



Growth prospects strong but Brexit adds to long list of uncertainties

Who would envy a forecaster of the Irish economy? As if the prospect of a global growth slowdown, financial stress caused by problems in loans to emerging markets and oil and mining industries, increased global risk aversion and currency volatility were not enough, now we have to deal with possible Brexit and probable domestic political uncertainty. At the time of writing it would appear that the Irish electorate puts a relatively low value on stable government and a high value on expressing its general discontent by electing a large number of “independents” whose sole common feature is their low likelihood of forming a functioning government. Perhaps the electorate is impressed by the performance of Belgium which has appeared to thrive in spite of political deadlock. The pessimists might point to Spain where, after two months, there is still no sign that a viable Government will be formed. Neither Spain nor Belgium have the same need to deal with the elephant in the room – the possibility of the United Kingdom leaving the EU.

When economic historians reflect on February 2016 half a century from now they will wonder how Brexit was scarcely raised as an issue in an election which was supposedly about the management of the economy. They may also wonder how so many of those seeking election were more concerned with redistributing the current levels of income than ensuring the continued growth of that income. The implicit assumption seems to have been that the economic pie would continue to grow, regardless of the election outcome, and the only issue was the appropriate division of this pie.

There is no doubt that the economy is on a strong and sustainable growth path. If it is not knocked off course there is a good chance that employment levels will reach the pre-recession peak. However this time employment will not be overly dependent on unsustainable construction investment. Domestic demand growth is taking over from export growth as the main driver of increased incomes and employment. But none of this is a given. Major dislocations caused either by domestic political uncertainty or British exit from the EU could see a sharp reversal of the optimism which is driving consumption and investment. On current trends, this is unlikely to be replaced by strong growth in the external international environment.

Weaker sterling will affect the profitability of Irish exporters and will also contribute to downward pressure on domestic prices. The uncertainty over Brexit may cause a slowdown in UK growth even if the eventual result is in favour of remaining in the EU. These factors will differentially affect Ireland given the nature and scale of its links to the UK. At the moment it would appear that none of these factors are in the forecasts for the Irish economy. The current expectation is that 2017 will see a slowdown in the rate of growth but it will remain one of the strongest in the EU. Only an optimist would expect upward revisions in forecasts as 2017 comes into clearer view.

Forecasts At a Glance

	2015e	2016f	2017f
	%	%	%
GNP	5.7	4.4	3.7
GDP	6.8	4.7	3.9
Domestic Demand (ex. Stocks)	8.0	5.1	4.0
Private Consumption	3.4	3.2	2.7
Public Expenditure	2.4	1.8	1.9
Investment	23.3	11.0	7.7
Exports	12.8	5.6	5.4
Imports	14.9	7.2	5.6
Unemployment Rate	9.4	8.1	7.3
Employment Growth	2.6	2.6	2.4
Wage Growth	2.2	2.1	1.9
CPI Inflation	-0.1	0.9	1.6
General Gov. Balance	-1.7	-0.7	0.1
General Gov. Debt	96.3	91.2	88.2

In this issue:

- ▶ Consensus forecasts show GDP of 4.7% in 2016 and 3.9% in 2017.
- ▶ Continued strong growth in domestic demand of 5.1% in 2016 and 4.0% in 2017.
- ▶ Supply will remain the ongoing challenge in the housing market.
- ▶ The downward trajectory in unemployment continues.
- ▶ Balanced budget by end 2017: -0.7% in 2016 and 0.14% in 2017.
- ▶ Brexit poses particular risks for Ireland as well as the EU.

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	4.5	4.0	5.0	4.5	3.0	3.0	2.0	2.0	9.5	7.0	7.5	6.5	7.0	
BOI	4.6	3.7	5.0	4.0	3.4	3.0	2.0	2.0	12.0	7.5	8.0	6.0	9.0	6.4	Feb-16
Central Bank	4.3	3.9	4.8	4.4	2.8	2.0	1.1	1.9	11.8	7.4	6.5	4.9	6.9	4.4	Jan-16
Dept Finance	3.9	3.2	4.3	3.5	3.5	2.0	1.1	1.0	12.5	8.9	6.9	4.9	8.2	5.4	Oct-15
ESRI	5.3		4.8		3.4		1.0		19.2		7.6		10.1		Dec-15
EU			4.5	3.5	2.5	2.0	2.0	2.3	12.0	8.3	6.9	6.7	7.7	7.5	Feb-16
Goodbody	4.7	3.7	5.0	3.7	3.8	3.1	2.6	2.0	3.2	9.7	5.5	4.3	3.5	5.1	Jan-16
IBEC	4.4		4.3		4.4		3.1		13.1		9.1		11.5		Dec-15
IMF	4.0	3.2	4.2	3.3	3.1	2.7	0.3	1.9	7.6	6.3	4.5	4.2	4.2	4.4	Jan-16
KBCI	3.5		4.5		3.5		2.5		14.0		6.5		8.0		Dec-15
Investec	4.5		5.0		2.8		1.6		12.1		7.5		8.0		Feb-16
OECD			4.1	3.5	2.9	3.2	1.1	0.0	10.6	7.1	4.7	4.5	4.8	4.8	Nov-15
Ulster Bank			4.8	3.8											Feb-16
Average	4.4	3.7	4.7	3.9	3.2	2.7	1.8	1.9	11.0	7.7	5.6	5.4	7.2	5.6	

The domestic recovery continues strongly...

GDP growth forecast to exceed all other Eurozone countries, but concerns over stability of the future government increases uncertainty.

The recovery continued at a remarkable pace in 2015 indicated by the expected 6.8% GDP growth yoy from the consensus forecast. 2016 and 2017 are forecast to continue growing strongly, by 4.7% and 3.9% yoy respectively according to the consensus forecast. With strong growth projected and the general election at full speed, the potential for fiscal expansion has been a hot topic during the General Election, specifically the amount of fiscal space available for the next government. However, the IMF has clearly recommended that any government surplus should be put towards debt reduction, noting that the economy is still vulnerable to external shocks due to high public and private debt and elevated unemployment levels. General government debt as a percentage of GDP is expected to fall to 91.2% in 2016 and 88.2% in 2017.

Additionally, uncertainty about the formation of a new stable government poses a risk for international investors, so scope for fiscal expansion should be viewed with caution. In a similar vein, the continued stability of the Irish government is important if Irish bond yields are to remain stable and low, as evidenced by recent experience in Portugal and Spain. The latest polls indicate that the current Fine Gael/Labour coalition is unlikely to achieve a majority, so some novel configuration will be needed if a majority government is to be formed.

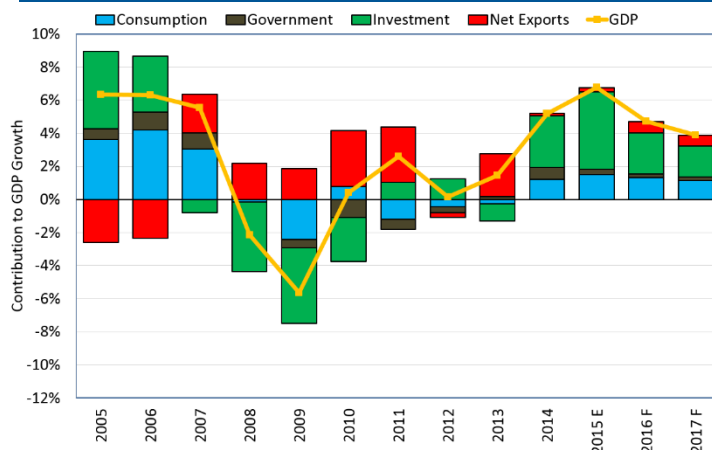
Domestic demand growth is projected to be the fastest in the Euro Area, at 5.1% in 2016 and 4.0% in 2017 yoy. Conditions for consumers improved greatly during 2015, and this is expected to continue due to a combination of low interest rates, decreasing unemployment, low inflation and wage growth, combined with the tax and social welfare changes in Budget 2016. These factors have all increased disposable income, creating favourable conditions for higher private consumption. The consensus forecast expects private consumption to grow by 3.2% and 2.7% in 2016 and 2017 respectively. However, Ireland's private household debt burden is still the highest in the EU at 167% of disposable income in 2015. With interest rates expected to remain low in 2016 the debt is manageable, but it is a continuing vulnerability.

...as global growth uncertainty poses a risk

2016 so far has seen increasing concerns about global growth rates, which pose definite risks for the Irish economy.

In the past Ireland has been particularly vulnerable to global shocks, due to the openness of the economy. Latterly, volatility has been rooted in the increased uncertainty regarding global growth. Global stock prices have been extremely volatile so far this year. Monday 9th February saw the sharpest fall in the ISEQ Overall Index since August 24th 2010, as the index fell by 5.5 percent in one day. Although Ireland's growth is increasingly driven by internal factors, vulnerability to global shocks remains. Exports are expected to grow by 5.6% and 5.4% yoy in 2016 and 2017 respectively, lower than the 2014 and 2015 levels.

Historic & Expected Contribution to GDP Growth



Source: CSO 2005-2014, DKM Economy Watch 2015E-2017F

Multinationals' corporate tax remains an issue

The ongoing investigations into taxes paid by multinational corporations such as Google and Apple have significant implications for Ireland.

In recent months the European Commission's Competition Authority led by Magrethe Vestager has investigated a number of large multinational companies (Apple and Google) and their alleged tax avoidance activities. The continued investigations will pose challenges for the Irish government and cause concerns about future foreign direct investment.

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	8.0	7.0	2.5	2.4					0.5	1.5	-0.5	0.5	90.0	85.0	Jan-16
BOI	8.2	7.4	2.5	2.2			0.7	1.6							Feb-16
Central Bank	8.2	7.4	2.4	1.9	2.5	2.6	1.0	1.9	1.0	1.9					Jan-16
Dept Finance	8.3	7.7	2.4	2.0	2.4	2.6			1.2	1.5	-1.2	-0.5	92.8	90.3	Oct-15
ESRI	7.9		2.6		2.3		1.0		1.2		-0.5		86.7		Dec-15
EU	8.5	7.8	1.6	1.4	2.1	2.2			0.6	1.4	-1.3	-0.8	93.9	91.5	Feb-16
Goodbody	7.3	6.3	2.5	2.2	2.0	2.3	0.9	1.4			-0.3	0.9	90.0	86.0	Jan-16
IBEC	8.0		2.6												Dec-15
IMF	8.5	7.7	2.0	1.9	1.7	1.8			1.5	1.6	-0.9	-0.1	91.5	88.1	Jan-16
KBCI	8.0		2.5						1.0		-0.7				Dec-15
Investec	8.1						1.0		1.0		-0.8		91.0		Feb-16
OECD	8.3	7.5							1.6	2.0	-1.1	-0.3	98.3	95.1	Nov-15
Ulster Bank	8.4	7.7	2.2	2.1					1.0	1.6					Feb-16
Average	8.1	7.3	2.6	2.4	2.1	1.9	0.9	1.6	1.0	1.6	-0.7	0.1	91.2	88.2	

Challenges continue in the housing market

Inadequate supply, increasing demand and macro-prudential rules remain features of market.

House price growth in 2015 slowed sharply as mortgage demand slowed due to the Central Bank's macro-prudential rules, while new supply grew only modestly. However, the market awaits the review of the macro-prudential measures by the Central Bank over the summer, with some speculation that the rules may be eased for Dublin first time buyers. The supply side has been weak with only 8,000 residential commencements in 2015, well short of what is required and substantially below the expected average annual rate of household formation of 30,000 in 2016-2020. Therefore recent measures to boost supply are very welcome, although the two year rent freeze in the rental market is likely to reduce returns on investment and thus discourage new residential construction.

ESRI/KBC consumer sentiment index

The upward trend of consumer sentiment continues.

The KBC/ESRI Consumer Sentiment Index started on a strong note in 2016, increasing to 108.6 in January from 103.9 in December, leaving the index at a ten year high. Similarly the three month average increased to 105.2 in January from 102.8 in December showing a continued upward trend. Consumer expectations were varied as perceptions of the labour market and economic conditions in 2016 disimproved, while expectations about personal finances strengthened. The index measuring consumers' perception of the buying climate increased from 112.9 in December to 121.4 in January.

Strong performance of exchequer returns

The exchequer returns made space for fiscal expansion and debt reduction in 2015 and are expected to do so again in 2016 and 2017.

One of the most encouraging results from 2015 was Ireland's exchequer returns which outperformed projections throughout the year. This was mainly driven by a €3.5bn overshoot in government revenues due to higher corporation tax receipts of €2.3bn, and higher than expected VAT and income tax receipts. This left the government with some fiscal space for a moderate expansion in Budget 2016. Simultaneously, spending surged in the last few months of 2015 leaving total capital spending at €3.8bn or 2% of GDP. In 2016 the government will be limited by EU fiscal

rules, and spending caps will be used to bring down the budget deficit, which is forecast to be eliminated over the next year or so.

Manufacturing growth at six month high

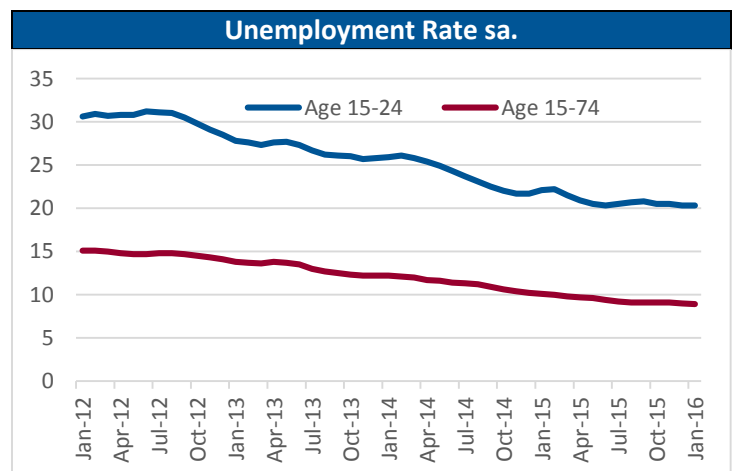
As indicated by Investec's monthly manufacturing Purchasing Managers' Index in January 2016.

The index increased to 54.3 in January from 54.2 in December, the 32nd successive month of expansion. An acceleration in new orders as well as increasing output and employment have driven the increase. The continuing difficulties in global commodities markets extended the current sequence of falling commodities prices to five months. The volatility in oil, copper and steel prices have in particular reduced input costs for the Irish manufacturing sector.

...As the unemployment rate drops to new lows

The unemployment rate continued its downward trend in January.

January recorded a decrease in the seasonally adjusted unemployment rate to 8.9%, compared to 9.0% in December 2015, with the number of unemployed persons falling by 3,000. Overall unemployment has been on a downward trend since its 15.1% peak in January 2012, as seen in the graph below. Youth unemployment is on a similar downward trajectory, hitting 20.3% in January from its peak of 30.9% in February 2012.



Source: CSO

FOCUS ON THE EXTERNAL ENVIRONMENT

Global growth is expected to be 3.4% and 3.6% in 2016 and 2017 respectively (IMF, January 19th 2016), which is a decrease from the October forecast for 2016 of 3.6%. Issues in the Chinese economy, low energy and commodity prices and turbulence in emerging markets are causing uncertainty for growth prospects in 2016-17, which has led to global stock markets tumbling in February. Meanwhile the gradual exit from the extraordinary monetary policy in the United States and UK needs be managed carefully as growth prospects are still uncertain.

Euro Area

Slow growth continues, as the possibility of 'Brexit' poses risks for the future of the European Union.

Modest recovery in the Euro Area is projected to continue with a growth rate of 1.7% yoy in both 2016 and 2017. The recovery is expected to be fairly resilient to temporary uncertainties such as the turbulence in emerging markets in recent months. Growth has been driven by lower oil prices, the relatively weak euro boosting exports, the continued quantitative easing programme, notwithstanding stringent fiscal policies by the member states. Private consumption and exports have driven economic growth, while investment is still lagging behind. Debt levels however remain inflated with five member states having debt/GDP ratios above 100% in 2015. The challenge of retaining fiscal responsibility and bringing down debt will be ongoing, especially in the wake of the large inflow of asylum seekers into the EU, which will impact on government spending.

The unemployment rate in some member states remains high, with **Greece** at 25.7% unemployment in 2015, compared to 22.3% in **Spain**, 15.6% in **Cyprus**, 12.6% in **Portugal** and 11.6% in **Slovakia**. However unemployment rates in all the Eurozone members except **Germany** and **Estonia** are forecast to decrease in 2016 and 2017.

Overall the European Union is under pressure as the migrant crisis develops, with countries reluctantly welcoming refugees and anti-immigration parties gaining popularity. Additionally, the risk of the UK exiting the Union in a referendum on June 23rd adds to the uncertainty. How the European institutions handle these crises will determine the future stability of the Union. EU leaders have worked intensively over the last week to secure a deal which Prime Minister David Cameron can attempt to sell to the British public and deliver a 'stay' vote in the upcoming referendum.

United States

Domestic demand progresses as the Fed comes under pressure to lower interest rates.

The US economy is expected to grow steadily in the coming years, with a growth rate of 2.6% yoy in both 2016 and 2017. The growth is rooted in domestic demand as employment continues to increase, financial conditions become more supportive, and energy prices remain low, as well as the strong dollar which improves the purchasing power of Americans. However, the appreciating dollar is affecting export growth negatively which alongside economic turbulence in China is causing sluggish external demand.

After the interest rate hike by the Fed in December 2015, the first increase in nearly a decade, markets were initially expecting the Fed Chairperson Janet Yellen to raise interest rates four times in 2016. However as inflation remains low due to low oil prices, interest rates are unlikely to increase in the near future. Meanwhile both the Swedish and Japanese Central Banks have introduced negative interest rates, which resulted in high volatility in stock prices in early 2016 as growth prospects were questioned. The Fed will decide on interest rates again at their next meeting in mid-March 2016.

Major economies' GDP growth forecasts			
	2015e (%)	2016f (%)	2017f (%)
Global	3.1	3.4	3.6
UK	2.2	2.2	2.2
US	2.5	2.6	2.6
Euro area	1.5	1.7	1.7
Germany	1.5	1.7	1.7
Japan	0.6	1.0	0.3
China	6.9	6.3	6.0
India	7.3	7.5	7.5

Source: IMF World Economic Outlook 19th January 2016.

United Kingdom

Domestically driven growth as net exports remain negative.

The British economy is expected to grow by 2.2% in both 2016 and 2017. Growth is primarily driven by domestic demand, with consumption expected to increase by 2.4% in 2016 and 2.3% in 2017. Consumption is fuelled by growth in real household disposable incomes, increased employment and higher productivity. Exports were boosted in H2 2015 by weaker Sterling, which in January 2016 fell to its lowest level against the Dollar since January 2009. However imports grew by 3% yoy in 2015 compared to 2.2% growth in exports, resulting in negative net exports in 2015. The trade deficit is expected to continue in 2016 and 2017. Investment is projected to grow by 3.9% in 2016 and 3.7% in 2017.

Bank of England governor Mark Carney has stated that interest rates will not increase for the foreseeable future as the British economy may be adversely affected by the turbulence in the global economy. This comes against the backdrop of tough negotiations between the British Prime Minister and the European Council President Donald Tusk last weekend. The deal was secured on Friday 19th February after which David Cameron announced a June 23rd referendum. Sterling has experienced increased volatility this week as the debate over "Brexit" has intensified.

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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