



The Irish Economic Update:

*Continuing good growth, but
challenges remain*

March 2020

Oliver Mangan
Chief Economist
AIB

Strong growth by Irish economy over 2013-2019

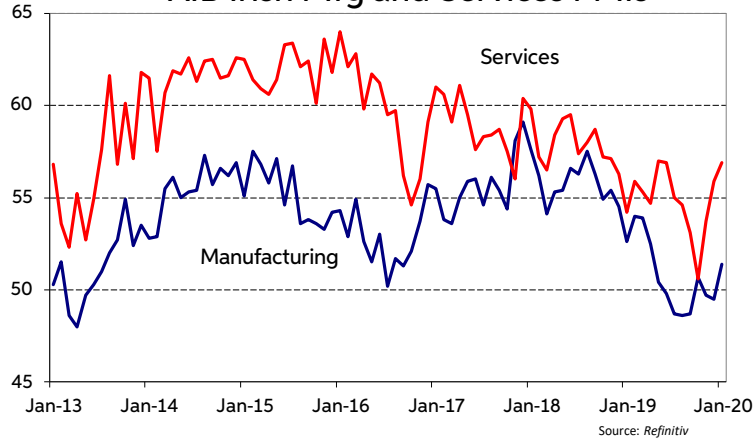


- Very severe recession in Ireland in 2008-2009. GDP fell by 8.5% and GNP down 11%
- Collapse in construction activity and banking system, severe fiscal tightening, high unemployment. Ireland entered a 3 year EU/IMF assistance programme from 2010-2013
- GDP at end of 2008-09 recession was still over 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 has 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 now in surplus
- Major deleveraging by private sector, including households, in past decade
- Balance of payments in surplus

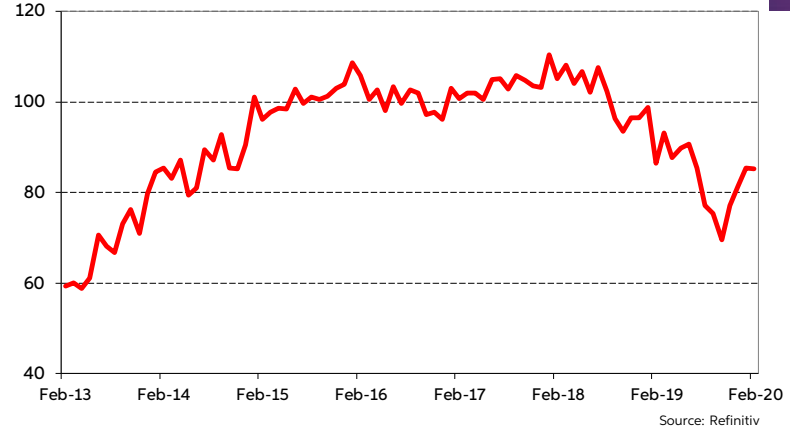
Some better survey data recently



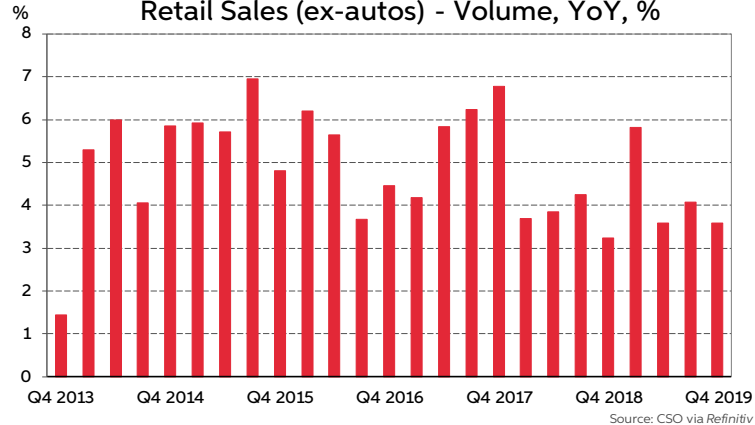
AIB Irish Mfg and Services PMIs



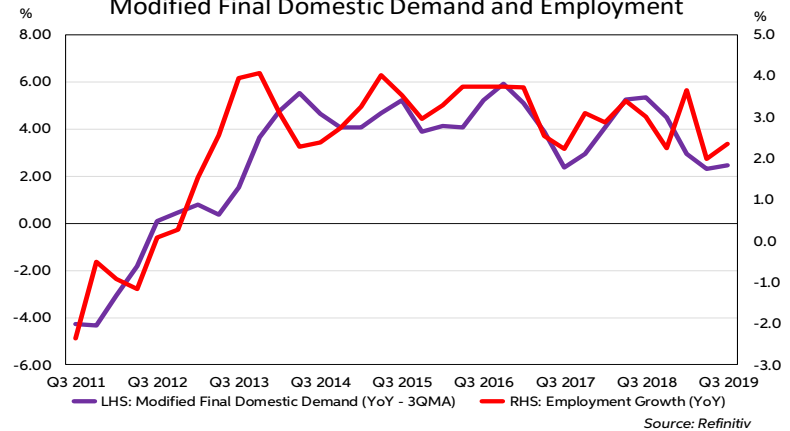
Consumer Confidence (ESRI - KBC)



Retail Sales (ex-autos) - Volume, YoY, %



Modified Final Domestic Demand and Employment



Real indicators held up well in 2019



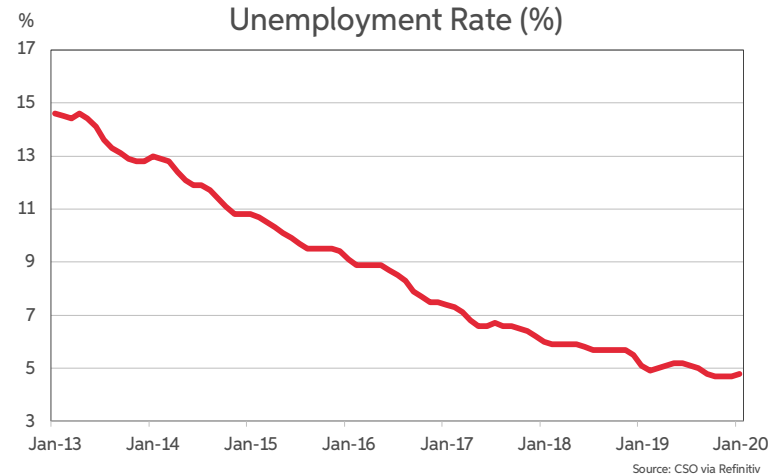
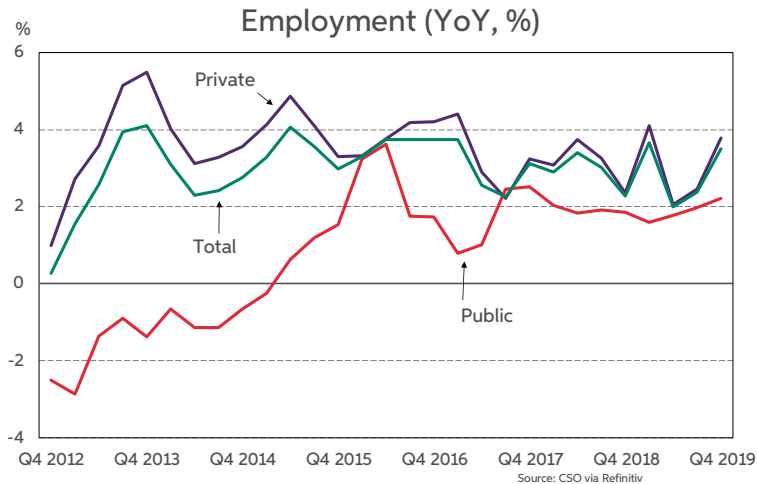
- Robust jobs growth of 2.9% yoy in 2019, matching rates seen in previous years
- Downtrend in unemployment rate continues, as it drops to 4.7% in Q4 2019
- Housing completions up strong 18% yoy to over 21k in 2019, though slower growth than in 2018
- Rising housing commencements – up 25% yoy to Sept 2019, close to robust 2018 growth rate
- Mortgage lending growth slowed to 9.5% yoy in 2019 – flattening house prices a factor
- Construction PMI weakened notably in 2019. At level consistent with only modest pace of activity in Jan
- Retail sales (ex-motor trade) rose strongly again last year, increasing by 4.3%
- Total car registrations (new + 2nd hand imports) dip at start of 2020 after strong performance in 2019
- Manufacturing PMI weakened markedly during 2019. Picked up in first month of 2020
- Services PMI slipped in 2019, but rebounded strongly over winter and hit a 7-month high in January
- Consumer confidence fell sharply to 6 year lows in 2019 as Brexit fears weighed, but now trending higher
- Budget surplus rose to €1.4bn or 0.4% of GDP in 2019. Tax receipts up by strong 10% yoy in January 2020

Jobs growth still strong, unemployment rate below 5%



Year Average	2016	2017	2018	2019	2020(f)	2021(f)
Unemployment Rate %	8.4	6.8	5.8	5.0	4.6	4.5
Labour Force Growth %	1.9	1.1	1.8	2.0	1.8	1.8
Employment Growth %	3.7	2.9	2.9	2.9	2.2	1.9
Net Migration : Year to April ('000)	16.2	19.8	34.0	34.0	35.0	35.0

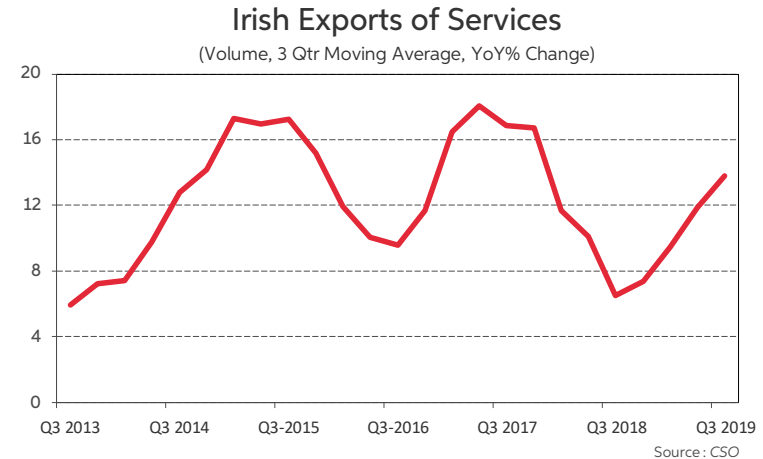
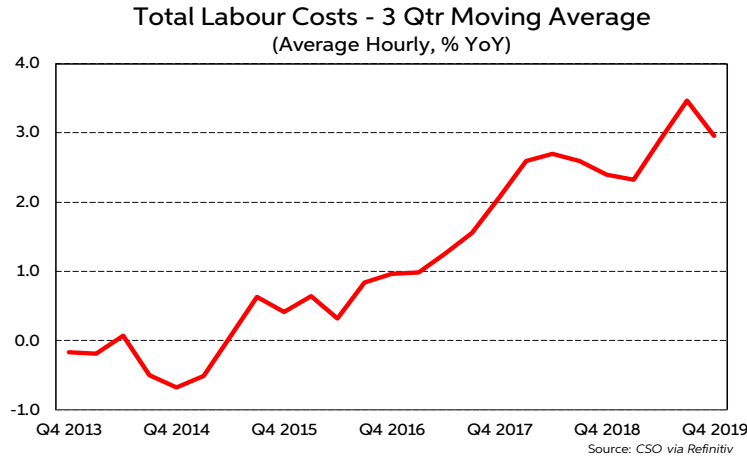
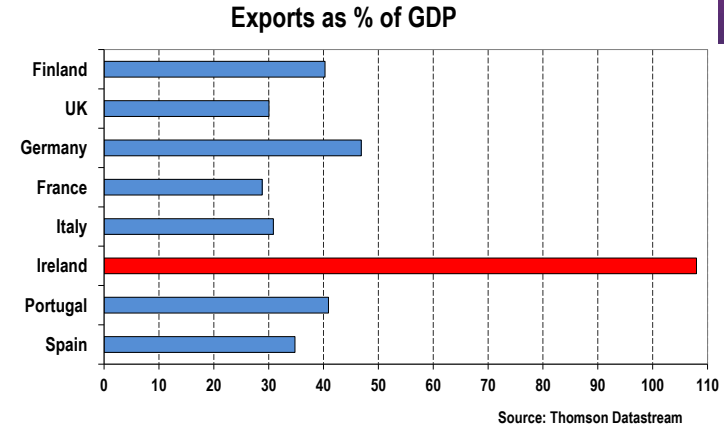
Source: CSO and AIB ERU forecasts



Large Irish export base performing very well



- Ireland a very open economy – exports, driven by enormous FDI, equate to well over 100% of GDP
- Major gains in Irish competitiveness earlier in decade – though wage growth now picking up
- Exports rise strongly, helped by large FDI inflows
- Total exports up by 10.4% in 2018, with a further strong rise of 12% yoy in Q1-Q3 2019



FDI and the Irish economy



WHAT ATTRACTS FDI TO IRELAND?

- Access to European markets
- Low corporate tax rate of 12.5%
- English speaking country
- Well educated, flexible workforce
- Common law legal system
- Stable political framework
- Long history of successful FDI
- Access to decision makers

KEY FDI IMPACTS ON THE IRISH ECONOMY

- 1,550 multinational companies now in Ireland
- 33% of MNCs have been here for more than 20 years
- 63% of new MNCs came from US in 2019. Share falling
- €129bn in FDI Exports (68% of total exports)
- 245,000 Jobs in FDI firms (10.5% of total emp.)
- Ten MNCs account for 50% of Corporation Tax
- €14bn Spending on Irish services/materials/capex
- €13.3bn in Payroll

WORLD LEADERS CHOOSE IRELAND

- 17 of the top 20 in ICT
- 10 of the top 10 in Pharmaceuticals
- 14 of the top 15 in Medical Devices
- 8 of the top 10 Industrial Automation
- 10 of the 'top born on the Internet' firms
- 20 of the top 25 Financial Services firms
- UK now less attractive for FDI owing to Brexit

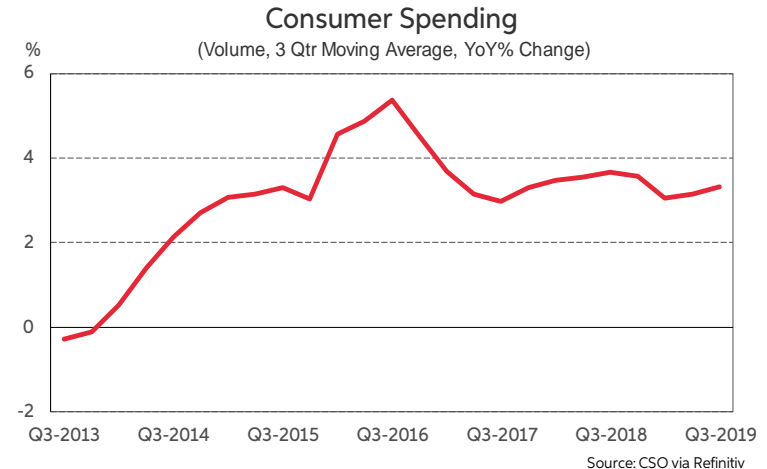
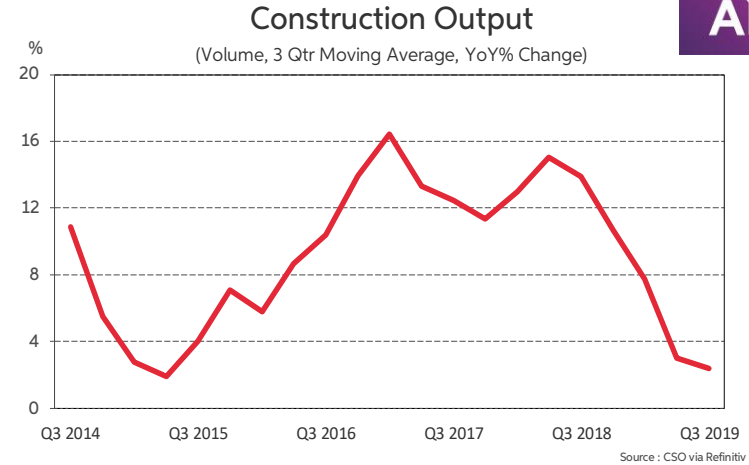
US TAX CHANGES HAVE NOT HIT FDI

- US firms have well established operations here
- Need highly skilled, multi-lingual workforce
- Firms do not move to Ireland to avoid US tax
- Ireland is base to service their European markets
- Easier to operate in local rather than US time zone
- Still wide gap between US & Irish corporate tax rates
- Very strong FDI inflows in both 2018 and 2019

Domestic economy has rebounded strongly



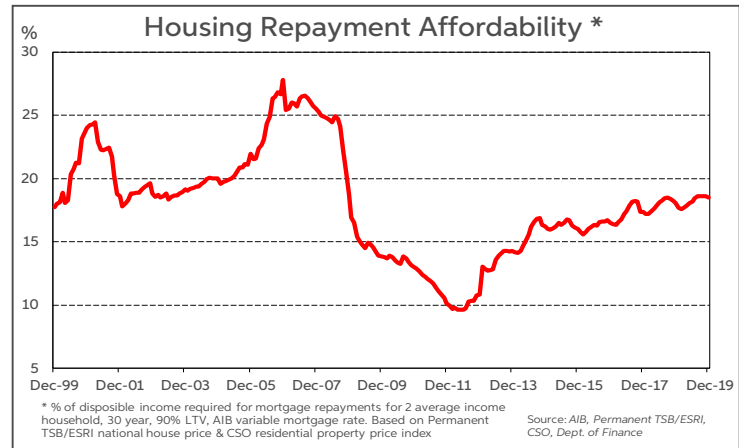
- Construction sees strong recovery since 2013. Output up nearly 12% on average in 2016-18 period
- Slowdown in non-residential construction activity last year – construction output up 4% yoy in Q1-Q3 2019
- Business investment (ex aircraft/intangibles) has picked up strongly since 2013
- However, Brexit uncertainty saw decline in business investment in 2019
- Consumer spending grew by 3.5% on average over 2014-2018 period. Up by 3.4% yoy in Q1-Q3 2019
- Core retail sales rose by a strong 4.3% in 2019
- Total car regs (new + used imports) remained at high levels in 2019, though dip at start of 2020
- Modified final domestic demand grew at 4.4% rate in 2014-2018 period. Up 3.5% yoy in Q3 2019



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



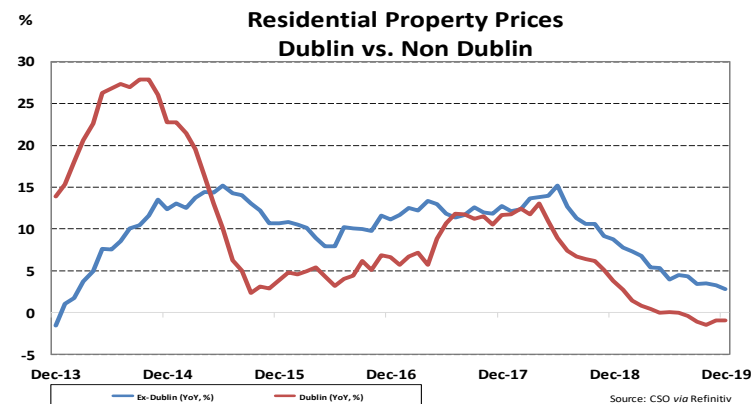
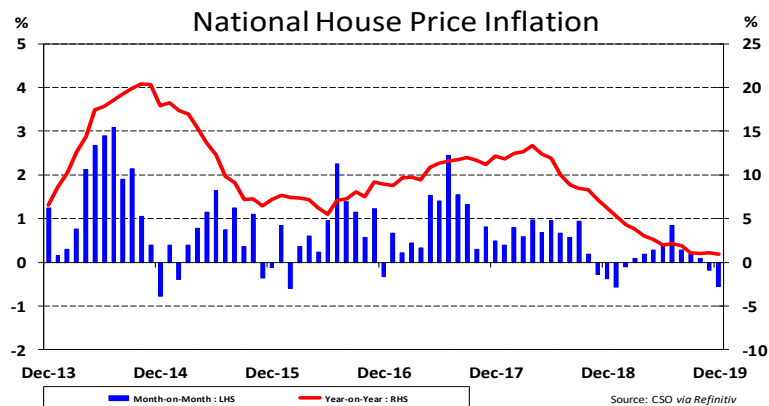
- Housing completions up 18% yoy to over 21,000 units in 2019, a slight moderation on 2018's 25% growth rate
- Housing commencements rose 25% yoy to end Q3 2019 following a 28% increase in 2018
- Planning permissions up 23% yoy in Q1-Q3 2019, with 12 month running total now above 34,000
- Measures put 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 35,000 units
- Completions forecast at circa 24,500 in 2020, rising to around 28,000 in 2021
- Mortgage lending growth eases to 9.5% in 2019, though mortgage approvals did pick up over the year
- Affordability broadly stable as earnings growth offsets modest increase in house prices



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 84% by Dec 2019 from low in March 2013 – Dublin prices up by 93%, non-Dublin rise 83%
- But house prices still some 18% below 2007 peak
- House price inflation slows sharply in 2018/19 reflecting Central Bank rules
- Prices up 2.5% yoy nationally in 2019. Eased to 0.9% by December, down from high of 13.3% in April 2018
- Dublin prices fell 0.9% yoy in Dec, down from +13% in Apr '18; non-Dublin slows to 2.8% from 15% last year
- CSO rental inflation moderating. Index dipped for first time since 2012 in Jan. Flat in Nov/Dec



AIB Model of Estimated Housing Demand



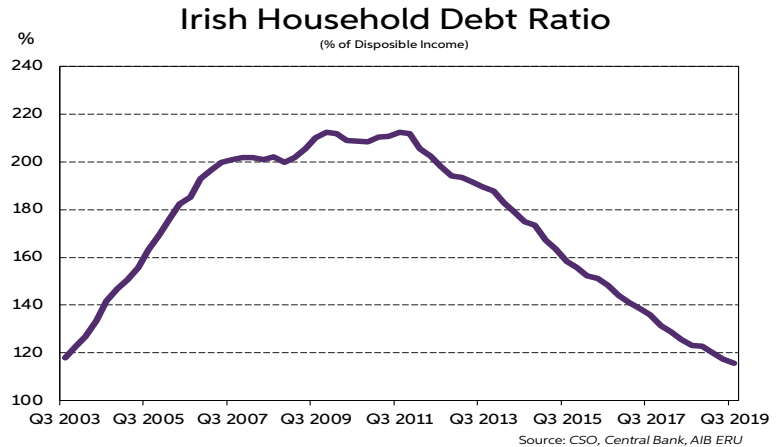
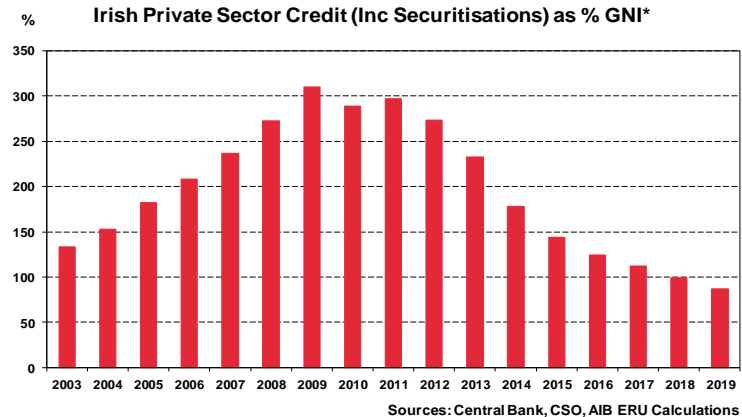
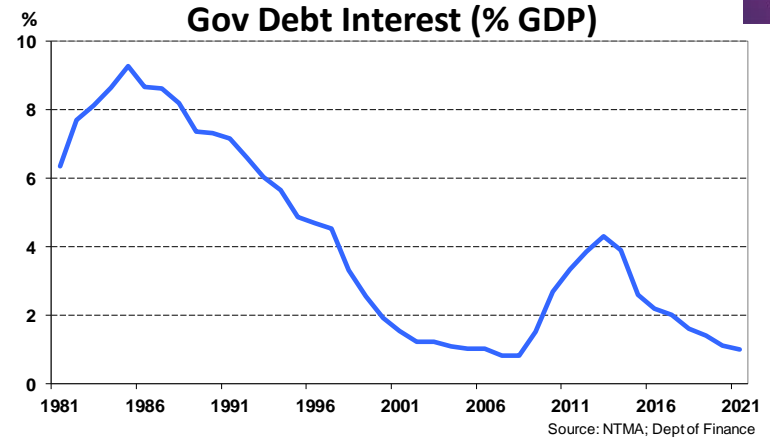
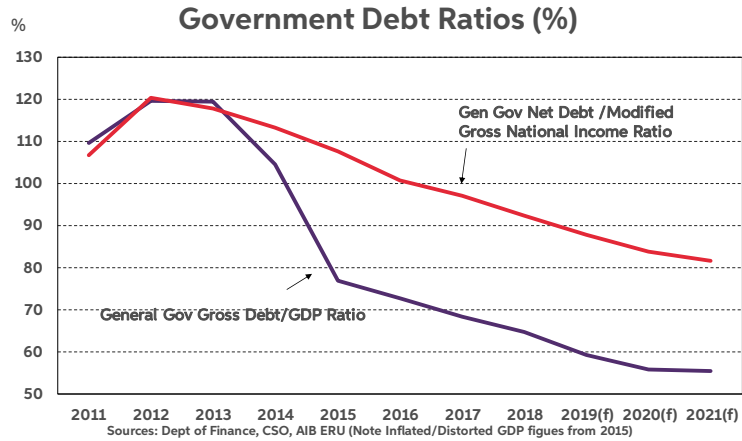
- Rising headship rates added circa 8,000 per year to housing demand in 2002-2011 period
- Shortage of housing, high rents, tighter lending rules saw average household size rise in 2011-16. Thus, headship fell – was a drag of circa 10,000 p.a. on housing demand
- Assume no change in headship in 2016-2020 – 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 2016-20

Calendar Year	2016	2017	2018	2019	2020
Household Formation	26,500	26,500	26,500	27,500	27,500
<i>of which</i>					
Indigenous Population Growth	18,000	18,500	17,500	16,500	14,500
Migration Flows	8,500	9,500	12,000	13,000	13,000
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	32,000	33,500	35,000	35,000	33,000
Completions	9,900	14,400	18,100	21,250	24,500
Shortfall in Supply	-22,100	-19,100	-16,900	-13,750	-8,500

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

Sources: CSO, DoECLG, AIB ERU

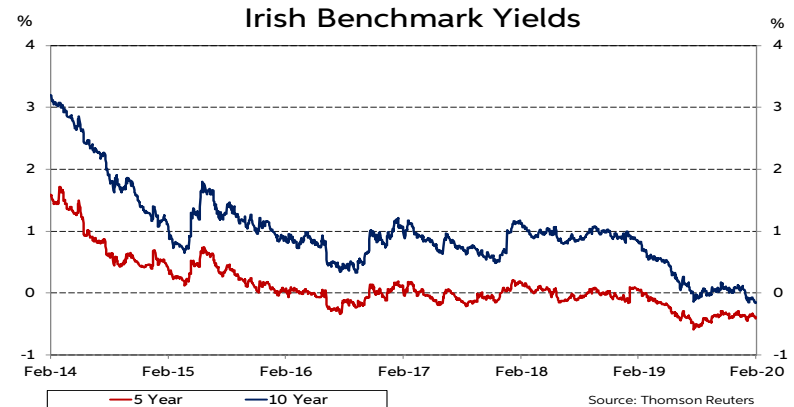
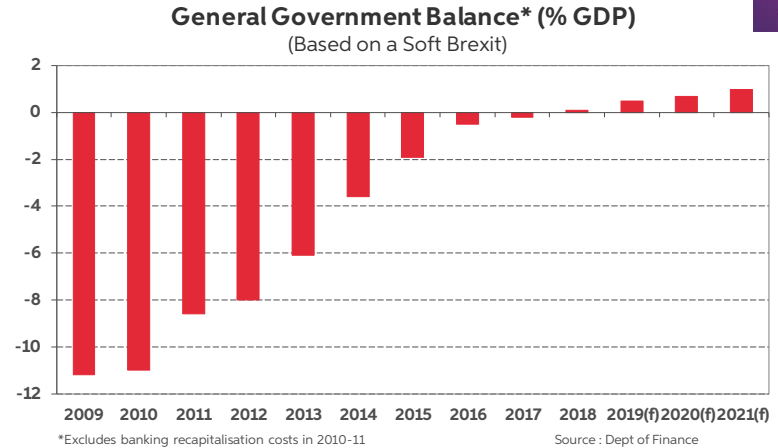
Govt debt ratios fall, private sector deleverages



Government finances return to surplus in 2018/19



- Budget deficit declined sharply over last decade, with small €170m surplus recorded in 2018
- Public finances were ahead of target last year – strong tax receipts, rose by 6.8% yoy in 2019
- Budget surplus exceeded target. Rose to €1.4bn or 0.4% of GDP in 2019
- 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
- Budget surplus expected to rise further in 2020
- Tax receipts up by 10% yoy in January, aided by strong income tax take
- Gov Debt/GDP ratio has fallen sharply
- Irish bonds yields negative out to 10 years
- Sovereign debt ratings upgraded in recent years; S&P at AA-, Fitch at A+, Moody's A2 for Ireland



Brexit: Difficult trade talks lie ahead in 2020



- 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 to last until end 2020
- UK government rules out extending transition period beyond this date
- Thus, EU-UK talks on future trade relationship will need to be completed by end 2020
- Negotiations likely to prove difficult and fractious. Challenge to be done by end 2020
- 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 included 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



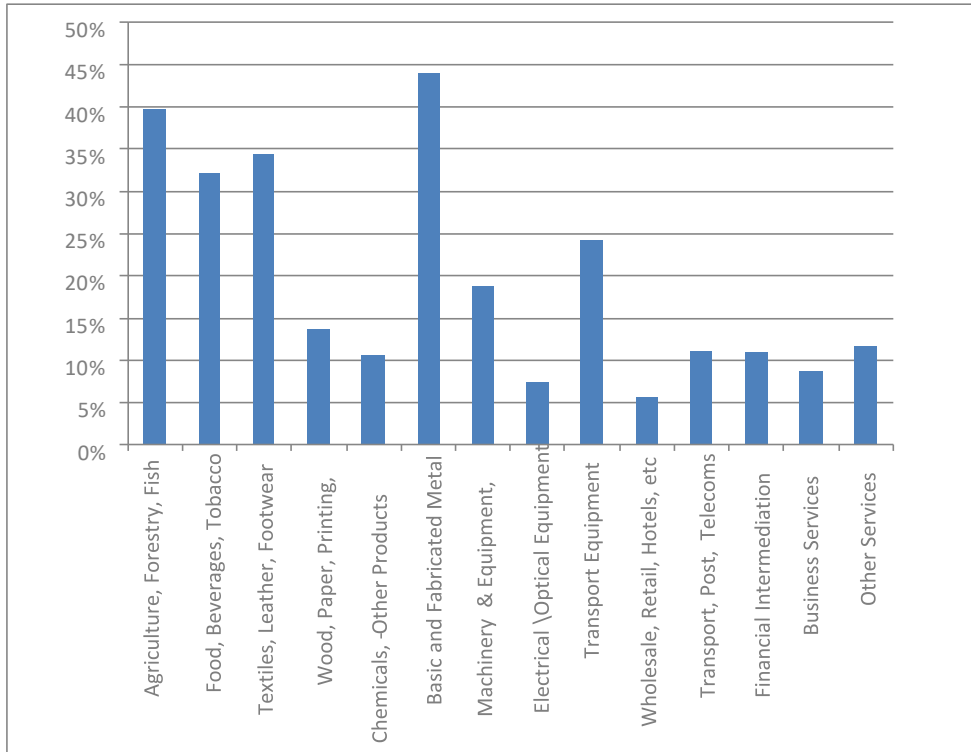
- UK outside EU Customs Union after transition period ends so both exports and imports will need paperwork, even if tariff free trade is agreed under FTA that implies no Customs Duties
- Need to get Customs Registration Numbers in both Ireland (EORI) and the UK from Revenue
- Customs Declaration forms 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

Vulnerable food sector as 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 to cut tariffs 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

AIB Brexit Sentiment Index



- A total of **700 SME's (with up to 250 employees)** across the island of Ireland



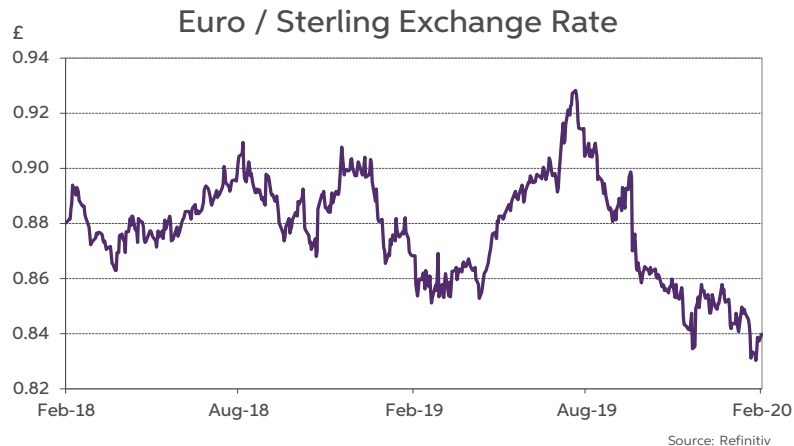
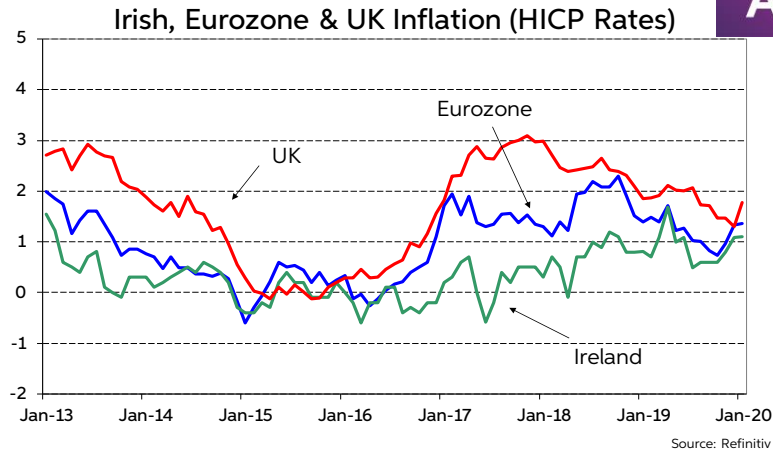
Source: Ipsos MRBI

*The Index reflects and measures the sentiment of Irish SMEs in the Republic of Ireland and Northern Ireland towards Brexit, summarised as a single number, with a potential range from +100 to -100. It takes the difference between the positive and negative responses across four key measures: Impact on business now, Impact on future business (next 5 years), Level of visibility and, finally, the Wider economic impact of Brexit.

- Headline index **weak again** in Q3. One of the most notable features of the surveys in 2019 was the number of firms that said Brexit having a **negative impact on their business**
- **Manufacturing, Food & Drink, Transport, Tourism and Retail sectors most concerned** about Brexit
- **50% of ROI and 66% of NI firms** who had investment plans said they have been **cancelled or postponed** owing to Brexit.

Good Irish growth can continue if external risks avoided

- Irish economy should continue to grow at impressive pace, but not as strongly as in recent years
- House building picking up from still low output levels
- Public spending on the rise
- Activity supported by low interest rate environment
- Strong growth in household incomes
- Continuing good inflows of FDI
- Irish inflation still very low
- However, Brexit remains real challenge for economy
- Important too that global economy avoids recession
- GDP growth forecast at 4% in 2020 & 3% in 2021, assuming EU-UK trade deal & no global recession
- ESRI had estimated medium-term growth rate of economy at around 3.25% for the period 2020-2025. Will now be lower, with UK out of EU



AIB Irish Economic Forecasts



<i>% change in real terms unless stated</i>	2017	2018	2019 (e)	2020 (f)	2021 (f)
GDP	8.1	8.2	5.5	4.0	3.0
GNP	5.1	6.5	3.0	3.7	2.75
Personal Consumption	3.0	3.4	3.5	3.0	2.5
Government Spending	3.9	4.4	4.0	3.0	3.0
Fixed Investment	-6.6	-21.1	48.0	5.0	5.0
Core Fixed Investment*	4.0	13.0	2.0	5.0	5.0
Exports	9.2	10.4	11.0	7.5	5.0
Imports	1.1	-2.9	24.0	8.0	5.5
HICP Inflation (%)	0.3	0.7	0.9	1.1	1.3
Unemployment Rate (%)	6.8	5.8	5.0	4.6	4.5
Budget Balance (% GDP)	-0.2	0.1	0.4	0.7	1.0
Gross General Gov Debt (% GDP)	68.0	63.5	59.3	55.5	55.0

*Excludes investment in aircraft and intangibles

Source: CSO, D/Finance; AIB ERU Forecasts

Risks to the Irish economy



- Main risks to the Irish economy are external
- Brexit still a big concern for Ireland given uncertainty about future EU-UK trading relationship
- Weaker external environment, with downside risks to global growth from the coronavirus, protectionism/tariffs, weak world trade/manufacturing activity, sluggish European economy
- 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 with output still at low levels
- 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

Note: All Irish data in tables are sourced from the CSO unless otherwise stated. Non-Irish data are from the IMF, OECD and Thomson Financial. Irish forecasts are from AIB Economic Research Unit. This presentation is for information purposes and is not an invitation to deal. The information is believed to be reliable but is not guaranteed. Any expressions of opinions are subject to change without notice. This presentation is not to be reproduced in whole or in part without prior permission. In the Republic of Ireland it is distributed by Allied Irish Banks, p.l.c. In the UK it is distributed by Allied Irish Banks, plc and Allied Irish Banks (GB). In Northern Ireland it is distributed by First Trust Bank. In the United States of America it is distributed by Allied Irish Banks, plc. Allied Irish Banks, p.l.c. is regulated by the Central Bank of Ireland. Allied Irish Bank (GB) and First Trust Bank are trade marks used under licence by AIB Group (UK) p.l.c. (a wholly owned subsidiary of Allied Irish Banks, p.l.c.), incorporated in Northern Ireland. Registered Office 92 Ann Street, Belfast BT1 3HH. Registered Number NI 018800. Authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. In the United States of America, Allied Irish Banks, p.l.c., New York Branch, is a branch licensed by the New York State Department of Financial Services. Deposits and other investment products are not FDIC insured, they are not guaranteed by any bank and they may lose value. Please note that telephone calls may be recorded in line with market practice.