

IRELAND



EUROLAND



View from the top

The Irish economy contracted by 2.3% in 2008 – the first annual contraction in output for 25 years. Output is forecast to contract at a faster pace in 2009, and is unlikely to begin recovering before the second half of 2010.

Key metrics

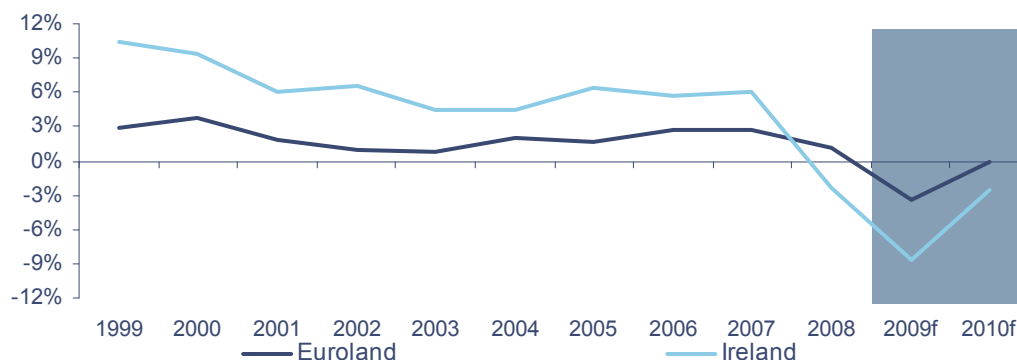
Indicator	2008	2009 <sup>f</sup>	2010 <sup>f</sup>
GDP growth	-2.3%	-8.7%	-2.5%
Inflation	3.1%	-1.3%	0.5%
Base interest rate	2.5%	▼*	◀*
General outlook		Negative	Negative

Source: Central Statistics Office; Eurostat; European Central Bank; PricewaterhouseCoopers forecasts (f) \*Interest rate as of April 2009 was 1.25% Inflation measure shown is the Harmonised Index of Consumer Prices (HICP).

Key trends

- Consumer confidence remains low due to rapidly rising unemployment, falling house prices and the effects of the banking crisis.
- Ireland entered a period of deflation in March, with the harmonised index of consumer prices contracting by 0.7% year-on-year.
- The Irish government announced an emergency package of tax increases in April in order to slow the accumulation of public sector debt.

Economic growth profile (GDP, annual % change)



Source: Central Statistics Office, Eurostat; PricewaterhouseCoopers forecasts (f)

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Yael Selfin

yael.selfin@uk.pwc.com  
+44 (0)20 7804 7630

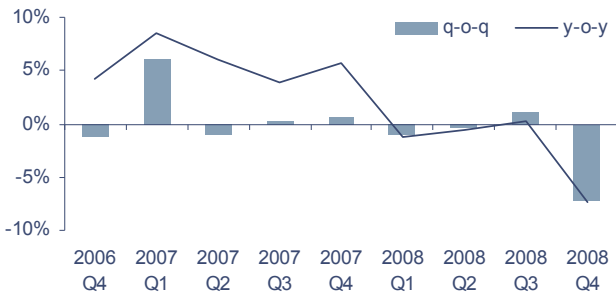
Alexander Baker

alex.baker@uk.pwc.com  
+44 (0)20 7212 2350

Ireland

The Irish economy contracted by 7.1% quarter-on-quarter in the final quarter of 2008, as shown in Chart 1 below. Over 2008, economic output shrank by 2.3%, compared to growth of 6% in 2007 – a significant deterioration in economic performance, and far below the economy’s long run growth rate.

Chart 1: Irish GDP growth



Source: Central Statistics Office

What started as a housing-led slowdown has now broadened into other sectors. The Q4 results show a contraction in economic activity in all major private sector industries compared to the same quarter a year earlier, although the building and construction sector performed particularly badly, shrinking by 16% during 2008.

Ireland’s economic performance is also being affected by the ongoing financial market turbulence and associated lack of consumer and business credit, which act as a constraint on consumer expenditure and business investment.

Consumer confidence remains low, but appears to have stabilised somewhat. Such low confidence, partly the result of falling house prices, the rate of unemployment, lack of credit and the banking crisis, is clearly impacting on expenditure – non-food retail sales volumes continued to decline y-o-y in January, as shown in Chart 2 below.

Chart 2: Non-food retail sales and consumer sentiment



Source: Central Statistics Office, Economic and Social Research Institute

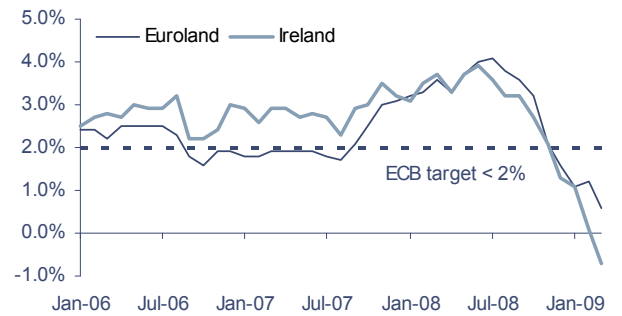
Consumer spending will be squeezed further over 2009 and 2010 as the effect of rapidly rising unemployment feeds through. The rate of unemployment rose to 11% in March 2009 – more than double its rate a year earlier. It is likely to rise further in 2009.

Rising unemployment, when combined with lack of credit, will continue to put downward pressure on the housing market. House prices fell for the twenty-fourth consecutive month in February, and are now almost 18% below their

peak level. Employment fears are also likely to prompt an increase in so-called ‘precautionary saving’ by households, which implies lower expenditure.

The annual rate of change in the Harmonised Index of Consumer Prices – the EU’s preferred measure of consumer price inflation – dropped below zero in February, as Chart 3 shows below. While the ECB has slashed its headline interest rate in recent months, very weak domestic demand and a stronger euro are likely to put further downward pressure on prices during 2009. If deflationary expectations become entrenched, then this may result in consumers spending less. Conversely, a short period of deflation may encourage expenditure.

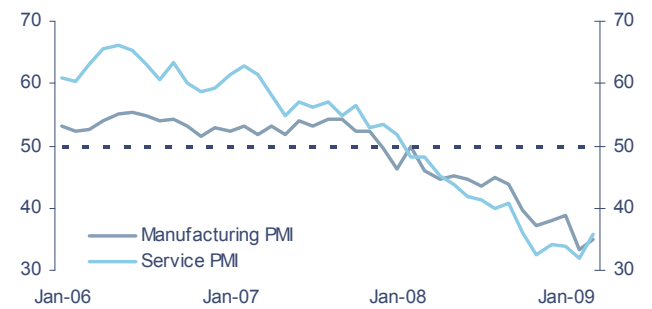
Chart 3: Consumer price inflation



Source: Central Statistics Office, Permanent TSB

Forward looking surveys of business confidence continue to show a pessimistic outlook for the trajectory of the economy. Despite modest rises in the Purchasing Managers’ Index (PMI) for both the manufacturing and service sectors in March, the indices are well below 50, indicating continued expectations of a contraction in economic activity, as shown below in Chart 4.

Chart 4: Purchasing Managers’ Index



Source: NCB Stockbrokers

The Irish government has been constrained in its response to Ireland’s worsening economic performance by a rapidly deteriorating fiscal position. In a supplementary budget on April 7, Finance minister Brian Lenihan announced a package of tax increases designed to constrain a swelling budget deficit, which the government estimates will reach almost 11% of GDP in 2009 and 2010 (taking the measures into account). As the Irish government highlighted at the time, the budget measures are likely to have a negative impact on the country’s economic performance in the short term – potentially reducing output by 1% in 2009 according to its estimates. Further tax increases or expenditure cuts cannot be ruled out.

The Irish government appears reticent to use further short-term fiscal expansion to combat the effects of the current recession. Its ability to service additional borrowing has recently been called into question by the decision of some credit rating agencies to downgrade the government's sovereign debt rating. This has pushed up the cost of debt compared to some other Euroland countries.

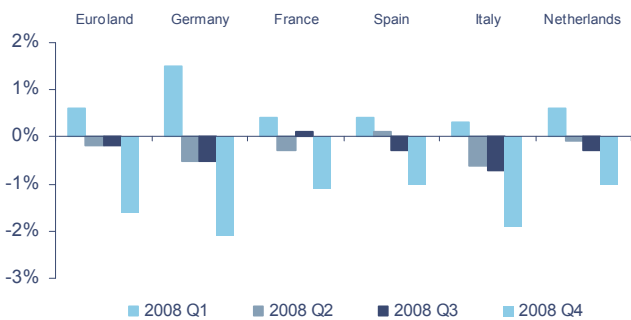
As a result, a recovery in Ireland's economic performance will be largely reliant on the external sector. Irish export growth has recently suffered from a combination of weak demand and a strengthening of the euro against sterling and the dollar. Growth in demand for exports will depend on an improvement in the economic outlook of Ireland's main trading partners – the UK, the US and Euroland – which is unlikely until sometime in 2010, unless further fiscal stimuli in those jurisdictions are put in place and prove effective.

Given the weak outlook for the Irish economy, we forecast a contraction of 8.7% in output in 2009, and a further contraction of 2.5% in 2010. A recovery is unlikely to begin taking place until the second half of 2010 at the earliest. However, given the combination of a banking crisis, a housing asset bubble correction, a global recession, rising unemployment, deflation, and tax increases, forecasts of economic growth are subject to great uncertainty. Needless to say, the risks to the Irish economy are firmly weighted to the downside at present.

**Euroland**

The contraction of the Euroland economy accelerated in the fourth quarter of 2008, with GDP falling by 1.6% compared to a 0.2% fall in Q3 (see Chart 5 below). It was the third consecutive quarter of falling output and the sharpest contraction since Euroland quarterly economic growth records began in 1995.

Chart 5: Quarter-on-quarter GDP growth rates

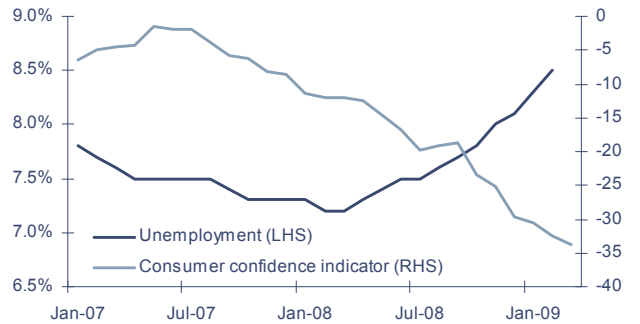


Source: Eurostat

Despite expectations to the contrary at the start of the economic crisis, the German and Italian economies are contracting faster than the Spanish economy. Across the 16 Euroland countries, the Q4 change in GDP ranged from a fall of 7.1% in Ireland to an expansion of 2.1% in Slovakia. Apart from Slovakia, only Greece and Cyprus managed to grow in the last quarter of 2008.

The Q4 contraction was driven by a 4% fall in investment and a 6.7% reduction in exports. This confirms that the current recession is largely business-driven, except in the countries like Spain and Ireland that are suffering from burst property price bubbles. However, the pain is gradually moving from the factory to the home, as reflected in the rising unemployment rate (see Chart 6 below).

Chart 6: Unemployment and consumer confidence



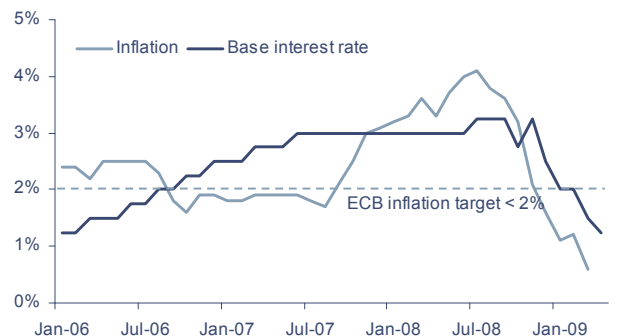
Source: Eurostat; European Commission

With falling export orders resulting in idle factories across the continent, the unemployment rate reached 8.5% in February 2009, the highest level since May 2006. The reaction of consumers has been proportionate. Although consumer confidence has been generally on a downward trajectory since the start of the financial crisis in mid-2007, it has fallen precipitously since late-2008 (see Chart 6 above), as the rise in unemployment picked up. Accordingly, consumer spending contracted by 0.3% in Q4. An upside of falling consumer confidence is that, despite the strength of the euro, imports also fell in Q4, by 4.7%.

Despite the depth of the recession, policy thus far has been cautious. Although fiscal stimulus packages have been announced by national governments across Euroland and by the European Commission (EC), the amounts committed relative to GDP are lower than in the US, Japan or China, according to ILO estimates. In fact, government spending decelerated in the second half of 2008.

The monetary policy response has been similarly timid. Although interest rates have fallen considerably since November 2008 (see Chart 7 below), the European Central Bank (ECB) has not gone as far as its counterparts in the US or the UK. However, with inflation anchored safely below the ECB's 2% ceiling, there is further scope for supporting the economy through lower interest rates.

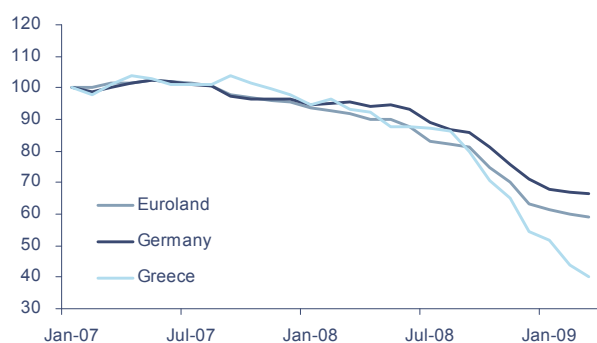
Chart 7: Interest rates and inflation



Source: European Central Bank; Eurostat

Although some 'green shoots' are being observed in the US, it is expected that the recovery in Euroland will lag behind. Nevertheless, the EC's Euroland economic sentiment indicator (ESI) may be bottoming out (see Chart 8 below). Since the start of 2009, the ESI for Euroland and Germany has fallen only marginally, but it has continued falling for Greece, which is yet to enter recession.

Chart 8: Economic sentiment indicator (Jan 07 = 100)



Source: European Commission

We expect the Euroland economy to continue contracting during 2009 but at a decreasing rate. The economy should resume growing very slowly during the course of 2010. We forecast a 3.3% overall contraction in GDP in 2009, while the Euroland economy is expected to record a negligible expansion of less than 0.1% in 2010.

Table 1: Euroland GDP growth outlook

GDP annual % change	2008	2009 <sup>f</sup>	2010 <sup>f</sup>
Euroland	0.9	-3.4	0.0
Austria	1.8	-1.8	0.1
Belgium	1.2	-2.5	0.5
Finland	0.9	-2.2	1.0
France	0.7	-2.6	0.3
Germany	1.3	-4.5	0.2
Greece	2.8	-0.2	1.0
Ireland	-2.3	-8.7	-2.5
Italy	-0.7	-3.6	-0.1
Netherlands	1.8	-3.1	-0.2
Portugal	2.0	-1.1	1.3
Slovenia	0.0	-2.3	-0.1
Spain	1.2	-3.0	-1.0
UK	0.7	-4.5	-0.5

Source: CSO, Eurostat; PricewaterhouseCoopers forecasts (f)

## Ireland: recent performance and forecasts

	2006	2007	2008	2009 <sup>f</sup>	2010 <sup>f</sup>
<b>Real growth (annual % change)</b>					
GDP	5.7	6.0	-2.3	-8.7	-2.5
Consumer spending	7.1	6.3	-0.8	-7.5	-3.2
Government	4.8	5.9	2.1	-0.8	-2.0
Investment	3.9	1.0	-20.0	-24.8	-8.8
Export	5.7	6.8	-0.4	-6.0	0.0
Imports	6.4	4.1	-4.3	-8.5	-1.4
<b>Contribution to GDP growth (%)*</b>					
Consumer spending	3.3	3.0	-0.4	-3.6	-1.6
Government	0.7	0.8	0.3	-0.1	-0.3
Investment	1.1	0.3	-5.1	-5.2	-1.5
Export	4.6	5.4	-0.3	-4.9	0.0
Imports	-4.4	-2.8	2.9	5.7	0.9
Domestic demand	5.4	3.3	-4.9	-9.0	-3.4
Net exports	0.2	2.6	2.6	0.8	0.9
<b>Economic structure (% of GDP)*</b>					
Consumer spending	47.2	47.3	48.0	48.7	48.3
Government	13.7	13.7	14.3	15.6	15.6
Investment	26.9	25.6	21.0	17.3	16.1
Export	79.9	80.5	82.0	84.5	86.7
Imports	69.1	67.9	66.4	66.6	67.4
<b>Inflation</b>					
HICP (% change, annual average)	2.7	2.9	3.1	-1.3	0.5

Source: Central Statistics Office, Eurostat; PricewaterhouseCoopers forecasts (f). \*Component shares of GDP may not add up to 100% owing to stockbuilding and statistical discrepancy

## Size of the economy

	2006	2007	2008	Share of 2008 world total
Population (millions)	4	4	4	0.07%
GDP, market rates (US\$ billions)	223	261	285	0.46%
GDP, PPP rates (US\$ billions)	173	188	189	0.27%
GDP per capita, market rates (US\$)	52,505	60,209	64,660	
GDP per capita, PPP rates (US\$)	40,806	43,414	42,780	

Source: International Monetary Fund

Report date: 20 April 2009

## Definitions

Base interest rate – The policy interest rate for Euroland is the main refinancing operations minimum bid rate

Base interest rate forecasts – ▲ increase; ▼ decrease; ◀▶ no change

General outlook – In the Key Metrics table on page 1, the overall economic environment is assessed as being Positive, Stable or Negative

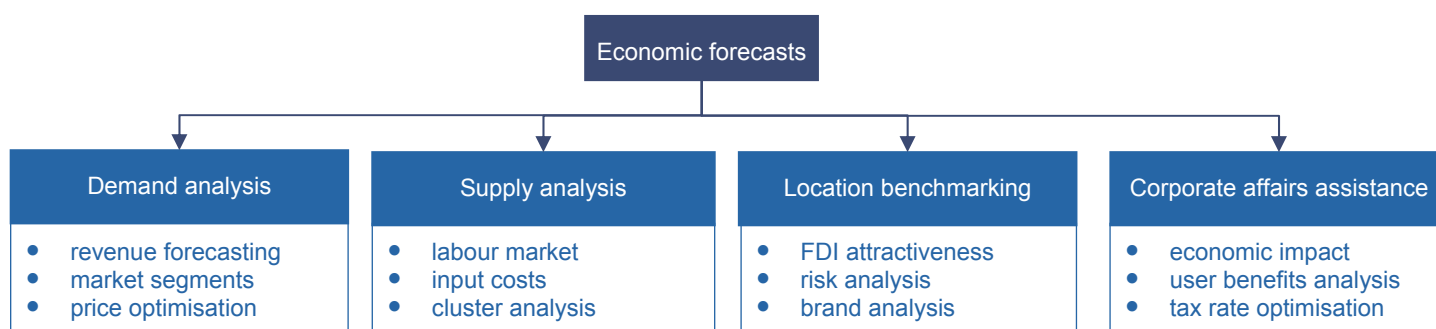
EOP – End of Period;

HICP – Harmonised Index of Consumer Prices

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For more information about our services please contact one of the members of the Macro Consulting team below:

<b>Yael Selfin</b>	Head of Macro Consulting	+44 (0)20 7804 7630	yael.selfin@uk.pwc.com
<b>Mal Božić</b>	Global	+44 (0)20 7804 4089	mal.bozic@uk.pwc.com
<b>Jas Ellis</b>	Africa	+44 (0) 20 7213 3966	jas.a.ellis@uk.pwc.com
<b>Felicity Cumming</b>	Asia Pacific	+44 (0)20 7212 4705	felicity.cumming@uk.pwc.com
<b>Sajeel Shah</b>	Eastern Europe	+44 (0) 189 552 2365	sajeel.shah@uk.pwc.com
<b>Michael Nowak</b>	Latin America	+44 (0)20 7804 6732	michael.nowak@uk.pwc.com
<b>Alex Baker</b>	North America	+44 (0)20 7212 2350	alex.baker@uk.pwc.com
<b>Paul Swinney</b>	Western Europe	+44 (0) 207 804 2577	paul.a.swinney@uk.pwc.com
<b>Robert Sullivan</b>	Special situations	+44 (0) 20 7804 0663	robert.s.sullivan@uk.pwc.com

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