



The Bulletin

A monthly analysis of international and Irish markets

Deficits and Bailouts

- Ireland is funded through 2013
- Bond rally raises possibility of issuance

Under the terms of the Troika programme, Ireland can borrow up to €62.5bn from the EU/IMF with just under €5bn pledged in additional bilateral loans from a number of countries including the UK. By end-2011 the NTMA had drawn down €34.5bn and some have argued that Ireland will eventually need additional funds from official sources (a second 'bailout') while those that envisage a return to the debt market do not foresee this before mid-2013. It is premature to be definitive on this issue, however, as uncertainties abound – indeed, the precipitous fall in Irish yields of late have prompted speculation that Ireland may return to the market much earlier than anyone expected.

The forecast funding arithmetic is clear enough. Ireland is projecting a total exchequer deficit of €33bn over the next two years, which is exactly equal to the remaining sum available under the current programme. In addition €1.5bn of outstanding bonds are due for redemption (€5.5bn in March this year and the balance in April 2013) and some €4.5bn in short term debt, giving a total of €16bn. The NTMA had accumulated just under €18bn in cash balances as at end-December 2011 and another €3bn or so would normally flow in over the two years via State savings products, implying that the exchequer is funded till end 2013 but that cash balances would be severely depleted and additional funding would therefore then be required particularly as an additional €12bn of debt was due for redemption in January 2014, although the NTMA has now switched €3.5bn of this into 2015.

The projected exchequer deficits over the next two years include around €6bn in Promissory Note funding and the Government is seeking to reduce this annual payment, which if successful would obviously reduce the annual borrowing requirement. The deficits are also unlikely to emerge exactly as planned, given the experience of the past decade, and the latest consensus GDP forecast is now below that of the government's, although the January exchequer returns do show a strong start to the year. The attitude of investors to Irish debt is key, of course, and in that respect the past few months have seen a very significant change, – the Irish 2-year bond (the 4% 2014) traded at 10% in November (and 22% last July) but is now offered in the market at just over 4%, compared to the 4.77% yield when the NTMA last issued these in September 2010. The NTMA may offer more switch terms into the 4.5% 2015 if demand allows or indeed issue the latter, although Ireland's success in securing a lower interest rate on EU loans make it less attractive to borrow in the market at current rates.

Dr. Dan McLaughlin.

United Kingdom

Page 2

BoE likely to announce more QE

Europe

Page 3

Conditions improve but ECB may still cut rates

United States

Page 4

Fed says low rates likely 'til at least late 2014

Economic Diary - February

Page 6

Forecasts

Page 7

Bank of Ireland estimates

- Exchange rates
- Official interest rates
- Five-year swap rates
- GDP and inflation

Contacts

Page 8

United Kingdom

BoE likely to announce more QE

Negative Q4 but recent data stronger...

The latest GDP data show that the economy slipped back into negative growth in Q4, and we do not expect any great improvement in the early stages of this year. GDP contracted by 0.2% in the final quarter of last year, which was slightly worse than the flat or -0.1% reading that was generally expected. In 2011, the economy grew by 0.9%, down from 2.1% growth in 2010 and has only recovered about 45% of the lost output during the most recent recession. Industrial output fell by 1.2% in Q4, which accounted for most of the fall in GDP. This decline was driven by weakness in the energy sector. Aside from this, it is production of intermediate goods that has been pulling down growth of the production industries since April and a fall in output of consumer non-durables also made a small negative contribution to growth in Q4. Services output was flat in the quarter, while construction output fell by 0.5%. Within the services sector, two sub-sectors - distribution, hotels and catering, and transport, storage and communication – both contracted. Business and financial services output was flat, while government and other services grew by 0.4 per cent. It is likely that growth in Q1 will also be weak or negative, an outcome which would mean the UK is already in a technical recession. However, there is a small glimmer of hope that activity may be improving somewhat. January's PMI's all posted above 50 readings which indicates expansion. Manufacturing PMI rose to 52.1, its highest reading since April of last year, and only the second time in the past 7 months that the reading has been above 50. Manufacturing output expanded at the fastest pace since last March according to the report while new orders rose for the first time in seven months. Companies also reported an increased willingness to spend among UK clients and a further increase in new export orders. Services PMI also posted a strong reading in January, jumping to 56 from 54 in December; again this is the strongest reading since early last year (March). The report noted strong increases in measures of new business, employment and business confidence.

...but BoE ready to act.

The question now moves on to what, if anything, the Bank of England intend to do in the face of slow or flat growth. Already the Bank has restarted its asset purchase scheme, raising the total in November by £75bn to £275bn. The MPC minutes from the January meeting revealed another 9-0 vote to keep this policy on hold but the language indicates that the Bank will increase the asset purchase scheme total again during Q1. The minutes said that "for some members, the risks of undershooting (the inflation target) meant that a further expansion of asset purchases was likely to be required...but there was no compelling need to increase the scale of the program before completing those already announced'. The current round of asset purchases was completed in early February and the language in these minutes is stronger and more definite than "asset purchases might well become warranted in due course" language that was in the previous two sets of minutes. The Committee continues to see considerable risks to the downside from the global economy but acknowledged that there had been some positive developments over the past month that had moderated some of the more serious near-term downside risks. They specifically noted that the ECB's LTRO eased the "immediate risk of a more severe dislocation in the euro area arising from banking-sector difficulties". They also noted the sequence of slightly stronger data in the US. However, in the UK itself, there was little data to alter the view that output was like to be broadly flat in Q4 and Q1. The MPC will also have a new inflation report to inform their decision in February and, in the current environment, it's difficult to see any dramatic upward revision to inflation forecast. An announcement on further asset purchases may come before the end of Q1 with a decision likely at the February meeting.

Europe

Conditions improve but ECB may still cut rates

ECB signals easing bias...

After two successive quarter point reductions in November and December, the ECB left its key interest rate unchanged at 1% in January. In the post-meeting statement, the ECB said that while there were 'tentative signs' that economic activity in the euro zone was stabilising albeit at low levels, the outlook was still subject to 'high uncertainty' and 'substantial downside risks'. The ECB also said that '*a very thorough analysis of all incoming data and developments over the period ahead is warranted*'. This specific language was first introduced into the statement following the ECB meeting of September last and was retained in the October statement, before the ECB cut interest rates in November and December. The fact that the language was re-introduced into the January statement suggests that the ECB has at least a bias to cut interest rates further, but whether it does so depends on how economic and market conditions evolve.

...but data shows situation improving...

Over the past month, it has to be noted, market conditions have notably improved. The ECB's decision to offer abundant liquidity to banks in December, in the form of 36-month loans, has reaped dividends with more market stability at the beginning of this year. Interbank rates have dropped considerably with overnight euro rates more than halving since early December and are currently at about 30bps. The environment for EA sovereign debt has also vastly improved with some EA countries, which had been under significant pressure in Q4, able to sell debt. Italy and Spain are two of the Euro countries under the most scrutiny yet they have managed to bring yields down sharply while getting away not insignificant amounts of debt; Italian 10-year yields have fallen nearly 200bps since a recent peak in late November and now trade at around 5.6%, while Spanish 10-year yields have also fallen 200bps in the past two months and are down to under 5%. Spain has also now completed, in just one month, about 20% of the planned debt sales for this year paying much lower official yields than prevailed during the final auctions of 2011. Economic data also points to an improving situation, as while it seems almost certain that the euro area economy contracted in the final quarter of last year, the latest survey data. The Purchasing Managers composite index of activity across the manufacturing and services sectors rose to 50.4 this month from 48.3 in December, and is the first time the indicator has been above the 50 level (which denotes contraction from expansion) since August of last year.

...however further action may still be required.

While the data in the intervening period since the last meeting seem to confirm activity appears to be stabilizing, it is coming from a low base and the financial markets remain vulnerable to further turmoil as the debt crisis is far from definitively solved. The ECB is still likely to say, at their next meeting, that downside risks remain, and is also likely to reiterate that inflation will fall below 2%. Whether this will be enough to prompt a cut in rates remains to be seen. Some members may point to the fact the some market rates are already below the 1% refinancing rate set by the ECB and hence there is no need to lower the latter further, while others are likely to argue that monetary policy should do more to support growth given that inflation is likely to be subdued. While the data in the first month of the year is encouraging, it remains overwhelming likely that the economy is only going to grow very weakly, at best, in the first half of this year and hence the environment for inflation is going to very subdued this year. This gives the ECB room to act if it chooses, and we would not be surprised to see another rate cut before the end of this quarter.

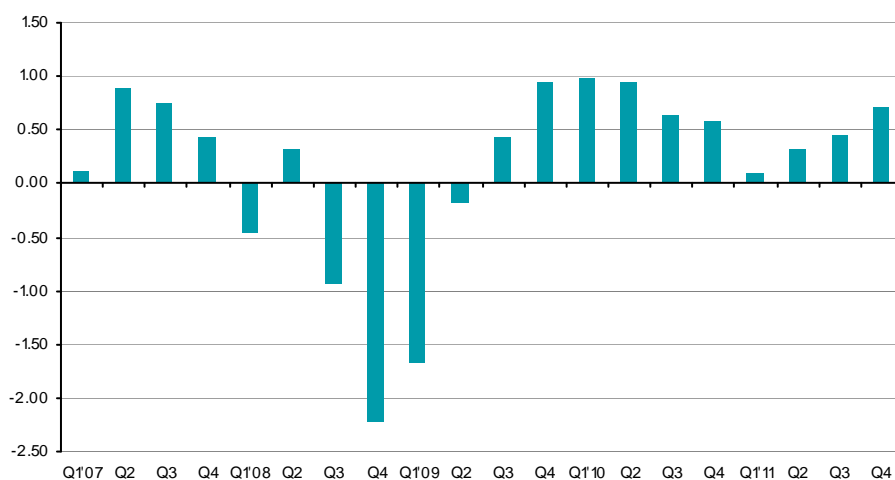
United States

Fed says low rates likely 'til at least late 2014

Growth picked up in Q4...

The pace of economic growth picked up in the final quarter of 2011, with real GDP increasing by 0.7% - or at an annualized rate of 2.8% - following an increase of almost 0.5% (1.8% annualized) in the third quarter of the year. Much of the growth in Q4 was due to a rebuilding of stocks, which contributed almost 0.5% points to the increase in GDP. Real final sales (or final demand for good and services) grew by just 0.2% in the quarter, with increases in consumer spending and investment (albeit the latter rose by much less than in Q3) partially offset by a large decline in government spending (particularly at the Federal level). Export growth held up quite well in Q4 considering the slowdown in global activity, though imports rose by more than in Q3, hence *net* exports overall made little or no contribution to the increase in GDP.

Real GDP, % Change Quarter-on-Quarter



...and 2012 off to a good start...

The subdued growth in final demand in the fourth quarter followed a relatively strong increase in the third quarter, while the second half of 2011 was notably better than the first half with the average quarterly increase of 0.5% more than double that recorded over the first two quarters of the year. Meanwhile, the available data suggests 2012 has got off to a reasonably good start. The purchasing managers' measures of manufacturing and services activity both rose further in January (to levels above the average in Q4), while employment increased by almost 250k last month, the largest increase since April 2011. The unemployment rate fell further in January, to 8.3%, its lowest level in almost two years.

...but Fed lowers its forecasts albeit marginally...

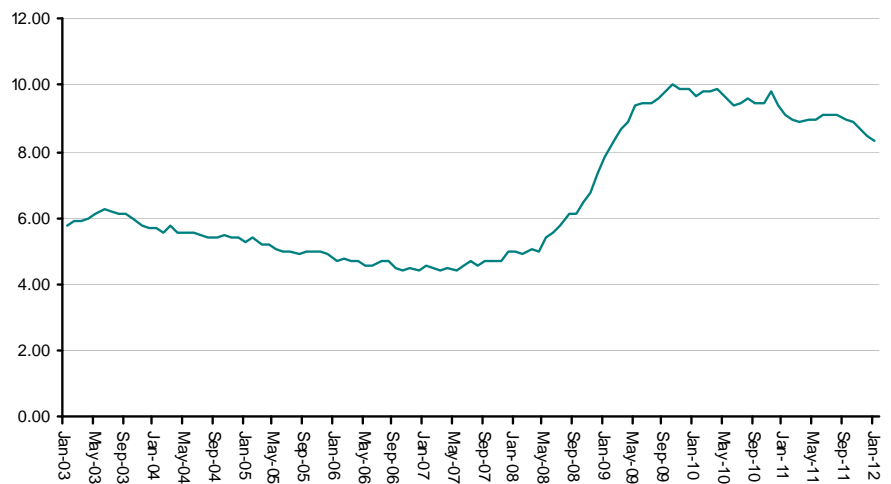
Notwithstanding the pick up in the economy over the second half of last year, the Fed has revised down slightly its forecast for GDP growth in 2012, partly on account of the slowdown in the global economy, though it still expects activity to be stronger this year than last. It now expects GDP to increase by 2.5% over the course of this year (from 2.7% previously), after an increase of 1.6% in the year to the fourth quarter of 2011, while growth is projected to strengthen further to 3% in 2013, though this too represents a downward revision from its previous forecast of 3.25%. The expected pick up in growth this year is forecast to have only a modest impact on the unemployment rate, which is projected to fall to between 8.2% and 8.5% by the end of 2012, from an average of 8.7% at the end of 2011. The unemployment rate is expected to fall further over the following two years although it is forecast to still be around 7% by end-2014. This is well above the level the Fed considers to be the economy's longer-run normal rate of unemployment, which is between 5.2% and 6%. Inflation is forecast to fall to 1.6% by the end of this year, from 2.6% in the final quarter of last year, and to average 1.75% a year over the 2013-14 period. Hence, inflation is expected to *undershoot* the

Fed's new, *explicit* target of 2% which it announced in a *Longer-Run Goals and Policy Strategy* statement published after its two-day meeting in January.

...and now expects exceptionally low fed funds rate until late 2014...

The January meeting also saw the Fed publish for the first time individual members' projections for the federal funds rate over the next few years. These included each individual member's assessment of the appropriate *timing* of the first increase in the federal funds rate from its current level of near zero percent, as well as each member's projection of the appropriate *level* of the funds rate at the end of each year up to and including 2014. In terms of the appropriate timing of the first increase in the federal funds rate, 3 of the 17 members said it should occur this year, another 3 said 2013, while 11 said the federal funds rate should not be increased until 2014 or later (2 members said the Fed should not raise rates until 2016). In terms of those members who thought the federal funds rate should be higher at the end of 2014 than it is currently, the individual projections ranged from 0.75% to 2.75%. A weighted average of *all* members' projections for end-2014 (including 6 who thought rates should still not be increased by the end of 2014) yields a federal funds rate of 1%.

Unemployment Rate (%)



...depending on economic conditions...

It is in this context that the Fed said in its regular monetary policy statement published following January's meeting that '*economic conditions – including low rates of resource utilization and a subdued outlook for inflation over the medium term – are likely to warrant exceptionally low levels for the federal funds rate at least through late 2014*'. This extended the period over which the Fed expects the federal funds rate to remain exceptionally low by about 18 months relative to its previous guidance (which was that exceptionally low rates were likely until at least mid-2013), and prompted a fall in government bond yields and a decline in the value of the dollar.

...especially the labour market.

It is important, though, to note the *conditional* nature of the forward guidance provided by the Fed. The guidance has been framed *not* as an *unconditional* commitment to a specific federal funds rate path, but rather as an expectation that is explicitly contingent on economic conditions (i.e. low rates of resource utilization and a subdued outlook for inflation). A consequence of such conditionality is that incoming information about economic developments leads the market to revise the outlook for the federal funds rate even in the absence of a change in the forward guidance language. For example, as noted above, the Fed expects the unemployment rate to average between 8.2% and 8.5% in the final quarter of this year. However, as also noted, it stood at 8.3% in January, having fallen by 0.8% *points* over the past year. If it falls at a faster pace than the Fed is currently forecasting, then the market may well bring forward its expectation for the timing of the first rate hike, which it currently doesn't envisage until the second half of 2014.

Economic Diary - February

	Europe	United Kingdom	United States
1	PMI Manufacturing	Nationwide House Prices PMI Manufacturing	ADP Employment ISM Manufacturing
2	PPI's		Initial Jobless Claims
3	PMI Services, Retail Sales	PMI Services	Payrolls, Unemployment Data ISM Non-Manufacturing Factory Orders
6	German Factory Orders		
7	German Industrial Production		
8			
9	ECB Meeting	BoE Meeting Industrial Production	Initial Jobless Claims
10		PPI's	U. of Michigan Confidence
14	Industrial Production ZEW Survey	Inflation Data	NFIB Small Business Optimism Retail Sales
15	Q4 GDP	Bank of England Inflation Report Labour Market Data	Empire Manufacturing Industrial Production FOMC Minutes
16			PPI's, Initial Jobless Claims Housing Starts, Philly Fed
17		Retail Sales	Inflation Data, Leading Indicators
22	PMI's, Industrial New Orders	Bank of England Minutes	Existing Home Sales
23	IFO Surveys		Initial Jobless Claims, House Prices
24		Q4 GDP	U. of Michigan Confidence New Home Sales
27			Pending Home Sales
28	Confidence Data		Durable Good Orders S&P/Case Shiller Home Prices Consumer Confidence
29	Inflation Data Retail Sales		Q4 GDP

Forecasts

Bank of Ireland estimates

Exchange Rates

	Current	End Mar	End Jun	End Sep
EUR/USD	1.32	1.27	1.27	1.27
EUR/GBP	0.83	0.82	0.82	0.82
USD/JPY	77	80	85	85
GBP/USD	1.58	1.55	1.55	1.55

Source: Bank of Ireland Global Markets

Official interest rates

	Current	End Mar	End Jun	End Sep
USD	0-0.25	0-0.25	0-0.25	0-0.25
EUR	1.00	0.75	0.75	0.75
GBP	0.50	0.50	0.50	0.50

Source: Bank of Ireland Global Markets

Swap rates: 5 year

	Current	End Mar	End Jun	End Sep
US	1.10	1.20	1.35	1.50
Eurozone	1.60	1.60	2.00	2.00
UK	1.60	1.60	1.75	2.00

Source: Bank of Ireland Global Markets

GDP and inflation (annual average)

	GDP	2011	GDP	2012
		Inflation		Inflation
US	1.7	3.2	2.2	2.1
Eurozone	1.6	2.7	0.0	1.9
UK	0.9	4.5	0.7	2.5

Source: Bank of Ireland Global Markets

Contacts

Bank of Ireland Global Markets

www.boi.ie/globalmarkets

Chief Executive: Austin Jennings
 Head of Global Customer Business: Kevin Twomey

Colvill House, Talbot Street, Dublin 1, Ireland
 Fax: +353 1 799 3035 Tel: +353 1 799 3000
 e-mail: info@boigm.com

Economic Research Unit (ERU)

Chief Economist, Bank of Ireland: Dr. Dan McLaughlin
 Senior Economist: Michael Crowley
 Economist: Patrick Mullane

Tel: +353 1 609 3341
 e-mail: eru@boigm.com
 Listen to Daily Commentary on Freephone: 1800 60 70 60

Corporate & Institutional Sales

Freephone 1800 30 30 03

Retail Sales

Freephone 1800 790 153

Head of Corporate & Institutional Sales: Aine McCleary
 Head of Corporate Sales: Liam Connolly +353 1 790 0000
 Head of Customer Group Funding: Paul Shanley +353 1 609 3212
 Institutions: Gavin Rylands 1800 60 70 40
 Property & Specialised Finance: Ed Preston +353 1 609 3277
 Corporate Relationship Manager: Eamon McManamy +353 1 609 3215

Deputy Head Global Customer Group, Head of Retail Sales &
 Customer Group Operations: John Moclair
 Business Development & Sales Management: Adrienne McNally
 Head of Customer Group Operations: Osna O' Connor
 Business Banking Sales: Leslie Cosgrave

Global Markets United Kingdom (UK)

Head of UK: Liam Whelan 0044 207 4299 111
 Head of Specialised Treasury: Mark Doody 0044 207 4299 103
 Head of Corporate Sales: Kai Fisher 0044 207 4299 109
 Business Banking Sales: Sandra Perry 0044 207 4299 121

P.O. Box 62929, Bow Bells House, 1 Bread Street, London EC4P 4BF
 Tel: +44 (0) 20 7429 9111
 GB Treasury Sales Team Freephone: 0800 039 0038
 Tel: +44 (0) 7429 9121; Treasury Sales Team: 0800 776 616

Global Markets United States (US)

Head of US: Darsh Mariyappa
 Head of US Business Development: Joe Connolly
 Head of US Sales: Garreth Boyle

300 First Stamford Place, Stamford, CT 06902, US
 Tel: +1 203 391 5555
 Fax: +1 203 391 5901

Global Products Team

Global Head of Structured Business: Brian Vaughan
 Head of Structured Products Distribution: Barry McLoughlin

Tel: +353 1 790 0040
 Tel: +353 1 790 0400

Marketing

Head of Marketing: Andrew Hearnden

Tel: +353 1 609 3302

Market data supplied by Thomson Reuters

Disclaimer

Produced by the Economic Research Unit at Bank of Ireland Global Markets ("GM"). Bank of Ireland is regulated by the Central Bank of Ireland. In the UK, Bank of Ireland is authorised by the Central Bank of Ireland and authorised and subject to limited regulation by the Financial Services Authority. Details about the extent of our authorisation and regulation by the Financial Services Authority are available from us on request. This document is for information purposes only and GM is not soliciting any action based upon it. GM believes any information contained herein to be materially accurate but GM does not warrant its accuracy or completeness and this information should not be relied upon for any purpose. No prices or rates mentioned are bids or offers by GM to purchase or sell any currencies, securities or financial instruments. Except as otherwise may be specifically agreed, GM has not acted nor will act as a fiduciary, financial or investment adviser with respect to any derivative transaction that it has executed or will execute. Any investment, trading and hedging decision of a party will be based on its own judgement and not upon any view expressed by GM. This document does not address all risks related to the transactions described. You should obtain independent professional advice before making any investment decision. Any expressions of opinion reflect current opinions as at 8th February 2012. This publication is based on information available before this date. For private circulation only. This document is property of GM. The content may not be reproduced, either in whole or in part, without the express written consent of a suitably authorised member of GM staff.