

The Irish Economic Update:

Strong start to 2023, but slowdown in growth likely, with more binding capacity constraints

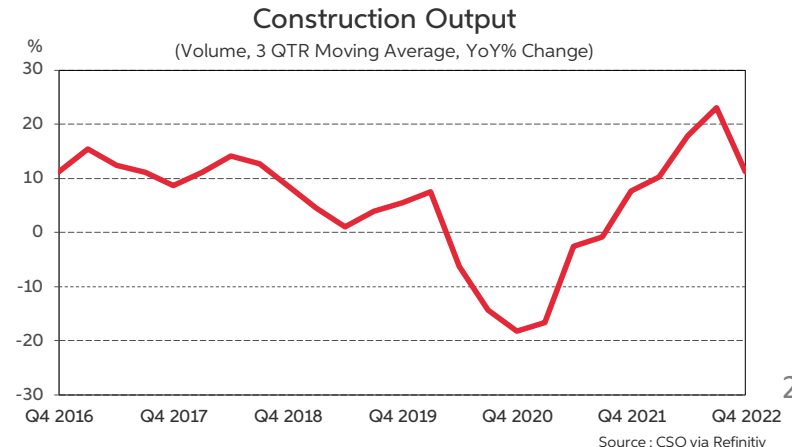
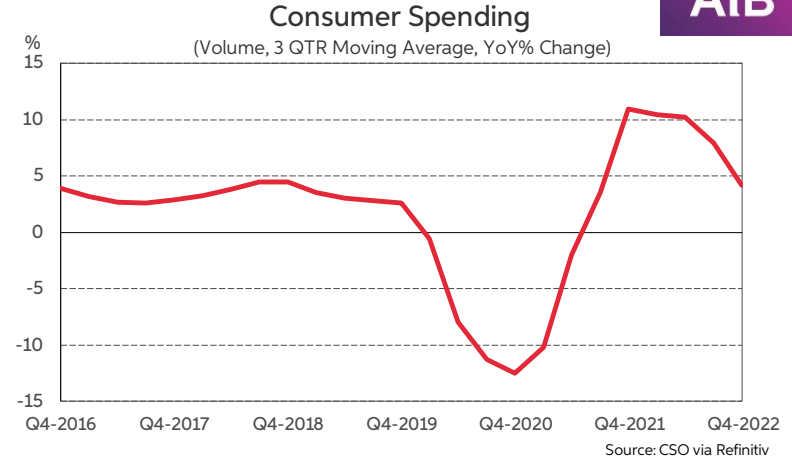
April 2023

Oliver Mangan
Chief Economist
AIB

Economy rebounded very strongly in 2021-22 from COVID



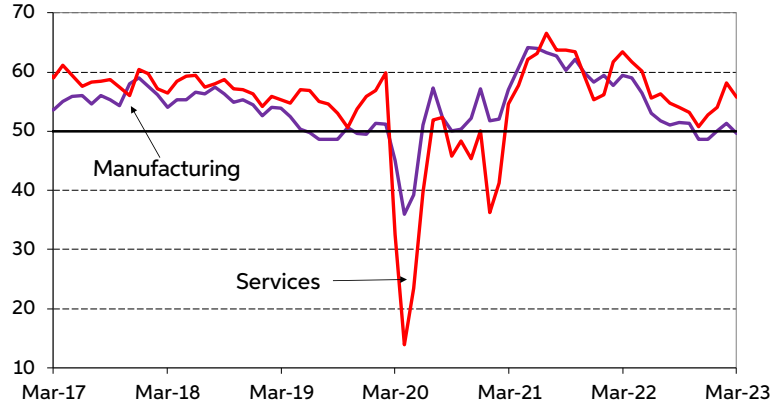
- Another very strong rise in GDP in 2022 of 12%, following the 13.6% increase seen in 2021
- Surging inflows of foreign direct investment a key factor in rapid growth of economy during 2021-22
- Exports up strongly again in 2022, rising 15%
- Modified final domestic demand rose by 8.2% in 2022 following the increase of 5.8% recorded in 2021
- Consumer spending up by 6.6% last year, with very strong rise in expenditure on services of 11.5%
- Robust growth in investment continued, up 20% in 2022, with buoyant business investment
- Construction output rebounded in 2022 from COVID hit, rising by 14%. Big jump in house building activity
- However, modified domestic demand declined in both Q3 and Q4 on weaker investment after big jump in Q2
- Both investment in machinery & equipment, and non-residential construction fell sharply in H2 2022



Indicators point to slower economic growth this year

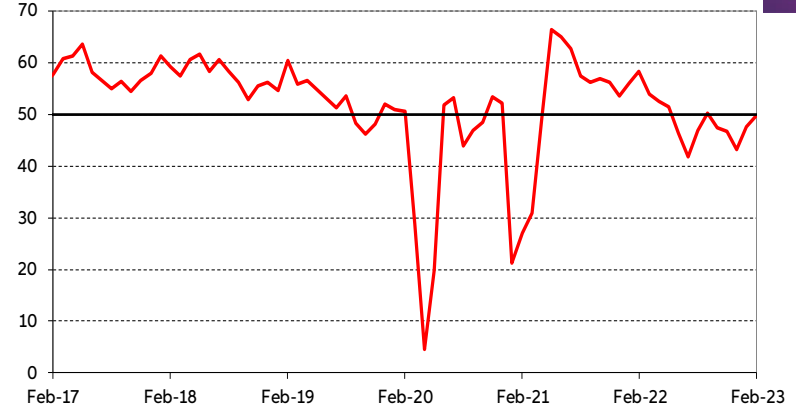


AIB Irish Mfg and Services PMIs



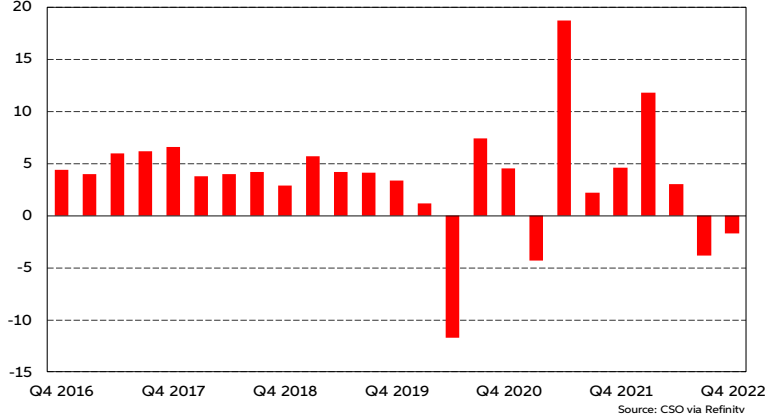
Source: Markit via Refinitiv

Ireland Construction PMI



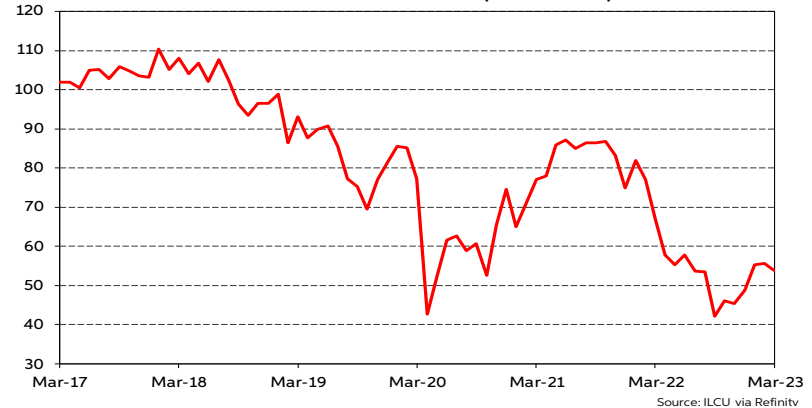
Source: Refinitiv

Retail Sales (ex-autos) - Volume, YoY



Source: CSO via Refinitiv

Consumer Confidence (KBC/ILCU)



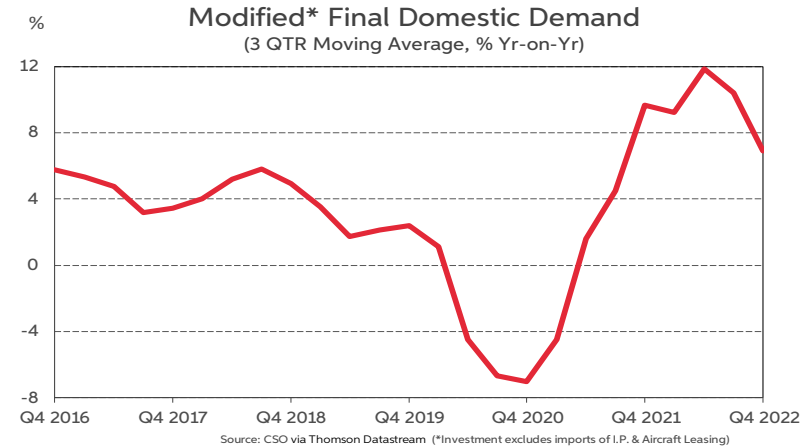
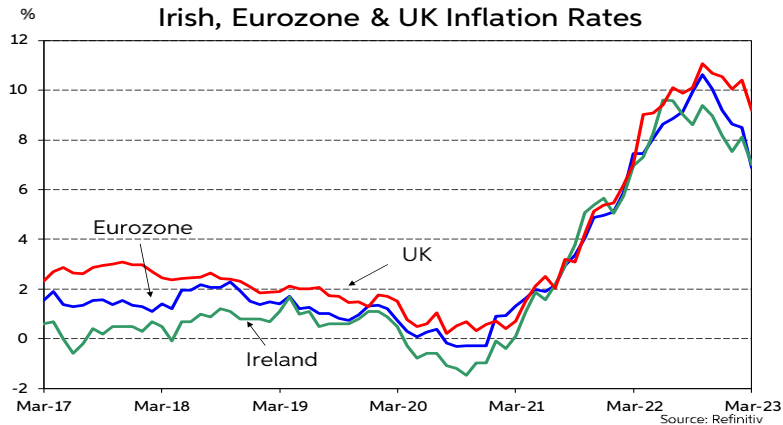
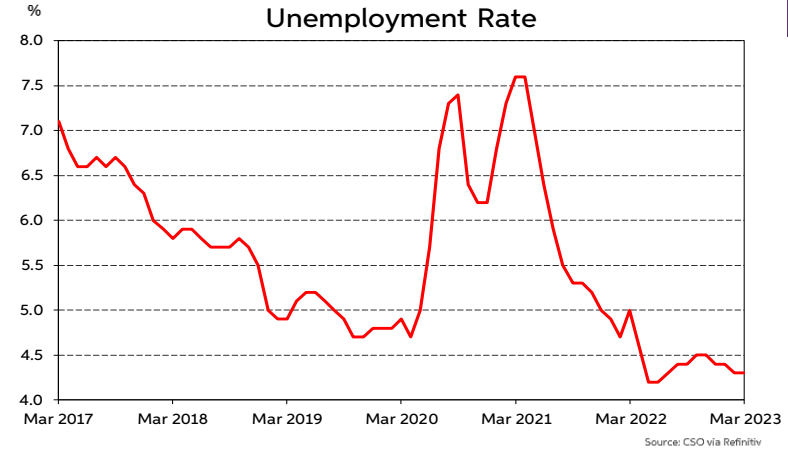
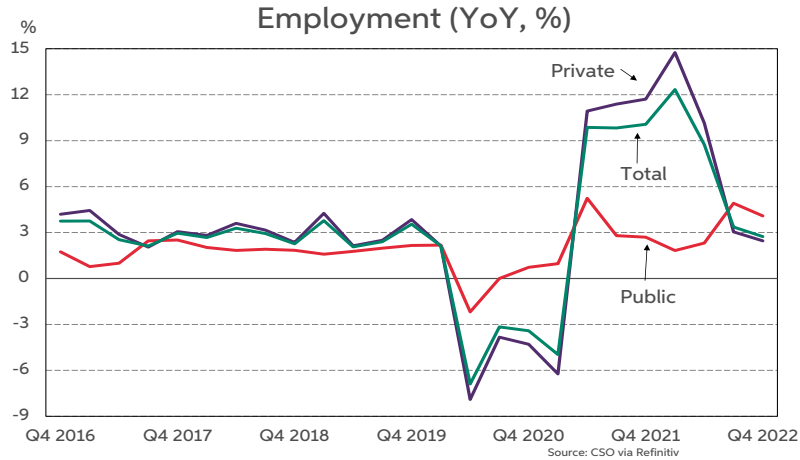
Source: ILCU via Refinitiv

Though data remained strong in Q1 2023



- As elsewhere, Irish data stronger than expected in Q1 2023, with official growth forecasts revised up
- Mfg PMI fell sharply in H2 2022 to below 50 by Nov/Dec. Modest pick-up in Q1 2023, averaged 50.4
- Services PMI solid in 2022. Picked up strongly in early 2023, at 58.2 in Feb and 55.7 in March
- Housing commencements hit 35k peak last March. Fall back, but stable at 27k in Sept-Feb period
- PMI for construction fell sharply in 2022. Averaged 45.8 in Q4. Picked up to 47.7 in Jan and 49.8 in Feb
- Core retail sales subdued in 2022, rising by just 1.7% in volume. Stable sales in Jan/Feb 2023
- New car sales improved in H2'22, but flat for full year. Picked up in early 2023 – rose 16.5% yoy in Q1
- Consumer confidence recovers some ground in early 2023 after sharp fall from spring to autumn 2022
- Tax receipts rose by very robust 21.5% last year. Remained strong in Q1 2023, up 14.6% yoy
- Unemployment rate fell to 20-year lows below 4.5% in 2022. Stays very low at 4.3% in Feb/Mar 2023
- Employment rose by 6.8% in 2022. Up by 9.2% at end 2022 from end 2019, with labour force up 8.9%
- Inflation rose sharply in 2022, but HICP rate down to 7% by March 2023 - peaked at 9.6% last June/July

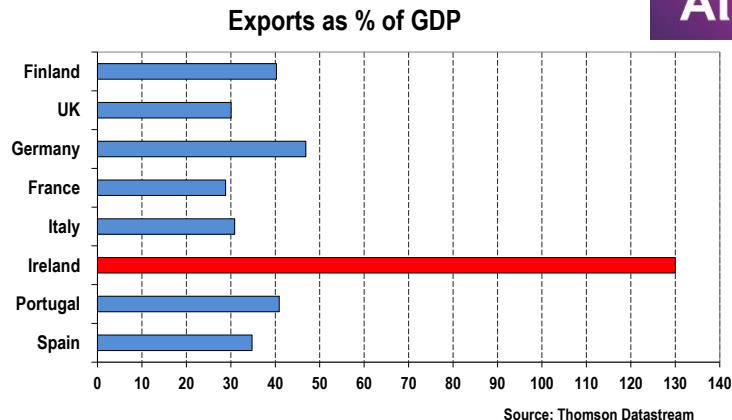
Unemployment falls to very low level, inflation now easing



Exports perform very strongly in 2021-22 as FDI surges



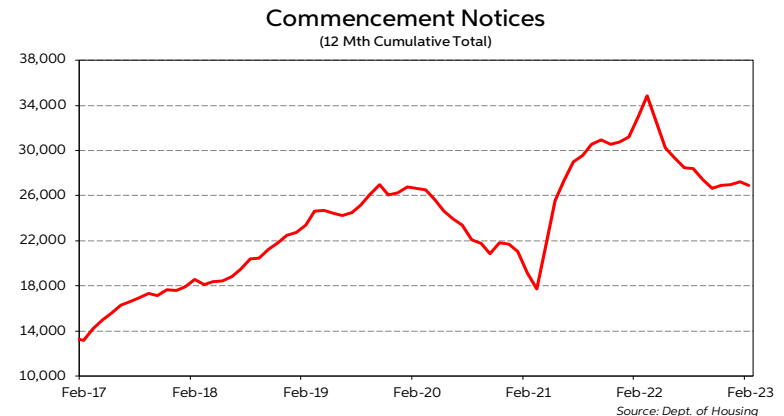
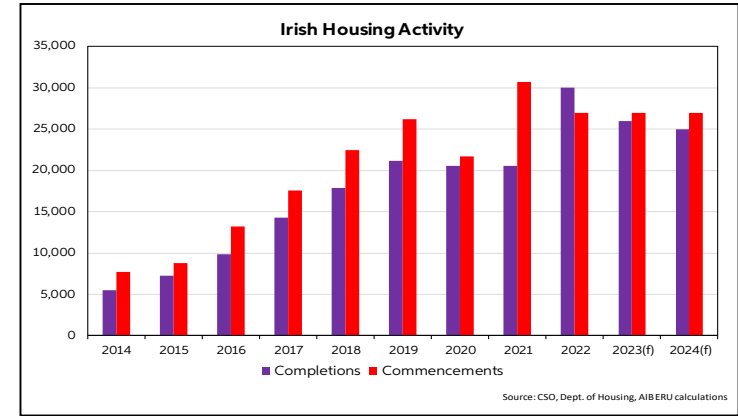
- Ireland is a very open economy – exports, driven by large scale FDI, are a huge part of economy
- Exports have risen strongly in recent years, helped by very large FDI inflows
- IDA reported record FDI in 2021 and high levels again in 2022, with good pipeline for H1 2023
- Pharma, medical care products, ICT, business & financial services main elements of FDI
- Irish FDI inflows may be benefitting from Brexit
- Eastern Europe may also becoming less attractive for FDI following Russian invasion of Ukraine
- Total exports up by 14% in 2021 and 15% in 2022
- Goods exports rose by 18% in 2021 and 22.5% in 2022– this overstates actual growth
- Exports include goods manufactured abroad by sub-contractors on behalf of Irish based firms
- Service exports up by 10.3% in 2021 and 7.3% in 2022, a better measure of export performance



House completions jump, but commencements fall back



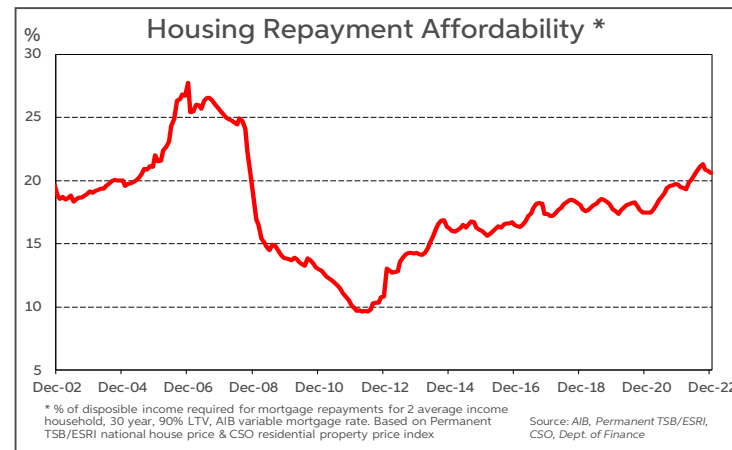
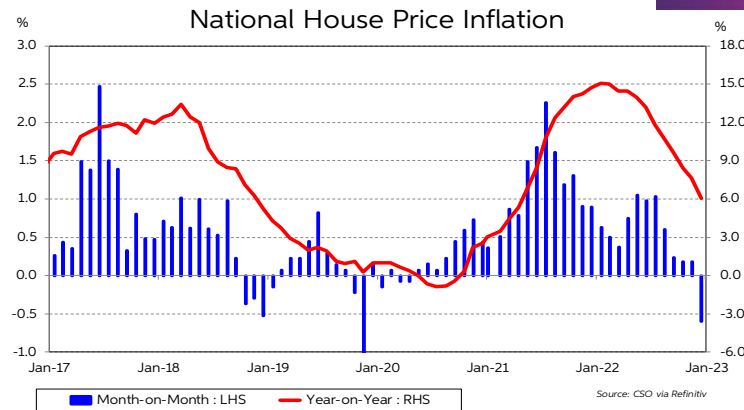
- Completions amounted to 20,500 in 2020 & 2021, just 2.6% down on 2019 level despite lockdowns
- Completions then jumped sharply to 30,000 in 2022, helped by rebound from COVID lockdowns
- Estimated annual housing demand put at over 30k
- Big jump in planning permissions from 2018-2021, but sharp fall of 20.5% in 2022 – all apartments
- 12 month commencements hit 35,000 peak in Q1'22 but fall back and running at steady 27,000 since Sept
- Completions may move down to 25-26k in 2023-24. Rising costs/yields could dampen apartment builds
- Mortgage drawdowns rose by sharp 34% to €14.1bn in 2022. Big impact from switching activity
- Early indications in 2023 from mortgage applications are for a fall-off in switcher activity this year



House prices levelling off



- House prices declined sharply, by 55% over 2007-13. Prices have fully recovered - back above 2007 peak level
- Low supply, remote working, strong public/institutional demand, enhanced help-to-buy scheme, rising personal savings, pent-up demand all supportive of house prices
- Marked moderation in house price inflation during 2022
- Annual rate eased to 6.1% yoy by Jan 2023, down from peak of 15% in Feb/Mar 2022. Prices fell in January
- Non-Dublin Jan prices up 7.4% yoy, Dublin rate at 4.3%
- Rising interest rates and slower economic growth suggest house price inflation will continue to decelerate
- Property websites show asking prices were flat in H2 2022, with a slight fall in Q1 2023
- Housing affordability deteriorated as prices rose, but starts to improve again in Q4'22 as price growth slows
- Rents jump sharply in 2021/22. Annual rate peaked at 12.9% in July. Fell to 10.6% end 2022, 10.4% in Jan/Feb



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 2016-2022 – 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 again in 2016-22

Calendar Year	2020	2021	2022	2023	2024
Household Formation	26,000	29,000	28,000	25,000	24,500
<i>of which</i>					
Indigenous Population Growth	21,000	20,000	16,500	14,500	14,500
Migration Flows	5,000	9,000	11,500*	10,500*	10,000*
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	31,500	34,500	33,500	30,500	30,000
Completions	20,500	20,500	30,000	26,000	25,000
Shortfall in Supply	-11,000	-14,000	-3,500	-4,500	-5,000

**Headship is % of population that are heads of households. Assumed it remains constant

* Does not include Ukrainian refugees

Sources: CSO, DoECLG, AIB ERU.

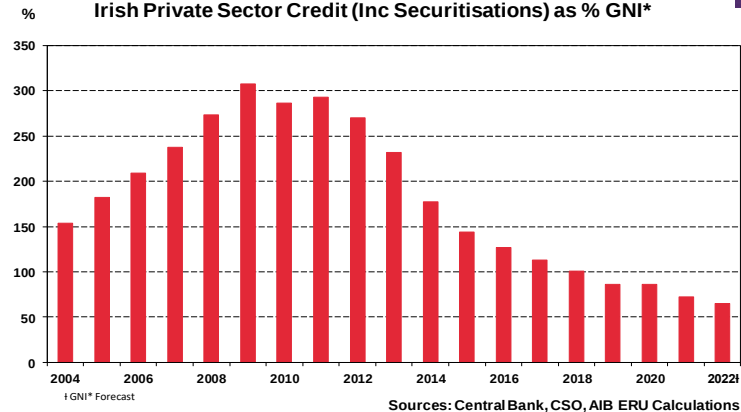
Private sector deleverages, Gov. debt ratios fall to low levels



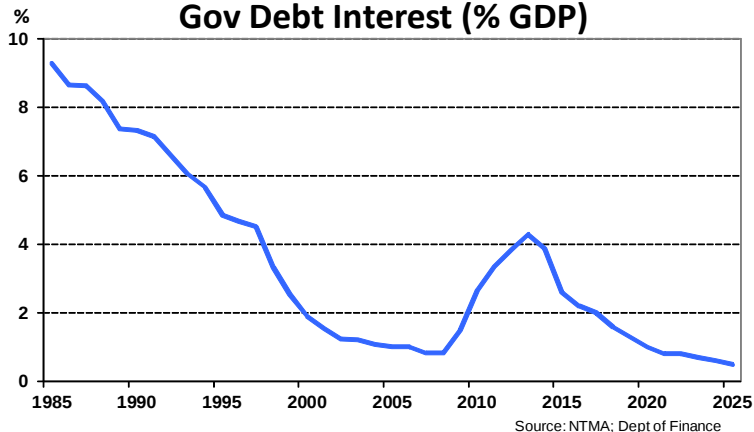
Irish Household Debt Ratio



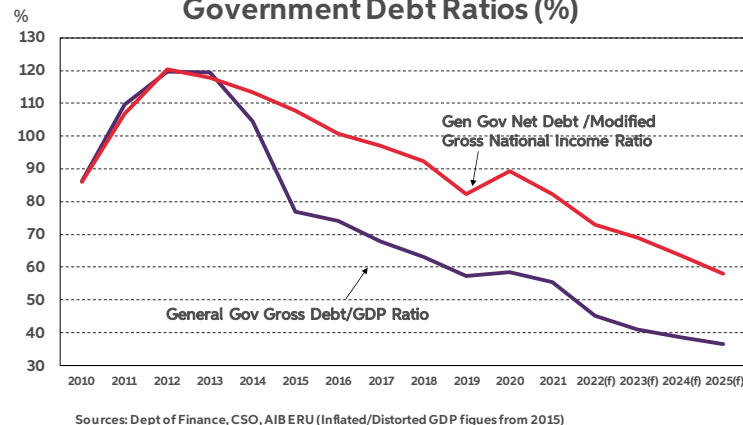
Irish Private Sector Credit (Inc Securitisations) as % GNI*



Gov Debt Interest (% GDP)



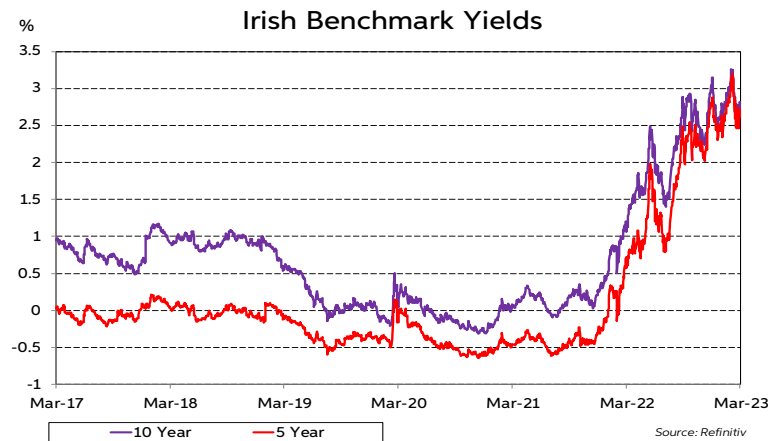
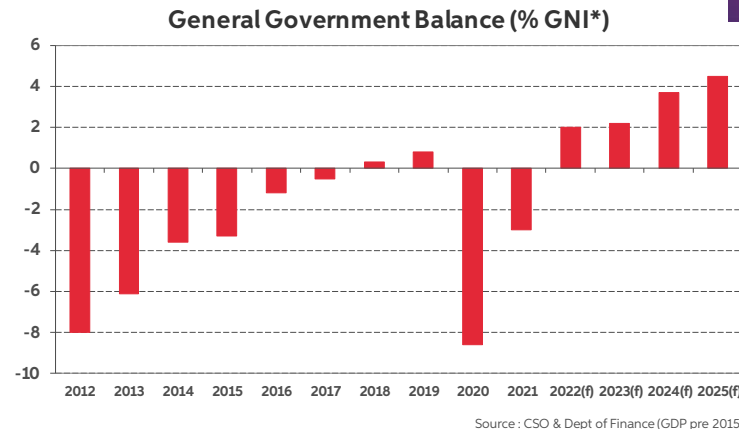
Government Debt Ratios (%)



Strong growth sees public finances return to surplus



- Budget deficits in 2020 and 2021 owing to COVID
- Tax revenues rose very strongly across the board in 2022; up 21.5% after a 20% rise in 2021
- Budget target was a deficit of €8bn for 2022, but a surplus of €5bn was recorded (2% of GNI*)
- Government provides some temporary energy support payments for households and firms
- Budget surplus targets of 2.2% and 3.7% of GNI* set for 2023 and 2024, respectively
- Good start to 2023, with tax receipts up 14.6% to end March and budget surplus continuing to rise
- Budget surplus looks set to exceed target in 2023
- Gov. Debt ratios falls sharply – at 73% of GNI*
- Irish bond yields rise sharply as elsewhere
- Budget surpluses, very large cash balances and long-dated debt mean very little funding needed
- Irish sovereign debt ratings; S&P AA-, Fitch AA-, Moody's A1. Fitch & Moody's upgraded in 2022

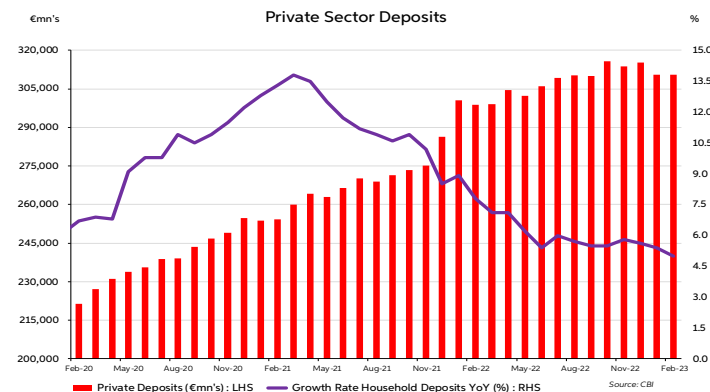


Good growth likely in 2023 despite headwinds & capacity issues



- Mounting headwinds and capacity constraints, but solid growth expected by Irish economy in 2023-24
- Strong data in Q1 2023 – PMIs, tax receipts, car sales
- FDI inflows continuing, boosting investment, exports and employment – good pipeline in 2023
- Fiscal policy to remain supportive of growth – Budget has 5-6% rise in core gov. spending in 2023 and 2024
- Economy has deleveraged; low private sector debt
- A rundown of some of the 44% surge in private sector deposits during 2020-2022, could support spending
- High inflation, rising rates and slowing global growth are significant headwinds, though, for Irish economy
- Capacity constraints emerging also – housing, labour, electricity, water, infrastructure, planning laws
- GDP growth to slow from 12% in 2022. Recent official forecasts are for 5%+ growth in 2023-24
- More moderate growth rates expected for modified domestic demand in 2023-24

OECD Global GDP Forecasts (Mar 2023)				
% Vol	2021	2022	2023	2024
World	5.9	3.2	2.6	2.9
US	5.9	2.1	1.5	0.9
Eurozone	5.3	3.5	0.8	1.5
UK	7.6	4.0	-0.2	0.9
Japan	2.2	1.0	1.4	1.1
China	8.1	3.0	5.3	4.9



AIB Irish Economic Forecasts



<i>% change in real terms unless stated</i>	2020	2021	2022	2023 (f)	2024 (f)
GDP	6.2	13.6	12.0	4.0	3.7
GNP	2.7	14.7	6.7	3.5	3.3
Modified Final Domestic Demand	-6.1	5.8	8.2	3.0	2.8
Personal Consumption	-10.9	4.6	6.6	3.0	3.0
Government Spending	11.6	6.5	0.7	2.3	2.0
Fixed Investment**	-16.5	-39.0	25.9	3.5	3.0
Exports	11.2	14.1	15.0	6.0	5.0
Imports**	-2.1	-8.3	19.0	4.5	5.0
Employment (%)	-2.8	6.2	6.8	1.5	1.5
Unemployment Rate (%)	5.9	6.3	4.5	4.8	5.0
HICP Inflation (%)	-0.5	2.4	8.1	5.0	2.5
Budget Balance (GGB % GNI*)	-8.6	-3.0	2.0	2.2	3.7
Gross General Gov Debt (% GDP)	58.4	55.3	45.0	41.0	39.0
Net General Gov Debt (% GNI*)	89.3	82.2	73.0	69.0	63.5

Changes to Global Corporate Tax Regime



Importance of FDI:

- Some 1,800 multinational companies are based in Ireland, accounting for over 300,000 jobs in direct employment
- Corporation tax receipts of €22.6bn in 2022 or 27% of total tax revenue – well over 80% comes from MNCs

Changes to Corporate Tax Regime Agreed:

- Ireland's 12.5% corporate tax rate in place for last two decades and a key cornerstone in attracting FDI
- Ireland signs up to OECD proposal of minimum global corporate tax rate of 15% for very large companies
- Also larger multinationals, mainly digital, to pay some taxes on profits in countries where sales made
- DoF has allowed for a €2bn hit to Irish corporation tax receipts from changes to global tax system
- Ireland retaining its 12.5% rate – will be 2.5% top-up for larger companies. Takes effect from 1 Jan 2024 in line with EU
- Close watch still needs to be kept for any changes in US Corporate tax rate on companies overseas earnings (Gilti rate)
- Doubts also remain about whether all countries will ratify the new Global Corporate tax deal, most notably the US

Ireland to Remain Attractive FDI Location :

- Ireland's main competitor for FDI has been UK, but it is now out of EU, Single Market & Customs Union
- Ireland has many other attractions –English speaking, well educated mobile workforce, common law legal system
- Key industries have large presence in Ireland, with its strong pro-enterprise culture, leading R&D and innovation
- Irish rates still comparatively low by European standards. UK rate being raised from 19% to 25% in 2023
- Strong inflows of FDI continue despite the changes to global corporate tax rules. Brexit may be helping inflows

Risks to the Irish economy outlook



- Very open Irish economy vulnerable to weaker global outlook, including FDI inflows, with concerns about downsizing in the tech sector in particular given big presence in Ireland
- High inflation and rising interest rates will weigh on Irish activity in 2023, as elsewhere
- Very reliant on energy imports so could be impacted by disruptions to European gas supplies
- Covid-19 retreats as a risk, but concerns remain about possible new variants
- Changes to US corporation (Gilti) tax regime still possible, with negative impact on FDI here
- Supply constraints in new house building activity, with output still at low levels, falling starts
- Other capacity constraints emerging – labour, electricity, water, infrastructure, planning laws
- Competitiveness issues - high house prices, high rents, high personal taxes, high wages & prices
- Credit constrained – tight lending rules, on-going deleveraging, subdued 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 Allied Irish Bank Northern Ireland (NI). 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 Allied Irish Bank (NI) 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.