

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