# Irish Economy Monitor

## Q3 2018

Philip O’Sullivan
T +353-1-4210496
E philip.osullivan@investec.ie

**Contents**


| | Page |
|---|---|
| General View on Ireland and Forecast Summary<br>*Growth is broad-based and running ahead of expectations* | 2 |
| Timely Data<br>*Consumer, Housing, Construction, Credit, Industry and Exports* | 4 |
| Irish Debt<br>*Composition, Irish Household Debt, Contingent Liabilities* | 14 |
| Ireland's Strong Points<br>*FDI, Current Account and Ireland's Relative Advantages* | 18 |
| Forecasts<br>*Overview of Investec's Economic Forecasts* | 24 |
| Public Finances<br>*Current Exchequer Performance, Debt Composition and Maturity* | 27 |
| NAMA and the Irish Banking Sector<br>*NAMA's Progress and Mortgage Arrears* | 31 |
| What Brexit Means for Ireland<br>*Context is Key* | 36 |

## *General View on Ireland: Growth is broad-based and ahead of expectations*

National accounts data show that Irish GDP was +9% y/y in H118, with modified domestic demand (a measure that minimises multinational-related distortions) +6.25% y/y.

**1.** The PMIs show that growth is broad-based, with Manufacturing at 57.5; Services at 58.0 and Construction at 58.3 in August.
**2.** Total employment was +3.4% y/y in Q218. The total number of people with a job here (2.3m) is the highest since independence, while unemployment is at a 10 year low of 5.6%.
**3.** Housing completions totalled 7,945 in H118, +31% y/y. While the increased output is very welcome, it will be some time in the 2020s before supply meets new household formation.
**4.** This mismatch between supply and demand means that the path of least resistance for both house prices and rents remains to the upside. Economic strengthening and Brexit-related relocations continue to paint a positive picture for the commercial property market here.
**5.** The year to date merchandise trade surplus, at €31.0bn, is +17% y/y. Services exports were +2.1% y/y in H118 despite tough comparatives.
**6.** While tax receipts have marginally undershot expectations in the first eight months of the year, an underspend on discretionary items and national debt servicing costs means that the public finances are likely to show a *de minimis* deficit in 2018, absent any surprises in next month's Budget.
**7.** The key risks to the economy are mainly external – the fallout from monetary policy normalisation moves, rising protectionist sentiment and the Brexit negotiations. Housing shortages and wage inflation are the main domestic concerns. The broad nature of the expansion and economy-wide deleveraging (household debt is back at 2005 levels; business borrowings have been contracting since 2009; government debt / GDP has almost halved from its highs) should help to mitigate against any weakness. We opt to retain our non-consensus call that the government may take advantage of its strong poll ratings and hold a general election alongside local and European votes next May. However, we don't see an election resulting in any meaningful policy changes in Ireland.

## *Forecast Summary: We now see growth of 7% this year, with risks to the upside*

As mentioned on the previous slide, the economy expanded by more than 9% y/y in GDP terms in H118. While GDP is always distorted to some extent by the multinationals, a range of other indicators show strong growth: tax receipts +5.1% y/y in the year to date; retail sales +5.8% y/y in Q2; and total employment is growing by 1,400 a week.

Were you to hold quarterly GDP flat on the Q218 outturn, this would produce growth of 6.5% in 2018. With all three PMIs pointing to solid growth in Q3, this approach seems excessively cautious, although it is worth noting that the Irish national accounts can be volatile and subject to revision. We have raised our previous 5.0% growth forecast for FY18 by 200bps to 7.0%, while holding (notwithstanding the higher base) our 4.5% and 3.8% forecasts for the next two years steady. While Brexit poses a risk to the latter, the UK accounts for less than a sixth of headline exports, which limits this threat. Another consideration is that lead indicators for construction activity suggest that underlying investment will be very strong in 2019.

Barring any shocks in next month's Budget, we see the public finances moving into surplus next year, with headline debt/GDP set to fall below the 60% Stability & Growth Pact level by end-2019.

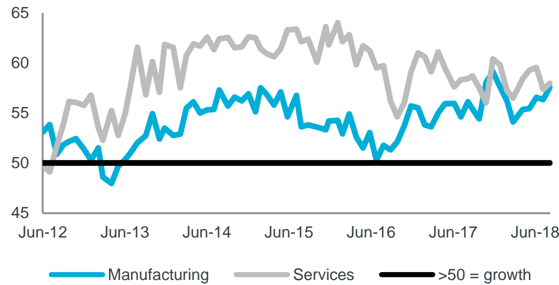
**Investec Summary Forecasts, full forecasts are on slides 25 and 26**

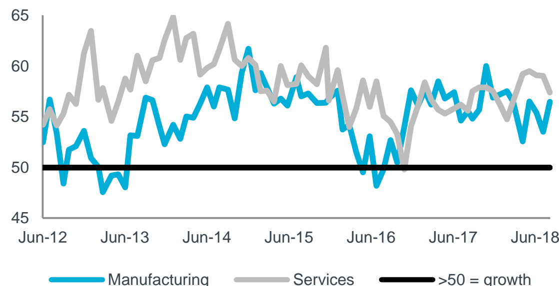
| | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 |
|---|---|---|---|---|---|---|---|---|---|---|
| GNP | 0.5% | 0.0% | 5.8% | 9.2% | 13.6% | 11.5% | 4.4% | 7.7% | 4.8% | 4.1% |
| GDP | 3.7% | 0.2% | 1.3% | 8.8% | 25.1% | 5.0% | 7.2% | 7.0% | 4.5% | 3.8% |
| Gross Domestic Exp. | -0.3% | 2.4% | -1.7% | 8.4% | 15.1% | 22.6% | -13.3% | -0.2% | 7.0% | 6.5% |
| Employment | -1.9% | -0.4% | 3.1% | 2.6% | 3.5% | 3.6% | 2.9% | 2.8% | 2.3% | 1.8% |
| General Gov Deficit/GDP | -12.8% | -8.1% | -6.1% | -3.6% | -1.9% | -0.7% | -0.3% | 0.0% | 0.7% | 1.6% |
| Gross Govt Debt / GDP | 110.9% | 119.9% | 119.7% | 104.1% | 76.8% | 73.4% | 68.0% | 63.8% | 59.9% | 55.6% |
| Current Account / GDP | -1.6% | -3.4% | 1.5% | 1.1% | 4.4% | -4.2% | 8.5% | 10.2% | 8.6% | 6.0% |

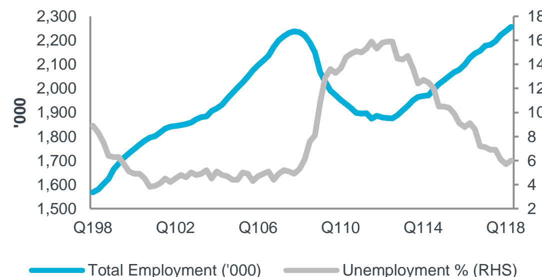
# Timely Data

# Current Indicators of Economic Activity

## Underlying growth of 6.25% y/y in H118




- The latest PMI data show continued broad-based growth in Ireland. In August the Manufacturing PMI came in at 57.5, a seven month high, while the Services PMI improved to 58.0. The Construction PMI was at 58.3. September will, almost certainly, mark the fifth year of simultaneous above-50 readings for all three Irish PMIs.

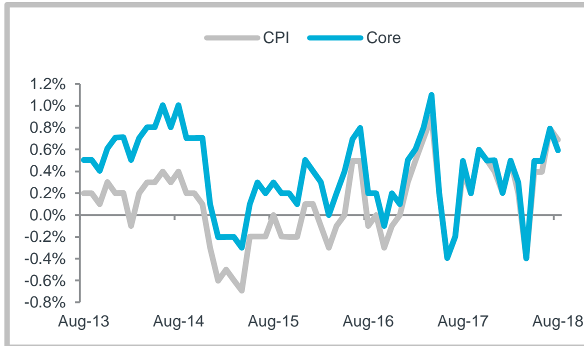
- Despite the more uncertain global backdrop, Irish exports have performed strongly in recent months. National accounts data show growth of 9.2% y/y in H118.

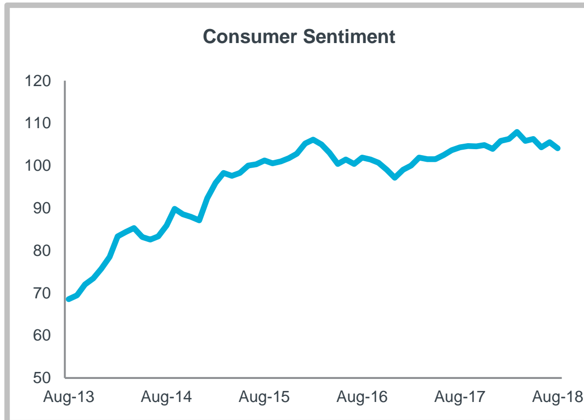
- The labour market remains a source of good news for Ireland. Total employment was +3.4% y/y in Q218, with the seasonally adjusted number of people at work (2.3m) the highest since independence. Monthly unemployment data show that the unemployment rate fell 20bps m/m to 5.6% in August, a 10 year low.

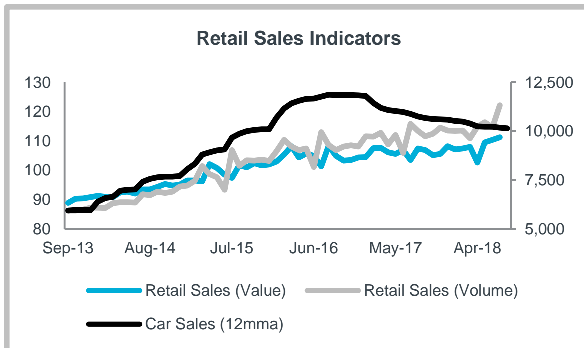
**Growth remains broad-based**

# Consumer

## Buoyant spending, notwithstanding a willingness to shop around




- The headline CPI was +0.7% y/y in August, with the main narrative being one of domestic inflationary pressures (rising rents, higher socialising costs) being mitigated by imported deflation due (at least in part) to the weak sterling. The headline inflation rate has been persistently sub-1% for five-and-a-half years, helping to underpin a meaningful advance in real incomes (nominal wage inflation was +3.3% y/y in Q218).

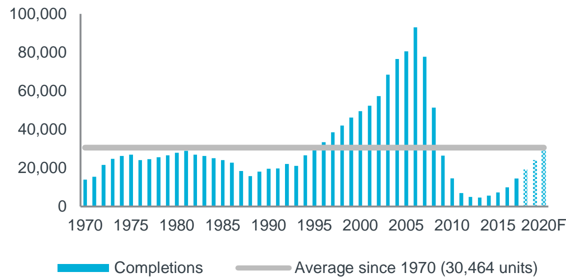
- While headline consumer confidence has eased back a little in recent months (likely due to the more uncertain international backdrop), it remains elevated.

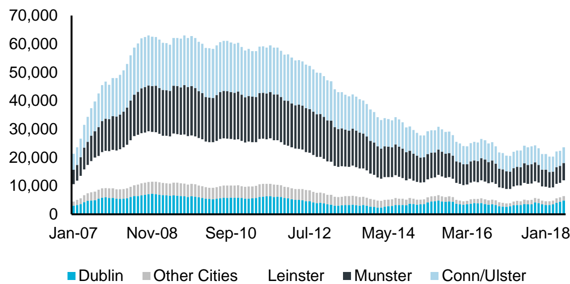
- Headline retail sales growth was a very strong 5.5% y/y (in volume terms; the value of sales was +5.1% y/y) in July, suggesting that the bumper growth seen in Q2 is continuing into the current quarter. One area of weakness remains new car sales. These were -4.5% y/y in the first eight months of the year, likely due to competition from sterling dealers. Indeed, imports of second hand cars (mostly from the UK) were +10.4% y/y in the year to date.

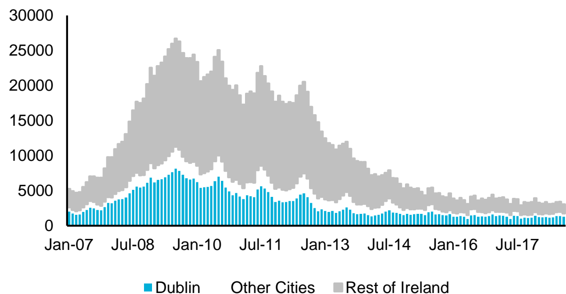
**Ex-auto sales continue to show strong growth**

# Housing Market (i)

## Despite recent improvements, supply is running far behind demand




- In 2017 14,446 dwellings were completed. While this outturn was more than 3x the trough reached during the recession, output is well below both the long term average of 30,464 units and the low end of the range of estimates of new household formation (30,000 – 50,000 units per annum). We estimate that output will rise to 30,000 in 2020.

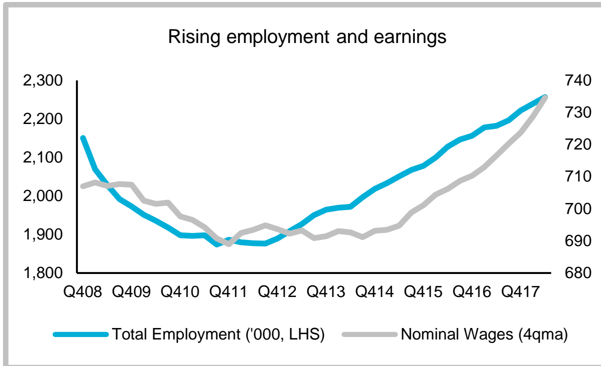
- Supply issues are not only limited to the new homes market. The latest (June 2018) data from Daft.ie show that only 23,550 units were listed for sale across Ireland, equivalent to 1.1% of the housing stock and 44% below the average number of listings since the start of 2007. The latest Property Price Register data show that 54,587 transactions were recorded in Ireland in 2017, a churn rate which implies that housing is changing hands once every 37 years on average – a clearly unsustainable level of activity.

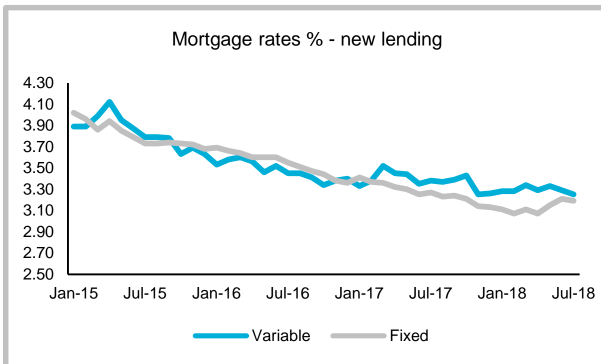
- On a similar note, rental property listings (3,070 across Ireland, of which 1,397 were in Dublin at the start of August), are 74% below the average since Daft.ie began compiling its records.

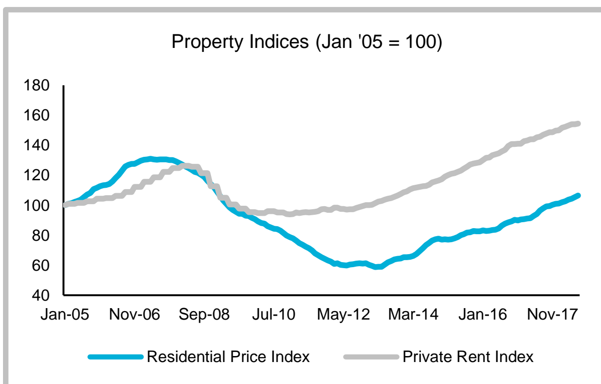
**Housing supply (both new and second-hand) remains abnormally low**

# Housing Market (ii)

## Buoyant demand pushing up on prices



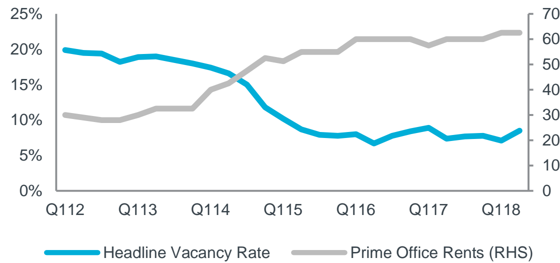



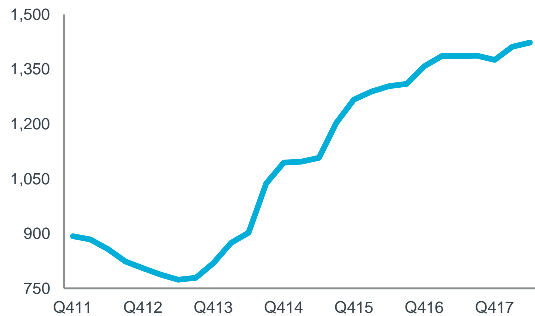

- Labour market conditions in Ireland continue to tighten, with total employment at a record 2.3m (and increasing by c. 1,400 a week) and unemployment having fallen to a 10 year low. These dynamics have pushed nominal wages to an all-time high, with purchasing power supported by muted headline inflation. The economic strengthening is supporting the demand for housing.

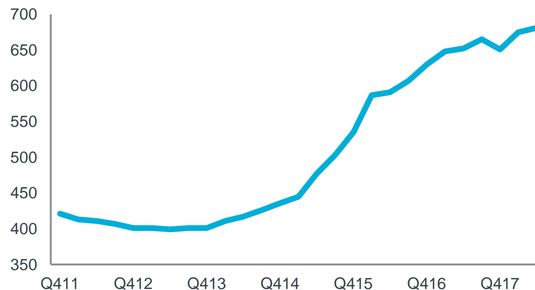
- Front-book mortgage rates continue to trend downwards, which provides a lift to affordability. It is also worth noting that c. 44% of housing transactions in H118 were on a cash only (no mortgage) basis.

- Buoyant demand and an as-yet inadequate supply response has seen both prices and rents rise rapidly in recent years. With supply unlikely to rise to meet the flow of new demand until early in the next decade, the path of least resistance for capital values and rents remains to the upside.

**Capital and rental growth driven by supply shortages**




- Prime Grade A rents in Dublin city centre were static at €60-65 psf in Q216 in spite of buoyant demand (annualised take-up in the year to date is in-line with last year's record 3.6m sq ft) as more supply comes on stream. The latter helped the headline vacancy rate tick up to 8.5% at end-Q2, a five quarter high, although it should be noted that 1.6pc of this is reserved.

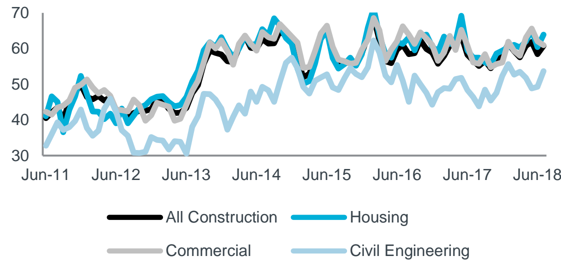
- Retail capital values increased for a second successive quarter in Q2. The cumulative recovery from the Q213 trough is now 84%, reflecting improved trading (a function of the higher employment and earnings detailed elsewhere in this report) and yield tightening. We argue that Ireland is less exposed to the structural headwinds being experienced by retailers elsewhere in Europe due to a combination of: (i) the minimal supply additions after the 2008 crash; (ii) our low population density; and (iii) high postal rates.

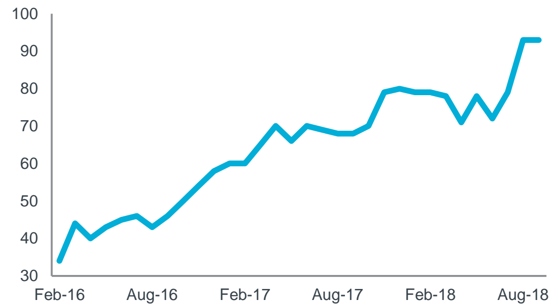
- Industrial capital values have increased by 71% from their respective trough. A shortage of high quality accommodation and the need to recalibrate supply chains in response to Brexit underpin a positive outlook for further capital appreciation from here.

**The outlook for Irish commercial property remains positive**

# Construction Activity

## A record 93 cranes on the Dublin skyline



- The headline Ulster Bank Construction PMI posted its 60th successive above-50 reading in August. Growth is concentrated in the Housing and Commercial segments, with Civil Engineering showing a more mixed performance in recent times.

- The Irish Times' Dublin Crane Count, produced in conjunction with Savills, rose to a record (in this cycle, at least) 93 in early September. When the survey commenced in February 2016 only 34 machines were visible on the capital's skyline. Activity has shifted more towards the north side of city in recent times, with 42 cranes on that side of the river in September, versus 14 in the same month last year. The number of cranes on the south side has fallen by three in the past 12 months.

- Planning permissions totalled 15,079 units in H118, +66% y/y. This growth rate will, however, have been flattered by the introduction of the 'fast track' planning system for developments of 100 or more units in Ireland, which saw applications held back into the start of 2018. Indeed, the growth rate in Q218, while still an impressive +52% y/y, was much lower than Q118's 79% y/y increase. Planning permissions are a lead indicator for completions, so these data bode well for sector output.

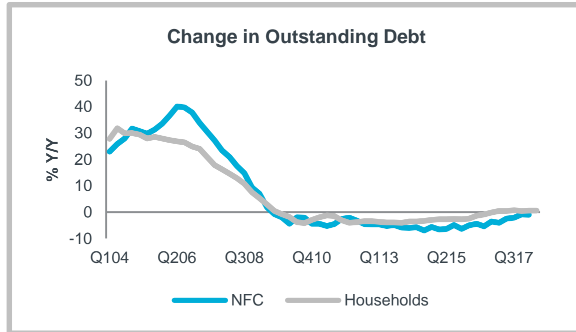
**Indicators show a broad-based increase in construction output**

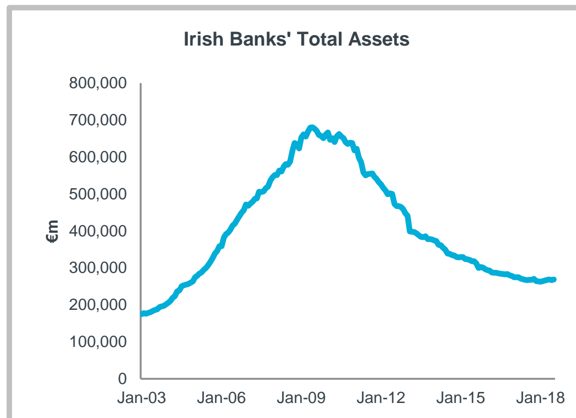


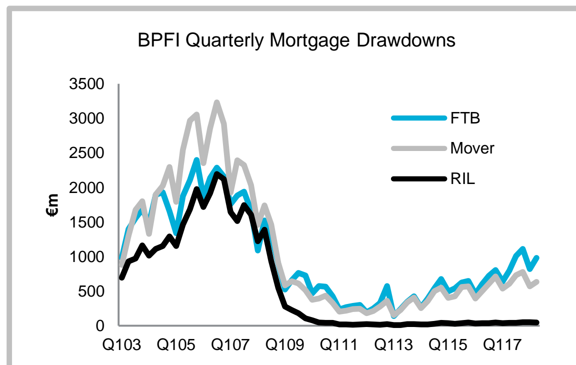
Investec

# Credit Dynamics

## Credit growth led by the household sector



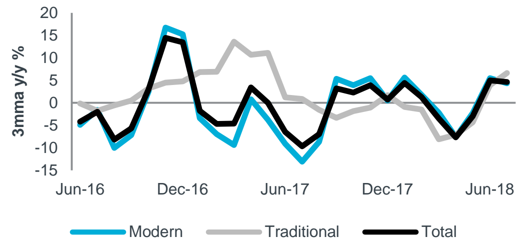



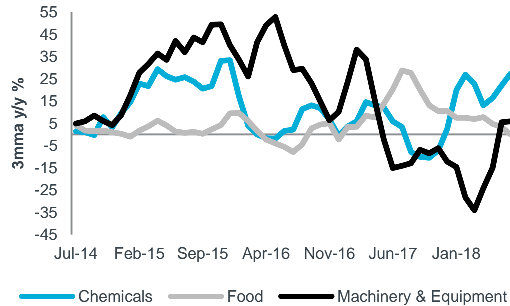

- The latest Central Bank data show that credit to households rose by 0.6% y/y in Q218, representing a sixth successive quarter of annual growth. Business credit remains in the doldrums, however, with a 1% y/y decline recorded in Q118, led by the real estate segment, extending a sequence of annual falls that began in Q309.

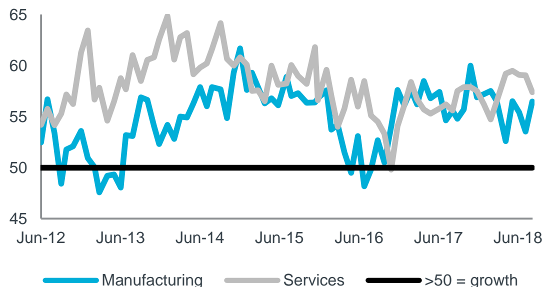
- The Irish banks' total assets fell 61% from peak to trough, pushing the sector loan-to-deposit ratio below 100%. Sector assets have climbed 2% from the trough, although loan sales are a headwind to meaningful short-term growth.

- Mortgage drawdowns totalled €3.7bn in H118, +22% y/y. We expect total lending this year to come in a little above €9bn, which would represent the highest annual outturn since 2008, but this is still less than a quarter of the previous peak (€39.9bn in 2006) that was recorded during the credit bubble of the noughties. We see €10-12bn as a normalised level of annual mortgage lending in Ireland.

**Bank balance sheets have started to grow again on an underlying basis**




- Following a difficult 2017 (-2.7% y/y), industrial production has returned to growth this year. Q2 production was +4.3% y/y, with strong growth seen across the multinational-dominated ‘modern’ sector (+4.9% y/y) and the indigenous-oriented ‘traditional’ sector (+3.9% y/y). We wouldn’t be surprised to see an uptick in production in H218 as some exporters may wish to stockpile finished goods ahead of Brexit.

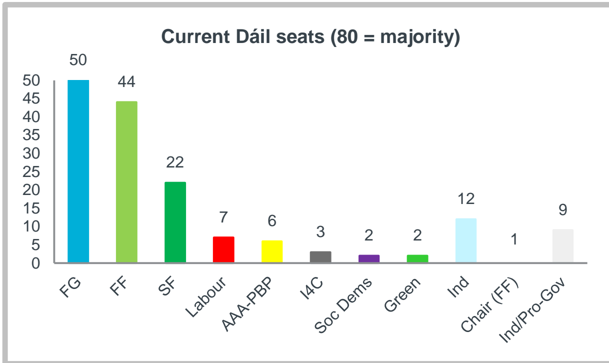
- Headline merchandise (goods) exports have enjoyed a strong start to 2018, with year to date exports +11% y/y, while imports have increased by 8% y/y in the same period. These serve to produce a January-July trade surplus of €31.0bn, 17% above year-earlier levels. However, the performance at a sectoral level is somewhat more mixed than what the headline growth figures suggest.

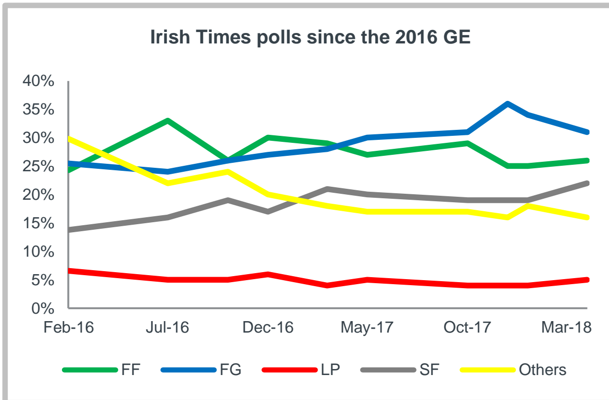
- The Export component of the Investec PMIs suggests that the strong momentum seen earlier this year was maintained in Q3. The national accounts show annual growth in exports of close to 9% y/y in H118.

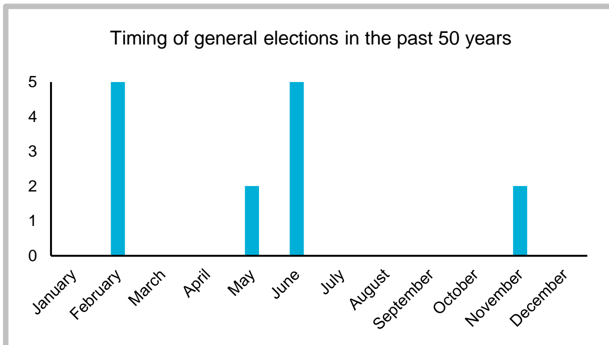
**The trade surplus has increased significantly this year**

# Political Landscape

## Strong polling numbers may tempt FG to call an election



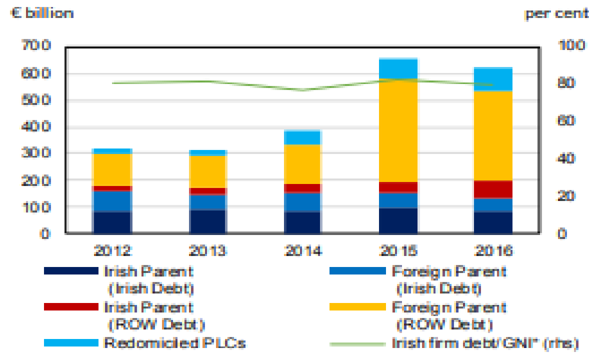

- Under the terms of the 'Confidence and Supply' deal under which the largest opposition party, Fianna Fáil, facilitates the minority Fine Gael/Independent administration, three Budgets were to be passed and the deal was to be reviewed at the end of 2018. Next month will see the third of the three Budgets put before the house. While there has been some engagement about extending the deal, might the country go to the polls in the New Year?

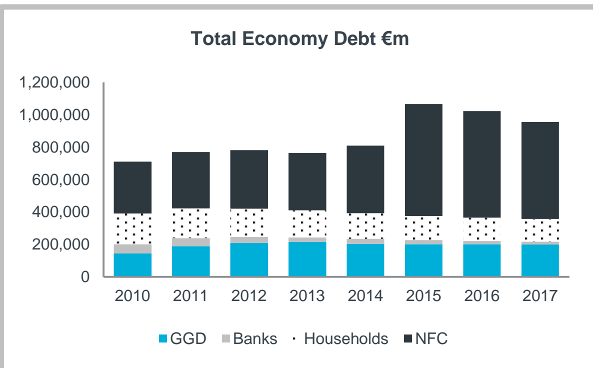
- The latest (Sunday Business Post, 16 September and Sunday Times, 23 September) opinion polls put Fine Gael support on 32-33%, 7-11 percentage points ahead of Fianna Fáil. On these numbers another hung Dáil could be in prospect were an election to be held. But might Fine Gael be tempted by the prospect of meaningful seat gains (it got 26% of the vote in 2016)?

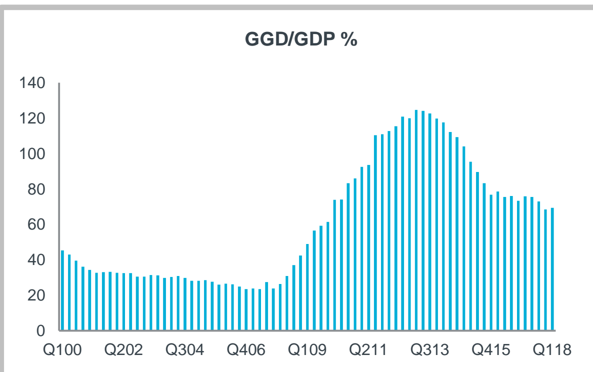
- An important consideration is that there are only a few 'windows' in which a vote is likely to be held. Of the 14 general elections in the past 50 years, 10 of these were held in either February or June, with two apiece in May and November. The November polls were 'event driven' (failure to pass a Budget and the fallout from the early 1990s Beef Tribunal). Does this mean a spring election? Unlikely, given Brexit considerations. What then? Local elections are scheduled for 24 May 2019, the same day as the European elections. Rather than incur the expense and strain of running separate national campaigns in the same year, might politicians decide to go for a 'Super Friday' style election and hold national, local and European polls on the same day next year?

**Don't rule out a 'Super Friday' election in May 2019**

# Irish Debt



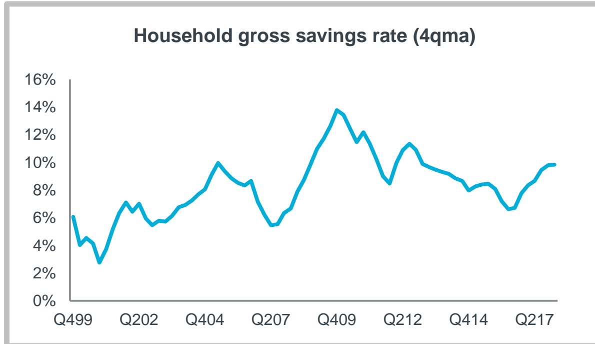



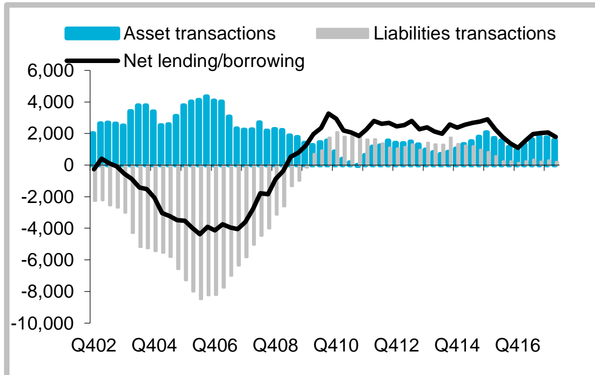

- Irish statistics are complicated by the fact that it is a global financial services sector, with assets and liabilities far greater than the Irish economy. This often distorts figures and paints a picture which does not reflect 'Irish' debt. The chart on the left from the Central Bank of Ireland's Q118 Macro-Financial Review shows that domestic NFC indebtedness had fallen (by that stage) to c. 80% of GNI*.

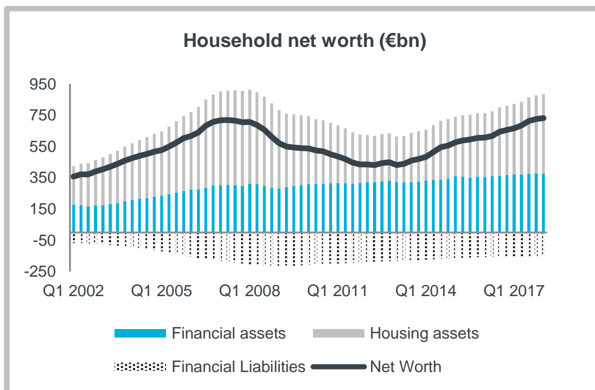
- We now judge that total headline economy-wide debt fell sharply to 325% of GDP by the end of 2017 from 374% at the end of 2016. This move was down to a combination of economic growth and deleveraging by the NFC sector, with most of the latter linked to multinational enterprises (as illustrated above). As the underlying Irish economy continues to grow we expect to see increased 'flow' of new borrowing by the domestic sectors.

- Ireland's general government debt peaked at 124.6% of GDP in Q113. Since then it has fallen sharply (to 69.3% at end-Q118), mainly due to the resolution of IBRC and robust (if, to a point, inflated) headline GDP growth. With the general government balance moving towards surplus; further State asset sales anticipated; and strong growth expected into the medium term; more progress is foreseen.

**Overall deleveraging is drawing to a close as new lending picks up**




- The Irish household savings rate remains quite elevated, particularly given the country's strong demographics. The gross household savings rate was at a five year high of 8.5% on a 4qma basis in Q417, well ahead of the pre-crisis average (6.6%) and also above the average since the series began in Q199 (7.8%). Despite the brighter economic prospects, we expect savings rates to remain elevated given Central Bank rules around minimum deposit sizes for mortgages.

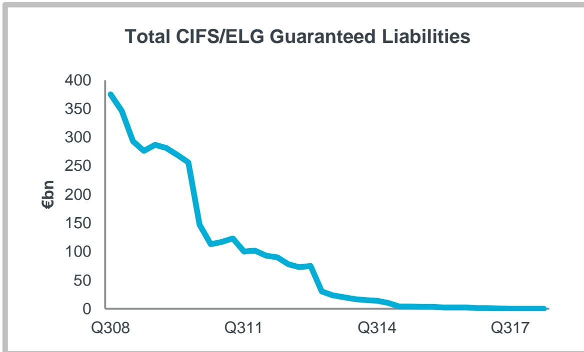
- The Quarterly Financial Accounts for Ireland show the inflection point in the credit cycle, with liabilities transactions (shown on a 4qma basis) about to move back into negative (i.e. growth) territory for the first time since the crisis. The asset side of the balance sheet continues to grow at a steady clip, as evidenced by the savings ratio cited above.

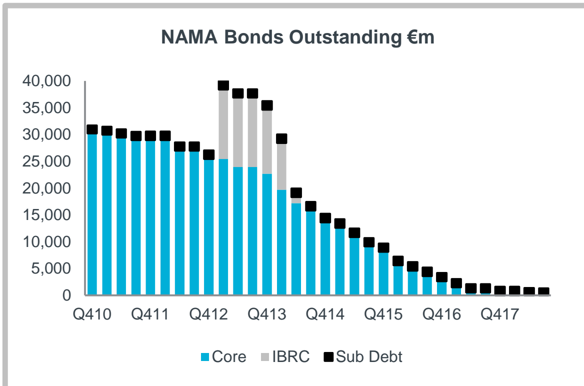
- Other Central Bank data further illustrate the improvement in household balance sheets. Household net worth slumped by 40% during the crisis, but it has since increased by 70% to stand at a new peak of €732bn (2% above the Celtic Tiger era high). Household debt has fallen back to levels last seen in 2005.

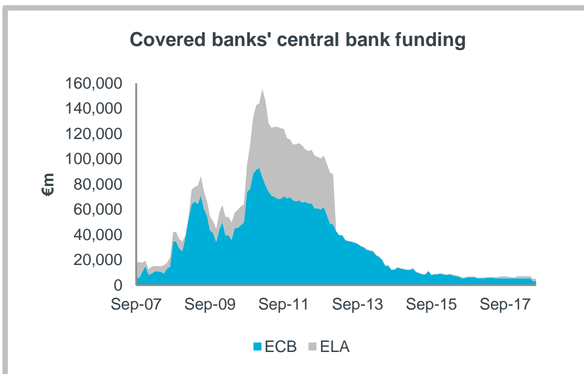
**Household net worth has increased for 20 successive quarters**

# Contingent Liabilities

## Crisis-linked liabilities finally eliminated



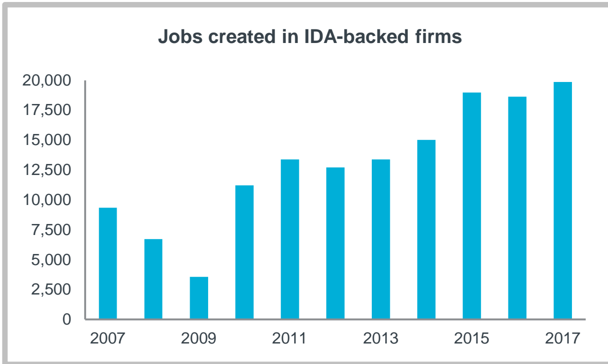

- In Q118 the last of the liabilities guaranteed by the State under the ELG scheme (and its CIFS predecessor) rolled off. At the end of September 2008 the State was exposed to €375bn under these guarantees, so the removal of this risk is welcome.
- All of NAMA's government guaranteed senior debt securities have been redeemed, leaving the agency with just €1.3bn of (remaining) unguaranteed subordinated bonds. NAMA projects that it will deliver a €3.5bn surplus to the Exchequer, guidance we view as conservative (we think that it will make lifetime earnings of €4.5bn).
- The elimination of Central Bank of Ireland Emergency Liquidity Assistance (ELA) following the liquidation of IBRC and the return of ECB funding to pre-crisis levels were welcome developments in terms of the resolution of legacy issues.

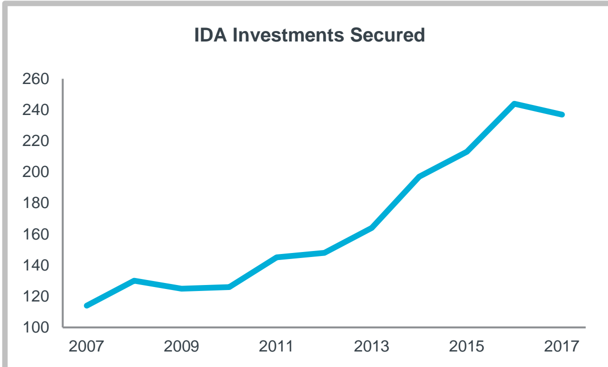
**Vast majority of Ireland's crisis-linked liabilities have been eliminated**

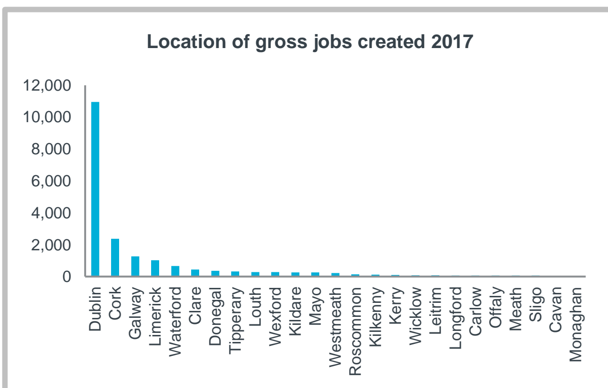


Investec

# Ireland’s Strong Points




- Despite political uncertainty in a number of Ireland's key trading partners, 2017 proved to be a vintage year for job creation by IDA Ireland supported (multinational) companies here. The number of gross jobs created hit a record 19,851, which is equivalent to 1% of total employment. With global growth set to improve to a seven year high in 2018 we were optimistic of the prospects for this year. In this regard, the 3% growth in job creation flagged in IDA Ireland's H118 results, while welcome, did not come as a surprise.

- The job creation achieved in 2017 came from 237 distinct investments. The prospects for this year look encouraging, with 139 distinct investments in H118 accounting for the 11,300 positions that are expected to be created.

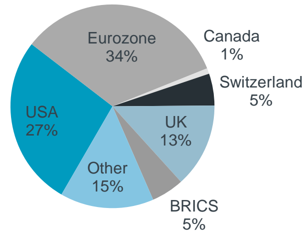
- IDA data show that 55% of the new jobs created by multinational corporations (MNCs) in 2017 went to the capital, followed by Cork (12%) and Galway (7%). Only 5% of all jobs created went to the 13 (out of a total of 26) counties which saw the smallest number of new positions created last year.

**Multinationals directly account for about a tenth of total employment**

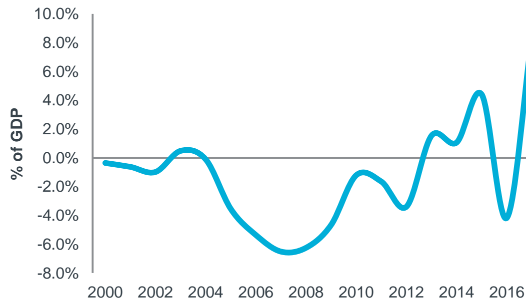
# Current Account

## 2017 surplus flattered by MNC effects

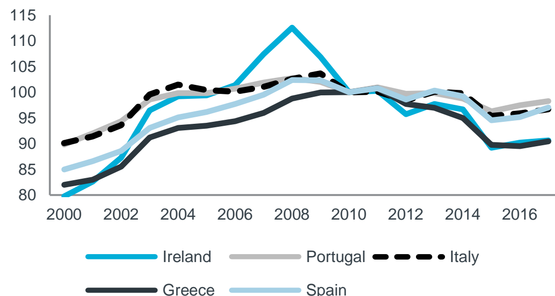
**Merchandise Exports Destinations**




**Current Account Balance**




**REER, CPI Adjusted**

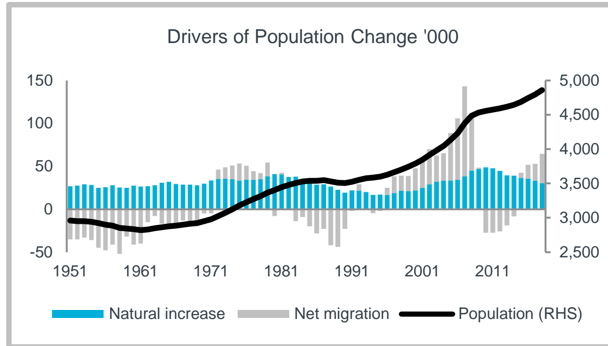


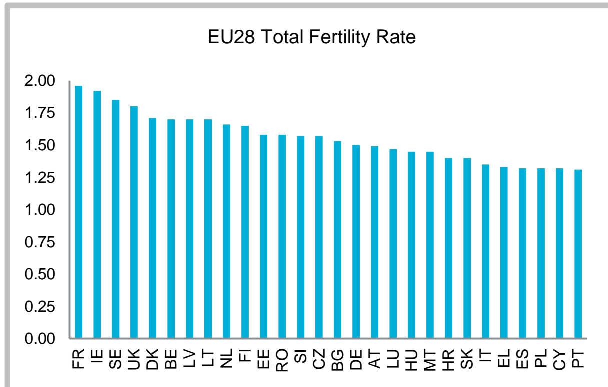

- Approximately 80% of Irish merchandise exports and 66% of Irish services exports go to either Europe or North America. As a small open economy Ireland's performance is particularly influenced by developments in those markets. To this end, the weakening of the euro since the start of 2018 provides a modest tailwind to Irish exporters.

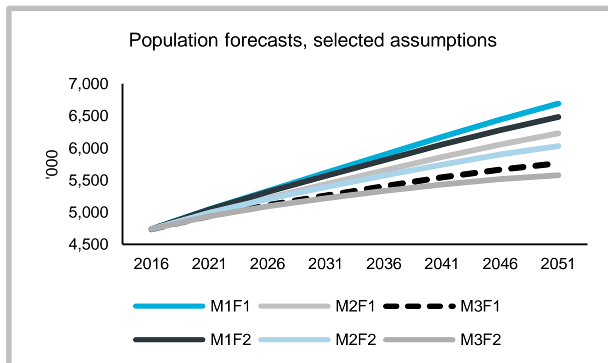
- Ireland's current account surplus was a remarkable 8.5% of GDP in 2017, mainly due to a slump in intangibles imports driven by the multinational (MNC) sector. Balance of Payments data for H118 suggest that last year's outturn could be eclipsed this year, although we caution that the data can be volatile on a quarterly basis.

- Ireland saw a significant improvement in its cost competitiveness during the recession in both absolute and relative terms. Recent developments suggest that some of these competitiveness gains are likely to be reversed.

**MNC distortions camouflage the 'real' performance**




- The latest Population and Migration Estimates from the CSO show that Ireland's population reached a new post-independence high of 4.9m in April 2018. The population increased at its fastest pace since 2008 in the 12 months to end-April, helped by net inward migration of 34k (again, a 10 year high) during the period.

- As the latest (2016) comparable data from Eurostat show, Ireland has the second highest total fertility rate in the EU. Ireland's natural rate of increase in population was sufficient to more than offset the numbers that have emigrated from the State in recent years. Ireland's population total has not had a 'down year' since 1990.

- Long-term population projections from the CSO, incorporating a range of assumptions relating to fertility and migration, suggest that the population could increase to between 5.6m and 6.7m by 2051.

**Ireland's demographics are a stark contrast to many developed countries**



Investec

| | Institutions | Infrastructure | Health and Primary Education | Higher Education and Training | Goods Market Efficiency | Labour Market Efficiency | Technological Readiness | Innovation and Sophistication |
|---|---|---|---|---|---|---|---|---|
| Belgium | 25 | 24 | 5 | 11 | 16 | 44 | 19 | 14 |
| Finland | 1 | 26 | 1 | 2 | 17 | 23 | 16 | 8 |
| France | 31 | 7 | 24 | 22 | 36 | 56 | 21 | 17 |
| Germany | 21 | 10 | 13 | 15 | 11 | 14 | 8 | 3 |
| Greece | 87 | 38 | 48 | 44 | 93 | 110 | 50 | 71 |
| Ireland | 19 | 31 | 16 | 10 | 8 | 21 | 18 | 19 |
| Italy | 95 | 27 | 25 | 41 | 60 | 116 | 41 | 28 |
| Netherlands | 7 | 3 | 4 | 4 | 5 | 13 | 3 | 4 |
| Portugal | 43 | 18 | 18 | 34 | 34 | 55 | 26 | 36 |
| Spain | 54 | 12 | 32 | 28 | 49 | 70 | 28 | 38 |
| UK | 12 | 11 | 17 | 20 | 10 | 6 | 4 | 9 |

*Source: WEF Global Competitiveness Report 2017-2018*

| | Potential GDP | Potential Productivity | Potential Employment |
|---|---|---|---|
| Belgium | 2.2 | 1.8 | 0.3 |
| France | 2.1 | 2.0 | 0.1 |
| Germany | 1.2 | 1.8 | -0.6 |
| Greece | 2.4 | 2.2 | 0.2 |
| **Ireland** | **2.6** | **1.5** | **1.1** |
| Italy | 0.7 | 0.7 | 0.1 |
| Netherlands | 2.0 | 2.1 | 0.0 |
| Portugal | 1.9 | 1.8 | 0.1 |
| Spain | 2.2 | 1.6 | 0.6 |
| UK | 2.2 | 1.7 | 0.5 |

**OECD potential GDP projections and drivers, average annual % change 2018-2030**
*Source: OECD Medium and Long-Term Scenarios for Global Growth and Imbalances*



Investec

# Forecasts

| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018E | 2019E | 2020E |
|---|---|---|---|---|---|---|---|---|---|---|---|
| GNP (2016 = €222.2bn) | 3.6% | 0.5% | 0.0% | 5.8% | 9.2% | 13.6% | 11.5% | 4.4% | 7.7% | 4.8% | 4.1% |
| GDP (2016 = €273.2bn) | 1.9% | 3.7% | 0.2% | 1.3% | 8.8% | 25.1% | 5.0% | 7.2% | 7.0% | 4.5% | 3.8% |
| Components of GDP | | | | | | | | | | | |
| Consumption | 0.9% | -1.7% | -0.8% | -0.6% | 2.1% | 3.6% | 4.0% | 1.6% | 4.0% | 3.0% | 2.3% |
| Government consumption | -6.7% | -1.6% | -3.8% | 0.4% | 4.5% | 1.4% | 3.5% | 3.9% | 1.9% | 1.9% | 1.8% |
| Investment | -14.9% | 0.2% | 15.8% | -3.7% | 18.3% | 50.8% | 51.7% | -31.0% | -6.8% | 13.8% | 13.2% |
| Gross Domestic Expenditure | -3.7% | -0.3% | 2.4% | -1.7% | 8.4% | 15.1% | 22.6% | -13.3% | -0.2% | 7.0% | 6.5% |
| | | | | | | | | | | | |
| Exports | 6.0% | 3.2% | -0.9% | 2.9% | 14.6% | 39.3% | 4.4% | 7.8% | 7.0% | 3.5% | 3.0% |
| Imports | 0.4% | 2.7% | -0.9% | 1.0% | 14.6% | 33.2% | 18.5% | -9.4% | 1.5% | 5.0% | 4.8% |
| | | | | | | | | | | | |
| Prices | | | | | | | | | | | |
| CPI | -0.9% | 2.6% | 1.7% | 0.5% | 0.2% | -0.3% | 0.0% | 0.3% | 0.5% | 1.0% | 1.5% |
| HICP | -1.6% | 1.2% | 1.8% | 0.5% | 0.3% | 0.0% | -0.2% | 0.3% | 0.5% | 1.0% | 1.5% |
| | | | | | | | | | | | |
| Labour market indicators | | | | | | | | | | | |
| Employment | -4.4% | -1.9% | -0.4% | 3.1% | 2.6% | 3.5% | 3.6% | 2.9% | 2.8% | 2.3% | 1.8% |
| Unemployment rate | 14.6% | 15.4% | 15.5% | 13.8% | 11.9% | 10.0% | 8.4% | 6.7% | 5.8% | 4.9% | 4.2% |



Investec

| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018E | 2019E | 2020E |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Revenue receipts (€ millions) | 36,230 | 39,286 | 41,735 | 44,687 | 46,403 | 54,222 | 53,687 | 58,375 | 58,437 | 61,865 | 65,736 |
| Expenditure outlays (€ millions) | 54,450 | 63,907 | 56,630 | 56,010 | 54,434 | 54,293 | 54,662 | 56,468 | 59,292 | 61,601 | 62,959 |
| Exchequer balance (€ millions) | -18,220 | -24,621 | -14,895 | -11,323 | -8,031 | -71 | -975 | 1,907 | -855 | 264 | 2,777 |
| | | | | | | | | | | | |
| General govt balance (€ millions) | -53,711 | -21,886 | -14,112 | -11,020 | -6,955 | -4,977 | -1,842 | -1,008 | -115 | 2,324 | 5,677 |
| General govt balance to GDP | -32.0% | -12.8% | -8.1% | -6.1% | -3.6% | -1.9% | -0.7% | -0.3% | 0.0% | 0.7% | 1.6% |
| General govt balance to GDP (excluding financial interventions) | -11.2% | -8.6% | -8.1% | -6.0% | -3.6% | -1.9% | -0.7% | -0.3% | 0.0% | 0.7% | 1.6% |
| | | | | | | | | | | | |
| Gross Government Debt (GGD) / GDP | 86.0% | 110.9% | 119.9% | 119.7% | 104.1% | 76.8% | 73.4% | 68.0% | 63.8% | 59.9% | 55.6% |
| GGD to GNP, % | 103.6% | 138.1% | 150.1% | 142.9% | 124.1% | 100.6% | 90.3% | 85.8% | 79.9% | 74.5% | 68.7% |
| | | | | | | | | | | | |
| NAMA senior bonds | | 29,106 | 25,440 | 34,618 | 13,590 | 8,100 | 2,590 | 0 | 0 | 0 | 0 |
| NAMA senior bonds % GDP | | 17.0% | 14.5% | 19.2% | 7.0% | 3.1% | 0.9% | 0.0% | 0.0% | 0.0% | 0.0% |
| State liabilities (GGD + NAMA bonds) | | 127.9% | 134.4% | 138.9% | 111.1% | 79.9% | 74.4% | 68.0% | 63.8% | 59.9% | 55.6% |
| | | | | | | | | | | | |
| Net debt (GGD less ISIF, cash) % GDP | | 97.3% | 102.8% | 105.6% | 94.8% | 69.6% | 67.3% | 62.3% | 58.5% | 55.0% | 50.9% |
| Net debt, % GNP | | 121.3% | 128.7% | 126.1% | 112.9% | 91.2% | 82.8% | 78.6% | 73.3% | 68.4% | 62.9% |



Investec

# Public Finances

# Exchequer Returns

## Revenue miss more than offset by lower spending

| Tax revenue performance | | | |
|---|---|---|---|
| | **Actual** | **Forecast** | **Variance** |
| Customs | 202 | 216 | -6.6% |
| Excise Duties | 3,475 | 3,724 | -6.7% |
| CGT | 201 | 189 | 6.2% |
| CAT | 143 | 136 | 5.4% |
| Stamp | 870 | 937 | -7.2% |
| Income Tax (+USC) | 13,051 | 13,072 | -0.2% |
| Corporation Tax | 4,366 | 4,090 | 6.7% |
| VAT | 9,382 | 9,463 | -0.9% |
| Unallocated | 48 | 0 | n/m |
| Motor Tax | 684 | 696 | -1.7% |
| **Total Revenue** | **32,421** | **32,523** | **-0.3%** |

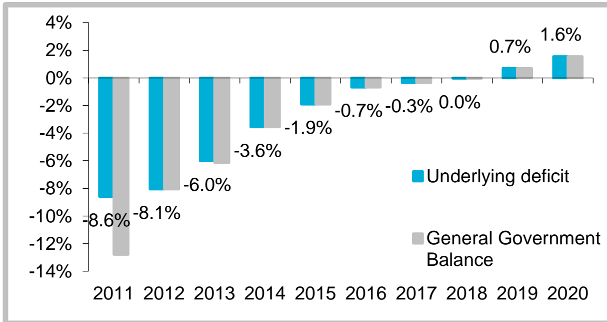
*Source: DoF. Data relate to Jan-Aug 2018*

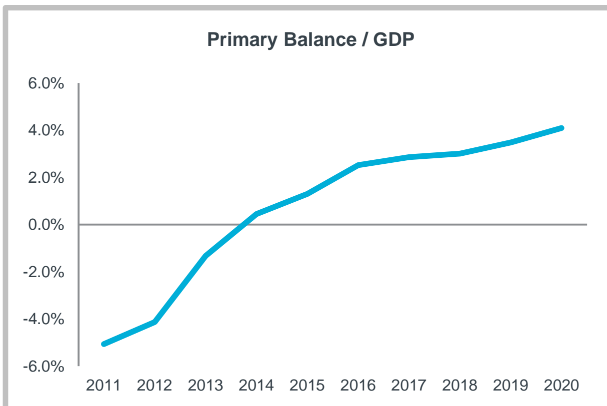
- Last October's Budget projected growth in tax revenues of 6.0% (to €53.7bn) in 2018. In the period to end-August tax receipts were 5.1% ahead of year-earlier levels, suggesting downside risk to this top-line forecast.
- In cash terms the undershoot on tax revenues is €100m. However, gross voted (discretionary) spending in the opening eight months of the year of €39.5bn was €152m lower than profile, while national debt interest costs of €4.2bn were €117m lower than guidance.
- When the above are combined with non-voted (mandatory) spending and non-tax revenues, the underlying general government balance for the first eight months of the year of -€4.2bn is €598m better than profile.
- For 2018, the Department of Finance currently forecasts a general government deficit of €780m. Were the outperformance noted above to be sustained into the year end, a modest surplus would be on the cards. However, the potential for expansionary measures in next month's Budget means that a small deficit is probably the likeliest outturn.

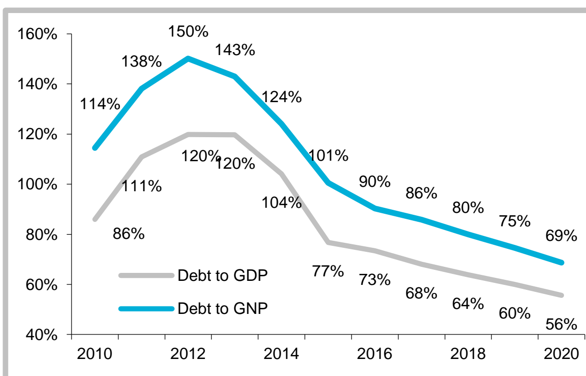
**Year to date General Government Balance is €598m ahead of target**

# Deficit & Debt Forecasts

## On the cusp of a surplus



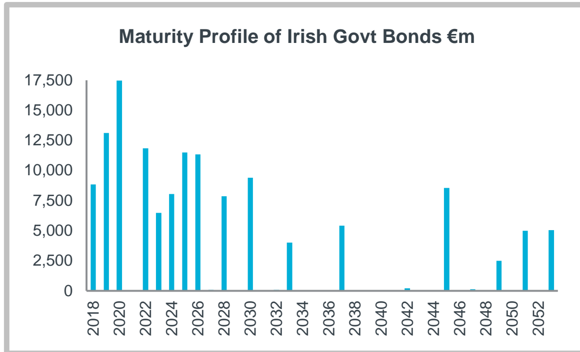



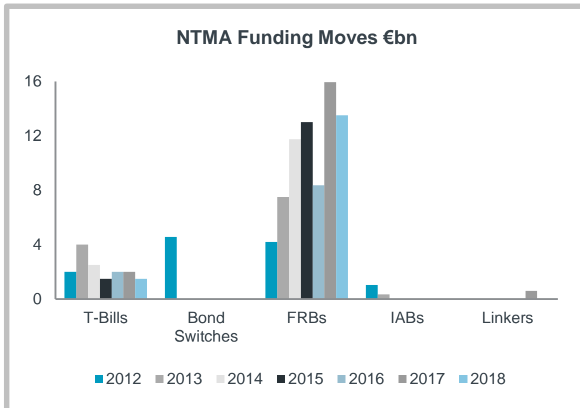

- We prudently forecast a *de minimis* general government deficit for 2018, although the year to date outperformance (while both tax receipts and expenditures have been lower than profile, the latter has undershot guidance more than the former) of the general government balance suggests a small surplus may be possible, absent any fiscal giveaways in next month's Budget.

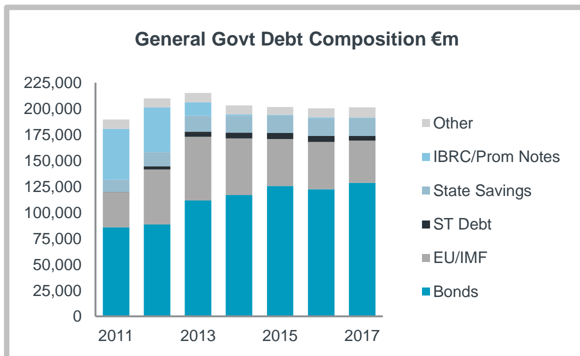
- Ireland is on course for its fifth successive annual primary surplus in 2018. The average interest rate on the General Government Debt is guided to be 2.7% in 2018, producing a cost of €5.4bn (<2% of GDP).

- General Government (Gross) Debt peaked at 124.2% of annualised GDP in H113 and has steadily improved since then (to 69.3% at end-Q118). This pace of improvement is flattered by multinational related distortions to the national accounts (the double-digit annual growth in nominal GDP in H118 being a further reminder of this), but the resolution of IBRC and early retirement of Troika-era borrowings have also played a key role. More gradual reductions are envisaged for the coming years, although additional State asset sales could accelerate this.

**The public finances continue to strengthen**




- NTMA secondary market operations, long dated new public issuance (of up to 100 years maturity), the replacement of €25bn worth of amortising Promissory Notes with long-term bonds (the benefits of this debt, which is effectively funded at the ECB MRO, has been reduced as a result of buybacks) have helped to significantly extend the maturity profile of Irish government bonds. The current weighted average maturity of Irish bonds is 8.8 years.

- The NTMA's funding target for 2018 is to issue €14-18bn of bonds over the course of the year. Given expectations of an upward move in yields, we are not surprised to see that the agency front-loaded this, raising €13.5bn from bond sales in the year to date. In addition, the NTMA has sold €1.5bn worth of T-bills at negative yields so far this year.

- Following the 2013 Promissory Note restructuring and several waves of early redemptions of Troika borrowings (in 2014, 2015 and 2017), Irish government bonds now account for a sizeable (c. 64%) majority of the country's general government debt, followed by the remaining Troika loans (c. 20%) and local/retail debt.

**Year to date issuance is already at the low end of the 2018 target range**



Investec

# NAMA & The Irish Banking Sector

- The nominal value of the core loans originally acquired was €74.2bn, settled through the issuance of €31.6bn of NAMA bonds.
  - NAMA's accounting value of its remaining core net loan book at end-March 2018 was €3.2bn
  - 93% of loans by loan nominal were non-performing at end-March 2018
  - 62% of NPLs by loan nominal were 120+ days in arrears by end-March 2018

- Breakdown by asset classification at end-Q417 was: Land 36%, Development 26%, Residential 15%, Office 11%, Retail 7%, Hotel & Leisure 3%, Industrial 1%, Other 1%.
- Breakdown by geography at end-Q417 was: Ireland 84%, UK 12%, Other 4%.

- Following the redemption of all of the government guaranteed senior debt linked to NAMA's core (original) portfolio, the agency's remaining debt securities outstanding at end-2017 were €1.6bn, all of which were subordinated.
  - AIB €0.4bn;
  - BKIR €0.3bn;
  - Another €0.9bn of NAMA subordinated debt was in private hands, of which €0.3bn was redeemed since the start of 2018.

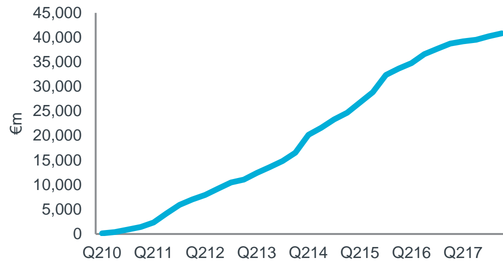
- NAMA redeemed the final €2.6bn of the €30.2bn of senior debt that was linked to the original portfolio in 2017. This served to remove a contingent liability from the Sovereign.

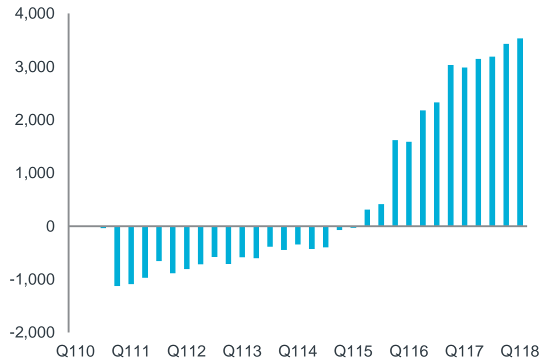
- Separately, NAMA issued €12.9bn of bonds in February 2013 as part of the IBRC liquidation process, all of which were redeemed by the end of October 2014.

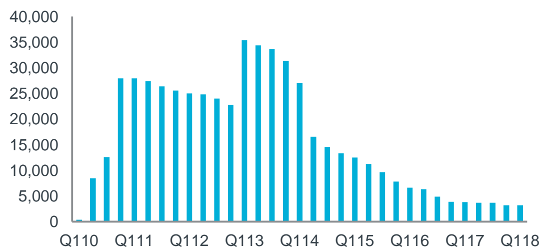
- From inception to end-March 2018 NAMA received cash proceeds from asset sales and non-disposal income totalling €41.3bn.



Investec



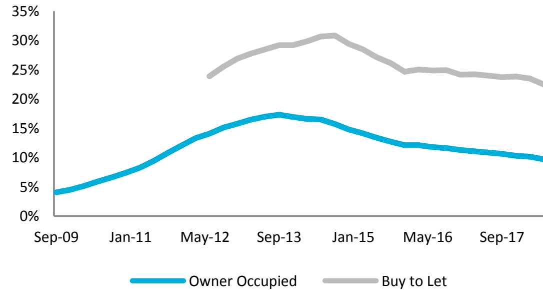



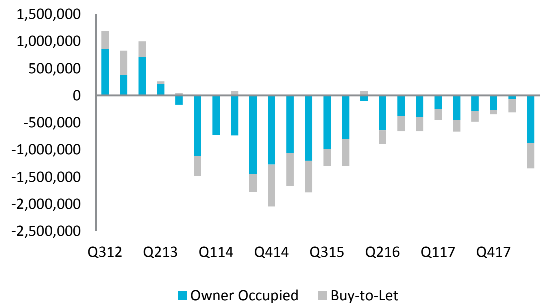

- NAMA has been an impressive cash generator since its inception. By end-March 2018 it had generated cumulative operating cashflow of €40.8bn.

- These cash flows have funded the redemption of all of NAMA's senior bonds and €0.3bn (of €1.6bn) of its subordinated bonds – while also facilitating significant investment in enhancing the value of its asset base. In June NAMA raised its target for lifetime earnings to €3.5bn but this looks very conservative, not least given that its retained earnings are already above this level. Add in further write-backs from its €1.4bn stock of provisions as property values climb and consider the strong underlying profitability (its net interest margin was a remarkable 7.0% in 2017) and a €4.5bn return to the Exchequer remains a distinct possibility.

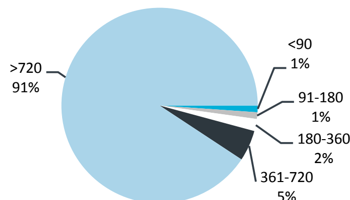
- NAMA's balance sheet reduced by 30% in 2017, finishing the period at only about a seventh of its peak size. The agency should have all of its work resolved by end-2020, with the main risk to this projection being a politically mandated transformation of its business model.

**NAMA likely to beat €3.5bn lifetime profit guidance by €1bn**




Duration (days) of PDH arrears




- The latest Central Bank of Ireland data covering all banks resident in Ireland show that there were 725,693 PDH (owner-occupied) mortgage loan accounts, with a total balance of €98.2bn, at end-Q218. In the same quarter there were 118,234 BTL mortgages with a total balance of €20.9bn.

- Both segments have seen arrears sharply reduce from peak levels. Some 6.3% of PDH accounts were in arrears of more than 90 days past due (90dpd) in Q218, with the balance on these equivalent to 9.7% of the stock of mortgages in issue. The latter was the first sub-10% reading since Q211 and also well below the Q313 peak of 17.3%. BTL accounts in arrears that are more than 90dpd equate to 14.7% (volume) and 22.5% (value) of the stock, down from the Q314 respective peaks of 22.1% and 30.8%.

- Of those mortgage accounts in arrears of more than 90 days, the euro amount in arrears (€2.7bn) represents 28% of the euro balance on those mortgages for PDH and €2.1bn (44%) for BTL. The high concentration of very long-term arrears (i.e. the most troubled accounts) is a key challenge for credit institutions.

**Loan sales and the economic upturn are helping to clean up loanbooks**

- Central Bank of Ireland data for Q2 2018 provide details on the stock of restructured mortgages in Ireland:

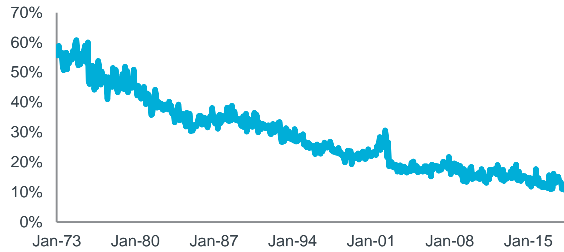
| | Number | Balance ('000) | Arrears ('000) | | Number | Balance ('000) | Arrears ('000) |
|---|---|---|---|---|---|---|---|
| **Total No of Restructured PDH Mortgages** | **116,010** | **15,752,159** | **413,813** | **Total No of Restructured BTL Mortgages** | **19,834** | **4,531,867** | **160,292** |
| o/w not in arrears | 91,800 | 11,712,137 | | o/w not in arrears | 16,221 | 3,635,005 | |
| **Restructure by Type** | | | | **Restructure by Type** | | | |
| Interest Only | 3,269 | 586,333 | 19,354 | Interest Only | 1,926 | 505,995 | 27,922 |
| Reduced Payment > Interest Only | 6,126 | 1,319,569 | 155,167 | Reduced Payment > Interest Only | 4,096 | 1,223,874 | 50,277 |
| Reduced Payment < Interest Only | 598 | 123,486 | 10,313 | Reduced Payment < Interest Only | 51 | 9,811 | 925 |
| Term Extension | 13,996 | 1,479,892 | 44,319 | Term Extension | 3,505 | 573,221 | 22,434 |
| Arrears Capitalisation | 38,170 | 5,915,784 | 95,237 | Arrears Capitalisation | 4,260 | 844,938 | 39,429 |
| Payment Moratorium | 1,116 | 167,401 | 3,586 | Payment Moratorium | 186 | 26,000 | 1,345 |
| Deferred Interest Scheme | 21 | 3,845 | 584 | Deferred Interest Scheme | 0 | 0 | 0 |
| Permanent Interest Rate Reduction | 118 | 20,063 | 65 | Permanent Interest Rate Reduction | 2 | 1,070 | 451 |
| Split Mortgage | 27,464 | 2,719,975 | 13,510 | Temporary Interest Rate Reduction | 104 | 20895 | 114 |
| Trade Down Mortgage | 64 | 9,576 | 1 | Split Mortage | 1,923 | 237,657 | 520 |
| Temporary Interest Rate Reduction | 5,542 | 1,063,670 | 15,702 | Other | 3,781 | 1,088,406 | 16,875 |
| Other | 19,526 | 2,342,565 | 55,975 | | | | |

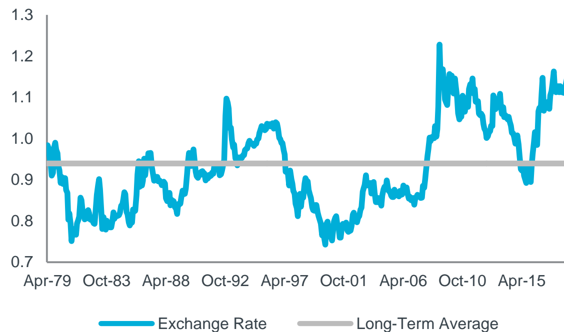
*Source: Central Bank of Ireland*

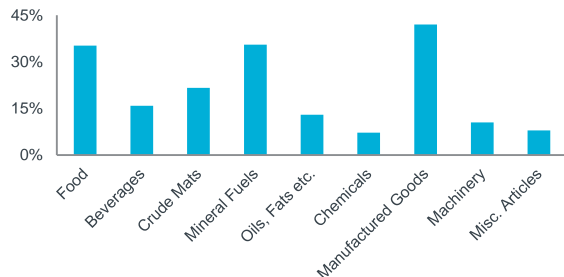
## What Brexit Means For Ireland

# What Brexit Means For Ireland

## Negative, but context is important




- While the UK remains an important trading partner for Ireland, the economic umbilical cord that had existed between the two countries after independence has largely been unwound. In 1926 the UK accounted for 97% of Irish merchandise exports and provided 76% of the State's goods imports. By January 1973, when both countries joined the then EEC, 58% of Irish goods exports went to its closest neighbour. This share has continued to fall, accounting for only 11% in H118.

- The benefits of this diversification are perhaps best illustrated by the fact that the old Irish punt (holding it at the fixed conversion rate that it joined the single currency at) has at times in the period following the Brexit vote stood above the levels seen after Black Wednesday in 1992. A quarter-century ago the UK accounted for more than double the share of headline Irish goods exports as it does today.

- Adding in the services sector (16% of whose exports go to the UK) means that Ireland's closest neighbour accounts for less than a sixth of total exports. For some segments of the economy its importance is far greater – c. 40% of indigenous firms' exports go to the UK, while a number of sectors (Food, Manufactured Goods, Transport, Cross-Border Financial Services, Tourism) are very reliant on that market.

**The UK is the destination for less than a sixth of total Irish exports**

# Implications for Ireland

## Short and long term

- Short term:
  - Firms exporting to the UK remain under pressure as a result of the weak pound
  - Competition from UK imports has been unhelpful for many domestic firms (e.g. new car sales are -4.5% y/y in the year to date) but it is also resulting in cheaper input costs for others
  - Business and consumer confidence is likely to be negatively impacted, with knock-on consequences for investment and retail sales
  - But Ireland is likely to grow its share of FDI to (part-?) compensate for this – we note a steady flow of encouraging announcements thus far
  - Brexit will likely inform some of the thinking around next month's Budget, such as the government's deliberations on whether or not to retain the special low VAT rate for the hospitality sector
  - Economic growth will likely be slower than would otherwise have been the case – every 1pc move in UK GDP moves Irish GDP by c. 0.2pc
- Long term:
  - Estimates from leading research houses (IFO Institute, Oxford Economics, LSE/CEP) have suggested that Brexit could permanently reduce Irish GDP by between 0.8% and 2.7% relative to baseline
  - However, the reality is that we don't know what the ultimate impact will be as much hinges on the nature of trading arrangements struck between the UK and EU. At the time of writing there remains considerable uncertainty about how these will look
  - Irish exporters will likely have to deal with a structurally weaker sterling as the UK's 'safe haven' status has gone the way of its AAA rating. Major changes to supply chains will also probably be needed. The transition period (to end-2020) provides space for this
  - Ireland could win big from the relocation of operations out of the UK e.g. certain financial services. Openness to skilled migrants could also help to boost investment. But can our residential property market handle this?

# No quick fix for the Brexit camp

## ‘Brexit’ could take many years to finalise

- Last year the UK triggered Article 50, ending the ‘Phoney War’ that had existed since the Brexit vote in June 2016 and thus commencing the formal stage of its divorce negotiations with the EU.

- Negotiating period / remaining EU membership is set at two years under Article 50, but this can be extended indefinitely by unanimous EU28 vote. We note that the EU-Switzerland bilateral trade deal took six years to finalise. The 21 month transition period after March 2019 may well be extended, so we wouldn’t necessarily view 1 January 2021 as the new “cliff edge”.

- Phase I of the Brexit discussions brought welcome reassurance for Ireland, particularly in terms of trade on the Island of Ireland and between Ireland and Britain (and beyond). However, we remain some distance from a politically acceptable solution to the Northern Ireland border. Hopefully October’s summit will bring much-needed clarity.

- The UK doesn’t just have to cut a deal with the EU. WTO membership also needs to be renegotiated and existing trade deals with 53 other third party areas would cease in the event of an EU divorce

- What model could the post-EU UK follow? It’s hard to tell at this juncture

  - Switzerland secured tariff free goods access, but limited Single Market access for financial services – this is unpalatable for the UK given the importance of The City. Switzerland also had to agree to the free movement of labour and has to implement most EU law without having a vote on it
  - Norway has access to the Single Market for most goods and services (excluding fisheries and agriculture). It also has to accept the free movement of labour and most EU legislation. Norway has to pay for its market access – it is the 12th biggest contributor to the EU budget despite not being a member
  - One alternative is to follow the WTO frameworks. This would involve adopting 4% EU import tariffs on average, but penal charges on certain items produced in the UK makes this an unattractive option

Investec Bank plc (Irish Branch) (“**Investec**”) has issued and is responsible for production of this publication. Investec Bank plc (Irish Branch) is authorised by the Prudential Regulation Authority in the United Kingdom and is regulated by the Central Bank of Ireland for conduct of business rules. Investec Bank plc is a member of the London Stock Exchange and the Irish Stock Exchange.

This publication should be regarded as being for information only and should not be considered as an offer or solicitation to sell, buy or subscribe to any financial instruments, securities or any derivative instrument, or any other rights pertaining thereto (together, “**investments**”). Investec does not express any opinion as to the present or future value or price of any investments referred to in this publication. This publication may not be reproduced without the consent of Investec.

The information contained in this publication has been compiled from sources believed to be reliable, but, neither Investec, nor any of its directors, officers, or employees accepts liability for any loss arising from the use hereof or makes any representations as to its accuracy and completeness. The information contained in this publication is valid as at the date of this publication. This information is subject to change without notice, its accuracy is not guaranteed, it may be incomplete or condensed and it may not contain all material information concerning the matters discussed herein.

This publication does not constitute investment advice and has been prepared without regard to individual financial circumstances, objectives or particular needs of recipients. Readers should seek their own financial, tax, legal, regulatory and other advice regarding the appropriateness or otherwise of investing in any investments or pursuing any investment strategies. Investec operates exclusively on an execution only basis.

An investment in any of the investments discussed in this publication may result in some or all of the money invested being lost. Past performance is not a reliable guide to future performance. To the extent that this publication is deemed to contain any forecasts as to the performance of any investments, the reader is warned that forecasts are not a reliable indicator of future performance. The value of any investments can fall as well as rise. Foreign currency denominated investments are subject to fluctuations in exchange rates that may have a positive or adverse effect on the value, price or income of such investments. Certain transactions, including those involving futures, options and other derivative instruments, can give rise to substantial risk and are not suitable for all investors.

Investec (or its directors, officers or employees) may to the extent permitted by law, own or have a position in the investments (including derivative instruments or any other rights pertaining thereto) of any issuer or related company referred to herein, and may add to or dispose of any such position or may make a market or act as a principal in any transaction in such investments or financial transactions.

Investec’s conflicts of interest policy is available at http://www.investec.ie/legal/uk/conflicts-of-interest.html.