Economic Research

GDP forecast remains around 4% 18 Sept 2017

Irish seasonally adjusted real GDP rose by 1.4% in the second quarter, following a revised 3.5% decline in q1. This still left the annual change at 5.8% from 5.2%, thanks to very strong growth in the second half of 2016 although the corollary is that these base effects will have a big influence on the annual figures over the remainder of this year. Data revisions can be large but in the absence of substantial changes we still expect a marked slowdown in annual growth in h2 and an average figure for 2017 of 3.8%, which is below consensus.

The plunge in GDP in the first quarter reflected a massive fall in capital spending, in turn related to R&D (or intangibles) by the multinational sector. This reversed in the second quarter, rising by 120% and hence boosting overall investment , which rose by 40%, contributing 9 percentage points to GDP growth. Most of the R&D is also captured in the National Accounts as a service import, and as a result overall import growth was strong, at 12%, dwarfing flat exports. Consumer spending actually fell in the quarter, reflecting weak car sales, although the gross number of new cars on Irish roads is actually rising, with a surge in personal imports of cars, in turn due to the weakness of sterling against the euro.

The impact of multinationals on the Irish National accounts has prompted the CSO to produce a new measure on an annual basis, Modified National Income, which excludes a number of multinational flows. In the quarterly accounts the CSO produce a modified capital formation indicator, which excludes aircraft leasing and R&D imports, and that modified figure grew by 3.1% in Q2. This adjustment also allows the estimation of modified domestic demand , which slowed to 4.2% annual growth in q2, from 6.1% in the first quarter, albeit still producing an average figure of 5.2% for the half –year and as such broadly consistent with the buoyant employment growth that has been evident for some time.

One puzzle, given the strength of the labour market, is the limp rise in recorded personal consumption, which is averaging 1.8% in the first two quarters. Pay is picking up, showing 2.2% annual growth in q1, while CPI inflation is around zero, so one might expect stronger spending from households. One factor may simply be that the data is not adequately capturing the level of internet shopping, particularly from UK sites, which has no doubt risen as a result of the euro's appreciation .

The consumption figures may be revised but on the available data we have marked down our forecast for the year as a whole, to 2%. Personal consumption now only accounts for around a third of GDP however, with capital spending rapidly approaching the same share, while the volatility of R&D spending increases the probability of forecast error in the investment component as a whole and therefore in GDP. Machinery and equipment investment is actually down year to date and base effects are also a significant factor , given a surge in intangibles in the last quarter of 2016; we now expect total spending on machinery. equipment, and intangibles to be flat this year. Spending on construction, notably housing, is growing strongly from a low base and we forecast a 20% rise in 2017, to give a 4% increase in capital spending overall.

Lower forecast investment spending and consumption have also prompted us to revise down our projection for imports, and we now expect a flat reading . Exports are difficult to gauge given the scale of contract (i.e. offshore) manufacturing in the Irish national accounts, although the impact has appeared to slow year to date, and on the basis of the first two quarters we have revised forecast export growth down, to 2%. This still means that net exports contribute positively to GDP, which alongside positive contributions from domestic spending and inventories results in 3.8% real GDP growth for the year. The second quarter recorded a big increase in profit and interest outflows and as a result GNP fell sharply, following a decline in q1, and we now expect annual GNP growth in 2017 of 1.5% following a 9.6% increase last year.

One striking feature of the economy given the pace of economic growth is the inflation rate, which remains remarkably soft (0.4%in August) and substantially below the euro average. Energy prices are starting to rise on an annual basis and the impact of falling mortgage costs is now small but a big factor is sterling's weakness, which has had a significantly deflationary impact on the Irish High Street, notably in terms of Food . CPI inflation is likely to average just 0.7% this year, but in the absence of another lurch downward in energy prices may rise to average 2% next year. In the Labour market the pace of decline in the unemployment rate has slowed of late, perhaps indicating we are nearer to full employment; we expect the rate to average 6.5% this year and to move below 6% in 2018. In terms of fiscal policy the 2017 deficit is likely to emerge around target at 0.4% of GDP, with a broad balance in prospect for 2018.

Real GDP (% change)	**2016**	**2017(e)**	**2018 (f)**
Personal Consumption	3.3	2.0	2.5
Government Consumption	5.3	2.0	2.0
Fixed Capital Formation	61.2	4.0	10.0
Stocks (% GDP)	1.0	0.3	0.3
Exports	4.6	2.0	4.0
Imports	16.4	0.0	5.3
GDP	5.1	3.8	3.9
GNP	9.6	1.5	3.6

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