ALWAYS LOOK ON THE BRIGHT SIDE?

Come 2017, we must face Brexit and Trump head on, if we are to successfully navigate the challenges ahead of us, writes **Tero Tiilikainen**

Sure, look. It'll be grand. Chin up. These are the things we say when we don't know what to say. And that's the best way to describe the current investment environment, really. It's left us speechless.

It's not that the prevailing economic conditions are unfamiliar. As scary as they might be – negative government bond yields, a looming equity market correction, and a plummeting sterling exchange rate – they at least conform to the first principles of economics we were taught in school.

It's the political environment and the uncertainty that it portends that has left us flabbergasted.

Consider that the radical right is on the march in Austria, France and Poland; the left is on the rise in Greece, Italy and Spain; in fact, in Spain, the people were so fed up that they chose to carry on without a government for more than ten months (to their credit, they did just fine on their own).

And America?

America, if you believe the hype, has just elected a man who will do no less than dismantle the entire neo-liberal economic orthodoxy that has underpinned western prosperity since 1945.

That's some heavy stuff.

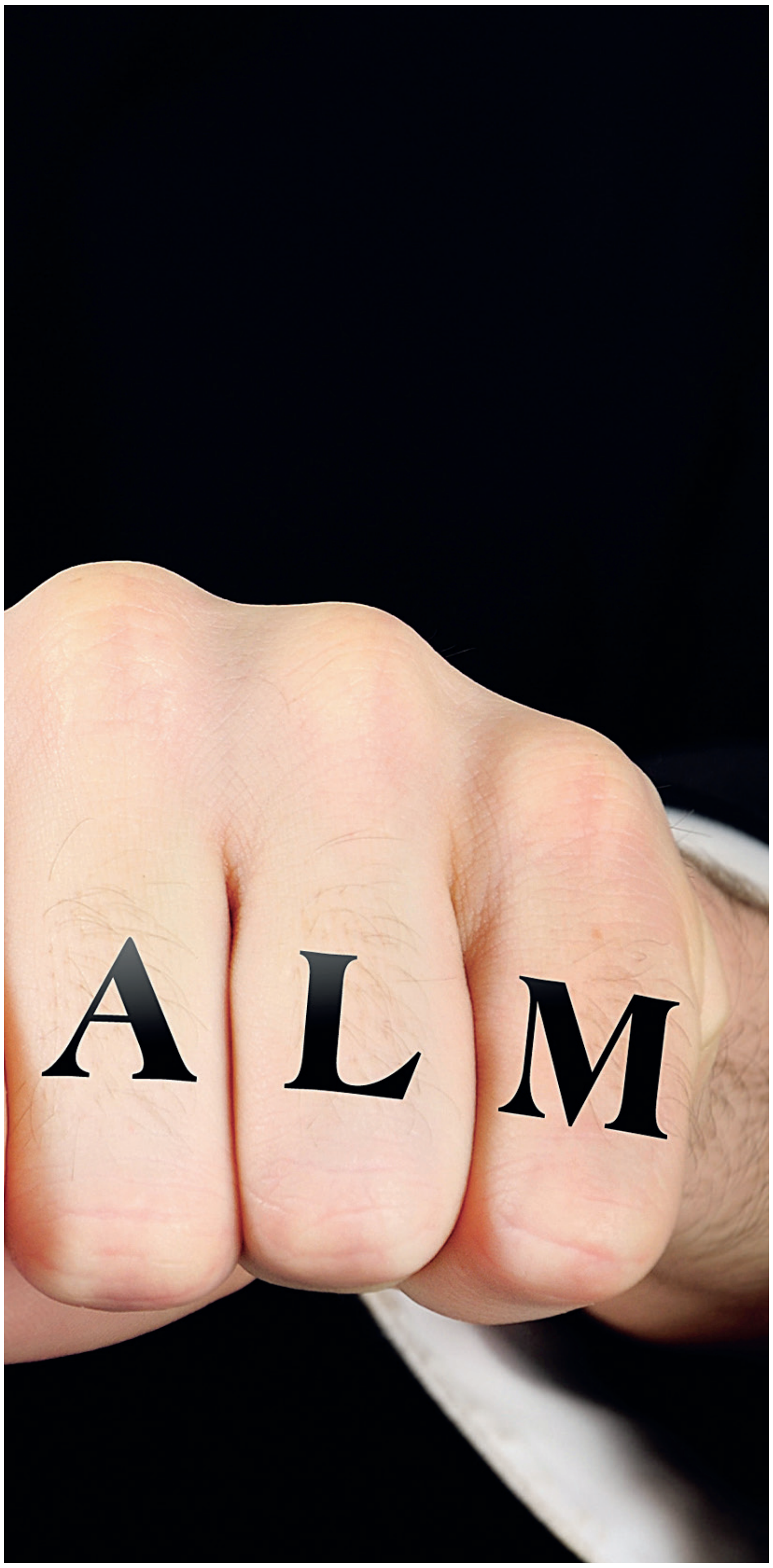
It's no wonder investors are a bit skittish.

But putting aside hyperbole, it is Brexit – our own local version of this global melodrama – that has left too many Irish investors unable or unwilling to transact for fear of putting a foot wrong.

And so it is Brexit that we will need to address head on in if we are to dispense with the platitudes of 2016 and get on with the business of making informed investment decisions in 2017.

Brexit is not the problem . . . yet

To say that Ireland will benefit from Brexit would be disingenuous. To say that we cannot make the most of a bad situation would be defeatist.



Yes, in the short term things will be difficult. Of that there is no doubt. But the short term has little to do with Brexit. Britain hasn't yet left the EU.

What we are experiencing now is a historically weak pound.

Nothing else has changed. A weak pound has been and always will be a bugbear for Irish exporters, regardless of prevailing economic sentiment or trading agreements.

We share a trade area with Britain, not a currency. When sterling falls, Irish exporters suffer. Such is life for a small, export-oriented economy, Brexit or no Brexit.

But this is nothing new. We saw sterling at similar levels in 2009. And we're likely to see volatility in the pound for years to come as markets come to terms with what Brexit truly means for Britain.

No, what should concern investors as the calendar turns to 2017 is Ireland's long-term viability in a post-Brexit world, and how we can make the most of a bad situation.

The sum total of the facts

Let's consider the facts.

First, Ireland has always and will always trade with Britain. It is an economic and cultural imperative. And while the rest of the EU might not be as dependent on our friends across the Irish Sea, the fact remains that Britain is the fifth largest economy in the world; the EU could no more stop trading with Britain than they could the Americans or the Chinese.

Second, the EU is more than an agreement on tariffs and customs. A tariff is just a number, after all. Tariffs could, in theory, be set at zero in a post-Brexit world (they won't), and will only pose a serious threat to future EU-British trade if Brussels and London choose to employ them as weapons (they might).

What's harder to control is the regulatory framework of common standards that has been cobbled together over decades to allow goods to move freely across borders. This is the real work of the EU. Alas, once Britain formally exits it will need to maintain EU standards and mirror new ones without the benefit of a representative presence in Brussels (if it wants to continue unfettered trading with the EU). But that is its choice and its cross to bear. Not ours.

Ireland is an Atlantic economy that just happens to transact in euro. Our economic fate is much more closely tied to that of the Americans and the British

Similarly, while the flow of human capital will be curtailed by Brexit, Ireland stands to gain some small advantage in this respect. Ireland and Britain have always had a special relationship. The Common Travel Area predates Irish and British ascension to the European Community by 50 years. It is a near certainty that some element of this agreement – reciprocal rights with respect to residence, work, welfare, and voting – will be retained. Any such remnant will be a competitive advantage for Ireland relative to its European peers.

Third, Ireland is an Atlantic economy that just happens to transact in euro. Our economic fate is much more closely tied to that of the Americans and the British than it is to that of the Germans or the French. We are unique in Europe in this respect and will benefit disproportionately to the rest of the EU from US and British growth.

And while the inverse of this is also true, the smart money is on US and British growth to outstrip that of the EU over the long term.

Finally, look around. We have no Trump. No Corbyn. No Tea Party. No Syriza. No Marine Le Pen-like backbenchers calling for an Irish referendum on the EU. We lament and lambast our political parties as sport, but the fact of the matter is that Ireland's long record of political stability is as much an attraction to foreign direct investment, as is our favourable corporate tax rate or our educated English speaking population – perhaps even more so given the political tumult currently enveloping the rest of the EU.

A final platitude

There are no easy answers for 2017. Not with all the uncertainty in the world. Not with the spectre of an increasingly isolationist US and what that might mean for global trade. Not with Brexit looming, which will without question bring with it more challenges than rewards, particularly for our small export-oriented island. Nonetheless, investment decisions must be made. In the absence of answers, perhaps investors can take some small measure of comfort from the sum total of the facts, which suggest that Ireland will be okay in the long run.

In the meantime, sure, look. It'll be grand. Chin up.

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Other challenges in 2017

Sick of Brexit and Trump? Don't fret. There are plenty of other challenges to face in 2017

Lacklustre growth has been the defining characteristic of the European economic recovery, which to date has been driven by conditions that would normally support much more robust improvement: rising private consumption, low inflation, growing employment, low oil prices and an expansionist monetary policy. Unfortunately, growth is unlikely to accelerate six years into a recovery. If anything, it's likely to slow further in the wake of Brexit and the US elections.

Quantitative easing isn't working. The European Central Bank is set to decide the future of QE at its December meeting. Many think they'll have little choice but to extend the programme given slow growth throughout the eurozone region and the yet-to-be determined fallout from the various exogenous shocks of 2016. Either way, there's little left for them to do – the current ECB base rate is already at 0 per cent – short of simply extending the expiry date or expanding the pool of eligible assets.

Brexit aside, exports will be challenged. A weak euro for the past several years has been a boon for European exports. But how long this can continue is in question, given growing uncertainty in emerging markets, which have been a key destination for European exports, but are now suffering on the back of weaker commodity prices. Also, growing uncertainty in the US is now threatening to renegotiate several long-standing trade agreements.

Euro contagion. Italy will hold a referendum on legislative reform on December 4 which, while not a vote on EU membership, could lead to a change in government and a future EU referendum.
On the same day, Austria will hold presidential elections that could see the far right Freedom Party elected to office. In the spring, France will hold presidential elections that could see Marine Le Pen and her anti-EU agenda ascend to the presidency. Ditto, the Netherlands, whose presidential elections in March will be seen as a litmus test for EU membership.

Housing. Closer to home, we are experiencing a rather inexplicable crisis; despite rising house prices and robust rental growth, we are in the midst of a housing shortage that shows no signs of abating. Property crises are nothing new in Ireland, but this time we cannot blame the developers. The demand is there. If the supply hasn't materialised, it is incumbent upon local councils, planners, the Revenue and the Central Bank to figure out why not. Otherwise, we risk undermining our own economic recovery.

Credit markets. While much has been made about the resurgence of the bank lending market, the practical reality is that Irish SMEs remain underserved and over reliant on bank funding. This phenomenon isn't unique to Ireland – it is European convention – but it is particularly acute here given the limited number of banks remaining in Ireland following the global financial crisis. Should Europe or Ireland experience one or more unexpected shocks in 2017, the lending appetite of Irish banks could be negatively affected, putting undue pressure on SMEs at a time when they most need the support of their lenders.