IRISH QUARTERLY ECONOMIC OUTLOOK: JUNE 2010

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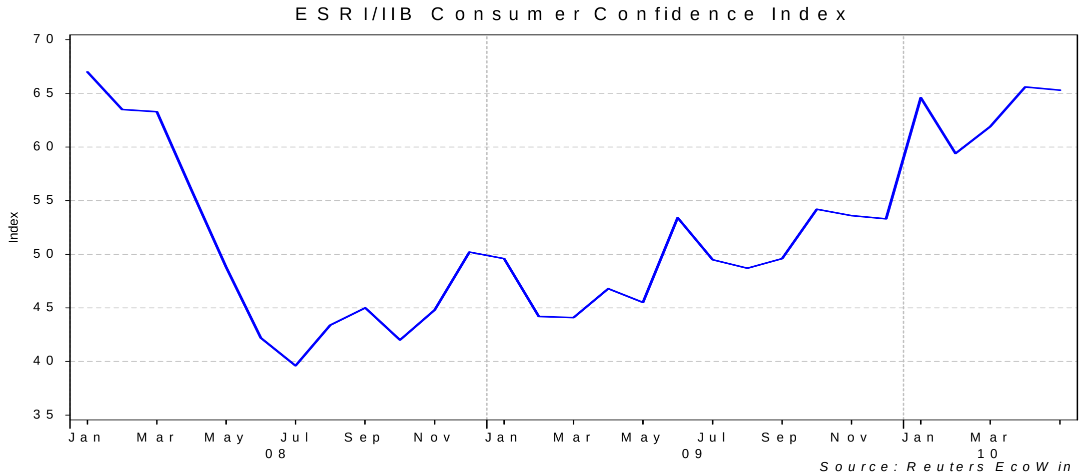
Executive Summary

•A strong global economic recovery is under way, and is unlikely to be thrown off course by European debt woes or the improbable event of the bursting of an asset bubble in China. While the sovereign debt crisis in Europe is indeed a serious matter, the world recovery at this point in time looks very strong and seems unlikely to be derailed. ***The American economy as measured by gross domestic product (GDP) should recover to pre-global crisis levels by the third quarter of this year. And a healthy US economy can only be good news for Ireland.***

•One of the positive developments from the Eurozone debt crisis has been the sharp fall in the euro, and a weak single currency benefits Ireland more than most. Ireland's economy is one of the most open in the world. Irish exports to non-Eurozone economies account for over 50% of GDP, compared to around 20% to 25% in Germany and the other northern economies and just 10% or so in Southern Europe. In addition, it has a high exposure to the US economy (exports to the US are equal to nearly 20% of GDP). ***The euro has already depreciated 13% against the dollar and 5.5% against sterling so far this year, and further weakness is forecast in the second half of 2010, boosting Irish exports in the process.***

•The recovery in external demand seems set to be complemented by the improving competitiveness of Irish exporters—***the lowering of the cost base arising from the decline in wages and prices across the economy is expected to place Ireland in a very favourable position to benefit from the recovery in trade flows.***



• There now appears to be a general feeling out there that Ireland is over the worst and the economy is on the road to recovery. This is being reflected in reduced savings and increased spending. A strong sterling exchange rate against the euro is also helping to reduce the numbers from the Republic crossing the border into Northern Ireland to do their shopping. Quite clearly, the big winner this year as regards consumer spending will be the motor industry. Already new car sales in 2010 to date are higher than for the whole of 2009. However, other retail sectors are also likely to see positive gains. ***Assuming the Eurozone 'debt' crisis issue doesn't drag on for a prolonged period and seriously dent consumer sentiment in the process, then there is every chance in our view that overall personal spending will be higher in real terms this year than in 2009.***

• At the moment personal spending is being driven by what we call the 'conservative' consumer, those members of the public who have no mortgage and/or carry very little personal debt. But these people can only push spending so far. At the end of the day it will need the '*other*' consumers, who rely on bank credit to help their expenditure, to come on board as the year goes on. However, ***this will require the banks to get back to some sort of 'normal' lending practices. If they don't then personal spending will eventually falter again, and the economy will hit a brick wall, and all bets on a speedy economic recovery would then be off.***

continued overleaf

- Although there are clears signs that the economy is improving, that is not as yet being reflected in the labour market. Indeed, it looks like there will be a high level of unskilled workers permanently on the dole queues even when the Irish economy eventually returns to positive growth. We don't see the jobless rate returning to the 4.0% level again unless major policy initiatives are taken to 'up-skill' a significant part of the workforce and/or the minimum wage is reduced. In our view the permanent jobless rate won't drop below 7/8%. ***The bottom line is that the labour market will be the last piece of the jigsaw in the Irish recovery story and it will be some months yet before things start to pick up on the jobs front.***

Employment & Unemployment (Annual Average)

(000s)	2009	2010 (f)	2011 (f)	2012 (f)
Industry	411	364	355	365
Services	1,422	1,375	1,375	1,395
Agriculture	96	90	90	90
Total	**1,929**	**1,829**	**1,820**	**1,850**
Unemployment (LFS basis)	259	278	260	230
Labour Force	2,187	2,107	2,080	2,080
Jobless Rate (% of labour force)	11.8	13.2	12.5	11.1

- There is no doubt that the Greek debt crisis has increased the chances of a default by not only the Mediterranean country itself, but other small 'peripheral' Eurozone countries like Portugal and Ireland too. Although the idea of defaulting on our debt may seem appealing to some, in our opinion going down that route could do more damage than good in the long-run, especially in terms of the level of interest rates we end up having to pay to raise funding on the international markets. ***The debt issue has the potential to put a spanner in the works as regards the Irish economic recovery, though we're still confident we can ride out the storm. If the Government can continue to deliver on fiscal austerity measures, and the public sector unions row in behind, then there is every chance we will get through this crisis with our economic integrity and reputation intact.***

- However, there is a lot to be said for the trade union view that fiscal correction, not just in Ireland, but in Euroland as a whole, takes place over a longer time-span, 10 years rather than the 3-4 years being suggested by the European Commission at present. ***Even though Germany might not like it, we wouldn't be too surprised if this yet turns out to be part of the solution to the Eurozone debt crisis, which would be good news all-round, limiting the negative impact on economic growth.***

- In summary, things have improved on the Irish economic front in the first half of the year, and at a quicker pace than expected by most economists at the start of 2010. Although we are not completely out of the woods yet, ***we believe the recession has ended, and assuming the Eurozone 'debt' issue doesn't turn into a full-blown crisis, then Ireland should be roaring back up the Eurozone GDP growth league table over the next twelve months, led in the main by a strong export performance.*** As regards Irish real GDP growth, we now expect an overall average increase of around 0.5% this year, compared with our previous projection back in March of a 0.75% contraction.

Bloxham Main Irish Economic Forecasts

	Real	Real	Avg.	General Government Balance		Unemployment		Debt/GDP
	GDP Growth	GNP Growth	Inflation Rate (%)	€m	% GDP	Level '000	Rate (%)	Ratio (%)
2009	-7.1	-11.3	-4.5	-23,400	-14.3	259	11.8	64.5
2010 (f)	0.5	-1.0	-1.1	-18,500	-11.5	278	13.2	83.5
2011 (f)	3.5	2.2	1.5	-16,400	-9.7	260	12.5	88.0
2012 (f)	4.0	3.5	2.0	-12,200	-6.7	230	11.1	88.5

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Global Economic Outlook

- ***strong global recovery under way***

A strong global economic recovery is under way, and is unlikely to be thrown off course by European debt woes or the improbable event of the bursting of an asset bubble in China. While the sovereign debt crisis in Europe is indeed a serious matter, the world recovery at this point in time looks very strong and seems unlikely to be derailed. ***The American economy as measured by gross domestic product (GDP) should recover to pre-global crisis levels by the third quarter of this year.*** Some concern has been expressed at the latest US non-farm payrolls data, but we think private-sector job creation will start to pick up in the Summer, gradually pushing the jobless rate lower this year. However, it is hard to see the Federal Reserve raising interest rates until there is a clear improvement in the labour market and the unemployment rate is falling on a sustained basis. Low interest rates will boost economic activity. The big concern at the moment remains the Eurozone fiscal crisis. The European Central Bank needs to step up its purchases of sovereign debt to contain the movement in '*peripheral*' bond yield spreads. But the authorities also need to offer a support package for banks that may be required to calm investor fears of a European banking crisis. There may also be a '*soft-patch*' in the US economic data in the near-term, which could re-open the 'double-dip' debate. ***Ultimately, though, we still believe that the 'soft patch' will be within the context of a sustained economic and profit recovery. And a strong US economic performance can only be good news for Ireland.***

World GDP Forecasts

%	2008	2009	2010 (f)	2011 (f)
World	**3.0**	**-0.6**	**4.3**	**4.5**
US	1.2	-2.4	3.0	2.8
Japan	-0.7	-5.2	1.8	2.0
China	9.0	8.7	10.5	10.2
Eurozone	0.7	-4.1	1.3	1.8
UK	0.7	-4.9	1.3	2.3
Ireland	**-3.0**	**-7.1**	**0.5**	**3.5**

- ***Ireland to benefit more than most from euro weakness***

One of the positive developments from the Eurozone debt crisis has been the sharp fall in the euro. Exchange rates have fluctuated significantly during the global financial crisis, reflecting turbulence in the markets. The euro had been exceptionally strong against both the greenback and sterling, but has weakened sharply this year in the wake of the Greek debt crisis. So far in 2010, the euro has fallen 13% versus the dollar and 5.5% versus sterling. There has been a close relationship between annual changes in Irish export growth and the exchange rate in the past, suggesting that the weaker euro could provide exporters with a significant lift. What's more, deflation and rising productivity suggest that the real exchange rate is likely to fall even more sharply than the nominal exchange rate this year. Ireland's economy is one of the most open in the world. Irish exports to non-Eurozone economies account for over 50% of GDP, compared to around 20% to 25% in Germany and the other northern economies and just 10% or so in Southern Europe. In addition, it has a high exposure to the US economy (exports to the US are equal to nearly 20% of GDP), which looks set to perform especially well over the next year or two. The upshot is that if the euro continues to weaken and head down towards the $1.10 level over the coming months, which many analysts are forecasting, and the US recovery continues, then Ireland could soon begin expanding again despite its severe domestic problems. Whatever about the dollar, the euro/sterling exchange rate is particularly important for Ireland's 'indigenous' exporters (food, drink, tourism) given that over half of these goods and services go to the UK. We have consistently said that we thought the pound would strengthen to the 0.80 level against the euro by year-end, and we have no reason to change that view at this juncture all things considered. In fact, if the euro were to fall to $1.10 versus the dollar, then sterling could possibly appreciate to the 0.75-0.80 level against the single currency. ***The recovery in external demand seems set to be complemented by the improving competitiveness of Irish exporters—the lowering of the cost base arising from the decline in wages and prices across the economy is expected to place Ireland in a very favourable position to benefit from the recovery in trade flows.*** However, the expected rebound in exports may be held back somewhat by sector-specific effects. For instance, the chemicals sector, which accounts for around half of overall Irish merchandise exports, is expected to face somewhat limited upside potential amid the recovery in world trade in view of the slightly acyclical nature of demand for its output.

Irish Economy

On the domestic economic front, things are clearly starting to look up for Ireland. Manufacturing output was up almost 6% year-on-year in the first four months of 2010, while retail sales were up just over 2% in volume terms over the same period, mainly due to strong car sales. Consumer confidence hit a two-year high in April, and was little changed in May, with the increased optimism in the personal sector reflected in new car sales in 2010. In the first five months of this year, new car sales were close on 42% higher than in the same period in 2009 and this after a very bad start to January as a result of the severe weather conditions. ***Already at the end of May new car sales were running over 2,000 higher than the full-year total for 2009, which is a very positive development as regards consumer spending and the domestic side of the economy.*** However, the export sector will be the main driver of the economic recovery in the short-term.

- ***things continue to improve on the Irish economic front***

Bloxham Main Economic Forecasts

%	2009	2010	2011 (f)	2012 (f)
GDP	**-7.1**	**0.5**	**3.5**	**4.0**
Consumer Spending	-7.2	0.7	3.5	3.8
Fixed Investment	-29.7	-19.5	3.0	4.0
Government Spending	-1.2	-3.0	0	0.8
Exports	-2.3	2.8	4.5	5.5
Imports	-9.3	-1.3	2.8	3.0
Consumer Prices	-4.5	-1.2	1.5	2.0
Unemployment Rate	11.8	13.2	12.5	11.1

The most recent Live Register figures were disappointing to say the least. The numbers signing on increased by a seasonally-adjusted 6,600 to a record high of 439,100 in May. Meanwhile, the monthly unemployment rate jumped up to 13.7%, its highest level since July 1994, having held steady at 13.4% for the four previous months. According to the Central Statistics Office there were no special factors contributing to the surprising sharp monthly increase in the numbers on the dole queue. We can only put it down to the ending of some temporary government-sponsored schemes aimed at re-training some of those out of work, a problem in the seasonal-adjustment process in relation to the early closure of some second-level schools for the Summer holidays, or just simply more people coming back into the labour force as economic conditions improve. The US economy came out of recession in the middle of 2009, but it was only in the past few months that things have started to pick up on the jobs front, and it should be no different here in Ireland. ***The bottom line is that the labour market will be the last piece of the jigsaw in the economic recovery process and it will be some months before things start to pick up as regards employment prospects.***

- ***labour market will be last piece of the jigsaw***

There is no doubt that the Greek debt crisis has increased the chances of a default by not only the Mediterranean country itself, but other small 'peripheral' Eurozone countries like Portugal and Ireland too. Although the idea of defaulting on our debt may seem appealing to some, in our view going down that route could do more damage than good in the long-run, especially in terms of the level of interest rates we end up having to pay to raise funding on the international markets. The debt issue has the potential to put a spanner in the works as regards the Irish economic recovery, though we're still confident we can ride out the storm. If the Government can continue to deliver on fiscal austerity measures, and the public sector unions row in behind, then there is every chance we will get through this crisis with our economic integrity and reputation intact. However, ***there is a lot to be said for the trade union view that fiscal correction, not just in Ireland, but in Euroland as a whole, takes place over a longer time-span, 10 years rather than the 3-4 years being suggested by the European Commission at present. Even though Germany might not like it, we wouldn't be too surprised if this yet turns out to be part of the solution to the Eurozone debt crisis, which would be good news all-round, limiting the negative impact on economic growth.***

- ***Eurozone government debt crisis could de-rail recovery***

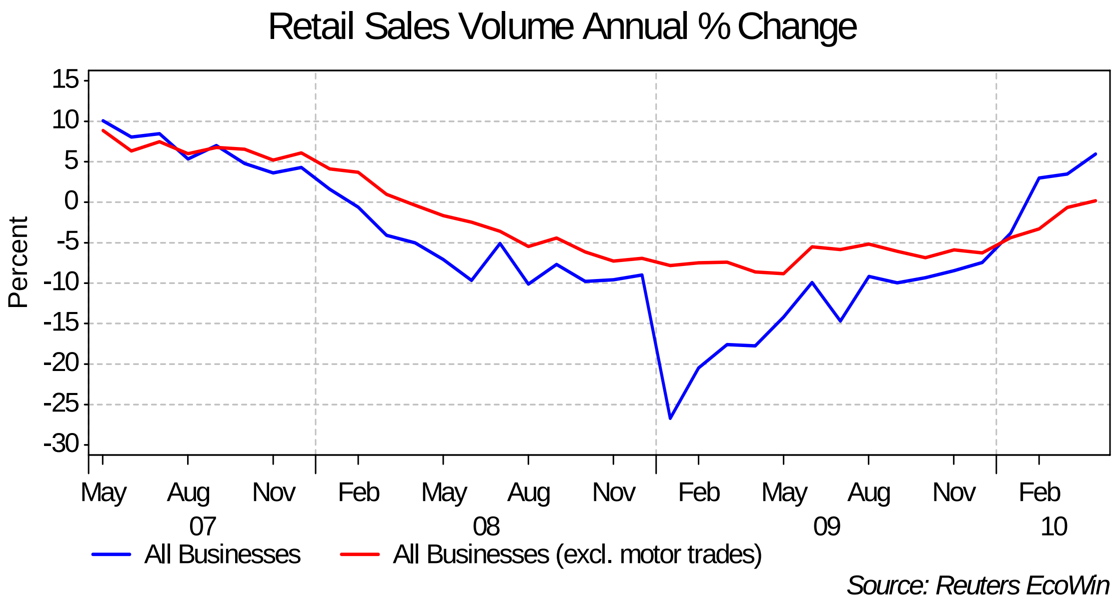
In summary, things have improved on the Irish economic front in the first half of the year, and at a quicker pace than expected by most economists at the start of 2010. Although we are not completely out of the woods yet, ***we believe the recession has ended, and assuming the Eurozone 'debt' issue doesn't turn into a full-blown crisis, then Ireland should be roaring back up the Eurozone GDP growth league table over the next twelve months, led by a strong export performance.***

- ***out of recession sooner than thought***

Personal Spending:

Retail sales figures in the year to date have been quite positive. The latest available data show that the volume of retail sales (i.e. excluding price effects) increased by 6.0% in April compared with April 2009 and there was a monthly rise of 1.8%. The annual increase in the volume of headline retail sales in February was the first recorded since January 2008, and the March and April figures have carried that trend on, which is very encouraging. Furthermore, the year-on-year increase in April was the highest since September 2007. The annual rise in retail spending in recent months can be primarily explained by strong new car sales, with annual growth of 35.4% recorded in the Motor Trades sector in April. But, encouragingly, a number of other retail sectors posted healthy annual rises in April apart from the motor industry. Excluding motor trades, the volume of retail sales fell by 0.2% month-on-month in April, though year-on-year there was a small annual increase of 0.3%, the first positive rise since March 2008. In the first four months of the year, total retail sales were 2.2% higher in volume terms than in the same period last year, while excluding motor trades, there was a average annual volume decrease of 2.1% in January-April. Retail sales were down 14% in volume terms in 2009 while overall spending on goods and services last year was 7.2% lower on average in real terms than in 2008. The decline in consumer expenditure in 2009 reflected the impact of contracting disposable incomes and exceptionally weak consumer confidence which prompted an increase in precautionary savings. ***Although the labour market remains quite weak and consumers are suffering a further erosion of disposable incomes arising from falling wages and an increased tax burden, due to the carryover from 2009, sentiment has picked up in recent months.***

- ***car sales set to be very strong this year***



There now appears to be a general feeling out there that Ireland is over the worst and the economy is on the road to recovery. This is being reflected in reduced savings and increased spending. A strong sterling exchange rate against the euro is also helping to reduce the numbers from the Republic crossing the border into Northern Ireland to do their shopping. Quite clearly, the big winner this year as regards consumer spending will be the motor industry. Already new car sales in 2010 to date are higher than for the whole of 2009. However, other retail sectors are also likely to see positive gains. Unfortunately, we don't have any official figures at this stage on spending on services, but one has to assume a similar trend to that of goods. ***Assuming the Eurozone 'debt' crisis issue doesn't drag on for a prolonged period and seriously dent consumer sentiment in the process, then there is every chance in our view that overall personal spending will be higher in real terms this year than in 2009.*** At the moment personal spending is being driven by what we call the '*conservative*' consumer, those members of the public who have no mortgage and/or carry very little personal debt. But these people can only push spending so far. At the end of the day it will need the '*other*' consumers, who rely on bank credit to help their expenditure, to come on board as the year goes on. However, this will require the banks to get back to some sort of '*normal*' lending practices. If they don't then personal spending will eventually falter again, and the economy will hit a brick wall, and all bets on a speedy economic recovery would then be off.

- ***greater confidence that things are past the worst***

Government Spending:

Preliminary National Accounts data show a decline in the volume of Government consumption of 1.2% last year. ***On the basis of expenditure plans as set out in 2010 revised Estimates Volume, government consumption is projected to fall by around 3.0% this year.***

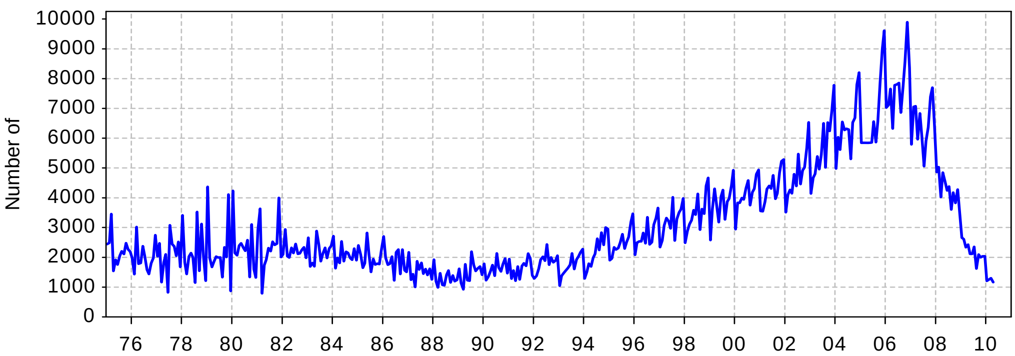
- ***government spending set to decline in the coming quarters***

Investment:

There is very little reason to be optimistic on the building sector. Indeed, all the indications are that construction will remain the biggest drag on economic growth for some time to come. ***For 2010, available data and forward-looking indicators suggest that activity is likely to decline further, with very little new construction activity in the pipeline given stagnant demand, significant levels of oversupply and limited availability of credit.*** Indeed, according to the latest *Ulster Bank Construction Purchasing Managers' Index*, operating conditions in Ireland's building sector deteriorated again in May, with a steeper decline in activity than in the previous month. The index fell to 40.0 from 42.5 in April. The level is still below the 50-mark that would represent a return to growth for the building industry, which led Ireland's economic boom and subsequently bore the brunt of the country's deep recession. The May reading indicates that the recession in the beleaguered construction industry has now lasted for three full years. Although rates of decline in new business and employment both slowed in May, they remained sharp, the survey showed. Meanwhile, house completions totalled around 27,000 in 2009, but this year they are likely to be only half that, comprising mostly of one-off units as new schemed and apartment developments come almost to a halt. This forecast is assuming that a portion of currently unfinished developments transferred to NAMA will be competed towards the end of the year. Coupled with some limited growth in repairs and maintenance, investment in residential housing is likely to be down by a third in 2010, following another substantial decline of close on 40% in 2009. Looking forward to 2011, house-building activity is likely to remain at a low level, with house completions projected to again total 13,000, as overcapacity, financial constraints and a lack of demand are still the prevalent forces in the market.

- ***building activity will remain the biggest drag on domestic demand for some time***

Monthly House Completions



Source: Reuters EcoWin

Following a decrease of almost 30% in 2009, weakness in non-residential construction is also set to continue into this year as commercial, retail and industrial market fundamentals remain weak and government investment posts significant declines as outlined under the Public Capital Programme in 2010. ***The demand for property in most sectors continues to be poor, with oversupply, falling capital values and rents impacting on the market.*** That said, there are some tentative signs of stabilisation in the market with regard to rents and yields. On the other hand, the appetite for funding further investment in this area is likely to remain weak over the forecast horizon. Accordingly, non-residential investment is projected to fall around 13% and 7% in 2010 and 2011, respectively. Taken together, the forecasts for residential and non-residential construction imply that investment in building and construction is projected to decrease by about a fifth this year, followed by a much smaller reduction of close on 7% in 2011. On a more positive note, though, the forward-looking component of the *Ulster Bank Construction Purchasing Managers' Index,* recorded another increase in May to show confidence at its highest level since March 2007 as firms expressed more hope that economic conditions will strengthen in the coming year. ***While indicators of current activity in the construction sector continue to paint a picture of weakness, the more forward-looking elements of the survey continue to offer some encouragement about future prospects.***

- ***non-residential part of construction weak too***

Stocks:

There was a significant decline in the stock of inventory levels in 2009 which made a negative contribution to the change in GDP last year of 1.7 percentage points. ***A modest deceleration in destocking is projected for 2010 in line with improving prospects for output growth.***

- ***modest deceleration in destocking this year***

External Trade:

Taking all relevant factors into account, Irish merchandise exports were remarkably resilient amid the collapse in world trade during much of last year. But, there was evidence of significant weakening in the final quarter of 2009, with an annual fall in volume terms of over 8%. The weakened fourth quarter out-turn may to some degree be down to the broad chemicals sector, most notably, organic chemicals, which can be quite volatile to say the least. The performance of the more traditional exporting sectors, such as food and drink remained weak. Following the latest revisions to last year, the overall trade surplus for 2009 is now put at €38,526m, €9,716m or just under 34% higher than the overall surplus of €28,810m recorded in 2008. Furthermore, it was the highest annual trade surplus on record, though a lot of that can be put down to the weakness in imports rather than the strength of exports. In the first quarter of 2010, the cumulative trade surplus amounted to €9,790m, or €406m higher than the cumulative surplus of €9,384m posted in the opening quarter of 2009. The 2010 outlook for merchandise exports depends heavily upon the strength of the recovery in external demand as well as the external market share that Irish exporters are able to capture. With economic conditions clearly improving in the United States, this augurs well in our view for Irish exports, and we still think the growth risks are tilted to the upside. Furthermore, figures from Dublin Port (Ireland's largest port) in the year-to-date have been quite positive. ***It is quite clear at this stage that the export sector will be the key player in the Irish recovery story over the next few years. The trade performance last year was quite impressive by international standards, and we expect another solid performance in 2010, with a positive contribution to GDP.***

- ***exports key to Ireland's economic recovery***

Balance of Payments on Current Account (€m)

	2009	2010 (f)	2011 (f)	2012 (f)
Trade	32,647	37,500	39,500	42,000
Services	-4,958	-4,100	-2,500	-2,300
Net Factor Income	-31,582	-33,000	-35,000	-36,500
Current Transfers	-921	-1,000	-1,050	-1,200
Current Account	**-4,814**	**-600**	**950**	**2,000**
(as % of GNP)	(-3.7)	(-0.5)	(0.7)	(1.4)

Balance of Payments:

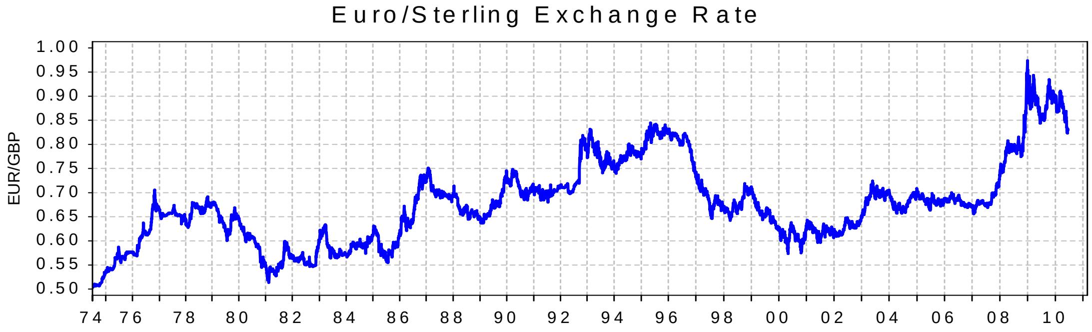
Services exports will become an increasingly important part of the Irish recovery story in the months/ years ahead. Services account for 47% of total Irish exports, the highest percentage of any western economy. The tentative signs of recovery in services exports evident in the third quarter of 2009 strengthened dramatically in the final three months of last year, with a year-on-year increase of 7.0% in volume terms. Such signs of recovery have been further reflected in the new export component of the services sector PMI. Similar to merchandise exports, services trade seems set to benefit from the recovery in external demand and improvements in cost competitiveness over the next few years. In particular, the performances of computer services and business services are projected to improve further. Meanwhile, the volume of services imports declined by 3.3% on an annual basis in the final quarter of 2009. At a sectoral level, much of this weakness emanated from tourism and travel services and insurance services. Net factor income outflows rose by 18.2% last year, reflecting in the main a sizeable fall-off in income inflows. It is forecast that net factor income outflows will increase further during 2010 followed by another rise in 2011. The international transfers component of the current account was negative during 2009 as a whole, and the negative contribution to the current account arising from this component is set to set to be maintained over the next few years. ***Combining the perspective trends across the current account, a deficit of 3.7% of GNP or €4,814m was recorded in 2009. The current account deficit is projected to narrow considerably this year, to €600m (-0.5% of GNP), and then turn positive in 2011, with a surplus of €950m (0.7% of GNP) forecast.***

- ***services exports strengthening***

Sterling:

Following the recent announcement of the €750bn EU/IMF Eurozone fiscal aid package and the news that a Conservative/Liberal Democrats coalition will form the next British government, investors remain uncertain as to how the euro/sterling exchange rate will play out over the remainder of this year. ***At the start of 2010 we projected that the pound would appreciate to 0.80 versus the euro by year-end, and we are sticking to this view.*** However, forex movements are likely to be quite volatile in the coming months. Indeed, if traders cannot make money by selling Euroland government bonds, they may turn their sights on the currency. Currency traders will have noted that the ECB seems divided on its participation in the purchase of Euroland government bonds. Bundesbank President and ECB Governing Council member Axel Weber has already expressed reservations. This is hardly a reason to buy euro. Popular antipathy to Eurozone bail outs by the German public, who are footing the bill, may already have contributed to Chancellor Angela Merkel's electoral setback in North-Rhine Westphalia last month. German popular confidence will not be enhanced with publicly expressed reservations by the highly-respected Axel Weber.

- ***exchange rate movements to be volatile***



Source: Reuters EcoWin

Anyway, with the European Union (EU) and European Central Bank pre-occupied in the credit markets, would European policy-makers oppose a further orderly decline in the euro? The 'peripheral' Eurozone states themselves would welcome further euro depreciation as they seek to shore up their competitive position ahead of fiscal retrenchment. It is surely no coincidence that as the crisis has unfolded and the euro fallen in value, German exports posted their sharpest rise in nearly 18 years in March. And one shouldn't forget that Germany is Europe's largest exporter of capital goods. Of course, the UK is in no great shape itself. The new coalition government will have to tackle a record budget deficit running at more than 11% of GDP, and is expected to cut £6bn of spending this financial year. Britain's public sector will face similar austerity measures to those seen in Ireland, Greece, Portugal and Spain. But the UK has only itself to think about, while in the Eurozone it needs just one of 16 countries to unravel to cause problems for the whole region and weaken the euro. There are still question marks over whether the new coalition arrangement can last for long. However, the announcement of a newly created Office for Budget Responsibility suggests that both parties are serious about tackling Britain's huge fiscal imbalance. The same cannot be said of the Eurozone, which continues to look like an odd collection of 16 countries each doing their own thing. Meanwhile as regards the economic outlook for the UK and Eurozone, the OECD said in recent weeks that the UK would out-perform many of the countries in Euroland this year and next, a point further underlined by the latest European Commission forecasts released in May. The Commission is projecting UK GDP growth of 1.2% and 2.1% in 2010 and 2011 respectively, higher than the respective Euroland forecasts for the same period of 0.9% and 1.5%. Furthermore, inflation in the UK, at 2.4% this year is expected to be higher than in the Eurozone, at 1.5%. In fact, the UK inflation projection looks a bit on the low side given that the current inflation rate is 3.4% (well above the Bank of England's 2.0% target) and more than double the current Euroland rate of 1.6%. Although it is now hard to see either the Bank of England or European Central Bank moving to increase official interest rates this year given the uncertain financial climate, higher inflation and GDP growth in the UK argue in favour of the Bank of England tightening monetary policy ahead of the ECB, another positive for sterling. In many ways the UK and Eurozone are as bad as each other, and it may well come down to who needs and wants a weaker exchange rate the most. ***Given that inflation in Euroland is less of a problem than in the UK at the moment and Britain is likely to post higher GDP growth (even allowing for the proposed £6bn in spending cuts this year) than the Eurozone in 2010 and 2011, then we continue to believe that sterling will appreciate versus the euro over the next few months. We expect it to strengthen to around the 0.80 level by the close of the year.***

- ***UK in better economic shape than Eurozone***

Dollar:

Since sliding to an ignominious low of 1.1875 versus the dollar on June 7, the euro has generally climbed higher. It is currently trading at $1.2460, an increase of almost 5%. Although it seems highly likely the vast majority of the buying interest came from increasingly concerned traders who found themselves short and squeezed, the move still counts. ***Participants in the foreign-exchange market, perhaps taking too seriously the dictum that "currencies trend," tend to extrapolate the move of the moment to either infinity or zero, and in consequence increasingly ambitious upside targets are being posited for the single currency.*** The time may be right, then, to examine what might have changed, fundamentally as well as technically, in a way that supports the euro's newfound direction. It may well be that the battered currency has room to roam on the upside from a technical perspective, but without necessarily finding itself in the clear at the end of the process. There may be some merit to the suggestion that the euro did not deserve to explore the sub-$1.19 depths. The Special Purpose Vehicle that was created to provide backup funding for member nations in acute fiscal distress took on tangible form in early May. Greece, followed by Spain, Italy and Portugal, made an evidently serious effort to begin addressing the fiscal imbalances that had brought on the crisis, and in general, European governments, the ECB, and the IMF made it clear that they were prepared to do what was necessary to at least create some breathing space. That all of this was done to the accompaniment of exasperated sighing from German officials wasn't necessarily helpful, but Germany's essential participation was, however grudgingly, obtained. So, perhaps, the market overshot to the downside, just as arguably CDS and bond spreads widened out more than was warranted, given the financial guarantees offered by the European authorities.

- ***euro rebounding versus the dollar***

Spot Exchange Rates 2010/2011

	Current	End June (f)	End Sept (f)	End Dec (f)	End Mar (f)
€/GBP	0.8350	0.8350	0.8150	0.8000	0.7800
€/$	1.25	1.21	1.15	1.10	1.05
€/Yen	113	108	106	103	100
$/Yen	91	89	92	94	95
GBP/$	1.49	1.45	1.41	1.38	1.35

While there were questions as to the mechanisms involved, there was no real doubt, given for example the decision by the ECB to accept most printed pieces of paper as collateral for repo purposes, that Europe's various authorities were determined to make certain that their initiatives achieved the desired goal. Still, while some dressings have been applied, wounds are still apparent. Moody's, in downgrading Greece's sovereign debt to BA1 from A3, observed in passing that Greece might not be forced to restructure its debt. Many analysts, looking at prospects for Greek economic and productivity growth, continue to believe it is already far too late for the nation to avoid restructuring. French and German banks, including many smaller institutions, reportedly own alarming amounts of both public and private debt in stressed parts of Europe. Indeed, without a fairly miraculous recovery in Spanish real estate prices, for example, very sizeable change-offs would appear to be in store. The market is made uneasy by the sounds of officials pledging changes. France's push for "*economic governance*," for example, seems unlikely to be regarded as euro-positive by market participants. If the fundamental picture is mixed, it normally is, an alternative is to look at the history of supply and demand through technical analysis. While these techniques can't do much to explain the "*why*," they can be very helpful in trying to understand what the implications of changes in fundamentals might be for the market. ***In the case of the euro versus the dollar, there is no doubt that the large majority of outstanding positions are still short euro.*** The dollar, maligned only a few months ago as likely to lose its reserve status, has become in times of stress, one of the few available life rafts. In short, the fundamentals are mixed, but the best (and sometimes, worst) efforts of the European authorities appear to have done no more than to buy some time as short euro positions are unwound. Technical analysis suggests that a move back above $1.30 would be required to signal a reversal of the trend from "*down*" to "*up*", and the gains seen in the past few days can hardly constitute a technical reversal. It may be much more difficult to push a more or less neutrally positioned market higher, and the technical setup strongly suggests that the current rally will do no more than provide the ammunition for another, potentially strong, test of the previous lows. ***All in all, we continue to believe that a euro/dollar exchange rate of $1.10 looks more likely than $1.30 over the next few months, providing a further boost to the Irish export sector in the process.***

- ***euro to weaken again versus dollar in the coming months***

Employment:

As widely expected, the latest Quarterly National Household Survey (QNHS) showed an easing off in the year-on-year fall in employment in the first quarter of 2010, but the data are still a sobering reminder to the Government of the current weak state of the labour market. Based on these latest figures, it will take a lot more than shuffling ministers/personnel around and changing Departmental names to sort the unemployment problem out. There were 1,857,600 persons in employment in the first quarter of 2010, an annual decrease of 108,000 or 5.5%. This compares with an annual fall in employment of 8.1% in the previous quarter and a decline of 7.5% in the year to the first quarter of 2009. There was a year-on-year fall of 80,400 or 7.5% in the number of men in employment, while the number of women in work decreased by 27,500 or 3.1%. As seen in previous quarters, almost 63% of the fall in male employment was attributable to a decline of 50,500 in the number of males employed in the Construction sector. At the height of the economic boom there were around 270,000 employed in the Construction sector, but it is less than half that now. At the peak of house building, 170,000 were working in residential construction, but that has now fallen to below 60,000. There were 275,000 unemployed in the opening quarter of 2010 representing an annual increase of 52,200 (+23.4%). Male unemployment rose by 36,500 (+23.0%), with the number of unemployed females increasing by 15,700 (+24.3%). However, when seasonal factors are taken into account there was a quarterly decrease of 7,300 in the numbers out of work with the seasonally-adjusted unemployment rate falling from 13.3% to 12.9% over the quarter. ***The QNHS jobless rate of 12.9% is 0.5 percentage points lower than the Live Register published unemployment rate of 13.4% for the same period, implying that the current jobless rate (May 2010) is 13.2% and not 13.7% as in the most recent monthly Live Register release.***

- ***year-on-year rate of decrease in employment easing off***

Employment & Unemployment (Annual Average)

(000s)	2009	2010 (f)	2011 (f)	2012 (f)
Industry	411	364	355	365
Services	1,422	1,375	1,375	1,395
Agriculture	96	90	90	90
Total	**1,929**	**1,829**	**1,820**	**1,850**
Unemployment (LFS basis)	259	278	260	230
Labour Force	2,187	2,107	2,080	2,080
Jobless Rate (% of labour force)	11.8	13.2	12.5	11.1

There were 2,132,700 in the labour force in the first quarter of this year, an annual decrease of 2.5% (-55,700). Almost 70% of the decline was attributable to a fall in participation of 38,800. In addition to changes in participation, the labour force is also affected by changes in the number of persons of working age in the State (demographic effect). Up to the start of 2008 this demographic effect had been adding 60,000 or more to the labour force on an annual basis, primarily driven by net inward migration. With the decline in inward migration the demographic effect declined through 2008 and became negative in the third quarter of 2009. In the first quarter of 2010 this negative demographic effect contributed just under 17,000 to the overall decline in the labour force. Meanwhile, employment fell on an annual basis in 9 of the 14 economic sectors. The largest decline in employment in the first quarter was once again recorded in the Construction sector where the numbers employed fell by 50,800 (-28.2%) over the year. The next largest annual decreases were recorded in the Agriculture, forestry and fishing and Industry sectors where the numbers at work fell by 20,900 (-20.6%) and 20,300 (-7.7%) respectively. It should be noted though that the Central Statistics Office suggests caution in the interpretation of the trend in the Agriculture sector at this juncture. Overall, these latest numbers could be seen as another step in the right direction as regards the Irish economy and labour market, with the jobless rate set to peak in and around the 13.5% level. However, that's more a reflection of increased emigration, lower participation and higher numbers of people returning to education than actual job creation. Indeed, it looks like there will be a high level of unskilled workers permanently on the dole queues even when the Irish economy eventually returns to positive growth. We don't see the jobless rate returning to the 4.0% level again unless major policy initiatives are taken to '*up-skill*' a significant part of the workforce and/or the minimum wage is reduced. Even when the economy returns to '*normal*' we think the permanent jobless rate won't drop below 7/8%. ***The bottom line is that the labour market will be the last piece of the jigsaw in the economic recovery process and it will be the end of the year at least before things start to pick up on the employment front.***

- ***labour market last piece in the jigsaw***

Inflation:

- ***annual rate of deflation continuing to ease***

Having peaked at 6.6% last October, the most recent consumer price index released by the Central Statistics Office showed a continuation of the easing in the annual rate of deflation since then. Overall prices in May were 1.1% lower than in the same month last year, compared with a year-on-year rate of deflation of 2.1% in April. On a monthly basis, prices were 0.6% higher than in April, the fourth monthly increase in a row. In fact, one has to go back to March-June 2008 for the last time we had four consecutive monthly rises in the CPI. Furthermore, the monthly increase in May was the biggest since the 0.8% jump in May 2008. Headline deflation has predictably decelerated a year on from the large falls in energy prices in late 2008. However, once the energy effects have worked through, and the recent increases in mortgage interest rates are taken into account, the inflation outlook is still in the main dominated by disinflationary pressures. Indeed, the HICP measure of inflation, which excludes mortgage interest repayments, was up only 0.3% month-on-month in May, giving an annual rate of deflation on this basis of 1.9% as against 2.5% in the previous month. Meanwhile, the latest HICP figures for the EU as a whole showed that Ireland is now only one of two countries within the 27-member bloc, along with Latvia to still be in deflationary territory at this point in time. This should be no surprise given that they were the two countries within the EU to implement severe wage/price reductions across the board. While Ireland needs to make significant downward wage/price adjustments to become more competitive and return the economy to sustainable growth, the last thing we need is to get stuck in a deflationary spiral like Japan, which will do more damage than good in the medium- to long-term. Thankfully, we don't think that will be an issue. In fact, we believe prices will pick up over the next twelve months, but Ireland's HICP will still be running below the Eurozone/EU average which will be good news as regards regaining competitiveness. International food commodity prices have picked up sharply since the end of 2009, which will apply upward pressure on domestic food retail prices. However, the effects on Irish inflation from a rebound in global commodity prices will likely be mitigated by weak domestic factors such that overall inflationary pressures should remain muted during 2010. In particular, challenging labour market conditions and declines in disposable incomes will constrain demand and the pricing power of firms. There is also some negative carryover from 2009. That said, upward base effects will play a prominent role and will likely push the headline inflation rate back into positive territory before the year is out. In fact, based on these latest CPI figures, we now think we will see a positive year-on-year change in the CPI at some point in the third quarter. ***The bottom line is that overall prices in Ireland are likely to be lower on average again in 2010. However, the rate of deflation is set to ease considerably this year. Following an average drop in prices of 4.5% in 2009, we are looking for a much more modest annual average fall in 2010 of around 1.1%.***

House Prices:

- ***house prices to continue falling in the short-term***

According to the latest Reuters survey of Irish economists, house prices are likely to continue falling for another couple of years. The survey predicts that house prices will decline by 14% on average in 2010, with a further decline of 4% on the cards in 2011. Indeed, it will be 2012 before the average change in house prices is back in the black. Although we think these median forecasts may be a bit on the pessimistic side, there is no doubt that the short-term risks to house prices remain to the downside. Given weak labour market conditions and the continuing lack of available bank credit it is hard to be optimistic on the prospects for the property market in the immediate future. All in all, it is difficult to see the property market improving dramatically until labour market conditions get better and consumers become more confident about their job prospects going forward. And even then, consumers will be relying on the banks to make credit more freely available than what they are doing at the moment. Although houses have in general terms become more affordable in terms of price, this is of little comfort to potential purchasers if credit is still very tight. As such, it is therefore imperative that the country's banking system is put back on a sound footing as soon as possible. The recent news that rent prices have started to rise may suggest that residential property prices are close to a bottom, but we still think prices will fall further in the months ahead. However, with the economy expected to return to positive growth sooner than thought this year, there is the possibility that house prices may rise slightly towards the latter part of 2010. But, ***in overall terms, we believe house prices will drop by close on 10% on average this year, with Dublin again seeing the biggest decline. Looking further ahead, we think house prices should rise on a five-year view as the labour market returns to normal.*** That said, the level of any increase over the next few years should only be in single digits as banks adopt a more cautious stance to lending than in the 'Celtic Tiger' era, interest rates return to '*normal*' and the possible introduction of a property tax for '*principal*' homes of residence all weigh negatively on the market.

Public Finances:

- ***tax receipts broadly on target***

The Exchequer deficit was €7,687m at end-May 2010 compared to €10,588m in the corresponding period in 2009. This was generally in line with expectations and according to the Department of Finance means the Budget Day targets remain valid. The year-on-year difference in the Exchequer deficit was largely attributable to payments to the National Pensions Reserve Fund (NPRF). At end-May 2009, €3bn had been paid to the NPRF but due to the frontloading of the 2010 NPRF contribution into 2009, no NPRF payment is due this year. Taxes were just over €1.4bn or 10.4% below the same period last year while net voted expenditure was some €1.7bn or 8.9% lower. Tax receipts to end-May were broadly on target, with net voted expenditure down somewhat on profile in overall terms. In total, €12,117m in tax receipts were collected to the end of May. This was €148m or 1.2% below profile. Small surpluses on VAT and corporation tax were offset by income tax being behind target. The end-May year-on-year decline was 10.4%. At end-April it was 10.8% and at end-March it was 15%. ***There are significant targets to meet in the months ahead and there has been considerable movement across the tax-heads so far this year but the end-May data mean that the Budget 2010 forecast for tax revenues of just over €31bn, or a year-on-year decline of 6% is still on course.*** Total net voted expenditure at end-May this year was €17,867m, over €1.7bn or 8.9% below the same period in 2009. The Revised Estimates Volume projected a decline of 1.9% in total net voted expenditure in 2010. Net voted current expenditure, at €16,251m was €851m or 5% down year-on-year. It was on target, at just €26m or 0.2% above profile. Net voted capital expenditure, at €1,616m at end-May, was €891m or 35.5% below the corresponding period in 2009. It was €390m or 19.5% below profile. The year-on-year variation in net voted expenditure is largely due to the expenditure control decisions taken by Government. The variation against profile can be mainly put down to timing issues. Still, as already stated above, a worrying feature of overall Government expenditure in the year to date is the increasing shortfall in capital investment. Voted capital expenditure was some €400m or 20% below forecast come end-May. Capital investment by its nature can be lumpy but it is important that investment is maintained in much needed capital infrastructure. Any further cutbacks in the capital programme would be very damaging to the economy's growth potential going forward. ***But in terms of the overall underlying budget deficit for 2010, the Exchequer is in our view on course to come in with a figure slightly below the official Budget target of just under €19bn (-11.6% of GDP).*** However, what the actual out-turn for 2010 will be remains to be seen, and will depend on how the additional monies paid out to prop up Anglo Irish Bank and Irish Nationwide will be treated by Eurostat. Although the Government could take comfort from the measures it implemented to tackle the fiscal deficit in 2009, it was dealt a psychological blow by Eurostat's decision to include the recapitalisation of Anglo Irish Bank in the deficit calculation. While this is primarily a book-keeping adjustment, the optics are not good, as it means that Ireland had the largest recorded deficit in the EU last year, higher even than Greece. And that will again be the case in 2010 if the remaining required projected funding for Anglo/Nationwide (€10-15bn?) is front-loaded into this year. Depending on the amount of money involved it could push the actual General Government deficit into the high teens or above 20%. Obviously, that would again be the highest deficit within the Eurozone, and could temporarily at least put the spotlight back on to Ireland at a time when arguably other '*peripheral*' Euroland countries like Greece, Portugal and Spain are under greater underlying stress. The sharp widening in Eurozone '*peripheral*' bond yield spreads over German benchmark Bunds in recent weeks is a clear indication that the bond market vigilantes are back in force and are taking no prisoners. It is therefore imperative that the Government continues to deliver on the fiscal austerity front even if domestic economic conditions improve.

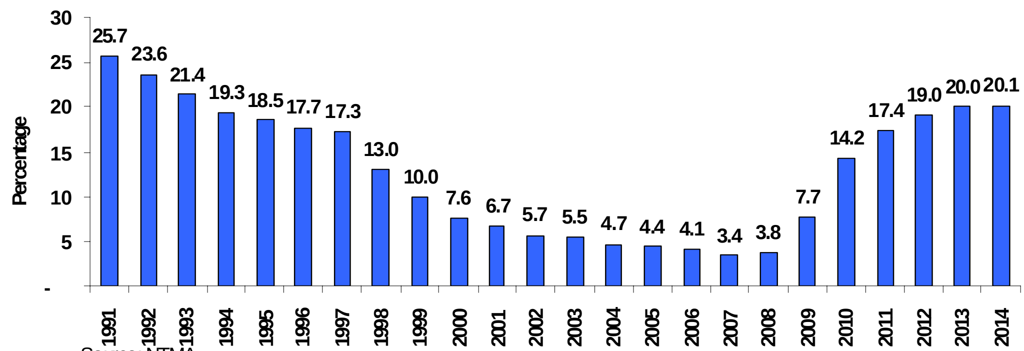
Irish Underlying Exchequer Returns (€m)

	2009	2010 (f)	2011 (f)	2012 (f)
Central Fund	4,992	6,880	8,200	9,000
Supply Services	40,256	40,200	40,300	40,000
Total Current Spending	**45,248**	**47,080**	**48,500**	**49,000**
Tax Revenue	33,043	31,225	34,100	38,400
Non-Tax Revenue	836	2,355	1,300	1,500
Total Revenue	**33,879**	**33,580**	**35,400**	**39,900**
Current Budget Balance	**-11,369**	**-13,000**	**-13,100**	**-9,100**
Capital Balance	**-13,272**	**-5,000**	**-4,200**	**-4,900**
Exchequer Balance	**-24,641**	**-18,500**	**-17,300**	**-14,000**
(% of GDP)	**(-15.1)**	**(-11.5)**	**(-10.2)**	**(-7.7)**
General Government Balance (% of GDP)	**-23,400 (-14.3)**	**-18,500 (-11.5)**	**-16,400 (-9.7)**	**-12,200 (-6.7)**

Having predominantly focused earlier in the adjustment process on taxation and levy increases, the 2010 Budget consisted of a €4bn expenditure based consolidation package (just over €3bn net), with only minimal changes on the taxation side, with the aim of stabilising the General Government Deficit at 11.6% of GDP. The main adjustments on the expenditure side in the December Budget were as follows: (1) Public Sector Pay: €1.0bn in payroll savings through tiered pay cuts; (2) Social Welfare: €0.8bn in savings; (3) Other current expenditure savings of €1.3bn and (4) Capital savings amounting to €1.0bn. ***Despite these consolidation efforts, significant pressures remain on the current expenditure side due to the operation of automatic stabilizers coupled with a much higher national debt interest burden, as evidenced by a further sharp increase in central fund expenditure in 2010.*** In terms of the latter, higher national debt interest payments will become an increasing drag on resources in the coming years, rising from approximately 8% of tax revenue in 2009 to a projected 20% of tax revenue by 2014. These pressures on the current spending side emphasise the necessity to keeping to a viable medium-term convergence path. The big question though, is where will the Government target next to meet the required savings? Current projections indicate that a €3bn adjustment will be needed in 2011 as part of the process to restore the public finances to stability. It has already been announced that €1bn of this adjustment will come from capital expenditure, leaving the other €2bn to be found from further spending cuts/and or increased taxation. The '*Croke Park*' agreement, while welcome in some ways, as it reduces the chances of public sector unrest, limits the Government's options in terms of targeting areas to reduce current spending. We can't see '*greater efficiencies*' being enough to find the required money, so the Government, unless it is specifically going to target the capital side, which would be a big mistake in our view, will be left with no choice but to hit the Health and Social Welfare votes in our opinion. Social welfare benefit rates will at the very least have to be frozen over the next few years. On the taxes front, water charges and a property tax will at some stage be introduced, and whether the trade unions like it or not a significant widening of the tax base is essential to boost revenues going forward.

- ***where will the Government target next?***

Debt Interest as % of Tax Revenue



Source: NTMA

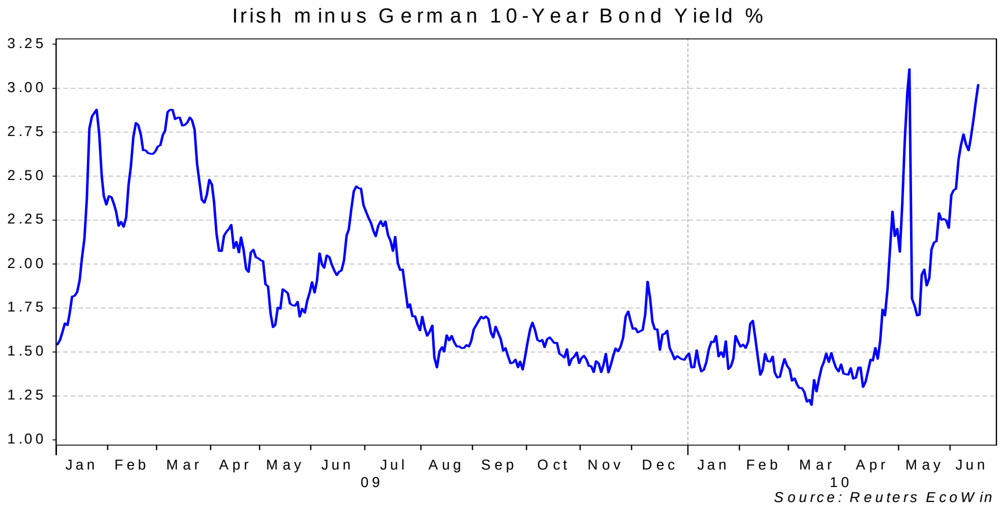
A number of the Eurozone '*peripheral*' countries have recently introduced fiscal austerity measures. From an Irish perspective, one of the most interesting features of the plans was the selling of State assets. Although the European Commission has ruled that privatisation receipts cannot be taken into account when calculating the General Government Deficit under the Maastricht Treaty, privatisation receipts can be included to reduce the National Debt, another of the Treaty criteria. A lower National Debt reduces interest payments made by government and therefore indirectly the General Government Deficit. In the likes of Spain, Portugal, France and Italy, privatisation receipts are seen as a less politically painful way of reducing the National Debt than spending cuts or tax increases. But here in Ireland, politicians seem reluctant to discuss the issue, saying the timing isn't right etc. However, if the Irish public were given the choice of selling off State assets or reducing government spending (including lowering public sector wages) or increasing taxes, to raise money to sort out the country's fiscal woes, we are fairly confident about which option the majority would choose. It is difficult to know exactly how much money could be raised through privatisation, though we believe that a figure of €5bn could be generated if the ESB and Bord Gais were sold. With the VHI already on the road to privatisation (irrespective of the reason why), then it hard to see why the Government is so opposed to the practice in general of selling State assets. ***Clearly if other 'peripheral' Eurozone countries are going down this route to reduce their debt service costs, then the political establishment here needs to seriously consider this option as well.***

- ***privatisation receipts a way of generating funds***

NTMA Funding:

The National Treasury Management Agency was back in June tapping the market for a further €1.5bn in the sixth of its eleven scheduled monthly (January-November) bond auctions for 2010. Since the previous monthly auction in mid-May, Euroland '*peripheral*' bond markets have remained under severe pressure on the back of the Greek debt crisis, so it was always going to be interesting to see how demand for this latest sale went. Although Ireland had the field to itself on June 15 in terms of bond sales, the timing of the auction wasn't helped by Moody's investors service cutting Greece's credit rating to junk the day before, and in the process refocusing market attention on the Eurozone's debt problems. Indeed, at the open before the latest Irish bond sale all '*peripheral*' bond yield spreads widened out over Germany. As regards the auction itself, demand was again quite solid, but the average interest rate paid to raise the funding was significantly higher (86bps for the 2016 bond) than earlier this year. Two bonds were offered at the June auction, the 4.60%, Treasury 2016 and the 4.50%, Treasury 2018 issues. The overall total amount of the two bonds offered in the auction was in the range of €1bn to €1.5bn. It was decided to issue a total of €1.5bn, as the total bids received amounted to €4.445bn, or 3 times the maximum amount on offer in the auction. A total of €750m of the 4.60%, Treasury, 2016 bond was issued where the total bids received were 3.1 times the amount allocated, while €750m of the 4.50%, Treasury, 2018 bond was also issued where the total bids received were 2.9 times the amount allocated. It was the first time out this year for the 2018 bond, with the last sale of this issue taking place last August, so for comparative purposes the shorter-dated maturity, which has featured in two auctions already in 2010 is the best one to look at. The average yield on the 2016 bond was 4.521% as against 3.663% in April when €750m of the issue was sold and the bid/cover ratio was 3.0. This latest auction brought the total funds raised from the bond market to date to €15.0bn, or 75% of the NTMA's bond issuance programme of €20bn for 2010. Another €1.4bn has also been raised in the retail market. With more than 80% of its long-term borrowing programme completed Ireland is in a strong funding position. Allowing for other cash balances, the Exchequer is fully funded through end-2010. ***However, as we've pointed out on numerous occasions recently, Ireland, despite leading the way in fiscal austerity measures, is now being "tarred with the same brush" as the likes of Greece, Portugal and Spain, which suggests that the NTMA may well end up paying higher interest rates to raise funds at the remainder of this year's scheduled auctions.*** Given its comfortable funding position, the NTMA could have easily skipped the June auction if it wanted to. However, at this point in time it is not about the sovereign, but more about sending out the right signal to markets to leave the door open for the domestic banks to raise required funding. Sorting out the banks' funding issues is now the '*main game in town*'. Indeed, an estimated €30bn of bank debt has to be re-financed between now and year-end. As we've already outlined, Irish economic fundamentals are clearly improving, and we believe the risks to GDP growth are now to the upside rather than the downside. In fact, we think Ireland may surprise a few international commentators with the speed of the recovery. But, the Government must continue to deliver on the tough fiscal measures to sort out the public finances. If it can continue to stand tall, then there is no reason why bond investors won't eventually reward the country with lower yield spreads over Germany again. ***That said, there is a lot to be said for the Irish trade union call for fiscal austerity measures across the whole of Euroland to be delivered over a longer time frame (10 years) than the current 3-4 years demanded by the EU Commission. If there is a "Europe 2020" strategy for sustainable growth and jobs, why can't fiscal austerity targets be incorporated as part of the plan.***

- ***NTMA in very comfortable funding position***



BLOXHAM

Private-Sector Credit:

- ***credit growth continues to weaken***

The latest monthly banking figures, released by the Central Bank, show credit to non-financial corporations (NFCs) fell by 4.5% in the year ending April, following annual declines of 4.6% and 3.6% in March and February respectively. The pace of decline in NFC eased slightly in April, as the net flow of credit transactions during the month was -€109m, compared with -€1.3bn in March and -€842m in February. Residential mortgages (including securitised mortgages) declined by €348m during the month, and stood at €146.1bn at end-April. The annual rate of change in mortgage lending was –1.6% in April, as against –1.4% in March. Repayments on personal credit cards were approximately €11m higher than new spending on credit cards during the month. This difference between repayments and new spending was smaller than in previous months (€71m in March and €26m in February). The year-on-year change in personal credit card indebtedness increased in April to 0.1%. The combined developments in both mortgage and non-mortgage credit during April, excluding valuation effects and the impact of NAMA transfers, led to a reduction of 0.3% in total household credit during the month, with the net flow of credit transactions being -€346m. On a year-to-year basis, household credit declined by 1.8% in April, following similar annual declines in February and March of 1.8% and 1.9% respectively. Meanwhile, M3 deposits increased by approximately €1bn over the month. Underlying this was a decline in deposits with agreed maturity up to two years, which was more than offset by increases in overnight deposits, deposits redeemable at notice up to three months and repurchase agreements. Overnight deposits increased by €362m, while deposits redeemable at notice of up to three months rose by €402m and deposits with an agreed maturity of up to two years declined by €480m. Separate figures released by the European Central Bank this morning showed overall Euroland corporate borrowing fell €14bn month-on-month in April to its lowest level since June 2008, and was down 2.6% in the year. But this was offset by a €17bn increase in household borrowing, taking overall lending to a new record high and posting the sixth annual increase in a row, of 2.5%. April was the first month in 2010 where the Irish M1 contribution to Eurozone money supply increased, as both currency in circulation and overnight deposits rose. ***Even allowing for muted demand for businesses for bank credit, the latest lending data maintain concern that the Euroland/Irish economic recovery could be held back over the coming months by a significant number of companies being unable to get the credit that they need. On the positive side, the data support the view that the European Central Bank will keep official interest rates on hold at 1.00% for the remainder of this year, with no rate hike likely until the first half of 2011.***

- ***mortgage arrears could become problematic as regards banking sector***

Another area that is getting a lot of attention at the moment and could be problematic for the banking sector and in turn the economic recovery going forward, is the level of mortgage arrears. The most recent data from the Financial Regulator on mortgage arrears and repossessions showed that at end-March this year there were just over 791,000 private residential mortgage accounts in Ireland to a value of €118bn. Of these, 32,321 or 4% were in arrears for more than 90 days, of which 21,817 or 2.8% were more than 180 days in arrears. By value €6.1bn was owed in relation to all accounts more than 90 days in arrears of which €4.1bn was owed for accounts more than 180 days in arrears. Mortgage accounts in arrears for more than 90 days increased by 13% since the end of December 2009. There was an increase of 7.2% in the number of formal demands outstanding which have been issued by mortgage lenders bringing the total number outstanding to nearly 5,500. In these cases the level of arrears amounted to €79.1m on outstanding mortgages totaling €1.1bn. However, there was a decrease in the level of outstanding arrears cases where court proceedings had been issued to enforce the debt/security on the mortgage. At the end of March there were just over 3,000 of such cases, a decrease of 4.8% since the end of December. Here the level of arrears amounted to €90.4m on outstanding mortgages totaling €670m. The data also showed that overall mortgage debt outstanding for private residential mortgages decreased by over €285m in the opening quarter of 2010. Meanwhile, at the beginning of the year mortgage lenders held a stock of 397 repossessed residential properties. A further 91 were repossessed during the first quarter of which 26 were repossessed on foot of Court Orders and 65 repossessed following voluntary surrender or abandonment. A total of 32 properties were disposed of during the opening quarter. This left mortgage lenders with 456 repossessed residential properties at the end of March. ***We think the official mortgage arrears data understate the true extent of the problem, but it will be the end of the year before we can really gauge how serious the issue is, and the potential knock-on impact for the banking sector and the economy in general.*** Media hype about house repossessions could seriously dent consumer confidence, and personal spending as a result. ***For the moment, though, we are taking the view that the level of mortgage arrears/repossessions is manageable, and not a major threat to the economic recovery story.*** However, it is something that needs to be monitored closely and politicians and the financial authorities cannot afford to become complacent on the issue.

Interest Rates:

- ***no change in ECB interest rates likely until 2011***

The European Central Bank promised extra cash at its June monetary policy meeting to keep Eurozone liquidity flush until the end of the year but kept a resolute silence on details of its controversial bond buying programme. The ECB kept official interest rates on hold at a record low of 1.00%, as expected, and predicted uneven economic growth in the 16-nation region while inflation could tick up in the next six months. Acknowledging that money markets were still not working perfectly, the ECB decided to offer banks unlimited funds at its next 3-month lending operation, which will buoy money supplies until year-end and smooth the repayment of €442bn in 12-month funds later in June. The move throws the ECB's strategy for exiting stimulus measures even further into reverse, after the central bank was forced to stem a widening sovereign debt crisis a month ago by buying bonds and making extra loans available. At the press conference following the latest monetary policy announcement, ECB President, Jean-Claude Trichet, said the decision to offer extra unlimited 3-month funds in July, August and September was agreed unanimously, in contrast to the decision to buy government debt. ***Bundesbank President Axel Weber has openly criticized the bond move, arguing it creates serious stability risks, and in our view the split is undermining the ECB's efforts to stabilize markets and could suck it further into the murky waters of European politics.*** Asked about disunity, Trichet said: "*There is one currency, there is one ECB, there is one Governing Council*." But does anyone believe him? Amid criticism that the bond purchases may fuel inflation, Trichet said the ECB was inflexibly committed to price stability and would adjust liquidity and interest rates "*as appropriate*". Eurozone central bank staff raised inflation forecasts on the back of higher commodity prices, though price pressures are seen below the ECB's 2.0% ceiling both this year and next. Staff now see inflation of about 1.5% on average this year, rising slightly to 1.6% in 2011. ***The inflation outlook and the depth of the Eurozone debt crisis suggest that it will be some time before the European Central Bank is raising official interest rates. We don't see any move until the opening quarter of 2011 at the earliest.*** However, from the prospective of Irish mortgage holders, unchanged interest rates from the ECB doesn't necessarily mean that the financial institutions here won't raise mortgage rates independently again before year-end. A lot will depend on whether the banks can raise sufficient funding from asset sales or market operations, but another increase in mortgage rates before the end of 2010 cannot be entirely ruled out.

Bloxham: Main Irish Economic Forecasts

	Real	Real	Avg.	General Government Balance		Unemployment		Debt/GDP
	GDP Growth (%)	GNP Growth (%)	Inflation Rate (%)	€m	% GDP	Level '000	Rate (%)	Ratio (%)
2009	-7.1	-11.3	-4.5	-23,400	-14.3	259	11.8	64.5
2010 (f)	0.5	-1.0	-1.1	-18,500	-11.5	278	13.2	83.5
2011 (f)	3.5	2.2	1.5	-16,400	-9.7	260	12.5	88.0
2012 (f)	4.0	3.5	2.0	-12,200	-6.7	230	11.1	88.5

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