# The Irish Economic Update:

*Strong summer rebound continuing, with last of Covid-19 restrictions due to go this month*

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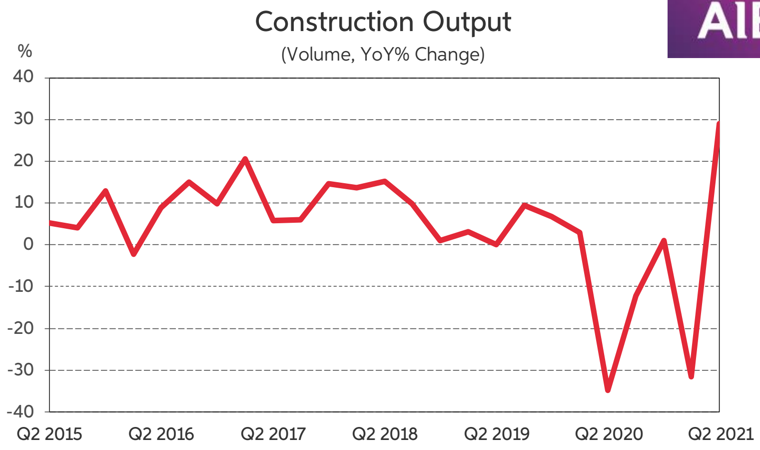
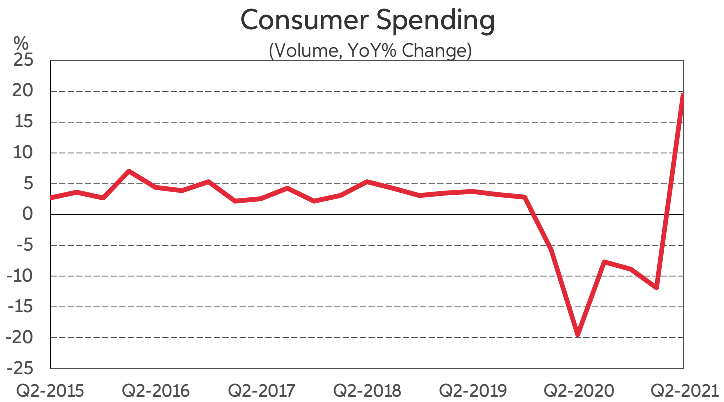
# Economy rebounds strongly as lockdowns end

- GDP grew by 5.9% in 2020, with GNP up 3.4%
- Modified final domestic demand fell by 4.9% and modified gross national income down 3.5% in 2020
- Third lockdown saw GNP contract by 3% in Q1 2021 but rebound by 6.7% in Q2 as economy re-opened
- MFDD fell by 5% in Q1, but up 8.4% in Q2
- Consumer spending contracted by 5.7 % in Q1, before rebounding by 12.6% in Q2
- Domestic investment fell 6.6% in Q1, up 6.1% in Q2
- Construction output fell 31% in Q1, up 23% in Q2
- Strong growth in manufacturing output continued in H1'21, up 11% in Q1 and 5% in Q2
- As a result, goods exports up 10% & 7.5% in Q1/Q2
- This is inflating GDP, which was up by 8.7% & 6.3% in Q1 & Q2, respectively. GNP growth much lower



Source : CSO via Refinitiv

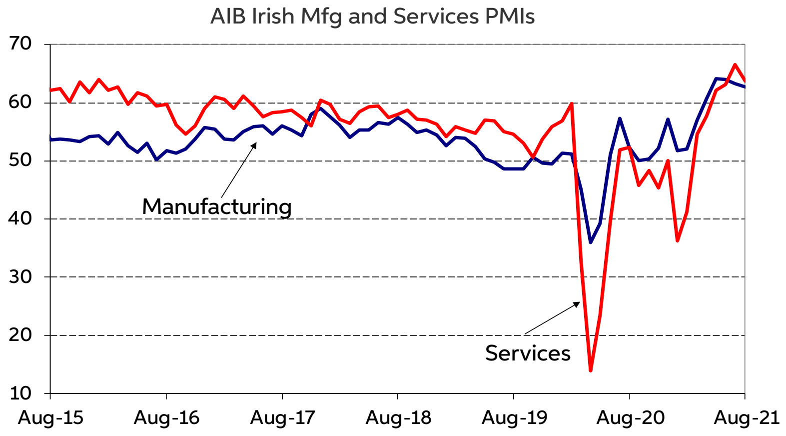


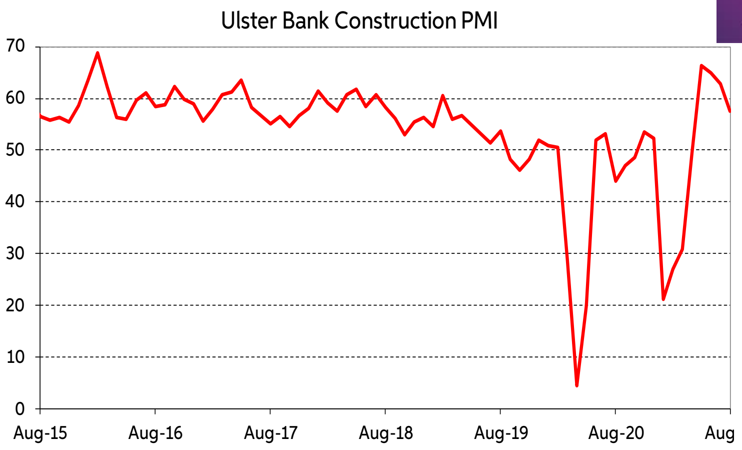
Source: CSO via Refinitiv

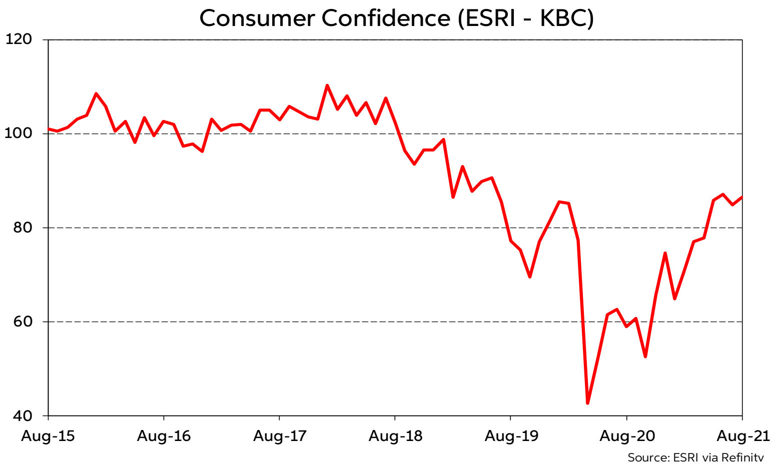
# Very big rebound in activity as restrictions are eased

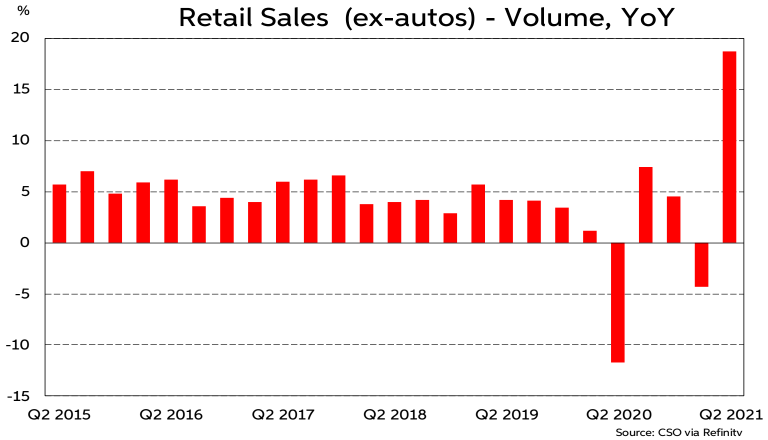
- Restrictions started to be lifted during Q2 after long third lockdown imposed in Q1
- Indicators point to very strong rebound in activity in Q2 and Q3 after lockdown ended
- Mfg PMI hit record high of 64.1 in May, and stays well above 60 over summer - 62.8 in August
- Services PMI jumped to twenty year high of 66.6 in July, at 63.7 in August
- Construction PMI soared in May to 66.4, falling back to still strong level of 57.5 by August
- Big jump of 10% in core retail sales in Q2. Sales remain strong in July/August
- New car sales rose by 23% yoy in January-August period
- Tax receipts running ahead of target by 5.4% at end August – and up 15.2% year-to-date
- Jobless rate (including PUP) falling rapidly – down from 27% earlier in year to 12.4% by Aug
- Inflation accelerating; rises to 2.8% in August from -1.5% last autumn. Could reach near 4%
- Spike to prove temporary. Infaltion forecast to fall back to 2% or below by end of next year

# Indicators pick up strongly as economy reopens

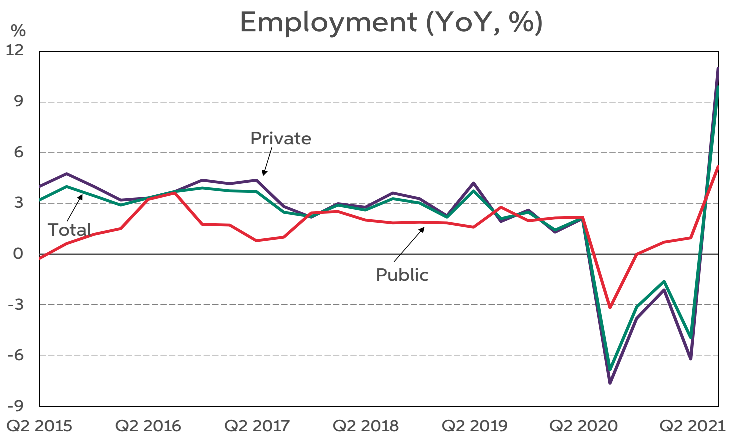


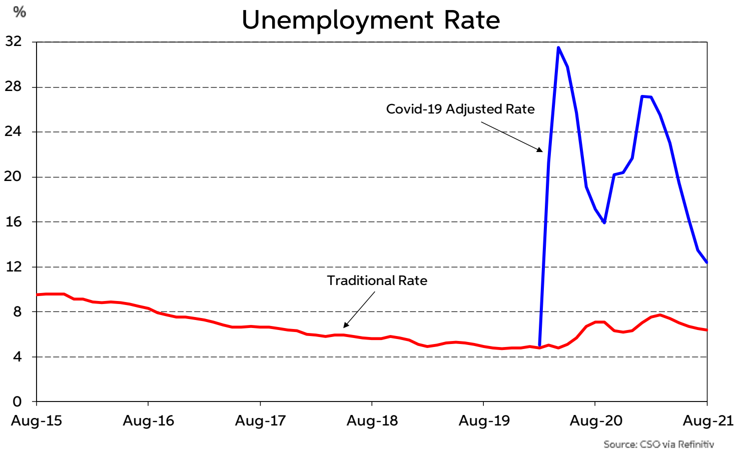



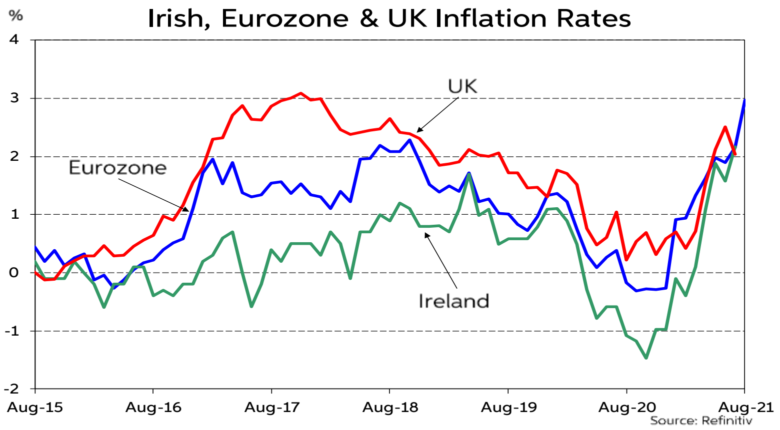



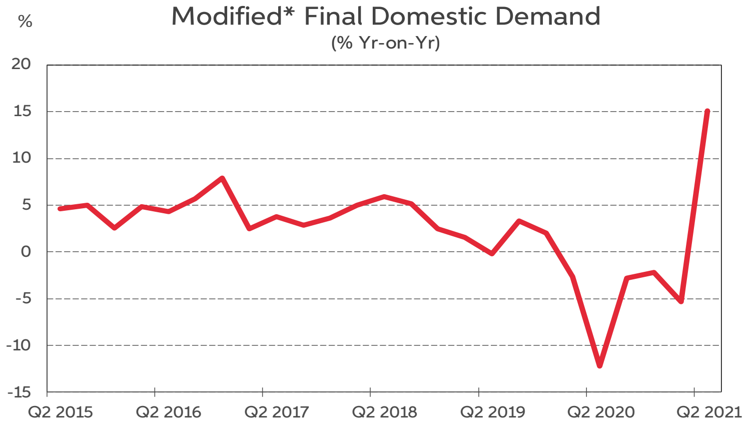



# Unemployment declining rapidly, inflation on the rise



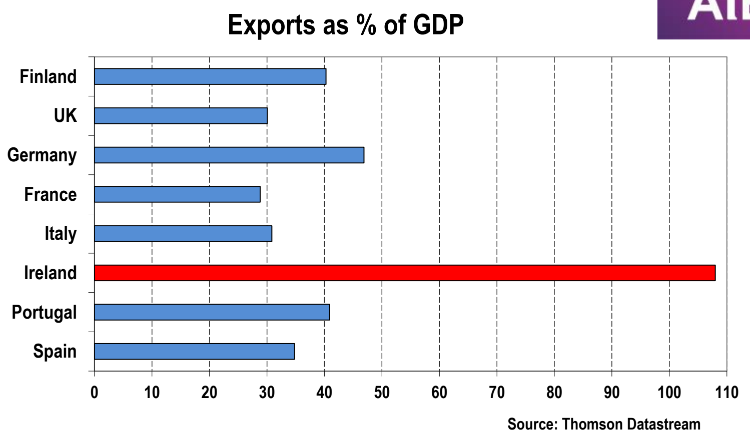



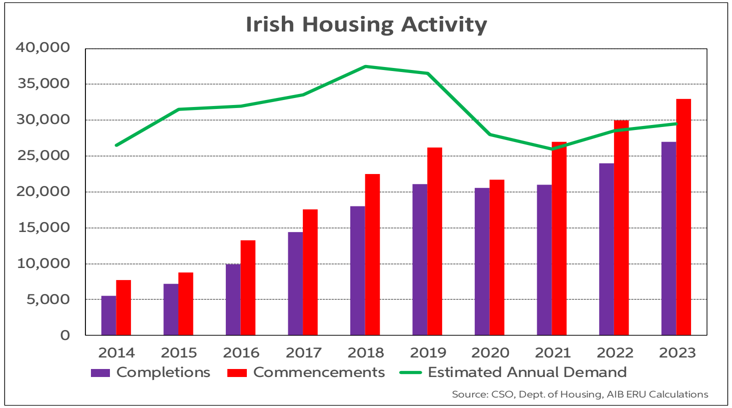
# Exports perform very strongly throughout the pandemic

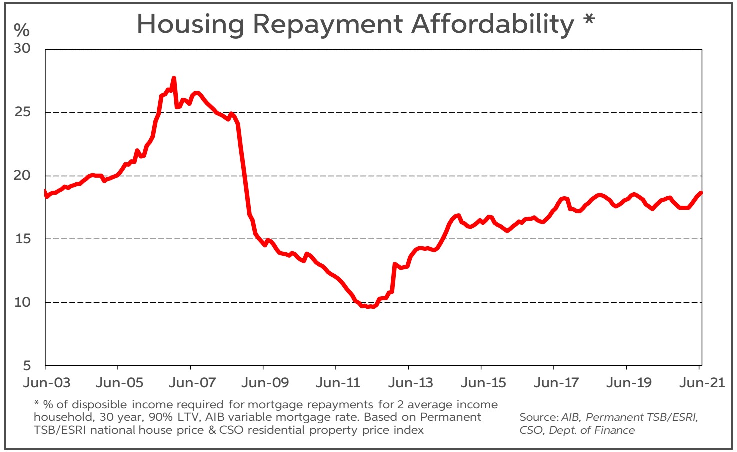
- Ireland a very open economy – exports, driven by large scale FDI, are a huge part of economy
- Exports rise strongly in recent years, helped by large FDI inflows
- Pharma, medical care products, IT equipment, and food & drink are main goods exports
- IT, business, financial and tourism are the main service exports
- Total exports rose by 9.5% in 2020 and were up 21% yoy in H1 2021
- Goods exports up 16.5% in 2020 and 28% yoy in H1'21, fuelled by very big jump in pharma
- Service exports rose by 2.6% in 2020 and were up 13% yoy in H1 2021
- Collapse in earnings from tourism & travel, but computer service exports show strong growth




# House building holds up, while commencements rebound

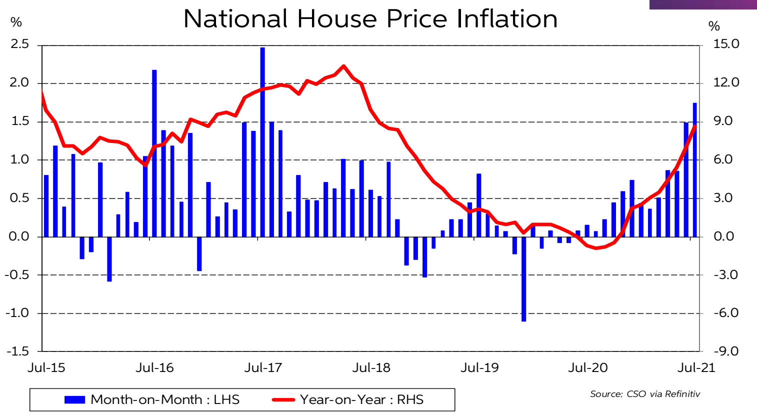
- Total completions amounted to 20,535 in 2020, just 2.6% down on 2019 level despite a 6-week lockdown
- Big jump in planning permissions in past couple of years
- Commencements fell by over 17% to 21,700 in 2020
- Further sharp fall in commencements in Q1’21, but they surged in Q2 as house building sector reopened
- Commencements jump to 29,000 in 12 months to July
- Smaller than expected fall in completions in Q1 2021 and rebound strongly in Q2. Up 9.7% yoy in H1 2021
- Completions likely to be circa 21,000 again in 2021 and should pick up considerably in 2022-23
- Mortgage lending fell by 12% to €8.4bn in 2020
- However, mortgage lending rose over 25% yoy in H1’21
- Forecasts are for a €10bn+ mortgage market in 2021
- Housing affordability disimproves slightly as prices rise

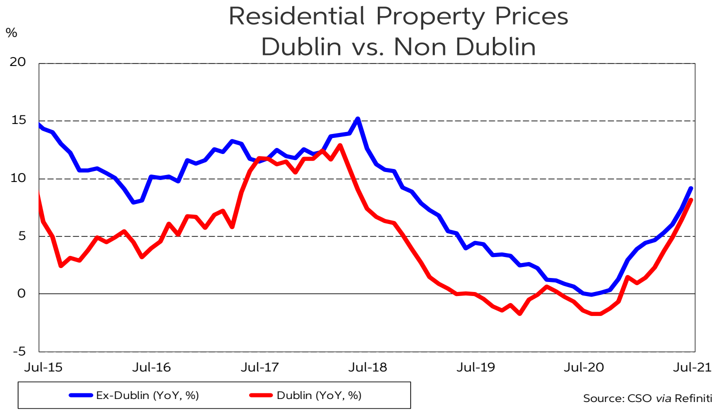


# House prices on marked upward trend

- House prices declined sharply, by 55% over 2007-13
- Prices have since recovered strongly, but still 11% below 2007 peak
- CSO data show house prices little changed over 2019-20, until starting to move higher from Q4 last year
- Strong rises in house prices to date 2021, with yoy rate accelerating to 8.6% by July
- Non-Dublin prices up 9.2% yoy in July, above Dublin rate of 8.2% yoy - prices rising strongly everywhere
- Property websites show big jump in asking prices since mid-2020. Running at circa 9% yoy in Q3 2021
- Low supply, remote working, strong public/institutional demand, enhanced help-to-buy scheme, rising personal savings, pent-up demand are all supporting house prices
- Rents recover strongly after declining last year. Annual rate of growth accelerates to 4.5% by August 2021



# 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

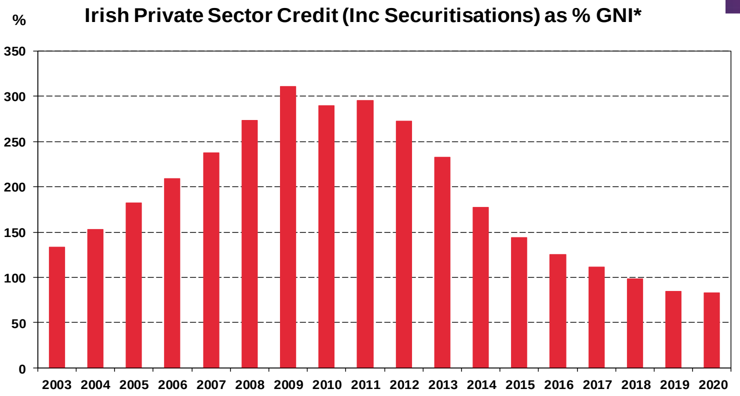
| Calendar Year | 2019 | 2020 | 2021 | 2022 | 2023 |
|---|---|---|---|---|---|
| **Household Formation** | 31,000 | 22,500 | 20,500 | 23,000 | 24,000 |
| ***of which*** | | | | | |
| ***Indigenous Population Growth*** | *21,000* | *17,500* | *16,000* | *15,500* | *14,500* |
| ***Migration Flows*** | *10,000* | *5,000* | *4,500* | *7,500* | *9,500* |
| ***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** | **36,500** | **28,000** | **26,000** | **28,500** | **29,500** |
| **Completions** | **21,000** | **20,500** | **21,000** | **24,000** | **27,000** |
| ***Shortfall in Supply*** | *-15,000* | *-7,500* | *-5,000* | *-4,500* | *-2,500* |

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

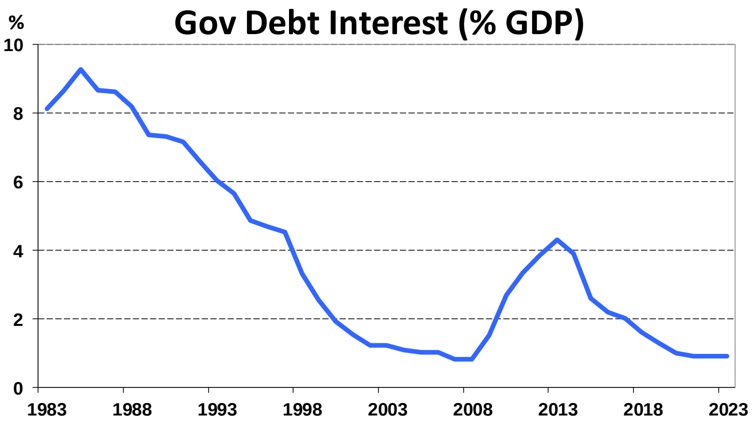
Sources: CSO, DoECLG, AIB ERU.

# Private sector deleverages, Gov. debt ratios move higher

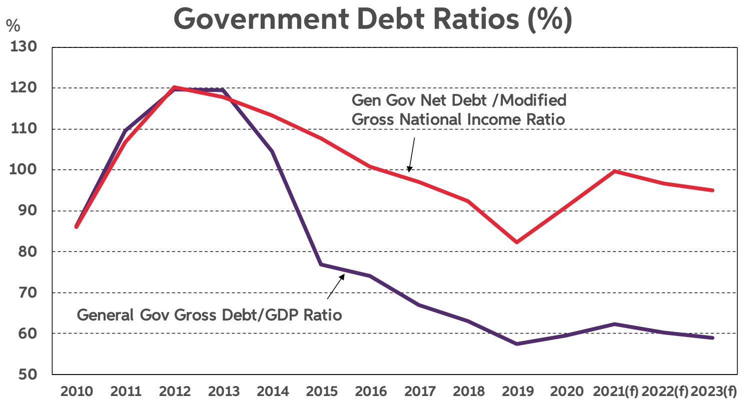

Source: CSO, Central Bank, AIB ERU




Sources: Central Bank, CSO, AIB ERU Calculations




Source: NTMA; Dept of Finance

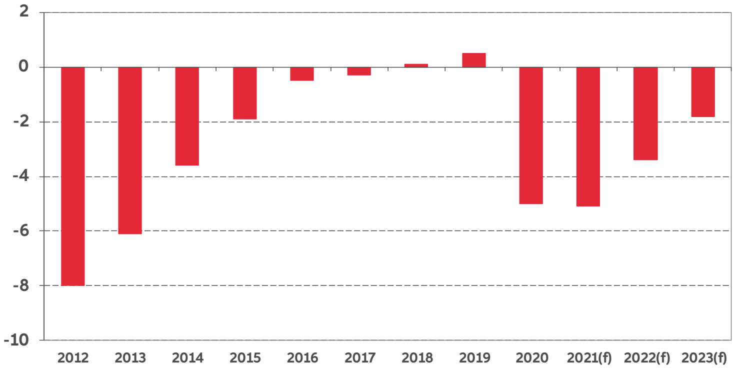



Sources: Dept of Finance, CSO, AIB ERU (Inflated/Distorted GDP figues from 2015)

# Big 2020-21 budget deficits to decline sharply in 2022-23

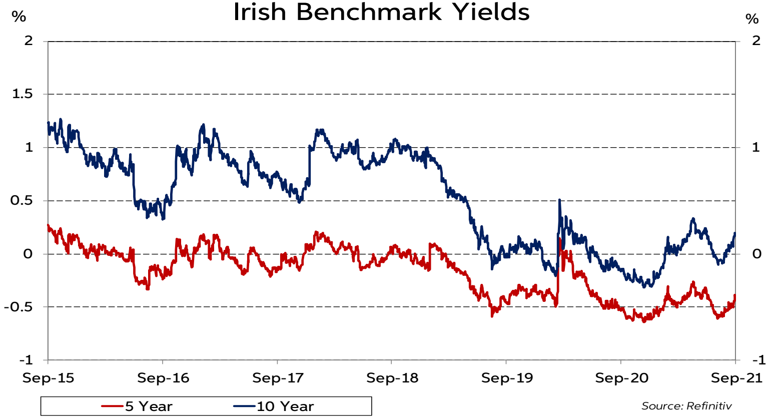
- Budget deficit fell sharply in last decade, with small surpluses recorded in 2018 and 2019
- However, Covid-19 and efforts to mitigate it saw the public finances deteriorate during 2020
- General Government budget deficit of €18.4bn in 2020, or 5% of GDP
- Strong rebound in tax receipts in 2021 – up over 15% year-to-date at end August
- Dept. of Finance forecasting another large deficit of circa €20bn in 2021, or 5% of GDP
- Deficit forecast to fall to 3.4% in 2022 and 1.8% in 2023 as Covid supports end & economy recovers
- Gov. Debt ratios had fallen in last decade, but move higher in 2020 and 2021
- Bond yields low and stable despite big jump in budget deficit and large rise in debt issuance
- Ireland's sovereign debt ratings hold steady; S&P at AA-, Fitch at A+, Moody's A2

General Government Balance (% GDP)




Source : Dept of Finance

Irish Benchmark Yields




Source: Refinitiv

# Economy was in very strong shape ahead of Covid shock

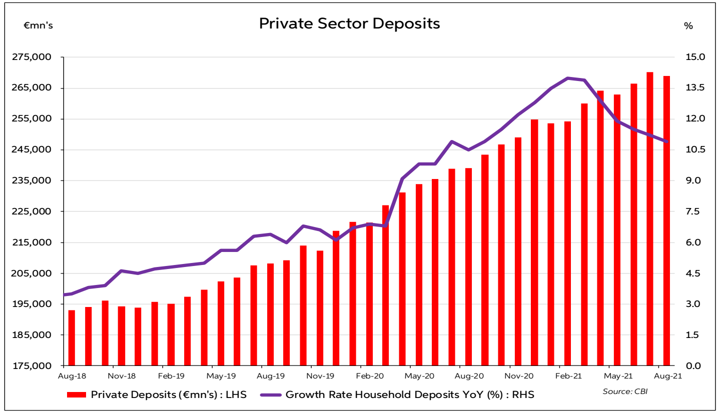
- Economy was in very strong shape ahead of being hit by very deep 2020 Covid recession
- Well balanced, robust underlying growth of circa 5% per annum over 2013-19 period
- Large inflows of FDI and strong export growth remain key features of the economy
- Strong jobs growth, averaging over 3% per annum 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
- Sound financial system, with well capitalised banks
- Stable housing market - moderate growth in mortgage market and house prices pre-Covid
- Very low, stable CPI inflation of below 1% over 2013-19 period
- Balance of payments returned to large surplus

# Elements in place for return to strong Irish economic growth

- Key ingredients in place for a strong rebound by Irish economy from 2021 onwards
- Rollout of vaccines allows economies to reopen here and elsewhere – very high Irish vaccination rates
- World economy rebounding strongly, which augurs well for export orientated countries like Ireland
- House building to pick up in coming years from still low output levels – big focus of government policy
- Fiscal policy can remain supportive of growth -DoF forecasts provide for increased core spending
- Activity aided by continuing very low interest rates
- Economy has deleveraged; low private sector debt
- Large build-up in private savings in 2020-H1'21 will help fuel strong growth in domestic spending
- Strong growth forecast for 2021-22 - GDP bloated in 2021. Growth in GNP and MFDD much lower

**OECD Global GDP Forecasts**

| % Vol | 2020 | 2021 | 2022 |
|---|---|---|---|
| World | -3.4 | 5.7 | 4.5 |
| OECD | -4.8 | 5.3 | 3.8 |
| US | -3.4 | 6.0 | 3.9 |
| Eurozone | -6.5 | 5.3 | 4.6 |
| UK | -9.8 | 6.7 | 5.2 |
| Japan | -4.6 | 2.5 | 2.1 |



# AIB Irish Economic Forecasts

| *% change in real terms unless stated* | 2019 | 2020 | 2021 (f) | 2022 (f) | 2023 (f) |
|---|---|---|---|---|---|
| **GDP** | **4.9** | **5.9** | **8.0** | **5.5** | **4.0** |
| **GNP** | 5.0 | 3.4 | 5.5 | 5.0 | 3.5 |
| **Modified Final Domestic Demand** | **1.7** | **-4.9** | **4.0** | **5.3** | **3.7** |
| **Personal Consumption** | 3.3 | -10.4 | 3.7 | 7.5 | 4.0 |
| **Government Spending** | 7.1 | 10.9 | 1.7 | -1.5 | 1.0 |
| **Fixed Investment*** | 99.5 | -23.0 | -40.0 | 7.0 | 5.0 |
| **Exports** | 10.4 | 9.5 | 9.5 | 5.2 | 4.5 |
| **Imports*** | 41.7 | -7.4 | -9.5 | 5.2 | 4.5 |
| **HICP Inflation (%)** | 0.9 | -0.5 | 1.9 | 1.9 | 1.5 |
| **Unemployment Rate (Estimated %)** | **5.0** | **10.4** | **11.0** | **8.2** | **6.9** |
| **Budget Balance (% GDP)** | 0.5 | -5.0 | -5.0 | -3.4 | -1.8 |
| **Gross General Gov Debt (% GDP)** | 57.4 | 59.5 | 60.3 | 59.0 | 58.0 |



*Data very distorted by aircraft and intangibles (IP)

Source: CSO, D/Finance; AIB ERU Forecasts

# Brexit: The EU-UK Trade & Cooperation Agreement

## The Trade Deal:

- EU and UK finally agreed on a trade deal before end 2020, thereby allow for continuing tariff-free and quota-free trade in goods
- However, the FTA is much inferior to the EU Single Market, involves a lot of extra admin costs and delays at ports – it marks an end to frictionless UK-EU trade
- The FTA is unique in that it increases trade barriers– new customs procedures, compliance with onerous rules of origin requirements, documentary evidence needed to move goods
- Agri-food products may require export health certs and veterinary inspections at borders
- FTA does not extend to services. Financial services not given equivalence/passporting rights

## The Fall-Out:

- Irish PMI surveys show firms reporting considerable import delays at ports, with longer supply chains and higher admin costs as a result of Brexit
- Estimated that higher trade costs will knock circa 0.5% off UK/RoI annual GDP growth rate in next few years
- UK not fully implementing all customs checks until 2022 when Irish exporters to GB will see impact
- Issues with NI protocol and GB-NI trade flows – Customs declarations, regulatory checks, political impact

# Ireland’s 12.5% Corporate Tax regime at risk

## Importance of FDI:

- Some 1,600 multinational companies are based in Ireland, accounting for over 250,000 in direct employment or about 18% of total jobs in terms of direct and indirect employment.
- Corporation tax accounts for €12bn or circa 20% of total tax revenue... 80% of this comes from MNCs

## Threats to Ireland’s Corporate Tax Regime:

- Ireland’s relatively low & stable 12.5% corporate tax rate has been viewed as key cornerstone in attracting FDI
- OECD has moved to introduce a minimum global corporate tax rate. This is being supported by most countries, who have agreed to a minimum rate of 15%. Ireland seeks further clarification and discussion on matter
- President Biden initially proposed 21% global minimum tax rate for US companies, up from the current 10.5%. He may instead now move in line with OECD and opt for a 15% rate
- OECD also agrees on other tax changes whereby larger multinationals, mainly digital, would pay some taxes on profits in countries where they make sales, rather than where they are based- to apply to 20% of their sales

## Major Uncertainties Remain:

- DoF has allowed for a €2bn hit to Irish corporation tax receipts by 2025 from changes to global tax system
- Uncertainty remains as (1) still unclear what minimum US global rate will be – needs to be approved by Congress (2) Ireland seeking clarity that proposed minimum 15% global corporate tax will not be any higher (3) unclear what sectors/companies the digital tax on 20% of sales will apply (4) No indication on when changes would take effect
- Irish government holding out at present on moving from 12.5% corporate tax rate given all these uncertainties

# Ireland has other advantages besides low tax rate

## Ireland will remain attractive FDI location:

- Big multinationals will still need to retain large global operations, whatever happens in the tax field
- US companies require employees with language skills to service European customers in European time zone
- English speaking country with common law system remains key attraction of Ireland for US companies
- Ireland’s main competitor for FDI has been UK, but it is now out of EU, Single Market & Customs Union
- Strong talent pool of internationally mobile, highly skilled, well educated workers (17% of workforce is non-Irish)
- Key industries have large presence in Ireland, with its strong pro-enterprise culture, leading R&D and innovation

## Change is coming, but FDI inflows continue:

- Irish Finance Minister has conceded that a “period of significant change is coming”
- Could see agreement on new global corporate tax regime reached later this year, but ratification is not guaranteed
- Tax changes usually phased in after a number of years
- Big rises in corporate tax rates in the pipeline for major economies (proposal to raise US rate from 21% to 28%; UK going from 19% to 25% in 2023). Thus, even if it is raised, Ireland’s rate will likely remain comparatively low
- Strong inflow of FDI continues in 2021 (Intel, Stripe) despite moves to change global corporate tax rules

# Reprise of risks to the Irish economy

- Main near term risk is still Covid-19 – high case numbers, concerns about new variants
- Virus could leave lasting scarring effects – rising business failures & bad debts, job losses
- Very open nature of Irish economy means it is exposed to any weakening in global economy
- Changed EU-UK trading relationship may yet negatively impact some Irish industries
- Questions around Ireland's corporation tax regime (pressure for tax harmonisation in EU, OECD digital tax/minimum tax rate proposals, changes to US overseas corporate tax rate)
- Supply constraints in new house building activity, with output still at very low levels
- Competitiveness issues - high house prices, high rents, high personal taxes, high wages
- Credit constrained – tight lending rules, on-going deleveraging, weak credit demand