OXFORD ECONOMICS

Ernst & Young

Economic Eye Summer 2010 Forecast

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Technical data notes
For brief technical notes on the Ernst & Young Economic Eye forecasting model, please refer to the spring 2009 and winter 2009 Ernst & Young Economic Eye publications, available at:

Spring 2009: http://www.ey.com/Publication/vwLUAssets/Economic_Eye_-_May_2009_forecast/$FILE/Economic%20Eye%20report%20-%20May%202009%20-%20final.pdf

Winter 2009: http://www.ey.com/Publication/vwLUAssets/EY_Economic_Eye_-_2009_Winter_Forecast/$FILE/0249_Web.pdf

Forecasts are consistent with the UK and Eurozone ITEM Club forecasts

Executive summary

Recession longer than expected

Quarterly GDP growth in the Republic of Ireland (ROI) remained negative throughout 2009, including in Q4 2009, when GDP fell by 2.3%. This was the second largest quarterly decline in output during the recession thus far. This also followed a number of downward revisions to Q2 and Q3 GDP data, which had initially suggested that the recession in ROI had ended. Overall ROI GDP declined by 7.1% in 2009 and a more severe 11.3% in GNP terms.

This performance was in contrast to the UK where a series of upward revisions to data and actual growth in output increased the scale of recovery to 0.4% in Q4 2009, when the UK economy technically moved out of recession. This pattern was continued in Q1 with 0.3% growth. The annual rate of decline in GDP for the UK in 2009 was 4.9%, a less weak performance than ROI, but still the worst performance on record since the 1930s.

While no GDP / GVA data exists for Northern Ireland (NI) on a quarterly basis, the labour market showed its usual seasonal bounce in Q4 according to the unadjusted Quarterly Employee Series (QES) for jobs. Although the seasonally adjusted QES series continued to fall at the end of 2009. When annual GVA data becomes available for NI for 2009, it is likely to show NI's growth was somewhere between the ROI and UK decline. In technical terms, the recession is expected to have ended in Q4 in NI, though only just. There is a distinct prospect of a fall back in Q1 2010 in NI given the weakening of the euro, rising oil prices and the bad weather.

The downward revisions to ROI GDP have nonetheless been modest in scale. Overall the 'peak to trough' loss of ROI GDP remains relatively unchanged since the winter 2009 Ernst & Young Economic Eye forecast report at 12% (17% for GNP). Looking across the Island, north and south combined, this means that output has fallen by 10% since the outset of the recession (using GDP for ROI) and 300,000 net jobs have been lost (11% of the total[1]).

Relative to other world economies over the same period, many of which have managed to avoid major job losses at the expense of overall productivity, these output and job losses have been extremely severe. This reflects the unique set of pressures weighing on the Island, namely a fiscal crisis in ROI and a collapse in the property and construction sectors, coupled with falling global demand.

We forecast a fall in GDP in ROI of 1% overall in 2010, though quarterly growth is expected to return in Q1. Northern Ireland is expected to move back into positive territory, though at 0.7% it is below the corresponding UK figure. Into the longer term ROI returns to enjoying the fastest growth across the three economies by 2013, with NI lagging behind both ROI and UK as the public expenditure squeezes take hold.

With re-balancing pain becoming evident

The pain of re-balancing away from a debt-led economy, into one where exports are the primary engine of growth, has been starkly evident across the Island during the last 6 months since the previous Ernst & Young Economic Eye forecast report. The banking sector has required significant injections of public money across the Island and the construction sector has lost over two-fifths of its workforce, reflecting the reality of re-balancing.

In ROI the impact of public sector cuts is also beginning to impact and further dampen demand. This pattern is likely to persist for some time yet given the scale of fiscal overhang. The general government balance is estimated to have run to over 14% of GDP in 2009, based on the Eurostat fiscal definition, or 12% using the Department for Finance's definition which excludes the bail outs of banks.

[1] Based on annual average and mid-year employment

For NI this re-balancing process, specifically in terms of reducing public spending, lies ahead. The Conservative-Liberal Democratic coalition government has announced plans to bring forward public expenditures cuts into this financial year. For a region so heavily dependent on public expenditure - roughly £17bn of public spend is three-fifths of nominal GVA, and 3 in 10 persons are directly employed in the public sector - this will clearly have a severe impact on NI.

The implications of the re-balancing process will be a sluggish and largely 'jobless' recovery across the Island. The Ernst & Young Economic Eye summer 2010 suggests that it will be well over a decade before all-Island employment returns to its peak of 2.9m achieved in 2007.

Uncertainty abounds

Unfortunately the risks to the forecasts remain more pronounced on the downside. One of the main risks is the ability to reduce public borrowing, even given the plans already in place, with the possibility of contagion from the Greek debt crisis making this an increasing challenge. Nervousness over the ability of the UK economy under a coalition government to make the tough choices on spending and tax which are necessary to reduce the fiscal deficit is a further risk.

Coupled with risks over rising energy prices, euro exchange rate volatility and the strength of the global recovery it is clear that the road to economic recovery remains littered with potential obstacles.

That said, the strong performance of the US economy, which is forecast to grow by 3.5% in 2010, improving confidence and corporate indicators, and 'bottoming out' in the labour market, give comfort that the worst of the recession is over and the Island economy is, finally, beginning to look upwards.

Ireland is not Greece

Much has been made of ROI's public finance problems, not least as it was the first Eurozone economy to enter recession and the first to run into double-digit deficit territory. As a result, Ireland has been branded alongside Portugal, Spain, Italy and Greece in the rather unflattering 'PIIGS' moniker.

Though there are similarities in the scale of fiscal deficits, bloated and now shrinking construction sectors (Spain and Ireland), and problems in the banking sector (Greece and Ireland), the Ernst & Young Economic Eye summer 2010 forecast report clearly identifies a range of factors in which the economies differ markedly.

For example Ireland has an extremely strong and large export sector, with a significant proportion of exports being high value added. Like the UK and US, Ireland has a healthy service sector export base in addition to a significant pool of high-end production exports.

In addition the overall stock of government debt, built up over the long-term and not just recently, is much lower in ROI than in other fiscally challenged countries, when expressed as a share of national output. This matters for issues of solvency and investor confidence, as much, if not more, than recent annual fiscal deficit borrowing. Prices and wages have also been falling and correcting past excesses in Ireland, thus curbing costs and enhancing cost competitiveness. This is much in the same way as the German economy developed since the euro was introduced. With no option to devalue its currency, Ireland's export competitiveness relies heavily on its 'international cost'. Ireland also has a stronger and faster improving graduate skills base than other 'PIIGS' countries, and corporation tax remains highly competitive.

As a result of these competitiveness and structural fundamentals, the Ernst & Young Economic Eye summer 2010 forecast is for ROI to return to relatively strong rates of growth in the medium-term, above those in the UK and NI, and well above the growth expectation for Greece and Portugal.

While the recession has been extremely painful for Ireland, its internationalism and enviable list of corporates located within the country, across a range of high value added, high growth potential sectors, means that its prospects are move favourable than the countries which it is currently being branded alongside.

1 Data disappoints

1.1 Island has contracted by 10 per cent

The peak-to-trough contraction in the Island economy's output has been an eye-watering 10% in GDP terms. The Island economy has also lost 300,000 net jobs, 11% of the total, since the start of the recession. Average house prices have fallen on average by two-fifths in ROI and one-quarter in NI.

Indeed in GNP terms, a more useful measure of domestic economic strength, the ROI economy has contracted by a staggering 17% from peak-to-trough.

While the recession may technically have ended in 2009 Q4 in the UK / NI and is predicted to end in 2010 Q1 in ROI, the overall outlook for 2010 remains hampered by a number of factors. These include cuts in public current and capital spending, constraints on consumer spending as households re-build savings, and restricted bank lending.

Even the medium-term recovery has a number of hurdles to clear before it can gather any momentum. There has been increasing debate about the possibility of a double dip recession in the UK as the result of public expenditure squeezes and / or tax rises beginning to bite. The ROI economy is not yet confirmed as being out of recession, though the Q1 data, due by end June, is expected to confirm a return to growth, provided exports bounce back from their dip at the end of last year. However the rate of quarterly growth is expected to only be modest, suggesting the economy has not 'sprung into recovery' as has been the case in the past.

Table 1.1: All-Island and UK economic growth performance and forecasts (annual % growth)

	ROI (real GDP)	ROI (real GNP)	NI (real GVA)	UK (real GDP)	All-Island
2008	-3.0	-2.8	0.1	0.5	-2.4
2009	-7.1	-11.3	-4.6	-4.9	-6.7
2010	-1.0	-1.3	0.6	1.0	-0.7
2011	2.8	3.2	2.0	2.7	2.7
2012	3.9	3.7	2.7	3.4	3.6
2013	3.5	3.3	2.6	3.1	3.3

Source: CSO, ONS, Ernst & Young Economic Eye

The sluggish recovery in 2010 is precisely as predicted in the Ernst & Young Economic Eye winter 2009 forecast report. This is due to the pressures faced by both the public purse and consumers. It is 2012 before the recovery gathers any real momentum and even then it is more a recovery in output than jobs. As such for the general population, the recovery will continue to feel sluggish for some time.

1.2 Contrasting recent fortunes of ROI and the improving UK

The 2009 whole year outturn for ROI GDP has turned out slightly less negative than expected in the winter 2009 Ernst & Young Economic Eye forecast report, at 7.1% compared to an expectation of 7.3%. GNP in contrast has turned out more negative. Private consumption, investment and export outturns have been weaker than expected, and de-stocking has been higher. These have all been offset however by extremely weak import demand. As imports are a leakage, when they fall, GDP rises. Conversely therefore, weak domestic demand for imports has helped to improve GDP performance, when actually it reflects a lack of demand.

GDP data for Q4 was particularly disappointing for ROI, with a 2.3% quarter-on-quarter contraction in GDP. This was the worst quarterly performance figure since Q1 2009, and the second worst quarterly performance throughout the recession. Disappointingly this came at a time when the worst of the recession was expected to be over.

The contraction in output in Q4 was acute in investment, although this has been in keeping with the recent past and reflects a sharp reduction in spend by the residential construction sector. Commercial build and public works have also contributed to the sharp falls in investment.

Table 1.2: ROI economic growth performance by expenditure component (real quarterly % growth)

	Private consumption	Government consumption	Investment	Exports	Imports	GDP
2008 Q3	0.2	-0.9	0.4	-0.3	0.5	0.0
2008 Q4	-2.4	1.1	-15.6	-1.5	-4.9	-4.7
2009 Q1	-4.9	0.0	-12.4	-0.7	-3.2	-2.0
2009 Q2	0.4	-1.7	1.5	0.2	0.4	-0.7
2009 Q3	-0.6	-1.1	-10.3	-0.6	-4.7	-0.1
2009 Q4	-0.3	-0.8	-9.7	0.1	-0.1	-2.3

Source: CSO

In contrast with the UK where it is still rising, government consumption has been falling for three quarters in Ireland. Private consumption, apart from Q2 2009, has not returned to positive territory in ROI as it has just done in the UK.

Table 1.3: UK economic growth performance by expenditure component (real quarterly % growth)

	Private consumption	Government consumption	Investment	Exports	Imports	GDP
2008 Q3	-0.3	0.5	-3.6	-0.6	-1.1	-0.9
2008 Q4	-1.2	1.1	-2.4	-4.5	-6.1	-1.8
2009 Q1	-1.6	-0.4	-7.3	-7.2	-6.5	-2.6
2009 Q2	-0.9	0.9	-7.2	-1.8	-2.9	-0.7
2009 Q3	0.0	0.6	2.8	0.6	1.2	-0.3
2009 Q4	0.4	1.0	-2.7	3.8	4.7	0.4

Source: ONS

These figures confirm the UK exited recession before the Irish economy. The UK economy also entered recession later. However the interpretation is perhaps not as gloomy for ROI as it might appear.

The contraction in government consumption reflects the swift corrective actions taken by the Irish government. These corrections lie ahead for the UK and time will tell whether the delay in enacting them has been wise. Equally the unwinding of the construction bubble, whilst extremely damaging, is a one-off correction that will not continue through into the medium-term.

1.3 Weak Irish goods exports performance in second half of 2009

The contraction of over 12% in goods exports between Q2 and Q4 2009, a disappointing feature of recent performance in ROI, was dominated by a fall in export earnings of one of the major commodities - organic chemicals. This made up one fifth of goods exports in H1 2009. We do not expect this pattern to continue and indeed it may give a slightly misleading view of overall export performance. Though organic chemicals dominated the fall in goods exports, performance in office machinery, essential oils and electrical machinery was also relatively weak in H2.

Table 1.4: ROI goods export performance (nominal bi-annual % growth / change)

	Bi-annual growth			Bi-annual change (Euro bn)		
	2008 H2	2009 H1	2009 H2	2008 H2	2009 H1	2009 H2
Medicinal & pharmaceutical products	9.2	11.9	-0.1	0.7	1.0	0.0
Organic chemicals	-8.8	31.4	-36.6	-0.8	2.7	-4.1
Office machines & data processing equipment	-2.3	-25.0	-7.1	-0.1	-1.2	-0.2
Essential oils, perfume materials, toilet preparations	-10.5	11.1	-9.3	-0.3	0.3	-0.3
Misc manufactured articles	7.8	-1.2	-2.0	0.2	0.0	0.0
Electrical machinery & appliances	-1.1	-26.9	-9.2	0.0	-0.6	-0.2
Chemical materials & products	-3.2	0.9	-4.1	-0.1	0.0	-0.1
Professional, scientific & controlling apparatus	22.1	-8.1	8.7	0.3	-0.1	0.1
Meat & meat preparations	10.0	-16.0	6.9	0.1	-0.2	0.1

Source: CSO
Note: Merchandise Euro nominal export earnings. The above commodities make up 80% of total goods exports

Despite the H2 goods export weakness in ROI, both the UK and Ireland have enjoyed more robust export performance during the recession than a number of competitor countries. This is largely due to the high end nature of much of their manufactured products, and less cyclical demand for key goods exports – e.g. pharmaceutical products, and the larger contribution to overall exports from the service sector. Although service sector exports have been impacted by problems in tourism and international financial services, it is important to stress for the latter how many firms in this sector have already returned to growth, and the significant role the sector still plays in world trade.

Looking at UK and Irish service sector exports in Q4, both recorded positive growth, with the Irish growth spectacular at over 12% growth on Q3. This reflects a strong service sector performance through the recession, in spite of the problems in the financial sector, and is a major factor in our medium-term optimism for both the ROI and UK economies.

Table 1.5: ROI and UK export performance (real quarterly % growth)

	ROI		UK	
	Exports of goods	Exports of services	Exports of goods	Exports of services
2008 Q3	-2.1	2.5	-0.5	-0.6
2008 Q4	-9.3	10.3	-7.4	-0.2
2009 Q1	5.2	-8.1	-7.9	-6.1
2009 Q2	1.9	-2.2	-1.0	-2.8
2009 Q3	-3.8	4.0	2.2	-1.6
2009 Q4	-8.8	12.3	5.6	1.2

Source: CSO, ONS

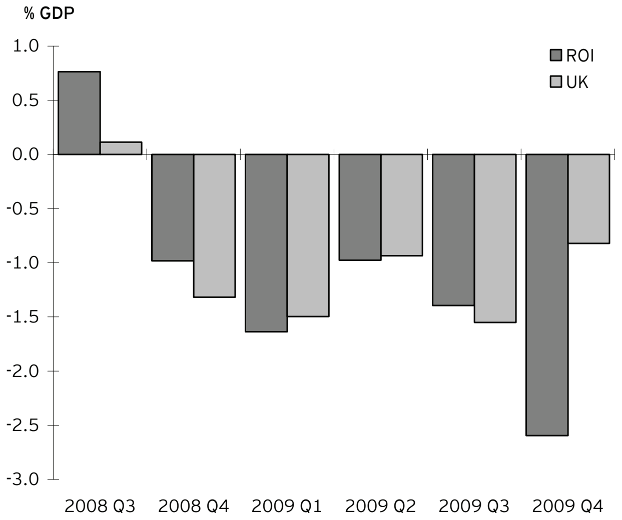
There is no quarterly data on NI exports. However the latest annual figures for 2008/09 showed a 9% increase in manufacturing sales to the EU (including ROI), reflecting potentially the benefits of sterling weakness against the euro at that time. The employment data in export sectors also suggest that exports may have held up rather well during the recession. The sharp falls in manufacturing employment have been largely in the sectors supplying to construction, such as aggregates, minerals etc, which have a lower propensity to export. Major exporting sectors, such as food & drink, electrical & optical equipment, pharmaceuticals and machinery & transport equipment have faired rather better, aided by a broadly favourable exchange rate despite some recent correction.

1.4 De-stocking continues

Another small, but important contributing factor to overall GDP performance, is the level and change in stocks in the economy. Net stock changes through 2009 in both ROI and the UK have been consistently negative, i.e. on balance stocks are being run down, with a sharp fall of net stocks as a share of GDP to over 2.5% in ROI in Q4.

This in fact contributed 1% to the overall GDP contraction of 2.3% in the quarter. This de-stocking cannot go on indefinitely, as stocks must be starting to run low, but has been an important part of the recession story in 2009 in both ROI and the UK.

Fig 1.1: ROI and UK net change in stocks (real % GDP)



Source: CSO, ONS

2 Has the labour market bottomed out?

2.1 Labour market still contracting?

Across the Island, the labour market has suffered significant job loss, estimated at 300,000 net jobs since the start of the recession. Although given the scale of contraction of output, job losses have perhaps been slightly less than initial expectations in NI. The data on the labour market in late 2009 / early 2010 is far from clear and there are a number of inconsistencies in published sources, meaning a wider source of data is required to draw effective conclusions.

The rate of job losses slowed over the course of 2009, and on a seasonally unadjusted basis, employee jobs actually rose in Q4 in NI. This however is expected to be temporary and will be largely reversed in the Q1 data when it is published.

Using comparable International Labour Organisation (ILO) definition data for both ROI and NI [from the Quarterly National Household Survey (QNHS) and Labour Force Survey (LFS)], the quarterly pattern suggests that the NI labour market actually began to expand in Q3 2009, a trend which has continued in the two subsequent quarters. This is however not corroborated by the more robust Quarterly Employment survey of employee jobs, nor by unemployment data. This implies that the labour market has not in fact 'turned' in NI.

As of Q4 2009, the ROI labour market continues to contract, albeit at its most modest quarterly rate since Q2 2008.

Table 2.1: All-Island employment performance (quarterly % growth)

	ROI		NI		NI	
	QNHS (adjusted)	QNHS (unadjusted)	LFS (adjusted)	LFS (unadjusted)	QES (adjusted)	QES (unadjusted)
2008 Q1	0.0	-0.7	0.5	0.4	0.3	-0.6
2008 Q2	-0.8	-0.5	0.9	1.1	0.0	0.0
2008 Q3	-1.4	-0.3	-0.5	-0.3	-0.8	-1.2
2008 Q4	-1.8	-2.5	-1.8	-2.0	-1.0	0.3
2009 Q1	-3.6	-4.3	-2.3	-2.5	-1.0	-1.9
2009 Q2	-1.7	-1.4	-1.4	-1.5	-0.8	-0.9
2009 Q3	-2.0	-0.8	0.8	1.4	-0.7	-1.1
2009 Q4	-1.2	-1.8	1.7	1.6	-0.4	1.0
2010 Q1	na	na	1.1	0.7	na	na

Source: CSO, LFS, DETI

As previously reported by the Ernst & Young Economic Eye forecast, jobs losses have been dominated by the construction sector (approximately half of total losses), and the manufacturing and retail & distribution sectors.

Business services have contracted more sharply in ROI, with an almost 10% reduction in employment levels, more than twice the rate of loss in NI or UK. However this is still proportionally less than the losses in the production sectors. This pattern reflects the longer 'lead time' in the service industry in reacting to market conditions, given its labour intensity and inability to 'turn off production' in the same way as factories and construction sites can. There are likely to be further job losses across both business and financial services as a result of restructuring, mergers and cost reduction programmes, many of which are already underway.

The job losses in the agriculture sector in ROI, compared to gains in NI, perhaps partly reflect the prevailing exchange rates over the course of the recession. Although it is worth noting that agriculture employment data is less reliable than for other sectors. The euro's strength, until recently, will also have played a part in the more pronounced job losses in retailing in ROI. Efforts to restore price competitiveness in ROI supermarkets, by purchasing in sterling from GB farmers, may also explain part of the job losses in agriculture.

The public sector has remained the strongest element of the labour market in the three jurisdictions during the recession. Though ROI, where public sector employment is no longer growing, is in contrast to the still expanding public service sectors in NI and the UK. As remarked earlier, this reflects the alternate fiscal stance, partly a result of European Commission and investor pressures, and possibly also a reflection of divergent economic strategies.

Table 2.2: All-Island and UK sectoral employment forecast change (2008-2010)

	2008-2010 (change 000s)		2008-2010 (% change)		
	ROI	NI	ROI	NI	UK
Agriculture, forestry & fishing	-20	2	-16	8	-3
Production & construction	-147	-22	-27	-13	-10
Mining	-1	0	-13	-14	-6
Manufacturing	-31	-9	-12	-10	-11
Utilities	-2	0	-13	-4	-1
Construction	-114	-13	-45	-18	-9
Services	-80	-15	-6	-3	-2
Distribution & retail	-42	-10	-14	-8	-5
Hotels & catering	-6	-1	-5	-2	-3
Transport & communications	-2	-1	-2	-2	-3
Financial services	2	-1	2	-5	-5
Business services	-18	-5	-9	-6	-4
Public administration	-1	0	-2	1	0
Education	-2	2	-2	4	3
Health	-1	2	0	2	5
Other services	-9	-1	-7	-4	0
Total	**-247**	**-34**	**-12**	**-4**	**-3**

Source: CSO, DETI, Ernst & Young Economic Eye

Note: ROI annual figures are the calendar average of four quarters. NI and UK figures are mid-year (change in land forces and government training schemes employment not reported seperately for NI). Employment is people-based for all juridictions

In terms of unemployment, the rate actually fell on the ILO measure in NI towards the later half of 2009. Though again this was not corroborated by other data sources, including the claimant count. ROI ILO unemployment continues to rise, albeit at a slowing rate. The unemployment rate in ROI stood at 13% at the end of 2009, over twice the corresponding rate in Northern Ireland, which itself was well above the lows of 2007 and 2008.

Looking at the claimant count in NI and live register in ROI, which are alternate measures of unemployment, although the live register is not as close a proxy, there is evidence of a 'bottoming-out' in late 2009 / early 2010. Unemployment levels are now relatively flat or falling in the latter part of 2009 in both economies. However a modest rise in unemployment occurred in early 2010 which is likely a result of the post-Christmas effect, whereby seasonal staff are laid off. Furthermore the impact of the very bad weather in January, and more recently the ash cloud, are likely to have been the 'straw' that will have broken the backs of many businesses already in a perilous state as a result of the recession.

Fig 2.1: ROI live register and seasonally adjusted ILO unemployment rate

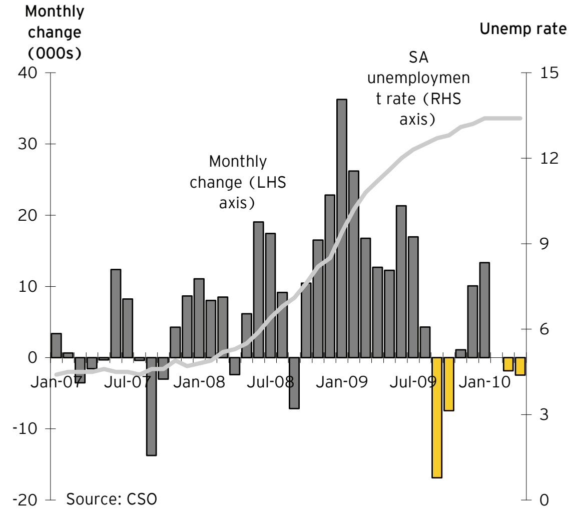
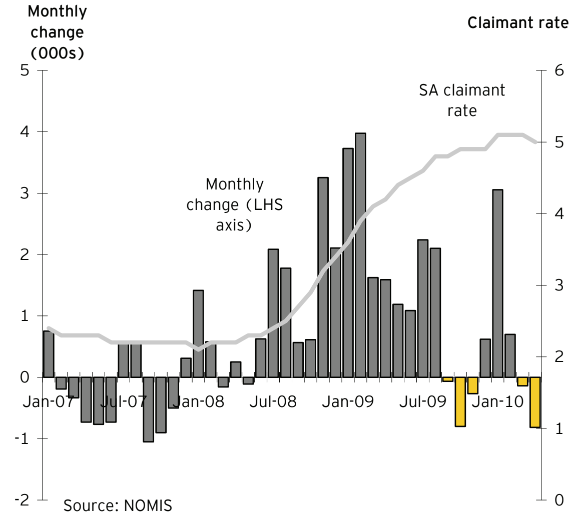


Fig 2.2: NI claimant count and seasonally adjusted claimant unemployment rate



2.2 A recession of the young

The unemployment data suggests this recession has, across the Island, been disproportionately damaging for the young. According to the ILO definition, in ROI there has been a rise in the number unemployed of almost 160,000 between 2008 Q1 and 2009 Q4. In NI the claimant count has risen by 28,000 over the same period. Note the corresponding figure from the ILO measure for NI is only 10,000.

In ROI, 56% of the total increase in unemployment has been in the 'prime working age' category of 25-44, slightly higher than the corresponding NI figure of 48%. Note these figures are not reported in the table below. Under 25s make up 23% of the increase in ROI and 32% in NI. According to the Live Register unemployment rates are around a third for 15-19 year olds, and close to a quarter for 20-24 year olds in ROI. In Northern Ireland the claimant rate is around 10% in the 20-24 age category. In both jurisdictions these rates of unemployment are higher than in any other age groups.

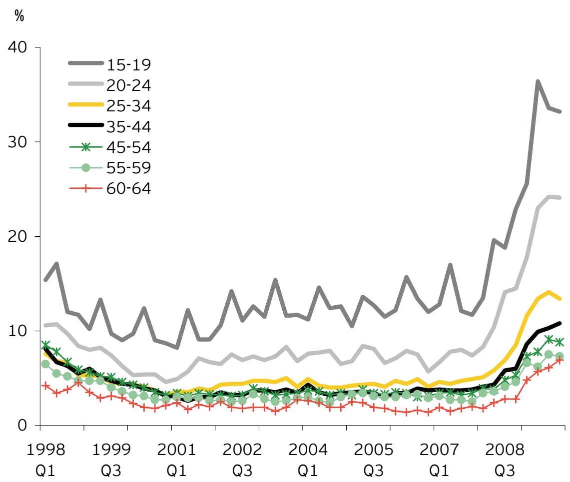
This is in contrast to previous recession which had a much greater impact on older age categories. This may reflect the ease of letting temporary workers go, costs associated with paying off older workers, or recognition of the unique skills set and experience in older workers. It may also be a factor that many older people do not move onto the unemployment register or declare themselves as unemployed, thus they may be under-represented in this type of analysis.

Table 2.3: ROI unadjusted ILO unemployment and NI unadjusted claimant count unemployment by age band[2]

	ROI (ILO unemployed)		NI (claimant unemployed)	
	Change 2008 Q1-2009 Q4 (000s)	2009 Q4 (% total)	Change 2008 Q1-2009 Q4 (000s)	2009 Q4 (% total)
Under 19	8	7	2	9
20-24	28	19	7	23
25-34	53	33	8	26
35-44	36	21	6	20
45-54	22	14	4	16
55-59	6	4	1	5
60+	5	2	0	1
Total	158	100	28	100

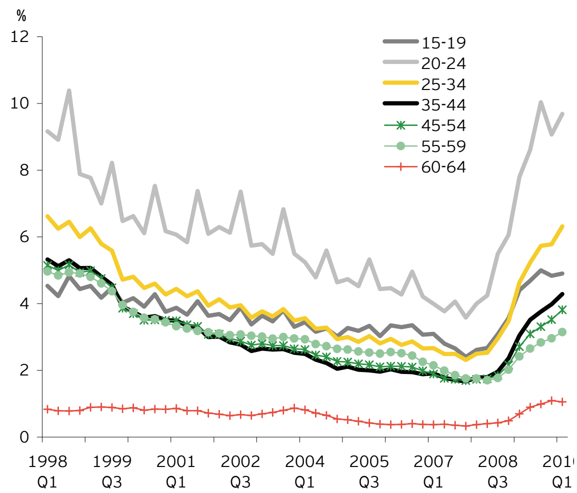
Source: CSO (ROI), NOMIS (NI), Ernst & Young Economic Eye

Fig 2.3: ROI unadjusted ILO unemployment rates by age band



Source: CSO

Fig 2.4: NI unadjusted claimant unemployment rates by age band



Source: NOMIS

The recession has also pushed up rates of long-term unemployment, defined as persons unemployed for more than a year. This is of particular concern as it is expensive and more difficult to get people back into work after a protracted period of absence, quite apart from the obvious financial and psychological pressures placed on the individuals.

The long-term ILO unemployment rate in ROI is now 4% (of the labour force) compared to just 1% in NI (claimant % working age population). This, to a degree, reflects the earlier onset of the recession in ROI. It is likely a significant proportion of these people in ROI are construction workers with negligible job opportunities in the sector at present, and a skills profile which does not match the few opportunities that may be available.

2.3 Do confidence indicators suggest improvement?

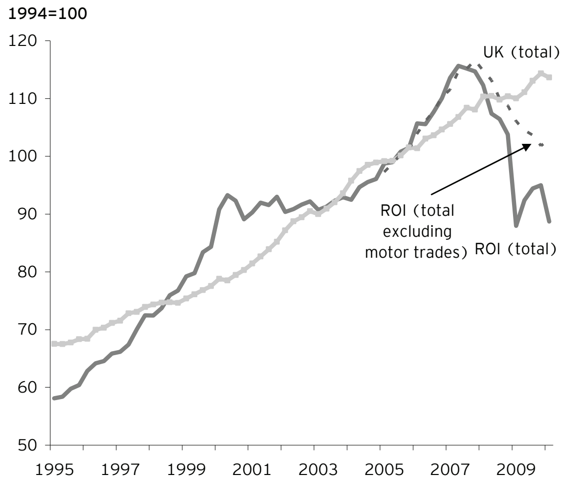
To support the evidence of a turn in the economy, for which the labour market data gives us only inconclusive evidence, and ROI GDP data is not yet available for Q1 2010, retail sales and confidence data prove useful data points.

[2] NI LFS unemployment data by age band is not reported here due to small sample size issues.

The retail sales data, which is not available for NI separately, showed only a modest slowdown through the recession in the UK. This is a remarkable outcome, and is a function of falling interest rates and reduced mortgage repayment costs, a relatively limited level of net job loss (given what was originally feared), discounting in shops and policies such as Vat cuts, and the car scrappage scheme. It is likely that retail sales in the UK will moderate in 2010 as the impact of public spending cuts, tax rises (one for Vat is likely) and the end of fiscal stimulus becomes a reality.

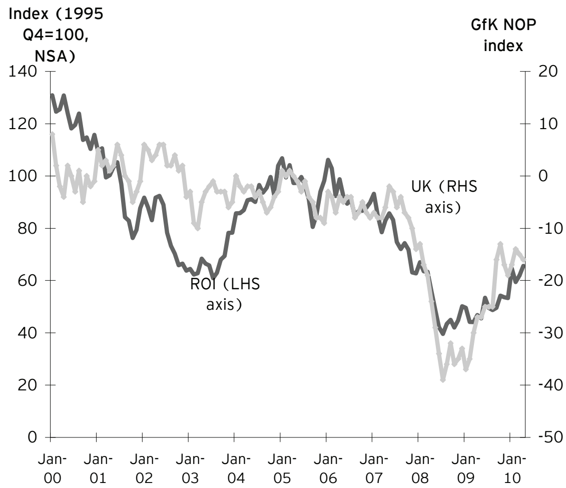
For ROI, retail sales fell precipitously from 2007, and the debt bubble effect is evident with retail sales levels, in volume terms, returning to the levels of 2000-2005, which would appear more sustainable into the longer-term. A large part of this fall is accounted for by a sharp fall in motor sales, in which cross border retail flows played a major factor. Excluding motor trades, the fall has been more modest and again a bottoming out and even a modest improvement is evident in early 2010.

Fig 2.5: ROI and UK retail sales volume index



Source: CSO, ONS

Fig 2.6: ROI and UK consumer confidence



Source: ESRC / KBC, GfK

Note: A decline in / lower value for the ROI consumer sentiment index and UK GfK NOP index indicate a fall in confidence / lower level of confidence.

Business and consumer confidence indicator conditions are definitely well improved from the lows of 2008, with the reversal in fortunes more marked in the UK. However the pattern is not one of steady improvement, with confidence levels still well down on pre-recession levels. The consumer confidence indices appear to confirm the slight improvement toward the turn for the year, but holding steady is about as positive as the summary of early 2010 can be termed.

The Purchasing Managers Indices (PMI) are rather more encouraging for ROI than NI, with both manufacturing and services reaching positive territory by late 2009 / early 2010. This is in stark contrast to NI where the PMI continues to report contraction (i.e. index values less than 50), as it has done through 2009 and early 2010, for both output and jobs – the only UK region to do so[3].

This divergence between ROI and NI may partly reflect the severity of the fall in ROI compared to NI, where a sharper decline is followed by a more noticeable recovery. However it does all signal a

[3] One exception is the PMI index for manufacturing new orders in NI which marginally exceeded 50 in February 2010.

concern for NI and reveals its relative exposure to the public sector and construction , compared to other UK regions.

3 The reality of a sluggish recovery

3.1 Debt overhang

As previous Ernst & Young Economic Eye forecast reports have projected, economic recovery on the Island is likely to be relatively slow and not the V-shaped recovery that has typified many previous recessions. The primary reason for this is the scale of debt overhang, both in the public and consumer sectors, which will act as drag on growth for some time.

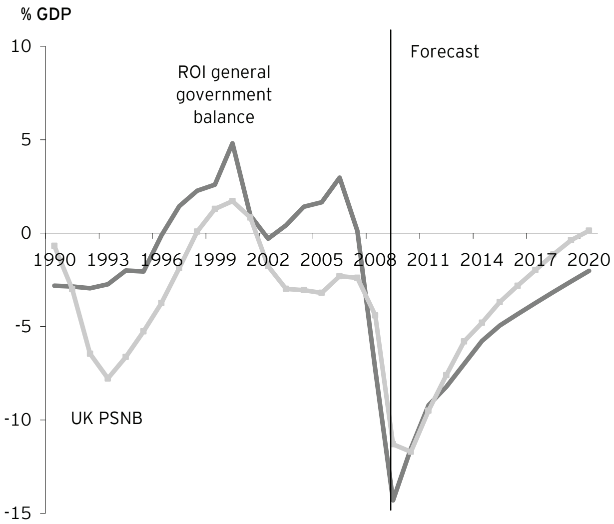
The size of the annual government fiscal deficit in 2009 is larger in ROI, at around 14% of GDP (Eurostat definition), compared to 10% in the UK (public sector net borrowing definition). This actual higher outturn level of public borrowing in ROI in 2009 has diverged from the previously expected similar level to the UK for 2009. UK government borrowing has turned out lower than expected but higher in ROI with the inclusion of bank bail out spending in the figures.

With a new political administration in the UK, decisions are already being made which signal earlier spending cuts than would have been the case had the Labour government still been in power. It remains to be seen, however, the extent and pace with which the UK coalition government will be able to tackle the deficit. This is partly given the differences in opinion between the Conservatives and the Liberal Democrats over issues such as tax policy and public spending cuts.

The Summer 2010 Ernst & Young Economic Eye forecast suggests that both economies will struggle to meet their European Commission targets and deadlines for deficit reduction. This is partly as the economic recovery is expected to be less robust than official projections suggest, at least for the UK. The Irish Department for Finance appears more realistic in its assessment of recovery prospects and it will be interesting in the UK to see if the new Chancellor makes any alternation to the existing Treasury growth projections, which assumed huge growth in investment levels in 2011 (over 10%). One of the agreements so far by the coalition government is that new forecasts of growth and borrowing should be made by an independent Office for Budget Responsibility.

Though the ROI re-balancing and fiscal austerity actions have begun earlier than in the UK, we predict a similar trajectory in deficit closure. This is because the Irish economy has suffered a greater contraction and its problems in the construction and domestic sectors are more acute.

Fig 3.1: ROI general government balance and UK PSNB performance and forecast



Source: Dept Finance, CSO, HM Treasury, ONS, EY Economic Eye

3.2 Can NI avoid the UK-wide spending cuts?

The NI election manifestos revealed an almost unilateral strategy of resisting any cuts to public expenditure. Given the result of the UK national election, this reluctance to cuts is unlikely to meet with success. It may have done if any of the NI parties could have offered an overall majority to either Labour or the Conservatives with their seats at Westminster. It is unclear however to what extent the manifestos reflected a populist message to voters, or a genuine belief that Northern Ireland should be exempt from the round of impending cuts that all other regions of the UK are likely to face.

Given NI's significant public sector dependence - roughly £17bn of public spend is three-fifths of nominal GVA, and 3 in 10 persons are directly employed in the public sector - there is no doubt public spending cuts will have a significant impact. However it seems inconceivable that any economic case of need can be made to preserve this high level of spend per capita, when the economic plight of much lesser-funded regions such as the North East and Wales are taken into account.

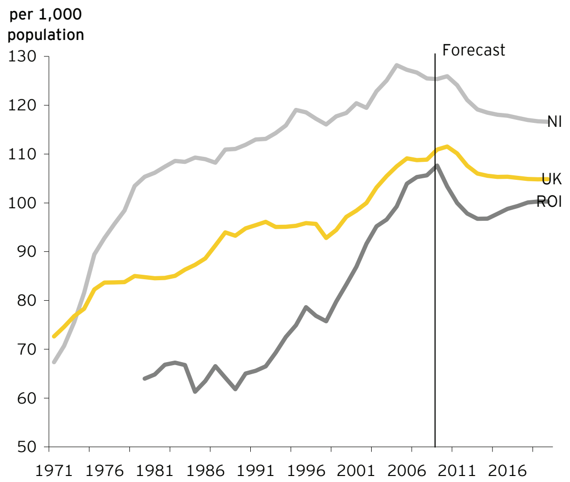
So although NI does not have a formal level of borrowing which it otherwise would need to scale back on, rather it receives a grant subvention, it will be expected to shoulder its share of public spending reductions. It has been confirmed that cuts for NI will be in the order of £128m in 2010, in addition to existing efficiency savings, now that the Conservative's plan for £6bn cuts this year has been announced. Overall estimates of total cuts for NI over the medium-term range from £750m to over a £1bn. These depend crucially on the overall strength of recovery in the UK economy and exchequer performance, and rather less on the fortunes and performance of the NI economy itself.

3.3 Rebalancing implications of fiscal austerity

Reducing government borrowing allied to potential consumer caution on the back of tax rises will be to act as a drag on overall economic growth prospects.

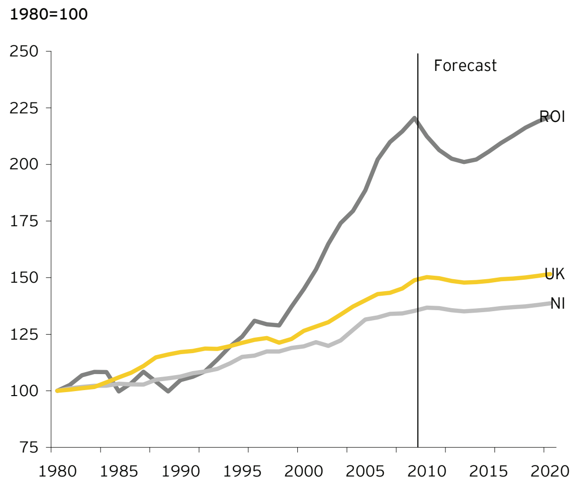
The Summer 2010 Ernst & Young Economic Eye forecast suggest contraction in public sector employment, defined as public administration, health and education in this instance[4], of 30,000 across the Island by 2015 (4% of total). The extent to which this figure is realised depends upon the scale of efficiency savings from non-wage budget areas, the ability to control pay levels and adopt flexible working in public service, and the level of cuts internalised as opposed to passed to the private sector through reduced procurement and capital investment. It should be stated however that relative to job losses in other sectors, 4% is by no means a high figure and only moderately redresses recent growth in the sector.

Fig 3.2: All-Island and UK public sector employment per capita performance and forecast



Source: CSO, DETI, NISRA, ONS, Ernst & Young Economic Eye

Fig 3.3: All-Island and UK public sector employment performance and forecast



Source: CSO, DETI, ONS, Ernst & Young Economic Eye

4 Note this will include elements of private education and health which are difficult to isolate and remove from the data.

Looking back to the boom years in the 1990s, Ireland's growth was fuelled by extremely strong export performance, but this was augmented by strong investment, government and consumer expenditure. In the following decade pre-recession, export growth moderated but government consumption accelerated to an average of over 5% per annum. In other words ROI shifted from export-led to domestic-led growth. In the decade ahead, government consumption growth is forecast at just 0.5% per annum, akin to growth in the 1980s. With consumer spending and investment also forecast to grow slower, the GDP growth outlook is more moderate than in the two decades previous, though forecast GDP growth for Ireland is still well above the UK average projected for the same period.

Ireland's economic performance appears much more spectacular when looking back. However recall the Irish economy was playing catch-up with much lower standards of living at the start of the period covered in the table – the early 1970s. UK average annual GDP growth has not averaged above Irish growth in any of the last four decades, though it has contracted by less during this recession. The pattern of slower UK growth compared to ROI is forecast to continue over the next decade, with the drag from constrained government spending very apparent in the table - just 0.3% per annum, less than in any of the previous four decades.

Table 3.1: ROI and UK historic and forecast economic growth performance by expenditure component (real annual average % growth)

	1970s*	1980s	1990s	2000s (excl 2008/9-2010)**	2008-2010	2010s
ROI						
Private consumption	3.1	3.4	5.6	5.0	-4.7	2.8
Government consumption	5.5	0.6	4.1	5.1	-2.7	0.5
Investment	4.2	1.1	7.9	5.6	-24.4	4.0
Exports	7.8	8.6	15.2	5.8	0.7	4.9
Imports	5.3	5.5	13.9	5.3	-5.4	4.4
GDP	3.8	4.2	7.1	5.5	-4.1	3.5
GNP	3.1	3.0	6.5	4.7	-6.4	3.5
UK						
Private consumption	1.1	3.5	2.8	2.5	-1.5	2.4
Government consumption	1.8	0.8	1.3	2.5	1.8	0.3
Investment	-0.4	4.4	2.8	3.1	-9.3	3.6
Exports	3.7	3.5	6.0	3.5	-3.2	5.8
Imports	1.6	5.6	6.2	4.1	-4.5	4.2
GDP	1.0	2.7	2.5	2.3	-2.0	2.7

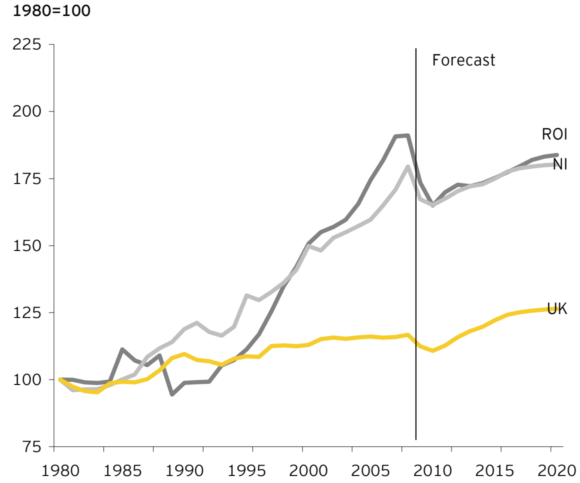
Source: CSO, ONS, Ernst & Young Economic Eye
Notes: * 1973-1980; ** excluding 2008-2010 ROI, 2009-2010 UK)

3.4 Consumer pressures

Pressures on the consumer in ROI will remain severe in the short to medium-term, despite prices having fallen in Ireland. Wage settlements are expected to remain very subdued, and there could be further agreed pay cuts in some cases, and tax rises, if they come, will further squeeze real incomes.

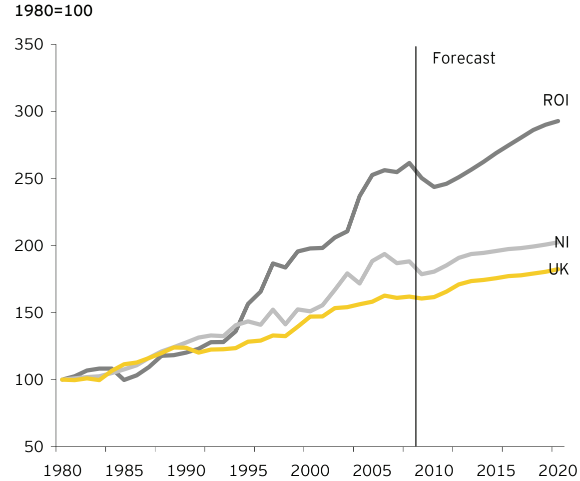
This means that prospects for consumer spending sectors, such as retailing and other services (which includes leisure), will also struggle to gather much pace. Thus these sectors will contribute only modestly to job growth in the medium-term.

Fig 3.4: All-Island and UK retail & distribution employment performance and forecast



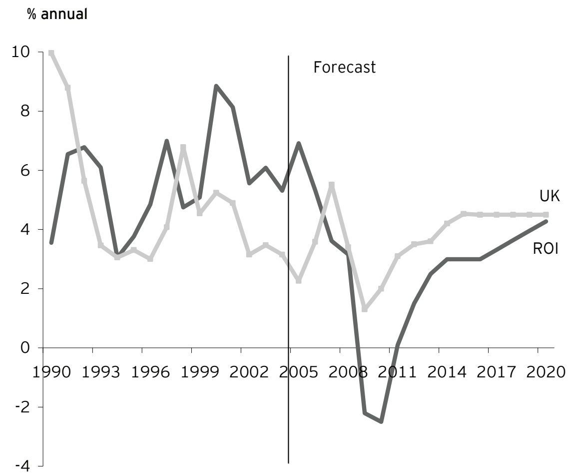
Source: CSO, DETI, ONS, Ernst & Young Economic Eye

Fig 3.5: All-Island and UK other personal services employment performance and forecast



Source: CSO, DETI, ONS, Ernst & Young Economic Eye

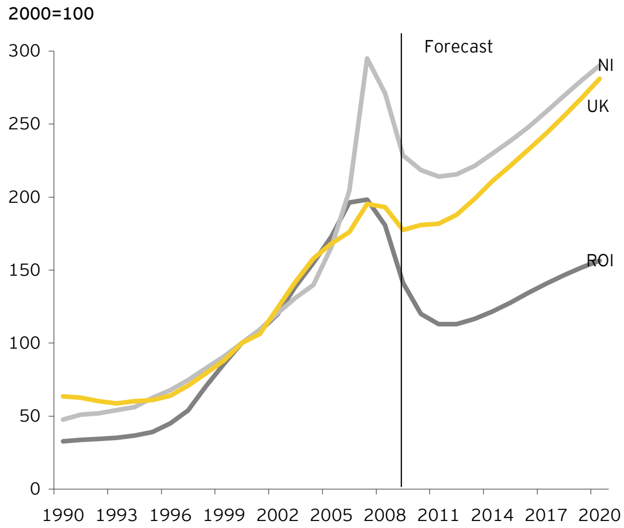
Fig 3.6: ROI and UK earnings growth performance and forecast



Haver Analytics, Ernst & Young Economic Eye

Consumer confidence is improving slightly as the labour market bottoms out, but muted pay growth and stagnant house prices will further weaken the feeling of wealth in the economy. Though house prices have, or are close to ending their sharp falls, there is little prospect of significant rises. Further declines would be a more likely outcome. This is due to factors such as (1) the prospect of higher interest rates, (2) relatively restrictive lending criteria, though this is arguably a more prudent long-term lending stance, and (3) in the case of ROI, a significant over-supply of housing and likely out migration pressures (see later). A period of sustained house price stagnation should however be welcome from an affordability perspective, given constrained wage growth or a further round of pay cuts. If house prices rose strongly in the recovery, issues of affordability would quickly surface again.

Fig 3.7: All-Island and UK house price performance and forecast



Source: Haver Analytics, DCLG, Ernst & Young Economic Eye

3.5 Inevitable unpopular but necessary decisions

Further evidence of the reality of re-balancing, in addition to the shift from debt-led and domestic-led growth to export-led growth, is the difficult policy choices which are currently being made across the Western world.

Bank bail outs have caused considerable unease in both the UK and Ireland, with the public vocal in their displeasure. Politicians have consequently sought to tap into this public mood by recouping taxpayers' investments and imposing new regulations and taxes. The UK had a temporary bankers' tax which appears to have generated above expected tax returns (an estimated £2bn). The US has also been vocal in a desire to prevent future banking excesses and is currently passing new more restrictive legislation.

However at the same time, both the UK and Irish governments understand the importance of the financial services sector, not only to a fully functioning economy, but also as a major source of tax revenues and exports. They also recognise its global nature so any regulatory pressure is likely to remain fairly light touch and in keeping with what is being done elsewhere. This is for fear of driving the jobs and tax revenues off-shore.

In Ireland the news that future additional taxpayers' money will be needed to prop up the banks has been very badly received by the public. It remains to be seen how much damage this might cause to other negotiations, most notably public sector pay and jobs.

NAMA has attracted significant attention, and is one very visual example of the re-balancing process that is going on. It remains difficult to be precise about how this will affect the Irish economy, and indeed the UK and NI economies, as many of the holdings of assets are located there. Nevertheless the process itself has provided significant demand for a range of financial and professional skills, and is seen internationally as a decisive action to address a serious financial problem.

Not all of the land to be held by NAMA will be unprofitable and in the main, the policy, in tandem with the bank bail outs, has helped to support continued bank lending and stability in a dangerously fragile system. In addition, the plan has offered a plausible way forward in what otherwise could have been a period of damaging stagnation in the lending markets.

Longer-term it remains to be seen how many banking institutions survive across the Island but the advantageous tax base, pool of available skills, and continued world demand for financial and professionals services skills, means the sector's projections look positive into the medium-term. A previously mooted strategy to attract overflow financial jobs from Dublin to Northern Ireland however looks rather less likely than it previously did, as labour and skill shortage pressures have eased in Dublin.

3.6 Public sector reform – opportunity or risk?

Although there are positive opportunities from public sector reform, the impact of potential public sector job losses should not be underplayed, particularly when considering how significant the sector has been as a source of job growth over the previous decade. The Summer 2010 Ernst & Young Economic Eye forecast only returns the public sector to peak employment levels by 2021. A more severe decline in public sector employment in the short to medium-term is entirely possible.

Spending cuts are inevitable and have already started in ROI. The ability to manage the process without strike action and to swiftly enact adjustments to spending (either on wages, welfare benefits, procurement or capital), will be the key challenge for the foreseeable future. The June 22nd emergency budget in the UK and the Autumn comprehensive spending review will provide a greater degree of clarity on the UK strategy and in our Winter report we will be able to compare and contrast deficit reduction strategies more effectively..

To date ROI has shown greater capacity to achieve this aim. The famed Bord Snip report has highlighted a range of areas in which money could be saved. Not all of the savings and recommendations will be implemented but it has clearly raised the debate and identified areas in which potential savings could be made. This is a debate which has barely taken place, let alone been won in the UK, largely given the sensitivities over election season. With the change in government in the UK, its response to cuts is however likely to hasten. It still remains to be seen whether the delay in action by Labour will prove sound Keynesian economics, or merely delaying the inevitable and holding back long-term recovery and re-balancing.

As said earlier, Northern Ireland remains set against cuts at a political level, but these will be imposed starting this year, alongside already agreed efficiency savings. It remains unclear publicly what preparation for cuts has gone on in NI. There is no equivalent to Bord Snip in the public domain and it is unclear to what extent cuts will fall internally or externally through reduced procurement or capital spend.

Box 4.1: Opportunities from public sector reform

The focus on public expenditure cuts has been on the damage it may do, primarily in terms of jobs and front-line services, in the short-run. Whilst short-term pain is almost certain, as other sectors such as construction and manufacturing have been quick to experience, the nature of the spending reduction could present opportunities and support greater growth potential in the medium-term, if done correctly. It can be difficult to be precise about the expenditure cut process but there are a number of ways in which it can be turned to longer-term economic advantage, including:

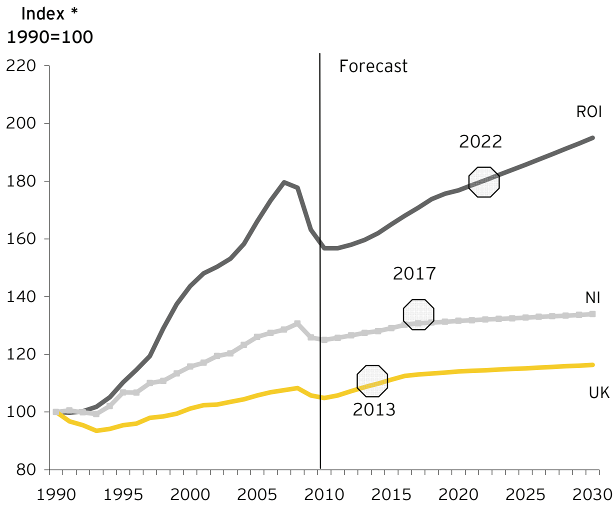
1) Carefully reviewing 'need' and cutting waste / inefficiencies from the system and thus improving the value for public money;
2) Engaging in co-operative dialogue with employees and unions to ensure civil action is avoided and pay freezes or reductions can be implemented - this can help to build better relations and potentially limit headline job losses;
3) Cuts in capital investment (which affects the private sector directly) can have a severe impact, the effects of which can take a long time to reverse. However appropriate consideration of spending can ensure priority projects displace luxury projects and the cost of procurement can be driven down;
4) Staff released, perhaps through voluntary redundancy schemes, can be a very useful resource for the private sector, especially as many of the workers will be business ready and relatively highly skilled;
5) Consideration of alternative funding and delivery models could lead to productivity growth and greater value for money – perhaps through internal mergers, use of non for profit private enterprise models or privatisation of certain functions or activities, or more simply through adopting processes and technologies used elsewhere in the economy;
6) Control over public sector pay, in times of similar control or falls in private sector wages. This helps to avoid a growing imbalance between public and private sector wages, and potential future 'crowding out' of skills from the private sector. It also helps to enhance international cost competitiveness and would share the re-balancing burden between the public and private sectors; and
7) The change management process can provide income fees for a wide range of private sector services including HR consultancy, management consultancy, IT and legal services, though clearly there is a desire to reduce unnecessary consultancy costs in the short-term to reduce overall spending.

3.7 Long road to employment recovery and implications of export-led growth

The implication of addressing the public debt overhang, re-balancing, the pressures on consumers, allied to a private sector looking to keep costs down and its own level of debt under control, is an extremely sluggish recovery in the labour market. Furthermore with many export sectors more capital intensive and highly skilled, the scope for future job creation is much more modest than it was in the more labour intensive government and construction sectors which have driven growth in pre-recession times. While new, emerging sectors such as low carbon and green technologies undoubtedly offer growth opportunities, very little is actually known about the scale of job potential, and relative to the needs of the labour market, the quantum of opportunities is likely to be small, never mind whether the unemployed have the skills profile to match the needs of these sectors.

The Summer 2010 Ernst & Young Economic Eye forecast continues to project that it will take over a decade for the ROI economy to regain its peak employment level achieved in 2007.The labour market recovery is projected to be modestly more rapid in the UK and NI, with peak employment forecast to be returned in 2013 / 2017 respectively.

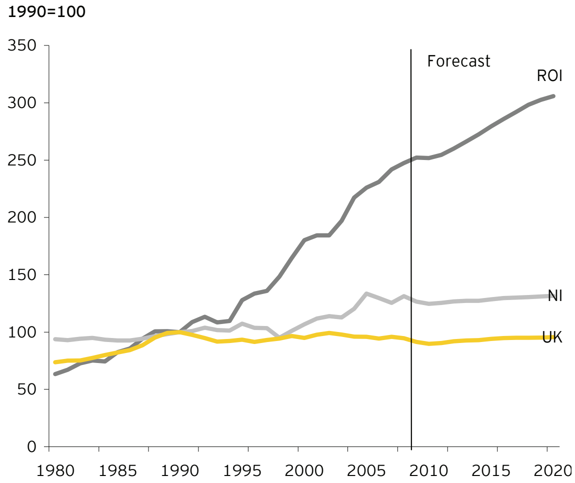
Fig 3.8: All-Island and UK total employment performance and forecast



Source: CSO, DETI, ONS, Ernst & Young Economic Eye
Note: People-based employment
* Employment index

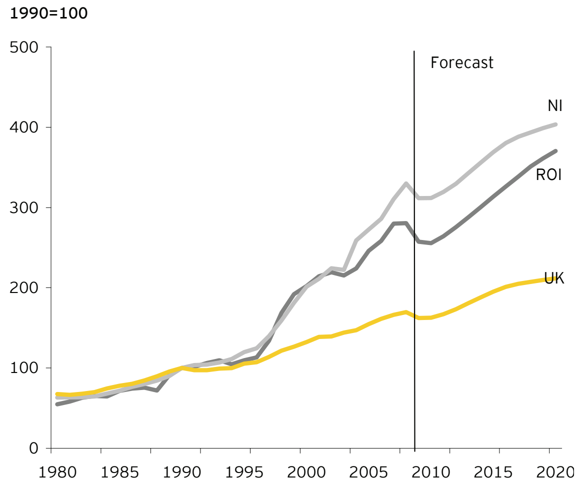
Sectorally the main source of job recovery is expected to be in the professional services sectors, which despite all the recessionary fears over financial services in particular, remain in demand globally. There are, as of yet, only a few countries which provide these exports in sufficient quantity and quality, of which Ireland, the US and the UK, are three of the most prominent. There are short-term fears over mergers and rationalisations across the sector, and the implications of public sector spending cuts on sectors such as consultancy and architecture should not be underplayed. However we still expect these sectors to dominate the job creation picture, with over 100k net new jobs in business services in the decade to 2020 across the Island.

Fig 3.9: All-Island and UK financial services employment performance and forecast



Source: CSO, DETI, ONS, Ernst & Young Economic Eye

Fig 3.10: All-Island and UK business services employment performance and forecast



Source: CSO, DETI, ONS, Ernst & Young Economic Eye

The tourism sector offers potential for future growth, especially in NI which has untapped potential with ROI's out-of-state market. However the cost of transport, relative exchange rates and the cost competitiveness of the product remain crucial in locking in any recovery. In addition, accessibility and direct flights remain an important factor. Notably many airlines have already closed routes across the Island. The Ernst & Young Economic Eye Summer 2010 forecasts projects a gain of around 25,000 jobs in the hotels and restaurants sector in the decade to 2020.

Manufacturing is expected to continue to shed jobs in NI and gain modesty in ROI, partly as a result of capital intensity and expected productivity gains, and partly the continued impact of lower cost competition from elsewhere globally. There may be potential in a range of green energy sectors and high-end sectors such as advanced electronics, pharmaceuticals and transport / defence. The continued outsourcing of activities such as IT, HR, industrial cleaning, design and marketing, will continue to shift industrial jobs in to professional services under official industrial classifications.

The retailing and leisure sector is expected to recover some of the losses in the recession relatively quickly, though movements in the exchange rate, if the euro strengthens, may alter this recovery somewhat and the pattern of growth across the island. At an all-Island level, 70,000 net jobs are forecast over the decade ahead in retail and other personal services, more than offsetting recent losses in the recession, but nothing like the scale of growth enjoyed during the pre-recession decade.

Table 3.2: All-Island and UK sector employment forecast (2010-2020)

	2010-2020 (change 000s)		2010-2020 (% change)		
	ROI	NI	ROI	NI	UK
Agriculture, forestry & fishing	-9	-3	-9	-8	-7
Production & construction	30	-4	8	-2	-7
Mining	0	0	1	-13	-14
Manufacturing	8	-8	4	-10	-19
Utilities	0	-1	1	-20	-14
Construction	22	5	16	9	11
Services	216	45	16	8	12
Distribution & retail	30	11	11	9	14
Hotels & catering	22	7	18	20	15
Transport & communications	19	4	16	11	12
Financial services	21	1	21	6	7
Business services	82	24	45	29	30
Public administration	-4	-6	-4	-11	-6
Education	6	-2	4	-2	-2
Health	17	2	7	2	2
Other services	23	4	20	12	13
Total	**238**	**39**	**13**	**5**	**9**

Source: Ernst & Young Economic Eye
Note: Employment is people-based for all jurisdictions

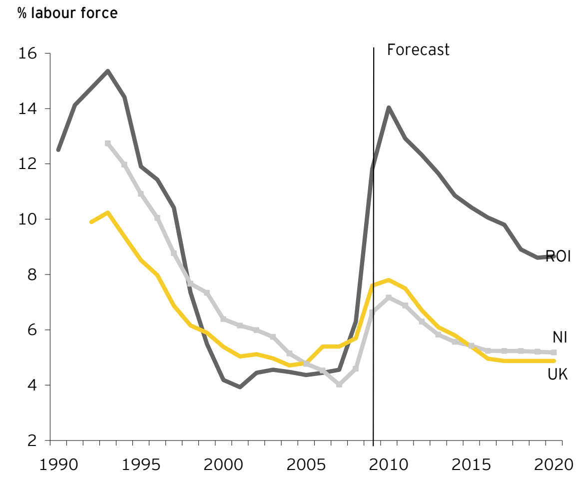
3.8 Unemployment to remain a medium term concern

The impact of this sluggish recovery in employment is for unemployment to remain a significant problem for at least the next decade, subject to migration patterns (see below). We forecast that by 2020, all three economies will continue to have unemployment rates well above the low rates enjoyed over much of the last decade.

Part of the reason for the stubborn high rates of unemployment is the inability for even a moderately strong economic recovery to require many of the skills now residing amongst those persons currently out of work. The significant pool of construction and manual labour which has dominated the rise in unemployment is not projected to be required in significant numbers given the excess in commercial and residential property that currently exists and the necessary constraints on public capital expenditure.

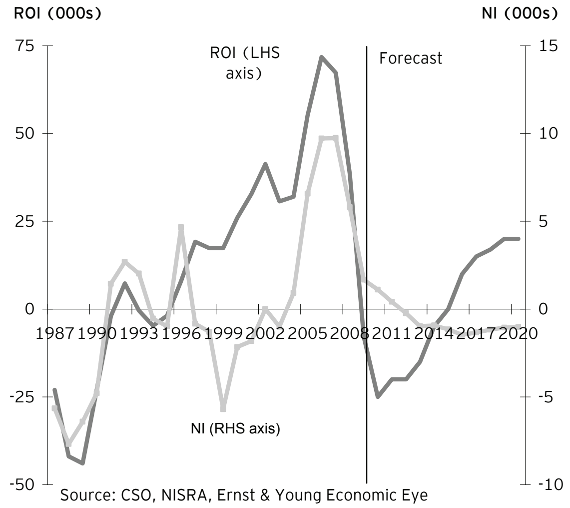
Policy, particularly environmental policy, may be able to act as some form of catalyst to construction growth (e.g. home insulation schemes), but its job impact is likely to be limited unless extremely brave taxation and legislative incentives are put in place.

Fig 3.11: All-Island and UK ILO unemployment rate performance and forecast



Source: CSO, LFS, Ernst & Young Economic Eye

Fig 3.12: All-Island net migration performance and forecast



Source: CSO, NISRA, Ernst & Young Economic Eye

3.9 Out-migration – a blessing or cause for concern?

Key to understanding the labour market is how migration levels respond. In the first Ernst & Young Economic Eye forecast report in Spring 2009, we projected a sharp reversal in ROI migration patterns, from net inflows to net outflows. Latest data has since proven this projection accurate. Although the reversal is not yet quite as marked as predicted, or as responsive to deteriorating economic conditions. This probably reflects a combination of the integration of migrants into Irish society, a relatively generous benefits system, and lack of employment opportunities elsewhere in Europe where the recession has spread.

Net migration is estimated at -8,000 in 2009, compared to a recent high of 72,000 in 2006. A net outflow of 25,000 is forecast in 2010, and only gradually moderating from this level in the medium-term as a result of the pressures in the labour market going forward. The Summer 2010 Ernst & Young Economic Eye forecasts predict a return to migration balance – international inflows matching outflows - only by 2016/2017. This is a moderation from previous forecasts where we projected a more rapid return to a positive net in-migration figure.

For Northern Ireland net migration has also fallen from record highs, but is forecast to remain modestly positive in 2009 (+2,000), and is expected to remain roughly in balance throughout the forecast period.

The path of migration will not only impact the wider labour market, but will have important implications for demand, especially for housing and public services, and wage inflation. Though the costs of supporting a large out-of-work population is a worry, particularly for the ROI government - NI does not pay its own welfare benefits as this is an automatic payment from Westminster - the significant stock of vacant housing suggests a sharp outflow of population would add to the already significant problems of demand in the construction sector and in certain local communities.

4 Eurozone concerns but can Ireland's international focus save it?

4.1 Eurozone concerns add to risks

Ireland has rather unflatteringly been branded alongside Portugal, Italy, Greece and Spain in the so called 'PIIGS' group. These countries are typified by high levels of public borrowing and in certain cases, having structural economic and competitive weaknesses. Though there are some similarities across the PIIGS, there are other economies with similar levels of deficits that are not part of the group (the UK amongst them).

The Greek economic crisis, and subsequent concerns over other similarly indebted countries, of which Ireland is one, have led to real concerns over the economic prospects for the individual countries, for the Eurozone area as a whole and the future of the single currency. The crisis has also led to falls in the euro versus the US dollar and other major currencies. There has been growing resentment in the Eurozone's major economies, most notably Germany, at the concept of securing Greek debt, especially if this is a forerunner to similar requirements for Portugal, Spain and others, possibly Ireland.

At the time of writing, the immediate danger of Greek default and contagion of the crisis to other at risk countries appears to have been averted, but only by guaranteeing the Greek debt in return for a significant austerity package. However the situation is extremely fragile and there is growing concern that not all the facts are known and that there may be further surprises to come and this represents a hugely significant risk to economic recovery, not just in the Eurozone but globally. The austerity package has not been received well in Greece with strikes and civil unrest further highlighting concerns. Spain, Portugal and Italy have implemented a similarly austere package of measures and as already discussed, Ireland is some way down the road of a similar plan.

Table 4.1 presents the Ernst & Young Economic Eye Summer 2010 outlooks for the All-Island economies, the main Eurozone economies and other major world economies. The main message is that prospects for the at risk countries, i.e. the PIIGS, are not uniformly weak into the medium-term, with Ireland having a more upbeat outlook than Greece and Portugal (see the Ernst & Young Eurozone Forecast Spring 2010 report for further details).

Table 4.1: Eurozone and major economy economic growth performance and forecasts (real annual % growth)

	2008	2009	2010	2011	2012	2013
ROI	-3.0	-7.1	-1.0	2.8	3.9	3.5
ROI (GNP)	-2.8	-11.3	-1.3	3.2	3.7	3.3
NI	0.1	-4.6	0.6	2.0	2.7	2.6
All-Island	-2.4	-6.7	-0.7	2.7	3.6	3.3
Other Eurozone						
Germany	1.0	-4.9	1.5	1.8	1.9	2.2
France	0.3	-2.2	1.2	1.8	2.2	2.0
Italy	-1.3	-5.1	0.5	0.8	1.6	1.8
Spain	0.9	-3.6	-0.6	0.5	1.6	1.6
Netherlands	2.0	-4.0	1.0	2.0	2.4	2.6
Greece	2.0	-2.0	-4.6	-2.8	1.1	1.7
Finland	1.2	-7.8	1.5	3.0	4.0	3.6
Portugal	0.0	-2.7	0.1	0.4	1.7	1.4
Other major economies						
US	0.4	-2.4	3.5	3.8	3.3	2.9
Japan	-1.2	-5.2	1.6	1.6	2.1	2.0
UK	0.5	-4.9	1.0	2.7	3.4	3.1
China	9.6	8.7	9.0	8.8	9.3	9.0
India	7.4	6.4	7.8	9.0	9.0	8.8

Source: Ernst & Young Economic Eye
Note: Home currency; GDP except NI (GVA)

The reason for the more upbeat outlook for Ireland, compared to other PIIGS, is down to number of core fundamentals, namely:

- A large and diverse export base, with an enviable mix of high value added sectors such as pharmaceuticals, software and international financial services;
- A lower overall stock of government debt despite recent borrowing;
- The extent to which austerity measures are already in place and accepted by the population;
- Corrections in recent wage and price inflation, which are improving cost competitiveness; and
- Supply capacity, as determined by the sectoral and skill base, to generate future export growth.

A table comparing a range of the key economic and competitiveness factors, which should be influencing investors and debt rating agencies, is set out below.

Table 4.2: Eurozone and major economy public finance and competitiveness fundamentals

	General government balance % GDP (2009)	Government debt stock % GDP (2009) *	Exports % GDP (2009)	CPI inflation rate ** (2009)	Tertiary attainment % age group 25-34 (2006) ***
ROI	-14.3	64	87	-4.5	42
NI ****	-28.0	na	20	2.2	36
Rest Eurozone					
Germany	-3.9	73	46	0.3	22
France	-8.2	73	27	0.1	41
Italy	-5.3	116	24	0.8	17
Spain	-11.4	53	28	-0.3	39
Netherlands	-5.3	74	81	1.2	36
Belgium	-6.0	97	76	-0.1	42
Austria	-4.3	66	54	0.5	19
Greece	-13.5	115	20	1.2	27
Finland	-2.3	44	44	0.0	39
Portugal	-6.6	77	33	-0.8	20
Slovakia	-4.3	9	84	1.6	na
Luxembourg	-0.8	na	174	0.0	34
Slovenia	-1.5	na	67	0.8	27
Cyprus	-1.5	na	45	0.2	na
Malta	-1.2	na	87	1.8	na
Other major economies					
US	-10.3	na	11	-0.3	39
Japan	-8.7	na	13	-1.4	54
UK	-11.2	63	26	2.2	37
China	-1.1	na	34	-0.7	na
India	-7.1	na	23	10.9	na

Source: Ernst & Young Economic Eye, * EC, *** OECD
Note: ** National CPI inflation as opposed to based on harmonised indices; **** NI general government balance based on an assumed subvention of approximately £9m; GDP denominator estimated from Regional Accounts GVA. NI exports sum of manufacturing sales outside UK, high-export potential service exports and out-of-state tourism spend (excluding GB)

As Table 4.2 clearly indicates, though Ireland is bottom of the Eurozone league in terms of the size of its fiscal deficit in 2009 (Eurostat definition), it rates rather better in the other indicators. Indeed for 2006 where comparable cross-country data is last available, ROI is top of the Eurozone league for graduate skills of the prime 25-34 age group, prices are falling faster which is improving cost competitiveness, and it is second in export orientation, behind Luxembourg. It is these fundamentals, along with maintained low corporation tax and the early and decisive fiscal actions taken by the government, that lie behind the more optimistic medium-term outlook for the ROI economy. It is important however to bear in mind that the ability to maintain the momentum of deficit reduction will be crucial to ensuring this forecast will become a reality.

Northern Ireland cannot be compared on all of the metrics effectively. There is no stock of public debt as such, and even current borrowing levels, equivalent to the subvention, are less meaningful as the region is not obliged to pay back this amount directly. Nevertheless the lower export orientation, greater public sector dependence, which will mean fiscal tightening will be particularly felt in NI, and higher level of UK inflation, are factors in the more modest NI outlook over the medium-term. In addition euro weakness will reduce cross-border trade flows, which to date have helped to prop up parts of NI's retail and tourism sectors.

4.2 ROI's export focus

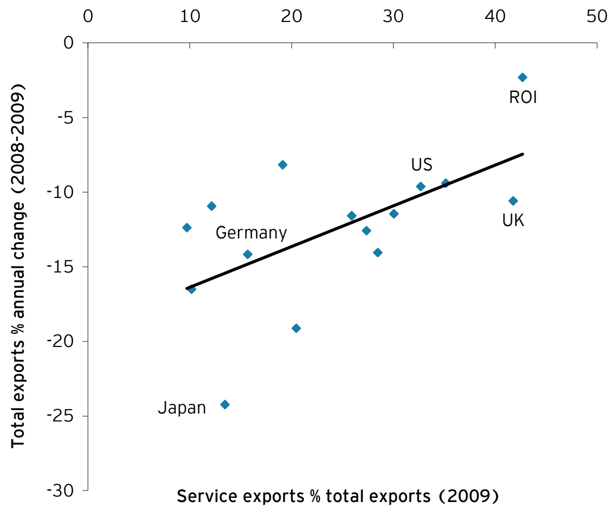
As discussed above, the ROI economy remains heavily export focused and this is one of the cornerstones of the Ernst & Young Economic Eye's optimistic medium-term outlook for Ireland. Despite the weak performance of goods export in H2 2009, which was part down to the performance of a single commodity group, Irish exports have held up well during the recession, as have those in the UK and US to a lesser extent. The resilient performance of exports has prevented an even more severe recession. The share of service sector exports in overall exports has been an important factor in the minimal contraction of exports, as evidenced by a scatterplot of the service export concentration and the 2008-2009 fall in export values across major economies (Fig 4.1).

Table 4.3: Eurozone and major economy export focus and performance (2009)

	Exports % GDP (2009)	Exports % change (2008-2009) **
ROI	87	-2.3
NI *	20	na
Rest Eurozone		
Germany	46	-14.2
France	27	-10.9
Italy	24	-19.1
Spain	28	-11.5
Netherlands	81	-8.2
Belgium	76	-12.6
Austria	54	-14.1
Greece	20	-18.1
Finland	44	-24.4
Portugal	33	-11.6
Slovakia	84	-16.5
Luxembourg	174	-8.9
Slovenia	67	-16.6
Cyprus	45	-11.8
Malta	87	-3.3
Other major economies		
US	11	-9.6
Japan	13	-24.2
UK	26	-10.6
China	34	-12.4
India	23	-9.4

Source: Haver Analytics, Ernst & Young Economic Eye
Note: * NI exports sum of manufacturing sales outside UK, high-export potential service exports and out-of-state tourism spend (excluding GB); ** Real growth

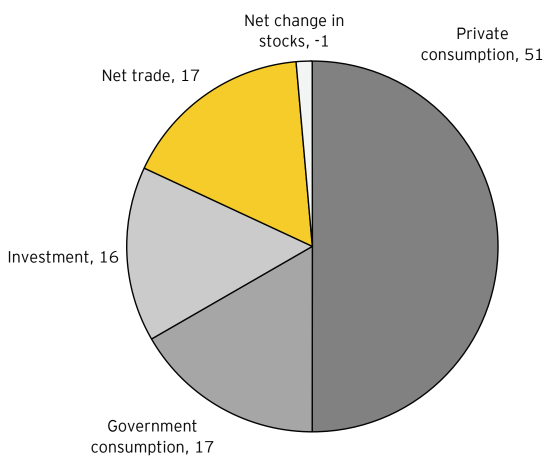
Fig 4.1: Eurozone and major economy service export focus and performance (2009)[5]



Source: Haver Analytics, Ernst & Young Economic Eye

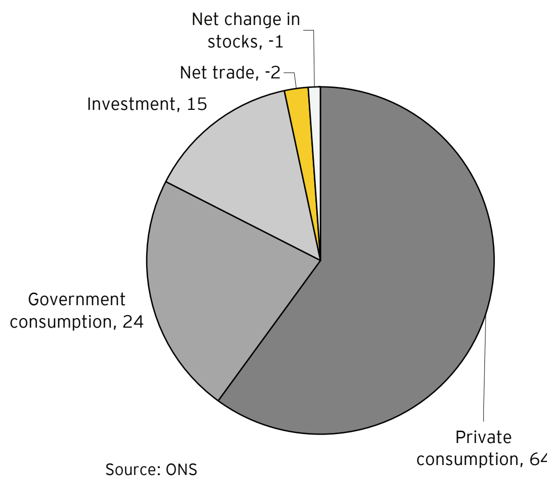
Exports are a much larger share of overall GDP / GVA in ROI than in either the UK or NI[6]. Net trade, which is defined as exports minus imports, accounts for 17% of GDP in ROI compared to just 2% in the UK. In contrast private consumption in the UK is close to two thirds of GDP compared to just over a half in ROI.

Fig 4.2: ROI GDP composition (2009)



Source: CSO
Note: Based on nominal GDP

Fig 4.3: UK GDP composition (2009)



Source: ONS
Note: Based on nominal GDP

The export-orientated nature of the Irish economy is further highlighted by the Ernst & Young / EIU globalisation index, which places Ireland third in the world according to the overall rank, behind only Singapore and Hong Kong in 2010. This was despite the considerable recessionary, budgetary and reputational pressures facing Ireland over the last 18-24 months.

Scoring particularly well in the labour and technology (behind only Sweden) domains further highlights the core economic strength which underpins the Irish economy, a fact sometimes lost in

[5] R-squared 36%

[6] Although no national accounts data exists for NI to directly source this measure, which is based on the export value to GDP ratio, manufacturing sales and high-export potential service export data from DETI yields sufficient information to make this conclusion for NI.

the current pessimism around record GDP falls and banking and fiscal crises. The UK is well behind Ireland in this globalisation index. The UK is 15th overall and varies from 12th to 30th across the domains.

Table 4.4: Ernst & Young / Economist Intelligence Unit globalisation index (2009)

	Overall rank	Trade rank	Capital rank	Technology rank	Labour rank	Culture rank
Singapore	1	1	5	5	2	2
Hong Kong (SAR)	2	2	1	9	28	1
Ireland	3	4	4	2	1	3
Belgium	4	3	2	6	9	10
Sweden	5	15	9	1	20	8
Denmark	6	14	3	3	24	12
Switzerland	7	22	20	7	3	4
The Netherlands	8	7	7	11	11	9
Israel	9	19	18	8	17	5
Finland	10	27	11	4	27	18
UK	15	30	10	12	28	14
Germany	16	17	20	13	30	16
France	19	35	15	20	25	15
Spain	21	32	16	26	10	12
US	24	34	17	22	41	20
Portugal	26	36	24	30	7	30
Italy	31	40	44	25	12	33
Greece	32	53	35	27	22	11
Japan	37	46	29	17	57	57
China	40	37	46	28	49	51
India	46	54	43	49	40	41

Source: Ernst & Young / Economist Intelligence Unit

The export focus for ROI built into the Ernst & Young Economic Eye forecast model is based upon forecast growth in the countries to which Ireland exports and the sectors which make up the export base. The majority of ROI's goods exports are sold to the rest of Europe, the US and GB. Chemicals and business services are the major exports by value, both of which have relatively positive global outlooks.

NI exports, or at least sales outside NI, are very focussed on the GB market, with the EU and the US a much smaller share of export destinations than the corresponding figures for ROI. Sectorally industrial sectors dominate the NI export list, with food the major sector. Note excise tax can distort the NI food exports figure slightly. The UK is also focussed on selling to the EU, although the US is important for service exports. Machinery & transport is the UK's largest export sector, followed by business & financial services. It is this sectoral export focus towards services in the ROI and UK, which NI does not have, that provides a boost to medium-term forecasts in ROI and UK, which is absent for NI.

Table 4.5: All-Island and UK export destination and composition

	ROI		NI		UK	
Top 3 export markets *	Europe excluding UK	48%	GB	51%	Europe	58%
	US & Canada	22%	ROI	14%	US & Canada	18%
	UK	16%	Rest EU	13%	Rest of World	16%
	Goods only		Goods and services		Goods and services	
Major goods and services exports **	Chemicals & related	29%	Food, drink & tobacco	57%	Machinery & transport equip	22%
	Business services	27%	Machinery & transport equip	18%	Business services	14%
	Machinery & transport equip	16%	Electrical & optical equip	13%	Financial & insurance services	12%
	Financial & insurance services	11%	Tourism	3%	Chemicals & related products	11%

Source: CSO, DETI, ONS, OECD
Note: * 2009 data for ROI, 2008 data for UK, 2008/09 data for NI; ** 2007 data for ROI and UK from OECD and 2008/09 data for NI

4.3 Export sensitivity of ROI outlook

To conclude this section, it is useful to highlight just how significant an impact export performance could have on the ROI economy. Under a lower export growth trajectory, the Irish economy could decline by 6% in 2010, and with a higher export growth trajectory, the overall economy could grow by just under 2%. Recall the central Ernst & Young Economic Eye base projection is a contraction in GDP of 1.0% in 2010. Either of these export trajectories is well within the range of historical Irish performance and forecast comparator country export performance in 2010, and thus can be considered plausible potential outcomes. In light of the Eurozone uncertainties consideration of a lower export trajectory is a prudent approach, indeed the outcome could be even worse than set out in the table as the knock on effects of a loss of confidence in the debt laden countries would be significant

Table 4.6: ROI alternate export growth scenarios (2010)

	Export growth (2010)	GDP growth (2010)
Low export growth scenario	-2.0	-6.0
Central base export scenaro	3.8	-1.0
High export growth scenario	7.0	1.8

Source: Ernst & Young Economic Eye

5 Competitiveness and trading conditions key

In the context of a global market, the importance of the strength of the export sector has already been discussed. This sector will be heavily influenced by global trading conditions and the international competitiveness of the relevant exporting sectors.

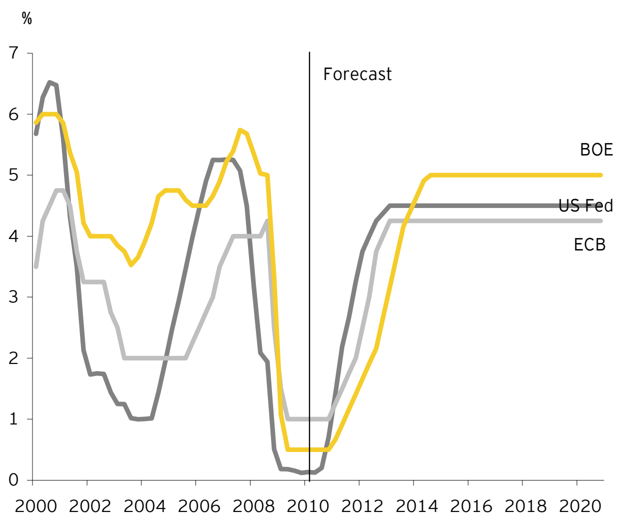
As has already been discussed, the curbing of wage inflation will help to improve global competitiveness, an area in which ROI had been losing ground prior to the recession. Note this applies much less to NI. In this section we explore a range of other macroeconomic conditions which will impact upon competitiveness in the two jurisdictions.

5.1 Interest rates

Interest rates remain at historic lows and the desire of the European Central Bank and Bank of England to raise them, in light of inflation pressures, is tempered by the fragile nature of the recovery. Given the strength of the US economy, the expectation might be for the Fed to raise interest rates first, but continued problems in the housing market make this far from certain.

The emergence of the Greek crisis and the austerity plans in Spain, coupled with unease amongst Germans over the Greek bail out, has lead to a downgrading of Eurozone prospects and consequently an expectation that interest rates will be raised later than we previously expected. Today, it must be remembered, remains an era of relatively low interest rates, though these are not being passed on to primary borrows. The Ernst & Young Economic Eye forecasts predict rates to remain low well into 2011 and reaching more normal levels, by recent standards, only by 2013/2014.

Fig 5.1: Policy interest rate performance and forecast



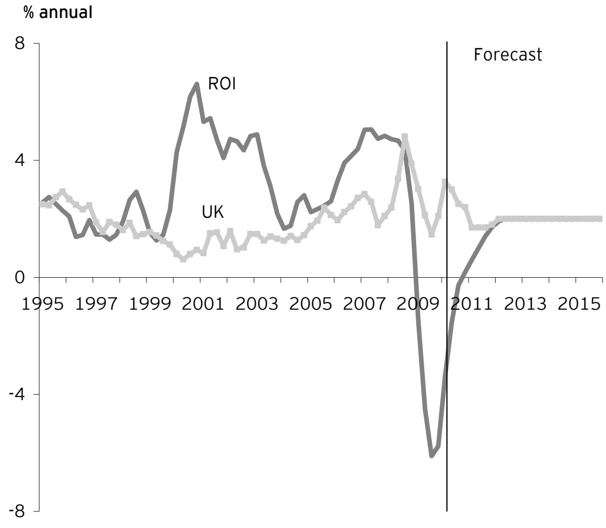
Source: Haver Analytics, Ernst & Young Economic Eye

5.2 Inflation

The major concern in the UK with respect to interest rates is inflation, which has proved more stubborn that expected. Deflation concerns have not materialised as was one feared. As of March 2010, UK inflation remains well above target at 3.4%. Though the expectation remains for a fall in inflation, the possibility remains that inflationary pressures could hasten interest rate rises, as could any return to quantitative easing which has not been ruled out by the Bank of England.

Irish annual inflation has been in negative territory for some time, reflecting the sharply adjusting market and cost cutting across a wide range of sectors. Though inflation is expected to rise, there appears no prospect of any significant upward pressures. Although a weakening exchange rate could increase imported inflation from goods and services purchased outside the Eurozone.

Fig 5.2: ROI and UK CPI inflation performance and forecast



Source: CSO, ONS, Ernst & Young Economic

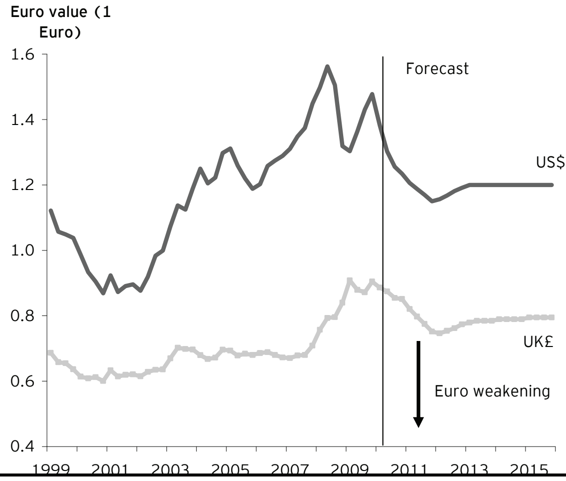
5.3 Exchange rates

Perhaps of greater interest to the prospects for exports, and cross-border trade, is the exchange rate, with an estimated three-fifths of ROI goods exports being sold outside the Eurozone in January 2010.

The euro has depreciated recently under the pressure of the Greek crisis and concerns over the other at risk indebted countries. This was a potential risk flagged in the previous Ernst & Young Economic Eye forecast reports and as such, the shift in the euro-sterling exchange rate has, as was foreseen, been more a result of weakness in the Eurozone economy than due to sterling / the UK economy's strength. The shift however is relatively modest and does not fully erode the appreciation in 2008. As of May 2010, the euro, at €1=US$1.25, was 19% below peak. Against sterling The euro is still over 25% higher than the relatively stable rate between 2003-2007.

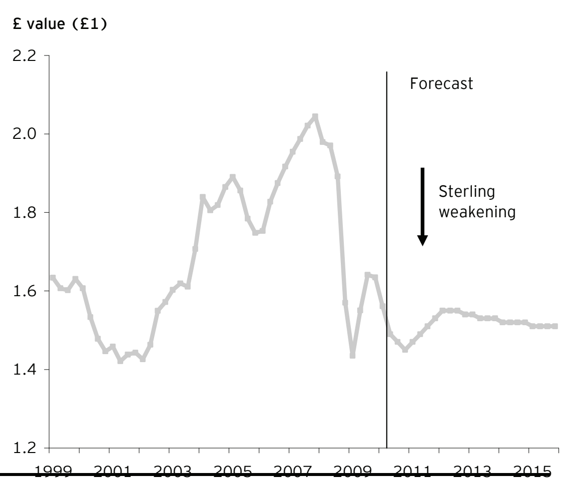
The US dollar remains relatively buoyant on the back of a strong domestic economy. However fears over the US fiscal deficit and a flight to riskier currencies as the recovery takes hold is preventing a sustained appreciation in our forecast. We expect the US dollar to remain strong however as the US recovery locks in and thus a depreciation of the euro to US dollar 1.20 is our medium-term outlook. Obviously major shocks could occur and any contagion from the Greek crisis could present a very significant threat to the stability of this outlook and could lead to a more protracted weakening in the euro. This would help the more export dominated economies such as Germany and Ireland.

Fig 5.3: Euro-Dollar and Euro-Sterling exchange rate performance and forecast



Source: ECB, BOE, Ernst & Young Economic

Fig 5.4: Sterling-Dollar exchange rate performance and forecast



Source: BOE, Ernst & Young Economic Eye

Against the dollar, sterling has fallen in late spring 2010, again more over UK fears surrounding the election and the knock on impacts from Greece, rather than any pronounced shifts in the underlying economies. We expect the sterling-US dollar exchange rate to stabilise and do not think a significant weakening of Sterling is the most likely outcome. Although any fall back in economic recovery in the first half of 2010, or fears about the UK's debt rating, could yet spark the fall that some commentators have raised as a possibility.

5.4 Oil prices

One major factor in inflation, and an often overlooked component in the cause of the global recession, is oil prices. Oil prices have been volatile in early 2010, rising to $87 per barrel very recently, before moderating down towards $80. This remains one of the key risks to the forecast with US recovery in particular dependent on oil prices. Despite recent discoveries, a fast accelerating global economy is likely to lead to oil price rises again, and thus a more potent automatic brake than it has been historically. The link with exchange rates is crucial when assessing the impact of shifting oil prices in dollars in local currency terms. This has contributed to record highs experienced in UK pump prices.

Table 5.1: World oil price performance and forecast (US$, euro and £ per barrel)

	2008	2009	2010	2011	2012	2013	2014	2015
Oil price per barrel								
US$	98	62	81	86	89	92	95	98
Euro	66	44	63	73	76	77	79	82
£	52	39	55	57	58	60	63	65
Annual % change								
US$	35	-37	32	6	3	3	3	3
Euro	24	-33	44	16	4	1	3	3
£	44	-25	40	5	0	4	4	4

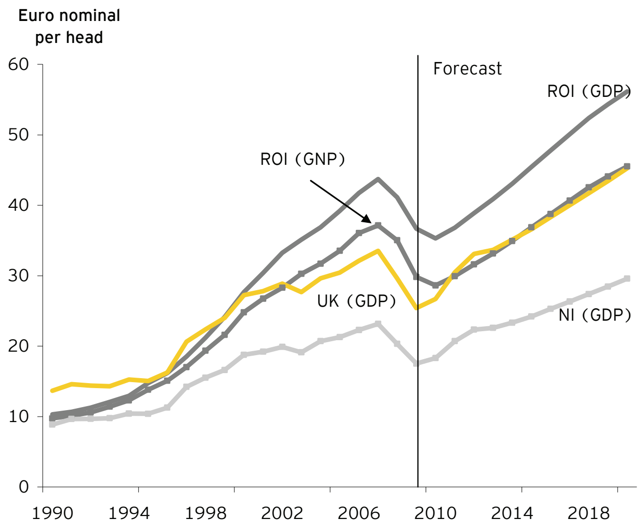
Source: Haver Analytics, Ernst & Young Economic Eye

6 Summary – the long road to recovery

The Summer 2010 Ernst & Young Economic Eye forecasts suggest the Island of Ireland has / will come out of recession in Q1 2010, though only just. Significant uncertainty still surrounds the stability and pace of the recovery. The problems across the Island in the property market, public expenditure cuts, or the fear of them, and the fall out from both the Iceland volcanic ash and more worryingly the Greek economy, all add to the feeling of nervousness which tempers any positive data emerging.

The labour market appears to be holding steady at present. While this is far from ideal it is an improvement on a year ago, and given tentatively positive confidence and retail data for early 2010 this suggests a cautious upturn is at last underway. The scale, nature and pace of public expenditure cuts will have a very significant impact on the overall state of recovery and the labour market in particular. For ROI this process is already underway. For NI it remains ahead, though the new UK government is bringing forward cuts into this financial year. However well received spending cuts are received by financial markets, they are unlikely to be popular domestically and certainly not in NI where the effect of spending cuts will be relatively more important.

Fig 6.1: All-Island and UK output per capita performance and forecasts



Source: CSO, ONS, NISRA, Ernst & Young Economic Eye

Our short-term forecasts are for a contraction in the ROI economy of 1.0% in 2010, before recovery of 2.8% (GDP) in 2011. Actually recovery will occur during 2010 but will not appear in annual figures until 2011. For NI the corresponding GVA growth figures are 0.7% and 2.2% respectively. Given the obvious concerns in relation to public finances and employment, and pressures still weighing on consumers, who are likely to face rising taxes and at best stagnant wage growth, this means that exports will be the key determinant of economic recovery and a central feature of re-balancing.

It is the nature and scale of ROI exports which lead to a more optimistic outlook for ROI in the medium-term (2011 and beyond), compared to either NI or the UK. ROI's export-orientated structure, allied to a lower stock of government debt, stronger graduate skills base and an already in-place fiscal cut back programme, with some degree of wider acceptance and consensus, means that comparisons with Spain, Portugal, Italy and in particular Greece are misplaced.

The optimism over the medium term in ROI is not shared in NI where the export base is much more modest and the reliance on public expenditure much greater. Though in job terms its recovery will be quicker - regaining net lost jobs by 2017 compared to 2022 in ROI. This is more because of the scale of job losses in ROI during the recession rather than the pace of recovery. In GDP terms, the ROI growth forecast is comfortably ahead of the corresponding NI outlook, and UK outlook, from 2012 onwards.

The medium-term optimism over the ROI economy should not detract from either the scale of economic difficulties at present, nor the risks to future recovery which are significant and mostly on the downside. Further banking crises, failure to control public expenditure, the persistence of unemployment and a sustained loss of labour remain risks which should not be discounted when considering the forecasts. For NI the medium term, just like the short-term, appears all about the scale and nature of public expenditures cuts. They present an opportunity for re-balancing towards a private sector led economy so often sought after in strategy documents, but the pain of this transition and the political reality of delivering remain significant obstacles.

Annex: All-Island forecasts

<to be added in next version>

ROI

Table A.1: ROI major indicator forecasts

NI

Table A.2: NI major indicator forecasts

Sectoral GVA forecasts

Table A.3: All-Island and UK sectoral GVA forecasts

	2010-2020 (change GVA)		2010-2020 (% annual average GVA growth)		
	ROI (Euro bn 2005 prices)	NI (£bn 2005 prices)	ROI	NI	UK
Agriculture, forestry & fishing	-0.3	0.0	-1.2	0.4	0.5
Production & construction	24.6	1.5	4.1	2.3	2.1
Mining	1.0	0.0	8.5	-0.7	-0.9
Manufacturing	18.7	1.0	4.0	2.6	2.2
Utilities	1.4	0.0	4.6	0.8	1.5
Construction	3.5	0.4	3.9	2.0	2.2
Services	36.7	4.9	3.3	2.4	3.0
Distribution & retail	4.5	0.8	3.0	2.1	2.6
Hotels & catering	0.9	0.2	2.3	3.0	2.6
Transport & communications	1.9	0.4	2.3	2.8	3.0
Financial services	7.1	0.6	3.7	4.1	4.3
Business services	18.0	2.0	5.3	4.5	4.7
Public administration	0.4	-0.1	0.6	-0.3	0.2
Education	0.9	0.2	1.3	0.9	0.9
Health	1.9	0.6	1.7	2.0	2.0
Other services	1.1	0.2	2.4	1.5	1.8
Total	**61.1**	**6.3**	**3.5**	**2.4**	**2.8**

Source: Ernst & Young Economic Eye