Ireland back from the brink

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Cliffton Castle in Ireland. Less than a year after Ireland took an £85-billion ($119.2-billion) bailout, the country's fortunes seem to have taken a decided swing for the better.

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Less than a year after Ireland took an £85-billion ($119.2-billion) bailout, the country's fortunes seem to have taken a decided swing for the better.

Positive news suddenly abounds in a country whose banks buckled when its overleveraged real estate market collapsed during the 2008 global financial crisis.

"Amazingly, Ireland — the poster child for financial sector bailout bungles — has turned in two consecutive quarters of positive economic growth this year," Wilfred Hahn, chairman of Hahn Investment Stewards, said in a research note last week.

Second-quarter GDP increased 1.6%, following a gain of 1.9% in the first three months of the year. Compared to the second quarter of 2010, GDP was up 2.3%, the second-fastest rate of growth in Europe.

The Organization for Economic Co-operation and Development said Friday Ireland is on track to meeting its key budget deficit target through 2015 set by the European Union and International Monetary Fund when the duo provided the rescue package in November 2010.

Ratings agency Fitch even said last week it could foresee a boost in the country's credit rating and Ireland could return to borrowing on the markets in 2013. Yields on its benchmark 10-year bonds fell to 8% in late August, down dramatically from 14% in mid-July, as investors regained confidence in Irish debt.

"Basically the pitch is that Ireland has recently been doing pretty well," said Ben May, European economist with Capital Economics in London.

Dublin was quick to implement austerity measures and recapitalize the country's banks following the bailout. Ireland hosts many international computer, pharmaceutical and chemical companies, and exports were the main contributor to annual growth, the Central Statistics Office said in September. Net exports grew 23.9% at constant 2009 prices between the second quarter of 2010 and the second quarter of 2011.

"It's doing better than its southern European peers because it's a very open economy, so it should always fare pretty well when global trade is growing strongly," Mr. May said.

Ireland also has a lower cost structure than the rest of Europe by virtue of its low corporate tax rate, said Alex Jurshevski, founder of debt-management firm Recovery Partners Ltd., which specializes in sovereign debt.

"That's what's really been very supportive of the austerity program, and it does appear to be working," he said, adding, "The Irish are highly educated and hard-working; in a lot of other economies you don't have the same demographics at work."

Martin Schwerdtfeger, an economist at Toronto-Dominion Bank, pointed out that because Ireland went into recession earlier than other countries, it has a cyclical advantage in that its economy is already turning around.

"The Irish economy was also more resilient and more flexible in that it could endure lowering wages much faster in order to regain competitiveness, and that has helped," he added.

But the road to economic redemption remains an uphill one for the nation of about 4.2 million people that Canadian Finance Minister Jim Flaherty is set to visit Monday.

Mr. May said a predicted slowdown in global economic growth in the coming quarters will dampen the outlook for Irish exports.

"Second, there are precious few signs that domestic demand is beginning to pick up," he said, adding that the double-edged sword of austerity measures places a heavy fiscal squeeze on citizens. "Certainly from the perspective of households, the outlook remains pretty dire."

Unemployment in the country is hovering around 14.2% in 2011 and Mr. May predicted general economic conditions mean businesses will be reluctant to take on more staff and wage growth will remain weak.

“If Europe does flatline, and it looks like it’s starting to flatline, then the Irish are going to feel a direct impact there. We’re not out of the woods yet with any of these heavily indebted countries,” Mr. Jurshevski said.

In a major review released Friday, the OECD said the Irish government should reduce its budget deficit in an even shorter period than the bailout requires to rebuild the country’s market credibility.

Although bond yields have fallen, they need to drop further — to around 5% or 6% — before Ireland’s debt-management agency begins re-issuing long-term debt. (The last time Ireland raised long-term debt was in September 2010, when its 10-year yields were around 4.9%.)

A silver lining to flagging European fortunes may be found in the prospect of a sharply falling euro, something Mr. May is forecasting.

“That could help Ireland, particularly because it is so export-oriented and a lot of its exports go to the U.S. and U.K.,” he said, although he added that a weak exchange rate won’t answer all of the country’s problems.

Successful sovereign-debt restructurings are rare and as political regimes change, momentum and commitment are often lost, Mr. Jurshevski said.

“It typically takes a long period of adjustment and we have to remember that the economies in Europe individually don’t have the luxury of changing the currency value.”
Mr. Jurshevski said Ireland has still staggered out from its debt crisis better than most other debt-burdened economies, like Spain, Portugal and Greece.

“Whether this can sustain itself over the next five to seven years — which is kind of the time frame you need in order to dig out of the fiscal hole — is another question. But for now, it’s looking pretty good.”