

UK View



UK growth expected to fall to 0.3% this quarter, but light at end of tunnel

UK Economy

UK growth was lower than expected in the first quarter at 0.4%. Whilst the service sector remained in the region of 0.7% per quarter (the annual rate was 3%), there was a significant reduction in extraction, which includes oil and gas. This is likely to be repeated this quarter. In Q3, there will be a clearer picture of overall growth. Government surveys such as the monthly Bank of England Summary of Business Conditions point to a certain resilience in most sectors of the economy, as evidenced by the relative stability of the labour market. There is no evidence that unemployment is rising and underlying average earnings are relatively stable at 3.8% per annum. The one sector of the economy where growth has slowed is the financial services sector, as the impact of the credit crunch is clearly felt. Central bank injections of liquidity should ease pressure on the sector, although the fall out from the US non prime debt problem will continue to impact on financial sector sentiment for some time to come.

A key component of economic growth, personal consumption, has remained robust despite the downturn in the economy. In the first quarter, retail sales growth was 5% per annum. The latest data shows net consumer credit of £1.2 billion, a level compatible with a resilient consumer sector. Whilst we expect the retail sales growth rate to slow, the annual rate should remain above 3% per annum for most of 2008. There has been a slowdown in investment activity in part linked to the higher cost of period finance. We believe that investment will recover in second half 2008, as the funding situation improves. The government contribution to growth this year is likely to be neutral - neither expansionary nor contractionary. Export growth is limited by the slowdown in the UK's principal market, the eurozone, although global economic growth remains above long term trend, reflecting high growth rates in the rapidly expanding economies in eastern Europe, south America and Asia.

Data

	31 Mar 2008	30 Apr 2008	Change	Yr End View
\$/£	1.9837	1.9886	0.2%	1.95
€/£	1.2565	1.2719	1.2%	1.33
£ weighted index	92.6	93.3	0.8%	95.0
Base Rate	5.25	5.00		4.75
FTSE 100	5702	6087	6.8%	6500
S & P 500	1323	1386	4.8%	1500
Eurostoxx 50	3628	3825	5.4%	4200
Nikkei 225	12526	13850	10.6%	15000
Crude Oil (\$/bl)	100	113.70	13.7%	100

In this Issue

- ◆ **UK Economy**
UK economy expected to reach low point in summer
- ◆ **Foreign Exchange Market**
£ likely to consolidate in coming weeks
- ◆ **Interest Rates**
Base rate predicted to fall to 4.75% this month or next
- ◆ **Equities**
Equity market trend now more positive
- ◆ **Commodities**
Commodity price inflation remains feature of 2008
- ◆ **Commercial Property**
Commercial property market activity slows, but likely to recover later in the year
- ◆ **Housing Market**
Trough in annual rate of house price inflation expected to occur mid-summer



Foreign Exchange Market

The past month has seen increased demand for sterling versus the euro. This reflects the increase in oil prices and evidence of a slowdown in the eurozone economy. The pound has also been bolstered by a revised view of UK base rate prospects. In a recent speech to the CBI, MPC member Dr Andrew Sentance made reference to the inflationary consequences of this year's substantial fall in the value of the pound, indicating that room for further base rate cuts is limited. Sterling appreciated by 1% on the trade weighted index in late April. The one major currency where sterling failed to gain ground is the US dollar. Market expectations of further US interest rate reductions have been scaled back due to an improvement in US financial market sentiment. We are probably approaching the end of the US interest rate reduction cycle. Whilst there may be one further ¼% reduction this summer, the US authorities are likely to place more emphasis on inflation control in the coming months given the strength of commodity prices. The European Central Bank has been adopting strong anti-inflationary rhetoric for some time. We therefore feel that with minimal prospect of a euro repo rate cut near term, there is limited downside on the euro. Overall, we expect to see a period of relative stability in sterling's exchange rate against the euro and the dollar.

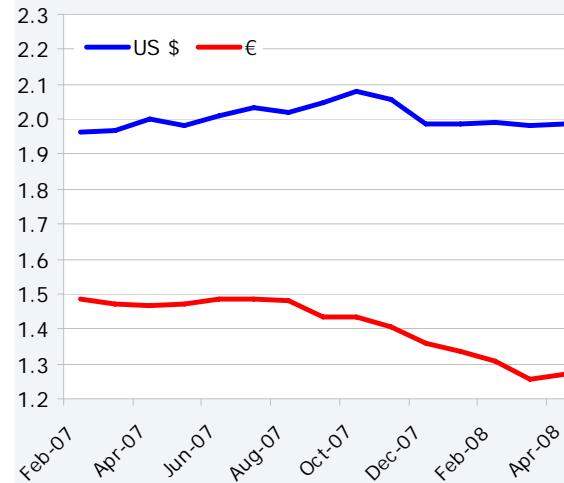
Interest Rates

The full impact of the international liquidity crunch is now being felt by the UK economy, hence the record £50 billion money market facility. The scheme has had a very gradual impact - the 3 month LIBOR rate is currently falling by an average of 0.01% per day. There will be a more significant reduction following the next reduction in base rate to 4.75%, this month or next. The case for a further move to 4.50% is finely balanced. The challenge facing the MPC is that CPI may well rise to the top of the 1-3% target band in second half 2008, in response to higher food and oil prices and the 5% decline in the sterling trade weighted index this year. The primary challenge facing the economy is money market liquidity. This is an international problem, which will possibly require a further co-ordinated central bank injection of liquidity. We are probably nearing the end of the base rate reduction cycle and longer-term rates are now reflecting the recent increase in inflationary pressure. There is likely to be a large volume of negative economic data in the coming weeks and there could well be one further downturn in period rates to a trough in the region of 5%. Thereafter period rates will probably increase in the final third of the year, if as we predict, signs of economic recovery emerge.

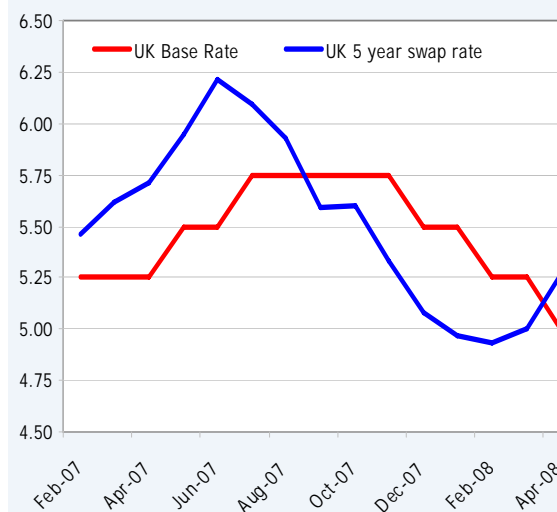
Equities

The equity market tone in April was slightly more positive. In the final week of April, the FTSE 100 traded around the levels of mid January, a period just before the full impact of the international credit crunch became apparent. During April, equity markets responded positively to the large scale central bank injection of liquidity and to the cut in UK base rate. Although economic and financial data in the coming weeks is likely to be somewhat negative, we are close to the low point of the economic cycle. The more positive tone in equity markets reflects the strength of the global economy, still above trend growth despite the downturn in the "western" economies. Whilst forecast growth rates for China and India have been revised down in recent weeks, the consensus forecast is in the region of 10% and 8% per annum respectively. World equity markets are also forward looking. The full benefit of liquidity injections and benchmark interest rate cuts will be felt over a long time frame. Base rate reductions take up to 18 months to work through the UK economy via a series of economic multipliers, as increased activity boosts personal sector and business confidence. The scale of recent events suggests that the underlying rate of equity market recovery will be gradual, with a number of temporary setbacks.

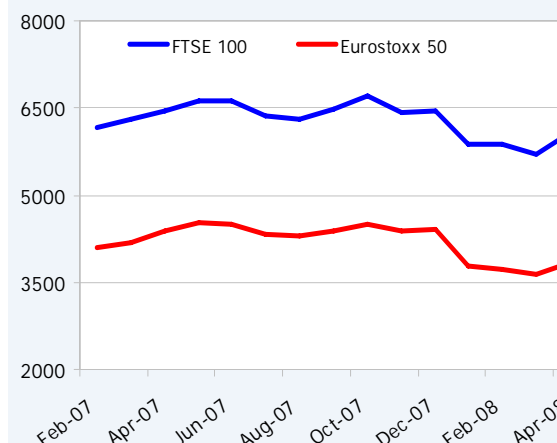
Foreign Exchange Rates v £



UK Base Rate & 5 year swap rate



FTSE 100 & Eurostoxx 50



Commodities

There has been a further significant rise in commodity prices. This reflects a combination of above trend growth in the global economy, disruptions to supply and an increased level of speculative activity. The price pressures are most clearly evident in the oil market. The price of Brent crude rose by 14% in April. World oil supply and demand is finely balanced in the region of 87 million barrels per day. This represents an effective shortfall of supply, allowing for factors such as condensation, refinery fuel and an imbalance between refinery output supply and demand – a surplus of heavy fuel and a shortfall of lighter oil products. Any disruption to supply can have a disproportionate impact on crude oil prices, as was the case with the disruption to the UK sector oil output, when Grangemouth facilities were temporarily closed by industrial action. In demand terms, the impact of the slowdown in western economies is more than matched by increased demand from the rapidly industrialised nations. The strength of commodity prices indicates that global growth is higher than official figures suggest. There is also a very tight balance between supply and demand in respect of food prices and certain metals.

Commercial Property Market

Commercial lending activity has slowed in the past month in response to the downturn in the UK economy and impact of the international credit crunch on funding costs. The impact has been felt both on shorter-term rates (LIBOR fixings), still at an exceptionally high level in relation to base rate, and longer rates which increased significantly in April. The large scale injection of money liquidity should in due course reduce the pressure on shorter rates, especially if as we predict the MPC reduces base rate to 4.75% this month or next. Period rates may well ease in the coming weeks, given the slowdown in the economy. We expect commercial lending activity to pick up in the second half of the year, ahead of a likely recovery in the UK economy. We predict that UK economic growth will rise to 2.5% next year, broadly in line the long term average growth rate of the UK economy (2.4% per annum). The commercial lending environment next year is likely to be one where specific areas and sectors perform well in response to the probable upturn in the economy.

Housing Market

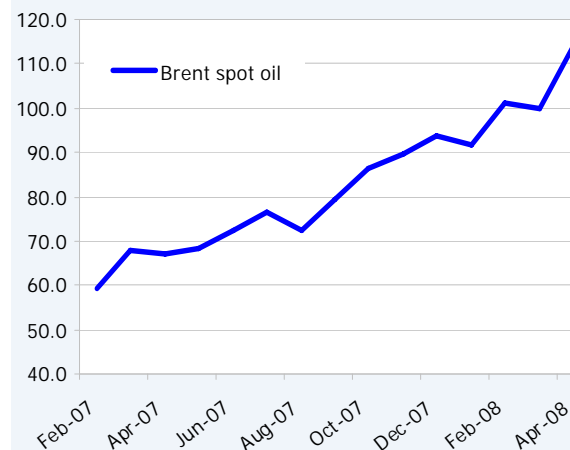
The housing market is in downturn mode. The leading house price indexes are now in negative territory, notably the Halifax index at minus 0.9% year on year. Gross approvals fell in March by over £2 billion to £24 billion, with net advances down £0.3 billion to £6.9 billion. The low point in the housing market is expected to occur in the early summer months, with average house price inflation in the region of minus 3% - minus 5% and net advances close to £6 billion. Thereafter we expect a very gradual recovery to a fourth quarter with average house price level close to zero and net advances for the year totalling circa £85 billion. The principal challenge facing the housing market at present is shortage of cost effective funds. As liquidity gradually improves, this should benefit both the availability and cost of mortgage finance. There are signs that the Bank of England's liquidity injection is starting to impact beneficially on the cost of short term finance. A modest fall in swap rates is expected in the coming weeks, but the most significant development is likely to be a gradual increase in the supply of loanable funds. Next year, we predict a very measured recovery in the housing market with average house prices rising by 2% per annum and net lending increasing to £95 billion.

Key Monthly Data

(all statistics are yoy apart from UK Trade Balance which relates to monthly data)

Date	Data	Previous Level	Forecast
07-May	Industrial Production	1.3% Feb-08	0.8% Mar-08
07-May	Manufacturing Production	1.9% Feb-08	1.3% Mar-08
08-May	BOE Base Rate Decision	5.00% Apr-08	5.00% May-08
13-May	Consumer Price Inflation (CPI)	2.5% Mar-08	2.6% Apr-08
13-May	Retail Price Inflation (RPI)	3.8% Mar-08	3.9% Apr-08
14-May	Average Earnings	3.8% Feb-08	3.7% Mar-08
14-May	Unemployment Rate	5.2% Feb-08	5.3% Mar-08
21-May	MPC Minutes	Apr-08	May-08
22-May	Retail Sales	4.6% Mar-08	3.8% Apr-08
23-May	UK Gross Domestic Product (GDP)	2.5% 1Q 08 (adv)	2.5% 1Q 08

Brent Oil



Contact Us

Head of Business Development **Duncan Wilson**
Tel: 020 7560 8612
Mob: 078 1217 3633

London **Sandra Perry**
Tel: 020 7634 3444
Mob: 077 1114 9631

Guy Huntrods
Tel: 020 7560 8616
Mob: 077 2546 1338

South **Richard Hale**
Tel: 0118 952 0188
Mob: 0791 354 4999

Scotland **Scott Cowan**
Tel: 0131 247 6683
Mob: 0776 890 2675

Northern Ireland **Henry Cleary**
Tel: 0289 043 3281
Mob: 0771 213 7126

Further Information: www.boigm.co.uk

Incorporated in Ireland with limited liability. Authorised by the Financial Regulator in Ireland and by the Financial Services Authority; regulated by the Financial Services Authority for the conduct of UK business.

This document is for information purposes only and does not constitute an invitation, offer, advice, recommendation or solicitation by the Bank of Ireland to buy or trade any securities, currencies or financial instruments. Bank of Ireland does not warrant the accuracy of the information and accepts no responsibility whatsoever for any loss or damage caused by any act or omission taken as a result of the information contained in this document. This document is property of Bank of Ireland Global Markets UK (GMUK). The content may not be reproduced, either in whole or in part, without the express written consent of a suitably authorised member of GMUK staff.

If you wish to unsubscribe from this service, please email: treasurysalesuk@boigm.com

Laurence Sanders
Economist
Bank of Ireland Global Markets
Tel: 0117 943 2217