Irish Economy Monitor

Q2 2018

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Contents

General View on Ireland: Q1 slowdown proved to be ‘snow problem’

High frequency data suggest that growth has gotten back on track after a soft patch in late Q1. The indications are that Ireland will remain one of the fastest growing developed economies this year.

1. Activity has rebounded from the weather-related disruption seen in Q1, with the Manufacturing, Services and Construction PMIs at three, four and 12 month highs respectively in May.
2. Total employment rose 3.1% y/y in Q417. We believe the Q118 data, when released, will show that the total number of people with a job has finally eclipsed the Q407 peak of 2.24m.
3. Unemployment has fallen to a 10 year low of 5.8% and the employment components of the PMIs suggest that it will continue to fall.
4. The CSO’s new method of counting housebuilding shows that new supply is running at less than half the rate of new household formation. House price (+13% y/y in April) and rent (+7.0% y/y in May) inflation will remain sharp. Elsewhere, the fundamentals remain strong in the commercial property sector.
5. Monthly merchandise trade data paint a positive picture, with export growth of 5.9% y/y in the year to date, while the January – April trade surplus (€18.3bn) is 13.0% above year-earlier levels.
6. Growth in tax receipts has accelerated as the year has gone on, turning an undershoot into a 40bps outperformance by the end of May. Lower than expected spending has also helped the year to date general government balance (-€2.4bn) to come in €603m better than had been guided.
7. In terms of the key risks, these haven’t changed since our last report, namely: Brexit (c. 14% of headline exports go to Ireland’s closest neighbour); Rising protectionist sentiment; and the potential fallout from monetary policy normalisation moves. In terms of domestic politics, as discussed on slide 12 we don’t see a credible ‘window’ for an election until 2019, when the logistics of waging national campaigns may see the government opt for a triple crown of general, European and local elections on the same day. In any event, the government’s poll lead suggests that a general election, whenever it comes, is unlikely to result in meaningful policy changes.

Forecast Summary: High frequency indicators support an upgrade

High frequency indicators show that while the inclement weather cooled growth in Q1, activity has picked up since the start of Q2. The PMIs are all at multi-month highs; the annual rate of growth in tax receipts surged to 8.6% in May; and exports are performing strongly.

As we noted in the last Monitor, were you to hold quarterly GDP flat on Q417's outturn, this would produce growth of 5.5% this year. Despite this, we had prudently assumed growth of 4.4% due to concerns about the volatility of Irish national accounts and uncertainties around a number of key trading partners. Given the strength signalled by recent data, we raise our GDP growth forecasts by 60bps (to 5.0%) for 2018 and by 50bps (to 4.5%) in 2019. The forecast for this year is still probably a little conservative, although the bad weather in February and March and (presumed) revisions to national accounts from the new approach to measuring housebuilding in Ireland warrant caution.

On the public finances, as noted above a sparkling performance from May's Exchequer returns put tax receipts 40bps ahead of target for the year to date, while spending is also lower than had been guided. However, a recent CSO ruling means that a surplus is now likely in 2019 instead of 2018.

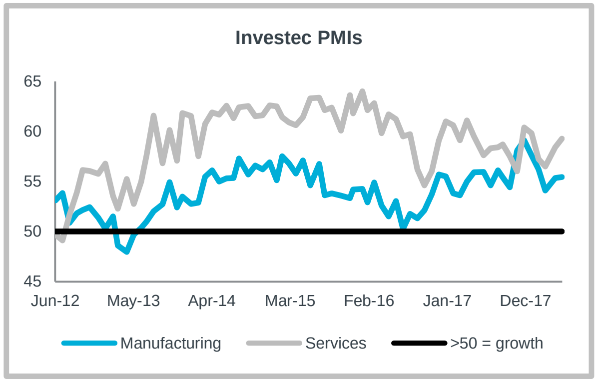
Investec Summary Forecasts, full forecasts are on slides 24 and 25

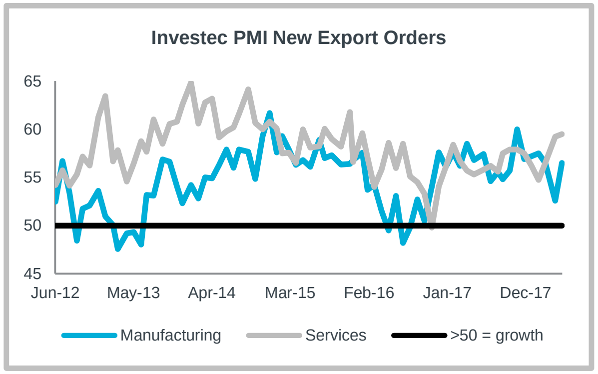
	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
GNP	-0.4%	1.1%	5.5%	9.0%	16.3%	9.6%	6.6%	5.3%	4.9%	4.1%
GDP	3.0%	0.0%	1.6%	8.3%	25.6%	5.1%	7.8%	5.0%	4.5%	3.8%
Gross Domestic Exp.	-0.4%	2.5%	-1.8%	8.3%	9.4%	21.1%	-7.9%	5.3%	4.4%	3.9%
Employment	-1.9%	-0.4%	3.1%	2.6%	3.5%	3.7%	2.9%	2.3%	2.0%	1.8%
General Gov Deficit/GDP	-12.7%	-8.0%	-6.1%	-3.6%	-1.9%	-0.7%	-0.3%	-0.1%	0.0%	0.6%
Gross Govt Debt / GDP	110.3%	119.6%	119.4%	104.5%	76.9%	72.8%	68.0%	64.9%	62.7%	60.1%
Current Account / GDP	-1.6%	-2.6%	2.1%	1.6%	10.9%	3.3%	12.5%	6.6%	7.0%	7.4%

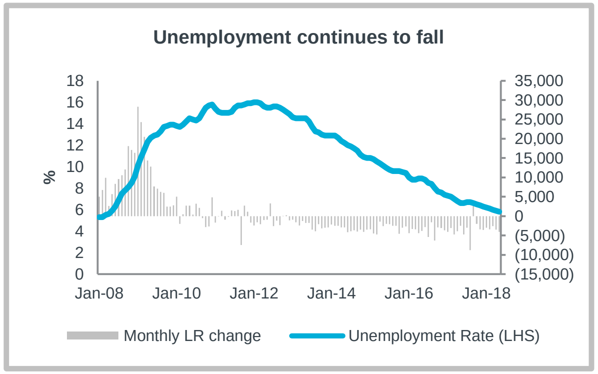
Timely Data

Current Indicators of Economic Activity

Growth rebounded in Q2 after a snow affected Q118





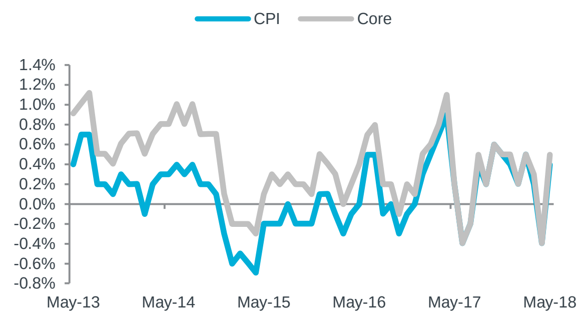


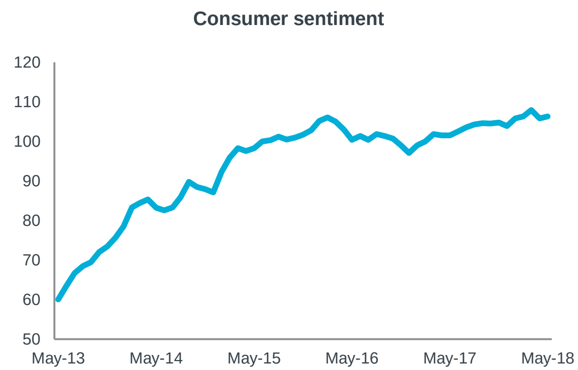
- The PMIs suggest that economic activity rebounded in Q2 after being negatively impacted by the unusually cold weather in late February / early March. The headline Investec Manufacturing and Services PMIs stood at 55.4 (a three month high) and 59.3 (a four month high) respectively in May, while the Ulster Bank Construction PMI came in at 61.8 (a 12 month high).

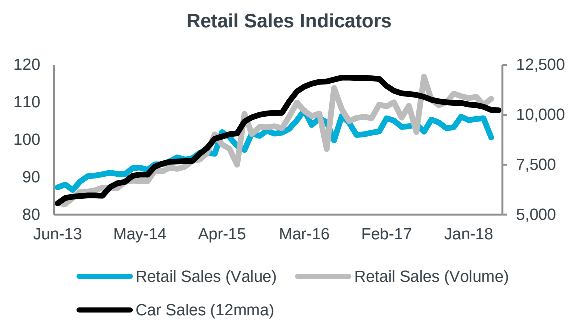
- While there was some evidence of weather-related slowdown in (particularly goods) exports in late Q1, the latest PMIs show an uptick in the growth rate in Q2.

- The labour market remains the main source of good news in Ireland. The latest data show that unemployment has fallen to 5.8%, its lowest rate since April 2008. The number of people ‘signing on’ the Live Register has fallen in all but one of the past 66 months.

Growth has picked up again after a temporary moderation in Q1







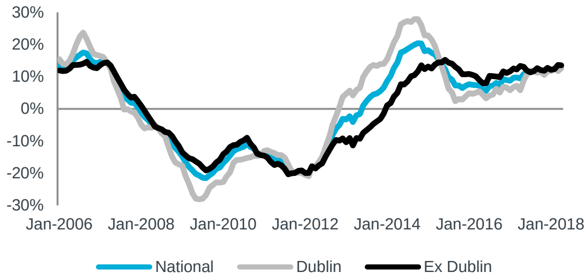
- The headline CPI was +0.4% y/y in May, with the main divisions contributing to the annual increase being Housing (+5.5% y/y, due to higher rents and utility costs); and Restaurants & Hotels (+2.4% y/y, due to rising visitor numbers and the domestic economic strengthening). These have been partly cancelled out by falling Food & Beverage (-2.3% y/y, reflecting deflationary pressures); and 'Miscellaneous Goods & Services' (-3.6% y/y, mainly due to falling insurance rates) prices.

- Headline consumer confidence has remained elevated, augmenting strong real earnings growth in pushing core retail sales higher.

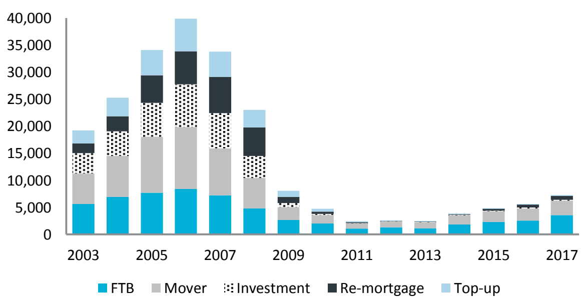
- Headline retail sales growth in April (volumes +4.8% y/y) was flattered by the disruptive weather seen in late February and early March. Headline sales in the year to date have been dampened by ongoing weakness in the new car market (a function of ongoing strong competition from sterling-based dealers). Ex-auto sales volumes have grown 4% y/y in the year to date.

Headline retail sales are still being distorted by weak new car sales

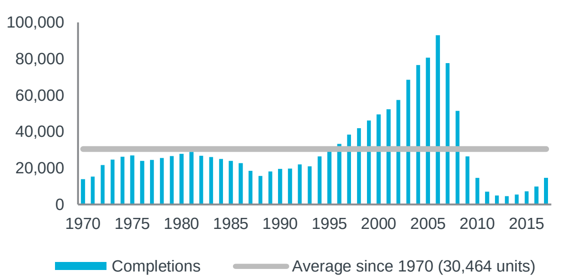
Ongoing strong house price inflation



Mortgage Drawdowns (€m)



Irish Housing Completions (New methodology used from 2011 onwards)



- The Residential Property Price Index (RPPI) continues to post strong gains, rising 0.7% m/m (+13.0% y/y) in April. We continue to see an 8% increase in prices over the course of 2018, as base effects should see the annual rate of growth start to come down later this year.

- Some €7.3bn worth of mortgages were drawn down in Ireland last year. While this was 29% above the outturn for 2016 it is still abnormally low – we estimate that in normal market conditions Irish lenders should be writing c. €12bn of new business per annum. In the current year we see €9.1bn of drawdowns, a forecast that is supported by approvals data (running at €9.6bn on a 12mms basis in the period to end-April 2018).

- For almost 50 years connections to the State electricity grid were used as a proxy for housing completions. A new CSO publication shows that 53,578 units were completed in the period from 2011 to 2017, 37% below what the 'old' methodology (still used in the chart on the left for pre-2011 values) suggested. While completions have trebled since the 2013 trough, at 14,446 units in 2017 they are well adrift of the low end of the range of estimates (30-50k) of annual new household formation.

Despite a recent uptick, housing completions remain abnormally low

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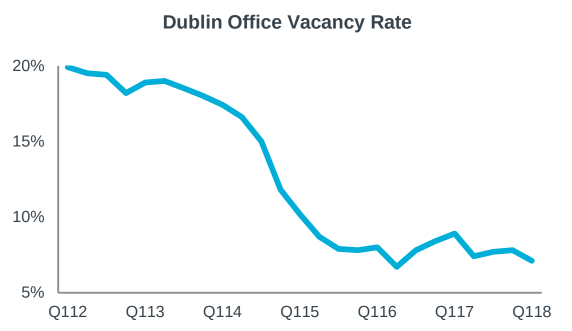

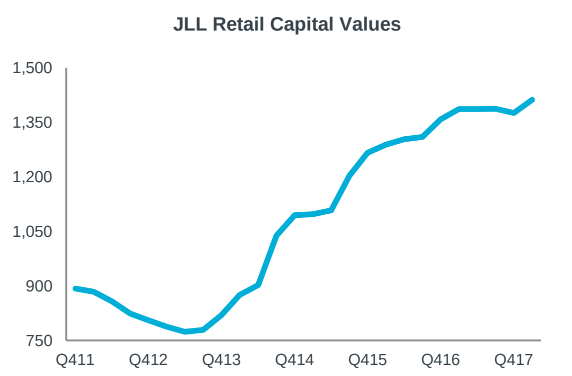

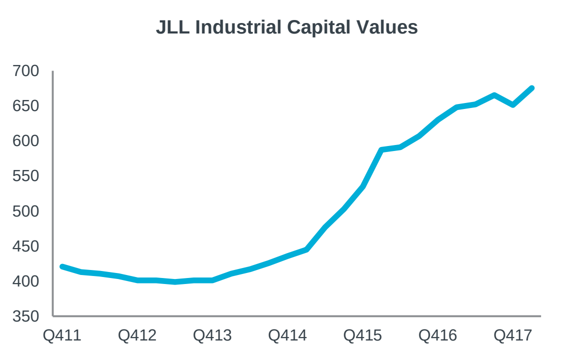

- Prime Grade A office rents in Dublin city centre ticked up to €60-65 psf in Q118, with the uptick in new supply helping to meet occupier needs (take-up was a record 3.6m sq ft in 2017). The headline vacancy rate had increased to an eight quarter high of 8.9% in Q117 but helped by the strong take-up mentioned earlier it has since fallen to 7.1% (in Q118), the second lowest recorded level.

- Retail capital values increased at their fastest quarterly pace (+2.6%) in more than a year in Q118, but this was flattered by the decline caused by the trebling of commercial stamp duty in October's Budget. While the sector is under pressure from a number of structural headwinds, the strong domestic backdrop provides supportive fundamentals.

- Industrial capital values also enjoyed a sharp rise in Q118. Apart from the help offered by a fast-growing Irish economy, the outlook for this sector is supported by an expected structural kicker to growth arising from changes to supply chains in response to the UK's vote for Brexit.

The outlook for Irish commercial property remains positive

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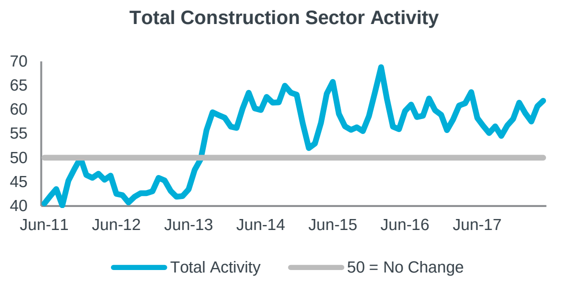

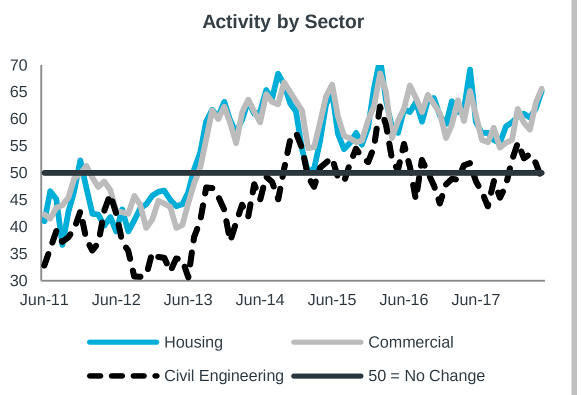

- The headline Ulster Bank Construction PMI surged to a 12 month high of 61.8 in May as the sector continued its recovery from the cooling of growth that was produced by the poor weather in Q1.

- Growth in the construction sector at this time is concentrated in the Housing and Commercial segments, with Civil Engineering dropping back below the 50 'no change' line for the first time in six months in May.

- Q118 planning permissions came in at 8,405 representing growth of 80.8% y/y and the highest quarterly outturn since Q309. However, this growth rate is likely to have been flattered by the fact that this was the first quarter where 'fast track' applications could be made directly to the national planning authority, An Bord Pleanála. These accounted for 62% of the quarterly increase so there's probably an element of front-loading here. On a 4qms basis permissions are tracking at 24,531 units. With actual completions running at 15,193 units in the 12 months to end-Q118 it could be 2021 or 2022 before supply rises to meet demand.

Planning permissions growth flattered by timing issues

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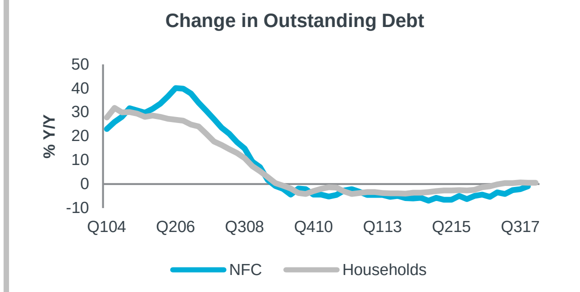

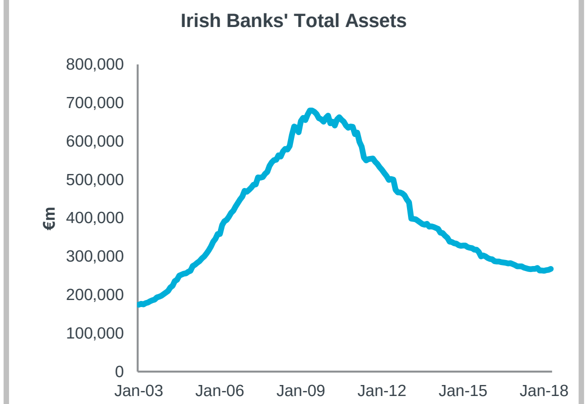

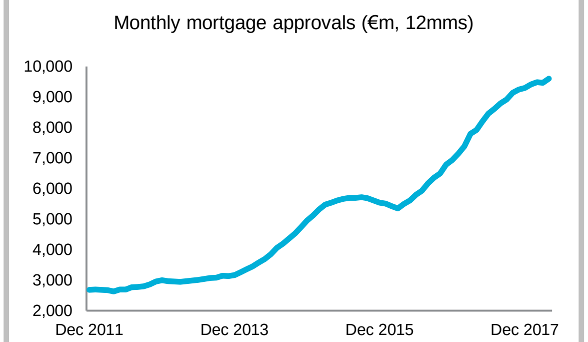

- Central Bank data show that credit outstanding to households rose by 0.5% y/y in Q118, representing a fifth successive quarter of growth on an annual basis. Credit to Irish NFCs fell by just 1.0% y/y in Q417, the slowest pace of decline since Q309. Fuelled by the economic strengthening, the underlying stock of credit outstanding has returned to growth for the first time since the crisis.

- 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 approvals data continue to point to material growth in lending. We see c. €9.1bn of drawdowns in 2018, which would represent a one-quarter increase on the 2017 outturn. Recent housing market data (transactions, prices) suggest that the risks to this forecast lie to the upside.

Credit has returned to growth

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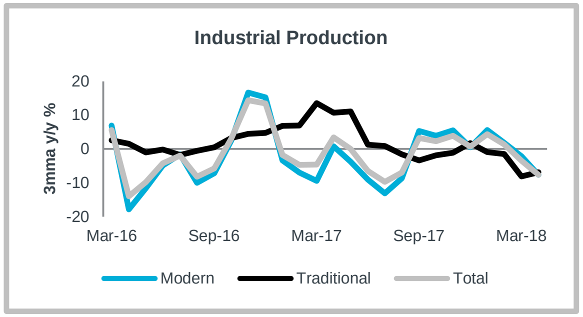
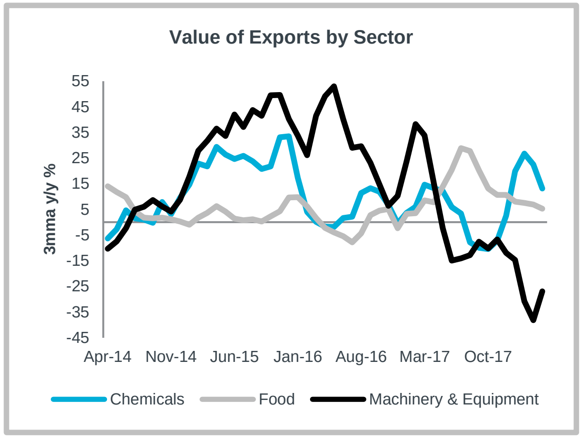
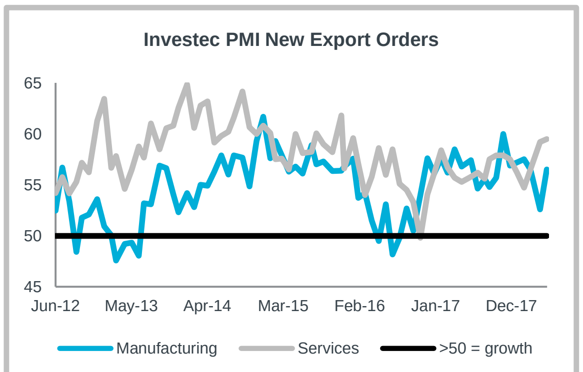
FX headwinds have given way to tailwinds







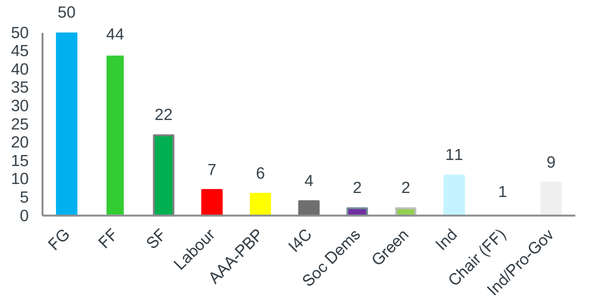
- Industrial production had a tough 2017, falling 2.7%. This outcome will not have been helped by the euro strength seen last year. The recent softening of the euro should help to improve matters in 2018.

- The latest Merchandise Trade data from the CSO points to a stronger headline performance since the start of this year. Year-to-date, exports are +5.9% y/y while imports have increased by 1.4% y/y. This has helped to produce a 13.0% y/y increase in the trade surplus to €18.3bn. However, it is worth noting that this outturn has been driven by strength in a number of segments, notably Chemicals, as opposed to a blanket improvement.

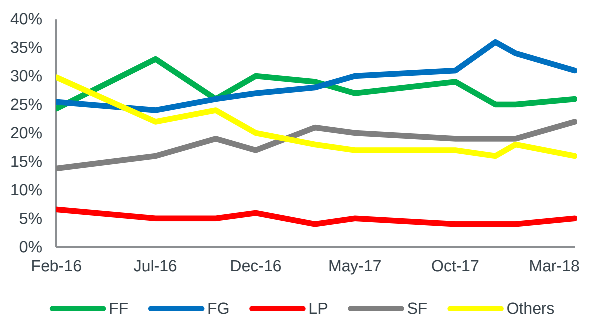
- The Export component of the Investec PMIs points to good momentum on the services side while manufacturing exports picked up in Q2 following the weather-related disruption seen earlier in the year.

Stronger global growth and supportive FX moves should lift exports

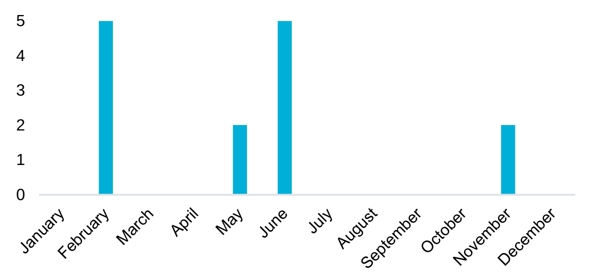
Current Dáil seats (80 = majority)



Irish Times polls since the 2016 GE



Timing of general elections in the past 50 years



- 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. This October will see the third of the three Budgets put before the house, while speculation about fresh elections has picked up.

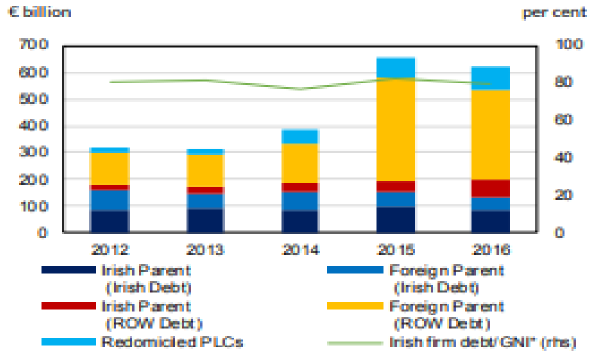
- We are not so sure about a near-term election. The momentum is behind Fine Gael (FG), with recent polls placing it on 30-34%, 7-9pc ahead of Fianna Fáil. However, its traditional coalition partner, Labour, is polling just 6%, meaning that another hung Dáil (i.e. FG minority government) is likely were an election to be held soon.

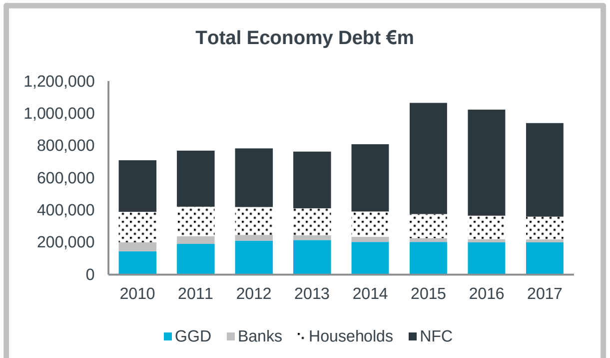
- Another consideration is that there are only a few 'windows' in which a vote is likely to be held. Of the 14 general elections in the past 50 years, 10 of these were held in either February or June, with two apiece in May and November. The November polls were due to the failure of one administration to pass a Budget (unlikely, given the above deal) and the fallout from the early 1990s Beef Tribunal. Absent any political upsets, our bet is that the Coalition will avoid an election until 2019.

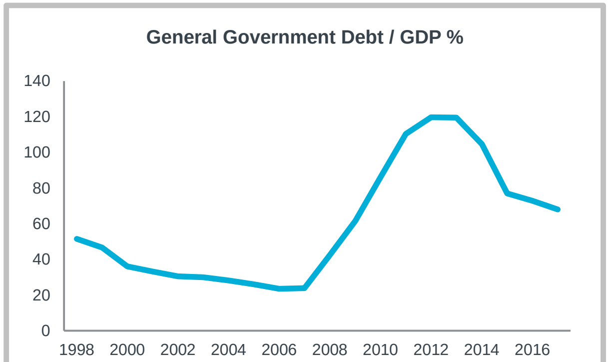
- Does this mean a spring election? Unlikely, given Brexit considerations. What then? Local elections are scheduled for 24 May 2019, the same day as the European elections. Rather than incur the expense and strain of running separate national campaigns in the same year, might politicians decide to go 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 has fallen to c. 80% of GNI*.

- We estimate that total headline economy-wide debt sharply to 317% of GDP by the end of 2017 from 371% 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 124.2% of GDP in 2013. Since then it has fallen sharply (to 68% at end-2017), 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.

Domestic deleveraging likely to end as the economy strengthens

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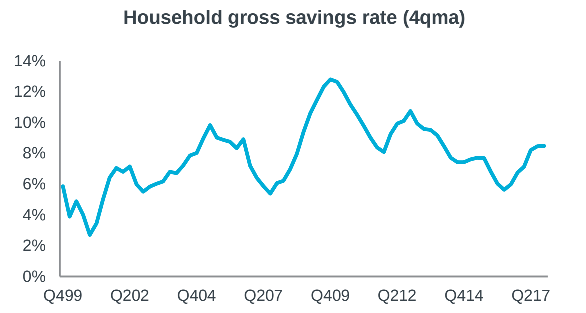
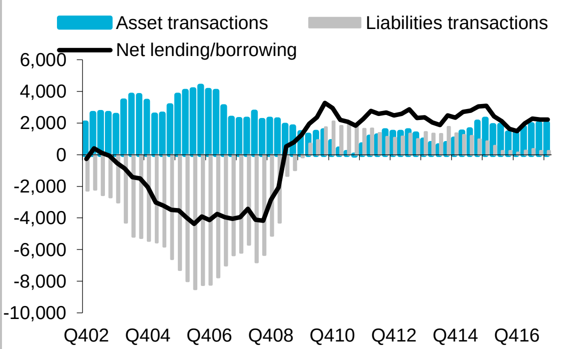
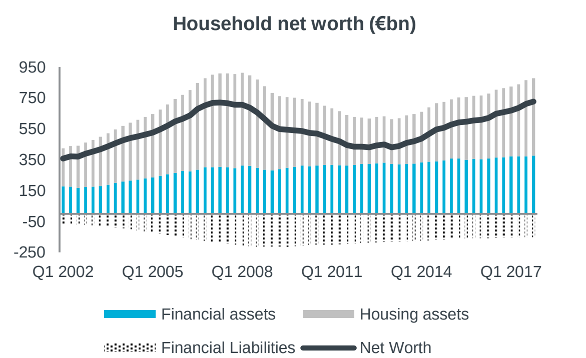
Household Debt

Balance sheets continue to strengthen







- The Irish household savings rate remains quite elevated, particularly given the country's strong demographics. The gross household savings rate was at a 16 quarter 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.

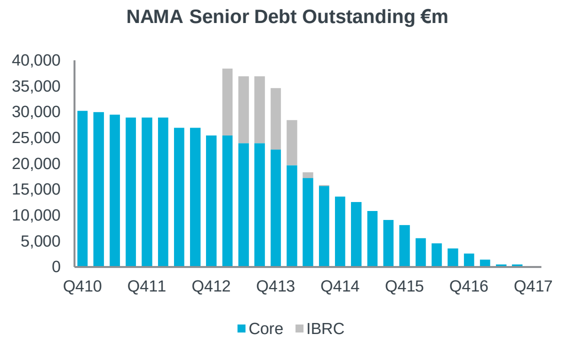
- The Quarterly Financial Accounts for Ireland show the inflection point in the credit cycle, with liabilities transactions (shown on a 4qma basis) about to move back into negative (i.e. growth) territory for the first time since the crisis. The asset side of the balance sheet continues to grow at a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

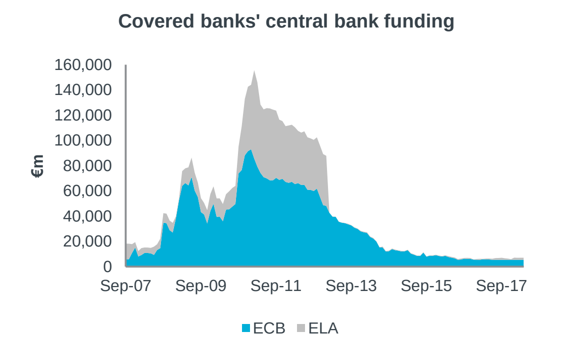
- Other Central Bank data further illustrate the improvement in household balance sheets. Household net worth slumped by 40% during the crisis, but it has since increased by 69% to stand at a new peak of €727bn (1% above the Celtic Tiger era high). Household debt has fallen back to levels last seen in 2005.

Household net worth has increased for 19 successive quarters

Contingent Liabilities

Crisis-linked liabilities are nearly all gone





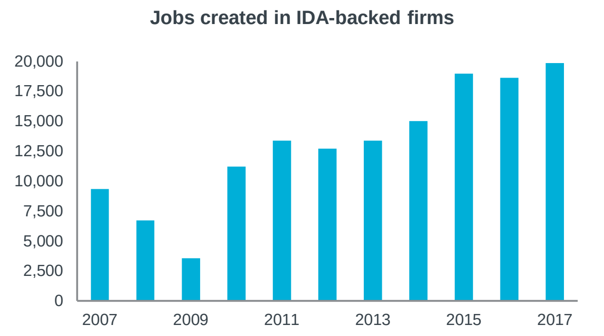
- Total liabilities guaranteed by the State under the ELG scheme (and its CIFS predecessor) have been virtually eliminated (-99.9% from peak). Only €276m of liabilities were still covered at the end of 2017.

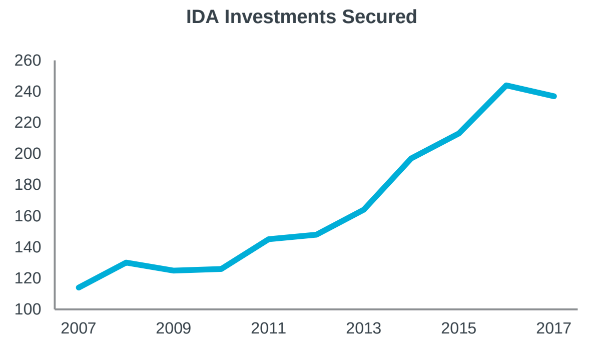
- All of NAMA's government guaranteed senior debt securities have been redeemed, leaving the agency with just €1.4bn of unguaranteed subordinated bonds. NAMA projects that it will deliver a €3.5bn surplus to the Exchequer, guidance we view as conservative (we think that it will make lifetime earnings of up to €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

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 behind 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 (half) of the counties which saw the smallest number of new positions created last year.

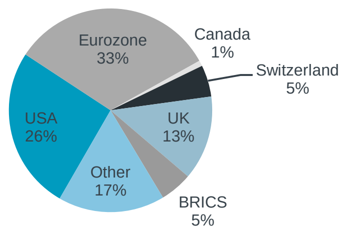
Multinationals directly account for about a tenth of total employment

Investec

Current Account

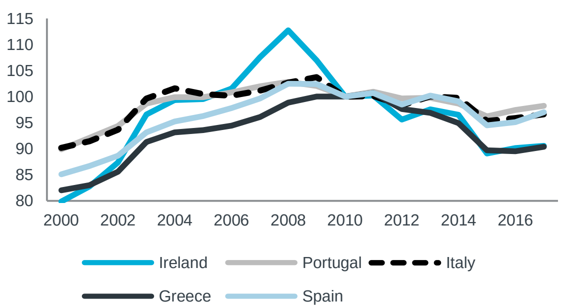
2017 surplus flattered by MNC effects

Merchandise Exports Destinations



Current Account Balance

REER, CPI Adjusted

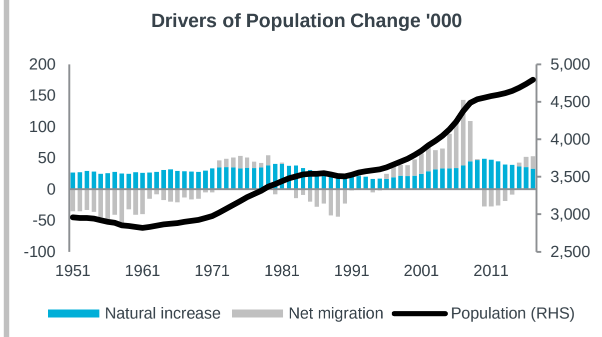


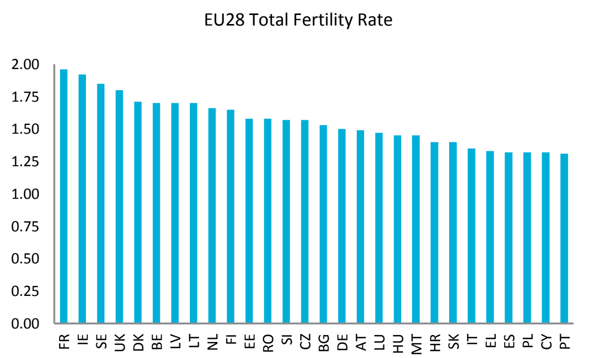
- Approximately 79% of Irish merchandise exports and 66% of Irish services exports go to either Europe or North America. As a small open economy Ireland's performance is particularly influenced by developments in those markets. To this end, the recent weakening of the euro provides a tailwind to Irish exporters.

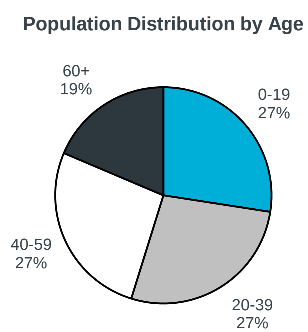
- Ireland's current account surplus widened to a remarkable 12.5% of GDP in 2017, mainly due to a slump in intangibles imports driven by the multinational (MNC) sector. We expect that this surplus will moderate over the coming year.

- 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 post-independence high of 4.79m in April 2017. The population increased at its fastest pace since 2008 in the 12 months to end-April, helped by net inward migration of 19,800 during the period (up from +16,200 in the 12 months to end-April 2016).

- 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.

- 55% of Ireland's population in April 2017 was under the age of 40.

Ireland's favourable demographics are a key differentiator

	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

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	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

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Forecasts

	2010	2011	2012	2013	2014	2015	2016	2017	2018E	2019E	2020E
GNP (2015 = €206.0bn)	3.5%	-0.4%	1.1%	5.5%	9.0%	16.3%	9.6%	6.6%	5.3%	4.9%	4.1%
GDP (2015 = €262.0bn)	1.8%	3.0%	0.0%	1.6%	8.3%	25.6%	5.1%	7.8%	5.0%	4.5%	3.8%
Components of GDP											
Consumption	0.9%	-1.7%	-0.9%	-0.7%	2.0%	4.2%	3.3%	1.9%	2.8%	2.3%	2.0%
Government consumption	-6.7%	-1.6%	-3.8%	0.4%	4.8%	1.8%	5.3%	1.8%	1.9%	1.9%	1.8%
Investment	-14.9%	-0.2%	16.4%	-3.7%	18.1%	27.9%	61.2%	-22.3%	10.1%	9.1%	8.4%
Gross Domestic Expenditure	-3.7%	-0.4%	2.5%	-1.8%	8.3%	9.4%	21.1%	-7.9%	5.3%	4.4%	3.9%
Exports	5.8%	3.2%	1.6%	3.0%	14.4%	38.4%	4.6%	6.9%	4.0%	3.5%	3.0%
Imports	0.4%	2.7%	2.5%	0.9%	14.9%	26.0%	16.4%	-6.2%	4.5%	3.0%	2.8%
Prices											
CPI	-0.9%	2.6%	1.7%	0.5%	0.2%	-0.3%	0.0%	0.3%	0.8%	1.3%	1.8%
HICP	-1.6%	1.2%	1.8%	0.5%	0.3%	0.0%	-0.2%	0.3%	0.8%	1.3%	1.8%
Labour market indicators											
Employment	-4.4%	-1.9%	-0.4%	3.1%	2.6%	3.5%	3.7%	2.9%	2.3%	2.0%	1.8%
Unemployment rate	14.6%	15.4%	15.5%	13.8%	11.9%	10.0%	8.4%	6.7%	5.8%	5.1%	4.6%

	2010	2011	2012	2013	2014	2015	2016	2017E	2018E	2019E	2020E
Revenue receipts (€ millions)	36,230	39,286	41,735	44,687	46,403	54,222	53,687	58,375	58,077	59,954	62,706
Expenditure outlays (€ millions)	54,450	63,907	56,630	56,010	54,434	54,293	54,662	56,468	59,235	61,997	63,570
Exchequer balance (€ millions)	-18,220	-24,621	-14,895	-11,323	-8,031	-71	-975	1,907	-1,158	-2,043	-864
General government balance (€ millions)	-53,711	-21,886	-14,112	-11,020	-6,955	-4,977	-1,842	-1,008	-418	17	2,036
General government balance to GDP	-32.1%	-12.7%	-8.0%	-6.1%	-3.6%	-1.9%	-0.7%	-0.3%	-0.1%	0.0%	0.6%
General government balance to GDP (excluding financial interventions)	-11.2%	-8.5%	-8.0%	-6.0%	-3.6%	-1.9%	-0.7%	-0.3%	-0.1%	0.0%	0.6%
Gross Government Debt (GGD) / GDP	86.1%	110.3%	119.6%	119.4%	104.5%	76.9%	72.8%	68.0%	64.9%	62.7%	60.1%
GGD to GNP, %	103.7%	137.3%	147.9%	141.7%	123.4%	97.9%	88.5%	83.5%	79.5%	76.6%	73.4%
NAMA senior bonds		29,106	25,440	34,618	13,590	8,100	2,590	0	0	0	0
NAMA senior bonds % GDP		16.9%	14.5%	19.2%	7.0%	3.1%	0.9%	0.0%	0.0%	0.0%	0.0%
State liabilities (GGD + NAMA bonds)		127.3%	134.1%	138.6%	111.5%	80.0%	73.7%	68.0%	64.9%	62.7%	60.1%
Net debt (GGD less ISIF, cash) % GDP		96.9%	102.6%	105.4%	95.1%	69.8%	66.7%	62.3%	59.6%	57.6%	55.3%
Net debt, % GNP		120.6%	126.8%	125.0%	112.3%	88.7%	81.1%	76.5%	73.0%	70.4%	67.4%

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Public Finances

Tax revenue performance			
	Actual	**Forecast**	**Variance**
Customs	123	127	-3.1%
Excise Duties	2,075	2,143	-3.2%
CGT	162	153	5.9%
CAT	73	76	-3.9%
Stamp	539	562	-4.1%
Income Tax (+USC)	8,090	8,109	-0.2%
Corporation Tax	2,081	1,834	13.5%
VAT	6,916	7,021	-1.5%
Unallocated	49	0	n/m
Motor Tax	436	441	-1.1%
Total Revenue	**20,544**	**20,466**	**0.4%**

Source: DoF. Data relate to Jan-May 2018

- October's Budget projected growth in tax revenues of 6.0% (to €53.7bn) in 2018. However, the early Exchequer Returns for 2018 sowed doubt on this forecast, with cumulative revenue growth of 3.6% y/y in the period to end-April.
- However, May's returns showed annual growth of 8.6%, helping the year to date performance to strengthen to +5.0% y/y, which is 40bps ahead of profile (forecast) for this period (i.e. there is a H2 bias to growth baked into the Department's guidance.
- The tax headings give a good idea of the dynamics across the economy. Year to date, income tax receipts are +6.1% y/y, reflecting rising employment and wages. Excise dutires are -7.8% y/y, reflecting muted new car sales. VAT receipts, on the other hand, are +1.3% y/y, broadly in line with the increase in the value of core (ex-auto) retail sales. Capital taxes are showing strong growth, helped by rising asset values.
- On the spending side, net voted (discretionary) spending was 1.3% lower than profile, while debt servicing costs were 1.2% lower than guidance.
- The underlying general government deficit is €603m better than profile in the opening five months of 2018, which gives us comfort in our forecast for the public finances to outperform the Department's guidance of a deficit equal to 0.2% of GDP.

Revenue growth should quicken throughout 2018

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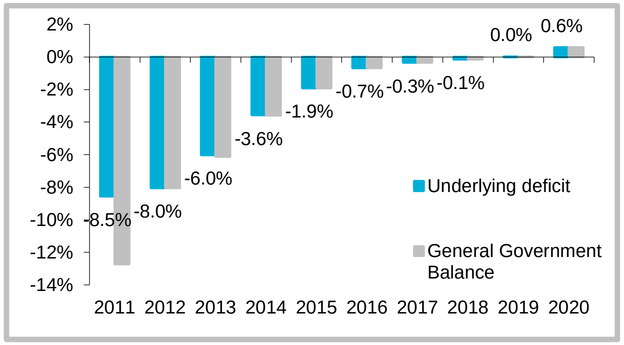

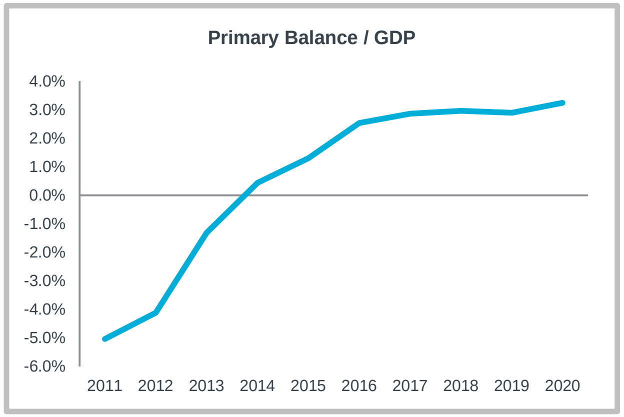

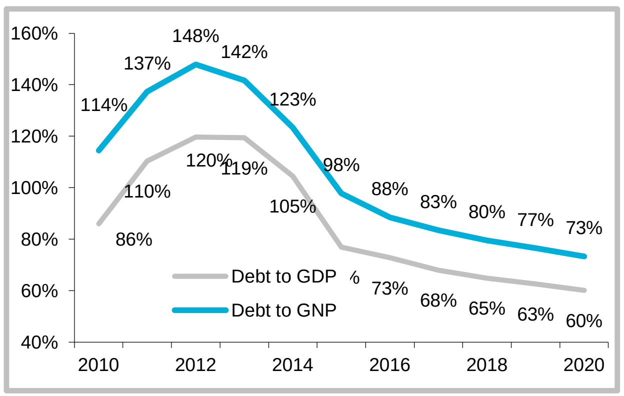

- From the previous slide, we now forecast that the general government balance will transition into surplus in 2019, one year later than we had previously expected but still one year earlier than the Department of Finance projects. This is partly driven by the inclusion of Approved Housing Bodies in the General Government sector following a December 2017 ruling by the CSO, which adds c. €0.5bn to the deficit.

- Ireland achieved its fourth successive primary surplus in 2017. 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 68% at end-Q417). This pace of improvement is flattered by multinational related distortions to the national accounts 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

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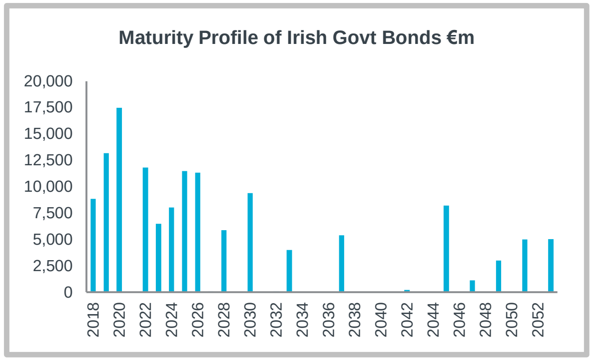

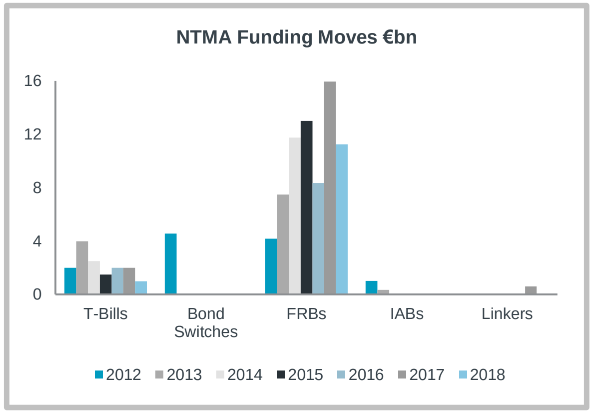

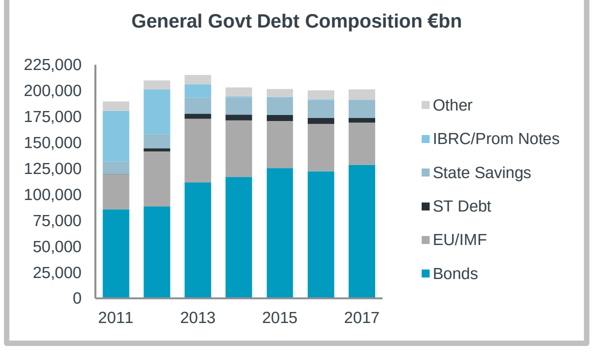

- NTMA secondary market operations, long dated new public issuance (of up to 100 years maturity) and the replacement of €25bn worth of amortising Promissory Notes with new bonds (the last of which doesn't mature until 2053) have all helped to significantly extend the maturity profile of Irish government bonds. The current weighted average maturity of Irish bonds is 9.4 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 has front-loaded this, raising €11.25bn from bond sales by the end of May. In addition, the NTMA has sold €1bn worth of T-bills at negative yields.

- 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.

2018 debt issuance was front-loaded into H1

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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-December 2017 was €3.2bn
  - 93% of loans by loan nominal were non-performing at end-December 2017
  - 63% of NPLs by loan nominal were 120+ days in arrears by end-December 2017

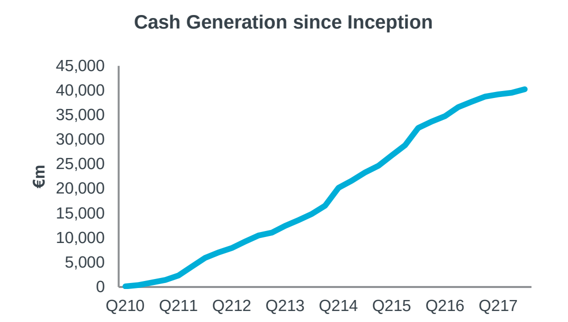
- Breakdown by asset classification at end-Q417 was: Land 36%, Development 26%, Residential 15%, Office 11%, Retail 7%, Hotel & Leisure 3%, Industrial 1%, Other 1%.
- Breakdown by geography at end-Q417 was: Ireland 84%, UK 12%, Other 4%.

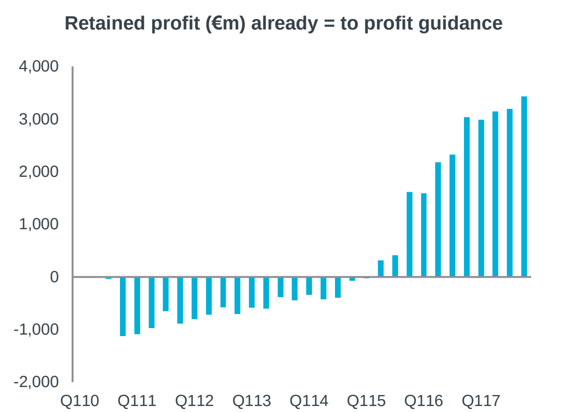
- Following the redemption of all of the government guaranteed senior debt linked to NAMA's core (original) portfolio, the agency's remaining debt securities outstanding at end-2017 were €1.6bn, all of which were subordinated.
  - AIB €0.4bn;
  - BKIR €0.3bn;
  - Another €0.9bn of NAMA subordinated debt was in private hands, of which €0.2bn was redeemed in H118.

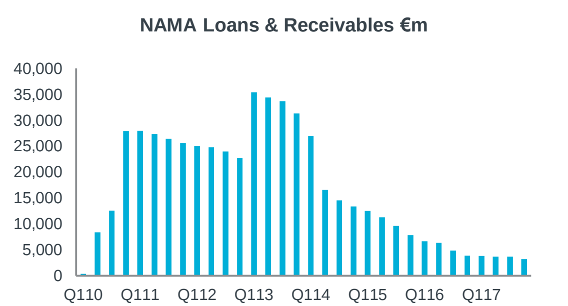
- NAMA redeemed the final €2.6bn of the €30.2bn of senior debt that was linked to the original portfolio in 2017. This served to remove a contingent liability from the Sovereign.

- 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-December 2017 NAMA received cash proceeds from asset sales and non-disposal income totalling €40.1bn.





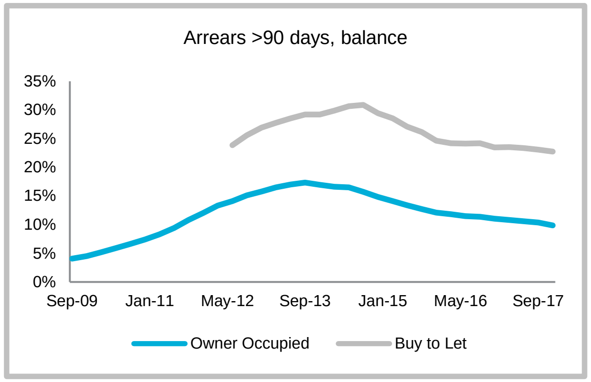


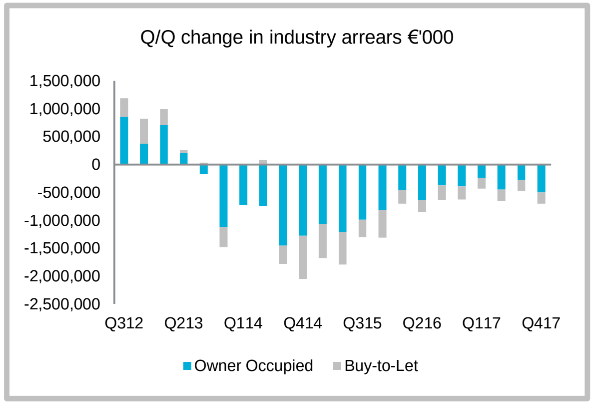
- NAMA has been an impressive cash generator since its inception. By December 2017 it had generated cumulative operating cashflow of €40.1bn.

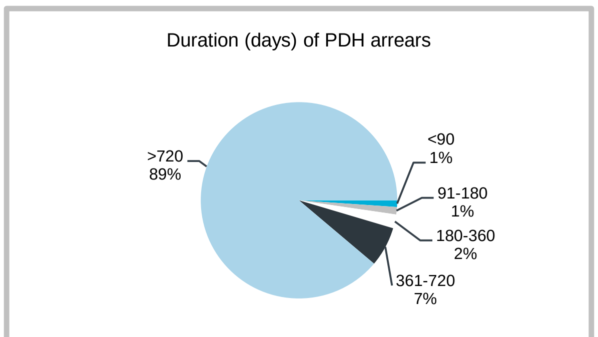
- These cash flows have funded the redemption in full of both tranches of NAMA bonds – those relating to the core portfolio acquired in 2010/2011 and the IBRC related issuance (all of which was subsequently extinguished) in 2013 – while also facilitating significant investment in enhancing the value 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 core equity (total equity adjusted for the sub debt and non-controlling interests) was above €3.4bn at end-2017 while the agency itself has guided that the adoption of IFRS 9 from this year will boost (pre-tax) retained earnings by €150m. 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 seems 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







- The latest Central Bank of Ireland data covering all banks resident in Ireland show that there were 729,722 PDH (owner-occupied) mortgage loan accounts, with a total balance of €98.5bn, at end-Q417. In the same quarter there were 122,366 BTL mortgages with a total balance of €22.0bn.

- Both segments have seen arrears sharply reduce from peak levels. Some 6.6% of PDH accounts were in arrears of more than 90 days past due (90dpd) in Q417, with the balance on these equivalent to 9.8% 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 14.9% (volume) and 22.7% (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 (€2.5bn) represents 26% of the euro balance on those mortgages for PDH and €1.8bn (36%) for BTL. The high concentration of very long-term arrears (i.e. the most troubled accounts) is a key challenge for credit institutions.

PTSB BTL deal helped the pace of resolution quicken in Q4 2017

- Central Bank of Ireland data for Q4 2017 provide further colour on the stock of restructured mortgages in Ireland:

	Number	Balance ('000)	Arrears ('000)		Number	Balance ('000)	Arrears ('000)
Total No of Restructured PDH Mortgages	**118,477**	**16,020,381**	**310,008**	**Total No of Restructured BTL Mortgages**	**22,265**	**5,116,765**	**161,915**
o/w not in arrears	92,999	11,905,945		o/w not in arrears	17,559	3,960,684	
Restructure by Type				**Restructure by Type**			
Interest Only	3,571	647,623	20,140	Interest Only	2,237	585,438	38,918
Reduced Payment > Interest Only	5,868	1,207,353	54,865	Reduced Payment > Interest Only	4,939	1,444,615	23,506
Reduced Payment < Interest Only	531	103,151	7,771	Reduced Payment < Interest Only	52	11,252	1,158
Term Extension	14,784	1,565,186	40,577	Term Extension	3,642	590,126	20,494
Arrears Capitalisation	39,203	5,973,694	105,499	Arrears Capitalisation	5,035	1,008,717	58,988
Payment Moratorium	1,334	214,228	7,048	Payment Moratorium	256	44,116	1,587
Deferred Interest Scheme	21	3,900	547	Deferred Interest Scheme	0	0	0
Permanent Interest Rate Reduction	117	20,127	224	Permanent Interest Rate Reduction	2	1,045	402
Split Mortgage	27,475	2,747,798	12,818	Temporary Interest Rate Reduction	113	23315	462
Trade Down Mortgage	62	9,632	0	Split Mortage	2,058	270,936	717
Temporary Interest Rate Reduction	5,956	1,167,543	18,321	Other	3,931	1,137,205	15,683
Other	19,555	2,360,146	42,198				

Source: Central Bank of Ireland

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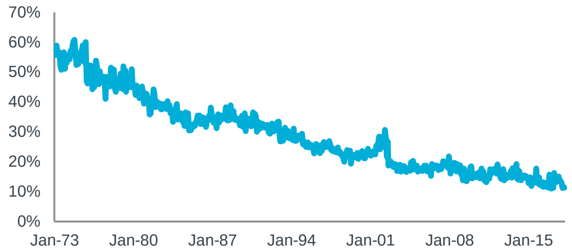
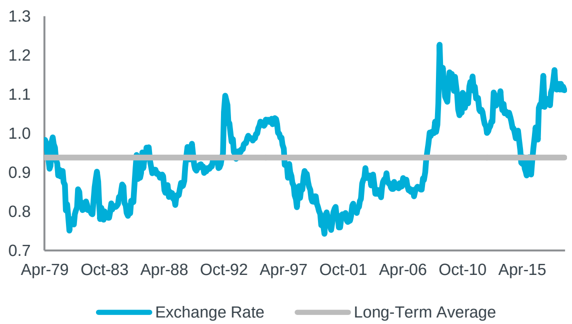
What Brexit Means For Ireland

What Brexit Means For Ireland
Negative, but context is important

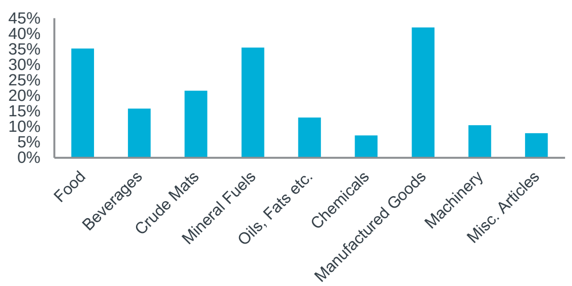
The UK's share of Irish goods exports



GBP per IEP



GB share of certain merchandise exports



- 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 Q118.

- 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

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- Short term:

  - Exports 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 were -10.5% y/y in 2017 and have remained weak into this year) 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 likely informed some of the thinking around Budget 2018, such as around the government's decision 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 is still 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?

- 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.

- 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

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