Exploiting the Global Growth Renaissance

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Economic Outlook

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The global economy is in recovery mode.

Key Points

- The global economy is in recovery mode. In the second half of last year as the world became obsessed with the Brexit referendum and the election of Donald Trump, the focus was very much on politics rather than economics. However, the economic story that was building in the global economy was becoming quite compelling and remains so in 2017.

- The US economy is growing at a steady pace; the UK economy is not being adversely affected to any great extent by Brexit; and the Euro Zone growth story is getting steadily better.

- US interest rates could rise by up to 1% by the end of 2017. If the Euro Zone growth recovery continues to improve, the ECB will eventually move away from its current unprecedented interest rate policy. That is more likely to be a story for 2018 and 2019 rather than 2017. However, the important point to note is that the current very unusual interest rate environment will not last forever and the turn may be approaching.

- Euro Zone politics are evolving in a positive manner. The Dutch election on March 17th rejected anti-EU forces; and the French Election delivered the most pro-EU candidate possible. Macron now faces legislative elections on June 11th and 18th, which will be a key determinant of his capacity to succeed. German elections take place on September 24th, with a strong chance that Merkel will be successful. The biggest political challenge now facing the Euro Zone is the Italian election, which must be held by May 2018. The anti-EU Five Star Movement is showing strongly in the polls. This could evolve into a serious source of instability for the EU in 2018. It is one to watch.

- Uncertainty will continue to characterise the whole Brexit process. It promises to be a very fractious affair, with Macron likely to take a very hard line approach to the negotiations as he does not want an agreement that would weaken the EU.

- The solid momentum evident in the Irish economy in 2016 has carried over into 2017 and most economic indicators are continuing to develop in a positive manner, notwithstanding some grounds for caution.

- Despite the strong labour market and the generally positive economic background, consumer behaviour remains somewhat cautious. Despite the growth in employment, the Income Tax take is somewhat disappointing. The most obvious conclusion is that many of the jobs being created are relatively low paid and following changes to the USC in the past couple of budgets, many of the new employees may not be in the USC net at all or are paying very little tax based on earnings; the financial burden on the personal sector is still intense. House prices are rising strongly, which is putting upward pressure on mortgage repayments. In addition, the cost of living is rising quite strongly and is soaking up disposable incomes. In the year to the end of April, private rents increased by 7.9% (they have increased by 53.4% since the end of 2010); the cost of petrol increased by 9%; the price of diesel increased by 13.8%; the cost of home insurance increased by 8%; the cost of Private Health Insurance increased by 10.1%; and the cost of motor insurance declined by 2.7%, but has increased by 57% over the past 4 years. All of these increases in the price of what are necessities for many people are putting financial pressure on the personal sector and discretionary spending is still challenged; and Brexit-related uncertainty is undoubtedly engendering cautious behaviour.

For a small open economy like Ireland, the stronger global backdrop is very important.

- The overall trade performance so far in 2017 is holding up very well and there is little reason to believe that this will change very much over the remainder of the year given the increasingly positive momentum building in the global economy.
- For a small open economy like Ireland, the stronger global backdrop is very important. Prospects for the year ahead are looking better than at the beginning of the year. Sterling has stabilised; the labour market is strong; and business investment intentions are promising. Real GDP could well expand by 4.3% this year, which is up from a forecast of 3.3% at the beginning of the year.
- The key challenges for Irish policy makers over the coming year will be Brexit related uncertainty; pay pressures in the public sector; pressure to increase expenditure on public services; and solving the crisis in the housing market. It will take strong political leadership to steer the economy through these challenges.
- As a small open economy that is so dependent on external trade, a big challenge for Ireland now is to exploit the opportunity presented by the improving global economic cycle and the opportunities presented by Brexit. Faced with the challenges posed by Brexit, the possible corporate tax policies of President Trump, and the domestic imbalances and shortcomings, a number of policy areas need to be afforded top priority.
- The areas of priority should include controlling all of the costs of doing business, particularly pay pressures in the public sector; all aspects of infrastructure; the supply of high quality affordable housing for owner-occupier and rental purposes; and high quality public services. A supply side approach should dominate the housing supply issue, while all stakeholders need to recognise that the more money is devoted to public sector pay increases, the less that will be available for investment in public services.

In 2016, the US economy expanded by 2.3% and the unemployment rate fell to 4.7% by the end of the year.

International Background

In the second half of last year as the world became obsessed with the Brexit referendum and the election of Donald Trump, the focus was very much on politics rather than economics. However, the economic story that was building in the global economy was becoming quite compelling. In short, more parts of the global economy were experiencing stronger economic momentum and this has continued into 2017. Table 1 provides the most up to date data on inflation, unemployment and GDP growth across a range of economies. It presents a relatively upbeat assessment of global economics.

Table 1: Global Checklist

	Inflation (YoY)	Unemployment Rate	GDP Growth Q1 2017 (YoY)
Euro Zone	1.9%	9.5%	1.7%
Germany	2.0%	3.9%	1.7%
France	1.4%	10.1%	0.8%
Italy	2.0%	11.7%	0.8%
Spain	2.6%	18.2%	3.0%
Netherlands	1.4%	5.1%	2.8%
Belgium	2.7%	6.9%	1.5%
Greece	1.6%	23.5%	-0.5%
Portugal	2.4%	9.8%	2.8%
Ireland	0.9%	6.2%	5.2% (Q4 2016)
US	2.2%	4.4%	1.2%
UK	2.3%	4.6%	2.0%

Source: Eurostat, Bloomberg & ONS.

In 2016, the US economy expanded by 2.3% and the unemployment rate fell to 4.7% by the end of the year. The momentum has remained good so far in 2017. GDP growth in Q1 was just 1.2%, but this was due to weather factors rather than any fundamental weakness in the economy. Second quarter growth should rebound. The unemployment rate has declined to 4.4% and ISM indices of manufacturing and services stood at a healthy 54.8 and 57.5 respectively in April, suggesting that both sectors are expanding at a reasonable pace. Consumer confidence in April was just off record highs.

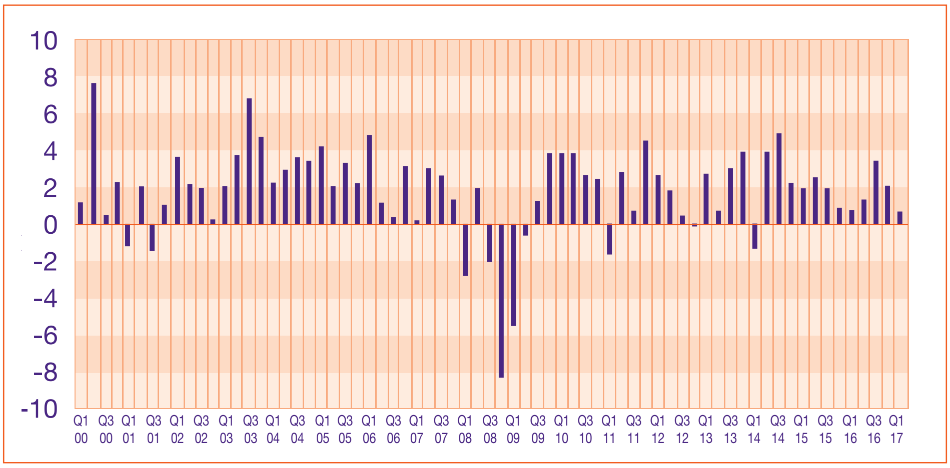
US equity markets continue to do well, with the S&P 500 up 7.1% to date this year and the Dow Jones Industrial Average has gained 6%. Markets are being supported by the ongoing growth story, but also by the prospect of President Trump cutting the corporation tax rate, the election pledge was to cut it from 35% to 15%, and a fiscal stimulus package focused on aggressive infrastructure investment. There is considerable doubt hanging over his ability to deliver either, so markets may become less buoyant at some juncture. For the moment, however, they look well supported.

On the back of the economic growth story, the Federal Reserve has increased interest rates on three occasions by a combined 1% over the past 18 months and there is more to come. The labour market is starting to get quite tight and wage pressures could start to emerge.

To date the impact of Brexit has been very muted and the economy looks capable of delivering growth of around 2% in 2017.

Underlying inflation, which excludes food and energy, is running at 1.9%. The Federal Reserve has a target of 2%, so the chances are that as the labour market tightens further, further rate increases of up to 1% could be delivered by the end of the year.

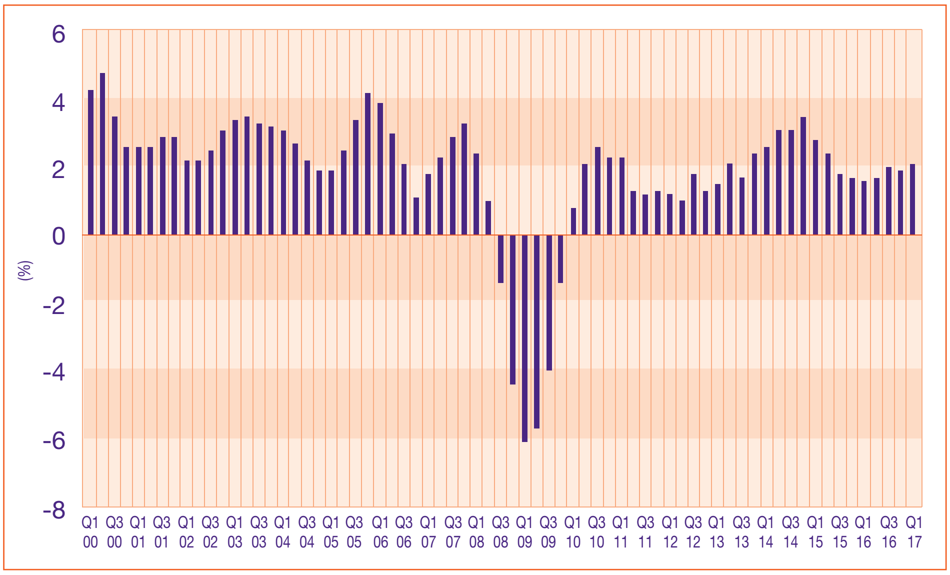
Figure 1: US GDP Growth (SAAR)



Source: Bloomberg

The UK economy has maintained steady growth despite the Brexit vote last June, helped by the weakness of sterling, which is boosting the UK export performance. Retail sales data in the first quarter were soft, reflecting the fact that sterling weakness is feeding through to higher retail prices. However, April saw a strong rebound in consumer spending. Economic growth in the first quarter was somewhat soft, with a quarterly expansion of just 0.2%, which was 2.0% higher than the first quarter of 2016. The labour market continues to perform strongly, with the unemployment rate falling to 4.6% in March, which is the lowest level since 1975. To date the impact of Brexit has been very muted and the economy looks capable of delivering growth of around 2% in 2017. There is still an expectation of a slowdown in 2018 as the real implications of Brexit for business investment become more real. Time will tell.

Figure 2: UK GDP Growth (YoY)

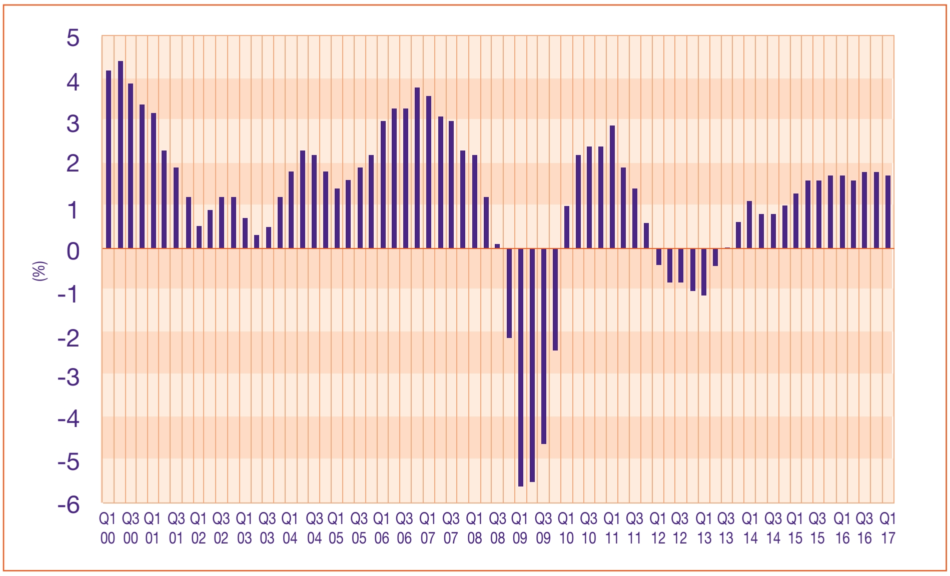


Source: ONS

The Euro Zone economy has been performing quite strongly over the past 6 months.

The Euro Zone economy has been performing quite strongly over the past 6 months. It is coming off a low base after years of economic under performance, but the indications are positive. Economic activity expanded by 0.5% during the first quarter to give a year-on-year growth rate of 1.7%. Greece was the only economy to contract. The labour market in the Euro Zone continues to improve at a gradual pace, with an average unemployment rate of 9.5% in March, which compares to 10.2% in March 2016.

Figure 3: Euro Zone GDP Growth (YoY)



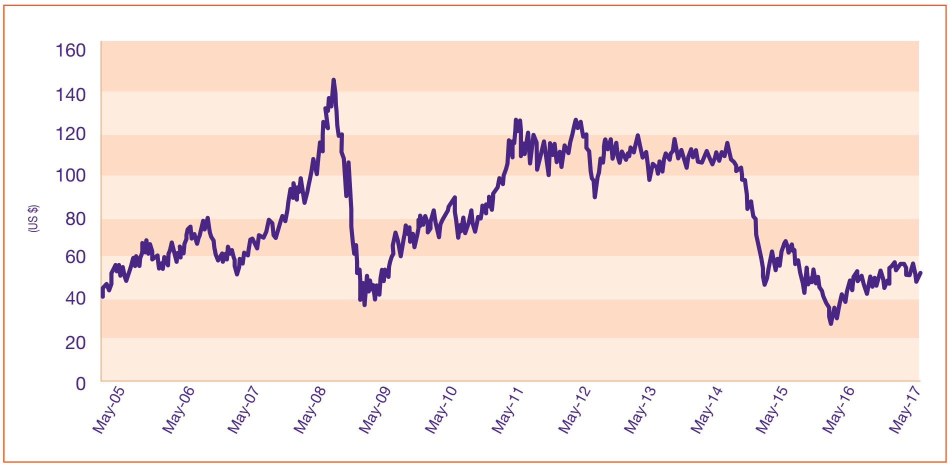
Source: Eurostat

Euro Zone politics are evolving in a positive manner. The Dutch election on March 17th rejected anti-EU forces; and the French Election delivered the most pro-EU candidate possible. Macron now faces legislative elections on June 11th and 18th, which will be a key determinant of his capacity for success. German elections take place on September 24th, with a strong chance that Merkel will be successful. The biggest political challenge now facing the Euro Zone is the Italian election, which must be held by May 2018. The anti-EU Five Star Movement is showing strongly in the polls. This could evolve into a serious source of instability for the EU in 2018. It is one to watch.

One possible implication of stronger growth in the Euro Zone could well be a change in the historically low interest rate regime. The European Central Bank (ECB) has taken interest rates down to zero due to sluggish growth, high unemployment and the threat of deflation, or falling prices. The ECB has a mandate to keep Euro Zone inflation around 2% or slightly lower. Up until recently the inflation rate had been hovering around zero and hence the Quantitative Easing programme and the zero-interest rate policy.

In recent months, the headline inflation rate has hit 2%, which could in theory set alarm bells ringing in the ECB.

Figure 4: Brent Crude Oil Price



Source: Bloomberg

In recent months, the headline inflation rate has hit 2%, which could in theory set alarm bells ringing in the ECB. However, it remains to be seen what this Euro Zone growth recovery might mean for the interest rate policy of the ECB. The inflation rate has hit 2% largely due to the impact of higher oil prices over the past 6 months, but excluding energy costs, inflation remains quite muted. However, if the growth recovery continues in the Euro Zone, the ECB will eventually move away from its current unprecedented interest rate policy. That is more likely to be a story for 2018 and 2019 rather than 2017. However, the important point to note is that the current very unusual interest rate environment will not last forever and the turn may be approaching.

Table 2 shows the latest forecasts from the IMF and they present a reasonably upbeat assessment of global growth prospects.

Table 2: Global Growth Forecast

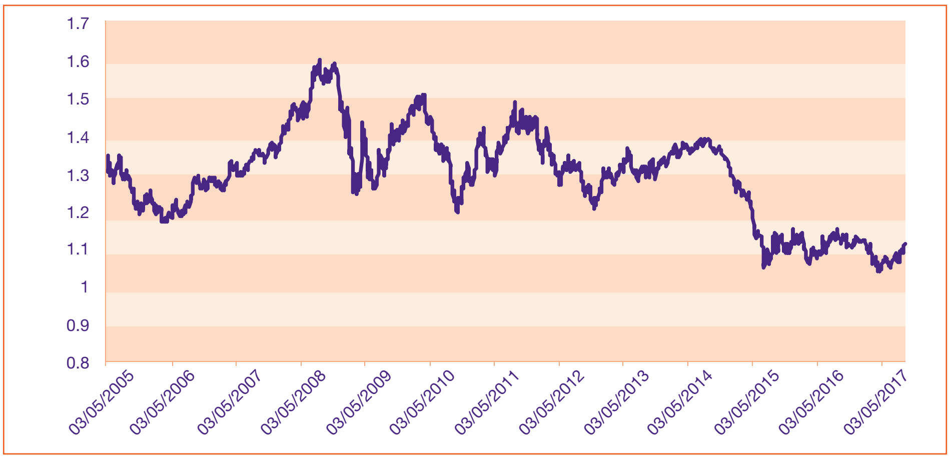
	2016	2017f	2018F
World Output	+3.1%	+3.5%	+3.6%
Advanced Economies	+1.7%	+2.0%	+2.0%
US	+1.6%	+2.3%	+2.5%
Euro Zone	+1.7%	+1.7%	+1.6%
Germany	+1.8%	+1.6%	+1.5%
France	+1.2%	+1.4%	+1.6%
UK	+1.8%	+2.0%	+1.5%
Japan	+1.0%	+1.2%	+0.6%
Emerging Economies	+4.1%	+4.5%	+4.8%
China	+6.7%	+6.6%	+6.2%
India	+6.8%	+7.2%	+7.7%

Source: IMF, April 2017

The euro would appear capable of gaining further ground against the dollar over the coming months.

The euro has been gradually appreciating against the dollar over the past quarter. This is being driven by the Euro Zone growth story and the positive outcome from recent European elections. The euro would appear capable of gaining further ground against the dollar over the coming months.

Figure 5: US$ v Euro



Source: Bloomberg

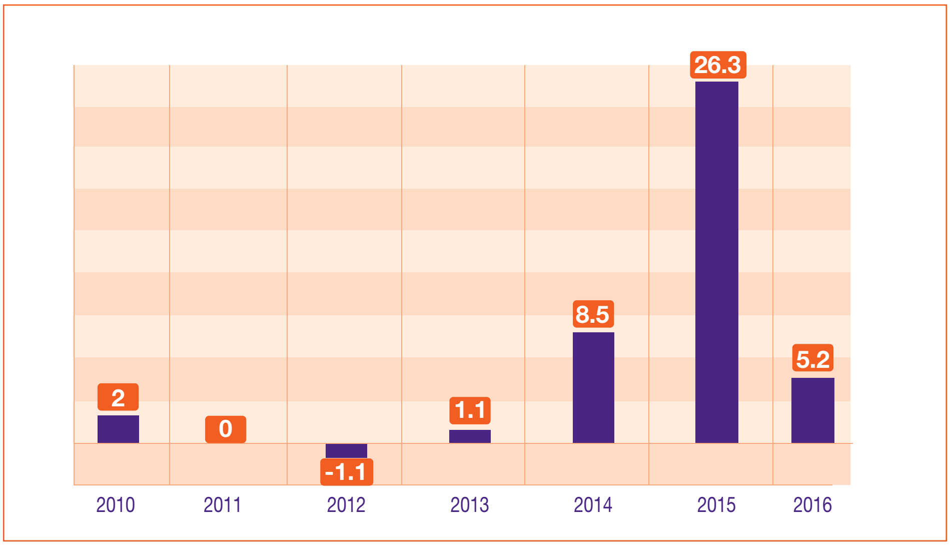
The solid momentum evident in 2016 has carried over into 2017 and most economic indicators are continuing to develop in a positive manner, notwithstanding some grounds for caution.

Irish Economic Background

Overview

2016 was a year of strong growth for the Irish economy. For the year as a whole, initial estimates suggest that gross domestic product (GDP) expanded by 5.2%; gross national product (GNP) expanded by 9%; consumer expenditure expanded by 3%; investment expanded by 45.5%; imports of goods and services expanded by 10.3%; and exports of goods and services expanded by 2.4%. The investment outturn is distorted by the shifting of items such as Intellectual Property rights into Ireland, but notwithstanding such accounting transactions, the underlying growth picture was solid on all fronts.

Figure 6: GDP Growth in Constant Price Terms (% YoY)



Source: CSO

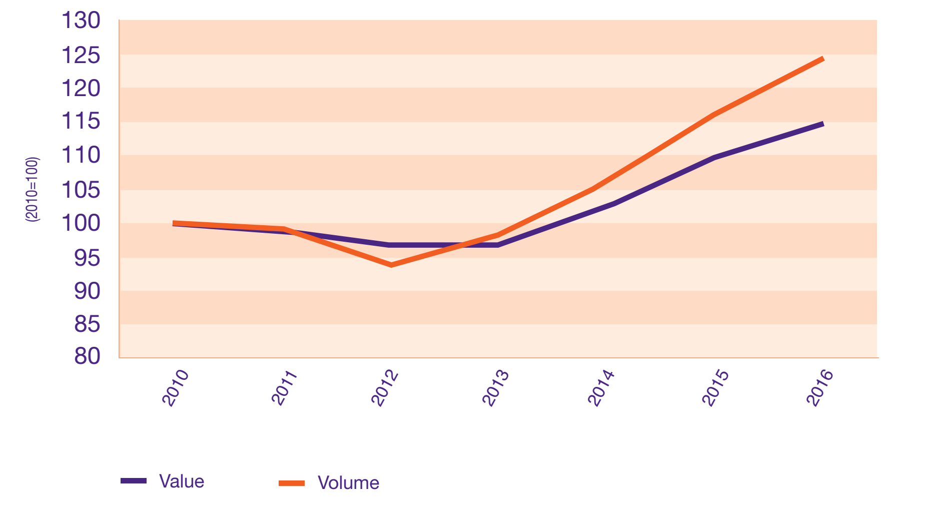
The solid momentum evident in 2016 has carried over into 2017 and most economic indicators are continuing to develop in a positive manner, notwithstanding some grounds for caution.

Consumer Dynamics

Despite the strong labour market and the generally positive economic background, consumer behaviour remains somewhat cautious. In the first three months of the year, the value of retail sales was up by 0.9% and volume of sales was up by 2.9%. However, weak new car sales have distorted these figures. When car sales are excluded, the value of retail sales was up by 3.3% and the volume of sales by 5.9%. The persistent gap between the value and volume metrics is indicative of a consumer sector that is still resistant to higher prices. New car registrations in the first 4 months of the year were down by 10.1%.

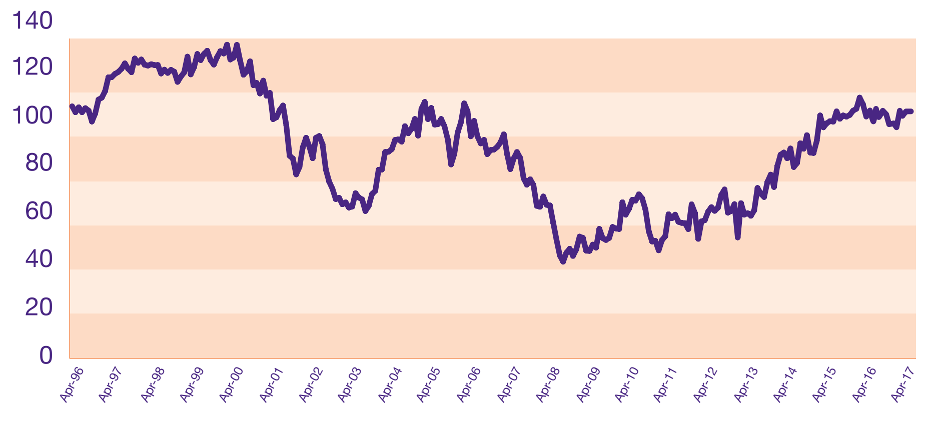
Consumer sentiment has levelled off in recent months.

Figure 7: Retail Sales – Divergence of Value & Volume



Source: CSO

Figure 8: Consumer Confidence – Levelling off in Recent Months



Source: KBC Bank/ESRI

Consumer sentiment has levelled off in recent months and a wide gap still exists between the volume and value of growth in retail sales. The causal factors are likely to include:

- Despite the growth in employment, the Income Tax take is somewhat disappointing. The most obvious conclusion is that many of the jobs being created are relatively low paid and following changes to the USC in the past couple of budgets, many of the new employees may not be in the USC net at all or are paying very little tax based on earnings;

Employment increased by 68,600 or 3.5% in the year to the end of March 2017.

- The financial burden on the personal sector is still intense. House prices are rising strongly, which is putting upward pressure on mortgage repayments. In addition, the cost of living is rising quite strongly and is soaking up disposable incomes. In the year to the end of April, private rents increased by 7.9% (they have increased by 53.4% since the end of 2010); the cost of petrol increased by 9%; the price of diesel increased by 13.8%; the cost of home insurance increased by 8%; the cost of private health insurance increased by 10.1%; and the cost of motor insurance declined by 2.7%, but has increased by 57% over the past 4 years. All of these increases in the price of what are necessities for many people are putting financial pressure on the personal sector and discretionary spending is still challenged; and
- Brexit-related uncertainty is undoubtedly undermining confidence and big ticket consumer items such as cars may be suffering.

The Labour Market

Employment growth in the economy continues at a strong pace. Employment increased by 68,600 or 3.5% in the year to the end of March 2017. Employment in the first quarter stood at 2.045 million on a non-adjusted basis and 2.064 on a seasonally adjusted basis. The sectoral breakdown of employment is strong. All but two sectors recorded strong growth in the previous 12 months. Employment in the Industrial sector increased by 13,800; Construction increased by 11,200; the Accommodation and Food Services sector increased by 9,800; the Information and Communications sector increased by 7,500; and employment in the Wholesale and Retail Trade increased by 4,000. Agriculture experienced a decline of 1,600 and there was a modest decline of 300 in the Financial, Insurance and Real Estate sector (Table 3).

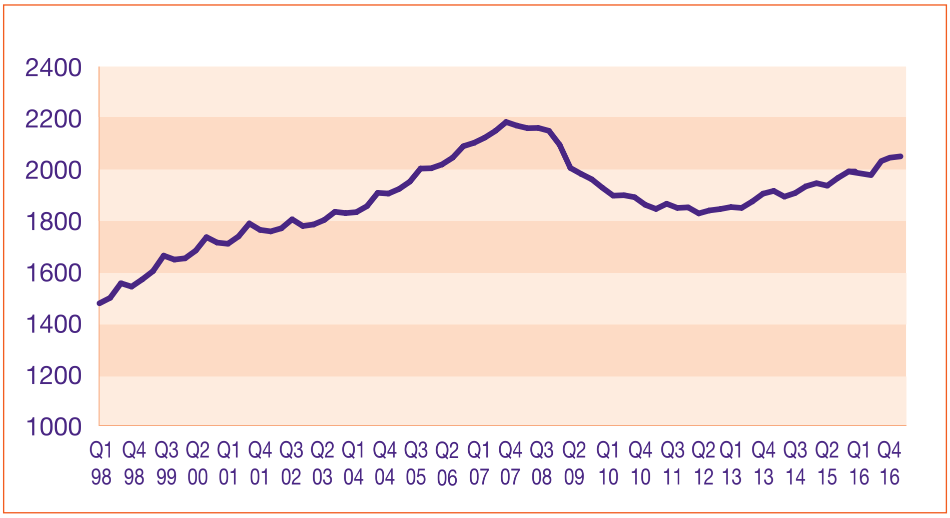
The overall increase in employment was made up of a very strong increase of 84,200 or 5.5% in full-time employment and a decline of 15,600 in part-time employment. The latter changes are really indicative of the strength of the overall labour market and the improving confidence of the business community. The overall employment rate for people aged between 15 and 64 years is now up at 65.4%.

The long-term unemployment rate has fallen to 3.6%, but long-term unemployment still accounted for 53.8% of total unemployment. Therein lies an ongoing challenge for policy makers and labour market policy generally.

The real note of caution in the labour market data is that we lack qualitative information on the nature of the employment being created. Indicators of consumer activity such as value growth in retail sales, car sales, consumer confidence and Income Tax returns would suggest that a lot of the jobs being created are not particularly well paid. The hope would be that as time passes and the economic momentum continues to build, the quality of the labour market will improve further. What is most probably happening in the Irish labour market is not unique and has for example been a strong feature of the US labour market performance in recent times. The challenge is to continually seek to go up the value chain.

Unemployment rate fell to 6.2% of the labour force, which is the lowest rate since June 2008.

Figure 9: Employment



Source: CSO

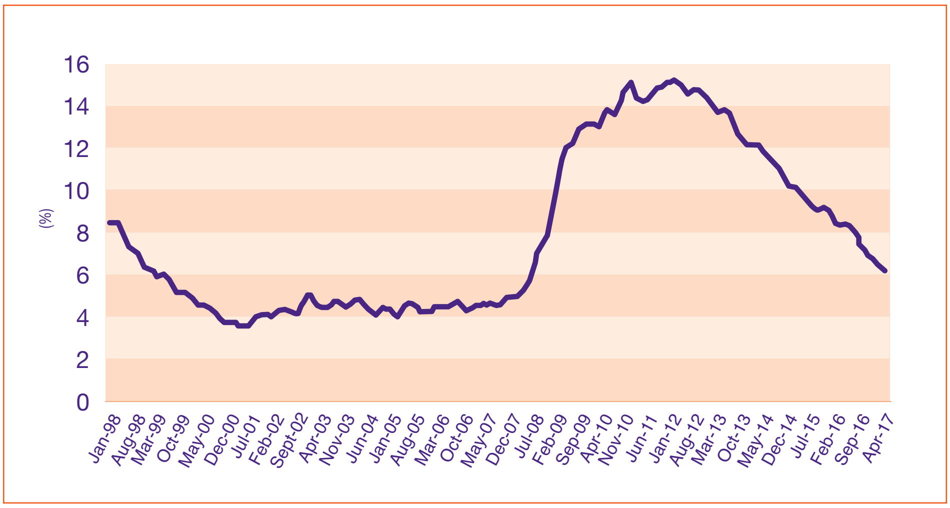
Table 3: Employment by Sector (Q1 2017)

Sector	Q1 2017	YoY Change
Agriculture, Forestry & Fishing	107,700	-1,600
Industry	263,800	+13,800
Construction	142,500	+11,200
Wholesale & Retail Trade	276,500	+4,000
Transportation	95,400	+400
Accommodation & Food Services	152,200	+9,800
ICT	92,700	+7,500
Financial Services & Real Estate	100,400	-300
Professional Services	116,500	+6,200
Administration & Support Services	72,200	+4,000
Public Administration & Defence	100,700	+2,200
Education	158,100	+4,200
Human Health & Social Services	256,200	+7,500
Other	103,100	-1,000
TOTAL*	2,045,100	+68,600

Source: CSO QNHS (may not add up due to rounding & Not Stated Category)*

Other labour market data show that the number of unemployed declined by 15,500 during the first 4 months of the year and the unemployment rate fell to 6.2% of the labour force, which is the lowest rate since June 2008.

Figure 10: Unemployment Rate



Source: CSO

The Public Finances

An Exchequer deficit of €2,537 million was recorded in the first 4 months of the year, which is €1,482 million higher than the first 4 months of last year. However, when timing factors are accounted for, there was an underlying improvement of €313 million.

Table 4: Exchequer Returns Jan-April 2017

Tax Heading	€M	Profile €M	Year-On-Year (€M)	Year-On-Year (%)
Income Tax	6,179	-198	+75	+1.2%
VAT	4,768	+257	+602	+14.5%
Corporation Tax	587	-223	-172	-22.7%
Excise	1,740	-117	-345	-16.5%
Stamps	290	-78	-34	-10.4%
CGT	106	+1	-23	-18.0%
CAT	58	-2	-1	-2.3%
Customs	98	-12	-1	-1.0%
Local Property Tax	253	+6	+6	+2.5%
Unallocated Tax	24	+24	-40	-61.8%
TOTAL	14,104	-344	+68	+0.5%

Source: Department of Finance

Total tax revenues were €68 million or 0.5% ahead of last year.

Total tax revenues were €68 million or 0.5% ahead of last year, but they were €344 million behind projections. Of some concern is the fact that Income Tax receipts are just €75 million ahead of last year, representing an annual growth rate of just 1.2%. More surprisingly, Income Tax receipts are running €198 million behind what the Department of Finance had expected. This is surprising because all of the labour market indicators are pointing towards a very positive background. The quandary is how the strong labour market indicators tally with the relatively disappointing Income Tax returns. The most obvious conclusion is that many of the jobs being created are relatively low paid and following changes to the USC in the past couple of budgets, many of the new employees may not be in the USC net at all or are paying very little tax based on earnings.

Exports

Ireland's export sector performed well in 2016. The value of merchandise exports was 4% ahead of the previous year, but exports to the UK were 3.9% lower, reflecting sterling weakness. Merchandise exports in the first 3 months of 2017 were 10.6% ahead of the same period in 2016. Exports to the Euro Zone increased by 3.8%; exports to the US increased by a scarcely believable 31.2%; and encouragingly, sales to the United Kingdom increased by 4.5%. Exports of Chemicals & related products to the US increased by 36.7%, which is quite extraordinary. Time might tell what is going on there. Interestingly, sales of Food and live animals to Great Britain (sectoral data not available for Northern Ireland) increased by 7.2%. Sterling has strengthened a bit and more importantly has stabilised, and the UK economy is still holding up well. Overall exports of Food and live animals increased by a strong 9.8% in the first quarter.

The overall trade performance so far in 2017 is holding up very well and there is little reason to believe that this will change very much over the remainder of the year given the increasingly positive momentum building in the global economy. Enterprise Ireland has alluded to the more difficult task that the exporting companies that it supports faced in the UK market last year due to sterling weakness. Its strategy is now going to be increasingly focused on building markets in Euro Zone countries. This is a noble aspiration, but the reality is that the UK is by far the easiest market for Irish agri-food exporters to sell into. A massive 37% of agri-food exports went to the UK last year, and it is estimated that of the prepared consumer foods that Ireland exports, 70% go to the UK. It will not be easy to wean exporters off the UK market.

Tourism

Last year was a record year for Irish tourism. A total of 9.58 million overseas visitors came to Ireland, which represented an increase of 10.9% on 2015. In the first quarter of 2017, a total of 1.8 million overseas visitors came to Ireland, representing an annual growth rate of 0.6%. Visitor numbers from Great Britain fell by 6.5%.

The housing market remains one of the biggest challenges facing Irish policy makers.

The Housing Market

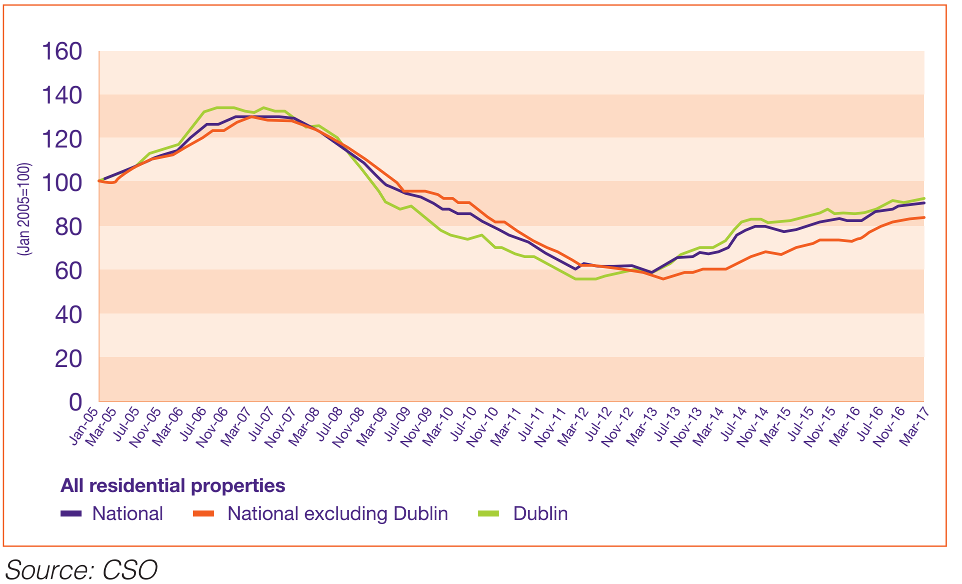
The housing market remains one of the biggest challenges facing Irish policy makers. There is a significant shortage of owner-occupied housing, social housing and rental property. Although house building is recovering, the level of completions based on figures from the Department of Housing, Planning, Community & Local Government, is still well below what is required. In 2016, there were 14,932 new house completions, which is 80% higher than the low point of 8,301 in 2013. However, these numbers are based on ESB connections and recent Census data suggest that the real level of house completions is considerably lower than official data suggest.

Despite some improvement in supply, the level of house building is way below requirements. It is probable that Ireland needs up to 30,000 new houses every year for at least the next decade, but between 2010 and 2016, house completions averaged just 11,497 per year

Against a background of limited supply and strong demand, house prices and private rents are rising strongly. The following are the key trends in residential house prices:

- National average house prices declined by 54.4% between the peak of the market in April 2007 and the low point of the market in March 2013. Between March 2013 and March 2017, prices have increased by 50.4%. Prices in March 2017 were 9.6% higher than a year earlier;
- In the Rest of Ireland (excluding Dublin), average house prices declined by 56.5% between the peak of the market in May 2007 and the low point of the market in May 2013. Between May 2013 and March 2017, prices have increased by 46.2%. Prices in March 2017 were 11.8% higher than a year earlier; and
- In Dublin, average house prices declined by 59.1% between the peak of the market in February 2007 and the low point of the market in May 2012. Between May 2012 and March 2017, prices have increased by 67.6%. Prices in March 2017 were 8.2% higher than a year earlier.

Figure 11: House Price Index

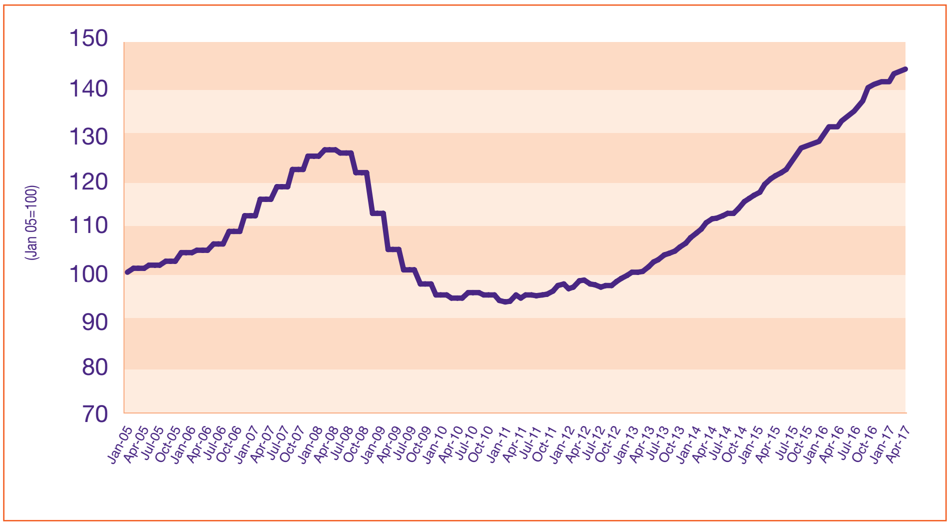


Source: CSO

In April 2017, private rents were 8% higher than a year earlier, and were 53.4% higher than the bottom of the rental market in late 2010.

Private rents declined by 25.7% between March 2008 and the end of 2010. They have increased strongly subsequently. In April 2017, private rents were 8% higher than a year earlier, and were 53.4% higher than the bottom of the rental market in late 2010.

Figure 12: Private Rent Index



Source: CSO, Consumer Price Index, April 2017

BREXIT

On March 29th, the UK Prime Minister formally applied to leave the EU by invoking Article 50. On April 29th, the EU Council presented the EU-27's formal negotiation position. The negotiations were due to commence in May, but this has been delayed until after the UK general election. These negotiations will be akin to agreeing the terms of a divorce settlement. In theory, this process must really by over by November 2018, because the UK will have to leave by March 29th 2019, two years after the invocation of Article 50. This looks like an impossible ask. It promises to be a very difficult negotiation process, with no certainty about the outcome. It is only when a deal has been agreed, that any consideration will be given to the crucial issue for Ireland, which is the future trading relationship between the UK and the EU. There is a long way to go in this process and there will likely be many twists and turns.

One of these twists has emerged with the surprise announcement that a snap General Election will be held on June 8th. This is an explicit admission by the Prime Minister that she will need a stronger majority to navigate what will be an extremely difficult negotiation process. It was always going to be extremely difficult for her to get support within her fractured party for whatever deal she managed to negotiate with the EU. Her hope is that with a stronger majority she will be in a better position to push through a deal that would be in the best interests of the UK. Such a majority is now far from certain. However, that would not make the process any easier because the EU-27 basically holds all of the trump cards.

Uncertainty will continue to characterise the whole Brexit process. It promises to be a very fractious affair, with Macron likely to take a very hard line approach to the negotiations as he does not want an agreement that would weaken the EU.

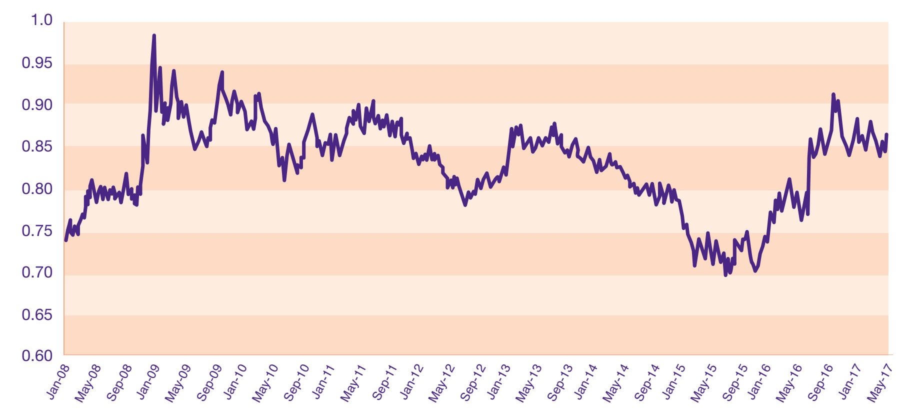
For a small open economy like Ireland, the stronger global backdrop is very important.

The Economic Outlook for Ireland

As we approach the mid-point of the year, it is clear that Ireland continues to enjoy broadly based growth. The global and domestic economic background is looking increasingly better.

For a small open economy like Ireland, the stronger global backdrop is very important. Prospects for the year ahead are looking better than at the beginning of the year. Sterling has stabilised; the labour market is strong; and business investment intentions are promising. Real GDP could well expand by 4.3% this year, which is up from a forecast of 3.3% at the beginning of the year.

Figure 13: Sterling v Euro



Source: Bloomberg

The key challenges for Irish policy makers over the coming year will be Brexit related uncertainty; pay pressures in the public sector; pressure to increase expenditure on public services; and solving the crisis in the housing market. It will take strong political leadership to steer the economy through these challenges.

Table 5: Economic Growth Forecast

(average)	2016p	2017f
GDP	+5.2%	+4.3%
GNP	+9.0%	+4.0%
Consumer Expenditure	+3.0%	+3.2%
Government Consumption	+5.3%	+3.5%
Investment	+45.5%	+10.0%
Exports Goods & Services	+2.4%	+4.0%
Imports Goods & Services	+10.3%	+6.5%
Unemployment Rate (%)	7.9%	6.0%
Employment (000s)	2,020	2,080
Inflation (CPI)	0.0%	+1.0%

As a small open economy that is so dependent on external trade, a big challenge for Ireland now is to exploit the opportunity presented by the improving global economic cycle and the opportunities presented by Brexit.

Exploiting The Global Upturn

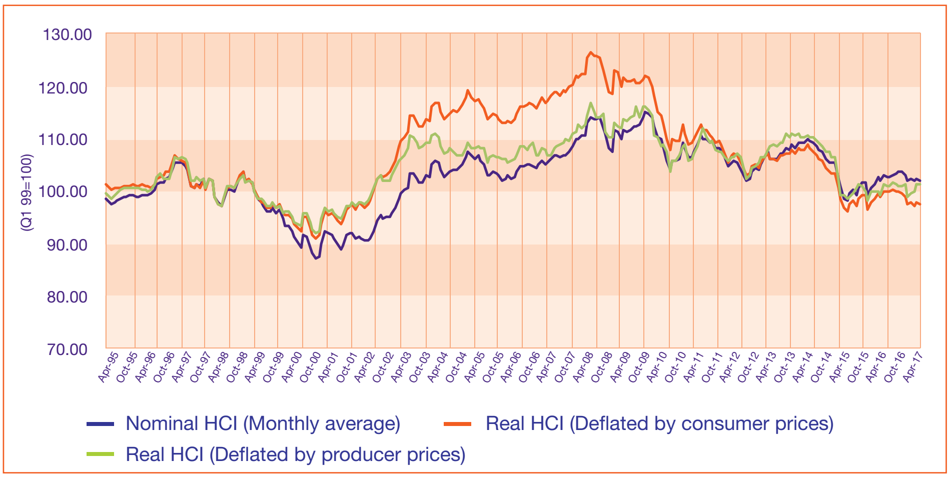
As a small open economy that is so dependent on external trade, a big challenge for Ireland now is to exploit the opportunity presented by the improving global economic cycle and the opportunities presented by Brexit. Faced with the challenges posed by Brexit, the possible corporate tax policies of President Trump, and the domestic imbalances and shortcomings, a number of policy areas need to be afforded top priority.

Controlling Costs

Key to this will be ensuring that issues around competitiveness get top priority. Costs are obviously an important element of competitiveness, including wage costs, the various costs of doing business such as commercial rates, rents, ICT costs, professional fees and energy.

Figure 14 shows recent developments in Ireland's international competitiveness. An upward trend signifies a loss of international competitiveness and vice-versa. Competitiveness improved significantly from 2008 onwards as the economy crashed, aided by a weaker euro. There has been some deterioration in the cost environment over the past year and the euro has strengthened on the exchanges.

Figure 14: Harmonised Index of Competitiveness



Source: Central Bank of Ireland

Inevitably, as the labour market continues to tighten and as public sector unions push for higher wages, wage pressures will build across the economy.

Wage talks have begun with the public sector unions. The relative pay levels between the public and private sector; pensions; and security of tenure will likely feature prominently in any decisions on pay and conditions. This of course will be subject to constraints imposed by the state of the public finances, which could well be adversely affected by possible Brexit outcomes. It is also likely that once the FEMPI-induced public sector pension levy is abolished, it will be replaced by a pension levy on public sector workers earning above a certain level, probably in the region of €60,000 per annum. It is of course incumbent on both sides to address areas where recruitment difficulties are prevalent, such as nurses. There is a lot to play for on both sides and it is unlikely to be an easy process. In any debate on public sector pay there is a pre-occupation with relative pay in the private sector. Comparing relative pay is incredibly difficult, not least due to length of service, qualifications, the quality of pension coverage, bonuses, and other perks such as free parking that might be enjoyed by either side. Furthermore, how easy is it to compare somebody who works in a shop with any public-sector job?

It is imperative that pay pressures are controlled in the economy if Ireland is to fully exploit the upturn in the global economy.

The more fundamental point is the relevance of such comparisons. The reality is that private sector employers will pay workers what they can afford, and if they pay more than that, they will go out of business and if they pay less, they will most probably lose their employees, depending of course on the economic environment. In contrast, public sector workers are paid from limited tax revenues, and are subject to budgetary constraints. If the public sector pay bill grows too strongly, then resources will be diverted from potential tax cuts for all tax-paying workers or from the quantity and quality of public services. It is a relatively straight-forward trade off.

If private sector workers believe that the public sector is so much better, then there is little stopping them from moving across to the public sector. On the other hand, if public sector workers believe that the private sector is so much better, then they are free to attempt to move across. There is nobody forcing anybody to choose one sector over the other, so why the pre-occupation with these dubious comparisons?

It is imperative that pay pressures are controlled in the economy if Ireland is to fully exploit the upturn in the global economy. Pressure is building in the public and the private sector. Wage increases in the public sector will impact on the public finances and wage increases in the traded part of the private sector will damage Ireland's international competitiveness. Rather than allow pay rise too strongly, it would be better for Ireland's fiscal situation and competitiveness if the taxation system were used to put money into workers' pockets rather than pay increases. This would benefit all workers who pay income tax and would enhance Ireland's competitiveness.

Infrastructure

Infrastructure is a key element of international competitiveness. This includes IT infrastructure; the energy infrastructure; roads; rail; and air access. Ireland has made considerable progress in recent years, but continued strong investment is required across all of these areas.

Residential Housing

To be a competitive economy and one where skilled workers want to live and where business wants to locate, an affordable supply of high quality housing for owner-occupier and rental purposes is essential. Ireland is badly lacking in this regard. Demand side policies do not work and the 'help to buy' scheme is ultimately more likely to generate house price inflation and undermine rather than enhance the situation facing first-time buyers. Ireland currently does not have enough developers either willing or able to build the quantity of housing that Ireland requires. Issues such as planning, development levies and the VAT rate need to be addressed to improve the economics of house building. An adequate supply of housing in areas where demand exists is the best approach to solving what is an intractable problem.

Public Services

The availability of high quality public services such as education, health and law & order is an essential element of a country's attractiveness and competitiveness. Ireland's public services are not up to standard at the moment. There is obviously a fiscal constraint on funding for public services, but there is a clear need for more spending on public services along with more efficient delivery systems. The bottom line is that the more the Department of Public Expenditure and Reform gives on the public sector pay side, the less that will be available for investment in services. It is a straightforward trade-off.

THIS PUBLICATION IS BASED ON DATA AVAILABLE UP TO JUNE 1st 2017.
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