

QUARTERLY
ECONOMIC
COMMENTARY

Spring 2010

ALAN BARRETT
IDE KEARNEY
JEAN GOGGIN
THOMAS CONEFREY



THE ECONOMIC AND SOCIAL RESEARCH INSTITUTE

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**ALAN BARRETT
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*The forecasts in this Commentary are based
on data available by early April 2010*

RESEARCH BULLETIN

10/1

EDITOR: TIM CALLAN

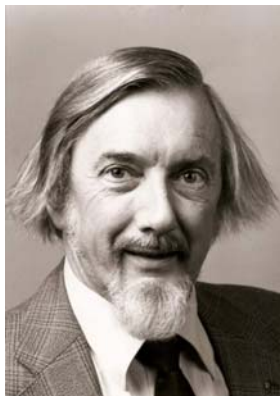
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Alan Barrett is a Research Professor, Ide Kearney is an Associate Research Professor and both are Editors of the *Commentary*, Jean Goggin and Thomas Conefrey are Research Assistants at the Economic and Social Research Institute (ESRI).

The *Commentary* and the *Research Bulletin* contained within have been accepted for publication by the Institute, which is not responsible for either the content or the views expressed. Draft completed 8 April 2010.

**This issue of the
Quarterly Economic Commentary
is dedicated to the late**



Terry Baker

Terry Baker, who died on 3 January 2010 after a short illness, was the founding editor of the *Quarterly Economic Commentary* and edited the *Commentary* from 1968 to 1973 and again from 1983 until 1999 when he retired from the ESRI. Terry was one of the “Three Wise Men” appointed by the government in 1981 as the “Committee on Costs and Competitiveness”. He and his colleagues Brendan Walsh and Dermot McAleese were the most respected independent experts on the Irish economy at that time.

For public and policymakers alike, Terry was the face of the ESRI for much of the dismal 1980s and the resurgent 1990s. In this role he set a standard in terms of the balance of his comments, the wisdom of his advice and the prescience of his conclusions that the Institute continues to try and uphold.

On his retirement, Terry delivered a seminar at the Institute in which he presented an overview of the Irish economy from the 1960s up until his retirement in 1999. This paper, entitled “The Irish Economy: Then, Now And Next”, was published in the *Quarterly Economic Commentary*, December 1999.

He is remembered with affection by all his former colleagues.

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SUMMARY TABLE

	2008	2009	2010(f) [*]	2011(f)
OUTPUT				
(Real Annual Growth %)				
Private Consumer Expenditure	-1.0	-7.2	-¾	1½
Public Net Current Expenditure	2.6	-1.2	-3	-2
Investment	-15.5	-29.7	-20¼	2½
Exports	-1.0	-2.3	2¼	4½
Imports	-2.1	-9.3	-1¼	3½
Gross Domestic Product (GDP)	-3.0	-7.1	-½	2½
Gross National Product (GNP)	-2.8	-11.3	0	2¾
GNP per capita (constant prices)	-4.6	-12.1	¼	2½
PRICES				
(Annual Growth %)				
Harmonised Index of Consumer Prices (HICP)	3.3	-1.7	-1½	½
Consumer Price Index (CPI)	4.1	-4.5	¼	1¾
Wage Growth	3.5	-2.0	-3	-1
LABOUR MARKET				
Employment Levels (ILO basis (000s))	2,100	1,929	1,856	1,857
Unemployment Levels (ILO basis (000s))	141	258	294	280
Unemployment Rate (as % of Labour Force)	6.3	11.8	13¾	13
PUBLIC FINANCE				
Exchequer Balance (€bn)	-12.7	-24.6	-20.2	-21.0
General Government Balance (€bn)	-13.3	-19.3	-19.3	-17.5
General Government Balance (% of GDP)	-7.3	-11.8	-12	-10¾
General Government Debt (% of GDP)	44.2	65.2	79¾	89½
EXTERNAL TRADE				
Balance of Payments Current Account (€bn)	-9.4	-4.9	0.7	2.0
Current Account (% of GNP)	-6.1	-3.7	½	1½
EXCHANGE AND INTEREST RATES (end of year)				
US\$/€ Exchange Rate	1.47	1.39	1.40	1.40
STG£/€ Exchange Rate	0.79	0.89	0.87	0.86
Main ECB Interest Rate	2.50	1.00	1.00	1.75

* In the tables and text we present percentages (rates of change or percentage shares) of historical data to one decimal point. For our forecasts such percentages are presented as fractions rounded-off to the nearest quarter. This is to emphasise the distinction between historical data and forecast numbers.

SUMMARY

For 2010, we expect GNP to be essentially unchanged from its 2009 volume; the corresponding figure for GDP is $-\frac{1}{2}$ per cent. Underlying these annual figures is a quarterly profile in which positive growth emerges during the year but not at a pace to return the annual figure to positive territory. For 2011, we expect GNP to grow by $\frac{2}{4}$ per cent and GDP to grow by $\frac{2}{2}$ per cent. While this return to growth is to be welcomed, it should be seen as a modest pace of growth.

We expect that the return to annual growth in 2011 will be led by exports, which we forecast to grow by $\frac{4}{2}$ per cent. This forecast is based in part on an expected acceleration in growth in the world economy in 2011. We also expect that Ireland will regain some of the competitiveness that was lost in the run up to the recession. Consumption is expected to fall by $\frac{3}{4}$ per cent in 2010 and then to grow again in 2011 at a rate of $\frac{1}{2}$ per cent. Investment is also expected to return to positive growth in 2011, with a growth rate of $\frac{2}{2}$ per cent forecast compared with an expected contraction of $\frac{2}{4}$ per cent in 2010.

We noted above that the forecast growth rate of $\frac{2}{2}$ per cent in 2011 should be seen as being modest. One manifestation of this is that employment is not expected to grow between 2010 and 2011. Instead, we expect the number employed to average close to 1.86 million in both 2010 and 2011. In spite of the stability in the numbers employed, we expect unemployment to fall between 2010 and 2011, averaging $13\frac{3}{4}$ per cent in 2010 and 13 per cent in 2011. This expected fall in the rate of unemployment is related to expected migratory outflows – 60,000 in the year ending April 2010 and 40,000 in the year ending April 2011. We also expect to see on-going falls in labour force participation and this issue is discussed in some detail in a box on participation.

We assume that the Government will implement its indicated budgetary package for 2011 where spending cuts and tax increases will amount to €3 billion. When combined with a return to modest growth and the consequent impact on revenues, we expect to see the General Government Deficit falling to $10\frac{3}{4}$ per cent of GDP in 2011, down from 12 per cent in 2010.

In our *General Assessment*, we refer back to a paper published by Institute researchers in May 2009¹ in which growth rates averaging around 5 per cent were shown to be possible in the period 2011 to 2015. It is still our view that such growth rates are attainable in the coming years. However, obstacles are still present which will see growth falling short of this in 2011. These obstacles include the on-going difficulties in the banking system which make it difficult to be optimistic about the capacity of the banking system to play an early role in facilitating the return to strong growth. In the context of banking, we note that the recapitalisation needs of the Irish banks are now likely to be at least €33 billion assuming that the State investment in Anglo Irish Bank ultimately amounts to €22 billion. We make two points in this context. First, while this will be a large addition to the national debt it is manageable and in no way threatens the solvency of the State. Second, the situation should never have arisen whereby the Irish taxpayer is faced with such a financial burden due to the behaviour of the private sector.

¹ Bergin *et al.*, 2009. *Recovery Scenarios for Ireland*, ESRI Research Series No. 7, Dublin: The Economic and Social Research Institute.

NATIONAL ACCOUNTS 2009 (Estimate)

A: Expenditure on Gross National Product

	2008 €bn	2009 Estimate €bn	Change in 2009				
			€bn		%		
			Value	Volume	Value	Price	Volume
Private Consumer Expenditure	93.9	84.2	-9.7	-6.7	-10.3	-3.4	-7.2
Public Net Current Expenditure	28.9	28.2	-0.7	-0.4	-2.4	-1.2	-1.2
Gross Fixed Capital Formation	39.5	25.5	-14.0	-11.7	-35.4	-8.1	-29.7
Exports of Goods and Services (X)	151.9	148.5	-3.4	-3.5	-2.3	0.0	-2.3
Physical Changes in Stocks	0.3	-2.8	-3.1	-3.3			
Final Demand	314.5	283.5	-31.0	-26.0	-9.8	-1.7	-8.3
less:							
Imports of Goods and Services (M)	133.0	120.3	-12.7	-12.3	-9.6	-0.3	-9.3
less:							
Statistical Discrepancy	-0.4	0.3	0.7	-0.8			
GDP at Market Prices	181.8	162.9	-18.9	-12.9	-10.4	-3.6	-7.1
less:							
Net Factor Payments (F)	-27.2	-32.1	-4.9	-4.7	18.0	0.7	17.2
GNP at Market Prices	154.6	130.8	-23.8	-17.5	-15.4	-4.6	-11.3

B: Gross National Product by Origin

	2008 €bn	2009 Estimate €bn	Change in 2009	
			€bn	%
Agriculture, Forestry, Fishing	2.9	2.2	-0.7	-25.0
Non-Agricultural: Wages, etc.	78.9	71.4	-7.5	-9.5
Other:	63.1	57.0	-6.1	-9.6
Adjustments: Stock Appreciation	-0.2	-0.2		
Statistical Discrepancy	-0.4	0.3		
Net Domestic Product	144.4	130.7	-13.6	-9.4
less:				
Net Factor Payments	-27.2	-32.1	-4.9	18.0
National Income	117.1	98.6	-18.5	-15.8
Depreciation	17.4	16.1	-1.4	-7.9
GNP at Factor Cost	134.6	114.7	-19.9	-14.8
Taxes less Subsidies	20.0	16.1	-3.9	-19.7
GNP at Market Prices	154.6	130.8	-23.8	-15.4

C: Balance of Payments on Current Account

	2008 €bn	2009 Estimate €bn	Change in 2009	
			€bn	%
Exports (X) less Imports (M)	19	28	9	
Net Factor Payments (F)	-27.2	-32.1	-4.9	
Net Transfers	-1.1	-0.9	0.2	
Balance on Current Account	-9.4	-4.9	4.6	
as % of GNP	-6.1	-3.7	2.4	

D: GNDI and Terms of Trade

	2008 €bn	2009 Estimate €bn	2009 Volume Change	
			€bn	%
Terms of Trade Loss or Gain		0.6		
GNP Adjusted for Terms of Trade	154.6	137.7	-16.9	-11.0
GNDI*	153.5	136.7	-16.7	-10.9
National Resources**	153.5	136.8	-16.8	-10.9

* GNDI is GDP adjusted for terms of trade and net international transfers.

** GNDI including capital transfers.

FORECAST NATIONAL ACCOUNTS 2010

A: Expenditure on Gross National Product

	2009 Estimate €bn	2010 Forecast €bn	Change in 2010				
			€bn		%		
			Value	Volume	Value	Price	Volume
Private Consumer Expenditure	84.2	82.5	-1.7	-0.7	-2	-1 ¼	- ¾
Public Net Current Expenditure	28.2	25.1	-3.1	-0.8	-11	-8 ¼	-3
Gross Fixed Capital Formation	25.5	19.8	-5.7	-5.2	-22 ¼	-2 ½	-20 ¼
Exports of Goods and Services (X)	148.5	151.3	2.9	3.2	2	- ¼	2 ¼
Physical Changes in Stocks	-2.8	-0.1	2.7	2.2			
Final Demand	283.5	278.5	-4.9	-2.1	-1 ¾	-1	- ¾
less:	0.0	0.0	0.0	0.0			
Imports of Goods and Services (M)	120.3	118.3	-2.0	-1.5	-1 ¾	- ½	-1 ¼
less:							
Statistical Discrepancy	0.3	0.3	0.0	0.0			
GDP at Market Prices	162.9	159.9	-3.0	-0.6	-1 ¾	-1 ½	- ½
less:							
Net Factor Payments (F)	-32.1	-31.4	0.7	0.6	-2 ¼	- ½	-1 ¾
GNP at Market Prices	130.8	128.5	-2.2	-0.1	-1 ¾	-1 ¾	0

B: Gross National Product by Origin

	2009 Estimate €bn	2010 Forecast €bn	Change in 2010	
			€bn	%
Agriculture, Forestry, Fishing	2.2	2.3	0.1	5
Non-Agricultural: Wages, etc.	71.4	66.9	-4.6	-6 ½
Other:	57.0	58.9	1.9	3 ¼
Adjustments: Stock Appreciation	-0.2	-0.2		
Statistical Discrepancy	0.3	0.3		
Net Domestic Product	130.7	128.2	-2.5	-2
less:				
Net Factor Payments	-32.1	-31.4	0.7	-2 ¼
National Income	98.6	96.8	-1.8	-1 ¾
Depreciation	16.1	16.0	-0.1	- ¼
GNP at Factor Cost	114.7	112.8	-1.9	-1 ¾
Taxes less Subsidies	16.1	15.7	-0.4	-2 ¼
GNP at Market Prices	130.8	128.5	-2.2	-1 ¾

C: Balance of Payments on Current Account

	2009 Estimate €bn	2010 Forecast €bn	Change in 2010	
			€bn	%
Exports (X) less Imports (M)	28.2	33.0	4.9	
Net Factor Payments (F)	-32.1	-31.4	0.7	
Net Transfers	-0.9	-0.9	0.0	
Balance on Current Account	-4.9	0.7	5.6	
as % of GNP	-3.7	0.6	4.3	

D: GNDI and Terms of Trade

	2009 €bn	2010 Estimate €bn	2010 Volume Change	
			€bn	%
Terms of Trade Loss or Gain		0.3		
GNP Adjusted for Terms of Trade	130.8	131.0	0.2	¼
GNDI*	129.9	130.1	0.2	¼
National Resources**	129.9	130.1	0.2	¼

* GNDI is GDP adjusted for terms of trade and net international transfers.

** GNDI including capital transfers.

FORECAST NATIONAL ACCOUNTS 2011

A: Expenditure on Gross National Product

	2010 Forecast €bn	2011 Forecast €bn	Change in 2011				
			Value	€bn Volume	Value	% Price	Volume
Private Consumer Expenditure	82.5	84.5	2.1	1.2	2 ½	1	1 ½
Public Net Current Expenditure	25.1	24.1	-1.0	-0.5	-4	-2	-2
Gross Fixed Capital Formation	19.8	20.2	0.4	0.5	2	- ½	2 ½
Exports of Goods and Services (X)	151.3	159.3	8.0	6.7	5 ¼	¾	4 ½
Physical Changes in Stocks	-0.1	0.0	0.1	0.0	0	0	0
Final Demand	278.5	288.1	9.6	8.5	3 ½	½	3
less:							
Imports of Goods and Services (M)	118.3	123.7	5.4	4.2	4 ½	1	3 ½
less:							
Statistical Discrepancy	0.3	0.3	0.0	0.1			
GDP at Market Prices	159.9	164.1	4.2	4.2	2 ½	0	2 ½
less:							
Net Factor Payments (F)	-31.4	-32.7	-1.3	-0.6	4	2	2
GNP at Market Prices	128.5	131.4	2.9	3.5	2 ¼	- ½	2 ¾

B: Gross National Product by Origin

	2010 Forecast €bn	2011 Forecast €bn	Change in 2011	
			€bn	%
Agriculture, Forestry, Fishing	2.3	2.4	0.1	5
Non-Agricultural: Wages, etc.	66.9	66.2	-0.6	-1
Other:	58.9	62.4	3.4	5¾
Adjustments: Stock Appreciation	-0.2	-0.2	0.0	0
Statistical Discrepancy	0.3	0.3	0.0	0
Net Domestic Product	128.2	131.1	2.9	2¼
less:				
Net Factor Payments	-31.4	-32.7	-1.3	4
National Income	96.8	98.4	1.6	1¾
Depreciation	16.0	16.5	0.5	3
GNP at Factor Cost	112.8	114.9	2.1	1¾
Taxes less Subsidies	15.7	16.5	0.8	5
GNP at Market Prices	128.5	131.4	2.9	2¼

C: Balance of Payments on Current Account

	2010	2011	Change in 2011
	Estimate	Forecast	
	€bn	€bn	€bn
Exports (X) less Imports (M)	33.0	35.6	2.6
Net Factor Payments (F)	-31.4	-32.7	-1.3
Net Transfers	-0.9	-0.9	0.0
Balance on Current Account	0.7	2.0	1.3
as % of GNP			

D: GNDI and Terms of Trade

	2010	2011	2011 Volume Change	
	€bn	Estimate €bn	€bn	%
Terms of Trade Loss or Gain		-0.3		
GNP Adjusted for Terms of Trade	128.5	131.8	3.3	2½
GNDI*	127.6	130.9	3.3	2½
National Resources**	227.6	230.9	3.3	1½

* GNDI is GDP adjusted for terms of trade and net international transfers.

** GNDI including capital transfers.

THE INTERNATIONAL ECONOMY

Main Developments

The global economy emerged from recession in the second quarter of 2009 and recovered more strongly in the third and fourth quarters than previously anticipated, prompting a number of international forecasters to revise their growth projections upward. The UK's National Institute of Economic and Social Research (NIESR) now expects the world economy to expand by 3.6 per cent this year, followed by 3.9 per cent in 2011. However, the global recovery is proceeding at a different pace across the various regions, and this projected expansion in 2010 and 2011 reflects the current expectations of relatively vigorous activity in many of the emerging economies. By contrast, the recovery in most advanced economies is expected to be gradual, and this is reflected in the NIESR growth forecasts for OECD countries of 1.9 per cent and 2.3 per cent in 2010 and 2011 respectively.

Even among the advanced economies, a multi-speed recovery process appears to be under way. The US economy came out of recession in the third quarter of 2009 and grew at an annual rate of 5.6 per cent in the fourth quarter.² This was its strongest quarterly performance in the last six years, and while much of this impressive fourth quarter growth was fuelled by businesses easing the pace at which they reduced inventories, both consumer spending and spending on residential construction rose during this period. The US economy also appears to have made a positive start to 2010. Strong retail sales figures from January and February provided a further boost to recovery hopes, although the data from March showed a small month-on-month decline. Industrial output rose in February for the eighth consecutive month and was up by 1.7 per cent compared to February 2009. Overall, the US economy is expected to register growth of 2.4 per cent this year, and 2.6 per cent in 2011.

In contrast, the Euro Area recovery lost momentum in the final months of 2009 and quarter-on-quarter growth in Q4 was flat. A strong performance by France failed to offset contractions in Italy and Spain while German growth in the fourth quarter was also flat, with consumption, government spending and investment all falling. The latest indicators suggest that there has been little improvement in the early stages of 2010 and NIESR is forecasting growth of just 1.0 per cent this year, followed by growth of 1.7 per cent in 2011.

² This is the third and most recent estimate of fourth quarter US GDP.

The economic challenges facing the Euro Area are undoubtedly being compounded by the public finances situation in a number of member states and in particular by the on-going debt crisis in Greece. The magnitude of the Greek deficit combined with its existing national debt, estimated to be about 110 per cent of GDP, has resulted in widespread market concerns that have spilled over to a number of peripheral member states. After much debate, Euro Area leaders finally agreed on a rescue package at the end of March, consisting of a joint mechanism of coordinated bilateral loans from the other 15 member states as well as IMF assistance. According to this agreement, the rescue package will only be triggered in the event that Greece is unable to secure sufficient market financing. While the Greek government is still expected to execute its own fiscal consolidation programme in order to restore stability to its public finances, it is hoped that the announcement of a rescue package will ease the pressure on Greece in the international financial markets.

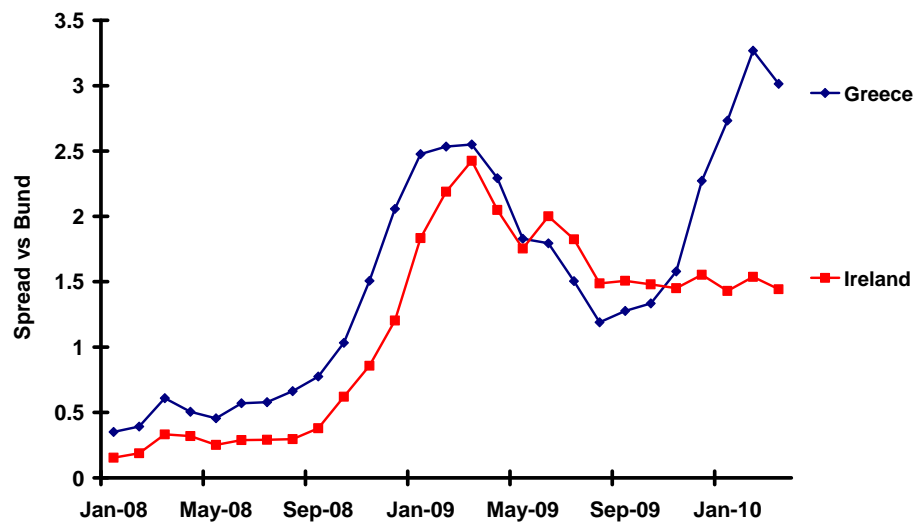
The UK has also experienced a slow start to its recovery, registering quarter-on-quarter growth of 0.4 per cent in the final three months of 2009. Domestic factors continue to act as a drag on growth, with ongoing weakness in consumption and investment apparent from the fourth quarter figures. In addition, figures from the Bank of England show that lending to private companies in February was 4.1 per cent lower than in February 2009, suggesting continued weakness in the supply of credit to businesses. Meanwhile, in spite of a weakened pound, the UK's trade deficit in January was at its widest since August 2008 as exports dropped sharply. NIESR remains optimistic, however, that strong world trade growth and the competitiveness gains from the depreciation of sterling will result in a sharp increase in export volumes in 2010 and 2011. Overall, the UK economy is expected to grow by 1.1 per cent in 2010 and by 2.0 per cent in 2011. As shown in Table 1, the UK is forecast to have the largest public deficit of the major economies in 2010 and with a general election looming next month, tackling this deficit will be one of the first major priorities of the new government.

As discussed in previous *Commentaries*, there are potential downside risks to these forecasts, particularly in Europe where the recovery appears to be considerably more fragile. Financial market conditions have undoubtedly improved, with signs of stabilisation in money markets and a rebound in equity markets. Nonetheless, there remains a concern that the outstanding impairments in financial systems and in housing markets, together with rising unemployment levels, may impede the recovery in household spending to a greater extent than currently expected. In addition, much of the rebound in global economic activity has been driven by the extraordinary policy stimuli and there are still few indications that autonomous private demand is taking hold in the advanced economies. One of the key risks is that a premature termination of supportive policies may undermine the recovery. On the other hand, concerns about rising public debt and medium-term fiscal sustainability in many advanced economies could potentially derail the recovery process by unsettling financial markets and increasing the cost of borrowing, thereby crowding

out private consumption and investment. Designing the appropriate exit strategies from the exceptional policy measures introduced during the economic crisis will be one of the main priorities for governments and policymakers over the coming year.

On a related note, the commitments to restoring fiscal discipline and to credible fiscal policy over the medium term are among the key factors that are likely to determine the pace of recovery in Euro Area countries. The Greek experience in the government bond markets over the last few months demonstrates clearly how a lack of credible fiscal strategy rapidly affects investor confidence. Figure 1 shows the yield spread between German ten-year government bonds and the Greek and Irish equivalents. Greek bond yields have fluctuated widely since the beginning of the year, and as concerns regarding the fiscal position escalated in late January, the spread on the Greek ten-year government bond yield over the German equivalent rose sharply to almost 400 basis points – its highest level since Greece joined the Euro Area in 2001. In contrast, the Irish bond spread vis-à-vis Germany narrowed significantly towards the end of 2009 in the wake of government actions aimed at stabilising the deficit and, although partly hit by a Greek spillover effect in February, the spread has remained relatively stable at under 150 basis points throughout the first three months of the year. However, the Greek experience should serve as a reminder to Ireland of the crucial importance of an ongoing commitment to fiscal sustainability.

Figure 1: Ten Year Government Bond Spreads, Jan 2008-March 2010



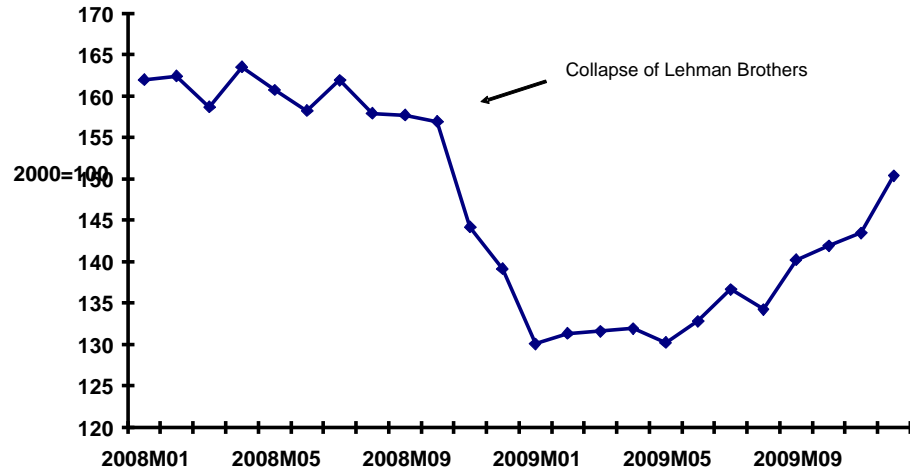
Implications for Ireland

EXPORTS

As mentioned in previous *Commentaries*, Irish exports proved to be relatively resilient during the recession and the magnitude of decline was much less severe than that experienced by many other advanced economies. This is discussed further in the *Exports* section and Figure 13 highlights the superior performance of Irish exports over the past year, relative to the performance of Euro Area exports. While Euro Area exports declined by

13.2 per cent in volume last year, Irish exports contracted by just 2.3 per cent. This relatively resilient performance is largely due to the composition of Irish exports and in particular the importance of pharmaceutical products and chemicals, which proved to be somewhat recession proof.

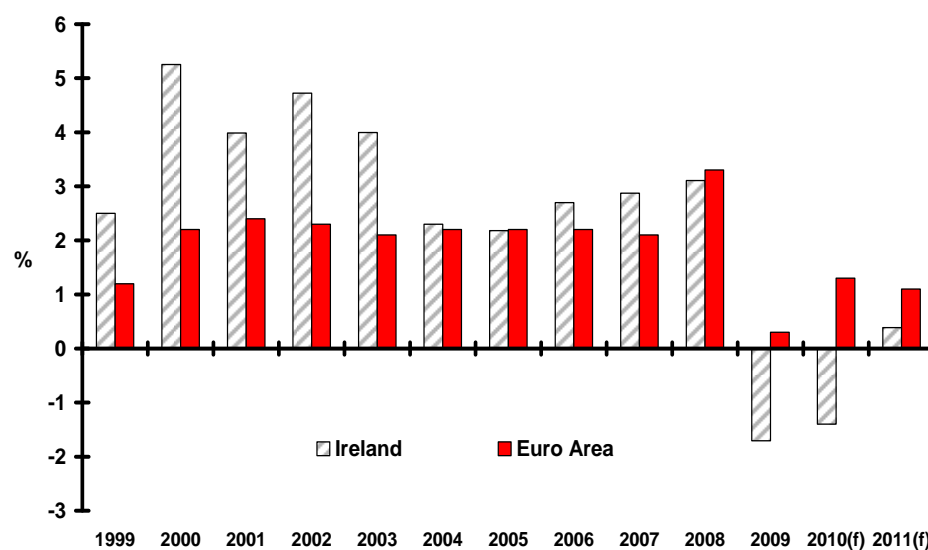
Figure 2: Index of World Trade, 2008-2009



Source: World Trade Monitor, Centraal Planbureau (The Netherlands).

Looking ahead, the outlook for Irish exports over the forecast horizon depends crucially on the international recovery and on the recovery in world trade, which collapsed dramatically towards the end of 2008. As shown in Figure 2, world merchandise trade has picked up significantly in recent months, and at the end of 2009 was almost back to its level prior to the Lehman Brothers collapse. Our future export performance also depends on the extent to which Ireland can regain competitiveness relative to other countries and on this issue it is difficult to know how much progress has been made thus far. We do know that there have been significant wage reductions in the public sector and although we do not yet have a clear picture of private sector wage developments for 2009, we have estimated that an economy-wide wage reduction of 2.0 per cent occurred last year. NIESR has estimated a 1.1 per cent increase in average earnings in the Euro Area in 2009 and its forecasts for 2010 and 2011 imply further increases of 2.3 per cent in each year. Combined with our own forecasts for further wage reductions this year and next, Ireland should expect to make some competitiveness gains in this area. In addition, Ireland experienced a significant reduction in consumer prices in 2009. Our forecasts suggest that the Harmonised Index of Consumer Prices (HICP) inflation in Ireland will remain below the level of Euro Area inflation in both 2010 and 2011, having been consistently higher prior to 2008 as shown in Figure 3.

Figure 3: Irish and Euro Area HICP Inflation Rates



Source: CSO, Eurostat (historic), NIESR (Euro Area forecasts) and own forecasts.

EXCHANGE RATES

Related to the issue of competitiveness and the outlook for Irish exports are the expected developments in bilateral exchange rates. As with all the international numbers quoted in this *Commentary*, the exchange rates are taken from the most recent NIESR *Economic Review*.³ These exchange rates are presented by NIESR as “forecast assumptions” and their current assumptions imply that the STG/EUR exchange rate will average 0.87 in 2010 and 0.86 in 2011, while the USD/EUR exchange rate will average 1.40 in both years. The NIESR view regarding 2010 exchange rates has changed considerably since our last *Commentary*. At that time, the assumed STG/EUR and USD/EUR rates for 2010 were 0.90 and 1.49 respectively.

The euro fell sharply at the beginning of 2010, largely due to concerns about Euro Area sovereign ratings, and in particular the fiscal difficulties facing Greece. Expected growth differentials are also playing a role and the expectation that Euro Area growth will remain relatively subdued in 2010 is maintaining the downward pressure on the euro. Meanwhile the dollar rallied in the first three months of 2010, on the back of encouraging US data and an improved economic outlook. The euro is now expected to average \$1.40 in 2010, considerably lower than the \$1.49 that was previously assumed.

³ NIESR *Economic Review*, No. 211, January 2010.

Table 1: Short-term International Outlook

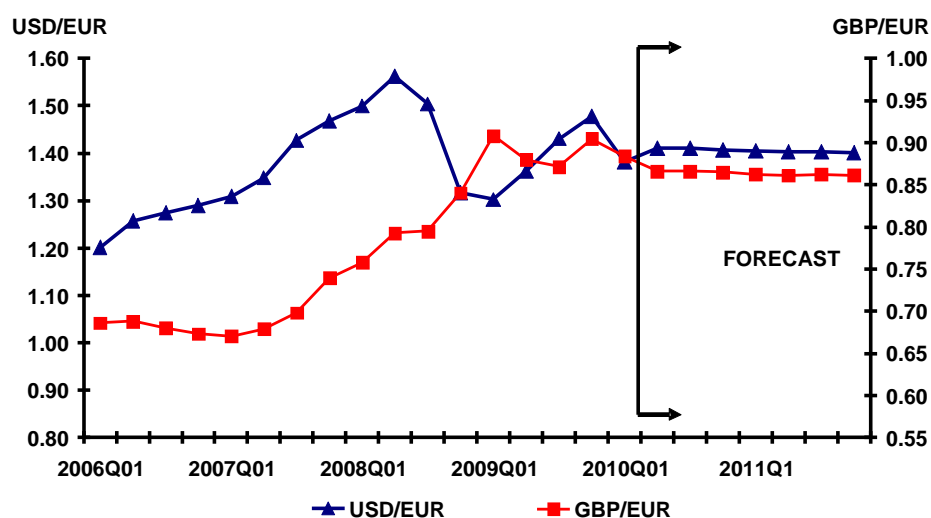
Country	GDP Output Growth			Consumer Prices* Inflation			Unemployment Rate			General Government Balance % of GDP			Government Debt % of GDP		
	2009	2010	2011	2009	2010	2011	2009	2010	2011	2009	2010	2011	2009	2010	2011
UK	-4.8	1.1	2.0	2.2	2.9	1.7	7.6	8.7	9.2	-11.9	-13.2	-11.5	68.4	78.3	85.8
Germany	-5.0	1.7	1.9	0.2	0.9	1.0	7.6	8.4	8.4	-3.4	-5.9	-5.8	74.1	79.2	83.6
France	-2.2	1.4	1.7	0.1	1.3	1.3	9.4	10.0	9.8	-8.3	-8.3	-7.7	77.2	83.7	88.9
Italy	-4.8	0.9	1.6	0.8	1.0	0.8	7.7	8.5	8.7	-5.4	-5.2	-4.9	114.2	117.8	120.2
Euro Area	-3.9	1.0	1.7	0.3	1.3	1.1	9.4	10.3	10.3	-6.4	-7.0	-6.3			
USA	-2.6	2.4	2.6	0.2	2.0	2.3	9.2	9.6	9.1	-11.1	-10.9	-8.8	82.8	89.7	93.6
Japan	-5.4	0.8	1.8	-2.0	-0.4	1.1	5.1	5.4	5.2	-8.0	-10.0	-9.7	192.4	197.2	199.0
China	8.7	8.5	9.0	5.9	-0.1	0.6	9.8	7.8	8.6						
OECD	-3.4	1.9	2.3	0.4	1.7	1.9									
Ireland	-7	-½	2½	-1¾	-1½	½	11¾	13¾	13	-11¾	-12	-10¾	65.2	79¾	89½

Source: NIESR, *Economic Review*, No. 211, January 2010.

*HICP for EU countries, consumption deflator for rest of world.

Sterling has been severely impacted since the onset of the financial crisis. The weak economic performance in the UK, combined with the very loose nature of monetary policy and the UK's perceived exposure to the financial sector, have all contributed to a weak pound. Sterling started 2010 on a strong note, but has come under increasing pressure of late, largely related to the uncertainty ahead of the general election and the concerns about the impact a hung parliament may have on the political ability to tackle the fiscal deficit. The UK is forecast to have one of the highest deficits in Europe in 2010 and is currently without any firm medium-term plan to get the public finances back to a sustainable level. In spite of this, the on-going fiscal difficulties in Euro Area countries and their impact on the single currency have resulted in a downward revision to expectations regarding the STG/EUR exchange rate relative to our last *Commentary*. The euro is now expected to average £0.87 in 2010 and £0.86 in 2011.

Figure 4: Exchange Rates



Sources: CBFSAI (historic) and NIESR *Economic Review*, No. 211 (forecast).

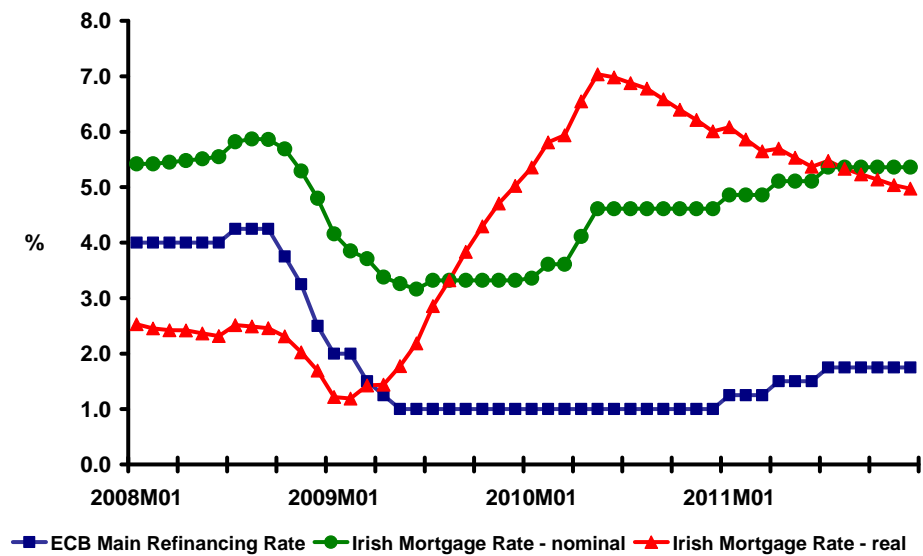
INTEREST RATES

The ECB has cut interest rates by a cumulative 325 basis points since October 2008, bringing the official rate to an historic low of 1.0 per cent. The consensus seems to be that we have reached the bottom of the current cycle, now that the Euro Area economy has technically emerged from recession. However, the ECB has repeatedly stated that the refinancing rate is at an appropriate level, suggesting that it is very much on hold for the foreseeable future. The current NIESR forecasts suggest a HICP inflation rate of 1.3 per cent in the Euro Area in 2010. Given the anaemic growth prospects for the Euro Area and the absence of any significant inflationary pressures, it seems unlikely that the ECB will consider raising interest rates until early 2011. Therefore, our forecasts are based on the assumption that the refinancing rate will be 1.0 per cent at the end of 2010, rising to 1.75 per cent by the end of 2011. From an Irish perspective, an unchanged rate in 2010 would certainly be welcomed, given the particularly fragile nature of the economic recovery here. In previous *Commentaries* we have expressed a concern about the possibility of interest rate increases occurring at a time

when the Euro Area recovery is well under way, but when the activity in Ireland remains relatively subdued.

We have also previously highlighted the possibility that mortgage interest rates in Ireland may increase in 2010, even in the absence of an ECB rate hike. Prior to the financial crisis, Irish interest rate margins were low by international standards and they have declined further since the onset of the crisis. In the last two months, both AIB and *permanent tsb* have announced a 50bps increase in their standard variable mortgage rate and it appears likely that these are the first of a number of increases to come in the months ahead. We have factored this in to our assumptions regarding future interest rates, as shown in Figure 5. It should be noted from Figure 5 that in spite of the expected significant increase in nominal interest rates over the forecast horizon, our expectations regarding inflation imply an overall reduction in the real interest rate, relative to its current level.

Figure 5: Interest Rates



Source: CSO, ECB and own forecasts.

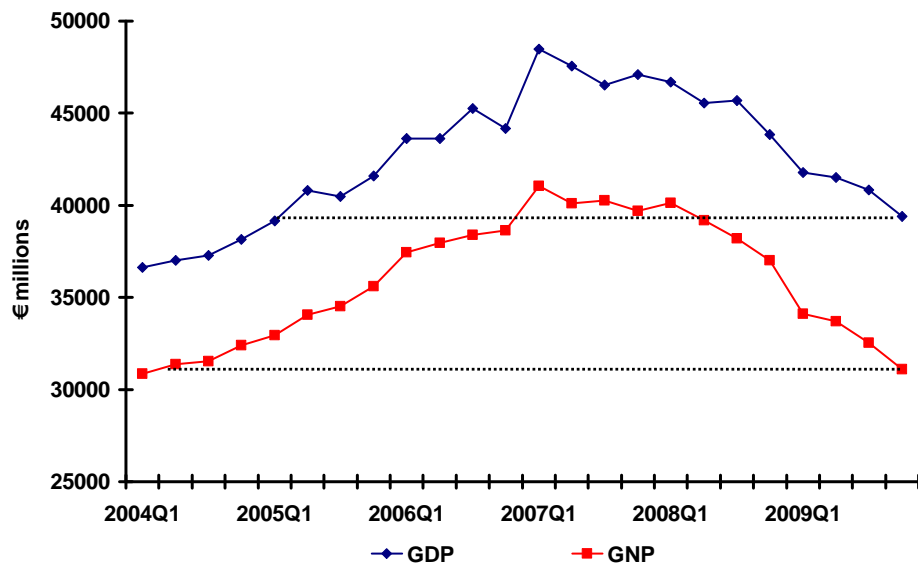
THE DOMESTIC ECONOMY

In this *Quarterly Economic Commentary* we provide our first forecasts of economic prospects for the economy in 2011. Following a further small contraction in the economy in 2010 we expect growth to resume in 2011 with both GDP and GNP growing by 2½ per cent. These forecasts are based on the expectation among international forecasters that growth in the world economy will recover during 2010, picking up further in 2011. The pick-up in world growth in 2010 is reflected in a significant improvement in external demand. However we expect domestic demand to contract further this year, driven both by a large contraction in investment of over 20 per cent and a decline in both private and public consumption as a result of the cuts of €4 billion implemented in Budget 2010. In 2011 we expect the collapse in investment to bottom out and, together with a further increase in external demand, this should be sufficient to see a modest resumption of growth.

Our first estimates suggest that the pre-announced budgetary cuts of €3 billion in 2011 could reduce the growth rate by up to one percentage point. We estimate that these measures could reduce the General Government Deficit by two percentage points of GDP in 2011. In relation to the labour market, our forecast of unemployment for 2010 is largely unchanged from the previous *Commentary* at 13¾ per cent, in 2011 we expect this rate to fall to 13 per cent. However, it is important to stress that as we expect no change in the average level of employment in 2011, the fall in the unemployment rate is rather due to a fall in labour supply driven by falling participation rates and net migration outflows.

Prices have fallen rapidly in 2009 and this has had a significant impact on the measured size of the economy. In value terms, national income as measured by either GDP or GNP has fallen even more rapidly than in volume terms. The most recent *Quarterly National Accounts* for the final quarter of 2009 estimate that volume GNP fell by over 11 per cent, however in value terms GNP fell by over 15 per cent. From a peak in 2007 Q1, the value of GNP had fallen by one quarter by 2009 Q4. Figure 6 shows the most recent quarterly data on GDP and GNP in current prices, indicating that by the last quarter of 2009 GNP had fallen to levels last recorded in 2004 Q1 (for GDP 2005 Q1).

Figure 6: GDP and GNP at Current Prices, Seasonally Adjusted



Source: Quarterly National Accounts, CSO.

Table 2 shows the implied carryover from the latest *QNA* data, in other words what the volume growth rate across the main expenditure headings would be in 2010 on the assumption of no further change in levels throughout the year. Contrasting this with the *QEC* forecast for 2010 gives an overview of our forecast changes for 2010. Looking first at private consumption, the implied carryover is -0.4; our forecast of a bigger fall of -1 per cent reflects the impact of the most recent budgetary cuts on consumption behaviour, especially in the first half of the year. The same applies for public consumption, where we forecast a fall of 3 per cent, much larger than the implied carryover of -1.6. In relation to investment, we expect a fall of over 20 per cent, relative to a carryover rate of 12 per cent; this reflects a further large contraction in the building and construction sector. It is in the external sector that we expect an improvement relative to 2009, with exports expected to grow by 2¼ per cent relative to carryover of -0.2. This is due to both the improved world environment in 2010 and the gradual improvement in competitiveness. For imports we expect a further contraction in 2010 of -1¼ per cent, while this is higher than the implied carryover rate of -2.4, it is relatively subdued due to the further contraction in private consumption.

Table 2: Implied Carryover (% change)

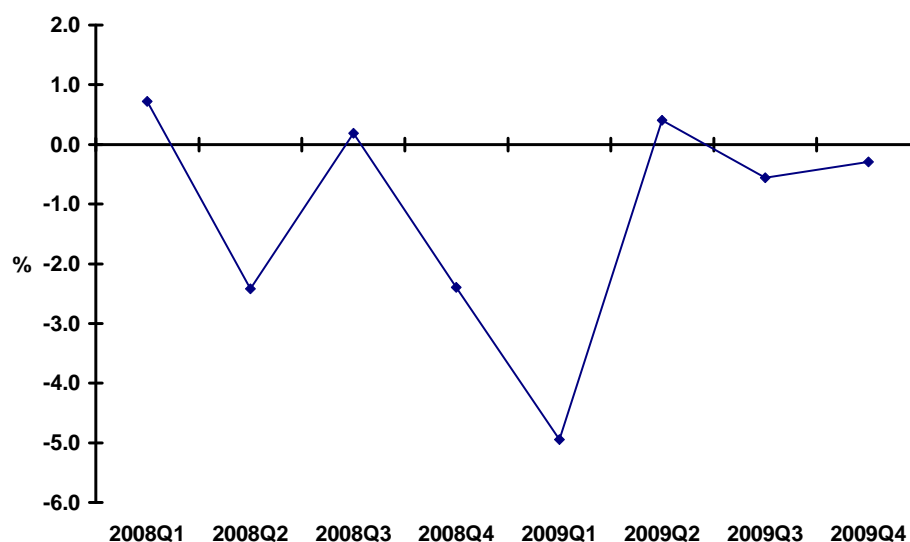
	Estimate	Carryover	QEC Forecast	
			2010	2011
Private Consumer Expenditure	-7.2	-0.4	-0.9	1.5
Public Net Current Expenditure	-1.2	-1.6	-3.0	-2.0
Private Investment	-29.7	-12.3	-20.3	2.6
Exports	-2.3	-0.2	2.2	4.5
Imports	-9.3	-2.4	-1.2	3.6
GDP at market prices	-7.1	-1.9	-0.4	2.6
GNP at market prices	-11.3	-3.0	-0.1	2.7

Our forecasts for 2011 assume a continuation of gains in competitiveness, through further falls in wages and very subdued price increases. We also assume that the fiscal package of €3 billion in cuts for 2011 indicated by the Government will be fully implemented. This may well prove difficult to achieve: it will involve further increases in average tax levels, cuts in current expenditure programmes and further cuts in the capital programme. Allied to these two key assumptions, and assuming the international forecasts for world growth prove correct, is a maintained assumption that the measures currently being undertaken to address the serious problems in the Irish banking system will be successful in restoring confidence and credit flows. Were one or more of these assumptions to prove incorrect then there is a danger in the short term that this could lead to an increase in the cost of borrowing for the Exchequer, exacerbating the scale of the fiscal correction needed. In the medium term this would mean that the economy could underperform relative to its potential.

Consumption

The *Quarterly National Accounts (QNA)* for Q4 2009 show that the volume of consumption spending fell by 7.2 per cent in 2009. In Figure 7, we show the quarter-on-quarter growth rates (seasonally adjusted) which underlie this annual figure, along with the corresponding growth rates for 2008. The figure indicates that the annual decline resulted from particularly sharp declines in Q4 2008 and Q1 2009 and then some stabilisation in the latter part of the year.

Figure 7: Quarter-on-Quarter % Change in Volume of Consumption, Seasonally Adjusted



Source: *Quarterly National Accounts*, CSO.

This pattern of consumption decline is also evident in Table 3 where we show a range of recent indicators of changes in consumption. The biggest changes across the quarters in annual rates of decline are generally seen in late 2008 and early 2009. Looking at the “all businesses” column under retail sales, we can see that the annual rate of decline had essentially stabilised between Q3 2009 and Q4 2009. A similar point can be made in

respect of car sales, both the “new” and “all” categories. The data from the January retail sales index shows that the annual rate of decline has moderated to 12.2 per cent.

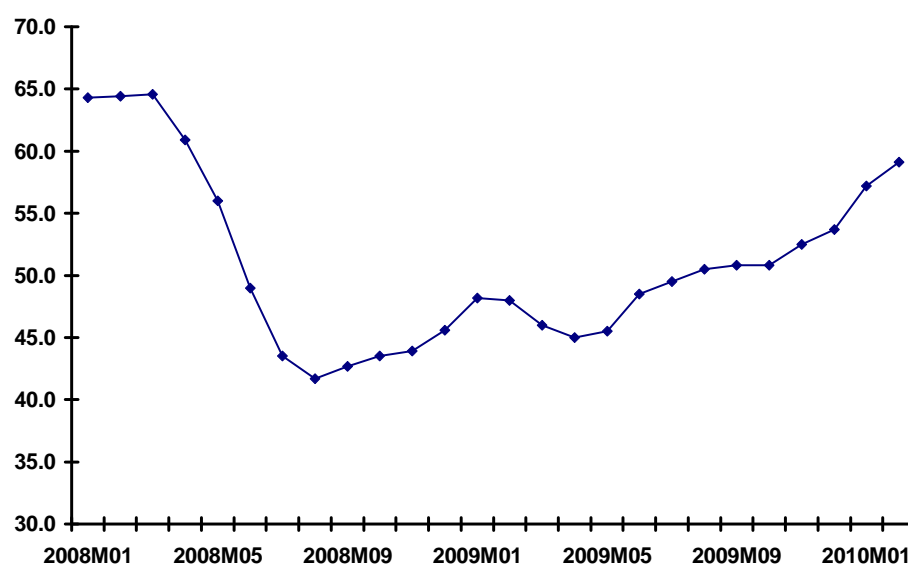
Table 3: Recent Indicators of Consumption (Annualised Volume Growth Rates)

	Retail Sales (Unadjusted)		Trips Abroad	New Vehicle Sales	All Vehicle Sales
	All Businesses	Excl. Motor Trade			
2008Q1	4.6	6.0	11.6	-1.5	-2.6
2008Q2	0.6	3.6	8.3	-10.3	-13.7
2008Q3	-2.7	0.8	6.2	-12.8	-18.0
2008Q4	-6.0	-2.7	2.1	-15.4	-20.9
2009Q1	-11.6	-5.3	-3.1	-31.9	-44.7
2009Q2	-13.4	-6.6	-5.0	-37.3	-53.3
2009Q3	-14.3	-6.9	-9.6	-46.1	-62.2
2009Q4	-14.2	-6.8	-10.5	-47.1	-62.5

Source: CSO.

A further insight into recent trends under this heading is provided by the KBC/ESRI Consumer Sentiment Index. Figure 8 shows that the index fell below 50 in June of 2008 (on a 3 month moving average basis) and remained below 50 up to August of 2009. Since then, it has been on an upward trend indicating a growing degree of confidence. This in turn is likely to have been related to slowing pace of growth in unemployment in the latter part of 2010.

Figure 8: Consumer Sentiment Index (3 Month Moving Average)



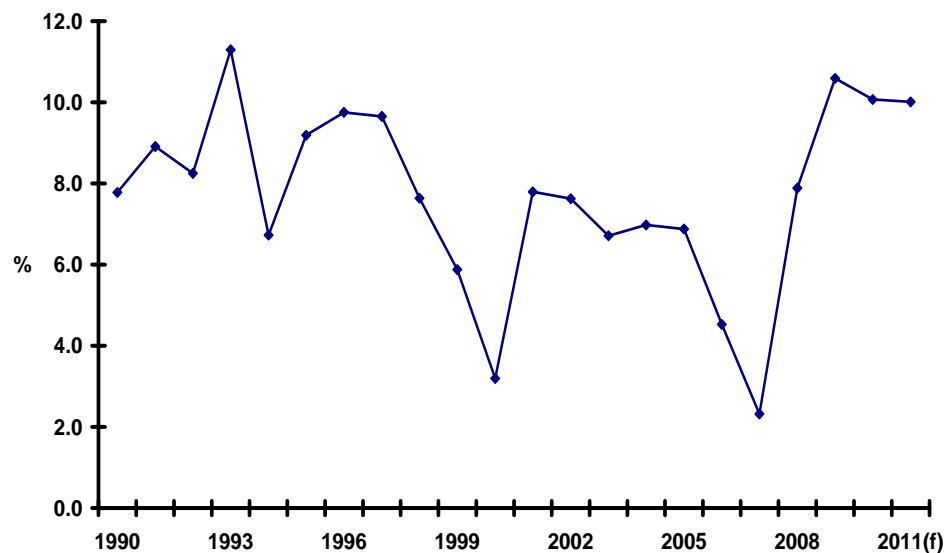
Source: Consumer Sentiment Index, KBC Ireland and ESRI.

Turning to our forecasts, we expect consumption to fall by $\frac{3}{4}$ per cent in 2010. Since the carry-over from 2009 is estimated at 0.4 per cent, our forecast for a steeper decline arises from our expectation of further declines in 2010 as a result of wages cuts, welfare cuts and on-going job

losses. Following the general outlook in our forecasts, our quarterly profile sees the falls in consumption occurring in the first two quarters followed by stabilisation in the latter part of the year.

For 2011, we expect consumption to grow by 1½ per cent. The forecasts for consumption growth in 2010 and 2011 are consistent with the savings rate falling minimally between 2009 and 2011, from 10.6 in 2009 to 10¼ in 2011. If consumer confidence returned with greater strength and more quickly than we anticipate the possibility remains of stronger growth in consumption. In Figure 9, we show the saving rate going back to 1990, along with our forecasts for 2010 and 2011. Over the period 1990 to 2009, the savings rate averaged 7.5 per cent. From 2000 to 2009, it averaged 6.5 per cent. Each one percentage point fall in the savings rate amounts to a consumption increase of almost €1 billion. Hence, a return to the 2000-2009 average would amount to a significant spending boost. But with no employment growth envisaged in 2011 and on-going concerns about access to credit for consumers, our cautious stance on this seems appropriate.

Figure 9: Savings Rate (Personal Savings Relative to Disposable Income) 1990-2009, Forecasts for 2010 and 2011



Source: CSO and own calculations.

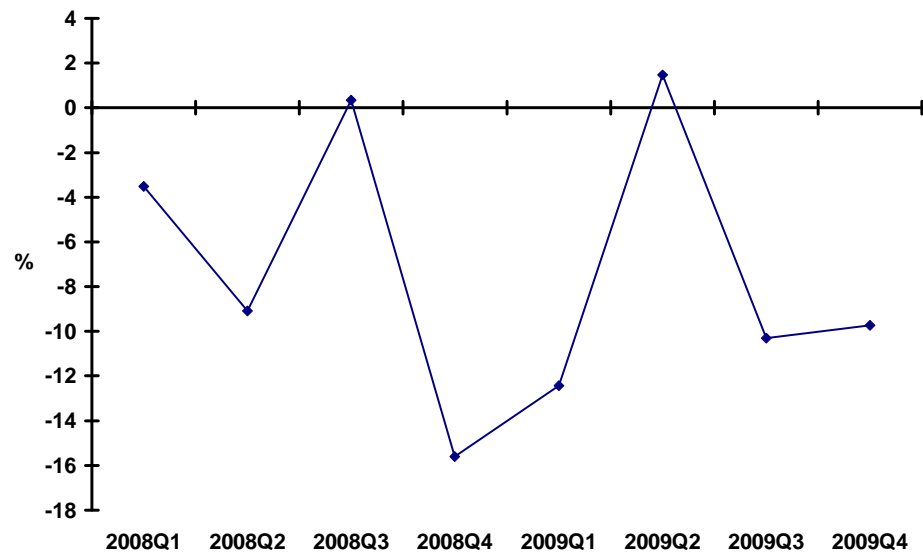
Investment

The *QNA* for Q4 2009 show that the volume of investment spending fell by 29.7 per cent in 2009. This figure was made up of a fall of 33.8 per cent in building and 15.7 per cent in machinery and equipment. Looking at Figure 10, it can be seen that, as was the case with consumption spending, the Q4 2008 and Q1 2009 quarter-on-quarter declines were particularly steep. However, the quarter-on-quarter declines in consumption were less than 1 per cent in Q3 and Q4 of 2009, compared to the falls in the case of investment which were in the region of 10 per cent.

Table 4: Gross Fixed Capital Formation

	2008	% Change in 2009		2009	% Change in 2010		2010	% Change in 2011		2011
	€bn	Volume	Value	€bn	Volume	Value	€bn	Volume	Value	€bn
Housing	15.1	-38.3	-49.1	7.7	-39	-41 ¼	4.5	5	2	4.6
Other Building	13.2	-25.3	-30.5	9.2	-15	-21	7.3	-5 ½	-8 ¼	6.6
Transfer Costs	1.7	-61.2	-68.8	0.5	-15	-20	0.4	10	10	0.5
Building and Construction	30.0	-33.8	-42.0	17.4	-26	-30	12.2	-1	-4	11.7
Machinery and Equipment	9.5	-15.7	-14.7	8.1	-5	-6	7.6	10	11 ¾	8.5
Total	39.5	-29.7	-35.4	25.5	-20 ¼	-22 ¼	19.8	2 ½	2	20.2

Figure 10: Quarter-on-Quarter Growth in the Volume of Investment Spending (Seasonally Adjusted), Q1 2008 to Q4 2009

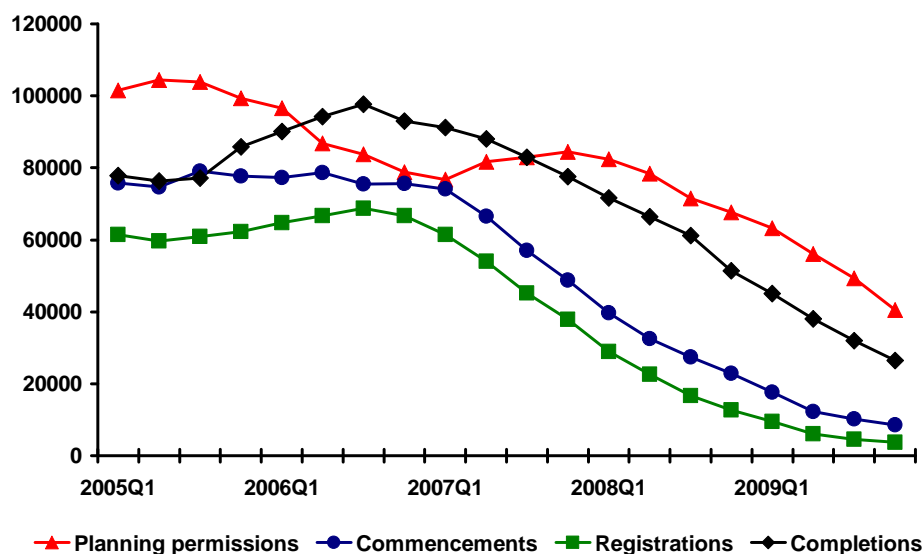


Source: Quarterly National Accounts, CSO.

In Figure 11, we look at statistics on housing output and the trend that has become so familiar since 2007 remains. Housing commencements in the year ending Q4 2009 were 8,552, with registrations running at 3,743. Completions for the year 2009 were 26,420, while planning permissions amounted to 40,556. The level of completions, at over 26,000, exceeded the expectations which we held at the start of 2009. In the *Commentary of Spring 2009*, we had forecast completions of 17,500 for 2009, followed by 15,000 in 2010. Given that the speed of decline in 2009 was lower than we had expected, we now think that housing completions will be 10,000 in 2010 and so the contraction in housing activity will remain a drag on the economy in 2010. For 2011, we expect completions to be stable at 10,000 units. Hence, although the housing contraction will no longer be a drag on growth, neither will this sector contribute to growth in 2011. On prices, the *permanent tsb*/ESRI House Price Index shows that prices had declined by 31.5 per cent between their peak in early 2007 and December 2009.⁴ The decline in December, at 3.6 per cent, was higher than the declines in the preceding three months and so the pace of decline showed no signs of moderating. Our forecasts are based on new house prices being 50 per cent below their peak by the end of 2011, with prices stabilising during the course of 2011.

⁴ Due to the low volume of transactions, the Index is now being produced on a quarterly basis and not a monthly basis as had been the case.

Figure 11: Housing Statistics, Annualised numbers



Source: CSO and Department of the Environment, Heritage and Local Government.

We expect the volume of total investment to fall by 20¼ per cent in 2010. Underlying this is a fall in housing investment volume of 39 per cent, a fall of 15 per cent in other building and a fall in investment in machinery and equipment of 5 per cent. For 2011, we expect to see a return to growth in investment spending driven mainly by investment in machinery and equipment. Following substantial falls in this component beginning in 2008, we would expect some turnaround and our forecast for 2011 is for volume growth of 10 per cent. Housing is shown in Table 4 to expand in 2011 but the growth is assumed to be in repair and renovation as opposed to an increase in housing unit completions relative to 2010. Other building and construction is forecast to fall in 2011, partly as a result of an assumed fall of €1 billion in capital spending by the government. Further details on this element are provided in the next section.

Government Spending and Public Finances

The most recent exchequer returns for the first three months of 2010 show a continued decline in total exchequer tax receipts. Total tax revenue in March 2010 was €1.3 billion lower than in the same period in 2009. This continued deterioration in tax revenue meant that the exchequer deficit in March 2010 widened despite a fall of over €1 billion in voted expenditures (see Table 5).

Table 5: Exchequer Returns

	March 2008	Change		March 2009	Change		March 2010
	€bn	€bn	%	€bn	€bn	%	€bn
Total Receipts	12.5	-3.1	-25	9.4	-1.2	-13	8.2
<i>of which</i>							
Tax Revenue	11.1	-2.6	-23	8.5	-1.3	-15	7.2
Excise	1.4	-0.4	-32	0.9	0.0	-2	0.9
Capital Gains Tax.	0.5	-0.4	-70	0.2	-0.1	-35	0.1
Stamps	0.5	-0.3	-62	0.2	-0.1	-29	0.1
Income Tax	3.1	-0.2	-7	2.9	-0.3	-10	2.6
Corporation Tax	0.8	-0.4	-44	0.5	-0.3	-74	0.1
VAT	4.5	-0.8	-18	3.7	-0.5	-13	3.2
Total Expenditure	12.8	0.4	3	13.2	-1.1	-8	12.1
<i>of which:</i>							
Voted Capital	1.6	-0.1	-6	1.5	-0.5	-31	1.0
Voted Current	9.6	0.8	8	10.3	-0.6	-6	9.7
Exchequer Balance	-0.4	-3.4		-3.7	-0.2		-3.9

Table 6: Public Finances

	2008	%	2009	%	2010	%	2011
	€bn	Change	€bn	Change	€bn	Change	€bn
Current Revenue	41.6	-18.6	33.9	¼	34.0	- ¼	33.9
<i>of which: Tax Revenue</i>	40.8	-19.0	33.0	-4 ¼	31.6	3 ½	32.8
Current Expenditure	44.7	1.2	45.2	4 ¼	47.1	3 ¼	48.7
<i>of which: Voted</i>	40.8	-1.2	40.3	- ¼	40.2	½	40.4
Current Surplus	-3.1		-11.4		-13.2		-14.8
Capital Receipts	1.4	4.8	1.5	14 ¼	1.7	-2 ½	1.6
Capital Expenditure	11.0	33.5	14.7	-40 ¾	8.7	-10 ¼	7.8
<i>of which: Voted</i>	8.6	-19.3	6.9	-14 ½	5.9	-15	5.0
Capital Borrowing	-9.6		-13.3		-7.1		-6.2
Exchequer Balance	-12.7		-24.6		-20.2		-21.0
<i>as % of GNP</i>	-8.2		-18.8		-15 ¾		-16
General Government Balance*	-13.3		-19.3		-19.3		-17.5
<i>as % of GDP</i>	-7.3		-11.8		-12		-10 ¾
Gross Debt as % of GDP	44.2		65.2		79 ¾		89 ½
Net Debt as % of GDP**	33.6		51.5		50 ½		59 ¾

*2010 and 2011 figures are based on National Accounts estimates.

**Net of NPRF, Social Insurance and Exchequer Balances.

Table 5 shows the changes in the key tax headings over the past two years. Total tax revenue in March 2010 was almost €4 billion lower than in March 2008. One-third of this decline, €1.3 billion, was due to a fall in VAT receipts, one-fifth, €0.7 billion, was due to a fall in corporation tax, while €0.5 billion was due to lower income taxes. Looking at the changes over the past two years, the pace of decline has slowed for most of the indirect tax heads in 2010, however the pace of decline in income taxes has accelerated. Figure 12 shows the rolling annual total between December 2005 and March 2010. It confirms the continued downward trend which began in the middle of 2007. For the year ended March 2010, total tax revenue was just below €32 billion, a fall of €15 billion from the peak in October 2007.

Figure 12: Total Exchequer Tax Revenues, Rolling Annual Total⁵



Source: Department of Finance.

Our forecast of tax revenue for 2010 is for an overall decline of 4¼ per cent. This is equivalent to a full-year tax take of €31½ billion. This is based on a pick-up in growth in the second half of this year which should be sufficient to stabilise the current rapid pace of decline. If this forecast proves correct, and assuming budgetary targets for current and capital expenditure are met, then we estimate that the General Government Balance will be -12 per cent of GDP in 2010. For 2011 we have implemented a stylised budget based on the pre-announced targets included in *Budget 2010*. In the document these include total cuts of €3 billion, with €2 billion targeted at the current side of the budget and a €1 billion reduction in capital expenditure. To operationalise this budget we have assumed an increase in €1 billion in taxation, split between increases in income tax (including PRSI) and some form of property taxation. On current expenditure we have assumed a freeze in welfare payments and public sector pay rates together with further reductions in the volume of

⁵ There is a discrete shift in November in each year. This reflects the impact of collection of capital gains tax and corporation tax, which are both concentrated at this time of year.

public consumption which is forecast to fall by 2 per cent in 2011. It is important to stress that this is not a prescriptive recommendation; we have implemented these measures to estimate the impact of the pre-announced budget plans on the public finances and the wider economy.

We estimate that such a budget package would reduce the General Government Deficit by between 1½ and 2 percentage points of GDP.⁶ The impact on the wider economy is to reduce the growth rate by approximately one percentage point.⁷ In addition, the level of employment is lower and emigration flows higher than in the absence of such a package. These are real costs attached to the programme of fiscal consolidation being pursued by the government. Despite these costs it is the view of this *Commentary* that such measures are necessary to ensure the medium-term sustainability of the public finances. Given the range of measures which have already been introduced, the 2011 budget is likely to involve some very difficult choices. While there are likely to be significant cost savings to be made in the capital programme which should mitigate the effects of the cuts on the levels of volume investment, it is nevertheless the case that by 2011 public investment levels in current prices will be one-third lower than in 2008. Implementing further cuts in current expenditure and increases in taxation will also be challenging. In this context the measures proposed in the recent Commission on Taxation report and the Bord Snip Nua report could help ensure that these choices are made within a coherent framework of medium-term reform of the public sector and the taxation system.

The recently announced plans for providing support to the banking system involve very significant increases in the level of government involvement in the financial sector. It is very difficult to put exact figures on the level of government monies involved. However, a tentative estimate of the order of €73 billion,⁸ equivalent to 47 per cent of GDP in 2010, can provide a guideline. These numbers are discussed in more detail later in the section on the monetary sector.. Of course these are gross figures and much of this liability is matched by assets both within NAMA and in AIB and Bank of Ireland. Nevertheless, it is possible that the net cost to the taxpayer of this support to the banking system, based on the latest figures available, will be of the order of €25 billion or more.

For 2010 and 2011, we have assumed that the Government will borrow €2 billion in each year to fund the recapitalisation of Anglo Irish Bank and INBS. This increases the exchequer deficit in both years by €2 billion, but it does not appear in the estimate of the General Government Deficit. In

⁶ The figures presented here show a gap of 1½, this is because we have assumed that the €20 billion in promissory notes which is to be used to recapitalise Anglo Irish Bank and INBS, will be issued over a ten-year period in equal amounts. This increases the interest payments due in calculating the General Government Deficit, with a maintained assumption that there will be no counterparty receipts.

⁷ This estimate is based on comparing the “with budget” forecasts presented in this *Commentary* with the forecast growth rates which would arise given a neutral budget.

⁸ This figure includes an estimated €40 billion investment in NAMA, €7 billion to Allied Irish Bank and Bank of Ireland, and an estimated €26 billion to Anglo Irish Bank, EBS and INBS.

doing this we are following the official statistical guidelines which treat monies put into Anglo Irish Bank as an investment by the State. The interest cost of this extra borrowing is included in the General Government Deficit, with a maintained assumption that there will be no counterparty return on these “investments”. Because of this payment, our figure for gross government debt in 2011 is €4 billion higher, equivalent to over 2 per cent of GDP. We are assuming that this will also increase the net debt by the same amount.

Given the very large liabilities which the State has now taken on through transfers to NAMA and other funding for the banking system, it would be useful to have a consolidated balance sheet for the General Government Sector. We believe there is now a real need to develop such a balance sheet. This would help clarify the net liabilities of the Government in relation to the banking system and track these over time.

Exports

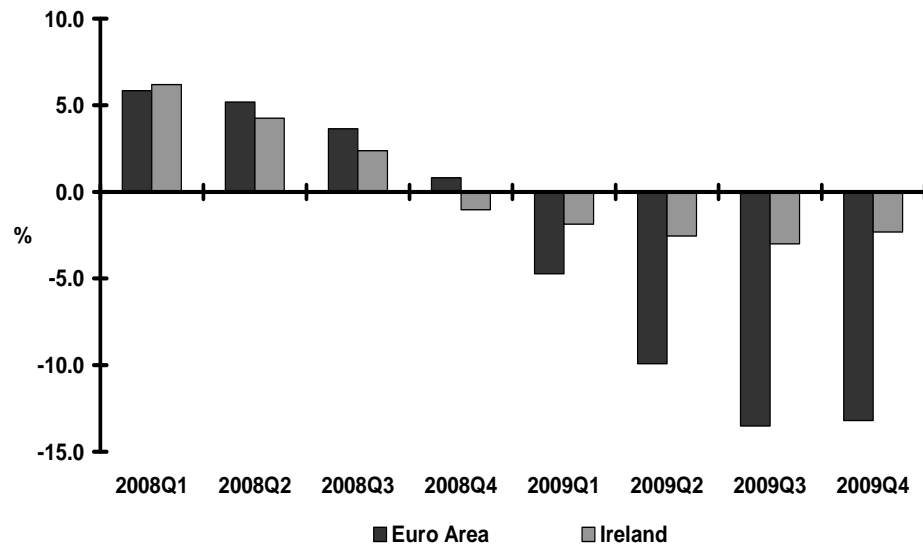
The performance of Irish exports given the collapse in world trade which accompanied the global economic downturn, represents one of the few encouraging signs to emerge from the Irish economy in 2009. The *Quarterly National Accounts* for Q4 2009 indicate a fall in the volume of total exports in 2009 of 2.3 per cent. Consistent with the trend over the previous 3 quarters of 2009, exports of goods and services (seasonally adjusted) held up in the final quarter of 2009 with a small volume increase of 0.1 per cent recorded compared to Q3.

Turning to the components of total exports, the latest data show a fall in merchandise exports of 5.4 per cent in 2009 compared to the previous year. While this decline illustrates that Irish merchandise exports were not immune to the contraction in world demand in 2009, the resilience of Irish merchandise exports in comparison to the large declines in exports experienced in our major trading partners is notable (Figure 13). Much of this resilience is due to the concentration of Irish exports in sectors such as pharmaceuticals which have been less adversely affected by the downturn in the international economy than sectors such as machinery and transport. Exports of chemicals and related products (mostly medical and pharmaceutical products and organic chemicals), which accounted for over half of the value of total merchandise exports in 2009, grew by 6.8 per cent compared to 2008 according to the latest *External Trade* statistics. The strong performance of chemicals exports helped to offset some of the decline in exports experienced in other sectors of the economy. Exports of electrical machinery and computers fell by 30 per cent compared to 2008. Exports of goods from the traditional sector of the economy also declined reflecting the difficult trading conditions created by the weakness of sterling and contraction in the UK economy.

Table 7: Exports of Goods and Services

	2008		% Change in 2009		2009		% Change in 2010		2010		% Change in 2011		2011
	€bn	Volume	Value	€bn	Volume	Value	€bn	Volume	Value	€bn			
Merchandise	81.5	-5.4	-4.3	78.0	1	2	79.5	4	5	83.5			
Tourism	4.3	-16.4	-18.1	3.5	- ½	-1	3.5	5¼	8	3.7			
Other Services	64.9	2.6	1.4	65.8	3¾	2	67.1	5	5½	70.8			
Exports of Goods and Services	150.7	-2.3	-2.3	147.3	2¼	2	150.1	4½	5¼	158.1			
FISIM Adjustment	1.2			1.2			1.2			1.3			
Adjusted Exports	151.9	-2.3	-2.3	148.5	2¼	2	151.3	4½	5¼	159.3			

Figure 13: Quarter-on-Quarter % Change in Merchandise Exports, Constant Prices, Seasonally Adjusted



Source: Quarterly National Accounts, CSO and the European Central Bank.

The recent data from the *Balance of Payments* illustrate the mixed performance of services exports in 2009. The disruption in international financial markets is likely to have contributed to the decline of 11 per cent in value terms recorded in exports of financial services. Exports of insurance services declined by 17 per cent while tourism exports fell by 18 per cent. Offsetting these declines were substantial year-on-year increases in receipts from royalties/licences, business services and other services. Exports of I.T. services also performed strongly and in Q4 2009 were over 6 per cent higher compared to Q4 2008. Overall, services exports increased modestly by 0.2 per cent in 2009 compared to a year earlier.

Based on the prospects for the world economy discussed in the *International* section, the outlook for Irish exports in 2010 and 2011 is now more favourable. The latest data from the Centraal Planbureau (CPB) points to an ongoing recovery in world trade in the early months of 2010. The most recent forecasts indicate that world trade volumes should increase by 7.5 per cent in 2010. We expect the recovery in the international economy and in world trade to boost the demand for Irish exports over the forecast horizon. Overall, we expect export growth to resume in 2010 following two years of contraction in export volumes. Having remained relatively intact despite the collapse in world trade, we expect merchandise exports to expand in volume terms by 1 per cent in 2010 and 4 per cent in 2011. The manufacturing wholesale price index which is a good indicator of merchandise export prices has been increasing in recent months. As a result, we expect slightly higher growth in the value of merchandise exports in 2010 and 2011 of 2 and 5 per cent respectively.

Turning to our forecasts for services exports, following a solid performance in 2009 we anticipate that non-tourism services exports will grow by 3¾ per cent in volume terms in 2010 and 5 per cent in 2011. We

expect a more sluggish recovery in tourism exports with a further small volume decline expected this year. For 2011, the volume of tourism exports is expected to grow by $5\frac{3}{4}$ per cent.

Imports

The most recent data for 2009 from the *Quarterly National Accounts* estimate that the volume of imports declined by over 9 per cent as shown in Figure 14. While there was a small increase in the volume of services imports of 0.4 per cent, merchandise imports fell by almost 22 per cent. 2009 also saw a substantial decline in tourism imports of over 10 per cent.

Consistent with the severe reduction in expenditure on consumption and investment, merchandise imports declined across a range of categories in 2009. According to the latest *External Trade* statistics, some of the largest year-on-year falls were recorded in imports of road vehicles and other transport equipment (-70 per cent), manufactured goods (-38 per cent) and petroleum and related products (-33 per cent, mostly due to falls in fuel prices), with declines also recorded in imports of consumption goods. With final demand expected to remain weak this year, we are forecasting a further decline in merchandise imports in 2010 of $6\frac{1}{2}$ per cent in volume and 7 per cent in value. For 2011, we expect a modest rise in merchandise import volumes of 2 per cent.

Current price data from the balance of payments suggest that services imports declined marginally in Q4 2009 following quarter-on-quarter increases in each of the previous three quarters. Growth in imports of royalties and business services was offset by reduced imports of insurance and financial services. Tourism imports declined during each quarter of 2009 and were almost 10 per cent lower for the year as a whole compared to 2008. Looking ahead, we expect a small volume increase in other services imports of $2\frac{1}{2}$ per cent in 2010, rising to $4\frac{3}{4}$ per cent in 2011. Tourism imports are expected to fall again this year by $2\frac{1}{2}$ per cent with a return to growth of 2 per cent anticipated in 2011.

Figure 14: Exports and Imports, Volume Growth Rates, Annualised



Source: Quarterly National Accounts, CSO.

Based on a forecast recovery in economic activity, consumption and disposable income in 2011, we anticipate that total imports of goods and services will increase by 3½ per cent in volume in 2011, following a further contraction of over 1 per cent in total imports in 2010.

Balance of Payments

The sharp drop of over a fifth in merchandise imports in 2009 greatly exceeded the fall in merchandise exports which gave rise to a significant increase in the merchandise trade surplus of around €8.8 billion last year. The services trade balance deteriorated significantly in 2008 as a result of a decline in services exports. Services exports performed surprisingly well in 2009 recording a small increase on their 2008 level. The performance of services exports, in addition to lower imports, contributed to a narrowing of the services trade deficit in 2009 by over €400 million. Our forecasts imply a further increase in the merchandise trade surplus both this year and next year. Our projections for services exports and imports indicate a further narrowing of the services deficit in both 2010 and 2011. Having increased by €9.2 billion in 2009, these projections would result in a further expansion in the overall trade balance from 25¼ per cent of GNP in 2010 to 26¾ per cent in 2011; the equivalent figure for 2008 was just 11.9 per cent of GNP.

Turning to net factor flows, the Q4 2009 balance of payments data show a sharp fall in 2009 in both factor inflows and factor outflows. Factor inflows decreased by 36 per cent driven mainly by a 43 per cent fall in portfolio investment income. Factor outflows also registered a substantial decline of 23 per cent. Our forecasts imply a further small reduction in factor outflows in 2010 followed by an increase in outflows in 2011 as the expected recovery in economic activity increases profit outflows from the multinational sector. Factor inflows are expected to remain unchanged over the period of the forecast.

Table 8: Imports of Goods and Services

	2008		% Change in 2009		2009		% Change in 2010		2010		% Change in 2011		2011	
	€bn	Volume	Value	€bn	Volume	Value	€bn	Volume	Value	€bn	Volume	Value	€bn	
Merchandise	57.7	-21.6	-21.4	45.3	-6½	-7	42.1	2	4	43.8				
Tourism	7.1	-10.4	-10.9	6.3	-2½	-3	6.1	2	4	6.3				
Other Services	67.5	1.4	0.7	68.0	2½	2	69.4	4¾	5	72.8				
Imports of Goods and Services	132.2	-9.3	-9.6	119.6	-1¼	-1¼	117.6	3½	4½	123.0				
FISIM Adjustment	0.8			0.7			0.7			0.7			0.7	
Adjusted Imports	133.0	-9.3	-9.6	120.3	-1¼	-1¼	118.3	3½	4½	123.7				

Table 9: Balance of Payments*

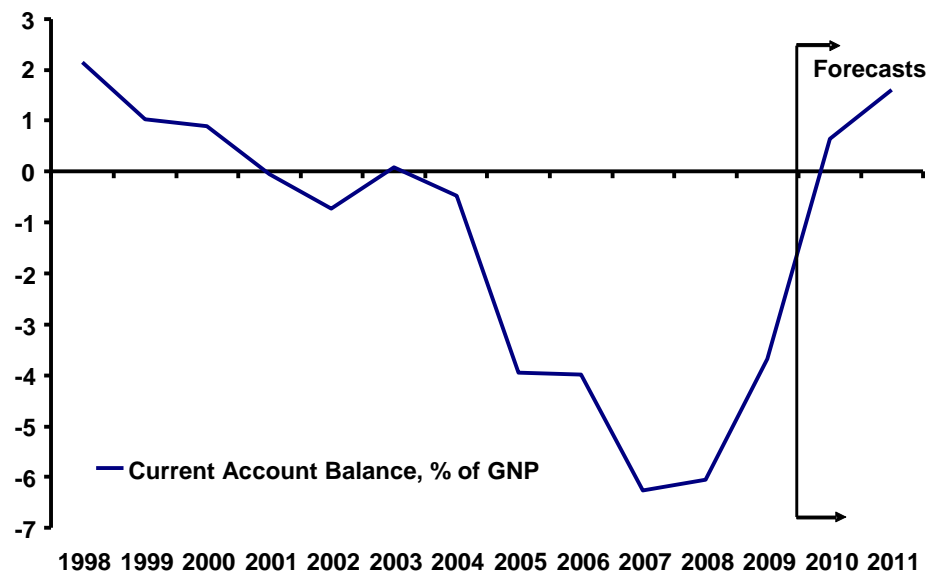
	2008 €bn	Change %	2009 €bn	Change %	2010 €bn	Change %	2011 €bn
Merchandise Trade Balance	23.8		32.6		37.4		39.7
Service Trade Balance	-5.4		-5.0		-4.8		-4.6
Trade Balance in Goods and Services on BoP basis	18.4		27.7		32.5		35.1
% of GNP	11.9		21.2		25 ¼		26 ¾
Total Debit Flows	110.6	-22.9	85.3	-¾	84.6	1½	85.8
Total Credit Flows	83.8	-36.0	53.7	0	53.7	0	53.7
Net Factor Flows	-26.8	18.0	-31.6	-2¼	-30.9	4	-32.1
Net Current Transfers	-1.1		-0.9		-0.9		-0.9
Balance on Current Account	-9.4		-4.8		0.7		2.0
Capital Transfers	0.1		0.0		0.1		0.1
Effective Current Balance	-9.4		-4.8		0.8		2.1
% of GNP	-6.1		-3.7		¾		1½

*This table includes adjustments to *Balance of Payments* basis.

Despite the increase in net factor income outflows, the expansion in the merchandise trade surplus contributed to a rapid fall in the current account deficit over the course of 2009. The latest *Balance of Payments* statistics show that the current account deficit fell to just €166 million in Q4 2009. As a result the current account deficit for the year as a whole fell to €4.6 billion or 3.7 per cent of GNP, the lowest annual deficit since 2004. Our projections for a further increase in the trade surplus both this year and next imply a rapid closure of the remaining deficit on the current account. As shown in Figure 15, we expect a small surplus on the current account of ½ per cent this year and for this to increase to 1½ per cent in 2010.

The increasing deficit on the current account of the balance of payments after 2003 was an important indicator of growing imbalances in the economy at that time. Similarly, the disappearance of that deficit over the course of 2009, and the prospects for the emergence of a current account surplus this year, is symptomatic of the important structural realignment currently underway in the Irish economy as it readjusts towards the exporting sector.

Figure 15: Current Account Balance, % of GNP



Source: Balance of Payments and Own Calculations.

Measures of Performance

Table 10: Performance Indicators

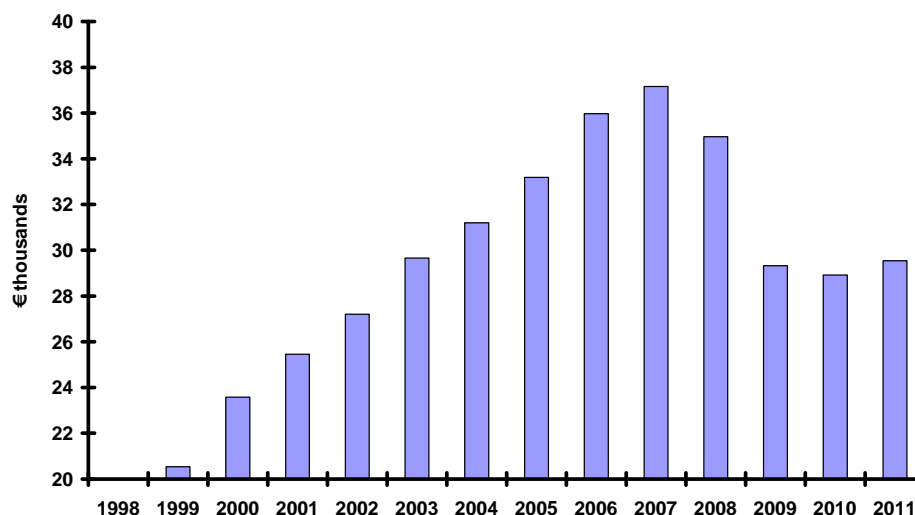
	2005	2006	2007	2008	2009	2010(f)	2011(f)
GNP in current prices	8.7	11.2	5.7	-4.1	-15.4	-1¾	2¼
GNP, in constant prices	5.6	6.3	4.4	-2.8	-11.3	0	2¾
GNDI, constant prices	4.4	4.7	1.6	-4.1	-10.9	¼	2½
National Resources GNP per capita (constant prices)	4.4	4.7	1.5	-4.1	-10.9	¼	2½
Consumption per capita (constant prices)	3.3	3.7	2.0	-4.6	-12.1	¼	2½
Investment in Housing/GNP	14.9	14.8	13.4	9.8	5.9	3½	3½
Investment/GNP	31.5	31.2	30.7	25.5	19.5	15½	15½
Domestic Demand	8.7	6.3	3.7	-4.4	-13.6	-3½	1
Labour share of GNP	47.7	47.2	48.0	51.1	54.6	52	50½

Source: CSO and own forecasts.

Table 10 shows some indicators of the performance of the economy across the recent and forecast period. Because of the dramatic fall in incomes in 2008 and especially 2009, it will take several years before the economy returns to pre-recession income levels. The recession which began in 2008 led to a fall in volume income (GNDI) of 4 per cent in that year, this was followed by a dramatic decline of 11 per cent in 2009. For 2010 and 2011, our forecast figures suggest stagnation of volume income in 2010 followed by an increase of 2½ per cent in 2011. These figures imply that the cumulative fall in volume GNDI between 2007 and 2011 is of the order of 12 per cent.

In relation to money income, using GNP in current prices as a measure of the size of the economy, our forecasts suggest that by the end of 2011 the economy will be one-fifth smaller than at its peak in 2007. This loss of income is illustrated in Figure 16, which shows the forecast figures for nominal GNP per capita. By the end of 2011, our forecasts suggest that income per head will be below 2003 levels.

Figure 16: Nominal GNP Per Capita



Source: CSO and own forecasts.

The very rapid contraction in the economy is most sharply reflected in the investment figures. Investment as a share of GNP is forecast to halve from a peak of over 31 per cent in 2006 to just over 15 per cent by 2011. This adjustment was driven by the collapse in house building and other building and construction. Over the medium term, a share of 15 per cent is very low. The average in developed economies is typically around 20 per cent.

Sectoral Output

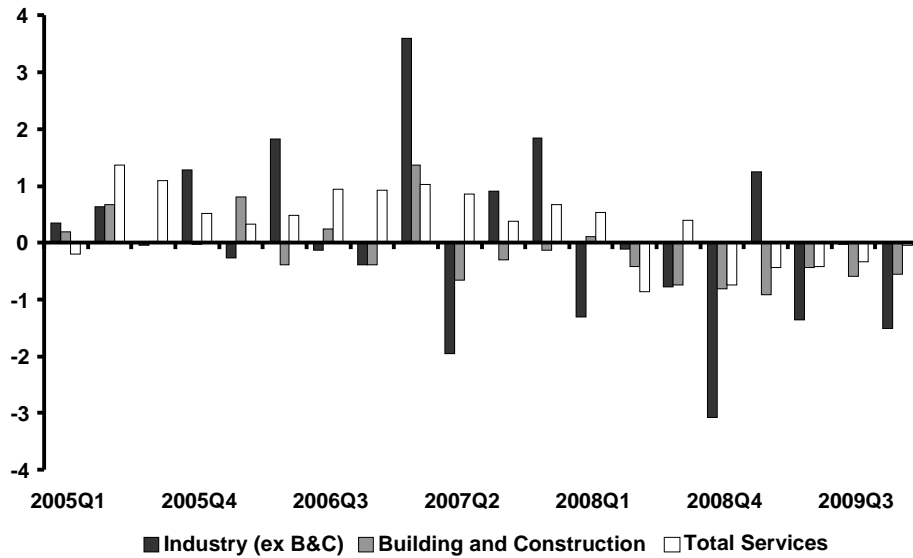
The *Quarterly National Accounts* for 2009 Q4 show that industrial output (including building and construction) fell by almost 9 per cent in 2009. Output in building and construction contracted during each quarter of 2009 with the result that total building output in 2009 was 31 per cent lower than in 2008. For industry, excluding building and construction, output remained broadly unchanged over the course of 2009, declining by just 0.6 per cent.

Figure 17 shows the weighted contributions to the total growth rate in output for building and construction, industry and services. The expansion in industrial output in Q1 2009 helped to offset the falls in output experienced in the other sectors over the course of the year. Following large falls in building and construction and services output during Q4 2008 and in early 2009, there are some indications that the declines in output, particularly in services, are beginning to moderate. Services output recorded its smallest drop in 5 quarters during the final quarter of 2009. This reflects the solid performance of services exports discussed earlier.

Table 11: GDP by Sector

	2008		% Change		2009	% Change		2010	% Change		2011
	€bn	Volume	Value	€bn		Volume	Value		€bn	Volume	
Agriculture	3.7	5.4	-19.7	2.9	1	5	3.1	1	5	3.2	
Industry:	52.2	-8.7	-11.4	46.2	-3 ¼	-4 ½	44.1	3 ½	3	45.4	
Other Industry	38.4	-0.6	-1.0	38.0	2	1	38.4	4 ½	4	39.9	
Building & Construction	13.8	-31.2	-40.4	8.2	-26 ½	-30 ¼	5.7	-1 ½	-4 ½	5.5	
Services:	106.3	-4.2	-8.5	97.3	1 ¼	-¾	96.7	2 ½	2	98.6	
Public Administration & Defence	6.2	-3.3	-2.4	6.0	-3	-11	5.4	-7	-8 ½	4.9	
Distribution, Transport and Communications	25.3	-8.8	-8.8	23.1	1	1	23.4	2	2 ¼	24.0	
Other Services (including rent)	74.8	-2.8	-8.9	68.2	1 ¾	-¼	68.0	3 ¼	2 ½	69.7	
GDP at Factor Cost	162.2	-5.4	-9.7	146.5	-¼	-1 ¾	143.9	2 ¾	2 ¼	147.3	

Figure 17: Quarter-on-Quarter Growth Rates, Weighted Contributions, Seasonally Adjusted⁹

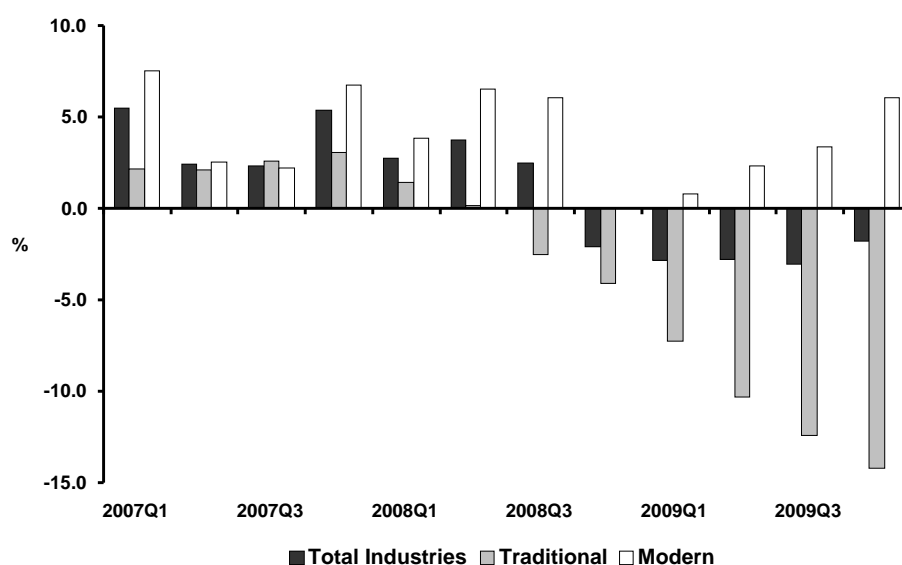


Source: Quarterly National Accounts, CSO.

The performance of the industrial sector over the course of 2009 is illustrated in Figure 18 which shows the annualised changes in the industrial production index. The graph emphasises the contrasting fortunes of the traditional and modern sectors in 2009. As discussed in the *Exports* section, the traditional sector has been more severely affected during the recession than other sectors as a result of its greater dependence on the UK market. The effects of the weakness of sterling and the downturn in the UK economy have had a major impact on the level of output produced in the sector as shown in Figure 18. While the pace of output decline in the traditional sector accelerated over each quarter in 2009, the opposite trend is evident for the modern sector. Annualised growth increased during each quarter last year and stood at 6 per cent in the final quarter of 2009. The strong performance of the modern sector, driven by the solid performance of pharmaceutical exports, is helping to stabilise overall industrial output, despite the sharp fall in activity in the traditional sector.

⁹ Weighted by the share in total constant price GDP at factor cost.

Figure 18: Annual Growth Rates in Industrial Production Index



Source: Industrial Production Index, CSO.

Our forecasts suggest that total output in industry, excluding building and construction, will expand by 2 per cent in 2010 driven by a recovery in world demand. We anticipate that as the recovery gathers momentum in 2011, industrial output excluding building will grow by 4½ per cent in volume terms. The ongoing difficulties in the building and construction sector are reflected in our forecasts for output. We expect another sharp fall in building and construction output of over 25 per cent in 2010 with a further 4½ per cent decline projected for 2011. If these forecasts materialise, by the end of 2011, total output of the building and construction sector will have fallen by a massive 66 per cent from its 2007 level. The fall in output reflects the fall in the share of housing investment in GNP, which is expected to drop to just 3½ per cent in 2010 having peaked at almost 15 per cent at the height of the housing bubble.

We expect that services output will increase by over 1 per cent in 2010 and by 2½ per cent in 2011. The continued contraction in publicly provided services is expected to be offset by an increase in other services output as a result of the anticipated pick up in consumption.

As discussed in Box 1 below on agriculture, 2009 was an extremely difficult year for the sector. Based on an expected recovery in dairy and beef prices, our forecasts suggest a modest increase in agricultural output of 1 per cent in both 2010 and 2011.

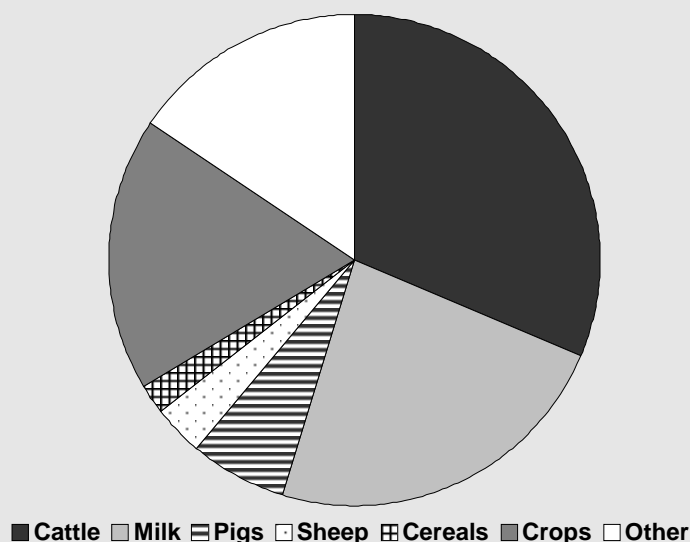
Box 1: Irish Agriculture

While the severe contraction in economic activity in Ireland in 2009 affected all sectors of the Irish economy, the agriculture sector recorded particularly large declines in output and income over the course of the year.

Preliminary estimates from the CSO¹⁰ show that income in agriculture fell by almost a third in 2009. Based on records going back to 1973, this is the largest annual decline ever recorded in the operating surplus. The fall in income was driven by sharp falls in the value of agricultural output, especially milk and cereals, with poor weather and flooding also likely to have reduced output in 2009. Overall, output at farm gate prices declined by almost 19 per cent in value and 4 per cent in volume (Table 1A). While savings were made on inputs, with the value of intermediate consumption falling by 9.5 per cent, the deduction for depreciation remained broadly unchanged from 2008, which contributed to the dramatic decline in the overall operating surplus.

The structure of the agriculture sector is illustrated in Figure 1A which shows the share of gross output accounted for by the main commodities. In 2009, cattle and milk output accounted for over half of total gross output with cereals accounting for around 2 per cent of output.

Figure 1A: Structure of Agriculture Sector: Main Commodities



Source: CSO *Output, Input and Income in Agriculture 2009- Preliminary Estimates*.

The main commodity outputs from Irish farms experienced substantial price falls in 2009 as shown in Table 1A. The downturn in the international economy impacted on global food demand and contributed to the decrease in commodity prices observed over the course of 2009. The value of milk output declined by almost 33 per cent, or €530 million, due almost entirely to a decrease in milk prices. Cereals output declined by over 50 per cent in value and 30 per cent in volume. There was also an 11 per cent decline in the value of livestock output, again primarily driven by price falls. Despite a fall in intermediate consumption of almost 10 per cent, due to lower energy and fertilizer prices, gross value added at basic prices still fell by over 41 per cent in 2009.

¹⁰ CSO, 2010. *Output, Input and Income in Agriculture 2009- Preliminary Estimates*.

Net value added at basic prices measures the prices farmers receive for their output, net of product specific subsidies and taxes. In 2009, this declined by 77 per cent to just €195.5 million. In addition, farmers receive direct payments which in 2009 amounted to €1.9 billion. Thus, the operating surplus in agriculture fell from €2.3 billion in 2008 to €1.6 billion in 2009, a drop of almost 31 per cent.

Table 1A: Output, Input and Income in Agriculture

	2008	2009	Value Change 2008/2009	Volume Change 2008/2009
	€Million			
All Livestock	2,541.0	2,250.4	-11.4	-3.2
Livestock - Cattle	1,668.0	1,485.3	-11.0	-1.4
Livestock - Pigs	333.8	299.9	-10.2	-2.2
Livestock - Sheep	171.4	161.2	-6.0	-9.9
All Livestock Products	1,677.5	1,142.4	-31.9	-3.1
Livestock Products - Milk	1,629.7	1,100.8	-32.5	-3.2
All Crops	1,608.2	1,340.4	-16.7	-6.7
All Cereals	200.0	94.5	-52.8	-34.2
Crops - Forage Plants	1,008.1	857.5	-14.9	-2.0
Goods Output at Producer Prices	5,826.6	4,733.2	-18.8	-4.0
Contract Work	281.0	269.2	-4.2	-8.2
Subsidies less Taxes on Products	6.2	15.0		
Agricultural Output at Basic Prices	6,113.8	5,017.5	-17.9	-4.0
Intermediate Consumption	4,493.9	4,065.8	-9.5	-3.6
Gross Value Added at Basic Prices	1,619.9	951.6	-41.3	
Fixed Capital Consumption	763.0	756.1	-0.9	
Net Value Added at Basic Prices	857.0	195.6	-77.2	
Other Subsidies Less Taxes on Production	1,904.4	1,846.3	-3.1	
Factor Income	2,761.4	2,041.9	-26.1	
Compensation of Employees	436.3	427.2	-2.1	
Operating Surplus	2,325.1	1,614.7	-30.6	

To derive a measure of farm income at basic prices, it is necessary to deduct from net value added at basic prices expenditure by farmers on hired labour, interest payments on borrowed capital and land rental. In 2009, these totalled €427.2 million, €328.0 million and €153.0 million respectively. This implies that in 2009, farm income at basic prices was minus €713 million. Thus, the only return to farm enterprises in 2009 came from direct payments paid for by the EU under the CAP and by the Exchequer.¹¹ This highlights the dependence of farm enterprises on direct payments, a situation which leaves the agriculture sector highly vulnerable to future reforms of the CAP and to changes in the EU budget.

Despite the poor outturn for the agriculture sector in 2009, prices of the main agricultural commodities are expected to strengthen over the medium-term according to the latest projections from the OECD and

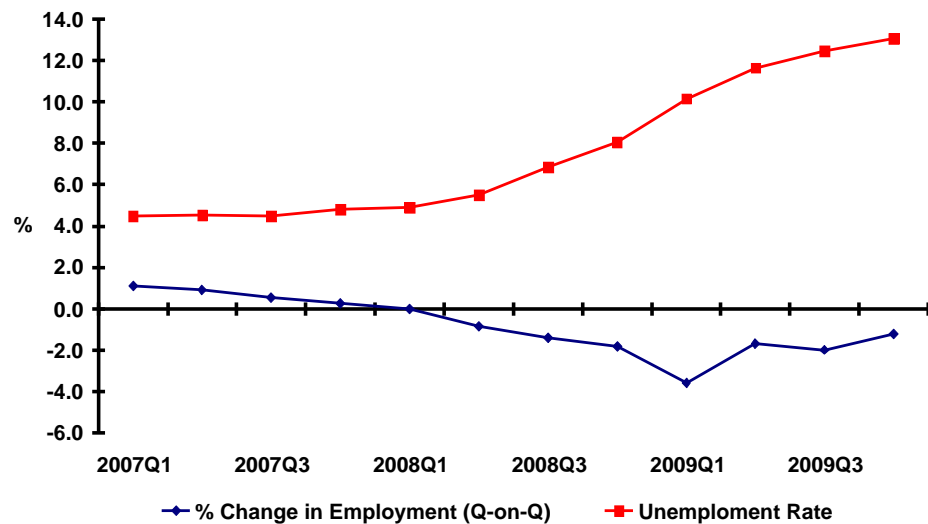
¹¹ In addition, payment of capital grants under the Farm Waste Management Scheme is expected to exceed €900 million. Payments to farmers under this scheme are being made on a phased basis over the period to 2011.

FAPRI.¹² While food prices fell sharply in 2009 from the record levels reached in 2007, growth in population and incomes is expected to sustain a recovery in meat and dairy prices. Milk prices in Ireland are expected to recover gradually in 2010 while cattle prices are forecast to rise by 4 per cent.¹³ Thus some of the reduction in agricultural incomes which occurred last year should be reversed over the course of 2010 and 2011, as reflected in our forecasts. Nevertheless, the Irish agriculture sector faces a significant competitiveness challenge if it is to adjust to the more liberalised conditions which are likely to exist in international commodity markets in the coming years.

Employment

The latest figures from the *Quarterly National Household Survey (QNHS)* indicate that employment fell by 8.1 per cent in 2009, while the seasonally adjusted rate of unemployment in the final quarter of the year was 13.1 per cent. Figure 19 shows the quarter-on-quarter developments in employment and unemployment and reveals signs of relative stabilisation in the trend during the second half of 2009. The pace of increase (decrease) in the unemployment (employment) level has eased since 2009 Q2, and the latest Live Register figures suggest that this stabilisation pattern has continued into 2010. The seasonally adjusted monthly pace of increase in the Live Register averaged 0.2 per cent in the six months up to March 2010. In addition, the seasonally adjusted standardised rate of unemployment in March 2010 was 13.4 per cent according to the Live Register, compared to the *QNHS* estimate of 13.1 per cent in the final quarter of 2009.

Figure 19: Unemployment Rate and Quarter-on-Quarter % Change in Employment, Seasonally Adjusted



Source: Quarterly National Household Survey, CSO.

¹² OECD-FAO *Agricultural Outlook 2009-2018*.

http://www.oecd.org/document/10/0,3343,en_36774715_36775671_42852746_1_1_1_1_00.html; FAPRI 2009 *World Agricultural Outlook*:

<http://www.fapri.iastate.edu/outlook/2009/>

¹³ <http://www.teagasc.ie/publications/2010/20100118/>

Table 12: Employment and Unemployment

	Annual Averages 000s			
	2008	2009	2010	2011
Agriculture	115	96	88	88
Industry	520	411	373	373
Services	1,465	1,422	1,395	1,397
Total at Work	2,100	1,929	1,856	1,857
Unemployed	141	258	294	280
Labour Force	2,241	2,187	2,150	2,138
Unemployment Rate %	6.3	11.8	13 ¾	13
Net Migration	38.5	-7.8	-60.0	-40.0
of which: Inward Migration	83.8	57.3	10.0	20.0
Change in Participation Rate*	-0.3	-1.2	- ¼	¼

Note: Participation rate measured as share of population aged 15-64 years; based on Q2 figures as are migration figures.

The slower pace of increase in the unemployment level may be partly due to the fall in labour force participation. Since the end of 2007 the labour force participation rate has fallen by 2.6 percentage points. This has formed a significant offset to the fall in employment in the measured unemployment rate. For example, between 2007 Q4 and 2009 Q4, total employment fell by 251,000 while total numbers unemployed increased by 166,000. Had the numbers unemployed increased by 251,000, the measured unemployment rate in 2009 Q4 would be 15.7 per cent. The fall in participation has been much more pronounced among younger members of the working age population, particularly males. This is discussed in greater detail in Box 2.

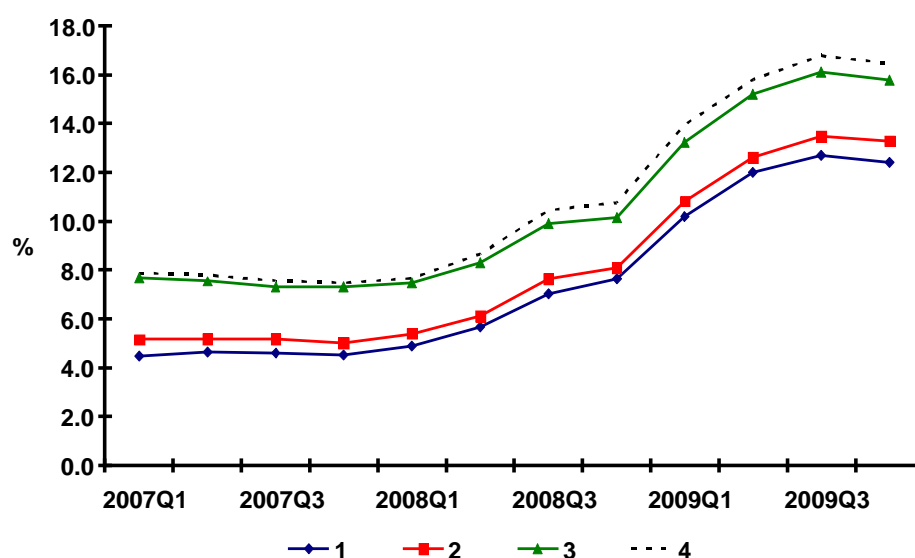
Such a sharp fall in labour force participation suggests that there may be a growing number of individuals who are not classified as unemployed, but are currently without work and are available for work. Using *QNHS* data, we can examine potential labour supply by extending our analysis beyond the standard measure of unemployment and including other jobless individuals who consider themselves available for work. Table 13 shows the standard unemployment rate at 2009 Q4 (unadjusted) as well as three wider measures of unemployment which are reported by the CSO. Individuals who are outside of the labour force but are available for work include passive jobseekers, discouraged workers and others not engaged in education. Within the labour force, part-time underemployed workers¹⁴ are another group who consider themselves available for additional work. If we include all of these groups, along with the individuals characterised as unemployed, then our measure of unemployment or potential labour supply rises to 16.5 per cent. The equivalent measure in the final quarter of 2008 was 10.8 per cent, as shown in Figure 20.

¹⁴ A respondent who works in a part-time job is classified as 'underemployed' if he/she is looking and available for another job and has explicitly stated that the hours worked currently are 'too few'.

Table 13: Measure of Unemployment or Potential Labour Supply (%), 2009 Q4

	%
1. Unemployed, as a percentage of the labour force	12.4
2. Unemployed plus 'marginally attached', ¹⁵ as a percentage of the labour force plus 'marginally attached'	13.3
3. Unemployed plus 'marginally attached' plus others not in education who want work, as a percentage of the labour force plus 'marginally attached' plus others not in education who want work	15.8
4. Unemployed plus 'marginally attached' plus others not in education who want work plus underemployed part-time workers, as a percentage of the labour force plus 'marginally attached' plus others not in education who want work	16.5

Figure 20: Potential Labour Supply,¹⁶ 2007-2009



Source: Quarterly National Household Survey, CSO.

The *QNHS* reveals other interesting dimensions in relation to the trends in unemployment. First, the Q4 figures indicate a widening spread between male and female unemployment, as shown in Figure 21. Male and female unemployment rates were essentially equal before the downturn in the economy, but the latest figures suggest that while the female unemployment rate is 9.0 per cent, unemployment among males is

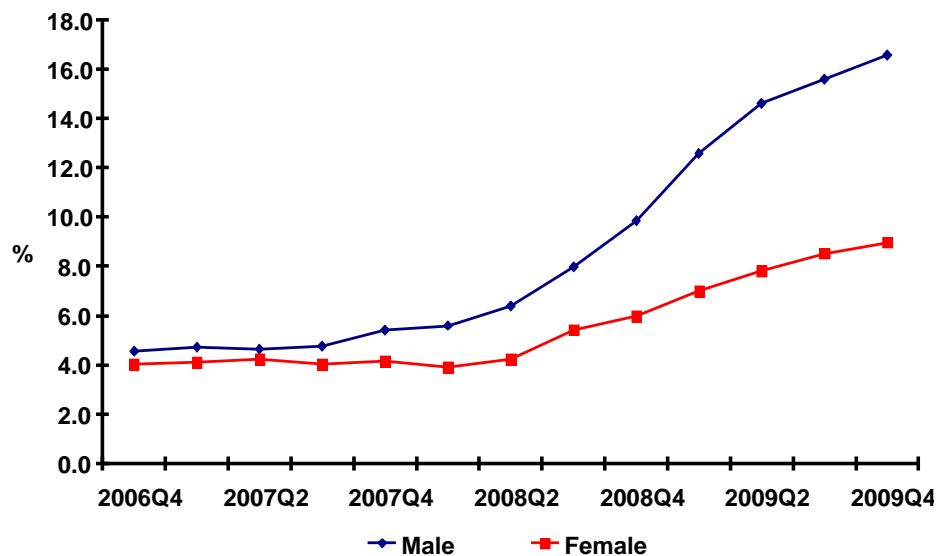
¹⁵ The category 'marginally attached to the labour force' includes passive jobseekers and discouraged workers. These are individuals who are available for work but are not actively seeking work, so are not included in the labour force and therefore are not characterised as unemployed.

¹⁶ 1,2,3 and 4 refer to the four measures of unemployment shown in Table 13.

considerably higher at 16.6 per cent. This development is not entirely surprising, given that over half of the total fall in employment over the last two years is accounted for by the construction sector.

A second interesting development in the fourth quarter *QNHS* data relates to the trend in long-term unemployment.¹⁷ More than half of the increase in total unemployment in 2009 was in long-term unemployment, bringing the total level of long-term unemployment to 89,100. In 2009 Q4 long-term unemployment accounted for 33 per cent of total unemployment, compared to 22 per cent a year previously.

Figure 21: Male and Female Unemployment Rate



Source: Quarterly National Household Survey, CSO.

Turning to our forecasts, our views regarding 2010 are largely unchanged – we expect employment to average 1.86 million, implying a fall of 3¾ per cent relative to 2009. We are forecasting no significant change to the overall employment level in 2011. While the pace of increase in unemployment is likely to moderate further, we do expect to see some additional job losses in the financial sector, construction and the public sector. The unemployment rate is expected to peak at just under 14 per cent at the end of 2010, before falling back to an average rate of 13 per cent in 2011.

Following a fall of 2.4 per cent in the size of the labour force in 2009, we expect to see a further fall of 1¾ per cent this year and ½ per cent next year. This will result in the labour force averaging 2.14 million in 2011, a level last seen in 2006. The decline in the labour force will be driven by a further fall in the participation rate in 2010 and by an expected net outflow of 60,000 in the year ending April 2010, followed by an additional net outflow of 40,000 in the year ending April 2011.

¹⁷ According to the *QNHS*, long-term unemployment refers to individuals who have been unemployed for one year or more.

Box 2: Unemployment and Labour Force Participation

The true impact of the current recession is probably best reflected in the challenging labour market conditions. The total number of people in employment has fallen by 12 per cent since the end of 2007, and the current rate of unemployment stands at 13.1 per cent of the labour force. The pace of increase in the numbers unemployed slowed in the second half of 2009, partly due to the sharp fall in labour force participation. The participation rate has now fallen by almost three percentage points since the end of 2007. A period of rising unemployment is often associated with a decline in participation, as many individuals become discouraged about their work prospects, while others choose to return to education.

The fall in labour force participation over the last year has not been uniform across the working age population, as shown in Table 2A. The overall participation rate fell by 1.7 percentage points between Q4 2008 and Q4 2009, with a higher fall of 2.7 percentage points for males. The data in Table 2A show that the fall in participation has been concentrated among the youngest and oldest groups in the working age population, and in particular among individuals aged 15-19 years and among males aged 20-24 years. In total, there were 69,100 fewer people in the labour force in Q4 2009 compared to the same period in the previous year. The fall in participation by those in the 15-24 year age cohort accounts for over half of that overall decline.

Table 2A: Year-on-Year Change in Participation Rate by Selected Age Category, 2009 Q4

	All	Male	Female
Working age population	-1.7	-2.7	-0.7
15 - 19 years	-3.3	-1.7	-5.1
20 - 24 years	-2.8	-5.6	0.1
55 - 59 years	-2.0	-4.4	0.5
60 - 64 years	-1.8	-3.9	0.3

Table 2B examines in detail the change in the status of those aged 15-19 years and 20-24 years, between the third quarter of 2008 and the third quarter of 2009.¹⁸ The data indicate that there was a decline of over 60,000 in the total number of males and females aged 15-25 in the labour force between Q3 2008 and Q3 2009. While some of this decline is explained by demographic effects,¹⁹ approximately 26,000 individuals in this cohort are now classified as not in the labour force. Of this 26,000 who are not in the labour force, over two thirds are classified as students.

¹⁸ For the purpose of this detailed analysis we used data on student numbers, provided by the CSO. At the time of writing these data were only available up to 2009 Q3.

¹⁹ Between Q3 2008 and Q3 2009 there was a fall of approximately 35,000 in the total population aged 15-24 years.

Table 2B: Year-on-Year Change in Status of Working Age Population, Age 15-19 Years and 20-24 Years, Q3 2009

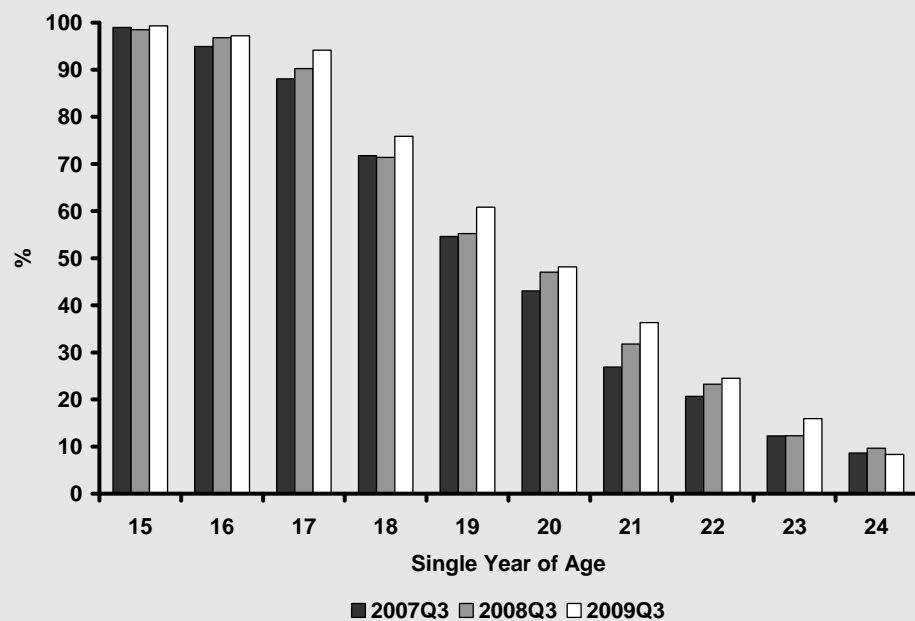
		Q32008 (000)		Q32009 (000)		Year-on-Year Change (000)	
		15-19 Years	20-24 Years	15-19 Years	20-24 Years	15-19 Years	20-24 Years
Males	Total	144.2	164.2	141.7	147.1	-2.6	-17.1
	In Labour Force	43.9	136.5	33.6	111.3	-10.3	-25.2
	Not in Labour Force	100.3	27.7	108.1	35.8	7.8	8.1
	Of which						
	Students	97.0	19.8	103.4	23.5	6.4	3.8
	Others	3.3	8.0	4.7	12.3	1.4	4.3
Females	Total	139.6	167.0	136.6	154.5	-3.0	-12.4
	In Labour Force	43.5	119.8	29.7	108.5	-13.8	-11.4
	Not in Labour Force	96.1	47.1	106.9	46.1	10.8	-1.1
	Of which						
	Students	91.4	27.6	102.9	24.5	11.5	-3.2
	Others	4.7	19.5	4.1	21.6	-0.7	2.1
Total	Total	283.9	331.2	278.3	301.6	-5.5	-29.5
	In Labour Force	87.4	256.3	63.3	219.8	-24.1	-36.5
	Not in Labour Force	196.4	74.9	215.0	81.9	18.6	7.0
	Of which						
	Students	188.4	47.4	206.3	48.0	17.8	0.6
	Non-Students						
	Not in Labour Force	8.0	27.5	8.7	33.9	0.8	6.4

Looking at these younger age categories in more detail, the fall in participation by those aged 15-19 years is particularly striking and would appear to suggest that the youngest members of the working age population are choosing to remain in education. This is confirmed by the data in Table 2B and by Figure 2A. While the total number of individuals aged 15-19 years classified as not in the labour force increased by 18,600, this was almost entirely driven by an increase in the number of students in this age cohort. Young males in the 20-24 years category have also experienced a sharp fall in participation in the last year. This partly reflects the fact that they have been most exposed to job losses in the construction sector. The total fall in employment between Q3 2008 and Q3 2009 among this cohort was approximately 37,500. However, while 12,400 males in this age category became characterised as unemployed during this period, an additional 8,100 males aged 20-24 years became classified as not in the labour force, compared to the same period in 2008, as shown in Table 2B. Looking at statistics on male students aged 20-24 years, there has been an increase of approximately 3,800 students classified as not in the labour force over the same time period. This suggests that less than half of the 8,100 males aged 20-24 years who left the labour force between Q3 2008 and Q3 2009 are now engaged in education.

Figure 2A shows the number of students by single year of age from 15-24 years as a proportion of the total population by single year of age. The

graph indicates an increase in the proportion of students across all age groups, with the exception of those aged 24 years. The increase in the proportion of students by age has been particularly pronounced for certain groups. For example, the number of students as a percentage of the total population aged 21 years has increased from 27 per cent in Q3 2007 to 36 per cent in Q3 2009. The graph indicates a significant increase in the number of students within the cohort aged 15-24 years who have exited the labour force and are now in the education system. The increase in the number of students is also reflected in the rise in the number of applications received by the Central Applications Office (CAO) in 2010. The number of applications for third level places increased to 72,000 this year, a 10 per cent increase compared to the previous year.

Figure 2A: Students by Single Year of Age as a Proportion of Total Population by Single Year of Age



The contraction in economic activity in Ireland which has taken place since 2008 has been reflected in a significant deterioration in labour market conditions with a sharp rise in unemployment and a decline in labour force participation. The decline in the overall participation rate has been driven by a fall in participation among the youngest and oldest age groups in the working age population. In particular, there has been a sharp fall in participation among all persons aged 15-24 years. The analysis here indicates that a significant proportion of those who have exited the labour force, but who remain in Ireland, are now engaged in education, particularly those aged under 20 years. Approximately 86 per cent of all individuals aged 15-24 years who are not in the labour force are classified as students. Previous ESRI research on the labour market (O'Connell, 2009)²⁰ shows the importance of raising the skill level of those who have

²⁰ O'Connell, P.J., 2009. "What Works? Applying Lessons from the 1990s", Available at http://www.esri.ie/docs/What_works_300049.ppt#256,1.

lost their jobs or exited the labour force in order to minimise the risk of long-term unemployment.

Incomes

The most recent data on wages come from a new CSO survey which covers all sectors of the economy. The data series begin in 2008 Q1 and the most recent release at the time of writing provides preliminary estimates for 2009 Q2. Table 14 summarises the annual rate of change in weekly and hourly earnings from these series. The picture presented is quite mixed. In relation to average weekly earnings, these fell across several sectors in the first two quarters of 2009, most notably in financial insurance and real estate sectors at -13.3 per cent in 2009 Q2,²¹ but also in a range of other sectors including construction, wholesale and retail trade, transportation and storage. The fall across all sectors was -1.1 per cent. However from the data it appears that most of this fall in weekly earnings was due to a fall in hours worked, the data on hourly earnings estimate that hourly wage rates rose by 3.6 per cent in 2009 Q1 and 1.8 per cent in 2009 Q2. With so little data it is difficult to detect a pattern. Nevertheless, across all sectors the data that are available suggest a downward trend in wages in the first two quarters of 2009.

Table 14: Annual Changes in Average Earnings for All Employees

	Average Weekly Earnings		Hourly Earnings	
	2009 Q1	2009 Q2	2009 Q1	2009 Q2
All sectors	0.3	-1.1	3.6	1.8
Private sector	-1.7	-3.1	2.0	0.2
Public sector	3.1	1.3	4.6	2.6
Industry	1.2	0.6	5.8	4.4
Construction	2.9	-1.3	7.3	4.0
Wholesale and retail trade	-1.7	-1.7	1.5	1.3
Transportation and storage	-3.2	-3.5	1.6	-2.3
Accommodation and food services	-3.3	-1.5	2.5	0.6
Information and communication	-4.3	0.1	-3.3	1.1
Financial, insurance and real estate	-11.8	-13.3	-10.5	-11.6
Professional, scientific and technical	4.1	-1.8	4.5	-1.6
Administrative and support services	-1.8	-0.6	2.3	1.1
Public administration and defence	2.3	0.7	0.3	0.4
Education	5.8	1.0	6.6	4.1
Human health and social work	3.1	0.3	5.9	3.3
Arts, entertainment, recreation and other service	-2.7	-1.2	3.2	1.2

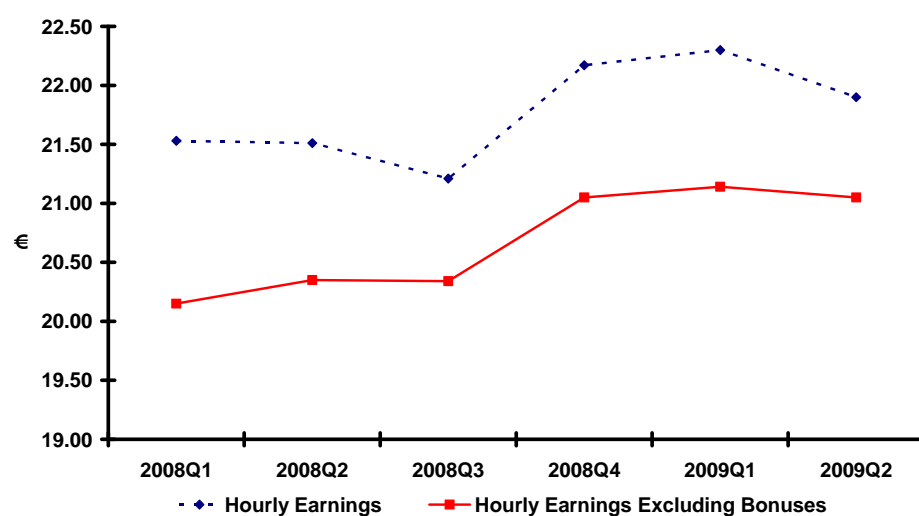
²¹ The fall in hourly earnings in the financial, insurance and real estate sector was largely due to a significant fall in irregular bonuses, in 2009 Q2 hourly earnings fell by -11.6, excluding bonuses this was -0.6.

Table 15: Personal Disposable Income

	2008		Change		2009		Change		2010		Change		2011	
	€bn	%	€bn	€bn	%	€bn	€bn	%	€bn	€bn	%	€bn	€bn	
Agriculture, etc.	2.9	-25.0	-0.7	2.2	5	0.1	2.3	5	0.1	2.4				
Non-Agricultural Wages	78.9	-9.5	-7.5	71.4	-6 ½	-4.6	66.9	-1	-0.6	66.2				
Other Non-Agricultural Income	19.2	-17.0	-3.3	15.9	-3 ¾	-0.6	15.3	22 ½	3.5	18.8				
Total Income Received	101.0	-11.4	-11.5	89.5	-5 ¾	-5.1	84.5	3 ½	3.0	87.4				
Current Transfers	24.3	9.4	2.3	26.6	8	2.1	28.7	1 ¾	0.5	29.3				
Gross Personal Income	125.3	-7.3	-9.2	116.1	-2 ½	-2.9	113.2	3	3.5	116.7				
Direct Personal Taxes	23.4	-6.1	-1.4	22.0	-2 ½	-0.6	21.4	5 ½	1.2	22.6				
Personal Disposable Income	101.9	-7.6	-7.8	94.1	-2 ½	-2.3	91.8	2 ½	2.3	94.1				
Consumption	93.9	-10.3	-9.7	84.2	-2	-1.7	82.5	2 ½	2.1	84.5				
Personal Savings	8.0			10.0			9.3			9.6				
Savings Ratio	7.9			10.6			10 ¼			10 ¼				
Average Personal Tax Rate	18.7			18.9			19			19 ¼				

The new series also provides an estimate of private sector and public sector wages. These suggest that there were significant falls in private sector weekly earnings in the first two quarters of 2009; while these falls were mainly due to falls in hours worked the growth in hourly earnings in 2009 Q2 was just 0.2 per cent suggesting stagnation in wage rates. The figures for the public sector suggest that public sector hourly wages grew by 2.6 per cent in 2009 Q2. However, it is important to emphasise that these estimates of public sector earnings do not take account of the 7 per cent pension levy introduced in 2009 Q2. Figure 22 shows the pattern of hourly earnings for all employees. These data suggest that hourly earnings have started to fall. Assuming that this downward trend in wage rates continued for the rest of 2009 we estimate that average earnings could have fallen by 2 per cent in 2009.

Figure 22: Hourly Earnings



Source: Earnings, Hours and Employment Costs Survey (EHECS), CSO.

For 2010 our forecast is for a larger fall in average earnings of 3 per cent. This is partly driven by the cuts in public sector pay rates in the budget, but also by an expectation that the weak labour market will continue to put downward pressure on private sector wage rates. For 2011 our tentative forecast is for a further fall in average wage rates of 1 per cent. These cuts if realised will impact on the real standard of living of those in employment. The sustained fall in consumer prices throughout 2009 will have helped to cushion the real impact of these nominal wage falls. However, given that we expect consumer prices to stabilise in 2010 and even increase slightly in 2011, this means that in 2010 and 2011 real wages will also fall significantly if our forecasts prove accurate.

Combining these wage forecasts with our employment numbers means that we estimate non-agricultural wage income to have fallen by -9.5 per cent in 2009. Despite an increase in transfer income of 9.4 per cent, total disposable income is estimated to have fallen by 7.6 per cent. While dramatic, this is exceeded by the estimated fall in consumption of 10.3 per cent, consequently, we estimate that the savings rate in 2009 has risen to 10.6 per cent. As discussed in the previous *Commentary* there is strong

evidence of precautionary savings behaviour among households as they attempt to restore their balance sheets.

Our forecasts for 2010 and 2011 do not imply any significant change in the savings rate in these years. Further falls in wages and employment will lead to a further fall in wage income of 6½ per cent in 2010. This dramatic fall is likely to be offset by a forecast 8 per cent increase in transfer income so that total disposable income is forecast to fall by 2½ per cent in 2010, implying a savings rate of 10¼ per cent. For 2011 we expect a modest pick-up in both consumption and disposable income, with the savings rate unchanged at 10¼ per cent. The average personal tax rate in 2011 is expected to increase to 19¼ per cent due to budgetary measures already introduced and an anticipated further increase in direct personal taxes in the 2011 budget.

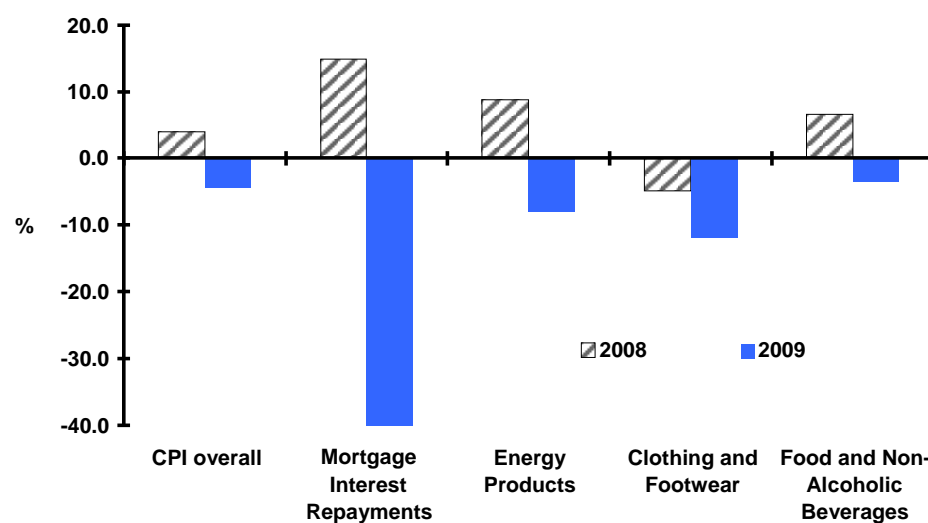
Consumer Prices

The annual average rate of inflation, measured by the Consumer Price Index (CPI), was -4.5 per cent in 2009. This followed annual inflation of 4.1 per cent in 2008. Having reached a trough at -6.6 per cent in October 2009, the pace of price decline has moderated in recent months, and according to the latest figures from the CSO, the CPI fell by 3.2 per cent in February 2010, compared to the same period last year. The pace of decline in the Harmonised Index of Consumer Prices (HICP) has also slowed. This index fell by 2.4 per cent in February, year-on-year.

While the pace of overall price decline in 2009 averaged 4.5 per cent, many of the sub-indices of the CPI fell by significantly more. Figure 23 shows the annual percentage change in the overall CPI and a variety of its components, both in 2008 and 2009. The mortgage interest component, the single biggest contributor to CPI volatility over the last two years, fell by 40 per cent in 2009, following the aggressive cuts to ECB interest rates. Excluding this component from the CPI reduces the average rate of inflation in 2009 to -1.2 per cent. Energy prices have been another source of overall CPI volatility during 2008 and 2009 as shown in Figure 23, falling by an average of 8 per cent last year. Although the price of electricity and gas rose marginally, petrol, diesel and home-heating oil prices fell sharply in 2009, by 8 per cent, 18 per cent and 32 per cent respectively. We expect to see some reversal in these trends this year, as oil prices are projected to be 30 per cent higher on average in 2010.²² However, gas and electricity prices are expected to moderate over the coming year. Prices of food, clothing and footwear also showed significant declines last year and this is largely related to the weakened sterling and its impact on the prices of goods that are heavily imported from the UK.

²² NIESR *Economic Review*, No. 211, January 2010.

Figure 23: Annual % Change in Consumer Price Index and Selected Sub-Indices, 2008 and 2009



Source: Consumer Price Index, CSO.

Looking ahead, we expect the CPI to increase marginally this year, by $\frac{1}{4}$ per cent. We are forecasting average CPI inflation of $1\frac{3}{4}$ per cent in 2011. Once again, we expect the mortgage interest component to be the main driver of price growth and so, as ever, our forecasts are sensitive to our assumptions regarding future interest rates. As discussed in the *International* section, we are not currently expecting to see any ECB interest rate increases in 2010, given the current forecasts for Euro Area growth and inflation. However, we have factored in two further 50 basis point increases in domestic mortgage interest rates in the coming months, in light of recent announcements by a number of Irish mortgage lenders. As pointed out in the *International* section, our inflation forecasts imply an overall reduction in the real interest rate, in spite of the assumed increases in the nominal interest rate. The importance of the mortgage interest component as the main source of overall price increases is evident in our forecasts for the HICP, which does not include mortgage interest repayments. We expect HICP inflation to average $-1\frac{1}{2}$ per cent this year and $\frac{1}{2}$ per cent next year. These forecasts take into account the current expectations regarding exchange rates, as outlined in the *International* section above. However, if sterling were to weaken further, this would put additional downward pressure on HICP inflation.

Table 16: Inflation Measures (%)

	2007	2008	2009	2010(f)	2011(f)
CPI	4.9	4.1	-4.5	$\frac{1}{4}$	$1\frac{3}{4}$
Mortgage Interest	40.4	15.0	-40.0	22	29
HICP (Ireland)	2.9	3.1	-1.7	$-1\frac{1}{2}$	$\frac{1}{2}$
HICP (Euro Area)	2.1	3.3	0.3	1.3	1.1

PRIVATE SECTOR CREDIT

The decline in the annual rate of change in headline private sector credit (PSC) continued during the last months of 2009 and into 2010. Headline PSC declined in June 2009 for the first time since 1993 and the pace of decline has accelerated in recent months (Table 17). Following seven consecutive monthly falls, headline PSC declined by 6 per cent in the year ending December 2009. Around two-thirds of this annual decline was due to valuation effects, including write-downs of loans, increased bad debt provisions and exchange rate effects as the euro strengthened during the year reducing the book value of non-euro denominated loans.

There have recently been important changes in the factors accounting for the fall in credit outstanding to the private sector. Up to November 2009, the majority of the decline in PSC was due to valuation effects with the underlying stock of private sector credit remaining broadly unchanged. Recent months have seen a reversal of this trend with the fall in private sector credit in December 2009 and in the early months of 2010 being driven by changes in underlying transactions rather than valuation effects. Following a decline of almost €1.2 billion in December, PSC declined by €2.4 billion in January and by a further €3.9 billion in February. These declines were primarily due to underlying transactions as repayment of debt exceeded draw-downs during these months.

Table 17: Private Sector Credit

	End Month	Private Sector Credit	Un-adjusted Growth Year-on-Year	Adjusted Year-on-Year	Residential Mortgage Lending	Adjusted Year-on-Year
		€million	%	%	€million	%
2007	December	376,796	18.6	17.0	139,842	13.4
2008	March	384,340	17.1	17.1	142,403	11.6
	June	392,937	14.6	14.1	145,341	10.2
	September	399,143	10.8	10.5	147,550	8.5
	December	395,070	4.9	7.3	148,115	5.9
2009	March	392,258	2.1	2.4	148,542	4.3
	June	387,350	-1.3	-0.8	148,349	2.1
	September	378,086	-5.3	-3.4	147,969	0.3
	December	371,879	-5.9	-6.0	147,654	-0.3
2010	January	369,461	-7.2	-7.1	147,385	-0.7
	February	365,527	-8.2	-7.3	147,229	-0.9

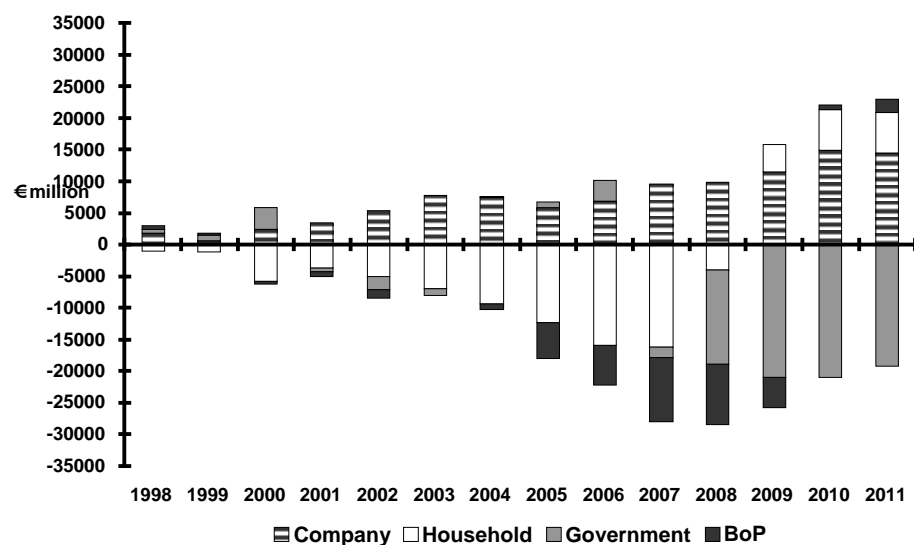
Source: Central Bank Monthly Statistics.

Residential mortgage lending accounts for around 40 per cent of total private sector credit outstanding. Growth in residential mortgages outstanding moderated sharply during the first half of 2009, and in November 2009, fell by €134 million following a decline of €161 million in October. The November 2009 decline represented the eight consecutive monthly fall in mortgage lending outstanding and resulted in a fall in mortgage debt outstanding on a year-on-year basis of €207 million or 0.1 per cent. This was the first annual decline in mortgage lending outstanding since the series began in the early 1990s. Mortgage debt outstanding

declined further in December 2009 and during the early months of 2010 with the annual rate of change in mortgage lending falling to -0.9 per cent by the end of February.

Deleveraging by the household and company sector, as shown in the latest statistics in Table 17 on private sector debt outstanding, is reflected by developments in the flow of funds in the Irish economy (Figure 24). Our forecasts imply that as a result of the decline in the financing needs of the household sector as well as the increase in the savings rate, the rate of net acquisitions of the household sector should remain in surplus in 2010 and 2011. A continuation of the current trend of debt repayment exceeding new credit outstanding would also reduce the overall liabilities of the banking system.

Figure 24: Flow of Funds in the Irish Economy



Source: Balance of Payments Statistics and own calculations.

CREDIT CONDITIONS

The fall in private sector credit discussed above reflects the ongoing weak demand for credit and the contraction in credit supply as a result of banks' balance sheet constraints and the higher cost of sourcing funds. The ECB's Bank Lending Survey provides evidence on credit conditions in the Irish economy. According to the latest Bank Lending Survey, which is based on the responses of senior lending officers in the participating banks, credit standards on loans to enterprises tightened further during Q4 2009 as shown in Table 18.

Table 18: ECB Bank Lending Survey, Change in Credit Standards

		Q1 2009	Q2 2009	Q3 2009	Q4 2009
Enterprises	Overall	2.20	2.40	2.60	2.40
	Loans to SMEs	2.20	2.75	3.00	2.75
	Loans to large enterprises	2.00	2.25	2.50	2.25
	Short-term loans	2.20	2.40	2.60	2.40
	Long-term loans	2.20	2.40	2.60	2.40
Households	House purchase	2.75	2.50	2.75	3.00
	Consumer credit and other lending	2.75	2.75	3.00	3.00

1 = tightened considerably; 2 = tightened somewhat; 3 = basically unchanged; 4 = eased somewhat; 5 = eased considerably

Source: ECB Bank Lending Survey.

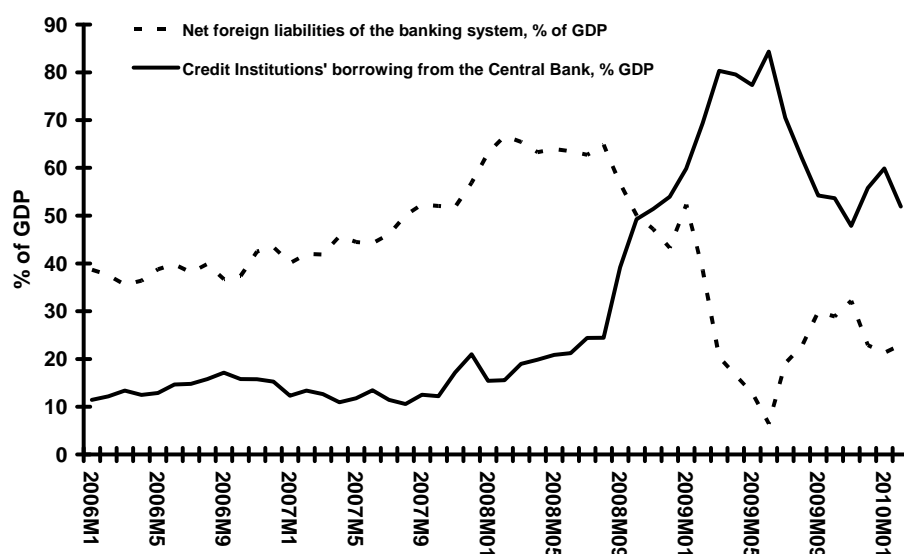
Credit standards on loans to both SMEs and large enterprises tightened during the final quarter of 2009. The tightening of credit standards was due mainly to an increase in banks' cost of funds and balance sheet constraints. For households, credit standards on loans for house purchase and for consumer credit remained unchanged in Q4 2009. The demand for loans from both households and enterprises remained weak in the final quarter of 2009. Lower levels of fixed investment and uncertainty regarding housing market prospects contributed to the decline in demand.

The Bank Lending Survey included for the first time questions regarding the expected change in credit standards on loans to enterprises and households over the coming year. The participating banks indicated that they expect credit standards to remain unchanged over the next 12 months.

BANK FUNDING

Dislocation in Euro Area money markets since September 2008 resulted in an increase in Irish credit institutions' borrowing from the Central Bank. This lending to credit institutions by the Irish Central Bank has in turn been funded by the ECB through refinancing operations such as its longer term refinancing operations (LTROs). As shown in Figure 25, lending to credit institutions by the Irish Central Bank as part of the Eurosystem's monetary policy operations peaked in June 2009 at over €130 billion as banks availed of a new 12 month LTRO.

Figure 25: Net Foreign Liabilities of the Banking System and Credit Institutions Borrowing from the Central Bank, % of GDP



Source: Central Bank Monthly Statistics.

A gradual normalisation of interbank markets over the second half of 2009 resulted in a reduction in Irish banks' borrowing from the Central Bank and a gradual increase in net external liabilities as access to wholesale funding improved. The provision, in December 2009, of the Eurosystem's final 12 month LTRO resulted in a reversal of this trend with Irish credit institutions' borrowing from the Central Bank rising by almost €13 billion to over €90 billion or around 56 per cent of GDP (Table 19). The provision of non-standard measures by the ECB is being phased out as part of the exit strategy from exceptional policy interventions. As a result, it is expected that Irish banks' dependence on borrowing from the Central Bank will decline in the coming months. Meanwhile, the repayment of debt by the private sector, discussed in the section above, should reduce the overall liabilities of the banking system, both domestic and foreign.

In discussing the liabilities of the banking system, it is important to distinguish between the liabilities of Irish owned banks and the liabilities of all credit institutions located in Ireland. In February 2010, the liabilities of all financial institutions resident in Ireland amounted to €1,296 billion. However, the liabilities of Irish owned banks were €567 billion, less than half of the total, and not all of these are covered by the government guarantee. The remaining liabilities (€729 billion) are not contingent liabilities of the Irish government. The large difference between the figure for the total liabilities and the liabilities of Irish banks is due to the presence of foreign credit institutions in Ireland, mostly IFSC companies.

Table 19: Central Bank Lending to Credit Institutions in Ireland

		Lending by the Irish Central Bank to Credit Institutions in Ireland in €	Eurosystem Net Lending to Euro Area Credit Institutions in € Related to MPO	Credit Institutions in Ireland, Share of Eurosystem Lending	Credit Institutions' Borrowing from the Central Bank, % of GDP
2007	March	24,020	421,633	5.7	12.7
	June	25,535	438,038	5.8	13.5
	September	23,751	420,169	5.7	12.5
	December	39,449	475,324	8.3	21.0
2008	March	34,395	483,600	7.1	19.0
	June	38,373	460,645	8.3	21.2
	September	58,671	471,362	12.4	39.2
	December	88,562	613,857	14.4	54.0
2009	March	120,628	607,356	19.9	79.8
	June	130,423	615,980	21.2	83.9
	September	91,573	583,939	15.7	53.9
	December	90,899	564,495	16.1	55.6

Box 3: Measures Adopted by the Government in Support of the Banking System

On 30 March 2010 the government announced the latest in a series of measures aimed at resolving the financial crisis and addressing the needs of individual banks. The latest announcement follows a number of important measures implemented by the government since September 2008 in response to the financial crisis. These measures began with the introduction of the deposit guarantee scheme and the two year blanket guarantee of all deposits, covered bonds, senior debt and dated subordinated debt for six Irish institutions. In early 2009, the government announced a programme of recapitalisation and nationalisation. Anglo Irish Bank was nationalised and €4 billion in State funding was provided for recapitalisation. In February 2009, the government announced that it would provide €3.5 billion in core tier 1 capital for both Allied Irish Banks and Bank of Ireland (Table 3A). This recapitalisation programme would be funded from the National Pensions Reserve Fund.

In the April Supplementary 2009 Budget, the government announced its plans for the establishment of the National Asset Management Agency which would buy loans of around €80 billion from the covered banks at an appropriate discount and pay for them by the issue of Irish government bonds. The legislation giving effect to the set up of NAMA was passed in early November 2009. In January this year, the NPRF acquired 180 million ordinary shares in Bank of Ireland, equivalent to the amount of the dividend owed to the State in respect of the preference shares it received under the recapitalisation agreement. This transaction left the State with a 16 per cent shareholding in the Bank of Ireland.

The process of transferring the first tranche of loans from the designated financial institutions to NAMA began in March 2010. These loans represent 20 per cent of the anticipated total assets to be transferred to NAMA. It was announced that NAMA would pay €8.5 billion for the first

tranche of loans which have an estimated book value of €16 billion. New capital requirements have been imposed by the Regulator on the banks which stipulate that they must meet an 8 per cent core tier 1 capital requirement by the end of 2010.

Based on an assessment of capital requirements for each bank, the Regulator announced the additional capital requirements for each of the institutions participating in NAMA. Allied Irish Banks and Bank of Ireland are estimated to need additional capital of €7.4 billion and €2.4 billion respectively. If additional State funding is needed to enable these institutions to meet the capital requirement, it will be provided by the NPRF.

Table 3A: Overview of Existing and Estimated Government Support to Banks

	Total of Existing and Estimated State Investment in the Banks €billion	Source of Exchequer Funding
Anglo Irish Bank*	22.3	€4 billion already provided by Exchequer. €8.3 billion to be paid over 10-15 years via issue of promissory note.
Irish Nationwide	2.6	Exchequer via Issue of Special Investment Shares and promissory note.
Allied Irish Bank	3.5	NPRF
Bank of Ireland	3.5	NPRF
EBS	0.8	Exchequer via Issue of Special Investment Shares and promissory note.
Total of existing and estimated State recapitalisation	32.7	
Payment Planned for Loans under NAMA	40 - 50	Issue of government guaranteed NAMA bonds.
*€12.3 billion in State funding has already been committed with a further €10 billion likely to be required.		

Regarding Anglo Irish Bank, the government announced that it would be providing €8.3 billion immediately to boost the bank's capital position. These funds will be provided in the form of a promissory note payable over 10-15 years. In addition, the government announced that the bank may need a further €10 billion to cover future losses. This would bring the total amount of funding provided by the State for the recapitalisation of Anglo Irish Bank to 22.3 billion, as shown in Table 3A.

The Regulator determined that EBS and Irish Nationwide will need €0.8 billion and €2.6 billion to meet capital requirements. Since the NPRF cannot invest in non-listed institutions, this capital will be provided directly by the State.

Honohan (2002)²³ distinguishes three different channels through which a banking crisis impacts on the macroeconomy. The first of these is the stock component – the waste of resources, which would include the houses built that are unlikely ever to be occupied, the costs incurred by those who fail to meet their mortgages, and the wipe out of important financial institutions. The second channel is the fiscal cost of the crisis – something that one can only begin to estimate as the elements of the resolution of the banking crisis become clearer. The third, which Honohan refers to as the flow component, is the slump in the economy that has occurred as a result of the banking crisis.

The potential fiscal costs (the second channel) of the current crisis can usefully be separated into three elements:

- NAMA;
- the recapitalisation of Bank of Ireland, AIB and the EBS and;
- the recapitalisation of Anglo Irish Bank and the Irish Nationwide Building Society.

In the case of NAMA there is a prospect that the eventual returns on the assets may equal the cumulative price paid for them, leaving no net cost for the Exchequer. However, the gross sums (assets and liabilities) are large and even small unexpected losses or gains could see a substantial cumulative benefit or cost for the State.

The second element of the bank rescue, the recapitalisation of the banks “with prospects”, also holds out the possibility that the State may recoup its eventual investment in their recapitalisation. Should the economy recover as suggested in Bergin *et al.* (2009), the banking system could also return to profitability. Such a return to profitability due to an economic recovery would allow the State to sell its stake in these banks with a good prospect of realising its investment (including the associated costs of financing that investment). However, as with NAMA, the gross assets (shares in the banks) and the related liabilities of the State are likely to be large and minor difference in rates of return on these assets could see the State realising either a significant gain or a significant loss in the long term.

The third element of the banking resolution is the treatment of Anglo Irish Bank and Irish Nationwide. We now know that the State may end up “investing” up to €25 billion in these two institutions – approximately 15 per cent of GDP. As of today, there seems little prospect of the State recouping a significant part of this investment. As a result, it is this element of the banking resolution that is likely to account for the vast bulk of the fiscal cost for the State.

The third channel (identified by Honohan, 2002) through which the banking crisis will impact on the economy is the cumulative loss of output

²³ Honohan, P., 2002. ‘Comment on “Costs of Banking System Instability: Some empirical evidence”’, *Journal of Banking and Finance*, Vol. 26, No. 5, pp. 857-860.

as a result of a recession induced by the banking crisis. In the case of the current economic crisis not all the loss of output can be attributed to the banking crisis in Ireland. In fact a serious recession was already inevitable as a result of the bursting of the property market bubble and the wider world recession. Nonetheless, the banking crisis has greatly aggravated the situation, and if not addressed, it has the potential to greatly prolong the pain associated with the crisis.

While the costs involved in restoring the domestic banking system to health are substantial, the Exchequer outlay should be affordable. In addition, it is important to place the long term cost to the State from the resolution of the banking system in the context of the debts accruing as a result of borrowing to fund the normal day-to-day activities of the government. Ireland's national debt increased by almost €38 billion between 2007 and 2009 due to extremely large increases in the General Government Deficit incurred during that period. The General Government Deficit this year is expected to amount to around €19 billion. While the measures taken to address the banking crisis will aggravate the debt burden faced by the State and increase uncertainty, the overall cost to the State as a result of these measures may turn out to be smaller than the deficit accruing as a result of the normal activities of government. This highlights the importance of ensuring there is no slippage in terms of the announced budgetary targets for the coming years.

GENERAL ASSESSMENT

In their paper of May 2009 Bergin *et al.*,²⁴ showed that, with a reasonable recovery in the world economy and assuming that outcomes in respect of the public finances, competitiveness and the banking system are all achieved, the Irish economy could rebound from its current difficulties to see an average rate of growth in GDP in the region of 5 per cent per annum between 2011 and 2015. This could restore income to pre-recession levels by 2015. It remains our view that such rates of growth are achievable in the coming years. In generating our forecasts for 2011 we had to decide first if it was the case that the relevant conditions were likely to be in place to facilitate growth of this magnitude in 2011. On balance, we formed the view that a more modest pace of growth in 2011 was more likely and our analysis has led to us forecasting a growth rate of 2½ per cent in GDP in 2011.

Before setting out where we see obstacles to achieving the higher growth rates in the medium term, we can point to the factors which we believe are turning in Ireland's favour and which were central to the analysis in Bergin *et al.* (2009).

The world's economies continue to show signs of recovery. While the pace of recovery is uneven across countries, no major economy remains in recession. This was not the case at the time of the last *Commentary*, as the UK only emerged from recession in Q4 2009. As fiscal and monetary policy remains highly stimulatory across the globe, fears remain about the potential deflationary impacts of exit strategies, especially if they are poorly timed relative to sustainable recoveries taking hold. However, on balance we can be increasingly confident about the prospects for the world economy.

Since the on-set of recession in Ireland, we have argued that a strong export performance would be needed to lead Ireland out of recession. The improved global environment is necessary to facilitate it but a second condition is also required, namely, improved competitiveness. As discussed in the section on *Incomes* above, the data which we have available to us on earnings relate to Q2 2009. Based on those data, there was no conclusive evidence of falls in hourly earnings in the private sector. However, our expectation is now that wages across the economy will have fallen by 2 per cent in 2009 and that they will fall by 3 per cent in 2010 and by a further 1 per cent in 2011. With GDP-based productivity expected to grow by 3¾

²⁴ Bergin *et al.*, 2009. *Recovery Scenarios for Ireland*, ESRI Research Series No. 7, Dublin: Economic and Social Research Institute.

per cent in 2010 and by $2\frac{3}{4}$ per cent in 2011, the combined effect will be positive for competitiveness. As an illustration, our forecasts suggest that labour's share of GNP will fall from 54.6 per cent in 2009 to $50\frac{1}{2}$ per cent in 2011. This demonstrates that we are optimistic with respect to the competitiveness challenge which built up in the years leading up to the economic collapse.

In the context of wages falls, the Box above on agricultural incomes shows how the income falls being experienced in that sector are particularly severe. Along with those who have lost their jobs, it appears that farmers have suffered losses in this recession which generally exceed those suffered by people who remain in employment.

Restoration of sustainability in the public finances was another element which underpinned the thinking in Bergin *et al.* (2009). As discussed in the last *Commentary*, in the immediate aftermath of Budget 2010, the overall management of the public finances can be viewed in positive terms. One important development since the Budget has been the successful conclusion of talks between the government and the leadership of the public sector unions, although at the time of writing it was unclear as to whether the agreement would be approved by the union membership. While the pay cuts announced in Budget 2010 were in line with the thinking set out in a number of *Commentaries*, the prospect of widespread industrial action in the public sector, were it to occur, has the potential to erode some of the reputational credit which the government had earned in international lending markets. To the extent that this could lead to a renewed widening in interest rate spreads, the successful conclusion of the process initiated by the Labour Relations Commission could yield real economic benefit in addition to avoiding lost output through work to rules and strikes. A further benefit would accrue in the form of greater efficiency in the delivery of public services as a result of the proposed changes in work practices. A more efficient delivery of public services would provide another boost to the economy's competitiveness, as lower taxes would be needed to fund a given level of service. Just as the traded sector of the economy has to adjust continually to the challenges imposed by global economic changes, we see the proposed changes in the public sector as this sector reacting to challenges imposed upon it as a result of the collapse in tax revenue in particular.

The world economy, expected improvements in competitiveness and the strategic management of the public finances are now providing positive inputs into the overall economic context which Ireland will face in the medium term.²⁵ However, challenges remain in the short term and it is these which have led us to temper our expectations for growth in 2011 relative to the possibilities which hold in the medium term.

²⁵ Of course, in the short term efforts to reduce the public deficit are acting as a negative in terms of growth in a direct sense, even if such efforts are important for re-building confidence in the medium-term and in holding down interest rate spreads.

The restoration to health of the banking system has been seen by us and many others as being a necessary condition for the achievement of growth rates in the region of 5 per cent. In spite of the announcements on this issue on March 30, it remains unclear as to whether the Irish banking system will be in a position to support strong growth through appropriate lending in the near future.

A number of positives can be taken from the March 30, 2010 announcements. For example, the discount on the first tranche of loans going into NAMA, at 47 per cent, exceeded expectations and so lessened concerns about taxpayers over-paying for distressed assets. However, the revelations in respect of the scale of losses in Anglo Irish Bank and the consequent needs for recapitalisation were well beyond anything that we, like many others, had anticipated.

Bergin *et al.* (2009) based their analysis on a recapitalisation need of €20 billion and also assumed that NAMA would be paying €50 billion for the assets it purchased. As discussed above, the final recapitalisation need is likely to be at least €33 billion assuming €25 billion goes to Anglo Irish and Irish Nationwide combined. Clearly, there will be extra demands on the public finances arising from the interest that will be paid. As the financing will be provided in part through promissory notes, the precise timing of the interest implications is unclear to us but they will be significant.

To put the €25 billion which has gone or will go to Anglo Irish Bank and Irish Nationwide in context, it is equal to about 15 per cent of (forecast) 2010 GDP. While such an addition to the national debt is obviously large, it is manageable. When combined with the resolute action on budgetary matters, we can feel increasingly assured that the overall solvency of the State is not under threat. But having said that, it also has to be said that the taxpayer should never have been put in a position whereby it had to fund Anglo Irish Bank to this extent. If the bank was of systemic importance, and that has never been established to our satisfaction, it should have been regulated accordingly. Hopefully, the banking enquiry will shed more light on this so that lessons can be learned.

Apart from banking, another critical plank of strong recovery is domestic confidence, on the part of both consumers and investors. With ongoing wage falls envisaged for next year, continued migratory outflows and the probability of tax increases in Budget 2011, it is difficult to envisage any significant spending surge on the part of consumers. We do expect consumer spending to grow but we do not expect a significant turnaround in the savings rate. For investors, we do see a greater degree of optimism and expect, for example, that investment in machinery and equipment will grow by 10 per cent in 2011.

Our experience in forecasting for much of 2009 was of continual downward revisions. Our forecasts for 2011 are our best estimate based on current information but we are mindful of the possibility that we might be surprised on the upside during the coming months.

KEY OUTCOMES FOR CHILDREN: NEW EVIDENCE FROM *GROWING UP IN IRELAND*

*James Williams** and *Sheila Greene***

*Economic and Social Research Institute, Dublin, Ireland

**Trinity College, Dublin

The welfare of children is a key concern of Irish society and of government policy. A major new project, *Growing Up in Ireland*, aims to describe the lives of a large scale representative sample of Irish children, and to analyse the factors associated with positive and negative outcomes in terms of such areas as health and education. Such evidence is of critical importance in guiding policy choices affecting children. The study is a longitudinal one, i.e. it will follow two groups or “cohorts” of children over time: a cohort of 11,000 infants (nine months old) and cohort of 8,500 nine-year olds. A recently published report[†] based on initial data gathered on the nine-year old group already provides a great deal of interesting evidence on several domains of child outcomes including:

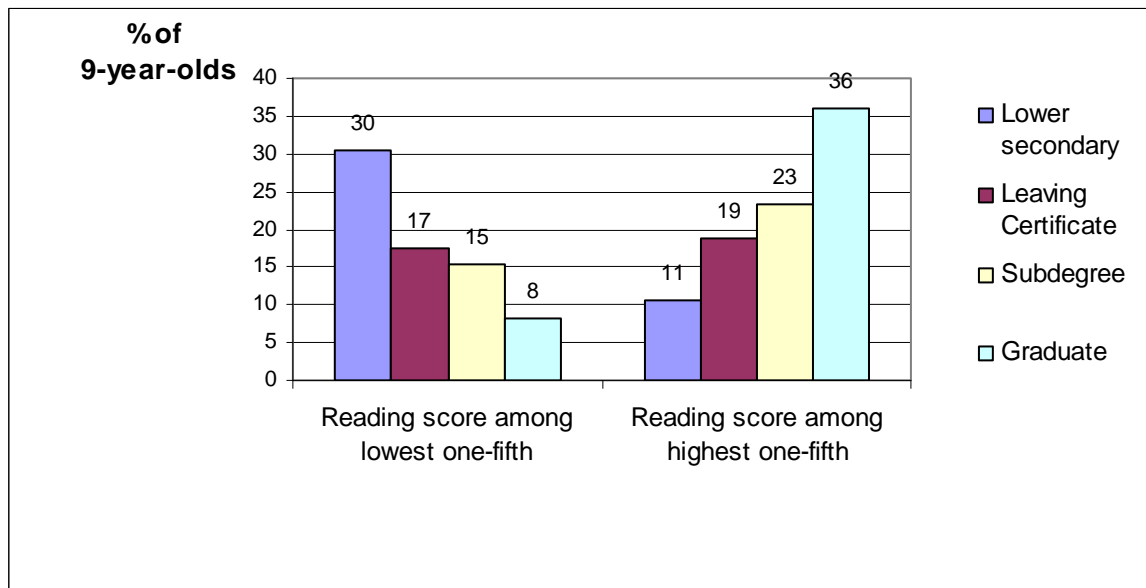
- physical health and well-being,
- educational achievement and intellectual development,
- social, emotional and behavioural well-being.

In this bulletin article we summarise some of the key findings regarding the educational achievement and intellectual development of nine-year olds, and their physical health.

The *Growing Up in Ireland* study gathered information on the reading and mathematical ability of the nine-year-olds, using the Drumcondra reading and maths tests. Academic success, even at nine years of age, was strongly related to the child’s socio-economic circumstances. Figure 1, for example, outlines the proportion of children with the lowest reading scores (among the bottom 20 per cent or bottom “quintile”) classified by level of maternal education. This shows that children whose mother was herself less well educated were much more likely to be in the lowest reading quintile than were the children of graduate mothers (30 per cent compared with 8 per cent). The corollary, of course, is seen on the right hand side of Figure 1, which shows that 36 per cent of children whose mother is a graduate were in the highest reading quintile, compared with 11 per cent of those whose mother left school at lower secondary level or less. The pattern for other aspects of social background (income, social class etc.) was consistent with that for maternal education.

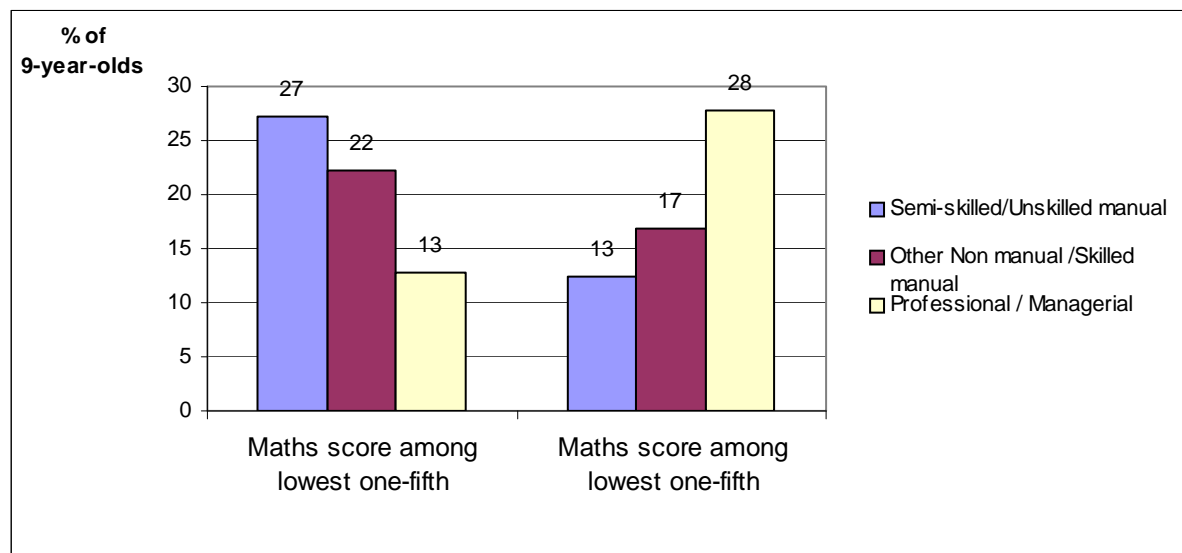
* james.williams@esri.ie; ** sgreene@tcd.ie

Figure 1: Proportion of Nine-Year-Olds with Reading Scores Among the Lowest and Highest One-fifth, Classified by Level of Maternal Education



The pattern of children’s performance in Maths was very similar to that in reading. In general, children from higher social class backgrounds, income categories and maternal education groups had a much higher chance of being in the highest quintile of scores on the Maths test (Figure 4).

Figure 2: Proportion of Nine-Year-Olds with Maths Scores Among the Lowest and Highest One-fifth Classified by Family Social Class



The importance of the intellectual and cognitive development of children cannot be over-emphasised. The child’s early experiences in the home, in school and in the broader community will have a significant impact on that development which will, in turn, have long-term consequences for his/her life chances. A child’s attitude towards and engagement with school have been identified as having an important effect on his/her academic performance.

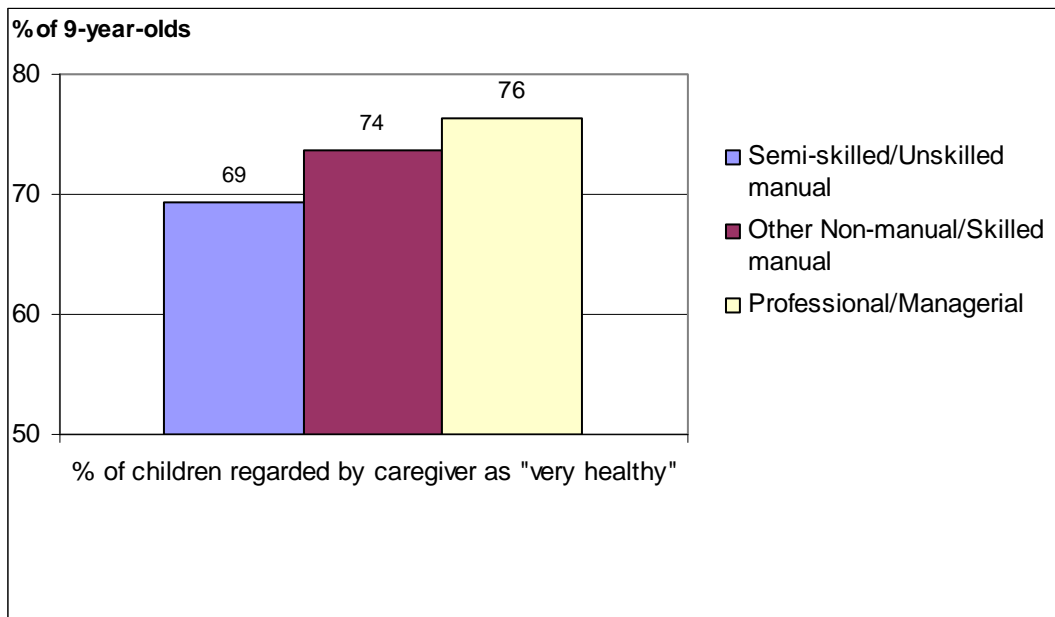
Nine-year-olds generally had a very positive attitude towards school. Over one-quarter (27 per cent) said they *Always* liked it, 67 per cent said they *Sometimes* liked it and only 7 per cent said they *Never* liked. Similar positive views were expressed about their teacher (only 6 per cent of nine-year-olds said they *Never* liked their teacher). Overall, girls had a somewhat more positive attitude towards school than boys.

Absenteeism among children will clearly affect their school performance. On average, nine-year-olds were absent from school on 6.4 days in the year preceding their interview. Significant differences in the number of days missed were apparent in terms of the child's socio-economic characteristics. For example, children whose mothers had lower levels of educational attainment had higher levels of absenteeism than those whose mothers were third level graduates (7.6 days compared to 5.4 days respectively).

Childhood health is important for children's well-being and development and is a good predictor of adult health. It is also widely accepted that the experience of poor childhood health may contribute to socio-economic and other differences in health later in life (e.g. Palloni, Milesi, White and Turner, 2009).

The majority of nine-year-old children were reported by their mother to be in good health – 73 per cent were reported to be *Very Healthy* and 25 per cent to be *Healthy with a few minor problems*. Although there were no statistically significant differences in the health statuses of boys and girls, children from higher social class groups were more likely to be reported as *Very Healthy* than those from lower ones – 76 per cent of nine-year-olds from Professional/Managerial groups were reported to be *Very Healthy* compared with 69 per cent of those from Semi-skilled/Unskilled Manual backgrounds (Figure 1).

Figure 3: Proportion of Children Regarded by Main Caregiver as “Very Healthy” by Family Social Class

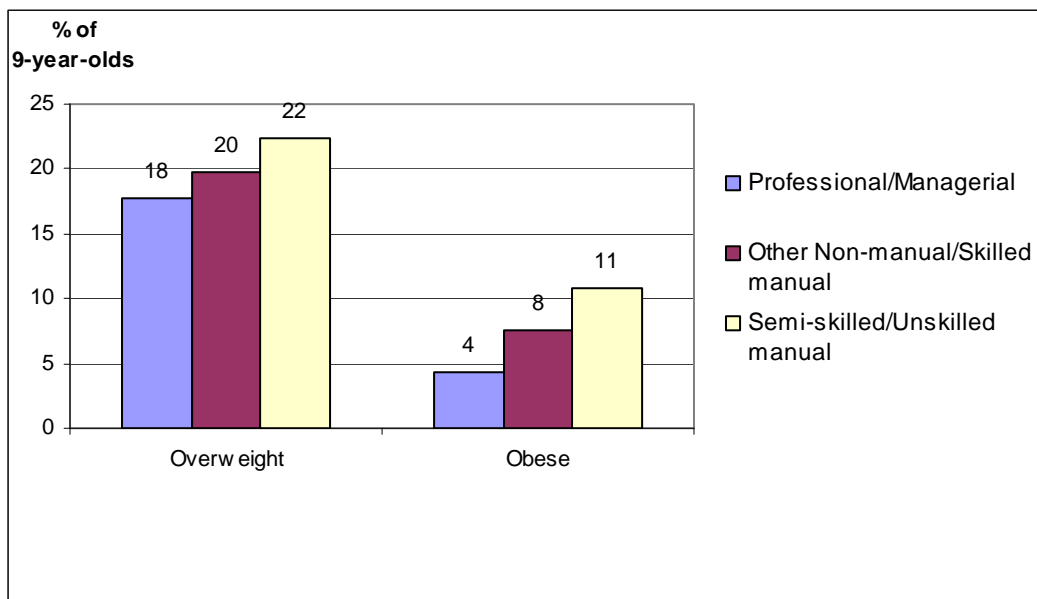


Overall prevalence of on-going chronic illness or disability among nine-year-olds was reported at 11 per cent by their mothers, with 7 per cent of the children who had a chronic illness or disability being reported to be severely hampered by it in their daily activities.¹

Increases in childhood overweight and obesity have been recognised as a serious public health problem (National Taskforce on Obesity, 2005). Obese children have a higher chance than others of becoming obese adults (Dietz, 1998) and the link between childhood obesity and health problems in later life has been well established (Regan and Betts, 2006).

Using international thresholds for Body Mass Index (BMI) *Growing Up in Ireland* found that 19 per cent of nine-year-olds were overweight and a further 7 per cent were obese. This means that one in every four nine-year-olds in Ireland has an elevated BMI. Girls were significantly more likely than boys to be overweight (22 per cent compared with 16 per cent) and obese (8 per cent compared with 6 per cent). Social gradients were also clearly apparent in the weight status of nine-year-olds. A total of 22 per cent of children from the Semi-skilled/Unskilled Manual group were classified as overweight compared with 18 per cent of children from Professional/Managerial backgrounds. The corresponding figures for obesity were 11 per cent and 4 per cent respectively (Figure 2).

Figure 4: Proportion of Children Classified as “Overweight” or “Obese” by Social Class Category



The policy and related challenges presented by some of the findings contained in the first substantive report from *Growing Up in Ireland* are substantial. In important areas such as health and education the clear social (and in some cases gender) differentiation in child outcomes, even at the relatively early age of nine years, must be a source of concern and a matter of focus for policymaking and service delivery.

¹ This means that 0.7 per cent of all nine-year-olds were reported by their mothers as experiencing a chronic illness or disability and being severely hampered by it.

The specific issues sketched above represent only a tiny fraction of the information recorded in the *Growing Up in Ireland* project. A wealth of quantitative and qualitative information has been recorded from an array of informants – from the children themselves, their parents/guardians, teachers, school principals, non-resident parents and other regular caregivers, as appropriate to the age and circumstances of the child. An anonymised version of the data will shortly be deposited in the Irish Social Science Data Archive (ISSDA). This will facilitate all interested researchers in their work on children and child development. The longitudinal approach greatly enhances the analytical potential of the project, particularly in identifying causal relationships and establishing links between early events and experiences on the one hand and later outcomes on the other.

The study covers a broad range of child outcomes with a view to documenting how well children in Ireland are doing along a number of key dimensions. In so doing, it will facilitate comparison with findings from similar international studies, as well as establishing domestic norms. Being longitudinal in nature the study will also address developmental trajectories over time and will allow researchers to explore the factors which have the greatest impact on those trajectories and on the life chances of children as they grow and develop. By providing an evidence-base of research and insights into children and childhood, the study will inform and contribute to the setting of responsive policies and the design of services for children and their families.

†WILLIAMS, J., S. GREENE, E. DOYLE, E. HARRIS, R. LAYTE, S. MCCOY, C. MCCRORY, A. MURRAY, E. NIXON, T. O'DOWD, M. O'MOORE, A. QUAIL, E. SMYTH, L. SWORDS, M. THORNTON, 2009. *The Lives of 9-Year-Olds*, *Growing Up in Ireland/National Longitudinal Study of Children*, Report No. 1, Dublin: Stationery Office.

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Growing Up in Ireland is funded by the Department of Health and Children through the Office of the Minister for Children and Youth Affairs, in association with the Department of Social and Family Affairs and the Central Statistics Office. The Study is being carried out by a consortium of researchers led by the Economic and Social Research Institute (ESRI) and Trinity College Dublin (TCD).

IS A CODE OF PRACTICE NEEDED FOR THE GROCERY TRADE?

*Paul K. Gorecki**

Economic and Social Research Institute, Dublin, Ireland

The introduction of a Code governing grocery supplier/retailer relations, enforced by an Ombudsman, is favoured by the Department of Enterprise, Trade and Employment in its Consultation Paper, *Code of Practice for Grocery Goods Undertakings* (August 2009). A recent analysis of the issues[†] questions the need for a Code, and suggests that the issues which have prompted calls for such a Code would be better dealt with in the context of the government's "better regulation" agenda and the provisions of the Competition Act as amended in 2006.

The Code proposed in the Consultation Paper constrains the behaviour of the retailer with respect to certain practices that include those that shift risk from the retailer to the supplier as well as those that result in unexpected costs to suppliers. For example, a retailer shall not directly or indirectly require a supplier to make any payment or grant any allowance for the advertising or display of grocery goods. The rationale for the Code appears to be that devaluation of sterling, combined with the recession means that retailers are able to put increased pressure on local suppliers for lower prices, which in turn squeezes suppliers' margins. In other words, retailers can import grocery products either from the UK or elsewhere at lower prices than are available from suppliers and distributors in Ireland. This gives rise to an alleged imbalance in the relationship between retailers, on the one hand, and suppliers and distributors, on the other.

Governments normally intervene in markets where there are market failures relating to market power, externalities and information problems. These market failure rationales do not apply in the case of the Code. In reality the Code is a form of protectionism occasioned by the inflow of lower priced imports. The retailer is simply the channel through which these lower-priced imports reach consumers. The problem facing Irish suppliers is not the retailer, but the competition from imports. Local suppliers should adapt through developing better products and becoming more efficient, rather than seeking shelter from market forces. At the same time, macroeconomic policies are currently aiming to restore Ireland's competitive position.

* Paul.Gorecki@esri.ie

One of the objectives of the Code is to restore “balance” between retailer and suppliers. Viewed in this context the key objective of the Code is to restore the old equilibrium. The Code permits the restoration of the status quo by reducing the freedom of manoeuvre and discretion of the retailer through the adoption of explicit and transparent contracts and restricting the availability of certain discounting mechanisms. This is meant to increase the bargaining power of the supplier vis-à-vis the retailer and thus increase the return to suppliers. If the above characterisation is accepted as reasonably accurate, then grocery prices are very likely to be higher under the Code than without the Code.

It is argued that the Consultation Paper should be withdrawn and reissued, but in a manner consistent with the government’s better regulation agenda which is currently ignored. This agenda sets a framework within which regulation can be assessed prior to its introduction. The framework requires that the question of necessity be addressed. In other words, is the regulation necessary? The Consultation Paper sidesteps that question, focusing almost entirely on the details of how the Code would be specified and operated, with little attention given to the issue of whether a Code should be introduced.

Although the Consultation Paper discusses the need to enhance consumer welfare and ensure that there is no impediment to the passing-on of lower prices to consumers, there is no provision in the Code that ensures that these conditions are satisfied. This contrasts with the Competition (Amendment) Act 2006, which includes a competition test and also applies to the grocery sector. If a compelling case can be made that there are business practices that damage competition and consumers in the grocery sector, then such practices should be either prosecuted under the 2006 Act, or the Act should be amended to outlaw them.

The objectives of the Code are inherently contradictory. The Code’s stated purpose is to achieve balance between grocery undertakings, while at the same time increasing consumer welfare and ensuring that there is no impediment to lower prices being passed-on to the consumer. However, in achieving balance the Code proposes to constrain the behaviour of retailers in favour of suppliers so that the Code is likely to lead to a rise in prices for suppliers with no mechanisms or tests for considerations of consumer harm to be taken into account. Amending the 2006 Act where a compelling case can be made would be a better option.

[†]GORECKI, P.K., 2009. “A Code of Practice for Grocery Goods Undertakings and an Ombudsman: How to Do a Lot of Harm by Trying to Do a Little Good”, *The Economic and Social Review*, Vol. 40, No. 4, Winter 2009.

GET BACK IN THE GAME: SPORT, THE RECESSION AND KEEPING PEOPLE ACTIVE

*Pete Lunn**

Economic and Social Research Institute, Dublin, Ireland

International research has established that the importance of physical activity for health is more serious than its role in the “obesity epidemic”, which inspires so much commentary. Physical activity reduces the risk of various cancers, coronary heart disease, stroke and diabetes, and improves skeletal health. A major part of the overall physical activity of adults consists of sport and recreational physical exercise. To the extent that sports policy has the ability to increase participation in sport and exercise, there is consequently a sound justification for spending public money on it.

The *Irish Sports Monitor*[†] is a large, representative survey of participation in sport and exercise by adults (16 years and over). In 2008, it revealed that weekly participation had dropped from 32.9 per cent in 2007 to 30.8 per cent, abruptly halting a rising trend over recent decades. Although the fall was somewhat compensated for by more people walking and cycling as a mode of transport, it nevertheless means that of those adults engaged in a regular physical activity in 2007, one-in-sixteen had ceased participation one year later. Those who dropped out are likely to suffer a direct impact on their health and quality of life.

Evidence strongly suggests that this significant change in sport and exercise habits was linked to the recession. Although prior to the recession those in higher income groups were very much more likely to participate, the relationship strengthened markedly in 2008. Furthermore, while traditional team sports maintained their participation rates, popular but relatively expensive individual pursuits, such as personal exercise (going to the gym, exercise classes, etc.) and golf, were the activities most affected. One in every seven members of a gym or health/fitness club gave up their membership in 2008. Young men, the social group whose economic prospects have been hardest hit, had the greatest fall in participation.

How should policy respond? The Institute’s programme of research in sport and physical activity, undertaken in collaboration with the Irish Sports

* pete.lunn@esri.ie

Council, provides a significant body of evidence that can inform policy choices.

In line with international research, we find evidence that those who participate in sport and exercise in Ireland benefit through better health. Thus, to the extent that public funding contributes to higher participation, cuts in the sport budget are likely to result in significant costs to individuals and society, in terms of poorer public health.

Yet while higher participation is the primary stated goal of sports policy, in recent years over 60 per cent of the sports budget assigned to the Department of Arts, Sport and Tourism has been directed to elite rather than grassroots sport. Tight public finances and the fall in participation demand that policymakers refocus on their main target.

The survey evidence on barriers to participation is clear. While there remains scope for improving facilities for young children, lack of sporting facilities no longer presents a barrier to adult participation in Ireland. Thus, if cuts must be made, the evidence concurs with last year's decision to suspend the Sports Capital Programme, which provides grants for clubs (not schools) to improve facilities.

Instead, the most effective way to attract people is likely to involve tackling the main barriers to participation faced by adults, which are family and work commitments. International evidence shows that it is possible to increase participation through the organisation and marketing of affordable and convenient sporting opportunities, such that existing facilities are used more frequently.

At whom should participation programmes be targeted? Much existing policy effort aims to get children involved in sport. While this is an important policy goal, the evidence shows that greater attention needs to be paid to adults, because a large proportion of people drop out as they enter adulthood. Continued participation generally involves making the transition, usually in young adulthood, from team sports to individual sports such as swimming, personal exercise, golf, running and many minority sports. The importance of this transition is particularly noticeable in the Midlands region, which has the highest participation in team sports in Ireland, yet the lowest proportion of adults participating in sport and exercise overall. Young adults in lower socio-economic groups are most likely to drop out; more so during the recession.

Hence, we need participation programmes to organise and market events and opportunities that target less advantaged adults and that appeal to those who are likely to have moved on from the sports of their youth. Activities need to be affordable and to cover a variety of sport and exercise pursuits. Local sports partnerships, local authorities and sporting national governing bodies constitute networks through which such policies can be implemented.

The sport budget is not there merely to promote recreation and entertainment, though it may enhance both, but should instead be considered an important part of public health policy. The recession is reducing our

physical activity and hence harming our health. An effective policy response requires funding, but it also requires that the funding goes to where evidence indicates it will get the highest return.

[†]LUNN, P., R. LAYTE, 2009. [*The Irish Sports Monitor, Second Annual Report 2008*](#), Dublin: The Irish Sports Council and the Economic and Social Research Institute.

THE ESRI ENVIRONMENTAL ACCOUNTS

**Seán Lyons^a and Richard S.J. Tol^b*

^a Economic and Social Research Institute, Dublin, Ireland

^b Vrije Universiteit, Amsterdam, The Netherlands

The national accounting framework, including such key concepts as Gross National Product, is a vital input to economic decision making. However, the standard national accounting framework does not take account of the pressure or damage to the environment caused by the economic activity. Thus, similar levels of GNP might involve quite different environmental damage, with implications for both current and future welfare and economic activity. Environmental accounts are now constructed in many countries to take account of these concerns, building on initial research by Nordhaus *et al.* (1972) and agreed international standards (United Nations *et al.*, 2003). Environmental accounts build on the well-established and coherent national accounting framework, but add to this what are termed “satellite accounts” dealing with environmental issues, in a way which allows for them to be integrated and measured in a more comprehensive framework. This provides an increasingly sound basis for decision making on the environment.

A recent paper** presents the ESRI Environmental Accounts for the Republic of Ireland 1990-2006. The paper describes the principles of environmental accounts, and illustrates their use by discussing trends in emissions and resource use in Ireland, by comparing the trend in carbon dioxide emissions in Ireland to other countries, and by attributing emissions to consumption.

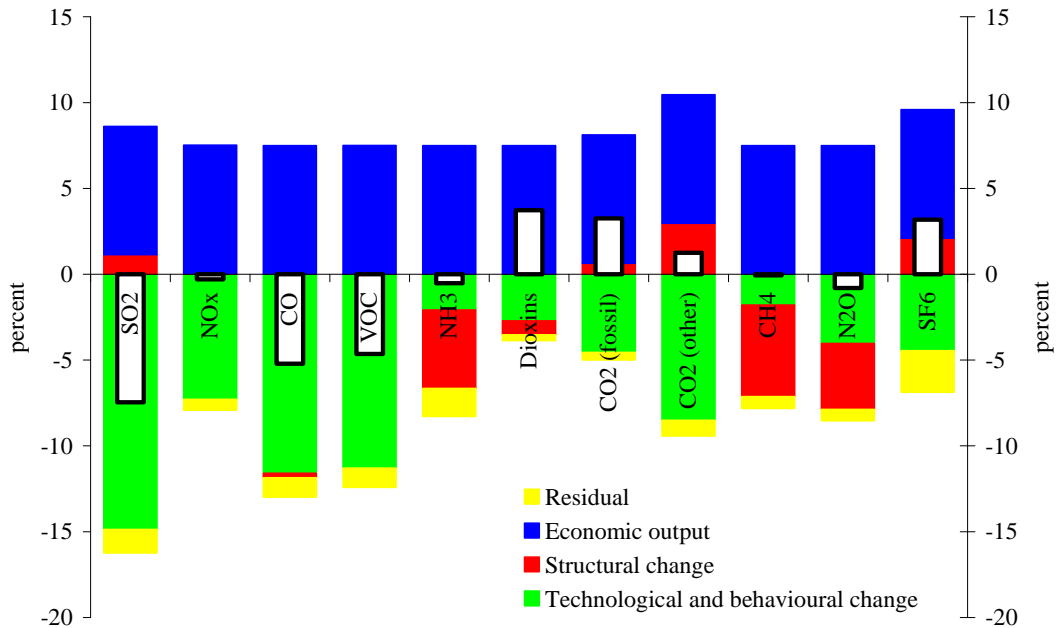
There are four parts to the environmental accounts: (1) emissions and waste, (2) resource use, (3) expenditures on environmental protection, and (4) economic value. Data are given by economic sector. The ESRI Environmental Accounts are the most extensive accounts for Ireland, and the only ones that adhere to the international standards. There are 63 substances (26 emissions, 12 types of waste and 25 resources) for 20 sectors (19 production sectors plus households) for the period 1990-2006. The data come primarily from the Central Statistics Office (CSO), the Environmental Protection Agency (EPA) and Sustainable Energy Ireland (SEI). Data on expenditures on environmental protection will be available in the near future. Data on the economic value of the environment is scattered and inconsistent. While the amount of data on emissions and resource use is impressive at first sight, the ESRI Environmental Accounts are heavily skewed towards climate and energy, with a reasonable coverage of waste and acidification. The use of land, water, and materials is largely omitted. Large

*sean.lyons@esri.ie; richard.tol@esri.ie

groups of chemicals, including many potentially harmful ones, have to be ignored because of the lack of suitable data.

The ESRI Environmental Accounts are proper satellite accounts of the National Accounts. We can, therefore, readily integrate economic and environmental data. This allows us to interpret trends and, for example, allocate responsibility for particular emissions to the relevant sectors of activity.

Figure 1: A Decomposition of the Growth Rate of Emissions^a

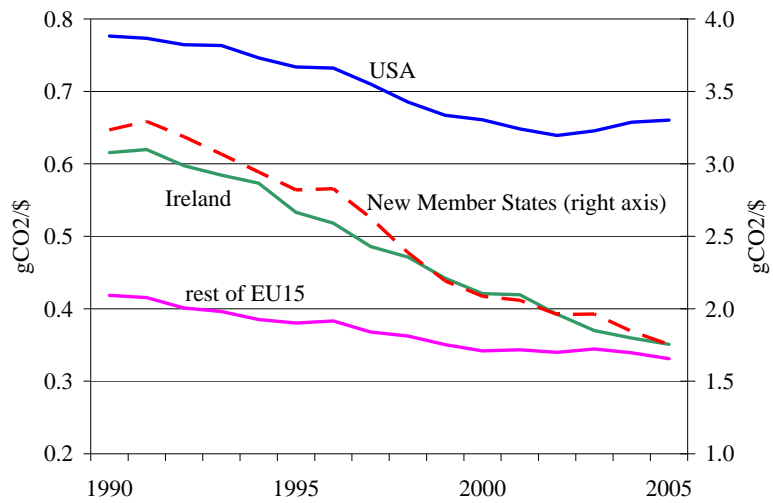


^a The average annual growth rate for the period 1990-2006 is presented as the white insert. The growth rate is decomposed into the economic growth rate, the rate of structural change in the economy, technological and behavioural change, and a residual. The figure for dioxins is a projected value; the rest were measured.

Source: ESRI/EPA ISus model.

Figure 1 shows the average growth rates for the period 1990-2006 for emissions to air and energy use; this data is taken from the environmental accounts. Some emissions have fallen, notably sulphur dioxide, carbon monoxide, and volatile organic compounds. Other emissions have increased, notably carbon dioxide from fossil fuel combustion. Figure 1 also shows a decomposition of the growth rate (Ang, 2005); this data is taken from the integrated environmental and economic accounts. Economic growth has increased all emissions. Changes in the structural composition of the economy has increased some emissions (process carbon dioxide, sulphur hexafluoride) but decreased others (ammonia, methane, laughing gas). Technological and behavioural change has reduced all emissions, and particularly sulphur dioxide, carbon monoxide, and volatile organic compounds.

Figure 2: The Carbon Intensity of Ireland, Other EU Countries^a and the USA

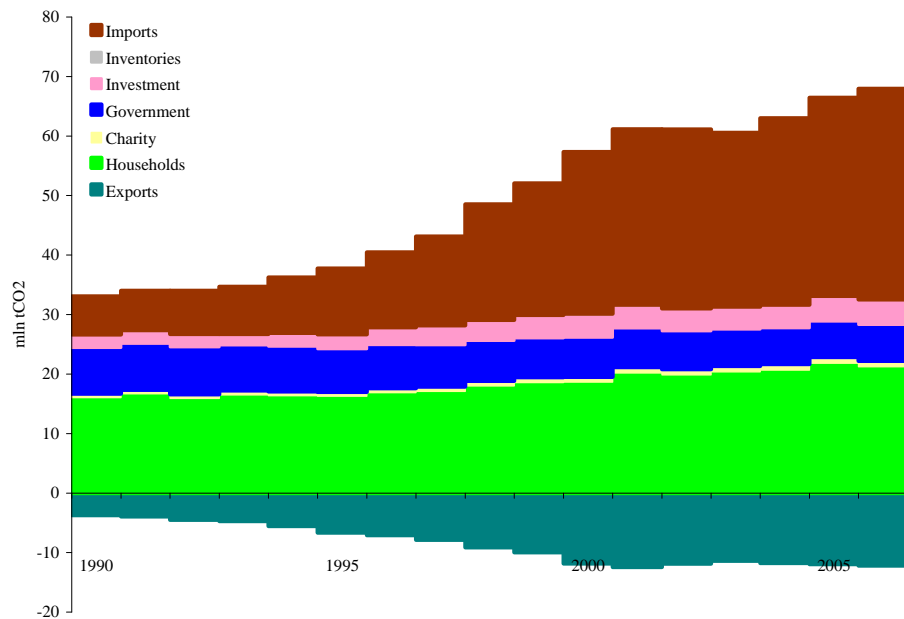


^a EU countries are split into the 15 countries that were Member States between 1995-2004 and the 12 countries that have joined since 2004.

Source: ESRI Environmental Accounts; <http://earthtrends.wri.org>

For carbon dioxide, economic growth outpaced technological change. Emissions thus increased. Technological and behavioural change reduced emissions at a rate of 4.5 per cent per year, however. Figure 2 shows that this is unusually fast in an international context. While in 1990 Ireland emitted 50 per cent more carbon dioxide per euro value added than the rest of Western Europe, this difference had disappeared by 2005 (despite a low use of public transport in Ireland). Ireland's rate of improvement in carbon intensity was comparable to that of Eastern Europe.

Figure 3: Fossil Carbon Dioxide Emissions in Ireland by Demand

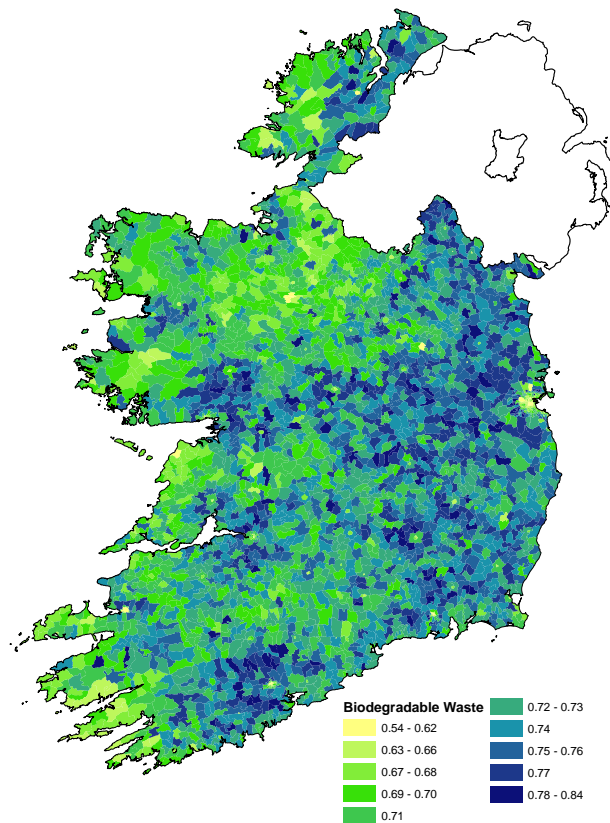


Source: ESRI/EPA ISus model.

The ESRI Environmental Accounts are *production* accounts: Emissions are allocated to the economic activity that generates the emissions. But because the environmental accounts are integrated with the economic accounts, we can use an input-output table to construct *consumption* accounts†, in which emissions are attributed to final consumption. Figure 3 shows whose consumption is ultimately responsible for carbon dioxide emissions from fossil fuel combustion. Households are the largest indirect emitters, followed by exports, the public sector, and capital accumulation. Figure 3 shows three distinct trends. Carbon dioxide emissions from domestic production for domestic consumption increased by about one-fifth between 1990 and 2006. Carbon dioxide emissions from domestic production for export out of Ireland doubled between 1990 and 2000, and then levelled off. Carbon dioxide emissions from foreign production for import into Ireland tripled in size between 1990 and 2006.

Fossil carbon dioxide emissions from domestic production for domestic consumption are further decomposed using household consumption data (CSO, 2008). This shows that the 10 per cent of people with the lowest incomes are responsible for only 5 per cent of emissions. The emissions share gradually increases for higher income deciles. The 10 per cent of people with the highest incomes are responsible for 15 per cent of emissions. While the average income of the richest 10 per cent is 14 times as high as the average income of the poorest 10 per cent; the average CO₂ emissions are only 3 times as high.

Figure 4: Biodegradable Waste Generation Per Household Per Year By Electoral District (Imputed)



Source: ESRI Regional Environmental Accounts.

Emissions can also be analysed by location and activity using the Tourism Satellite Accounts (Fáilte Ireland, 2005). Three-quarters of fossil carbon dioxide emissions from domestic production for domestic consumption is by people at home. Nine per cent is by Irish residents on leisure or business trips in Ireland, and 2 per cent by Irish residents on their way abroad. Foreigners travelling to Ireland for leisure or business account for 14 per cent of emissions.

The ESRI Environmental Accounts are nationwide. Some environmental issues are local rather than national in nature, while environmental policy may have varying effects on different areas. Selected parts of the environmental accounts have therefore been downscaled, imputing emissions, energy use and waste on the basis of census data[§]. Figure 4 shows a map of biodegradable waste from households, averaged for each of the 3,401 electoral districts. The pattern is largely determined by the average household size with income playing a smaller role. There are distinct differences between the cities (small families), the commuter belt (large families), and the deep countryside (small families).

Environmental accounts are a powerful tool to understand pressures on the environment, particularly when integrated with economic accounts. The ESRI Environmental Accounts are the most extensive accounts for Ireland. In this paper, we illustrate their use by decomposing trends in emissions, by comparing Irish trends to international trends, by attributing emissions to consumption, by splitting emissions by type of consumption and by imputing waste per local area.

Future research will extend the ESRI Environmental Accounts and develop further tools for interpretation, for example, distinguishing between imports for export and imports for consumption. Extensions will include material flows, expenditures on environmental protection, and the value of the environment.

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IDENTIFYING THE BARRIERS TO HIGHER EDUCATION PARTICIPATION

**Selina McCoy and Delma Byrne*

Economic and Social Research Institute, Dublin, Ireland

As economic circumstances remain difficult and CAO applications reach record numbers, there has been renewed focus on higher education. In part this reflects the severe deterioration in labour market opportunities for young people, particularly in relation to apprenticeships. Postponement of labour market entry among school leavers more generally and growing numbers of (young) adults returning to college to improve their skills also play a role. In this context, identifying the potential barriers young people face in gaining entry to college is of central importance. Furthermore, identifying barriers to higher education participation is of great policy relevance given the impact of third level education on life chances. A recent study† focuses on a group which has not shared in the general trend towards increased third-level participation – the “lower non-manual” group. This group largely comprises lower level service workers (such as chefs, bus drivers, hairdressers) and accounts for just under 10 per cent of the population. It has not been previously identified as ‘disadvantaged’ in terms of educational participation, but the study shows that young people from this socio-economic group are poorly placed in terms of college participation and are also the only social group to have seen a fall in levels of college entry over time. The study analysed the factors shaping entry or non-entry to college, using a combined analysis of 10 years of School Leavers’ Survey data and in-depth life-history interviews with school leavers whose parent(s) were employed in such non-manual jobs.

School Experiences

Many of those who enter college reported positive orientations towards, and experiences of, their initial education – most simply they placed a value on education. Among those that do not go to college, this research identifies some important issues around self-belief and aspirations with young people typically stating that college ‘is not for me’. While these beliefs to some extent stemmed from a more short-term orientation and a necessary priority on earning money in these families, they also reflected the nature of their previous educational experiences at second level. The findings pointed to a greater risk of disengagement from school among this group of young people who reported skipping school, lack of motivation and misbehaviour which fed into a negative cycle of interaction with teachers. Moreover this group of young people felt that they had been treated unfairly by their teachers and perceived that their teachers held low expectations for them. Going to college was perceived as an extension of school for this non-manual group and hence to be

**selina.mccoy@esri.ie; delma.byrne@esri.ie*

avoided. Low levels of school completion and poor performance in the Leaving Certificate examination among this group were the result of these often negative school experiences, meaning large numbers were ineligible for college. However, even among those who were eligible, this group were the group least likely to apply for a college place.

Information and Advice

This research highlights how the availability of information and advice on college is another key factor in the decision to go to college. In many ways, this group of young people were far more reliant on the advice and support from their school in making college decisions, since few had parents with experience of college and their siblings and peers were also not generally familiar with the college 'process'. However, findings show that for the lower non-manual group career guidance was variously absent, only focused on certain groups of students (such as the 'honours' class), narrowly focused or directed them away from college altogether. Some young people felt they would have liked more help in evaluating the range of post-school options, rather than just receiving information.

Financial Constraints

Financial issues also influenced the post-school choices of this group of school leavers. For some, the financial commitment to study was perceived as too great or would exert too much hardship for themselves and their families. Many felt that they would not have been eligible for financial support (and in fact this group saw the sharpest fall-off in grant receipt levels over time), or if eligible, they felt the support would not have been adequate. Again there was evidence of insufficient information and understanding of the system of financial supports and the costs entailed in going to college. The research also found that perceived financial barriers also framed the aspirations of these young people and, among those who were eligible to apply to college, perceived financial barriers often shaped that final decision not to attend.

The study also pointed to the importance of focusing not only on college entry and supporting students in that regard, but also on supporting young people through their college lives. Levels of dropout from college during the first 18 months were found to vary dramatically across socio-economic groups. It is clear that, alongside initiatives promoting college entry, support for young people to fully participate in both the academic and non-academic aspects of college life is important. Ongoing monitoring of the relative position of this lower non-manual group both in terms of college entry and completion will also be important. Recent economic conditions are likely to further restrict the ability of these and other students to fund their studies through part-time employment. The current economic situation is also likely to curtail the ability of their parents, situated in vulnerable economic sectors, to support their children through college and increase the pressure on these young people to seek employment.

†MCCOY, S., D. BYRNE, P.J. O'CONNELL, E. KELLY and C. DOHERTY, 2010. [Hidden Disadvantage? A Study on the Low Participation in Higher Education by the Non-Manual Group](#), Dublin: Higher Education Authority.



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