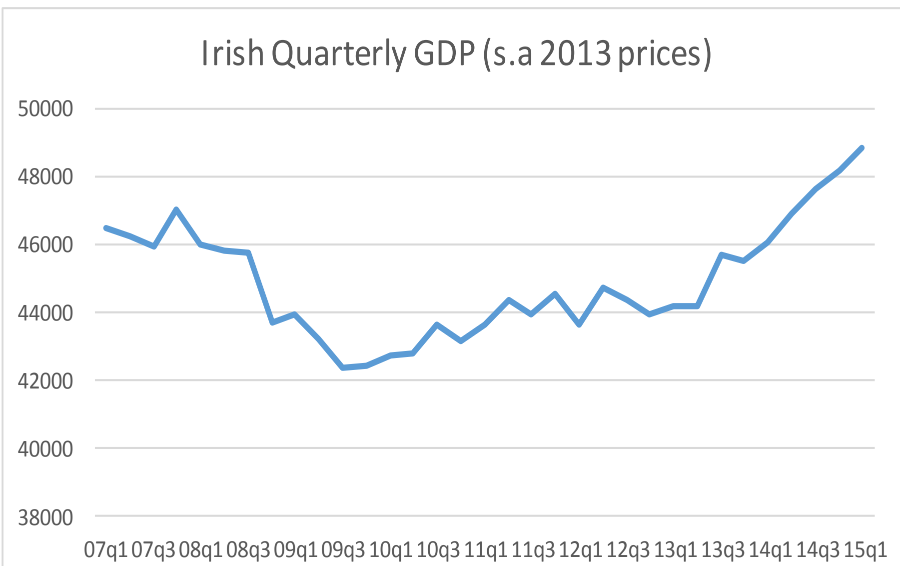
Economic Research

Irish Economy soaring,GDP well above pre-crash peak   31 July 2015

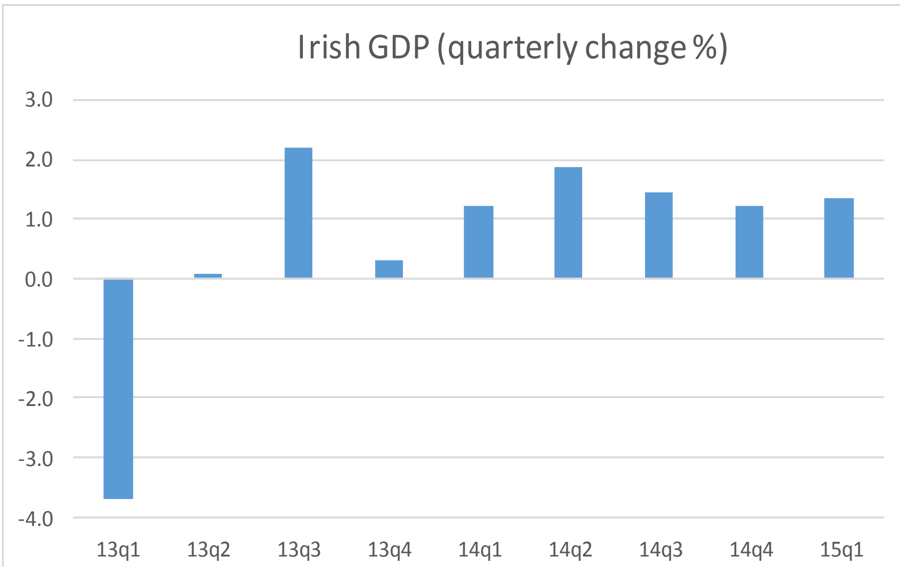
The CSO has just published Irish National Accounts for the first quarter, incorporating data revisions and an adjustment for aircraft leasing, with gross aircraft flows now included as against a net figure. In the event the combined impact of the changes was substantial, with upward revisions to all GDP components, leaving nominal GDP in 2014 at €189bn compared with the previous estimate of €185bn. In real terms the recession in 2008-09 is now seen to have been milder, albeit a still bleak 9.8% fall in GDP over 8 consecutive quarters, with the recovery stronger; the new data shows the economy to have grown in every one of the past five years, with the 2014 initial estimate of 4.8% now put at 5.2%. As a result it now appears that all the output lost in the crash was recovered by the third quarter of 2014 and real GDP is currently 3.8% above the previous peak recorded in the final quarter of 2007..



The pattern of the recovery as previously understood remains broadly intact, with a positive impact from external trade offsetting falling domestic demand, although the latter is now seen to have grown in 2012 , driven by investment spending, before declining again in the following year. Consumer spending of late is now stronger than previously recorded , which is more consistent with retail sales , while GDP as a whole is now better aligned with the recovery in employment, which started in early 2013. The recovery picked up strong momentum in 2014, with all the 5.2% expansion in real GDP driven by domestic demand, led by double digit growth in business spending on machinery and equipment alongside a 10% rise in construction. Consumer spending also grew , by 2%, although the reported 4.6% rise in Government spending is more difficult to fathom, and appears to be related to the productivity gains assumed to flow from the Haddington Road agreement with public sector unions.

The previously published data had shown a marked slowdown in the second half of last year but that has now been revised away, with the result that the economy entered 2015 in a stronger position than initially thought. Moreover, growth in Q1 was also robust, at 1.4%, leaving the annual change in real GDP at 6.5%. Consumer spending is now rising strongly in volume terms, by an annual 3.8% , although the annual growth in investment spending slowed to 4%, albeit dampened by the volatile aircraft sector.

Net exports also made a strong contribution to the annual growth figure in q1, adding 2.1 percentage points, with the figures now reflecting aircraft leasing as well as last year's methodological changes. Exports grew by an annual 21% in value terms ,and by 14.3% in volume terms, with the latter marginally lagging import growth of 14.7%, although such is the scale of exports that a similar growth figure in imports still generates a strong net contribution from the external sector. The trade data has also confounded the many looking for much smaller gains in 2015, and that, alongside the GDP figure itself, will likely prompt upward revisions to forecasts for 2015 as a whole, and we are now projecting 5% growth.



The combination of rising employment, the resumption of wage growth , historically low mortgage rates , zero inflation ,and the prospect of some tax relief has helped propel consumer confidence to pre-crash levels and that is now translating into stronger household spending. Retail sales data for q2 is consistent with a further acceleration in the pace of personal consumption and we now expect an average rise of 4.2% this year. Government consumption, too, is likely to rise, given the q1 reading (an annual increase of 5.9%) but base effects alone imply a slowdown through the remaining quarters and we have penciled in a 2.5% average increase for 2015. The other component of final domestic demand, capital formation, was surprisingly soft in the first quarter and we have revised down our forecast for the year, both in terms of construction and spending on machinery and equipment. The former is now expected to grow by 4.5% and the latter by just over 10%, giving an aggregate increase of 8%, down from 14.3% last year. In sum then, domestic demand is forecast to again grow strongly, by 4.8%, following the 5.2% increase in 2014.

Stockbuilding added 0.9 percentage points to growth in 2014 and we expect another strong addition this year, 0.7%, given the first quarter data. All of the domestic components of spending will therefore be making a positive contribution but the scale of the external sector (exports amounted to 115% of GDP in q1, with imports at 97%) is such that small swings in that sector can swamp domestic factors in terms of recorded GDP. Moreover, most of the external flows in the National Accounts are not captured in the monthly trade data, so adding to the uncertainty about net exports. On the available evidence from the first quarter we expect the volume of exports to rise by 12% this year, with imports up by 13%, which still means that the external sector adds over 1 percentage point to growth.

Overall then, real GDP is projected to rise by 5%, with domestic demand making most of the contribution, a marked departure from the early years of the recovery. Another unusual feature in the Irish data of late is the pick up in export prices and this is having a significant impact on nominal GDP, which grew at a surprising 12% annual pace in the first quarter. Consequently, we now expect a 10% rise in nominal GDP in 2015, to €207bn, A third novelty in the national accounts is the trend in GNP. This measures the income of Irish residents and often lags GDP growth given the scale of multinational profit outflows. Outflows have slowed, however, and income inflows have picked up with the result that real GNP grew by 6.9% last year and we expect this outperformance to continue in 2015, with a forecast GNP growth of 5.4%. A final change is to the current account on the Balance of Payments , with last years' surplus now reduced to 3.6% of GDP from over 6%.

Irish Real GDP(% change)	**2014**	**2015**	**2016**
Personal Consumption	2.0	4.2	3.5
Government Consumption	4.6	2.5	2.0
Capital Formation	14.3	8.0	9.5
Construction	9.7	4.5	5.0
Machinery + equipment	16.7	10.3	12.0
GDP	5.2	5.0	4.0
GNP	6.9	5.4	4.2

The Irish economy would therefore seem in rude health. The recovery is now seen to have been stronger than thought, the output lost in the crash has been recovered and the short term outlook looks positive, with the prospect of strong growth this year and next, albeit with the usual caveat that external events are often the key risk for such an open economy.. The strength of GDP also has significant implications for Ireland's debt and deficit ratios, with the former likely to be around 102% this year with the fiscal deficit under 2%. Good news then, but one final implication: the Central Bank, IFAC and the ESRI have already urged the government to reduce the size of the proposed fiscal stimulus in the 2016 Budget and the GDP figures strengthen their case, it would seem, although one doubts if that will cut much ice with the Government ahead of the election.