OUTLOOK

The fundamentals of the economy remain favourable for retail property with strong economic growth contributing to a benign cycle of jobs creation, increased earnings and tax cuts. This has led to a rebalancing of growth with domestic demand gradually taking over from net exports as the driving force behind the economy.

Brexit has added a new layer of uncertainty to the economic outlook. The full effects of this will take time to emerge. However, likely negatives include a swing in the trade balance because of slower UK growth and weaker Sterling. In the longer run, and depending on the outcome of negotiations between Britain and the EU, obstacles such as quotas and tariffs may introduce further challenges to bilateral trade between Ireland and the UK. Despite the potential offsetting effect of prolonged low interest rates, therefore, Brexit is expected to have a negative impact on the Irish economy. Pre-exit estimates suggested that a leave vote could deduct 0.5-2 percentage points from Ireland's GDP growth by the end of 2017. However, even discounting current consensus growth forecasts by this amount would still leave Ireland with robust GDP growth rates. A specific concern for the retail sector is the impact of Brexit on UK brands that are already here or that may have been planning to enter the Irish market. A slowdown in the UK economy is now expected, and traditionally this has caused British retailers to adopt an introverted posture and focus on their domestic market. However, with the consumer economy in Ireland strengthening and the Euro appreciating against Sterling, we do not anticipate any major withdrawals of UK traders from the Irish market.

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Market in Minutes
Ireland Retail

July 2016

Zara (flagship) - Dundrum Shopping Centre

ECONOMIC OVERVIEW

Ireland's Retail Market

Ireland's economy has continued to go from strength to strength since our last report. GDP grew by 7.8% in 2015, leaving Ireland at the top of the European leaderboard for the second year running. While exports remain strong, a continued pick-up in the demand for consumer goods means imports are also growing quickly, somewhat offsetting the contribution of net trade to GDP growth. Therefore, the recent expansion has been largely home-grown, with domestic demand rising by 8.6% last year. Employment growth has accelerated to 2.4%, with almost 47,000 jobs created in the twelve months to Q1. As a result, unemployment is falling, earnings are rising and aggregate household disposable incomes are back to their pre-crisis peak.

Prezzo - Liffey Valley Shopping Centre

Retail Economy

While the macro-economic environment continues to improve, an ongoing challenge to the consumer economy is that households are trying to balance their resources between competing priorities. In spite of rock-bottom interest rates household deposits are growing, and the savings rate has risen for five successive quarters[1]. This may reflect mortgage lending restrictions which are requiring first-time buyers, and perhaps their parents, to save more intensively for housing deposits. Households are also paying down debt, with outstanding bank loans falling by €4.8bn in the year to May. However four-fifths of this decline has been due to mortgages being repaid more rapidly than new ones are being drawn down. In contrast, after 75 months of unbroken contraction, the stock of outstanding consumer credit increased sharply in April and rose even more quickly in May.While two months does not constitute a trend, this turnaround does suggest that a corner may have been turned in both consumers' and credit institutions' attitudes to consumer debt.

As shown in Table 1, and despite the recent announcement of Brexit, the latest indicators point to a continuing and broadly-based improvement in the consumer economy. As a result, and with more favourable base effects kicking-in over the summer months, the positive run in retail sales figures is expected to continue.

Sales growth remains broadly based, with all store types sitting above the horizontal axis in Figure 2 – indicating growth in sales volumes over the last 12 months. While furniture and lighting stores (+14.4%) and car dealerships (+10.3%) are registering the strongest growth, other sectors including hardware (+9.8) and clothing and footwear (+7.5%) are also trading well.

Although household economies are improving, consumers have become more price-conscious. Consequently, the retail mix on our high streets and shopping centres is evolving, with value and mid-market brands increasing their presence. This compositional shift goes some way to explaining why average prices in most sectors – those positioned to the left of the vertical axis in Figure 2 – continue to fall on an annual basis. A good example of this is clothing and footwear. Prices have fallen by 1.7% in the last twelve months and our leasing teams are seeing increased demand for retail space from mid-price fashion and footwear brands such as Zara, H&M, Dune of London, Sketchers, New Look and Selected (part of the Bestseller group).

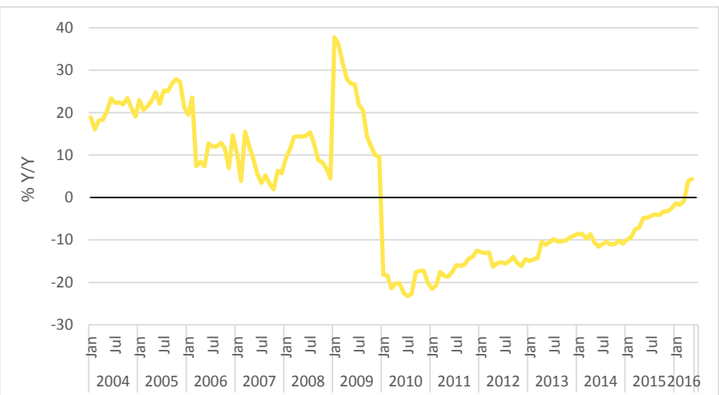
TABLE 1
Consumer Economy Dashboard

Indicator	Period	% Change Y/Y
Live Register	May 2016	-11.2
Real GDP	Q4 2015	+9.2
Real Retail Sales	May 2016	+8.1
Real Final Domestic Demand	Q4 2015	+7.6
Real VAT Receipts	May 2016	+5.5
O'Connell Street Footfall	Weeks 0-25	+5.3
Real GNP	Q4 2015	+5.2
Henry Street Footfall	Weeks 0-25	+3.6
Real Personal Consumption Expenditure	Q4 2015	+3.1
Total Employment	Q1 2016	+2.4
Consumer Sentiment (3MMA)	May 2016	+2.2
Real Average Gross Earnings	Q1 2016	+1.4
Grafton Street Footfall	Weeks 0-25	-5.3

Sources: CSO, KBC Bank Ireland/ESRI, Dublin Town and Dept. of Finance.

While changes in the retail mix can explain some of the price deflation, retail remains a highly competitive sector, and discounting is a factor for many traders. However, costs have been generally well contained across the industry. Wages, one of the biggest costs for retailers, have only risen by 4.3% in the last three years. This is significantly lower than in many others sectors, e.g. finance (+12.0%), ICT (+11.5%), manufacturing (+7.5%) and accommodation and food (+7.3%). In addition, despite annual ERV growth of more than 20% on Grafton St., a 65bp gap between reversionary and initial yields suggests that at least some traders are still paying below-market rents. Meanwhile, rental growth has been slower to take off in many less prime locations. These factors, along with higher volume sales, have enabled retailers to cut prices without jeopardising trading viability.

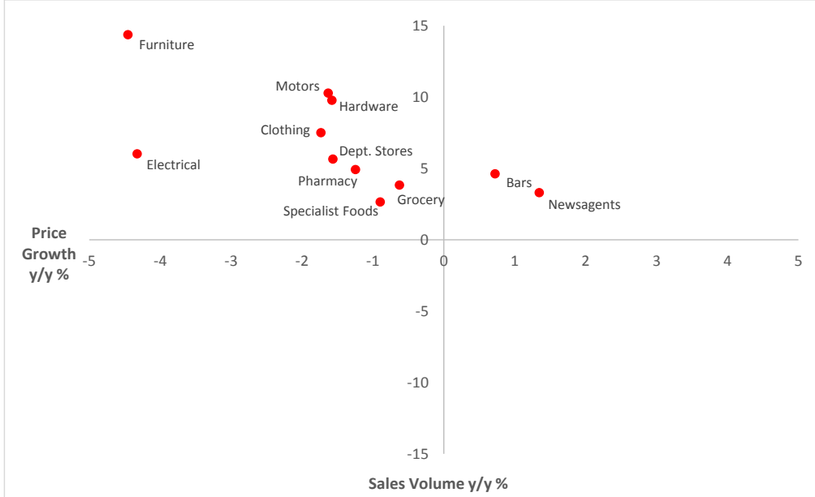
FIGURE 1:
Annual Growth in Consumer Credit



Source: Central Bank of Ireland

[1]*Savings rate calculated on a four-quarter moving average basis.*

FIGURE 2:
Retail Sales Volumes and Price Growth by Sector (3mma), April 2016



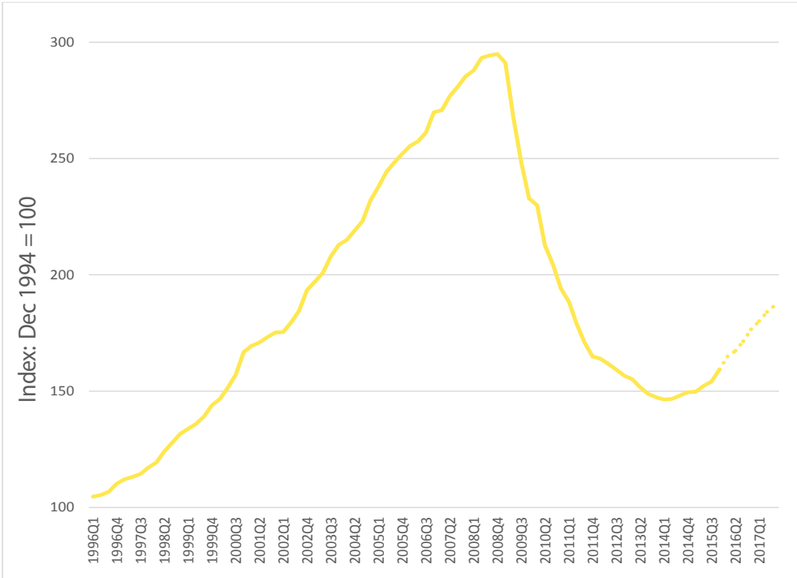
Source: CSO, Savills Research

Outside of the fashion sector, new entrants such as Danish homeware store Søstrene Grene continue to arrive in the market, while a number of existing operators are growing. Variety store Flying Tiger Copenhagen (previously Tiger) and lingerie chain Ann Summers are continuing with their expansion strategies, while outdoor specialist Cotswold has leased its first premises on Trinity Street. Elsewhere IKEA has agreed to lease approximately 1,400 sq.m. of space in The Park, Carrickmines, with the opening of its first 'order and collection point' in Ireland. Meanwhile, in the food and beverage sector, Carluccio's, Las Iguanas, Prezzo, Cosmo and Zizzi are actively pursuing opportunities. Consequently, the availability of retail space is tightening which, in turn, is underpinning rents.

Retail Rents

With vacancy falling, and development only starting to re-emerge, rents have been rising. The MSCI overall retail ERV index increased by 8.6% in the twelve months to March, and the rate of rental growth has accelerated for six consecutive quarters. Looking ahead, our medium-term forecasting model predicts a cumulative uplift in the index of 17.4% between Q1 2016 and Q3 2017. The confidence interval around this forecast currently indicates a 95% probability of cumulative rental growth falling within the range of 13.1%-21.8%. However, the UK's unexpected decision to leave the EU introduces additional risk to these forecasts. Sterling immediately plummeted against the Euro after the announcement of Brexit and we believe that the Pound could fall further in the medium term. This is mixed news for the retail economy – on one hand, the currency swing will result in cheaper imports from the UK which could boost consumption. A stronger Euro relative to Sterling may also encourage the ECB to keep Euro Area interest rates lower for longer, which would clearly be beneficial for retailers. On the other hand, the increased potential for leakage due to cross-border shopping could negatively impact on Irish traders and spending by UK tourists is also likely to fall. Moreover, all of these effects have to be taken in the context of a likely reduction in economic growth due to Brexit. Rental growth in prime locations has continued to outperform, with the Grafton St. ERV index rising by just over 20% in the 12 months to March. As a result, Zone A rents on the street are currently at around €5,500 per sq.m.. Looking forward, our forecasting model currently predicts compound rental growth in this location of just over 21% between Q1 2016 and Q3 2017. As with the overall forecasts, however, the margin of error around this projection has widened due to the UK leave vote.

FIGURE 3:
Overall Retail Rents Forecast Q1 2016 – Q3 2017 Inclusive



Source: Savills Research