



Ireland

General election against a background of economic recovery

- The Irish economy has recovered from the 2007/08 crisis in spectacular fashion. Growth is much stronger than that of its European neighbours, and in 2015 was identical to that of the People's Republic of China.
- This fact has been a major election campaign theme in February.
- However, the outgoing government has been preparing for the election since last year. Its budget for 2016 marks a break with the years of austerity that followed the crisis, with the aim of increasing its chances of re-election.
- If Fine Gael manages to form another coalition government with the Labour Party, that would represent a first for the party. It would also keep Fianna Fail, which was punished badly in the 2011 election for its handling of the crisis, in opposition.
- However, anti-austerity parties have gained ground, and that could complicate things in the aftermath of 26 February's parliamentary election.

In early February, rating agency Fitch upgraded its rating on Ireland from A- to A, only one notch below Standard & Poor's A+ rating. Moody's is remaining more cautious about Irish risks, keeping its rating at Baa1. However, the Irish economy has bounced back spectacularly since December 2013, when it left the international assistance programme managed jointly by the IMF and the European Union.

Economic recovery

In 2015, the economy grew by just over 7%, and the growth overhang in Q3 was already 6.6%. This represents a sharp acceleration relative to 2014 (5.2%). Ireland's GDP growth is the strongest in the European Union (see Focus on previous page). The recovery is being supported by the multinationals that operate in Ireland, which are major players in sectors that traditionally show little sensitivity to fluctuations in the economic cycle, like chemicals and pharmaceuticals. However, domestic demand is taking over from exports as the main growth driver. Real GDP overtook its pre-crisis level in 2015.

GDP grew 1.4% q/q in Q3-15 and 7% year-on-year (the Q4 GDP estimate will be published by end-March). Growth was mainly supported by private-sector investment (+4.9%) and consumer spending (+0.7%). Public spending, conversely, fell by 1%. In 2016, fiscal policy will be less of a drag on growth (see below). Finally, the impressive 2015 numbers came despite export growth (2.2%) being dwarfed by import growth (5.4%) in the third quarter, which means that foreign trade dragged GDP growth down by 2.9 points in Q3. Exports should remain buoyant in 2016, supported by the weak euro and demand from Ireland's three main trade partners: the eurozone (a third of total exports), the USA (over 20%) and the UK (over 10%).

Growth

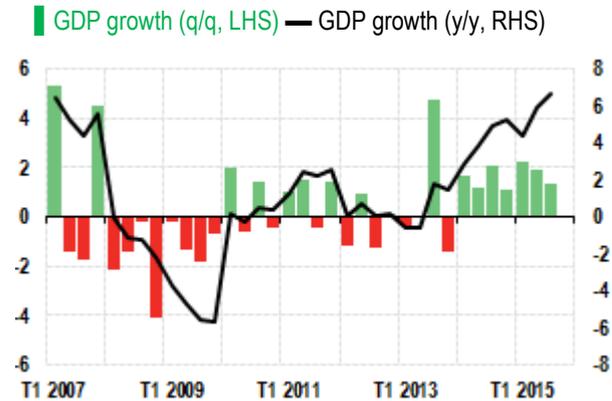


Figure 1

Source: Central Statistics Office Ireland

Foreign demand

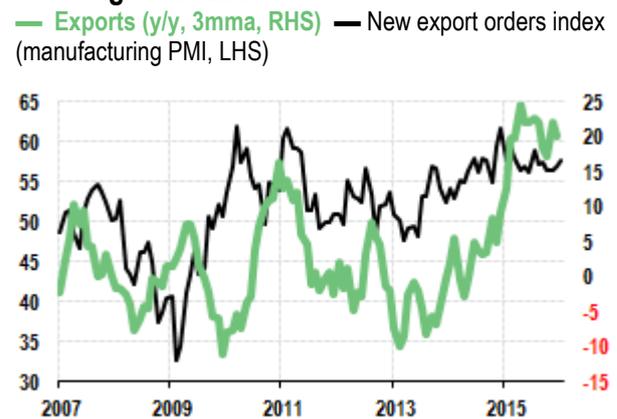


Figure 2

Source: CSO Ireland, Markit PMI

Surveys in early 2016 remain positive, showing that the recovery remains firmly on track. In the service sector in particular, the activity index based on the PMI survey in January hit its highest level since June 2006.

Labour-market conditions are also continuing to improve. The unemployment rate was 9.1% in Q3-15, below the eurozone average, and has been falling steadily since it peaked at over 15% in early 2012. At that time, the property bubble burst triggered a collapse in activity and employment in the sector which finally weighed on all sectors of the economy. However, long-term unemployment remains high. Wages are rising steadily, after falling 0.5% per year on average between 2008 and 2014. In Q3-15, year-on-year wage growth was over 2%. Consumers' disposable incomes therefore rose 1% in real terms in 2015, since consumer price inflation was near-zero. In 2015, inflation continued to fall and turned slightly negative at -0.1% as opposed to +0.3% in 2014. That explains why the



consumer confidence index published jointly by the Economic and Social Research Institute (ESRI) and KBC Bank reached a 15-year high in January.

Election issues

It was against this positive economic background that the head of Ireland's government (Taoiseach), Enda Kenny, dissolved Ireland's parliament (Dail Eireann) and called a general election for 26 February. On that day, voters in 43 constituencies will elect Ireland's 166 members of parliament. Despite the Irish economy's strong recovery, the outcome of the election cannot be predicted with any certainty. The traditional centre-right – Fine Gael ("Tribe of the Irish" in English) and Fianna Fail (the republican party) – or centre-left parties (Labour Party) have seen their influence wane in the last few years while anti-austerity movements have become increasingly popular with an electorate bruised by the economic and financial crisis.

Since 1932, Fine Gael and Fianna Fail have taken turns to govern Ireland. If Enda Kenny, who led Fine Gael to victory in 2011 after being out of power for more than 30 years, becomes Taoiseach again, this would be a first for his party. However, Fine Gael is unlikely to win the election without the support of its traditional ally, the Labour Party. The current Fine Gael/Labour coalition now has two thirds of the seats in parliament (112 in total, i.e. 75 for Fine Gael and 37 for Labour, versus 20 for Fianna Fail). The latest surveys give Fine Gael around 30% of the vote, down from 36% in 2011, and Labour only 10%. To achieve a majority of 80 seats in parliament, the outgoing coalition would therefore have to link up with one of the two new small parties, either the Social Democrats or Renua Ireland ("ré nua" in Irish meaning "new era" in English), a splinter from Fine Gael.

Key campaign issue: the end of austerity

In the last general election, the Irish punished Fianna Fail, which was held responsible for the economic and financial crisis, having governed Ireland almost constantly since 1926. In early February 2016, Fianna Fail, led by Micheal Martin, had not really recovered in the polls, which gave it only 17% of the vote, almost identical to its vote share in 2011.

In late 2015, the outgoing coalition, aware of the risks facing it, announced a stimulus budget for 2016 after years of austerity. The pace of economic growth since 2014 has accelerated the improvement in the public finances, giving the government substantial fiscal room for manoeuvre. Tax revenues rose over 10% year-on-year in 2015. As a result, the public-sector deficit/GDP ratio, which was still close to 6% 2013, was less than 2% last year. A stimulus package of EUR1.5bn (less than 1% of GDP) was announced in the 2016 budget. Of this, half relates to tax cuts (income tax, social security, extension of the renovation tax credit etc.) and half to increased spending (family allowances, pensions, unemployment benefit etc.). The budget also contains a raft of measures designed to help households buy a home. Many of Ireland's youngest families are struggling to find housing, and rents are back at their pre-crisis level. In addition, household debt still equalled almost 180% of disposable income in Q2-15. Although that represents a 10-year low, banks have changed their lending criteria

Foreign demand

Exports (y/y, 3mma, RHS) — New export orders index (manufacturing PMI, LHS)

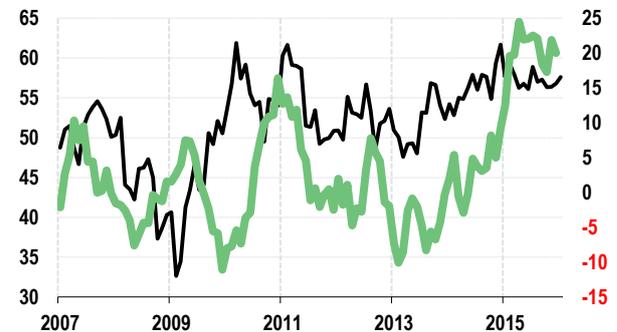


Figure 2

Source: CSO Ireland, Markit PMI

in line with new regulatory rules and are now taking into account the borrower's income instead of just the value of the property being purchased. As a result, the 2016 budget includes EUR811m of spending on housing. In addition, NAMA (Ireland's "bad bank") will co-ordinate with property developers to complete 20,000 new homes (EUR4.5bn) before 2020, 90% of which will be in the Dublin area.

Despite these numerous electoral hand-outs, the last few months have seen the rise of the radical left in Ireland in the form of the Anti-Austerity Alliance (AAA), which was set up in May 2014 following the formation of Podemos in Spain and Syriza in Greece. Its leader Paul Murphy won a crushing victory against the governing coalition in a Dublin by-election in October 2014. However, the context in late 2014 was different, because the benefits of the government's austerity policy were not yet clearly visible and the Labour Party was being criticised for not doing enough to defend the welfare state against the demands of the Troika. In addition, the principle of free water had just been scrapped with the introduction of a new water distribution tax starting in early 2015, triggering large demonstrations. Ireland's political landscape is also unusual in that it contains Sinn Féin, the political wing of the Irish nationalist movement, which is very well established and popular. It is also anti-austerity, and that could allow the AAA to make a breakthrough at the national level because of the single transferable vote system. Turnout among Sinn Féin supporters is traditionally low, and although polls suggest that 19% of people will vote Sinn Féin as opposed to 9.9% in 2011, it is unlikely to do better than in the previous election, when it won 14 seats.

Overall, the 2016 budget aims to boost the disposable incomes of Irish households, without threatening European targets for improving the public finances. Public-sector debt fell below 100% of GDP in 2015, having peaked at 120% in 2012/13, and should continue falling this year, while the public-sector deficit should be close to 1%. Irish voters are likely to recognise this and vote in favour of the economic recovery, if not the outgoing government.