Comment

Economic data confirm the continuation of a strong upswing in Irish economic activity over the past year, with GDP now projected to have grown by just below 7 per cent in 2015. The strong growth performance reflects a recovery which has become broadly based and has increasingly come to be driven by a significant rebound in domestic demand. While methodological changes to the National Accounts and some changes to the activities of multi-national firms complicate the interpretation of the data and overstate the strength of domestic demand, the pick-up in consumption and the continuing strength of employment growth confirm that a convincing recovery is well established on the domestic side of the economy.

Last year also saw an exceptionally strong rise in nominal GDP, likely to have been around 12.5 per cent. The strength of the rise in nominal GDP has contributed significantly to the projected falls in the fiscal deficit and debt ratios in 2015. While partly reflecting the robust increase in real GDP, the rise in nominal GDP was also influenced by the estimated strong rise of 5.6 per cent in the GDP deflator. The latter primarily reflects the impact of external factors, in particular exchange rate and oil price movements last year[1].

On the real side of the economy, the stronger growth performance has been underpinned by both the stabilising influence of the policy and macroeconomic adjustments which have been undertaken, as well as the coming together of a broad set of favourable factors, which have reinforced each other to support growth. In particular, the stimulus to incomes from an employment-rich recovery has been augmented by both the emergence of wage growth and the further boost to purchasing power from lower energy prices[2]. Growth has also benefitted from a more benign policy environment, reflected in both the easing of the pace of fiscal consolidation and continued favourable financial conditions, while additional support has been provided by the on-going improvement in household and firm balance sheets and continuing favourable conditions in Ireland's main export markets. It is the positive alignment of all these factors, many of which have acted to boost domestic demand, which has helped growth to strengthen and, excepting the uncertainty related to the recent re-emergence of tensions in global financial markets, broadly supports a continued favourable outlook.

On the domestic side, the most direct evidence of improvement has been strong growth in employment, especially full-time employment. Over the past two years, the economy has created jobs at an average rate of around 45,000 per annum, reflecting employment growth of close to 2 1/2 per cent a year. Allied to the return of wage growth, and benefitting also from very low inflation, this has helped to boost real incomes and consumer confidence. Combined, these factors have stimulated a strong pick-up in consumer spending which, last year, grew at its fastest rate since 2007. Looking ahead, the continued favourable labour market outlook, rising real disposable incomes and improved consumer confidence are projected to support the outlook for consumer spending. However, as the pent-up demand which provided some of the boost to consumer spending in 2015 eases and the growth in employment slows a little, a gradual moderation in consumption is in prospect this year and next.

While the growth in overall investment spending was exceptionally strong in 2015, the overall level of investment is distorted

1 Developments in nominal GDP and the GDP deflator are discussed more fully in Box C on page 21.

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

by the impact of investment in aircraft and the transfer of patents into Irish entities by some multinational corporations. However, abstracting from these two categories, underlying investment, net of aircraft and intangibles, is still growing strongly. Looking ahead, the broadly favourable overall economic outlook combined with the fact that underlying investment levels are still recovering, suggests that the pace of expansion in underlying investment is likely to moderate only slightly over the forecast horizon.

On the external side, trade and factor income flows remain heavily influenced by the impact of corporate restructuring in parts of the multinational sector. As a consequence, the growth of both exports and imports has been much stronger than previously projected. Notably, however, exports of indigenous sectors, such as agri-food and tourism, have also performed strongly, supported by favourable demand conditions and exchange rate developments. Looking ahead, overall export growth is expected to come to reflect demand in trading partner countries more closely over the forecast horizon. As a result, exports are now expected to increase at a slightly slower pace than previously projected, although growing concerns about the global outlook increase uncertainties further.

Taking account of the evolution of developments and prospects since the last Bulletin, suggests a stronger outturn for GDP growth last year, and also, on balance, a broadly similar outlook for this year, compared to the previous forecast. Buoyed by the strength of domestic demand, GDP is now estimated to have grown by 6.6 per cent last year. Reflecting a favourable outlook for consumer and investment spending this year, domestic demand will continue to be the main driver of economic growth in 2016. GDP growth of 4.8 per cent is forecast for 2016, a marginal upward revision to the previous projection, while the forecast for GNP growth, at 4.3 per cent, is marginally lower. In 2017, on the basis of forecasts of growth in trading partner countries consistent with those underlying the latest ECB macroeconomic projections and reflecting some moderation in the growth of domestic demand, GDP is forecast to grow by 4.4 per cent, with GNP projected to rise by 3.9 per cent.

For now, risks to the 2016 forecasts are judged to be balanced, while tilted to the downside for 2017. This reflects some upside potential from the possibility of stronger domestic dynamics and the lagged impact of exchange rate and oil price movements, offset on the downside by rising risks to the global outlook, with potential spillovers to global trade.

The latest forecasts continue to suggest that the economy is going through a period of exceptionally strong growth which is likely to ease only modestly over this year and next. While, in part, the current strong growth phase reflects a rebound from past weakness, to a greater extent, it represents a movement back towards the full utilisation of resources and the realisation of the economy's potential. On the basis of the current projections, there is still sufficient spare capacity to accommodate such growth over the forecast horizon without encountering major constraints. More importantly, the strong growth outlook provides an opportunity to tackle the remaining legacies of the crisis and minimise future risks to economic, fiscal and financial stability. This opportunity needs to be taken. Reducing the remaining vulnerabilities and strengthening economic resilience are necessary to mitigate the risk of future boom-bust cycles and ensure stable and sustainable medium-term growth.