

The Irish Economic Update:

*Tough start to 2021, but prospects
brighten as vaccine roll out begins*

February 2021

Oliver Mangan
Chief Economist
AIB

Now in third lockdown, but outlook brightens on vaccines

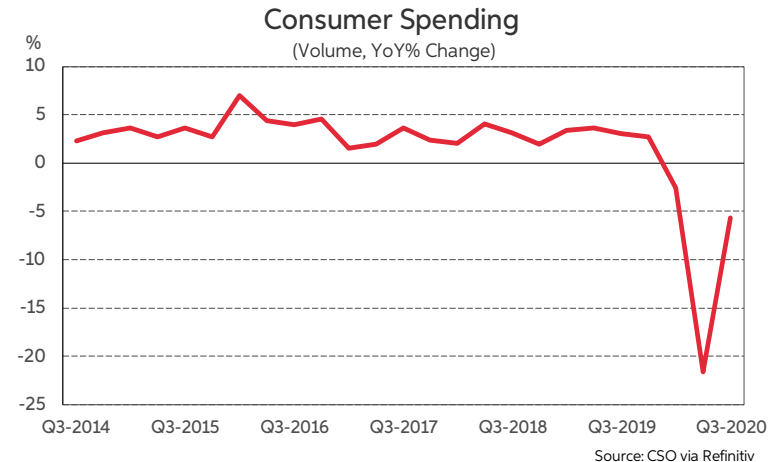
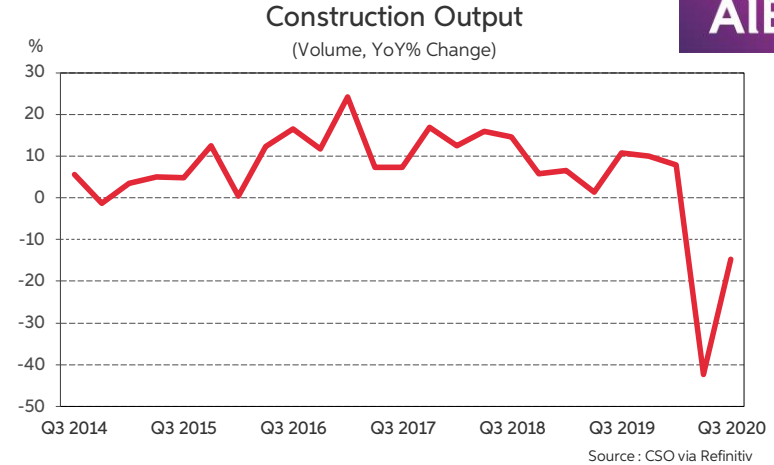


- Second lockdown imposed from late Oct to end November as Covid cases spiked higher
- Domestic economy may have contracted again in Q4 given lockdowns re-imposed for a period
- However, core retails sales up 4% yoy in Q4'20, well above pre-Covid levels
- Third lockdown imposed over Xmas period, which is set to last for much, or all, of first quarter
- Thus, weak start on the cards for economy in Q1 2021, given the extensive lockdown
- Contraction in economy in Q1 will be nowhere as severe as last Spring– more activity going on
- Restrictions on activity in some sectors set to last until mid-year, given virus more infectious
- However, growth prospects improve for H2 2021 and 2022 as vaccines roll out gathers pace
- Central Bank forecasts GDP growth of 3.8% in 2021 and 4.6% in 2022
- It sees modified domestic demand rising by 2.9% this year and 3.6% in 2022
- CBI also forecasts that official unemployment rate will top out at below 10% in 2021

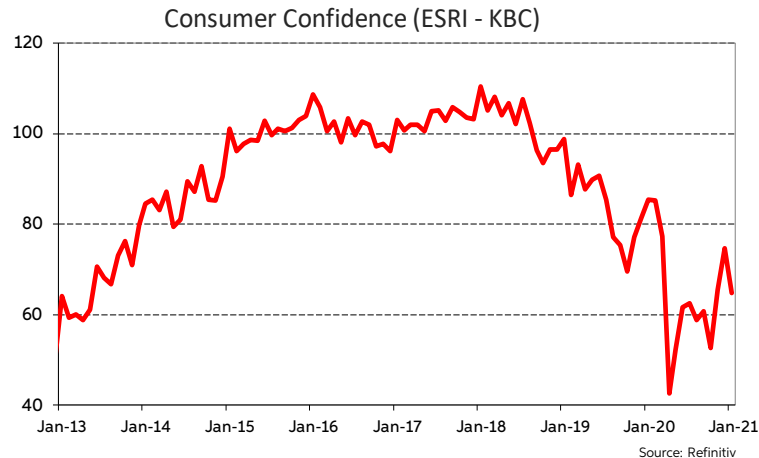
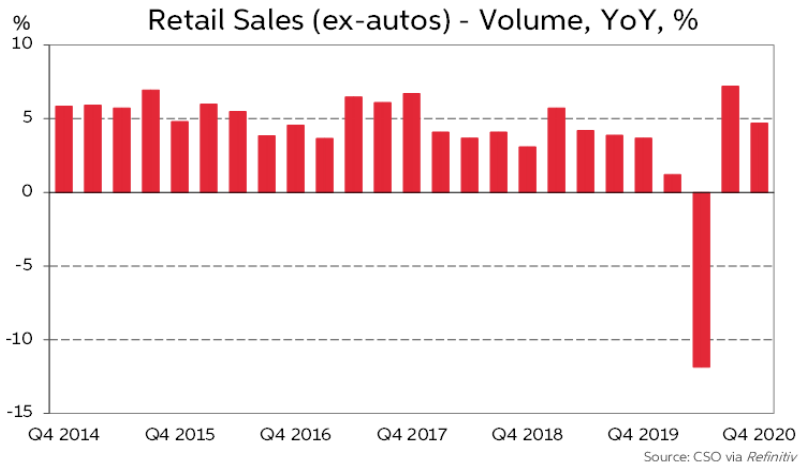
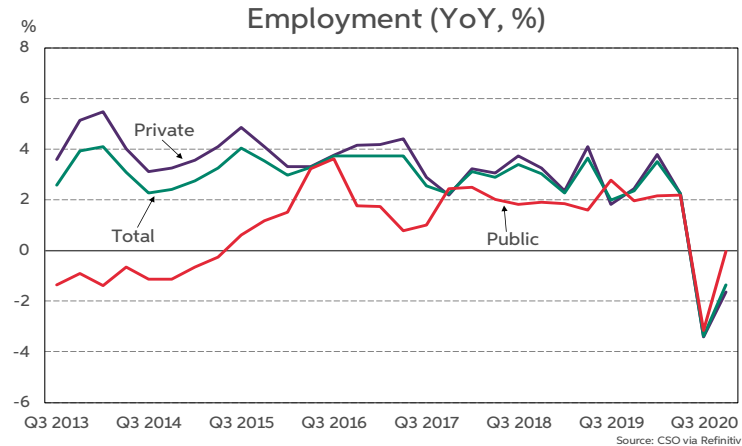
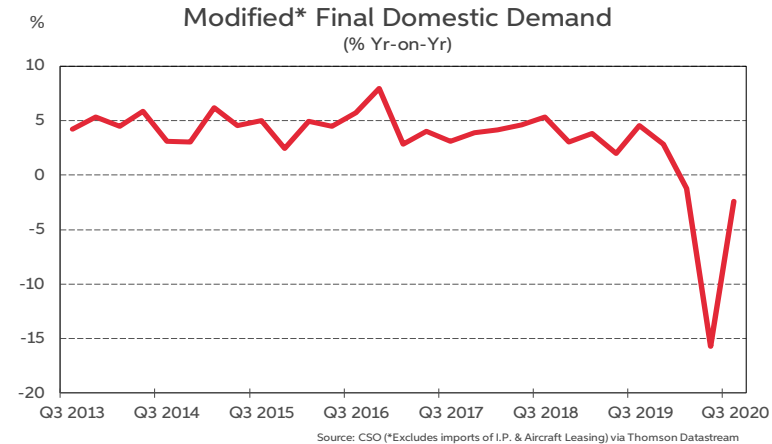
Strong Q3 rebound after big Covid hit to economy in H1'20



- Modified final domestic demand up by 18.7% in Q3, after declines of 1.6% & 15.5% in Q1 and Q2 2020
- Overall, modified domestic demand was down by 6.4% yoy over Q1-Q3 2020 period
- Consumer spending up by 21% in Q3 after falls of 2.2% in Q1 & 20% in Q2 – down 10% yoy in Q1-Q3
- Domestic fixed investment rebounded by 34.4% in Q3 after 27.5% fall in Q2 –down 10% yoy in Q1-Q3
- Construction output rebounded by 53.5% in Q3 after 45.5% in Q2 –down 16.5% yoy over Q1-Q3
- GDP was boosted in 2020 by strong performance of net trade, so up 3.6% yoy in Q1-Q3 period
- GNP up 0.3% yoy in same period – takes account of big rise in profits outflows from multi-nationals



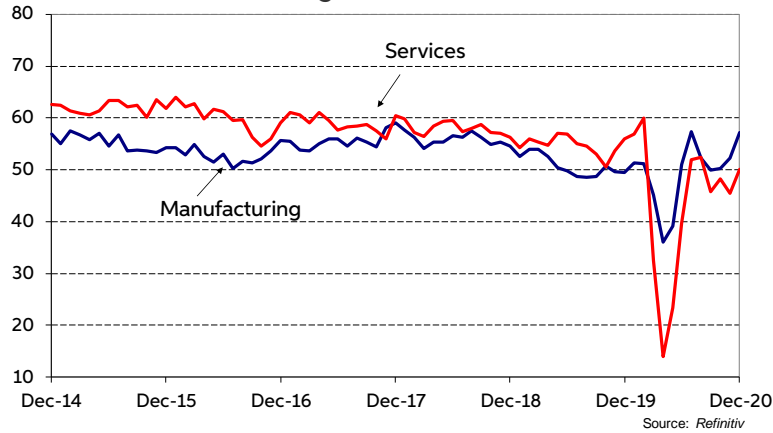
Q3 spending recovery continued in Q4, despite lockdown



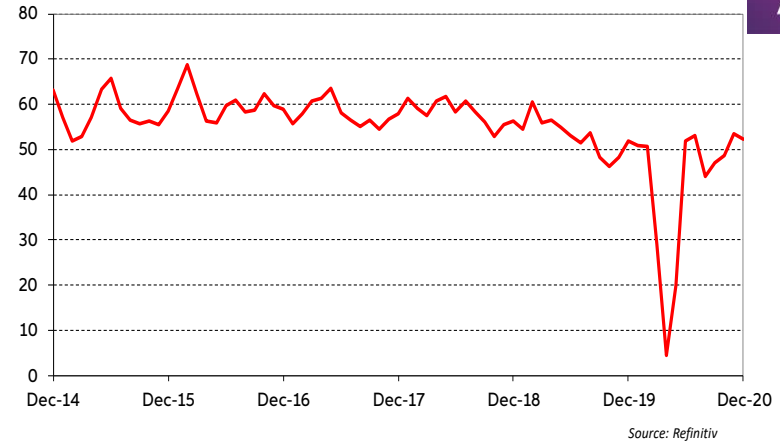
Second lockdown sees activity dip somewhat in Q4



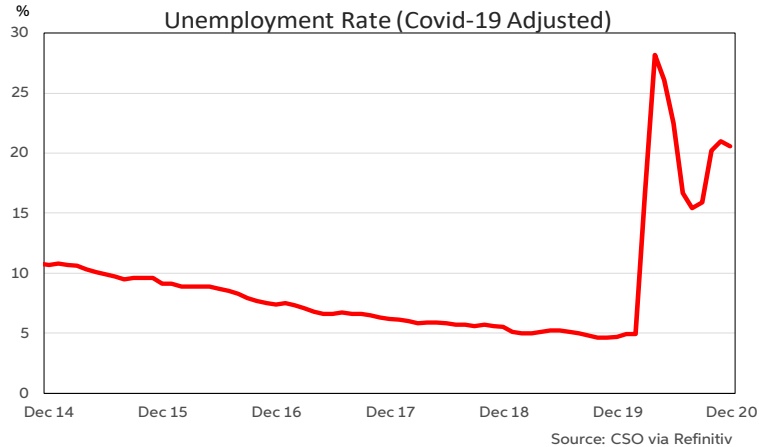
AIB Irish Mfg and Services PMIs



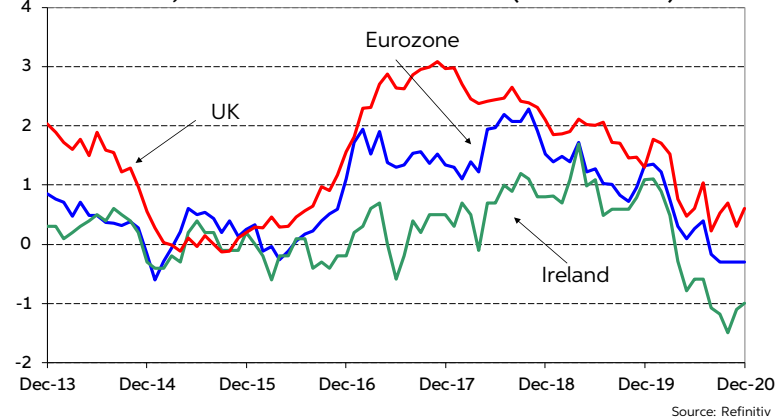
Ulster Bank Construction PMI



Unemployment Rate (Covid-19 Adjusted)



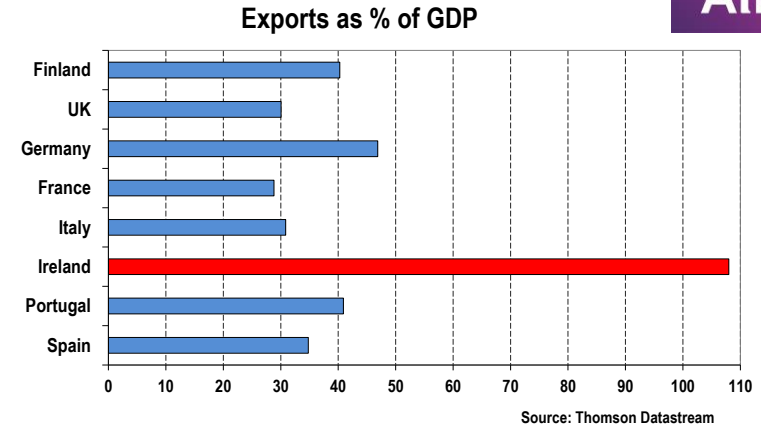
Irish, Eurozone & UK Inflation (HICP Rates)



Goods exports up strongly in 2020, but services exports fell



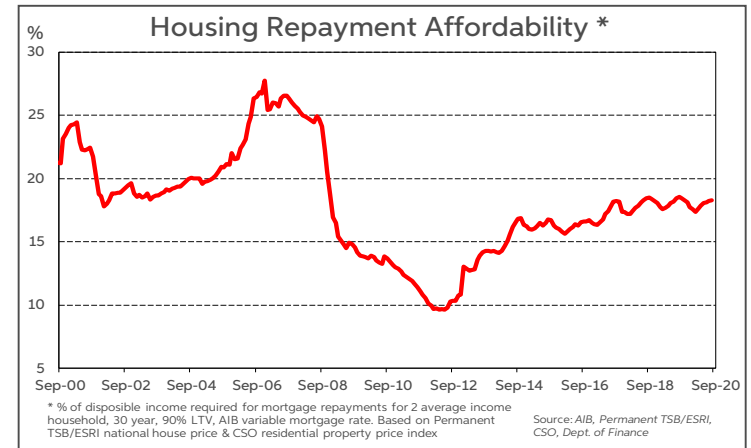
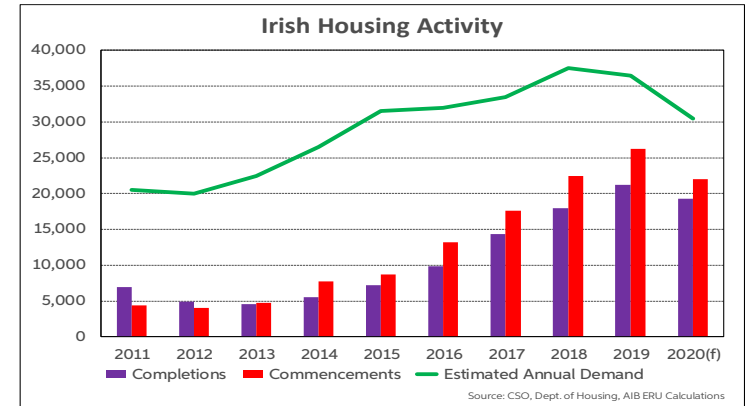
- Ireland a very open economy – exports, driven by large scale FDI, are a huge part of economy
- Exports rise strongly in recent years, helped by large FDI inflows
- Total exports rose by 10.4% in 2018 and 11.1% in 2019.
- Pharma, medical care products, IT equipment, and food & drink are main goods exports
- IT, business, financial and tourism are the main service exports
- Total exports rise 4.4% yoy in Q1-Q3 2020
- Goods exports up 10.7% yoy over the period, fuelled by very big jump in pharma exports
- Service exports down 4.3% yoy in Q1-Q3 2020
- Collapse in earnings from tourism & travel, but computer service exports show strong growth



New house building activity held up in 2020



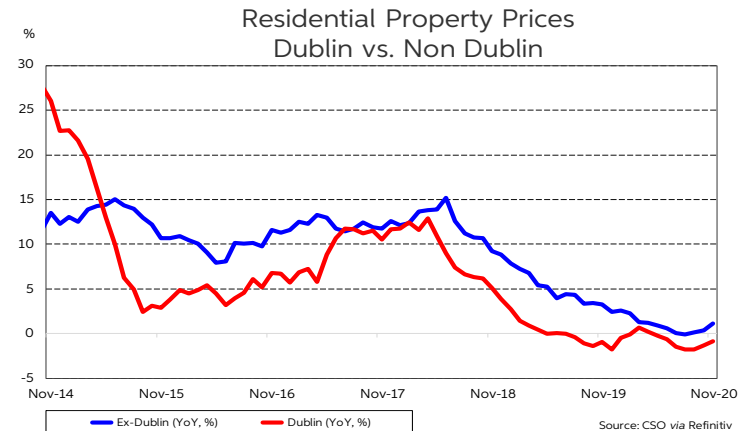
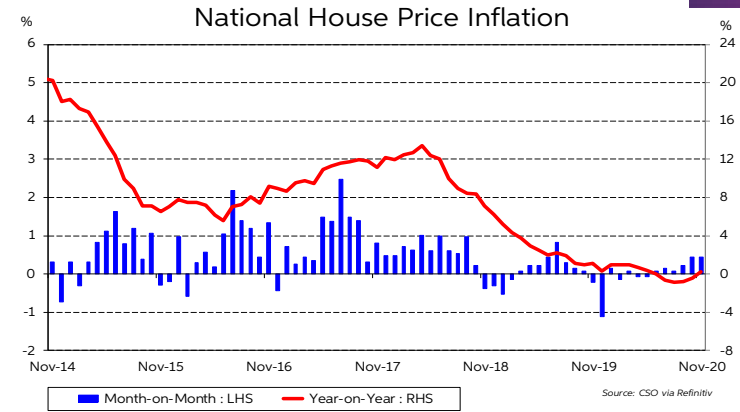
- Housing completions rose 18% to 21,240 units in 2019
- Completions down by 32% yoy in Q2 on lockdown, but recover strongly in Q3 – down 9% yoy in Q1-Q3 period
- House commencements up 17% in 2019 to 26,000 units
- Commencements fell sharply in 2020 – down 18% to November, though signs stabilising at 22k over autumn
- Planning permissions jump sharply – up 25% yoy to September despite weak second quarter
- Overall, completions hold up better than expected in 2020. May be above 19k and around 20k in 2021
- Housing output remains well below annual new housing demand, estimated at 30,000 units
- Mortgage lending rose by 9.5% to €9.5bn in 2019, but Covid saw it fall by 12% to €8.4bn in 2020
- However, mortgage approvals surge over the autumn
- Housing affordability metrics remain quite stable



House prices starting to move higher again



- House prices declined by very sharp 55% over 2007-13
- Prices have since recovered strongly; 85% above trough by October 2020, but still some 17% below 2007 peak
- House price inflation slowed sharply in 2018/19 reflecting tighter Central Bank lending rules
- House prices little changed in 2020 until the autumn - prices up by 1% in the three months to November
- Prices +0.4% yoy nationally in Nov 2020: Dublin down 0.9%, while non-Dublin up 1.2% yoy
- Property websites - big jump in asking prices in H2'20
- Low supply, remote working, strong public/institutional demand, enhanced help-to-buy scheme, rising personal savings are all supporting prices
- Growth in rents had slowed a lot before the virus hit
- Rents recover somewhat in H2 after steep falls in H1'20, but still down 3% yoy in December



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	2017	2018	2019	2020	2021
Household Formation	28,000	32,000	31,000	25,000	25,000
<i>of which</i>					
Indigenous Population Growth	18,500	21,000	21,000	17,500	16,000
Migration Flows	9,500	11,000	10,000	7,500	9,000
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	33,500	37,500	36,500	30,500	30,500
Completions	14,400	18,100	21,250	19,250	20,000
Shortfall in Supply	-19,100	-19,400	-15,250	-12,250	-10,500

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

Sources: CSO, DoECLG, AIB ERU.

Private sector deleverages, Govt. debt ratios rising again

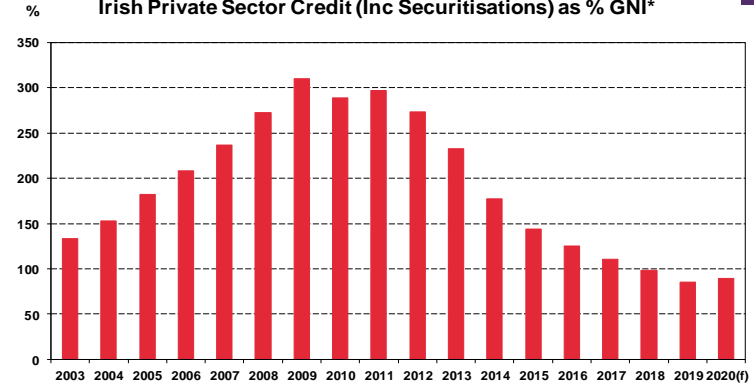


Irish Household Debt Ratio



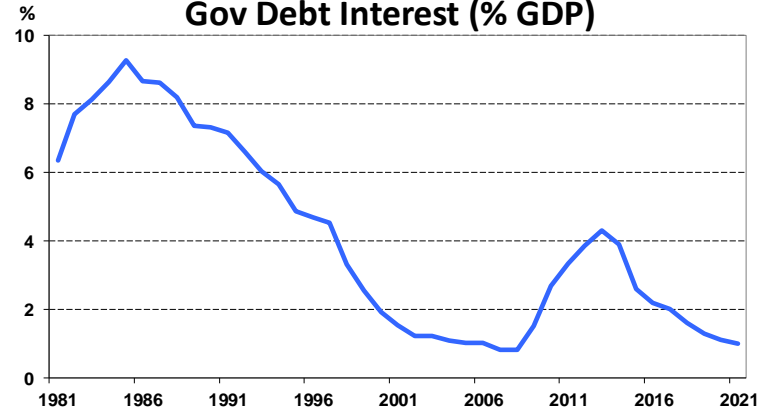
Source: CSO, Central Bank, AIB ERU

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



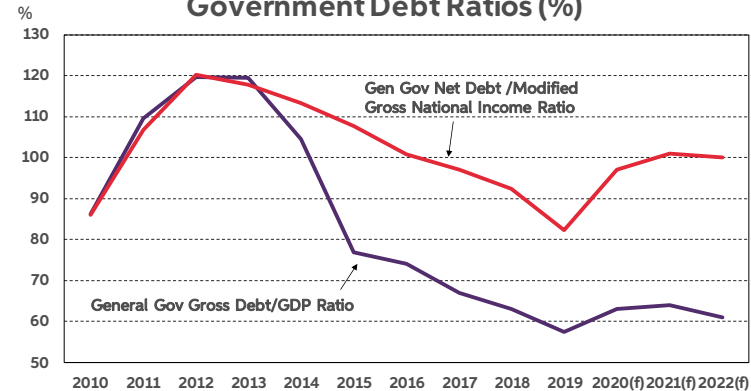
Sources: Central Bank, CSO, AIB ERU Calculations

Gov Debt Interest (% GDP)



Source: NTMA; Dept of Finance (Pre Coronavirus)

Government Debt Ratios (%)

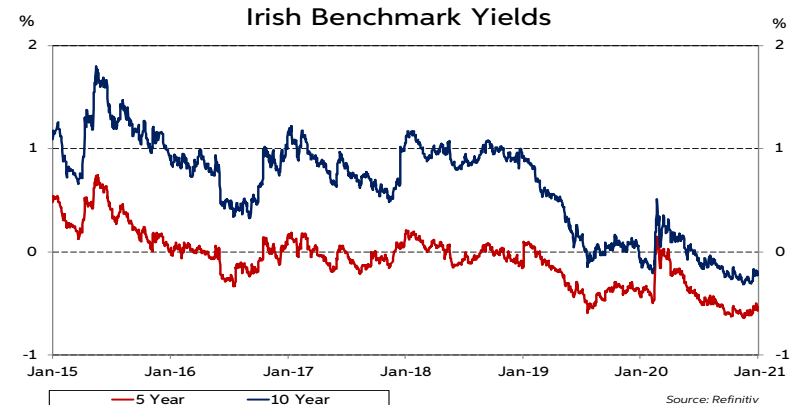
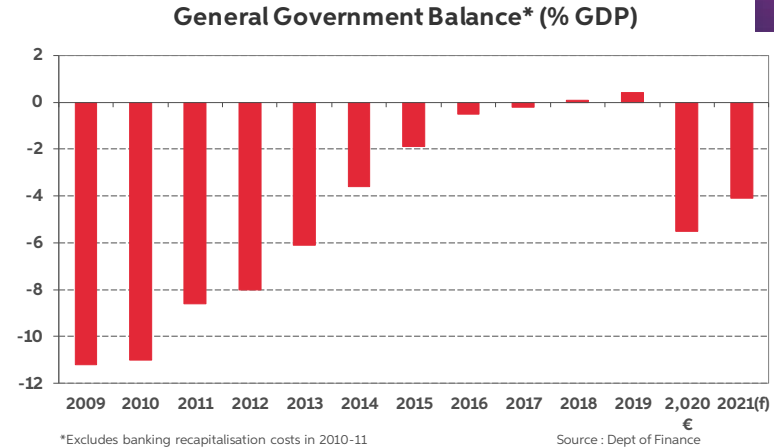


Sources: Dept of Finance, CSO, AIB ERU (Inflated/Distorted GDP figures from 2015)

Large budget deficit in 2020 and again in 2021



- Budget deficit declined sharply over last decade, with small surpluses recorded in 2018 and 2019
- Primary budget surplus (i.e. excluding debt interest) of 1.8% of GDP in 2019
- However, Covid-19 and efforts to mitigate it saw the public finances deteriorate during 2020
- Tax receipts were down 3.5% last year, while net voted government spending soared by 25%
- Budget deficit of circa €19bn in 2020, or around 5.5% of GDP
- Dept. of Finance forecasting another large budget deficit of above €20bn in 2021
- Gov. Debt ratios had fallen in past decade, but moved higher in 2020
- 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



Main points about the EU-UK Free Trade Agreement



- EU and UK finally agreed on a trade deal just before Christmas, 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 likely delays at ports, including the land bridge route to Europe via UK
- 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
- Already signs of delays at ports impacting supplies in January, higher trade costs
- FTA does not extend to services. Financial services not given equivalence/passporting rights
- Maintains current common standards. Tariffs possible if they diverge appreciably
- No right of redress for companies via courts. Provision for an arbitration panel in disputes
- Estimated that higher trade costs will knock circa 0.5% off annual Irish GDP growth rate

Economy was in very strong shape ahead of Covid shock



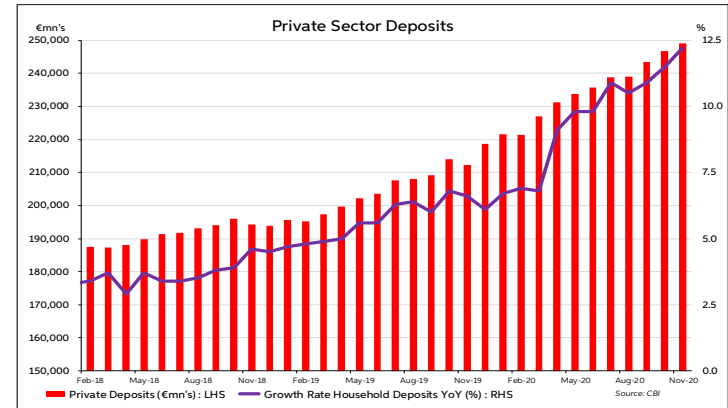
- Economy was in very strong shape ahead of being hit by very deep 2020 Covid recession
- Well balanced, robust underlying growth of circa 5% per annum over 2013-19 period
- Large inflows of FDI and strong export growth remain key features of the economy
- Strong jobs growth, averaging over 3% per annum during the period 2013-19
- Unemployment rate fell from 16% in early 2012 to below 5% in H2 2019
- Budget deficit eliminated quicker than expected. Public finances in surplus in 2018/19
- Major deleveraging by private sector, including households, during the past decade
- Sound financial system, with well capitalised banks
- Stable housing market - house price inflation at 1%, moderate growth in mortgage market
- Very low, stable CPI inflation of below 1% over 2013-19 period
- Balance of payments returned to large surplus

Key medium-term Irish growth drivers remain in place



- Favourable medium-term drivers of strong Irish growth remain in place
- House building picking up from still low output levels – big focus of government policy
- Government spending supportive of growth
- Activity to be aided by continuing very low interest rate environment
- Ireland still an attractive destination for FDI
- Labour market dynamics supportive of growth
- Economy has deleveraged, big jump in savings
- World economy expected to rebound from 2021, helped by roll out of Covid vaccines
- The EU-UK trade deal has removed a major risk to Irish economy
- Strong Irish growth likely over next few years

OECD GDP Forecasts (Dec 2020)			
% Vol	2020	2021	2022
World	-4.2	4.2	3.7
OECD	-5.5	3.3	3.2
US	-3.7	3.2	3.5
Eurozone	-7.5	3.6	3.3
UK	-11.2	4.2	4.1
Japan	-5.3	2.3	1.5



AIB Irish Economic Forecasts



<i>% change in real terms unless stated</i>	2018	2019	2020 (f)	2021 (f)	2022 (f)
GDP	8.5	5.6	3.0	4.0	5.0
GNP	7.3	3.4	-0.5	3.5	4.5
Personal Consumption	2.8	3.2	-9.0	4.0	5.0
Government Spending	5.8	6.3	8.7	0.0	-2.5
Fixed Investment*	-6.2	74.8	-16.5	-2.0	7.0
Exports	11.1	10.5	4.0	5.0	5.0
Imports*	4.0	32.4	-7.5	2.7	5.0
HICP Inflation (%)	0.7	0.9	-0.5	0.3	1.0
Unemployment Rate (%)	5.8	5.0	10.4	10.0	7.5
Budget Balance (% GDP)	0.1	0.5	-6.5	-5.7	-3.0
Gross General Gov Debt (% GDP)	63.0	57.4	63.0	64.0	61.0

*Data very distorted by aircraft and intangibles (IP)

Source: CSO, D/Finance; AIB ERU Forecasts

Risks to the Irish economy



- Main near term risk is still Covid-19 – continues to weigh heavily on growth & employment
- Persistence of virus could see scarring effects – high business failures, rising bad debts, job losses
- Very open nature of Irish economy means it is exposed to weakening global trade patterns
- Changed EU-UK trading relationship may negatively impact some Irish industries
- Questions around Ireland's corporation tax regime (moves on tax harmonisation in EU, OECD tax reform/minimum tax rate proposals) and rise in protectionism could impact FDI
- Supply constraints in new house building activity, with output still at very low levels
- Competitiveness issues - high Dublin house prices, high rents, high personal taxes, high 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.