Economic Research

Strong Q3 data prompts Irish forecast revision 10 Dec 2016

Ireland's national accounts have long been strongly impacted by multinational production, trade and profit flows and that influence has grown of late following methodological changes to the measurement of international trade and capital formation. A number of large firms have also re-domiciled to Ireland. As a result , quarterly GDP figures are prone to high volatility and the expenditure components as well as the overall national income aggregates can be distorted, as was clearly shown in 2015.

That pattern was again evident in the third quarter data, showing real GDP growth of 4%, following a 2.1% contraction in q1 and a 0.7% expansion in q2. The surge in q3 brought the annual growth rate to 6.9% and the average year to date to 4.6%. Consequently, we now expect the annual growth rate to average 3.6% in 2016, given the strong negative base effects in q4, although the scale and volatility of component flows means that a much higher or indeed lower number is still possible. The annual growth in GNP in q3 was even stronger, at an extraordinary 10.2% and we now forecast a 7.2% average rise this year.

A strong stock build contributed 1 percentage point to GDP growth but the main driver was net exports, adding a full 10 percentage points, following an 8.6% plunge in imports and a modest 1.7% rise in exports. The latter was again characterised by a huge volume of goods manufactured abroad by Irish registered companies, albeit weaker than of late, while imports suffered from a big decline in multinational spending on R&D services. That , in turn, was picked up in the investment component, with expenditure on intangibles down by 61% in the quarter, following a 124% rise in q2. That plunge was only partially offset by a 30% rise in spending on machinery and equipment , itself distorted by strong aircraft orders, and a 4.6% increase in building and construction, with overall capital formation declining by some 18%.

Consumer spending rose by 0.7% and government consumption by 0.8% but this was dwarfed by the slump in capital formation, so domestic demand fell by 5.6%. Overall, then, we have an economy growing by 4% in one quarter but in which domestic demand slumped, as did imports, with the strength of net exports resulting in a €10bn Balance of Payments surplus in just three months, equivalent to some 15% of GDP.

Another surprising feature of the data was the softness of personal consumption, which has slowed on an annual basis, to 2.1% growth in q3, and a figure around 3% is now forecast for the year as a whole, a reduction from our previous 3.5%. New cars sales have lost momentum in recent months but the overall consumption figure is still somewhat at odds with the strong rise in employment , some modest growth in nominal wages and zero price inflation..

Spending on building and construction is growing strongly, both in terms of residential and commercial, and is forecast to rise by some 15% this year. Against this, spending on machinery and equipment is actually falling when one strips out aircraft, although the latter is strong , albeit volatile, as are outlays on R&D, and an expected decline in the latter results in an overall modest fall in capital spending excluding construction.

We had anticipated a substantial fall in the growth of external trade , with imports outstripping exports, but in the event the deceleration is sharper than we initially forecast, and we have trimmed our export growth forecast to 1.5%, against a 1.0% rise in imports. So net trade now boosts GDP, by 0.7%, with domestic demand adding another 2.1% and stock building 0.8%, summing to a 3.6% rise in GDP in 2016. The GDP deflator is still expected to decline, but by only 1% now given upward revisions to earlier quarters, with the result that nominal GDP is now expected to rise by 2.6%, taking it to €262bn.

For 2017, we are revised down our forecast for personal consumption, given the recent trend, and for external trade, but revised up our forecast for government consumption and capital formation .This also means that our 3.2% GDP projection is also unchanged, although, as usual, large swings in what is now very unpredictable trade data is the main risk , as well as the well-known uncertainties surrounding Brexit, the new US administration and the potential for political and financial upheaval in the euro zone.

Real GDP (% change)	**2014**	**2015**	**2016(e)**	**2017 (f)**
Personal Consumption	1.7	4.5	3.0	2.5
Government Consumption	5.4	1.2	4.2	3.0
Fixed Capital Formation	18.2	32.7	4.4	8.0
Stocks (% GDP)	1.6	0.6	0.8	0.6
Exports	14.4	34.4	1.5	3.0
Imports	15.3	21.7	1.2	3.5
GDP	8.5	26.3	3.6	3.2
GNP	9.2	18.7	7.2	3.2

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