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Investec Europe
Research Weekly
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Economics | Treasury | Corporate Finance | Private Client Lending

This Research Weekly takes a look at economic events over the past week as governments, here and abroad, look to gradually ease lockdown restrictions. We also examine this week's developments in FX and commodity markets courtesy of Investec Treasury, while our Corporate Finance and Private Client Lending teams look at the topics of Trade Credit Insurance and the residential rental markets.

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Economic Roundup: Ireland

As the government grapples with the unenviable task of plotting a course towards the gradual restarting of economic activity, the data this week again emphasised the scale of the challenge ahead.

Workers on Wage Subsidy Scheme +18% – Friday 1 May
427,000 workers are now being supported through the government's Wage Subsidy Scheme, with this representing a 64,600 increase in the week.

Separate figures earlier this week showed that 591,000 people were in receipt of the COVID-19 Pandemic Unemployment Payment, with the net weekly increase in this figure a modest 7,000. We are mindful of mixing the datasets given the different reference time periods and the ongoing flow in both directions between the Wage Subsidy Scheme and the Pandemic Unemployment Payment. However the combined figures suggest that more than one million people are being supported by the State between just these two schemes as a result of COVID-19. This represents more than 40% of the numbers in employment in Q4 last year and suggests that the size of the workforce in "regular employment" has dropped from 2.4m to 1.4m. The scale of the challenge facing the government and the country is stark.

Manufacturing PMI drops at a record pace – Friday 1 May
The AIB Ireland Manufacturing PMI for April unsurprisingly showed a severe fall to 36.0 from 45.1 in March. This was the third lowest reading on record (behind February and March 2009) and the month-on-month decline was the largest in the index's history.

Output, new orders, exports and purchasing all fell at the fastest rates in the 22-year survey history and the overall decline would have been more severe was it not for the record lengthening of suppliers' delivery times which is treated as a positive indicator given that it is typically associated with strengthening demand. The Output index clearly shows the disruption to

industry caused by the virus outbreak – the 21.8 monthly decline was more than twice the previous record, which occurred in March. Where output rose, this was linked to healthcare products. Employment in the manufacturing industry also suffered in April, with the pace of job losses the joint-fastest on record. The Future Output Index hit a new record low during the month, but the month-on-month decline in the index was much lower than in March, suggesting that firms are not much more pessimistic now than a month ago.

With an unparalleled economic lockdown in place throughout April, none of the historic declines in this morning's data should come as a surprise. Indeed, the Irish figures are in line with similar figures from the UK, the US and the Eurozone. The hope is that the only place from here is up.

Retail sales data reflect an extraordinary situation – Friday 1 May
The CSO's retail sales data for March showed a significant aggregate fall in the month, but also showed an enormous variance in sales figures between different retail sectors.

Overall retail sales volumes declined 12.7% m/m in March and by 11.1% on a y/y basis. Eight of the 13 business sectors recorded declines in sales volumes, with the average fall an unprecedented 31% (on both a m/m and y/y basis). The sectors with the largest falls were those hit hardest and earliest by government restrictions – Bars (-53% m/m), Clothing & Footwear (-49% m/m) and Motor Trades (-31% m/m).

However five sectors grew sales volumes in March, with the average m/m growth amongst these businesses a remarkable 9%. Food, Beverages & Tobacco (+17%), Non-Specialised Stores, incl. supermarkets (+14%) and Pharmaceuticals, Medical & Cosmetics (+9%) recorded the highest growth in the month and it is likely that such businesses will continue to see resilient sales given the nature of the current crisis.

Reflecting the current situation, the CSO also outlined its difficulties in collecting the source data for its publication. Data is collected from 1,600 retail businesses each month and, despite the operational challenges of store closures, etc, the response rate was just five percentage points lower than normal and still covered 53% of sales in the economy. However the CSO supplemented its usual data with other information sources, such as card expenditure data, retailers' websites and media reports. These challenges will clearly deepen for April's data collection, with only those businesses deemed essential still trading in the month.

Small weekly increase in unemployment claimants – Tuesday 28 April
This week's update from the Department of Employment Affairs and Social Protection showed that 591,000 people are in receipt of the COVID-19 Pandemic Unemployment Payment (PUP), a modest net increase of 7,000 from last week's total. The increase stood at 50,000 last week.

The relatively small increase in the number of PUP recipients indicates that the country is likely close to the peak in terms of pandemic-related jobless claims and if some sectors are allowed to return to work after May 5th, we may see the unemployment numbers begin to decline at that point (this "if" remains significant however). The small net increase should also not detract from the enormous and profound disruption to the labour market witnessed in the past several weeks. Combined with the Wage Subsidy Scheme, upwards of 850,000 people are being supported by the State as a result of COVID-19. This equates to around 35% of the pre-crisis workforce and highlights the fine line that must be tread between keeping the virus in check and reopening the economy while as many businesses as possible are in a position to re-hire.

Economic Roundup: International

Another tumultuous week with humbling economic data contrasting with hope inspired by the reopening of some economies and positive news regarding a COVID-19 drug development. Meanwhile, stimulus from authorities continues to trickle through attempting to mitigate the damage.

We have had more colour this week from European nations on their lockdown exit strategies. Spanish PM Pedro Sanchez elaborated on last week's hints, with a two-month plan to reopen the economy. In France, restrictions are set to be eased from 11 May and there has been a swathe of similar announcements across Europe. Damning figures from the Euro area showed the extent to which the economy has already suffered. Eurozone GDP contracted by 3.8% in Q1 2020, the sharpest decline on record. On a member state basis, France and Spain were two of the worst hit countries; activity declined by 5.8% and 5.2% respectively. Whilst the hit was not quite as sharp in the US, where GDP fell by 1.2% (4.8% saar) in Q1 compared with Q4 2019. Steeper downturns in activity are expected in both the US and the Euro area in Q2.

In terms of monetary policy, although headline policies were held steady at their meetings this week, both the ECB and the Federal Reserve announced measures to increase funding for businesses. The Fed relaxed its eligibility criteria for its Main Street Lending Progam, whilst the ECB, in a surprise move, developed a new financing scheme, the Pandemic Emergency

Longer-Term Refinancing Operations (PELTROs). President Lagarde described the PELTROs as a liquidity backstop. Alongside improved pricing for banks borrowing funds under existing schemes, the measures are aimed at addressing some of the continued signs of stress in Euro area money markets. The Bank of Japan also stepped-up its response measures this week.

Amidst the hit to economic activity and a worsening in the fiscal outlook on Tuesday Fitch made the surprise, unscheduled move in cutting Italy's sovereign rating one notch to BBB-, one notch above junk status, whilst the outlook was revised to stable from negative. Fitch expects debt/GDP to reach 156% in Italy this year. This follows the relief in when S&P opted not to cut Italy's rating at the end of last week, although Italian yields have had a steady week.

Investec Treasury

ECB and month-end flow to the rescue as big data failed to shake FX markets out of slumber

Staring at the screen yesterday afternoon following two big data points and two hugely important central bank monetary policy announcements, one would have found it hard to see what if anything (barring another unwelcome equity rout) at this stage could jolt the FX markets back into life. As Christine Lagarde was beginning her press conference yesterday afternoon, the benchmark EUR/USD rate was sitting just below the top of a very tight fortnightly range of 1.0730/1.0880 and looked to be resigned to the fact that we would probably be stuck in that same range for the foreseeable future.

The first big data drop was on Wednesday afternoon; US GDP data showed that the US economy shrank by an annualised 4.8% over Q1 (i.e. 1.2% on the quarter). Consensus had been for a 4.0% annualised drop. Given the timings of the lockdowns in the US, Q2's readings in three months' time should make for even grimmer reading. The dollar didn't budge. Wednesday evening then saw the Fed (unsurprisingly) maintain its policy stance, saying it would continue to buy Treasuries, agency bonds and mortgage backed securities in the amounts needed to support smooth market functioning. No real shock that the dollar didn't react to a 'stand your ground' Fed.

Yesterday morning we were greeted with Eurostat figures that showed the Euro area contracting by 3.8% (qoq) in Q1, marking a record quarterly contraction. Our own estimate had been for a 3.2% fall. Data from individual states had also been published, including those from France which at -5.8% (vs. -4.0% expected) was the largest quarterly decline in just over 70 years. Spain contracted by -5.2%, another record contraction. However despite the extraordinarily weak data for Q1, similar to the US, the figures for Q2 are likely to look much worse given that most of the social restrictions as a result of COVID-19 only came into force in mid to late March. Surely truly awful data would drag the single currency lower? It was not to be.

Finally yesterday afternoon, the champion of market liquidity that is the ECB added some more acronyms to their already exhaustive list of specific liquidity programmes. In a surprise move, they announced a reduction of 0.50% on the rate applied to their TLTRO-III programme, they also added non-targeted pandemic emergency longer-term refinancing operations, or PELTROs. These essentially are seven liquidity operations with a maturity of roughly 1-year and priced at -25bps under the average main refinancing rate (which currently sits at 0.0%) during the term of the borrowing. The single currency loved the news! Month-end 're-balancing' inflows to the euro in tandem with the surprise increase in liquidity support from the ECB ensured that the EUR/USD smashed through key resistance levels of 1.0890, surging nearly 1.5% to over fortnightly highs of in/around 1.0970. At last something for FX markets to get their teeth into.

Brent opens almost 50% higher from weekly lows of below $19pb
Oil markets have had a much more positive tone over the last couple of days, here's a few reasons why:

- US inventories increased by less than expected (crude up by 9m barrels and gasoline down by 3.7m)
- Traffic congestion has returned to major Chinese cities, indicating that domestic demand is recovering
- US crude output has dropped again and is now 1m b/d below the peak reached in March
- Norway's Petroleum and Energy Ministry has announced that output will be cut by 250 kb/d in June and 134 kb/d over H2-20 relative to a reference rate of production of 1.86 m b/d

The cut in Norway's output, though small in the scheme of things, is significant in that it is the first example of a non-OPEC+ state deliberately cutting its output. Oil markets are by no means out of the woods and the reported build in US inventories earlier in the week (which references the end of last week) was close to record highs. This almost certainly means that at the end of this week (which figures will be published next Wednesday), US inventories will have set a new record high. As the process of rebalancing proceeds, market focus will increasingly switch to figuring out the recovery phase of the coronavirus disruption. The question here is how much production survives the rebalancing, will this be sufficient to provide for the recovery in demand and how much inventory will be available to plug shortfalls. At present, the range of possibilities is still very, very large, but over the coming weeks, as the rebalancing proceeds, the range of uncertainty will narrow and a somewhat clearer picture will emerge.

Investec Corporate Finance

Trade Credit Insurance – Action urgently needed

Do you trust a counterparty's IOU to pay for your goods in 45 days' time like you might have done in the past…or take the tough decision to decline an order that could get your volumes back up towards where they were before the COVID-19 crisis? The decision is all the more difficult if that counterparty is in another jurisdiction and international transport and storage is involved. That's the dilemma a lot of our clients will be faced with in the months ahead.

Many businesses across the country have been placed into what might be described as a medically-induced coma. And while revenues have evaporated significantly (and completely in some cases), some effective life-support cashflow measures have been put in place for the short-term such as the temporary Wage Subsidy Scheme and bank support measures.

As Government turns its focus towards re-opening the economy on a tentative step-by-step basis over coming months, company owners and managers face re-opening their businesses into a very different trading environment from where they left off before the COVID lock-down.

Working capital challenges as business reopens
When companies look to ramp back up, two immediate working capital challenges present themselves:

- Firstly, collection of their debtor book (which will be 90 days or more over-due in many cases) and
- Secondly, the value of their inventory (which may now be partly perished, out of season, subject to cancelled orders, etc.)

These are likely to be major challenges in one shape or another right along the supply chain for many sectors.
The domino-effects of these impacts to balance sheet solvency will only begin to emerge in the months following the re-opening, and business insolvencies will almost inevitably rise later this year and into 2021. Trade credit insurance in place prior to the crisis will cushion the bad-debt impact to some extent. However, there are worrying signals from the credit insurers that they will withdraw cover from the market partially or completely unless governments and the EU step in to provide support in the form of risk-sharing and reinsurance.

Loss of trade credit cover would seriously compound an already difficult situation where volumes and margins in the early stages of the recovery are likely to be challenging for many companies. Credit terms of 30-90 days based on counterparty trust were the norm previously – where this trust becomes questioned, and credit cover becomes unavailable to reinsure it, then normal trading terms will become less accommodating and working capital requirements will escalate sharply all along the supply chain. This is bad for business and bad for the economy overall.

EU partners moving ahead with their own solutions
Germany, France, and Belgium have already stepped in to provide effective reinsurance for the trade credit insurers in their respective markets – the total backstop provided by these three EU states is approaching €50bn. Whether the German or French back-stops would cover policies written by their respective insurers in other jurisdictions is unclear – the players in those markets (the largest of which is Allianz owned Euler Hermes) are also key providers of such cover in Ireland.
The Dutch government has even introduced a COVID-19 Export Credit Insurance scheme for its internationally-active capital goods manufacturers and contractors, available only to Netherlands-registered companies. The UK Treasury has also confirmed that it is looking at a credit-insurance back-stop arrangement – details are expected imminently.

So what can or should Ireland do in this regard?
Considering the massive scale of our MNC exports relative to the size of our domestic tax base, it is difficult to see how the risks of a broadly based export credit scheme could be borne by the Irish tax payer. So any Irish scheme will need to be tailored towards domestic needs, with a focus on the maximum multiplier in the Irish economy. In this regard, IBEC proposes an export credit scheme with rolling contract cover capped at €1m; IBEC estimates this facility would cost the State €50m, while supporting exports of €8bn. While this is an excellent idea, it may be too limiting in scale, and doesn't address the issues of trade credit protection within Ireland itself. Government, and more particularly EU, supports to share risks with insurers so that they can maintain cover as near as possible to previous levels will be a crucial aid to getting business quickly cranked-up and going again and to hastening our economic recovery.
Several EU states have already moved unilaterally on this (Germany's commitment of capital is 0.8% of GDP, France about 0.4%) and the UK is about to do the same. We would hope that our government is active on this issue at EU Commission and European Council level; the International Credit Insurance & Surety Association (ICISA) is reported to be in discussions at EU level, and we need our voice to be heard in those discussions.

If COVID bonds are a bridge too far for certain EU governments, then at least it should be harder for these to argue against collective and even-handed support for EU-wide trade credit insurance which will deliver both geographic and sectoral risk-spreading and, at the same time, protection of the European Single Market. And all entirely consistent with the fine words emerging from last week's European Council meeting; Solidarity, Cohesion, and Convergence.

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Investec Private Client Lending

The impact of COVID-19 on the Irish rental market

As we see other countries beginning to emerge from the government imposed restrictions that have been in place over the last number of weeks, the citizens of Ireland await an update from An Taoiseach in relation to our own set of restrictions. At the time of writing this article we are all waiting to see what measures may be eased (or not). As we all know, the longer that this period endures the more of an impact it is likely to have on the property market and the economy in general.

It is believed that property prices have come back a bit as result of the pandemic but, as it stands, there is no firm evidence to support this. We have heard of purchasers looking for a reduction in sale prices as well as vendors offering a discount to try and get deals over the line but it will be a number of weeks and months before there is any clear data which can be relied upon. We understand that deals that had been agreed prior to the impact of COVID-19 have gone ahead for the most part, but there has also been deals which have fallen through as purchasers worry about their own job security.

One area that we do know is being affected is the Irish rental market. Many tenants have suffered a reduction in their income or loss of their job entirely, leading to some to seek a temporary rent reduction agreement with their landlord. In turn, the landlord may look for a moratorium from their bank if they have a mortgage on the property. The initial period of mortgage moratoriums of three months has since been increased to up to six months.

Despite these difficulties, we have heard of ongoing lease agreements being concluded. In the case of at least one large institutional landlord, a key is left in the property door for a potential tenant who shows themselves around while the landlord's rep remains at a distance. When it's time to sign, the tenant, rep and documentation are all in different rooms and they take turns to enter and sign whatever is needed!

There has been a marked increase in the number of rental properties available. According to daft.ie there was a 71% y/y increase in the number of properties coming to market in central Dublin over a five week period between 13 March and 16 April; 964 versus 563 in 2019. However this increase does not hold true for areas outside of Dublin with the number of properties available to rent down 25% for the same period.

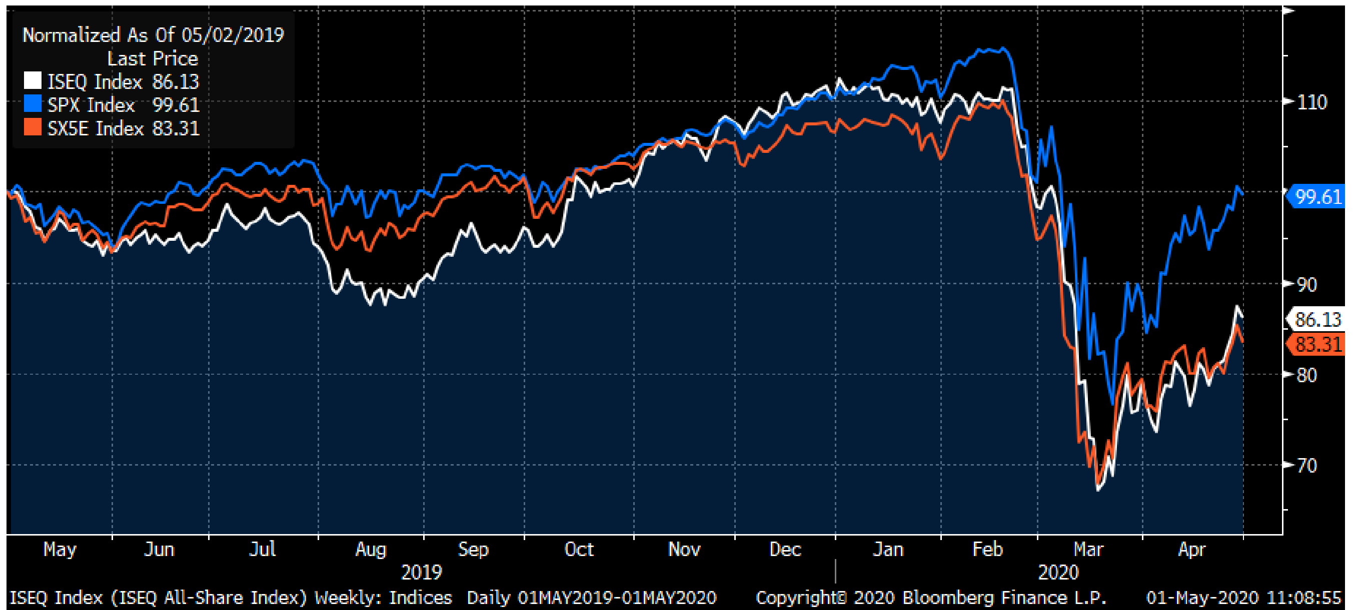
There may be a number of factors which contribute to the increase in central Dublin with one being the fact that there are significantly less properties being put up for sale compared to the same time last year. According to some estimates, this reduction could be as high as 80%. So what can be inferred from this? Are more properties in central Dublin being put up for rent where they may otherwise have been put on the sale market? It's certainly true that the properties becoming available are ones that would otherwise have been let on a short-term basis either to tourists or via Airbnb. There has been some suggestions that it may be down to students returning home during the crisis but the data does not support this. The increase in rental property availability has not been focused in areas of Dublin where students typically live such as the surrounding areas of UCD or DCU.

The Irish government have been quick to introduce legislation to support tenants during this crisis. Landlords that were due to increase rental rates are now unable to do so and any notice of termination which was due to take effect cannot now proceed. These measures were introduced on 27 March for three months, but the possibility remains that they could be extended beyond this point. Other government supports such as the Pandemic Unemployment Payment have also been made available very quickly. There are also existing schemes which an affected tenant can apply for, such as rent supplement.
Hopefully things will soon become clearer as to when some sort of normality will return to our daily lives. It's encouraging to see many estate and letting agents adopting new ways of conducting business such as virtual tours; although when the process of recovery begins, property viewings will inevitably resume as there can often be no substitute for viewing something with your own eye. And so the waiting game continues.

Currency Pairs: EUR/GBP (white, LHS); EUR/USD (blue, RHS)

Source: Bloomberg

Stock Market Indices (indexed to 100): ISEQ (white); S&P 500 (blue); Eurostoxx 50 (orange)



Source: Bloomberg

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