THE SUNDAY TIMES

Celtic tiger regains its roar

Ireland has staged an economic comeback. Greece and Spain are also improving — just another lull, or is the eurozone crisis over?

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The Irish have reason for cheer, but it's not all good news in the economy

THE Irish prime minister, Enda Kenny, had good reason to feel bullish as he headed towards Dublin's docklands to open the new offices of Arvato Finance, a German payments company, last September.

It would be the second time in a week he had stood alongside an international executive to announce the creation of hundreds of jobs in Ireland.

Two days before, he had welcomed Peter Moore, chief operating officer of Electronic Arts, one of the world's biggest electronic gaming companies, as it pledged to create 300 posts at its European service centre in Galway.

Job creation was not the only thing on Kenny's mind, however. He had just been interviewed by Time, the American news magazine, about the "Celtic comeback" — and the publication was to put him on its cover in October. It would be the first time an Irish leader had graced the front since 1963.

After his appearance, Paddy Power immediately started taking bets on Kenny being named Time's Person of the Year for 2012.

That honour eventually went to President Obama, but the taoiseach did pick up the European of the Year award in Berlin in November for his “determined response” to the financial crisis.

Ireland has staged a “remarkable economic renaissance” since 2011, when Kenny took power, according to Capital Economics, the consultancy. The government’s deficit has fallen from more than 13% of GDP to a forecast 8% in 2013 and the country is expected to be out of its international bailout programme by the end of the year.

Positive signs have also been emerging from the eurozone’s southern periphery, where Greece, Portugal and Spain have all enjoyed a dramatic improvement in their balance of payments over the past year.

So did 2012 see “the worst of the crisis pass”, as Kenny claimed when he accepted Ireland’s six-month presidency of the European Union this month? Or is this just another lull before the next eurozone storm?

On the same day Kenny visited Arvato Finance, owned by the German media giant Bertelsmann, to celebrate the creation of about 100 jobs at its new premises, Bord na Mona, a 75-year-old peat company, announced it was laying off more than 100 temporary workers because of a dreadful harvest.

The contrast highlighted how, for all Ireland’s strides in attracting high-tech foreign companies through a combination of low corporate tax rates and improving competitiveness, its domestic economy remains in the doldrums.

The Irish government’s 2013 budget, delivered last month, outlined further austerity measures of about €3bn (£2.5bn), including a higher property tax for houses worth more than €1m and limits on pension tax relief. The Irish people still face several years of austerity, so it is no wonder many scoffed when their premier appeared on the cover of Time last year.

Paradoxically, it is domestic weakness that has led to such a sharp improvement in the balance of payments of the European periphery. As imports have plunged, exports have picked up and their balance of payments deficits have shrunk. To some extent, this is what economists would expect after such a deep recession, but there are hopes it could be the start of a structural change rather than just a cyclical one.

“The current account positions of southern eurozone countries have improved dramatically and they could be running sustained surpluses before too long, which is certainly encouraging,” said Ben May, European economist at Capital Economics.

The Greek current account deficit is likely to average about 3.5% of GDP in 2012, against 10% in 2011 and 15% in 2008, reckons Capital Economics.

Portugal, Spain and, to a lesser extent, Italy have also enjoyed big improvements. Ireland is forecast to record a 3% surplus for 2013 — something Britain can barely hope for.

Export growth in Spain, Portugal and Ireland has been better even than in Germany since the end of 2011. Firms have used a fall in labour costs and the weakness of the euro in the first half of last year to boost their competitiveness.

“In the past two years, peripheral current accounts have improved markedly, even adjusting for cyclical factors,” said Huw Pill at Goldman Sachs. “As a result, the real exchange- rate depreciation required to achieve external balance in these economies has decreased substantially on estimates, but a substantial rebalancing is still needed.”

Spanish ministers were in London a fortnight ago to press home the message that their country is on the mend — albeit tentatively. In a presentation to international investors, Luis de Guindos, the economy minister, said that while the outlook remained challenging, “our structural imbalances are on the way to being corrected”.

Goods exports increased 4% in 2012, on a par with Germany, while non-tourism services exports increased by an astonishing 140%. The country is expected to record a 3% trade surplus for 2013, and this is a “structural change in our current account”, de Guindos said.

Spain’s trade position has improved thanks partly to a big advance in its competitiveness, as wages have risen by 5% less than the eurozone average over the past three years. If labour costs fall another 3%, the country will be back to the competitiveness it enjoyed in 1998 relative to the rest of the euro area, the ministry said.

Spain is now one of the most attractive countries in the world in which to invest, according to an independent research note, The Case for Spain, from the Madrid-based adviser Arcano Group. Labour costs are 30% lower than the eurozone average, but productivity is only 10% lower.

“Spain was not the best place to invest in 2006, but it could be in 2013,” said Ignacio de la Torre, an analyst at Arcano. “Spain will emerge from its ashes, like the phoenix.”

It is perhaps not surprising that Spanish analysts are talking up their country, but many investment banks are also detecting positive trends.

“We believe that Spain, in line with other periphery countries, has already started to harvest the first fruits of efforts to restructure its economy and make its labour market more competitive,” said Yiagos Alexopoulos, European analyst at Credit Suisse.

Ireland, meanwhile, saw record exports of €173bn last year, 10% higher than in 2007, its highest pre-crisis figure. Another good performance is expected this year.

The verdict from the bond markets has been positive. Yields for periphery eurozone sovereign debt were already on a downward trend after last summer’s pledge by Mario Draghi, president of the European Central Bank, to

do “whatever it takes” to save the euro. The improving economic data reinforces growing confidence among international investors.

Last week Spain successfully sold €4.5bn of new bonds at a lower cost than in its previous auction, while Ireland reached an important milestone earlier this month when its first mainstream debt offering since the 2010 bailout was three times oversubscribed.

More than 200 pension funds, asset managers and institutional investors, of which nearly one-third were British, snapped up the €2.5bn fundraising. The response bodes well for Ireland’s plans to be self-financing — and therefore to exit the bailout programme — by the end of this year.

“It is a reflection of strong liquidity and improved sentiment towards [eurozone] peripherals,” said Alan McQuaid, chief economist at Merrion stockbrokers in Dublin.

However, Ireland is far from being in the clear. If the eurozone recession turns out to be deeper than expected — and economists already predict a 2% contraction for 2013 — it will hinder the efforts of the periphery economies to get their finances back on track and markets will take fright.

“There is clearly a possibility that if general market sentiment deteriorates, yields will go back up and Ireland might still need a further bailout,” said May of Capital Economics.

The renewed strength of the euro, if sustained, is another big risk because it threatens to choke off the tentative improvement in competitiveness that has been seen in southern Europe and Ireland.

“There is, we think, a risk that current conditions make for a more substantial appreciation of the euro: the ECB is not undertaking any stimulus at present, in contrast to a more expansionary stance from the Federal Reserve and Bank of Japan; and the euro area’s trade and current account surplus is rising,” said Alexopoulos.

“If the euro were to appreciate significantly, that could eventually pose some downside risks to growth, unless monetary policy was eased further to offset those effects.”

The housing market, too, could derail the nascent recovery. Standard & Poor’s, the rating agency, warned last week that Spanish house prices could fall another 8% this year. Ireland, where property prices have halved since 2007, could be “seeing some light at the end of the tunnel” although it is still sitting on swathes of unsold housing stock that will delay the recovery.

With domestic economics still weak, an improvement in the periphery will depend on the strength of global demand.

“Further austerity measures are going to dampen domestic demand and high levels of private sector debt mean household spending will be pretty lacklustre,” said May. “We could certainly see another modest recovery in

exports, but we are unlikely to see the booming global economy needed to drive sustained growth.”