

Irish Economy March 2009

Population (2008):
GNP per capita (2008):
Exchange Rate
(10 Mar 2009)

4.4 million
EUR 35,230
EUR/STG: 0.92
EUR/DLR: 1.27

Key Themes

- Global growth prospects have deteriorated sharply since our November Quarterly, and the timing and extent of the recovery is subject to considerable uncertainty.
- **GNP is now forecast to contract by 7.9% in 2009**, compared with our previous estimate of minus 4%. This downward revision reflects a sharp contraction in two key areas, namely consumer spending and investment, driven by a negative employment outlook and a very significant fiscal contraction.
- We expect GNP to **fall by a further 3.4% in 2010**, as non-residential investment weakens further and ongoing job losses keep spending subdued. That is, we now forecast a **three-year recession**, with GNP set to fall by a total of almost 14% over the period 2008-2010.
- The recovery, when it happens, will likely be export led, and will follow recovery in our main trading partners.
- Housing remains the main drag on growth this year, subtracting some 4.3 percentage points from GNP, but non-residential construction and machinery are also contributing to the decline. Non-residential investment will eventually replace housing as the main negative for total investment activity, which is set to fall by 28% in 2009 and by a further 9% in 2010.
- We have pared back our house completions forecasts to 18,500 this year and 15,000 in 2010, but housing essentially ceases to subtract from growth next year. Continued weakness in the residential property market means that **house prices will fall by an estimated 40% from peak to trough**.
- The outlook for **consumer spending** has worsened significantly, and we now forecast a **decline of 6.5% this year**. The main driver here is the more pronounced level of job losses.
- Consumer spending is expected to fall by a further 5.0% in 2010, as the employment situation continues to weaken. In 2010, the falloff in consumer spending will subtract almost 3 percentage points from growth, with investment taking away less than 2 percentage points - a reversal of the pattern in the preceding two years.
- **Unemployment is set to hit 14%** by the end of 2009, up from 7.7% in 2008, and the highest rate since 1989. This forecast assumes 220,000 job losses this year, more than half of them in services and the remainder split between construction and manufacturing. We expect a further 100,000 job losses next year, and an unemployment rate of **16% by end 2010**.
- The projected sharp rise in unemployment and fall in tax revenue will put severe pressure on the already strained public finances. The extent of the deterioration in the fiscal situation is evident from our forecast the rise in the **government deficit to 11% of GDP** this year, the largest in the Euro area.
- The upcoming emergency Budget will likely look for €4 billion in savings, via a combination of spending cuts and tax hikes. This will be difficult to achieve and we estimate that the eventual deficit will still **overshoot the 9.5% target**, by 1.5 percentage points.
- The medium-term fiscal outlook is clearly dependent on the degree of success the Government has in reaching the 2009 target. The figures published in early January proposed a profile that would bring the deficit below 3% by 2013. This envisaged further pain in the form of corrective measures of the order of 2% of GDP in both 2010 and 2011, declining towards 1.5% in 2013. This will be a major negative for growth in coming years.
- As flagged in our November quarterly, the economy will experience deflation in 2009, for the first time since 1946. The extent of the decline in prices is even greater than we previously expected, with the **CPI now set to fall by 4.0% this year**.
- This reflects large falls in mortgage rates, supplemented by declines in energy and food prices.
- **HICP**, a better measure of core inflation, is forecast to **fall by 1.1%** this year, evidence that deflationary forces are becoming more widespread.
- Looking forward, both the **CPI and HICP rates will remain low in 2010**, with the former flat and the latter rising by a mere 0.4%. The risks to these forecasts lie to the downside.

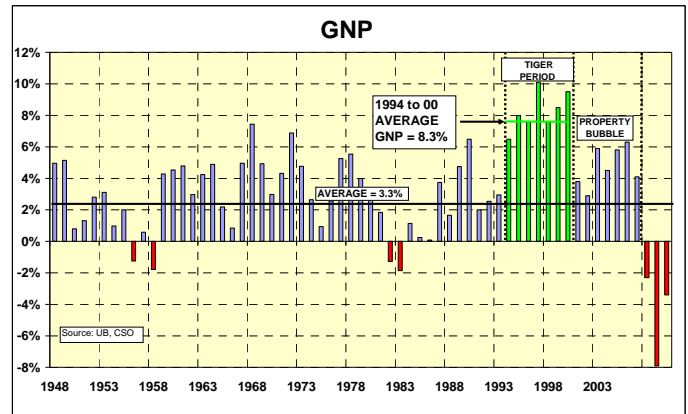
Overview

Following an estimated contraction of 2.3% in 2008, GNP is forecast to fall by 7.9% this year. GNP is our preferred measure of growth because it excludes profits of multinationals which accrue to non-residents, and includes profits earned abroad by Irish residents. Our most recent 2009 GNP estimate compares with a forecast contraction of 4% in our November Quarterly.

There are a number of reasons for the downward revision. Firstly, the credit crisis has exacerbated and prolonged the decline in the property market. The domestic property correction is forecast to deduct 5 percentage points from growth in 2009. In its absence, GNP would still contract, but by a more modest 2.8%. The second major negative influence on our 2009 forecasts is consumer spending. Though inflation is set to fall sharply, (from 4.1% in 2008 to minus 4.0% in 2009) boosting the ability to spend, the reality of continuing job losses will cause consumers to reduce spending. Those who do not lose their jobs are reacting to uncertainty by curbing spending in favour of precautionary savings. As consumer spending accounts for about 60% of total GNP, the impact is severe, and explains a good deal of the change in our forecast. Thirdly, the likelihood of a significant fiscal contraction between now and 2013 – with the Government taking about 2 percentage points out of the economy each year – adds to the negative influences and pushes out the timing and extent of the eventual recovery. Finally, the credit crunch is impacting those businesses that have a demand for credit.

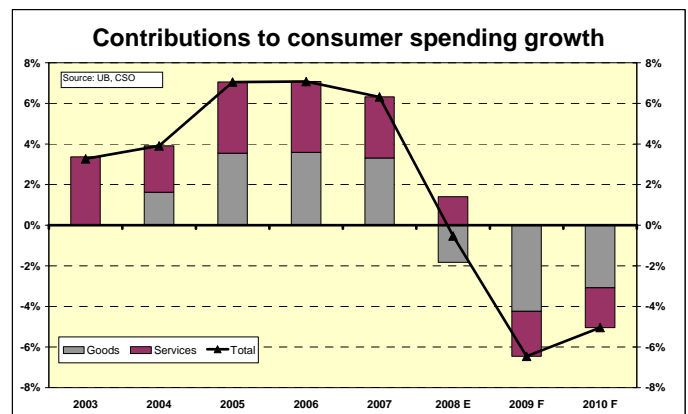
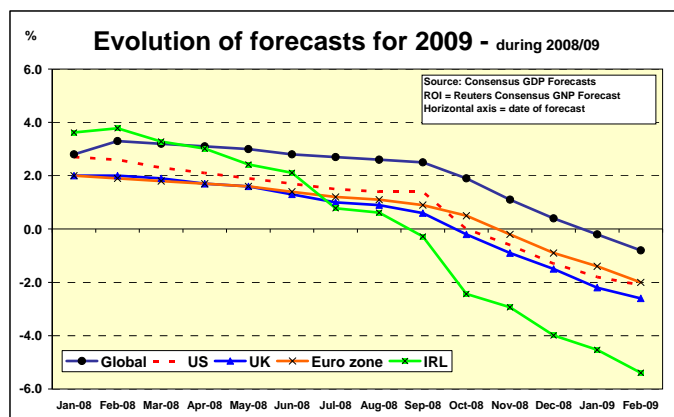
The external environment has deteriorated sharply, with recessions now forecast in all of Ireland's main trading partners. Forecasts for growth have been revised down in recent months, as the global economy, exacerbated by the credit crisis, has deteriorated. However, consensus 2009 GNP forecasts for Ireland have fallen even more sharply, from 3.6% in January 2008 to minus 5.4% in February 2009. This reflects the superimposition of the global recession on top of the factors noted above. Moreover, the true situation is worse as the consensus is invariably a lagging indicator.

consumer spending, the ongoing fiscal contraction, the credit crisis and the global slowdown.



Consumer spending

Consumer spending is made up of two components, spending on goods and spending on services, each of which accounted for roughly 50% of the total in recent years. In the year to September spending on goods fell by an average of 2.8%, while services spending fared considerably better, rising by 3.2%. The significant 8.1% fall in retail sales in the final quarter, signals a further sharp fall in the goods component of consumer spending. However, we believe that services spending continued to hold up reasonably well. On this basis, we have revised our 2008 consumer spending forecast to minus 0.5%. This assumes minus 4% in goods and a 2.6% increase in spending on services, mostly tourism-related.



In our last quarterly we forecast a return to modest positive growth in 2010, however, given the extended banking sector crisis and the implications of this for both global and domestic growth prospects, in addition to our view that consumer spending will remain subdued, we now expect a further fall in GNP in 2010, of 3.4%. Taking the period 2008-10 together, GNP is forecast to contract by almost 14% in total. This will be only the third recessionary period since records began in the late 1940s, with past recessions typically lasting for two years. Therefore, this recession differs in two main ways. Firstly, the duration will be longer, as it is set to last for a minimum of three years, and, secondly, its intensity will be greater because it has multiple drivers – the domestic property correction, the falloff in

While lower inflation and mortgage rates are a positive for spending power, the effects of this will be more than offset by our forecast 9.5% contraction in average employment in 2009. The deteriorating employment outlook will also result in a significant rise in precautionary savings this year, and a related fall in consumer spending.

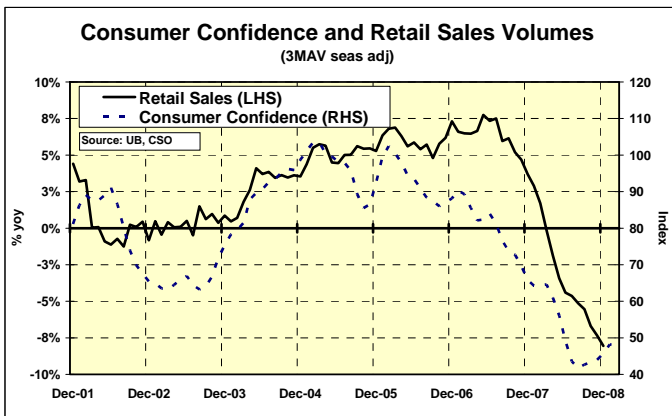
One area where a further significant decline in consumer spending is likely to be observed is in sales of cars. We forecast car sales will decline by 60% in 2009 – given that they have a weighting of 5% in PCE, this alone knocks 3 percentage points off consumer spending. The retail sector most linked to residential construction, namely household goods, which comprises of sales of electrical goods and furniture, is forecast to experience a 20% decline in sales volumes, as the level of completions falls to 18,500, from 51,724 in 2008. Food businesses are also expected to have a poor year as households curb spending on luxury food items, and the strength of the euro versus sterling continues to encourage

cross-border shopping. Other areas of non-discretionary spending, such as spending on clothing and footwear and in bars, are expected to fall also.

As outlined above, spending on goods fell by an estimated 4% in 2008, while services spending remained in positive territory, thereby preventing a larger fall in total consumer spending. The same does not hold for 2009. We forecast a decline in spending on goods, of 10%, in addition to a 4% decline in services spending. On this basis, we anticipate a much greater fall in consumer spending this year, in the region of minus 6.5%.

Continued weakness in the labour market in 2010, with employment forecast to fall by a further 7.5%, combined with a fall in average wages should see consumer spending remain in decline in 2010, and we forecast a fall of 5%. This is driven by a 7% fall in spending on goods and a 3.5% decline in spending on services.

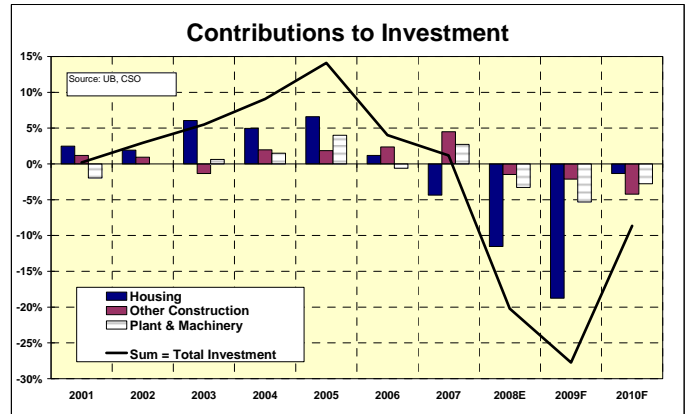
Consumer confidence remains depressed and close to record lows. Retail sales and confidence came back into line in 2008, as spending slowed to match depressed sentiment. In recent months, confidence has levelled off, while retail sales are continuing to decline. We expect both will level off in the course of 2009, albeit at historically low levels.



Investment

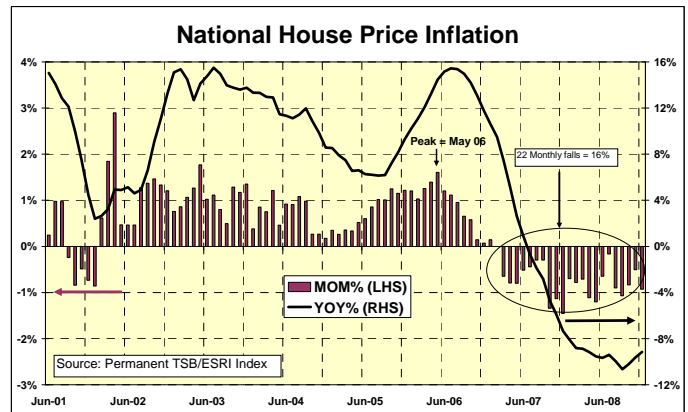
2008 saw a major contraction in investment, as the housing correction accelerated, other building stagnated and purchases of plant and machinery also turned negative. The decline in total investment is estimated at 20.2%.

We forecast an even more substantial decline of 27.7% in 2009, followed by a more modest fall of 8.7% in 2010. The primary factor in the turnaround is housing. Housing output as a percentage of GNP peaked at over 15% in 2005. In 2009, we expect it will fall to 5.5% and will remain at a similarly low level in 2010. We now expect only 18,500 completions this year and a further fall to 15,000 in 2010. This means that housing will take away 4.3 percentage points this year, but essentially ceases to subtract from growth next year, as it is boosted by improvements. Instead, the main negative for investment in 2010 is the sharper fall forecast in other building and construction and, to a lesser extent, in machinery and equipment.

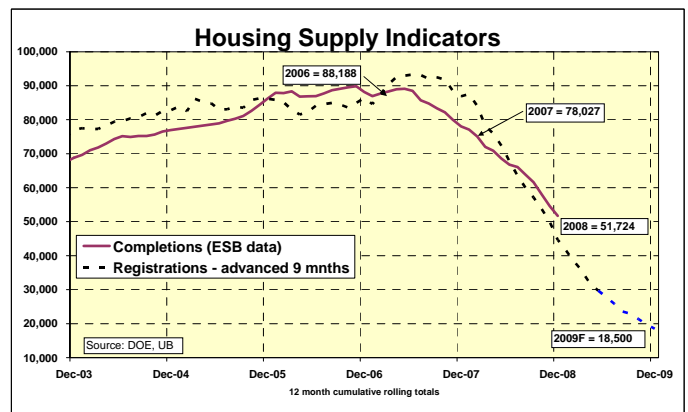


Housing

Annual house price inflation peaked at 15.5% in mid-2006 but fell off rapidly thereafter as rising interest rates curbed affordability. By January 2009 we had experienced 22 successive monthly price falls and the cumulative reduction in average prices was 16%, according to the Permanent TSB/ESRI house price index. Given the lags in reporting – the statistics are based on bank drawdowns – and the virtual absence of transactions, the true decline is much greater. We believe that the real fall is in the region of 30% and predict a further fall of 10% this year, resulting in a total fall from peak of 40%. This, in turn, implies sharp reported falls of 15% in the Permanent TSB/ESRI index this year and a further drop of 15% next year, as the index comes into line with reality.

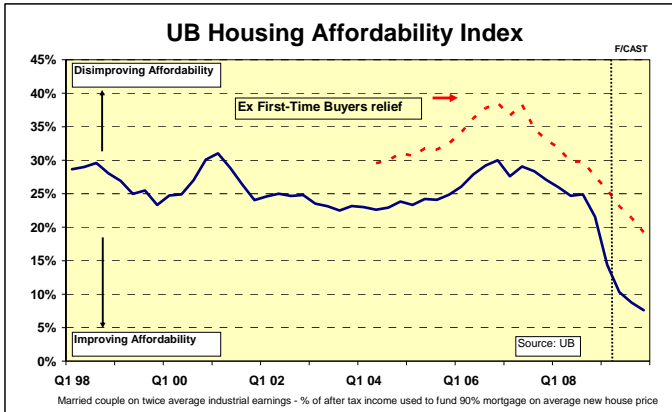


The industry response to falling prices and rising unsold stocks has been to curtail supply sharply. Registrations for insurance against structural defects are used as a proxy for starts and, nine months later, for completions. However, while still down 34% on 2007 levels, completions totalled 51,724 in 2008, over 7,000 more than the leading indicator suggested.

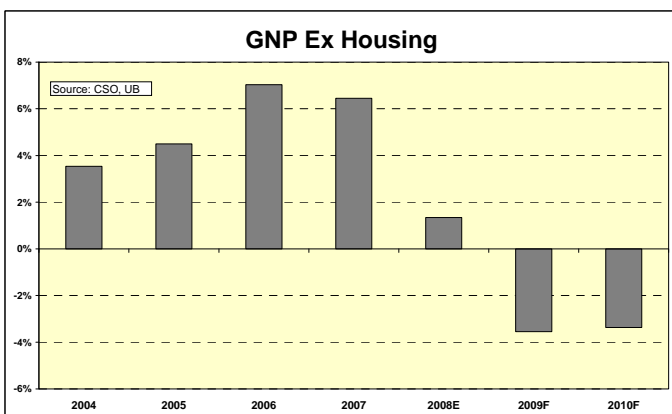


At this stage, our model produces forecasts for the first ten months of 2009. They are down 68% on the corresponding period in 2008, hence our low, 18,500, prediction for the whole of 2009. We expect a slightly lower level of 15,000 in 2010.

The cumulative level of completions for the three years 2008 to 2010 is 85,000. This compares to an underlying medium-term demand of just over 40,000 per annum or 125,000 in total. The 40,000 difference is a rough approximation of the excess supply of new houses at the moment, which we expect to be worked off over the next two years – the Construction Industry Federation have estimated the overhang at 35,000 units, others feel it is higher. In reality, no one knows as there are no statistics on unsold new houses. Recent data from the DAFT website indicate that the stock of unsold second hand houses and apartments is of the order of 55,000.



Affordability is no longer a constraint on house purchase. On a stress-tested basis, a first-time buyer couple who can avail of the tax relief will soon be back at early nineties' affordability levels. This reflects significantly lower house prices, huge increases in mortgage interest relief, augmented by recent very substantial mortgage interest-rate reductions. While this undoubtedly helps, it is confidence that will ultimately determine the recovery of the Irish housing market. At the moment, the confidence factor is outweighing the dramatic increase in affordability that has occurred, as prospective buyers sit on the fence in the anticipation of further price falls. New house starts, in turn, will not recover until buyers emerge and the overhang of unsold stock begins to be eroded. We expect this to commence some time in 2010.



The estimated reduction in activity on account of housing was 3.7 percentage points in 2008 and this is set to rise to 4.3 percentage points this year. Another way of looking at this is to model the growth in the economy ex housing. Though slowing sharply, GNP ex housing is estimated to have remained positive in 2008, at 1.3% (compared with -2.3% when housing is included). GNP ex housing is set to turn negative in both

2009 and 2010, with forecast declines of 3.5% and 3.4% respectively. The gap between GNP and GNP ex housing is gone by 2010, as housing is no longer the main drag on growth, rather consumer spending is.

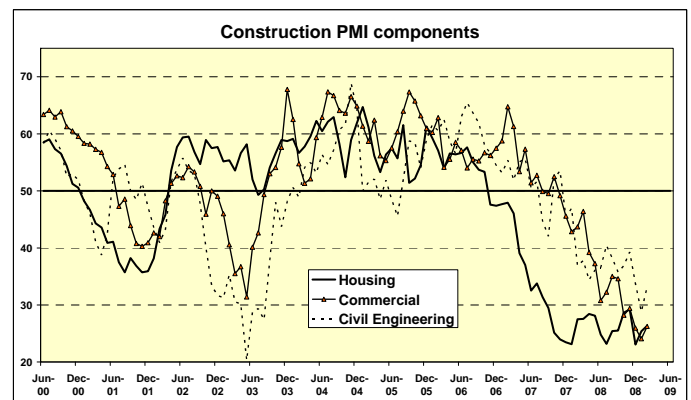
Other Building & Construction

The Ulster Bank Construction PMI indicated that both commercial and civil engineering activity weakened significantly in 2008. While the CSO quarterly national accounts (QNA) data for the first three quarters of the year confirmed these sectors were weak, with a contraction of more than 3% year-on-year, the PMI data leads us to believe that the true rate of decline was even greater. At this stage, it is clear that the slowdown has extended well beyond housing and we have pared back our non-housing activity estimates accordingly.

The slowdown in the commercial property sector has resulted in a virtual absence of transactions here as in housing so it is difficult to get realistic property values. Estimates, subject to more uncertainty than usual, point to falls of 40 to 50 percent in commercial prices in 2008. Looking forward, we expect much more modest price declines this year.

We estimate that a decline of 5.3% in non-residential construction activity took place last year, and expect that this will be followed by a further 6.5%, contraction in 2009 as the economic slowdown and the sharp drop in commercial property prices feeds through. Given that the commercial property sector tends to lag the rest of the economy, we forecast a 10% decline in this sector in 2010, based on the belief that projects completed in 2009 will not be replaced next year.

Investment in machinery and equipment was surprisingly weak in the first half of 2008, down more than 20%. This includes transport equipment, mainly aeroplanes, which fell by over 40% probably reflecting timing shifts in delivery, but the non-transport component was also weak, down 17.5%. While M&E investment rose in the third quarter, driven by investment in transport equipment, we expect that the final three months of the year saw the more negative trend resume, to leave the average fall in machinery and equipment in 2008 at 14.4%.



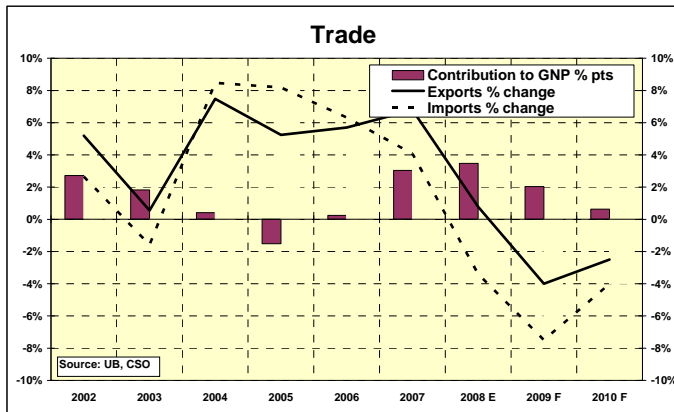
Sales, and by extension imports, of LCVs and HCVs are down 82% and 72%, respectively, in the year to February, and we expect this trend to continue. Accordingly, we see machinery and equipment remaining in negative territory for the foreseeable future, down 21.8% this year, and 10.5% in 2010.

Trade

Exports and imports rose by 6.8% and 4.1%, respectively, in 2007. The picture in the first nine months of 2008 was radically different. Volume growth in both exports and imports fell off sharply, and the third quarter was particularly weak, with exports rising by a mere 0.6%, and imports falling by 6%. For the year

as a whole, we estimate that exports rose modestly, by 0.8%, and that imports fell by a significantly greater 3.4%; hence the positive contribution of net exports to growth was significant and in the order of 3.5 percentage points.

There is a close correlation between exports and imports as we import much of what we export. In recent years, almost 90% of materials used by foreign firms were imported and over 90% of such firms' output was exported. However, the gap between imports and exports should remain, not because exports will rise anytime soon, but because the slowdown in the domestic economy will curb imports by more. The decline in consumer spending on goods shows up in lower imports of consumer durables. The most obvious manifestation of this is car sales which are expected to fall by about 70%, and imports of machinery and equipment are also in substantial decline.



In 2009, the external environment will be considerably more challenging because (i) growth in Ireland's main trading partners will be negative, (ii) the appreciation of the euro, particularly against sterling, will make it more difficult to export and (iii) the domestic cost base is still far too high. This shows up in a significant decline in the forecast rate of growth in exports, however, the projected deceleration in imports is even faster.

Given the challenges outlined above, we forecast that exports will fall by 4% in 2009. While merchandise exports held up reasonably well in 2008, we expect a fall of 3.8% in 2009. On the services side we anticipate exports will fall by 4.4%, primarily as the result of poor performance in insurance and financial services, and trade related business services – that is the sectors most exposed to the banking sector crisis.

Despite the forecast substantial decline in exports this year, net exports will continue to be a positive for growth, as we expect imports will decline by 7.5%. The reasons for this significantly lower level of imports are similar to those that explain the sharp reduction in consumer spending – namely the rise in unemployment, fall in wages and increase in savings.

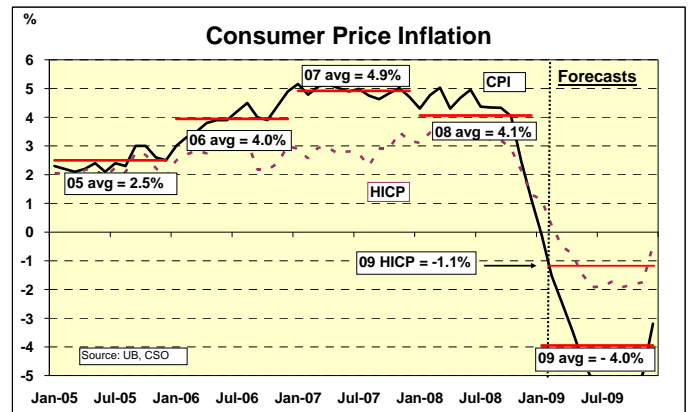
In terms of the breakdown, merchandise imports are projected to fall by 12% this year. Services imports should hold up better, albeit still falling by 4%, driven by a falloff in the categories causing the decline on the export front. Tourism outwards, namely spending by Irish residents abroad, is expected to remain positive in 2009, preventing an even greater decline in services imports.

Following the sharp deterioration in 2009, growth in our main trading partners is expected to recover somewhat in 2010. All else equal, this would provide a boost to Irish exports. However, given that competitiveness is likely to remain an issue for some time, we forecast a further fall in exports in 2010, at a more moderate rate of decline of 2.5%. We anticipate that this decline will again be offset by a larger fall in imports, of 4.0%. While net exports will thus remain a positive for growth in 2010, the contribution is expected to fall back to 0.6%, from an average of almost 3% over the period 2008 to 2009. The external sector

has boosted growth in recent years but this factor will be less potent in 2010.

Inflation

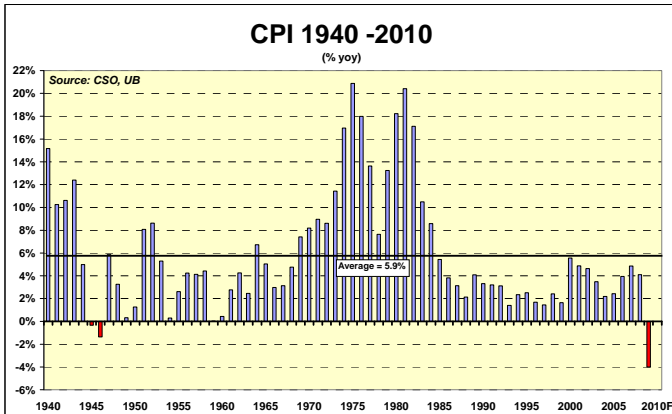
There has been a dramatic turnaround in inflation in a short space of time. As recently as June 2008, the CPI was bouncing off 5%, when inflation was boosted by rising commodity prices, notably food and energy, as well as mortgage rate increases. As late as October, energy price inflation was running at 11% while the mortgage component of the CPI was up 17%. As mortgage rates, energy and food prices started to fall, so too did the CPI, and annual inflation dropped to 1.1% by December, but averaged 4.1% for 2008 as a whole. The HICP rate, which excludes mortgage interest, averaged a lower 3.1% in 2008.



The annual CPI rate turned modestly negative in January of this year, the first time that this has taken place since the quarterly series commenced in 1975. We now expect that the CPI will remain negative for all of 2009, giving an average fall of 4%. Indeed, it will likely be Spring 2010 before the rate turns positive again. Our forecast incorporates further significant falls in energy and food prices, as evidenced from the HICP rate, which we expect will fall by 1.1% this year, with the risks unambiguously to the downside. It is important to point out that the HICP rate goes negative for thirteen consecutive months, which given that this is the closest we have to a core inflation measure, signals that we are entering a period of deflation. Adding to this, a recent IMF report placed Ireland as the fourth most likely region to experience deflation in 2009, behind only Japan, Taiwan and the United States. Within the eurozone, the deflationary forces are greater in the peripheral states.

Our 2009 forecast incorporates more interest rate cuts, albeit that we have assumed that not all of them will be passed on. The ECB has cut rates by a total of 275 bps so far. Our 2009 CPI forecast assumes a further fall of 50 bps in coming months, taking the rate from the current level of 1.5% to 1%. In 2009, we expect mortgage inflation to be down 40% on average accounting for the vast bulk of the decline in the CPI.

Our forecast for a 4.0% fall in the CPI is notable, given that a negative rate of inflation last occurred in 1946, more than 60 years ago, and even then it fell by a much lower 1.4%. A flat CPI rate is forecast for 2010, considerably below the long-term average of 5.9%. The HICP rate will also remain low in 2010, rising by 0.4%. The difference between the two series reflects the mortgage rate impact. As this lasts for a year before falling out of the comparison, the two come more into line in 2010 when both headline and core inflation are close to zero. Looking forward, we expect the rate to climb gradually to 2% over the medium term, i.e. the inflationary outlook is likely to remain quite subdued for the foreseeable future.



Budget

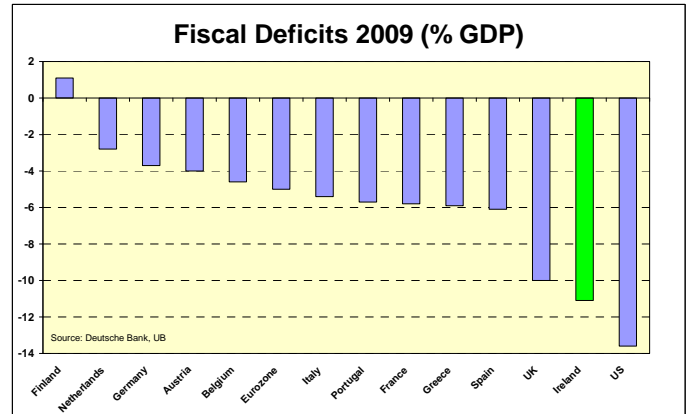
The 2008 Budget was quite expansionary with adjustments to Income Tax bands and allowances boosting after-tax incomes and spending increases in near double digits. At the same time, policy was designed to post a deficit of 0.9% of GDP but with property-related taxes strongly underperforming and the rest of the economy slowing drastically, the eventual 2008 deficit was significantly higher, at minus 6.3%.

This sharp deterioration in the public finances prompted the Government to introduce some corrective measures in July and to bring forward the 2009 Budget from December to October 2008. A General Government Deficit (GGD) of 6.5% of GDP was forecast for 2009 clearly above the 3% limit in the Stability and Growth Pact. The pace of the fiscal deterioration subsequently accelerated, causing the Government to issue a revised set of forecasts in early January. The Government then estimated that savings of €2 billion would be required to prevent the deficit from breaching 9.5% in 2009. In February, these savings were achieved by a combination of measures, notably an increase in public sector pension contributions. However, the further deterioration in the fiscal position since the beginning of the year means that further corrective action is now required to meet the 9.5% target. This is turn has prompted the Government to announce an emergency Budget in early April which is likely to target a further €4 billion of savings.

The absence of the usual monthly profile of receipts and expenditure makes it difficult to analyse the budgetary performance this year. Property related taxes are still underperforming but the rot has spread to spending taxes such as VAT and excises which are now posting sizeable percentage and absolute falls. Clearly, the virtual absence of activity in the property and stock markets is affecting CGT and Stamps. However, the dramatic falloff in retail sales and other spending is increasingly impacting on VAT and excises. In the case of the latter, it is likely that VRT accounts for the vast bulk of the shortfall given that new car registrations are down 65% in the first two months. The growing Income Tax decline reflects the worsening employment situation. It is still holding up reasonably well though receipts in Feb would have been boosted by the IT levy which yielded €50 to €60 million. However, Corporation Tax is a casualty reflecting the impact of the global recession on the big companies, including the banks, which operate here.

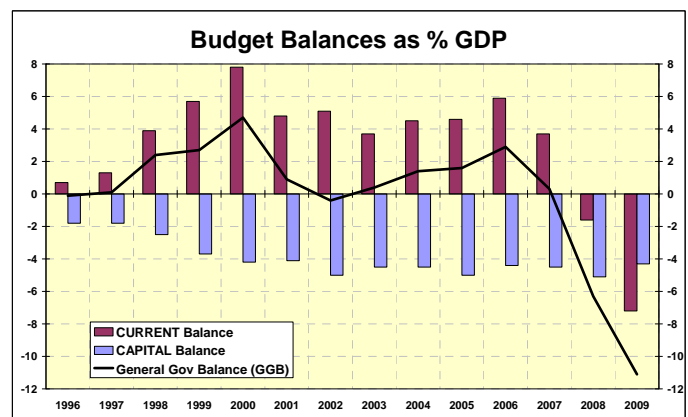
For the year as a whole we reckon that the likely tax undershoot will be in the order of €3 billion. This would take the January total tax estimate down to €34 billion, or slightly above the receipt in 2004. On the spending side, current spend was up 3% but capital was down 7.1% in the first two months of this year. Spending for the year is likely to overshoot by a billion reflecting higher social welfare given likely Live Register developments. The total shortfall in the Budget numbers is, thus, of the order of

€4 billion. However, this €4 billion in savings has to be found in nine months - so annual cuts of €5.3 billion are required. In turn, this would knock €1.6 billion off tax revenue making the gross requirement almost €7 billion. It is our opinion that this is not achievable. Instead, we believe that the Government will struggle to reach €4 billion savings via a combination of spending cuts and tax increases, and that the outturn budget deficit will in the event be in the order of €19 billion, or 11% of GDP.



The medium-term fiscal outlook is clearly dependent on the degree of success the Government has in reaching the 2009 target. The figures published in early January proposed a profile that would bring the GGD below 3% by 2013. This envisaged further pain in the form of corrective measures of the order of 2% of GDP in both 2010 and 2011, declining towards 1.5% in 2013. This will be a major negative for growth in coming years.

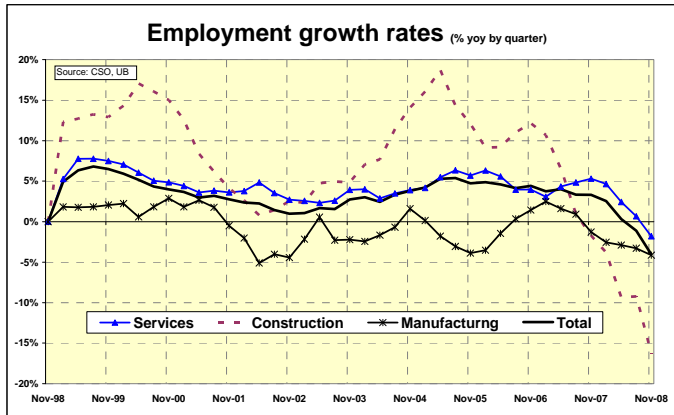
Given that we expect the Government to fail to secure a deficit 9.5% in 2009, the task in coming years will be that much greater. For example, the anticipated GGD for 2010 was €16.9 billion, but this was after another €4 billion, or 2% of GDP, was taken out of the economy in the 2010 Budget. The shortfall carried forward from this year would add another €1 billion, meaning that the corrective measures in the 2010 Budget would have to be €5 billion instead of €4 billion. The magnitude of the fiscal task facing us is still not well understood though the announcement of an emergency Budget has helped in this regard.



Employment

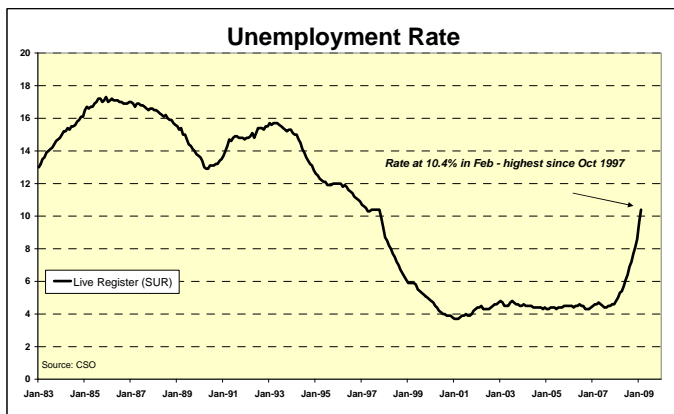
The more broad based weakness in the Irish labour market, outside of construction, has become increasingly evident in recent months. This was further confirmed in the latest Quarterly National Household Survey (QNHS) for the fourth quarter of 2008, which showed employment losses mounting in

the services sector, particularly in Wholesale and Retail. Employment fell by 4.1% in Q4'08, the largest annual decrease in the history of the labour force survey, which dates back to 1975. For a while, the true fall was masked by a shift into part-time work and self employment. However, this has now ended and the latest figures show a large increase in full time unemployment.



The Live Register estimate of the unemployment rate was 10.4% in February, up from 9.6% in January. According to this measure, unemployment is at levels last seen in 1997. The Live Register measures unemployment claimants rather than unemployment per se, but acts as a useful leading indicator.

The official unemployment figures are those contained in the QNHS, the most recent of which showed an unemployment rate of 7.7% for the fourth quarter of 2008 (Sep-Nov). The Live Register under-estimated the unemployment rate for this period (7.4% versus actual 7.7%), and therefore all months since then have been revised upwards - hence the January rate is now 9.6%, from 9.2% previously. This is the second quarter in a row in which the official unemployment measure has outstripped the live register estimate, which given that it does not include part-time workers, indicates that full-time unemployment is rising. That is, those who had been previously part-time unemployed are increasingly moving into full-term unemployment as the economic situation worsens.



Following a surprisingly slow adjustment given the deteriorating economic climate, the labour force fell by 15,000 in the fourth quarter of 2008. While we expect that it will continue to decrease in coming quarters, the partial buffer effect of a falling labour force is not materialising to the extent we expected, and unemployment is set to rise at a significantly faster pace as a result. A key factor in this is that the current downturn is a global one, therefore limiting the employment prospects for Irish workers prepared to emigrate. Whilst we do expect a significant decline in the labour force, in the order of 100,000, in 2009, this will not be enough to prevent a sharp rise in the

unemployment rate, which we forecast will be close to 14% by the end of the year, and average 12% for 2009 as a whole.

This forecast assumes that employment will fall by 220,000, or 9.5%, in 2009. More than half of these job losses will be in services, and the remainder split between construction (-65k) and manufacturing (-30k). The construction losses are mainly in housing but commercial construction will feature increasingly from now on. However, the focus is now on services. A range of services, notably wholesale and retail, as well as financial and business are likely to experience substantial falls, with Government workers also likely to be increasingly affected as time goes on.

Looking forward to 2010, we expect a further fall in the labour force, as the US and UK economies start to recover and employment prospects abroad improve. However, employment, which is a lagging indicator, is set to fall by a further 100,000, or 7.5%, in 2010. Forecast job losses in the services sector account for over half of this and the rest again split between construction and manufacturing. Within services, we expect public sector employment will fall, as the government steps up its measures to cut spending. Based on our labour force and employment assumptions, we forecast that unemployment will reach almost 16% by end 2010, and average 15.5% for the year.

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Summary Table

	2006	2007	2008E	2009F	2010F
GROWTH					
Consumer Spending (%YOY)	7.1	6.3	-0.5	-6.5	-5.0
Investment (%YOY)	4.0	1.2	-20.2	-27.7	-8.7
- Housing	2.4	-9.2	-27.0	-48.0	-4.8
- Other Building & Construction	10.8	19.2	-5.3	-6.5	-10.0
- Machinery & Equipment	-2.7	13.5	-14.4	-21.8	-10.5
Government Spending (%YOY)	4.8	6.0	2.9	0.0	-2.0
Exports (%YOY)	5.7	6.8	0.8	-4.0	-2.5
Imports (%YOY)	6.3	4.1	-3.4	-7.5	-4.0
Real GDP (% YOY)	5.7	6.0	-1.7	-8.0	-3.5
Real GNP (% YOY)	6.3	4.1	-2.3	-7.9	-3.4
PRICES					
CPI (% YOY) Average	4.0	4.9	4.1	-4.0	0.0
HICP (% YOY) Average	2.7	2.8	3.1	-1.1	0.4
HOUSING MARKET					
Completions	88,187	78,027	51,724	18,500	15,000
House Price Inflation (% end-year)	13.4	1.1	-9.4	-15.0	-15.0
LABOUR MARKET					
Employment (% YOY) Average	4.4	3.6	-0.6	-9.5	-7.5
Unemployment Standardised avg.%	4.4	4.5	6.3	12.0	15.5
PUBLIC FINANCE					
Budget Balance (% GDP)	2.9	0.2	-6.3	-11.0	-10.5
EXCHANGE AND INTEREST RATES					
ECB Refi Rate (End of Period)	3.5	4.0	2.5	1.0	1.5
EUR/\$ (End of Period)	1.32	1.46	1.40	1.30	1.30
EUR/£ (End of Period)	0.67	0.74	0.96	0.80	0.76