

The Irish Economic Update:

Strong rebound underway as vaccine rollout allows re-opening of economy

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Economy starts to rebound after long third lockdown

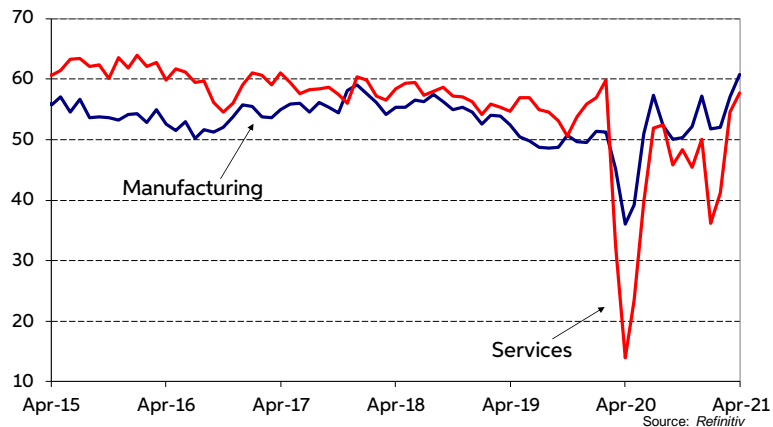


- Irish GDP grew by 3.4% in 2020, with GNP up 0.6%, as exports increased by 6.2%
- Domestic economy contracted by 5.4% last year, with consumer spending down 9% and fixed investment falling by 8.5%, partially offset by 9.8% rise in government expenditure
- Long third lockdown imposed after Xmas, with restrictions only being lifted during Q2
- Sharp fall in construction & services PMIs in early 2021, decline in consumer spending
- Indicators pick-up in the second quarter as economy starts to re-open
- Mfg PMI rises to 57.1 in March and hits record high of 60.8 in April
- Services PMI jumps to 54.6 in March, 57.7 in April. Construction PMI climbs to 49.3 in April
- Prospects for strong growth in H2 2021 and 2022, with economy now on the rebound
- Recent forecasts from DoF, ESRI, IMF and EC are for growth of 4.5% in 2021, 5% in 2022
- Inflation accelerating; rises to 1% in April from -1.5% last autumn. Could hit 3% later in year
- Spike to prove temporary. HICP rate forecast to average circa 1.5% in 2021 and 2022

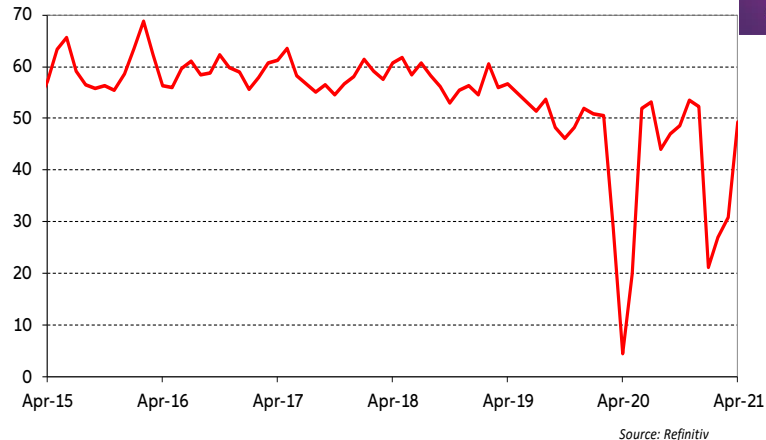
Lead indicators rebound strongly after weak start to 2021



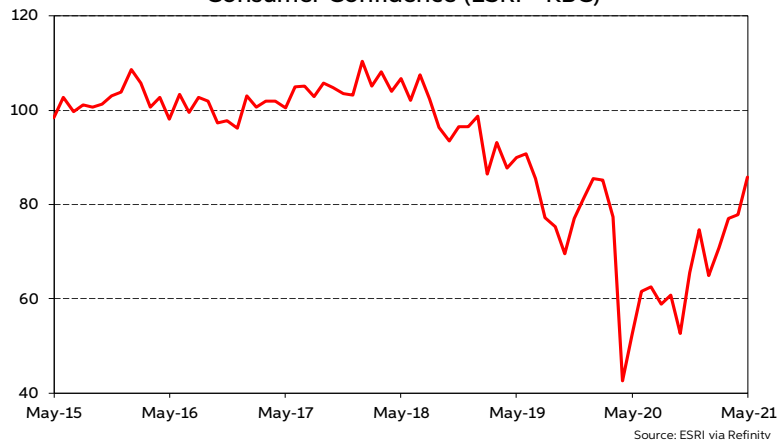
AIB Irish Mfg and Services PMIs



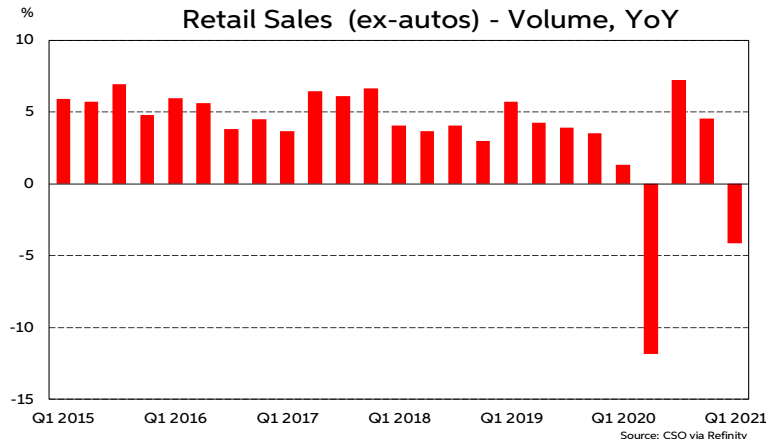
Ulster Bank Construction PMI



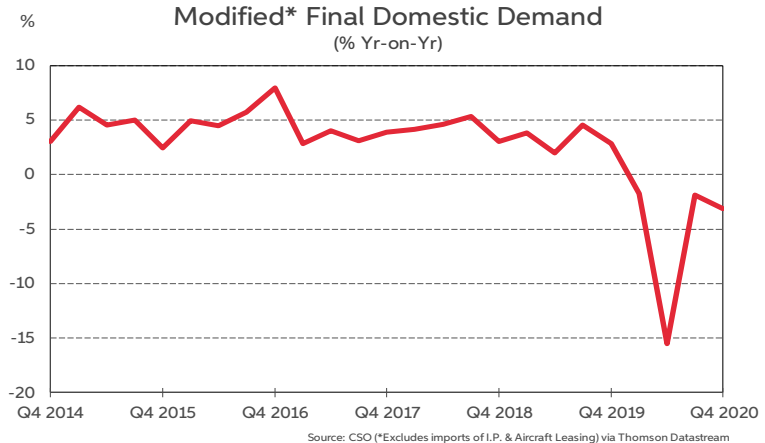
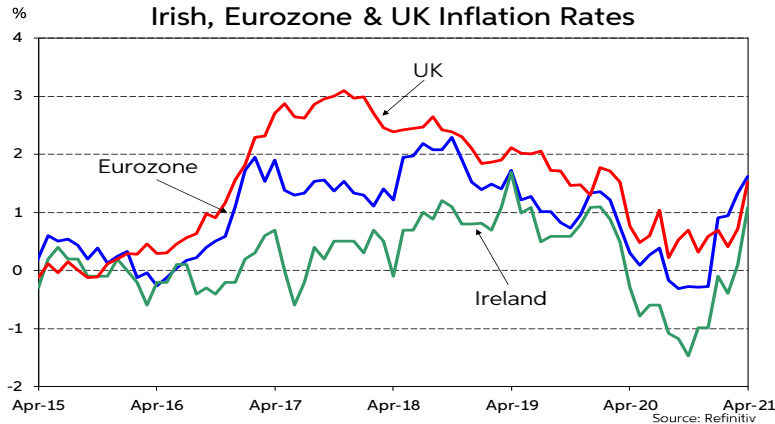
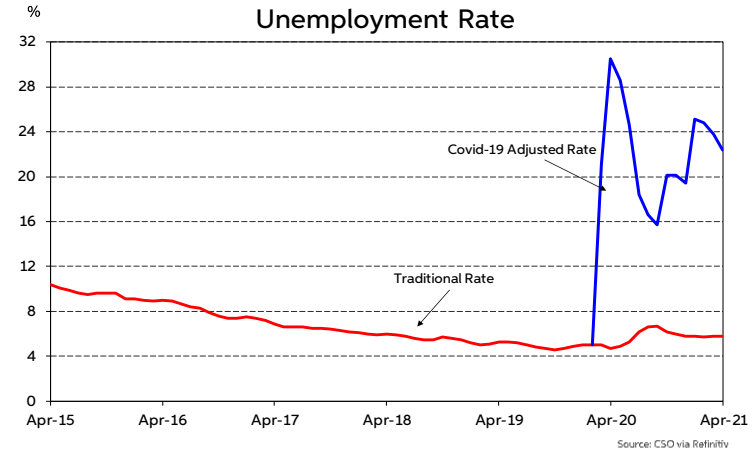
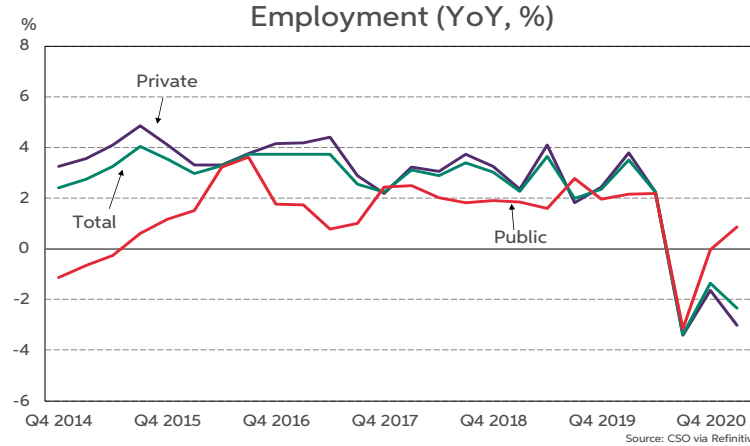
Consumer Confidence (ESRI - KBC)



Retail Sales (ex-autos) - Volume, YoY



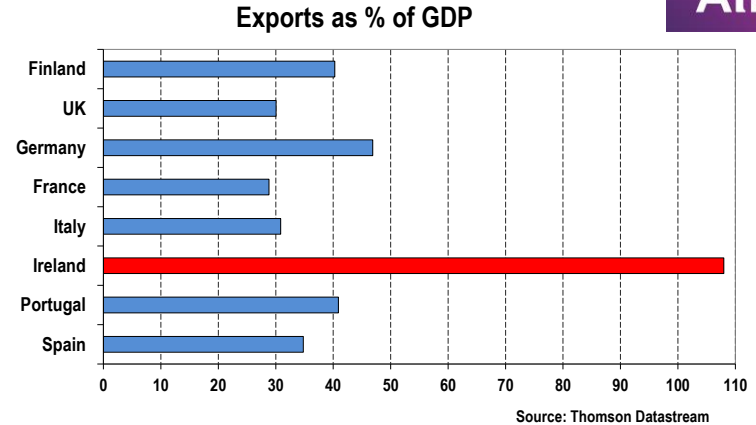
Unemployment starting to fall again, inflation picking up



Goods exports up strongly last year, services exports flat



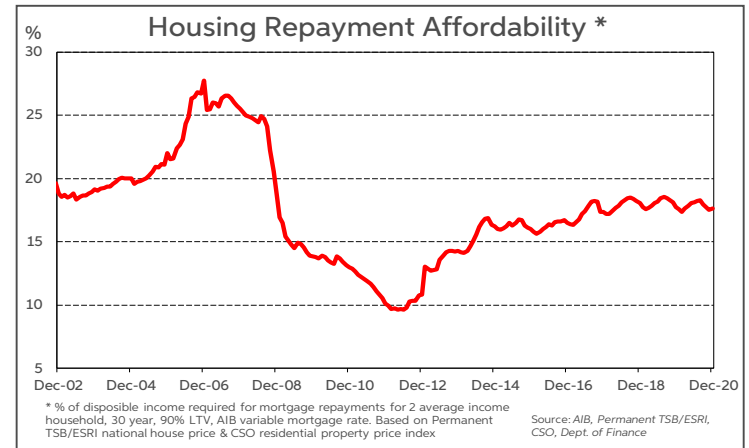
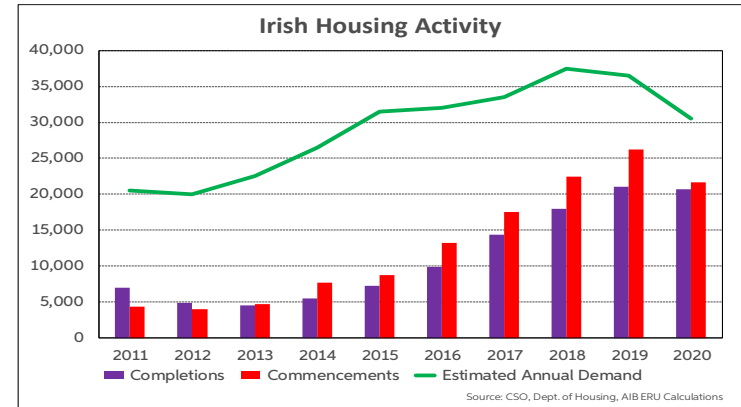
- Ireland a very open economy – exports, driven by large scale FDI, are a huge part of economy
- Exports rise strongly in recent years, helped by large FDI inflows
- Total exports rose 10.4% in 2018, 11.1% in 2019
- Pharma, medical care products, IT equipment, and food & drink are main goods exports
- IT, business, financial and tourism are the main service exports
- Total exports rise 6.2% in 2020
- Goods exports up 11.8% last year, fuelled by very big jump in pharma exports
- Service exports flat in 2020 – fell sharply in H1 but strong rebound in second half of year
- Collapse in earnings from tourism & travel, but computer service exports showed strong growth



House building continues to hold up despite lockdowns



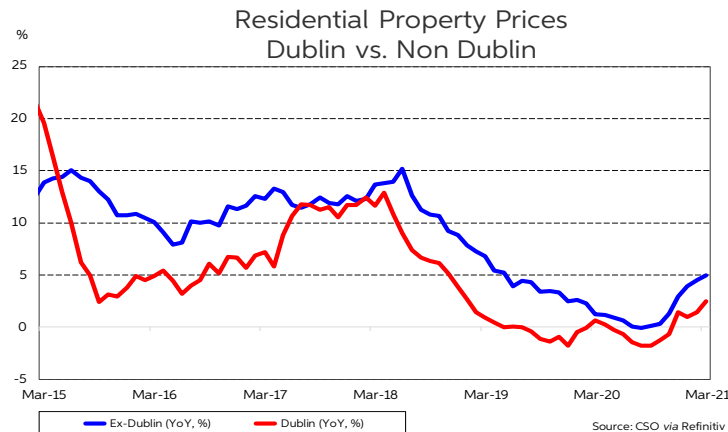
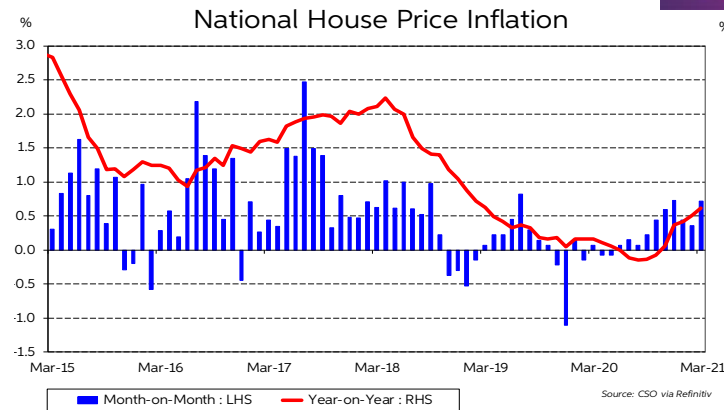
- Total completions amounted to 20,676 in 2020, just 2% down on 2019 level despite a 6-week lockdown
- Commencements fell by over 17% to 21,700 in 2020 from 26,240 in 2019
- Planning permissions jumped sharply last year – up 13.5% as apartments surged for second year
- Smaller than expected fall in housing completions in Q1 2021, though sharp commencements decline continues
- Completions may fall below 20,000 in 2021
- Marked fall in commencements over last year suggests a big rise in completions is unlikely in 2022
- Mortgage lending fell by 12% to €8.4bn in 2020
- However, mortgage approvals surged in H2 2020 and rose by 7.3% yoy in Q1 2021
- Forecasts are for €9.5-10.0bn mortgage market in 2021
- Housing affordability metrics remain quite stable



House prices on marked upward trend



- House prices declined by very sharp 55% over 2007-13
- Prices have since recovered strongly; 90% above trough by March 2021, but still 15% below 2007 peak
- CSO data show house prices little changed over 2019-20, until moving much higher from Q4 last year
- Further rise in house prices in Q1 2021, with March yoy at 3.7%. Prices rise at 6.5% annualised rate since Oct'20
- Non-Dublin prices up 5% yoy in March, still well above Dublin rate of 2.5% yoy
- Property websites show big jump in asking prices since mid-2020. Running at 7.5% yoy in Q1 2021
- Low supply, remote working, strong public/institutional demand, enhanced help-to-buy scheme, rising personal savings are all supporting house prices
- Marked fall in rents in H1 2020 during first lockdown
- Rents rise strongly since December. Up by 0.8% in March and 1.2% in April, with yoy rate turning positive



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 | 21,100 | 20,700 | 17,500 |
| Shortfall in Supply | -19,100 | -19,400 | -15,400 | -9,800 | -13,000 |

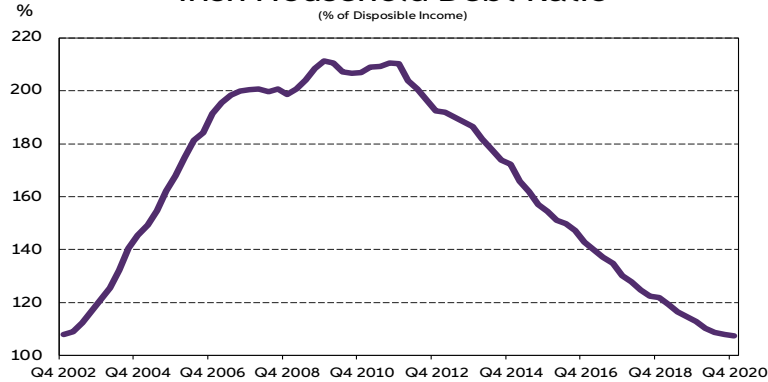
*Headship is % of population that are heads of households.

Sources: CSO, DoECLG, AIB ERU.

Private sector deleverages, Gov. debt ratios move higher

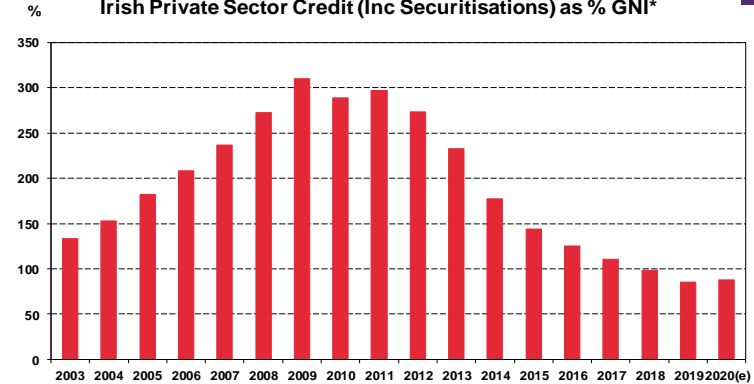


Irish Household Debt Ratio



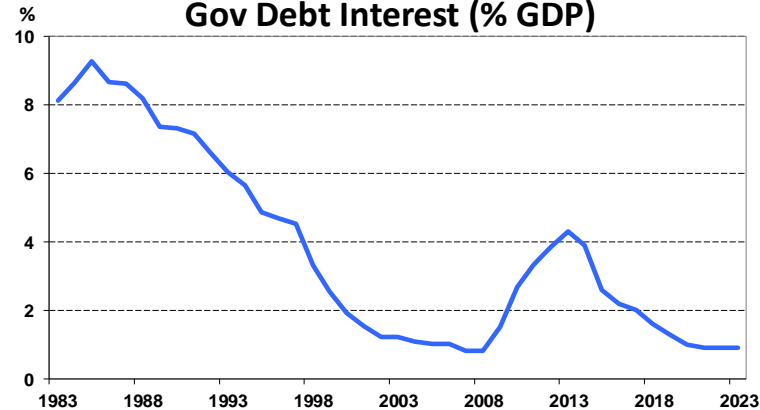
Source: CSO, Central Bank, AIB ERU

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



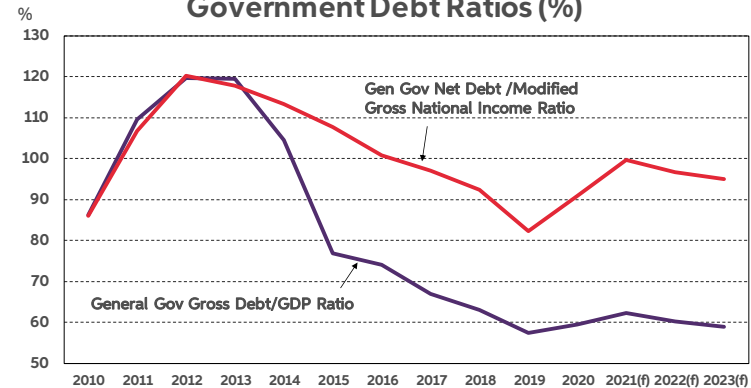
Sources: Central Bank, CSO, AIB ERU Calculations

Gov Debt Interest (% GDP)



Source: NTMA; Dept of Finance

Government Debt Ratios (%)

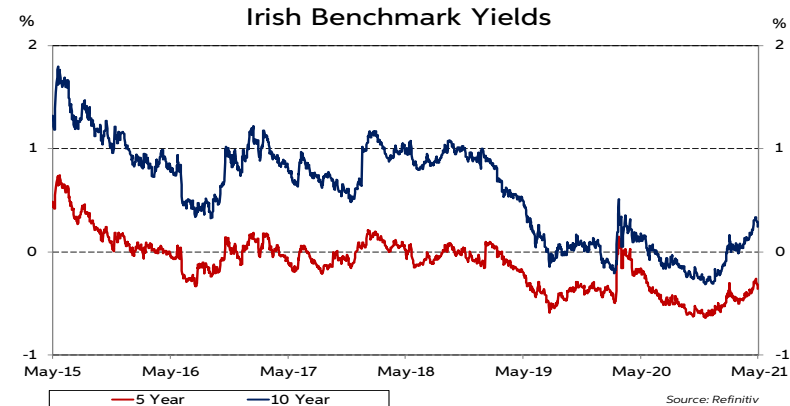
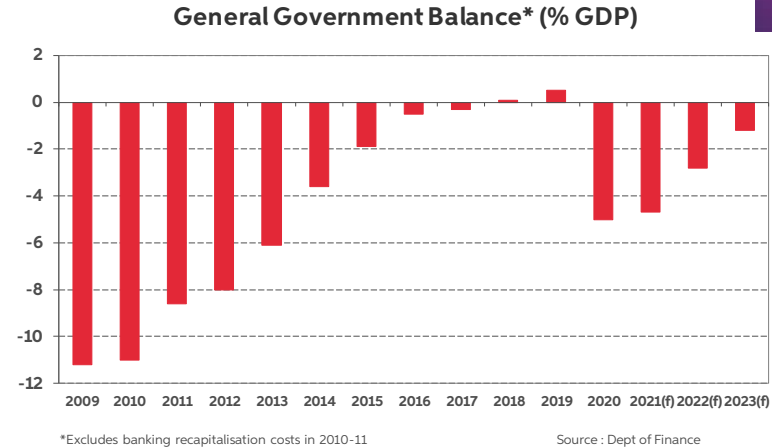


Sources: Dept of Finance, CSO, AIB ERU (Inflated/Distorted GDP figures from 2015)

Big 2020-21 budget deficits to decline sharply in 2022-23



- Budget deficit fell sharply in last decade, with small surpluses recorded in 2018 and 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%
- General Government budget deficit of €18.5bn in 2020, or 5% of GDP
- Dept. of Finance forecasting another large deficit of €18bn in 2021, 4.7% of GDP
- Deficit then forecast to fall sharply to 2.8% in 2022 and 1.2% in 2023 as economy recovers
- Gov. Debt ratios had fallen in past decade, but move higher in 2020 and 2021
- 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



Economy was in very strong shape ahead of Covid shock



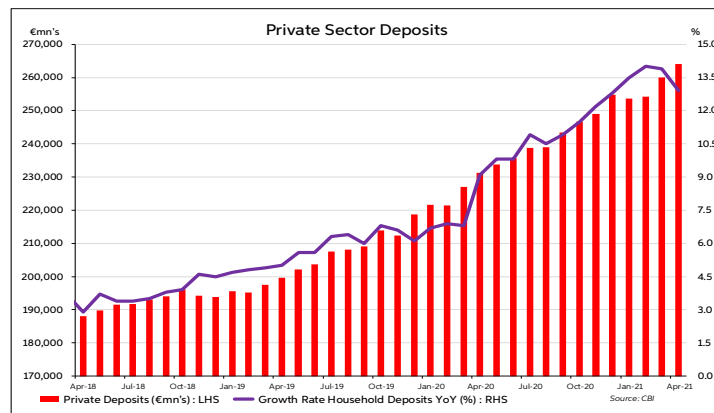
- Economy was in very strong shape ahead of being hit by very deep 2020 Covid recession
- Well balanced, robust underlying growth of circa 5% per annum over 2013-19 period
- Large inflows of FDI and strong export growth remain key features of the economy
- Strong jobs growth, averaging over 3% per annum 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

Factors in place for strong rebound by Irish economy



- Key ingredients in place for a strong rebound by Irish economy from mid-2021 onwards
- Rollout of vaccines gathering momentum, with economies reopening here and elsewhere
- 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
- Government policy can remain supportive of growth - DoF forecasts provide for increased core spending
- Activity aided by continuing very low interest rates
- Economy has deleveraged; low private sector debt
- Large build-up in private savings in 2020-Q1'21 will help fuel strong growth in domestic spending
- Recent official forecast are for GDP to rise by 4.5% in 2021 & 5.0% in 2022 – AIB will update its forecasts when CSO publishes Q1 GDP data on June 4th

| IMF GDP Forecasts (April 2021) | | | |
|--------------------------------|------|------|------|
| % Vol | 2020 | 2021 | 2022 |
| World | -3.3 | 6.0 | 4.4 |
| OECD | -4.7 | 5.1 | 3.6 |
| US | -3.5 | 6.4 | 3.5 |
| Eurozone | -6.6 | 4.4 | 3.8 |
| UK | -9.9 | 5.3 | 5.1 |
| Japan | -4.8 | 3.3 | 2.5 |



AIB Irish Economic Forecasts



| <i>% change in real terms unless stated</i> | 2019 | 2020 | 2021 (f) | 2022 (f) | 2023 (f) |
|---|------------|-------------|-------------|------------|------------|
| GDP | 5.6 | 3.4 | 3.0 | 5.5 | 4.0 |
| GNP | 3.4 | 0.6 | 2.5 | 5.0 | 3.5 |
| Modified Final Domestic Demand | 3.3 | -5.4 | 2.8 | 5.5 | 3.5 |
| Personal Consumption | 3.2 | -9.0 | 3.0 | 7.5 | 4.0 |
| Government Spending | 6.3 | 9.8 | 1.5 | -3.0 | 1.0 |
| Fixed Investment* | 74.8 | -32.3 | -6.5 | 8.0 | 4.5 |
| Exports | 10.5 | 6.2 | 4.5 | 5.0 | 4.5 |
| Imports* | 32.4 | -11.3 | 1.5 | 5.2 | 4.3 |
| HICP Inflation (%) | 0.9 | -0.5 | 1.6 | 1.6 | 1.5 |
| Unemployment Rate (Estimated %) | 5.0 | 10.4 | 11.0 | 8.2 | 6.9 |
| Budget Balance (% GDP) | 0.5 | -5.0 | -4.7 | -2.8 | -1.2 |
| Gross General Gov Debt (% GDP) | 57.4 | 59.5 | 62.5 | 60.5 | 59.0 |

*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 Fall-Out:

- 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/Ireland annual GDP growth rates
- 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 – Customs declarations, regulatory checks, political impact

Ireland's 12.5% Corporate Tax regime at risk



Importance of FDI:

- Some 1,600 multinational companies are based in Ireland, accounting for over 250,000 in direct employment or about 18% of total jobs in terms of direct and indirect employment.
- Corporation tax accounts for €12bn or circa 20% of total tax revenue... 80% of this comes from MNCs

Threats to Ireland's Corporate Tax Regime:

- Ireland's relatively low & stable 12.5% corporate tax rate has been seen as key cornerstone in attracting FDI
- **OECD seeking to introduce a minimum global corporate tax rate.** Move is being supported by larger economies. Recent speculation that this could be set at 15%, not that far above the Irish rate
- President **Biden initially proposed 21% global minimum tax rate for US companies, up from the current 10.5%.** He may instead now move in line with OECD and adopt 15% rate
- **OECD also planning new digital sales tax** whereby multinationals would pay taxes on profits in countries where they make digital sales, rather than where they are based

Major Uncertainties Remain:

- DoF has allowed for a €2bn hit to Irish corporation tax receipts by 2025 from likely changes to tax system
- Uncertainty remains as (1) still unclear what minimum US global rate will be – needs to be approved by Congress; (2) OECD has not yet formally proposed a minimum global corporate tax (3) unclear if OECD will also get agreement on digital sales tax (4) No indication on when any changes would take effect
- Irish Finance Minister expects the Irish 12.5% corporate tax rate to remain in place over coming years

Tax changes coming, but Ireland still has advantages



Ireland will remain attractive FDI location:

- Big multinationals will still need to retain large global operations, whatever happens in the tax field
- US companies require employees with language skills to service European customers in European time zone
- English speaking country with common law system remains key attraction of Ireland for US companies
- Ireland's main competitor for FDI has been UK, but it is now out of EU, Single Market & Customs Union
- Strong talent pool of internationally mobile, highly skilled, well educated workers (17% of workforce is non-Irish)
- Key industries have large presence in Ireland, with its strong pro-enterprise culture, leading R&D and innovation

Change is coming, but FDI inflows continue:

- Irish Finance Minister has conceded that a “period of significant change is coming”
- Could see agreement on new global corporate tax regime reached this summer
- Tax changes usually phased in, while MNCs unlikely to make any quick decisions on moving locations
- 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). Thus, even if it is raised, Ireland's rate will likely remain comparatively low
- Strong inflow of FDI continues (Intel, Stripe) despite moves to change global corporate tax rules

Reprise of risks to the Irish economy



- Main near term risk is still Covid-19 – concerns about new variants
- Virus could leave lasting scarring effects – high business failures & bad debts, job losses
- Very open nature of Irish economy means it is exposed to any weakening in global economy
- Changed EU-UK trading relationship may yet negatively impact some Irish industries
- Questions around Ireland's corporation tax regime (pressure for tax harmonisation in EU, OECD digital tax/minimum tax rate proposals, changes to US overseas corporate tax rate)
- 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

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.