Comment

A wide range of domestic spending and activity indicators suggest that Irish economic activity continues to expand at a healthy pace, though growth momentum may have slowed slightly over the first half of the year. Gauging the strength of the economy is complicated by the uncertainties surrounding GDP and GNP as reliable measures of domestic incomes and production. However, the broad thrust of data for the first half of the year suggest some weakening in the external performance, along with some moderation in the growth of domestic demand. On balance, the outlook is for a modest slowdown in growth this year relative to earlier expectations. Looking ahead, a further moderation in growth is projected in 2017. Domestic factors are set to be the main drivers of growth over the forecast horizon, with risks to the outlook coming mainly from external factors.

Given the problems of interpretation with the main National Accounts measures, it is necessary to look beyond the headline GDP and GNP figures to other, more reliable, spending and activity indicators to get a more accurate measure of the level of activity in the domestic economy. These indicators suggest that, while economic activity continues to expand at a reasonably healthy pace, some signs of slowing have emerged. Signals in relation to consumer spending have become more mixed, although the balance of evidence across a range of indicators points to only a marginal slowdown, with consumer spending still supported by solid gains in employment and rising earnings. With regard to investment, while growth in the overall aggregate has increased, this has largely been driven by strong growth in intangibles investment, with some softening in the domestic components. As a result of these developments, growth in underlying domestic demand, which excludes investment in intangibles and aircraft, has moderated in the first-half of 2016. However, while some easing in the pace of growth may be emerging on the domestic side of the economy, the extent of the slowing would appear to remain relatively modest.

In addition to the uncertainties arising from the absence of a meaningful, commonly agreed, measure of Irish economic activity, assessing the outlook for the economy is further complicated by the potential adverse effects on Ireland of Brexit. Given the close relationship between the Irish and UK economies, a slowdown in UK growth and a weakening of sterling against the euro would adversely affect those sectors with a high dependency on exports to the UK.

Reflecting these concerns, the Bank materially revised its growth forecast for the Irish economy for 2016 and 2017 in the last Bulletin. In the interim, the initial fears in relation to Brexit have given way to a more sanguine assessment in recent months, against the background of some more positive UK economic data and an accommodative policy environment. While this leads to the judgement that it is not appropriate, at this point, to make a further negative Brexit adjustment to the forecasts, the potential for adverse macroeconomic, financial and currency market effects to quickly reemerge remains. In such circumstances, risks to the latest forecasts remain clearly tilted to the downside (see Box B, page 15).

Looking ahead, the main impetus to growth this year and next will come from domestic demand. The outlook for the growth of consumption and investment spending remains healthy, although growth rates are projected to moderate over the forecast horizon. Having grown by just below 5.0 per cent in 2015, underlying domestic demand is projected to grow by close to 4 per cent this year, slowing to 2.7 per cent in 2017. The projected slowdown in 2017 reflects the unwinding of some positive factors which have boosted disposable income growth this year and some adverse effects from Brexit. On the external side, the outlook for exports is subject to considerable uncertainty, in view both of the volatility surrounding recent data and potential Brexit effects. Subject to these caveats, export growth is expected to moderate over the forecast horizon.

Taking account of developments and prospects since the last Bulletin, the latest forecast is for slightly lower GDP growth in 2016 and unchanged growth in 2017, compared to the previous projections. GDP growth of 4.5 per cent is now forecast for 2016, 0.4 per cent lower than the previous projection, largely reflecting a weaker external contribution. In 2017, reflecting the unchanged negative Brexit adjustment incorporated in the last Bulletin, GDP growth is projected to slow to 3.6 per cent. Risks to these projections are clearly weighted to the downside, reflecting the possibility of a more adverse impact of Brexit on the UK economy than currently envisaged, a larger spill-over to the broader international economy or the potential for more negative domestic confidence and labour market effects than incorporated in these forecasts.

Given these risks, policies should remain focussed on underpinning stability and reducing uncertainty. Ireland is especially exposed due to the legacy of high public and private sector debt levels, the sensitivity of small, highly open economies to international shocks and Brexit-related vulnerabilities. In this regard, a prudent fiscal strategy remains essential given the feedback loops between fiscal stability, financial stability and macroeconomic stability. To underpin such a strategy, it would be desirable to establish long-term targets, which would appropriately reflect Ireland's risk exposures and be robust to statistical issues, and which can act as an anchor for annual budgetary decisions. The greater the commitment to attaining such targets, the more it would be possible to run a flexible, counter-cyclical fiscal policy in response to temporary shocks.

The volatility of the headline National Accounts measures also emphasise the importance of differentiating between temporary and permanent influences on the future paths of revenue and expenditure. While the uncertainties in relation to the measurement of economic growth make it more difficult to calculate the underlying path for tax revenues, it would be prudent to assume that some fraction of the recent surge in corporation tax revenues might be temporary in nature.