SUMMARY

The final year of the millennium, 1999, was a highly successful one for the economy. Real GNP grew by an estimated 7½ per cent. The annual rise in employment was 95,000, or 6¼ per cent, and by the end of the year the official unemployment rate was down to 5.0 per cent. When account is taken of net foreign transfers and the improved terms of trade, the rise in real Gross National Disposable Income (GNDI) per head of population – the most comprehensive measure of the overall growth in living standards – was 6¾ per cent. There was a further large improvement in the public finances, while the surplus on the balance of payments rose to nearly 1½ per cent of GNP.

The only dark cloud on the horizon relates to prices. Wholesale prices began to rise in the second half of the year and at an accelerated rate towards the close of the year. The inflationary impulses have not yet had their full impact on the Consumer Price Index (CPI), which for 1999 as a whole rose by a moderate 1.6 per cent – though the rise in the wider measure of the deflator of personal consumer expenditure was much higher at 4 per cent.

Looking to the future, the outlook for 2000 and 2001 is for a continuation of strong growth in output and employment, though at progressively decelerating rates as capacity constraints begin to bite, accompanied by more obvious manifestations of the inflationary pressures already in train. For the year 2000, we forecast a growth rate of real GDP of 7¼ per cent, and 6 per cent for 2001. In both of these years, as in 1999, large increases in outflows of net factor income, associated with high levels of profitability, will reduce the impact of GDP growth on the growth of GNP. The effect on living standards, however, will be partly offset by continuing improvement in the terms of trade. The unemployment rate is expected to be down to about 4¼ per cent by the end of 2001, while the balance of payments will continue in surplus this year and next. Consumer price inflation, however, will show a sharp rise: we project a 4 per cent annual increase for 2000, but moderating to less than 3 per cent in 2001.

In our general assessment, we focus particularly on the possible threats posed by price and cost inflation. The biggest source of concern, and the one over which we have some control, relates to non-traded goods and services – especially housing and certain sheltered services (e.g., legal, taxis). We take the view that while the pay provisions of the *Programme for Prosperity and Fairness* do not pose a serious danger to the economy, the timing of the commitments to tax reductions and expenditure increases, on top of an already expansionary budget in December 1999, could seriously endanger the medium-term prospects for stable economic growth. We also emphasise the urgent need to increase the supply of serviced sites for housing, and to cut back temporarily on some elements of housing demand. Competition policy, in its broadest sense, remains a key factor in controlling cost and price increases in sheltered activities.

FORECAST NATIONAL ACCOUNTS 1999

A: Expenditure on Gross National Product

	1998	1999	Change in 1999				
	Preliminary £m	Forecast £m	£m Value	£m Volume	Value	% Price	Volume
Private Consumer Expenditure	30,689	34,550	3,861	2,532	12.9	4.0	8.3
Public Net Current Expenditure	7,983	8,741	758	343	9.5	5.5	4.3
Gross Fixed Capital Formation	13,398	16,337	2,939	1,591	21.9	9.0	11.9
Exports of Goods and Services (X)	50,305	58,188	7,883	7,040	15.7	1.5	14.0
Physical Changes in Stocks	788	546	-242	-301			
Final Demand	**103,163**	**118,362**	**15,199**	**11,205**	**14.7**	**3.5**	**10.9**
less:							
Imports of Goods and Services (M)	43,326	49,459	6,133	5,741	14.2	0.8	13.3
GDP at Market Prices	**59,837**	**68,903**	**9,066**	**5,465**	**15.2**	**5.5**	**9.1**
less:							
Statistical Discrepancy	200	605	405	219			
Adjusted GDP	**59,637**	**68,299**	**8,662**	**5,245**	**14.5**	**5.3**	**8.8**
less:							
Net Factor Payments (F)	7,455	8,929	1,474	1,345	19.8	1.5	18.0
GNP at Market Prices	**52,182**	**59,369**	**7,187**	**3,900**	**13.8**	**5.9**	**7.5**

B: Gross National Product by Origin

	1998	1999	Change in 1999	
	Preliminary £m	Forecast £m	£m	%
Agriculture, Forestry, Fishing	2,301	2,085	-216	-9.4
Non-Agricultural: Wages, etc.	24,542	27,627	3,085	12.6
Other:	22,005	26,004	3,999	18.2
Adjustments: Stock Appreciation	76	-160		
Financial Services	-2,051	-2,389	-338	16.5
Statistical Discrepancy	200	605	405	202.6
Net Domestic Product	**47,073**	**53,772**	**6,699**	**14.2**
less:				
Net Factor Payments	7,455	8,929	1,474	19.8
National Income	**39,618**	**44,843**	**5,225**	**13.2**
Depreciation	6,075	6,967	892	14.7
GNP at Factor Cost	**45,693**	**51,810**	**6,117**	**13.4**
Taxes less Subsidies	6,489	7,559	1,070	16.5
GNP at Market Prices	**52,182**	**59,369**	**7,187**	**13.8**

C: Balance of Payments on Current Account

	1998	1999	Change in 1999
	Preliminary £m	Forecast £m	£m
X – M	6,979	8,729	1,750
F	-7,455	-8,929	-1,474
Net Transfers	1,039	1,032	-7
Balance on Current Account	**563**	**832**	**269**
as % of GNP	1.1	1.4	0.5

FORECAST NATIONAL ACCOUNTS 2000

A: Expenditure on Gross National Product

	1999	2000	Change in 2000				
	Preliminary £m	Forecast £m	£m Value	£m Volume	Value	% Price	Volume
Private Consumer Expenditure	34,550	38,634	4,084	2,315	11.8	4.8	6.7
Public Net Current Expenditure	8,741	9,640	899	350	10.3	6.0	4.0
Gross Fixed Capital Formation	16,337	19,177	2,839	1,253	17.4	9.0	7.7
Exports of Goods and Services (X)	58,188	66,385	8,198	6,522	14.1	2.6	11.2
Physical Changes in Stocks	546	582	36	-44			
Final Demand	**118,362**	**134,418**	**16,056**	**10,396**	**13.6**	**4.4**	**8.8**
less:							
Imports of Goods and Services (M)	49,459	55,702	6,243	5,133	12.6	2.0	10.4
GDP at Market Prices	**68,903**	**78,716**	**9,813**	**5,262**	**14.2**	**6.1**	**7.6**
less:							
Statistical Discrepancy	605	736	131	376			
Adjusted GDP	**68,299**	**77,980**	**9,682**	**4,886**	**14.2**	**6.6**	**7.2**
less:							
Net Factor Payments (F)	8,929	10,594	1,665	1,398	18.6	2.6	15.7
GNP at Market Prices	**59,369**	**67,386**	**8,016**	**3,488**	**13.5**	**7.2**	**5.9**

B: Gross National Product by Origin

	1999	2000	Change in 2000	
	Preliminary £m	Forecast £m	£m	%
Agriculture, Forestry, Fishing	2,085	2,333	248	11.9
Non-Agricultural: Wages, etc.	27,627	30,603	2,975	10.8
Other:	26,004	30,619	4,615	17.7
Adjustments: Stock Appreciation	-160	-120		
Financial Services	-2,389	-2,709	-320	13.4
Statistical Discrepancy	605	736	131	21.7
Net Domestic Product	**53,772**	**61,461**	**7,689**	**14.3**
less:				
Net Factor Payments	8,929	10,594	1,665	18.6
National Income	**44,843**	**50,867**	**6,024**	**13.4**
Depreciation	6,967	7,913	946	13.6
GNP at Factor Cost	**51,810**	**58,780**	**6,970**	**13.5**
Taxes less Subsidies	7,559	8,606	1,046	13.8
GNP at Market Prices	**59,369**	**67,386**	**8,016**	**13.5**

C: Balance of Payments on Current Account

	1999	2000	Change in 2000
	Preliminary £m	Forecast £m	£m
X – M	8,729	10,683	1,954
F	-8,929	-10,594	-1,665
Net Transfers	1,032	1,027	-5
Balance on Current Account	**832**	**1,116**	**284**
as % of GNP	1.4	1.7	0.4

FORECAST NATIONAL ACCOUNTS 2001

A: Expenditure on Gross National Product

	2000	2001	Change in 2001				
	Forecast £m	Forecast £m	£m Value	£m Volume	% Value	% Price	% Volume
Private Consumer Expenditure	38,634	42,389	3,755	2,125	9.7	4.0	5.5
Public Net Current Expenditure	9,640	10,630	990	386	10.3	6.0	4.0
Gross Fixed Capital Formation	19,177	22,294	3,117	1,338	16.3	8.7	7.0
Exports of Goods and Services (X)	66,385	74,478	8,093	6,646	12.2	2.0	10.0
Physical Changes in Stocks	582	613	31	-6			
Final Demand	**134,418**	**150,404**	**15,896**	**10,489**	**11.9**	**3.8**	**7.8**
less:							
Imports of Goods and Services (M)	55,702	62,077	6,375	5,534	11.4	1.4	9.9
GDP at Market Prices	**78,716**	**88,327**	**9,611**	**4,955**	**12.2**	**5.6**	**6.3**
less: Statistical Discrepancy	736	817	81	308			
Adjusted GDP	**78,980**	**87,510**	**9,530**	**4,647**	**12.2**	**5.9**	**6.0**
Net Factor Payments (F)	10,594	12,189	1,595	1,358	15.1	2.0	12.8
GNP at Market Prices	**67,386**	**75,321**	**7,935**	**3,289**	**11.8**	**6.6**	**4.9**

B: Gross National Product by Origin

	2000	2001	Change in 2001	
	Forecast £m	Forecast £m	£m	%
Agriculture, Forestry, Fishing	2,333	2,304	-29	-1.2
Non-Agricultural: Wages, etc.	30,603	33,547	2,944	9.6
Other:	30,619	35,487	4,868	15.9
Adjustments: Stock Appreciation	-120	-60		
Financial Services	-2,709	-3,016	-306	11.3
Statistical Discrepancy	736	817	81	11.0
Net Domestic Product	**61,461**	**69,079**	**7,618**	**12.4**
Net Factor Payments	10,594	12,189	1,595	15.1
National Income	**50,867**	**56,890**	**6,023**	**11.8**
Depreciation	7,913	8,873	959	12.1
GNP at Factor Cost	**58,780**	**65,763**	**6,983**	**11.9**
Taxes less Subsidies	8,606	9,558	952	11.1
GNP at Market Prices	**67,386**	**75,321**	**7,935**	**11.8**

C: Balance of Payments on Current Account

	2000	2001	Change in 2001
	Forecast £m	Forecast £m	£m
X – M	10,683	12,401	1,718
F	-10,594	-12,189	-1,595
Net Transfers	1,027	919	-108
Balance on Current Account	**1,116**	**1,131**	**15**
as % of GNP	1.7	1.5	0.0

The International Economy

General

Globally, economic activity strengthened during 1999. There was stronger than anticipated growth in the US and UK and some recovery in Asia and Latin America. At the same time there were few signs of inflationary pressures internationally. In general, 2000 is starting with a more positive international economic environment. It now seems likely that growth in world output will increase in 2000 driven mainly by strong growth in world trade as a result of further recovery in the Asian region. However, despite this improvement, risks remain which include a fall in world stock markets, or the repercussions from a correction of external imbalances such as the US current account deficit. The upturn in growth has already raised worries about inflationary pressures and so interest rates are expected to move upwards over the course of the next year at least.

US Economy

Preliminary figures show that the US economy put in another strong performance again in 1999, growing by 4.1 per cent. This is marginally slower than in 1998 but above our estimate in the December *Commentary*. Personal consumption and private fixed investment were the main sources of growth while the contribution of the external sector was negative. The US economy remains an important source of world demand and the outlook is for a continuation of strong, albeit slower, growth. GDP growth is expected to slow to 3½ per cent in 2000 and further to around 3 per cent in 2001. Despite the strong growth rates, inflation, as measured by the consumer price index, has not increased excessively, averaging 2.7 per cent in 1999, while wider measures of inflation were also low. However, the annual rate of inflation has risen in recent months. A weaker dollar, coupled with higher energy prices, is expected to contribute to higher inflation and so an annual average of 3 per cent is forecast for the next two years. In February official interest rates were raised by a ¼ percentage point to 5¾ per cent due to concerns that excess demand in the economy would lead to inflationary pressures. Further increases are expected and official rates are expected to rise by a further ½ percentage point by the end of 2000 to 6¼ per cent. Further substantial increases are unlikely during 2001 as inflationary pressure eases.

The unemployment rate remains low in the US, averaging 4.2 per cent in 1999. High levels of job creation have reduced the unemployment rate substantially in recent years. The tightness of the labour market means that we do not expect continued growth of the US economy to bring about further large reductions in the unemployment rate and an annual average of 4¼ per cent is forecast for 2000. In line with the forecast slowdown in activity in 2001 we anticipate that the unemployment rate will increase but will remain below 4½ per cent on an annual basis.

Rapid import growth fuelled by domestic demand, and low export volumes, reflecting the poor external environment have resulted in a widening of the merchandise trade deficit and the deficit on the current account. An improvement in the world economy should result in slower growth in the deficit over the next two years.

High interest rates in the US have maintained the strength of the dollar on international currency exchanges. The currency seems set to remain strong as US interest rates continue to rise and strong growth supports the currency. However, an improvement in the economic situation in the euro zone coupled with the size of the US current account deficit should result in a gradual appreciation of the euro against the dollar in the second half of 2000.

The European Economy

Throughout 1999, attention focused on the performance of the euro and on signs of improvement in economic activity in some of the main EU economies. Contrary to expectations the euro has depreciated over the first year of its existence against both the dollar and sterling. Economic indicators suggest that the improving performance of the European economy should support the currency. However, this is not likely to happen until later in the year. In February the European Central Bank raised official interest rates by ¼ percentage point to 3¼ per cent due to worries that inflation would be higher than originally anticipated over the coming months. Indeed, the prolonged weakness of the euro was one of the factors of concern. Euro zone annual inflation rose to 1.7 per cent in December, the same as for the EU 15. Official figures show that real GDP in the EU 15 and Euro-zone rose by 1 per cent in the third quarter of 1999, compared with the previous quarter. GDP growth is expected to average around 2 per cent in 1999. While higher interest rates will offset some of the benefits of a more positive international environment European GDP growth is expected to increase in 2000 by 3 per cent, with a similar increase in 2001. A comparative business survey undertaken by institutes in France, Germany and Italy points to a strengthening of confidence in these economies at the end of 1999. Official figures show that in the three months to November 1999, European industrial production rose by 1.2 per cent, compared to the previous three months. One problem that has persisted in recent years has been a high rate of unemployment. However, Eurostat figures show that the unemployment rate in the EU fell to 8.8 per cent in December 1999. Further declines are forecast for 2000 and 2001. Having averaged 9.5 per cent in 1999 the unemployment rate is expected to fall to an annual average of 8.7 per cent in 2001.

According to the Federal Statistical Office, German GDP rose by 1.5 per cent in real terms in 1999, below the rate of 2.2 per cent achieved in 1998. Some of the areas that contributed most to economic growth in 1999 were household expenditure and investment in machinery and equipment while investment in construction declined and the balance of exports and imports decreased. Figures point to an upturn in activity throughout the course of 1999 and growth is expected to continue over the coming year due mainly to an increase in personal consumption levels and the external sector benefiting from the upturn in world trade. On this basis growth of 2½ per cent is forecast for each of the next two years. Over the medium-term the German Federal Ministry of Finance projects annual average GDP growth of 2 per cent.[1] Unemployment rates have remained high, although there was an improvement during the year, and the annual rate averaged 10½ per cent in 1999. The upturn in growth should result in some improvement and an annual average of 10 per cent is

[1] Federal Ministry of Finance *German Stability Programme* December 1999 update.

forecast for 2000 and 9¾ per cent in 2001. Inflation in Germany, as measured by the consumer price index, was very subdued in 1999, increasing by just 0.6 per cent on an annual average basis. Rising import and oil prices should result in a higher rate of inflation in 2000 and 2001, although at an annual average of 1½ per cent, this will not be excessive.

In recent years the French economy has performed better than other core EMU economies. Growth in the French economy appears to have accelerated in the second half of 1999, following a slowdown in the first half of the year, partly as a result of growth in domestic demand. The upturn was also due to growth in world demand and improved competitiveness as a result of the weak euro leading to strong export growth. All sectors of the economy are now expanding and GDP growth is forecast to average 3 per cent a year in 2000 and 2001. This means that the French economy will continue to be one of the better performing of the core European economies. An increase in energy prices has resulted in a slight increase in inflation, although the annual rate is expected to remain subdued, at ¾ per cent in 1999 and an annual average of 1¼ per cent in 2000 and 1½ per cent in 2001. Continuing growth has reduced the unemployment rate, which has remained stubbornly high for some time. Numbers employed in industry, which had been declining, began to recover in the latter half of the year and employment increases in services remained strong throughout 1999. The annual average unemployment rate in 1999 is estimated at 11 per cent, down from an annual average of 11.7 per cent in 1998. A further decline to an annual average of 10½ per cent is forecast for this year and 10 per cent in 2001.

The downturn in world trade affected the Italian economy quite severely. However, recovery in domestic demand and the external sector means that the outlook is now more positive. This will narrow the gap in performance between the Italian and other EU economies. GDP growth in Italy is estimated at 1¼ per cent in 1999 and is forecast to increase to an annual average of 2½ per cent in 2000 and 2001. Indeed, as growth picks up across Europe, activity levels are likely to become gradually more harmonised. In recent years GDP growth in some of the smaller countries has been much stronger than the core economies.

The UK Economy

Last year started with worries that the UK economy would move into recession. Official figures now estimate that the UK economy grew by 0.8 per cent in the fourth quarter, unchanged from the previous quarter, bringing the annual growth rate to 1.9 per cent during 1999. The service sector was again the main source of growth, although the manufacturing sector also performed well. There is evidence that growth in the UK has become more balanced over the course of the year. Recovery in Europe has resulted in the external sector making an increasing contribution rather than activity being driven purely by domestic demand.

Seasonally adjusted figures for manufacturing production show that the three months to December 1999 saw an increase of 0.7 per cent in output levels compared with the previous three months, and 1.9 per cent compared with the same period a year earlier. Reflecting the strength of the UK economy, the unemployment rate remains low. For the period September to November 1999 the ILO unemployment rate was 5.9 per cent, unchanged from the previous three-month period and the annual average is estimated to be 6¼ per cent. Unemployment has fallen in recent years from a peak of 10½ per cent annual average in 1993. The forecast increase in growth could well result in further falls and an annual average of 6 per cent is forecast for each of the next two years. While helped at least partly by the strength of sterling, underlying inflation, excluding mortgage interest payments, remained stable over the final quarter of 1999 at 2.2 per cent, resulting in an annual average of 2.3 per cent, compared to the official target of 2½ per cent. Underlying inflation is expected to increase over the coming year to an annual average of 2½ per cent, with the possibility of a further increase in 2001 to 2¾ per cent. The output price index for home sales of manufactured products rose by 2.3 per cent in the twelve months to December 1999, compared with a rise of 2.1 per cent in the year to November. The Bank of England's Monetary Policy Committee raised official interest rates by ¼ per cent in both January and February of this year to 6 per cent. This increase was on the grounds that, although currently below target, inflation is likely to rise reflecting developing pressures in the labour market and on productive capacity. Average earnings increased by 4.9 per cent in the year to November, unchanged from the October figure.

A feature of the UK economy has been its performance in the face of a strong currency. For a number of years sterling has been considered overvalued on the international currency exchanges. Despite talk of recession and a series of interest rate cuts the UK currency has remained strong, and indeed has strengthened in recent months. Official figures suggest that the manufacturing sector is coping with the strength of the currency as manufacturing output levels have been increasing in the last few months. Continuing recovery in Europe should result in an appreciation of the euro against the UK currency. The expectation that official interest rates will be increased over the coming year means that any depreciation for sterling is unlikely to be substantial.

The Rest of the World

Continued buoyancy in exports allowed recovery in the Asian region to become more securely based during 1999. There are also indications that domestic demand is reviving as well as employment increases and inflation levels decline. However, the outlook for the Japanese economy remains uncertain. Having grown in the first two quarters the economy contracted again in the third quarter of the year. GDP growth is expected to average ¾ per cent in 1999. External demand, boosted by recovery in Asia, has increased export volumes, although this has not been helped by the appreciation of the yen. The extent of any recovery remains very uncertain and so GDP growth of 1 per cent is projected for this year. Modest recovery in personal consumption should help to underpin growth and further recovery in GDP growth of 1¾ per cent is forecast for 2001. Although there has been some improvement in the seasonally adjusted unemployment rates, these remain high by historic standards, averaging around 4¾ per cent in 1999. Despite the improvement in the economy, restructuring by companies means that large reductions are unlikely and an annual average unemployment rate of 4½ per cent is forecast for 2000 and 2001.

The return to sustained recovery by the Asian economies will help many of the world economies move towards stronger growth this year. Along with the recovery in exports, domestic demand levels have been increasing due to rising employment. South Korea is performing particularly well. While growth in the region has still not reached pre-crisis levels weaker economies like Thailand and Indonesia have also returned to moderate growth.

TABLE 1: Short-term International Outlook

	GNP		Consumer Prices		Hourly Earnings		Unemployment Rate		Current Account Balance	
	Percentage Change						%		% of GNP	
Country	2000	2001	2000	2001	2000	2001	2000	2001	2000	2001
UK	2.5	3.0	2.5	2.8	5.3	5.3	6.0	6.0	-1.5	-1.8
Germany	2.5	2.5	1.5	1.5	3.3	3.3	10.0	9.8	-0.3	0.0
France	3.0	3.0	1.3	1.5	2.5	2.5	10.5	10.0	2.0	2.0
Italy	2.5	2.5	1.8	2.0	3.0	3.0	11.3	10.8	1.5	1.3
Total EU	3.0	2.5	2.3	2.3	3.3	3.3	9.0	8.8	0.8	1.0
USA	3.5	3.0	3.0	3.0	3.5	3.5	4.3	4.4	-3.5	-3.5
Japan	1.0	1.8	0.5	0.5	0.5	0.5	4.5	4.5	2.5	2.5
Total (OECD)	3.2	3.0	2.5	2.5	3.0	3.0	6.5	6.5	-1.0	-1.0
Ireland	5.9	4.9	4.0	2.7	6.5	6.5	4.7	4.4	1.7	1.5

The Context for Ireland

Sustained recovery by the Asian economies is expected to provide a boost to world economic activity in 2000 compared with 1999. World trade levels are also expected to increase faster this year than in 1999. Thus the general background should be more positive this year. Exporters, particularly to continental Europe, should benefit from the upturn in demand in these markets. Growth in world output and an increase in the European growth rate will result in international foreign investment flows remaining high. Ireland remains an attractive location. However, as mentioned in our last *Commentary*, supply constraints will pose problems in attracting large-scale investments.

Internationally, inflation rates are expected to increase. Commodity prices have increased and growth prospects have improved resulting in some decline in unemployment rates. Economies such as the US and UK will grow strongly in 2000 and increases in pay will result in inflationary pressures. The prolonged weakness of the euro has raised concerns about inflation within the euro zone. These factors are all likely to contribute to higher interest rates. Ireland's domestic interest rates are determined by the European Central Bank. A box on page 15 outlines the ECB's interest rate setting policy. Our forecast is that the annual average level of interest rates will be higher in 2000 and 2001 than in 1999. Stronger growth in the eurozone should result in interest rates increasing by a further ¾ per cent in both 2000 and 2001. Short-term rates in the UK rose in January and February to 6 per cent. The strength of consumer demand and the overall economy in the UK means that further increases are expected in 2000, with official short-term interest rates ending the year at least a ½ percentage point higher. The Federal Reserve appears to be increasingly concerned about the build-up of inflationary pressures in the US economy. On this basis, US interest rates are set to move higher by another ½ percentage point by the end of this year.

The performance of the main currencies on the international financial markets during 1999 was in contrast to widely held expectations at the beginning of the year. The newly launched euro was expected to appreciate against the dollar and against sterling, which is viewed by many as being overvalued. However, the euro has depreciated and both the dollar and sterling remain strong. Provided the recovery of economic momentum in Europe is sustained, then the euro can be expected to recover at a moderate pace against the other main currencies in the latter half of this year and during 2001.

Box A: Setting Interest Rates in the Euro Area

The arrival of the euro in January 1999 has meant that interest rates for the Irish economy are now set by the Governing Council of the European Central Bank (ECB). Interest rates are set to achieve price stability within the euro area. In order to increase the transparency of its policy actions the ECB has announced a *Stability-oriented Monetary Policy Strategy.*[2] The strategy consists of three elements: a quantitative definition of price stability and "two pillars" to assess the risks of inflationary pressures. The first pillar provides a reference value for the growth in broad money while the second pillar involves a broad based assessment of the risks to price stability.

The strategy has a medium-term orientation so as to avoid inappropriate reactions to short-term volatility in prices caused by non-monetary factors such as indirect tax changes. Price stability is defined to be a year-on-year increase in the Harmonised Index of Consumer Prices (HICP) for the euro area of below 2 per cent.

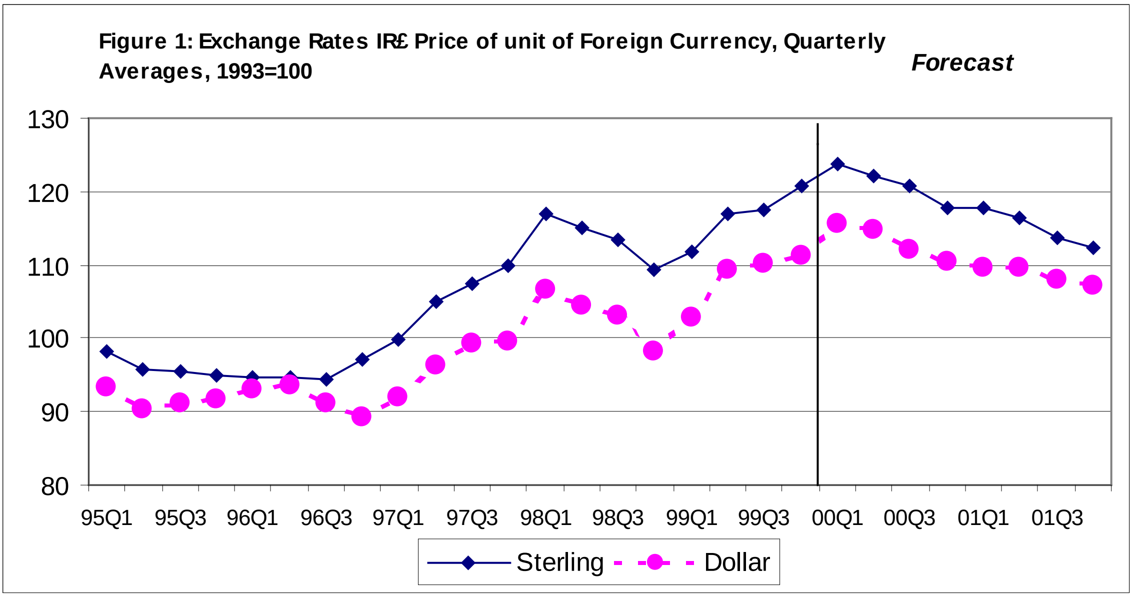
The predominant role accorded to money in the first pillar acknowledges the belief that inflation is a monetary phenomenon in the long term. A quantitative reference value for monetary growth is determined on the basis of a long-run relationship between prices, trend output and the turnover or velocity of money. The reference value for the aggregate M3 broad money growth has been set at 4½ per cent. It is stressed that this is a reference value and that interest rates changes do not automatically follow from deviations from this rate.

The second pillar incorporates a wide range of economic indicators to inform on inflationary risks over the medium term. The range of indicators used include real activity measures; wage developments; the exchange rate; bond prices; fiscal measures; price and cost indices; business and consumer surveys etc.

In raising its interest rate by ¼ per cent in early February, the ECB justified the rise on the basis of its stated strategy. In the first pillar the prolonged deviation of aggregate M3 money growth from the reference value, as well as strong credit growth, were considered to be contributing to the upside risks to price stability. Factors that were judged to increase inflationary risks through the second pillar included the increased expectations of a lasting upswing in euro area economies as reflected in rising long-term nominal interest rates; depreciating euro nominal effective exchange rate; improved outlook for the world economy; high levels of industrial and consumer confidence; improved prospects for ongoing employment growth and falling unemployment, and a rise in the annual rate of change in the overall HICP towards 2 per cent due to an high annual increase in energy prices.

The factors that determined the scale and timing of the interest rate decision were based mainly on large macroeconomic aggregates. As Irish output and monetary data form less than one per cent of the euro area's aggregated data, interest rate decisions will not be influenced in an appreciable way by conditions in Ireland.

[2] European Central Bank (1999). "The Stability-Oriented Monetary Strategy of the Eurosystem", *Monthly Bulletin*, January, Frankfurt.



The Domestic Economy

General

The range of official statistics that form the basis for short-term economic forecasting has improved greatly in recent years. At the time of going to press, we have available to us detailed employment figures covering all four quarters of 1999, and quarterly national accounts covering the first two quarters of the year. These data give a more up-to-date picture of the trend in overall economic activity in the recent past than was formerly available, especially in regard to the output, as distinct from the expenditure, side of the economy. They therefore provide a more solid foundation for short-term forecasting – although, given that the future is inherently unknown, they do not guarantee an improvement in the quality of our forecasts.

In this *Commentary*, we provide our first estimate of the outturn for 1999, a revised forecast for 2000, and our first forecast for 2001. The final figures for GDP (and GNP) are based on independent forecasts of the expenditure and output sides of the economy. As in the case of the official *National Accounts,* these two forecasts differ from each other, and the final figure used is an average of the two. The amount by which either of the separate forecasts has to be adjusted to bring it into line with the final forecast is shown by the Statistical Discrepancy.

Exports

On the evidence of trade statistics available to date, it seems likely that export growth in 1999 was slower than in recent years. The volume of visible exports is estimated to have risen by 14¼ per cent. Annual average export prices have shown a slight decline in the first ten months. However, price indices for both exports to non-EU countries and manufacturing industries export sales increased in the later months of the year and so we have revised upwards our export price deflator. The value of merchandise exports in 1999 is estimated to have risen by 15.7 per cent, an upward revision from our estimate in the December *Commentary*. Because the latest figures for sectoral origin of exports lag subsequent revisions to the total of visible exports, the 1999 base for composition of exports is indicative only. It is clear, however, that after very strong growth in 1998, manufactured exports, particularly from the high technology sector, increased at a slower rate in 1999, as did other industrial exports. Tourism earnings increased at a steady pace in 1999, if slightly slower than in recent years. The rise in other service exports is estimated at 15 per cent, bringing growth in the volume of exports of goods and services to 14 per cent in 1999.

TABLE 2: Exports of Goods and Services

Estimates

	1998	% Change in 1999		1999
	£m	Volume	Value	£m
Agricultural	2,903	2.5	3.5	3,005
Manufactured	37,920	16.5	18.2	44,839
Other Industrial	3,501	2.8	4.0	3,642
Other	882	2.8	3.8	915
Total Visible	**45,205**	**14.3**	**15.9**	**52,401**
Adjustments	357	15.5	15.5	413
Merchandise	**45,562**	**14.3**	**15.9**	**52,814**
Tourism	2,281	7.3	9.9	2,508
Other Services	2,462	15.0	16.4	2,867
Exports of Goods and Services	**50,305**	**14.0**	**15.7**	**58,188**

Forecasts

	1999	% Change in 2000		2000	% Change in 2001		2001
	£m	Volume	Value	£m	Volume	Value	£m
Agricultural	3,005	2.5	3.8	3,118	2.0	3.5	3,229
Manufactured	44,839	13.0	16.1	52,062	11.5	13.7	59,210
Other Industrial	3,642	2.5	5.3	3,836	2.0	3.8	3,981
Other	915	2.5	2.8	940	2.0	2.3	961
Total Visible	**52,401**	**11.5**	**14.4**	**59,956**	**10.2**	**12.4**	**67,381**
Adjustments	413	13.5	13.5	468	13.0	13.0	529
Merchandise	**52,814**	**11.5**	**14.4**	**60,424**	**10.3**	**12.4**	**67,910**
Tourism	2,508	5.0	7.4	2,692	3.0	5.8	2,849
Other Services	2,867	11.3	14.0	3,269	11.0	13.8	3,719
Exports of Goods and Services	**58,188**	**11.2**	**14.1**	**66,385**	**10.0**	**12.2**	**74,478**

Although the outlook for exports is positive, the magnitude of further growth is somewhat uncertain. The anticipated increase in world trade and global economic activity as discussed in the International section should support further strong export growth. However, as discussed in this and previous *Commentaries,* the impact of supply constraints will ultimately determine the outcome. Export prices are expected to increase during this year and next due to the relative weakness of the euro on international currency exchanges and a rise in energy prices. Slower growth in tourism receipts due to supply constraints and domestic inflation is expected in both 2000 and 2001. Other service exports are likely to grow at a slower pace and so the volume of exports of goods and services is expected to increase by 11¼ per cent in 2000.

Provided world trade growth, economic recovery in Asia and the upturn in activity in Europe continue, the outlook for Irish export volumes of both goods and services remains favourable. Growth will continue to be limited by capacity constraints and also by the anticipated gradual appreciation of the euro against both the dollar and sterling. Allowing for these factors, we expect the volume of exports of goods and services to increase by 10 per cent in volume and by about 12¼ per cent in value in 2001.

Stocks

The level of stockbuilding in 1998 was higher than expected. While there may have been some build-up in stocks at the end of 1999 in anticipation of possible year 2000 effects, we still expect a somewhat smaller build-up of stocks than in the previous year. For 2000 and 2001 we see little change in the rate of stockbuilding. The rapid increase in industrial output means that work in progress, a component of industrial stockbuilding, will continue to grow. In the case of agricultural stockbuilding we expect a small fall as farmers react to the very poor market environment over the last year.

Because the rise in output prices took place very late last year, there is likely to have been some rise in the value of stocks over the course of 1999. This rise in output prices will also affect valuations this year. To take account of this price effect, we have included a negative adjustment for stock appreciation.

TABLE 3: Stock Changes

	1998 £m	Change in Rate £m	1999 £m	Change in Rate £m	2000 £m	Change in Rate £m	2001 £m
Farm Stocks	43	-43	0	-20	-20	-20	-10
Irish intervention Stocks	-13	-37	-50	50	0	50	0
Other Non-agricultural Stocks	758	-162	596	6	602	6	623
Total	**788**	**-242**	**546**	**36**	**582**	**36**	**613**

Investment

Most indicators of fixed investment grew strongly in 1999. Housing statistics for the first three quarters of the year suggest that the volume of residential construction grew by an estimated 11½ per cent, which will bring the number of house completions in 1999 to over 47,000, in line with forecasts in previous *Commentaries*. While most indicators point to strong growth within the sector, employment in building and construction grew at a slower rate than in 1998. Thus, it is estimated that volume growth in building and construction amounted to 11¾ per cent in volume in 1999 and 27¼ per cent in value terms. Registrations of goods vehicles and imports of capital goods suggest that investment in machinery and equipment grew by 22 per cent in value terms in 1999.

Starting from a much higher base, the rate of increase in the volume of building and construction in 2000 is unlikely to match that of 1999. The growth in volume terms should slow to 7½ per cent as capacity constraints limit the increase. Given the strength of activity within the sector the rate of increase in the price deflator is expected to remain high and so the value increase is forecast at 21¾ per cent. On the basis of the buoyant economic outlook, and the number of projects underway, or set to commence, investment in machinery and equipment should continue to grow at a reasonably strong pace this year and next. A volume increase of about 8 per cent is forecast for 2000 and 7½ per cent for 2001. Provided that our forecasts for the individual sub-sectors are correct total gross fixed capital formation is projected to increase by 7.7 per cent this year and by 7 per cent in 2001.

TABLE 4: Gross Fixed Capital Formation

Estimates

	1998 £m	% Change in 1999 Volume	% Change in 1999 Value	1999 £m
Housing	4,541	15.0	38.0	6,267
Other Building	3,814	8.0	14.5	4,366
Building and Construction	8,355	11.8	27.3	10,633
Machinery & Equipment	5,043	12.0	13.1	5,705
Total	13,398	11.9	21.9	16,337

Forecasts

	1999 £m	% Change in 2000 Volume	% Change in 2000 Value	2000 £m	% Change in 2001 Volume	% Change in 2001 Value	2001 £m
Housing	6,267	5.8	22.9	7,704	4.5	20.2	9,258
Other Building	4,366	10.0	19.9	5,235	10.0	19.6	6,263
Building and Construction	10,633	7.5	21.7	12,939	6.7	20.0	15,521
Machinery & Equipment	5,705	8.0	9.3	6,238	7.5	8.6	6,773
Total	16,337	7.7	17.4	19,177	7.0	16.3	22,294

Consumption

Provisional figures show that the value of retail sales increased by 10.9 per cent and the volume by 9 per cent during 1999. As is shown in Table 5, the value of personal consumption usually increases faster than the retail sales index, and this difference is expected to continue, reflecting a strong increase in tourism spending abroad. Thus, the 1999 increase in total personal consumption is estimated at 12 per cent in value terms. We estimate that while the implied deflator for retail sales increased by 1.6 per cent, the overall personal consumption deflator for the year will be much higher. On this basis the volume of personal consumption increased less rapidly than the retail sales index, at an annual increase of 8.3 per cent.

With both employment and disposable income increasing and relatively low interest rates by historical standards, personal consumption should continue to rise throughout the course of the next two years. The rate of increase in 2000 could be marginally less rapid than in 1999, reflecting a lower rate of growth in employment. Even so it is still probable that the value of retail sales will rise by about 9½ per cent, while the volume of personal consumption is forecast to increase by about 6¼ per cent.

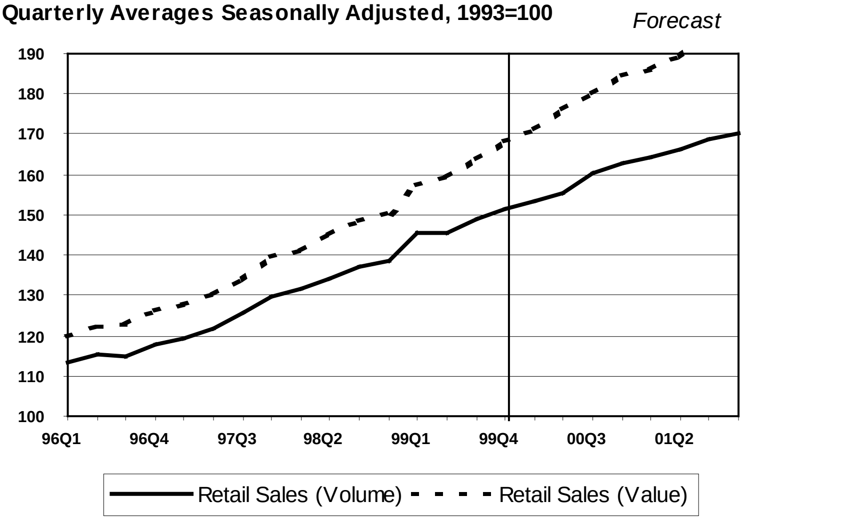
A further moderation in employment growth, coupled with higher interest rates will lower the rate of increase in consumption during 2001. Although the value of personal consumption is expected to increase by 9.8 per cent, the fact that the deflator is expected to remain high at 4 per cent means that volume growth in personal consumption of goods and services will be 5.5 per cent.

TABLE 5: Consumption Indicators

	Annual Percentage Change						
	1995	**1996**	**1997**	**1998**	**1999 Forecast**	**2000 Forecast**	**2001 Forecast**
Consumption Value							
NIE 1997, Personal Consumption	6.6	9.3	10.0	11.4	13.4	11.6	9.7
Retail Sales Index, Value	4.8	8.3	9.0	9.7	10.9	9.5	8.0
Divergence	1.8	1.0	1.0	1.7	2.5	2.1	1.7
Consumption Volume							
NIE 1997, Personal Consumption	3.7	6.5	7.3	7.4	8.3	6.3	5.5
Retail Sales Index, Volume	2.8	6.2	7.9	8.8	9.0	6.8	6.0
Divergence	0.9	0.3	-0.6	-1.4	-0.8	-0.6	-0.5
Consumer Prices							
NIE 1997, Personal Consumption Deflator	2.8	2.6	2.5	3.7	4.8	5.0	4.0
Retail Sales Index Deflator	2.0	1.7	1.2	1.6	2.1	2.1	2.1
Consumer Price Index	2.5	1.6	1.5	2.4	1.6	4.0	2.7

Government consumption grew less rapidly than the other components of final demand in 1999, with the increase estimated to be 4¼ per cent in volume and 9½ per cent in value. Broadly similar growth is expected in the volume of public expenditure over the next two years. The price deflator for public consumption is expected to increase to 6 per cent in 2000 and so a value increase of 10.3 per cent is forecast. A similar increase is forecast for 2001.

Figure 2: Consumption
Quarterly Averages Seasonally Adjusted, 1993=100



Final Demand

We estimate that final demand in 1999 rose by almost 11 per cent in volume terms and 14¾ per cent in value – rather less than the massive increases of 14¾ per cent and 19 per cent, respectively, in 1998. In volume terms, domestic demand (excluding stocks) grew by 8½ per cent in 1999, while exports of goods and services rose by 14 per cent.

A progressive slowing down in the rate of growth of the volume of final demand is forecast for 2000 and 2001, with projected increases of 8.8 per cent in 2000 and 7.8 per cent in 2001. The deceleration in volume growth is expected to be shared between domestic demand and exports, with the former growing by 6.6 and 5.7 per cent in 2000 and 2001, respectively, and the latter by 11.2 and 10 per cent, respectively, in the same two years.

The figures suggest that over the period 1998-2001 there will be a progressive, though small, reduction in the import intensity of final demand in current values. This is entirely a price phenomenon, however, due to the price of imports rising much less rapidly than the price of domestic expenditure. In fact, in volume terms the import intensity of final demand is expected to continue to rise.

Imports

The slow growth rates recorded during the first half of 1999 for both the value and volume of visible imports was surprising given the strength of domestic demand in the economy. On this basis, previous *Commentaries* argued that a substantial downward revision to our import forecasts was unnecessary. A strong pick-up in growth rates shown in available data for the second half of the year suggests that our approach was correct.

As with exports, the breakdown of imports by use category is only available for part of the year. However, the figures do show that in the first nine months of the year both imports of capital goods and consumer goods rose quite strongly, although well below the increases of 1998.

From balance of payments estimates for the first three-quarters of 1999, it appears that the balance of payments adjustment has increased slightly. Therefore merchandise imports in 1999 are estimated to have increased by 9½ per cent in volume and 9¾ per cent in value. The rise in tourism spending abroad is estimated at 11 per cent in volume while other service imports, including royalty payments, increased by 24 per cent. Thus, total imports of goods and services in 1999 are estimated to have risen by 13¾ per cent in volume.

In keeping with our forecast for the rise in domestic demand this year the rate of growth in imports of capital goods and consumer goods is expected to be lower than last year. Similarly the slower rate of growth projected for manufactured exports is likely to be reflected in a reduced rate of increase of imported intermediate goods. Visible imports are therefore forecast to rise by just under 9 per cent in volume terms in 2000. World trade prices for many commodities have begun to increase in recent months and the decline in the value of the euro is expected to feed through to higher prices in Irish pounds for many imports. On this basis we have forecast that the annual average increase in import prices will be over 2 per cent this year. Thus, the value of visible imports is expected to increase by 11¼ per cent in 2000. Tourism spending abroad is expected to remain strong, boosted by increases in employment and disposable incomes, but other service imports are expected to rise less rapidly than last year. Total imports of goods and services are therefore forecast to increase by 10½ per cent in volume and by 12½ per cent in value this year.

Similar factors are expected to influence growth in imports in 2001 and so the volume growth of imports of goods and services is expected to slow to 10 per cent while price increases will mean that the growth in value terms will be 12½ per cent.

TABLE 6: Imports of Goods and Services

Estimates

	1998 £m	% Change in 1999 Volume	% Change in 1999 Value	1999 £m
Capital Goods	4,069	9.0	9.3	4,446
Consumer Goods	6,499.9	10.5	11.6	7,254
Intermediate Goods:				
Agriculture	496.3	2.0	2.0	506
Other	18,596	10.0	10.0	20,456
Other Goods	1,604	4.0	4.0	1,668
Total Visible	**31,266**	**9.5**	**9.8**	**34,331**
Adjustments	-573	10.0	10.0	-630
Merchandise Imports	**30,693**	**9.5**	**9.8**	**33,701**
Tourism	1,663	11.0	13.2	1,883
Other Services	10,970	24.0	26.5	13,875
Imports of Goods and Services	**43,326**	**13.3**	**14.2**	**49,459**

Forecasts

	1999 £m	% Change in 2000 Volume	% Change in 2000 Value	2000 £m	% Change in 2001 Volume	% Change in 2001 Value	2001 £m
Capital Goods	4,446	8.8	11.6	4,961	8.3	9.9	5,451
Consumer Goods	7,254	9.8	12.6	8,168	9.3	10.9	9,058
Intermediate Goods:							
Agriculture	506	1.5	1.5	514	1.0	1.0	519
Other	20,456	9.3	11.4	22,795	8.8	9.8	25,038
Other Goods	1,668	4.0	4.7	1,747	3.5	4.2	1,821
Total Visible	**34,331**	**8.9**	**11.2**	**38,186**	**8.4**	**9.7**	**41,886**
Adjustments	-630	9.3	9.3	-689	8.9	8.9	-750
Merchandise Imports	**33,701**	**8.9**	**11.3**	**37,497**	**8.4**	**9.7**	**41,136**
Tourism	1,883	11.8	14.0	2,146	11.3	13.5	2,435
Other Services	13,875	13.8	15.7	16,059	13.3	15.2	18,505
Imports of Goods and Services	**49,459**	**10.4**	**12.6**	**55,702**	**9.9**	**12.6**	**62,077**

Balance of Payments

On the basis of our revised estimates of export and import values, and official balance of payments statistics for the first three quarters of 1999, it now seems likely that the visible trade surplus increased in 1999 to £18,070 million. The deficit on trade in services is also estimated to have increased sharply, so that the rise in the surplus of trade in goods and services is estimated to have been just over 25 per cent.

It is estimated that profit outflows increased by 22 per cent in 1999, while reinvested earnings rose by 18 per cent. National debt interest continues its decline, but other debit flows increased strongly. Credit flows also increased sharply, so that the net factor outflow is estimated to have risen by 19¾ per cent. Net current transfers are estimated to have fallen marginally and the overall surplus on the current account is estimated at £832 million. When capital transfers are taken into account, the effective current balance in 1999 is estimated at £1,432 million.

Our trade forecasts for 2000 and 2001 indicate that the visible and merchandise trade surpluses will rise further, although the projected rate of increase will slow.

TABLE 7: Balance of Payments

	1998 £m	Change %	1999 £m	Change %	2000 £m	Change %	2001 £m
Visible Trade Balance	13,939	29.6	18,070	20.5	21,770	17.1	25,494
Adjustments	930		1,043		1,157		1,279
Merchandise Trade Balance	**14,869**	**28.5**	**19,113**	**20.0**	**22,927**	**16.8**	**26,773**
Service Trade Balance	-7,890	31.6	-10,383	17.9	-12,244	17.4	-14,372
Trade Balance in Goods and Services	**6,979**	**25.1**	**8,729**	**22.4**	**10,683**	**16.1**	**12,401**
Factor Flows:							
Debit Flows:							
Remuneration of Employees	-51	0.0	-51	0.0	-51	0.0	-51
Distributed Profits, etc.	-7,506	22.0	-9,157	19.0	-10,897	17.0	-12,750
Reinvested Earnings	-1,790	18.0	-2,112	17.0	-2,471	17.0	-2,891
National Debt Interest	-651	-12.0	-573	-9.0	-521	-9.0	-474
Other Debit Flows	-4,489	25.0	-5,611	20.0	-6,734	17.0	-7,878
Total Debit Flows	**-14,487**	**20.8**	**-17,505**	**18.1**	**-20,674**	**16.3**	**-24,045**
Credit Flows:							
Remuneration of Employees	216	0.0	216	0.0	216	0.0	216
Direct Investment Income	806	16.3	937	16.0	1,087	16.0	1,261
Other Credit Flows	6,010	23.5	7,422	18.3	8,777	18.3	10,379
Total Credit Flows	**7,032**	**21.9**	**8,575**	**17.5**	**10,080**	**17.6**	**11,856**
Net Factor Flows	**-7,455**	**19.8**	**-8,929**	**18.6**	**-10,594**	**15.1**	**-12,189**
Net Current Transfers	1,039	-0.7	1,032	-0.5	1,027	-10.5	919
Balance on Current Account	**563**		**832**		**1,116**	**-**	**1,131**
Capital Transfers	661	-9.2	600	-8.3	550	-9.1	500
Effective Current Balance	**1,224**		**1,432**		**1,666**		**1,631**

Profit outflows are expected to increase substantially, but capacity constraints are likely to result in some slowing in the rate of growth. National debt interest paid overseas should continue its long-run decline and, assuming similar rates of increase in other debit and credit flows, net factor outflows are forecast to rise by 18.6 per cent this year and by 15.1 per cent in 2001. These assumptions result in the effective balance on the current account increasing to £1,666 million this year before declining slightly to £1,631 million in 2001.

As outlined in the August 1999 *Commentary* the balance on the current account is no longer as important an indicator as previously now that Ireland is a member of EMU. The size of the surplus does indicate, however, that nationally the level of savings is increasing. As is evidenced by our assumptions of a broadly unchanged personal savings ratio, the improving current account balance reflects a high level of saving by the public sector. Strong growth in the public finances means that this seems set to continue.

Gross National Product

Real GNP rose by an estimated 7.5 per cent in 1999, fractionally higher than our forecast in the December 1999 *Commentary* and not far short of the increase of 8.1 per cent the previous year. The CSO *Quarterly National Accounts* show a rise of 7 per cent in real GNP in the first half of 1999, and our forecast of 7.5 per cent for the year as a whole is in line with this – given the indications that economic activity was higher in the second half of the year.

While there was a small reduction in net current transfers, this was more than offset by improved terms of trade. Accordingly, the estimated rise in real Gross National Disposable Income (GNDI) in 1999, at almost 8 per cent, was greater than the rise in real GNP. The change in GNDI per head of population provides the most comprehensive measure of the overall average rise in living standards. It is worth noting that, according to this measure, living standards in Ireland have risen by almost one-third over the four-year period 1995-1999 – an extraordinary achievement by any standards.

For the years 2000 and 2001, the projected growth rates of real GNP are 5.9 per cent and 4.9 per cent, respectively. In both of these years, as in 1999, a large increase in the outflow of net factor income, associated with the high levels of profitability, will considerably reduce the impact of GDP growth on the growth of GNP, but the impact on living standards will be partly offset by continuing improvement in the terms of trade. Accordingly, the projected rise in real GNDI is 6.4 per cent in 2000 and 5.3 in 2001.

Agriculture

The CSO preliminary estimate of agricultural output for 1999 indicated a fall of 1 per cent in the volume of gross agricultural output. Even though farmers cut back heavily on fertiliser inputs, the total volume of inputs of materials and services fell only slightly: this was because large amounts of feeding stuffs had to be purchased in the early months of 1999 to compensate for the poor harvest of the previous year. Accordingly, there was a fall in 1999 of 1¾ per cent in the volume of gross agricultural product, which represents the difference between gross output and inputs of materials and services. Consequently, even allowing for increased output in forestry and fishing, the volume of GDP in the broad agricultural sector fell by 1¼ per cent.

For the years 2000 and 2001, a rise in volume of GDP in the broad agricultural sector of a little over 1 per cent each year is forecast, assuming "average" weather conditions and no new agricultural crises.

Industry

The growth in the volume of manufacturing output in the first half of 1999 slowed to slightly less than half of the rapid rate of 16.7 per cent achieved in 1998. With the pick-up in the growth of manufactured exports in the second half of the year, however, and the general buoyancy of the domestic economy, the annual increase in the volume of manufacturing output in 1999 is estimated at 9½ per cent. Output in building and construction continued to rise strongly, and the growth in the volume of GDP in the broad industrial sector is estimated at 10 per cent in 1999. The price of manufacturing output was beginning to rise rapidly towards the end of the year, and in December 1999 was over 5 per cent higher than a year earlier.

Some slowing down in the rate of expansion in building and construction is expected during 2000, and this together with a slight deceleration in the rate of growth of manufacturing is projected to reduce the volume growth of GDP in the broad industrial sector in the year 2000 to 8½ per cent. The output price is projected to be at least 3½ per cent higher on average than in 1999.

With labour scarcity likely to be a constraining factor in 2001, we expect a further deceleration in the growth of output in both manufacturing and building, with an average volume rise of less than 7 per cent in the broad industrial sector. The rate of increase in output prices is expected to accelerate a little further in 2001 – to 4 per cent for manufacturing and 6 per cent for building.

Services

With an average employment growth of over 7 per cent in 1999, we estimate the growth in the volume of GDP in services for the year at 7½ per cent.

This rapid growth in services output cannot be sustained, however, in the face of a tightening labour market and a slower growth of final demand next year. We forecast that the rate of growth in GDP volume in services will taper down to 5½ in 2000 and to 4½ per cent in 2001.

Employment

Since publication of the December *Commentary,* the *Quarterly National Household Survey* results for the third and fourth quarters of 1999 have become available. They show a further acceleration in the second half of the year in the already rapid growth of employment in 1999. For the year as a whole, the average annual rise in total employment was 95,000, or 6¼ per cent. The vast bulk of the increase was in full-time employment, which in fact grew slightly faster than part-time employment. Female employment in the second half of the year continued to grow more rapidly than male, and for the year as a whole rose by 7.9 per cent, as against 5.2 per cent for males. While overall average hours worked per week fell in 1999 to 38.3 from 38.8 the previous year (a decline of 1.4 per cent), the fall was heavily concentrated among the self-employed and was much less in the case of employees.

TABLE 8: Employment and Unemployment*

	A: March-May Estimates ’000				
	1998	**1999**	**2000**	**2001**	**2002**
Agriculture	135	136	133	130	127
Industry	429	451	468	479	489
Services	931	1,004	1,053	1,088	1,118
Total at Work	**1,495**	**1,591**	**1,654**	**1,697**	**1,734**
Unemployed	127	97	83	78	77
Labour Force	**1,622**	**1,688**	**1,737**	**1,775**	**1,811**
Unemployment Rate %	7.8	5.7	4.8	4.4	4.3
Live Register	231	197	166	158	155

	B: Annual Averages ’000			
	1998	**1999**	**2000**	**2001**
Agriculture	135	137	134	131
Industry	436	458	473	484
Services	950	1,017	1,061	1,095
Total at Work	**1,521**	**1,612**	**1,668**	**1,710**
Unemployed	125	95	83	78
Labour Force	**1,646**	**1,707**	**1,751**	**1,788**
Unemployment Rate %	7.6	5.6	4.7	4.4
Live Register	227	193	165	160

*All data (including the unemployment rate) are based on ILO definitions, except for the Live Register.

Among the sectors, services continued to lead the way with the fastest growth of employment. On average, services employment rose by 7.1 per cent in 1999 and accounted for 68,000 of the total rise of 95,000. The most rapidly growing sub-sector of services was finance and business services, where employment in 1999 rose by 12¾ per cent – shared about equally between males and females. Employment growth in manufacturing was sluggish at an average rate of 2¼ per cent, although the rate picked up consistently during the year from 1¾ per cent in the first quarter to 2¾ per cent in the fourth quarter. The main impetus to the growth of industrial employment came from building and construction, where there was an average annual rise of almost 13 per cent.

The labour force in 1999 grew at an annual average rate of 4 per cent – a rate which we do not regard as sustainable unless net immigration were to rise substantially above the level of 18,500 in the year to April 1999.

Accordingly, we anticipate a deceleration in the rate of growth of the labour force and employment over the next two years. We project that the growth in the labour force, which was 4.1 per cent in the year to March-May 1999, will fall to 2.9 per cent in the year to March-May 2000, to 2.2 per cent in the year to March-May 2001 and to 2.0 per cent in the year to March-May 2002. The growth of total employment, on an annual average basis, is projected at 3½ per cent in 2000 and at 2½ per cent in 2001. Services employment is expected to continue as the spearhead of overall employment growth, accounting for about four-fifths of the total increase in both years.

Unemployment fell substantially in 1999, whether measured on the ILO or Live Register basis. By February 2000, the official, seasonally-corrected, standardised unemployment rate was down to 4.9 per cent, and we expect the rate to go on falling, but at a slower pace. As already projected in the last *Commentary*, it is virtually certain that the official unemployment rate will average less than 5 per cent in 2000, and is likely to dip below 4.5 per cent for 2001 as a whole. By March-May 2002, we project an unemployment rate of about 4¼ per cent.

Incomes

In addition to the fact that there was a fall of 1¾ per cent in the volume of gross agricultural product, farmers' incomes in 1999 were depressed by two other significant factors. First, prices were low: on average, the implied market price of gross agricultural product was nearly 4 per cent less than in 1998. Second, subsidies were down by over £100 million because of advance payments in 1998 that would normally be made in 1999. The result was a massive fall in farmers' incomes, estimated by the CSO at over 12 per cent. Allowing for a marginal increase in agricultural wages and salaries, and a modest increase in incomes in forestry and fishing, we estimate incomes in the broad agricultural sector in 1999 fell by about 9½ per cent.

In the year 2000, it is expected that the decline in agricultural incomes will be reversed, since the adverse factors affecting 1999 will no longer be operative. The volume of gross agriculture product is projected to rise slightly; the overall output price will improve somewhat; there will be less need for the exceptionally large inputs of feeding stuffs required in the two previous years; and subsidies will not only be back to normal, but will be augmented by the first payment under the EU *Agenda 2000* package agreed in Berlin last year. The rise in farmers' incomes in 2000 is therefore projected at 14½ per cent. Even this large increase, however, will still leave farmers' incomes slightly below the 1998 level. When account is taken of agricultural wages and salaries and of forestry and fishing, the increase in incomes in the broad agricultural sector in 2000 will be somewhat lower, at nearly 12 per cent.

The recovery in farmers' incomes is not expected to be maintained in 2001. At best, increased subsidies will do no more than compensate for renewed downward pressure on output prices, while input prices will continue to rise, probably at an accelerated rate. Consequently, for 2001, we project a drop of 2½ per cent in farmers' incomes and of 1¼ per cent in the broad agricultural sector.

TABLE 9: Personal Disposable Income

Estimates

	1998 £m	Change %	£m	1999 £m
Agriculture, etc.	2,301	-9.4	-216	2,085
Non-Agricultural Wages,	24,542	12.5	3,072	27,614
Other Non-Agricultural Income	9,341	17.6	1,645	10,986
Total Income Received	**36,184**	**12.4**	**4,501**	**40,685**
Current Transfers	6,905	7.0	483	7,388
Gross Personal Income	**43,089**	**11.6**	**4,984**	**48,073**
Direct Personal Taxes	8,378	8.6	717	9,095
Personal Disposable Income	**34,711**	**12.3**	**4,267**	**38,978**
Consumption	30,689	13.4	4,110	34,799
Personal Savings	4,022	3.9	158	4,179
Savings Ratio	11.6			10.7

Forecasts

	1999 £m	Change %	£m	2000 £m	Change %	£m	2001 £m
Agriculture, etc.	2,085	11.9	248	2,333	-1.2	-29	2,304
Non-Agricultural Wages,	27,614	10.8	2,971	30,585	9.6	2,944	33,529
Other Non-Agricultural Income	10,986	13.2	1,450	12,436	15.1	1,876	14,313
Total Income Received	**40,685**	**11.5**	**4,669**	**45,355**	**10.6**	**4,791**	**50,145**
Current Transfers	7,388	7.2	530	7,918	6.0	477	8,395
Gross Personal Income	**48,073**	**10.8**	**5,199**	**53,273**	**9.9**	**5,268**	**58,540**
Direct Personal Taxes	9,095	6.8	618	9,713	9.2	897	10,610
Personal Disposable Income	**38,978**	**11.8**	**4,581**	**43,560**	**10.0**	**4,371**	**47,930**
Consumption	34,799	11.6	4,024	38,822	9.7	3,774	42,596
Personal Savings	4,179	13.3	558	4,737	12.6	597	5,334
Savings Ratio	10.7			10.9			11.1

The remarkable increase in employment last year of 6.2 per cent, when combined with a rise in average earnings, also of around 6 per cent, resulted in an estimated increase in the non-agricultural wage bill of over 12.5 per cent. The rise in average earnings is slightly higher than the rise in wage rates received by individual workers because of the changing skill composition of the work force. This factor has had a continuing impact on average earnings over the course of the 1990s.[3]

In 2000 and 2001 we expect a slightly higher increase in average earnings of around 6.5 per cent a year. This builds in the assumption that the *Programme for Prosperity and Fairness* is accepted by all parties. When taken together with the forecast rise in employment this year of 3.5 per cent, it gives a forecast increase in the wage bill of around 10.8 per cent. For next year, with the rate of increase in employment expected to slow further to 2.5 per cent, the wage bill is forecast to grow by around 9.6 per cent.

[3] See J.J. Sexton, B. Nolan and B. McCormick, (1999). "A Review of Earnings Trends in the Irish Economy since 1987" in *Quarterly Economic Commentary,* December.

Since our last *Commentary*, we have revised upwards our forecast for the rate of inflation in the GDP deflator. This reflects expectations of higher inflation in consumer prices, but also the expected effect of the recent rise in the dollar on trade prices. For many firms in the tradable sector this is likely to be reflected, at least initially, in an increase in margins and in profitability. For US multinationals operating in Ireland, who effectively price in dollars on the export market, the increased value of the dollar will enhance profitability measured in Irish pound terms. Because of the timing of the change in the dollar-euro rate the repatriation of some of these profits may be delayed until 2001. In certain non-tradable sectors of the economy, most notably the building industry, excess demand has resulted in a major expansion of margins and, as a result, in profitability. Until there is a sign of an easing in demand pressures in these sectors, margins can be expected to increase further.

While the enhanced profitability this year and next will add to the demand for labour, increasing upward pressures on wage rates, it will take some time before current profit margins are eroded. Even with a substantial rise in retained profits, as shown in Table 9, "Other Non-Agricultural Income" can be expected to rise rapidly this year and next. A further factor pushing up the rate of increase in this item is the rapid increase in the item "imputed rent". This is an allowance in the national accounts for the increased value of owner-occupied housing. A similar adjustment is made to total consumption – the effect of this aggregate is to raise the rate of increase in both the income and the expenditure sides of the accounts.

Because of the forecast continuing fall in unemployment there will be an easing in pressures on transfers to the private sector from the government. When combined with the moderate increase in welfare benefits incorporated in the budget, it gives rise to a forecast in Table 9 of an increase in current transfers of around 7.2 per cent in 2000.

The marked reduction in personal taxation provided for in the budgets for 2000 and 2001 should reduce the share of personal taxation in personal income from around 19.4 per cent in 1998, to 18.9 per cent in 1999, and to around 18.2 per cent this year. For 2001, we are assuming that tax rates and bands are indexed to the rise in earnings, so that the average rate of personal taxation will remain broadly unchanged. As a result of these varying assumptions, personal disposable income in 1999 is forecast to have grown by 12.1 per cent, with increases of 12.0 per cent and 10.2 per cent forecast for 2000 and 2001 respectively.

The "feel good factor" has boosted the level of consumer confidence. The impact of this on the demand for housing has already been discussed. In the case of personal consumption, the impact of the enhanced confidence is that consumers are encouraged to bring forward future consumption through increased borrowing. The result was the estimated fall in the personal savings ratio in 1999 of almost 0.4 percentage points from 11.6 per cent in 1998 to 11.2 per cent. Little change is forecast for the savings ratio this year and next.

Consumer Prices

As estimated in the December *Commentary* consumer price inflation averaged 1.6 per cent in 1999. The low rate of inflation reflects a fall of 7.8 per cent in the housing index, while the remainder of the index rose by 4.2

per cent. The EU Harmonised Index of Consumer Prices in the twelve months to December 1999 rose by 3.9 per cent in Ireland. This compares with a provisional average of 1.7 per cent for the whole EU.

The consumer price index is one of the most widely quoted measures of inflation in the economy. A number of other measures can also be calculated which include the implicit prices of personal consumption, gross domestic expenditure and gross national product. Probably the most comprehensive indicator of domestic prices is the gross domestic expenditure price (GDE). This deflator is a composite of the changes in the prices of total consumption, government and private, and investment. One of the main reasons for the divergence between the CPI and other measures is the treatment of housing. The consumer price index measures the change in mortgage costs actually incurred by house owners to occupy the house, by tracking the cost of a fixed basket of mortgages of varying duration (i.e. lower older ones are covered as well as current high mortgages). By including changes in rent (actual and imputed) and the cost of investment in new housing, gross domestic expenditure is a broader measure capturing the current impact of increasing house prices. For the 1990s, the GDE price manifests much higher inflation than the CPI. The divergence is particularly pronounced over the period 1995-2000 when the GDE deflator increased at an annual average rate over twice the rate for the CPI.

A sharp rise in the annual inflation rate in recent months has given rise to some concern about inflation in the Irish economy. A rise in euro interest rates over the next two years will bring about an increase in the housing component of the CPI. However, offsetting this, a number of factors that contributed to the recent large increase are expected to unwind over the course of this year. Part of the rise has resulted from an increase in tobacco excise while oil prices resulted in increased energy costs. On the assumption that oil prices come down somewhat from their current high levels it seems likely that the annual increase in consumer price inflation should average about 4 per cent this year.

While the strength of domestic demand will serve to keep price inflation in services and related expenditure increasing quite strongly, at present it seems unlikely that any of the other components of the CPI will record substantial price rises in 2001. On this basis we assume an annual average for the CPI in 2001 of 2.7 per cent.

TABLE 10: Consumer Price Index – Recent Trend and Forecast

	Quarterly Trend								Annual			
	1998				1999				1998	1999	2000	2001
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4				
Index Nov. 1996=100												
Housing	102.1	103.2	104.5	100.8	93.6	92.2	93.1	86.7	102.6	91.5	92.2	92.8
Other	101.8	103.2	103.6	104.0	104.3	105.8	106.3	107.5	103.2	105.9	110.0	112.5
Total CPI	101.8	103.2	103.7	103.7	103.4	104.7	105.2	105.9	103.1	104.7	108.9	111.9
Annual % Change												
Housing	2.3	0.7	3.7	-1.2	-8.3	-10.7	-10.9	-14.0	1.3	-10.8	0.7	0.7
Other	1.7	2.9	3.2	2.4	2.5	2.5	2.6	3.4	2.6	2.6	3.9	2.3
Total CPI	1.7	2.7	3.2	2.1	1.6	1.5	1.4	2.1	2.4	1.6	4.0	2.7
Quarterly % Change												
Housing	0.1	1.1	1.3	-3.5	-7.1	-1.5	1.0	-6.9				
Other	0.2	1.4	0.4	0.4	0.3	1.4	0.5	1.1				
Total CPI	0.2	1.4	0.5	0.0	-0.3	1.3	0.5	0.7				

Public Finances

Even before the Budget last autumn it was clear that strong growth in the economy meant that the buoyancy in government revenue would continue into this year. However, since our last *Commentary* in December, we have revised upwards our estimate of the rate of inflation in GDP and its components. The effect of this is a higher forecast growth in the value of GDP in 2000 and a forecast of continuing high nominal growth rates into 2001. The tax system is quite sensitive to such factors and, as a result, we anticipate that revenue for this year will significantly overshoot the forecasts made at the time of the Budget.

In the case of expenditure there will also be pressures arising from the higher than anticipated rate of inflation. While some of this effect from increased inflation is already factored in through the provisions we made in our forecasts for increases in public sector pay, the pressures on government investment expenditure will be considerable. However, we have assumed that for 2000 the expenditure limits provided for in the *Public Capital Programme* will be adhered to. The rapid fall in the numbers unemployed combined with the increases in welfare rates provided for in the budget should see a moderate increase in transfer payments this year.

For 2001 we have assumed that personal tax rates and bands, as well as social welfare rates, are indexed to the forecast increase in wage rates.

The volume of current expenditure is forecast to grow at roughly the same rate as this year, and the provisions of the *National Development Plan* are expected to be fully implemented in government capital expenditure.

We now anticipate that when all the effects of privatisations and special funds are excluded that the exchequer surplus will increase by around a percentage point of GNP both this year and next. This will allow a more rapid run-down in government debt than expected, with some additional savings in debt interest next year.

If the *National Development Plan* programmes for investment are to be realised the cost may be higher than planned. This is particularly the case in building and construction investment. The need by the state to pre-empt additional building resources to carry out its own plans, at a time when the industry is operating at capacity may prove expensive. The further stimulus from the budget enhances this problem.

General Assessment

In the forecasts set out in this *Commentary* we envisage a gradual slow-down in the rate of economic growth over the next two years. This deceleration is expected to occur in spite of the recovery under way in the broader EU economy. While in the past such a recovery would have led to accelerated growth in Ireland, because of the supply constraints that we now face, the economy, while still growing much faster than the rest of the EU, will show a rather different pattern. The very competitiveness of the economy means domestic firms face buoyant orders and foreign firms continue to see Ireland as an attractive location from which to serve the growing EU market. The problem will be shortage of capacity.

While the Irish economy in the mid-1990s had a very big potential for growth in the supply of labour, especially skilled labour, the exceptional increase in employment over the last 5 years has nearly exhausted this "reserve". With the effects of the decline in the birth rate in the 1980s expected to start biting in the next few years, and given the already high participation rate for women with good qualifications, the potential growth in the labour supply in 2000 and 2001 is much more limited.

In recent years immigration has been a very important source of skilled labour, with many Irish emigrants returning. This inflow is unlikely to rise in the next two years and will probably fall as the stock of younger Irish emigrants abroad declines. In the last four years the returning emigrants have been augmented by an inflow of skilled workers who are not Irish citizens. On average, they have been even more skilled than the returning emigrants[4] and they have added further to the growth potential of the economy. However, the pressure of returning emigrants and new immigrants has added significantly to the demand for housing. In the *Medium-Term Review* it was estimated that housing the inflow of workers required around 6,000 dwellings a year and, by adding to the already high level of demand, this has had a very significant impact on house prices.

While in this *Commentary* we are assuming that there will continue to be an influx of returning emigrants and skilled non-Irish immigrants, we expect that their numbers will fall this year and next, due to the high cost

[4] Barrett, A., and F. Trace, 1998, "Who is Coming Back? The Educational Profile of Returning Migrants in the 1990s", *Irish Banking Review*, Summer.

of living, especially housing. Until the current infrastructural constraints (especially in housing) are dealt with, it seems unlikely that returning emigration and immigration will continue at previous levels. If it were to do so it would further aggravate the crisis in housing. Public policy must take this into account and a slow-down in economic growth would be preferable to mounting a major campaign to attract even more labour from outside of Ireland, be they returning emigrants or new arrivals.

The constraints on the supply of labour in the next few years, discussed in detail in the last *Medium-Term Review*, mean that the economy must slow down. However, the favourable external environment and the stimulation provided by the budget mean that the "accelerator" is still fully down. Under these circumstances the considerable inflationary pressures, especially in the labour market, are likely to continue, or even grow. Many firms are now reporting shortages, not just of skilled, but also of unskilled labour. Their continuing high profitability will mean that they may react by paying wage increases in excess of those provided in the draft *Programme for Prosperity and Fairness* (PPF) in an attempt to meet their needs. In turn, this will result in the closure of some firms in the tradable sector that cannot match these rises, releasing workers for the more profitable sectors. The indications are that these pressures will remain through to at least the end of 2001.

This process may prove painful where the new jobs are not becoming available in the same locations as the jobs that are being lost. Recent experience in Donegal exemplifies this problem.

The pick-up in the rate of inflation in consumer prices in the last month has given rise to concerns about the future. In the context of monetary union, some of these concerns are misplaced. However, when the broader developments in prices, in particular in asset prices, are taken into account there are genuine worries that should prompt a change in fiscal policy, the key instrument within monetary union for controlling regional inflationary pressures.

In Ireland, since the mid-1970s, policy-makers have understood that the rate of inflation of consumer goods is ultimately determined by external inflationary pressures and changes in the exchange rate. Under these circumstances, within monetary union, regional goods price inflation will tend to follow that of the union as a whole and the monetary authorities will not pay too much attention to regional variations. You will not hear of the US Federal Reserve worrying about the rate of inflation in Wyoming.

However, Ireland faces a more complex situation than many other members of the EMU because of the very heavy weighting of UK firms in its retail sector, and because of the importance of UK firms as suppliers of imports. The "inflationary surprise" of the last two years was not the rise in consumer prices in the last two months, but rather that the rate of consumer price inflation did not rise dramatically in early 1998 when sterling's value in Irish pound terms rose rapidly. The failure of inflation in the price of consumer goods to respond at the time reflected a change in behaviour of UK firms faced with the impending monetary union. There was apparently a shift to price setting in euros, rather than in sterling, so that the inflationary implications of bilateral changes in the sterling-Irish pound exchange rate were reduced compared to the past.

What we are seeing today in the acceleration in the rate of inflation in consumer prices is a combination of a number of factors: a very big increase in oil prices, the increase in tax on tobacco, and rapidly rising prices for private services. It is the latter factor – inflation in the price of private services, that is of concern. International competition has little direct impact on the price of sheltered services and domestic wage inflation is passed fully through to consumers. There is no doubt that Irish wage inflation is higher than in our EU neighbours, but that is not necessarily a cause for immediate concern. The tightening labour market is driving this increase, and, as discussed above, some loss of competitiveness is inevitable.

The concern about this trend is whether it will continue for a number of years, leading to such a loss of competitiveness that unemployment eventually rises. The rise in the price of domestic services will, in turn, feed back on wage rates and the competitiveness of the tradable sector. Under monetary union such an overshoot in wage rates could only be tackled through two possible channels: an actual reduction in nominal wage rates or a wage freeze for a number of years. The former would be both a painful and difficult process. In the case of the latter, while nominal wages could remain static for a period, with inflation effecting a reduction in real rates, this could take some time in a low inflation environment. Slow adjustment under such circumstances would have a high cost in terms of unnecessary unemployment.

The developments in inflation, including wage inflation, must be seen as part of a wider convergence process. Irish goods prices were brought broadly into line with goods prices elsewhere in the EU over the last 20 years. The completion of the internal market played an important role in this process. Wage rates, and consequently services' prices, faced less pressure to converge. However, as Irish living standards move towards the EU average, there will be a tendency for this to be reflected in the labour market and in services' prices. Even in the long term this process of price convergence will be much weaker than in the case of goods' prices, and policies to increase competition could significantly improve the end result.

Thus, countries that are experiencing convergence in living standards are likely to face higher inflation than countries that are already at the EU average. However, this difference in inflation rates should not necessarily cause concern as, when convergence is attained, the process driving the accelerated inflation will disappear. It is only if the price convergence is occurring so rapidly that an overshoot takes place that policy may need to be changed.

Where there is real cause for concern today about the sustainability of the current growth is in the inflation in asset prices – housing and other property. Its immediate impact is to add to labour cost pressures. However, it also has wider implications with the potential to cause real regional problems in any monetary union. This has happened in the past in the US. Here we should be concerned because of the danger that the rise in property prices could greatly overshoot its long-run equilibrium level and that there could be a sudden "bust" brought on by an external shock.

For the bulk of the population who are well housed, the rise in the cost of accommodation will not affect their standard of living. However, probably the households most adversely affected by rising inflation are those seeking accommodation today. They face rapidly escalating house prices and no feasible increase in incomes or tax cuts could compensate them for their loss. Instead the solution must lie in the broadly canvassed supply side measures.

The costs of accommodation would appear to be higher in our cities than in those of most of our European partners. In the long run the cost of building should be no greater in Ireland than elsewhere – we have more abundant supplies of land than around Amsterdam or Brussels. The problem is the absence of serviced sites and the labour shortage that has arisen due to the exceptional growth rates faced by the industry. If the problems of land availability are tackled urgently, over time the industry and the labour market will adjust, and the cost of new building should eventually be significantly lower than today. In the short term, the use of fiscal measures to take money out of the housing market would ease inflationary pressures.

The likelihood that current prices for dwellings are probably well above their long-run supply price, and that the inflation in prices is being driven by consumers' expectations about the future, means that any sudden shock to the economy and buyers' expectations could cause a serious, though temporary, recession. The fact that such an event seems far away now is not a reason for ignoring it. The "safe stopping" or braking distance of the economy can be quite long so that if the dangers posed by local asset price inflation are to be controlled, fiscal policy, the only instrument available to the government, should already have been tightened in the last few budgets. The economy may still get away with the stimulatory fiscal measures being adopted in successive budgets, but the possible dangers are certainly enhanced by the current stance of policy.

The wage increases provided under the draft PPF agreement seem reasonable and within the range that the economy can be expected to carry. In the absence of an agreement, market forces might well deliver similar increases, though the process of local bargaining could be more painful and wasteful of resources.

What could destabilise this process is the continuing very rapid increase in the demand for labour, encouraging an overshooting in wage rates beyond their long-term sustainable level. With demand picking up in the wider EU economy the stimulatory nature of domestic fiscal policy is increasing this danger. While tax cuts can affect labour supply, their immediate impact on demand is much greater, leading to enhanced inflationary pressures in the labour market.

Overall, our judgement is that the provisions in the *Programme for Prosperity and Fairness* on pay increases will not pose a serious medium-term danger to the economy. However, the commitment on cutting taxes and increasing expenditure, if invoked before the economy has slowed, could seriously endanger the medium-term prospects for stable economic growth. Instead as recommended in the *Medium-Term Review* published last October, further tax cuts should be postponed until the economy has begun to slow in 2002 or 2003.