Economic Research

Growth slows in q3; 6.5% average likely for year 17 Dec 2018

The consensus growth forecast for Ireland in 2018 has steadily risen through the year, following strong annual growth outturns in the first two quarters. Initial estimates were always too low in our view given the strong carryover effects from 2017 and the Department of Finance recently raised its 2018 forecast to 7.5%. However, the third quarter data revealed a sharp slowdown in the annual growth rate, to under 5%, and incorporated downward revisions to the first half of the year and as a consequence estimates of 7-8% or above , which are now commonplace, look too high absent further revisions to the data ,and we retain our 6.5% projection.

The high frequency data had pointed to strong growth in the quarter and real GDP duly rose, by 0.9%, although this was well below the same period last year, which alongside revisions resulted in the slowdown in the annual growth figure to 4.9% from 8.7% in q2. Consumer spending rose by 1% in q3 and looks on course for average growth of over 3% in 2018, which implies a degree of caution from households as the savings ratio appears to be inching higher. Government consumption is outpacing the consumer, rising by 1.8% and an annual 6.1%, with the authorities taking advantage of higher than expected tax receipts, notably from corporation tax, to boost spending on Health.

On the investment side, construction remains buoyant, rising by 3.6% in the quarter, with annual growth likely to average over 16% for the year. The quarterly accounts often reveal a surprising figure from investment or external trade and in this case machinery and equipment spending jumped by 40% in q3, with a surge in aircraft investment . Spending on Intangibles also rose strongly with the result that total capital formation increased by 22% in the quarter . The annual increase was positive at 43%, so breaking an 18-month period of contraction in that component. The rebound in q3 also means that spending on machinery , equipment and Intangibles is also now likely to be marginally positive for the year, so boosting investment growth overall to over 6%.

The aircraft are all imported, as is most of the spending on Intangibles , so the net impact is GDP neutral, although it does distort the relative contributions from domestic demand and external trade. In q3, for example, imports rose by over 7%, dwarfing a 1.5% rise in exports, and so net trade made a minus 4 percentage point contribution to the change in GDP, offset by a 4.5% positive contribution from investment alone, with modest additional positives from consumption and government spending.

As noted, we have not changed our 6.5% growth forecast for the year, although revising up investment with an offsetting change to imports, although net exports still make a positive contribution to growth , alongside domestic demand. The CSO also publishes a modified version of the latter, which adjusts for aircraft leasing and import spending on R&D, and that slowed in q3, with annual growth of 4.1% from 5.6% over the first half of the year. Consequently, the annual figure may be under 5% which is also below consensus.

Modified domestic demand is highly correlated with employment and the latter is still expanding at a rapid clip, rising by an annual 3.0% in the third quarter. Labour force growth is also picking up, boosted by a return to strong net immigration, but the unemployment rate has continued to decline, falling to a fresh cycle low of 5.3% in November. Most forecasters expect that to dip below 5% but whatever uncertainty exists about the level of full employment the tighter labour market has pushed up wage growth, to an annual 3.2% in q3 and 3.6% in the private sector. Despite that, inflation remains remarkably subdued, and at 0.8% in November on the HICP measure was the lowest in the EA.

We expect GDP growth of 3.8% in 2019 but the risks appear to be all on the downside. The carryover effect from Irish GDP in 2018 is likely to be weak and the global economy has slowed, including the euro area. Indeed, the most recent indicators there have not supported the view that the marked slowdown in the third quarter was temporary. If one adds in Brexit it is not inconceivable that we may see a recession across Europe, including the UK, although that is not our base case. However, weaker than expected growth and subdued inflation means that we may not see a rate rise from the ECB over the next twelve months. So monetary policy in Ireland is likely to remain very accommodative. On the fiscal side broad balance is expected on the General Government budget , with the structural deficit forecast to decline to 0.7% of GDP from 1.0% this year. On that basis fiscal policy is modestly contractionary, after a very expansionary 2018, although estimates of the output gap in Ireland vary widely, and perhaps a better indication of the fiscal stance is that General Government spending is forecast to rise by 5.1%.

Real GDP (% change)	**2017**	**2018(e)**	**2019 (f)**
Personal Consumption	1.6	3.2	2.5
Government Consumption	3.9	4.4	4.0
Fixed Capital Formation	-31.0	6.2	6.8
Stocks (% GDP)	1.3	1.0	0.8
Exports	7.8	9.0	5.0
Imports	-9.4	8.0	5.5
GDP	7.2	6.5	3.8
GNP	4.4	6.6	4.0

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