Economic Research

Irish q2 growth implies 2019 consensus too low 15/9/19

Irish GDP grew by 0.7% in the second quarter, following an upwardly revised 2.7% in q1 (was 2.4%). The annual growth rate slowed to 5.8% from 7.4% leaving the average over the first half of the year at 6.6%, which means that growth would have to be negative over the final two quarters to fall to the 4.4% consensus for the full year. A contraction is always possible and sentiment indicators have weakened considerably of late ,but exports , the key to Irish GDP, still look robust and so we retain our 5.6% forecast.

As is often the case with the Irish national accounts, decisions by a few large multinationals can have an outsized impact on GDP. In this case the import of business services rose by €36bn in the quarter and by €38bn over the previous year, largely due to a transfer of intellectual property . As a consequence total imports jumped by 43% in q2, bringing the annual increase to 61%. This surge is neutral for GDP however, in that imports are either consumed or invested and in this case contributed to a 182% increase in capital formation in the quarter, no doubt largely due to spending on Intangibles. In fact the CSO did not give a figure for spending on that component for 'confidentiality reasons', and also excluded total spending on machinery and equipment .

We do know that spending on building and construction rose by 5.6% in annual terms in q2 and that the pace of expansion there is slowing- indeed spending was broadly flat in the quarter itself when adjusted for the normal seasonal upswing. Robust government spending has been a feature of the economy of late and that remains the case , with annual growth in government consumption averaging 4.1% over the first half of the year. This is outpacing consumer spending of 2.8%, and the latter is also lagging household income growth, implying a rising savings ratio; the past year has seen a remarkable increase in household deposits, despite virtually zero rates of return.

Exports were again the main driver of growth in the quarter, with a 2.8% increase bringing the annual change to over 10%. This includes offshore contract manufacturing and the latter has been on a softer trend over the past year, perhaps indicating that trade tensions are having an impact. None the less the aggregate figure is still remarkably strong, and the monthly trade data for July shows the third quarter got off to a strong start .

The most recent high frequency data implies that Brexit uncertainty is having an impact on the domestic economy; sentiment has weakened , retail sales have fallen, credit growth has slowed and the housing market has softened, with residential prices in Dublin showing a marginal annual fall in July. Following recent data revisions it now appears that unemployment actually rose over the Spring and early Summer, and that employment growth has slowed. A prolongation of the uncertainty regarding the Brexit outcome is therefore the main negative for the economic outlook, at least in terms of domestic demand. Domestic spending is certainly important in terms of employment but is small in relation to GDP (personal consumption accounts for less than a third for example) , so it will be the export picture that will determine what happens to the overall growth rate.

We maintain our 5.6% forecasts for GDP this year, although the components have changed; capital formation has been revised up substantially but then offset by a much higher import figure. The unemployment rate is likely to remain around 5%, and wage inflation has continued to accelerate, averaging 3.5% over the first half of the year, implying that we are at or close to full employment. Despite this, HICP inflation has remained remarkably low (the euro/ Sterling rate has a strong influence) , at only 0.6% in August, although the full year average may rise to over 1% given the prospect of higher energy prices over the next few months.

On the fiscal side Ireland's debt ratio has plunged in recent years, reflecting the emergence of a primary budget surplus alongside buoyant GDP growth and a significant decline in the average interest rate on the debt. Indeed, Ireland recently issued 10-year paper at a marginally negative rate. The Government anticipates a modest budget surplus this year and had anticipated that to rise further in 2020 but the Minister for Finance has recently indicated that the upcoming Budget (due in early October) will be predicated on a hard Brexit. In that event the Minister will allow automatic stabilisers to kick in and the fiscal position to shift to a modest deficit, although of course the outcome may differ substantially from that anticipated at this stage, be it to the upside or the downside.

Real GDP (% change)	**2018**	**2019 (e)**	**2020 (f)**
Personal Consumption	3.4	2.8	2.5
Government Consumption	4.4	3.5	2.0
Fixed Capital Formation	-21.1	42.1	1.2
Stocks (% GDP)	0.4	0.5	0.4
Exports	10.4	12.0	7.0
Imports	-2.9	23.0	7.0
GDP	8.2	5.6	3.2
GNP	6.5	4.1	2.0

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