Irish Economy Update

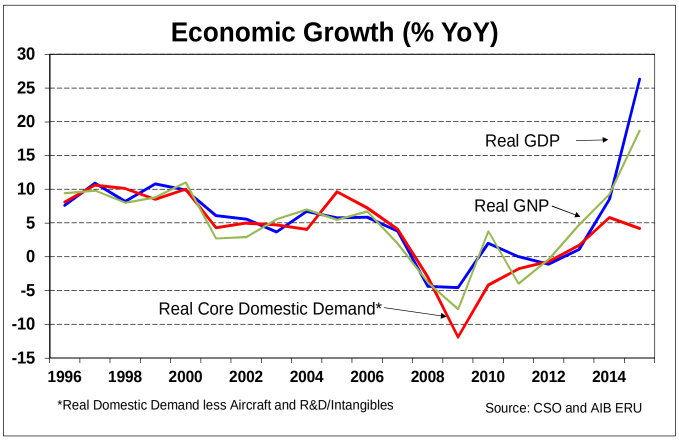
August 2016

AIB Treasury Economic Research Unit

Getting to grips with Irish economic data

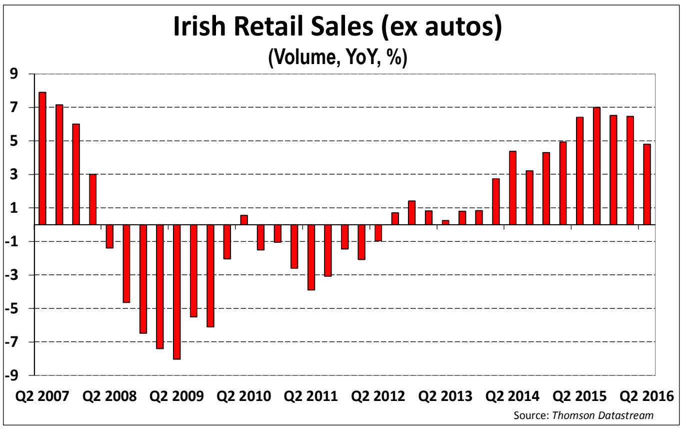
We can no longer rely on the CSO National Accounts, which measure GDP and GNP or the total value of goods and services produced in the country, to tell us how the Irish economy is performing. **The figures for 2015 were greatly inflated** by corporate restructuring and balance sheet adjustments in the multi-national (MNC) sector. As a result, Irish GDP is reported to have grown by 26%. This was brought about by the **transfer of assets to Ireland by company's** that redomiciled here, including via corporate inversions, plus MNCs, already resident here, transferring assets. These assets greatly boosted Ireland's capital stock in 2015.

It is believed that most of these assets are intellectual property (IP) rights (patents). The patents are used by the Irish resident companies to **contract companies in another country to manufacture products**. While the production occurs abroad, it is done under contract and thus the output is counted as Irish because **the IP behind the production is now located here.** As a result, gross value added in Irish industry doubled in 2015, **creating the surge in GDP.**



The CSO is forced to follow Eurostat conventions and rules and so was unable to adjust the Irish National Accounts data to allow for such distortions and produce meaningful measures of GDP and GNP. We also have our suspicions about the 2014 CSO figures, which showed that the economy grew by some 9%. This seems implausible given employment grew by just 1.7% in that year.

It is the case, though, that the National Accounts do contain useful data on various sectors of the economy, as well as the main components of domestic demand. Indeed, it is **possible to extract a reliable measure of how the domestic economy has performed** from the National Accounts data.



Core domestic demand, which excludes investments in aircraft and intangibles (IP), **averaged growth of 5% in the last two years.** This is a much more realistic indication of how the economy performed than the growth rates for GDP and GNP, which are put at 26.3% and 18.7%, respectively in 2015, and 8.5% and 9.2% in 2014.

Given the vagaries of Irish National Accounts data down through the years, it has always been **wise to look at a wide range of indicators to gauge how the economy is performing.** Looking at other indicators for 2015, consumer spending rose by 4.5%, employment was up by 2.6%, the unemployment rate fell to 9.5% from 11.3% in 2014, construction output rose by 7%, while both income tax and VAT receipts increased by 7%. Meanwhile, survey based measures of activity and confidence returned to levels seen in the earlier part of the last decade when the economy was growing strongly.

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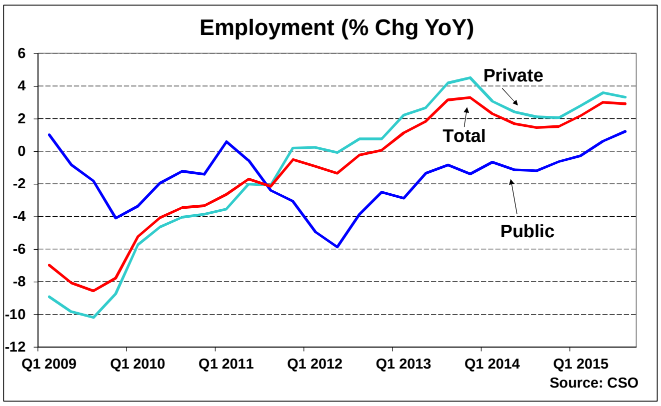
Brexit will impact strong Irish growth

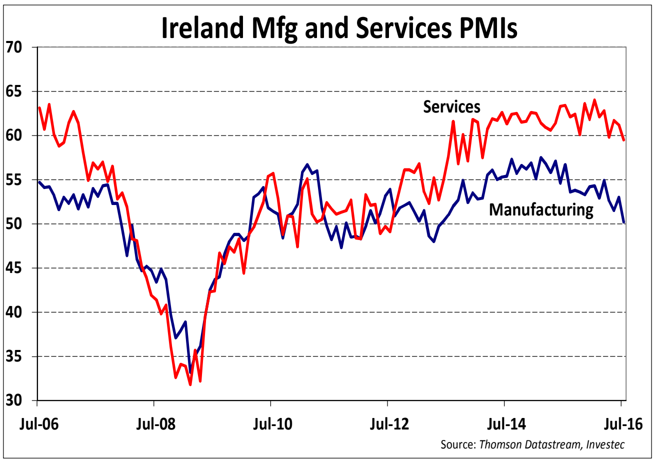
Thus, it seems quite evident that the economy put in a strong growth performance last year, although nothing on the scale suggested by GDP and GNP figures. Turning to 2016, it is likely that we will have to again turn to indicators, other than GDP and GNP, to get a reliable indication of the performance of the economy.



All the signs are that the economy is performing well again this year, though possibly not as strong as in 2015. **Consumer spending did grew strongly in the first quarter,** rising by 5% on an annual basis. Retail sales and car registrations data point to a continued good performance in the second quarter of the year, albeit not as buoyant as in Q1.

There was a **slowdown in investment activity in Q1,** with a noticeable weakening in business investment in particular. Meantime, housing completions were up 18% in the first half of the year, while tax receipts rose by 8.5% in the first seven months of the year. The **strong downtrend in unemployment has remained in place,** with the jobless rate dropping below 9%, while employment continued to grow at close to a 2.5% rate in Q1.

Survey based measures of activity and confidence remain at high levels, consistent with continuing strong growth by the economy. The vote for Brexit in the UK did see a fall in the PMI for the manufacturing sector last month, but the indices for other sectors remained very high, with consumer confidence also staying at an elevated level in July. Overall, **growth in domestic demand could slow to 4% or slightly above** this year, largely because of somewhat slower growth in consumer spending and business investment than in 2015.



The sharp fall in sterling and expected marked weakening of the UK economy as a result of its vote to leave the EU, as well as the great uncertainty this has created, will dampen activity in the Irish economy over the next couple of years**.** Thus, the underlying economic growth could fall back to 3.5% or slightly below in 2017/18.

While it is useful to look at a broad range of indicators on the economy, there is still **no substitute for a proper set of National Accounts.** Having accurate measures of the size and growth rate of the economy are key components in the formation of public policy, not least in regard to the public finances, especially over the next few years as Ireland adjusts to the UK's departure from the EU.

A top level **review group has been established to examine the National Accounts.** Let's hope the end result is that while the CSO will still need to produce national statistics that comply with Eurostat rules, it can also compile and publish another set of data that tell what is really happening in the Irish economy.