

The Irish Economic Update:

*Deep Covid-19 recession beckons,
but economy can rebound quickly*

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Strong growth by Irish economy over 2013-2019 period



- Very severe recession in Ireland in 2008-2009. GDP fell by nearly 9.5% and GNP down 12%
- 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 almost 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 also 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 in surplus in 2018/19
- Major deleveraging by private sector, including households, in past decade
- Balance of payments returned to large surplus

But coronavirus to cause short, deep recession in H1 2020



- Tourism and travel took earliest hit when restrictions imposed and people reluctant to go out/travel – hotels/restaurants/bars accounts for 8% of Irish employment. But many other businesses now closed
- Consumer spending being impacted as most retail outlets forced to close, bar those deemed essential
- Rising unemployment and tightening of financial conditions to impact activity also
- Uncertainty and reduced cash flow due to lockdowns will hit many businesses hard. Investment to decline
- Exports, a big part of Irish economy, will be impacted by downturn in world activity
- Flash Markit PMIs for March at / close to historic lows in the Eurozone, UK and US, especially for services
- Big falls in GDP in Ireland and elsewhere in H1 2020 – forecasts that it could fall by 10% or more
- Activity expected to rebound strongly in H2 2020 as virus abates and restrictions on activity are lifted
- Risk of a smaller second virus outbreak later in year. Other factors may also impede pace of recovery
- GDP will fall in 2020 as a whole – broad range of forecasts from 1.5% to 7% declines
- Strong growth expected in 2021 given depressed base for this year – growth of 5% possible

Most data show economy was performing well pre-virus

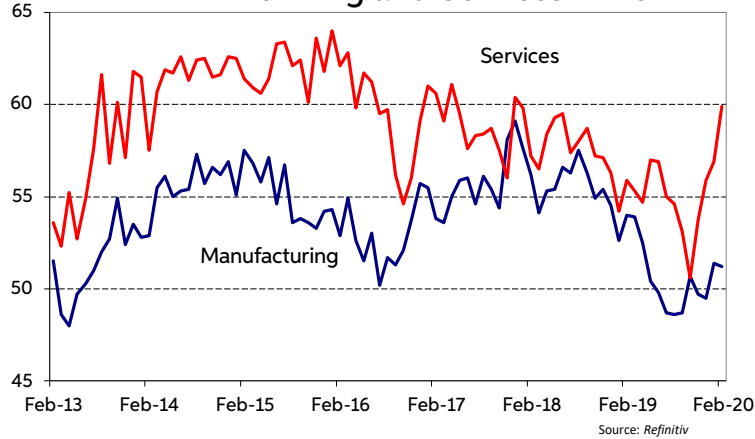


- Robust jobs growth of 2.9% yoy in 2019, matching rates seen in previous years
- Unemployment rate held at 4.8% in February, with Live Register continuing to decline in early 2020
- Housing completions up strong 18% yoy to over 21k in 2019
- Further rise in housing commencements – up 17% in 2019 to 26,000
- Mortgage lending growth slowed to 9.5% yoy in 2019 – flattening house prices a factor
- Construction PMI weakened notably in 2019 and remained at a subdued level in early 2020
- Retail sales (ex-motor trade) rose 4.4% in 2019. Down by 0.5% in Jan/Feb 2020 on strong Q4 2019 level
- Total car registrations (new + 2nd hand imports) fell at start of 2020 after solid performance in 2019
- Manufacturing PMI weakened markedly during 2019. But back above 50 in first two months of 2020
- Services PMI slipped in 2019, but rebounded very strongly over winter to hit 59.9 by Feb, a two year high
- Consumer confidence fell sharply to 6 year lows in 2019 as Brexit fears weighed, but had picked up again
- Budget surplus rose to €1.4bn or 0.4% of GDP in 2019. Tax receipts up strong 14% yoy at end Feb 2020

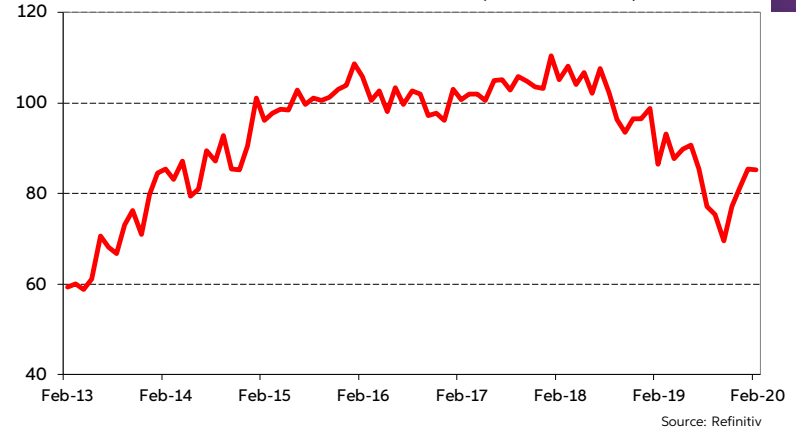
Notably, survey data improved over winter



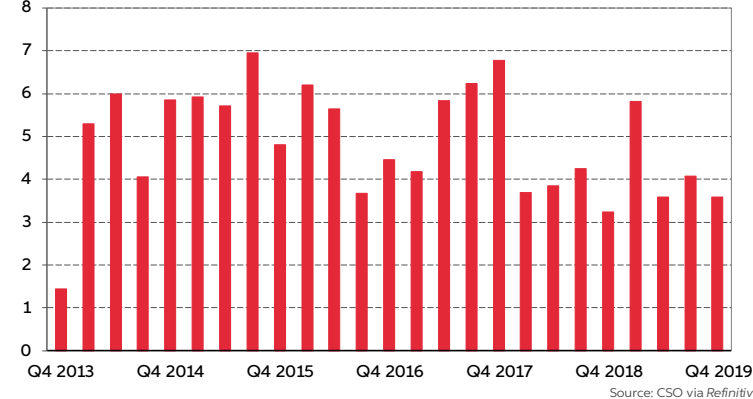
AIB Irish Mfg and Services PMIs



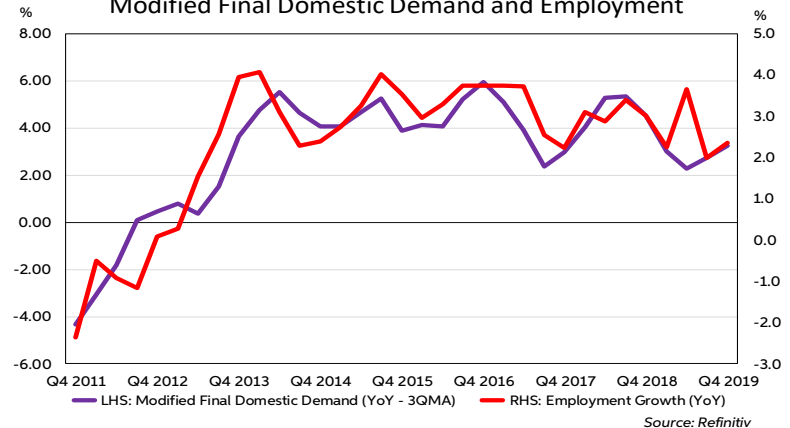
Consumer Confidence (ESRI - KBC)



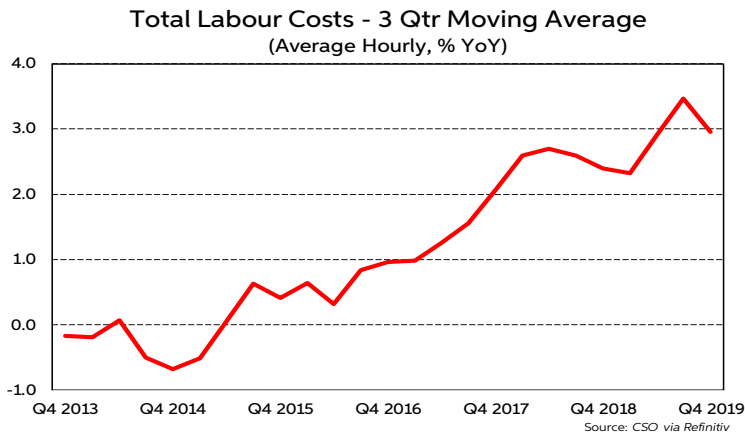
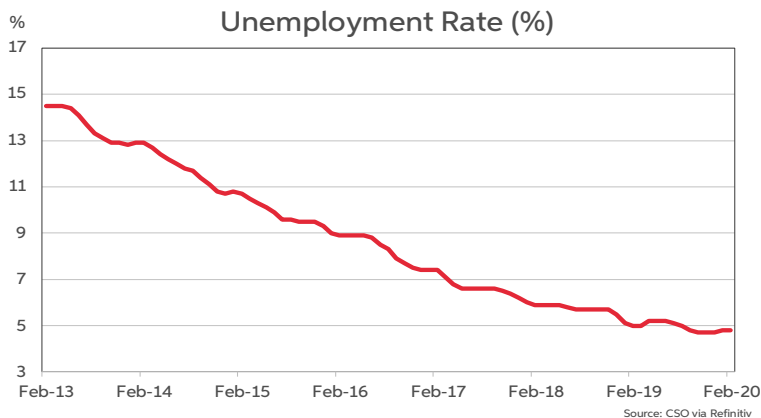
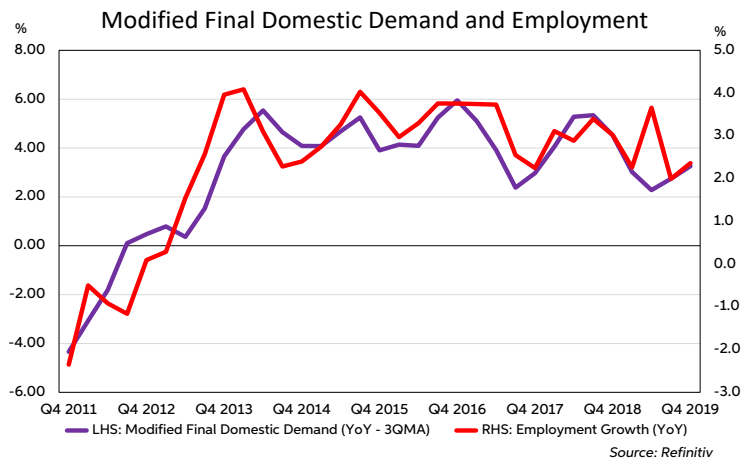
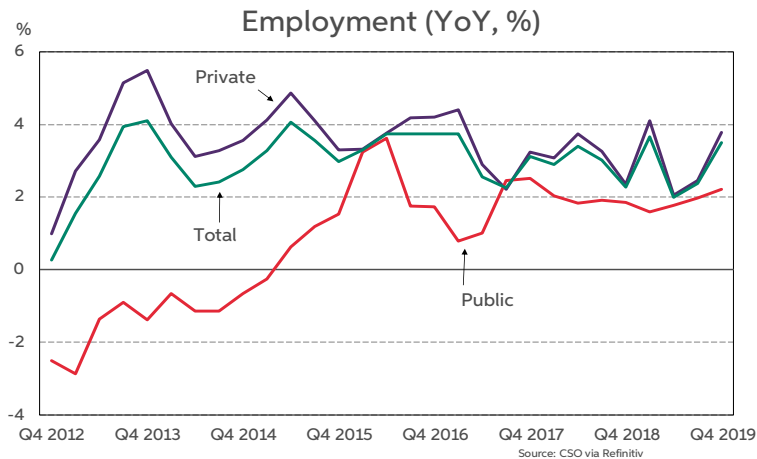
Retail Sales (ex-autos) - Volume, YoY, %



Modified Final Domestic Demand and Employment



Strong jobs growth, unemployment rate below 5%

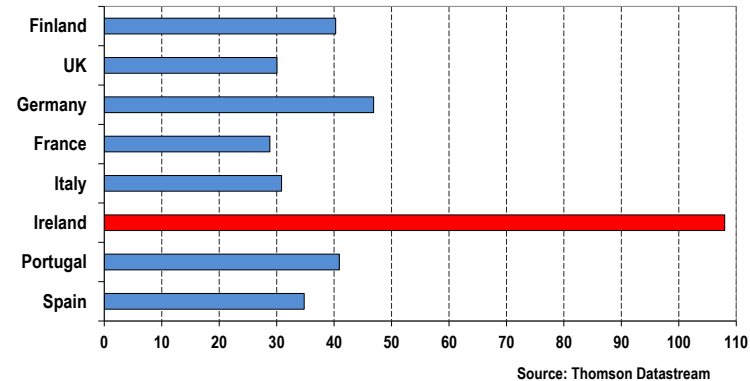


Large Irish export base performs very well



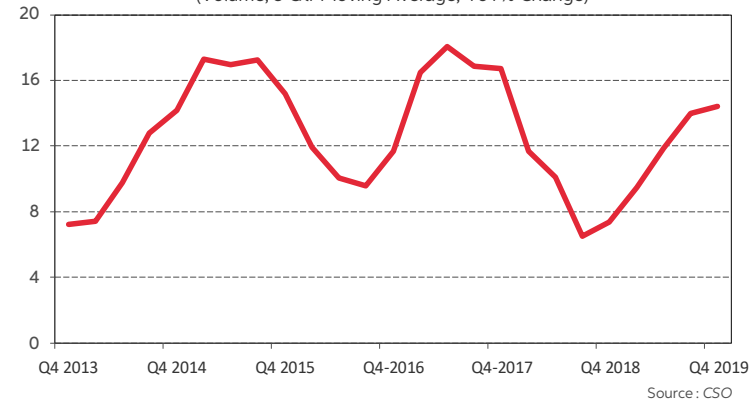
- Ireland a very open economy – exports, driven by large scale FDI, are a huge part of economy
- Exports rise strongly in recent years, helped by large FDI inflows
- Total exports rose by 10.4% in 2018 and 11.1% in 2019
- Pharma, medical care products, IT equipment, and food & drink are main goods exports
- IT, business, financial and tourism are the main service exports
- Multi-nationals account for almost 70% of exports per IDA
- Eurozone, US and UK are the three biggest export markets
- Ireland a big importer from UK – it is the UK's 5th biggest export market

Exports as % of GDP



Irish Exports of Services

(Volume, 3 Qtr Moving Average, YoY% Change)



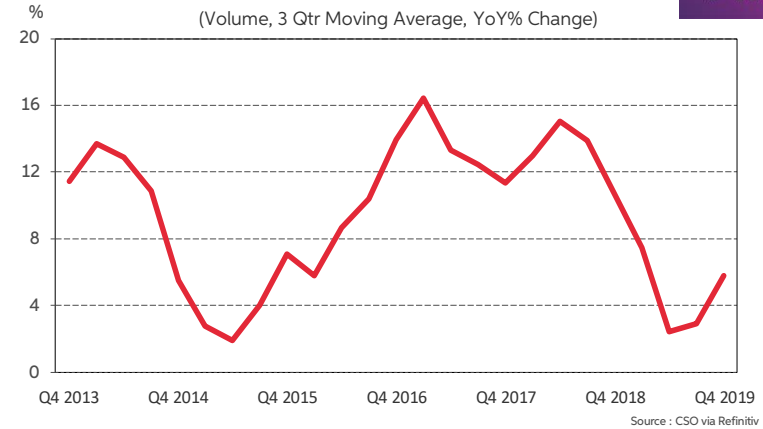
Solid domestic economy – grew by 3% in 2019



- 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 5.8% in 2019
- Business investment (ex aircraft/intangibles) has recovered strongly since 2013
- However, Brexit uncertainty saw business investment flat-line in 2019
- Consumer spending grew by 3.5% on average over 2014-2018 period. Up by 2.8% in 2019
- Core retail sales rose by a strong 4.4% in 2019. Were down by 0.5% in Jan/Feb on high Q4 2019 level
- Total car regs (new + used imports) remained at high levels in 2019, though fell at start of 2020
- Modified final domestic demand grew at 4.4% rate in 2014-2018 period. Rose by 3% in 2019

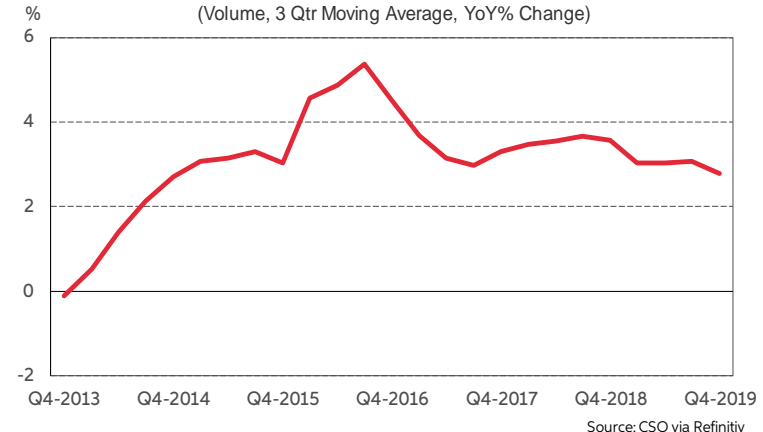
Construction Output

(Volume, 3 Qtr Moving Average, YoY% Change)



Consumer Spending

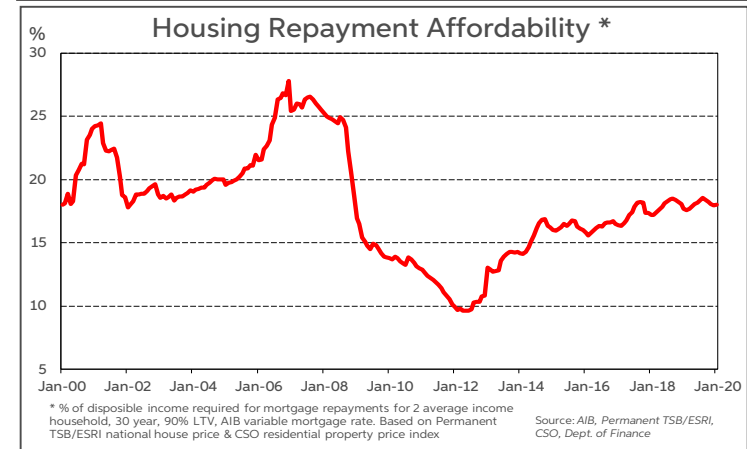
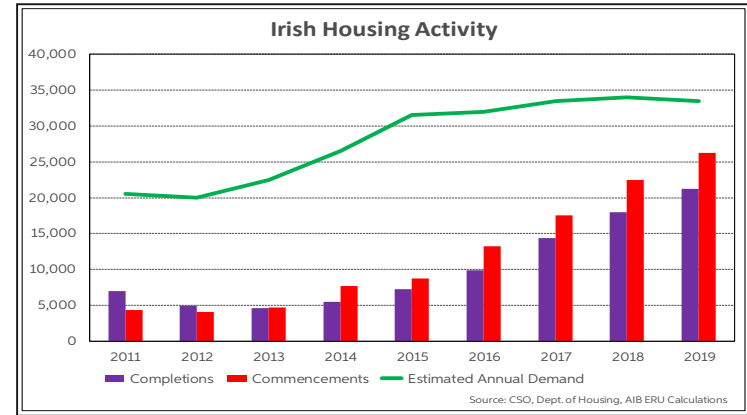
(Volume, 3 Qtr Moving Average, YoY% Change)



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



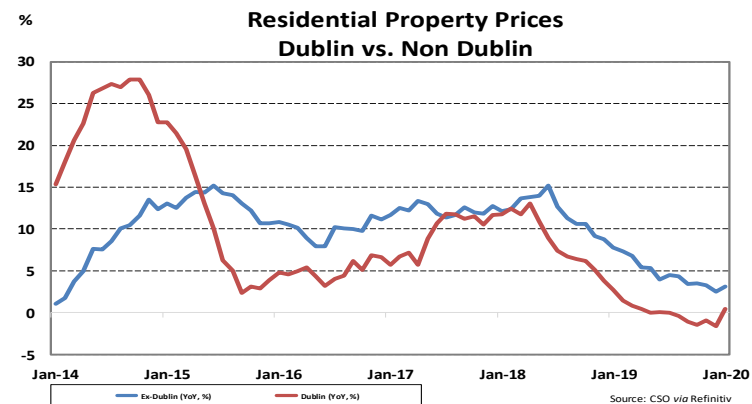
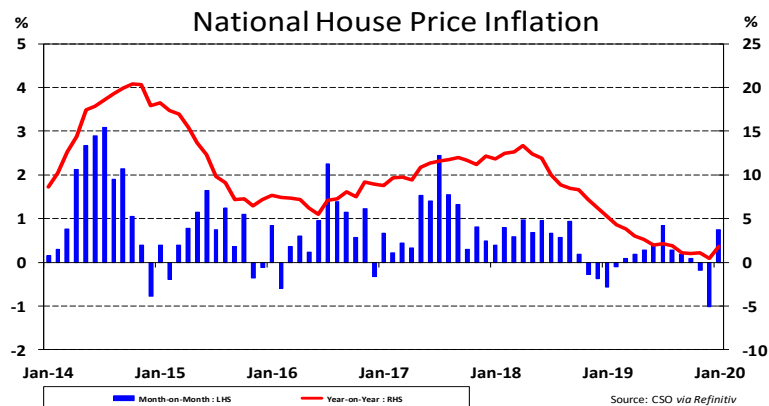
- Housing completions up 18% yoy to over 21,000 units in 2019, a moderation on 2018's 25% growth rate
- Housing commencements by further 17% in 2019 to 26,000 units
- Planning permissions jump by 38% YoY to over 40k in 2019, driven by a sharp rise in apartment applications
- Measures put in place to boost new house building. More NAMA activity, apartment planning rules relaxed
- Housing output still running well below annual new housing demand, estimated at close to 35,000 units
- Forecast for completions of circa 24,500 in 2020 before coronavirus outbreak
- Mortgage lending growth eases to 9.5% in 2019, though mortgage approvals did pick up over the year
- Income growth now outpacing house price inflation, which helps affordability metrics



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 85% by Jan 2020 from low in March 2013 – Dublin prices up by 95%, non-Dublin rise 83%
- But house prices still some 17% below 2007 peak
- House price inflation slows sharply in 2018/19 reflecting tighter Central Bank lending rules
- Prices up 1.8% yoy nationally in Jan 2020, down from a high of 13.3% in April 2018
- Dublin prices up 0.5% yoy in Jan, down from +13% in Apr '18; non-Dublin at 3.1% vs. 15% last year
- Annual growth in rents has slowed to less than 4% per CSO data



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 2017-2021 – 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 2017-21

Calendar Year	2017	2018	2019	2020	2021
Household Formation	28,000	28,500	28,000	28,000	28,000
<i>of which</i>					
Indigenous Population Growth	18,500	17,500	16,500	16,500	16,000
Migration Flows	9,500	11,000	11,500	11,500	11,500
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	33,500	34,000	33,500	33,500	33,000
Completions	14,400	18,100	21,250	24,500	28,000
Shortfall in Supply	-19,100	-15,900	-12,250	-9,000	-5,000

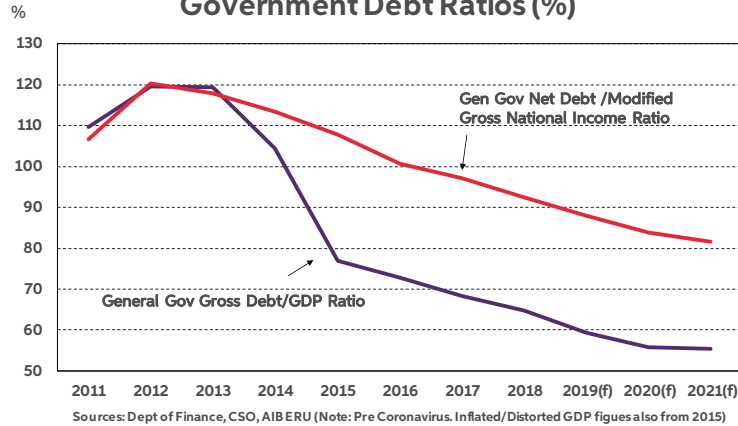
*Headship is % of population that are heads of households.

Sources: CSO, DoECLG, AIB ERU. Note 2002-21 estimates are pre coronavirus

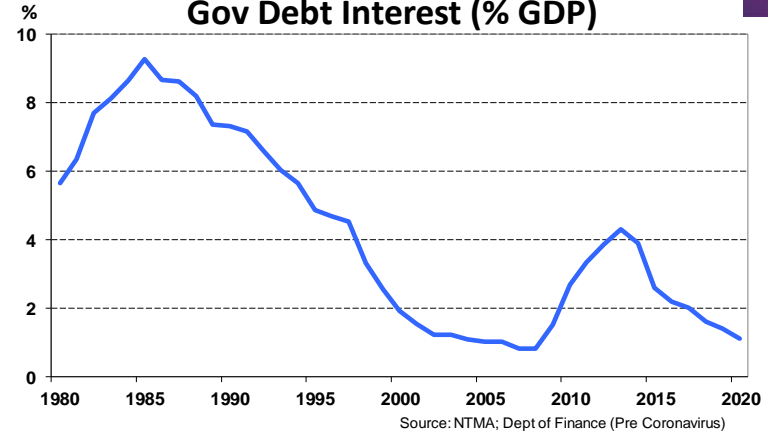
Govt debt ratios fall, private sector deleverages



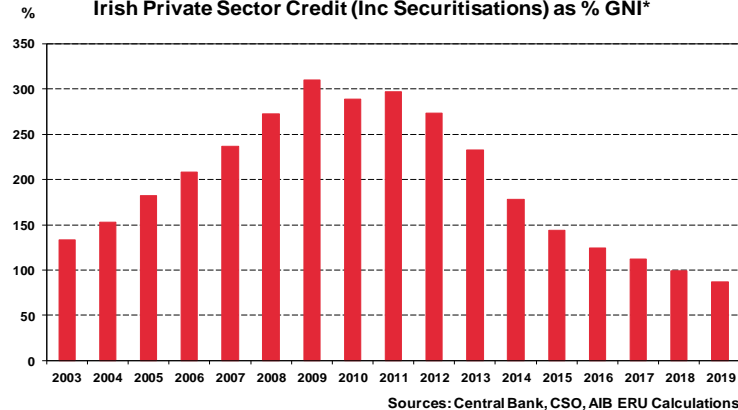
Government Debt Ratios (%)



Gov Debt Interest (% GDP)



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



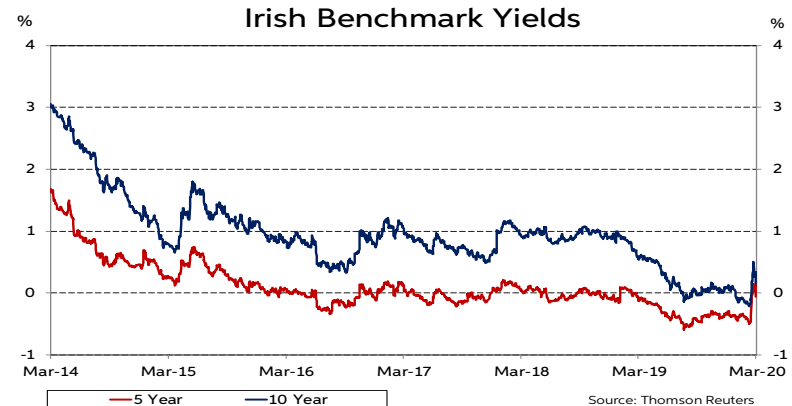
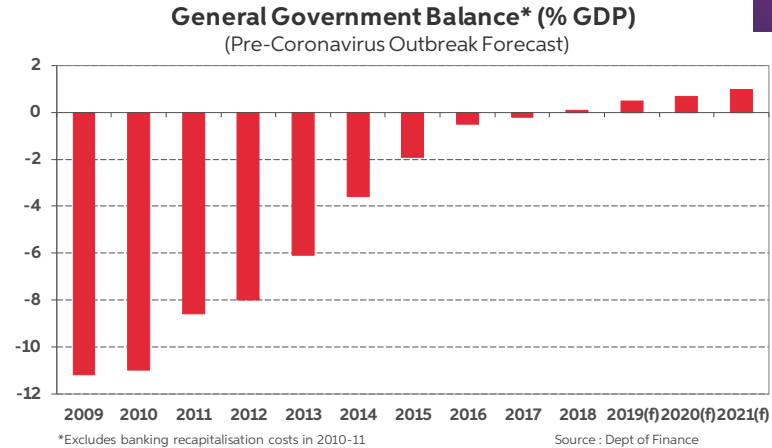
Irish Household Debt Ratio (% of Disposable Income)



Public finances will be impacted by Coronavirus



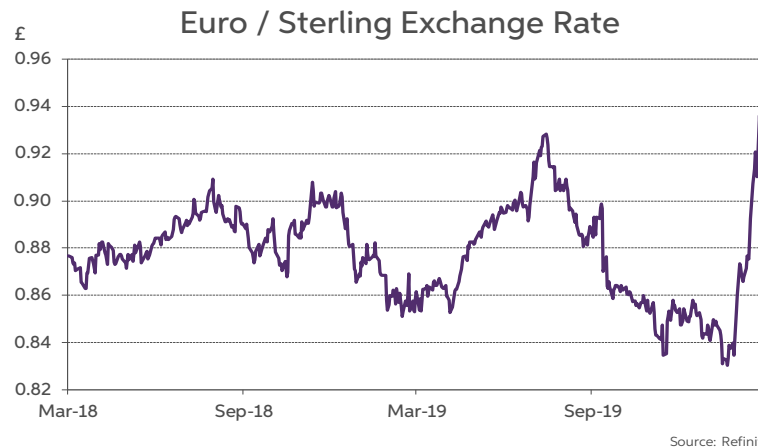
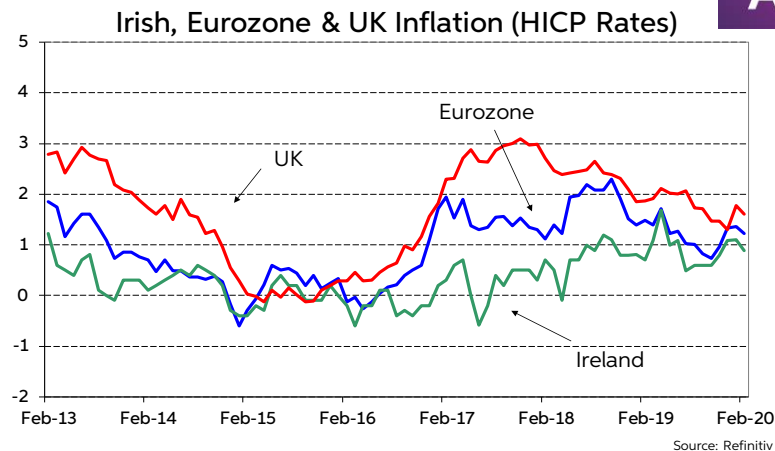
- Budget deficit declined sharply over last decade, with small €170m surplus recorded in 2018
- Budget surplus rose to €1.4bn or 0.4% of GDP in 2019 as taxes continued to exceed target
- Primary budget surplus (i.e. excluding debt interest) of near 2% of GDP in 2019
- Debt interest costs very low – at 1.4% of GDP
- Cautious budget for 2020, the budget surplus continuing to rise
- Tax receipts up by 14% yoy to end Feb 2020, aided by strong corporation and income taxes
- However, coronavirus and efforts to mitigate it will see the public finances deteriorate in 2020
- Return to significant budget deficit this year
- Gov Debt/GDP ratio has fallen sharply, as have Irish bond yields, in recent years
- Sovereign debt ratings upgraded in recent years; S&P at AA-, Fitch at A+, Moody's A2 for Ireland



But key medium-term growth drivers still in place



- Favourable medium-term drivers of strong Irish growth remain in place
- House building picking up from still low output levels – big focus for next government
- Government spending supportive of growth
- Activity to be aided by continuing very low interest rate environment
- Good inflows of FDI expected to continue
- Labour market dynamics supportive of growth
- Economy has deleveraged, no obvious imbalances
- World economy will rebound from 2021
- Strong Irish growth of circa 5% seems likely next year after sizeable fall in GDP in 2020
- Move to UK-EU FTA will lower Irish growth, but this may now not happen until 2022



Brexit: EU-UK trade talks expected to be difficult



- 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 in place until end 2020
- UK government had ruled out extending the transition period beyond this date
- However, with talks postponed due to virus outbreak, this position is likely to be reviewed
- Negotiations, when they resume, likely to prove difficult and fractious
- 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 includes 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

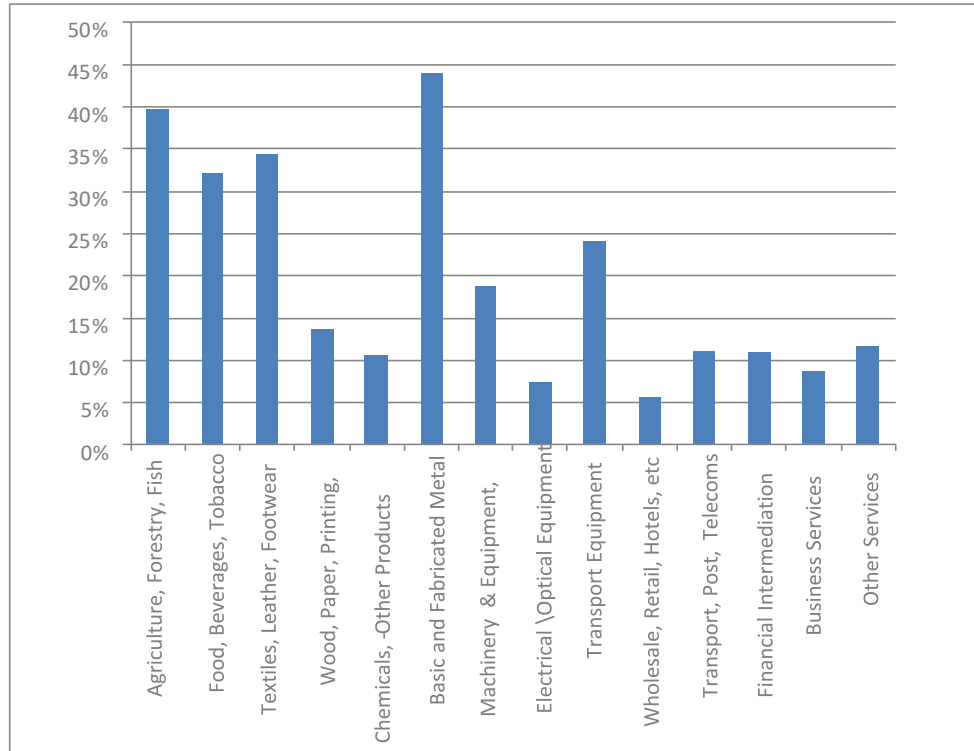


- UK outside EU Customs Union after transition period ends so both exports and imports will need paperwork, even if tariff free trade is agreed under FTA that implies no Customs Duties
- Need to get Customs Registration Numbers in both Ireland (EORI) and the UK from Revenue
- Customs Declaration forms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

Agri-food industry 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 that sees tariffs cut 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

Risks to the Irish economy



- Main near-term risk is obviously the coronavirus – will weigh heavily on growth this year, with impact dependent on length of outbreak and extent to which the economy can rebound
- Highly open nature of Irish economy means it is particularly vulnerable to a global slowdown, lingering effects from coronavirus could hamper global recovery for some time
- Brexit remains a challenge given uncertainty about future EU-UK trading relationship
- 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
- 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.