Goodbody STOCKBROKERS

Ireland

Irish Competitiveness

Devaluation the hard way

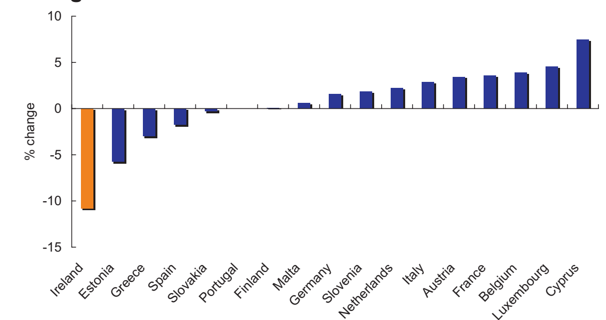
- **Despite currency headwinds, adjustments to key costs of labour... -** Unlike past crises, euro-zone economies do not have the benefit of currency devaluation to aid an improvement in international competitiveness. In the absence of such devaluation, domestic costs in the Irish economy are reducing at an impressive pace. The broadest measure of this internal devaluation is unit labour costs: these have fallen by 9% relative to the rest of the euro-zone in the 2009/2010 period and are expected to decline by a further 4% in 2011/2012. This has already started to yield tangible benefits for the Irish economy, with the number of foreign direct investment projects increasing by 18% in 2010, while over twenty separate investments have been announced already by the IDA in 2011 thus far.

- **...and property... -** The most dramatic fall in domestic prices has been for property. The capital value of offices has fallen by 59%, while rents have fallen by 42%. Similar declines have been experienced for retail and industrial units. From being among the most expensive in 2006, Ireland is now placed mid-table in rankings of office and industrial property costs.

- **...are already yielding results, with exports up... -** Our newly constructed trade-weighted index shows that currency movements have been no help in the achievement of an export-led growth strategy since the crisis began. With this constraint, there is no magic bullet for Ireland to achieve its goal. Nevertheless, Ireland has already begun to reap the benefits of falling costs. Exports grew by 10.6% yoy in Q4 2010, while net exports are contributing strongly to growth. The turnaround in the current a/c from a deficit of 5.6% in 2008 to an expected surplus this year is a clear signal of the improvement in Ireland's external competitiveness, unlike other economies facing similar challenges. Without large currency devaluation, the export-led recovery in Ireland is unlikely to be a V-shaped one similar to that enjoyed in Scandinavia in the early 1990s.

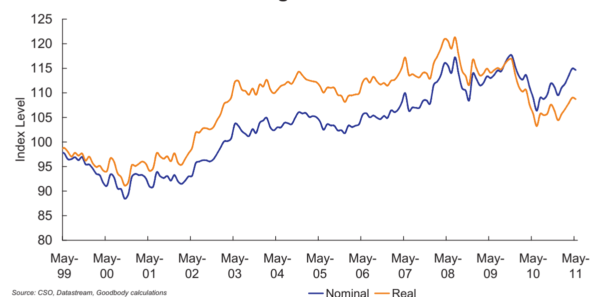
- **...and FDI trends remaining strong -** The improvement in Ireland's competitive position is backed up by our conversations with the IDA, the body responsible for attracting FDI into Ireland. The arrival of the IMF/EU programme in Ireland in December and the crises over recent years has done some damage to Ireland's reputation but the work of the IDA in particular has ensured that the impact on prospective inward FDI has been minimised. Many considerations come into the decision-making process for multi-national firms, but the uncertainty about Ireland's corporation tax rate is not helpful and must be concluded soon.

Change in Unit Labour Costs between 2009 and 2012



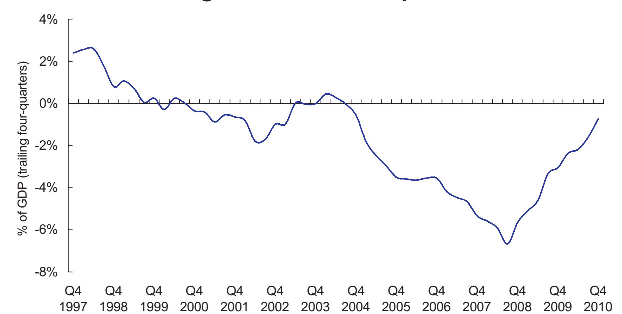
Source: European Commission

Real vs Nominal Trade Weighted Index - Ireland



Source: CSO, Datastream, Goodbody calculations

Current a/c moving back towards surplus



Source: CSO

Economist: **Dermot O'Leary** T *+353-1-641-9167* E *dermot.c.oleary@goodbody.ie*
Economist: **Juliet Tennent** T *+353-1-641-9469* E *juliet.c.tennent@goodbody.ie*

25 May 2011

Goodbody Stockbrokers is regulated by the Central Bank of Ireland and is a member firm of the Irish Stock Exchange and the London Stock Exchange. Please see the end of this report for analyst certifications and other important disclosures

IRISH COMPETITIVENESS

Following large credit-driven expansions (and subsequent busts), countries are commonly left with problems such as banking and fiscal crises. Ireland is just one of a long list of countries (Sweden, Finland, Japan, Latvia, Iceland and Estonia to name a few) to find itself in that situation. We have written extensively on these topics over recent years.

Improving competitiveness without currency devaluation

Progress on tackling a third challenge, that of competitiveness, has received relatively less attention than the first two. This note attempts to redress that balance.

The key difference in the situations in the euro-area countries is, of course, the absence of currency devaluation, thus ensuring the need for a real devaluation to bring about an export-led recovery. The recent examples of Latvia and Estonia, whereby a significant internal reduction of costs has led to a return to growth, show that this can be done without a devaluation of the currency.

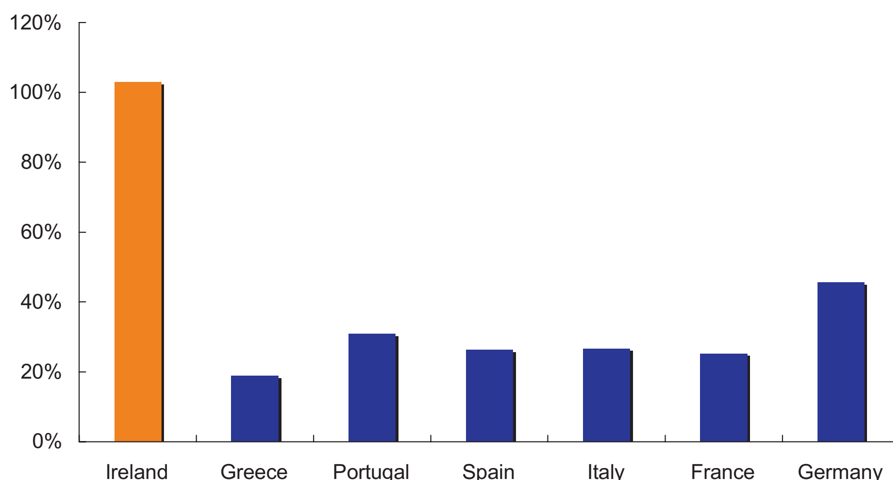
Ingredients for an export-led recovery

To achieve export-led growth, a number of important ingredients are required. We don't intend to exhaustively cover these elements in this note, but we focus on what we think are the most relevant, comparing them to other countries in the euro-zone.

The first point to make is that Ireland has the biggest export sector by far. As can be seen in the chart below, exports represented over 100% of GDP in Ireland in 2010 (with imports accounting for 84% of GDP), substantially above levels in other euro-area economies.

Very large export sector

Export/GDP ratios

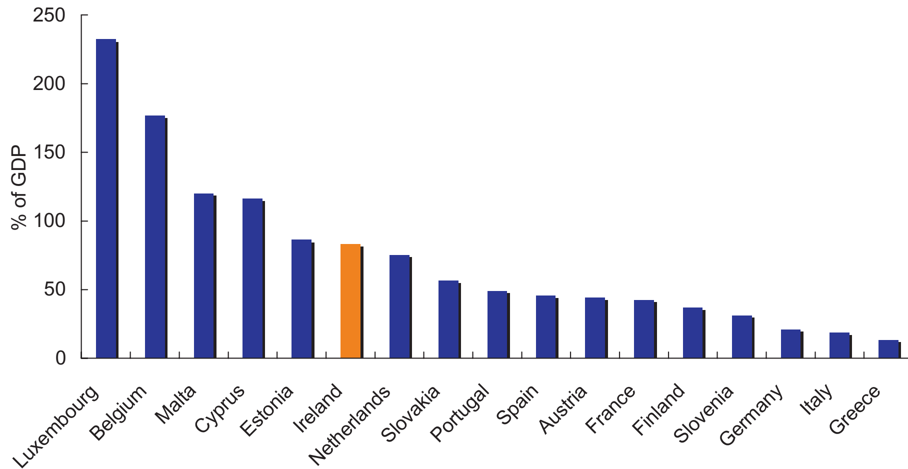


Source: Datastream

Ireland also has a strong track record of attracting foreign direct investment, which has been maintained since the crisis. Although the stock of foreign direct investment in Ireland fell from 2002 to 2006, it rose in 2009 to 83% of GDP, putting it well ahead of the other peripheral economies with significant competitiveness issues.

Strong track record of FDI

Stock of FDI is high in Ireland



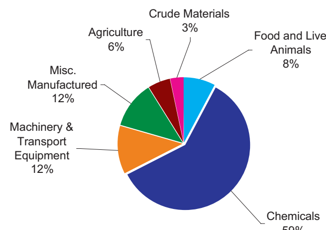
Source: UNCTAD

What does Ireland export?

Composition of exports matters

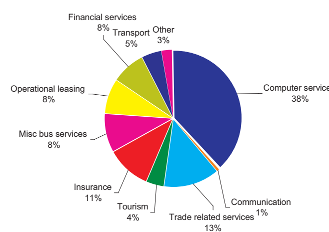
The composition of exports has important implications for the ability of an economy to bring about export-led growth. Specifically, a developed economy that specialises in higher-value add activities is better positioned relative to a country that produces lower value-add manufacturing goods and thus faces intense competition from low-cost developing nations. This is a major problem for Greece and Portugal.

Breakdown of goods exports 2010



Source: Datastream

Services exports by type (2010)

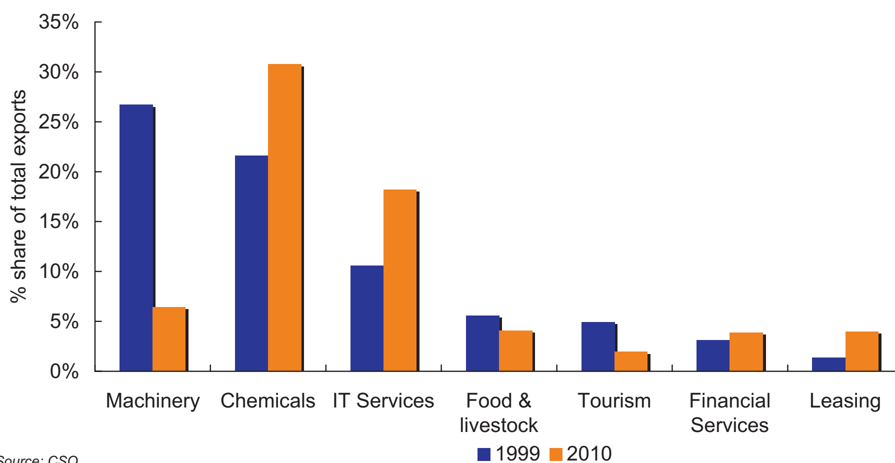


Source: CSO

For Ireland, exports are roughly split 50/50 between goods and services. Within these categories, Ireland's largest export sectors are shown above. For goods, almost 60% is accounted for by chemicals and pharmaceutical output, almost all of which is produced by foreign multi-nationals. Services have seen superior growth over recent years, with the biggest component being computer services, particularly internet services.

Chemicals and IT services have become the largest export categories

Services have been a major driver of export growth in recent years



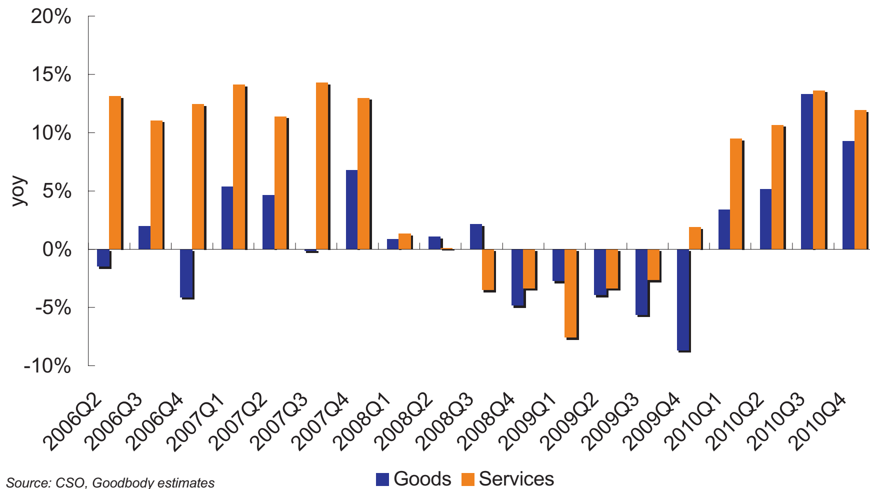
Source: CSO

Recent performance of trade & FDI

Net exports have already been making a significant positive contribution to Irish economic growth. For example, in 2009, when Irish GDP collapsed by 8%, net exports contributed almost 4% to GDP, while in 2010, there was positive contribution of 3.5% from net exports. We expect a further 3% contribution in 2011.

Positive recent export performance

Exports have resumed impressive growth

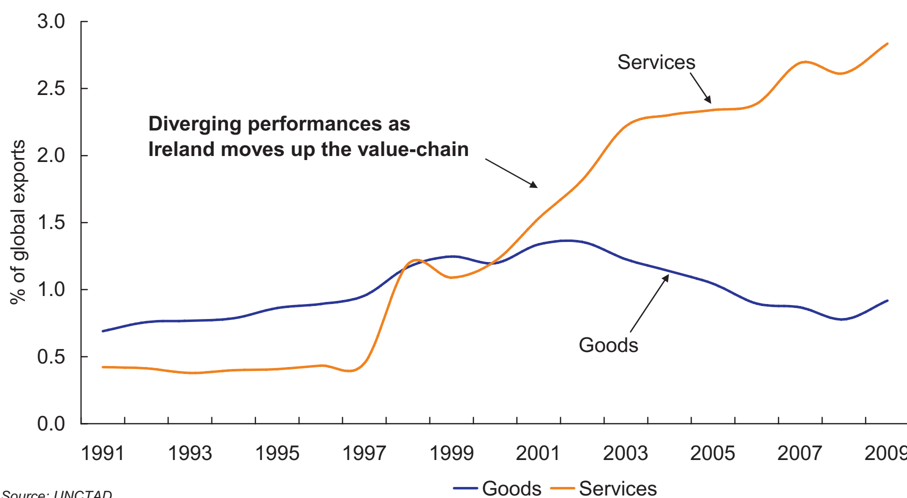


Source: CSO, Goodbody estimates

Ireland has consistently increased its global market share of services exports since 1997, with the share now standing at 2.8% in 2009 (latest data available). Ireland's export share of the goods market peaked in 2002 at 1.4% and declined to 0.8% in 2008 before increasing modestly in 2009. There will be some areas of manufacturing where Ireland will not be competitive against lower cost economies. However, recent evidence suggests that Ireland is able to attract some specialist manufacturing activity such as medical devices and engineering equipment.

Steady increase in market share of global services exports

Share of global exports



Source: UNCTAD

Despite the problems in the domestic economy, inward FDI picked up strongly in 2010. This trend has continued into 2011, with 22 projects already announced in the year to date and a strong pipeline for the rest of the year. The tables on the next page show how Ireland performed relative to other Western European countries in 2010. It is a significant achievement for Ireland to be in the top five in terms of the number of projects given the size of the economy here. In terms of major cities, Dublin ranked fifth in Western Europe for FDI announcements in 2010, while the number of jobs created was second only to London in Western Europe.

Ireland was in the top-five for FDI into Western Europe in 2010

Top five FDI destinations 2010

	Number of projects	% change		Capex (€bn)	% change		Jobs created	% change
Country			**Country**			**Country**		
UK	748	-11%	UK	20.11	-50%	UK	49,856	-26%
Germany	379	-39%	Spain	11.74	8%	Spain	21,916	-26%
France	268	-17%	Germany	11.73	-34%	Germany	21,590	-35%
Spain	232	-9%	Netherlands	9.5	13%	France	15,606	-36%
Ireland	147	18%	Italy	7.23	-28%	Italy	11,809	-15%
City			**City**			**City**		
London	241	8%	London	3.92	-16%	London	7,496	-135%
Paris	87	14%	Dresden	2.18	766%	Dublin	4,179	70%
Dublin	75	27%	Paris	1.93	88%	Genk	3,056	2926%
Munich	49	7%	Rotterdam	1.73	480%	Turin	3,000	1900%
Madrid	44	-4%	Dublin	1.69	32%	Vienna	2,891	2891%

Source: FDiIntelligence

FOCUS: VIEWS OF THE IDA

The IDA is the Government body responsible for attracting FDI into Ireland. The IDA currently supports c.1,000 companies with c.140,000 employees directly. The IDA also notes that these companies support a further c.100,000 jobs in the wider economy. The success of the IDA as an organisation is borne out by the quality of the companies that have set up operations in Ireland. In the ICT/Content area, these include Google, Facebook, Intel, Microsoft and IBM. In fact, 8 of the top ten ICT companies have operations in Ireland. 9 of the top 10 pharmaceutical companies are based in Ireland, including Pfizer, GlaxoSmithKline and Johnson & Johnson. Meanwhile, over 50% of the world's leading financial services firms have set up operations in Ireland.

Leading global companies have been attracted to Ireland

To assess the relevant issues for potential FDI into Ireland, we met with the IDA to discuss the issues. We have divided the main takeaway from our discussion into five sections

- Recent trends
- Strategy
- Reputation
- Cost competitiveness
- Corporation tax

We met with the IDA to discuss the relevant issues

Recent trends

The IDA sets targets on the number of investments and the jobs that they will create on a multi-annual and an annual basis. After a strong year for investment in 2010, there have already been over twenty separate investments announced in the opening months of this year, the most significant of which is Intel's €500m expansion in its plant in Leixlip, County Kildare. Investments from the US represent the majority (70%-80%), while sectors such as ICT services, financial services and, surprisingly, manufacturing (further investment by a medical equipment manufacturer was announced just last week) provide the bulk of investment.

Strong pipeline of FDI projects

It expects a number of further significant announcements in the rest of the year too and targets are broadly on track, despite the negative perception of Ireland due to the arrival of the IMF/EU programme.

Strategy

In a bid to present the most compelling case to potential investors in the Irish economy, the IDA focuses on the four Ts – Talent, Technology, Tax and Track record.

The four Ts - Talent, Technology, Tax and Track record

Talent – Ireland is recognised for having a well-educated workforce but the competition is intensifying for the types of projects Ireland is trying to attract. The IDA believes it is important that Ireland consistently focuses on skills especially in the mathematics and science areas and are very supportive of government initiatives in this area e.g. bonus points for maths and project maths.

Technology – With IT services being a major growth area, advanced IT infrastructure must be in place. While Ireland would like to be leader in terms of speed of broadband infrastructure, the IDA believes that the current infrastructure is not a constraint. Ireland has been very successful in winning investment from global leaders e.g. ebay, Google, Amazon, Linkedin and Facebook as well as significant investments from the computer games industry. The IDA believes that Ireland must ensure that it continues to invest in broadband infrastructure to continue to win the investments of the future.

Tax – The low and transparent corporation tax rate is a cornerstone of Irish industrial policy and the recent pressure on Ireland from some quarters to increase it, and the subsequent media coverage it has generated, has not been helpful. Companies need certainty on these issues, so the sooner this is resolved the better.

Track record – Ireland's track record speaks for itself. The success of Ireland as a destination for FDI is borne out by the quantity and quality of the companies that continue to locate their businesses here.

Reputation

The negative media publicity of Ireland over recent years provides a constant challenge for the IDA, as it finds itself trying to counter this by increased media presence, roadshows and presentations. These have put pressure on the resources of the IDA but it finds it to be a very worthwhile exercise, as when current and potential investors are informed of the reality of falling costs, stable government and a continuing flow of inward investment into Ireland, it does counter the image that they may have due to the media coverage of the Irish crisis. The IDA is intent on reinforcing that Ireland is definitely open for business and has become much more competitive over recent years following a time in which growth in costs was excessive.

IDA has recently had to counter negative perception of Ireland from abroad

Cost competitiveness

The IDA states that Ireland is now able to compete in industries and against other destinations that it was not able to in recent years due to the fall in costs in the economy. While there is not widespread pay cuts in the multi-national companies supported by the IDA, it notes that the flexibility of the Irish workforces (including working longer hours for the same pay) has meant that these firms have been able to increase productivity and thus reduce unit labour costs. This is supplemented by drastically reduced wages in newly-created positions.

Back competing in sectors which were out of reach a few years ago

The fall in property costs, both from the perspective of the worker, where higher mortgage and rental costs were pushing up wages, and from the cost of buying or renting a business premises, has been important. Finally, Ireland has gone from above the European average to in-line with the rest of Europe in terms of energy costs for large users, which has again been important.

The IDA often breaks down investment targets into five levels, with level 1 being the low-value add, low cost activity and level 5 being high-value add, R&D-type projects. Due to the increase in costs in the 2004-2008 period in particular, Ireland could only realistically compete in Levels 4 & 5. However, Ireland is now increasingly competing for Level 3 type investments, which would include manufacturing activity in areas such as engineering and medical devices.

Corporation Tax

Although there are clearly many attributes that firms locating in Ireland recognise when setting up operations here, Ireland's position as having one of the lowest corporation tax rates in Europe clearly helps. The rate is a red-line issue for the IDA and it believes that there has been sufficient support, be it by way of direct vetoes in the European Treaties and support of the new Irish Government, that it is not going to change. The IDA cites the example of Puerto Rico, where policy changed in relation to corporation tax and it had a very damaging impact in terms of inward direct investment into that country. Even a small movement upwards in the rate would set a bad precedent as it would increase the risk of creep in the years ahead.

Corporation tax rate of 12.5% is an important incentive and must be maintained

WHAT COSTS ARE IMPORTANT FOR MULTI-NATIONAL BUSINESSES?

Amongst location-sensitive cost factors, labour is the most important by a significant margin, based on a manufacturing survey carried out by KPMG. The next most important is the cost of capital, which would obviously be a negative for Ireland at the current time given the difficulties in the banking sector. However, it is worth noting that the survey did not include Ireland and it is likely that the majority of multi-national companies based in Ireland use international banks for their credit facilities.

Location-sensitive cost factors (percentage ranges)

	Manufacturing
Labour	46-60
Cost of Capital	11-24
Transportation	5-18
Taxes	5-14
Property	2-7
Electricity & Gas	2-7

Source: KPMG, Central Bank of Ireland

Labour costs are most important for manufacturing firms

A TRADE-WEIGHTED INDEX FOR IRELAND

The broadest measure of competitiveness is the Central Bank's trade weighted index, which takes into account relative currency movements with our trading partners as well as relative price changes. We have replicated this index in this note for the first time, giving an opportunity to update the indicator on a timely basis.

Roughly 40% of Ireland's exports are destined for either the UK or the US, making the dollar and sterling the most important currency exposures. In fact, a significant proportion of exports to the US are likely to be due to intra-company transfers in multi-nationals based in Ireland. These exports are likely to be priced in dollars, making the currency movements less relevant. It can be argued, therefore, that despite its falling share of total exports, movements in sterling are still the most important for Irish trade.

Sterling still most important currency for Irish trade

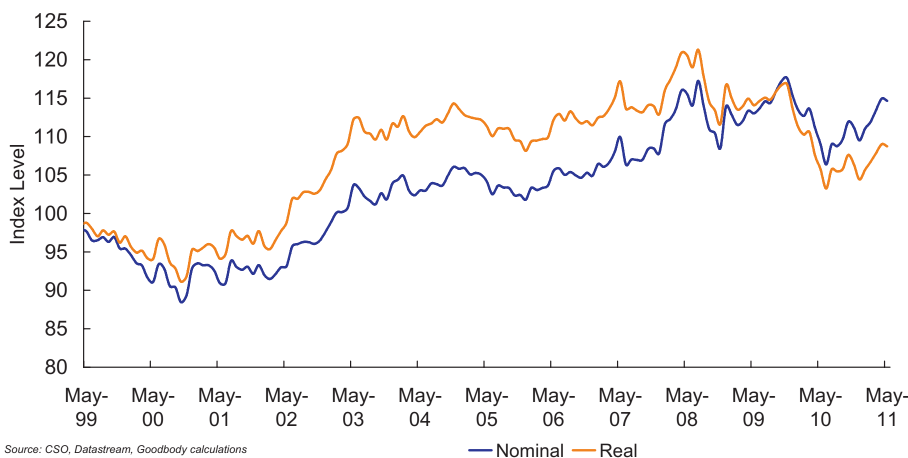
The trade-weighted index (TWI), which had been on an upward trajectory during 1999 driven by weakness in the euro, started to deteriorate from November 2000. This process occurred all the way up to July 2008, with the TWI appreciating by 30% in real and nominal terms.

30% appreciation in TWI from 2000 to 2008...

Since that time Ireland has restored some of this lost competitiveness, with improvements of over 9% in nominal and 15% in real terms, as deflation took hold. However, our index shows that since the middle of 2010 the strength of the euro (+18% versus the dollar) has seen the nominal improvement narrow to only 2%, while the real gains have been greater at close to 10%. While it is difficult to know the appropriate level for the TWI, it would take a further 15% devaluation to get back to the level achieved when Ireland entered the euro.

...while currency movements have been of little help since the start of the crisis

Real vs Nominal Trade Weighted Index - Ireland

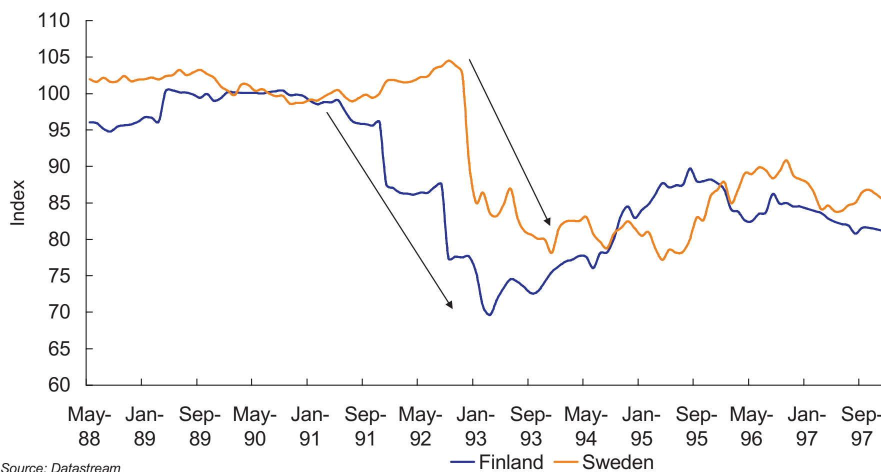


Source: CSO, Datastream, Goodbody calculations

When compared with currency depreciations in crisis-hit countries in the past, it is this lack of a currency lever that may ultimately prove to be the main impediment to continued export-led growth. In Sweden and Finland in the 1990s, their respective currencies depreciated by c30% on a trade-weighted basis, triggering a significant export-led recovery in both economies.

Sweden & Finland had the advantage of large currency depreciation

Large devaluations were a feature of the Scandinavian crises of the 1990s



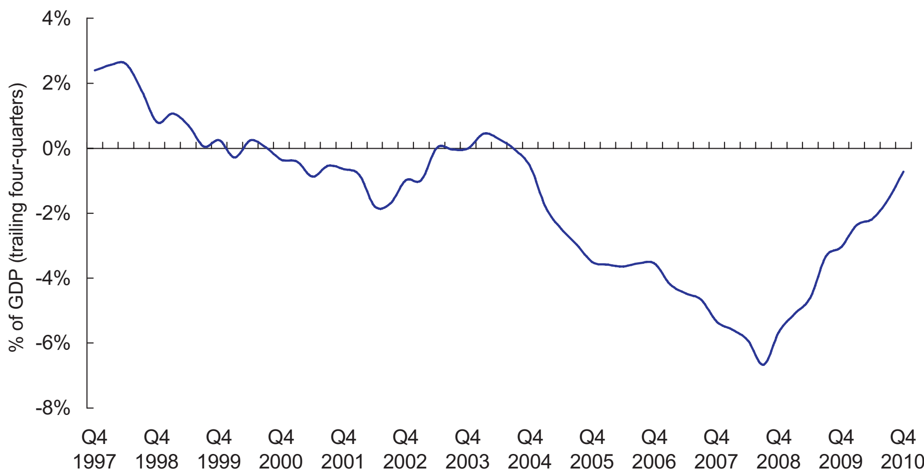
Source: Datastream

CURRENT A/C WARNINGS NOT FLASHING ANYMORE

A familiar “canary in the coalmine” for economies that appear to be overheating and losing competitiveness is a large current account deficit. Ireland’s current a/c reached over 6% of GDP at the height of the boom, reflecting overheating in the economy. A significant reversal has taken place since late-2008, with the combination of lower domestic demand (and imports) along with a strong export performance expected to push Ireland into current a/c surplus in 2011. This is not the case in either Portugal or Greece, which means that these economies are still effectively living beyond their means when one takes account of both the public and private sectors

Current a/c moving back to surplus...

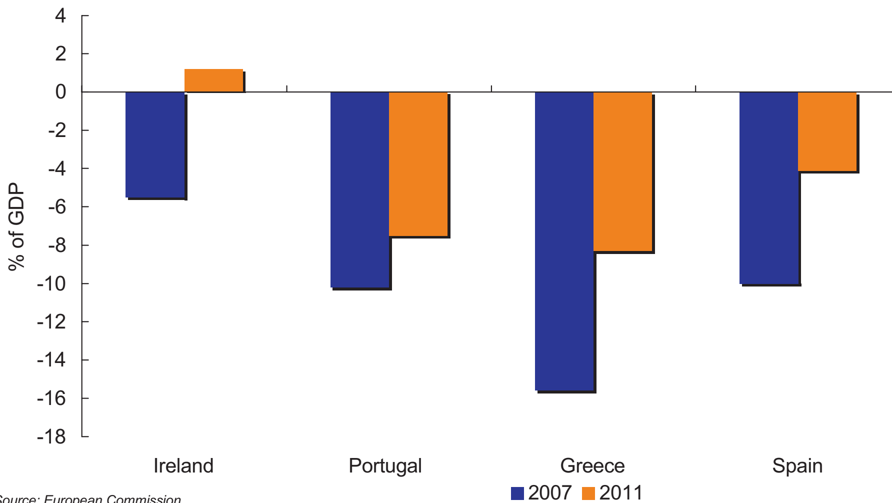
Current a/c moving back towards surplus



Source: CSO

...unlike the other peripheral economies

Current a/c balances - before and after the crisis



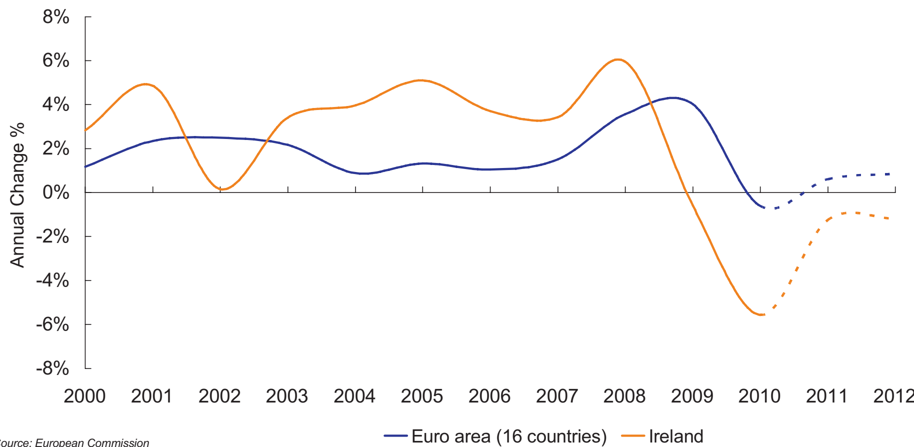
Source: European Commission

Unit labour costs

A common gauge of Ireland's loss of competitiveness is unit labour costs. From 2000-2008, unit labour costs increased by 34%, double the pace of the euro-area (16%) and the OECD (17%).

Trend in unit labour costs has reversed sharply...

Annual Change in Unit Labour Cost 2000 - 2012

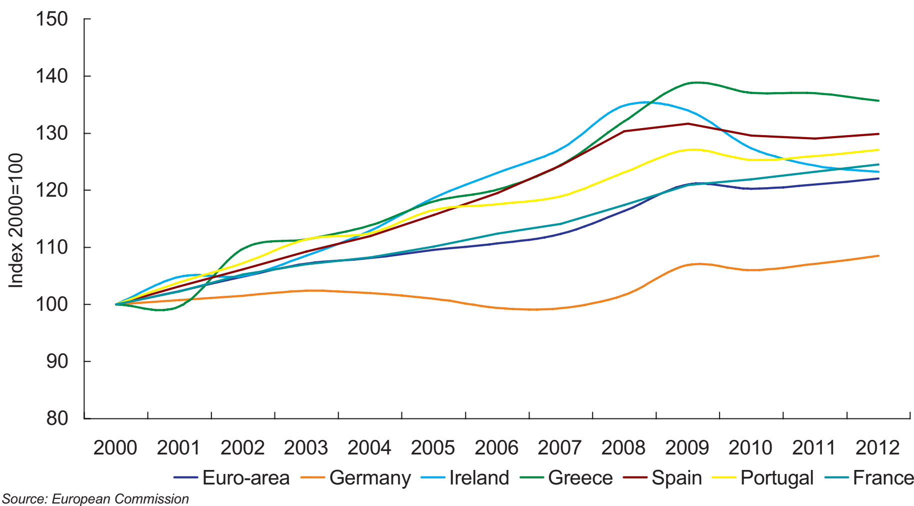


Source: European Commission

Ireland was not alone in this loss of competitiveness relative to the rest of the euro-area. Familiar trends were witnessed in Greece, Spain and Portugal. The notable difference in the euro-area was Germany, which experienced a significant improvement in its competitiveness position over the same period.

...and much faster than the rest of the euro-zone

Unit labour costs



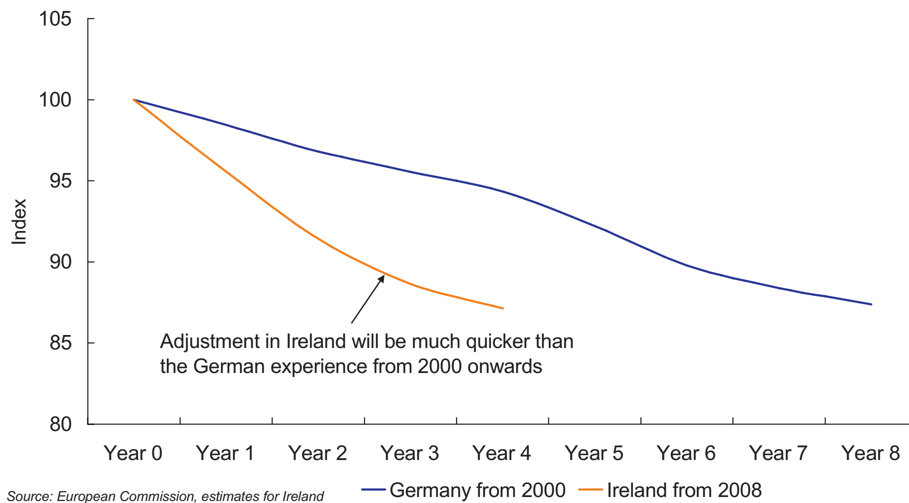
Source: European Commission

A reversal has been in train for Ireland since 2009. Unit labour costs in Ireland fell by 4% between 2008 and 2010 and are forecast to contract by a further 2% by the end of 2012. Meanwhile, following an initial decrease in 2010, euro-area unit labour costs are expected to increase by 5% by 2012.

Impressive headline gains in competitiveness

Using the impressive German performance in the 2000s as a guide, the next chart shows the relative change in unit labour costs for Germany, against the expected Irish performance from 2008 onwards. Germany saw a 13% improvement relative to the euro-area over an eight year period. On current expectations from the European Commission, Ireland is on course for an improvement of a similar magnitude over half the time period.

ULCs relative to euro-area average



Source: European Commission, estimates for Ireland

Change in unit labour costs happening at a much faster speed than Germany in the 2000s

How have these reductions occurred?

Despite significant anecdotal evidence of firms reducing wage rates and two separate pay cuts in the public sector, the aggregate data continues to suggest that the majority of the progress being made on unit labour costs is coming from improvements in productivity as well as important compositional shifts in the economy towards relatively higher productivity sectors, rather than reductions in pay rates.

This is not to say that nominal wages are not falling. Wages are indeed falling, just at a slow pace. For example, average hourly earnings (excluding bonuses) in the private sector have fallen by less than 1% from the peak (to Q4 2010), while average hourly earnings in the public sector have fallen by 4.4% (not including a further effective cut as a result of the imposition of the pension levy).

Falling unit labour costs largely coming from productivity gains...

From a competitiveness point of view, an across the board cut to nominal wages would speed up the process of real devaluation and thus accelerate the rewards.

Significant wage cuts for new positions

While the aggregate data do not yet show significant improvements in competitiveness from wage cuts, it is clear that high unemployment rates continue to put downward pressure on wage rates. This is particularly the case for new positions. To gauge this, the table below shows an analysis of wage surveys carried out by IrishJobs.ie (a recruitment website) in 2011 relative to similar surveys carried out in 2008. It is clear from these surveys that, at the margin, significant reductions in wage rates have indeed taken place for new positions that are being advertised. Unsurprisingly, the construction sector has been the most affected. While unions have agreed to accept a 7.5% across the board cut to rates, some positions are being advertised for half the rate of pay that existed in 2008. More generally, most positions, outside of specialist roles, have seen reductions ranging from 10% to 20%. These reductions are important for competitiveness from the point of view of new investment coming into the country.

...but wages are falling for new positions

Salary reductions 2011 versus 2008 for new positions

Sector	Comment
Banking	Up to **30%** for senior roles, but in general a **c.10%** decrease
Call Centres	Close to **20%** for managerial roles
Construction	Sector which has seen largest declines; of up to **50%** in the case of Site Managers. More general declines of at least **30%**.
Office Management	Large dispersion ranging from **3%** to **16%** declines
Sales & Marketing	Very dependent on sectors, but declines of up to **16%** in ICT sales for example
Engineering & Production	c.**10%** decline
IT	More specialist roles not seen a reduction in salaries, but general roles have seen declines of up to **15%**
Public Practice & Taxation	Declines ranging from **10%** to **26%**
Fund services	Varies depending on role but **not much change** in general
Hotels & Catering*	**15%** but up to **30%** for more senior managerial roles
Legal*	**10%** for newly qualified solicitors, although salaries are up for experienced legal staff in some areas

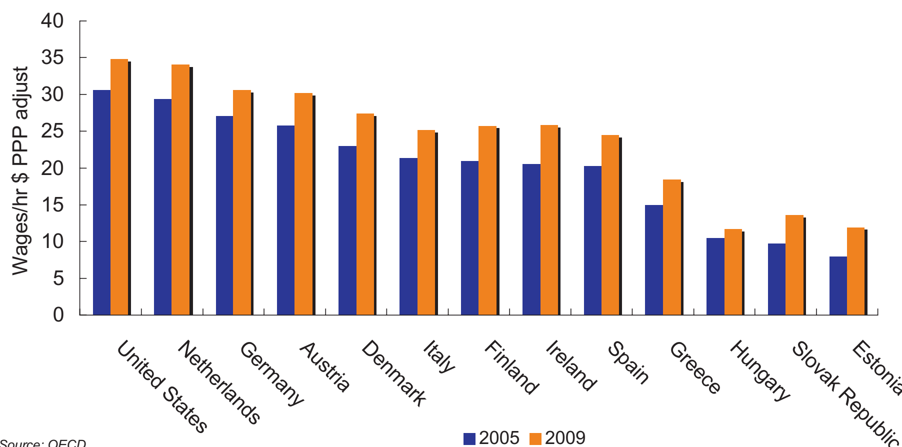
Source: IrishJobs.ie
*taken from 2010 survey

Large declines for newly advertised positions

What about wage levels?

While assessing growth rates are important in any analysis of competitiveness, one must look at the levels to get a gauge of the country's relative position. The chart below (based on wages per hour adjusted for PPP) shows that Ireland ranks mid-table in terms of wage levels for the economy overall, despite the growth in wage levels over recent years.

Hourly wages for total economy



Source: OECD

The Central Bank recently published a report in which it broke down cost competitiveness by sector. The next table breaks down the four components – food and beverage, broad chemicals, computer, electronic and optical and machinery equipment. Together, these sectors account for 76% of value-add and c.50% of employment in the manufacturing sector in Ireland.

Compensation costs for the manufacturing sector as a whole are still low relative to core European nations. This is particularly the case for the machinery and equipment sector and the broad chemicals sector, where compensation costs are between 40%-50% below that of Germany. Deterioration has occurred in the food and beverage sector over recent years. The most relevant trading partner to compare costs here is the UK, given its historically close links with domestic industry. Over the 2007-2010 period, compensation costs have gone from 4% below the UK to 12% above. This is largely due to the fall in the value of sterling over this time period, and highlights the role that currency movements can play over a short period of time.

Currency movements have affected the food sector in particular over recent years

Compensation per hour by manufacturing sector

	Food & Beverage	Broad Chemicals	Computer, electronic & optical	Machinery & equipment	Total Manufacturing
2007					
Belgium	29.4	47.6	36.0	33.4	34.7
US	24.0	48.0	46.2	31.5	32.2
Germany	18.9	44.2	36.7	34.9	31.9
France	23.5	52.9	32.3	31.1	29.7
Netherlands	29.9	41.1	32.5	29.3	28.9
Ireland	19.5	25.8	21.7	18.2	20.8
UK	20.4	33.1	21.0	18.8	20.4
2010					
Belgium	30.3	49.7	37.7	35.0	36.2
Germany	18.9	45.0	39.5	36.4	32.5
Netherlands	31.3	43.5	39.1	32.9	31.6
France	24.4	54.4	34.7	32.1	31.1
Ireland	21.2	26.7	25.0	19.1	22.8
UK	18.9	29.1	20.8	18.7	18.1

Source: Central Bank Quarterly Bulletin April 2011

Superior productivity performance expected to continue

Productivity growth rates in Ireland have been impressive over a sustained period. In the 1990s, productivity growth (output per worker) averaged 3.2%, relative to 1.7% in the euro-area and US. While productivity growth did slow in the 2000s, partly due to a higher concentration on lower productivity construction activity, it was still impressive at an average of 2.0% over the period, again outstripping the US and euro-area. Expectations are for this superior productivity performance to continue in the 2010-2012 period also. This is in stark contrast to the expected performances in Greece and Portugal in particular.

Productivity growth continues to be impressive

Productivity growth performances

	1990-1999	2000-2009	2010-2012f
Ireland	3.2%	2.0%	2.3%
Germany	1.7%	0.6%	2.1%
United States	1.7%	1.9%	2.0%
United Kingdom	2.1%	1.1%	1.9%
Euro-area	1.7%	0.8%	1.6%
Spain	1.1%	0.9%	1.2%
Portugal	2.7%	0.9%	1.0%
Greece	1.2%	1.7%	-0.3%

Source: AMECO

Falling property costs…

The cost of property in Ireland has seen the most dramatic reversal over the past three years. Irish commercial property values, down 61%, are now back to levels last seen in 1998, while commercial rents, after experiencing a 40% decline, are back to 1999 levels.

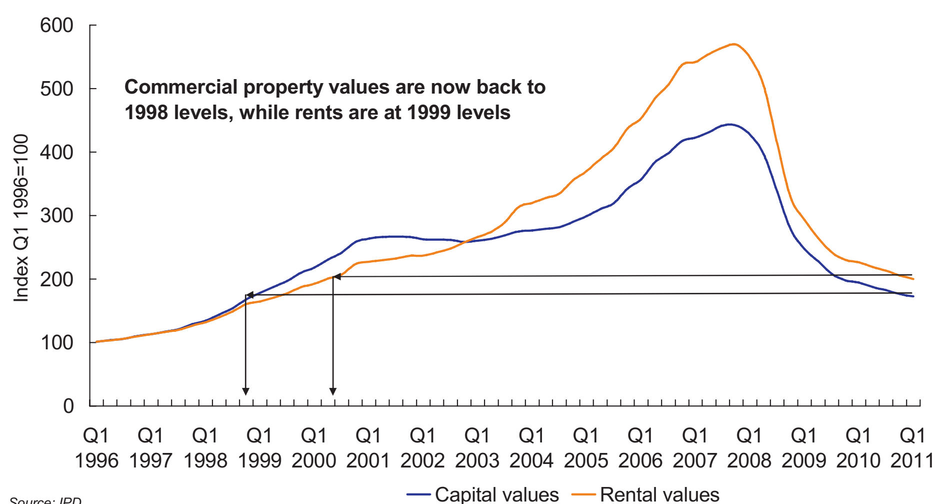
Property values back to en-1998 levels

Summary of commercial property prices & rents

	All Props	Retail	Office	Industrial
Capital value peak	Dec-07	Dec-07	Sep-07	Sep-07
Fall from peak	-61%	-65%	-59%	-54%
Level last seen in:	Dec-98	Mar-00	Sep-98	Dec-97
Rental value peak	Dec-08	Dec-08	Sep-08	Dec-08
Fall from peak	-40%	-37%	-42%	-44%
Level last seen in:	Jun-99	Sep-02	Dec-98	Mar-95

Source: IPD

Irish commercial property



Source: IPD

…have put Ireland into a much more competitive position.

Analyses of global rental costs, carried out by Cushman & Wakefield, show the progress that Ireland has made from a competitive perspective over recent years. As recently as 2008, Ireland (Dublin) was the second most expensive location for industrial space, but the latest survey puts us at 16 in the rankings, with rents likely to have fallen further in the interim period. A more marked improvement has been seen in the office sector, where Ireland has gone from 6th most expensive in 2007 to 26th in 2011.

Property costs were a major impediment...

Ranking of Dublin rental costs (out of c.50 cities)

	2006	2007	2008	2009	2010	2011
Office	12	6	9	14	17	26
Retail	6	7	5	8	13	
Industrial	3	4	2	3	7	16

Source: Cushman & Wakefield

Lower ranking denotes cheaper rents

...but not anymore

TAX ENVIRONMENT IS VERY FAVOURABLE

The most controversial incentive for companies to locate in Ireland, especially given the fiscal crisis, is the 12.5% corporation tax rate, half the European average. This does not, however, tell the whole story. PWC and the World Bank have produced a detailed study on taxes that businesses face across the world. We have re-produced these data for the euro-zone in the table below.

Total tax rates for businesses

	Headline Corporation Tax Rates	Effective Corporation Tax Rate	Labour Tax	Other Tax	Total	Rank
Luxembourg	28.6	4.1	15.4	1.6	21.1	1
Cyprus	10.0	9.4	11.6	2.2	23.2	2
Ireland	12.5	11.9	11.6	3.0	26.5	3
Denmark	25.0	21.9	3.6	3.7	29.2	4
Slovenia	20.0	14.8	18.2	2.4	35.4	5
Netherlands	25.5	20.9	17.9	1.7	40.5	6
Portugal	26.5	14.9	26.8	1.6	43.3	7
Finland	26.0	15.9	27.7	1.0	44.6	8
Greece	24.0	1.4	31.7	1.6	47.2	9
Germany	29.8	22.9	22.0	3.3	48.2	10
Slovakia	19.0	7.0	39.6	2.1	48.7	11
Estonia	21.0	8.0	39.2	2.4	49.6	12
Austria	25.0	15.7	34.6	5.2	55.5	13
Spain	30.0	20.9	34.9	0.7	56.5	14
Belgium	34.0	4.8	50.4	1.8	57.0	15
France	34.4	8.2	51.7	5.9	65.8	16
Italy	31.4	22.8	43.4	2.4	68.6	17
Average	24.9	13.3	28.3	2.5	44.8	n/a

Source: Headline rates from the European Commission as of 28/06/2010

Source: Effective rates from "Paying Taxes 2011" PWC & The World Bank

Seven countries have lower effective corporation tax rates than Ireland

An interesting finding is that while Ireland has the second lowest headline corporation tax rate in the euro-zone, when one accounts for special exemptions, the effective corporation tax rate in Ireland is actually higher than seven other countries in the bloc. Ireland fares favourably in relation to employer payroll taxes, particularly lower employer social contributions.

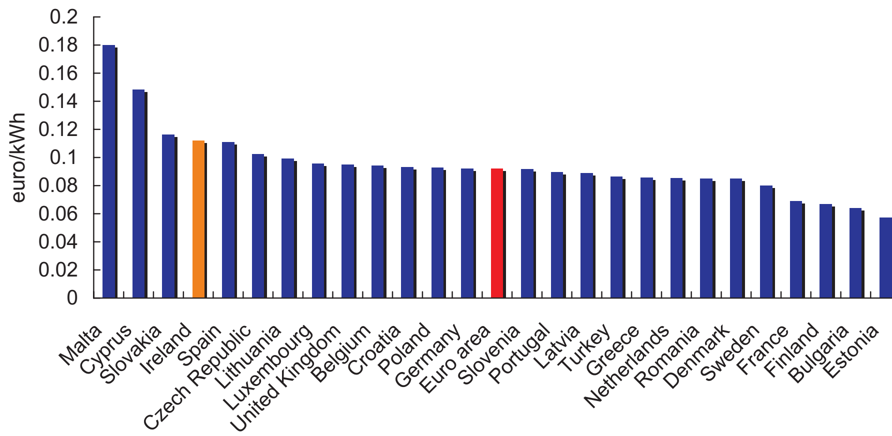
The key point to take from this is that the furore over Ireland's corporation tax rate is a non-event. On a comparative basis, if there were to be an increase in taxes on businesses, it should actually occur in relation to payroll taxes. However, with Ireland in the midst of an unemployment crisis also, it would make little sense to make alterations at this stage of the cycle.

In relation to the corporation tax rate, an increase would be very detrimental to Ireland achieving export-led growth. The OECD suggests that a 1% increase in the rate results in a decrease in FDI of 3.7%, with estimats from the World Bank supporting this.

More to do in relation to energy costs

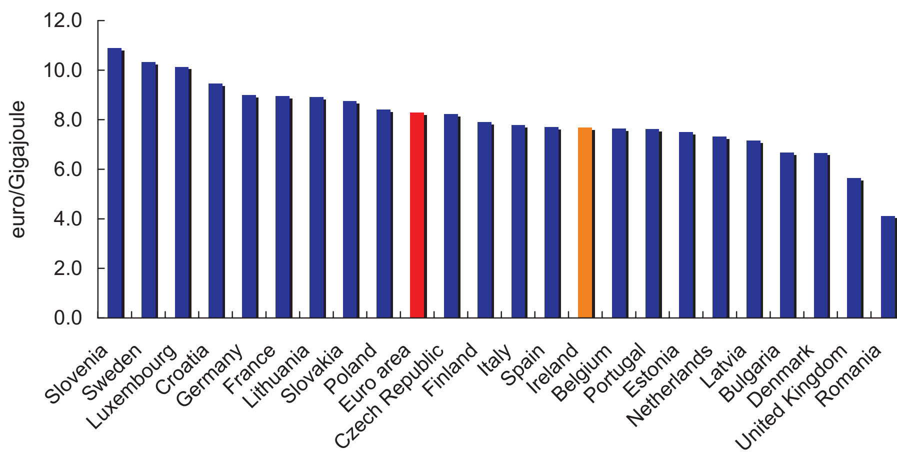
While there has been progress in relation to energy costs in Ireland we still have some way to go with electricity costs 22% ahead of the euro area average. Some of the reasons for this is structural and will not be resolved over the short-term. Ireland fares better in relation to gas prices where costs are 7% cheaper than the average, however Ireland is 36% more expensive than the UK. In addition, much of the cost reduction for business has been made at the expense of households.

Irish electricity prices for Industrials at upper end of European scale in 2010



Source:Eurostat

Irish gas prices for Industrials below euro area average in 2010



Source:Eurostat

Issuer & Analyst Disclosures

Recommendation History

Analyst Certification
The named Research Analyst certifies that: (1) All of the views expressed in this research report accurately reflect my personal views about any and all of the subject securities and issuers. (2) No part of my remuneration was, is, or will be, directly or indirectly, related to the specific recommendations or views expressed by me in this report.

Regulatory Information
Goodbody Stockbrokers is part of the Fexco Group of companies. Goodbody Stockbrokers is regulated by the Central Bank of Ireland and is a member firm of the Irish Stock Exchange and the London Stock Exchange. This publication has been approved by Goodbody Stockbrokers. The information has been taken from sources we believe to be reliable, we do not guarantee their accuracy or completeness and any such information may be incomplete or condensed. All opinions and estimates constitute best judgement at the time of publication and are subject to change without notice. The information, tools and material presented in this document are provided to you for information purposes only and are not to be used or considered as an offer or the solicitation of an offer to sell or to buy or subscribe for securities.

Conflicts of Interest
Goodbody Stockbrokers has procedures and policies in place to identify and manage any potential conflicts of interest that arise in connection with its research business. Goodbody Stockbrokers' analysts and other staff who are involved in the preparation and dissemination of research operate and have a management reporting line that is independent to its Corporate Finance business. Information barriers are in place between the Corporate Finance arm and the Research arm to ensure that any confidential and or price sensitive information is handled in an appropriate manner.

Our Investment Research Conflicts of Interest Policy is available at
http://www.goodbody.ie/research_disclosures/conflictsofinterest

Investors should be aware, that, where appropriate, research may be disclosed to the issuer(s) in advance of publication in order to correct factual inaccuracies only and not to materially amend the research in any way. Goodbody Stockbrokers is satisfied that it has operational procedures in place, which ensure that such disclosures will not compromise the report's objectivity.

Goodbody Stockbrokers and its associated companies may from time to time perform investment banking or corporate finance services, including underwriting, managing or advising on a public offering for, or solicit business from any company recommended in this report.

Goodbody Stockbrokers may have acted, in the past 12 months, as lead manager / co-lead manager in the securities of any company named in this report.

Goodbody Stockbrokers acts as corporate broker to Aer Lingus, Allied Irish Banks, Datalex, Diageo, DCC, FBD Holdings, First Derivatives, Grafton Group, Greencore, Independent News & Media, Kingspan, NTR, Origin Enterprises, Prime Active Capital, Paddy Power, Real Estate Opportunities, United Drug and UTV Media

Goodbody Stockbrokers is a registered market maker in the majority of companies listed on the Irish Stock Exchange and their equivalent on the London Stock Exchange and may hold positions in any of the companies mentioned in this report from time to time. A complete list of the companies that Goodbody Stockbrokers makes a market in is available at
http://www.goodbody.ie/research_disclosures/regulatorydisclosures

Goodbody Stockbrokers, Ballsbridge Park, Ballsbridge, Dublin 4, Ireland
T (+ 353 1) 667 0400 **F** (+ 353 1) 667 0280 **W** www.goodbody.ie **E** research@goodbody.ie

Other disclosures
A description of this company is available at www.goodbody.ie/research

All prices used in this report are as at close of business of the previous working day unless otherwise indicated.

A summary of our standard valuation methods are available at
http://www.goodbody.ie/research_disclosures/valuationmethodologies

A summary of share price recommendations and whether material investment banking services have been provided to these companies is available at http://www.goodbody.ie/research_disclosures/regulatorydisclosures

Other important disclosures are available at http://www.goodbody.ie/research_disclosures/regulatorydisclosures

Goodbody Stockbrokers updates its recommendations on a regular basis. A breakdown of all recommendations provided by Goodbody Stockbrokers is available at http://www.goodbody.ie/research_disclosures/regulatorydisclosures. Where Goodbody Stockbrokers has provided investment banking services to an issuer, details of the proportion of buys, adds, reduces and sells attributed to that issuer will also be included. This is updated on a quarterly basis.

Recommendation Definitions
Goodbody Stockbrokers uses the terms “buy”, “add”, “reduce” and “sell”. The term “buy” means that the analyst expects the security to appreciate in excess of 15% over a twelve month period. The term “add” means that the analyst expects the security to appreciate by up to 15% over a twelve month period. The term “reduce” means that the analyst expects the security to decline by up to 15% over the next twelve months. The term “sell” means that the security is expected to decline in excess of 15% over the next twelve months. In the event that a stock is delisted, the firm will automatically cease coverage. If, however, the firm ceases to cover a stock for any other reason, the firm will disclose this fact.

For US Persons Only
This publication is only intended for use in the United States by Major Institutional Investors. A Major Institutional Investor is defined under Rule 15a-6 of the Securities Exchange Act 1934 as amended and interpreted by the SEC from time-to-time as having total assets in its own account or under management in excess of $100 million. All transactions by US persons involving securities of companies discussed in this report must be effected through Goodbody Securities Inc.

Disclaimer
While all reasonable care has been taken in the production and dissemination of this report it is not to be relied upon in substitution for the exercise of independent judgement. Nothing in this report constitutes investment, legal, accounting or tax advice, or a representation that any investment or strategy is suitable or appropriate to your individual circumstances, or otherwise constitutes a personal recommendation to you.

Private customers having access, should not act upon it in anyway but should consult with their independent professional advisors. The price, value and income of certain investments may rise or may be subject to sudden and large falls in value. You may not recover the total amount originally invested. Past performance should not be taken as an indication or guarantee of future performance; neither should simulated performance. The value of securities may be subject to exchange rate fluctuation that may have a positive or adverse effect on the price or income of such securities.

All material presented in this report, unless specifically indicated otherwise is copyright to Goodbody Stockbrokers. None of the material, nor its content, nor any copy of it, may be altered in any way, transmitted to, copied or distributed to any other party, without the prior express written permission of Goodbody Stockbrokers.

Goodbody Stockbrokers, Ballsbridge Park, Ballsbridge, Dublin 4, Ireland
T (+ 353 1) 667 0400 **F** (+ 353 1) 667 0280 **W** www.goodbody.ie **E** research@goodbody.ie