



The Irish Economic Update:

Second wave to Covid-19 interrupts recovery from recession

November 2020

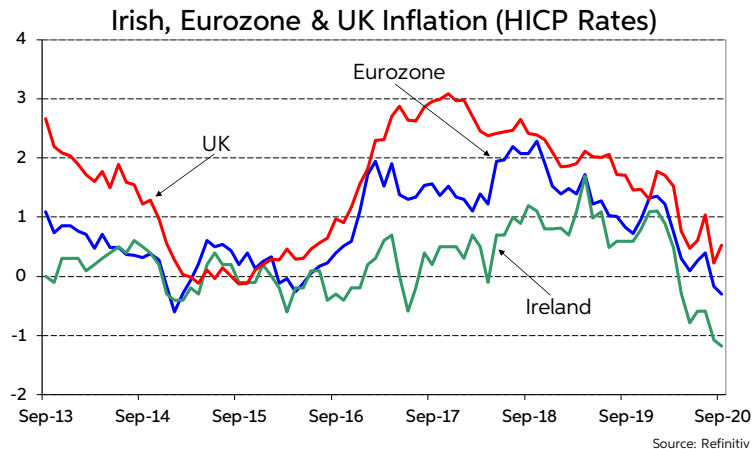
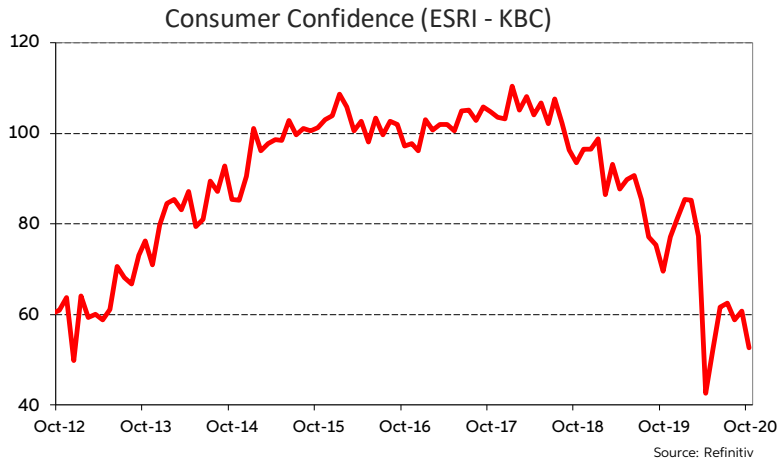
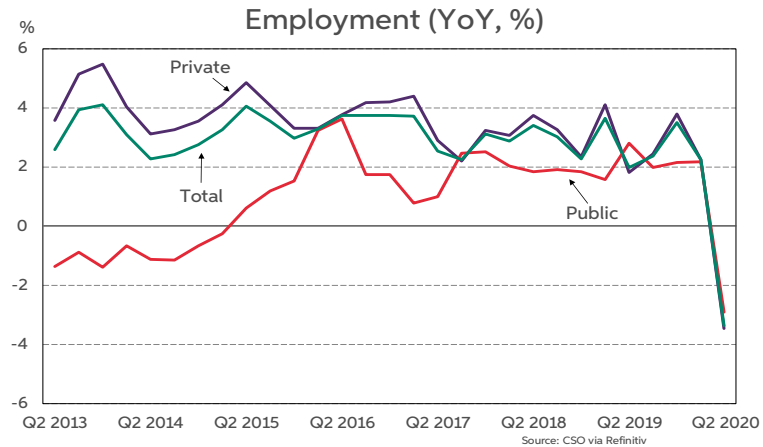
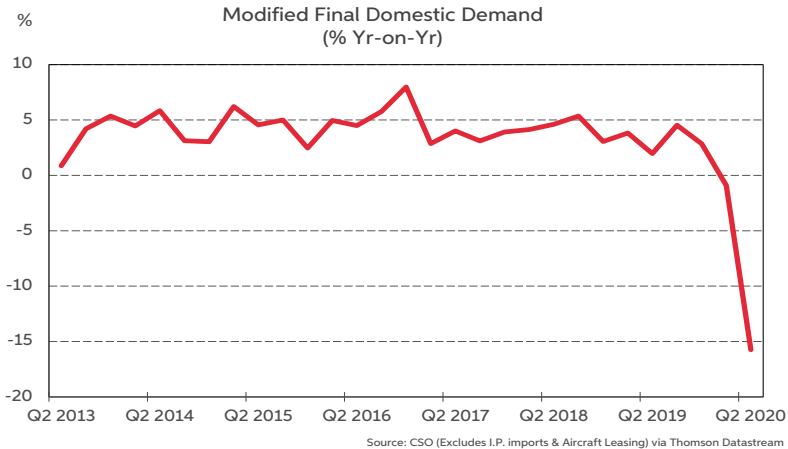
Oliver Mangan
Chief Economist
AIB

Economy in very strong shape ahead of Covid shock



- Irish economy was in very strong shape ahead of being hit by very deep H1 Covid recession
- Economy had recovered strongly from severe recession of 2009-2012 period
- Well balanced, robust underlying growth of circa 5% per annum over 2013-19 period
- Large inflows of FDI and strong export growth remain key features of the economy
- Strong jobs growth, averaging over 3% per annum during the period 2013-19
- Unemployment rate fell from 16% in early 2012 to below 5% in H2 2019
- Budget deficit eliminated quicker than expected. Public finances in surplus in 2018/19
- Major deleveraging by private sector, including households, during the past decade
- Stable housing market - house price inflation at 1%, moderate growth in mortgage market
- Very low, stable CPI inflation of below 1% over 2013-19 period
- Balance of payments returned to large surplus

Big Covid hits to domestic demand, employment, inflation



Steep contraction in activity during Q2 lockdown

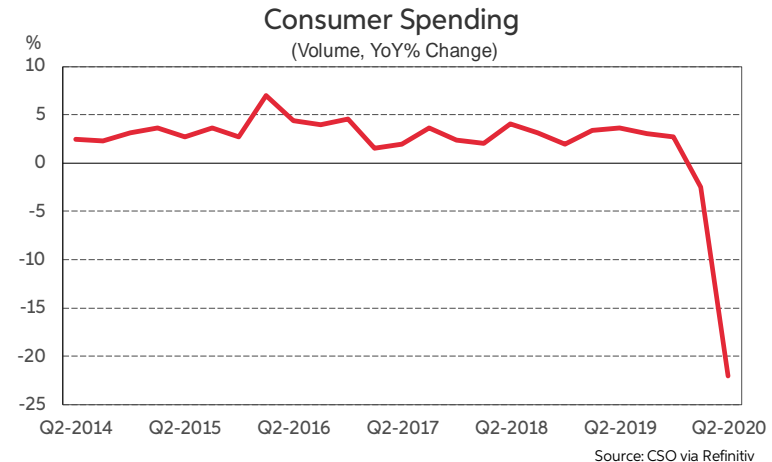
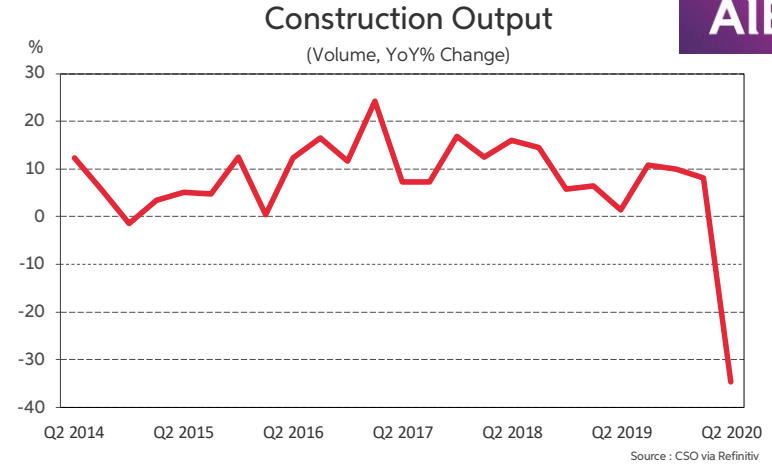


- GDP fell by 2.1% in Q1 and 6.1% in Q2, so economy entered a deep recession
- Modified final domestic demand fell by a very steep 16.4% in Q2 after 1.3% fall in Q1
- Sharp declines of 20% in consumer spending and 28% in domestic fixed investment in Q2
- Strong performance by exports (pharma +28% yoy) and lower Royalties on IP boost net trade in H1
- Jobless rate soared in March-May; COVID-19 adjusted unemployment rate rose to near 29%
- Big fall of 6.3% in employment in Q2, especially in part-time jobs – but understates real decline
- Hours worked fell by 22% yoy in Q2, which shows real impact of COVID-19 on activity
- PMIs sank to very low levels in April and May, especially for services and construction
- 67% drop yoy in number of cars licensed for first time (new + 2nd-hand imports) in 3 months to May
- Retail sales (ex motor trade) fell by 12% in Q2 - sales plunged by 24% in April alone
- But tax receipts held up better than expected – rose 0.7% yoy in H1 2020: Corpo tax well up
- Activity started to rebound from June as virus brought under control and restrictions were relaxed

Domestic spending falls sharply on Covid impact in H1'20



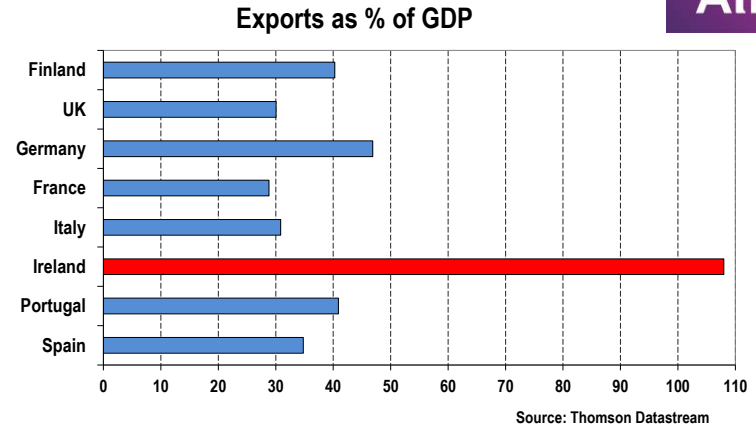
- Average growth rate of 4.25% in modified final domestic demand in period 2014-19
- Covid hit sees modified FDD fall by 16.4% in Q2 2020, after decline of 1.3% in Q1
- Consumer spending contracted by 3.6% in Q1 and then fell by 19.6% in Q2
- Core retail sales down by 12% in Q2, with very sharp fall in April in particular
- New car sales fell by 37% yoy in H1 2020
- Domestic fixed investment contracted by 28% in Q2
- Construction output fell by 38% in Q2
- Transport & Hospitality output down by 30% in Q2
- Consumer spending rebounded over summer with Q3 retail sales moving well above pre-Covid level
- New car sales up in August/September on year-on-year basis – first such monthly rises in 2020



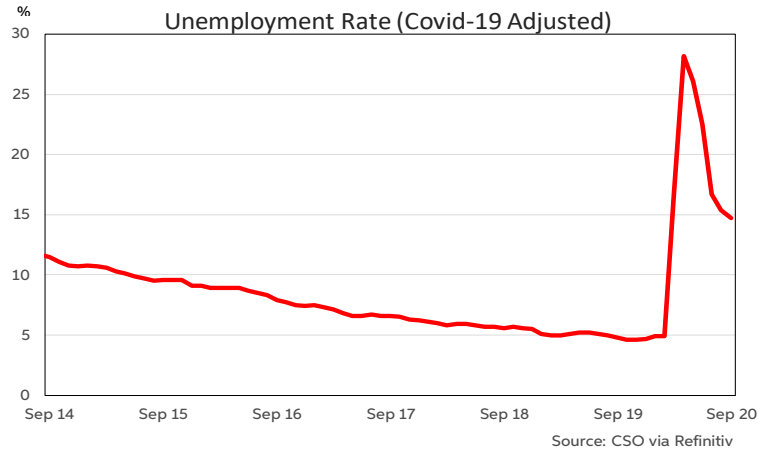
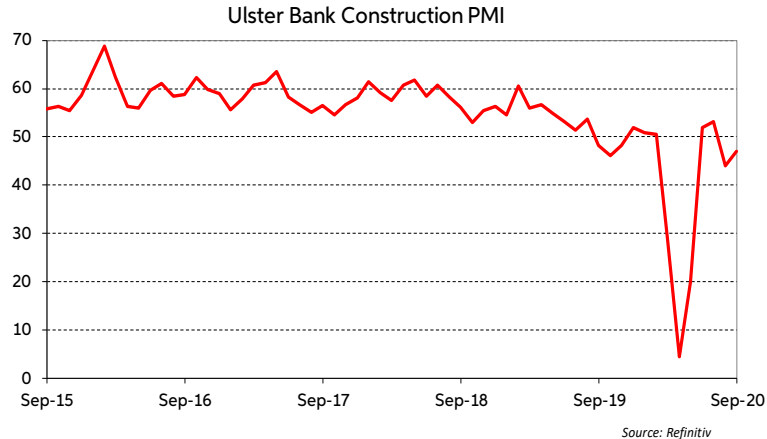
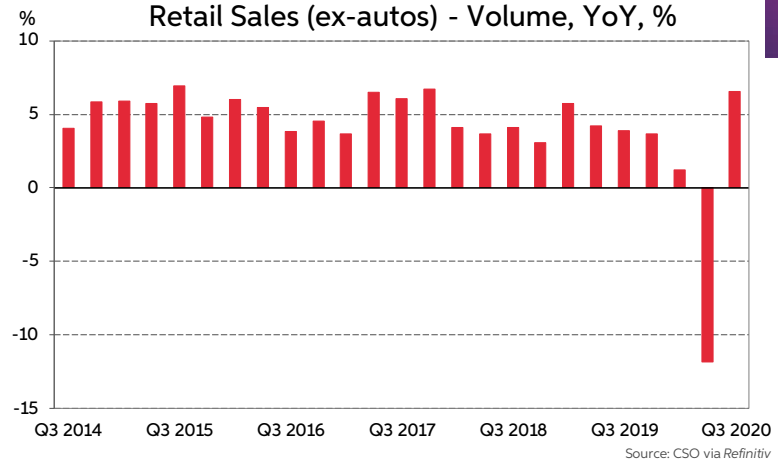
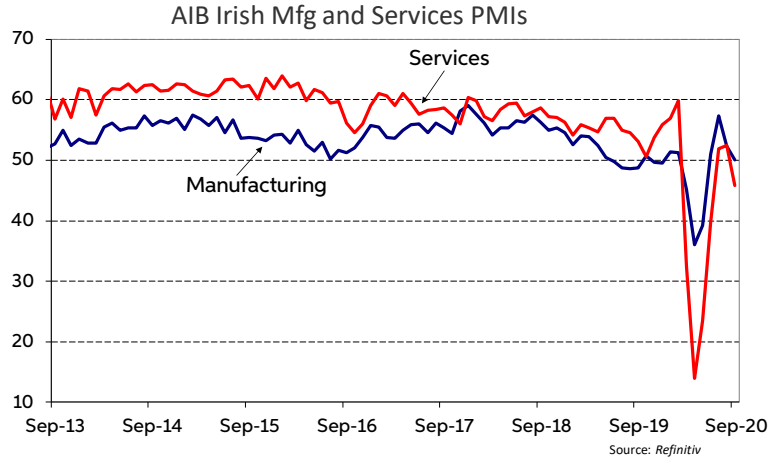
Goods exports performed well in H1'20, services exports fell



- 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
- Total exports rise 3.2% yoy in H1 2020 – goods up 7.3% but services fall by 1.1% yoy
- Big jump in pharma exports in H1 at +28% yoy, other goods exports held up quite well
- Collapse in earnings from tourism & travel in Q2, but computer service exports up 10% yoy



Activity picks up over summer as lockdown lifted



Recovery interrupted as new lockdown imposed

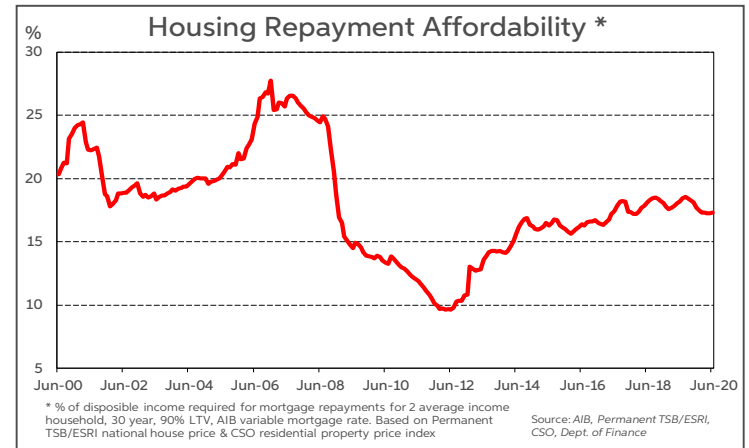
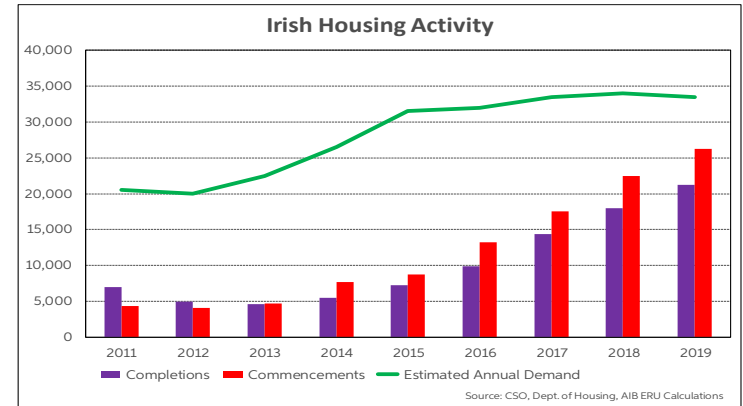


- Unemployment rate down to 14.7% by September, but set to rise sharply again in Q4 on lockdown
- Core retail sales rebound strongly; up over 21% in Q3 vs Q2 level, +6.5% yoy. Set for fall back in Q4
- New car registrations rose in August/Sept after very weak H1 2020 – down 26% to end September
- Modest pick-up in consumer sentiment during the summer, but falls back again in October
- Manufacturing PMI rebounded strongly to 57.3 by July, before easing to 52.3 in August and 50 in Sept
- Services PMI picked-up to 52.4 in August but fell to 45.8 in September as second Covid wave hit
- Construction PMI at 53.2 in July but fell back to 44 in August and 47 in September
- Clear signs in September that recovery losing momentum as some restrictions imposed to curb virus
- Broad-based 6 week lockdown imposed from late Oct to end November as new Covid cases spike
- Domestic spending to contract again in Q4 with lockdown, though government provides big supports
- GDP to fall by 3.0-3.5% in 2020 - resilient exports offset part of steep decline in domestic demand

New house building activity falls back in 2020



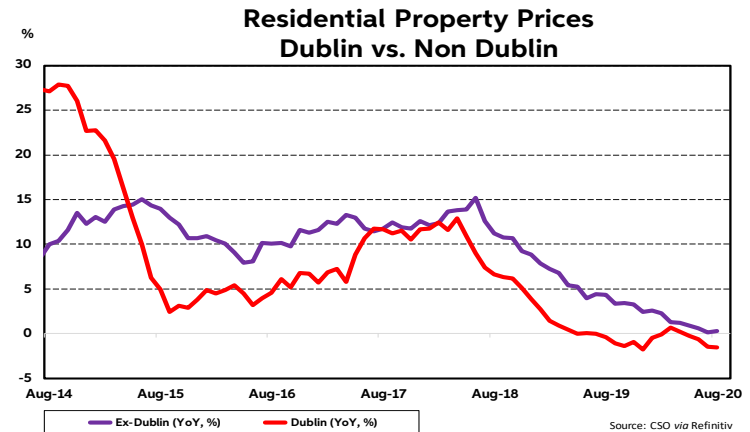
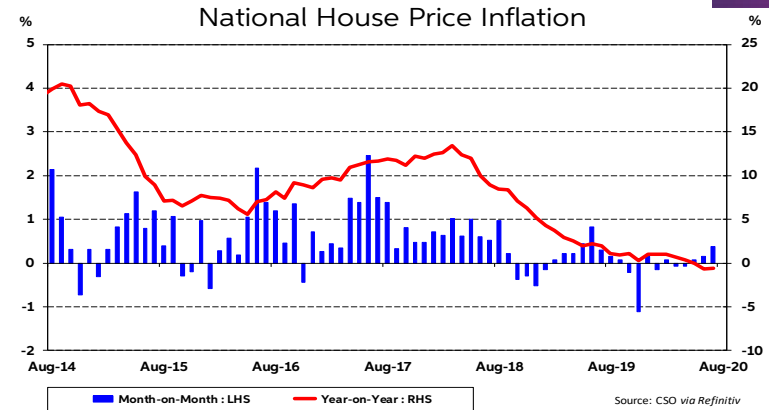
- Housing completions up 18% yoy to over 21,000 units in 2019, up from 18,250 in 2018
- Completions rose by further 17% yoy in Q1 2020, before declining by 32% yoy in Q2 on lockdown impact
- Housing commencements increase by further 17% in 2019 to 26,000 units. Fall by 19% yoy in H1 2020
- Planning permissions jump by 38% to over 40k in 2019. Surge 97% yoy in Q1'20, but fell back by 29% in Q2
- Commencements fell sharply over the summer
- Completions expected to be down by 15-20% in 2020 to 17,000-18,000 and forecast at around 20,000 in 2021
- Housing output remains well below annual new housing demand, estimated at 30,000 units
- Mortgage lending rose by 9.5% to €9.6bn in 2019, but Covid sees drawdowns fall by 20% yoy to end Q3
- Housing affordability metrics remain quite stable



House prices broadly stable to date this year



- House prices declined by very sharp 55% in 2007-13 period, but have recovered strongly since then
- Prices up 84% by August 2020 from March 2013 trough
- But house prices still some 18% below 2007 peak
- House price inflation slowed sharply in 2018/19 reflecting tighter Central Bank lending rules
- Prices down 0.6% yoy nationally in August 2020: Dublin down 1.6%, while non-Dublin up 0.3% yoy
- House prices in 2020 actually up 0.6% to end August
- Property web-sites see big jump in asking prices in Q3
- Low supply, remote working, strong public/institutional demand, enhanced help-to-buy scheme support prices
- Annual growth in rents had slowed before virus hit
- Rents recover in Q3 after steep falls in H1'20 lockdown



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 2016-2021 – 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 2016-21

Calendar Year	2017	2018	2019	2020	2021
Household Formation	28,000	32,000	31,000	25,000	25,000
<i>of which</i>					
Indigenous Population Growth	18,500	21,000	21,000	17,500	16,000
Migration Flows	9,500	11,000	10,000	7,500	9,000
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	33,500	37,500	36,500	30,500	30,500
Completions	14,400	18,100	21,250	18,000	20,000
Shortfall in Supply	-19,100	-19,400	-15,250	-12,500	-10,500

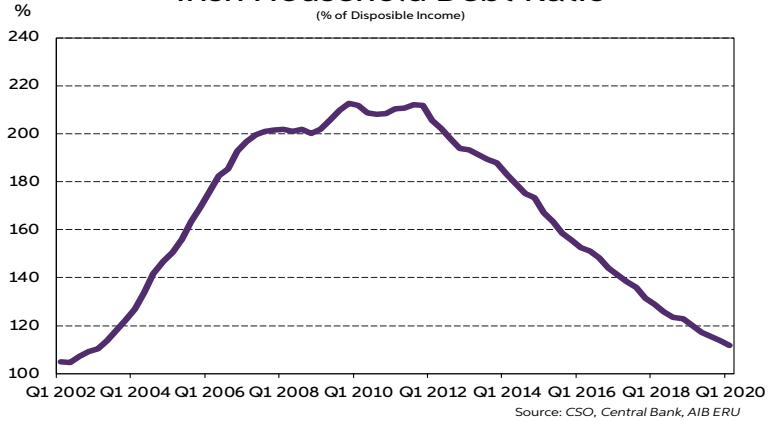
*Headship is % of population that are heads of households.

Sources: CSO, DoECLG, AIB ERU.

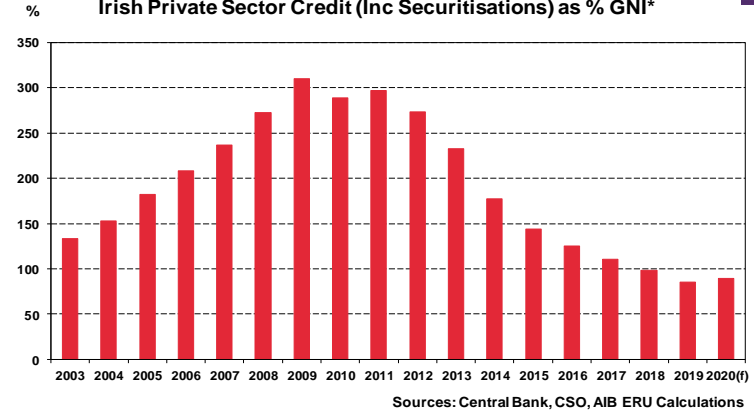
Private sector deleverages, Govt. debt ratios rising again



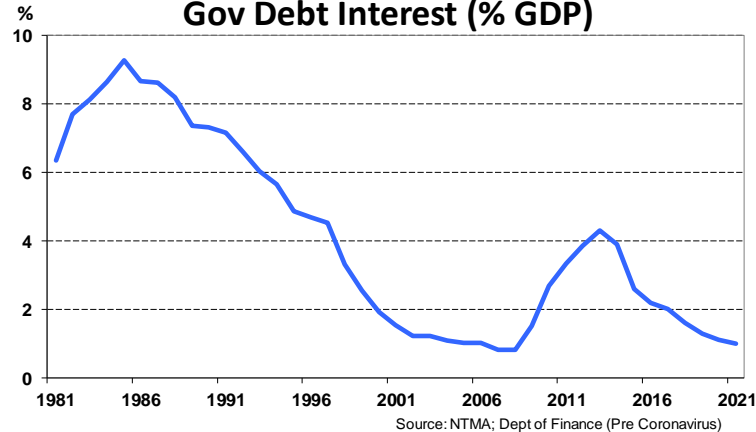
Irish Household Debt Ratio



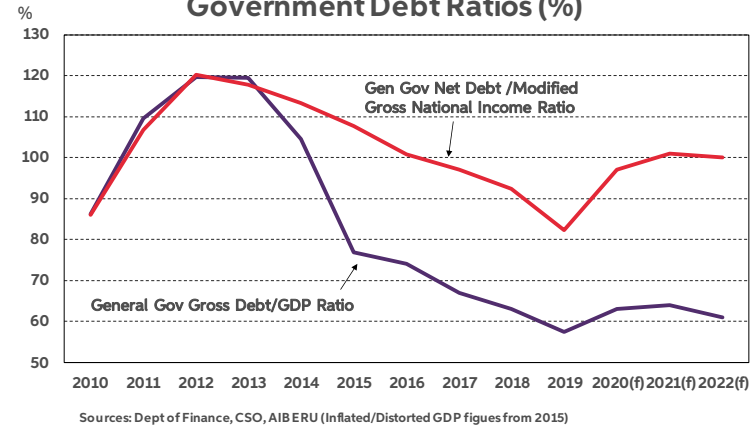
Irish Private Sector Credit (Inc Securitisations) as % GNI*



Gov Debt Interest (% GDP)



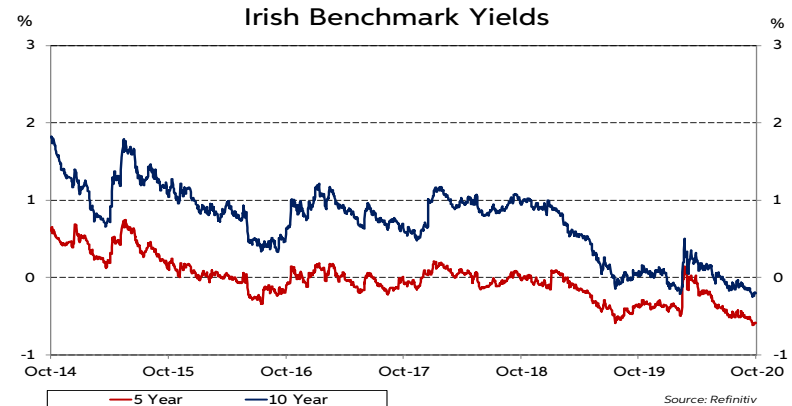
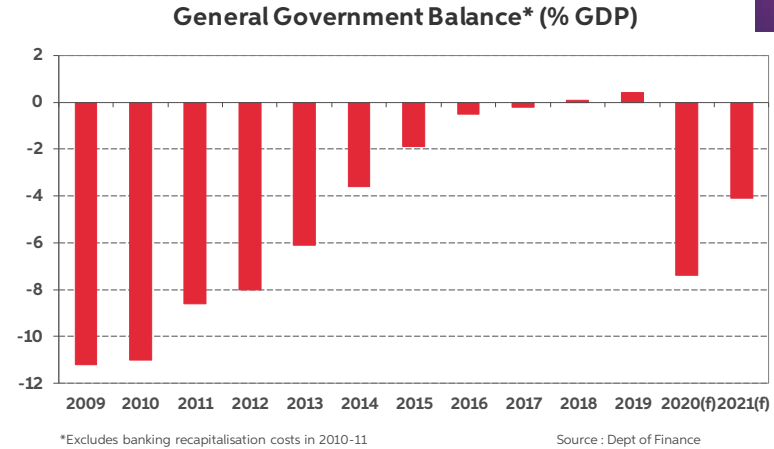
Government Debt Ratios (%)



Blowout budget deficit in 2020 despite resilient tax take



- Budget deficit declined sharply over last decade, with small surpluses recorded in 2018 and 2019
- Primary budget surplus (i.e. excluding debt interest) of 1.8% of GDP in 2019
- However, Covid-19 and efforts to mitigate it see the public finances deteriorate during 2020
- Tax receipts down 3% to end September, while voted government spending soars by 25%
- Budget deficit expected to be €22bn or above this year, or close to 6.5% of GDP
- Dept. of Finance forecasting another large budget deficit of above €20bn in 2021
- Gov Debt ratios had fallen in past decade, but will move higher this year and next
- Bond yields low and stable despite blow-out in budget deficit and big rise in debt issuance
- Ireland's sovereign debt ratings hold steady; S&P at AA-, Fitch at A+, Moody's A2



Brexit: EU-UK trade talks enter final crucial stage



- UK left the EU on Jan 31st 2020 in orderly exit. Transition period in place until end 2020
- UK government has ruled out extending the transition period beyond this date
- Slow progress on key issues in talks to date, with time running out
- EU wants considerable regulatory alignment; UK government puts focus on ‘taking back control’
- State aid rules key stumbling block, as well as fishing rights in UK waters
- Some type of FTA seems likely as it’s the best outcome for both the UK and EU
- Progress made in late October after a short breakdown, with increasing pace to talks
- Any trade deal likely to be limited to goods, mainly based on no tariffs or quotas
- Deal would need to be agreed by mid-November to allow time to ratify before year end
- Still a risk of no trade deal and thus effectively a Hard Brexit at end 2020
- This would see UK adopt WTO rules, implying tariffs on some goods and damaged EU-UK relations

Key points about any EU-UK Free Trade Agreement

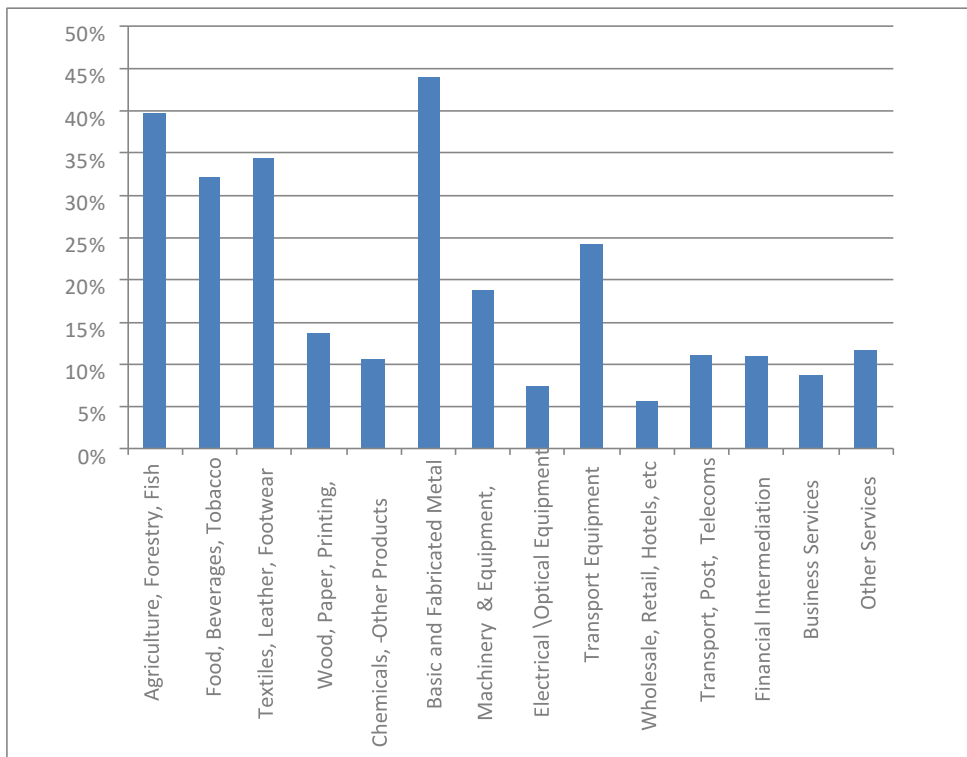


- Any FTA will be much inferior to the EU Single Market, involve a lot of extra admin costs
- Significant restrictions on trade will come into play in a FTA– new customs procedures, compliance with onerous rules of origin requirements, more regulations etc.
- Documentary evidence needed for customs clearance, 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

Food industry is 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
- UK could impose tariffs on EU food imports to protect its agri-industry if no trade deal
- 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)



Brexit to lower growth rate of Irish economy



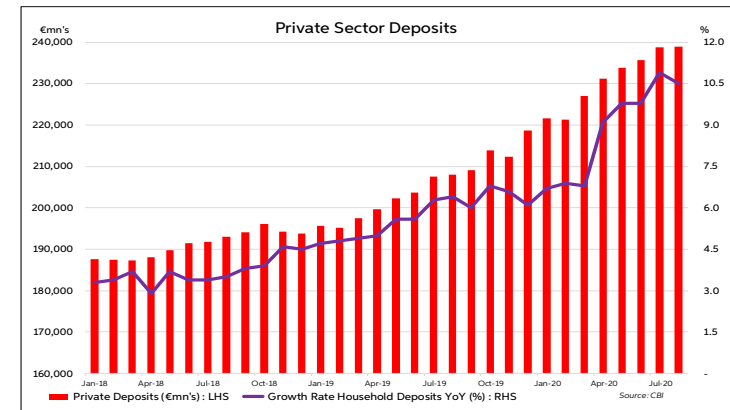
- **Multiple hits to the Irish economy if there is a no EU-UK Trade deal** at end of transition period: further sharp fall in sterling, weak UK economy, disruption to trade/supply lines, tariffs, new administrative and regulatory costs etc.
 - Sharp fall-off in trade with UK likely if there is no trade 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 also be impacted 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

Key medium-term Irish growth drivers remain in place



- Favourable medium-term drivers of strong Irish growth remain in place
- House building picking up from still low output levels – big focus of new government
- Government spending supportive of growth
- Activity to be aided by continuing very low interest rate environment
- Still an attractive destination for FDI
- Labour market dynamics supportive of growth
- Economy has deleveraged, big jump in savings
- World economy expected to rebound from 2021
- Strong Irish growth to be expected next year after sizeable fall in GDP in 2020
- However, a failure to reach an EU-UK trade deal would weigh on Irish growth prospects in 2021-22

OECD GDP Forecasts (Sept 2020)		
% Vol	2020	2021
World	-4.5	5.0
G20	-4.1	5.7
US	-3.8	4.0
Eurozone	-7.9	5.1
UK	-10.1	7.6
Japan	-5.8	1.5



AIB Irish Economic Forecasts



<i>% change in real terms unless stated</i>	2018	2019	2020 (f)	2021 (f)	2022 (f)
GDP	8.5	5.6	-3.0	5.0	4.5
GNP	7.3	3.4	-2.5	4.5	4.0
Personal Consumption	2.8	3.2	-10.5	5.5	3.5
Government Spending	5.8	6.3	8.0	-2.5	2.0
Fixed Investment*	-6.2	74.8	-17.0	-0.5	5.0
Exports	11.1	10.5	0.5	5.5	5.0
Imports*	4.0	32.4	-6.4	3.0	4.7
HICP Inflation (%)	0.7	0.9	-0.5	0.5	1.0
Unemployment Rate (%)	5.8	5.0	10.4	10.0	7.5
Budget Balance (% GDP)	0.1	0.5	-6.5	-5.7	-3.0
Gross General Gov Debt (% GDP)	63.0	57.4	63.0	64.0	61.0

*Data very distorted by aircraft and intangibles (IP)

Source: CSO, D/Finance; AIB ERU Forecasts

Risks to the Irish economy



- Main risk is obviously the coronavirus – could continue to weigh heavily on growth & employment
- Persistence of virus could see scarring effects – high business failures, rising bad debts, job losses
- Very open nature of Irish economy means it is quite exposed to global recession
- Brexit remains a risk as still uncertainty about future EU-UK trading relationship
- Questions around Ireland's corporation tax regime (Apple case, moves on tax harmonisation in EU, OECD tax reform/minimum tax rate proposals) and rise in protectionism could impact FDI
- Supply constraints in new house building activity, with output still at very low levels
- Competitiveness issues - high Dublin house prices, high rents, high personal taxes, high 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.