Appendix F.
Ireland: the Celtic tiger retracts its claws

Although Ireland returned to growth in 2011, its recovery has been fragile and inadequate: at the end of 2011, real GDP was still significantly lower-by 8.8%-than its pre-crisis level. Unemployment has continued to rise and stood at 14.7% of the active population by June 2012. Moreover, ever since the first quarter of 2010, Irish growth has alternated between periods of recovery and decline. The first quarter of 2012 offered a reminder of the precariousness of the recovery, with GDP falling by 0.7%. The government's steps towards fiscal consolidation, coupled with the after-effects of the banking crisis, are still weighing heavily on households and, by extension, on domestic demand. As a result, growth depends critically on the external component. But this is being endangered by the macroeconomic situation of Ireland's European partners. Although Ireland is less exposed to the euro zone than Europe's other small countries[11], it is highly dependent on global macroeconomic conditions. The relapse into recession of the euro zone and the United Kingdom in 2012, along with slower growth in US GDP, will thus remove the last available tool for powering Irish growth. GDP is expected to fall by 0.4% in 2012 and another 0.1% in 2013.

In fact, notwithstanding the numerous measures already taken since 2010, fiscal consolidation has continued in 2012. The standard VAT rate was raised two percentage points as of 1st January 2012, and child benefit was also reduced starting from the third child. In all, the government's cost-cutting measures over the course of 2012 amount to 3.8 billion euros (2.4% of GDP). For the period 2013-2015, Ireland expects to achieve additional savings of 8.6 billion euros, for a negative annual fiscal stimulus equivalent to 1.8% of GDP. As the government is maintaining its strategy of preserving the competitiveness of Irish firms, the new measures will primarily affect households, which have already seen a reduction in the minimum wage and cuts in civil service employment and wages, along with reduced spending on social services and healthcare. Accordingly, the decline in household purchasing power that began in 2009 is likely to continue in 2012 and 2013. At the same time, the desire to reduce household debt levels[12] and the fear of unemployment will be pushing the savings rate upwards. By year's end 2013, the savings rate is expected to reach 12.4%, compared to 11.6% at the end of 2011 and just 4.4% at the close of 2007. Consequently, we anticipate a continued drop in household consumption—by 2.9% in 2012 and 2.1% in 2013—and in housing investment.

11. With the exception of Finland: Ireland and Finland conduct an identical share of their trade with other countries in the zone (35%). The figures for Austria and Belgium are 60%, and for Portugal the share exceeds 65%. Nearly 40% of Greece's trade is with other euro zone nations.
12. The level of household debt has already fallen 20 points since the close of 2009. But it still stands at 214% of gross disposable income—one of the highest levels in the OECD.

Ireland's growth can only come from beyond its borders. In that regard, the country's competitiveness has improved substantially since 2007. Two factors are contributing to this trend. First, the manufacturing base has benefitted from lower wages, the result of measures taken by the government to reduce labour costs and the high unemployment rate, which is eroding employee bargaining power. Moreover, after falling sharply through the end of 2008, the productivity cycle has gradually closed again. Thus, since the start of 2009, Ireland's competitiveness with respect to its European partners has increased by nearly 17%. However, the effectiveness of this strategy of internal devaluation has been dampened by weak foreign demand[13]. The increasing number of consolidation measures, notably within the euro zone, is reducing demand among Ireland's trade partners. In 2013, budgetary constraints will be less severe in the euro zone but more significant in the United States, which accounts for almost 20% of Ireland's trade, while the euro zone countries represent about 35%. As a result, despite their renewed competitiveness, Irish firms will have difficulty finding markets for their goods, which will in turn affect their ability to invest via a multiplier effect. Investment will slide once again in 2012 and 2013. Even though this drop is resulting primarily from continued adjustment in the property market, the lending terms available to businesses will also weigh heavily on their ability to invest. A recent study by the Central Bank of Ireland[14] showed that the terms of credit—the need for loan guarantees, interest rates, quantitative rationing—are among the most stringent in the euro zone, whereas demand for credit among Irish SMEs ranks about average. Ireland’s banking system is still on life support, following the creation of the National Asset Management Agency in December 2009. The major nationalized banking institutions announced new losses during the first half of 2012, attributed to macroeconomic conditions and continued adjustment in the property market.

Ireland, then, is among the countries that have seen only a short-lived emergence from the recession, and this in turn is hampering the government's ability to fulfil its commitment to reduce the budget deficit. With regard to the public finances, the government will meet its objectives in 2012, insofar as the deficit will be below the target of 8.3% defined in the stability programme. But in 2013, with the deficit rising from 8% to 8.4% versus the target of 7.5%, the government will likely not be able to meet its commitments unless new cost-cutting measures are adopted, measures that in this case would deepen Ireland's recession. It should be noted, however, that the rise in the deficit will result primarily from an anticipated rise in interest payments to service the debt in 2013[15]. Government debt will continue to climb and could reach nearly 100% of GDP in 2013, exceeding 2007

13. Ireland’s level of economic openness exceeds 90% of GDP, compared to less than 40% in Portugal and 29.5% in Italy.
14. See http://www.centralbank.ie/publications/Documents/Economic%20letter%20no.%208,2012.pdf.
15. For more information, see page 24 of the 2012 stability programme (http://ec.europa.eu/economy_finance/economic_governance/sgp/pdf/20_scps/2012/01_programme/ie_2012-04-27_sp_en.pdf).

levels. Nonetheless, we should emphasize that cumulative debt among households, non-financial firms, the government and monetary and financial institutions continued to fall in early 2012. As a result, the rise in public debt is simply offsetting a reduction in debt among households and monetary and financial institutions.

Table F. OFCE, ECLM, IMK macroeconomic forecasts

Ireland

%	2010	2011	2012	2013
GDP	-0.8	1.4	-0.4	-0.4
Private consumption	0.5	-2.3	-2.4	-1.6
Investment	-22.7	-12.7	-11.6	-19.3
Public consumption	-4.6	-4.4	-4.4	-2.4
Exports	6.2	5.0	2.8	1.1
Imports	3.6	-0.3	-0.6	-1.3
Contribution to growth				
Internal demand	-4.3	-3.5	-3.1	-3.0
External trade	3.4	5.9	3.7	2.4
Inventories	0.1	-1.0	-1.0	0.2
Unemployment rate	13.7	14.4	14.9	15.5
Inflation	-1.6	1.2	1.9	1.8
Public deficit % GDP	-31.2	-13.1	-8.0	-8.6
Fiscal impulse % GDP	-4.4	-1.5	-2.4	-1.8
Public debt % GDP	92.5	108.2	117.6	123.3
Current account % GDP	—	—	—	—
Unit labour costs	—	—	-4.0	-4.7

Source: National accounts, Eurostat, OFCE, ECLM, IMK.