Economist's Weekly Market View

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Saving Grace

There has been a stream of good news flow on the Irish economy in recent weeks culminating in an upgrade to its sovereign debt rating to Aa3 from A1 by Moody's. Despite the double shock of a sharp rise in inflation and much higher interest rates over the past year, as well as a marked slowdown in the global economy, the Irish economy continues to display considerable resilience.

Data published for the opening quarter of the year show continuing very strong growth in tax receipts, a sharp jump in new car sales, unemployment remaining very low and a pick-up in PMI activity indicators. As anticipated, though, early estimates for first quarter GDP point to a marked slowdown in growth in 2023, compared to the very strong 12% rise registered in 2022.

Nonetheless, with data remaining strong, there have been a raft of upgrades to Irish growth forecasts in the past month, most notably from the Central Bank, ESRI and Dept. of Finance. GDP is now seen as expanding by circa 5.5% this year, with growth in 2024 and 2025 put in a 4-6% range. The domestic economy is seen as growing in a 2.5-4.0% range in the next couple of years.

Meanwhile, the unemployment rate is projected to remain very low at 4.5% or below over the next three years, with inflation gradually falling back to close on 2%. The government budget surplus is projected to double from €8 billion last year to €16 billion in 2024. Altogether, this is very much a sweet spot in terms of economic performance.

Underpinning the Irish economy's strength and resilience are very strong financial fundamentals. Ireland has been transformed into a low debt, high savings economy over the past decade. There has been an enormous amount of deleveraging in the aftermath of the Global Financial Crisis of 2008-2010, with debt metrics falling to very low levels. Meanwhile, the household savings ratio has risen to over 20%, reaching a peak above 30% during the COVID pandemic.

The public finances have seen a return to large and rising budget surpluses, as well as sharply declining government debt ratios. High savings ratios are also resulting in very large balance of payments surpluses, projected at 11% of GDP this year by the Dept. of Finance.

The strength of the public finances means the government has been able to use fiscal policy to cushion the impact of the COVID pandemic and cost-of-living crisis on households and firms. Combined with record levels of FDI, this has laid the basis for the recent very strong growth performance of the economy.

A key issue now facing the economy is increasingly binding capacity constraints, most notably the very tight labour market, acute shortage of housing and growing pressures on public infrastructure and services. The emergence of a large budget surplus and high levels of savings means Ireland has the scope to take measures that can ease these capacity constraints, in particular through increased public investment. This would help lay the basis for continuing strong growth in the economy.

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