KFW ECONOMIC RESEARCH

Economics in Brief

One Pager

No. 60, 31st October 2014

Ireland: Successful return

Author: Dr Barbara Richter, phone +49 (0) 69 7431-8221, research@kfw.de

A year ago, in our publication „Ireland: Return with risks“ (Focus No. 36), we looked at Ireland's prospects after the end of the EU-IMF aid programme. In the outlook we concluded that the sustainability of Ireland's return to the capital markets would hinge above all on two factors: The recovery of the economy and the stability of the banking sector.

Growth: here to stay

After rather weak growth of 0.2 % in 2013, the Irish economy will grow at a rate of 4.5 % this year, as estimated by the Irish central bank; 3.4 % are expected for 2015. The unemployment rate continues to fall and now stands at 11.4 %, which is below the Eurozone average. In parallel with this improvement, the budget deficit will be reduced to an expected 3.7 % of GDP this year.

The deficit is expected to fall below the Maastricht limit of 3 % of GDP in 2015 already − a remarkable achievement considering the deficit in the crisis year of 2010 stood at 32.4 %. The government debt ratio will fall from 123.3 % of GDP at the end of 2013 to 110.5 % at year-end 2014 in large part due to the proceeds from the Irish bank resolution corporation (IBRC). Yet another piece of evidence of the sustainable recovery of the economy is the planned early repayment of part of the IMF's loans.

Banks: marked progress

Thanks to the ECB's Comprehensive Assessment, the state of the Irish banking sector is no longer guesswork. Four of the five banks assessed have enough equity even in the event of another crisis; the fifth bank should meet its additional equity needs by March 2015. Two of the banks in crisis (Allied Irish Bank and Bank of Ireland) were able to post profits in the first half of 2014; the third rescued bank (Permanent tsb) is well on its way there, too. That profit margins rose over the course of 2014 has certainly been helpful.

The share of non-performing loans, however, is still high and continues to burden the banks. The growth of new loans, especially for loans of up to EUR 1 million, is therefore still negative – in August 2014 at a rate of -19 % compared to a year ago. Demand for loans on the other hand has increased markedly this year.

Risks still remain

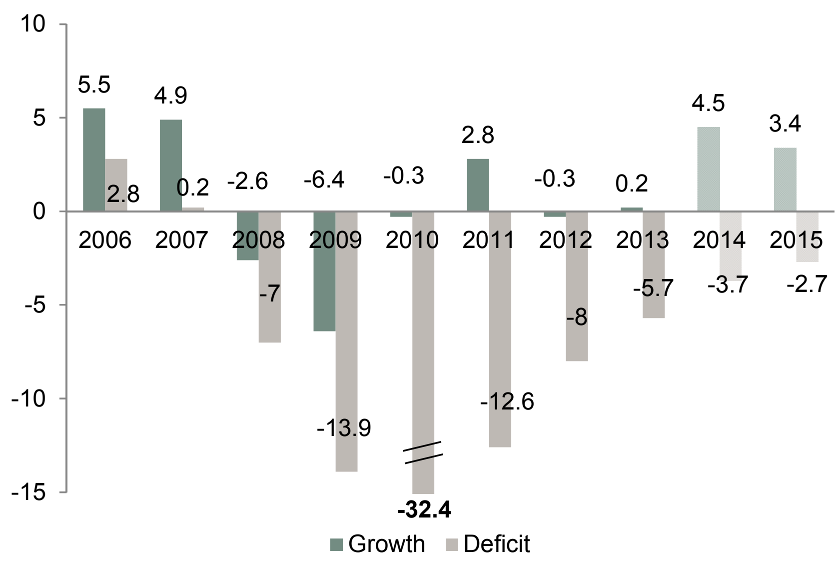
Due to its integration into world trade, Ireland is very susceptible to weak growth in the world economy. A downturn especially in the UK and the US would thus hit the Irish economy hard. No stimulus can be expected from the rest of the Eurozone in the near future anyway.

Another problem is that so many mostly young Irish people have emigrated since the start of the crisis, as they cannot find work in Ireland. Creating new, well-paid jobs would make the return for the emigrants easier and stop the “brain drain” that is harmful in the long run.

Foundation of success

Ireland itself has created the prerequisites for its positive development in the last months – and presumably also in the next years: At the start of the crisis the banking sector was cleaned up radically, without regard to the country's finances, and property prices were allowed to fall drastically. Then, the process of reducing the deficit began and competitiveness was restored via partly painful reforms. The Irish have backed this path without excessive protests, despite the social hardships it entailed. Financial markets now honour this path with low levels of interest rates and high levels of trust. Growth returns; debt ratios fall. ■

Figure: GDP growth and budget deficit in per cent of GDP (2014 and 2015 forecasts)



Source: Eurostat