Comment

National Accounts data for the first half of 2015 indicate a sharp acceleration in the pace of growth of the Irish economy. The recovery has become more widespread and has matured beyond the initial net export-driven rebound in activity. While some of the conventional measures, including GDP and GNP, are affected by the activities of multi-national firms, faster growth in consumption and employment confirm that the domestic economy is now expanding strongly and growth has become much more broadly based. This broadening and acceleration reflects the confluence of a number of growth-supportive developments, including the employment-rich nature of the recovery, a less constrained policy environment, as reflected in easing fiscal consolidation and favourable financial conditions, the boost to purchasing power from lower energy prices, the on-going easing of the balance sheet legacies of the crisis and broadly favourable conditions in Ireland's main export markets. It is the coming together of these factors which underpins the robust growth in the level of economic activity evident in economic data in recent quarters.

Over the past year, the gathering pace of growth has come to be driven by a strengthening impetus from domestic demand. While the rebound on the domestic side was initially driven by a recovery in investment spending, consumer spending has revived and is now playing a more prominent role. Consumption has benefitted from rising employment, particularly full-time employment. Since mid-2013, the economy has generated an additional 90,000 jobs almost all of which are full-time, with the pace of employment creation increasing over the past year. This has helped boost household incomes and, in turn, has stimulated a strong pick-up in consumer spending. Allied to the continuing strong rebound in underlying investment (that is, abstracting from the volatility in aircraft and intangibles investment), this has strengthened the pace of growth in domestic demand.

On the external side, the first-half of 2015 has seen further strong growth in both exports and imports, in part, continuing to be related to Ireland's involvement in global production chains. Of note, however, has also been a rise in the exports of indigenous sectors, such as agri-food and tourism, which are being supported both by favourable demand conditions in their main markets and exchange rate developments. Looking ahead it is assumed that exports will return to growing broadly in line with projected growth in external demand. Helped by Ireland's trade links with the US and UK markets, this should continue to generate a strong rate of growth for exports in 2016.

On the domestic side, the momentum of growth has accelerated and the outlook is now more favourable than at the time of our last published forecasts. Looking ahead, the prospect of strong increases in employment, rising real disposable incomes and improved consumer confidence should support solid growth in consumer spending, which is now expected to grow faster this year and next than previously projected. In addition, growth in underlying investment spending – again abstracting from the volatile aircraft and intangibles components – is forecast to remain robust.

Largely as a result of the robust growth recorded in the first half of 2015, the projected growth rate of overall economic activity for this year has been raised significantly as compared to the forecasts published in the previous Bulletin, which were based on National Accounts data up to the fourth quarter of last year. GDP growth of 5.8 per cent is now forecast for 2015, an upward revision of 1.7 per cent relative to the previous Bulletin projection. While, in the main, this upward revision is driven by the strength of the reported data for the first half of 2015, the outlook has also become more favourable. It is primarily this factor, particularly the prospect of a further strengthening of domestic demand, which is responsible for the upward revision to the growth projection for 2016, with GDP now forecast to grow by 4.7 per cent, 0.5 per cent higher than the previous Bulletin forecast. The risks to these forecasts are seen to be broadly balanced, with some risk to the projected outlook for domestic demand broadly offset by some downside risk to the external outlook.

The projections suggest that the economy overall is going through a period of exceptionally strong growth which is forecast to ease only modestly next year. While part of this reflects a rebound from a period of exceptional weakness, more fundamentally it represents the economy moving back towards realising its full productive potential and has been made possible by the ability of the economy, the public and policy to successfully respond to the challenges that were faced since the onset of the crisis. At the overall level, available evidence suggests that there is still sufficient spare capacity to allow the economy to grow rapidly over the forecast horizon without encountering major constraints. This capacity is not limitless, however, and inevitably growth will need to slow down to a lower, more sustainable rate[1] in the years ahead.

Ensuring that the recovery transitions to a sustainable pace of steady growth is the key challenge for policy in the period ahead. The strong growth outlook provides an opportunity to resolve the legacies stemming from still high levels of public and private sector indebtedness. Focussing policy on reducing remaining vulnerabilities and strengthening resilience is essential to minimise future risks to economic, fiscal and financial stability.

With respect to the public finances, Exchequer developments have continued to be unusually favourable. Reflecting the stronger economic performance, tax revenues have continued to grow ahead of target and overall expenditure has remained lower than profile in the year to date. At the aggregate level, the very strong rise in the nominal, or money value, of GDP which will grow at close to double-digit pace this year and remain high next year, implies that the ratios of government borrowing and debt as a share of GDP should fall more sharply than previously expected in 2015 and 2016. The strong growth outlook provides the opportunity to make greater progress with fiscal consolidation and debt reduction in favourable circumstances. The level and burden of public debt remains high and taking advantage of strong growth to lower it more quickly would reduce the vulnerability of the public finances and the economy more generally to future adverse shocks. It is imperative, from the point of view of stabilisation policy, to avoid a return to the type of pro-cyclical fiscal policies observed in the past. Past experience also highlights the danger of using windfall fiscal gains to finance long-lasting spending commitments. Reaping the benefit of strong growth to reduce debt to lower and safer levels would also solidify Ireland’s reputation for creditworthiness, help to maintain current favourable financing conditions and underpin a lasting recovery.

1 A more extensive discussion of this issue is contained in Box A on page 11.