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ECONOMIC OUTLOOK

IBEC

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New Government must deliver credit, confidence and competitiveness

The IMF/EU Commission loan agreement of last November was a traumatic event for this country. International investors were unsettled by the dramatic developments and Ireland's international reputation was further tarnished. The agreement means that the new Government will have considerably less discretion in relation to economic policy than would otherwise have been the case. Nevertheless, there are a number of important issues which it must urgently address in order to accelerate economic recovery.

Credit availability and affordability

IBEC has set out a very specific set of priority tasks for the new administration in relation to the jobs agenda in a separate publication and the comments contained here are of a more broad nature. Cost and availability of credit remains the single biggest challenge facing the employment-intensive SME sector. Lending volumes continue to fall and in the absence of normal credit flow, firm expansion is impossible and employment prospects remain weak. It is difficult to disentangle the impact of lower demand, tight supply and the ongoing weakness of the business environment in relation to credit provision. It is clear, however, that many viable businesses continue to have difficulty in accessing affordable credit. This is currently providing an additional challenge for those retail and hospitality businesses affected by the pre-Christmas adverse weather conditions. Immediate measures, including a loan guarantee scheme for SMEs, are required in order to ensure that further businesses and jobs are not lost due to lack of access to working capital.

International reputation and domestic confidence

Confidence in the Irish economy has been undermined both at home and internationally. The new Government must immediately set about convincing international markets that Ireland is now in fact a more attractive location in which to invest than before the crisis. Prices of business inputs, consumer goods and tourism services have fallen dramatically and Ireland now offers much better value for money for investors and for visitors. A coordinated push by business, the state development agencies and Government is required in the early months of 2011 to aggressively promote and sell Ireland internationally. Crucially, the new Government must also quickly restore confidence in the future of the economy to Irish households. It must detail a credible action plan for economic recovery - one that will be based on a solid economic framework with a strong emphasis on enterprise and employment generation. It must fully recognise the funding difficulties facing the Exchequer and rapidly demonstrate a capacity to operate effectively within these and other external constraints.

More to do on competitiveness

Over the course of the economic crisis the Irish economy has restored about half of the competitiveness loss experienced in the previous decade. Through nominal cost reductions and exceptional productivity growth, many Irish firms have successfully priced themselves back into international markets. Significant further competitiveness adjustments are required, however, and the new Government cannot be complacent on this issue. IBEC members with operations across a number of countries continue to experience comparatively high energy and labour costs in their Irish sites.

Economic output better than expected in 2010

The Irish economy was largely flat in 2010 but the gap between the performance of the export and domestic sectors widened further. Encouragingly, GDP fared better than forecasters and Government expected. This was largely due to the stellar export performance. Exports grew by over 8% to a record high, supported by a better-than-expected recovery in our main export markets, more benign exchange rates and improved competitiveness. The euro area bounce-back was stronger than anticipated, led by growth of 3.6% in Germany.

Growth outlook for 2011

In 2011, Ireland's export markets will largely sustain the pace of recovery experienced last year and we expect exports to make a further solid contribution to GDP growth this year. Domestic demand remains fragile. Consumers will have to reduce their savings ratio somewhat in order to offset the negative disposable income impact of the Budget. At best, consumer demand will be flat this year and will most likely contract marginally. The ongoing decline in construction activity means that investment will continue to drag a little on growth but nothing like the scale of what occurred in recent years. Encouragingly, firms are set to increase their investment in machinery and equipment, as many businesses have postponed investments since 2008 and some are now facing capacity constraints.

GDP in 2011 will record annual growth for the first time since 2007 - our current forecast is that it will expand by 1.8% - but GNP recovery will be more muted, reflecting the ongoing weakness in domestic demand. The labour market will remain very weak, with any new employment growth struggling to offset the impact of further job losses and firm closures. Government cannot singlehandedly deliver employment growth but its role in shaping the optimum environment in which business can create new jobs will be crucial.

Economic growth

Following a disappointing performance in the second quarter of 2010, the Irish economy grew again in the third quarter. The quarterly growth numbers for an exceptionally open economy such as Ireland obviously come with significant health warnings. Nevertheless, Q3 2010 was the first time since the final quarter of 2007 that both GDP and GNP grew. Last year remained a very difficult year for the domestic economy, with consumer demand still in decline. Consumers faced the significant headwinds of pay cuts, welfare rate reductions and a sharp fall in employment. Although consumer spending flattened off in Q2, a combination of extreme uncertainty surrounding the IMF/EU loan deal and weather-related factors resulted in further deterioration in the second half of the year. Although investment as a share of GDP has fallen substantially since 2007, its further volume decline in 2010 of 25% continued to have a significant drag on growth.

Exports grew by over 8% in 2010 to a record level. A strong rebound in international markets, coupled with a restoration of competitiveness, resulted in improved market conditions for Irish exporters. While the modern sector was the primary driver of export growth, the performance of the traditional sector also improved, particularly in the second half of the year. The final quarter economic output data will not be available until the end of March but it is expected that both GDP and GNP remained fairly weak. Following a 7.6% fall in GDP in 2009, however, the economy largely stabilised last year and probably recorded a marginal output fall of about 0.5%.

The big challenge facing the economy in 2011 is the robustness of consumer spending. Household budgets will remain under pressure due to the severe personal tax measures in the Budget. Higher prices for energy, insurance and food will also squeeze disposable incomes, while the vast majority of workers are facing another year of pay freezes. In such circumstances we think households will be forced to run down their high savings rates a little. Even allowing for this, however, we expect the volume of consumer spending to contract again this year, although firms in the consumer sector are likely to see flat to marginally positive revenue on the back of rising prices.

Strong growth in exports will continue to be the only source of economic growth and with fairly weak imports, net trade will make a strong contribution to GDP. The investment sector will remain in decline but it is approaching the bottom. We forecast that GDP will grow by about 1.8% this year with GNP expanding by 0.8%. For 2012, we expect to see both consumer spending and investment making a contribution to growth and assuming that global demand remains relatively solid, the Irish economy should expand by close to 3%.

GNP and its components

Annual % change

	2010	2011	2012
Consumer spending	-1.7	-0.5	0.5
Government spending	-4.5	-4.5	-3.0
Investment	-25.2	-3.5	4.1
Exports	8.4	5.8	4.5
Imports	4.1	3.2	2.7
GDP	-0.5	1.8	2.7
GNP	-2.5	0.8	2.2

Table 1

Business outlook

The Q4 2010 IBEC Business Sentiment Report shows that despite the anxiety caused by Ireland's public finance difficulties in the latter part of the year, the majority of managers remained confident in the outlook for their own businesses. The "own business" confidence indicator rose to +13 in Q4 - a significant improvement on the -17 reported in Q1 of last year. Unsurprisingly, businesses remained concerned about the wider economic environment, with the overall business confidence indicator showing a balance of -32.

The current nature of the two-speed economy was very evident in the growing divergence between firms' expectations for export sales and domestic sales. Expectations for domestic sales weakened considerably to -12 in Q4 while those for exports were at +33 - a difference of 55. In the first quarter of the year the corresponding gap was 24.

The outlook for the manufacturing sector improved steadily during 2010. Output grew by about 7% during the year with the modern sector up about 10% and output from the traditional sector growing by 1.5%. Pharmaceutical output was particularly strong throughout the year, while production in sectors such as food, plastic and metals strengthened as the year progressed. Manufacturing output growth has been almost exclusively export driven and the prospects for global demand have remained solid in the early part of 2011. Indeed the NCB manufacturing purchasing managers index (PMI) recorded its highest reading in over a decade in January, although it is likely that a recovery from the pre-Christmas adverse weather conditions had an impact on this.

The traded services sector also recorded an exceptionally strong 2010. Exports from the sector grew by 11.3% in the first three quarters of the year, led by a recovery in financial services exports and continued growth in ICT services. In the domestic economy, however, the services sector remains deeply distressed. Falling consumer spending, adverse weather conditions and access to credit difficulties mean that many firms have faced into 2011 in a fragile state.

IBEC Business confidence indicator

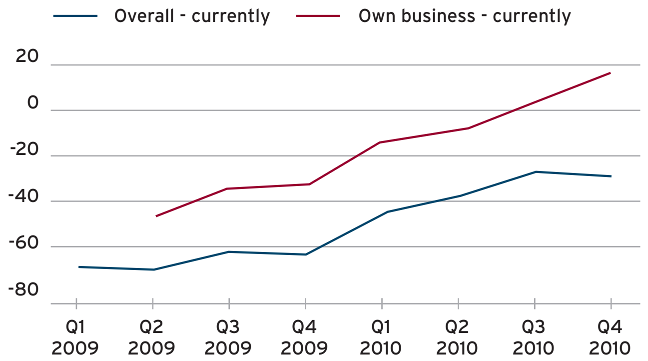

Figure 1

Consumer spending

Consumer confidence weakened sharply in December in the aftermath of the EU/IMF loan deal and the €6 billion austerity budget. (The slight uptick in January was caused by seasonal factors during the sales period.) Retail sales figures for December were also very weak, with a 2.5% decline in sales excluding cars resulting in the annual fall accelerating to 3.6%. Because the weather conditions were so exceptional, however, the figures give no useful indication of the underlying trend in Irish retail sales or consumers' reaction to the difficult Budget and the IMF/EU loan deal.

National accounts for the third quarter showed a disappointing deterioration in consumer spending, which had appeared to have stabilised during the first half of the year. On a quarterly basis, consumer spending fell by 0.5%, following a drop of just 0.2% in Q2, while the annual decline accelerated to 1.3%, up from 1.1%.

Given that activity during the final quarter is likely to have been very weak, owing to both economic uncertainty and the snow, consumer spending will have fallen by 1.7% during 2010 overall. Since the onset of the recession, the volume of consumer spending has fallen by over 10%. Given the sharp price decreases seen across both goods and services, consumer expenditure in money terms has fallen by over 15%.

With the Budget reducing consumers' disposable incomes by about 3% on average coupled with a weak labour market, it is likely that consumer spending will fall further during 2011 and we have pencilled in a drop of 0.5%.
To date, the fall in consumer spending has been far more severe than the decline in disposable incomes. We therefore believe that there is some scope for consumers to maintain expenditure levels by reducing the savings rate slightly - but given the high level of indebtedness the Irish consumer will continue to pay back debt for some years to come, keeping the savings rate above its long-term average.

The risks to the forecast are mostly on the downside.
A worsening of the labour market or further bad news about the financial sector could dent consumer confidence even further, resulting in a more negative outcome for 2011.
The outlook for domestic demand remains weak for the foreseeable future, but we expect that consumer spending will return to marginal growth in 2012 of 0.5%.

KBC-ESRI Consumer Sentiment Index

Figure 2

Investment

The pace of decline in the investment sector of the economy only slowed marginally during 2010. The cumulative decline in the sector to date, however, is such that any further falls are unlikely to have a substantial impact on overall economic growth. Investment has fallen from 25% of GDP in 2007 to 13% in 2010. All of the investment sub-sectors recorded significant decline during 2010, with the housing sector again faring the worst.

Housing completions are estimated at about 14,000 in 2010, down from 27,000 in 2009. The commencement and registration data now appear to be levelling off at an exceptionally low level and the run-rate suggests a further decline in house completions to about 10,000 in 2011.
While the last few years have seen some completion works undertaken on housing schemes which were already in progress, the industry is now largely confined to some one-off housing. There are varying estimates of the existing overhang of housing stock, but it is unlikely that any significant housing schemes will be commenced in 2011 or 2012. Even allowing for the regional divergences in excess housing, employment trends and credit conditions suggest that a return to medium-term sustainable housing activity levels remains some way off yet. Home improvements were also subdued during 2010, reflecting the ongoing anxiety of householders and the difficulties which consumers are facing in getting access to even relatively modest levels of credit.

The public capital investment programme and a series of other large one-off investment projects made an important contribution to the construction sector during the otherwise

Reform programme under the EU/IMF loan agreement

The conditions for the EU/IMF loan package set out a timetable for fiscal consolidation, banking sector restructuring and structural reform. Officials from the IMF, European Commission and ECB will monitor progress on a quarterly basis. The timetable becomes more open-ended towards the end of the loan programme in 2013.

The incoming government will have some scope to negotiate and shape the plan to suit its own policies, as long as it meets the fiscal targets. Any changes to the current plan will, however, need to be agreed with the Commission, IMF and ECB. Moreover, it is likely that the timetable on the more challenging reforms will slip somewhat, since the incoming Government will almost certainly want to put its own stamp on the programme.

Fiscal consolidation

As a first step, and a condition for receiving the first tranche of funding, Government implemented a €6 billion Budget for 2011; the total adjustment over the 2011-2014 period will be €15 billion. The consolidation measures for 2012 will amount to at least €3.6 billion, including an increase in personal taxation and carbon tax; reductions in private pension tax relief; and the introduction of a property tax.

The Budget will also lead to reductions in social spending and capital expenditure, as well as savings on the public sector pay bill through lower staff numbers and pension reductions. The agreement makes it clear that if the Croke Park deal, coupled with cuts in staff numbers, cannot deliver sufficient savings, the Government will need to relook at issues such as staff numbers and pay.

Financial sector reform

A substantial portion of the EU/IMF loans is directed to the banking sector, with €10 billion to form an immediate recapitalisation injection. A further €25 billion is allocated as a contingency, in case further loan losses, from for instance the mortgage books, result in a need for additional capital.

The initial capital injection will bring the equity ratio in the banks to 12%, well above the regulatory minimum of 10.5%. The authorities hope that "super capitalising" the banks will help investor confidence. The Central Bank and the regulator will complete reviews of the banks' capital and liquidity positions by the end of March, making sure that the banks have made sufficient loan loss provisions to withstand even a "stress case" deterioration in asset quality. To date, NAMA has taken over all developers' loans over €20 million. Now the scope of NAMA has been extended to include property loans between €5 and €20 million; the loans, with a book value of €16 billion, will be transferred by the end of Q1 2011.

Ultimately, Ireland will end up with a much smaller banking sector. AIB has now been mostly nationalised, but will eventually be sold off to private investors. The Irish authorities will present their plans for Anglo and Irish Nationwide resolutions, which will be overseen by the EU/ECB/IMF troika. The remaining banks will be required to sell off non-core activities.

Structural reform

Labour market reform receives a substantial amount of attention in the loan documentation. The minimum wage was reduced by €1 to €7.65 per hour, effective from 1 February 2011. Another reform in relation to the minimum wage will be the extension of the "inability to pay" clause, allowing firms to invoke it more than once. This measure should come into effect by May 2011. A review of registered employment agreements (REAs) and employment regulation orders (EROs) will commence by the end of Q1 2011 and will, hopefully, result in a substantial reform, if not outright abolition, of the outdated system.

The Government has started the process of reforming the social welfare system. The first step of this was to align the employment services section of FÁS with the Department of Social Protection. The purpose of this is to provide more efficient services for clients. This was facilitated in the social welfare acts in December 2010.

The Government has also begun the process of tackling replacement rates, lowering the rate of job seekers allowance for certain age categories in Budget 2010. Lastly, the social welfare act introduced a measure of conditionality for payments where someone turns down a training or work position.

A number of reforms to be actioned by the end of Q2 and Q3 2011 have direct relevance for the business sector. The voluntary 15-day prompt payments rule will apply to the HSE, local authorities and state agencies. Legislation to enhance competition, including allowing judges to impose fines and other sanctions in competition cases, will be put forward. An economic impact study will examine the removal of the cap on the size of retail premises. Legislative measures will improve competition in the so-called sheltered sectors, including law, medicine and pharmacies.

Investment

Annual % change	2009	2010	2011	2012
Building & construction	-34.9	-32.5	-11.3	-0.1
Plant & machinery	-19.3	-8.0	10.0	10.0
Total	-31.0	-25.2	-3.5	4.1

Table 2

exceptionally difficult past two years. Many major construction projects were completed during 2010, however, and the pipeline for new projects remains exceptionally bare. Last year saw the completion of the major interurban motorway programme, the new terminal at Dublin airport, the convention centre, Aviva stadium and the theatre at the Grand Canal Dock. These projects supported a significant volume of jobs and their completion entails a more negative construction sector employment outlook for 2011. The further reductions in the public capital investment programme for 2011 to 2014, announced in the four-year plan, also mean that employment supported by Exchequer investment in infrastructure will be much lower than previously expected. By 2014, Exchequer capital investment will be some 60% lower than that in 2008. In addition, there is still a lack of certainty surrounding major projects such as the Metro North and much is likely to depend on the policy preferences of the new Government.

Commercial development in the retail and office sectors will remain very limited but a small number of relatively large scale construction projects are likely to be advanced in the manufacturing sector, following some recent plant expansion announcements.

Firms' investment in machinery and equipment remained weak in 2010 but the pipeline is looking more positive for 2011 and beyond. Many investment projects were mothballed since 2008, but given the better-than-expected pick-up in global demand in 2010 and the strong rebound in Irish manufacturing output, many firms now have limited spare capacity. It is therefore likely that further increases in manufacturing output to meet global demand in 2011 will require some investment in firm-level capacity. Many companies also postponed modernisation investment in new technology during the past couple of years and are likely to increase their spend in 2011. This is likely to be particularly true of the multinational sector; many indigenous SMEs will continue to be constrained by credit availability. Despite this difficulty, overall firm-level investment in equipment, plant and machinery is likely to experience a significant pick-up over the coming years and should provide a timely fillip to both the investment sector of the economy and to wider economic activity.

The ongoing weakness of the construction sector means that investment is forecast to fall by a further 4% in 2011 before growing by a similar scale in 2012.

Labour market

Employment data from the CSO for the third quarter of 2010 were disappointing, showing an acceleration in quarter-on-quarter job losses to 23,400, up from 8,700 in the previous quarter. This was the highest increase since Q3 2009 and reverses three consecutive quarters, when the flow of job losses appeared to be slowing.

On an annual basis, the construction sector lost the most jobs (36,800). The sector has now lost over 140,000 jobs, or over half of the employment at the peak. Industry also continued to reduce jobs, 11,200 in the year, but the pace is slowing both on an annual and a quarterly basis. As activity in the more labour-intensive indigenous sectors is now expanding again, we would expect to see some recovery in manufacturing employment during 2011 and 2012. Given that the sharp drop in activity resulted in considerable spare capacity, the employment gains will, however, remain fairly modest.

Financial services lost 10,800 jobs in the year to Q3 2010. The international sector fared relatively well during the global crisis and has returned to strong growth, but restructuring at the domestic banks will drag on employment numbers in finance for the next few years.

Employment in wholesale and retail appears to be stabilising, with the pace of job losses slowing to 2,100 from 31,400 in Q3 2009. However, given weak consumer spending, the sector is likely to lose some further employment in 2011. The hospitality sector has managed to largely maintain employment levels; this means, however, that though activity is likely to improve somewhat in 2011, owing to lower prices and a weaker euro, the impact on employment will be limited.

Only three sectors posted annual employment gains in the year to Q3 2010: education (+9,800), health (+3,700) and ICT (+800). While a portion of education and health employment is in the private sector, much of the resources come from the public purse. It is unlikely, therefore, that employment in the two sectors will continue to expand, given the impact fiscal

Labour market

000's annual average	2009	2010	2011	2012
Agriculture	96	86	90	90
Industry	411	360	354	354
Services	1,422	1,410	1,401	1,411
Total	1,929	1,856	1,844	1,855
Unemployed	259	290	280	267
% Unemployed	11.8	13.5	13.2	12.6
Labour force	2,187	2,146	2,124	2,123

Table 3

austerity will have on all departmental budgets. Jobs growth in ICT has slowed over the past number of quarters and may be restricted by lack of skilled staff.

The outlook for the labour market remains fairly bleak and 2011 is likely to see a further drop in employment of just over 10,000. This would represent the fourth consecutive year of job losses and bring the total number of jobs in the economy to levels last seen in 2004.

Given that jobs growth is not likely to resume until 2012, and even then at a much slower pace than before the crisis, the labour market is essentially facing a lost decade. The challenge for the new Government will be to ensure that young people leaving the education system have opportunities in Ireland and are not forced to emigrate and that long-term unemployment does not become entrenched.

Prices and wages

Following two years of falling prices the consumer price index (CPI) returned to positive territory in August 2010. Despite this return to rising prices, the overall price level remains about 6% below where it was prior to the economic crisis in summer 2008. The annual average CPI in 2010 was 1% below that in 2009. The return to positive inflation during the year was largely due to the mortgage interest component of the CPI. The harmonised index of consumer prices remained negative right through 2010.

Recently a number of additional factors have been influencing average price trends. Rising commodity prices have resulted in something of a spike in global inflation and Ireland is currently suffering from some imported inflationary pressures. A combination of higher world oil prices, a weaker euro and excise hikes in Budget 2011 have resulted in a near 10% rise in fuel prices during the past three months or so. Both the exchange rate and the world price of oil are likely to continue to pose energy price pressures during 2011.

Food commodity prices are also on the rise and in many cases are back near the record highs of 2008. Domestically, this has resulted in an end to falling food prices and a return to some inflationary pressures in this sector. Recent price increase announcements will mean that health insurance will also add to the CPI during 2011. Imported commodity, insurance and other aspects of the public sector are therefore likely to be main drivers of inflation in 2011. Elsewhere in the economy, significant spare capacity remains and with the outlook for domestic demand remaining fragile, price pressures are likely to remain constrained to the above mentioned sectors. On average, the CPI will increase by a little over 1.5% during 2011, but the price level in the economy will still remain well below the 2008 peak. Reflecting the absence of widespread domestic price pressures, the harmonised index will increase by much less than the CPI this year and is likely to be about 1% higher than in 2010.

A little benign inflation would be no bad thing for the Irish economy at present, and would help both firm turnover and the public finances. Unfortunately the mainly imported inflation we will see during 2011 will merely depress consumer spending power and will provide an obstacle to further competitiveness adjustment. Over the coming years it looks like price growth will remain very moderate, particularly when the distortions of the mortgage interest component of the CPI are excluded. The harmonised index is unlikely to rise by any more than 1% in 2012 and the CPI will grow by about 1.3% - but the latter will of course be heavily influenced by the crucial interest rate stance taken by the ECB.

There continues to be little or no wage growth in the Irish economy. Following extensive nominal pay cuts in 2009, the incidence of pay cuts slowed somewhat in 2010 and was largely confined to those firms operating in the domestic economy. IBEC research suggests that the majority of firms plan a further pay freeze during 2011, but with some export firms planning to deliver pay increases of up to 2%. A small number of firms in continued trading difficulties will seek to further reduce pay rates. Average private sector wages in 2011 are therefore expected to remain flat.

Economy-wide nominal pay rates are now about 5% lower than pre-crisis levels and given that the majority of trading partners have seen a similar scale increase in wage rates over this period, Ireland's wage cost disadvantage has been narrowed by about 10%. The gain in unit labour costs has been much greater than this as Irish productivity growth has far outstripped that in most other developed economies over the past couple of years.

Inflation forecasts

2011	Annual	Annual Average
March	1.9%	1.6%
June	1.8%	
September	1.5%	
December	1.2%	
2012		
March	0.9%	1.3%
June	1.2%	
September	1.5%	
December	1.7%	

Table 4

Exports and exchange rates

After a challenging 2009, 2010 saw a resurgence in Irish exports. During the first three quarters of the year, exports grew by 9% relative to the same period of 2009. Growth accelerated from 6.1% in Q1 to 7.6% in Q2 and 13.2% in Q3. For the year as a whole, exports grew by over 8% and net exports made a contribution to GDP of about 4%.

More detailed monthly data on goods exports, available up until October 2010, reveal that the recovery has been fairly broadly based. All sectors, except machinery and transport, recorded growth during the first ten months of the year, relative to the same period in 2009. Encouragingly food and drink, both important indigenous sectors, rebounded strongly, growing by 10.6% and 12.7% respectively. Of the so-called modern sectors, chemicals exports performed strongly, growing by 7.4% overall, with pharmaceuticals posting 15.2% within the sector.

After the exceptional bounce-back in global trade last year, Irish exports will slow somewhat during 2011, but growth will still come in at close to 6%. As the global economy slows somewhat in 2012, we have pencilled in export growth of 4.5% in 2012. Most importantly, however, Irish firms will continue to increase their share in global markets.

Since the onset of the global crisis, currency markets have been extremely turbulent, with double-digit percentage changes in exchange rates over very short periods. Exporters did, however, benefit from a weakening of the euro during 2010. The currency weakened against the dollar from a high of $1.50 in late 2009 to the latest trough of $1.20 in the middle of the year, before recovering to the current level of about $1.35.

The strengthening of sterling last year from £0.91 in March to about £0.86 currently was a welcome help, particularly for the indigenous companies for whom the UK is the predominant destination. Despite some strengthening to the most recent peak of £0.89 in October, the average for the year from April was £0.85.

The weaker currency was the silver lining of the eurozone's sovereign debt troubles, but a strengthening of the euro from its current level poses an obvious risk for the continued strength of Ireland's exporting sectors. Officials at the ECB are using a much more hawkish tone than their counterparts at the Bank of England or the Fed. This, coupled with the ECB's unwillingness to expand its monetary policy support and a desire to reign in extraordinary liquidity facilities extended to the banks as quickly as possible, is putting further upward pressure on the euro, at least for the moment. A resurgence in euro area woes, though unwelcome from the point of view of economic stability, would likely result in the currency weakening again.

Inflation

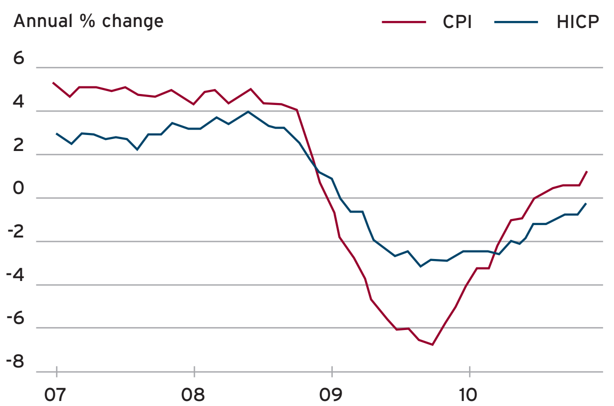

Figure 3

Exchange rates

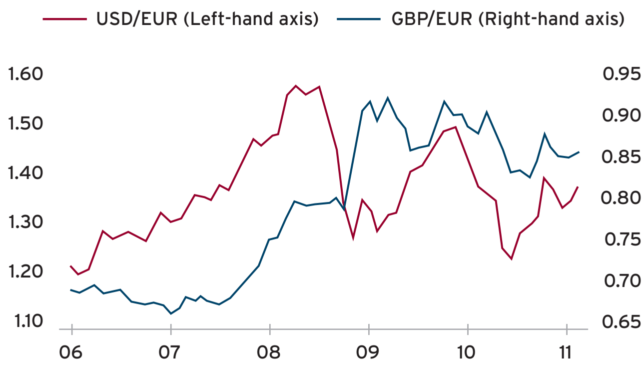

Figure 4

Public finances

The January Exchequer returns were relatively positive and total tax take was up nearly 2% on January 2010. Corporation tax and stamps were up 78% and 39% respectively, but January is not the main payment month for these tax heads so the tax take was only €72 million and €41 million respectively. VAT was up €58 million, or 3.6%, but income tax take was down €65 million, or 6.2%, despite the January tax hikes. It is clear that the labour market remains very weak, but the increase in the VAT take is an encouraging indicator of potential stabilisation in activity levels in the domestic economy.

The estimates for debt servicing expenditure are an arresting illustration of the urgent need to keep the debt burden under control. During 2011, the servicing of the national debt will cost the state €5 billion and take up 14% of total tax revenue.

International economies

Overall, 2010 was a much better year for the global economy than initially expected. Global trade rebounded strongly, benefitting exporting economies such as Germany and Ireland. Growth in emerging economies resumed its pre-recession trajectory and China surpassed Japan as the world's second largest economy. The divergences between rapidly growing emerging economies and developed countries mired in banking and fiscal troubles are, however, becoming more and more evident. The risks relating to sovereign debt in advanced economies have not gone away, as evidenced by the recent downgrading of Japan's credit rating, and the European banking sector is not yet out of the woods. Emerging economies, meanwhile, face risks from imbalanced growth and potential overheating. Global imbalances will require careful navigating from policymakers and politicians across the developed-emerging divide over the coming years to ensure sustained and sustainable world economic growth.

Euro area

The eurozone economies outperformed many forecasters' expectations last year and returned to relatively robust growth of 1.7%, despite the sovereign debt crisis. The recovery has largely been driven by the exporting and industrial sectors, helped by the weaker euro exchange rate. The latest business and consumer surveys indicate that 2011 has gotten off to a positive start, while the ECB's bank lending survey indicated an improvement in demand for credit from the business sector and in particular a stabilisation in demand for investment loans. Considerable downside risks nonetheless still remain. A slowdown in global growth would hit exports; fiscal tightening across the region is likely to dampen growth; and the troubles for peripheral sovereign debt and the euro area banks are far from having been resolved. Looking at individual countries, the German economy rebounded strongly off the back of double-digit export growth. France coped better with the global recession than Germany, but in the upturn is benefitting less from a boost in trade. Political turmoil, high public debt and a weak competitiveness position mean that Italy will stay in the sights of the international markets during 2011, while growth will remain anaemic.

UK

The UK economy remains weak, as demonstrated by the 0.5% quarterly fall in Q4 2010. Although the bad weather certainly had a significant impact, the underlying trend was broadly flat. Adding further to the country's economic difficulties, Bank of England governor Mervyn King recently stated that inflation may reach as high as 5% in the coming months. The effect should be temporary, however, given that the spike in inflation is mainly caused by temporary or external factors, including VAT hikes, weaker sterling and higher commodity prices. The fiscal squeeze will begin to bite properly this year and GDP growth is likely to remain sluggish, but in positive territory.

US

Growth in the US was fairly robust during 2010. After some weakness over the summer, GDP expanded by an annualised 3.2% in the final quarter. Growth remains, however, heavily reliant on both monetary and fiscal stimulus and it is unclear whether it will become self-sustaining once that support is withdrawn. Therefore, despite the relatively benign short-term outlook, dark clouds loom on the horizon. Consumers' indebtedness remains and the resumption in house price decline will push even more homeowners into negative equity. It is unlikely that the recent brisk pace of consumer spending growth can be maintained, particularly given the weak labour market. Unemployment remains high, at nearly twice the pre-recession level, and jobs growth has been muted. The extension of the Bush-era tax cuts only further postpones the day of reckoning for the public finances, a problem that will not go away, with the federal deficit at an all-time record this year.

Real GDP growth - selected countries

Annual % change	2010	2011	2012
Euro area	1.7	1.7	2.0
UK	1.8	1.7	2.0
Germany	3.5	2.5	2.2
France	1.6	1.6	2.0
US	2.7	2.2	3.1

Table 5

Inflation - selected countries

Annual % change	2010	2011	2012
Euro area	1.5	1.3	1.2
UK	3.1	2.6	1.6
Germany	1.0	1.2	1.4
France	1.6	1.1	1.1
US	1.6	1.1	1.1

Table 6

Compensation per employee - selected countries

Annual % change	2010	2011	2012
Euro area	1.7	2.1	2.0
UK	3.8	2.4	3.3
Germany	2.0	2.6	2.3
France	2.8	2.2	2.5
US	2.2	2.5	2.6

Table 7

Source: *OECD Economic Outlook, November 2010*

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