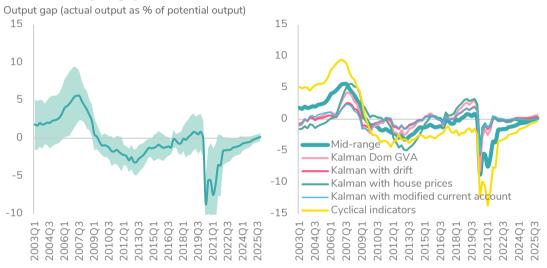
S2. The cycle and imbalances

This section looks at estimates of the Irish cycle and potential imbalances in the Irish economy. Estimates of the cycle are based on the Council's models, which primarily focus on Domestic Gross Value Added — a measure of domestic economic activity that strips out sectors dominated by foreignowned multinationals (see Casey, 2019). Potential output is the maximum level of economic output sustainable where output is not unduly influenced by external, domestic or financial economic imbalances. The output gap is the gap between actual output and its potential.

Council's output gap models

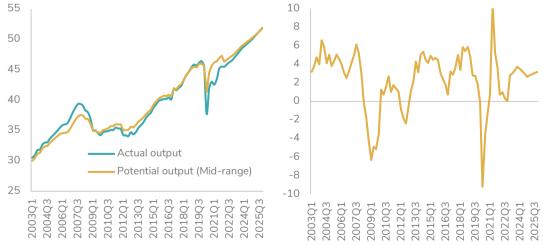


Sources: Fiscal Council workings.

Notes: Fiscal Council models of the output gap are applied to the Department's demand-side forecasts.

Council's estimates of potential output

Levels (€ billion) in left panel and potential output growth rates in right panel



Sources: Fiscal Council workings.

Notes: Fiscal Council models of the output gap are applied to the Department's demand-side forecasts.

As well as producing estimates of the cycle, the Council monitors potential economic imbalances that might be overlooked by single indicators like output gaps. It focuses on four areas in particular: (1) the labour market and prices; (2) Ireland's external balances with the rest of the world; (3) investment and housing; and (4) financial conditions.

The following heat map assesses potential imbalances across four areas based on their departure from historical norms. Colder (bluer) indicators suggest spare capacity, while hotter (redder) suggest potential overheating or other imbalances.

Heat map of economic imbalances

 Tiles show the extent of departure from historical norms (in standard deviations)

 -2.00
 -1.75
 -1.50
 -1.25
 -0.00
 0.25
 0.50
 0.75
 1.00
 1.25
 1.50
 1.75
 2.00
 NA

Aggregate

Output gap Change in output gap

Labour Market and Prices

Unemployment (% labour force) Construction (% total employment) Net migration (% labour force) Inflation (HICP) Core inflation Personal consumption deflator Hourly wage inflation Real hourly wage inflation Relative hourly wage growth (Ireland / Euro Area)

External Balances

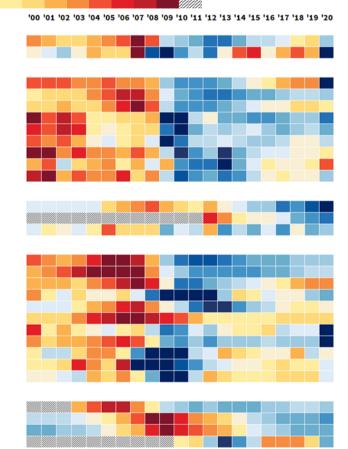
Modified current account (% GNI*) Adjusted NIIP (% GNI*) Change in modified current account (% GNI*)

Investment and Housing

Underlying investment ($\sqrt{6}$ GNI*) New dwelling completions (thousands) Non-residential construction (% GNI*) Residential property price growth Residential price-to-income ratio Residential price-to-rent ratio Household savings ratio (% disposable income) Household net lending/borrowing (% GNI*) Change in underlying investment (% GNI*) Change in new dwelling completions Change in non-residential construction (% GNI*)

Credit and Financial

New mortgage lending (% GNI*) Credit to private sector Ex FI (% GNI*) Adjusted private sector credit (% GNI*) New SME credit (% GNI*)



Sources: The main sources for the data underpinning the table are the CSO; Central Bank of Ireland; Department of Finance; and Fiscal Council workings. For more information on the data used and basis for deriving the heat map, see Timoney and Casey (2018).