Economic Research

Real 2.5% growth in 2016, but flat nominal GDP   20 Sept 2016

The CSO estimate that the Irish economy, as measured by real seasonally adjusted GDP, recovered a little in the second quarter, expanding by 0.6% following an unrevised 2.1% contraction in q1. Investment spending rose strongly, by 39%, reflecting a rebound in the volatile intangibles component (spending on R&D, patents and licenses), which more than doubled, and a 5% rise in construction, although spending on machinery and equipment fell by over 10%. Government consumption also rose and a large inventory build also added a positive contribution to GDP. Consumer spending had risen strongly in the first quarter, supported by buoyant car sales, but fell in q2, by 0.5%, as auto spending slowed, with outlays on services also declining. Imports outpaced exports, with the result that the external sector also made a negative contribution.

The data showed annual growth in real GDP of 4.1% in q2, and the initial figure for q1 was revised up to 3.9%. The consensus forecast for the full year is 4.9% but we feel this is unlikely to be achieved, given strong base effects (cumulative GDP growth was 5.9% in the final two quarters of 2015) and we forecast 2.5% growth this year, albeit revised up from our initial estimate of 2.0%. Annual growth in q1 is now stronger than initially reported and external trade is higher than we expected, although we have revised down our estimate for consumer spending following the fall in q2. Data revisions are always possible, and as we know from last year's data the multinational influence can result in extraordinary GDP readings but on the available information we expect the consensus forecast to move lower.

Some analyst prefer GNP as a better measure of economic activity in Ireland, as it adjusts for international profit and other factor income flows , which are large and a net negative given the scale of the multinational presence . However, a number of large multinationals have re-domiciled to Ireland and as a result less of that profit may be flowing abroad. Growth as measured by GNP is certainly stronger than GDP at the moment, with annual growth in the former at 4.6% in q2 following over 12% growth in q1. Consequently we expect GNP growth for the full year to be better than GDP, coming in at 5.2%.

Net factor income outflows still exceed inflows by a wide margin, nonetheless (it is the change which affects GNP growth) and Ireland's deficit on service imports is rising (in part due to spending on intangibles) and the large merchandise trade surplus is declining. Consequently the Balance of Payments surplus in 2016 , although still large, is likely to be under €20bn compared to over €26bn in 2015 (which was 10% of GDP).

The second quarter GDP figures also revealed the re-emergence of deflation in the national accounts, in that nominal GDP actually fell by a seasonally adjusted 1% in q2, following a 5.6% decline in q1. The negative trend in the GDP deflator largely reflects falling export prices, in turn strongly influenced by the fact that many multinationals in Ireland price in US dollars. The corollary is that when the US dollar is strong, as in 2015, it translates in to a rise in prices as measured in euros, so boosting the deflator. In 2016 the euro has stabilized and rebounded a little against the dollar, so export prices are now seen to be falling.

In our view the impact of a negative deflator will offset the 2.5% forecast rise in the GDP volume, leaving the nominal level of GDP broadly unchanged from last year's €255bn. If so, Ireland's debt ratio may rise modestly in 2016, to 79.6% from 78.7% in 2015. The fiscal deficit ratio in 2016 is forecast at 0.8% of GDP, although it is apparent that the growth in tax receipts has slowed in recent months, and excluding corporation tax, revenue is now behind profile. This comes as a surprise to the Department of Finance, as it had revised its tax forecasts up by around €1bn only a few months ago.

Employment growth in Ireland remains buoyant and may rise by over 50k in 2016, or 2.7%. Despite this, the steady fall evident in the unemployment rate over recent years has stalled , reflecting a recovery in the labour force , in turn supported by the return of net immigration. Pay growth has been modest, averaging an annual 1% in the first half of the year, although much stronger in the private sector, at 2.1%. That translates into a similar rise in real earnings as price inflation remains around zero.

For 2017 we forecast GDP growth of around 3%, although the outlook is even more uncertain than usual given Brexit , the probability of higher US interest rates and the possibility that the ECB may taper or even stop its current bond purchase programme. Inflation may also pick up in the absence of further falls in oil prices. The upcoming Irish Budget is set to inject around €1bn into the economy next year,, bringing the total injection to some €2.5bn given higher incremental spending this year and pre-announced increases for 2017. Political stability is not guaranteed, however, and it is not certain whether the current minority coalition government can survive the competing claims for the available limited resources.

Real GDP (% change)	**2014**	**2015**	**2016(e)**	**2017 (f)**
Personal Consumption	1.7	4.5	3.2	3.5
Government Consumption	5.4	1.2	4.0	2.0
Fixed Capital Formation	18.2	32.7	1.0	8.0
Stocks (% GDP)	1.6	0.6	0.7	0.4
Exports	14.4	34.4	3.1	4.0
Imports	15.3	21.7	4.0	5.0
GDP	8.5	26.3	2.5	3.2
GNP	9.2	18.7	5.2	3.2

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