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QUARTERLY ECONOMIC COMMENTARY

by

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CONTENTS

SUMMARY

Latest indications suggest that the growth of real GNP in 1987 could have been as high as 3¼ per cent. Such a figure, however, is somewhat misleading, as it rests partly upon a strong export boom in the second half of the year, the profits from which have not yet had time to be expatriated. Genuine progress was made during the year towards correcting the public finances, improving the balance of payments and reducing the rate of inflation. On the other hand, the fall in employment continued unabated, although this is not fully reflected in the unemployment statistics.

The most likely course of economic developments in 1988 is that there will be virtual stagnation in the growth of real GNP and that employment will continue to fall. At the same time inflation will remain low, the balance of payments will move into substantial surplus, and the Exchequer borrowing requirement could be reduced to 8 per cent of GNP. Thus 1988 can be viewed as an unpleasant year of adjustment, in which the conditions could be set for a sustained resumption of growth in the future.

Given the inevitable uncertainties of forecasting, the year could prove substantially worse or better than predicted here. Weakness and instability in the world market might be worse than expected, with a depressing impact on Irish exports, investment, growth and State revenue. Conversely, not only might exports continue to perform above expectations, but an improvement in consumer and business confidence could follow the arrival of stable and relatively low interest rates and the perceived improvement in the public finances. In this case there could be significant real growth in 1988, and revenue buoyancy could reduce the borrowing requirement even faster than planned.

At the present time it would appear rash to anticipate this more optimistic interpretation of the year, and prudent to base economic management on the expectation of stagnation or worse in 1988. In particular it appears vital to maintain fiscal discipline through adhering to the published Estimates and resisting any temptation to reduce the aggregate level of real taxation. The encouraging feature about 1988 is that if such discipline is accepted, the public finances could end the year in a condition approaching sustainability. Relaxation is not a realistic option even in 1989, but at least a further round of severe cuts might well be avoidable.

ESTIMATED NATIONAL ACCOUNTS 1987

A: Expenditure on Gross National Product

	1986 Provisional £m	1987 Estimated £m	Change in 1987 £m Value	£m Volume	% Value	% Price	% Volume
Private Consumer Expenditure ...	10552	10869	317	0	3	3	0
Public Net Current Expenditure ...	3514	3655	141	− 80	4	6¼	− 2¼
Gross Domestic Fixed Capital Formation	3451	3498	47	18	1¼	¾	½
Exports of Goods and Services (X) ...	10335	11735	1400	1510	13½	− 1	14½
Physical Changes in Stocks	93	219	126	89			
Final Demand	27945	29976	2031	1537	7¼	1¾	5½
less:							
Imports of Goods and Services ...	9706	10414	708	851	7¼	− 1½	8¾
GDP at Market Prices	18239	19562	1323	686	7¼	3½	3¾
less:							
Net Factor Payments	2032	2184	152	173	7½	− 1	8½
GNP at Market Prices	16207	17378	1171	513	7¼	4	3¼

B: Gross National Product by Origin

	1986 Provisional £m	1987 Estimated £m	Change in 1987 £m	Change in 1987 %
Agriculture, Forestry, Fishing ...	1304	1487	183	14
Non-Agricultural: Wages, etc. ...	9830	10274	444	4½
Other	3357	3798	441	13¼
less:				
Net Factor Payments	2032	2184	152	7½
National Income	12459	13375	916	7¼
Depreciation	1789	1887	98	5½
GNP at factor cost	14248	15262	1014	7
Taxes less subsidies	1959	2116	157	8
GNP at Market Prices	16207	17378	1171	7¼

C: Balance of Payments on Current Account

	1986 Provisional £m	1987 Estimated £m	Change in 1987 £m
X—M	628	1321	693
F	− 2032	− 2184	− 152
Net Transfers	1075	900	− 175
Balance on Current Account ...	− 329	37	366
as % of GNP	− 2	¼	2¼

FORECAST NATIONAL ACCOUNTS 1988

A: Expenditure on Gross National Product

	1987	1988	Change in 1988				
	Estimated £m	Forecast £m	£m Value	£m Volume	% Value	% Price	% Volume
Private Consumer Expenditure ...	10869	11168	299	27	2¾	2½	¼
Public Net Current Expenditure ...	3655	3618	−37	−183	−1	4	−5
Gross Domestic Fixed Capital Formation	3498	3549	51	−16	1½	2	−½
Exports of Goods and Services (X) ...	11735	12844	1109	1023	9½	¾	8¾
Physical Changes in Stocks	219	184	−35	−30			
Final Demand	29976	31363	1387	821	4½	1¾	2¾
less:							
Imports of Goods and Services ...	10414	11061	647	570	6¼	¾	5½
GDP at Market Prices	19562	20302	240	251	3¾	2½	1¼
less:							
Net Factor Payments	2184	2446	262	246	12	¾	11¼
GNP at Market Prices	17378	17856	478	5	2¾	2¾	0

B: Gross National Product by Origin

	1987	1988	Change in 1988	
	Estimated £m	Forecast £m	£m	%
Agriculture, Forestry, Fishing ...	1487	1480	−7	−½
Non-Agricultural: Wages, etc. ...	10274	10608	334	3¼
Other	3798	4012	214	5¾
less:				
Net Factor Payments	2184	2446	262	12
National Income	13375	13654	239	2
Depreciation	1887	1991	104	5½
GNP at factor cost	15262	15645	383	2½
Taxes less subsidies	2116	2211	95	4½
GNP at market prices	17378	17856	478	2¾

C: Balance of Payments on Current Account

	1987	1988	
	Estimated £m	Forecast £m	Change in 1988 £m
X—M	1321	1783	462
F	−2184	−2446	−262
Net Transfers	900	1000	100
Balance on Current Account ...	37	337	330
as % of GNP	¼	2	1¾

COMMENTARY

The International Economy

General

Although considerable uncertainty persists, the prospects for the world economy in 1988 have become a little clearer since the previous *Commentary* was prepared in October. Equity prices in the major markets would appear to be fluctuating within a range close to the trough reached in late October. On previous post-war experience, a period of over two months' relative stability is unlikely to be followed by a further severe fall, and a gradual recovery in the course of 1988 seems more probable.

The dollar depreciated much further and faster than was assumed likely when the October *Commentary* was being prepared. Compared with the rate which was maintained throughout the summer under the Louvre Agreement, the dollar declined by over 15 per cent against the Deutschemark, although it has since recovered about half of this fall. Downward pressure on the dollar might well reappear, but it seems unlikely that this will result in an uncontrolled collapse of the currency, as its value has already moved much of the way towards a medium-term equilibrium level. However, the danger remains that the markets could over-react to poor US trade figures in the short term, and that the dollar could undershoot its equilibrium value.

The behaviour of both capital and currency markets has been heavily influenced by the actions of the authorities in the major economies. By agreeing on a rather modest fiscal package over the next two years, while maintaining interest rates at close to the level to which they were reduced in the immediate aftermath of the equity shock, the US authorities have contributed both to the relative stabilisation of share prices and to the decline in the dollar. The actions of European and Japanese authorities in easing monetary policy have also helped to establish a floor to equity prices while to some extent limiting the dollar depreciation. Throughout most of the period since the equity shock, central bank currency intervention seems to have been restricted to controlling the dollar's decline rather than to any attempt to establish a new parity range, although this might have been the aim in the last few weeks.

The overall effect of these developments in the past two months has been to confirm the assumption made in the October *Commentary* that 1988 is more likely to produce a slowing down of the growth in world output and trade than an acute recession. Because of the dollar depreciation, this slowdown is now likely to be more concentrated in Europe and Japan, while prospects for the USA are rather more favourable than foreseen in October.

The US Economy

Such indications as are available for the final months of 1987 suggest that the fall in share prices did not have much immediate impact on consumer or business expenditure. In the course of 1988 some restriction of consumer spending is likely to result from the negative wealth effect of the equity shock and from the marginal increase in taxation. However, provided there is no major increase in interest rates, a reduction in the rate of growth of personal consumption seems much more likely than an actual downturn.

The decline in the dollar should provide some stimulus to US output through an improvement in the volume of trade balance, and could also act as an incentive to continue the already high level of US industrial investment. Such developments could largely offset the slower growth in private consumption and the restriction on government spending. It is thus reasonable to predict that US growth in 1988 will be only slightly slower than in 1987, at perhaps 2¼ per cent against 2½ per cent. This is an upward revision on the forecast presented in the October *Commentary* in the immediate aftermath of the equity shock, and results from the lower value of the dollar and the apparent determination of the US authorities to keep interest rates relatively low.

The main danger to this favourable outlook is that the market will force up interest rates significantly in spite of the official desire to prevent this. Such a development could result from a failure to deliver the modest budgetary adjustments agreed in principle between Congress and the Administration, or from a too rapid depreciation of the dollar forcing the authorities themselves to raise interest rates. This latter danger could well emerge if undue market attention is focused on the monthly trade balance. Experience suggests that the J-curve response of the US economy to currency depreciation is normally very pronounced. Thus, even if the response on this occasion is more rapid than in 1985, the initial effect of the fall in the dollar since October is likely to be unfavourable for the trade balance, with a marked improvement following in the second half of 1988, and in 1989. On an annual basis, 1988 is not expected to show much reduction in the value of the trade deficit compared to 1987.

Despite the currency movements, inflation is expected to increase only modestly in 1988, perhaps to about 4¾ per cent. The size of pay settlements has so far remained moderate, although unemployment levels have fallen and seem unlikely to rise significantly in 1988.

The European Economy

Although the current forecast for the USA suggests that there may not be much improvement in the US trade balance in dollar terms in 1988, there will undoubtedly be a switch in favour of the USA in the volume of trade flows. Thus European exporters face a probable reduction in their volume of exports to the USA and to some third markets. The key question, in the wake of the dollar depreciation, is whether there will be sufficient growth in the domestic European market to offset the deterioration in the volume of trade balance.

Initial reaction to the equity shock and the fall in the dollar was encouraging, with immediate interest rate reductions in many countries followed by a further co-ordinated reduction in early December. Whether these monetary moves will be re-enforced in 1988 by the adoption of a more relaxed fiscal stance in the major European countries is still uncertain. The best guess at present is that any relaxation is likely to be very modest initially, but that if a European recession appears to be developing in 1988 then further measures might be taken in the course of the year.

On this general policy assumption, it seems probable that European growth will be slower in 1988 than in 1987. Export growth will certainly be lower, as may be export-related investment. Conversely, both domestic consumption and related investment can still be expected to rise slightly faster than in 1987, boosted by lower interest rates which should at least offset any wealth effects from reduced equity prices. Trade between EEC member countries, largely related to domestic European demand, thus seems likely to continue to expand. Inflation now seems unlikely to accelerate significantly in 1988, and indeed could be slightly lower than in 1987, due both to the decline in the dollar and the probable weakness in oil prices.

As usual, the UK is a special case. UK growth in 1987 has been well above the EEC average, with GDP rising by about 4 per cent and personal consumption by almost 5 per cent. Despite a projected slowdown to about 2½ per cent in GDP and 3½ per cent in personal consumption, UK growth in 1988 is likely to remain above the EEC average. Imports of goods and services increased by about 6½ per cent by volume in 1987, and are expected to grow by a similar percentage in 1988.

Partly as a consequence of its more rapid growth, inflationary pressures in the UK are considerably stronger than in the major continental economies. The annual average rise in the consumer price index in 1987 has been under 3 per cent, but this figure has been influenced by changes in real tax rates, and understates the underlying rate of inflation. Most projections indicate that consumer prices will rise by at least 4½ per cent in 1988. Perhaps more relevant is the fact that average earnings have risen by about 7½ per cent in 1987 and are expected to increase by at least as much in 1988.

Whether this faster rate of inflation can be accommodated within the existing exchange rates *vis-a-vis* the EMS currencies throughout 1988 must be regarded as doubtful. If sterling does come under pressure, it is not clear how far the authorities will allow it to depreciate and how far they will attempt to hold its value by increasing UK interest rates. On balance it seems reasonable to project a slightly lower value of sterling, and a slight widening of the interest rate differential between West Germany and the UK.

The Rest of the World

While Japan is likely to be affected in much the same way as Europe by the fall in the dollar, the decline in export growth will take place against the background of a more vigorously expanding domestic economy. Following what at the time seemed minor fiscal moves earlier in the year, domestic demand is thought to have grown by over 4 per cent in 1987, and GNP by at least 3 per cent. Consumption and investment seem set to continue their strong growth into 1988, but export volumes seem certain to fall. It seems doubtful that Japanese exporters can pare margins much further in an attempt to maintain their dollar prices unchanged, and so the loss of price competitiveness *vis-a-vis* the US could be greater than after the previous dollar depreciation.

TABLE 1: Short-term International Outlook

	GNP		Consumer Prices		Hourly Earnings		Unemployment Rate		Current Account Balance	
	Percentage Change						%		% of GNP	
Country	1987	1988	1987	1988	1987	1988	1987	1988	1987	1988
U.K.	4	2½	3½	4½	7½	7½	11¼	10¾	-½	-1¼
W. Germany	1½	1½	¾	¾	3¾	3	9¼	9½	3¼	2¼
France	1½	1¼	3½	2½	3¾	3½	11¼	12	-¼	-¾
Italy	3	2½	5	6	7¾	7½	11½	11¾	0	-¾
Total EEC	2¼	1¾	3	3	4½	4½	11½	11¾	1	¼
USA	2½	2¼	4	4¾	3½	4½	6¾	6¾	-3¼	-2¾
Japan	3	2¾	¼	¾	3	3¼	3	3¼	4	3¼
Total (OECD)	2½	2	3½	3¾	4	4¼	8¼	8½	-¼	-¼
Ireland	3¼	0	3¼	2½	5¼	4¾	18¾	19½	¼	2

Sources: OECD NIESR, and individual country sources.

Overall, Japanese GNP is expected to increase by about 2¾ per cent in 1988. Some progress appears to have been made in liberalising import procedures, and a substantial rise in import volumes is projected for 1988. In consequence, there should be a significant narrowing of the current account balance of payments surplus in 1988, even in terms of the depreciated dollar. Japanese inflation and interest rates are expected to remain very low throughout 1988.

How far the newer industrialised countries of Asia follow the Japanese experience in 1988 depends to a considerable extent on the exchange rate policies they follow. The fact that so many tracked the dollar down during 1985 and 1986 is one reason why the US deficit responded so sluggishly to that depreciation, and it is somewhat surprising that international efforts to reduce trade imbalances do not include greater control of such currencies.

At the time of writing it appears that production discipline within OPEC has largely broken down, with widespread discounting of contract oil prices and a severe fall in spot prices. Whether the weakness will continue and intensify, or whether a price collapse will shock members into re-introducing effective production limits cannot be forecast with any certainty. The most reasonable working assumption is that average crude-oil prices in 1988 will be lower than in 1987, but not dramatically so in dollar terms. When currency changes are taken into account, the effective price is likely to be substantially lower, leading to a further reduction in OPEC investment and imports.

Provided the major industrial countries avoid a full scale recession in 1988, most commodity prices are expected to retain the gains made in 1987, but not to rise very much further. On this basis many of the primary producing countries could show a modest rise in income in 1988. The weakness of the dollar might slightly ease the debt-servicing burden, although many of the countries concerned will, of course, see their currencies depreciate more rapidly than the dollar. Thus while the sovereign debt problem will remain chronic throughout 1988, there seems no clear reason at present why it should intensify to a critical degree.

The Context for Ireland

The prediction that there will be some slowing down of growth, particularly in Europe, rather than an actual fall during 1988 represents a fairly broad consensus among international commentators. If this view is correct, then the major markets for Irish exports should remain reasonably favourable. Irish competitiveness on these markets will be determined primarily by changes in relative costs and by exchange rate variations.

On current projections, Irish costs seem likely to rise by close to the average of the major European economies; a little faster than those in West Germany or the Netherlands, but significantly less than those in the UK. Exchange rate movements are a great deal more volatile. For this *Commentary* the working assumption is made that the dollar will fluctuate around its recent levels against the EMS currencies, giving an annual average rate against the Irish pound of about $1.64 or some 11 per cent below the 1987 average. Some commentators have suggested that such a dollar rate could eventually trigger a minor realignment within the EMS. Even if this were to occur, it seems unlikely to alter the average rate of the Irish pound against any individual EMS currency by more than 2 per cent. The major imponderable is sterling. Despite its strength for most of 1987, it seems very likely that sterling will come under some pressure during 1988. The assumption made for this *Commentary* is that the average value of sterling in 1988 will be about 92 pence, a depreciation of less than 2 per cent compared with the 1987 average.

Such currency movements would undoubtedly have adverse effects for companies exporting directly to the USA, while leaving competitiveness little changed in relation to most European countries, including the UK. However, if it is correct that currency changes in 1987 benefited those multinational exporters who obtain most of their inputs from dollar sources, then the further decline in the dollar could provide an additional gain in 1988. Taking all factors into account, it is assumed that the total environment for industrial exports will be slightly less favourable than in 1987.

International industrial investment might well grow more slowly in 1988, given the weaker world growth prospects and the continued currency instability. However, Irish cost projections, and the recent profitability of many Irish exporting branches, might improve the share of such investment which is located in Ireland, either in the form of new arrivals or as extensions of existing facilities.

With regard to interest rates, it is assumed that there will be little change from current nominal levels in most countries, with US and UK rates perhaps rising slightly. On an annual basis this would leave international interest rates in 1988 significantly lower than the 1987 average. Apart from the scope this might permit for a further reduction in Irish domestic interest rates, it would also, in alliance with the projected exchange rate adjustments, tend to reduce significantly the cost of servicing the external national debt.

General

The recent publication of the ESRI *Medium-Term Review* provides a framework for assessing the progress of the economy over the next five years. Each issue of the *Commentary*, drawing on the latest information, is likely to amend slightly the forecast for the immediate future, without necessarily altering the projection for the longer term. For instance, this issue of the *Commentary* is able to incorporate the actual Exchequer returns for 1987 rather than late-autumn estimates, and to take account of more up-to-date figures on trends in trade-flows, prices and registered unemployment.

Largely because of new information on stockbuilding and the strong export performance revealed in the trade statistics for October and November, the estimate of economic growth in 1987 has been revised upwards substantially compared with the October *Commentary* and the *Medium-Term Review.* The forecast for 1988 is much less changed. It remains likely that there will be virtually no growth in real GNP, as the fiscal depression of domestic demand counterbalances the continued expansion in net exports. The impact of lower interest rates on personal consumption and private sector investment is a major imponderable, especially within the context of international uncertainty, and at this stage it is prudent to allow for only a minor expansionary effect.

Exports

The growth in visible exports in 1987 was unexpectedly strong, especially from May onwards. The increase of about 14 per cent in the value of exports implies a volume rise of over 15½ per cent, even allowing for some overstatement of the annual price decline in the monthly export price indices. Such a volume growth is comparable to the 18½ per cent recorded in 1984. The rise in the value of agricultural exports is partly accounted for by an increase in overseas storage of intervention stocks, but also reflects higher prices for most products, and a significant shift in the composition of meat exports towards value-added products and more remunerative markets. Among manufactured exports the most rapid expansion again took place in data processing equipment, while cola concentrates are largely responsible for the surge in other industrial exports. However, in the second half of the year there were clear signs that the buoyant export performance was spreading to most branches of industry. With tourist earnings recovering sharply from the 1986 setback and other service exports expanding rapidly, total exports of goods and services are estimated to have increased by 13½ per cent in value and 14½ per cent in volume.

Export prospects for 1988 are difficult to assess, as there are several strong and conflicting influences. There is likely to be a significant decline in the raw material for agricultural exports, but this could be partly offset by a fall in the rate of intervention stockbuilding, by price increases for some products, and by continued upgrading in products and markets. On balance, a moderate fall in the volume of agricultural exports and virtual stagnation in their value seems the best guess at present.

With regard to industrial exports, the growth in world trade is expected to be quite sluggish in 1988, although trade within Europe might be rather more buoyant than world trade as a whole. These expected conditions are not greatly different from those obtaining in 1987. What could be more significant are changes in competitiveness, largely resulting from exchange rate fluctuations.

Undoubtedly the fall in the average value of the dollar will adversely affect direct exports to the USA and other countries with dollar-linked currencies. With or without a minor EMS adjustment, general competitiveness against continental Europe seems unlikely to change significantly in 1988. However, if the IDA is correct in asserting that the earlier decline in the dollar was largely responsible for improving the effective competitiveness of the dollar-based Irish electronics industry in 1987, then the process could continue vigorously in 1988. If sterling maintains roughly its present parity against EMS currencies, then competitiveness *vis-a-vis* the UK should improve steadily during 1988. A small and gradual depreciation of sterling would leave such competitiveness at about 1987 levels. Only if sterling depreciates more sharply than the divergent inflation rates would justify would there be a significant deterioration in the competitive position of Irish exporters to the UK. Such a development certainly cannot be ruled out, but at present it looks less likely than approximate stability in the real sterling-Irish pound exchange rate, which is assumed in this *Commentary*.

The final major influence on the level of industrial exports in 1988 is the amount of capacity in exporting industries. Much of the growth in 1987 reflected increased capacity in the modern industries, resulting both from expansions to existing plants and from new arrivals. Thus, at a minimum, the capacity exists to maintain industrial exports through 1988 at the levels achieved in the autumn of 1987. Given the rate of growth of exports and of the resulting profits during 1987, there would appear to be a strong incentive to expand capacity further during 1988. Offsetting this, the current uncertainties concerning the world economy in general and exchange rate volatility in particular could act as a constraint on new investment.

Taking both demand and supply factors into account, the forecasts shown in Table 2 represent essentially a holding of the volume of industrial exports achieved in the later months of 1987, with no significant change in their average price levels. This view, that further gains in exports to Europe will be offset by

TABLE 2: Exports of Goods and Services

	1986 £m	% Change Volume	% Change Value	1987 £m	% Change Volume	% Change Value	1988 £m
Agricultural	1770	7½	10	1955	–3	0	1955
Manufactured	6103	16	13¾	6916	10	10	7602
Other Industrial	1417	25	22	1730	16	16	2006
Other	98			92			92
Total Visible	9388	15½	14	10693	8½	9	11655
Adjustments	–212			–270			–240
Merchandise	9176	15¼	13¾	10423	9	9½	11415
Tourism	640	9	12	720	5½	8	778
Other Services	519	11	14	592	7½	10	651
Exports of Goods and Services	10335	14½	13½	11735	8¾	9½	12844

some loss of trade to North America, could well prove unduly cautious as the year progresses and new capacity becomes available but in present circumstances it would be rash to assume a continuation of the rate of growth obtained during 1987.

The volume of export tourism is forecast to rise in 1988, although less rapidly than in 1987 which included a substantial element of recovery. The American market seems likely to be adversely affected by the depreciation of the dollar, but this should be more than offset by continued growth of the UK and continental markets under the stimulation of lower access prices. With little current information available, a steady growth in other service exports is assumed. On this basis, exports of goods and services in 1988 would grow by 8¾ per cent in volume and 9½ per cent in value.

Stocks

Apart from exports, the other area where the latest information has forced an upward revision to 1987 growth estimates is the rate of stockbuilding. It now appears probable that the decline in farm stocks will be considerably smaller than was expected earlier in the year, with increases in the number of other livestock offsetting much of the decline in cattle numbers. Far more important, end-year estimates suggest that intervention and EEC-aided stocks have grown faster in 1987 than in 1986. This compares with earlier forecasts that the rate of such stockbuilding would be approximately halved in 1987. Indeed the latest figures are decidedly puzzling in view of the increase in agricultural exports and the relatively small decline in cattle numbers. The implication is that there must have been substantial smuggling of cattle into the country in the course of the year. No information is available concerning other industrial and distribution stocks, but given the expansion in industrial output, some increase in the rate of stockbuilding, including work in progress, is likely to have taken place.

TABLE 3: Stock Changes

	1986 £m	Change in Rate £m	1987 £m	Change in Rate £m	1988 £m
Farm Stocks	-97	77	-20	20	0
Irish Intervention Stocks[1]	113	37	150	-75	75
Other Non-agricultural Stocks	77	12	89	20	109
Total	93	126	219	-35	184

[1]Including subsidised private storage.

It seems possible that there will be little or no change in the volume of farm stocks in 1988, as the rundown in the dairy herd nears completion and sheep numbers continue to increase. With milk production likely to be significantly lower than in 1987, the increase in intervention storage of milk products is also likely to decline sharply, and quite possibly be reversed. Intervention stocks of meat could continue to grow, as third market meat sales could prove sluggish. In total, it is assumed that the rate of intervention and related stockbuilding will be approximately halved in 1988, although, as experience shows, such assumptions are subject to very large margins of error. A further modest increase in other non-agricultural stocks is forecast, as industrial output continues to grow and as lower interest rates reduce the cost of holding stocks. On these projections, as shown in Table 3, stockbuilding seems likely to make a negative contribution to economic growth in 1988, in contrast to a strong positive contribution in 1987.

Fixed Investment

No change seems necessary to earlier forecasts of fixed investment in 1987. Investment in building and construction is still thought to have declined by about 6¼ per cent in volume and by 3½ per cent in value. Conversely, investment in machinery and equipment, largely reflecting the expansion of industrial capacity, rose by about 7 per cent in volume and 6 per cent in value.

There will undoubtedly be another large fall in the volume of building and construction investment in 1988. On the basis of the public capital programme for 1988, many commentators are predicting a fall of over 10 per cent in the volume of building investment. Such projections make little allowance for any pick-up in private building in response to lower interest rates.

Although demographic factors would appear to rule out any possibility of a return to 1970's levels of private house building, the upturn in activity and prices in parts of the second-hand housing market in the second half of 1987 does suggest that private housing demand could be in the process of recovering from its lowest levels. Econometric work suggests that housing demand is quite elastic to interest rates, so that a further rise in demand during 1988 appears probable. Whether this can be absorbed by the existing stock of houses and current building levels is hard to assess in the absence of official data on housing stock. However, it is not unreasonable to expect some increase in the demand for new private houses in the course of 1988, particularly if it becomes clear during the year that the severest phase of public expenditure cuts is approaching its conclusion, and that surviving jobs are becoming more secure.

A minor upturn in agricultural investment also seems possible in the wake of the large improvement in agricultural incomes in 1987, while if industrial expansion continues, there is likely to be some building component in industrial investment. Lower interest rates could encourage some expansion in commercial development, over and above the £40 million expected to be spent on the Custom House scheme in 1988.

On balance, therefore, a small rise is forecast in most forms of private building investment, which could go some way towards offsetting the massive cuts in publicly funded construction. Thus an 8 per cent fall in the total volume of building and construction investment, as shown in Table 4, seems a reasonable projection for 1988.

TABLE 4: Gross Fixed Capital Formation

	1986 £m	% Change Volume	% Change Value	1987 £m	% Change Volume	% Change Value	1988 £m
Building and Construction	1676	−6¼	−3½	1616	−8	−5	1535
Machinery and Equipment	1775	7	6	1882	6	7	2014
Total	3451	½	1¼	3498	−½	1½	3549

Given the rate of industrial growth in 1987 and the profitability of many export enterprises, the incentive would appear to exist for a continuation of the rapid rate of industrial investment seen since 1986. IDA figures confirm that there is no appreciable slackening in the rate of investment and expansion projects. It is possible that some slow-down will be seen later in the year if export demand begins to flatten, but offsetting this are expected deliveries of expensive items of capital equipment such as new aircraft. In total, a volume increase in machinery and equipment investment only a little lower than in 1987 is forecast. This would leave the volume of total gross fixed capital formation showing a decline of about ½ per cent in 1988, just about cancelling out the marginal rise experienced in 1987.

Consumption

On the evidence both of the retail sales index and of tax returns, personal consumption appears to have been exceptionally sluggish in 1987. Even allowing for non-retail spending, the value of personal consumption seems to have risen by no more than 3 per cent, implying no change at all in volume terms. Despite the fiscal squeeze, personal disposable income is believed to have risen by almost 4¼ per cent in 1987, so that the estimated level of personal consumption implies an increase of about 1 per cent in the personal savings ratio.

Personal disposable income is projected to rise by only 2¾ per cent in 1988. However, the composition of income increases is likely to be considerably less conducive to saving than in 1987. Taken in conjunction with the possible effect of lower interest rates on the uptake of consumer credit, this suggests that the personal savings ratio is unlikely to rise in 1988. On the assumption that the savings ratio will remain roughly constant, personal consumption could thus rise by about 2¾ per cent in value terms, implying a marginal volume increase of about ¼ per cent. By comparison with recent UK experience, where the combination of falling interest rates with increasing consumer confidence has led to a sharp rise in the propensity to consume during the past 3 years, this is a cautious projection. However, given the history of stagnant consumption in Ireland in recent years, it would appear premature to predict a significant rise in personal consumption.

Public consumption appears to have risen by about 4 per cent in value in 1987, which represents a volume decline of about 2¼ per cent. On the basis of the Estimates, public authority consumption is expected to fall by roughly 1 per cent in value and no less than 5 per cent in volume in 1988. Such a volume reduction is in itself equivalent to just over 1 per cent of GNP.

Final Demand

The volume of final demand is estimated to have risen by 5½ per cent in 1987. Less than ¼ per cent was contributed by domestic demand, and that primarily in the form of physical stock formation. Overwhelmingly, the growth in final demand was due to the rise in exports of goods and services. Even in current price terms, exports accounted for over two-thirds of the total increase of 7¼ per cent.

The pattern of final demand changes forecast for 1988 is even more extreme.

The volume growth of exports of goods and services is forecast to contribute 3½ per cent to final demand, while domestic demand will account for a fall of ¾ per cent. At current prices, exports are forecast to provide almost 80 per cent of the increase in final demand. This heavy dependence on export growth, and particularly on increased industrial exports, results in the pattern of final demand being relatively import intensive in both years.

Imports

Visible imports increased by about 6¼ per cent in value in 1987. As in the case of exports, it appears probable that the annual rate of price decline will be rather smaller than that indicated by monthly unit price indices, and so the volume increase in visible imports is estimated at about 8¼ per cent.

Capital goods imports were particularly buoyant, rising in value by about 10 per cent. Although the destination of such imports is not known in detail, it seems reasonable to assume that a relatively high proportion was devoted to expanding industrial capacity. The other category showing a major increase, not surprisingly, was of intermediate products for industry, representing the raw materials and components necessary for the boom in industrial exports.

Making largely offsetting allowances in the balance of payments adjustment for reduced cross-border retail trade and increased cattle smuggling, the estimated growth in merchandise imports is similar to that in visible imports. Irish tourist expenditure abroad is believed to have grown quite rapidly, although not so fast as in 1986. Other imported services have increased dramatically, due mainly to changes in industrial structure. In total, as shown in Table 5, imports of goods and services are estimated to have increased by 7¼ per cent in value and 8¾ per cent in volume in 1987.

Import volumes in 1988 are forecast to reflect the expected pattern of industrial exports, with their growth slowing to a little under two-thirds of the 1987 increase. Expansion is projected to continue in capital goods imports and goods for further industrial processing, but consumer goods imports are likely to show only a small increase and a further decline in the volume of inputs for agriculture is expected.

With consumer spending limited, the rapid growth in tourism imports is

TABLE 5: Imports of Goods and Services

	1986	% Change		1987	% Change		1988
	£m	Volume	Value	£m	Volume	Value	£m
Capital Goods	1192	11	10	1312	8	8	1417
Consumer Goods	2332	6	4	2425	3½	4½	2534
Intermediate Goods:							
Agriculture	432	−3	−7	402	−5	−5	382
Other	4648	9¾	7¾	5008	6¼	6½	5338
Other Goods	26			33			37
Total Visible	8629	8¼	6¼	9180	5¼	5¾	9708
Adjustments	−14			−30			−40
Merchandise	8615	8¼	6¼	9150	5¼	5¾	9668
Tourism	497	5½	8½	539	2¼	5	566
Other Services	594	19	22	725	11	14	827
Imports of Goods and Services	9706	8¾	7¼	10414	5½	6¼	11061

forecast to taper off, but another large increase in imports of other services is projected. In total, therefore, imports of goods and services are forecast to rise by about 5½ per cent in volume in 1988, which seems reasonably in keeping with the size and composition of the increase in final demand. Given the depreciation of the dollar and the relative weakness of oil prices likely in 1988, the increase in the price of imports is expected to be negligible. The value of imports of goods and services is thus forecast to rise by 6¼ per cent, implying a price increase of ¾ per cent.

Balance of Payments

The estimates of exports and imports for 1987 show a surplus on visible trade of £1,513 million and on trade in goods and services of £1,321 million. Such surpluses are unprecedented, and reflect the boom in industrial exports within the context of a depressed domestic economy which restricts the demand for imports. Because of the suddenness of the upsurge in exports, it seems unlikely that it will be fully reflected in an increase in profit expatriation during 1987. As O'Malley and Scott demonstrated in the *Medium-Term Review,* there is generally a lag of some six months between recorded exports and the resultant profit outflow. The major decline in the dollar occurred too late in the year to have much impact on the cost of servicing the external national debt in 1987, but falling interest rates and a lower level of new direct foreign borrowing restricted the increase in debt service to about 7 per cent. Thus the total net factor outflow in 1987 is estimated at about £2,184 million, an increase of 7½ per cent, although a considerable margin of error still attaches to this estimate.

If the postponement of the fourth quarter EEC payments results in a fall in net current transfers from £1,075 million in 1986 to £900 million in 1987, the total current balance of payments for 1987 would show a small surplus of £37 million, the first since 1967. It is known, however, that balance of payments accounting is under review by the Central Statistics Office, and it is possible that some items currently included in the residual might be identified and transferred to the current account. In this case 1987 could still show a small current deficit, but no feasible revision will prevent the current external deficit from having shown a large improvement in 1987, in spite of the temporary handicap of delayed transfer payments.

Another substantial increase in the trade balance is forecast for 1988, with the visible trade balance rising to £1,947 million and the balance in goods and services to £1,783 million. In contrast to 1987, however, experience suggests that there will be a very large increase in profit expatriation in the wake of the mid-1987 boom in the exports of multinational companies. Even allowing for little, if any, rise in debt interest payments, as new net foreign borrowing will be low and the benefits of the dollar depreciation will become apparent, the increase in net factor outflows is likely to be substantial. An increase of 12 per cent, to £2,446 million seems a reasonable projection for 1988.

Assuming that net transfers recover to about £1,000 million with the resumption of four quarters' payments, the current balance of payments in 1988 is forecast as a surplus of £337 million on present accounting methods. Even if significant revisions are made in accounting procedures, it remains likely that 1988 will show a surplus on current account.

Output

Upward revisions to export and stock estimates have resulted in Gross Domestic Product appearing to have risen in volume by about 3¾ per cent in 1987 when measured from the demand side of the national accounts. On the supply side this increase is matched by upward revisions to industrial and agricultural output. With some slowdown of export growth, negative stockbuilding, and heavy fiscal deflation, it seems probable from the demand side that GDP will rise by only 1¼ per cent in 1988. In terms of output, virtually all this limited growth seems likely to come from the industrial sector.

Agriculture

There can be no doubt that agricultural output recovered strongly in 1987, although there is still some uncertainty as to just how strong the recovery was. Due largely to favourable weather resulting in excellent grass growth and high yields of most crops, it appears that gross agricultural output remained roughly constant, in spite of a lower milk quota, a reduction in arable acreage and a smaller breeding herd. The volume of farm inputs fell significantly, so that gross agricultural product, the equivalent of value added in agriculture is thought to have risen by almost 3 per cent in volume terms. When allowance is made for the increased fish catch, the contribution of agriculture, forestry and fishing to the volume growth in GDP is likely to have approached ½ per cent in 1987.

Unless weather conditions are freakishly good, the volume of gross agricultural output seems certain to fall in 1988. The operation of the super levy quota will reduce milk output significantly, the contraction of the breeding herd will continue to restrict cattle output, while an increase in crop acreage is most unlikely. However, a further reduction in the volume of inputs seems probable, so that a fall of perhaps 4 per cent in gross agricultural output would be consistent with a decline of less than 2 per cent in gross agricultural product. Taking fishing and forestry into account, the contribution of the wider agricultural sector to GDP growth in 1988 is projected as only marginally negative.

Industry

Due mainly to the surge in industrial exports, industrial production grew very rapidly in 1987. The index of industrial production showed that the gross production of manufacturing industry rose by 9¼ per cent in the first nine months of the year. For 1987 as a whole, manufacturing production is estimated to have grown by over 10 per cent and production of all industries by 9 per cent. With profit margins tending to widen, value added in industry probably rose even faster than gross production. Taking into account a fall of some 5 per cent in total building output, including its consumption element, it would appear that the industrial sector in its broad definition contributed almost 2½ per cent to the growth of GDP in 1987.

With domestic consumption again likely to be virtually static in 1988, and with the pace of export expansion forecast to slacken, a slower rate of industrial growth can be expected. However, with the carryover from the rise during 1987 very substantial, it seems reasonable to project increases in the annual average of the index of industrial production of some 7 per cent for manufacturing and

6 per cent for all industries. The achievement of such increases implies some further growth during 1988 in the output of the modern industries and continued progress in the food industry in compensating for reduced raw material supplies by increasing the value added per unit.

The decline in building output is expected to be even more severe than in 1987 as the consumption element will fall as grant-aided refurbishment comes to an end. Thus, total building output could decline by almost 10 per cent, and the contribution to GNP of the industrial sector in 1988 is forecast at just over 1 per cent.

Services

Despite the reduction in the output of public services in 1987, it appears that the output of the service sector as a whole grew fairly rapidly. Led by financial and exported services, including tourism, it seems likely that total service output expanded by around 1½ per cent, contributing about ¾ per cent to the growth in GDP.

Government expenditure cuts will lead to a fall in the volume of public services in 1988 at least twice as sharp as that suffered in 1987. At the same time the increase in tourist services is likely to be slower, the equity shake-out might inhibit the growth of financial services, and the stagnation forecast in personal consumption is likely to prevent any significant increase in distributive services. Under these conditions, very little growth can be expected from the service sector as a whole, and its contribution to GDP growth is likely to be minor.

Employment

With employment statistics lagging so far behind most other economic indicators, it is not yet possible to assess employment trends in 1987 with any confidence. Preliminary figures for the first half of the year suggest that employment in manufacturing industry was a little below the seasonally-corrected level of December 1986. Given the increase in manufactured output in the second half of 1987, it seems possible that there was some rise in employment in manufacturing during that period, and that the annual average could prove to have been almost the same as that in 1986. Most other forms of employment, especially in the building industry and in the public service, are likely to have declined significantly, so that the average total at work in 1987 may well have fallen by about 13,000 to 1,055,000.

Manufacturing employment seems likely to increase slightly in 1988 if the projection for industrial output is correct. However, the declines in building and public service employment are due to continue and even intensify. Given a continued secular decline in the number engaged in agriculture, the total at work is projected to fall by a further 14,000 to 1,041,000, as shown in Table 6.

Unemployment statistics have ceased to be a useful indicator of employment trends, both because of the volatility of migration flows and because of measures to reduce the number on the Live Register. Thus the fact that for the first time since 1979 there has been virtually no increase in the Live Register in the twelve months to December 1987 does not, unfortunately, provide evidence that the haemorrhage of job losses has been staunched. Indeed, if the

TABLE 6: Employment and Unemployment

A: Mid-April Estimates '000	1985	1986	1987	1988	1989
Agriculture	171	168	163	159	155
Industry	306	301	294	291	290
Services	602	606	603	596	592
Total at Work	1079	1075	1060	1046	1037
Unemployed	226	227	245	249	251
Labour Force	1305	1302	1305	1295	1288
Unemployment Rate %	17.3	17.4	18.8	19.2	19.5
Live Register	228	232	250	249	251

B: Annual Averages '000	1985	1986	1987	1988
Agriculture	170	166	161	157
Industry	304	298	294	290
Services	604	604	600	594
Total at work	1078	1068	1055	1041
Unemployed	226	232	245	249
Labour Force	1304	1300	1300	1290
Unemployment Rate %	17.3	17.8	18.8	19.3
Live Register	231	236	247	249

official estimates are accepted that over 13,000 individuals have been removed from the Register under the Jobsearch Scheme, other than by being found jobs, then the underlying rise in unemployment in 1987 was at least of the same order of magnitude as in the previous two years. Of course, it is possible that many of those who failed to attend interview would have left the Register anyway. Some allowance is made in Table 6 for the effect of Jobsearch, by altering the relationship between the number on the Live Register and the number unemployed on a Labour Force basis.

With regard to 1988, the average level of unemployment on either basis will depend to a large extent on the rate of net emigration. In the absence of any reliable data, it is assumed that after a temporary reduction in the early months of 1987 net emigration rose quite sharply in the second half of the year, and will continue at an annual rate of 30,000 during 1988. This could reduce the 1988 labour force by about 10,000, and limit the rise in the Live Register to about 2,000.

Incomes

Much of the upward revision to the growth rate in 1987 is absorbed in higher, temporarily undistributed, corporate profits, but some upward revision has also been made in personal incomes. With favourable movements in relative prices accompanying the increase in agricultural product, income arising in the agricultural sector is now estimated to have risen by 14 per cent. Average weekly earnings in the private sector are believed to have risen by a little over 5 per cent and those in the public service by about 6½ per cent. However, job losses of about 1 per cent of all employees restrict the estimate of aggregate earnings from employment to an increase of 4½ per cent, unchanged from the previous *Commentary*. Other personal income, largely in the form of interest and dividends, is now estimated to have risen by about 6½ per cent in 1987, while current transfers to the personal sector are thought to have increased by about 4 per cent.

Thus gross personal income is estimated to have risen by 5½ per cent, and personal disposable income by 4¼ per cent, an upward revision of ¼ per cent since the October *Commentary*. With personal consumption rising by only 3 per cent, the personal savings ratio is estimated to have risen quite sharply to nearly 20 per cent. Given the composition of the income increases, such a rise cannot be regarded as unusual, but it does offer some evidence that there has not yet been a revival in consumer confidence.

With the likely developments in agricultural output and input prices less favourable than in 1987 and a small decline in the volume of agricultural product expected, there could be a marginal reduction in income arising in the agricultural sector in 1988. Average earnings in both the private sector and the public service seem likely to rise by about 4¼ per cent in 1988 but with another fall of about 1 per cent in the number of employees all too likely, aggregate earnings are forecast to increase by only 3¼ per cent. The impact on self-employed incomes of the depressed domestic market in 1988 and the considerably lower level of average interest rates projected for the year restrict the forecast increase in other income to 3½ per cent. Assuming indexation of benefit rates but tight restrictions on eligibility, the rise in transfer payments could be about 2¾ per cent.

As Table 7 shows, this would result in gross personal income also rising by just over 2¾ per cent. Direct personal taxes are forecast to rise by 3½ per cent, in keeping with a basic assumption of indexation of tax bands and allowances, but allowing for the lag in collecting some taxes. On the basis of this assumption, personal disposable income would increase by just under 2¾ per cent, the smallest increase in nominal terms for nearly 30 years. In contrast to 1987, the income increases are not concentrated in areas with a high propensity

TABLE 7: Personal Disposable Income

	1986	Change		1987	Change		1988
	£m	%	£m	£m	%	£m	£m
Agriculture etc.	1310	14	183	1493	– ½	– 7	1486
Non-Agricultural Wages, etc.	9845	4½	445	10290	3¼	334	10624
Other Non-Agricultural Income	2062	6½	134	2196	3½	77	2273
Total Income Received	13217	5¾	762	13979	3	404	14383
Current Transfers	3410	4	137	3547	2¾	98	3645
Gross Personal Income	16627	5½	899	17526	2¾	502	18028
Direct Personal Taxes	3618	9½	344	3962	3½	140	4102
Personal Disposable Income	13009	4¼	555	13564	2¾	362	13926
Consumption	10552	3	317	10869	2¾	299	11168
Personal Savings	2457	9¾	238	2695	2¼	63	2758
Savings Ratio	18.9			19.9			19.8

to save and so no effective change in the savings ratio is postulated. If consumer confidence were to recover during 1988 then there could be a substantial fall in the savings ratio and the rise in consumption would be correspondingly greater.

Consumer Prices

The consumer price index rose by an average of 3.2 per cent in 1987, and by 3.1 per cent in the year to November. However, well over half of the annual rise occurred in the first quarter, when the removal of food subsidies, increases in excise duties and higher mortgage interest rates all contributed to a quarterly increase of 1.8 per cent in the index. Since February, the index has been rising at an annual rate of about 1.7 per cent.

The increase in prices in the quarter to February is likely to be much lower in 1988 than 1987. There are no further food subsidies to abolish, interest rates are falling rather than rising, and oil-related fuel prices are declining. Even allowing for some increase in specific indirect tax rates, the annual rise in the February index is likely to be just under 2 per cent, the lowest twelve-month increase for over 20 years.

For the rest of the year, the rise in consumer prices may be a little faster than in the corresponding period of 1987. Import prices are likely to be static, rather than below the previous year's levels, as in 1987. After their first quarter fall, interest rates are most unlikely to decline as much from their February level as they did in 1987, while food prices could increase if the weather is less favourable. Allowing for quarterly price increases of the order of ¾ per cent from February through to November the annual average of the consumer price index in 1988 would be about 2½ per cent higher than in 1987, while the increase in the twelve months to November would be about 3.1 per cent, almost identical with 1987.

Public Finances

Given that consumer spending was significantly lower than was predicted in the first half of the year, the meeting of the target for the 1987 current budget deficit was a considerable achievement. Receipts from excise duties and VAT were together over £100 million short of budget, but additional receipts from other forms of revenue, especially stamp duty, restricted the total revenue shortfall to £65 million, or almost 1 per cent of the budgeted total. Compared with 1986, total revenue rose by just over 6½ per cent, but the increases in excise duty and VAT were only 0.8 per cent and 3.8 per cent, respectively.

Total current expenditure, at £8,331 million was £86 million below budget, with the savings almost equally divided between Central Fund and Supply Services. Compared with 1986, Central Fund expenditure increased by 6.7 per cent and current supply service spending rose by only 1.6 per cent, implying a significant reduction in real terms.

The saving of £20 million on the current budget deficit, leaving it at £1,180, or approximately 6.8 per cent of GNP, was reinforced by a reduction compared with budget of £52 million in required borrowing for capital purposes. Thus the overall Exchequer borrowing requirement for 1987 was £1,786 million, or 10.3 per cent of GNP. This compares very favourably with the borrowing requirement of £2,145 million, or 13 per cent of GNP, in 1986.

Assuming that expenditure in 1988 conforms to the limits set out in the Estimates, with due allowance for agreed pay increases, severance costs and the probable indexation of social welfare benefit rates, it is likely that net supply service current expenditure will be in the region of £5,930 million. This would be about the same as 1987 spending in current price terms. With the level of new borrowing likely to be significantly reduced in 1988, interest rates payable on new borrowing and variable-rate loans considerably lower than the 1987 average, and the depreciation of the dollar providing substantial savings in the Irish pound cost of servicing about one-third of the overseas debt, the rise in Central Fund spending in 1988 could well be limited to under 4 per cent. This represents a considerable reduction from the forecast in the October *Commentary,* as a result of the faster than expected decline in the dollar and the lower than budgeted borrowing requirement in 1987.

Such an out-turn would leave total Exchequer net current expenditure in 1988 at almost £8,420 million, an increase of less than £90 million or about 1 per cent of the 1987 total. Of course, the achievement of such a low rate of expenditure increase will depend both on interest and exchange rate levels remaining relatively favourable and on strict control being maintained throughout the year on domestic public spending.

The impact of expenditure restraint on the overall position of the public finances obviously depends on the level of revenue flows generated in 1988. It is not the purpose of the *Commentary* to predict the detailed provisions of the Budget, or to recommend a specific mix of tax changes. Thus the technical assumption is made that tax structures remain unchanged and that there is approximate indexation of allowances and bands for direct taxes, and of specific rates of indirect taxes. In its strict form such an assumption is unrealistic, but it does appear reasonable to assume that whatever changes are made in the structure of taxation will result in a similar flow of total revenue. On this basis, but allowing for the normal lag in collecting revenue pertaining to some incomes generated in 1987 or earlier, it seems likely direct taxes will rise by about 4 per cent, indirect taxes by about 3 per cent and total revenue by about 2¾ per cent, when a probable fall in non-tax revenue is taken into account.

The implied current budget deficit for 1988, if the tax assumption proves correct, is thus about £1,070 million or about 6 per cent of GNP. Such a result, if it is achieved, would represent substantial progress towards attaining a sustainable level of current deficit, in a year in which the costs of reducing public service numbers are likely to be high.

If the Estimates are adhered to with regard to the Public Capital Programme, borrowing for capital purposes will be reduced by £280 million or more than 40 per cent. Taken together with the forecast current budget deficit, this would result in an Exchequer borrowing requirement in the region of £1,450 million, or just over 8 per cent of GNP. In absolute terms, the reduction in the borrowing requirement between 1987 and 1988 would thus be of the same order of magnitude as that achieved between 1986 and 1987. Over the two years together there would have been a reduction of about 5 per cent in the borrowing requirement as a proportion of GNP, and a large part, although by no means the whole, of the required adjustment in the public finances would have been accomplished.

Interest Rates

After reaching crisis levels, at least in real terms, during the early months of 1987, interest rates fell substantially in the remainder of the year. The one-month interbank wholesale rate, to which most retail interest rates are related, fell from almost 14½ per cent in February to under 8½ per cent by the end of the year. The fall in yields on long dated government securities was less dramatic, from 12¾ per cent in January to about 10¼ per cent by the end of December. To some extent these reductions in Irish interest rates reflected declines in overseas rates, particularly in London. However, the greater part of the decline represented a narrowing of the Irish differential over international rates, as sterling-related currency fears abated and as confidence grew in Irish fiscal management.

Entering 1988, the prospects appear favourable for at least the continuation of the present, relatively low, levels of retail interest rates and possibly for some further modest decline. Gilt yields should almost certainly fall further, given the strong funding position of the Exchequer and the current premium over UK gilt yields. Once the substantial inflation differential between the UK and Ireland becomes an established fact with the publication of the February consumer price index, rather than a matter of commentators' predictions, the emergence of a reverse differential between UK and Irish yields could become more acceptable to the markets.

Only if there is a rapid depreciation of sterling, over and above the moderate adjustment which would appear justified by the relative inflation rates of the UK and Germany, or if there is prolonged speculation about a major realignment within the EMS, would serious upward pressure be placed on Irish interest rates. At present, neither eventuality appears likely, and so the unfamiliar probability of stable or gently declining interest rates could provide the conditions for a revival in business and consumer confidence in the course of the year.

General Assessment

It has been a welcome change in 1987 to have to revise upwards successive forecasts of the growth rate for the year. However, it needs to be stressed that a considerable proportion of the latest estimate of a 3¼ per cent growth rate is due to the timing of profit expatriation. If there were no lag between recorded exports and the resulting profit outflows, the 1987 growth rate would have been about 2½ per cent. Conversely, in such a case the predicted growth in 1988 would be ¾ per cent rather than zero.

If the two years are considered together, a more balanced picture of economic performance emerges, provided of course that the estimates and forecasts are broadly correct. Average economic growth for the two years is over 1½ per cent per annum, despite an annual average reduction of about 2½ per cent of GNP in the Exchequer borrowing requirement. This is made possible by an improvement of almost 2 per cent per annum in the external trade balance, together with a significant increase in privately financed investment in response to favourable export conditions and lower interest rates. On the supply side, the major contribution is from a large rise in manufacturing production, with lesser increases from the growth in private sector services and agriculture.

Again, on the assumption that the forecasts are correct, 1989 will be entered with the public finances nearer equilibrium than at any time in this decade, and with the prospect that the carryover from cuts made during 1988 will bring the 1989 borrowing requirement within the range where a stabilisation of the debt/GNP ratio is possible. Provided that external conditions remain conducive to export growth and that restraint is maintained with regard to domestic costs, 1989 could thus see a return to an underlying growth rate of about 3 per cent.

However, it must be stressed that all forecasts are subject to a considerable degree of uncertainty, and this one is no exception. Although it represents our assessment of the most likely outcome for 1988, actual developments could prove significantly more or less favourable as the year progresses. If both consumer and business confidence were to recover more strongly than assumed, growth would be faster and revenue more buoyant than predicted here. While it would be imprudent to anticipate this happening, the possibility cannot be ruled out. If it were to happen, then the proper response would be simply to allow the conditions to bring about a faster than expected improvement in the public finances during 1988, by adhering strictly to the expenditure estimates. The bringing forward of structural growth policies in 1989, while continuing to keep tight control of general public expenditure, could then be considered.

Conversely, if the world economy performs more weakly than predicted in 1988, or if the impact of international uncertainties on the Irish economy is more severe than assumed here, then export and investment growth could be weaker than forecast. In this case there would be a significant decline in real GNP, and the improvement in the public finances would be less than that forecast. Again, there would be a strong argument for simply implementing the planned expenditures during 1988, but it would clearly be necessary to prepare for a further round of spending cuts in 1989.

Thus on the central forecast, and on optimistic or pessimistic variants, it appears essential to maintain rigid fiscal discipline in 1988, by holding to the expenditure Estimates and avoiding real reductions in total tax levels. During the year it would seem prudent to plan for another moderate round of spending cuts for 1989, with the hope that in the event they might not need to be implemented or that they could be counterbalanced by tax reductions in 1989.

The main difference between 1988 and previous years in this decade is that the acceptance of a year of strict fiscal control could, with a little good fortune, result in the achievement of a sustainable borrowing requirement in the following year. Premature relaxation would endanger this prospect with no lasting benefit.

Employment will inevitably fall in 1988 as a result of this fiscal stance, but a stabilisation of job levels could follow in the ensuing years. Unfortunately, the restoration of a significant growth in employment would appear to rest on a change of policy in the major world economies and particularly within the EEC. What influence Ireland possesses should continue to be used in favour of such policies, and this influence could be marginally strengthened if Ireland's public finances are perceived as having been corrected. However, it remains difficult to hold out much hope of a major improvement in European employment trends in the medium term. It might well be time to consider seriously the question of ameliorating the problems of the unemployed in future years, rather than seeking vainly for a conventional reduction in the number registered as without a job.

STATISTICAL APPENDIX

		Output Indicators			Employment		Output per Head	
	1	2	3	4	5	6	7	8
	Manufacturing	Transportable Goods	Electricity Output	Cement Sales	Manufacturing	Transportable Goods	Manufacturing	Transportable Goods
	1980 = 100	1980 = 100	G.W.H.	000 Metric Tons	000's	000's	1980 = 100	1980 = 100
1981	102.7	101.6	10767	1812.5	222.5	234.2	105.0	103.7
1982	104.6	103.6	10792	1486.1	215.1	225.8	110.6	109.6
1983	112.6	111.1	11039	1382.4	202.4	212.5	126.5	125.0
1984	126.7	125.1	11424	1298.4	196.2	205.8	146.8	145.3
1985	130.1	126.8	11919	1233.2	188.9	197.6	156.6	153.3
1986	133.8	130.4	12466	1147.9	186.8	194.9	163.0	160.0
1987								
Quarterly Averages or Totals								
1984 I	120.2	117.1	3136	271.5	197.3	206.6	138.5	135.5
II	133.8	133.9	2672	366.3	196.6	207.4	154.7	154.3
III	117.9	118.5	2562	350.0	196.7	206.2	136.3	137.3
IV	135.1	130.9	3054	310.6	194.0	202.7	158.4	154.4
1985 I	132.2	128.1	3259	241.3	189.2	197.9	158.9	154.7
II	137.8	134.4	2818	350.4	188.3	198.0	166.4	162.3
III	119.4	117.1	2705	333.1	189.6	198.0	143.2	141.4
IV	141.7	127.8	3137	308.3	188.3	196.4	158.9	155.5
1986 I	132.5	127.6	3356	205.0	185.7	193.5	162.2	157.5
II	139.2	135.7	2996	319.1	186.6	195.7	169.6	165.7
III	124.7	123.0	2814	330.6	188.3	196.1	150.6	150.0
IV	138.8	135.2	3300	293.2	186.7	194.2	169.1	166.0
1987 I	136.6	131.3	3466	218.5	184.4	192.3	168.4	163.1
II	156.7	153.3	3015	323.8	184.0		193.6	
III	139.9		2956	321.3				
IV								
Quarterly Averages or Totals Seasonally Corrected								
1984 I	120.1	118.3	2852	340.2	198.7	208.5	137.4	135.7
II	126.6	126.5	2819	328.7	197.4	207.2	145.8	145.9
III	126.2	124.5	2853	318.0	195.4	204.8	146.9	145.3
IV	133.8	130.4	2902	311.5	193.2	202.4	157.5	154.0
1985 I	132.0	129.4	2959	308.2	190.6	199.8	157.5	154.8
II	130.7	127.4	2973	314.3	189.0	197.8	157.2	153.9
III	128.1	123.5	3005	301.5	188.2	196.6	154.8	150.1
IV	130.2	127.0	2990	307.1	187.5	196.1	157.9	155.0
1986 I	132.3	129.0	3044	264.5	187.1	195.4	160.8	157.7
II	132.0	128.7	3161	285.9	187.3	195.4	160.2	157.3
III	133.8	129.7	3120	298.5	186.9	194.7	162.8	159.1
IV	137.5	134.3	3151	291.2	186.0	194.0	168.1	165.4
1987 I	135.7	131.9	3143	284.7	185.9	194.2	166.0	162.2
II	148.7	145.4	3182	289.7	184.7		183.1	
III	150.3		3274	289.7				
IV								

Unemployment	Prices						
9	10	11	12	13	14	15	
Live Register Av. Monthly	Consumer Price Index	Agricultural Price Index	Import Unit Value	Export Unit Value	Terms of Trade	Price of Stocks + Shares	
000's	Nov. 1982 = 100	1980 = 100	1975 = 100	1975 = 100	1975 = 100	1975 = 100	
127.9	82.4	117.7	232.4	208.4	89.7	219.9	1981
156.6	96.5	127.5	249.4	231.5	92.8	179.9	1982
192.7	106.6	135.4	261.1	251.9	96.5	223.7	1983
214.2	115.8	139.4	286.5	273.0	95.3	296.1	1984
230.6	122.0	135.6	293.2	280.6	95.7	316.8	1985
247.3	130.7	135.2	260.5	260.0	99.8	489.8	1986
							1987
Quarterly Averages or Totals							
215.2	112.9	146.6	281.5	266.0	94.5	309.6	1984 I
210.8	115.5	150.0	283.7	269.8	95.1	314.9	II
212.6	116.9	135.6	294.3	276.6	94.0	280.7	III
218.1	117.7	134.4	297.9	283.3	95.1	279.1	IV
232.8	119.9	140.7	297.3	280.3	94.3	284.7	1985 I
226.5	121.5	140.2	300.6	288.0	95.8	289.4	II
231.8	123.3	133.1	298.0	289.9	97.3	333.3	III
231.2	123.5	134.3	289.7	282.7	97.6	359.8	IV
238.7	125.4	140.8	279.0	270.0	96.8	426.8	1986 I
231.8	126.9	139.1	266.0	268.4	100.8	508.5	II
235.1	127.1	131.4	266.7	267.5	100.3	509.5	III
240.0	127.4	134.5	267.5	265.0	99.1	514.6	IV
252.1	129.7	143.0	257.1	256.0	99.6	632.4	1987 I
247.9	130.5	143.3	259.2	258.1	99.6	706.2	II
246.3	131.2	140.1	261.3	260.5	99.7	799.8	III
243.0	131.3						IV
Quarterly Averages or Totals Seasonally Corrected							
209.0	113.0	143.2	No Seasonal Pattern	No Seasonal Pattern	No Seasonal Pattern	No Seasonal Pattern	1984 I
212.8	115.2	145.9					II
215.1	116.7	139.0					III
219.8	118.2	138.0					IV
226.4	119.9	137.4					1985 I
228.7	121.1	136.3					II
234.2	123.1	136.7					III
233.1	124.1	137.8					IV
232.3	125.3	137.5					1986 I
233.9	126.5	135.2					II
237.4	126.9	135.1					III
242.0	128.1	138.1					IV
245.6	129.6	139.6					1987 I
250.1	130.1	139.3					II
248.6	131.0	144.1					III
245.0	132.0						IV

	Money Earnings Weekly Averages		Real Earnings		Consumption Indicators		
	16	17	18	19	20	21	22
	Manufacturing	Transportable Goods	Manufacturing	Transportable Goods	New Cars Registered	Retail Sales Value	Retail Sales Volume
	1982 = 100	1982 = 100	1982 = 100	1982 = 100	Total	1980 = 100	1980 = 100
1981	88.6	88.8	107.6	107.8	104645	118.3	99.4
1982	100.0	100.0	103.7	103.6	72603	129.4	94.0
1983	111.7	111.8	104.8	104.9	61094	137.0	90.5
1984	125.3	125.1	108.3	108.0	55893	145.8	89.4
1985	135.3	134.2	110.9	110.0	59592	155.9	91.0
1986	145.4	145.6	114.8	114.9	58760	158.8	90.5
1987							

Quarterly Averages or Totals

	16	17	18	19	20	21	22
1984 I	120.2	119.3	106.5	106.1	19263	140.0	88.1
II	124.0	124.8	107.4	108.0	18443	144.3	88.9
III	126.5	125.5	108.2	107.6	11708	143.6	87.4
IV	130.7	130.0	110.1	110.4	6479	154.1	92.8
1985 I	129.8	129.1	108.2	107.7	19914	147.5	87.5
II	135.1	134.7	111.2	110.9	19200	153.4	89.9
III	136.3	134.9	110.5	109.2	13287	155.3	90.2
IV	140.2	138.2	113.5	111.9	7191	165.8	95.6
1986 I	140.1	139.4	111.7	111.2	19177	155.5	89.0
II	144.3	145.6	113.7	114.7	18202	154.7	88.3
III	147.0	147.6	115.7	116.1	14093	157.3	89.9
IV	150.3	149.9	118.0	117.7	7288	166.4	94.1
1987 I	149.1		114.9		17376	155.6	86.9
II	154.3		118.2		17405	159.1	88.2
III					12136	159.1	87.9
IV							

Quarterly Averages or Totals Seasonally Corrected

	16	17	18	19	20	21	22
1984 I	121.8	121.7	104.1	107.7	13567	141.8	89.2
II	123.6	123.5	103.2	107.2	15312	146.6	90.5
III	126.5	126.0	104.4	108.0	13339	145.2	88.4
IV	129.4	129.2	106.1	109.3	12914	147.8	88.8
1985 I	131.4	130.9	105.7	109.1	14355	150.0	89.0
II	134.7	133.4	107.0	110.1	15544	155.5	91.3
III	136.4	135.2	106.7	109.8	15024	157.4	91.4
IV	138.8	137.4	108.4	110.6	14420	158.8	91.3
1986 I	141.9	141.2	109.2	112.7	14120	158.5	90.8
II	143.8	143.4	109.3	113.3	14491	156.7	89.6
III	147.1	147.9	111.7	116.6	15750	159.4	91.0
IV	148.8	149.0	112.7	116.2	14718	159.0	89.8
1987 I	151.0		112.3		12973	158.9	88.8
II	153.7		113.6		13694	161.2	89.5
III					13516	161.3	89.0
IV							

Government			Monetary Developments				
23	24	25	26	27	28	29	
Current Revenue	Current Expenditure	Current Deficit	Money Supply M3	Licensed Banks Domestic Credit Government	Licensed Banks Domestic Credit Non-Gov.	External Reserves	
£m	£m	£m	£m End Period	£m End Period	£m End Period	£m End Period	
3973	4796	823	n.a.	1277.4	n.a.	1473.1	1981
4908	5896	988	7291.9	1564.7	6655.1	1594.0	1982
5711	6671	960	7697.4	1775.6	7493.8	2014.8	1983
5952	6991	1039	8473.9	2247.9	8127.6	2101.2	1984
6331	7615	1284	8924.8	2514.1	8441.1	2271.9	1985
6709	8104	1395	8836.9	2725.7	9065.5	2205.3	1986
7151	8331	1180					1987
Quarterly Totals			Monthly Totals				
1290	1719	429	7697.4	1831.2	7512.5	2117.7	1984 I
1516	1684	169	7934.1	2142.4	7724.4	1952.0	II
1457	1714	257	8161.6	2223.0	7938.4	1875.0	III
1689	1873	184	8473.9	2247.9	8127.6	2101.1	IV
1325	1981	656	8438.9	2166.3	8151.0	2632.5	1985 I
1635	1792	157	8545.0	2319.1	8291.7	3124.8	II
1562	1838	276	8639.4	2421.6	8206.8	3009.6	III
1809	2004	195	8924.8	2514.1	8441.1	2271.9	IV
1416	2057	641	8567.5	2510.1	8730.6	2232.8	1986 I
1736	2051	315	8449.5	2354.6	8596.7	2296.5	II
1591	1845	254	8677.0	2277.8	8744.7	2116.4	III
1967	2152	185	8836.9	2725.7	9065.5	2205.3	IV
1476	2171	695	8838.5	2619.0	9201.8	2295.7	1987 I
1894	2115	221	9216.3	2556.7	9195.1	2477.8	II
1701	1904	203	9549.1	2561.8	9078.1	2810.9	III
2080	2141	61					IV
Quarterly Totals (S.C.)			Monthly Totals (S.C.)				
1449	1669	219	No Seasonal Pattern	No Seasonal Pattern	No Seasonal Pattern	No Seasonal Pattern	1984 I
1487	1677	189					II
1509	1813	304					III
1493	1838	345					IV
1514	1918	403					1985 I
1586	1783	197					II
1620	1959	339					III
1596	1956	360					IV
1634	1989	356					1986 I
1672	2039	367					II
1653	1978	324					III
1735	2095	360					IV
1710	2099	389					1987 I
1817	2102	285					II
1773	2046	273					III
1833	2082	249					IV

	Visible Trade Indicators					Exchange Rates	
	30	31	32	33	34	35	36
	Imports (Value)	Exports (Value)	Trade Surplus (Value)	Imports (Volume)	Exports (Volume)	Effective Index	Sterling
	£m	£m	£m	1975 = 100	1975 = 100	Dec. 1971 = 100	Per IR£
1981	6578.4	4777.6	– 1800.8	166.0	158.3	67.75	0.8002
1982	6816.2	5691.4	– 1124.7	160.3	169.8	67.35	0.8125
1983	7366.8	6943.8	– 422.0	165.3	190.2	65.13	0.8222
1984	8912.2	8897.5	– 14.6	182.6	225.2	62.26	0.8134
1985	9428.2	9743.0	314.8	188.7	239.9	62.41	0.8234
1986	8629.7	9388.2	758.5	194.4	249.5	66.65	0.9147
1987							
Monthly Averages							
1984 I	744.6	654.4	– 90.1	186.3	203.8	62.58	0.7952
II	714.9	770.0	55.0	177.4	236.5	62.58	0.8101
III	710.5	722.7	12.2	170.0	216.6	61.84	0.8142
IV	801.3	819.0	17.7	189.3	239.7	62.05	0.8360
1985 I	819.9	800.4	– 19.6	194.4	236.6	61.93	0.8586
II	807.2	856.1	48.9	189.3	246.2	61.45	0.8074
III	740.9	795.3	54.4	175.0	227.5	62.17	0.7963
IV	775.4	796.0	20.6	188.6	233.3	64.15	0.8330
1986 I	732.4	762.6	30.2	185.0	234.6	66.65	0.8978
II	723.1	786.4	63.4	191.4	243.1	67.33	0.8976
III	666.9	753.4	86.5	176.1	233.6	66.40	0.9144
IV	754.2	827.0	72.8	198.6	258.8	66.22	0.9497
1987 I	738.9	773.6	34.8	202.4	250.6	66.77	0.9422
II	763.0	927.4	164.4	207.3	298.1	66.01	0.9024
III	731.5	882.7	151.1	197.2	280.9	65.56	0.8997
IV							
Monthly Averages. Seasonally Corrected.							
1984 I	709.6	684.3	– 25.3	176.8	211.1	No Seasonal Pattern	No Seasonal Pattern
II	705.5	733.1	27.6	174.4	225.5		
III	759.2	733.6	– 25.7	183.5	220.5		
IV	794.6	812.1	17.5	187.7	239.2		
1985 I	794.8	836.1	41.3	187.4	244.6		
II	797.5	817.7	20.2	186.3	235.1		
III	779.8	810.2	30.4	186.2	232.6		
IV	768.4	782.3	13.9	186.3	231.3		
1986 I	711.4	800.8	89.4	179.1	243.3		
II	715.4	754.8	39.4	188.7	233.0		
III	700.1	763.4	63.3	186.4	237.6		
IV	748.1	810.8	62.7	196.8	256.0		
1987 I	716.9	813.2	96.4	195.2	260.8		
II	756.6	887.2	130.6	204.7	284.8		
III	771.4	891.8	120.4	210.2	284.8		
IV							

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