

# Q1

January -  
March 2014

# Ibec Quarterly Economic Outlook

## Balanced recovery taking hold

### Economic growth

Economic recovery underway, GDP figures volatile due to the patent cliff

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Jobs growth of 3.3% in 2013, strong employment growth to continue

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Credit conditions tight, demand for lending increasing

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The recovery in Ireland's domestic economy can be clearly seen in spectacular private sector employment numbers and strong increases in consumer confidence, business confidence and investment. Despite this, GDP growth disappointed in 2013 due to the continuing disproportionate impact of the pharma patent cliff on exports. We strongly believe that the recent economic resurgence will be reflected in the official data in 2014 and that GDP will grow by close to 3% this year.

### GNP and its components

Annual % change	2012	2013	2014	2015
Consumer spending	-0.3	-1.1	1.9	2.4
Government spending	-3.7	-0.5	-0.8	-0.4
Investment	-1.0	4.2	21.5	12.7
Exports	1.6	0.2	3.8	3.9
Imports	0.0	1.0	5.1	4.1
GDP	0.2	-0.3	2.9	3.1
GNP	1.8	3.4	2.3	2.5

## GDP and components

### Economic Growth

Full year GDP figures for 2013 disappointed due in part to the continued effects of the pharma patent cliff. In addition, consumption reacted surprisingly poorly to the strong growth in employment. Despite this, the sustained uptick in consumer and business confidence, along with strong employment and investment numbers, shows the Irish economy is firmly in recovery.

Although the patent cliff means GDP figures have the potential to be volatile again in 2014, we strongly believe that the recent economic resurgence will be reflected in the official data on consumption and investment over the coming quarters.

### Carry-over effects

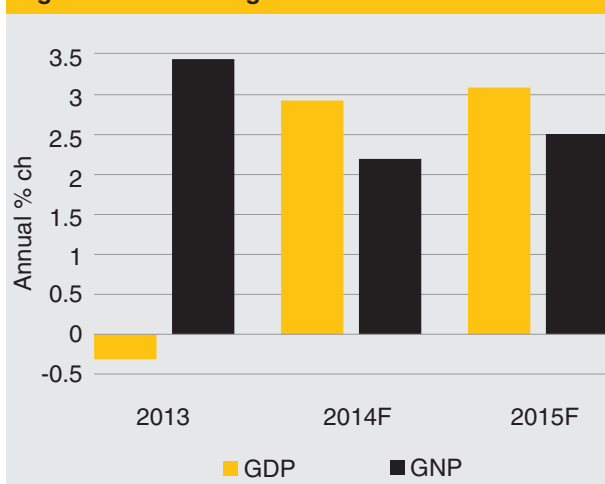
As a result of the poor economic performance in the first half of last year, significant carry-over effects will be evident in a number of Ireland's macroeconomic indicators. Carry-over effects for each GDP component represent the annual rate of growth that would result in 2014 if the level of a macro indicator reached in Q4 2013 remained constant throughout 2014. These effects are particularly important for the trade and investment figures. If there was no quarter-on-quarter growth in investment in 2014, total investment in the economy would still be up almost 9.7% on 2013 due to these base effects. Additionally, over 60% of our forecast export growth and 90% of our forecast import growth would happen in 2014 without having quarter-on-quarter growth during the year. The trade effects will have a small and negative effect on overall GDP growth for 2014.

### Outlook for exports

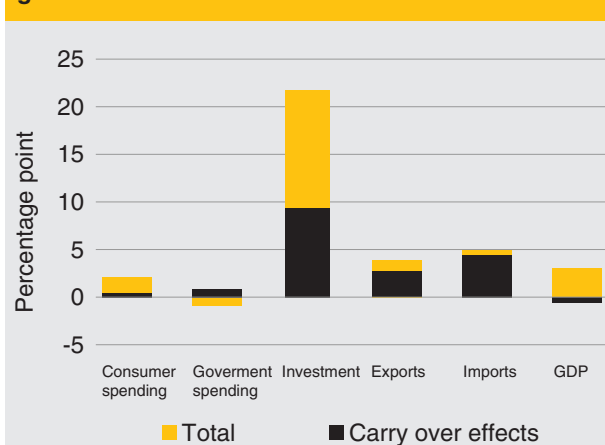
Last year saw Ireland's worst goods export growth for ten years as the pharma patent cliff effect wiped almost €5 billion off the value of Ireland's exports. Other categories of goods exports also struggled, with declines in the year-on-year performance of four of the five highest value goods export categories. The effects of weak goods exports were offset by strong growth in traded services (5%), leaving overall export growth at 0.2% for 2013.

Although the effects of the patent cliff will continue into 2014, we expect to see its impact begin to ease slightly as fewer high value drugs come off patent. Additionally, strong economic growth in key trading partners should see continued robust growth in services exports and a recovery in goods exports. This allied to significant carry-over effects from 2013 will help achieve export growth of close to 4% in 2014.

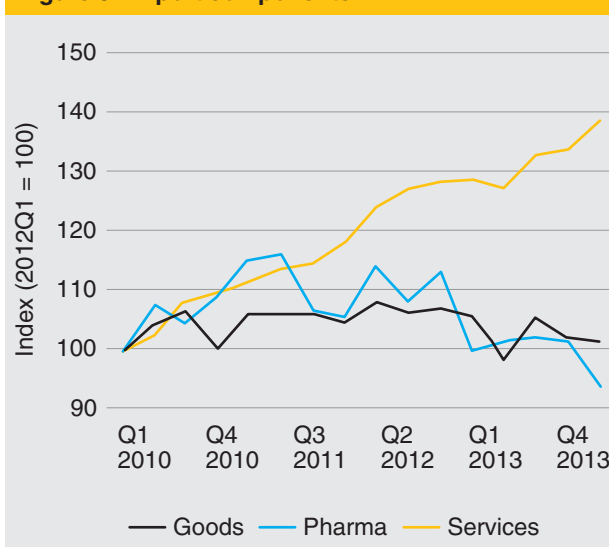
**Figure 1: Economic growth**



**Figure 2: The impact of carry-over effects on growth in 2014**



**Figure 3: Export components**



### Investment outlook

The main positive in Ireland's GDP numbers in 2013 was investment. Annual growth in volume terms amounted to 4.2%. This was the first rise in five years and the strongest since 2005. Construction activity showed a strong increase of 11.6% in 2013, after a decline of 5.2% the previous year. In contrast, investment in machinery and equipment fell by 4.2%. Nevertheless, these figures were distorted by aircraft purchases which traditionally are very volatile. Excluding aircraft, investment in machinery and equipment rose by 22.7%. Despite the increase in 2013, investment remains at low levels. Investment as a proportion of real GDP at 11% is well below the 20 year average of 18.4% and below the equivalent average for the EU of around 17%. This indicates that there is significant growth potential for investment in the coming years.

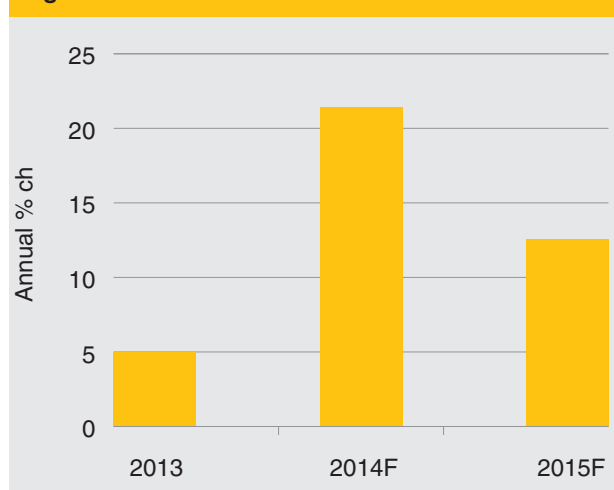
### Investment components

The outlook for investment remains positive. A low interest rate environment, the on-going recovery of the global economy, and strong business confidence - Ibec's business confidence indicator rose to an all-time high in Q4 2013 - bode well for investment. For this year we expect investment to grow by 21.5%. In part, this is due to favourable base effects. The rise in spending will be broad based. Residential construction should gradually recover, while non-residential investment will continue its upward trend. We also expect strong growth in machinery and equipment as aircraft investment should rise again. In 2015 annual growth in investment should remain strong at 17%.

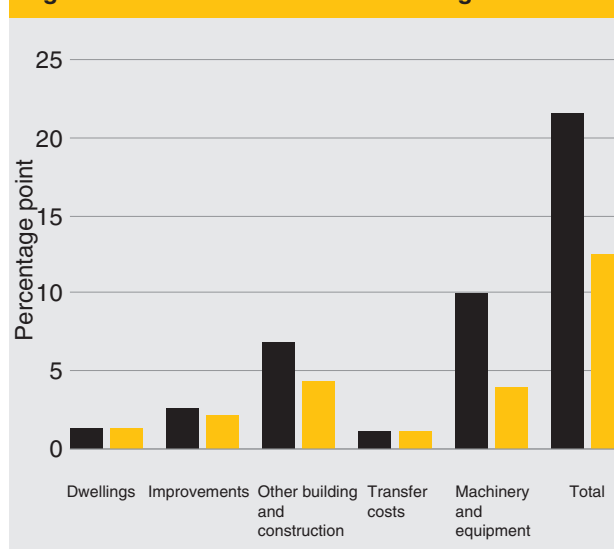
### Consumer spending

Consumer spending remained sluggish in 2013. Despite last year's strong employment growth of 3.3% consumer spending contracted by 1.1%. Nevertheless, there are signs that spending should recover throughout the year. Consumer sentiment rose steadily in the last few months. In February, the KBC/ESRI Consumer Sentiment Index reached its highest level since June 2007. This is mirrored in the development of retail sales. In volume terms, retail sales started to increase in the second half of last year and in January they reached a four-year high. For the coming quarters we expect that the labour market improvement will continue. This in turn should support incomes and lead to a consumer spending recovery. We therefore forecast an increase in consumer spending of 1.9% this year.

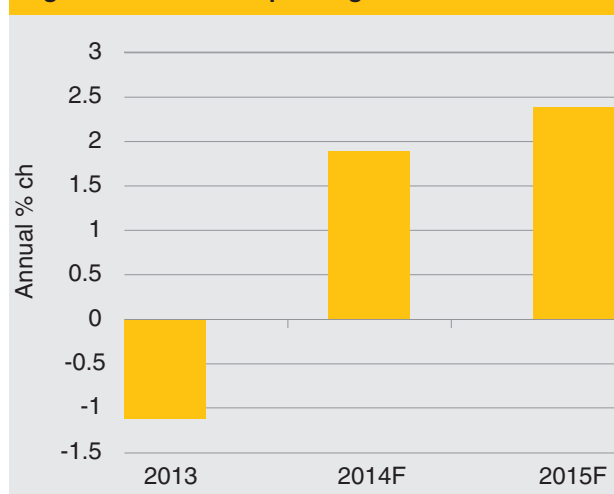
**Figure 4: Investment**



**Figure 5: Contributions to investment growth**



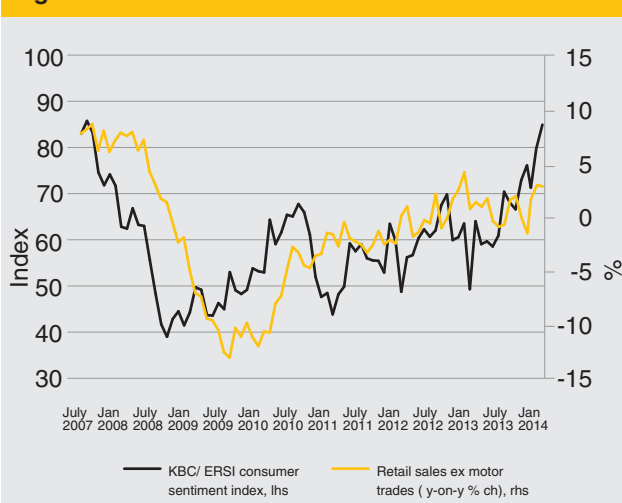
**Figure 6: Consumer spending**



### Consumer confidence and retail sales

Retail sales figures from mid-2013 suggested a strong divergence between consumer sentiment and the growth of consumer spending. This trend seems to have adjusted somewhat in recent months with retail sales in the final quarter of last year seeing strong growth in volume terms. This continued in January with the volume of sales, excluding motor trades and bars, rising by 2.8% compared with January 2013. Consumer sentiment is now at its highest level since mid-2007 with the expectations element of the index reaching a measure of 75.6 in February a rise of 50% on the same period in 2013. Recent strong increases in employment should see the domestic consumer continue to grow in confidence during 2014 as households begin to see signs of recovery impact on their disposable income.

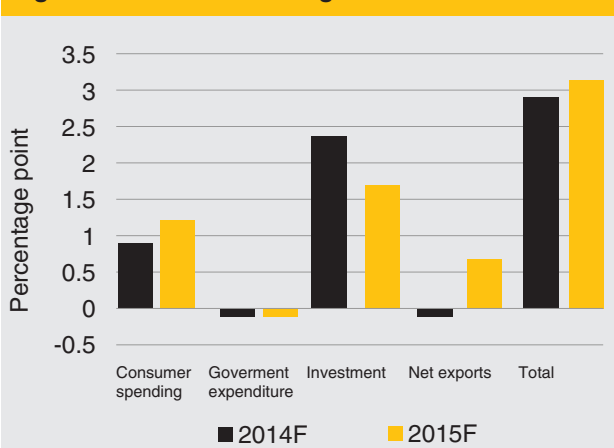
**Figure 7: Retail sales and consumer sentiment**



### Summary of contributions to growth

Economic growth should become more balanced in 2014. In the years following the recession the recovery was mainly export-led. Then, last year business investment replaced exports as the main driver of growth. In line with a continued rise in employment we believe that private consumption will support the overall economy this year and in 2015. In our forecast investment will remain a strong pillar of Ireland's economic recovery. With global demand firming, exports will recover. However, this year's net exports will remain a drag on GDP though to a lesser extent than last year. In 2015 they should contribute positively to GDP. In contrast, government spending will remain a drag on GDP this year and next, though less so than in the past couple of years.

**Figure 8: Contributions to growth**



**Table 1: Risk assessment for 2014**

Factors	Probability		
	High	Medium	Low
Financial Market stability		■	
Fiscal pressure		■	
Wage pressures	■		
Global oil prices			■
Exchange rate			■
Bank lending conditions		■	
International economy	■		
Labour market conditions	■		

■ Downside risk      ■ Upside risk

Source: Ibec assessment

## Labour market

### Employment forecast

The numbers of people in employment in the Irish economy rose again in Q4, continuing a spectacular recent upturn in labour market performance. Total employment in Q4 was up 3.3% or 61,000 on the same period a year earlier, meaning employment increased in all four quarters of 2013. Over 54,000 of the Q4 increase was in full-time employment with employment in full-time equivalents rising by 58,000. Ibec expects employment growth for the full year of 2014 to be in the region of 2%.

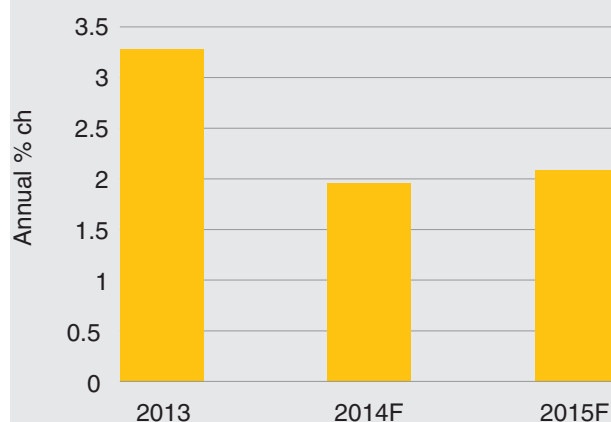
Sampling effects, which have inflated recent year-on-year increases in agriculture and fishing (although not overall employment figures), will come to an end during 2014 allowing us to observe sectoral employment growth more clearly. Ibec expects this will reveal strong growth in traded services in line with recent strong export figures and patterns of job announcements.

### Private sector employment

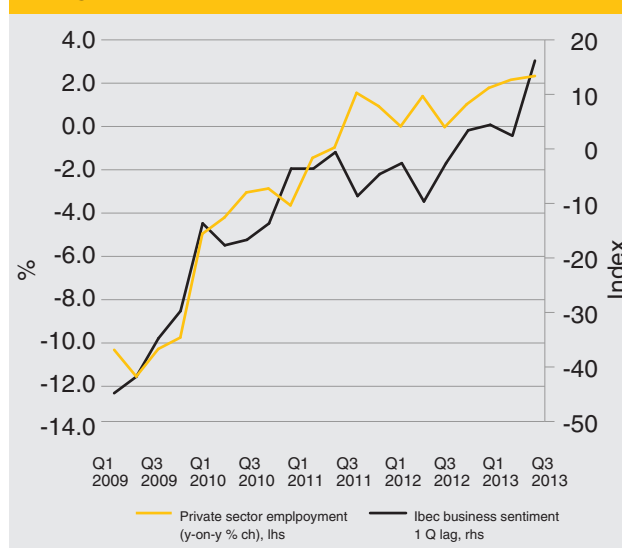
Ibec's business sentiment employee index, which has continued to track private sector employment closely, recorded a series high reading of +16 in Q4 2013 - a spectacular rise from +3 in Q3. Crucially, positive sentiment for employment growth now exists among both exporting and non-exporting companies with employment sentiment among managers in firms operating in the domestic economy rising considerably to +10 following a measure of -6 in Q3 2013.

This positive sentiment was reflected in private sector employment which saw its ninth consecutive quarter of growth in Q4 2013. The year-on-year rise in employment of 2.4% was the largest rise in private sector employment in over five years and is indicative of a continuing upward trend in private sector employment for the year ahead.

**Figure 9: Employment**



**Figure 10: Private sector employment and Ibec hiring intentions index**



**Table 2: Labour market summary**

Employment 000s annual average	2013	2014	2015
Agriculture	107	117	118
Industry	342	362	378
Services	1,431	1,452	1,476
Total	1,880	1,931	1,971
Unemployed	282	235	209
Unemployment rate (%)	13.0	10.9	9.6
Labour force	2,163	2,166	2,175

Source: Ibec forecasts

## Prices and business costs

### Inflation outlook

Price increases have been benign in the Irish economy during 2013. The overall price of goods and services rose by just 0.5%, meaning price levels are still below their 2008 levels. Price rises were predominantly influenced by taxation or government related increases. This is evident in areas such as alcoholic beverages and tobacco (+5.2%), health insurance (+8.7%) and education (+4.6%). On the other hand, prices in categories such as furnishings and household equipment (-3.5%), clothing and footwear (-3%) and communications (-3.7%) continued to fall. Ibec expects inflationary pressures to remain low in 2014, despite low interest rates and growth in consumer spending, due to sustained price competition in key consumer markets. Stable oil prices and mortgage interest rates should also play a key role in reducing pressures on consumer prices.

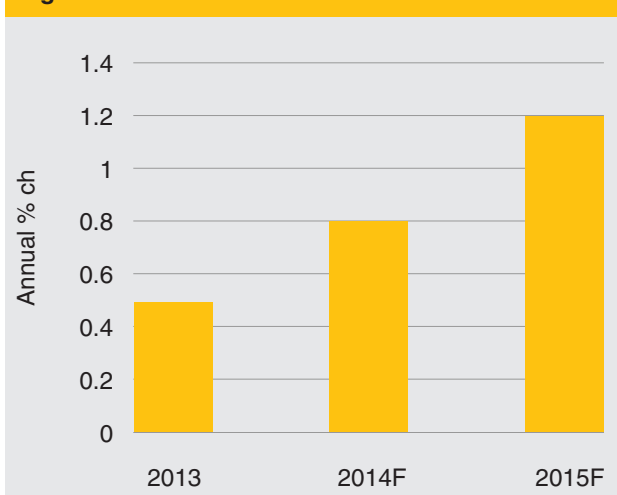
### Labour costs and wages

Labour costs for business have now been rising for two consecutive years eroding the hard won competitiveness gains of recent years. CSO data show labour costs have increased by 0.4% in 2013 following a sharp upturn in labour costs in Q4. This reflects the impact of Budget 2014 on employers, with increases in employers' PRSI, health insurance and sick pay. Data from Q4 2013 show that average hourly wages are now back at the same level as seen in Q4 2008. Average hourly earnings in the private sector rose by 0.4% in 2013 reflecting a return of moderate wage growth. Ibec survey data suggest some moderate wage growth will continue during 2014. These wage pressures will, however, be focused on the more strongly performing sectors of the economy with many firms not in a position to carry additional costs.

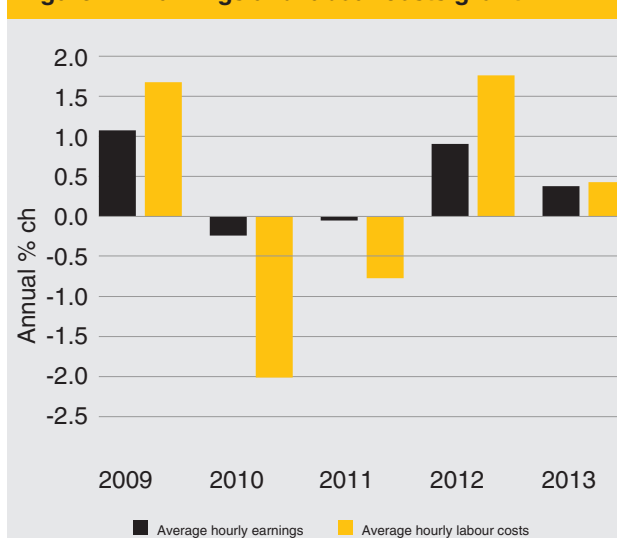
### Business costs

For many firms non-wage business costs continue to form a significant proportion of their cost base. The second half of the year saw a divergence in the growth of non-wage business costs. Bi-annual average costs for gas rose by 13% on the back of concerns about supply to the European market following developments in the Ukraine. Health insurance costs also continued their meteoric rise putting a major strain on company provision of private health insurance. On the other hand, the second half of the year saw small annual falls in fuel and electricity prices. Prices in these areas remain, however, a large cost item for many manufacturers.

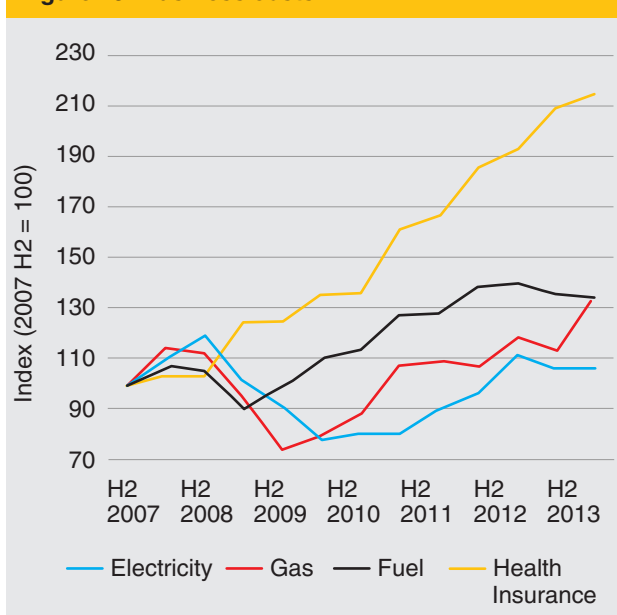
**Figure 11: Inflation**



**Figure 12: Earnings and labour costs growth**



**Figure 13: Business costs**



## International economies

### World economy in recovery mode

The economy in the eurozone is gradually recovering. In the last quarter of 2013, GDP in volume terms rose by 0.3% quarter-on-quarter, the third increase in a row, with the majority of member states contributing positively to growth. Leading indicators such as the Purchasing Manager's Index signal that the eurozone's economic recovery should continue in the coming months. 2013 was a good year for the UK economy. Real GDP grew by 1.8% in 2013, after 0.3% growth in 2012, driven by private consumption and investment. Across the Atlantic, poor weather conditions dampened economic activity in the USA in the last few months. With the weather-related effects fading, the US economy will gather momentum.

### Euro remains strong

Financial market hopes that the ECB would further loosen monetary conditions to stimulate the eurozone economy at its council meeting on March 6th were dashed. Instead, ECB president Mario Draghi reported that the bank expects inflation to gradually rise. With an on-going economic recovery this makes a further rate cut unlikely. Consequently, the euro strengthened against sterling to nearly £0.84. With a stronger growth outlook for the UK, sterling should appreciate versus euro. On March 19th Janet Yellen, the new Fed chief, indicated that the Fed could hike its policy rates from April 2015 onwards. Markets reacted promptly and the euro weakened against the dollar. Yet, with the eurozone's economy gradually regaining strength we expect euro-dollar to remain on high levels. Nevertheless, the dollar is a classical crisis currency and should strengthen if the crisis in the Ukraine develops into a real threat to the global economy.

Figure 14: Growth in major economies

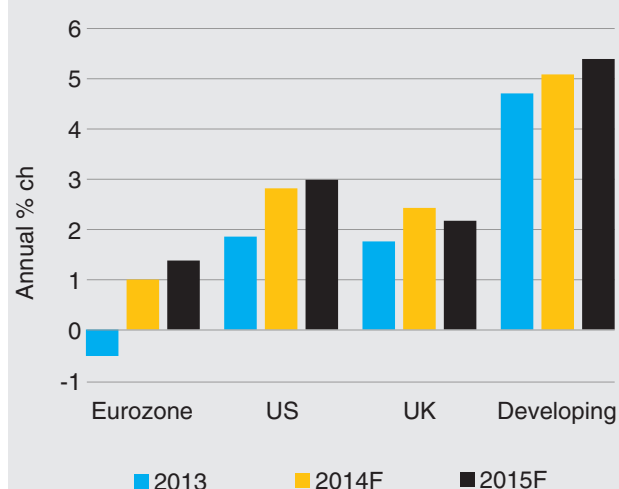


Figure 15: Exchange rates

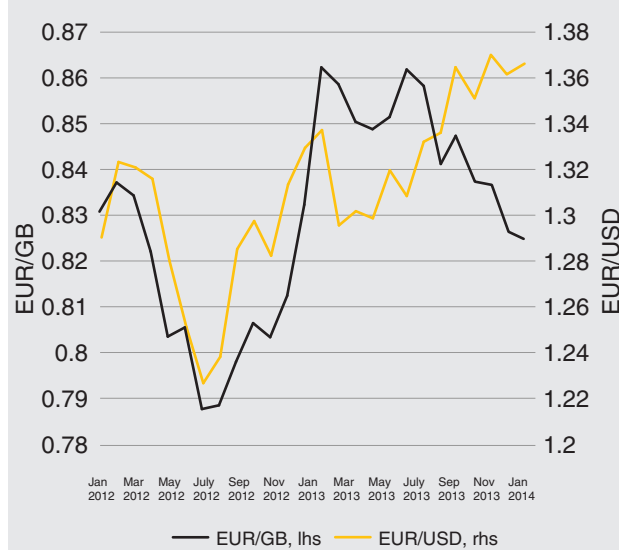


Table 3: International economies summary

	Real GDP, y-on-y % ch			Inflation, y-on-y % ch		
	2013	2014	2015	2013	2014	2015
<b>Eurozone</b>	-0.4	0.9	1.3	1.5	1.5	1.4
<b>UK</b>	1.4	1.8	2	2.7	2.3	2
<b>US</b>	1.6	2.6	3.3	1.4	1.5	1.8
<b>Emerging market</b>	4.5	5.1	5.3	6.1	5.7	5.2
<b>World</b>	2.8	3.6	4	3.8	3.8	3.6

Source: IMF economic outlook



## Regional focus

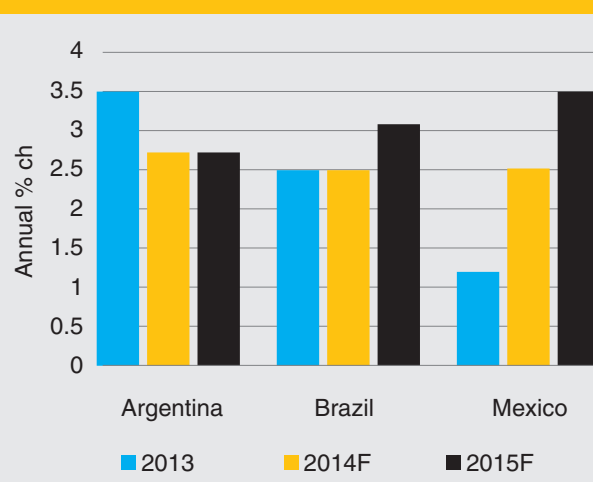
### Moderate growth in Latin America

Economic growth in Latin America and the Caribbean remains weak. The IMF expects annual growth of real GDP to improve from 2.6% in 2013 to 3% and 3.3% this year and next. This is moderate in comparison to Developing Asia which should grow by nearly 7%. Economic momentum in Brazil, Latin America's largest economy, picked up towards the end of last year. The composition of growth improved with stronger net exports and investment. Reforms to strengthen the economy could be delayed due to this year's World Cup and the elections in October. Mexico already implemented necessary reforms to improve its competitiveness last year. This should lead to stronger growth of 3% this year after a weak performance of 1% in 2013. Economic prospects for Argentina are bleak. After the strong depreciation of the peso in the last few months, financial markets fear that a recession is looming.

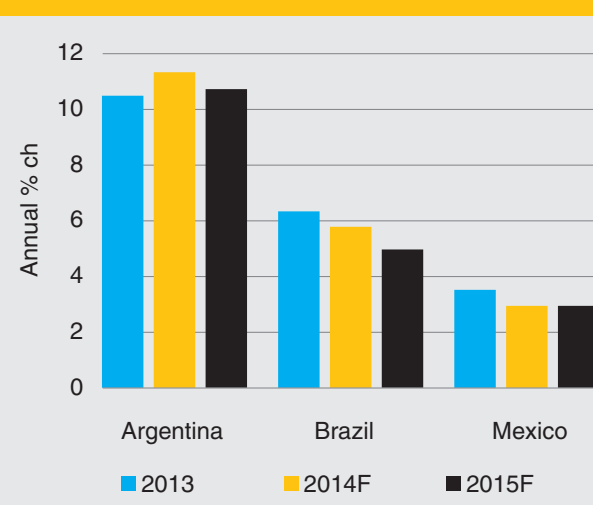
### Diverging inflation patterns

Inflation patterns in Brazil, Mexico and Argentina are very different. Brazil's inflation trended downwards since the middle of last year. Yet, with inflation at 5.7% in February 2014 the rate is clearly above the central bank's target of 4.5%. In order to rein-in prices, Brazil's central bank already raised its policy rate to 10.75% and further rate hikes could follow. In Mexico inflationary pressures are likely to be modest. On account of one-off effects such as tax increases and adjustments to administered prices the inflation rate climbed to 4.5% in January. In the coming months inflation should fall back to the central bank's comfort zone of 2% to 4%. In Argentina, inflation remains a big issue. In the last couple of years it fluctuated around 10%. The risk that consumer prices would rise even further has increased due to the latest strong peso devaluation.

**Figure 16: Growth in major Latin American economies**



**Figure 17: Inflation in major Latin American economies**



**Table 4: Latin America economy summary, y-on-y % ch**

	Real GDP			Inflation		
	2013	2014	2015	2013	2014	2015
Argentina	3.5	2.8	2.8	10.5	11.3	10.8
Brazil	2.5	2.5	3.1	6.3	5.8	5.3
Chile	4.4	4.5	4.5	1.7	3.0	3.0
Mexico	1.2	3.0	3.5	3.6	3.0	3.0
Colombia	3.7	4.2	4.5	2.2	3.0	3.0
Peru	5.4	5.7	5.8	2.8	2.5	2.0
Venezuela	1.0	1.7	2.2	37.9	38.0	31.0
Latin America	2.7	3.1	3.5	6.7	6.5	5.9

Source: IMF economic outlook



## An Ireland that works

Ibec has launched a major new policy campaign aimed at enhancing the business environment for growth and jobs. Following extensive consultation with our members we have identified a range of policy changes required across five different priority areas. Our overall ambition is to work with government to help put more people back to work and to make Ireland the best country in the world to do business. We firmly believe that the Irish economy can grow by an average of 3% to 4% annually over the next 20 years or so.

While Ireland has made considerable progress in recent years, we still need further reform and policy change. Business has already greatly exceeded all expectations in helping to put people back to work but government can clearly do more to improve the conditions for growth and employment. The five priorities, and the specific actions, which we have identified are:

### 1. Reduce the tax burden

- Increase the entry point to the higher marginal tax rate
- Reduce the fully-loaded marginal income tax rate below 50%
- Bring the marginal tax rate for the self-employed back into line with other workers
- Drop the unfair private sector pension levy
- Reverse excessive increases in excise rates
- Reform capital gains tax to support enterprise investment over speculative activity

### 2. Better government

- Embed rigorous regulatory impact assessment into the policy making process
- Eliminate unnecessary regulatory and administrative costs
- Introduce a new low-cost, timely and non-judicial appeals model for regulated sectors
- Simplify and reform enterprise support structures, particularly innovation funding
- Reform the procurement process to reduce costs and encourage SME participation
- Reduce the cost of local government and introduce a fairer, more transparent system of local government charges for business
- Extend recent changes to public sector pensions for new entrants to all staff
- Protect Ireland's successful, voluntarist approach to collective bargaining

### 3. Invest in the future

- Increase public investment in infrastructure to 4% of GDP by 2020
- Streamline the planning process, particularly for

energy projects and show greater leadership on community acceptance for infrastructure projects

- Ensure public private partnerships (PPPs) are the key delivery mechanism for investment
- Develop a new national spatial strategy, which supports balanced regional development
- Involve more employers in the reform and roll-out of activation and training programmes
- Increase effective investment in education and skills and put in place a sustainable funding model for the third-level sector
- Implement a co-ordinated strategy for further education and training, and update the second-level curriculum so school leavers have core employability skills

### 4. Extend Ireland's global reach

- Support Ireland's competitive position in relation to international tax reform
- Complete agreements with the US, Asia and others to support trade and investment opportunities for Irish and EU business
- Proactively shape EU policy and regulation, promoting Irish business priorities to influence the European Council, Commission and Parliament
- Work with business and authorities at national, EU and international level to advance trade facilitation and efficient customs procedures
- Support exporters, particularly SMEs, by reducing regulatory and administrative barriers

### 5. Promote enterprise and entrepreneurship

- Improve credit flow to business by enhancing tax-based investment schemes, state-backed capital funds, EIB support and the venture capital environment
- Address business costs, such as the government element of labour costs, utilities and government charges
- Prioritise entrepreneurial attributes and skills at all levels of the education system
- Improve the innovation and technology supports for SMEs
- Ensure Ireland's R&D tax credit model is world-class
- Enhance the links between business and higher education

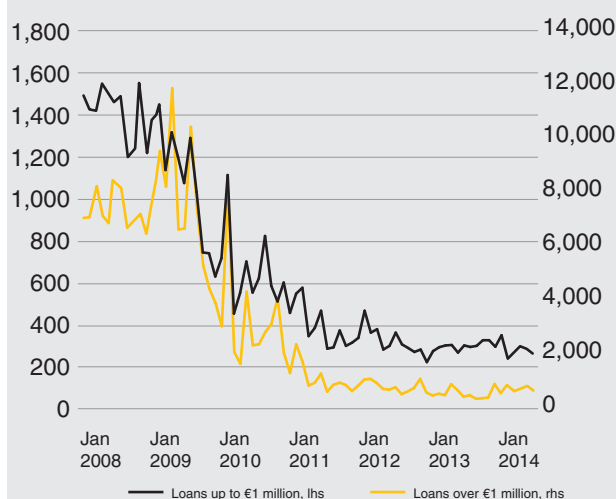
This new campaign will form the basis for our policy and lobbying efforts over the next two years or so and we will be rolling-out a series of publications, research material and events to drill into all of the issues addressed above. We look forward to engaging with our members and policy stakeholders on the detail of this work.

## Credit conditions

### Credit conditions for business

Credit conditions for non-financial enterprises and businesses remain tight. The Central Bank's Bank Lending Survey conducted in Q1 2014 shows that the respondent banks did not ease their credit standards on loans to large enterprises or SMEs, though the overall economic environment gradually improved. Also, in the last few months interest rates on loans to enterprises rose and the spread between Irish and German interest rates widened. Consequently, the volume of new lending to large companies and SMEs did not rise, but rather was flat throughout last year. Nevertheless, the Bank Lending Surveys also signal that banks expect the demand for loans should pick up in the coming months. A positive economic performance together with improved bank balance sheets should ultimately lead to higher lending to non-financial enterprises.

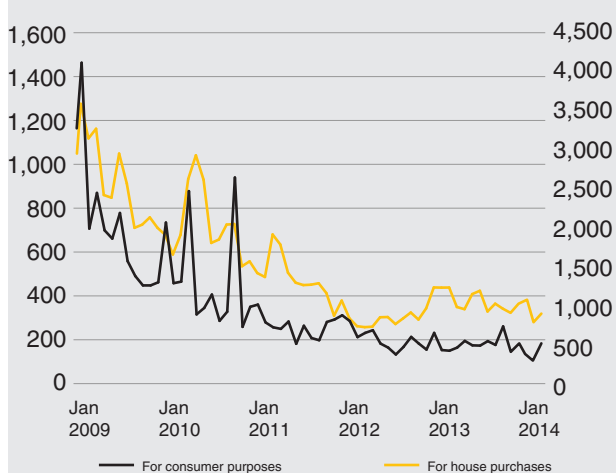
**Figure 18: Loans to non-financial corporations, new business, volume (€ millions)**



### Lending to private households remains weak

Lending to private households in the year to date has been sluggish. Throughout last year the volume of new loans for house purchases and consumer loans remained at historically low levels, as private households are still occupied with deleveraging. Yet, there are signs that lending could gradually recover this year and next. In the Central Bank's latest Bank Lending Survey the respondent banks noted that demand for loans increased albeit slightly. The survey also revealed that demand was positively affected by an improvement in housing market prospects and consumer confidence. In the coming months economic conditions for private households should improve further. We expect the growth of employment to continue and incomes to rise. Together these will lead to a pick-up in lending.

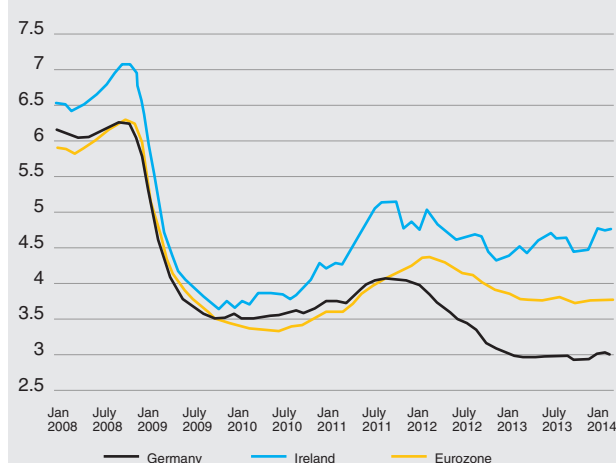
**Figure 19: Loans to households, new business, volume (€ millions)**



### Interest rates for business

Irish companies continue to pay relatively high interest rates on bank loans. This is especially true for SMEs who typically ask for loans of less than €1 million. In January 2014, non-financial corporations in Ireland had to pay an interest rate on loans up to and including €1 million of nearly 4.8%. This is a lower than in Spain and Portugal, but it is one percentage point higher than the eurozone's average and it is one and three-quarter above the interest rate in Germany. Larger firms pay less. The interest rate Irish non-financial companies had to pay for loans above €1 million was a little less than 2.9% and 0.9 percentage points above Germany's interest rate. The spread between Irish and German interest rates has widened since 2010 making it more difficult for Irish companies to invest compared to their international counterparts.

**Figure 20: Interest rates on loans to non-financial corporations up to €1 million (3mma)**





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