Investec Europe
Market Bulletin
November 2020

Out of the Ordinary®

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Contents

Executive Summary

Our Market Bulletin for November shines a spotlight on the residential market, which has proven remarkably resilient this year, particularly from a price perspective. We are mindful however that a prolonged period of heightened economic restrictions (or a repeated on/off scenario) could have a longer-lasting impact on confidence and prompt more enduring behavioural changes by households, notwithstanding the positive news this week on vaccine development.

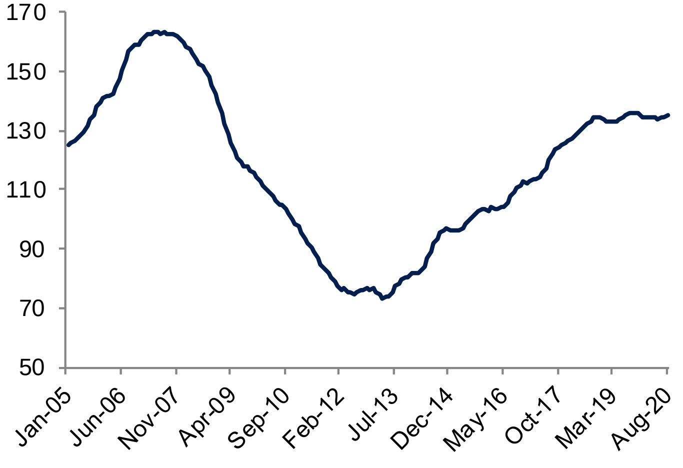
Investec Treasury looks at the steady march lower of interest rates and how this trend is unlikely to reverse in the near future. The Commodities desk examines the recent uptick in oil prices, Investec Corporate Finance looks back on a decent quarter for domestic M&A activity and our colleagues on Investec's lending desk round-up the latest news from the commercial property market.

Stay safe and healthy and don't hesitate to contact us if we can be of assistance.

Economic Update: Ireland

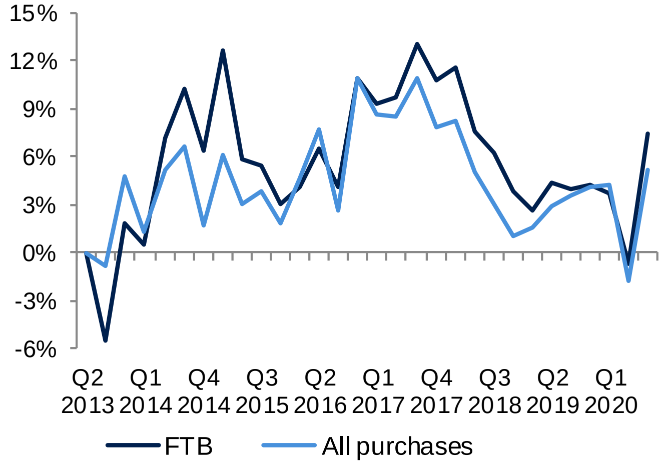
Spotlight on a resilient property market

Residential Property Price Index



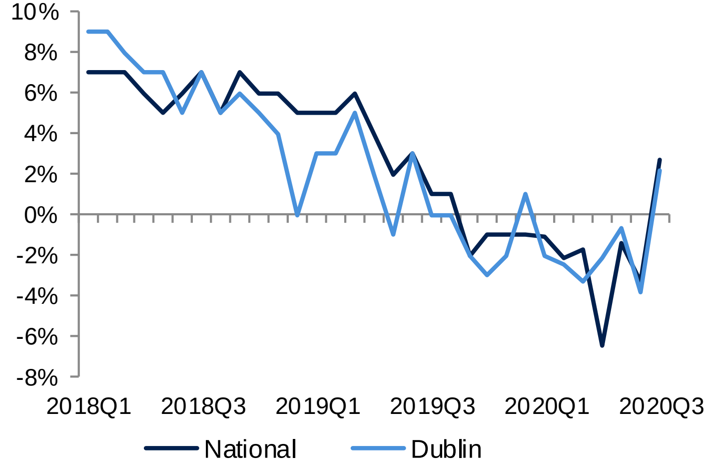
Source: CSO

Size of average mortgage drawdown (y/y)



Source: BPFI

Average listed price on Daft.ie (y/y)



Source: Daft.ie

- The pandemic has clearly had a major impact on many aspects of the domestic economy. In previous notes, for example, we have examined the labour market and the immense rise in unemployment, as well as the hit to the Exchequer and the public finances. Here we take a closer look at the property market, which so far has proven to be remarkably resilient.

Prices have barely budged this year according to the CSO

- As seen in the first chart, the CSO's Residential Property Price Index, the most authoritative record of property prices, has shown little impact from the pandemic. Indeed, prices have been more stable in the past 18 months than at any point in the past 15 years! Throughout H1 2020, the greatest month-on-month move in either direction was 0.1% and prices in June this year were unchanged on December 2019. Between June and August prices moved higher by 0.5%. We are mindful however that this series may not reflect current sentiment. It is based on stamp duty returns which can lag the closure of transactions by several weeks (this is why data to August is the latest available), and even these transactions may have commenced a number of months previously.

Activity has fallen substantially, but is now bouncing back strongly

- Notwithstanding a resilient price environment, transaction and mortgage volumes have unsurprisingly taken a sizeable hit this year. Transactions in the year to mid-October are -26% y/y and mortgage lending (by our forecasts) will fall by 20% this year. Recent approval volumes are encouraging however and suggest deferred demand from earlier in the year is now coming through. Mortgage approvals were just -3% y/y in Q3 and were +35% y/y in September alone (by value).

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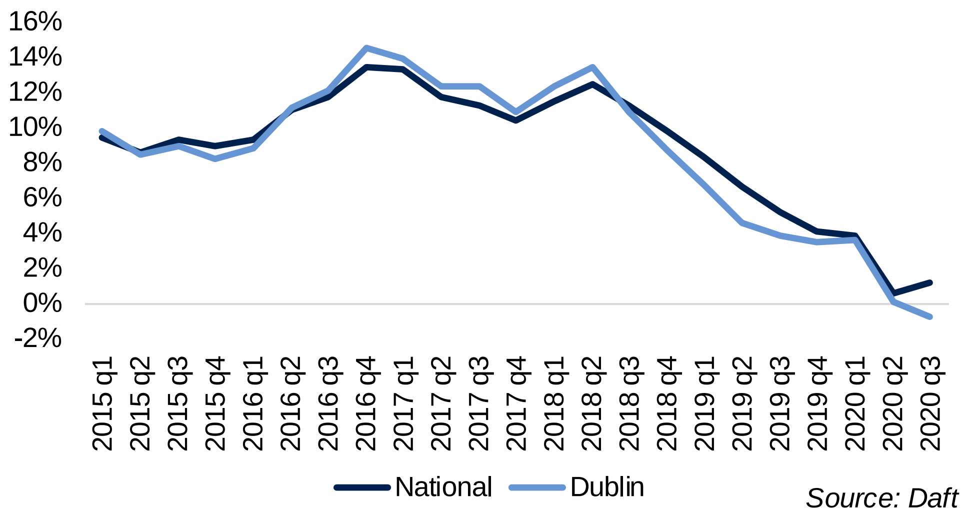
Economic Update: Ireland

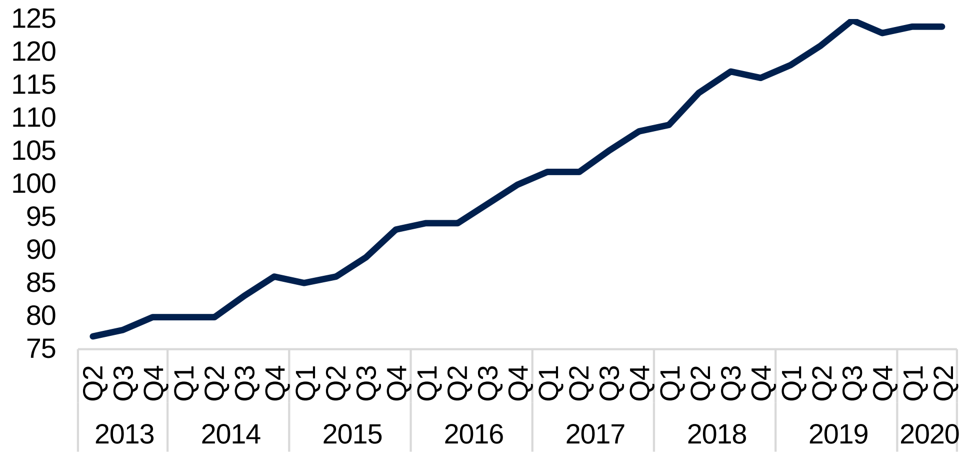
Spotlight on a resilient property market

Average rent on new listings on Daft.ie (y/y change)



Source: Daft

National Rent Index (RTB)



Source: RTB

Forward-looking indicators suggest some upward price momentum but pandemic-related restrictions are still a key risk to sentiment

- Mortgage data, which are a little more up to date, are also very positive from a price perspective. Both recent drawdown data, reflecting deals that were largely struck in the early stages of the pandemic, and approval figures, which are a more forward looking but imperfect indicator, have been surprisingly healthy. The size of the average mortgage drawn down for a house purchase in Q3 2020 was +5.2% y/y and the size of the average mortgage approval for a house purchase in the same period was +7.5% y/y. In both instances, it is the first-time buyer segment that is driving the growth. Some of this upwards step may be due to an increase in the credit strength of the average borrower as those most affected by the pandemic now find themselves unable to obtain mortgage credit, but the buoyancy in the data is remarkable nonetheless.
- The latest figures from Daft.ie showed that the average residential listed price increased by 4.8% in Q3, the largest quarterly increase in five years, following a 1.9% decline in Q2. Data from myhome.ie indicate a very similar upward trend of late.

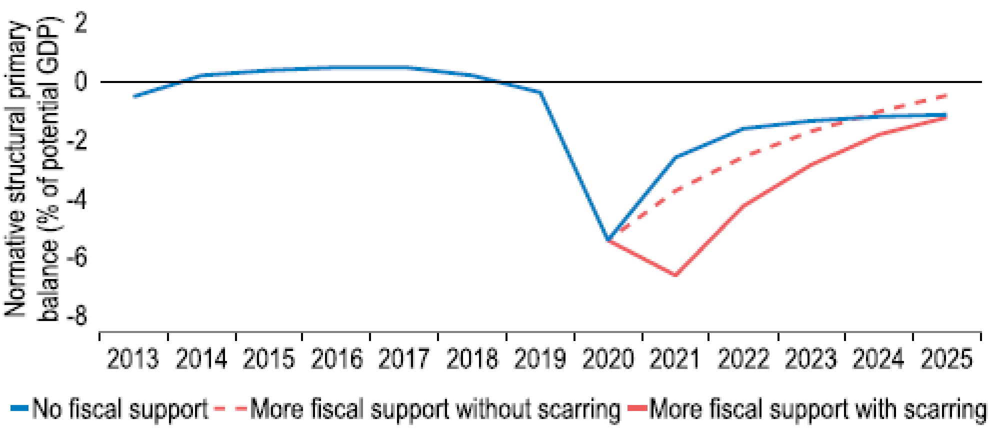
Rental market also holding up very well, but Dublin rental inflation ends as supply increases

- Although the rental market has also proven very resilient, rental trends in Dublin have not been quite as robust. Turning to Daft.ie again, the average listed rent rose by 1.5% q/q nationally in Q3, following a 1.4% fall in the previous quarter. On a y/y basis, national rents have continued to tick higher and were +1.2% in Q3. In Dublin however, the average listed rent was only marginally higher q/q in Q3, at +0.2%, and rents are -0.8% in the past year. Data from the RTB are only available up to Q2, but they also show rental inflation coming to a halt in Dublin and continuing at a modest pace elsewhere. Tellingly, rental availability in Dublin has doubled in the past year as short-term lets have moved to the long-term market.

Economic Update: International

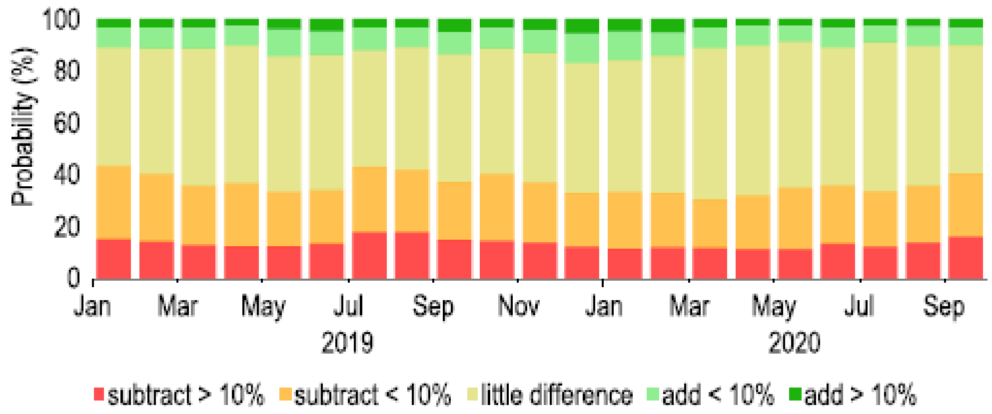
Events moving at pace

IMF warns that economic scarring warrants added stimulus



Source: IMF

40% of UK businesses expect a sales decline even with a EU deal



Source: Bank of England

- The news this week that the double-dose COVID-19 vaccine from Pfizer/BioNTech appears more than 90% effective, well in excess of the US FDA's 50% efficacy requirement, has understandably generated much excitement and relief. The end may be in sight. However caution is warranted and timelines remain unclear. While further studies will be required before any widespread rollout, the two companies aim to secure emergency approval for the vaccine by the end of this month. The apparent success of this vaccine however also bodes well for others that are still undergoing trials. Should other vaccines show similar potential, this could well mean that social distancing restrictions can begin to be gradually relaxed from early next year.
- In the US, with the Democrats landing the Presidency and maintaining control of the House of Representatives, albeit with a reduced majority following their failure to win many of the tight "toss-up" races, much now depends on whether the last two remaining Senate seats in Georgia are ultimately taken by Democratic candidates. The Democrats need both seats to split the chamber 50/50 with Vice President in-waiting Harris then wielding a decisive vote. That would give the "Blue Wave" which investors had been eyeing as paving the way to more material fiscal stimulus next year. In the absence of this, a more bipartisan approach could well curtail not only what stimulus we can expect, but the wider policy agenda, particularly given the disunity and polarisation that characterises US politics. The two run-off elections in Georgia take place on 5 January.
- Closer to home, we are approaching another "do or die" moment in the Brexit negotiations. Progress has been made recently, but the distance between the sides on the core issues of the "level playing field" and fisheries has not yet been substantially closed. A 16 November deadline has been noted by the EU in order to allow democratic processes play out in the European Parliament and with national governments, but there is likely a small window available past this date. It has been reported that the European Parliament could meet virtually in late December to approve any deal – an unprecedented measure for an unprecedented situation in unprecedented times.

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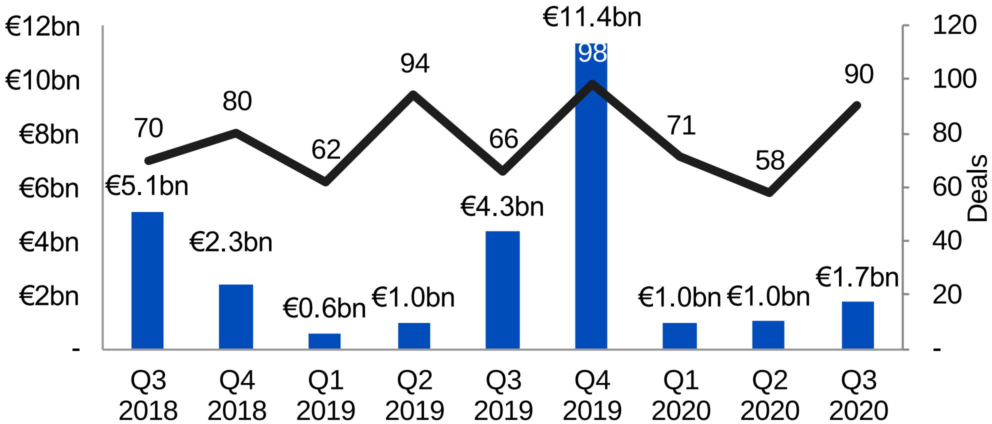
Investec Corporate Finance

M&A Tracker Q3 2020

Quarterly Value and Volume Trend



Most Active sectors (by volume)

Media & Publishing	13
IT & Telecoms	12
Professional & Technical	12

Transaction Type (by volume)

Foreign Acquisitions	27
Irish Deals (In-market)	27
Financial Investor	5

Investec Commentary

- There were 90 deals announced during the quarter, an increase of 55% relative to the second quarter of 2020 which brings the 2020 YTD above the level for the same period in 2019
- Total disclosed transaction value improved versus the first half of the year, with a value of €1.7bn in Q3 higher than either of the first two quarters
- Notable transactions which were announced during the quarter include US based Madison Dearborn Partners' proposed acquisition of IPL for a reported €624m, Roche Holding's €380m acquisition of Inflazome, and Amdocs' €157m purchase of Openet Telecom
- Irish companies were also active overseas during the quarter, with a total of 27 transactions (26 in Q2'20)
- There was 27 in-market transactions during Q3 in addition to 8 transactions involving a UK-based buyer of an Irish business
- The Media & Publishing sector was the most active in the quarter, with 13 transactions announced. It was followed by the IT & Telecoms (12 transactions) and Professional & Technical (12 transactions) sectors
- While the impact of Covid-19 resulted in reduced volumes for the previous quarter, activity levels were up year--on-year in Q3, albeit with lower transaction value in the same period
- Looking forward, many businesses got to grips with the impact of Covid-19 during the first lockdown in March-April 2020 and are now much more externally oriented and businesses that have proven resilient are resuming M&A
- Further detail can be found on https://www.investec.com/content/dam/ireland/downloads-and-documents/ma-tracker/MA-Tracker-Q3-2020.pdf

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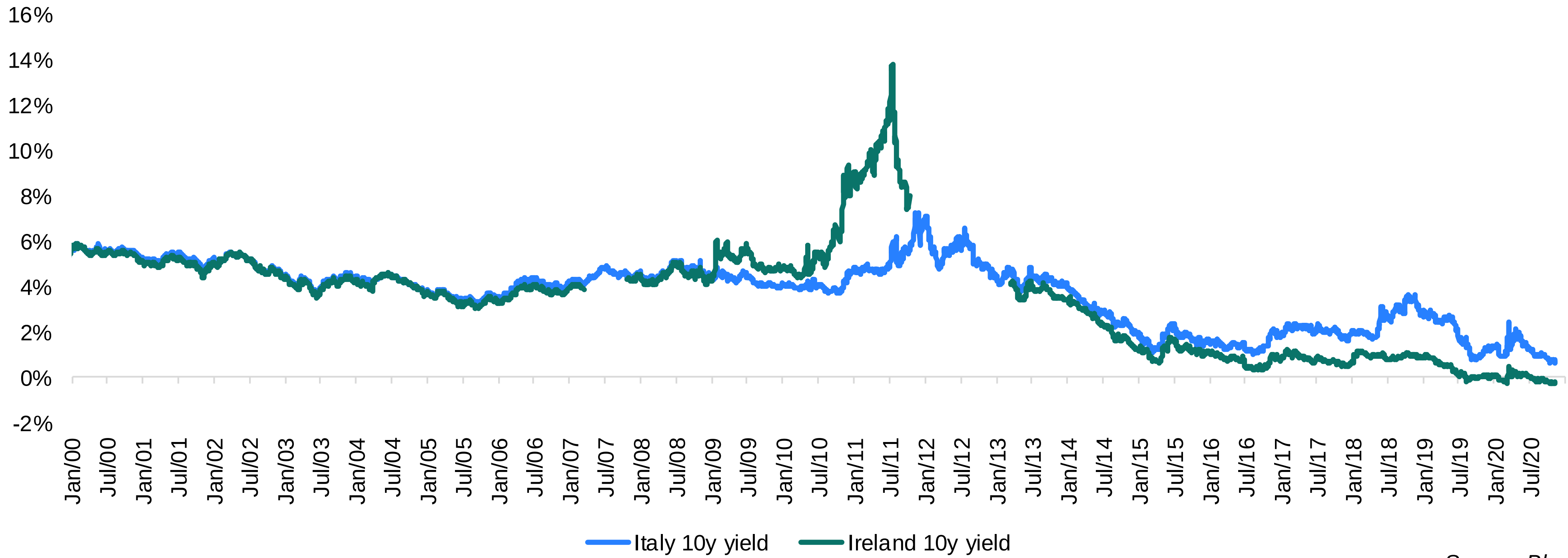
Investec Treasury: Currencies

Wrap up well, it gets cold sub- zero

Italian and Irish 10-year government bond yields



Source: Bloomberg

- From the outset of the pandemic the ECB has been delving deep into its war chest of “unconventional” monetary policy tools. The numbers so far have been nothing short of impressive: Since May, the ECB has already purchased €585bn (of a total €1.35tn PEPP QE envelope) worth of public and private sector European bonds and has pumped out a whopping €1.6tn (TLTRO III & PELTRO) in ultra-cheap loans to qualifying European financial institutions.
- This flood of liquidity has certainly had the desired effect, most notably on the targeted depression of long- term interest rates. In mid- October, Italy’s 10-year yield on their sovereign debt dropped to an all-time low and it successfully sold its very first portion of debt with a coupon of 0%. Two days later, the rate on our very own Irish benchmark 10-year bond also slumped to its lowest level ever of in/around (negative) -0.27%. If all that wasn’t sobering enough, it is also worth noting that nearly a quarter of all investment grade bonds are now trading with negative yields.

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Investec Treasury: Currencies

Wrap up well, it gets cold sub- zero

- As is the norm, in times of extreme monetary policy manoeuvers there are winners and losers. While this new twist in the ECB's ultra-loose monetary policy saga is tailored to be advantageous to the borrower (particularly EU sovereign governments), it will definitely bring prolonged pain to the depositor/saver. As counter-intuitive as rewarding the profligate and penalising the responsible sounds, given the current "unconventional" environment, that is exactly what the ECB is setting out to do.

- So much so that the ECB is currently charging an overnight deposit rate of (negative) -0.50% to dissuade EU financial institutions from placing funds with it. In order for the economy to reboot, for growth to take hold and green shoots of inflation to begin to protrude, the ECB wants us borrowing and spending as opposed to saving and hoarding.

- Banks have been grudgingly passing on this ECB negative charge (in some shape) to larger, institutional-type depositors for the last few years with retail depositors generally being spared the pain. The issue now is that the Irish 'spending classes' will have been tethered to the rolling lockdowns for nearly nine months by the time early December comes around. Some experts are suggesting that private consumption (e.g. dining out & travelling) has dropped by anywhere between 30%-40% since March. It's no real surprise therefore that recent data from the Central Bank of Ireland showed that Irish household deposits grew by an unprecedented €11.8bn in the year to end-Q3 and indicates that household income has remained extremely resilient even though households have become ever more restrained with their spending.

- The ECB is fully aware that the cost of servicing its wall of freshly minted debt will be virtually unsustainable in the medium to longer term without it pushing and keeping real rates in uber-low/negative territory for years to come. This renewed commitment from the ECB to 'lower for longer' interest rates in tandem with this huge glut of 'excess savings' will probably see negative deposit rates start to slowly trickle down to the Irish retail market. Our fear is this will happen sooner rather than later.

- A timely reminder coming from the Dutch Central Bank President and ECB Governing Council member, Klaas Knot. On 18 October, he went on record saying that he does not "see any factors looming on the horizon that would make me think that interest rates will change significantly in the coming years." Unfortunately, that puts the euro depositor squarely in the ECB's cross hairs for the foreseeable future and one of the weapons of choice in its arsenal of "unconventional" monetary policy tools is negative interest rates. Irish retail depositors should be fully prepared to go sub-zero in the near future.

Investec Treasury: Commodities

Oil continues to track risk assets higher

Brent Crude Front Contract

Source: Bloomberg

- Brent crude oil traded over $45/barrel this week, breaking all of its moving averages and the highs of last month. The next big target would be the post-COVID high of 46.53 $/b set at the end of August. Is the move justifiable on the strength of a vaccine when only 50m doses will be available this year? Is the oil market being caught up in a forward looking asset rally that does not reflect the present realities? Back in August it looked like the virus was fizzling out across the world and it was expected that oil demand would continue to recover through the rest of the year. The reality has been more mixed as much of Europe went back into lockdown and so it might seem odd than Brent is returning to those levels.

- Taking a step back, all Brent crude oil has really done since the lows at the end of October, is move back into the 39 to 45 range it traded in over the summer. This has perhaps brought an end to the moderate downtrend from the end of August, but the emergence of a vaccine does diminish the prospect of continued harsh restrictions and on-off lockdowns through 2021. With the market continuing to reduce inventory, albeit not has fast as had been thought a few months ago, it does seem reasonable for the downtrend to reverse. Brent has also benefitted from speculative players having sold Brent short and there being limited bullish speculative positions when news of the vaccine broke - i.e. speculators buy Brent to cover shorts and add long positions to participate in the rally. The main risk now is perhaps not fundamentals, but that asset markets decide they have got ahead of themselves leading to a correction.

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Commercial Property Market Update

- Last month we discussed financing of CRE and the COVID-19 impact.

- This month we are providing a summary of the extensive high quality CRE research provided by key players.

- You'll also note our colleague Ronan Dunphy's residential market overview in this publication. We noted the attractive residential property alongside has gone sale agreed.

- **CBRE Ireland Bi-Monthly Research Report November 2020 notes-**
    - Office occupiers reluctant to make long-term commitments in the current climate with little urgency in getting transactions signed
    - Until restrictions are lifted & office workers begin their return to their workplaces in a meaningful way, there will be little urgency to commit to leases other than short-term commitments
    - Some softening in headline office quoting rents albeit the magnitude of decline is marginal compared to the very sharp correction that occurred following the Global Financial Crisis
    - An even greater proportion of retail spending in the run up to Christmas will occur online this year. This in turn, is fuelling occupier demand for logistics properties, with rents in this sector increasing of late
    - When new letting evidence emerges, prime headline retail rents likely to be between 10% and 20% below the Zone A rental values that prevailed at the beginning of 2020.
    - Sales processes have become more elongated & decision-making is taking longer, meaning that many of the investments launched for sale during the Autumn season are unlikely to complete until early 2021

44 Fitzwilliam Square, Dublin 2 is sale agreed having been marketed by Lisney at €3.5m.

Investec Private Finance Ireland Limited

Commercial Property Market Update

- **Cushman & Wakefield Irish Investment Market Q3 2020 notes**
    - While COVID-19 has slowed investment activity there was still €251m of investment sales in Q3 2020.
    - There was also a number of encouraging forward commitments totalling €680m in the 3 month period.
    - YTD activity stands at €1.15bn across 64 transactions but year-on-year is down from €2.6bn.
    - Office assets represent 69% of YTD transaction value.
    - Unsurprisingly Dublin accounted for 97% of investor demand.
    - The most significant deal in the quarter was the sale of 2 Burlington Road for €94m.

IPFIL Perspective:

- *We have seen our own lending activity YTD has been predominantly dealing with delayed closings of Q1 2020 transactions.*
- *We are prepared for an increase in activity in Q1 2021 based on new transactions that are coming to market in Q4 2020 and beyond.*

2 Burlington Road was previously owned by Green REIT, which was acquired by Henderson Park Capital for €1.34bn in 2019. (Irish Times)

Contact Details

Corporate Finance

Liam Booth
liam.booth@investec.ie
T: +353 1 421 0345
M: +353 86 2841805

Shane Lawlor
shane.lawlor@investec.ie
T: +353 1 421 0347
M: +353 86 8073904

Tommy Conway
tommy.conway@investec.ie
T: +353 1 421 0358
M: +353 87 6187842

Jonathan Simmons
jonathan.simmons@investec.ie
T: +353 1 421 0351
M: +353 87 6370984

Eoin Kennedy
eoin.kennedy@investec.ie
T: +353 1 421 0386
M: +353 87 986 3426

Treasury

Aisling Dodgson
aisling.dodgson@investec.ie
T: +353 1 421 0084

Philip Ahearne
philip.ahearne@investec.ie
T: +353 1 421 0128

Peter Ellis
peter.ellis@investec.ie
T: +353 1 421 0223

Gearoid Keegan
gearoid.keegan@investec.ie
T: +353 1 421 0098

Alan Harrison
alan.harrison@investec.ie
T: +353 1 421 0086

Mark O'Brien
mark.obrien@investec.ie
T: +353 1 421 0091

Investec Private Finance Ireland Limited (IPFIL)

John McWeeney
john.mcweeney@investec.ie
T: +353 1 421 0005

David Gilligan
david.gilligan@investec.ie
T: +353 1 421 0433

Helen Fitzgerald
helen.fitzgerald@investec.ie
T: +353 1 421 0050

Economics

Ronan Dunphy
ronan.dunphy@investec.ie
T: +353 1 421 0468

Ventures

Leo Hamill
leo.Hamill@investec.ie
T: +353 1 421 0431

Chief Executive Officer

Michael Cullen
michael.cullen@investec.ie
T: +353 1 421 0074

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