2018: Strong Tail Winds & Some Head Winds

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Economic Outlook

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December 2017

The global growth outlook for 2018 looks positive.

Key Points

- 2017 has turned out to be a good year for the global economy, with an improving trend almost everywhere. The US economy expanded at a steady pace; the Euro Zone economy is showing compelling signs of a geographically broad-based and increasingly sustainable economic recovery; and the emerging economies, including China, are doing reasonably well. The UK economy has not surprisingly lost some momentum.

- The global growth outlook for 2018 looks positive. Notwithstanding the obvious risks, the world economy seems to be in the sweetest spot for a decade and growth is likely to surprise on the upside in the coming year.

- Official interest rates everywhere were taken down to historically low levels in the aftermath of the global financial crisis reflecting the weakness of the global economy and the nature of the unprecedented challenge facing policy makers. As the global economic weakness dissipates, official interest rate policy is starting to change. Since December 2015, the Federal Reserve has taken official interest rates from 0 to 1.25%. Another rate increase looks likely in December and rates could rise by another 1% during 2018.

- The Bank of England increased its base rate from 0.25% to 0.5% in November, which was the first interest rate increase in a decade. This increase was prompted by the uptick in inflation to 3%. With the economy clearly losing some momentum, it is unlikely that this is the beginning of a sharp monetary policy tightening. Rates could rise by around 0.5% during 2018.

- The European Central Bank remains very relaxed about interest rates, despite the relatively strong growth recovery. Inflation remains well behaved at 1.4% and although the labour market is improving significantly, unemployment still remains at a high 8.9%. Later in 2018, the ECB will cease its bond buying programme under QE, but it is likely to be 2019 before official rates start to move back towards normality.

- Although equity markets look modestly overvalued, they are likely to be supported in 2018 by economic recovery and solid growth in corporate earnings. It is not easy to see what would cause a significant correction just yet. With official interest rates and bond yields remaining very low and with Quantitative Easing (QE) still leading to lots of liquidity, markets can certainly go higher from here, but the reversal of QE and monetary tightening could impact at some stage. On balance, 2018 is likely to see more modest equity market gains than in recent years.

- In difficult circumstances, sterling has held up relatively well. The currency could have fallen much further. Sterling has been supported somewhat by a reasonably robust economy and an increase of 0.25% in UK interest rates in early November. Looking ahead to 2018, sterling is likely to remain volatile, but it looks vulnerable to further weakness.

- The growth momentum in the Irish economy during 2017 has been solid and broadly based. Consumer spending is getting gradually better; consumer confidence is quite high; exports are doing well; and the public finances are continuing to improve. In 2018, we are likely to see an ongoing improvement in economic conditions, notwithstanding the challenges posed by Brexit.

There is a lot of heat in the housing market at the moment and it does look set to get worse.

- As we move towards 2018, the momentum in the Irish economy is strong and prospects for the coming year look promising. The global economic cycle is steadily improving, with the US and the Euro Zone in particular showing solid momentum. The impact of Brexit is starting to be felt on the UK economy, which is not surprising, as uncertainty is the enemy of business and consumer confidence. The only thing we can say with certainty about Brexit is that it is characterised by deep uncertainty.

- Despite the recovery, the challenges facing Ireland are very clear. The main ones are a chronic lack of housing, under-funded and inefficient public services, managing the balance between public expenditure and taxation, growing wage and other business cost pressures, and of course Brexit. These challenges will have to be faced up to and will require strong political leadership.

- There is a lot of heat in the housing market at the moment and it does look set to get worse. Demand is being driven higher by solid fundamentals such as population growth, employment creation, an improvement in credit availability, and a basic improvement in confidence about Ireland's future. On the supply side, we are simply not building enough houses for a variety of reasons, but official policy has not and is not helping the situation.

- Not surprisingly, the debate has started again about the bubble-like properties of the market. The crunch for any market comes when it is hit by a shock, such as the sub-prime crisis back in 2008. If rising house prices have pushed debt levels higher, which is now happening, then the whole market and the economy becomes very vulnerable as we found out a decade ago. We need to increase housing supply as a matter of urgency. That is the only real solution. Meanwhile, national average house prices look set to rise by up to 15% in 2018.

- For a small open economy like Ireland, the stronger global backdrop is very important. Consequently, real GDP should expand by at least 4.8% in 2017.

- Real GDP should be capable of expanding by around 4% in 2018.

- It is essential that national policy focuses very strongly on broadly-defined competitiveness. This includes wages and other business costs; IT infrastructure and capability; high quality public services; prudent management of the public finances; and the personal tax burden.

- The two biggest threats to Ireland in 2018 and thereafter will be posed by Brexit and global corporation tax developments, which have the potential to pressurise Ireland's FDI model over the coming years. There will have to be a greater focus on providing support to the indigenous economy.

This is the strongest year-on-year growth rate since the first quarter of 2011.

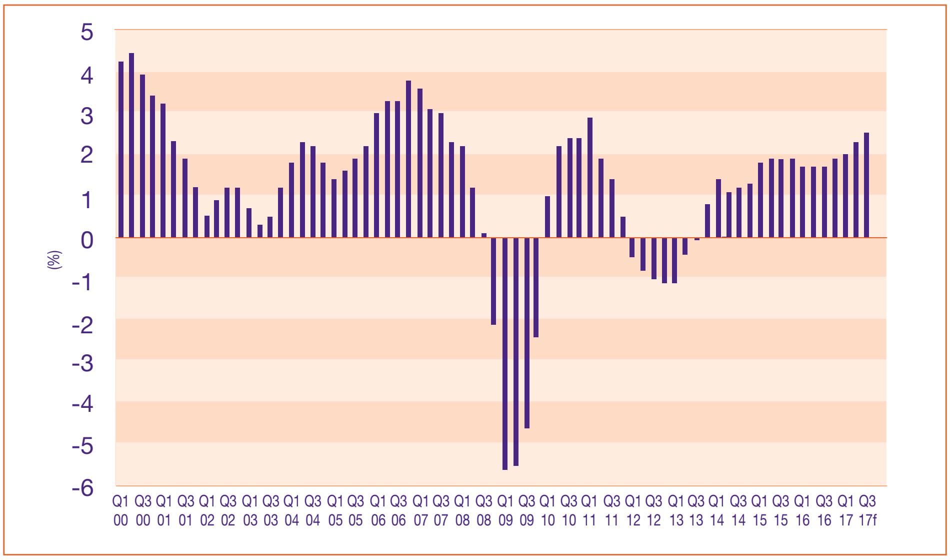
International Backdrop

Economic Activity

2017 has turned out to be a good year for the global economy, with an improving trend almost everywhere. The US economy is expanding at a steady pace; the Euro Zone economy is showing compelling signs of a geographically broad-based and increasingly sustainable economic recovery; and the emerging economies, including China, are doing reasonably well. The UK economy is starting to demonstrate some negative Brexit impact.

In the third quarter of the year, Euro Zone GDP expanded by 0.6% during the quarter and by 2.5% year-on-year. This is the strongest year-on-year growth rate since the first quarter of 2011. Germany recorded annual growth of 2.8%; France 2.2%; Italy 1.8%; and the Netherlands 3.3%. The latest Purchasing Managers Index (PMI) for October show the manufacturing index jump to a strong 60, the services index to 56.2, and the composite index to 57.5. Strong readings that are suggestive of a robust growth background.

Figure 1: Euro Zone GDP Growth (YoY)



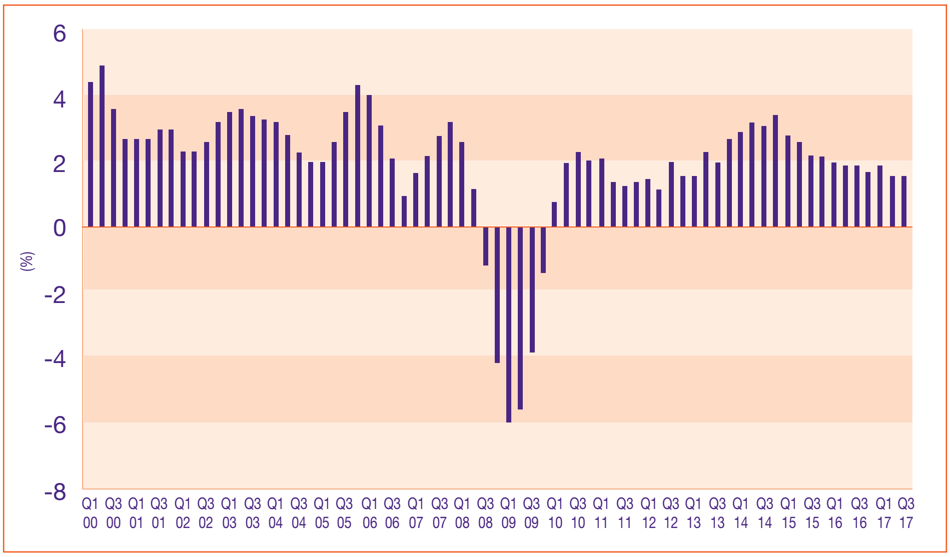
Source: Eurostat

The UK economy held up well in the aftermath of the Brexit referendum, helped in no small way by the weakness of sterling, which gave a major boost to exports. However, sterling weakness is fuelling higher inflation and this is undermining consumer spending power, as evidenced by a year-on-year decline of 0.3% in October retail sales; business investment spending is slowing due to political and associated Brexit-related uncertainty; manufacturing output is being helped by sterling; car sales are softening, and property prices in London are now in decline. Growth in the economy slowed to 1.5% in the third quarter, which is the lowest annual growth rate since 2012. Brexit is creating enormous uncertainty for the UK economy and there is still a long way to go before there is any clarity on the incredibly divisive issue.

The US economy continues to perform quite strongly.

In Budget 2018, the Chancellor of the Exchequer revised growth forecasts for 2017 down to 1.5% from 2%; 1.4% in 2018; 1.3% in 2019 and 2020; and 1.5% in 2021.

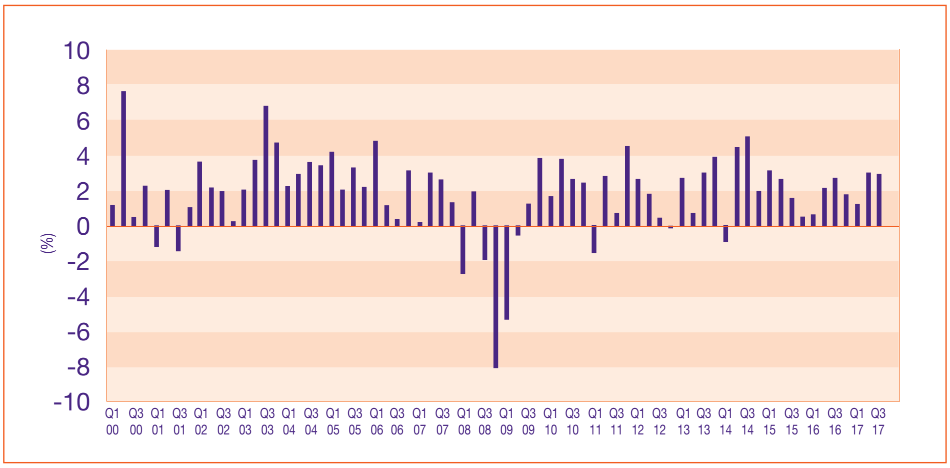
Figure 2: UK GDP Growth (YoY)



Source: Bloomberg

The US economy continues to perform quite strongly. GDP expanded at an annualised rate of 3% in the third quarter. The last Federal Open Market Committee (FOMC) minutes from the Federal Reserve upgraded growth prospects and described growth as solid. Consumer confidence is at very high levels; unemployment is low at 4.1% of the labour force; and manufacturing and service sector activity are at high levels. Core inflation remains well behaved at 1.8%, but looks set to rise over the coming year.

Figure 3: US GDP Growth (Annualised)



Source: Bloomberg

Brexit – the negotiations have not gone well and the outlook remains as uncertain as ever.

Table 1 summarises the latest growth forecast from the International Monetary Fund (IMF). The likelihood is that these growth forecasts are too conservative and global growth in 2018 could surprise on the upside, just as it did in 2017.

Table 1: Global Growth Forecast

	2016	2017f	2018f
World Output	+3.2%	+3.6%	+3.7%
Advanced Economies	+1.7%	+2.2%	+2.0%
US	+1.5%	+2.2%	+2.3%
Euro Zone	+1.8%	+2.1%	+1.9%
Germany	+1.9%	+2.0%	+1.8%
France	+1.2%	+1.6%	+1.8%
UK	+1.8%	+1.7%	+1.5%
Japan	+1.0%	+1.5%	+0.7%
Emerging Economies	+4.3%	+4.6%	+4.9%
China	+6.7%	+6.8%	+6.5%
India	+7.1%	+6.7%	+7.4%

Source: IMF, October 2017

The key risks to the outlook at this juncture appear to be as follows:

- German political uncertainty – the formation of a government has proved difficult, but regardless of whether some form of coalition is cobbled together or another election is held, economic policy is unlikely to change in any significant way;
- Brexit – the negotiations have not gone well and the outlook remains as uncertain as ever. Any outcome is possible at this stage, but the odds are still leaning towards a 'hard Brexit', with WTO tariff rates applying after March 2019. However, a transition period cannot be ruled out, but it is difficult to see the EU giving the UK any concessions on the 4 key pillars of the EU, namely freedom of movement of goods, services, capital and people. The Prime Minister's political position is precariously poor, so she is negotiating from a position of extreme weakness, unlike the EU side. Intense uncertainty will prevail for the foreseeable future;
- If President Trump seeks to push ahead with his protectionist agenda, global growth would ultimately be damaged;
- Equity markets have come a very long way since the first quarter of 2009. While markets look modestly overvalued it is not obvious what would cause a significant correction just yet. With official interest rates and bond yields remaining very low and with Quantitative Easing (QE) still leading to lots of liquidity, markets can certainly go higher from here, but the reversal of QE and monetary tightening could impact at some stage;
- While the Chinese economy has stabilised financial imbalances remain a feature of that economy;
- Geo-political uncertainty is still a key feature of the landscape, ranging from ISIS led global terrorism to North Korea to migration-induced tensions in the EU;
- The growth of nationalism in countries such as Catalonia, Hungary, Poland and Austria; and
- An election must be held in Italy before the end of May 2018.

Notwithstanding these obvious risks, the world economy seems to be in the sweetest growth spot for a decade.

As the global economic weakness dissipates, official interest rate policy is starting to change and move back towards 'normality'.

Interest Rates

Official interest rates everywhere were taken down to historically low levels in the aftermath of the global financial crisis reflecting the weakness of the global economy and the nature of the unprecedented challenge facing policy makers. As the global economic weakness dissipates, official interest rate policy is starting to change and move back towards 'normality'.

Since December 2015, the Federal Reserve has taken official interest rates from 0 to 1.25%. Another rate increase looks likely in December and rates could rise by another 1% during 2018.

The Bank of England increased its base rate from 0.25% to 0.5% in November, which was the first interest rate increase in a decade. This increase was prompted by the uptick in inflation to 3%. With the economy clearly losing some momentum, it is unlikely that this is the beginning of a sharp monetary policy tightening. Rates could rise by around 0.5% during 2018.

The European Central Bank remains very relaxed about interest rates, despite the relatively strong growth recovery. Inflation remains well behaved at 1.4% and although the labour market is improving significantly, unemployment still remains at a high 8.9%. Later in 2018, the ECB will cease its bond buying programme under QE, but it is likely to be 2019 before official rates start to move back towards normality. However, if the current strong growth momentum is maintained, the ECB could start to become less relaxed as 2018 progresses.

Table 2: Euro Zone Economic Checklist

	HICP Inflation	Unemployment Rate
Euro Zone	+1.4%	8.9%
Germany	+1.5%	3.6%
France	+1.2%	9.7%
Italy	+1.1%	11.1%
Spain	+1.7%	16.7%
Netherlands	+1.3%	4.7%
Belgium	+1.8%	6.1%
Greece	+0.5%	21.0%
Portugal	+1.9%	8.6%
Ireland	+0.5%	6.0%

Source: EuroStat

Rising interest rates would pose a challenge to the still highly indebted personal and business sectors in Ireland, but rising rates would be a sign of a stronger Euro Zone recovery and hence should be seen on balance as a positive development for Ireland.

While sterling has weakened considerably over the past year, it is still somewhat stronger than in 2008.

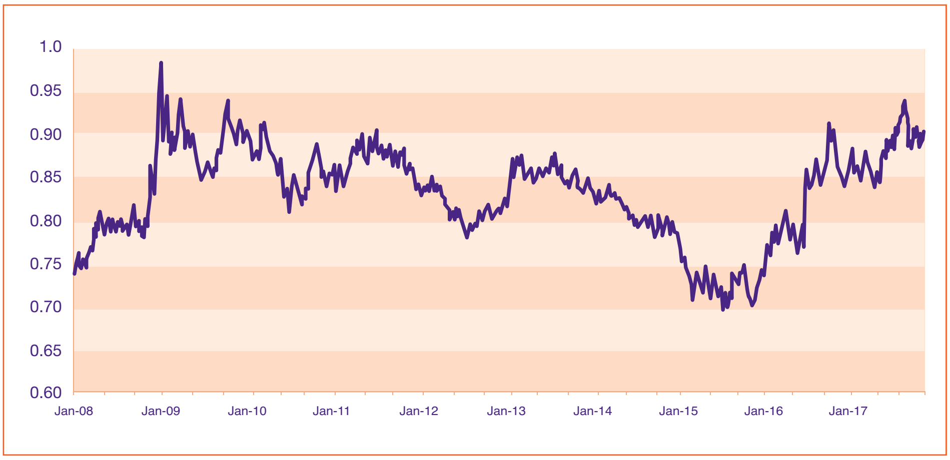
Exchange Rates

Sterling has been under consistent and at times intense pressure against the euro since November 2015. In the middle of November 2015, the UK currency was trading at 69.90 pence against the euro. It is currently trading at just over 89 pence, but has been as high as 92.95 pence at the end of August 2017.

Sterling weakness pre-dated the Brexit vote on June 23rd 2016, but the weakness of the currency has been compounded by the environment of intense political and economic uncertainty that has prevailed since that vote.

Figure 4 shows the trend in sterling against the euro since 2008. While sterling has weakened considerably over the past year, it is still somewhat stronger than in 2008, when it reached 97.93 pence.

Figure 4: Sterling v Euro



Source: Bloomberg

Looking ahead to 2018, sterling is likely to remain volatile, but it looks vulnerable to further weakness.

Table 3 shows the average annual exchange rate since 2008. On this measurement, sterling is still on average slightly stronger than in 2009, but the adjustment over the past two years has been sharp and severe.

The market environment for sterling over the past two years has been difficult and uncertain. This has resulted in significant volatility and weakness for the currency. The political background has been very challenging since the Brexit vote, but this has been compounded by the general election result in June, which has considerably weakened the position of the Prime Minister. This is not good as she seeks to negotiate EU exit.

Article 50 was invoked on March 29th 2017, and in theory the UK will have to leave the EU by March 29th 2019. The negotiations have been very difficult to date and there is no clarity or certainty as to how the process will unfold.

This is not a good background for any currency, but in such difficult circumstances sterling has held up relatively well. The currency could and probably should have fallen much further. Sterling has been supported somewhat by a reasonably robust economy and an increase of 0.25% in UK interest rates in early November. Looking ahead to 2018, sterling is likely to remain volatile, but it looks vulnerable to further weakness.

Table 3: Average Sterling Exchange Rate v Euro

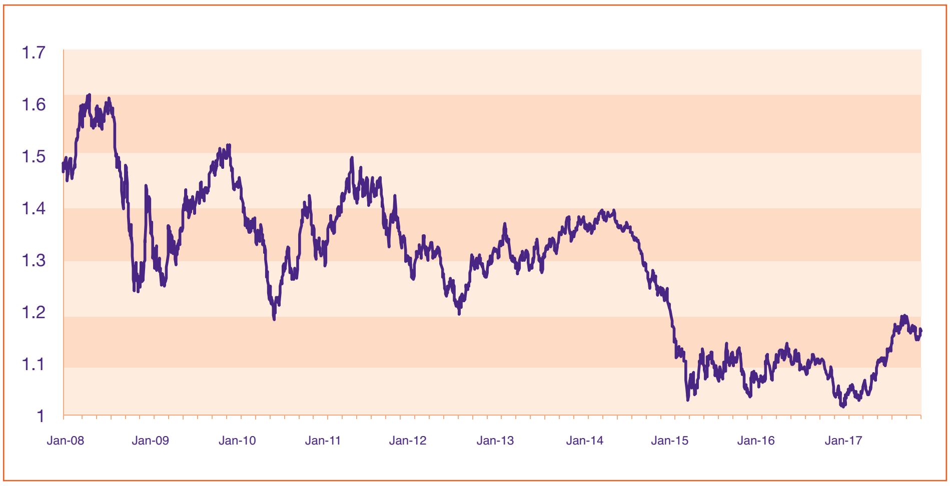
Year	Average Exchange Rate
2008	79.75 p
2009	89.12 p
2010	85.81 p
2011	86.80 p
2012	81.11 p
2013	84.94 p
2014	80.60 p
2015	72.63 p
2016	81.92 p
2017 (Jan 1st – November 21st)	87.55 p

Source: Bloomberg

The euro strengthened against the dollar during 2017, but it remained within a range of 1 to 1.20 with no serious attempt to break out of this range. Looking ahead to 2018, the euro should be supported by a solid growth background, but the US economy and US interest rate trends should also prove supportive of the dollar. Against this background, sideways range trading could be the feature of this exchange rate relationship for much of 2018, but there could be a bias towards a stronger euro.

Oil prices were quite stable for much of 2017.

Figure 5: USD v Euro

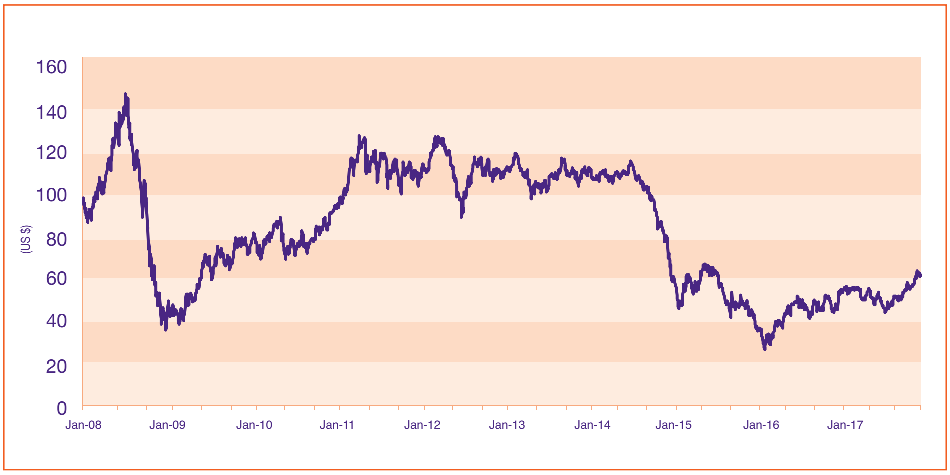


Source: Bloomberg

Oil Prices

Oil prices were quite stable for much of 2017, but in recent weeks they have edged higher on the back of political developments in Saudi Arabia. Looking ahead to 2018, prices could edge higher due to increased demand on the back of a stronger global growth cycle, and OPEC is likely to seek to curb supply.

Figure 6: Brent Crude Oil



Source: Bloomberg

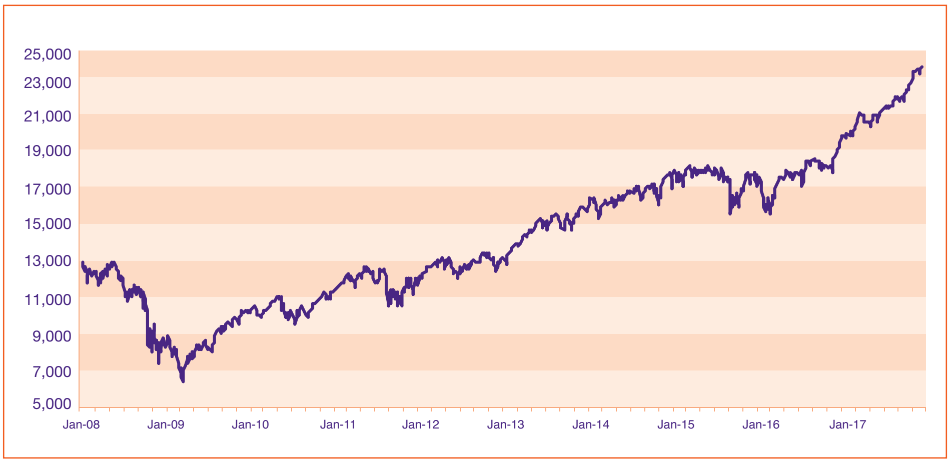
Global equity markets have been on a strong run since the first quarter of 2009.

Equity Markets

Global equity markets have been on a strong run since the first quarter of 2009. This is despite serious economic and financial difficulties and intense political uncertainty during much of the period. Markets have been supported by strong liquidity on the back of QE, good growth in corporate earnings, and a lack of investment options against a background of historically low interest rates and bond yields.

Although equity markets look modestly overvalued, they are likely to be supported in 2018 by economic recovery and solid growth in corporate earnings. It is not easy to see what would cause a significant correction just yet. With official interest rates and bond yields remaining very low and with Quantitative Easing (QE) still leading to lots of liquidity, markets can certainly go higher from here, but the reversal of QE and monetary tightening could impact at some stage. On balance, 2018 is likely to see more modest equity market gains than in recent years.

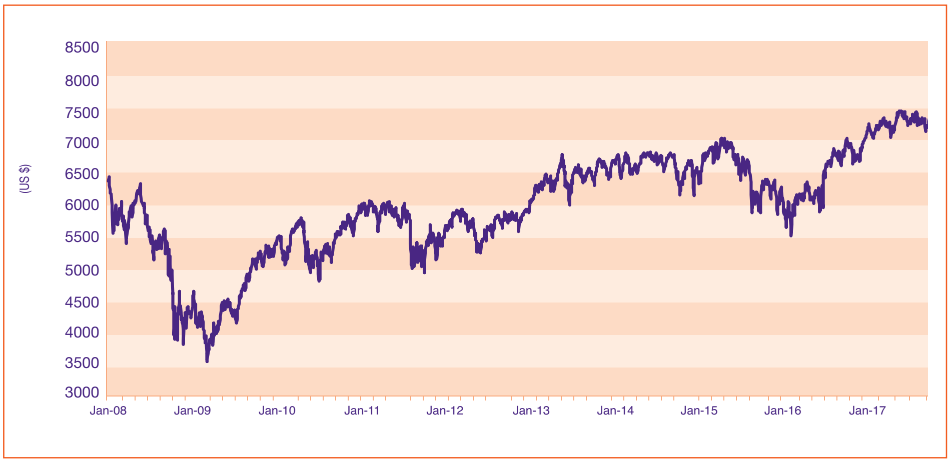
Figure 7: US Dow Jones Industrial Average



Source: Bloomberg

On balance, 2018 is likely to see more modest equity market gains than in recent years.

Figure 8: UK FTSE 100



Source: Bloomberg

Figure 9: German DAX

Source: Bloomberg

As we move towards 2018, the momentum in the Irish economy is strong and prospects for the coming year look promising.

Irish Economic Update

Overall Assessment

For the small open Irish economy, the health of the global economic cycle is of prime importance. Just as the Irish economy was taken down by the collapse in the global economy after 2007, it is currently being driven forward by the strong showing of the global economy over the past year.

As we move towards 2018, the momentum in the Irish economy is strong and prospects for the coming year look promising. The global economic cycle is steadily improving, with the US and the Euro Zone in particular showing solid momentum. The impact of Brexit is starting to be felt on the UK economy, which is not surprising, as uncertainty is the enemy of business and consumer confidence. The only thing we can say with certainty about Brexit is that it is characterised by deep uncertainty.

The growth momentum in the Irish economy during 2017 has been solid and broadly based. Consumer spending is getting gradually better; consumer confidence is quite high; exports are doing well; and the public finances are continuing to improve. In 2018, we are likely to see an ongoing improvement in economic conditions, notwithstanding the challenges posed by Brexit.

Despite the recovery, the challenges facing Ireland are very clear. The main ones are a chronic lack of housing, under-funded and inefficient public services, managing the balance between public expenditure and taxation, growing wage and other business cost pressures, and of course Brexit. These challenges will have to be faced up to.

National Accounts Data

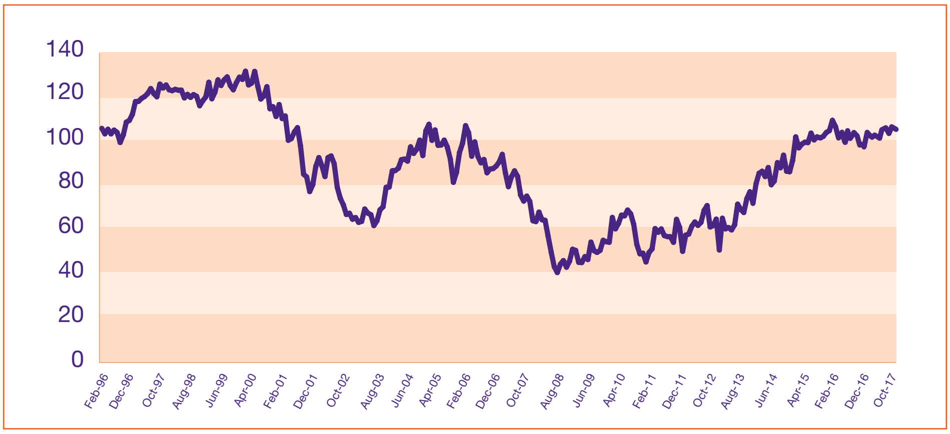
In the first half of 2017, gross domestic product (GDP) expanded by 5.5% and gross national product (GNP) expanded by 2.6%. Consumer spending on goods and services increased by 1.7%; investment expanded by 3.1%; exports of goods & services expanded by 3.2%; and imports of goods & services declined by 1.9%. Third quarter data will not be available until December, but they will show an ongoing improvement in economic activity.

Consumer Dynamics

In the first 9 months of the year, the value of retail sales increased by 0.6% and the volume of sales increased by 3%. However, weak new car sales have distorted these figures. When car sales are excluded, the value of retail sales increased by 3.7% and the volume of sales increased by 6.8%. The persistent gap between the value and volume metrics is indicative of a consumer sector that is still resistant to higher prices. New car sales in the first 11 months of the year were 10.3% lower than the first 11 months of 2016. At the same time, used imports from the UK increased by more than 33%. Used imports are being propelled higher by sterling weakness and these imports are displacing new car sales.

Consumer confidence remains at high levels, although there has been some levelling off in confidence readings during 2017. This reflects concerns about Brexit; the high personal tax burden; and modest earnings growth.

Figure 10: Consumer Confidence

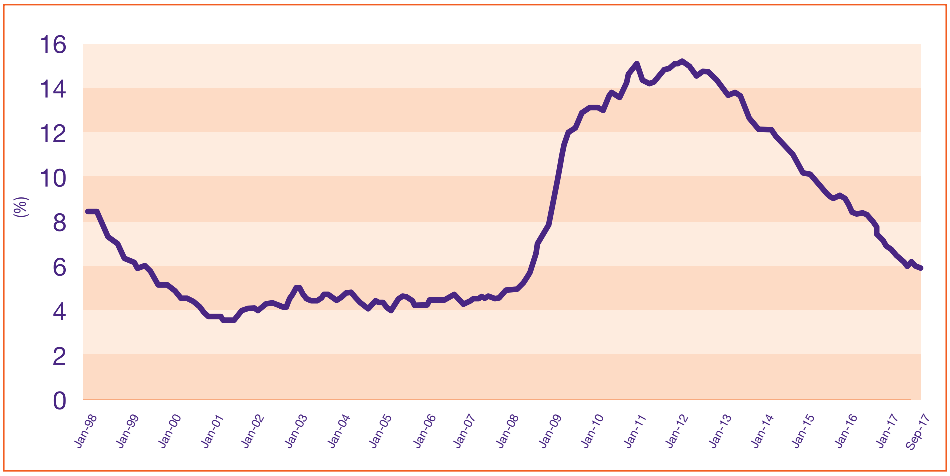


Source: ESRI

The Labour Market

The labour market is performing very strongly. Employment increased by 48,100 or 2.4% in the year to the end of June 2017. Employment in the second quarter stood at 2.063 million. The sectoral breakdown of employment growth is strong. The overall increase in employment was made up of a very strong increase of 77,800 or 5% in full-time employment and a decline of 29,700 (-6.7%) in part-time employment. The latter changes are really indicative of the strength of the overall labour market and the improving confidence of the business community.

Figure 11: Unemployment Rate



Source: CSO

The export sector of the economy has performed reasonably well so far in 2017.

The long-term unemployment rate has fallen to 3.1%, and accounted for 48.7% of total unemployment in Q2 2017. This is the first time since Q3 2010 that long-term unemployment has accounted for less than 50% of total unemployment. This represents very positive progress.

The unemployment rate stood at 6% of the labour force in October 2017, down from 15.2% in 2012. The seasonally adjusted number of people unemployed stood at 131,300 in October and has declined by 66,600 over the past two years.

External Trade

The export sector of the economy has performed reasonably well so far in 2017, but growth has eased as the year has progressed. In the first 9 months of the year, the value of merchandise exports was 1.8% ahead of the same period in 2016. Exports of food and live animals increased by 14.7%; exports of Chemicals and related products expanded by 2.6%; and exports of machinery and transport equipment (which includes IT manufacturing) declined by 10.9%. Somewhat surprisingly given the weakness of sterling, exports to the UK increased by 11.9%. It is probably the case that Irish exporters to the UK are using price to maintain competitiveness in the face of very adverse exchange rate movements. This would have negative implications for business margins and would not be a sustainable situation for business. Sterling weakness remains a significant threat to the indigenous export sector.

Tourism

The tourism performance continues to be very strong. In the first 9 months of 2017, the number of overseas visitors to Ireland was 2.9% ahead of the same period in 2016. However, visitor numbers from Great Britain were 6.7% lower. Visitors from Great Britain accounted for 36.7% of total overseas visitors to Ireland in the first 9 months of 2017 - this is down from 40.5% in 2016. Sterling weakness is pressurising this market.

Visitors from North America increased by 18.6% in the first 9 months of the year. This growth is potentially under threat from recent weakness of the US dollar against the euro. It is currently trading just under 1.19 against the euro, having been at 1.0384 at the end of 2016.

Table 4: Overseas Visitors to Ireland (Jan 17-Sept 17)

Area	2017	2016	% Change
Great Britain	2,810,500	3,013,500	-6.7%
Other Europe	2,704,800	2,613,400	+3.5%
North America	1,654,900	1,395,900	+18.6%
Other Areas	491,000	422,400	+16.2%
Total	7,661,200	7,445,200	+2.9%

Source: CSO

One significant feature of the public finances is the ongoing strong growth in tax revenues.

The Public Finances

The Exchequer returns for the first 10 months of the year show that the Government remains well on course to achieve the fiscal targets set in Budget 2017. In the year to October, an Exchequer surplus of €326 million was recorded, which compares to a deficit of €2.4 billion in the same period last year. The year-on-year improvement of €2.75 billion is mainly due to the State's sale of over 28% of its shareholding in AIB. When this and another AIB transaction in 2016 are accounted for, there was an underlying improvement of €921 million in the Exchequer's position. Economic growth is driving an ongoing improvement in the public finances and this looks set to continue in 2018.

One significant feature of the public finances is the ongoing strong growth in tax revenues. Just under €39 billion was collected in the first ten months, which is €2.3 billion or 6.2% ahead of the same period last year. Income tax is the single biggest category of taxation at €15.25 billion, which is €813 million higher than the same period in 2016. Income tax, which includes the Universal Social Charge (USC), accounted for just over 39% of total tax revenues collected. This is a big number and shows exactly where the main burden of taxation falls in this country. The second biggest category is VAT at €11.2 billion.

Table 5: Exchequer Returns Jan-October 2017

Tax Heading	Amount (€m)	Against Target (€m)	Yoy (%)
Income Tax	15,250	-153	+5.6%
VAT	11,219	-118	+6.7%
Corporation Tax	5,422	+216	+13.5%
Excise	4,949	+49	+0.7%
Stamps	981	-80	+3.4%
Capital Gains Tax	217	+41	+9.1%
Capital Acquisitions Tax	257	+26	+14.8%
Customs	276	-18	+5.7%
Local Property Tax	385	+15	+2.9%
Unallocated	29	+29	-
Total	38,986	+7	+6.2%

Source: Department of Finance

Against a background of limited supply and strong demand, house prices and private rents are rising strongly.

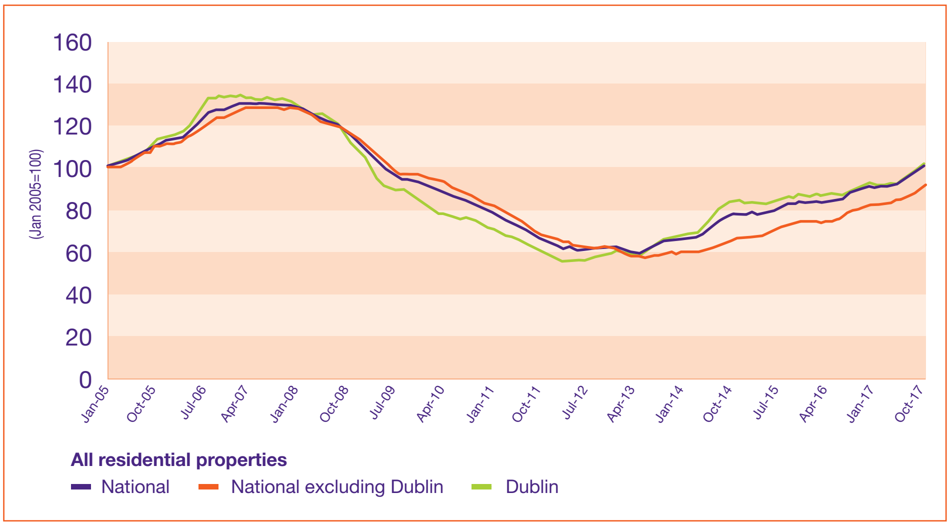
The Housing Market

The crisis in the housing market continues to dominate the domestic political agenda. There is still a significant shortage of owner-occupied housing, social housing and rental property.

Against a background of limited supply and strong demand, house prices and private rents are rising strongly. The following are the key trends in residential house prices:

- National average house prices declined by 55.2% between the peak of the market in April 2007 and the low point of the market in March 2013. Between March 2013 and September 2017, prices have increased by 70.2%. Prices in September 2017 were 12.8% higher than a year earlier;
- In the Rest of Ireland (excluding Dublin), average house prices declined by 56.5% between the peak of the market in May 2007 and the low point of the market in May 2013. Between May 2013 and September 2017, prices have increased by 61.4%. Prices in September 2017 were 13.2% higher than a year earlier; and
- In Dublin, average house prices declined by 59.6% between the peak of the market in February 2007 and the low point of the market in February 2012. Between February 2012 and September 2017, prices have increased by 87%. Prices in September 2017 were 12.2% higher than a year earlier.

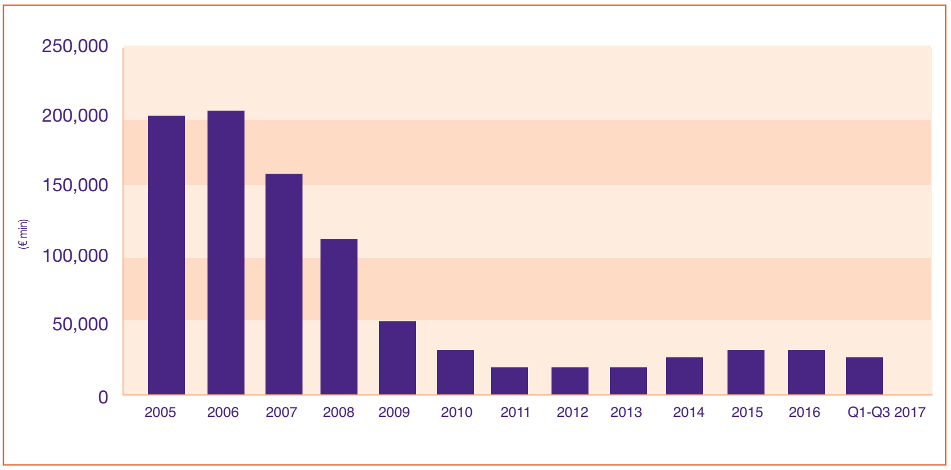
Figure 12: House Price Index



Source: CSO

The value of mortgages drawn down in the first nine months of the year reached €5.056 billion.

Figure 13: Number of Mortgages Drawn Down



Source: BPFI

Latest data from the BPFI shows that in the first nine months of 2017, 24,448 mortgages were drawn down, which represents an increase of 19.9% on the same period in 2016.

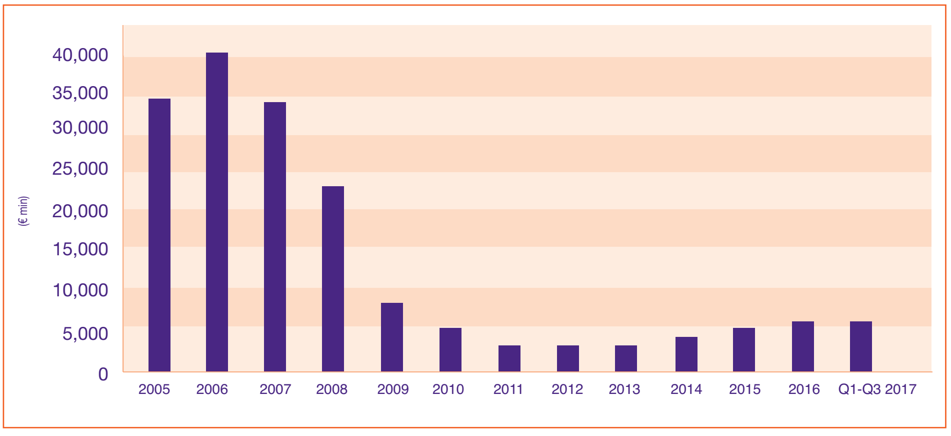
The value of mortgages drawn down in the first nine months of the year reached €5.056 billion, which is 31.6% higher than the first nine months of 2016.

In the third quarter of 2017, the average mortgage was €212,032, which was 10.7% higher than the third quarter of 2016. The average mortgage for first time buyers was €206,856, which was 13.1% higher than a year earlier, and the average mortgage for mover purchasers was €256,159, which was 10.4% higher than a year earlier.

In the first 9 months of the year, first time buyers accounted for 48.4% of total mortgage lending in value terms, and mover purchasers accounted for 37.1% of the market.

Mortgage availability is improving and the market could reach €6.5 billion for the full year. It is still about half what it should be if the market was normal, but it is gradually improving.

Figure 14: Value of Mortgages Drawn Down

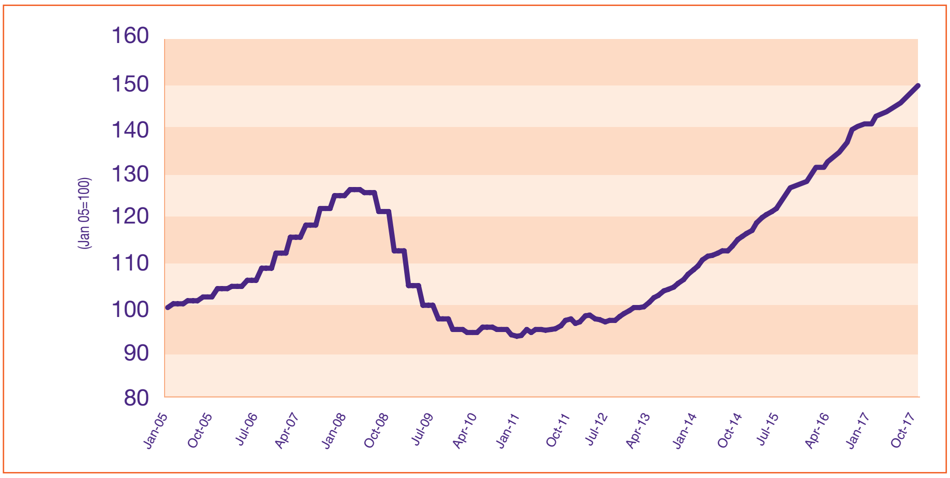


Source: BPFI

The global economic background is looking increasingly better and most domestic indicators are positive.

Private rents increased by 5.6% in the year to October and have increased by 58.3% since the end of 2010.

Figure 15: Private Rents



Source: CSO

This sample of statistics demonstrates clearly the heat that is in the housing market at the moment and it does look set to get worse. Demand is being driven higher by solid fundamentals such as population growth, employment creation, an improvement in credit availability, and a basic improvement in confidence about Ireland's future. On the supply side, we are simply not building enough houses for a variety of reasons, but official policy has not and is not helping the situation.

Not surprisingly, the debate has started again about the bubble-like properties of the market. The argument about whether it is a bubble or not, is not really the point. The crunch for any market comes when it is hit by a shock, such as the sub-prime crisis back in 2008. If rising house prices have pushed debt levels higher, which is now happening, then the whole market and the economy becomes very vulnerable as we found out a decade ago. We need to increase housing supply as a matter of urgency. That is the only real solution. House prices look set to rise by up to 15% in 2018.

Economic Outlook

It is clear that Ireland continues to enjoy broadly based growth. The global economic background is looking increasingly better and most domestic indicators are positive.

For a small open economy like Ireland, the stronger global backdrop is very important. Real GDP should expand by at least 4.8% in 2017 (higher than the official Budget 2018, Department of Finance forecast detailed in table below). The table below shows the economic assumptions underlying Budget 2018. Based on current evidence, this medium-term forecast looks realistic, with GDP growth expected to average 3.5% per annum out to 2020. Such an economic outturn would describe an economy gradually getting better over time. The domestic and external risks/challenges will need to be managed very carefully.

It is essential that national policy focuses very strongly on broadly-defined competitiveness.

Table 6: Department of Finance Budget 2018 Economic Forecast

	2017f	2018f	2019f	2020F	Average 2017-2020
GDP	4.3%	3.5%	3.2%	2.8%	3.5%
GNP	0.0%	3.3%	3.0%	2.5%	2.2%
Consumption	2.3%	2.3%	2.2%	2.1%	2.2%
Investment	-3.7%	6.1%	5.6%	4.2%	3.1%
Government	2.0%	2.0%	2.0%	1.9%	2.0%
Exports Goods & Services	3.5%	4.8%	4.3%	4.0%	4.2%
Imports Goods & Services	-1.0%	5.5%	4.9%	4.4%	3.5%
Unemployment	6.3%	5.7%	5.5%	5.5%	-
Employment (000s)	2,075	2,125	2,170	2,208	-
Inflation	0.2%	0.8%	1.4%	1.8%	1.1%

Source: Department of Finance

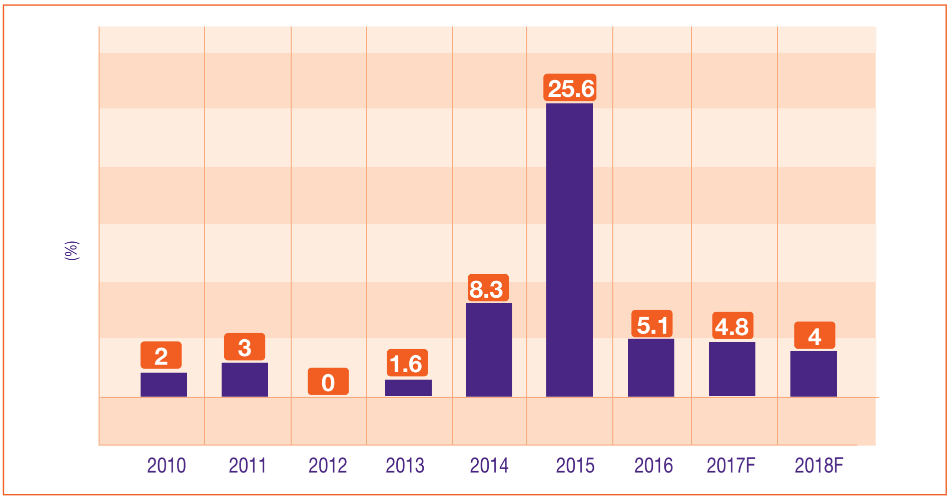
Looking ahead to 2018, the Department of Finance growth forecast of 3.5% looks somewhat conservative. Real GDP should be capable of expanding by around 4% in 2018. This growth should be driven by the following factors:

- The ongoing improvement in the global economy will prove supportive of the Irish export sector. The improvement in the Euro Zone should offset the weakness of the UK. Further sterling weakness does pose a threat to the indigenous export sector and visitor numbers from the UK;
- Consumer spending should be supported by employment growth of 2.9%; average wage growth of around 4%; a modest easing of the tax burden; and growth of around 6% in personal disposable incomes;
- The investment performance in 2017 is distorted by multi-national transactions, but these should feed out of the system in 2018. Construction output should expand strongly and business investment expenditure should expand quite strongly;
- Exports will be supported by the global economic recovery, but the UK market is likely to prove challenging.

It is essential that national policy focuses very strongly on broadly-defined competitiveness. This includes wages and other business costs; IT infrastructure and capability; high quality public services; prudent management of the public finances; and the personal tax burden.

The two biggest threats to Ireland in 2018 and thereafter will be posed by Brexit and global corporation tax developments, which have the potential to pressurise Ireland's FDI model over the coming years. There will have to be a greater focus on providing support to the indigenous economy.

Figure 16: GDP Growth (%YoY)



Source: CSO & Jim Power

Table 7: Friends First Economic Forecast

	2017f	2018f
GDP	+4.8%	+4.0%
GNP	+2.5%	+2.6%
Consumer Expenditure	+2.7%	+3.0%
Government Consumption	+3.0%	+3.5%
Investment	0.0%	+7.5%
Exports Goods & Services	+3.6%	+4.5%
Imports Goods & Services	+4.9%	+4.5%
Unemployment Rate (%)	6.3%	5.8%
Employment (000s)	2,060	2,120
Inflation (HICP)	-0.1%	+1.5%

THIS PUBLICATION IS BASED ON DATA AVAILABLE UP TO NOVEMBER 23RD 2017. IT IS SUBJECT TO CHANGE WITHOUT NOTICE. THE VIEWS AND OPINIONS EXPRESSED IN THIS REPORT ARE THOSE OF THE AUTHOR.

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