The Irish Economic Update

Good growth continues in H1 2019, but some soft spots start to emerge

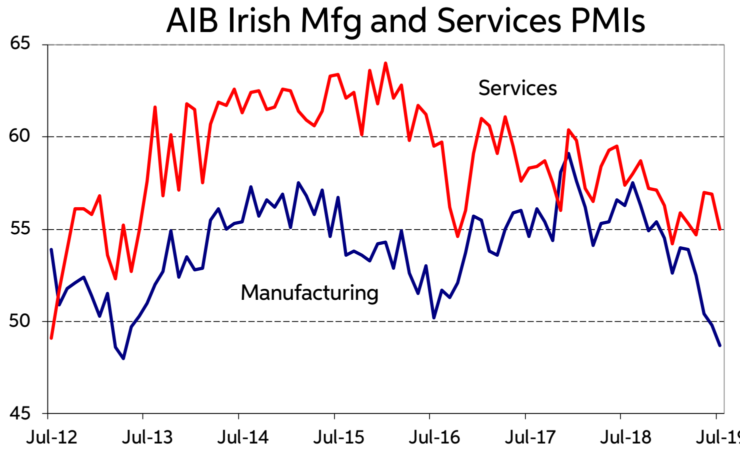
August 2019

Oliver Mangan
Chief Economist
AIB

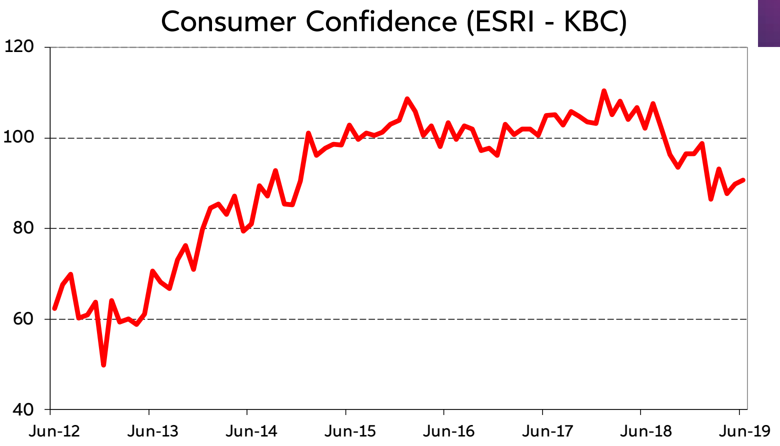
Strong growth by Irish economy in 2013-2018 period

- Irish economy boomed from 1993 to 2007 with GDP up by over 250% – Celtic Tiger
- Very severe recession in Ireland in 2008-2009. GDP fell by 8.5% and GNP down 11%
- 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 over 25% higher than in 2001, highlighting that the economic crash came after a long period of very strong growth
- Ireland tackled its problems aggressively in the public finances, banking sector and property market. Imbalances in economy unwound – housing, debt levels, competitiveness, BoP
- Ireland focused on generating growth via its large export base as the route to recovery
- Economy grew very strongly over 2013-18 – underlying growth averaged 4.5% for the period
- Domestic economy has recovered strongly, led by rebound in investment and retail spending
- Strong jobs growth. Unemployment rate fell from 16% in early 2012 to 4.5% at mid-2019
- Budget deficit eliminated at a quicker than expected pace. Moved into surplus in 2018

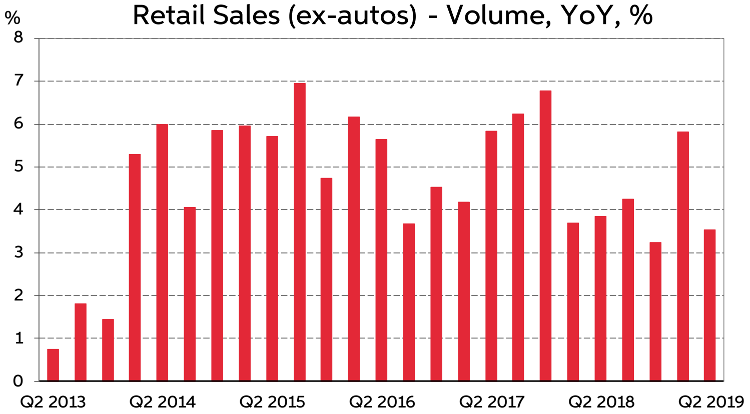
Mainly good data in 2019, but manufacturing slows



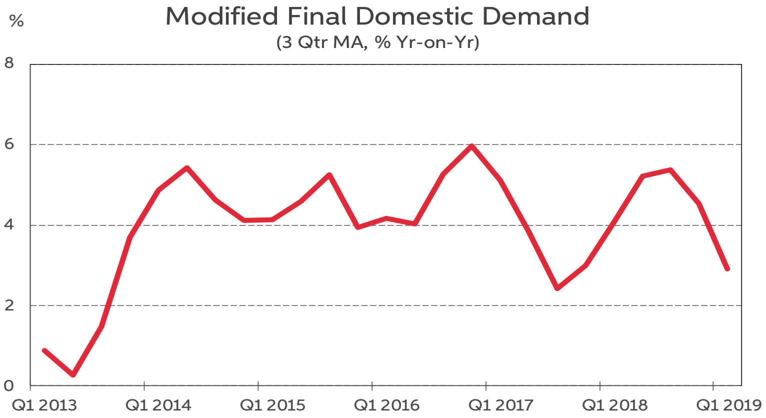
Source: *Thomson Datastream*



Source: ESRI - KBC, Thomson Datastream



Source: *Thomson Datastream*



Source: CSO (Excludes I.P. imports & Aircraft Leasing) via Thomson Datastream

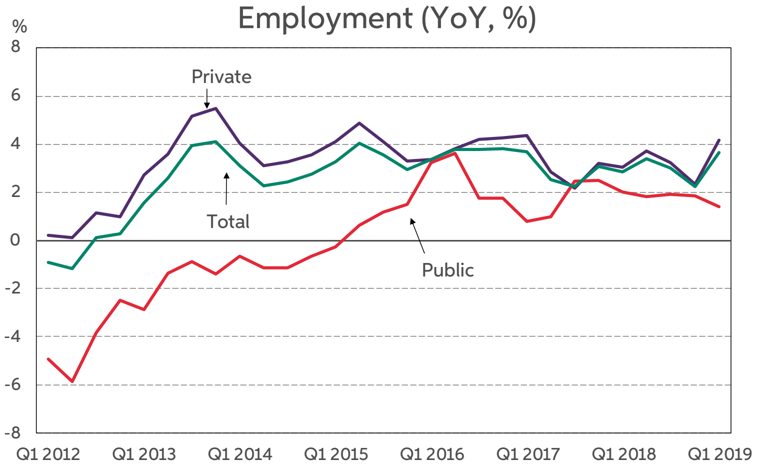
Most indicators remain strong, but some have softened

- Continuing very strong jobs growth – employment rose by 3.7% yoy in Q1 2019
- Unemployment rate falls to 4.5% by mid-year from 5.5% at end 2018. Live Register decline continues
- Further good rise in housing completions in Q1 2019– up 23% yoy
- Uptrend in housing commencements and registrations, though, has slowed year-to-date
- Mortgage lending slows to 11% yoy in H1 2019. Mortgage approvals have picked up recently
- Construction PMI averages a strong 56 in H1 2019 – housing PMI at a very robust 59.7
- Retail sales (ex-motor trade) up 4.7% yoy in H1 2019
- Total car registrations (new + second hand imports) down 3.6% yoy in H1 2019
- Manufacturing PMI remains weak – at a 6-year low level of 49.8 in July
- Services PMI, though, continues to point to robust growth – at 55 in July
- Consumer confidence well off last summer's highs. Near four year lows, though still at good level
- Impressive yoy growth of 8% in tax receipts in year to July, while budget surplus rises

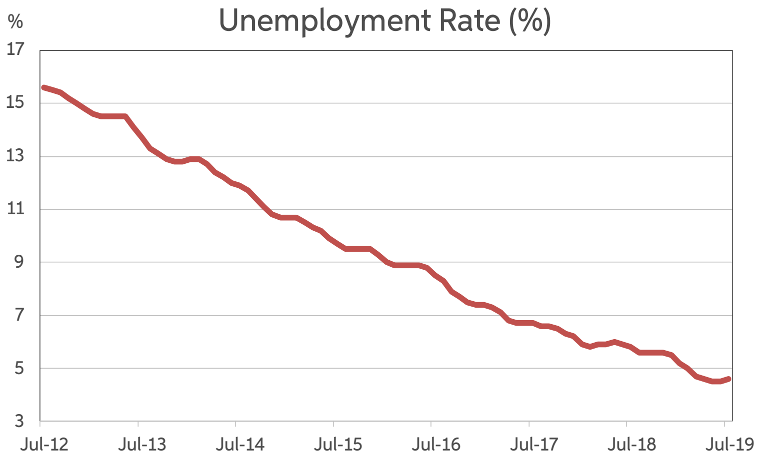
Strong jobs growth; unemployment rate down to 4.5%

Year Average	2016	2017	2018	2019(f)	2020(f)	2021(f)
Unemployment Rate %	8.4	6.8	5.8	4.8	4.4	4.2
Labour Force Growth %	1.9	1.1	1.8	2.5	2.0	1.8
Employment Growth %	3.7	2.9	2.9	3.6	2.4	2.0
Net Migration : Year to April ('000)	16.2	19.8	34.0	40.0	45.0	50.0

Source: CSO and AIB ERU forecasts



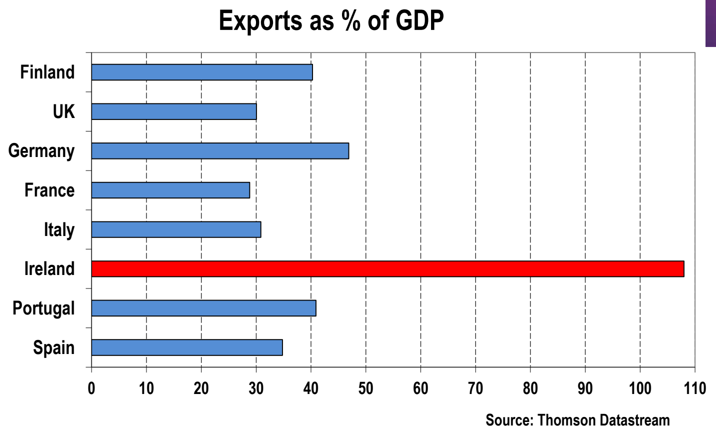
Source: CSO via Thomson Datastream

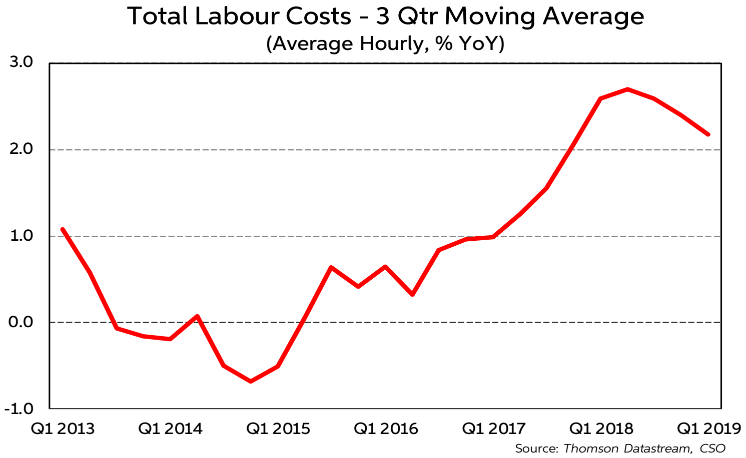


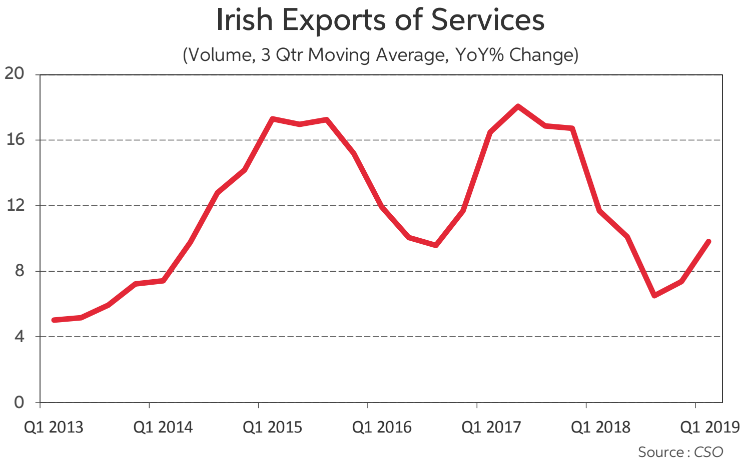
Source: CSO via Thomson Datastream

Large Irish export base performing very well

- Ireland a very open economy – exports, driven by enormous FDI, equate to well over 100% of GDP
- Major gains in Irish competitiveness earlier in decade - weakening of euro also helpful
- Exports have risen strongly, helped by large FDI inflows and recovery in global economy
- Total exports up by 10.4% in 2018, with a further strong rise of 13.8% yoy in Q1 2019







FDI and the Irish economy

WHAT ATTRACTS FDI TO IRELAND?

- Access to European markets
- Low corporate tax rate of 12.5%
- English speaking country
- Well educated, flexible workforce
- Common law legal system
- Stable political framework
- Long history of successful FDI
- Access to decision makers

KEY FDI IMPACTS ON THE IRISH ECONOMY

- Some 1,200 multinational companies
- €189bn in Exports
- 230,000 Jobs in FDI, 390,000 in total
- €7bn in Corporation Tax (67% of total)
- 33% of State's income tax/PRSI/USC
- €13.2bn Spending on Irish services/materials
- €11.7bn in Payroll
- 67% of Business R&D expenditure

WORLD LEADERS CHOOSE IRELAND

- 17 of the top 20 in ICT
- 10 of the top 10 in Pharmaceuticals
- 14 of the top 15 in Medical Devices
- 8 of the top 10 Industrial Automation
- 10 of the 'top born on the Internet' firms
- 20 of the top 25 Financial Services firms
- UK becoming less attractive for FDI owing to Brexit

US TAX CHANGES SHOULD NOT HIT FDI

- US firms have well established operations here
- Need highly skilled, multi-lingual workforce
- Firms do not move Ireland to avoid US tax
- Ireland is base to service their European markets
- Easier to operate in local rather than US time zone
- Still wide gap between US & Irish corporate tax rates
- Very strong year for FDI in 2018

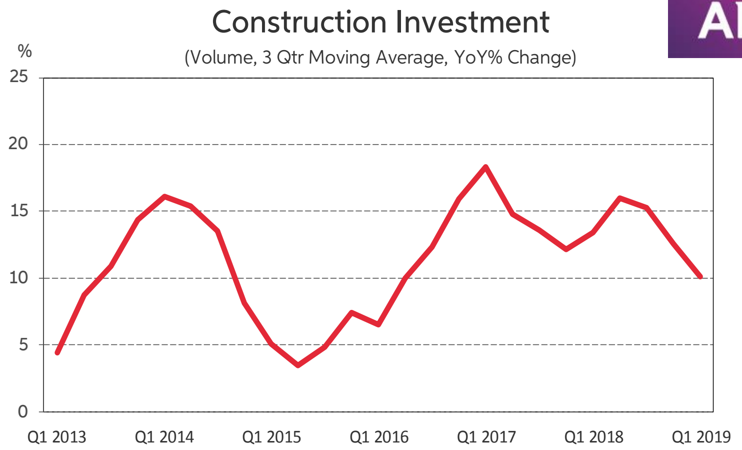
Many top global companies have big operations in Ireland

AIB

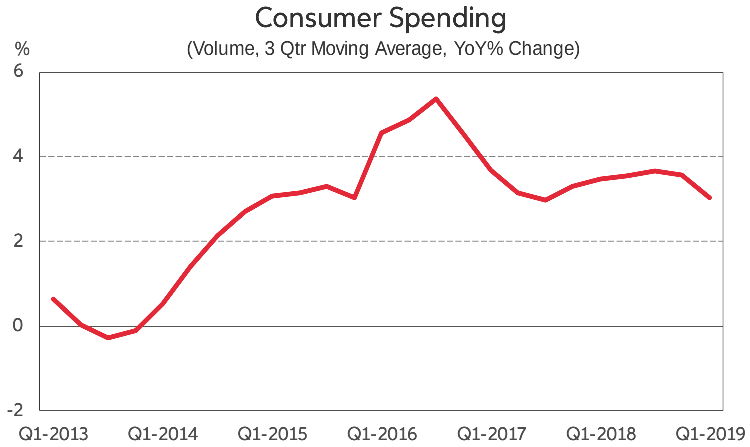
ebay
Abbott
Pfizer
Boston Scientific
Google
gsk GlaxoSmithKline
citi
ZURICH
BNY MELLON
DELL EMC
f
IBM
intel
Microsoft
ANALOG DEVICES
SAP
NOVARTIS
SIEMENS
accenture
Johnson & Johnson
STATE STREET

Strong performances across domestic economy

- Domestic economy contracted by 20% in period from 2008-2012, with particularly big fall in construction
- Construction sees strong recovery since 2013. Output up nearly 12% on average in last three years
- Output in construction rose 7.4% yoy in Q1 2019
- Core business investment (ex aircraft/intangibles) up 1.2% yoy in Q1 2019 – strong recovery since 2013
- Consumer spending grew by 3.5% on average over 2014-2018 period. Up by 2.9% yoy in Q1 2019
- Core retail sales rose by a strong 3.9% in 2018, and were up by 4.7% yoy in H1 2019
- Total car regs (new + used imports) rose to high levels in 2017-18, but down 3.6% yoy H1 2019
- Overall, modified final domestic demand has averaged growth of 4.4% over the 2014-2018 period



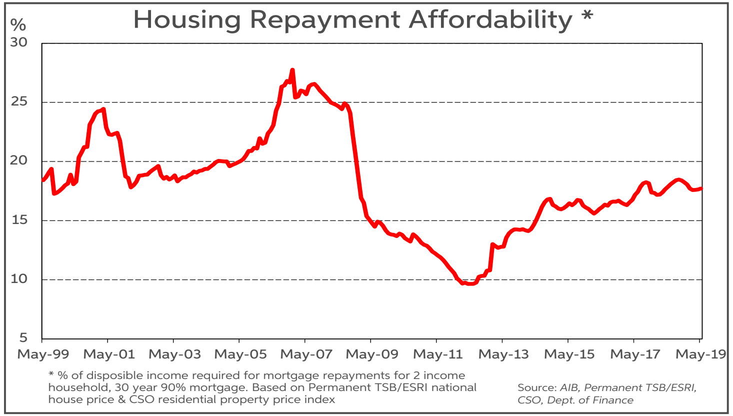
Source : CSO via Thomson Datastream



Source: CSO

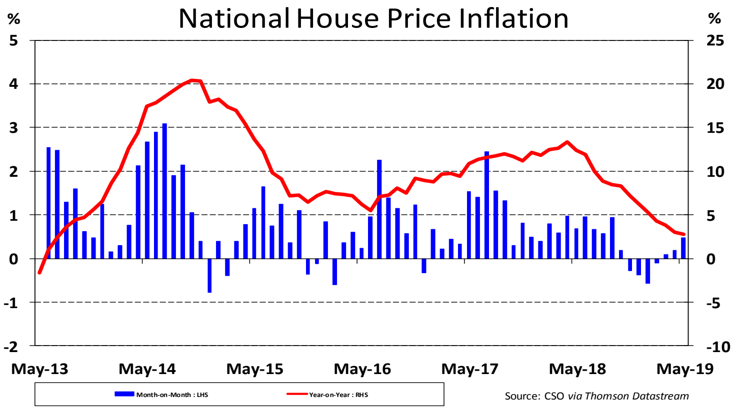
House building on the rise, but still at quite a low level

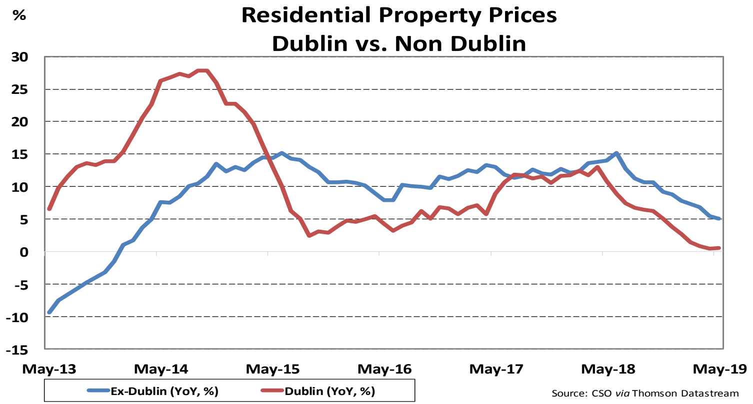
- Housing completions up 23% yoy in Q1 2019 - rose by 25% to over 18,000 in 2018
- However, marked slowing in new housing registrations and commencements during H1 2019
- Fall back in planning permission in Q1 2019, but partly reflects impact of base effects
- Measures put in place to boost new house building. More involvement of Local Authorities and NAMA
- Housing output still running well below annual new housing demand, estimated at 35,000 units
- Could be at least 2022 before output rises to this level
- Mortgage lending +20% in 2018, but slowed to 11% in H1 2019. Mortgage approvals pick up year-to-date
- Affordability improved recently. Reflects moderating house price inflation and good earnings growth



House price inflation slows sharply in past year

- 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 house building
- Prices up 82% by May 2019 from low in March 2013 –Dublin prices up by 92%, non-Dublin rise 80%
- But house prices still some 20% below 2007 peak
- House price inflation slowing sharply as Central Bank lending rules and affordability impact
- Prices up 2.8% yoy nationally in May 2019, down from high of 13.3% in April 2018
- Dublin up 0.5% yoy in May, down from 13% in Apr '18; non-Dublin slows to 5.6% from 15.2% last June
- Rents have also rebounded strongly – are now 28.7% above previous peak reached in 2008, per CSO data





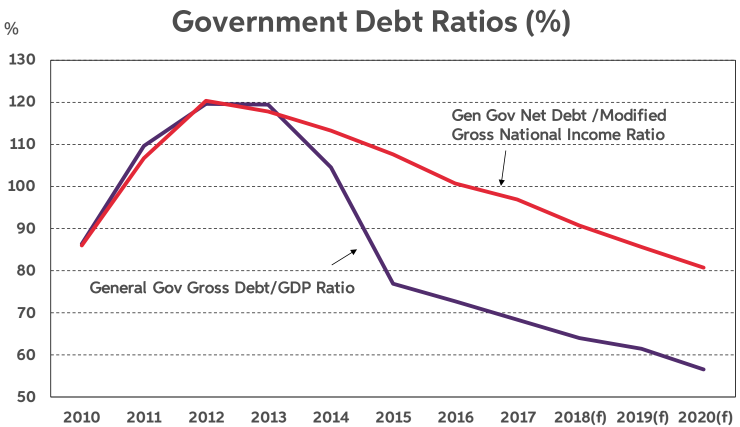
AIB Model of Estimated Housing Demand

- 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 2016-2020 – 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 2016-20

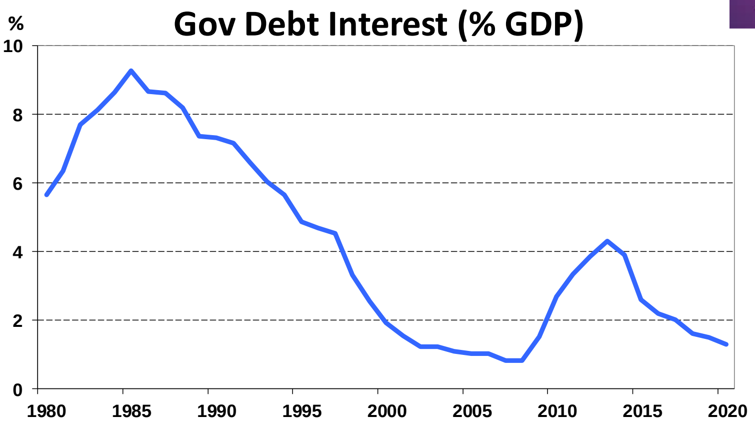
Calendar Year	2016	2017	2018	2019	2020
Household Formation	26,500	26,500	26,500	27,500	27,500
of which					
Indigenous Population Growth	*18,000*	*18,500*	*17,500*	*16,500*	*14,500*
Migration Flows	*8,500*	*9,500*	*12,000*	*13,000*	*13,000*
Headship Change*	*0*	*0*	*0*	*0*	*0*
Second Homes	500	500	500	500	500
Replacement of Obsolete Units	5,000	5,000	5,000	5,000	5,000
Estimated Demand	**32,000**	**33,500**	**35,000**	**35,000**	**33,000**
Completions	**9,900**	**14,400**	**18,100**	**22,000**	**26,000**
Shortfall in Supply	***-22,100***	***-19,100***	***-16,900***	***-13,000***	***-7,000***

**Headship is % of population that are heads of households.* *Sources: CSO, DoECLG, AIB ERU*

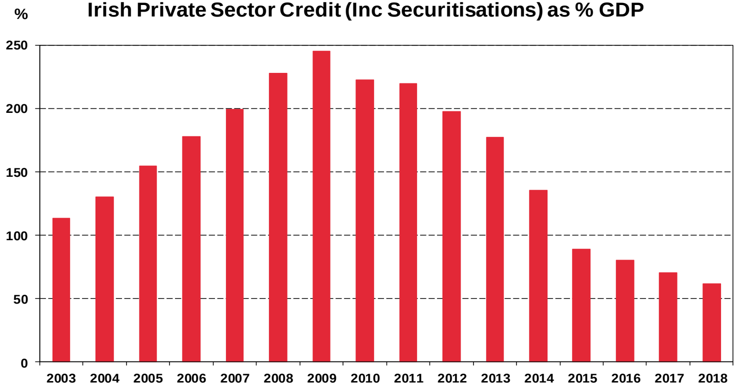
Govt debt ratios fall, private sector deleverages



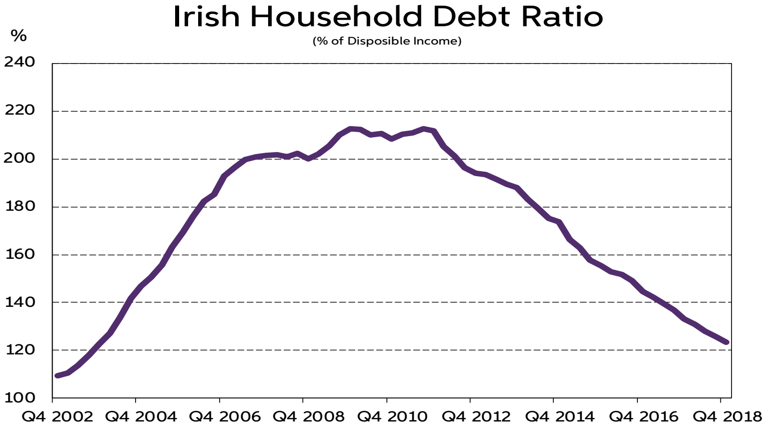
Sources: Dept of Finance, CSO, AIB ERU (Note Inflated/Distorted GDP figues from 2015)



Source: NTMA; Dept of Finance



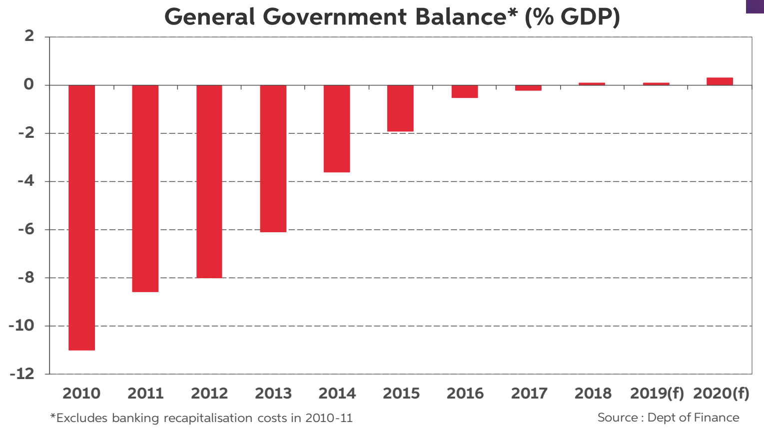
Sources: Central Bank, CSO, AIB ERU Calculations (Note Inflated/Distorted GDP figs for 2015-18)

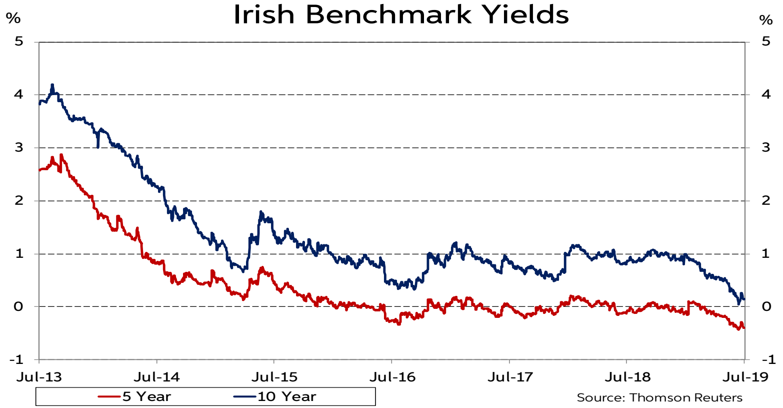


Source: CSO, Central Bank, AIB ERU

Government finances back in surplus

- Some €30bn (18% of GDP) of fiscal tightening implemented in 2008-2014 period
- Budget deficit has fallen sharply over past decade. Fell to 0.2% of GDP in 2017
- A small surplus was recorded in 2018, estimated at 0.1% of GDP
- Primary budget surplus (i.e. excluding debt interest) of 1.5% of GDP in 2018
- Debt interest costs low – at 1.5% of GDP
- Government aims to maintain the budget in surplus in coming years
- Public finances close to target in year to July – tax receipts up by 8%, surplus rises
- Gross Gov Debt/GDP ratio has fallen sharply
- Irish bonds yields at very low levels
- Sovereign debt ratings upgraded; S&P have Ireland at A+, Fitch at A+, Moody's A2





Brexit expected to lower growth rate of Irish economy

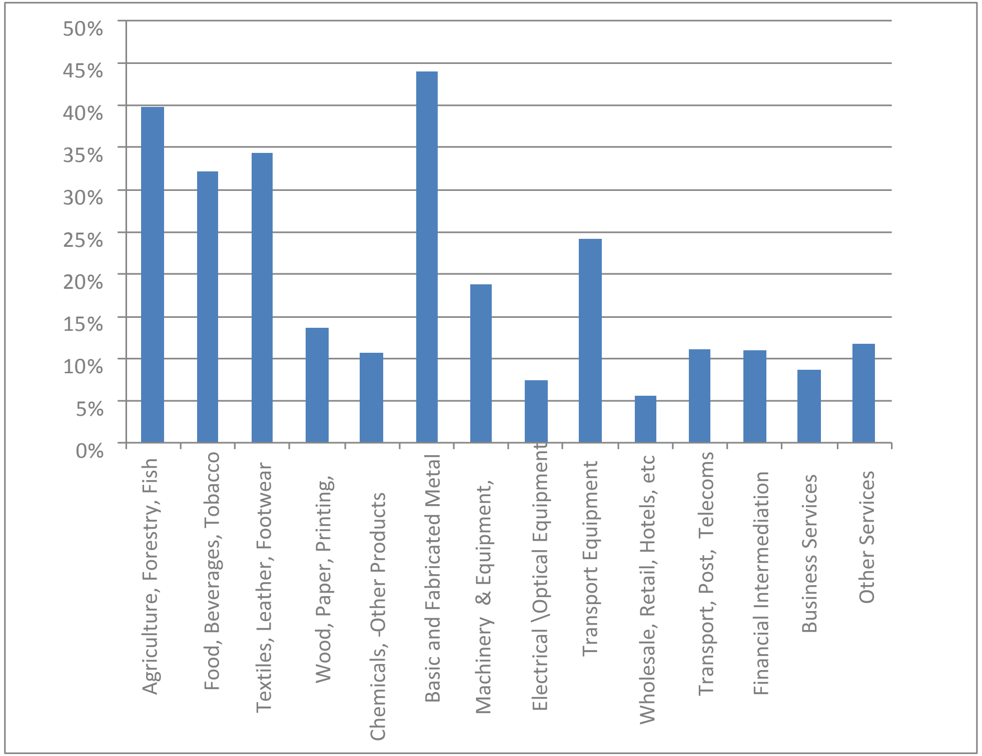
- **ESRI** estimate that Irish output would be reduced over time by **2.6% under a ‘deal’ scenario** in the long run (i.e. after 10 years). Unemployment rate is 1 percentage point higher
- In a ‘**disorderly no deal’** scenario, ESRI estimates that GDP would be **5% lower** after 10 years Unemployment rate would be 2 percentage points higher
- Sharp fall-off in trade with UK likely on a no-deal Brexit, with this **shock front loaded,** with around half of the impact on trade taking place in the two years
- **Central Bank** say a disorderly hard Brexit could reduce Irish growth by 4% in first year and 6% in long run

- **Copenhagen Economics** Report considered costs of regulatory divergence for goods and services and of border checks, as well as tariffs in assessing impact of Brexit
- Estimates impact by 2030 is to reduce Irish GDP by 2.8% under a soft Brexit (EEA), 4.3% in a FTA and 7% in a no-deal, hard Brexit WTO scenario

Agri. sector would be severely impacted by hard Brexit

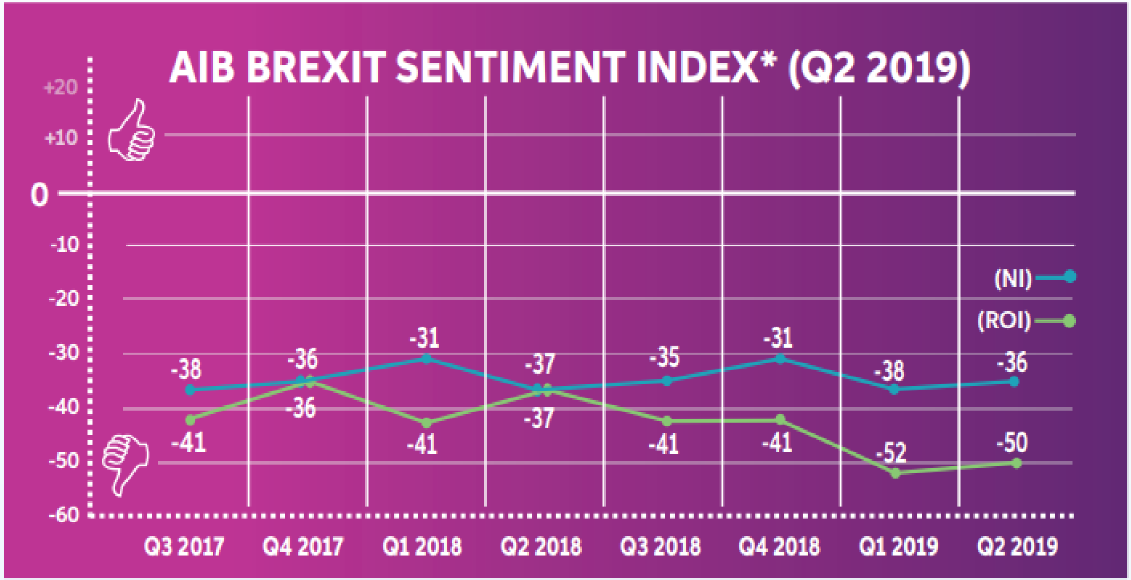
- Main EU tariffs relate to food products, keeping prices high. UK may impose tariffs on EU food imports post Brexit
- Food and Beverages account for 25% of total Irish exports to UK
- Around 40% of Irish food exports go to the UK
- Other sectors very dependent on UK market include machinery and transport, metal products, textiles
- Some 40% of indigenous Irish exports go to UK compared to 10% for foreign owned companies

Share of Exports by Industry Destined for the UK (ESRI)



AIB Brexit Sentiment Index – Q2 2019

- A total of ***700 SME's (with up to 250 employees)*** across the island of Ireland



Source: Ipsos MRBI

*The Index reflects and measures the sentiment of Irish SMEs in the Republic of Ireland and Northern Ireland towards Brexit, summarised as a single number, with a potential range from +100 to -100. It takes the difference between the positive and negative responses across four key measures: Impact on business now, Impact on future business (next 5 years), Level of visibility and, finally, the Wider economic impact of Brexit.

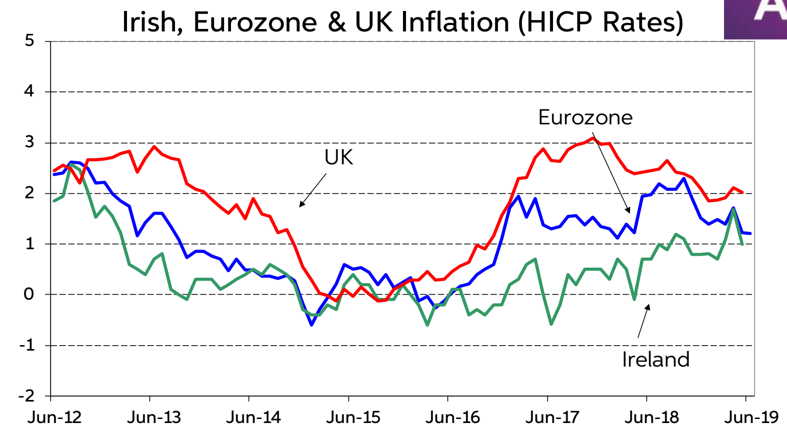
- **Slight improvement in headline index in Q2 but number of firms reporting negative impact of Brexit is having on their businesses increased in both ROI and NI**
- **SMEs also remain concerned about Brexit's impact in the future, both on their own business & the wider economy**
- **Manufacturing, Food & Drink, Tourism and Retail sectors most concerned about Brexit**
- **40% of RoI and 38% of NI firms who had investment plans say they have been cancelled or postponed owing to Brexit.**

Still much uncertainty about Brexit

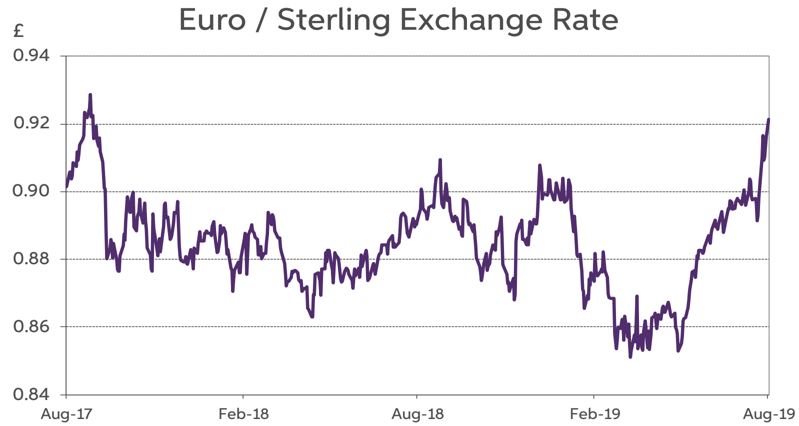
- Departure date delayed as UK Parliament could not agree on an exit deal
- The Withdrawal Agreement (WA) rejected by UK Parliament on three occasions
- UK Parliament has voted by large majority against leaving EU without a deal
- EU grants extension to Article 50 up to end October – another cliff-edge Brexit date
- New PM Johnson says he wants the UK to leave by end October, with or without a deal
- Parliament against leaving the EU without a deal so logjam persists in UK
- Appear to be 4 options (1) No deal exit (2) Remain (3) Extend again (4) Agree Soft Brexit
- Possible developments: default hard Brexit, general election, new referendum,
- EU likely to need solid grounds to give UK further extension e.g. new referendum
- WA only sets the departure terms. Difficult talks on future trade relationship to follow after UK has left the EU. No clear idea what future trade relationship will look like

Good Irish growth can continue if external risks avoided

- Irish economy should continue to grow at impressive pace, but not as strongly as in recent years
- Construction picking up from still low output levels
- Public spending on the rise
- Activity supported by low interest rate environment
- Good growth in household incomes
- Continuing strong inflows of FDI
- Irish inflation still very low
- However, Brexit is a challenge for the economy
- Important also that global economy avoids downturn
- GDP growth forecast at 4.0% for 2019 and 3.25% in 2020, assuming hard Brexit/global downturn avoided
- ESRI estimates medium-term growth rate of economy at around 3.25% in the period 2020-2025



Source: Thomson Datastream



Source: Refinitiv

AIB Irish Economic Forecasts

% change in real terms unless stated	2016	2017	2018	2019 (f)	2020 (f)
GDP	**3.7**	**8.1**	**8.2**	**4.0**	**3.25**
GNP	9.9	5.1	6.5	3.7	3.0
Personal Consumption	5.2	3.0	3.4	2.8	2.5
Government Spending	3.6	3.9	4.4	4.0	3.0
Core Fixed Investment*	9.2	4.0	13.0	6.0	6.0
Modified Final Domestic Demand*	5.8	2.8	4.7	4.0	3.7
Exports	4.1	9.2	10.4	8.0	5.0
Imports	18.4	1.1	-2.9	8.5	5.5
HICP Inflation (%)	-0.2	0.3	0.7	1.3	1.5
Unemployment Rate (%)	8.4	6.8	5.8	4.8	4.4
Budget Balance (% GDP)	-0.5	-0.2	0.1	0.2	0.3
Gross General Gov Debt (% GDP)	72.8	68.0	64.0	61.0	56.5

*Excludes investment in aircraft and intangibles

Source: CSO, AIB ERU Forecasts

Risks to the Irish economy

- Main risks to Irish recovery no longer internal but external, in particular Brexit
- Brexit major issue for Ireland given its strong trading links with UK and sharp fall by sterling
- Slowing external environment with growing downside risks to global growth from increasing protectionism/tariffs, problems in some emerging economies, weaker EU economy
- Questions around Irish corporation tax regime (Apple ruling, moves on tax harmonisation in EU, cuts in US/UK rates) could impact FDI. Note that Ireland retains the right to set its own tax rates
- Supply constraints in new house building activity, which is recovering at a slow pace with output still at low levels
- Competitiveness issues - high Dublin house prices, high rents, high personal taxes, rising wages
- Credit constraints – tightening of lending rules, on-going deleveraging