An Roinn Airgeadais
Department of Finance

The Irish Economy in Perspective

May 2012

Department of Finance

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Overview

- Successful transition over 20 years
- Imbalances and property bubble
- Policy responses
- EU-IMF Programme of Support
- Emergence from recession
- Underlying strengths remain

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The Irish economy was **transformed over the past two decades**. Against the backdrop of strong export led growth, per capita incomes rose significantly over the period 1985 to 2007, converging towards and subsequently overtaking European average levels.

From the early part of the last decade, however, **imbalances** began to emerge which made the economy increasingly vulnerable. A major property bubble began to unwind from 2007, and the fall-out from this was exacerbated by a rapid downturn in the global economy. As a result, Irish real GDP declined sharply, recording a peak-to-trough fall of 12.4%.

Funding of the Irish banks and the sovereign became increasingly difficult in the second half of 2010. Against the backdrop of a strong increase in Irish bond yields, the Government agreed to enter an **EU-IMF Programme of Support**.

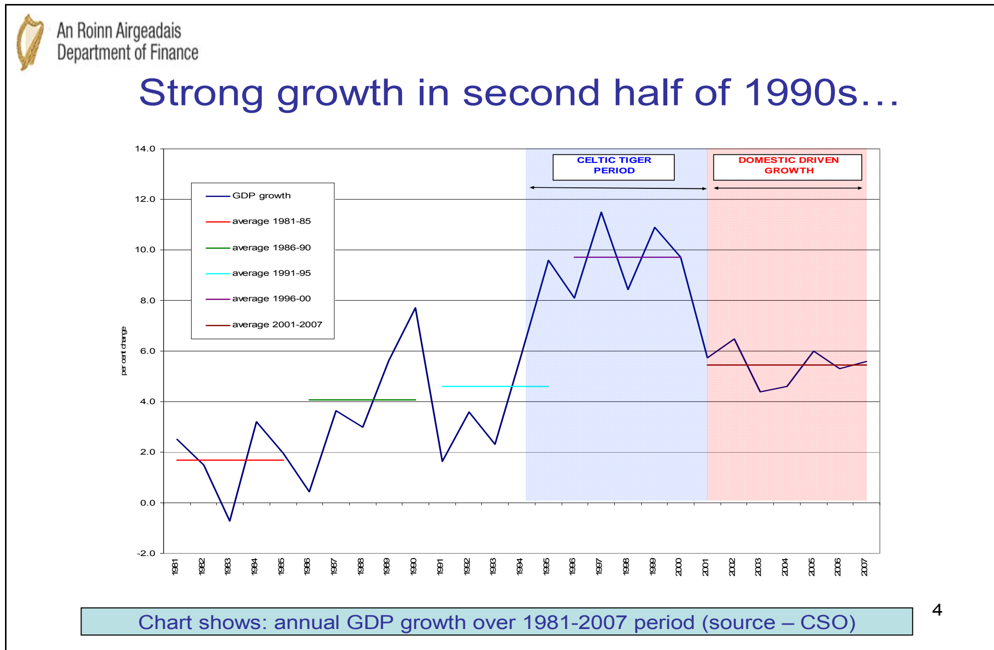
Significant **policy responses** had been undertaken prior to entering the Programme, and important steps continue to be taken to stabilise the public finances, ensure banking stability, improve our competitiveness position and encourage job creation.

Supported by these measures, the Irish economy grew in 2011, for the first time in four years. Based on the Department of Finance's assessment as set out in the Irish Stability Programme Update published in April, a second successive year of positive growth is expected in 2012, with the recovery expected to broaden and gain ground in 2013.

The Irish economy retains many of its **underlying strengths**, particularly strong flexibility, a highly educated workforce, positive demographics and a pro-enterprise environment. Supported by policy measures, a gradual firming of activity is expected over the medium term, with growth of 3% per annum on average projected for the period 2014-15.

Section 1

Successful transition



During the 1980s, GDP growth averaged around 2½% per annum, and living standards remained well below those in other advanced economies.

Following a modest acceleration in the growth rate in the first half of the 1990s, GDP growth accelerated sharply in the second half of the decade, averaging 9¾% per annum over this period. This was mostly export-led growth, which is how growth in a small open economy such as Ireland's should be driven. By 2000 overall economic output was almost double that in 1990.

This very sharp economic growth resulted in a rise in Irish income per capita, from around two-thirds of the EU average in the 1980s to above average levels.

The pace of growth slowed somewhat post-2000, averaging 5½% per annum over the 2001-2007 period. While still a strong rate of expansion, growth in this period became increasingly unbalanced, driven by domestic sources - consumption and construction (see later) – and by the mid-part of the decade growth was heavily skewed towards residential construction.

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Explaining Ireland’s rapid growth…

- Improving competitiveness;
- Attracting foreign direct investment;
- Investing in education and skills;
- Infrastructure investment, with EU assistance;
- Reforming the tax system to promote growth and employment;
- Improving flexibility;
- Social partnership;
- Putting our public finances in order;
- Pro-enterprise culture;
- Participation in EU / EMU.

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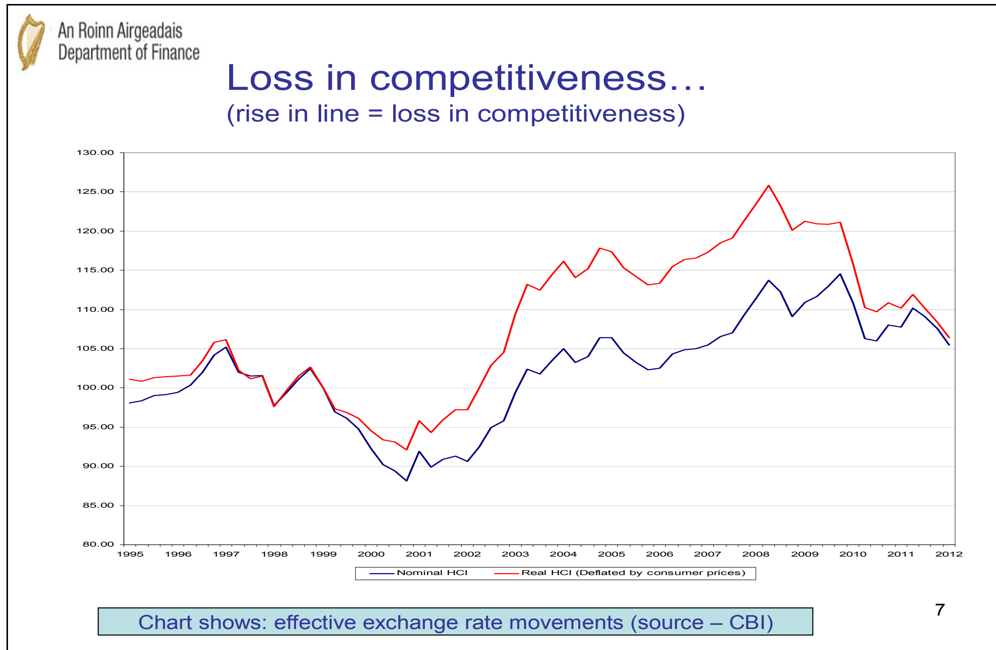
There is no single factor which explains Ireland’s economic transformation. Instead, the period of rapid economic growth is often seen as one of delayed convergence – up to the mid-1990s, per capita incomes failed to keep pace with those elsewhere in Europe because of policy mistakes in the first few decades of independence.

Over time, the policies necessary for economic progress were gradually put in place (see the bullet points above). Thus, by having the correct economic conditions in place, Ireland was able to take advantage of a period of sustained global economic expansion. As a result, **per capita incomes rose rapidly to levels in other advanced countries.**

Section 2

Imbalances and the property bubble



From 2000 onwards, the economy began to **lose competitiveness**. This reflected a combination of factors: a higher nominal exchange rate, and a loss of cost and price competitiveness.

With regard to the former, Ireland's Harmonised Competitiveness Indicator (HCI) - a trade-weighted exchange rate – increased by around 10% between the introduction of the euro in 1999 and the end of 2008. A rise in the index implies an appreciation of the euro, making Irish goods and services more expensive outside the euro area.

Exchange rate developments were exacerbated by a loss of price competitiveness. The real HCI – which takes account of relative price movements as well as exchange rate developments – increased by more than 20% over the same period, as inflation in Ireland exceeded that in our major export markets (although price developments in subsequent years have seen the gap close).

There was also a decline in cost competitiveness for much of the last decade as pay increases in the economy exceeded productivity, thus adding to the problem.

Reflecting these factors, the rate of export growth slowed from the early part of the last decade.

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Post-2000 developments…

- Lost competitiveness ⇨ slower export growth
- Shift in drivers of growth:
  - away from exports
  - towards domestic demand
- Domestic demand driven by a housing boom
  - house building reached unsustainable levels
  - employment in construction unsustainably high
  - living standards were artificially inflated
- Unbalanced growth

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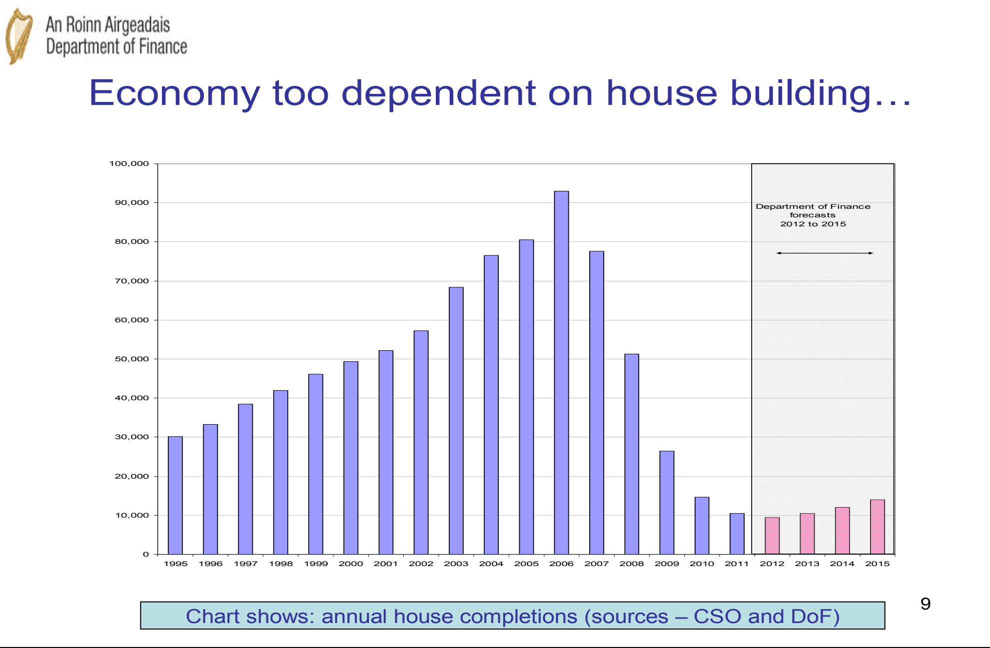
This deterioration in competitiveness resulted in a sharp moderation in export growth from 2000 onwards. The export growth rate slowed from an average of 17.8% in the five years to 2000 to just 5.3% in the five years to 2005.

Nevertheless, GDP growth remained relatively strong as robust domestic demand - and new house building in particular - took over in driving the expansion.

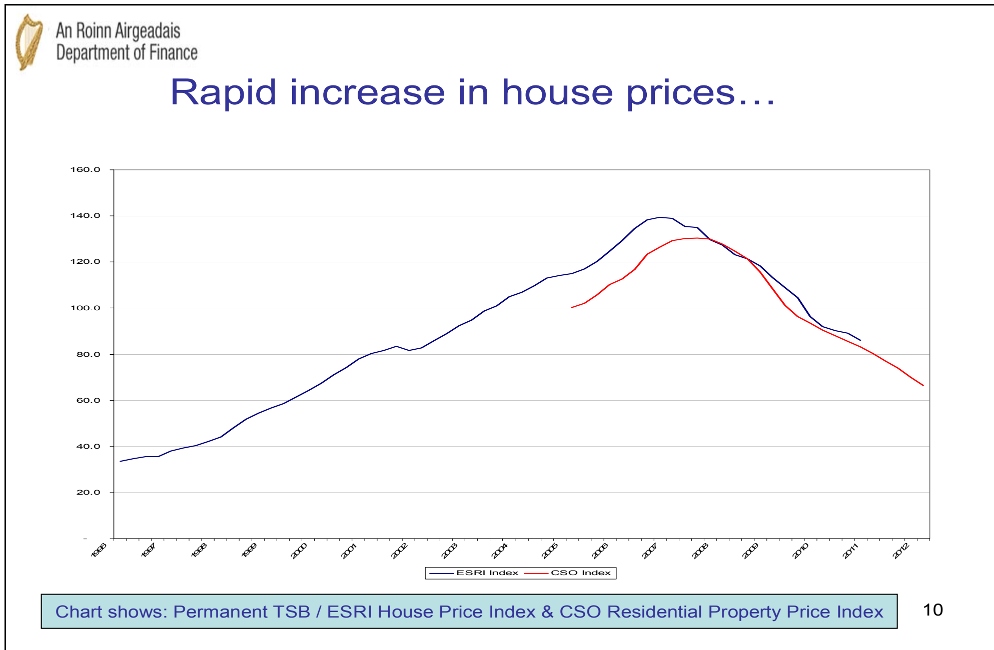
Construction-led growth of this sort was unsustainable, however. House building, house prices, employment in the construction sector and credit growth all moved above sustainable levels as a bubble developed in the market, while living standards in the economy were artificially inflated. The construction bubble would also have significant consequences for the public finances, with government revenues becoming increasingly reliant on transitory sources of revenue.



The growing dependence of the economy on house building is evident from the chart above, which shows that by 2006 house completions had surpassed 90,000 units per annum. As a result, the ratio of residential investment to GDP reached nearly 13% that year.

The subsequent sharp decline in house completions acted as a major drag on the country's growth rate particularly through 2007-2010.

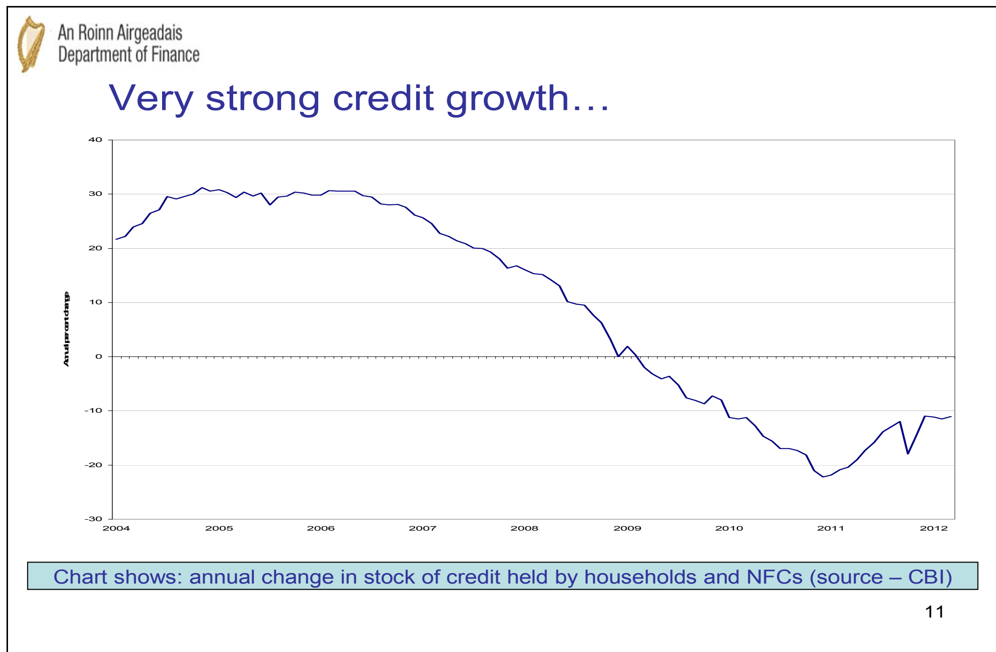
New house completions are forecast to decline further this year before picking up over the forecast horizon. Given that there is currently an overhang of unsold properties, however, this increase will occur at a very gradual pace. As such, housing construction will make a modest positive contribution to growth again.



Focusing on house price dynamics, the Permanent TSB/ESRI Index reveals that national prices increased at an average pace of almost 15% per annum between the years 1997 and 2006, resulting in a cumulative increase of 240% over the period.

The data indicate that prices peaked in the final months of 2006, and fell persistently thereafter. By the fourth quarter of 2010 prices had fallen by 40% from their peak and were back at a level last seen in 2002.

Following the introduction of a monthly residential property price index by the CSO, the ESRI house price index has ceased production. Reflecting further declines, the CSO data reveal that house prices have now fallen by 49% from their peak (although it sets the peak slightly later in mid-2007).

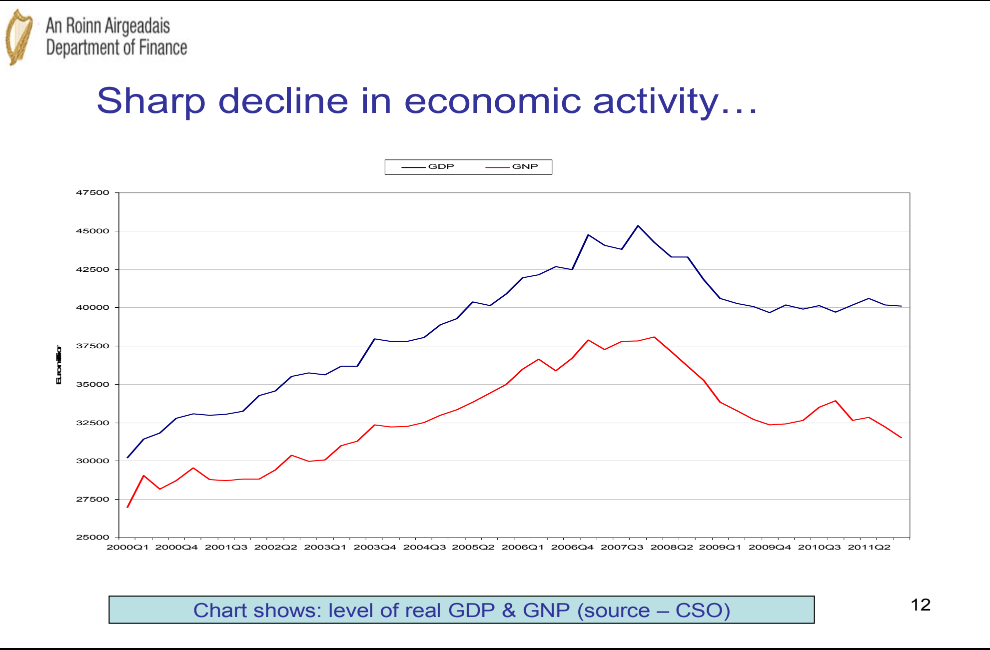


The housing boom was supported by a rapid growth in bank lending. Data from the Central Bank reveal that the stock of credit held by households and non-financial corporations increased at an average annual rate of around 30% between the years 2004 and 2006. The rate of increase in the euro area, by comparison, averaged just under 8% over this period.

Credit growth was supported by a number of factors, notably very low real interest rates, more integrated financial markets and innovation in these markets which led to a range of new products. With regard to the former, participation in EMU meant that monetary policy was set with regard to economic conditions in the euro area as a whole, with the result that nominal interest rates were too low in Ireland. Combined with high inflation, **real interest rates were negative** for much of the period 2000 to 2006.

With credit growth exceeding the growth rate of deposits in the banking sector, Irish banks increasingly resorted to borrowing from abroad in order to fund the property boom. One implication of this was that Irish banks were increasingly dependent upon wholesale money markets, making them more exposed to the credit crunch which emerged from 2008. Another was that the country began to run a large balance of payments deficit - the nation as a whole was borrowing an annual average of 4¼% of national income from abroad over the 2005-2009 period, increasing our indebtedness to foreigners.

The current deleveraging process is evident from the Chart above, which shows that households and non-financial corporations have been reducing outstanding credit since 2009.



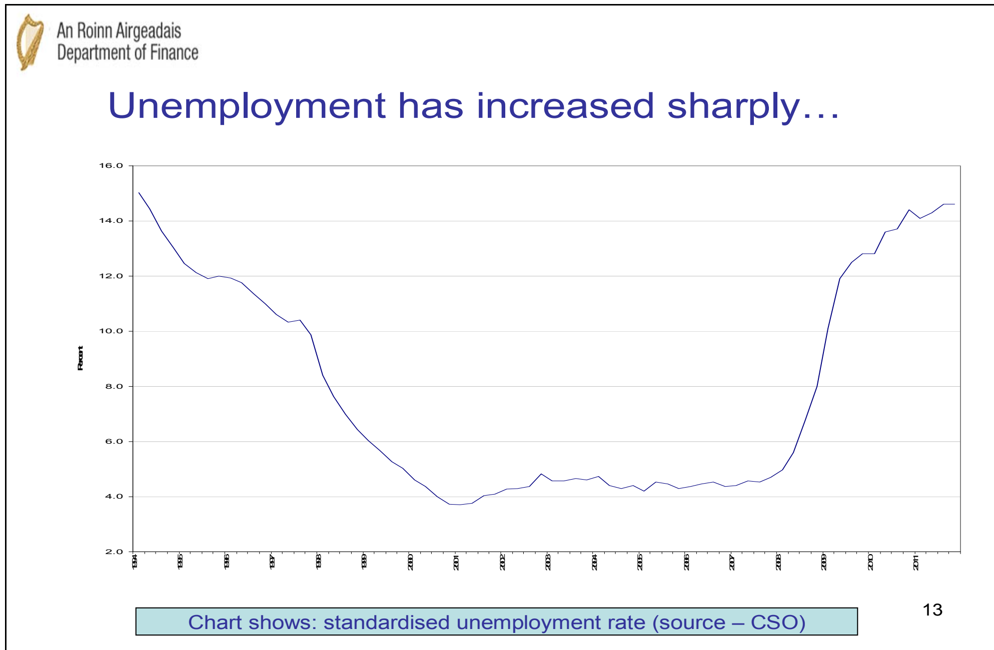
As a result of these accumulated imbalances, the Irish economy was especially exposed to the 'Great Recession', the rapid global downturn of 2008-2009. The collapse in world demand, together with the loss in domestic competitiveness (exacerbated by euro appreciation during the turbulence) had a detrimental impact on most of the exporting sectors.

Housing output – which had already begun to decline – fell sharply as the demand for housing effectively collapsed. A dramatic fall in confidence resulted in an unprecedented contraction in personal consumption – for example, new car sales fell by two-thirds in 2009.

Against this backdrop real GDP recorded annual contractions in 2008, 2009 and 2010, resulting in a peak-to-trough decline of 12.4% (Q4 2007 to Q4 2010).

Real GDP returned to growth in 2011 (0.7%) on the back of a strong export performance.

Real GNP also contracted sharply and remains in negative territory.



The labour market has been hard-hit by the recession. Around 330,000 jobs have been lost since employment peaked in the second half of 2007, with the construction, retail and manufacturing sectors particularly hard hit. The construction sector has accounted for around half of the total jobs lost.

Recent years have also seen a decline in the labour force, reflecting both a fall in the participation rate (from 64% in 2007 to 60.3% in Q4 2011) and the emergence of net outward migration.

The fall in the labour force has not been large enough to compensate for the decline in employment, and, as a result, unemployment has risen sharply. The unemployment rate is likely to have peaked in 2011 at 14.4% - its **highest since the mid-1990s -** but is forecast to ease gradually as economic growth resumes.

Indeed figures from the first four months of 2012, point to **stabilisation in the labour market** with the Standardised Rate of Unemployment falling to 14.3% in both March and April.

Section 3

Policy Responses

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Guiding principles…

- Restoring sustainability to public finances;
- Repairing the banking system;
- Improving competitiveness;
- Structural reforms.

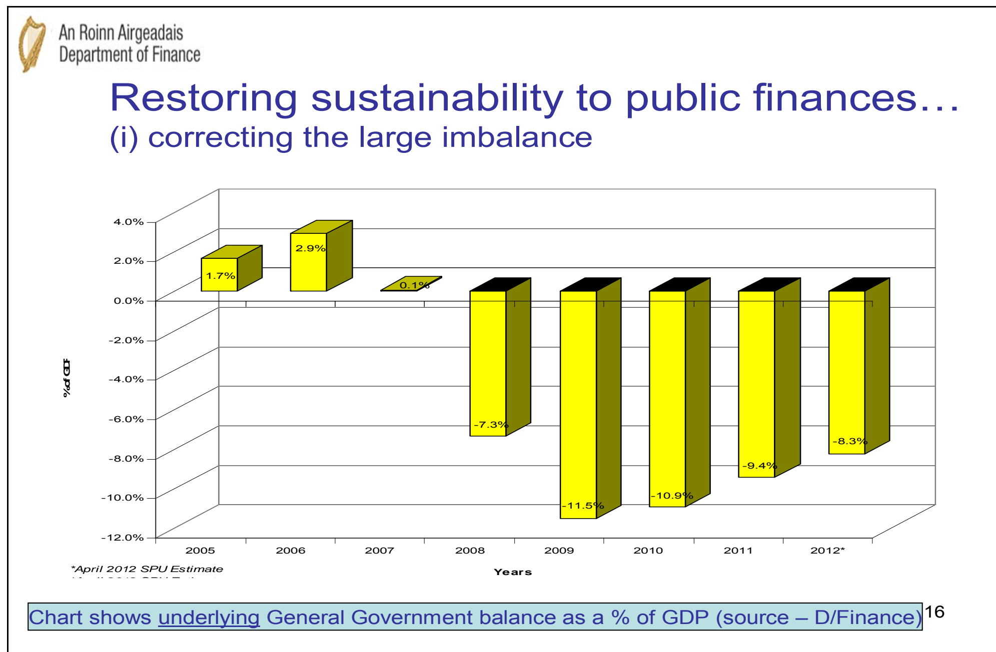

Chart shows underlying General Government balance as a % of GDP (source – D/Finance)[16]

The rapid economic deterioration exposed underlying problems in the structure of the public finances, problems that have been exacerbated by the necessary and very significant level of support provided by the State to the banking sector.

Revenues had become too dependent on transitory taxes such as those associated with the property market; spending had been increased significantly on foot of these while at the same time income taxes had been lowered. Between 2007 and 2010, tax revenue fell by one-third. Combined with increased unemployment related expenditure and higher debt servicing costs, a very large, unsustainable gap opened up between Government spending and revenue, a gap that is currently being filled by borrowing.

As the Chart shows, the underlying General Government deficit – that is the deficit excluding the impact of banking support measures – is showing signs of improvement. On foot of a very large consolidation effort implemented in Budget 2011, the underlying deficit was reduced to an estimated 9.4% of GDP last year. This is well within the 10.6% of GDP limit set as part of the EU/IMF Programme and an improvement on the 2010 underlying deficit outturn of 10.9% of GDP.

On a headline basis the deficit was 13.1% of GDP in 2011, due to the inclusion of some €5.8 billion (3.7 percentage points of GDP) in deficit worsening capital transfers arising from the July 2011 recapitalisation of the banking sector. The headline deficit in 2010 was over 30% of GDP largely because of the inclusion of the full €31 billion in Promissory Notes committed to Anglo Irish Bank and INBS (now IBRC) and EBS although the financing of these Promissory Notes is being spread out over a lengthy period of time.

Restoring sustainability to public finances…

(ii) significant corrective measures have been implemented

- Corrective action underway since mid-2008.
- Including Budget 2012, measures designed to save/yield around €25 billion (circa 16% of 2012 GDP) implemented, most of these at a time of economic contraction.
- Approximately ⅔ of this adjustment on the spending side.
- All areas of discretionary spending affected by reductions in allocations, including cuts in Social Welfare rates, public sector pay and numbers and public capital investment.
- Revenue raising measures also implemented with increases in income tax, capital taxes, indirect taxes, carbon, pensions and property related taxes together with significant base broadening.

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The Irish authorities were quick to react, in mid-2008, to the widening gap in the public finances.

Beginning in July 2008, significant budgetary consolidation measures have been implemented over the course of seven separate policy announcements, with the most recent – Budget 2012 – implementing a package designed to save/yield €3.8 billion (inclusive of some element of carry-over on the revenue side from measures introduced in Budget 2011).

In total, budgetary adjustments designed to save/yield around €25 billion (or close to 16% of 2012 GDP) have been implemented so far. These adjustments have been wide ranging and have included reductions in public service pay, social welfare rates and capital expenditure and a significant widening of the tax base. Crucially, only one third of these adjustments have occurred on the revenue side, which should limit the dampening impact on growth.

Despite the very significant package of measures introduced in 2011, annual GDP growth returned last year for the first time since 2007.

Restoring sustainability to public finances…

(iii) 2012

- Deficit target of 8.6% of GDP in 2012, in line with Programme commitments.
- Next step on path to reducing deficit below 3% of GDP by 2015.
- Budget 2012 implemented a €3.8 billion adjustment (2.4% of GDP) in 2012.
- Just under 60% of the overall package on the spending side.
- Focus of revenue measures on indirect tax (VAT and excise) rather than income tax given key objective of Government is to get people back to work.

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Under the terms of the EU/IMF Programme, the General Government deficit must be no more than 8.6% of GDP in 2012.

The Government is fully committed to meeting this deficit target and is, on the basis of fiscal data for the first four months of the year, satisfied that it is on track to do so.

Just under 60% of the budgetary adjustment in 2012 reflects adjustments on the expenditure side, with spending decisions made on the basis of the high level outcomes of the Comprehensive Expenditure Report 2012-2014 published in early December. Reductions in expenditure are being implemented right across the board and in virtually all Ministerial Vote Groups.

On the revenue side, the focus of Budget 2012 is on indirect tax rather than income tax measures. This reflects the broad consensus that the former are less economically damaging and that a key objective of Government is to get people back to work.

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Restoring sustainability to public finances…
(iv) medium-term consolidation framework

- Corrective process to continue in coming years.
- Further though declining levels of adjustment necessary as economic growth strengthens and modest employment growth resumes.
- November 2011 Medium-Term Fiscal Statement sets out a path to reducing deficit below 3% of GDP by 2015.
- Government commitment to this target absolute.
- Restoration of public finance sustainability key to sustained economic revival.

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Moving towards a balanced budget position is a key condition for restoring the economy to sustained economic and employment growth, and to ensure that the sovereign can re-enter international financial markets to source its own funding.

The Irish Government is committed to bringing the public finance deficit below the Stability and Growth Pact threshold of 3% of GDP by 2015 and has set out a credible multi-annual plan to achieve this goal.

Restoring sustainability to public finances…

(v) medium-term consolidation framework

Year	Projected General Government Deficit (% of GDP) – *as per April 2012 SPU*	Total Adjustment (€ billion) – *as per November 2011 MTFS*	Main Consolidation Form	Estimated Saving (€ billion)
2013	7.5	3.5	Expenditure	2.25
			Revenue	1.25
2014	4.8	3.1	Expenditure	2.0
			Revenue	1.1
2015	2.8	2.0	Expenditure	1.3
			Revenue	0.7

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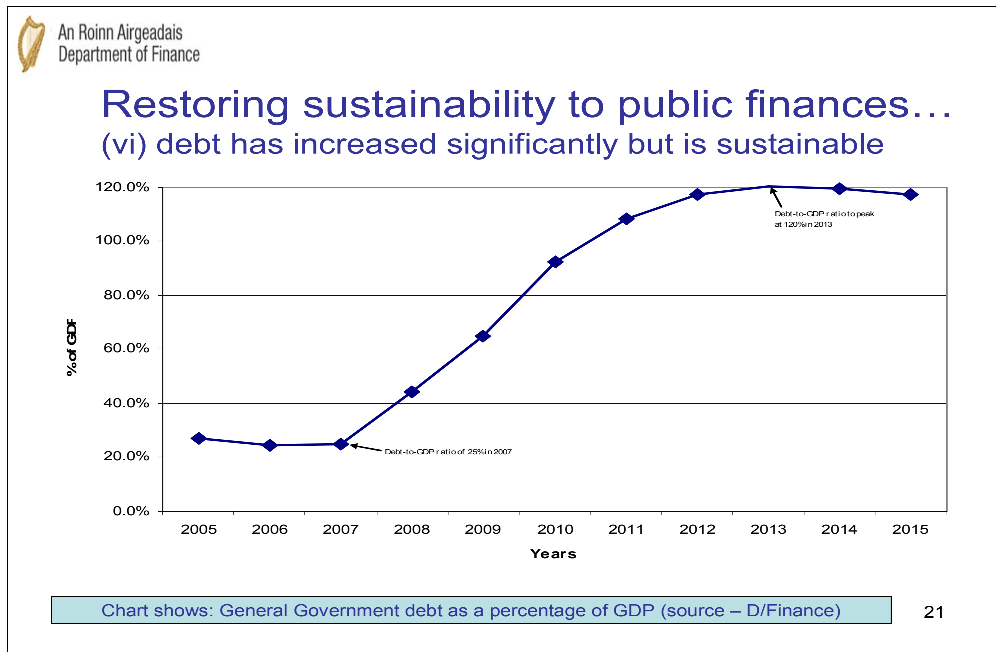
The levels of consolidation necessary each year should decline as economic activity strengthens and modest employment growth returns.

This Table is a technical table showing the current deficit estimates as well as the level of consolidation underpinning those estimates (and consistent with those set out in the November 2011 Medium-Term Fiscal Statement) over the three-year period 2013 to 2015.

It is presently estimated that two-thirds of the future adjustment will come through expenditure measures, with the remainder coming from the revenue side.

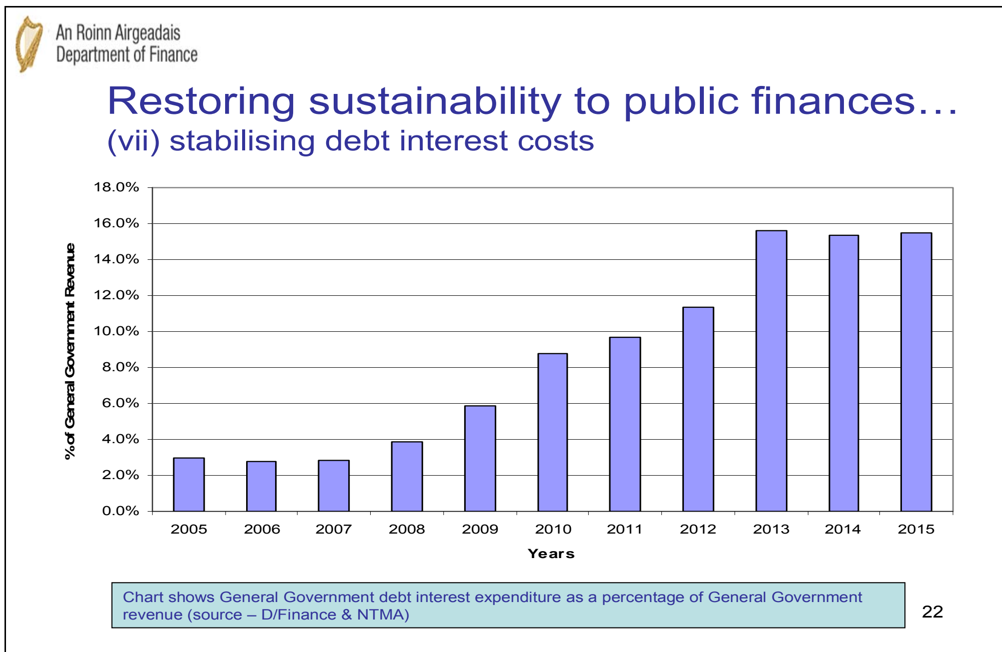


The stock of public debt has increased dramatically in recent years, albeit from a very low starting point. This is a result of the large gap that has emerged between the revenues and expenditures of the State, caused by the economic downturn and the requirement for significant levels of State support to the banking sector.

The debt position is sustainable, however, provided the correct economic and fiscal policies continue to be pursued. Fiscal consolidation measures (those already implemented as well as future adjustments) together with the implementation of growth-friendly economic policies will help reduce the build-up of public debt. The General Government debt-to-GDP ratio is expected to peak at around 120% of GDP next year before declining to approximately 117% by 2015.

A primary General Government surplus – an excess of revenues over expenditure excluding debt interest expenditure – is forecast to emerge by 2014. This is an important development in the context of debt sustainability.

General Government Debt is a gross measure that does not allow the netting-off of liquid assets. However, netting-off the €13.8 billion in cash, deposits and other liquid assets held by the Exchequer, as well the €5.4 billion discretionary portfolio of the NPRF, would give a net General Government debt position of 96% of GDP as of end-2011 (compared to 108% of GDP in gross terms).



The measure of debt interest expenditure as a percentage of revenue is a commonly used indicator of debt sustainability. This measure has also increased dramatically in recent years, but is projected to stabilise in the coming years.

In 2011, General Government interest expenditure as a percentage of General Government revenues amounted to just under 10%. By contrast, in 2007, the equivalent figure was just under 3%.

By the end of the forecast horizon in 2015, and based on current assumptions regarding the evolution of revenues, debt levels and interest rates on Government borrowing, the equivalent of just under 16% of General Government revenues will be required to service General Government debt.

Repairing the banking system…

(i) Key objectives for the banking system

1. PCAR 2011 ensured the Irish banks are **viable financial institutions** which can fund themselves with reduced support from the State;

2. To provide a **secure financial system for deposits** and ensure the **flow of credit** to Irish consumers and businesses; and

3. Return the banks to profitability and to broad based market funding with a view to eventually **realising maximum value from the State's shareholding** in these institutions.

The banking system must be the enabler of economic recovery by restoring public and market confidence in its financial health, management competence and ethical integrity.

A comprehensive restructuring of the banking system is well underway which will ensure a sustainable system that is fit for purpose - for the economy, businesses and households. The future profile of the Irish banking sector will be appropriate to the size of the economy and will be focused on supporting economic recovery.

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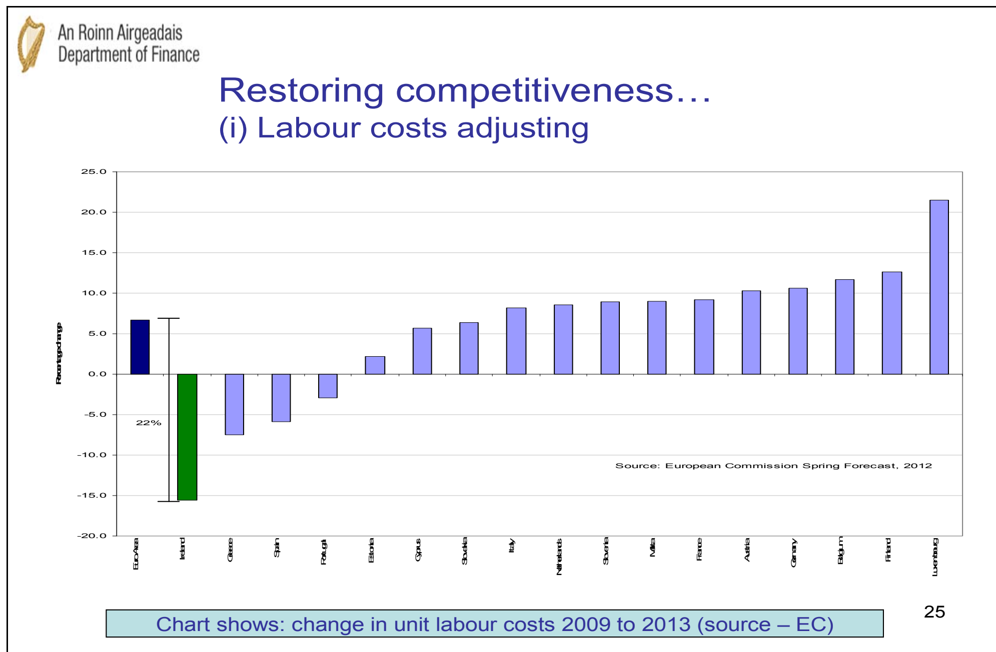
Repairing the banking system…
(ii) Much progress has been made to date

	Objective	Progress	
Renew/ merge	• Mergers of AIB/EBS and Anglo/INBS • Establish ILP as a viable institution	• *Integration of EBS into AIB progressing well. IBRC established.* • *Certainty over future of ILP*	✓
Recapitalise	• Recapitalise the covered banks to international standards	• *Successfully completed recapitalisation with €16.5bn total invested by State*	✓
	• Burden sharing with sub-debt	• *Generated €5.2bn from LMEs*	✓
	• Attract private capital	• *Bank of Ireland raised €1.7bn in equity placements in 2011*	✓
Delever system	• Deleveraging progressing well	• *Pillar banks achieved deleveraging targets for 2011 and are on track in 2012.*	✓
Liquidity	• Stabilise & grow deposit base • Wholesale funding focus	• *Customer deposits stable and growing in covered banks* • *BoI and AIB regained access to secured term wholesale funding markets*	✓
Future	• Building sustainable business models	• *Focus on new domestic lending and SME lending targets on track*	✓

Major steps have been taken to address the challenges in the banking system in order to create a robust, sustainable and better capitalised banking system that will effectively serve the needs of the Irish economy and can operate on a viable basis with reduced recourse to the State.

The Government succeeded in completing the PCAR 2011 recapitalisation of the domestic banking sector for a total cost of c. €16.5 billion. The recapitalisation has been entirely sourced from State funds, without the need to draw on EU/IMF funds, primarily as a result of €7.5 billion secured via a series of successful LMEs and other capital generating measures by the banks.

Significant progress has been made in relation to deleveraging the banking system. System wide deleveraging targets in 2011 have been achieved both in terms of amount deleveraged and impact on regulatory capital.

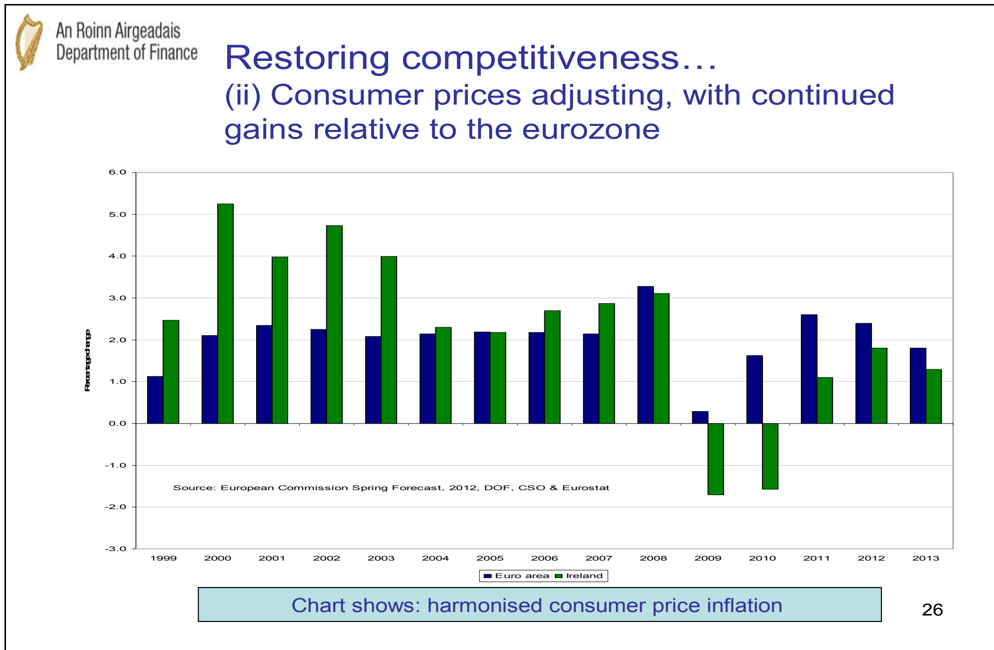


The necessary competitiveness adjustments are underway. Unit labour costs are a key component of competitiveness in an economy, showing how wages are moving after adjusting for productivity.

Following declines in 2009, 2010 and 2011 the European Commission anticipates that Irish unit labour costs will fall by a cumulative 16.5% over the period 2009 to 2013. This decline reflects a recovery in productivity coupled with a decline in compensation per head.

Unit labour costs in the euro area as a whole, by comparison, are forecast to increase by close to 6.7% over the same period (as the Chart above shows, Ireland is one of only four euro area countries that will experience a decline between 2009 and 2013). In other words, economic projections show that **Ireland's relative position will have improved by around 22% vis-à-vis the euro area since 2009**, a rapid turnaround.

This partly reflects declines in nominal wages. Public sector wages have been reduced by an average of 14%, while weekly wages in the private sector recorded annual declines since 2008. This clearly illustrates the flexibility of the labour market.



The Harmonised Index of Consumer Prices is the appropriate measure for comparing inflation across the euro area. This differs from the national measure – the Consumer Price Index – through the exclusion of mortgage interest payments in the harmonised measure.

Irish inflation was considerably higher than that in the euro area in the early years of monetary union, resulting in a deterioration of our price competitiveness.

In 2009 and 2010, however, Irish price levels declined while those in the euro area continued to increase, helping to recover some of these competitiveness losses.

Irish inflation rates are forecast to remain below those in the euro area for the period 2012 to 2013 as a whole, further improving our relative competitiveness position.

Structural Reforms

- The Government has been very active in implementing a series of structural reforms, both from a domestic policy agenda and under the EU/IMF Memorandum of Understanding
- In this regard, the Government has announced the following major initiatives in labour market reform in the last year:
  - Pathways to work
  - Jobs Initiative
  - Action Plan for Jobs
- Furthermore, a series of micro-economic reforms in product markets have been undertaken which aim to boost competition in sheletered sectors

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Reforms to boost the economy’s medium term growth potential are being pursued. These will focus on measures to raise competitiveness and enhance job creation:

service sector growth is being promoted through vigorous action to remove remaining restrictions on trade and competition;

changes have been introduced to facilitate re-adjustment in the labour market and to create greater incentives to take up employment.

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Section 4

External assistance

EU / IMF Programme of Financial Support

- **€85 billion of financial support over 3 year period from external and domestic sources:**
  - Based on strong conditionality
- **Key objectives:**
  - Return our economy to sustainable growth
  - Renewed public finance sustainability
  - Ensure that we have a properly functioning healthy banking system
- **Main elements of strategy:**
  - structural reforms to raise growth potential
  - ensure fiscal sustainability through fiscal consolidation and reform
  - restore financial stability
- **Programme is on track:**
  - Government has concluded fifth quarterly review, and sixth review visit took place in April
  - External funding partners: 'Ireland's program implementation continues to be strong'

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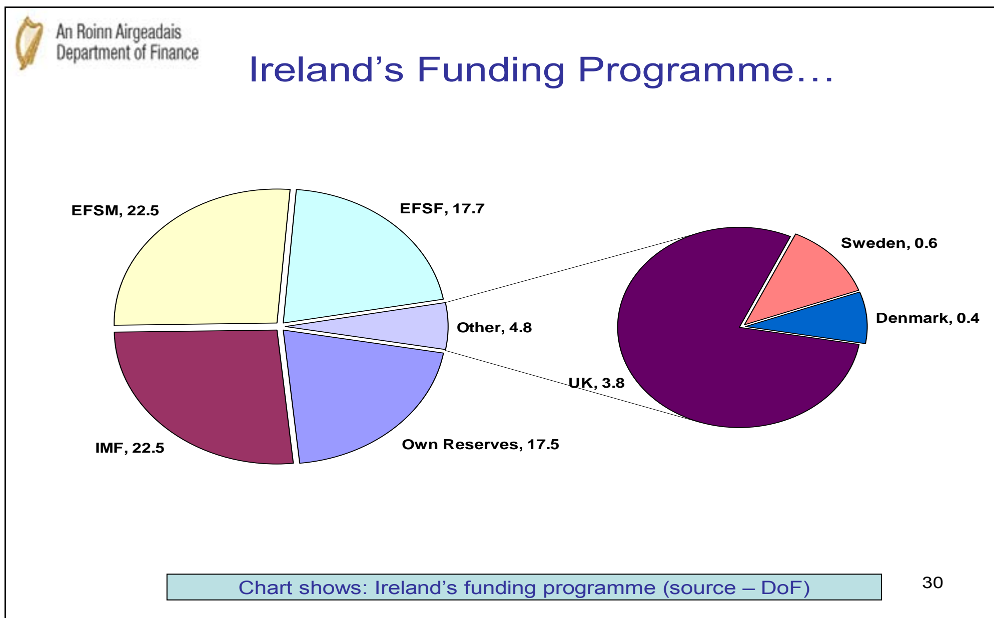
Despite a robust policy response, funding of the Irish banks and the sovereign became increasingly difficult in the second half of 2010. Against the backdrop of a strong increase in Irish bond yields, the Government agreed to a programme of financial support totalling €85 billion – €17.5 billion drawn from Ireland's own resources and €67.5 billion provided by Member States of the European Union and the International Monetary Fund on the basis of specified conditions.

The purpose of the external financial support is to return our economy to sustainable growth, achieve fiscal consolidation and ensure that we have a properly functioning healthy banking system. This will boost market confidence in the banking sector and sovereign, so as to restore market access at reasonable interest rates. It provides time to restructure the banking sector, consolidate fiscally and implement growth enhancing structural reform measures.

Without this external support, the State would not be able to raise the funds required to pay for key public services for our citizens and to provide a functioning banking system to support economic activity.

Following the sixth quarterly review visit under the Programme in April 2012, our external partners noted that Ireland's program implementation continues to be strong.



The €85 billion of financial support is coming from both external and domestic sources. The external element amounts to €67.5 billion shared amongst (i) the European Financial Stabilisation Mechanism (€22.5bn), (ii) the European Financial Stability Facility (€17.7bn), (iii) bilateral loans from the UK, Sweden and Denmark (€4.8bn), and (iv) the International Monetary Fund (€22.5bn).

The Irish State is contributing €17.5 billion of the total, which is coming from the National Pension Reserve Fund (NPRF) and other domestic cash resources.

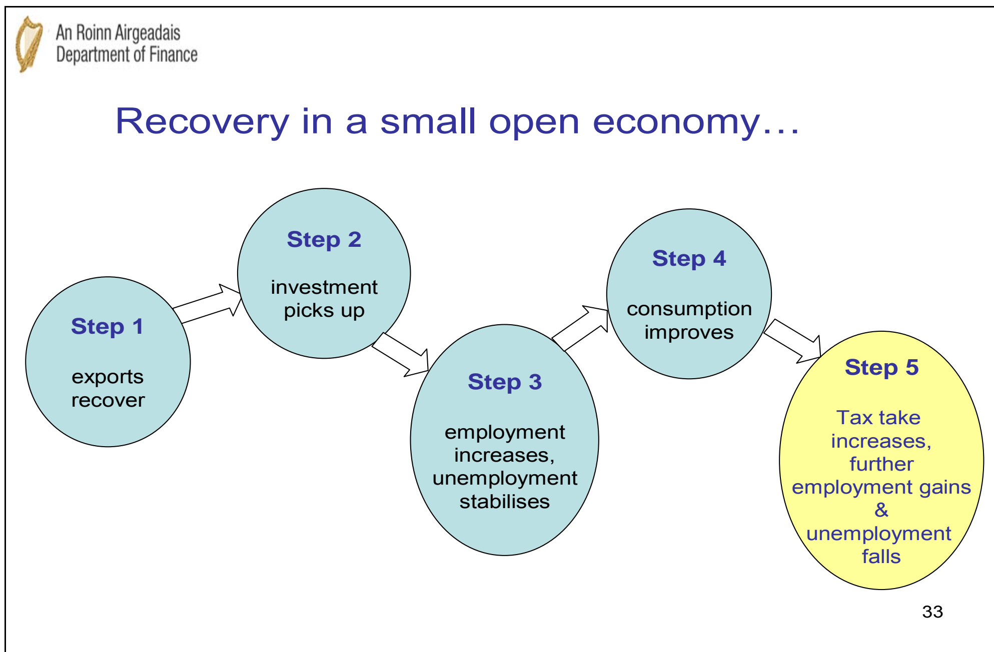
Structural reforms…

- **Improved fiscal architecture:**
  - Fiscal Council commenced operations in July 2011.
  - Fiscal Responsibility Bill published for information in context of referendum on Stability Treaty. It provides for:
    - a budget and debt correction rule (along SGP lines)
  - Statutory base for fiscal council.
  - Statutory base for already introduced multi-annual expenditure ceilings will be provided for in further legislation to be published in September 2012.

The EU/IMF Programme condition that we introduce a Fiscal Responsibility Bill has been overtaken by the developments in Europe, notably the 6-pack reforms to the Stability and Growth Pact and the Stability Treaty. A referendum is required under our Constitution to ratify the Stability Treaty and in the context of informing the debate, the Government has published a general scheme of the Bill that will be introduced to implement the provisions of the Treaty. Consequently, it is the fiscal rules set out in the Treaty that we will be introducing into our national law.

Section 5

Emergence from recession



As a small open economy (SOE), the sequencing of recovery in Ireland can usefully be categorised into five steps or phases.

The **first step** is an increase in net exports. Against the backdrop of a global recovery and an improvement in our competitiveness position, Irish exports have recorded strong growth over the past two years.

As the global economic recovery gains momentum, **the second step** sees indigenous and multinational investment in Ireland pick up to meet stronger global demand. Given developments in Europe, reaching this step has been delayed somewhat but investment is expected to pick up from 2013 on.

There is typically a lag between the recovery in activity and recovery in the labour market. In the **third step**, however, as a result of higher investment, firms will start to hire once again, so that employment will begin to expand.

Increasing employment will improve household disposable incomes and underpin consumer confidence, so that in the **fourth step** consumption improves.

Finally, the **fifth step** sees a strengthening of domestic demand. As domestic activity is more employment-intensive, tax revenue will recover, while unemployment will fall. Crucially, this is not domestically-driven growth, but a more sustainable evolution of domestic demand.

Given the impact of fiscal consolidation and the necessary unwinding of private sector imbalances, it will take somewhat longer than normal for export growth to filter through to the domestic side of the economy during the current recovery.

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Department of Finance

Continued growth expected this year…

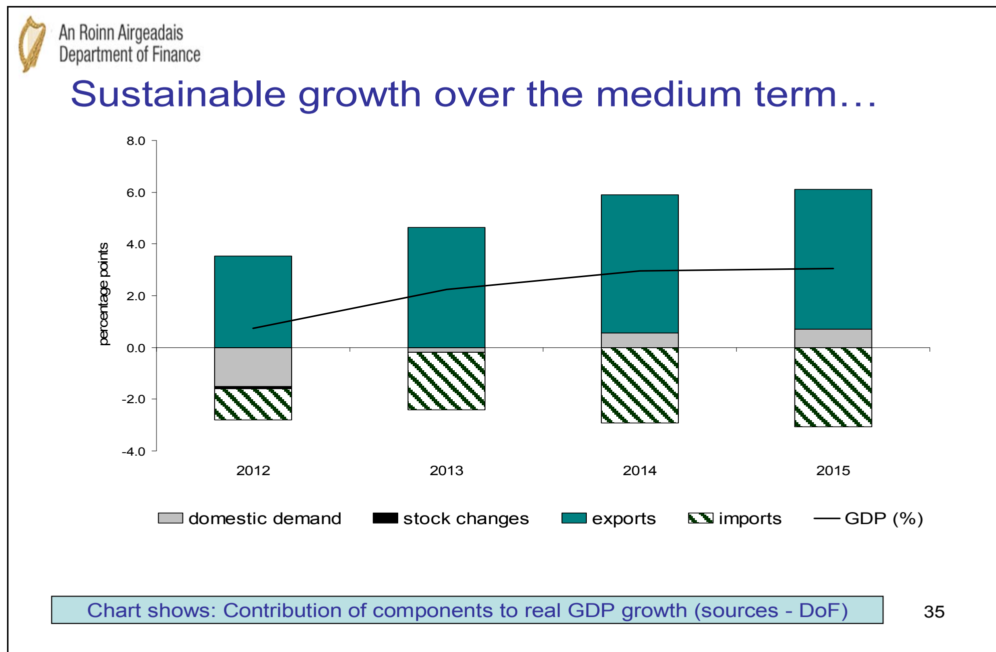
	Release Date	2012	2013
ESRI	Feb 2012	0.9	2.3
Central Bank	Apr 2012	0.5	2.1
Reuters Consensus	Apr 2012	0.5	2.0
Department of Finance	**Apr 2012**	**0.7**	**2.2**
IMF	Apr 2012	0.5	2.0
European Commission	May 2012	0.5	1.9
OECD	May 2012	0.6	2.1

Chart shows: Real GDP forecasts (sources named)

The outlook is for a second consecutive year of positive growth in 2012. The Department of Finance has forecast a real GDP increase of 0.7% for the year as a whole. The recovery is expected to gain ground and broaden next year.

Looking to the medium term, activity is expected to strengthen with annual average growth of 3% foreseen by the Department of Finance for 2014-2015. These medium term projections take account, in so far as is possible for an economy such as Ireland's, of the trend growth rate and the amount of slack in the economy.

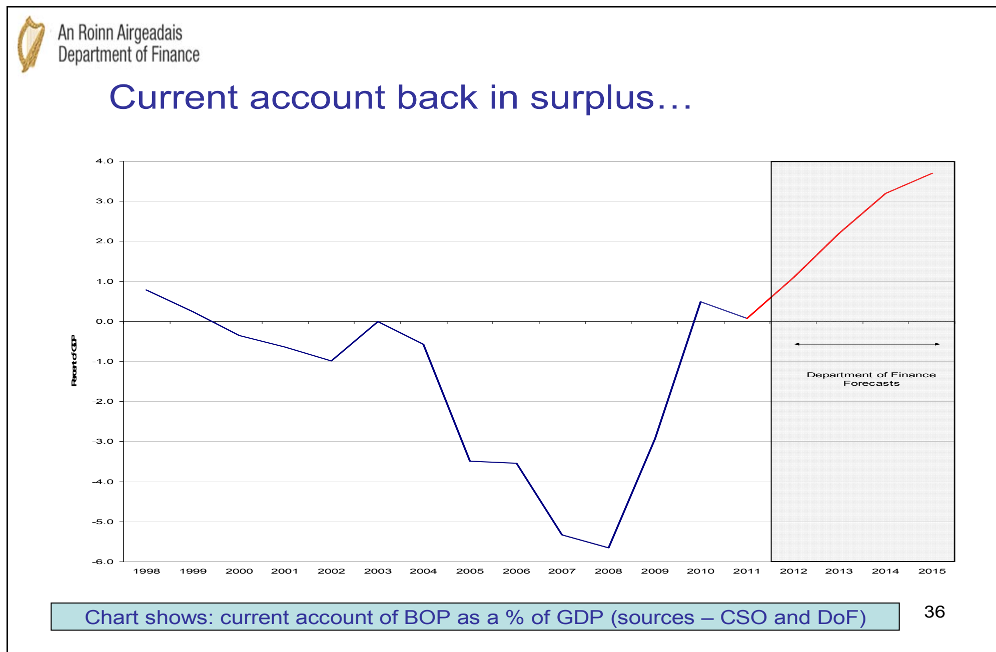
The expectation of a continuation of growth in 2012 is shared by all major forecasters, both domestic and international. The private sector consensus and Troika – the European Commission, IMF and ECB - anticipate that growth will average in the region of 2½% per annum over the period 2013-2015, broadly in line with Department of Finance expectations.



Growth in the Irish economy will be on a more sustainable basis over the period 2012 to 2015 than was the case in the past decade.

Exports are driving the recovery, a trend that is expected to continue throughout the forecast horizon. While the recent deterioration in the external environment will hold back export growth in the short-term, strong competitiveness improvements made in recent years will provide some support. As global activity regains momentum, export growth is forecast to strengthen over the medium term.

Domestic demand, however, is currently weighing on the growth rate. The domestic components of GDP are expected to be make a positive contribution to growth further out the forecast horizon, but this is likely to be limited given the ongoing impact of fiscal consolidation and balance sheet repair in the private sector.

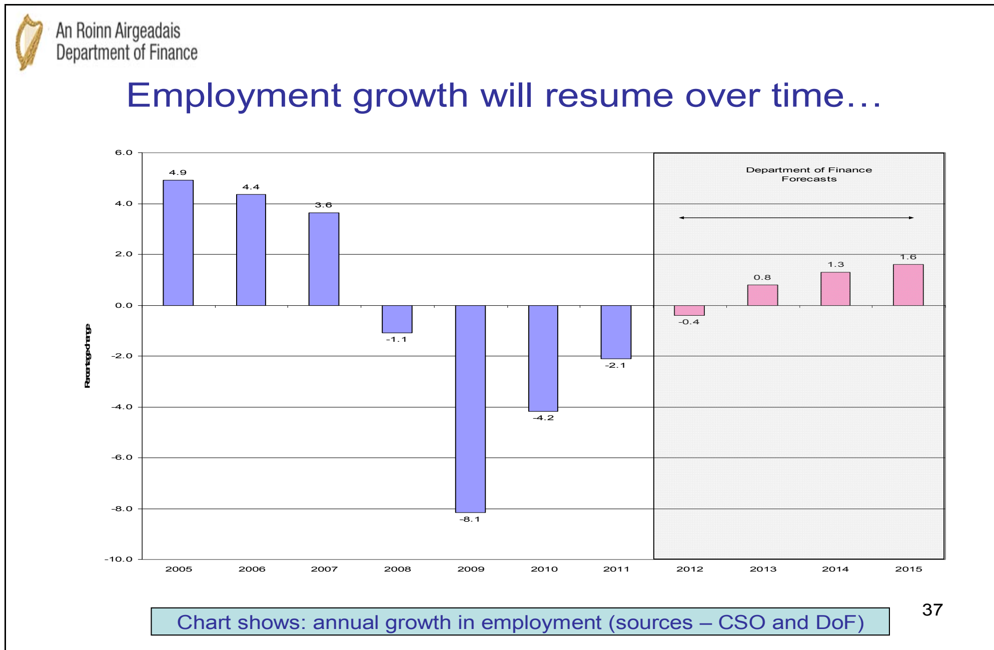


One consequence of the recent strength of exports is that the current account of the balance of payments has turned positive once again.

Having been in deficit for most of the last decade - and substantially in deficit as recently as 2008, when it was -5.6% of GDP - the current account ran a surplus of 0.5% of GDP in 2010 and another small surplus in 2011.

Given an expectation of export led growth, this surplus is forecast to increase further over the forecast horizon to 3.7% of GDP by 2015.

The return of the current account position to surplus is an important development. It means that the Irish economy is no longer be accumulating external liabilities, but is once again paying its way in the world.



While the Irish labour market remains weak, the outlook is for a gradual improvement over the forecast horizon, supported by Government measures.

For 2011 as a whole, employment contracted once again although there were 10,000 jobs created in Q4 2011, the first quarter of employment growth since 2007.

The number in work is expected to fall slightly in 2012, by 0.4%. This contraction – despite an expanding economy - reflects the less labour-intensive nature of export-led growth coupled with the tendency for firms to be more conservative when making hiring decisions in the early stages of recovery. The latter's effect is likely to be amplified by the uncertain external environment.

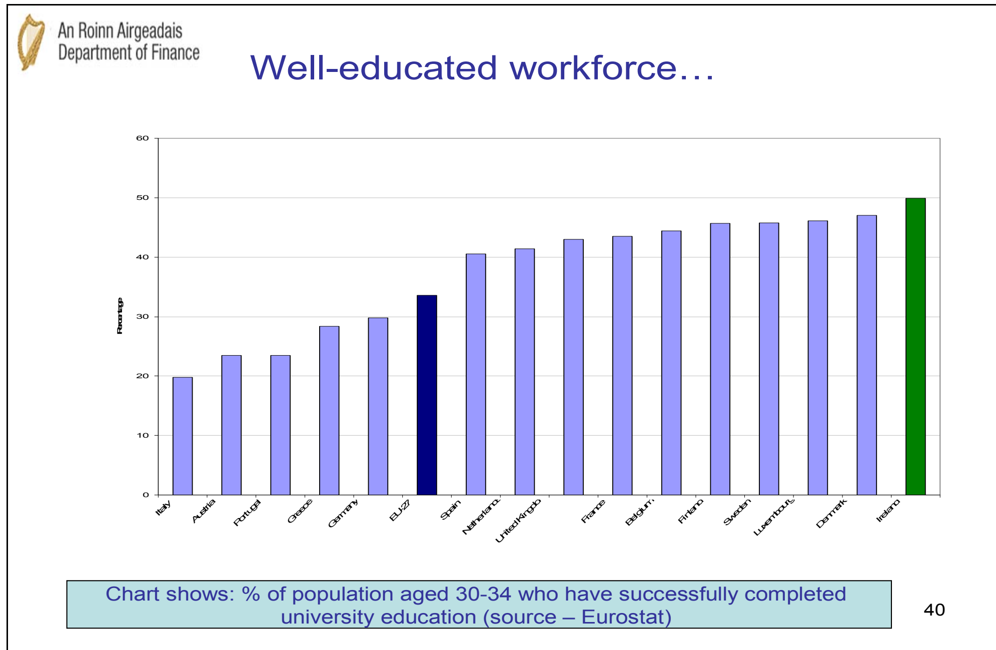
The economy is expected to be creating jobs on a full year basis in 2013. Hiring is then set to strengthen in subsequent years as the recovery gains traction and broadens out. The unemployment rate will remain at an elevated level throughout the forecast horizon, however. From an average of 14.4% in 2011 it is expected to have fallen to 11.7% in 2015.

Section 6

Ireland’s underlying strengths remain

Ireland’s underlying medium term strengths remain in place…

- Well-educated workforce;
- Favourable demographics;
- High level of employment;
- Very open economy….
- …with high-tech export base;
- Pro-enterprise environment.



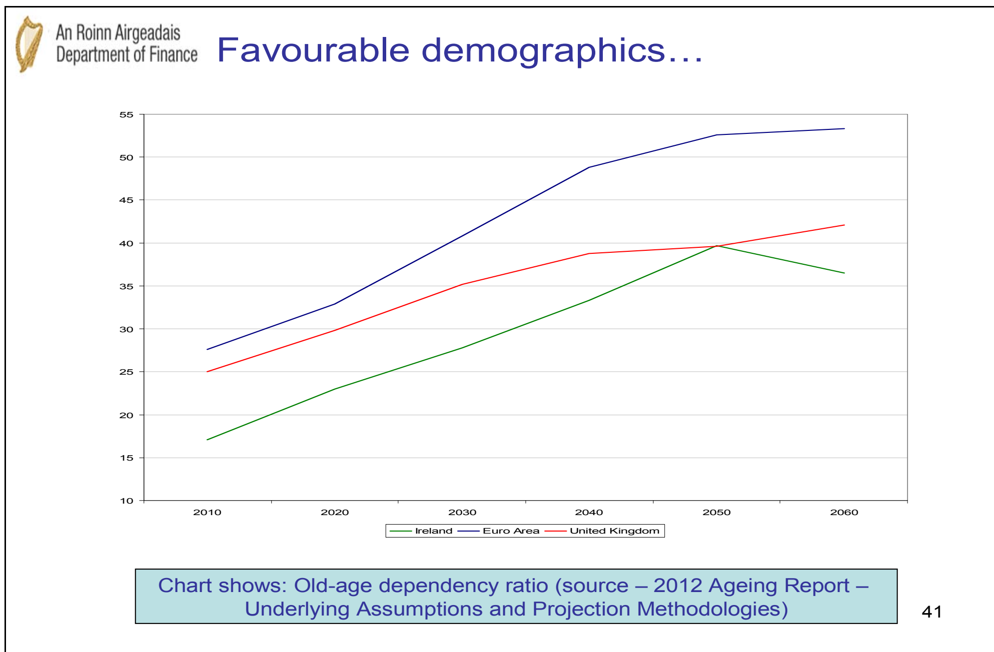
The Irish economy benefits from a highly educated and well qualified workforce, demonstrating the benefits of the substantial investment in education made over many years.

The number of people aged between 30 and 34 in Ireland who have successfully completed university education is the highest in the EU27 and is well above the European average (source: Eurostat);

The number of people aged between 20 and 24 who are educated to at least upper second level is the highest in the EU15 (source: Eurostat);

Ireland produces the fourth highest number of maths, science and computer graduates per 1,000 of population (aged 20-29) in the euro area (source: National Competitiveness Council);

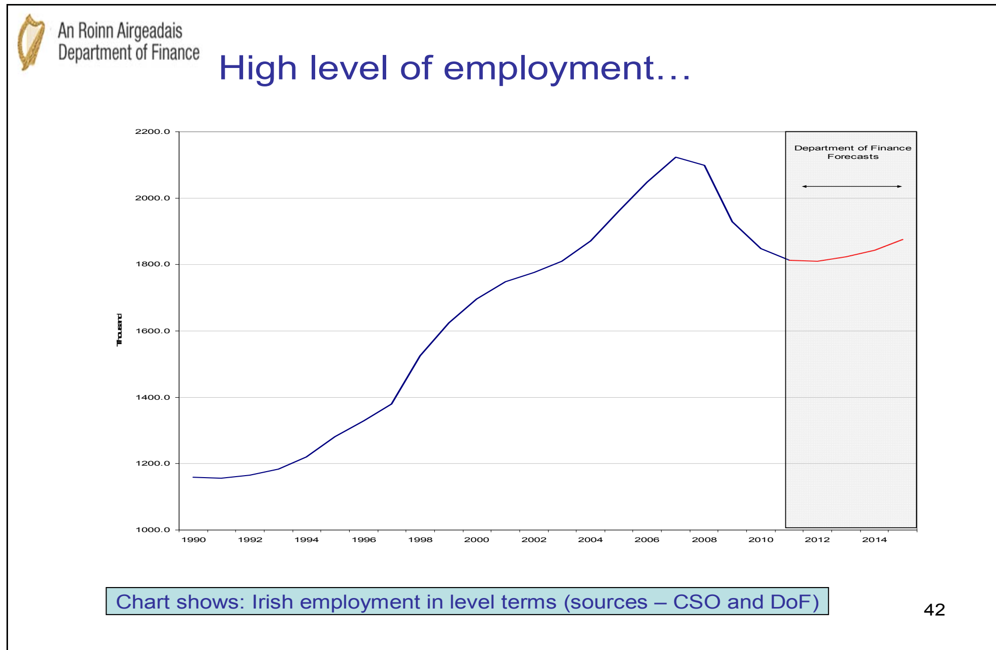
The number of PhD students per 1,000 of population is above the OECD-24 average (source: National Competitiveness Council).



Following a baby boom in the 1970's and early 1980's, the Irish population is relatively young by international standards, especially by European standards.

Data from Eurostat estimate that the Irish old-age dependency ratio (population aged over 65 as a proportion of the working age population) was just 17.1 percent last year, the lowest in the EU15. This compared to ratios of around 28 per cent in the euro area and 25 per cent in the UK.

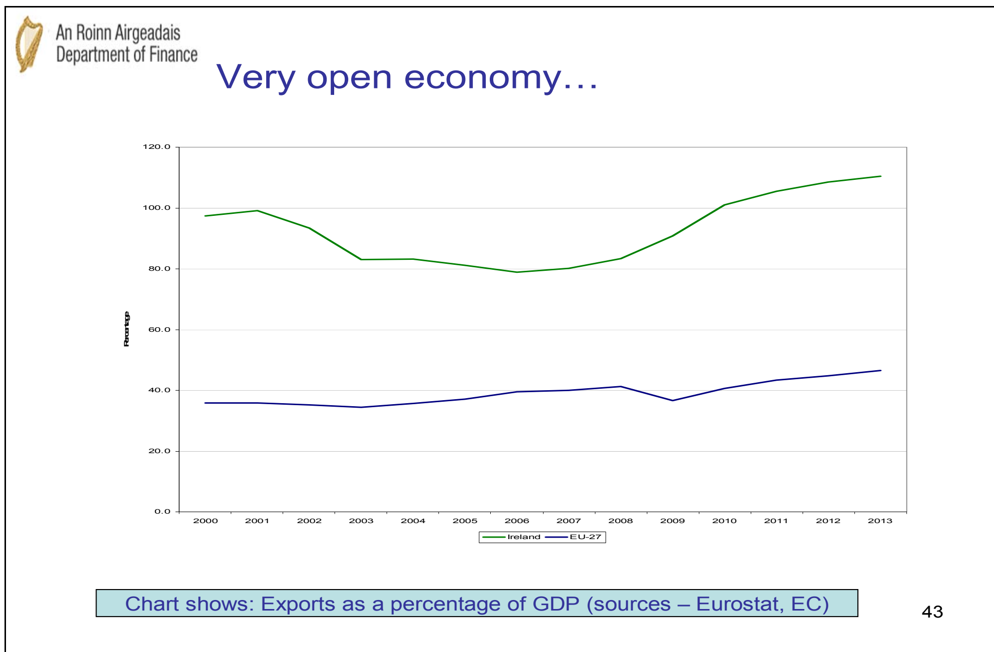
Looking ahead, the old-age dependency ratio is expected to remain relatively low in the coming decades, increasing to around 37 per cent by 2060.



While the numbers in work have fallen against the backdrop of a sharp decline in activity, the level of employment remains relatively high from a historical perspective. In the final quarter of 2011 there were 1.8 million people at work in Ireland, compared to around 1.2 million in the early to mid-1990s.

As noted earlier, supported by Government policies, employment is anticipated to increase over the forecast horizon. While, in annual terms, the economy is expected to experience a marginal contraction in employment in 2012, annual increases are expected from 2013 onwards. The pace of annual employment growth is forecast to strengthen from 0.8% in 2013 to 1.6% by 2015.

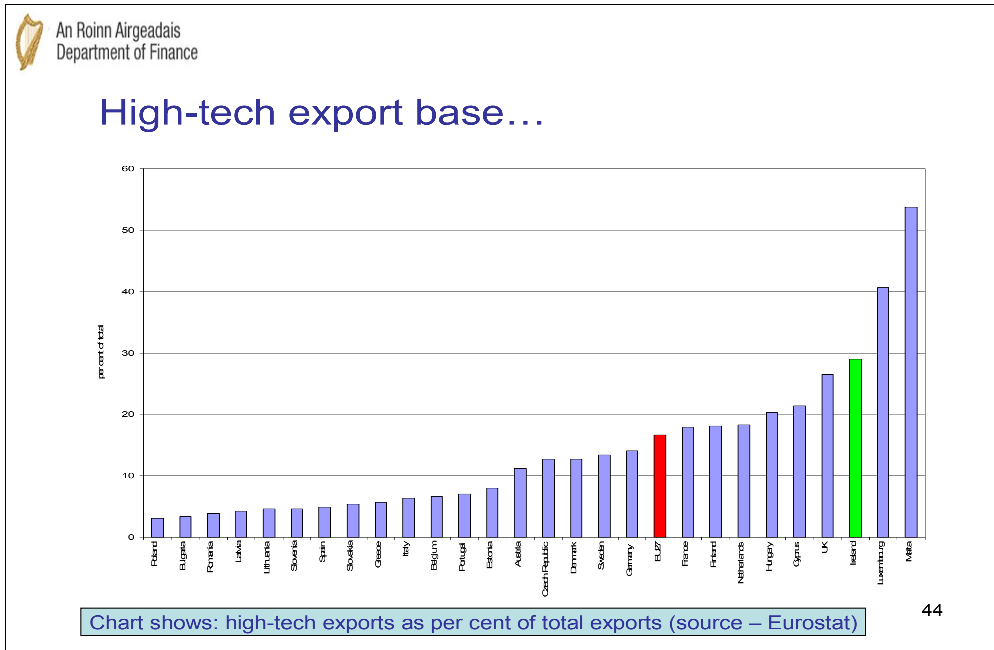
By 2015 the proportion of the population in employment is forecast to be around 40%, below the peak of 50% reached in 2007, but well above the level of around one-third recorded in the late 1980's.



Ireland remains one of the most open economies in the EU and indeed in the world. Irish exports increased to over 100% of GDP in 2010, above their level at the start of the decade. The Commission has forecast a further strengthening to around 110% of GDP by 2013.

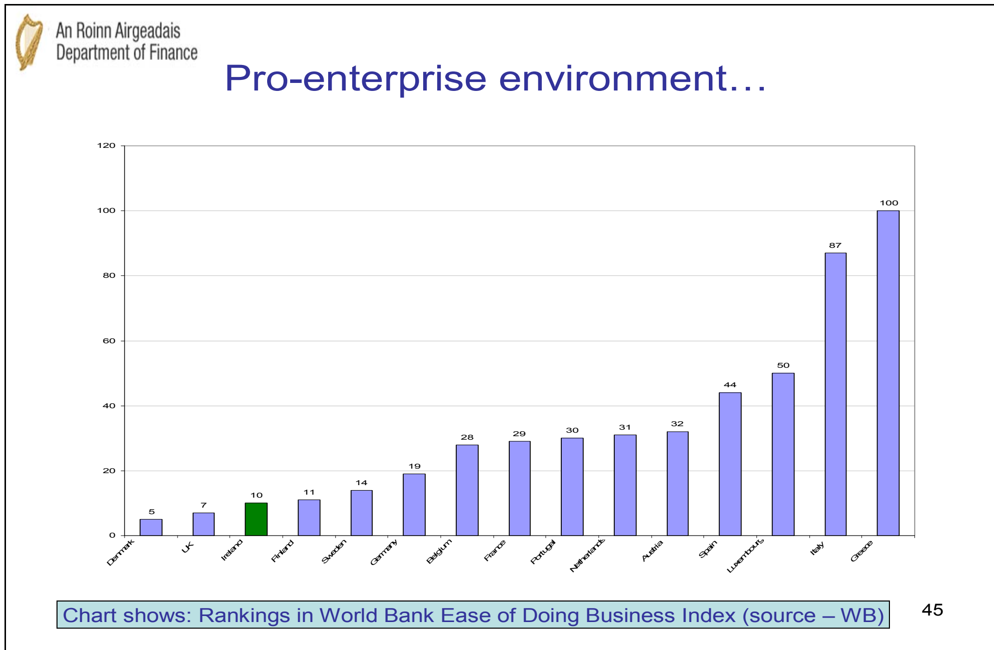
In the EU 27 as a whole, by comparison, exports were just 40% of GDP in 2010 and are forecast to increase modestly to around 47% of GDP by 2012.

This openness is helping the country trade its way to recovery, even while the domestic components of growth remain weak.



Ireland has achieved critical mass in a number of high-technology sectors. Data from Eurostat, illustrated above, reveal that nearly one-third of Irish exports are classified as high tech (such as IT and chemicals) as business functions shift to higher value activities. This compares with an average of 17% in the EU-27.

The high concentration of our exports in high technology sectors is a key factor behind our relatively resilient export performance despite the very sharp global economic downturn. While the European Commission expect exports in the euro area as a whole to grow by 2.1% in 2012, Irish exports are forecast to grow at around a percentage point above that.



The Irish economy continues to be recognised as one of the most pro-enterprise environments in the world. Ireland was ranked tenth in the World Bank's 2012 Ease of Doing Business Index, making it the highest ranked euro area country, and the third highest-ranked country in the European Union.

Ireland continues to attract considerable inward FDI. Almost 1,000 companies, including Google, eBay and Facebook, have chosen Ireland as the hub of their European networks.

Eight of the top ten global medical technology companies have a manufacturing base in Ireland, while eight of the top ten pharmaceutical companies have operations here. So Ireland remains open for business and is still the destination of choice for many of the world's leading firms.

The Government have been extremely clear in stressing that the 12½% corporation tax rate is here to stay. The Minister for Finance reiterated this point once again in his Budget 2012 speech.

An Roinn Airgeadais
Department of Finance

In conclusion…

- Ireland is recovering from a very deep downturn:
  - The economy returned to growth in 2011 for the first time in four years.
  - Relatively strong growth is expected over the medium-term.
  - The economy's underlying strengths remain intact.
- There has been a significant policy response:
  - On track to correct the excessive deficit by 2015.
  - Determined approach to banking issues.
  - Large improvement in competitiveness.
  - Government employment initiative will assist in employment creation.
- EU/IMF programme is on track:
  - Five quarterly reviews have been completed, with the sixth nearing completion.
  - Policy implementation strong.
  - Aim to end reliance on Programme funding and return to markets on schedule.

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The economy is currently emerging from an extremely deep recession. Following three successive annual contractions, real GDP grew in 2011 and is expected to grow again in 2012.

Crucially, our society is cohesive, we enjoy political stability and a shared understanding of our economic problems. Furthermore, the economy's underlying strengths remain intact.

Significant policy responses have been taken:

- Tough decisions have been made to bring about stability to the public finances, and the deficit will be reduced below 3% of GDP by 2015;
- The banking system is being repaired;
- Our asset prices, wage levels and price levels are all adjusting rapidly to the new circumstances, thereby improving our competitiveness;
- Various Government employment initiatives, such as the Jobs Initiative and the Action Plan for Jobs, will assist in employment creation.

The financial assistance programme is on track. The Government has concluded five quarterly reviews with the Troika and is in the process of agreeing the sixth, and our external funding partners have concluded that our policy implementation has been strong. While there is no complacency about the challenges that lie ahead, we are making good progress and we remain steadfast in our commitment to overcome those challenges and bring to an end our reliance on Programme funding.

This document was produced by the Department of Finance.

Updates are produced periodically. Comments are welcome and should be addressed to:

Niall Feerick
Economic Division
Department of Finance

e-mail: niall.feerick@finance.gov.ie
ph: +353 1 604 5898

Note that the figures and text are up-to-date as of late April 2012 but will change as further data become available. Department of Finance forecasts set out in this document are those contained in the Stability Programme Update 2012, published on April 27 2012.

A more detailed presentation from the Department's banking division is available at www.finance.gov.ie/viewdoc.asp?DocID=7002

Initials are used to indicate sources in many of the charts. They are: CSO (Central Statistics Office); DoF (Department of Finance); EC (European Commission Spring 2012 forecast); WB (World Bank), Central Bank of Ireland (CBI), NTMA (National Treasury Management Agency).

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