ECONOMIC TRENDS

IBEC

APRIL 2008

New Minister for Finance must keep firm hand on current expenditure

Overall, revenue receipts in 2008 are going to be well below forecast and the exchequer deficit will be larger than that expected on Budget Day. The real challenge for the new Minister for Finance will be to ensure that current expenditure does not exceed budgets.

Despite the headline shortfall in the exchequer returns in the first quarter of the year, there are positives to be taken from the performance of a number of tax heads in what has been a challenging few months for the economy. An exchequer deficit of €354 million was recorded in the January to March period, with total tax revenue €600 million below the Department of Finance forecast. The main culprit has been capital gains tax (CGT). Although this is a relatively small tax head – accounting for less than 10% of total tax revenue – the shortfall of 40% in the year to date has been a major drag on revenues. The payment deadlines for CGT are February and October and it is unlikely therefore that the February weakness can be recovered before the end of the year. The weakening property market and collapse in share prices are the obvious causes for this revenue collapse.

The other main weakness in the exchequer finances has been VAT receipts. This is the largest tax head, accounting for about 40% of total revenue. In the first quarter of this year, total VAT receipts were flat on the same period last year but were €250 million below the Department's forecast. Core retail sales have probably slowed a little but would still have grown by about 4% in the first quarter. The main weakness for VAT receipts has most likely occurred in relation to the sale of new houses and probably cars. Unfortunately the outlook for housing for this year and next is weaker than the Department would have thought on Budget Day so VAT receipts are likely to remain under pressure for some time yet.

The main positive in the exchequer returns so far this year has been the performance of taxes on income – both personal and corporate. Combined they yielded €75 million more than expected, with income tax revenues up 5.1% on last year's level. This is somewhat surprising given that the labour market has been much weaker in recent months than would have been expected. The number on the Live Register increased by 16% in the quarter but encouragingly this has not yet resulted in lower income tax receipts.

Manufacturing output

Annual % change

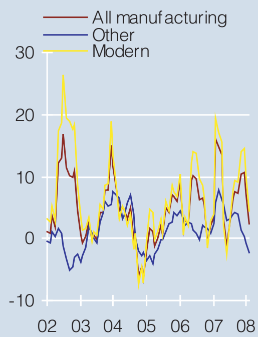

Figure 1

Industrial output

Data on manufacturing output for the first two months of the year record a marked slowdown in industrial sector activity compared with 2007. Manufacturing output figures for the month of February recorded an annual increase of only 1%, compared with 2.3% in January and 10.8% in the last quarter of 2007. On a seasonally adjusted basis, output fell month-on-month by 0.8% following a January fall of 1.2%. Total manufacturing output growth in the first two months of 2008 slowed to an annual 1.6%. This slowdown clearly reflects the deceleration in global demand and the pressure on competitiveness resulting from the continued strength of the euro against the dollar and sterling. In particular, the sharp fall in the value of sterling is especially damaging to the traditional sectors. The timing of theses adverse trading developments is unfortunate as the performance of the manufacturing sector had staged a comeback in 2007 and growth had outpaced any recorded since 2002. With construction activity slowing down in 2007, the resurgence of

Industrial output

Annual % change
Jan - Feb 08

Food & beverages	-5.6
Textiles/clothing	-2.5
Leather products	+79.3
Wood products	-20.2
Pulp and paper	-0.9
Publish/print/ record media	-6.6
Chemicals	+5.7
Rubber & plastics	-5.1
Other non metallic	-7.1
Metals/metal products	+1.2
Machinery & equipment	-6.7
Electrical/optical	+5.4
Office mach/computer	+5.9
Transport equipment	-0.1
Unclassified	+0.5
All manufacturing	+1.6

Table 1

Order books

Survey balance – 3mma

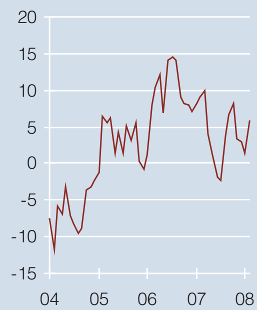

Figure 2

IN THIS ISSUE:
- Manufacturing output up 1.6% in first two months;
- Live Register increases by 12,000 in March;
- Inflation reaches 5% in March;
- Retail sales up 3.1% in January;
- Euro hits £0.80 mid-April.

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the industrial sector was playing an important part in the rebalancing of the economy away from over-reliance on domestic demand to a higher contribution from the traded sectors.

Output growth of the modern sector was a solid 8.7% in 2007 and revised figures show that the traditional sector output increased by 3.7%, which was the fastest growth since 2000. However, despite the very strong growth of 14.5% in the modern sector in the final quarter of 2007, signs of slowing growth were emerging in December as annual growth slowed to 6.1% and final quarter seasonally adjusted figures recorded a sharp quarterly deceleration from 7.1% in the third quarter to 2.8% in the fourth quarter. In the first two months of 2008, output in the modern sector recorded a modest annual growth of 3.6%. The total chemicals sector grew by an annual 5.7% in the first two months, with pharmaceuticals maintaining a very rapid growth of 28.5%, while basic chemicals output declined by 1.6%. Electrical and optical equipment output grew by 5.4% with the strongest sub-sector, medical, precision and optical equipment, growing by 9.9% and computers by 5.9%. Recorded media output fell by 8%. Output in the traditional sector declined by 3.2%, with output of food recording only a 0.4% increase, and beverages a decline of 23.7%. Wood output, affected by the construction slowdown declined by 20.2%.

IBEC/ESRI monthly industrial survey

Average balance for 3 months ending

	Manufact. Jan	Manufact. Feb	Consumer Jan	Consumer Feb	Capital Jan	Capital Feb	Intermed. Jan	Intermed. Feb
Production expectations	-2	+5	+1	+8	+3	+9	-16	-11
Order books	+1	+6	+16	+19	-10	-7	-26	-17
Domestic sales expectations	-9	-10	-10	-10	-3	-2	-16	-18
Export expectations	+10	+12	+18	+17	+10	+13	-10	-5
Employment expectations	-8	-1	-2	+5	-2	+8	-27	-29
Capacity utilisation	+76	+77	+72	+74	+84	+83	+77	+78
Selling prices	+11	+10	+7	+6	-3	-3	+32	+29

Table 2

Production expectations

Survey balance – 3mma

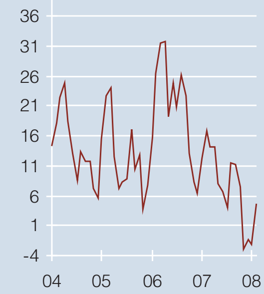

Figure 3

Labour market

The data in the most recent Quarterly National Household Survey from the Central Statistics Office, discussed in last month's *Economic Trends*, refer to the period September-November 2007. The Live Register and the FÁS/ESRI vacancies report are more timely indicators of the state of the labour market. Both reinforce the decelerating trend that was evident in the QNHS. The seasonally adjusted Live Register jumped by 12,000 in March, to a total of 199,900. This compares with an increase of 8,500 in February and is the largest monthly increase on record. While we expect the absolute changes in Live Register figures to increase in magnitude as the labour force grows, the 27% annual increase in March was exceptional even in relative terms. The last similar annual percentage increase occurred in 1983; moreover, on a quarterly basis, the percentage increase was the greatest since January 1975.

Employment

Sector	Sept - Nov 06	Sept - Nov 07	% change
Agriculture	115.0	118.9	+3.4
Production industries	296.5	292.5	-1.3
Construction	283.3	277.8	-1.9
Wholesale/retail	288.5	312.3	+8.2
Hotels/restaurants	125.2	133.7	+6.8
Transport/storage/communications	117.1	121.3	+3.6
Financial/other business services	277.3	298.3	+7.6
Public administration	103.0	105.5	+2.4
Education	137.0	138.1	+0.8
Health	211.2	221.8	+5.0
Other services	120.5	122.0	+1.2
Total	2073.1	2140.9	+3.3

Table 3

Average weekly earnings

Sector	Period	Annual % change
Business services	Sept 07	4.4
Distribution	Sept 07	3.9
Public sector (excl. health)	Sept 07	4.0
Industry	June 07	4.9
Banking and insurance	June 07	6.9
Construction	Sept 07	7.2

Table 4

Up until last month, most of the rise in claimants could be explained by housebuilders being made redundant. That may no longer be the case. The March increase was split evenly between males and females, while between December and February, males accounted for 82% of the rise in claimants. This is clearly an indication that the contraction in the construction sector is having an impact on related businesses across the economy. The pace of job losses for males in March was similar to that recorded over the previous two months but job losses for females have surged from just 3,000 over the previous 12 months to 6,000 in the month of March alone. Since the March redundancy figures did not indicate a slowdown of the labour market of this kind, it is likely that those most affected to date are self-employed, part-time and temporary workers.

Unemployment

% of Labour force

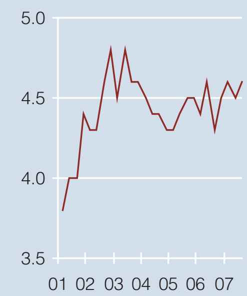

Figure 4

The FÁS/ESRI vacancies report for February 2008 also indicates that the labour market is cooling. The percentage of firms reporting vacancies fell by four percentage points, to 10%. The vacancy rate in February last year was 12%.

Inflation

There was a disappointing acceleration in inflation in March to 5%. Inflation started the year at 4.3% but rose in February to 4.8%. This was higher than the consensus forecast of 4.7%. Average inflation in the first quarter averaged 4.7%. The EU Harmonised Index, which omits interest rates, some insurance products and some building products, rose from 3.1% in January to 3.5% in February and 3.7% in March. The preliminary flash estimate for March inflation in the euro area was 3.5%. The gap between Irish inflation and euro area inflation has closed from 1% in March 2007 to 0.2% in March 2008. It is imperative for competitiveness reasons that Irish inflation is not higher than euro area inflation and therefore a closing of the gap is welcome. It is little comfort from an inflation management perspective that the gap has been closed because of an acceleration in euro area inflation. It does, however, demonstrates that Ireland is not and cannot be immune from international price pressures, which are generally manifested in goods sector inflation.

There is a significant feature of recent trends in Irish inflation which is worthy of comment. Irish harmonised inflation was 2.7% in 2006 and 2.8% in 2007 and in the first quarter of 2008 has accelerated to 3.4%. In 2006, goods sector inflation was a modest 1.1% while service sector inflation was 3.5%. In 2007, goods sector inflation decelerated slightly to 1% while service sector inflation accelerated sharply to 4.8%. In the first quarter of 2008, goods sector inflation accelerated sharply to 3.8% while service sector inflation decelerated to 3.1%. Indeed service sector inflation peaked in March 2007 at 5.6% decelerating throughout the year to 3% in December. This suggests that domestically generated inflation was gradually becoming more contained throughout 2007. The recent surge in inflation in 2008 primarily reflects the surge in global goods inflation particularly that of food commodities and energy. Food inflation in March was 9.3% and the price of petrol and diesel increased by an annual 12.3% and 17.3% respectively.

Consumer prices (CPI)

Annual % change

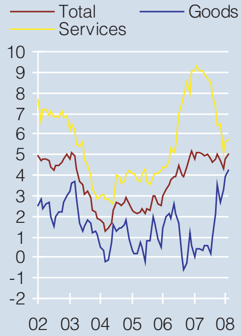

Figure 5

Output prices

Annual % change

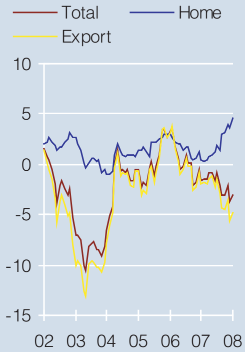

Figure 6

CPI commodity groups

Annual % change – Mar 2008

Food/beverages	+9.3
Alcohol/tobacco	+3.9
Clothing/footwear	-3.6
Housing & energy	+12.3
Furnishings, house equip.	-1.3
Health	+5.7
Transport	+5.6
Communications	+1.0
Recreation	+1.2
Education	+5.9
Catering	+3.2
Miscellaneous	+1.9
All items	+5.0

Table 5

EU harmonised price index

Annual % change – Feb 2008

Belgium	+3.6
Germany	+2.9
Greece	+4.5
Spain	+4.4
France	+3.2
Ireland	+3.5
Italy	+3.1
Luxembourg	+4.2
Netherlands	+2.0
Austria	+3.1
Portugal	+2.9
Finland	+3.3
Denmark	+3.3
Sweden	+2.9
United Kingdom	+2.5
Euro-zone	+3.3
EU27	+3.4

Table 6

External trade

The Quarterly National Accounts, released by the CSO, show that exports of goods and services grew by 8.2% in 2007. The aggregate, however, hides differing performances between the goods and services sectors. Goods exports in 2007 grew by 4%, while services exports increased by 15%. This highlights the relative strength of the services sector, more so than a weakness in the goods sector; in fact, goods exports grew at the fastest pace for some years. This is a solid performance in the context of a slowing world economy and the strong euro exchange rate against sterling and dollar. Imports grew by 6.4% in 2007. The strong euro should help moderate the impact of rising global commodity prices. Detailed data on goods exports show that organic chemicals grew by 14% in 2007, but pharmaceuticals exports increased by only 2.5%. The value of exports in office machines and data processing equipment; electrical machinery; and professional and scientific apparatus all declined slightly in 2007. Food and beverages exports were stronger, however, growing by 4.8% and 5.6%, respectively.

Trade

Annual % value change: Jan - Dec 2007/2006

	Imports	Exports
Food	+11.5	+4.8
Beverages and tobacco	+12.6	+5.7
Crude materials	+2.4	+1.5
Mineral fuels	+3.7	+22.9
Chemicals	+2.7	+7.5
Manufactured goods	+8.5	+5.4
Machinery & transport equipment	-2.2	-6.2
Miscellaneous manufactured articles	+1.4	-2.6
Total	+2.2	+2.1

Table 7

Trade

% vol. change – 3mma

Figure 7

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Retail sales

Latest retail sales data record that annual sales growth slowed to a modest at 3.1% in January 2008, though excluding motor trades the growth was a more buoyant 4.8%. Motor trade sales, furniture and lighting, electrical goods and hardware, glass and paint were all weak with growth rates ranging from -1% to under 2%. Department store and clothing and footwear sales were the only strongly upbeat sectors. Car sales up only 0.7% may have been affected by the change in taxation to favour more energy efficient vehicles to be introduced in the second half of the year. Revised retail sales data record that total sales grew by 6.4% in 2007. Sales were very strong in the first half of the year growing by an annual 7.4%; in the third quarter, growth slowed a little to 6.5% and further in the final quarter to 4.5%. Excluding motor trades, first half year annual growth of 6.9% slowed to 6.5% in the third quarter and 5.7% in the final quarter.

Retail sales

% vol. change – 3mma

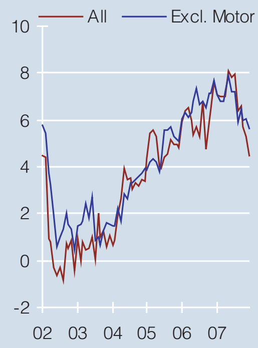
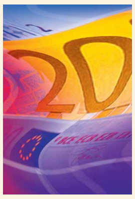


Figure 8

Retail sales

Annual % change: Jan 08	
Motor trades	+0.7
Non-specialised stores	+4.6
Department stores	+10.5
Food/beverages/tobacco	+1.4
Pharmacies	+4.4
Textiles and clothing	+7.4
Footwear and leather	+9.2
Furniture and lighting	-1.1
Electrical goods	+1.5
Hardware	+1.9
Books/news/ stationery	-0.4
Other retail	+4.0
Bars	-5.0
Excl. motor trades	+4.8
All businesses	+3.1

Table 8



Financial

The response from the central banks to the financial crisis has continued to follow a familiar pattern. The US Federal Reserve cut interest rates by 75 basis points to 2.25% on 18 March. The next scheduled meeting is at the end of April, when further cuts are expected. The Bank of England cut rates by a more modest 25 basis points on 10 April, to 5%. On the same day, the European Central Bank held the interest rate at 4% for the tenth consecutive month.

Exchange rates – monthly averages

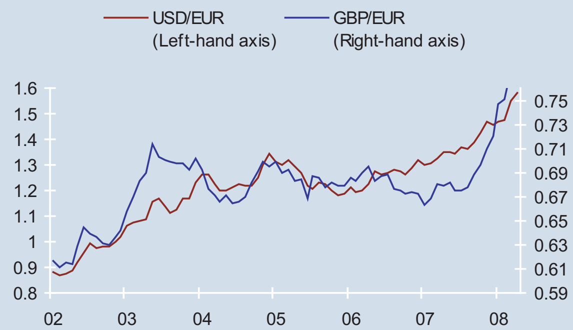


Figure 9

Despite his hawkish tone over inflationary pressures in the euro area, ECB President Jean-Claude Trichet admitted concern about the recent 'excessive' exchange rate movements of the euro against sterling and the dollar. The euro has continued to strengthen against both the dollar and sterling. The pound broke through the £0.80 barrier on 10 April. The dollar at $1.58 looks increasingly likely to reach $1.60 in the near future. This, coupled with a gradual slowdown in growth, is likely to force the ECB to cut rates later in the year.

Domestic credit

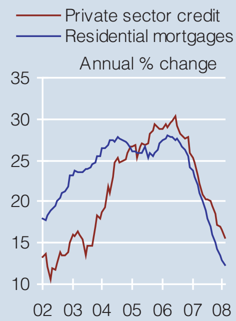


Figure 10

Economic indicators – Ireland

Annual % change

	2005	2006	2007	2008	2009
GDP	5.9	5.7	4.9	3.5	3.8
GNI	5.7	7.0	4.4	2.8	3.8
Personal consumption	7.3	5.7	6.6	3.4	3.7
Public consumption	4.0	5.3	5.0	3.5	3.0
Gross Fixed Capital Formation	11.8	3.1	0.6	-0.5	2.6
Final demand	6.5	5.1	5.3	4	4.6
Compensation per employee	5.0	4.5	5.2	4	4.0

(Source: European Commission Forecast, Autumn 2007)

Economic indicators – Ireland

Annual % change

	2005	2006	2007	2008	2009
Employment	4.7	4.3	3.3	1.3	1.5
Unemployment (%)	4.3	4.4	4.5	5.3	5.5
Consumer prices (HICP)	2.2	2.7	2.8	2.2	2.0
General gov't balance (% GDP)	1.2	2.9	0.9	-0.2	-0.6
Exports of goods and services	5.2	4.4	7	5.8	6.2
Imports of goods and services	7.7	4.4	6	4.7	5.9
Trade balance (% of GDP)	17.5	14.5	13.3	13.2	13.3

(Source: European Commission Forecast, Autumn 2007)