DKM ECONOMIC CONSULTANTS

Economy Watch

Snapshot of Irish Economic Forecasts

Issue 18, November 2016

Brexit is not the only European issue

The general consensus among forecasters of the Irish economy for 2017 is for a significant slowdown in GDP growth. This slowdown is reflected in lower growth estimates for all the major demand categories with strong deceleration expected in fixed investment, government spending and exports. The latter may reflect concerns about the impact of falling sterling on Irish exports to the UK.

The main effect of the UK Brexit vote appears to have been on the exchange rate. This is hardly surprising as the UK has not yet left the EU and indeed has not yet formally confirmed that it will leave the EU. So attempting to take account of the Brexit impact on the Irish economy is futile until far more is known about the shape of post-Brexit trade and service flows. However, the apparent pledge to Nissan, the exact nature of which is unknown, suggests that the UK will not be slow to use whatever discriminatory power it gains from EU exit to favour UK producers. That cannot be good news for Irish exporters reliant on the UK market.

It is vital that the Irish Government is not distracted by Brexit, which will be a long drawn out affair, to the detriment of other policy matters emanating from Brussels. In particular the proposed common corporate tax base proposals, while seeming innocuous in principle, will be detrimental to small countries which export to EU member states. The issues are not just base shifting but the extent to which exporters' profits are taxed in the "home" country or in the destination country.

We cannot rely on the Revenue Commissioners or the Department of Finance, who have collectively presided over the current dog's dinner of an income tax system, to mount a coherent intellectual challenge to the EU proposals. If we focus entirely on what concessions Ireland can obtain from the Brexit negotiations, we may lose far more by the latest EU attempts to harmonise corporate taxes within the EU.

There is little the Government can do as a policy response to Brexit in spite of the clamour of opposition politicians. At best it might provide guarantees to small businesses who want to hedge their sterling exposures but find the weakened Irish banks unable or unwilling to provide such cover within their current credit limits. Irish exporters that compete with UK producers are in for a tough time regardless of hedging capacity. But exporters competing with other EU producers in the UK market will find that over time the impact of the sterling devaluation will be to push up UK import prices which will offset the devaluation. The most policy can do is to try and ensure Irish exporters are still around to benefit from that price adjustment.

In this issue:

- **Steady GDP growth expected in 2016 and 2017, albeit lower than the artificially inflated 2015 rate**
- **Unemployment rate continues on steady downward path**
- **Housing supply the key priority for Government**
- **Consumers perceive increased uncertainty about the future**
- **Irish government bond yields trade closer to that of France and Spain than Italy and Portugal**

Forecasts At a Glance

	2015	2016f	2017f
	%	%	%
GNP	18.7	5.6	3.3
GDP	26.3	4.6	3.5
Total Domestic Demand	9.9	6.2	5.5
Private Consumption	4.5	3.9	3.2
Public Expenditure	1.2	3.5	2.0
Investment	32.7	12.1	9.3
Exports	34.4	5.5	4.8
Imports	21.7	6.7	5.7
Unemployment Rate	9.5	8.2	7.5
Employment Growth	2.6	2.5	1.9
Wage Growth	2.8	2.2	2.1
CPI Inflation	-0.3	0.3	0.9
General Gov. Balance	-1.9	-0.8	-0.3
General Gov. Debt	78.6	75.3	72.5

Snapshot of Irish Economic Forecasts

Annual real % change

	GNP		GDP		Private Consumption		Public Expenditure		Investment		Exports		Imports		Forecast Date
	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	
AIB	5.5	3.0	3.5	3.5	3.0	3.0	3.0	1.0	9.5	6.0	4.5	4.5	6.2	4.8	Oct-16
BOI	4.5	2.8	4.3	3.0	3.8	3.2	2.0	2.0	8.0	7.0	4.8	3.8	6.0	5.7	Jul-16
Central Bank	4.5	3.1	4.5	3.6	3.8	2.2	2.5	1.1	14.0	7.0	5.6	4.4	7.8	4.7	Oct-16
Davy	5.9	3.6	6.0	4.0	3.7	2.5	1.1	1.5	7.5	7.1	8.0	4.7	5.8	4.4	Apr-16
Dept. Finance	7.5	3.3	4.2	3.5	3.3	2.9	5.9	2.4	15.8	6.0	3.6	4.5	5.9	5.1	Oct-16
ESRI	4.1	3.5	4.3	3.8	4.2	4.0	1.0	1.0	16.2	18.6	8.3	7.6	12.1	11.9	Sep-16
EU			4.9	3.7	2.7	2.0	1.3	2.0	13.4	8.3	6.9	6.6	7.7	7.4	May-16
Goodbody	7.2	3.1	4.3	2.9	3.3	2.8	4.3	2.0	3.3	7.3	3.8	2.6	3.5	3.2	Oct-16
IBEC			3.9	3.2	4.9	3.5			7.9	7.2	5.9	5.2	7.1	6.6	Sep-16
IMF			4.9	3.2							6.5	5.0	7.0	5.9	Oct-16
KBCI	3.7	2.5	4.0	3.0	3.5	3.0	6.0	3.0	16.7	11.3	4.2	4.0	7.5	6.0	Oct-16
Investec	3.9	2.8	4.8	3.5	3.6	2.8	1.1	1.9	8.3	7.8	4.0	3.0	4.0	3.0	Sep-16
OECD			5.0	3.4	3.0	3.0	1.6	2.1	10.7	4.3	6.0	4.5	6.9	4.5	Jun-16
Ulster Bank			4.4	3.2	3.7	2.8									Oct-16
Average	**5.6**	**3.3**	**4.6**	**3.5**	**3.9**	**3.2**	**3.5**	**2.0**	**12.1**	**9.3**	**5.5**	**4.8**	**6.7**	**5.7**	

Irish economy forecast to grow by 4.6% in 2016 and 3.5% in 2017

The consensus forecasts indicate a generally positive outlook for the Irish economy.

The Irish economy is expected to grow by 4.6 per cent and 3.5 per cent in 2016 and 2017 respectively, largely due to growth in investment and private consumption. Consumers and companies have been experiencing favourable conditions in the past two years with remarkably low inflation and low interest rates as well as steady wage inflation increasing the disposable income of consumers. Specifically, private consumption is forecast to grow by 3.9 per cent and 3.2 per cent in 2016 and 2017 respectively, which is lower than materialised in 2015. This is possibly due to the uncertainty of the effect of Brexit on Irish consumers. Similarly Brexit is having a substantial effect on companies with many Irish exporters being squeezed due to the plummeting pound sterling. Investment is projected to grow at 12.1 per cent in 2016, with a moderation to 9.3 per cent in 2017. These forecasts are subject to particular uncertainty as the negotiations between the UK and the EU will not commence until March 2017 and the full effect on Ireland will thereby remain uncertain until more details on the deal have been revealed.

Net exports are expected to be in balance over the next couple of years as exports and imports will grow by 5.5 and 4.8 per cent in 2016, and by 6.7 and 5.7 per cent in 2017 respectively (see chart). The labour market is forecast to improve significantly as the unemployment rate drops to 7.5 per cent by 2017 and wage inflation continues at a steady rate - 2.2 per cent this year and 2.1 per cent in 2017 – while price inflation remains subdued.

Budget 2017 presented tax cuts and a moderate increase in spending

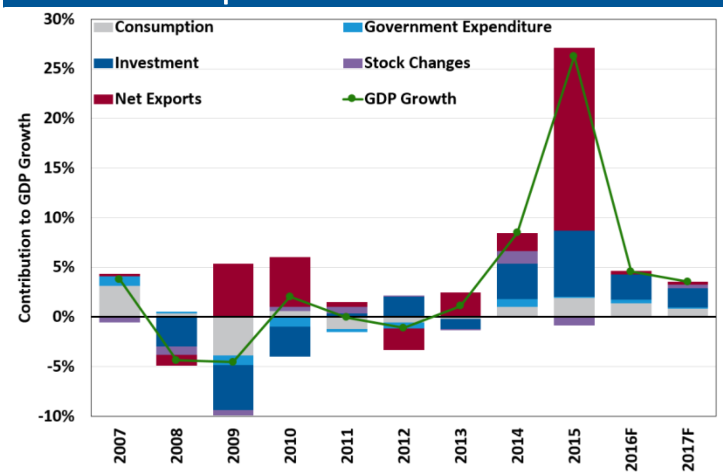
Finance Minister Michael Noonan presented an expansionary budget on October 11th

Despite increased growth in recent years and improved public finances, Budget 2017 presented a moderate expansion for the third year in a row with a modest fiscal space of €1.2 billion or 0.4 per cent of GDP. This allowed the Minister to reduce the three lowest USC rates by 0.5 percentage points, and increase childcare support and social welfare benefits, alongside spending increases on public sector pay, health, education and housing. Total gross voted spending is to increase to €53.5 billion in 2017. Public expenditure is thus expected to grow by 3.5 per cent in 2016 and 2.0 per cent in 2017.

The structural budget deficit is forecast to fall to 1.9 per cent of GDP in 2016, and 1.1 and 0.5 per cent in 2017 and 2018 respectively. Ireland has thus eliminated its previously large deficit and is expected to reach the EU's set medium term objective of a 0.5 per cent structural deficit in 2018. This has been due to spending reductions from 2009-2013 alongside significant revenue increases from, amongst other items, higher corporate tax receipts. The significantly lower deficit from 2018 will provide the Government with a larger fiscal space, which could allow for stronger spending growth from 2019 onwards. Similarly Ireland's general government gross debt as a percentage of GDP is forecast to fall to 75.3 per cent and 72.5 per cent in 2016 and 2017 respectively. However this improvement is largely down to the level shift of GDP in 2015, which caused an overstatement of the rate of improvement and underestimated the size of the real debt burden. When looking at the debt-to-revenue ratio it is clear that the Irish debt burden remains high but is declining. However, the continuing low level of interest rates is somewhat diminishing the impact of the high debt levels on the economy and public finances.

The backdrop of increased uncertainty in the Euro Area due to Brexit was addressed in some policies presented in the Budget. For example the hospitality sector is significantly exposed to Brexit risks, and will benefit from the retention of the reduced VAT rate of 9% on tourism-related activities which is aimed at maintaining the attractiveness of Ireland to visitors from the UK. However, as the specifications of Brexit are still unknown, it is difficult at this stage to mitigate the potential impacts.

Historic & Expected Contribution to GDP Growth



Source: CSO 2005-2015, DKM Economy Watch 2016E-2017F

DOMESTIC PERFORMANCE

Snapshot of Irish Economic Forecasts

Annual real % change * year average;
**Underlying GGB as % of GDP ***General Govt. Gross Debt as % of GDP

	Unemployment Rate*		Employment Growth		Wage Inflation		CPI Inflation		HICP Inflation		General Govt. Balance**		General Govt. Debt***		Forecast Date
	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	2016	2017	
AIB	8.1	7.2	2.7	2.3			0.3	0.8	0.0	0.5	-0.9	-0.5	75.0	72.0	Oct-16
BOI	7.9	7.3	2.4	1.9			0.5	1.5	0.6	1.6					Jul-16
Central Bank	8.3	7.7	1.5	0.8	2.5	2.5	0.2	1.0	0.0	1.0					Oct-16
Davy	8.3	7.4	2.4	2.3	2.8	2.6					-0.3	0.4	88.4	84.2	Apr-16
Dept. Finance	8.3	7.7	2.6	2.1	2.9	2.7			-0.1	1.3	-0.9	-0.4	76.0	74.3	Oct-16
ESRI	8.3	7.3	2.3	1.6	2.3	2.3	0.5	1.0			0.1	0.5	73.6	68.7	Sep-16
EU	8.2	7.5	1.7	1.4	2.2	2.1			0.3	1.3	-1.1	-0.6	89.1	86.6	May-16
Goodbody											-1.0	-0.6	76.0	73.0	Oct-16
IBEC	8.2	7.5	2.8	2.1			0.3	0.6							Sep-16
IMF	8.3	7.7	2.5	1.7			0.3	1.2					74.6	72.6	Oct-16
KBCI	8.2	7.5	2.7	2.0					0.0	0.5	-0.7	-0.2	75.7	72.0	Oct-16
Investec	7.9	7.2	2.3	2.0	1.0	0.8	0.0	0.5	0.0	0.5	-1.1	-0.7	76.4	74.8	Sep-16
OECD	8.2	7.6	2.6	2.4	2.3	3.0	1.0	1.0							Jun-16
Ulster Bank	8.2	7.3	2.7	2.1					0.2	1.5					Oct-16
Average	8.2	7.5	2.5	1.9	2.2	2.1	0.3	0.9	0.1	1.0	-0.8	-0.3	75.3	72.5	

Consumer Prices unchanged in September 2016

Average prices remained the same in the year to September.

Consumer prices have been volatile in the past year, experiencing annual percentage changes between -0.3 to +0.5. The Consumer Price Index (all items) decreased from 102.2 in August to 101.8 in September, bringing the index back to September 2015 levels. The most noticeable annual changes were in Furnishing, Household Equipment & Routine Household Maintenance (-3.5%), Transport (-3.2%), Communications (-2.7%) and Recreation & Culture (-1.8%). The main increases occurred in Miscellaneous Goods & Services (+4.4%), Education (+3.8%), Restaurants & Hotels (+2.2%) and Health (+1.6%).

Drop in the Consumer Sentiment Index

September saw a slight decrease in the overall consumer sentiment index, indicating growing unease amongst consumers.

The overall ESRI/KBC Consumer Sentiment Index decreased to 102.0 in September from 102.7 in August, leaving the index slightly higher than the September 2015 reading of 100.6. Consumer expectations decreased to 88.4, from 90.8 in August, indicating that consumers are uncertain about the future. This has possibly been influenced by the Brexit vote, the EU ruling on Apple and the unprecedented 26.3% GDP growth in 2015, which makes it difficult for the average consumer to assess economic conditions in Ireland and future prospects.

Housing supply challenge a key priority

The Government's Action Plan aims to restore a properly functioning housing market

The Action Plan for Housing and Homelessness provides a multi-stranded, action-oriented approach to achieving many of the Government's key housing objectives, as set down in the Programme for a Partnership Government. These include significantly increasing the supply of social housing, doubling overall housing output to at least 25,000 per annum by 2020, servicing all tenure types, and tackling homelessness. Its success will be measured by how quickly it is implemented, and thus the work of the dedicated Housing Delivery Office is likely to be closely monitored. Alongside the Plan, Budget 2017 also introduced the Help-to-Buy scheme in the form of a tax rebate to assist first time buyers to raise the necessary mortgage deposit.

Irish government bond yields continue to fall

The improving economic conditions in Ireland can be clearly seen in bond yields.

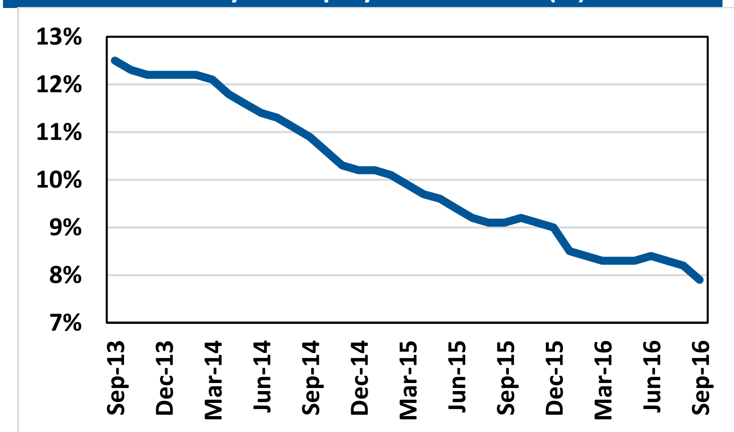
The ten year government bond yield reached 0.55% on Wednesday October 12th 2016, down from 11.8% on June 1st 2011. The Irish ten year government bond is trading closer to that of France and Spain than Italy and Portugal. This has been reinforced by improving economic conditions in Europe, the robust creditworthiness of Ireland (A-rating with all three main rating agencies), as well as the extended Quantitative Easing programme managed by the ECB. The National Treasury Management Agency has thereby been able to raise €6.6 billion long-term funding in 2016 at very low cost. Irish debt however remains vulnerable to negative external shocks.

Unemployment hits new low since peak in Jan-12

Monthly unemployment rate below 8% in September.

The seasonally adjusted unemployment rate decreased to 7.9% in September 2016 from 8.2% in August. This decrease represents a net 7,300 individuals who found jobs in the month. The number of people who were unemployed in September totalled 172,900, down 24,000 compared to the corresponding figure in 2015. Youth unemployment decreased to 15.9% in September from 17.0% in August and 20.9% in September 2015. Thus the labour market continues to improve, and unemployment is expected to average 7.5% in 2017.

Monthly Unemployment Rate SA (%)



Source: CSO

FOCUS ON THE EXTERNAL ENVIRONMENT

The global GDP growth rate was revised down by 0.1 percentage points by the IMF in their October Outlook, compared to their April forecasts. This has been due to weaker than expected growth in the US and the adverse effect on advanced economies by the Brexit vote. Global growth is therefore expected to be 3.1 per cent in 2016 and 3.4 per cent in 2017. Consequently interest rates remain low as expansionary monetary policy persists in many countries. Financial sentiment in emerging Asian markets has improved with low but stabilising commodity prices and positive policy changes. Advanced economies are however subject to substantial uncertainty and downside risks which makes broad-based economic policy critical according to the IMF.

Euro Area

Brexit, distressed European banks, Greek bailout and political polarization dominates discussions in the Euro Area.

The Euro Area is experiencing significant challenges - from the vote by the UK to leave the European Union to the continuing refugee crisis and the rising popularity of right wing parties favouring protectionism and anti-immigration policies. Given these uncertainties GDP growth is expected to slow in 2016 and 2017 to 1.7 per cent and 1.5 per cent respectively, from 2.0 per cent in 2015. Final domestic demand is expected to grow by 1.9 per cent in 2016 and then fall to 1.6 per cent in 2017. Despite these challenges and the expected slowing growth, unemployment continues to fall in the Euro Area, reaching 10 per cent and 9.7 per cent in 2016 and 2017 respectively. This development is due to significant decreases across the board, except for **Germany**, **Austria** and **Malta**.

Amidst the uncertainty surrounding the consequences of the Brexit vote, the third bailout of **Greece** is under review, and stirring up old tensions. Several member states disagreed on whether the Greek government had fulfilled the requirements imposed by the European lenders, which resulted in the finance ministers releasing €1.1 billion in funding but retaining an additional €1.7 billion, pending further discussions and data. The Greek government led by Syriza leader Alexis Tsipras has failed to implement many of the reforms conditioned in the rescue package. Specifically, the Greek government still has to privatize many state assets among other reforms to lower spending.

United States

The US election campaign is intensifying while the economy is slowing.

The all-encompassing American election campaign is intensifying as November 8th approaches. This can be seen in the rhetoric of the presidential debates which, to date, has focused little on economic policy. However, both candidates have suggested opposition to the Transatlantic Trade Investment Partnership, which is a sentiment shared by many political parties in advanced economies in recent years. While Hillary Clinton continues to hold a marginal lead in the polls, crises affecting both the Democratic and Republican candidates have resulted in a tightening in the polls as the election date draws closer.

Whatever the result of the election, the next president of the United States will have to face difficult economic challenges such as lower productivity growth, slowing wage gains and rising income inequality. GDP growth is expected to slow to 1.6 percent in 2016 but then pick up to 2.2 per cent in 2017. Unemployment is expected to decrease to 4.9 and 4.8 per cent in 2016 and 2017 respectively.

Major economies' GDP growth forecasts

	2015 (%)	2016f (%)	2017f (%)
Global	3.2	3.1	3.4
UK	2.2	1.8	1.1
US	2.6	1.6	2.2
Euro area	2.0	1.7	1.5
Germany	1.5	1.7	1.4
Japan	0.5	0.5	0.6
China	6.9	6.6	6.2
India	7.6	7.6	7.6

Source: IMF World Economic Outlook October 4th 2016

United Kingdom

Uncertainty dominates the UK economy with firms, workers and governments paying close attention to Government pronouncements.

The British Prime Minister Theresa May pinpointed at the Conservative Party conference on October 2nd that she would invoke Article 50 of the EU treaty by the end of March 2017, thereby formally beginning the negotiations for the UK to leave the European Union. The statement was received by a nervous market and immediately saw the pound plummet to a thirty year low against the dollar. Untethered access to the European single market, necessary for financial services in particular, is inherently contradictory to the desire to control UK borders. Since any deal between the UK and EU has to be accepted by all 27 nation states it is likely that negotiations will be complex and drawn out. As most member states consider the free movement of labour, capital, goods and services inseparable, a harder Brexit, where the UK will exit both the EU single market and the customs union, is in prospect. Although the full extent of the deal will not be revealed until early 2019 at the earliest, the consequences are likely to be felt for decades to come.

As a consequence of the June referendum UK growth forecasts have been revised down by the IMF. The UK economy is now expected to grow by 1.8 per cent and 1.1 per cent in 2016 and 2017 respectively which is a -0.1 and -1.1 percentage point reduction on previous forecasts. The forecasted effect of Brexit is generally negative given the UK economy's heavy dependence on trade.

NOTE: The average figures presented in this report represent a weighted average of the latest forecasts for the Irish economy from 13 independent sources, compiled by DKM. Older forecasts are given a lower weighting in calculating this average. Figures quoted represent the latest available from each source at the time of going to press. DKM would like to thank those who kindly contributed their economic forecasts for inclusion in this report.

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