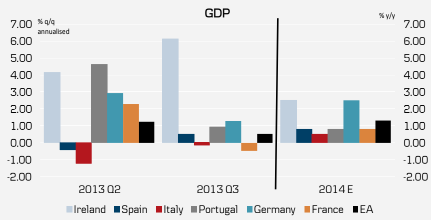
19 January 2014

Flash Comment

Ireland upgraded to investment grade (+) by Moody's

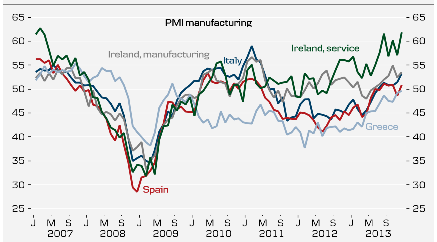
- On Friday evening after US close Moody's finally upgraded the Irish sovereign rating by one notch to Baa3 (investment grade) from Ba1 (non-investment grade). Furthermore, Moody's put Ireland on positive outlook.
- The motivation behind the upgrade is two-fold. To quote Moody's: "1) **the growth potential of the Irish economy**, which together with ongoing fiscal consolidation is expected to **bring government debt ratios down from their recent peak**; 2) The Irish government's **exit from its EU/IMF support programme on schedule, with improved solvency and restored market access**."
- It is not our impression that the rating upgrade was consensus expectation in the market. A Bloomberg survey conducted last week showed that 9 out of 10 analysts did not expect an upgrade, see *FT*. **On Thursday 16 January we recommended going long Ireland in anticipation of a rating upgrade of Ireland in H1**, see *Government Bond Weekly Take profit on 5Y Portugal and enter 10Y Ireland*, 16 January.
- In hindsight, the rating upgrade should maybe not come as such a surprise. On 19 December Irish GDP data was released and with a Q3 print of 1.5% q/q and an upward revision of Q2 the hard data constituted confirmation that Irish growth has accelerated. The data release prompted Moody's to lift its 2014 GDP forecast on Ireland to 2.8% in a credit opinion that was released on 22 December. Note, though, that a rating upgrade of a sovereign that is on stable outlook is not that common.
- While a rating move has often limited market impact, **we do expect Irish bonds to get some tailwind at the open Monday**. The non-investment grade from Moody's has prevented some investors from entering Ireland. Going forward, we in particular expect increased interest from official money resulting in a broader investor base.
- Despite Moody's hesitation, the Irish recovery has been well accepted and understood in the market, which currently is pricing Irish sovereign bonds as BBB+ (or better). This is also the current rating from both S&P and Fitch (that is two notches higher than Moody's).
- **Moody's positive outlook indicates that we could see more upgrades of Ireland this year**. An upgrade could come if "1) the government continues to comply with its fiscal consolidation targets; and 2) the economy grows rapidly enough to place government debt metrics on a firm downward path... Continued stabilisation in the banking system in the run-up to and aftermath of the ECB's asset quality review would also prompt upward pressure." **The next reporting date is 16 May.**
- **Growth has accelerated, Ireland is set to achieve a primary surplus in 2014, government debt has peaked and the large cash buffer at the NTMA implies that Ireland is prefunded to 2015. The Irish government has so far delivered all the fiscal belt-tightening required by the Troika programme. In short, another upgrade this year seems likely.**

Irish GDP growth has accelerated



Source: Eurostat and Danske Bank forecast

PMIs still signal outperformance



Source: Macrobond and Danske Bank Markets

Unemployment is coming down

Source: Macrobond and Danske Bank Markets

Senior Analyst
Anders Møller Lumholtz
+45 45 12 84 98
andjrg@danskebank.dk

Senior Analyst
Owen Callan
+353 1 484 4605
owc@danskebank.com

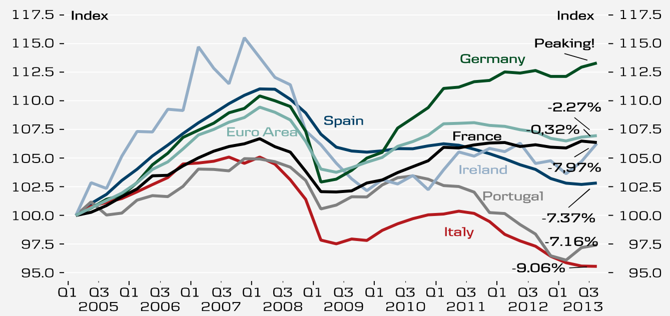
Accelerating growth in Ireland

Irish recovery has recently gained pace. Data on Q3 GDP growth showed a very strong growth of 1.5% q/q and the Q2 figure was revised up in December to 1.0% q/q from 0.4% in the first release. The leading indicators have in general jumped during H2 13, signalling growth of around 0.5-1% q/q. Note, though, that the Irish GDP figures historically have been very volatile.

For 2014 we forecast growth of around 2.5% and we even see upside risk to this forecast. Consensus is currently 1.9%, according to Bloomberg.

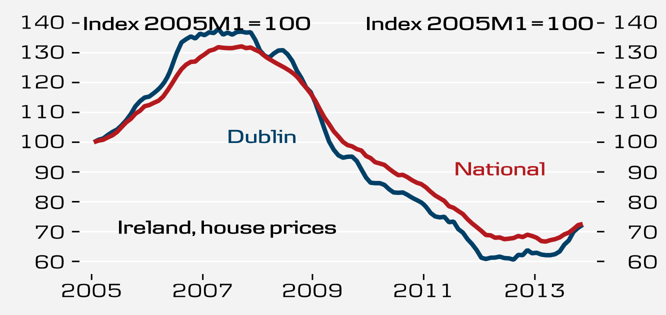
Growth will be driven by a strong export market, increasing investments and a gradual improvement in private consumption. Ireland will benefit from improving growth in the US, the UK and the core euro area, which are the country's biggest trading partners

Irish GDP still 7%-points below peak – room for catch up



Source: Macrobond and Danske Bank Markets

Irish housing market has turned



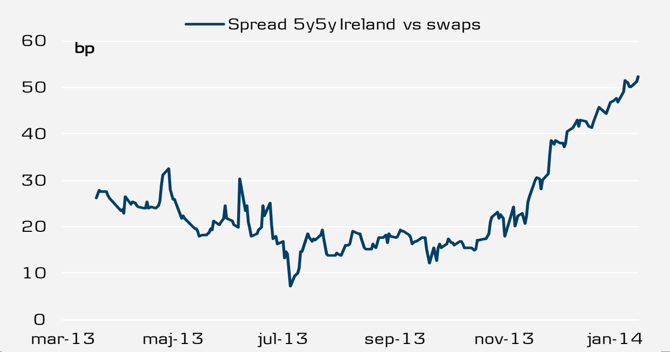
Source: Eurostat, Danske Bank forecast (European Commission for Portugal)

Trade recommendations on Ireland, opened 16 January

We expect the long-end of Ireland to catch-up with the strong performance in shorter matured bonds. Hence, **we recommend to buy IRISH Mar-23 vs swaps and sell Oct-18 vs swaps @ 54bp - a 5y5y vs swap box trade.**

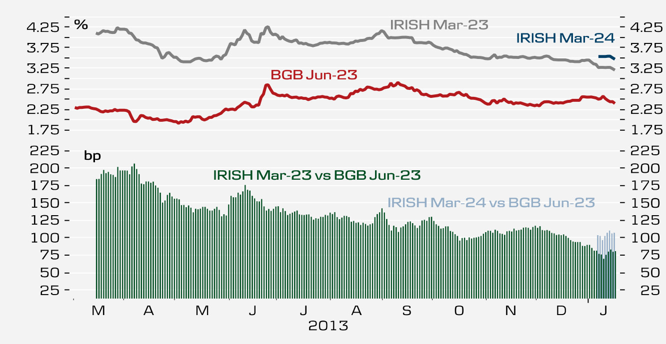
The pricing of Ireland is, in our view, likely to continue to move in the direction of the semi-cores such as Belgium and France. Hence, as an alternative to the box trade we recommend to **buy IRISH Mar-24 vs Jun-23 BGB @ 107bp (or alternatively France)**.

5y5y IRISH vs swap box trade



Source: Macrobond and Danske Bank Markets

IRISH Mar-24 vs BGB Jun-23



Source: Macrobond and Danske Bank Markets

Moody's has acknowledged the turn in the Irish economy and it is even forecasting growth of 2.8% in 2014 (according to an update from 22 December). In the 22 December update Moody's stated that:

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This research report has been prepared by Danske Bank Markets, a division of Danske Bank A/S ('Danske Bank'). The authors of the research report are Anders Møller Lumholtz, Senior Analyst and Owen Callan, Senior Analyst .

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