Ulster Bank Weekly Economic Commentary

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10 May 2019

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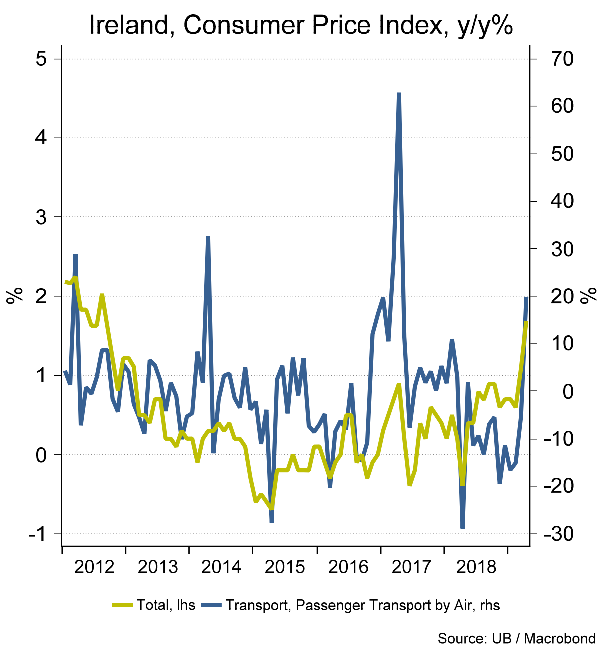
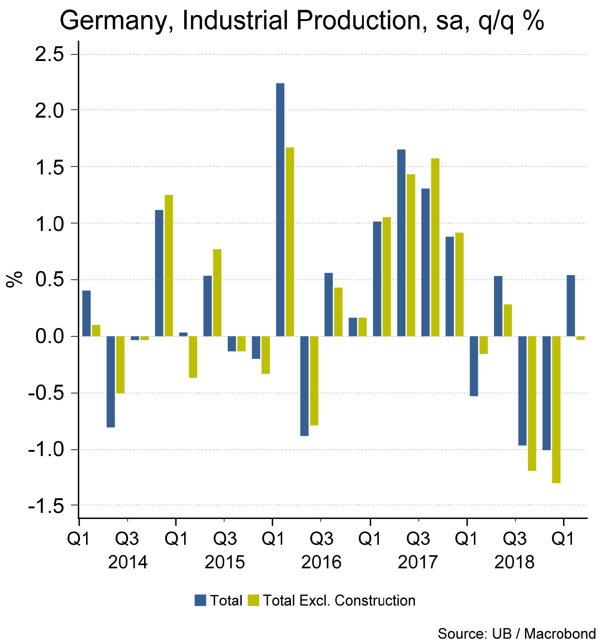
Ireland: Commission forecast highlights that the Irish outlook remains favourable, but uncertain; spike in airfares sends inflation higher



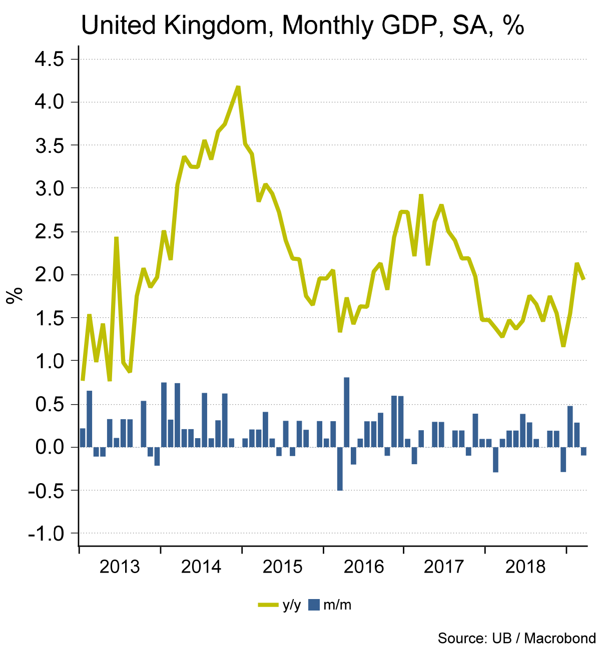
This week's Spring Forecast from the European Commission provided a useful overview of the Irish economic outlook. Its key – and uncontroversial – conclusion is that Irish growth is expected to moderate reflecting a less supportive external growth environment, while underlying activity is anticipated to remain robust, helped by rising construction investment and still-positive labour market developments. As with all Irish forecasts, the Commission's update notes the high levels of uncertainty which cloud the outlook and identifies several familiar sources of external risk including Brexit as well as possible changes in the international tax and trade environment. Domestically, it highlights the risk of overheating – a theme that gained a little traction this week following an upside surprise in the latest Irish inflation figures. Both the CPI and HICP measures rose from 1.1% in March to 1.7% in April – levels last seen over 5 years ago. The strong acceleration in April was partly – but importantly - related to a surge in inflation in airfares (which jumped from -5% to +20%y/y) which on its own accounted for about half of the overall acceleration in April. But this is very likely to reflect an Easter timing impact and so we wouldn't at all be surprised to see an unwind of this effect next month (as happened in 2014 and 2017 for example). More generally, however, with spare capacity running low as the economy closes in on full employment, we think that there is upside risk to measures of domestic costs and prices, especially in the event that prominent international sources of downside risk don't materialise.

Eurozone: German industrial production figures surprise positively again, but underlying trends look less healthy



German industrial production figures out this week recorded a second consecutive monthly increase in output in March, in the process also beating analyst expectations for the second month on the trot. Production rose by 0.5%m/m in March following on from a 0.4% rise in February to leave total output up 0.5% in Q1 after two sizeable quarterly drops in the second half of last year. We think a number of qualifications apply to the interpretation of these figures, however. Firstly, the Q1 performance was boosted considerably by a surge in construction output (which is included in total IP). Excluding construction, production fell again in Q1, albeit marginally. Second, more timely and more forward-looking indications from available surveys including the PMIs and Ifo suggest that underlying factory-sector activity trends have remained weak early in the second quarter in both Germany and in the wider global economy. We do observe that the official data for Q1 have pointed to somewhat more resilience than indicated by the surveys, that even in the surveys themselves there are tentative signs that activity trends may be in the process of bottoming out, if at weak levels, and that there are some signs of a pickup in the Chinese economy. However, our overall read of the evidence is that we can't yet be confident that a sustainably more positive trend has taken hold in the key manufacturing sector of the euro zone's largest economy.

UK: GDP at a solid-looking 0.5% in Q1 but a weak end to the quarter points to a weaker Q2



Consensus expectations for a solid 0.5% quarterly rise in Q1 GDP in the UK were validated in today's preliminary figures. This marked a welcome pick-up from the subdued and sub-trend 0.2% q/q pace registered in Q4 of last year, and leaves the annual rate of growth at a 6-quarter high of 1.8%. Private consumption, government consumption and gross capital formation (GCF) contributed positively to growth, while net trade subtracted significantly following a flat export performance and a surge in imports. A 6.8% q/q spike is imports and a very strong 2.2% q/q increase in manufacturing output are in our view both consistent with Brexit-related stock-building having played a potentially sizeable role in Q1 growth performance – a theme that has also come through clearly from recent surveys, including the PMIs. But any such Brexit-related stock-building boost to Q1 growth is likely to be temporary and thus likely to act as a drag in Q2. Indeed, the monthly GDP figures for March do point to softer growth momentum having taken hold at the end of Q1, with GDP reported to have fallen by 0.1%m/m. This was a touch weaker than the unchanged reading expected by City analysts and reflects a poor end to the quarter for the important services sector of the economy which saw output contract by 0.1% m/m. So, overall, Brexit-related noise means that the headline figure for Q1 paints an overly flattering picture of recent UK growth performance, with the arithmetic of the soft monthly number for March combining with the more underlying headwind of Brexit uncertainty to dampen prospects for growth in the near term.

US: Softer-than-expected inflation readings continue to provide support for the Fed's wait-and-see approach

Last Friday's April employment report confirmed the strength of labour market conditions in the US. Payrolls growth picked up to 263k in April, leaving the average for the year to date at 205k per month. This is just a touch less robust than the 213k average recorded in 2018 and is a pace of job creation that is very much consistent with ongoing downward pressure on the unemployment rate. Indeed, the jobless rate hit a new cycle and near-50 year low of 3.6% last month - below all mainstream estimates of full employment, including that of the Fed which regards 4.3% as the sustainable jobless rate over the longer run. And yet despite this further tightening of labour market conditions, signs of acceleration in measures of underlying costs and prices generally remain limited. Indeed, growth in average hourly earnings was actually a little weaker than expected in holding steady at 3.2% in April rather than pick up to 3.3% as had been expected. Similarly, this week's CPI figures also posted a modest downside surprises with the core CPI rosing by only 0.1% in April – the third 0.1% monthly reading in a row. Recent commentary from Powell at al. has indicated that the Fed views some of the recent weakness in core inflation as likely reflecting temporary factors. Nonetheless, our sense is that policy makers will likely continue to take comfort from recent indicators which suggest that the absence, for the time being at least, of a firming of price pressures provide ample justification for the Fed's patient, wait and see approach to interest rate policy, especially given the renewed intensification of trade risks.

Financial Markets: Risk appetite knocked back as Trump re-escalates trade tensions; sterling on the drift once again

The world's major stock indices have had a rough week this week reflecting President Trump's renewed enthusiasm for his adversarial approach to the ongoing trade discussions with China. The decision to raise tariffs on $200bn of US goods imports from China - and the threat of more to come – marked a major shift relative to prior indications that a deal was within reach and has sparked a notable deterioration in investor risk appetite. Mirroring similar declines in many other exchanges, the S&P has lost around 3% this week as investors now eye the Chinese response. Indications from Beijing are that retaliatory measures are likely, though the form and extent remains unclear as of yet. This latest escalation of tensions is very unwelcome as, beyond resulting weakness in stock markets, it risks a renewed deterioration in global economic confidence at a time when sentiment and momentum is already lacklustre in many regions. Elsewhere, sterling has once again come under pressure as traders continue to grapple with rising levels of political uncertainty reflecting ongoing tensions both across and within the Conservative and Labour parties. It seems as if PM May is aiming for yet another Parliamentary vote on her deal in the coming weeks, though it seems extremely unclear that she will have sufficient support to get it over the line, thus keeping a wide variety of various political (including general election) scenarios in play . In the meantime, sterling is on the drift as the UK unit closes out the week with losses of 1.5% against the euro to trade at 86.3p.

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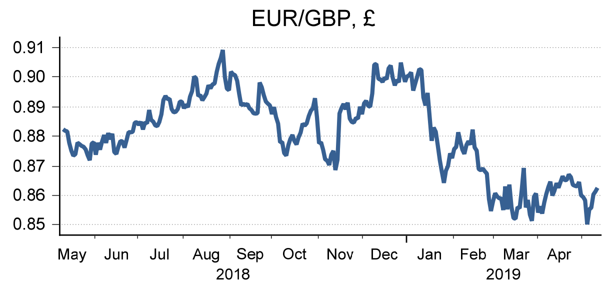
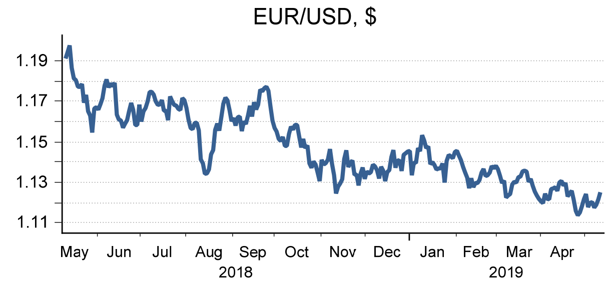
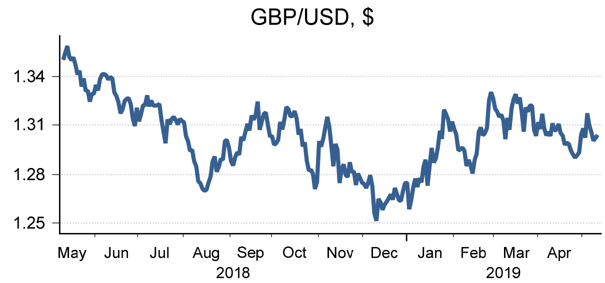
Currency and interest rate market trends



Source: UB / Macrobond



Source: UB / Macrobond



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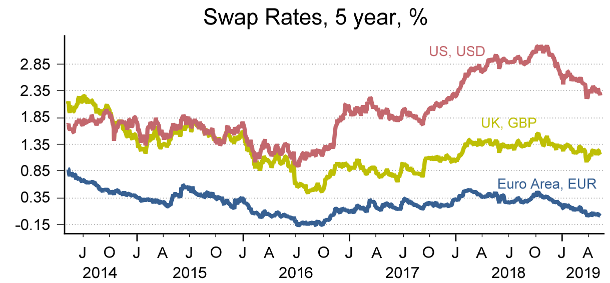

Source: UB / Macrobond

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Market Monitor

Foreign Exchange Markets

	Latest	weekly Δ, %
EUR/GBP, £	0.863	1.5
GBP/EUR, €	1.159	-1.5
EUR/USD, $	1.124	0.4
GBP/USD, $	1.303	-1.1
EUR/JPY, JP¥	123.3	-1.0
GBP/JPY, JP¥	142.8	-2.4
USD/JPY, JP¥	109.6	-1.3
EUR/CHF, CHF	1.137	-0.2

Stocks & Commodities

	Latest	weekly Δ, %
ISEQ	6,259	-3.7
STOXX Europe 600	378	-3.3
FTSE 100	7,212	-2.3
S&P 500	2,848	-3.3
Dow Jones	25,608	-3.4
Nasdaq	7,828	-4.1
NIKKEI	21,345	-4.1
OIL (London Brent)	70.6	-0.4
Gold	1,286	0.4

Interest Rate Markets

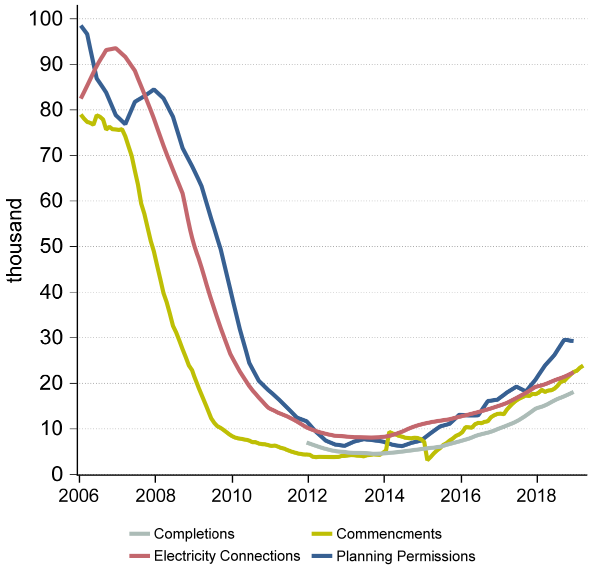
		Latest (%)	weekly Δ, bps
EUR	3 Month Euribor	-0.308	0.1
	2 Year Swaps	-0.21	-1
	5 Year Swaps	0.01	-4
	10 Year Swaps	0.48	-5
GBP	3 Month Libor	0.805	-0.7
	2 Year Swaps	1.00	-6
	5 Year Swaps	1.16	-8
	10 Year Swaps	1.32	-8
USD	3 Month Libor	2.528	-3.2
	2 Year Swaps	2.34	-10
	5 Year Swaps	2.27	-10
	10 Year Swaps	2.42	-9

Note: the data in the tables are indicative only and are sourced from Bloomberg. Latest data are updated as at the time of publication. "weekly Δ" refers to the change from the previous week's closing levels.

Ulster Bank Cost of Funds Rate (365 day count) = 0.38%
Euro rates are quoted in 360-day convention.
To convert to 365 day count, divide by 360, & multiply by 365

Highlights for the week ahead: Irish house price inflation may ease further as supply continues to pick up; US retail figs to show healthier Q2 spending

Ireland, Housing Supply, 4-quarter sum



Source: UB / Macrobond

A busy week on the domestic and international calendars sees the focus at home very much on the housing market with key indicators on construction and prices on the docket. Monday's UB Construction PMI will provide a timely steer on construction trends early in the second quarter, while Thursday's official new dwelling completions data are expected to show a further solid pick up in new home construction in Q1. This follows last year's total of over 18k, which was up 25% on 2017 levels, and 4 times the level of homebuilding at the historic and cycle low of 4.6k in 2013. This uplift in supply is playing an important role in the observed deceleration in price inflation which has slowed from over 13% in May of last year to 4.3% in February, with recent trends pointing to the likelihood of further cooling in price inflation in the March figures (due on Wednesday). Elsewhere, Wednesday's US retail sales figures will be closely eyed for confirmation that US consumer spending trends are looking healthier early in the second quarter after a disappointingly weak end to 2018, while the Empire and Philly Fed indices will provide an early (if regional only) look at business activity trends in May. In the EZ, reflecting the recent slowing in the pace of overall economic growth, we wouldn't be surprised to see some further moderation in the pace of jobs growth in Q1 from the still-solid 1.3% y/y pace recorded in Q4. Labour market figures will be in focus in the UK too where the question is the extent to which recent resilience will be sustained following the drop in the unemployment rate to a 4-decade low of 3.9%.

Economic calendar for the week commencing May 13th

Ireland / Eurozone	UK	US
	Monday	
01.00 – Ulster Bank Construction PMI (Apr)		
	Tuesday	
10.00 – EZ Industrial Production (Mar); GE ZEW Survey (Apr)	09.30 – Labour Market Data (Mar); Productivity (Q1)	08.15 – Fed Speech (Williams) 11.00 – NFIB Small Business Optimism (Apr) 13.30 – Import Prices (Apr) 17.45 – Fed Speech (George)
	Wednesday	
10.00 – EZ Employment (Q1); GDP (Q1 – 2nd est) 11.00 – Residential Property Price Index (Mar); Goods Exports and Imports (Mar)		13.30 – Retail Sales (Apr); Empire State Manufacturing Survey (May) 14.15 – Industrial Production (Apr) 15.00 – Business Inventories 17.45 – Fed Speech (Barkin)
	Thursday	
10.00 – EZ Trade Balance (Mar) 11.00 – New Dwelling Completions (Q1)		13.30 – Housings Starts and Permits (Apr); Initial Jobless Claims; Philly Fed Manufacturing Survey (May)
	Friday	
10.00 – EZ Construction Output (Mar); HICP (Apr – final)		15.00 – Univ. of Michigan Consumer Sentiment (May); Index of Leading Indicators (Apr)

The Calendar uses Irish local time

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