Economic Research

Average annual growth exceeds 9% in H1 19 Sept 2018

Having contracted by a revised 0.4% in the first quarter the Irish economy rebounded in q2, with real GDP growth of 2.5%. This brought the annual growth figure to 9.0% from 9.3% in q1, thanks to a very strong performance in the second half of last year. These base effects imply that the annual growth rate will slow over the next two quarters and we have kept our 6.5% forecast for the year as a whole unchanged, particularly as some of the domestic components of demand are exceeding expectations. The consensus growth figure for 2018, a little over 5%, may well be revised up.

One surprising feature of the economy of late has been the performance of consumer spending, given the strength of employment , the pick up in wage growth and the absence of any discernable price inflation. Personal consumption did accelerate appreciably in q2, however, with annual growth of 4.4% and we have revised up our projection for the year as a whole, to 3.3%. Government consumption is also growing very strongly , at 4.2%, and we have also revised up that component.

On the investment side, housebuilding grew by an annual 38% in q2 , driving double digit growth in building and construction, which alongside a 26% increase in spending on machinery and equipment excluding aircraft leasing resulted in a 13% rise in modified capital formation, a CSO measure of investment excluding certain multinational driven spending. Modified domestic demand is a related concept and that grew by 6.2% following similar growth in q1, indicating that the indigenous economy is performing extremely well.

GDP as a whole also includes investment in aircraft leasing and Intangibles and of course exports and imports. The Intangible component is notoriously volatile and in this case plunged an annual 63%, with the result that overall capital formation fell by 32%, giving a very different picture from that gleaned using solely domestic components. Spending on Intangibles is also largely captured as a service import, and imports overall fell by an annual 6.0%, in contrast to the 11.3% increase in exports. Consequently, net trade made a 20 percentage point contribution to annual GDP, aided by a strong stock build ,but partially offset by a negative contribution of some 10 percentage points from domestic demand.

The contribution approach to measuring GDP growth throws up a curious result for the quarterly figure in q2, as net exports added 6.8 percentage points which alongside a stock build and a modest rise in domestic demand implies that the economy grew by over 8%. The reported figure of 2.5% therefore reflects a very large statistical adjustment of -€2.4bn.

Multinational related distortions aside, the labour market certainly suggests strong underlying momentum in activity. Employment grew by an annual 74,000 or 3.4% in the second quarter and we have revised up our projection for average employment growth for the year, to 3%. Labour force growth is now seen to be more rapid than previously thought (reflecting higher net immigration estimates) and as a result unemployment and the unemployment rate have been officially revised higher ,from an initial 5.1% in August to 5.6%. The implication is that we are perhaps not as close to full employment as previously envisaged, although wage inflation is picking up, to an annual 3.3% in q2 from 2% a year earlier.

Despite this and the booming economy CPI inflation has been remarkably subdued, reflecting a combination of euro appreciation against sterling and more intense competition on the High street, notably in Food. The annual inflation rate average just 0.2% in the first half of the year and although some acceleration is now evident, given the uptick in energy inflation, and we expect an annual average of 0.8% for 2018 or 1.0% on the HICP measure. On the fiscal side the 2018 budget appears broadly on track, with another outperformance from corporation tax, and the Government has some €3,5bn in fiscal pace for 2019, with most going on higher current and capital spending.

There are clear supply constraints in the economy but demand shocks are always possible and two, in particular, have increased in probability. One is a generalized slowdown in global trade as a result of higher tariffs and associated uncertainty while the second relates to Brexit ; the chances of the UK leaving the UK in a disorderly manner have risen, so increasing the risks of a significantly negative impact on the Irish economy. Consequently, our forecasts for 2019 are shrouded in more than the usual uncertainty.

Real GDP (% change)	**2017**	**2018(e)**	**2019 (f)**
Personal Consumption	1.6	3.3	3.0
Government Consumption	3.9	4.0	3.0
Fixed Capital Formation	-31.0	-1.2	6.7
Stocks (% GDP)	1.3	1.0	0.6
Exports	7.8	6.0	5.0
Imports	-9.4	2.0	5.5
GDP	7.2	6.5	3.6
GNP	4.4	6.4	4.5