KBC

Flash

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Irish bonds: buying opportunity?

Irish bonds underperformed ahead of next general election; buying opportunity?

Spread widening also triggered by Brexit-debate and global risk aversion

Buoyant economic recovery; 4.5% growth expected this year

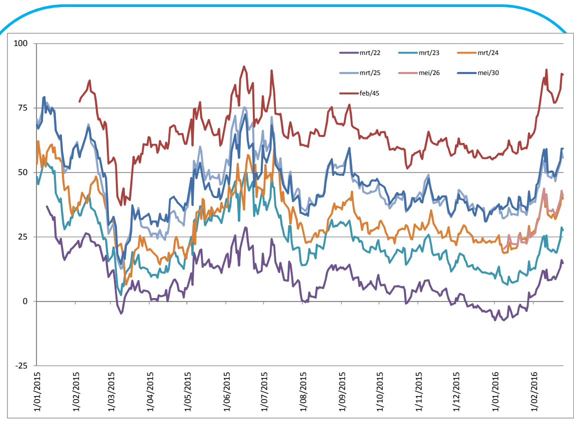
Lack of supply pressure positive factor; no new syndications expected

Rating upgrade by Moody's ahead?

In the run-up to this week's **general election, the Irish bond market has underperformed.** Expectations of an indecisive outcome and indications in opinion polls of increased support for more radical parties and independents have played a significant part in this underperformance. These concerns have developed in spite of the persistence of a broad and strong consensus on economic policy matters within mainstream Irish politics.

Quite apart from the election uncertainty, the intensifying **Brexit-debate** is also weighing on sentiment. Around 20% of Irish exports are headed to the UK, which is the 2nd largest trade partner (after the US). Importantly, the land border between the Republic of Ireland and the six counties of Northern-Ireland, which are part of the United Kingdom, coupled with the small geographic distance between Ireland and Great Britain, mean economic links between the two countries have much more of the character of a regional rather than an international relationship.

Of course, recent Irish bond market underperformance also owes something to more generalised **risk aversion** internationally that has spread from equity and commodity markets to European government bond markets and soured general sentiment.



Graph 1: Evolution ASW-spreads outstanding Irish government bonds (tenors: 2022-2045)

Rainbow coalition

On Friday, the next **Irish general election** will take place. In the election campaign, current coalition government parties of Prime Minister Enda Kenny's **Fine Gael (centre-right) and the Labour Party (centre-left) have presented separate (but largely compatible) programmes and indicated their preferred outcome is for the return of the current Government. Between them, they are expected to have the largest block of seats in the next Dáil (the Irish parliament) but the consistent message in a range of**

opinion polls is that they will fall some significant way short of an absolute majority. Recent polls put Fine Gael's support around 30% and Labour at between 5% and 10%. If their election mantra of stability and sustaining recovery echoes with voters, **they may be in a position to reach out to a number of independent members of parliament or suitable smaller parties in order to form a "rainbow coalition" that would largely continue on the present political (and economic) course.** If the current coalition parties poll badly (an outcome that is increasingly priced in by markets), they may not be able to attract sufficient sustainable support from independents. Without the formal support of independent MP's or minor parties, a minority government is the most likely outcome. Although there is a reasonably broad consensus on economic and political matters in Ireland- as demonstrated by the large measure of social cohesion through the recent very painful fiscal adjustment programme - the probability is that a minority government might be relatively short lived and another election could be in prospect before the end of the year.

We consider it unlikely that the two largest opposition parties will be part of the next government. Fianna Fáil gets the backing of around 20% of the voters in the opinion polls, but a grand coalition with Fine Gael seems very unlikely. It would be the first time in history that these two traditionally dominant parties would join forces.While there is no unbridgeable ideological divide between these two parties that were born out of the opposing sides of a civil war that followed Irish independence in 1922, it may still be too early for such a leap.

Apart from the fundamental change this would imply to the political landscape, the current strong economic environment in Ireland means that there isn't the compelling influence of crisis conditions to force such a difficult political 'marriage'. Indeed, the current strength of the Irish economy is a key factor which diminishes pressure on all parties to contemplate arrangements that might be forced on them in more difficult circumstances.

Sinn Féin, historically linked to the IRA, has substantially increased its support base since its central role in the peace process in Northern Ireland and is now emerging as a radical alternative to mainstream parties. It currently polls around 15 to 20%. However, neither it or any of the mainstream parties are likely to be willing to come together as part of a coalition government at this juncture.

The outcome of the election is unlikely to prompt any marked change in the thrust of Irish economic policy. That said, in common with the changing global mood, there is likely to be increased emphasis on a fiscal stance that provides a measure of support to household spending power as well as increasing outlays to improve the health services and infrastructure. Importantly, scope for a modest element of fiscal largesse is likely to be provided by a strongly recovering Irish economy while the scale of any stimulus will be notably limited by EU budget rules as well as domestic memories of the recent crisis.

Graph 2: Evolution spread IRISH 5.4% Mar2025 vs BGB 0.8% Jun2025 (black) and IRISH 5.4% Mar2025 vs FRTR 0.5% May2025 (yellow) in ASW terms

Economic recovery at full speed

We believe that the recent cheapening of Irish bonds might be an opportunity and target new narrowing of asset swap spreads and spreads versus other (semi-)core countries. Especially at the longer end of the Irish curve, the pick-up becomes attractive (eg graph 2: 10-yr Ireland VS 10-yr Belgium/France). **The Irish economy is travelling with exceptional forward momentum. Last year, GDP grew by around 7%.** The strength and spread of the recovery have become much more impressive through the past year. Importantly, the forces supporting this improvement seem likely to remain in place for some time to come. As a result, the Irish economy is expected to deliver clear gains in activity, incomes and employment in 2016 and beyond barring a dramatic deterioration in the global economy. **While a difficult global backdrop may restrain export growth well below last years double digit pace, the emerging improvement in domestic demand means the easing in economy-wide growth can be controlled. As a result, we expect this year's GDP growth to be around 4.5%.**

Low government borrowing (see below) an rapid increases in GDP have resulted in a substantial reduction in public debt which has fallen from a peak of 120% of GDP in 2012 to an estimated 96% of GDP at end 2015. **The ratio could slip below 90% by the end of 2016.**

No supply side pressure

From the supply side, no new syndicated deals are expected in 2016. Lack of supply pressure is positive for Irish bonds. Year-to-date, the Irish National Treasury Management Agency (NTMA) raised €4B via launching and tapping IGB 1% May2026. NTMA's official funding need is €6-10B, but they'll probably end around the lower bound of expectations. **With around €10B cash reserves, NTMA is already fully funded for approximately 12 months in advance.** Moreover, the ECB is currently purchasing Irish government bonds at an annualised rate of €9.4bn.

The Irish maturity profile remains beneficiary with low redemptions during 2016-2018, allowing NTMA to reduce cash reserves and lower the debt ratio further. The weighted maturity of outstanding debt is an impressive 11.6 years, way above EMU average (around 6.6 years).

Ireland is rated A+ at S&P, A at Fitch and Baa1 at Moody's. The outlook is stable with S&P and Fitch, but positive with Moody's. The rating agency recently cited the marked improvement in the country's credit fundamentals, including a stronger economic recovery, faster fiscal consolidation and a substantial decline in the government's debt burden as the main reasons. **Another rating upgrade can thus be expected.** It would further strengthen Ireland's status of semi-core country and fully lift the country in the category of "A-rated" category.

These considerations mean that while an element of 'event risk' is now priced into Irish bonds and such influences may well persist in the short term, Ireland's underlying economic strength and political stability could present an attractive buying opportunity.

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