The Outlook for the Irish Economy

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Recovering from a Deep Recession

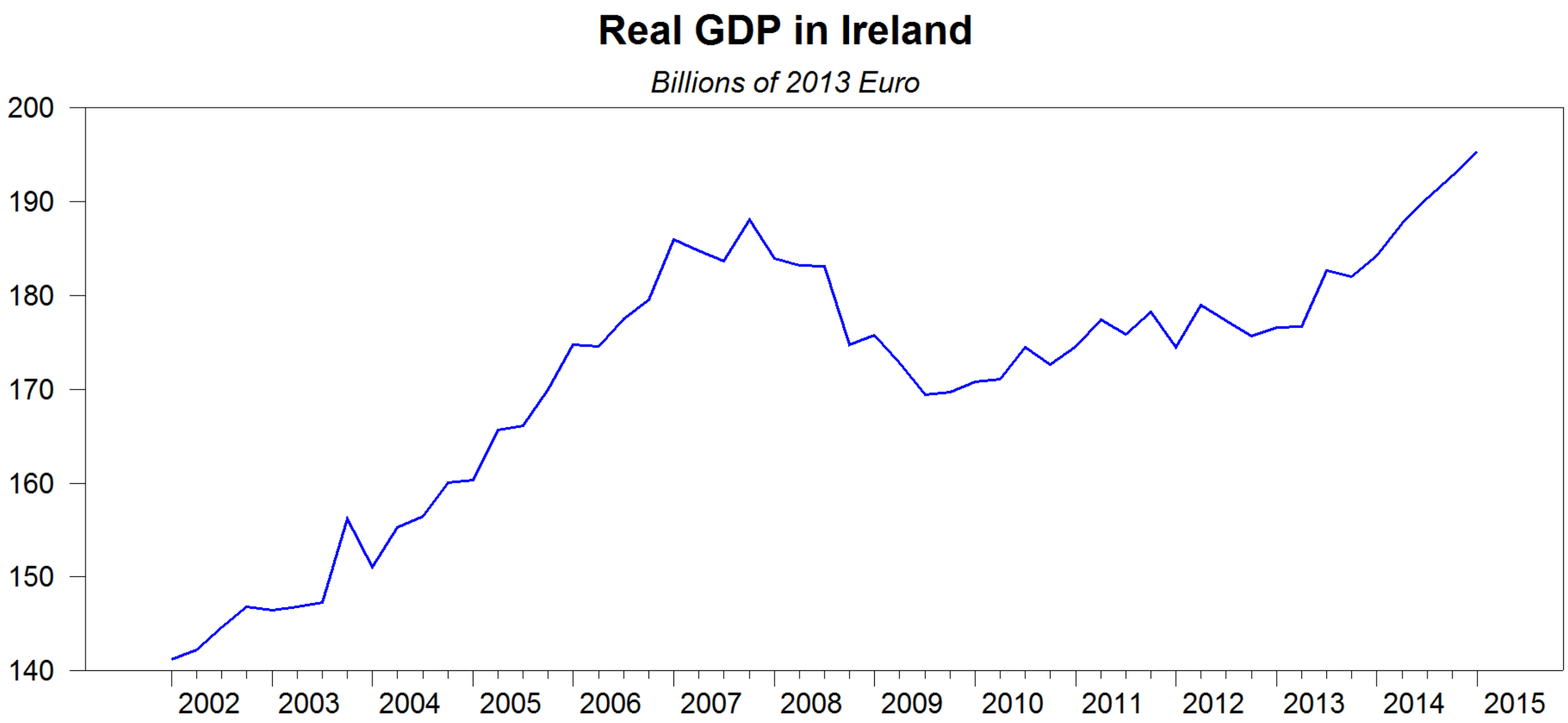
- The Irish economy grew rapidly from 1990 until 2007.
- The later years of the expansion featured **huge increases in credit**, a **property bubble** and a **construction boom**.
- The economy then suffered a severe recession, with the main elements now well known:
  - Falling house prices and a construction sector crash.
  - A fiscal crisis as unemployment soared and tax revenue fell.
  - Austerity produced large tax increases and spending cuts.
  - A banking crisis as all the major banks failed with huge (and controversial) costs passed on to the state.
- This lead to an EU-IMF programme from 2010-13 but the economy is now undergoing a strong recovery.

Questions About Ireland’s Recovery

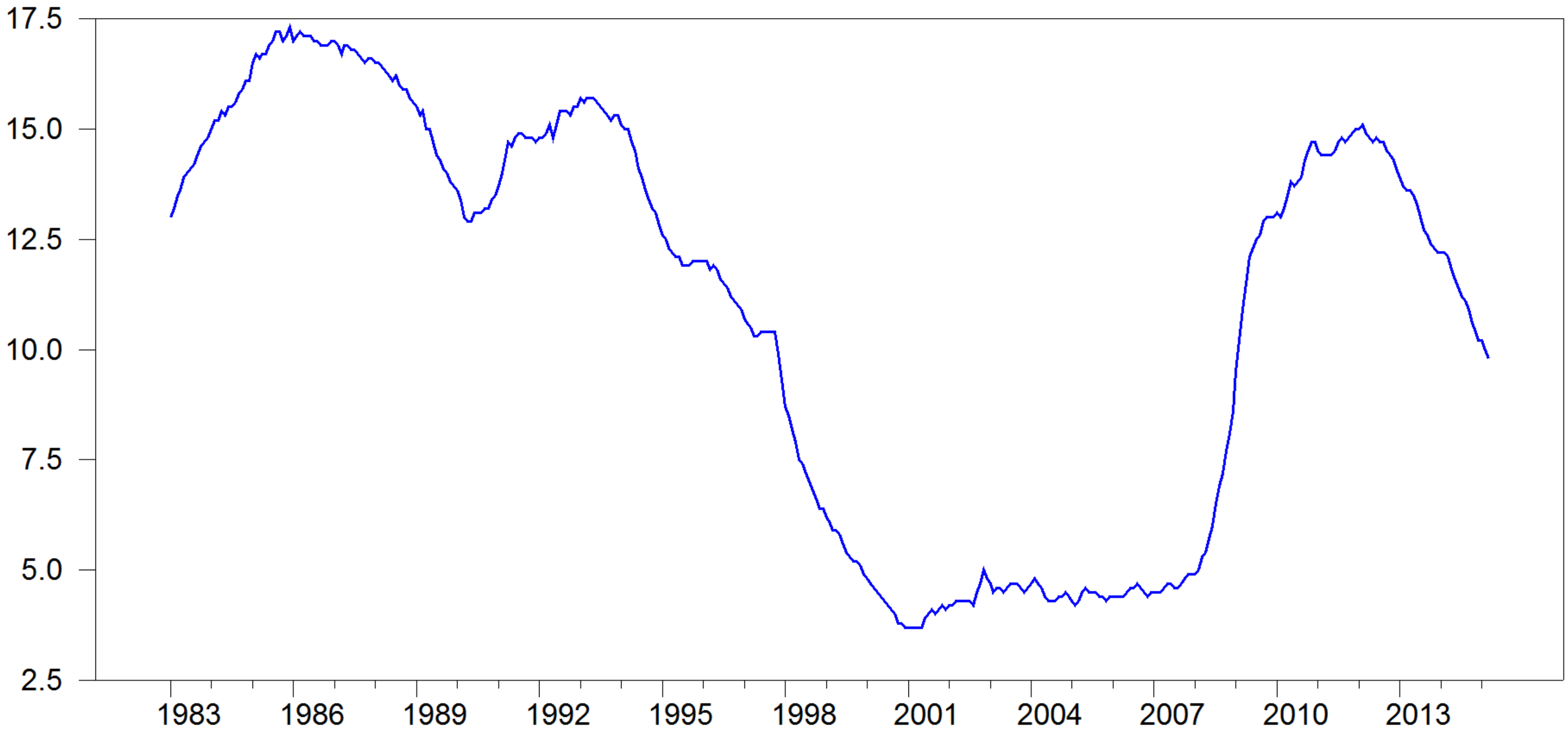
- Was the Celtic Tiger a “mirage” fuelled by credit or was the recession a “nasty blip” with Ireland set for another Celtic Tiger period of rapid growth?
- House prices are rising again: Is Ireland in danger of making the same mistakes?
- What role did “structural reforms” play in Ireland’s recovery?
- What are the key medium-term risks for the Irish economy?
- As Ireland has much in common with regional economies, many of the answers to these questions have a **regional\spatial** element to them.

Ireland’s Recovery: Some Facts

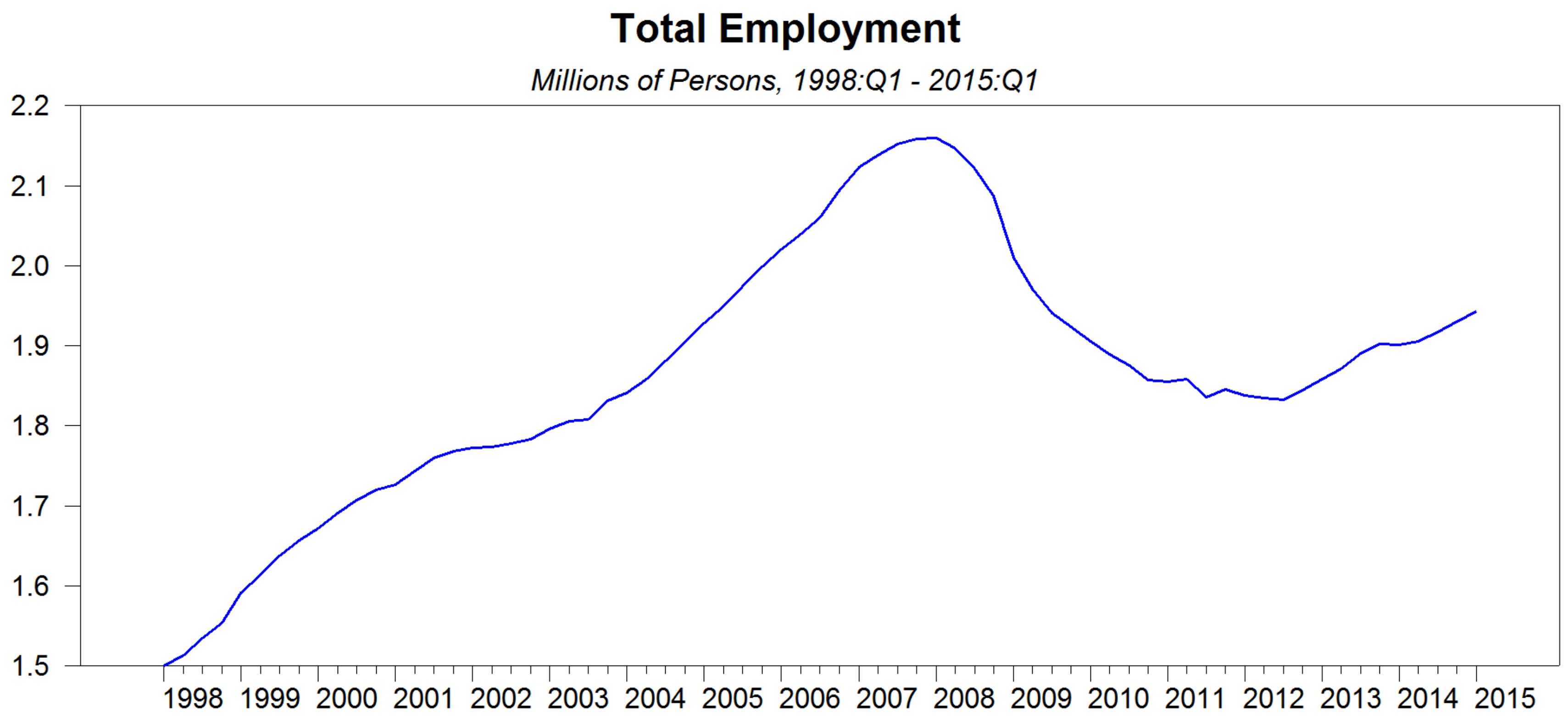
GDP is Now Growing At A Fast Pace



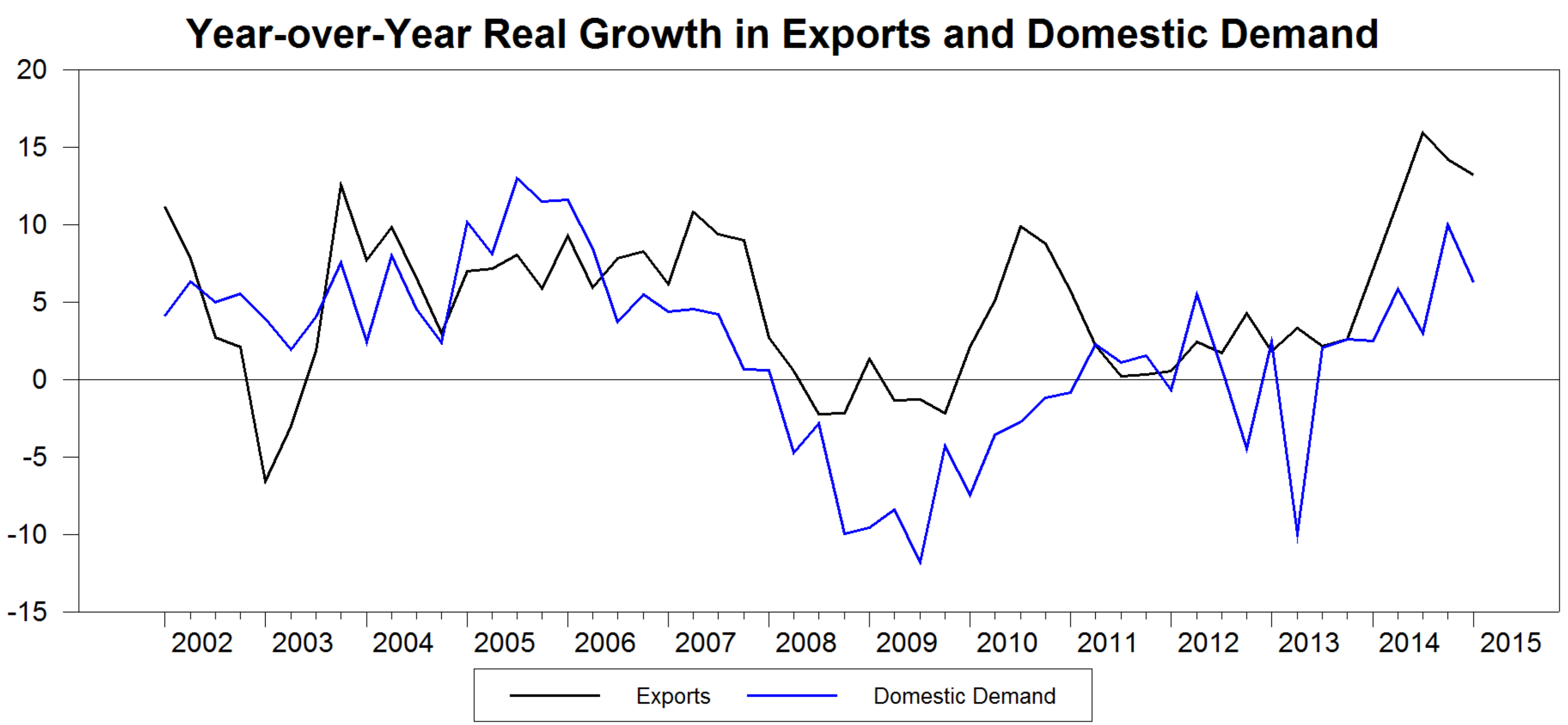
Unemployment Rate is Falling Fast



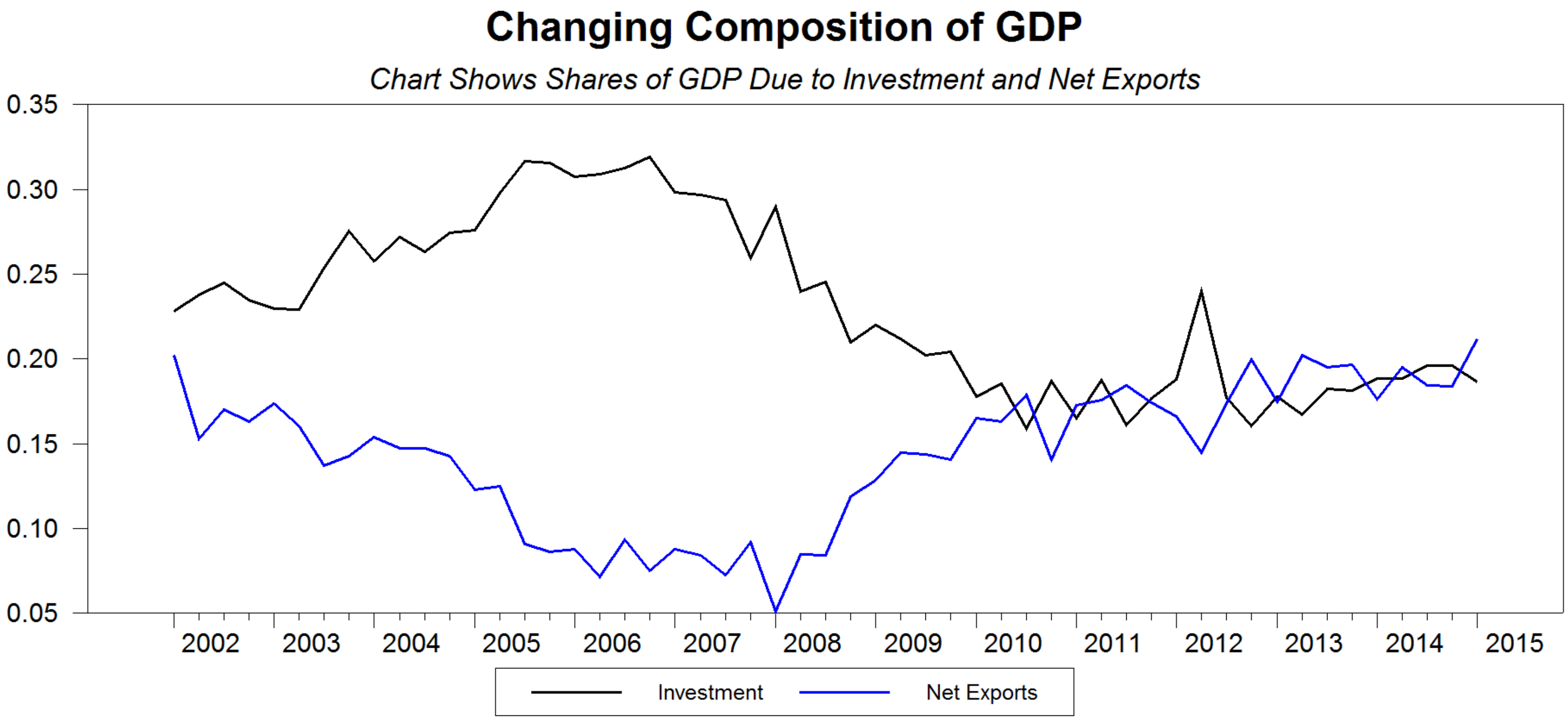
Employment Is Up



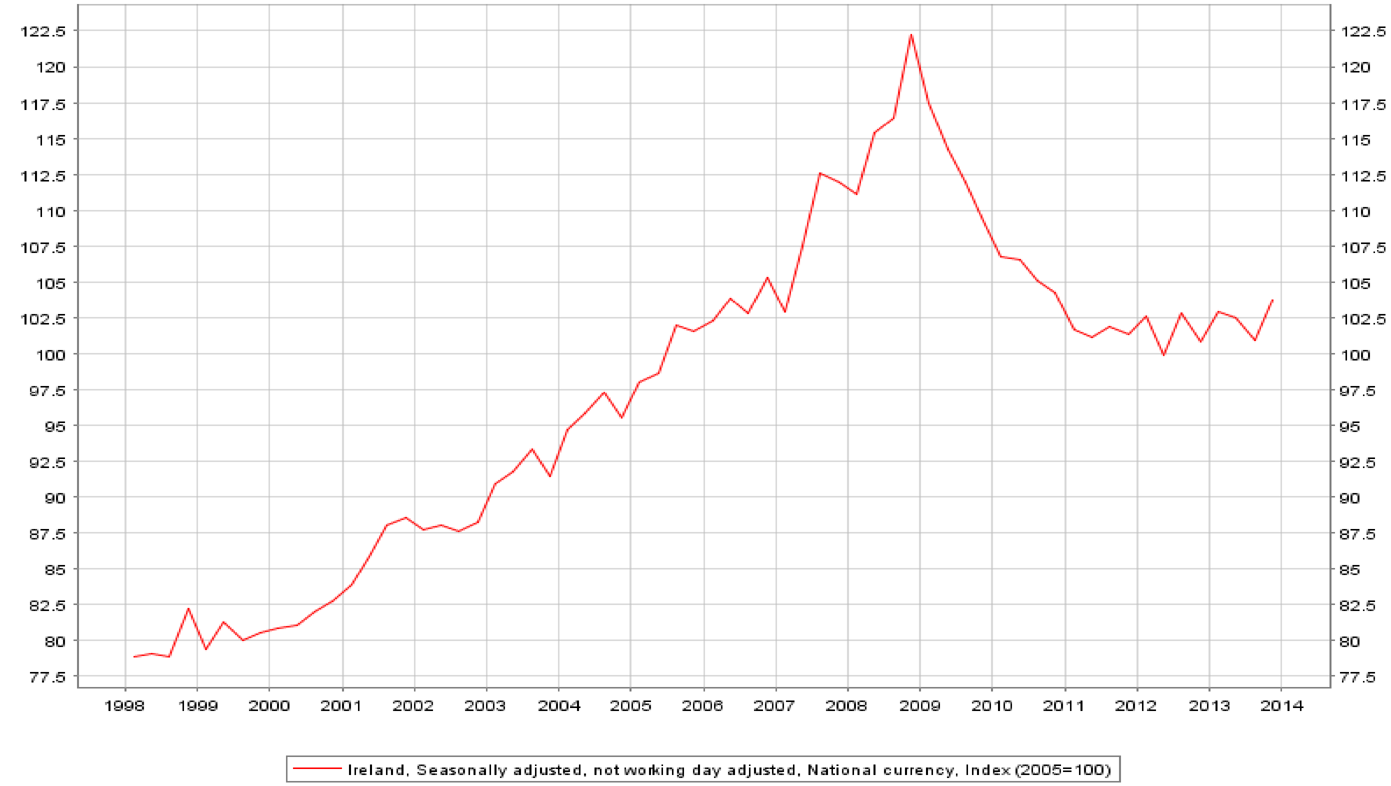
Exports Driving Growth



So Economy Has Re-Balanced



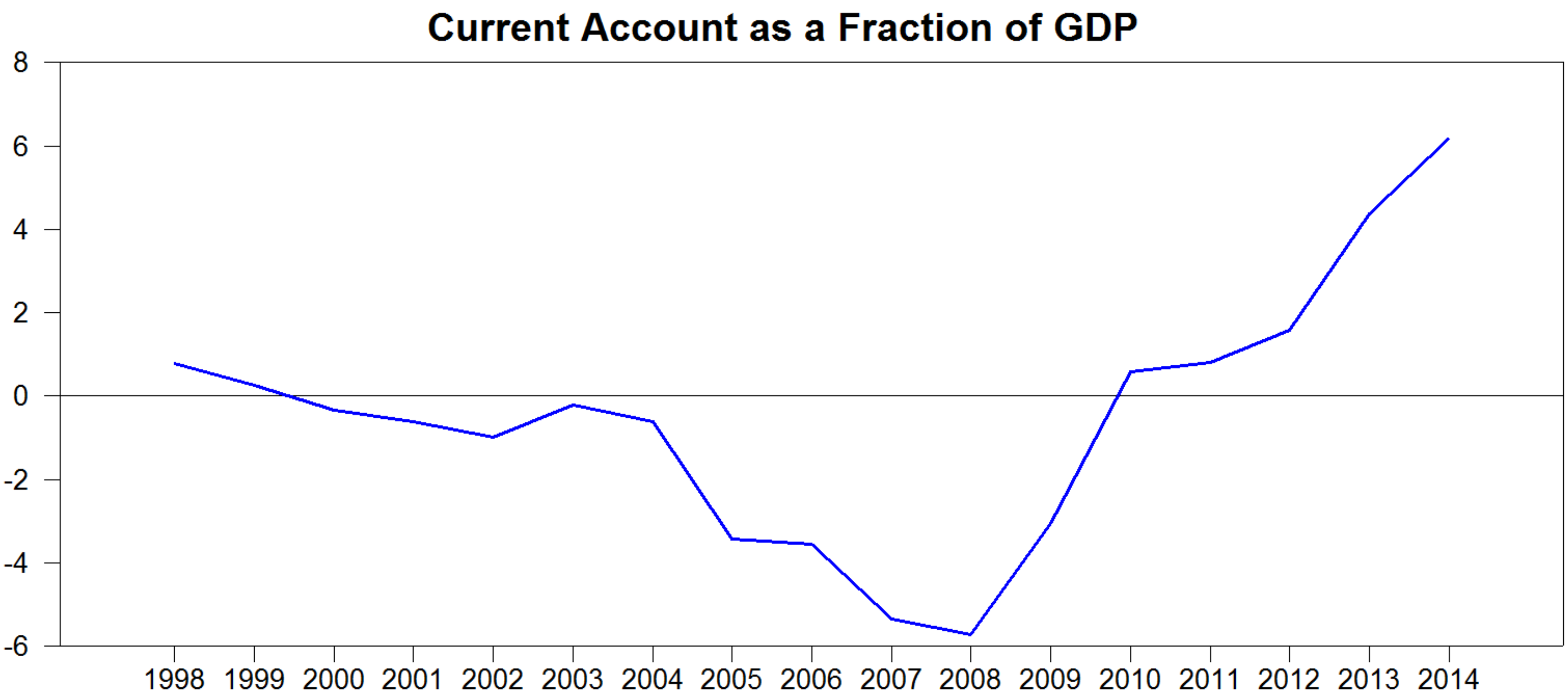
Improved Competitiveness: Unit Labour Costs Are Now Lower



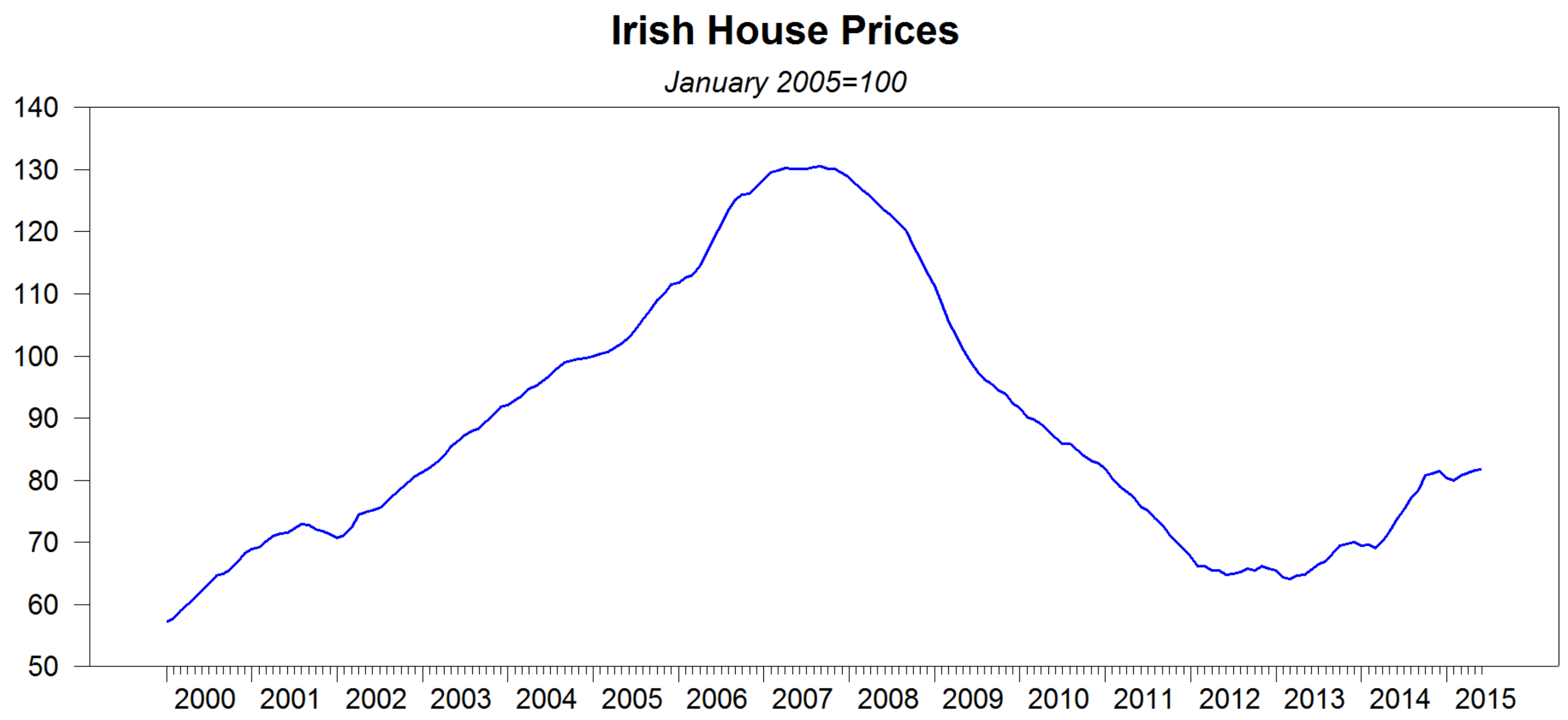
External Environment Has Improved

- Ireland’s location and its historical linkages mean it trades heavily with the UK and the US and these economies have registered solid growth rates over the past few years.
- This partly explains why Ireland has done so much better than other euro area economise.
- The euro area economy is also now in a recovery, though there are long-run structural problems.
- Combined with improved competitiveness, this has allowed Irish exports to perform well over the past few years.

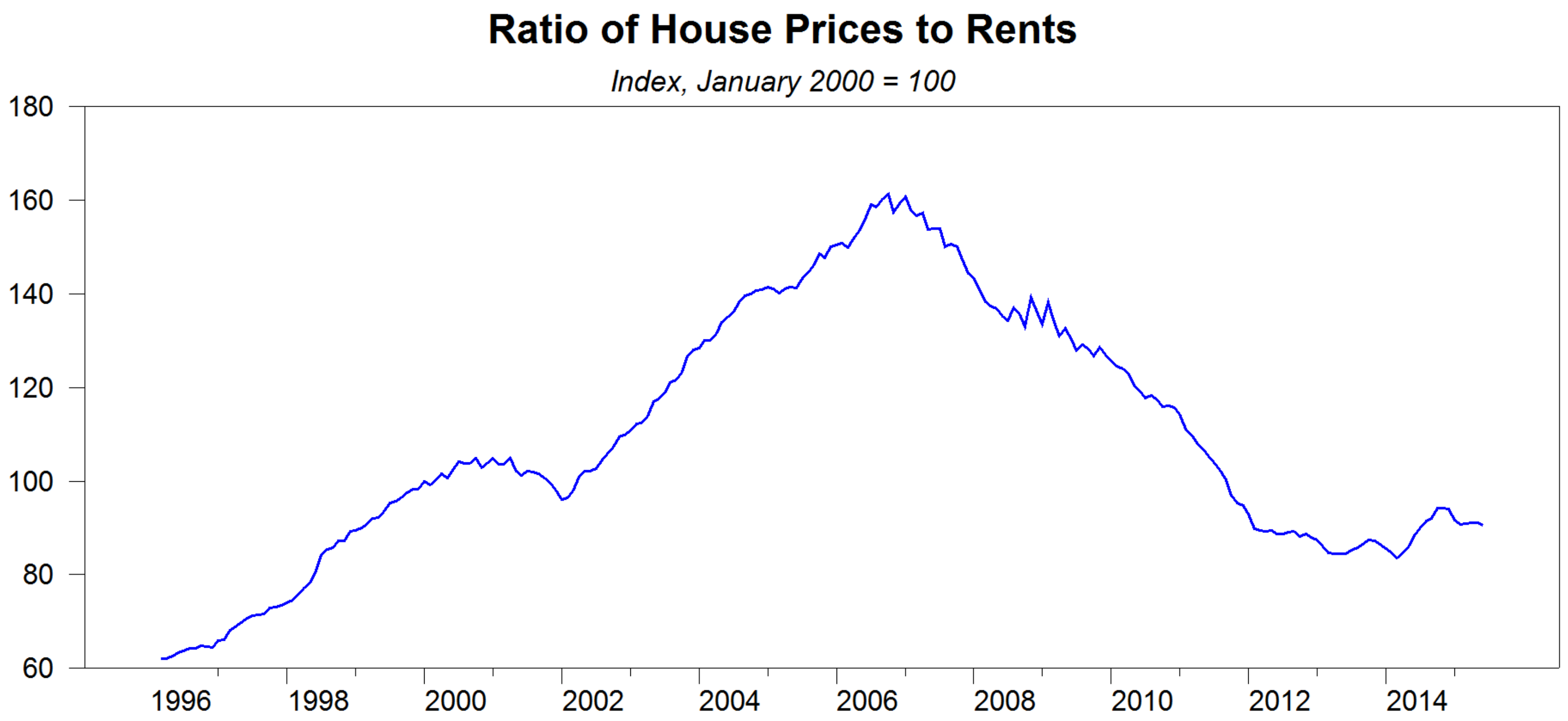
Current Account is Positive So Ireland Is Running Down Its Debt



House Prices Are Up Sharply



But Valuations Are Still Way Below Peak Levels



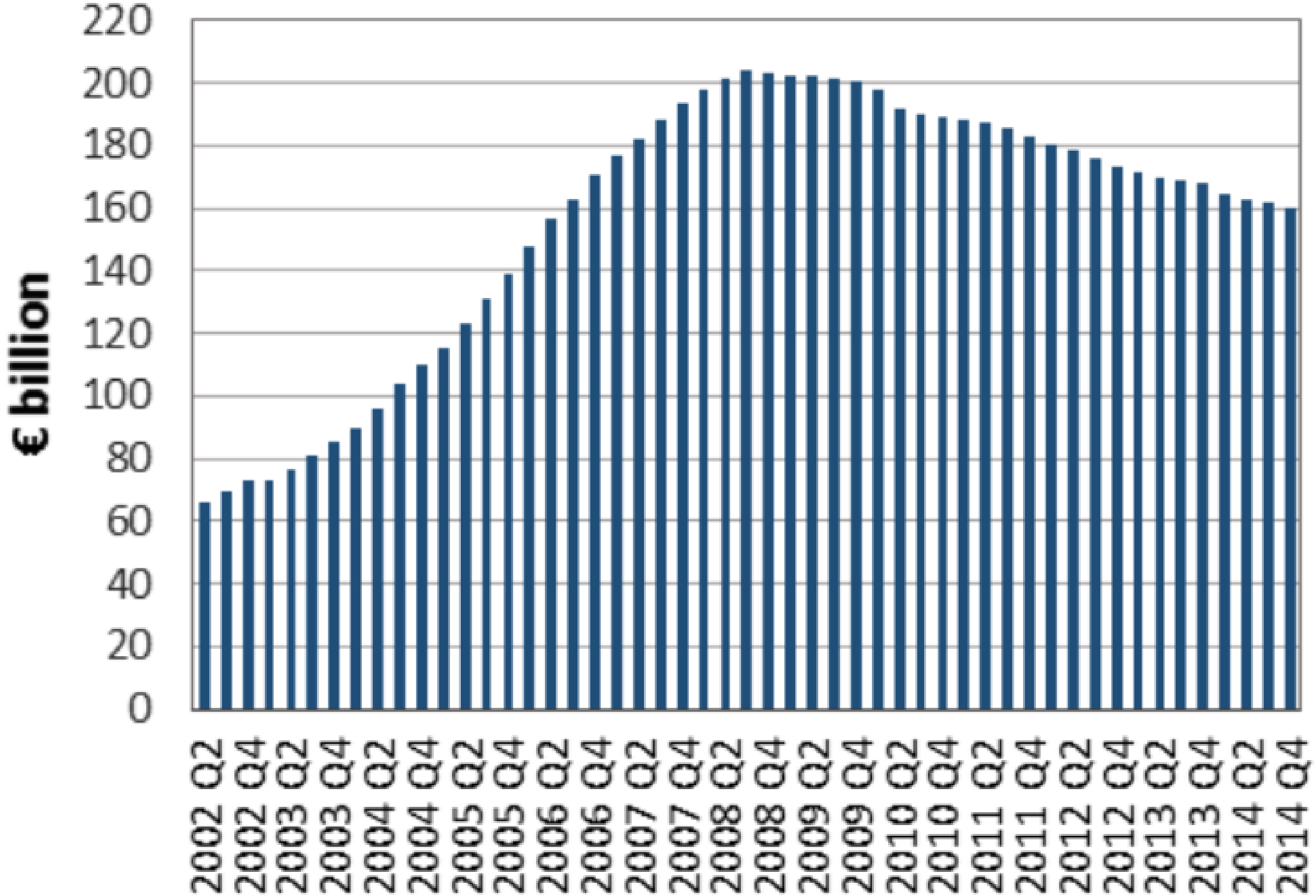
Fiscal Stabilisation But With High Debt

- Budget 2015 was the first non-contractionary budget after seven years of austerity.
- The fiscal deficit is set to go below 3 percent this year.
- Debt\GDP ratio fell from 123 percent in 2013 to 110 percent last year due to GDP growth and running down stocks of cash.
- Markets are very confident that prospect of default is gone but fiscal policy will need to be managed carefully for many years to keep the debt ratio on a downward path.

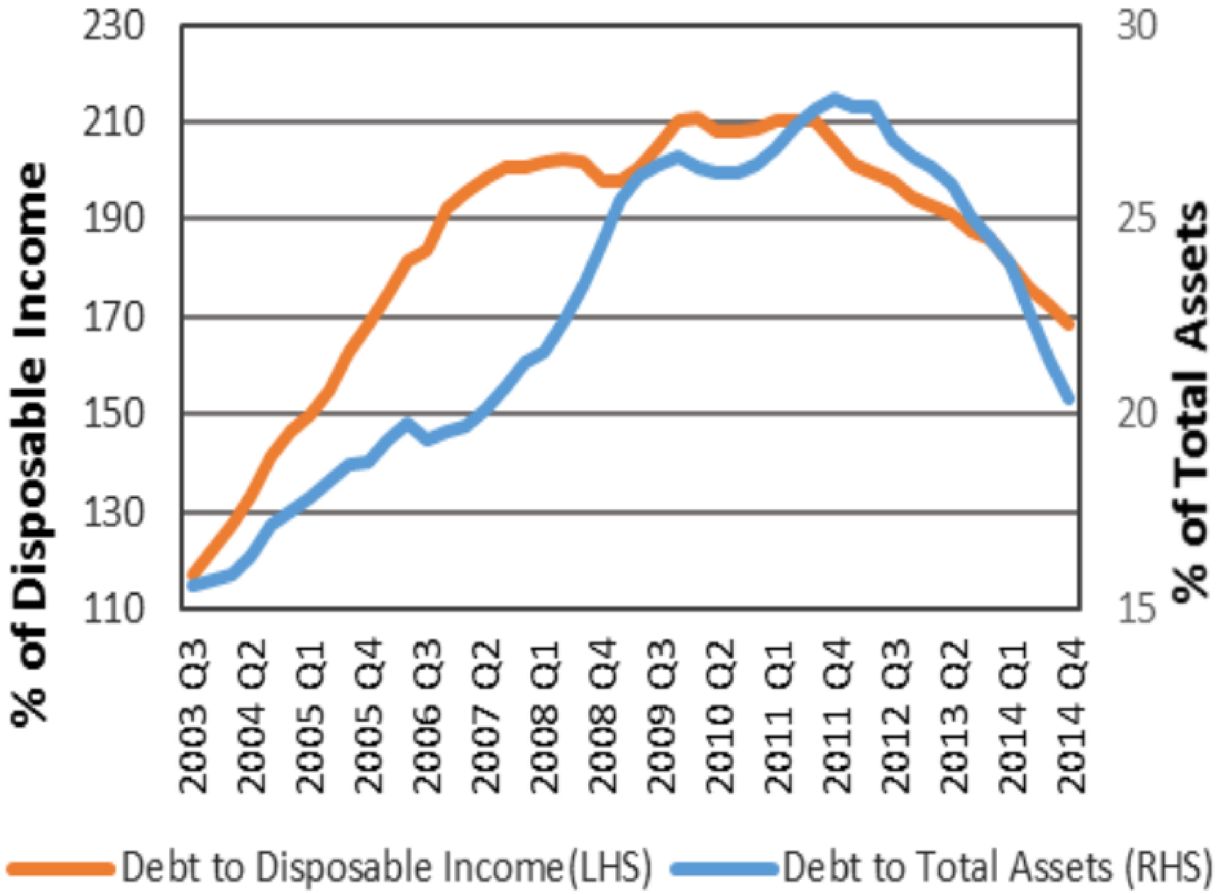
Ten-Year Sovereign Yield

Is Another Credit-Fuelled Bubble Beginning?

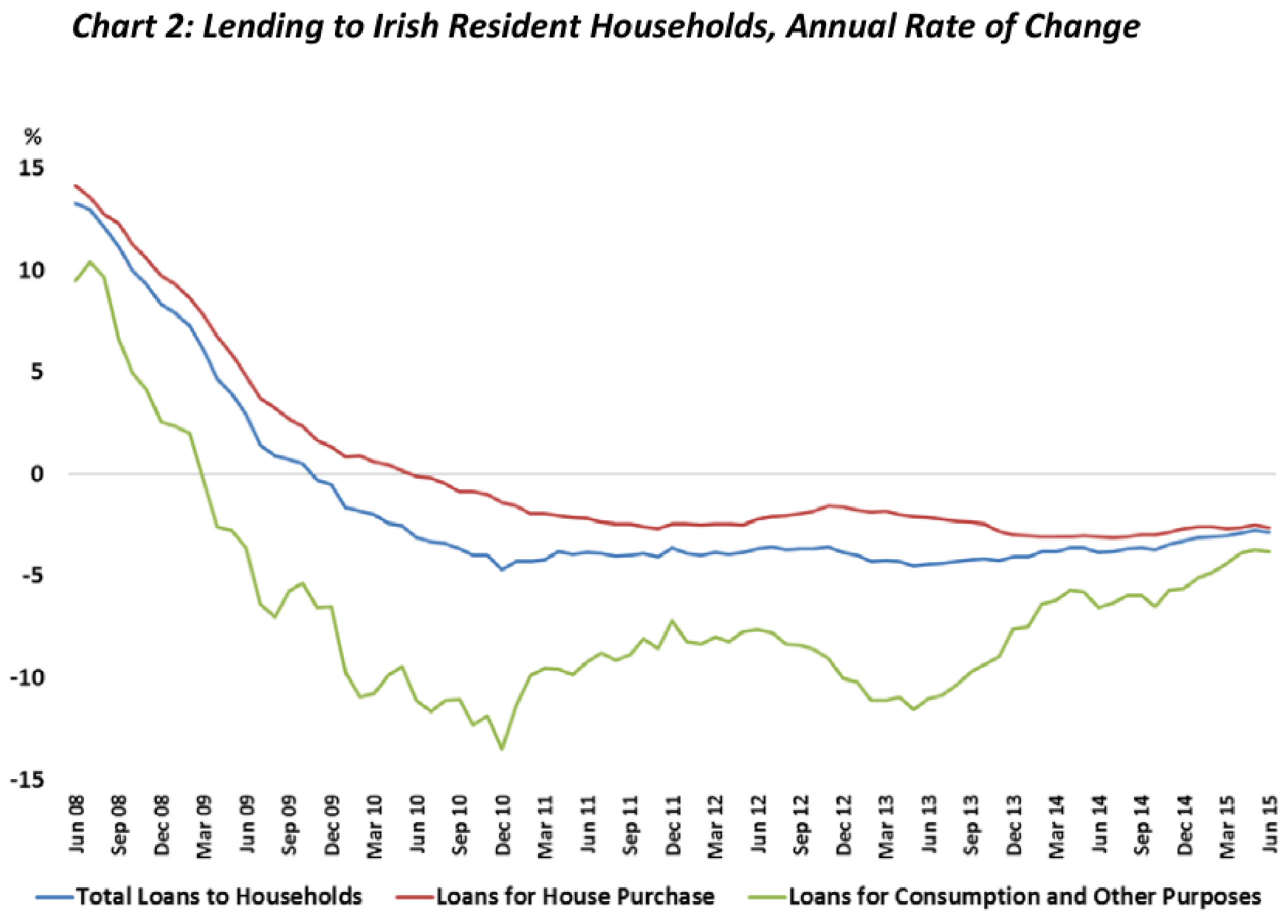
Household Debt Is Down



But Remains High Relative To Incomes

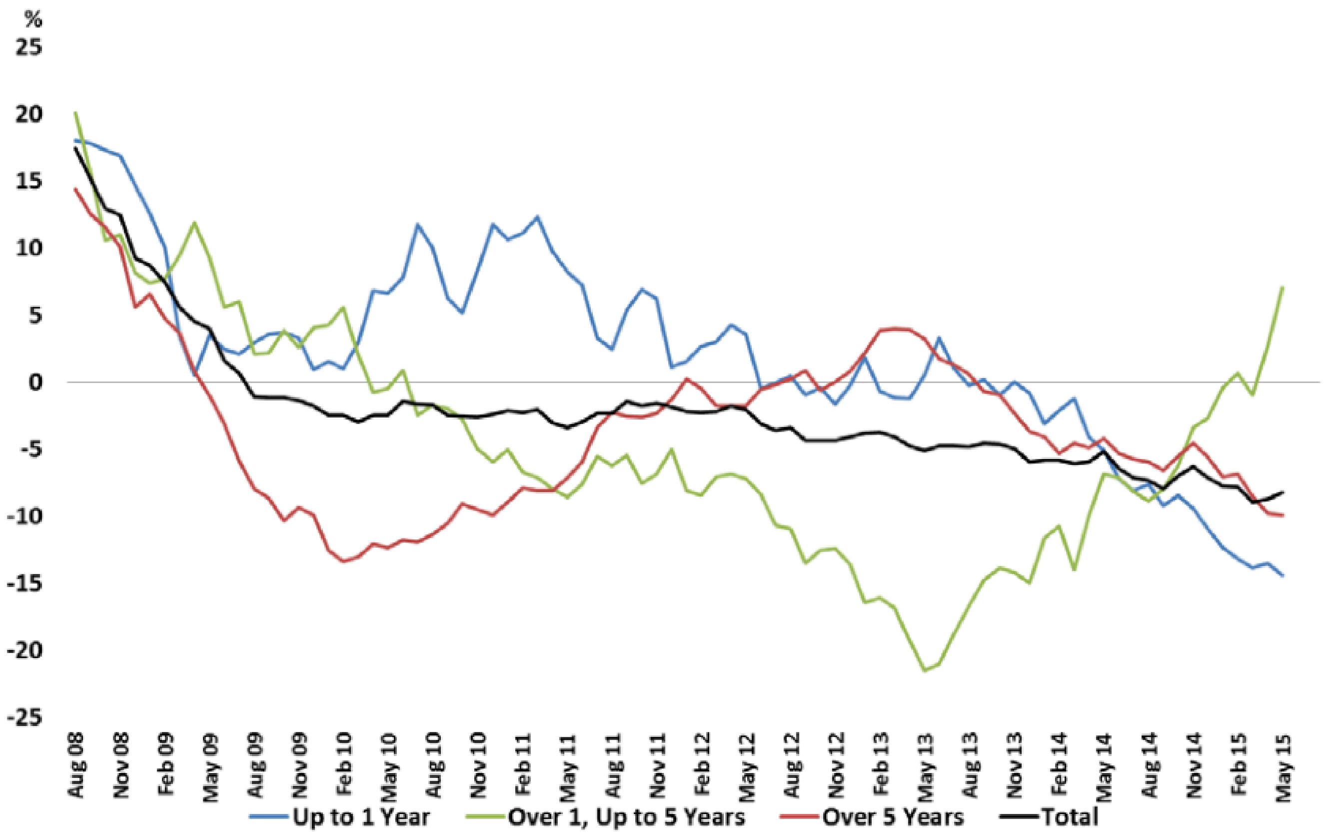


Credit to Households Is Contracting

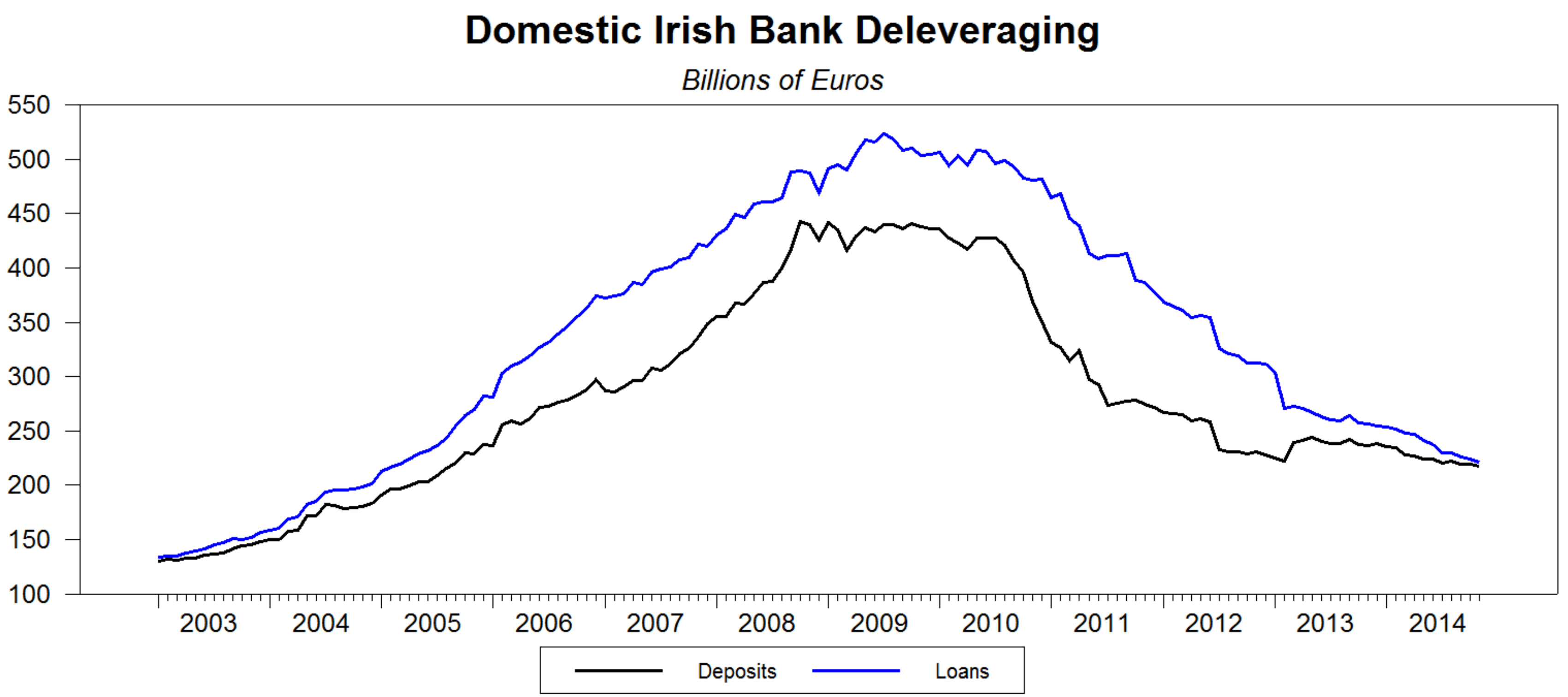


As Is Credit to Business

- ***Chart 1: Loans to Irish Resident Non-Financial Corporations, Annual Rate of Change***



Bank Deleveraging Completed: Credit Supply Constraints Loosening



A Framework For Irish GDP Projections

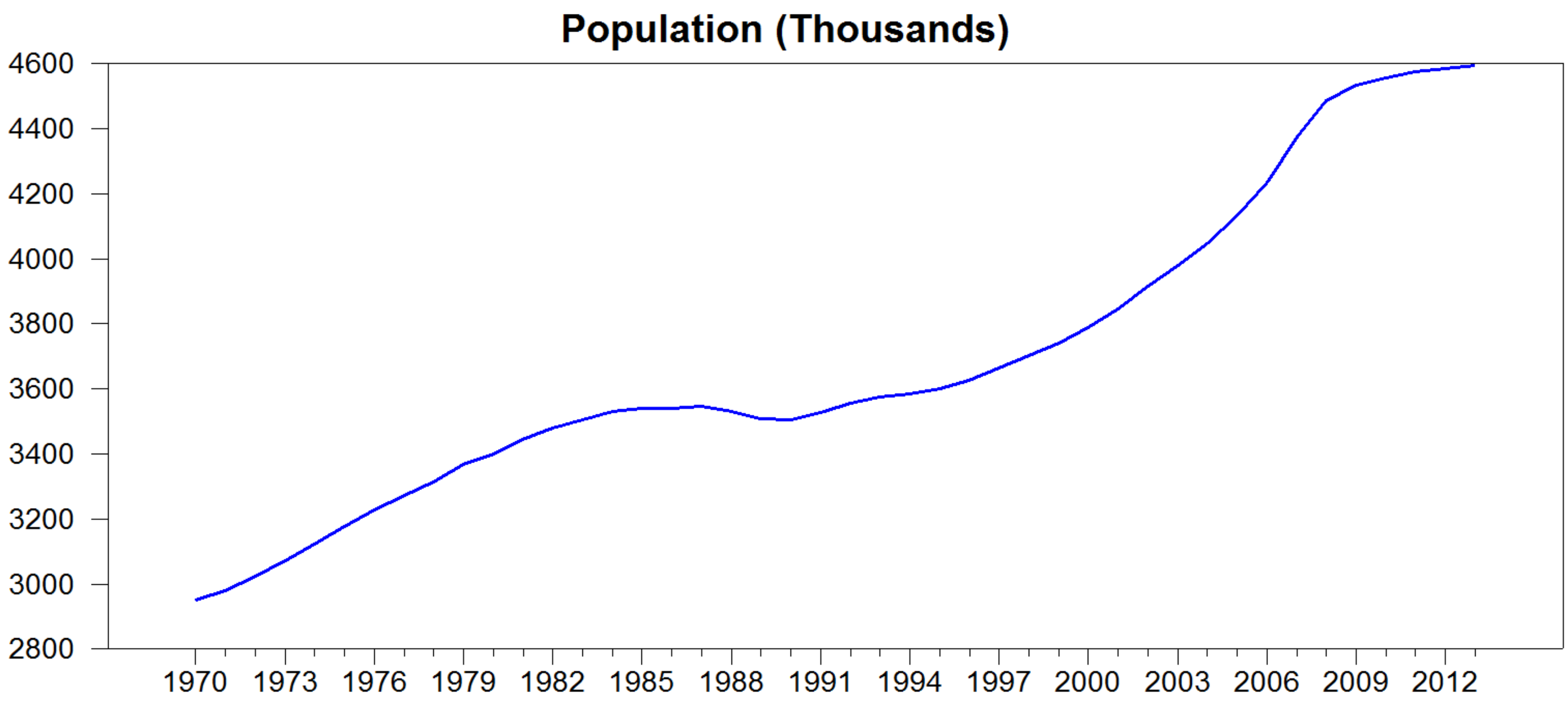
What Determines GDP?

- A country's GDP is determined by three factors

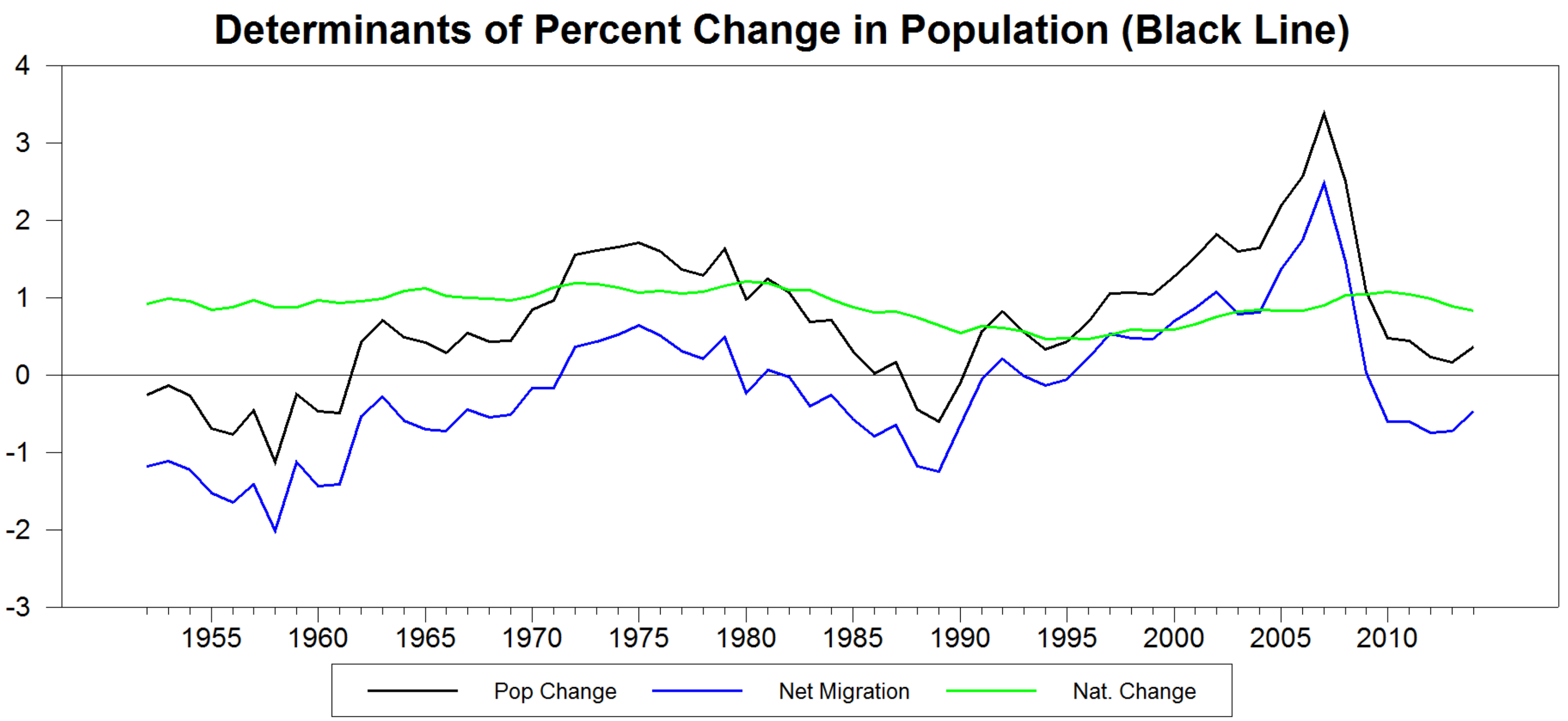
1. How many people are there in the country?
2. What fraction of these people are in paid employment?
3. How much output does the average worker produce?

- There are many interesting patterns underlying the answers to these questions for Ireland.

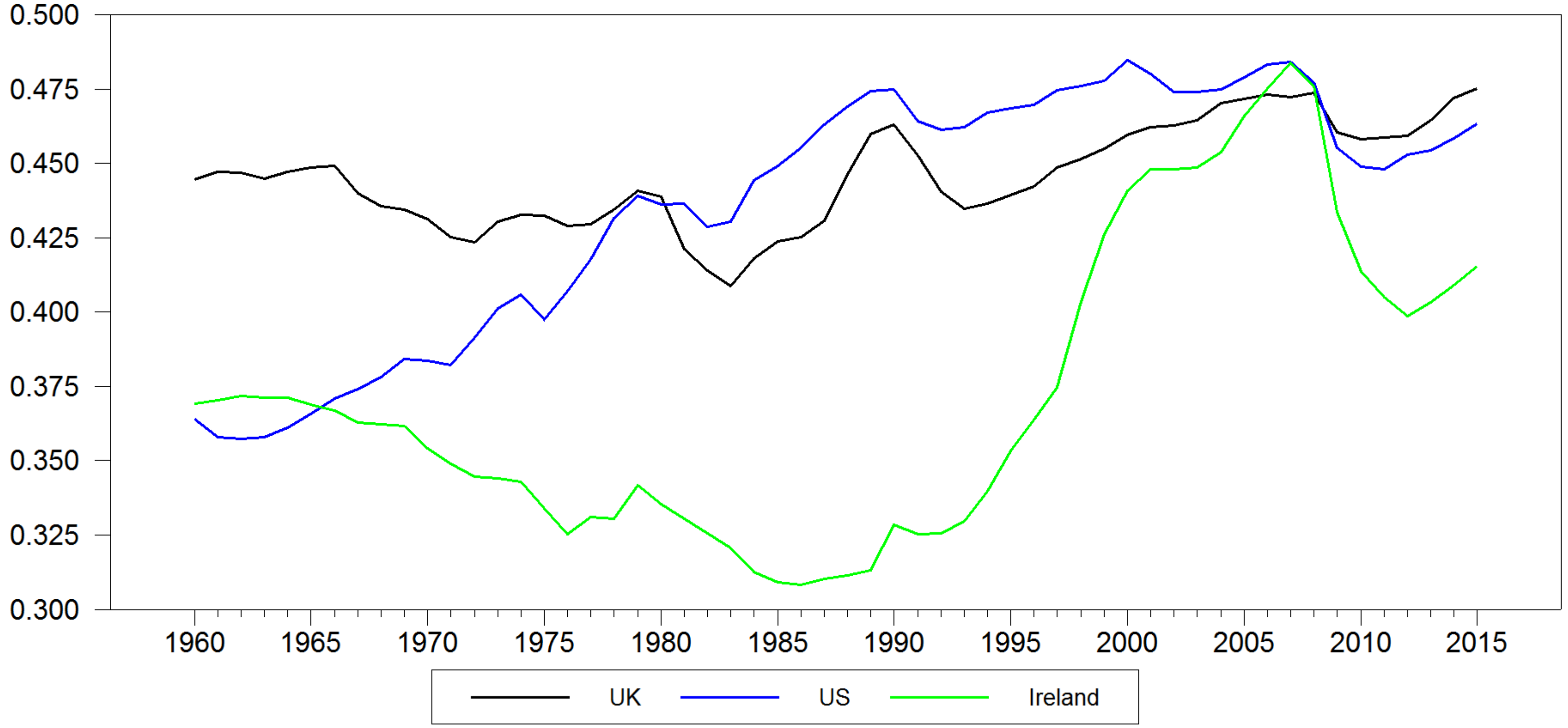
Population in Ireland



Migration Driving Population



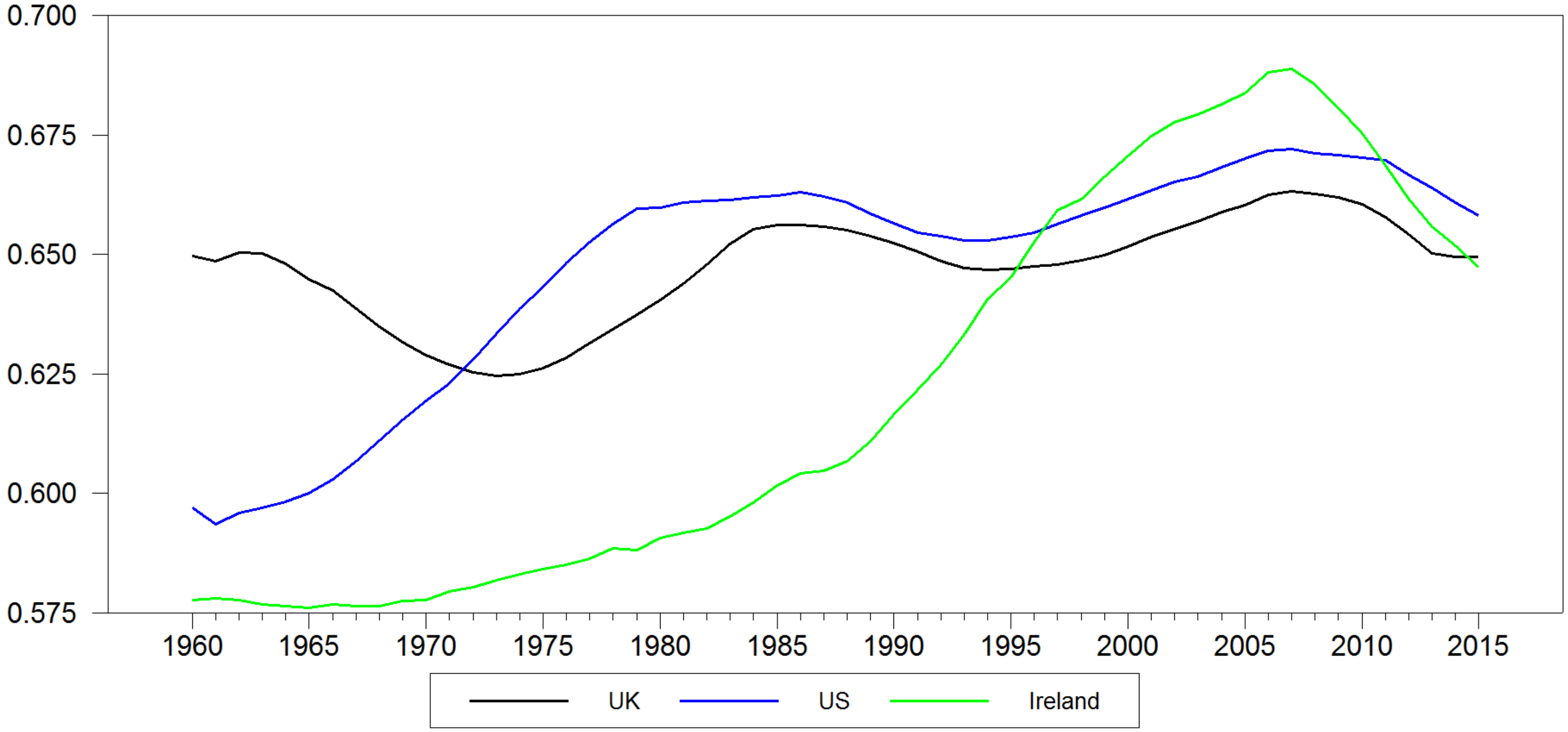
Fraction of People Employed



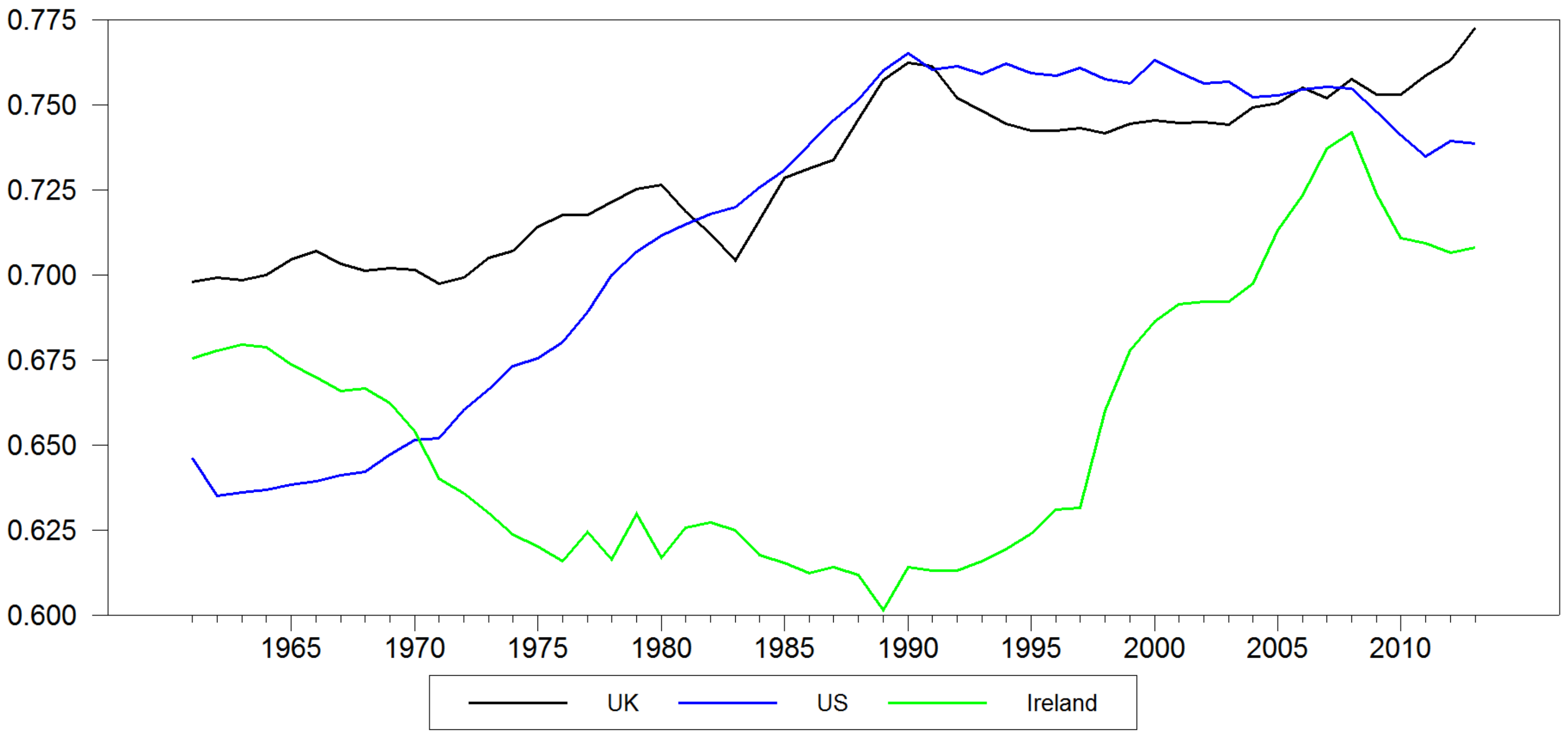
Factors Driving Fraction of People Employed

- The fraction of the population in employment is determined by
  - The fraction of people of working age.
  - The fraction of people of working age in the labour force.
  - The fraction of the labour force in employment.

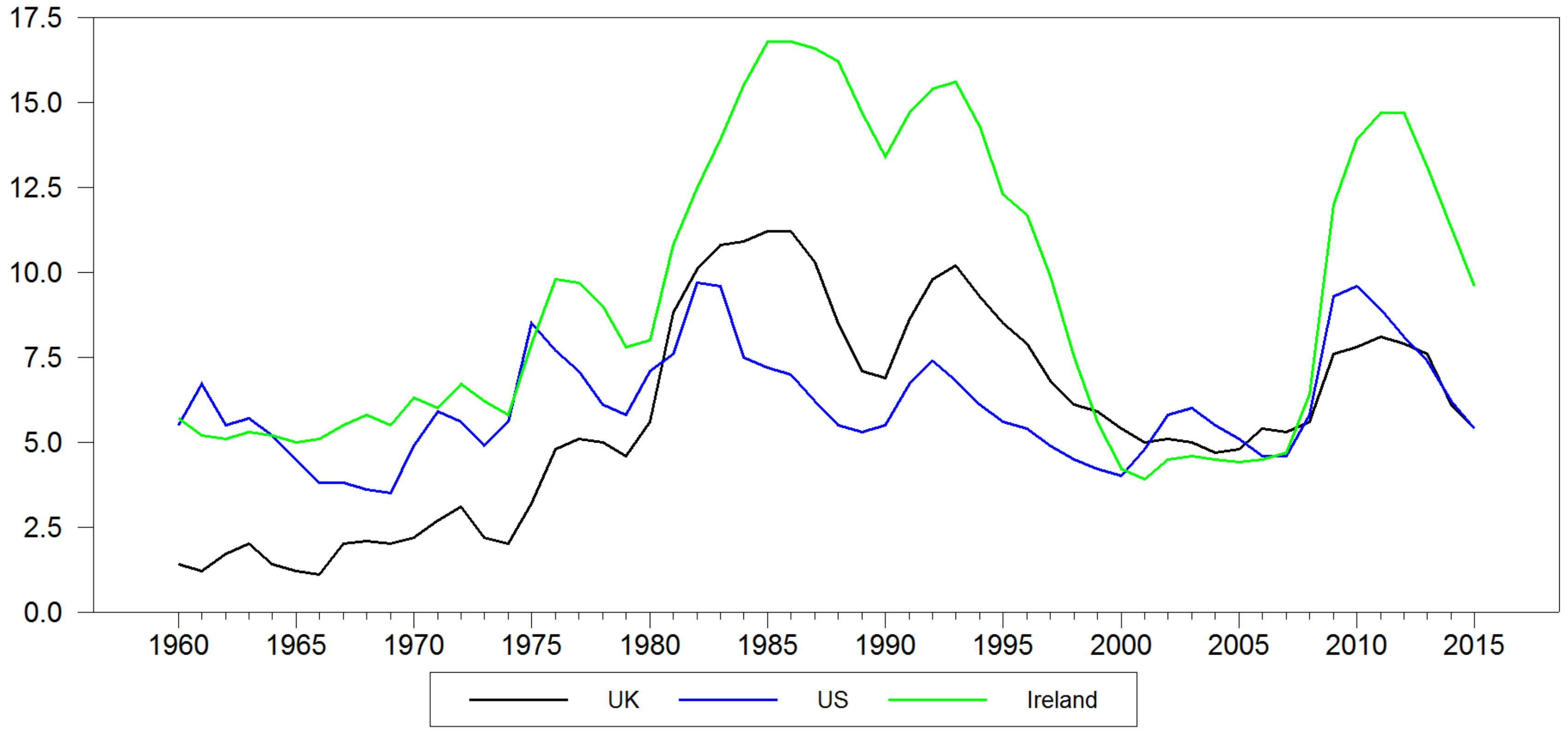
Fraction of Population Aged 15-64



Labour Force Participation Rate

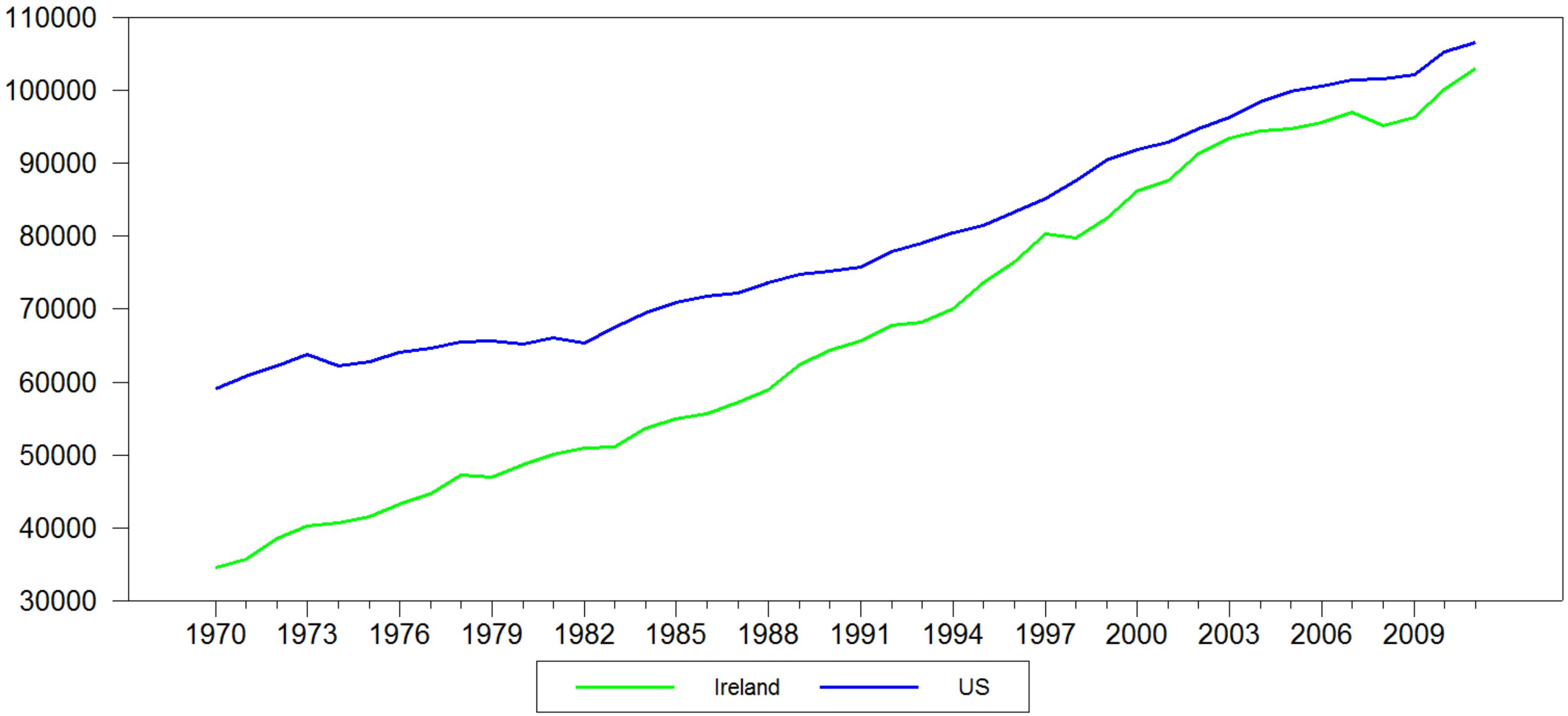


Unemployment Rate



Ireland’s Productivity Performance

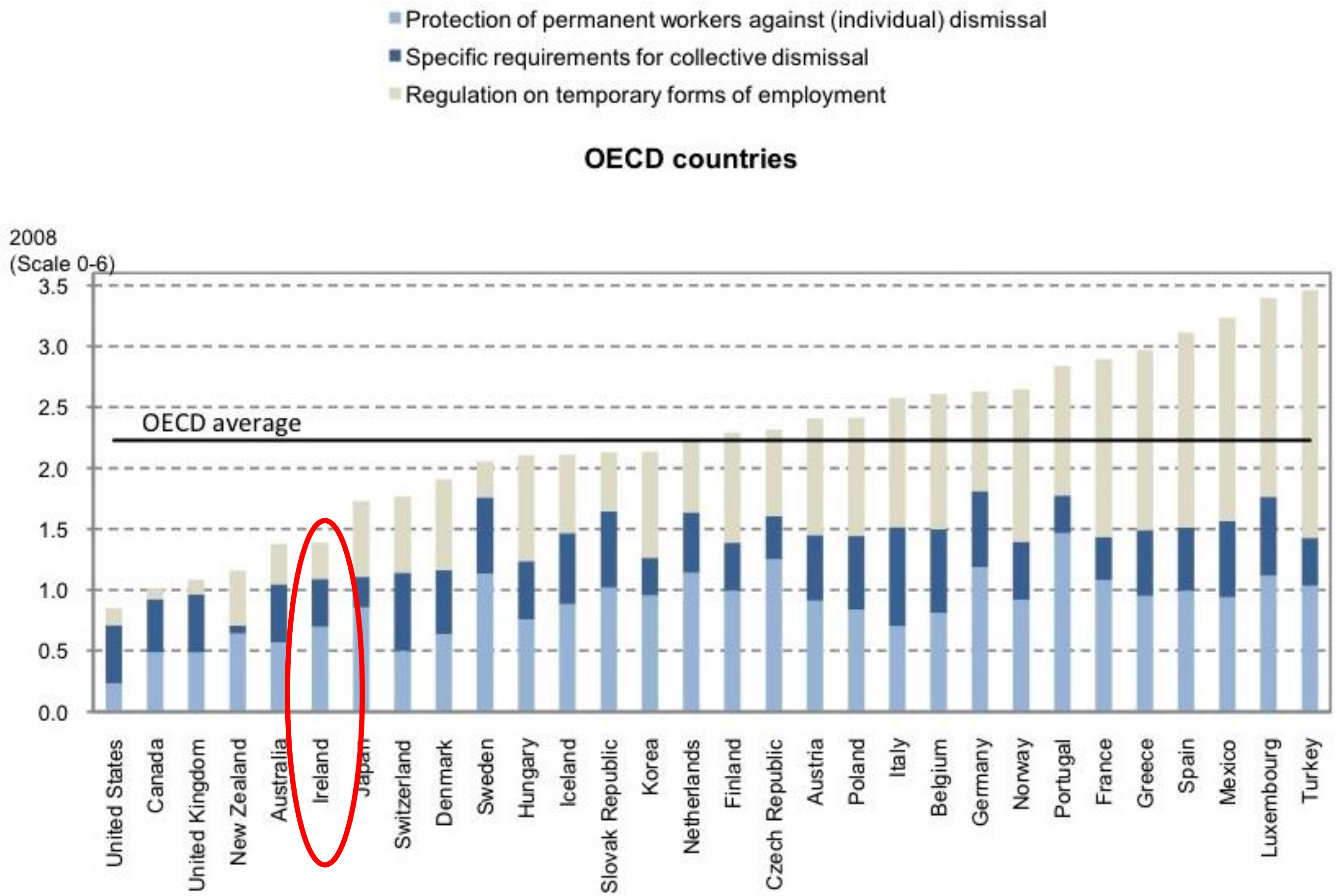
Productivity is High: GDP Per Worker Close to US Levels



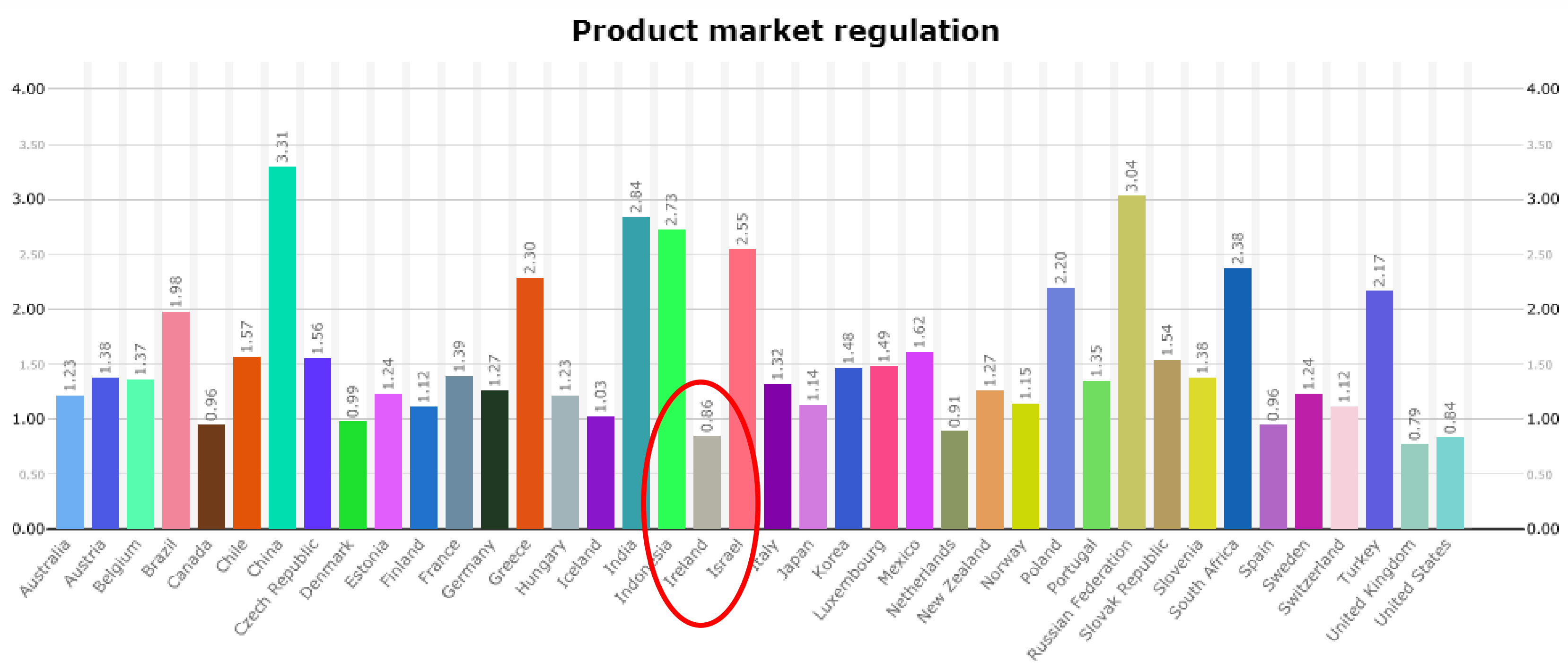
Reasons for High Productivity

- **Positive Business Environment**:
  - World Bank Doing Business publication ranks Ireland 13th for overall ease of doing business.
  - OECD scores Ireland similar to US and UK for low levels of product market regulation.
  - These features pre-date the EU-IMF agreement and do not reflect structural reforms undertaken by current government.
- **Stable Low Corporate Tax Regime**:
  - Attractive for high value-added multinationals focused on exports.
  - Many of the world's leading companies are located in Ireland.
- **High Levels of Educational Qualifications**

Ireland Has A Relatively Flexible Labour Market



Low Product Market Regulation



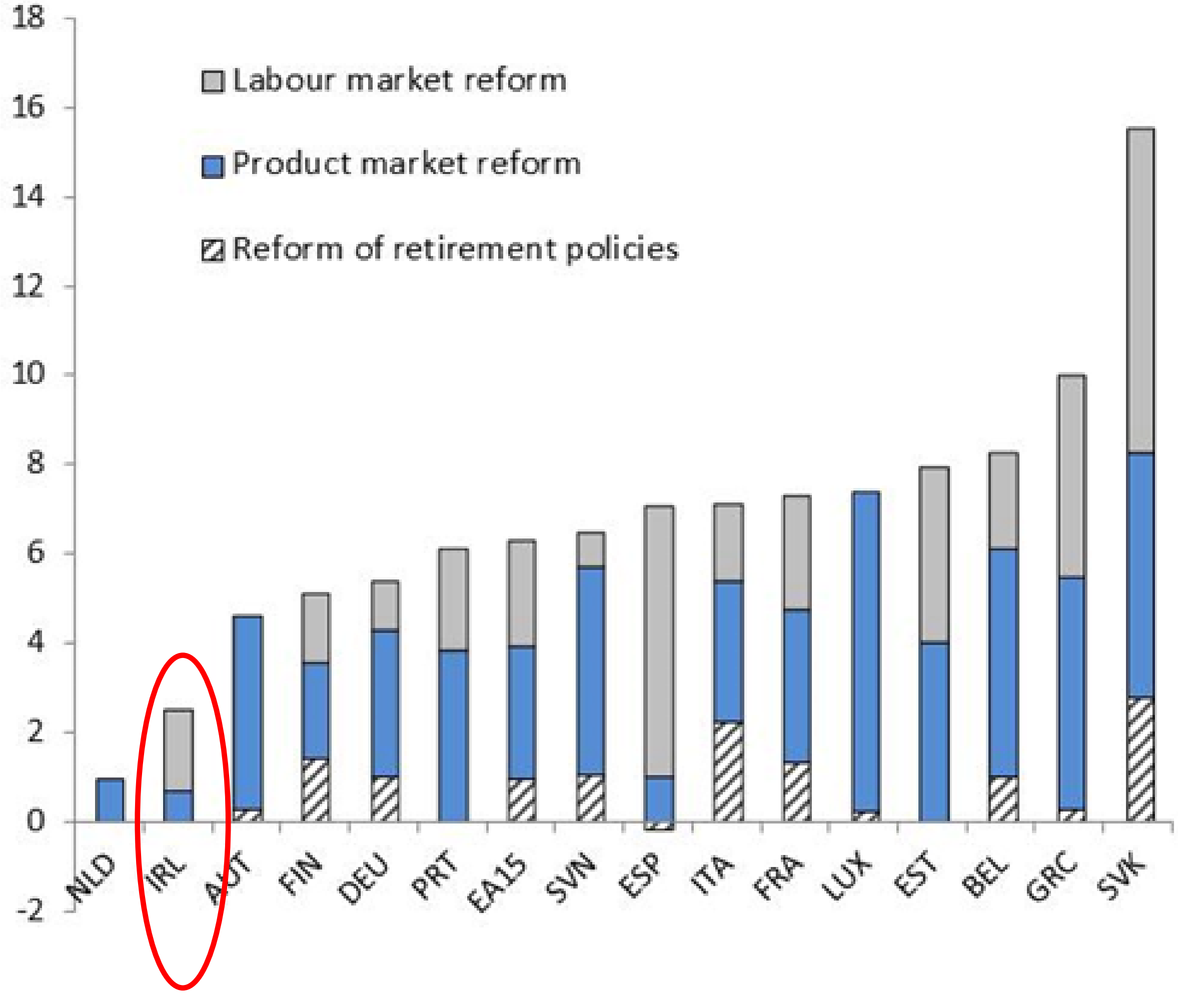
Boost From Rising Education (But This Is Flattening Out)

Highest Level of Education Completed				
	Primary	Secondary	Third Level	Not Stated
1991	0.332	0.502	0.131	0.035
1996	0.286	0.491	0.190	0.033
2002	0.211	0.492	0.247	0.051
2006	0.180	0.483	0.291	0.046
2012	0.152	0.510	0.291	0.047

Productivity Growth Has Slowed

1974-1983	1984-1993	1994-2003	2004-2013
2.48%	2.86%	3.64%	0.99%

OECD Estimates of Potential Output Increases from Structural Reforms



Longer Term: No Return to the Tiger

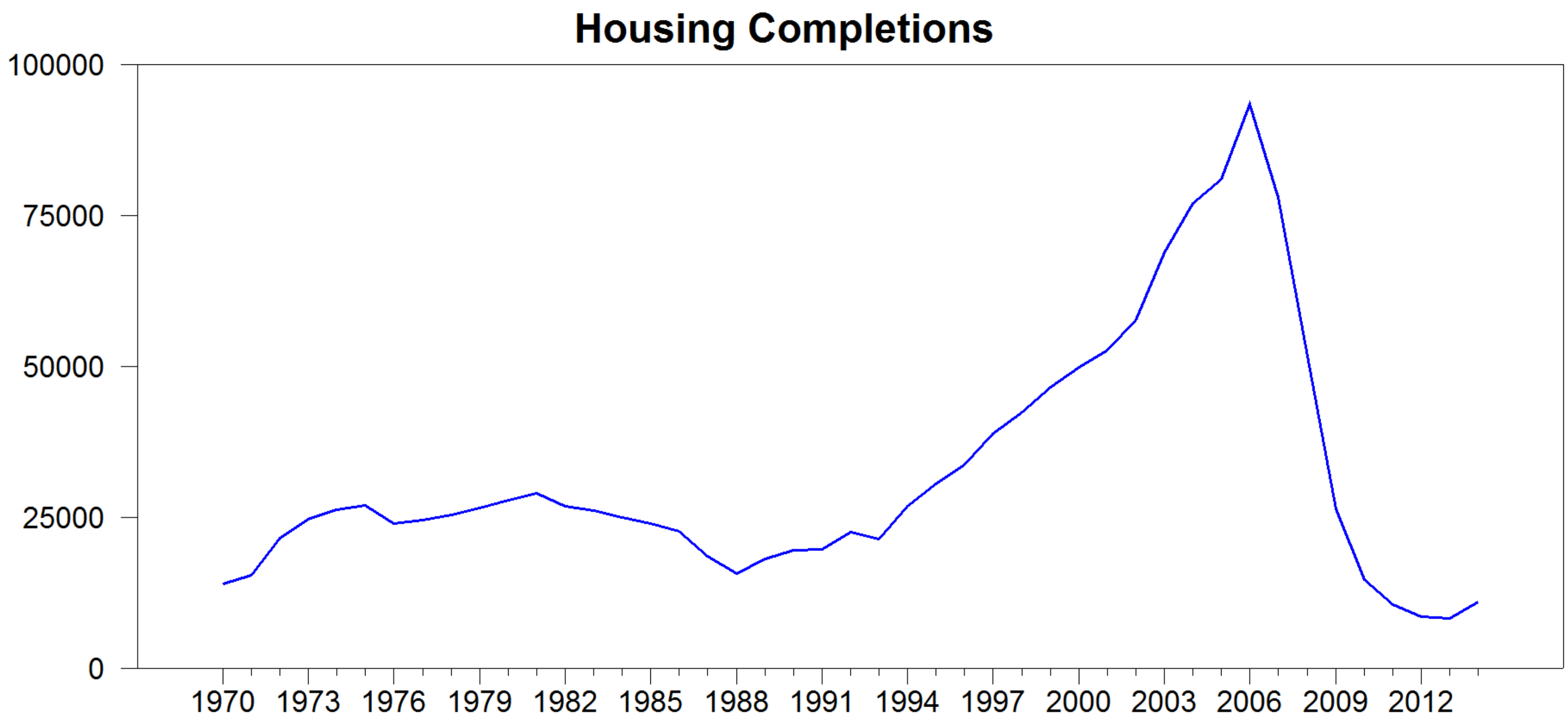
- The current recovery looks to be based on strong fundamentals.
- However, there are a number of reasons why the rapid growth of the Tiger era is not going to come back.
  - Not nearly as under-employed as in the early 90s.
  - Population is ageing.
  - Less room for productivity catch-up.
  - Limited gains from "structural reforms"

Risks

A Poorly Functioning Housing Market

- While house prices are well below their peak, they are still high relative to many other countries.
- After years of over-building, Ireland appears to be moving towards a housing shortage, particularly in Dublin.
- Poorly designed regional tax policies and absence of a coherent spatial plan meant many properties built during the boom are still unused.
- Process for planning and delivering construction projects still working very poorly.
- This is likely to keep costs high and hinder competitiveness.

Housing Completions



Corporate Tax

- Ireland’s FDI strategy relies heavily on its low corporate tax rates.
- Risks to this strategy depending on global factors outside Ireland’s control.
  - U.S. Congress can change tax laws in ways that make Irish subsidiaries less attractive.
  - European proposals such as CCCTB or a possible common tax rate.
- Are taxes that important to FDI?
- Clearly many other factors at work but Ireland appears to have attracted a set of companies that are particularly sensitive to corporate tax rates.
- Medium-run impact of external changes could be considerable.

Brexit?

- Costs and opportunities.
- **Costs**
  - Loss of FDI using Ireland as low-tax base to export to the UK.
  - Higher trade costs with a key trading partner.
  - Border-related complications hindering all-island trade.
- **Opportunities**
  - Chance to obtain EU-oriented FDI that would otherwise have chosen the UK.
  - Brave talk of poaching financial businesses from the City of London.
- I would guess costs are greater than opportunities.

Fiscal Policy Cyclicality

- Public debt remains high.
- Policy needs to formulated on the understanding that growth will generally be much slower than the Tiger era.
- Already there are signs that government and opposition parties are promising tax cuts and spending increases that will not be feasible. Limited efforts to broaden the tax base are being eased up on.
- Recommendations of new independent fiscal council are being ignored.
- There has been no substantial political reform: Have Ireland's politicians really learned from the crisis?