Economic Research

Exports continue to drive strong Irish GDP growth 16/12/19

The Irish economy grew by 1.7% in the third quarter, following a revised marginal fall in q2 and a 3% expansion in the first quarter. The result left annual growth in q3 at 5% and the average year to date at 5.9%. Consequently we are revising up our forecast for 2019 as a whole to 6%, from 5.6%, and also expect a stronger 2020 than initially projected, with growth at 4.5%.

Exports dominate Irish GDP (amounting to 125% of output in 2018) and so growth is largely determined by the external sector, in turn dominated by multinationals. Exports have picked up momentum this year despite headwinds from Brexit and a slowdown in global trade. The seasonally adjusted increase in q3 was 2.4% which maintained the double digit pace of annual growth, and we retain our 12% forecast for the full year. On the import side the second quarter saw a surge in service imports, related to R&D expenditure by multinationals, and as a result has distorted the annual figure which we expect to show 23% growth for the full year. This is GDP neutral, of course, in that imports are also captured in investment and consumer spending, but it does also distort the relative share of the expenditure components, in that capital formation is now running above 30% of GDP while consumption has slipped to below 32%.

Looking at capital formation in more detail the annual growth in spending on machinery, equipment and intangibles slowed in q3, to 1.2% after an extraordinary 219% expansion in q2. Indeed the CSO has not given a breakdown in that quarter but we do know that investment in machinery did fall sharply in the third quarter, albeit again distorted, this time by aircraft leasing. Excluding this, underlying domestic investment in machinery and equipment rebounded a little in q3 following weakness over the first half of the year. Building and Construction, the other component of total capital formation, has also slowed appreciably this year, with annual growth at 2.8% in q3, despite a 20% increase in house building, which was largely offset by falls in improvements and commercial construction. The employment numbers in construction are also consistent with a slowdown , although it is unclear whether it is due to weaker demand or supply constraints on the labour side.

The upward revision to our growth forecast largely reflects stronger consumer spending, which grew at an annual 3.3% in the third quarter and is now expected to average 3.5% for the full year. Sentiment indicators have weakened this year , probably Brexit related, but the actual spending numbers do not reflect this, at least to date.

So we now expect 6% real GDP growth in 2019, which alongside a modest increase in the deflator will push up nominal GDP to €346bn. Some analysts prefer to emphasise domestic demand as modified by adjusting for investment in aircraft leasing and imported R&D although this of course completely ignores all exports, including from indigenous firms, and so we do not think it that meaningful. Moreover, modified domestic demand has slowed and is likely to emerge at only 2.5% which appears low given employment growth of 2.6%. The latter has pushed the unemployment rate to under 5%, again raising the issue of full employment, particularly as the decline in unemployment this year is all on the female side, as male unemployment has risen.

CPI inflation has remained remarkably low, at around 1% in 2019, with rising services inflation offset to a large degree by further falls in goods prices, in turn influenced by the past appreciation of the euro/ sterling rate. Household disposable income grew by an average 6.7% in the first half of the year, so real income growth is unusually strong. Tax receipts, too have benefitted and the Government is now expecting a surplus of €1.4n this year (0.4% of GDP) albeit flattered by yet another huge outperformance from corporation tax.

The 2020 budget projected a deficit of €2bn (0.6% of GDP) , including a €1.2bn contingency , based on a no-deal Brexit and GDP growth of only 0.7%. A no-deal Brexit is still possible at the end of 2020 but now looks less likely and the budget arithmetic looks redundant. On growth, uncertainty as to the post-Brexit landscape may persist but in the absence of a sharper global slowdown Irish exports are again forecast to ensure that Irish growth remains robust. The recent rebound in sterling may also push up Irish inflation and dent real income and hence consumer spending , but exports will largely determine what happens, and we forecast GDP growth of 4.5%.

Detailed forecasts available on http://www.danmclaughlin.ie

Real GDP (% change)	**2018**	**2019 (e)**	**2020 (f)**
Personal Consumption	3.4	3.5	3.2
Government Consumption	4.4	4.0	3.0
Fixed Capital Formation	-21.1	42.5	16.5
Stocks (% GDP)	0.4	0.5	0.4
Exports	10.4	12.0	9.0
Imports	-2.9	23.0	13.0
GDP	8.2	6.0	4.5
GNP	6.5	3.4	4.1