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by

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SUMMARY

In relation to the targets of the National Plan, 1985 is likely to see a considerable shortfall in employment and a modest shortfall in the public finances. Performance is ahead of the Plan with regard to the rate of inflation and the Balance of Payments, both of which will show the best outcome for more than a decade. Partly because of the very poor summer weather the growth rate of GNP is likely to decline to about 1¼ per cent.

Even on the assumption of modest reflationary action on the part of Japan and West Germany, the growth in world trade is expected to decline from 5½ per cent in 1985 to about 4 per cent in 1986, with a slight further fall in both international interest rates and the value of the dollar after their precipitate declines during 1985. Against this background it is likely that Ireland will achieve a GNP growth rate of about 2 per cent in 1986, with a further small improvement in the Balance of Payments taking the external deficit down to 3 per cent of GNP. Consumer prices are likely to rise by no more than 5 per cent, but unemployment is expected to increase slightly to an annual average Live Register of about 236,000.

Due to a much lower rate of increase in the interest payable on the national debt, there could be some reduction in the current budget deficit in 1986. However, the reduction forecast, which itself is dependent on tight control of public service pay, is only to a level of £1,220 million, which at about 7¼ per cent of GNP is roughly equivalent to the size of the deficit in 1984. If the public service pay bill increases by significantly more than the 5 per cent assumed here, even this modest progress would be jeopardised. The prospect for placing the public finances on a tenable course would be deferred indefinitely and would ultimately rest on the future adoption of draconian spending cuts or tax increases.

The long-term interest of public service workers, even more than the remainder of the community, lies in the restoration of a sustainable fiscal balance, which is essential for their future job security and income growth. It is to be hoped, therefore, that the present impasse over public pay rates will be resolved by the members and leaders of the public service unions taking a longer-term view of their advantage. Whatever the understandable pressures for the alleviation of immediate income shortage, Union leaders would serve their members well by adopting a flexible attitude to negotiations on the procedural and short-term pay issues at the heart of the dispute.

FORECAST NATIONAL ACCOUNTS 1985
A: Expenditure on Gross National Product

	1984	1985	Change in 1985 £m		Change in 1985 %		
	Provisional £m	Forecast £m	Total	Volume	Total	Price	Volume
Private Consumer Expenditure ...	9465	10155	690	142	7¼	5¾	1½
Public Net Current Expenditure ...	3083	3283	200	31	6½	6½	1
Gross Domestic Fixed Capital Formation	3415	3671	256	69	7½	5¼	2
Exports of Goods and Services (X) ...	9742	11134	1392	884	14¼	5	9
Physical Changes in Stocks	355	140	− 215	− 185			
Final Demand	26060	28383	2323	941	9	5	3½
less:							
Imports of Goods and Services (M) ...	9778	10760	982	540	10	4¼	5½
GDP at market prices	16282	17623	1341	401	8¼	5½	2½
less:							
Net Factor Payments (F)	1609	1930	321	221	20	5½	13¾
GNP at market prices	14673	15693	1020	180	7	5¾	1¼

B: Gross National Product by Origin

	1984	1985	Change in 1985	
	Provisional £m	Forecast £m	£m	%
Agriculture, Forestry, Fishing ...	1474	1341	− 133	− 9
Non-Agricultural: Wages etc. ...	8740	9395	655	7½
Other	2600	3044	444	17
less:				
Net Factor Payments	1609	1930	321	20
National Income	11205	11850	645	5¾
Depreciation	1580	1785	205	13
GNP at factor cost	12785	13635	850	6¾
Taxes less subsidies	1888	2058	170	9
GNP at market prices	14673	15693	1020	7

C: Balance of Payments on Current Account

	1984	1985	
	Provisional £m	Forecast £m	Change in 1985 £m
X—M	− 36	374	+ 410
F	− 1609	− 1930	− 321
Net Transfers	808	990	+ 182
Balance on Current Account ...	− 837	− 566	+ 271
as % of GNP	− 5¾	− 3½	+ 2

FORECAST NATIONAL ACCOUNTS 1986

A: Expenditure on Gross National Product

	1985 Forecast £m	1986 Forecast £m	Change in 1986 £m Total	Change in 1986 £m Volume	Change in 1986 % Total	Change in 1986 % Price	Change in 1986 % Volume
Private Consumer Expenditure ...	10155	10895	740	210	7¼	5	2
Public Net Current Expenditure ...	3283	3459	176	0	5¼	5¼	0
Gross Domestic Fixed Capital Formation	3671	3968	297	120	8	4½	3¼
Exports of Goods and Services (X) ...	11134	12543	1409	868	12¾	4¾	7¾
Physical Changes in Stocks	140	120	– 20	– 20			
Final Demand	28383	30985	2602	1178	9	4¾	4¼
less:							
Imports of Goods and Services (M) ...	10760	12020	1260	760	11¾	4½	7
GDP at market prices	17623	18965	1342	418	7½	5	2¼
less:							
Net Factor Payments (F)	1930	2123	193	97	10	4¾	5
GNP at market prices	15693	16842	1149	321	7¼	5	2

B: Gross National Product by Origin

	1985 Forecast £m	1986 Forecast £m	Change in 1986 £m	Change in 1986 %
Agriculture, Forestry, Fishing ...	1341	1406	65	5
Non-Agricultural: Wages etc. ...	9395	9994	599	6¼
Other	3044	3348	304	10
less:				
Net Factor Payments	1930	2123	193	10
National Income	11850	12625	775	6½
Depreciation	1785	2015	230	13
GNP at factor cost	13635	14640	1005	7¼
Taxes less subsidies	2058	2202	144	7
GNP at market prices	15693	16842	1149	7¼

C: Balance of Payments on Current Account

	1985 Forecast £m	1986 Forecast £m	Change in 1986 £m
X—M	374	523	+ 149
F	– 1930	– 2123	– 193
Net Transfers	990	1089	+ 99
Balance on Current Account ...	– 566	– 511	+ 55
as % of GNP	– 3½	– 3	+ ½

COMMENTARY

The International Economy

General

Despite major currency fluctuations, world trade has continued to grow quite rapidly in 1985. Prospects for the next few months are still dominated by conflicting expectations concerning the US economy, but it is possible that by the latter half of 1986 the economic decsions taken by European countries will become the major consideration in determining the course of the world economy. The fiscal, as well as monetary, adjustments necessary to sustain a controlled reduction in the value of the dollar include some reflation of the underemployed European economies as well as a serious attempt to reduce the US budget deficit. Whether such action will in fact be forthcoming could become the crucial question in international economic management during 1986.

In the absence of countervailing measures, the decline of the dollar, if it continues, could lead to a severe reduction in the rate of growth of world trade in 1986, as US imports begin to fall in response to the improving competitiveness of US industry. Alternatively this process could be accelerated by the introduction of effective protective measures by the US, even without a further dollar decline.

The US Economy

In the short run the evolution of the US economy remains the key factor in assessing the prospects for world output and trade. As they have been throughout 1985, the indicators are confusing. As explained in the last *Commentary,* most consumption indicators have been reasonably buoyant but production is depressed by the high volume of imports. The initial estimate of a 3.3 per cent third quarter rise in GNP was rather disappointing, although experience suggests that these first estimates are little more than a crude indicator. The general, but by no means unanimous, opinion of analysts is that there will be some recovery in the growth rate in the second half of 1985, but that this recovery will be weaker than had previously been forecast. For 1985 as a whole, a GNP growth of a little under 3 per cent appears likely.

The outlook for 1986 depends in large measure on the trading performance of the US economy. The situation of the first half of 1985, where the growth of US demand resulted in higher imports and lower exports, is most unlikely to be repeated. Unless there is a substantial trading improvement, the US growth rate is liable to decline significantly, or even stagnate. More probably, there will be a recovery in the US trading performance, particularly with regard to checking import penetration. There is a considerable danger that this will be achieved through the introduction of protective measures for at least some industries. More optimistically it could be achieved through the reduction in the value of the dollar. The extent, and even more crucially the timing, of trade responses to a given fall in the exchange rate are matters of some uncertainty. However, the dollar has already fallen by almost 20 per cent from the peak it reached briefly in February 1985. This is a major reduction, and even allowing for a lag of between 9 and 12 months before the positive trade effects become apparent, there should be a marked trade improvement in the course of 1986. If the dollar continues to fall, stronger results should be seen by the latter half of 1986.

After its deterioration to about $150 billion in 1985, it is thus reasonable to anticipate that the US balance of payments deficit will at worst stabilise, and at best might show some improvement in 1986. If this happens a modest growth rate of some 2½ to 3 per cent could be expected in the US economy in 1986.

Although the rise in the external deficit might thus be checked in 1986, at present it seems unlikely that 1986 will see any significant reduction of the other major imbalance in the US economy, the current budget deficit. It is, however, possible that steps will be taken during the year towards modest reductions in following years. Even in an economy as self-contained as the US, a major currency decline is likely to have some impact on the price level, and consumer prices could well rise by 5 per cent in 1986, compared with 3½ per cent in 1985. If GNP does grow by 2½ per cent or more, employment should increase sufficiently to prevent any rise in the average level of unemployment, which is expected to be about 7¼ per cent of the labour force in both years.

So far as the impact of the US economy on the rest of the world is concerned, it appears inevitable that there will be a considerable slackening of US import growth. The most likely cause, as outlined above, is that improved American competitiveness due to the decline of the dollar will check import penetration. If, however, this does not happen then slower economic growth will depress demand for imports or protectionist measures will divert a proportion of demand to home production. After the substantial fall in US interest rates during 1985, present indications are that there will be no great change in 1986. Failure to reduce the budget deficit and the likelihood of rising prices both militate against further substantial cuts in interest rates. On the other hand, the new-found desire to depress the value of the dollar should act against raising interest rates. Indeed, if managing the exchange rate remains a central feature of economic policy, US interest rates could become dependent on the rates established in other countries, thus following rather than leading world trends.

The European Economy

Economic growth in the EEC is still expected to be about 2½ per cent in 1985, and to be accompanied by lower inflation but higher unemployment than in 1984. Economic policy in the major EEC countries remains restrictive, with a further reduction in the rate of inflation still a major policy aim.

With regard to 1986, the outlook is rather uncertain, and heavily dependent on policy decisions in the major countries. Exports have provided much of the stimulus to growth in 1984 and 1985, but the likely evolution of the US economy will preclude strong export growth in 1986. The effect on capacity constraints of economic growth since 1983 and the significant fall in interest rates in the course of 1985 should both work towards high private investment in 1986, although the prospects of slower export growth, and, in the case of the UK, changes in tax treatment due to be effective from April 1986, will have a countervailing influence. In general, private investment should continue, as in 1985, to make a significant contribution to European growth in 1986, but seems most unlikely on its own to replace export growth as a major economic stimulus. Private consumption has tended to rise more slowly than GNP in 1985. Although some acceleration in consumer spending can be expected in 1986 as the rate of price inflation in most countries is likely to fall by more than the rate of earnings increase, this will not be sufficient to offset the probable reduction in export growth.

If European exports show the expected decline in their rate of growth, either directly through the reduction of US import growth or indirectly through the effect of this on third markets, it thus seems unlikely that autonomous domestic expenditure can maintain the current rate of economic growth. If there is not to be a slowing down in the EEC economy, some stimulus will have to be provided from official policy. Whether such action will in fact be undertaken is the key to world economic prospects in 1986 and beyond.

Taken at face value, West German policy pronouncements would appear not to preclude the possibility of some fiscal stimulus if export growth becomes sluggish. Either through bringing forward planned tax cuts or through increasing certain types of public investment, domestic demand could be expanded quite rapidly. The very low rate of inflation, likely to be reduced still further in 1986 by the lower value of the dollar, a healthy balance of payments surplus, historically high unemployment and a budget deficit likely to stand at under 1½ per cent of GNP despite the unemployment level, all suggest that such countervailing policies could be undertaken without any danger of overheating the economy. Interest rates have been reduced in 1985, but if the stated international objective of keeping the dollar weak is to be achieved it may prove difficult to lower German rates any further unless there is firm agreement that American rates will follow suit.

The United Kingdom is less well placed than West Germany to initiate expansionary moves. Growth in 1985, at an estimated 3½ per cent, has been among the highest in the EEC, although this is partly due to a rebound effect from the miners' dispute. Unemployment remains very high at 13 per cent of the workforce, with little or no prospect of a reduction in 1986 when the growth in GNP could be below 2 per cent. However, inflation has been running at levels which are unacceptable to the authorities, the money supply has been expanding beyond the guidelines set for it, and the public finances are perceived as needing further correction. Given also that oil revenues are likely to decline in 1986 and that the government remains ideologically committed to both restricted public spending and reduced inflation, it would seem improbable that the UK will take the initiative in adopting expansionist policies.

Nevertheless, as part of a genuine international effort to achieve stability, it is possible that the UK would be prepared to respond to other countries' initiatives with a slightly more expansionist stance than would otherwise be adopted.

Other EEC countries, although in no more favourable a position than the UK economically, do not possess the ideological rigidity of the present UK government, and might thus be prepared, not only to follow a West German policy lead but to urge such a first step on the German authorities with a prior commitment that they would respond.

The Rest of the World

If West Germany holds the key to European economic prospects in 1986, Japan also will play a vital role in the necessary adjustments in the world economy. With a 1985 growth rate of about 5 per cent, a massive balance of payments surplus, low inflation and unemployment and with the public finances in virtual balance, Japan at present would appear to need no change of policy. The expected fall in US import growth in 1986, however, will inevitably affect Japanese exports which have formed a large proportion of recent US imports. Beyond this, the sheer size of the Japanese trade surplus is a deflationary influence on the rest of the world.

Some domestic expansion, to replace lost export growth in 1986, would thus appear likely on internal grounds. An additional domestic expansion, coupled with a reduction in exports as the yen is encouraged to rise against most other currencies, would be an important contribution to international economic stability. With an appreciating currency tending to reduce price levels, there would appear to be little inflationary risk in such a policy, the first steps in which have recently been announced.

The newly industrialised Asian countries, which achieved very high rates of economic growth in 1983 and 1984, have suffered something of a set-back in 1985. The slowing down of the US economy and weaknesses in particular industries have adversely affected exports and industrial production. Prospects for 1986 depend in part on the evolution of world trade, but past experience suggests that internal responses will be sufficiently flexible to recover some of the trading share lost in 1985. Other developed economies will similarly tend to be followers rather than initiators of world trends.

The strains on OPEC discipline have been growing in 1985 and there appears a genuine danger of collapse in 1986. Although the resulting fall in oil prices would be of short-term benefit to importing countries and would serve to reduce inflationary pressures still further, the longer-term loss of stability could be damaging. Even if OPEC can survive, it seems likely that there will be a further fall in trade-weighted crude oil prices in 1986.

The reductions in international interest rates during 1985 should be of some benefit to the debtor countries of the third world in 1986, provided that workable solutions to immediate scheduling difficulties can be agreed. The overhanging debt will continue to pose a threat to the world banking system, and thus to world trade as a whole, but there are reasonable grounds for hoping that the threat will remain latent for another few years.

TABLE 1: Short-term International Outlook

Country	GNP/GDP % Change		Consumer Prices % Change		Hourly Earnings % Change		Unemployment Rate %		Budget Deficit as % of GNP/GDP		Current Account Balance as % of GNP/GDP	
	1985	1986	1985	1986	1985	1986	1985	1986	1985	1986	1985	1986
United States	3	2½	3½	5	3½	4	7¼	7¼	3¾	3¾	—3¼	—3¼
Canada	3¼	2	3¾	4	3½	3¾	10¾	10¾	6	5½	½	¾
Japan	5	4½	2¼	2	5	5½	2½	2½	1½	½	3¼	3¾
West Germany	2¾	2¾	2¼	2	4	4	8½	8	1½	1¼	2	2¾
France	1¼	2	6¼	5	6¼	5	10½	11¼	3½	3½	0	½
UK	3½	2	5½	4½	8¼	7	12½	12½	3¾	3	¼	¼
Italy	2	2½	9½	9	9½	8¾	10¾	11	13	13	—1½	—1
Belgium	1¾	1½	5	4½	5½	5	13¾	14¼	10½	9½	½	1½
Denmark	3	2¾	4½	2½	3½	1	9¼	9	3	1¾	—2½	—1¾
Netherlands	1¾	2	2	1½	1½	1½	15¼	15	5½	6	5	6
Sweden	2½	1¾	6½	4½	5¾	5¼	2¾	3	3	2½	—½	—½
Total (OECD)	3	2½	4½	5	5	5	8¼	8½	3¾	3½	—1	—1
Ireland	1¼	2	5¾	5¼	7½	6	17	17¼	8¼*	7¼*	—3½	—3

Sources: OECD *Economic Outlook,* June 1985, miscellaneous individual country forecasts.

*Not directly comparable with OECD definitions, which would show a higher deficit for Ireland.

The Context for Ireland

From the Irish point of view, the most important elements in the world economic situation are the expected state of export markets, the likely movement of exchange rates and international interest rates, and the trend of commodity prices.

World trade in 1985 is expected to have grown by about 5½ per cent in volume terms, with US imports and Japanese exports both higher than originally forecast. In 1986 a reduction in the volume growth of world trade to about 4 per cent is forecast, although it could be a little higher if more expansionary policies are followed in Europe and Japan. The pattern of trade should become more balanced as US imports cease to dominate the scene. European manufactured imports should continue to grow, but the falling purchasing power of OPEC members could adversely affect some of Ireland's middle eastern markets.

The exchange-rate outlook is perhaps less uncertain than it was earlier in the year, although so long as the two major trading currencies are free to float some doubt must remain. The very substantial fall in the dollar since February, amounting to well over 20 per cent in terms of the Irish pound, obviously reflects some change in sentiment as well as a small shift in relative interest rates. The recent commitment of the five major trading countries to keeping the dollar low, is of considerable importance in assessing likely further developments. Action taken by the Central Banks concerned to prevent any recovery in the value of the dollar should help to promote an attitude that moves in the dollar rate are more likely to be downwards than upwards. Provided that such action is maintained when necessary, and, even more crucially, provided that some adaptation of domestic policies is undertaken in support of the desired aim, the behaviour of the dollar over the next year could be reasonably stable, with occasional modest declines being followed by longer periods of little change. On average, the value of the dollar in 1986 should be below its present level, implying a very substantial reduction in the annual average between the two years.

More worrying from an Irish point of view is the possible trend of the pound sterling. After a period of acute weakness in the early months of 1985, sterling rose sharply against the EMS currencies and the dollar in the following months. Since August, however, sterling has declined significantly against the EMS currencies although rising further compared with the dollar. The uncertainties concerning its future movements arise in part from its status as a petro-currency and in part from a lack of clarity in official UK exchange rate policy. Weak oil prices in 1986 are likely to exert a downward pressure on the value of sterling. Official exchange rate policy seems likely to remain confronted with conflicting aims. On the one hand, sterling is correctly perceived as overvalued in terms of the deutchmark and yen, so that a further depreciation would be beneficial in stimulating exports and employment. On the other hand, a general depreciation would work against reducing the inflation rate both directly through higher import costs and indirectly through the effects of the lower interest rates and expanded money supply which would presumably be the mechanism for bringing about such a depreciation. On balance, it is probable that the latter argument will carry more weight, and that the policy aim will be to maintain approximate stability in the trade weighted value of sterling. If this is so, then any further decline in the dollar may be accompanied by a smaller decline in the value of sterling against the EMS currencies, but any such movements are likely to be quite small. The possibility of sterling joining the EMS at somewhere near its present parity cannot be ruled out, but such a step does not appear imminent.

Provided that any further change in the value of the major floating currencies is limited, there seems no reason to expect any significant realignment of EMS currencies in the near future. Ultimately, the lower inflation rates of West Germany and the Netherlands might need to be reflected in the appreciation of their currencies, but with the marked lessening of the divergence between inflation rates in the participating countries, there is no immediate pressure for such an adjustment. However, were sterling to depreciate significantly against the EMS, and particularly if this were the prelude to sterling's entering the system, then there might be some case for seeking a moderate devaluation of the Irish pound.

The considerable fall in international interest rates in 1985 has been of substantial benefit to Ireland. The trend for the remainder of 1985 and for 1986 is likely to be far more sedate, although further reductions appear more probable than an increase. Thus average interest rates in 1986 will be much lower than in 1985, and could help to encourage direct foreign investment as well as easing the burden of debt service. Finally, most commodity prices, including oil, are likely to remain depressed in 1986, which in conjunction with the cheaper dollar should prevent much external contribution to price inflation in 1986.

The Domestic Economy

General

The forecast National Accounts for 1985 presented here show significant changes from the forecast published in the July *Commentary*. In particular the forecast growth rate of GNP has been approximately halved, in spite of a more favourable prediction of the Balance of Payments deficit.

There are three main reasons for this downward revision. In the first place, the publication of the official provisional National Accounts for 1984 suggest that a much higher proportion than expected of last year's growth resulted from a build up of stocks, and this is most unlikely to be repeated in 1985. In the second place, revisions always have to be made between *Commentaries* as new information becomes available. For example, current indicators suggest that factor outflows will be higher, and industrial production lower, than previously forecast. Finally, the impact of the wet summer on agricultural net output is likely to have reduced gross national product by almost 1 per cent. On the assumption of a return to normal weather conditions in 1986, the changes to the forecast National Accounts for 1986 are much less dramatic than those for 1985.

Exports

Visible exports in the first 9 months of 1985 were 14¼ per cent higher in value than in the first 9 months of 1984. However, the seasonally corrected trend is somewhat disappointing, with second quarter exports below first quarter and with the third quarter still lower. Although June exports at £926 million were an all-time record, on a seasonally corrected basis they fell well short of the level reached in March. This pause in export growth was due mainly to a failure of the modern industries to maintain their previous rate of growth, and to a fall in the value of metal ore exports. The value of exports of the more traditional industries on the other hand continued to rise modestly.

It seems probable that the check to exports, particularly in the electronics industry, was part of a world-wide adjustment in stock levels and thus likely to be temporary. Indeed the responses to the CII-ESRI Business Survey, summarised later in Table 6, suggest that there could be a strong recovery in manufactured exports in the later months of 1985, as there was in the corresponding period of 1984. Taken in conjunction with the high level achieved in the first quarter, this could leave the increase in the value of visible exports in 1985 at over 14 per cent. With price increases for most products being well below those obtained in most recent years, such an increase in value would imply a volume increase of about 9¼ per cent.

On the assumption that moderate growth continues in Ireland's main overseas markets, substantial increases in exports should again be recorded in 1986. However, it seems likely that both price and volume rises will be a little lower than in 1985, so that the increase in the value of visible exports could be in the region of 13 per cent. Table 2 sets out the expected composition of exports in each year.

Despite the impact of the weather on domestic tourism it is clear that 1985 has been a good year for export tourism, which rose in volume by about 6 per

TABLE 2: Exports of Goods and Services

	1984 £m	% Change Volume	% Change Value	1985 £m	% Change Volume	% Change Value	1986 £m
Agricultural	1725	6	7½	1854	4	7½	1993
Manufactured	5623	10	16½	6549	8¾	14	7466
Other Industrial	1446	11½	14½	1657	10	14	1889
Other	103	—5	0	103	0	5	108
Total Visible	8898	9¼	14¼	10163	8	12¾	11456
Adjustments	—212	—	—	—195	—	—	—178
Merchandise Exports	8686	9¼	14¾	9968	8¼	13¼	11278
Tourism	591	6	11¾	660	3½	9	719
Other Current Receipts	465	3¼	8¾	506	3	8	546
Exports of Goods and Services	9742	9	14¼	11134	7¾	12¾	12543

cent and in value by nearly 12 per cent. With the decline in the dollar likely to curtail American overseas tourism in 1986 and with a possible reaction in the market to the poor weather experienced in 1985, it would seem prudent to expect a considerably slower growth in 1986.

With other service exports assumed to continue to grow, but at a declining rate, and making allowance for the expected adjustments to visible trade for balance of payments purposes, total exports of goods and services are forecast to increase by 14¼ per cent in value and 9 per cent in volume in 1985, and by 12¾ per cent in value and 7¾ per cent in volume in 1986.

Stock Changes

There can be no disguising the fact that the scale of stock-building in 1984 as estimated in the provisional National Accounts came as a considerable surprise to most observers of the economy, including the authors of the *Commentary*. All categories of stock rose by more than had been anticipated, but the greatest increase over expectations was in industrial stocks.

This change in the starting point for the year forces revisions to forecasts for 1985. Rather than a substantial expansion in industrial stock-building from a low base, it now seems probable that 1985 will see a reduced rate of industrial stock increase from a relatively high base. With regard to intervention stocks, a basically unchanged forecast of the rate of growth of stocks in 1985 now implies a larger decline from the revised 1984 level. Similar considerations apply to forecasts of meat held in subsidised private storage. Because of the adverse fodder situation it is believed that there will still be some reduction in the number of livestock held on farms, in spite of the fact that there was a surprisingly large increase in 1984.

The stock changes now expected in 1985 are summarised in Table 3, together

TABLE 3: Stock Changes

	1984 £m	Change in Rate £m	1985 £m	Change in Rate £m	1986 £m
Livestock on Farms	34	—44	—10	0	—10
Irish Intervention Stocks[1]	193	—123	70	—40	30
Other Non-ag. Stocks	128	-48	80	+20	100
Total	355	—215	140	—20	120

[1]Including subsidised private storage of meat.

with tentative projections for 1986. The table implies that reduced rates of stock increase will exert a significant downward influence on the growth of GNP in 1985, and a slight downward influence in 1986.

Fixed Investment

As noted in the July *Commentary,* 1984 saw an unusual divergence between the behaviour of building and construction on the one hand, which declined quite sharply, and machinery and equipment, which increased significantly. This divergence is continuing and even intensifying in 1985.

On the evidence of cement sales and other indicators it seems probable that the volume of building and construction in 1985 could decline by as much as 5 per cent, with the absence of any summer weather accounting for a small proportion of the drop. Imports of capital goods on the other hand, which are the principal form of expenditure on machinery and equipment, rose by 28 per cent in value in the first 7 months of 1985. Even allowing for a substantial reduction in the rate of increase in the second half of the year, for price increases well above the average increase for all imports, and for a much lower rate of growth for purchases of domestically produced capital equipment, an increase in investment in machinery and equipment for 1985 as a whole of 8½ per cent in volume and 15 per cent in value seems likely.

Looking to 1986, it is assumed that the public capital programme will again allow for only a very small increase in the value of public capital spending on construction, implying another modest fall in volume. However, with interest rates having fallen and with real incomes for most of those at work tending to rise, it is reasonable to postulate some upturn in privately financed building, especially in housing. There is no adequate empirical analysis of the effect of high and rising real interest rates on the level of private construction, but theoretically it would seem inescapable that they must have made a large contribution to the depression of the building market in recent years. If this is so, then the trend to lower real interest rates since the late Spring of 1985, even though they are still high by historical standards, should have a marked effect in reversing the downward trend in private construction during 1986. Putting together the assumption of a further fall in the volume of public construction expenditure and the expectation of some recovery in private, Table 4 sets out a forecast of no change in the volume of total construction in 1986.

A continued increase in the volume of investment in machinery and equipment seems probable in 1986. Lower interest rates and a modest expansion in domestic consumption should encourage this trend, which is expected to outweigh the running down of specific investment programmes in the semi-state sector.

TABLE 4: Gross Fixed Capital Formation

	1984 £m	% Change Volume	Value	1985 £m	% Change Volume	Value	1986 £m
Building and Construction	1652	—5	—½	1644	0	4½	1718
Machinery and Equipment	1763	8½	15	2027	6	11	2250
Total	3415	2	7½	3671	3¼	8	3968

Consumption

Insofar as the retail sales index is a reliable indicator of total personal consumption, such expenditure was unexpectedly weak in the first four months of 1985, but recovered quite strongly from May to July. Private car registrations suggest that consumer spending may have continued to exceed 1984 levels during the summer months. The reduction in interest rates can be expected to increase total personal expenditure, as well as that on items included in the retail sales index, during the second half of the year. This is because reductions in interest paid out, on mortgages or personal loans, frees income for alternative forms of sending, while the reduction in interest received on personal deposits in such media as building societies or the post office is more likely to reduce saving than expenditure, as such interest normally accrues to the account rather than being paid out as income.

Thus a total increase in consumer spending of about 1½ per cent in volume or 7¼ per cent in value appears a reasonable expectation in 1985, even though this implies a small reduction in the personal savings ratio.

If it is assumed that both direct personal taxes and specific indirect tax rates are approximately indexed and that the personal savings ratio falls by about ½ per cent for the same reasons as in 1985, a volume increase of about 2 per cent in personal consumption would seem likely in 1986. With inflation set to remain low this would convert to a value increase of 7¼ per cent, about the same as in 1985.

Public consumption expenditure in 1985 is expected to rise by about 1 per cent in volume and 6½ per cent in value. Obviously the trend of such expenditure in 1986 depends on decisions yet to be taken. For the purpose of forecasting it is assumed that the volume of public consumption will be held constant, and that a compromise agreement on public pay will lead to a price, and thus also value, increase of about 5¼ per cent.

Final Demand

If the forecasts for the categories of expenditure so far discussed are correct, then Final Demand in 1985 will increase by about 9 per cent in value and 3½ per cent in volume. As has become usual in recent years, by far the largest contribution to this increase will come from exports, with the growth of domestic spending remaining relatively sluggish. What is unusual in the 1985 prospect is that stock changes are likely to exert a major depressing influence on the total of Final Demand. This is not due to an actual rundown of stocks, except on farms, but to a failure to match the quite extraordinarily high level of stockbuilding which is reported to have occurred in 1984.

On the assumption of a more normal evolution of stock levels in 1986, together with slightly faster growth in the volume of consumption and investment, domestic demand is likely to increase a little more rapidly in 1986 than in 1985. However, this will probably be offset by a reduced rate of growth in exports, so that total Final Demand in 1986 will increase at much the same rate as in 1985, namely 9 per cent in value and 4¼ per cent in volume.

Imports

Imports in the first 9 months of 1985 have slipped further behind earlier expectations than have exports. Total visible imports from January to September were only 9.2 per cent above their value for the corresponding period last year. It is believed that a considerable proportion of this reduction in the rate of import increase is due to an adjustment in industrial stock levels in the summer.

If this belief is correct, then a fairly vigorous upturn in imports, especially of intermediate goods, can be expected in the later months of the year. With interest rates lower, currency fluctuations probably completed for the time being, and evidence, as shown in Table 6, that industry's stocks of materials are beginning to be perceived as inadequate, it would be surprising if there were not some degree of re-stocking before the year's end. Similarly, consumer goods imports can be expected to respond to the likelihood of a higher level of consumer spending in the second half of the year, as well as receiving a small boost, on an annual basis, from the diversion of a certain amount of consumer buying from unrecorded cross-border trade to conventional channels. Some upturn in imports of grain and other feeding stuffs can also be anticipated in view of the poor harvest. Thus three of the main import categories are expected to show substantial seasonally corrected increases in the final quarter of the year. The fourth category, capital goods, may show some seasonally corrected decline from the extremely high levels recorded in the first half of the year.

In total, therefore, Table 5 shows that visible imports might increase by about 10¾ per cent in value and some 6 per cent in volume in 1985. Allowing for a fairly substantial reduction in the level of cross-border trade, for virtual stagnation in the volume of tourist spending overseas and a steady increase in other service imports, total imports of goods and services are forecast to grow by 5½ per cent in volume and 10 per cent in value. Past experience suggests that such increases are by no means incompatible with the forecast growth in Final Demand.

The forecast level of imports in 1986 is based primarily on the size and composition of the Final Demand projections for that year. The faster rate of

TABLE 5: Imports of Goods and Services

	1984	% Change		1985	% Change		1986
	£m	Volume	Value	£m	Volume	Value	£m
Capital Goods	1,084	8½	15½	1,252	7½	12½	1,409
Consumer Goods	2,098	4½	9¼	2,292	4	8½	2,486
Intermediate Goods:							
Agriculture	425	7	10½	470	4	6	498
Other	5,295	6	10	5,825	9	13¾	6,626
Other Goods	11	—	—	35	—	—	40
Total Visible	8,913	6	10¾	9,874	7½	12	11,059
Adjustments[1]	—29	—	—	—75	—	—	—80
Merchandise Imports	8,884	6	10¼	9,799	7½	12	10,979
Tourism	379	0	5½	400	2	7½	430
Other Services	515	3½	9	561	4	9	611
Imports of Goods and Services	9,778	5½	10	10,760	7	11¾	12,020

[1]The adjustment factor allows for a substantial reduction in the estimated value of unrecorded trade in 1985.

increase postulated for intermediate products for industry merely reflects the expectation that a normal relationship will be resumed between production and stock-building.

Balance of Payments

On the basis of the forecasts for exports and imports there should be a substantial improvement in the balance of trade in 1985. Visible trade, as measured in the trade statistics, is expected to move from a deficit of £15 million in 1984 to a surplus of £289 million in 1985. After adjustments for balance of payments purposes, total merchandise trade is forecast to improve by even more, from a deficit of £198 million to a surplus of £169 million. Due to the good foreign tourist season, exports of services are also expected to have risen by more than imports, so that the total balance of trade in current goods and services is forecast to improve by £410 million, to a surplus of £374 million.

As frequently explained, the true Balance of Payments benefit from increased exports is less than the improvement in the trade balance, because a substantial proportion of export earnings tends almost automatically to be expatriated as profits or service charges by the multinational companies responsible for the increased exports. High levels of profit expatriation in the first half of the year confirm that 1985 will be no exception. However, the mid-year check in the rate of export growth and the altered exchange rate outlook suggest that such payments may grow less rapidly in the second half of the year, leaving the annual increase at about 25 per cent. Similarly, interest payments on the overseas public debt were very high in the first quarter, but the falling dollar, and, to a limited extent, lower interest rates could restrict the outflow in the final months of the year. In all, net factor payments could total some £1,930 million for 1985, a massive 20 per cent higher than the 1984 value, which is substantially higher than the forecast in the July *Commentary*. Due to a higher level of disposals from intervention stocks, net inward transfers from the EEC are also expected to rise very sharply in 1985, offsetting a considerable proportion of the net factor outflows.

Taking these large conflicting movements in the constituent elements together, the Balance of Payments deficit on current account looks likely to be reduced by some £270 million, to a level of £566 million or about 3½ per cent of forecast GNP. This will be the smallest deficit as a proportion of GNP since 1975, and beginning to approach a level which could be regarded as sustainable in the long term. However, it should be recognised that it is being achieved at a time of continuing recession in the home market, and would be liable to rise sharply if there were to be a vigorous recovery in domestic demand.

There is not expected to be a vigorous recovery in domestic demand during 1986, so a further small improvement in the overall Balance of Payments is forecast for next year, reducing the deficit to about 3 per cent of GNP. Once more increased surpluses on trade in goods and services and on net current transfers are likely to be partly offset by an increased deficit in net factor payments. The degree of movement in each component, however, is likely to be considerably lower than in 1985, with the growth in net factor payments being restricted by more favourable exchange rates, lower interest rates and a slower rate of increase in the Irish profits of multinational companies.

Output

The reduced forecast for GNP growth in 1985 compared with earlier *Commentaries* has been discussed so far from the demand side, with reduced stockbuilding and a moderation in export growth being its main feature. This downward revision of the growth rate is, of course, matched on the output and income side of the National Accounts.

Agriculture

The exceptionally poor summer weather has clearly had a major impact on agricultural output and incomes. The grain harvest is well below normal, let alone the record levels of 1984. At the same time the wet weather has led to an impending fodder shortage for much of the livestock industry in the coming winter. In spite of the grain arrangement made with the EEC it seems certain that imports of feed will rise over the coming season and that the volume of inputs generally will increase, thus reducing net output and incomes. Moreover, the threat of a shortage of feed has led some farmers into distress selling of livestock at depressed prices. It is too early yet to obtain a reliable estimate of the total loss to agriculture, especially as the situation has led to a degree of income redistribution within farming, as those who have sold surplus fodder at high prices or bought store cattle at low prices could well have been net gainers. However, with the poor weather exacerbating a situation in which incomes were already being squeezed by the rise in many input prices, it is clear that there will be a substantial fall in farm incomes. There could also be some decline in income from fishing which was also affected by the weather.

A somewhat tentative forecast is made that for 1985 the fall in the nominal value of income arising in agriculture, forestry and fishing will be 9 per cent or about £130 million. Of course, some of the effects will continue into 1986, with inputs likely to be high and cattle output curtailed by the fall in the size of the breeding herd. At the same time it must be assumed that in the present economic and political climate of the EEC there will be very little increase in price levels in 1986 although the decline in the dollar should have a beneficial effect on many input prices. On balance, a modest recovery of 5 per cent or £65 million seems a reasonable forecast for income arising in agriculture, forestry and fishing in 1986.

Industry

The performance of manufacturing industry in the first half of 1985 was below previous expectations. On an annual basis the index of industrial production for manufacturing industry rose by 10.6 per cent in the first quarter and by only 2.6 per cent in the second. On a seasonally corrected basis these figures represent a decline of 1.4 per cent between the fourth quarter of 1984 and the first quarter of 1985 and of a further 1.1 per cent between the first two quarters of 1985. The most obvious cause of this check to growth has been the virtual stagnation of the previously fast growing sectors of chemicals, office and data processing machinery and instrument engineering.

As discussed in relation to exports, it seems probable that this pause in growth is related to an adjustment in stock levels, both in Ireland and worldwide, especially in the case of the electronics industry. Evidence to support this

TABLE 6: Manufacturing Industry — Survey Responses

Balance of Positive over Negative Answers

	1984				1985								
	S	O	N	D	J	F	M	A	M	J	J	A	S
Production in the Next few Months	17	12	15	14	23	11	11	13	2	—1	11	20	17
Home Sales in the Next few Months	—4	8	—2	7	2	5	2	—7	—5	—1	—8	2	2
Exports in the Next few Months	12	18	18	6	22	13	14	18	14	2	18	22	15
Adequacy of Stocks[1] of Finished Products	0	—1	4	—1	6	3	6	4	14	8	2	—2	- 3
Adequacy of Stocks [1] of Raw Materials	5	—2	—2	—1	5	4	5	4	3	10	1	—2	0
Adequacy of Capacity[1] for the Coming Year	25	19	22	22	19	32	27	24	20	22	12	9	17

[1]On these questions a negative reply implies insufficient stock/capacity.
Source: CII-ESRI Industrial Survey.

interpretation can be drawn from the monthly responses to the CII-ESRI Industrial Survey, which are summarised in Table 6. Some caution must be taken in interpreting these data, as the Survey has been running on the current updated sample only since September 1984[1], so detailed analysis of relationships cannot yet be undertaken. However, the picture which emerges seems fairly clear and quite encouraging. Stock levels of both finished products and raw materials, which were perceived as excessive by a significant proportion of firms in May and June, have since been reduced to a level perceived as barely adequate. This movement is common to a majority of industries, although it is most pronounced in metals and engineering. At the same time expectations of the level of production, exports and, to a lesser extent, home sales in the next few months have improved dramatically in the latest Surveys. An expectation that this upturn will continue can, perhaps, be read into the declining balance of firms which consider their present capacity adequate to meet their needs for the coming year.

Thus there are reasonable grounds for optimism that there will in fact be a recovery in manufacturing output in the second half of the year, taking the annual average increase in the industrial production index to perhaps 7 per cent, compared to the 6.2 per cent achieved in the first half of the year.

Provided pay rates continue to rise only moderately, and that assumptions concerning world and European trade trends are accurate, there is no reason why manufacturing output should not increase substantially again in 1986.

As was shown in the Appendix to the April *Commentary,* labour cost competitiveness in the traditional industries tended to improve in 1984, while in the modern growth industries the reduction in unit labour costs in recent years was dramatic. Although full figures are not available for 1985, general trends suggest that competitiveness has probably continued to improve, and so far as Europe is concerned, the improvement should persist into 1986, so long as there is not a marked decline in the value of sterling.

With investment in plant and equipment having increased considerably in

[1]See July *Commentary* for a discussion of the revisions.

1985, even though not all of this can be attributed to manufacturing industry, the capacity should exist for higher production in 1986. In all, an increase in manufacturing production of 7 or 8 per cent in 1986 appears a reasonable forecast and compatible with the projections for final demand.

The extractive industries have been depressed in 1985 by the decline in construction activity, the fall in base metal prices and by the weather, which has had a dramatic effect on turf production. On the assumption of normal weather, and in line with the prediction that the decline in construction should come to an end, there should be a recovery in the extractive industries in 1986. The public utilities of electricity, gas and water increased their output quite sharply in the first half of 1985, and a moderate rate of expansion should continue into 1986. For all industries, therefore, the growth in output in 1985 could be around 5½ per cent and in 1986 could approach 7 per cent. As discussed in the section on investment, building output is expected to fall by about 5 per cent in 1985 but to hold level in 1986.

Services

Up-to-date indicators of service output do not exist. On an annual basis public service output is expected to rise marginally in 1985 and is assumed to be held constant in 1986. Private service output, including that of the non-industrial semi-state sector, is forecast to show a moderate increase in 1985, with substantial gains obtained by tourism and its ancillary transport services. Although tourism is projected to grow more slowly in 1986, the faster expansion forecast for the economy as a whole should ensure a slightly greater increase for the total output of private services.

Employment and Unemployment

The unexpectedly small growth in the size of the total labour force in the year to April 1984, revealed in the most recent Labour Force Survey, alters the basis for forecasting employment and unemployment trends. In the absence of later data, it is assumed that the growth in the labour force in the years from 1985 to 1987 will revert to the previously anticipated rate of about 12,000 per annum, but from a lower starting point. Thus it is now assumed that by April 1987 the labour force will total 1,347,000, some 12,000 less than previously expected.

With regard to current employment trends it appears likely that the unforeseen check to industrial expansion in the first half of 1985 has delayed the modest rise looked for in manufacturing employment in the course of 1985. However, at least a stabilisation of manufacturing employment is still expected as production rises in the second half of the year. Allowing for building employment to have continued declining during 1985, a fall of some 5,000 jobs in industry as a whole is predicted between April 1985 and April 1986. The growth in private service employment is expected to outweigh a further marginal fall in normal public service jobs, while the total of recorded service employment will be boosted by the numbers engaged under the Social Employment Scheme, assumed to be about 5,000 by April 1986.

Both industrial and service employment could grow very modestly between April 1986 and April 1987 despite the probability of another small reduction

TABLE 7: Employment and Unemployment

A: Mid-April Estimates '000

	1983	1984	1985	1986	1987
Agriculture	189	182	179	176	173
Industry	331	320	309	304	307
Services	605	608	613	623*	632*
Total at work	1125	1110	1101	1103*	1112*
Unemployed	184	204	222	232	235
Labour Force	1309	1314	1323	1335	1347
Unemployment Rate %	14.1	15.5	16.8	17.4	17.5
Live Register	188	214	228	236	239

B: Annual Averages '000

	1983	1984	1985	1986
Agriculture	186	181	178	175
Industry	328	316	306	305
Services	606	610	617*	626*
Total at work	1120	1107	1101*	1106*
Unemployed	191	211	227	232
Labour Force	1311	1318	1328	1338
Unemployment Rate %	14.6	16.0	17.1	17.3
Live Register	193	214	230	236

* Including numbers estimated to be engaged in the Social Employment Scheme (5,000 in April 1986 and 8,000 in April 1987, 1,000 on average in 1985 and 7,000 average in 1986).

in the direct public service. Table 7 sets out the projections for employment until April 1987, and converts these into annual averages for 1985 and 1986. On this basis it can be seen that a fall in the total at work of about ½ per cent is expected in 1985, with a rise of a similar magnitude in 1986, if the Social Employment Scheme is included. Without that scheme, approximate stability in employment is expected.

The implication of these projections is that unemployment will continue to rise slowly with an average unemployment level, on a Labour Force basis, of 17.1 per cent in 1985 and 17.3 per cent in 1986. The Live Register averages for the two years are 230,000 and 236,000 respectively. With regard to 1985, this annual average for the Live Register total implies that the levels recorded in June, July and August were to some extent distorted, both by the number of school leavers registering and by effects of the unseasonable summer weather. Thus some further reduction in the seasonally corrected level of the Live Register is anticipated after the fall in September.

Incomes

The publication of the provisional National Accounts for 1984 indicates that personal incomes were rather higher than had been anticipated. Working from this new base, Table 8 sets out the current forecasts for incomes in 1985 and 1986.

The decline of agricultural incomes in 1985, and their low rate of recovery in 1986 have already been discussed. The increase of 7½ per cent in non-agricultural wages etc. implies an increase in aggregate private sector earnings of about 8 per cent and in total public sector earnings of about 5½ per cent. When allowance is made for pay drift, and for a small decline in the number of private sector employees, the implied increase in average private sector pay rates, including the carryover from 1984, is about 7¾ per cent. Of course this average conceals very large variations between companies, with the size of settlements tending to be related quite strongly with ability to pay.

The forecast for an increase of 6¼ per cent in total non-agricultural wages in 1986 is far more tentative. With the timing of settlements now so spread out that the concept of pay-rounds in the private sector is virtually obsolete, and with the divergence in the size of pay increases now so wide, it is increasingly difficult to generalise from any sample of agreements what the overall average is likely to be. However, with the labour market remaining depressed, with the rate of price inflation likely to fall to 5 per cent, and with a lower carryover into 1986, it seems reasonable to predict that average private sector pay rates might be about 6½ per cent higher in 1986 than in 1985. Of course, many workers will receive higher increases than this, and many will settle for less. Allowing for virtual stability in the number of private sector employees and a small amount of drift, total private sector earnings are thus projected to rise by about 7 per cent in 1986.

For the purpose of the forecast it is assumed that the Government will maintain its policy of restricting the rise in the public sector pay bill, and will eventually manage to convince the unions and their members of the necessity for this stance. To allow for an increase of only 5 per cent in total public service earnings leaves little room for manoeuvre. Carryovers from 1985 and from the later phases of previous special increases will account for at least 3 per cent. Even assuming that a decline in numbers will offset salary scale drift, no more than 2 per cent would be available for new pay increases, including special increases. In practice, therefore, the assumption implies that new special increases will not be paid in full, and that a substantial pay pause will be followed by a low rise in pay rates.

Other non-agricultural income, including that of the self employed, is forecast to rise by 10 per cent in 1985 and 8 per cent in 1986. Such forecasts are inevitably tentative as there are no running indicators and the total has to be projected forwards from 1983 National Accounts estimates. However, the forecasts appear reasonable in the context of modest GNP growth, an expected increase in the number of self employed in 1985, and some upturn in the profitability of indigenous Irish industry.

Forecasts for current transfers in 1985 are based on known benefit and assistance rates for 1985, a significant increase in the number of recipients as the Live Register continues to rise, and an increased flow of current transfers from abroad. For 1986 it is assumed that benefits will be indexed, but for a lower rate of inflation than in 1985, that the increase in the number of recipients will be less, and that there will be a further, but slower, rise in current transfers from abroad.

If these predictions of trends in the different types of income are correct, then gross personal income can be expected to grow by about 6½ per cent in 1985 and 6¾ per cent in 1986. On the working assumption that direct taxes will be

TABLE 8: Personal Disposable Income

	1984	Change		1985	Change		1986
	£m	%	£m	£m	%	£m	£m
Agriculture etc.	1,474	—9	—133	1,341	5	65	1,406
Non-Agricultural Wages, etc.	8,753	7½	656	9,409	6¼	600	10,009
Other Non-Agricultural Income	1,800	10	180	1,980	8	158	2,138
Total Income Received	12,027	5¾	703	12,730	6½	823	13,553
Current Transfers	2,894	9¾	282	3,176	8¼	262	3,438
Gross Personal Income	14,921	6½	985	15,906	6¾	1,085	16,991
Direct Personal Taxes	3,123	7	217	3,340	7	234	3,574
Personal Disposable Income	11,798	6½	768	12,566	6¾	851	13,417
Consumption	9,465	7¼	690	10,155	7¼	740	10,895
Personal Savings	2,333	3¼	78	2,411	4½	111	2,522
Savings Ratio	19.8%			19.2%			18.8%

indexed in 1986 to about the same extent as they were in 1985, the tax take on this income would rise by about 7 per cent in each year, leaving the rise in personal disposal income at about 6½ per cent in 1985 and 6¾ per cent in 1986. With inflation likely to be some ¾ per cent lower in 1986, real disposal incomes are thus forecast to increase by about ¾ per cent in 1985 and 1¾ per cent in 1986.

Given the composition of the projected income increases, with the high-saving agricultural sector accounting for a significantly lower proportion of the total, and given also the likely effects of lower interest rates, it is reasonable to assume that there should be a slight fall in the personal savings ratio in each year.

Consumer Prices

The quarterly rates of increase in the Consumer Price Index for the first three quarters of 1985 have been 1.9 per cent, 1.3 per cent and 1.5 per cent. There are grounds for expecting the fourth quarter rise to be a little less than average for the year, although cheaper interest charges and petrol may be countered by a rise in some food prices. If the fourth quarter rise is 1.1 per cent, then the annual average rise in the index would be 5.7 per cent, and the November to November increase would be 5.9 per cent.

For 1986 the cautious assumption is made that the average quarterly increase in the index will be just under 1¼ per cent. This would leave both the annual average and the November to November increase at about 5 per cent. Such a forecast is cautious because both the fall in interest rates and the lower dollar should impart a powerful downward impetus to the inflation rate. The projection, however, makes allowance for some increase in food prices and for the assumption that indirect tax rates in 1986 will be fully indexed, as they were not in 1985.

Public Finances

While 1985 has seen a major improvement in the balance of payments deficit, it clearly has not seen a parallel improvement in the other major economic constraint, the current budget deficit. The target for the year allowed for a small deterioration from 7¼ to 7¾ per cent of GNP. Following the September revenue returns the official estimate was that the deficit could be some £80 million above its target of £1,234 million and could thus represent over 8¼ per cent of GNP.

It is possible that the official forecast of an £80 million overshoot in the deficit will prove accurate. However, on the analysis presented in this *Commentary* of the timing of economic developments in 1985, it seems probable that the revenue shortfall will not be so great as calculated at the end of September, and that the deficit will accordingly remain under £1,300 million and represent a little under rather than a little over 8¼ per cent of GNP. This is still, of course, a disappointing result, and demonstrates yet again the difficulty of effecting any improvement in the public finances.

For 1986, the technical assumption has been made that both direct and indirect taxes will be approximately indexed, but that no other significant tax changes will be introduced. On this basis, the income and expenditure increases forecast for 1986 could be expected to result in an increased tax revenue of about 7 per cent. If allowance is made for a similar rise in non-tax revenue, total revenue could be expected to reach about £6,820 million. Although such calculations are crude they do give a reasonable idea of the basic order of magnitude of revenue under a continuation of present policies.

It is much more difficult to estimate likely expenditure. Key spending decisions have not been finalised, while factors beyond the influence of the Government can have a major impact on total current spending.

The most important such factors which are either totally or largely beyond domestic control are the behaviour of exchange rates and the level of interest rates, both of which are major determinants of Central Fund expenditure. Adverse movements in the effective average of interest rates and exchange rates between 1984 and 1985 accounted for nearly half of the very large expected rise of 18¼ per cent in national debt interest in 1985. The remainder of the increase, of course, is due to payments on new net borrowing. This increase in national debt interest, so much higher than the rate of increase in other major forms of expenditure or in total revenue, can reasonably be held as the principal reason for the deterioration in the current budget deficit in 1985 compared with 1984.

On the assumptions made in this *Commentary,* and indeed on movements already recorded during the summer and early autumn of 1985, the level of exchange and interest rates in 1986 should be much more favourable than in 1985. The precise benefit derived from this, even on firm assumptions concerning detailed exchange and interest rates, depends on the proportion of debt held in particular currencies, on the timing of payments on these debts, and on the proportion of debt either subject to variable interest rates or capable of being rolled-over from higher to lower rates of interest. The outside commentator does not possess sufficient of this information to make detailed and accurate forecasts of total interest charges. However, even crude calculations suggest that the savings in interest payable on existing external debt should almost counterbalance the interest due on new borrowings, so that total external national debt interest should show, at worst, a marginal increase of less than ½ per cent. Interest on domestic debt is likely to show a less dramatic fall, as a higher proportion of such debt is in the form of fixed interest securities which cannot easily be rolled over, so that the effects of a fall in interest rates take a long time to work through fully onto total interest payments. Taking this into account, along with the level of new borrowing, it seems probable that domestic national debt interest charges might grow by over 5 per cent in 1986.

If these crude calculations are of the correct order of magnitude it appears likely that the 1986 growth of national debt interest could be about 3 per cent, well below the expected rate of revenue increase. Even if contributions to the EEC once more increase substantially, as seems likely, the rise in total Central Fund expenditure could well be no more than 3½ per cent.

Outlay on supply services depends on the volume of planned expenditure, on decisions to be made concerning the rates of social welfare benefits, and, crucially, on the level of public service pay. On the assumptions made in this *Commentary* that the volume of spending on current goods and services will be held constant, that there will be a modest increase in unemployment, that social welfare benefits will be barely indexed to the rate of price inflation, and that the rise in the public service pay bill will be held to 5 per cent, the total increase in supply service expenditure should be a little over 5½ per cent.

Total current expenditure on these baseline assumptions would rise by somewhat over 4½ per cent to a level of about £8,040 million. This implies a current budget deficit of about £1,220 million, or just about 7¼ per cent of GNP, much the same as in 1984 although about 1 per cent lower than the likely 1985 outturn. If the public capital programme falls 1½ per cent in volume terms, and thus increases by about half the GNP rise in nominal terms, the total government borrowing requirement in 1986 would decline slightly in nominal terms and by about 1¼ per cent as a proportion of GNP. It would, however, remain well above the target implied for 1986 by the National Plan.

General Assessment

As the first full year covered by the National Plan, *Building on Reality,* 1985 has seen mixed progress. Of the two underlying policy aims, unemployment is considerably worse than envisaged in the Plan, but the reduction in inflation is ahead of schedule. Of the two major constraints on economic progress, the balance of payments has improved more rapidly than anticipated, but the public finances have deteriorated.

Looking ahead to 1986 it seems probable that the gains in relation to the balance of payments and price inflation will be consolidated. However, in Ireland, as in the EEC as a whole, it is difficult to hold out any hope that unemployment will fall in 1986, although the rise should be the smallest since the increase began in 1980. There could indeed be a significant improvement in the public finances due to the lower interest rates and the depreciation of the dollar, but the current budget deficit is likely to remain well above the level required if the Plan target of 5 per cent in 1987 is to be achieved.

Even this inadequate rate of improvement is dependent on an assumption that severe restraint will be exercised in relation to public service pay. At the time of writing it is by no means clear whether this assumption is fully justified, as the present confrontation between the Government and the public service unions is both complex and ominous. On the one hand, any serious weakening of Government resolve could wipe out the prospect of even the modest reduction in the nominal budget deficit forecast here, and would thus lose the opportunity for progress presented by the improved outlook for interest payments. On the other hand, apart from the hardship it could cause, prolonged industrial unrest in the public service could well have a strong deterrent effect on the flow of new overseas industrial investment in Ireland, which is still a major pre-condition for long-term growth in exports and employment.

The complexity of the confrontation is caused by the entanglement of procedural issues concerning arbitration with the more basic issue of a general pay increase and the Government's ability to pay. The best hope of resolving the problem would appear to lie in the unions lengthening their time horizons, and recognising that their members' long-term interests do not necessarily coincide with their immediate short-term advantage, however pressing the need for that short-term gain might appear.

With regard to the actual level of pay settlements finally agreed for 1986, it should be clear that the higher the immediate increase the greater will be the burden of future national debt interest incurred, and the further will be postponed the time when the public finances reach a state where employment in such vital services as education and health can once more be expanded to the benefit of both employees and the general public. On the issue of arbitration, it should be equally clear that the more vehement the insistence upon full implementation of a handful of special awards, which in the context of current rates of inflation are prohibitively expensive, the greater the danger that a valuable part of the industrial relations framework will be irreparably damaged.

The leaders and members of the unions concerned are thus in a key position in determining whether 1986 will see limited but real progress towards long-term economic recovery or a further sinking into the morass of external debt. Commentators have a responsibility to help them in this choice by pointing out its consequences. In particular, the dangerous notion, which seems recently to have been gaining ground, that because there has been some slippage from public financial targets in 1985 the whole strategy of attempting to correct the deficit should now be abandoned, should be firmly refuted. The greater the amount of foreign borrowing for purposes which yield no financial return, of which the current budget deficit is the outstanding example, the greater the burden of debt servicing to be met from taxation in future years. Attempting to forget this simple but basic truth will not make it vanish. The drain on resources will merely accelerate, posing ever increasing problems for future Governments and citizens.

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
1979	100.9	101.2	10853	2067.8	226.7	238.3	101.0	101.5
1980	100.0	100.0	10733	1814.9	227.2	238.8	100.0	100.0
1981	102.7	101.6	10767	1812.5	220.7	232.3	105.5	104.5
1982	102.4	101.7	10792	1486.1	213.8	224.7	108.6	108.2
1983	110.0	108.6	11039	1382.4	201.0	211.3	124.2	122.8
1984	124.6	122.9	11424	1298.4	194.6	204.4	145.3	143.7
1985								

Quarterly Averages or Totals

	1	2	3	4	5	6	7	8
1982 I	101.6	99.2	2954	335.2	217.2	228.1	106.0	103.9
II	108.5	108.2	2514	436.2	214.7	226.8	114.7	114.0
III	95.8	97.6	2425	405.9	213.5	224.2	101.8	104.0
IV	103.7	101.7	2899	308.8	209.7	219.6	112.2	110.7
1983 I	107.9	105.7	2990	298.1	203.0	212.9	120.7	118.6
II	113.1	110.9	2650	367.1	200.7	211.9	120.7	118.6
III	103.9	105.4	2470	371.5	201.4	212.0	117.0	118.0
IV	115.3	112.7	2929	345.7	198.8	208.3	131.6	129.0
1984 I	117.4	114.6	3136	271.5	195.7	205.2	136.0	133.6
II	132.6	132.4	2672	366.3	195.1	206.1	154.0	153.0
III	116.1	116.4	2562	350.0	195.2	204.4	135.0	136.0
IV	132.6	128.5	3054	310.6	192.2	201.1	156.5	152.7
1985 I	129.3	125.4	325.9	241.3	188.0	196.8	156.2	152.3
II	136.0	132.6	281.8	350.4				
III								
IV								

Quarterly Averages or Totals Seasonally Corrected

	1	2	3	4	5	6	7	8
1982 I	102.4	101.2	2677	388.2	218.4	229.7	106.4	105.3
II	102.3	102.1	2661	396.0	215.6	226.8	107.7	107.6
III	101.1	100.7	2731	371.4	212.6	223.1	108.0	107.9
IV	103.3	102.1	2721	324.0	208.6	219.1	112.6	111.3
1983 I	108.7	107.8	2712	356.0	204.1	214.5	120.9	120.2
II	106.6	104.7	2809	332.0	201.6	212.0	120.0	118.0
III	110.0	109.1	2774	341.0	200.5	210.9	124.6	123.7
IV	115.0	113.4	2753	360.0	197.7	207.8	132.0	130.5
1984 I	118.0	116.5	2847	323.9	196.8	206.7	136.1	134.7
II	125.3	125.2	2828	329.9	195.9	206.3	145.2	145.1
III	123.0	120.5	2907	319.3	194.2	203.8	144.0	141.3
IV	131.9	128.9	2877	321.2	191.5	201.0	156.4	153.3
1985 I	130.2	127.7	2955	289.4	189.1	198.2	156.3	146.3
II	128.8	125.8	2983	315.9				
III								
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. 1975 = 100	1980 = 100	1975 = 100	1975 = 100	1975 = 100	1975 = 100	
89.6	158.5	102.8	165.9	165.0	99.5	215.6	1979
101.5	187.3	100.0	195.6	179.5	91.8	212.0	1980
127.9	225.6	117.7	232.4	208.4	89.7	219.9	1981
148.2	264.2	125.2	249.4	231.5	92.8	179.9	1982
192.7	291.8	135.6	261.1	251.9	96.5	223.7	1983
214.2	316.9	139.7	286.5	271.2	94.7	296.1	1984
							1985
Quarterly Averages or Totals							
146.8	249.5	131.1	243.5	222.2	91.3	192.3	1982 I
149.0	263.9	130.9	248.4	231.1	93.0	174.6	II
159.0	269.5	126.5	254.0	235.0	92.5	175.5	III
171.6	273.8	126.5	255.6	238.3	93.2	178.3	IV
188.3	280.6	132.0	247.0	237.3	96.1	172.0	1983 I
188.1	288.3	133.7	254.5	247.7	97.3	206.1	II
193.0	296.5	138.8	268.8	257.0	96.7	249.7	III
201.3	302.0	138.5	275.3	263.3	95.6	267.2	IV
215.2	309.1	146.4	281.5	266.0	94.5	309.6	1984 I
210.8	316.2	149.8	283.7	269.8	95.1	314.9	II
212.6	320.1	136.1	294.3	276.6	94.0	280.7	III
218.1	322.3	135.2	297.9	283.3	95.1	279.1	IV
232.8	328.3	141.2	297.3	281.3	94.6	284.7	1985 I
226.5	332.7	139.5	300.6	289.8	96.4	289.4	II
231.8	337.6						III
							IV
Quarterly Averages or Totals Seasonally Corrected							
141.5	250.1	128.3	No Seasonal Pattern	No Seasonal Pattern	No Seasonal Pattern	No Seasonal Pattern	1982 I
150.5	263.1	128.4					II
162.1	269.1	128.5					III
172.4	274.6	129.9					IV
182.7	281.2	129.2					1983 I
189.8	287.5	131.1					II
196.2	295.8	140.9					III
202.2	302.7	142.1					IV
209.4	310.0	143.5					1984 I
212.4	315.5	146.9					II
215.8	319.2	138.1					III
219.0	323.3	138.7					IV
226.9	329.0	138.5					1985 I
228.3	332.0	136.8					II
235.2	336.5						III
							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
	1973 = 100	1973 = 100	1977 = 100	1977 = 100	Total	1980 = 100	1980 = 100
1979	271.3	271.1	107.9	107.9	95938	87.1	100.7
1980	321.2	321.0	108.1	108.1	91032	100.0	100.0
1981	373.8	372.6	104.4	104.2	104645	118.3	99.4
1982	419.1	419.8	100.0	100.2	72603	129.4	94.0
1983	468.3	469.2	101.1	101.4	61094	137.4	90.1
1984	423.8	525.1	104.1	104.5	5589	145.2	89.2
1985							
Quarterly Averages or Totals							
1982 I	393.3	390.6	99.3	98.7	28114	124.4	95.3
II	417.6	423.0	99.7	101.1	21223	125.8	92.1
III	424.0	423.6	99.1	99.1	14012	128.3	91.6
IV	441.3	441.9	101.6	101.8	9981	137.4	96.1
1983 I	440.6	440.8	98.9	99.1	29851	135.5	92.0
II	458.4	463.1	100.2	101.3	12255	130.2	86.1
III	476.3	475.9	101.2	101.2	12110	135.4	87.6
IV	497.9	497.1	103.9	103.8	6878	148.5	94.8
1984 I	502.3	503.0	102.4	102.6	19263	139.8	87.9
II	518.5	523.8	103.3	104.5	18443	143.9	88.6
III	528.2	528.1	104.0	104.1	11708	143.5	87.3
IV	546.0	545.6	106.8	106.8	6479	155.8	93.7
1985 I					19914	147.6	87.5
II					19047	153.2	89.8
III							
IV							
Quarterly Averages or Totals Seasonally Corrected							
1982 I	400.0	397.9	100.3	99.9	19083	124.8	95.5
II	418.5	418.2	99.5	100.3	18701	128.1	94.4
III	423.5	422.6	99.4	99.2	15862	130.5	93.4
IV	437.3	440.0	100.5	101.3	18786	132.1	91.9
1983 I	447.0	449.3	100.4	100.9	19882	136.0	92.4
II	456.3	457.8	100.0	100.2	10961	132.8	88.3
III	476.6	476.0	101.3	101.3	13821	137.9	89.4
IV	493.6	493.0	103.0	103.0	14634	142.5	90.5
1984 I	508.4	512.9	103.6	104.7	12693	141.2	88.8
II	516.6	517.3	102.9	103.2	16163	146.5	90.4
III	528.3	528.7	104.0	104.2	13563	146.2	89.1
IV	541.6	541.0	105.9	105.9	13129	149.0	89.2
1985 I					13144	149.2	88.5
II					16682	155.9	91.6
III							
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	
2384	2905	521	n.a.	1005.9	n.a.	974.7	1979
3155	3708	553	n.a.	1132.6	n.a.	1346.0	1980
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	1775.7	7493.8	2014.8	1983
5952	6991	1039	8473.9	2247.9	8127.6	2101.2	1984
							1985
Quarterly Totals			Monthly Totals				
1044	1437	393	n.a.	1334.1	n.a.	1406.0	1982 I
1176	1474	298	n.a.	1369.9	n.a.	1464.6	II
1184	1457	267	n.a.	1510.7	n.a.	1521.0	III
1505	1534	29	7291.0	1564.7	6655.1	1594.0	IV
1220	1646	426	7229.1	1499.9	6888.3	1235.1	1983 I
1405	1654	249	7345.5	1638.4	6904.8	1343.2	II
1440	1560	120	7439.7	1749.7	7302.1	1914.4	III
1646	1811	165	7697.4	1775.7	7493.8	2014.8	IV
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	1715	258	8161.8	2223.0	7938.4	1875.0	III
1688	1873	185	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				3124.8	II
1562	1838	277					III
							IV
Quarterly Totals (S.C.)			Monthly Totals (S.C.)				
1116	1415	229	No Seasonal Pattern	No Seasonal Pattern	No Seasonal Pattern	1375.1	1982 I
1184	1465	281				1554.7	II
1233	1507	272				1528.6	III
1340	1515	195				1463.7	IV
1333	1607	274				1208.5	1983 I
1403	1655	252				1424.4	II
1497	1621	124				1920.2	III
1456	1789	333				2084.7	IV
1433	1663	230				2119.6	1984 I
1508	1699	190				2039.7	II
1503	1785	281					III
1495	1849	354					IV
1485	1910	425					1985 I
1622	1811	189					II
1607	1917	311					III
							IV

	Visible Trade Indicators					Exchange Rates	
	30	31	32	33	34	35	36
	Imports (Value)	Exports (Value)	Import Excess (Value)	Imports (Volume)	Exports (Volume)	Effective Index	Sterling
	£m	£m	£m	1975 = 100	1975 = 100	Dec. 1971 = 100	Per IR£
1979	4817.5	3501.1	1316.4	170.3	146.5	77.08	0.9646
1980	5419.6	4130.9	1288.7	162.6	158.9	74.01	0.8862
1981	6578.4	4777.6	1800.8	166.0	158.3	67.75	0.8002
1982	6812.3	5687.9	1124.4	160.3	169.8	67.35	0.8125
1983	7355.0	6936.0	419.0	165.3	190.2	65.13	0.8222
1984	8913.5	8897.7	15.8			62.26	0.8134
1985							
Monthly Averages							
1982 I	597.7	411.2	126.4	172.8	153.3	67.71	0.8126
II	589.5	503.7	85.8	167.1	180.7	67.72	0.8171
III	532.5	475.0	57.5	147.6	173.2	66.88	0.8022
IV	550.8	506.5	44.3	151.7	176.3	67.10	0.8185
1983 I	585.8	471.5	114.3	167.1	164.8	69.46	0.8943
II	592.1	575.8	16.4	163.8	192.6	65.14	0.8171
III	602.4	606.8	—4.4	157.8	195.6	63.28	0.7894
IV	673.2	658.9	14.3	172.7	207.6	62.74	0.7896
1984 I	744.5	654.4	90.1	186.3	203.8	62.58	0.7951
II	715.0	769.9	—54.9	177.4	236.5	62.56	0.8097
III	710.5	722.7	—12.2	170.0	216.6	61.86	0.8143
IV	801.1	818.9	—17.8	189.3	239.7	62.04	0.8352
1985 I	820.6	800.3	20.3	194.4	236.0	61.95	0.8590
II	808.2	855.8	- 47.6	189.3	244.7	61.44	0.8075
III	740.5	795.6	- 55.1				
IV							
Monthly Averages. Seasonally Corrected.							
1982 I	586.8	436.4	143.9	169.7	163.4	No Seasonal Pattern	No Seasonal Pattern
II	573.3	500.5	72.8	163.7	181.3		
III	547.4	468.8	78.6	152.0	165.4		
IV	567.1	488.2	79.9	154.5	167.9		
1983 I	570.6	507.7	62.9	163.6	176.2		
II	577.3	565.9	11.4	160.9	191.1		
III	620.6	601.3	19.3	162.5	194.3		
IV	690.2	641.3	48.9	175.5	200.6		
1984 I	722.7	711.6	11.1	180.4	218.8		
II	699.8	741.6	—41.8	174.0	229.6		
III	725.9	711.3	14.6	174.6	213.9		
IV	833.7	800.8	32.9	196.9	233.5		
1985 I	792.4	862.1	—69.7	185.6	251.2		
II	795.6	817.8	—22.2	185.5	235.0		
III	774.3	792.7	—18.4				
IV							

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