Ulster Bank Weekly Economic Commentary

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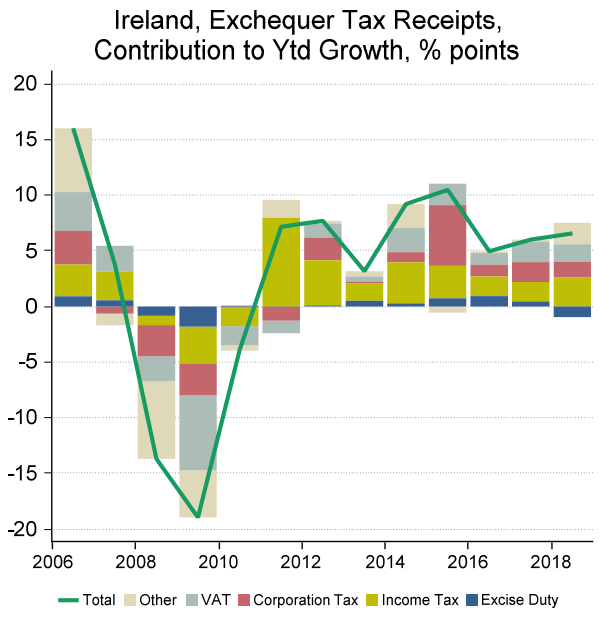
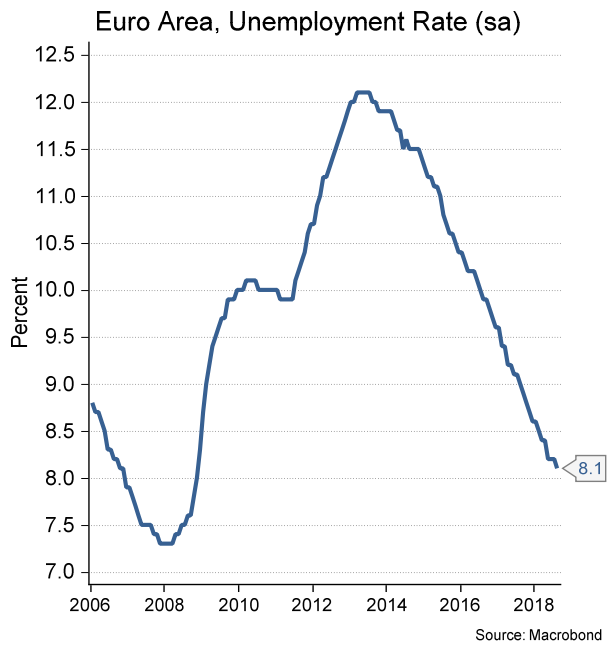
Ireland: Unemployment falls to new cycle low; public finances broadly on plan despite health spending overshoot



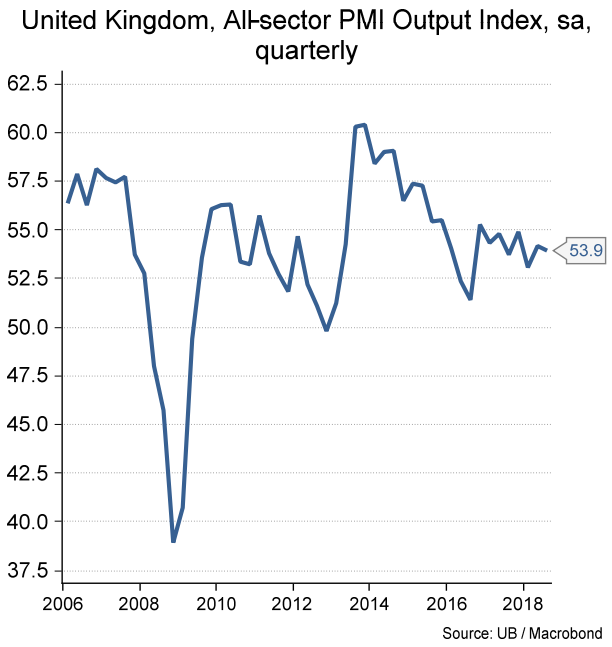
The final set of Exchequer returns ahead of next week's Budget confirm that the Irish public finances are performing broadly in line with expectations. As ever, this high-level summary masks several points of note within the returns. On the tax side, the ongoing solid – and in-line-with-expectations - growth (+6.8%ytd) in receipts of income tax (the single-largest tax head, accounting for 40% of the total) continues to offer encouragement and chimes well with the latest unemployment data. Provisional monthly figures out this week showed the jobless rate fell to a new cycle low of 5.4% in September, down from the official estimate of 5.8% in Q2 and from 6.6% in September 2017. Elsewhere, corporation tax receipts continue to grow strongly at 10.5% ytd leaving them €300m (or 6.3%) higher than plan, a welcome overshoot given the €330m undershoot in excise duties (which is being partly attributed to past stockbuilding of tobacco imports by retailers ahead of the introduction of plain packaging regulations). On the spending side, day-to-day expenditure is up 6.3% ytd and is running €265m (0.6%) above plan. The overshoot is again entirely due to the now-familiar pattern of overspending on health which is €300m (2.7%) higher than budgeted so far this year having risen by 7.2%ytd. Overall, it looks like the public finances are probably on track to meet if not exceed the government's deficit target of 0.2% of GDP. But the de facto ongoing reliance on upside surprises in corporation tax receipts to compensate for health spending overshoots is not a sustainable basis on which to plan the public finances.

Eurozone: Jobless rate drops to a new cycle low; Italy's fiscal plans continue to worry investors



Positive trends in the Eurozone labour market remain in place judging by the latest drop in the jobless rate to a nearly decade-low of 8.1% in August, down from 8.2% in July. This provides an important underpinning for the ECB's expectation that the recent pick-up in wage growth will continue over the period ahead, which ultimately is expected to translate into underlying price pressures. However, for the time being core inflation remains subdued with last Friday's figures for September unexpectedly showing core inflation at 0.9% (vs. 1.1% expected by the consensus), down from 1% in August. In line with expectations, headline inflation picked-up by 10bps to match a cycle-high of 2.1% in September, with the recent spike in oil prices likely to exert some further upward pressure in headline inflation over the period ahead. Meanwhile, Eurozone retail sales unexpectedly recorded a 2nd consecutive decline in August, while there were also news in the revisions which showed monthly retail sales growth at a 2018 low of -0.6% in July. Evidence of sluggish consumer spending trends so far in Q3 points to some downside risk to ECB expectations for unchanged growth of 0.4% q/q in Q3. Finally in Italy, the ruling coalition did revise slightly lower its budget deficit targets beyond 2019. However, the plan's credibility and the apparent lack of commitment to adherence to EU fiscal rules continue to worry investors in Italian bonds which have come under notable selling pressure (10-year yields were at one point at a new over 4-year high of 3.46%), in the process leaving the single currency trading on the back foot.

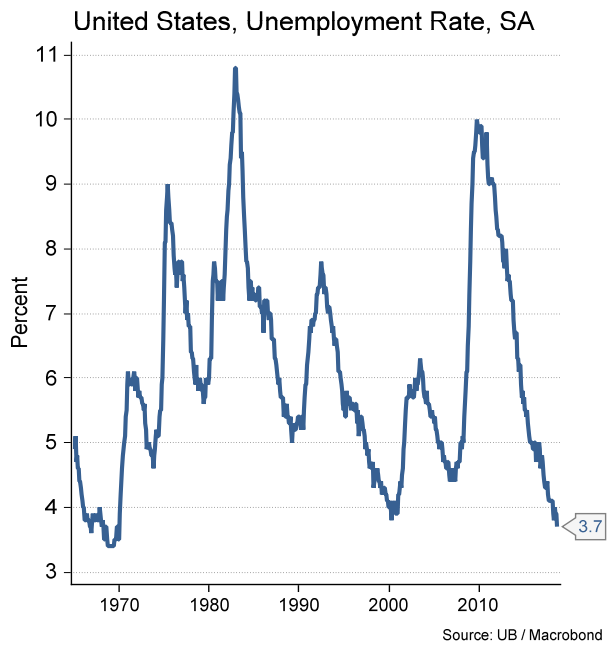
UK: Healthy and steady PMIs close off a positive quarter for the economy; UK government may present a new backstop proposal in coming days



The latest PMI survey results indicated that the UK private sector economy continued to experience healthy and steady activity growth in September as growth in the manufacturing sector picked-up in September offsetting slowdowns in in both services and construction activity growth. This leaves the combined PMI results for Q3 as a whole near the Q2 average when the UK economy rose by 0.4% q/q, with the strength of initial 'hard' data for Q3 underpinning some expectations (including from the BoE) for a slight pick-up in Q3 growth to 0.5%. Other elements of the survey were also broadly encouraging, suggesting that healthy growth could be sustained over the near-term. New order flows increased modestly for a 2nd month in a row, which in turn supported a further pick-up in the rate of job creation to reach a 7th month high. Sentiment about future activity prospects also rose, though the level of confidence remains relatively subdued, mainly reflecting Brexit uncertainties. Brexit also continues to be linked to signs of household caution over borrowing, with the latest credit figures showing growth in net lending to individuals at a 17th month low of 3.7% y/y as in August.

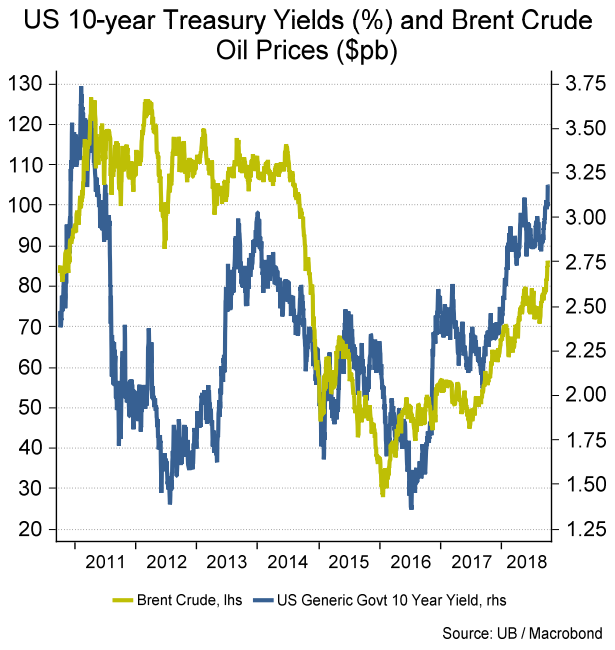
Meanwhile on Brexit negotiations, while we remain concerned about 'hard' Brexit risks, there are some signs of progress behind the scenes now that the Tory party conference is behind us. Of particular note, media reports suggest that a new backstop proposal from the UK government may soon be forthcoming and may feature greater flexibility regarding the operationalisation of the backstop, a development likely to be welcomed in Brussels.

US: Powell describes US economic conditions as "remarkably positive", indicates the Fed is still a long way from neutral rates



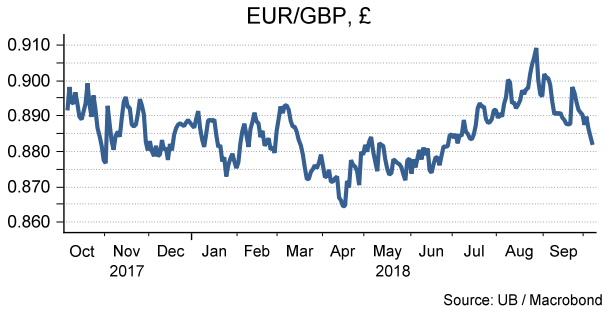
Echoing last week's post-meeting press conference, Fed Chairman Jay Powell's characterisation of the US economy in a key speech this week was notably upbeat. He noted that growth is strong, unemployment is near 50-year lows and inflation is roughly at the Fed's 2% target, and that the baseline outlook of forecasters inside and outside the Fed is for more of the same. Indeed, the latest economic news very much supports the Chairman's assessment. Last Friday's price data showed the core PCE deflator at 2%, while today's jobs report shows employment continuing to expand at a healthy, if more moderate, pace of 134k in September with the unemployment rate falling to a new cycle low of 3.7%. The last time the jobless rate was lower was in 1969. In describing US economic circumstances as "remarkably positive", Powell observed that "the historically rare pairing of steady, low inflation and very low unemployment is testament to the fact that we remain in extraordinary times". In this context, the challenge for policy makers is to extend the current expansion while maintaining stable inflation, with Powell making the case that the Fed's ongoing policy of gradual interest rate normalization reflects its efforts to "balance the inevitable risks that come with extraordinary times". His post-speech remarks emphasised the Fed's current view that gradualism very much remains the path of choice. However, in saying that "we're a long way from neutral" and may need to "go past neutral" to ensure that inflation stays tame, he was clearly indicating that this Fed hiking cycle likely has some ways to run yet.

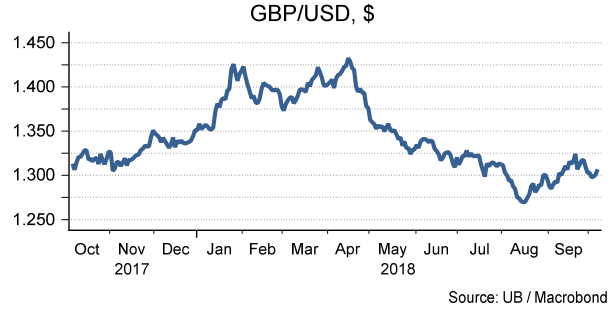
Financial Markets: Oil prices and US 10-year yields make multi-year highs

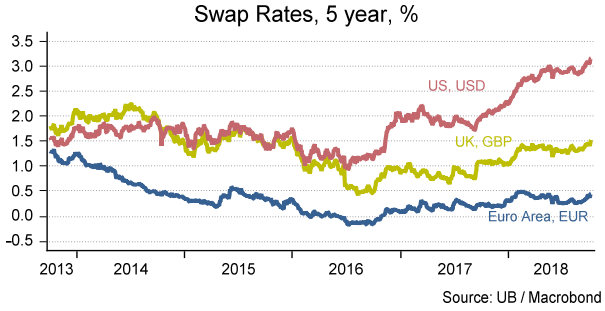


This latest bout of upward price pressure on oil prices has taken Brent crude to a 4-year high around $85pb following a 2.1% gain on the week. On the demand side, the international growth backdrop remains generally favourable, with this week's news on the new US-Mexico-Canada trade agreement helping to ease concerns about trade-related risks to the global outlook. But supply-side considerations have been especially to the fore this week as investors seek to allow for the impact of reduced supply in an already-tight market as US sanctions on Iran are set to kick in from next month. Annual growth in crude prices now stands at over 50% - a marked acceleration from the ca. 10% pace of growth a year ago. One consequence has been associated upward pressure on headline rates of consumer price inflation. This is less of an issue for the ECB (given that core inflation in the euro zone remains some way below target) than for the Fed in the US where core inflation is already back at target and where any remaining labour market slack is very limited. Taken together with Fed Chairman Powell's positive messaging on the US economy this week, the result has been further upward pressure on US market interest rates and bond yields. 10-year US Treasury yields made a new cycle (and 7-year) high of over 3.2% this week as US market interest rate pricing continues to adjust higher towards Fed guidance. The upmove in US yields has provided support for the dollar which is generally stronger across the board, but is creating something of a headwind for stock prices in developed and, especially, emerging markets.

Currency and interest rate market trends







Market Monitor

Foreign Exchange Markets

	Latest	weekly Δ, %
EUR/GBP, £	0.882	-1.0
GBP/EUR, €	1.134	1.0
EUR/USD, $	1.153	-0.7
GBP/USD, $	1.307	0.3
EUR/JPY, JP¥	131.2	-0.5
GBP/JPY, JP¥	148.8	0.4
USD/JPY, JP¥	113.8	0.1
EUR/CHF, CHF	1.144	0.4

Stocks & Commodities

	Latest	weekly Δ, %
ISEQ	6,440	-1.3
STOXX Europe 600	377	-1.7
FTSE 100	7,341	-2.3
S&P 500	2,902	-0.4
Dow Jones	26,627	0.6
Nasdaq	7,880	-2.1
NIKKEI	23,784	-1.4
OIL (London Brent)	84.5	2.1
Gold	1,203	0.9

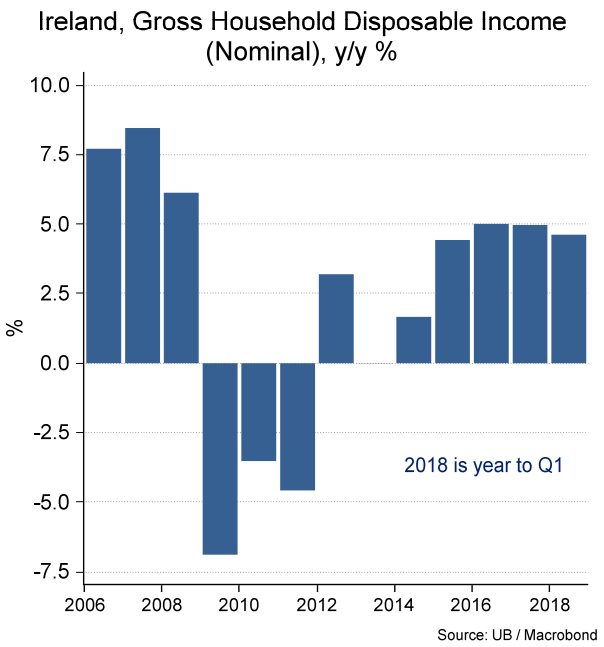
Interest Rate Markets

		Latest (%)	weekly Δ, bps
EUR	3 Month Euribor	-0.318	0.0
	2 Year Swaps	-0.09	2
	5 Year Swaps	0.45	6
	10 Year Swaps	1.07	8
GBP	3 Month Libor	0.802	0.2
	2 Year Swaps	1.20	5
	5 Year Swaps	1.53	9
	10 Year Swaps	1.75	10
USD	3 Month Libor	2.408	1.0
	2 Year Swaps	3.06	8
	5 Year Swaps	3.18	12
	10 Year Swaps	3.26	15

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) = 0.44%
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 sector accounts and house price growth, ECB minutes and Brexit negotiations in focus



An important week ahead on the Irish economic calendar includes the Institutional Sector Accounts (on Thursday). As usual, nominal household income growth will be a particular point of interest for us and we wouldn't be surprised to see a pick-up in growth from a solid 4.6% y/y in Q1 following very favourable labour market and wage developments in Q2. Thursday's HICP figures are also expected to highlight that the household sector continues to benefit from subdued inflation, further underpinning real terms growth in total spending power. Meanwhile, we think that the annual rate of national house price inflation (on Tuesday) is likely to ease for a fourth consecutive month in August following 10.4% in July. Domestic construction will also be in focus, with the release of the September results of the Ulster Bank Construction PMI on Monday.

Away from home, while the September ECB monetary policy meeting was light on major new policy insights, Thursday's ECB account is likely to include an important discussion on both downside and upside risks to the outlook. In the UK, with the government expected to issue a new backstop proposal and Rabb and Barnier meeting in Brussels, Brexit will remain in focus. In terms of the economic data, monthly UK GDP figures (on Wednesday) for August are expected to show healthy growth of 0.2% m/m, which following a robust increase of 0.3% in July would leave the economy on track to grow by at least 0.5% q/q in Q3. In the US, core CPI inflation (on Thursday) is expected to have remained unchanged at 2.2% in September.

Economic calendar for the week commencing October 8th

Ireland / Eurozone	UK	US
Monday		
01.01 – Construction PMI (Sep) 09.30 – EZ Sentix Investor Confidence (Oct)		15.00 – Conf. Board Employment Trends (Sep)
Tuesday		
11.00 – Residential Property Prices (Aug); New Vehicle Licenses (Sep)	00.01 – BRC Sales like-for-like (Sep)	11.00 – NFIB Small Business Optimism (Sep)
Wednesday		
11.00 – Household Travel Survey (Q2)	09.30 – Monthly GDP (Aug); Index of Services (Aug); Industrial / Manufacturing Production (Aug); Construction Output (Aug) 10.00 – BoE speech (Chief Economist Andy Haldane)	02.15 – Fed speech (Williams - voter) 13.30 – PPI Inflation (Sep) 17.15 – Fed speech on the economy (Evans) 23.00 – Fed speech on economic outlook (Bostic - voter)
Thursday		
11.00 – Institutional Sector Accounts (Q2); HICP Inflation (Sep) 12.45 – ECB Account of September monetary policy meeting	00.01 – RICS House Price Balance (Sep) 09.30 – BoE Credit Conditions & Bank Liabilities Survey	13.30 – CPI (Sep); Initial Jobless Claims 19.00 – Monthly Budget Statement (Sep)
Friday		
10.00 – EZ Industrial Production (Aug) 11.00 – Trade Statistics (July)	00.01 – Rightmove House Prices (Oct)	15.00 – U. Michigan Consumer Confidence (Oct)

The Calendar uses Irish local time

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