

AIB GLOBAL TREASURY SERVICES

Topic of the Day

NO ESCAPING RISING COST OF LIVING

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No Escaping Rising Cost of Living

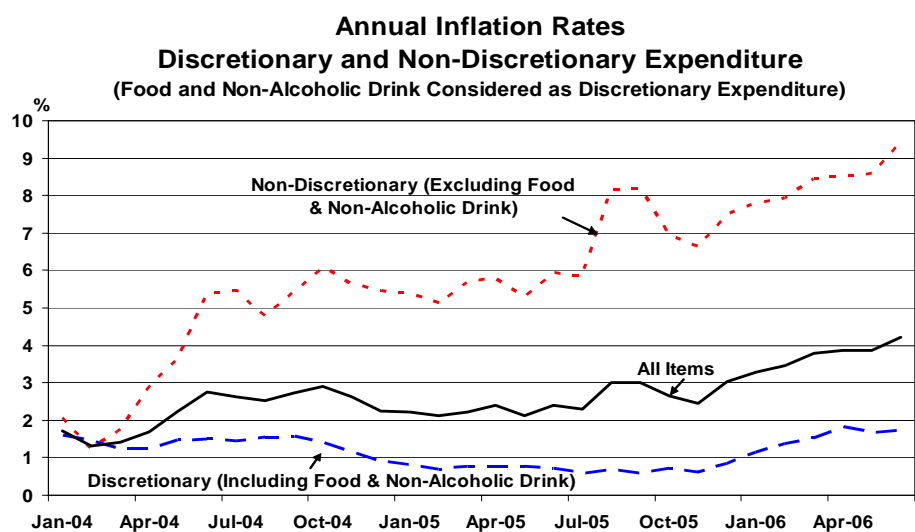
Inflation Approaching 10% on Non-Discretionary Consumer Expenditure

The annual rate of headline inflation in Ireland increased to 4.2% in July from 2.5% at the end of last year and from under 2% at the start of 2004. Increases in fuel prices and housing costs (due to higher mortgage payments) are putting upward pressure on inflation. In addition, there have been significant increases in some service sector costs. In general, prices have been rising much faster in the non-discretionary areas of consumer spending where there is little escape for consumers in terms of either the ability to avoid expenditure or to substitute for lower cost products.

We have redistributed the CPI into two baskets of discretionary and non-discretionary items with food lying somewhere between the two. **The annual inflation rate for non-discretionary expenditure was 9.4% in July**, if food items are excluded. Though food is a necessity, there is significant scope for product substitution in this sector. Even if food and non-alcoholic drink are included, the inflation rate for non-discretionary expenditure was 7.4%.

The annual inflation rate on our basket on non-discretionary items was below 2% at the start on 2004, very similar to the annual rate for discretionary items and for the all items headline inflation rate.

The subsequent acceleration in the headline rate to 4.2% in July 2006, reflects the strongly rising prices for non-discretionary items. In contrast, there has been virtually no change in the inflation rate for discretionary expenditure (which stood at 1.7% or 1.8% in July, depending whether food & non-alcoholic beverages are included).



Looking forward, rising mortgage costs are likely to continue pressurising non-discretionary expenditure, though the impact of higher energy prices may moderate if oil prices stabilise.

Thus, largely as a result of continuing strong price rises for non-discretionary items, we are looking for the headline inflation rate to continue higher over the balance of the year to close to 5% in Q4.

The non-discretionary items included in our basket include housing, transport (excluding purchases), health, education and childcare costs (see table below).

Meanwhile, clothing and footwear, household goods, recreation and restaurant and hotel expenditure, purchase of transport equipment, personal goods and care along with some services are considered as discretionary expenditure. This is on the basis that purchase can be avoided altogether, significantly delayed or substituted for a lower cost product if it is felt that costs have risen too far or that general pressures on incomes mean that expenditure as a whole has to be curtailed.

Expenditure on food and non-alcoholic beverages lies somewhere between the two. Food, in particular, is a basic necessity. However, there is considerable scope for product substitution if prices on certain items rise too fast or if there is overall pressure on household expenditure. sector.

Thus in calculating the inflation rates for the two baskets of goods (discretionary and non-discretionary items) we have both included and excluded the food and non-alcoholic drink.

ANNUAL INFLATION RATES	
July 2006 YoY %	
Non-Discretionary Items	
Housing, Water, Electricity Gas and Other Fuels	16.5
Health	4.3
Transport (Ex purchases)	7.2
Communications	-0.4
Education	5.0
Childcare & Nursing Homes	4.0
Insurance	2.0
Food & Non-Alcoholic Beverages	1.5
Discretionary Items	
Alcoholic Beverages	0.5
Clothing & Footwear	-2.6
Furnishings, Household Equipment and Routine Household Maintenance	-1.2
Transport - Purchases	1.1
Personal Care	1.0
Personal Goods	-1.5
Other Services (Not already included)	2.2
CPI - All Items	4.2
Non-Discretionary Items (Inc. Food & Non-Alcoholic Beverages)	7.2
Non-Discretionary Items (Ex. Food & Non-Alcoholic Beverages)	9.4
Discretionary Items (Inc. Food & Non-Alcoholic Beverages)	1.7
Discretionary Items (EX. Food & Non-Alcoholic beverages)	1.8

Undoubtedly, within the broad groupings we have taken there are items that could more properly fit within the opposing basket. However, these calculations give some idea of the strong price pressures that are being faced in terms of non-discretionary expenditure from which there is no escape.

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