Q3 2015 Ibec Quarterly Economic Outlook

Ireland unprepared for population and growth surge

The Irish economy will grow by around 6% in volume and 11% in value terms in 2015. This surge of growth was not totally unexpected given the strength of Ireland's business model and the catch up effects after a lost half-decade. 2015 should also be the last year of net-emigration with the population likely to grow by one third over the next three decades. While Government's recent capital investment plan is welcome it is not nearly ambitious enough. Much more investment is needed in infrastructure, education and innovation in order to secure sustainable future growth.

GNP and its components

Annual % change	2014	2015	2016
Consumer spending	2.0	3.1	3.5
Government spending	4.6	1.8	1.4
Investment	14.3	11.5	7.6
Exports	12.1	12.6	7.8
Imports	14.7	12.4	7.6
GDP (Volume)	5.2	5.9	5.0
GNP	6.9	4.9	5.3
GDP (Value)	5.3	11.0	6.4

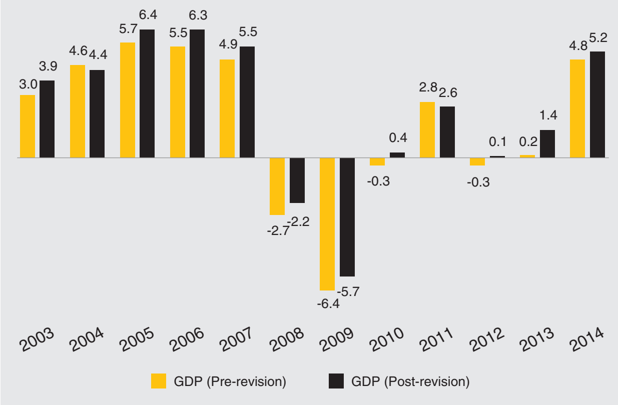
Ibec
For Irish Business

GDP and components

Economic growth

The most recent figures released by the CSO show that the economy grew by an astonishing 7% - in volume terms- in the first half of 2015; this on the back of revisions to national accounts data which show that the economy grew by 5.2% in 2014. The publication of the full year economic figures for 2014 came along with some revisions to past data which now give a better reflection of the activities of the aircraft leasing sector in the economy and updates the accounts to include some new data. These revisions revealed three things – that growth in the boom was larger than previously thought , the recession was not quite as deep and the turnaround in the economy began, albeit tentatively, in 2010 rather than 2013 as previous figures had shown. On the back of the strong figures in the first half of the year and the lack of significant headwinds in the global economy we have increased our 2015 GDP forecast marginally to 5.9%.

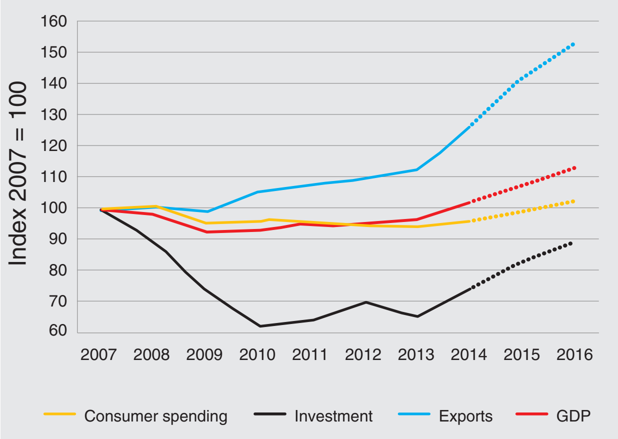
Figure 1: GDP growth, %



Pre-crisis peaks

In volume terms the Irish economy is now larger than its pre-crisis peak for the first time. This, however, belies differences in the pace of recovery across sectors of the economy. Consumer spending despite growth of 2% in 2014 remains 4% below its pre-crisis peak in volume terms. In addition, the collapse in the construction sector and government cap-ex means investment is still more than 25% below its peak despite business investment reaching record highs. On the other hand, exports are now 26% higher than they were in 2007. This remaining shortfall in domestic demand, along with high but falling unemployment, suggests the domestic economy still has significant space for recovery remaining and will become the primary source of growth over the coming years. The major downside risk to sustained growth and competitiveness is now internal supply side pressures. Years of under-investment means we are unprepared to meet an economic and demographic upturn. In addition, recent developments in the global economy (P. 8) are the primary external risks faced by Ireland.

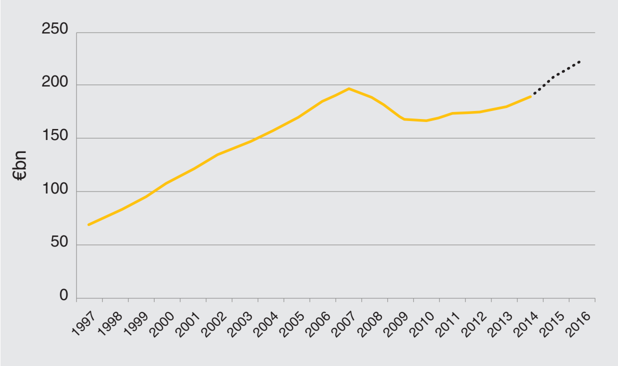
Figure 2: Recovery in GDP components



Nominal growth

While Ireland's growth in volume terms was very strong in the first half of the year, it was the nominal (turnover) growth of the economy which was the stand-out from the most recent set of economic data. Ireland's GDP in turnover terms grew by 12% in the first half of the year; with strong underlying volume growth aided by strong growth in the price of Irish exports. These export price increases are due to the fact that a large proportion of Irish exports (mainly from multinational firms) are traded in dollars; this includes many exports to the eurozone. Exchange rate movements have meant the euro value of these exports has risen significantly in the first half of the year. We expect Ireland's nominal GDP to grow by around 11% this year and around 6% next year as the impact of exchange rate movements subside. As we show later in this publication (P. 9), however, this has large and important effects for the sustainability of Ireland's debt and deficit positions.

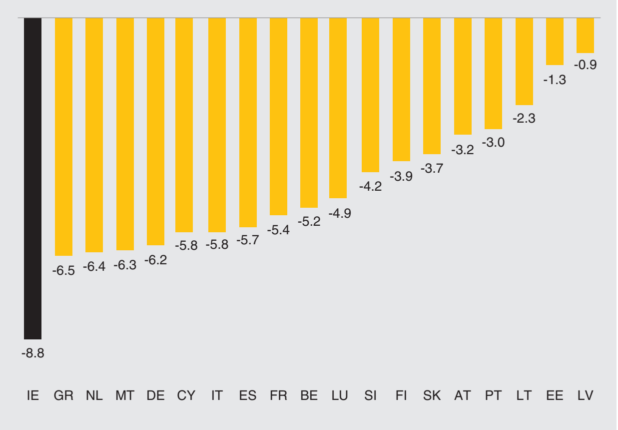
Figure 3: Nominal GDP forecast



Outlook for exports

The fall in the euro versus the dollar and sterling has seen Ireland's real effective exchange rate (REER - exchange rate weighted by trade partners) decrease at the fastest rate of any eurozone country in 2015. Ireland's REER fell by 8.8% in the first half of 2015 compared with the same period last year. This fall is a full 2.3 percentage points greater than adjustments in any other eurozone country meaning Ireland has received the largest external competitiveness boost from the weakening euro. Goods and services exports, as measured by the national accounts, were up 13.8% in volume terms in the first half of the year while imports rose by 16.3% over the same period. As both these very strong figures are somewhat inflated by growth in contract manufacturing (although the net effect on GDP is negligible) it is likely the actual underlying trade growth is somewhat smaller but still strong on the back of the falling euro.

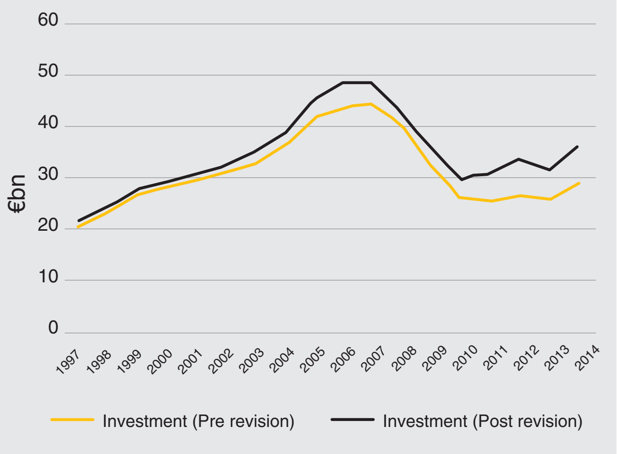
Figure 4: Real effective exchange rate, y-on-y % ch



Investment outlook

The recent revisions to the national accounts mean that airplanes bought by Irish resident companies are now registered as both an import and investment in Ireland no matter where they are registered. Previously this had only been the case if they were registered in Ireland. This has meant that the level (but not the growth) of both imports and investment have risen compared to previous estimates; with no net effect for GDP as a whole. Investment in the first half of 2015 rose by 21.8% on the same period a year earlier. This continued on from growth of 14.3% in the full year of 2014. This upturn in early 2015 was, however, driven in part by some once-off IP activity. Strong business investment along with continued improvement in the construction sector should see investment come in at 11.5% in 2015.

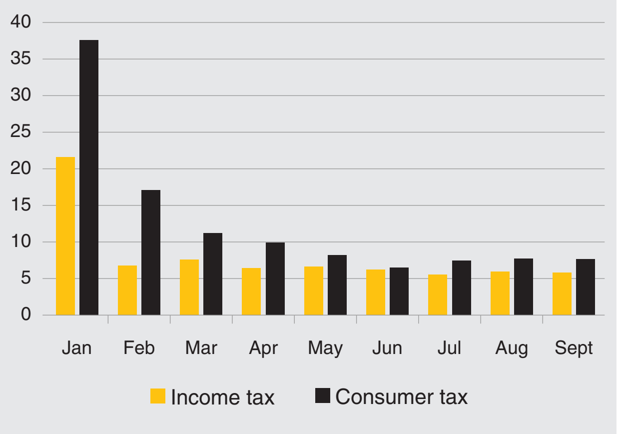
Figure 5: Investment revisions



Consumer spending

Full year data showed that consumer spending rose by 2% in volume terms in 2014 in line with Ibec forecasts. This strong upturn continued in the first half of 2015 as personal expenditure rose by 3.2% year-on-year on the back of strong employment numbers and moderate wage growth. This trend has continued into the second half of the year with the main consumer taxes (excise and VAT) up 11% in Q3 when compared to the same period in 2014. This is in addition to an annual 6.4% increase in the first half of the year. Income taxes which are up 5.7% annually in the year to September (despite some tax cuts) are indicative of moderate wage growth and a continued strong upturn in employment. In addition to continued rising consumer sentiment we expect this to drive an increase of 3.1% in the volume of consumer spending this year and 3.5% in 2016.

Figure 6: Income and consumer tax receipts 2015, y-on-y % change



Consumer confidence and retail sales
Consumer sentiment is continuing to rise with sentiment up 18% in the first eight months of this year, as measured by the KBC Bank Ireland/ESRI consumer sentiment index. Q2 was particularly strong with expectations up 21% over the same period last year. In relation to retail sales, volumes have increased substantially while growth in turnover lags behind. In 2014 the value of retail sales grew by 1.5% and the volume grew by 4%. In the first eight months of 2015, volumes were up by 6.2% and turnover was up by 2.3% over the same period in 2014. Much of this rise has been driven by sharp rises from Q2 this year. Despite this, the fact that growth in volumes continues to outweigh growth in values suggests that high price competition in the retail sector remains.

Summary of contributions to growth
Following on from the impressive growth figures in the first half of 2015, early signs for the second half of the year suggest that economic growth in 2015 could be in the region of 6%. More so than in previous years this will be driven by a mix of recovering domestic demand and external tailwinds. The current slowdown in the global economy remains a real risk to the Irish economy but its effects are yet to be felt in the Irish economy. The major immediate threats to sustained prosperity are within our gift and primarily lie on the supply side of the economy. The immediacy of Ireland's challenges in recent years has meant crucial investment has been put on the hold; particularly in areas such as transport infrastructure, education and housing. Continued lack of investment will put pressure on a growing economy meaning a loss in competitiveness and a poorer quality of life in the long run.

Figure 7: Retail sales value and consumer sentiment

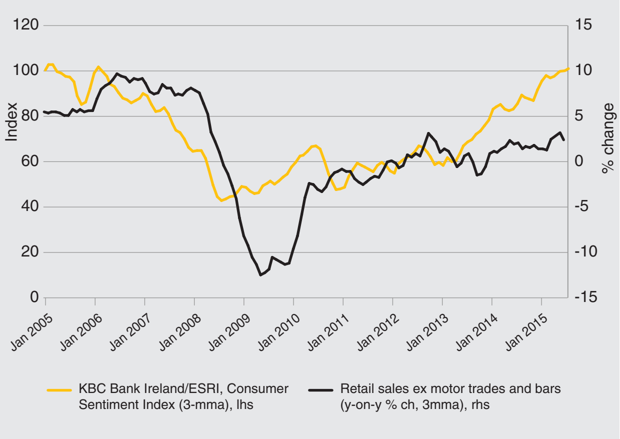


Figure 8: Contributions to growth

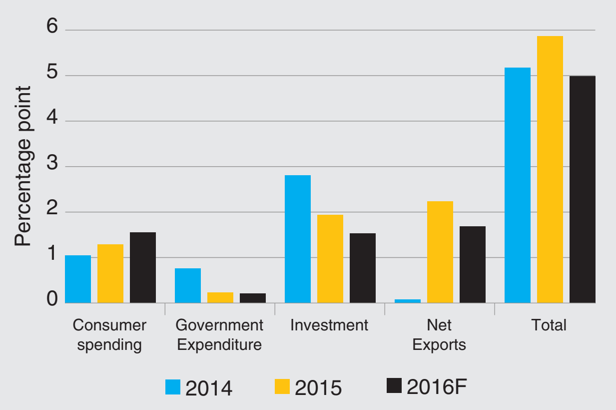


Table 1: Risk assessment for the remainder of 2015

Factors	Probability: High	Probability: Medium	Probability: Low
Financial market stability		🟨	
Infrastructure gaps (housing, transport etc.)	🟨		
Fiscal pressure		⬛	
Wage pressures	🟨		
Global oil prices		⬛	
Exchange rates	⬛		
Bank lending conditions			🟨
International economy	🟨		
Labour market conditions	⬛		

🟨 Downside risk ⬛ Upside risk

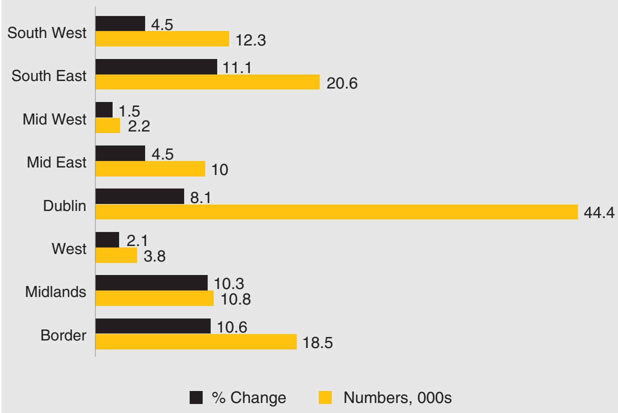
Source: Ibec assessment

Labour market

Employment forecast

CSO figures for Q2 show annual employment growth of 3%, with unemployment likely to drop below 9% by the end of the year. These figures provide the best evidence we have of a broadening recovery, with employment growth in 11 of 14 sectors and evenly spread across all regions. We now expect employment growth of just over 50,000 jobs in both 2015 and 2016 with employment breaking the 2 million barrier in the first half of 2016. Of the 57,100 annual net employment growth in Q2, almost three-quarters (41,700) was outside Dublin. Dublin makes up roughly 30% of total employment in the country and has accounted for a similar share of the new jobs (36%) that have been created since the turnaround in the labour market in 2012. This, however, should not mask the fact that during the crisis, Dublin had by far the lowest drop in employment from its peak at 7.6% compared to 10.6% in the rest of the country exacerbating regional inequalities.

Figure 9: Regional employment growth, 2012 Q2 - 2015 Q2



Jobless households

New detailed data on jobless households released by the CSO has given more information on rates of joblessness and unemployment in Ireland. The proportion of persons aged 0-59 living in jobless households has fallen to 13.2% in Q2 2015. This is down from 17.2% at its height in Q2 2012. Regional breakdowns show that household joblessness has been persistently higher in the Midlands and Border regions mirroring regional disadvantage in unemployment figures. Despite this, Ireland's rate of household joblessness remains well above the European average. This is despite the fact that Irish unemployment rates are now well below the EU average. The main drivers of this phenomenon are structural. Irish employment rates are well below European norms for women, lone parents, carers and those with disabilities. This suggests that targeted interventions by government including improved childcare provision are needed in order to reduce the number of jobless households.

Figure 10: % of people aged 0-59 living in jobless households

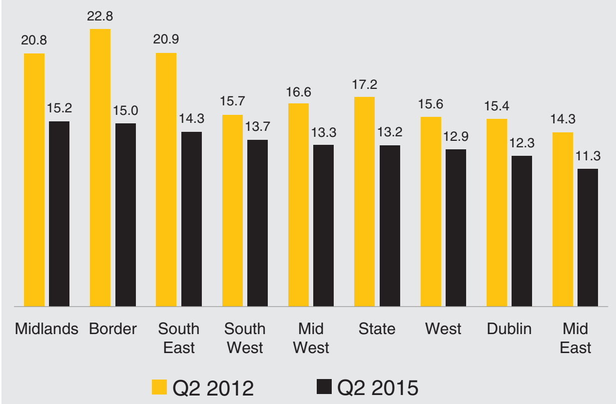


Table 2: Labour market summary

Employment 000s annual average	2014	2015	2016
Agriculture	109	111	111
Industry	348	376	396
Services	1,454	1,472	1,509
Total	1,911	1,960	2,016
Unemployed	243	201	176
Unemployment rate (%)	11.3	9.3	8.0
Labour force	2,157	2,165	2,192

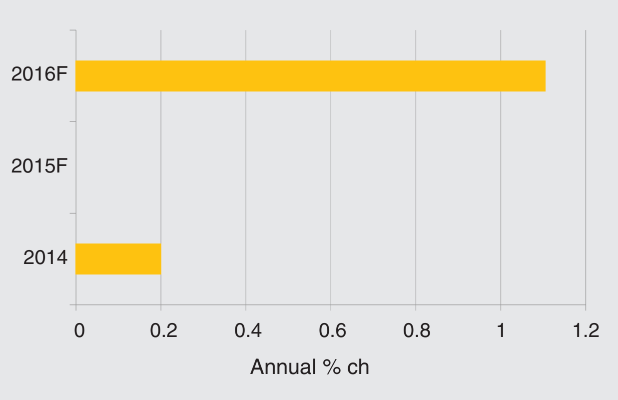
Source: Ibec forecasts

Prices and labour costs

Inflation outlook

Annual inflation in the year to August was negative at -0.4% as measured by the consumer price index. This deflation in the economy has been driven by falling oil prices allied with strong price competition in the retail sector. Figures for the first eight months of the year show a continuing disparity in price pressures with goods prices falling 3.7% year-on-year while service prices have risen by 2.2%, driven by housing, education and restaurants and hotels. As a result of the continued fall in oil prices and retail competition we expect inflation to be flat in 2015. For 2016, however, we expect price pressures to return to the economy as continued inflation in services is joined by a recovery in goods prices and a stabilisation in oil prices. With import prices increasing due to exchange rate movements, wholesale prices have been on the rise throughout the year. The price of non-durable consumer goods has increased by 7.6% during the year. Feedback from members suggests these increases are being swallowed in the supply chain rather than passed on to consumers. This erosion of margins cannot last indefinitely and is likely to end in 2016.

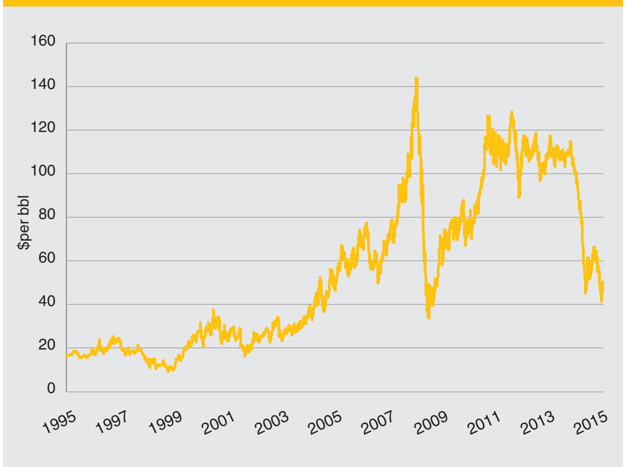
Figure 11: Inflation



Falling oil prices

The Brent oil spot price has fallen by more than 50% since this time last year. This fall has been driven by both supply and demand factors. Oil exporting countries have been increasing their production of oil while consumption has slowed in both OECD and emerging market economies. The US Energy Information Administration expects this falling trend to reverse in 2016 with a slight increase in the price of Oil to $59 per barrel, up from $54 in 2015. In historical terms, this forecast is still very low suggesting that markets will take some time adjusting to this surplus in supply. Falling prices are already having an impact on the value of Irish imports, with oil only accounting for 6.4% of imports in the first 7 months of 2015 compared to 9% in the same period last year. Were it not for the offsetting effects of a strong dollar (oil imports are priced in dollars), this share would have been even smaller, providing an additional boost to net exports.

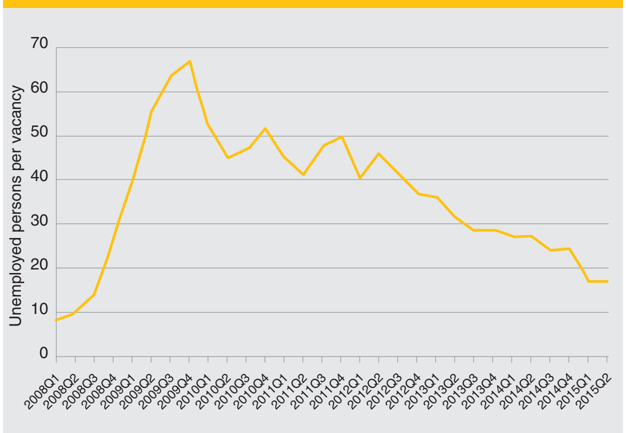
Figure 12: Brent Spot Price



Labour market tightness

The labour market is said to be "tight" if employers are having difficulties filling jobs. It is measured by dividing the total number of unemployed people by the number of job vacancies. This ratio can be low (hard to fill a vacancy) for two reasons: if unemployment is very low or if firms are having difficulties finding workers with the right skills needed to fill job vacancies. A falling unemployed/job vacancy ratio is also a good signal of private sector wage pressures as fewer unemployed persons are available for each role. This measure has fallen substantially and as of Q2 2015 there were 16 unemployed people for each job vacancy, down from 55 persons per vacancy in 2009. On a sectorial level however, skills gaps have emerged, particularly in the ICT sector which has had a high vacancy rate for some time but has experienced annual job growth that is below the national average.

Figure 13: Unemployment/Vacancies ratio



International economies

International Economies
Global GDP is expected to grow by 3.1% in 2015, marginally lower than the growth that was achieved in 2014. Growth reflects two separate trends: an improvement in advanced economies and a slowdown in emerging economies, compared to last year. Growth in advanced economies is expected to rise from 1.8% in 2014 to 2.0% in 2015. The eurozone is expected to grow by 1.5% in 2015, the fastest growth in the past four years. This growth however, still lags behind the US and the UK, both of whom are expected to grow by more than 2% this year. Growth in emerging markets is expected to slow slightly this year from 4.6% to 4.0%. This is the result of lower commodity prices and greater economic uncertainty regarding China.

Currency movements
In September the euro appreciated slightly against both the pound and the dollar but is still very weak in historical terms compared to the two currencies. If the Federal Reserve had raised interest rates in September, the dollar would have become even stronger relative to the euro. The euro would have also devalued relative to the pound had the Bank of England raised interest rates. In the US, the unemployment rate is 5.1% and wages are beginning to grow leading some to suggest that it may be the right climate to raise interest rates. However, the decision to raise rates was put off in September due to the slowdown in China and the adverse impact this would have on the global economy. A rate rise could still happen by the end of 2015, particularly if conditions in the domestic economy continue to improve.

Figure 14: Growth in major economies, % ch

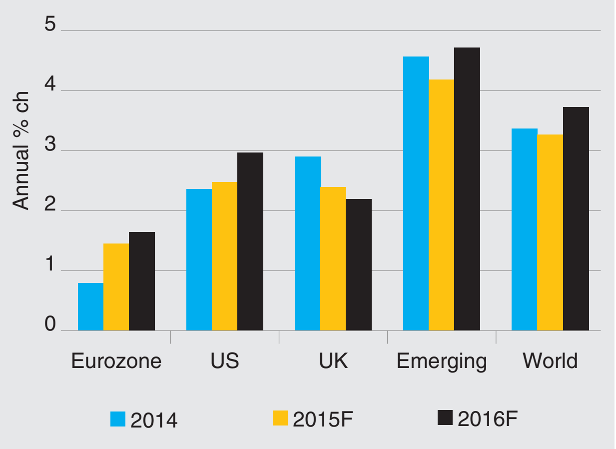


Figure 15: Euro exchange rates

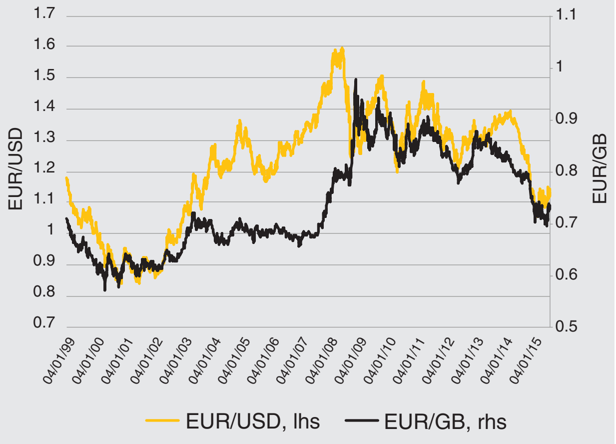


Table 3: International economies summary

	Real GDP, y-on-y % ch			Inflation, y-on-y % ch		
	2014	**2015**	**2016**	**2014**	**2015**	**2016**
Eurozone	0.9	1.5	1.6	0.4	0.2	1.0
UK	3.0	2.5	2.2	1.5	0.1	1.5
USA	2.4	2.6	2.8	1.6	0.1	1.1
Emerging markets	4.6	4.0	4.5	5.1	5.6	5.1
World	3.4	3.1	3.6	3.5	3.2	3.3

Source: IMF economic outlook

China update

Chinese stock volatility

The Shanghai Composite Index peaked on the 12th of June, having grown by almost 60% since the beginning of the year. Since this peak, the stock market has fallen in value by 40% with two severe daily tumbles of 8.5% on both the 27th of July and the 24th of August. This sharp descent seems more like a correction in a stock market that had become overvalued, as the growth prior to this fall did not coincide with significant improvements in the economy. Furthermore the index is still 30% higher than it was one year ago. Despite this, it has still raised concerns over the adverse impacts a slowdown in China could have on the global economy.

A changing China

The rate of economic growth in China has fallen from 14% in 2007 to 7% in 2014. This accompanied by a fall in manufacturing suggests that China is in the process of undergoing a structural shift which due to its size will inevitably have an impact on the global economy. Investment as a share of GDP was 46% in 2014, high by international standards and has been driven by high government spending in this sector and a high savings rate. This is unsustainable and it is likely that this investment share will fall as a growing middle class means people gradually shift away from saving towards consumption. Over the past two years investment has been the main contributor to economic growth and therefore it seems likely that if this share starts to fall it will be met by a corresponding fall in GDP growth.

Global effects

Since 2012 world growth has been falling. According to the IMF, world GDP should grow by roughly 3.5% annually until 2020. This is down from 5.7% growth in 2007. Fifteen years ago both advanced and emerging market economies accounted for an equal share of world growth. This has changed over time with emerging markets now accounting for more than 80% of world growth. A slowdown in China therefore could have a serious impact on world GDP growth as it accounts for a large share of the contribution made by developing economies. Not only this, but a fall in Chinese demand for commodities (resulting from a fall in investment) would have an adverse impact on other emerging markets, such as Brazil who are dependent on exports of such goods to China.

Figure 16: Shanghai stock exchange composite index

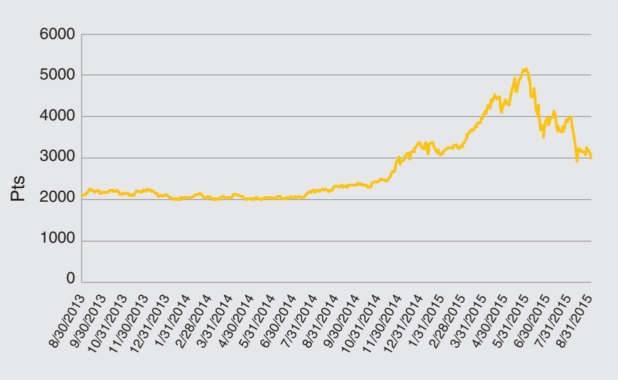


Figure 17: Investment (% of GDP) in China

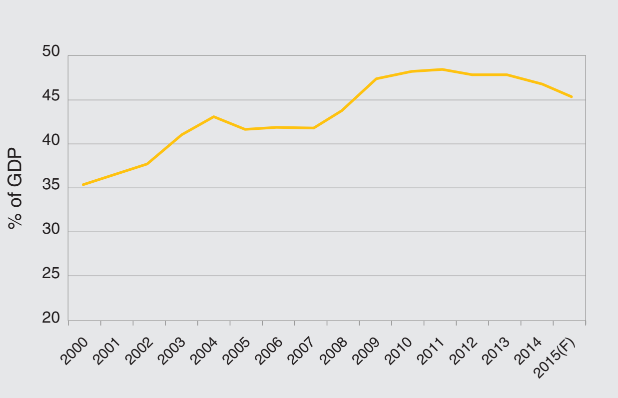
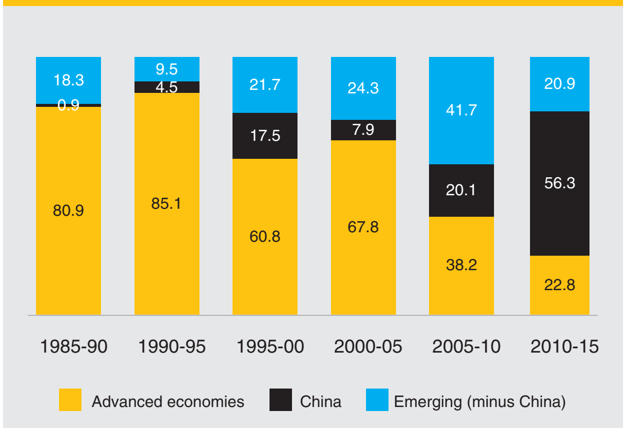


Figure 18: Shares of world GDP growth %



Growth and the state's financial sustainability

Nominal growth and tax

Previous European commission estimates have suggested that total tax revenue has an elasticity of around 0.9 to nominal GDP (i.e. a 1% increase in nominal GDP increases the tax-take by 0.9%). This has broadly held in Ireland so far in 2015 as 12% nominal growth in H1 has led to the state's tax take rising by 9.8% year-on-year over the same period. Budget 2015 on the other hand was based on an expectation that the economy would grow by 5.3% in cash terms with the tax take rising by just 4.1% year-on-year. As a result of the over-performance in the economy the state's tax take was already €1.7 billion (5.8%) above expectations by September and is likely to be in the region of €2 billion ahead of target by the year end. On the other hand, expenditure is broadly in line with expectations. Although a number of areas such as health and transport will see substantial supplementary funds toward the end of the year. It is likely given the fiscal compact rules, which tie growth in expenditure to a mix of the economy's long term growth rate and policy induced tax increases, that this additional tax will not be available for additional spending but rather will go to reducing the state deficit.

Deficit forecasts

In cash terms, the size of the economy is now likely to grow by over €20 billion in 2015. This increase in the size of the economy in nominal terms is unprecedented and will go a substantial way to reducing the size of the fiscal deficit as a proportion of the economy and ensuring compliance with our fiscal rules. Given the over performance in exchequer tax figures in the year so far and allowing for some departmental overspends it is likely that the fiscal deficit will fall to just over €3.5 billion in 2015 well below the €4.6 billion expected in Budget 2015 or April's Stability programme update. This would be equivalent to 1.7% of GDP in 2015 against Budget expectations of 2.3% and a limit of 2.9% set by the fiscal rules. Given our forecasts and the expectation of a €1.5 billion expansion in Budget 2016, the deficit could well fall to 1.2% of GDP in 2016.

Debt forecasts

The Irish government debt-to-GDP ratio peaked in 2013 at 123.2 per cent of GDP. Since then it has been on a steady downward path. With the boost of 11% nominal growth forecast in 2015 we could well see Ireland's gross debt to GDP ratio dip under 100% this year for the first time since the crash. Our current forecast is for a debt to GDP ratio of 99% by the end of 2015. In net terms (when including the state's reserves of cash and liquid assets) Ireland's debt to GDP ratio is likely to fall to 79% in 2015. This does not include the retained value the state has in shares in the pillar banks which may well be worth in the region of €15 billion (7% of GDP) in 2015. Looking at Ireland's current debt position, it is still elevated compared to pre-crash levels but it is on a firm downward path and is now at levels which are on par with other developed nations. Additionally, the average maturity of Ireland's debt, at 12 years, is among the longest in the developed world with rollover costs at all-time lows.

Figure 19: Taxation and nominal GDP

Figure 20: Budget deficit, % of GDP

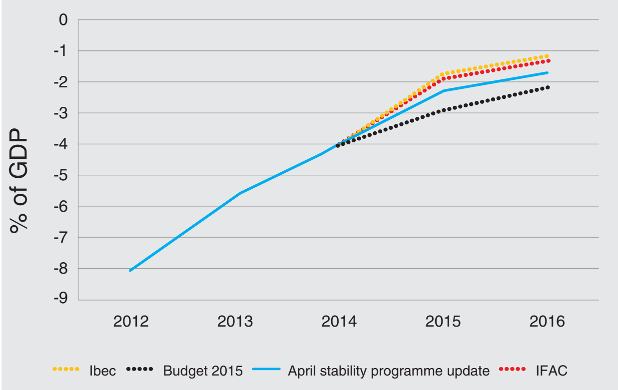
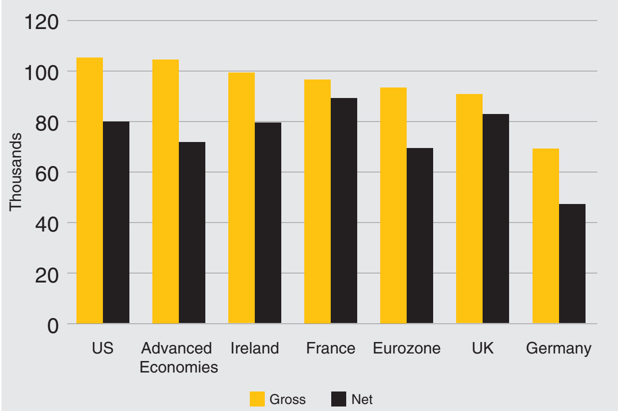


Figure 21: Ireland national debt 2015, % of GDP

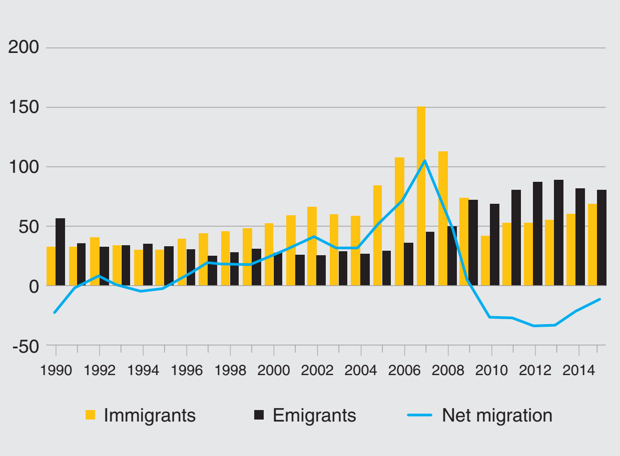


Demographic pressures

Migration trends

Ireland experienced positive net migration from 1996 onwards which peaked in 2007 with the numbers immigrating outweighing those emigrating by 104,800 people. This trend has since reversed and for the past five years Ireland has experienced net outward migration. This has been falling and in the year prior to 2015, net outward migration was 11,600. Of those emigrating this past year, 44% were Irish nationals while only 17% of those immigrating were Irish. Net outward migration is currently one third what it was three years ago and has primarily been driven by a rise in immigration, as the number emigrating is still at the same level it was at in 2011. If this trend continues it is likely that net migration will be positive again by the end of this year, providing an additional boost to population growth. Furthermore, given that emigration numbers have not fallen and immigration figures continue to grow, it may be the case that there has been a structural shift brought on by the crisis whereby Ireland will continue to see a higher movement of people to and from the country.

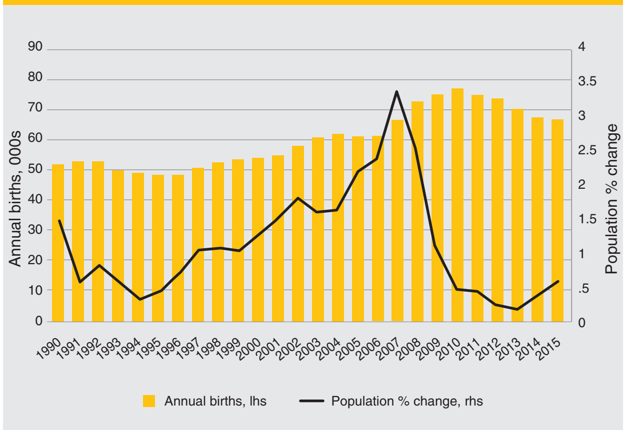
Figure 22: Migration trends



Population and birth rates

The population has been growing substantially since the 1990s and is now 12% higher than it was ten years ago. This is not only the result of high levels of immigration experienced prior to 2008, but has also been boosted by high birth rates. During the past five years the population has been growing despite the high levels of net outward migration as this was offset by high birth rates, which were at their highest sustained level since the famine. In 2014, the birth rate (births per 1,000 persons) was 14.4, the highest in the EU and well above an EU average of 10.1. These demographic trends mean that Ireland now has the youngest population in the EU with 48.4% of its population under 35 years of age.

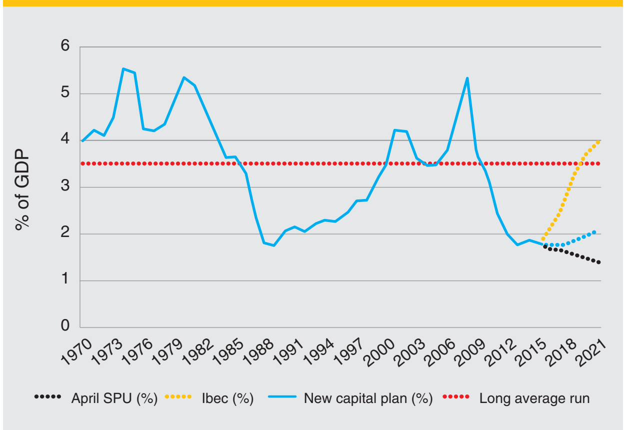
Figure 23: Population growth



The state's capital spending programme

On the 29th of September Government launched its new capital programme outlining Ireland's capital budget and priorities until 2021. Many of the proposals including the Dublin metro link, strategic road upgrades as well as in health and education were welcome. Despite this the plan as a whole lacked ambition with the increase amounting to only 0.3% of GDP per annum (€600 million in today's money) over the current maintenance budget. Ireland currently has the second lowest spend in infrastructure of any EU country (1.9% of GDP), but the fastest growing population. The plan would increase spending by 2020 to the equivalent to the fifth lowest (2.1% of GDP) in today's terms. Indeed, the infrastructure spending commitments over the next five years would mean the smallest government capital budget on record. This along with population and economic growth pressures will result in growing pressure on housing, transport, education and other elements of our capital stock. Despite the new projects announced we still estimate that Ireland will have an annual investment gap of about €2.5 billion.

Figure 24: Government Capex, % of GDP



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For Irish Business

Dates for Diary - General Election Business Forum and Regional AGM

South East: 12 November, Tower Hotel, The Mall, Waterford

Cork: 13 November, Maryborough Hotel, Maryborough Hill, Douglas, Cork

Mid West & Kerry: 17 November, Dunraven Arms Hotel, Adare, Limerick

West: 18 November, Ardilaun Hotel, Taylor's Hill, Galway

North West: 19 November, Harvey's Point Hotel, Lough Eske, Donegal

Dublin & Mid East: 24 November, Ibec Head Office, 84/86 Lower Baggot Street, Dublin 2

Agenda:
The next election will profoundly affect how the country develops over the next five years and beyond. All political parties need to recognise the intrinsic link between a successful business community, job creation and a thriving economy and society. As part of this year's regional AGM series, you are invited to attend a business forum on the general election hosted by Ibec CEO Danny McCoy which will bring together businesses, politicians and stakeholders to examine the choices now on offer for the country and discuss the best way forward.

To book your place, please visit
www.ibec.ie/General-Election-Regional-AGM

Further information

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