

Quarterly ECONOMIC OUTLOOK



July 2012

Economy resilient in difficult external conditions

There were a number of positive domestic developments on the economic front recently but unfortunately the weakening external environment continues to delay a meaningful recovery in growth and employment. The passing of the Fiscal Stability Treaty in May was followed by a number of other significant events. The better-than-expected outcome of the end-June EU summit yielded significant benefits for Ireland and led to a sharp fall in secondary bond yields. Indeed, Ireland has so far been the biggest winner from the summit decision to break the link between bank and sovereign debt. The growth agenda has advanced at both an EU and national level and the Government's recent infrastructure stimulus is an important first step towards restoring domestic demand. The economy and the public finances also remain in fairly good shape despite weak external demand. GDP growth last year at 1.4% was double the original estimate and the Exchequer tax revenues are comfortably ahead of target for the first half of the year.

Slowing external demand

The international economic environment remains very challenging and demand in Ireland's main markets has weakened since the start of the year. The eurozone avoided a technical recession in Q1 but sentiment data have deteriorated since then and GDP is expected to dip into negative territory in Q2. The UK economy is also suffering from the crisis in Europe while the US recovery has lost momentum following a strong Q1. Data from the emerging economies have disappointed also and the overall external demand picture is one of slowing growth in almost all markets. Despite these challenging trading conditions, Irish exporters continue to perform strongly. Export volumes in Q1 were up over 6% on the corresponding period last year and were 2.6% stronger than in Q4 2011. Irish exporters are therefore doing well in very difficult trading conditions due to a combination of improved cost competitiveness and productivity but also recently due to a much weaker euro. Some 60% of Irish exports go outside the eurozone so the 12% euro depreciation against sterling and the 16% against the dollar over the past year has been a major boost to the competitive position of Irish exports.

Advancing the growth agenda

Government's recently launched infrastructure stimulus package will have a welcome, if somewhat modest, impact on economic growth over the coming years. It is essential,

therefore, that Government supplements this with a much more comprehensive growth plan for the whole economy. As part of our Driving Ireland's Recovery campaign we have launched an Action Plan for Recovery which suggests 50 practical ideas to drive growth. The plan sets out a range of actions targeted at supporting job creation, restoring domestic demand and helping to deliver world-class public services. We believe that long-term sustainable economic growth can only be achieved through a combination of investment and reform. We also advocate a broadening out of the investment focus to include funding for enterprise growth and greater commitment to education and R&D. The package of measures we have proposed would not come at any additional cost to the Exchequer and we will be engaging strongly with Government on our suggestions over the coming weeks and months.

Short-term forecasts

The revisions to the 2011 economic output data mean that the money size of GDP last year was €4 billion greater than estimated in December's Budget. The revisions show that the Irish economy is now reflatting as we have achieved a combination of volume and price growth in output. The Q1 2012 economic data show that while the economy contracted on a quarterly basis by 1.1%, it continued to grow in annual terms. Growth was particularly strong in nominal GDP which was up 4.3% in the year. The negative quarter-on-quarter number was largely due to a spike in the imports of services such as royalty payments rather than a fall in output. With exports continuing to hold up reasonably well we still expect net trade to make a positive contribution to growth this year. Investment jumped by 12% in Q1 and while much of this was due to higher aeroplane purchases, spending by enterprise on machinery and equipment also increased.

The revisions to last year's economic output data and the many positives in the Q1 numbers give us confidence in our above-consensus full-year GDP growth forecast of 1%. The external environment is likely to be tougher in the second half of the year due to the further deterioration of sentiment in our main markets. Irish exporters, however, are set to grow their market share in these tough trading conditions as their previous competitiveness gains are supplemented by the weaker euro. Uncertainties still abound in relation to the eurozone crisis but our Government must be more innovative with the growth leavers at its own disposal.

Economic outlook

The full-year National Income and Expenditure results for 2011 included a number of significant revisions to the economic data for last year. GDP growth was revised substantially from the initial estimate of 0.7% to 1.4%. In particular, the economy performed much stronger in the second half of last year than was originally estimated. The revised outturn of 1.4% GDP growth means that economic growth in Ireland last year was on a par with the EU average and well ahead of that in the UK and the southern European countries. In addition to the revision to the GDP growth rate, the nominal or money size of the economy was also revised sharply upwards. GDP in money terms last year was some €4 billion larger than estimated by Government in last year's Budget. This is a significant boost to Ireland's debt sustainability and should reduce the debt-to-GDP ratio by between 2% and 3%. The revisions to the 2011 outturn provides a much stronger opening position from which to reach the 2012 fiscal targets.

The Q1 2012 Quarterly National Accounts, published alongside the 2011 revised numbers, provided a more mixed assessment of the economy. The revisions to the Q3 and Q4 data for 2011 meant that the economy did not re-enter recession last year. The Q1 2012 headline GDP number was somewhat weaker than expected, however, and showed that the economy contracted by 1.1% compared to the final quarter of last year. We would caution against reading too much into this single observation. The quarterly data on the Irish economy are exceptionally volatile, mainly due to very high trade flows. It is also important to note that the Q1 weakness was largely due to a spike in imports rather a fall in output. Imports of traded services such as royalty payments are often quite lumpy and the trend may well be reversed over the coming quarters. It is also likely that the rise in imports will result in higher export activity over the coming quarters. Overall, while the Q1 economic data were weak it is unlikely that they are a signal of a further slowdown in economic activity.

GNP and its components

Annual % change	2010	2011	2012	2013
Consumer spending	1.0	-2.4	-2.0	0.5
Government spending	-6.5	-4.3	-4.0	-3.0
Investment	-22.6	-12.6	0.0	8.6
Exports	6.2	5.1	3.5	4.0
Imports	3.6	-0.3	1.1	3.1
GDP	-0.8	1.4	1.0	2.3
GNP	0.9	-2.5	-0.2	1.4

Table 1

Our forecasts for 2012 and 2013 are largely unchanged from our previous estimates. Export growth remained solid in Q1 and despite the worrying global economic outlook, we remain confident that net exports will result in a positive GDP outcome again in 2012. Consumer spending remains weak and the poor summer weather will further hinder any recovery in the domestic economy. The investment sector performed strongly in Q1, largely due to strong aeroplane purchases but also as a result of a 6% increase in expenditure on equipment and machinery by firms.

Our growth forecasts for both 2012 and 2013 carry significant downside risks given the very uncertain global economic environment but the economy has made a reasonably positive start to the year. A major silver lining of the eurozone crisis is the much weaker euro and this will provide a boost to Ireland's export sector in difficult trading circumstances.

Business outlook

The Q2 Business Sentiment Survey, conducted in May, indicates that the turbulent external environment is taking a toll on the business outlook. Confidence in the overall business climate dipped only slightly, but CEOs' outlook for their own firms declined more sharply. Export expectations softened markedly and the index at +20 was at its lowest since the end of 2009, down from +41 in the previous quarter. This, coupled with a drop in order books expectations to +12 from +27, indicates that managers have factored in the global slowdown to their sales forecasts.

A more fine-grained analysis reveals diverging sectoral patterns. For firms in the technology sectors, sentiment has moderated somewhat from a very buoyant level, but remains strong. Sectors that are more sensitive to the global business cycle, however, recorded a more dramatic drop in sales and order book expectations; the trend is particularly clear in those sectors that primarily supply components to other

IBEC business sentiment indicator

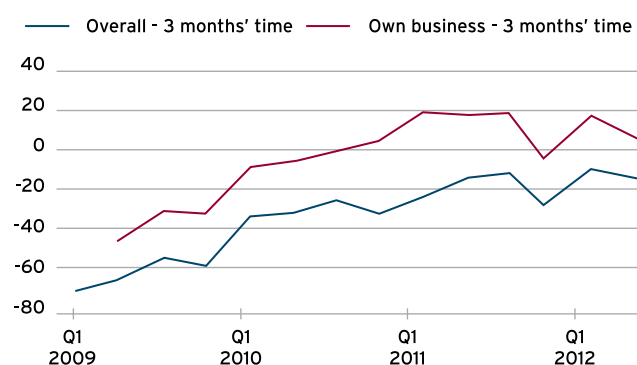


Figure 1

European manufacturers. Renewed volatility in the business outlook is particularly pronounced in firms' expectations about domestic sales. The index dropped to -9 from -2 in Q1 and, following a period of stabilisation in earlier quarters, has fluctuated sharply since Q4 2011.

Consumer spending

National accounts reveal that the consumer market remained very weak in the first quarter of the year. The annual decline in the volume of consumer spending accelerated to 2.2% from 1.5% in the previous quarter. The volatility between the end of last year and the start of this one is even more apparent in the seasonally adjusted quarterly changes. The Q1 drop of 2.1% was the sharpest since early 2009, entirely wiping out the 1.8% gain recorded in Q4 2011.

This confirms our view that the January 2012 VAT increase, flagged well in advance of the Budget, led to consumers bringing forward spending decisions on big-ticket items. However, the value of spending fell less than volume and the national accounts data show that in money terms consumer spending fell by 0.8% in the quarter and 0.4% on Q1 2011. These more benign price trends are likely contributing to the inflow of VAT receipts; with revenues coming in as planned and troika targets as the over-riding objective, it will be difficult to see any reversal on VAT rates.

The amelioration in price trends was also apparent in the revisions to the 2011 outturn, as the initial estimate of a 1.8% decline in the value of sales was halved to a drop of 0.9%. The upshot is that in money terms consumer expenditure was some €300 million greater in 2011 than we had previously thought. However, the volume-based metric, because it holds prices constant from one year to the next, is a more important measure of activity. The adjustment here was less marked, with an initial estimate of a 2.7% decline revised to a 2.4% drop.

Retail sales and consumer confidence

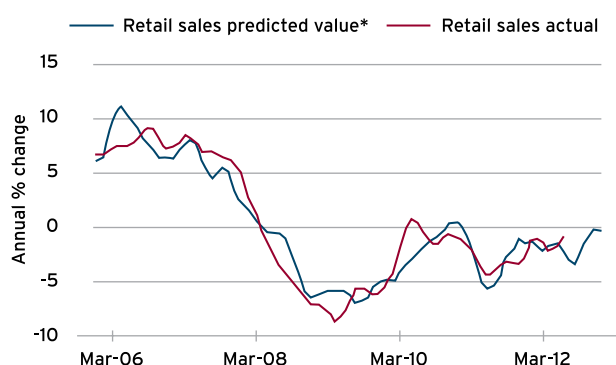


Figure 2

*Retail sales predicted value based on a simple regression of the future expectations component of the KBC Bank Ireland/ESRI Consumer Sentiment Index

We have left unchanged our forecasts of a further fall in consumer spending of 2% this year, and a very modest recovery of 0.5% in 2013. For the total market, consumer confidence, future expectations in particular, will be a key driver of overall spending. Despite the slight uptick seen this year, as Figure 2 indicates, a further recovery is needed if the consumer market is to return to even modest growth next year. At a sectoral level, demographic trends will affect spending patterns. As we discuss in the labour market section, emigration is predominantly concentrated in the younger age cohorts. The birth rate, however, remains one of the highest in Europe, implying high continued demand for certain products and services. Finally, a recovery in housing market activity in Dublin, which now appears possible, would lead to an increase in associated activity. However, the outlook for the rest of the country on this front remains more challenging.

Investment

The investment sector of the economy recorded its fourth consecutive annual decline in 2011, although the output decline of 12.6% was much less than that recorded in both of the previous two years. Overall, investment activity last year was down 54% from the 2007 peak. New housing activity was down 80%, while other building and construction dropped by 53%. The home repair, maintenance and improvement (RMI) sector fared relatively better and was 20% down from the peak. Investment in machinery and equipment fell by 37% over the 2007-to-2011 period. The collapse in investment activity has been a major contributor to the fall in Ireland's GDP since 2008, but it now appears that the sector has stabilised. While construction and building activity may contract again this year, this is likely to be offset by an increase in investment in machinery and equipment.

House building continued to fall in 2011 with total completions at 10,500 almost 30% down on the 2010 level. Data for the first five months of 2012 indicate that the number of completions continues to decline and is unlikely to exceed 8,000 this year. Essentially some one-off housing activity is continuing but little or no scheme activity is in progress. The completions data will also reflect some electricity connections in previously semi-completed estates and will therefore somewhat overstate the actual level of building activity in the housing sector.

Despite the continued decline in new housing there are a number of indicators which suggest that some home sales activity is returning. In Dublin at least, house prices are beginning to stabilise and there is lots of anecdotal evidence of increased interest amongst home purchasers. This may well translate to increased mortgage lending and home purchases in the second half of the year. RMI activity could pick up as a result of this and the stock of vacant houses would also reduce. The RMI sector has performed relatively

50 ideas to drive growth

In April this year IBEC launched its Driving Ireland's Recovery campaign, setting out the ambition of the business community and four strategic priorities for recovery: supporting job creation; restoring domestic demand; delivering world-class public services; and keeping Ireland strong in Europe. In July, we unveiled our Action Plan for Recovery: 50 ideas to drive growth. The document looks at the first three of the priorities from a growth perspective; on the fourth, keeping Ireland strong in Europe, IBEC was already active during the referendum campaign and will continue to address the issue in the context of Ireland's EU Presidency.

The business community is ambitious for growth in Ireland and has demonstrated this through its actions. Firms are hiring more staff as well as investing in machinery and equipment. Thanks to strong exports, GDP grew in 2011 for the first time in four years and, despite the turbulent eurozone background, the economy is set to expand in 2012 also.

Nonetheless, growth remains muted and urgent action is needed to support activity and help get people back to work. Government has shown awareness of the need for growth-promoting measures, but has yet to present a whole-of-economy strategy. The constructive initiatives have in many cases been negated or outweighed by retrograde steps that have restricted flexibility or added on to the cost of doing business. The domestic economy in particular has received scant attention. With the debate advancing at a European level, it is now necessary for Ireland to formulate a strategic action plan to drive growth for the next decade.

We are realists: there are no silver bullets here. Instead, the document presents 50 action points that the business community has identified as priorities for driving growth and as a totality these recommendations can make the difference. The emphasis is on tangible actions that can be delivered quickly, though not all can be achieved immediately; some action points will result in an immediate and visible benefit, while others will pay off over a longer time horizon. This balance between 'the now' and 'the future' is necessary to ensure a sustainable growth model that delivers continued prosperity.

Crucially, the package of 50 actions can be delivered at no net additional cost to the Exchequer. While some of the demand-led tax schemes carry some upfront cost, the resulting additional activity will mean no net fiscal burden. Other proposals, such as the release of non-

core pensions, provide a direct injection of funds to the Exchequer. The next section highlights some of the key priorities and the full document is available at www.ibec.ie/0/RecoveryActionPlan.

Support job creation

To ensure that businesses and entrepreneurs have access to credit, the action plan calls for:

- a new state-backed investment bank, financed by the European Investment Bank and the National Pensions Reserve Fund to deliver financing through the existing banking network (Action 1)
- the establishment of internationally recognised property investment funds, to facilitate international investment in the sector (Action 4), and
- an improved tax offering for mobile investment, to ensure that we stay ahead of competitor jurisdictions such as the UK (Action 7).

To tackle unemployment, we need to:

- ensure that there is a structure to support people getting back to work or onto training courses (Action 9)
- enforce the conditionality around unemployment assistance (Action 10), and
- overhaul the work visa regime to make it easier for top talent and skilled graduates to work in Ireland (Action 13).

Restore domestic demand

The action plan sets out a range of proposals to kick-start the domestic economy, including:

- reform of pension rules to allow people to unlock and use part of their AVC and personal pension savings (Action 25)
- tax incentives to encourage additional home renovation activity and move work from the informal to the formal economy (Action 26), and
- a new social welfare smart card system, to ensure child benefit payments are spent in the domestic economy (Action 27).

Deliver world-class public services

Despite some positive steps, the pace of public sector reform needs to accelerate. The action plan calls for:

- more flexible work practices in the public sector (Action 43, 44)
- reform of public procurement procedures to give SMEs a better chance to compete for contracts (Action 48), and
- greater use of outsourcing as a means of saving money and improving services (Action 49).

Investment

Annual % change	2010	2011	2012	2013
Building & construction	-30.1	-15.8	-8.0	2.3
Plant & machinery	-8.5	-8.3	10.0	15.0
Total	-22.3	-12.6	0.0	8.6

Table 2

well over the past few quarters and offers the potential for further employment gains in the short to medium term.

The number of active major construction projects has fallen considerably over the past 18 months and this is reflected in the 22% decline in non-residential construction activity last year. Government's recent announcement of an infrastructure project stimulus package will provide some boost to activity but the majority of projects will not enter construction phase for some time yet. There will be some project commencements in late 2012 and 2013 but the construction activity of the €2.3 billion package will stretch out as far as 2018. It is therefore likely to only have a modest positive impact on our short-term forecasts for investment activity. Other initiatives such as the intention of NAMA to provide €2 billion of loans for project completions and a commitment to address the issue of availability of sufficient high-tech office space will also boost construction activity in the short term.

Investment in equipment and machinery was particularly strong in the first quarter of this year following a drop of 8% last year. A key feature of the sector is the extent to which aeroplane purchases affect the overall position. Purchases of planes typically account for almost one-third of total machinery and equipment purchases and were valued at just short of €2 billion last year. This activity is particularly lumpy, however, and the fluctuations can have a significant impact on the total investment figure. Excluding the aeroplanes from the Q1 data shows that investment by firms in equipment and machinery was a healthy 6% higher than in the corresponding quarter last year.

Our overall forecast for investment this year is that the position will be largely unchanged from the 2011 outturn. Construction activity is forecast to fall by 8% on the back of persistent weakness in the new housing sector. The RMI sector will expand by 5% while we have pencilled in a drop of 10% for non-housing construction activity. We forecast an increase of 10% in investment in equipment and machinery – it was up 25% in Q1 but we expect more moderate growth over the remainder of the year. For 2013 we expect that the investment sector will expand by just short of 10% and will therefore make a contribution to economic growth for the first time since 2007.

Prices and wages

Inflation in the developed economies has eased significantly in recent quarters and Ireland has also seen consumer prices moderate. The headline increase in the consumer price index (CPI) has fallen from 2.2% in January to 1.7% in June. The more internationally comparable Harmonised Index of Consumer Prices (HICP), however, recorded an increase of 1.9% in June, up from 1.3% in January. The main difference between the two is the inclusion of mortgage interest costs in the CPI and these declined significantly in recent months. Overall, price pressures remain muted in the Irish economy due to continued weakness in domestic demand and inflation is largely confined to imported energy products and the impact of higher government taxes.

Of the 1.7% increase in prices in the 12 month period to June, energy accounted for over half while total services (including utility bills) accounted for two-thirds of inflation. Goods inflation accounted for one-quarter of the price growth. Mortgage interest costs fell by 7% in the year and are now almost 50% below the peak recorded in summer 2008. This very substantial reduction in mortgage costs has provided major relief to heavily indebted households and will result in an increase in spending power by mortgaged households this year. The average mortgage payment cost by households last year was just short of €11,000 and we estimate that repayments will be down by close to €2,000 in 2012. This will result in an increase in the spending power of mortgaged households of about 3% this year.

Energy is another large expense item which impacts on consumer spending power. The average working household spent over €5,300 on energy related items in 2011 and prices have increased sharply over the past two years. Annual energy inflation was running at 9% in June but there was some relief in more recent months as lower global oil prices had some impact on fuel pump prices.

Inflation forecasts

2012	Year-on-year quarterly average	Annual average
March	2.2%	1.9%
June	1.8%	
September	1.7%	
December	2.0%	
2013		
March	1.8%	1.6%
June	1.5%	
September	1.7%	
December	1.5%	

Table 3

The energy component of the CPI fell by 0.6% over the past three months and was down 2.1% in the month of June. This reduction was primarily due to falling petrol and diesel prices which declined by 2.6% and 3.0% respectively in June. Despite recent falls, however, fuel prices remain 7% higher than this time last year and average energy bills for consumers this year are likely to be somewhat higher than in 2011.

Prices for most consumer goods remain either relatively flat or have fallen over the past year. Clothing and footwear prices are unchanged in the year and have fallen by over 30% in the past five years. Food prices were up just 0.8% in the year and are also largely unchanged over the past five years while furniture and household item prices were down 2.5% in the year and by 15% over the past five years.

Following three years of falling pay rates a modest increase in average pay is expected in 2012. The recently published IBEC HR Update shows that one-third of firms will implement some increase in basic pay rates in 2012. This was an increase from 25% of firms which reported that they would increase pay this year in a similar survey in early spring. The majority of firms (63%) expect that pay rates will be unchanged this year. Pay rate increases are largely confined to the high-tech export sectors and the proportion of domestic firms planning pay increases remains small. The average increase in pay rates this year across the entire economy is estimated at 0.5%.

Labour market

The last few quarters of employment data from the CSO have been fairly volatile. In Q3 2011 seasonally adjusted employment fell by 19,100 in the quarter, turning to a gain of 11,100 in Q4, the first one since 2007. However, owing to public sector exits, and also some weakness across the board, the first quarter of this year saw a renewal in the downward trend with 7,300 job losses. Unemployment ticked up to 14.8% from 14.5% in the previous quarter and 14.1% at the start of 2011.

Employment

000s annual average	2010	2011	2012	2013
Agriculture	85	83	81	81
Industry	360	341	339	341
Services	1,403	1,385	1,371	1,374
Total	1,848	1,810	1,792	1,797
Unemployed	292	304	312	300
Unemployment (%)	13.6	14.4	14.8	14.3
Labour force	2,140	2,114	2,103	2,097

Table 4

Given the sharp movements in the quarter-on-quarter employment levels, the more stable year-on-year comparisons give a better view of the trend. Overall, the picture is of a labour market slowly inching towards stabilisation. The Q1 drop of 1% was only slightly more than the 0.8% decline recorded in Q4, and much improved from the 2.9% fall in employment in the first quarter of 2011. Nonetheless, given that the weakness in the external environment will have an impact on the Irish economy, we now feel that the outlook for the labour market is somewhat weaker than we had anticipated earlier this year. For 2012 we now expect that employment will fall by 1%, followed by a small gain of 0.3% in 2013.

A decomposition of public and private sectors reveals that public sector staff numbers fell by 16,700 or 4.2% in the year, while the number of employees in the private sector (excluding self-employment) grew by 13,500 or 1.2%. The more detailed sectoral data of the Quarterly National Household Survey reveal that five of the fourteen NACE categories added jobs on an annual basis, including accommodation and restaurants (+8.5%), information and communication (+6.7%) and industry (+0.8%). The most significant declines were in professional and scientific activities (-7.2%), public administration (-6.3%, influenced by the temporary census field staff employed in 2011), transportation and storage (-5.3%) and construction (-4.3%).

Firms in the domestic economy will continue to lose jobs, or at best maintain employment levels. The infrastructure investment plan announced in mid-July will provide a modest boost to construction employment over the coming years, but the impact will not be immediate. Although accommodation and restaurant employment grew strongly on an annual basis, the quarterly change was a loss of 4,400 jobs. Given the weaker visitor numbers for the first five months of the year, the jobs boost from the tourism sector may well have hit a pause for now. High-tech sectors, meanwhile, continue to add jobs, but are in many cases constrained by skills gaps that need urgent attention.

Migration has returned as one of the most powerful forces shaping the Irish labour market and consumption patterns. We have limited data, but estimates for the year ending April 2011 reveal that in net terms 23,900 people aged 15-24 and 14,000 aged 25-44 had left the country. The underlying pattern is somewhat mixed, with outflows for both age cohorts about the same at 33,000-34,000, but with an inflow of 20,400 of 25-44-year-olds more than double that in the younger cohort. With visa applications to top destinations such as Australia and Canada remaining high, it is unlikely that the migration patterns will reverse until a significant improvement in the labour market and economic sentiment occurs.

Exports and exchange rates

Revised figures from the national accounts show that the volume exports grew by 5% in 2011, up from the previous 4.1% estimate. This upward revision came on the back of strong export services growth of 7.7%, up from the previous 4.9% estimate. Data for Q1 2012 show that exports remain strong, up 2.6% on the previous quarter. This was the strongest export growth in the eurozone, highlighting the resilient nature of the Irish export sector.

The more timely monthly indicators paint a mixed picture. Trade data point to some weakening in the second quarter but the series is highly volatile and the correlation between it and the national accounts has been poor recently. The seasonally adjusted volume of manufacturing output for the three months to May was 2.9% higher than in the previous three-month period. The increase, however, masks diverse sectoral performances. Chemicals and pharmaceuticals expanded by 6.3%, computer, electronic and optical products by 3.2% and dairy by 17.6%. However, some of the traditional sectors, particularly those outside of food products, record falling output. The industrial production results, combined with the June manufacturing PMI which points to expanding activity for the fourth consecutive month, indicate that exports will remain fairly robust in the coming months.

Quarterly balance of payments data show that total service exports rose by €2.1 billion to €21.1 billion in Q1 compared to the same period last year. Computer services continue to dominate this picture, growing 19% on the same quarter last year and accounted for two-thirds of the increase in service exports in the first quarter.

The euro is continuing to weaken against both sterling and the dollar. In July, the euro was down nearly 6% to \$1.23 compared with the start of the year and 12% from the 2011 average. The decline against sterling has been sharper so far this year, down nearly 9% and around 10% from last year's average. The decline is the result of a weaker eurozone economy with the resulting boost to exports a silver lining. While a weaker euro is beneficial to all member states, the effect is significantly higher in Ireland as most Irish exports go outside the eurozone.

The ECB reduced interest rates in July to a historic low of 0.75%, marking the third rate cut in nine months. ECB president Mario Draghi indicated that interest rates have reached their floor and are likely to remain at current levels for the foreseeable future, although the IMF and others argue that the ECB could do more. All told, further falls in the exchange rate are possible later in the year with the dollar to euro rate likely to move into the teens. Sterling continues to be a safe haven for international investors and is also likely to strengthen further against the euro over the course of the year.

Public finances

Exchequer returns for the first six months were largely positive, with tax revenues performing well, although expenditure continues to run ahead of budget. Tax-take at the end of June was up 8.3% year-on-year and 3.1% ahead of profile. The positive tax returns were driven primarily by corporation and income tax. Corporation tax receipts were €274 million ahead of target, buoyed by a strong second quarter. Income tax was up 13.5% year-on-year and around 3% ahead of profile.

Despite the weakness in the domestic economy, VAT returns are coming in on target and the take for the first six months was €29 million ahead of profile, although the second quarter was not as strong as the first. The four smaller tax groups taken together are in line with expectations, although the major collection months for capital gains tax, capital acquisitions tax and stamps are not until later in the year.

Expenditure in both health and social protection is above budget. In health, net voted expenditure was €145 million ahead of target for the first six months. The troika after its latest visit in July expressed concerns about this, adding a new commitment that measures to address the spending overruns be specified before the end of September. Social protection recorded a €320 million overspend, although €192 million of this is related to a shortfall in PRSI receipts. There were smaller cost overruns in some other departments, most notably in transport of €71 million. Nonetheless, offsetting cost savings of €250 million across other departments meant total net expenditure was €386 million, or 1.8% above target.

While the public finances are moving towards a sustainable footing government should not become complacent. The budget deficit is still some €9.4 billion and the aforementioned expenditure overruns remain a concern, requiring immediate government action. Nevertheless, the public finances are adjusting as planned, a point underlined by the seventh troika review predicting a budget deficit of 8.3% this year, well under the 8.6% target.

Exchange rates - monthly averages

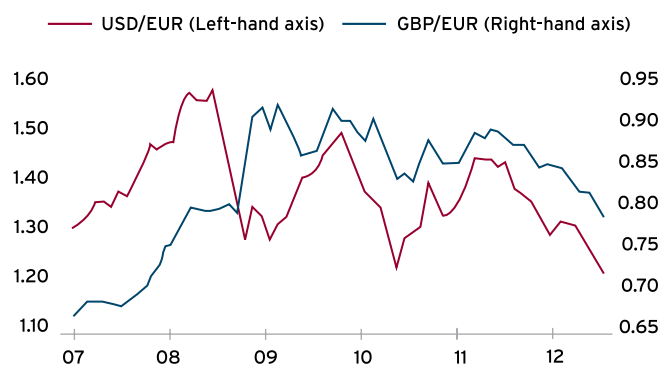


Figure 3

International economies

Global growth in the first half of the year disappointed as developed economies struggle with high unemployment and anaemic growth. The debt crisis in the eurozone remains the focal point and the spill-over effect internationally has restrained growth. The Chinese government announced two interest rates cuts in June and July to support investment growth, as inflation concerns dissipate. While emerging economies have weathered the crisis relatively well up to now, the weaker external environment is beginning to bite. This is the case particularly in export-oriented countries such as Singapore, which contracted in Q2. Despite the slowdown, emerging economies are still expected to grow by over 5% in 2012 and will be the main source of growth for the world economy.

United States

The momentum in the US economy waned somewhat in the second quarter of the year. Although the unemployment rate remained at 8.2%, jobs growth slowed from 226,000 per month in Q1 to 75,000 a month in Q2. Retail sales fell for the third consecutive month in June, down 0.5% on the previous month, the longest run of falling sales since autumn 2008. The housing market, however, continues to rebound with the total number of house sales up 10% in May compared to a year earlier. The annual rate of inflation remained at 1.7% in June, raising the possibility that the Federal Reserve might launch a third round of quantitative easing later in the year. The outlook for the remainder of the year points to fairly moderate growth. Beyond the recent fall in consumer spending, which is a concern, the eurozone crisis and uncertainty over fiscal policy are the major headwinds holding back a sustainable recovery.

United Kingdom

The UK economy continues to flat-line and shows few signs of an impending recovery. The recent Jubilee celebrations provided a temporary boost to consumer spending, but the underlying trend was broadly flat. The recent rise in value of the pound against a basket of currencies, including the dollar and euro, will put pressure on exporters. As such, the external sector is unlikely to provide a boost to GDP. Inflation fell to 2.4% in July - the lowest since November 2009 and is likely to continue to fall throughout the year. This will reduce the squeeze on consumer's purchasing power, and it gives room to the Bank of England to extend its asset buying stimulus programme later this year should the economy fail to improve over the coming months.

Eurozone

The outlook for the eurozone has been bleak for over two years and there is little to suggest any tangible recovery, at least in the short term. While the region avoided falling into a technical recession in Q1, with flat growth, the likelihood of an improvement is slim. Unemployment reached a record high of 11.1% in May, while Spanish unemployment has risen for the last 13 consecutive months to a record 24.6%, the highest in the eurozone. Despite contracting mildly in the final quarter of 2011, the German economy grew by 0.5% in Q1, although recent surveys indicate a difficult period ahead. The EU Summit at the end of June marked a change in policy by the European authorities. The main change allows the ESM to recapitalise banks directly rather than through governments, allowing sovereign debt to be decoupled from banking debt. If the EU authorities can progress plans for a banking union and a meaningful growth pact then activity may pick up in the later part of the year, although risks remain very much to the downside.

Real GDP growth - selected countries

Annual % change	2011	2012	2013
World	3.9	3.5	3.9
Advanced	1.6	1.4	1.9
Emerging	6.2	5.6	5.9
Euro area	1.5	-0.3	0.7
US	1.7	2.0	2.3
Germany	3.1	1.0	1.4
France	1.7	0.3	0.8
Italy	0.4	-1.9	-0.3
China	9.2	8.0	8.5
Japan	-0.7	2.4	1.5
UK	0.7	0.2	1.4

Table 5

Private consumption - selected countries

Annual % change	2011	2012	2013
Euro area	0.2	-0.6	0.4
US	2.2	2.2	2.6
Germany	1.5	0.5	0.8
France	0.3	0.1	0.7
Italy	0.2	-2.1	-1.1
Spain	-0.1	-0.9	0.6
Japan	0.0	1.1	1.6
UK	-1.2	0.5	1.6

Table 6

Sources: Real GDP - IMF World Economic Outlook July 2012 Update;
Private consumption - IMF World Economic Outlook April 2012



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