How Ireland's Economy Rebounded After the Financial Crisis
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The “Celtic tiger” now leads the eurozone in growth

Prior to the global financial crisis (GFC), Ireland’s economy was a stellar performer, earning the country the moniker of “Celtic tiger.” The onset of the GFC caused a major economic contraction and a housing crash — but today, Ireland is once again the fastest-growing economy in the eurozone. In this blog, I examine the key elements that allowed Ireland to regain its footing.

Key components of the recovery

From 1998 through 2007, Ireland’s real gross national product (GNP) growth averaged 5.7% per year, and then fell by an average of 2.4% annually between 2008 and 2012.¹ By 2014, the Irish economy started consistently expanding again, and in the fourth quarter of 2016, real GNP growth hit 10.1% year-on-year.¹

There are three reasons for the economic reboot:
1. The September 2008 decision by the Irish government to bail out the banks by guaranteeing all banks, bank loans and deposits
2. Wage adjustment, which brought the cost of domestic labor back down to a level that was regionally competitive
3. The gradual deleveraging of both private and public sector balance sheets

These actions have led to an improvement in the labor market and a reduction in leverage, which have cleared the way for renewed spending and growth.

**Flexible Irish labor market continues to improve**

During the last half of the “Celtic tiger” era, Ireland enjoyed very low rates of unemployment, averaging just 4.6%. However, during and after the GFC, unemployment surged, peaking at 15.2% in January 2012.

Due to Ireland’s flexible labor regulations, employers were able to reduce payrolls when conditions warranted, in contrast to many other countries in continental Europe. Therefore, Irish employment was swift to rebound as the recovery took hold. Since January 2013, employment in Ireland has been growing at an average of 2.3% year-on-year. For the eurozone, the average has been just 0.5%. Similarly, Ireland’s unemployment rate fell to 6.2% in April 2017, while in the eurozone, unemployment was 9.5% in March 2017.

The robust recovery of Ireland’s labor market is due in large part to declines in private and public sector wages, especially relative to other eurozone economies. Ireland’s labor cost index was 63.7 in the first quarter of 2000, but rose strongly during the “Celtic tiger” years, peaking at 102 in the first quarter of 2009. This represented an increase of 60% over nine years, compared with a 29% increase in the labor cost index for the eurozone as a whole over the same period. This proved to be unsustainable: Between 2009 and 2011 there was a huge adjustment, with the Irish labor cost falling from 10% above the eurozone level to 2% below it.

Since 2014, the Irish labor cost index has resumed its rise, but has been fueled entirely by private sector earnings. This is a welcome development: Public sector wages remain as much as 37% above those in the private sector, which is too wide for the long-term good of the economy. I believe public sector wage restraint should continue to be enforced until that gap narrows.

**The deleveraging process continues**

The second major achievement in Ireland since the GFC has been the magnitude of balance sheet deleveraging, which is best demonstrated by the change in the ratio of total debt to gross domestic product (GDP). Irish public sector debt-to-GDP reached a high of 123.9% in the second quarter of 2013, but fell to 75.6% by the end of 2016, thanks to rising GDP and falling debt. This effort was the result of the government gaining greater control over spending and improving the country’s credit rating, which enabled officials to roll over remaining debt at lower rates.

Deleveraging has been even more dramatic in the financial sector. The excessive debt built up during
the boom years pushed this sector’s debt-to-GDP ratio to 244% by mid-2008. Following the bank bailout, this ratio began a swift fall, dropping all the way to 75.6% at year-end 2016.

Households deleveraged nearly as dramatically, from 118% at the close of 2010 to 54% in the third quarter of 2016. In the aftermath of Europe’s biggest real estate bubble, Ireland’s businesses and households are still deleveraging. In fact, Irish households haven’t been this unencumbered since 2004.

Recovery is well underway

Ireland has emerged from the GFC very healthy with more competitive wages, low inflation, recovering consumer demand, reduced housing costs and strengthened balance sheets. It has resumed its growth path, but a couple of obstacles remain. At this point in the recovery, the Irish economy needs a resumption of bank lending growth and more stable money growth, which hopefully will occur as the deleveraging process winds down. And ironically, a recent concern involves the current European Central Bank interest rate policy. Some believe eurozone rates are unsuitable (i.e., too low) for Ireland’s much more robust growth. These will be areas to watch as we go forward.

1. Macrobond as of June 5, 2017

2. Thompson Reuters Datastream as of June 5, 2017

Read more market and economic views by Invesco’s Chief Economist John Greenwood here.

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Based in London, John is Chief Economist of Invesco Ltd. with responsibility for providing economic analysis and forecasts to Invesco portfolio managers and clients.

John started his career in 1970 as a visiting research fellow at the Bank of Japan. He joined our company four years later in 1974 as Chief Economist, based initially in Hong Kong and later in San Francisco. As editor of Asian Monetary Monitor in 1983, he proposed a currency board scheme for stabilizing the Hong Kong dollar. John was a director of the Hong Kong Futures Exchange Clearing Corporation for four years until 1991, and in 1992 became a council member of the Stock Exchange of Hong Kong, a position he held for twelve months. In that same year, he was an economic adviser to the Hong Kong Government. He has been a member of the Committee on Currency Board Operations of the Hong Kong Monetary Authority since 1998. He is also a member of the Shadow Monetary Policy Committee in England, and he serves on the board of the Hong Kong Association in London.

John holds an MA from the University of Edinburgh, and an Honorary PhD, also from the University of Edinburgh.

Important information

Blog header image: Michail Makarov/Shutterstock.com
The quarterly Labour Cost Index (LCI) for Ireland measures change in the total hourly costs incurred by employers of maintaining their employees. The LCI covers the economic activities of industry and services (including public administration) and is determined by Eurostat.

Total debt to GDP is defined as total public and private sector debt (financial corporate, non-financial corporate, government and household) as a percentage of gross domestic product.

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