

# Ireland Outlook

February 2017

Domestic Economy to the Fore

2017

GDP

↑3.2%

EMPLOYMENT

↑2.3%

UNEMPLOYMENT  
RATE

6.8%

INFLATION  
RATE

0.7%

Sustained consumer spending

Investment to pick up

Export headwinds

Unemployment to fall further

“Growth is set to continue, with domestic activity leading the way against an unsettled external backdrop”

Loretta O'Sullivan  
Group Chief Economist

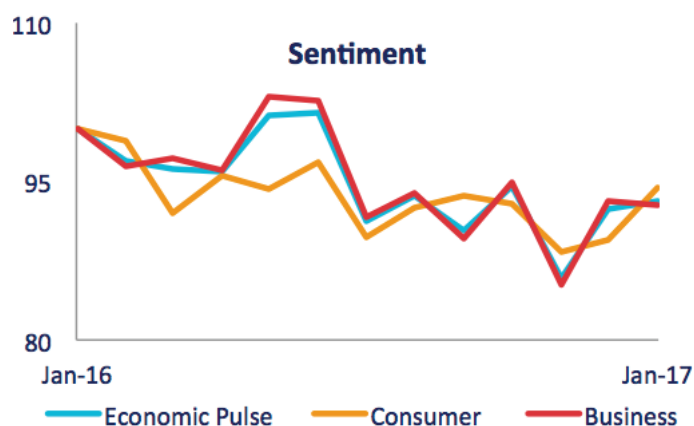
**Overview** 2016 was an eventful year. The general election and industrial unrest at home, the UK voting to leave the EU, and the outcome of the US Presidential election also made it an uncertain year. Against this background, the economy has held up well with annual GDP growth averaging 4.6% in the first three quarters. So far, the main impact of these developments has been some softening in sentiment among consumers and businesses, and a weaker pound which is affecting firms selling into the UK market. While the external situation remains unsettled, the outlook is for continued growth in Ireland. We had already revisited our forecasts last July, revising down post the Brexit vote, and we still expect this to have dampening effect on activity, though the better than expected performance of the UK economy to date and the improved outlook for the US has us nudging up our 2017 GDP forecast a little to 3.2% (from 3.0% previously). Growth of 3.1% is projected for next year. Domestic activity is set to take over from net exports as the key driver of the economy, with ongoing job and income gains supporting consumer spending and an uptick in residential construction and core business investment also helping. Despite some headwinds, the export sector should contribute as well as our key trading partners continue to expand. On the back of all of this, the unemployment rate - which is already at an eight year low - is projected to fall further, to below 6% by the end of next year.

## Outlook

	2016 (e)	2017 (f)	2018 (f)
Personal Consumption	3.4%	3.2%	3.0%
Government Consumption	4.5%	2.5%	2.5%
Investment	4.8%	7.5%	6.0%
Exports	2.5%	4.5%	4.3%
Imports	2.0%	5.6%	5.3%
GDP	4.5%	3.2%	3.1%
GNP	7.8%	3.0%	2.9%
Employment	2.8%	2.3%	1.8%
Unemployment Rate (Average)	8.0%	6.8%	6.2%
CPI	0.0%	0.7%	1.2%

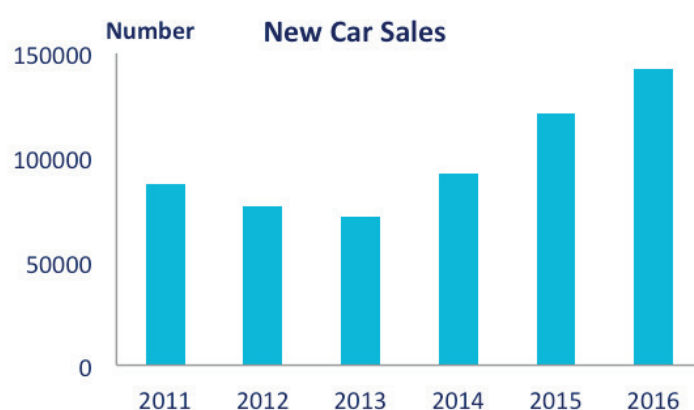
## Pulse insights

Developments at home and abroad took their toll on sentiment over the course of 2016, with our Economic Pulse ending the year below where it started it, albeit still at a relatively high level. The index held steady at the start of 2017 - the Business Pulse was little changed and the Consumer Pulse strengthened. The detailed findings of the January surveys show that one in two households see the economy improving in the next twelve months, while one in three expect their own finances to do the same. On the business front, two thirds of firms have ambitions to expand in the next one to three years, all of which augurs well for the outlook.



## Sustained consumer spending

Consumer spending in the first three quarters of 2016 rose by 3.2% year-on-year. This solid performance was driven by continued gains in employment and incomes. Increases were evident across a broad range of retail categories, not least car sales which came in at over 140,000 last year, the most since 2008. Budget measures and the falling level of household debt will also provide support over the forecast horizon, though uncertainty and the projected modest increase in inflation may weigh on confidence and households' spending power respectively. Allowing for this, and given healthy spending over the past two years, we expect personal consumption growth to ease back to 3.2% in 2017 and 3.0% in 2018. On the Government side, spending increases of 2.5% are pencilled in for each year.



## Investment to pick up

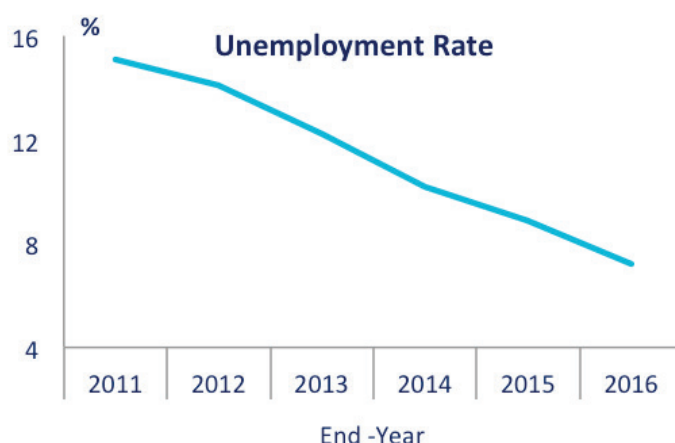
Investment was very volatile during 2016, with a sizable jump in Q2 in between two quarters of decline. This owed much to fluctuations in spending on intangibles (which tends to be dominated by multinationals). Construction saw a healthy increase, whereas core business investment (i.e. machinery and equipment excluding planes) declined. The outlook for construction remains favourable, with a number of commercial and residential developments in the pipeline. The disappointing performance of core business investment last year may be partly down to the impact of a specific one-off and we expect some rebound in the coming years. While uncertainty could weigh on sentiment, the flow of FDI remains strong - the IDA reported a record number of investments in 2016 - and domestic activity should support SMEs. Overall investment growth of 7.5% is forecast for this year and 6.0% next year.

## Export headwinds

Export growth over the first three quarters of last year averaged 2.1% in annual terms, more modest than in recent years. There are a number of factors behind this. Firstly, outsourcing by multinationals (contract manufacturing) looks to have been subdued and has impacted goods exports in particular. Secondly, external developments were a concern and the weaker pound has hit firms selling into the UK market, especially those in price sensitive smaller indigenous sectors. On the more positive side, our main trading partners - the US, UK and euro area - are continuing to expand. Notably, the UK economy has proven more resilient than anticipated post the Brexit vote and we have revised up our GDP growth forecast for the UK this year to 1.6% (from 0.7% in our July Outlook). For 2017, export growth of 4.5% is projected and 4.3% in 2018, while imports are expected to increase by 5.6% and 5.3% respectively.

## Unemployment to fall further

The surest sign of economic growth is the performance of the labour market. Employment has risen consistently since the end of 2012 and another 57,500 net jobs were added in the year to Q3 2016, with more than two million now in work. These gains have been broad-based across sectors and regions. Solid domestic activity, including in the labour intensive construction sector, is a positive and we expect employment gains to continue - albeit at a slower pace of 2.3% this year and 1.8% in 2018. We also see a further increase in the labour force, aided by returning migrants. The rise in employment has helped to lower the unemployment rate, which in January 2017 was 7.1% and is set to fall further to below 6% by the end of next year.



## Upward house price pressure

Last year was somewhat mixed for the property market. House price gains continued, with annual growth outside of Dublin outpacing that of the capital. Activity, as measured by transactions, looks to have been a little weaker in 2016 than in 2015, though leading indicator data – such as mortgage approvals – picked up during the second half of the year. Looking ahead, supply is set to gather pace but to remain shy of what is needed. Meanwhile, the new help to buy scheme for first time buyers and the loosening of the Central Bank's loan to value restrictions for this group will support demand. This mismatch should support prices, with one in three expecting increases in excess of 5% according to the January 2017 Housing Pulse.

## Inflation to turn positive

Inflation has been subdued throughout 2016. Low oil prices for most of the year and the ongoing impact of past reductions in mortgage interest rates did much to dampen the headline rate of CPI inflation, which averaged 0% for the year as a whole. While there is still some spare capacity in the economy and the weaker pound should push down on import costs, inflation is expected to pick up over the forecast horizon as domestic activity provides support, and the recent increase in oil prices following the OPEC agreement starts to feed through. With these factors in mind, we are projecting CPI inflation of 0.7% in 2017 and 1.2% in 2018 (the corresponding HICP forecasts are 0.8% and 1.2%).

## Public finances improving

The public finances continued to improve in 2016 aided by solid tax revenues, spending control and the low interest rate environment. Total tax revenue rose by 5.0% year-on-year (1.4% ahead of target) to a record level. Strong corporation tax receipts were mainly responsible for the overshoot, although income taxes were also above target. With net spending coming in below profile, the Government is likely to meet the 2016 General Government deficit target of 0.9% of GDP. Financing the State was made easier by falling bond yields - with the 10 year yield reaching new lows during the year - and the debt ratio is estimated at 76% of GDP at the end of 2016. The public finance position is set to improve further, but with public sector pay back on the agenda and signs of industrial tension, there may be challenges ahead.

## Risks to the outlook

The open nature of our economy always makes Ireland vulnerable to external developments. There are numerous uncertainties on this front at present, among them Brexit, the protectionist nature of the new US administration's trade policy and elections across Europe. These may weigh on activity and confidence by more than expected and pose downside risks to the outlook. On the upside, risks include rising employment and house prices which could result in a stronger 'wealth effect', a faster uptick in construction, with relocating FDI in the wake of the UK's decision to leave the EU also a possibility.



## Recent Developments

## Consumer

Core retail sales  
YoY ↑New car sales  
142,688  
↑ 17.8%  
YoY 2016Household debt  
↓

1 in 2 expect the economy to improve in next 12 months  
1 in 3 expect their own household finances to improve

## Investment

House completions  
+18.2% YoY  
Jan - Nov 2016

Majority expect house prices and rents to ↑ in coming year



2/3 Businesses plan to expand in next 1-3 years

## Exports

FDI Investment  
+14.6%  
YoY 2016 "Record Level"Trading partners growing  
↑

Exchange rate movements

## Labour Market

>2m  
in workEmployment increasing  
↑  
Sectors  
↑  
RegionsUnemployment rate  
7.1%  
January 2017Net inward migration  
↑

2 in 5 expect pay increase in next 12 months

## The Irish Economy

"Domestic activity to drive growth against an unsettled external backdrop"

## Outlook

	2016e	2017f	2018f
GDP	4.5%	3.2%	3.1%
Consumer Spending	3.4%	3.2%	3.0%
Investment	4.8%	7.5%	6.0%
Exports	2.5%	4.5%	4.3%
Employment	2.8%	2.3%	1.8%
Unemployment Rate	8.0%	6.8%	6.2%

Faster uptick in construction activity  
Stronger housing "wealth effect"



## Uncertainty

- Brexit
  - US Trade Policy
  - Elections across Europe
- Weaker £

## Risks

Prepared by: Bank of Ireland Economic Research Unit  
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