

7. IRELAND

Strong growth against external headwinds

GDP is forecast to expand robustly over the forecast horizon, but the pace will moderate. Improving labour market conditions are expected to support domestic demand. However, the practices of multinationals in the country, which can have large statistical effects, continue to create some unpredictability. Public finances are projected to improve but risks to the fiscal outlook remain.

GDP has performed better than expected

In 2016, real GDP grew by 5.2%, well above the euro area average. GDP accelerated in the second half of the year despite heightened economic and political uncertainties that emerged over the same period. However, some of the impressive headline figures are still heavily distorted by the activities of multinational enterprises in the country. Nevertheless, domestic activity appears to have been strong, driven by positive developments in the labour market, consumption and construction investment. Growth of underlying domestic demand, which strips out the volatile investment in intangible assets and aircraft, is forecast to remain strong around 3.5% in the medium term.

Domestic demand and jobs to underpin the economic activity

The labour market's better-than-expected performance, combined with continued robust wage growth and improving household balance-sheets are expected to support consumption in 2017-2018. The unemployment rate is forecast to fall to 5.9% in 2018 and employment trends to remain positive as well. Consumer sentiment has improved again after declining in the second half of 2016, while retail sales remain strong.

Residential property is projected to remain an important driver of the real domestic investment activity over the forecast horizon, supported by government policies. The headline investment figures should be interpreted with caution as total investment experienced another surge in 2016, of which investment in equipment and intangible assets (such as intellectual property rights) accounted for approximately 80%.⁽³⁹⁾

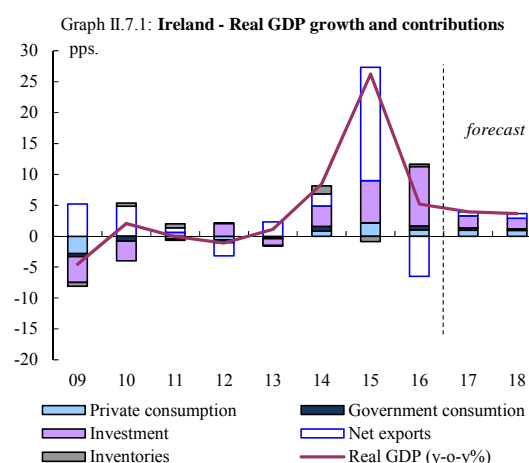
Subdued inflation is expected to support consumption in the medium term. Consumer prices

⁽³⁹⁾ 2016 split data for machinery and equipment and intangible assets have not been published by the Central Statistical Office (CSO) due to confidentiality restrictions.

(HICP) rose slightly in early 2017 due to rising energy prices. However, this effect is projected to wear off over the coming months as oil prices are expected to moderate. Nevertheless, inflation should continue to recover slowly due to upward pressure from the services sector including rapidly increasing residential rents, related to the limited supply of residential property.

Trade developments remain highly exposed to the activities of multinationals

Imports increased sharply in 2016, particularly in the last quarter, on the back of large imports of intellectual property services. Export growth slowed last year partly due to the fall in sterling and the decline in 'contract manufacturing' by multinationals. Consequently, net exports had a negative impact on GDP growth in 2016. They are expected to contribute marginally to GDP growth in 2017 and 2018, as exports are projected to increase in line with global trade.



Risks to the macroeconomic outlook remain elevated

Considerable uncertainty surrounds the final outcome of negotiations between the UK and the EU, as well as potential changes to US tax and trade policies, to which Ireland is highly exposed. The activities of multinationals could impact GDP growth in either direction.

Public finances further recovering

In 2016, the general government deficit fell to 0.6% of GDP. Taking into account one-off factors⁽⁴⁰⁾, the underlying deficit was 0.7% of GDP, an improvement of 0.4 pps. on the previous year's underlying position. The improvement echoed the sustained pace of Ireland's economic growth. Tax revenues, including social security contributions, increased by 4.9%, driven by the strong performance of corporate tax and excise duty. These gains were partly off-set by the reduction in non-tax revenues.⁽⁴¹⁾ Government expenditure, excluding one-offs, also increased compared to the previous year, notably public pay (+2.8%), intermediate consumption (+5.3%) and public investment (+12.7%). Savings on interest debt, due to relatively low interest rates, eased deficit reduction.

⁽⁴⁰⁾ Headline deficit figures are distorted by significant one-off transactions. These mainly relate to the deficit-increasing restructuring of a state owned bank's capital base in 2015 (0.8 % of GDP) and the deficit-reducing EFSF pre-paid margin repayment in 2016 (0.2 % of GDP).

⁽⁴¹⁾ The fall is primarily due to the gradual decline in bank guarantee fees, interest and Central Bank income directly attributable to financial crisis measures, as well as lower dividends from state-owned companies.

External risks could hamper fiscal progress

Despite the expansionary measures in Budget 2017 of around 0.5% of GDP in tax cuts and spending increases, the deficit is projected to fall slightly to 0.5% of GDP in 2017. Projections are based on the expectation of relatively robust increases in tax revenue and buoyant current primary expenditure amid public wage pressures.

Based on a no-policy change assumption, the deficit is expected to gradually decline to 0.3% of GDP in 2018. Risks to the fiscal forecast are on the downside, mainly reflecting policy uncertainty and risks to the global economic outlook.

The structural deficit is estimated to have slightly improved in 2016 to about 1¼% of GDP and further narrowing to around 1% and ½% of GDP in 2017 and 2018 respectively. Gross general government debt fell to 75.4% of GDP in 2016, down from 78.7% of GDP the year earlier. It is projected to further decline to 73.5% and 72.7% of GDP in 2017 and 2018 respectively, contingent on moderate yet robust GDP growth and the realisation of primary budget surpluses.

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 | 5.2 | 4.0 | 3.6 |
| Private Consumption | 87.3 | | 34.1 | 3.8 | -0.3 | 1.8 | 5.0 | 3.0 | 2.8 | 2.7 |
| Public Consumption | 32.1 | | 12.5 | 3.5 | -1.3 | 4.5 | 0.3 | 5.0 | 3.2 | 2.3 |
| Gross fixed capital formation | 54.2 | | 21.2 | 4.1 | -5.7 | 18.3 | 32.9 | 45.4 | 6.7 | 5.6 |
| of which: equipment | 16.4 | | 6.4 | 7.4 | -6.3 | 24.2 | 3.0 | 4.2* | 7.5 | 6.5 |
| Exports (goods and services) | 317.2 | | 124.0 | 8.2 | 3.1 | 14.4 | 34.4 | 2.4 | 3.9 | 4.3 |
| Imports (goods and services) | 236.0 | | 92.2 | 7.9 | 1.1 | 15.3 | 21.7 | 10.3 | 4.1 | 4.6 |
| GNI (GDP deflator) | 203.9 | | 79.7 | 3.4 | 5.1 | 8.7 | 18.2 | 9.0 | 4.2 | 3.9 |
| Contribution to GDP growth: | | | | | | | | | | |
| Domestic demand | | | | 3.3 | -1.5 | 4.9 | 8.9 | 11.3 | 3.3 | 2.9 |
| Inventories | | | | 0.0 | -0.1 | 1.3 | -0.8 | 0.4 | 0.0 | 0.0 |
| Net exports | | | | 1.2 | 2.3 | 1.9 | 18.3 | -6.5 | 0.6 | 0.7 |
| Employment | | | | 2.1 | 2.5 | 1.7 | 2.5 | 2.7 | 2.6 | 2.1 |
| Unemployment rate (a) | | | | 7.5 | 13.1 | 11.3 | 9.4 | 7.9 | 6.4 | 5.9 |
| Compensation of employees / head | | | | 3.9 | 1.4 | 1.8 | 2.8 | 2.9 | 3.0 | 2.5 |
| Unit labour costs whole economy | | | | 1.8 | 2.8 | -4.5 | -16.5 | 0.5 | 1.6 | 0.9 |
| Real unit labour cost | | | | -0.7 | 1.4 | -3.4 | -20.4 | 1.8 | 0.4 | -0.3 |
| Saving rate of households (b) | | | | - | 10.3 | 10.9 | 10.7 | 10.5 | 10.4 | 10.3 |
| GDP deflator | | | | 2.6 | 1.4 | -1.2 | 4.9 | -1.2 | 1.2 | 1.3 |
| Harmonised index of consumer prices | | | | 2.3 | 0.5 | 0.3 | 0.0 | -0.2 | 0.6 | 1.2 |
| Terms of trade goods | | | | 0.5 | 0.9 | -5.6 | 8.3 | -0.8 | -0.1 | -0.1 |
| Trade balance (goods) (c) | | | | 21.7 | 19.1 | 21.1 | 43.2 | 38.7 | 38.0 | 37.3 |
| Current-account balance (c) | | | | -1.7 | 2.1 | 1.7 | 10.2 | 4.7 | 4.8 | 5.0 |
| Net lending (+) or borrowing (-) vis-a-vis ROW (c) | | | | -1.3 | 1.6 | -1.8 | 9.7 | 2.6 | 4.6 | 4.8 |
| General government balance (c) | | | | -3.5 | -5.7 | -3.7 | -2.0 | -0.6 | -0.5 | -0.3 |
| Cyclically-adjusted budget balance (d) | | | | -3.7 | -3.4 | -3.9 | -2.8 | -1.5 | -1.1 | -0.3 |
| Structural budget balance (d) | | | | - | -3.8 | -3.8 | -2.0 | -1.7 | -1.1 | -0.3 |
| General government gross debt (c) | | | | 50.7 | 119.5 | 105.3 | 78.7 | 75.4 | 73.5 | 72.7 |

(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.

* Estimated. The CSO suppressed 2016 data on investment in intangibles and machinery and equipment for confidentiality reasons.