Economic Research

GDP forecast broadly unchanged despite Q1 fall 24 July 2017

Ireland's first quarter GDP data incorporated revisions to past releases, including a sizeable increase in the level of GDP, which is now put at over €275bn in 2016. This is €10bn higher than the initial estimate and means that the economy is a full €100bn larger than it was in 2012, which in turn has had a material impact on the General Government debt ratio, now at under 73%. Revisions to annual real growth rates were modest (5.1% last year from 5.2%) but the quarterly pattern in 2016 now looks very different, and the resultant base effects imply a sharp slowdown in annual growth is likely in the second half of the year, given that the economy is now seen to have grown by 3% in the third quarter and a massive 5.8% in q4.

That growth surge in the latter half of last year resulted in a huge carryover effect into 2017, such that annual growth in q1 was 6.1% despite a 2.6% contraction in the quarter. The fall was due to a 38% plunge in investment spending, with a rise in building and construction offset by steep declines in machinery and equipment and intangibles. The latter includes intellectual property and is largely related to the multinational sector, also usually captured as a service import. Total imports duly fell sharply, by 12.7%. Exports were flat in the quarter and government consumption grew marginally so the only significant positive momentum came from personal consumption, which expanded by 1..2%

The Irish data is prone to substantial revision but, absent that, the annual pace of growth appears likely to slow sharply in the second half of the year given the quarterly profile, although the annual growth rate in the first quarter is higher than we anticipated, providing some partial offset. The net result is that we expect annual GDP growth in 2017 to emerge at 3.8%, marginally higher than our initial 3.6% forecast, from 5.1% last year, with the slower pace largely reflecting investment spending, which we project to rise by 16% compared with 62% in 2016. The latter included an 111% increase in intangibles and we do not envisage a repeat, given the q1 figure, although clearly it is an extremely volatile component of the national accounts and hence still throw up a wild number. Spending on building and construction is growing strongly (we forecast a 20% rise) but investment in machinery and equipment is soft, so dampening overall capital formation.

The projected slower pace of growth of investment should also impact imports, which we anticipate rising at less than half the rate of 2016, albeit still outpacing exports ,such that the external sector's contribution to GDP is negative. Government consumption is forecast to rise by 3% and we have pencilled in a 2.5% rise in consumer spending The latter also represents a slowdown from 2016 and in truth the consumption data has been surprisingly soft given the strength of employment growth, the absence of any pressure on prices and the positive wealth effect stemming from the ongoing appreciation in house prices. Against that, credit to the household sector is still contracting, with deleveraging on the mortgage side still a feature, offsetting an up-turn in new mortgage lending and a rise in net non-mortgage lending, largely auto related.

Wage growth in Ireland has been modest, at least as measured by the quarterly earnings data, with annual growth in q1 at 1.4% following an average rise of 1.1% in 2016. Consumer price inflation is the lowest in the euro zone, with prices actually falling by an annual 0.6% in June, reflecting the impact of the stronger euro/ sterling exchange rate, and we forecast HICP inflation to average 0.5% this year. In the labour market em-ployment growth has accelerated (an annual 3.5% in q1) and unemployment continues to fall steadily; we project an average unemployment rate of 6.5% this year and an end-year figure around 6%. The implication is that Ireland is rapidly approaching full employment and indeed the economy is deemed to be operating with a positive output gap according to the European Commission.

The impact of the multinational sector on the Irish national accounts has been much discussed and the CSO have introduced a new concept, modified national income (GNI*), in an attempt to give a better picture of un-derlying domestic income. GNI* adjusts GDP (€275bn in 2016) for net profit and interest outflows (€49bn) and then takes off the profits of re-domiciled multinationals in Ireland (€6bn), Intellectual Property imports (€28bn) and depreciation on aircraft leasing (€5bn) leaving GNI* at €189bn or 69% of GDP. The implication is that GDP is a poor measure of economic activity in Ireland, although it remains the international standard.

Real GDP (% change)	**2016**	**2017(e)**	**2018 (f)**
Personal Consumption	3.5	2.5	2.5
Government Consumption	5.3	3.0	2.0
Fixed Capital Formation	61.2	16.0	10.0
Stocks (% GDP)	1.0	0.6	0.3
Exports	4.6	4.0	5.0
Imports	16.4	6.8	6.0
GDP	5.1	3.8	4.2
GNP	9.6	4.0	4.0

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