For the life you're after

AIB Economic Outlook

October 2024

AIB Group Plc

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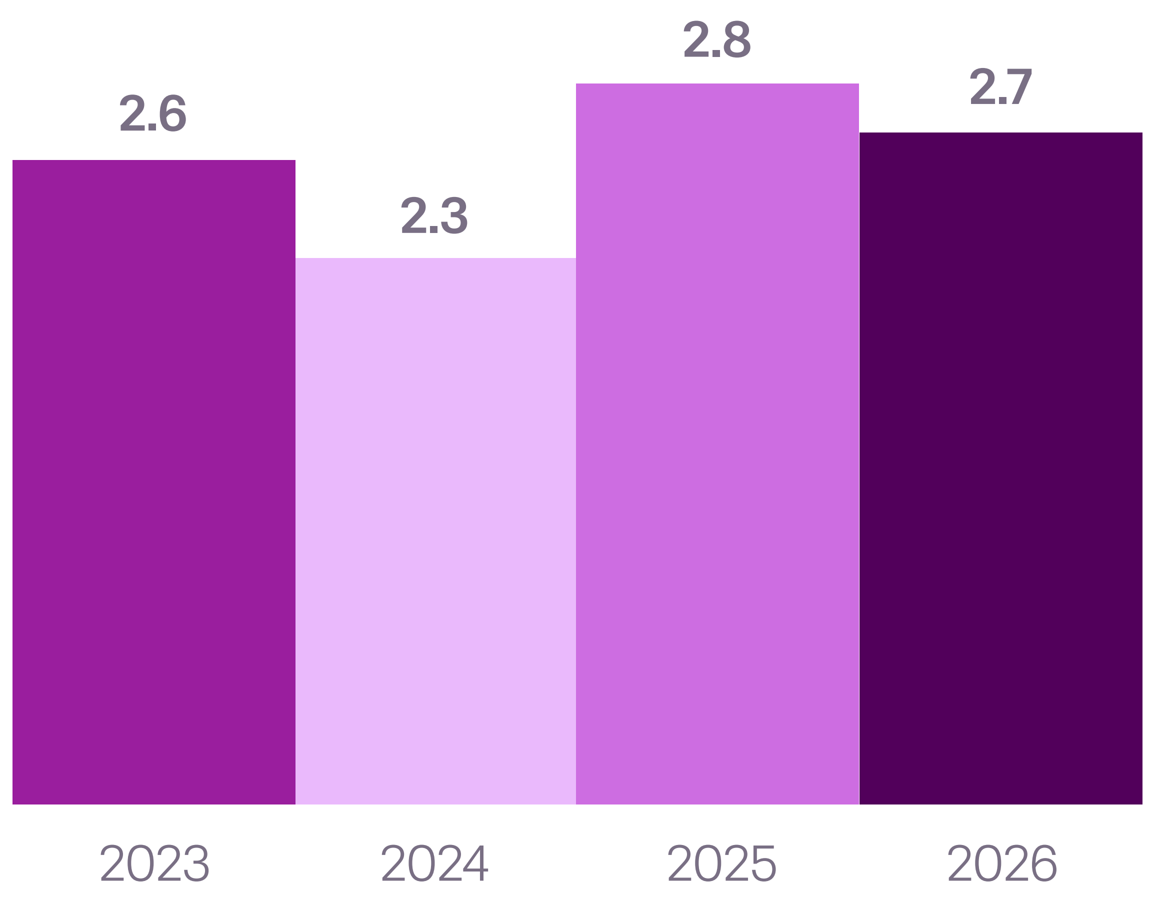
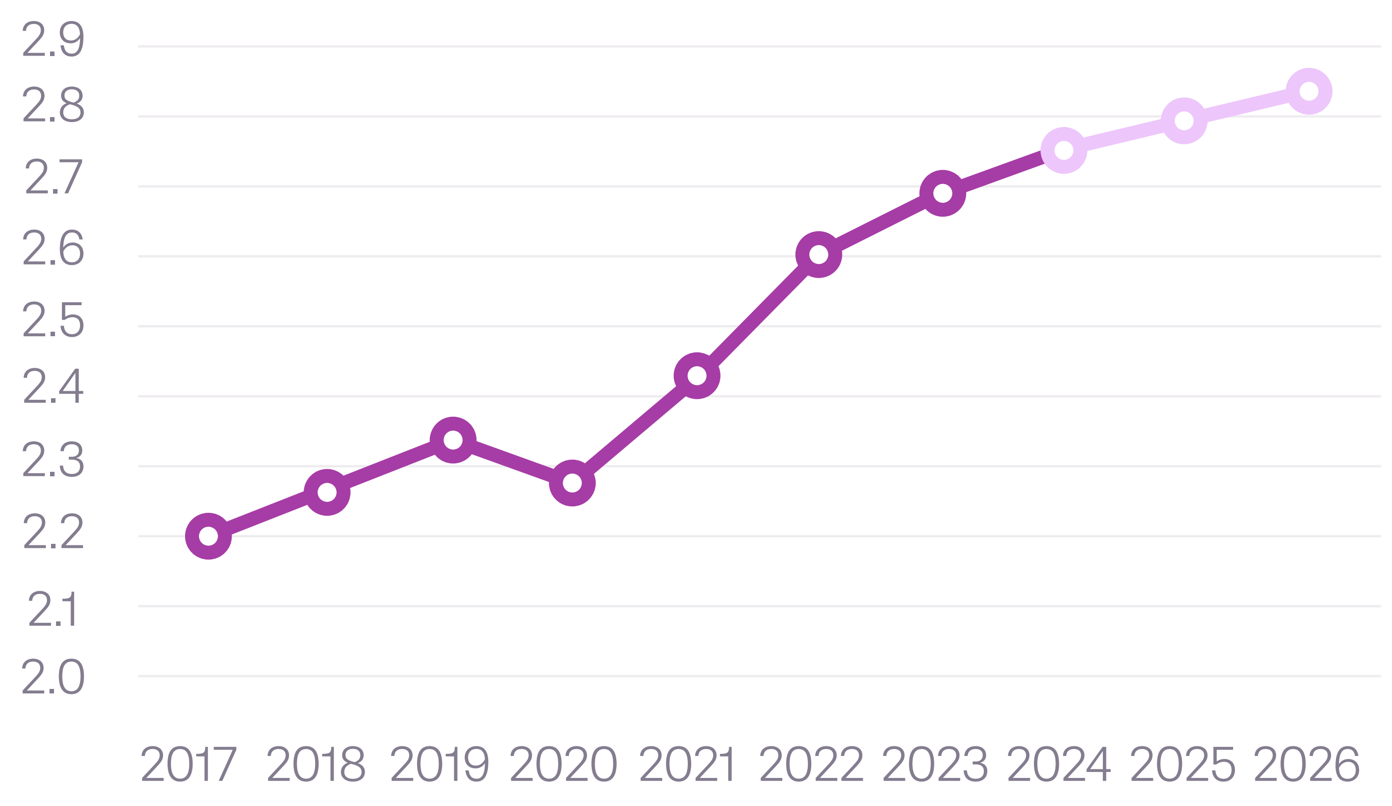
Economic Growth Forecasts*

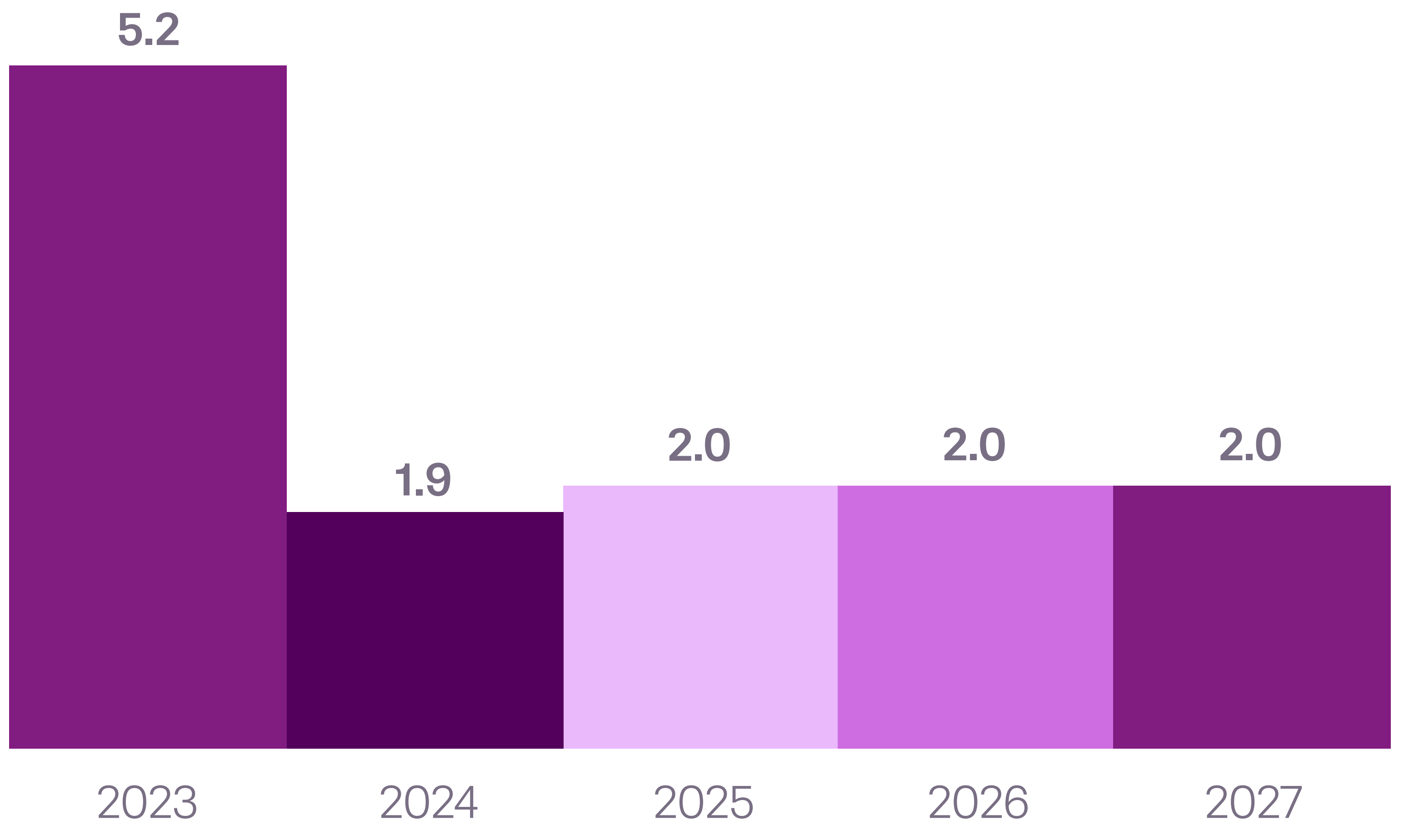


*Based on Modified Final Domestic Demand

Employment Forecast (Millions)



Inflation Forecast*



*Based on Harmonised Index of Consumer Prices

Macro Outlook

Global Backdrop – steady growth, but risks building

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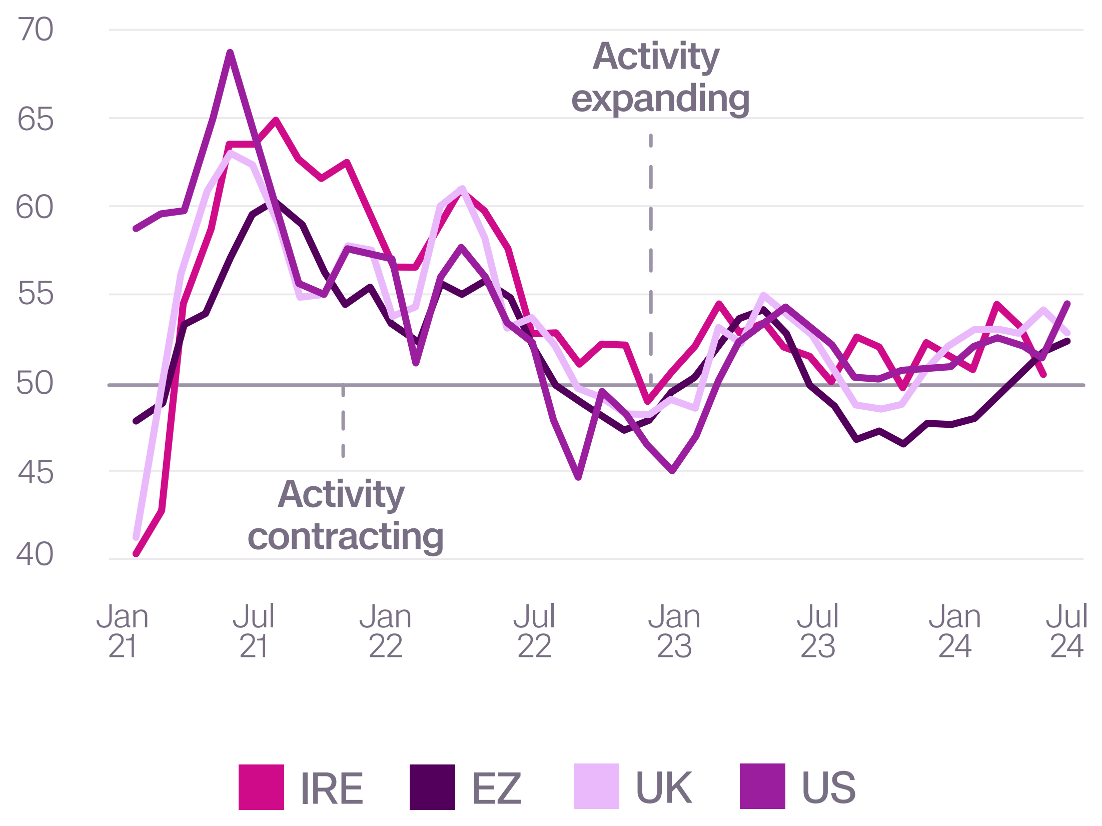
Ireland's key trading partners are growing at a steady, but varied pace. The US economy continues to outperform, but is showing signs of slowing. The UK economy has seen an upturn, but Eurozone growth remains anaemic.

The global economy regained some momentum in the first half of 2024, with indicators pointing to stronger growth in the Eurozone and UK, and continued robust, yet moderating growth in the US. However, this growth impetus has waned in recent months, with indicators pointing to slower growth in the US following a stellar period in 2022-23, while the Eurozone growth profile remains anaemic. Labour markets remain exceptionally tight with unemployment at very low levels, which has underpinned still-high core inflation across most economies.

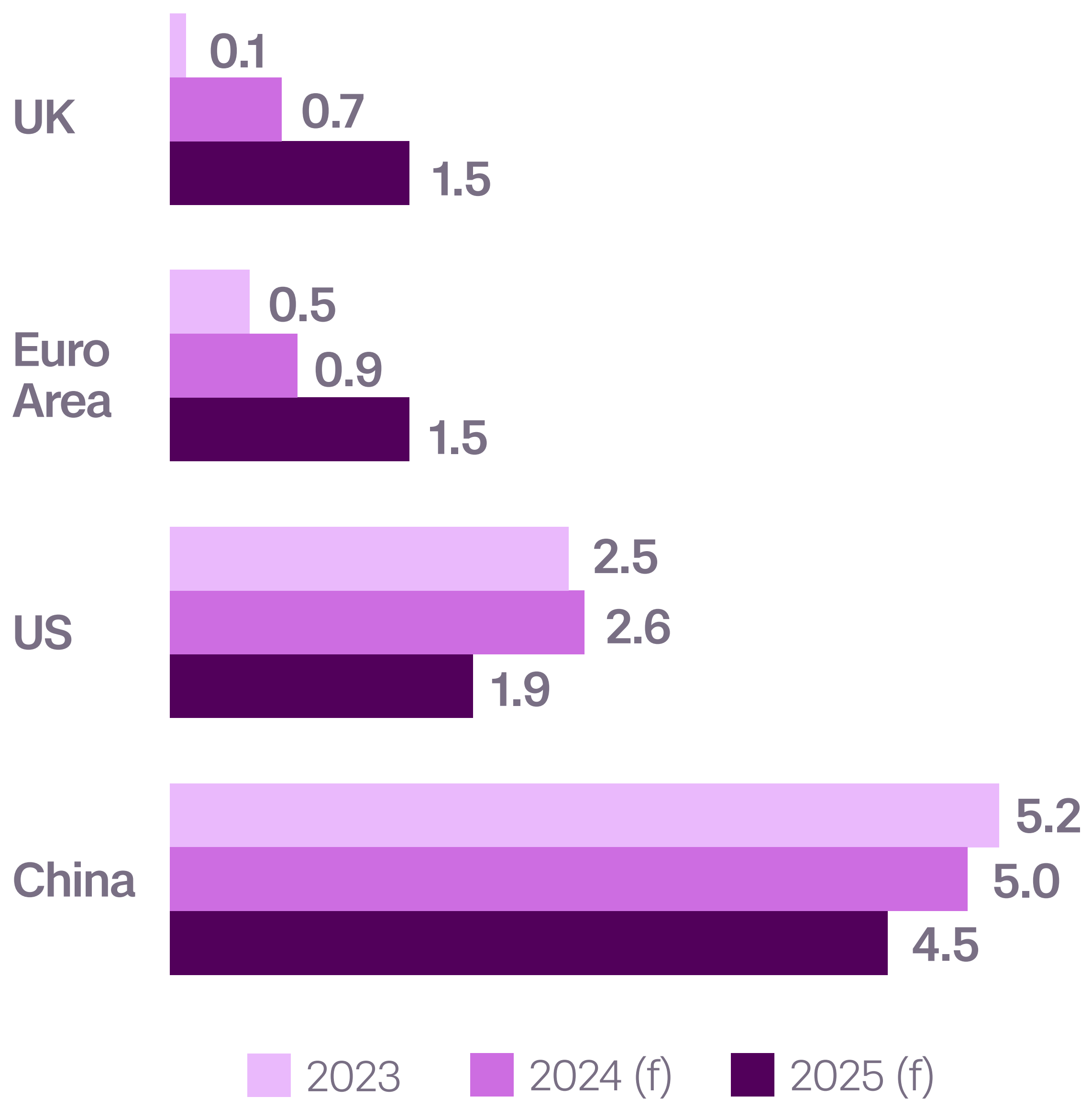
Composite PMIs for Ireland and key trading partners



Source: S&P Global/Refinitiv

Central banks have now pivoted from inflation to growth concerns, beginning rate cutting cycles over the course of the summer. The aggressive 50 basis point cut by the US Federal Reserve in September has also now embedded expectations for further cuts in the coming months. Long term, there remains uncertainty on where rates will land, with markets currently pricing in a decline in ECB rates to c.2% by end-2025. In China, authorities have announced significant monetary and fiscal stimulus policies to prop up flagging GDP growth and guard against the risk of deflation. These actions in the US and China should support global growth, but risks remain tilted to the downside as geopolitical events remain to the fore, which could spill over to economic activity in the coming months.

GDP forecasts for Ireland's key trading partners



Source: IMF, July 2024

Irish Outlook - moderate growth expected

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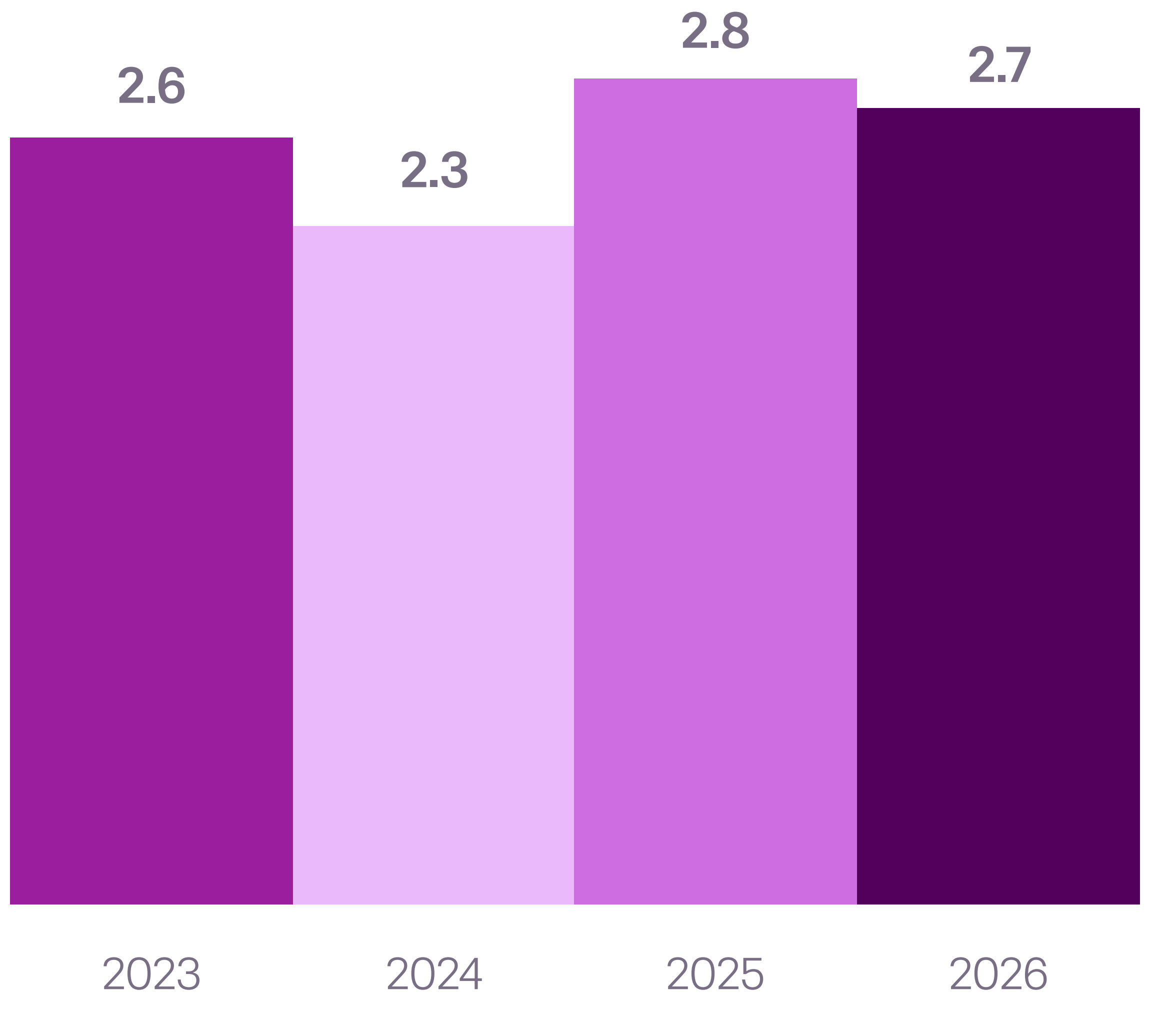
In Ireland, we expect a moderate pace of economic growth in the near term, with modified domestic demand growing at 2.5-3% per annum.

Following fall in GDP in 2023 due to a downturn in the pharmaceuticals sector, Ireland's industrial output and goods exports have bounced back in 2024. However, GDP remains a volatile gauge of activity, as evident in the sharp swings in growth in recent quarters. A more reliable gauge of the domestic economy, as measured by modified domestic demand, will continue to expand at a robust pace. This will be underpinned by employment growth and private consumption, supported by a renewed rise in real wages, with inflation falling back to the normal range. However, with the economy and labour market reaching full capacity, we expect a moderate pace of growth in the coming years of 2.5-3% per annum.

Irish Growth Forecasts - Modified Domestic Demand



Source: CSO, AIB ERU

Lead indicators, such as AIB's Purchasing Manager Indices (PMIs) suggest domestic growth has sustained a robust pace in recent months. Consumer spending continues to grow at a decent rate, while Exchequer tax returns point to a very healthy domestic picture so far in 2024. On the external side, trade data also signal goods exports have picked up following a downturn in 2023, particularly in the pharmaceuticals sector.

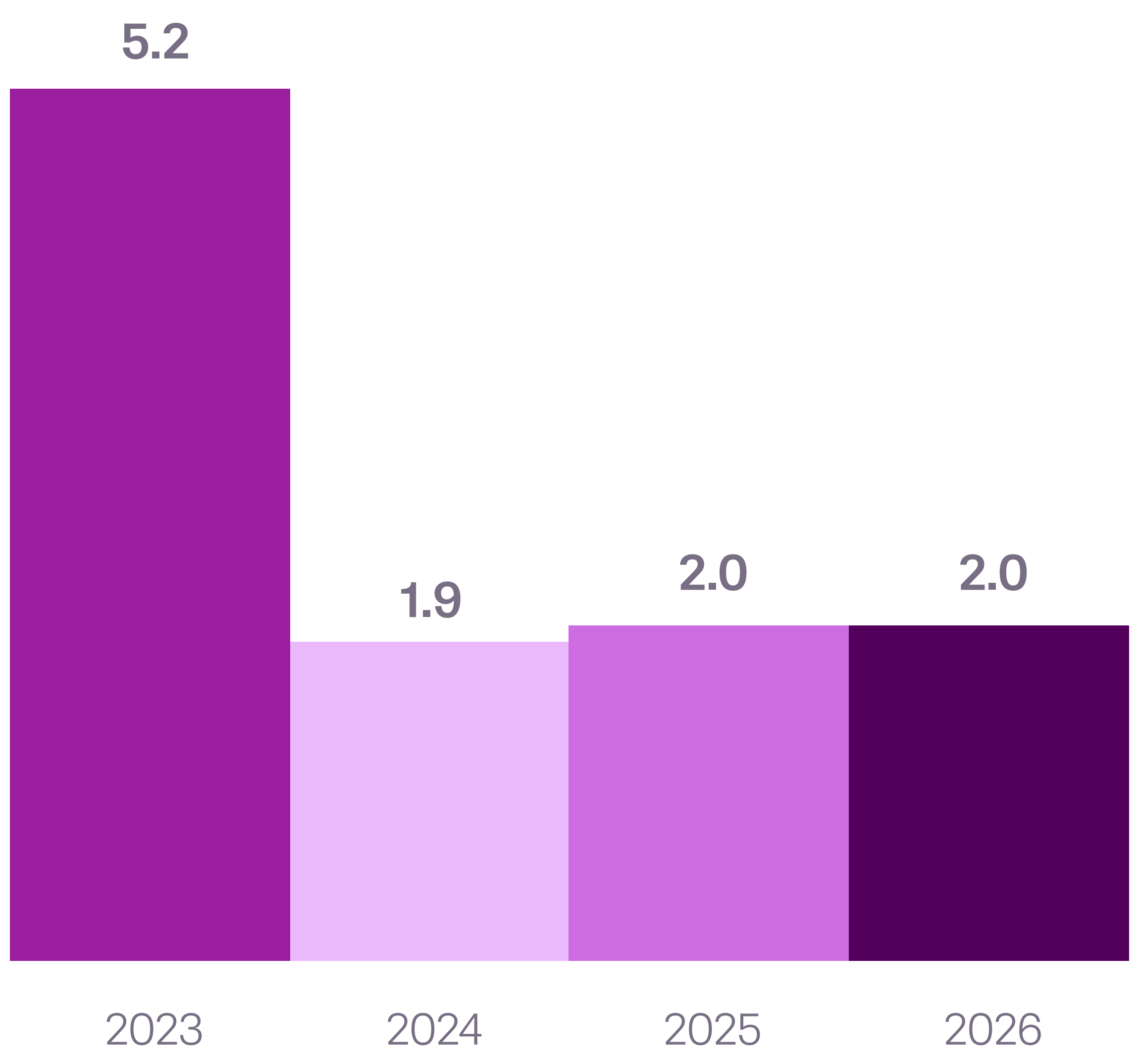
On the investment side, the picture is clouded by volatile data. Domestic sector investment has been sluggish so far in 2024, likely owing to still restrictive monetary policy rates, and we expect this trend to persist in the near term. On the foreign direct investment side, IDA Ireland has indicated that there is a more "challenging international environment" in 2024. The number of investments supported by the IDA in H1 2024 fell to 131, down from 139 in the same period in 2023. This supports the future delivery of 8,900 jobs, a 26% drop on the first half of 2023 at 12,072 roles. The IDA indicates infrastructure constraints, particularly in housing, electricity, water and transport, could blunt Ireland's competitive advantage in the more resource-intensive pharmaceuticals and manufacturing sectors.

The Irish economy is not immune to the downside risks still facing the global economy. Furthermore, the persistence of an increasing number of domestic capacity constraints is expected to have a restraining impact on the economy. These constraints are primarily in relation to housing, transport, social and utilities infrastructure. However, private sector balance sheets are characterised by low debt levels and high savings. As a result, while moderate growth is expected in the medium term with risks tilted to the downside, the public and private sectors have built up resilience. We discuss the key risks to the outlook later in this report.

In terms of the growth outlook, we see modified domestic demand (MDD) rising by 2.3% in 2024, 2.8% in 2025 and 2.7% in 2026. This is a more moderate growth profile than recent years and reflects the fact that the economy is running close to, or at, full capacity, with less scope for the rapid growth observed during much of the past decade.

Irish inflation has been in decline over the course of the past year as the sharp price rises in 2022 and 2023 drop out of the annual rate. The annual Harmonised Index of Consumer Prices (HICP) inflation rate declined to 0% by September 2024, but core inflation, which excludes food and energy, is proving stickier, driven by still high inflation in some services sectors. Additionally, the base effects of earlier energy price declines should wash through the data in the coming months, moving the index back towards 2%. However, lead indicators such as producer prices and PMI surveys point to some lingering inflationary pressures at present, which implies risks are to the upside for inflation in the near term. We see HICP inflation averaging 1.9% in 2024, and 2% in both 2025 and 2026, respectively.

Irish Inflation Forecasts - HICP Inflation



Source: CSO, AIB ERU

Risks to the Outlook – still tilted to the downside

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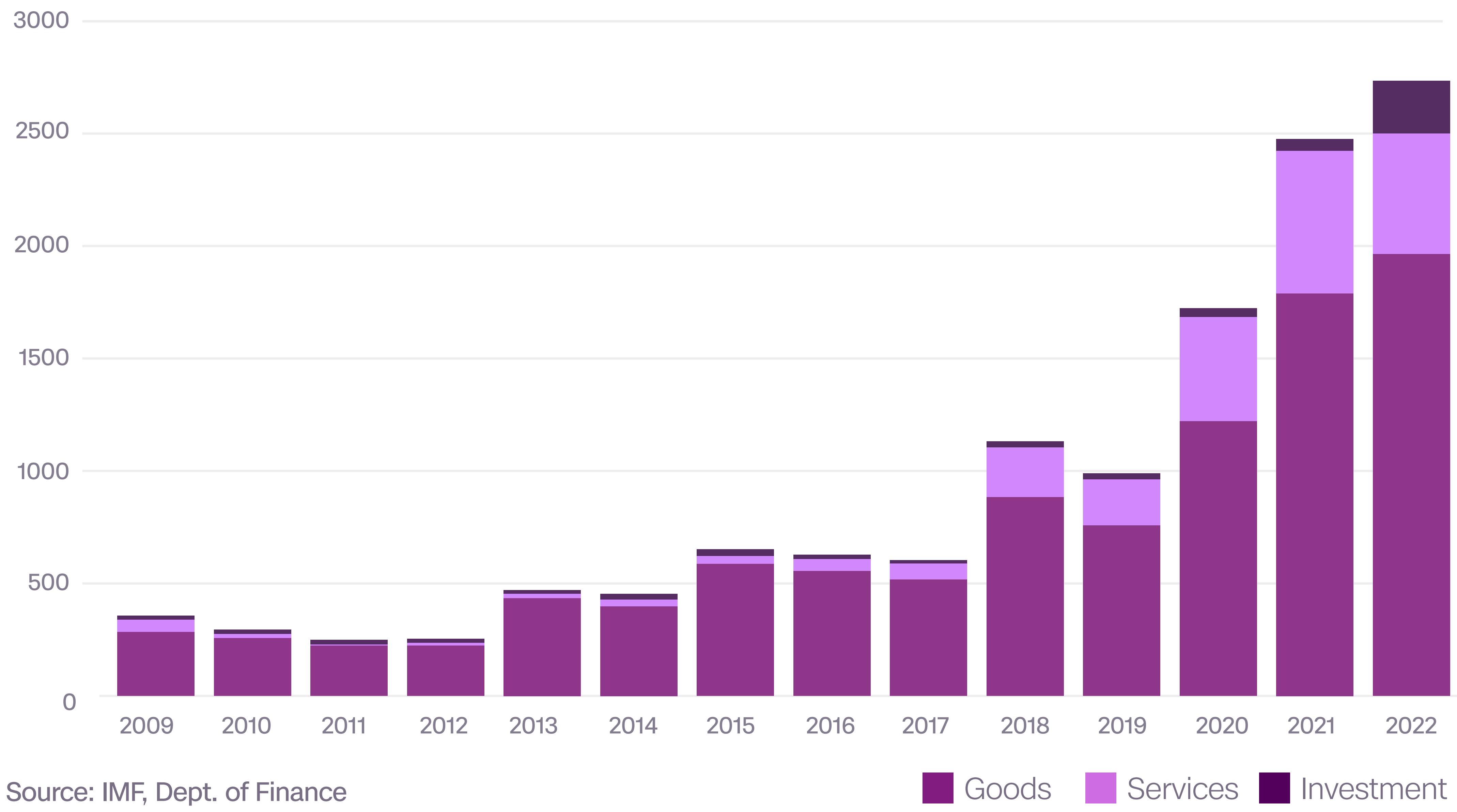
Geopolitical risks remain front and centre, and could dampen the outlook for global economic growth this year. On the upside, Irish households maintain an exceptionally high level of savings. These savings could drive stronger growth in consumer spending than expected.

The risks to the global and domestic outlook remain tilted to the downside, with the weak trajectory for Eurozone growth and its more direct exposure to geopolitical risks front and centre. The primary geopolitical risks which could spill over to economies, particularly in Europe, remain the war in Ukraine, alongside escalating conflicts in the Middle East. So far this year, these conflicts have yet to have a meaningful economic impact outside of the immediate regions, but this could change quickly. Indeed, commodity prices have shown volatility in recent months on the back of developments in the Middle East. This direct impact via higher commodity prices and supply chain disruption could quickly feed through to higher inflation, and upend central bank rate cutting cycles. Indirect impacts of weaker domestic demand could also dampen growth as evidenced by the sharp decline in consumer and business sentiment in Europe following the Russian invasion of Ukraine in 2022.

Another downside risk relates to trade protectionism. As highlighted in the chart, nations have been utilising trade barriers and tariffs at an expanding rate. Notably, the US and China have engaged in tit-for-tat tariffs and restrictions on export goods. The EU has also targeted Chinese imports, albeit to a lesser extent than the US. With both US presidential

Number of global trade restrictions imposed



Source: IMF, Dept. of Finance

candidates favouring protectionist measures against China and others, to varying degrees, the global economy appears set for a continued era of rising trade barriers and reductions in global trade flows. This is a key risk to a small, open economy such as Ireland.

In terms of upside risks, precautionary savings remain at relatively high levels in many economies, particularly Ireland, and could underpin stronger domestic spending in 2024, if geopolitical risks do not materialise. Our central assumption is that Irish households continue to maintain savings close to current historically high levels, but as explained in our consumer and labour market outlook in this report, this should not hold back spending growth to a great extent. However, a brightening economic outlook might spur even stronger consumer spending than we anticipate in the coming years.

In conclusion, given the openness of the Irish economy, the risks remain tilted to the downside on our outlook.

Consumer & Labour Market Outlook

Consumer Outlook – Households remain cautious, but spending growth robust

Labour Market Outlook – signs of easing jobs growth

Consumer Outlook – Households remain cautious, but spending growth robust

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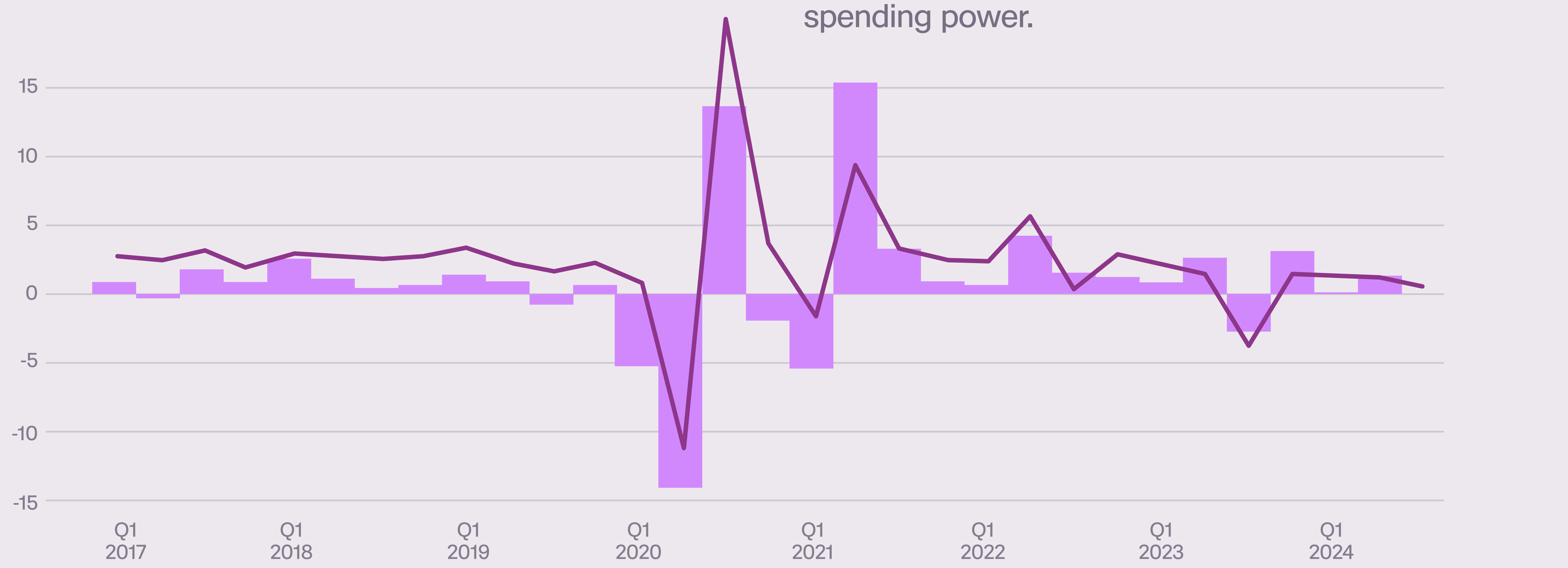
Consumer spending growth is expected to remain robust, reflected in recent AIB card spending data. However, households remain cautious, putting a significant proportion of their earnings into savings at present.

While Ireland's economic recovery from the pandemic has been exceptional, the growth in consumer spending has been more muted. At an aggregate level households have seen strong growth in wages and disposable incomes, on the back of the robust performance of the Irish labour market. However, precautionary savings remain elevated, with households retaining high cash deposits since the onset of the pandemic. Indeed, since the beginning of 2023, the household sector has, on average, saved nearly 14% of disposable income each quarter, compared to a pre-pandemic average 12.5% between 2013 and 2019. The rise in inflation has also blunted the spending power of households in recent years, which combined with high savings rates, has led to more modest gains in consumer spending.

AIB Card Spend vs. Irish Consumer Spending, q/q%



Source: AIB, CSO

Consumer Spending (real), seas adj. AIB Card Spend (real), seas adj.

Consumer sentiment surveys suggest this cautious consumer behaviour will persist in the near term. For example, the ECB's Consumer Expectations Survey shows that while Irish households are increasingly optimistic about their financial situation, one third still believe they will be worse off in a year's time, above the Eurozone average. At the same time, the share of Irish households that intend to save over the next 12 months has risen across most income groups.

This trend in consumer spending is borne out in AIB's Spend Trend data[1]. The AIB Spend Trend card data provide a close-to-real time view of consumer spending behaviour on a monthly basis. Our new inflation and seasonally adjusted series highlights that while spending growth has been robust in cash terms, the growth in real (inflation-adjusted) spending growth has eased over the past two years as the impact of higher prices has blunted household spending power.

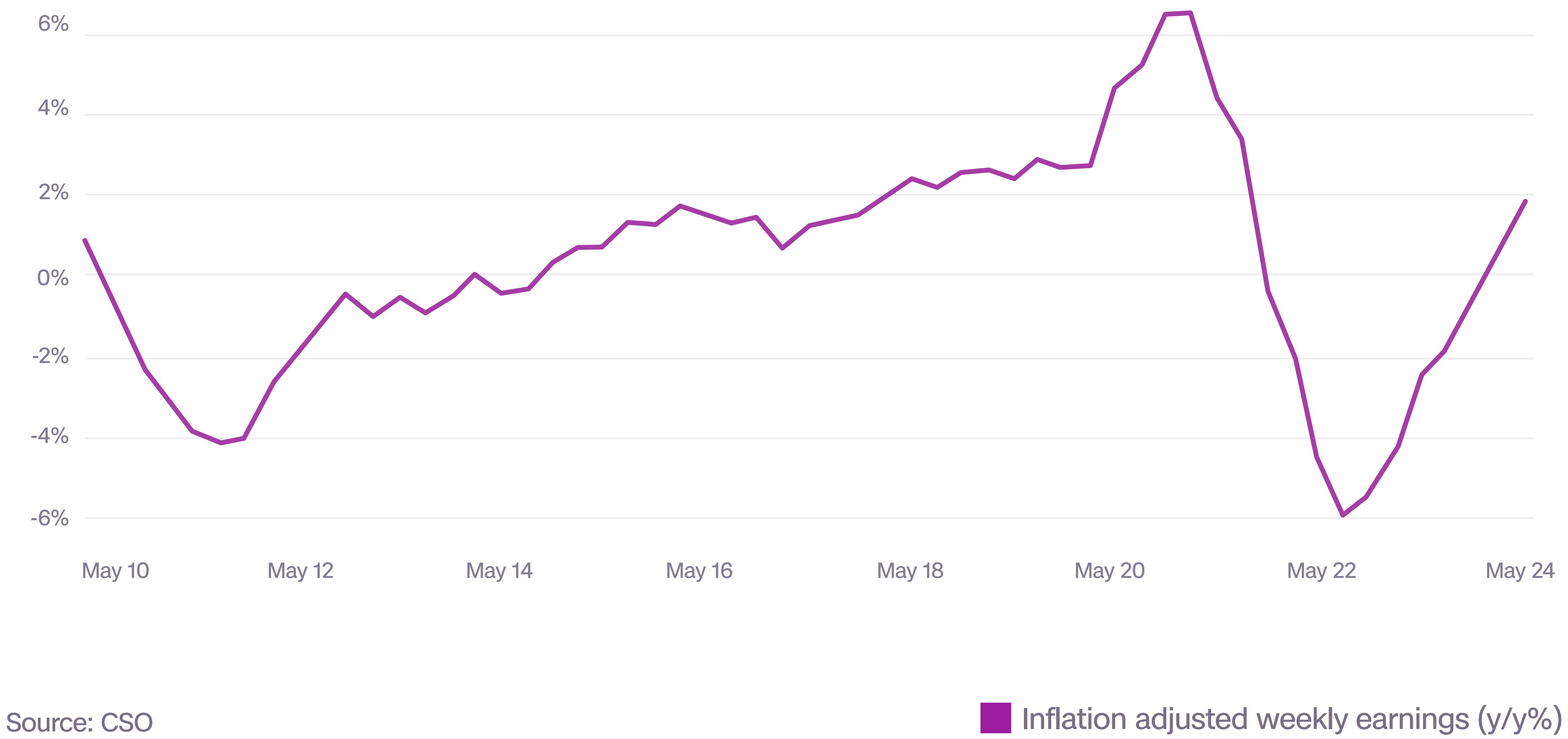
[1] AIB Retail Spending Report, Q2 2024

The latest AIB card spend data show that the number of transactions are up by 5.7% year-to-date in the first three quarters of 2024. This equates to a 2.6% increase in real card spending over the same period. The card spend data broadly tally with the increase in consumer spending seen in the first half of the year (data are only available up to the end of Q2), which show that real spending rose by 1.6% year-on-year in H1 2024. AIB data for Q3 2024 point to continued solid growth in consumer spending, with real card spending up 0.8% on the quarter.

Despite the ongoing caution, consumer spending should continue to expand at a decent pace for several reasons. First, Ireland's population and labour force continue to grow strongly, which will underpin consumer spending. Second, wages are rising at an exceptional pace due to tight labour market conditions. In the year to Q2 average weekly earnings grew by 5.6% year on year (y/y). Third, overall wage gains are now outpacing inflation once again. These real wage gains will boost household disposable income, and support consumer spending, despite the prevailing high savings rates.

We expect consumer spending to grow by 2.7% in 2024, rising to 3% in 2025, as real wage gains become more wide spread across the economy.

Wage growth ahead of inflation once more



Source: CSO

Labour Market Outlook – signs of easing jobs growth

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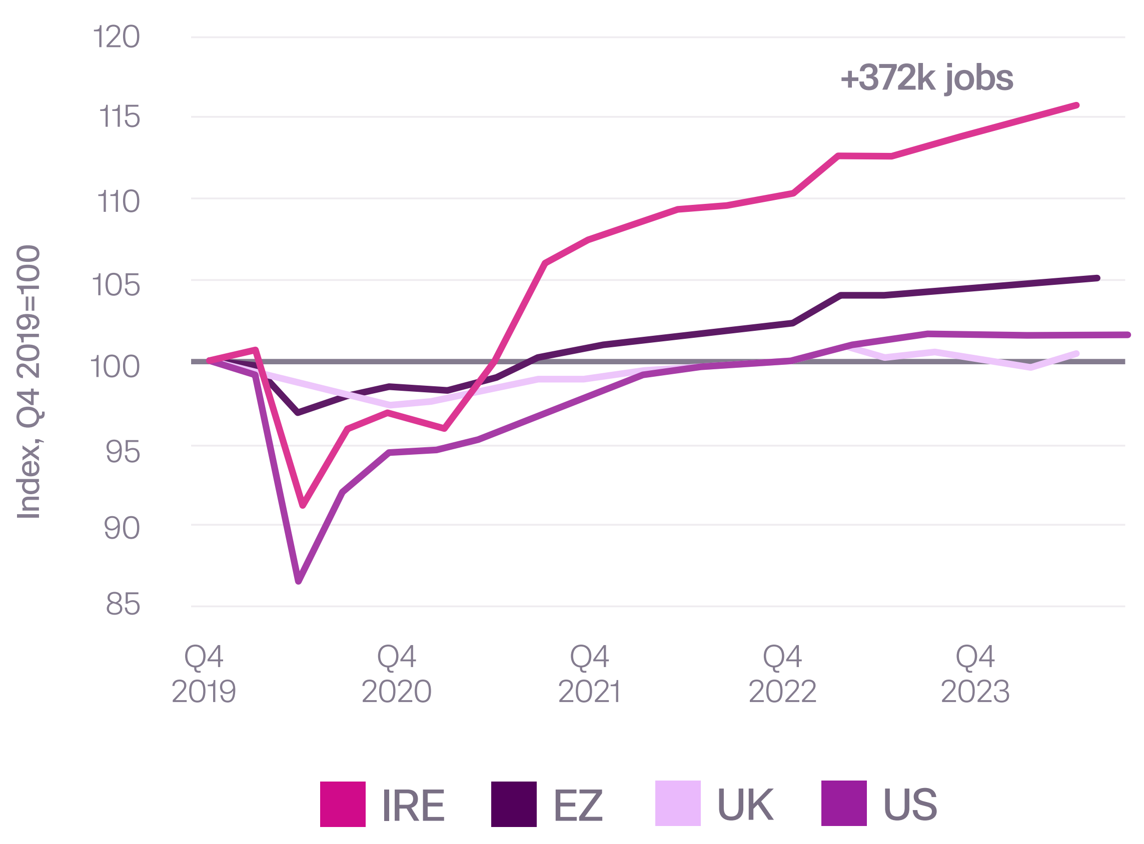
We expect continued robust growth in the labour market, with unemployment remaining close to current low levels and employment topping 2.8 million people by 2026.

Ireland's jobs growth vs. peers since 2020

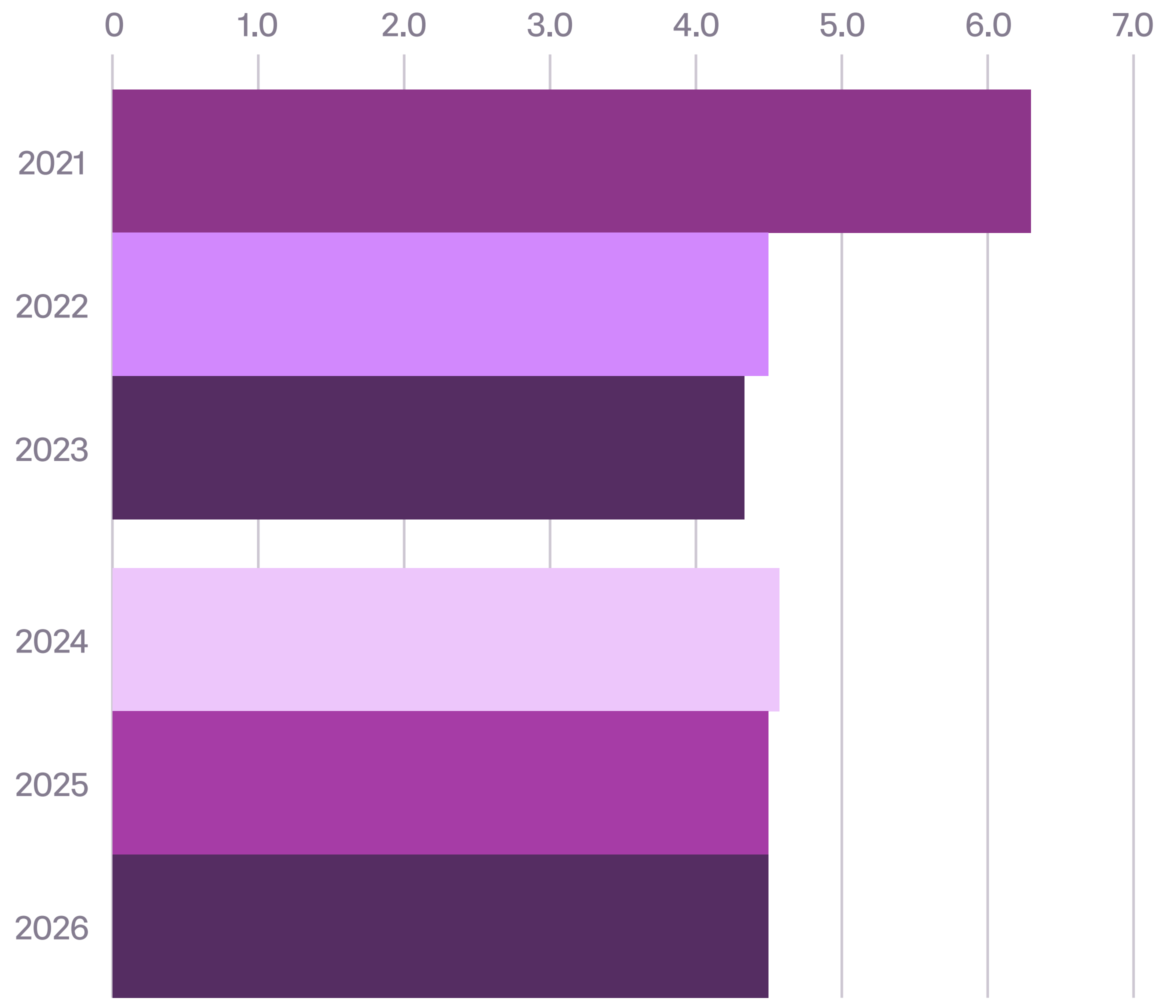


Source: CSO, AIB ERU

The growth in the labour market highlights the exceptional performance of the Irish economy in recent years. Since the beginning of 2020, employment has grown by nearly 372,000, or 16%, to a record high of 2.74 million people. This compares to a trough of 1.87 million in 2012 post the global financial crisis. In an international context the performance of Ireland's labour market is exceptional, far outstripping peers in European and US economies. This rapid growth in the labour market has also boosted wage growth, with average weekly earnings rising by 5.6% in the year to Q2 2024.

However, there are signs that this exceptional growth is beginning to cool as Ireland's economy and labour market near full capacity. The latest job openings data from sources such as recruitment website Indeed suggest waning employer demand, while AIB PMI surveys point to more cautious hiring trends in the manufacturing and services sectors. Moreover, the exceptional growth in the labour force is unlikely to continue at the same pace as the recent rise in female participation levels off, and inward migration has eased following the rise associated with the war in Ukraine in 2022 and 2023. Following a 3.5% rise in 2023, we see employment growth averaging 2.2% in 2024 and 1.6% in 2025, with total employment topping 2.8 million people by 2026. We expect the unemployment rate to average 4.5% in 2024 and 4.4% in 2026.

Unemployment rate forecast



Source: CSO, AIB ERU

Theme in focus

Theme in Focus – FX markets: Will the dollar weaken from here?

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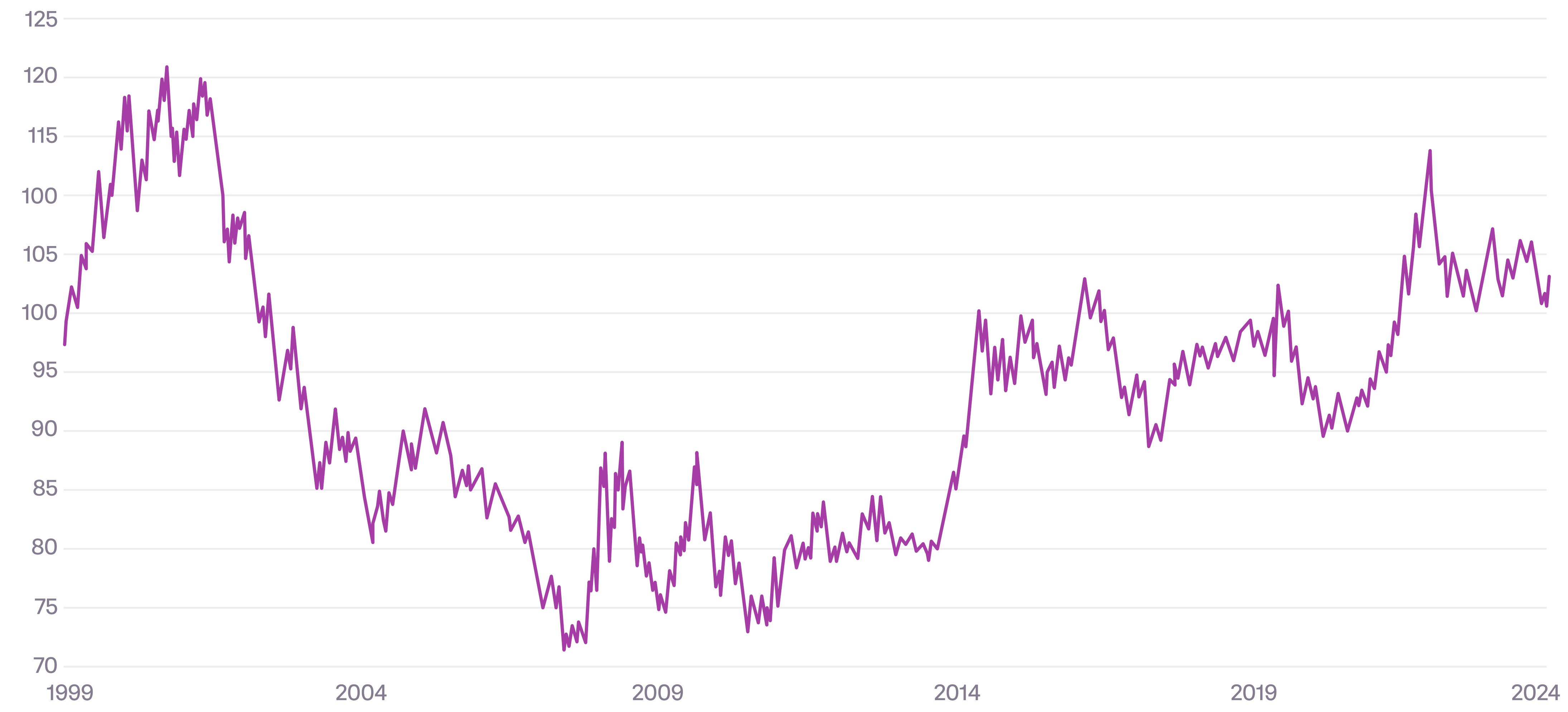
The dollar remains the world's reserve currency, with strong appreciation in recent years against other major currencies. However, given its current historically-elevated level, looming economic and political headwinds could yield downward pressure on the 'greenback' in the coming years.

The US dollar is the key currency on foreign exchange markets. The most recent Triennial FX Transactions Survey from the Bank of International Settlements (2022) showed that 88% of currency transactions involved the dollar on at least one side of a trade. This compares to 31% for the euro, 17% for the yen and 13% for sterling. At the same time, while the dollar remains the main 'reserve' currency, its share of total FX reserves has fallen in recent years. However, this highly 'liquid' market means that the dollar is deemed a safe haven and therefore tends to be in demand when there are bouts of risk aversion on markets.

It is useful to look at the dollar's performance over recent years to put in context its current trading ranges and to assess its potential future trading levels. The period 2014-2016 was characterised by a sharp appreciation in the dollar and the currency remained at elevated levels for the rest of the decade. This was against the backdrop of supportive interest rate differentials as the US Federal Reserve adopted a more hawkish tone amid signs of an improving US economy. In contrast, the euro was hampered by a weak Eurozone economy and negative interest rates, while sterling was impacted by the fallout from Brexit.

Aside from the boost the dollar received in March 2020 from safe haven demand on the back of the Covid pandemic, it was moving steadily lower in the early part of the 2020's. The EUR/USD pair rose above the $1.20 level for only the second time since 2014, while GBP/USD regained the $1.40 level.

Dollar Index



Source: Refinitiv, Dollar versus basket of global currencies

These moves were not sustained, though. The dollar came back into the ascendancy from around mid-2021, benefitting from the 'perfect storm' of rising US interest rates, increasing US bond yields and higher commodity prices. It received additional support from the Russian invasion of Ukraine which triggered a flight to safety. Key resistance levels gave way for the EUR/USD pair. During the summer of 2022, the major support at $1.04 (representing 20-year low point) was breached as the Fed ramped up its pace of rate hikes, resulting in EUR/USD falling below parity to a low of $0.95. Meanwhile, the dollar rose to its highest level on a trade-weighted basis since 2002.

However, the final quarter of 2022 saw a change in the dollar's fortunes. The currency started to give up some of its gains as other central banks picked up their pace of rate tightening. This was reflected in EUR/USD moving back above parity, trading to a high of $1.10 by early 2023. At the same time, GBP/USD moved up from $1.04 to $1.24. The emergence of stress in the US banking system in March 2023 was a headwind to the dollar. However, EUR/USD was unable to sustain a break above the $1.12 threshold and the easing of concerns over US banks coincided with some upside for the greenback.

Year-to-date, EUR/USD has been trading within a $1.06-1.12 range, while GBP/USD has mostly operated in a $1.23-1.34 corridor. However, the dollar had come under some pressure over the summer and into early autumn. This was reflected in EUR/USD testing $1.12 at various stages in recent months, a level it has not traded above on a consistent basis since the early part of this decade.

Two key factors have underpinned the dollar strength over the last number of years. These were: (1) the outperformance of the US economy relative to elsewhere, and (2) the more aggressive pace of rate tightening from the US Fed. However, both of these supports are starting to wane.

US macro data have been more mixed in recent months, including in relation to the labour market, which underpins the all-important consumer side of the US economy. While the US economy is still on track to outperform most of the other advanced economies this year, there are some signs that it is on a slowing trajectory. This will likely become more apparent as we move through 2025. At the same time, the Fed has entered an easing cycle for its interest rate policy, getting the ball rolling with a larger than expected 50bps rate cut in September. There is the potential for a greater degree of rates cuts from the Fed compared to the European Central Bank and Bank of England and if this interest rate differential materialises, it would act as a headwind for the dollar.

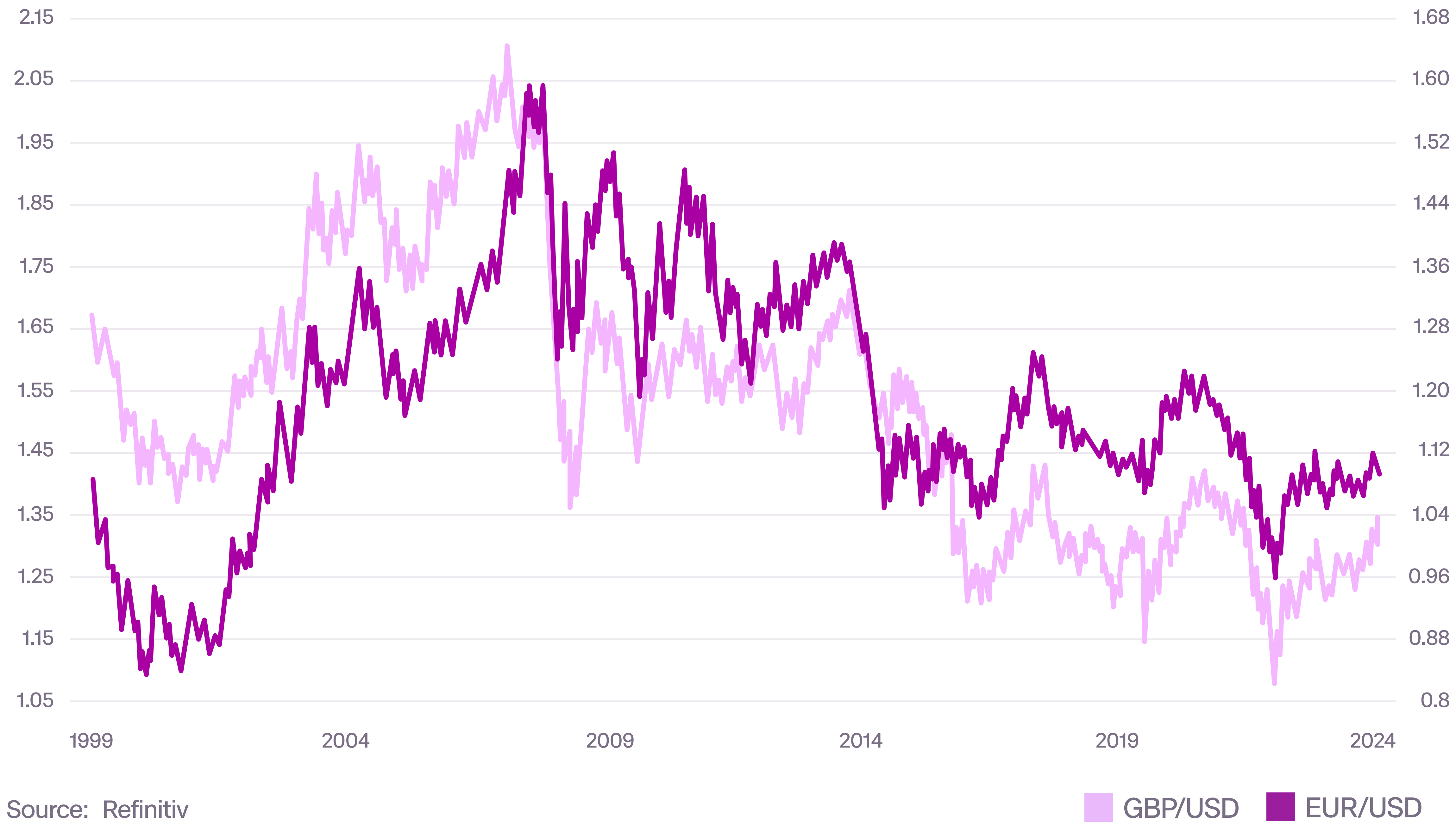
Meanwhile, if the US economy starts to lose further momentum next year, then its inherent imbalances i.e. twin deficits (fiscal and current account deficits) may start to receive more attention, which could become a significant headwind for the US currency. The upcoming US Presidential Election remains neck-and-neck and could be a source of volatility for the dollar in the immediate aftermath. Moreover, both candidates seem to favour expansion to fiscal policy, which would likely result in a further widening in the already high fiscal deficit.

Overall, assessing the evolving interest rate outlook, as well as medium term considerations in relation to US imbalances, implies a weakening dollar trend. Of course, this may not be without interruption. Bouts of risk aversion on markets would likely result in safe haven demand for the dollar, which would be supportive of the currency. We have seen an example of this in recent weeks against the backdrop of concerns over the conflict in the Middle East and some positive surprises from US macro data, helping to underpin some renewed momentum in the dollar. This is reflected in EUR/USD falling back from the $1.12 level to below $1.09 and GBP/USD going from $1.33-1.34 to under the $1.31 handle.

Looking at trading levels over the last 10-15 years, the dollar remains elevated. The average trading level for the EUR/USD pair over the period 2010-2020 was $1.23. Meanwhile, for the GBP/USD pair, the average over the same timeframe was $1.47. This suggests there is more scope for the greenback to fall.

In terms of important levels to keep a close watch on, for EUR/USD, a first step would be regaining ground up through $1.10 to $1.12. Following this, the $1.13-1.14 band would be the next key staging post for any continued upward momentum in the pair. Further out, the $1.20 mark would represent a significant breakthrough, as the pair has not traded on a sustained basis above this threshold since 2014. For GBP/USD, it generally held above $1.40 since the mid-1980s up to the Brexit referendum in 2016. Therefore, this level would be a noteworthy capture for the pair. Of course, it will likely require some sustained underlying momentum on the part of the euro and sterling and not just dollar weakness to achieve these trading milestones.

Long term EUR/USD & GBP/USD



Source: Refinitiv

Appendix

Detailed Forecast Tables

Irish macroeconomic forecasts (% change)

	2023	2024	2025	2026
Consumer Spending	4.8	2.7	3.0	2.9
Government Spending	4.3	2.9	2.8	2.1
Investment	2.8	-23.7	16.3	2.2
Exports	-5.8	8.1	2.7	2.9
Imports	1.2	5.2	4.0	2.8
GDP	-5.5	-0.3	2.8	2.8
Modified Investment	-4.4	0.7	2.0	2.5
Modified Domestic Demand	**2.6**	**2.3**	**2.8**	**2.7**
HICP Inflation	**5.2**	**1.9**	**2.0**	**2.0**

Irish labour market forecasts (% change)

	2023	2024	2025	2026
Unemployment rate	4.3	4.5	4.4	4.4
Employment Growth	3.5	2.2	1.6	1.5
Employment ('000)	2,685	2,730	2,771	2,813
Earnings Growth	3.9	4.4	3.5	3.0

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