

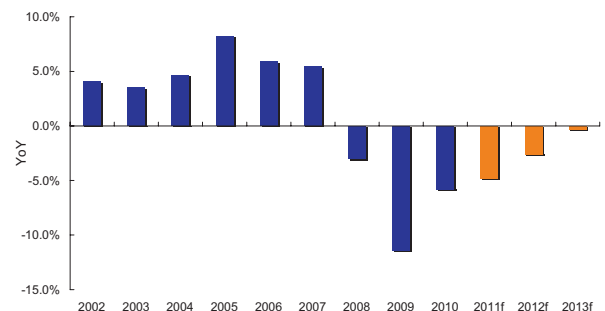
Ireland - 2012 Outlook

Economics

The challenge continues

- Ireland's first full year in an IMF/EU programme provided mixed results...** - In contrast to other programme countries, 2011 saw the Irish economy return to modest economic growth. However, it is a fragile economic recovery totally dependent on net exports. The hurdles of stability in the banking sector, a labour market recovery and the question of debt sustainability have yet to be fully negotiated.
- ...but forecast downgrades...** - Following the disappointing Q3 National Accounts, we have downgraded our forecasts for growth in 2012 on the back of trade and domestic demand. We expect GDP growth of 0.7% (relative to 1.2% previously), but GNP is expected to decline by 0.8% (+0.7% previously), while domestic demand will contract by 2.6%. Growth will improve in 2013, but the process of deleveraging by banks and households, coupled with fiscal consolidation, will contribute to a further modest decline in domestic demand in that year.
- ...highlight the challenges ahead, with a number of critical issues for 2012...** - We identify six key issues to watch out for in the coming twelve months: (i) A possible referendum on the recently agreed fiscal compact, will be framed as a vote on the euro; (ii) debt sustainability and the possible restructuring of the promissory notes will remain key; (iii) Ireland's aims to tap the debt markets in some way later in the year; (iv) banking trends, in relation to arrears, loan losses and deposit trends will remain crucial; (v) fiscal consolidation efforts, which have totalled 12% of GDP already, will continue throughout the year, but tax revenue targets may fall short due to growth; (vi) a continuation of the falling unit labour costs and an improving current account position is likely to further distinguish Ireland from other peripheral euro-zone economies in difficulty.
- ...and focus will have to move from austerity to growth** - We estimate that the debt/GDP ratio will rise to 124% in 2014, while the deficit will not reach the 3% of GDP deficit target by 2015. The Fifth Review of Ireland's Programme, starting this week, must focus on the issue of growth and debt sustainability, rather than just austerity. A restructuring of the c.€30bn in promissory notes provides an opportunity to reduce debt to a more sustainable level without the difficulties that Greece is currently experiencing with PSI. Another important issue is bank deleveraging. Strict loan-to-deposit ratio targets are creating incentives for the banks to reduce the size of their loan books and while this is appropriate for non-Irish assets, continued contraction in domestic credit continues to impact on growth, asset prices and thus loan arrears. We argue that this process of bank deleveraging should be slowed, but this will require further assistance by Europe for Ireland's banking system.

Domestic demand continuing to decline



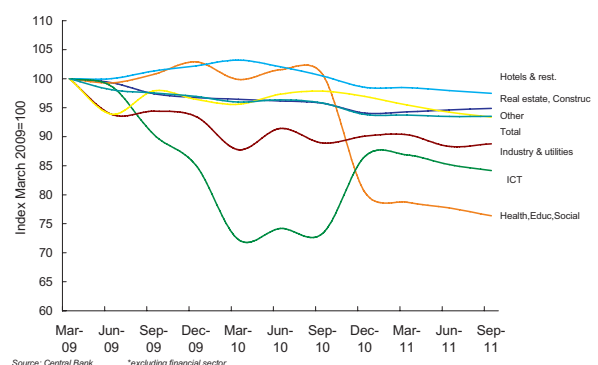
Source: CSO, Goodbody Estimates. Note: Domestic demand is sum of consumption, government and investment spending

Irish growth forecasts

	2011f	2012f	2013f
Consumption	-3.2%	-2.0%	-0.4%
Government	-3.4%	-3.5%	-2.0%
Investment	-13.9%	-4.2%	3.2%
Dom Demand	-4.8%	-2.6%	-0.3%
Exports	3.8%	1.5%	2.7%
Imports	0.0%	0.2%	1.3%
GDP	0.8%	0.7%	1.6%
GNP	-1.5%	-0.8%	0.8%

Source: CSO and Goodbody estimates

Business lending flows* by sector 2009-2011



Source: Central Bank *excluding financial sector

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THE IRISH ECONOMY IN 2012

Ireland's first full year in its IMF/EU programme in 2011 contained a number of achievements and a number of disappointments. The true test of the success of this difficult period in Ireland's economic history will be a return to sustainable economic growth, a reduction in the unemployment rate from excessively high levels and the achievement of debt sustainability. Ireland has seen a return to, albeit modest, economic growth for 2011 as a whole, in contrast to the other countries in economic programmes, but it is a fragile economic recovery totally dependent on net exports. The other tests have certainly not been passed as yet.

A fragile recovery...

Growth is very much of a two-speed nature and this will continue through 2012. Following the disappointing recent Q3 National Accounts, we have downgraded our forecasts for growth in 2012 on the back of trade and domestic demand. We expect GDP growth of 0.7% (previously 1.2%), but GNP is expected to decline by 0.8% (previously +0.7%), while domestic demand will contract by 2.6%. Growth will improve in 2013, but the process of deleveraging by banks and households and fiscal consolidation will contribute to a further decline in domestic demand in that year. This is an exceptionally shallow recovery from a very deep downturn with a slowing in the deleveraging plans of the banks in particular needed to encourage any recovery in the domestic economy.

...with growth very much of a two-speed nature

Irish growth forecasts

	2008	2009	2010	2011f	2012f	2013f
Consumption	-1.1%	-6.9%	-0.8%	-3.2%	-2.0%	-0.4%
Government	0.5%	-4.5%	-3.8%	-3.4%	-3.5%	-2.0%
Investment	-10.2%	-28.7%	-24.9%	-13.9%	-4.2%	3.2%
Dom Demand	-3.0%	-11.4%	-5.8%	-4.8%	-2.6%	-0.3%
Exports	-1.1%	-4.2%	6.3%	3.8%	1.5%	2.7%
Imports	-3.0%	-9.3%	2.7%	0.0%	0.2%	1.3%
GDP	-3.0%	-7.0%	-0.4%	0.8%	0.7%	1.6%
GNP	-2.8%	-9.8%	0.3%	-1.5%	-0.8%	0.8%

Source: CSO and Goodbody estimates

The absence of nominal growth continues to impact on Ireland's ability to bring about public debt sustainability. We now estimate that the debt/GDP ratio will rise to 124% in 2014, while the deficit will not reach the 3% of GDP deficit target by 2015 agreed under the Memorandum of Understanding with the Troika. Ireland needs assistance if it is to meaningfully reduce debt levels, especially that resulting from the banking crisis. Austerity on its own will not work, but will have to be supplemented with growth-enhancing efforts, particularly in relation to the deleveraging of the banking system.

Ireland is likely to require further international assistance...

2012 will be a pivotal year for the Irish economy. In this note, we identify six key issues to watch out for in the coming twelve months. Firstly, there is the possible referendum on the recently agreed fiscal compact which will be framed as a vote on the euro and of which there is no guarantee of it being passed. Secondly, debt sustainability and the possible restructuring of the promissory notes will also remain key. Third, we discuss the sovereign's need and ability to regain access to wholesale debt markets. Fourth, trends in the banking system in relation to arrears, deleveraging and deposit retention will be crucial. Fifth, maintaining progress in relation to fiscal consolidation particularly in the light of a slowing economy and sixth, distinguishing Ireland from other programme countries, in terms of the performance of the current account and competitiveness issues.

...with 2012 set to be another pivotal year, with a possible referendum in the offing

A disappointing Q3 leads to forecast downgrades for 2011 and 2012

Following growth in the first half of the year, the economy resumed its contraction in the third quarter of the year, with GDP falling by 1.9% and GNP declining by 2.2%, quarter-on-quarter, seasonally-adjusted. Following these numbers, we are downgrading our expectations for 2011 and 2012. We now estimate that after a 0.7% increase in GDP in 2011 (previously 1.3%), that GDP will expand by only 0.7% in 2012 (previously 1.2%) and by 1.6% in 2013. GNP is expected to contract by 0.8% in 2012 and grow by 0.8% in 2013.

*Forecast downgrades following
Q3 National Accounts...*

The biggest disappointment in the quarter was investment, which fell by 21% in the quarter alone. This category can be notoriously volatile though, due to the presence of aircraft purchases (which would not affect overall GDP given that the imports would subtract from GDP). However, there was a notable change in the trend in non-aircraft investment, while construction investment continues to decline, reaching a new low – 70% below peak levels – in Q3.

*...where investment spending
was the weakest component...*

Irish economic growth

	Cons.	Gov.	Invest.	Exports	Imports	GDP	GNP
2008	-1.0%	0.3%	-10.2%	-1.1%	-3.0%	-3.0%	-2.8%
2009	-6.9%	-4.5%	-28.7%	-4.2%	-9.3%	-7.0%	-9.8%
2010	-0.8%	-3.8%	-24.9%	6.3%	2.7%	-0.4%	0.3%
Annual growth							
Q4 2010	-0.3%	-1.7%	-25.1%	6.6%	5.0%	-0.2%	4.8%
Q1 2011	-2.9%	-3.3%	-8.9%	6.1%	4.3%	0.2%	0.8%
Q2 2011	-2.4%	-2.8%	-15.6%	4.9%	0.1%	2.1%	0.9%
Q3 2011	-3.9%	-3.9%	-22.2%	2.4%	-3.3%	-0.1%	-4.2%
Quarterly - Seasonally-adjusted							
Q4 2010	-0.9%	0.1%	-4.1%	-2.7%	-1.0%	-1.4%	0.4%
Q1 2011	-1.8%	-1.5%	3.1%	3.1%	0.0%	1.8%	-3.1%
Q2 2011	0.1%	-1.1%	-0.1%	1.1%	-0.8%	1.4%	0.7%
Q3 2011	-1.3%	-1.3%	-20.9%	0.8%	-1.5%	-1.9%	-2.2%

Source: CSO

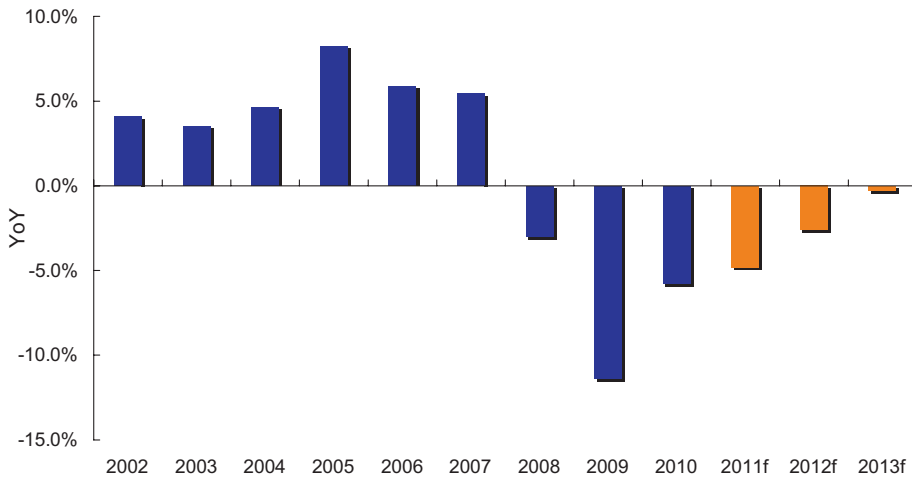
Consumer spending also fell at a faster pace in Q3. On an annual basis, the 3.9% drop in spending was the worst since Q4 2009, with spending on services falling at a faster pace than during the 2009 downturn. With car sales likely to fall in 2012, given the absence of the car scrappage scheme, spending on goods will fall quite sharply once again. We also believe that spending on services will fall again in 2012, with a further fall in employment, of 0.6% on average, being the major driver.

*...and consumer spending fell
at a faster pace*

It goes without saying that government spending will also decline this year due to the ongoing austerity measures. These three factors will lead to a decline in domestic demand of 2.6% in 2012, following a decline of 4.8% in 2011. This represents downgrades of c.1% for both years. We now also expect another decline of 0.3% in 2013. In terms of trade, we expect a substantial slowdown in export growth to just 1.5% in 2012, on the back of recession in the euro-area and the UK and a slowdown in most of the developed world. However, due to the large size of exports in Irish GDP and relatively flat import growth, net exports will still contribute strongly to growth in 2012, before a pick-up in exports occurs in 2013.

*Domestic demand will continue
to decline into 2013*

Domestic demand continuing to decline

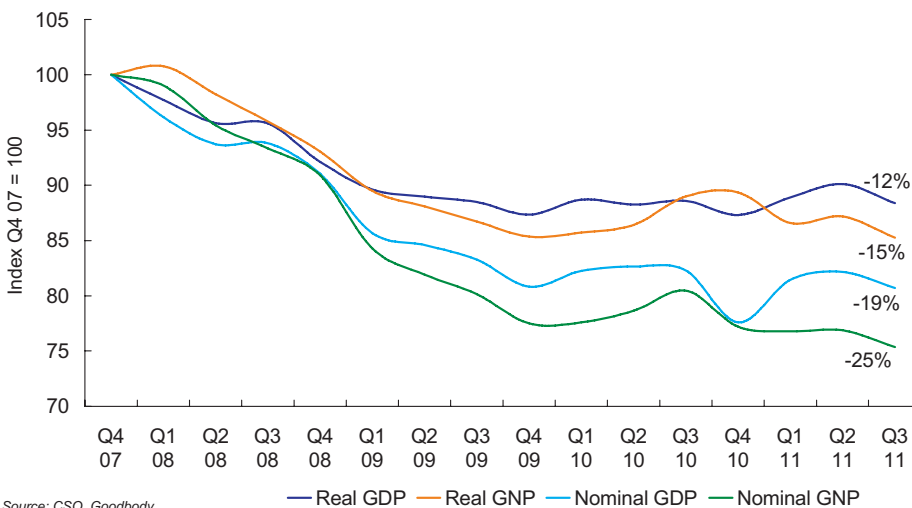


Source: CSO, Goodbody Estimates Note: Domestic demand is sum of consumption, government and investment spending

This represents an extremely shallow recovery from a very severe downturn. The chart below shows that depending on how one measures output in Ireland, the downturn varies from 12% (real GDP) to 25% (nominal GNP). The difference between the two relates to two issues: (1) the external sector, for which there are large multi-national profits not accruing to Irish residents, and; (2) price declines leading to a larger fall in nominal rather than real GDP. According to analysis from Harvard, the 15% drop in real GNP puts Ireland's downturn as the 14th most severe since the Second World War, with only the collapses in Latvia and Estonia being slightly more severe in the most recent financial crisis.

Downturn has already reached historical proportions

Measures of declines in output in Ireland since Q4 2007



Source: CSO, Goodbody

WHAT TO WATCH OUT FOR IN 2012 FOR IRELAND?

(1) Referendum likely, effectively on the euro

Ireland may be in the unusual position in 2012 of being the only country to hold a referendum on the fiscal compact agreed on December 9th 2011. Although Irish Finance Minister, Michael Noonan, has been criticised for terming this possible vote a referendum on the euro, we believe this is an appropriate representation; the reaction of Merkel and Sarkozy to the announcement of a referendum in Greece in November is telling in this regard. EU leaders have essentially told programme countries especially, but also other countries with high debt and deficits, that rules must be complied with if aid is to be forthcoming from Europe. The recently announced fiscal compact, although falling down in some areas, is believed to be an important cornerstone in this regard.

A Referendum on the euro

(2) Sovereign debt sustainability & promissory notes

Despite the large fiscal consolidation efforts since 2008, Irish debt levels have ballooned. Our forecasts now suggest that the debt/GDP ratio will increase to 124% in 2014, up from as low as 25% of GDP in 2007. Worryingly, we estimate that the budget deficit will still be well above the 3% of GDP target by 2015. Within this, we estimate that interest costs will rise to over 6% of GDP and 17% of total government revenue.

*Irish debt levels to rise above
120% of GDP...*

In 2011, we made the call that Europe would require Ireland to restructure its debt in some way when the country had to request further official funding in 2013. This view was predicated on the precedent that was set by Greece as well as the inclusion, at the time, of specific mention of Private Sector Involvement (PSI) in the text of the European Stability Mechanism (ESM). This has since been taken out of the draft text, and there has also been a campaign by the Irish authorities to facilitate a restructuring of the promissory notes that have been provided to Irish Bank Resolution Corporation (IBRC), as a way to reduce the debt burden.

We believe that this restructuring is now necessary if Irish debt levels are to be put on a sustainable footing. Discussions between the Irish government, the ECB, the EU and the IMF will be important in 2012. Depending on how the restructuring occurs, there could be a significant annual saving to the government.

*...and Ireland will need further
European assistance to achieve
debt sustainability*

Goodbody Fiscal forecasts

	2009	2010	2011f	2012f	2013f	2014f	2015f
Budget Deficit (% of GDP)	-14.5%	-31.6%	-10.1%	-8.7%	-7.7%	-6.7%	-4.9%
Excluding Banking costs	-11.9%	-11.8%	-10.1%	-8.7%	-7.7%	-6.7%	-4.9%
General Government Debt (% of GDP)	65%	92%	107%	116%	121%	124%	124%
Interest/GDP	1.6%	2.6%	3.5%	4.4%	5.9%	6.2%	6.3%
Average interest rate	5.1%	5.4%	5.3%	5.4%	5.4%	5.4%	5.5%
Assumed interest rate on new debt	5.1%	5.0%	5.0%	4.0%	4.0%	4.0%	4.0%
GDP growth (real)	-7.0%	-0.4%	0.8%	0.7%	1.6%	2.0%	2.5%
GDP growth (nominal)	-10.8%	-2.9%	-0.7%	0.9%	2.3%	3.5%	4.0%

Source: Goodbody estimates

(3) Sovereign funding

The table on the next page shows the estimated funding needs for the State for the next 3 years. What it illustrates is that Ireland is fully funded, through the official troika programme and the State's own cash reserves, until the end of 2013. However, this depletes the sovereign's cash reserves, which would likely be unacceptable to the NTMA which has previously maintained an average of €5bn in cash buffers.

*Fully funded up to 2013, but
only just...*

In addition, there is €11.9bn in long term debt maturing in January 2014 and it is the NTMA's stated aim to return to the wholesale markets as soon as market conditions permit to pre-fund this. According to the Minister for Finance, the NTMA intends to increase its issuance of short-dated paper in the second half of 2012 and ideally intends to issue some longer-term debt late in the 2012, with full re-entry to the bond market by mid-2013.

...which means that Ireland will have to return to bond markets in some way sooner...

This is of course dependant on market conditions and while there has been a change in sentiment towards the sovereign that has seen Irish bond yields retreat from their highs, they remain at levels that are unsustainable. In addition, the entire euro-area bond market is currently dysfunctional as the authorities have struggled to regain the confidence of bond investors in the face the escalating debt crisis. If things stay as they are, Ireland will have to resort to the ESM some time in 2013. The recent removal of the Private Sector Involvement issue from the future shape of the permanent bailout fund should ultimately have positive implications for the euro-area debt markets but current uncertainties make it difficult to see an improvement in the near-term.

...so market developments are once again vital

Financing Needs and Sources

€bn	2012	2013	2014
Needs			
Exchequer deficit	18.9	14.1	10.2
LT debt maturing	5.8	6.1	11.9
ST debt maturing	0.0	0.0	0.0
Total	24.7	20.2	22.1
Sources			
EU-IMF	19.0	10.0	0.0
Retail Funding	1.5	1.5	1.5
Required Cash	4.2	6.9	20.6
Total	24.7	18.4	22.1
<i>Cash Balances</i>	<i>13.5</i>	<i>9.3</i>	<i>2.4</i>

Sources: Bloomberg, NTMA & Goodbody estimates

Note: Assumes no market financing

It is worth noting that the State also has access to c€5bn that remains in the National Pension Reserve Fund (NPRF). Also, any restructuring of the interest bill on the promissory note will help reduce the exchequer deficit and thus the State's funding needs. The estimated market funding is based on the NTMA's estimates for government retail savings products in July 2011.

(4) Bank stress tests, deleveraging and arrears

The 2012 PCAR/PLAR exercise will take place in conjunction with the wider stress test in Europe (at the end of H1 2012). Thus far, asset sales in the Irish banks have been completed with lower haircuts than those assumed in the Financial Measures Programme last March. However, the arrears trends, particularly for mortgages, have been concerning.

Banking system still an area of concern...

Arrears

The table on the next page shows that among owner-occupiers, the number of mortgage-holders in arrears or with restructured mortgages amounts to 12.8% of total. This translates into 16% of the total value of the loan book. Central Bank analysis has shown that non-covered banks have higher levels of arrears, but the direction of the trend provides risks to the baseline forecasts in the 2011 stress test exercise. This exercise also assumed a 55% peak to trough house price decline and a 60% peak to trough decline for commercial prices in its base case. Under a stressed scenario, a 60% house

...with arrears rising at a worrying rate

Residential mortgage arrears

	Sep-10	Dec-10	Mar-11	Jun-11	Sep-11
<i>Owner-occupied mortgages (No.)</i>	788,745	786,164	782,429	777,321	773,420
Arrears 91-180 days	12,423	13,170	14,268	15,723	16,599
%	1.58%	1.68%	1.82%	2.02%	2.15%
Arrears over 180 days	28,049	31,338	35,341	40,040	46,371
%	3.56%	3.99%	4.52%	5.15%	6.00%
Total over 91 days	40,472	44,508	49,609	55,763	62,970
%	5.1%	5.7%	6.3%	7.2%	8.1%
Restructured (not in arrears)		4.5%	4.7%	4.7%	4.7%
In arrears or restructured		10.1%	11.0%	11.9%	12.8%
<i>Outstanding balance (€m)</i>	117,401,600	116,683,253	115,957,640	115,088,537	114,412,371
Arrears 91-180 days	2,318,207	2,436,471	2,563,539	2,852,565	3,058,984
%	2.0%	2.1%	2.2%	2.5%	2.7%
Arrears over 180 days	5,476,752	6,189,355	7,035,684	7,985,161	9,310,970
%	4.7%	5.3%	6.1%	6.9%	8.1%
Total	7,794,959	8,625,826	9,599,223	10,837,726	12,369,954
%	6.6%	7.4%	8.3%	9.4%	10.8%
Restructured (not in arrears)		5.1%	5.3%	5.2%	5.2%
In arrears or restructured		12.4%	13.6%	14.7%	16.0%

Source: Financial Regulator

Concerning trends in mortgage
arrears...

price decline is assumed as well as a 70% commercial price decline. As it currently stands, estimated price declines are coming more in line with the stressed scenarios.

Moreover, with the downgrades to our economic assumptions, the macro-variables are also more in line with the stressed scenario, as is shown in the table below.

Stress test assumptions compared

	Baseline			Adverse			Goodbody		
	2011	2012	2013	2011	2012	2013	2011	2012	2013
GDP	0.9	1.9	2.5	-1.6	0.3	1.4	0.8	0.7	1.6
GNP	-1.5	0.8	1.5	-2.6	0.2	1.2	-1.5	-0.8	0.8
Consumption	-1.9	-1	0.5	-3.9	-1.3	0.1	-3.2	-2.0	-0.4
Investment	-8.9	1.8	4.3	-11.3	-1.7	-0.3	-13.9	-4.2	3.2
<i>Construction</i>	-15.6	-1.3	2						
<i>Equipment</i>	1.4	5.8	7.1						
Government	-5.7	-1.8	-2.4	-5.5	-4.3	-2.4	-3.4	-3.5	-2.0
Exports	4.5	4.5	4.6	2	2.1	2.5	3.8	1.5	2.7
Imports	0.9	2.7	3.3	-1.1	0.5	1.7	0.0	0.2	1.3
Balance of Payments									
% GDP	1.2	2.2	2.6	1.6	3.1	4.3	0.8	1.8	2.7
Employment	-0.8	0.5	1.1	-2.5	-1.1	0.1	-1.7	-0.1	1.0
Unemployment	13.4	12.7	11.5	14.9	15.8	15.6	14.4	14.3	13.4
Inflation									
<i>HICP</i>	0.4	0.6	1.6	0.1	0.6	1	1.2	1.8	0.9
<i>CPI</i>	0.9	0.8	1.6	0.7	0.9	1	2.5	1.3	1.0
House Prices	-13.4	-14.4	0.5	-17.4	-18.8	0.5	-16.4	-13.1	-4.7
Commercial Property	-2.5	1.5	1.5	-22	1.5	1.5	-16.0	-5.0	3
Personal Disposable Income	-1.9	-1.3	0.4	-3.9	-1.2	0.2	-1.0	-0.7	0.0

Source: Central Bank, Goodbody

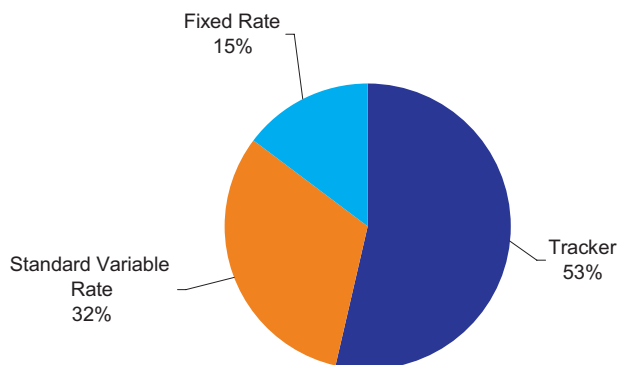
...as macro backdrop moves
towards the "Adverse" stress
test scenario

Interest Rates

Interest rate cuts will help Irish homeowners in 2012, but studies have shown that the more important determinants of arrears trends are employment and incomes. We are forecasting that the ECB will cut rates to 0.5% in Q1 2012. With 53% or €70bn of Irish mortgages on tracker rates, each 25bp cut results in €175m interest savings for households over the full year. Along with the December reduction feeding through in January, this would result in savings of c.€525m to households or 0.4% of 2010 disposable income. If the banks were to pass the cuts on in full to standard variable rate mortgages a further €315m could be saved (0.25% of 2010 disposable income).

Lower interest rates will help at
the margin

Irish mortgages split by type



Homeowners will benefit at the margin from ECB rate cuts

Source: Central Bank

However, the banks have shown an unwillingness to pass on rate cuts to this category as they repair net interest margins. In addition, as households are in the midst of the deleveraging process, any increase in disposable income is unlikely to find its way into higher consumption.

Deleveraging

The pillar banks have a target of a loan to deposit ratio (LDR) of 122.5%. To achieve this, the covered Irish banks need to reduce their assets by c.€70bn, through both asset sales and deleveraging.

Deleveraging plans 2010-2013

€bn	AIB	Bol	EBS	ILP	Total
Core	2.1	-2.6	-2.6	-5.3	-8.4
Non Core	-20.9	-30	-2.3	-10.4	-63.6
Total	-18.8	-32.6	-4.9	-15.7	-72
Non Core Disposals					-34
Deleveraging					-38
Non Core disposals 2011	1.5	8.6	0	0	10.1

Source: Central Bank of Ireland, NTMA, Department of Finance, Bank of Ireland and Goodbody estimates

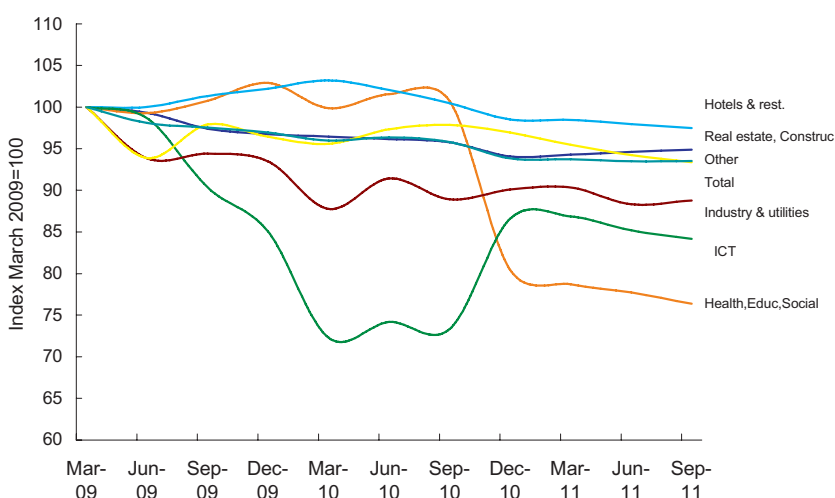
Banks are meeting deleveraging targets thus far...

Bank of Ireland reached an LDR of 153% at the end of October, while AIB had an LDR of 143% at the end of June. Both pillar banks are currently ahead of target on their deleveraging plans. This reduction is reflected in the decline in the covered banks dependence on ECB/ELA funding, which has fallen from a high of €156bn in February to €115bn in November. There have also been signs of stabilisation in deposit flows with private sector deposits seeing their first increase in a year in October.

While the majority of deleveraging in the Irish banks is planned for the “non-core” parts of the banks (particularly international assets), underlying credit flows continue to be negative, thus affecting domestic demand in the Irish economy. We argue that the presence of loan-to-deposit ratio targets is creating incentives for the banks to reduce the size of their loan books and this is happening across the board (see chart on next page). There is no doubt that demand for credit is also low, but we would look for ways in which the authorities could increase the flow of credit in the economy in 2012. These may include medium-term liquidity support, loan guarantees and a relaxation of the deleveraging plans.

...but we believe that this is having a damaging effect on the economy

Business lending flows* by sector 2009-2011



Source: Central Bank *excluding financial sector

Credit still falling across all sectors

(5) Fiscal Consolidation & the Troika

Ireland has shown consistent determination to close the budget deficit since the middle of 2008. This encompassed €18bn in revenue-raising and expenditure cutting decisions. This amounts to 11.6% of 2011 GDP, putting it among the largest consolidation efforts ever. However, these consolidation efforts are far from being complete. In 2011, the budget deficit still stood at c.10% of GDP, while Ireland still has the highest primary deficit in the euro-area at 7% of GDP.

Consolidation efforts have amounted to 12% of GDP already...

In Budget 2012, the government announced a further €3.8bn in consolidation measures to bring the deficit to 8.6% of GDP. We think that a slowing in the economy will mean that the target may not be reached. However, comments from the IMF suggest that if this is due to growth falling short, the government should not try to increase consolidation efforts, given the further depressing effects that this would have on the economy.

...but the budget deficit remains at unsustainable levels

Assuming that the consolidation plan is implemented in full over the coming years, the government forecasts that the debt level will reach 119% of GDP by 2013 before beginning to reverse. This is subject to the government's current growth forecasts which we see as optimistic and as such we see the debt/GDP ratio rising to 124% by 2015. While the decision earlier this year to reduce the interest rate on loans from Europe are helpful, the fragility of the international environment and continued domestic deleveraging poses downside risks to growth. As such, we expect the Irish government to continue to press the EU for a reduction in the overall debt burden carried by the State, with the most obvious target being a restructuring of the promissory notes.

Consolidation plan 2012-2014

€bn	2012	2013	2014	2015	Total
Revenue					
New measures	1.0	1.0	0.9	0.4	3.3
Carry forward	0.6	0.3	0.2	0.3	1.4
Total	1.6	1.3	1.1	0.7	4.7
Expenditure					
Current	1.5	1.7	1.9	1.3	6.4
Capital	0.8	0.6	0.1	0.0	1.4
Total	2.2	2.3	2.0	1.3	7.8
Total consolidation	3.8	3.5	3.1	2.0	12.4
Budget deficit (% of GDP)	8.6	7.5	5.0	2.9	

Source: Department of Finance

6) Stocks & flows – Distinguishing Ireland from the rest

Ireland entered 2011 in the eye of the sovereign storm in the euro-zone. During 2011 though, with the successful completion of bank stress tests, recapitalisation and continued adherence to Troika targets, Ireland managed to distinguish itself from other euro-zone states in difficulty, particularly Portugal and Greece.

There are other important differences that are likely to be in evidence once again this year. In particular, when assessing the fundamentals of an economy, it is best to distinguish between stocks and flows. While it has been convenient during the euro-zone debt crisis to group the PIIGS countries together, there are important differences between these economies that tell us a lot about the flexibility and prospects for those economies.

Ireland managed to distinguish itself from other peripherals in 2011...

Current a/c back into surplus

The current account balance provides an important gauge of sustainability. During the boom years, the large current account deficit in Ireland, Spain, Portugal and Greece provided the signal that those economies were operating on an unsustainable footing. Traditionally, markets would have corrected this imbalance through a depreciation of the currency and subsequent export-led recovery. Within EMU, this has to be done by way of a real depreciation, which depends on the flexibility of the individual labour markets.

...with the current account moving back to surplus

The table below shows that Ireland returned to a current account surplus in 2010. This is on the back of a very strong export performance over recent years, which is attributable to more impressive improvements in its competitive position. This is in sharp contrast to Spain, Greece, Portugal and even Italy.

Current a/c balances (% of GDP)

	1992-96	1997-01	2002-06	2007	2008	2009	2010	2011	2012	2013
Germany	-1.0	-0.9	4.0	7.5	6.2	5.8	5.8	5.1	4.4	4.2
Belgium	4.3	4.5	4.5	3.9	1.1	0.7	3.2	2.4	2.1	2.4
Ireland	2.6	1.0	-1.3	-5.5	-5.6	-2.9	0.5	0.7	1.5	0.7
Finland	1.0	6.4	5.6	4.2	3.2	2.7	2.8	-0.1	1.0	0.1
France	0.7	2.2	0.0	-1.4	-1.9	-2.1	-2.2	-3.2	-3.3	-3.0
Spain	-1.4	-2.4	-6.0	-10.0	-9.6	-5.1	-4.5	-3.4	-3.0	-3.0
Italy	1.0	1.2	-0.8	-1.3	-2.9	-2.0	-3.5	-3.6	-3.0	-2.3
Portugal	-5.5	-8.8	-8.9	-10.2	-12.6	-10.8	-9.7	-7.6	-5.0	-3.8
Greece	-0.5	-6.7	-11.9	-16.9	-17.9	-14.3	-12.3	-9.9	-7.9	-6.9

Source: European Commission

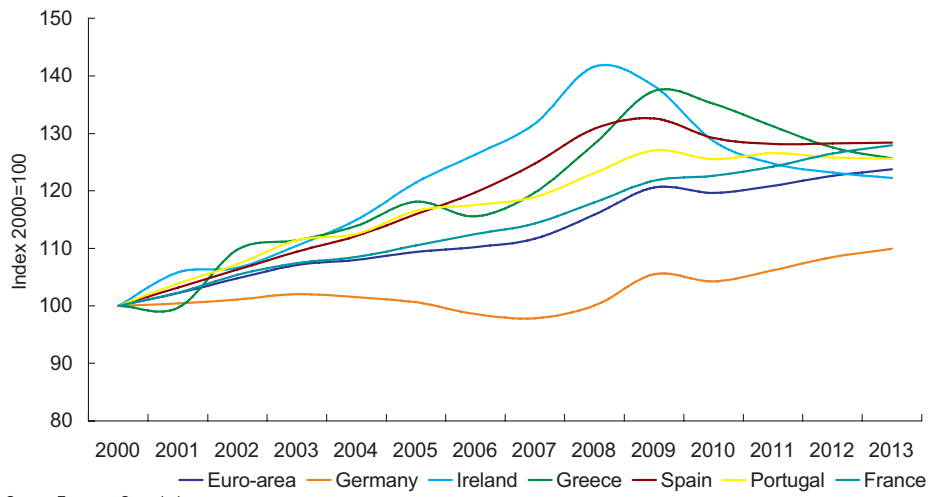
Unit labour costs

Some of the reversal of the current account position is due to competitiveness improvements that have occurred in Ireland in recent years. The chart on the next page shows that in the period from 2000-2008, Ireland experienced the largest increase in unit labour costs in the euro-zone, with an increase of 42% relative to a euro-zone average of 16%. Unit labour costs in Germany did not grow at all over that time period, implying an enormous loss of competitiveness over that time period.

...and unit labour costs falling sharply

Since then, the turnaround has been impressive, with unit labour costs falling by 12% in Ireland, relative to a 4% increase for the euro-zone in aggregate. Over the same time period, the two other programme countries, Greece and Portugal, only saw declines of 5% and 0.4%, respectively. As a result, Ireland has managed to claw back some of its lost competitiveness, with the increase in unit labour costs since the foundation of the euro only 4% greater than the euro-zone aggregate. There is a lot done, but a lot more remains.

Unit labour costs



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