Quarterly
ECONOMIC OUTLOOK

IBEC

April 2012

Referendum represents opportunity for confidence boost

The referendum on the Fiscal Stability Treaty provides a valuable opportunity to give a confidence boost to consumers and investors. A YES vote will remove uncertainty in relation to Ireland's future funding options and allay investor concerns on further economic dislocation. From a business and economic perspective there is not a single benefit to be gained from rejection of the treaty. The Irish economy has stabilised over the past two years and returned to growth in 2011 for the first time in four years. Despite the ongoing nervousness surrounding the eurozone crisis, the economy will again expand by about 1% this year. It is essential, however, that we do not undermine that sector of the economy - exports and FDI - which is working well by casting uncertainty on our future place in Europe and the funding options of the State. A YES vote will be positive for investment, jobs and consumer confidence and will help us along the path to economic recovery.

The treaty is essentially about better management of public finances. In isolation it will not solve all of Europe's economic difficulties but it is an important step in ensuring that we avoid future crises. Together with other economic and fiscal governance reforms which eurozone governments have already agreed to, it will deliver greater economic stability in the future and help avoid the boom and bust cycle which Ireland, in particular, has been vulnerable to. The treaty will not mean greater austerity. In order to get back into the markets at a reasonable cost Ireland will have to repair its public finance position. This imperative, rather than EU rules, will be the predominant determinant of Ireland's fiscal policy for many years to come. Crucially, endorsement of the treaty provides a platform for strong economic recovery, and growth is the most effective antidote for austerity.

The business community's ambition for Ireland

IBEC has recently launched a major campaign to support economic recovery. *Driving Ireland's Recovery - the Business Community's Ambition for Ireland* identifies four strategic priorities needed to achieve a return to economic prosperity. These are restoring domestic demand; keeping Ireland strong in Europe; supporting job creation; and delivering world-class public services. We have set out our broad objectives under each of these areas and will be following this with detailed action plans over the next year or so.

We also presented our ambition for where we see the Irish economy over the medium-term. The fundamentals of Ireland's business model and labour market suggest that the economy has a potential growth rate of between 3% and 4% - about double the EU average. The campaign aspires to getting 2 million people in work by 2020 and to make Ireland one of the most prosperous regions in the EU. The other goals are improved quality of life; increasing the export share of indigenous companies; a return to balanced economic growth and making Ireland the best country in the world in which to do business.

Economic outlook for 2012

The short-term outlook for the economy remains relatively stable. We expect to see continuation of the trend in 2011 whereby exports will contribute to growth but domestic demand remains weak. Export growth will most likely be slower this year due to renewed weakness in the UK and eurozone but the improved outlook for the US and a much more favourable exchange rate environment will help offset some of these difficulties. The weaker euro will also be a major boon to those companies making inroads into third-country markets such as China. Ireland has made excellent progress in regaining competitiveness within monetary union and a further depreciation of the euro would substantially lift the competitive position of the growing share of exports going outside the eurozone.

The Irish consumer remains nervous. Despite some improvement in consumer fundamentals such as the stabilisation of incomes, no income tax increases and a reduction in mortgage interest costs, consumer spending has still not bottomed-out. We believe that 2012 will see the end of the downward trajectory and we expect to see modest recovery in consumer spending from next year. The employment situation has stabilised and the unemployment rate is unlikely to go any higher. There is also some income growth returning to the economy and this will be important in terms of lifting consumer spending power. Mortgaged households will have higher discretionary income this year but they will need the confidence to spend it before this is reflected in consumer activity. The construction sector is also close to bottoming-out and will most likely do so over the next 18 months or so. The fundamentals of the economy therefore suggest that we are about to return to meaningful growth rates but the eurozone's problems and lack of confidence continue to delay the recovery. The referendum vote on May 31st is an opportunity to help address the confidence issue.

Economic growth

Following a strong recovery in economic output in the first half of 2011, the Irish economy slowed again in the second half of the year as heightened nervousness about the eurozone crisis impacted on both export and domestic demand. GDP had grown by over 2% between Q4 2010 and Q2 2011, largely on the back of a stellar export performance. Export orders slowed sharply from last August, however, and GDP contracted in both Q3 and Q4. The ongoing eurozone crisis has clearly constrained the pace of economic recovery but nevertheless GDP grew last year for the first time since 2007 and we are forecasting a similar improvement this year.

Economic output stabilised in 2010 as GDP fell by just 0.4% following two years of sharp declines This export-led recovery maintained its momentum into 2011 as the sector benefited from a combination of improved competitiveness and stronger international demand. The domestic economy remained in recession, however, as both consumer spending and investment continued to decline. Following the recovery in GDP in the first half of last year it fell by 1.3% in the final two quarters. The annual average GDP for the full year grew by 0.7% in volume terms.

Crucially from a public finances perspective the nominal or money value of GDP also increased last year. Nominal GDP for the year was actually €1.2 billion greater than the Department of Finance's estimate in Budget 2012. This meant that the underlying budget deficit for the year at 9.4% was well ahead of the Budget expectation of 10.1% and the target in the MoU with the Troika of 10.6%. The better than expected nominal GDP performance gives important wriggle room in relation to the 2012 budget deficit target. The first quarter public finances have also bettered expectations and Government looks well placed to reach the deficit target of 8.6% for this year.

The economy has experienced a fairly challenging start this year due to the weaker economic activity in both the eurozone and the UK. The ongoing uncertainty in the eurozone has also impacted on both investor and consumer confidence. The US economy has performed better than expected, however, and looks on track to record growth of about 2.5% in Q1. Irish exporters have also made progress in capturing greater market share in emerging markets and the recent high profile trade missions to China will further boost confidence and ambition to exploit these growth opportunities. Overall, however, the weak European market situation will mean that export growth this year will not be as strong as in either of the last two years.

The domestic economy remains fairly fragile and we expect that reduced net incomes and relatively weak confidence will mean that consumer spending will fall by a further 2% this year. Investment in construction activity is expected to fall by 10% or so, while investment by firms in equipment and machinery will increase and help offset some of the construction related decline. We expect GDP to grow by 1% in 2012 with momentum gathering a little as the year progresses.

GNP and its components

Annual % change

	2010	2011	2012	2013
Consumer spending	-0.8	-2.8	-2.0	0.5
Government spending	-3.8	-3.7	-4.0	-3.0
Investment	-24.9	-10.6	-2.2	6.1
Exports	6.3	4.1	2.8	4.0
Imports	2.7	-0.7	1.3	2.9
GDP	-0.4	0.7	1.0	2.4
GNP	0.3	-2.5	-0.1	1.9

Table 1

Business outlook

The stabilisation in the eurozone had a dramatic and immediate impact on business confidence in Ireland and IBEC's business sentiment index in the first quarter of the year made up for the ground lost at the end of 2011. Following a Q4 dip to -28, overall confidence recovered to -16 in Q1 2012, while the three-month outlook improved to -11 from -29. Own business confidence also rebounded strongly, with the current conditions index recording a reading of +16 and the forward-looking index at +18. Both are now back at the level held for the first three quarters of 2011.

Exporters in particular are optimistic about the outlook for their businesses and confidence in the three-month outlook rose to +29 from +19 in the previous quarter, while the index for export sales increased to +43, the highest reading since the start of last year. This is founded in a sharp upturn in order books expectations, which recorded a series high. The outlook for firms trading predominantly in the domestic sectors is, however, much more muted.

IBEC business confidence indicator

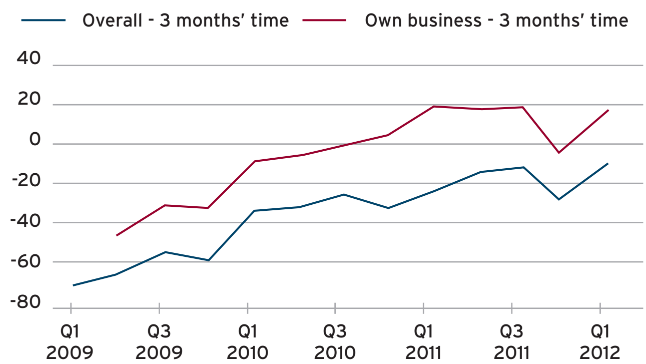

Figure 1

Expectations on domestic sales improved in Q1, but remain four points below the Q3 2011 reading. Retailers are the most pessimistic, with nearly 70% expecting a decrease in sales in the coming three-month period.

Consumer spending

The volume of consumer spending fell by 2.7% in 2011, an acceleration on the 0.8% drop seen in 2010. The one slight silver lining is that, for the first time since 2008, value at -1.8% was down less than volume. This marks an end to a protracted period of falling prices and should provide some relief to consumer-facing businesses.

The final quarter of 2011 ended on a more positive note, with consumer spending up 0.5% on a seasonally adjusted basis in volume and 0.9% in value. The more positive outturn was likely driven by consumers bringing forward buying decisions on some big ticket items ahead of the VAT hike, rather than signalling a decided improvement in the trend.

The messages for the first quarter have been somewhat mixed. Retail sales fell by 1.3% year-on-year, but VAT returns for the first quarter were up 3.4% on expectations. This was a positive surprise, particularly given the very weak retail numbers and could indicate that the non-retail side of consumer spending (about half of the total) is picking up some momentum. However, with the impact of the VAT hike yet to be fully taken into account, it is too early to make a call on any improvement in the underlying trend.

Overall, we have pencilled in a further drop in consumer spending of 2% for 2012, with a return to modest growth of 0.5% in 2013. Crucially, some of the key consumer fundamentals have begun to stabilise. Household gross incomes increased marginally in 2011 and Budget 2012 avoided income tax hikes meaning that take-home pay this year has not fallen. The impact of higher energy, fuel and health costs should dissipate next year, leading to a stabilisation in discretionary incomes also.

Consumer spending and retail sales

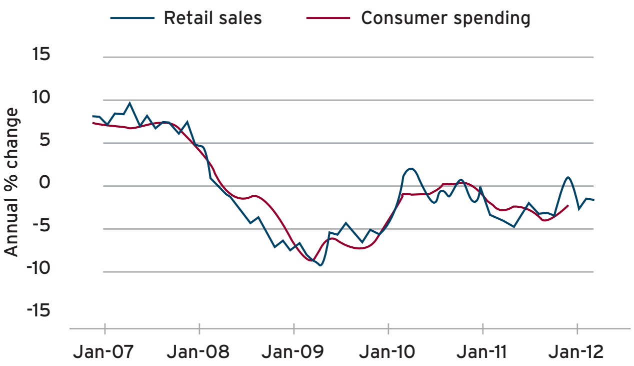

Figure 2

Increasingly, a return to more normal levels of consumer confidence will determine the turning point for the domestic economy. The savings ratio at about 10% remains high, with at least some of it precautionary in nature. It is essential that disjointed Government communications about property taxes and water charges do not undo the tentative gains in consumer confidence, particularly future expectations, seen in the first quarter.

Investment

Investment in construction activity and equipment and machinery declined again in 2011 but the pace of decline at 10% was much less severe than the drops of almost 30% experienced in each of the previous two years. The construction sector remains fragile and following cumulative output peak to trough falls of about two-thirds, further contraction is expected in 2012. Investment in equipment and machinery also declined in 2011 but this was due to a reduction in investment in aeroplanes. Investment by industry increased last year for the first time since 2007 but after a very promising start to the year, the situation deteriorated in Q3 as the escalation of the eurozone crisis created increased uncertainty.

New house completions fell sharply for the fourth consecutive year in 2011. Completions were estimated at 10,500 last year, down from 93,000 in 2006. About two-thirds of housing completions were accounted for by one-off builds with scheme developments and social housing activity continuing to fall sharply. Industry estimates indicate that the official data published by the Department of the Environment, Community and Local Government somewhat overstate activity in the housing sector as the statistics are collected on the basis of electricity connections.

The Census shed some new light on the issue of the vacant housing stock in the State and while the vacancy rates were not as high as earlier estimates, the vacancy rate of almost 15% indicates considerable supply overhang on the market. Significantly, however, the vacancy rate was actually lower than that recorded in 2006 and there was a wide variation in the rate across the country. South Dublin recorded a vacancy rate of just 5%, while in Leitrim it was over 30%. It is also important to recognise that even in times of tight housing supply there is a significant vacancy rate in the market - in 2002 the vacancy rate was 10%. So while there is clearly unsold stock on the market much of this is in the wrong location and of the wrong type i.e. apartments rather than family homes.

Crucially, however, there is still no evidence of unsold stock levels being reduced as housing transaction levels remain exceptionally low. Any recovery in the housing sector will depend on region specific factors and the Dublin area for example is likely to experience a shortage of supply quite quickly after a pick-up in transaction levels. In the short-

The Economics of the Fiscal Stability Treaty

The Fiscal Stability Treaty essentially represents a stronger legal enshrinement of a series of public finance rules which EU governments have already largely signed up to. Unlike some other recent EU treaties which have been subject to referendum votes in Ireland, this treaty is relatively straightforward and focuses exclusively on the single issue of how best to ensure that future fiscal crises in Europe can be avoided. The treaty is an important part of a wider package of reforms which will result in a major improvement in economic governance in the eurozone and help restore investor confidence in the single currency area. From an Irish perspective, support for the treaty also provides vital access to the public finance funding safety net of the European Stability Mechanism.

Treaty is important part of a wider reform package

Eurozone governments have already agreed to substantive reforms of the region's economic governance rules. The Six Pack of measures, which came into effect in December 2011, address both public finance management rules and the wider issue of economic imbalances in the eurozone. The Fiscal Stability Treaty in isolation would most likely not have prevented the current Irish economic crisis but taken together with the economic governance reforms of the Six Pack, the entire package would have had a major impact. The economic imbalances measures would have required policy action from government once the warnings lights around loss of competitiveness, credit growth and house price inflation started to flash. The new package also includes an explicit government expenditure growth rule which would have prevented the reckless increases in spending experienced in the early part of the last decade.

The structural deficit rule

The treaty gives much greater prominence to a balanced budget rule which is based on the structural deficit. The structural deficit is a relatively complex concept and is difficult to measure but there is strong logic for choosing it as the primary budget target rather than the simple headline deficit. The structural deficit moves in line with the business cycle so that when the economy is in recession the structural deficit is less than the headline deficit and when the economy is growing above its long-term average it is greater than the headline number. The rule in effect requires governments to be more prudent with the public finances in good times and enables them to support economic activity and allow automatic stabilisers such as welfare expenditure take effect in a downturn. This is classical counter-cyclical or Keynesian economic policy.

The major flaw with the simple headline deficit rule is best illustrated by the case of Greece. There were many years in which the Greek economy was performing relatively well but the government continued to run budget deficits, albeit within the 3% deficit rule of the Stability and Growth Pact. This meant that debt levels continued to rise and its public finance position became more vulnerable and exposed to external shocks. The structural deficit rule would have ensured more prudent public finance management in the good times and would have left the country better able to cope with the global economic crisis.

Implications for the public finances

Those opposed to the treaty claim that it will result in additional austerity from 2015. They point to the fact that the government forecast for the structural deficit in 2015 is 3.5%, greater than the structural deficit limit of 0.5% permitted under the treaty. The Irish Government will not be required to close this gap overnight, however, and a transitional timeframe will be negotiated with the EU Commission over which it would be reasonable to make the adjustment. The market realities of Ireland's public finance position means that this gap will need to be closed irrespective of the treaty rules. In order to regain market funding access Ireland must continue to reduce its debt levels and run budget surpluses for a number of years. The treaty will not lead to additional austerity over the coming years but the reality of Ireland's precarious public finances will mean that ongoing fiscal reform will be needed long after the agreement with the Troika is completed.

Implications for the public finances

IBEC is convinced that the long-term interests of Ireland are best served by voting YES to this treaty. A YES vote will mean:

- Greater domestic economic stability and significantly reduced risk of a future fiscal crisis
- National governments will be better able to use fiscal policy to respond to an economic downturn due to the requirement to run budget surpluses in the good times
- A more certain business environment due to the reduced risk of future reckless economic and spending policies
- Access to ESM funds if needed and an easier route back to the bond markets
- No additional austerity over the coming years as Ireland's fiscal policy will be determined by either its programme commitments or the requirement to reduce the cost of borrowing
- A much better functioning governance model for the eurozone, which as part of the wider economic, fiscal and financial reforms will ensure the future success and prosperity of monetary union
- A confidence boost for both investors and consumers as uncertainty is removed and Ireland's future at the heart of Europe is endorsed.

Investment

Annual % change	2010	2011	2012	2013
Building & construction	-30.3	-15.6	-11.1	-2.0
Plant & machinery	-14.5	-2.6	10.0	15.0
Total	-24.9	-10.6	-2.2	6.1

Table 2

term the forward-looking indicators suggest that housing completions will drop by a further 25% or so this year and will fall again in 2013.

Repair and maintenance activity has held up relatively better than new construction and now represents the majority of business for those still operating in the industry. The sector recorded growth of 4% in 2011 and was larger in size than new house building for the first time ever. Activity this year is expected to stablilise. Non-housing construction activity fell by 17% last year as declines were recorded in both commercial and civil engineering construction projects. The Government's revised public capital investment budget suggests a further drop of about 10% this year and while there is growing evidence that a shortage of suitable commercial property will emerge fairly shortly, funding constraints are likely to depress activity in this sector for a further period. We expect total investment in building and construction to drop by a further 11% this year and to record a marginal decline in 2013.

The strong growth in exports over the past three years has meant that the majority of exporting firms have limited spare capacity. This resulted in an increase in investment by firms in the first half of the 2011 - it rose 4% compared to the same period in 2010. Following a dip in new investment in Q3, it recorded a further annual increase of 5% in the final quarter of the year. The recent sentiment indicators from industry suggest that this momentum will be maintained in 2012 and we expect investment in machinery and equipment to increase by 10% this year. The ongoing weakness in construction and building will mean that overall investment in the economy will fall by about 2%.

Labour market

Following a disappointing third quarter, the seasonally adjusted employment figures for the final quarter of 2011 provided a welcome positive surprise with 10,000 job gains. This is the first time since the end of 2007 that the economy has added jobs.

On an annual basis, the pace of decline eased to 0.8%, the slowest since mid-2008. For the whole of 2011, the pace of jobs losses slowed to 2.1%, half that in 2010. The seasonally adjusted unemployment rate remained steady at 14.6% and was only marginally up on the 14.4% recorded at the end of 2010.

Industry added a very healthy 5,800 jobs, signalling that export-led growth is beginning to translate to employment gains. Although firms have in recent years placed greater focus on productivity in an effort to win market share, there comes a point at which increasing volume of activity necessitates greater levels of employment. Moreover, given that some of the more labour-intensive sectors such as agri-food have a bright outlook, we may well see somewhat of a mini-resurgence in manufacturing employment, though not quite at the pace recorded at the end of 2011.

Employment in the hospitality sector grew for the third consecutive quarter, adding 4,300 jobs. The sector has now made up for the 10,000 jobs lost in the first quarter of 2011 and the fading of this recovery effect means that the sector is unlikely to keep on adding jobs at the current, very rapid pace. However, provided that the positive trend in tourism numbers from the first few months of 2012 continues, the sector should nonetheless be a net job creator this year. This of course, is very much dependent on developments in the main markets of UK, US and Europe.

Other highlights of the 2011 employment figures are the ICT sector and administrative/support services. This illustrates both Ireland's ability to attract high-tech, high-skill services, but also the positive impact of the improved cost base on some of the medium-sophistication activities such as call centres.

Despite the very strong final quarter figures, the outlook for 2012 and 2013 has not changed substantially. The effect of the weak third quarter and strong final quarter is to set the overall trend back onto a stabilising trajectory.

Two effects are at play. On the one hand, some very clear positives are beginning to emerge and the start of the year has seen a number of job announcements. Encouragingly, these have been from a wide range of companies, multinational and indigenous, small and large, and across a number of sectors.

Employment

000s annual average	2010	2011	2012	2013
Agriculture	85	83	84	83
Industry	360	341	342	344
Services	1,403	1,385	1,380	1,389
Total	1,848	1,810	1,806	1,816
Unemployed	292	304	289	273
Unemployment (%)	13.6	14.4	13.8	13.1
Labour force	2,140	2,114	2,095	2,089

Table 3

Nonetheless, some significant headwinds remain and these will weigh on the aggregate employment figures. The impact of public sector staff reductions will be particularly pronounced in the first two quarters of 2012, while the effect of banking sector job losses will be more dispersed. We have therefore pencilled in a 0.2% fall in employment this year, and a return to modest growth of 0.6% in 2013. However, the dynamism of the Irish economy means that over the medium term, once the major structural adjustments are complete, the outlook is much brighter and we may see employment back at two million by the end of the decade.

Prices and wages

Higher energy costs and the impacts of last December's Budget have pushed up the price of some key household expenditure items in recent months. Ireland's headline inflation rate remains well below the EU average, however, and we continue to regain both price and labour cost competitiveness against our main trading partners. With the exception of energy costs, price pressures will remain fairly subdued for some time yet due to the overall weakness of the domestic economy.

Following two years of falling consumer prices, the Consumer Price Index (CPI) increased by 2.6% last year. The average increase in the CPI in the first quarter of 2012 was 2.2%. The overall price level in the Irish economy, however, remains 2.3% below where it was prior to the global economic crisis of autumn 2008. The majority of consumer items have not experienced any significant price increases over this period and the recent increase in the inflation rate has been predominantly due to rising global energy costs and higher Government taxes. Over the past year prices in the food and non-alcoholic beverages, clothing and footwear and furniture and household equipment categories have all fallen. While higher energy costs have been reflected in the housing and transport categories and the impact of Government taxes and charges has been evident in the price increases in the education and health categories.

While the overall increase in the CPI has remained fairly modest, consumer perceptions of price increases are likely to have been heightened by substantial increases in a number of important expenditure items. Natural gas prices are up 15% in the year; electricity 12%; petrol and diesel 9%; third-level education charges 13%; and health insurance 14%. Commuter families are therefore likely to have experienced much higher cost of living increases than other household types and their discretionary incomes will have experienced a larger reduction than average.

Inflation is likely to moderate somewhat during 2012 and into 2013 in line with the trend elsewhere in the eurozone. Government taxes and charges will continue to impact on prices, however, and we expect the CPI increase to average 2.3% this year and 1.8% in 2013.

The vast majority of firms will continue to hold pay rates unchanged during 2012. IBEC surveys show that some 65% of firms will leave their basic pay rates unchanged this year. About one quarter of companies have provided for pay increases while one in ten firms reported that pay rates will be lower in 2012. Given the ongoing weakness of domestic demand and the need for some sectors to achieve further competitiveness gains it is unsurprising that the majority of firms envisage no pay increases in the current year. Some sectors, however, are experiencing skills shortages and their remuneration policies are more determined by global sector trends rather than by domestic factors and the incidence of pay increases has therefore increased in high-tech multinational firms.

Data recently published by Eurostat show that Ireland is the only country in the EU to record a reduction in labour costs over the duration of the economic crisis. Average hourly labour costs in Ireland were €27.4 in 2011 - down from €28 in 2009. More significantly Ireland's labour costs as a percentage of the EU average improved from 127% in 2009 to 119% in 2011. When taken together with the substantial productivity improvements which have been achieved over this time, it is clear that Ireland has been remarkably successful in achieving competitiveness gains within monetary union. Considerable progress has therefore been made in restoring competitiveness but further relative gains will need to be delivered over the coming years. For the majority of sectors this will now be achieved through lower labour cost increases compared to our trading partners rather than through further nominal wage cuts.

Inflation forecasts

2012	Year-on-year quarterly average	Annual average
March	2.2%	2.3%
June	2.5%	
September	2.3%	
December	2.3%	
2013		
March	2.0%	1.8%
June	1.8%	
September	1.7%	
December	1.6%	

Table 4

Exports and exchange rates

Exports continue to be the only source of growth in the Irish economy. Data from the national accounts show that exports grew by 4% in 2011. This was balanced between goods, up 3.4% and services, up 4.9%. While the rate of growth slowed, 2011 was a record year in both volume and value terms.

More detailed monthly data for the year show that the major exporting sectors continue to contribute to growth, although like the headline figure, this rate of growth slowed as the year progressed. The value of food exports grew by 12.5% in 2011 with the sector overcoming much of the losses accumulated in 2009. Medicinal and pharmaceutical products grew by a solid 9% in 2011 although the first two months of 2012 showed a 4% decline. The value of total goods exports fell 3.5% in the first two months with machinery and transport disappointingly down nearly 8.5% after returning to growth for the first time in 4 years in 2011. Imports are down 7.5%, and with nearly two thirds of imports accruing to production, this points to a slowdown in exports also.

Quarterly balance of payments data show that growth in computer service exports continued in Q4, growing by 13.5% for the year. The sector now accounts for around 20% of total exports, although the contribution to net exports is comparatively smaller due to the large royalty and licence imports associated with the sector.

Despite the ongoing turmoil in the eurozone, the euro continues to hold its value against the dollar. After a volatile January, the currency has stabilised somewhat at around $1.32, 2% higher than at the start of the year. The ECBs longer-term refinancing operation (LTRO) of €1 trillion over three years to the banking sector seems to have eased immediate fears of large scale bank defaults, calming investors. The benign inflation outlook recently espoused by ECB president Mario Draghi means further interest rate cuts cannot be ruled out. This combined with political upheavals and the threat of recession point to the currency losing value over the course of the year.

Sterling continued its end of year trend and strengthened to £0.81 against the euro at the end of April. This compares to around £0.89 at the same time last year and is indicative of expectations that the Bank of England will end the recent inflation inducing quantitative easing programme. This continues to be welcome news for exporters to the UK who can capture market share even in the face of demand constraints. However, with over a third of imports coming from the UK a strong sterling could begin to increase cost pressures elsewhere in the economy.

Public Finances

The exchequer returns for Q1 point to the stabilisation of the public finances with taxes up €758 million, or 10.1% year-on-year and €351 million, or 4.4% ahead of target. Income tax is 3.5% ahead of target and up 18.5% year-on-year. Corporation tax returns are flat year-on-year. VAT returns amount to €3.3 billion, €182 million ahead of last year and reflect the impact of the two percentage point increase introduced in Budget 2012. This is 3.2% or €101 million ahead of target, and was accounted for entirely by the returns for March coming in €128 million above target. This points to growth in non-retail sales, however, since the increase occurred over just one month the figures should be treated with caution. Excise duty returns disappointed and were €42 million or 4.1% behind target. Each of the four smaller tax-heads, stamps, CGT, CAT and customs all came in broadly on target.

Expenditure, however, is some 2.6% or €289 million ahead of target due to cost pressures in the departments of Health and Social Protection. The combined over-run for these departments amounted to around €365 million, however, savings of €178 million for the remaining departments lessened the expenditure overruns.

The exchequer deficit was €2.8 billion lower than for the same period last year following the deferral of the €3.1 billion promissory note at the end of March. Once account is taken of this payment, and a number of other adjustments, the underlying exchequer deficit is around €6.7 billion, €340 million lower than the same period last year. The returns are generally positive and government is on track to meet the budget deficit requirement of 8.6% of GDP, however, a tighter rein over expenditure is necessary over the coming quarters.

Exchange rates - monthly averages

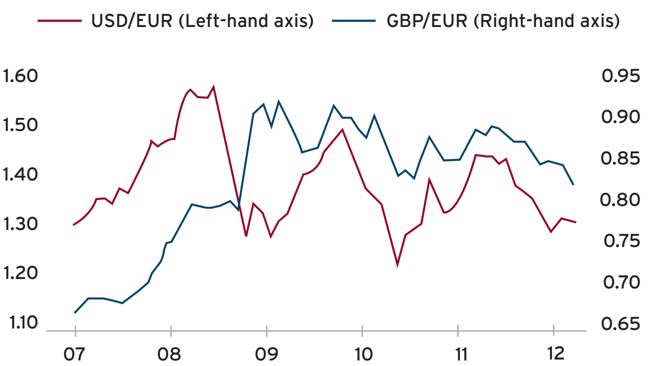

Figure 3

International economies

The global economy will continue to expand over the course of the year as many of the factors that dampened activity last year have lost some or all of their intensity. The eurozone crisis, however, will continue to be the main factor restraining growth. Following the effects of the earthquake, Japan is set to grow again largely on the back on reconstruction spending. The Chinese government's policy of monetary tightening in 2011 has been successful in curbing inflation which has fallen under the government's 4% target. This gives room to loosen policy in the future to compensate for any decline in activity. Emerging nations have already begun to ease monetary policy in support of renewed economic growth as inflation pressures abate. The IMF has pencilled in world growth of 3.5% in 2012 rising to 4.1% in 2013.

United States

The outlook for the United States continues to improve with growth increasing, inflation stabilising and unemployment falling. The growth rate strengthened to 3% in Q4 and unemployment fell to 8.2% in March, the lowest since January 2009 after strong employment gains in construction, retail and manufacturing over the last 12 months. Crucially, the housing market continues to rebound in 2012 and unlike previous years looks set to contribute to growth for the first time since 2007. U.S. auto sales also kept up recent momentum and rose by about 13% in March, the best quarter for U.S. vehicle sales since 2008. The continued decline in government spending remains the main drag on growth and fiscal consolidation is expected to weigh on overall economic activity over the coming quarters. Nevertheless, the renewed traction in the US economy is a welcome development for the global recovery process.

UK

As feared the UK fell back into recession in Q1 as output declined 0.2% in the quarter, driven largely by a 3% quarterly drop in construction output. These estimates are highly volatile, and an upward revision is possible, particularly given the recent spate of positive indications from retail and survey data. The squeeze on real incomes looks set to dissipate somewhat as inflation eased to a 14 month low in February; however, stubbornly high unemployment will limit the extent to which consumer spending can contribute to growth. Sterling shrugged off the poor growth figures and continues to remain strong which puts further pressure on exporters hoping to expand. The prospect for an immediate recovery in Q2 is unlikely due to an extra Bank Holiday in June to celebrate the Queen's jubilee.

Eurozone

The eurozone, which contracted by 0.3% in Q4 2011, is on the brink of recession as activity across the core and periphery waned in the opening months of 2012. Last year saw a number of countries fall into mild recession most notably the Netherlands. Political upheaval in the Netherlands and France also creates another bout of unwanted uncertainty. Importantly, the German economy will avoid recession and continue to grow albeit at a slower pace. German consumer confidence reached a 12-month high in March, highlighting the potential for growth in consumer spending which could provide a bounce to demand for exports from the periphery. Greece agreed to new funding arrangements and debt is set to fall to 117% of GDP after a 54% debt write off was negotiated with the banking sector. The recent liquidity operations averted a funding crisis, and while the strengthening of crisis management facilities is a welcome development, the core challenge for European policymakers is to get the economy back onto a sustainable growth path.

Real GDP growth - selected countries

Annual % change	2011	2012	2013
World	3.9	3.5	4.1
Advanced	1.6	1.4	2.0
Emerging	6.2	5.7	6.0
Euro area	1.4	-0.3	0.9
US	1.7	2.1	2.4
Germany	3.1	0.6	1.5
France	1.7	0.5	1.0
Italy	0.4	-1.9	-0.3
China	9.2	8.2	8.8
Japan	-0.7	2.0	1.7
UK	0.7	0.8	2.0

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

Source: IMF World Economic Outlook, April 2012.

Further information:

Fergal O'Brien, chief economist
Tel: 01 - 605 1544
Email: fergal.obrien@ibec.ie

Reetta Suonperä, senior economist
Tel: 01 - 605 1603
Email: reetta.suonpera@ibec.ie

Website: www.ibec.ie/economics
www.ibec.ie/drivingirelandsrecovery
Twitter: @ibec_econ