# The Irish Economic Update:

## *Deep COVID-19 recession, but resilient Irish economy can bounce back*

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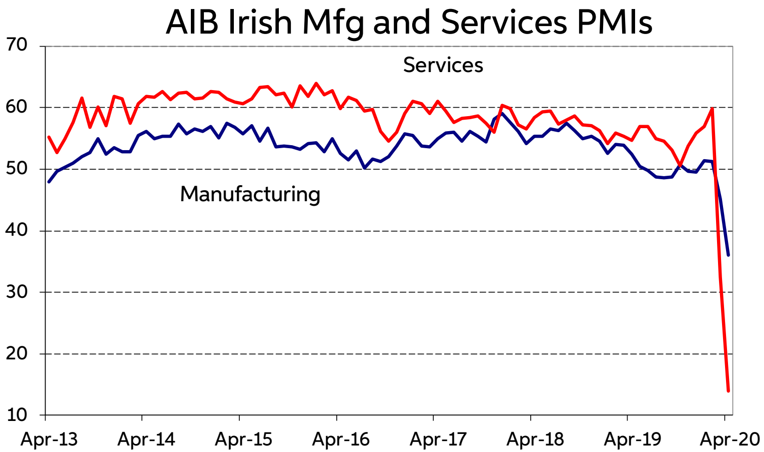
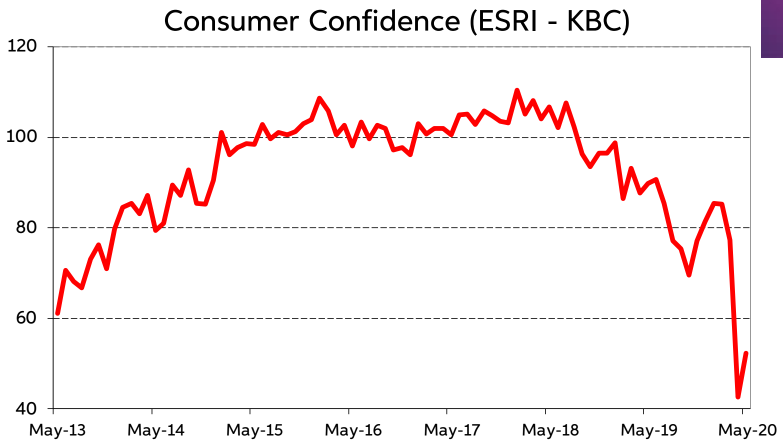
# Coronavirus pandemic triggers deep H1 2020 recession

- Ireland hit by deep recession in H1 2020 as economy put into lockdown to contain coronavirus
- Some 1.25 million or 50% of labour force enrolled on various State income support schemes
- Jobless rate soars in March-April; COVID-19 adjusted unemployment rate hits 28% in April
- PMIs in April sink to 36.5 for manufacturing, 13.9 for Services and 4.5 for Construction
- Big fall in GDP will be seen in Ireland, as elsewhere, in H1 2020
- Activity expected to rebound in H2 2020 as virus abates and restrictions on activity are lifted
- Government plan is to ease most restrictions gradually in stages from mid-May to mid-August
- Nonetheless, IMF, ESRI, EC and Central Bank still expect that GDP will fall by circa 7-8% in 2020
- Strong growth expected in 2021 given depressed base for this year – growth of over 6% per IMF
- Broad range of government supports announced to help household incomes and businesses
- Blow-out in public finances, with budget deficit likely to hit 7-9% of GDP in 2020

# Data slump as COVID-19 lockdown restrictions bite hard




Source: *Refinitiv*

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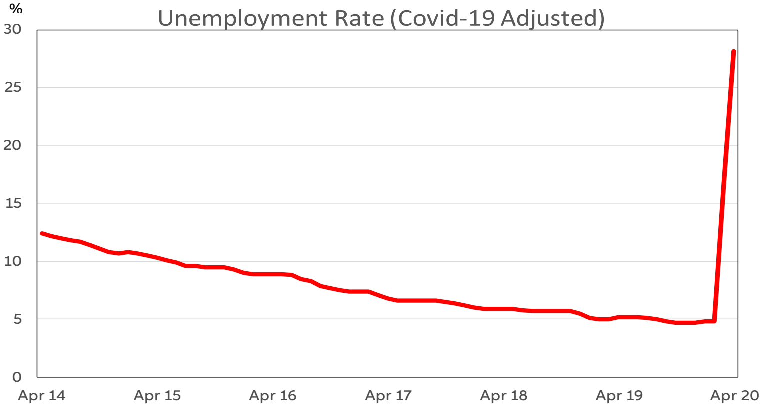
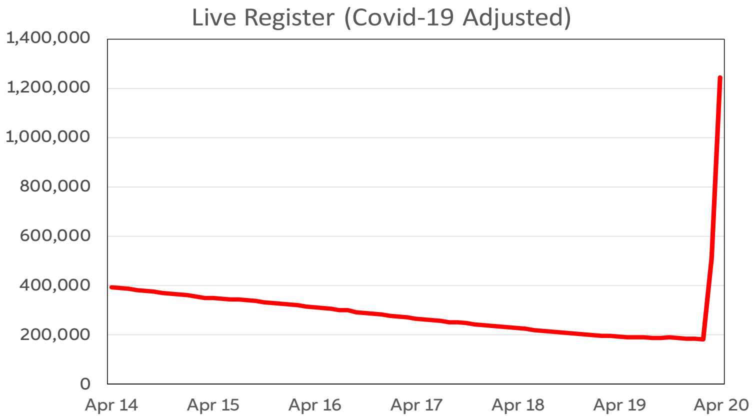



Source: CSO via Refinitiv



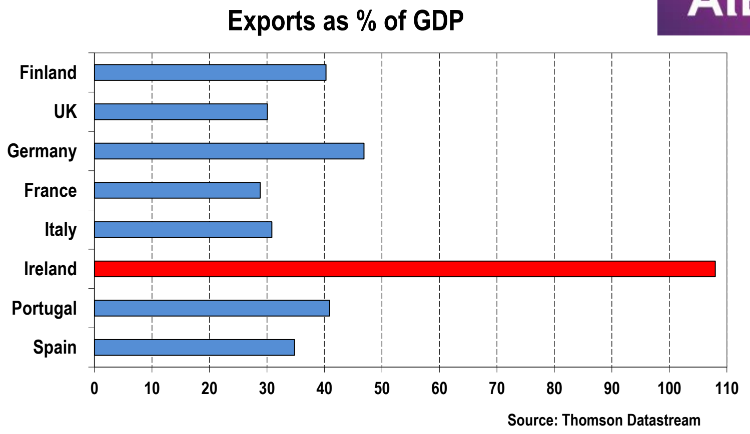

*Source: CSO via Refinitiv*

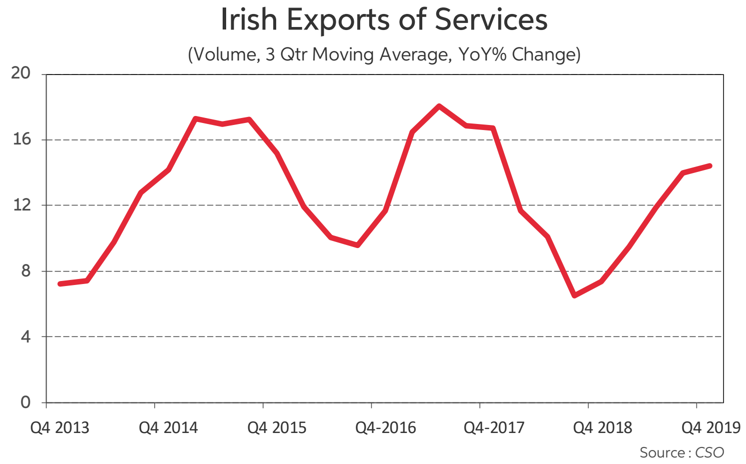
# Activity data weaken sharply with economy in cold-storage

- Unemployment rate spikes from 4.8% in Feb to COVID-19 adjusted figure of 28.2% in April
- Some 1.25 million workers either in receipt of Pandemic Unemployment Benefit / standard unemployment benefit or enrolled on State's temporary wage subsidy scheme by end April
- Retail sales (ex-motor trade) fell by 0.7% in Q1, with sales down by 1.9% in March
- Consumer confidence collapses to near record low in April, but recovers somewhat in May
- Drop of 90% yoy in total number of cars licensed for first time (new + second-hand imports) in April
- Manufacturing PMI falls sharply in April to 36.0 as virus outbreak hits output and orders hard
- Services PMI plummets to record low of 13.9 in April, with many sectors shut down
- Construction PMI slumps to just 4.5 in April, with sector in full lockdown
- Tax receipts fall sharply March-April; government spending rises. Big budget deficit on cards in 2020
- But goods export soar in March as the large pharma sector sees surge in output

# But Ireland's Pharma exports surge on COVID-19 outbreak

- 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
- Goods exports rise 13% yoy in Q1 2020. Surge by 40% yoy in March to record high level
- Pharma exports (36% of good exports) up 60% yoy in March due to COVID-19 pandemic
- Organic chemicals (27% of good exports) jump by 121% yoy in March

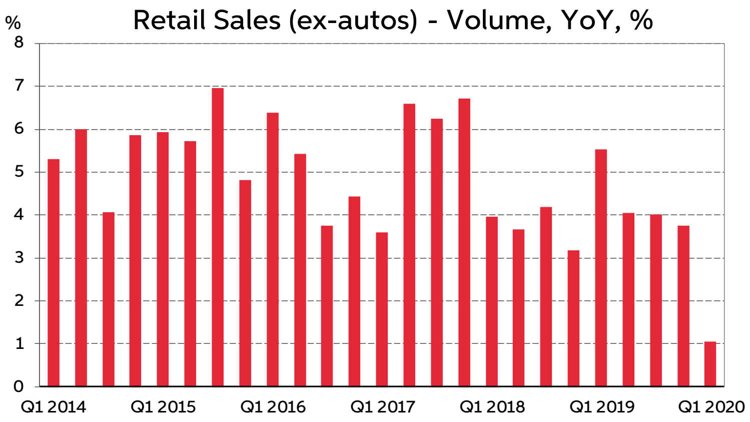


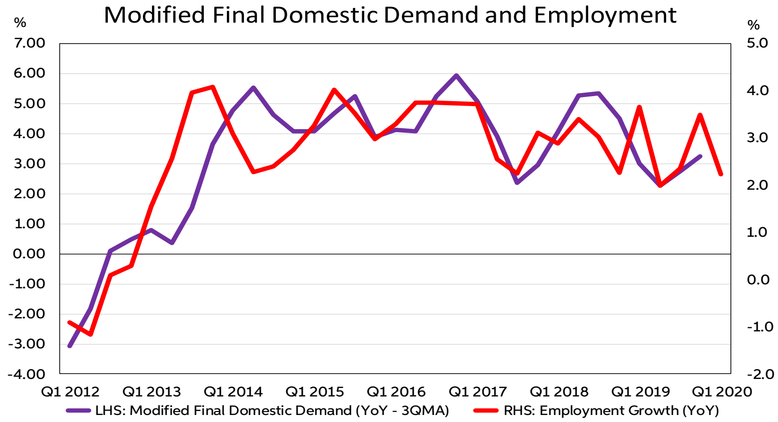
# COVID recession comes after strong growth in 2013-2019

- Previous Irish recession of 2008-2009 also severe. GDP fell 9.5%, with GNP down 12%
- Collapse in construction activity and banking system, severe fiscal tightening, high unemployment
- GDP at end of 2008-09 recession was still almost 25% higher than in 2001, highlighting that 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 & property market. Imbalances in economy unwound – housing, debt levels, competitiveness, BoP
- Economy recovered strongly, with robust underlying growth of circa 5% in 2013-19 period
- Focus was on generating growth via the large export base and FDI as the route to recovery
- Recovery in domestic economy followed, led by rebound in investment & retail spending
- Strong jobs growth. 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 last decade
- Balance of payments returned to large surplus

# Economy was performing very well before virus struck




Source: CSO via *Refinitiv*

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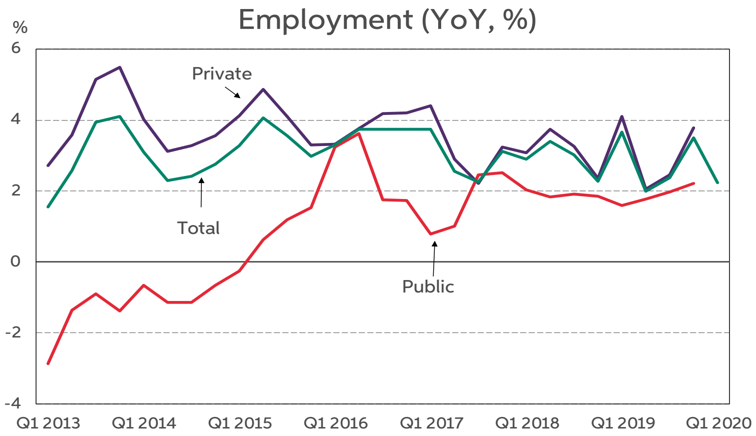


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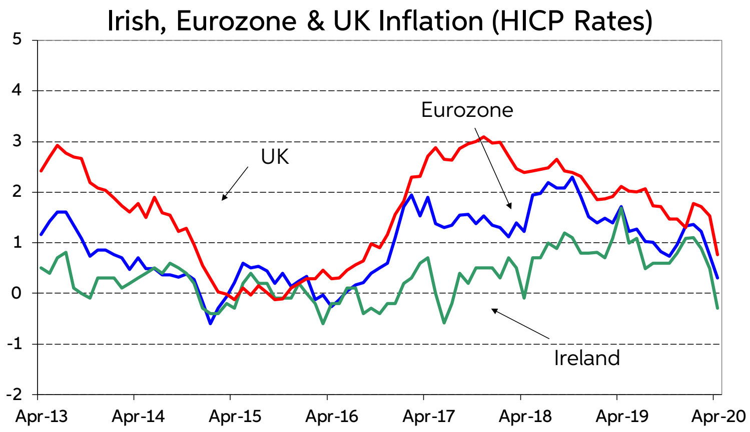
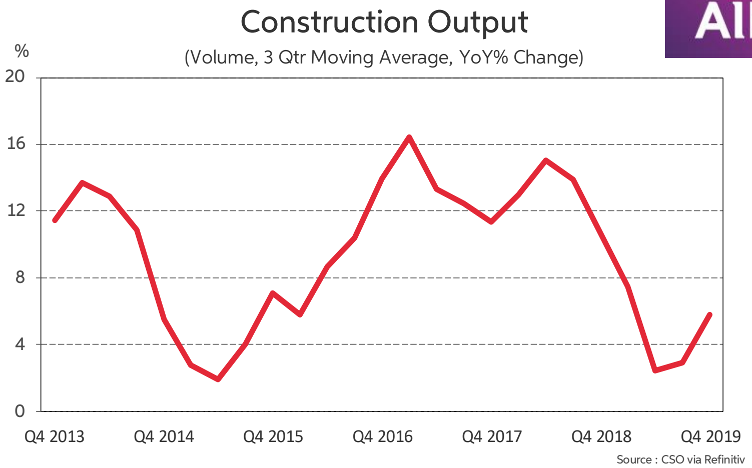
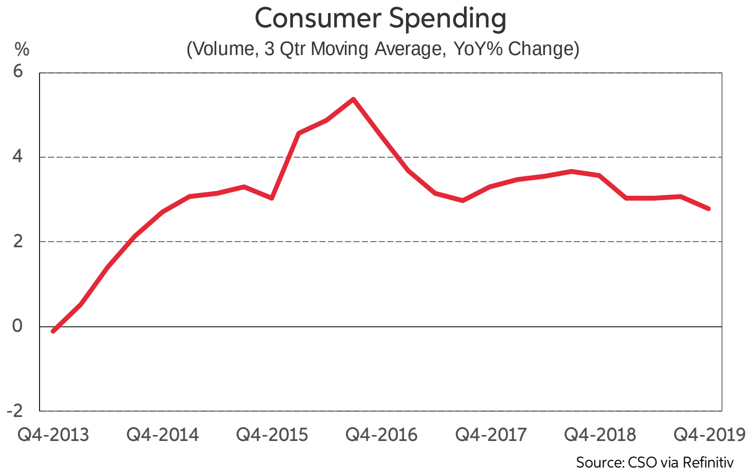



Source: Refinitiv

# Domestic demand solid ahead of the pandemic

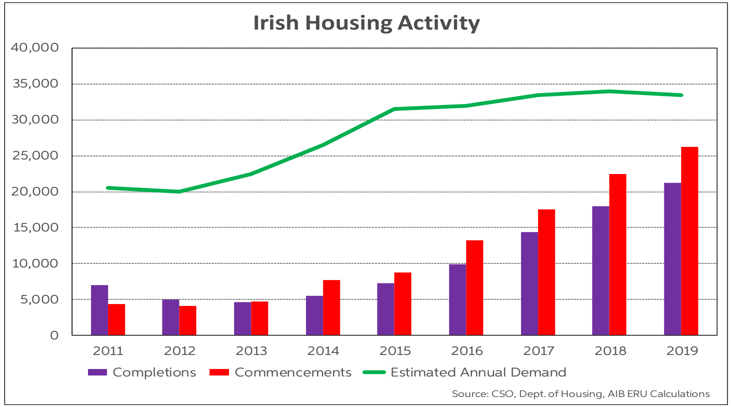
- Construction sees strong recovery since 2013. Output up nearly 12% on average in 2016-18 period
- Slowdown in non-residential construction activity last year – construction output up 5.8% in 2019
- Business investment (ex aircraft/intangibles) has recovered strongly since 2013
- However, Brexit uncertainty 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
- Modified final domestic demand grew at 4.4% rate in 2014-2018 period. Rose by 3% in 2019
- Strong growth in core retail sales of circa 4-5% in recent years – rose by 4.4% in 2019
- Car sales returned to very high levels in 2018-19, with notable rise in direct imports from UK
- Good employment growth continued in Q1 2020

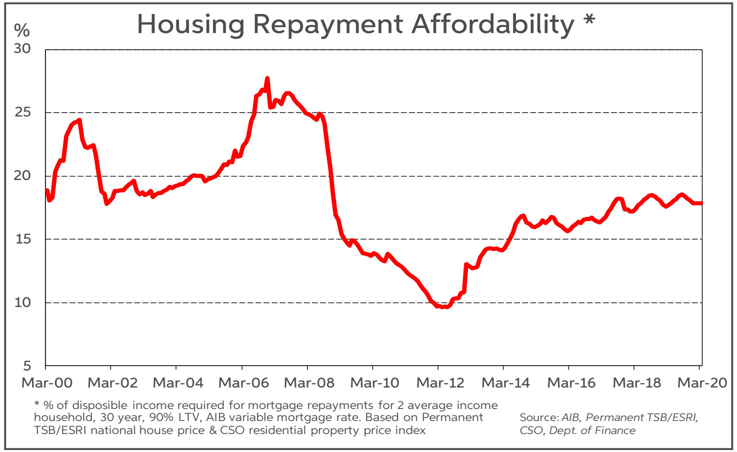


# House building on steady rise before virus halted activity

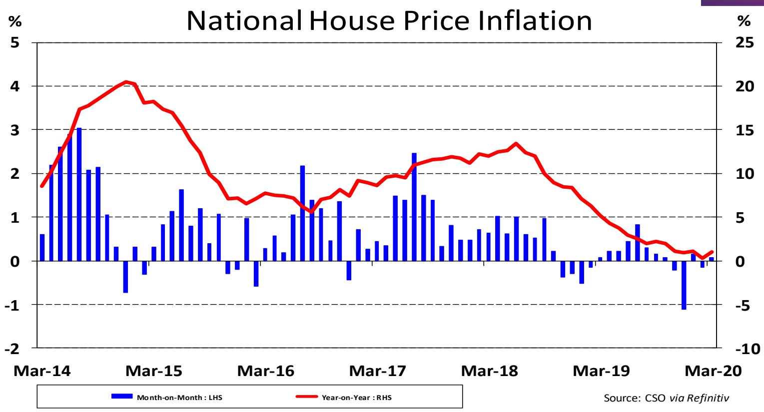
- Housing completions up 18% yoy to over 21,000 units in 2019, a moderation on 2018's 25% growth rate
- Housing commencements increase by further 17% in 2019 to 26,000 units
- Planning permissions jump by 38% YoY to over 40k in 2019, driven by a sharp rise in apartment applications
- Housing completions rose by 17% yoy in Q1 2020
- Completions were forecast at circa 24,500 for 2020
- Now expected to be down 15-25% at 16,000-18,000
- Housing output remains well below annual new housing demand, estimated at 30,000+ units
- Mortgage lending rose by 9.5% to €9.6bn in 2019, but big decline in store for 2020 after good start in Q1
- Housing affordability metrics stable ahead of crisis



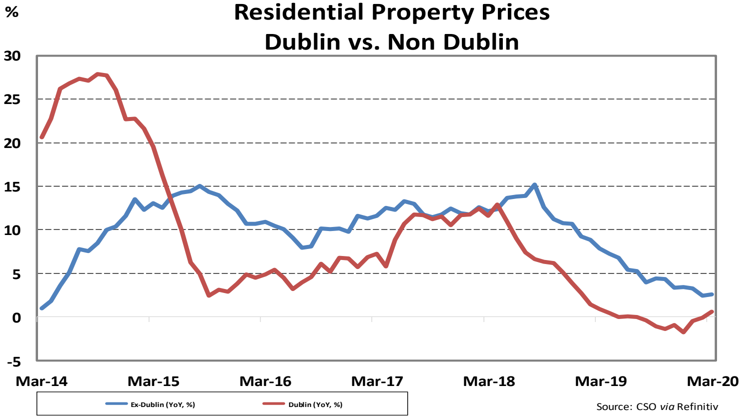



# House price inflation slows sharply

- 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 83% by March 2020 from March 2013
- But house prices still some 18% below 2007 peak
- House price inflation slows sharply in 2018/19 reflecting tighter Central Bank lending rules
- Prices up 1% yoy nationally during Q1 2020, down from a high of 13.3% in April 2018
- Dublin prices up 0.6% in March, non-Dublin +1.5%
- Recession to see price falls, but may be limited if economic downturn short and given low supply
- Annual growth in rents had slowed before virus
- Rents now starting to fall as recession takes hold




Source: CSO *via Refinitiv*




Source: CSO *via* Refinitiv

# AIB Model of Estimated Housing Demand

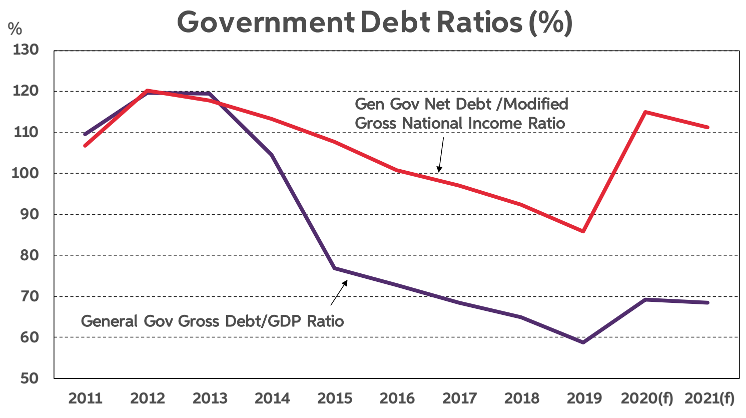
- Rising headship rates added circa 8,000 per year to housing demand in 2002-2011 period
- Shortage of housing, high rents, tighter lending rules saw average household size rise in 2011-16. Thus, headship fell – was a drag of circa 10,000 p.a. on housing demand
- Assume no change in headship in 2016-2021 – 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 | 28,500 | 28,000 | 26,500 | 25,000 |
| ***of which*** | | | | | |
| ***Indigenous Population Growth*** | *18,500* | *17,500* | *16,500* | *16,500* | *16,000* |
| ***Migration Flows*** | *9,500* | *11,000* | *11,500* | *10,000* | *8,500* |
| ***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** | **32,000** | **30,000** |
| **Completions** | **14,400** | **18,100** | **21,250** | **18,000** | **20,000** |
| ***Shortfall in Supply*** | *-19,100* | *-15,900* | *-12,250* | *-14,000* | *-10,000* |

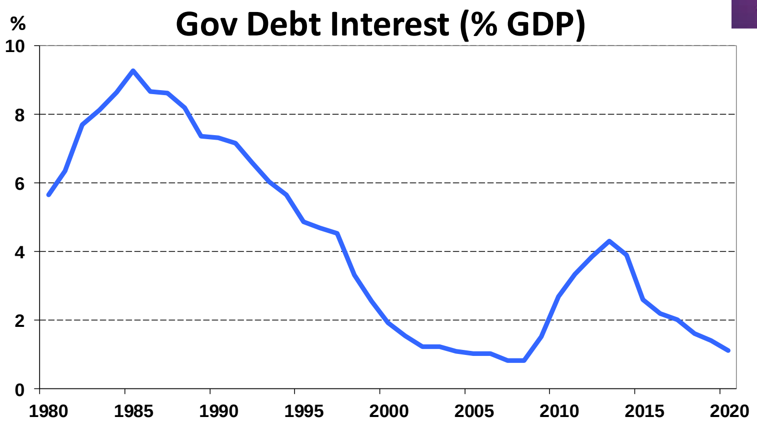
*Headship is % of population that are heads of households.

Sources: CSO, DoECLG, AIB ERU.

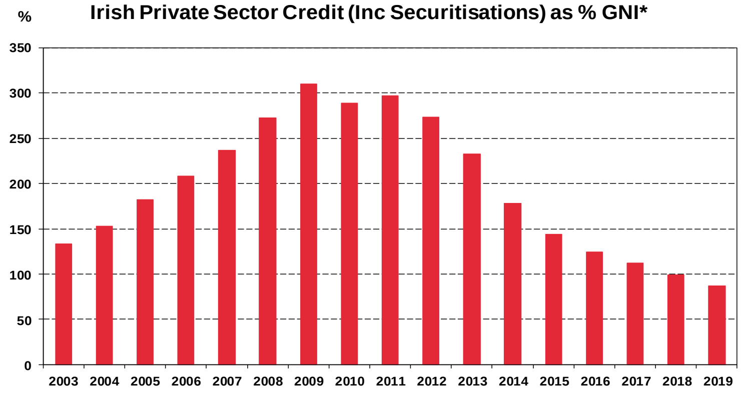
# Govt. debt ratios had fallen, private sector deleverages



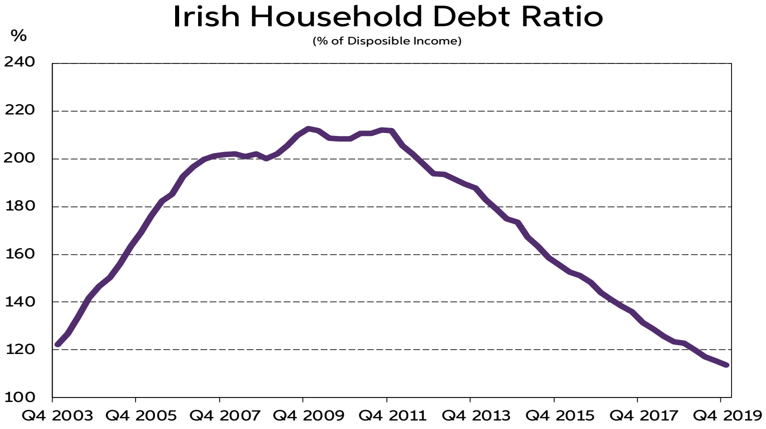

Sources: Dept of Finance, CSO, AIB ERU (Inflated/Distorted GDP figues from 2015)




Source: NTMA; Dept of Finance (Pre Coronavirus)



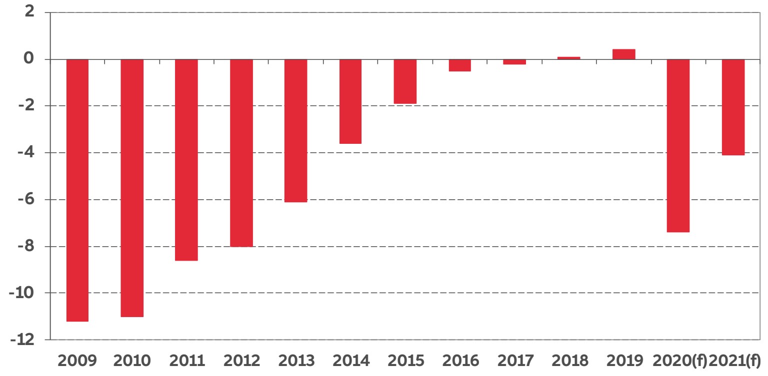

Sources: Central Bank, CSO, AIB ERU Calculations




Source: CSO, Central Bank, AIB ERU

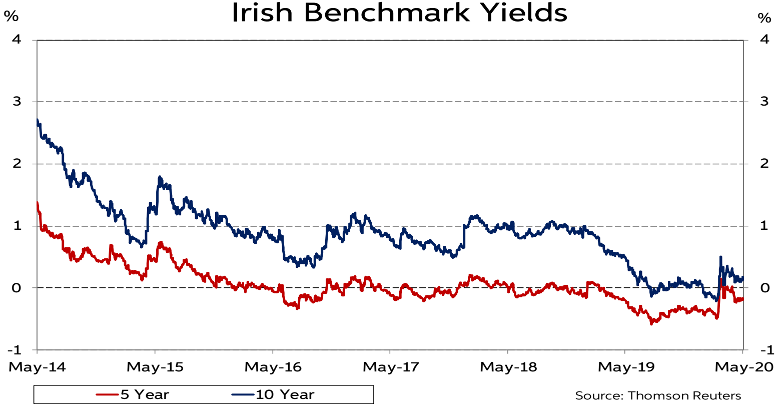
# Large budget deficit in 2020, but bond yields stay very low

- Budget deficit declined sharply over last decade, with small surpluses recorded in 2018 and 2019
- 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
- However, Covid-19 and efforts to mitigate it see the public finances deteriorate in 2020
- Tax receipts 5.7% below profile to end March. Gov spending 13.5% above profile by end April
- Dept. of Finance forecasting budget deficit of 7.4% of GDP this year. Could be even higher
- Gov Debt/GDP ratio has fallen sharply, as have Irish bond yields, in recent years
- Debt ratio will move higher this year
- Bond yields stable despite blow-out in budget deficit and much larger debt issuance in 2020
- Ireland's sovereign debt ratings hold steady; S&P at AA-, Fitch at A+, Moody's A2




*Excludes banking recapitalisation costs in 2010-11

Source : Dept of Finance




Source: Thomson Reuters

# Brexit: EU-UK trade talks making little progress

- EU and UK agreed on revised Withdrawal Agreement 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 continues to rule out extending the transition period beyond this date
- Trade talks resume after delay due to virus outbreak, but little sign of progress being made
- Negotiations proving difficult and fractious. Wide gap between both sides
- EU insisting on level playing field for trade, with considerable regulatory alignment, common rules
- UK government puts focus on 'taking back control' and non-alignment with EU
- UK could opt for 'no deal' rather than have close alignment with EU rules – still risk of Hard Brexit
- However, some type of FTA seems likely as it's the best outcome for both the UK and EU
- Could require more time, though, to get a deal done. Extension to transition period a possibility

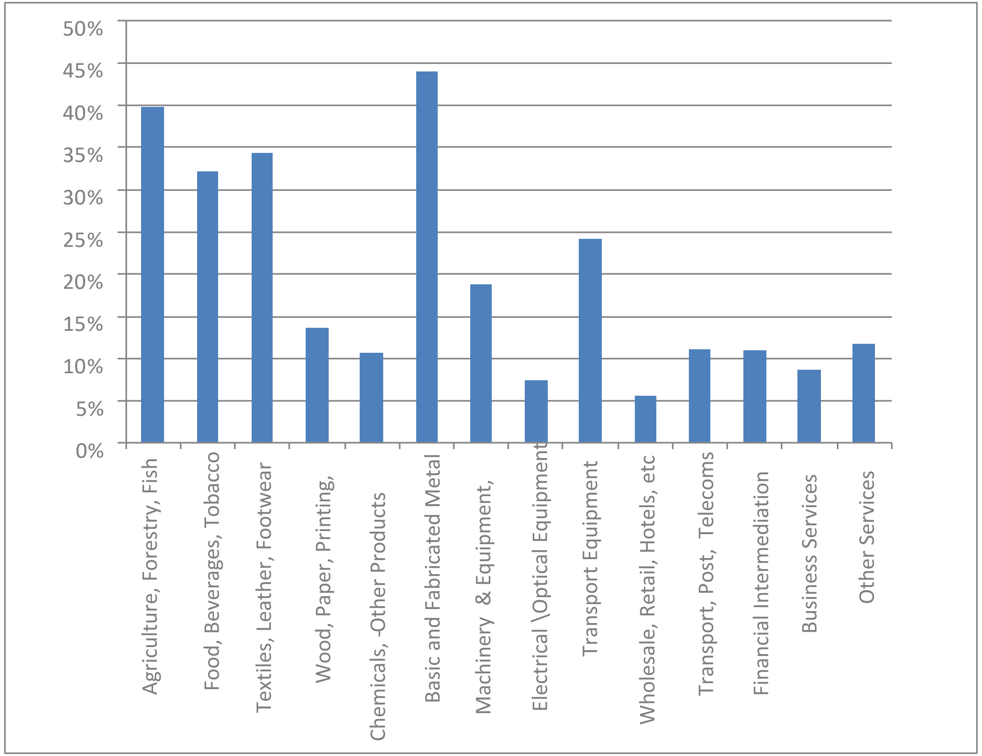
# Key points about any EU-UK Free Trade Agreement

- 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 included 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

# Food industry is 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
- UK could impose tariffs on EU food imports to protect its agri-industry if no trade deal
- 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)



# Brexit 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, weak UK economy, disruption to trade/supply lines, tariffs, new administrative 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 also be impacted 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

# 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 next government
- Government spending supportive of growth
- Activity to be aided by continuing very low interest rate environment
- 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
- Strong Irish growth of circa 6% possible next year after sizeable fall in GDP in 2020
- A UK-EU FTA will lower Irish growth somewhat, possibly by around 0.5% per annum for some years

| Irish GDP Forecasts | | |
|---|---|---|
| % Vol | 2020 | 2021 |
| IMF | -6.8 | 6.3 |
| ESRI | -7.1 | N/A |
| Department of Finance | -10.5 | 5.8 |
| Central Bank of Ireland | -8.3 | N/A |
| European Commission | -7.9 | 6.1 |
| AIB | -7.5 | 6.3 |

| IMF: WEO Irish Forecasts | | |
|---|---|---|
| % | 2020 | 2021 |
| GDP | -6.8 | 6.3 |
| Unemployment Rate | 12.1 | 7.9 |
| CPI | 0.4 | 1.7 |
| Current Account* | 6.3 | 5.3 |
| Budget Balance* | -7.4 | -4.1 |

*% of GDP (Department of Finance for Budget f/c)

# AIB Irish Economic Forecasts

| *% change in real terms unless stated* | 2018 | 2019 | 2020 (f) | 2021 (f) | 2022 (f) |
|---|---|---|---|---|---|
| **GDP** | **8.2** | **5.5** | **-7.5** | **6.3** | **3.5** |
| **GNP** | 6.5 | 3.3 | -6.5 | 5.5 | 3.0 |
| **Personal Consumption** | 3.4 | 2.8 | -8.0 | 5.0 | 3.0 |
| **Government Spending** | 4.4 | 5.6 | 12.0 | -5.0 | 2.0 |
| **Fixed Investment*** | -21.1 | 94.1 | -8.0 | 4.8 | 4.0 |
| **Exports** | 10.4 | 11.1 | -6.0 | 6.3 | 5.0 |
| **Imports*** | -2.9 | 35.6 | -5.4 | 5.3 | 4.7 |
| **HICP Inflation (%)** | 0.7 | 0.9 | 0.0 | 0.7 | 1.0 |
| **Unemployment Rate (%)** | 5.8 | 5.0 | 13.5 | 9.0 | 7.1 |
| **Budget Balance (% GDP)** | 0.1 | 0.4 | -7.5 | -4.0 | -2.5 |
| **Gross General Gov Debt (% GDP)** | 63.5 | 59.3 | 67.5 | 66.0 | 64.0 |

*Data for 2018 & 2019 very distorted by aircraft and intangibles

Source: CSO, D/Finance; AIB ERU Forecasts

# Risks to the Irish economy

- Main risk is obviously the coronavirus – will weigh heavily on growth this year
- Persistence of virus or fresh outbreak could delay global/Irish recoveries
- Highly open nature of Irish economy means it is quite exposed to global recession
- 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, Trump views on Pharma) 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