

## New Irish economic forecasts

### DAVY VIEW

**We expect Irish GDP growth of 5% in 2017, revised up from 3.7%. GDP growth in 2016 was stronger than expected and artificially depressed by a €20bn import of intellectual property assets in the final quarter. In addition, short-term indicators such as PMIs and falling unemployment point to rapid growth in early 2017. We expect consumer spending will grow by 3.4% in 2017 and employment by 2.8%, with the unemployment rate falling to 5.3% on average in 2018.**

### Irish GDP to grow by 5% in 2017, revised up from 3.7%

We now expect Irish GDP to grow by 5% in 2017, up from 3.7% previously. Our first forecast for GDP growth in 2018 is 3.8%. We have revised up our forecasts because GDP growth of 5.2% in 2016 beat expectations, rebounding in H2. In addition, €20bn of imported intellectual property assets in the final quarter of 2016 will push up on Irish GDP in 2017. Short-term indicators such as the PMIs and a falling unemployment rate point to rapid growth in early 2017. The softness in some indicators, mainly relating to the export sector, following last year's Brexit referendum has now unwound.

### Consumer spending to accelerate to 3.4% growth in 2017

We expect consumption will grow by 3.4% in 2017, up from 3.0% in 2016. Despite robust growth last year, household spending was held back by a rise in the savings ratio to 6%. Nominal household spending grew by 4% but was weaker than the 5% rise in household incomes – driven by 3% jobs growth and rising wages. We do not expect a further rise in the savings ratio so consumer spending growth should accelerate to 3.4%. High savings mean that the household debt to disposable income ratio will fall from 136% currently to below the United Kingdom level of 127% before the end of 2018.

### House price inflation of 10% in 2017, mortgage market €7.5bn

The Help-to-Buy scheme and the loosening of the Central Bank rules have added fresh impetus to Irish house price inflation. We have accordingly revised up our forecast for Irish house price inflation to 10% through 2017. With residential transaction and mortgage approval volumes showing strong growth early in the year, we have also revised up our forecast for mortgage lending in 2017 from €6.9bn to €7.5bn.

### Government deficit 0.3% of GDP in 2017, balanced in 2018

We expect the deficit to fall to 0.3% of GDP in 2017 and the debt/GDP ratio to 72%. Our forecast is for a balanced budget deficit in 2018. However, political pressures for spending and tax cuts are clearly growing. If successful, these pressures could lead to a larger deficit but add to momentum in domestic demand.

### Brexit remains the key risk to the Irish economy in 2019

Our base case is that a transitional Brexit deal will be agreed to avoid the worst case scenario of a 'hard' Brexit, where World Trade Organization (WTO) tariffs are imposed in 2019, hurting Irish exports. If not, Irish GDP growth will slow sharply with agriculture, indigenous manufacturers and small- and medium-sized enterprises (SMEs) particularly exposed. The Department of Finance recently estimated that a 'hard' Brexit could reduce Irish GDP by close to 2% within one to two years of WTO tariffs being imposed.

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#### Davy economic forecasts, % change

	2017	2018
Consumer spending	3.4	2.7
Government	2.6	2.0
Investment	-18.8	7.0
Exports	4.5	4.4
Imports	-3.8	4.0
<b>GDP</b>	<b>5.0</b>	<b>3.8</b>
<b>Nominal GDP (€bn)</b>	<b>282.4</b>	<b>298.6</b>
Government Balance (% GDP)	-0.3%	0.0%
Government Debt (% GDP)	72%	71%
Employment growth	2.8	2.3
Unemployment rate (%)	6.1%	5.3%

Source: Davy

**We have revised up our forecast for GDP growth in 2017 to 5% from 3.7% previously**

## Revising up our forecast to 5% GDP growth in 2017

We have revised up our forecast for Irish GDP growth to 5% in 2017 from 3.7% previously. This means that Ireland is once again likely to be the fastest-growing economy in Europe this year, well ahead of the current consensus forecast for 1.7% euro area GDP growth in 2017.

We have revised our forecasts for several reasons. The 5.2% GDP growth recorded in 2016 was slightly stronger than the 4.8% we had expected – with a strong rebound in the second half of the year. Also, some indicators relating to the export sector softened following the June Brexit referendum but have picked up in early 2017, pointing to robust growth. Finally, €20bn of intellectual property assets imported in the final quarter of 2016 should start to contribute to Irish GDP in 2017.

Table 1: Davy forecasts for the Irish economy

	2016	2017F	2018F
Consumer spending	3.0	3.4	2.7
Government	5.3	2.6	2.0
Investment	45.5	-18.8	7.0
Exports	2.4	4.5	4.4
Imports	10.3	-3.8	4.0
<b>GDP</b>	<b>5.2</b>	<b>5.0</b>	<b>3.8</b>
<b>Nominal GDP (€bn)</b>	<b>265.8</b>	<b>282.4</b>	<b>298.6</b>
General Government Balance (% of GDP)	-0.5%	-0.3%	0.0%
General Government Debt (% of GDP)	75%	72%	71%
Employment growth	2.9	2.8	2.3
Labour force growth	0.5	1.2	1.1
Unemployment rate (%)	7.9	6.1	5.3

Source: Central Statistics Office; Davy

### Key features of our new Irish economy forecasts

- Irish GDP to grow by 5% in 2017 and 3.8% in 2018.
- Consumer spending to accelerate to 3.4% growth in 2017.
- Underlying investment should remain robust, up 8.4% in 2017. However, a €20bn investment in intellectual property products in late 2016 will fall away in 2017, pushing the headline growth to -18.8%.
- Government expenditure will rise by 2.6% in real terms in 2017.
- Export growth to pick up from 2.4% in 2016 to 4.5% in 2017 and 4.4% in 2018.
- Employment to expand by 2.8% in 2017 and 2.3% in 2018, sufficient to push the unemployment rate to 5.3% on average next year.

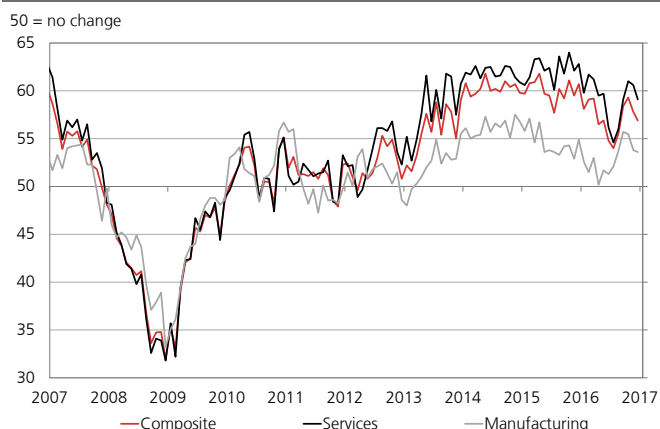
## Short-term indicators rebound, pointing to rapid growth in early 2017

In the aftermath of the June Brexit referendum, a number of short-term indicators on the health of the Irish economy softened. For example, Ireland’s manufacturing PMI fell back markedly in H2 2016 with companies citing softer orders and sterling’s depreciation as holding back the export sector. Indeed, traditional sector (excluding multinationals) indigenous manufacturing output contracted by 0.7% in 2016.

However, most indicators now point to faster growth in 2017. The Composite PMI was 58.7 in April, averaging 58.2 in the first four months of the year and signalling rapid GDP growth. The unemployment rate fell sharply to 6.2% in April, down from 6.9% in December – suggesting that the 3% growth in employment recorded last year is likely to be repeated. Retail sales have also been buoyant, up 6.1% year-one-year (yoy) in the first quarter (excluding volatile motor trades). Clearly, Ireland is set for another strong year of GDP growth in 2017.

**Short-term indicators on the pace of Irish GDP growth have picked up in early 2017**

Figure 1: Irish Purchasing Manager Indices



Source: Thomson Reuters Datastream

Table 2: Short-term indicators on the Irish economy

	2015	2016	2017ytd	Date
<b>Composite PMI (50 = no change)</b>	60.0	57.8	58.2	April
Manufacturing	55.2	52.8	54.5	April
Services	62.0	59.7	60.5	April
Construction	57.5	60.5	58.1	March
<b>Industrial production, yoy %</b>	34.8	0.7	-5.6	March
Traditional sector	4.2	-0.7	2.8	March
<b>Goods exports, yoy %</b>	21.4	4.7	11.5	February
Non-pharmaceuticals	16.2	5.1	9.8	February
<b>Retail sales, yoy %</b>	9.6	6.7	2.3	March
ex-motor trades	7.4	5.4	6.1	March
<b>Tax revenues, yoy %</b>	10.5	5.0	0.5	April

Source: Central Statistics Office; Thomson Reuters Datastream

**The quarterly pattern of GDP and employment growth last year will ensure that calendar year growth in 2017 will be robust**

Calendar year GDP growth in 2017 will be pushed up by a strong base at end-2016. Irish GDP fell by 0.7% in Q1 2016 before rising by 0.8% in Q2, 4.0% in Q3 and 2.5% in Q4. If Irish GDP was flat quarter-to-quarter through 2017, then the calendar year GDP growth rate would still equal 4.0%. The same is true of employment. Even if the level of employment was flat at the 2,045,000 recorded in Q4 2016, it would still be 1.2% higher on average in 2017 than in 2016.

GDP will also be pushed up by the import of €20bn of intellectual property assets in Q4 2016. A conservative estimate is that these assets will provide a 10% yield, or €2bn of revenues. If so, this would add 0.75% to the level of Irish GDP in 2017. Essentially, the purchase of intellectual property assets imported into Ireland in late 2016 will only start to push up the level of Irish GDP in 2017.

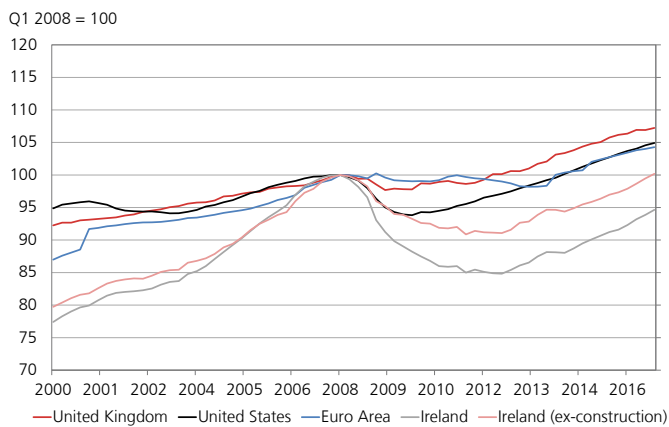
**Despite 2.9% growth in 2016, the level of employment is still 5% below its pre-recession peak recorded in 2008**

## Employment growth remains robust

Irish employment expanded by 2.9% in 2016, with full-time employment growing by 3.2% and part-time work by 1.9%. The early signs indicate that the robust pace of jobs growth recorded in 2016 has been sustained into early 2017. The Central Statistics Office's (CSO) preliminary estimate of the unemployment rate fell to 6.2% in April with 135,800 unemployed, down 47,300 on the year. Ireland's PMI surveys indicated that jobs growth in the services and manufacturing sectors was strong.

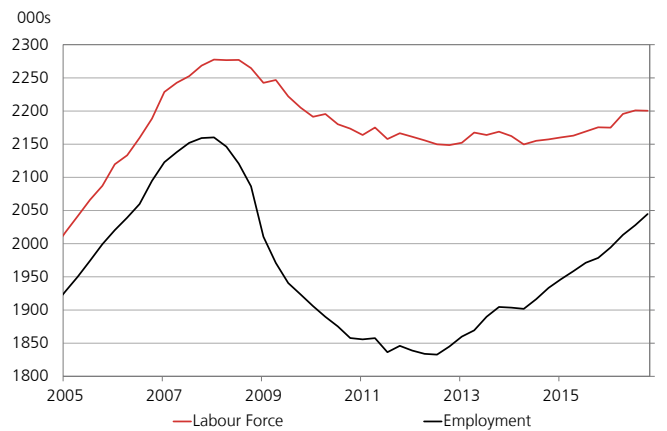
Despite the enormous progress in Ireland's labour market, the overall recovery has been slower than in the euro area, UK and US. The level of Irish employment is still 5% below its pre-recession peak. Even excluding the construction sector, Irish employment has only recently returned to peak 2007 levels. In contrast, the levels of employment in the euro area (+4.3%), UK (+7.2%) and US (+4.9%) are now well above their previous peaks.

Figure 2: Employment levels against peak



Source: Central Statistics Office; Thomson Reuters Datastream

Figure 3: Irish employment and labour force



Source: Central Statistics Office

**Ireland's labour force participation rate remains low, pointing to spare capacity in the labour market**

Figure 3 illustrates that although Irish employment has recovered rapidly since 2013, there has been little pick-up in the labour force. Labour force participation remained weak at 60.2% in 2016, down from the 64.0% peak in 2007. Weak participation has pushed down on the measured unemployment rate.

Our forecast for the Irish unemployment rate is especially uncertain given the results of Census 2016, which indicated that the population is 90,000 larger than the 4.67m originally estimated, mainly due to net outward migration. Most of these extra people are in working-age groups and will be included in the official unemployment rate data towards the end of 2016. It is therefore possible that the unemployment rate will be revised up from its current rate of 6.3% as these revisions occur.

Table 3: Davy labour market forecasts

	2016	2017	2018
Employment	2.9	2.8	2.3
Labour force	0.5	1.2	1.1
Unemployment rate (%)	7.9	6.1	5.3

Source: Davy

**Ireland's household savings ratio rose to 6% in 2016 despite 3% real growth in consumer spending**

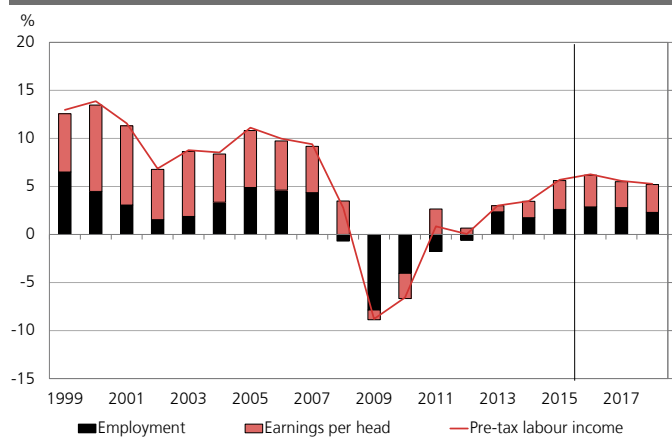
## Consumer spending set to accelerate in 2017

Irish consumer spending grew by 3.0% in real terms in 2016. Although an exceptional pace of growth by European standards, this represented a slowdown from the 4.5% rise in 2015. Furthermore, household disposable (post-tax) incomes grew 5.1% faster than nominal consumer spending at 4.0% (Table 4). In this context, Irish consumer spending growth looks puzzlingly weak.

The CSO data imply that the household savings rate rose to 6.2% in 2016. However, given that consumer credit is now beginning to grow again, up 5% in the year to January 2017, a further rise in the savings ratio now looks less likely.

The consumer spending data are prone to revision and could be revised up. The CSO has indicated that the 3% real growth in 2017 was split between a 6.3% rise in household spending on goods but a very weak 0.4% increase in services. It may be that the true level of consumption of services is stronger and could be revised up.

Figure 4: Irish pre-tax labour income growth



Source: Central Statistics Office; Davy

Table 4: Irish household income growth

	2014	2015	2016	2017F	2018F
Employment	1.7	2.6	2.9	2.8	2.3
Wages per head	1.7	3.0	3.3	2.7	2.9
Labour income	3.5	5.7	6.3	5.6	5.3
Pre-tax household income	5.0	6.6	5.0	4.5	4.3
Post-tax household income	3.9	7.3	5.1	4.7	4.3
Nominal consumer spending	3.3	5.3	4.0	4.6	4.4
Household savings ratio	3.4%	5.2%	6.2%	6.2%	6.2%
Consumer price inflation (CED)	1.5	0.7	1.0	1.1	1.6
Real consumer spending	1.7	4.5	3.0	3.4	2.7

Source: Central Statistics Office; Davy

**Irish household debt, at 137% of disposable income, is set to fall below the UK level of 127% by end-2018**

Looking forward to 2017, we expect household incomes to see another year of strong growth – driven by employment gains and wage rises. We estimate that consumer price inflation will remain muted (close to 1% on average), helping households' real incomes. The key judgement is that nominal consumer spending will grow in line with incomes so that the savings rate remains flat in 2017. This means that consumer spending will expand by 3.4% in real terms in 2017.

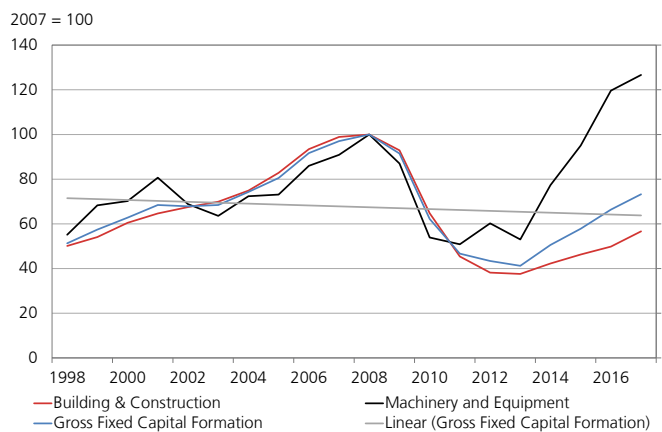
One feature of Ireland's recovery has been the extraordinary reduction in household debt. We estimate that household debt was €142bn in Q1 2017, or 136% of household disposable income, compared with the UK at 127%. Past cuts in disposable income pushed up Ireland's household debt to income ratio, but the opposite is now occurring. We expect household post-tax income to grow by 4.7% in 2017 and 4.3% in 2018. On its own, rising incomes should push Ireland's household debt/income ratio below the UK by end-2018. However, high savings and debt pay-down will probably mean this event will take place in 2017.

Once again, investment spending in 2016 was distorted by activity in the multinational sector

## Underlying construction investment rebounding as FDI remains strong

Ireland’s investment figures are routinely distorted by the multinational sector. Specifically, the aircraft leasing sector and the transfer of intellectual property assets add volatility. In 2016, investment expanded by 45% and we expect a 19% decline in 2017. Figure 5 shows that core investment spending in 2016 was still 27% below peak 2007 levels. However, machinery and equipment spending was 37% above the previous peak. Strong foreign direct investment (FDI) flows into Ireland’s ICT and pharmaceutical sectors have contributed to this recovery.

Figure 5: Core investment spending



Source: Central Statistics Office

Table 5: Total investment spending, nominal (€bn)

	Residential	RMI	Other building	Machinery & equipment	Total investment
2007	16.6	3.5	13.1	8.2	56.6
2008	10.6	3.9	12.8	7.0	46.5
2009	4.6	3.0	8.8	4.4	35.9
2010	2.6	2.2	6.0	4.1	29.5
2011	1.9	1.9	5.2	4.8	29.8
2012	1.6	1.5	6.0	4.3	34.2
2013	1.6	1.7	7.1	6.3	32.9
2014	2.2	1.9	7.7	8.0	39.6
2015	2.7	1.8	8.9	10.2	54.1
2016	3.6	1.9	10.1	10.3	41.2

Source: Central Statistics Office

Capital expenditure on building and construction remains 27% below peak levels

In contrast, capital expenditure on building and construction remains 27% below peak. Housing completions equalled just 14,900 in 2016 – still well short of the natural demographic demand of at least 30,000 per annum. More recent estimates have suggested that the return of net migration, obsolescence and falling household sizes may mean actual demand is closer to 40-50,000 units per annum. Our forecast is for housing completions to rise to 17,800 in 2017 and 21,400 in 2018.

Government capital expenditure also remains subdued. The official forecast is for government fixed capital formation to equal €5.3bn in 2017, or 1.9% of nominal GDP. This is still the weakest level in decades and compares with €10bn, or 5% of nominal GDP, at the height of the Celtic Tiger era. In addition, there is currently 3.6m square metres of office space under construction in Dublin, equivalent to almost 10% of the stock; this follows many years of no construction activity.

Table 6: Davy forecasts for investment spending

	2016	2017F	2018F
Residential Investment	19.0	17.3	14.3
Other Building and Construction	11.4	10.0	8.0
Machinery and Equipment	5.9	8.4	5.8
Other Transport Equipment	15.9	4.0	4.0
Intangible Assets	89.3	-40.0	6.0
<b>Total Investment Spending</b>	<b>45.5</b>	<b>-18.8</b>	<b>7.0</b>

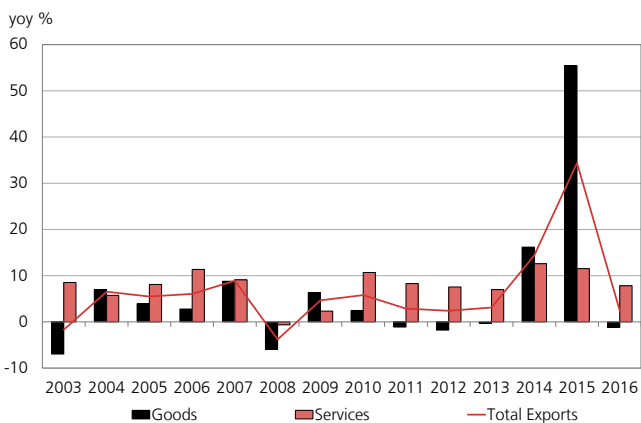
Source: Davy

## Net trade performance to improve in 2017

Irish exports expanded by 2.4% in 2016, a relatively mediocre performance. Services exports rose by 7.8%, recording another strong year of growth related to on-going investment in the multinational-dominated ICT and business services sectors. However, goods exports contracted by 1.2%.

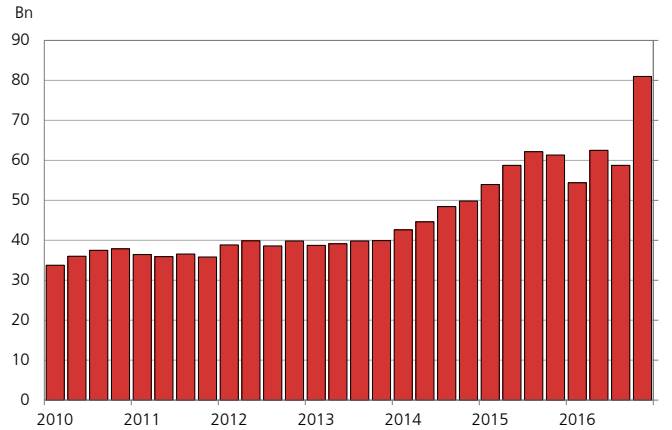
The contraction in Irish goods exports is difficult to analyse given the range of measurement distortions related to contract manufacturing. Monthly trade data indicate that nominal goods exports expanded by 4.7% (and by 5.1% excluding pharmaceuticals) – relatively robust growth. This suggests that contract manufacturing distorted Ireland’s export figures downwards in 2016.

Figure 6: Irish export growth



Source: Central Statistics Office

Figure 7: Nominal Irish imports



Source: Central Statistics Office

**Ireland’s manufacturing PMI weakened markedly in the wake of the Brexit referendum, with companies citing softer export orders and sterling’s depreciation as holding back activity**

**The net contribution to GDP growth was artificially distorted by a surge in imports in the final quarter from €58.7bn to €80.9bn**

Ireland’s manufacturing PMI weakened markedly in the wake of the Brexit referendum, with companies citing softer export orders and sterling’s depreciation as holding back activity. Irish export markets grew by just 2.4% in 2016. This included relatively subdued import growth in France (+2.9%), Germany (+2.9%), Italy (+2.2%), the UK (+2.4%) and the US (+0.9%). However, the OECD’s current forecast is for Irish export markets to expand by 3.3% in 2017 and 3.6% in 2018. Notably, the current consensus forecast for euro area GDP growth in 2017 has been revised up to 1.7% from 1.4% at the time of our last Irish economic forecasts in January.

The net contribution to GDP growth was artificially distorted by a surge in imports in the final quarter from €58.7bn to €80.9bn. This was associated with the import of €20bn of intellectual property assets. The CSO has indicated that the value add associated with these assets should start to contribute to Irish GDP in early 2017. A conservative estimate is that it will add 0.75% to Irish GDP, one reason we have revised up our forecasts.

Table 7: Davy trade forecasts

	2016	2017	2018
Export volume growth	2.4	4.5	4.4
Irish export markets	2.3	3.3	3.6
Current account balance as % GDP	10.2%	4.7%	11.2%

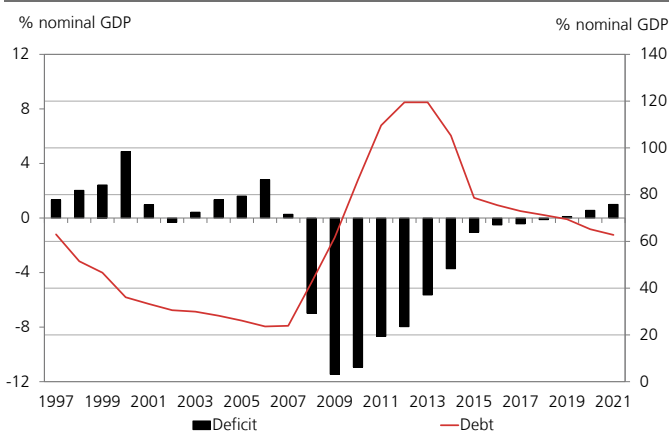
Source: Davy; OECD; Central Statistics Office

## Balanced budget expected in 2018

Ireland's deficit fell to €1.4bn, or 0.5% of nominal GDP, in 2016. The debt/GDP ratio was 75.5%, well down from the 120% peak recorded in 2013. The Department of Finance's official forecast is for Ireland to achieve a small surplus by 2018, rising to 1% of GDP by 2021.

Table 8 illustrates the projections out to 2021. Revenue is forecast to grow strongly, by 3.6% on average through 2017-2021, given robust nominal GDP growth of 4.7% on average. However, expenditure growth is expected to be held in check, averaging just 2.5% per annum – only slightly above the pick-up in HICP inflation towards 2% by 2020.

Figure 8: Irish government deficit and debt (% GDP)



Source: Department of Finance

Table 8: Irish government public finance projections (bn)

	2016	2017	2018	2019	2020	2021
Government revenue	73.0	75.1	78.0	80.7	84.1	87.3
% change		2.8%	3.8%	3.5%	4.2%	3.9%
Government expenditure	74.4	76.3	78.3	80.4	82.3	84.0
% change		2.6%	2.6%	2.6%	2.4%	2.1%
Government deficit	-1.4	-1.2	-0.4	0.3	1.8	3.3
% nominal GDP	-0.5%	-0.4%	-0.1%	+0.1%	+0.6%	+1.0%
Nominal GDP	265.8	280.6	294.7	308.2	321.6	335.1
% change		5.5%	5.0%	4.6%	4.4%	4.2%
HICP inflation	-0.2%	0.6%	1.2%	1.8%	1.9%	1.9%

Source: Department of Finance

**We forecast the deficit to fall to 0.3% of GDP in 2017 and 0.0% in 2018. The debt/GDP ratio is forecast to decline to 72% in 2017 and 71% in 2018.**

Ireland's medium-term fiscal planning is governed by EU fiscal rules. These rules include a limit on expenditure growth – based on the structural growth rate of the economy. In Budget 2017, this limit was calculated at 2.4% in 2017, rising to 4.9% by 2021. Hence, the Budget calculated that there was €9.3bn of 'fiscal space' available for additional spending rises and tax cuts, over and above existing commitments and demographic pressures. Budget 2018 is likely to provide an additional €1-2bn of spending rises and tax cuts.

The big picture is that the austerity years for Ireland's public finances are now over. These included large budgetary adjustments, often worth 1-2% of nominal GDP, deepening the severity of the recession. It remains to be seen whether the EU fiscal rules can prevent the normal pro-cyclical nature of Irish fiscal policy. Our forecast is that the deficit will fall to 0.3% of GDP in 2017 and 0.0% in 2018. The debt/GDP ratio is forecast to decline to 72% in 2017 and 71% in 2018.

Table 9: Davy forecasts for the public finances, % nominal GDP

	2016	2017	2018
General Government Balance	-0.5%	-0.3%	0.0%
General Government Debt	75%	72%	71%

Source: Davy



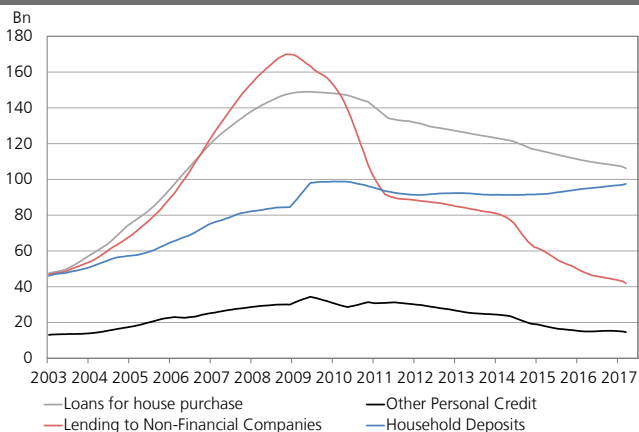
**There are now growing signs that the Irish credit cycle is finally starting to turn upwards after a long period of deleveraging**

## Bank lending: process of deleveraging gradually coming to an end

There are now growing signs that the Irish credit cycle is finally starting to turn upwards after a long period of deleveraging (Figure 9). For example, household deposits in the banking system now equal €98bn, up 2.8% in the year to February 2017, indicative of stronger household balance sheets. Total household deposits in the banking system will soon exceed mortgage lending of €106bn.

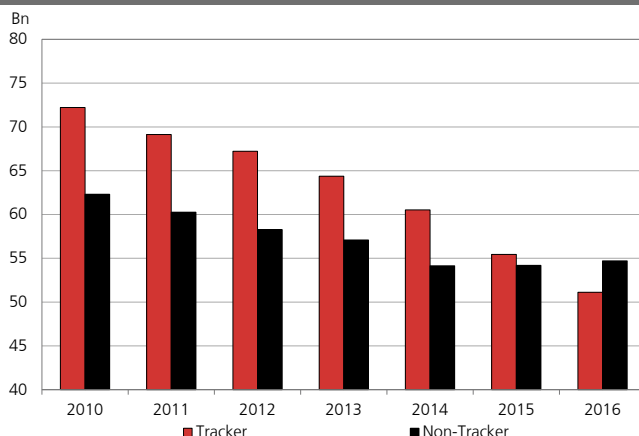
A key development in 2016 has been that consumer credit started to expand, up 5.4% in the year to February 2017. Consumer credit was €11.2bn at the beginning of 2016, well down from a peak of €29bn in 2009. However, after a long period of deleveraging, it grew by 4% through 2016. Notably, the number of active personal credit cards in Ireland has now stabilised, having declined over the past five years, as has the stock of credit card debt.

Figure 9: Irish bank lending



Source: Central Bank of Ireland

Figure 10: Tracker and non-tracker mortgage debt



Source: Central Bank of Ireland

**Higher margin 'non-tracker' and performing mortgage debts are already starting to grow**

A key issue for banking sector profitability has been that household deleveraging was concentrated in 'tracker' mortgage products issued during the peak of the last housing cycle, typically with a low interest margin tied to the European Central Bank (ECB) official re-financing rate. Figure 10 shows that tracker mortgage debt has fallen by 30% from €72bn in 2010 to €51bn in 2016. In contrast, the stock of 'non-tracker' mortgage debt stabilised in 2014 and has started to expand again. Similarly, as mortgage arrears have fallen, the stock of performing mortgage debt has risen.

### Corporate deleveraging linked to the property sector close to complete

Bank lending to private non-financial companies (PNFCs) has contracted from a peak of €171bn in 2008 to just €42bn in early 2017. Figure 11 illustrates that bank lending to property-related sectors now equals just €16bn, down from a €115bn peak in 2008. This deleveraging process, which is close to completion, has been facilitated by the transfer of assets to NAMA and the work-out of non-performing loans. Equity has replaced debt finance through loan sales to private equity but also the emergence of the Irish Real Estate Investment Trust (REIT) sector.

Figure 11: Irish bank lending to PNFCs



Source: Central Bank of Ireland

Table 10: Irish bank lending to PNFCs

	Q1 2003	Q1 2008	Q4 2016	Q4 2016 yoy %
<b>PNFC lending (1)+(2)</b>	<b>48.0</b>	<b>166.9</b>	<b>44.2</b>	<b>-4.5%</b>
<i>property</i>	19.1	109.0	16.2	-12.2%
<i>ex-property</i>	28.8	57.9	28.0	+1.2%
<b>SME lending (1)</b>	<b>n/a</b>	<b>n/a</b>	<b>28.0</b>	<b>-11.7%</b>
<i>property</i>	n/a	n/a	11.9	-14.8%
<i>ex-property</i>	n/a	n/a	16.0	-8.8%
<b>Large PNFC lending (2)</b>	<b>n/a</b>	<b>n/a</b>	<b>16.2</b>	<b>+10.5%</b>
<i>property</i>	n/a	n/a	4.3	-4.9%
<i>ex-property</i>	n/a	n/a	11.9	+18.0%

Source: Central Bank of Ireland

**The process of deleveraging related to the contraction in property-related bank lending is now close to complete with just €16bn remaining**

However, the process of corporate deleveraging has not been entirely linked to property-related sectors. Table 10 illustrates that bank lending to non-property related sectors was just €28bn in Q4 2016, less than 50% of the €59bn peak recorded in 2008. This contraction has been broad-based across sectors. A key point is that bank lending to PNFCs (excluding property) is now at its lowest level since records began in 2003. Moreover, PNFC lending (excluding property) expanded by 1.2% in the year to Q4 2016.

SMEs have been most aggressive in reducing their bank debts. Bank lending to SMEs contracted by 11.7% through 2016 to €28bn (and by 8.8% excluding property to €16bn). As domestic-facing sectors have joined in the recovery, SMEs have responded by paying down bank debts at an even faster pace. However, lending to larger PNFCs rose by 10.5%, evidence that the recovery in the Irish economy is finally feeding into lending growth.

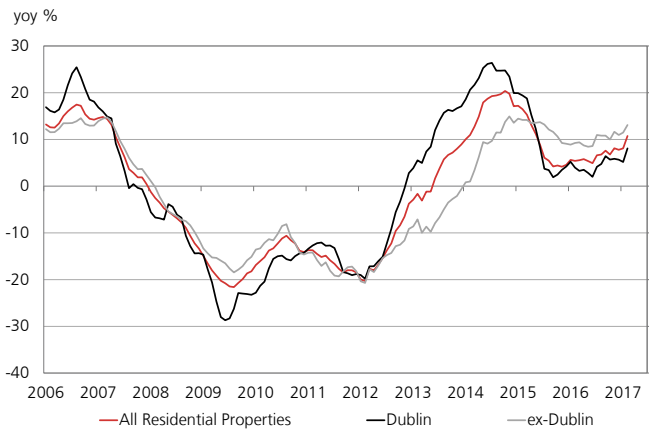
**Irish house price inflation has accelerated above 10%**

## House prices to rise by 10% through 2017

The latest indicators of activity in Ireland’s housing market point to renewed impetus in price and activity. In February, the CSO Residential Property Price Index (RPPI) rose by 1.5% on the month, up 10.7% on the year.

Table 11 illustrates that the housing market in 2016 was characterised by ‘catch-up’ in more rural parts of Ireland where the recovery began later. For example, prices rose by 16% in the south east and west regions. However, the announcement of a new Help-to-Buy scheme and the loosening of the Central Bank’s mortgage lending rules appear to have brought fresh impetus to the market. In Dublin, house price inflation has accelerated from a 2% low in June to 8.3% in February 2017.

Figure 12: Residential property prices



Source: Central Statistics Office

Table 11: Irish residential property price inflation

	2014	2015	2016
All residential properties	17.1	4.6	7.9
House prices	17.2	5.0	7.9
Dublin	19.9	4.2	5.8
Ex-Dublin	13.0	8.7	11.1
Border	9.7	13.3	8.6
Midlands	3.9	20.8	11.1
West	13.4	3.4	15.8
Mid-East	23.8	8.5	7.7
Mid-West	8.9	10.1	10.8
South East	17.1	7.3	16.0
South-West	13.9	10.5	12.0

Source: Central Statistics Office

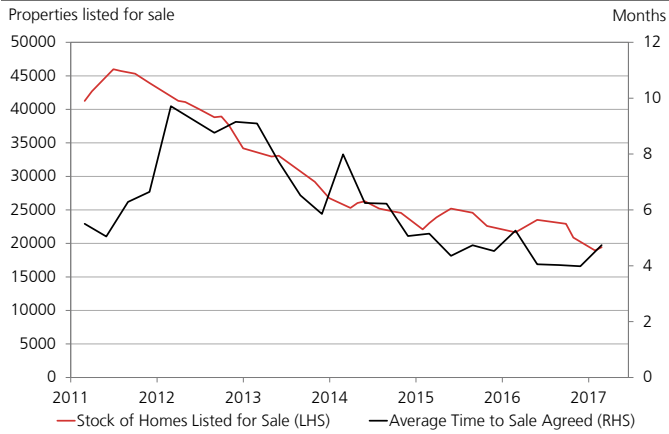
**Developments in asking prices and bank lending point to sustained momentum in Irish house prices through 2017**

Our latest MyHome report paints a similar picture. Asking price inflation on newly listed properties accelerated to 9.0% nationally and to 10.2% in Dublin. Typically, there is a lag of three to six months between asking prices and transaction prices. Recent movements in asking prices suggest that transaction prices will sustain strong momentum through 2017.

The housing market remains exceptionally tight and illiquid. Fewer than 19,500 properties were listed for sale on MyHome in early 2017, less than 1% of the housing stock of 2m homes. Also, the average time to sale agreed fell to just four months (three months in Dublin). In total, there were 47,800 housing market transactions in 2016, comprising just 2.4% of the housing stock.

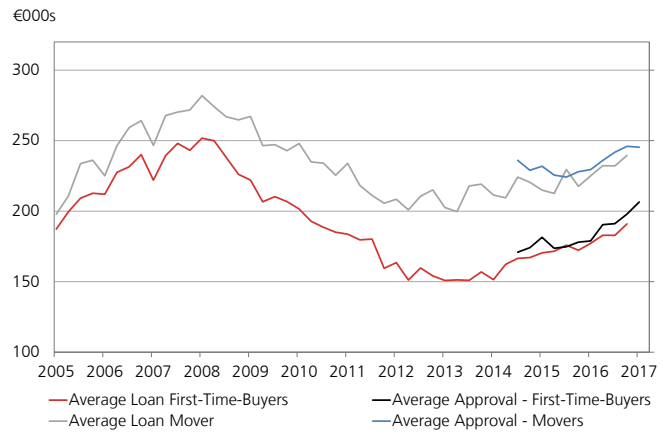
Mortgage lending figures suggest house prices will continue to rise, stimulated by buyers taking out higher levels of mortgage debt. The average mortgage approved to first-time buyers in February 2017 was €206,500, up 15.2% on the year from €179,300 (see Figure 14). The average mortgage approval to mover-purchasers was up 9.8% to €245,400. Taken together, the average approval for house purchase was 11.8% on the year to €214,000. Hence we now expect Irish house price inflation to accelerate to 10% growth through 2017, up from our previous forecast of 8% and the 7.9% recorded in 2016.

Figure 13: Properties listed and average time to sale agreed



Source: MyHome.ie

Figure 14: Average mortgage loan approvals



Source: Banking & Payments Federation Ireland

**We have revised up our forecast for Irish mortgage lending to €7.5bn in 2017, up from €6.9bn previously**

Our forecast for mortgage lending for house purchase to equal €5bn in 2016 was exactly in line with the final data. Total lending equalled €5.7bn, including re-mortgaging and top-ups. Lending in Q1 2017 has shown very strong growth. Drawdowns for house purchase equalled €1.2bn, up 37% on the year. Approvals in Q1 2017 equalled €1.8bn, up 77% on the year. Hence, we have decided to revise up our forecast for Irish mortgage lending for house purchase to €6.4bn and total lending to €7.5bn.

Figure 15: New mortgage lending and housing completions



Source: Central Statistics Office

Table 12: Davy forecasts for mortgage lending

	2016	2017	2018	2019	2020
Mortgage lending for house purchase	5.0	6.4	8.0	9.5	11.0
Top ups and re-mortgaging	0.7	1.0	1.2	1.4	1.7
<b>Total mortgage lending</b>	<b>5.7</b>	<b>7.5</b>	<b>9.2</b>	<b>10.9</b>	<b>12.8</b>

Source: Davy

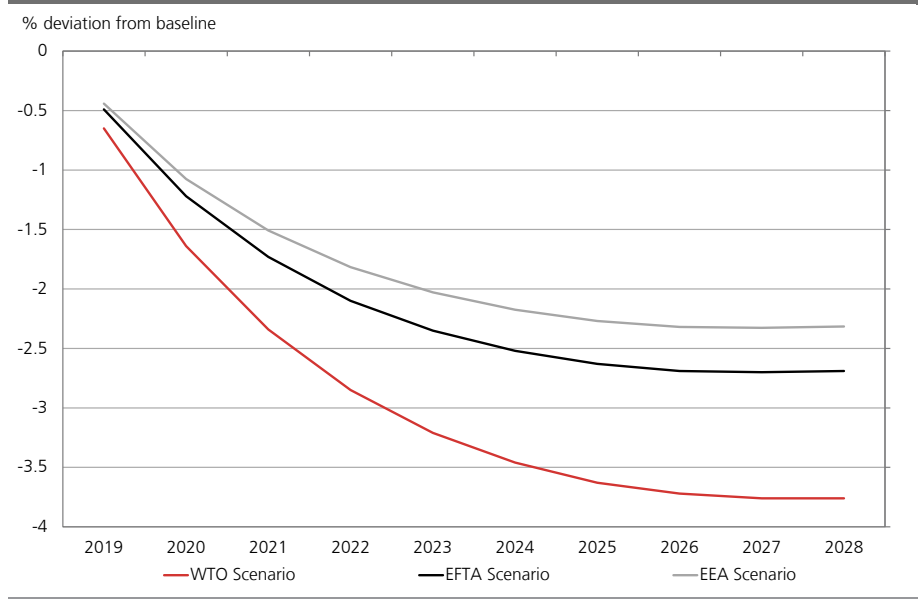
**The Department of Finance has estimated that a 'hard' Brexit might reduce Irish GDP by 2% within one year of WTO tariffs being imposed**

## Brexit the key risk to the Irish economy

Brexit is the key risk facing the Irish economy in the medium term. So far, the impact has been confined to a weaker sterling exchange rate – with a limited effect on export performance. The key issue is whether a 'hard' Brexit, including the imposition of WTO tariffs in 2019, will take place. Our base case is that this scenario will be avoided, either through a transitional deal or an extended negotiation period.

However, the possibility remains that EU and UK negotiators will fail to come to an agreement. If so, a 'hard' Brexit would have a significant negative impact on Irish GDP growth. For example, the Irish Department of Finance and the Economic and Social Research Institute (ESRI) recently estimated the impact of various scenarios for EU/UK trade after Brexit using a macro-econometric model. In the WTO scenario, Irish GDP would be 1.5-2.0% lower within one year, relative to a baseline forecast.

**Figure 16: Estimated impact of Brexit on Irish GDP**



Source: Department of Finance

Brexit would impact an Irish economy still in recovery mode, growing in excess of 3% per annum in 2018 (Davy forecasts). According to the estimates above and our forecasts, a 'hard' Brexit might slow Irish GDP growth towards 0-1%, avoiding an outright recession. That said, the impact of Brexit would be highly uncertain. Furthermore, in these scenarios the multinational sector (with little exposure to the UK) would soften the impact; however, agriculture, SMEs and consumer confidence would be more sharply affected, hitting credit demand.

### Brexit makes Ireland more attractive for foreign direct investment

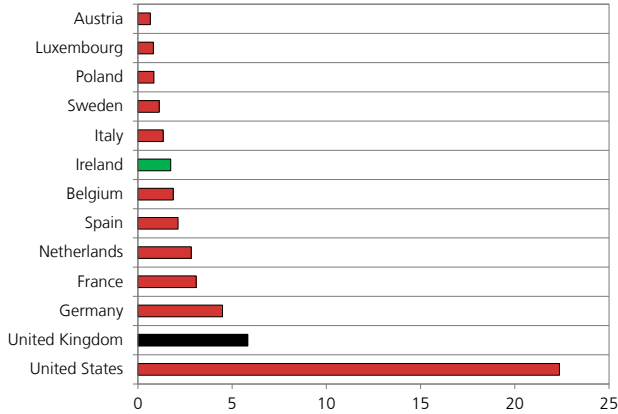
The UK's inward FDI stock equalled \$1.5trn in 2015, equivalent to 6% of total global FDI – second only to the US. Over the four years 2012-2015, inward FDI to the UK has averaged £26.2bn, or 2.8% of the £950bn stock. The UK's global share is equivalent to Germany (4.5%) and Italy (1.3%) combined. Ireland currently attracts 1.7% of global FDI.

Financial services accounts for 30% of the total FDI in the UK (Figure 18). Manufacturing (including construction, energy & extraction) accounts for 28%, retail trades 12%, information and communications 9% and other services 17%. Notably, European Union

**Ireland's main competitor for FDI has the second-largest inward investment stock in the world**

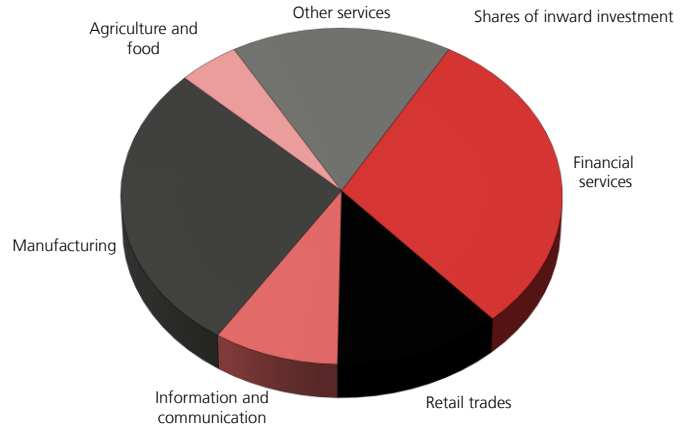
companies are the most important investors in the UK, accounting for 46%, followed by the US on 27%. A key point for Ireland is that the UK is an important destination for pharmaceuticals, life sciences, ICT and financial services investment – all sectors in which Ireland is specialised. Given that Ireland has captured 8% of FDI flows into the EU on average through 2007-2014, it could expect to benefit from the reduced flow of FDI into the UK or from relocation activity.

Figure 17: Shares of global FDI stock



Source: UN UNCTAD Database

Figure 18: Shares of UK inward FDI

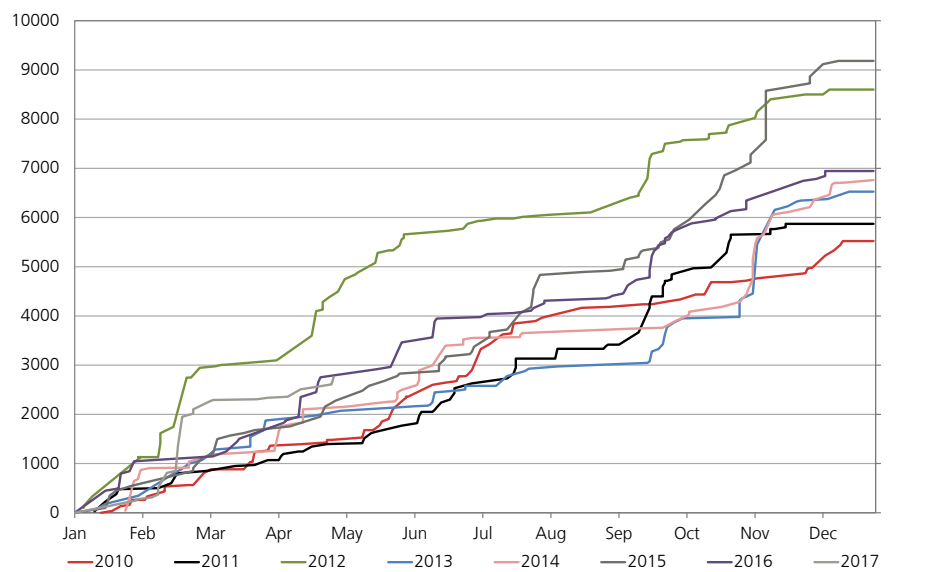


Source: Office for National Statistics

**Multinational job announcements in 2017 have been strong, largely dominated by the ICT sector operating in Dublin**

So far, however, explicit Brexit announcements of UK-based companies relocating activity to Dublin remain few and far between. In its latest outlook, CBRE reported that although several Brexit-related mandates remain active, the UK election could delay decisions to take up office space in Dublin. So far in 2017, FDI-related job announcements have once again been dominated by ICT companies operating in Dublin and compare well to previous years (Figure 19).

Figure 19: Multinational job announcements



Source: Department of Finance

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		Percent	Count	Percent
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Neutral	38	28	4	10
Underperform	12	9	0	0
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Suspended	5	3	0	0
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