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EXPORT MARKET WATCH

International Construction

Investec

#GlobalAmbition

The Enterprise Ireland/Investec Export Market Watch Survey International Construction

45% of panellists say that they have **reduced their exposure to the UK** following the Brexit vote

Only **one in three** panellists believe that they currently have **sufficient resources in place to expand into new markets**

69% view the Eurozone as attractive

72% say they **would hire** if entering new markets

Market knowledge cited as the highest barrier to entry

Sterling & USD are the major **non-euro currency exposures**

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Introduction and key findings

Export Market Watch **is a new publication from Enterprise Ireland, in conjunction with Investec, that is designed to help support Irish firms by providing insights into developments across the country's major export markets, as well as the outlook for exchange rates. Within the report, macroeconomic analysis is complemented by expert commentary from Enterprise Ireland's sector specialists and a survey of exporters to better understand where the most attractive opportunities for growth are, along with exploring the impact of events such as Brexit.**

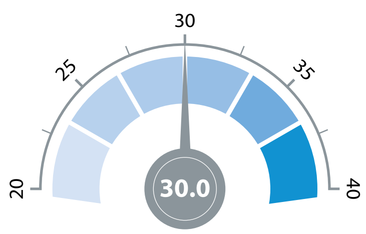
In this quarter's report, we examine the prospects for the construction sector. The responses provided to our survey of firms in the industry provide a fascinating snapshot of how companies are adapting to the post-Brexit vote environment. Some 45% of respondents have taken steps to cut their UK exposure since last year's referendum, but with Ireland's closest neighbour still identified as the country with the best near-to-medium term opportunities (possibly a function of the limited geographical scope for exports of some construction products) it is clear that the UK will remain an important customer.

What is also clear, however, is that other markets, particularly in the Eurozone, will grow in terms of export importance in the coming years. Hi-tech construction services in the areas of data centres, pharmaceutical plants and other hi-tech manufacturing facilities are particular areas of growth for Irish construction companies in the Eurozone and US. Indeed, many Irish construction services firms are leading the charge in these areas with expertise initially gained from working with Multinationals in Ireland and their early adoption of new Building Information Modelling (BIM) digital technology processes. We note that companies report a number of challenges including: market knowledge; adequate staffing; customer targeting; and regulatory uncertainty as being among the key barriers to entry into new markets – findings that should prove helpful in terms of informing business strategy discussions in the coming years.

While currency was not highlighted as a top barrier to entry by our panellists, we suspect that this outturn is due to Ireland's membership of the Eurozone. For those firms with current or anticipated non-euro exposures, given the likely uptick in volatility in the currency markets arising from evolving Central Bank policies in the coming years, it is prudent to consider strategies to protect revenues and margins from any sudden exchange rate moves.

Irish Merchandise Exports

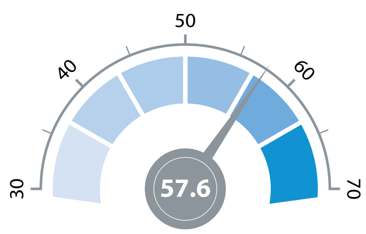
Q2 2017



Value: € Billions

Investec Manufacturing PMI New Export Orders

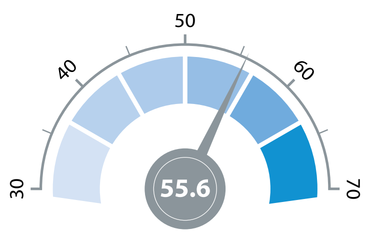
Q2 2017



Index Level

Investec Services PMI New Export Orders

Q2 2017



Index Level

Recent export performance and FX perspectives

KEY POINTS

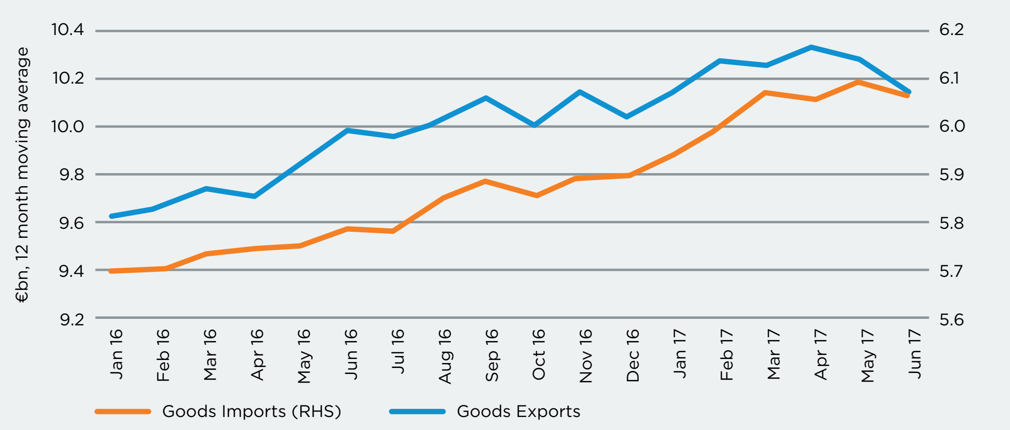
- **Trade surplus +16%** in the year to date
- **Goods exports +7%** in the year to date – an impressive performance given the headwind of a weak pound
- PMI findings suggest a similar **strong performance in the services sector**

Irish exports have made a very strong start to 2017, with nominal merchandise (goods) exports increasing by 7% y/y in the year to June according to the CSO. Helped by this momentum, the trade surplus has widened by 16% y/y (to €25.1bn) over the same period. Eight of the nine major commodity groups have posted annual growth in nominal exports in the first six months of the year.

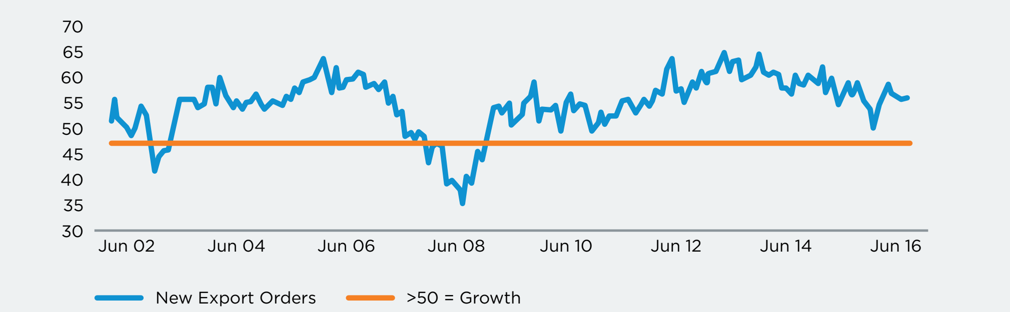
Elsewhere, with eight successive above-50 readings, the export component of the Investec Services PMI report for Ireland suggests that, similar to goods, the strong momentum in this area should continue.

The above progress is particularly encouraging given some recent adverse currency movements from an Irish perspective, most notably from sterling.

Merchandise Trade



Services PMI New Export Orders



Outlook for FX markets and monetary policy

KEY POINTS

- The focus in FX markets is shifting back to **economic fundamentals** from political developments
- As the **ECB** moves to tighten policy, this should see the euro strengthen
- However, **volatility in the euro-sterling exchange** rate may also become an increasing feature

With most of the key scheduled political events of 2017 now behind us, the focus where the outlook for monetary policy is concerned has largely switched back to the economic fundamentals. In the US, the Federal Reserve has continued its gradual tightening, with projections from the members of the Federal Open Market Committee suggesting that further rate increases are likely into 2019. Most analysts assume that it is just a matter of time before the other big Central Banks (the European Central Bank and the Bank of England in particular) follow suit and begin to tighten policy.

Eurozone/EUR: A combination of the diminution of perceptions of political risks and a brighter economic growth outlook for the Eurozone have contributed to a strengthening of the single currency. Following July's meeting of the ECB's Governing Council, at which it referenced a 'continued strengthening of the economic expansion', the euro surged to a 30 month high against the US dollar. However, given the gap between the rate of inflation in the Eurozone (1.3% in June) and the ECB's mandate of at or just below 2%, it will likely be at least 12 months before a rate hike will even be considered. Investec sees the euro at US$1.14 and £0.88 at year-end, rising from there to US$1.18 and £0.90 by the end of 2018.

UK/GBP: The Monetary Policy Committee of the Bank of England took markets by surprise at its June meeting, with three (of the eight) members voting to raise the Bank Rate by 25bps to 0.50%, which led to a brief rally in sterling. Rising domestic inflation pressures are a key concern for members of the Committee at this time, but economic fundamentals may be once again overshadowed by political events in the wake of the recent UK General Election. While Investec sees the pound strengthening against the US$ (to $1.30 at end-2017 and $1.32 at end-2018), improving economic conditions in Europe will likely prevent similar gains for the pound against the single currency. However the evolving policy outlook looks set to result in elevated volatility in the euro-sterling exchange rate over the coming quarters at least.

Euro-Sterling Rate

Euro-Dollar Rate

Investec Currency Forecast

		2017			2018	
		18 Aug	Q3	Q4	Q1	Q2
Euro	€:$	1.176	1.14	1.14	1.15	1.16
Sterling	€:£	0.913	0.89	0.88	0.89	0.89
	£:€	1.095	1.13	1.14	1.13	1.13

US/USD: Members projections' (the so-called 'dot plot') accompanying the June meeting of the Fed implies that it sees one further hike this year and three in 2018. Investec expects a slower pace of tightening, with our confidence in this stance underpinned by the evident nervousness from some at the Fed about inflationary developments.

Oil: Brent Crude touched a low of 44.35 $/b in June – its lowest level since November 2016. Looking ahead, questions are increasingly being asked about what will happen at the end of March 2018 when the currently agreed OPEC production cuts are scheduled to end. The International Energy Agency's latest monthly Oil Market Report made sobering reading in this regard, as it suggested that increases in non-OPEC production would be more-or-less sufficient to satisfy total global demand growth in 2018. This would leave OPEC members with limited room to increase output in 2018 and means that some form of cap would need to be maintained once the present one ends. For the next few months the key fundamental question is whether OPEC's cuts will finally start to make real inroads into oil inventories at a time of seasonal high demand.

Risk Management: FX and commodity markets have exhibited considerable volatility since the Brexit vote. Of particular note to Irish corporates has been the marked appreciation in EURGBP, now 19% higher than pre-Brexit trading levels, impacting significantly on the euro value of overseas exports. Irish companies affected by this could consider solutions that could provide the certainty of protection over the value of expected revenues for the year ahead.

The global outlook

KEY POINTS

Global growth is accelerating, which has positive implications for Irish exporters

Economic strengthening in the US and Eurozone is particularly helpful for Ireland

Eurozone growth is expected to reach 2.1% this year

Turning to the wider global outlook, Investec forecasts that world GDP will grow by 3.6% this year and 3.9% in 2018. Economic data continue to point to momentum having firmed in recent months. Global manufacturing PMIs are particularly robust, with the most marked recovery occurring in advanced economies. Happily for those Irish firms who export abroad, the pace of growth in global trade has picked up over the past six months or so.

In terms of Ireland's major trading partners, Investec continues to judge that the US economy has decent momentum, with GDP expected to expand by 2.4% this year and by a further 2.6% in 2018.

In the Eurozone, growth is accelerating, with Q1 seeing quarterly expansion of 0.6% q/q, matching the positive backdrop that had been signalled by PMI surveys. Investec sees Eurozone GDP +2.1% this year, with a similar expansion expected in 2018.

In the UK, as hinted to above, recent signals from the Bank of England have heightened risks of a tightening of policy, but Investec remains sceptical of the prospects of an early hike. Investec sees UK GDP +1.6% this year and +1.7% in 2018.

A little over a year has passed since the UK voted to leave the European Union. While Article 50, the instrument needed to effect this change, was triggered at the end of March 2017, the formal commencement of talks on the terms of Britain's departure was delayed until after June's General Election. With the extensive and complex negotiations set to continue for some time, the Brexit process is likely to remain a significant source of uncertainty for both the UK economy and certain segments of the Irish economy.

International Construction Markets

KEY POINTS

In the **US** construction industry, the housing market is the main engine of growth

There are clear signs that **UK** construction activity has lost momentum

Strengthening **Eurozone** conditions are benefiting the construction sector

An examination of the latest developments across the global construction market reveals ongoing momentum for the US residential construction market, but at the same time Investec notes less positive (if somewhat volatile) indicators for the non-residential sector. Closer to home, the UK is clearly underwhelming, overall construction activity is just +0.9% y/y and consumer price inflation is now trending ahead of wage inflation, depressing consumer spending power. The Eurozone continues to improve, with strong consumer and construction confidence evident in Ireland, Germany and the Netherlands and a big improvement more recently in France.

As alluded to above, in the US the residential market is the growth engine for now. US construction slipped 1.3% in June (+1.6% y/y), with residential -0.3% m/m (+9.0% y/y); and non-residential -2.0% m/m (+3.1% y/y). The overall residential outlook remains favourable in our view, with home sales, mortgage rates and the NAHB (National Association of Housebuilders) index all still trending in the right direction. On the flipside, non-residential is lacking momentum, with lead activity indicators for non-residential (ABI – Architecture Billings Index, Dodge – Momentum Index etc.) give a mixed message.

In the UK, total construction activity declined by -0.1% m/m in June and is now just +0.9% y/y, the second month in a row of declining yoy growth. The most recent RICS (Royal Institute of Chartered Surveyors) survey shows that new house buyer enquiries are negative and lacking momentum – poor for new house sales and for renovation and repair markets. Consumer confidence remains weak and CPI inflation is now trending ahead of wage inflation, a headwind for the industry. Non-residential fell 1.2% m/m, its fourth decline in the past five months.

Construction markets in Europe (excluding UK) continue to recover following the poor weather seen earlier in the year. While actual construction activity in June across Europe fell -0.2% m/m (+3.6% y/y) lead indicators for construction and consumer confidence show good momentum across Europe. Construction and consumer confidence indicators are particularly strong in Ireland (Construction PMI above 50 for 47 successive months), Germany and the Netherlands but we have also seen a big improvement in France. Other markets such as Poland which has been very depressed for the last nine years continue to show consistent recovery, led by improving consumer confidence, with construction volumes +13.4% y/y in June.

Staying with Ireland, the latest data shows that the recovery in activity continues. Housing completions were +24% y/y in Q1, while planning permissions data (a lead indicator for completions) show growth of 39% y/y to 17,394 units on a four-quarter-moving-average basis to end-Q117. Despite this improvement, we expect the mismatch between supply and demand to endure until the end of the decade at least. This, in turn, informs our forecast for house price inflation of 7% this year and 6% next year.

Construction Outlook

What are the most attractive ways for Irish SMEs in the construction space to play this international economic strengthening? Combining an analysis of official economic data with the on-the-ground insights of Enterprise Ireland's sector specialists identifies a number of opportunities, namely:

US: At a headline level, the prospects for the housing market seem to be healthier than for the non-residential component of the US construction market. Enterprise Ireland's client companies have identified housing, data centre construction and healthcare as the market segments offering the most attractive growth prospects at this time.

UK: Weak consumer confidence and negative real wage growth are headwinds for the owner-occupied housing market (both new sales and the repair, maintenance and improvement (RMI) markets). However, the build-to-rent component of the residential market is seen as having strong structural growth opportunities for the coming years. Elsewhere, while the overall momentum is negative in the non-residential market, infrastructure remains a bright spot, particularly in the transport sector. Interestingly, the weak pound has not undermined Irish firms' competitiveness when tendering for projects, although companies have expressed concern about FX volatility over the lifetime of tenders.

Eurozone: The broad economic upturn in continental Europe is providing a strong tailwind for the construction sector generally. There is a big emphasis on opportunities in the non-residential sector, with data centres, pharmaceutical facilities and healthcare infrastructure all identified as areas with attractive growth profiles.

Looking ahead, with the world's most influential Central Banks embarking on divergent paths in terms of rate-setting, we are likely to be in for a period of extended volatility in the currency markets. So, the advice for SMEs here is that, along with successfully identifying the best 'micro' (sector and sub-sector) opportunities for growth, they should embrace tactics such as hedging in order to protect their revenue and cost lines against any adverse 'macro' developments.

Key results from the survey

KEY POINTS

Nearly one in two construction firms say that they have **reduced their exposure** to the UK

However, Ireland's closest neighbour is still seen as a **key market** by firms in the sector

The Brexit vote seems to be encouraging Irish construction firms to consider **new markets** and 69% believe the Eurozone offers attractive opportunities

For our inaugural survey we canvassed views from clients of Enterprise Ireland in the construction sector. The survey attracted responses from firms operating in both the services and product spaces and they provide good insights into how EI's clients in the sector view opportunities for export growth in the post-Brexit vote environment.

Since the June 2016 poll, some 45% of panellists say that they have reduced their exposure to the UK. A number of firms said that they have withdrawn from the UK completely, with many of these switching their efforts to Continental Europe, the US and Asia. For those retaining a presence in Ireland's nearest neighbour, they have adapted their business models – we note that some panellists spoke of implementing 'natural hedging' (sourcing more UK suppliers to mitigate against currency risk) while others have introduced more conventional currency and raw material hedging tactics.

This is not to say that Irish construction firms are likely to withdraw from the UK altogether. It is still the most commonly cited market by panellists when asked to identify the countries that offer their business the best near-to-medium-term opportunities. However, the survey suggests that it will face stiffer competition in the coming years from other markets where investment decisions are concerned. For example, while 52% of respondents currently do business with the Eurozone, 69% view it as offering attractive future prospects for their firm.

With that being said, in terms of preparedness for overseas expansion, only one in three panellists believe that they currently have sufficient resources in place to expand into new markets. The constraints identified for such a move are multifaceted – a lack of market knowledge; human resources; regulatory uncertainties and the capital required are all highly cited by panellists. Interestingly, currency risk is identified as an issue for 63% of respondents, which may suggest a need for greater awareness of the approaches that can be adopted to mitigate this volatility. Unsurprisingly, sterling and the US dollar are the major currency exposures for Irish construction firms with overseas business. Equipping firms with the skills to overcome these challenges will likely deliver tangible benefits, with 72% of respondents saying that they would increase their employee numbers if they move into new markets.

Another consideration is that some firms' business models currently exclude the possibility of expanding too far from the home market. Some panellists stated that the nature of their operations (e.g. heavy construction products) made further geographical exposure a challenge.

Enterprise Ireland construction sector adviser views

We present here some perspectives from Enterprise Ireland's sector experts on current conditions across the Irish construction industry's major export markets.

IRELAND: *"Construction sector activity in Ireland is strong and according to the latest Purchasing Managers Index by Ulster Bank August marked the 47th successive month of increased activity. From an export perspective, construction exports by Enterprise Ireland clients are at an all time high and many construction companies, who diversified during the downturn, are now well positioned to capitalise on global growth in key markets. The impact of Brexit on construction companies remains to be seen fully. While the weaker pound has not appeared to have significantly impacted negatively on demand, this may be due to contracts already priced and in place and we have been advising clients to use our Brexit SME Scorecard to prepare for Brexit and to put in place currency risk management measures. From an Enterprise Ireland perspective, there is a focus on helping SME clients upskill in relation to BIM, which larger client companies have adopted and recent successful trade missions to Scandinavia highlight the significant capabilities of Irish construction companies in the areas of hi-tech, data centre and pharma construction which we as an organisation are focusing on as part of a new export promotion initiative".*
Stephen Hughes, Head of Construction, Ireland.

UK: *"Demand continues to remain supported and as yet the immediate impact of the weaker pound does not appear to have impacted competiveness of Irish firms operating in that market. However, corporate clients are increasingly concerned about the ongoing volatility in FX markets when looking to tender and price new longer term projects. In the medium term, increased uncertainty in the aftermath of Brexit and UK Elections are likely to impact more acutely the Commercial and Retail areas of the market traditionally more exposed to changes in consumer spending, inflationary pressures and general market confidence. On the other side, UK infrastructure and Residential offer opportunities as the Government prioritises spending as a form of economic stimulus and is focused on new approaches to address the shortage in the housing market, in particular Build to Rent initiatives.*

Given capacity constraints coupled with a more conservative investment approach adopted by UK based suppliers, there are opportunities for Irish firms to re-engage with UK clients as they seek to diversify their supply chain. In particular these opportunities are seen to be for those offering offsite construction, digital design and construction and lean construction. Irish clients have not expressed much concern to date regarding the imposition of tariffs, and in fact FX movements can often represent a much greater percentage cost increase."
John Hunt, Market Adviser, UK Construction.

US: *"The US market holds significant opportunities for Irish companies with products and services for the Construction industry. The industries Irish companies have succeeded in are data centres, pharma, healthcare and mixed use commercial & residential developments due to their experience in them. Since Brexit, Enterprise Ireland has noticed an increase in Irish Construction Firms looking to explore the US Market. EI recommends a targeted geographical approach within a specific industry supported by a physical presence on the ground. Each of the 50 states can have their own set of rules and regulations and even yield different opportunities, so it is important to research the market carefully."*
Caroline Donnelly, Market Adviser, North America.

EUROZONE: *"Most markets are in a recovery phase, which mirrors the broader economic strengthening across the Eurozone. The availability of funding, however, remains a challenge in parts of the construction industry. There are a number of growth areas in Germany and Benelux in hi-tech construction such as data centres, pharmaceutical facilities and healthcare infrastructure – all segments that Irish firms have significant expertise in. Irish hi-tech construction professional services firms are differentiating themselves with their Building Information Modelling (BIM) expertise in the market which is a key selling point. In Germany, demand remains strong and the market is characterised by long standing local relationships and having a presence in the market is highly regarded by German contractors. Enterprise Ireland client Collen Construction recently opened an office in Frankfurt. Benelux region also remains stable albeit some uncertainty remains in the Netherlands as a new Government is yet to be formed."*
Vincenz Wenger, Market Adviser, Germany Construction;
David Corcoran, Market Adviser, Benelux Region.

Table of Recent Sector Reports

Marketline

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Ireland's European Structural and Investment Funds Programmes 2014-2020
Co-funded by the Irish Government and the European Union

European Union
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