Investec Europe
Research Bulletin
September 2020

Out of the Ordinary®

Contents

Executive Summary

In September's Research Bulletin we look at some of the mixed indications in the domestic economic data at present and round-up international trends as economic recoveries take hold.

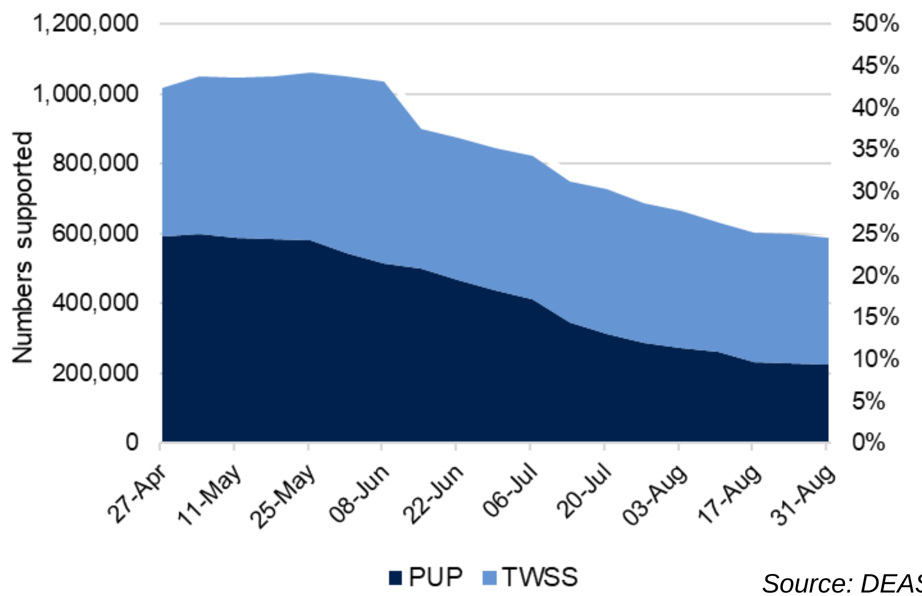
Investec Treasury summarises the latest Brexit-related currency moves and looks at what renewed volatility in oil markets means. We also have contributions from Investec Corporate Finance, who examine the capital raising activities of Irish and UK listed companies, and Investec Private Finance Ireland Limited, who look at the latest trends in the residential market.

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

Economic Update: Ireland

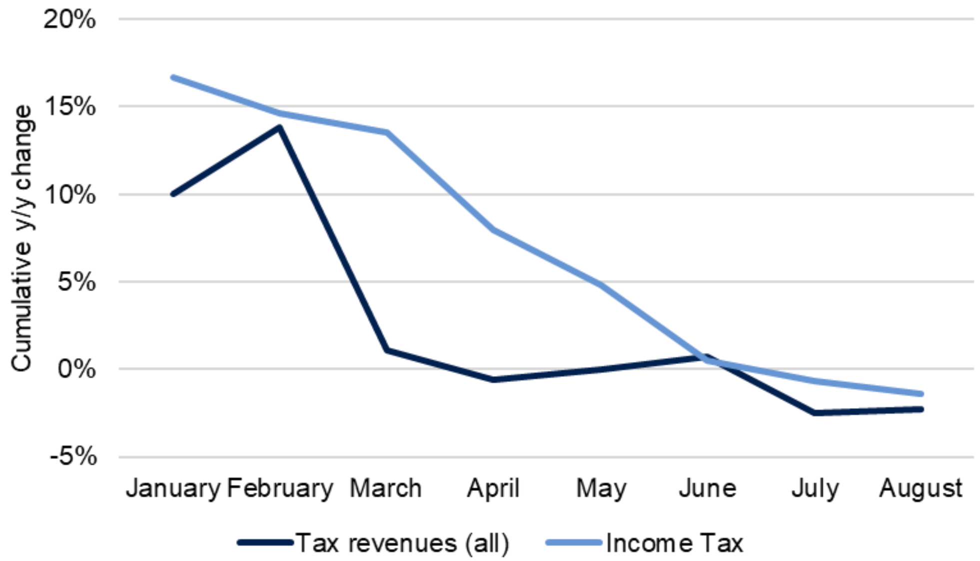
Economic resilience to be tested as caution abounds

Key pandemic income supports



Source: DEASP

Tax revenues: y/y change in 2020



Source: DoF

- **Labour market gains gave slowed:** The total number of Pandemic Unemployment Payment (PUP) claimants has declined by 63% from peak to 220k, although the pace of decline has slowed markedly since mid-August. 25% of the labour force is currently being supported by either the PUP or the TWSS (prior to the change to the Employment Wage Subsidy Scheme in recent days), but this figure was 45% in May.
- **Sudden disruption of this scale would be expected to decimate the tax base, but this has not happened:** Total tax receipts in August were within 0.5% of the total in August of last year, and cumulative receipts YTD are just 2.3% lower y/y – a remarkable performance in light of the challenges. Income Tax, the most significant component of the tax base, is just -1.4% YTD with this resilience attributable to a strong early-year performance and the subsequent employment loss being weighted towards low-paid roles. Although VAT receipts are -21% y/y, higher Corporation Taxes have offset much of this fall.
- **Household sector has held up so far, but the Irish consumer is wary**: Spending bounced back in the summer months, and retail sales volumes in June and July were higher than in the same months of last year. However a number of indicators suggest that caution is now the order of the day. Household deposits increased by the largest amount on record in the six months to July this year, consumer sentiment was lower in August than in July and the State income supports are now beginning to taper.

Economic Update: International

Economic trajectory still tied to virus developments

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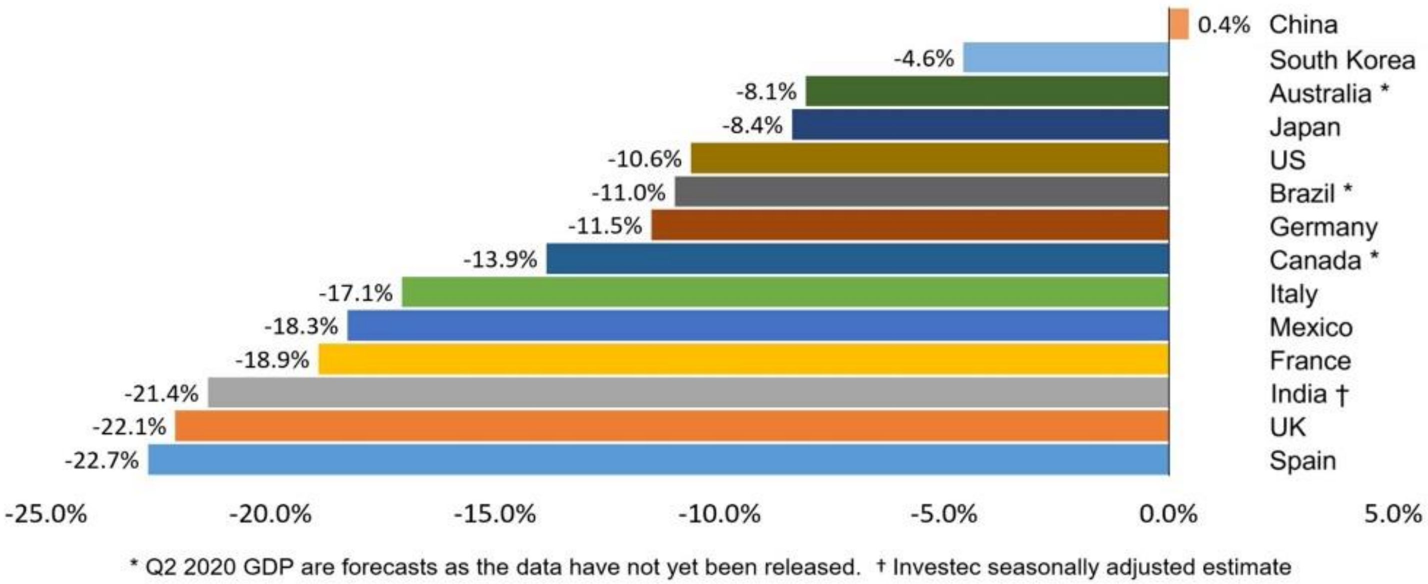


Source: Macrobond, Investec

- **Eurozone**: Q2 saw the Euro area economy contract at the fastest pace on record with a 12.1% quarterly contraction (-3.1% was the previous record), albeit with differences in regional performance influenced by the stringency of individual country lockdown measures and some varying statistical approaches (GDP in Ireland was -6.1%). Q3 is set to see a material rebound given the generalised easing in restrictions through the quarter. Risks remain elevated however as virus cases have climbed again in many countries, most notably in Spain and France. While wholescale lockdowns have so far been eschewed in favour of localised restrictions, at some point the level of cases may become unpalatable for governments prompting more widespread measures. One sign that the recovery is at risk came from August's PMIs with the Composite PMI falling back from July's level.
- **UK**: GDP climbed by a record 8.7% in June as the re-opening of the economy pushed forward, whereas surveys and real-time data indicate the recovery has persisted through both July and August. Despite the positivity, risks to the outlook remain to the downside, not least due to the possibility of a severe second wave. Besides this, the continued stalemate in UK-EU negotiations brings with it the prospect of a cliff-edge at the end of the year.
- **US**: The evolution of the COVID-19 situation in the US looks less concerning given lower daily infections and rapid declines recorded in hotspots such as Florida and Arizona. Despite a lack of agreement on a fiscal stimulus bill in Congress and some related weakness in selected economic indicators, the balance of news has been positive over the past month.

Investec Treasury: Currencies

Back to school, back to Brexit

EUR/GBP: May – September 2020

Source: Bloomberg

- Brexit, like the school bully, seems to be ever present. Those few summer months of blissful reprieve begin to ebb away as the dread of September approaches. Walking through the school gates for the first time in six months and there he is bigger and bolder than ever before. Brexit never went away, it was just cloaked in an even more unappealing haze of COVID-19 related newsfeed. As that very same mist has started to lift in recent weeks so too has market sentiment and the G10 currency that mirrors it the most (sterling) has been buoyed atop that slowly rising tide. Only last Thursday, the pound hit near three month highs (£0.887) against the single currency as US and European equity markets hit all-time and multi-month highs respectively. While the mood music surrounding the Brexit negotiations during the summer months was hardly encouraging, there was phrases such as 'constructive' and 'moving in the right direction' being heard. General consensus however is that it was a wasted summer of unproductive talks and it won't take much or a further deterioration.

- Last week we saw a visibly frustrated EU chief Brexit negotiator, Michel Barnier, say that the UK has "refused to engage on credible guarantees for open and fair competition." If that wasn't bad enough, the 'no deal' rhetoric increased significantly over the weekend as news reports suggested that the PM feels that the Withdrawal Agreement "never made sense" and will need to be rewritten. This recent ramp up in negative Brexit chatter has seen the pound grind lower over the last few trading sessions. The benchmark EUR/GBP rate is now 2p higher than last Thursday's lows, currently sitting around £0.9100.

- We will have to wait and see if Mr. Johnson's new Brexit approach is just political posturing, but this never-ending Brexit uncertainty is concerning. Throw in the (probably) imminent cancellation of the uber-supportive pandemic furlough program and the outlook for the pound in the short/medium term begins to look increasingly negative. With all this in mind, we stand by our mantra of the last few months that for Irish exporters to the UK and sterling sellers in general, anything in the £0.8850/£0.9000 region has, and will continue to be, very attractive.

Investec Treasury: Commodities

Oil volatility back with a vengeance

Brent Crude Front Contract

Source: Bloomberg

- Looking back to March and April this year we became accustomed to oil prices moving by 5% to 10% in a day, while over the last three months oil price volatility had been very subdued. In recent days we have seen volatility pick up and oil markets selling off with Brent crude oil prices falling to 39.31 $/b this week, having traded at 46.50$/b on 1 September. Periods of low volatility often end in a quite spectacular spike in volatility, but how significant is this move in terms of the recovery from the coronavirus demand shock?

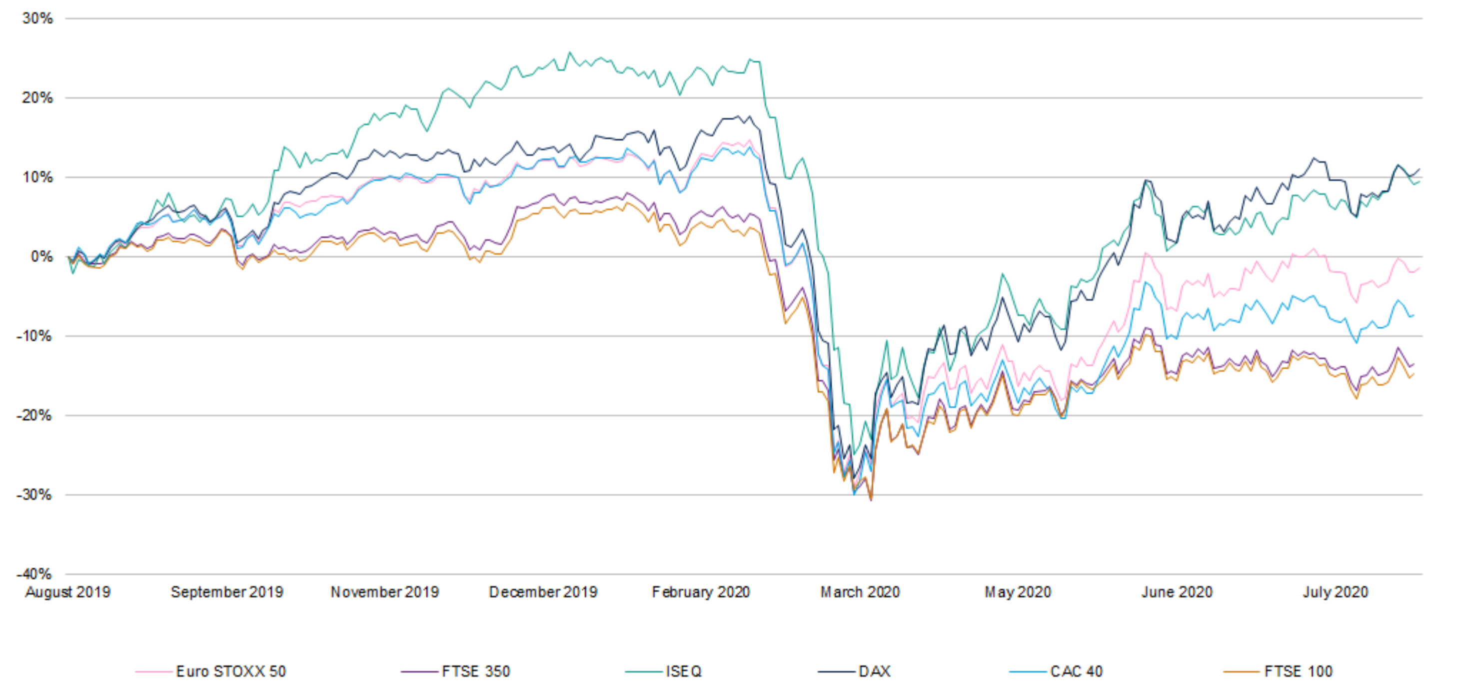
- On the demand side, governments experiencing second waves of increasing virus numbers are unsurprisingly reluctant to re-introduce severe lock-downs, favouring local measures that aim to protect economic activity and oil demand. The number of cases globally has now approached 27.5 million as of 9 September according to Johns Hopkins University data. The question as to whether oil prices will continue lower from here may well depend on whether downward momentum builds in equities. The sharp correlated falls in equities, gold, oil and the rally in the USD that we have seen in recent days have echoes of the moves we saw last March and April.

Investec Corporate Finance

Equity Capital Markets update – Post lockdown recovery remains on track

- The driving factor behind equity markets performance so far this year has been Covid-19 and the impact of worldwide economic lockdowns on global economic activity levels.
- During March 2020 all major European equity indices fell by an average of approximately 40% from their Q1 levels in response to the widespread imposition of lockdowns.
- Since May / June 2020, countries across Europe have been slowly reopening their economies and this has been matched by a recovery of all major equity indices, albeit not all indices have recovered to the same degree and many indices remain below their levels at the start of the pandemic (e.g. FTSE100, CAC40).
- By comparison the ISEQ index of Irish listed companies is trading 10% above its level at the commencement of lockdowns and only approximately 10% off its 12 month highs during Q4 2019.

Key European Equity Indices – 12 Month Performance



- As such, the ISEQ index is one of the top performing indices in Europe and most Irish company share prices are at or above levels in early March 2020.
- A major feature of equity markets globally since the commencement of the pandemic has been a high level of secondary issuance by listed companies.
- This was primarily for the purpose of ensuring that these companies had sufficient capital available to both weather the impact that Covid-19 would have on their businesses and also to be able to move quickly to take advantage of investment opportunities that would arise during or after the pandemic.
- On the London Stock Exchange, over £15bn in secondary issuance was raised by over 150 companies during the first half of the year of which over £10bn was raised during Q2 2020 when share prices were at their most depressed levels.
- By comparison, companies listed on Euronext Dublin (formerly the Irish Stock Exchange) raised little or no additional capital during the same period (Hostelworld was the only exception, raising €14mn at the end of June 2020).
- Since then, Dalata Hotels and Ryanair have raised almost €500mn on equity markets, albeit off far better share prices from the perspective of existing shareholders.
- This likely reflects the strong capital position of most companies listed on Euronext Dublin leading into the pandemic and a greater ability to pick the most opportune time to raise additional capital to support the balance sheet.

Investec Private Finance Ireland Limited

BPFI mortgage data demonstrate resilience in demand through pandemic so far

- With daily media coverage of the impacts of the COVID-19 pandemic and its negative economic effects, it would be easy to overlook some positive data in respect of activity and transactions in the mortgage space.
- According to BPFI data, mortgage approval volumes continued to recover in July, while remaining 30% below year earlier levels.
- Approvals by value amounted to €811mn in July, compared with €1,162mn in July 2019.
- This was a decent increase however on the €536mn of approvals recorded in June and the 30% y/y decline was a steady improvement on the y/y falls of 61% in May and 48% in June.

- The first-time buyer segment led July's improvement with FTB approvals down just -25% y/y and likely helped by the expansion of the government's Help to Buy scheme.
- The recovery in the mover-purchaser market was much slower last month with approvals still -46% y/y – both segments had recorded very similar y/y declines of 54% and 55% respectively in June.
- Mortgage approval volumes were unsurprisingly at very depressed levels through Q2, so an improvement is welcome even though the total in July was still significantly below normal levels.
- It will be interesting to see whether the pace of recovery holds in subsequent months or whether the slower recovery now manifesting in other indicators (e.g. employment, confidence) also hits the mortgage market.

Transactional activity holding up at Glenveagh in H1

- Turning to transactional data, Glenveagh Properties' recently published H1 interim results reflect the disruption of the pandemic on the new homes sector while at the same time demonstrating signs of resilience in demand and stability of pricing in the starter homes bracket.
- Encouragingly, price inflation at the group's starter-home segment was "marginally positive" in H1 while the order book has expanded to 906 of sold, signed, or reserved units reflecting robust demand.
- Looking forward, Glenveagh now expects to deliver 650 units this year and 1,000 in 2021. Although pre-pandemic guidance was 1,000 and 1,400 units respectively, the group has reiterated its ambition of scaling to 3,000 units per annum.
- Reflecting the resilience of the starter-homes market, ongoing demographic pressures and structural supports such as the Help-to-Buy scheme, Glenveagh has now tightened its focus on this market segment. The sale of higher-priced properties, such as those at Greystones Marina Village and Proby Place, Blackrock, will now be accelerated.
- While Glenveagh's lofty volume ambitions may now take longer to fulfil, the medium and long-term fundamental housing requirement in Ireland is a long way from being met by current supply.

Notable increase in lending enquiries at Investec

- Our experience at Private Client Lending reflects this slowdown in activity in H1.
- However we have observed a noticeable increase in new enquiries for support in non-mortgage lending transactions since late August and into September.
- This increase in activity is driven in part by the "return to school" season which has brought some sense of normality to daily routines that impact across the economy.
- We note that counterparties with an ability to transact are seeking to capitalise on opportunities that currently exist in the market.
- While remote working is continuing across the board, there appears at least to be an increased pace and focus to "get things done" in the professional sectors which are involved in all stages of the larger re-finance and acquisition projects.
- Our focus is to continue to support a sub-set of the market with Specialised Lending solutions in the provision of funding for re-finance and acquisition projects in the Dublin market in particular.

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