

The Irish Economic Update:

Strong summer rebound continuing, with last of Covid-19 restrictions due to go this month

October 2021

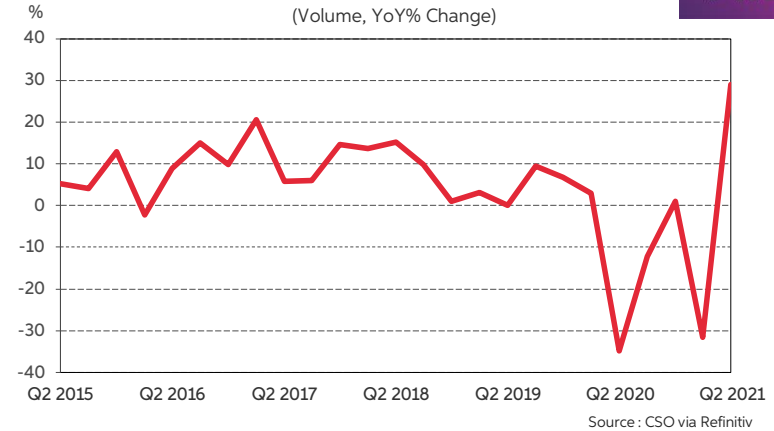
Oliver Mangan
Chief Economist
AIB

Economy rebounds strongly as lockdowns end

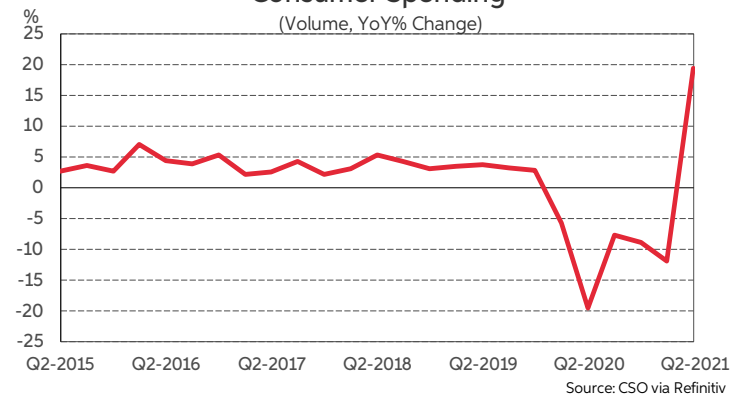


- GDP grew by 5.9% in 2020, with GNP up 3.4%
- Modified final domestic demand fell by 4.9% and modified gross national income down 3.5% in 2020
- Third lockdown saw GNP contract by 3% in Q1 2021 but rebound by 6.7% in Q2 as economy re-opened
- MFDD fell by 5% in Q1, but up 8.4% in Q2
- Consumer spending 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

Construction Output
(Volume, YoY% Change)



Consumer Spending
(Volume, YoY% Change)



Very big rebound in activity as restrictions are eased

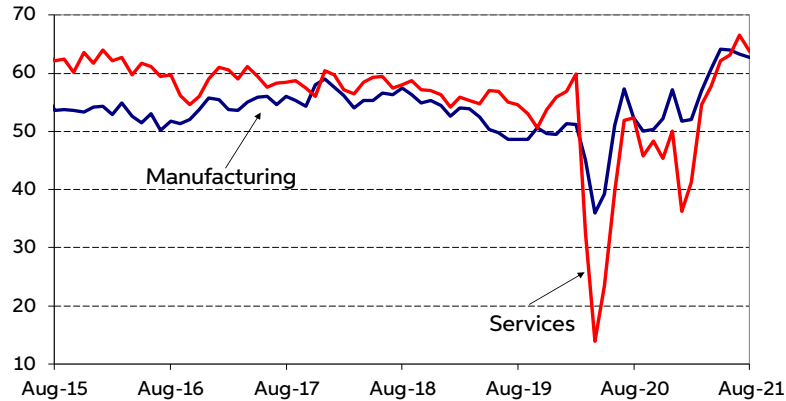


- Restrictions started to be lifted during Q2 after long third lockdown imposed in Q1
- Indicators point to very strong rebound in activity in Q2 and Q3 after lockdown ended
- Mfg PMI hit record high of 64.1 in May, and stays well above 60 over summer - 62.8 in August
- Services PMI jumped to twenty year high of 66.6 in July, at 63.7 in August
- Construction PMI soared in May to 66.4, falling back to still strong level of 57.5 by August
- Big jump of 10% in core retail sales in Q2. Sales remain strong in July/August
- New car sales rose by 23% yoy in January-August period
- Tax receipts running ahead of target by 5.4% at end August – and up 15.2% year-to-date
- Jobless rate (including PUP) falling rapidly – down from 27% earlier in year to 12.4% by Aug
- Inflation accelerating; rises to 2.8% in August from -1.5% last autumn. Could reach near 4%
- Spike to prove temporary. Inflation forecast to fall back to 2% or below by end of next year

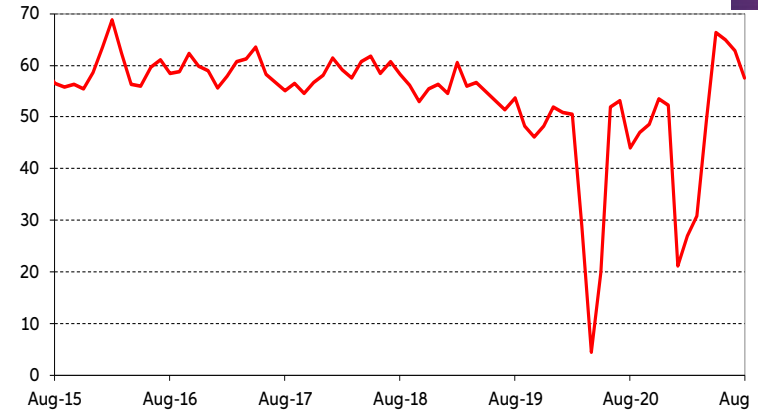
Indicators pick up strongly as economy reopens



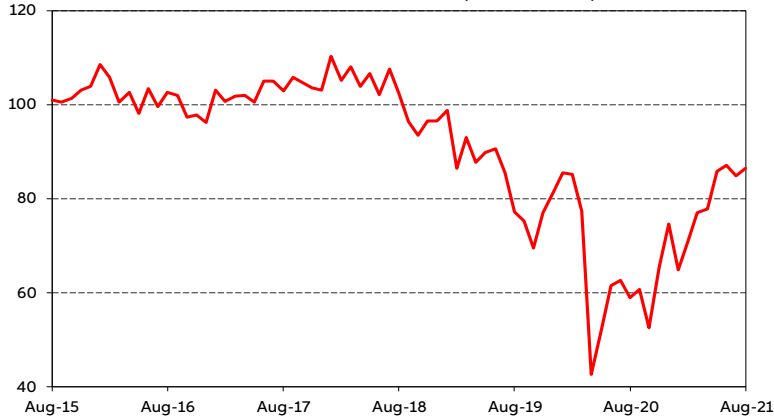
AIB Irish Mfg and Services PMIs



Ulster Bank Construction PMI

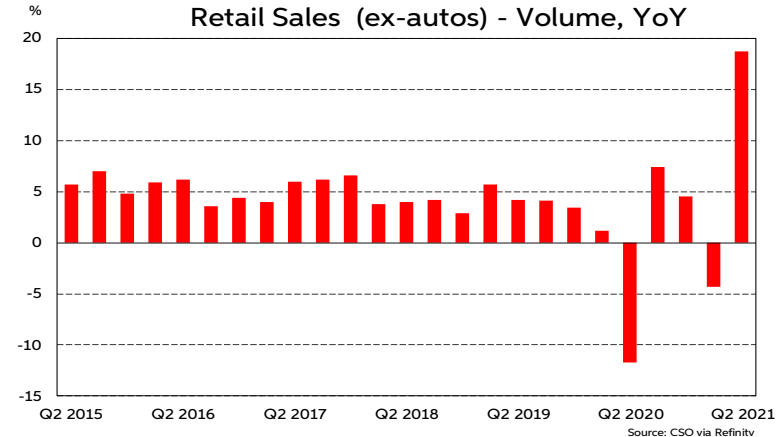


Consumer Confidence (ESRI - KBC)



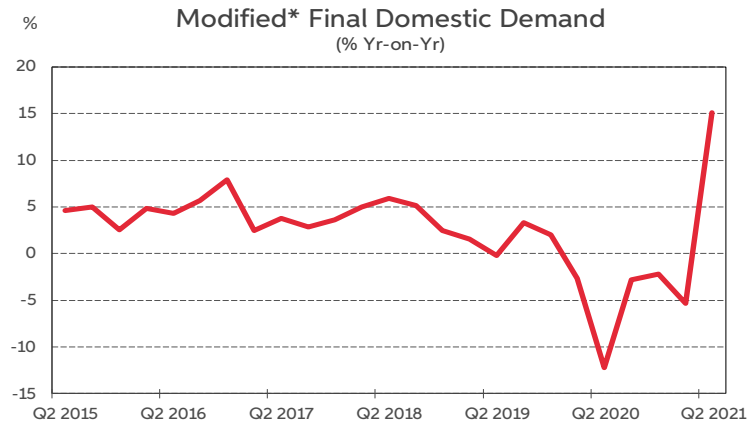
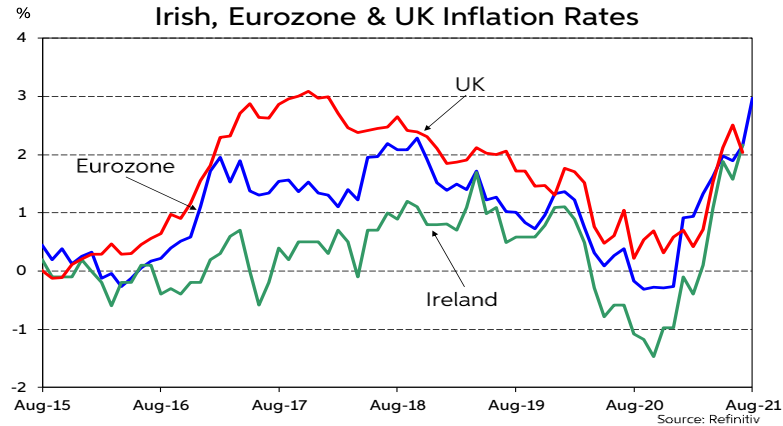
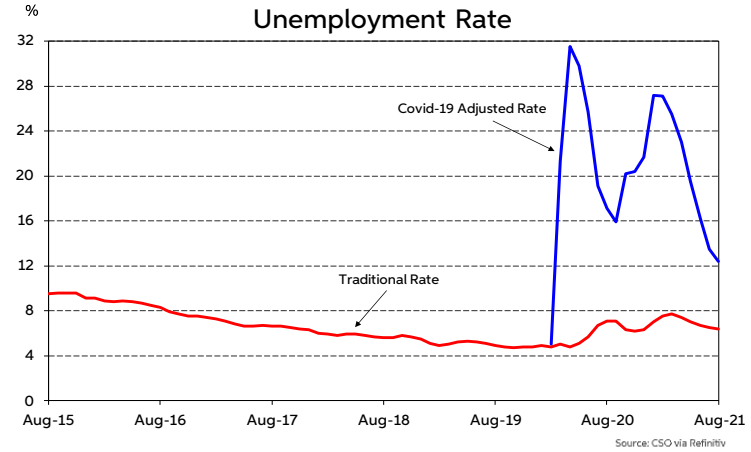
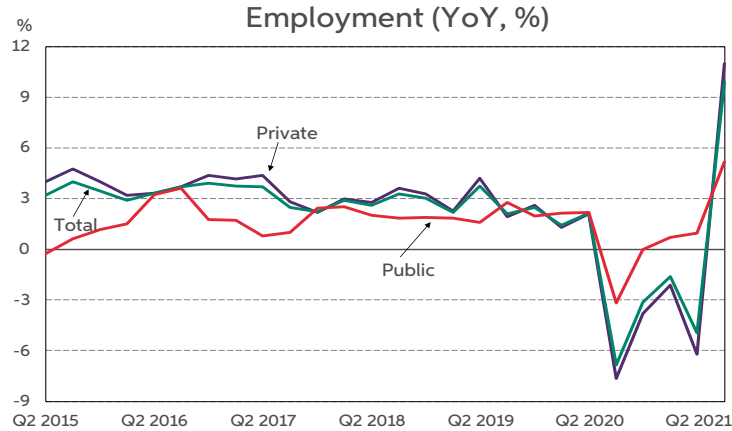
Source: ESRI via Refinitiv

Retail Sales (ex-autos) - Volume, YoY



Source: CSO via Refinitiv

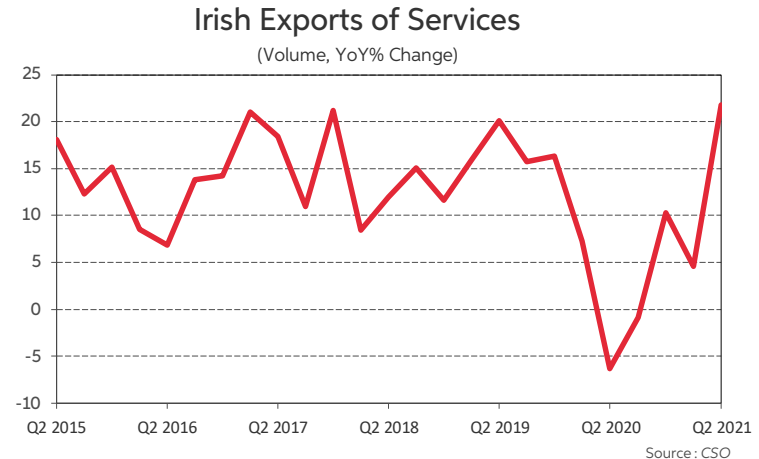
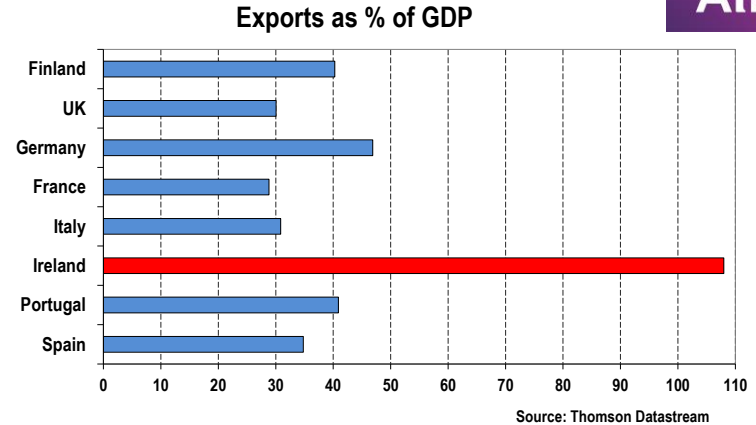
Unemployment declining rapidly, inflation on the rise



Exports perform very strongly throughout the pandemic



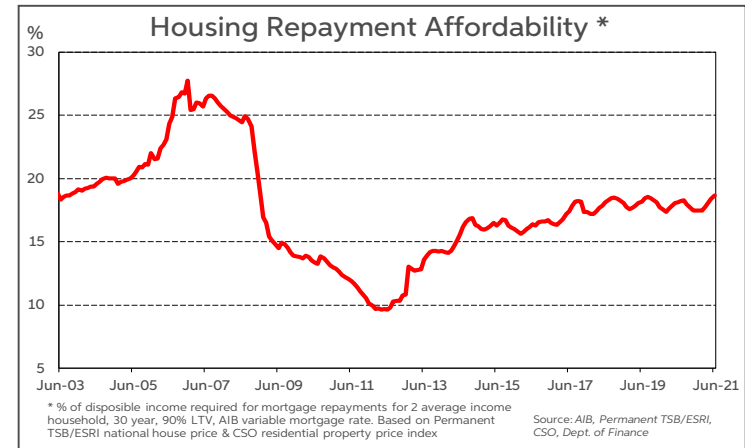
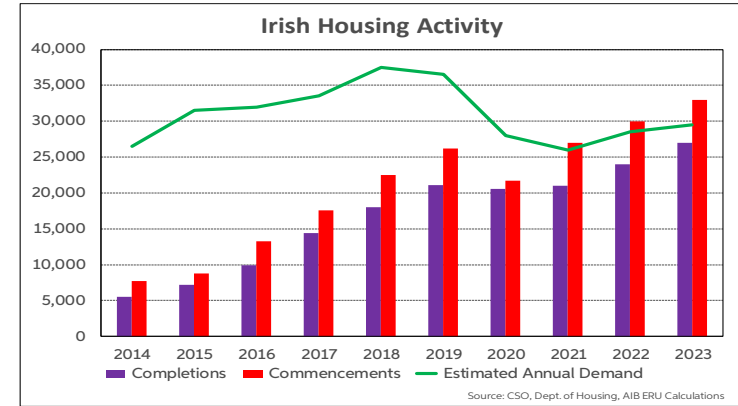
- Ireland a very open economy – exports, driven by large scale FDI, are a huge part of economy
- Exports rise strongly in recent years, helped by large FDI inflows
- Pharma, medical care products, IT equipment, and food & drink are main goods exports
- IT, business, financial and tourism are the main 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



House building holds up, while commencements rebound



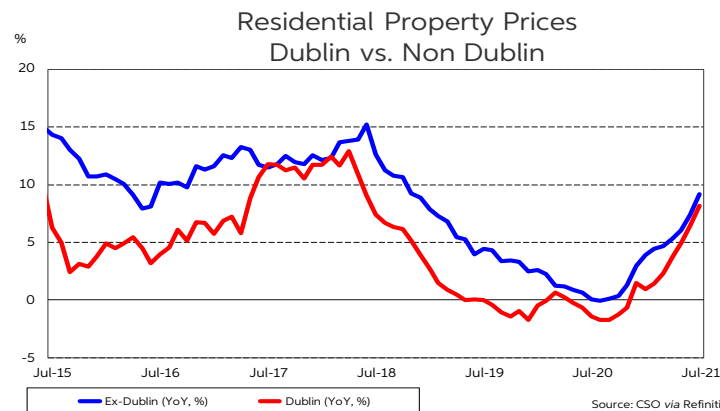
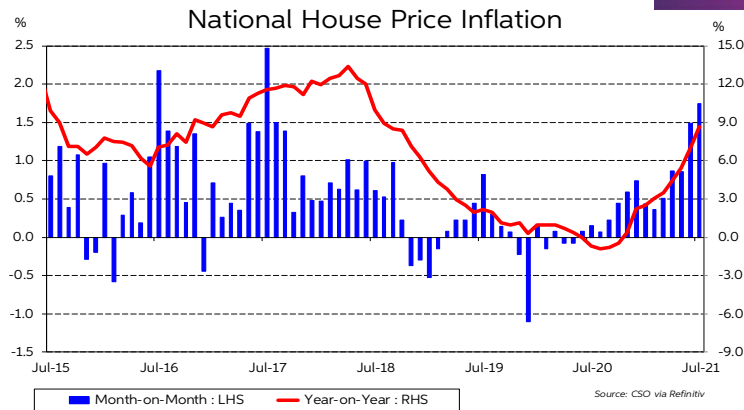
- Total completions amounted to 20,535 in 2020, just 2.6% down on 2019 level despite a 6-week lockdown
- Big jump in planning permissions in past couple of years
- Commencements fell by over 17% to 21,700 in 2020
- Further sharp fall in commencements in Q1'21, but they surged in Q2 as house building sector reopened
- Commencements jump to 29,000 in 12 months to July
- Smaller than expected fall in completions in Q1 2021 and rebound strongly in Q2. Up 9.7% yoy in H1 2021
- 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 rose over 25% yoy in H1'21
- Forecasts are for a €10bn+ mortgage market in 2021
- Housing affordability disimproves slightly as prices rise



House prices on marked upward trend



- House prices declined sharply, by 55% over 2007-13
- Prices have since recovered strongly, but still 11% below 2007 peak
- CSO data show house prices little changed over 2019-20, until starting to move higher from Q4 last year
- Strong rises in house prices to date 2021, with yoy rate accelerating to 8.6% by July
- Non-Dublin prices up 9.2% yoy in July, above Dublin rate of 8.2% yoy - prices rising strongly everywhere
- Property websites show big jump in asking prices since mid-2020. Running at circa 9% yoy in Q3 2021
- 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. Annual rate of growth accelerates to 4.5% by August 2021



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
<i>of which</i>					
<i>Indigenous Population Growth</i>	21,000	17,500	16,000	15,500	14,500
<i>Migration Flows</i>	10,000	5,000	4,500	7,500	9,500
<i>Headship Change*</i>	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 move higher

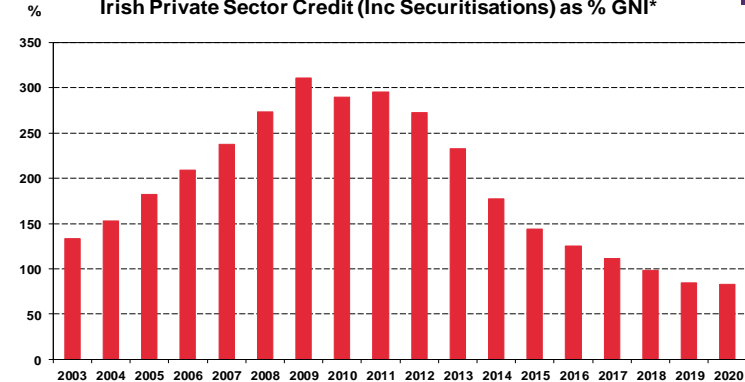


Irish Household Debt Ratio



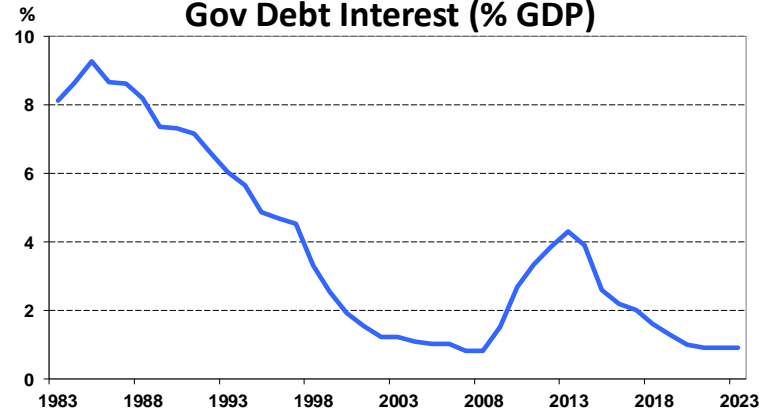
Source: CSO, Central Bank, AIB ERU

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



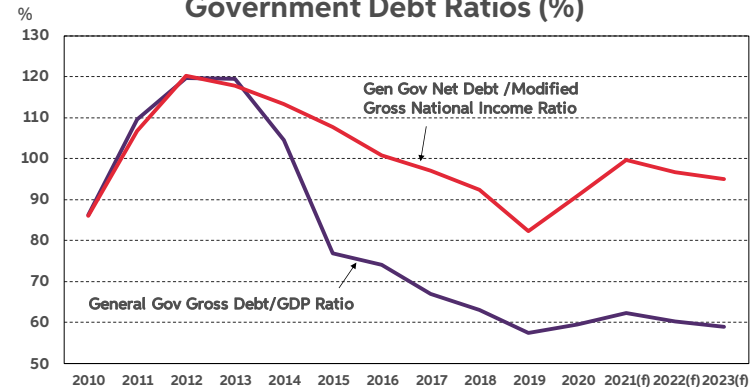
Sources: Central Bank, CSO, AIB ERU Calculations

Gov Debt Interest (% GDP)



Source: NTMA; Dept of Finance

Government Debt Ratios (%)

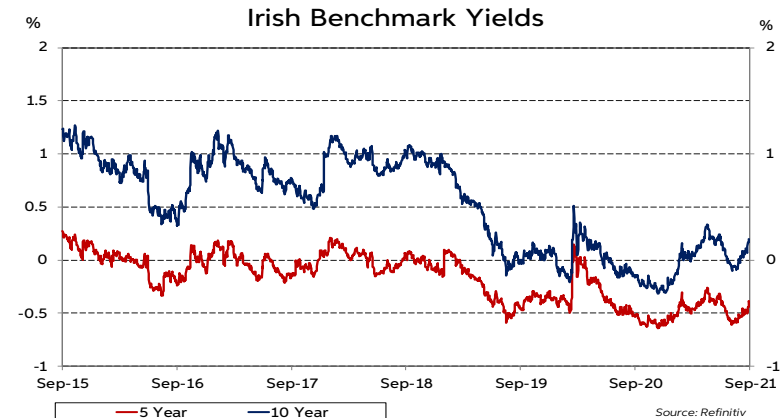
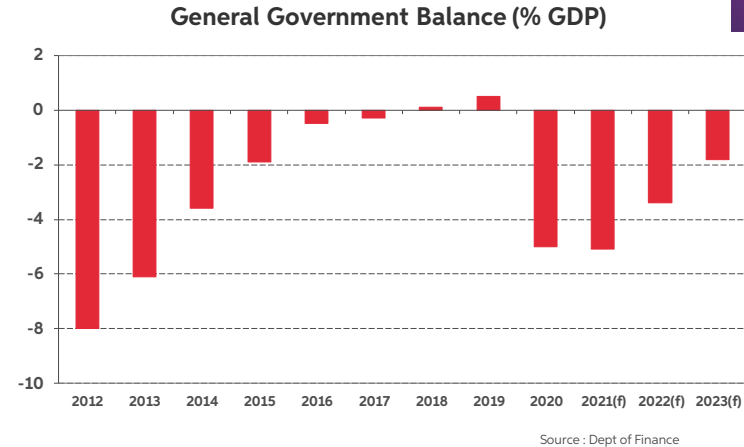


Sources: Dept of Finance, CSO, AIB ERU (Inflated/Distorted GDP figures from 2015)

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
- General Government budget deficit of €18.4bn in 2020, or 5% of GDP
- Strong rebound in tax receipts in 2021 – up over 15% year-to-date at end August
- Dept. of Finance forecasting another large deficit of circa €20bn in 2021, or 5% of GDP
- Deficit forecast to fall to 3.4% in 2022 and 1.8% in 2023 as Covid supports end & economy recovers
- Gov. Debt ratios had fallen in last 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



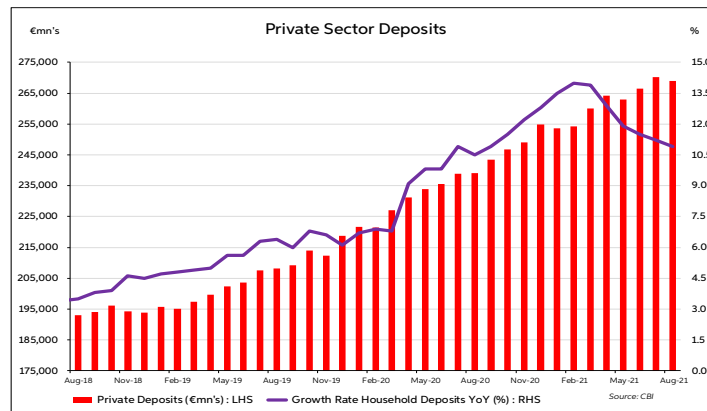
- Economy was in very strong shape ahead of being hit by very deep 2020 Covid recession
- Well balanced, robust underlying growth of circa 5% per annum over 2013-19 period
- Large inflows of FDI and strong export growth remain key features of the economy
- Strong jobs growth, averaging over 3% per annum 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 - moderate growth in mortgage market and house prices pre-Covid
- Very low, stable CPI inflation of below 1% over 2013-19 period
- Balance of payments returned to large surplus

Elements in place for return to strong Irish economic growth



- Key ingredients in place for a strong rebound by Irish economy from 2021 onwards
- Rollout of vaccines allows economies to reopen here and elsewhere – very high Irish vaccination rates
- 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 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-H1'21 will help fuel strong growth in domestic spending
- Strong growth forecast for 2021-22 - GDP bloated in 2021. Growth in GNP and MFDD much lower

OECD Global GDP Forecasts			
% Vol	2020	2021	2022
World	-3.4	5.7	4.5
OECD	-4.8	5.3	3.8
US	-3.4	6.0	3.9
Eurozone	-6.5	5.3	4.6
UK	-9.8	6.7	5.2
Japan	-4.6	2.5	2.1



AIB Irish Economic Forecasts

<i>% change in real terms unless stated</i>	2019	2020	2021 (f)	2022 (f)	2023 (f)
GDP	4.9	5.9	8.0	5.5	4.0
GNP	5.0	3.4	5.5	5.0	3.5
Modified Final Domestic Demand	1.7	-4.9	4.0	5.3	3.7
Personal Consumption	3.3	-10.4	3.7	7.5	4.0
Government Spending	7.1	10.9	1.7	-1.5	1.0
Fixed Investment*	99.5	-23.0	-40.0	7.0	5.0
Exports	10.4	9.5	9.5	5.2	4.5
Imports*	41.7	-7.4	-9.5	5.2	4.5
HICP Inflation (%)	0.9	-0.5	1.9	1.9	1.5
Unemployment Rate (Estimated %)	5.0	10.4	11.0	8.2	6.9
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 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/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 – 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 viewed as key cornerstone in attracting FDI
- OECD has moved to introduce a minimum global corporate tax rate. This is being supported by most countries, who have agreed to a minimum rate of 15%. Ireland seeks further clarification and discussion on matter
- 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 opt for a 15% rate
- OECD also agrees on other tax changes 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

Major Uncertainties Remain:

- DoF has allowed for a €2bn hit to Irish corporation tax receipts by 2025 from changes to global tax system
- Uncertainty remains as (1) still unclear what minimum US global rate will be – needs to be approved by Congress (2) Ireland seeking clarity that proposed minimum 15% global corporate tax will not be any higher (3) unclear what sectors/companies the digital tax on 20% of sales will apply (4) No indication on when changes would take effect
- Irish government holding out at present on moving from 12.5% corporate tax rate given all these uncertainties

Ireland has other advantages besides low tax rate



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 later this year, but ratification is not guaranteed
- Tax changes usually phased in after a number of years
- 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 in 2021 (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 – high case numbers, concerns about new variants
- Virus could leave lasting scarring effects – rising 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.