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Investec Europe Research Weekly 17 April 2020

Economics | Treasury | Corporate Finance | Private Client Lending

This week's note rounds up economic events in Ireland and abroad, as the scale of the problems posed by COVID-19 were illustrated in a flurry of US data. We also get the latest thoughts on markets from our Treasury desk, our Corporate Finance team outlines some advice for businesses in these unprecedented times and our Private Client Lending team assesses the early impact on the Irish property market.

- **Economic Roundup: Ireland – page 1**
- **Economic Roundup: International – page 2**
- **Investec Treasury – page 3**
- **Investec Corporate Finance – page 4**
- **Investec Private Client Lending – page 4**
- **FX and Stock Index Charts – page 6**

Economic Roundup: Ireland

Good news was in short supply again this week with the focus remaining on the impact of the outbreak on the labour market – more than three quarters of a million people have been made unemployed by the pandemic or are having the majority of their wage paid by the State. This is how we described events as they unfolded:

Regular employment looks to have fallen by one-third – Thursday 16 April
A few more details have emerged this week on the scale of the current dislocation in the labour market and the extent of the government support schemes that aim to minimise the long-term economic damage from the outbreak.

The Minister for Finance yesterday announced a number of amendments to the government's Wage Subsidy Scheme (WSS), which refunds employers a portion employees' salaries if workers are kept on payroll. These changes will increase the rate of the subsidy to 85% for workers earning less than €24,400 per year and a tiered approach will now apply to those earning above €38,000 per year, although the maximum subsidy remains €350 per week. The Minister also advised that 255,000 people have already received at least one payment under the scheme, a significant increase from the last update that we had. On Tuesday it was revealed that 533,000 people were in receipt of the new Pandemic Unemployment Payment (PUP), a net increase of 26,000 from 3 April. There is likely to be significant movement between the schemes (those receiving the PUP transferring to the WSS as their employers sign-up for example), and the latest numbers hint at these flows, which makes precise calculations difficult.

Nevertheless, we do know that the labour force measured 2.47mn at the last count in Q4 last year and 2.36mn were in employment. The numbers this week indicate that one-third of those in employment before the crisis hit are now either effectively unemployed and receiving the new unemployment benefit or are being supported by the new wage subsidy scheme, while the total still in regular employment (i.e. not availing of the new supports) has fallen dramatically to between 1.5mn and 1.6mn. The sheer speed and scale of this turnaround is shocking. However the hope persists that the labour

market will quickly recover once restrictions on business ease and the vast majority of people will be reinstituted in their previous roles.

Consumer confidence collapses – Thursday 16 April
Consumer confidence in Ireland unsurprisingly took a battering this month, with the KBC Bank Consumer Sentiment Index falling from 77.3 in March to 42.6 in April. This was the largest drop in the survey's 24-year history by far and the index narrowly avoided beating its all-time low reading from 2008.

All index components declined significantly in April but, perhaps reflecting the labour market difficulties discussed above, the reading for current conditions was the lowest on record in April. Searching (perhaps in vain) for a bright spot in the results, the reading for consumer expectations remained a little above the previous low point during the last crisis, which could reflect the hopefully short-lived nature of this crisis. The scale of the economic collapse underway at present however suggests that the path to recovery will not be easy.

Payment breaks for 5% of all mortgages – Tuesday 14 April
In the latest indication of the impact of the coronavirus on the economy, figures from the Banking and Payments Federation Ireland (BPFI) show that more than 45,000 mortgage payment breaks have been granted, or are close to completion, by the country's five retail banks. This sum represents approximately 5% of all mortgages.

The sector-wide initiative, whereby borrowers whose income has been reduced as a result of the outbreak can apply for a payment moratorium of up to three months, was introduced shortly after the outbreak took hold. In addition, close to 14,000 payment breaks for SMEs have been granted in the past three weeks, and banks have also received 3,200 requests for working capital facilities. Two-thirds of the demand for banking supports from SMEs have taken the form of payment break requests, with working capital facilities accounting for about one-third of such requests. The BPFI also noted that up to 50% of bank staff have been reallocated in recent weeks to deal with the changed operational priorities.

It is not a surprise to see these numbers from the BPFI, given the scale of distress in the labour market at present. The latest data from the Department of Employment and Social Protection showed that more than half a million people were in receipt of the new Pandemic Unemployment Payment as of Friday 3 April.

Economic Roundup: International

War comparisons: The scale of the collapse in some indicators this week is being compared with the period of WW2

A flurry of economic indicators were released in the US this week and they painted a bleak picture of the current situation. Two indicators plummeted to historic lows – industrial production showed the biggest monthly decline since 1946 when the end of the Second World War prompted the termination of output that had been assisting with the war effort and retail sales dropped by the most since the data started being collected in 1992.

Separately, jobless claim data showed that more than five million Americans filed for unemployment benefits last week, bringing the total in the month since the coronavirus pandemic throttled the U.S. economy to 22 million, effectively erasing all of the job creation since the Global Financial Crisis.

In the UK on Tuesday the Office for Budget Responsibility (OBR) published a coronavirus scenario for the economy and the UK public finances. It is based on a three-month shutdown and the government measures currently in place. A key result of the scenario analysis is a 35% fall in GDP in Q2 2020, before a sharp bounce back is seen. The scenario details the drop in output on a sector by sector basis, with the largest declines seen in education, accommodation and food services and construction. The implications for the public finances are similarly enormous with the scenario pencilling in a borrowing total of some £273bn (14% of GDP) this year; that would be the largest single-year deficit since the Second World War.

Figures released overnight laid bare the damage that the coronavirus has dealt to the Chinese economy at the start of this year. GDP was recorded as being 6.8% lower than a year ago in Q1, marking the first negative print since official quarterly data began in 1992. But on a more positive note, monthly figures point to a tepid recovery towards the end of the quarter with industrial production paring its rate of decline and the urban unemployment rate falling in March.

While extreme uncertainty still prevails, the IMF updated its global economic forecasts this week. It projects a 3.0% decline in world GDP this year, followed by a 5.8% rebound in 2021. However the picture is gloomy in Europe. The Euro area is expected to contract by 7.5% this year and rebound by just 4.7% next. The UK follows a similar pattern of a 6.5% 2020 slump followed by growth of 4.0% in 2021. The respective US GDP numbers are -5.9% and +4.7%.

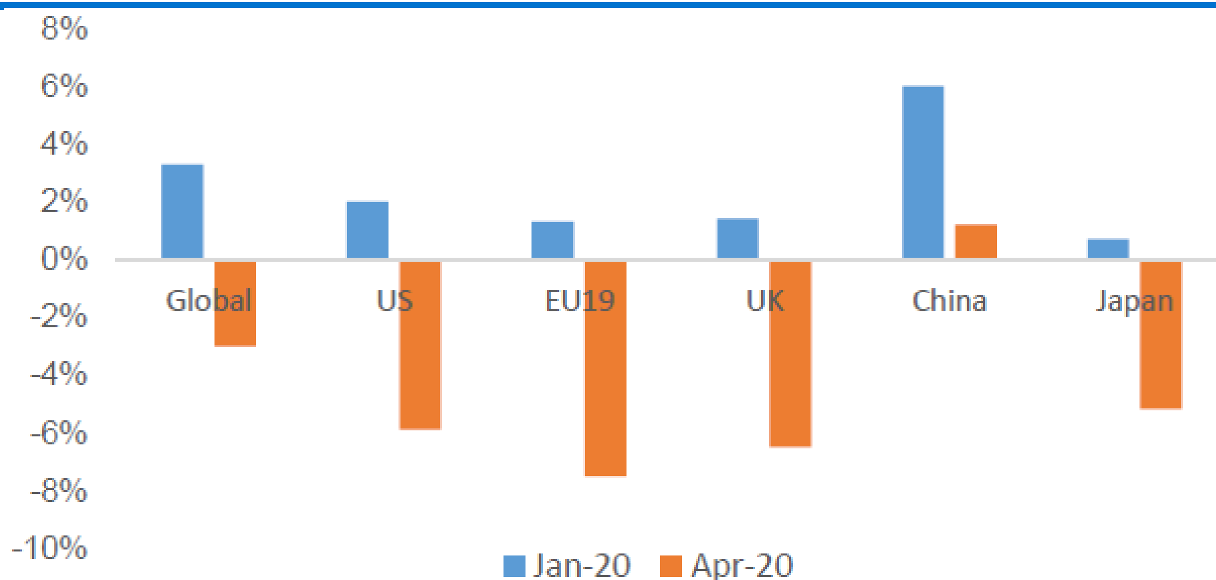
Investec Treasury

It's all in the numbers

Another week, another grim milestone as total numbers of reported global infections breached the two million mark, the number doubling over the last fortnight. As of last night global fatalities have risen to almost 146k. Meanwhile in China there has been a sharp upward revision (just over 50%) in the reported number of coronavirus deaths in Wuhan. Overnight, the local authorities have pushed up their estimate of fatalities by 1,290, which takes the number now to 3,869. Figures from the UK's Office of National Statistics (ONS) suggest that UK deaths in the week up to 3 April were 15% higher than those reported by Public Health England, when taking into account suspected but not confirmed COVID-19 cases. A similar picture has been seen in New York, where only confirmed COVID-19 cases were previously counted. There are however further signs of improvement in continental Europe, where deaths and new cases are falling in Spain and Italy as well as in Germany and Austria. This has been sufficient for the first easing of social restrictions to be announced in Austria, Denmark and Spain. Any relaxation of the UK's lockdown remains some way off with a three-week extension announced yesterday evening.

The big question remains what impact COVID-19 and the associated lockdown measures will have on the global economy. Whilst there is still a huge amount of uncertainty, the IMF added to the underlying tone of grimness after it updated its global growth forecasts earlier this week. It expects global growth to contract 3.0% in 2020 - this compares to -0.1% during the 08/09 financial crisis. The US is forecast to contract 5.9%, whilst figures for the UK and Euro area are more severe at -6.5% and -7.5% respectively. A 5.8% rebound in global growth is projected in 2021. Risks definitely remain tilted to the downside, with the IMF outlining a more severe scenario where GDP could be almost 8% below the updated baseline in 2021.

IMF slashes 2020 GDP growth forecasts



Source: IMF April 2020 World Economic Outlook

Oil market settles lower following production agreement

For all the 11th hour diplomacy going into the global oil deal struck last Sunday, the market reaction and price volatility has settled down this week. Though historic in its scale with the number of participating countries, the impact of the deal will hopefully prevent inventory becoming completely full - a situation that could lead to a complete collapse in the oil industry making the eventual recovery from COVID-19 even more difficult. In the short term, large amounts of crude will continue to flow into inventories, especially as the OPEC+ cuts will not come into effect until May and it is likely that inventories will continue to build even after that. Saudi Arabia has reduced its selling prices for May making it clear that it continues to see stiff competition to sell product even as the OPEC cuts come into force. The pressure is particularly acute on US crude futures which now trade at a 9 $/b discount to Brent. The nascent signs of lock-downs easing in Europe will take time to translate into demand recovery and the virus is still spreading elsewhere. Short-dated oil prices are likely to remain under pressure. Brent has broken lower through 30 $/b after breaking out of the post-Trump tweet range. We could now see another test on the end of March lows in the low 20s over the coming weeks.

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Investec Corporate Finance
Managing Funder Communications

As it looks like a clean end to “lockdown” periods is increasingly unlikely, both here and abroad, the impact of COVID-19 on businesses and economies will be far greater than originally anticipated. Indeed, with unemployment estimated to be above 25%, COVID-19 is already extracting an increasingly serious toll on businesses and their finances and owners and managers are focussing all of their accumulated experience and expertise to best protect businesses and employees.

By now the majority of business owners and managers will have had some level of discussions with existing external providers of finance regarding the impact of COVID-19 on their business. With this in mind, we have set out some key principles for business owners and managers to keep in mind when dealing with external financial partners during uncertain times.

Funders are not managers
When dealing with external providers of finance (in both tougher and easier times) it is always important to remember that they are not the managers of your business, nor do they want to be (regardless of what veto and approval or board representation rights they may possess). External providers of finance have backed the existing team to lead the business and formulate strategies for its success and do not want to have to step into that role except as a last resort.

Maintain good communication
In this regard, we wrote previously how, at a time of crisis and uncertainty, it is natural to have a preference not to engage with critical external providers of finance until there is greater clarity or “better news”. This is rarely, if ever, the best approach. Instead, during difficult times our experience is that it is more important than ever for business managers and owners to maintain proactive and regular engagement with the company’s external providers of finance.

Leadership is critical
In our experience, one of the things that external providers of finance fear most in challenging times is a lack of leadership or decision-making that creates a dangerous vacuum in which challenges increase and opportunities are lost. Even during good economic conditions it can sometimes be difficult to always know the “best” course of action or decision to make and this applies even more during difficult times. Nonetheless, it is essential that there are leaders in the business who are decisive and make the best decisions they can based on the information that is available and communicate those decisions appropriately.

Know your numbers and be realistic on the challenges
In order to make the best decisions for the long-term success of the company it is essential that those decisions are based on detailed and carefully analysed financial assumptions, budgets and forecasts for the business. These forecasts and plans (and scenarios) will form the foundation for all decisions and actions around the company’s financial health. It is equally important to be upfront on the challenges that the business will face. In our experience external providers of finance understand that the results and performance will be challenged. This approach will always yield both greater levels of support (including potentially additional funding) and also more time to address the challenges.

Conclusion
As independent corporate finance advisers our expertise and experience is, when the time is right or when there is a necessity, helping business managers and owners to find the right financial solutions and partners for their business.

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Investec Private Client Lending
The Irish property market and the effects of COVID-19

It is now seven weeks since the first case of COVID-19 was reported here in Ireland. Although the number of infections has not climbed to the levels originally predicted by this point, the tragic loss of life is still immense. Our thoughts are with anyone who has been personally affected.

Since that first diagnosis, we have seen massive changes in our own society as well as around the globe. With introductions by the Irish government on social distancing and further restrictions on movement two weeks later, those who are still lucky to continue working are doing so from home. This poses challenges for people from a technological standpoint, not to mention the potential strain on their mental health. For ourselves in Private Client Lending, we are set up to work remotely and continue to be available to meet the ongoing needs of our clients.

Within one day of social distancing being introduced, estate agents were reporting a significant drop in viewing appointments, while existing appointments were being cancelled by both purchasers and vendors. The residential market has had to adapt quickly with many agents now using virtual property tours coupled with phone and online consultations.

Nevertheless, the number of properties listed on Daft.ie between 15 and 18 March was approximately half of what was listed in the same period last year (1,300 versus 2,574); with the overall number of properties listed in March down 12% year on year. Although it is fair to say that the supply was trending lower prior to this period.

From a valuation standpoint, the current crisis has made it more difficult for agents to put a value on property both logistically and commercially. In normal circumstances valuers would gain access to a property to appraise which of course is impossible in the current climate, although drive-by valuations are still being considered. Commercially, uncertainty still prevails as to how long we could see the current measures by the Irish government remain in place. Therefore it is difficult to predict how long it will take a normal functioning property market to resume. There has been some guidance issued by the Royal Institution of Chartered Surveyors (RICS) in that valuations may at times be carried out but with restricted information and that such instances must be clearly disclosed. RICS has also introduced wording around a “materially uncertain declaration”. It has left the use of this clause up to the individual surveyor but where an RICS member concludes that there is material uncertainty then they must state this in their survey.

Ireland has also seen the closure of the Property Registration Authority (PRA). There has therefore been no applications for registration being processed in the last number of weeks. Vendors, purchasers and of course lenders are all looking for current transactions to close and for business to not completely stall in the coming months. According to the PRA website, the office will reopen to receive applications via An Post and DX from Monday 20 April. Registration of deeds will also recommence, however the PRA is currently not in a position to provide searches or copy memorials.

As we know, many other businesses have closed temporarily resulting in unemployment levels skyrocketing. Although there are government measures in place to support these individuals, one would expect the sudden loss of jobs to have affected some property transactions mid-way through the process. The anecdotal evidence is that many deals have fallen through and it may be up to 12 months before we see people remarketing their properties.

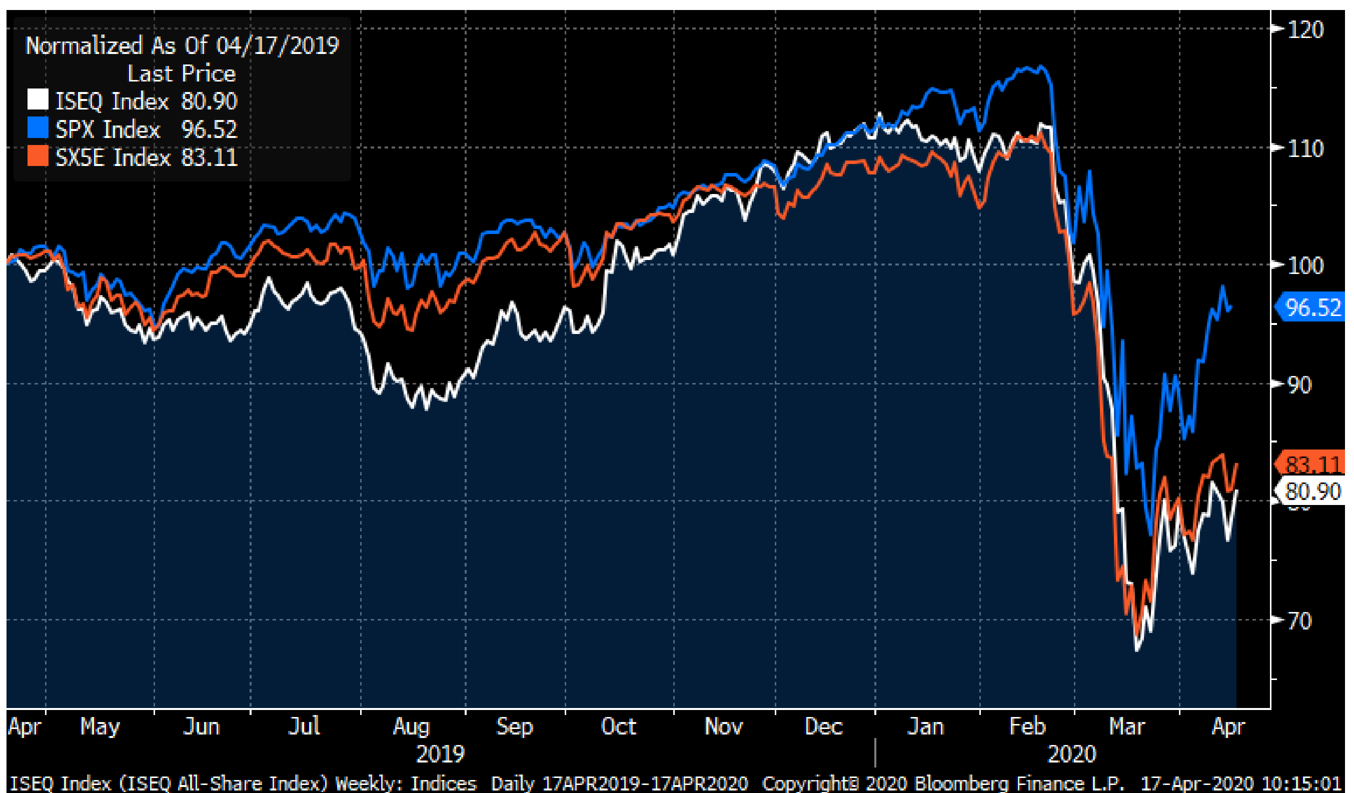
The increase in unemployment numbers will include many involved in the building trade with the impact of social distancing making it difficult for building sites to remain open. This will have a knock on effect on residential supply, but to what extent property prices will be affected is hard to ascertain at this point. On the one hand you would expect prices to decline due to the economic impact of job losses, but this may be counteracted by a slowdown in the growth of new housing stock.

For now, it is very much a case of wait and see. The impact from COVID-19 came too late in Q1 to force prices lower; according to daft.ie the average asking price rise from January to March 2020 was 2.2%. The general sense is that when we get over this pandemic, the market will return. The unknown is simply, how long that will take?

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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