ECONOMIC TRENDS

IBEC

MAY 2008

Pay talks must reflect global difficulties

The Governing Council of the European Central Bank decided at its 8 May meeting in Athens to keep interest rates on hold at 4%. The tone of the Bank's statement and the comments made by ECB President Jean Claude Trichet gave strong signals that interest rates were unlikely to come down in the near future and expectations are that any reductions are not likely to be forthcoming until the last quarter of the year. There was even a hint in the use of the word 'vigilant' that further tightening was still a possibility, though this seems improbable. The IMF, too, has warned that inflation has emerged as a major threat to the world economy due to soaring energy and food prices. The ECB is concerned that the recent sharp increases in food and energy prices could result in second-round effects on inflation expectations and wages in the euro area. To ensure that this recent rise in inflation rates 'remains temporary', the Bank's statement said, 'it is imperative that they do not become entrenched in longer term expectations or lead to broadly based second-round effects in wage and price setting'.

This has resonance for Ireland in the current pay talks. How well Ireland reacts to the global downturn, high euro exchange rates and recent inflation, relative to how our trading partners react, will be crucial to our competitive position over the next five years. At the beginning of the decade, we experienced the impact on inflation caused by inappropriately high wage increases. Ireland lost competitiveness, as inflation in the years 2000 to 2003 was double that of the euro area average; this resulted in the greatly reduced contribution to growth from the traded sectors. As the economy now rebalances from over-reliance on the construction sector, and adjusts to a slower pace of growth, it is critical that the traded sector reverts to the more dynamic role it played in driving Ireland's recent success. The harmonised index records that Irish service sector inflation has decelerated over the past year from 5.5% to 2.9%. We must ensure that this benign momentum continues. A pay agreement, which takes full account of the economic slowdown and does not chase short-lived illusory gains to compensate for higher global prices, will contribute greatly to containing rising unemployment, mitigate the impact of slower world growth and ensure that the economy is well positioned to exploit fully the opportunities that will come as the global economy recovers.

Manufacturing output

Annual % change

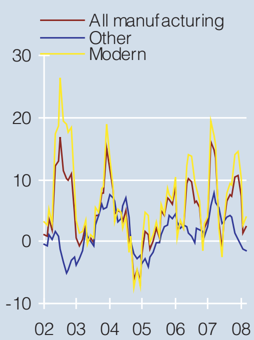


Figure 1

Industrial output

Manufacturing output recorded a relatively strong annual growth of 6.9% in March, bouncing back from a 2.1% fall in February, but the general first quarter trend was one of marked slowdown. Manufacturing output had performed strongly in 2007 recording a solid 7.5% growth. This was the best performance since 2002. Growth in the modern sector was buoyant recording an 8.7% increase and the traditional sector experienced its strongest growth performance since 2000 recoding an increase of 3.7%.

Despite the good March performance, first quarter manufacturing growth was only 1.9%, compared with the first quarter of 2007. On a seasonally adjusted basis, growth all but stagnated. Output had increased by 5.2% quarter-on-quarter in the third quarter of last years, slowing to 1.6% in the final quarter. In the first quarter of 2008, the quarterly increase was only 0.3%. The wider all industries index was even more sluggish with the seasonally adjusted quarterly growth of 5.4% being followed by a growth

Industrial output

Annual % change
Jan - Mar 08

Food & beverages	-2.5
Textiles/clothing	-3.6
Leather products	+40.4
Wood products	-20.5
Pulp and paper	-2.0
Publish/print/record media	-2.2
Chemicals	+3.1
Rubber & plastics	-5.1
Other non metallic	-10.7
Metals/metal products	+3.1
Machinery & equipment	-5.3
Electrical/optical	+6.7
Office mach/computer	+4.9
Transport equipment	+7.6
Unclassified	-2.2
All manufacturing	+1.9

Table 1

Order books

Survey balance – 3mma

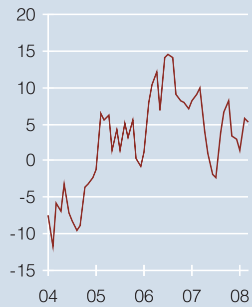


Figure 2

IN THIS ISSUE:
- Manufacturing slows in first quarter;
- Live register stabilises at 199,700;
- Inflation decelerated to 4.3% in April;
- Retail sales fall by 0.1% year-on-year;
- ECB keeps interest rates on hold;
- The euro retreats from highs against dollar and sterling.

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

of 1.2% in the final quarter of 2007 and no growth in the first quarter of 2008. The high technology sector recorded particularly strong annual growth of 10.2% in March, following an annual decline of 2.2% in February. However, the first quarter annual growth of 3.5% was very much weaker than 8.9% growth in the third quarter of 2007 and the 14.5% final quarter increase. On a seasonally adjusted basis, the slowdown is clear: quarterly growth of 7.1% in the third quarter of 2007 was followed by a slower increase of 2.8% in the final quarter and there was a fall of 0.2% in the first quarter of 2008. Chemicals sector growth slowed very sharply from a final quarter annual increase of 25.8% to a first quarter 2008 increase of 3.1%. The electronics sector, however, gained momentum, with final quarter annual growth of 2.5% accelerating to 6.7% in the first quarter of 2008.

Output in the traditional sectors slowed to an annual increase of 0.5% in the final quarter of 2007, after a strong 5% increase in the first three quarters of the year. This was followed by a fall of 1.7% in the first quarter of 2008. Part of this weak performance is due to industries connected to the construction sector; in the first quarter, wood output fell by an annual 20.5% and rubber and plastic products were down 5.1%.

IBEC/ESRI monthly industrial survey

Average balance for 3 months ending

	Manufact.		Consumer		Capital		Intermed.	
	Feb	Mar	Feb	Mar	Feb	Mar	Feb	Mar
Production expectations	+5	+2	+8	+6	+9	+5	-11	-13
Order books	+6	+5	+19	+18	-7	-3	-17	-22
Domestic sales expectations	-10	-9	-10	-9	-2	+1	-18	-18
Export expectations	+12	+8	+17	+11	+13	+11	-5	-4
Employment expectations	-1	-9	+5	-3	+8	+10	-29	-44
Capacity utilisation	+77	+76	+74	+74	+83	+81	+78	+79
Selling prices	+10	+3	+6	-2	-3	+5	+29	+19

Table 2

Production expectations

Survey balance – 3mma

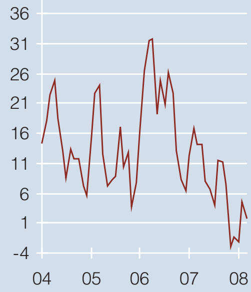


Figure 3

The food sector output is suffering from sterling's weakness, with annual declines in the output of meat, dairy products, bread and sugar and chocolate confectionery.

Labour market

The most recent Quarterly National Household Survey from the CSO points to a slowing labour market. Total employment in 2007 increased by 3.6% (or by 73,200) to 2.117 million; the rate of increase decelerated from 4.9% in 2005 to 4.5% in 2006 and to 3.6% in 2007. The pace of growth slowed from 4% in the second quarter to 3.2% in the final quarter. The increase of 73,200 jobs was widely distributed across the sectors. Average figures, however, conceal emerging sectoral trends. On a seasonally adjusted basis, construction employment peaked in the first quarter of 2007 and has declined by 3.2% since then. Industrial non-construction employment continued to grow up to the second quarter of 2007, but turned down in the final quarter. By contrast, the financial and business services sector and the wholesale and retail sector recorded solid growth throughout the year. The April Live Register figures were somewhat more encouraging than the previous month, as the seasonally adjusted number of claimants decreased by 200 in the month. This compares with an increase of 12,000 in March and indicates that the early Easter may have resulted in some seasonal adjustment problems. Crucially, some of the increase in female claimants that happened in March was reversed, as claimants fell by 2,200. The number of males on the Live Register continued to climb, with an increase of 2,100. The standardised unemployment rate remained at 5.5%. The good news on the Live Register was overshadowed, however, by data from the Department of Enterprise, Trade and Employment showing a 47.5% increase in redundancies in April. Redundancies for the first four months of the year are up by 27.3% on the same period of 2007. Overall, the labour market is much weaker than it has been for some time and there is a significant challenge for the social partners to both help stem the rise in redundancies and assist those who have lost jobs to find alternative employment.

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

Unemployment

% of Labour force

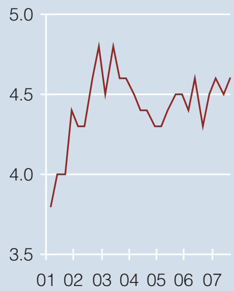


Figure 4

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	Sept-07	4.8
Financial	Sept-07	2.3
Construction	Dec-07	6.9

Table 4

Inflation

Following the surprising acceleration of annual inflation to 5% in March, inflation fell back to 4.3% in April. This is much more in line with our expectations and we would anticipate further moderation in the second half of the year. Measured on the basis of the EU Harmonised Index, which excludes mortgage interest and some insurance and building products, the annual rate of inflation for Ireland fell from 3.7% to 3.3%. Flash estimates for inflation in the euro area indicate a similar deceleration from 3.6% to 3.3%.

The high March figure reflected the strong seasonal impact of the St Patrick's Day holiday and the Easter period, which pushed up air transport prices by 46% in the month and by 7.2% on an annual basis. Annual inflation in air transport fell back by 25% in April. Food inflation was also a strong feature of the March index, increasing by 0.9% m-on-m and by an annual 9.6%. There was no increase in the month of April resulting in annual food inflation slowing a little to 8.4%.

Mortgage interest rates have been a driving force in keeping headline inflation up. Excluding mortgage interest the inflation rate is 3.5%. In April 2007, the index jumped by 6%, following the ECB quarter-percent rate increase on 8 March; this increase has now fallen out of the year-on-year comparison easing inflation by almost 0.4 percentage points. A similar beneficial impact can be expected in July as the last of the ECB interest rate hikes took place on 6 June last year. A further downward impulse would be given to inflation if the ECB begins to reduce interest rates towards the end of the year; the beneficial impact on inflation would largely be felt in 2009.

Global influences have had a strong impact on prices, especially in food and energy. In April goods sector inflation was 3.8% and service sector inflation was 4.8%. However, if mortgage interest is excluded from the service sector calculation, service sector inflation is a more moderate 3.3%. Measured on the HICP basis, service sector inflation has fallen to 2.9%,

Consumer prices (CPI)

Annual % change

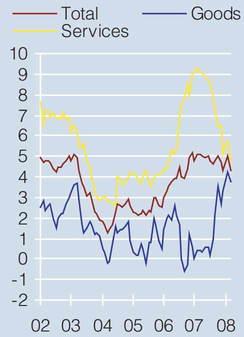


Figure 5

Output prices

Annual % change

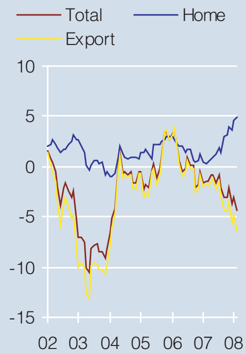


Figure 6

CPI commodity groups

Annual % change – Apr 2008

Food/beverages	+8.1
Alcohol/Tobacco	+3.7
Clothing/Footwear	-2.8
Housing & energy	+9.7
Furnishings, house equip.	-1.0
Health	+6.2
Transport	+3.4
Communications	+1.2
Recreation	+1.1
Education	+5.8
Catering	+3.2
Miscellaneous	+3.0
All items	+4.3

Table 5

EU harmonised price index

Annual % change – Mar 2008

Belgium	+4.4
Germany	+3.3
Greece	+4.4
Spain	+4.6
France	+3.5
Ireland	+3.7
Italy	+3.6
Luxembourg	+4.4
Netherlands	+1.9
Austria	+3.5
Portugal	+3.1
Finland	+3.6
Denmark	+3.3
Sweden	+3.2
United Kingdom	+2.5
Euro-zone	+3.6
EU27	+3.8

Table 6

External trade

Despite the slowing global economy, data from the CSO show that the value of Irish goods exports grew by 3% in February when compared with the same month in 2007. However, since exports declined by 3.7% in January, the contraction in the first two months of 2008 has been 0.4% on the same period last year. Imports fell by 4.1% in the first two months of the year, reflecting the slowdown in economic activity. Detailed data, available for January, show some sectoral variation. Chemicals exports contracted by 4.9% year-on-year. Within the sector, pharmaceuticals declined by 1.5%, while organic chemicals exports fell by 13.5%. However, chemicals output is notoriously volatile. Machinery and transport equipment declined by 0.7%. Within the sector, office machinery and data processing equipment exports fell by 12%, while other electrical machinery increased by 15.7%. Professional and scientific equipment increased by 4.9%. Food exports fell by 1.9%, while beverages declined by 2.5%; both sectors had posted solid growth in 2007. The value of food imports increased by 10.8%, reflecting higher global commodity prices.

Trade

Annual % value change: Jan '07 - Jan '08

	Imports	Exports
Food	+10.8	-1.9
Beverages and tobacco	+2.9	-1.0
Crude materials	-26.1	-7.3
Mineral fuels	-2.5	+43.3
Chemicals	-2.1	-4.9
Manufactured goods	-3.1	-1.8
Machinery & transport equipment	-9.5	-0.7
Miscellaneous manufactured articles	-9.9	-2.7
Total	-5.7	-3.7

Table 7

Trade

% vol. change – 3mma

Figure 7

IRISH BUSINESS AND EMPLOYERS CONFEDERATION

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

CORK
Knockrea 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

Data from the CSO show that retail sales recorded an annual decrease in February, the first since January 2004. Retail sales fell by 0.1% on an annual basis, and by 1.9% when compared with the previous month. Motor trades declined by a seasonally adjusted 4.2% in the month and recorded a 4.5% decline in the year. Excluding motor trade, retail sales grew by 2.3% in the year, but declined by 0.3% in the month. The sluggish figures reflect weak growth or outright declines across all sectors; even sectors like clothing and footwear that were growing strongly a few months ago have slowed significantly. The IIB/ESRI Consumer Sentiment Index recorded declining consumer confidence, as the index slipped to an all-time low of 56.0 in April, from 63.3 in March and 83.0 a year previously. Job losses, rising prices and the outlook for the property sector are the main drivers behind the downbeat outlook. However, so far consumers are more worried about the general economic environment than their own personal finances.

Retail sales

% vol. change – 3mma

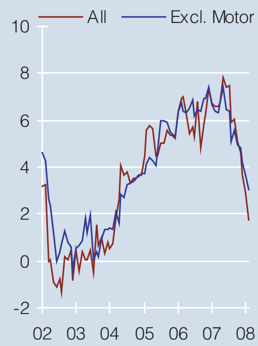


Figure 8

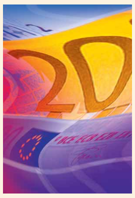
Retail sales

Annual % change: Jan- Feb 08

Motor trades	-2.2
Non-specialised stores	+5.5
Department stores	+7.1
Food/Beverages/Tobacco	-1.1
Pharmacies	+2.7
Textiles and clothing	+4.7
Footwear and leather	+3.2
Furniture and lighting	-0.6
Electrical goods	-3.3
Hardware	+2.5
Books/News/ Stationery	-0.9
Other retail	+1.7
Bars	-4.6
Excl. motor trades	+2.6
All businesses	+0.9

Table 8

Financial



The ECB kept interest rates on hold at 4% at its governing council meeting on 8 May. The tone remained hawkish, with the focus on the imperative that current high inflation rate remained temporary and did not become entrenched in longer-term expectations. Thus, there was no sign of an early cut in interest rates. Likely weaker economic data is expected to lead to a cut in September at the earliest; market expectations are that rates by year-end could be down to 3.5%. The twenty-month deceleration in private sector credit growth reversed in March; it grew by 17.1%, up from 15.6% in February. Residential mortgage lending growth, however, continued to decelerate from 12.3% in February to 11.6% in March. In early May, the euro weakened against the dollar from $1.59 in late April to $1.54; against sterling it weakened from £0.80 to under £0.79.

Exchange rates – monthly averages

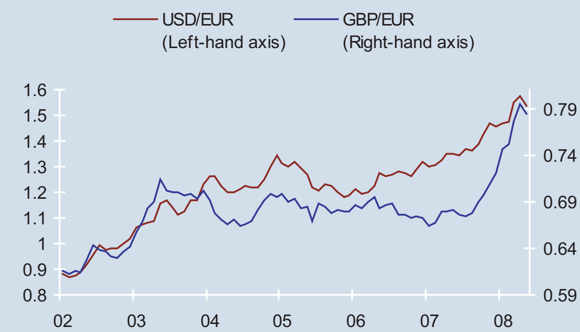


Figure 9

Domestic credit

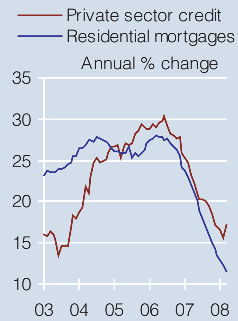


Figure 10

Economic indicators – Ireland

Annual % change

	2005	2006	2007	2008	2009
GDP	6.0	5.7	5.3	2.3	3.2
GNI	5.8	7.0	4.4	1.3	3.6
Personal consumption	7.4	5.7	5.4	2.9	3.2
Public consumption	5.2	5.5	6.7	3.5	1.6
Gross fixed capital formation	11.7	3.1	0.2	-7.4	2.5
Final demand	6.7	5.1	5.7	2.7	3.7
Compensation per employee	5.0	4.5	5.8	4.9	3.5

Source: European Commission Forecast, Spring 2008

Economic indicators – Ireland

Annual % change

	2005	2006	2007	2008	2009
Employment	4.7	4.3	3.6	0.7	1.6
Unemployment (%)	4.3	4.4	4.5	5.6	5.8
Consumer prices (HICP)	2.2	2.7	2.9	3.3	2.4
General gov't balance (% GDP)	1.6	3.0	0.3	-1.4	-1.7
Exports of goods and services	5.2	4.4	8.2	5.4	4.9
Imports of goods and services	7.7	4.4	6.4	3.3	4.5
Trade balance (% of GDP)	17.5	14.5	12.3	11.3	10.3

Source: European Commission Forecast, Spring 2008