

Better perspective on inflation needed



Media reports in 2007 focussed much attention on the headline rate of inflation, which oscillated around 5% for most of the year. This focus is damaging in two respects; firstly, it is inaccurate as a measure of the increase in the cost of living since it is distorted by interest rate changes. Secondly, and more importantly, it generates an inflationary psychology that suggests inflation is higher than it really is, which then translates into high inflation expectations that can impact on the outcome of wage setting by the social partners.

Mortgage interest affects the measured consumer price index and especially the service component. The two accompanying graphs show inflation trends since 2002 in goods, services and the total as measured by the consumer price index and the same variables again, adjusting for mortgage interest. In the first graph recorded inflation, particularly for the services sector, moderates in 2004 before accelerating rapidly in 2006. In the second graph, however, it is readily seen that inflation adjusted for mortgage interest has been relatively well-contained since 2004. Service sector inflation hovered around 3% for much of the period, accelerating a little towards the end of 2006 before subsiding again. This is in stark contrast to service sector inflation at the beginning of 2002, when the annual rate of increase was at 9%.

INFLATION

Annual % change



Figure 1

Energy and food prices have caused inflation to tick up in the last four months of 2007, but the trend in service sector inflation is down and non-food sector inflation will moderate as the global economy cools and the strength of the exchange rate moderates import prices.

Irish wage inflation has outpaced that of our trading partners by over 3% per annum since 2000. According to the competitiveness indicators published by the Central Bank, Irish competitiveness has been eroded by 20%. There is a need to reverse this trend by ensuring that wage settlements reflect productivity increases. This will help counteract the adverse consequences of the global slowdown and possible recession in important trading partners.

INFLAT. LESS MORTGAGE INT.

Annual % change

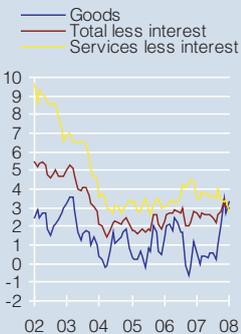


Figure 2



Industrial output

With preliminary figures for manufacturing output and industrial production now available for December, the outcome for the year 2007 is a little less robust than we had expected. Overall, industrial production grew by 7.2% in 2007, and manufacturing output by 7.4%. This represented a considerable acceleration on

2006 where growth rates of 5% and 5.2%, respectively, were recorded, and the pace of growth was by far the most rapid recorded since 2002. However, almost up to the very end of the year, growth looked on target to hit 8%. An annual growth of just 1% in December pulled down the average. Given the rather weak December figure the annual growth in all industries in the final quarter was 8.4%.

On a seasonally adjusted basis the quarterly growth rate was patchy throughout the year with manufacturing output growth

INDUSTRIAL OUTPUT

Annual % change
Jan - Dec 07

Food & beverages	+1.8
Textiles/clothing	-13.8
Leather products	+71.3
Wood products	-9.4
Pulp and paper	+6.5
Publish/print/ record media	+22.6
Chemicals	+8.4
Rubber & plastics	-1.9
Other non metallic	+4.0
Metals/metal products	+7.1
Machinery & equipment	+5.9
Electrical/optical	+4.2
Office mach/computer	+5.8
Transport equipment	+9.0
All manufacturing	+7.4

Table 1

MANUFACTURING OUTPUT

Annual % change - 3mma



Figure 3

rising in the first quarter by 5% quarter-on quarter, falling back by 9% in the second quarter, rising again by 7.6% in the third quarter and falling back by 2.4% in the final quarter.

IN THIS ISSUE:

- Manufacturing output grew by solid 7.4% in 2007;
- Unemployment rose to 4.9% in January;

- Inflation continued to decelerate in January to 4.3% from 4.7% in December;
- Export values slowed in second half of 2007;

- Retail sales grew by 6.4% in 2007, fastest pace since 2000;
- ECB interest rates remain on hold as US Fed embarks on aggressive cuts;

Further information:

David Croughan, chief economist
Email: david.croughan.ibec.ie
Reetta Suonperä, economist
Email: reetta.suonpera@ibec.ie

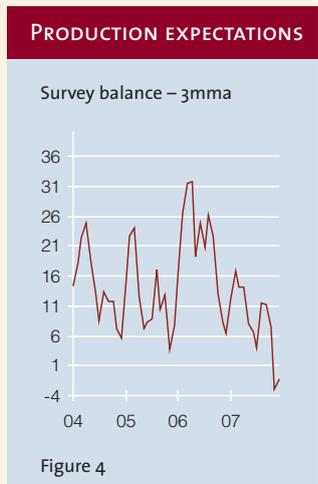
The modern sector grew by 9.1% in 2007, well above any year since 2002 when there was a growth of 12.1%. In the first quarter of the year the annual growth of the sector was a strong 12.4%. Recorded media output grew by 25.5% in 2007, with exceptionally strong annual growth of over 30% in the first nine months of the year subsiding to a lower but still significant 12.7% in the final quarter. The chemicals sector recorded strong growth of 8.4% with the pharmaceuticals sector growing by a phenomenal 37.9%; basic chemicals output fell by 1.5% in the year. The production of office equipment and machinery grew by an unimpressive 5.4% and ended the year with weak annual growth of 1.9%. The output of

IBEC/ESRI MONTHLY INDUSTRIAL SURVEY							
Average balance for 3 months ending							
	Manufact.		Consumer		Capital		Intermed.
	Nov	Dec	Nov	Dec	Nov	Dec	Nov Dec
Production expect.	-3	-1	+11	+7	-21	+3	-26 -26
Order books	+3	+3	+16	+17	-6	-4	-23 -25
Domestic sales expect.	-8	-11	-8	-13	+0	-0	-14 -17
Export expectations	+14	+9	+33	+22	-10	+1	-18 -20
Employment expect.	-11	-8	-8	-7	-8	+1	-19 -19
Capacity utilisation	+76	+75	+73	+73	+83	+84	+76 +75
Selling prices	+10	+13	+11	+12	-3	-3	+20 +31

Table 2

the medical and precision instruments sector increased by 7.3% with a weak first half giving way to strong growth in the second half. Output in the traditional sector increased by a modest 2.5%, continuing a seven-year run of unimpressive

growth, averaging 1.3%. The last time this sector recorded strong growth was in 2000, when output increased by 5.5%. The food sector recorded a growth of 2.2% with the production of dairy products stagnating and meat output falling by 1.3%.



Output in the sugar and chocolate confectionary sector fell by 13.3% reflecting the closure of sugar production. Wood fell by 9.4%.



Labour market

Employment grew by an annual rate of 67,700 in the third quarter of 2007, according to the Quarterly National Household Survey from the CSO. This represents a 3.3% increase and compares with annual growth in Q3 2006 of 4.2%. Financial services, retail and wholesale trade accounted for almost 60% of employment growth in the year, with 28,700 and 11,800 additional jobs, respectively. Other sectors also recording growth were hotels and restaurants, health and education.

There was only a small gain of 0.5% in industrial employment on Q3 2006. Construction sector growth slowed sharply at the end of 2007. While employment in Q3 2007 still grew year-on-year, annual growth slowed to 1.3%. The growth rate was 6.7% in the previous quarter, and compares with growth of 10.2% in Q3 2006. Employment in the sector declined on a seasonally adjusted basis for the second consecutive quarter, having fallen by 6,100 since Q1 2007.

EMPLOYMENT			
Sector	Jun - Aug 06	Jun - Aug 07	% change
Agriculture	121.7	117.9	-3.1
Production industries	296.6	298.0	+0.5
Construction	277.8	282.6	+1.7
Wholesale/retail	297.8	309.6	+4.0
Hotels/restaurants	120.6	130.0	+7.8
Transport/storage/communications	128.3	122.2	-4.8
Financial/other business services	267.7	296.4	+10.7
Public administration	105.8	112.2	+6.0
Education	123.7	131.4	+6.2
Health	210.9	218.6	+3.7
Other services	122.4	122.1	-0.2
Total	2073.3	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	Jun-07	4.9
Banking and insurance	Jun-07	6.9
Construction	Sept-07	7.2

Table 4

The January Live Register figures indicate that the rapid slowdown in housing activity is spreading to related sectors of the Irish labour market. The seasonally adjusted Live Register total increased by 7,800, to 171,600. This compares with an increase of 2,200 in December.

On a seasonally adjusted basis, the number of females on the Live Register increased by 1,400 in the month while the number of males was up 6,400. The sharp increase in female unemployment in the month suggests that jobs are currently being lost in estate agents and



related parts of the financial and legal sectors. The standardised unemployment rate in January was 4.9%. This compares with 4.4%, the latest seasonally adjusted unemployment rate from the Quarterly National Household Survey.

The most recent FÁS/ESRI vacancies survey also points towards a softening labour market. According to the survey, 14% of firms across all sectors report vacancies. This is a decline of two percentage points from the previous month and reflects a decline in reported vacancies in each of the sectors surveyed: construction, industry, retail and services.



Inflation

The annual rate of inflation continued on its downward trajectory in January, down to 4.3% from 4.7% in December and 5.0% in November. In fact, this is a 15-month low. On a monthly basis the Consumer Price Index fell by 0.5%; this compares with a decrease of 0.1% in January 2007. The driver of the monthly price fall was clothing and footwear, reflecting the traditional winter sales. Despite retailers beginning the sales earlier than normal in December, when prices declined by 3.4%, there was still room left for deep discounting in January. Clothing and footwear prices fell by 12.9% in the month. The decrease in clothing and footwear in the year was 4.7%. Also driven by the sales, household equipment and furnishing fell by 2.9% in the month with a price decrease of 2.6% in the year.

The annual rate of services inflation was 5.1% in January, lowest since May 2006, while

goods prices increased by 3.3% in the year. Food prices increased by 0.4% in the month and at an annual rate of 7.0%. In January, beef prices rose by 4.2% and lamb prices by 4.7%, with annual meat price inflation accelerating to 2.3%. Price increases in last few months of 2007 were mainly concentrated in dairy, eggs and flour; the acceleration in meat prices may indicate that food price increases will become more widespread in the coming months. Other areas where annual inflation remains high are energy prices (+8.3%), education (+6%) and health (+5.2%).

Rents have increased by 12.3% in the year, driven by strong demand as potential first-time buyers await for the property market to settle. As supply has increased strongly in recent months, there is some evidence of slowing rent growth.

The Harmonised Index of Consumer Prices (which differs from the Consumer Price Index in the main by omitting mortgage interest) recorded inflation in January at 3.1%. This is just below the 3.2% rate estimated for the euro area average, indicating that Irish inflation is aligning to its European counterparts.

CONSUMER PRICES (CPI)

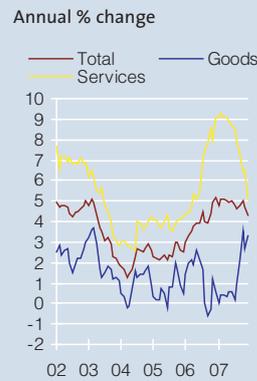


Figure 6

OUTPUT PRICES



Figure 7

CPI COMMODITY GROUPS

Annual % change – Jan 2008

Food/beverages	+6.7
Alcohol/tobacco	+3.3
Clothing/footwear	-4.7
Housing & energy	+11.6
Furnishings, house equip.	-2.6
Health	+5.2
Transport	+4.2
Communications	+1.2
Recreation	+1.3
Education	+6.0
Catering	+3.2
Miscellaneous	+1.7
All items	+4.3

Table 5

EU HARMONISED PRICE INDEX

Annual % change – Dec 2008

Belgium	+3.1
Germany	+3.1
Greece	+3.9
Spain	+4.3
France	+2.8
Ireland	+3.5
Italy	+2.8
Luxembourg	+4.3
Netherlands	+1.6
Austria	+3.5
Portugal	+2.7
Finland	+1.9
Denmark	+2.4
Sweden	+2.5
United Kingdom	+2.1
Euro-zone	+3.1
EU27	+3.2

Table 6



External trade

The value of goods exports grew by 3.8% in the first eleven months of 2007, compared to the same period in 2006. This is a sharp slowdown from the 5.8% growth achieved in the first half of the year, but can be accounted for largely by the strength of the euro against the currencies of two of our main trading partners, the UK and the US.

Export prices fell by 2.9% in the first ten months of 2007, compared to 2006, while the volume of goods exports

TRADE

Annual % value change: Jan - Oct 2007/2006

	Imports	Exports
Food	+11.4	+6.2
Beverages and tobacco	+12.9	+9.7
Crude materials	+7.1	+6.8
Mineral fuels	-2.6	+17.6
Chemicals	+2.8	+9.0
Manufactured goods	+9.9	+6.5
Machinery & transport equipment	-1.6	-3.9
Miscellaneous manufactured articles	+2.5	-0.9
Total	+2.4	+3.9

Table 7

increased by 6.7%. Detailed data available for the year to October show that, compared to 2006, exports of organic chemicals increased by 19%, industrial machinery by 22% and eggs and dairy products by 25%. On the

other hand, exports of computer equipment, as well as professional and scientific equipment, decreased by 8%. Emerging markets are becoming an increasingly important destination for Irish goods. The

TRADE

% vol. change – 3mma



Figure 8

value of exports to China increased by 33% and to the Philippines by 113%, while exports to Great Britain only grew by 8% and the US remained static. Imports increased by 2.8%.



IRISH BUSINESS AND EMPLOYERS CONFEDERATION

Confederation House
84/86 Lower Baggot Street
Dublin 2
Tel: (01) 605 1500
Fax: (01) 638 1500

CORK
Knockree House
Douglas Road, Cork
Tel: (0214) 295 511/2/3
Fax: (0214) 295 534

SOUTH EAST
Confederation House
Waterford Business Park
Cork Road, Waterford
Phone: (051) 331 260
Fax: (051) 331 261

MID-WEST
Gardner House, Bank Place
Charlotte Quay, Limerick
Tel: (061) 410 411/410 127/
410 654/412 838
Fax: (061) 412 205

WEST
Ross House
Victoria Place, Galway
Tel: (091) 561 109,
566 405, 566 368
Fax: (091) 561 005

NORTH WEST
Third Floor, Pier 1
Quay Street
Donegal Town
Co. Donegal
Tel: (074) 972 2474
Fax: (074) 972 2476

EUROPE
Irish Business Bureau
89 Avenue de Cortenbergh
Boite 2, 1000 Bruxelles, Belgium
Tel: (00-32-2) 512 33 33
Fax: (00-32-2) 512 13 53
Website: www.ibb.be

Further information on IBEC's services and activities can be found on the IBEC site at: www.ibec.ie



Retail sales

Retail sales grew by 6.4% in 2007, a small acceleration on the 6.2% growth recorded in 2006. This was a second year of solid growth and in the last two years retail sales growth has well outpaced that in any year since 2000, when growth hit a peak of 11.9%. Retail sales were very resilient in 2007, although some sectors showed signs of slowing

in the second half of the year. Clothing and footwear and electrical goods sales recorded double digit growth, albeit the growth in electrical goods sales fell sharply to 3.6% in the second half of the year after an exceptionally strong first half year growth of 17%. Supermarket, pharmacy, furniture and lighting and hardware, glass and paints all recorded strong increases in excess of 6%. Early discounting might have boosted December sales, nevertheless there was a slowdown in sales of furniture and lighting, books and newspapers and 'other goods' in the final quarter.

RETAIL SALES



Figure 9

RETAIL SALES

Annual % change: Jan – Dec 07

Motor Trades	+6.4
Non-Specialised Stores	+6.3
Department Stores	+3.9
Food/Beverages/Tobacco	-1.2
Pharmacies	+6.4
Textiles and Clothing	+14.3
Footwear and Leather	+12.9
Furniture and Lighting	+6.7
Electrical Goods	+9.8
Hardware	+8.0
Books/News/Stationery	+2.3
Other Retail	+4.9
Bars	-0.0
Excl. Motor Trades	+6.5
All Businesses	+6.4

Table 8



Financial

In response to negative economic indicators and stock market turmoil, the Federal Reserve dropped interest rates by 75 basis points in a surprise move on 22 January and by a further 50 basis points to 3% on 30 January. This is the most aggressive cut in interest rates since the early 1980s. The rapidly slowing UK economy pushed the Bank of England to cut rates by 25 basis points to 5.25% on 7 February, while the ECB has held rates steady at 4% since June

EXCHANGE RATES – MONTHLY AVERAGES



Figure 10

2007. The euro exchange rate against the dollar came back from its mid-January peak of \$1.49 to \$1.46 in mid-February. Sterling was at £0.74. Reflecting the slowdown in the domestic

DOMESTIC CREDIT

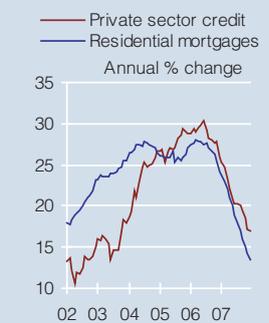


Figure 11

economy, credit growth in Ireland decelerated significantly in 2007. Adjusted private sector credit growth slowed from 25.3% in January to 17.0% in December. The slowdown in mortgage

lending was even more dramatic, with growth slowing from 23.7% in January to 13.4% in December. This is the slowest rate of mortgage credit growth since the series commenced in 1996.

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)