Economic Research

GDP rises annual 10.5% in third quarter 18 Dec 2017

The Irish quarterly national accounts are notoriously volatile, largely reflecting the scale of multinational flows on net trade and investment , and the latest data was another in a long line of surprises; real GDP grew by 4.2% in q3, with the annual change accelerating to 10.5%. This brought the average annual growth over the year to date to 7.4% and implies that the outturn for the full year will be well above the consensus, which was around 4.5%. A very negative base effect will impact in the final quarter (the economy grew by 6.8% in q4 2016) but even if growth was zero in q4 this year the average for 2017 as a whole would now be 6.5%. In terms of headline GDP the economy is currently an extraordinary 50% above the pre-crash peak (in the final quarter of 2007) in real terms, with exports having doubled.

Exports now amount to 125% of real GDP so the performance of the external sector is usually the main influence on growth in the overall economy and that was the case in the third quarter; exports grew by 4.4% while imports fell by 10.9%, a combination which would have resulted in GDP growth of over 16%. The plunge in imports was partly due to a huge fall in R&D spending by multinationals (captured also as a service import) and this contributed to a 36% quarterly decline in capital formation. The latter dwarfed an acceleration in personal consumption (1.9% increase) and a modest increase in government consumption , such that domestic demand fell by over 13%. There was also a very strong stock build in the quarter.

The CSO now attempt to adjust for some of the larger distortions stemming from the multinational flows to provide a clearer picture of underlying economic activity. On a quarterly basis modified domestic demand data is produced, which strips out aircraft leasing and multinational R&D imports. On that basis domestic demand actually rose, by 2.4%, bringing the annual increase to 5% and the average year to date growth to 4.9%, which is more consistent with the employment data than the headline GDP reading.

Nonetheless, GDP is the international standard used to measure national output and on that basis Ireland's debt ratio may end 2017 at 68.4%, down from 120% in 2012. Similarly, the trade data, however skewed, contributed to an €14.5bn current account surplus on the Balance of Payments in q3, equivalent to 18% of GDP., and the annual surplus may now well be close to 10% of national income.

Base effects can be very important in terms of forecasting. For example, Irish real GDP rose by 3.3% over the first three quarters of 2017, so the annual double digit growth rate in q3 was primarily due to the surge in the final quarter of 2016. The final quarter of this year will therefore play a very important role in determining forecasts for GDP in 2018, and we may well see significant changes to the consensus when that finally emerges in March. For now the consensus envisages growth of between 3% and 4%, which seems reasonable at this stage, although contract manufacturing now plays a very important role in Irish exports and we have little or no indication of the drivers of that component.

At this time we expect some recovery in imports next year, given the big fall in 2017, which is also consistent with a rebound of sorts in spending on Intangibles . Further growth in construction, driven by housebuilding, will also be supportive of capital formation overall. In terms of personal consumption, we expect a 2.5% increase, with headwinds from slowing employment growth and a pick up in inflation offset by some acceleration in pay and a fall in the savings ratio as credit growth resumes after an eight-year decline. There is also a strong wealth effect, notably from rising house prices.

Some caution is warranted on the labour market. The Irish unemployment rate is currently at 6.1%, having fallen from over 15%, indicating perhaps little or no slack available. The 2016 census data casts doubt on that however, as the labour force was revealed to be higher than the CSO estimated so the unemployment rate may well be revised up in the New Year, therefore throwing a different light on the degree of spare capacity in the economy.

Another surprising feature of what is in many ways a unique economy is the low inflation rate, which currently stands at 0.5% against a euro average of 1.5%. Sterling's fall appears to be having a big disinflationary impact on Irish goods prices but that will fade absent another appreciation in the euro, and we expect inflation to average over 1.5% next year.

Real GDP (% change)	**2016**	**2017(e)**	**2018 (f)**
Personal Consumption	3.3	2.2	2.5
Government Consumption	5.3	2.0	2.5
Fixed Capital Formation	61.2	-9.0	10.5
Stocks (% GDP)	1.0	0.9	0.3
Exports	4.6	3.5	4.5
Imports	16.4	-4.0	5.5
GDP	5.1	6.5	3.7
GNP	9.6	4.5	3.5