QUARTERLY REVIEW
ECONOMIC TRENDS

IBEC

MARCH 2010

# The necessity for credibility

IBEC has fully supported the Government's uncompromising corrective action to consolidate the public finances even though it unavoidably results in a short-term negative impact on the economy, causing some difficulties to business. We summarise in a box on page 4 the importance of Ireland's international reputation. The wisdom of pursuing this course of action is borne out by the credibility that Ireland has gained in financial markets, in marked contrast to Spain, Portugal and in particular Greece. Financial markets are ruthless in their pursuit of any perceived weakness and in identified fragile economies, all actions taken by government and other economic agents are constantly in the spotlight; digressions from what is expected are punished by higher interest rates. Irish ten-year government bond yields, which had been moving in close synchronisation to Greek bonds were favourably differentiated following the consolidation measures announced in the December 2009 Budget, which focused in particular on current expenditure reductions. As Greek yields rose sharply those of Ireland eased back reflecting the markets current increased confidence in the Irish economy.

We would urge trade unions to be cognisant that threats of industrial action gain international notice and could rapidly undermine the confidence gained and undo the credibility that has been established. The credibility of corrective action must go beyond the public sector finances, and for sustainability it must be seen to have gained public acceptance. So far Ireland has demonstrated the flexibility of its labour market. In both the public and private sectors there have been wage reductions and pay freezes and changes in work practices that have helped companies survive the worst of the recession. Companies as far as possible have tried to maintain employment by moving to short-time working, cancelling overtime and reducing bonuses.

Wages increased much more rapidly in Ireland than in the euro area in the seven-year period 2002-2008, precipitating a serious competitive decline. As a result, unit labour costs increased by 31% in the period compared with an increase of 9% in the euro area. The imbalance was reflected in a mounting current account balance of payments deficit, which rose in the period from 0.5% of GNP to over 6%. The necessary correction of this unsustainable position is under way and must be maintained until competitiveness is restored. Some progress is clearly evident. The European Commission calculates that unit labour costs in Ireland will have fallen by 6% in the two years 2009-2010, compared with an increase in the euro area of 2.9%. This suggests that an internal devaluation is taking place through wage and productivity adjustments. The Central Bank expects the current account deficit on the balance of payments to fall to 2.4% of GNP in 2010.

In a single currency, there is no currency depreciation option to realign lost competitiveness. This has good and bad aspects; on the one hand there is no quick fix which anyway often turns out to be only a temporary respite; on the other hand it forces governments to take meaningful actions. One way to reduce unit labour costs is to reduce wage rates, a process that is clearly under way in the Irish economy. The other way is to improve productivity through better work practices and investment in the best available technology. This will bring real gains to the economy and ensure that Ireland is able to fully participate in the global upturn. The gains, however, are more medium term – and more enduring – in nature but there is a danger that this essential correction could be less attractive to a government bedevilled with immediate financial difficulties.

It is important therefore that within the consolidation process, government does not endanger the medium-term prospects for the economy by focusing expenditure reductions on essential investments which include not only the physical infrastructure but also the upgrading of skills and research and development. These more positive medium-term goals are just as important in reviving and maintaining the confidence of investors in the Irish economy as it is to correct the public finances or restore the capacity of the financial sector to provide credit for the economy.

Further information:
David Croughan, chief economist. Email: david.croughan@ibec.ie • Fergal O'Brien, senior economist. Email: fergal.o'brien@ibec.ie
Reetta Suonperä, economic policy executive. Email: reetta.suonpera@ibec.ie • IBEC Agenda: http://agenda.ibec.ie

## Output

The international backdrop against which the Irish economy must operate is showing a modest if uncertain improvement. Many economies moved out of recession in the third quarter of 2009, recording positive quarterly growth. The major developing economies hardly entered recession and were growing strongly by the third quarter; of the developed economies, the US recorded a quarterly growth of 0.6% and the euro area 0.4%. Some economies (Japan, Germany and France) began the recovery phase in the second quarter, while others (the UK) began in the fourth quarter. Greece, Spain and Italy have yet to emerge. This of course does not mean that the level of GDP in most countries has grown on an annual basis. In the last quarter of 2009, only the US recorded positive annual GDP growth of 0.1%; other economies recorded negative growth, for example Japan -0.9%, the euro area -2.1%, the UK -3.3.

Ireland has suffered one of the worst recessions of all economies but it too managed a third quarter growth of 0.3%. However, this still left GDP 7.4% below the third quarter of 2008. Data for the final quarter of 2009 are not yet available but the consensus view of Irish economists is that GDP in the final quarter will be 4.3% below the final quarter of 2008 and on a quarterly basis, GDP is likely to have slipped back by as much as 2%.

The Quarterly National Accounts for the third quarter suggested some mild deceleration in the pace of the annual fall in industrial output from 11.7% in the second quarter to 9.6%. Output in the transportable goods and utilities sectors was responsible for the improvement, and the Central Statistics Office estimates that the annual fall in these sectors decelerated from -4.8% to -0.3%. However, the CSO's monthly Survey of Industrial Production shows that output of industry excluding the utilities fell by an annual 2.4% in the third quarter gaining pace to an annual decline of 4% in the final quarter. The construction sector continued to record increasingly negative annual declines with output down by 34.4% in the third quarter compared with a 32.7% fall in the second quarter. The Ulster Bank Construction PMI report for February showed that output continued to fall, albeit at the slowest pace since November 2007.

### GNP and its components

Annual % change

| | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|
| Consumer spending | -1.0 | -7.5 | -2.5 | 2.0 |
| Government spending | 2.6 | -1.0 | -3.0 | -1.5 |
| Investment | -15.5 | -29.7 | -10.9 | -0.5 |
| Exports | -1.0 | -2.5 | 1.0 | 3.8 |
| Imports | -2.1 | -9.0 | -1.5 | 2.9 |
| GDP | -3.0 | -7.3 | -0.7 | 2.1 |
| GNP | -2.8 | -10.4 | -1.0 | 1.9 |

Table 1

### Economic output

Seasonally adjusted

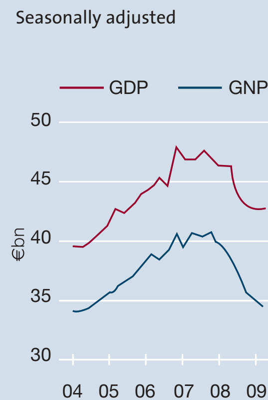


Figure 1

For 2009 as a whole, industrial output fell by 2.4% and manufacturing output by 1.8%. This is a significantly better performance than the euro area average where industrial production in 2009 fell by 14.8%. However, the aggregate industrial production figures hide a much more negative picture in some sectors. The modern sector grew by 5.8% in 2009, but worryingly, almost entirely resulting from the growth of over 21% in pharmaceutical; other key modern sectors suffered badly, especially computers, which recorded a 31% decline in output. This reflects the closure of the Dell facilities in Ireland but also the very difficult trading conditions in the computer and electronics sector generally. Traditional industry performance was much more in line with the sharp decline experienced in the industrial sector in the euro area. Output in the traditional sectors fell by 14.3% with important sectors such as food falling by 4.2%.

Looking forward into 2010 and 2011, the global upturn will assist exporters to a limited degree. The greatest increases in growth will be in the developing country markets, especially in Asia, where Ireland does not yet have a significant presence. For Ireland, therefore, the trading climate is likely to remain challenging. The US economy is moving out of recession much more rapidly than the European Union, but the sustainability of that recovery as fiscal and monetary policy supports are withdrawn is not a certainty. Within the euro area, the German export-led recovery is unlikely to give a major boost to other member states unless accompanied by a revival in domestic consumption. The UK economy will not be a vibrant source of demand for Irish exports. The country has a public deficit problem as large as that of Ireland which, together with political uncertainty surrounding the upcoming general election has put further downward pressure on sterling. This will continue to make competition with the UK extremely difficult. The loss of output from Dell will be a drag on growth statistics for the first half of the year and the negative carryover in output generally into 2010 of 3.5% will make it difficult for the manufacturing sector to make any gains in 2010. The Purchasing Managers Index remains stubbornly under 50, the borderline between growth and decline. We therefore expect little growth in manufacturing, which is likely to result in further employment losses of the order of 3%.

According to the Purchasing Managers Services Index, output and employment up to February were still in decline. The consolidation process under way in the public sector suggests that output and employment will also decline in 2010.

These negative influences stem from the necessary rebalancing process that the economy must go through before it can regain the lost competitiveness of recent years, which will enable a return to an export led growth. We therefore believe that the economy will continue to decline in 2010 by 0.7%, although some uptick in activity will emerge before the end of the year. Consumer spending, we feel, will remain weak as the impact of the tax increases in 2009 carry over into 2010 and consumer confidence remains weak in the light of further employment falls. In 2011, the strength of the global economy will be a significant determinant of GDP growth; we expect only a modest return to growth of 2.1%.

## Employment

The rebalancing of the economy and the mayhem caused by the financial crisis and global recession will, we estimate, result in a further 67,000 job losses in 2010 following the loss of 176,000 jobs in 2009 and 23,000 in 2008. This amounts to 266,000 jobs in total, more than all the jobs generated in the three years to 2007. It is unlikely that employment, which will have fallen to 1.86 million in 2010, will reach the 2.1 million peak of 2007 before 2015.

Taking our estimates for 2010, the non-agricultural private sector of the economy will have shed 265,000 jobs, the agricultural sector lost 12,000 while the public sector gained 11,000.

The construction sector has borne the major burden of this collapse with 133,000 of the 267,000 jobs in the sector in 2007 lost in the three-year period. This amounts to half of all construction jobs and coincidentally is half of all the job losses in the country. The job losses in the construction sector were a consequence of the unwinding of the unbalanced nature of economic activity in Ireland, the bulk of which was largely unavoidable. There was a loss of over 45,000 in the wholesale, retail and distribution sectors which represents a retrenchment of some 15% of the total workforce in the sector. This too, as a bi-product of the bubble, is a consequence of the unsustainable nature of the Irish economic growth model. A further concern is that between public administration, health and education, public sector employment reached

**Employment**

000's annual average

| | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|
| Agriculture | 115 | 99 | 98 | 98 |
| Industry | 520 | 411 | 380 | 383 |
| Services | 1,465 | 1,414 | 1,378 | 1,383 |
| Total | 2,100 | 1,924 | 1,856 | 1,863 |
| Unemployed | 141 | 264 | 296 | 268 |
| % Unemployed | 6.3 | 12.1 | 13.7 | 12.6 |
| Labour Force | 2,241 | 2,187 | 2,152 | 2,131 |

Table 2

**Live register**

Seasonally adjusted

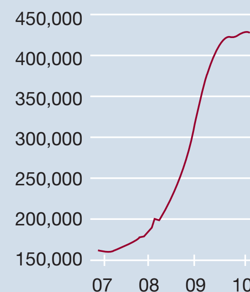


Figure 2

458,000 at the height of the boom in 2007 having been only 387,000 three years earlier; by 2009, while almost all of the economy was shedding jobs, a further 29,000 were added to public sector employment. The government's fiscal stabilisation plan, involving redundancies and early retirement in the public sector is likely to result in public sector employment losses in the final quarter of 2009.

A major concern is the fact that the industrial sector, comprising of many exporting companies, will have shed 51,000 jobs by the end of 2010 as the impact of the recession and the weakening sterling expose competitiveness problems. Within the services sector, there has been a continuing flow of net job gains in the information and communications, financial, insurance, and real estate sectors. There have been declines in professional, scientific and technical activities and in administrative and support service activities.

Our expectation is that about 67,000 jobs will be lost in 2010, the bulk of them in the first half of the year. While there are some companies starting to rehire, taking advantage of lower wage levels, we think many companies will be slow to make commitments ahead of much firmer indications of the sustainability of the recovery. Even though we believe economic growth will be above 2% in 2011, it is unlikely to translate into a major jobs recovery. It is not until 2012, that we would begin to see some measurable growth in employment of the order of 1.5%. After 2012 employment growth could pick up markedly as there will be a supply of skilled labour available at more competitive wage rates than in 2009.

## Prices and wages

Significant progress was achieved in 2009 in addressing Ireland's competitiveness difficulties. Prices and wages declined and the gap between the cost of doing business in Ireland and that for our main competitors in the EU was narrowed somewhat. The EU Commission estimates that unit labour costs in Ireland fell by 3% last year but increased by about 2% in the EU 15 – thereby resulting in an unit labour cost competitiveness gain of about 5%. Our unit labour cost competitiveness disadvantage remains in the region of 10% but 2009 saw an important first step in addressing Ireland's competitiveness difficulties.

Prices, as measured by the Consumer Price Index (CPI), fell by 4.5% during 2009. This was the largest fall in annual average prices since 1931 and was much larger than price falls

## Gains for Ireland from confronting economic crisis

### Tackling public finances, cost base

Ireland's decisive and credible action in curbing its deficit has gained recognition in the international markets. This has differentiated Ireland from Greece, Spain and Portugal and financial commentaries now include Spain and Portugal, not Ireland, as companions to Greece. Since the Budget in December 2009, the cost of borrowing relative to the benchmark German ten-year bonds has stabilised, while the bond spreads of the other three countries have trended upward.

Following adjustments amounting to around €8 billion, or 5% of GDP, Budget 2010 set out a realistic path for bringing down the budget deficit to 3% of GDP by 2014 and delivered expenditure cuts of €4 bn. Unchecked, Ireland's deficit was trending towards 14% of GDP; the Government's resolute action has stabilised the deficit at 11.6% of GDP in 2010.

The worst of is now behind us. Further adjustments (comprising expenditure and taxation) are necessary to meet the deficit target by 2014, but they will be smaller in magnitude than those delivered in the April and December 2009 Budgets. The Minister for Finance has repeatedly stated that there is no scope to further increase income taxes at the top end, though the tax base will likely be broadened.

The Department of Finance forecasts that Ireland's deficit will be 11.6% in 2010, with a debt-to GDP ratio of 78%. This compares to deficits in excess of 12% in countries such as the UK and the US, and debt-to-GDP ratios of 80%, 94% and 113% in the UK, US and Greece, respectively.

Consumer prices in Ireland relative to trading partners fell during 2009. On the EU harmonised basis, deflation in Ireland was 1.7%, while prices in the euro area increased by 0.3%. Prices in Ireland are likely to fall further during 2010. Cost of accommodation, particularly in Dublin, was a significant component of Ireland's high cost base during the boom. Large falls in house prices (-30%) and rents (-25%) have dramatically improved Ireland's attractiveness as a destination for young, mobile workers.

Moreover, as detailed elsewhere in this publication, the Irish labour market has demonstrated exceptional flexibility. Apart from outright reductions in nominal pay rates, companies have been able to reduce pay bills in a number of ways. These include reductions in bonus and shift and over-time premia, short-time working arrangements and decreases in employee numbers.

### Fundamental strengths remain

Ireland is still a good location for business. The labour force is among the best educated in the world; the share of population aged 25-34 with a third level qualification is higher than in the US or the UK, and the OECD average. Ireland is ranked 3rd in Europe (7th in the world) by the World Bank in terms of ease of doing business. Ease of paying taxes and starting a business, as well as investor protections, are some areas where Ireland scores particularly well.

Ireland has a favourable business taxation regime and is a very attractive location to do business. The corporation tax system is comparatively simple, wide-based and transparent, while income taxes remain relatively low. The Minister for Finance restated Ireland's commitment to the 12.5% corporation tax rate, the lowest in the OECD, in his Budget 2010 speech. The recent report on Ireland's tax system from the Commission on Taxation stressed that positioning the tax system to support economic activity is of central importance. The tax offering, particularly to support the knowledge economy, is continually being developed. Recent improvements include an increase in the research and development tax credit from 20% to 25% and other enhancements to the scheme including the introduction of a payable credit.

Thanks to clusters and networks of multinational companies in areas such as pharmaceutical, medical technologies financial services, ICT and newer internet-based companies, Ireland has achieved critical mass in a number of high-tech sectors. As a result of specialisation in relatively recession-proof sectors, Ireland's manufacturing output in 2009 fell by much less than in other European countries. Ireland is no longer a low-cost location. However, with its educated and flexible labour force, Ireland has been able to meet this challenge. The functions located in Ireland are shifting to higher value added activities and in many cases are becoming increasingly R&D-driven.

**Ten-year government bond spreads**

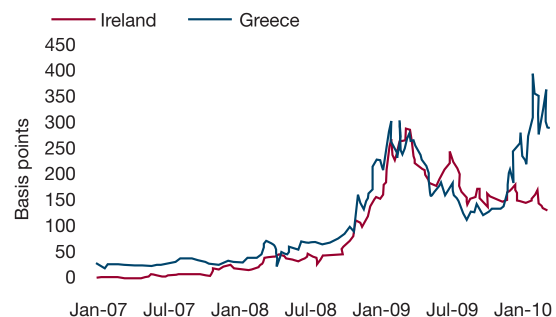


Figure 3

experienced in any other EU country. Although price declines were recorded across a broad range of product categories, rapid decline in mortgage interest was the single largest factor in last year's deflation, as the CPI excluding mortgage interest fell by just 1.2%. Mortgage interest repayments in 2009 were 40% lower than those recorded in 2008.

Lower food prices were the other main contributor to deflation during 2009. On average, food prices were 3.5% lower than 2008 and food prices in December 2009 were 8.1% below those in December 2008. Falling commodity prices, exchange rate factors and increased competition in the retail sector all contributed to significant falls in food prices during the year. Clothing and footwear prices fell by a massive 11.7% during the year and following a number of years of decline are over 20% lower than they were in 2005. The public-sector-dominated health and education sectors both recorded significant prices increases during 2009 with health up by 3.5% and education 6.4% higher.

Monthly deflation is likely to persist until autumn 2010 and the annual average CPI for the year will fall by a further 1.1%. Deflation peaked at -6.6% in October last year and had fallen back to -3.9% by January. Given the recent slowing of the economic recovery in the euro zone and the increasing concern over sovereign debt levels, the ECB is unlikely to raise interest rate in the near term. While changes to lending margins are likely to have some impact on mortgage interest costs in 2010 it is most likely to be 2011 before euro zone base rates are increased. Given the considerable spare capacity in the Irish economy, domestic price pressures are therefore likely to remain subdued for some time. Ongoing concerns about the global economic recovery are also likely to mean that international commodity price pressures will not greatly add to Irish inflation in the short-term. The CPI is therefore forecast to increase by about 1.7% in 2011. In the context of potential wage pressures emerging in 2011, it is important to recognise that although prices are likely to start rising again next year the actual price level in the Irish economy will remain well below the pre-crisis mark for some time yet. Between September 2008 and January 2010 the average price level has already fallen by 8.4%. Assuming further moderate price increases in 2012 and 2013, it would take until the end of 2013 before the price level would return to that recorded in September 2008.

**Inflation forecasts**

| 2010 | Quarterly | Annual | Annual Average |
|---|---|---|---|
| March | 0.1% | -3.3% | -1.1% |
| June | 0.4% | -1.5% | |
| September | 0.5% | -0.2% | |
| December | 0.0% | 0.6% | |
| **2011** | | | |
| March | 0.5% | 1.3% | 1.7% |
| June | 0.8% | 1.8% | |
| September | 0.5% | 1.8% | |
| December | 0.3% | 2.0% | |

Table 3

Average wage rates were reduced in both the public and private sectors during 2009. IBEC's Quarterly Business Sentiment Survey sampled about 600 members during each quarter of 2009 and provided remarkably consistent data on pay trends in the private sector. On average, about one in four private sector workers in IBEC member companies experienced pay rate reductions during the year, while about 60% were subject to pay freezes and 15% benefited from pay increases. The average pay rate change across the entire sample was a reduction of 3%. In cases where pay was reduced, however, the cuts ranged from 12% for production workers to 18% for management.

About one in ten firms plan to reduce pay rates during 2010. The average reduction in pay rates is set to be about 1% but those firms actually cutting pay will implement pay cuts of about 10%. Some 70% of firms plan to freeze pay during 2010 while only about 10% are planning pay increases.

## Consumer spending

The consumer spending boom which saw personal consumption of goods and services rise by 28.4% in volume terms and 46.9% in value terms in the six years from 2002 to 2007, came to an abrupt halt in the second quarter of 2008. According to the Quarterly National Accounts, the annual growth slowed sharply in the first quarter of 2008 from an average of close to 6% to 2.6%. The annual decline in the volume of sales accelerated in the last quarter of 2008 to 3.6% followed by a massive 9.5% fall in the first quarter of 2009. Since the first quarter the pace of decline moderated a little with declines of 6.9% and 7.3% in the second and third quarters respectively. We expect that when final quarter figures are released, the pace of decline will have moderated to around 6%. Total retail sales fell much more sharply in 2009, recording a volume fall of 14.1% and a value fall of 18%. The first quarter annual decline was 21.5%, moderating to a decline of 8.2% in the fourth quarter. Excluding motor trades, the remainder of retail sales fell by 6.8% in 2009, with the final quarter falling by an annual 6.4%.

There are little hard data so far in 2010. Retail sales are now available for January and show a year-on-year decline of 4.7% but a month-on-month rise of 0.1%. However, January sales distort normal trade and the value/volume figures suggests that price discounting moderated in January from the heavy discounting in December. The data suggest that the fall in sales may be coming close to stability. The VAT returns in March will give a better guide to the level of retail activity. Unemployment is also showing signs of stabilising, but this is helped by outward migration as people who lost their jobs also left the labour force. The January data for outstanding credit on credit cards fell further in January suggesting

### Consumer confidence

Figure 4

consumers are choosing to pay down debt rather than spend. The KBC/ESRI Consumer Sentiment Index weakened in February with both components – consumers' perceptions of their future financial situation and their current situation – becoming more pessimistic. The fall in the savings ratio may, therefore, be more modest than expected. Other factors which may begin to bite on spending are further wage reductions, and the increases in mortgage interest rates announced at the beginning of March. Given that employment levels are likely to remain below 2008 levels for the next five years, any recovery in consumer spending is likely to be quite modest.

Given the prevailing conditions, we expect consumer spending to fall by a further 2.5% in 2010, although the pace of decline will moderate and stabilise by mid-year. On a quarterly basis, sales are likely to record modest declines before showing some growth from mid year onwards. Growth of about 2% is anticipated in 2011.

## Investment

Investment in the Irish economy remained particularly weak throughout 2009. The collapse in new housing activity peaked during 2009 as completions fell by 55%, following a 34% decline in 2008. New housing activity has yet to bottom out, however, and completions will slip a further 40% during 2010. Overall, investment was by far the worst performing component of the economy last year. The total volume of investment fell by some 30% – building and construction was 34% lower while investment in plant and machinery was down by 15%. Investment last year was about half of the level recorded in 2007.

Work on housing developments all but ceased during 2009. The small number of houses that were being completed by end year were mainly in the social and one-off housing sectors. The number of new house completions declined from 52,000 in 2008 to about 26,000 in 2009 and will decline further to about 15,000 in 2010. Demand for housing has obviously collapsed, while recent estimates for the number of unoccupied housing units are much higher than previously thought. A UCD study has found that the housing vacancy rate is currently 17% but when holiday homes and normal vacancy patterns are accounted for, the excess housing supply in the market is in the region of 170,000 units. At a reasonably sustainable medium-term demand level of 35,000 units or so, it will take about five years for this excess stock to run down. Although, estimates from the construction industry indicate that the level of unsold stock is much lower, it is clear that it will take a number of years for the sector to return to equilibrium. The value of new housing output in 2010 is set be less than one fifth of that achieved in 2007. The housing improvements sector will actually be larger in 2010 than the new housing sector.

The volume of construction activity in the retail, office and other commercial sector also slowed rapidly during 2009. Oversupply exists across all property sector categories and regions and access to credit issues have greatly added to the difficulties facing the sector. The public capital investment programme held up reasonably well during 2009, despite the difficulties in the public finances. Total Exchequer capital investment declined from €8.6 billion in 2008 to €7.4 billion in 2009, although the fall in the volume of activity is likely to have been proportionately less due to some reductions in unit costs. Exchequer investment is budgeted to be a further €1 billion lower in 2010, while the completion of the inter-urban motorways by the end of this year will signal a further contraction in the public capital investment programme for 2011. Total investment in the non-residential building and construction sector fell by 20% in 2009 and is set to fall by about 15% in 2010. Further reductions in the public capital programme over the coming years will mean that contraction in this sector will continue for some time.

Given the severity of the domestic and global recession, investment in machinery and equipment actually held up reasonably well during 2008 and 2009. This was mainly due to the large airplane component in the numbers which tends to distort the data trends somewhat. Total investment in machinery and equipment fell by 15% in both 2008 and 2009. When the volatile airplanes sector is excluded, however, investment by firms in machinery and equipment fell by 35% in 2009. We are forecasting that a pick-up in export orders and global investment patterns generally will lead to modest recovery in this sector during 2010. It has to be acknowledged, however, that considerable risks remain to this forecast and access to credit issues in particular could continue to suppress investment activity during the coming quarters.

### Investment

Annual % change

| | 2008 | 2009 | 2010 | 2011 |
|---|---|---|---|---|
| Building & construction | -15.5 | -34.0 | -16.9 | -3.2 |
| Plant & machinery | -15.4 | -15.0 | 5.0 | 5.0 |
| Total | -15.5 | -29.7 | -10.9 | -0.5 |

Table 4

## Trade

In the context of a 12% decline in world trade during 2009, Ireland's export performance held up reasonably well throughout the worst of the global recession. The value of Irish merchandise exports declined by just 3% last year, while the volume indices for the first 11 months of the year indicate a fall of 6% in volume terms.

As expected, exports to the UK were well down on year earlier levels as the weakness of sterling made it very difficult for Irish suppliers to preserve market share. The value of Irish goods exports to the UK last year fell by 15%. The food and drinks sector remains particularly reliant on sales to the UK and experienced very difficult trading conditions in 2009 as a result of sterling weakness.

Despite the equally challenging exchange rate climate faced by those businesses selling to the US, exports to Ireland's single largest market destination actually increased in 2009. The value of goods exported to the US reached €17.5 billion last year – an increase of about 6% on sales achieved in 2008. Ireland's trade relationship with the US is often less directly affected by currency movements as a high proportion of exports are accounted for by intra-company sales. Goods exports to euro zone countries increased marginally, while sales into the main Asian economies also remained fairly solid for Irish exporters during 2009.

The value of exports in most product categories declined in 2009 with the notable exception of the chemical/ healthcare sector. Exports of chemical, pharmaceutical and medical products increased by over 8% in the year. The food industry suffered from both weaker demand and lower prices in both its consumer and commodity sectors during 2009. Exports from the IT sector suffered a substantial decline during the year, largely due to the cessation of production at the Dell plant in Limerick.

## Exchequer finances

Taxation receipts were marginally lower than expected during the first two months of the year and remained in the region of 18% down on year earlier levels. The full year tax revenue target of just over €31 billion represents a decline of 6% of the 2009 outturn, so the year-on-year performance will have to strengthen considerably as the year progresses if the Government's target is to be achieved. The Exchequer deficit was 15% higher than in the same period last year but expenditure was down by 8%.

Deflationary pressures are continuing to suppress tax receipts in the economy. Despite the hikes in income taxes during the past year, receipts in the first two months of 2010 were down 12%. Pay cuts, unemployment and under-employment are continuing to take their toll on Government's tax revenue and the income tax head is likely to remain under pressure throughout this year at least. VAT, which is the second largest tax head, was 13% below year earlier levels but the revenue received by the Exchequer to date relate to sales which largely occurred during November and December 2009. The volume of retail sales actually increased on a monthly seasonally adjusted basis in January of this year and it is likely that the year-on-year comparisons for VAT will become much more favourable as the year progresses. The final outturn for VAT receipts, however, will remain highly dependent on price trends and it is too early to conclude that deflationary pressures have subsided.

It is too early in the year to draw any conclusions in relation to the performance of the other tax heads. Nevertheless, the overall outcome to date highlights the challenge the Government faces in narrowing the year-on-year decline in total tax receipts to 6% for the full year. Although some emerging "straws in the wind" such as the recovery in new car sales and some improvement in housing transaction levels point to improvement over the coming months.

## Finance

According to the Central Bank's Monthly Statistics, headline private sector credit declined by 7.1% in the year ending January 2010, an acceleration from the annual decline in December of 6%. Credit growth, which had been very strong for a number of years, recorded its first decline in this recession in June 2009 when annual growth fell by 0.8%. Half of the annual decline in January was the result of valuation effects such as write-downs of loans and increased bad debt provision. The strengthening of the euro throughout 2009 contributed to the decline as the book value of non-euro denominated loans fell. The month-on-month decline in private sector credit was mainly due to underlying transactions as repayments were higher than draw-downs during the month. Indebtedness on personal credit cards fell by an annual 1.3% in January 2010 compared with an increase of 5.1% in January 2009, 8.9% in 2008 and 17.9% in 2007.

The value of the euro has experienced quite divergent trends against the dollar and sterling; falling against the dollar and strengthening against sterling. Following the Fed's raising of the discount rate on 18th February signaling its first major step to unwind its massive economic stimulus the dollar strengthened sharply against the euro, moving from €1.46 in mid January to €1.35 at 1st March. It signaled the prospects of a stronger economic recovery, suggesting the dollar would remain firm. This cannot be said for the prospects for sterling and if anything continuing weakness is more likely, keeping pressure on exporters. Sentiment has turned against sterling as the UK's own public finances come under scrutiny and fears have emerged of a hung Parliament after the May general election.

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
11/12 Mill Court
The Diamond
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

## International

The main forecasting agencies are revising global forecasts upwards, but growth is still dependent on fiscal and monetary stimulus. The economy performed better than expected in the latter half of 2009, but there is a risk that growth will lose momentum in 2010. The IMF points out that few indicators are showing private sector demand taking hold independently, particularly in the advanced economies. Overall, emerging economies have fared better in the crisis, thanks to less vulnerable financial systems and swift policy response. The structural challenge of rebalancing the global economy – stimulating domestic demand in countries excessively reliant on exports and shifting resources to the traded sector in those too dependent on domestic consumers – remains formidable.

### UK

The UK experienced seven consecutive quarters of falling output before posting a quarterly gain of 0.3% in the final quarter of 2009. Overall, output fell by 4.8% last year. The data for 2010 have so far been weak. Unemployment and inflation have both risen, while retail sales and bank lending have contracted. The IMF forecasts a return to growth this year, with GDP expanding by 1.3%. The European Commission, however, is more pessimistic, projecting growth of just 0.6%. Household indebtedness will drag on consumer spending, while a government deficit of 12% this year will necessitate fiscal tightening down the line, again dampening GDP growth. However, as world trade recovers, UK exporters are set to benefit from the weaker currency, though the boost to output will likely materialise with a lag of a few years.

### US

The US exited recession in the third quarter of 2009, but GDP nonetheless fell by 2.5% during the year as a whole. Most of the rebound in activity has been from government stimulus and stock building by firms and it is not yet clear that the recovery is self-sustaining. The IMF forecasts that the US economy will growth by 2.7% this year, slowing to 2.4% in 2011. Other commentators, however, are more pessimistic, expecting that growth will slow significantly towards the end of the year and into 2011. The risk of a so-called jobless recovery is real. Small firms accounted for a larger share of employment losses in this time than in previous recessions. They also tend to account for a substantial share of job creation in the recovery. However, continuing credit constrains may now stop small firms from hiring additional staff. A weak labour market together with high household indebtedness and fiscal restraint point towards a protracted period of weak consumer spending.

### Euro area

The euro area also exited recession in the third quarter of 2009. The European Commission forecasts that the bloc as a whole will grow by 0.7% in 2010, following from a 4% fall in output last year. The recovery, however, remains fragile. Latest data show that quarterly GDP growth in Q4 2009 slowed to just 0.1%, from 0.3% in Q3. Incoming data for the first months of the year have also been weak – but this at least partially reflects the exceptionally bad winter, which has had a negative impact on construction and retail sectors. The European Commission expects that the German economy will gather pace from the second quarter onwards, boosted by recovery in world trade. Greece has announced concrete measures to bring down its deficit to 8.7% of GDP this year, winning approving comments from markets and European partners. In Spain, high public and private indebtedness will drag on the recovery, but improved consumer and business sentiment that domestic demand may perform better than previously expected. France fared better than many other eurozone countries in 2009, but the outlook for 2010 is not without risk and fiscal consolidation will dampen growth.

**Real GDP growth – selected countries**

| Annual % change | 2009 | 2010 | 2011 |
|---|---|---|---|
| Euro area | -3.9 | 1.0 | 1.6 |
| UK | -4.8 | 1.3 | 2.7 |
| Germany | -4.8 | 1.5 | 1.9 |
| France | -2.3 | 1.4 | 1.7 |
| US | -2.5 | 2.7 | 2.4 |

Table 5

**Inflation – selected countries**

| Annual % change | 2008 | 2009 | 2010 |
|---|---|---|---|
| Euro area | 3.3 | 0.3 | 0.8 |
| UK | 3.6 | 1.9 | 1.5 |
| Germany | 2.8 | 0.1 | 0.2 |
| France | 3.2 | 0.3 | 1.1 |
| US | 3.8 | 0.4 | 1.7 |

Table 6

**Unemployment rate – selected countries**

| Annual % change | 2008 | 2009 | 2010 |
|---|---|---|---|
| Euro area | 7.6 | 9.9 | 11.7 |
| UK | 5.5 | 7.6 | 9.3 |
| Germany | 7.4 | 8.0 | 10.7 |
| France | 7.9 | 9.5 | 10.3 |
| US | 5.8 | 9.3 | 10.1 |

Table 7

*Source: IMF forecasts, January 2010 and October 2009.*