



UKView

A monthly analysis of UK markets

UK economy has entered recovery territory

Treasury Manager: Laurence Sanders

There is clear evidence that the level of UK economic activity expanded in the fourth quarter, albeit from a low base. Monthly gross domestic product estimates compiled by the National Institute for Social and Economic Research indicate that UK gross domestic product (GDP) entered recovery territory in September. A key driver of economic recovery will be stock rebuilding – third quarter GDP data indicated that a significant reduction in stocks was one of the principal factors behind the decline in UK growth in Q3. Office of National Statistics data suggests that UK economic growth (GDP) probably reached a trough in third quarter 2009 at 100.9 (2005=100), representing a 6.0% decline from peak to trough - the largest decline since compatible GDP data was first compiled in the 1950's. The term "UK economic recovery" must therefore be placed into context. It will take many quarters for UK growth to return to the level of 1Q 08.

Export demand is likely to be a major driver of UK economic recovery in 2010. The IMF predicts that world economic growth will be 3.1% this year, versus a forecast figure of minus 1.1% in 2009. The other key drivers of UK recovery will be stock rebuilding and the housing market. To some extent, these factors will be offset by fiscal tightening. We anticipate that the annual rate of UK growth in 2010 will be in the region of 1¼%, returning to trend level of 2¾% in 2011, as global economic recovery gathers momentum. One of the most positive factors in the UK economic scenario is the flexibility of labour markets. The rise in unemployment has been well below consensus forecast. In the three months to October, the unemployment rate was unchanged at 7.9%, as was the participation rate at 72.5%. Average earnings have taken the strain. Excluding bonus, the annual rate of growth of earnings, was 1.7% in the three months to October. Upward pressure on average earnings in 2010 and 2011 will be limited by the Chancellor's Pre Budget Report statement that public sector pay increases will be capped at 1% per annum in the next two fiscal years. Retail sales growth in 2010 and 2011 will therefore be increasingly dependent on foreign tourist income, boosted by the competitive level of the pound versus the euro - and by housing market related purchases, boosted by the probable increase in the supply of mortgage finance.

Data and Forecasts

Data	30-Nov	31-Dec	Change	Year End view
£ wtd index	79.4	80.5	1.4%	83.0
US dollar	1.6397	1.6102	-1.8%	1.55
Euro	1.0941	1.1096	1.4%	1.13
Yen	141.52	148.03	4.6%	155
Base Rate	0.50	0.50		1.50
5 year swap rate	3.02	3.39	0.37	4.00
FTSE 100	5191	5413	4.3%	6000
S & P 500	1096	1115	1.7%	1250
Eurostoxx 50	2797	2965	6.0%	3250
Nikkei 225	9346	10546	12.8%	11500
Crude Oil (\$/ bl)	68.00	78.80	15.9%	\$87/ bl

Foreign Exchange Market

Page 2

Sterling upside limited by public sector deficit and political risk factor

Interest Rates

Page 2

The future trend in period rates is likely to be upward

Equities

Page 2

Global equity markets sustain momentum

Commodities

Page 2

Commodity price increases in 2010 constrained by stockbuilding in 2H'09

Commercial Lending

Page 3

Signs of recovery in sectors of the commercial property market

The Housing Market

Page 3

Level of mortgage lending on gradually rising trend

Contacts

Head of Business Development:

Duncan Wilson Tel: 020 7560 8612 Mob: 0781 217 3633

Corporate, BCB Midlands and North:

Guy Huntrods Tel: 020 7560 8616 Mob: 0772 546 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: 028 9043 3281 Mob: 0771 213 7126

Head of London Treasury Sales:

Sandra Perry Tel: 020 7634 3444 Mob: 0771 114 9631

Foreign Exchange Market

Sterling upside limited by public sector deficit and political risk factor

Sterling has briefly stabilised in a range, whose central point is circa 80 on the trade weighted index. The principal drivers of foreign exchanges markets are interest rate differentials, economic growth differentials and the balance of payments -both capital and current accounts. In addition, the path of sterling in 2010 will be impacted by the two specific factors. The more immediate factor is the scale of the public sector deficit, which, in the coming financial year, will total £176 billion - equivalent to 12% of GDP, based on the HM Treasury economic growth forecast of 2% in fiscal year 2010/11. Total public sector debt, as a % of GDP, is projected to rise to 78% by fiscal year 2014-15. This figure has led to a questioning of the UK's AAA status. Whilst we perceive that any UK government will take the requisite action to avoid a downgrade, the mere possibility of a change in the UK's credit status will limit sterling's upside in 2010. In addition, a UK general election will take place no later than June 2010. The inevitable fluctuations in opinion polls will, from time to time, place pressure on sterling if the polls indicate a hung Parliament, with the consequent uncertainty over the direction of government economic policy. Should the Conservative party extend their lead in the opinion polls, this would boost sterling given that a Conservative administration would take further action to reduce the public sector deficit. Near term, the underlying trend in sterling is likely to remain neutral given the current similarity in the path of the economic cycle in the eurozone, US and UK, and the probability that G7 benchmark interest rates will remain on hold throughout first quarter 2010.

Interest Rates

The future trend in period rates is likely to be upward

The underlying trend in period rates is likely to be upward given increasing signs of global economic recovery. In addition, MPC Minutes showed a 9-0 vote in favour of an unchanged asset purchase programme. This was interpreted by financial markets as a sign that there was unlikely to be a further expansion of the quantitative easing policy. However, we do not rule out further asset purchases in February should the decline in retail sales following the January 1st VAT increase, raise the prospect of negative GDP in quarter one. Any such move would be a confidence building measure given that UK growth is likely to be in positive territory in quarter 2, in response to the impact of the upturn in the global economy on UK export demand. UK bank rate is almost certain to remain on hold in first half 2010. Thereafter the path of the UK benchmark interest rate will be determined partly by the path of other G7 target interest rates. At present the futures market view is that UK bank rate will rise to 1% in August and to 1.5% in November – the months co-incide with publication of the Bank of England Quarterly Inflation Reports. In the past the Bank of England Governor has indicated that the first upward move in bank rate will occur around publication date of a Quarterly Inflation Report, which will explain the rationale for the change in monetary policy stance.

Equities

Global equity markets sustain momentum

The underlying path of equity markets in second half 2009 was one of gradual upturn, a trend which looks set to continue in first half 2010. FTSE 100 ended 2009 at 5413, close to the high of the year (5445). A similar pattern was evident on other leading indexes, notably the US Standard & Poor's 500 and the eurozone Eurostoxx 50. There is a strong correlation between the leading European and North American indexes reflecting the extensive cross border activities of the largest corporates. The strongest equity market performers in 2H09 included indexes in the rapidly developing countries. This factor is expected to be more pronounced in 2010, given the widening gap in economic growth rates. The IMF, in its October review, predicted that the "emerging and developing economies" will increase their average annual growth rate from 1.7% in 2009 to 5.1% in 2010 – versus a forecast growth rate of 1.3% for the advanced economies (we expect both numbers to be revised up in the April IMF review). Economic growth rates will also vary significantly between the advanced economies. The strength of the Australian economy is reflected in the monetary tightening policy of the Australian Reserve Bank, the first advanced economy central bank to sanction benchmark rate increases. The Canadian economy is also expected to outperform the average western economy. By contrast, economic growth is expected to be subdued in Japan, in part reflecting the increased outsourcing of production to lower labour cost south-east Asia countries, which should benefit the expanding Japanese corporations.

Commodities

Commodity price increases in 2010 constrained by stockbuilding in 2H'09

The underlying trend in metal prices in first half 2010 is likely to be a gradual upward trend, reflecting the path of the world economy. Crude oil prices will be, in large part be determined by OPEC, whose members include key marginal producers who have the capacity to expand production if required. Current OPEC policy appears to be maintenance of oil prices in the region of \$70 -80/ barrel in respect of benchmark oil prices. The current Brent 1 month crude oil price reflects the period of peak seasonal demand in the northern hemisphere, hence the recent movement of the Brent 1 month crude oil price to just above the top quartile of the trading range. In 2010, the International Energy Agency forecasts that crude oil demand will increase by 3%, a level that is within the range of existing oil production capacity - in the absence of major disruptions to supply. We therefore anticipate that Brent crude will remain in the region of \$70-80/ barrel for much of 2010 - rising to a peak of circa \$90/ barrel in the event of any major disruption to supply. Metal prices continue to be driven by Asian demand, although given the high level of stockpiling in China, upside pressure on the principal metal prices appears limited in the absence of major disruptions to supply, which in the case of metals, tend to be related to industrial relations disputes. There could be pressure on forward metal prices later in the year given the lack of investment in refining capacity during the global economic downturn, and the increasing marginal cost of new production facilities.

Commercial Lending

Signs of recovery in sectors of the commercial property market

Both the commercial and residential markets are currently being boosted by investment demand, driven by currency considerations. The pound's depreciation against the euro over the past 2 years has reached a level whereby foreign investors view sterling properties in terms of both capital and currency appreciation. Domestic demand for property is more subdued, especially in the retail sector. UK economic recovery is unlikely to be consumer driven, given the negative impact on personal disposable income of the slow rate of growth of average earnings (both excluding and including bonuses) and the prospect of substantial fiscal tightening that will encompass both personal tax increases and public sector labour force rationalisation. The outlook for modern factory property is more positive. The latest PMI manufacturing survey (December) showed a 4 point rise in the new orders component to 57.4, the highest level since July 2007 - in the era immediately prior to the era of financial turbulence. The strength of the PMI manufacturing index is compatible with anecdotal evidence of increasing manufacturing sector relocation to the UK, in response to the competitive level of sterling and a narrowing of the differential in labour costs between the UK and the rapidly industrialised nations. There is also a stronger degree of momentum in the office sector. The financial services sector, in terms of business volumes, has weathered the economic downturn better than expected, as evidenced by the resilience of UK invisible exports of financial services.

The Housing Market

Level of mortgage lending on gradually rising trend

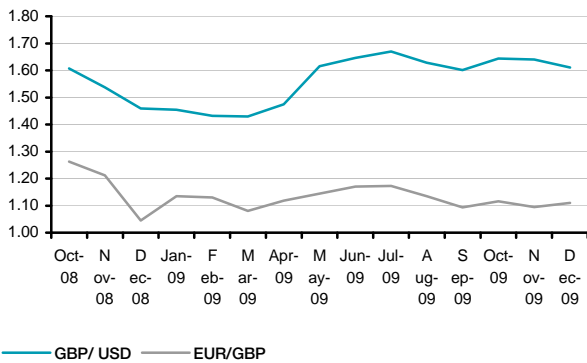
The housing market overall is in recovery mode, as evidenced by transaction, house price and mortgage lending data. The key driver of the housing market is cash transactions, notably investment business driven by: the low level of sterling versus the euro, historically low bank rate and period rates and the prospect of economic recovery in 2010 and 2011. Mortgage housing business is expanding at a gradual rate. The number of net mortgage advances has fallen from a low point of circa £600 million per month in the second quarter to an average of £1,200 million per month in the three months to November. The increase in the number and volume of mortgage approvals in November indicates that the upward momentum will be maintained. If the current gradual increase in mortgage lending is sustained, we anticipate that net lending will return to a sustainable normality of £2bn per month in mid 2011. The average rate of house price increases has already reached sustainable territory. Recent increases in both the Nationwide and Halifax price increases suggest that the underlying rate of average house price growth is in the region of 6% per annum. There are wide regional variations. In part, house price inflation is driven by migration, both external and internal. Recent Office of National Statistics (ONS) data showed the extent of internal migration to south east and south west England. The ONS predicts that eastern England (including the east Midlands) will be the fastest growing region in population terms during the next 5 years.

Monthly calendar and key charts (changes on the month)

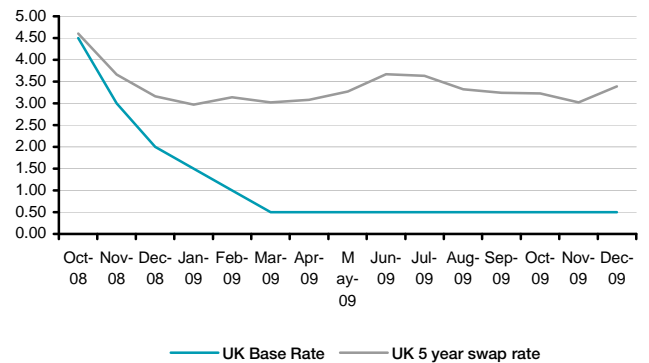
Key data releases for January

Date	Data	Previous	Period	Forecast
20-Jan	MPC Minutes		Jan-10	
20-Jan	Unemployment	7.9%	Nov-09	7.8%
20-Jan	Ave Earnings ex bonus	1.7%	Nov-09	1.6%
21-Jan	CBI Industrial Trends Survey			
21-Jan	Public Sector Net Borrowing	minus £20.3bn	Dec-09	minus £16bn
26-Jan	UK growth (GDP)	minus 0.2% qoq	3Q 09	minus 0.1% qoq

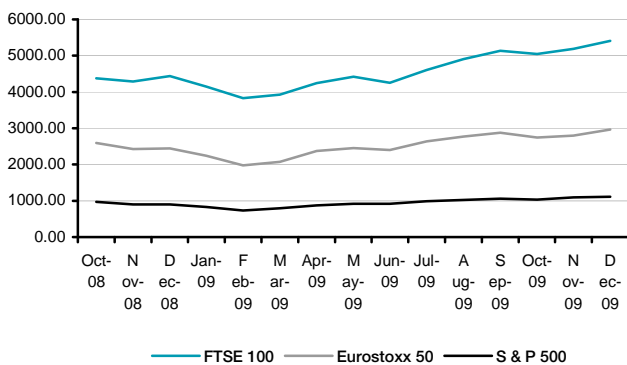
Foreign Exchange Rates vs GBP



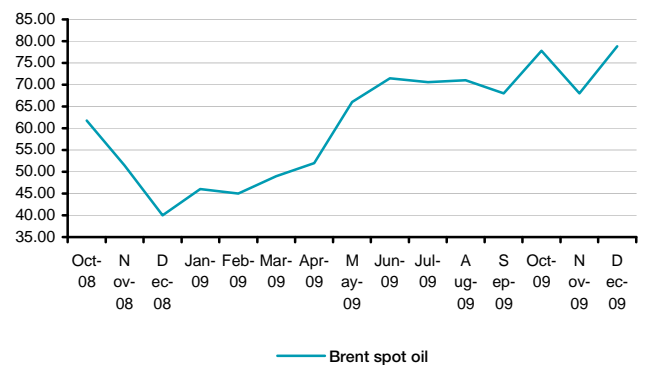
UK Base Rate and 5 Year Swap Rate



World Equity Indices



Brent Sport Oil



Market data supplied by Reuters

Disclaimer

Produced by the Economic Research Unit at Bank of Ireland Global Markets ("GM"). Bank of Ireland incorporated in Ireland with limited liability. Bank of Ireland is regulated by the Financial Regulator. In the UK, Bank of Ireland is authorised by the Irish Financial Regulator 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 19 January 2010. 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.