Business Sentiment Report

Business confidence Q3 2012

Slowing global economy has mixed impact on exporters

Confidence in the overall business environment changed only marginally in Q3. The current conditions index at -19 was stable, while expectations for the three-month outlook fell slightly to -19 from -14 in the previous quarter. The stabilising trend is also evident in managers' assessment of the prospects for their own business. The Q3 reading for current conditions inched up marginally to +10, while the forward-looking index was unchanged at +6.

Exporters' perception of Ireland as a business location had dropped from broadly balanced in Q1 to -10 in Q2 and recorded only a marginal improvement to -8 in Q3. At the time we had theorised that the impending referendum may have been a cause for the drop in confidence, and that the effect might prove temporary. This has not been the case, which sounds a clear warning bell for Budget 2013 on any measures that would increase employment or business costs.

The impact of the slowdown in global growth, in particular the on-going weakness in the eurozone, is evident in the export expectations index. Q3 saw a continuation of the softening trend that has been evident for a few quarters now. The index fell to +12 from +20 in the previous quarter and +31 recorded in Q3 2011. This is the lowest reading since 2009.

A number of sectors, including food and drink, pharmachem, medical devices and IT services continue to expect robust growth in export sales. However, the outlook in industries more sensitive to the global and European business cycles has deteriorated sharply over the last few quarters. Profitability and unit selling price expectations in pharmaceutical firms have been trending down for a few quarters now; this may reflect the impact of the so-called patent cliff. However, some food and drink firms are benefiting from higher global commodity prices, lifting the trend for the sector overall.

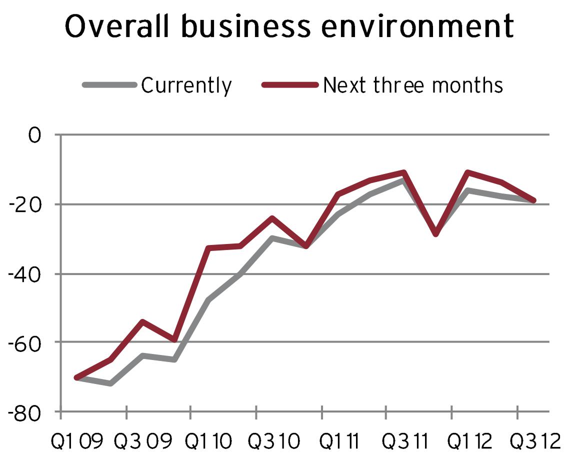
The outlook for domestic sales remains muted, with little prospect of recovery in the near future. The index inched up slightly in Q3 to a reading of -3. However, it has not been in positive territory since Q3 2011, when, for the first part of the year, the domestic market appeared to be close to stabilisation. Firms in the hospitality sector have recorded a positive index reading for three consecutive quarters now, reflecting the improved trend in hotel room occupancy rates.

Indicator (balance of respondents)	Q4 2011	Q1 2012	Q2 2012	Q3 2012
Business confidence currently – overall	-28	-16	-18	-19
Business confidence 3 months' time – overall	-29	-11	-14	-19
Business confidence currently – own business	+4	+16	+5	+10
Business confidence 3 months' time – own business	-3	+18	+6	+6
Domestic sales	-17	-2	-9	-3
Export sales	+29	+43	+20	+12
Order books	+5	+27	+12	+12
Unit selling price	-16	-9	-11	-9
Profitability	-13	+2	-2	-11
Customer base	+20	+23	+18	+21
Employee numbers	-8	-4	-2	-9

Business confidence – overall business environment

Confidence in the overall business environment changed only little in Q3. The current conditions index at -19 was broadly stable, while expectations for the three-month outlook fell slightly to -19 from -14 in the previous quarter.

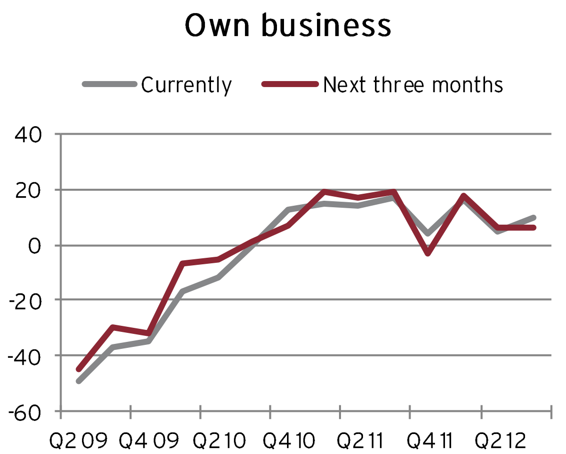
Exporters' perception of the business environment in Ireland had dropped from broadly balanced in Q1 to -10 in Q2 and recorded only a marginal improvement to -8 in Q3. At the time we had theorised that the impending referendum may have been a cause for the drop in confidence, and that the effect might prove temporary. This has not been the case, which sounds a clear warning bell for Budget 2013 on any measures that would increase employment or business costs.



Business confidence – own business

The stabilising trend is also evident in managers' assessment of the prospects for their own business. The Q3 reading for current conditions inched up marginally to +10, while the forward-looking index was unchanged at +6. Exporters were marginally less optimistic about the prospects for their firm in Q3 than in Q2, while managers in non-exporting firms reported a slight improvement in confidence.

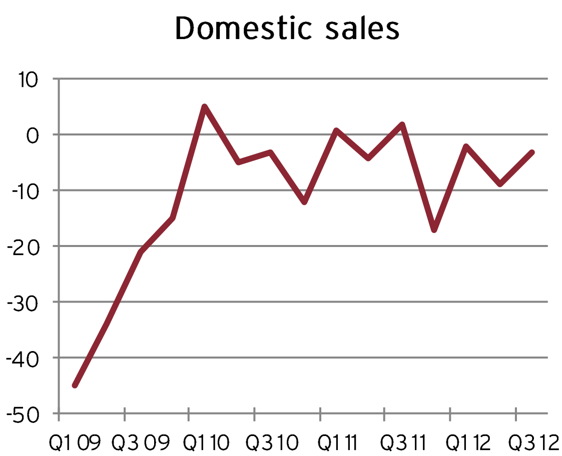
Sectoral trends reveal that a number of the high tech sectors, including pharmachem, medical devices and ITC have remained very optimistic, both about the current situation and the three-month outlook. Firms in other exporting sectors are somewhat more cautious. Of firms operating primarily in the domestic economy, education and health report the most positive sentiment.



Domestic sales

The outlook for domestic sales remains muted, with little prospect of recovery in the near future. The index inched up slightly in Q3 to a reading of -3. However, it has not been in positive territory since Q3 2011, when, for the first part of the year, the domestic market appeared to be close to stabilisation.

The sectoral breakdown shows a divergent pattern. Firms in the hospitality sector have recorded a positive index reading for three consecutive quarters now, reflecting the improved trend in hotel room occupancy rates. Conversely, the sentiment of businesses in the food and drinks sector has been negative for a few quarters now.



Export sales

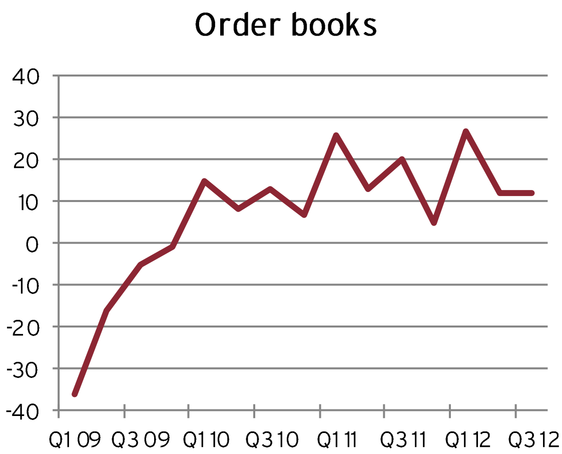
Q3 saw a continuation of the softening trend that has been evident in export expectations for a few quarters now. The index fell to +12 from +20 in the previous quarter and +31 recorded in Q3 2011. This is the lowest reading since 2009.

A number of sectors, including food and drink, pharmachem, medical devices and IT services continue to expect robust growth in export sales. However, the outlook in industries more sensitive to the global and European business cycles has deteriorated sharply over the last few quarters, reflecting the on-going eurozone crisis and its negative impact on real economic activity,

Order books

The reading for firms' expectations about order books for the coming three-month period remained unchanged from the Q2 reading at +12. Just under a third of managers expect no change, while 41% expect that order books will increase.

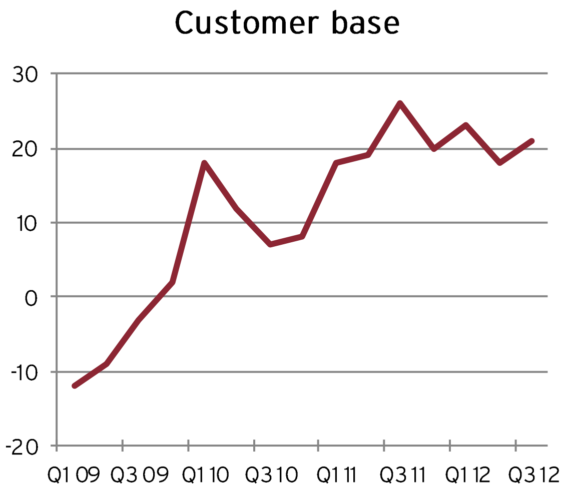
The sectoral trend is broadly similar to that of export sales. The high tech sectors as well as food and drink report strong expectations for the coming three months, while businesses primarily supplying components to other European manufacturers note a softening, or even negative, outlook. In the domestic economy, the majority of firms in the hospitality sector expect that order books will increase in the coming quarter.



Customer base

Managers' expectations about the customer base ticked up marginally in Q3 to +21 from +18 in the previous quarter. Slightly more than a third of firms expect to increase the customer base in the coming three months, while about half expect no change.

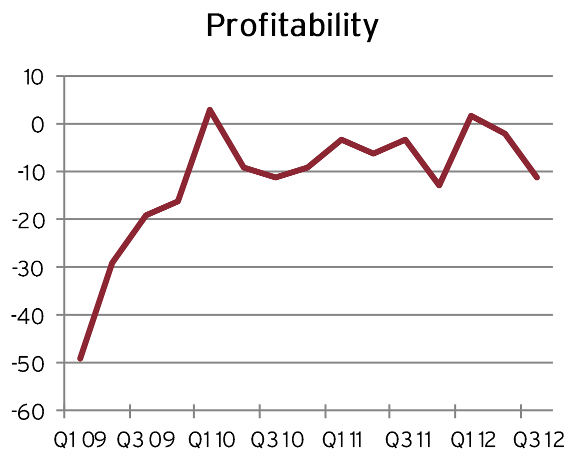
The sectoral trends reflect export expectations fairly closely. Firms in more cyclical sectors exposed to the slowing eurozone economy report more negative readings. High-tech sectors and food and drink, however, record strong positive expectations on customer base. For the former, this is likely driven by on-going robust demand and favourable market conditions, while firms in the food and drink sector are benefitting from improved competitiveness.



Profitability

Expectations about profitability dropped in Q3 to -10 from -2 recorded in the previous quarter and -3 in Q3 2011. The index had briefly turned positive in Q1 of this year, before dipping back into negative territory. Sectoral data reveal that profitability expectations of pharmaceutical firms have been trending down for a few quarters now; this may reflect the impact of the so-called patent cliff.

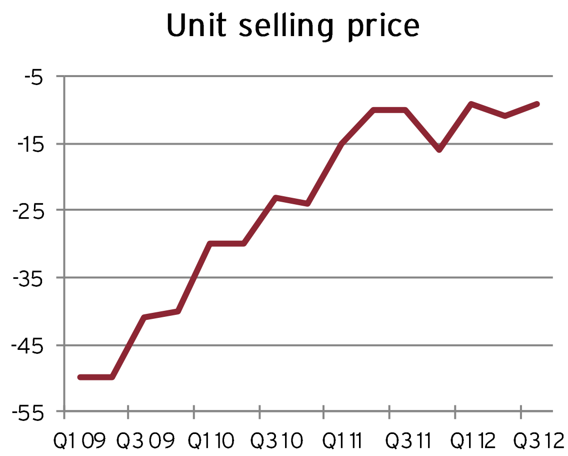
Coupled with the stabilised but negative trend in unit selling prices, this likely indicates that exporters are using the weaker euro exchange rate to boost market share rather than increase margins. Meanwhile, firms in the domestic market are unlikely to pass on cost increases to the customer, leading to a squeeze on profitability.



Unit selling price

The trend in unit selling price has stabilised in recent quarters and the Q3 reading at -9 was virtually unchanged from -11 recorded in Q2 and -10 in Q3 2011. The difference between exporters (-7) and non-exporters (-12) narrowed from the previous quarter, when domestically trading companies were substantially more negative on the price outlook (-24) than were exporting firms (-4).

Detailed sector data reveal divergent patterns. Notably, the weakened profitability trend of pharmaceutical firms is repeated in unit selling prices. However, some food and drinks businesses appear to be benefitting from higher commodity prices. Though the effect is limited to specific areas, it has been enough to lift average unit selling prices expectations in the sector as a whole for the past few quarters.



Employee numbers

Given the weaker trend across a number of indicators, the dip in managers' expectations on employee numbers comes as no surprise. The index dipped to -9 from -2 in the previous quarter and a balanced reading in Q3 2011. For the last few quarters the index had been pointing towards stabilisation, but it now appears that companies are taking a more negative view on future staffing levels.

The deterioration is roughly balanced between fewer firms expecting to hire new staff and a greater number reporting an expected decline in employee numbers. Nonetheless, 55% expect to keep staff levels constant and 18% expect to hire in the coming three months. Exporting companies in high-tech sectors are the most optimistic, while domestically trading firms report the most negative outlook on staffing levels.

Methodological note

The Business Sentiment Report is based on a survey of manufacturing and services firms and presents the balance of respondents' sentiment for a series of indicators. Each quarterly sample consists of about 400 IBEC member companies.

The report findings are presented as simple balances of the difference between the positive and negative responses. A positive balance indicates that more firms responded positively than negatively to a particular question; for instance, a positive balance for order books means that a greater percentage of firms expect order books in the coming months to be higher rather than lower.

Four confidence questions ask firms to rate the overall business environment and their own business, currently and in the next three months. Possible answer options for each question are very good, good, average, poor and very poor.

Activity-based indicators ask companies to rate their expectations in three months' time on a range of indicators such as order books, profitability and employment levels. Possible answer options for each indicator are decrease substantially, decrease slightly, stay the same, increase slightly and increase substantially.

IBEC

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