Irish Economy Update

AIB Treasury Economic Research Unit

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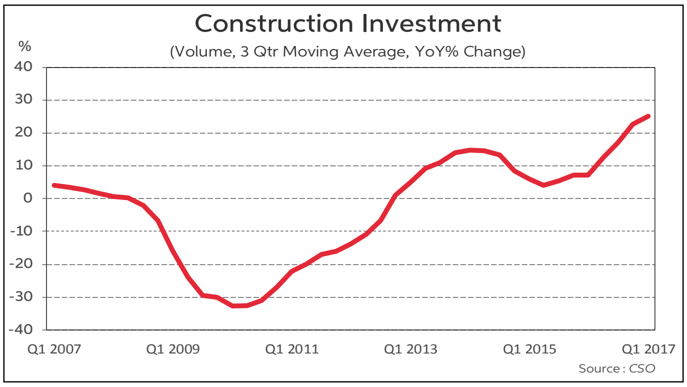
Strong growth forces at work in Irish economy

The considerable uncertainty surrounding Brexit and sharp depreciation of sterling over the past two years certainly present **challenges for the Irish economy. However, it continues to power ahead,** with little sign yet of any significant deceleration in growth from the 5% rate recorded in 2016.

Clearly, there are **an array of strong growth factors at work in the Irish economy.** The external environment is very important given the economy's dependence on exports. **Global growth has strengthened** this year, with a noticeable pick-up in the pace of activity in the Eurozone in recent quarters. Growth is also stronger in the US this year. Meantime, activity has held up better than expected in the UK post the vote for Brexit. GDP growth of 1.7% is being forecast for the UK this year, little changed from 2016.

Meanwhile, although the euro has appreciated sharply against sterling and recovered ground generally this year, it is still at a relatively low level against many currencies. Notably, it remains below $1.20 against the dollar, having traded in a $1.20-1.60 range against the US currency over the period 2003-2014. This is also helping Irish exporters.



Exports are also being supported by a **continuing strong inflow of foreign direct investment.** The IDA has reported very strong figures again for the first half of 2017. Overall then, it is hardly surprising that CSO data show exports of services were up by 15% in the first quarter of 2017.

The domestic economy is also performing strongly, growing at a rate of around 5%. **Construction is rebounding from very low levels of activity,** with output rising by 20% in the opening quarter of the year and employment in the sector up by almost 10%. Lead indicators and survey data for the sector point to a continuation of the strong rebound, as output still has a considerable way to rise to overcome a shortfall in supply.

Consumer spending is performing well, supported by robust employment growth, very high levels of consumer confidence, improving wage growth and very low inflation. Goods price inflation is actually running at -3% year-on-year, largely reflecting much lower prices for imports from the UK as a result of sterling weakness. Overall **CPI inflation is close to zero,** while average weekly earnings are up by 1.5% year -on-year. Thus, real incomes are rising.

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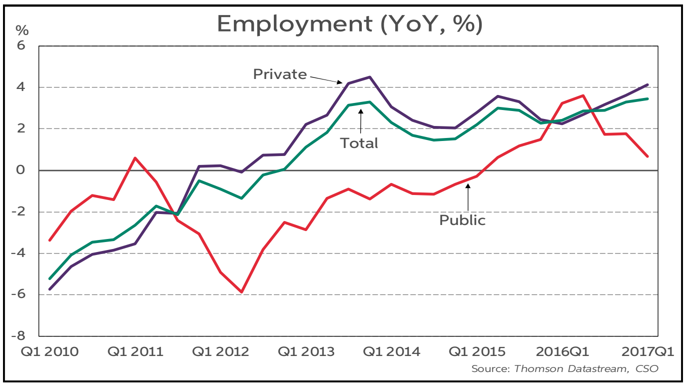
Brexit expected to cause Irish growth rate to slow

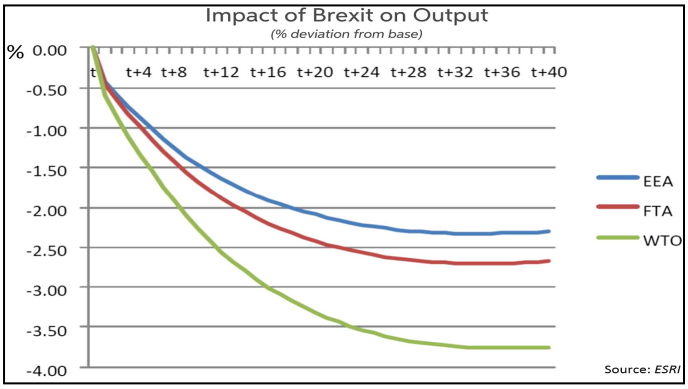
With **employment growing by over 3%,** it is hardly surprising that retail sales, excluding the motor trade, rose by 6.5% year-on-year in the opening half of 2017. Meanwhile, car purchases (new plus used car imports from UK) are up 3% year-to-date from their already high levels in 2016.

Continuing very low interest rates are also supporting economic activity, both directly in Ireland in terms of business investment, housing activity and consumer spending, as well as indirectly, in terms of stimulating global growth, most notably in the Eurozone, which helps Irish exports.



Low interest rates are particularly beneficial to Ireland because of its high levels of both private and public sector debt. Indeed, savings on debt interest payments have helped facilitate the move away from a tightening budgetary stance to a mildly expansionary fiscal policy in the past couple of years.

The on-going strength of the Irish economy has seen growth forecasts revised upwards for this year. **The Central Bank is now forecasting GDP growth of 4.5% for 2017**, with the Dept. of Finance at 4.3%, up from 3.5% earlier in the year.



The positive growth factors should remain in play over the next couple of years, allowing the economy to continue growing at a strong pace, provided a 'hard' Brexit that disrupts trade and economic activity in both the UK and Ireland, can be avoided. However, even a soft Brexit, (where the UK remains in the European Economic Area or secures a Free Trade Agreement with the EU) is likely to cause **Irish growth to slow somewhat in the next couple of years**. The lagged effects of the sharp fall of sterling against the euro is also expected to have some slowing impact on activity.

An analysis by the ESRI suggests that **a soft Brexit could lower Irish output by around a cumulative 2.5% over a number of years,** mainly through the impact on trade with the UK. It is not surprising, then, that the **Dept. of Finance, Central Bank and ESRI all see growth slowing to near 3.5% next year, with the Dept. forecasting GDP growth of circa 3% in 2019,** still a relatively strong rate. The track record of the Irish economy, both in this cycle and previous periods of expansion, has been for growth to exceed expectations. It will be interesting to see if Ireland can sustain this record over the next number of years as it navigates its way through the Brexit process.

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