

Quarterly ECONOMIC OUTLOOK



April 2013

Balancing growth and fiscal consolidation

Ireland's economy performed better than most expected in 2012. GDP in volume terms increased by 0.9%, while in value terms it was up 2.9%. This ensured that the budget deficit outturn at 7.6% was well ahead of the targeted 8.6%. The emerging economic recovery, coupled with ECB policy developments, resulted in a sharp fall in Irish sovereign bond yields and the State is now well placed to exit the bailout programme at the end of this year. Many challenges remain, however, particularly in relation to the international growth outlook. Domestically, high unemployment, fragile consumer confidence and the debt overhang remain obstacles to growth. On balance, though, it appears that the worst is clearly behind us and the Irish economy is now poised for a more meaningful recovery. The speed and nature of the global pick-up will determine its timing.

The great austerity debate

Recent weeks saw an escalation of the European austerity debate. Opponents to austerity have argued that some of its theoretical foundations were based on flawed economic analysis, while many EU political leaders have come under renewed pressure due to poor growth and rising unemployment. Austerity fatigue is clearly setting in across Europe and politicians are debating their options. In Ireland, the restructuring of the promissory note arrangements and the extension of the repayment period on some bailout loans led to some improvements in the fiscal outlook. Government now has the option of delivering a somewhat lower fiscal adjustment while still hitting its fiscal targets. The external policy environment may indeed be shifting and this should be to Ireland's advantage. A stronger focus on growth across the EU coupled with some reduction in the pace of fiscal consolidation in Ireland would clearly be a very positive development for the short-term economic outlook.

The recession continues to deepen in most southern EU countries, while the performance of the eurozone core has been anaemic. Even the German economy has weakened in recent months and overall eurozone GDP is forecast to contract marginally this year. Weak economic activity has meant that, with the exception of Ireland, the troubled eurozone economies which have delivered austerity programmes have struggled to reduce their budget deficits. Despite the crisis across the region, Germany delivered a budget surplus last year. There is now a strengthening view that EU policy makers need to deliver bolder growth measures and some policy shift could emerge over the coming months.

The Irish government currently remains committed to delivering the targeted €3.1 billion adjustment in Budget 2014, which is scheduled for mid-October. The Minister for Finance has acknowledged, however, that if the public finances permit, resources may be available to support growth and employment creation. IBEC believes that the time is now right to ease back somewhat the pace of fiscal adjustment. We are 85% of the way towards returning the fiscal deficit to below the 3% limit and further adjustments in the public finances are needed over the coming years. This must be achieved in a way, however, which limits the damage on growth and employment. In particular, we believe that the tax burden has been pushed as far as it can go and no further additional taxes should be included in Budget 2014. We also argue that it is essential that existing employment supports such as the reduced VAT rate for the hospitality and related sectors and the cut in the lower employer PRSI rate must be retained beyond 2013. In relation to expenditure reductions, we believe that further public sector must be delivered including the savings identified in the Croke Park II proposals.

Growth outlook

The economy has returned to modest, if unspectacular, growth. This trend is likely to continue in 2013 and we forecast GDP growth of 1.8%. The recovery is becoming better balanced, however, and as exports slowed somewhat last year due to weak global demand, the domestic economy compensated for this and returned to growth. Investment recorded its first annual increase since 2007 last year, buoyed by a strong increase in equipment and machinery by Irish business. However, the recovery remains fragile. Export demand will remain weak during the early part of this year and the tentative improvement in the consumer market is highly susceptible to swings in sentiment, as evidenced by the weak Q1 retail sales.

Despite the somewhat weaker start to the year, we expect the second half of 2013 to show some improvement, both domestically and internationally. The Irish labour market is improving and consumer fundamentals are also edging upwards. An improvement in the external economic outlook and a rise in consumer confidence should lead to better business conditions in the latter part of the year. Our current GDP growth forecast for 2014 is 2.5%.

Economic growth

The Irish economy outperformed consensus expectations in 2012. The provisional estimates for the full year show that GDP increased by 0.9% in volume terms and 2.9% in value. The stronger-than-expected value growth was a key factor in bringing the budget deficit in at 7.6% - a full one percentage point ahead of target. This reasonably solid growth was delivered in very difficult external conditions and Ireland achieved the third highest GDP growth rate in the eurozone last year.

Last year was very much a year of two halves. Growth was largely driven by exports in the first six months, but the export performance slowed in the second half of the year when domestic demand contributed to growth for the first time since 2007. Export growth, at just short of 3%, slowed from that recorded in 2010 and 2011, as the more difficult external environment resulted in tougher trading conditions for Irish exporters. The global patent cliff in the pharmaceutical sector also had a significant impact on goods exports in the latter half of last year and continues to cast uncertainty on the short-to-medium-term export prospects. Services trade continued to perform exceptionally well, however, with exports rising by 9% in 2012 on the back of 8% growth in 2011. For the first time ever, services are larger than goods exports and accounted for 52% of total outward trade last year.

The 2012 National Accounts data provided further evidence that the domestic economy has bottomed out. On a seasonally adjusted basis, consumer spending grew by 1% in the final quarter of the year, compared to Q3 2012. Total investment in the economy also expanded for the first time since 2007 in the second half of the year. On an annual basis consumer spending was up 0.2% in the second half of the year and investment was up almost 5%. Investment in equipment and machinery was the star performer in this period and recorded annual growth of 20%. When the volatile spending on aeroplanes is stripped out, investment by Irish firms in new plant and machinery was up 10%. This demonstrates that many Irish businesses, particularly exporters, have limited spare capacity and now have the confidence to invest for economic recovery. The construction sector has also stabilised and for the time since the start of the economic crisis, it is no longer a drag on growth.

Our forecasts for 2013 and 2014 remain largely unchanged from the Q1 2013 Economic Outlook and we expect GDP to

GNP and its components

Annual % change	2011	2012	2013	2014
Consumer spending	-2.4	-0.9	0.0	1.0
Government spending	-4.3	-3.7	-3.3	-2.0
Investment	-12.6	1.2	7.1	9.6
Exports	5.1	2.9	3.0	4.0
Imports	-0.3	0.3	2.0	3.6
GDP	1.4	0.9	1.8	2.5
GNP	-2.5	3.4	0.9	1.9

Table 1

grow by 1.8% this year. The drivers of growth are becoming better balanced as we now expect domestic demand to perform somewhat stronger than forecast at the start of the year. This will offset the on-going weakness in the goods export sector. We believe that the Irish economy is now poised for a solid economic recovery but the outlook remains dependent on global demand. At present, the economy is performing relatively well in difficult external circumstances. More impressive growth rates and a sustained fall in unemployment will only be achieved when economic performance improves in our main trading partners.

Business outlook

Business confidence improved at the start of the year, according to the Q1 2013 IBEC Business Sentiment Report. The majority of the indicators climbed higher and many recorded the highest reading in the history of the survey, which began at the height of the crisis in 2009. CEOs' perceptions of the overall business environment in Ireland continued to improve, with the current conditions index rising to -6 from -13 in Q4 2012, while the three-month forward-looking index increased to -4 from -13 in Q4 2012.

Managers' assessment of the current situation and future outlook for their own businesses also recorded a robust improvement. The current conditions index rose to +19 from +15 in Q4 2012, while the index for the three-month outlook jumped to a series-high of +23, up from a relatively weak reading of +10 in the previous quarter. Underlying this positive trend are improvements in sales and order books expectations. The export sales index remained at a high reading of +35, while the domestic sales index rose to a series-high of +7 from a weak -2 recorded in Q4 2012. The index for order books rose to +21 from +15 recorded at the end of 2012.

As a result of the improved outlook for company performance, the employee numbers index is now for the first time in the history of the series in the positive and one in four managers indicated they would increase employee numbers in the coming quarter. It now appears that sustained job creation is taking hold in the exporting sectors, and the index reading for these companies was +10.

IBEC business sentiment indicator

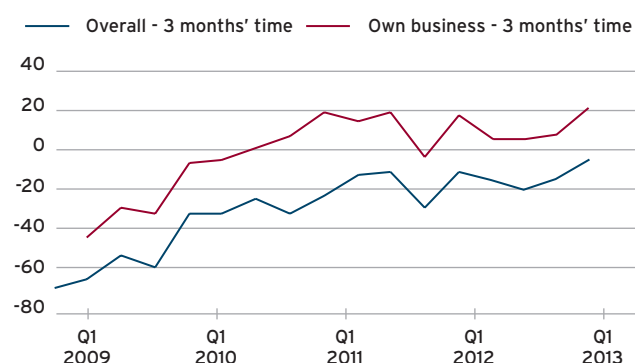


Figure 1

Consumer spending

The volume of consumer spending fell by 0.9% during 2012 as a whole, but the year was one of two halves. During the first six months, consumer spending was down 1.2% on the same period of 2011; however, activity rebounded during the summer, and expenditure was up 0.2% during the latter six months. When considering goods and services, the main component parts of total consumer spending, the whole-year average conceals differing trends. During 2012 as a whole, goods sales fell by 1.0%, while services were down by 0.9%. However, a diverging pattern emerged during the year, and in Q4 2012 goods sales were up 0.7% on an annual basis while services were down 0.3%.

The improved trend on the goods side was largely due to a temporary boost from the sale of audio-visual equipment ahead of the Olympics and the digital switchover, and the sale of electrical goods was up 15.4% in the period July-December when compared with the same months of 2011. This strong performance helped lift overall retail sales, but a number of sectors faced a more challenging environment with sales falling on an annual basis; these include hardware, paints and glass (-6.2%), motor trades and fuel (-5.1%), bars (-5.1%) and clothing and footwear (-3.0%).

Though the volume side of consumer spending remains muted at best, an improvement on the value side proved somewhat of a silver lining during 2012. The value of consumer spending increased by 0.8% - the first rise since 2008. However, as we detail in the section on prices and wages, the improvement on the value side is likely to have been predominantly due to a weaker euro exchange rate; domestic price pressures in the economy remain muted.

With a stronger euro this year, we expect value growth to subside somewhat. The more detailed data on monthly retail sales support this view. During the first three quarters of 2012, the value of sales was on average 0.7% ahead of the volume on an annual basis. However, the trend began to turn in the final quarter of the year, and in the first quarter of the year value was only 0.1% ahead of volume.

At the time of writing, we had retail sales data for the first quarter of the year. With very weak outturns in both January and March (the latter likely owing to the exceptionally inclement weather in that month) core retail sales were flat on an annual basis and down 2.0% in the quarter. National Accounts data are therefore likely to show that consumer spending contracted on a quarterly basis in Q1 2013. Nonetheless, if the recovery in fundamentals and sentiment persists, the second half of the year should be stronger - much like the pattern observed last year. In particular, the earlier timing of the budget may well remove some of the volatility and uncertainty in activity typically seen either side of Christmas. We have therefore kept unchanged our forecast of flat consumer spending in volume terms for 2013 as a whole.

As consumer fundamentals improve and spending power returns to growth in 2014, a strengthening in consumer confidence should bring down precautionary savings from the current high level. In the absence of further negative shocks, the current stabilising trends for the consumer market should turn more positive and become self-reinforcing, and we have pencilled in consumer spending growth of 1.0% for 2014.

Investment

The investment sector of the economy recorded annual growth in 2012 for the first time since 2007. Ireland's recession was predominantly caused by a collapse in investment activity. Although the fall in investment activity was most acute in 2009 and 2010, the sector also declined by some 13% in 2011. The peak-to-trough fall in investment was a staggering 72% and despite the modest growth recorded in 2012, output last year was less than half of that recorded in 2007. The collapse in GDP, employment and tax revenue is predominantly due to the halving of investment activity but after four years of decline, the sector has now finally stabilised.

A significant improvement in machinery and equipment spending last year led to the stabilisation in overall investment activity. The construction sector continued to contract but even here further signs of stabilisation came through in the second half of the year and we expect that 2012 to have been the final year of falling construction activity.

Capital deepening and reinvestment by Irish firms was a major positive story in the Irish economy last year. Total investment in equipment and machinery was up 10% in 2012 and when we strip out the volatile aeroplane purchase component, investment by enterprise grew by 7.7%. It is therefore very positive to see that despite the fragile economic environment and the overall weak demand for and supply of credit, Irish business is reinvesting again. We had flagged some time ago that there was limited spare capacity in exporting firms and it is therefore no surprise to us to see that many businesses are investing in the expectation of new orders and economic recovery.

A number of sector specific issues such as the removal of milk quota controls in the dairy sector are also likely to affect positively on business investment trends over the coming years. We expect that the positive momentum seen in 2012 will continue into 2013 and, despite the headwinds for goods exports, investment in equipment and machinery will increase by 10% this year and a little stronger in 2014.

Retail sales and consumer confidence

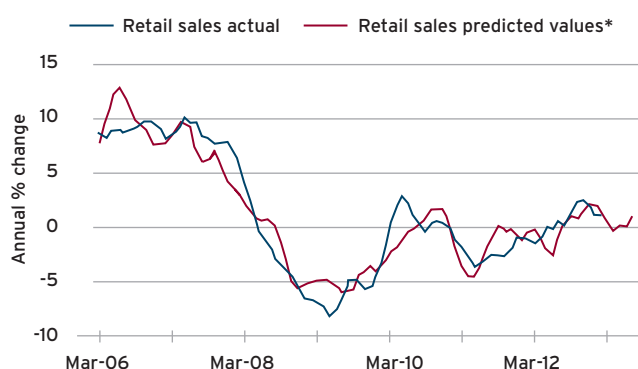


Figure 2

*Retail sales predicted value based on a simple regression of the future expectations component of the KBC Bank Ireland/ESRI Consumer Sentiment Index

Outlook for the Irish consumer in 2013 and 2014

IBEC's Irish Consumer Monitor analyses in detail the income trends facing consumers for the next few years. We consider four distinct household types - mortgaged working, non-mortgaged working, retired and unemployed/other - which we see facing very different income and expenditure trends. We examine the change in after-tax income for each household type, factoring in developments in major cost items such as mortgages, energy and health. This enables us to estimate the movement in consumers' discretionary income or spending power which, together with developments in the savings ratio and employment, forms the basis of our forecast for overall consumer spending in the economy.

Following a very difficult 2011 when discretionary incomes fell by 6%, average Irish consumer spending power during 2012 was essentially flat. Mortgaged working households benefitted from a significant drop in interest costs and some modest income growth, and saw spending power improve by 2.6%. However, other household types saw varying degrees of decline in their discretionary incomes, with unemployed households hit the worst by a 3.1% drop.

Spending power of the average Irish household will improve marginally by 0.2% in 2013 and is set to grow by about 0.7% in 2014. While there are significant differences between household types, some trends affect a large portion of all consumers. The PRSI changes introduced in Budget 2013 will have had a widespread albeit fairly modest impact, while many households will also be affected by a rise in health care costs. We expect utility costs to increase by an average of 5% this year, but have pencilled in a similar reduction in motor fuel costs, largely on the back of currency factors.

The local property tax will affect some 1.1 million households, but will have a fairly limited impact on spending power. As the property tax replaces the existing flat household charge of €100, we estimate that the additional cost will be €150 in 2013, or 0.3% of after-tax income for working households, and a further €150 in 2014. However, given the emotionally charged nature of this tax, the more significant impact is on consumer sentiment; nonetheless, even this should begin to fade by mid-year, as consumers get certainty on the tax liability and accept the inescapability of the charge.

Looking specifically at the different household cohorts, we see some significant variation. Gross incomes for working households will rise by about 1% in 2013 as a result of some modest wage growth and other income increases. Mortgaged households will benefit from a carry-over impact of the 2012 interest rate cuts, with some chance of a further ECB cut during 2013 a potential upside. Spending power of mortgaged working

households will therefore increase by 1.4% this year and by 1.9% in 2014. Non-mortgaged working households, faced with higher costs and not benefitting from lower interest rates, will see a very marginal decline in discretionary income during 2013, turning to a modest improvement of 0.5% in 2014.

Retired households with private pensions will benefit from index-linked increases, but those fully reliant on state pensions will see no change. On average, spending power of retired households will remain essentially flat in 2013 and rise by 0.5% in 2014. Income of unemployed households will continue to fall due to social welfare cuts and various changes to scheme eligibility and spending power will decrease by 1.6% this year and by 1.8% in 2014.

The savings ratio, which is now the main moving part determining consumer spending, remains high. Overall, many of the fundamentals driving precautionary saving such as incomes and employment have stabilised, and may begin to have a positive contribution. Two interlinked key factors will drive savings behaviour over the next few years: the housing market and consumer confidence.

The housing market now appears to be stabilising, albeit with Dublin outperforming the rest of the country. Given that a large share of Irish households' assets is tied up in property, a stabilisation in house prices has meant that consumers' net wealth position began to improve in the latter half of 2012. This in turn should provide support for the tentative recovery in consumer sentiment seen recently and in the absence of further bad news, consumer confidence should improve further during 2013. With both fundamentals and sentiment now supporting recovery, the outlook for the Irish consumer market is finally beginning to look brighter, albeit from an exceptionally difficult starting position.

Download the complete Irish Consumer Monitor on the IBEC website at <http://www.ibec.ie/O/ConsumerMonitor2013>.

Consumer spending power forecasts

Household type	Annual % change	
	2013	2014
Mortgaged	1.4	1.9
Non-mortgaged	-0.2	0.5
Retired	0.1	0.5
Unemployed	-1.6	-1.8
Average	0.2	0.7

Investment

Annual % change	2011	2012	2013	2014
Building and construction	-15.8	-5.6	4.4	7.1
Plant and machinery	-8.3	9.6	10	12
Total	-12.6	1.2	7.1	9.6

Table 2

Total construction output contracted for a fifth consecutive year in 2012. Output was down almost 6% and the sector is now about one-third of the size it was in 2007. Housing activity continued to fall in 2012 and the number of new housing completions is now less than one-tenth of the record output level in 2007. The total number of completions last year was about 8,500 – a drop of 20% on the 2011 outturn. We expect that housing construction has now finally bottomed out but we are unlikely to see any recovery for some time yet. Although housing transactions, particularly in Dublin, increased significantly last year, excess supply remains in much of the country and any significant new construction remains some way off. It is likely, however, that the Dublin market will require some additional supply of new family homes in the short-to-medium term.

Following an increase in activity in 2011 of about 6%, it was somewhat surprising to see that activity in the home improvement sector fell back by 15% last year. There was also a weakening trend as the year progressed. This pattern does not appear to align with the increase in housing transactions which occurred but there is likely to be a lag between home purchases and improvement activity. We therefore expect to see an increase in home improvement spend this year of about 5% as many home owners undertake refurbishment works on the stock purchased during 2012. Non-residential building and construction activity increased by 2.5% in 2012 and some public capital investment projects were advanced and modest commercial activity also progressed. The sector is also likely to have benefited from investment activity by business as many plant expansion plans obviously have a significant construction element to them.

We expect that overall construction activity will experience a modest improvement this year. The sector has now bottomed out and will no longer be a drag on economic growth. From both an employment and tax revenue perspective, however, we are likely to see a slow return to a more normal level of construction activity over the coming years. Total investment will contribute to GDP growth over the coming years, and we forecast an increase of 7% in 2013 followed by 10% in 2014.

Prices and wages

Average price growth remained very modest in 2012 and the overall price level in the economy is still lower than where it was prior to the economic crisis. Falling prices in 2009 and 2010 followed by some limited inflation since then have therefore protected the real incomes or purchasing power of both working and social welfare dependent consumers. The consumer price index (CPI) increased by 1.7% last year while the harmonised index of consumer prices (HICP), which

excludes mortgage costs, increased by 2%. Energy was the main driver of inflation last year with transport costs up 6% and the average price for energy products higher by over 9%. Prices in the furniture, communications and recreation sectors all recorded further declines in 2012.

The pattern of very modest inflation has continued in the early months of 2013. The CPI increased by just over 1% annually in January and February and by only 0.5% in March. The stronger euro this year has reduced the cost of imported goods while the overall fragility of the domestic economy has meant that consumer businesses remain reluctant to alter price points. Fuel prices have eased back somewhat with petrol prices in March down 1% over the year and diesel falling by 2%. Despite fairly elevated food commodity prices there has very limited pass through to Irish consumers. Although food prices are up about 1.5% over the past year, they have fallen back in recent months and dropped by 0.5% in March.

Mortgage costs, which account for about 5% of the total CPI basket, are down 7% over the past year as householders on tracker mortgages benefited from ECB rate cuts. It is now likely that the central bank will cut its base rate again before the summer and this will place further downward pressure on the CPI in the second half of the year. Low interest rates coupled with a stronger euro and weak domestic demand are likely to result in very moderate inflationary pressures over the coming quarters. We currently forecast that the CPI will increase by no more than 1.3% this year – with the risk currently on the downside – and we expect it to grow by less than 2% in 2014.

Moderate inflation is an important part of Ireland's effort to regain competitiveness. Our inflation rate remains one of the lowest in the EU and is well below the EU average of 2%. However, it is also important for both the business community and the public finances that some price growth emerges and that the economy reflate. The happy medium is one of prices growing but inflation remaining lower than that in our main trading partners.

Although the era of widespread pay reductions is behind us, Ireland continues to regain labour cost competitiveness against most other EU countries. Some pay growth has now returned to the economy and IBEC research indicates that about 40% of Irish businesses will award pay increases during 2013. The majority of companies, however, plan to freeze pay – many of which for the fifth successive year. Where pay growth does occur, the median increase is estimated to be in the region of 2%. The average pay rate change across the private sector is estimated at just north of 0.5%, marginally higher than that recorded in 2012. Strong productivity growth and pay increases which are less than

Inflation forecasts

Annual % change	2011	2012	2013	2014
Consumer price index	2.6	1.7	1.3	1.9

Table 3

in our competitor countries can ensure that Ireland will continue to make inroads into its competitiveness challenge without the need for further nominal adjustments.

Separate data from the CSO show that total wages in the Irish economy grew by €711 million or just over 1% last year. This was a result of a small increase in average pay rates and, most likely, some compositional improvement in employment. With an improved outlook for total employment this year, continued job creation in the high-tech sectors and modest pay growth, the total gross wages income in the economy is likely to increase by between 1.5% and 2%. This will help domestic demand and offset the impact of the austerity measures. The same dataset from the CSO also reported a significant increase in the earnings of the self-employed sector last year which is a further indicator of gradually improving business conditions.

Labour market

Last year marked a turning point for the Irish labour market. While employment for the year as a whole fell by a further 0.6%, this was the slowest pace of decline since job losses started. The end of 2012 saw a number of positive developments and 2012 is likely to go on record as the last year of falling employment.

The final quarter of the year saw a small annual gain of 1,200 in the number of people at work – the first since the downturn began in 2008. On a seasonally adjusted basis, employment increased relative to the previous period in both Q3 (+2,200) and Q4 (+6,500), marking the first consecutive quarters of jobs growth since 2008. The most encouraging reading, however, comes from data on private sector employees. The quarterly trend is somewhat volatile, but the number of employees returned to growth already in Q4 2011, and during 2012 as a whole the private sector added 7,000 jobs.

Looking at the underlying sectoral trends, some clear patterns have emerged. Any employment growth has taken place in the services sector, while manufacturing and construction have continued to lose employment. Internationally traded services have performed particularly well. Employment in the IT sector grew by 5.2% in 2012, and while employment in professional and scientific activities was up by just 0.7% for the year as a whole, the second half saw growth accelerate to 5.1%.

Employment

000s annual average	2011	2012	2013	2014
Agriculture	83	86	88	90
Industry	348	336	333	334
Services	1,418	1,414	1,426	1,445
Total	1,849	1,838	1,848	1,869
Unemployed	317	316	297	287
Unemployment (%)	14.6	14.7	13.9	13.3
Labour force	2,166	2,154	2,145	2,156

Table 4

Looking at the domestic sectors of the economy accommodation and tourism is a bright spot, with employment growth of 2.8% in 2012. The catch-all category other services, which includes arts, entertainment and recreation, was up by 2.5%, albeit with a slowing trend throughout the year. Retail and wholesale saw a decline in employment of 0.7%, but with an improving trend in the second half of 2012.

Employment in industry fell by 2.6%, and with a weaker outlook for goods exports, the manufacturing sector is likely to struggle in 2013. While construction employment fell by a further 5.6%, jobs losses should now be near an end. Agriculture added 3.5% to employment, a positive trend which we see continuing, given the growth prospects for the sector.

We have pencilled in employment growth of 0.5% for 2013, rising to just over 1% in 2014. Although we have no hard data for the year so far, softer indicators point to the positive momentum from 2012 carrying into 2013. The employment component of IBEC's Business Sentiment Survey, which correlates well with actual labour market developments, rose to a positive reading for the first time in the history of the series. IBEC's Jobs Report for April 2013 also showed that over 5,000 vacancies were announced in the first quarter of the year.

Despite the positive trends now beginning to emerge in the labour market, the recovery is fragile and needs to gain momentum in order to bring down the unemployment rate in a sustained manner. This requires sustained growth in exports, but also a return to growth in the more labour-intensive domestic sectors of the economy. Government must ensure that economic policies are supportive of growth and that labour market activation policies deliver training and interventions that are close to the market, with a focus on areas where jobs growth is likely and skills gaps exist.

Exports and exchange rates

The trade figures for February 2013 show a 2.2% (€154 million) monthly increase in goods exports, but when compared with February 2012 the value of exports was down 10% (€753 million). The annual decrease is a result of both the patent cliff and adverse external conditions as the eurozone economy suffers from anaemic growth, but despite an overall weakness in the trend, some sectors saw growing export sales.

When comparing the first two months of 2013 to the same period a year earlier the major growing export sector was in food and live animals. This sector rose from 7.8% of total exports to 9.4% in that period, an increase in sales of around 7%. The chemical and related products sector, which accounts for almost 60% of all exports, saw the largest decrease. Exports from the sector fell by €1.4 billion or 16% on an annual basis. It is clear from these figures that the patent cliff is continuing to create a significant drag on Irish goods exports figures.

On a month-to-month basis the value of imports was down 1.7% (€69 million) in February, taking Ireland's seasonally adjusted trade surplus to €3.1 billion. On an annual basis imports were down 2% or about €61 million, mostly due to a

€128 million decrease in the import of 'petroleum and related products'. Because of the high import content in a number of exporting sectors, reduced imports will offset weaker export performance, and on a net basis goods trade continues to make a positive contribution to GDP in 2013.

The EU remains Ireland's major export partner. EU countries accounted for 58% of all Irish goods exports in February, compared with 22% going to the US. Within the EU our major trading partner was the UK with €888 million in exports and €1.3 billion in imports. The UK accounted for 13% of total exports and almost 33% of total imports during the month of February.

The latest data on services trade showed that in Q4 2012 services exports were up €2.1 billion on an annual basis, a 10% increase. This was driven by a strong performance from the computer services sector. These results underline the differing challenges facing the traded goods and traded services sectors. Goods exports are struggling due to the continued negative effects of the patent cliff and weakness in destination markets, while services exports perform strongly. The challenge for goods exporters therefore is to grow new markets for Irish goods in developing markets where economic growth is more robust.

With this in mind a major downside risk to goods exporters in 2013 is the euro strengthening against currencies of Ireland's major non-euro trade partners such as the UK and US. The euro strengthened in early 2013 reaching above \$1.35 against the dollar for the first time in two years and climbed to above £0.87 relative to sterling. However, continued political and economic uncertainty in Europe as well as on-going strife surrounding the Cyprus bailout has clawed back many of those gains, proving a slight silver lining for Irish exporters. By the time of writing in late April, the euro had fallen to \$1.30 against the dollar and marginally to £0.85 against sterling. While a recovery in the European economies is to be hoped for, it may also bring its own challenges in the form of a strengthening euro exchange rate.

Public finances

The Department of Finance's Maastricht returns show that the government deficit for 2012 was 7.6% of GDP, one full percentage point ahead of targets set by the Troika programme. Minister Noonan has signalled that any 'spare capacity' in this year's budget may be used to encourage growth and employment. IBEC believes any initiative to support employment should include the renewal of PRSI and VAT incentives which expire in December 2013. These incentives make it easier for employers to take on new employees, particularly in labour intensive sectors.

March's Exchequer statement showed the Exchequer deficit at €3.6 billion, down €568 million from the same period in 2012. Tax receipts were up 1.1% on the previous year, while also 0.5% ahead of expected receipts Q1 2013. Within this income tax, VAT and excise receipts came in below target, with a shortfall of €118 million. This was, however, more than made up for by higher-than-expected corporation tax returns, which were €147 million or nearly 60% ahead of target.

Expenditure voted on in the Dáil fell by €689 million (5.9%) year-on-year. Current expenditure is down 4.9% (€545 million) from the same period last year. This has been driven by decreases in spending at large departments such as Social Protection and Education, with the largest single fall coming in Social Protection where spending was €315 million less than in 2012. While the health sector has been able to deliver some expenditure savings, these have been below target and will remain an area of focus for the Troika.

Non-voted current expenditure is up by nearly €600 million; this, however, is mainly due to one-off payments under the Eligible Liabilities Guarantee Scheme (the government guarantee on deposits) resulting from the promissory note deal and the dissolution of IBRC. These payments have cost in the region of €930 million thus far and are expected to be close to €1.1 billion overall. Benefits of the promissory note deal - about €1 billion per year - are expected to be seen in Exchequer figures in 2014.

The cost of servicing the national debt in the year to March was down about 16% (€434 million) year on year, although this has much to do with the timing of payments rather than falls in the debt levels. A more informative measure of the cost of debt servicing is the level of interest repayments which is up €234 million on this period in 2012.

As Ireland moves toward an expected exit from the Troika programme later in the year recent agreements to extend the maturity of Irish loans from EU partners by up to seven years should be welcomed. This would smooth the Exchequer's debt profile and prevent repayments of these loans complicating Irish debt issuances as we return to normal market funding. As yet, however, this agreement must first be ratified by several national parliaments before it comes into force. Any additional relief through bank recapitalisation using permanent bailout funds is likely further away. These, along with the promissory note deal, would significantly improve Ireland's chances of successfully returning to the market, creating a much needed good news story for the eurozone.

Exchange rates - monthly averages

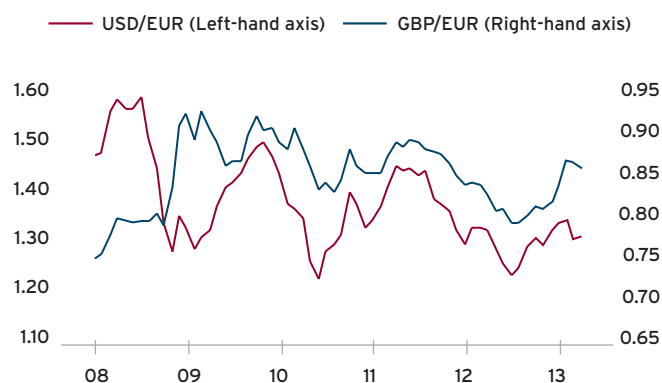


Figure 3

International economies

Economic activity has picked up encouragingly in some major economies in early 2013. The US economy has started the year particularly well and is expected to grow by 2% this year. However, the uncertainty caused by the handling of Cyprus's bailout and continued fiscal contraction means that the eurozone will continue to drag on the global economy in the first half of 2013. Growth will be further hindered by signs of renewed slowdown in the German economy after a poor performance in late 2012. In addition, major European countries such as France and Italy are expected to suffer negative economic growth leading to poor overall growth prospects for the eurozone. However, this weakness in the eurozone may well prompt policy makers to renewed activism, in the form of lessened austerity and easier monetary policy by the ECB.

United States

Strong private sector employment growth and PMI figures point to a solid US recovery in early 2013. The OECD has estimated growth in the US economy was 3.5% in Q1 2013 and forecast growth of 2% in Q2. In its latest forecasts, the IMF expects the US economy to grow by 2% this year and 3% in 2014. The private sector added over 400,000 jobs in January and February 2013 despite strong headwinds such as the \$110 billion rise in payroll taxes. Recent forecasts have shown unemployment falling to almost 6.0% by the end of 2015. There is, however, some scepticism as to how long the current positive trend will last, with slow growth in Europe dragging on a worldwide recovery.

Eurozone

The EU's unemployment rate hit another record high of 12% in February, making it the 22nd continuous month of rising unemployment. Continued uncertainty about the political management of the eurozone crisis has seen the IMF downgrade its 2013 GDP forecasts for the eurozone twice since January, to -0.3% currently.

The PMI for the eurozone was at 46.5 in March, the 19th out of the past 20 months that this index has been below the 50 mark which indicates positive growth and confidence. Slow growth in the eurozone as a whole is now affecting even the relatively strong German economy. The German PMI fell to 48.8 in April, signalling an end to four months of output expansion.

The OECD and IMF have both highlighted the twin problems of fiscal contraction and poor credit availability to business and households as the reasons for Europe's continued sluggish performance. The OECD in its interim assessment argued that the ECB should ease monetary policy further to aid ailing demand and employment. The effectiveness of Europe-wide austerity has been questioned by a number of similar high profile commentators in recent months. This appears to have gained some traction at EU level with European Commission President Barroso stating that austerity had "reached its limits".

United Kingdom

After suffering three quarters of recession in 2012 the UK is expected to return to very modest growth in 2013. The IMF has stated that the Government should consider greater fiscal flexibility as poor demand conditions are hampering an already uncertain recovery.

Undoubtedly, the major news from the UK is the current Government's stated intention to hold a referendum on EU membership in the coming years. A survey of over 4,000 businesses by the UK Chamber of Commerce found 60% of firms feared the consequences, if the vote does happen, for their firms and the economy at large. However, the same survey also found strong support for repatriation of some powers to the UK in the areas of employment and health and safety law. The possible outcomes of this referendum and the extended period of debate before the referendum (likely to be held in 2017) will have a detrimental effect on investor certainty in the UK. This presents both a substantial challenge and opportunity for the Irish business community.

Real GDP growth - selected countries

Annual % change	2012	2013	2014
Australia	3.7	3.0	3.2
France	0.2	0.3	1.3
Germany	0.9	0.6	1.9
Italy	-2.2	-1.0	0.6
Japan	1.6	0.7	0.8
United Kingdom	-0.1	0.9	1.6
United States	2.2	2.0	2.8
Russia	3.4	3.8	4.1
Eurozone	-0.4	-0.1	1.3
Total OECD	1.4	1.4	2.3

Table 5

Domestic demand growth - selected countries

Annual % change	2012	2013	2014
France	-0.4	0.3	1.2
Germany	0.0	1.1	2.6
Italy	-4.5	-1.9	0.0
Japan	2.4	0.8	0.5
Spain	-3.9	-4.0	-0.9
United Kingdom	0.8	1.0	1.1
United States	2.2	2.1	3.0
Eurozone	-1.9	-0.6	1.0
Total OECD	1.0	1.3	2.2

Table 6

Source: IMF World Economic Outlook April 2013



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