DKM
ECONOMIC CONSULTANTS

Economy Watch

Snapshot of Irish Economic Forecasts

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TIMEO GERMANI ET DONA FERENTES

The forecasts for 2010 show a wide variance in expected GDP growth but a surprisingly narrow variation in the projected government borrowing level (excluding the bonfire of public funds for Anglo Irish Bank and Irish Nationwide). Clearly the forecasters believe that come hell or high water the public deficit will be on track, for fear of emulating the Greeks. With the big stick of EU (read German) prior inspection hanging over the 2011 Budget, the 2010 outturn will be on target even if that means a further brake on spending.

The first casualty of war is not truth but objectivity. And Ireland is in a war against the market which wants to punish profligate borrowers by raising the cost of their funding and throwing into doubt their commitment to the Euro. The brokers, who have to sell bonds and shares to skeptical foreigners, have rallied to the cause hailing each on-target Exchequer return as an important victory and projecting relatively strong 2010 and 2011 outturns for growth and borrowing.

Strangely, none of the forecasters, broker or not, currently envisage more than a 2.6 percentage point decline in the public borrowing requirement as a % of GDP for 2011, reflecting a more leisurely approach to reaching the EU target considered acceptable in the pre-Hellenic days. Those projecting the highest growth in 2011 are, generally, also those projecting the lowest relative borrowing requirement.

Perhaps we have moved to a situation of Ricardian equivalence in Ireland where the private sector automatically offsets any stimulus or contraction emanating from the public sector. If so, the few remaining die-hards of the Chicago School will rejoice. But one suspects that the contractionary effects of any serious move to reduce the public deficit in 2011 are understated.

Perhaps it is the case that 2010 public capital spending is mainly paying the bills for actual activity in 2008 and 2009 so that even a much lower level of 2011 spending will generate more construction activity. But I doubt it. In any event it is hard to see an expansion in production and export of pharmaceuticals, medical devices and software offsetting the impact of reduced public spending and higher tax rates in 2011. The apparent stabilisation of employment may encourage consumers to open their wallets. But that will be after the Exchequer has already helped itself to much of the contents to meet the 2011 borrowing target.

The consensus projection for 2011 shows growth in Ireland well above the EU average and second only to Slovakia. If that is achieved, while substantially reducing the public deficit, then the world media will arrive, not to gloat at our bust but to marvel at our unique performance. But don't book the National Convention Centre for the moment.

In this issue:

- 2009 an *Annus Horribilis* but economy expected to stabilise over 2010/2011.
- The worst may be over with some improvement in consumer sentiment and the traded sector.
- Exports to lead modest recovery, but no improvements in sight for unemployment.
- Competitiveness improving, but Sterling instability a concern.

Forecasts At a Glance

	2009a %	2010f %	2011f %
GNP	-11.3	-1.4	2.6
GDP	-7.1	-0.5	2.9
Private Consumption	-7.2	-1.5	1.9
Public Expenditure	-1.2	-3.0	-0.9
Investment	-29.7	-17.8	0.9
Exports	-2.3	2.3	4.3
Imports	-9.3	-1.2	2.8
Unemployment Rate	11.8	13.5	12.8
Employment Growth	-0.1	-3.0	0.6
Wage Growth	-2.0	-3.8	-0.8
CPI Inflation	-4.5	-1.1	1.7
HICP Inflation	-1.7	-1.3	0.8
General Gov. Balance	-14.3	-11.9	-10.1

Snapshot of Irish Economic Forecasts

Annual % change

	GNP		GDP		Private Consumption		Public Expenditure		Investment		Exports		Imports		Forecast Date
	2010	2011	2010	2011	2010	2011	2010	2011	2010	2011	2010	2011	2010	2011	
AIB	-2.7	2.0	-2.0	2.5	-3.0	2.0	-3.0	-0.5	-24.0	-3.0	2.0	4.0	-1.5	2.5	Apr-10
BOI	-1.0	2.5	1.0	3.0	0.0	2.0	-3.0	-1.0	-20.0	-5.0	3.0	6.0	-1.0	4.0	Apr-10
Bloxhams	-4.0	2.0	-0.8	3.0	-1.8	2.2	-3.0	0.0	-19.5	3.0	2.0	3.5	-2.5	1.5	Apr-10
Central Bank	-1.5	2.4	-0.5	2.8	-2.6	1.1	-3.0	-0.5	-16.1	-3.4	2.0	4.3	-1.1	2.6	Apr-10
Davy	-0.6	2.9	1.0	4.2	1.0	4.0	-5.0	-2.0	-12.8	-0.6	2.5	6.0	1.4	5.0	Apr-10
Dept Finance	-1.7	3.0	-1.3	3.3	-3.0	2.6	-3.0	-0.5	-19.2	4.5	0.4	3.4	-2.8	2.6	Dec-09
ESRI	0.0	2.8	-0.5	2.5	-0.8	1.5	-3.0	-2.0	-20.3	2.5	2.3	4.5	-1.3	3.5	Apr-10
EU			-0.9	3.0	-2.4	1.4	-2.7	2.0	-17.6	4.2	2.0	4.3	-1.3	3.5	May-10
Goodbody	-1.2	2.8	-1.0	2.8	-2.0	1.0	-2.5	-2.5	-21.7	2.6	1.5	3.3	-3.0	0.7	Apr-10
IBEC	-1.0	1.9	-0.7	2.1	-2.5	2.0	-3.0	-1.5	-15.0	-0.5	2.0	3.8	-1.5	2.9	Apr-10
IMF			-1.5	1.9											Apr-10
NCB	-0.5	2.8	0.6	3.3	-0.2	2.1	-2.8	-1.4	-15.6	2.1	3.2	3.7	-0.5	1.7	Mar-10
NIB			0.0	3.5	-2.0	3.0	-2.0	-2.0	-12.0	0.0	4.0	5.0	1.0	3.0	Apr-10
OECD			-2.3	1.0	-2.2	-1.4	-2.9	1.3	-16.7	0.5	1.1	2.4	-0.6	1.2	Nov-09
Ulster Bank	-1.2	3.5	-0.5	3.5	-1.1	2.4	-3.0	-0.7	-19.3	7.4	2.5	4.3	-3.0	3.6	Apr-10
Average	**-1.4**	**2.6**	**-0.5**	**2.9**	**-1.5**	**1.9**	**-3.0**	**-0.9**	**-17.8**	**0.9**	**2.3**	**4.3**	**-1.2**	**2.8**	

The Worst may be past

The outturn for 2009 was even worse than most commentators expected, with GNP contracting by an extraordinary 11.3%. A more modest contraction of 1.4% is projected for 2010, before a return to growth of 2.6% in 2011.

2009 was clearly the economic nadir for Ireland, recording as it did the biggest contraction on record. Between 2007 and 2010 GNP will have fallen by 15%. On a quarterly basis the numbers are even more drastic: from Q1 2008 to Q4 2009 GNP has fallen 17.2% (seasonally adjusted).

Quarterly data can also call the turn in a trend quicker than annual data. While the momentum of last year's numbers will generate negative growth for 2010 as a whole, many commentators now believe that the economy began to grow in Q1 2010, and that this growth will consolidate quarter-on-quarter going forward.

A number of important indicators have turned positive, helped by the global economic recovery which will in particular increase demand for Irish exports.

The internal devaluation in Ireland appears to be continuing apace, and falling prices and wages have given a welcome boost to competitiveness.

The unfolding Greek crisis and the unprecedented steps taken by EU finance ministers to prevent contagion underlines how fragile things are, however. It also proves the adage "it's an ill wind that blows no good", as the resultant Euro weakness eases the pressure for internal adjustment (more on page 4).

Instability and uncertainty are the order of the day for the short term at least, however, as the fortunes of Sterling will be dependent on the actions of the new UK Government in the coming months.

Improvement in retail & consumer sentiment

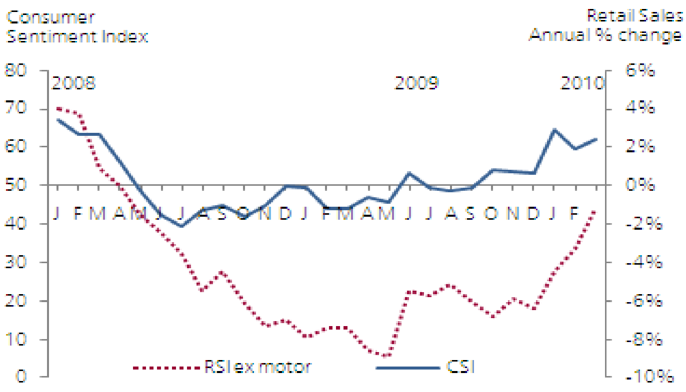
Year-on-year Retail Sales volumes grew in both February and March 2010, for the first time since early 2008, largely due to the boost to car sales. With car sales stripped out, yoy retail volumes are still falling, albeit at a slowing pace (see chart). Meanwhile Consumer Sentiment is improving steadily, and has been firmly in positive territory (indicated by a score above 50) since late 2009.

A majority of retail sectors actually recorded yoy growth in March, but a number of important sectors remain strongly negative, notably the Licensed Trade, Fuel, Hardware and Books & Newspapers.

Private Consumption volumes are expected to contract further in 2010 yoy, before recording modest growth in 2011. On a value basis the yoy figures are more negative, reflecting price deflation over the last year.

House prices were 18.9% lower in Q1 2010 compared with Q1 2009, and are 34% below the peak in Q4 2006 (ptsb/ESRI House Price Index). There is no sign of a turning point in this series. Indeed, such was the dearth of housing transactions in early 2010 that the index has been changed from monthly to quarterly. Consumers or banks or both clearly believe there will be more downward adjustment before this market stabilises.

Retail Sales and Consumer Sentiment



Source: CSO, KBC/ESRI.

For better or worse, we are now firmly in the embrace of NAMA, with the recent transfer of the first tranche of loans from the banks. This was accompanied by further disconcerting revelations of banking mal-practice, and it remains to be seen whether the hoped for freeing up of the credit and property markets will materialise.

However, such is the overhang of unsold property that there will be a substantial lag between the property markets starting to move again and actual new investment materialising.

DOMESTIC PERFORMANCE

Snapshot of Irish Economic Forecasts

Annual % change * year average; **underlying GGB (excl recapitalisation of Anglo-Irish Bank and INBS) as a % of GDP; DOF 2010 forecast dated April 2010.

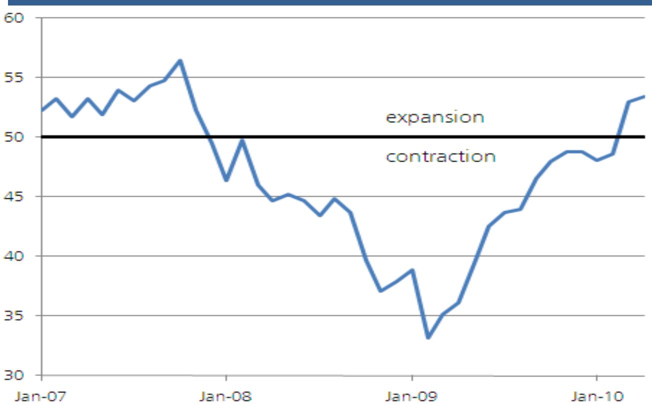
	Unemployment Rate*		Employment Growth		Wage Inflation		CPI Inflation		HICP Inflation		General Govt. Balance**		Forecast Date
	2010	2011	2010	2011	2010	2011	2010	2011	2010	2011	2010	2011	
AIB	13.5	13.6	-4.2	0.0	-5.2	-1.0	-0.7	2.0	-1.0	1.0	-11.7	-10.4	Apr-10
BOI	13.4	12.4	-4.0	0.0			-1.2	2.0	-1.3	1.5	-11.6	-9.0	Apr-10
Bloxhams	12.8	11.8	-2.1	1.3	-3.0	0.0	-1.2	2.3	-1.2	2.0	-11.2	-9.4	Apr-10
Central Bank	13.7	13.2	-3.9	-0.5	-6.1	-2.1	-1.4	1.1	-1.3	0.7	-11.6	-10.0	Apr-10
Davy	13.6	12.9	-3.7	0.9	-2.0	1.0	-1.9	0.4	-2.1	-1.2	-10.9	-10.1	Apr-10
Dept Finance	13.2	12.6	-3.4	1.0			-0.8	1.8	-1.2	1.0	-11.5	-10.0	Dec-09
ESRI	13.8	13.0	-3.8	0.1	-3.0	-1.0	0.3	1.8	-1.5	0.5	-12.0	-10.8	Apr-10
EU	13.8	13.4	-3.5	0.4	-5.0	-1.7			-1.3	0.8	-11.7	-12.1	May-10
Goodbody	13.7	12.8	-3.0	1.1	-3.2	-1.3	-1.5	1.0			-11.1	-9.0	Apr-10
IBEC	13.7	12.6	-3.5	0.0	-2.5	-0.5	-1.1	1.7	-1.1	1.3	-11.2	-10.0	Apr-10
IMF	13.5	13.0	1.9	1.9					-1.1	0.1	-12.2	-11.0	Apr-10
NCB	13.2	12.1	-1.5	1.7			-1.4	1.5	-1.2	1.1	-11.0	-9.5	Mar-10
NIB	13.2	12.0							-1.0	1.0			Apr-10
OECD	14.0	13.8							-0.7	0.4	-12.2	-11.6	Nov-09
Ulster Bank	13.6	13.0	-4.2	0.5			-0.8	3.0	-1.5	0.8	-11.5	-9.6	Apr-10
Average	**13.5**	**12.8**	**-3.0**	**0.6**	**-3.8**	**-0.8**	**-1.1**	**1.7**	**-1.3**	**0.8**	**-11.9**	**-10.1**	

More hope for an export-led recovery

The strongest element of the economy going forward is expected to be the traded sector. Exports are projected to grow by 2.3% in 2010, accelerating to 4.3% in 2011.

The volume of exports fell by 2.3% in 2009, while imports shrank by 9.3%, reflecting weak domestic demand. Imports are also expected to fall by a further 1.2% in 2010, before recording 2.8% growth in 2011 as consumption recovers. After 27 straight months in negative territory, the NCB Purchasing Managers' Index (PMI) finally turned positive in March 2010, although it had been on an improving trajectory for the last year (see chart).

NCB Purchasing Managers' Index



Source: NCB

Irish competitiveness has improved by over 5% since late 2009, as a result of a stronger Pound Sterling and price deflation in the domestic economy. Ongoing Sterling instability is a concern however.

The CPI fell by 4.5% in 2009 and is expected to fall a further 1.1% in 2010, before recording modest growth of 1.7% in 2011. On a monthly basis, prices peaked in September 2008, and as of April 2010 are 7.1% lower.

Unemployment will remain high

Unemployment averaged 11.8% in 2009, but reached 13.2% by December, and has stabilised at 13.4% in the first four months of this year. The rate is expected to average 13.5% over 2010, before falling back slightly to 12.8% in 2011. Thus there is little short term relief in sight for jobseekers.

The weak labour market is also reflected in projections of wage inflation, with wages expected to fall in both 2010 and 2011.

Combined with the expected growth in exports, we appear to be returning to the "jobless growth" of the late Eighties and early Nineties. It is to be hoped that improvements in the labour market will eventually follow, as happened in the mid- to late-Nineties.

Fiscal stability an ongoing challenge

General Government Balance restated to -14.3% in 2009. Expected to gradually improve to -10.1% by 2011.

Whatever comfort could be taken from the Government's steps to tackle the fiscal deficit in 2009 was dealt a psychological blow by Eurostat's decision to include the recapitalisation of Anglo-Irish Bank in the deficit calculation. While this is a book-keeping adjustment, the optics are not good, as it means that Ireland had the largest recorded deficit in the EU last year, higher even than Greece.

Looking at actual Exchequer performance thus far this year, the results for April were in line with expectations, but were ahead on VAT, CGT and Corporation Tax. Income tax receipts however remain weak. More positively, expenditure is also behind forecast.

Given the lag between activity and tax receipts, a number of commentators expect revenues to beat expectations for the year as a whole. This is not to minimise the considerable challenge of achieving the EU Stability Pact target of 3% of GDP by 2015, not helped by the reduction in flexibility created by the Croke Park agreement with the public sector unions (see more in chairman's opinion piece on page 1).

FOCUS ON THE EXTERNAL ENVIRONMENT

The recovery in the global economy is now well established, albeit the pace of growth is far from uniform. Worryingly for Ireland, there are concerns about both the UK and the Eurozone going forward. Following the UK election, a significant fiscal contraction there is unavoidable, which will dampen demand for Irish exports. The Eurozone countries are in general recording muted growth, and worries about the stability of the common currency are overshadowing other concerns. US growth slowed somewhat in Q1 2010, but still recorded a respectable 3.2% annualised, and is expected to outstrip growth in other developed regions. Meanwhile South-East Asia and the other large emerging economies continue to power ahead.

Major economies GDP growth forecasts

	2009a %	2010f %	2011f %
UK	-4.9	1.2	2.1
US	-2.4	2.8	2.5
Eurozone	-4.1	0.9	1.5
Germany	-5.0	1.2	1.6
Japan	-5.2	2.1	1.5
China	8.7	10.3	9.4
India	5.7	8.1	8.0

Source: European Commission

UK

UK GDP shrank by 4.9% in 2009, in line with most major economies. The economy grew in Q4 2009, expanding by 0.4% qoq, a performance repeated in Q1 2010. This is expected to accelerate moderately to 0.5% in the remaining quarters of this year, and to 0.6% per quarter in 2011. Unemployment reached 8% in Q3 2009 and has remained at that level since. It is expected to average 7.8% over 2010, before moderating slightly to 7.4% in 2011.

How the new Government will tackle the fiscal deficit is the overarching concern with the UK economy. A related concern centres around monetary policy and the impact on the value of Sterling. The General Government Balance in the UK in 2009 was -11.5%, right up there with Ireland and Greece, and is recognised as being unsustainable, although it is expected to reach -12% in 2010. The fiscal retrenchment needed to tackle the deficit will have a depressing impact on domestic demand for the coming years, and hence on Irish exports to the UK.

US

Economic growth resumed in the US in the second half of 2009, helped along by substantial fiscal and monetary stimulus, and the economy has now recorded three consecutive quarters of growth. Q4 2009 growth was particularly strong, due in large measure to a sharp decline in the rate of destocking. This effect is a one-off, however, as was reflected in the fall back in growth recorded in Q1 2010.

Consumer expenditure and investment in plant and machinery have also expanded in recent quarters as the household savings ratio has stabilised, although the housing market is still weak.

Unemployment remains a problem, and reached 10% in Q4 2009. The one upside of this is that inflation remains subdued despite the stimulus (prices fell slightly in 2009), reflecting the level of under-utilised resources and weak demand in the economy.

The fiscal deficit, as elsewhere, is an issue, hitting 11% in 2009. This points to difficulties going forward as the stimulus package will have to be reversed in order to rein in the deficit. However, it is expected to unwind only slowly, barely dipping below 10% in 2011.

Eurozone

The Eurozone economies, having contracted sharply in 2009, are expected to recover slowly, with growth of 0.9% in 2010 and 1.5% in 2011. Growth will be variable across the zone, however. Several countries (Ireland included) will record negative growth in 2010, while the bulk of countries will grow by no more than 1.3%. For 2011, interestingly, Ireland is projected to be one of the strongest performers in the Eurozone with twice the average growth rate - only Slovakia is expected to perform better.

This is being overshadowed, however, by the ongoing need to finance large fiscal deficits in many countries, and the resultant uncertainty over the stability of the currency.

Greece is the Eurozone's obvious litmus paper, but Portugal, Spain, Ireland and possibly Italy are also weak links. Between them they represent a substantial chunk of the Eurozone economy, hence the need for a €750 billion fund, designed to head off any doubts about the zone's willingness and capacity to assist members in difficulty. Without this commitment, there was a real danger of a shutdown of the sovereign debt market in the short term.

This development is a step towards the type of federal fiscal relationship that is inevitable in a largescale currency union, but which the politicians of Europe thought they could dodge until now. It will be accompanied by much more intrusion into national budget setting. One proposal would see EU finance ministers seeing national budgets before national parliaments do. The United States of Europe is one considerable step closer.

(Forecasts quoted here draw largely on the EU Commission's *European Economic Forecast – Spring 2010*).

NOTE: The average figures presented in this report represent a weighted average of the latest forecasts for the Irish economy from 15 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.

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