The Irish Economic Update:

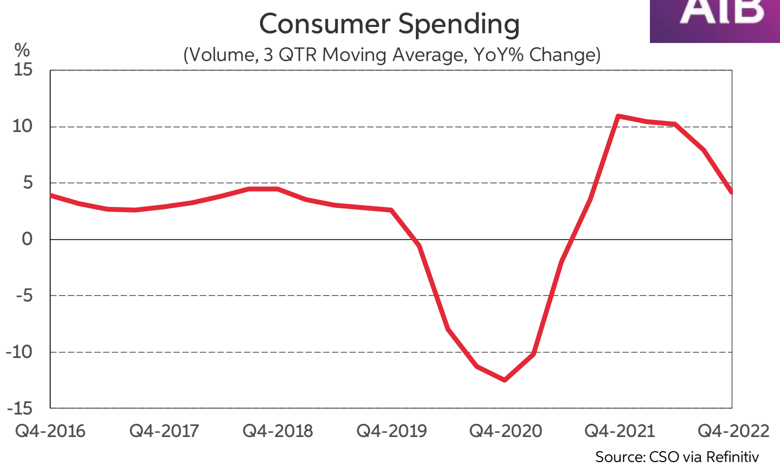
Strong start to 2023, but slowdown in growth likely, with more binding capacity constraints

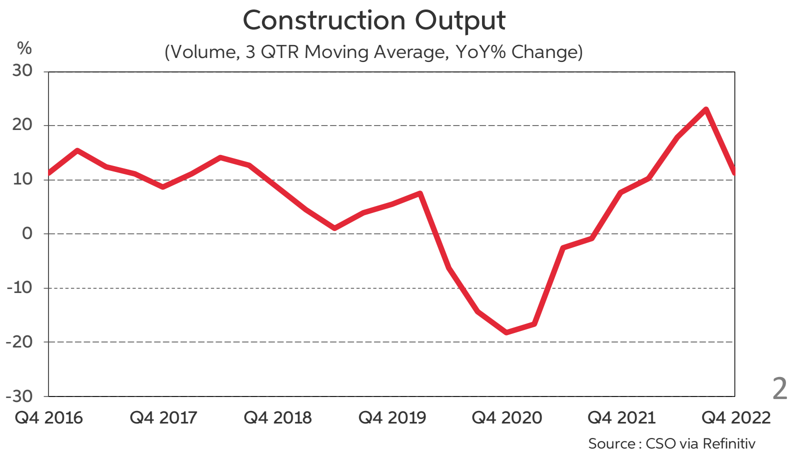
April 2023

Oliver Mangan
Chief Economist
AIB

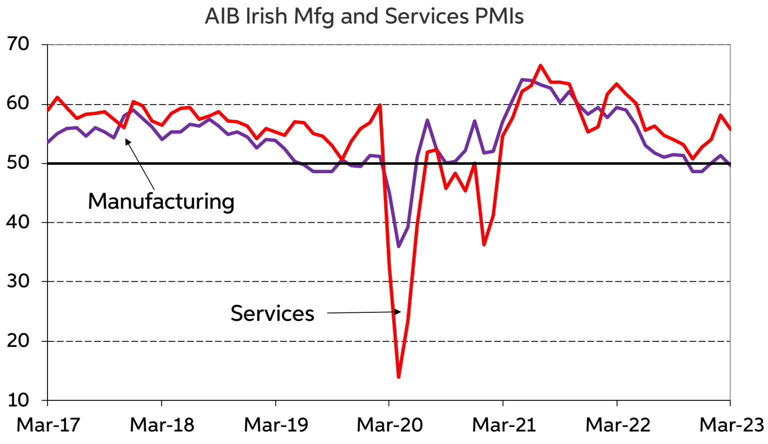
Economy rebounded very strongly in 2021-22 from COVID

- Another very strong rise in GDP in 2022 of 12%, following the 13.6% increase seen in 2021
- Surging inflows of foreign direct investment a key factor in rapid growth of economy during 2021-22
- Exports up strongly again in 2022, rising 15%
- Modified final domestic demand rose by 8.2% in 2022 following the increase of 5.8% recorded in 2021
- Consumer spending up by 6.6% last year, with very strong rise in expenditure on services of 11.5%
- Robust growth in investment continued, up 20% in 2022, with buoyant business investment
- Construction output rebounded in 2022 from COVID hit, rising by 14%. Big jump in house building activity
- However, modified domestic demand declined in both Q3 and Q4 on weaker investment after big jump in Q2
- Both investment in machinery & equipment, and non-residential construction fell sharply in H2 2022

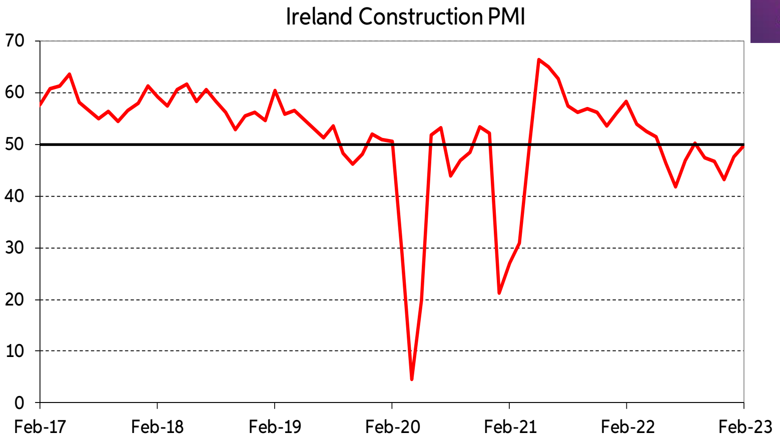




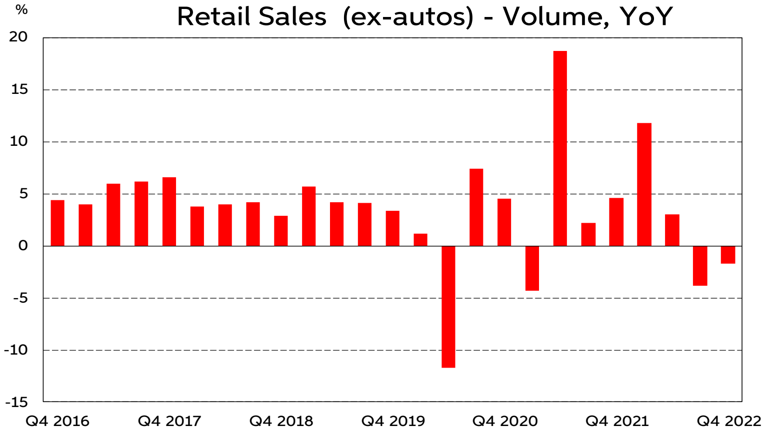
Indicators point to slower economic growth this year



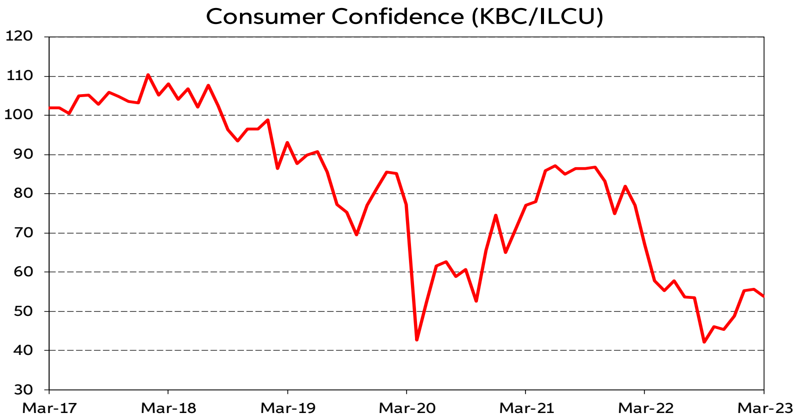
Source: Markit via *Refinitiv*



Source: Refinitiv



Source: CSO via Refinitv

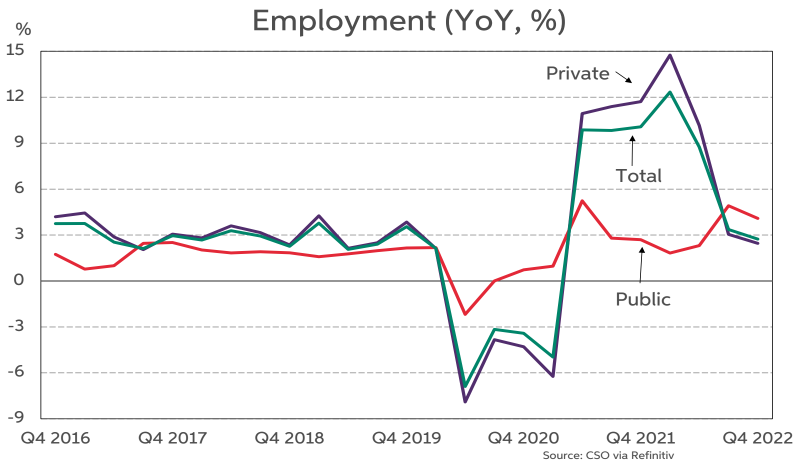


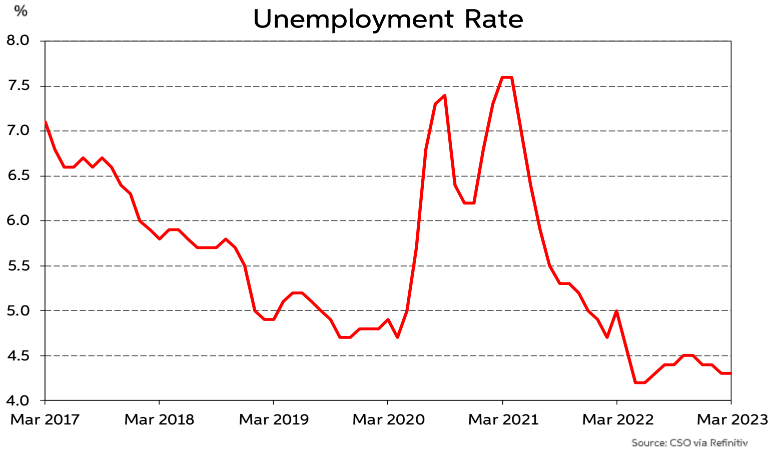
Source: ILCU via Refinitv

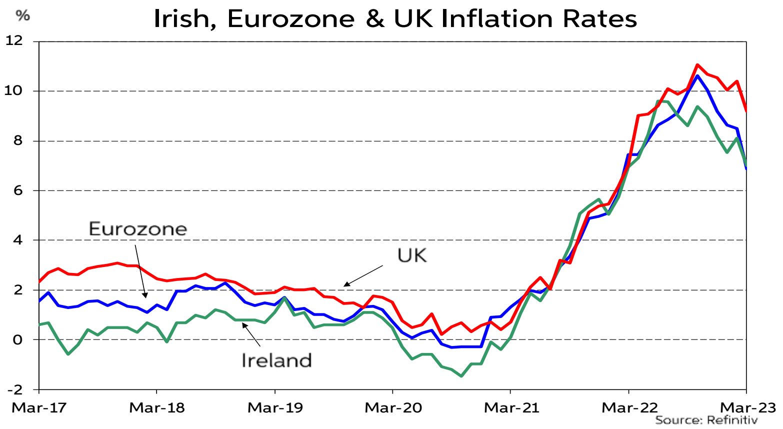
Though data remained strong in Q1 2023

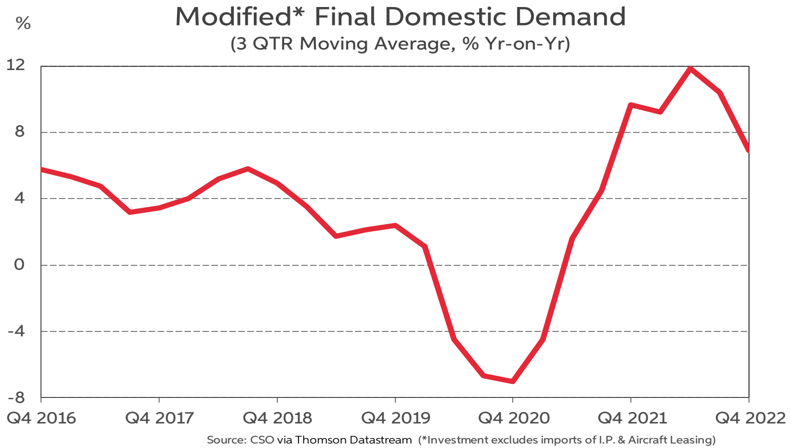
- As elsewhere, Irish data stronger than expected in Q1 2023, with official growth forecasts revised up
- Mfg PMI fell sharply in H2 2022 to below 50 by Nov/Dec. Modest pick-up in Q1 2023, averaged 50.4
- Services PMI solid in 2022. Picked up strongly in early 2023, at 58.2 in Feb and 55.7 in March
- Housing commencements hit 35k peak last March. Fall back, but stable at 27k in Sept-Feb period
- PMI for construction fell sharply in 2022. Averaged 45.8 in Q4. Picked up to 47.7 in Jan and 49.8 in Feb
- Core retail sales subdued in 2022, rising by just 1.7% in volume. Stable sales in Jan/Feb 2023
- New car sales improved in H2'22, but flat for full year. Picked up in early 2023 – rose 16.5% yoy in Q1
- Consumer confidence recovers some ground in early 2023 after sharp fall from spring to autumn 2022
- Tax receipts rose by very robust 21.5% last year. Remained strong in Q1 2023, up 14.6% yoy
- Unemployment rate fell to 20-year lows below 4.5% in 2022. Stays very low at 4.3% in Feb/Mar 2023
- Employment rose by 6.8% in 2022. Up by 9.2% at end 2022 from end 2019, with labour force up 8.9%
- Inflation rose sharply in 2022, but HICP rate down to 7% by March 2023 - peaked at 9.6% last June/July

Unemployment falls to very low level, inflation now easing



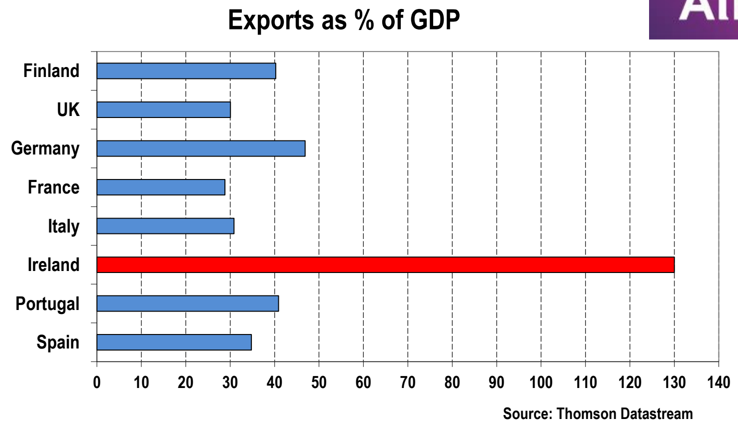


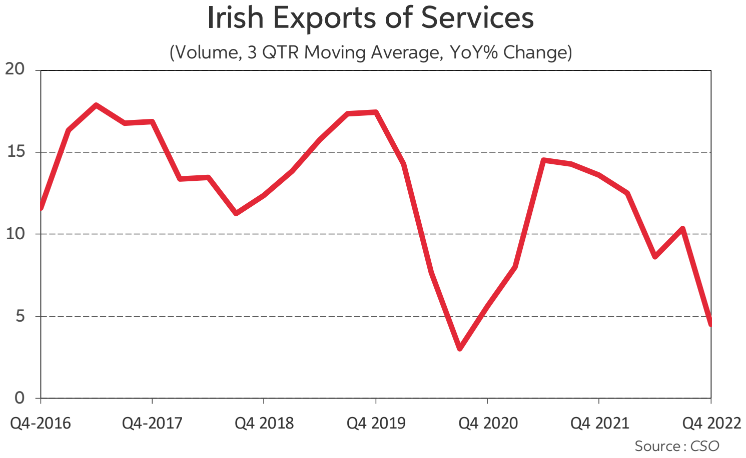




Exports perform very strongly in 2021-22 as FDI surges

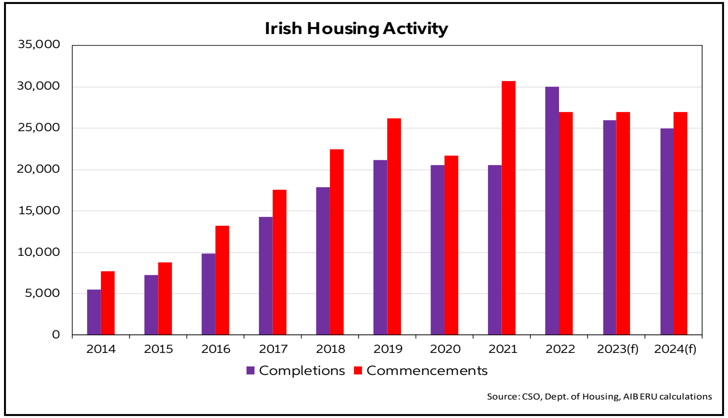
- Ireland is a very open economy – exports, driven by large scale FDI, are a huge part of economy
- Exports have risen strongly in recent years, helped by very large FDI inflows
- IDA reported record FDI in 2021 and high levels again in 2022, with good pipeline for H1 2023
- Pharma, medical care products, ICT, business & financial services main elements of FDI
- Irish FDI inflows may be benefitting from Brexit
- Eastern Europe may also becoming less attractive for FDI following Russian invasion of Ukraine
- Total exports up by 14% in 2021 and 15% in 2022
- Goods exports rose by 18% in 2021 and 22.5% in 2022– this overstates actual growth
- Exports include goods manufactured abroad by sub-contractors on behalf of Irish based firms
- Service exports up by 10.3% in 2021 and 7.3% in 2022, a better measure of export performance

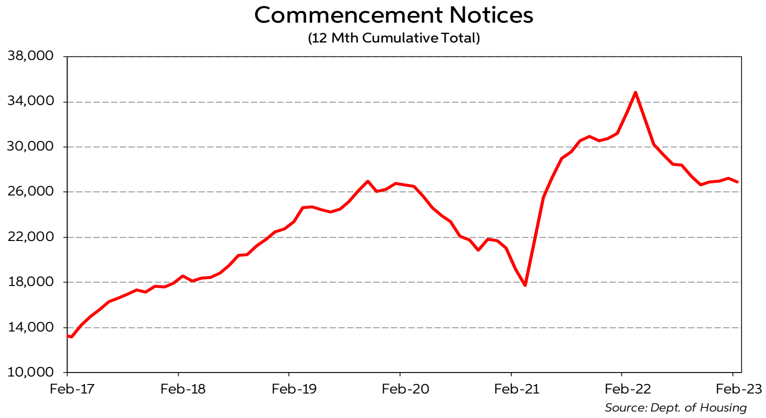




House completions jump, but commencements fall back

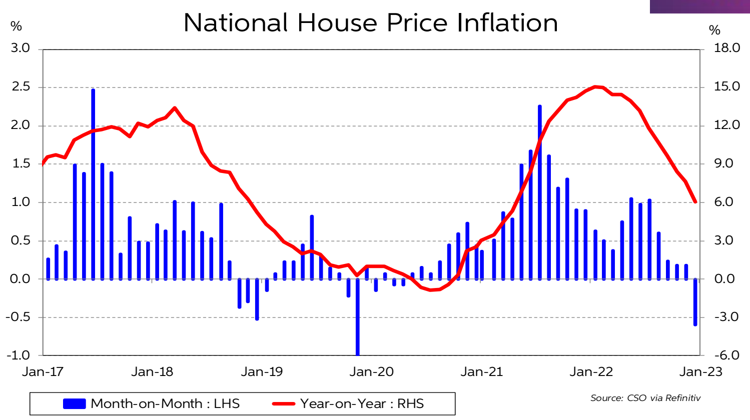
- Completions amounted to 20,500 in 2020 & 2021, just 2.6% down on 2019 level despite lockdowns
- Completions then jumped sharply to 30,000 in 2022, helped by rebound from COVID lockdowns
- Estimated annual housing demand put at over 30k
- Big jump in planning permissions from 2018-2021, but sharp fall of 20.5% in 2022 – all apartments
- 12 month commencements hit 35,000 peak in Q1'22 but fall back and running at steady 27,000 since Sept
- Completions may move down to 25-26k in 2023-24. Rising costs/yields could dampen apartment builds
- Mortgage drawdowns rose by sharp 34% to €14.1bn in 2022. Big impact from switching activity
- Early indications in 2023 from mortgage applications are for a fall-off in switcher activity this year

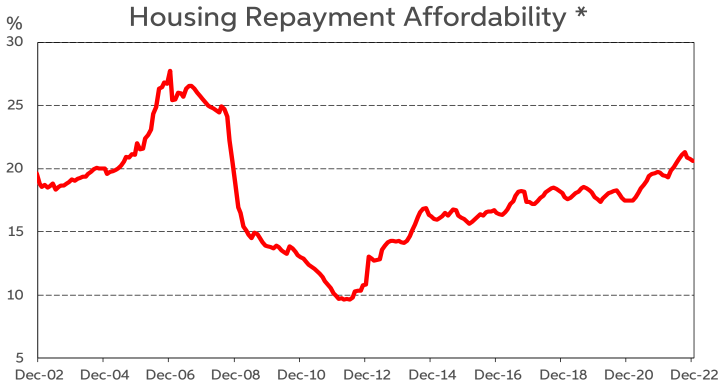




House prices levelling off

- House prices declined sharply, by 55% over 2007-13. Prices have fully recovered - back above 2007 peak level
- Low supply, remote working, strong public/institutional demand, enhanced help-to-buy scheme, rising personal savings, pent-up demand all supportive of house prices
- Marked moderation in house price inflation during 2022
- Annual rate eased to 6.1% yoy by Jan 2023, down from peak of 15% in Feb/Mar 2022. Prices fell in January
- Non-Dublin Jan prices up 7.4% yoy, Dublin rate at 4.3%
- Rising interest rates and slower economic growth suggest house price inflation will continue to decelerate
- Property websites show asking prices were flat in H2 2022, with a slight fall in Q1 2023
- Housing affordability deteriorated as prices rose, but starts to improve again in Q4'22 as price growth slows
- Rents jump sharply in 2021/22. Annual rate peaked at 12.9% in July. Fell to 10.6% end 2022, 10.4% in Jan/Feb





* % 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

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 2016-2022 – 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 again in 2016-22

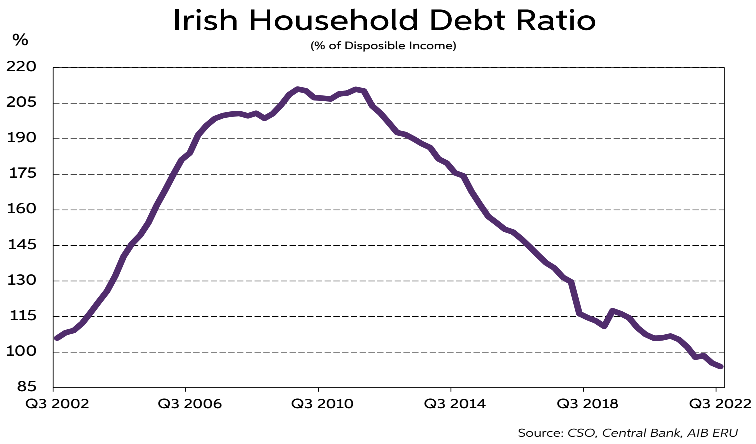
Calendar Year	2020	2021	2022	2023	2024
Household Formation	26,000	29,000	28,000	25,000	24,500
of which					
Indigenous Population Growth	*21,000*	*20,000*	*16,500*	*14,500*	*14,500*
Migration Flows	*5,000*	*9,000*	*11,500**	*10,500**	*10,000**
Headship Change*	*0*	*0*	*0*	*0*	*0*
Second Homes	500	500	500	500	500
Replacement of Obsolete Units	5,000	5,000	5,000	5,000	5,000
Estimated Demand	**31,500**	**34,500**	**33,500**	**30,500**	**30,000**
Completions	**20,500**	**20,500**	**30,000**	**26,000**	**25,000**
Shortfall in Supply	*-11,000*	*-14,000*	*-3,500*	*-4,500*	*-5,000*

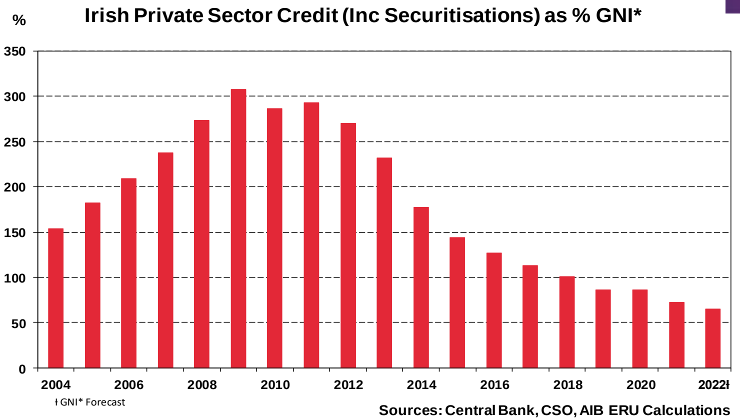
***Headship is % of population that are heads of households. Assumed it remains constant*

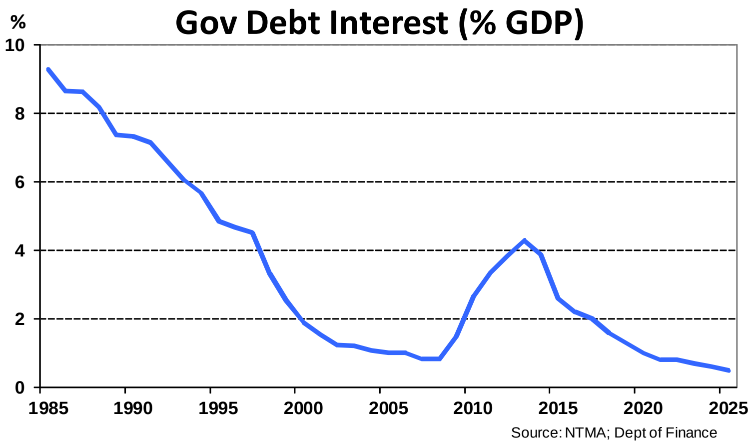
** Does not include Ukrainian refugees*

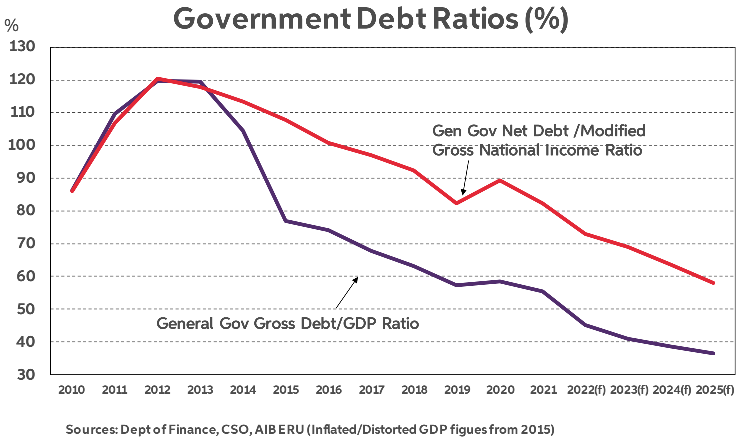
Sources: CSO, DoECLG, AIB ERU.

Private sector deleverages, Gov. debt ratios fall to low levels



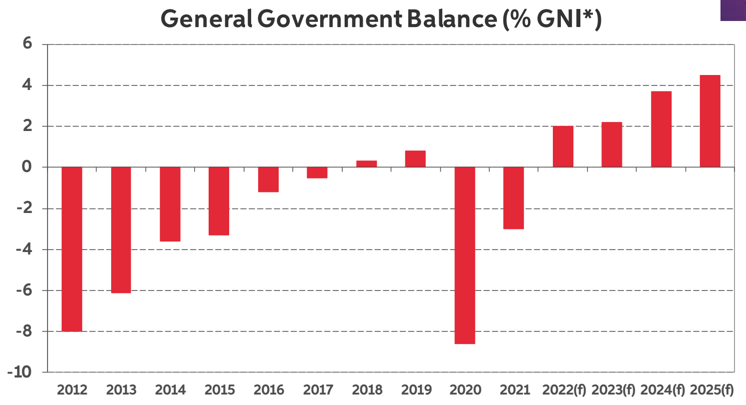




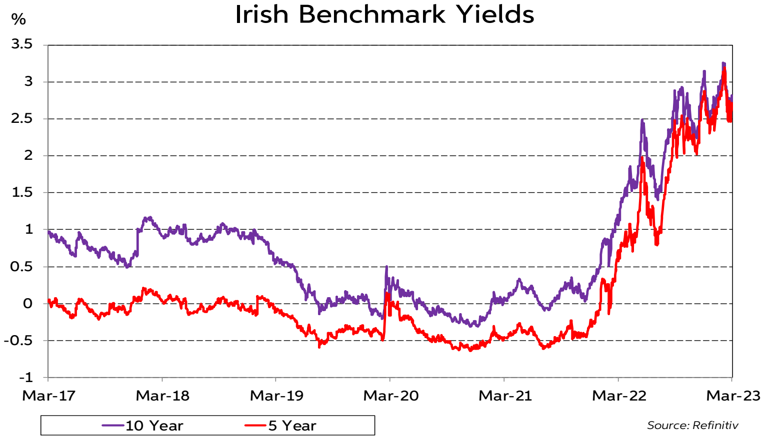


Strong growth sees public finances return to surplus

- Budget deficits in 2020 and 2021 owing to COVID
- Tax revenues rose very strongly across the board in 2022; up 21.5% after a 20% rise in 2021
- Budget target was a deficit of €8bn for 2022, but a surplus of €5bn was recorded (2% of GNI*)
- Government provides some temporary energy support payments for households and firms
- Budget surplus targets of 2.2% and 3.7% of GNI* set for 2023 and 2024, respectively
- Good start to 2023, with tax receipts up 14.6% to end March and budget surplus continuing to rise
- Budget surplus looks set to exceed target in 2023
- Gov. Debt ratios falls sharply – at 73% of GNI*
- Irish bond yields rise sharply as elsewhere
- Budget surpluses, very large cash balances and long-dated debt mean very little funding needed
- Irish sovereign debt ratings; S&P AA-, Fitch AA-, Moody's A1. Fitch & Moody's upgraded in 2022



Source : CSO & Dept of Finance (GDP pre 2015)

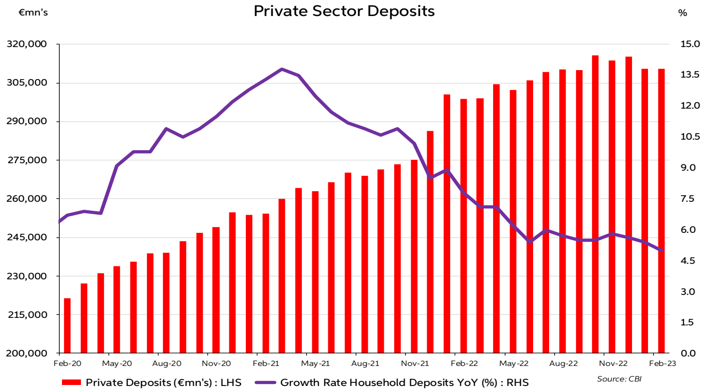


Source: Refinitiv

Good growth likely in 2023 despite headwinds & capacity issues

- Mounting headwinds and capacity constraints, but solid growth expected by Irish economy in 2023-24
- Strong data in Q1 2023 – PMIs, tax receipts, car sales
- FDI inflows continuing, boosting investment, exports and employment – good pipeline in 2023
- Fiscal policy to remain supportive of growth – Budget has 5-6% rise in core gov. spending in 2023 and 2024
- Economy has deleveraged; low private sector debt
- A rundown of some of the 44% surge in private sector deposits during 2020-2022, could support spending
- High inflation, rising rates and slowing global growth are significant headwinds, though, for Irish economy
- Capacity constraints emerging also – housing, labour, electricity, water, infrastructure, planning laws
- GDP growth to slow from 12% in 2022. Recent official forecasts are for 5%+ growth in 2023-24
- More moderate growth rates expected for modified domestic demand in 2023-24

OECD Global GDP Forecasts (Mar 2023)				
% Vol	2021	2022	2023	2024
World	5.9	3.2	2.6	2.9
US	5.9	2.1	1.5	0.9
Eurozone	5.3	3.5	0.8	1.5
UK	7.6	4.0	-0.2	0.9
Japan	2.2	1.0	1.4	1.1
China	8.1	3.0	5.3	4.9



AIB Irish Economic Forecasts

% change in real terms unless stated	2020	2021	2022	2023 (f)	2024 (f)
GDP	**6.2**	**13.6**	**12.0**	**4.0**	**3.7**
GNP	2.7	14.7	6.7	3.5	3.3
Modified Final Domestic Demand	**-6.1**	**5.8**	**8.2**	**3.0**	**2.8**
Personal Consumption	-10.9	4.6	6.6	3.0	3.0
Government Spending	11.6	6.5	0.7	2.3	2.0
Fixed Investment**	-16.5	-39.0	25.9	3.5	3.0
Exports	11.2	14.1	15.0	6.0	5.0
Imports**	-2.1	-8.3	19.0	4.5	5.0
Employment (%)	-2.8	6.2	6.8	1.5	1.5
Unemployment Rate (%)	**5.9**	**6.3**	**4.5**	**4.8**	**5.0**
HICP Inflation (%)	-0.5	2.4	8.1	5.0	2.5
Budget Balance (GGB % GNI*)	-8.6	-3.0	2.0	2.2	3.7
Gross General Gov Debt (% GDP)	58.4	55.3	45.0	41.0	39.0
Net General Gov Debt (% GNI*)	89.3	82.2	73.0	69.0	63.5

**2020-22 data very distorted by aircraft leasing and intangibles (IP)   Source: CSO, D/Finance; AIB ERU Forecasts (except public finances)

Changes to Global Corporate Tax Regime

Importance of FDI:

- Some 1,800 multinational companies are based in Ireland, accounting for over 300,000 jobs in direct employment
- Corporation tax receipts of €22.6bn in 2022 or 27% of total tax revenue – well over 80% comes from MNCs

Changes to Corporate Tax Regime Agreed:

- Ireland's 12.5% corporate tax rate in place for last two decades and a key cornerstone in attracting FDI
- Ireland signs up to OECD proposal of minimum global corporate tax rate of 15% for very large companies
- Also larger multinationals, mainly digital, to pay some taxes on profits in countries where sales made
- DoF has allowed for a €2bn hit to Irish corporation tax receipts from changes to global tax system
- Ireland retaining its 12.5% rate – will be 2.5% top-up for larger companies. Takes effect from 1 Jan 2024 in line with EU
- Close watch still needs to be kept for any changes in US Corporate tax rate on companies overseas earnings (Gilti rate)
- Doubts also remain about whether all countries will ratify the new Global Corporate tax deal, most notably the US

Ireland to Remain Attractive FDI Location :

- Ireland's main competitor for FDI has been UK, but it is now out of EU, Single Market & Customs Union
- Ireland has many other attractions –English speaking, well educated mobile workforce, common law legal system
- Key industries have large presence in Ireland, with its strong pro-enterprise culture, leading R&D and innovation
- Irish rates still comparatively low by European standards. UK rate being raised from 19% to 25% in 2023
- Strong inflows of FDI continue despite the changes to global corporate tax rules. Brexit may be helping inflows

Risks to the Irish economy outlook

- Very open Irish economy vulnerable to weaker global outlook, including FDI inflows, with concerns about downsizing in the tech sector in particular given big presence in Ireland
- High inflation and rising interest rates will weigh on Irish activity in 2023, as elsewhere
- Very reliant on energy imports so could be impacted by disruptions to European gas supplies
- Covid-19 retreats as a risk, but concerns remain about possible new variants
- Changes to US corporation (Gilti) tax regime still possible, with negative impact on FDI here
- Supply constraints in new house building activity, with output still at low levels, falling starts
- Other capacity constraints emerging – labour, electricity, water, infrastructure, planning laws
- Competitiveness issues - high house prices, high rents, high personal taxes, high wages & prices
- Credit constrained – tight lending rules, on-going deleveraging, subdued credit demand