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Economic Research Unit

Bank of Ireland

2015

GDP	EMPLOYMENT	UNEMPLOYMENT	INFLATION
4.2%	2.2%	10%	0.3%

Strong export performance

Double digit investment growth

Consumer spending to gather pace

Jobs up, unemployment down

> "With all four stages of the economic recovery now on track, solid growth is on the cards for this year and next"

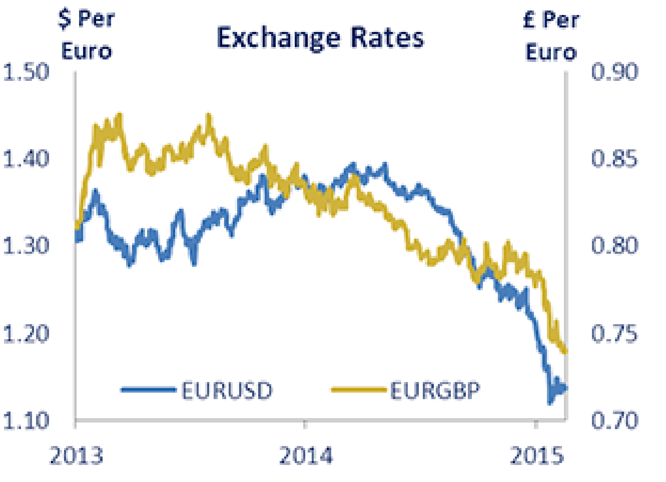
Loretta O'Sullivan
Chief Economist

Overview 2014 was an important year for the Irish economy. GDP growth averaged close to 5% over the first three quarters, as did GNP, with high-frequency data for the final quarter also auguring well. Reflecting this, we have left our headline forecasts for last year unchanged. Beyond a strengthening in activity, 2014 stands out because it was the year in which the four stages of Ireland's recovery – export growth, investment, employment and consumer spending - came together. With this, the recovery moved onto a firmer footing. Looking ahead, GDP is forecast to increase by 4.2% in 2015 (unchanged from our October Outlook), while growth of 3.8% is projected for 2016. Trading partner growth and a weak euro will support exports over this period, with the broadening out of domestic activity and the recovery in the property market helping investment. Moreover, on the back of further employment gains and improving household incomes, consumer spending is set to gather pace. With the economy growing, unemployment is forecast to fall to 10% this year and 8.8% next year. Inflation, however, is expected to remain fairly subdued.

Outlook	2014 (f)	2015 (f)	2016 (f)
Personal Consumption	1.0%	2.0%	2.2%
Government Consumption	1.5%	1.5%	1.7%
Investment	12.0%	12.0%	7.5%
Exports	12.2%	5.5%	5.3%
Imports	11.8%	5.2%	5.1%
GDP	5.0%	4.2%	3.8%
GNP	4.2%	3.7%	3.4%
Employment	1.8%	2.2%	2.2%
Unemployment Rate (Average)	11.3%	10.0%	8.8%
CPI	0.2%	0.3%	1.6%

Strong export performance

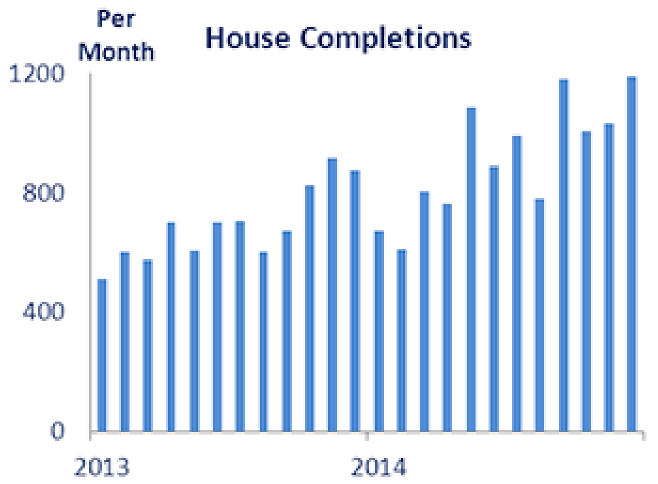
Exports of goods and services picked up significantly during 2014, increasing at an annual rate of 15.5% in the third quarter. Support has come from competitiveness gains and strengthening activity in the UK and US, with goods exports receiving an additional boost from positive base effects and contract manufacturing. The former follows from the unwinding of the pharmaceutical 'patent cliff' effect, while the latter relates to activities outsourced abroad which are recorded as Irish exports. This year and next, export growth is expected to moderate somewhat. Even so, healthy order books for manufacturing and services, brighter prospects for our trading partners, and favourable exchange rate movements, point to a rise in exports of over 5% for both years. In net terms - taking account of import trends - exports are set to make a positive (but more modest) contribution to GDP growth in 2015 and 2016.



For a small open economy such as Ireland's, there are, as always, risks to the outlook; including the slower pace of the euro area recovery on the downside, and the possibility that the euro depreciates by more than expected on the upside.

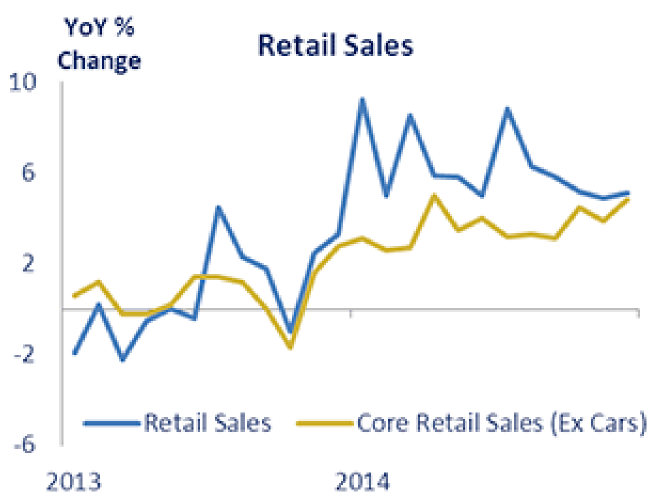
Double digit investment growth

Investment increased at an annual rate of 7.8% in the third quarter of last year, with double digit growth projected for the year as a whole. The machinery and equipment component is performing strongly (rising by some 37% year-on-year in the third quarter), helped by strong inward FDI and rising business confidence amid improving domestic demand. Developments on the construction front have also been positive of late. Non-residential building activity has picked up, while 11,000 residential units were completed in the course of 2014. This is up from the 2013 low of 8,300 units and data such as housing starts suggest a further increase this year. With overall investment coming off a low base, there is headroom for additional gains and robust growth of 12% is forecast for 2015 (7.5% in 2016).



Consumer spending to gather pace

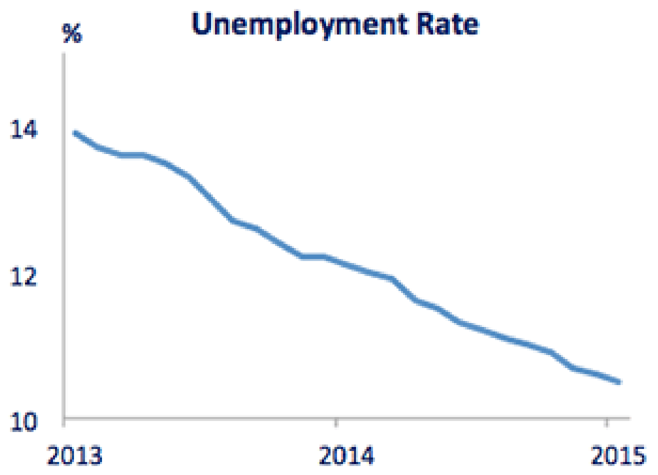
Consumer spending was flat year-on-year in the third quarter of last year, but averaged 0.6% over the first three quarters, leaving 2014 on track to be the first full year of positive growth since 2010. Looking to this year, available high-frequency indicators bode well, with new car sales up 26% on an annual basis in January (suggesting that sales of over 100,000 are achievable in 2015), and consumer confidence above its long term average and at its highest level since early 2006. Spending is forecast to increase by 2.0% this year and 2.2% next year, as household disposable incomes benefit from employment growth and a pick-up in earnings, as well as from lower oil prices and inflation. Ongoing balance sheet repair is likely to remain a headwind though. As for government consumption, growth of 1.5% is projected for 2015 and 1.7% for 2016.



So with domestic demand firming over the coming years and making a positive contribution, growth is set to become more broad-based.

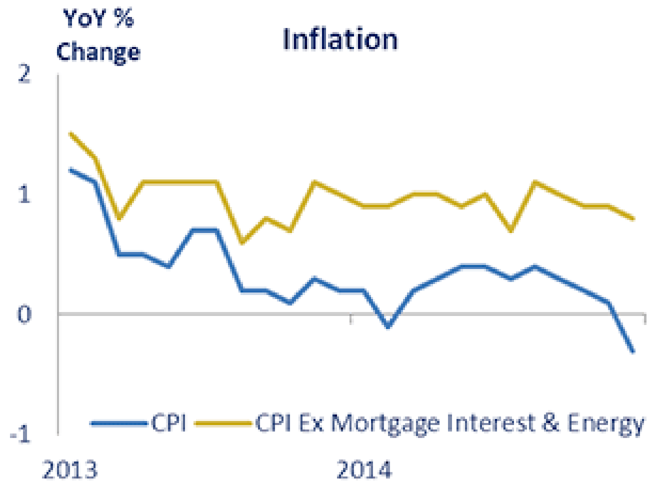
Jobs up, unemployment down

Further job gains in 2014 took the number of people in work to almost 1.93 million in the third quarter, the highest level since late 2009. Employment growth over the first three quarters of the year was a little softer than anticipated but, in line with expectations, was relatively broad based across sectors (with gains in services and construction) and regions, and mostly of a full time nature. The unemployment rate fell further over the course of the year, to 11.1% in the third quarter (down from 12.7% a year earlier) and, according to the Live Register estimate, stood at 10.5% in January 2015. This, alongside other high frequency indicators such as redundancies - the 2014 monthly average of 573 was half that of 2013 - and increased vacancies, implies that job gains are ongoing. We are forecasting employment growth of 2.2% this year and next, which equates to net job creation of around 42,000 per annum. The labour force is also projected to expand in both years, but by less than employment, so the downward trend in unemployment should be maintained, with the rate averaging 10% in 2015 and 8.8% in 2016.



Inflation remains subdued

Consumer price inflation averaged just 0.2% last year. While price pressures were subdued throughout the year, the downward trend accelerated in the closing months. Prices declined each month from September onwards, with the annual rate turning negative in December (-0.3%). The surprise and sizeable fall in oil prices at the back end of the year was one of the main drivers of this - energy products knocked 0.6 percentage points off the December rate, with mortgage interest subtracting a further 0.5 percentage points. The impact of past ECB rate cuts will continue to push down on inflation for much of this year, as will energy developments (oil futures indicate that prices are unlikely to pick up substantially in the next while). Against this, the improving domestic economy and weaker euro should exert some upward pressure on prices in 2015 and 2016, although spare capacity will limit the extent of this. CPI inflation (and similarly the European HICP measure) is now projected to average 0.3% this year and 1.6% next year.

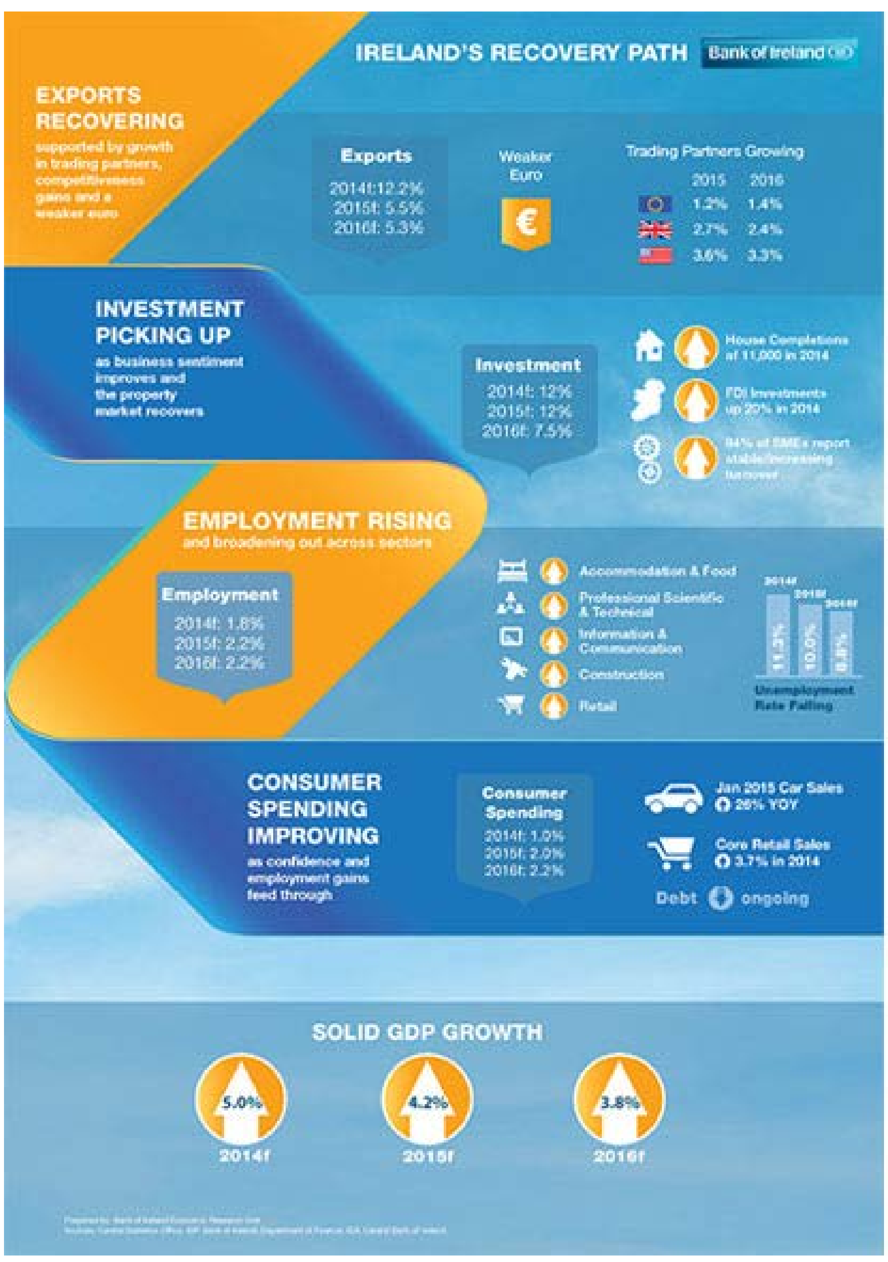


Property market recovering

Last year saw an increase in activity in the property market, with transactions rising to circa 43,000, up more than 40% on the 2013 figure. Mortgage activity has also picked up, albeit from a low base (20,155 loans for property purchase were drawn down in 2014, a 50% increase on 2013). Cash buyers are still a significant feature of the housing market though, accounting for approximately 50% of purchases. On the price side, the upward movement which started in Dublin in mid-2013 spread out over the course of 2014 to other areas. Dublin prices rose at an annual rate of 22.3% in December, while prices outside of the capital gained 10.2%. The private rents component of the CPI was also up some 8% year-on-year in December. Looking ahead, rising employment and household incomes, along with household formation trends, are set to support demand for housing; though the Central Bank's new macro-prudential regulations may have a dampening effect. The lack of supply in some urban areas remains a key issue and in response to these dynamics, new house building is expected to gradually increase in the coming years.

Deficit to fall below 3% of GDP

The Department of Finance foresees a general government deficit of 3.7% of GDP in 2014, well within the target of 5.1%. The improving economy meant that tax revenues last year were stronger than expected, while social protection spending was lower. This allowed for a stimulus package of €1 billion in Budget 2015, bringing seven years of fiscal consolidation totalling 19% of GDP to an end. The deficit is projected to fall to 2.7% of GDP in 2015, below the 2.9% target. The debt to GDP ratio, meanwhile, is expected to be 110.5% at the end of 2014 and under a 100% by 2018. Early signals for this year - the January exchequer returns - suggest that the public finances are continuing to improve, while the NTMA has already raised €8.5 billion of funding at record low yields (over half the planned amount). The Government has also repaid early some €12.5 billion of IMF loans, with a further €5.5 billion set to be repaid this year, which is estimated to save over €1.5 billion in interest costs.



Contact us at:

economics@boi.com

Dr. Loretta O'Sullivan
Chief Economist
+353 (0) 766 244 267

Patrick Mullane
Senior Economist
+353 (0) 766 244 269

Anne Mathews
Media Relations Manager
+353 (0) 766 234 771