Irish economic forecasts: recovery to gather pace this year

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DAVY VIEW

In our new set of forecasts for the Irish economy, we expect Irish GDP to expand by 3.5% in 2014, 3% in 2015 and 2.8% in 2016. The clear recovery in the domestic economy should become apparent in GDP growth this year, artificially depressed by poor export performance among multinationals last year. The recovery will also be more broad-based as consumer spending and investment growth accelerate. We expect the government deficit will fall to 2.9% of GDP next year based on a €500m adjustment in Budget 2015.

GDP growth of 3.5% in 2014 and 3% in 2015

In our new set of forecasts for the Irish economy, we expect Irish GDP to expand by 3.5% in 2014, 3% in 2015 and 2.8% in 2016. The big picture is that the temporary negative impact of the pharmaceutical patent cliff is now waning. The clear recovery in the domestic economy should become apparent in GDP growth in 2014, artificially depressed by poor export performance among multinationals last year. With GDP growth envisaged to be close to 3% thereafter, Irish GDP in real terms will return to pre-recession peak levels by 2016.

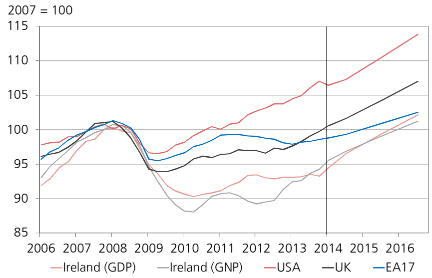
Domestic economy joining the recovery

We expect consumer spending will accelerate to 1.5% growth in 2014 and 1.9% in 2015. The investment recovery should materialise in 2014 as temporary distortions from the aircraft leasing sector unwind and as construction output recovers. We expect investment growth of 14.5% in 2014 and 8.6% in 2015 as the construction sector recovers off a low base. Our forecasts are based on housing starts rising to 9,850 in 2014, 12,150 in 2015 and 14,600 in 2016. We also expect employment growth to be sustained, expanding by 2.8% in 2014 and 2.3% in 2015. This means the unemployment rate will fall to 9.6% in 2015 and 8.6% in 2016.

Deficit of 2.9% of GDP in 2015 despite smaller Budget adjustment

Exchequer returns for the first seven months of 2014 show that the government is well on track to hit its 4.8% of GDP deficit target. Tax revenues were already €548m, or 2.5%, ahead of target in the year to July. Income taxes, VAT and excise duties have grown by around 7% on the year. National debt interest (including Central Bank surplus income) is over €500m below expectations. We have based our projections for the deficit on our stronger path for GDP growth, a smaller €500m adjustment in Budget 2015 and no adjustment in 2016. We also assume spending discipline is maintained so that current expenditure falls as planned in 2015. This means the deficit is expected to fall to 3.9% of GDP in 2014, 2.9% in 2015 and 1.9% in 2016.

Irish GDP growth versus peers



Source: Thomson Datastream; Davy

New Davy forecasts, % change

	2014	2015	2016
GDP	3.5	3.0	2.8
GNP	2.8	2.3	2.2
Consumer spending	1.5	1.9	2.4
Government	-0.7	-1.3	-1.0
Investment	14.5	8.6	6.8
Domestic demand	3.2	2.5	2.6
Exports	3.5	4.0	4.0
Unemployment (%)	11.0	9.6	8.6

Source: Davy forecasts

Introduction: revising up our Irish economic forecasts

We have revised up our 2014 forecasts for Irish GDP growth to 3.5% and 2.8% for GNP

In our new set of forecasts for the Irish economy, we expect Irish GDP to expand by 3.5% in 2014, 3.0% in 2015 and 2.8% in 2016. The big picture is that the temporary negative impact of the pharmaceutical patent cliff is now waning. The clear recovery in the domestic economy should become apparent in GDP growth in 2014, artificially depressed by poor export performance among multinationals last year. With GDP growth envisaged to be close to 3% thereafter, Irish GDP in real terms will return to pre-recession peak levels by 2016.

We expect consumer spending will accelerate to 1.5% growth in 2014 and 1.9% in 2015. The investment recovery should materialise in 2014 as temporary distortions from the aircraft leasing sector unwind and as construction output recovers. Our forecasts are based on housing starts rising to 9,850 in 2014, 12,150 in 2015 and 14,600 in 2016. We expect employment growth will be sustained, expanding by 2.8% in 2014 and 2.3% in 2015. This means the unemployment rate will fall to 9.6% in 2015 and 8.6% in 2016.

Short-term indicators have continued to improve in the first half of 2014, suggesting that Ireland is the fastest-growing economy in Europe

Short-term indicators suggest that the Irish economy is expanding at an exceptionally rapid pace (Table 1). In the first half of 2014, the composite PMI has remained close to 60; industrial production is up 17% on the year; goods exports are up by 4.3%; retail sales are up by 6.5%; and tax revenues are up by 5%. The unemployment rate has declined through H1 to 11.5%, down 1.5 percentage points from the 13.0% rate recorded in July 2013. Announced FDI projects in 2014 suggest a strong flow of investment and job creation, particularly in the ICT sector. Consumer and business confidence has continued to improve in 2014.

Table 1: Short-term macro-economic indicators

	Nov	Dec	Jan	Feb	Mar	Apr	May	June	July
Composite PMI	58.8	58.6	57.8	55	59	60.8	59.4	59.7	60.2
Manufacturing	52.4	53.5	52.8	52.9	55.1	56.1	55	55.3	55.4
Services	57.1	61.8	61.5	57.5	60.7	61.9	61.7	62.6	61.3
Construction	59.4	58.3	56.4	56.2	60.2	63.5	60.2	59.9	62.6
Consumer confidence	68.2	66.8	73.1	76.2	71	79.8	84.6	81.1	
Business confidence	n/a	n/a	17	n/a	n/a	35	n/a	n/a	n/a
Manufacturing output (ytd %)	-1.3	-1.3	4.1	9.2	10.7	17.3	20.4	17.5	
Modern	-4.1	-3.8	-3.5	3.9	8.2	18.6	22.6	18.3	
Traditional	2.5	2.8	11.4	12.9	9.1	10.1	11.5	11.5	
Goods exports volumes (ytd %)	-6.7	-4.2	10.2	5.7	3.1	2.2	4.3		
Retail sales (ytd %)	0.4	0.7	9.5	7.2	7.6	7.2	6.9	6.5	
Excluding motor trades	0.5	0.7	3.1	2.9	2.8	3.4	3.4	3.4	
Tax revenue growth (ytd %)	4.4	3.2	-15.2	2.2	5.8	4.5	4.5	4.2	5.3
Unemployment rate (%)	12.2	12.1	12.1	12	12	11.8	11.7	11.6	11.5

Source: CSO; Thomson Datastream

The improvement in Ireland's unemployment rate over the past 12 months is the best among 50 economies, suggesting that the recovery is being borne out in the labour market

These short-term indicators suggest that Ireland is the fastest-growing economy in Europe (Table 2). The 1.5 percentage point drop in the Irish unemployment rate in the year to July was the largest across 50 countries, including the US, UK and euro area economies. Ireland's composite PMI has averaged close to 60 through 2014, with only the UK's readings coming even relatively close among European economies. Indeed, the 17.5% growth in Irish industrial production in the first five months of 2014 far exceeds the 2.4% aggregate growth in the euro area.

Ireland's GDP data are finally catching up, rebounding in Q1 2014, as the negative impact from the pharmaceutical sector wanes

The release of Irish national accounts for Q1 2014 suggested that the recovery apparent in short-term indicators is finally becoming apparent in Irish GDP data. GDP expanded by 2.7% on the quarter, now up 4.1% in the year to Q1 2014. Part of the story is that the pharmaceutical sector is no longer pushing down on GDP growth, with exports rebounding (up 7.4% yoy in Q1 2014). In calendar year 2013, GDP grew by just 0.2%; this was caused by a 14% fall in multinational sector profits and by exports' worst performance since 2009 (an expansion of just 1.2%) due to the pharmaceutical patent cliff). GNP, which excludes multinational sector profits, grew by 3.2% in 2013 – more consistent with healthier signals from the domestic economy.

Table 2: Ireland's short-term indicators compared with European economies

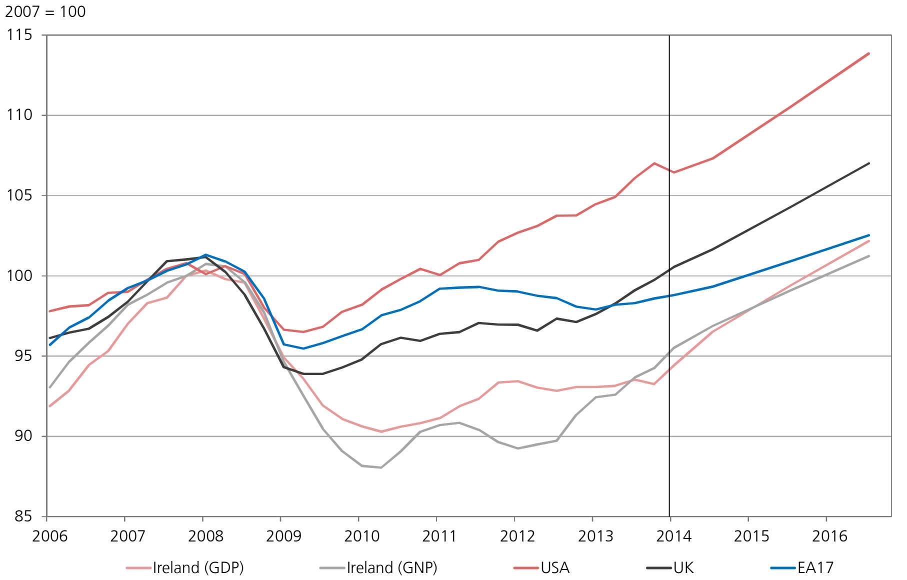
	Composite PMI, July 2014	Change in unemployment rate in last 12 months	Manufacturing output % change, Jan-May 2014 vs. 2013)
Ireland	**60.2**	**-1.5pp**	**+20.4%**
Euro area	**53.8**	**-0.4pp**	**+2.4%**
UK	58.8	-1.3pp	+3.7%
France	49.4	-0.2pp	+0.1%
Germany	55.7	-0.1pp	+3.4%
Italy	53.1	+0.5pp	+0.9%
Spain	55.7	-1.1pp	+2.5%

Source: Bloomberg; Thomson Datastream

The current high level of unemployment means that Ireland may have more spare capacity than the IMF believes

Figure 1 illustrates that there has been a much more consistent pick-up in Irish GNP since the trough in 2011. We expect this recovery in GNP will continue through 2014-2016. GDP is expected to grow by 3.5% in 2014, bouncing back as the impact of the pharmaceutical patent cliff wanes. Our forecasts imply both Irish GDP and GNP should surpass their pre-recession peak by 2016, nine years after the recession began in 2007. In the aftermath of a financial crisis and property price bubble, assessing Ireland's growth potential is difficult. Although Irish GDP and GNP are still currently 5% and 6% respectively below peak levels, the EU Commission and the IMF judge that the output gap in 2014 will be merely 1% of GDP, closing to zero in 2015. This is despite an unemployment rate of 11.5% in July. There could be room for the Irish economy to bounce back even more strongly than envisaged in our forecasts if there is more spare capacity in the Irish economy than implied by the EU/IMF estimate of the output gap.

Figure 1: Irish GDP and GNP to regain lost ground by 2016

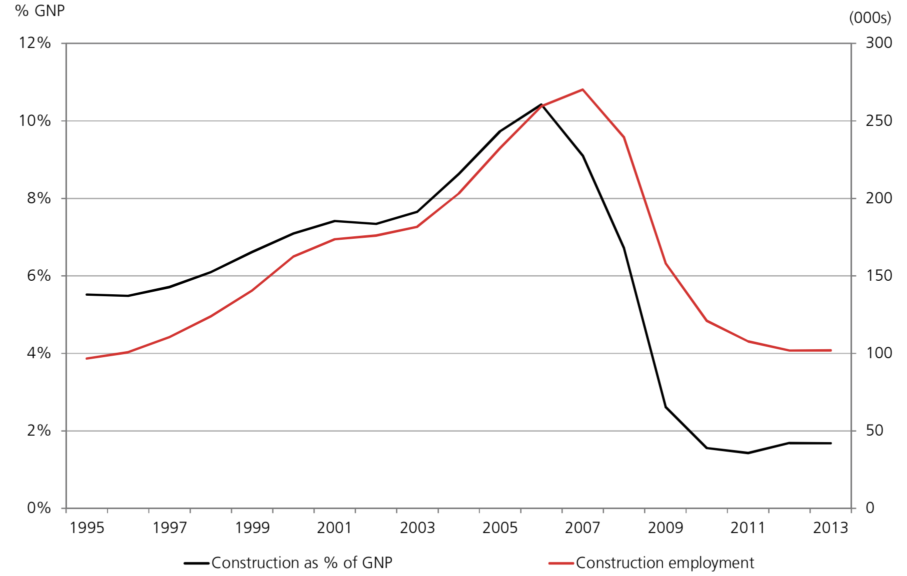


Source: CSO; Thomson Datastream

The construction sector is where the greatest amount of uncertainty lies. Employment in the sector is currently just over 100,000, still well below the 275,000 peak (Figure 2). Construction sector output is still down 75% from peak levels in 2007. Housing starts in 2013 were just 4,700, still well below levels closer to 80,000 during the boom years; current estimates suggest that 25,000 starts are required to satiate natural demographic demand. Planning bottlenecks, a lack of equity finance and constrained land availability may be holding back supply, particularly in urban areas. Our forecasts are based on housing completions rising to 14,600 in 2016. However, more effective policy measures to help construction activity could push GDP growth above our forecasts.

A stronger bounce-back in the construction sector poses clear upside risks to our forecast

Figure 2: Construction output at historically low levels



Source: CSO

The public finances have benefitted from the pick-up in the economy. We expect the deficit to equal 3.9% of nominal GDP this year, well inside the Budget 2014 forecast of 4.8%. Tax revenues and lower debt interest costs have placed the exchequer €1bn ahead of target in the first seven months of 2014. In addition, the substantial 6.6% upward revision to the level of nominal GDP to €174.8bn has artificially made it easier to hit the 3% deficit target for 2015. We expect the government will implement a budgetary adjustment worth around €500m in Budget 2015, which should be sufficient to reduce the deficit to 2.9% of GDP in 2015. Government debt will fall sharply from 123.1% of nominal GDP at end-2013 to 112% at end-2014. This mainly reflects the conclusion of IBRC's liquidation so that its liabilities are paid down and no longer contribute to general government debt.

Revising up our forecasts for 2014; further strong growth expected in 2015

In our new set of economic forecasts, we have revised up our GDP growth forecast for 2014 to 3.5%. GDP is expected to bounce back as the negative impact of the pharmaceutical patent cliff wanes. The recovery in the domestic economy has been apparent for some time in GNP growth, up 3.2% in 2013. We expect this recovery to continue with GNP expanding by 2.8% in 2014 and 2.3% in 2015.

Table 3: New Davy forecasts for the Irish economy (% change)

	2013	2014F	2015F	2016F
Consumer spending	-0.8	1.5	1.9	2.4
Government	1.3	-0.7	-1.3	-1.0
Investment	-2.4	14.5	8.6	6.8
Domestic demand	-0.2	3.2	2.5	2.6
Exports	1.2	3.5	4.0	4.0
Imports	0.6	2.9	3.5	3.7
GDP	**0.2**	**3.5**	**3**	**2.8**
Net factor payments	-13.9	8.0	6.6	6.0
GNP	**3.2**	**2.8**	**2.3**	**2.2**
Current account (% GDP)	4.4%	4.4%	4.5%	4.3%
General government balance (% GDP)	-5.6%	-3.9%	-2.9%	-1.9%
General government debt (% GDP)	123.1%	112.2%	110.1%	106.4%
Employment	2.4	2.8	2.3	2.1
Labour force	0.4	0.4	0.7	1.0
Unemployment rate	13.0%	11.0%	9.6%	8.6%

Source: CSO; Davy forecasts

Key features of our new forecasts

This set of economic projections embodies a slightly faster recovery for the Irish economy, in large part due to exports rebounding in early 2014.

- GDP to grow by 3.5% in 2014, 3.0% in 2015 and 2.8% in 2016.
- Export sector to recover, 3.5% growth in 2014, 4.0% in 2015.
- Domestic demand to grow by 3.2% in 2014.
- Consumer spending to accelerate to a 1.5% expansion in 2014 and 1.9% in 2015.
- Employment to grow by 2.8% in 2014 and 2.3% in 2015 with the unemployment rate to fall to 11.0% in 2014 and 9.6% in 2015.
- Government deficit to fall to 3.9% of nominal GDP in 2014 and, based on a €500m adjustment, 2.9% of GDP in 2015.

Irish exports: recovery in 2014 taking hold

The 1.2% expansion in Irish exports in 2013 was the worst performance since 2009. This entirely reflected the negative impact of the pharmaceutical patent cliff as revenues from blockbuster drugs diminished. A 5.2% contraction in nominal goods exports was starkly split between a 10.6% fall in pharmaceuticals and other goods exports flat. In contrast, services exports dominated by ICT companies grew by 7.2% in 2013.

The impact of the patent cliff has begun to wane

Trade data for the first five months of 2014 suggest that the negative impact of the pharmaceutical patent cliff has passed. Goods export volumes grew by 4.3% in volume terms, up 0.3% in nominal terms, on the same period in 2013. Pharmaceuticals fell by 2.3% and non-pharmaceuticals rose by 2.6%. The underlying picture is that indigenous Irish manufacturers now appear to be benefitting from stronger demand, particularly from the UK.

Table 4: Annual growth in Irish exports (%)

	Total export volumes	Services exports	Goods export volumes	Pharma export values	Non-pharma export values
2011	5.5	8.6	5.3	6.1	-2.5
2012	4.7	9.2	-6.3	-3.8	5
2013	1.2	7.2	-4.2	-10.6	0
2014 (year to May)			4.3	-2.3	2.6

Source: CSO

The recovery in Ireland's export markets will drive the recovery

In its May 2014 World Economic Outlook, the OECD forecast Irish export markets to grow by 3.6% in 2014 and 5.3% in 2015. These forecasts for Irish export demand were based on a slow recovery in the euro area of 1.4% with 1.8% GDP growth in 2014 and 2015 respectively and on the UK economy expanding by 3.2% in 2014 and 2.4% in 2015. Figure 3 illustrates that our forecasts for 3.5% export growth in 2014 and 4.0% in 2015 look quite conservative relative to expected global demand.

Figure 3: Irish export growth

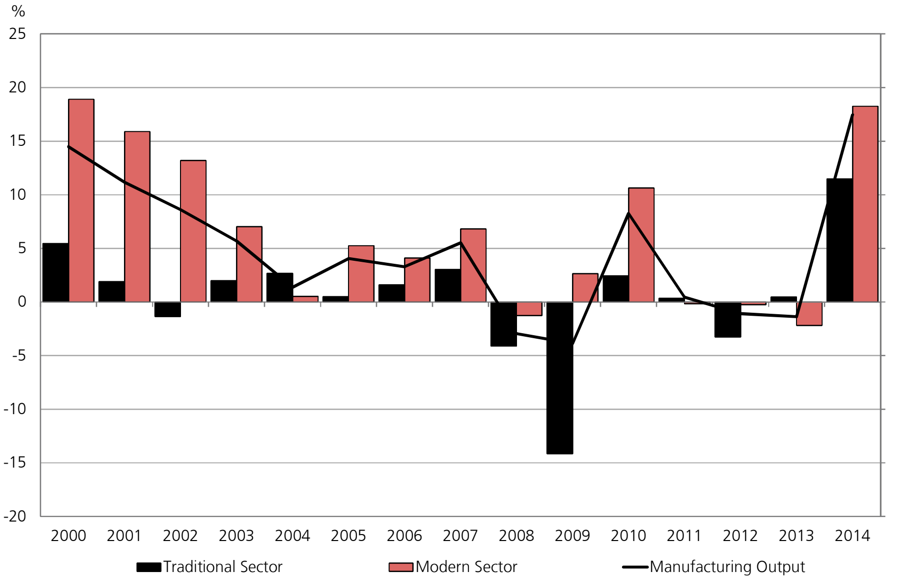
Source: CSO; OECD May 2014 Economic Outlook

In 2013, Irish industrial production declined by 1.3% – hurt by a 2.2% contraction in the modern sector (dominated by multinationals, particularly pharmaceutical companies). In contrast, traditional sector output rose by 0.5% in 2013. The traditional sector accounts for approximately two-thirds of total employment in Irish manufacturing.

Manufacturing data point to a sharp bounce-back in goods exports

Data for the first half of 2014 show an exceptionally strong bounce-back. Manufacturing output grew by 17.5% in H1 2014 compared with the same period in 2013. These exceptionally strong growth rates probably reflect volatility, especially in the modern sector. Nonetheless, output in the traditional sector is also up 11.5% in the first half of 2014 – suggesting that a recovery in activity is taking place.

Figure 4: Irish industrial production, annual growth



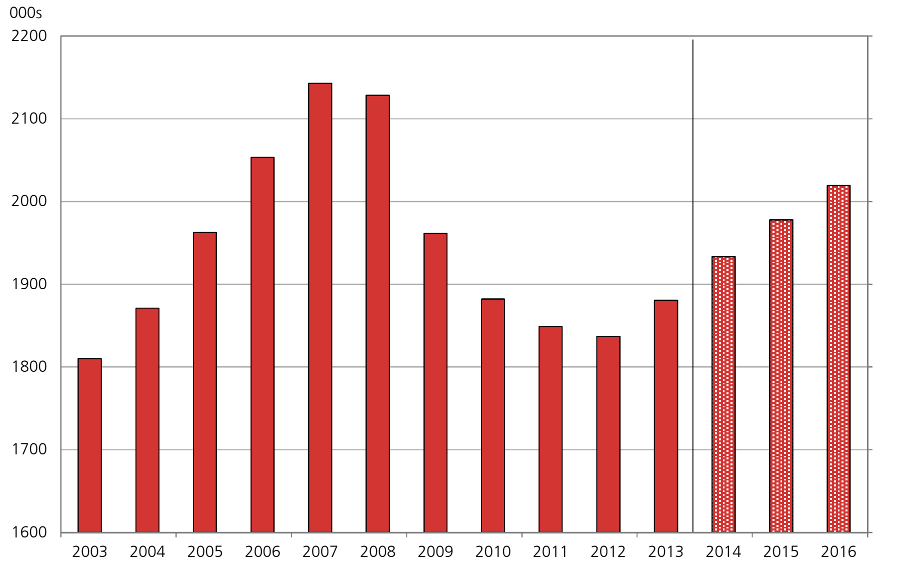
Source: CSO

Irish labour market: unemployment rate to fall below 10% by 2015

The labour market has performed far better than expected, helped by the recovery in the domestic economy and FDI flows

The labour market has performed far better than expected. The unemployment rate fell to 11.5% in July 2014, down 3.6 percentage points from the 15.1% peak in 2012. Irish employment increased by 2.3% in the year to Q1 2014, up 42,600 on the year. Employment growth in Q1 2014 was a little disappointing, with just a 0.1% rise on the quarter, largely reflecting an erratic contribution from part-time work – which could be revised. The annual growth in full-time employment was stronger – up 3.3% on the year.

Figure 5: Davy forecasts for Irish employment



Source: CSO; Davy forecasts

The PMIs for construction, manufacturing and services all point to further jobs growth into the second half of 2014. The IBEC business confidence survey of companies' employment intentions has continued to improve. Finally, the Irish Industrial Development Authority has announced a healthy flow of fresh FDI projects in the first half of 2014, concentrated in the ICT sector but also with substantial projects from pharmaceutical companies.

Table 5: Davy Irish labour market projections

	2013	2014	2015	2016
Labour force	0.4	0.4	0.7	1.0
Employment	2.4	2.8	2.3	2.1
Unemployment rate	13.0%	11.0%	9.6%	8.6%

Source: CSO; Davy forecasts

We expect employment to grow by 2.8% in 2014 and 2.3% in 2015

Employment is expected to grow by 2.8% in 2014, 2.3% in 2015 and 2.1% in 2016. Overall, this forecast implies the level of employment will rise from 1.88m in 2013 to just over 2m in 2016. This means the unemployment rate will average 11% this year, before falling to 9.6% in 2015 and 8.6% in 2016. Unemployment is expected to fall at a slower pace as participation rates start to rise from the current 60.2% rate – pushing up on labour force growth.

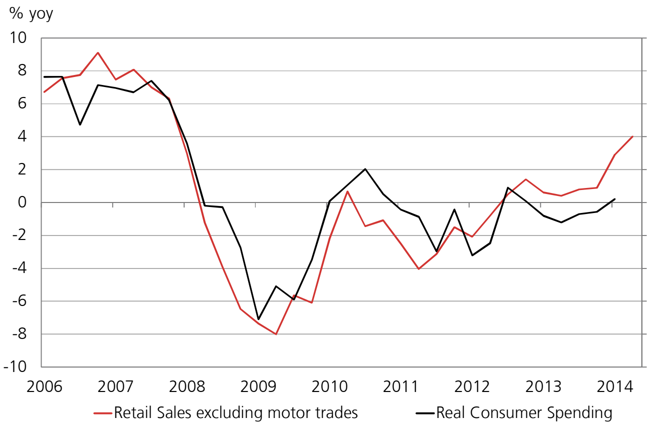
Consumer spending: underlying trends in the retail sector are improving

Retail sales grew 6.5% in H1, helped by a rebound in consumer confidence

Retail sales grew by 6.5% in the first half of 2014, largely reflecting buoyant car sales. New car registrations grew by 25.8% in the same period. Excluding motor trades, retail sales grew by 3.5% in H1.

The rebound in retail spending is not too surprising. Consumer confidence measures surged as Ireland approached the EU/IMF bailout exit, with households indicating that they were sufficiently confident to spend on big-ticket items. However, aggregate consumer spending has been puzzlingly weak. Real consumer spending fell by 0.8% in 2013 after a 1.1% decline in 2012. There appears to have been little improvement in early 2014. Consumer spending fell by 0.1% in Q1 2014, up only marginally on the quarter and by 0.2% on the year (Figure 6). At face value, Irish GDP data suggest that consumer spending has lagged behind the recovery.

Figure 6: Irish consumer spending and retail sales



Source: CSO

Table 6: Irish household spending (annual % changes)

	2012	2013	Q1 2014	Q2 2014
Consumer spending				
Real	-1.2%	-0.8%	0.2%	
Nominal	-0.6%	1.1%	1.8%	
Price deflator (CED)	0.6%	1.9%	1.6%	
Retail sales				
Real	-1.0%	0.7%	7.5%	6.8%
Nominal	-0.6%	-0.3%	5.3%	4.7%
Price deflator	0.4%	-0.9%	-2.0%	-1.9%
Consumer price inflation	1.7%	0.5%	0.1%	0.4%
CPI Goods	1.2%	-0.9%	-2.1%	-2.0%
CPI Services	2.0%	1.7%	1.9%	2.2%

Source: CSO

We expect consumer spending to grow by 1.5% in 2014 and 1.9% in 2015

However, nominal consumer spending rose by 1.1% in 2014 – the fastest pace since 2008. The CSO data suggest that consumers' purchasing power eroded by 1.9% in 2013, well above the CPI inflation of just 0.5%, with retail prices down 0.9%. We suspect the official consumer expenditure deflator has been distorted upwards artificially by measurement problems[1]. Using an alternative index such as the CPI would imply that real spending rose in 2013. Given the on-going strength of retail sales growth, we still expect the official measure of consumer spending will begin to pick up as 2014 progresses and to accelerate into 2015. We expect Irish consumer spending to grow by 1.5% in 2014 and 1.9% in 2015.

[1] Specifically, relating to imputed rents and financial services. For homeowners with tracker mortgages benefitting from ECB rate cuts, the CSO's statistical treatment implies their housing costs rose 6% in 2013, in line with private rents.

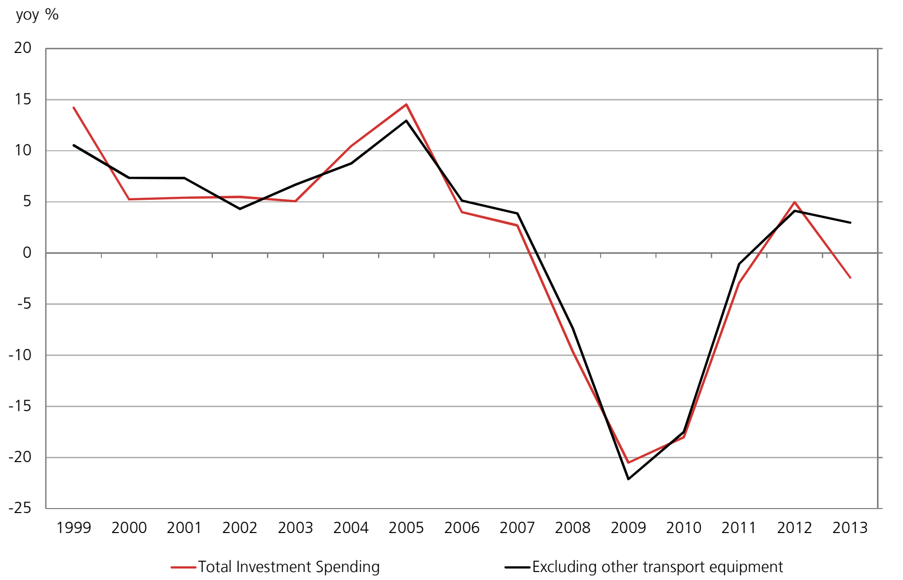
Investment spending to rebound sharply as construction sector bounces back

Investment has been impacted by the volatile aircraft leasing sector and R&D

Irish investment spending is now estimated to have contracted by 2.4% in 2013. This is a substantial downward revision from the 4.2% expansion originally estimated by the CSO. However, the contraction reflected the volatile aircraft leasing sector. Investment spending rose by 3.0% in 2013, excluding 'other transport equipment' in which aircraft leasing is concentrated. This paints a more encouraging picture (Figure 7).

Excluding these factors shows a solid recovery in business investment and construction last year

Figure 7: Irish investment spending



Source: CSO

Table 7 sets out a decomposition of the growth in investment spending. A key change in the revised Irish national accounts is that €7.1bn of R&D is now counted as investment spending rather than a cost, falling by 11.5% in 2013. Volatile movements in R&D spending are now likely to add to the difficulties in predicting Irish GDP growth. However, a large pick-up in 'Other Building & Construction' by 34% and 'Other Machinery & Equipment' by 46.5% is consistent with survey and anecdotal evidence that companies' investment intentions have improved, especially in the multinational sector.

Table 7: Real investment spending (year-on-year changes)

	2013 level	2010	2011	2012	2013
Dwellings	€3.1bn	-33.4	-20.5	-22.6	3.5
Roads	€0.7bn	-24.4	-34.8	-6.0	-39.1
Other building and construction	€6.6bn	-27.4	-5.5	17.6	30.4
Transfer costs	€0.5bn	-23.5	24.9	25.9	36.3
Transport equipment	€2.2bn	-14.7	-16.2	9.1	-38.1
Other machinery and equipment	€4.2bn	-7.1	26.3	-16.0	49.7
Research and development	€7.1bn	-0.4	11.5	17.3	-20.2
Other	€1.9bn	-0.5	6.1	12.1	-6.4
Total investment spending	**€26.5bn**	**-18.0**	**-2.9**	**5.0**	**-2.4**

Source: CSO

2013 saw a 6.5% rise in dwellings investment. However, we believe this was entirely accounted for by repair, maintenance and improvements. Housing completions fell to 8,300 in 2013, down from the 93,400 peak in 2006.

We expect a rebound in housing this year to boost investment

However, a rebound in housing construction now appears to be underway, albeit off an extremely low base and still well below necessary levels to satiate natural demographic demand. Housing completions were 3,941 in the first five months of 2014, up 31.5% on the same period in 2013. Housing commencements surged in early 2014, with 4,343 in February alone. In January and February 2014, commencements surpassed the entire 4,700 total recorded in 2013. However, the figures have probably been artificially inflated by the impact of new building regulations that came into effect in March.

Table 8: Davy projections for investment spending (% changes)

	2013	2014	2015	2016
Building and construction	14.1	11.4	11.2	9.6
Machinery and equipment	1.8	18.5	8.6	7.7
Research and development and intangibles	-20.2	15.0	8.0	5.0
Total	**-2.4**	**14.5**	**8.6**	**6.8**

Source: CSO; Davy forecasts

FDI flows will also boost machinery and equipment investment

Foreign direct investment by multinationals in new plants and repair and maintenance capital expenditure on building and construction will continue to grow. We have built in a slight rebound in R&D spending in 2014 with partial growth thereafter. Similarly, other transport equipment is expected to rebound in 2014 – pushing up on machinery equipment spending in 2014, with the aggregate growing by close to 8% per annum thereafter.

We forecast investment growth of 14.5% in 2014 and 8.6% in 2015

Our forecasts are based on strong growth in housing completions from 8,300 in 2013 to 9,850 in 2014, 12,150 in 2015 and 14,600 in 2016. This is one area where we are especially uncertain. It is estimated that the Irish economy requires 25,000 housing starts to satiate natural demographic demand. However, constraints in the planning process and high costs (both wages and government levies) may be holding back supply. That said, initiatives from NAMA to spark development on its land holdings may bring some success. In addition, the government recently launched a Construction 2020 strategy to address constraints on housing supply.

Public finances: deficit of 2.9% of GDP in 2015 despite smaller €500m adjustment

Tax revenues are €548m ahead of target in the year to July, a 7% yoy rise

Exchequer returns for the first seven months of 2014 show that the government is well on track to hit its 4.8% of GDP deficit target. Tax revenues were already €548m, or 2.5%, ahead of target in the year to July. Income taxes, VAT and excise duties have grown by around 7% on the year. National debt interest (including Central Bank surplus income) is over €500m below expectations. This reflects the inherent conservatism of budgetary projections and the impact of interest rate cuts on Ireland's official borrowings from the EU/IMF.

Spending pressures in Health are being offset by lower capital spending

Current spending has been broadly in line with budget plans. In the year to July, current expenditure was €66m, or 0.2%, above target, although still down 0.2% yoy. In contrast, capital spending was €89m, or 6.8%, below target. The underlying picture is that spending pressures are emerging in the Department of Health, which is already €243m, or 3.2%, over budget in the first seven months of 2014. That said, spending discipline in other government departments has been maintained at €141m, or 2.7% below expectations.

The large upward revisions to nominal GDP as the CSO adopted ESA2010 accounting standards will also help the government to hit its 3% of GDP deficit target for 2015. Nominal GDP at end-2013 was revised up to €174.8bn from the €164.1bn previously estimated. Our forecasts imply that nominal GDP will rise to €183bn in 2014, €191bn in 2015 and €199bn in 2016 – helping to push down on the debt/GDP ratio.

Large upward revisions to GDP will help the government hit deficit targets

A less welcome development in the new ESA2010 rules is that IBRC's liabilities are now counted within general government debt, around €12bn at end-2013. However, with IBRC's liquidation process now close to complete, government debt should fall sharply by end-2014 to close to 112% of nominal GDP. We have not pencilled in any further sales of state assets in the banking sector. Allied Irish Bank's return to profitability in H1 2014 has raised the prospect of the government realising further value, and the state retains its 14% share in Bank of Ireland.

Table 9: Public finances

	2013	2014	2015	2016
Deficit (€bn)	-10.0	6.9	5.5	3.9
% GDP	5.6%	3.9%	2.9%	1.9%
Debt (€bn)	216	204	209	211
% GDP	123.1%	112.2%	110.1%	106.4%

Source: CSO; Davy forecasts

We expect a smaller budget adjustment of €500m in 2015 with no adjustment in 2016

We have based our projections for the deficit based our stronger path for GDP growth, a smaller €500m adjustment in Budget 2015 and no adjustment in 2016. We also assume spending discipline is maintained so that current expenditure falls as planned in 2015. This means the deficit is expected to fall to 3.9% of GDP in 2014, 2.9% in 2015 and 1.9% in 2016. We expect the deficit will equal €5.5bn in 2015, slightly larger than the €5.2bn the Department of Finance had forecast in its April 2014 Stability Update. However, the higher level of nominal GDP means that the deficit will come inside the 3% of GDP the Department of Finance had forecast in April for 2015 despite a smaller budgetary adjustment.

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