Irish Economy Update

AIB Treasury Economic Research Unit

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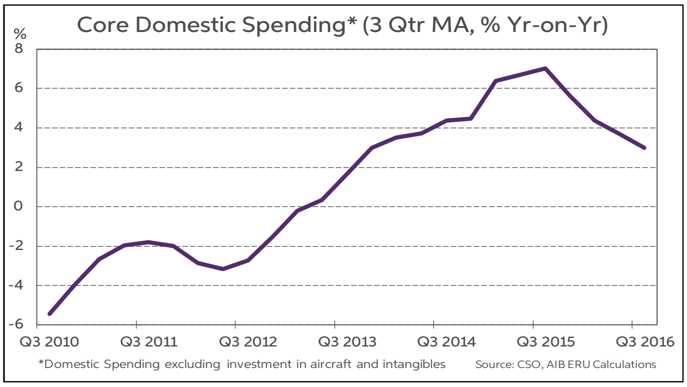
Economy Performing Well Despite Challenge of Brexit

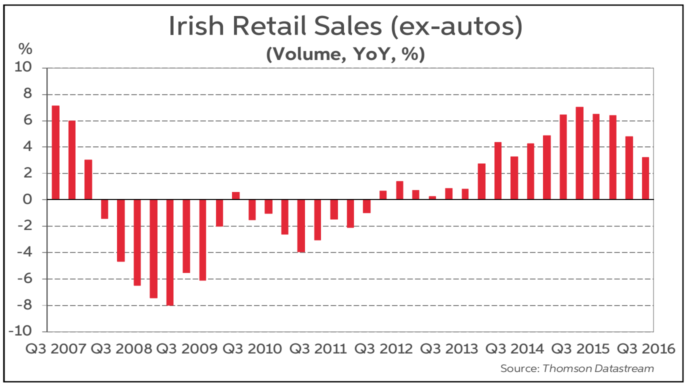
The Irish economy is both very small and very open, while many of the international companies based here have complex business operations and large balance sheets. This makes it **difficult for single headline indicators like GDP and GNP to accurately represent economic activity in Ireland,** as the CSO itself has acknowledged. Instead, one needs to look at a broad range of indicators to get the best gauge on how the economy is performing.



Nonetheless, the National Accounts, which provide measures of GDP and GNP, still contain lots of other useful information on the economy. The CSO recently published National Accounts data for the third quarter. These showed that **GDP grew by an estimated 4.6% year-on-year in the first three quarters of 2016.** This is a strong performance, but it represents a slowdown in the growth rate of the economy compared to 2014 and 2015. Meanwhile, GNP growth averaged 9% in the first three quarters of the year, but it was greatly boosted by a decline in the profit repatriations of multi-national companies. Hence, it does not provide a true reflection of the real performance of the economy.

The National Accounts data reveal quite a **slowdown in the rate of growth in core domestic demand** this year. Growth in core domestic spending—consumer and government spending plus real investment—slowed to 3% year-on-year in Q1-Q3 2016 from an average of 5.5% in the previous two years. **Business investment has fallen** back in particular this year, after rising strongly in the previous three years. This largely reflects the fact that catch-up demand saw a surge in business investment in 2013-15 which could not be sustained in 2016. Business investment in 2016, though, is still at quite a high level.

Meanwhile, **consumer spending has not sustained the strong growth rate of 4.5% seen last year**, averaging growth of 3.2% year-on-year for the first three quarters of 2016. This is also evident from other indicators of consumption. Indirect tax receipts are running behind schedule, while after a strong start to the year, **new car sales have lost much of their upward momentum**. Meantime, there has been a marked **deceleration in the growth of retail spending** since the spring, with core retail sales actually flat in the third quarter versus quarter two. The CSO has also indicated that spending on services has been particularly weak in 2016, declining in the third quarter compared to year earlier levels.



The **construction sector, though, is continuing to see strong growth**, with output up by almost 12% in the first three quarters of 2016 on year earlier levels. **House building continues to rebound** from low levels, with completions rising by 17% year-on-year in the first ten months of the year and commencements also picking up.

Meanwhile, **agricultural output is continuing to grow at a double-digit rate** for the third year in a row, following the lifting of EU quota restrictions on milk production. It rose by 11% year-on-year in the first three quarters of 2016. CSO National Accounts data also show **continuing strong growth in output from a broad range of service sectors,** including transport, communications, software, business and hospitality services.

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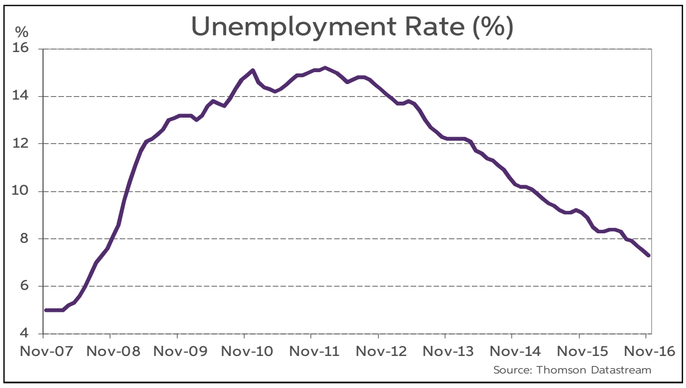
On the external front, CSO data suggest that **growth in exports has slowed** this year. Goods exports data have become distorted by contract manufacturing activity and other factors and so are not that reliable. **Service exports, though, grew by 6.5% in the first three quarters of the year,** after double-digit growth in 2014 and 2015. It may be that slower growth in advanced economies this year, combined with the sharp fall of sterling against the euro, has dampened the growth of exports somewhat in 2016.

The **PMIs for the manufacturing and services sectors fell back this year from high levels**, consistent with some slowdown in export growth. However, the PMI for manufacturing has picked up again in recent months, hitting 53.7 in November, while the services PMI was still at a high level of 56 in November.

Thus, a number of indicators suggest that growth in the Irish economy lost some momentum this year. However, we **should be careful not to overstate the extent of the slowdown in the economy**. Most indicators are still pointing to a strong performance. GDP did grow by 4.6% year-on-year in the first three quarters of the year, while **consumer confidence remains close to fifteen year highs.**

Labour market data also remain robust. Employment rose by 13,500 or 0.7% in the third quarter for a year-on-year gain of 57,500 or 2.9%, the same as in quarter two. The **job growth is spread right across the economy**, with particularly strong increases in the hospitality sector, construction and industry. Meantime, Ireland's **unemployment rate is now down to 7.3%**. This compares to a 9.1% rate a year ago and the peak of over 15% reached back in early 2012. The strong downtrend in the Live Register also remains firmly in place.

In summary, then, the **economy seems to have performed quite well in 2016, but growth has lost some momentum** and will be lower than in the last two years. GDP growth for this year is likely to average around 4.5%. GNP growth will be higher at circa 8%, but this gives a misleading picture of activity as it reflects a decline in profit repatriations from multinational corporations.



There are a number of other factors that should help the economy to continue to perform well in the next couple of years. **Growth in the global economy is expected to gain some momentum** in 2017-18, supported by a loosening of fiscal policy in some major economies, most notably the US, as well as a pick-up in activity in emerging economies who should benefit from a modest recovery in commodity prices. Meanwhile, **interest rates are expected to remain very low in the Eurozone,** with the ECB only this month extending the duration of its QE bond buying programme until at least the end of 2017.

On the domestic front, fiscal policy has turned mildly expansionary, while wage growth is starting to pick up. The **recovery in construction**, most notably house building, is expected to continue, helped by a number of recent measures that should further stimulate activity in the sector.

However, **the on-going uncertainty around Brexit and associated weakness of sterling** will continue to act as a headwind for the economy. Hence, GDP **growth could decelerate further in 2017.** Both the Dept. of Finance and the ESRI are projecting that the **economy will grow by 3.5% next year**, lower than in 2016 but still a relatively good performance.