The Irish Economic Update:

Deep Covid-19 recession beckons, but economy can rebound quickly

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Strong growth by Irish economy over 2013-2019 period

- Very severe recession in Ireland in 2008-2009. GDP fell by nearly 9.5% and GNP down 12%
- Collapse in construction activity and banking system, severe fiscal tightening, high unemployment. Ireland entered a 3 year EU/IMF assistance programme from 2010-2013
- GDP at end of 2008-09 recession was still almost 25% higher than in 2001, highlighting that the economic crash came after a long period of very strong growth going back to 1993
- Ireland tackled its problems aggressively in the public finances, banking sector and property market. Imbalances in economy unwound – housing, debt levels, competitiveness, BoP
- Focused on generating growth via its large export base and FDI as the route to recovery
- Domestic economy also recovered strongly, led by rebound in investment and retail spending
- Strong jobs growth. Unemployment rate fell from 16% in early 2012 to below 5% in H2 2019
- Budget deficit eliminated at a quicker than expected pace. Public finances in surplus in 2018/19
- Major deleveraging by private sector, including households, in past decade
- Balance of payments returned to large surplus

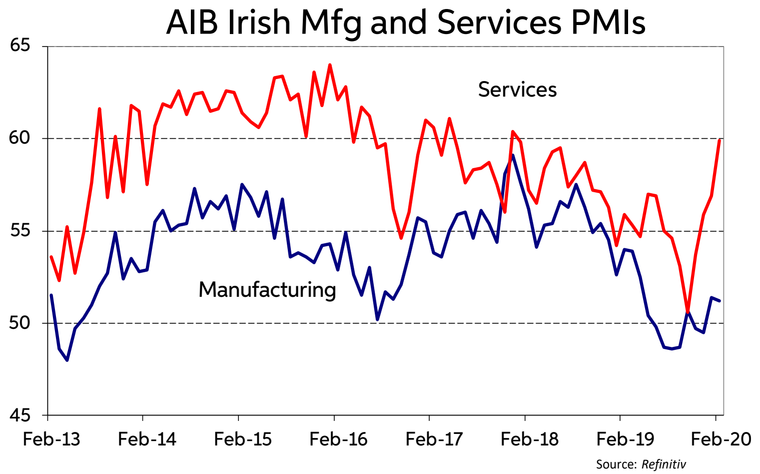
But coronavirus to cause short, deep recession in H1 2020

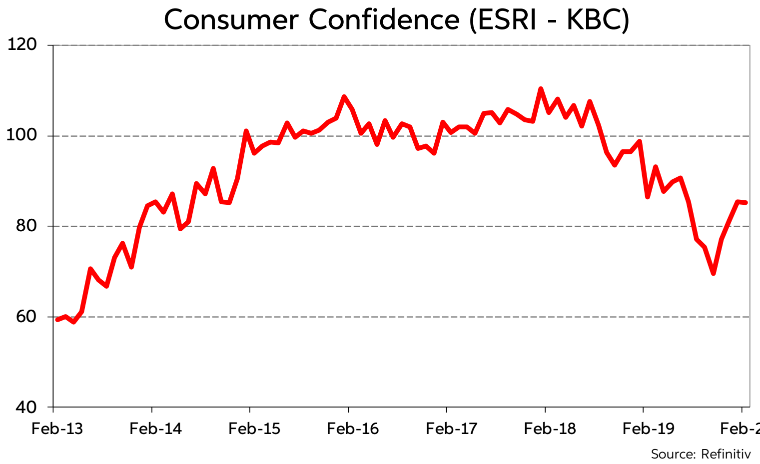
- Tourism and travel took earliest hit when restrictions imposed and people reluctant to go out/travel – hotels/restaurants/bars accounts for 8% of Irish employment. But many other businesses now closed
- Consumer spending being impacted as most retail outlets forced to close, bar those deemed essential
- Rising unemployment and tightening of financial conditions to impact activity also
- Uncertainty and reduced cash flow due to lockdowns will hit many businesses hard. Investment to decline
- Exports, a big part of Irish economy, will be impacted by downturn in world activity
- Flash Markit PMIs for March at / close to historic lows in the Eurozone, UK and US, especially for services
- Big falls in GDP in Ireland and elsewhere in H1 2020 – forecasts that it could fall by 10% or more
- Activity expected to rebound strongly in H2 2020 as virus abates and restrictions on activity are lifted
- Risk of a smaller second virus outbreak later in year. Other factors may also impede pace of recovery
- GDP will fall in 2020 as a whole – broad range of forecasts from 1.5% to 7% declines
- Strong growth expected in 2021 given depressed base for this year – growth of 5% possible

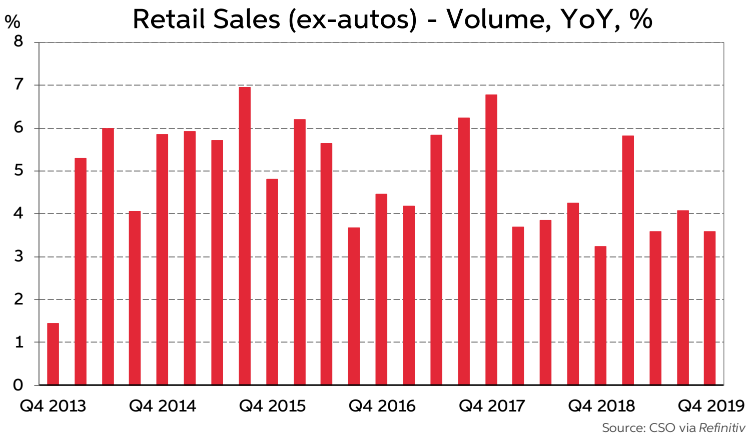
Most data show economy was performing well pre-virus

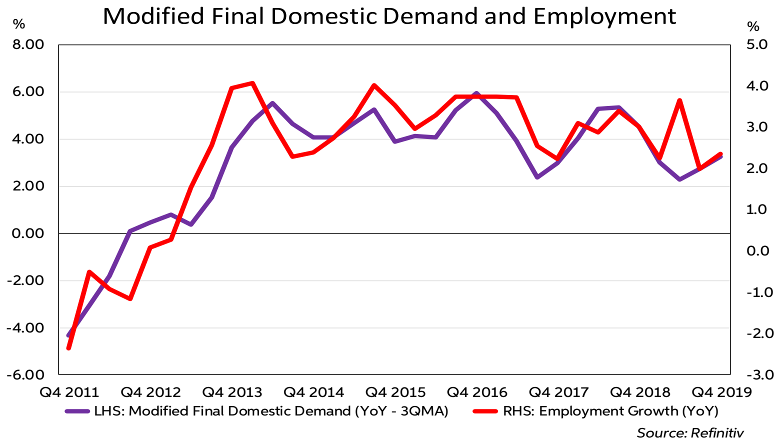
- Robust jobs growth of 2.9% yoy in 2019, matching rates seen in previous years
- Unemployment rate held at 4.8% in February, with Live Register continuing to decline in early 2020
- Housing completions up strong 18% yoy to over 21k in 2019
- Further rise in housing commencements – up 17% in 2019 to 26,000
- Mortgage lending growth slowed to 9.5% yoy in 2019 – flattening house prices a factor
- Construction PMI weakened notably in 2019 and remained at a subdued level in early 2020
- Retail sales (ex-motor trade) rose 4.4% in 2019. Down by 0.5% in Jan/Feb 2020 on strong Q4 2019 level
- Total car registrations (new + 2nd hand imports) fell at start of 2020 after solid performance in 2019
- Manufacturing PMI weakened markedly during 2019. But back above 50 in first two months of 2020
- Services PMI slipped in 2019, but rebounded very strongly over winter to hit 59.9 by Feb, a two year high
- Consumer confidence fell sharply to 6 year lows in 2019 as Brexit fears weighed, but had picked up again
- Budget surplus rose to €1.4bn or 0.4% of GDP in 2019. Tax receipts up strong 14% yoy at end Feb 2020

Notably, survey data improved over winter

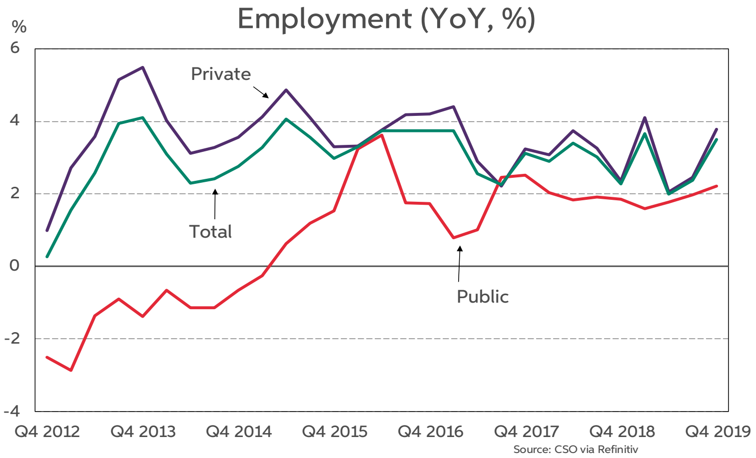


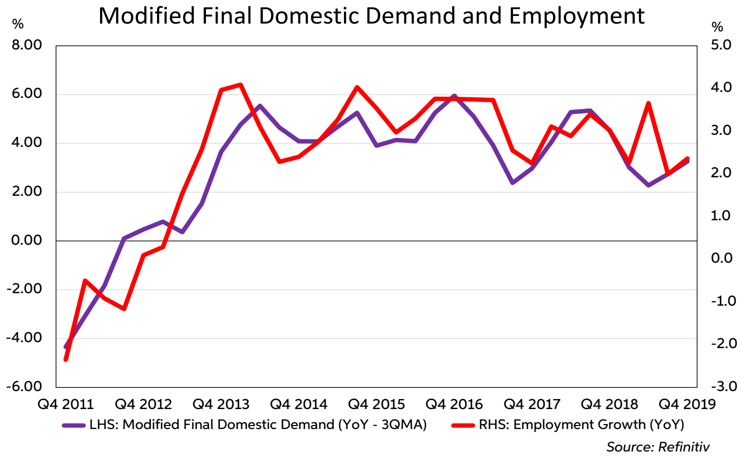


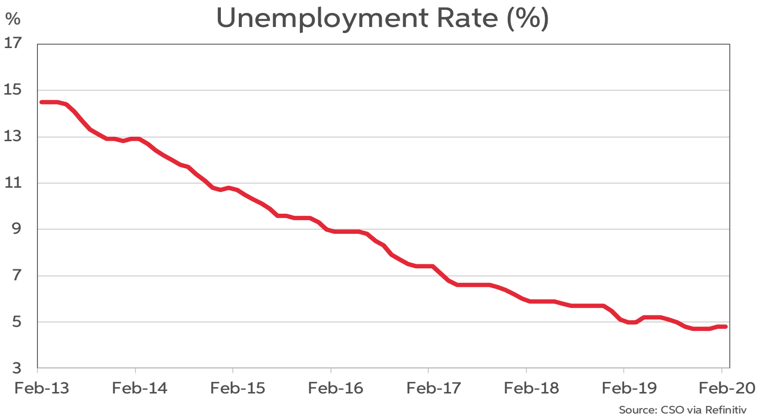


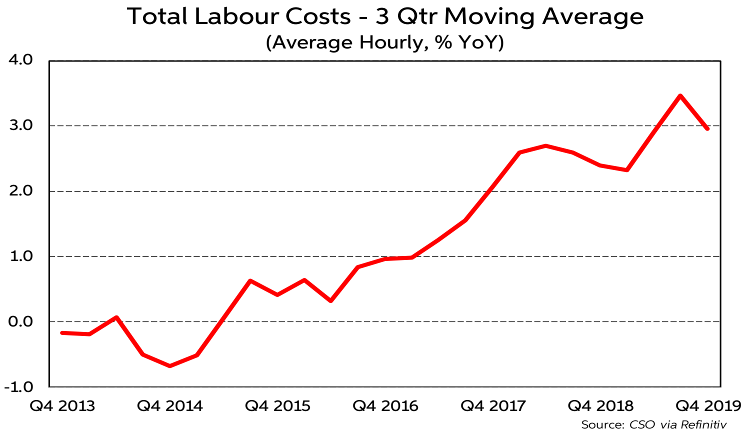


Strong jobs growth, unemployment rate below 5%





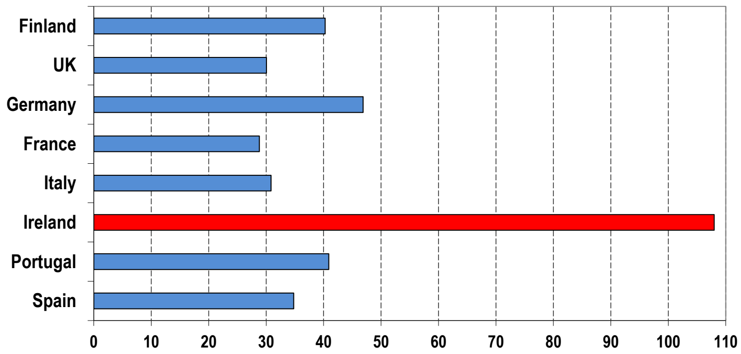




Large Irish export base performs very well

- Ireland a very open economy – exports, driven by large scale FDI, are a huge part of economy
- Exports rise strongly in recent years, helped by large FDI inflows
- Total exports rose by 10.4% in 2018 and 11.1% in 2019
- Pharma, medical care products, IT equipment, and food & drink are main goods exports
- IT, business, financial and tourism are the main service exports
- Multi-nationals account for almost 70% of exports per IDA
- Eurozone, US and UK are the three biggest export markets
- Ireland a big importer from UK – it is the UK's 5th biggest export market

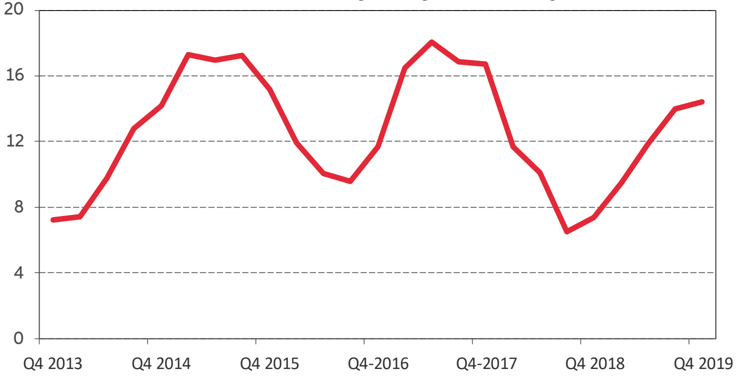
Exports as % of GDP



Source: Thomson Datastream

Irish Exports of Services

(Volume, 3 Qtr Moving Average, YoY% Change)

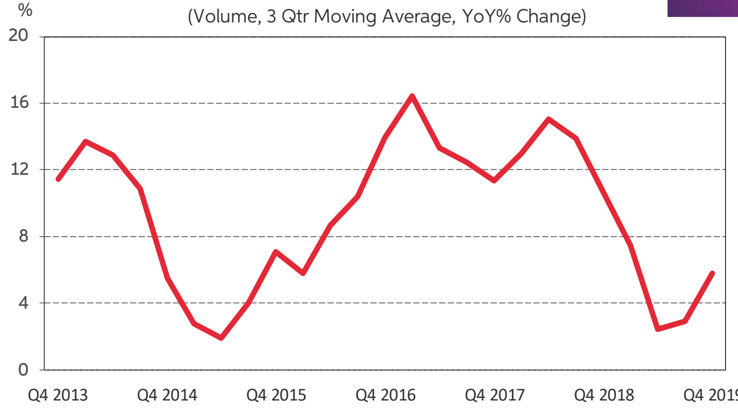


Source : CSO

Solid domestic economy – grew by 3% in 2019

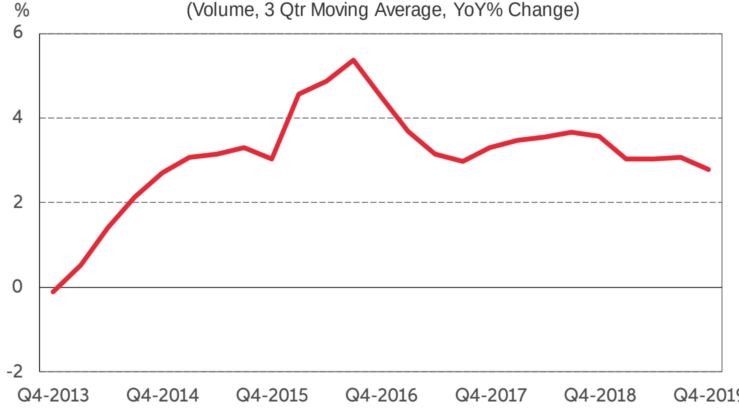
- Construction sees strong recovery since 2013. Output up nearly 12% on average in 2016-18 period
- Slowdown in non-residential construction activity last year – construction output up 5.8% in 2019
- Business investment (ex aircraft/intangibles) has recovered strongly since 2013
- However, Brexit uncertainty saw business investment flat-line in 2019
- Consumer spending grew by 3.5% on average over 2014-2018 period. Up by 2.8% in 2019
- Core retail sales rose by a strong 4.4% in 2019. Were down by 0.5% in Jan/Feb on high Q4 2019 level
- Total car regs (new + used imports) remained at high levels in 2019, though fell at start of 2020
- Modified final domestic demand grew at 4.4% rate in 2014-2018 period. Rose by 3% in 2019

Construction Output
(Volume, 3 Qtr Moving Average, YoY% Change)



Source : CSO via Refinitiv

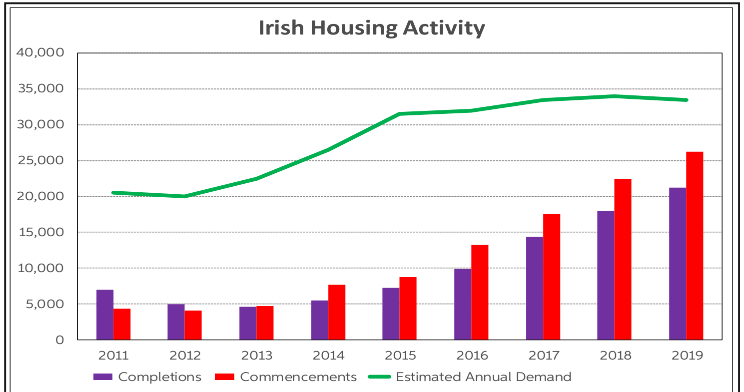
Consumer Spending
(Volume, 3 Qtr Moving Average, YoY% Change)



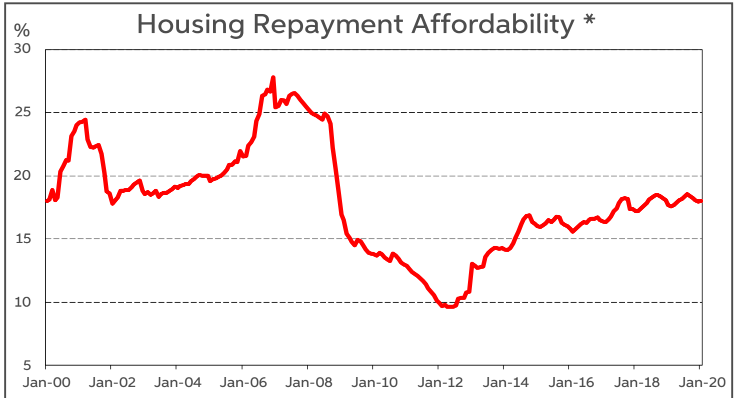
Source: CSO via Refinitiv

House building on the rise, but still at quite a low level

- Housing completions up 18% yoy to over 21,000 units in 2019, a moderation on 2018's 25% growth rate
- Housing commencements by further 17% in 2019 to 26,000 units
- Planning permissions jump by 38% YoY to over 40k in 2019, driven by a sharp rise in apartment applications
- Measures put in place to boost new house building. More NAMA activity, apartment planning rules relaxed
- Housing output still running well below annual new housing demand, estimated at close to 35,000 units
- Forecast for completions of circa 24,500 in 2020 before coronavirus outbreak
- Mortgage lending growth eases to 9.5% in 2019, though mortgage approvals did pick up over the year
- Income growth now outpacing house price inflation, which helps affordability metrics



Source: CSO, Dept. of Housing, AIB ERU Calculations

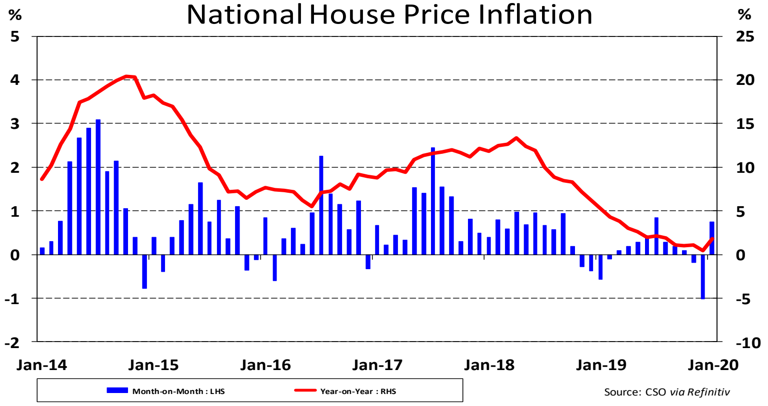


* % of disposable income required for mortgage repayments for 2 average income household, 30 year, 90% LTV, AIB variable mortgage rate. Based on Permanent TSB/ESRI national house price & CSO residential property price index

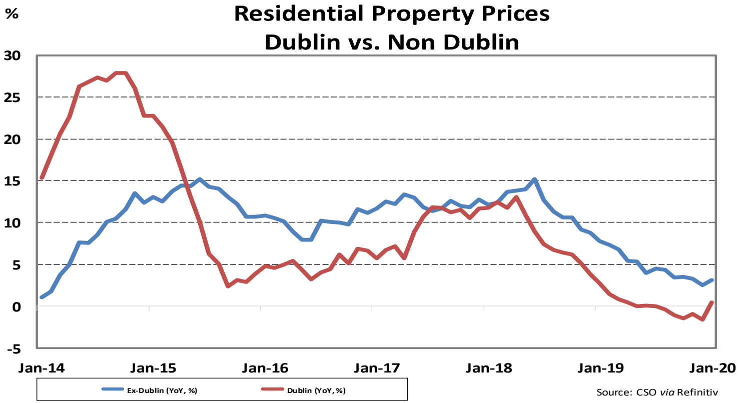
Source: *AIB, Permanent TSB/ESRI, CSO, Dept. of Finance*

House price inflation slows sharply

- House prices declined by a very sharp 55% between their peak in late 2007 and early 2013
- House prices have since rebounded as big housing shortage emerged after 90% fall in home building
- Prices up 85% by Jan 2020 from low in March 2013 – Dublin prices up by 95%, non-Dublin rise 83%
- But house prices still some 17% below 2007 peak
- House price inflation slows sharply in 2018/19 reflecting tighter Central Bank lending rules
- Prices up 1.8% yoy nationally in Jan 2020, down from a high of 13.3% in April 2018
- Dublin prices up 0.5% yoy in Jan, down from +13% in Apr '18; non-Dublin at 3.1% vs. 15% last year
- Annual growth in rents has slowed to less than 4% per CSO data



Source: CSO *via Refinitiv*



Source: CSO *via* Refinitiv

AIB Model of Estimated Housing Demand

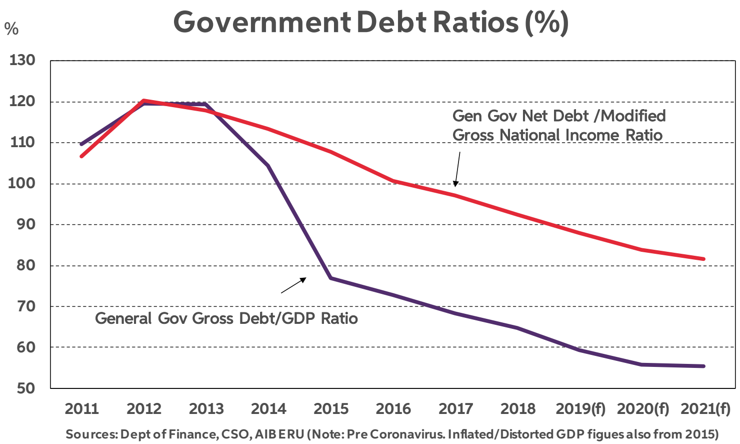
- Rising headship rates added circa 8,000 per year to housing demand in 2002-2011 period
- Shortage of housing, high rents, tighter lending rules saw average household size rise in 2011-16. Thus, headship fell – was a drag of circa 10,000 p.a. on housing demand
- Assume no change in headship in 2017-2021 – note long-term trend is upwards, adding to demand
- Pent-up demand has also built up in recent years from lack of supply
- Thus, forecast table may be under-estimating actual real level of housing demand
- Shortfall in supply met from run down of vacant stock and demand being reduced by fall in headship rate. Both factors very evident in 2011-16 and most likely in 2017-21

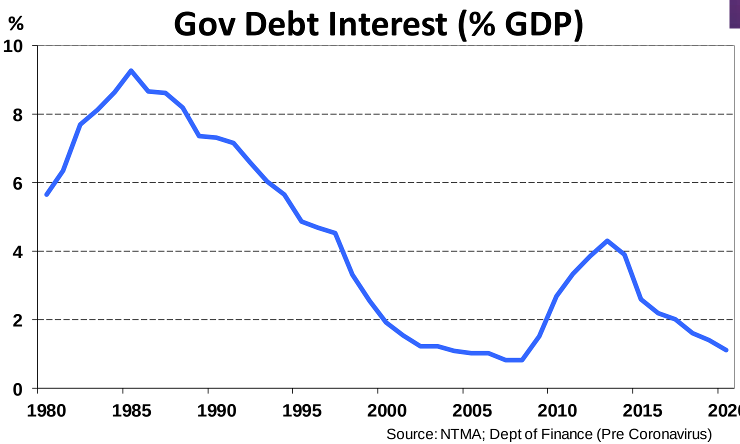
Calendar Year	2017	2018	2019	2020	2021
Household Formation	28,000	28,500	28,000	28,000	28,000
of which					
Indigenous Population Growth	*18,500*	*17,500*	*16,500*	*16,500*	*16,000*
Migration Flows	*9,500*	*11,000*	*11,500*	*11,500*	*11,500*
Headship Change*	*0*	*0*	*0*	*0*	*0*
Second Homes	500	500	500	500	500
Replacement of Obsolete Units	5,000	5,000	5,000	5,000	5,000
Estimated Demand	**33,500**	**34,000**	**33,500**	**33,500**	**33,000**
Completions	**14,400**	**18,100**	**21,250**	**24,500**	**28,000**
Shortfall in Supply	***-19,100***	***-15,900***	***-12,250***	***-9,000***	***-5,000***

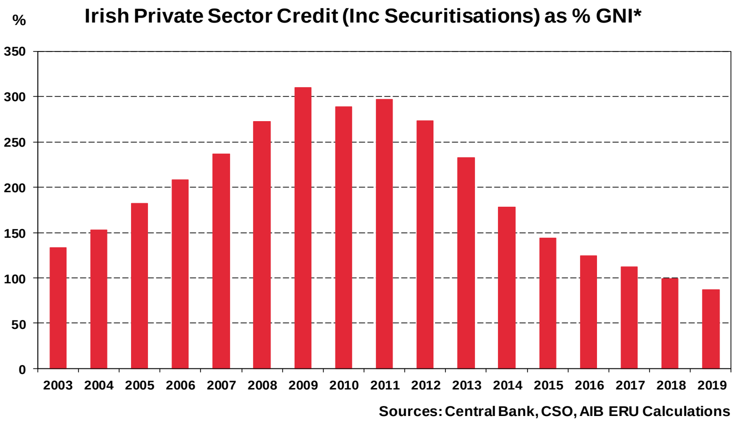
*Headship is % of population that are heads of households.

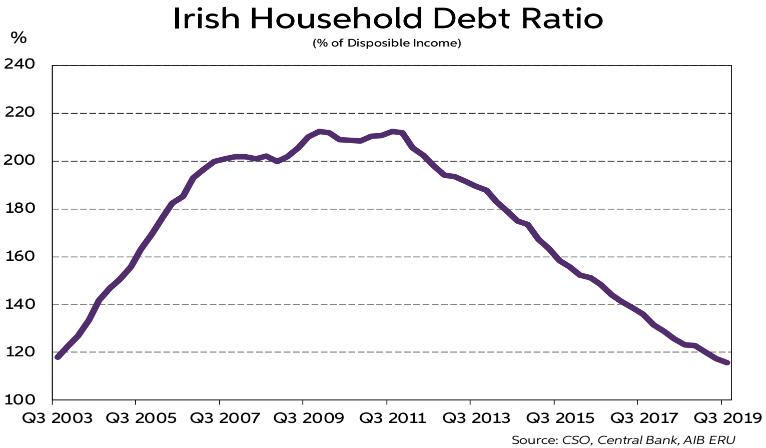
Sources: CSO, DoECLG, AIB ERU. Note 2002-21 estimates are pre coronavirus

Govt debt ratios fall, private sector deleverages



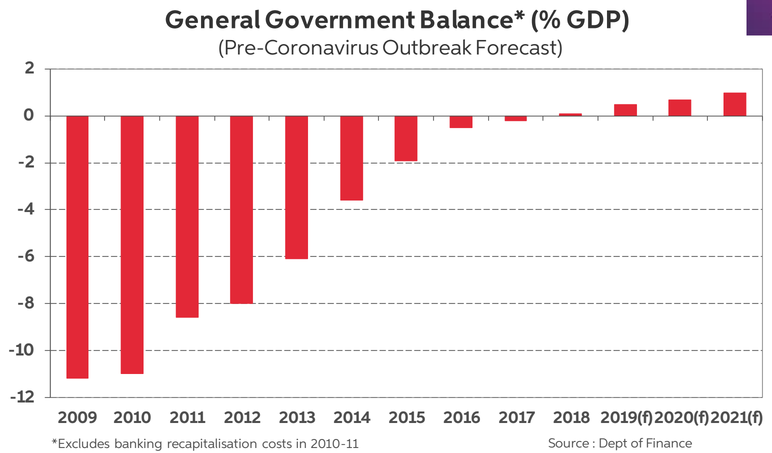


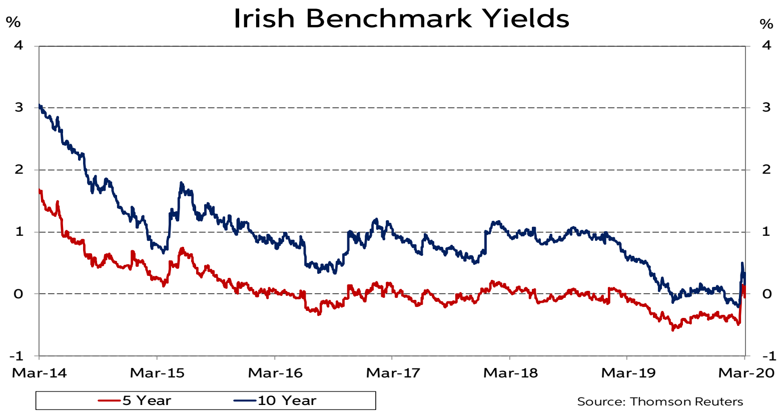




Public finances will be impacted by Coronavirus

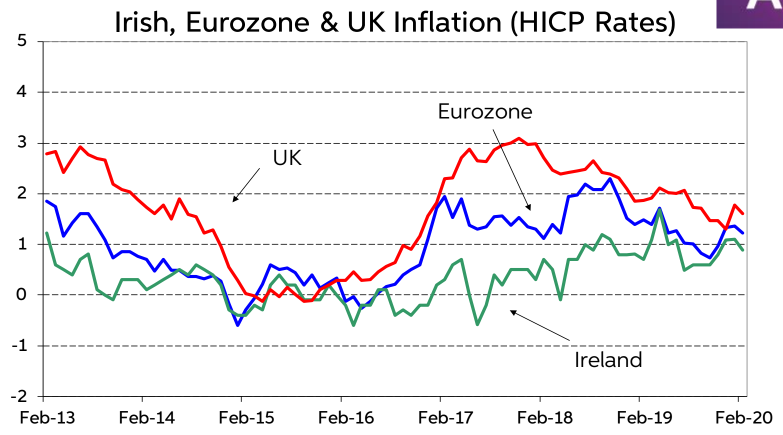
- Budget deficit declined sharply over last decade, with small €170m surplus recorded in 2018
- Budget surplus rose to €1.4bn or 0.4% of GDP in 2019 as taxes continued to exceed target
- Primary budget surplus (i.e. excluding debt interest) of near 2% of GDP in 2019
- Debt interest costs very low – at 1.4% of GDP
- Cautious budget for 2020, the budget surplus continuing to rise
- Tax receipts up by 14% yoy to end Feb 2020, aided by strong corporation and income taxes
- However, coronavirus and efforts to mitigate it will see the public finances deteriorate in 2020
- Return to significant budget deficit this year
- Gov Debt/GDP ratio has fallen sharply, as have Irish bond yields, in recent years
- Sovereign debt ratings upgraded in recent years; S&P at AA-, Fitch at A+, Moody's A2 for Ireland



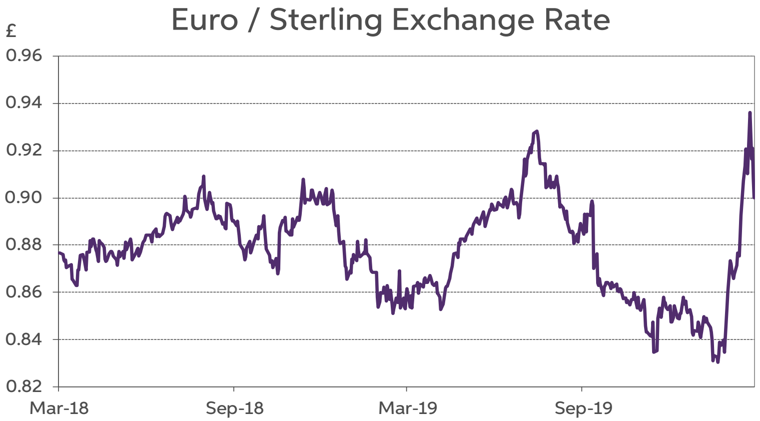


But key medium-term growth drivers still in place

- Favourable medium-term drivers of strong Irish growth remain in place
- House building picking up from still low output levels – big focus for next government
- Government spending supportive of growth
- Activity to aided by continuing very low interest rate environment
- Good inflows of FDI expected to continue
- Labour market dynamics supportive of growth
- Economy has deleveraged, no obvious imbalances
- World economy will rebound from 2021
- Strong Irish growth of circa 5% seems likely next year after sizeable fall in GDP in 2020
- Move to UK-EU FTA will lower Irish growth, but this may now not happen until 2022



Source: Refinitiv



Source: Refinitiv

Brexit: EU-UK trade talks expected to be difficult

- EU and UK agreed on revised Brexit deal at last October's Heads of State Summit
- NI to remain within Single Market for goods and have dual EU-UK customs system
- UK left the EU on Jan 31st 2020 in orderly exit. Transition period in place until end 2020
- UK government had ruled out extending the transition period beyond this date
- However, with talks postponed due to virus outbreak, this position is likely to be reviewed
- Negotiations, when they resume, likely to prove difficult and fractious
- EU insisting on level playing field, with considerable regulatory alignment
- UK government puts focus on 'taking back control' and non-alignment with EU
- Much uncertainty about outcome of talks, which will determine final shape of Brexit
- UK could opt for 'no deal' rather than have close alignment with EU rules under a FTA
- However, some type of FTA seems likely as it's the best outcome for both the UK and EU

Key points about any EU-UK Free Trade Agreement

- Any FTA will be much inferior to the EU Single Market, involve extra large admin costs
- Significant restrictions on trade will come into play in a FTA– new customs procedures, compliance with onerous rules of origin requirements, more regulations etc.
- Documentary evidence needed for customs clearance, proof all product made in country, compliance with regulatory standards/rules – non-tariff barriers are big costs
- Trade in agri-food products may require export health certs and could be subject to veterinary border inspections – both exports and imports
- While FTA should allow for continuing tariff-free and quota-free trade in most goods, such agreements generally do not extend to services or, indeed, fishing rights
- EU-Canadian FTA left some tariffs & quotas in place, but includes some services
- A big issue is financial services – EU likely to be very wary of giving UK permanent equivalence/passporting rights. Any other equivalence regime can be altered or terminated
- No right of redress for companies via courts under FTA, unlike in the EU Single Market

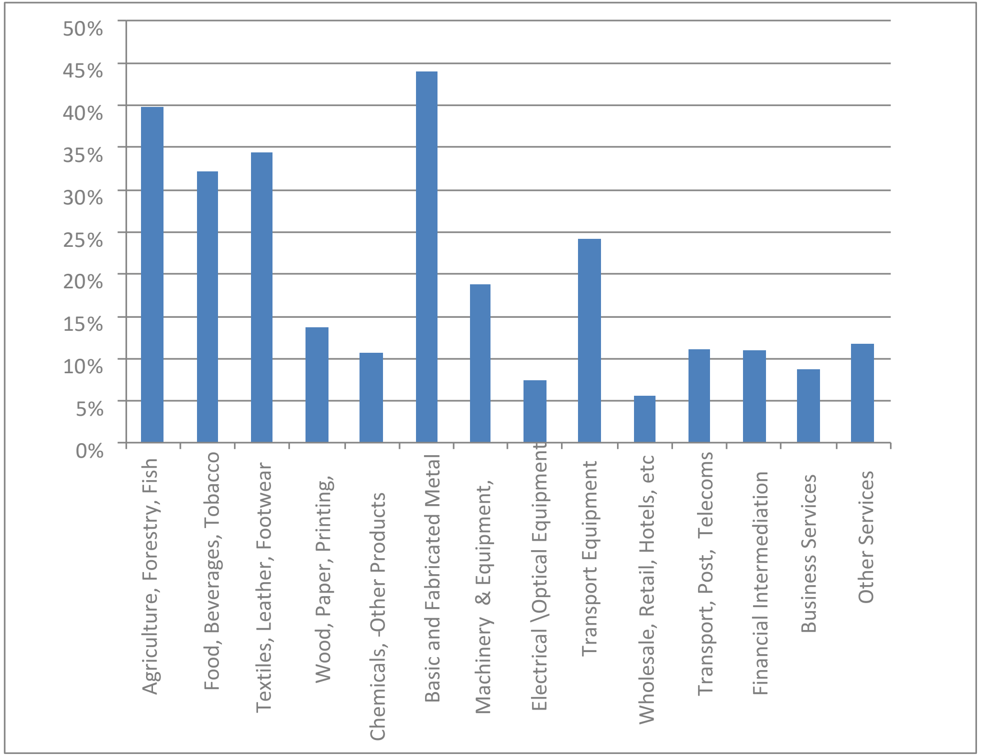
Exporters and Importers will be impacted by FTA

- UK outside EU Customs Union after transition period ends so both exports and imports will need paperwork, even if tariff free trade is agreed under FTA that implies no Customs Duties
- Need to get Customs Registration Numbers in both Ireland (EORI) and the UK from Revenue
- Customs Declaration forms to accompany all goods – may need a Customs Clearance Agent
- Deferred Payment Bank Account may be required by Revenue to cover any Duties/VAT
- Trade in some agri-food products likely to require additional veterinary checks and certs
- Compliance with onerous rules of origin may be required for some goods
- The UK suppliers and customers of businesses will also need to have new paperwork in place
- Land bridge route via Great Britain to mainland Europe will also be impacted
- Need transit documentation and possibly sealed containers, with delays likely at ports
- Additional working capital may be needed if cash flow impacted by trade frictions

Agri-food industry very dependent on UK market

- Food and Beverages account for 25% of Irish exports to UK
- Around 40% of Irish food exports go to the UK – key market for beef and cheese
- Main EU tariffs relate to food products, keeping prices high. UK may do new trade deals that sees tariffs cut on food imports
- Other sectors very dependent on UK market include machinery and transport, metal products, textiles
- Even with FTA, there will be new admin trading costs for those exporting & importing with UK –customs clearance docs, rules of origin etc.

Share of Exports by Industry Destined for the UK (ESRI)



FTA expected to lower growth rate of Irish economy

- **Multiple hits to the Irish economy if there is a no EU-UK Trade deal** at end of transition period: further sharp fall in sterling, likely recession in UK, disruption to trade/supply lines, tariffs, new administration and regulatory costs etc
- Sharp fall-off in trade with UK likely if there is no trade deal, with the **shock front loaded -** around half of the impact on trade would take place in the first two years, per ESRI
- Central Bank estimate GDP would be 5% lower if the UK moves to WTO rules at end of transition period. ESRI also put impact of no-deal hard Brexit at circa 5%
- Economy would be impacted over time by **UK move to FTA** as this would result in new significant non-tariff barriers, imposing costs and making trade more difficult with UK
- **Central Bank** estimate Irish **GDP would be 3.5% lower in long term under a FTA**

- **Copenhagen Economics** have examined various Brexit scenarios
- Estimate impact by 2030 is to **reduce Irish GDP** by 2.8% under a EEA scenario, **by 4.3% in a standard FTA, but 3.5% in enhanced FTA** with closer regulatory alignment
- CE estimate GDP would be 7% lower in a WTO (no trade deal) scenario

Risks to the Irish economy

- Main near-term risk is obviously the coronavirus – will weigh heavily on growth this year, with impact dependent on length of outbreak and extent to which the economy can rebound
- Highly open nature of Irish economy means it is particularly vulnerable to a global slowdown, lingering effects from coronavirus could hamper global recovery for some time
- Brexit remains a challenge given uncertainty about future EU-UK trading relationship
- Questions around Ireland's corporation tax regime (Apple ruling, moves on tax harmonisation in EU, OECD tax reform/minimum tax rate proposals) could impact FDI
- Supply constraints in new house building activity, which is recovering at a slow pace
- Competitiveness issues - high Dublin house prices, high rents, high personal taxes, rising wages
- Credit constraints – tightening of lending rules, on-going deleveraging, weak credit demand