Euler Hermes Economic Research

Country Report

Ireland

BIBBY FINANCIAL SERVICES

In partnership with Euler Hermes

Star performer

General Information

GDP	USD283.703bn (World ranking 40, World Bank 2015)
Population	4.64mn (World ranking 121, World Bank 2015)
Form of state	Parliamentary Republic
Head of government	Leo VARADKAR (Fine Gael)
Next elections	2021, legislative

Strengths

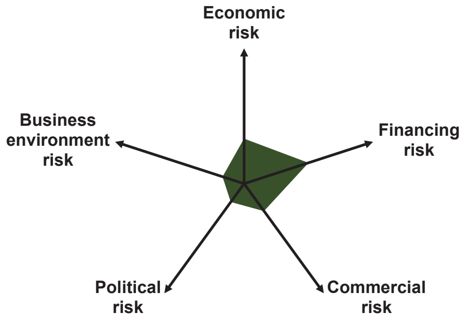
- Strong business environment
- Lowest corporate tax rate within the Eurozone
- Exports oriented towards sectors with high value added
- Robust current account surplus
- Strong education system
- English speaking business location

Weaknesses

- Sensitive to external shocks due to high openness to trade
- High dependency on foreign investment
- High private and public debt

Country Rating

A1



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports		Rank		Imports
United States	24%	1	32%	United Kingdom
United Kingdom	14%	2	12%	United States
Belgium	12%	3	10%	France
Germany	7%	4	9%	Germany
Switzerland	5%	5	5%	China

By product (% of total)

Exports		Rank		Imports
Pharmaceuticals	29%	1	11%	Aeronautics
Basic Organic Chemicals	20%	2	8%	Pharmaceuticals
Toiletries	8%	3	5%	Basic Organic Chemicals
Precision Instruments	5%	4	4%	Cars And Cycles
Aeronautics	4%	5	3%	Plastic Articles

Source: Chelem (2015)

Fastest-growing European economy since 2014

The successful implementation of policy reforms by the Irish authorities has borne fruit. Ireland has positioned itself as the fastest-growing European economy since 2014.

GDP increased by +5.2% in 2016, mainly driven by domestic demand growth. Continued double-digit investment growth has been supported by the very attractive business and fiscal environment and the UK's vote to exit the EU. Private consumption has been supported by the labor market improvement (see Figure 2) and rising wages.

The improving trade momentum at the global scale since H2 2016 and the stronger growth in the eurozone boosted export performance. The end of deflationary pressures – inflation rate expected at +0.5% in 2017, in positive territory for the first time since 2013 - has also triggered positive nominal effects (see Figure 3) and helped improve firms' pricing power.

We expect trade to remain a key driver of GDP growth in 2017 given the slightly lower EUR (1.08 against the USD after 1.11 in 2016), stronger eurozone growth (+1.9% in 2017) and the improving global economy. GDP growth is forecast to reach +6.1% in 2017 and +4.2% in 2017.

Inward investments remain significantly above 2012 levels

After an extraordinary boom in 2015, inward FDI positions and M&A volumes normalized last year, though remaining at levels over twice as high as in 2012. New PM Leo Varadkar, appointed in June, will likely keep a very liberal stance on economic and fiscal policy. The 2017 Draft Budgetary Plan includes expansionary measures such as tax cuts that mainly involve entrepreneurs.

The government's main challenge will be to trigger a new momentum in capital inflows despite a difficult political context – it has a slim majority in Parliament. Yet parliamentary support could be mustered to deal with Brexit's impact on Ireland.

Firms' payment behavior continues to improve, albeit at slower pace

After shrinking by -10% in 2015, business insolvencies continued falling in 2016 (-2%). This reflects the pro-business and low tax economic environment.

The trend is set to continue. We forecast a -8% decrease in bankruptcies in 2017 and -5% in 2018. At 900 in 2018, business insolvencies will remain 2.5 times above the 2007 level (see Figure 4).

Corporate debt still at very high levels, but decreasing

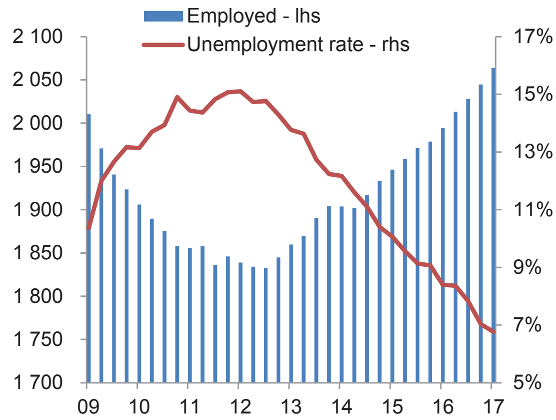
The Irish economy's rebound supports the deleveraging of non-financial corporations due to the increase in corporate margins. Mainly driven by multinationals which account for 2/3 of total corporate debt, corporate indebtedness remains high at 257.4% of GDP but has been decreasing since 2015 (see Figure 4). This represents a low financial stability risk for the economy as these companies finance their operations on the global capital markets. In addition, firms' profitability rates are at record high levels, close to 70% of the value added in 2016, hugely outperforming the eurozone average of 41%.

Figure 1 – Key economic forecasts

	2015	2016	2017f	2018f
GDP growth (% change)	26.3	5.2	6.1	4.2
Inflation (%, average)	-0.3	0.0	0.5	1.2
Fiscal balance (% of GDP)	-2.0	-0.6	-0.5	-0.3
Public debt (% of GDP)	78.5	75.4	73.5	72.3
Current account (% of GDP)	10.2	4.7	4.8	5.1

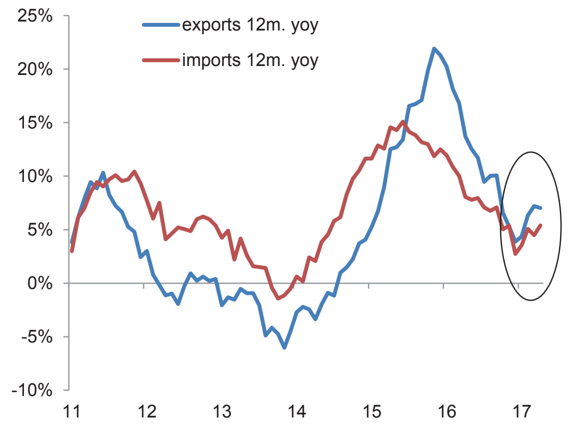
Sources: National sources, IHS, Euler Hermes

Figure 2 – Total employment vs unemployment rate



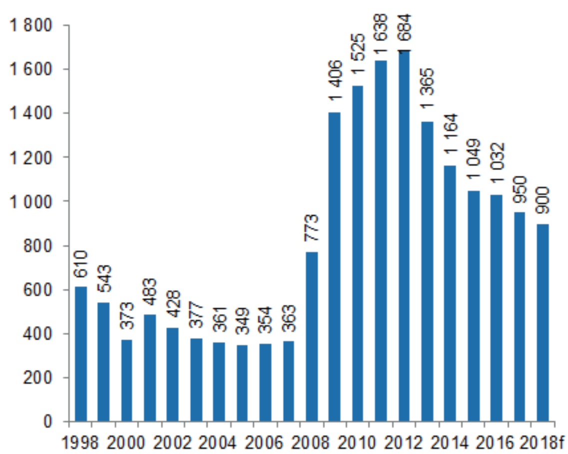
Sources: IHS, Euler Hermes

Figure 3 – Total goods' exports and imports (nominal)



Sources: IHS, Euler Hermes

Figure 4 – Ireland's trade in goods to the UK



Sources: National sources, IHS, Euler Hermes

Downside medium-term risks from Brexit

Ireland is highly exposed to the British economy: the UK is the second-biggest market for Irish exporters. It is also the first import market. Ireland is one of few EU countries to have a goods' trade balance deficit with the UK.

A UK slowdown in growth or a potential recession - should it exit the EU without a transit deal in 2019 - would negatively impact Irish exports to the UK. This is due to the strong sterling depreciation, which accounts for around 14% of Ireland's goods export and 20% of services exports. Sectors such as agrifood, chemicals, and electronics would bear the brunt. On the contrary, sectors highly dependent on imports such as agrifood, energy, chemicals, machinery and equipment, wood/paper, and textile are expected to benefit from lower import costs.

The total cumulative impact by 2021 is estimated at -1.2pp of GDP growth and will come from losses in both exports and investments (see Figure 5).

Are there any opportunities from Brexit?

We have assessed the tax environment of several European countries in comparison to the UK, to identify its potential competitors in a post-Brexit European Union. By plotting corporate tax rates against withholding dividends tax rates, we find a proxy for business attractiveness (see Figure 6).

Four countries stand out. In these markets, low corporate and withholding tax rates are coupled with low employers' social contribution rates.

Luxembourg looks like the most serious candidate. Its low tax rates combined with its advantageous geographic location – at the heart of Western Europe – could attract many businesses that consider relocating. A 2017 corporate tax cut (from 21% to 19%) signals a will to enhance competitiveness. Ireland, the Netherlands, and Germany are the next in line.

We have also looked at the World Bank's 2017 Doing Business Index to gauge countries' effective attractiveness for companies. The UK and the US's are clear leaders. Yet Germany, Austria, and Ireland are right on their heels. If UK-based companies relocate following Brexit, they will likely bring along at least part of their labor force.

Yet it is also interesting to assess the state of the labor force in competing countries. When plotting the Doing Business ranks against the adult education level in those countries, and using the results of the EF English Proficiency Index, the countries with the most favorable tax environments are again among the best performers. Ireland leads the pack, followed by Germany and the Netherlands.

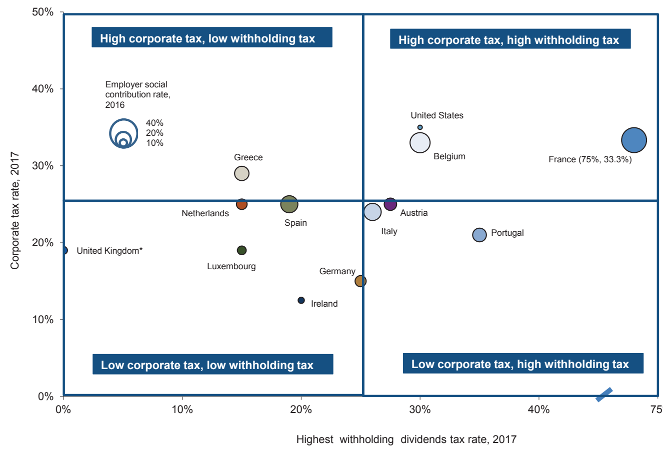
Figure 5 - Cumulated Brexit impact by country (2017-2021) in the baseline scenario (Limited FTA)

Cumulative Brexit impact by country between 2017-21 in the baseline scenario

		Limited FTA = FTA on goods (3% tariffs on average), few services sector add-ons (10% additional costs on average) *Cumulative currency depreciation : -16% since end-2016*				
		Exports of goods (EURbn)	Exports of services (EURbn)	FDI (EURbn)	GDP growth (pp)	Business insolvencies growth (pp)
High impact	Netherlands	-4.0	-0.6	-8.2	-1.8	2.0
	Ireland	-1.2	-0.5	-1.2	-1.2	1.5
	Belgium	-3.2	-0.3	-1.0	-1.0	1.0
Moderate impact	Germany	-8.4	-1.0	-2.1	-0.4	< 1
	France	-3.0	-1.2	-3.2	-0.3	< 1
	Spain	-1.6	-1.0	-1.8	-0.3	< 1
Low impact	United States	-3.5	-2.2	-13.5	-0.1	< 1
	Italy	-2.0	-0.4	-0.4	-0.2	< 1
	Austria	-0.4	-0.1	-0.1	-0.2	< 1
	Portugal	-0.3	-0.2	-0.1	-0.3	< 1
	Slovakia	-0.2	0.0	0.0	-0.3	< 1
	Finland	-0.3	-0.1	-0.1	-0.2	< 1
	Romania	-0.2	0.0	0.0	-0.1	< 1
	Greece	-0.1	-0.2	0.0	-0.2	< 1
Very low impact	China Region	-3.0	-0.3	-1.9	0.0	< 1
	Poland	-0.8	-0.2	-0.1	-0.1	< 1
	Denmark	-0.6	-0.1	-0.4	-0.1	< 1
	Sweden	-0.9	-0.2	-0.7	0.0	< 1
	Czech Republic	-0.5	-0.1	0.0	0.0	< 1
	Eurozone	***-24.6***	***-5.5***	***-18.2***	***-0.4***	***1.0***
	% of total	*0.7%*	*0.5%*	*1.9%*		

Sources: ONS, Chelem, Euler Hermes

Figure 6 - Corporate tax, withholding tax dividends and employer social contribution rates in a sample of selected EU countries and the USA



Sources: Deloitte, KPMG, Euler Hermes