



The Irish Economic Update:

*Second Covid wave interrupts recovery,
but news on vaccines improves prospects*

December 2020

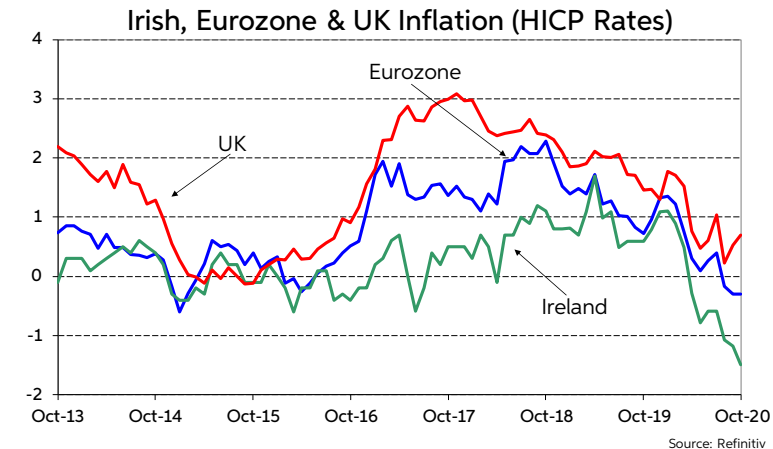
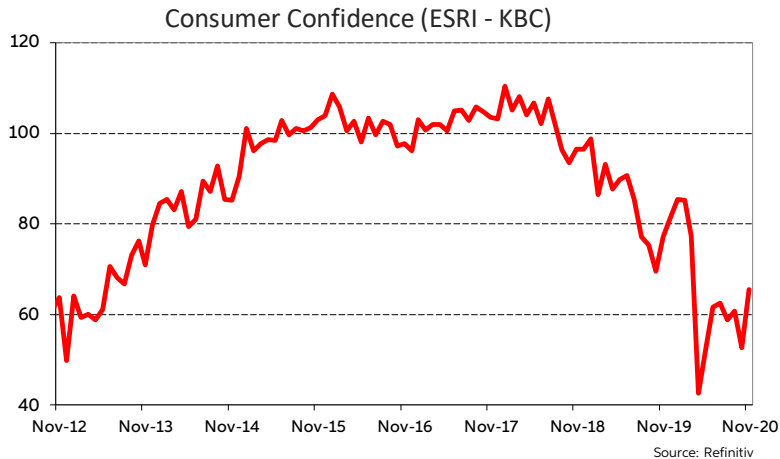
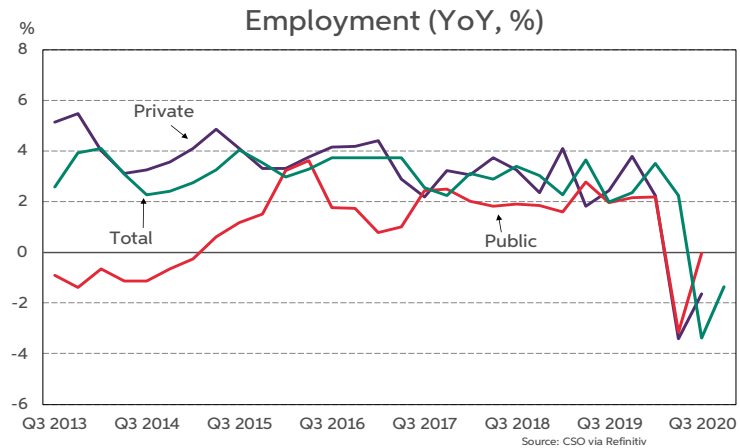
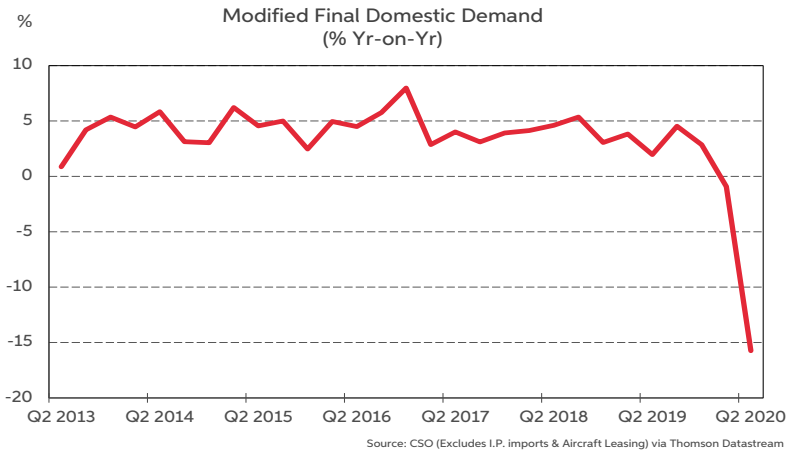
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Economy in very strong shape ahead of Covid shock



- Irish economy was in very strong shape ahead of being hit by very deep H1 Covid recession
- Economy had recovered strongly from severe recession of 2009-2012 period
- 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
- 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

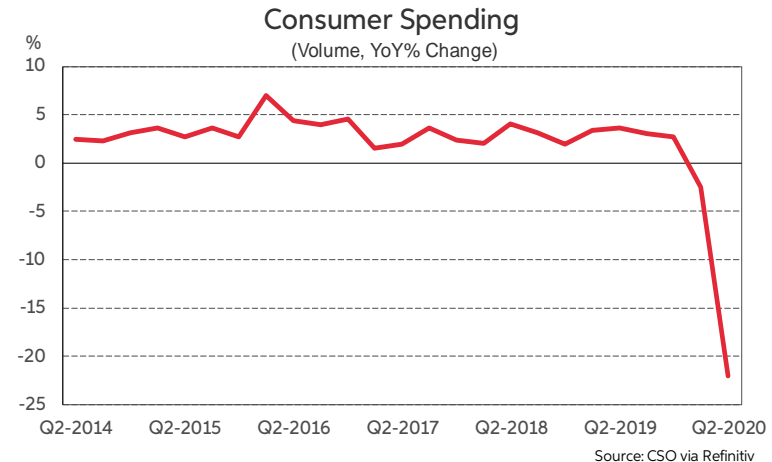
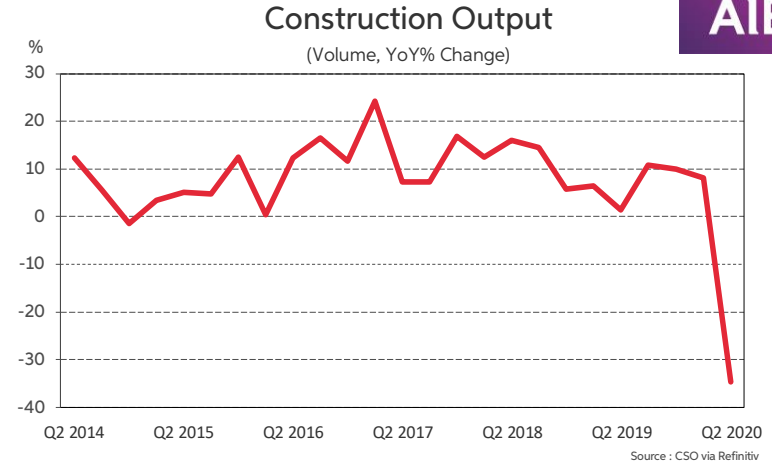
Big Covid hits to domestic demand, employment, inflation



Domestic spending fell sharply on Covid impact in H1'20



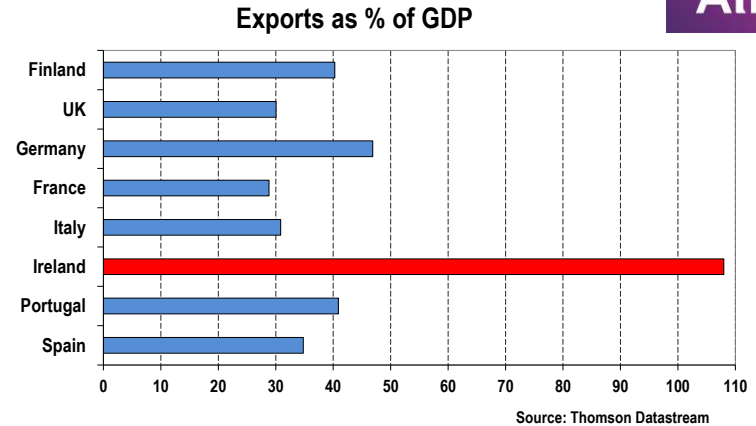
- Covid hit saw modified final domestic demand fall by 16.4% in Q2 2020, after decline of 1.3% in Q1
- Consumer spending contracted by 19.6% in Q2 following fall of 3.6% in Q1
- Core retail sales down by 12% in Q2, with very sharp fall in April in particular
- New car sales fell by 37% yoy in H1 2020
- Domestic fixed investment contracted by 28% in Q2
- Construction output fell by 38% in Q2
- Transport & Hospitality output down by 30% in Q2
- Jobless rate soared in March-May; COVID-19 adjusted unemployment rate rose to near 29%
- PMIs sank to very low levels in April and May, especially for services and construction
- Overall, GDP fell by 2.1% in Q1 and 6.1% in Q2, so economy entered a deep recession in H1 2020



Goods exports performed well in H1'20, services exports fell



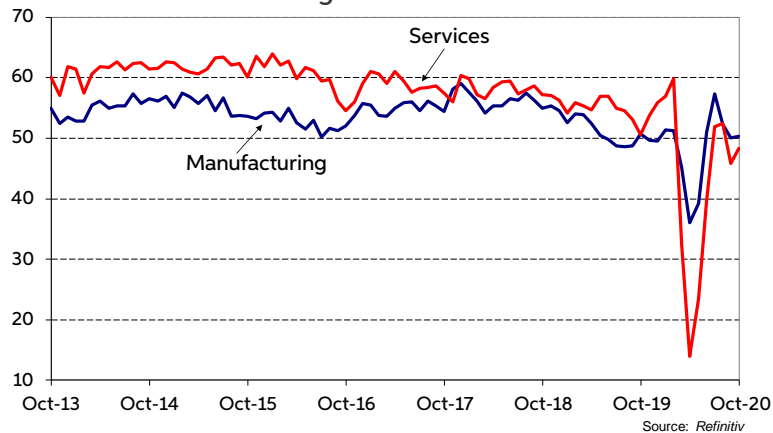
- Ireland a very open economy – exports, driven by large scale FDI, are a huge part of economy
- Exports rise strongly in recent years, helped by large FDI inflows
- Total exports rose by 10.4% in 2018 and 11.1% in 2019.
- Pharma, medical care products, IT equipment, and food & drink are main goods exports
- IT, business, financial and tourism are the main service exports
- Total exports rise 3.2% yoy in H1 2020 – goods up 7.3% but services fall by 1.1% yoy
- Big jump in pharma exports in H1 at +28% yoy, other goods exports held up quite well
- Collapse in earnings from tourism & travel in Q2, but computer service exports up 10% yoy



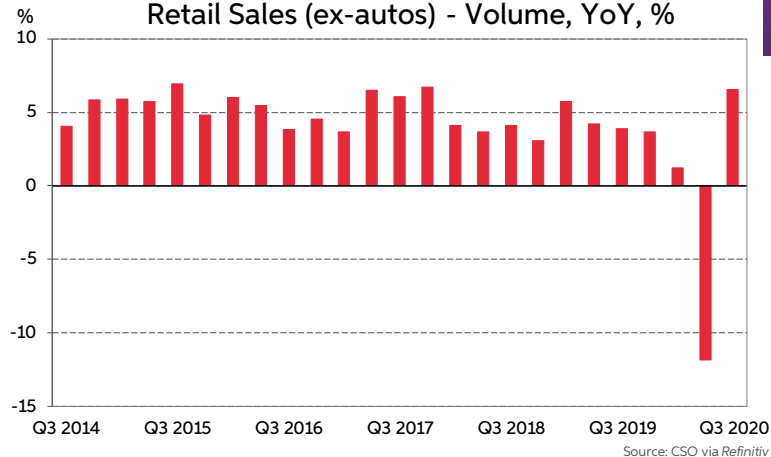
Activity rebounded over summer as lockdown lifted



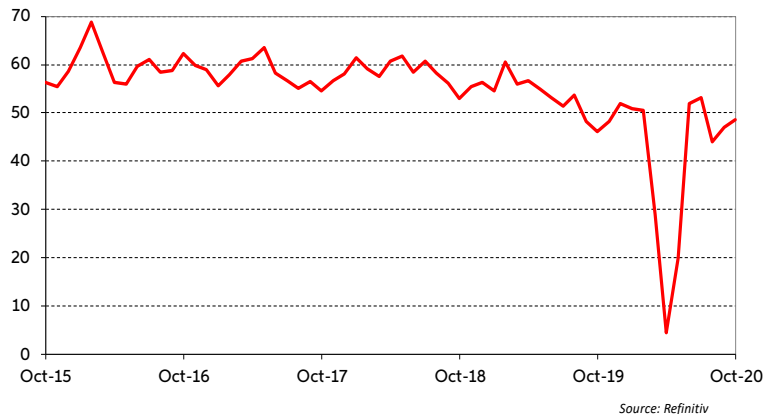
AIB Irish Mfg and Services PMIs



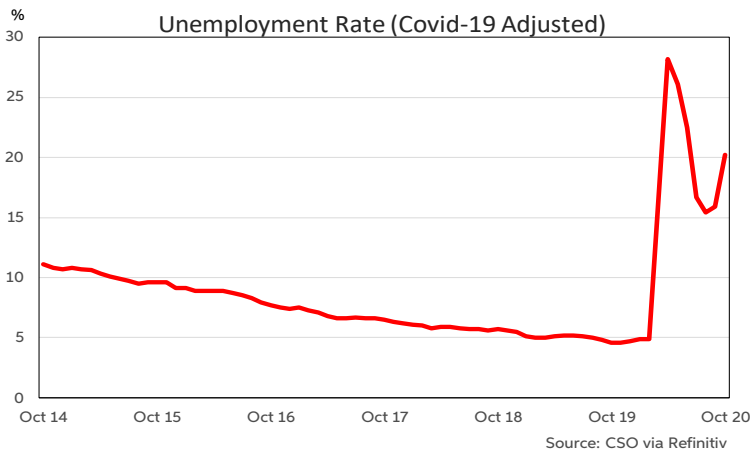
Retail Sales (ex-autos) - Volume, YoY, %



Ulster Bank Construction PMI



Unemployment Rate (Covid-19 Adjusted)



New lockdown in Q4, but prospects brighten on vaccines

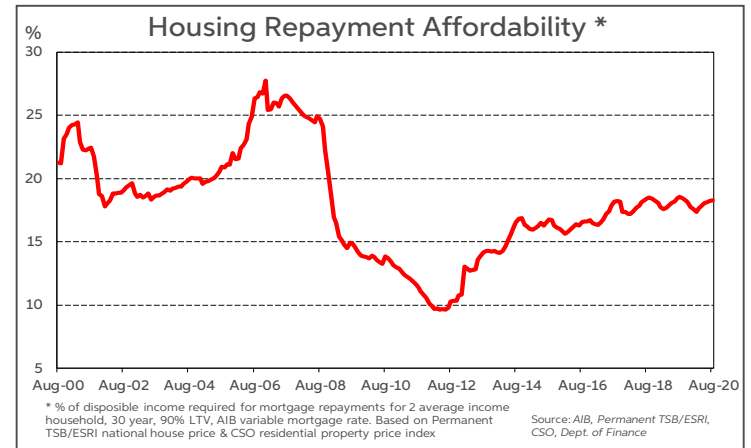
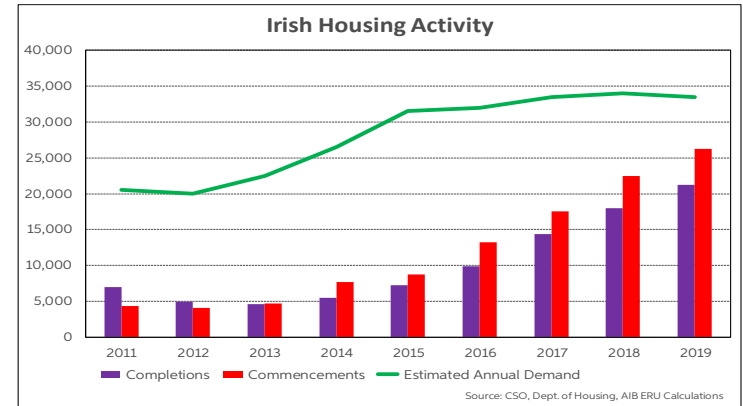


- Unemployment rate down to 14.7% by September, but rising sharply again in Q4 on new lockdown
- Core retail sales rebound strongly; up 22% in Q3 vs Q2 level, +7.2% yoy. Flat in October vs Sept
- New car registrations rose in August-October period after very weak H1 2020 – well down in 2020
- Modest pick-up in consumer sentiment during the summer, but does not build on this in the autumn
- Manufacturing PMI rebounded strongly to 57.3 by July, but back at 50 in September/October
- Services PMI picked-up to 52.4 in August but back below 50 in Sept/Oct on second Covid wave
- Construction PMI at 53.2 in July but back below 50 in subsequent three months
- New 6 week lockdown imposed from late Oct to end November as Covid cases spiked higher
- Domestic spending to contract again in Q4 with lockdown, though government provides supports
- GDP to fall by 3.0-3.5% in 2020 - resilient exports offset part of steep decline in domestic demand
- Growth prospects improve for 2021-22, with positive news on vaccines. Strong rebound likely

New house building activity holds up in 2020



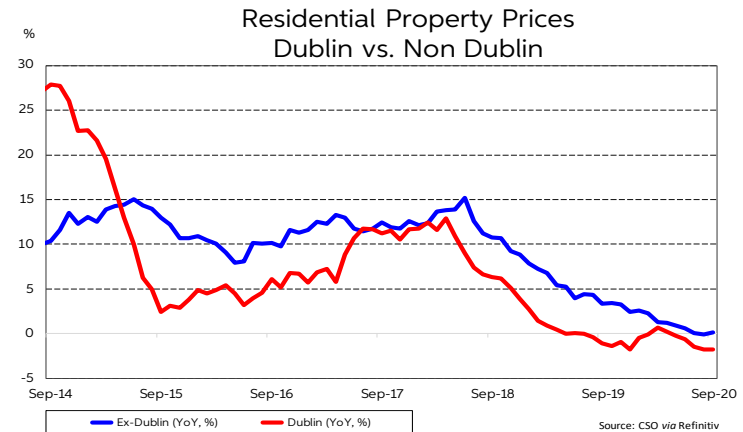
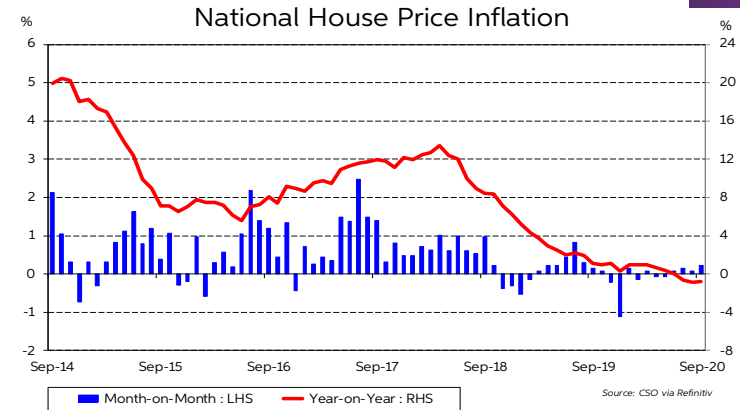
- Housing completions rose 18% yoy to over 21,000 units in 2019, up from 18,250 in 2018
- Completions down by 32% yoy in Q2 on lockdown impact, but recover in Q3 – were strong in Q1 also
- Housing commencements increased by further 17% in 2019 to 26,000 units. Fall by 19% yoy in H1 2020
- Planning permissions jump by 38% to over 40k in 2019. Surge 97% yoy in Q1'20, but fell back by 29% in Q2
- Commencements continued to fall over the summer
- Overall, completions hold up better than expected in 2020. May be above 19k and forecast at 21k in 2021
- 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 Covid sees drawdowns fall by 20% yoy to end Q3'20
- Housing affordability metrics remain quite stable



House prices broadly stable this year



- House prices declined by very sharp 55% in 2007-13 period, but have recovered strongly since then
- Prices up 84% by Sept 2020 from March 2013 trough
- But house prices still some 18% below 2007 peak
- House price inflation slowed sharply in 2018/19 reflecting tighter Central Bank lending rules
- House prices quite stable to date in 2020
- Prices down 0.8% yoy nationally in Sept 2020: Dublin down 1.7%, while non-Dublin up 0.1% yoy
- Property web-sites see big jump in asking prices in Q3
- Low supply, remote working, strong public/institutional demand, enhanced help-to-buy scheme support prices
- Annual growth in rents had slowed before virus hit
- Rents recover in Q3 after steep falls in H1'20 lockdown, but fall again in October with second Covid wave



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 | 21,000 |
| Shortfall in Supply | -19,100 | -19,400 | -15,250 | -12,250 | -9,500 |

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

Sources: CSO, DoECLG, AIB ERU.

Private sector deleverages, Govt. debt ratios rising again

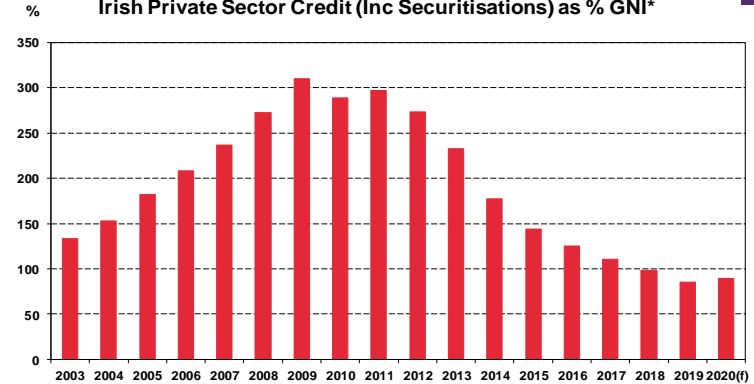


Irish Household Debt Ratio



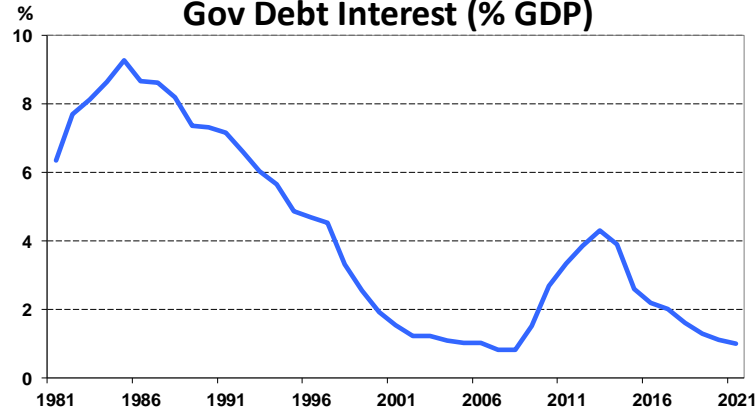
Source: CSO, Central Bank, AIB ERU

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



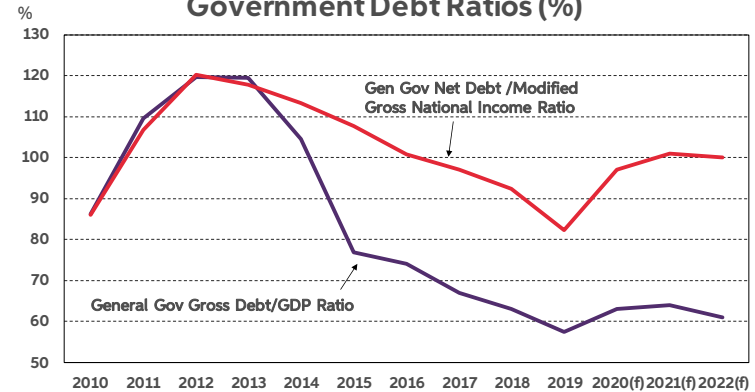
Sources: Central Bank, CSO, AIB ERU Calculations

Gov Debt Interest (% GDP)



Source: NTMA; Dept of Finance (Pre Coronavirus)

Government Debt Ratios (%)

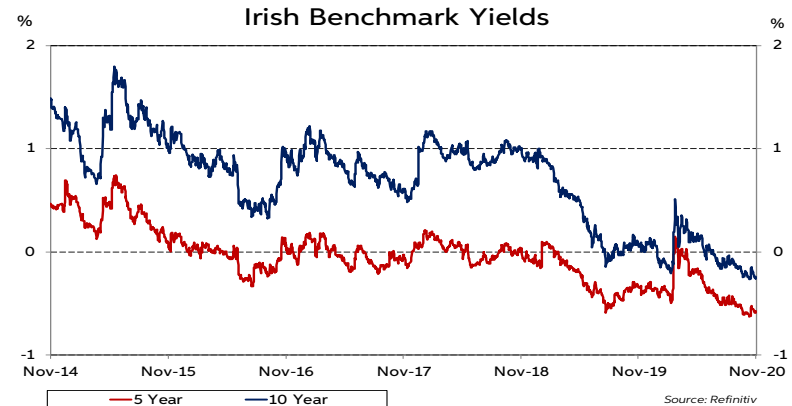
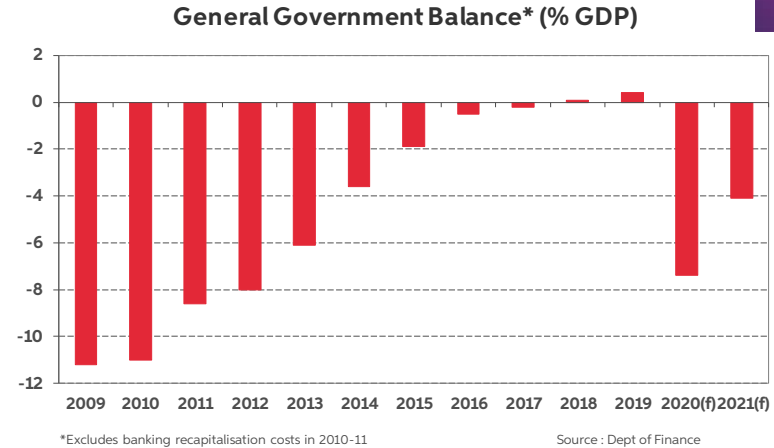


Sources: Dept of Finance, CSO, AIB ERU (Inflated/Distorted GDP figures from 2015)

Blowout budget deficit in 2020 despite resilient tax take



- 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 see the public finances deteriorate during 2020
- Tax receipts down 3% to end September, while voted government spending soars by 25%
- Budget deficit expected to be €22bn or above this year, or close to 6.5% of GDP
- Dept. of Finance forecasting another large budget deficit of above €20bn in 2021
- Gov Debt ratios had fallen in past decade, but will move higher this year and next
- Bond yields low and stable despite blow-out in budget deficit and big rise in debt issuance
- Ireland's sovereign debt ratings hold steady; S&P at AA-, Fitch at A+, Moody's A2



Brexit: EU-UK trade talks in crucial final stage



- UK left the EU on Jan 31st 2020 in orderly exit. Transition period in place until end 2020
- UK government has ruled out extending the transition period beyond this date
- Slow progress on key issues in talks, with time running out
- EU wants considerable regulatory alignment; UK government puts focus on ‘taking back control’
- Some type of FTA seems likely as it’s the best outcome for both the UK and EU
- Progress made in talks in late October/November, with 95% of legal text agreed
- State aid rules remain key stumbling block, as well as fishing rights in UK waters
- Any trade deal likely to be limited to goods, mainly based on no tariffs or quotas
- Deal would need to be agreed by start of December to allow time to ratify before year end
- Still a risk of no trade deal and thus effectively a Hard Brexit at end 2020
- This would see UK adopt WTO rules, implying tariffs on some goods and damaged EU-UK relations

Key points about any EU-UK Free Trade Agreement

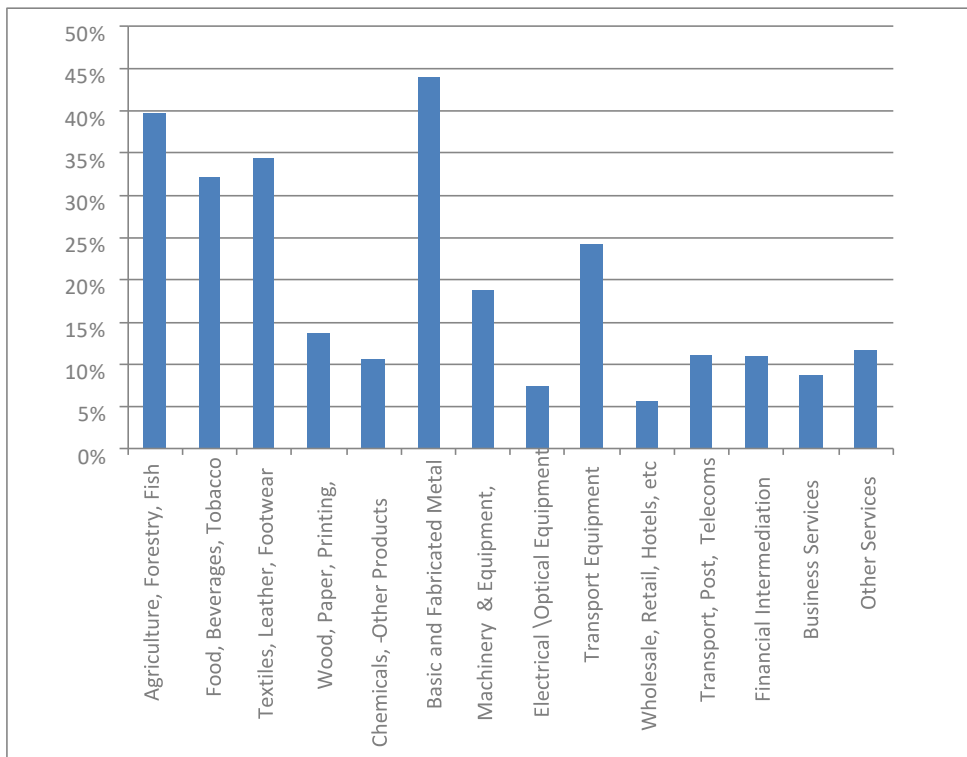


- Any FTA will be much inferior to the EU Single Market, involve a lot of extra admin costs
- Significant restrictions on trade will come into play in a FTA– new customs procedures, compliance with onerous rules of origin requirements, more regulations etc.
- Documentary evidence needed for customs clearance, 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



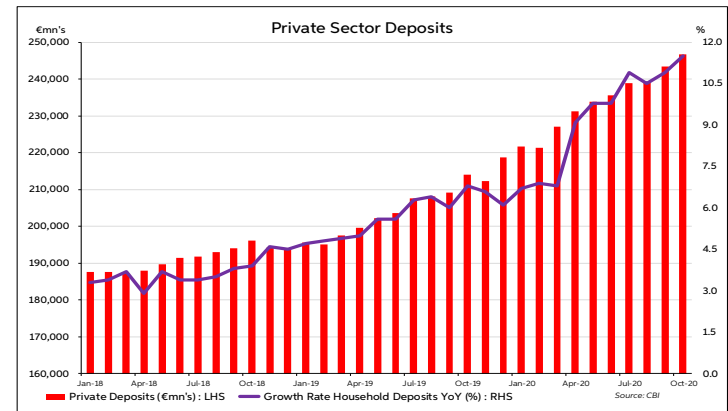
- **Multiple hits to the Irish economy if there is a no EU-UK Trade deal** at end of transition period: further sharp fall in sterling, weak UK economy, disruption to trade/supply lines, tariffs, new administrative and regulatory costs etc.
 - Sharp fall-off in trade with UK likely if there is no trade 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 new 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, helped by roll out of Covid vaccines
- Strong Irish growth to be expected next year on, after sizeable fall in GDP in 2020
- However, a failure to reach an EU-UK trade deal would weigh on Irish growth prospects in 2021-22

| OECD GDP Forecasts (Sept 2020) | | |
|--------------------------------|-------|------|
| % Vol | 2020 | 2021 |
| World | -4.5 | 5.0 |
| G20 | -4.1 | 5.7 |
| US | -3.8 | 4.0 |
| Eurozone | -7.9 | 5.1 |
| UK | -10.1 | 7.6 |
| Japan | -5.8 | 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 | 5.0 | 4.5 |
| GNP | 7.3 | 3.4 | -2.5 | 4.5 | 4.0 |
| Personal Consumption | 2.8 | 3.2 | -10.5 | 5.5 | 3.5 |
| Government Spending | 5.8 | 6.3 | 8.0 | -2.5 | 2.0 |
| Fixed Investment* | -6.2 | 74.8 | -17.0 | -0.5 | 5.0 |
| Exports | 11.1 | 10.5 | 0.5 | 5.5 | 5.0 |
| Imports* | 4.0 | 32.4 | -6.4 | 3.0 | 4.7 |
| HICP Inflation (%) | 0.7 | 0.9 | -0.5 | 0.5 | 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 risk is still the coronavirus – could continue to weigh heavily on growth & employment
- Persistent virus could see scarring effects – high business failures, rising bad debts, job losses
- Very open nature of Irish economy means it is quite exposed to global recession
- Brexit still a risk as uncertainty continues about future EU-UK trading relationship
- 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.