

## Most difficult economic climate for 15 years



The Irish economy has flourished over the last decade, with growth in GDP averaging 7% per annum and employment increasing by almost 4% per annum. Living standards have risen sharply as GNP per capita grew over 4.5% per annum. This coming year is likely to be the most challenging for business since the early 1990s; economic growth could slow significantly and our competitive position will be seriously challenged by adverse exchange rate movements, which now have to reckon with a depreciating sterling rate. It is essential that all the social partners understand this deteriorating position.

The global climate has changed dramatically in the last six months as the continuing fall-out from the collapse of the sub-prime mortgage market in the US continues to have significant adverse consequences for global growth. In particular, the US economy is now moving into recession and the UK economy is slowing sharply. These are two significant trading partners, whose fortunes will directly shape Irish economic prospects. The euro area, which thus far has been less affected by the financial crisis, is, nevertheless, slowing down. The banking and financial system is in turmoil and has global impact, as financial instruments spread risk on a worldwide basis; the re-pricing of risk will make the investment climate more difficult in the short term though in the longer term should make for better investment decisions. Climate change, too, is an added challenge to businesses, which must meet harsh carbon emissions targets.

Even without these not inconsiderable global constraints, the Irish economy has to manage the necessary rebalancing of the economy away from an over-dominant construction sector to a greater contribution from the traded sectors. This task has been made more difficult by the rise in the value of the euro against the dollar over the last two years with the euro hitting a peak of just under \$1.49 in mid-January. For the last five years, Ireland enjoyed exchange rate stability against sterling, as the exchange rate of the euro against sterling held for the most part in the range £0.65 - 0.69. In old Irish pound terms, this was a comfortable trading range of 85-89 pence sterling. The recent weakness of sterling has resulted in this rate moving sharply to the equivalent of 97 pence sterling and old parity levels could soon be broken. This will cause undoubted difficulties for exporters to the UK, particularly in the important food sector and other traditional sectors, which had shown significant recovery in the last year. Upcoming wage negotiations must recognise this added challenge.

### INDUSTRIAL OUTPUT

Annual % change	
Jan - Nov 07	
Food & beverages	+1.3
Textiles/clothing	-13.7
Leather products	+75.2
Wood products	-6.8
Pulp and paper	+7.2
Publish/print/ record media	+23.9
Chemicals	+9.7
Rubber & plastics	-1.6
Other non metallic	+4.6
Metals/metal products	+6.3
Machinery & equipment	+8.5
Electrical/optical	+4.8
Office mach/computer	+6.9
Transport equipment	+10.7
All manufacturing	+8.1

Table 1

### ORDER BOOKS

Survey balance – 3mma



Figure 2

growth remaining strong in the last two months of the year. If this level of output was maintained in the final month of the year, industrial output will have grown at its most rapid pace since 2001.

### MANUFACTURING OUTPUT

Annual % change – 3mma

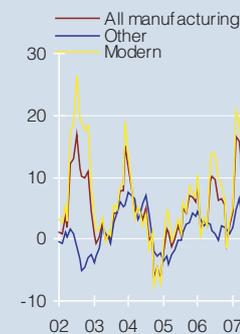


Figure 1



### Industrial output

The Quarterly National Accounts record that the industrial sector, (which includes construction) grew by 7.2% in the first three quarters of 2007, compared with the same period of the previous year. The construction sector grew by only 0.7% while the remainder of industry recorded a growth of 9.7%. The remainder of industry enjoyed strong

annual growth in the first quarter of 15.1%, slowed in the second quarter before recovering to record a 6.2% growth in the third quarter. The construction sector began the year with a 3.6% annual growth in the first quarter, but fell by 3.8% in the third quarter.

The survey of industrial enterprises carried out by the CSO has more timely data up to November. This shows that the broad category of industry made up of manufacturing, mining and utilities recorded an annual growth of 7.8% in the first eleven months of 2007, with

#### IN THIS ISSUE:

- Manufacturing output up annual 8.1% in first 11 months;
- Unemployment is 4.7% in December;
- Inflation decelerates from 5% to 4.7% in December;
- Retail sales up annual 6.9% in first 10 months, though

- showing signs of slowdown;
- Exchange rates: euro/dollar hits \$1.49; euro/sterling £0.75.

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Manufacturing output growth was even more buoyant in 2007 with an annual increase in the first eleven months of 8.1%. On a seasonally adjusted basis, output fell back somewhat from a high July peak, and survey results suggest December output will tread water.

The modern sector grew by an annual 10.1% in the first eleven months of 2007, the most rapid pace of growth since 2002. The annual growth in October and November remained very strong, averaging 19.2%. Reproduction of recorded media output grew by an annual 27.7% in the first eleven months of 2007, that of chemicals by 9.7%, office machinery and computers by 6.9% and medical and precision instruments by 7.3%. Output of

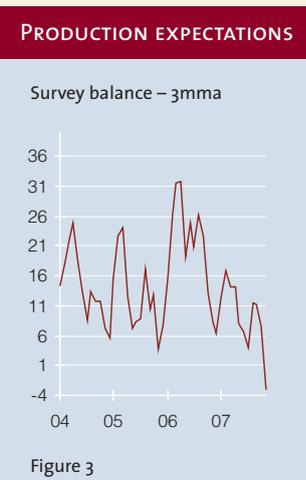
IBEC/ESRI MONTHLY INDUSTRIAL SURVEY								
Average balance for 3 months ending								
	Manufact.		Consumer		Capital		Intermed.	
	Oct	Nov	Oct	Nov	Oct	Nov	Oct	Nov
Production expectations	+8	-3	+21	+11	-16	-21	-9	-26
Order books	+8	+3	+16	+16	-2	-6	-5	-23
Domestic sales expectations	-4	-8	-2	-8	+1	+0	-13	-14
Export expectations	+24	+14	+43	+33	-5	-10	-3	-18
Employment expectations	-7	-11	-7	-8	-5	-8	-8	-19
Capacity utilisation	+76	+76	+74	+73	+83	+83	+76	+76
Selling prices	+12	+10	+14	+11	+2	-3	+16	+20

Table 2

electrical machinery declined by 3.7%.

The traditional sector lost momentum towards the end of 2007, declining by a seasonally adjusted 9% in the months of October and November. Having

started the year strongly with a first quarter annual growth of 4.4%, there was little or no growth in the following six months; in October and November output fell by 6%. Despite growth in meat and dairy products the food sector



declined by almost 15% reflecting the closure of sugar production. Wood products declined by over 7% reflecting weaker construction activity.



## Labour market

Total employment growth slowed to an annual rate of 67,700 additional jobs in the third quarter of 2007, according to the Quarterly National Household Survey from the CSO. This represents a 3.3% increase and compares to annual growth in Q3 2006 of 4.2%. Almost 55% of the increase is due to growth in part-time employment. Total employment in Ireland now stands at 2.14 million, while the labour force totals 2.25 million. Non-Irish nationals accounted for an estimated 71.6%, or 48,400, of the annual increase in the numbers employed. The majority, 40,100, came from the 12 new EU Accession states. Almost 12% of persons employed are now non-Irish nationals.

Financial services and 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 that also recorded growth were hotels and restaurants, health and education. There was no change in industrial

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

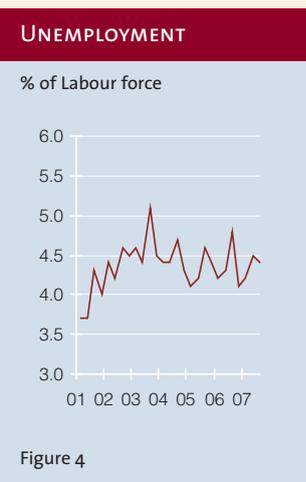
Table 3

AVERAGE WEEKLY EARNINGS		
Sector	Period	Annual % change
Business Services	Sept 07	4.4
Distribution	Jun 07	3.9
Public Sector (excl. health)	Jun 07	5.5
Industry	Jun 07	4.9
Banking and insurance	Jun 07	6.9
Construction	Sept 07	7.2

Table 4

employment from the second to the third quarter, and only a minute gain of 0.5% on the third quarter of 2006. While employment in construction in Q3 2007 still grew year-on-year, annual growth has slowed to 1.3%. The growth rate was 6.7% in the previous quarter, and

compares with growth of 10.2% in Q3 2006. On a seasonally adjusted basis employment in the sector declined for the second consecutive quarter. Employment in construction has declined by 6,100 since Q1 2007; the total number employed in the sector now stands at



282,600. Seasonally adjusted unemployment declined in Q3 2007 to 4.4%, compared to 4.5% in the previous quarter. The long-term unemployment rate remained constant at 1.3%. The most recent Live Register figures, however, show an increase in unemployment, with the standardised unemployment rate in December at 4.7%. This points to an increase in male unemployment, caused by the slowdown in house building. The total number of people on the Live Register in December was 15,100 higher than the same month in 2006. Males accounted for 14,200 of this. Most recent earnings data are given in Table 4.



## Inflation

The annual rate of inflation in December decelerated from 5% to 4.7%; this is likely to mark the beginning of a progressively decelerating rate of inflation throughout 2008. Inflation in the month of December increased by 0.1%, and it would have remained stable but for the increase in excise duties on tobacco announced in the December Budget.

Annual average inflation for 2007 was 4.9%, an acceleration on the rate of 4% for 2006, and indeed was the highest rate since 2000. The Harmonised Index of Consumer Prices (which differs from the Consumer Price Index in the main by omitting mortgage interest) recorded Irish inflation in 2007 at 2.8%, only marginally higher than the 2.7% in 2006. Inflation on this measure has averaged 2.5% for the past four years. Goods sector inflation averaged 1% in 2007 but accelerated from close to zero in the first quarter to 2.7% in December. Service sector inflation averaged 8.4%, but

excluding mortgage interest the rate was just under 4% and ended the year at 3.4%.

Excluding mortgage interest, the rate of inflation in December was 3.1%. Even though interest rates have not risen since June the sub-index for mortgage interest increased in December by 1%. This reflects the changing mortgage profile as new high mortgage holders replace old low mortgage holders and the termination of some fixed interest loans. This element in the price index distorts the measure of inflation and the focus possibly should shift to the HICP index as the most meaningful measure of inflation.

Inflation in December was helped by the 3.4% fall in clothing and footwear, which seemed to have resulted from the onset of sales ahead of the more normal January sales. The annual fall was 6.2%. Furnishings and household equipment registered an annual fall in inflation of 2.3% in December. On the other hand, energy prices increased by an annual 9.5% in December and food prices by 6.6%. Food prices accelerated sharply from an annual rate of 1.2% in the first quarter to 6.6% in December.

## CONSUMER PRICES (CPI)

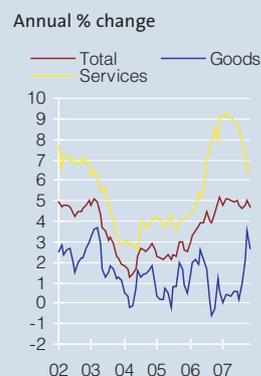


Figure 5

## OUTPUT PRICES



Figure 6

## CPI COMMODITY GROUPS

Annual % change – Dec 2007

Food/Beverages	+6.3
Alcohol/Tobacco	+3.5
Clothing/Footwear	-6.2
Housing & Energy	+15.1
Furnishings, House Equip.	-2.3
Health	+3.0
Transport	+5.1
Communications	+1.1
Recreation	+1.1
Education	+6.0
Catering	+3.5
Miscellaneous	+1.6
All Items	+4.7

Table 5

## EU HARMONISED PRICE INDEX

Annual % change – Nov 2007

Belgium	+2.9
Germany	+3.3
Greece	+3.9
Spain	+4.1
France	+2.6
Ireland	+3.5
Italy	+2.6
Luxembourg	+4.0
Netherlands	+1.8
Austria	+3.2
Portugal	+2.8
Finland	+2.1
Denmark	+2.5
Sweden	+2.4
United Kingdom	-
Euro-zone	+3.1
EU27	+3.1

Table 6



## External trade

The CSO estimates that exports of goods and services grew at an annual rate of 8.0% in the third quarter of 2007, while imports increased by 7.8%. The latest balance of payments data show that services exports have grown particularly strongly, with growth of 16.6% in the first three quarters of 2007. In the year to date, services have accounted for 43% of Ireland's total exports. The destination for 60% of services exports in 2006 was Europe, while 15% went to the US. Monthly data for goods

## TRADE

Annual % value change: Jan - Sept 2007/2006

	Imports	Exports
Food	+10.4	+5.3
Beverages and Tobacco	+13.3	+15.0
Crude Materials	+9.3	+10.2
Mineral Fuels	-5.3	+13.4
Chemicals	+2.0	+8.7
Manufactured Goods	+10.0	+6.3
Machinery & Transport Equipment	-0.7	-3.8
Miscellaneous Manufactured Articles	+2.2	-0.2
Total	+2.4	+4.0

Table 7

exports show that growth in the year to October slowed to 3.7%, despite a strong performance in the first part of the year. Detailed data for the year to September record that exports

of organic chemicals (+19%), industrial machinery (+21%) and dairy products and eggs (+22%) grew particularly strongly. Exports of computer equipment and professional, scientific and

## TRADE

% vol. change – 3mma



Figure 7

controlling apparatus both declined by 7%. The balance of payments deficit for 2007 on the current account is expected to come in at €8,617m, up from €7,276m in 2006.



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## Retail sales

The growth in retail sales is slowing gradually. Growth peaked in the second quarter with an annual increase of 7.8%, slowing to 6.6% in the third quarter. In October 2007 the volume of sales was up 5% on the same month in 2006, while excluding motor trades the annual increase was 6.0%. There are differences between sectors,

however, with annual growth in household equipment having slowed to 2.5% in October, but clothing and footwear continuing to grow strongly at 13.1%. On a monthly basis, there was a large dip in electrical goods, where the volume of sales fell by 6.4% in October. The trend of slowing growth in retail sales is likely to persist in 2008. The IIB/ESRI Consumer Sentiment Index fell marginally to 62.7 in December, from 63.1 in November. This continues the downward trend that has been evident in consumer confidence in 2007, as consumers become increasingly concerned over the general outlook of the economy.

## RETAIL SALES



## RETAIL SALES

Annual % change: Jan – Oct 07

Motor Trades	+7.3
Non-Specialised Stores	+6.5
Department Stores	+2.7
Food/Beverages/Tobacco	-1.2
Pharmacies	+6.8
Textiles and Clothing	+15.4
Footwear and Leather	+14.5
Furniture and Lighting	+8.0
Electrical Goods	+10.3
Hardware	+8.4
Books/News/Stationery	+3.3
Other Retail	+5.6
Bars	-0.1
Excl. Motor Trades	+6.7
All Businesses	+6.9

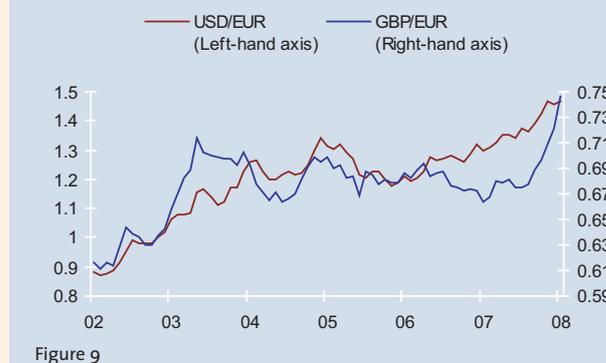
Table 8



## Financial

US interest rates fell from 5.25% in September 2007 to 4.25% in December. The continuing fall-out from the sub-prime crisis and real fears that the US is now sliding into recession is likely to bring another rate cut of 50 or even 75 basis points at the end of January. Neither euro area nor UK rates were moved in January, but the rapidly slowing UK economy is likely to push the Bank of England to further cuts in the near future. The likelihood

## EXCHANGE RATES – MONTHLY AVERAGES



of a rise in euro rates is receding as more evidence builds of a slowdown; it is more likely that the next move will be downwards in the second half of

the year. The euro exchange rate against the dollar hit a new peak in mid January of \$1.49. More significant is the rapid fall in the value of sterling, which

## DOMESTIC CREDIT



over the course of the last year has depreciated by some 16%, with almost all of that depreciation occurring in the second half of 2007.

## 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)