The Irish Economic Update:

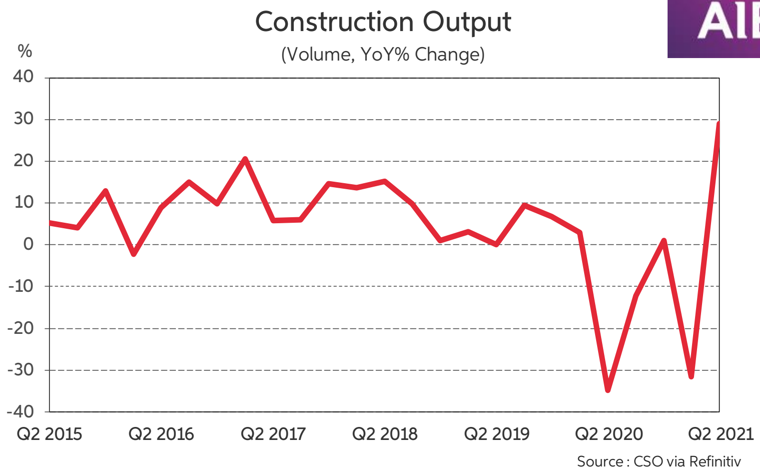
Very strong rebound in activity, but risks remain amid heightened uncertainty

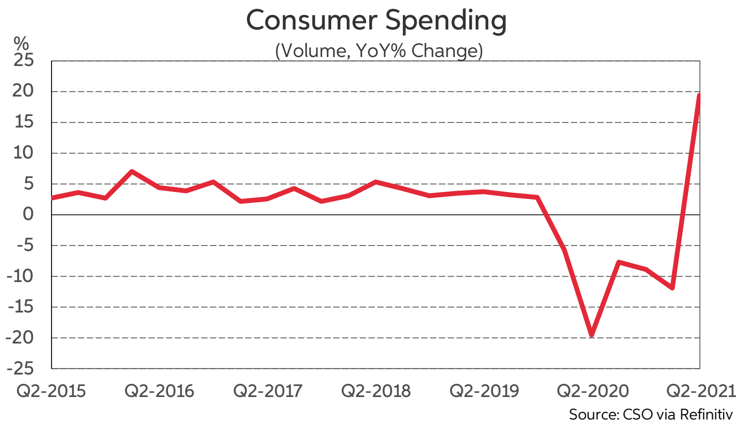
December 2021

Oliver Mangan
Chief Economist
AIB

Economy rebounds strongly post Q1 lockdown

- 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

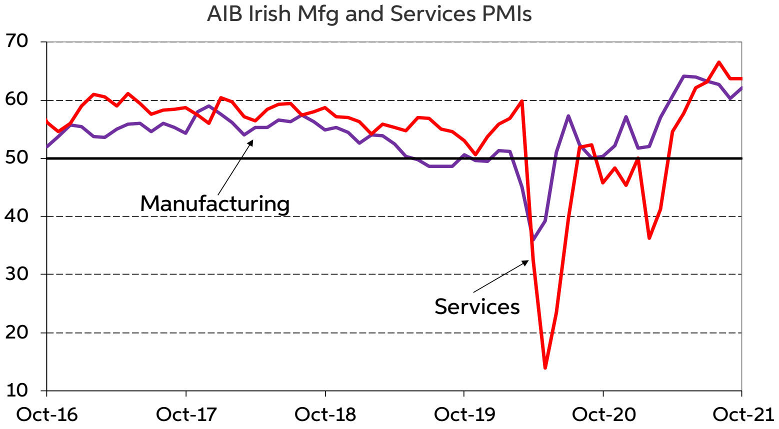




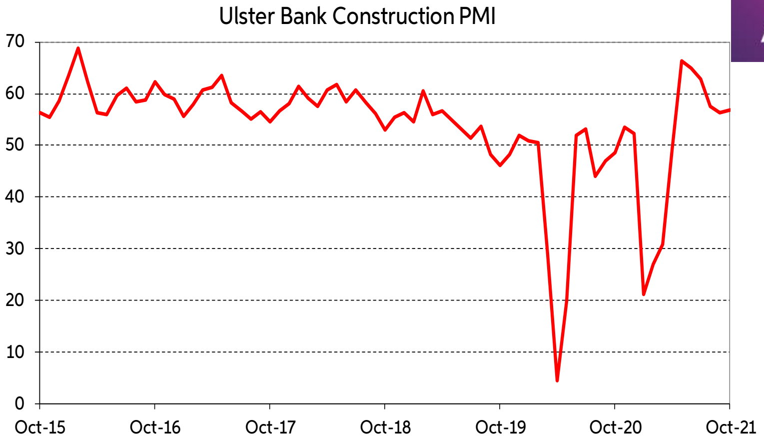
Robust recovery evident across the economy

- Indicators show very strong rebound in activity from Q2 onwards after third lockdown ended
- Mfg PMI hit record high of 64.1 in May, and has stayed above 60 since then. At 62.1 in Oct
- Services PMI jumped to twenty year high of 66.6 in July, at 63.7 in Sept, 63.4 in Oct
- Construction PMI soared in May to 66.4. Still at strong levels of 56.3 by Sept and 56.9 in Oct
- Housing commencements surge. Over 30k in 12 months to September, up from 18k in March
- Big jump of 10% in core retail sales in Q2. Rise by a further 5% in Q3
- New car sales rose by 21% yoy in January-October period
- Tax receipts running well ahead of target – up 20% to end Oct, well above 2019 level also
- Jobless rate (including PUP) falling rapidly – down from 27% earlier in year to 8% by October
- Very strong growth in both labour force and employment in Q2 and Q3 2021
- Inflation accelerating; rises to 5.1% in October from -1.5% a year earlier
- Spike expected to prove temporary. Inflation forecast to fall back to 2% or below by end 2022

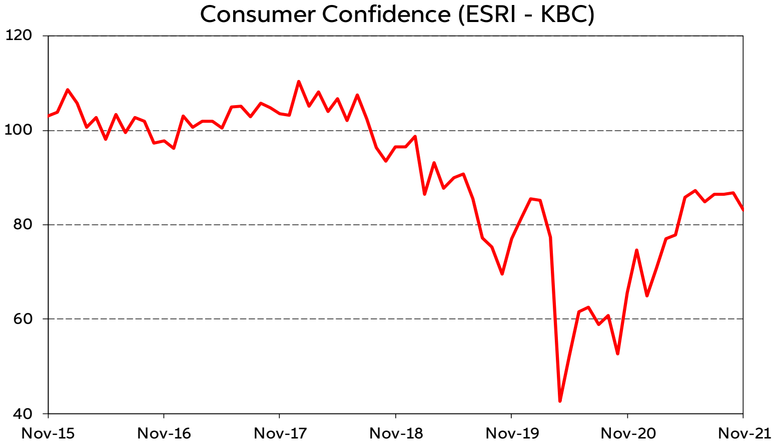
Indicators pick up strongly as economy reopens



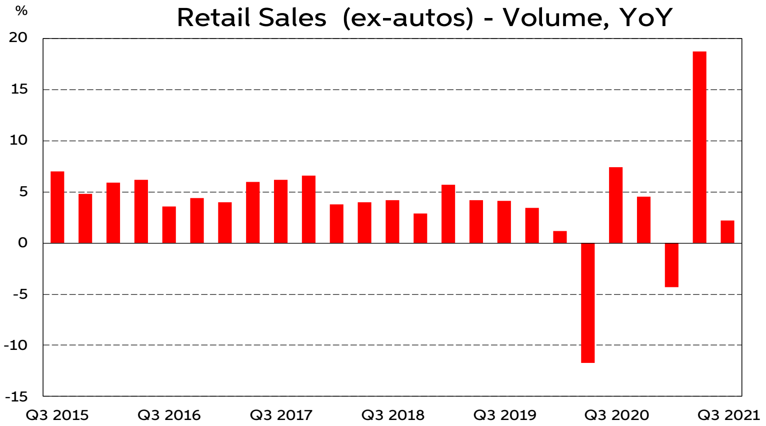
Source: Markit via *Refinitiv*



Source: Refinitiv

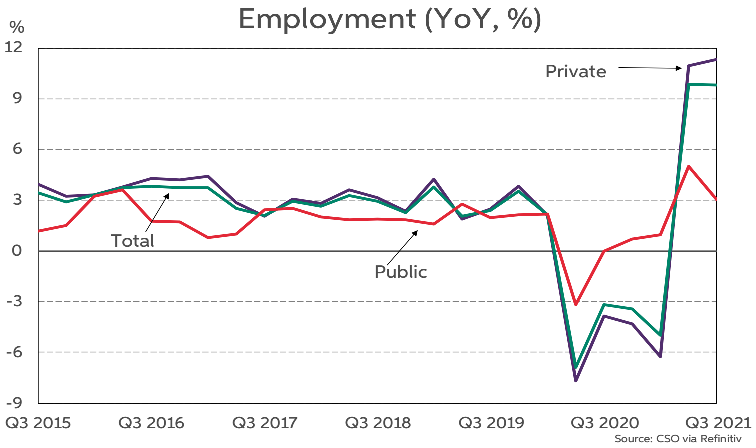


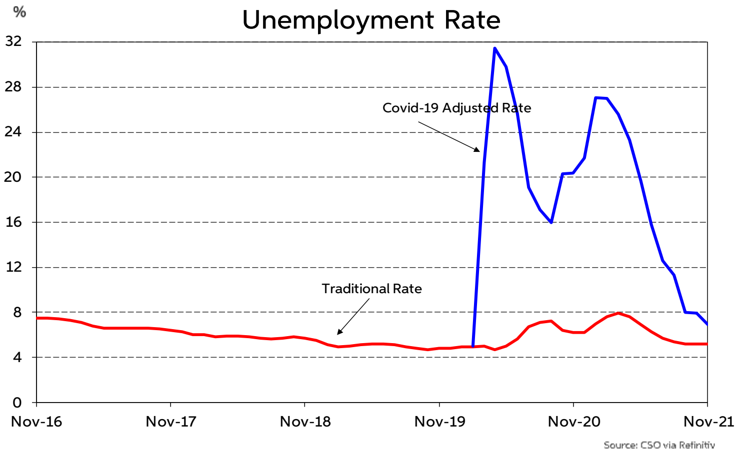
Source: ESRI via Refinitiv

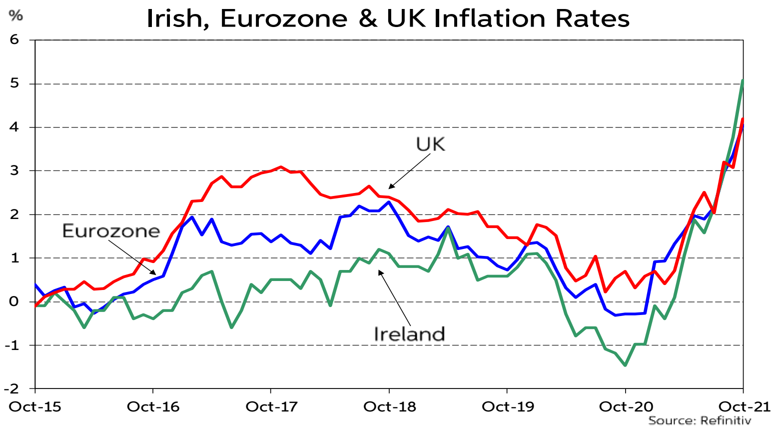


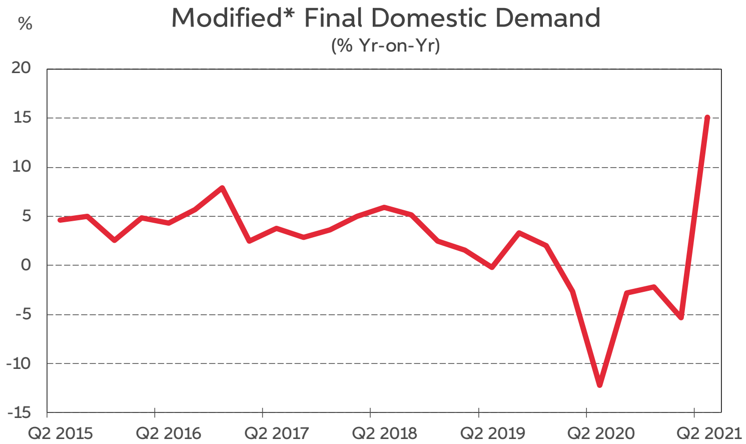
Source: CSO via Refinitv

Unemployment declining rapidly, inflation rising sharply





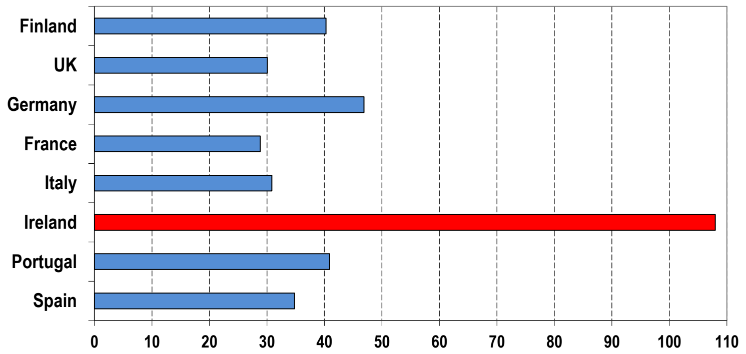




Exports perform impressively throughout the pandemic

- 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

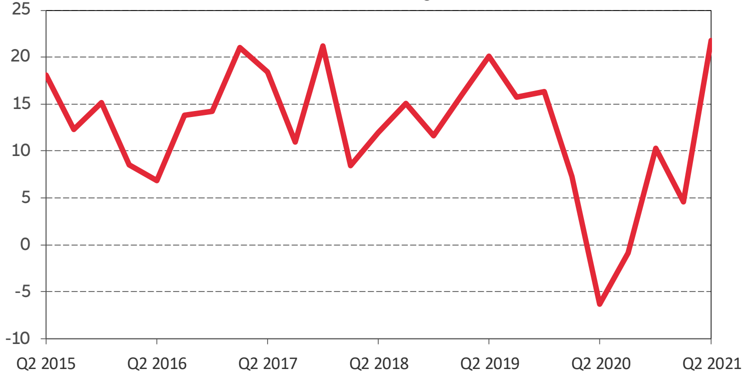
Exports as % of GDP



Source: Thomson Datastream

Irish Exports of Services

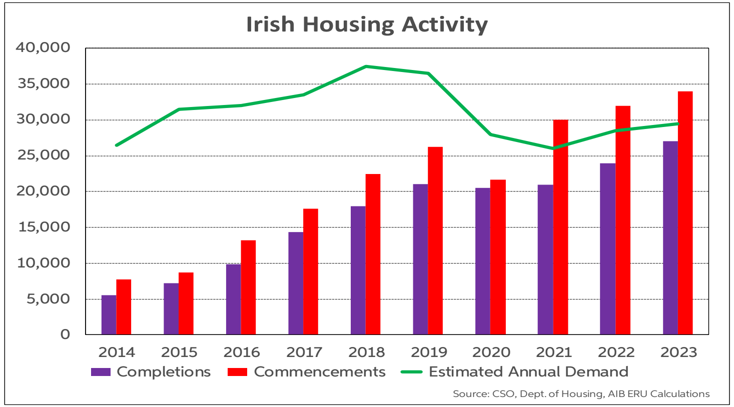
(Volume, YoY% Change)

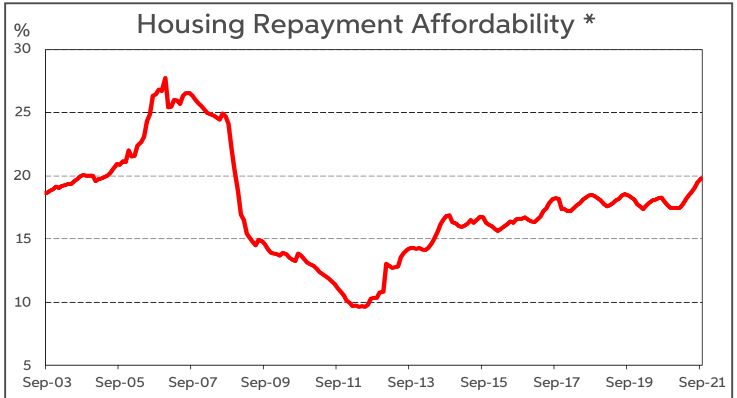


Source : CSO

House building holds up, commencements surge in 2021

- 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 have surged since then with construction reopen
- Commencements jump above 30k in 12 months to Sept
- Smaller than expected fall in completions in Q1 2021 and then recover in Q2 and Q3
- 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 rebounds strongly in 2021
- Forecasts are for a €10bn+ mortgage market this year
- Housing affordability deteriorates as prices rise sharply



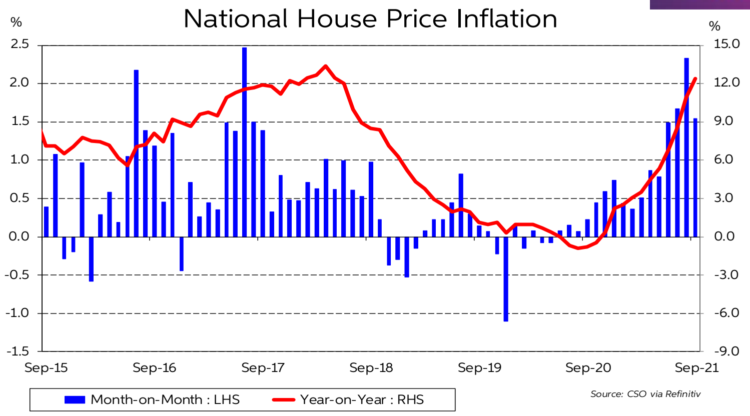


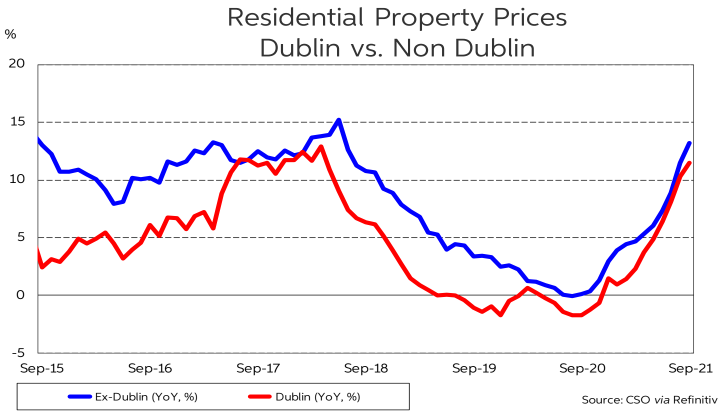
* % of disposable income required for mortgage repayments for 2 average income household, 30 year, 90% LTV, AIB variable mortgage rate. Based on Permanent TSB/ESRI national house price & CSO residential property price index

Source: *AIB, Permanent TSB/ESRI, CSO, Dept. of Finance*

House prices on sharp upward trend

- House prices declined sharply, by 55% over 2007-13
- Prices have recovered strongly; 7.5% below 2007 peak
- CSO data show house prices little changed over 2019-20, until starting to move sharply higher from Q4'20
- Strong rises in house prices in 2021, especially over summer - average monthly rise of 1.75% in June-Sept
- National house price inflation hits 12.4% in September. Non-Dublin prices up 13.2% yoy, Dublin rate at 11.2%
- Property websites show big jump in asking prices since mid-2020, but some signs levelling off recently
- 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. Jump sharply in recent months. Up 7.5% yoy in October





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

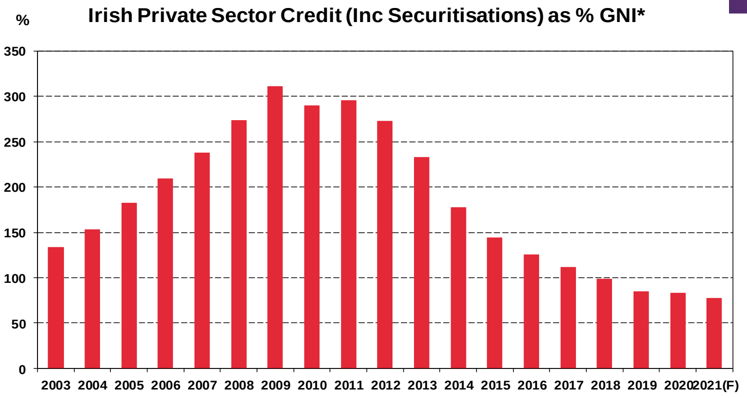
Calendar Year	2019	2020	2021	2022	2023
Household Formation	31,000	22,500	20,500	23,000	24,000
of which					
Indigenous Population Growth	*21,000*	*17,500*	*16,000*	*15,500*	*14,500*
Migration Flows	*10,000*	*5,000*	*4,500*	*7,500*	*9,500*
Headship Change*	*0*	*0*	*0*	*0*	*0*
Second Homes	500	500	500	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.*

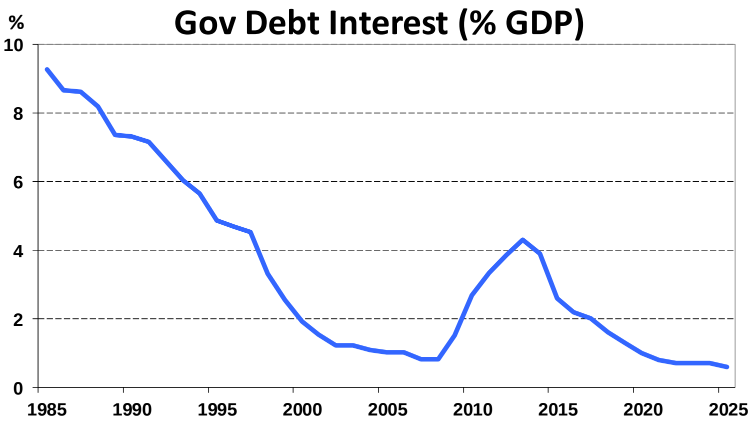
Sources: CSO, DoECLG, AIB ERU.

Private sector deleverages, Gov. debt ratios to resume downtrend

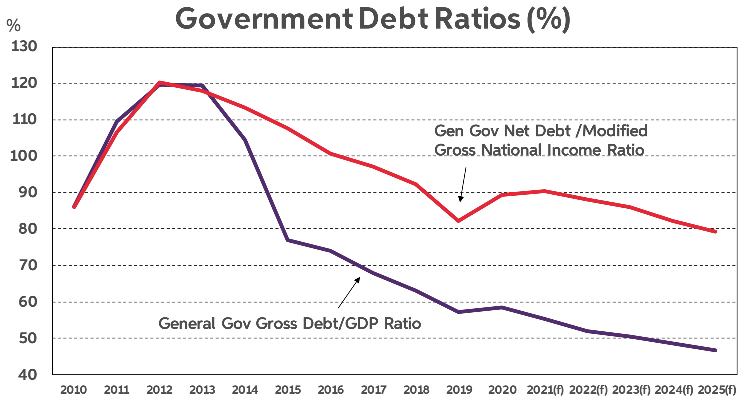
Source: CSO, Central Bank, AIB ERU



Sources: Central Bank, CSO, AIB ERU Calculations



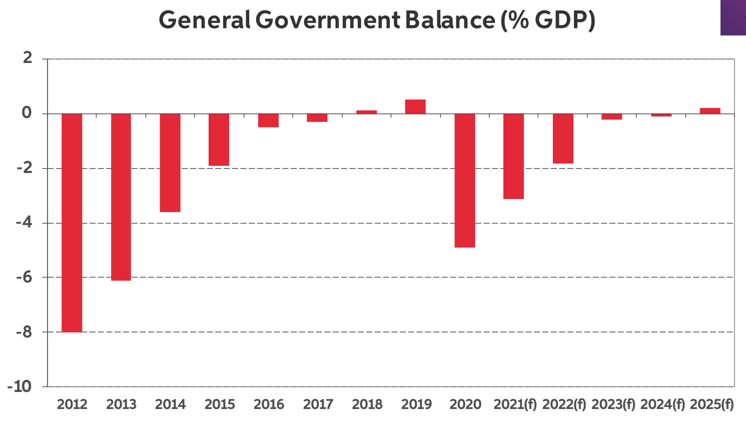
Source: NTMA; Dept of Finance



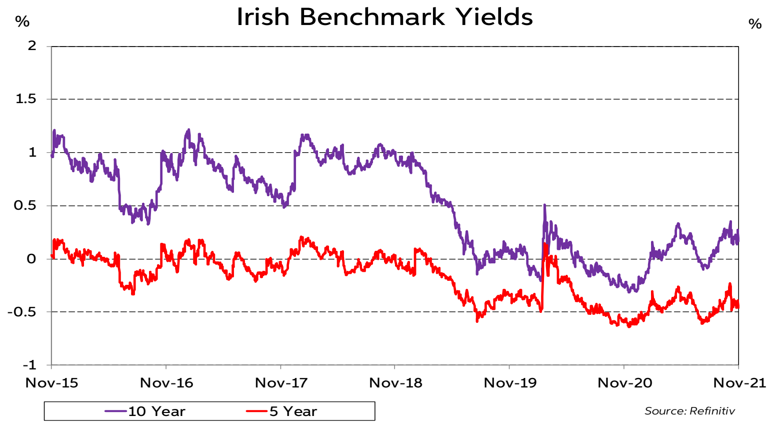
Sources: Dept of Finance, CSO, AIB ERU (Inflated/Distorted GDP figues from 2015)

Budget deficit in sharp decline as economy rebounds

- Budget deficit fell sharply during last decade, with small surpluses recorded in 2018 and 2019
- General Gov budget deficit of €18.4bn in 2020, or 5% of GDP, as Covid-19 hit public finances
- Strong rebound in tax receipts in 2021 – up 20% year-to-date . Covid spending declining
- Dept. of Finance expects budget deficit will be below target in 2021 at €13.25bn (3.1% GDP)
- Deficit forecast at €8.25bn in 2022 & €1.1bn in 2023 as Covid supports end & economy recovers
- Fiscal policy to remain supportive of growth. Rise of 5.0-5.5% in non-Covid spending planned
- Gov. Debt ratios fell in last decade, but moved higher in 2020-21. Downtrend set to resume
- 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



Source : Dept of Finance

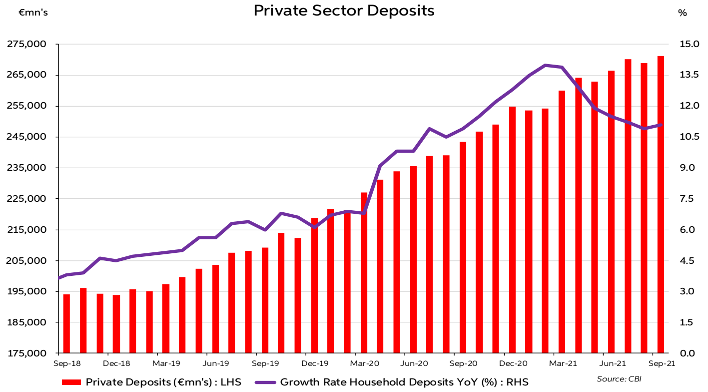


Source: Refinitiv

Strong economic growth likely, though risks remain

- Key ingredients in place for continued strong growth by Irish economy, following sharp rebound this year
- Very high Irish vaccination rates against Covid
- 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 will remain supportive of growth -DoF forecasts provide for 5% p.a. rise in core spending
- Activity aided by continuing very low interest rates
- Economy has deleveraged; low private sector debt
- A rundown of some of the build-up in private savings in 2020-2021 should boost domestic spending
- Strong growth forecast for 2022-2024 period
- However, much uncertainty with high Covid case numbers, uncertainty on global growth, high inflation

IMF Global GDP Forecasts (Oct 2021)			
% Vol	2021	2022	2023
World	5.9	4.9	3.7
Advanced Econs.	5.2	4.5	2.2
US	6.0	5.2	2.2
Eurozone	5.0	4.3	2.0
UK	6.7	5.0	1.9
Japan	2.4	3.2	1.4



AIB Irish Economic Forecasts

% change in real terms unless stated	2019	2020	2021 (f)	2022 (f)	2023 (f)
GDP	**4.9**	**5.9**	**14.0**	**6.0**	**4.0**
GNP	5.0	3.4	8.0	5.0	3.5
Modified Final Domestic Demand	**1.7**	**-4.9**	**5.5**	**6.3**	**3.8**
Personal Consumption	3.3	-10.4	6.5	8.5	4.0
Government Spending	7.1	10.9	2.5	-1.5	1.5
Fixed Investment*	99.5	-23.0	-42.0	7.7	5.0
Exports	10.4	9.5	15.0	7.0	5.0
Imports*	41.7	-7.4	-8.0	7.5	5.5
HICP Inflation (%)	0.9	-0.5	2.3	3.4	1.5
Unemployment Rate (Estimated %)	**5.0**	**10.4**	**10.4**	**7.2**	**6.0**
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 Impact:

- 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 – EC proposes changes and now in discussions with UK

Residual Brexit Issue Remains over NI Protocol

- UK does not rule out triggering Article 16 in dispute with EU over operation of NI Protocol
- EU has offered concessions on Protocol. Discussions with UK continuing, which is a positive sign
- Triggering Article 16 would effectively suspend operation of NI Protocol – relates to GB-NI trade only
- Should not have any great immediate impact as many checks on trade are not in operation at present
- Any EU response would have to be proportionate and thus limited. Both parties must enter talks
- Risk, though, that UK could take other actions, such as removing oversight role of ECJ in NI Single Market
- This might be seen by EU as major breach of Brexit deal and thus may look to suspend Trade Agreement
- 12 Months notice must be given to terminate Trade & Co-operation Agreement
- Intense negotiations likely in this period, similar to those held in 2019-2020, to avoid a Hard Brexit
- Thus, triggering Article 16 could lead to much uncertainty and protracted negotiations
- Solutions expected to be found on freer flow of goods from GB to NI
- Strong support in NI to remain in Single Market so ECJ will have to retain key oversight role
- Sterling shows no reaction to issue as markets expect problems with NI Protocol to be resolved in talks

Changes to Corporate Tax Regime Agreed

Importance of FDI:

- Some 1,600 multinational companies are based in Ireland, accounting for over 250,000 in direct employment
- Corporation tax receipts of €12bn in 2020 or circa 20% of total tax revenue - 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%. Due to take effect in 2023
- It also agrees to other OECD tax proposal 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
- DoF has allowed for a €2bn hit to Irish corporation tax receipts by 2025 from changes to global tax system
- Ireland is retaining the 12.5% rate for smaller companies – the SME sector

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
- Ireland’s new 15% rate still comparatively low. 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)
- Strong inflows of FDI continue in 2021 despite the changes to global corporate tax rules

Risks remain for the Irish economy

- Main risk is still Covid-19 – high case numbers, concerns about new variants, restrictions
- Virus could still have scarring effects – rise in business failures & bad debts, job losses
- Very open Irish economy so vulnerable to global slowdown, trade disruptions
- Changed EU-UK relationship impacting trade. Issues remain over NI Protocol
- Reforms to global corporation tax regime could still have some impact on Irish economy
- 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