DKM
ECONOMIC CONSULTANTS

Economy Watch

Snapshot of Irish Economic Forecasts

Issue 9, October 2011

SLOUCHING TOWARDS A MAÑANA REPUBLIC

It has been a constant theme of these comments in *Economy Watch* that the pace of fiscal consolidation was too slow and that announcements of future fiscal pain – without the details – was almost as deflationary as implementation of the measures themselves.

The recent excellent report of the Irish Fiscal Advisory Council* supports the notion that the path of fiscal adjustment is too stately and should be accelerated, albeit more modestly than we think appropriate. Unfortunately the report did not deal with two fundamental issues.

First, to what extent are the current expenditure plans by consumers and investors affected by the certainty that there will be substantial tax increases and public expenditure cuts in 2013 and 2014. Second, to what extent will a government deficit of 8 per cent plus of GDP in 2012 be an outlier in the deficit experience within the Euro area.

It is inconceivable that expectations about future fiscal policy do not affect current consumption and investment decisions. The promise of a property tax of an undisclosed size must surely affect house buying decisions or even decisions regarding property refurbishment and extensions. Similarly the threat of future public expenditure cuts must surely affect the savings behaviour of those dependent for their income on the public sector.

The reason for the focus on government borrowing – and presumably the rationale for the creation of the Council – is that, at present, the Exchequer is unable to fund itself through public markets at a reasonable cost and so is forced to rely on EU/IMF funding sources. The main objective in reducing the government borrowing requirement is to ensure that public markets will provide financing at reasonable terms to the Exchequer.

The relative cost of public market funding for Ireland will not depend solely on future fiscal targets or even recent fiscal consolidation. It will also depend on how Ireland looks – as a borrower – relative to other EU economies. While market faith in deficit projections by national governments is weak there is little doubt that if Ireland continues on the leisurely path to fiscal adjustment it will be an outlier among Euro members with a far higher fiscal deficit than most of the countries under pressure.

With Spain, Italy and Portugal currently planning far lower public deficits relative to GDP in 2012 (and France planning a tighter fiscal stance in 2012 in order to maintain its credit rating) the Irish borrowing requirement will appear very high to the market regardless of where it has come from and where it is planned to go.

All this suggests that it would be better if the Government, insulated by a sizeable parliamentary majority, bit the bullet and made the necessary adjustments now rather than spread them over three years. However it looks as if the Coalition will, as its predecessors did to their own destruction, kick to touch in the hope that something will turn up to reduce the need for adjustment in later years.

* www.fiscalcouncil.ie/publications

In this issue:

- **A positive outlook for GDP growth in 2011 and 2012 despite projections of contracting domestic demand.**
- **Exports will to lead the recovery in 2011 despite more unfavourable exchange rates with our trading partners.**
- **The *DKM Snapshot* projects a General Government Deficit of 9.88% of GDP in 2011 compared to the target of 10.5%.**
- **Unemployment rate to peak at 14.2% in 2011 before retreating slightly to 13.9% in 2012.**

Forecasts At a Glance

(a: Actual, f: Forecast)	2010a %	2011f %	2012f %
GNP	0.3	-0.1	0.8
GDP	-0.4	1.0	1.7
Private Consumption	-0.8	-2.4	-0.4
Public Expenditure	-3.8	-3.5	-2.9
Investment	-24.9	-8.7	-0.6
Exports	6.3	5.1	4.3
Imports	2.7	2.3	2.6
Unemployment Rate	13.6	14.2	13.9
Employment Growth	-4.2	-1.8	0.2
Wage Growth	-2.9	-1.2	-0.1
CPI Inflation	-1.0	2.2	1.4
HICP Inflation	-1.6	1.1	1.0
General Gov. Balance	-11.5	-9.88	-8.32

Snapshot of Irish Economic Forecasts

Annual real % change

	GNP		GDP		Private Consumption		Public Expenditure		Investment		Exports		Imports		Forecast Date
	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	
AIB	-0.3	1.0	0.7	1.5	-2.5	-0.5	-3.0	-2.0	-12.3	-3.0	4.2	3.0	1.0	1.0	Oct-11
BOI	1.0	1.5	1.5	2.2	-2.5	-1.0	-3.5	-2.0	-10.5	2.5	5.0	4.0	2.0	2.0	Oct-11
Bloxhams	0.4	1.0	0.8	1.5	-2.3	0.0	-3.3	-3.5	-12.5	-3.0	4.5	3.2	1.5	2.0	Oct-11
Central Bank	-0.4	0.7	1.0	1.8	-2.6	-0.8	-3.8	-3.6	-9.2	-0.5	5.3	5.2	2.7	3.2	Oct-11
Davy	0.2	1.0	1.1	1.7	-3.0	-1.1	-3.0	-3.2	-5.5	-0.3	5.7	4.8	2.7	3.0	Sep-11
Dept Finance	0.3	2.0	0.8	2.5	-1.8	0.0	-3.0	-2.3	-11.5	1.0	6.8	5.7	4.7	4.1	May-11
ESRI	0.2	0.7	1.8	2.3	-1.3	0.0	-3.3	-4.0	-6.7	-2.8	7.0	7.4	4.9	5.8	Aug-11
EU			0.6	1.9	-1.9	-1.0	-4.4	-0.4	-13.5	2.0	6.0	5.2	3.2	4.0	May-11
Goodbody	0.0	0.7	1.3	1.2	-2.3	-0.8	-3.5	-3.5	-9.0	-3.2	4.3	2.8	1.8	1.1	Oct-11
IBEC	0.4	1.6	1.4	2.4	-2.0	-0.5	-3.5	-4.0	-7.5	6.8	5.0	4.5	2.1	2.8	Oct-11
IMF			0.4	1.5											Oct-11
NCB	-1.8	-1.1	-0.7	1.7	-3.0	0.0	-3.5	-3.4	-9.3	-1.5	6.0	5.0	3.0	3.0	Sep-11
NIB			1.6	1.9	-2.0	0.5	-4.0	-2.0	-4.0	0.0	4.2	4.0	2.2	2.5	Sep-11
OECD			1.2	1.0	-2.5	-0.5	-3.4	-2.0	-6.3	-3.3	4.2	3.3	0.7	1.1	Oct-11
Ulster Bank	-0.8	0.8	0.3	1.5	-3.1	-0.4	-3.9	-2.5	-9.1	0.7	5.3	4.0	1.9	3.0	Aug-11
Average	**-0.1**	**0.8**	**1.0**	**1.7**	**-2.4**	**-0.4**	**-3.5**	**-2.9**	**-8.7**	**-0.6**	**5.1**	**4.3**	**2.3**	**2.6**	

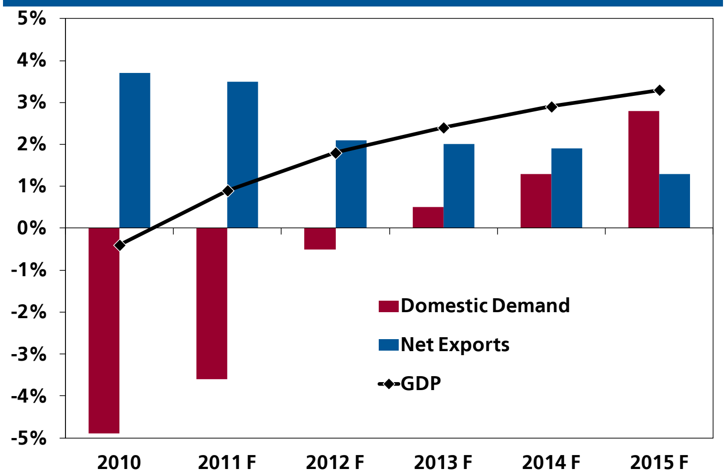
Weak domestic demand continues to drag on Ireland's economic recovery...

Household consumption, government spending and gross investment look set to contract even further in 2011, while GDP is expected to increase at a modest rate of 1.0% supported by a strong trade surplus.

Revised National Accounts figures indicate that the economy, as measured by GNP, actually expanded in 2010 by 0.3%, but GDP declined by 0.4%.

Robust export growth of 6.3% in 2010 resulted in a record high trade surplus and provided the economy with a much needed lifeline. Latest monthly figures indicate that exports increased (seasonally adjusted) by 10% in August 2011, resulting in a 15% increase in the trade surplus to €3,699 million, compared to July. Projected export growth of 5.1% for 2011 as a whole will continue to prop up economic growth.

Key Economic Growth Indicators 2010-2015



Source: IMF September 2011 (GDP 2013-2015)
GDP growth 2011-2012 as per *DKM Snapshot*

The remarkable performance of exports continues to be somewhat overshadowed by a sustained annual decline in domestic demand. An elevated private savings rate and an increased tax burden have inevitably impacted on personal consumption levels, but the projected decline of 2.4% in consumption this year can also be attributed to diminishing real incomes, as earnings continue to contract modestly in the face of inflation.

Fixed investment has been decimated since 2008 primarily due to the pace and depth of the construction downturn. This trend will continue in 2011 despite a quarterly increase of 6.4% (seasonally adjusted) in Q2 2011 – which incidentally resulted from the purchase of aircraft. With the bottoming out of residential and commercial construction in sight, the sharp declines in investment are expected to moderate in 2012.

Continued fiscal consolidation will further squeeze government expenditure this year. Despite this, there have been calls for the Government to ramp up consolidation measures in the forthcoming Budget compared to what has been agreed in the EU/IMF adjustment programme.

...but fiscal policy remains on track, for now

The International Monetary Fund's (IMF) recently published country report states that Ireland's fiscal policy is in a good position to achieve the 2011 General Government deficit target of 10.5% of GDP.

In the context of reducing the deficit to below 3% of GDP by 2015, the Government has committed to implementing savings of at least €3.6 billion in Budget 2012 through a combination of expenditure cuts and tax measures. There are risks however as to whether this level of consolidation can be sustained in subsequent years and this has prompted the Fiscal Advisory Council to call for an additional discretionary adjustment of €400 million in the forthcoming Budget.

Interestingly, the *DKM Snapshot* indicates that the State will surpass this target by achieving a deficit of 9.88% of GDP this year, followed by 8.32% in 2012 (see figures overleaf).

The Government is currently preparing a programme for the sale of State assets in an effort to achieve €5 billion identified in a recent Review of State Assets and Liabilities. It is envisaged that the proceeds will be realised before 2015.

Against this backdrop, Ireland has received international plaudits for the manner in which it is implementing its austerity measures. This is, of course, relative to the other bailed out countries, in particular Greece. The risk of contagion to Ireland from a Greek default has eased following the recent announcement by European policymakers.

Notwithstanding this, Ireland has yet to return to the international lending markets, from which the current fiscal policy will be ultimately judged.

Snapshot of Irish Economic Forecasts

Annual %real change

* year average;
** underlying GGB as a % of GDP (excluding State support to the banking sector)

	Unemployment Rate*		Employment Growth		Wage Inflation		CPI Inflation		HICP Inflation		General Govt. Balance**		Forecast Date
	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	
AIB	14.2	14.1	-1.9	0.0	-3.0	-1.0	2.6	1.7	1.2	1.2	-10.00	-8.60	Oct-11
BOI	14.2	13.9	-1.8	0.3			2.7	1.7	1.2	1.0			Oct-11
Bloxhams	14.2	14.0	-1.9	-0.9	-1.0	0.5	2.5	2.0	1.0	1.0	-10.00	-8.60	Oct-11
Central Bank	14.2	14.0	-1.7	0.1			2.2	0.9	1.2	0.7			Oct-11
Davy	14.3	13.9	-1.7	0.6	-0.4	0.9	2.6	1.2	1.4	1.2	-9.70	-8.60	Sep-11
Dept Finance	14.4	13.7	-1.6	0.5			2.5		1.0		-10.00		May-11
ESRI	14.3	14.5	-2.4	0.7	0.0	1.0	3.0	1.0	1.3	1.0	-9.30	-7.10	Aug-11
EU	14.6	14.0	-1.5	0.4	-2.5	-0.9			1.0	0.7	-9.50	-8.50	May-11
Goodbody	14.2	13.8	-1.7	0.0	-1.2	-1.5	2.6	2.2			-9.90	-8.10	Oct-11
IBEC	14.0	13.0	-1.5	0.9			2.5	1.5	1.2	1.0			Oct-11
IMF							1.1	0.6			-10.30	-8.60	Oct-11
NCB	14.3	13.8	-1.8	0.5			2.3	2.2	1.6	1.8	-9.80	-8.00	Sep-11
NIB	14.3	14.0							1.0	1.0			Sep-11
OECD	14.2	14.2							1.3	0.9	-10.00	-8.60	Oct-11
Ulster Bank	14.1	14.0	-2.1	-0.4			2.6	2.1	1.3	1.1	-10.10	-8.80	Aug-11
Average	**14.2**	**13.9**	**-1.8**	**0.2**	**-1.2**	**-0.1**	**2.2**	**1.4**	**1.1**	**1.0**	**-9.88**	**-8.32**	

No improvement in consumer sentiment as retail sales decline further...

Consumer confidence, as measured by the KBC/ESRI 3-month moving average index, slipped to 55 points in September 2011 compared to 60 in September 2010.

The deterioration in consumer sentiment is mirrored by a 3.9% decrease in the volume of retail sales in September 2011 compared with September 2010. Core retail sales did not differ greatly from the overall rate as motor trades declined by 5.4%. Furniture and lighting (-11.7%), Books, newspapers and stationary (-10.1%) and pharmaceuticals (-8.9%) were worst affected, while electrical goods was the only sector to record an increase in year-on-year sales (+3.2%).

... while unfavourable exchange rates impact on competitiveness

The Euro appreciated by 5.4% and 9.6% against the Pound Sterling and the Dollar respectively in Q3 2011 compared with the same period in 2010.

The appreciation against the currency of our main trading partner, the United Kingdom, has had an unfavourable effect on indigenous exporters. This is reflected in the real Harmonised Competitiveness Indicator, which showed a slight loss of competitiveness having deteriorated by 0.8% year-on-year in the 3 months to the end of September 2011.

Weaker inflation in Ireland compared to our main trading partners prevented competitiveness from deteriorating even further over this period.

Manufacturing production improves...

According to the CSO, production for manufacturing industries was 11.4% higher in August 2011.

The modern sector, which includes high technology and chemicals sectors, recorded an annual increase of 10.2% in August, while all other sectors (traditional) were up 10.8% over the same period.

Indications from the 3-month rolling averages show an increase of 1.2% in manufacturing output at the end of August compared with the end of May.

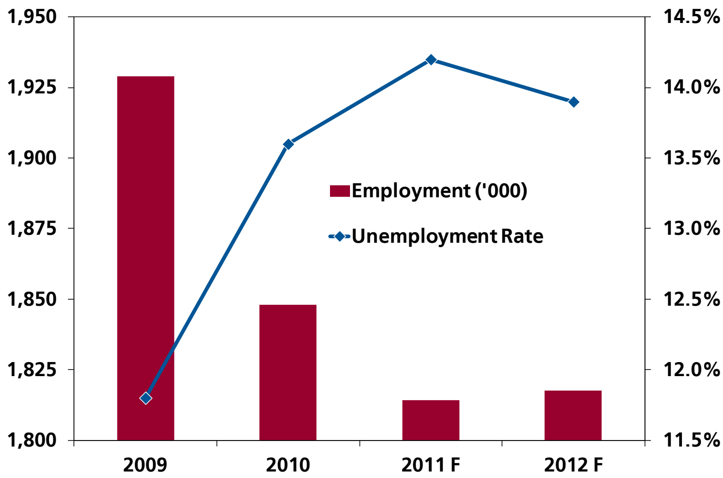
The NCB Purchasing Managers' Index however suggests that manufacturing output declined in September at its fastest rate since September 2009.

Unemployment expected to peak in 2011...

The unemployment rate rose to 13.6% in 2010 and is expected to increase further to an average of 14.2% in 2011, before retreating slightly to 13.9% in 2012.

The unemployment burden is one of the greatest challenges facing Ireland's policymakers at present. The latest available figures indicate that there were 304,500 persons (14.3%) unemployed as of Q2 2011. The number of people unemployed for more than one year accounted for approximately 54% of total unemployment in that period. This figure is rising rapidly and it is the first time since the late nineties that the long-term unemployed accounted for more than half of total unemployment.

Ireland's Labour Market 2009-2012



Source: DKM Snapshot

Certain subgroups have been particularly affected by the lack of employment. More than half of those unemployed are aged between 35 and 44. Moreover, males have been disproportionately affected, partially due to the demise of construction, with the male unemployment rate currently estimated at 17.5% compared with the female unemployment rate of 10.4%.

Despite the announcement of a Jobs Initiative in May 2011, the Live Register figures for September, which include part-time workers, provide little cause for optimism with just over 437,000 signing on.

FOCUS ON THE EXTERNAL ENVIRONMENT*

Economic activity in advanced economies (US, Euro Area, UK, Canada, and Japan) was particularly weak in the opening half of 2011 due to unanticipated global developments and in particular the sovereign debt and banking sector problems in the Euro Area. These unexpected disruptions have resulted in a sharp deterioration of consumer and business confidence across developed economies. Despite this however, if policymakers successfully tackle difficult economic challenges, the return to more robust activity in advanced economies will then be delayed rather than derailed by the turmoil. On this basis, the IMF expects output in advanced economies to increase by 1.6% in 2011 followed by 1.9% in 2012. While global output expanded by 5.1% in 2010, this growth is expected to moderate to 4% both this year and in 2012.

Euro Area

European policymakers, threatened by a major recession, respond with decisive action.

After a surprisingly strong first quarter, the recovery in Europe lost momentum in Q2 due to the escalation of the Euro Area crisis and a series of global shocks which have impacted on domestic demand.

With Europe at the epicentre of a global financial crisis, the threat of a major recession has negatively impacted on business and consumer confidence throughout the region. The annual rate of GDP growth in the Euro Area stood at approximately 2% in the first half of 2011. This is expected to slow to 0.25% in the second half of the year, as austerity measures aimed at tackling high public deficits and debt, weigh on growth in much of advanced Europe.

The President of the ECB has warned that Europe faces the worst crisis since World War II unless important decisions are taken. Key policymakers responded with a plan that requires banks to write off 50% of Greek debt. Additional measures agreed involve expanding the European bail-out fund to €1 trillion and providing Greece with an additional €100 billion.

The IMF assumes that the European response will be sufficient and envisages Europe averting a major recession with growth of 1.6% this year, followed by growth of 1.1% in 2012.

US

The US economy continues to limp along.

Latest figures from the US Bureau of Economic Analysis indicate that US output recorded quarterly growth of just 0.1% in Q1 and 0.3% in Q2 of this year. Annualised growth stood at 1.3% in Q2 2011 compared to 3.8% in Q2 2010. Notwithstanding a weakened performance, the economy remains in positive growth territory and while unemployment remained elevated at 9.1% (seasonally adjusted) in September 2011, it is a slight improvement on the 9.6% rate recorded in September 2010.

There are obvious downside risks to the US economy resulting from fiscal consolidation, a weak housing market and increased household savings, and while each of these warrant particular attention, deep political divisions continue to hamper the process. The implementation of certain policies will be required to sustain the recovery but it is imperative that a plan is implemented to put public debt on a sustainable path.

The materialisation of either of these risks has the potential to further weaken the domestic outlook of 1.5% growth in 2011, which would have severe repercussions for global growth.

Major economies GDP growth forecasts*

	2010a %	2011f %	2012f %
UK	1.4	1.1	1.6
US	3.0	1.5	1.8
Eurozone	1.8	1.6	1.1
Germany	3.6	2.7	1.3
Japan	4.0	-0.5	2.3
China	10.3	9.5	9.0
India	10.1	7.8	7.5

Source: IMF September 2011.

UK

Latest indications are of a very tepid recovery in the UK.

The first half of 2011 failed to sustain 2010 growth levels of 1.4%, having increased by a mere 0.4% and 0.1% in the first two respective quarters. Latest quarterly accounts show that household expenditure continued to decline at a faster rate of 0.8%, and while industrial production also fell by 1.2%, manufacturing rose slightly (0.2%). Quarterly increases were also recorded in services (0.2%) and construction (1.1%).

The recent decision by the Bank of England to add another £75 billion of Quantitative Easing is unlikely to be sufficient to restore the economic recovery whereas inflationary pressures will inevitably weigh on activity.

Negative wealth effects, depressed real disposable incomes and fiscal consolidation are all factors that have contributed to the sluggish economic growth projection of just 1.1% for 2011. This is expected to increase to 1.6% in 2012 due to the strengthening of net export growth resulting from past depreciation of the pound.

*Forecasts quoted here draw largely on the IMF World Economic Outlook – September 2011 and the IMF Regional Economic Outlook – Europe, October 2011.

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.

Telephone: +353 1 6670372; Fax: +353 1 6144499; Email: info@dkm.ie; Website: www.dkm.ie